STRATEGAS

Economics Report
Thu. Sep. 3, 2009

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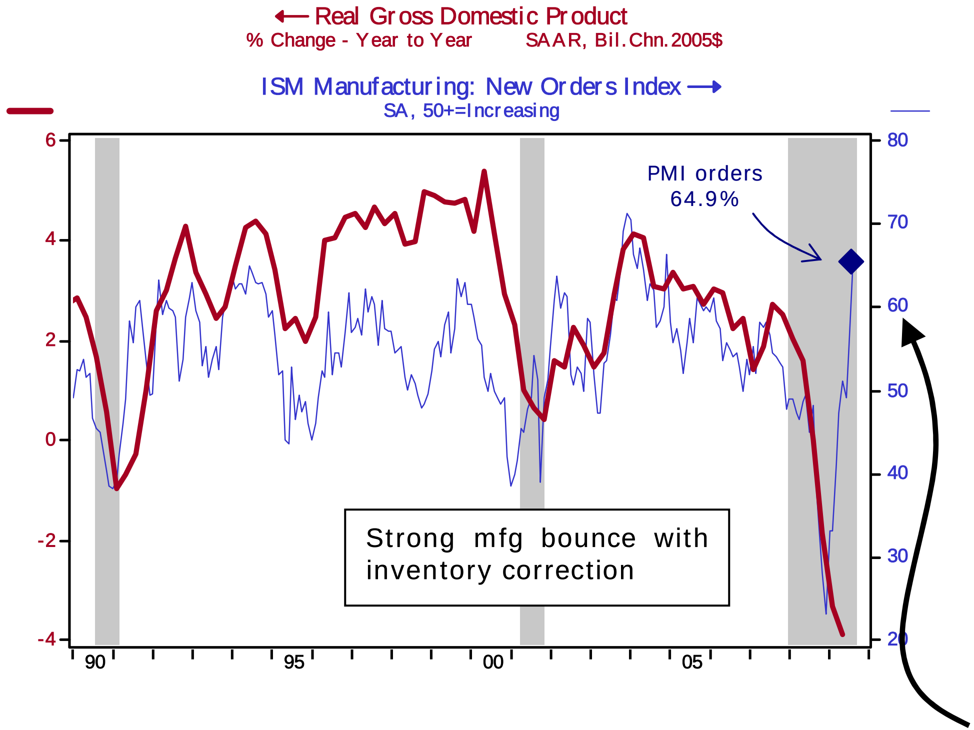
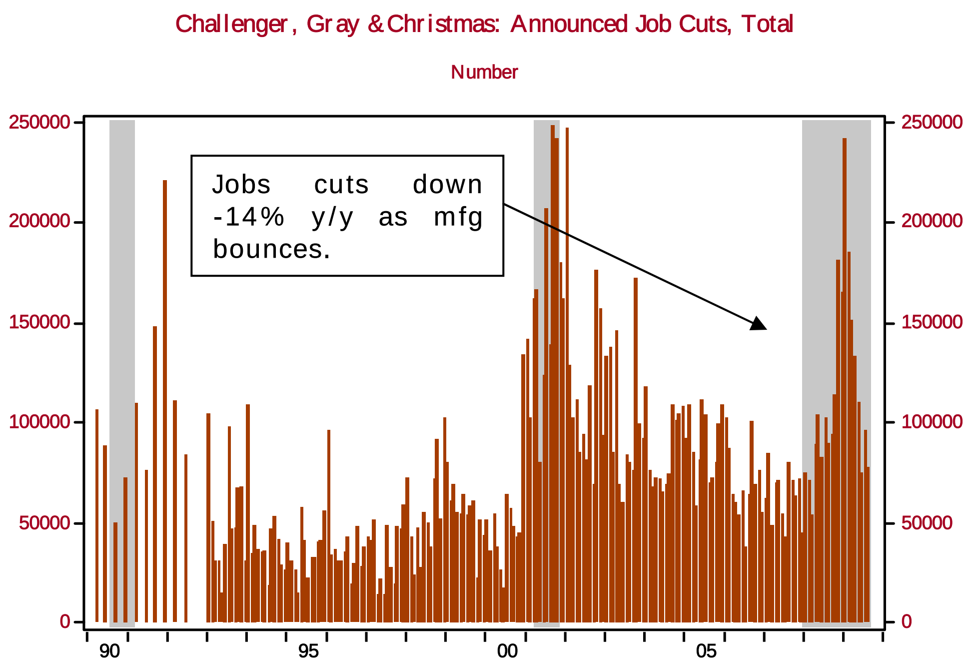
EMPLOYMENT & SERVICES STILL THE MISSING LINKS, BUT AGAIN A VERY STRONG PACKAGE OF CYCLICAL DATA.

