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Recent Data Weaker than Forecast, but Still Point to Recovery



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The two most important U.S. economic data releases for September, the employment report and the Institute for Supply Management manufacturing survey results, were both weaker than expected. The jobs report showed a greater than forecast decline in non-farm payrolls last month, although the weakness was exaggerated by a sharp decline in government employment. The ISM survey showed that the recovery in U.S. manufacturing slowed a bit in September from its August pace. A variety of other recent indicators also showed somewhat slower economic activity. Short-term reversals like this are typical of the early stages of a business cycle recovery. We do not believe that they call into question the view that the recession has ended and that activity should gather momentum in coming months.

Non-farm payrolls decline more than forecast; government jobs down sharply

Non-farm payrolls fell significantly more than expected in September. While much of the difference vs. expectations came from an unusually large decline in government jobs, private sector jobs also fell more than forecast. Job losses in manufacturing were in line with forecasts and smaller than in August. Hours worked in the private sector as a whole and in manufacturing both fell modestly. The unemployment rate rose to 9.8%, in line with the consensus forecast. Our assessment is that the September data do not materially change the trajectory of recovery in employment. We still expect smaller job losses through the end of the year and net increases in employment starting in the first quarter of 2010.

- Non-farm payrolls fell by 263,000 in September, following a 201,000 August decline (originally reported as 216,000) and a 301,000 July decline (revised from 276,000). The consensus forecast for September had been a decline of 175,000, with individual forecasts ranging from 100,000 to 260,000. Total hours worked were down 0.1 to 33.0 from 33.1, hours worked in manufacturing fell 0.1 to 39.8, and the aggregate hours index fell 0.5 to 98.5. (Hours data include production and non-supervisory workers in the private sector.) For the third quarter, the aggregate hours index fell at 3.0% rate compared to a nearly 8% rate in the second quarter and a 9% rate in the first.
- Private sector employment fell by 210,000 or 0.19%, more than in August (-182,000 or -0.17%), but less than any other month since August 2008. Government employment, however, declined by 53,000 (-0.24%) as state government education jobs and local government jobs outside education fell. These declines probably reflect strains on state and local governments, which federal aid from the fiscal stimulus package has not been able to offset.
- Manufacturing job losses were in line with expectations at 51,000 (-0.43%), and moderated in both durable and non-durable goods industries. Employment in durable goods industries fell by 43,000 or 0.6%, with the greatest declines in furniture, machinery and fabricated metals. Employment in electrical equipment was up slightly. Employment in non-durables manufacturing fell by 8,000 or 0.17%, as modest increases in textiles and the oil industry were not enough to offset declines in chemicals, food processing and printing. Construction job losses were 64,000, in line with the previous two months' declines, with non-residential construction jobs falling more than twice as fast as residential (-1.3% vs. -0.6%).

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- Total service employment fell by 147,000 or 0.13%, significantly more than the 69,000 (0.06%) seen in August but still more moderate than earlier months. Private sector service jobs fell by 94,000 or 0.1%, as job losses escalated in retail (to 39,000 from 9,000 in August) but moderated in professional services and in finance.
- The unemployment rate, computed from the separate household survey, rose 10 basis points to 9.8%, in line with consensus forecasts. As measured by the household survey, employment fell by 785,000, the largest decline since March. Broader measures of unemployment rose, with the widest measure (the officially unemployed, "discouraged" workers, and those working part-time for economic reasons) reaching 17% of the labor force. Labor force participation declined 0.5% to 65.17%. Average hourly earnings of production and non-supervisory workers rose 0.05% to \$18.67, but average weekly earnings fell 0.2% (to \$616.11) as hours worked declined.

Source: Bureau of Labor Statistics

ISM manufacturing index falls slightly compared with forecasts for a modest increase

The Institute for Supply Management (ISM) manufacturing index fell slightly in September, following a significant increase the month before. Forecasters had expected a modest further rise. The indices for new orders and production declined, but both remained above 50. Export orders showed continued growth, while the import index rose above 50. The inventory index suggested that manufacturers were continuing to reduce inventories, but more slowly. The price index fell modestly. The number of industries reporting growth last month was in line with or greater than in August. On balance, this report points to continued recovery in manufacturing, although at a modestly slower pace than seen in August.

