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Economic Update

September 1, 2010

Happy anniversary! Our economic recovery is now just a little over one year old, but it seems like there is about as much hand wringing and angst as there was one to two years ago. Is it really a recovery? Are we still in a recession? Are we going to experience a “double-dip” recession? We thought this would be a good time to share our perspective on things.

The economy isn’t nearly as strong as we’d like to see, but it isn’t a disaster either. It may not seem that way for those without jobs or those in certain sectors, such as real estate. But the key point is that we are still growing! Let’s look at some facts rather than anecdotes you may see in the news. Most charts show our current recession and at least the previous one in 2001.

Jobs. At its worst, the economy was losing over 700,000 jobs a month. Now we are gaining, as many as 240,000 in one month. That is a swing in the right direction of nearly one million jobs a month. We can’t keep up that kind of improvement forever, but we can settle in at gains of 150,000 or so. But even then, that wouldn’t be enough to lower unemployment. The ASA Staffing Index shows temporary jobs. While these aren’t permanent, they are a step in the right direction.

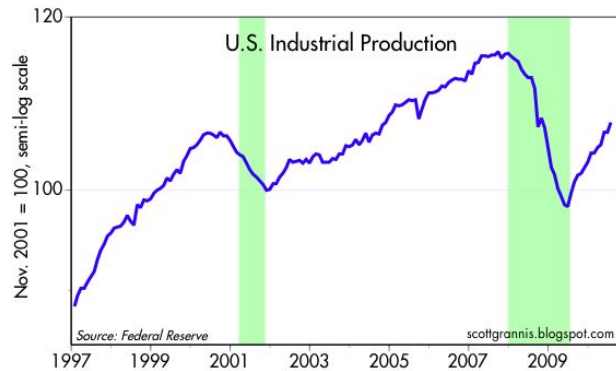
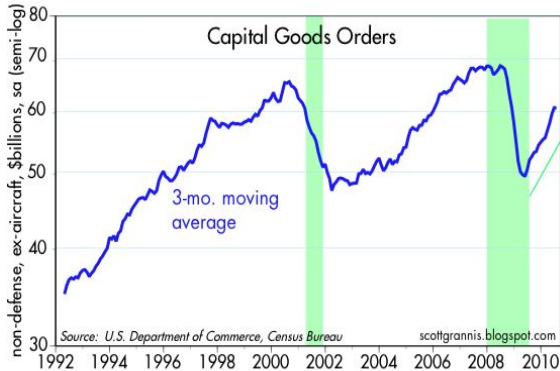


Incomes: They are higher. This is a way to get more income into the economy—give workers more money and ask them to work more hours.

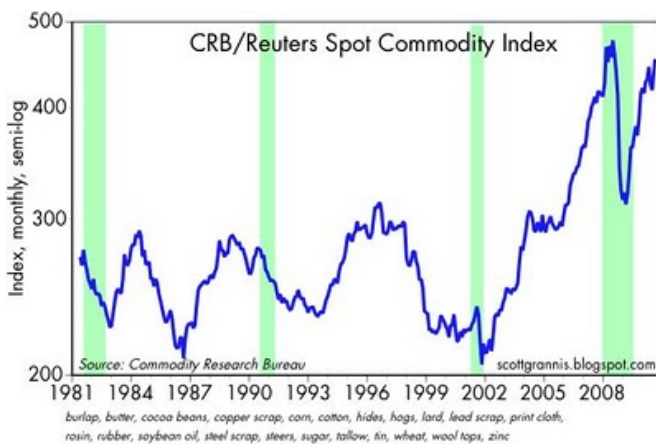
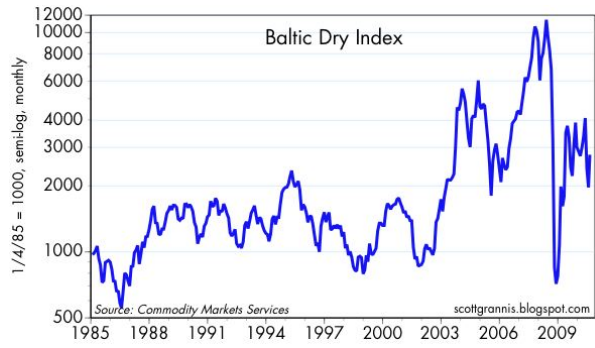
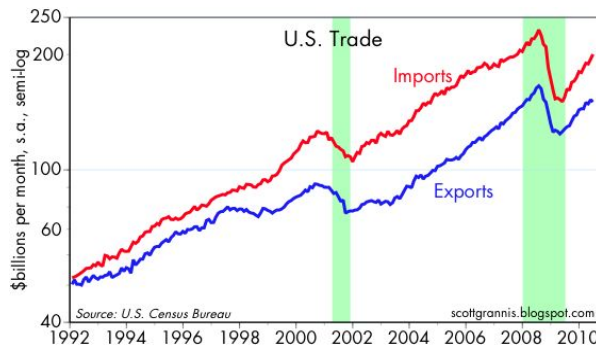
Consumption: Personal Consumption Expenditures (money we spend on goods and services) had been declining but now are rising modestly. We had a ‘buyers strike’ during the recession, but now we’re just being cautious about our spending. We will buy when we perceive a bargain. And in this process, Americans are prudently shoring up their own balance sheets.

