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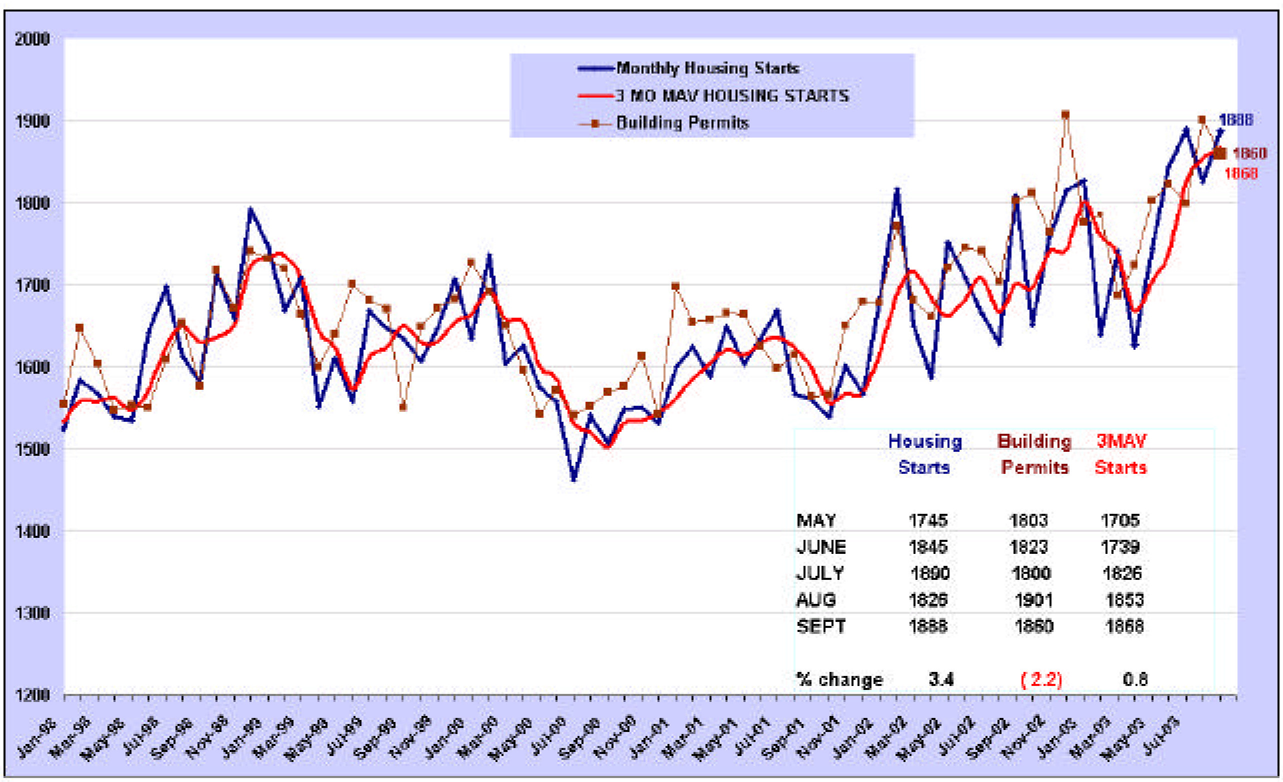
Data Review: Look Ma, No Hands

The recent run of data is painting an improving picture of the economy, one that gives optimists heart that the "turn" has finally begun. With all the focus on Jobs Jobs Jobs, pessimists will wait for hard evidence that hiring levels are really rising and that some of the lost millions are going back on the payroll. It has been our view that the tension point was the clear boost to consumer spending provided by the tax cuts as against the very low rate of job creation. In point of fact, the recent study by the BLS clearly indicates that what kills the employment data are the absence of new jobs, not the layoff pattern that is characteristic of nearly all recessions. We have always felt that the consumer would 'hang tough.' Ultimately, the real pessimists---none other that the managers of Corporate America who were battered by falling corporate profits, dwindling personal stock portfolios, enough 'bad apples' in the corporate governance world to make a very sour barrel of apple sauce, and the "China Syndrome"---would come around. They too would begin to spend and even commercial bank loans would begin to rise. The data run this week provides a very interesting look at optimism and pessimism.

