



OAKWORTH
CAPITAL BANK

COMMON CENTS

This morning, the Bureau of Labor Statistics released the Employment Situation report for December. It was better than expected. It seems the economy created some 200K jobs last month, and the Unemployment Rate fell to 8.5%, the lowest level in 3 years or so.

On its face, the headline is good; how could you possibly argue with that type of job creation? You would have to be some sort of miscreant to not just accept the number, and move on to other things, right? No one really likes the nerd in the group who needs to get 'to the bottom of things,' do they? However, we, and I repeat we, just can't help it; it is in our internal wiring.

So, what is the straight dope? What do the numbers really say? Without delving into the meat of the matter, you can look at the stock market and guess what they say. After all, why would the Dow Industrials be down roughly 50 points as I type? If this were such a good release, wouldn't investors be driving asset prices higher? Wouldn't we all be humming "Happy Days Are Here Again"? On the flipside, trading seems kind of uninspired. What gives?

Despite the attractive headline, there wasn't much in the report for the bulls to run with. If it makes you feel any better, there also wasn't much for the bears either.

The Unemployment Rate might get a lot of ink, but is increasingly irrelevant in so many ways. After all, if everyone left the workforce at the same time, the Unemployment Rate would be 0%. In other words, if the number of people NOT looking for a job increases at a more rapid rate than the number of folks in the labor force, the Unemployment Rate falls more rapidly than it would ordinarily.

For instance, the official Unemployment Rate was 9.4% last December (2010). Over the next 12 months, the 'civilian noninstitutional population,' which is the accepted pool of available labor, increase some 1.695 million. However, during 2011, the 'civilian labor force' increased only 274K. As a result, the number of folks 'not in the labor force' increased 1.421 million, and the 'labor force participation rate' fell from 64.3% to 64.0%. Hmm.

Even so, according to the Household Survey, the economy created a not so insignificant 1.570 million jobs last year. When you do all the math, the Unemployment Rate fell from the aforementioned 9.4% to 8.5%. That is a nice drop in anyone's book.

But what would it have been HAD the labor force participation rate stayed the same at 64.3%? What would those 1.570 million jobs have done to the Unemployment Rate IF so many people hadn't just opted out of the workforce? If we CAN make all of those assumptions, the Unemployment Rate would have been 9.0% in December. While still an improvement, it takes a little starch out of the headline, doesn't it?

Besides, what in the heck are all these people doing? Where did they go? To school? Surfing? I mean the number of age appropriate folks not looking for a job increased 1.421 million in 2011; is that really a sign of a vibrant labor market? One punctuated with high paying, career-type jobs?

You know, I am not a sociologist or a psychologist, so I can answer that question for all those folks who either didn't enter or quit the workforce. However, it would seem the answer would be, well,

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Experts often possess more data than judgment.

Colin Powell

Something to Think About, *cont.*

kind of a NO.

Then there were the types of jobs the economy created.

Let me start by saying, this was okay. There was a little more activity across most of the broad economic sectors outside of government, but little is the optimal word. In some areas, you would need a magnifying glass to find the jobs. For instance, the entire financial services sector added 2K jobs in December; Information added 6K more, and 'Professional & Technical Services' contributed 8.5K. We will take them, but that is tepid growth in some of the more highly paid economic sectors.

So where were the jobs if they weren't there?

I won't beat around the bush; we created another 27.9K retail sector jobs; 24K more positions at 'food services & drinking places,' and, drum roll please, 42.2K 'couriers & messengers.' There you have it: some 19% of the economy, on the lower end of the pay spectrum created fully 47% of the jobs. If we want to add 'wholesale trade' into the mix, and its 11.6K new jobs, um, 23% of the economy created 53% of new payroll positions.

Now, while the government 'seasonal adjusts' all these numbers, what is the likelihood the industries listed in the paragraph above added jobs for the holiday season? What is the possibility of many of the jobs evaporating this and next month? Particularly IF the consumer does as predicted, and retreats after spending more than they should have in December? Yeah.

