Weekly Economic Commentary

April 09, 2012

March Job Report Disappoints, but Labor Market Continues to Heal

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Highlights

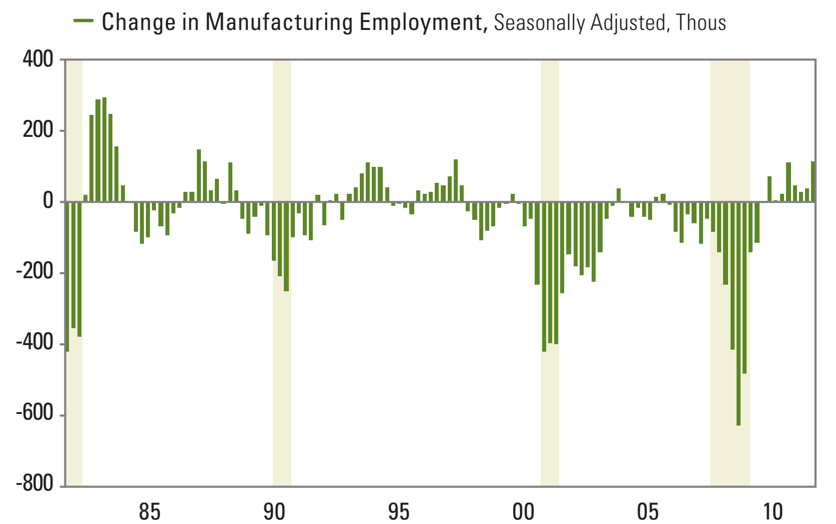
The labor market is healing and is probably in better shape than it was last summer.

The economy is probably not growing quickly enough to generate more than 200,000–225,000 jobs per month.

The Federal Reserve (Fed) may put another round of quantitative easing (QE) on the table in June.

The March employment report, released on Friday, April 6, 2012, was a disappointment relative to both expectations and the labor market data in recent months. Some of the disappointment in March 2012 may have been "payback" for a much warmer-than-usual winter. On balance, however, the report and its underlying details suggest that the labor market continues to heal, but it still has a long way to go to get back to normal. The lackluster March jobs report also puts another round of quantitative easing (QE) back on the table for the Federal Reserve (Fed).

1 The 120,000 Manufacturing Jobs Added in the First Quarter Were the Third Most in Any Quarter Since the Early 1980s



Source: Bureau of Labor Statistics, Haver Analytics 04/09/12

(Shaded areas indicate a recession)

The March jobs report does little to change our view that the U.S. labor market is healing, albeit slowly, but still has a long way to go to recoup all of the jobs lost during the Great Recession.

The March employment report revealed that the economy added 121,000 private sector jobs in March, far fewer than the consensus expectation of 215,000, and well below the 250,000 jobs created on average in the three months ending in February 2012. In fact, the result was below the lower end of the range of consensus expectations (+185,000 to +265,000). This has happened in just nine of the 63 months since early 2007. Despite the disappointment, there were some bright spots in the report, including the drop in the unemployment rate to 8.2% from 8.3% in February. The financial markets initially reacted poorly to the data. However, the March jobs report does little to change our view that the U.S. labor market is healing, albeit slowly, but still has a long way to go to recoup all of the jobs lost during the Great Recession.

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LPL Financial Research Weekly Calendar

2012	U.S. Data	Fed	Global Notables
9 Apr		Bernanke Lockhart Rosengren	**China: CPI (Mar.)**
10 Apr	**NFIB Small Business Optimism (Mar)** JOLTS (Feb) Wholesale Inventories (Feb)	Fisher Klocherlakota	**China: Imports and Exports (Mar.)** IMF Global Forecast Bank of Japan Meeting
11 Apr	Import Prices (Mar) Budget Statement (Mar)	**Beige Book** Rosengren Bullard Yellen	Germany: Bond Auction
12 Apr	Trade Balance (Feb) **Initial Claims (4/7)** Producer Price Index (Mar)	Plosser Klocherlakota	**Italy: Debt auction** Indonesia central bank meeting **China: Industrial Production (Mar)** China: Retail Sales (Mar)
13 Apr	Consumer Price Index (Mar) Consumer Sentiment (1H Apr)		**China: GDP (Q1)** South Korea central bank meeting Iran nuclear talks

Hawks: Fed officials who favor the low inflation side of the Fed's dual mandate of low inflation and full employment

Doves: Fed officials who favor the full employment side of the Fed's dual mandate

Behind the unambiguously disappointing headline job count, there were several bright spots in the March jobs report.

