CAPITAL MARKETS PERSPECTIVES

Weekly Market Review

Week ended **April 9th**

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

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Confidence Rises in the Recovery's Strength

Global markets posted further gains last week, as signs of economic recovery mounted. Successful auctions of 10-year and 30-year Treasuries, marked by solid bidding from overseas investors, helped allay concerns about a possible oversupply of Treasuries raised by two relatively poor March auctions. Treasury yields have risen recently, helping boost participation in the most recent auctions. Moreover, the rising demand for such securities is indicative of the market's growing confidence in the U.S. economy.

Is the U.S. consumer bouncing back?

Last week also brought reasonably positive data on the U.S. consumer. Faced with a housing market bust, massive job losses and widespread deleveraging, the consumer struggled to participate in, and contribute to, the economic recovery in its early stages. Signs are growing, however, that the consumer may be on the mend.

Readers may recall that two weeks ago we saw a welcome return to job growth, and consumer spending has risen for five months in a row. Last week, a report from the International Council of Shopping Centers (ICSC) showed **chain-store sales** up 9.0% in March versus the year-ago period, the fourth consecutive monthly gain and the largest jump since March 1999. An early Easter, good weather nationwide and easy comparisons with last year's weak data contributed to the rise. The report showed strength across retail categories, with apparel doing particularly well.

While these indicators are all positive, I don't expect consumers—or the economy as a whole—to come roaring back to the extent it has following earlier downturns. Besides the millions of lost jobs and huge inventory of unsold homes on the market, consumers are less able to rely on borrowing to finance consumption, which represents about 70% of Gross Domestic Product (GDP). **Consumer credit** has been in a downtrend for two years, and fell again in February, according to a report last week. Most of February's 5.6% annualized decline came from a fall in credit card debt. Essentially, consumers are relying on their incomes, rather than on borrowing, to make purchases. While this is sensible enough behavior on an individual basis, on a larger scale it clearly adds less to economic growth than leveraged spending. As we've been saying for some time, the key to stronger consumer spending in this recovery will be continued employment gains.

A jobs report last week on **Initial claims** for unemployment benefits rose 18,000 to 460,000 in the week ended April 3, but the Department of Labor advises that seasonal adjustments due to the Easter holiday and César Chávez Day (a state holiday in California) skewed the reading. Continuing claims fell 131,000 to 4.6 million in the week ended March 27 (the latest measurement period for this data set), the latest drop in a clear overall downtrend.

China may allow currency to strengthen

Amid ongoing complaints in the U.S. that China's fixed exchange rate gives it an unfair trade advantage, reports surfaced last week that the Chinese government would

soon allow the yuan to strengthen and become more flexible on a day-to-day basis. Treasury Secretary Timothy Geithner recently postponed the release of a report that many in Congress hoped would label China a currency manipulator, and flew to China last week for a series of meetings with Chinese officials. Allowing its currency to strengthen could help China stave off a trade war with the U.S. and may benefit both exporters to China and Chinese consumers. Any such move would also fit with China's other recent initiatives to absorb excess liquidity as its economy heats up.

Greece bailout speculation continues

Greek bonds sold off significantly early in the week before recovering some ground on Friday on reports that the debt-saddled nation may receive a bailout from the European Union and/or the International Monetary Fund (IMF). The 10-year Greek bond yield[1] closed at 7.15% on Friday, a spread of 346 basis points above 10-year German bonds, down from a post-inception of the Euro high of 426 basis points on Thursday. More specifics emerged over the weekend as European governments said they were prepared to extend Greece a €30 billion bailout if needed through three-year loans from fellow currency bloc members at an interest rate of close to 5%. Several steps remain before Greece can use the loan package. German officials say a Greek bond issue must first fail before loans would be considered and then would have to be unanimously approved by eurozone leaders. Greece would also have to agree to a loan arrangement with the IMF as a condition for eurozone aid. All euro-zone countries would contribute to the bailout pool in proportion to a rough measure of their economic size, a prospect that would put further pressure on other countries in peripheral Europe.

There will be no free lunches here. An outright bailout or a restructuring of the debt will come with strings attached forcing Athens to undertake severe austerity measures that will likely extend the recession in Greece for the foreseeable future. The fate of the creditors is still unclear but a restructuring of the debt could result in a "haircut" for bondholders.

[1] Bloomberg

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