



Weekly Economic Commentary

January 5, 2008



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ECONOMIC CALENDAR

Monday, Jan 5

Construction Spending
November

Domestic Car/Light
Vehicle Sales
December

Tuesday, Jan 6

Factory Orders
November

ISM NMI
December

Thursday, Jan 8

Initial Claims
wk 01/03

Chain Store Sales
December

Consumer Credit
November

Friday, Jan 9

Private Workweek
December

Average Hourly Earnings
December

MFG Payrolls
December

Unemployment Rate
December

Nonfarm Payrolls
December

Wholesale Inventories
November

Executive Summary:

Rocky End to 2008 Documented in the Economic Data

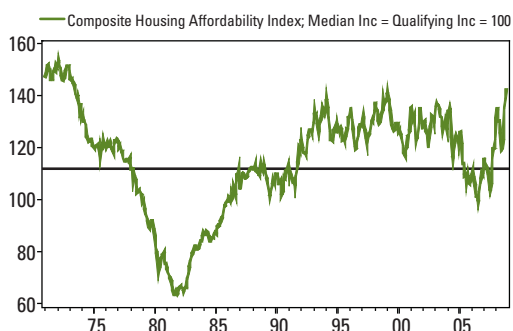
The best that can be said about the economic data for November and December released over the final two weeks of 2008 was that it was greeted, for the most part, by a shrug of indifference from financial market participants, who have pretty much written off the fourth quarter of 2008 as a lost cause at this point. In essence, financial markets have given the U.S. economy a “free pass” for Q4 2008. With the turn of the calendar to the new year however, markets will want to see some signs of improvement—or at least a slowing in the pace of decline—in the U.S. economy in January and in the first quarter of 2009.

Although markets largely looked the other way as the government’s number mills churned out economic data over the holidays, it is worth noting that on balance the data still suggest that the U.S. economy continued to decelerate to the downside in November and December. We are sticking with our previous forecast that the U.S. economy was headed for at least a 5.0% annualized decline in the just completed fourth quarter of 2008. The Q4 2008 gross domestic product (GDP) report is due out in late January 2009.

This week, financial markets will absorb another round of what is likely to be terrible economic data for December, including reports on vehicle sales, chain store sales, and the service sector economy. The most closely watched report will be the December jobs report, which is due out on Friday, January 9. The market is bracing for another abysmal reading on the labor market in December, and would welcome any signs that the job market improved—or even stabilized—between November and December.

Given its importance to the eventual recovery of the broad economy, the abysmal housing related data—the new and existing home sales data for November—was particularly disturbing. The data, which was released the week of December 22, revealed that both new and existing home sales fell again in November, as the housing market failed to respond to falling mortgage rates and depressed prices, which has led to a near record level of housing affordability. Indeed, it is clear that the faltering economy, and in particular the rapid deterioration in the labor market, far outweighed the positive impact on housing of falling mortgage rates. To be fair, the home sales data for November represented sales that closed in November, rather than contracts signed, so the huge drop in mortgage rates is not yet reflected in the home sales data. The U.S. economy must see some signs of stabilization in the housing market before the broader economy can begin to recover.

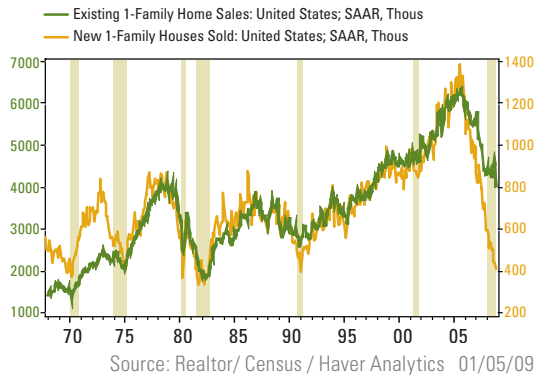
1 Despite Near Record Levels of Housing Affordability...



