

## WealthViews Economic & Market Update

October 2011

### MONTHLY QUOTE

“It takes a long time to grow an old friend.”

– John Leonard

### MONTHLY TIP

Think about setting up a system for 2012 to record your allowable income tax deductions and credits. Too many people spend too many hours trying to figure out deductions and credits in April.

### MONTHLY RIDDLE

I'm dressed in a golden jacket. I take it off abruptly, accompanied by a loud noise. When I do, I become larger, but I weigh less. What am I?

### Last month's riddle:

Take a 5-letter word identifying a crop. Take away the first letter, and you have a form of energy. Take away the first 2 letters and you have a verb. Rearrange the 3 letters left and you have a drink. What is this 5-letter word?

### Last month's answer:

Wheat.

***Happy Halloween!***

***From The Desk of Labrum Capital Advisors, LLC***



Upcoming Labrum Capital Events:

[http://www.labrumcapital.com/uploads/2011.10\\_Montly\\_Client\\_Event.pdf](http://www.labrumcapital.com/uploads/2011.10_Montly_Client_Event.pdf)

**THE MONTH IN REVIEW** by Sean Moore, Labrum Capital Chief Investment Analyst

### **Remember the Duncan?**

The Duncan Yo-Yo. If you ever had one, just the thought of that venerable toy can elicit a flood of memories, hopefully accompanied by a smile! When the investment markets reflect similar, sharp, up & down moves, however, about the last thing you'll see here at LCA is smiling. We certainly dislike the gut-wrenching moves of the past many weeks, not because we get emotional over a volatile corrective phase; rather, because we hope that it doesn't cause *the very folks* who've blessed us with so much trust and confidence undue stress or concern.

We analyze the past month's activity in the investment markets from a multi-dimensional perspective. Yes, there have been real, live risks to the short-to-intermediate term prospects of the global recovery, so “no,” we can't dismiss the recent volatility as purely “emotional.” The equity market, measured by the S&P 500 during September, dropped 7.18%. However, Q3 ending September was the worst 3-month return (-14.33%) since February 2009 (-17.98%), as the 2008 financial crisis was winding down. Year-to-date through this writing, however, we find the S&P 500 at a modest 5.0% decline for the year. Read on, and you'll find out why we use the word “modest.”

Since early September, the perception of future investment return potential has been skewed by three threats: 1) the potential for the US to slip back into recession, 2) the potential for a Greek sovereign debt default causing a contagion among other indebted

European countries, and 3) the potential for a “hard landing” in China as it attempts to cool off an overheated economy.

If the first threat, US recession, was the cloud overshadowing the past weeks, the volatility was caused by threat #2, Greek default. Almost daily news-flow provided perceived reason for worry or relief with no real resolution until just the past few days. Threat #3 took the hand-off, providing even greater concern about the global economy, when on 23 September a key gauge of China’s manufacturing activity reflected a very slight contraction. This was the proximate cause of the stake driven through the hearts of so many commodity prices, along with their associated stocks. Copper prices, widely thought to be the most accurate leading indicator of global demand for commodities, dropped 21% from just under \$4/lb in mid-September to \$3.10/lb by early last week.

We track over 150 economic indicators here at LCA. What we have seen over the past recent weeks strongly indicates that Threat #1, **a US recession, is not likely**. To be more specific, the most recent reports lead us to believe that the chances are now less than 20%, down from a 35% chance early last month. Construction spending, orders for Non-Defense Capital Goods, and New Orders for Durable Goods all came in much better than expected. Automobile sales are robust and 23 of the largest retailers in the country reported a very strong +5.1% gain in Chain Store Sales during September. Remember, ~70% of our economy is based on consumer demand and, while the current high unemployment rate is a tragedy for millions of families, 91% of Americans are working full or part time. A 55 cents/gallon decline in gas prices since May is probably a modest help as well, as *each penny* saves US consumers \$1 - \$1.4 *billion* dollars.

Threat #2 remains real, however, just in the past few days it **appears that the European countries are coming together to find a real solution**. We have problems in the US finding consensus with *two political parties*. Can you imagine the challenge with 17 *countries*, all of which must agree on the plan! We never thought a parliamentary vote (today) in Slovakia, a poor country with a population less than Maryland’s, could capture global attention; but yes, Slovakia is the final country to vote on the latest, and probably best plan to date. If approved, as is likely, we should find the European debt crisis relegated to page 2 for a while....providing welcome relief to global markets.