Housing Starts

During the summer as the 10-year bond began to rise and mortgage rates came off the bottom, the pessimists started to warn that the so-called Housing Bubble was going to pop. In fact, the Bubble did not get much larger, but more importantly, if it is a Bubble, it is deflating in a very orderly manner. It may turn out that the



high point was July and that the very solid months of August and September are the calm before the storm, but the economy has gotten a lot of 'extension' from continued strength in Housing, well after its predicted demise.

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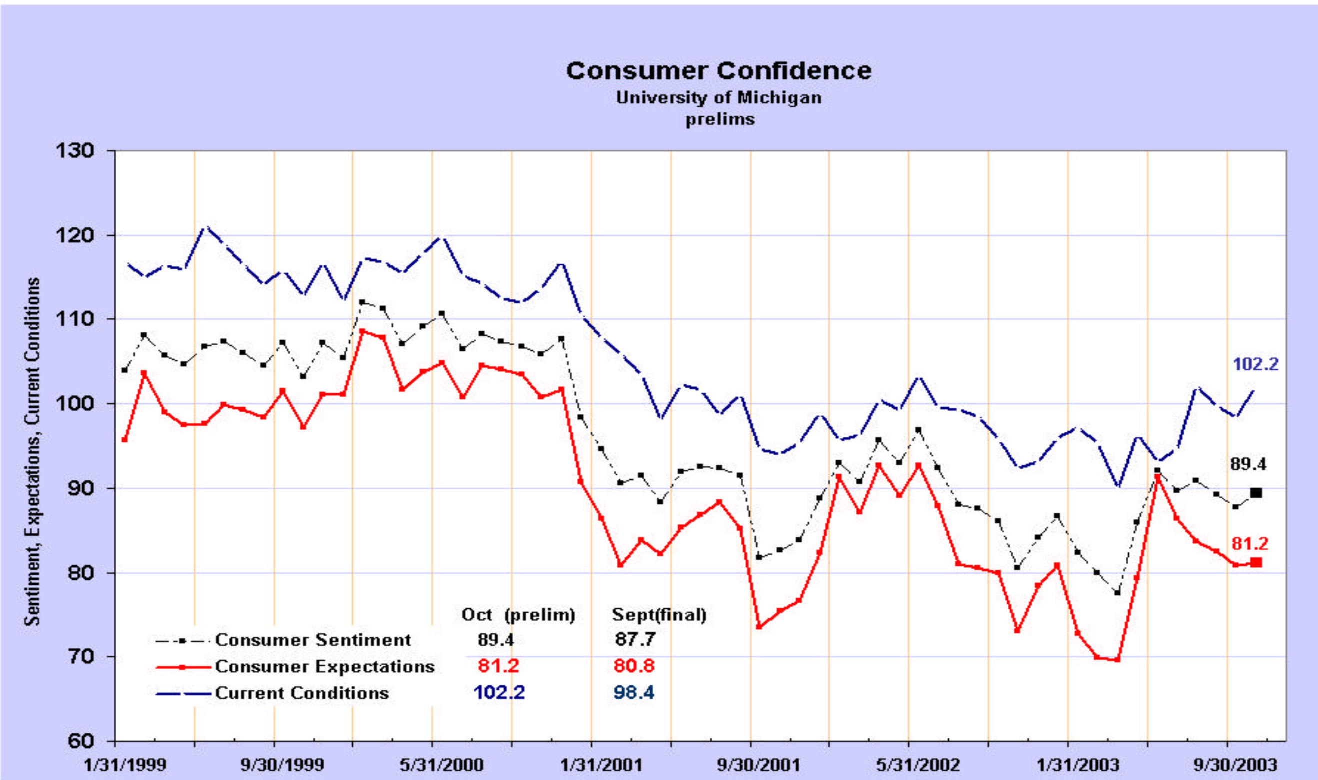
Even building permits, said to be a good prognosticator for future starts, while down 2.2 percent this month, are not collapsing. They are down, but off a record high at 1,901,000 in August. Those are pretty robust numbers if consumers are so stretched that a new house is beyond reach! Maybe the builders are too optimistic but there has been no heavy buildup of inventory of unsold homes. Furthermore, even the non-economist has to ask a question about consumer expectations if unsold homes are not piling up in the face of these robust housing data. How fearful could the consumer be if she is still buying the most important asset in her portfolio. Maybe the consumer is a more realistic economic woman than we commonly think?



