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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You can't spin this one

The financial markets reacted calmly to the news that non-farm payrolls fell more than expected during the month of September. Indeed, during last Friday's trading session, the prices of long-term Treasury debt actually declined while the broad equity averages more or less held their own. Based upon that performance, it is quite apparent that investors effectively discounted in advance the decline in jobs that was reported for the previous month. While that judgment per se may prove accurate, we seriously doubt that security valuations fully reflect the degree of weakness that was evident in the labor force as the third quarter came to a close. This consideration is underscored when analytical focus is directed toward other employment statistics beyond the payroll data that are part of the monthly report.

Even though the 263,000 decline in non-farm payrolls was almost 100,000 above consensus expectations, investors were still comfortable with the outright contraction as it fell well short of the monthly declines that transpired earlier in the year. From that perspective, the sense that the pace of job losses was moderating was still preserved. However, the alternate measure of employment that is extracted from the household survey reflected a different picture. Specifically, civilian employment tumbled by a historically large 785,000 individuals during September, suggesting that overall labor market conditions remain as severe as ever. Reinforcing the magnitude of the September drop, in the half year period following the Lehman Brothers bankruptcy, the average monthly decline in household employment registered 690,000 workers.

Conceivably, even more disappointing was the surprising weakness in the hours worked series. The private workweek fell one-tenth of an hour to 33.0 hours, the all-time low for this measure that was established during the second quarter. Both the manufacturing workweek and overtime hours in the factory sector fell as well, pointing toward broad-based weakness for the economy during September. At the same time, average hourly earnings rose by just one cent and, when coupled with the shrinking workweek, it is very apparent most American families once again experienced a softening pattern in their wage and salary growth right before the critical holiday period.

Needless to say, the drop in non-farm payrolls fails to communicate the devastating conditions in the current labor market regarding the ability to establish a career position, ultimately a very important factor in terms of buoying consumer sentiment. Incredibly, full-time jobs dropped by another 814,000 individuals last month, pushing the year-over-year decline in this series to 8.2 million workers. The unemployment rate for full-time employees currently posts 10.7% or nearly one-full percentage point above the nationwide average. College graduates now have a jobless rate of 4.9% or nearly double the year-ago reading, a clear cut indication that those individuals with the highest academic credentials are also finding minimal opportunities in the labor market at this point in the economic cycle. The same

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situation applies to younger individuals seeking employment as the teenage jobless rate has now risen to 25.9%, up six full percentage points from September, 2008.

The general belief within the Wall Street community is that employment conditions are a lagging indicator and that a recovery process is now underway, despite the input on September labor market activity. For sure, several business cycles in the past may have performed in such a fashion. But the current contraction has no precedent in the post- World War II period and, against that backdrop, the prevailing weakness in employment conditions should not be ignored. Augmenting the huge drop in full-time jobs that has characterized the present downturn, the nation unequivocally faces an environment of chronic unemployment that is likely to dampen household spirits for the indefinite future. The average duration of unemployment, which now totals 15.1 million individuals, is 26.2 weeks, nearly eight weeks above last year's level. The median duration also continues its upward climb, registering 17.3 weeks as of last month. The lack of meaningful employment opportunities prompted more than 800,000 people to withdraw from the labor force in September. Obviously, lacking that withdrawal, the nationwide unemployment rate would have risen by more than one-tenth of a percent during September. The fact that such a huge reservoir of individuals are on the sidelines now sets the stage for the overall jobless rate to hit 10.0% by year-end and perhaps as high as 10.5% during the first half of 2010.

If the trajectory of jobs does weigh heavily in favor of more losses, as appears to be the case, the employment situation will prove to be a leading indicator regarding the performance of the economy over the next few quarters. Not only will individuals be confronting potential layoffs, but those who remain on payrolls are likely to experience an erosion in real take home pay. In this environment, discretionary spending by families will be held in check, attention will be directed toward debt reduction and the building of liquidity reserves. Eventually, the message will surface that the prospects for a self-sustaining recovery process over the next year or so remain very limited. Top line revenue growth for many companies will fall well below the optimistic expectations that are seemingly reflected in today's financial marketplace. Moreover, in a setting of chronic joblessness and limited earnings potential, the probabilities seem to favor a consumer loan loss experience that will exceed most forecasts as the fourth quarter gets underway.

The maintenance of a moribund labor market will have an important impact on policy-making in the nation's capitol. A rising unemployment rate should encourage the Federal Reserve to sustain its accommodative stance well into the future, pointing towards a Fed funds target that remains at 25 basis points through the opening quarters of 2010. In addition, unless a turnaround in the employment situation occurs more quickly than expected, Congress may pursue another round of fiscal stimulus. The need for more pump-priming is made even more urgent by the Congressional elections that will be held next November. ■

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