



**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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Highlights of 3Q09 Flow-of-Funds Statistics

The recently released Federal Reserve Board Flow-of-Funds statistics for the third quarter of 2009 continued to reflect a financial system that was adapting to a new credit regime. Indeed, total debt creation sustained its historic slowdown during the July/September period, lead by a record decline in the pace of borrowing by the private sector. Augmenting the deceleration in overall credit formation was a visible reduction in the volume of new cash being raised by the U.S. Treasury during the summer as compared to the previous twelve months.

According to the Fed's report, non-financial debt expanded by only \$965 billion during the third quarter representing a seasonally adjusted annual rate of increase of just 2.8%. The growth rate in credit usage was the slowest for this series in more than three decades and compared to a 4.4% annualized gain during the first half of the year and a 9.0% increase as recently as calendar year 2006. Moreover, in a somewhat unusual development, the growth rate in total debt was actually less than the percentage rise in nominal Gross Domestic Product for the same period under review.

Perhaps the most noteworthy development during the third quarter was the continued erosion in debt use by the household sector. For the fifth quarter in a row, household borrowings contracted, an unprecedented string of declines for this group. Contributing to the 2.6% annual rate of decline was the maintenance of tightened lending standards by many financial institutions along with an unwillingness by households to add to their debt burdens in

an environment of rising joblessness. Home mortgage borrowings registered the largest drop of any category of indebtedness, falling at a 3.6% annual rate during the quarter. Even allowing for the recent roll-off in mortgages, households still have \$10.3 trillion in home loans outstanding, representing nearly 94% of disposable personal income. Households were also reducing their reliance on credit cards, with installment debt falling at a 3.2% annual rate during the three months ending September.

The business sector paid down outstanding borrowings as well throughout the third quarter. In particular, business related credit fell at a 2.6% annual rate, after having dropped at a 2.2% pace during the April/June interval. Notwithstanding the overall decline in borrowing, the business sector was able to raise a sizeable sum of fresh cash via the corporate bond market, where placements totaled a hefty \$262.0 billion on an annual basis. Another \$91.3 billion was garnered through direct sales of equity securities. Offsetting these fund raising efforts was a huge repayment in bank loans that tallied \$365.2 billion and a drop of \$162.0 billion in mortgage-related borrowings.

Needless to say, everything in the world of finance is relative and that concept certainly applies to the U.S. Treasury's borrowings during the third quarter. Specifically, the Federal Reserve Board indicates that the nation's debt managers borrowed "only" \$1.481 trillion on annualized basis during the third quarter. That sum was nearly \$700 billion under the

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volume of new cash that was raised during the October/December 2008 period when the requirements of the bank bailout program were at their peak. The latest quarterly total of borrowing represented a 20.6% annual rate of increase, well below the 37.0% pace that was evident late last year. If Federal security issuance were excluded, total borrowings last quarter would have contracted by more than one half trillion dollars underscoring the retreat in debt usage that is taking place in the U.S. economy, exclusive of the Government's activities.

The Flow-of-Funds data also contained some potentially good news vis-à-vis the economy and consumer spending in the period ahead. Specifically, the net worth of U.S. households rose for the second quarter in a row, climbing \$2.665 trillion after having logged a \$2.282 trillion gain during the April/June period. Similar to the second quarter experience, the latest increase in wealth positions was largely provided by a rebounding equity market, which boosted stock portfolios by another \$1.041 trillion. Effectively, since March, direct equity holdings along with mutual fund shares have accounted for more than 55% of the net gain in personal wealth over this six month period. A modest rebound in home values has also helped, bolstering wealth by about \$590 billion over the two most recent quarters for which official data are available. Clearly, given the resurgence in the broad stock market averages during the autumn months, equity holdings should continue to bolster wealth positions for most households during the fourth quarter as well.

When formulating monetary policy strategies, the Federal Open Market Committee

undoubtedly regards the buildup in wealth positions as a net positive for the economy's ultimate performance. However, the membership fully recognizes that a lengthy lag, perhaps 18 to 24 months, exists between ongoing shifts in wealth and how those adjustments will impact household behavior. As a result, even though the upturn in wealth positions is a welcome development, the trend may not affect personal consumption until 2011 at the earliest. Conceivably, more worrisome to the near term growth outlook is the unwillingness to borrow or the inability of households to gain access to credit. As long as the flow and/or use of credit by households remains truncated, there will be downside risks for the economy, even if the stock market sustains its recent rally. ■

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