



Weekly Economic Commentary



February 8, 2010

Where Are the Jobs?

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ECONOMIC CALENDAR

Tuesday, Feb 9	Retail Sales X-Autos
Wholesale Inventories	Jan
Dec	Retail Sales
Small Business Sentiment	Jan
Jan	Business Inventories
Wednesday, Feb 10	Dec
Trade Balance	Friday, Feb 12
Dec	U of Mich Consumer
Treasury Statement	Sentiment
Jan	Feb
Thursday, Feb 11	
Initial Claims	
wk 02/06	

The economic data released last week was solid, but largely overlooked, as markets focused on sovereign credit risk in southern Europe. The week's attention grabbing report, the January employment report, was again disappointingly weak, prompting the question, which serves as the title of this report, "Where are the Jobs".

The U.S. economic data due out this week is likely to take a backseat once again to the ongoing fiscal crisis in Europe, a fresh round of economic data in China, and testimony from newly reconfirmed Federal Reserve Chairman Ben Bernanke. The market will also digest key reports this week on small business sentiment and retail sales in January, as well as merchandise trade in December.

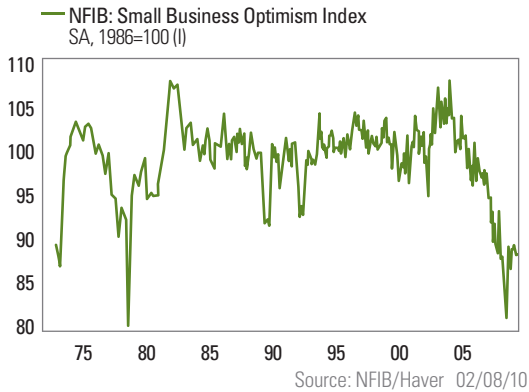
While the large majority of last week's economic data came in better than expected and continued to point to solid growth in the U.S. economy in the first half of 2010, the market's focus was elsewhere. For most of the week, the focus was on the fiscal uncertainty in Europe (please see this week's Weekly Market Commentary for details), but by the end of the week, the market's attention turned to jobs.

With the U.S. economy growing at nearly 6% in Q4 2009, and expected to grow by 3-5% in the first half of 2010, the economy should be adding jobs by now. But it is not. Why?

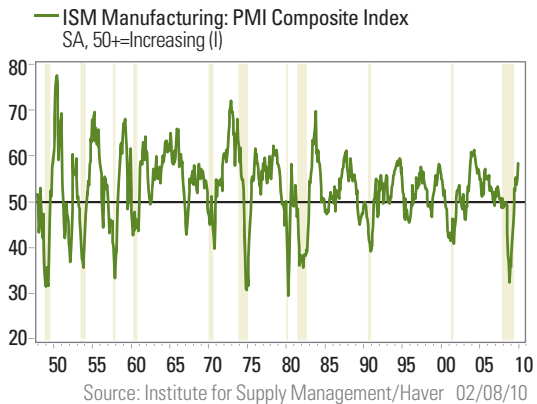
First, let's look at all of the leading indicators of the labor market that point to a dramatically improved labor market versus a year ago:

- 1. Big drop in jobless claims.** Layoffs have slowed dramatically over the past year. First time filings of claims for unemployment benefits were running at close to 700,000 per week in early 2009, and are now close to 450,000 per week.
- 2. Big drop in job cut announcements.** Job cut announcements in January 2010 were more than 70% below their January 2009 readings, and job cut announcements in December 2009 were among the lowest in 10 years.
- 3. Gains in temporary help employment.** Employment at firms providing temporary help has increased for four consecutive months through January 2010, and has been on an improving trend since early 2009. Businesses add temporary workers before adding full time staff.
- 4. Gains in hours worked.** Hours worked have been rising since October 2009. Businesses typically make existing workers work longer hours before adding new staff.

1 Small Business Pessimism May Be Holding Back Job Growth



2 The January Reading on the ISM Suggests Strong GDP Growth in 2010



- Gains in overtime hours.** Overtime hours in manufacturing have been increasing steadily since May 2009. Businesses typically make existing workers work longer hours before adding new staff.
- Gains in employment in other industrialized nations.** Canada, Australia, Malaysia, Philippines, and Taiwan have all seen sizeable jobs gains in the past six months.
- Big gains in productivity.** Output per hour worked in manufacturing increased at a near record clip in Q4 2009, while the cost of adding an additional worker (on a per hour basis) remains near an all time low. This suggests that businesses are pushing the limit in terms of worker productivity and that some hiring will need to take place soon.
- Big gains in business spending.** Business capital spending ran at a robust 13.3% annualized pace in Q4 2009, after a smaller 2% gain in Q3 2009, marking the first back to back gains in business spending in three years. Normally, a pickup in business spending, especially at such a robust pace, has been associated with solid gains in employment.

