



Weekly Economic Commentary



January 25, 2010

FOMC Meeting, Q4 GDP Report On Tap This Week

John Canally, CFA

Economist
LPL Financial

ECONOMIC CALENDAR

Monday, Jan 25

Existing Home Sales
Dec

Tuesday, Jan 26

Consumer Confidence
Jan

Wednesday, Jan 27

New Home Sales
Dec

FOMC Decision

Thursday, Jan 28

Initial Claims
wk 01/23

Durable Goods
Dec

Friday, Jan 29

Employment Cost Index
Q4

Real GDP

Q4

Chicago PMA

Jan

U of Mich Consumer
Sentiment

Jan

The economic data released last week was largely a sideshow, given the news on the special election in Massachusetts, financial regulation, the late -week drama surrounding the reappointment of Fed Chairman Ben Bernanke and policy tightening in China. The two most disturbing reports released last week were the December housing starts (-4.0% MoM) data and the big jump in jobless claims in the latest week, but on balance the economic data continued to support our view on the economy, inflation and the Fed.

This week, the main focus for the markets will be on the Fed—both the reappointment of Fed Chairman Ben Bernanke and the FOMC meeting—key reports on housing, manufacturing, and Q4 2009 GDP will draw attention as well.

Key Reports Last Week

The economic data released last week was largely a sideshow, given the news on the special election in Massachusetts, financial regulation, the late -week drama surrounding the reappointment of Fed Chairman Ben Bernanke and policy tightening in China.

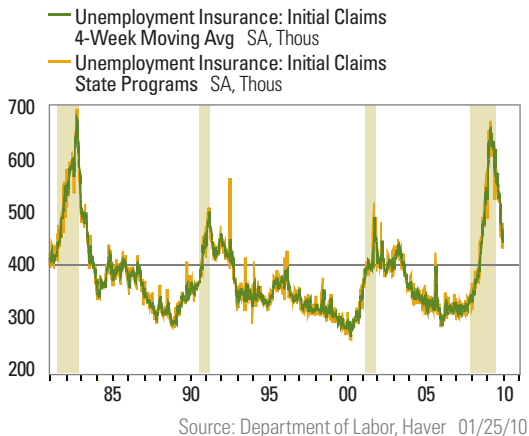
The economic data released last week continued to support our view on:

- **The economy**—(4.0 to 4.5% real GDP growth in Q4 2009, and 3.0 to 5.0% growth in the first half of 2010),
- **Inflation**—accelerating headline inflation but decelerating inflation excluding food and energy through mid year 2010, and
- **The Fed**—on hold until the second half of 2010, and no change in language at this week’s FOMC meeting that would hint at a rate hike.

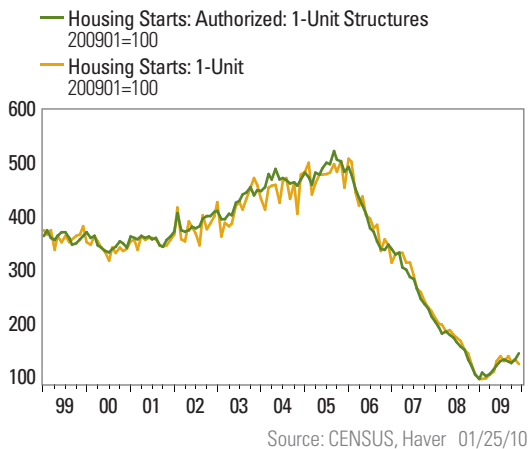
The two most disturbing reports were the December housing starts data (- 4.0% Month-over-Month (MoM)) and the big jump in jobless claims in the last week. Both data points were distorted—housing starts by cold weather in December and jobless claims by “administrative” issues—and do not reflect the underlying health of the housing and labor markets. The December PPI data was basically a non-event for markets, while the data on leading indicators for December and the Philly Fed index for January were quite constructive, suggesting that the economic recovery that began in Q3 2009, will continue (and likely accelerate) for the next several quarters.

The unexpectedly large rise in jobless claims in the latest week was due to “administrative” reasons, and not “economic conditions” according to the US Department of Labor. Apparently, the timing of the yearend holidays this

1 Despite the Backup, Jobless Claims Still Suggest A More Robust Recovery in the Labor Market than in the Prior Two Recoveries



2 Weather Had a Big Impact on Housing Starts in November and December 2009, But Underlying Recovery Still in Place



Business capital spending was a small plus for real GDP growth in Q3 2009, and we expect business spending to be a small plus again in Q4 and throughout 2010 as companies replenish severely depleted inventories, aided by low financing rates.

year (Christmas and New Years Day fell on Friday this past holiday season) along with cutbacks at some state government offices, which administer the jobless claims program, led to many claims being filed in late 2009 but not processed until last week. The bottom line is that the underlying improvement in the labor market remains in place, and the 200k+ drop in the four week average on claims since they peaked in March/April of 2009 still suggests that the labor market is on track for a more robust recovery than is now expected.

