

Weekly Economic Commentary

August 1, 2011



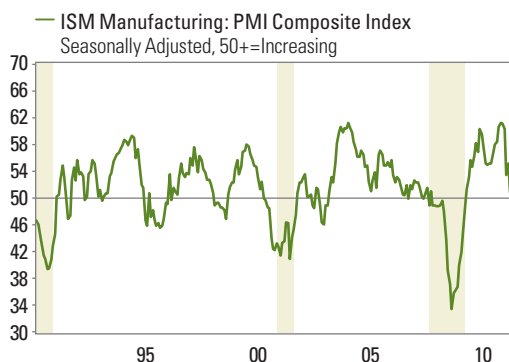
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Highlights

- Economic data replaces earnings and budget negotiations as the market's likely focus this week.
- Although the ink is not dry yet, the deal to raise the nation's debt ceiling will help to lift some of the uncertainty that has hampered economic activity over the past few months.
- The market is looking for a modest acceleration in private sector job creation in July and for the unemployment rate to remain stable at a still-elevated 9.2%

1 The ISM Typically Slides Back to 50 (or even below) Middle Part of the Economic Cycle



Source: Institute for Supply Management /Haver Analytics 08/01/11

(Shaded areas indicate recession)

Midsummer Madness

As if the debt ceiling debate was not enough madness for financial market participants to endure, this week's economic and policy calendar is full of events that could drive markets mad. The week kicked off with the release of the Chinese PMI data for July, and will end with the July jobs report. In between, data on vehicle sales, personal income and consumer spending, factory orders, chain store sales, and layoff announcements for June and July will all vie for the market's attention. This is the unofficial "quiet week" for Federal Reserve (Fed) officials, ahead of next week's Federal Open Market Committee (FOMC) meeting. Overseas, the Bank of England, the European Central Bank, the Bank of Japan and the Reserve Bank of Australia meet to set rates. None of these central banks are expected to raise rates. Outside of the central bank activity, there are very few key overseas economic reports due this week. The Chinese data for July is set to be released next week, August 7–13.

Although the ink is not dry yet, the deal to raise the nation's debt ceiling—see this week's *Weekly Market Commentary* for details—will help to lift some of the uncertainty that has hampered economic activity over the past few months. Of course, virtually all of the data due out this week references the period (June or July) during which the debt ceiling debate dominated the headlines. Thus, it may not be until mid-August that we get a "clean" set of data on the economy, free of any distortion from the debt ceiling debate.

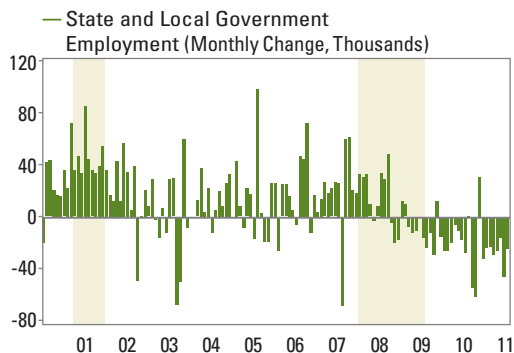
Until then, however, markets have plenty to digest. As this report was being prepared for publication, the Institute of Supply Management's (ISM) report on manufacturing for July was released. The report fell far short of expectations, was below the low end of the range of economists' estimates, but most importantly suggested that manufacturing activity in July slowed to near stall speed. The closely watched report saw marked deceleration across all of its key components (new orders, production, and employment), and the drop in the new orders index below 50—a reading below 50 in the ISM report indicates contraction in the index or component—was particularly worrisome. July 2011 marked the first time in two years that the new orders index was below 50. In addition, the 50.9 reading on the overall ISM index for July was the lowest since the first month of the recovery (July 2009).

While it is not unusual to see the ISM slide back toward 50 at this point in the economic cycle, it is clear that the slowdown in China, the ongoing recovery in the global supply chain from the earthquake and tsunami in Japan, the turmoil in Europe and the uncertainty surrounding the debt



The key for markets now is when do the negative factors fade and allow the positives to drive the manufacturing sector higher.

2 State and Local Governments Have Shed Jobs in 19 of the Past 20 Months



ceiling all impacted manufacturing activity in July. A slower-than-expected ramp up in auto production in July also likely hurt manufacturers. Still, booming exports (50% of U.S. exports head to fast growing emerging market economies), a weak dollar, low financing rates, and a low inventory-to-sales ratio all continue to support the manufacturing sector. The key for markets now is when do the negative factors fade and allow the positives to drive the manufacturing sector higher.

The other key report this week is the July jobs report. The report is due out on Friday, August 5. The market is looking for a modest acceleration in private sector job creation in July and for the unemployment rate to remain stable at a still-elevated 9.2%. The consensus forecast in private sector jobs is for a gain of 120,000 following the disappointing 57,000 gain in June. The job count totals are derived from a survey of businesses. As previously noted, the unemployment rate—derived from a survey of households about their employment status—is expected to remain at 9.2%, unchanged from June’s 9.2% reading, but below the recent peak of over 10.0% hit in late 2009.

We continue to expect further losses in state and local government employment in July, even after this sector of the economy has shed nearly 600,000 jobs over the past three years. Teacher layoffs could be a big swing factor in July (most state and local government fiscal years begin in July), and the auto sector could see some movement as well, given the unusually early auto plant summer shutdowns this year, which occurred in June rather than July, as is typically the case.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Stock investing involves risk including loss of principal.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

The ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

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