So what's holding back job growth?

- Outsourcing.** Jobs are being added, but U.S. businesses may be choosing to add the jobs outside of the U.S. to save on labor costs. This trend was not prevalent in the robust job growth periods following the severe recessions of the 70s and 80s, and suggests that we may never again see job growth as robust as those earlier periods. Point 6 above suggests that the "outsourcing" phenomenon remains in place today. [Chart 1]
- Small business uncertainty.** Since the early 90s, small businesses have created 64% of jobs in the U.S. Small businesses uncertainly surrounding legislative initiatives in Washington (healthcare, taxes, interest rates, etc) may be holding back hiring.
- Lack of bank lending to small businesses.** While banks say there is no demand for new loans, or that there are few credit worthy customers, many small business owners say banks won't lend. Bank lending typically doesn't pick up until well into a recovery, but the lack of lending early in this recovery has hampered the ability of small business owners to expand.
- There is uncertainty among all business in general about the stability and sustainability of the recovery. [Chart 2]

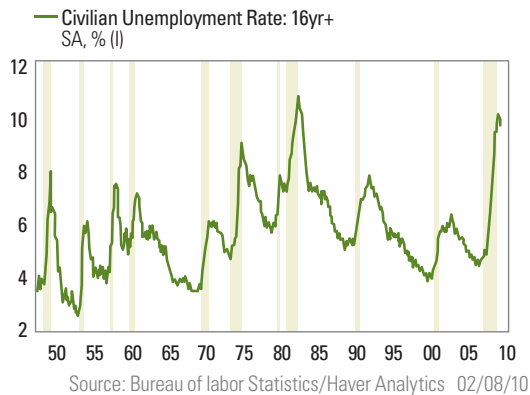
Key Reports Last Week:

There were several key reports on the economy last week, most of which came in above expectations. The incoming data continues to suggest that real economic growth in Q1 2010 and in the first half of 2010 will be above consensus, but that the Achilles heel of the recovery remains the stubbornly weak jobs market.

The stronger than expected data released last week included the 58.4 reading on the Institute of Supply Management's (ISM) index of manufacturing in January. A reading above 50 on this index suggests that



3 Although It Declined by 0.3% in January 2010, the Unemployment Rate Remains Uncomfortably High at 9.7%



Thus, the economy lost 1.4 million more jobs over the past 18 months than previously thought.

the manufacturing sector is expanding. The ISM index has been above 50 since August 2009. If sustained for all of 2010, the 58.4 reading on the ISM in January corresponds to a 5.5% growth rate for real GDP.

While the January jobs report was better than the “whisper number” floating around Wall Street during last Thursday’s equity market meltdown, the jobs report continued to underscore the lack of job creation.

In addition, the January jobs report was quite “noisy” with annual benchmark revisions, new seasonal factors, the hiring of workers for the 2010 Census and a big shift in weather between December and January adding to the confusion. The bottom line is that the economy lost more jobs during the early part of the recession (April 2008 through March 2009) and also lost more jobs since March 2009 than previously thought. [Chart 3]

The monthly jobs report is actually two reports; the household survey and the establishment survey.

- The unemployment rate-which fell by 0.3% to 9.7% in January 2010- is calculated using a survey of households. The Labor Department asks members of a household about their employment status (are you working?; do you want to work?; are you in school?) and uses this information to calculate the unemployment rate. This dataset was revised in December 2009, and as a result, the 9.7% reading on the unemployment rate is free of the distortions in the other survey in the monthly jobs report, the establishment survey.
- The monthly job count- the economy shed another 20,000 jobs in January 2010 after losing 150,000 in December 2009. This survey of business establishments throughout the U.S. is revised annually with updated tax records from companies. This year’s “benchmark” revision revealed that the economy lost 930,000 more jobs than previously thought between April 2008 and March 2009, the early part of the recession. Normal revisions made each year to seasonal factors and to the number of businesses started and closed since April 2009 led to a downward revision of 433,000 jobs over the final nine months of 2009. Thus, the economy lost 1.4 million more jobs over the past 18 months than previously thought.