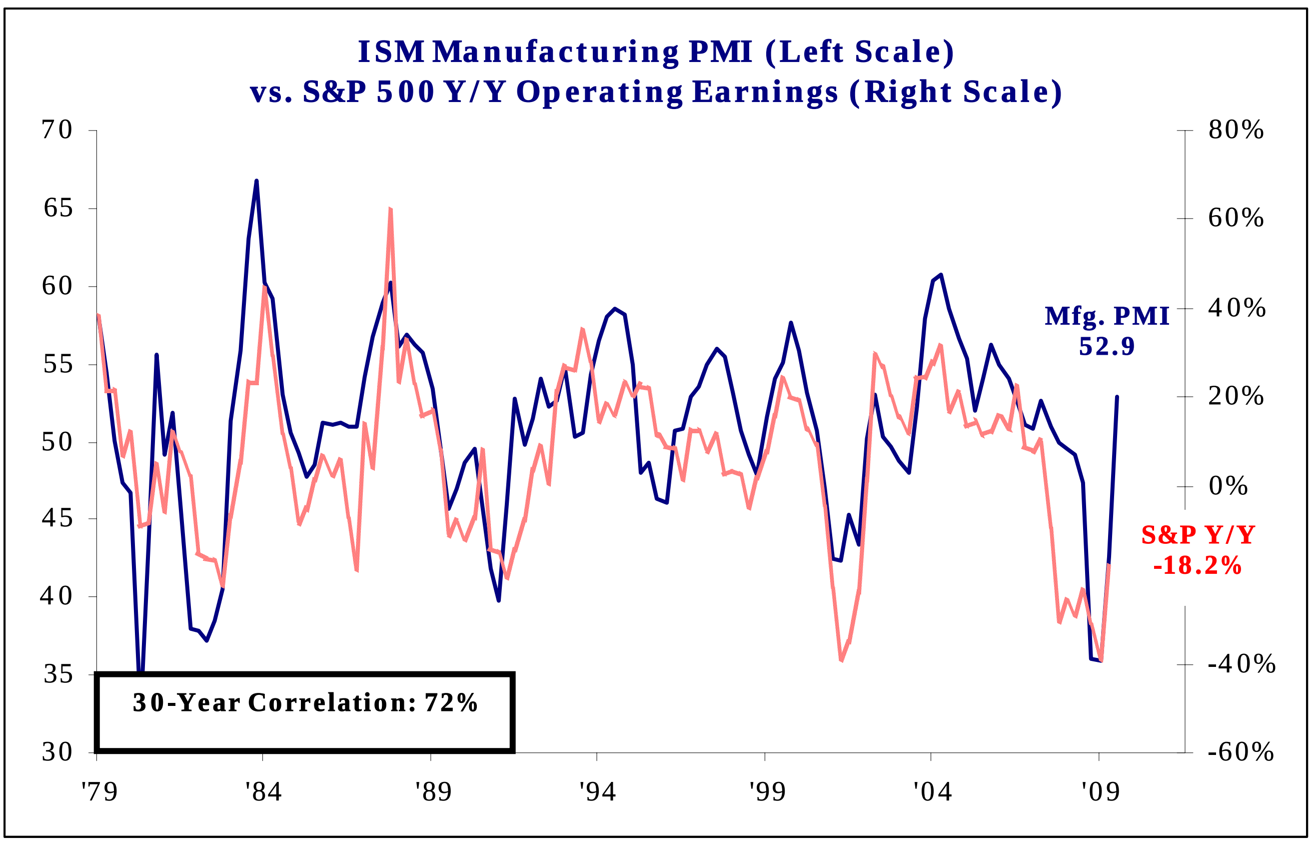




While construction spending overall declined slightly (-0.2% m/m) in July, pending home sales rose +3.2% in the month, contributing to what has been a very strong package of economic data globally so far this week. The manufacturing data has been particularly notable, including the bounce in the mfg PMI to 52.9% in August (solidly in expansion territory), as well as the continued surge in the new orders component to 64.9%. Vehicle sales bounced in August to a 14.1 million SAAR on the back of Cash for Clunkers, and while the sideways moves we've seen in confidence do not suggest a continued surge in spending of that magnitude (especially with employment still under pressure – the ADP report showed an August drop of -298,000 m/m in private payrolls), there does appear to be a floor developing in confidence & housing that indicates a sustainable path to recovery at this point.