The surprisingly large drop in housing starts (4.0% MoM) in December and the fact that housing starts have now posted sizeable month-over-month declines in two of the past three months is a concern, but we don't think the revival in housing is in jeopardy, in fact, the housing recovery is probably just getting underway. Why?

Weather plays a big role in the month-to-month swings in housing starts, and the cold (fourteenth coldest December on record since 1895) and wet December (14th wettest/snowiest) that followed the warm (second warmest since 1895) and dry (second driest) November artificially dampened starts in December. Building permits, which are not impacted by the weather, surged 11% MoM in December, and now stand at 16%, nearly 50% above their early 2000 lows, suggesting that housing activity will continue to pick up well into 2010.

Key Reports This Week:

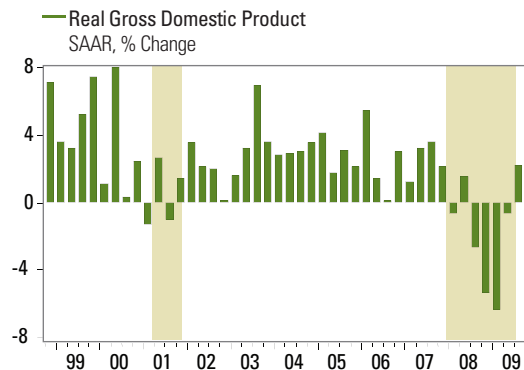
This week, the main focus for markets will be on the Fed—both the reappointment of Fed Chairman Bernanke and the FOMC meeting—but key reports on housing, manufacturing, and Q4 2009 GDP will draw attention as well. Markets will be particularly interested in the weekly jobless claims data, looking for the downward trend in claims (that has been in place for nine months) to resume. We do not expect the FOMC to remove its “extended period” language from the FOMC statement, but we do expect the Fed to comment on the recent swing from deflation to inflation, the better-than-expected holiday shopping season, and the sluggish labor market. Market participants will also be looking for signals from the FOMC about changes to its quantitative easing program, which is currently slated to wind down at the end of March.

December Durable Goods Orders (Thursday, January 28)

- Business capital spending was a small plus for real GDP growth in Q3 2009, and we expect business spending to be a small plus again in Q4 and throughout 2010 as companies replenish severely depleted inventories, aided by low financing rates.
- Although we have already digested qualitative reports on business spending, orders and inventories in December from companies reporting Q4 results, and from the various regional and national ISM reports and regional Federal Reserve surveys, the release of the December durable goods orders report represents the first “hard” data on business capital spending (durable goods shipments), future capital spending (durable goods orders) and business inventories in the final month of Q4 2009.



3 If the Consensus is Correct, the Quarterly Gain in Real GDP will provide More Evidence that the Economic Recovery is Gaining Steam



Source: Bureau of Economic Analysis, Haver 01/25/10

- A key theme for the December report is likely to be the big increase in aircraft orders in the month and the ongoing rebound in auto production in response to better-than-expected auto sales in the second half of 2009.
- Business capital spending, along with housing, has led the economy out of recession in each of the 10 recoveries since WWII.
- The market will want to focus on shipments and orders for capital goods, excluding aircraft. These “core” shipments and new orders are highly correlated to the business-spending portion of GDP.
- The inventory portion of this report will be closely watched by market participants looking to gauge the ongoing process of inventory restocking as Q4 2009 ended. A slower pace of inventory destocking added nearly 1.0% to real GDP growth in Q3, and the market is counting on a further slowdown in inventory destocking in Q4 2009 and in 2010.

Q4 2009 Real GDP (Friday, January 29)

- The consensus among economists calls for a 4.6% annualized gain in real GDP between Q3 2009 and Q4 2009. Inventories, consumer spending, housing, and government spending should add to GDP growth in Q4, while non-residential investment and exports could weigh on growth.
- If the consensus is correct, the quarterly gain in real GDP will provide more evidence that the economic recovery that began in Q3 2009 gathered steam in Q4 2009. This may help to reinforce the idea among investors, the financial media, and the public at large that the recession has in fact ended.
- From the market’s perspective, the Q4 GDP data is probably “old news” at this point as the market is already looking ahead to prospects for growth in Q1 2010 and all of 2010.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Investing in international and emerging markets may entail additional risks such as currency fluctuation and political instability. Investing in small-cap stocks includes specific risks such as greater volatility and potentially less liquidity.

Stock investing involves risk including loss of principal. Past performance is not a guarantee of future results.

This research material has been prepared by LPL Financial.

The LPL Financial family of affiliated companies includes LPL Financial and UVEST Financial Services Group, Inc., each of which is a member of FINRA/SIPC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and make no representation with respect to such entity.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by any Government Agency | Not a Bank/Credit Union Deposit