



Weekly Economic Commentary

November 17, 2008



John Canally, CFA

Investment Strategist
LPL Financial

ECONOMIC CALENDAR

Monday, Nov 17

NY Fed Empire State Mfg
November

Capacity Utilization
October

Industrial Production
October

Tuesday, Nov 18

Core PPI
October

PPI
October

NAHB Housing Survey
November

Wednesday, Nov 19

Housing Starts
October

Core CPI
October

CPI
October

Thursday, Nov 20

Initial Claims
wk 11/15

Philly Fed Index
November

Leading Indicators
October

Executive Summary:

Markets Still Trying to Assess the Severity and Length of the Recession

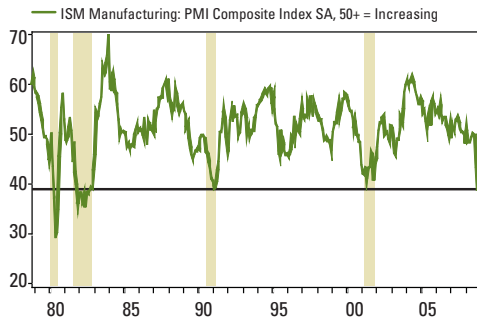
Over the past two weeks, financial markets have absorbed some absolutely horrible data on the U.S. economy for October and early November, as market participants attempted to get a handle on just how much damage has been done to the U.S. and global economies by the global credit crunch that intensified in mid September.

With the data now in hand, we can say with some certainty that the current downturn looks to be more severe than either of the mild recessions in 1990-91 and 2001. With the mild recession scenario off the table, we and other forecasters are trying to determine the breadth and depth of the recession in comparison to prior downturns. Is it as bad as the Great Depression, or is it more similar to the deep and prolonged recessions of 1973-75 and 1981-82? Right now, our view is that while we are not in a repeat of the Great Depression, this recession could end up being as severe as the 1974-75 downturn, which was second only to the 1981-82 recession in terms of duration and severity.

The data released over the past two weeks (see a recap of some of the most important releases below) is largely consistent with our view that the U.S. economy is likely to contract sharply in the current (fourth) quarter—by between 3.0 and 4.0%—which would mark the worst quarter for the U.S. economy since the deep and prolonged recession of 1981-82. The market would likely cheer any good news on the economy between now and the end of 2008, but shouldn't be further disappointed by weak news. Indeed, financial markets will be looking for signs that the unprecedented amount of policy actions put into place by the Federal Reserve, the U.S. Treasury and U.S. Congress are beginning to have an effect on the real economy. Once the calendar turns from 2008 to 2009, market participants will want to see definitive signs that all the policy actions have helped to stabilize the economy, and will begin to expect some better news from the economic data. Until then, we expect the daily and weekly drumbeat of economic data to look quite discouraging, especially the data for October. Unfortunately, most of the data due out over the next week is for October, which means another dose of bad news for financial markets to digest.

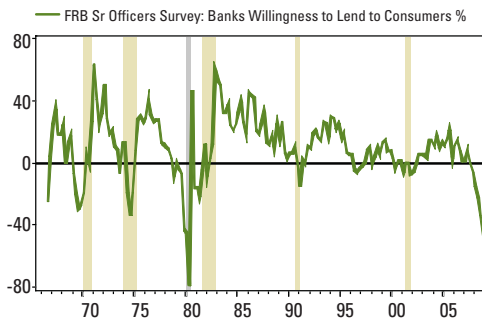


1 The ISM Survey of Manufacturing Fell into Deep Recession Territory in October



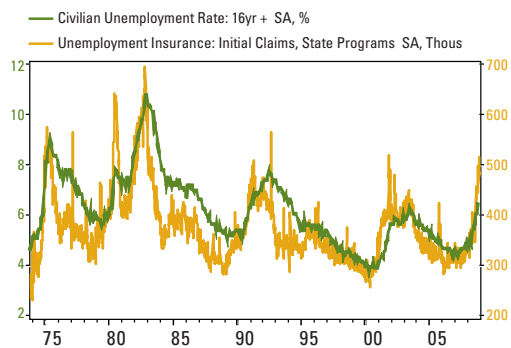
Source: Institute for Supply Management / Haver Analytics 11/17/08

