

Weekly Economic Commentary

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The Path to a More Transparent Fed

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Highlights

- Financial markets may not be able to ignore this week's slate of key economic releases.
- A few thoughts on a more transparent Federal Reserve.
- Where are we in the economic cycle?

Economic Calendar

Monday, March 28	Factory Orders <i>February</i>
Personal Spending <i>February</i>	Friday, April 1
Personal Income <i>February</i>	Private Workweek <i>March</i>
Pending Home Sales <i>February</i>	Average Hourly Earnings <i>March</i>
Tuesday, March 29	Mfg Payrolls <i>March</i>
Consumer Confidence <i>March</i>	Private Sector Payrolls <i>March</i>
Wednesday, March 30	Unemployment Rate <i>March</i>
Challenger Layoff Announcements <i>March</i>	Nonfarm Payrolls <i>March</i>
ADP Employment <i>March</i>	ISM Manufacturing <i>March</i>
Thursday, March 31	Construction Spending <i>February</i>
Initial Claims <i>wk 03/26</i>	Domestic Light Vehicle Sales <i>March</i>
Chicago PMA <i>March</i>	

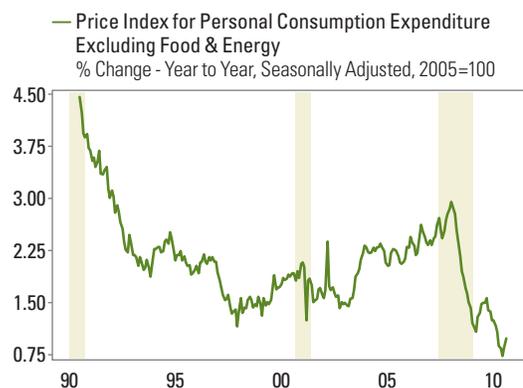
Last week's batch of economic data had a weaker tinge to it, but financial markets largely dismissed the data, focusing instead on events overseas. If history is a guide, the market may not be able to ignore this week's data, which includes key reports on manufacturing (Institute for Supply Management (ISM) and Chicago Area Purchasing Managers), consumer spending (personal income and spending for February and vehicle sales for March), and employment (Challenger layoff announcement, ADP employment and the government's employment report) in March. China's ISM report for March is also due out this week, as market participants continue to debate the timing and extent of the next interest rate hike in China. On the policy front, Congress returns from recess just in time to address the looming government shutdown (April 8). As emerging market nations continue to grapple with robust growth and rising domestic inflation, Taiwan's central bank is expected to raise rates this week. In addition, there are several notable Fed speakers on the docket this week, as market participants continue to debate when the Fed will begin to rein in some of the unprecedented monetary policy now in the system.

While the employment data and ISM for March (due out on Friday, April 1) will draw the most attention from policymakers and market participants, the February data on personal income, personal spending, and inflation that was released as this report was being prepared revealed accelerating incomes, slower spending, and another tick higher for core inflation. In addition, the February data on personal income and spending showed that spending by consumers on energy and energy-related goods and services accounted for 6% of total spending and 5% of total personal incomes in February. This is a metric we are watching closely as we gauge the impact of rising energy prices on the economy.

At the peak of energy prices in July 2008, consumer spending on energy goods and services represented 7% of total personal spending and 5.7% of personal incomes. In the early 1980s, consumer energy spending accounted for nearly 10% of spending and 8% of incomes.



1 Core Inflation Continues to Move Higher, Although it is Still Well Below the Lower End of the Fed's Comfort Zone



Source: Bureau of Economic Analysis/Haver Analytics 03/28/11

(Shaded areas indicate recession)

Detail of Consumer Energy Spending and Prices

	Spending in February 2011	% of Total in February 2011	Price Today	Price in July 2008
Gasoline	\$392.0 Billion	62%	\$3.56/gallon	\$4.11/gallon
Electricity	\$157.9 Billion	25%	\$42/MWH	\$115/MWH
Natural Gas	\$56.1 Billion	9%	\$4.41 BCF	\$13.35 BCF
Heating Oil	\$27.2 Billion	4%	\$3.06/gallon	\$3.90/gallon
Total	\$636.7 Billion	100%		

Source: Bureau of Economic Analysis, LPL Financial 03/28/11

Another Step Towards a More Transparent Fed

Last week, the Federal Reserve (Fed) announced that Fed Chairman Bernanke will hold a press conference after four of the eight meetings of the Fed's policymaking arm, the Federal Open Market Committee (FOMC). The press conferences will coincide with the release of the FOMC's quarterly economic forecasts, which are made at the FOMC meetings held in January, April/May, June, and October/November each year. Thus, on April 27, June 22 and November 2, 2011, the FOMC statement, along with the FOMC's forecast, will be released at 12:30 PM ET, and Bernanke will take questions at 2:15 PM ET. At the other FOMC meetings, the FOMC statement will be released, as usual, at 2:15 PM ET. Operationally, this suggests that any major shift in Fed policy is much more likely to come at one of the four press conference FOMC meetings, rather than at one of the four non-press conference meetings. These press conferences may also downgrade the importance of the release of the FOMC minutes (three weeks after the FOMC meeting) for market participants. Finally, the press conferences may make the weekly parade of Fed speakers less relevant to financial markets.

