

# QUARTERLY ECONOMIC UPDATE

A review of 3Q 2010

## QUOTE OF THE QUARTER

“The measure of success is not whether you have a tough problem to deal with, but whether it is the same problem you had last year.”

– John Foster Dulles

## QUARTERLY TIP

Consider deducting \$20 or \$40 a week from your paycheck to put into your savings. For example, automatic weekly savings transfers of just \$40 would mean an additional \$2,000 a year for your nest egg and likely won't affect your lifestyle.

## THE QUARTER IN BRIEF

Talk about a rollercoaster: stocks soared in July, tanked in August, and rebounded spectacularly in September, and 3Q 2010 wound up being the best quarter on Wall Street in a year, with the S&P 500 climbing 10.72%.<sup>1</sup> It was also a fine quarter for many commodities. The quarter was also distinguished by rock-bottom mortgage rates (and a housing market that seemed to have bottomed out). Deflation fears subsided; anxieties about debt in the Eurozone didn't. While Wall Street advanced, consumers grew increasingly impatient with the pace of the recovery.

## DOMESTIC ECONOMIC HEALTH

When the quarter began, deflation and unemployment were the concerns on many minds. Assumptions of deflation ebbed as the Consumer Price Index rose 0.3% in both July and August. Unemployment, on the other hand, moved slightly north to 9.6% from 9.5% in July (well, that was better than the 9.9% rate back in April). The Federal Reserve made no move with interest rates in the quarter.<sup>2,3</sup>

Americans were spending a little more: statistics from the Commerce Department showed personal spending was up 0.4% in both July and August; personal incomes were up 0.2% in July and 0.5% in August. The personal savings rate actually increased as well over those two months, from 5.7% to 5.8%.<sup>4</sup> Yet consumer confidence was shaky: the Conference Board's monthly consumer confidence index went from 51.0 to 53.2 to 48.2 across the quarter, and the Reuters/University of Michigan barometer went from 67.8 to 68.9 to 68.2 across that span.<sup>5,6</sup>

We had decent growth in the service and manufacturing sectors according to the Institute for Supply Management indexes. The ISM manufacturing index over the quarter went from 55.5 in July to 56.3 in August to 54.4 in September (the lowest number since November 2009). Incidentally, durable goods orders were up 0.7% in July and down 1.3% in August (but minus transportation orders, durable goods orders rose 2.0% in that month). ISM's service sector index was 54.3 for July, an unnerving 51.5 in August and then 53.2 for September.<sup>7,8,9</sup>

The Obama administration tried to combat the perception that it (and the Federal Reserve) has basically run out of options to rev up the economy. With strokes of his pen, the President extended emergency jobless benefits for the long-term unemployed for another six months in July and gave homebuyers more time to claim federal tax credits. He also signed a long-stalled, finally-passed bill creating a \$30 billion fund to encourage business loans at community banks (and hopefully, business hiring and expansion).<sup>10,11,12</sup> The Dodd-Frank financial reform bill (the “no more bailouts” bill) also became law: it authorized the creation of a new Consumer Financial Protection Bureau, created more transparency in the derivatives market, and set the FDIC insurance limit permanently at \$250,000.<sup>13,14</sup>

## GLOBAL ECONOMIC HEALTH

In July, the EU and the International Monetary Fund arranged a bailout of roughly \$1 trillion U.S. for Greece and other debt-plagued EU nations. But the story wasn't over: by the quarter's end, Moody's had downgraded Spain's credit rating and Ireland's central bank was arranging a massive bank bailout that would balloon its deficit to 32% of its GNP. The EU conducted a stress test of 91 banks in the quarter, and all but a handful passed; many economists scoffed at the test.<sup>15,16</sup>

As for economic expansion, mixed signals rolled in. In Europe, the respected Markit Purchasing Managers Index slid to 53.6 in September, indicating the slowest pace of

growth since February. On the other hand, China's Manufacturing PMI hit a four-month peak in August ... yet growth within its service sector hit a 19-month low in September, while India's service sector expansion also cooled to a 10-month low. The JPMorgan global services purchasing managers' index was 53.5 in August and dipped a bit to 52.3 in September.<sup>17,18</sup>

