

Weekly Economic Commentary

June 7, 2010



John Canally, CFA

Economist
LPL Financial

ECONOMIC CALENDAR

Monday, Jun 7

Consumer Credit
Apr

Tuesday, Jun 8

Small Business Sentiment
May

Wednesday, Jun 9

Wholesale Inventories
Apr

Beige Book

Thursday, Jun 10

Initial Claims
wk 06/05

Trade Balance
Apr

Treasury Statement
May

Friday, Jun 11

Retail Sales
May

U of Mich Consumer
Sentiment
Jun

Business Inventories
Apr

Is the Labor Market Changing Course?

There was a torrent of economic data released in the United States last week as market participants continue to sift through the incoming data very closely, looking for signs of contagion from the European fiscal situation. The good news is that virtually none of the U.S. economic data released over the past week showed any signs of contagion including:

- The Institute for Supply Management (ISM) report on manufacturing for May,
- Construction spending for April,
- Pending home sales for April,
- New vehicle sales for May,
- Layoff announcements for May,
- Chain store sales for May,
- The ISM's index of service sector activity for May,
- New orders and shipments of manufactured goods for April,
- Initial filings for unemployment insurance for late May, and
- The ADP employment report for May.

On balance, with the notable exception of the May employment report (see below for details) the economic data released last week in the United States met or exceeded market expectations, and in our view, keeps real gross domestic product (GDP) growth in the second quarter of 2010 on a pace to exceed the 3.0% growth rate in the first quarter of 2010. The caveat, however, is that it may be too soon for the slowdown in Europe to have reached these shores. We will continue to monitor the data on a daily basis looking for signs of a contagion, and make changes to our economic and market outlooks as needed.

Highlights

- There were few, if any, signs of a European contagion in last week's economic data in the United States.
- The May jobs report was certainly a disappointment to markets, but did not alter our view of the labor market in 2010.
- This week's economic calendar in the United States is relatively quiet, which will focus the market's attention on the Chinese economic data for May.

Was the May Employment Report a Game Changer?

The monthly employment report is actually two surveys in one—the establishment survey and the household survey. The establishment survey measures employment by surveying 140,000 businesses at 410,000 locations throughout the United States, gets most of the headlines, and generates the oft-cited monthly job gain/loss data. The household survey measures the employment status of individuals in 60,000 households, and generates the unemployment rate. Although 60,000 does not sound like a large number (compared to 300+ million people and the 110+ million



1 The Unemployment Rate Dipped to 9.7% in May, but Remains Uncomfortably High



The caveat, however, is that it may be too soon for the slowdown in Europe to have reached these shores. We will continue to monitor the data on a daily basis looking for signs of a contagion, and make changes to our economic and market outlooks as needed.

households in the United States), it is a very large sample size when compared to many national public opinion polls, which may survey only 2,000 or so households.

As noted above, the May employment report was a major disappointment to financial markets on Friday, June 4, as the economy created only 41,000 private sector jobs in May, well below the consensus estimate of an 185,000 gain in private sector employment. When subtracting the net downward revision to the private sector job count in April (to 218,000 from 231,000), the change in private sector employment was below the low end of the consensus range of +30,000 to +257,000.

Typically, when the monthly jobs report comes in above the upper end of the range of estimates, (or as was the case this month, below the lower end of the range of estimates) financial markets can move substantially. That is exactly what happened on Friday, June 4, as equity markets plunged and investors shunned riskier fixed income instruments in favor of the relative safety of U.S. Treasuries.

Beyond the weaker-than-expected gain in private sector employment in May, the mix of jobs created in May was uneven, with decent gains in some cyclically sensitive areas (temporary help services and transportation equipment), but declines in others (retail, furniture stores, furniture manufacturing). While the unemployment rate fell 0.2% to 9.7% in May, household employment fell by 35,000 jobs in May, after surging between January and April, adding nearly 1.7 million jobs. [Chart 1] The weakness in the household job count in May is concerning, but it must be placed in the context of the strength in household employment over the first four months of 2010, and virtually every other employment indicator released to date for April and May, which suggests that solid, but not spectacular, job growth is underway. We would have to see the weakness in household employment persist for several more months, and be confirmed by other data on employment (jobless claims, ISM, layoffs, hiring intentions, etc), before we change our view on the labor market.