ISM MANUFACTURING PMI ABOVE 50 SETTING THE STAGE FOR UPSIDE PROFIT SURPRISE IN 3Q

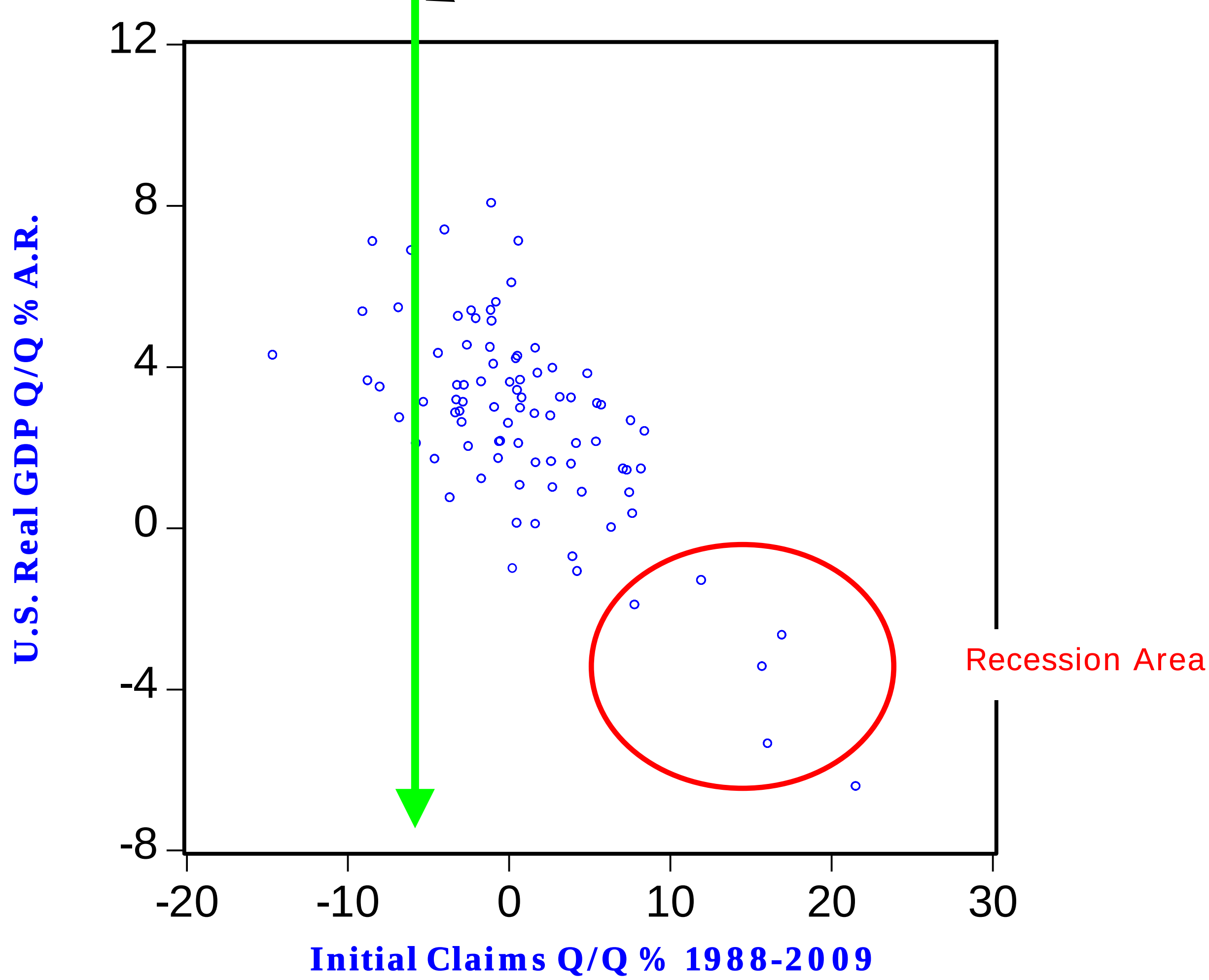
Past experience tells us that it's generally not wise to "blow off" "blow-out" reports. While the headline ISM Manufacturing report might have fallen just shy of that distinction, the new orders component of release certainly qualified. This could be important as we move into the 3Q earnings season since, as the chart below indicates, there is remarkable correlation between the ISM and S&P Y/Y earnings gains. During most recessions, companies tend to lay people off but keep wages constant for workers that remain. What's been odd about this cycle is that companies have laid off workers ***AND*** cut wages for the employees that have stayed-on (FedEx, Yellow Roadways, Wynn Resorts, Caterpillar and AMD). This sets the stage for big operating leverage gains in earnings in the coming quarters. On the next page, we've assembled a list of companies that have had the biggest declines in their COGS and SGA and might therefore provide the best opportunities for upside earnings surprises.



