



Friday, June 4, 2010

## Recovery Continues, Despite Headwinds

Employment generally begins to rise a few months or quarters into a typical economic recovery. Businesses see demand for their products and services rise faster than they can fill orders. The last bit of productivity squeezed from their workers and plant, they must hire. But when will we reach that point? We are in recovery from the 'Great Recession?' European debt concerns, slowing growth in China, and the greatest man-made oil spill in world history all serve to derail the chugging recovery.

The Labor Department reported today that 431,000 people were hired in May. Of that total 411,000 were hired on a temporary basis by the government to complete the 2010 census. Private payrolls rose only 41,000. The headline number that will be touted on tonight's news dropped from 9.8% to 9.7%, largely because more job applicants gave up the search than new applicants entered. The labor force shrank by 322,000 workers. A positive takeaway was that the underemployment rate, which includes part-time workers who'd prefer a full-time position and people who want work but have given up looking decreased to 16.6% from 17.1%.

While many companies continue to cut back, some are hiring. GE, the world's largest maker of jet engines, power-generation equipment and locomotives, said last month it will increase the number of jobs it will add in Michigan to more than 1,300. In a Bloomberg interview last week, CEO Jeff Immelt said that the US economy is "very good and improving." He also said that Europe's debt crisis is "solvable" and will not slow the global economic recovery. Chrysler also said that they will hire 1,100 workers at a Detroit factory that produces Jeep Grand Cherokees and add a second shift.

The government reported that productivity growth, while still healthy, was revised downward to 2.8% compared to an initial estimate of 3.6% for the first quarter. Annualized productivity was 6.1% in the first quarter, up from 5.6% in the fourth quarter. What is apparent though is that businesses may be reaching limits of what they can get from their existing workers. If business continues to improve, as it has lately, then employers will have to boost hiring.

The manufacturing sector continues to look very strong. Factory orders in April rose by 1.2% following an upwardly revised 1.7% in March. The report also shows that production and shipments are not keeping up with orders. Unfilled orders gained 0.4% in April after edging down 0.1 percent in March, according to the government report.

The Institute for Supply Management which surveys more than 300 manufacturing firms reported strong growth in new orders and manufacturing employment. New orders held steady at 65.7, a reading well over breakeven 50, and the third in a row over 60, according to Bloomberg. The Employment Index was last above 60 in May of 2004. May's reading came in at 59.8 for a 1.3 point gain to indicate significant acceleration in hiring. It appears the second quarter will be stronger than the first for manufacturing.

Expiring tax incentives for homebuyers continue to propel gains in housing. Pending home sales for April were up 6.0% following an upward revised 7.1% jump in March. Year-on-year, the index is up 22.4%. A pending sale is one in which a contract was signed, but not yet closed. It usually takes four to six weeks to close a contracted sale.

Economists believe that the credits are having an impact on home construction activity as inventories fall. Private residential outlays increased by 4.4% following no change in March and private non-residential construction gained 1.7%. Year ago construction outlays were down 10.5%.

While manufacturing and housing, to a lesser extent, propel an anemic recovery, the consumer remains largely in lock-down. Chain store sales reported mostly soft sales for May. Bloomberg reports that year-on-year same-store sales trends declined from the mid-to-low positive single digits to the low positive single digits.

European central bankers, meeting with the Group of 20 in South Korea, are delaying their earlier plans of withdrawing emergency stimulus funds in light of the current sovereign debt crisis. Countries such as Australia and Canada are saying that Europe's indebtedness and the US's continued low rates present hurdles to their raising interest rates to contain growth and inflation in their countries. They call on these countries to get their financial houses in order – to cut their debt. Failure to do so, according to Alan Greenspan and others, may trigger a bondholder revolt. The European market for corporate bonds closed on June 1<sup>st</sup> as concern banks there will take more write-downs and losses leading investors to shun all but the safest government debt.

Julian Callow, chief European economist at Barclays Capital in London says that central bankers are concerned that the biggest threat to the recovery is banks ceasing to lend and financial markets freezing as happened in 2008, rather than weaker European demand. Callow said "They are traumatized by what happened in 2008. Investors are nervous again."

Goldman Sachs Chief European Economist Erik Nielsen now expects the ECB to wait until the second quarter of next year to raise its benchmark rate rather than during the first three months of the year as he previously anticipated.

Economic indicators in China also show that country's growth slowing. Their Purchasing Managers' index fell to a lower-than-forecast 53.9 in May from 55.7 in the previous month. A separate index released the same day by HSBC Holdings and Markit Economics dropped to the lowest level in almost a year according to Bloomberg News. The FTSE China 25 index is down 16.5% since its November '09 peak.

Falling global interest rates and inflation may provide as much as a year's cover for the US Treasury to fund its mammoth debt. PIMCO's Bill Gross said Treasuries are the premier holdings for fixed-income investors with the US economy failing to produce private sector jobs and Europe's sovereign-debt crisis threatening that region's banking sector. "The US is the least dirty shirt," Gross said today on Bloomberg. "The world is full of dirty shirts in terms of

excessive debt, and the United States is one of those countries, but it still remains the reserve currency and still remains the flight to quality haven.” He went on to say that their focus was in the 5-10 year range. Hey, so is ours.

If you watch a much of CNBC, CNN, Bloomberg TV, or Fox, you almost certainly have a jaded view of our economy’s prospects. You may even be of the opinion of some I’ve talked to who believe we may not make it out this time. In a conversation the other day I asked one such person if he thought it possible that we might re-visit times like the Great Depression. He said he believed that for a number of reasons, I’ll spare you the details, he did. The Great Depression spanned a period from 1929 through 1939. To put the question in current terms, the following examples represent the period from 1929 to 1932.

During the first three years of the Great Depression, more than 40% of banks failed. Since January 2008 less than 2% of US banks have failed. Unemployment rose to 25%, we currently stand at 9.7%. GDP fell by 46% between 1929 and 1932. US GDP since 1Q 2008 is up 1.4%. From the market’s peak in 1929, the stock market collapsed by a total of 89% during the following three years. By contrast, the S&P 500 would have to fall to 173 from its October 2007 peak of 1,576 to in order to realize an 89% decline. From today’s level of 1078, the S&P would have to fall 83.4% to reach 173. So what do you think? Are we headed for another Great Depression?

Its questions like these that demonstrate why we do ongoing Wealthcare® analysis for our clients. Truth is no one knows what tomorrow brings. The evening news provides almost daily reminders of just how unpredictable our world is. Rather than guessing where markets will go we spend our time ensuring that each of our clients’ plans adequately reflects his or her goals and priorities. We stress-test the daylight out of them as we include over their lifetimes outliers like Great Recessions, Great Depressions, 135% gains like in 1933, and 70% gains like in 2009/2010. The result is a statistically reliable degree of confidence that they will meet or exceed their important life’s goals. Our clients have learned that they can literally replace worry with confidence.

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