MONTHLY ECONOMIC UPDATE

MONTHLY QUOTE

"Most 'necessary evils' are far more evil than necessary."

– *Richard Branson*

MONTHLY TIP

Want a rainy day fund? Ask if your bank will allocate a fixed percentage of your direct deposit to a new savings account that you create. Most banks can arrange this.

MONTHLY RIDDLE

It is round and has a big mouth, but never speaks. It is most often in a cabinet. What is it?

Last month's riddle: What goes in the blank below: Bob is Ken's son. Therefore, Ken is the _______of Bob's father.

Last month's answer: Name.

January 2013

THE MONTH IN BRIEF

Our economy doesn't revolve around a single issue – but in December, it almost seemed as if it did. Households, businesses, economists, financiers, journalists and politicians all worried that America would fall off the "fiscal cliff" come January 2. Congress passed a partial fix at the very edge of the cliff – on New Year's Day. In the wake of the crisis, stocks showed remarkable resilience – the S&P 500 actually gained 0.71% in December.

Away from the cliff, the real estate market was improving, overseas stock markets were rallying seemingly *en masse,* and commodity futures were all over the place. Hopefully, consumer confidence would rebound in January.[1]

DOMESTIC ECONOMIC HEALTH

The small-scale fiscal cliff deal hammered out in the waning hours of 2012 hiked some taxes, extended some tax breaks and settled more than a few questions. It preserved the Bush-era tax cuts for all but the wealthiest taxpayers (the highest federal income tax bracket went from 35% to 39.6%), took the top estate tax rate to 40%, permanently patched the Alternative Minimum Tax, extended long-term unemployment benefits for another year and set dividend and long-term capital gains tax rates at 20%.[2]

Consumers more or less bit their nails last month waiting on a resolution. The Conference Board's consumer confidence index fell 6.4 points to 65.1 in December; economists expected a decline of 1.5 points. The University of Michigan's consumer sentiment survey hit 72.9, losing 9.8 points on the month. On the bright side, the jobless rate had dipped to 7.7% in November.[3,4]

Households were spending more money. Retail sales managed to rise 0.3% in November, and personal spending rose 0.4% in that month. Consumer prices declined 0.3% in November – their first retreat since May. Annualized consumer inflation was running at a mere 1.8%.[5,6,7]

The Federal Reserve announced it would buy $45 billion in longer-term Treasuries beginning in January, following the expiration of Operation Twist v. 2.0. It also made one of its most direct and clear policy statements in some time: it said interest rates would remain at rock-bottom levels "at least as long" as inflation is 2.5% or less and the jobless rate remains above 6.5%.[7,8]

The twin Institute for Supply Management purchasing manager indices showed some improvement. The November service sector PMI rose 0.5% to 54.7 while the manufacturing PMI came in at 50.7 in December, up 1.2% for the month and back in expansion territory. Total durable goods orders had increased 0.7% in November; wholesale inflation fell 0.8% in that month to an annual pace of 1.5%.[6,9,10,11]

GLOBAL ECONOMIC HEALTH

As 2013 began, German finance minister Wolfgang Schaeuble looked at the EU debt problem and proclaimed, "I think we have the worst behind us." However, the *Wall Street Journal* reminded its readers that the EU was living with a "perma crisis". The eurozone didn't fracture in 2012, European stocks realized big annual gains, and net foreign portfolio investment in Italy and Spain actually turned positive in December. Yet many analysts saw a bailout ahead for Spain (even as its 10-year bond yield fell to 5.23% at the end of last month), and Greece hadn't left the danger zone. German manufacturing contracted for a tenth straight month in December, Italian manufacturing for a seventeenth straight month.[12,13,14]

China was holding up nicely: its official manufacturing PMI came in at 50.6 for a second straight month, and HSBC's China PMI reached its highest level since May. India's Markit PMI had its best month since January 2012 in December, rising to a healthy 54.7. Factory activity increased in the PRC, Taiwan and South Korea last month as well.[14]

WORLD MARKETS

Virtually all benchmarks of consequence advanced last month. In Europe, the DAX rose 2.79% in December, the FTSE 100 0.53% and the CAC 40 2.36%. On our side of the pond, the TSX Composite gained 1.59%, the Bovespa 6.05% and Mexico's Bolsa 4.48%. The Nikkei 225 soared an eye-popping 10.05%; the Shanghai Composite topped that with a December gain of 14.60%. The Sensex rose 1.46%, the KOSPI 3.32%, the Hang Seng 2.84% and the All Ordinaries 3.17%. Four major overseas indices gained 20% or better in 2012 – the Sensex (31.20%), the DAX (29.06%), the Nikkei 225 (22.94%) and the Hang Seng (22.91%). The MSCI World Index went +1.75% in December to finish 2012 at +13.18%; the MSCI Emerging Markets Index rose 4.78% last month, leaving it at +15.15% for 2012.[1,15]

