Monday, January 23, 2012

The Upshot

All the market insight and data you need to jumpstart your week

Focus Shifts from Fear to Fundamentals

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Last week's rally in stocks could be a launching point for investors to overcome anxiety and regain focus on market valuations, corporate earnings and improving macroeconomic conditions.

Investors are finally paying attention to fundamentals.

Fueling that focus was an abundance of positive economic data released last week, which confirmed the upward trend in the U.S. economy. After months of trepidation during which signs of improvement were repeatedly shrugged off, investors let go of their fears and sent the Dow Jones Industrial Average and the S&P 500 up over 2% on the week. The yield on 10-year Treasurys rose to 2.028%, marking its highest level in more than a month. Gold also increased but the price of oil remained sedate, safely under $100 per barrel.

First off, initial jobless claims for the week ended Jan. 14 came in at 352,000. This was far better than consensus expectations, which were in the neighborhood of 385,000. It is also an improvement over the already strong first-time unemployment claims we've seen in the past few months. But there have been other signs of improvement in the employment arena, as we've highlighted in *The Upshot* previously. The unemployment rate fell to 8.5% in December while non-farm payrolls have become increasingly strong. And the surprising 200,000 net gain in December payrolls, building upon earlier private-sector gains, was "a heartening sign of a potential firming trend," said Richmond Federal Reserve Bank President Jeffrey Lacker.

But even more important is the potential for further—and more substantial—improvement in the job market this year, as highlighted in research published by the Philadelphia Federal Reserve last week. Many strategists have been resolute in their view that the employment picture will not improve much this year due to all the political uncertainty in the United States, which they believe is prompting businesses to postpone major decisions such as hiring staff. However, in its recent survey, the Philadelphia Fed found that expected sales growth—not uncertainty about regulations or government policies—is the most important factor constraining hiring. One could argue credibly that sales growth or the expectation of

Index returns for the week ended January 20, 2012

Broad Market Returns	Total Return Wk (%)	Total Return MTD (%)	Total Return QTD (%)	Total Return YTD (%)
DJ Industrial Average	2.46	4.27	4.27	4.27
S&P 500	2.06	4.70	4.70	4.70
BarCap U.S. Agg Bond	-0.50	-0.09	-0.09	-0.09
DJ UBS Commodity	0.52	0.40	0.40	0.40
FTSE NAREIT All REITs	2.49	3.86	3.86	3.86
NASDAQ Composite	2.81	6.99	6.99	6.99
Equity Returns	**Total Return Wk (%)**	**Total Return MTD (%)**	**Total Return QTD (%)**	**Total Return YTD (%)**
Russell 1000	2.10	4.91	4.91	4.91
Russell Mid Cap	2.25	5.46	5.46	5.46
Russell 2000	2.68	5.93	5.93	5.93
MSCI EM	4.44	8.64	8.64	8.64
MSCI EAFE	4.04	4.26	4.26	4.26
MSCI Europe	4.65	3.88	3.88	3.88
MSCI Pacific	2.95	4.85	4.85	4.85
MSCI Pacific Ex-Japan	3.20	7.05	7.05	7.05
MSCI Japan	2.79	3.51	3.51	3.51
MSCI China	4.05	9.41	9.41	9.41
Bond Market Returns	**Total Return Wk (%)**	**Total Return MTD (%)**	**Total Return QTD (%)**	**Total Return YTD (%)**
BarCap U.S. Agg Bond	-0.50	-0.09	-0.09	-0.09
BofAML U.S. HY Master II	0.58	1.66	1.66	1.66
BofAML All Convertibles	1.45	4.48	4.48	4.48
JPM GBI Global Ex-U.S.	0.70	-0.25	-0.25	-0.25
JPM EMBI Global	1.01	0.47	0.47	0.47
BarCap Long Term U.S. Treasury	-2.90	-2.93	-2.93	-2.93
BarCap U.S. Treasury 1–3 Yr	-0.03	0.03	0.03	0.03
Equity Style Returns	**Total Return Wk (%)**	**Total Return MTD (%)**	**Total Return QTD (%)**	**Total Return YTD (%)**
Russell 1000 Value	1.86	4.90	4.90	4.90
Russell 1000 Growth	2.35	4.92	4.92	4.92
Russell Mid Cap Value	1.94	4.85	4.85	4.85
Russell Mid Cap Growth	2.57	6.09	6.09	6.09
Russell 2000 Value	2.57	5.73	5.73	5.73
Russell 2000 Growth	2.79	6.13	6.13	6.13
Russell Micro Cap Value	2.97	6.29	6.29	6.29
Russell Micro Cap Growth	2.21	7.03	7.03	7.03

sales growth is likely to occur well before we gain visibility on regulations and government policies. That would likely be a salve for distressed labor conditions.

"Expected sales growth—not uncertainty about regulations or government policies—is the most important factor constraining hiring."

Home Improvement

Housing is also showing signs of recovery. December existing home sales rose 5%, albeit slightly short of expectations, suggesting that the battered sector is making strides. December signaled the third straight month of sales increases, pushing the supply of existing homes listed for sale to its lowest level since 2006, according to the *Wall Street Journal*. The fact that mortgage rates hit another low should help move the needle on housing going forward.

In addition, recent releases from both the Philadelphia Fed and the New York Fed are confirming the "firming" of the economic recovery. The Philadelphia Federal Reserve Business Outlook Survey showed continued expansion at a modest pace in January. The general activity index, a broad measure of manufacturing conditions, showed a substantial increase from December to January. Meanwhile, the Empire State Manufacturing Survey also showed a continued acceleration in business activity, continuing a trend seen since October 2011. The New York Fed noted that its January survey recorded a "highly optimistic six-month outlook" from businesses. But this recovery is clearly not just regional: the Economic Cycle Research Institute's leading U.S. index jumped 2.3 points in the week ended Jan. 13 to 123.4, indicating an improvement in the nation's economic activity.

Finally, the European debt crisis, which has weighed heavily on global equity markets, appears to be improving. Indeed, the *Financial Times* reported that money market funds are once again buying European bank paper. There's no greater sign of confidence than actual investment. And so investors' move into equities could be a key sign of confidence in the economy and corporate fundamentals. In this type of market, they can answer the bell by staying focused on the fundamentals, so long as they don't let the noise in.

View the online version—including the chart of the week:

Surging home sales and sentiment suggest we have already seen the bottom in housing.

Market Movers

This week's economic calendar

Monday

No major economic releases

Tuesday

FOMC Meeting Begins

Wednesday

FHFA House Price Index
Previous: -0.2%/Consensus: -0.1%

Pending Home Sales Index
Previous: 7.3%/Consensus: -1.0%

FOMC Meeting Announcement (Fed Funds Target Rate)
Previous: 0.0%–0.25%/Consensus: 0.0%–0.25%

Thursday

New Durable Goods Orders
Previous: 3.8%/Consensus: 2.2%

New Jobless Claims
Previous: 352,000/Consensus: 370,000

New Home Sales
Previous: 315,000/Consensus: 320,000

Leading Indicators (month/month change)
Previous: 0.5%/Consensus: 0.7%

Friday

Real GDP (quarter/quarter change)
Previous: 1.8%/Consensus: 3.1%

GDP Price Index (quarter/quarter change)
Previous: 2.6%/Consensus: 1.5%

Consumer Sentiment
Previous: 74.0/ Consensus: 74.0