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## A Better Week than the Market Suggests

Stocks around the world took a turn for the worse yesterday as debt concerns from the Euro-zone mounted and first-time unemployment insurance claims came in considerably higher than expected. Today's good news on the overall unemployment rate slowed the market's decline, but hasn't stopped it. The S&P is now down 7.6% from its January 19<sup>th</sup> peak; however prices remain nearly 60% above their lows of March 2009. Alternatively, US Treasuries are rising. They gained yesterday as investors fled to quality amid uncertainty in Greece, Spain and Portugal. Three to seven-year Treasuries were up .6% to .8% and 7-10 year Treasuries were up .8% to 1%. Gold fell the most since 2008, with April futures losing 4.1% to \$1,066.60 an ounce in New York. The metal is down 26% from its high in early December as inflation has failed to materialize.

Today the Labor Department reported that the unemployment rate unexpectedly dropped to 9.7% in January and that more than half a million Americans found work. But the government also released a report that conflicted with these results. Nonfarm payroll employment in January fell 20,000, following a revised 150,000 drop in December and revised gain of 64,000 for November. Revisions to previous data increased the number of jobs lost in the recession to 8.4 million. The underemployment rate, which includes part-time workers who'd prefer a full-time job and people who want work but have given up looking, fell to 16.5% from 17.3%.

Just as the employment news on balance is positive, so is the week's economic news. On Monday the government reported a sharp rise in the pace of manufacturing in January. The ISM's manufacturing index jumped more than 3 points to 58.4 for its sixth straight indication of month-to-month growth. The report showed that demand from the manufacturing sector is driving up prices of raw materials, but manufacturers are as yet unable to pass the increases on in higher selling prices. The data point to a V-shaped recovery in manufacturing with exports (particularly in technology) leading the way.

Productivity skyrocketed for the fourth quarter as companies produce more with fewer employees. The first estimate for fourth quarter nonfarm production came in at an impressive 6.2% annualized, following a revised third quarter 7.2% jump. The latest productivity number marginally beat the market forecast for a 7.0% increase as the increase was telegraphed by last week's surprisingly high GDP number. Unit labor costs declined as well, dropping an annualized 4.4% in the fourth quarter, following a revised 1.5% decline in the third. Businesses are lean, healthy and competitive. With the dollar down 40% in the last ten years, the future looks bright indeed for American exports.

The good news spilled over from the manufacturing side of the economy to the service side as the ISM's non-manufacturing report showed that new orders rose more than 2-1/2 points in January to 54.7. While lagging the manufacturing side, the reading is still the strongest in more than two years. Rising orders suggest improving business activity and jobs prospects. And yesterday the government reported that factory orders rose 1.0% in December to follow a 1.0% percent gain in November (revised 4 tenths higher) and an unrevised 0.8% in October.

Automobile manufacturers continue to struggle, selling about 511,000 US-made cars and light trucks in January. That indicates an annual unit rate of 7.9 million vehicles, down significantly from December's rate of 8.5 million and well below historical norms of 13 million. Bloomberg reports that lost sales at Toyota for the month were not fully made up by sales at other manufacturers.

Perhaps the most significant negative economic warning comes from the President's proposed budget. While it will endure many changes in congressional debate, it sets a familiar tone of redistribution which is not helpful when proven incentives (tax cuts) are needed to incent risk taking and innovation.

Obama seeks a \$1.9 trillion tax increase over the next decade on Americans earning more than \$250,000 and targets an additional \$400 billion from businesses doing international business. Remember the strongest horse pulling the economy right now is exports. Remember also that those people earning over \$250,000 represent the small businesses in this country that create over 70% of the new jobs so integral to recovery.

Treasury Secretary Tim Geithner said "this set of tax reforms strikes a balance between targeted tax cuts to spur investments in job growth and innovation here at home, middle-class tax relief to make our tax system more fair, measures to crack down on abuses that send jobs overseas, and long-term fiscal discipline." Mr. Geithner, few Americans outside of Washington believe that the federal government is 'innovative,' 'fair,' or 'disciplined.'

The federal government is hiring like there's no tomorrow, but are government jobs as good for our economy as private sector jobs? The General Accounting Office reports that less than 30 cents of every dollar the federal government spends actually meets its intended purpose. Additionally, every federal job created further burdens the private sector with higher taxes. While it is difficult to compare private sector productivity to government productivity, because the government doesn't actually produce anything . . . hmmm, isn't that the point?

As of February 3<sup>rd</sup>, 268 of the S&P's 500 companies had reported their earnings. Nearly 77% of those reporting have exceeded analysts' projections. Removing financials whose recoveries distort the data, earnings are up 3.8% over the same period last year. The S&P currently sells at a reasonable valuation relative to earnings. The index is selling at 14x currently projected earnings for the next 12 months, which is fairly valued. If you are a foreign investor in US stocks, they have never been cheaper because of the relative cheapness of the US dollar. As is most often the case, stocks represent the best long term investment choice with dividend yields over 2% and a built-in inflation hedge.

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