WEEKLY MARKET REVIEW

Week ended December 18th

Stocks Fall Despite Generally Positive Economic News

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This will be our last Weekly Market Review for 2009, a year that began with the financial system in chaos, but is ending with marked improvement. We're now poised for an unprecedented synchronized global expansion, though the pace of the recovery, especially in the U.S. and the rest of the developed world, is likely to be subdued.

Last week, stocks fell and the dollar rallied significantly against the euro, as the eurozone continued to suffer from the effects of Greece's recent credit rating downgrade and Spain's lowered rating outlook.

Meanwhile, the economic news in the U.S. was mixed, but consistent with our expectation of modest growth compared to the recoveries that have followed previous recessions of similar severity.

The Federal Open Market Committee stated in the minutes of its most recent meeting that it anticipates fairly weak economic growth in the months ahead, continued slack in resource utilization and little in the way of inflation. The Federal Funds Rate should therefore remain "exceptionally low" for "an extended period," according to the statement. (The European Central Bank echoed these sentiments in its own statement last week.)

As economic conditions slowly improve in the U.S., we'll see the government scale back many of its stimulative programs, but accommodative interest rates are likely here to stay for some time.

Inflation remains tame despite December spike in wholesale prices

The **Producer Price Index** (PPI), a measure of inflation at the wholesale level, unexpectedly rose 1.8% in November, compared to a 0.3% gain in October. The "core" rate, which excludes energy and food prices, rose 0.5%, compared to a decline of 0.6% the previous month. A sharp spike in gasoline prices drove the headline number higher, while a surge in light truck and tobacco prices underpinned the core rate's rise.

Dr. Jerry Webman is Chief Economist for OppenheimerFunds, Inc. In this capacity, Dr. Webman provides strategic viewpoints on the overall financial and economic markets to investment management and the financial advisor and investor communities.

For over 20 years, Dr. Webman has been involved in the investment and economic markets—as a researcher, a financial advisor and a portfolio manager.

Dr. Webman holds a B.A. in political science, with honors, from the University of Chicago, where he graduated Phi Beta Kappa, and a Ph.D. in political science from Yale University. He is also a Chartered Financial Analyst.

WEEKLY MARKET REVIEW

Week ended December 18th

The PPI data are likely anomalous, given the weak economic backdrop and the much tamer November **Consumer Price Index** (CPI) readings, meaning that producers have been unable to pass cost increases on to the rest of us. The CPI rose to 0.4% from October's 0.3% level, while the "core" rate fell to 0.0% from 0.2%. Energy prices were again primarily responsible for the rise in the headline rate.

Industrial production and capacity utilization rise

Industrial production rose 0.8% in November after rising 0.1% in October, with manufacturing an area of particular strength. With manufacturers producing more goods across the board, they have put more of the nation's industrial resources back to work following a huge pullback during the recession. Capacity utilization, a key measure of industrial resource usage, rose to 71.3% in November from 70.7% the previous month. Despite this improvement, utilization remains low enough to forestall inflation concerns for the time being.

Two regional reports, the **Empire State Manufacturing Survey** and the **Philadelphia Fed Survey**, painted contradictory pictures of conditions in the manufacturing sector. As I've written previously, the sector's recovery remains intact, though we're likely to see bumps along the way.

Leading indicators rise sharply

The Conference Board's **Index of Leading Economic Indicators** rose 0.9% in November, compared to a 0.3% gain in October. The latest reading points to continued economic growth in the first half of 2010. Six of the index's 10 components, including a positive yield curve, rising stock markets and slowing job losses, drove the index higher. An increase in building permits, a longer factory workweek and a rising money supply also contributed to the gain, while worsening consumer expectations, faster supplier deliveries and a decline in capital goods orders detracted. Consumer goods orders were neutral.

Jobless claims drift higher, but downtrend remains intact

Initial claims for unemployment benefits rose by 7,000 to 480,000 in the week ended December 12. The smoother four-week moving average continued to fall, however, reaching its lowest level since September 2008.

WEEKLY MARKET REVIEW

Week ended December 18th

Seasonal employment shifts were likely a factor in last week's results, and I expect the downward trend in jobless claims to continue.

Housing shows signs of continued recovery

Housing starts rose 8.9% in November after falling 10.1% in October. A huge surge in new multifamily projects drove the gains, while single-family home starts barely edged higher. While new construction is important to economic growth, a modest pace of improvement in home starts may be the optimal outcome, since housing inventories remain above long-term levels.

Separately, the National Association of Home Builders' **Housing Market Index** fell slightly in December, to 16 from a reading of 17 in October. Respondents reported that tight credit conditions and high unemployment continue to weigh on the housing market.

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