

MONTHLY ECONOMIC UPDATE

January 2011

WEEKLY QUOTE

“To handle yourself, use your head; to handle others, use your heart.”

– Donald A. Laird

MONTHLY TIP

See that you are properly diversified for 2011. Diversifying your portfolio across different asset classes may provide more insulation against volatility and help you even out your returns.

MONTHLY RIDDLE

Add missing vowels to these three trios of letters to get the six-letter names of three different countries: PNM, MXC, KWT

Last month's riddle:

The English language has a noun with three consecutive double letters in it. The word is 10 letters long, and it describes a job involving math. What is this word?

Last month's answer:

Bookkeeper.

THE MONTH IN BRIEF

December lived up to its promise as one of the better months of the year for stocks, with the S&P 500 gaining 6.53%.¹ It was a strangely quiet time on Wall Street, and the biggest news item of the month was good news for investors. It didn't take long for President Obama and Congressional Republicans to reach a tax compromise, one with demonstrable benefits for all Americans. In December we learned that the jobless rate had increased; however, by the end of the month, initial claims were at a two-year low. Home sales improved, and so did retail sales. Optimism was back, or at least pessimism did not reign.

DOMESTIC ECONOMIC HEALTH

Two stories dominated the headlines in December: the bipartisan tax accord reached in Washington D.C., and the enthusiasm of shoppers at the malls.

There was no knock-down, drag-out fight on Capitol Hill when it came to resolving federal tax issues. On December 6, President Obama announced a compromise to extend the Bush-era tax cuts for all Americans (including the wealthiest) through 2012. Some of his fellow Democrats howled in protest. Nevertheless, the 2010 Tax Relief Act was signed into law on December 17 after overwhelming passage in the House and Senate. The new tax pact cut (employee) payroll taxes by 2% for 2011 and permitted businesses to expense 100% of their investments in 2011. It extended the college tuition tax credit and federal unemployment insurance; it restored the estate tax at 35% with a \$5 million individual exemption. In the estimate of the non-partisan Tax Policy Center, the deal improves the after-tax incomes of the wealthiest 20% of Americans by 5.7% and the poorest 20% of Americans by 3.7% (that is, compared to if the EGTRRA and JGTRRA cuts had lapsed).^{2,3}

All month, nightly news broadcasts spread the message that consumers were spending freely again. While these accounts were often anecdotal, the numbers on hand were encouraging. The Commerce Department reported a 0.8% gain in retail sales for November – the fifth straight monthly increase. Department store sales were up 2.8% in November, representing the biggest monthly gain in two years. Online sales improved 13.0% this past holiday season, according to Internet tracking firm comScore. At the car lots, J.D. Power & Associates said December auto sales were “significantly beating expectations” and forecast year-over-year sales volume to improve by 11.5% for 2010.^{4,5,6}

Other consumer signals flashed, hinting that things were looking up. Initial jobless claims fell to a low unseen since July 2008 during the week ending December 25. Consumer spending rose 0.4% and consumer incomes rose 0.3% in November while the federal government's Consumer Price Index ticked up but 0.1% (as did the core CPI).^{7,8,9}

There were plenty of other news items. The Labor Department informed us that unemployment had hit 9.8% in November. The Institute for Supply Management's manufacturing index improved in December to 57.0 from 56.6; its service sector index showed improvement for the month of November, going from 54.3 to 55.0. The Conference Board's index of leading economic indicators had risen 1.1% in November for its best month since March. The Reuters/University of Michigan consumer sentiment survey improved a bit to 74.6.^{10,11,12,13,14}

GLOBAL ECONOMIC HEALTH

Here's a news flash: Eurozone inflation leapt 2.2% in December, exceeding the European Central Bank's inflation target for the first time in two years. (Barclays

Capital analysts have forecast the EU inflation rate to reach 2.5% by February.) However, core EU inflation stayed close to 1% and unemployment in the EU's biggest economy – Germany – stayed near 7%. The Markit Eurozone Purchasing Manufacturers Index climbed to 57.1 in December, close to the 46-month high set last April.^{15,16}

China's official PMI dropped to 53.9 for December, while South Korea's key PMI reached that same mark. Taiwan's government revised its 2010 GDP estimate in December to 4.8%, much lower than the 10.0% it initially forecast for its export-rooted economy. India's PMI slipped a bit to 56.7 in December from 58.4 in November, but its November exports increased by 26.5%.^{17,18,19}