The bottom line is that despite the large downward revisions to the job count in 2008 and 2009 (which reflects the severity of the 2007-2009 recession), the leading indicators of employment in the report (temporary help jobs, hours worked, overtime hours, manufacturing employment, retail employment) all continue to point to a labor market that is getting better not worse. We still expect that the recovery in the labor market will be slower than that experience after other severe recessions, but will be somewhat stronger than the market is now expecting.

Key Reports This Week:

This week is shaping up to be a relatively quiet one on the U.S. economic data front, providing the market with somewhat of a breather after a nearly steady drumbeat of key U.S. economic data since the first of the year. The U.S. data that is released is likely to take a backseat to ongoing debt issues

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in Europe, the incoming data on China (see this week's Weekly Market Commentary for details), and testimony from Fed Chairman Bernanke.

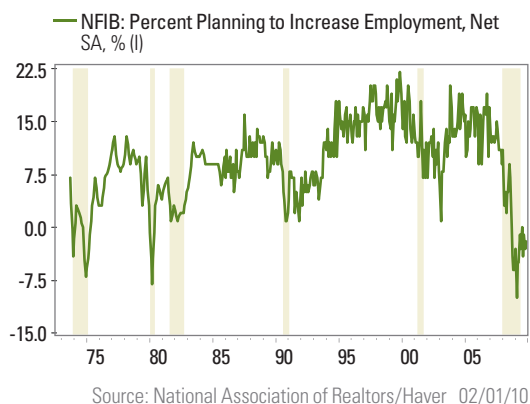
January Retail Sales (Thursday, February 11)

- The U.S. government will report its tally of January retail sales this week. The data will allow us to get a more comprehensive reading on how overall retail sales did during the first month of Q1 2010.
- Last week, the nation's retailers reported their sales for January. The data revealed that January sales on a "same store" basis, according to the International Council of Shopping Centers, rose 3.0%, triple the expectations of a 1% year-over-year (YoY) gain. January marked the second consecutive month (and the sixth in the past seven) in which comparable store sales exceeded estimates.
- Overall retail sales in January versus December are likely to be modest. The consensus is looking for a 0.3% month-over-month (MoM) gain, and a 0.5% MoM gain excluding auto sales.
- Chain store sales posted week over week gains in three of the five weeks of January.
- Virtually every measure of consumer sentiment rose between December and January, while gasoline prices rose \$0.10 per gallon.
- After a very cold and snowy December, the average temperature and average precipitation nationwide in January was closer to normal. Typically, colder (and wetter) than usual weather holds down retail sales, all else equal.

Small Business Sentiment (Tuesday, February 9)

- The National Federation of Independent Business (NFIB) releases a survey of its members each month. The survey asks small business owners about their outlook on the economy, pricing, borrowing, and hiring plans, among other questions.
- Small business optimism is unusually low at this point in a recovery, with higher taxes, poor sales, and government regulation as the biggest problems facing small business owners.
- Since small business have created more than 60% of the jobs since the early 90s, it is important to gauge their willingness to hire in this recovery.
- As noted in [Chart 4], small businesses are not planning to make any hires over the next six months, leaving small business hiring plans quite depressed.
- Any improvement in this metric would be welcome news to market participants looking for signs that hiring will soon pick up.

4 The Unemployment Rate Remains Uncomfortably High at 10.0%



December Trade Balance (Wednesday, February 10)

- Net exports added 0.8 percentage points to real gross domestic product (GDP) growth in Q4 2009, as exports surged (18.5%) more than imports



Judging by the new export orders data embedded within the various national and regional ISM and Federal Reserve manufacturing surveys for December and January, there is pretty solid evidence that U.S. export growth remained solid in December and January 2010.

(+10.5%) as global trade continued to recover from the Lehman shock of the Fall of 2008.

- With global economies recovering quickly, we expect the trade sector to be a positive contributor to GDP growth throughout 2010.
- Judging by the new export orders data embedded within the various national and regional ISM and Federal Reserve manufacturing surveys for December and January, there is pretty solid evidence that U.S. export growth remained solid in December and January 2010.
- With the U.S. domestic economy improving however, import growth is likely to rebound, especially given the uptick in oil prices recently.
- Exports have helped to lead the U.S. economy out of recession during the last two recoveries, in 1991 and in 2001.

IMPORTANT DISCLOSURES

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