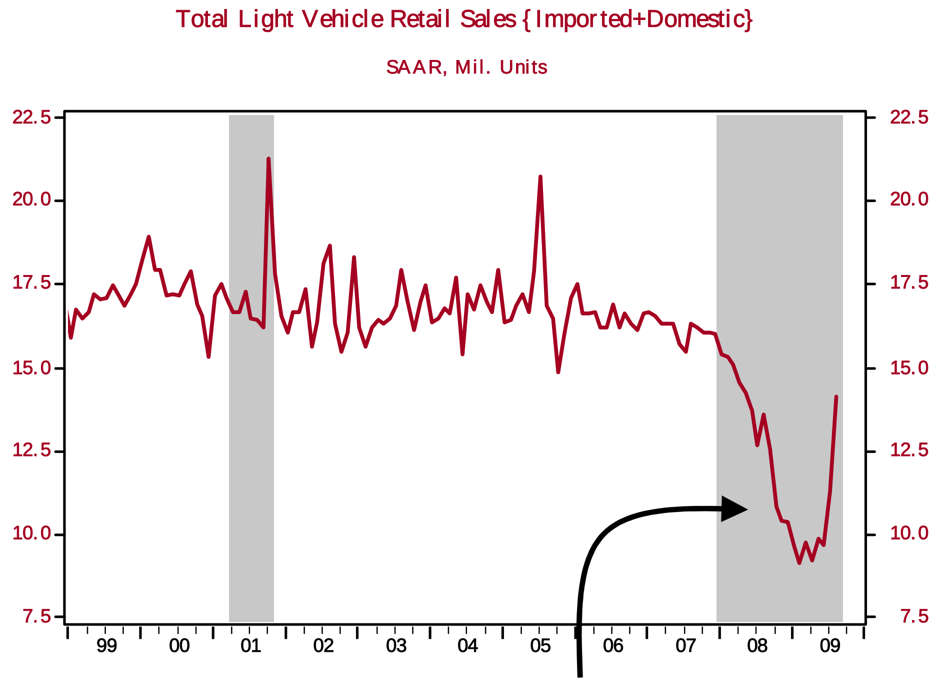
CLAIMS TRENDING LOWER ARE A STRONG SIGN THAT FIRING IS EBBING. NEXT STEP IS TO GET HIRING.

	Initial Claims	Q/Q %	GDP Q/Q % A.R.
2007 - Q3	318		3.6
2007 - Q4	335	5.3	2.1
2008 - Q1	349	4.2	-0.7
2008 - Q2	377	8.0	1.5
2008 - Q3	441	17.0	-2.7
2008 - Q4	512	16.1	-5.4
2009 - Q1	623	21.7	-6.4
2009 - Q2	624	0.2	-1.0
2009 - Q3 e	564	-9.6	

Initial claims were reported at 570,000 this week, which is still an elevated level, but so far in 3Q have averaged 564,000, which is a drop of roughly -10% q/q. This type of decline in claims suggests that the risks are still to the upside regarding 3Q growth – **claims are consistent with real GDP growth of +6.1% in the quarter**.

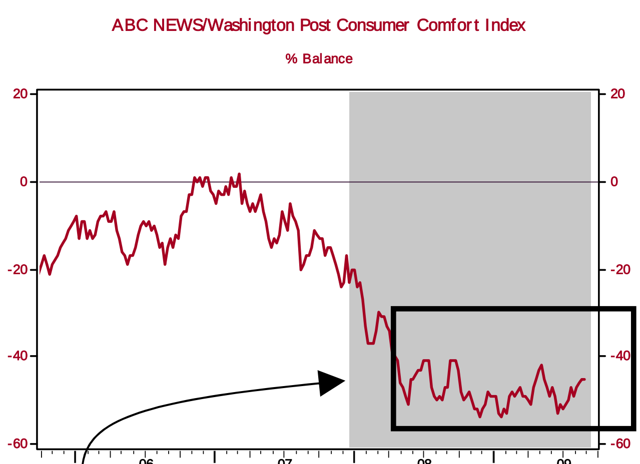


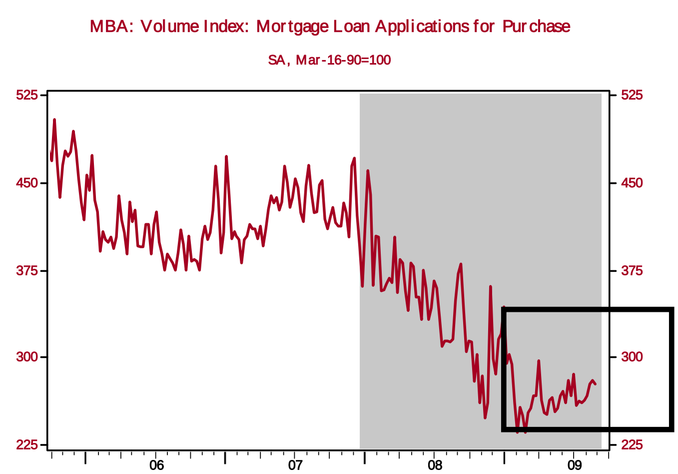
THE RECOVERY, WHILE CHOPPY, APPEARS SUSTAINABLE.



Government created boost, which is real, but job & income growth is needed for a normal cyclical bounce back.