- With the 120,000 gain in March, the economy has now added jobs in each of the past 25 months, the longest such streak since mid-2005 through mid-2007.
- The diffusion index—the number of industries adding workers less the number of industries shedding workers—stood at a robust 67.9% in March, and averaged 68% in the first quarter of 2012, one of the highest readings in 20 years.
- The manufacturing sector added 37,000 jobs in March 2012, the 16th time in the last 17 months that manufacturing jobs have increased. Q1 marked the third best quarter (Q3 1987 and Q4 1997) for manufacturing employment since the middle of 1984.
- State and local government employment, which has been a significant drag on overall employment for almost four years, may be stabilizing. State and local government employment fell just 1,000 between February and March 2012, but actually increased by 14,000 in the first quarter of 2012, the first quarterly gain in nearly four years. In 2011, state and local

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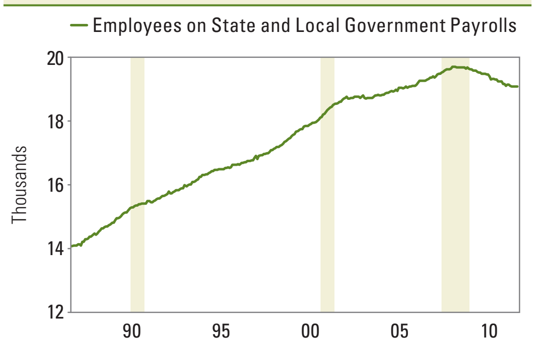
2 The Worst of the Job Losses at State and Local Governments Appears to Be Over



Source: Haver Analytics 04/09/12

(Shaded areas indicate a recession)

If the economy creates private sector jobs at the pace it did during the first quarter (210,000 per month), it would take until the beginning of 2014 (another 22 months) for the economy to get back to peak employment.

governments shed more than 20,000 jobs per month, and shed more than 650,000 jobs since August 2008, as they struggled to align costs with reduced revenues. Looking ahead, the recent data from this report, as well as from state and local government budgets and from surveys of layoffs in state and local governments, all suggest that the worst may be over for job losses at the state and local government level.

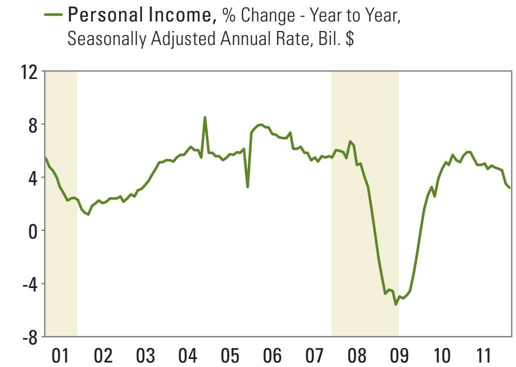
- The private sector economy created more jobs (635,000) in the first quarter of 2012 — or 212,000 per month — than in any quarter since the first quarter of 2006, when the economy, as measured by real Gross Domestic Product (GDP), was growing at 5.1%. While some of the increase in jobs was likely due to warmer-than-usual weather during the quarter, the vast majority of the jobs created recently likely represent actual economic activity. Weather-sensitive jobs excluding construction (Retail, Transportation & Warehousing, Services to Buildings and Dwellings, and Leisure & Hospitality) rose just 24,000 in March 2012 after the 26,000 gain in February. This metric posted an average gain of over 100,000 per month in the three months ended in January 2012. In short, the 212,000 jobs created on average, per month, in the first quarter is probably closer to the underlying trend of job growth than the 250,000 or so jobs added in the three months ending in February 2012, which were likely boosted by the warmer-than-usual winter.

Between February 2008 and February 2010 — during and immediately after the Great Recession — the economy shed 8.9 million private sector jobs. Since February 2010, the economy has added 4.1 million private sector jobs. Thus, the economy still needs to add 4.8 million jobs to recoup all the jobs lost during the Great Recession. If the economy creates private sector jobs at the pace it did during the first quarter (210,000 per month), it would take until the beginning of 2014 (another 22 months) for the economy to get back to peak employment. As we have noted in previous commentaries, many of the jobs lost during the downturn (Construction, Financial Services, and Real Estate) may never come back. But as of the end of January 2012, there were over 3.4 million open jobs in the economy (Please see the April 2, 2012 *Weekly Economic Commentary* for more details).

