

Weekly Economic Commentary



February 6, 2012

Job Creation on Track to Sustain Economic Growth

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Highlights

January's employment report, one of the best in many years, found that the private sector added 257,000 jobs and the unemployment rate dropped to 8.3%.

Jobs are being created in virtually every segment of the economy, except the government sector.

If private sector job growth continues, we could see two million jobs created between April 2011 and March 2012.

Economic Calendar

Tuesday, February 7

Consumer Credit
Dec

JOLTs Data
Dec

Thursday, February 9

Initial Claims
wk 2/4

Wholesale Inventories
Dec

Friday, February 10

Trade Balance
Dec

U of M Consumer
Sentiment
Feb

Treasury Statement
Jan

The week after the release of the monthly employment report is typically quiet for economic data and events in the United States, and this week (February 6–10) is no exception. There are few, if any, potentially market-moving economic events in the United States this week, and with the fourth quarter corporate earnings season winding down, market participants are likely to be focused on monetary and fiscal policy at home and abroad, along with Chinese economic data for January. In addition, this week's quiet domestic economic calendar will allow market participants to continue to mull over the January employment report in the United States, which was released on Friday, February 3. On balance, the report was one of the best readings on the United States labor market in years.

Private Sector Jobs Climb, Unemployment Rate Falls

The January employment report was one of the most robust employment reports in many years. The report found that the private sector economy added 257,000 jobs in January (versus expectations of a gain of just 160,000 jobs) and that the unemployment rate dipped another 0.2 percentage points to 8.3%. This result was much better than expected. Far from fluky, the January employment report was solid in nearly every respect, but more importantly, confirms other data on the economy in recently weeks that suggests the pace of the healing in the labor market has been accelerating.

Over the course of 2011 in the *Weekly Economic Commentary*, we wrote about "the next two million jobs," after the United States economy had created two million jobs between early 2010 and April 2011 — after shedding nearly nine million jobs in and immediately after the Great Recession (December 2007–June 2009).

In July 2011, we laid out our base, bull, and bear case scenarios for how quickly the economy would create the next two million jobs. Our base case was that the economy would create "the next two million jobs" by early 2012. The release last week of the United States government's labor market report for January 2012 provided a good opportunity for us to revisit our forecast. But first, a few housekeeping issues about the employment report, which is subject to a number of revisions that impact the labor market data each year at this time.



Breaking Down the Revisions in January's Employment Report

Every January, the Bureau of Labor Statistics (BLS) within the United States Department of Labor—the government agency that has been compiling the monthly jobs report for more than six decades—releases revised data on the number of workers on businesses' payrolls and on the unemployment rate. The January report also incorporates new seasonal factors that slightly changed the month-to-month pattern of job gains and losses over the past several years. The net result of the benchmark revisions and the new seasonal factors was that the economy created 162,000 more jobs than previously thought between March and December 2011.

This upward revision is not unusual, as the revision usually matches to the direction of the overall data. That is when the economy is weakening, and jobs are being lost, the annual benchmark revision to jobs is typically downward. On the other hand, when the economy is improving, and the economy is generally adding jobs, the benchmark revisions to the data usually add more jobs. The upward revision to the jobs data based on the new information was the first since 2006, a year in which the economy created a significant number of jobs.

Economy Continues to Track Our Base Case for the "Next Two Million Jobs"

A continuation of this pace of private sector job growth would see the economy recoup all the private sector jobs lost during the Great Recession in two years, by January 2014.

According to the revised data, the private economy created the first two million jobs in this recovery between March 2010 and March 2011. Since then the private sector economy has created an additional 1.7 million jobs, and continues to track our base case for the "next two million jobs" as first detailed in our July 5, 2011 *Weekly Economic Commentary*. As we noted in that commentary, which was updated on October 10, 2011, how quickly the economy created the next two million jobs would help to determine the health and sustainability of the recovery.

At our last update on the "next two million jobs" topic in October 2011, job creation had stalled amid the growth scare surrounding the global supply chain disruptions resulting from the Japanese earthquake and tsunami in March 2011, the uncertainty surrounding the European fiscal situation throughout the spring, summer and fall of 2011, and the debate in the United States about the debt ceiling and near-term tax and spending outlook in the summer and early fall of 2011. At that time, job creation was tracking at or below our bear case for the "next two million jobs" as first outlined in July 2011. However, since the summer hiring lull (the economy created just 52,000 private sector jobs in August) the economy's job creation engine has revved back up. On average, the economy has created under 220,000 private sector jobs per month since the beginning of September 2011, as some of the economic uncertainty surrounding the issues noted above retreated.