Threat #3 is probably the only one that was over-hyped in recent weeks. Yes, China’s economy is going to cool or has cooled, from the racy 11% growth range it has been tracking into the 7-9% range. **The prospect of a crash-like (for China) +3% growth rate is highly improbable**, if for no other reason than the government’s ability to re-stimulate their economy with almost \$2 trillion in reserves. We’ve already seen commodity prices begin to firm over the past week and expect that to continue as more data becomes available from China.

Our **outlook for the fourth quarter is positive**, but cautiously so as we watch the situation in Europe carefully. We’ll want to see more data out of China and the rest of Asia over the coming weeks to validate our position there. In fact, we see opportunity in the Emerging Markets and a few developed markets, using the year’s sharp declines in those markets as an entry opportunity for risk-tolerant investors. We know it’s hard to believe, but **the US market performance**, measured by the S&P 500 which closed yesterday, 10 October, at -5.0% on the year, is **the best of any of the 24 major “markets” on the planet**. According to the Wall Street Journal today, with China’s -16%, India’s -19%, Brazil’s -23%, and Germany’s -15% YTD returns, opportunities are out there, waiting to be evaluated. As always, we’ll do our utmost to measure the risk/reward trade-offs and steer you in the right direction.

## **DOMESTIC ECONOMIC HEALTH**

Consumer spending increased by 0.2% in August, down from a revised 0.7% gain in July. Consumer incomes declined by 0.1% in August for the first time in almost two years. Consumer confidence – which seemingly had nowhere to go but up in light of the July figures – did improve somewhat. The University of Michigan's final September survey rose to 59.4 from the final August 55.7 reading, 1.6 points better than the consensus forecast of economists polled by Bloomberg News; the survey's index of current conditions went up to 74.9 from August's final 68.7 mark. The Conference Board's consumer confidence index edged north 0.2% to 44.7. Consumer prices grew 0.4% in August, with core CPI up 0.2% and 2.0% year-over-year, the biggest annualized core inflation number in almost three years. Producer prices were flat in August, and so were U.S. retail sales. The jobless rate was 9.1% in August – the 25th time in the past 27 months it had been above 9%.<sup>3,4,5</sup>

The manufacturing and service sectors saw improved growth, at least by the gauge of the most recent Institute for Supply Management manufacturing and service sector indices. ISM's service sector index rose to 53.3 in August from July's 52.7 mark – an improvement few analysts were expecting. Its September manufacturing index rose a full percentage point to 51.6. Durable goods orders diminished in August, but not by much – just 0.1% overall. Core capital goods orders were up 1.1% and core capital goods shipments were up 2.8%.<sup>6,7,8</sup>

In Washington, there were two big news items. President Obama unveiled the American Jobs Act – a bill that would cut the payroll tax for workers and businesses to 3.1% in 2012, offer tax credits as large as \$4,000 to companies hiring the long-term unemployed, and devote about \$80 billion into infrastructure projects. To pay for it, the President proposed \$1.6 trillion in tax increases for upper-income Americans and corporations as a component of a \$4.4 trillion reduction of the federal deficit by fiscal year 2021. Republicans dismissed any direct link between taxes on the wealthy and future job creation, and it remains to be seen if the AJA will pass in anything like its entirety.<sup>9,10</sup>

## **GLOBAL ECONOMIC HEALTH**

Fears of sovereign contagion grew on rumors that Greece would soon default on its debt. At mid-month, European finance ministers and central bank governors (and even Treasury Secretary Timothy Geithner) conferred to try and figure out the least disruptive resolution to the crisis. The G-20 issued a statement promising a “strong and coordinated international response to address the renewed challenges facing the global economy”. That aside, both the Federal Reserve Open Market Committee and International Monetary Fund managing director Christine LaGarde saw appreciable “downside risks” for the U.S. and world economies.<sup>11</sup>

When investors weren't worried about Greek banks going belly-up or Greece ditching the euro for the drachma, they had concerns about China. Its central bank was trying to arrange a soft landing for its slowing economy. Data showed China's consumer prices up 6.2% in August from a year earlier; the People's Bank of China has raised interest rates five times in the last 12 months. China's official PMI improved a bit to 51.2 in September, but looking long-term, 59% of analysts and traders recently surveyed in Bloomberg's Global Poll of Investors think that its economy will see growth of less than 5% by 2016. Meanwhile, key PMIs in Australia (42.3) and India (50.4) went lower.<sup>12,13</sup>

