MARKET COMMENTARY

Let Me Check…Yep, Still Bad

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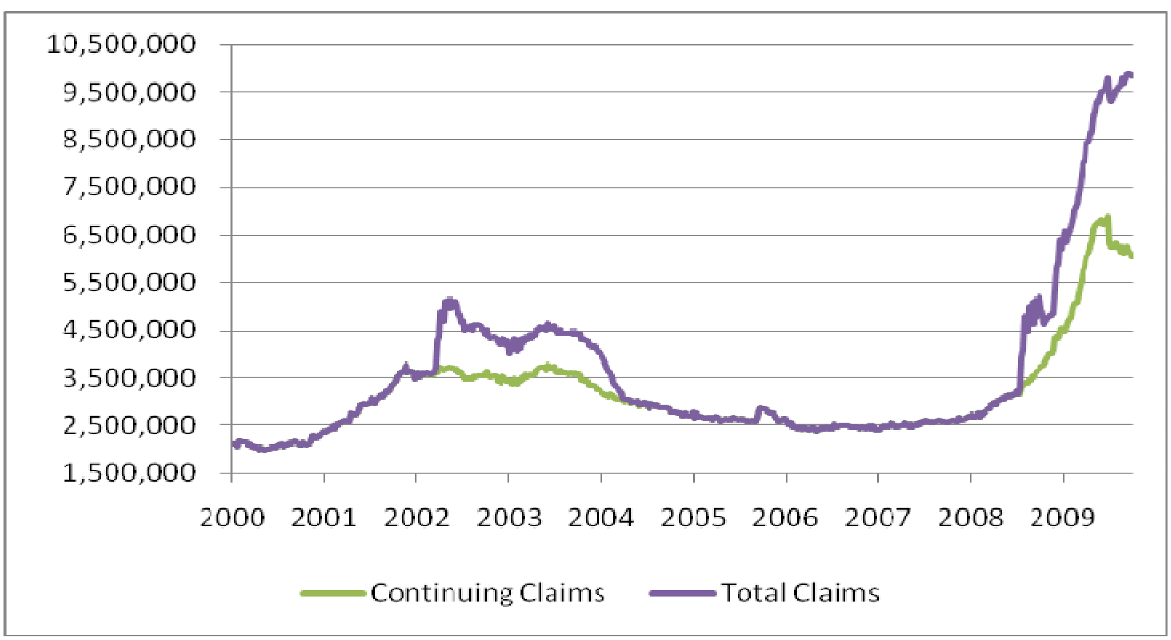
Risky asset markets continue to rally off the lows reached earlier this year. A bottoming housing market and a quickly reaccelerating manufacturing sector stoke hopes of a "V" shaped recovery in the economy. Toss in (so far) better than expected earnings in the stock market, and one has a nice mixture of fuel to propel markets higher. We have upped our allocation to equities over the last month, but still remain underweight. The pertinent question would be – why? The answer ultimately is – the consumer. The still-massive inventory overhang in the housing market looks to cap any potential surge in home prices. The debt burden of US consumers has shrunk recently, but it is still at a level of 100% debt/GDP and well above the level implied by historical trends. Finally, the job market is truly horrendous. As I wrote back in August (*Off the Radar*, 08/07/09), the official jobless claims data are distorting the true picture as workers who fall out of the continuing claims series are not doing so because they are finding work. Unfortunately they are merely exhausting their benefits and moving into the extended claims series. The chart below shows the large gap that has emerged between the continuing claims series and the total claims series. Of particular interest is the divergence of late, as the continuing claims series has declined but the total series has continued to increase. From its peak on June 27th, the continuing claims series has fallen by 864,000; however, the total claims series has increased by 35,000. The silver lining in this dark cloud is the fact that the continuing series has fallen, i.e., new claimants entering the pool has slowed considerably. This bodes well for a continuing moderation in job losses. But the bigger issue is that all those millions who have lost jobs are not finding any new ones. The percent of the work force with an unemployment duration of more than 26 weeks has reached record highs. Given the large uncertainties surrounding the economic outlook and with employers adept at squeezing every ounce of productivity from their labor pool, we do not see this dynamic changing anytime soon. With short-term stock valuations stretched, this situation leads us to our current strategic positioning of underweighting equities. We continue to offset this underweight by allocations to emerging market stocks and commodities, leveraging the growing economic power of the developing world and their debt-free consumers. We will continue to pick our spots on adding exposure to domestic equities, either when prices soften or the economic outlook becomes less cloudy.

Continuing and Total Unemployment Claims



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