Weekly Economic Commentary

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Labor Market Improvement Stalled Out in September

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ECONOMIC CALENDAR

Monday, Oct 5
ISM Non Manufacturing
Sept

Wednesday, Oct 7
Consumer Credit
Aug

Thursday, Oct 8
Initial Claims
wk 10/03

Wholesale Inventories
Aug

ICSC Monthly Chain Store Sales (YoY)
Sept

Friday, Oct 9
Trade Balance
Aug

The weak September jobs report, released on Friday, October 2, brought a disappointing month of economic data to a close. In June, July, and August, about 70% of the economic data came in above expectations. In September and early October however, the vast majority of economic releases were below (raised) expectations. As noted above, the much anticipated September jobs report also came in below expectations, and there were few "silver linings" in the report. (see below for details). Our key take away from the September jobs report is that the steady improvement in the labor market (from horrendous, to horrible, to awful, to bad) over the last eight months seems to have stalled out at "bad" in September. This calls into question our forecast that the economy will begin to generate job growth by year end. It does not, however, alter our overall views on the economy, inflation or the Fed.

We continue to expect solid GDP growth in Q3 2009, slightly softer (though still positive) GDP growth in Q4 2009, and stronger than expected GDP growth in 2009 led by exports, business spending and housing. We expect the Fed to stay on hold well into 2010, and that headline deflation will give way to (mild) headline inflation later this year, but that the Fed's preferred measure of inflation, core inflation, will continue to decelerate into year end and early 2010.

In our opinion (in line with the markets), there is no doubt that the recovery is in place. What remains in doubt, however, is the pace, composition and sustainability of the recovery.

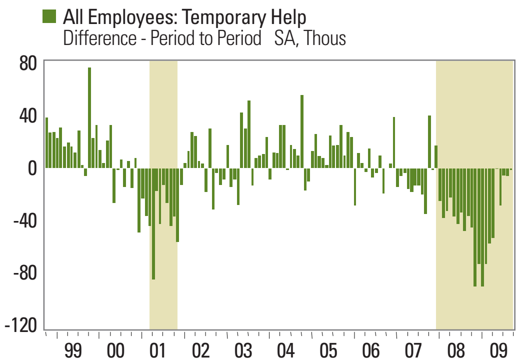
Unfortunately, there is not much in the way of economic data due out this week to help address those doubts. The Institute of Supply Management's report on the service sector in September was released as this publication was being prepared. Later in the week, markets will digest the regular weekly data on retail sales, mortgage applications and jobless claims—all of which are components of our Current Conditions Index. In addition, the nation's retailers will report their September sales on Thursday. This will provide markets with a solid reading on the strength of non-auto consumer demand in September and the important back to school shopping season. Finally, on Friday, markets will digest the merchandise trade report for August. The report will help market participants firm up their estimates for real gross domestic product (GDP) for Q3 2009. The Q3 GDP data is due out in late October.

With a few notable exceptions, the "leading indicators" of the report were pretty much just as bad as the headline. Hours worked and overtime hours fell between August and September, while the diffusion index (the percentage of industries adding workers to payrolls minus the percentage of industries

Disappointing September Jobs Report

The economy shed 263,000 jobs in September. The consensus was expecting a decline of 175,000 jobs. One of the few silver linings in the report was that the job loss in August was revised to show a 201,000 decline from the previously reported 216,000 drop. The unemployment rate rose 0.1% to 9.8% in September. That result was as expected, and keeps the unemployment rate on track to hit 10.0%.

