Lavery Consulting Group

March 14, 2009

Household Sector Net Worth Continues Its Revival

Of all the statistical emanations on the economy and financial markets that were reported in the past week, perhaps none was more fundamentally key than the Federal Reserve's release of the 4Q:'09 Flow of Funds data. A pessimist would say that, while household sector net worth rose in the final quarter of 2009, the advance was relatively small and less than the revival that occurred in the second and third quarter of last year. The reality is that household sector net worth increased 1.3% in 4Q:'09 to $54.2 trillion. The broad weaknesses in the housing sector will restrain the growth of net worth, but the bottom line is that net worth continues to improve.

Household sector net worth rose 4.5% in 2Q:'09 and surged 5.5% in 3Q:'09. Net worth still sits 21% south of its pre-recession peak of nearly $65.9 trillion. The key driver of household sector net worth is the price of stocks, which advanced almost 4% in 4Q:'09. That translates into an incremental $7.7 trillion of consumer net worth. Please note that the flow of funds definition of the household sector includes consumers and private pension funds. The other prime factor influencing net worth is housing valuations, which edged 0.2% higher in 4Q:'09. The low point for household sector net worth in this cycle was in 1Q:'09 at $48.5 trillion. The "great recession" began in December 2007 and ended in late spring or early summer of 2009.

More telling than the net worth recovery thus far is the deleveraging of the household sector. Per the Fed's Flow of Funds, aggregate household debt, including mortgages and credit card balances, dropped 1.7% in 2009. Those balances now stand at $13.5 trillion. This was the first time since the 1945 start of keeping comparable records that total U.S. household sector debt has declined for a full year.

The deleveraging has included a plethora of defaults, which really have commenced the financial recovery of the household sector. Deleveraging has not been confined to the household sector. The aggregate debt of financial companies fell 8.4% last year. While deleveraging has further to go, the recovery in the financial markets and the shrinkage of debt leaves the consumer in far better shape than conventional wisdom would think.

The February gain of 0.3% in retail sales edged our forecast of a 0.2%

The Lavery Consulting Group, LLC • PO Box 734 • Spring Lake, NJ 07762-0734
Office Phone 732-974-1946; Mobile 609-731-6226 • Fax: 732-974-3140
Jack Lavery • jlavery@laveryconsultinggroup.com
Website: http://www.laveryconsultinggroup.com

increase, but soundly beat consensus expectations of a 0.2% decline. Despite the record snowfall, the consumer was huge. The Toyota problems pulled auto sales down 2%, but spending in non-auto categories rose 0.8% in February, atop an increase of 0.5% in January.

In contrast, the preliminary March reading of the Reuters/University of Michigan Index of Consumer Sentiment was disappointing. At 72.5, it was below the final reading for February of 73.6, and slippage took place in both the current conditions and the expectations components.

January business inventories (BI) were unchanged vs. December. BI in January were down 8.6% y/y, the biggest such decline in eight months. The key yardstick, however, is the inventory to sales ratio. With business sales rising 0.6%, the inventory to sales ratio dropped in January from 1.26 to 1.25, the lowest since March 2006. **Business caution mirrors consumer sentiment, but with an employment upturn commencing in March, both the consumer and the business sector are set to materially contribute, and that is central to the recovery enduring.**

The January merchandise trade deficit for goods and services surprisingly narrowed to $37.3 billion from $39.9 billion in December. Both exports and imports remarkably receded in January, following increases in the prior eight months. Could storms and the Toyota problems have so strongly affected the data? In any event, we expect rising trade deficits ahead, which are normal in a U.S. recovery.

Economic Indicators in the Week Ahead:

Monday, March 15 8:30a.m. March NY Empire Manufacturing Index
We expect the New York Fed's Empire State Manufacturng Index fell to a still expanding measure of 21.0 in March, down from 24.91 in February. The strong February headline was up from 15.92 in January, but was contradicted by slippage in several subcomponents such as shipments, new orders, and expectations. The consensus sees the Empire Index dropping to 20.0 in March.

Monday, March 15 9:15a.m. Feb. Industrial Production & Capac. Util.
Industrial production (IP) was likely flat in February m/m, after a 0.9% rise in January. Weather hurt IP in February, as did the drop in manufacturing hours worked. The latter was reported as part of the February employment data. An unchanged IP would follow seven consecutive months of increases. February IP likely increased 1% y/y, following a 0.9% y/y advance in January. Capacity utilization in February likely remained at 72.6%.

The author/publisher shall not be responsible for any inaccuracy or omission in this publication. Copyright 2010 by Lavery Consulting Group, L.L.C.