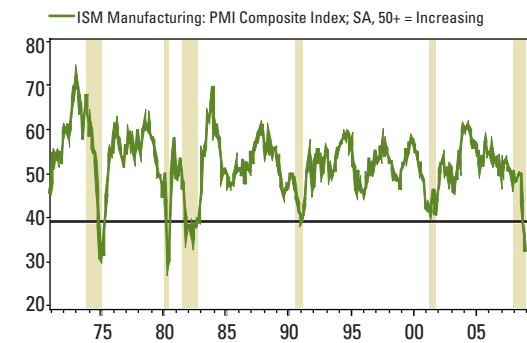
Source: National Association of Realtors / Haver Analytics 01/05/09



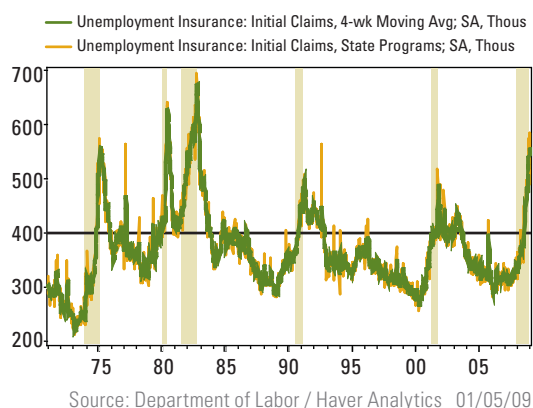
2 ... New and Existing Home Sales Plunged in November



3 The U.S. Manufacturing Sector Accelerated to the Downside in Q4



4 Jobless Claims Remain Near 26 Year Highs, and Will Move Higher as Auto Plants Shut Down



The reports on the U.S. manufacturing sector released over the past two weeks paint a dire picture of the business capital spending environment as the fourth quarter drew to a close. While the durable good orders report for November—a good proxy for future business spending—came in above sharply lowered expectations, the data nevertheless suggest that business spending fell sharply in Q4, and continued to decelerate to the downside in November. The other reports on manufacturing released over the past two weeks were the Chicago Area Purchasing Managers Index for December and the Institute of Supply Management's report on manufacturing for December. While the Chicago area report came in better than lowered expectations and above November's dismal reading—suggesting a pause in the decline in the manufacturing sector in December, the national ISM report was both below expectations and below November's tally. In fact, the ISM in December fell to its lowest level since May of 1980, suggesting that the nation's manufacturing sector continued to contract at a rapid pace in December.

There were two reports on weekly jobless claims released over the final two weeks of December, with one coming in well above expectations (i.e., more jobless claims than expected) and the other suggesting that the labor market improved dramatically in the final week of December, as jobless claims plunged to their lowest level in two months. The truth probably lies somewhere in-between, but we point out that the U.S. Department of Labor typically has a very difficult time seasonally adjusting the weekly jobless claims data around the year end period. Thus, we probably need to wait until at least mid January to get an accurate reading on claims. However, the planned month-long shutdown of 59 auto plants in the United States will almost certainly push claims over 600,000 for a few weeks in January and February.

Looking out over this week, the market will digest several key reports on the health of the economy in December.

- Early in the week, it's the vehicle sales data for December, which should be brutally bad, especially given the circus atmosphere surrounding the fate of government loan packages for two of the three Big Three automakers that dominated the headlines most of the month of December. A possible wild card here was the news which came very late in the month that GMAC got access to funds from the U.S. government's Troubled Asset Relief Program.
- The monthly chain store sales data for December, which will provide some clarity on just how bad the Christmas selling season was for retailers against the backdrop of what is shaping up to be the worst recession since the Great Depression.
- The market will also get another weekly reading on jobless claims, but the aforementioned difficulty in seasonally adjusting this data around the turn of the year, in addition to the unprecedented extended plant shutdowns among the nation's automakers, will continue to make the weekly claims data difficult to interpret.



- Finally, the most closely watched report this week will be the December employment report, which is due out on Friday, January 9. The market is looking for a 0.3% increase in the unemployment rate to 7.0% in December, and a decrease of 500,000 in the nonfarm payroll job count in the month, on the heels of the 533,000 decline in jobs in November. The market's reaction to the December jobs report will be key to gauging just how much of a "free pass" markets gave the U.S. economy in Q4. Any sign of improvement, or even a stabilization in the labor market, would be welcome news for the economy and financial markets, but our best guess is that any improvement in the labor market is probably months away.

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