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## You say Recovery, I say Recession

Economic recovery will be in the eyes of the beholder for months to come. From the perspective of employment, the economy may remain anemic for months. And Washington's stimulus efforts are having no discernable impact. Alternatively, the corporate sector seems to be showing life on several fronts including exports, inventory replenishment, and earnings from increasing sales.

The labor force continues to shrink as workers leave or accept less than full-time positions in their field. In September the total number of Americans in the workforce fell by 571,000. Had they not left, the number of unemployed would have been up 785,000 rather than 214,000.

The unemployment situation is actually worse than reported. Ed Yardeni points to the Bureau of Labor Statistics' unemployment rate known as U-4, which adds discouraged workers back into both the labor force and the unemployed rolls as well. It was at 10.2% in September vs. 9.8% for the official jobless rate known as U-3. Even more discouraging was the U-6 rate, which includes marginally attached workers plus those working part time for economic reasons. It rose to 17.0%, a high for the series going back to 1994.

Economists believe that the unemployment situation will improve between March 2010 and March 2011. That's a potentially long time. As we will discuss, shortly, there are reasons for optimism that improvement will start sooner than later. In essence, businesses may have pared more employees than they needed as it now looks like the recession will end sooner than earlier thought. Had the Congress focused their "stimulus" on tax cuts and credits aimed at small businesses and hiring rather than pork spending, we would likely be seeing a much more evenly balanced recovery by now.

Industrial Production will pick up dramatically in the coming months as the need to re-stock inventories depleted to historic lows. With rising exports and signs of increases in consumer spending the corporate sector will have to respond aggressively. That response will likely include adding more workers. Corporate cash flows will come back quickly as companies have gotten lean and healthy through this downturn.

As reported by Bloomberg, "wholesalers continued to burn through inventory in August despite sharp improvement in sales. Wholesale inventories, extending a long string of deep declines, fell 1.3% with the year-on-year rate deepening to minus 14.7%. Nearly every component posted a decline in the month including autos which were drawn down by cash for clunkers. But sales at the wholesale level, especially for autos, were very strong, up a total 1.0% on top of a 0.6% rise in July and a 0.3% rise in June."

The US international trade deficit shrank in August on both lower oil and consumer goods imports, reflecting a still sluggish economy. However, exports rose largely on industrial supplies,

services, and auto shipments to Canada. The overall US trade gap unexpectedly narrowed to \$30.7 billion from a revised \$31.9 billion shortfall in July.

Third quarter corporate earnings reports are just around the corner. Despite the fact that analysts were low on their reports for the first two quarters of the year, their third quarter estimates remain on the pessimistic side. They predict that S&P 500 companies earned \$14.82 for the third quarter, lower than Q2's actual result of \$16.03.

Ed Yardeni notes that the winner for the third quarter is likely to be Information Technology. The sector's price index leads the pack with a gain of 40.2% YTD. It is also up 5.1% year over year, while all the other sectors are down. Forward earnings are up seven straight months and are just 16.3% from their record high during July 2008, putting the sector in third place behind Consumer Staples and Health Care, which are at record highs. September's forward P/E was up to 17.0 from 16.3 and trading at a relatively low 12% premium to the market. It has been at a premium every month since January 1996. The profit margin fell for a fourth straight quarter to 9.5% in Q2, but was still the highest of the S&P 500 sectors.

The business sector may just pull us out of this recession. Chances that it will be a jobless recovery persist, but as noted, there is hope for some improvement as companies seek to add marginally to their job rolls as output improves. It seems that Washington is busy about everything except the economy. But as long as they stay out of the way, it can still happen despite their "help." Finally, Mr. Bernanke's greatest challenges may very well lie ahead, not behind. He was able to avert a massive global financial meltdown by throwing trillions of dollars at the system. Many wonder if he and the Central bank will be able to sop up the excess liquidity fast enough to avoid rampant inflation once the recovery does build sustainable momentum.

Others still, wonder if the greenback will decline still further as every major country except our staunchest of allies (yes not France) secretly make plans to replace it. A recent article in The Independent titled "*The demise of the dollar*" claims that a clandestine cabal of oil producers and consumers met secretly to plot an overthrow of the dollar as the world's key reserve currency: "In the most profound financial change in recent Middle East history, Gulf Arabs are planning--along with China, Russia, Japan and France--to end dollar dealings for oil, moving instead to a basket of currencies including the Japanese yen and Chinese yuan, the euro, gold and a new, unified currency planned for nations in the Gulf Co-operation Council, including Saudi Arabia, Abu Dhabi, Kuwait and Qatar. Secret meetings have already been held by finance ministers and central bank governors in Russia, China, Japan and Brazil to work on the scheme, which will mean that oil will no longer be priced in dollars."

We brought this mess on ourselves through years of greed and lax regulatory control. Hopefully, wiser policies will prevail to restore trust in the dollar and the US. On the other hand, a quick glance at the names of the country-co-conspirators reveals little commonality beyond hate for the US and greed. In human history, neither of these two conditions has created enduring bonds of cooperation. For now, the dollar and the US are safe as global leaders, but the clock is definitely ticking; Nobel Peace prizes notwithstanding.