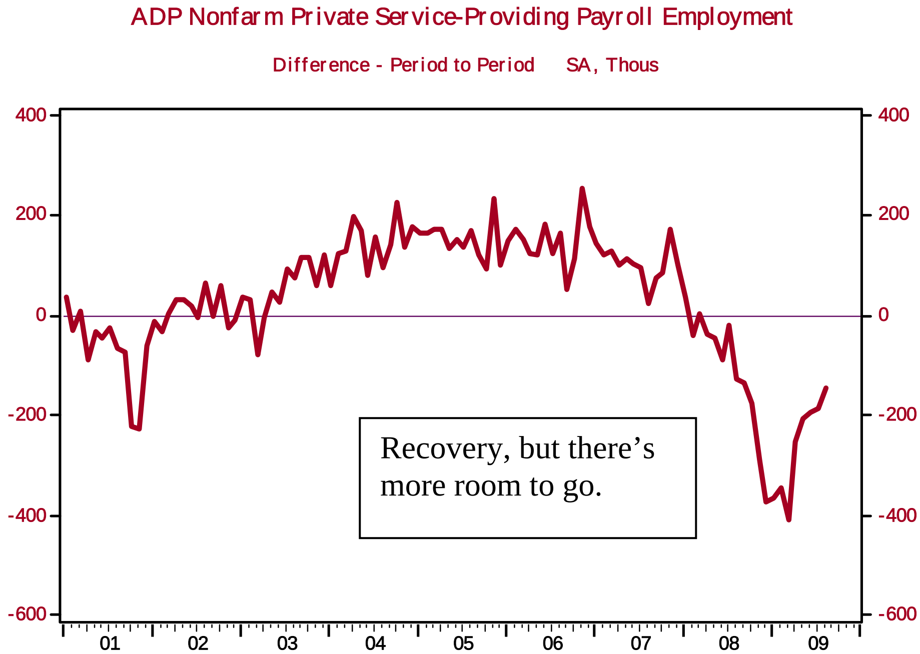
With the Cash for Clunkers program expiring, the boost to auto sales in August is very likely to be reversed. Consumer spending is most fundamentally driven by job and income growth, and though firing has slowed, the path back to hiring is still a long road, especially given the contraction in private payrolls in August. But the floor in consumer confidence and housing (mortgage apps for purchase fell -1.0% w/w this week, but are still in their sideways channel) is likely the key to a sustainable recovery.



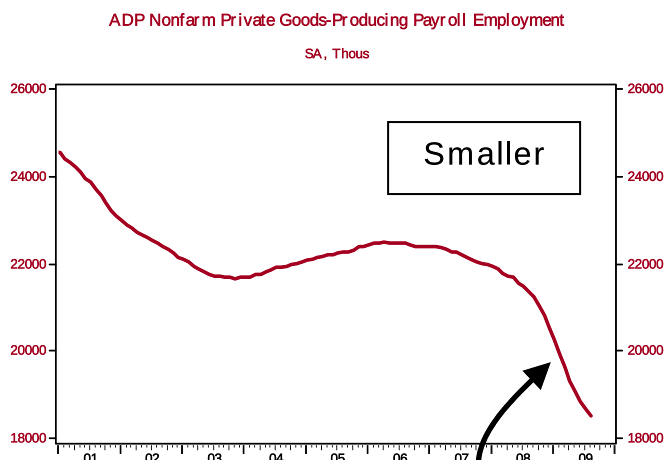


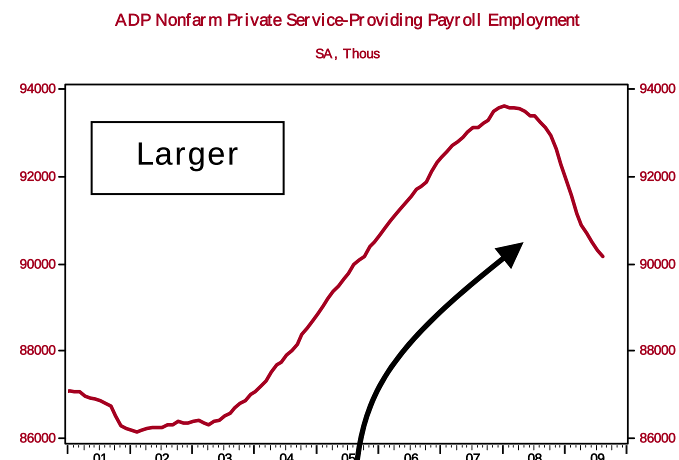
It's this floor in consumer confidence and housing that is the basis for the claim that the recovery appears sustainable. We have timely data on both these sectors, and will be watching closely for any change in direction. So far we've relied on fiscal policy, versus simply interest rate policy, to provide the support.

