

ECONOMIC & MARKET UPDATE: OCTOBER 3, 2011
“MARKETS WARNED OF IMPENDING RECESSION”
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Economic Data - Previous Week

Date	Series	Actual	Forecast	Prior	
9/26	New Home Sales	295K	293K	302K	New home sales lowest in nine months
9/27	Consumer Confidence	45.4	46.0	45.2	Labor market woes biggest weight on confidence
9/27	S&P/CS 20 City MoM Idx	0.05%	0.10%	0.04%	Prices dedine in 10 cities, mostly in West
9/28	Durable Goods	-0.1%	-0.2%	4.1%	New orders slip as expected after very strong July
9/29	GDP - Q2 3rd Est.	1.3%	1.2%	1.0%	Non-res structures, PCE, and exports boost GDP est.
9/30	Personal Spending	0.2%	0.2%	0.7%	Broad uptick in spending, though incomes dedine
9/30	UMich Confidence	59.4	57.8	57.8	Slight improvement from depressed levels

Economic Data - Upcoming Week

Date	Series	Actual	Forecast	Prior	
10/3	Construction Spending	--	-0.2%	-1.3%	Drop in housing starts points to dedine in spending
10/3	ISM Mfg Idx	--	50.5	50.6	No change expected from barely expansionary level
10/5	ISM Non-Mfg Idx	--	52.8	53.3	Slowdown in service sector predicted by analysts
10/7	Nonfarm Payrolls	--	58K	0K	Modest job creation expected after flat month
10/7	Unemployment Rate	--	9.1%	9.1%	No change expected as labor market remains weak
10/7	Consumer Credit	--	\$8.00B	\$11.97B	Slowdown in auto sales should rein in credit

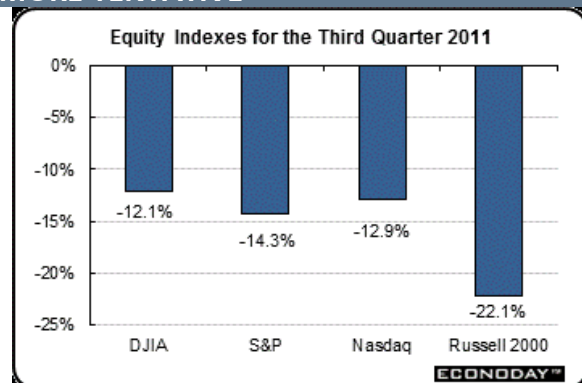
Source: Bloomberg

CONSUMERS BECOME MORE TENTATIVE

Volatility reigned supreme last week, but equity markets ended mostly flat. The S&P 500 Index was off 0.4% while the Dow Jones Industrial Average was up 1.3%.

Markets continued to trade in a spastic manner, reacting to every bit of news from Europe and each piece of economic data released in the US.

The third quarter will be one to forget for many investors, as equity markets lost anywhere from 12% to 22%. A wide range of issues crippled markets during the quarter, including the debt ceiling debate in early August and fears regarding the unresolved debt crisis in Europe.



Source: Econoday

In the latest week, economic data was mixed, but news on consumer income and spending raised concerns over the health of the all-important consumer sector.

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Even worse, a growing number of economists are highlighting the possibility of recession. One organization, the Economic Cycle Research Institute (ECRI), went as far as declaring that recession was unavoidable and warned, “there’s nothing policy makers can do to head it off.”

Such dire forecasts do nothing to bolster economic or market confidence. The ECRI has accurately predicted prior recessions, including the most recent one in 2008. At -7.2, the ECRI’s US Weekly Leading Index growth rate is merely back to levels seen last fall. What concerns the ECRI, however, is that many leading indicators are turning lower and pointing to “full-blown recession.”

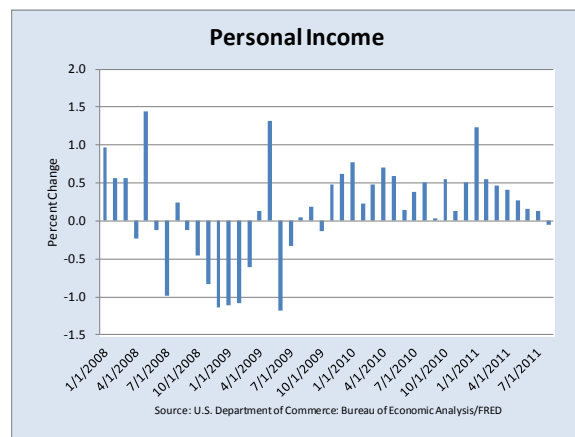
One bit of encouraging data is the realignment of economic expectations with economic reality. Early in the year, economists became very optimistic about the health of the economy and continually increased their outlooks. A handful of shocks, including the Arab Spring and the Japanese earthquake, caused fissures in the global economy and brought down growth rates. The negative feedback loop that ensued drove expectations way down. Since early June though, economic forecasts and actual data began returning to equilibrium.