COMMODITIES MARKETS

Precious metals had a poor month but a solid year. Silver futures dipped 2.2% in December and gold futures plunged 9.2%; platinum fell 3.9% while palladium gained 2.2%. For the year, gold gained 7.0% on the COMEX, finishing 2012 at $1,675.80 an ounce; palladium rose 7.2%, silver 8.3% and platinum 9.8%. NYMEX crude gained $1.02 on December 31 to settle at $91.82 a barrel (it lost 7.1% in 2012, its poorest year since 2008; Brent crude gained 3.4% last year). Natural gas rose 12.1% on the year. Crop futures were up and down, leading to the following annual gains and losses as December ended: cocoa, +6.0%; coffee, -37.0%; corn, +7.3%; soybeans, +18.8%; sugar, -16.0%; wheat, +19.3%. The U.S. Dollar Index ended 2012 at 79.77, losing 0.47% for December.[16,17,18,19]

REAL ESTATE

New home sales rose 4.4% in November, the Census Bureau noted. The National Association of Realtors reported November gains of 5.9% in existing home sales (to a three-year peak) and 1.7% in pending home sales; residential resales were up 14.5% in the past 12 months. The October S&P/Case-Shiller Home Price Index recorded the index's best annual advance in existing home prices since the May 2010 edition (4.3%). Building permits rose 3.6% in November; housing starts fell 3.0%, but were up 21.6% year-over-year.[4,20,21]

Some key mortgage rates ticked up in December. Comparing Freddie Mac's November 29 and December 27 Primary Mortgage Market Surveys, the average interest rate on the 30-year FRM rose 0.03% to 3.35%. Average rates on 15-year FRMs went from 2.64% to 2.65% in that period; average rates on 5/1-year ARMs declined 0.02% to 2.70. Average rates on 1-year ARMs were unchanged at 2.56%.[22]

LOOKING BACK…LOOKING FORWARD

All that worry masked a good year for equities. The S&P 500 ended 2012 at 1,426.19, the Dow at 13,104.14 and the NASDAQ at 3,019.51.[1]

% CHANGE	2012	1-MO CHG	1-YR CHG	10-YR AVG
DJIA	+7.26	+0.60	+7.26	+5.71

NASDAQ	+15.91	+0.31	+15.91	+12.61
S&P 500	+13.41	+0.71	+13.41	+6.21
REAL YIELD	12/31 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	-0.67%	-0.07%	1.73%	3.10%

Sources: bloomberg.com, bigcharts.com, treasury.gov, treasurydirect.gov - 12/31/12[1,23,24,25,26]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

Wall Street was elated when Congress passed a partial fix for the fiscal cliff dilemma. Will the exuberance continue through the new quarter, even if the next earnings season disappoints and legislators resume skirmishing over spending cuts? There is a growing assumption that 2013 will turn out to be a strong year for the markets, maybe a year in which stocks face milder threats than in 2011 and 2012. The optimism on Wall Street is palpable: there seems to be a base level of confidence in the potential of the market that we haven't seen in a while, and hopefully headlines about Spain or spending cuts or America's creditworthiness won't erode it. The economy is still facing obstacles, but 2013 may be a year without debacles of the kind that have threatened to wipe out gains entirely or invite a new recession. Will the bull market continue to flourish this year? Optimism seems to be catching on, and perhaps it will influence market behavior significantly in the coming quarters.

UPCOMING ECONOMIC RELEASES: The rest of January unfolds like this: ISM's December non-manufacturing index, November factory orders and the December jobs report (1/4), November wholesale inventories (1/10), December retail sales, November business inventories and the December PPI (1/15), January's NAHB housing market index, a new Fed Beige Book and December's CPI and industrial output (1/16), December housing starts and building permits (1/17), the University of Michigan's preliminary consumer sentiment survey for January (1/18), December existing home sales (1/22), the November FHFA housing price index (1/23), the Conference Board's Leading Economic Indicators index for December (1/24), December new home sales (1/25), December durable goods orders and pending home sales (1/28), the Conference Board's first monthly consumer confidence survey of 2013 and the November Case-Shiller home price index (1/29), an FOMC policy statement and the initial estimate of Q4 GDP out of Washington (1/30), and the December consumer spending report (1/31). The University of Michigan's final consumer sentiment survey for January actually comes out on February 1, a day loaded with other crucial data (the January jobs report, the January ISM manufacturing index and January auto sales figures).

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We will contact them first and request their permission to add them to our list.

«RepresentativeDisclosure»

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