- The manufacturing PMI fell to 52.6 in September from 52.9 in August, remaining above 50 for the second consecutive month. The mean forecast was for the index to rise to 53.9, with individual forecasts ranging from 51.5 to 56.0. September's index level is consistent with an annualized GDP growth rate of 3.6%, and the index average for the full third quarter, 51.5, is consistent with a GDP growth rate of 3.2%. This is slightly above consensus forecasts of 3.0% growth in the quarter; consensus economic forecasts have risen materially in recent months.
- The new orders series fell to 60.8 from 64.9 in August. The proportion of firms reporting stronger new orders was little changed at 42% vs. 43%, but the share reporting weaker new orders rose to 20% from 16%. As in August 13 of the 18 industry groups reported growth in new orders. The four reporting weaker new orders were primary metals, non-metallic minerals, machinery and furniture. The order backlog index rose modestly to 53.5 from 52.5 as 25% of firms reported greater order backlogs but 18% reported smaller backlogs.
- The production index fell to 55.7 in September from 61.9 in August, remaining above the 50.4 point indicating growth in industrial production for the fourth consecutive month. The number of firms reporting higher production levels fell to 36% last month from 43%, while the proportion reporting lower production levels was unchanged at 18%.

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- Manufacturers continued to draw down inventories in September, but to a lesser extent than in previous months. The inventory index rose to 42.5 from 34.4 in August, as 31% of firms cut inventories compared to 42% who reduced them last month. The proportion of firms with increased inventories, however, was unchanged at 14%.
- The export orders index declined modestly to 55.0 from 55.5, with 20% of respondents reporting higher export orders (vs. 24% in August) and 10% reporting lower export orders (vs. 13% in August). At the industry level, non-metallic minerals and primary metals were the only industries reporting lower export orders. The import index rose to 52.0 from 49.5; even though the share of companies reporting higher imports fell to 13% from 15%, the share reporting lower imports fell even more (to 9% from 16%).
- The manufacturing price index, which had increased ten points in August, fell 1.5 points to 63.5. Twelve of the 18 industry groups reported paying higher prices last month, while only food/beverages/tobacco reported paying lower prices.
- In response to a special question, 30% of firms indicated that they believed their industries would benefit from spending arising out of the fiscal stimulus program, and 27% believe their firms themselves will benefit. Administration economists believe that about 30% of the stimulus funds had been spent or obligated as of the beginning of September, so that this percentage may be expected to increase as more funds are spent.

Source: Institute for Supply Management

The manufacturing index, particularly the new orders component, had risen sharply in August. As with other data series that had had rapid increases, some pause was thus to be expected. Looking forward, continued inventory drawdowns mean that potentially large production increases lie ahead as recovery takes root.

Personal income and consumption rise more than forecast; spending jumps

Personal income and consumption rose slightly more than expected in August. Wage income increased for the second consecutive month, while the cash for clunkers program led to a jump in spending that should partially reverse itself in September. The savings rate continued its recent decline. The personal consumption price index rose a bit more than expected, largely because of higher energy prices. Some of the data in this report show signs of income recovery from sources other than government programs, but ultimately the release still points to weak income growth. It thus supports our view that consumption spending is likely to grow slowly for the next several quarters.

- Nominal personal income rose 0.16% in August following a similar increase in July. Real, after-tax income fell 0.2%. Compared with August 2008, nominal personal income was down 2.6% and real, after-tax income was up 1.3%.
- Wage and salary income increased for the second consecutive month, rising 0.2%, with similar increases for both the private sector and government. Manufacturing wages and salaries fell 0.5%, but manufacturing wages and salaries are now only 11% of total labor income. The manufacturing decline was offset by a 0.4% increase in service sector wage and salary income. Wage and salary income from more cyclical service industries (trade, transportation and utilities) rose 0.5%, its largest increase since before the recession began in late 2007. Year over year, however, wage and salary income was down 5.2%, led by a 13% drop in wage and salary income from goods-producing industries.
- Government benefit payments rose 0.9% in August as social security benefit payments rose 0.4%, unemployment insurance benefits rose 4.4% and contributions for social insurance programs rose 0.2%. Thus, even though the one-time payments in the stimulus program ended a few months ago, government benefits are continuing to support personal income growth.
- Personal consumption expenditures rose 1.3% in August following a 0.3% increase in July. With consumption rising much more rapidly than income during the month, the personal savings rate fell back to 3.0% from 4.0% in July.

