

September 7, 2010

What could be better than kicking off the Labor Day weekend with some good news about jobs?

Investors spent the first half of last week girding for the worst, but while the unemployment rate did indeed inch up, from 9.5% to 9.6%, the Labor Department reported an unexpected uptick in private sector positions that, coupled with earlier reports about manufacturing, sent the market soaring after three weeks of pain. The numbers seemed to (once again) set aside the idea of a double dip and underscore painfully slow growth for the nation's economy, but growth nonetheless. As Thomas Hoenig, president of the Kansas City Federal Reserve Bank said at the beginning of the week, "We'll slog our way through this."

The week began with the Commerce Department reporting that personal income rose 0.2% in July and consumer spending climbed 0.4% after being flat in June, with the core consumer index improving by 0.1%. The market was unimpressed; Monday saw the lowest trading volume for the Dow all year (four of the lowest trading volumes in 2010 came on Mondays in August). The Dow lost 140.92 points and fell 4.3% for the month, its first down August since 2005 and its weakest performance in that month since 2001. The S&P 500 and NASDAQ fared even worse in August, dropping 4.7% and 6.2% respectively, while the Russell 2000 index of small-cap stocks tumbled 7.5%.

On Tuesday, the Dow was all but stagnant, rising 4.99 points, though the Conference

	Key Market Data		
	Week ending...		
	9/3/10	8/27/10	Change
Dow Jones Industrial Average Index	10,447.93	10,150.65	+2.93%
S&P 500 Index	1,104.51	1,064.59	+3.75%
NASDAQ Composite Index	2,233.75	2,153.63	+3.72%
10-Year Treasury Note Rate	2.701%	2.654%	+0.047 pct. pts.
NYMEX Crude Future (Barrel)	\$74.60	\$75.17	-0.76%
Euro/U.S. Dollar	\$1.2895	\$1.2733	+\$0.0162

Board said its index of consumer confidence rose in August to 53.5 from 51 in July – the only caveat being that a reading of 90 indicates economic good health. The S&P/Case-Shiller index of home prices in 20 major metro areas also improved slightly in June, up 1% from May and 4.2% from June 2009, but the data was largely discounted by investors as it was thought to be positively impacted by the homebuyers' tax credit that expired at the end of April.

But, after mostly upbeat manufacturing reports from both the home front and China, the Dow leapt 245.75 points on Wednesday, the best first day of September since 1998. The Institute for Supply Management's (ISM) manufacturing index, which surveys U.S. purchasing managers, increased to 56.3 in August from 55.5 in July, the thirteenth straight month of expansion, while a similar index for China compiled by the China Federation of Logistics and Purchasing was up from 51.2 to 51.7. The ISM also said that its employment index hit 60.4, its high-water mark since 1978. The flip side came when it was announced that U.S. auto sales

plummeted 21% in August compared with 2009, though the news wasn't shocking, as the "Cash for Clunkers" program was in full swing a year ago.

Meanwhile, the International Monetary Fund (IMF) released a series of whitepapers that concluded that a number of wealthy countries are in danger of having so much debt that the market might start to push their interest rates up. According to the IMF's analysis of 23 countries, Greece, Ireland, Portugal and Italy are closing in on that point (though it minimized the possibility of a default in Greece), while Ireland, Spain, Great Britain and the United States are fast closing in.

Also on Wednesday, Christina Romer, the outgoing chairwoman of President Obama's Council of Economic Advisers (she left her job at week's end), delivered a valedictory and a mea culpa, saying that the administration's policies had averted "a second Great Depression" while trying to explain how her statement that the unemployment rate would never pass 8% was so far off the mark. She closed by putting in a plug for further stimulus: "Concern about the deficit cannot be an excuse for leaving unemployed workers to suffer," she said. "We have tools to bring unemployment down without worsening our long-term fiscal outlook, if we can only find the will and the wisdom to use them."

However, as the administration has learned, with an election impending, spending more stimulus money is a hard sell to Democrats and campaign fodder for the GOP.