2 About Half of Domestic Banks Indicated That They Had Become Less Willing to Lend to Households Over the Past Three Months



Source: Federal Reserve Board / Haver Analytics 11/17/08

3 Jobless Claims Are Now at Highest Level Since "Jobless Recovery" of 1991-93



Source: BLS, DOL / Haver Analytics 11/17/08

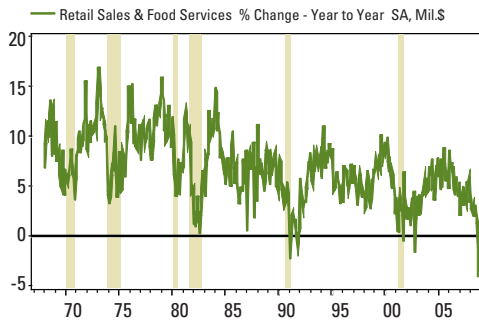
The data released over the past few weeks includes:

- The October vehicle sales data, which revealed that vehicle sales in the U.S. fell to just 9.1 million, the lowest reading since the severe 1981-82 recession.
- The October ISM data on manufacturing activity, which showed that manufacturing activity in the U.S. sank deeper into recession territory in October, even after a dramatic plunge in September. At 38.9, the ISM index of manufacturing is at its lowest level since the severe 1981-82 recession. [chart 1]
- The Fed's Senior Loan Officer Survey, which revealed that U.S. banks, somewhat belatedly, in our view, increased both lending standards and terms for all categories of loans. Specifically, the willingness of U.S. domestic banks to lend to households fell to -50% from -34% in the prior survey in July. The data in the latest survey were collected between October 2 and October 16, 2008, roughly two to four weeks after the collapse of Lehman Brothers, which signaled the beginning of the acute phase of the credit crisis. [chart 2]
- The October ISM report on service sector activity in the United States, which revealed that U.S. service sector activity fell into recession territory in October. This qualitative measure of activity in the service sector fell to its lowest level in the history of the series, which dates back to 1997.
- The October 2008 employment report, which revealed a 240,000 contraction in nonfarm payrolls in October, bringing the total job losses this year to 1.2 million. The report also showed that the U.S. unemployment rate moved up by 0.4 percentage points to 6.5%, the highest reading since early 1993, when the U.S. economy was in the so called "jobless recovery" from the rather mild 1990-91 recession.
- The initial jobless claims data for the week ending November 7, which revealed that jobless claims, one of the best "real time" indicators of the U.S. economy rose to 516,000. This reading was the highest since mid 1992, which, as noted above, was when the U.S. was still emerging from the shallow 1990-91 recession in the "jobless recovery." [chart 3]

The retail sales data for October, which showed that sales fell 2.8% in October versus September, the largest month-over-month decline in the history of the current retail sales series which goes back to only 1992. Retail sales were down 4.1% on a year-over-year basis in October 2008, the largest on record. (See nearby chart.) A huge 12.7% drop in gasoline service station sales in October—which was largely the result of the 18% drop in gasoline prices in the month—accounted for a large portion of the 2.8% decline in retail sales. However, the underlying retail sales data for October is consistent with a sizeable drop in real consumer spending in the fourth quarter, and the decline is likely to be more severe than the 3.1% drop in the third quarter. [chart 4]



4 The U.S. Consumer Virtually Stopped Spending in October as Retail Sales Fell the Most Ever on a Year Over Year Basis



Source: Census Bureau / Haver Analytics 11/17/08

Later this week, in addition to what is likely to be quite favorable news on both consumer and producer price inflation in October, markets will continue to digest what is likely to be horrible data on the economy for October and November, including:

- The October data on housing starts and building permits
- The NAHB housing market index for November
- The Philadelphia Fed manufacturing index for November
- Jobless claims for the week ending November 15

Among these reports, the ones referencing November are likely to be the most market moving, as market participants will want to see whether economic conditions stabilized or even improved a bit in November after an absolutely abysmal October.

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