

Weekly Economic Commentary



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Taking a Break

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Highlights

- This is a quiet week for U.S. economic data as markets look elsewhere for direction.
- The November jobs report was a major disappointment, but inconsistent with other data on the economy.
- The Outlook for 2011: Neither bulls nor bears in 2011, we expect the economy and the markets will be range-bound in 2011.

Much like the nation's annual holiday shopping spree often takes a break in the first week of December, so too will market participants get a break from the economic data. In sharp contrast to last week when markets were inundated with high-profile economic reports, there are only a handful of reports due this week, and those reports are not likely to be market moving. The data vacuum is likely to force the markets to look elsewhere for direction—see this week's *Weekly Market Commentary* for details—and at the moment there are plenty of "elsewheres" (China, Korea, taxes, and Europe).

Investors looking outside the United States for direction will have plenty to digest this week, with no less than eight major central banks, including the Bank of England, the Bank of Canada, the Reserve Bank of Australia, the Reserve Bank of New Zealand, and the central banks of Brazil and South Korea all meeting to discuss policy for the final time in 2010. The good news for markets is that none of these central banks are expected to raise rates this week, although Australia, Brazil, Canada, and South Korea have already begun to raise rates to combat inflation and overheating economies.

Late in the week, markets will begin to brace for the release of November economic data in China. Most of the data is due out very late in the week or early the following week (December 13-17). Markets remain concerned that the release of the Chinese economic data for November in mid-December could be accompanied by another round of rate hikes or policy tightening in China.

The November Jobs Report Was A Major Disappointment

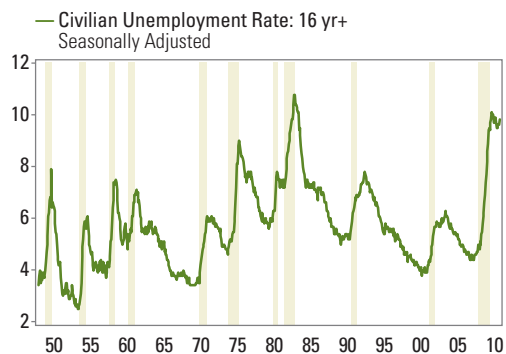
The November jobs report, released on Friday morning, December 3, was both weak and disappointing, but the market did not necessarily believe the report, after digesting a full plate of data last week (and over the past few weeks) that suggested that the U.S. economy, and the labor market in particular, had begun to gather momentum. The bulk of the data already in the books for November—initial claims for unemployment insurance, consumer sentiment, retail sales, vehicle sales, manufacturing sentiment, the Fed's Beige Book—suggest that the U.S. economy continued to reaccelerate out of a summer soft spot in November, and that the reacceleration was gaining, not losing, speed. Still, the monthly labor market report is one of the most robust (and important) of all the monthly reports on the economy, and cannot be completely dismissed. In our view, the weak November jobs report puts even more weight on the December jobs report to shine. That report is due out on Friday, January 7.

Economic Calendar

Tuesday, December 7 Consumer Credit <i>October</i>	Friday, December 10 Import Price Index <i>October</i>
Thursday, December 9 Initial Claims <i>wk 12/04</i>	Trade Balance <i>October</i>
Wholesale Inventories <i>October</i>	U of Mich Consumer Sentiment <i>December</i>
	Treasury Statement <i>November</i>



1 The Unemployment Rate Ticked Up 0.2% To 9.8% in November 2010, The Highest Reading In A Year



Source: Bureau of Labor Statistics/Haver 12/06/10
(Shaded areas in chart indicate recessions)

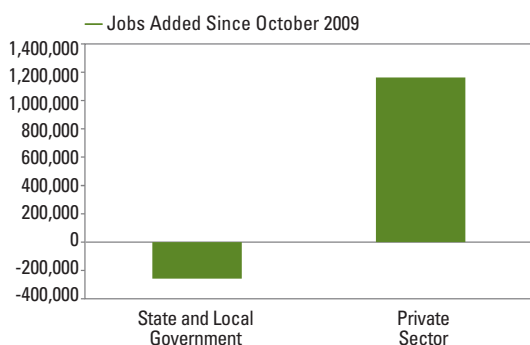
The unemployment rate rose to 9.8% in November (from 9.6% in October) and the economy created only 50,000 private sector jobs, far below the consensus estimate of a 160,000 gain. In fact, the result was below the low-end of the range of estimates (+115,000 to +200,000) and that has not happened in more than a year. There was little in the report to provide any holiday cheer for the labor market, as hours worked and overtime hours were stagnant, retail employment fell, and state and local government employment fell another 13,000.

After adding nearly 200,000 jobs in the first eight months of the recession (December 2007 through August 2008), state, and local governments have shed 380,000 jobs. Since private sector employment stabilized in the fall of 2009 [Chart 2], state and local governments—beset by budget woes—continued to shed jobs, as more than 250,000 state and local government jobs have been lost. We expect more of the same in 2011.

Although there were modest upward revisions to the private sector job counts in prior months, by creating only 50,000 jobs in November, the private sector failed to build on the momentum seen in the labor market over the prior four months (July, August, September and October 2010). The private sector generated at least 100,000 jobs in each of those months, with the average monthly job gain at 133,000 per month. Had the private sector economy created more than 100,000 jobs in November 2010, it would have marked the first time since late 2005/early 2006 that the economy had accomplished that feat. Hopefully, a new streak of monthly job gains of over 100,000 will commence in December 2010.

With the 50,000 jobs added in November, the economy has added 1.2 million jobs since the fall of 2009. While that puts job growth in this recovery well ahead of the pace of jobs added in similar periods in the “jobless recoveries” of the early 1990s and early 2000s, private sector employment remains 7.3 million below its prerecession high hit in December 2007. At the pace of job creation seen over the past year, the economy will not get back to its prior employment peak until the end of 2016, six years from now.

2 Private Sector Has Added 1.2 Million Jobs Since Fall of 2009, But State and Local Governments Have Shed Nearly 300,000 Jobs



Source: Haver 12/06/10

Outlook for 2011

Neither bulls nor bears in 2011, we expect the economy and the markets will be range-bound. Bound by economic and fiscal forces that will restrain growth, but not reverse it, we expect single-digit gains for stocks as earnings growth slows and valuations remain under pressure, and single-digit gains for bonds as yields remain range-bound.

We anticipate that:

- The job market will stage a comeback with nearly twice the pace of job creation experienced in 2010;
- GDP will be near the long-term average at 2.5–3%;
- Policymakers will deliver economic stimulus that turns to a drag on growth later in the year;
- Investors will play it safe as inflows to riskier markets will be anemic;
- The currency impact on investing will be pronounced in 2011.



Overall, 2011 will continue the economic and market volatility of 2010. The global economy remains out of balance, teetering back and forth between the soft spots that invoke a need for increasingly extended policy support and the growth spurts that provoke a desire to begin to pull back some of the record-breaking stimulus. The last time government spending comprised as much of GDP as it does today (1945–1960), the economy went through a period of heightened volatility driven by the swings in policy action.

The policy-driven theme of reflation, which is the intentional pursuit of modestly higher prices, and a broader U.S. foreign policy provide investment ideas that can thrive in a year where the performance of the major indexes is likely to be lackluster. Investors with a more opportunistic profile may benefit from a tactical approach to investing in order to find attractive opportunities and successfully take profits in volatile markets. Longer-term strategic investors should consider remaining broadly diversified.

For more insight on our outlook for next year, please see our *2011 Outlook* publication.

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