

August 30, 2010

Yet another week of disappointing economic news and lackluster stock market performance – the “new normal” – ended on a positive note after remarks by Federal Reserve Chairman Benjamin Bernanke at the Fed’s annual symposium in Jackson Hole, Wyoming on Friday. His statement that, in essence, the Fed stood ready to take further action if necessary, was enough to drive the Dow up 164.84 points and safely back over the 10,000 mark at week’s end, if not quite enough to put any of the three major indexes into the black for the week.

Though Mr. Bernanke did not commit to any new action, and though pundits have begun to question what, if anything, the Fed has left in its arsenal beyond printing more money, he nonetheless reassured investors by saying that he thought fears of deflation were overstated and that there would indeed be growth, however modest, for the rest of the year. He also said that “preconditions for a pickup in growth in 2011 appear to remain in place,” referring to increased lending by banks, a leveling off of the sovereign debt crisis in Europe, and a higher rate of savings by Americans. He then outlined the four policy options that “are available to provide additional stimulus,” while intimating that the third and fourth were not likely to be implemented. They were: 1) buy more government debt and long-term securities, 2) bring long-term interest rates down even further by persuading investors and the stock market that the Fed was going to stick to its record-low lending rate for even longer than expected, 3) reduce the interest rate paid on the money banks deposit with the Fed, and 4) raise the medium-term target for inflation,

	Key Market Data		
	Week ending...		
	8/27/10	8/20/10	Change
Dow Jones Industrial Average Index	10,150.65	10,213.62	-0.62%
S&P 500 Index	1,064.59	1,071.69	-0.66%
NASDAQ Composite Index	2,153.63	2,179.76	-1.20%
10-Year Treasury Note Rate	2.654%	2.614%	+0.039 pct. pts.
NYMEX Crude Future (Barrel)	\$75.17	\$73.46	+1.83%
Euro/U.S. Dollar	\$1.2733	\$1.2708	+\$0.0025

which might encourage banks to free up some cash for small businesses and consumers.

Also on Friday, the Commerce Department announced that, as expected, the growth rate for the second quarter had been revised downward, falling from 2.4% to 1.6%. However, as the figure had been expected to dip even further, the consensus was 1.4%, and because the new release actually showed that consumer spending had risen by 2%, more than originally reported, the “good news” contributed to Friday’s rally.

The Commerce Department also said that durable goods orders in July were up 0.3%, whereas an increase of 3% had been forecast. Excluding the volatile transportation sector, orders were off 3.8%.

The latest bleak news about the housing market was hardly a shock, especially as the numbers now coming in reflect the state of the market after the expiration of the homebuyer’s tax credit at the end of April. Even so, last week’s figures were worrisome

and worse than expected. On Tuesday, the National Association of Realtors said that sales of previously owned homes tumbled 27.7% from June to July (and 25.5% from July 2009) to a seasonally adjusted annual rate of 3.83 million, the lowest level since the group began tracking the data in 1999. The number of unsold homes on the market increased 2.5% in July to 4 million, which means that, at the current rate of sales, it would take 12.5 months to clear inventory compared to 8.9 months in June, the highest clip in a decade. And to cap it all off, nearly one out of every four homeowners is “underwater” with a mortgage that’s worth more than their house. The next day, the Commerce Department announced that sales of new homes fell 12.4% in July (down 32.4% from July 2009) to a seasonally adjusted annual rate of 276,000, also a new low since the government began keeping records in 1963.

The Labor Department said that first-time jobless claims fell for the first time in a month, down 31,000 to 473,000. However, the four-week moving average was at 486,750, its highest point since last November, an ominous trend to put it mildly.

And while Treasury prices were up slightly last week, there was plenty of evidence that investors continue to race for these “safe havens” despite the near-record-low yields. The Investment Company Institute, for instance, recently reported that investors had withdrawn \$33.12 billion from domestic stock market mutual funds through July of this year while putting \$185.31 billion into bond funds. And *The Wall Street Journal* said last week that the demand for bonds was such that there was renewed interest in the ultimate long bond, the “century” or 100-year bond, occasionally issued in the late 1990s by companies with very strong balance sheets but seldom seen since.

The broader view

For all of the middling economic stats that can be mustered at the moment, the one

that’s most watched and most impactful may be the jobless rate, stubbornly stuck in the 9-to-10% range, as it takes such a profound toll on the recovery, constraining consumer spending and dampening home sales. The Labor Department will release the rate for August this coming Friday, but in its August 28 issue, *The Economist* had an interesting take on the subject that began by noting that “Americans are used to thinking of their job market as lithe and supple,” and that “employment snaps back quickly after recessions,” before concluding that “America’s jobless market is not quite as flexible as it once was.” In between, the magazine makes the case that Americans will not be back on the job in significant numbers anytime soon because both the playing field and the rules have changed dramatically. For example, fully half of the 8 million jobs lost have been in construction and manufacturing “and those departing those industries may struggle to adapt to jobs in more vibrant areas such as education and health services.” Further, this “skills mismatch” will only be made worse by America’s “housing bust” because “households often stay put rather than default, leaving them trapped in places with high unemployment and unable to move where jobs are plentiful.” And the “rise of the two-income household has also made workers less mobile than they were.” Finally, there’s the fact that the long-term unemployed, those who have been out of work for at least 26 weeks, now account for almost half the jobless, and “this cohort may become unemployable as their skills atrophy and they become increasingly detached from the informal networks that would lead them to new jobs.”

A look ahead

There will be reams of facts and figures for investors to sift through this week, including updated data on personal income and spending; manufacturing, vehicle sales, factory orders, and nonfarm productivity; and, from the housing front, mortgage applications, pending home sales, and the

S&P/Case Shiller home price index. The Fed will also release the minutes from its August 10 meeting, which are said to reveal an unusual level of internal debate about the Fed's most recent move to buy government securities. Finally, as noted, the week will end with the latest on the nation's unemployment rate, currently at 9.5% and forecast to rise to 9.6%.

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