Investment: Capital Expenditures (business investments) were declining and now are rising. Inventories are being rebuilt and productivity is rising.

Industrial Production: Industry is growing nicely, partly due to the productivity of American workers, new capital expenditures, and technology. Much of the drive behind Wednesday’s huge rally was new data on a surge of manufacturing in the United States and abroad. (That new information is not shown in the chart below.)

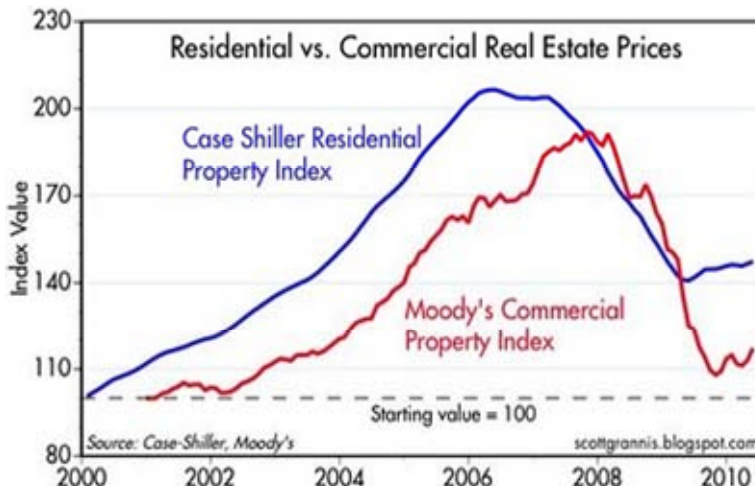


Trade: Imports and exports are growing. The Baltic Dry Index tracks worldwide shipping. Note how compared to earlier in the decade, world trade is up. The developing countries are continuing to absorb more of the world’s manufacturing jobs and production. They are also developing a larger middle class, a higher standard of living and stronger consumption. Someday, these new emerging consumers will augment the US and European consumers in driving the world economy.

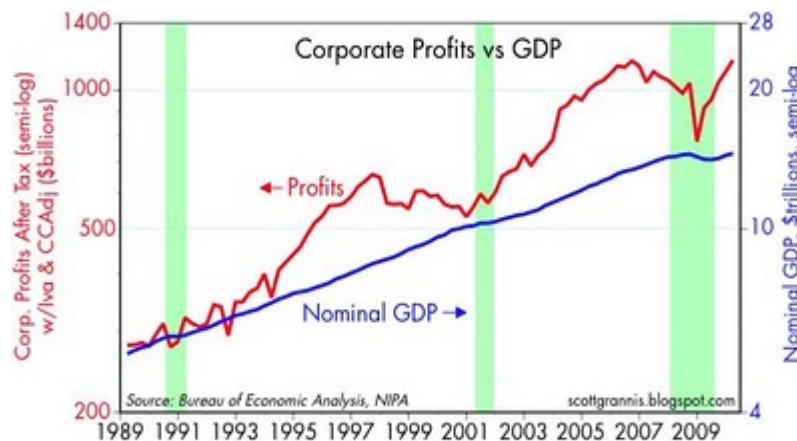


Commodities. The prices for the “stuff” we use (oil, steel, wheat, concrete, corn, gold, copper, etc.) are up across the board. We can’t have deflation when they are rising.

Real Estate. Unfortunately, real estate isn't rebounding as quickly as other indicators, but it is still trending up. The Standard & Poors/Case-Shiller home price index released August 30 posted a 1% increase from May to June and 4.2% over the past 12 months. Nationally, prices have risen 6% from their April 2009 bottom. In Portland, prices have risen 5% from their low in March of this year, but they are still down 38% from the speculative peak in August 2007.



