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Slow economic recovery yields few jobs

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The stock market is often regarded as a leading indicator of the economy. If so, the market is forecasting a bright future. The underlying economy has shown growth in profits with most S&P 500 companies beating estimates and raising profits. Industrial production is up. Consumer confidence is up. Retail spending and income are up. Confidence, spending and income are especially important because the consumer represents about 70 percent of the economy. Companies are sitting on large caches of money that can be expected to be redeployed through mergers and acquisitions, stock buybacks and dividends. IPO activity is picking up.

Even banks have begun to cooperate with the government in the effort to stimulate the economy by lending money to small and midsize businesses. Fed futures suggest that the Federal Reserve will not increase interest rates until the end of 2011.

Money has been leaving bond funds and flowing into stock funds in a reversal of past flows. Until the recent crisis in Egypt, money was also flowing into emerging economies because they are expected to grow faster than the U.S. economy, and because they don't have a housing crisis. However, the trouble in Egypt reminds all investors of the political risk in sinking money into emerging countries.

The catalyst for the market's rise has been the Federal Reserve buying bonds via so-called quantitative easing, a loose money policy, low interest rates, and rigorous belt tightening by companies. The Fed has been aided by a low rate of inflation.

The first round of quantitative easing began on May 9, 2009, after the markets rose about 80 percent from lows of March 9, 2009. When the Fed stopped buying securities last year, the market swooned and everyone suffered heartburn as it appeared that we were headed down again. But at the annual meeting of the Fed in Jackson Hole, Wyo., last fall, Chairman Ben Bernanke announced another round of quantitative easing that put wind under the wings of our economy. The market took off again, rising 9 percent in the past three months, and 21 percent for the trailing 12 months.

Globally we are beginning to see inflation in commodity prices, with minerals and agricultural commodities leading the way. Meanwhile, gold has dropped. Fear of inflation and a weak dollar have worked against the Fed's goal of lowering interest rates because investors have demanded more yield at the long end of bond maturities. Interest rates rose on the long bond, which was exactly opposite of what the Fed intended. It also made the bonds worth less, and as the equity markets recovered investors began to abandon bonds for equities, putting more pressure on yields.

In order to finance its ballooning deficit, the Federal government was forced to sell even more bonds, but because of the increased interest rates on the long bond, the government opted to sell shorter maturities, which put it in the same position as the savings and loan associations before their crisis. It was the same for Bear Stearns - selling short bonds to finance long-term debt, and we all know how that scenario turned out.

Unemployment numbers remain stubbornly high, with the official number at 9 percent, down from 9.8 percent in December. The government expressed relief at the number because it was expecting 9.5 percent. The government believed that 150,000 jobs would be created in January. This number, of

course, is far smaller than the 250,000 needed just to absorb new workers into the economy. Instead, 36,000 jobs were created; however, according to government number crunchers, the rate of unemployment actually fell. How can that be? Mark Zandi of Moody's analytics, known to crunch a few numbers himself, said, "I think these numbers are meaningless ... they don't mean anything." Obviously the governments' "haves" need to walk around to discover the actual jobless rate.

Simple analyses of the employment numbers show why the official numbers are unreliable. The government bases the unemployment numbers on a labor force participation rate of 64.2 percent. This number is significantly less than the rate for 2001-2008. The difference in the number of workers in the labor force in 2001-2008 and January 2011 is 4.9 million. One can believe that 4.9 million people have simply dropped out of the labor force, discouraged by their prospects. If the government simply returned to the size of its labor force in 2008, the current unemployment rate would be 12.3 percent. But because we know that the population is greater now than in 2008, we can assume that the labor force would be even greater now than in 2008, and therefore the unemployment rate is more than 12.3 percent.

It does not help that the jobs being created are not like the ones of the past that paid greater wages.

Germany, meanwhile, is suffering a labor shortage. So where would you like to put your money? Asia is doing relatively well, although China is trying to slow its economy; parts of Europe are doing well, although others are doing poorly; and until Egypt, emerging markets were doing well, and will again. The U.S. is rebuilding its equity markets. Bonds don't look so good. Hard assets will do well in inflationary times. The dollar appears to be in a secular downtrend - another reason for diversifying offshore.

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