That is why the markets are behaving the way they are; that is why the long-bond hasn't sold off like crazy, and stocks didn't come out of the gate with their hair on fire. That is why the markets are almost in slow motion today: the labor numbers were just okay, even if the headlines were better than okay. Yes, stocks are slowly grinding their way back up, as I now type; however, this time last year? What would have happened if we had had this number 12 months ago? Rally or non? I think you know the answer.

Investors and analysts are actually breaking down these numbers now. A year or so ago, any number that didn't suggest collapse was good news. These days, we want to see more than mediocre before giving the markets a pass. This release was better than expected, but just not better than it needs to be.

Something Else to Think About

Yesterday, the President was at the Pentagon announcing a 'leaner' US military for the future. The initial reactions were completely predictable, and political. Does anyone really believe we can continue spend the amount we have been spending forever? As I have said numerous times: "When you are borrowing money from the Chinese to subjugate Afghanistan, something has gone horribly wrong somewhere."

But how does this affect the economy? Let me give you what I submitted for my out-of-town column:

How do you like your budget cuts? Scrambled, fried, or sunny-side up?

Few of us would disagree the US needs to get its spending under control, and even fewer would agree on how to do it. Still, something needs a haircut to make the numbers work. Believe it or not, the Department of Defense is the low hanging fruit here.

At first blush the number seems enormous, some \$450 billion over the next 10 years. However, Washington doesn't budget the way you do at home. This is how it works.

Washington has a budget. The budget has projections on spending in the future. For instance: the budget might have \$300 billion for XYZ in Year 1, and \$500 billion in Year 10. Obviously, that is a \$200 billion increase.

Something Else to Think About, *cont.*

What happens if Washington decides to 'cut' future expenditures on XYZ to \$400 billion in Year 10 because of a fiscal crisis in Year 1? Well, it just slashed the budget \$100 billion, 'saving' that money in the process.

Keep in mind, this is money out in the future, that hasn't been collected or invoiced, let alone approved by the Congress. It is phantom stuff, money in the ether.

Consider this: the Administration's budget for fiscal year 2012 estimated defense expenditures of \$9.46 trillion dollars from 2012-2021 (Table S-3). The scheme the President announced on Thursday is designed to accommodate at least \$450 billion in cuts over the next decade. If you subtract one from the other, that is still a lot of money to spend.

I guess what I am trying to say is: this isn't as Draconian as maybe it seems. It doesn't mean the United States will be spending less in absolute dollars; it just means it will be spending less than originally envisioned, and, still, a whole lot more than anyone else. Further, a lot can change between now and 2021.

Besides, the Pentagon isn't going to go out tomorrow, and start closing bases and cancelling orders. However, the brass will have to be a little more cost conscious moving forward, and the easiest way for any entity to do that is to fight a war of attrition.

This will take the form of the closure of non-essential bases in Europe, as the US still has some 80,000 troops stationed over there according to the BBC. It will also mean we might enlist 2 people for every 3 that get out; that type of thing. In the end, that could make some domestic bases redundant, but we still don't know.

Where the rubber meets the road, the Administration's announcement on Thursday means the Pentagon will have essentially \$45 billion less per year to spend than it thought over the next decade, roughly 5% less than originally BUDGETED NOT PREVIOUSLY SPENT. When you put it like that, it doesn't seem quite as horrific.

Will it be fun? No, it won't be that. Will it be a death knell to the US economy? No, it probably won't be that either. Will it turn the US into a second rate power? Of course not, as our defense spending dwarfs everyone else's.

In the end, whether you know it or not, this is what we want and need to have: greater fiscal responsibility in Washington. If you thought we could do that by just cutting food stamps and grants to performance artists, you would be wrong.

So, again, how do like your cuts? Scrambled, fried, or sunny-side up?