SERVICE JOBS WILL BE KEY GOING FORWARD



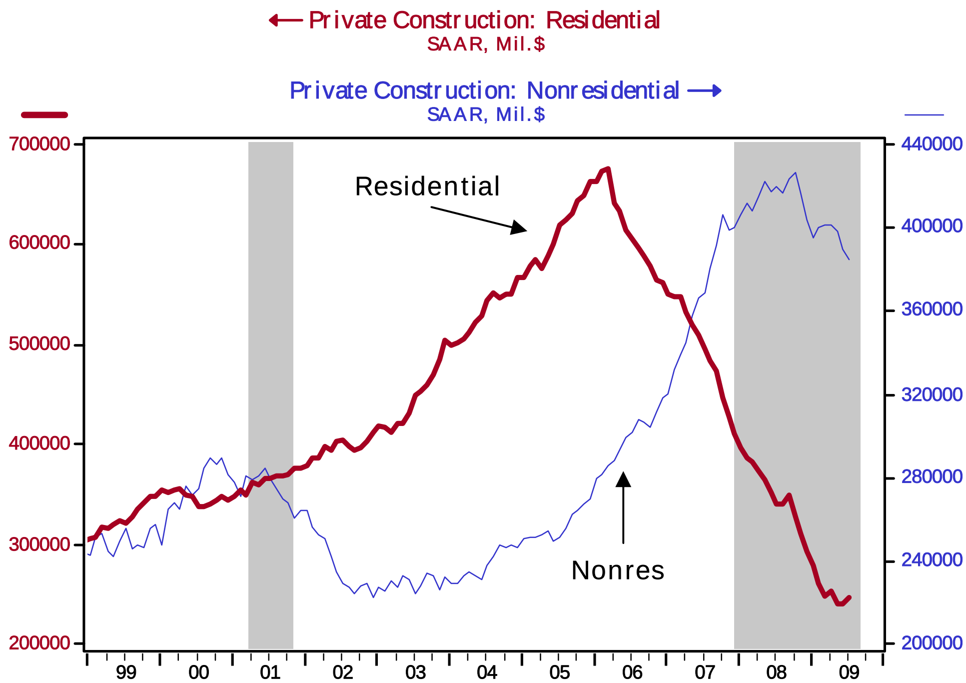
The ADP private payroll report continued to show losses in August, and most disturbing in the data were the continued losses in the service sector.





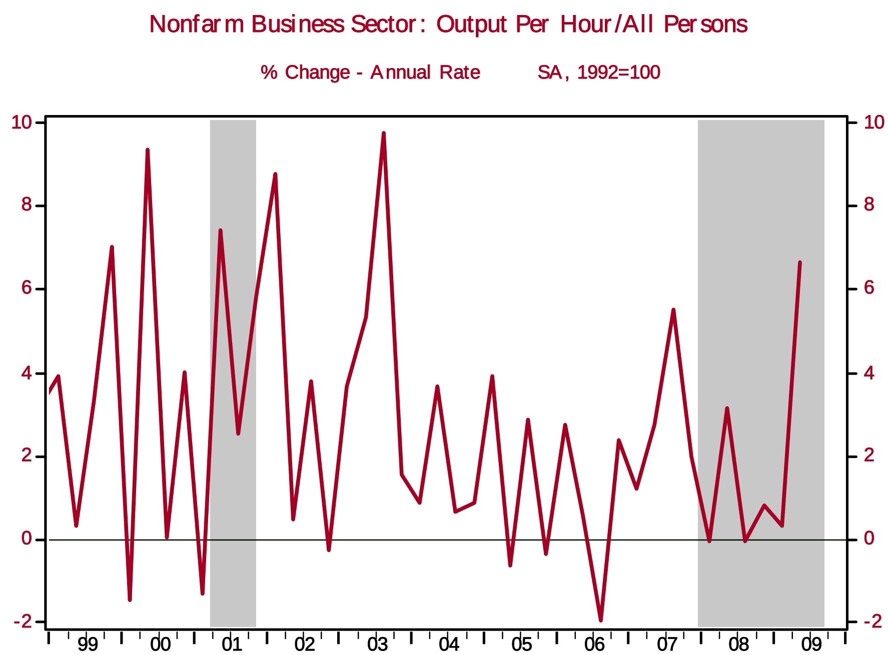
Both goods and services employment remain under pressure, and while there is a "V"-shaped bounce developing in manufacturing, especially as productivity bounces, the same cannot necessarily be said for services.

AS RESIDENTIAL CONSTRUCTION RECOVERS SLIGHTLY, NONRES CONSTRUCTION FADES.



There are sectors of the economy that remain weak, including lagging economic indicators such as nonresidential construction. The boost to residential construction is likely to continue to be muted in the overall data by nonresidential weakness.