## **WORLD MARKETS**

Losses abounded. Data from Morningstar tells the tale, with all of this measured in U.S. dollar terms. India's Sensex lost but 1.34% last month. The Nikkei 225 only lost 2.85%; Germany's DAX retreated 4.89% and England's FTSE 100 lost 4.93%. Now the greater descents: All Ordinaries, -6.86%; CAC 40, -8.44%; Hang Seng, -14.33%; TSX Composite, -8.97%; Shanghai Composite, -8.11%. After September, all of these indices were in the red by 10% or more YTD. The biggest loser among them? The DAX, -23.99% YTD. The MSCI World and Emerging Market indices respectively lost 8.85% and 14.78% in September.<sup>14,15</sup>

## **COMMODITIES MARKETS**

The U.S. Dollar Index rose 6.0% in September. That alone might tell you what kind of month it was. Gold lost 11.38% last month. Other precious metals also saw major selloffs last month –

platinum, -17.9%; palladium, 22.3%; silver, 28.0%. Oil futures slipped 10.82% in September. At month's end, the price of COMEX gold was \$1620.40 per ounce; NYMEX crude settled at \$79.20 a barrel. The 19-commodity Thomson Reuters-Jefferies CRB Index posted a 12.97% loss on the month, and just three crops in the 24-commodity Standard & Poor's GSCI Total Return Index of raw materials advanced – live cattle (+7.6%), feeder cattle (+7.7%) and lean hogs (+5.9%). The real yield of the 10-year note was but 0.17% on September 30, hardly changed from the 0.18% yield on August 31.<sup>2,16,17,18,19,20</sup>

## REAL ESTATE

The housing market appeared healthier than a year ago. Perhaps that isn't saying much, but the progress was tangible. Existing home sales improved 7.7% in August, putting them + 18.6% from a year earlier. There were 3.2% more housing starts in August, and that indicator registered 7.8% annual improvement. August data also showed 12-month gains in new home sales (6.1%) and pending home sales (7.7%). The S&P/Case-Shiller Home Price Index rose again in July (0.9%); the index was still 4.1% below July 2010 levels.<sup>21,22,23,24,25</sup>

How low could mortgage rates go? In September, the short answer was “even lower”. Homeowners who could manage a refi were looking at a 3.28% average rate for the 15-year fixed on September 29 according to Freddie Mac's Primary Mortgage Market Survey. That was down from 3.39% on September 1. The average rate on the 30-year FRM was a milestone 4.01% on September 29; it had been 4.22% on September 1. In the same interval, the average rates on the 5/1-year ARM actually rose to 3.02% from 2.96%; rates on the 1-year ARM went from 2.89% to 2.83%.<sup>26</sup>

## LOOKING BACK...LOOKING FORWARD

Appetite for risk truly waned in September, a month in which the dollar seemingly beat every asset class.

% CHANGE	Y-T-D	1-MO CHG	1-YR CHG	10-YR AVG
DJIA	-5.74	-6.03	+1.16	+2.35
NASDAQ	-8.95	-6.36	+1.97	+6.32
S&P 500	-10.04	-7.18	-0.86	+0.89
REAL YIELD	9/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.17%	0.75%	2.27%	3.50%

Sources: cnbc.com, bigcharts.com, treasury.gov - 9/30/11<sup>1,27,28,29,30</sup>

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

Uncertainty defines the market at this point. Could this next earnings season be powerful enough to send stocks north in October? Could anything divert enough attention from the risks in Europe? (Don't forget the pressure from a stronger dollar.) This is a market given to rapid sentiment shifts, and its present level of volatility might be with us for months. If it is any encouragement, October has been a decent month for Wall Street since 2000; in fact, it has been the DJIA's fifth-best month of the year since then with an average monthly performance of +1.16%.<sup>31</sup>

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weighted index of Greek stocks listed on the Athens Stock Exchange. The FTSE MIB is the primary benchmark Index for the Italian equity markets. Capturing approximately 80% of the domestic market capitalization, the Index is comprised of highly liquid, leading companies across ICB sectors in Italy. The FTSE 100 Index is a share index of the 100 most highly capitalized companies listed on the London Stock Exchange. The BSE Sensex or Bombay Stock Exchange Sensitive Index is a value-weighted index composed of 30 stocks that started January 1, 1986. The MSCI World Index is a free-float weighted equity index that includes developed world markets, and does not include emerging markets. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. The US Dollar Index measures the performance of the U.S. dollar against a basket of six currencies. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards. All information is believed to be from reliable sources; however we make no representation as to its completeness or accuracy. All economic and performance data is historical and not indicative of future results. Market indices discussed are unmanaged. Investors cannot invest in unmanaged indices. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional.

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