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# Weekly Viewpoint



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## Payroll Report Signals Recovery Intact

### WEEK IN REVIEW

11/30/09 – 12/4/09

The major indices finished the week moderately higher as investors received additional confirmation that the economic recovery is moving forward. The Dow and S&P 500 have now finished higher in four of the past five weeks, while the Nasdaq has gained in three of the past five.

### Performance for Week Ending 12/4/09

The Dow Jones Industrial Average (Dow) rose 0.8%, the Standard & Poor's 500 Index (S&P 500) added 1.3% and the Nasdaq Composite Index (Nasdaq) tacked on 2.6%. Sector breadth was positive as nine of the 10 S&P sector groups finished higher. The Utilities sector (+3.9%) was the best performing while Energy (-1.5%) was the worst. The Canadian market, as measured by the S&P/TSX Composite Index, gained 0.4%.

Index*	Closing Price 12/4/09	Percentage Change for Week Ending 12/4/09	Year-to-Date Percentage Change Through 12/4/09
Dow	10388.90	+0.77% ▲	+18.37% ▲
S&P 500	1105.98	+1.33% ▲	+22.44% ▲
Nasdaq	2194.35	+2.61% ▲	+39.14% ▲
S&P/TSX Composite	11510.80	+0.40% ▲	+28.07% ▲

\*See Last Page for Index Definitions.

### Market Observations: 11/30/09 – 12/4/09

The major indices finished the week moderately higher as investors received additional confirmation that the economic recovery is moving forward. The market over the past several weeks has demonstrated incredible resiliency in light of some unevenness in a handful of key economic reports. The ability to shrug off bad news underscores that investors likely gauge a bigger risk being out of the market than in it, in my opinion. Although the market has posted solid gains off the March lows, the macro environment of low interest rates, a budding economic recovery, and the pending turn in corporate profitability remains conducive for additional upside in the weeks and months ahead, in my opinion.

**Payroll Report...** As a signal that the employment situation in the U.S. may be stabilizing, the Labor Department reported that nonfarm payrolls fell by only 11K significantly outpacing the 125K decline expected by economists. In addition, the unemployment rate dipped to 10% from 10.2% in October. Other encouraging signs included the uptick in

temporary help and average weekly hours worked. Both tend to be leading indicators of future employment trends as employers typically test the waters through longer hours and temporary hiring before actually taking on permanent new employees. In fact, temporary hiring has increased by 117K jobs since July.

The report raises the probability that the economy will start to experience job growth by early next year. Because the U.S. economy is consumer-driven and consumers are accountable for approximately 70% of economic growth, stabilization/improvement in the labor markets is a vital component to rebuild consumer confidence. Last week's employment figures may be an early signal that the eventual transition to a consumer led recovery is gearing up.

**...Bittersweet?** With most investors having concluded that the Federal Reserve Board (the "Fed") will refrain from raising interest rates until the employment situation improves, the much better than expected payroll report raised fears that the Fed could act sooner rather than later. A look at the Fed Fund Futures shows that traders are beginning to raise their bets on higher rates. The current implied probability shows better than a 50% chance that the Fed Funds rate will be raised from the current range of 0% to 0.25% by mid-year. The Fed has kept interest rates very low in an effort to inflate asset prices by discouraging people from holding low yielding investments. The threat of higher interest rates could lessen the attractiveness of "risk assets" as well as raise borrowing costs. There's an old Wall Street saying: "Don't fight the Fed." While the threat of higher rates is worrisome to some, I believe that higher rates should be viewed as a sign the economy is healing. In addition, rates are so low that a modest uptick would likely do little harm.

**Recession Over?** While most economists have already come to the conclusion that the recession likely ended at the end of the second quarter, we are still waiting for the official "time stamp" from the NBER. Following the better than expected payroll report, Robert Hall who heads the National Bureau of Economic Research (NBER) Dating Committee opined, "The trough in output was probably sometime in the summer." Hall's conclusion also coincides with data released by The Conference Board that suggested that the recession ended at the end of June. The Conference Board's Composite of Coincident Economic Indicators (CEI) troughed at the end of June. The CEI is closely watched as it tracks the four primary indicators (payrolls, production, income, and business sales) that are used by the National Bureau of Economic Research to date the start and end of recessionary periods. The CEI has a stellar track record of peaking and troughing at the beginning/end of almost every recession since 1970. The bottoming in the data generally syncs with the consensus call from economists that the economy transitioned to an expansionary phase at the start of the third quarter. The generally sideways action since the trough also appears to be in line with expectations of a muted recovery.

**Bernanke in the Hot Seat.** Federal Reserve Chairman Ben Bernanke appeared in front of the Senate Banking Committee in a confirmation hearing for his nomination to a second term. The committee grilled Bernanke about the Fed's performance in stabilizing/reviving the economy, in what appeared to be "grandstanding" by several members. Ultimately, I believe Mr. Bernanke has done an admirable job in stabilizing the economy and without the myriad of programs enacted, the economic

situation could have been much worse. Despite the "tough crowd," it is expected that Mr. Bernanke will be confirmed.

**Economic Data – Fits and Starts.** Last week's data was spotty, but generally signaled the economic recovery remains intact. The Institute for Supply Management (ISM) reported their Manufacturing Index fell to 53.6 in November from 55.7 in October. While the headline number indicated a fourth consecutive month of growth in the manufacturing sector (the ISM is a diffusion index where reading above 50.0 signal expansion and below 50.0 contraction), the underlying components of the index were mixed. The new orders component rose to 60.3 while the inventory component fell to 41.3 from 46.9 and the employment component fell to 50.8 from 53.1. The ISM also reported their Non-Manufacturing Index (services) fell back into contraction mode. Despite the poor headline number, the ISM new orders component remained solidly in expansion mode, a potential precursor for future improvement. A recovery in the services side of the economy is vital as service oriented businesses account for almost 90% of the U.S. economy.