Lavery Consulting Group

Monday, March 15 1p.m. March NAHB Housing Market Index (HMI)
The National Association of Home Builders (NAHB) HMI is a measure of builder confidence, which likely declined from 17 in February to 16 in March. Foreclosures are rising, appraisals are still receding. The HMI has not exhibited an optimistic reading above 50 since April 2006.

Tuesday, March 16 8:30a.m. Feb. Housing Starts & Building Permits
Housing starts likely fell 6.1% in February to 555,000 units annualized from the 591,000 unit pace of January. Storm activity and declines in construction employment in February contributed to the decline in housing starts. Building permits likely fell 5% in February to 590K annualized, from 621,000 in January. Our expectations are weaker than the consensus, which sees 570K starts in February and 610K permits.

Tuesday, March 16 8:30a.m. February Import Price Index
We believe import prices dropped 0.2% in February m/m in line with consensus, following an energy price induced 1.4% jump in January. The petroleum import component fell about 2.5% in February. This would slow the rise in overall import prices to 11.3% y/y from 11.5% in January.

Wed. March 17 8:30a.m. February Producer Price Index & Core PPI
The headline PPI for finished goods in February likely fell 0.3% from January, after surging 1.4% in January due to food and energy. On a y/y basis, however, the headline PPI is likely 4.7% above recession impacted February 2009. The January y/y rise was 4.6%. The core PPI, excluding food and energy, was likely flat, in February. This would put the core PPI up 0.9% y/y, a lessening from the 1% y/y rise in January.

Thurs. March 18 8:30a.m. Weekly Jobless Claims, wk. ending 3/13
Initial jobless claims likely fell 20,000 in the week ending March 13 to 442K. This would reduce the four-week moving average of initial claims to 468,000, from 476K the week-ending March 6th.

Thurs. March 18 8:30a.m. Feb. Consumer Price Index & Core CPI
We envision the February CPI m/m to be unchanged from January, which registered an increase of 0.2% over December. The consensus sees a 0.1% increase in the February CPI m/m. The key factor keeping consumer prices flat is a decline of 1.3% m/m in retail energy prices in February, including a drop of 8 cents/gallon in retail gasoline prices. The CPI y/y likely remains at 2.2%. The core CPI (ex food and energy) likely rose 0.1% in February m/m in line with consensus. This follows a 0.1% decline in January, the first

The Lavery Consulting Group, LLC • PO Box 734 • Spring Lake, NJ 07762-0734
Office Phone 732-974-1946; Mobile 609-731-6226 • Fax: 732-974-3140
Jack Lavery • jlavery@laveryconsultinggroup.com
Website: http://www.laveryconsultinggroup.com

m/m drop since 1982. The core CPI would stand 1.4% above February 2009. This is below the January 1.6% y/y increase.

Thurs. March 18 8:30a.m. 4Q:09 Current Account Balance
The U.S. current account deficit likely widened in 4Q:'09 to $118.5 billion from a current account deficit of $108 billion in 3Q:'09. The consensus expects the current account deficit to reach $120.0 billion in 4Q:09. The key driver of the wider current account deficit is the larger merchandise trade deficit of $109 billion in 4Q:'09, up from $97 billion in 3Q:'09. The trade deficit worsening was driven by petroleum imports of $75.5 billion in 4Q:'09, up from $68.9 in the third quarter.

Thurs. March 18 10:00a.m. March Philadelphia Fed Manu. Survey
We believe the Philadelphia Fed's General Business Activity Index fell to 14.5 in March from 17.6 in February. The consensus expects the March reading to slip to 17.0. The region is still growing, but at a slower pace, consistent with an expectations component that slipped in February to its lowest reading since April '09.

Thurs. March 18 10:00a.m. Feb. Leading Economic Indicators (LEI)
We expect the February LEI increased 0.2% m/m, the 11th straight monthly gain. The consensus sees a 0.1% decline m/m. The February's gain we see followed a 0.3% January advance. February would be up 9.4% y/y, a gain over the January 8.7% y/y increase. The annualized growth rate over the past 6 months through February would be roundly 9%, less than the February y/y gain of 9.4%. When the 6 month growth rate falls below the y/y rate, a slowing in the quarterly momentum of economic growth generally lies ahead. Following the 5.9% annualized growth in real GDP in 4Q:'09, we expect the pace of economic growth to slow to 2.4 % in 1Q:'10.

Jack W. Lavery
CEO & Chief Economist

The author/publisher shall not be responsible for any inaccuracy or omission in this publication. Copyright 2010 by Lavery Consulting Group, L.L.C.