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U.S. Economy Beginning to Recover



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U.S. economic data released over the past week broadly support our view that the economy has begun to recover. The recovery is being spurred in particular by manufacturing, which declined sharply late last year. The Institute for Supply Management (ISM) manufacturing index went over the 50 mark in August and thus signaled that manufacturing has begun to expand for the first time since January 2008; ISM's non-manufacturing index also rose. Employment conditions are improving, but more slowly: non-farm payrolls fell by 216,000 in August vs. a 276,000 decline in July, while the unemployment rate rose to 9.7%. Finally, a stronger than expected increase in pending home sales for July augurs well for a continued recovery in existing home sales over the next two months.

ISM manufacturing

The Institute for Supply Management (ISM) manufacturing index rose more than expected in August, crossing above 50 for the first time in the nascent recovery. Strength was again broad based, with a particularly sharp increase in new orders. Importantly, the industries contributing to August's increase were not limited to the auto industry and its suppliers, suggesting that the surge in new orders was not just a one-time effect of the "cash for clunkers" program. The inventory index continued to decline even though purchasing managers remain convinced that their customers' inventories are too low. The price index rose significantly, with metals the largest single contributor.

- The headline manufacturing PMI increased to 52.9 in August from 48.9. The mean forecast had been 50.8, with individual forecasts ranging from 49 to 53.5. This is the highest level of the index since June 2007, well before the start of the last recession, and the first time since January 2008 that the index was above 50, signaling growth in manufacturing. August's 52.9 is historically consistent with a 3.7% annual GDP growth rate and the 50.9 average seen thus far for the third quarter is consistent with a 3.1% GDP growth rate. This compares with a current consensus growth forecast for the third quarter of 2.2%.
- The new orders series was particularly strong, rising nearly ten points to 64.9 from 55.3 and reaching its highest level since December 2004. While 43% of respondents reported higher new orders in August, vs. 33% in July, only 16% reported weaker new orders. Thirteen of the 18 industry groups in the survey reported stronger new orders, including textiles and apparel, electrical equipment, computers and electronics, fabricated metals, transportation equipment, machinery, chemicals, plastics/rubber, wood and paper. The industries reporting lower new orders were furniture, primary metals and food/beverages/tobacco. The supplier deliveries index rose to 57.1 from 52.0, confirming the strength seen in new orders.

Source: Institute for Supply Management

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Non-farm payrolls and initial jobless claims

Non-farm payrolls fell a bit less than forecast in August, but the unemployment rate was higher than expected. Job losses for May and June were somewhat greater than previously estimated. Job losses in manufacturing rose modestly compared to July, but were still much smaller than in the first six months of this year. Job losses in private service industries continued to moderate. Hours worked in the private sector as a whole and in manufacturing were unchanged, and hourly earnings increased. Today's data are broadly consistent with our expectation for smaller declines employment through the third and fourth quarters. We still expect the unemployment rate to rise a bit further in the next few months, however, consistent with typical business cycle dynamics.