If sustained in the next several months, the economy will achieve our base case scenario of creating "the next two million jobs" by early 2012, by creating two million jobs between April 2011 and March 2012. As noted



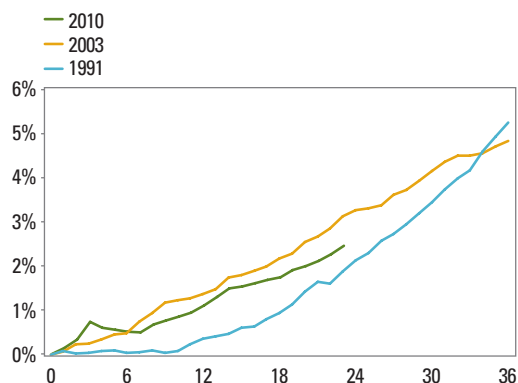
Various Outcomes for Job Creation

	Jobs Created Per Month	Date By Which Next Two Million Jobs Are Created	Months To Create "The Next Two Million Jobs"	How Many More Years To Recoup All Jobs Lost in Great Recession	Date By Which All Jobs Lost During Recession Would Be Recouped	Economic Outlook Under This Scenario	Fed Outlook Under This Scenario
Base Case	225,000	Early 2012	8–10	2.5	End of 2013	Modest GDP Growth Near 3.0%	On hold until mid-2012
Bull Case	325,000	Year End 2011	6	1.75	Early 2013	Robust GDP Growth Near 4.0%	Stimulus starts to be removed in late 2011
Bear Case	125,000	Late 2012	16	4.25	Late 2015	Very Sluggish GDP growth below 2.0%	More stimulus from the Fed

Source: LPL Financial Research 07/05/2011

The economic forecast set forth may not develop as predicted and there can be no guarantee that the strategies promoted will be successful.

1 Job Recovery Since Low in 2010 in Line With Past Recoveries



Source: LPL Financial, Bloomberg Data 02/06/2012

in the above table, a continuation of this pace of private sector job growth would see the economy recoup all the private sector jobs lost during the Great Recession in two years, by January 2014. This type of job growth would likely be accompanied by economic growth at or slightly above our GDP forecast for 2012 of 2.0% growth. This pace of job growth would likely still keep the Fed on hold until the end of 2014/early 2015.

As noted in [Chart 1](#), the pace of job creation since early 2010 (when the economy began to regularly create jobs again) is right in line with job creation seen at similar points in the recoveries from the 1990–91 and 2001 recessions. Although not shown on the chart, this pace of job creation pales in comparison to the 5 million and 7 million jobs created at similar points in the robust economic recoveries of the mid-1970s and early-1980s, respectively.

What Was Once Up Is Now Down

Growth areas include private education & healthcare, and leisure & hospitality

For perspective, of the 3.7 million private sector jobs created since early 2010, 400,000 have come in manufacturing, more than 150,000 in mining and just 43,000 in construction, a segment of the economy that was a leading job generator in the mid-2000s housing boom. In all, 600,000 jobs have been added in the goods producing sector of the economy since March 2010.

3.1 million service sector jobs have been created since March 2010. More than 1 million have been created in professional and business services (legal, accounting, bookkeeping, consulting etc.), more than 700,000 in private education and healthcare, nearly 600,000 in leisure and hospitality, 350,000 in retail trade, 140,000 in wholesale trade, nearly 200,000 in transportation and warehousing. On the other hand, financial jobs, which surged during the mid-2000s, have increased by just 43,000 in the past two years. Over the past two years, governments have shed almost 500,000 jobs, the vast majority of those coming in the state and local government sector.



Thus, at around 220,000 private sector jobs per month, the economy continues to track toward modest job gains, a modestly declining unemployment rate, a slightly below average rate of GDP growth, and a Fed that is poised to provide the economy more stimulus. However, if the pace of job growth accelerates to over 300,000 per month on a sustained basis, the Fed would likely hold off on any more moves to ease monetary policy. Alternatively, if job growth slows back to the 100,000 or so per month rate since during the spring and summer of 2011, the Fed would likely need to remove easy monetary policy measures more quickly than the market now expects. ■

LPL Financial Research 2012 Forecasts

- GDP 2%*
- Federal Funds Rate 0%^
- Private Payrolls +200K/mo.†

Please see our *2012 Outlook* for more details on LPL Financial Research forecasts.

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* Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

^ Federal Funds Rate is the interest rate at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis.

† Private Sector – the total nonfarm payroll accounts for approximately 80% of the workers who produce the entire gross domestic product of the United States. The nonfarm payroll statistic is reported monthly, on the first Friday of the month, and is used to assist government policy makers and economists determine the current state of the economy and predict future levels of economic activity. It doesn't include:

- general government employees
- private household employees
- employees of nonprofit organizations that provide assistance to individuals
- farm employees

The unemployment rate is the percentage of the total labor force that is unemployed but actively seeking employment and willing to work.

