Weekly Economic Commentary

March 29, 2010

Another Jobless Recovery?

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ECONOMIC CALENDAR

Monday, Mar 29
Personal Spending
Feb

Personal Income
Feb

Tuesday, Mar 30
Consumer Confidence
Mar

Wednesday, Mar 31
Chicago PMI
Mar

ADP Employment
Mar

Factory Orders
Feb

Thursday, Apr 1
Initial Claims
03/27

Challenger Layoffs
Mar

Construction Spending
Feb

ISM Manufacturing
Feb

Domestic Light Vehicle Sales
Mar

Friday, Apr 2
Unemployment Rate
Mar

Nonfarm Payrolls
Mar

Highlights

Last week, soft data on housing was overwhelmed by solid data on jobs, manufacturing and consumer confidence.

Are we in yet another jobless recovery? Yes.

The March employment report caps off a busy week for economic data.

Markets absorbed and shrugged off another round of weak housing data last week, as equity markets (as measured by the S&P 500 index) posted their fourth consecutive weekly advance, the sixth in the past seven weeks. A strong reading on durable goods shipments and orders in February, along with a comforting drop in first-time filings for jobless benefits provided a solid economic backdrop. On the policy front, Federal Reserve Chairman Ben Bernanke signaled that Fed policy would continue to remain accommodative for an "extended period."

The February durable goods report confirms that business capital spending is on track to post a third consecutive quarter-over-quarter gain in the first quarter of 2010. It also confirmed that the manufacturing sector continues to power both business spending and net exports, and is leading the recovery. The manufacturing sector added jobs in both January (20,000) and February (1,000) and those job gains are likely to accelerate over the course of 2010. Risks to the manufacturing sector include prolonged malaise in Europe (15% of our exports go to Europe) and a stronger dollar, which could limit the competitiveness of U.S. exports in the global marketplace.

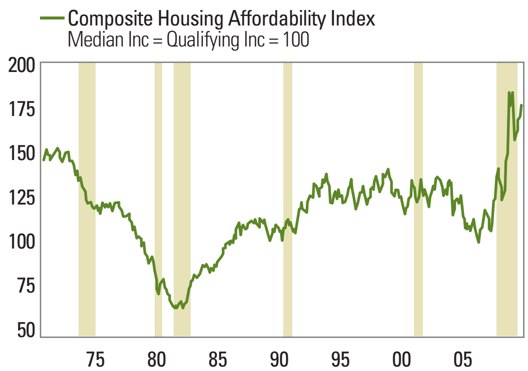
The February new and existing home sales data was, in a word, terrible. Both new and existing home sales posted month-over-month declines between January and February. While some of the drop may have been weather-related, the bottom line is that the housing market remains quite fragile. New home sales hit an all time low in February, while existing home sales came crashing back to earth after the first time homebuyer tax credit jolted sales higher in mid-to-late 2009.

If there is any good news on housing, it is that in inventories of unsold new homes remains historically low, and the inventory of unsold existing homes is well below recent peaks. In addition, while prices of existing homes are in line with levels a year ago, prices of new home are up between 5 and 10% from early 2009. Finally, housing affordability—the ability of the median household to afford the payment on a median priced home—is near record highs. The bottom line is that housing—along with bank lending and the labor market—continues to be the Achilles heel of the recovery.

The question many will be asking this week, ahead of the release of the March jobs report on April 2 is, are we in another jobless recovery? The quick answer yes. However, that may be about to change.

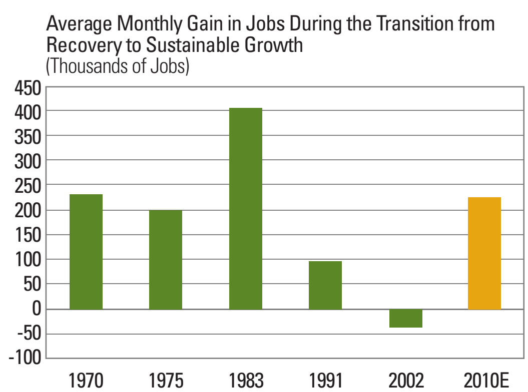
Assuming the 2007–2009 recession ended in June 2009, the recovery is about nine months old. Nine months into the robust recoveries that began in

1 Housing Affordability Remains Near All-Time Highs



Source: National Association of Realtors, Haver 03/29/10
Shaded areas represent recessions.

2 Job Growth Likely To Return as Economy Transitions to Sustainable Growth



Source: U.S. Department of Labor, FactSet 03/29/10

1970, 1975, and 1982, the economy had already created between 100,000 and 150,000 jobs per month. In the "jobless recoveries" following the 1991 and 2001 recessions, the economy had shed around 50,000 jobs per month in the first nine months of recovery. This time around—assuming the consensus is correct and the economy will create about 200,000 jobs in March 2010—the economy has shed an average of 100,000 jobs per month in the first nine months of the recovery. Another jobless recovery indeed.

The next 12 months will be a period of transition in the economy from recovery to sustainable growth. Looking at the labor market performance during the 12 months following the nine-month anniversary of the end of the prior recessions may provide some guidance on job growth in the months ahead.