- Total non-farm payrolls declined by 216,000 in August, compared to a 276,000 decline in July and a 463,000 decline in June. The mean forecast had been for a decline of 230,000, with individual forecasts ranging from -365,000 to -100,000. The consensus forecast had risen modestly after the ADP employment report on Wednesday showed a greater than expected decline in jobs. Total hours worked were unchanged vs. July at 33.1; manufacturing hours worked were unchanged at 39.8 and the aggregate weekly hours index fell to 98.9 from 99.1 in June and July. Thus far in the third quarter, the aggregate weekly hours index has fallen at a 2.6% annual rate, compared with a nearly 8% rate in the second quarter.
- Job losses in manufacturing were essentially in line with expectations at 63,000 vs. a 60,000 forecast, and were less severe than first estimated in July (-43,000 vs. an original -52,000). Job losses were more severe in durable goods manufacturing than in non-durables industries, and employment fell in all durable goods industries including motor vehicles and parts. In non-durables industries, modest job gains in food, beverages and tobacco processing partially offset job losses in printing, chemicals and plastics.
- Service sector employment fell by 80,000 or less than 0.1%, compared with 154,000 in July with private sector service jobs falling by 62,000 and government employment falling by 18,000. Among private service industries, job losses moderated significantly in retail. Temporary jobs fell by 6,500, in line with July's 7,600 and much less than the 74,000 rate seen in the first quarter. Financial services jobs fell by 28,000 or 0.4%, in line with the 25,000 average decline seen in May through July. State and local government employment fell by 13,000 or 0.1%, largely because of a fall in public education jobs; Federal jobs fell by 5,000 as a decline in postal service jobs was partially offset by increases elsewhere.
- The unemployment rate increased to 9.7% last month following an unexpected decline in July. The consensus forecast had been for 9.5%, with individual forecasts in ranging from 9.3% to 9.8%. The unemployment rate is derived from a separate household survey and its monthly movements therefore do not directly track those in non-farm payrolls. The household survey showed a decline of 392,000 jobs and an increase of 73,000 in the labor force; labor force participation was unchanged at 65.5%. Broader measures of unemployment and underemployment rose in August: the widest unemployment measure (the officially unemployed plus "discouraged" workers who have an economic reason for not looking for work plus those working part-time for economic reasons) rose to 16.8% of the labor force in August from 16.3% in July.
- Initial jobless claims fell by 4,000 on a seasonally adjusted basis to 570,000 in the week ending August 28. The mean forecast had been for 563,000, with forecasts in a range from 550,000 to 580,000. The four-week moving average rose from 567,250 to 571,250 and claims for the week ending August 21 were revised from 570,000 up to 574,000.
- Continuing claims rose unexpectedly in the week ending August 21, increasing 1.5% to 6,234,000 vs. a mean forecast of 6,137,000. Continuing claims for the August 14 week were revised upward slightly to 6,142,000 from 6,133,000. As a result, the insured unemployment rate increased on a seasonally adjusted basis to 4.7% from 4.6%, although the rate before seasonal adjustment fell to 4.2% from 4.3%.

Source: U.S Department of Labor

ISM non-manufacturing

The ISM non-manufacturing index increased in line with consensus forecasts in August following a small decline in July. Unlike the manufacturing survey, the headline index did not move over 50. Nevertheless, most components of the index were higher, with strength in the business activity, new orders and export orders series. The prices paid index, which had declined in July, rose sharply last month. At this initial stage of economic recovery, when the inventory and production cycle is a major driver of economic activity, it is reasonable to expect the non-manufacturing PMI to show a more muted move upward than the manufacturing index since many of the service industries contributing to this index are non-cyclical.

- The headline PMI for the non-manufacturing economy rose to 48.4 in August from 46.5 in July. The mean forecast had been for 48.4, with individual forecasts ranging from 45.0 to 51.0. The business activity index, which used to be the headline PMI, rose to 51.3 from 46.1 — 28% of respondents reported higher activity in August vs. 19% in July. The industry breakdown was a bit weaker, however, with seven of the 18 industry groups reporting stronger activity and ten reporting weaker. The industries reporting weaker activity included some of the more cyclical groups in the survey, including mining, construction, retail, and financial services, although real estate, transportation/warehousing and food service/lodging were among the stronger groups.
- Other components were on balance stronger than in July. The new orders index rose to 49.9, just below the growth threshold, from 48.1 in July as 27% of firms reported higher new orders. Seven industry groups reported stronger new orders while nine reported weaker orders.

Source: Institute for Supply Management

Pending home sales

The pending home sales index increased more than forecast in July. This was its sixth consecutive monthly increase, which leaves the index 12% year-over-year. The report suggests further strength in existing home sales in the late summer and early fall.

- The pending home sales index rose 3.2% to 97.6 in July following a 3.6% increase in June (left unchanged after revised data). The mean forecast had been for a 1.5% increase, with individual forecasts ranging from -1.0% to +5.0%.
- Sales varied by region in July, with sales falling 3.0% and 2.0% respectively in the Northeast and Midwest, rising 3% in the South and 12% in the West. (Before seasonal adjustment, the total index fell 7.4%, with declines in all regions except the West.)
- The National Association of Realtors affordability index fell marginally from 159.2 in June to 158.5 in July, but remains 36 points above its July 2008 level. An index level of 158.5 implies that a household earning the median income would have 58.5% more income than would be needed to afford the median-priced single family home, assuming a limit of 25% of gross income was spent on housing and that the house was bought with a 20% down payment.

Source: National Association of Realtors