**Housing.** The National Association of Realtors reported that Pending Home Sales jumped 3.7% in October and have gained for nine consecutive months. The combination of low financing costs, high affordability and the first time home buyers credit seem to be luring people off the sidelines. In fact last week, according to Freddie Mac, the rate on 30-year fixed rate mortgages fell to 4.71%, the lowest level in at least 38 years. Meanwhile, the Mortgage Bankers Association reported that mortgage applications in the week ended November 27 rose by 2.1%. The uptick in applications was the fourth gain in the past five weeks. The uptick in applications was driven by a 4.1% gain in the purchase component and 1.7% gain in refinancing activity.

**Gold.** After reaching a new high of over \$1225/oz. mid-week, gold fell sharply on Friday and finished the week down 1.4%. A rebound in the dollar and a much-needed round of profit taking were the primary reasons for the pullback, in my opinion. Following the parabolic move over the past several weeks, traders appeared to be blowing some froth off the yellow metal. The love affair with gold has generally become a crowded trade and might be compared to what happens when everyone stands on one side of a boat. From a purely technical point of view, gold appeared ripe for a period of consolidation. With that said, the macro environment and general concerns with fiat currencies will likely lead to higher prices over the foreseeable future. Pullbacks within a solid uptrend are very healthy and typically result in an opportunity to buy on weakness and/or establish new positions.

## Market Viewpoint

**Maintain Positive Intermediate Term Outlook.** Despite the fact that the S&P 500 has posted sharp gains since the March lows, I continue to believe that additional upside is likely over the intermediate term. While I believe the "easy money" in the market has been made and the pace of gains will likely slow, the combination of low interest rates, a projected turn in the corporate earnings cycle and the budding economic recovery, likely means the bull market rally has further room to run. In addition, bull market rallies rarely end at the early stages of a recovery in corporate profits. After nine

consecutive quarters of negative earnings growth, S&P 500 earnings are forecast to turn positive in the current quarter.

With that said, selectivity will also become more important going forward as the rising tide may not raise all ships as it has over the past several months. The recent return of the Institute for Supply Management (ISM) Manufacturing Index back into expansionary mode historically has favored “pro-economy” sectors (Materials, Energy, Tech, Industrials, Discretionary) over Defensive sectors. In addition, on an asset class level, a rotation into large-cap stocks from the small-caps space remains evident. Not only does relative valuation favor large-cap stocks, but large caps also tend to have a higher portion of revenues generated in the overseas markets and are likely to benefit from the positive “currency translation” effect associated with the weakness in the U.S. dollar.

**Potential Risks/Wildcards:** My expectation that stock prices will trend higher over the next 6 to 12 months assumes an economic recovery continues to progress, a stable to moderately declining price environment (no extended periods of deflation and/or hyperinflation), and a recovery in earnings growth. A delay of any of these events could ultimately prolong the market’s recovery period.

#### Definitions

**The Dow Jones Industrial Average** is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

**Standard and Poor’s 500 Index** is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

**The Nasdaq Composite Index** is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

**The S&P/TSX Composite Index** is a capitalization-weighted index designed to measure market activity of stocks listed on the Toronto Stock Exchange (TSX). The index was developed with a base level of 1000 as of 1975.

**The National Bureau of Economic Research (NBER)** is a private, nonprofit, nonpartisan research organization dedicated to promoting a greater understanding of how the economy works. The NBER is committed to undertaking and disseminating unbiased economic research among public policymakers, business professionals, and the academic community.

**The Conference Board Coincident Economic Index (CEI)** is a measure of current economic activity.

The Conference Board is a not-for-profit organization that creates and communicates knowledge about management and the marketplace to help businesses strengthen their performance and better serve society. The Conference Board operates as a global independent membership organization working in the public interest. It publishes information and analysis, makes economics-based forecasts and assesses trends, and facilitates learning by creating dynamic communities of interest that bring together senior executives from around the world.

#### Institute for Supply Management (ISM) Manufacturing and Non-Manufacturing Indices:

**The Manufacturing Index** is a monthly composite index that is based on surveys of 300 purchasing managers throughout the United States in 20 industries in the manufacturing area. The index is released on the first business day of the month and covers the previous month’s data, which makes it particularly timely. If the index is above 50, it indicates that the economy is expanding. Values below 50 indicate a contraction.

**The Non-Manufacturing Index** is based on surveys of 370 purchasing and supply executives. If the index is over 50, it typically indicates expansion among non-manufacturing components of the economy. A value under 50 indicates contraction. There are ten sub-indices. Of those, the business activity sub-index is most influential. The other nine indices are new orders, supplier deliveries, employment, inventories, prices, backlog of orders, new export orders, imports, and inventory sentiment. A limitation of the survey is that it doesn’t include any questions on wages, which is an important component of overall costs.

**National Association of Realtors (NAR)** strives to be the collective force influencing and shaping the real estate industry. It seeks to be the leading advocate of the right to own, use, and transfer real property; the acknowledged leader in developing standards for efficient, effective, and ethical real estate business practices; and valued by highly skilled real estate professionals and viewed by them as crucial to their success.

**The Mortgage Bankers Association (MBA)** is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. The mission of the Washington, D.C.- based association includes, but is not limited to, investing in communities across the nation by ensuring the continued strength of the nation’s residential and commercial real estate markets; expanding homeownership and extending access to affordable housing to all Americans and supporting financial literacy efforts.

Indices do not include any expenses, fees, or sales charges, which would lower performance. Indices are unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

The individual companies mentioned in this piece were for informational purposes only and should not be viewed as recommendations.

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