## WORLD MARKETS

Let's take a look around the world and see some of the 3Q gains. Three indices in Southeast Asia put up some amazing 3Q numbers: Thailand's SET, +22.3%; the Philippines PSE Composite, +21.6%; Indonesia's JSX Composite, +20.2%. Other gains from the region: India's Sensex, +13.4%; Hong Kong's Hang Seng, +11.1%; South Korea's Kospi, +10.3%; China's Shanghai Composite, +10.7%. In Europe, the German DAX was up 6.5% for the quarter, France's CAC 40 advanced 10.3% and England's FTSE 100 advanced 15.6%. The Brazilian Bovespa rose 13.4% and the Russian RTSI gained 14.5%. How did the MSCI indices do in the quarter? The World went +13.24% and the Emerging Markets Index went +17.16%.<sup>19,20,21</sup>

## COMMODITIES MARKETS

Crops and metals had a great third quarter, and oil advanced nicely as well. Gold surpassed the \$1,300 mark and futures rose 5.1% on the quarter, but other metals certainly outdid that advance: platinum rose 7.9%, silver gained 16.6%, nickel advanced 18.1%, copper jumped 24.2%, palladium futures soared 28.5%, lead rose 30.9%, and tin leaped 40.8% (big demand from China). Wheat had its best quarter in three years, gaining 45.0% (a drought plus wildfires in Russia were big influences). Sugar prices went up 40.3% on the quarter, corn gained 39.9% and soybeans advanced 16.7%.<sup>22,23,24</sup> Oil prices rose 5.74% in the 3Q while natural gas futures fell 16.72%. As for the U.S. Dollar Index, it dipped 8.44% on the quarter.<sup>25,26</sup>

## REAL ESTATE

Well, things got even worse on the homebuying front – and then they got just a tiny bit better, with everyone still wondering if the real estate downturn had finally bottomed out. A sunset on federal tax breaks hurt the numbers. New home sales were flat for August after a revised 7.7% drop in July; August 2010 sales were down 28.9% from a year ago and the median sale price declined 1.2% in that time. As for the crucial indicator here - sales of existing homes – the news was, to put it mildly, not good. In July, residential resales hit a 15-year low, falling 27.2% in the process. August was the second-lowest month on record for the last 15 years, but a 7.6% improvement from July. Pending home sales did improve by 4.3% in August.<sup>27,28,29</sup>

If you were able to buy a home (or refinance one), you could take advantage of mortgage rates that recalled the Eisenhower era. Over the quarter, rates on conventional 30-year home loans went from 4.58% to 4.32%. Rates on a 15-year fixed averaged 4.04% at the start of July and just 3.75% at the end of September. Average rates on the 5-year ARM moved down from 3.79% to 3.52% in that stretch, and so did average rates on the 1-year ARM, going from 3.80% to 3.48%.<sup>30</sup>

## LOOKING BACK...LOOKING FORWARD

At the end of August, did you expect that the third quarter would turn out like this? Stocks were well into negative territory YTD and we were heading into what is traditionally the poorest month of the year on Wall Street. As the numbers below indicate, things turned around.

% CHANGE	Y-T-D	QTD CHG	1-YR CHG	10-YR AVG
DJIA	+3.45	+10.37	+11.08	+0.13
NASDAQ	+4.38	+12.30	+11.60	-3.55
S&P 500	+2.34	+10.72	+7.96	-2.06
REAL YIELD	9/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO

10 YR TIPS	0.75%	1.56%	1.78%	4.03%
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Source: cnbc.com, bigcharts.com, ustreas.gov, bls.gov - 9/30/10<sup>1,31,32,33</sup>  
 Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.  
 These returns do not include dividends.

As the fourth quarter begins, we are not quite out of the woods: you might see the market react negatively to everything from less-than-expected partisan change in midterm elections to oncoming rising capital gains tax rates to sovereign debt concerns in the EU. Much attention could be focused on the November 3 Fed meeting, especially if economic indicators across the bulk of October are underwhelming. (Many economists think the Fed will start buying Treasuries again to help pressure interest rates.) The optimism on Wall Street right now might be aided by the potential of the fall earnings season and further encouraging data about consumer confidence, consumer spending, and the manufacturing and retail sectors. Let's hope the bulls aren't scared off – another quarter like this one would allow 2010 to be a decent year for stocks.

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