

MONTHLY EconUpdate

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Provided By:

Jude Wilson RFC, MBA

Wilson Group Financial Management
121 S. Orange Ave. Suite 1500
Orlando, FL 32801
www.wilson-fg.com
407-377-6622



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Monthly Economic Update for February, 2010

Quote of the month. “We would worry less about what others think of us if we realized how seldom they do.” – Ethel Barrett

The month in brief. Wall Street had an eye on Washington for much of last month. Anticipation of earnings season gave way to concern over what might happen if proposed limits on bank risk went into effect, and what might happen if federal tax credits in the housing market went away. Stock and commodities markets fared poorly as some economic data led traders, economists and investors to wonder how much of the recession recovery was attributable to government measures. Still, consumer confidence was on the rise and the economy was clearly on the mend.

Domestic economic health. Some very good news arrived in January: according to the Commerce Department, the preliminary 4Q GDP reading was +5.7%, the best quarter in six years and 1.0% higher than the expectations of analysts. Consumer spending represented 2.0% of the gain. Additionally, the Conference Board’s survey of consumer confidence hit a two-year high last month.¹ The University of Michigan consumer sentiment poll rose by 1.6 points to 74.4.² The latest consumer spending data showed a 0.2% gain for December. January also brought the best news on factory output in five years – the Institute for Supply Management’s manufacturing index read 58.4 for the month.³

Other news items bothered the Street. In late January, President Obama rolled out a proposal he referred to as “the Volcker rule”. Developed with input from former Federal Reserve chairman Paul Volcker and former SEC chair William Donaldson, the rule would prohibit banks and bank holding firms from getting involved in hedge funds or conducting proprietary trading operations.⁴ Intended as a corrective to the behavior of the 2000s, the proposed limits on bank size and bank risk sent stocks skidding, as investors saw reduced potential for bank profits. Tightening in China, debt problems in Greece and a downgrade of the U.K.’s banking system didn’t help the mood.

In terms of rates we all watch, things stayed pretty much the same: the benchmark interest rate remained between 0-0.25% after the latest Federal Open Market Committee meeting, and the Senate reconfirmed Ben Bernanke as Fed chair. We learned that the jobless rate stayed flat in December at 10.0%.⁵ The inflation rate (CPI) had inched north

0.1% for December, up 2.7% over the last 12 months with core CPI rising 1.8% in that stretch.⁶

A previously obscure Massachusetts state senator became a person of influence on Capitol Hill. The unexpected election of Sen. Scott Brown (R-MA) effectively derailed passage of the Obama administration’s seemingly assured healthcare reforms. White House press secretary Robert Gibbs claimed that the health care reform bill was still “inside the five-yard line.” There were signals that health insurance reform might be the new tack.⁷

Global economic health. Concerned about an overheated economy, China told its commercial banks to boost capital ratios; that led to the worst market day in Asia since early November, and it was the first in a series of cautions from the government.⁸ China’s GDP was +10.7% in 4Q 2009 with December showing amazing annualized gains in industrial output (+18.5%) and retail sales (+17.5%).⁹ The Bank of Japan forecast moderate improvement for that nation’s economy; Japan’s jobless rate fell to 5.1% in December, and its vehicle sales went north in January for the sixth consecutive month.¹⁰

In Europe, the government of Greece wrestled with a \$75 billion budget deficit. Standard and Poor’s took the United Kingdom’s banking system off of its global list of “most stable and low-risk” banking systems.¹¹ Yet Eurozone consumer confidence increased for the tenth consecutive month in January, even as the latest figures showed unemployment had reached 10.0% for November.^{12,13}

World financial markets. Indices in a few of the BRIC nations posted gains last month. Venezuela’s Caracas General pulled off a 7.7% increase, and Russia’s RTSI rose 3.3%; the Jakarta Composite in Indonesia gained 3.0%. (The world’s best performing index was the CASE 30 in Egypt, which rose 7.8% last month.) Most world indices took monthly losses, as follows: Hang Seng, -8.0%; Shanghai Composite, -8.8%; Sensex, -6.3%; All Ordinaries, -5.9%; Nikkei 225, -3.3%; STOXX 600, -2.4%; DAX, -5.9%; CAC 40, -5.0%; FTSE 100, -4.1%. The MSCI World Index fell 3.67% in local currency terms; the MSCI Emerging Markets index lost 4.47% in January.^{14,15,16}

Commodities markets. Most commodities struggled on the NYMEX last month. Three posted January gains of 5% or better: coal, +8.31%; sugar, +9.80%; orange juice, +5.46%. Platinum prices went up 3.15% and palladium prices gained 0.93%. Gold lost 1.20%, silver 3.89% and copper 8.79%. Gold

ended the month at \$1,083.00 per ounce. Crude oil, which finished January at \$72.89 per barrel, lost 8.15% for the month. Crops were hit hardest, with soybeans down 12.83%, wheat down 12.47%, corn down 13.99% and oats down 17.69%. The U.S. Dollar Index gained 2.07% last month.¹⁷

Housing & interest rates. What would happen with the housing market without federal subsidies in place? The latest new and existing home sales figures made analysts wonder. Purchases of existing homes fell by 16.7% while new home purchases dipped 7.6%; both figures reflected the assumption that government tax credits were expiring.¹⁷ Construction spending slipped 1.2% in December.¹⁸ On the bright side, National Association of Realtors tallies put existing home sales for 2009 approximately 5% above levels of 2008.¹⁹

What about mortgage rates? Did 30-year FRMs manage to average under 5% for another month? The answer is yes. On January 28, Freddie Mac tracked average interest rates on 30-year FRMs at 4.98%. Rates on 15-year FRMs were averaging 4.39%, rates on 5-year hybrid ARMs were averaging 4.25% and rates on 1-year ARMs averaged 4.29%.²⁰

Major indexes. January brought some chills to Wall Street, with the proposed “Volcker rule” and concerns about financial pressures in China, England and Greece affecting the three marquee indices.

% Change	1-Month	2009
DJIA	-3.46	+18.82
NASDAQ	-5.37	+43.89
S&P 500	-3.70	+23.45
10Yr TIPS Real Yield	-12.16	-30.84

(Source: CNBC.com, ustreas.gov, 1/29/09)^{17,21}

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

February outlook. The Dow opened February with strong gains, as it did in January – it seemed those who had sold stocks toward the end of the month wanted to buy back in. Some feel a correction is coming after the fantastic gains of 2009; in late January, the S&P 500 broke its 80-day moving average for the first time since March.²² Bulls feel January represented a short-term blip on the radar screen in response to the headlines of the moment, and that investors will proceed cautiously but with confidence.

Let’s take a look at February’s significant economic releases. We have the January ISM service sector index (2/3), December factory orders (2/4),

January’s unemployment report (2/5), December wholesale inventories (2/9), January retail sales and December business inventories (2/11), the University of Michigan’s February consumer sentiment index (2/12), January industrial production, housing starts and building permits (2/17), January PPI and the Conference Board’s leading indicators (2/18), January CPI (2/19), the Case-Shiller home price index for December and February consumer confidence as measured by the Conference Board (2/23), January new home sales (2/24), January durable goods orders (2/25) and January existing home sales (2/26). On March 1, we’ll learn about January consumer spending.

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Citations.

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