1 One Of The Few Silver Linings in the September Jobs Report: Employment At Temporary Help Supply Firms Has Nearly Turned Positive



Source: Bureau of Labor Statistics, Haver 10/02/09

shedding workers in the month) also fell between August and September. The "silver linings" were that payrolls at temporary help firms—a reliable leading indicator of future employment— fell just 2,000 in September. Earlier this year, during the worst of the recession, temporary help employment firms were shedding between 75,000 and 100,000 jobs per month. [Chart 1] Another silver lining was that the decline in private sector jobs in September (210,000) was not much different than the drop in August (180,000). But that is bad news as well, **as the steady improvement in the private sector job market—from an average monthly job loss of 700,000 in early 2009 to around 200,000 per month over the last three months—seems to have stalled out.**

The Week Ahead

The section below provides some observations on this week's key economic releases. Alongside the preview are questions that markets, the media and, yes, economists are likely to be asking as the data is released.

August Consumer Credit (Wednesday, October 7)

- One of the key wildcards in the August consumer credit report will be what impact, if any, the surge in vehicle sales in August due to "cash for clunkers" program had on consumer credit in August.
- In July, despite the start of the cash for clunkers program, consumer credit fell by a record $21 billion, as consumers continued to pay down debt both voluntarily and non-voluntarily.
- It is not unusual at all to see consumer credit growth slow (decelerate) or decline outright as the economy moves through and out of a recession.
- It is probably too early to tell whether we have hit bottom yet on the deceleration in consumer credit growth in this cycle.
- The real question is at what pace will consumer credit growth begin to expand again as the recovery takes hold in 2H 2009 and beyond?
- Anecdotal evidence and company earnings reports suggest that credit card companies are still cutting back on, and in some cases, pulling credit lines to consumers and small businesses.
- Consumers are already repairing balance sheets, and have been, in aggregate since mid 2008, as evidenced by the surge in the saving rate over the past 18 months, from under 1.0% in early 2008 to a high of 6.0% in May 2009.
- Real disposable income and consumer net worth (value of stocks, bonds, housing, consumer durables) both of which are up sharply over the past nine months, are better predictors of future consumer spending than consumer credit.

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2 We expect that consumers will be a bit more willing to purchase non essential items in 2H 2009 as the economy improves, the labor and housing markets stabilize, and the "wealth effect" (rising equity prices and rising home prices) kicks in.

Source: Institute for Supply Management, Haver 10/05/09

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September Chain Store Sales (Thursday, October 8)

- Will give the market a better sense of the health of the consumer (outside of the auto sector) in the heart of the important back-to-school shopping season, which by many accounts was later than usual this year.
- Real consumer spending is on track to expand by close to 3.0% in Q3, aided by a surge in spending on new vehicles.
- On balance, consumers are still spending on things they need, not things they want, and we would like to see that change over the remainder of 2009 to convince us that the recovery is sustainable.
- We expect that consumers will be a bit more willing to purchase non essential items in 2H 2009 as the economy improves, the labor and housing markets stabilize, and the "wealth effect" (rising equity prices and rising home prices) kicks in.
- Weekly retail sales were up in three of the four weeks of September, and the anecdotal evidence continues to suggest that much of the spending remains concentrated in non-discretionary items.

August Trade Balance (Friday, October 9)

- The August trade data will help firm up expectations for Q3 GDP.
- Imports have been falling faster than exports recently, helping to narrow the trade deficit which has helped to cushion the decline in real GDP, and will begin to boost GDP in 2H 2009.
- Judging by the new export orders data embedded within the various national and regional ISM and Federal Reserve manufacturing surveys for August and September, there is pretty solid evidence that exports have begun to turn up. With the economy improving, import growth is likely to rebound, especially given the uptick in oil prices recently.
- With an export rebound underway, the question remains whether or not the economies of our major trading partners have improved enough to support sustained export growth. The evidence thus far suggests that they have.
- Exports have helped to lead the U.S. economy out of recession during the last two recoveries, in 1991 and in 2001.
- Typically, both exports and imports decline during recessions. This time around, imports started falling first, but exports have fallen sharply since the collapse of Lehman Brothers in the fall of 2008.

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Investing in alternative investment may not be suitable for all investors and involve special risks such as risk associated with leveraging the investment, potential adverse market forces, regulatory changes, potential liquidity. There is no assurance that the investment objective will be attained.

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