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Weekly Market Commentary



February 6, 2012

The Budget Bombshell

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Highlights

In one week, President Obama is due to submit his budget. The 2013 budget is already going to have the biggest impact since the end of WWII, even if no action is taken in Washington.

The fiscal headwind under current policy totals over \$500 billion, or 3.5% of GDP. The United States has never experienced a deficit cut by more than 2% of GDP that did not end in a sharp decline in GDP.

The risk that a budget deal to mitigate this potential impact does not happen should keep markets from moving steadily higher in 2012, as they have done year-to-date, without a reality check.

In one week, President Obama is due to submit his 2013 budget, which covers the fiscal year beginning on October 1, 2012. The Congressional Budget Act of 1974 requires the President to submit a budget request to Congress on the first Monday in February, but the Administration has scheduled the release instead for one week later on February 13. In addition, Congress must pass a budget resolution by April 15 of every year. However, the President missed the deadline last year and while the House passed a budget resolution last year, the Senate did not. This year is likely to be no different, with no budget being passed. But this does not mean the 2013 budget does not have potentially market moving consequences.

The 2013 budget is already going to have the biggest impact of any budget in decades even if no action is taken in Washington. The fiscal headwind comprised of both tax increases and spending cuts under current policy totals over \$500 billion, or 3.5% of GDP.

2013 Fiscal Headwinds (in \$ billions)

Expiration of Bush tax cuts for middle income earners	205
Expiration of Bush tax cuts for high earners	50
Payroll tax cut for workers	112
Debt ceiling annual spending sequester for defense	55
Debt ceiling annual spending sequester for non-defense	55
Alternative minimum tax annual "patch"	38
Medicare tax of 3.8% on investment income from 2009 Obama health care plan	21
Total	536
Total as % of estimated 2013 GDP	3.5

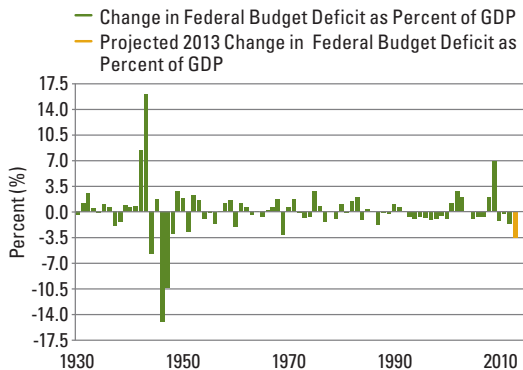
Source: LPL Financial, Congressional Budget Office, Office of Management and Budget 02/06/12

The 2013 budget changes, primarily consisting of tax increases, are already in the law and would need to be changed to mitigate or restructure them to be less of an economic drag; if not a return to recession may be looming in 2013.

While the United States economy is not likely to see the big declines in government spending that came after WWI and WWII, the United States has never experienced a deficit cut by more than 2% of GDP that did not end in a sharp decline in GDP. The last time the budget deficit was cut by a similar amount to the 3.5% on tap for 2013, it was 1969. In 1969, the deficit narrowed by 3.1% during the year, and GDP ended up shrinking -1.9% in the



1 Budget Change on Tap for 2013 Largest Since End of WWII



Source: LPL Financial, U.S. Census Bureau, U.S. Treasury 02/06/12

fourth quarter (and by -0.6% in the following quarter) as the U.S. entered a recession. Despite the recession, the efforts to narrow the deficit in 1969 had one pleasant outcome: they balanced the budget. Unfortunately, the budget changes on tap for 2013 will still leave the federal budget far from balanced.

The further apart the parties in Washington appear to be, even on extending the unemployment and payroll tax cuts that expire this month, may make investors increasingly nervous. This may result in the return of market volatility in February after stocks got off to a strong start to the year.

While the President's budget is unlikely to get much attention in Congress, the markets may begin to price in a major budget deal taking place in early 2013 for several reasons:

- the economic impact of the many scheduled tax increases and spending cuts,
- the debt ceiling will be hit again in early 2013 and require legislative action to approve an increase,
- the rating agencies have warned that they will be watching in 2013 for the United States to take actions to return to a path of fiscal sustainability, and
- the President and a newly elected Congress will have maximum political capital to make it happen in early 2013.

But the risk that a budget deal does not eventually happen should keep markets from moving steadily higher in 2012, as they have done year-to-date, without a reality check. With Congress now back in session and the President's budget due on February 13, just a week away, the markets may begin to refocus on the risks to the economy posed by inaction in Washington leading to a return of volatility. ■

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