Source: U.S. Bureau of Economic Analysis

Final report on 2Q09 GDP shows smaller rate of decline

The third or final report on second quarter U.S. gross domestic product (GDP) showed a smaller decline than previously reported, largely the result of stronger business investment spending. In particular, investment in IT equipment actually increased instead, although commercial construction fell even more sharply than previously believed. Corporate profits on a national accounts basis were about 2% lower in the quarter than first estimated, bringing the year-over-year decline to 15%. Measures of inflation changed little compared with the earlier report.

- Real GDP fell at a -0.7% annual rate in the second quarter, compared with a -1.0% rate in the first two reports. Domestic demand fell at a -0.9% rate, compared with -1.2% in the previous report, and final sales of domestic product rose at a 0.7% rate.
- The largest contributor to the decline in GDP was inventory liquidation, which at a \$160 billion annual rate changed little from the previous estimate. Inventory liquidation alone accounted for 1.4% of the GDP decline in the quarter.
- Consumption was little changed compared to earlier estimates, falling at a -0.9% rate instead of -1.0%. Spending on durable goods fell at a 5.6% rate, with the greatest decline in spending on household durables (-7.8%). Spending on motor vehicles and parts fell at a 6.3% rate.
- Business spending on equipment and software fell at -4.9% rate, compared with -8.4% in the first report. IT equipment spending was revised from a -1.3% annualized decline to a +5.5% annualized increase, and spending on software, previously estimated as having declined at a nearly 12% rate, turned out to be up slightly.
- Trade data were not significantly revised. The negative U.S. net export position was \$330.4 billion, or 2.56% of GDP, compared with 3% in the first quarter. Exports fell at a 4% rate in the quarter, but imports fell at a nearly 15% rate. The narrowing of the trade deficit compared with the first quarter contributed +1.65% to GDP growth in 2Q09.
- Government spending was the other major positive contributor, adding 1.3% to growth in the quarter and growing at a nearly 7% rate. Federal spending rose at an 11.4% rate, slightly higher than in the first report, driven by both defense and non-defense spending. State and local government spending also rose.
- Profit data were revised downward. Compared with the second quarter of 2008, after-tax profits on a national accounts basis fell 15%, compared with 13.5% in the earlier report. Cash flow, however, rose 8.6% year over year, little changed from the earlier release.

Source: U.S. Bureau of Economic Analysis

The second quarter should be the last negative GDP quarter in this cyclical episode. Looking forward, the contributions to GDP growth should shift as inventory liquidation diminishes, government spending flattens or even declines, and consumption and eventually business investment revive.

Case-Shiller home price index increases more than expected

The Case-Shiller home price index increased more than expected in July. This was the third consecutive monthly increase, and the rise in home prices was once again broadly based by region.

- The 20-region composite index increased 1.6% in July following increases of 1.4% in June and 0.5% in May. The consensus forecast was +0.6% and individual forecasts ranged from -0.4% to +2.6%. Year-over-year, the index was down 13.3%, compared with 15.4% in June.
- Prices rose in 18 of the 20 regions included in the index, as in June. In July the two areas with price declines were Las Vegas (-1.1%) and Seattle (down less than 0.1%). The regions with the largest price increases were Minneapolis (+4.6%), San Francisco (+3.3%), Chicago (+2.7%), San Diego (+2.5%) and Atlanta (+2.3%).
- On a year-over-year basis, all regions remained down, with the largest declines in Las Vegas (-31.4%), Phoenix (-29%), Detroit (-24.6%) and Miami (-21.2%).

Source: Standard & Poor's

The Case-Shiller composite index has now risen a cumulative 3.5% since April. While it may fall back late next year if the expiration of the tax credit for first-time homebuyers dramatically affects home sales, we nonetheless believe that April was the trough for this cycle. Slowly rising home prices and a recovery in stocks should continue to support a recovery in household net worth.