



Weekly Economic Commentary



November 23, 2009

Busy Week of Data Ahead of “Bargain Friday”

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ECONOMIC CALENDAR

Monday, Nov 23	PCE
Existing Home Sales	<i>Oct</i>
<i>Oct</i>	Personal Income
Tuesday, Nov 24	<i>Oct</i>
FOMC Minutes	Durable Goods
11/4	<i>Oct</i>
Real GDP (2nd estimate)	New Home Sales
<i>Q3</i>	<i>Oct</i>
Consumer Confidence	U of Mich Consumer
<i>Nov</i>	Sentiment
Wednesday, Nov 25	<i>Nov</i>
Initial Claims	Thursday, Nov 26
<i>wk 11/21</i>	Thanksgiving

It was a drab week overall for the economy last week. The data on housing and industrial production for October failed to meet expectations, while the three reports for November— jobless claims, Empire State Manufacturing and Philly Fed manufacturing index— came in at or above expectations. The October retail sales and leading indicator data for October was roughly in line with expectations. Taken together, the data released last week does not change our view that the economy will post a 3.0% growth rate in Q4 2009 and will deliver above consensus growth in 2010.

As the market awaits the unofficial beginning of the 2009 holiday shopping season this Friday, November 27 (“Bargain Friday”), it will digest a veritable cornucopia of economic data in this shortened holiday week, beginning with the October existing home sales data. In addition to the regular weekly data on chain store sales, mortgage applications and jobless claims for mid November, the data due out this week includes the new home sales data for October, the first revision to the Q3 2009 GDP data, the October income and personal spending reports, the minutes of the November 4 FOMC meeting, and the durable goods orders report for October.

The Week Ahead

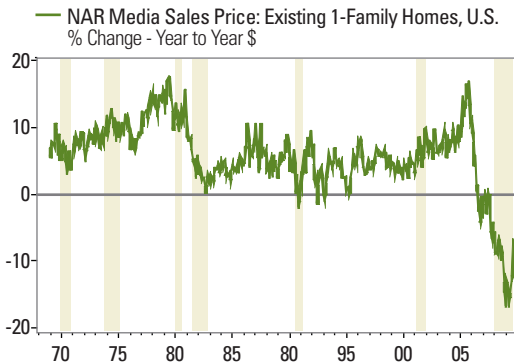
The section below provides some observations on this week’s key economic releases. Alongside the preview are questions that markets, the media and, yes, economists are likely to be asking as the data is released.

October Existing Home Sales (Monday, November 23)

- The October existing home sales report was released as the Weekly Economic Commentary was being published.
- The housing market was at the forefront of the economic and financial meltdown we saw in late 2008 and early 2009. We think housing (sales of new and existing homes, housing prices, and housing starts) has now finally entered a bottoming process.
- Existing home sales fell 38% from late 2005 through January 2009, bounced around near the bottom in early 2009, but have moved up by 21% since then (through October).
- Pending home sales, which tend to lead existing home sales by one or two months, rose for the eighth consecutive month in September, suggesting an ongoing rebound in existing home sales well into Q4 2009 and early 2010.



1 On a year-over-year basis through October, existing single-family home prices are down just 7%, a big improvement from the -16.7% year-over-year drop recorded in January 2009.



Over the past 25 years, the average revision to GDP between the advance and second estimate of real GDP is a revision of 0.5 percentage points (regardless of sign), making the likely revision to Q3 GDP larger than usual.

- At 3.0 million in October, the supply of single-family existing homes for sales is down from its peak in early 2008 (3.9 million), but remains elevated relative to its historic low (2.25 million units). The market will want to see further improvement in this metric before it is convinced that the housing recovery is for real, especially given concerns over the “shadow” inventory in the market—homes that were being held off the market until conditions improve.
- Despite the small drop between September and October, existing home prices are up 5.0% from the January 2009 low. On a year-over-year basis through October, existing single-family home prices are down just 7%, a big improvement from the -16.7% year-over-year drop recorded in January 2009.
- Because existing home sales are counted when a sale is “closed”, and not when the contract is signed, there is typically a lag of a month or so between a signed contract and closing. The small drop in mortgage rates between September and October was not likely impacted by this data.
- Looking ahead, mortgage rates held steady at close to 5.0% in November, which will continue to support a recovery in housing. It is unclear, however, how the extension (through mid 2010) and expansion of the first time homebuyer tax credit in early November will affect sales in November.

October New Home Sales (Wednesday, November 25)

- Due, in large part, to the 80% drop in housing starts over the past three years, the inventory of unsold new homes is now well below its long term average.
- As is the case with existing home sales, a potential threat to October’s tally of new home sales was the looming expiration of the \$8,000 first-time homebuyer tax credit in November.
- As mentioned above, the credit was extended (though mid 2010) and expanded. **New home prices were down 9% in September 2009 from September 2008. The market would view any signs that new home prices have bottomed as further evidence that the overall housing market was in the bottoming process.**

Q3 2009 Real GDP-Second Estimate (Tuesday, November 24)

- Q3 real GDP is likely to be revised to show a 2.7% to 3.0% gain, versus the originally reported 3.5% gain.
- Over the past 25 years, the average revision to GDP between the advance and second estimate of real GDP is a revision of 0.5 percentage points (regardless of sign), making the likely revision to Q3 GDP larger than usual.
- A faster pace of inventory drawdown, a bigger drop in spending on nonresidential construction, a slower pace of consumer spending and a wider trade deficit will drive the downward revision to GDP in Q3.



Business capital spending was a small-plus for real GDP growth in Q3 2009, and we expect business spending to be a plus again in Q4 and throughout 2010 as companies replenish severely depleted inventories.

- While the likely downward revision for Q3 points to a less rosy economy in Q3 2009, the composition of the revision (especially more inventory destocking) sets the stage for more robust growth in GDP in Q4 2009 and 2010.

October Durable Goods Orders (Wednesday, November 25)

- Although we have already digested a number of qualitative reports on business spending in October, the release of the October durable goods orders report represents the first “hard” data on business capital spending (durable goods shipments), future capital spending (durable goods orders) and business inventories in Q4 2009.
- A key theme for the October report is likely to be the big drop in aircraft orders and the ongoing rebound of auto production in response to better than expected auto sales in October.
- Business capital spending was a small-plus for real GDP growth in Q3 2009, and we expect business spending to be a plus again in Q4 and throughout 2010 as companies replenish severely depleted inventories.
- Business capital spending, along with housing, has led the economy out of a recession in each of the 10 recoveries since WWII.
- The market will want to focus on shipments and orders for capital goods, excluding aircraft. These “core” shipments and orders are highly correlated to the business-spending portion of GDP.
- The inventory portion of this report will be closely watched by market participants looking to gauge the ongoing process of inventory restocking in Q4 2009. A slower pace of inventory destocking added nearly 1.0% to real GDP growth in Q3, and the market is counting on a further slowdown in inventory destocking in Q4 2009 and in 2010.

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