Press conferences are only the latest in a series of moves toward greater transparency by the Fed over the past two decades. Beginning in the early 2000s, the FOMC began contemplating ways to better communicate its policies to the public. It set aside time at several FOMC meetings a year to discuss communication issues, ranging from full transparency (i.e. broadcast the FOMC meetings live) to a more nuanced approach (making more frequent economic forecasts, setting and communicating explicit targets for inflation and the economy) and speeding up the release of policy related documents like the FOMC minutes and economic forecasts.

Since the onset of the financial crisis in 2007, the FOMC (as a proxy for the Fed) has taken a more active role in the economy, and that has raised the ire of some politicians and raised suspicion among the public that is largely unaware of what the Fed does or how it operates. This pressure from Congress (and the public) has probably hastened the FOMC's move toward more transparency, and as the FOMC begins to unwind the massive monetary stimulus currently in the system over the next few years, clarity from the Fed on its goals for monetary policy and the economy is more crucial than ever. In addition, rising food and energy prices in recent months



also presents the FOMC with a communication issue with the public, given the policymakers' focus on consumer prices excluding food and energy.

Until the early-90s, a shift in Fed policy had to be gleaned by "Fed watchers" and market participants from analyzing trading in the relatively obscure market for the federal funds rate, the interest rate that banks charge each other to borrow overnight. Then, in 1994, the FOMC began issuing a statement the same day a change in monetary policy was made. In 1995, this change was made permanent, but it was not until 2000 that the FOMC began issuing a statement following all of its meetings, regardless of whether or not a change in policy occurred. This policy will continue.

The release of the minutes of each of the FOMC meetings has taken a similar path toward greater transparency. Today, the minutes of each of the eight FOMC meetings are released to the public three weeks after the meeting occurs. Between 1993 and 2004, the minutes were released three days after the subsequent FOMC meeting, or about seven weeks after the meeting was held. In the 1960s, FOMC minutes were released with a three-month lag, and prior to that time, the FOMC minutes were published only annually.

Prior to 2007, the FOMC issued two economic forecasts a year, which were presented by the Fed Chairman at Congressional testimony in February and July each year. Beginning in 2007, the FOMC started publishing four economic forecasts per year (of economic growth, inflation, and the unemployment rate). The forecasts are published three weeks after the FOMC meeting. Under the new regime, the FOMC's quarterly forecasts will be released the same day as the FOMC meeting.

From 1960 through most of the 1990s, the Chairman of the Fed rarely, if ever, made any public appearances, and took questions from the media even less frequently. Over the past several years, under increasing public and political pressure, Fed Chairman Bernanke has appeared on the television show *60 Minutes*, held a town hall meeting, held a press conference, authored an op-ed in the *Washington Post*, and held several events where he took questions from students at universities around the country. The move announced last week to hold a press conference after four of the eight FOMC meetings a year continues that trend, and more closely aligns the Fed's communication policy with that of other major foreign central banks like the European Central Bank and the Bank of England.

Where Are We in the Economic Recovery?

The current economic recovery commenced in June 2009, after the economy experienced the longest (18 months) and most severe (real gross domestic product declined by 4.1%) recession since the 1930s. Thus, the current economic recovery will be 21 months old at the end of March 2011. How does that compare to other recoveries?

Since 1945 (the end of WWII), there have been 12 recessions and 11 economic recoveries. On average, the 11 recoveries have lasted 58 months (around five years), and the median recovery (five were longer and five were shorter) was 45 months long. The shortest post-WWII recovery was



in 1980–81 (12 months), the longest was the 120-month expansion in the 1990s and early 2000s. The last three recoveries (1980s, 1990s, and 2000s) were 92, 120, and 73 months long, respectively, putting the average recovery during that time at around eight years.

As the 2007–2009 Great Recession was the longest and most severe recession since the Great Depression in the 1930s, we think it makes sense to look at the length of recoveries following the three most severe economic downturns in the last 110 years—the Great Depression in the 1930s, the 1973–75 recession, and the 1981–82 recession. We find that the recovery following the Great Depression of the 1930s lasted 80 months, the recovery following the 1973–75 recession last 58 months and the recovery following the 1981–82 recession lasted, as noted above, 92 months. The average here is around six years.

During the height of the double-dip recession fears in the middle of 2010, we wrote extensively about what usually causes a recession to occur. Although the source of each recession is different, generally speaking, some of the conditions that lead to the end of an economic recovery include:

- Widespread imbalances in the economy
- Too much debt in the personal sector
- A sudden and sharp tightening in Fed monetary policy
- An inverted yield curve (when short-term interest rates are above long-term interest rates)
- A soaring dollar
- Sharply tighter fiscal policy
- High nominal interest rates (think the late 70s/early 80s)
- Pronounced weakness in global trading partners
- A sudden and sharp spike in consumer energy prices

2 In the Past, a Sharp and Sudden Spike in Consumer Energy Prices was a Threat to Economic Expansions



Source: Haver Analytics 03/28/11

(Shaded areas indicate recession)

While some of these conditions (rising consumer energy prices, slower growth in some global trading partners) are in place today (and a few are often in place regardless of where we are in the economic recovery), many are not and, at just 21 months, the economic recovery that began in June 2009 is most likely only in its early stages. If the current recovery is the same length as the average recovery since the end of WWII, we are only about one-third of the way through. If this recovery follows the path of the recoveries following the three most severe recessions in the past 110 years, we are only about one-fourth of the way into the recovery. If the last 30 years is any guide, the current expansion will last eight years, and we are still in the “early innings” of the recovery.

Economic and market conditions can and will change, and we will continue to monitor the economic data and policy events in the United States and overseas as we assess the health of the economy and its impact on financial markets.



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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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