We often get asked about the "quality" of the jobs being added each month. What are the workers being paid? Are the jobs full-time or part-time? Our answer to that question is simply that the best gauge of the labor market may not be the jobs report at all, but rather the personal income and personal spending report that comes out three weeks after the monthly jobs report is released. In that report (the March 2012 personal income and spending report is due out on April 30, 2012) the personal income data, which basically adds up all the income made throughout the economy, is key. Personal income — which includes income from wages and salaries, but also from rental income, interest received and transfer payments (social security, unemployment insurance, Medicare payments, etc.) from the government — provides the buying power for personal spending, which in turn accounts for two-thirds of GDP.

Recently, personal income growth has been running about 3% above its year-ago levels, a big improvement versus the 3–4% year-over-year declines during

3 Personal Income Growth Is Probably the Best Measure of the Health of the Labor Market



Source: Bureau of Economic Analysis, Haver Analytics 04/09/12

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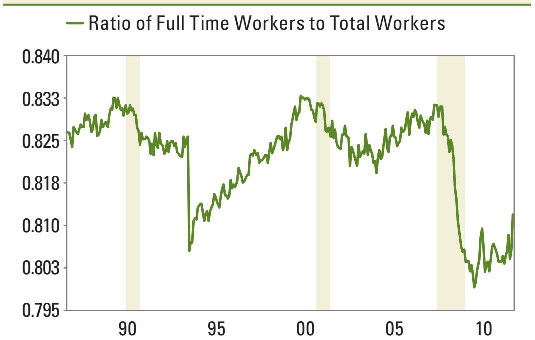
Thus, despite the disappointment in March 2012 relative to expectations, the labor market today is far stronger than it was in the middle of 2011, but still not booming.

4 The Ratio of Full-Time Jobs in the Economy Plunged During the Recession, but Is Steadily Climbing Back



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the Great Recession, but still far below the "normal" pace of income gains (5–7%). Compensation of employees, which accounts for about two-thirds of personal income, and is a good proxy for employment growth, is running about 4% above year-ago levels. This takes into account that in recent months, about 19% of the jobs in the economy are part-time jobs. During the 2001–2007 economic expansion, only 17–18% of jobs in the economy were part-time jobs. Presented another way, in March 2012, 81% of the jobs in the economy were full-time jobs, and just 19% were part-time jobs. The economy has added 2.7 million full-time jobs over the past year, and shed 233,000 part-time jobs. As recently as June 2012, the economy was still shedding full-time jobs (621,000 in the 12 months ending in June 2011), and adding part-time jobs (878,000 in the 12 months ending June 2011). Thus, despite the disappointment in March 2012 relative to expectations, the labor market today is far stronger than it was in the middle of 2011, but still not booming.

While Fed policymakers are likely to take note of all of these crosscurrents in the latest employment report, their key takeaway is likely to be similar to ours: the labor market is healing and is probably in better shape than it was last summer, but the economy is probably not growing quickly enough to generate more than 200,000–225,000 jobs per month. Is job growth at that pace enough to convince Fed policymakers that the economy does not need another round of QE? In our view, probably not, and the conversation in the marketplace about QE3 will likely heat up in the coming weeks. Although we do not expect the Fed to announce QE3 at the next Federal Open Market Committee (FOMC) meeting (April 25), it is likely to be discussed, and it could be introduced as soon as the FOMC meeting in late June. Please see our *Weekly Economic Commentary* from March 12, 2012 for our insights into what another round of quantitative easing from the Fed might look like. ■

LPL Financial Research 2012 Forecasts

- GDP 2%*
- Federal Funds Rate 0%^
- Private Payrolls +200K/mo.†

Please see our *2012 Outlook* for more details on LPL Financial Research forecasts.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

* Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

^ Federal Funds Rate is the interest rate at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis.

† Private Sector – the total nonfarm payroll accounts for approximately 80% of the workers who produce the entire gross domestic product of the United States. The nonfarm payroll statistic is reported monthly, on the first Friday of the month, and is used to assist government policy makers and economists determine the current state of the economy and predict future levels of economic activity. It doesn't include:

- general government employees
- private household employees
- employees of nonprofit organizations that provide assistance to individuals
- farm employees

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock investing involves risk including loss of principal.

The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasure securities).

Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.