

Weekly Economic Commentary

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Highlights

- The July ISM report and the July jobs report bookend an extremely busy week for U.S. economic data.
- The economic data released in the United States last week was mixed; the data in Europe was solid, and resource-based central banks continued tightening monetary policy last week.

Economic Calendar

Monday, August 2 ISM Manufacturing <i>July</i>	Wednesday, August 4 ISM-Service Sector <i>July</i>
Construction Spending <i>June</i>	Challenger Layoff Announcements <i>July</i>
Tuesday, August 3 Personal Spending <i>June</i>	ADP Employment <i>July</i>
Personal Income <i>June</i>	Thursday, August 5 Initial Claims <i>wk 07/31</i>
Factory Orders <i>June</i>	Chain Store Sales <i>July</i>
Domestic Light Vehicle Sales <i>July</i>	Friday, August 6 Nonfarm Payrolls <i>July</i>
Pending Home Sales <i>June</i>	Unemployment Rate <i>July</i>
	Consumer Credit <i>June</i>

July Economic Data Takes Center Stage

With the very successful second quarter 2010 earnings, reporting season now two-thirds over, the U.S. economic data will likely dominate market sentiment this week and over the next several months until the third quarter corporate earnings “preannouncement” season begins in mid-September. This week is chock full of key data for July, beginning on Monday, August 2 with the Institute of Supply Management’s (ISM) report on manufacturing, and ending on Friday, August 6 with the release of the July employment report.

In between, the market will be inundated with reports on the consumer (new vehicle sales, chain store sales, consumer credit, personal income and consumer spending), housing (pending home sales and construction spending for June), the service sector (ISM service sector report for July), and manufacturing (factory orders for June).

Overseas, the economic data calendar has already been active, with the release of the Chinese version of the ISM for July, which showed that Chinese authorities have thus far been successful in engineering a soft landing for the booming Chinese economy. The data calendar in Europe this week is every bit as busy as the U.S. calendar, with reports on manufacturing activity, employment, and inflation in July. Our view here is that Europe has yet to feel the pinch of the tax increases and spending cuts that were made in late spring and early summer. Thus, the data released in Europe this week may look decent, but the full force of the tax increases and spending cuts is yet to come.

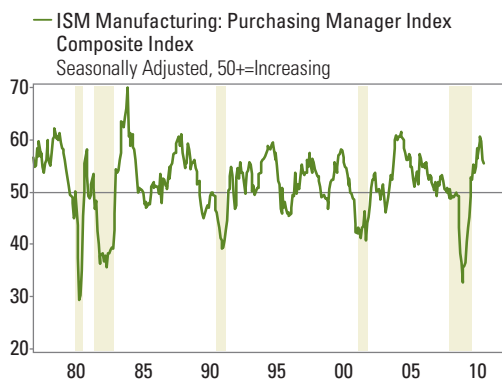
For the most part (except for an appearance by Federal Reserve Chairman Ben Bernanke in his home state of South Carolina on Monday, August 2) Fed officials will be out of the spotlight as they usually are the week before a Federal Open Market Committee (FOMC) meeting. The FOMC meeting is on August 10. As Fed officials fade into the background this week, foreign central banks will step in to fill the void.

There are no fewer than eight central bank meetings this week.

- The Bank of England and the European Central Bank will not raise rates this week.
- The market does expect that Peru’s central bank will hike rates this week. It would be the fourth rate hike in the cycle for that resource-rich country.
- Despite booming growth (both domestically and around emerging Asia) Indonesia has thus far resisted raising rates, and the market expects more of the same this week.



1 The July ISM Report Beat Expectations, But Is Following the Pattern of the Past 35 Years—Moving Steady Back Toward 50 About a Year After the End of a Recession



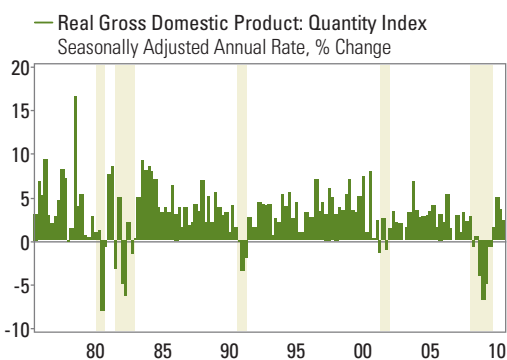
Source: Institute for Supply Management/Haver Analytics 08/02/10
(Shaded areas in chart indicate recessions)

- The Reserve Bank of Australia (RBA) meets this week, and is expected to hold rates steady. The RBA began raising rates in September 2009, and moved rates steadily higher through May, but has not raised rates at its last two meetings in June and July.
- Central banks in Eastern Europe (Czech Republic, Serbia, and Romania) are on the docket this week, and all are expected to hold rates steady.

