

Executive Economic Outlook & Summary

Spring/Summer 2010



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Multop Financial's official position for this economic outlook is: "We remain cautiously optimistic during this jobless recovery." Much of this recovery is due to the influx of government spending (e.g. TARP, Government Bailouts, Cash for Clunkers, Homebuyer Tax Credit, Stimulus Checks, etc.) rather than consumer spending and real job creation. This has resulted in an artificially propped up economy.

In our last Economic Outlook (Winter/Fall 09/10) we forecasted that the turbulent times had passed and the economy's foundation was beginning to stabilize, despite the lasting effects the "Great Recession" had on the consumer-based economy. Our assumptions were correct as GDP rose 5.4 percent in the fourth quarter of 2009 and GDP for the first quarter of 2010 is projected at 3.2 percent. While these figures indicate economic recovery, where is the job growth? When the recession began at the end of 2007 the unemployment rate was at 4.6 percent. Since then the economy has shed over 8 million jobs. Bloomberg estimates 175,000 jobs were added in April, following a gain of 162,000 workers in March. Yet, unemployment still rose to 9.9 percent, its highest levels since the recession began; maybe because much of April's increase was due to the hiring of 105,000 temporary Census workers, which is not real job growth.

Economists estimate a 3 percent growth in GDP is needed to keep up with population growth and a 5 percent growth in GDP is needed for one full year to drive down the unemployment rate by just 1 percentage point. Consider the last major recession in the 1980s; the unemployment rate peaked at 10.8 percent before dropping to 7.2 percent over an 18 month period, which took five straight quarters of GDP growth at 7 to 9 percent – a figure well off our current 3.2 percent GDP growth estimate.

These figures further reinforce the notion that the economy will continue to recover but not return to pre-recession levels in 2010:

- For the 17th straight month, the federal funds rate remained at 0 to 0.25 percent, increasing the severity of an inflationary climate in the future.
- Currently, the Case-Shiller index shows that home prices fell 0.9 percent in February compared to January, the fifth straight month-to-month decline. Prices could fall even further with March foreclosures increasing 19 percent from February.
- Despite recent turbulence, the Chicago Board of Options Exchange Volatility Index (VIX) has stabilized to a level at the high end of its normal trading range.
- The Consumer Confidence Index, which measures how consumers feel about the economy over the next six months, rose to 57.9 in April. A reading of 90 indicates the economy is on solid footing; above 100 signals strong economic growth.

- The Institute for Supply Management reported that manufacturing activity in April expanded, with the index increasing from 59.6 to 60.4 (numbers over 50 indicating growth).
- The National Federation of Independent Businesses reports that "April marks the 27th consecutive 'no new jobs' monthly reading." Small businesses are believed to be the key to job growth.
- The Commerce Department reported consumer spending modestly rose for the sixth straight month; increasing by 0.6 percent, while income grew by just 0.3 percent, showing signs that the US consumer might be ready to once again take on debt.
- Commodities may see increased volatility as world currencies continue to fluctuate.

The Congressional Budget Office projects the federal debt will reach 60 percent of GDP by the end of 2010, the highest level since 1952. Federal Reserve Chairman Ben Bernake issued strong warnings to President Obama's National Commission on Fiscal Responsibility and Reform, "...increased federal debt implies higher taxes in the future to cover the associated interest costs -- higher taxes that may create disincentives to work, save, hire, and invest. High levels of debt also decrease the ability of policymakers to respond to future economic and financial shocks; indeed, a loss of investor confidence in the ability of a government to achieve fiscal sustainability can itself be a source of significant economic and financial instability."

A robust recovery without job growth is possible but not sustainable and the probability of another recession occurring before we return to 2007 levels is approximately 15 percent. While the economy continues to work towards a sustainable recovery, investors should keep in mind that while small, there is a chance the economy could deteriorate and return to a recessionary climate. Markets may appear bullish but will inevitably suffer a summer lull due to escalating investor uncertainty and European debt woes. Look for an election year stimulus in late 2010 as the labor market continues to remain subdued. As we look beyond 2010 we expect inflationary risks to return and interest rates to return to normal levels.

When a recovery, such as this, lacks fundamentals like job growth, investors should remain cautious and risk averse. We are advising clients to stay away from volatile investments, whose risk will outweigh possible rewards, as well as stay away from longer-term bonds, which will suffer when interest rates begin rising. Instead, add inflation resistant investments to your portfolio, as government policy is potentially setting the stage for an inflationary climate. Consider adding blue chip, high dividend paying stocks or mutual funds that can yield a steady return. In the short term, invest globally, diversify outside of the US; invest in Brazil, India, China, Indonesia, but stray away from Europe, Japan and Russia. Consider adding non-market and negative market correlated assets to your equity portfolios to enhance your risk adjusted rate of return.

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