Tea Leaf

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*Your guide to understanding today's economy and financial markets*

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# A Soothing Fed

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The American stock market continued its psychotic behavior in recent days with up and down moves all over the map. A sharp 281-point downturn on Friday, August 3 gave way to a similar 287-point jump on Monday, August 6, the largest one-day percentage gain (up 2.2%) in four years.

Behavior on Tuesday was no less bizarre, with the Dow down as much as 121 points in afternoon trading before quickly rising 261 points to be up as much as 140 points for the day. When the dust had settled, the Dow finished higher by roughly 36 points at 13504.

## Bulls & Bears

What continues to develop is a classic struggle between market "bulls" and market "bears" as to where we go over the balance of the year. The bulls see recent credit market indigestion soon running its course, with a return to active debt financing of newly done deals, albeit with more rational pricing. They see mortgage lenders soon returning to prior methodology, with mortgage rates lower than levels that prevailed a few weeks ago.

Market bulls also see the associated sub-prime lending issue staying well contained, with little impact on the broad U.S. economy. Market bulls (including me) see stock prices as fairly valued, with strong earnings growth of recent years justifying higher equity (stock) prices.

The bears see the credit risk issue as yet to unfold further, with significantly more pain and angst to come. The bears see the sub-prime mortgage issue as one that can—and will—soon shake the economy to its knees, with recession soon emerging.

Market volatility of Tuesday, August 7, and likely of coming days, was triggered by the Federal Reserve. The Fed's Open Market Committee met, as scheduled, on August 7 to review the current status of the economy and financial markets. What the Fed delivered to financial markets was a *little* bit surprising and a *large* bit comforting.

Federal Reserve Chair Ben Bernanke

## Fed Speak

As expected, the Fed left its key interest rate unchanged. The Fed's federal funds rate (arguably the most important of all interest rates) has now remained unchanged at 5.25% since late June 2006.

The debate within the financial community involved how the Fed's accompanying statement would read. Many market players wanted to see the Fed acknowledge that, while the sub-prime mortgage lending and overall credit risk issues were indeed serious, such issues would not derail the economy.

Many financial market players hoped to see the Fed shift its "predominant concern" from one of inflation gaining traction to one focused on equal or greater concern about the health of the broad economy. These players were disappointed.

The Fed maintained its bias or "predominant concern" toward inflation containment. This terminology served two purposes. By keeping its focus on inflation containment as its prime concern, the Fed supported those who see credit risk issues as less onerous or less challenging to the economy.

A second purpose was to reiterate that what the Fed can do best is keep inflation under control. Such word posturing reinforced the idea that we already have enough to worry about in the economy and financial markets, without adding greater inflation anxiety involving the Fed losing its way.

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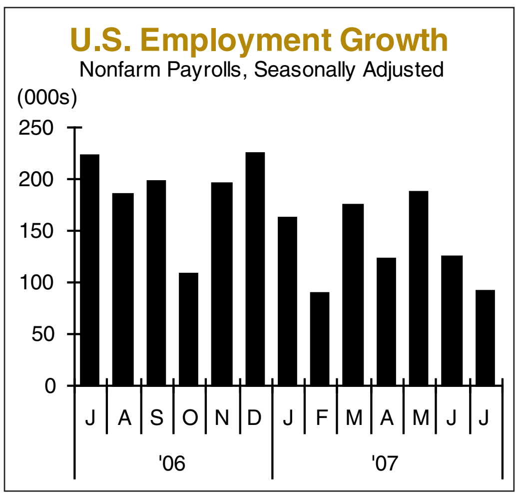
# Jobs Slow

The U.S. Department of Labor reported a net gain of 92,000 jobs in July 2007, below the 127,000 consensus view. Reported gains of the two prior months were revised lower by 8,000 jobs. The U.S. economy added an average of 136,000 net new jobs monthly in 2007's first seven months, down 28% from the 189,000 average monthly pace during 2006.

The U.S. unemployment rate was 4.6% in July—the highest level in six months—and up slightly from the 4.5% rate in the three prior months. March's 4.4% jobless rate matched that of October 2006 as the lowest in more than five years.

Goods-producing employment declined in July, with a net loss of 12,000 jobs. Construction employment fell by 12,000 positions, while manufacturing lost 2,000 jobs.




## Construction Mix

While overall U.S. construction employment has declined since peaking last September, the decline is less than one would have expected, given the harsh tone of national media reports of the past year regarding housing weakness. The decline of 75,000 jobs from the peak has found solid job gains in a strong commercial construction sector helping to offset widespread losses in residential construction.

Another view suggests that significant job losses of illegal immigrants working on various construction sites across the nation have not led to unemployment declarations with appropriate government regulatory bodies. A combination of both factors seems likely.

Service-providing employment led the way in July with a rise of 104,000 net new jobs. The education & health services sector added 39,000 net new positions, while the professional & business services sector added 26,000 jobs. The leisure & hospitality sector added 22,000 net new jobs.

The government sector lost a questionable 28,000 jobs in July, with the majority of the losses associated with state and local education. While the Labor Department does adjust the data to reflect tens of thousands of teachers who conclude teaching in the late spring and return to the classroom in the fall, such "seasonal" adjustments are known to be less than ideal.

## Out of Work

The nation's jobless rate has been within a tight range of 4.4% to 4.6% for the past 10 months. The jobless rate for adult men rose slightly to 4.2% in July versus 4.1% in June. The jobless rate for women climbed to 4.1% in July versus 3.9% in the prior month.

The news regarding teenage unemployment? Good news saw the rate decline during July by a meaningful 0.6%. Bad news saw the rate at a still unacceptable 15.2%.

The jobless rate for Whites was 4.2% in July, up from the 4.0% rate in June. The jobless rate for Blacks and African Americans fell sharply to a still-too-high 8.0% in July from 8.5% in the prior month. The jobless rate for workers of Hispanic and Latino ethnicity rose from 5.7% to 5.9%. As before, only those people employed or actively seeking employment are counted within the employment/unemployment data.

The average hourly wage rose 0.3% (six cents) to $17.45 hourly, a rise of 3.9% over the past 12 months. The 3.9% increase outpaces the 2.7% rise in consumer inflation for the 12-month period ending in June.

…stay tuned

Jeff

## "TEA"ser

A couple is lying in bed. The man says, "I am going to make you the happiest woman in the world."

The woman replies, "I'll miss you…"

—from Shaz (a friend)

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