



MEMO

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To: WFR Clients and Friends
Subject: Third Quarter 2009 Economic Trends

The quarter in brief. The third quarter of 2009 was spectacular for stocks, and it may have included the end of what history will apparently remember as the Great Recession. The S&P 500 gained 14.98% in 3Q 2009 after a 15.22% gain in the second quarter. The Dow just had its best quarter since 4Q 1998.^{1,2} Federal rebates and credits help to stimulate home and auto sales. The data stream from the housing sector was mostly positive. President Obama's vision of health care reform met with great public and Congressional contention. Watching the nightly news, the average American may have assumed we were still in the midst of the recession; economists, however, saw increasing signals that it was done.

% Change	3Q 2009	2Q 2009	Y-T-D
DJIA	+14.98	+11.01	+10.66
NASDAQ	+15.66	+20.05	+34.58
S&P 500	+14.98	+15.22	+17.03
10Yr TIPS Yd	-12.36	+24.48	-31.89

Source: CNBC.com, ustreas.gov, 9/30/09)^{1,2,11} Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

Domestic economic health. As the quarter drew to a close, evidence hinted that the economy was growing. The Institute for Supply Management's September service-sector index came in at 50.9 for September – that's right, expansion. (It had contracted in every month since October 2008.) The ISM's manufacturing index was above 52 in both August and September, another growth signal.³ Consumer spending increased in August by 1.3% after a 0.3% gain in July (credit some of that to the federal government's C.A.R.S. program, which the Transportation Department estimated led to 690,114 new auto sales).^{4,5} In fact, retail sales jumped 2.7% in August (+1.1% excluding autos) after going -0.2% for July.⁶ As for inflation, the big news was negative news – in September, we learned consumer prices had dropped 1.5% from August 2008 to August 2009. (However, core CPI advanced 1.4% during that stretch.)⁷

The Conference Board's index of leading economic indicators (signals that are supposed to hint at the state of the economy 6-9 months ahead) rose 0.6% in August, and that was the fifth straight monthly increase.⁸ The Federal Reserve's September Beige Book found that 11 of 12 Fed banks reported regional economies stabilizing or growing.⁹ The Fed held interest rates steady during the quarter, as expected. The jobless rate was 9.4% in July, 9.7% in August, and 9.8% in September.¹⁰

Major indexes. Don't you wish stocks behaved like this in every quarter? The Dow and S&P 500 posted coincidental 14.98% quarterly gains and the NASDAQ beat them both. The DJIA, S&P 500, NASDAQ and Russell 2000 all gained for the second consecutive quarter, and that hadn't happened in two years.²

Global economic health. In the Eurozone, the benchmark PMI was climbing, heading north to 48.2 in August and 49.3 in September – edging toward expansion after 16 months of contraction. Industrial output increased for the second consecutive month in September, as business inventories decreased for the second month. The EU administered a stress test to 22 major banks; all got the all clear. The EU jobless rate was 9.6% in August, .1% below the U.S. rate.^{12,13,14} The International Monetary Fund upped its growth forecast for China and India during the quarter, predicting 2009 growth of 7.5% and 5.4% for those economies. It also raised its 2010 forecast for those nations, foreseeing growth of 9.0% in China and 6.4% for India. Data showed that the economies of Singapore and China respectively grew 20.7% and 7.9% in 2Q 2009. The economies of Brazil and Japan had started growing again – GDP was +0.6% for 2Q 2009 in Brazil, and it was +1.9% for 2Q 2009 in Brazil.^{15,16,17,18}

World financial markets. Look at these gains. Germany's DAX gained 18.02% in 2Q 2009, its second straight 18% quarterly rise. The DJ Stoxx 600 rose 17.80% in the quarter. The FTSE 100 advanced 20.82%. France's CAC 40 soared 20.86%.¹⁹

Japan's Nikkei 225 managed the smallest gain among major indexes, affected by uncertainty linked to that nation's elections; the Nikkei gained just 1.8% in the quarter. There was one index that posted a notable 3Q loss – the Shanghai Composite, which fell 6.1%. Why? Lending slowed down this summer in China. Among emerging markets, Russia's RTS was up 27%, and Brazil's Bovespa up 20%. Turkey's ISE soared 30% and the Sensex gained 18% in India.²⁰

In 3Q 2009, the MSCI World Index rose by 17%. The MSCI Emerging Markets Index climbed 8.9% for September and 20% for the quarter.^{21,22}

Commodities markets. Oil prices - which had risen more than 40% during the second quarter – only increased by 1.03% in 3Q 2009. They settled at \$70.61 per barrel at quarter's end. Natural gas futures gained 62.61% in September alone, resulting in a 26.23% quarterly gain.²³

Gold, copper and silver all had another strong quarter. Gold was up +8.73% across 3Q 2009, settling at \$1,008.00 per ounce at the quarter's close. Prices rose \$80.90 for the quarter; they rose \$56.30 during September and \$14.90 on September 30. Copper futures gained 24% in the quarter. Silver prices rose 22%, the best quarter for that precious metal since 1Q 2006. As for the dollar, it suffered, sliding 4.14% versus the euro and 6.80% versus the yen in 3Q 2009.^{23,24,25,26}

In crops, the most notable news concerned sugar prices, which gained 43% in 3Q 2009 as a consequence of diminishing output in Brazil and India. The Dow Jones-UBS Commodity Index pulled off a 4% gain last quarter, which put it up 9% for 2009.²⁴

Housing & interest rates. What were the home sales numbers in this quarter? Existing home sales increased for the fourth straight month in July (a fantastic +7.2%) but then fell 2.7% in August. (About 30% of the purchases in July were made by first-time buyers, leaving some analysts to wonder what would happen in fall when the federal first-time homebuyer credit expired.)²⁷ New home sales rose by an underwhelming 0.7% in August after a revised 6.5% jump north in July.²⁸ However, pending home sales were up all quarter – in fact, when the August data (+6.4%) came out, they had increased for seven straight months to a level unseen since March 2007. Residential construction spending rose 0.8% for August to its highest level since August 1993.²⁹

Mortgage rates went even lower. The September 24 Freddie Mac nationwide survey had the average interest rate on a 30-year FRM at 5.04% (and rates would subsequently fall below 5% in early October). Compare that to 5.42% on June 25. The downward trend was evident for other home loan types: in the same time frame, average rates on 1-year ARMs decreased from 4.93% to 4.52%. Averages on 5-year ARMs fell from 4.99% to 4.51%. Rates on 15-year FRMs were averaging 4.87% on June 25, and just 4.46% on September 24.³⁰

Fourth quarter outlook. At the end of the second quarter, a key question was whether the consumer and the business owner would start spending again and back up the rally on Wall Street. At the end of the third quarter, that question still lingers. Some analysts see a shallow U-shaped recovery ahead, others see a W. Ten percent of the country is unemployed, and then you have the underemployed; foreclosure rates have stabilized but are still high. However, the indicators of oncoming growth or at least stability seem to outnumber the negatives lately. While another amazing quarter for stocks might be too much to hope for, we have seen the market do amazing things in its recent history – so let's hope that the quarter ahead will prove nicely positive and add to Wall Street's huge 2009 rebound.

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Citations.

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