Economic Update

Broadleaf Partners, LLC

Naughty and Nice

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We've been busy checking our list once, checking it twice, and trying to figure out which sectors have been naughty and which have been nice. And in spite of two continued lumps of coal in the housing and banking sectors, the news is actually quite encouraging.

Several economic data points came out this morning which suggest that a recession, while still possible, is not as likely. Here is a quick recap:

- **Decent Employment Growth.** ADP's employment report showed new payrolls of 189,000 compared to expectations of 50,000. Additional data on the employment report should be out shortly.
- **Inflationary Drivers Contained.** Unit labor costs, a primary determinant of inflationary pressures declined 2% versus a 1.2% expectation.
- **Positive New Order Data.** New factory and durable goods orders in October increased or were revised upwards, suggesting decent industrial demand, according to this morning's ISM release. At least things aren't falling apart.
- **More Positive CEO Outlook.** Consistent with the ISM release, a monthly CEO Roundtable survey was also encouraging. Two thirds of the CEO's surveyed were positive about their sales expectations for the next six months, expecting them to rise. This was a slight improvement over September's survey results.

Like technology stocks in 2001, most of the short and long term pain is being felt by a narrow subset of the overall economy, the housing and credit related markets. These areas do not appear, at this point in time, to be capable of dragging the rest of the economy into a recession. The data this morning is actually positive for the markets as a whole, as the tame unit labor cost data and the existence of a credit crisis should give the Fed plenty of room to cut rates.

From an investment perspective, there are two implications from this data. First, we'd still be cautious about housing and the banking related sectors. While valuations are depressed and dividend yields are high, the stocks could have further room to fall. History supports the notion that the stocks of pricked bubbles aren't good buys until they've retraced ALL of the gains they enjoyed on the upside. A quick look at the charts of the most common housing and banking related exchange traded funds aren't encouraging from this perspective. Of the two, banking looks a lot better, and while it may benefit more directly from Fed actions, we're still cautious.

The second implication of the data could be positive for the consumer discretionary sector going forward. This area of the market has been hit as hard as any and yet the

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decline hasn't been accompanied by deteriorating fundamentals, only the *expectation* of deteriorating fundamentals. If employment remains solid, as it has, spending might remain better than most expect and Christmas might not be such a disaster.

We're pretty sure Santa's still coming to town.

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