



Friday, March 12, 2010

Inching Towards Recovery

The American consumer is coming back. Sales at US retailers grew a surprising .3% in February according to a Commerce Department report released this morning, but the two previous months were revised downward. Excluding autos, February sales rose .8%, also surpassing expectations. Economists expected sales to fall .2% due to bad weather across the country.

All but three of the 13 major categories in the report showed increases in sales last month. Electronics and appliances stores and grocery stores led the way with purchases of electronics up 3.7%, the largest gain since January 2009. Receipts at bars and restaurants climbed .9%, the most since April 2008.

The report's same-store sales tally climbed 4.1% well ahead of estimates. Earlier in the week ICSC-Goldman released their survey showing that same-store sales jumped 2.9% for the biggest weekly gain in nine years. The report showed the year-on-year pace for the full month of March at plus 2.5 to 3.5%. The Redbook report cast the only wet blanket this week saying that the March 6 week is below plan because of an earlier Easter which will pull April sales into March.

The quarterly services survey added positive news. Most notably, employment services jumped 5.7% in the quarter to \$42.2 billion. First showing strength in October, payroll increases for temporary-help services remained strong through February. Information sector revenue rose .8% in the fourth quarter to \$286.2 billion, up 0.5% year-on-year.

The US trade deficit unexpectedly shrank in January despite higher oil prices. Exports slipped 0.3%, but imports fell a faster 1.7%. It's too early to tell if the drop suggests a less robust recovery, or simply a more normal reading compared to December's surprisingly strong exports of 3.4% and imports of 4.9%. Year-on-year, growth in overall exports of goods and services in January increased to 15.1% from 7.7% in December indicative of earlier poor results from the recession.

Unfortunately, the Reuters/University of Michigan Confidence report this morning sours a week of otherwise positive economic news. The index unexpectedly declined from 73.6 to 72.5 signaling that despite the rising stock market, the US consumer remains considerably worried about jobs. The weekly report of Americans filing initial claims for jobless benefits fell to 462,000, but the number should be below 450,000 or even 400,000 before economists will conclude that unemployment has turned the corner.

Yesterday, the government came to market with an additional \$13 billion of 30-year Treasuries. Supply is driving the yield curve, the difference in yields between 2 and 30-year Treasuries close to a record. 30-year bonds yield 3.78 % more than two-year notes. A gap of 3.85% reached on Feb. 17th was the most since at least 1980, according to data compiled by Bloomberg.

The difference between yields on 10-year notes and Treasury Inflation Protected Securities, or TIPS, a gauge of inflation expectations known as the breakeven rate, widened to 2.26% yesterday, from 2.18 points a week ago. The average over the past five years is 2.16%. President Obama has increased US marketable debt to an unprecedented \$7.41 trillion to fund a budget deficit the government predicts will swell to a record \$1.6 trillion in the fiscal year ending Sept. 30th.

As of yesterday The S&P 500 was up for its sixth straight day and closed at a 15-month high of 1150.24 on penny above its high reached on January 19th. It subsequently fell 8.1% on worries of inflation, Fed tightening, outpacing the recovery, and the Greek problems. After erasing the loss, the index is now up 70% since March 9, 2009.

Until more substantial data supporting recovery or the lack of it are available, it is doubtful the market will move significantly from here. Market watchers have worried recently over the lack of volume evident as stock prices rise. Another troubling issue is that equity mutual funds are burning through cash at the fastest rate in 18 years, leaving them with the smallest reserves since 2007 according to a recent Bloomberg article. It mentions Investment Company Institute data showing that cash dropped to 3.6% of assets from 5.7% in January 2009, leaving managers with \$172 billion in the quickest decrease since 1991.

Bears say that depleted cash reserves are a sign that returns will fall from last year, when the S&P 500 rose 23%, the most since 2003. Bulls say any pullback is a buying opportunity because investors still have \$3.17 trillion in money-market funds and may return to stocks after putting 16 times more money into bonds since last March.

“It will fluctuate”

J.P Morgan, when asked what the stock market will do following the crash of '29.

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