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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.

JVB FINANCIAL

Weekly Commentary

by Bill Sullivan, JVB Chief Economist

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Gold reclaims $1,000 as joblessness soars

Gold prices have firmed dramatically during the summer of 2009. Indeed, after falling to just above $900.00 per ounce in early July, the yellow metal has soared by nearly $100.00 climbing above the $1,000.00 mark for the first time in seven months. The formidable up-move has caught many market observers off guard and, in turn, has spurred a variety of explanations as why this metal has recently reclaimed its historic high.

Clearly, the stronger trend in gold prices has occurred in conjunction with some evidence that the worst in the global recession is now in the past. The positive read attached to several economic series has encouraged investors to boost their exposures to riskier assets, including stocks, corporate bonds as well as gold-related investments. From that perspective, the latest rally in precious metals could be viewed as an attempt to hedge against an acceleration in inflationary pressures, driven not only by firming demand conditions, but huge government budget deficits as well.

One of the interesting attributes to the recent two month surge in bullion is the fact that the run- up has transpired in the context of relatively stable interest rates on Treasury securities. As an example, in early July, the ten year note yield was trading in the 3.30% to 3.40% range, or very close to current levels. Similarly, the thirty year bond yield posted 4.19% on July 8, 2009, the low point for gold prices thus far in the third quarter and nearly identical to recent quotes. Effectively, another asset class – U.S. Treasury debt – that could also perform as an inflation hedge does not seem to reveal any extreme anxieties about the price outlook, as the strength in gold allegedly is doing. Conceivably, the lack of affirmation in the Treasury arena could be a signal that the upturn in gold is not an inflation alarm but is actually a function of other concerns, including renewed worries about the credit environment.

Gold investments are somewhat unique in that at times the yellow metal can be employed as a store of value against future inflation but it can also be utilized as a safe-haven vehicle for portfolio managers. Clearly, the tremendous strength during January and February was directly related to a heightened level of risk aversion as tensions mounted about the solvency of many major financial institutions. In large part, the preference for liquidity and safety during that period was a function of the uncertainty that surrounded the potential losses that banks would confront in terms of their exposures to mortgage-related securities, derivatives, default-swaps, etc. The dire aspects of these holdings have seemingly diminished as the Federal Reserve and the Treasury Department have taken major steps to limit the fallout from these positions. Although difficult to measure, it is not without possibility that the latest upturn in gold prices is also a credit related phenomenon. However, the current surge is perhaps being driven by the ongoing rise in nationwide joblessness and the implications that this trend will have for the broader economy.

Notwithstanding the accolades that the Wall Street community gave to the August employment situation report, the reality of the American job market is that the overall

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setting is becoming more difficult, with little improvement in sight. The trail-off in job losses, as measured by the non-farm payroll series, unfortunately deflects attention away from other data that underscore a more stressful environment. The alternate measure of employment that is extracted from the household survey, for instance, captured nearly double the layoffs that the payroll statistics reflected. Another 336,000 in full-time positions were eliminated last month, pushing the jobless rate for full-time workers up to an incredible 10.5%, a new high for the current cycle. Only 5.5% of those individuals classified as unemployed left their jobs during August, barely half the rate one year ago. The sharp decline in the "quit rate" is a clear indication that most workers recognize that the chances of finding a new job in the present milieu are negligible. The inability to gain access to new employment opportunities easily translates to an increased degree of caution among consumers and households. Moreover, the latest report needs to be judged in the context of August being the seventh month after the passage of a Government stimulus package that totaled almost $800.0 billion. As if to reinforce that point, the August data did not seem to pick up any additional momentum from the much discussed "Cash for Clunkers" program. The private and manufacturing workweeks were unchanged last month, after edging higher in July, while employment in the transportation equipment industry continued to decline, suggesting the bulk of the economic support from these rebates is over.

It is therefore not inconceivable to conclude that there is some linkage between the firming pattern of gold prices and the persistent deterioration in the nation's job markets that has obviously become more acute in recent months. The spectacular number of unemployed and underemployed individuals, registering almost 17.0% of the total civilian labor force, lays the groundwork for marked increases in the number of foreclosures, delinquencies, late payments and eventually personal bankruptcies; unless the trend is reversed in short order. With the near- term prospect of a material improvement in employment conditions appearing remote, the gold market could now be anticipating an acceleration in credit losses associated with consumer lending activities. A resurgence in loan write-offs could impair the recovery in bank earnings and balance sheets and in turn postpone any meaningful bounce in economic activity. In response, investors could be adopting a more defensive posture that is helping to lift gold prices. ■

William V. Sullivan, Jr.
Chief Economist
JVB Financial Group
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JVB Financial Group, LLC, member FINRA, SIPC
2700 N. Military Trail, Suite 200 / Boca Raton, FL 33431
(561) 416-5876 • www.jvbfinancial.com

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