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JVB FINANCIAL

Weekly Commentary

by Bill Sullivan, JVB Chief Economist

ABOUT BILL SULLIVAN

William V. Sullivan, Jr. serves as Chief Economist at JVB Financial Group, working closely with the firm's trading desk, providing analysis and commentary on the U.S. economy and the financial markets. Among his duties are authoring a weekly report on credit market trends and maintaining a regular schedule of conference calls that focus on interest rate developments. He appears frequently on Bloomberg TV and is often quoted in Barron's.

Mr. Sullivan is the familiar voice that JVB features on our weekly conference call, where he discusses the economy and the events that affect the marketplace.

He was previously associated with Morgan Stanley in New York City for more than twenty years, where he was an Executive Director and a Senior Economist in the firm's Retail Fixed Income Division. Bill published a widely quoted weekly letter on the financial markets and was a frequent guest commentator on several business networks, including Bloomberg TV, CNBC, and Fox News.

Mr. Sullivan received his Bachelor of Arts Degree in Economics from Fairfield University.

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Blue Christmas?

The holidays begin in less than three months and it is quite apparent that the odds favor a disappointing season for most retail merchants. Indeed, weighing against a strong performance is the sharp erosion in the employment situation since last year. In addition, several Government programs are beginning to expire or lose their impact as 2009 comes to a close, a situation that should sustain a cautious approach to big ticket purchases over the next few months. The outlook could also be influenced adversely by geopolitical events that would only add to the anxiety that many households already have regarding the future.

In November, 2008, or just before Thanksgiving Day, the nationwide unemployment rate tallied 6.8% as 10.5 million individuals were idled. The latest reading for this series places the jobless rate at 9.4% of the workforce, which equates to14.5 million people without jobs. Needless to say, the headline data fail to capture the degree of weakness that is present in today's employment setting with the jobless rate for full-time workers having recently hit 10.3% and personal income growth, exclusive of Government payments, continuing to shrink. Clearly, the backdrop is dramatically different than last year when fears of a financial meltdown were rampant and acted to curb spending during the holiday period. Moreover, there has been a massive dose of stimuli provided by the Federal Reserve and the Congress that are certainly possible supports for spending in the coming months. However, the tremendous contraction in the number of employed workers–a development that is likely to persist–should dominate consumer psychology over the period ahead. This situation will most likely prevent any significant rebound in household outlays that would meaningfully buoy holiday expenditures during the fourth quarter.

The recent timing of Government programs could further weigh against a strong Christmas selling season. To provide perspective, a huge volume of stimulus was provided in the springtime that won't be available to give a lift to household spending late in the year. This consideration is captured in the personal income statistics that are published monthly by the Department of Commerce. In May, "other" transfer payments from the Federal Government soared at a $936.2 billion annual rate, roughly $200.0 billion above the levels that prevailed earlier in the year. This category has retreated to the $792.0 billion area in July, indicating that the largest impact of this support program is in the past and is thus unlikely to be viewed as a permanent source of spending power for the vast majority of American households. Even the "Cash for Clunkers" operation could establish an added restraint on spending for some families. In particular, most of the vehicles traded-in were probably paid for, but the purchase of a new car has undoubtedly added to the debt load of many drivers. In response, there could be some downshifting of expenditures for non-auto goods that could act as another headwind for total spending during the holidays. Since the rebate from the Government is likely to be treated as current income, the tax liabilities of these new car buyers could jump in relative terms and may encourage a slower pace of spending through early next year as households attempt to raise the necessary funds for the higher tax payment.

More difficult to quantify, but nonetheless a real influence, is how households will judge the flow of events that

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emanate from Washington, D.C. Going into the holiday season last year, the American public had voted for a new president by a wide margin in a historical election. One attraction of the Democratic candidate was his focus on ending our presence in Iraq, and utilizing that strategy as a platform for Middle East peace. In contrast to that theme, many Americans now seemed puzzled by the increasing involvement of our military in Afghanistan. The reports out of that nation leave something to be desired as troop losses surge and some observers are implying the recent elections lacked legitimacy owing to widespread fraud. At a minimum, the public could be sensing that our country could be embarking on another mission that will require tremendous sacrifices in domestic resources, human and otherwise. Should the news continue to deteriorate as the year progresses, the geopolitical environment could become another source of caution for U.S. consumers, especially in a setting of little or no job creation and tightened credit standards for most individuals.

A reversal of fortune on the foreign policy front could even impact financial asset valuations. If the environment in the Middle East mandates larger commitments from the Pentagon, investors may conclude that the nation is bogged down once again in a situation that creates tremendous uncertainty for the economy and for business planners. Conceivably, a higher degree of risk aversion could return to the marketplace, driven by increased anxiety vis-à-vis the foreign policy picture. The reduction in risk profiles could lead to some visible selling pressure in stocks and a movement of cash towards the fixed income arena, particularly Treasury securities. If such a setback were to occur in stocks before year-end, the loss of equity wealth would become another factor that contributes to a "Blue Christmas." ■

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