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Introduction

There is a new economic report seemingly every day – GDP, ISM indexes, unemployment, housing starts, etc. After the data is released, the talking heads in the mainstream media and the financial pornography channels (CNBC, Fox Business, etc.) focus on that single data point and tell you that things are either peachy (not likely) or disastrous (more likely).

Most of the readers of Why We Plan are not trained in economics, so they tend to trust what the talking heads have to say (with the exception of those who have heeded our message to just turn it off). Remember, the media's goal is to serve its advertisers by getting you to pay attention; the goal is not necessarily to give you the full picture. Our goal, on the other hand, is to provide you with perspective and information so that you can make intelligent, well-informed decisions. Thus, the purpose of today's Why We Plan is to discuss the economy in (relatively) plain English that you can understand. We will highlight the good, the not so good and the ugly (I would have used "the bad", but we need to refrain from Clint Eastwood references for the time being). For reference, many of the data points relied on in this piece were obtained from First Trust Advisors.

The Economy - The Good

Given the tone of the media, you are probably thinking that this section will be relatively short. Actually, despite what you might be hearing elsewhere, there are a number of positive things going on in the economy. Of course, if the media told you that, you'd have no reason to tune in to hear more of their horror stories.

- By now, everyone knows that the increase in private payrolls in May was relatively low (54,000 after downward revisions). However, sometimes we need to look beyond the headline number. The total number of hours being worked by those with jobs increased by 2.2% over the last year and by a whopping 3.5% in just the last three months. So, companies may not be hiring because of uncertainty, but people are working longer. To put this into some perspective, if employees did not work more hours, average payrolls would have needed to increase at an average rate of

more than 300,000 to pick up the slack. In other words, eventually, this will translate into jobs – you can only work people so hard.

- You probably also know that unemployment ticked up again. Of course, this was due to an expanding work force. People who had given up looking for work are starting to look again and are entering into the stats. That means that there is a higher degree in confidence that they will be able to actually find work, which is a positive.
- The ISM non-manufacturing index measures growth in the non-manufacturing part of our economy (think services). Any reading over “50” indicates that there is growth. This measure rose from 52.8 in April to 54.6 in May suggesting that there is not only growth, but that the growth is increasing. It is worth noting that this part of our economy is much larger than the manufacturing sector; yet, we don’t hear much about it from the media. Could it be because the news is actually positive?
- Non-farm productivity rose at a 1.8% annual rate in the first quarter, and it is up 1.3% over the last year. In the manufacturing sector, productivity growth for the first quarter was 4.2%. So on top of more hours being worked, our companies are getting even more efficient. The more efficient our companies, the more profits they can generate.
- In fact, first quarter profits were up 8.5% year over year. **Corporate profits are now at record levels!** Less than two years after the “Great Recession” ended, the profits of American Companies have more than fully recovered. Once again, isn’t it interesting how little you hear about this from the media?
- Sales of new single-family homes rose 7.3% in April, and the median price of new homes sold was up 4.6% from a year ago. Of course, a year ago, sales of new homes was anemic, so we are coming off of a low base. It is worth noting that this statistic does not reflect sales of existing homes.
- Real Gross Domestic Product (GDP), the actual output of our economy, has grown for seven straight quarters.
- While you may be hearing that this economy cannot grow without the consumer, you might be surprised to learn that **consumer spending is also at record levels** - \$450 billion above its prior peak.
- American corporations continue to hold onto record levels of cash. Despite continued dividend increases, the dividend ratio (the dividend paid divided by the cash on hand) is the lowest it has been since the 1930s. In the near future, either companies will willingly begin to deploy cash or shareholder advocates will force them to do so. The result will likely be increased dividends, merger/acquisition activity, or business investment. Regardless of how it is used, the deployment of these funds will provide an additional tailwind for the economy.

Surprising isn’t it? It seems as if there may actually be some reason to be optimistic.