Heading into 2010, our view (shared by many other market participants) was that the labor market would be more robust than in the "jobless recoveries" following the mild recessions in 1990-91 and 2001, but not as strong as the robust job recoveries following the severe recessions in the mid-1970s and early 1980s. Thus far, the data has supported that view despite the weaker-than-expected reading on employment in May.

Net Job Gain/Loss in Thousands (First 10 Months of Recovery-Date Refers to Start of Recovery)

1970	1975	1982	1991	2001	2009
973	1642	2396	-423	-916	-176

Source: Bloomberg, LPL Financial 06/07/10



Our concerns on the labor market looking ahead to second half of 2010 (arranged from most likely to occur to least likely to occur) include:

- The best case is no hiring from state and local governments this year. The base case is for sizeable jobs losses in this sector, which accounts for about 15% of all employment.
- The oil-drilling moratorium in the Gulf of Mexico hurts oil and gas extraction employment. One hundred sixty six thousand people are employed in the oil and gas extraction sector (out of an economy with 131 million jobs) but every little bit helps.
- Small businesses continue to hold back on hiring due to lack of credit and ongoing regulatory and legislative uncertainty.
- European economies completely implode, which dries up export related jobs here in the United States.

We will continue to watch the incoming data on employment, including:

- Weekly jobless claims
- The regional ISM and Federal Reserve (Fed) manufacturing surveys (several are due out for June this week)
- Layoff announcements tracked by Challenger
- The employment discussion in the Fed's Beige Book (due out this week)
- Hiring intention surveys
- Daily consumer confidence readings
- Inter-bank liquidity spreads
- A major slowdown in economic activity in Europe

Our View on the Key Reports and Events of the Coming Week:

The data mills in the United States take a breather this week, which will allow the Chinese data set for May to take center stage. The key economic reports in the United States this week are likely to be the Fed's Beige Book—a qualitative assessment of economic conditions in each of the 12 regional Federal Reserve districts in the United States—and the May retail sales report.

On the policy front this week, Federal Reserve Chairman Ben Bernanke is slated to appear on Capitol Hill to testify on the economic and budget outlook. Bernanke is likely to continue to remind Congress that it is their job (not the Fed's) to address the nation's looming fiscal problems.

Overseas, there are a number of key central bank meetings, including meetings of the European Central Bank (ECB), the Bank of England, Reserve Bank of New Zealand, and the central banks of Brazil and India. While the Bank of England and the ECB are contemplating further easing, the consensus expects rate hikes from the central banks of both Brazil and New Zealand this week.

While the data mills in the United States take a breather, the data calendar heats up in China, with virtually every key report on the health of the

Any dramatic slowdown in the pace of Chinese exports to Europe in May (versus recent trends) might further fuel talk that the European fiscal situation is beginning to impact global trade.



2 China's Exports to Europe Have Increased Dramatically over the Past 10 Years



Chinese economy in May due out this week. The market will be particularly interested in the Chinese export data to Europe (and import data from Europe) in May, as participants continue to assess what, if any impact the European fiscal situation has had on world trade.

As noted in [chart 2](#), about 20% to 25% of China's exports go to Europe, placing Europe second (behind Asia) as China's largest export market. The chart also reveals that China's exports to Europe have increased dramatically over the past ten years year-to-date through April 2010; China's exports to Europe were up 32% versus the first four months of 2009. That 32% growth rate of Chinese exports to Europe in the first four months of 2010 versus the similar period in 2009, is just about the same growth in Chinese exports to Europe seen in the five years leading up to the worst of the Great Recession.

Any dramatic slowdown in the pace of Chinese exports to Europe in May (versus recent trends) might further fuel talk that the European fiscal situation is beginning to impact global trade. Strong German factory orders in April (reported on Monday, June 7) demonstrate the silver lining for the Eurozone exporters of a weaker euro stemming from the European debt problems.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Investing in international and emerging markets may entail additional risks such as currency fluctuation and political instability. Investing in small-cap stocks includes specific risks such as greater volatility and potentially less liquidity.

Stock investing involves risk including loss of principal. Past performance is not a guarantee of future results.

The fast price swings of commodities will result in significant volatility in an investor's holdings.

This research material has been prepared by LPL Financial.

The LPL Financial family of affiliated companies includes LPL Financial and UVEST Financial Services Group, Inc., each of which is a member of FINRA/SIPC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and make no representation with respect to such entity.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by any Government Agency | Not a Bank/Credit Union Deposit