The ISM ticked down a bit between June and July, but not by as much as the market expected. The key, forward-looking components of the report were mixed. On balance, the July ISM report continued to show that the manufacturing sector was expanding briskly, led by exports and inventory rebuilding and that employers continue to add to manufacturing payrolls. However, the July ISM data also revealed that the pace of the expansion in the manufacturing sector has slowed in recent months, which is quite typical for this stage in an economic recovery. In short, the ISM continues to support our view that the economic expansion that began in the summer of 2009 will continue into 2011, but perhaps at a slower pace than before.

The key reports this week will be on jobs. There are several warm-up acts (July ADP employment, Challenger-tracked layoff announcements for July, and weekly filings for unemployment insurance) ahead of the main event, the release of the July employment report. The market will once again focus on private sector employment, as workers hired by the U.S. government to conduct the 2010 Census in the spring continue to fall off government payrolls. Thus, while the overall headline on the July jobs report is likely to show another decline in employment (the market is looking for a 63,000 decline), the market expects private sector employment (excluding the impact of Census workers) to post a gain of 90,000. If the consensus is correct, July would mark the seventh consecutive monthly gain in private sector employment (and eighth in the past nine months). The market's concern is not so much, whether or not the economy will continue to generate private sector jobs in the near term, but at what pace the economy can create the jobs.

2 The United States Economy Continued to Expand in the Second Quarter of 2010, Marking the Fourth Consecutive Quarter of Growth Since the Likely End of the Great Recession in the Second Quarter of 2009



Source: Bureau of Economic Analysis/Haver Analytics 08/02/10
(Shaded areas in chart indicate recessions)

What We Make of the Key Reports and Events of Last Week

Last week's economic data continued the two steps forward, one-step back pattern that has been in place since the spring, which is typical behavior for an economy transitioning from recovery to expansion. New home sales, the Richmond Fed index, home prices, the Chicago Area Purchasing Managers Index, and jobless claims all moved in the right direction last week, while consumer confidence, durable goods orders, and second quarter Gross Domestic Product (GDP) failed to meet expectations.

Real GDP growth in the second quarter of 2010 rose at a 2.4% annualized pace, close to the consensus expectations (+2.5%), but below our forecast of a 3% gain. As is the case every July, the government agency that compiles the GDP data, the Bureau of Economic Analysis, revised the GDP data back three years effective with this report. The new pattern for GDP growth shows that the recession was a little deeper than previously thought, but that the pace of the recovery was about the same. The GDP growth in the first two quarters of the recovery (the third quarter and fourth quarter of



2009) was revised lower, but growth in the first quarter of 2010 was revised sharply higher (from 2.7% to 3.7%).

The composition of the growth pre and post revision was the same. It was, and continues to be, a business-led recovery, with business capital spending, inventory restocking, and exports leading the way, while the consumer merely hangs in there. This is the same pattern we saw coming out of the 1991 and 2001 recessions, and we expect the pattern to persist over the remainder of this year. We expect slower GDP growth in the second half of 2010 (2% to 3%) than we saw in the first half of 2010 (3.2%). The consensus is looking for 3.2% GDP growth in 2010 and 2.9% growth in 2011. No double-dip recession, but continued slow growth, that will only bring the unemployment rate down slowly over time.

Remarkably, the economic data in Europe last week was better than the data released in the United States, although we continue to point out that European economies have yet to feel the brunt of the tax hikes and spending cuts enacted by many European nations earlier this spring and summer.

Central banks around the world were generally raising rates last week, as Israel, India and New Zealand all raised rates. The rate hike in Israel was unexpected. It was the second rate hike of the cycle for resource-rich New Zealand and, if the consensus is correct, may be the last for a while, as the RBNA and other central banks in resource-rich areas step back to assess the impact of the rate hikes engineered thus far. In general, these hikes have been aimed at returning rates to normal after they got to unusually low levels in response to the 2007-2009 global financial crisis.

We (and the market) do not think that rate hikes will slow the trajectory of booming growth in Asia just yet, but we continue to monitor economic and financial conditions in emerging Asia and around the globe, looking for an inflection point in the rebound in global growth. The good news here is that many of the central banks that began tightening in late 2009 and early 2010 are now beginning to talk about when they will stop hiking rates. The bad news is that there are likely to be more headwinds associated with tighter monetary and fiscal policy hitting the global economy over the remainder of 2010 and into 2011.

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