After nearing -120 in June, the Citigroup US Economic Surprise Index slowly moved higher. As of Friday, the index stands at -29. The good news is that economic indicators are coming out more in line with forecasts. The bad news is that those forecasts are much lower than earlier in the year.



Source: Bloomberg

The latest disappointment came from the consumer sector, the largest single force behind growth in the US economy. In the month of August, personal income fell 0.1%, the first month of negative income growth since late 2009.

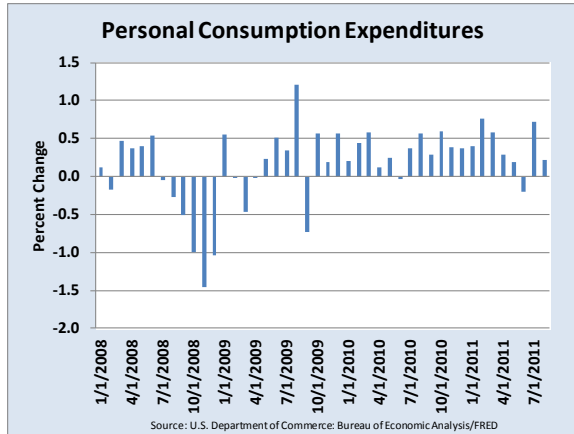


Source: Federal Reserve Bank of St. Louis

With less money in their pockets, consumers were more hesitant to spend. After a 0.7% increase in personal consumption expenditures (PCE) in July, August posted a

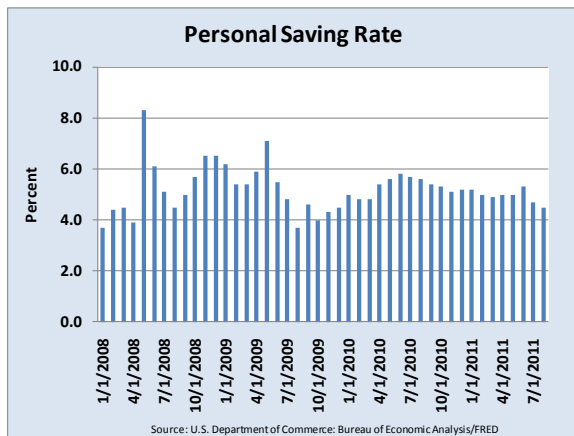
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more muted 0.2% gain. After adjusting for inflation, real PCE was slightly negative.



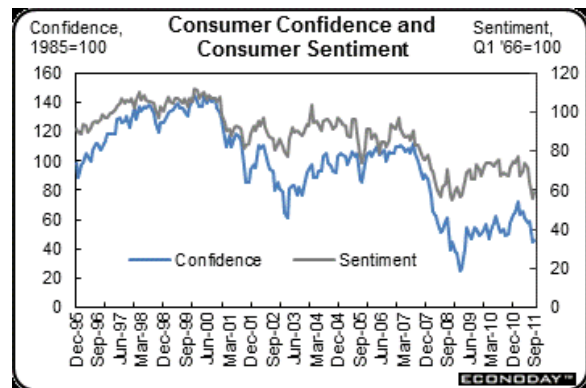
Source: Federal Reserve Bank of St. Louis

In order to compensate for the rising costs and spending, yet falling wages, consumers dipped further into their savings accounts. The personal savings rate fell to 4.5% in August and is down 0.8% in the last two months.



Source: Federal Reserve Bank of St. Louis

Concerns about the macroeconomic environment, coupled with a weak labor market in August, led to continued weakness in consumer sentiment. The University of Michigan Consumer Sentiment Index rose from 55.7 in August to 59.4 in September, with most of the improvement occurring in the current conditions component. Consumer expectations increased marginally in the month, but remain close to levels last seen in 2008/early 2009.



Source: Econoday

THE WEEK AHEAD

Markets will digest a plethora of important domestic and international data in the upcoming week. Domestically, all eyes will be watching Friday's nonfarm payroll report closely, with economists anticipating a modest

gain. In August, payrolls were flat. Traders will search for guidance prior to Friday in the initial jobless claims report as well as the ADP private sector employment report on Wednesday.

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Across the globe, we will have the manufacturing ISM reports for September. China's PMI, released over the weekend, was in line with expectations at 51.2%, signaling a continued moderate expansion in manufacturing activity. Manufacturing in the US is expected to hold slightly above the expansion/contraction mark, but the range of expectations is wide, indicative of the high degree of uncertainty right now.

Central banks around the world hold meetings this week, including those in Peru, Australia, Poland, Kenya, Serbia, England and Japan. In addition, the European Central Bank meets

later in the week, with most economists expecting some form of rate cut or additional quantitative easing measure.

Finance ministers from the European Union assemble on Tuesday in Luxembourg to discuss the ongoing bailout in Greece. Federal Reserve Chairman Bernanke will testify before a joint economic committee in Washington and provide an update on the Fed's economic outlook.

Several earnings reports that bear watching this week include Costco, Marriott and Monsanto.

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