PRODUCTIVITY REVISED SLIGHTLY HIGHER IN 2Q



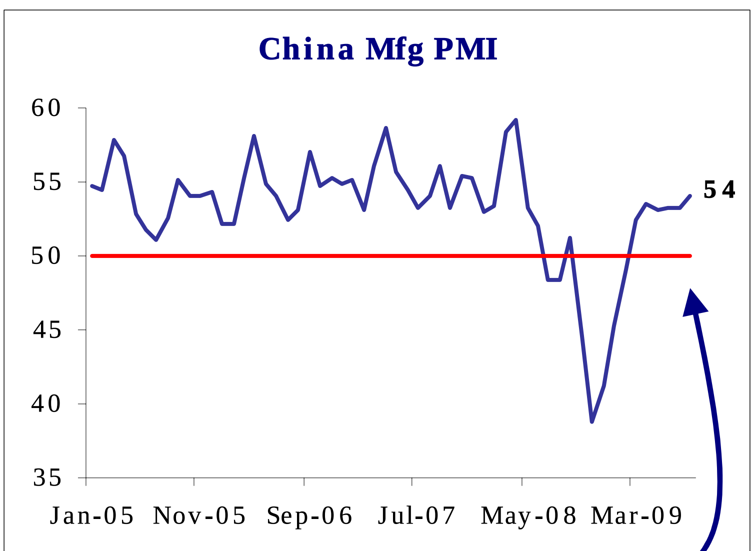
Productivity was revised slightly higher in 2Q from 6.4% to a 6.6% q/q annual rate, which fits with the profits from cost-cutting that we have seen. The top-line growth question, however, still remains, especially for companies that can't tap into faster growing areas outside the U.S.

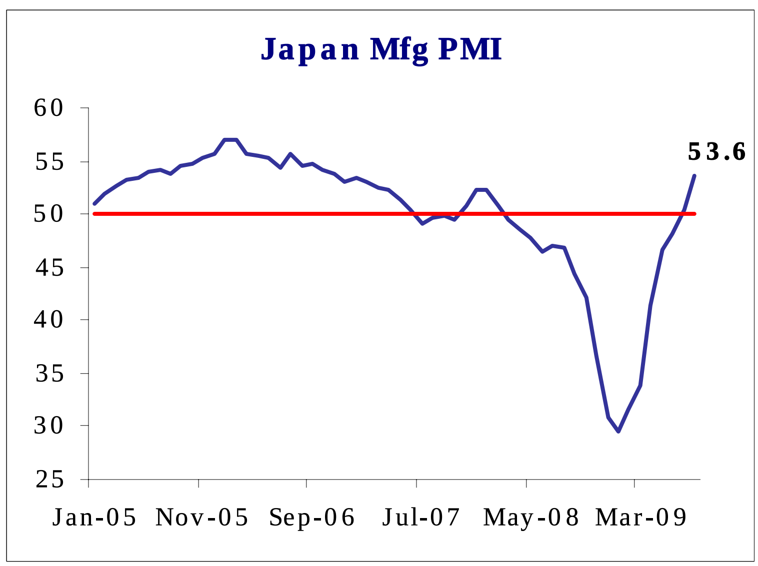
FOREIGN DATA ALSO SHOWING A SUBSTANTIAL CYCLICAL BOUNCE

Only a few bad apples in the group, but this week paints a positive picture overall.

This Week's International Data Updates

		Previous	Current
China	Manufacturing PMI	53.3	54.0
France	Manufacturing PMI	48.1	50.8
Germany	Manufacturing PMI	45.7	49.2
Italy	**Manufacturing PMI**	**45.4**	**44.2**
UK	**Manufacturing PMI**	**50.2**	**49.7**
Japan	Manufacturing PMI	50.4	53.6
Canada	Real GDP Q/Q	-6.1%	-3.4%
Japan	Vehicle Production	-34%	-32%
Italy	Retail Sales Y/Y	-2.5%	-0.8%
Germany	Retail Sales Y/Y	-2.0%	-1.0%
Italy	Bus. Confidence	72.4	74.8
UK	Construction PMI	47.0	47.7
Italy	CPI Y/Y	0.0%	0.2%

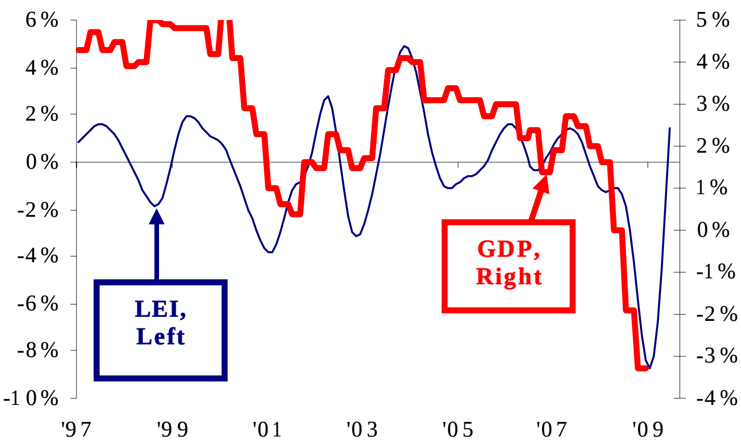




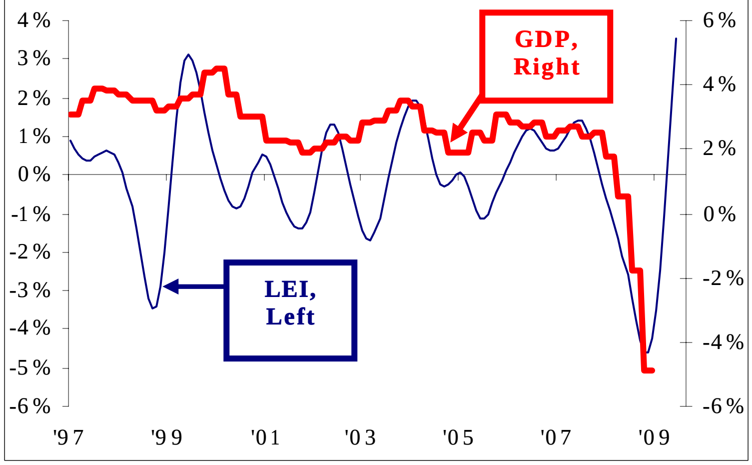
Notably, the China PMI was at a new high in August.