WORLD MARKETS

Assorted benchmarks logged some nice monthly gains. In Europe, Austria's ATX rose 11.4% last month; Ireland's ISEQ gained 8.8%, Russia's RTSI advanced 7.8% and Spain's IBEX rose 6.4%. The FTSE 100 gained 6.7% in December, while the CAC-40 rose 5.4% and the DAX moved north 3.4%. Turning to the Asia Pacific markets, we see the following December performances: Sensex, +5.1%; Australia All Ordinaries, +3.6%; Nikkei 225, +2.9%; Singapore STI, +1.4%; Hang Seng, +0.1%. Only three indices of consequence went south in December: the Shanghai Composite (-0.4%), the IPSA in Chile (-0.6%) and the Caracas Index in Venezuela (-1.2%).²⁰

The much-watched MSCI World and Emerging Markets Indexes also had healthy gains last month. In U.S. dollar terms, the World advanced 7.25% and the Emerging Markets rose 7.02%.²¹

COMMODITIES MARKETS

Gold cracked the \$1,400 ceiling in December, rising 2.61% to settle at \$1421.10 per ounce on December 31. Copper posted a 16.13% monthly gain, and silver kept climbing to reach a 30-year high (it gained 83.7% for the year). Crude oil pulled off an 8.64% December advance, with futures finishing 2010 at \$91.38 a barrel. The Thomson Reuters/Jefferies CRB index gained 10.0% in December, helped by huge annual gains for silver (see above), cotton (+92%), corn (+52%), and coffee hitting a 13-year peak. The U.S. Dollar Index sank 2.9% for the month.^{22,23,24,25}

REAL ESTATE

Had the market found a bottom? Was a rebound occurring? Or was a double-dip coming? Commenting on the October S&P/Case-Shiller home price index data, Standard & Poor's index committee chair David Blitzer said last month with regard to home prices that "[it] looks like a double-dip is pretty much on the way, if not already here." In the October edition, home prices dropped 1.3% and fell for the third straight month.²⁶

However, there were reasons for optimism. In November, existing home sales were up 5.6%, new home sales up 5.5% and housing starts up 3.9%. Pending home sales rose by 3.5% in November after a 10.4% leap in October.^{27,28,29}

Comparing and contrasting mortgage rates in the December 2 and December 30 surveys from Freddie Mac, we see home loans growing more expensive. Average interest rates for 30-year conventional home loans went from 4.46% to 4.86%. Average rates for 15-year FRMs rose from 3.81% to 4.20%. The rates on 5-year ARMs went from 3.49% to 3.77% and rates on 1-year ARMs barely moved, going from 3.25% to 3.26%.³⁰

LOOKING BACK...LOOKING FORWARD

The three major U.S. indices all gained at least 5% last month, and the Russell 2000 ended the year with a 7.79% December advance (it went +25.31% for 2010). Historically, December has often been a good month for stocks – since 1928, the Dow has gained more than 5% in the last month of the year on ten occasions. December 2010 went into the books as the best December for the Dow in seven

years.^{1,31}

% CHANGE	2010	1-MO CHG	1-YR CHG	10-YR AVG
DJIA	+11.02	+5.19	+11.02	+0.73
NASDAQ	+16.91	+6.19	+16.91	-0.74
S&P 500	+12.78	+6.53	+12.78	-0.47
REAL YIELD	12/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	1.00%	1.48%	2.06%	4.03%

Sources: cnbc.com, bigcharts.com, ustreas.gov, bls.gov - 12/31/10^{1,32,33,34}
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

Will optimism prevail this month on Wall Street? On the first day of trading in 2011, you had the S&P 500 closing at its highest level since September 3, 2008, the Dow to its highest mark since August 28, 2008 and the NASDAQ at its highest close since December 26, 2007. The December jobs report is shaping up to be the first big challenge to stocks this month; if it shows an improvement, it might convince more investors that the economy is moving in a positive direction. Some Wall Street analysts are looking at 2011 very positively: UBS Wealth Management thinks the S&P 500 will top 1,350 by the end of the year, and Citigroup thinks the index will reach 1,400. (Did you know that last month was the best December for the S&P 500 since 1991?)³⁵

UPCOMING ECONOMIC RELEASES: The schedule for the rest of the month is as follows: the December unemployment report (1/7), November wholesale inventories (1/11), the Federal Reserve's January Beige Book (1/12), the December PPI (1/13), the December CPI, December retail sales and industrial output, November business inventories and the initial January University of Michigan consumer sentiment survey (1/14), December housing starts and building permits (1/19), the Conference Board's December leading indicator index and December existing home sales (1/20), the November Case-Shiller home price index and the Conference Board's latest poll of consumer confidence (1/25), December new home sales and a Fed interest rate decision (1/26), December durable goods orders and November pending home sales (1/27), the final December University of Michigan consumer sentiment survey and the first estimate of 4Q 2010 GDP(1/28), and lastly December personal spending and personal income (1/31).

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