

Weekly Economic Commentary



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Certainty in an Uncertain World

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Highlights

- Despite a full slate of economic data, policy (or lack thereof) continues to dominate the discussion.
- Uncertainty reigns today, but uncertainty does not always end badly.

Economic Calendar

Tuesday, September 13	Initial Claims <i>wk 09/09</i>
Import Price Index <i>Aug</i>	NY Fed Empire State Mfg <i>Sep</i>
Treasury Statement <i>Aug</i>	CPI <i>Aug</i>
Wednesday, September 14	Capacity Utilization <i>Aug</i>
MBA Mortgage Applications Index <i>wk 09/09</i>	Industrial Production <i>Aug</i>
Retail Sales <i>Aug</i>	Philadelphia Fed Index <i>Sep</i>
PPI <i>Aug</i>	Friday, September 16
Business Inventories <i>Jul</i>	U of Mich Consumer Sentiment <i>1H Sep</i>
Thursday, September 15	
Current Account Balance <i>Q2</i>	

Economic decision makers (consumers, businesses, policymakers) and financial market participants dislike uncertainty, but as we head into the middle of September, uncertainty seems to be widespread, especially in Europe. This week, a mix of policy and data will drive markets as they seek shelter from the uncertainty that is surrounding Europe, and to a lesser extent the outlook for the U.S. economy.

After a relatively quiet week for data (September 5–9), the U.S. economic calendar is chock full of reports this week, with data on retail sales, industrial production, consumer prices and producer prices for August, the Empire State Manufacturing Index for September, as well as the regular weekly readings on retail sales, initial claims and mortgage applications. On the policy front, Federal Reserve (Fed) officials are largely ignoring the traditional "quiet period" ahead of the September 20–21 FOMC meeting, as several Fed officials, including Fed Chairman Ben Bernanke, are scheduled to deliver speeches this week.

Overseas, the Central Bank of India, the Reserve Bank of New Zealand and several emerging market central banks meet to set policy. After raising rates for most of the past 21 months many central banks in emerging markets and in commodity-rich nations have begun to reevaluate their monetary policy stance in light of the uncertainty in Europe and elsewhere. This trend is a potential policy catalyst that could begin to remove some policy related uncertainty.

Against this uncertain policy backdrop, the Group of Seven (G-7) finance ministers met this past weekend (September 9–10), but concluded the meeting without the bold policy steps the market has been calling for. Next weekend (September 16–18), the financial ministers from the European Union (EU) will meet again to debate and discuss what, if any, policy actions can be taken to arrest the fears over Europe's debt problem.

Uncertain Times

On Wednesday, September 7, the Fed released its Beige Book, a qualitative assessment of economic activity in each of the 12 regional Federal Reserve districts (Boston, New York, Philadelphia, Richmond, Dallas, etc.) as reported by bankers and business owners in each of the districts. The report is prepared eight times a year several weeks prior to each of the eight Federal Open Market Committee (FOMC) meetings held each year.

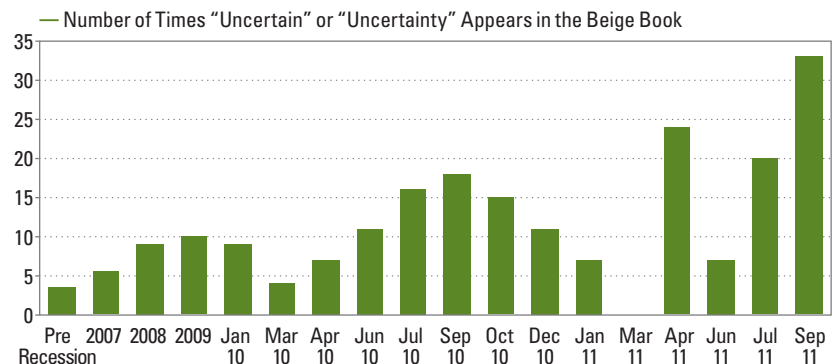


Still, it is clear that the certainty craved by businesses, consumers and policymakers is sorely lacking, and events thus far in September suggest that the word “uncertain” will make several appearances in the next Beige Book (due out in mid-October 2011) as well.

The word “uncertainty” appeared in the Beige Book 33 times, as business owners and lenders described what they saw during August, a period that saw a great deal of financial market turmoil accompanied by the partisan battle in Congress over the U.S. debt ceiling, and the downgrade of the U.S. credit rating by S&P in early August. Not all of the uncertainty was attributed to financial markets and the battle over the debt ceiling, as several economic decision makers cited the ongoing supply chain disruptions due to the aftermath of the Japanese earthquake. Still, it is clear that the certainty craved by businesses, consumers and policymakers is sorely lacking, and events thus far in September suggest that the word “uncertain” will make several appearances in the next Beige Book (due out in mid-October 2011) as well.

You can see in [Chart 1](#) how many times the words “uncertain” or “uncertainty” appeared in the Beige Book since January 2010. We also looked at how many times, on average, those words appeared in the Beige Book in pre-recession (2005 and 2006, right in the middle of the 2002–2007 recovery), as well as in 2007, 2008 and 2009, the years of the Great Recession. We note that the use of the word uncertainty peaked in 2009, just as equity markets were making multi-year lows.

1 Elevated Economic and Policy Uncertainty Evident in the Beige Book



Source: LPL Financial Research, Federal Reserve 09/07/11

We want to make it clear that not all periods of uncertainty are resolved the same way. At times, the uncertainty can clear up quickly in response to an economic event, policy action, or series of policy actions, and the clarity this provides to economic agents often leads to better results for financial markets and economies. An example of this type of uncertainty was the initial flare-up of the concerns surrounding European peripheral debt during the spring and summer of 2010. This flare-up coincided with a spike higher in the number of times the word “uncertain” showed up in the Beige Book over the summer and early fall of 2010. This heightened level of uncertainty led to a 15% peak to trough drop in S&P 500 Index over the late spring and summer months of 2010, and took four or five months to resolve. Low expectations for the economy, bold policy action (the announcement and enactment of QE2), and a series of better-than-expected results for global economies and companies helped to end that spate of uncertainty.



Our base case remains that the current environment of elevated uncertainty will be resolved in much the same way the uncertainty in 2010 was:

- With bold policy action from policymakers around the globe.
- Better-than-expected economic data (currently the U.S. economy in the nearly completed third quarter is on pace to accelerate from the second quarter's meager 1.0% pace) as expectations remain low.
- Solid corporate earnings, which ultimately drive equity prices.

Until then, uncertainty is likely to dominate the economic and investment landscape, and financial markets and economic decision makers will continue to call out for certainty in an uncertain world.

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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.

Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Stock investing involves risk including loss of principal.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Empire State Manufacturing Index is a seasonally-adjusted index that tracks the results of the Empire State Manufacturing Survey. The survey is distributed to roughly 175 manufacturing executives and asks questions intended to gauge both the current sentiment of the executives and their six-month outlook on the sector.

An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

The ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

International investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

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