The Economy - The Not So Good

Of course, things are not all sunshine and roses. It goes without saying that there are some headwinds and some areas of concern. But before we resort to histrionics (like the talking heads), let's try to figure out what's really going on:

- Employment growth/unemployment is still an issue. In the section above, we discussed hours worked and productivity, but we still need to get to the point where businesses have enough confidence to actually hire people.
- We discussed the ISM non-manufacturing index above. The ISM manufacturing is a similar index that focuses on the manufacturing part of the economy. Like its sister index, readings above "50" represent growth. In May, this index had a reading of 53.5. Despite all the talk of gloom and doom, we are still growing. However, I am placing this in the "not so good" category because growth is decelerating (it is down from 60.4 in April). Of course, between the earthquakes and nuclear disaster in Japan, which had a tremendously negative impact on auto manufacturing, and the weather/flooding in the U.S., which had its own impacts, it is very likely that this slowdown is simply a short term phenomenon that will reverse as business picks back up following these disasters. To understand the impact of the Japan disaster we can take a look at U.S. industrial production, a subset of overall manufacturing. According to First Trust Advisors, U.S. industrial production was flat in April. However if you exclude autos, the industry most impacted by events in Japan, it actually rose 5.3%. Thus, the Japanese disaster is having a very tangible impact on our economy; although it is one that should be transitory in nature.
- New orders for durable goods were down more than expected in April. The decline was led by orders for civilian aircraft, autos and machinery. Boeing (a major component of civilian aircraft) tends to be very volatile month-to-month, so one month's results are not too meaningful. Also, as discussed above, the Japan crisis has had a tremendous impact on the auto industry. So, while this statistic is disappointing, we need more data to determine whether it is a temporary dip or part of a longer term trend.
- Gross Domestic Product only increased at a 1.8% annual rate this past quarter. Historically, the growth rate has been closer to 3%. So, while the fact that we are growing is good, growth at this pace leaves a little to be desired.
- Existing home sales dropped in April versus a year earlier and prices for those homes that did sell were down year over year. You do not need to be an economist to understand that this is not a positive.
- Housing starts (i.e., new housing construction) fell more than 10% in April. However, if you exclude the South, which was devastated by tornadoes, housing starts were actually up more than 5%. Like the impact on the auto industry resulting from the Japan crisis, this may be a temporary phenomenon.

The key with most of these points is that the data is currently transitory. In other words, we need to keep an eye on things to see what happens as issues relating to Japan and the weather in the U.S. are resolved. If things begin to tick up, we can have some faith in the fact that the recovery is still going strong. On the other hand, if these things don't improve, we will need to understand why.

The Economy - The Ugly

We have touched upon the Good and the Not So Good. What about the Ugly? This is the easiest one of all – the government!

Despite your political leanings (or mine), both parties are to blame. The partisan wrangling over the debt levels and the deficit is resulting in a loss of confidence across the board. Moreover, there is tremendous uncertainty regarding what might ultimately happen with tax rates, regulation, etc. Frankly, it is downright ugly!

If the politicians would actually work together on a solution rather than trying to score political points, pandering, or demagoguing, the rest of the country, and the world, would be able to adjust accordingly. Moreover, the politicians (including the Fed) should cease meddling with the recovery. While this might be a topic for a different Why We Plan piece, it can be shown that their efforts to “improve” things are actually quite counterproductive.

In a nutshell, our politicians need to begin conducting themselves like the leaders they are supposed to be. Until they do so, this will likely continue to be a significant headwind.

Wrapping it Up

There are so many moving parts to our economy that it can be difficult to really understand what is going on. Hopefully this Why We Plan provided you with a different perspective than you may be getting from the evening news or the popular financial media. There are indeed some positive things happening. However, there are also a few transitory events that we need to monitor to ensure that they really are transitory and not the beginning of a negative trend. Finally, we have the government – it really doesn't get much uglier than that!

Please feel free to call or email if you would like to delve into this issue in greater detail. Likewise, feel free to share this with friends, family or associates that might benefit from the information. As always, we appreciate your trust and support.