SHARP GDP IMPROVEMENTS LIKELY AROUND THE WORLD

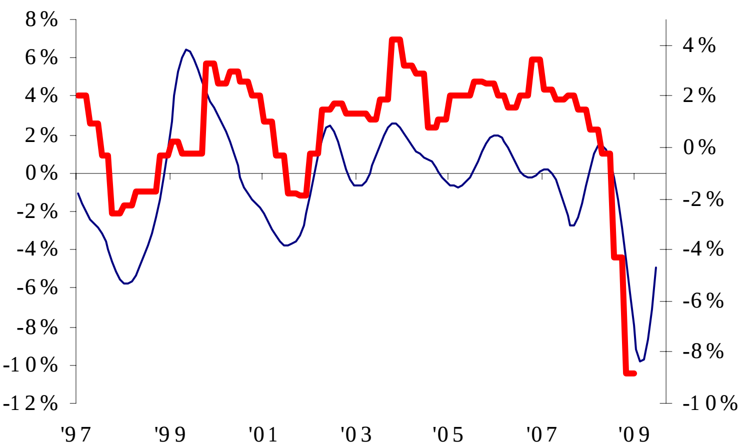
U.S. OECD LEI 6 Mo. % Chg (6 Mo. Lag)
vs. Real GDP Y/Y Pct. Chg



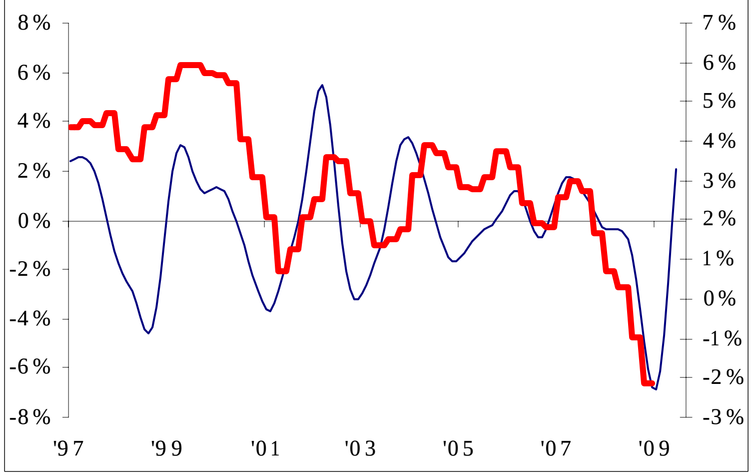
U.K. OECD LEI 6 Mo. % Chg (6 Mo. Lag)
vs. Real GDP Y/Y Pct. Chg



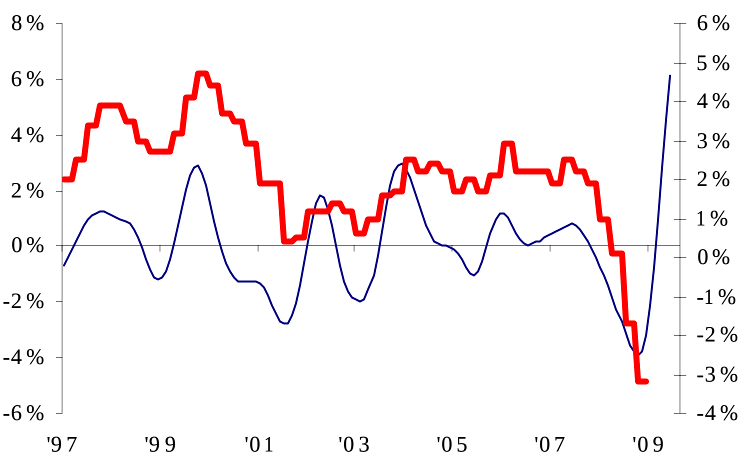
Japan OECD LEI 6 Mo. % Chg (6 Mo. Lag)
vs. Real GDP Y/Y Pct. Chg



Canada OECD LEI 6 Mo. % Chg (6 Mo. Lag)
vs. Real GDP Y/Y Pct. Chg



France OECD LEI 6 Mo. % Chg (6 Mo. Lag)
vs. Real GDP Y/Y Pct. Chg



Germany OECD LEI 6 Mo. % Chg (6 Mo. Lag)
vs. Real GDP Y/Y Pct. Chg