



June 7, 2010

Looking for a reason to rally after a dismal May, American investors spent much of last week trying to forget for a moment about what was going on in Europe while getting ready for what was expected to be a very upbeat jobs report from the Labor Department. But the week ended in disappointment with the news that there was almost no job growth whatsoever outside of the temps the federal government hired as census workers. Worse still, Friday also introduced yet another country to the growing watch list in Europe, Hungary, which hinted it might be on the way to default. Not surprisingly given this one-two body blow, the stock market reeled on Friday, with all three major indexes tumbling by at least 3% and the Dow finishing the week below the 10,000-point mark for the first time since the week ending Oct. 30, 2009.

Though the Labor Department announced that the jobless rate fell from 9.9% to 9.7% in May because 431,000 new jobs were added, almost all of that growth came from the 411,000 census workers hired by the government along with the discouraged workers who'd given up trying to find a job. The private sector created just 41,000 jobs (the expectation had been 150,000 or more), the smallest increase since January. And the ranks of the long-term unemployed, those out of work for at least 27 weeks, rose to 6.7 million, the highest figure since the Labor Department began tracking the data in the 1940s. For those looking for a glimmer of hope, manufacturers hired 29,000 workers and both hours worked and wages were up.

	Key Market Data		
	Week ending...		
	6/4/10	5/28/10	Change
Dow Jones Industrial Average Index	9,931.97	10,136.63	-2.02%
S&P 500 Index	1,064.88	1,089.41	-2.25%
NASDAQ Composite Index	2,219.17	2,257.04	-1.68%
10-Year Treasury Note Rate	3.197%	3.300%	-0.103 pct. pts.
NYMEX Crude Future (Barrel)	\$71.51	\$73.97	-3.33%
Euro/U.S. Dollar	\$1.1966	\$1.2270	-\$0.0304

As if the jobs report was not bad enough, the same day a spokesman for Hungary's government said that his country's economy was in a "very grave situation" and there was the possibility of default, blaming the predecessor government for manipulating budget figures and lying about the state of the economy. While roiling the market, many dismissed the statement as a ploy to scapegoat the previous Socialist leadership for the country's economic woes (much as Greece did) and also persuade the International Monetary Fund (IMF), which already bailed out Hungary in 2008 to raise its mandated deficit target from 3.8% for 2010. Compared to Greece, Hungary has a relatively healthy economy, having posted a budget deficit of only 4% of GDP in 2009. In addition, Hungary, unlike Greece, does not use the euro, and can therefore devalue its currency (the forint) to steady its economy. Even so, some analysts said that crying wolf may backfire as other countries may now be reluctant to lend money to Hungary. By Sunday, having moved into damage-control mode in an effort to restore investor confidence, Hungarian officials had

already backtracked, saying they would indeed adhere to the strict limits set by the IMF, that there was no risk of default, and that there would be an economic plan of action in place this week.

That wasn't the only grim report from Europe. Earlier in the week the European Central Bank (ECB) warned that European banks were in "ill health" and face an economic outlook that is "clouded by uncertainty." And Germany was miffed by the ECB's buying back Greek bonds from European banks which it perceived as a stealthy way of continuing to bailout Greece at a time when a number of other euro zone countries needed bolstering. Not surprisingly, the euro continued to plummet and investors seeking a safe haven headed for U.S. Treasuries, yet again driving down the yield.

But with the notable exception of the jobs report, it was another week of good news from the home front, with positive reports on car sales, home construction, manufacturing and earnings.

At midweek, it was announced that new vehicle sales were up for the seventh month in a row in May, climbing an impressive 19.1% with every major automaker except Toyota posting an increase of at least 17.5% (Toyota's sales increased 6.1%). Among American carmakers, Chrysler's sales jumped 32.7%, Ford's 22% (making it sixth months in a row with increases of at least 20%), and GM's 17.5%. On a side note, Ford also announced an end of an era when it said that it would cease making Mercurys this fall, a line introduced all the way back in 1939.

The Commerce Department reported that construction spending rose 2.7% in April from a revised 0.4% in March, the biggest increase in a decade, largely driven by the homebuyer's tax credit that expired at the end of that month, and the National Association of Realtors said that signed

contracts for pending home sales improved by 6% in April.

On the manufacturing front, the Institute for Supply Management (ISM) said that its manufacturing index dipped slightly in May to 59.7 from its six-year high of 60.4 in April, but any reading over 50 indicates expansion and that makes ten months straight. Though the good news was torpedoed by the Labor Department's jobs report on Friday, the ISM also said that its index of manufacturers' willingness to hire rose 1.3% to 59.8, its highest level since May of 2004. Furthermore, despite the crisis in Europe, the export orders index rose from 61 in April to 62, its highest point since 1988. Later in the week, the ISM said that the service sector grew in May with an index of 55.4, and the service sector employment index showed job growth for the first time since December 2007.

As for first quarter earnings, Thomson Reuters said that as of May 28, with 492 of the companies in the S&P 500 having reported, 78% had earnings above analyst expectations while only 15% came in below expectations. Nine of the ten sectors in the index had higher earnings compared to the first quarter of 2009, with the financial sector leading the way. Furthermore, of the 489 companies that reported revenues, 67% were above expectations compared to 33% that fell short.

The broader view

Finance ministers from the Group of 20 met in Seoul, South Korea, in large part to set the agenda for the upcoming meeting in Toronto at the end of June. The main issue continues to be what to do about the banks and financial institutions that are seen as having triggered the recession, but there's as yet no consensus on the proposed bank levy to prevent future bailouts, with some countries, Canada among them, reluctant to take that step as their banks did not stumble as far during the recession. Canada was also in the news because its central bank became

the first Group of 7 country to raise its lending rate since the financial crisis began, partly out of concern over inflation as a result of strong economic growth (Canada's gross domestic product was up 6.1% in the first quarter). Canada's central bank hinted that given the withdrawal of economic stimulus measures and the global slowdown, this might be the last hike for some time (Australia, which has raised its rate six times since last October, left it unchanged last week). Regarding the lending rate in the United States, Charles Evans, the president of the Federal Reserve Bank of Chicago who was at the G-20 meeting in South Korea told reporters that, given the crisis in Europe, he "wouldn't be surprised" if the Fed's low federal funds rate "gets extended just a little bit."

Also at the meeting in Seoul, Treasury Secretary Timothy Geithner told his counterparts that they could not rely on consumers from the United States to carry the global recovery, needing other countries such as Germany, Japan and China to stimulate domestic growth. Referring to the crisis in Europe, the joint statement issued at

the end of the meeting said, "Those countries with serious fiscal challenges need to accelerate the pace of consolidation," tepidly adding, in a nod to the concerns of the United States, "Within their capacity, countries will expand domestic sources of growth."

A look ahead

This week's key releases will include mortgage applications for May which some analysts expect to drop precipitously now that the homebuyers' tax credit has expired. On Wednesday, the Federal Reserve will release its Beige Book, an update of the state of the economy in twelve Fed districts, while other reports will cover business and wholesale inventories, the trade gap and retail sales.

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