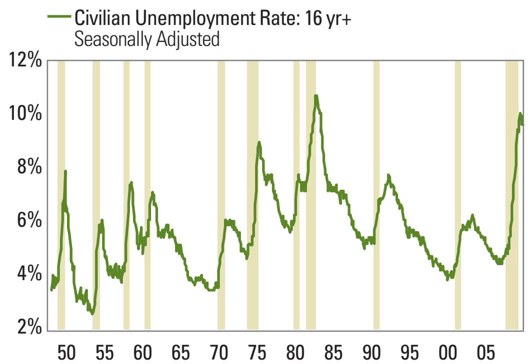
The economy produced an average of 231,000 jobs per month following the 1969–70 recession and 202,000 jobs per month following the 1973–75 recession. In the similar period following the severe 1981–82 recession, the economy generated job growth of 400,000 per month. However, during the jobless recoveries following the 1991 and 2001 recessions, the economy created just 100,000 jobs per month in the 1991 period and actually *shed* 37,000 jobs per month in the 2001 period.

Over the next 12 months, we think the economy can generate roughly the same number of jobs as were created in the similar periods following the 1970 and 1973–75 recessions—about 200,000 to 250,000 per month. This would be far below the more than 400,000 jobs created in the same period following the 1981–82 recessions, but would easily surpass the experience of the "jobless recoveries" of the early 90s and early 00s.

As discussed in a number of our previous *Weekly Economic Commentaries*, we think modest job growth is likely and here is why:

- Most of the leading indicators of employment hours worked, overtime hours, and temporary help employment began moving higher last summer.
- The decline in the four-week average on first time filings for unemployment claims since their peak in March 2009 is in line with the drop seen in other robust jobs recoveries.
- Layoff announcements are at a 10-year low.
- Corporate profits and business capital spending is booming, as measured by the S&P 500 and the U.S. Department of Commerce.
- Bank lending—while still not expanding—has stopped falling.
- Companies who used jobs to play "defense" in late 2008/early 2009 may use the labor market as "offense" to reclaim lost market share as the global economic recovery picks up steam.
- There is still plenty of fiscal and monetary policy stimulus left in the pipeline.
- Manufacturing employment turned positive in January 2010.
- Economies in Canada, Australia, Germany, Brazil, Mexico, Finland, Sweden, Japan, Taiwan, Singapore, Turkey, and Philippines are already creating jobs.

3 The Unemployment Rate Is Likely to Remain at an Uncomfortably High 9.7% in March



Source: Bureau of Labor Statistics, Haver 03/29/10
Shaded areas represent recessions.

Key Reports and Events of the Coming Week

The employment data will dominate the economic discussion this week, especially in the latter part of the week. The consumer sector is also front and center this week. As this report was being prepared, the February spending and income data were released. Later in the week, reports on consumer confidence and vehicle sales will temporarily divert the market's attention to the resilient U.S. consumer, but by week's end, all eyes will be on jobs.

March Employment Data (released throughout the week)

- The March jobs report is due out on April 2. The consensus is looking for about a 200,000 gain in jobs, including 100,000 or so temporary workers hired to help conduct the 2010 Census. The range of estimates is wide, with 400,000 on the high end, and -40,000 on the low end. As noted in the section above, our view is that the economy can create around 200,000 to 250,000 jobs (excluding Census workers) per month over the next year or so. While this result would be welcome, and certainly better than the "jobless" recoveries of the early 90s and early 00s, it wouldn't come close to matching the 350,000 to 400,000 jobs per month that were created after the end of the severe 1981-82 recession.
- Through the worst of the recession in late 2008 and early 2009, the Automatic Data Processing (ADP) employment report (Wednesday, March 31) provided a fairly reliable "early read" on the overall national employment report, as it accurately predicted the direction and magnitude of the job losses. Over the past year or so, however, the ADP report has had a spotty track record, overestimating the number of jobs lost relative to the national report in each of the past eight months.
- The Challenger job cut (Thursday, April 1) data was a good leading indicator of the labor market in 2009, peaking in January of 2009, roughly two to three months before jobless claims peaked in late March 2009. Layoff announcements in the three months ending in February were the lowest in any three-month period since 2000, indicating that the layoffs that plagued the economy in late 2008, early 2009 have largely ended.
- The four-week average on initial filings for jobless benefits (Thursday, April 1) has now declined by more than 200,000 from its peak in April 2009. Jobless claims are no longer tracking toward the "jobless recoveries" of 1991 and 2001, but, instead, are now tracking to the pattern seen in the robust job recoveries from the severe recession in the mid-1970s and early 1980s.
- The consensus is looking for the unemployment rate to remain at 9.7% in March.

IMPORTANT DISCLOSURES

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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 funds concentrated holdings will subject to greater volatility than a fund that invests more broadly.

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.

Bank loans are loans issued by below investment grade companies for short-term funding purposes with higher than short-term debt and involve risk.

The ADP National Employment Report®, sponsored by ADP®, was developed and is maintained by Macroeconomic Advisers, LLC. It is a measure of employment derived from an anonymous subset of roughly 500,000 U.S. business clients. During the twelve-month period through December 2009, this subset averaged over 360,000 U.S. business clients and over 22 million U.S. employees working in all private industrial sectors.