



...weekly since 1976

Your guide to understanding
today's economy and
financial markets

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FRB, GDP, Jobs, & ISM

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A plethora of economic data released during the past week paints a picture of a U.S. economy fighting to stay above water. The cumulative impact of the data suggests that the odds of a recession in the good ol' U.S. of A continue to climb.

Recent cover stories of *Newsweek* and *Business Week* illustrate the incredibly negative nature of national media reports during the past two years or so. The *Newsweek* issue dated February 4, 2008 features a cover story entitled **“ROAD TO RECESSION.”** The February 11, 2008 issue of *Business Week* is entitled **“MELTDOWN...FOR HOUSING, THE WORST IS YET TO COME.”**

...with friends like these, who needs enemies

These cover stories, along with constant negative reporting by *The New York Times*, *The Washington Post*, and many other publications, clearly illustrates the adage that “bad news sells newspapers” perhaps more than ever before...

...why consider buying a home now when the national media says it will be cheaper in six or 12 months?

FRB

As you are aware, the Federal Reserve sharply reduced its key interest rate—the federal funds rate—twice between January 22 and January 30. These policy moves were undertaken in an effort to prevent a U.S. recession from occurring, or to minimize the impact should a recession unfold.

The aggressive 0.75% rate cut announced on January 22 was the largest single rate reduction in 24 years and the first rate cut to occur outside of the Fed's regular meeting schedule in six years. This aggressive move was followed by another 0.50% cut at the Fed's regular FOMC meeting on January 30.

Weakness in the nation's housing sector has spread to other economic sectors. In addition, domestic and global credit markets have been at a heightened

state of anxiety since August 2007, inhibiting credit flows around the globe. The Federal Reserve and other central banks around the world have provided credit markets with enormous amounts of temporary liquidity to enhance credit flows.

The Federal Reserve had previously reduced the federal funds rate by 0.50% on September 18, followed by 0.25% cuts on October 31 and on December 11. The federal funds target rate is now at 3.00%, down sharply from the 5.25% level of mid-September. Our forecast assumes that the Fed will follow with another 0.50% rate cut on, or more likely before, March 18, 2008.

GDP

U.S. economic growth during 2007's final quarter was very soft. The U.S. Commerce Department reported that the American economy grew at a real (inflation adjusted) annual rate of 0.6% during the quarter. Our forecast was for a 0.8% growth pace, while the consensus of economists was for 1.1% growth. Just to keep things interesting, the Commerce Department will revise the 0.6% estimate in late February and again in late March as more complete data is available.

Such growth matched 2007's first quarter as the weakest in five years. The pathetic 0.6% growth pace also compared poorly to the 4.4% real annual growth pace during 2007's two middle quarters.

No secret...housing activity was extremely weak during the fourth quarter. Residential construction has now fallen for eight consecutive quarters. Consumer spending slowed but remained positive, growing at a 2.0% annual rate, versus a 2.8% growth pace during the third quarter. Export growth remained solid.

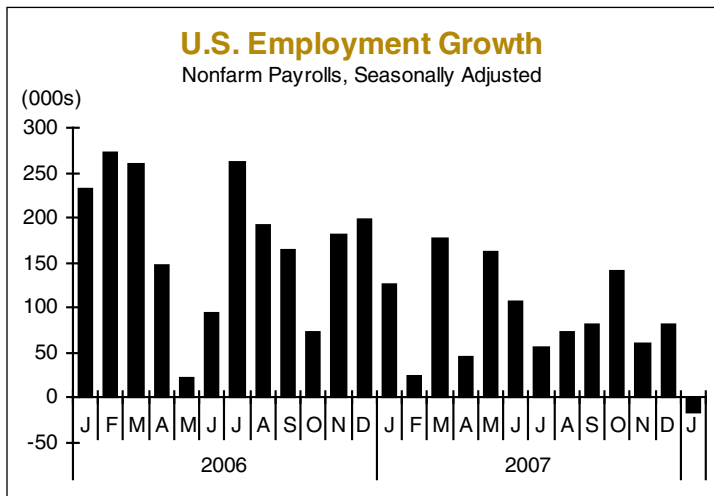
Ironically, one factor that contributed to weak fourth quarter performance will add to growth (or minimize decline) in coming quarters. Inventories of goods fell in the fourth quarter, single-handedly reducing growth by 1.3% versus the prior quarter. Declining levels of goods on store shelves and in warehouses suggest

production will have to be ramped up during 2008's first two quarters.

Most forecasts have growth during 2008's first half around a 0.3% to 1.5% growth pace, with a rising number of forecasters seeing negative growth in one or both quarters. Others continue to scoff at the recession view.

Jobs

Recession advocates added two arrows to their quivers in recent days. The first was the weak U.S. employment data for January.



The U.S. Department of Labor reported a net decline of 17,000 jobs in January 2008, the first drop in more than four years. The drop was sharply below the consensus forecast of a gain of 70,000 jobs.

Goods-producing employment continued to decline in January, with a net loss of 51,000 jobs. Manufacturing lost another 28,000 jobs, while construction employment fell by 27,000 positions.

Service-providing employment led the way in January with a rise of 34,000 net new jobs. The education & health services sector added 47,000 net new jobs, while the leisure & hospitality sector added 19,000 jobs. The professional & business services sector lost 11,000 jobs during the month, while the government sector lost 19,000 positions.

The U.S. unemployment rate was 4.9% in January, down slightly from December's 5.0% rate, which was the highest in two years. The average hourly wage rose 0.2%

(four cents) to \$17.75 hourly, a rise of 3.7% over the past 12 months.

Revised estimates now suggest the U.S. economy added 1.14 million net additional jobs in 2007, an average of 95,000 net new jobs monthly, and the weakest year for job gains since 2003. The 95,000 average monthly gain was down 46% from the 175,000 average monthly gain in 2006.

ISM

This data may not be familiar, but it is critical each month (along with the ISM Manufacturing Index) to financial market players. It is the single strongest piece of evidence yet suggesting an economy now in or facing recession. It was also the primary reason that stocks fell sharply yesterday.

The Institute for Supply Management (ISM) reported yesterday that its newly created Non-Manufacturing Index (NMI) was 44.6 in January, indicating decline in the non-manufacturing (services) sector. Note that services in the U.S. economy account for roughly 70%-80% of all U.S. economic activity.

The more familiar Business Activity Index fell to 41.9 in January, versus 54.4 in December. The 41.9 measure was the weakest in nearly five years. Note that a number above 50 suggests service sector growth, while a number below 50 suggests decline.

In Summary

A constant barrage of negative media stories...more Fed ease on its way...a fiscal stimulus program coming from the Congress...sickly U.S. economic growth...a fascinating if tiring Presidential campaign...a decline in jobs and service sector performance...snow piled high outside the window (local flavor)...and an economy where the recession die may already be cast...

"TEA"sers

Real Newspaper Headlines...

For sale: antique desk suitable for lady with thick legs and large drawers.

3-year-old teacher needed for preschool. Experience preferred.

We do not tear your clothing with machinery. We do it carefully by hand.

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