By nature, I am not a dove. However, fiscal realities are fiscal realities, and the reality here is we don't have the money to keep increasing the defense budget the way we have over the last decade. It has to slow, and the President was basically admitting the obvious. After all, if you don't want to cut defense spending, you had better be willing to make even LARGER cuts in Social Security and Medicare. He clearly doesn't, and the GOP doesn't want to do so in an election year either. So, IF you want to make some cuts AND keep your older voters happy, what do you do?

The answer is obvious, and the shrill cries against the proposed 'cuts' will evaporate in the wind.

Important Economic Releases

Release	Survey	Actual	Prior	Comments
Construction Spending (Nov)	0.5%	1.2%	-0.2%	<p>The economic data was fine this week. It wasn't great. The sharp negative revision for October took some of the starch out of the Construction Spending number, and the breakdown of the Employment Situation report PLUS negative revisions to the November data cooled things off a little.</p> <p>Combined, the data suggests a very mediocre economy, which is what we all thought anyhow. If you were hoping for either more or less, I apologize.</p> <p>Maybe next week.</p>
ISM Manufacturing (Dec)	53.5	53.9	52.7	
Total Vehicle Sales (Dec)	13.50M	13.48M	13.59M	
Initial Jobless Claims	375K	372K	387K	
ISM Non-Manufacturing (Dec)	53.0	52.6	52.0	
ICSC Chain Store Sales YOY (Dec)	4.0%	3.5%	2.8%	
Change in Nonfarm Payrolls (Dec)	155K	200K	100K	
Unemployment Rate (Dec)	8.7%	8.5%	8.7%	
Avg Hourly Earnings ALL Employees YOY (Dec)	2.1%	2.1%	1.9%	

Tables & Data Points

STOCKS	Dow Industrials	S&P 500	NASDAQ	Russell 2000	Nikkei 225 (¥)	DJ STOXX 50 (€) Price
12/31/10	11,577.51	1,257.64	2,652.87	783.65	10,228.92	2,792.82
12/31/11	12,217.56	1,257.60	2,605.15	740.92	8,455.35	2,216.55
12/15/11	11,868.81	1,215.75	2,541.01	716.01	8,377.37	2,224.89
12/22/11	12,169.65	1,254.00	2,599.45	745.51	8,395.16	2,273.02
12/29/11	12,287.04	1,263.02	2,613.74	744.98	8,398.89	2,292.28
1/5/12	12,415.70	1,281.06	2,669.86	752.29	8,488.71	2,315.75

BONDS	3-Mo UST	6-Mo UST	2-Yr. UST	5-Yr. UST	10-Yr. UST	30-Year UST
12/31/10	0.13	0.19	0.60	2.01	3.30	4.34
12/31/11	0.01	0.06	0.24	0.83	1.88	2.90
12/15/11	0.00	0.04	0.24	0.85	1.91	2.92
12/22/11	0.00	0.03	0.28	0.92	1.95	2.98
12/29/11	0.00	0.06	0.27	0.88	1.90	2.90
1/5/12	0.01	0.05	0.26	0.88	2.00	3.06

OTHER	Prime	Fed Funds	3-Month LIBOR	Gold/troy oz.	Oil— WIT/brl.	\$/Euro	JPY/\$	\$/GBP	CAD/\$
12/31/10	3.25	0.25	0.30	1,421.40	91.38	1.337	81.19	1.559	0.994
12/31/11	3.25	0.25	0.58	1,566.80	98.83	1.296	76.99	1.551	1.017
12/15/11	3.25	0.25	0.56	1,574.60	93.87	1.301	77.88	1.549	1.034
12/22/11	3.25	0.25	0.57	1,608.90	99.53	1.305	78.16	1.567	1.021
12/29/11	3.25	.025	0.58	1,540.90	99.65	1.294	77.71	1.540	1.022
1/5/12	3.25	.025	0.58	1,620.10	101.81	1.280	77.16	1.549	1.018

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