Corporate Profits. As we wrote in July, the corporate profits are up and the balance sheets are no longer a major concern. Corporate profits typically decline in the years leading up to a recession, but for the past 18 months they have been growing strongly—which in turn is typical of the early years of a recovery. Strong profits are the fuel for future investments in new job-creating ventures.



Global Issues. What about all the pending financial crises around the globe? The European sovereign debt crisis last May has calmed down. Rapid fiscal and monetary policy responses from the affected nations and their neighbors have turned that around. While Ireland is having major problems, the German economy defied the doom and gloom and has bounced back strongly.

We still have our usual assortment of political and military crises to worry about—Iran, Afghanistan, Pakistan, Sudan, Venezuela, Myanmar, the Middle East, and North Korea, to name a few. But you know what? We've always had them! If not these, then some other.

The Financial Markets. The markets are still focused, laser-like, on the economy. Whether traders understand the impact of each number or not, if it isn't better than expected, they sell. The nice thing now is that expectations are now so low that beating them is relatively easy. Much of the favorable stock market performance this quarter has been attributed to beating expectations with earnings surprises from strong corporate profits.

Another Recession?

Not every indicator is improving, and in many cases, such as auto sales, home starts, and job growth, we still have a long way to go. The charts can be seen as half full or half empty. Pundits and commentators have their opinions, and some of them are well-informed and well-reasoned.

However, based on our research, we believe that the odds of falling into another recession—the so-called “double dip” recession—are very small. For this to happen we’d have to assume that our all of the above growth trends stop, stabilize, and reverse. It really takes a lot of assuming to get past the fact that we are growing, albeit modestly. We believe that this growth should continue unless we get some sort of a massive shock to the system.

We are as impatient as everyone else for the recovery to go faster. But as we have said before, it took a long time to get into our economic situation, so this recovery will take time and we will experience setbacks. Nothing ever follows a straight line—a lesson hopefully everyone learned from housing prices.

One of our jobs is to keep our clients from following the herd. Right now, for example, it seems like the average retail investor wants out of stocks and into bonds. But the herd is almost always wrong. Look at the year 2000. That was a market top when every one moved money from bond funds to stock funds. Now look at 2009 and so far this year. They are bidding up the price of bonds while stocks remain a bargain, especially in the large companies with the strong profit margins and good dividends.

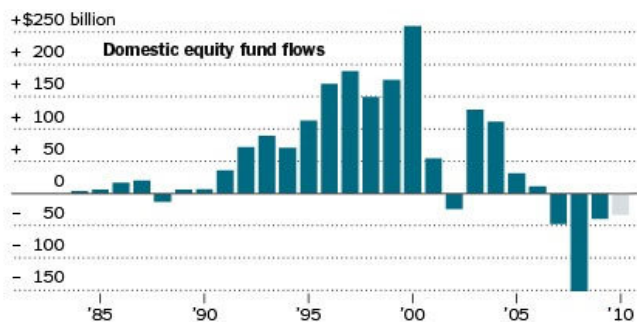
Meanwhile, a July 26 article in Bloomberg reports that the smart money—pensions and endowments—is spending more on stocks than at any time since the start of the bull market. The last time money managers and individuals were this far apart was at the beginning of 2009, before the Standard & Poor’s 500 Index began its 63% rally, according to Bloomberg.

We are experiencing an interesting time in American history. Never before have we been bombarded with so much intertwined economic and political information. We need more context, and perhaps less time with TV, radio, and the Internet. And while many issues are inter-related, we need to distinguish between short-term issues we must tackle today (such as the recovery) from long-term problems (such as the Federal deficit and inflation) we can deal with tomorrow.

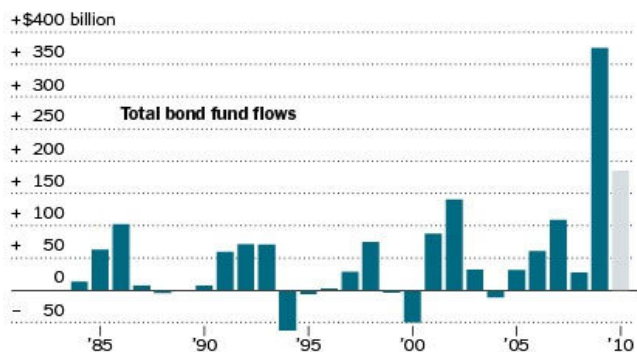
Thank you for giving us this opportunity to provide you with some context. It’s been a privilege to assist you during these interesting times, and we welcome your comments.

Flight to Safety

In the last few years, investors have been pulling their money out of stocks . . .



. . . and putting more in the relative safety of bonds.



Source: Investment Company Institute

THE NEW YORK TIMES