The Dow gained another 50.63 points on Thursday after Thomson Reuters reported that same-store sales, boosted by back-to-school discounts, were up 3.3% in August from a year ago after a 2.7% increase in July. Better still, the Labor Department said that first-time jobless claims fell for the second week in a row, down 6,000 to a seasonally adjusted 472,000, while the four-week average dropped 2,500 to 485,500 after five

weeks of increases. Factory orders were up 0.1% in July, but excluding transportation orders they fell 1.5% - the biggest dip in 16 months.

Jean-Claude Trichet, the president of the European Central Bank, said a double dip was "not in the cards" but, echoing our own central bankers, said he would leave the bank's lending rate at 1% "for as long as necessary." Meanwhile, Benjamin Bernanke, the chairman of the Federal Reserve, appeared before the Financial Crisis Inquiry Commission and admitted that he had failed to properly read the signs that America was headed into a disastrous recession back in 2008. He added that Americans had every right to be angry with "those who drove their companies into a ditch and walked off with lots of money."

Then, on Friday, the Labor Department's release sent the Dow up another 127.83 points to close out the best pre-Labor Day run in 20 years. Though the end of 114,000 jobs for census workers and state and federal layoffs resulted in an overall loss of 54,000 jobs in August, investors were cheered by the news that the private sector added 67,000 new positions and that the private sector numbers for both June and July had been revised upwards. While the number of Americans looking for work climbed from 14.6 million to 14.9 million, the number of people out of work for 27 weeks fell from 6.6 million to 6.2 million, and the median length of unemployment dropped from 22.2 weeks to 19.9 weeks. Speaking in the Rose Garden, the president said that the report was "positive news" but added that he would be unveiling a "broader package of ideas" for job creation this week. "The hard truth is that it took years to create our current economic problems," he said, "and it will take more time than any of us would like to repair the damage."

Lastly, also on Friday, the Institute for Supply Management (ISM) said its service sector index, which accounts for about 80% of the nation's jobs, improved for the eighth

month in a row at 51.5, though it was down from July's reading of 54.3 – its lowest point since January (any reading about 50 indicates growth).

The broader view

With the Labor Day holiday, jobs – and the lack thereof – are front and center and, despite Friday's better-than-expected figures, enough Americans are either out of work or worried about being out of work to restrain consumer spending and borrowing, the keys to bringing an end to this Great Recession. Earlier this week, Robert Reich, who was the labor secretary under President Bill Clinton, took his turn on the op-ed page of *The New York Times* to address the problem and offer some solutions.

Mr. Reich began with the ominous words, "This promises to be the worst Labor Day in the memory of most Americans" because of the number of people "unemployed, underemployed or underwater." He went on to note that none of the "standard booster-rockets" – record low interest rates, low bond borrowing costs, federal stimulus – have worked to free us from the "gravitational pull of the Great Recession" because of a lingering lack of consumer spending and a lack of purchasing power. The problem, he wrote, was that hourly wages have been falling for 20 years and "the median male worker earns less today, adjusted for inflation, than he did 30 years ago." He added that, "Even if nearly everyone was employed, the vast middle class still wouldn't have enough money to buy what the economy is capable of producing." Mr. Reich concluded that the problem was that all the money made over the boom years went to the top: in the late

1970s, the richest 1% of America's families took in 9% of the nation's total income; by 2007 it was 23.5%. "The Great Depression and its aftermath demonstrate that there is only one way to full recovery: through more widely shared prosperity." What does he suggest should be done? Among other suggestions, extend the earned income tax credit and fund it with a tax on carbon, and exempt payroll taxes on lower wage earners.

However, with just two months to go before the mid-term elections, these recommendations are unlikely to gain any ground with Republicans or many other voters, for that matter. Contrary to former secretaries' views, those most likely to go to the polls come November will want to see spending reined in and the deficit reduced. As a result, it's unlikely that any meaningful spending or tax increases would be put forth this fall. And going forward, corporate America and small businesses are looking for less government intrusion and stable, if not lower, taxes.

A look ahead

With the stock market closed for Labor Day and Rosh Hashanah on Thursday, this will be a very quiet week, with only a handful of updates including those on mortgage applications, the trade balance, and wholesale inventories. The Fed will also release its Beige Book, a roundup of business conditions in its 12 districts.

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ISM Index is a monthly index released by the Institute of Supply Management which tracks the amount of manufacturing activity that occurred in the previous month.