Consumer expectations are not reliable guides to purchasing---certainly not on a month-to-month basis—but a certain consistency seems to be emerging. The Initial Claims data suggest that the worst periods in the labor market are over and the Confidence data above give some support to that view. All three measures turned upward in the October preliminary numbers reported today from the University of Michigan Survey, albeit a modest turn in the Expectations number could be a thin reed. Current conditions clearly improved over last month.

The PhilFed Business Survey A quick scan of the PhilFed Business survey has to have heartened many hearts---particularly those that have long doubted that this recovery is an accomplished process. Note, our stress on the "process," not that a clear margin of safety has been achieved. Recoveries, like declines, are a series of unfolding events during which business cycle indicators presage and/o record data as colored dots allowing us to see a monumental landscape more clearly. No one dot makes or breaks a picture, despite what some seers like to tell us. But the pattern that emerges does give us some indication of where along the cycle path the economy lies at the particular moment of the snapshot.

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The Phil Fed Business Survey is an attitudinal picture of what businessmen are thinking along a number of vectors of the economy. The overall index, a summary figure, is frequently less informative than the details Here's the list of the Current Indicators. We will fill in some of the other dots that form the 6-month expectations horizon shortly.

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PHILLY FED BUS OUTLOOK INDEX Page 1/1

Source: Philadelphia Federal Reserve		Current Value	Current Date	Previous Value	Previous Date (09/30/03)	Pct Chng
1) PHILLY FED INDEX GNRL ACTIV	OUTFGAF	28.00	10/03	14.60	09/03	91.78
2) PHILLY FED INDEX NEW ORDERS	OUTFNOF	29.00	10/03	19.30	09/03	50.26
3) PHILLY FED INDEX SHIPMENTS	OUTFSHF	28.80	10/03	13.20	09/03	118.18
4) PHILLY FED INDEX UNFILLED	OUTFUOF	7.70	10/03	6.50	09/03	18.46
5) PHILLY FED INDEX DELIV TIME	OUTFDTF	2.30	10/03	-2.10	09/03	209.52
6) PHILLY FED INDEX INVENTORY	OUTFIVF	-2.50	10/03	2.80	09/03	-189.29
7) PHILLY FED INDEX PRICES PD.	OUTFPPF	22.30	10/03	22.50	09/03	-.89
8) PHILLY FED INDEX PRICES RC.	OUTFPRF	5.40	10/03	4.80	09/03	12.50
9) PHILLY FED INDEX # OF EMPLY	OUTFNEF	5.50	10/03	-4.70	09/03	217.02
10) PHILLY FED INDEX AVG WRK WK	OUTFAWF	13.50	10/03	3.50	09/03	285.71

The general activity number lifted sharply from 14.60 to 28, while new orders, shipments, employment and the average work week also moved positively. A look at the forward data does reveal some interesting tidbits.

New Orders and Shipments are expected to slow their rate of increase and Unfilled Orders are surveyed to decline six-months out. Price paid seemed to be lowered while Price Received were higher (could profit margins be getting better?). On the Employment side, the current readings show an improvement as do the forward figures. What instrument best characterizes the Philly data, a Bugle or a Drum? We just look at the emerging picture as being comforting, and it doesn't hurt that the general level of stock prices appears to be rising. Maybe the last shoe in this disturbance will start to drop…with a significant thud---the generalized pessimism of the Business Community that profit margins are depressed and volume is not growing sufficiently fast to justify some serious business investment?

It is not like having to wait for Godot. This recovery is arriving. Look, Ma! No Hands…and it works as long as the biker pedals faster.

There's more of a story to tell, to be sure. What is the character of the economy's growth in 2004? Monetary policy is still very accommodative, arguably creating an exit problem for the Fed. Fiscal policy continues to be expansionary. The dollar is weaker internationally, giving some help to battered exports. Each of these is a positive force. There are negatives as well, such as oil prices, further stories of corporate misgovernance and the agony of Iraq. On balance, less in the way of headwinds, possibly some economic optimism for a change.

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The equity market may have indeed given the right signal when the rally began in March…and the six-month lead is perhaps more than coincidence. For investors, the issue is whether to sell the good news. That depends on 2004. QIV is thought now to be coming in lower than the supposed Whopper of QIII. A breather before a further spurt in 2004? The job now is to read the data that will emerge next year.

It is said that the Bond Market gets it before the Equity Market. If so, there is going to be more steepening as long as the Fed keeps the 1% Fed Funds stake firmly anchored in the grounds of a "considerable period." That is where our focus has now turned. How does the Fed Exit the party it has created?