

## Will Business Spending Lead to New Jobs?

"Its August, its uncomfortable, irritating and sweaty" I wish I was talking about the weather! After reaching a powerful post-recession peak in late April, the markets have taken a pause. Markets that soar do not do so forever, but investors are not sure how to interpret the latest market actions as their own "vital signs" are not where they want them to be. Jobs and housing are typically the most visible evidence most of us have that our economic lives have been slowly improving. Unfortunately housing will take a while and jobs are the last to turn around, but there is evidence based on past recoveries that the timeline may be beginning.

**First** is the evidence of the increase in temporary jobs, considered a leading indicator to the future rise in permanent jobs. The rise in temporary jobs has been powerful but as of yet the conversion from temporary status has been slow. Business owners want to be confident that permanent hires make sense (taxes and healthcare) and confident their business trend is likely to last.

**Second**, Corporate earnings continue to be strong. The second-quarter earnings season is nearly complete and, on average, corporations have beaten expectations by an impressive 10%.

**Overall, 75% of companies have reported better-than-expected results. Non-financial corporate profits have grown by approximately 40% in the second quarter compared to 2009 and revenue growth has also been impressive.** As a sign that improvements in corporate earnings have been broad-based, all ten sectors of the market are showing positive gains

for the first time since the second quarter of 2007.\*

Companies whose sales and earnings are linked to growth in the global markets are outperforming their domestic only competitors and this in a period where China recently ratcheted



down growth.

**Third**, recent economic reports shows many U.S. corporations are sharply increasing their capital spending this year after scaling back drastically during the economic downturn. Deutsche Bank Economist Joseph LaVorgna says "People are way too focused on the consumer," **"The health of the corporate sector eventually will give way to hiring." Capital spending tends to ripple through the economy as purchases and construction boost business and create jobs. And jobs will lead to consumer spending.**

According to an August 19, 2009 article in USA Today:

... the annual rate of business spending on equipment and software in the second quarter was up 21.9% from the first quarter, the biggest increase in more than a decade, after plunging at annual rates of as much as 32% in 2008 and early 2009. Such spending accounted for the lion's share of the economy's modest 2.4% growth in the second quarter. Expenditures were especially robust for computers and software; trucks, cars and aircraft; and industrial machinery. Even outlays for commercial structures were up 5.2% from anemic levels.... And Coca-Cola (KO) increased investment by 15% in the first half of 2010 for new lab and plant equipment as North American sales in the second quarter grew for the first time since 2006.

**But... in general, investors are skeptical.** The recovery is taking too long, re-reinforcing their negative emotions. Because we are not in a typical consumer/housing led recovery we were accustomed to, individuals personally feel the sluggishness right at home. Despite the evidence that solid companies are performing well in the global marketplace and are great values, **investors have barely budged from their low return cash assets.**

People are not focused on where their investments should be for the long term, but on safety. In a recent talk I gave to a local business group there were more questions about poor job and housing confidence locally than about opportunities in the investment marketplace. Since investor success will likely be driven by global factors, investors will need to look beyond their local economic environment to be able to visualize opportunity. Like the economist above mentions, eventually global growth and domestic business spending will lead to improvement in our domestic economy and job market.

It is our belief that the recovery is ongoing and eventually investor confidence will rise causing the abundance of cash on the sideline to seek return beyond current low levels. Upon re-entry investors will likely be less aggressive in their behaviors than in the past. They will seek some assurance of return such as dividends that will pay them more than their dismal return on cash and money markets. Most bonds will **not** be a good alternative and may be risky with rates at rock bottom levels. According to Jeremy Siegel (author of Stocks for the Long Run): "If over the next year, 10-year interest rates, which are now 2.6%, rise to 3.15%, bondholders will suffer a capital loss equal to the current yield. If rates rise to 4% as they did last spring, the capital loss will be more than three times the current yield (or around minus 8%)". On the other hand a current investment the 30 stocks of the Dow Industrial Average will yield you around 3%. Bond market investors lose if rates rise, stock investors lose if the market falls. In an environment where corporate cash flow yields are several times the yield of treasuries, stocks could thrive once we move past the malaise created by expectations of a slowing economy and job growth.

Be sure to contact us if you have any questions.

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