



>: Market Wrap Up September 22, 2008

Monday, September 22, 2008 / Chris Rowe

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Every Monday afternoon at 6:30pm EST. he's posting a SUPER FAST market wrap-up for those of you who want to take a quick peek at the market, and go back to enjoying your life!

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A handwritten signature in black ink that reads 'Chris Rowe'.

Chris Rowe

Chief Investment Officer

[>](#)

Economic Calendar for the week of September 22 to September 26

Wednesday, Sept 24

10:00 Existing Home Sales

- * Importance (A-F): This release merits a C.
- * Source: The National Association of Realtors.
- * Release Time: 10:00 ET around the 25th of the month (data for month prior).
- * Raw Data Available At: <http://www.realtor.org/research.nsf/pages/EHSdata>.

The name speaks for itself - this report provides a measure of the level of sales of existing home sales. The report is considered a decent indicator of activity in the housing sector. Housing starts precede this report each month, but starts are a supply rather than demand-side indicator. Existing home sales precede the other key demand-side indicator of housing - new home sales - thus boosting the visibility of this report. Sales are highly dependent on mortgage rates, and will tend to react with a few months lag to changes in rates. Sales are also determined by the level of pent-up demand for housing - immediately after a recession, sales are typically quite strong due to the demand which accumulated through the recession.

The survey sample for existing home sales is larger than that of new home sales, making it somewhat less susceptible to large revisions. Both reports can see huge month-to-month swings in winter, when bad weather can significantly affect sales.

Aside from total sales, two other indicators are worth watching in this report -- the inventory of homes for sale and the median price. The inventory of homes for sale at the current sales pace is the inventory/sales ratio of the housing sector. For example, a 5.0 figure for inventory/sales indicates that the supply of homes for sale would be depleted within five months at the current sales pace. The lower this figure goes, the greater the need for new housing starts. The year/year change in the median price provides a good indication of inflation in home prices.

Highlights

- * The July jump in existing home sales reflects the leveling off of sales the past eight months. July sales at a 5.00 million annual rate were UP 1.8% from the 4.91 million annual rate back in December 2007.
- * The July sales rate was also 1.3% ahead of the average annual sales rate of 4.932 million so far in 2007. Demand has clearly stabilized, although an upturn is not yet evident. In addition, problems remain from the fact that inventory levels are high. That will keep the pressure on prices for a while, although stability there will also follow the stability in demand already evident.

Big Picture

Demand in the housing market has bottomed. Existing home sales remain at very low levels, but they have also leveled off the past eight months. The July sales rate of 5.00 million was 1.8% above the level of last December, and the sales rate has been steady through most of 2008. Inventories remain high, and that will pressure prices, but there is finally some light at the end of the tunnel. Demand has to bottom before prices, and that has started. The housing market remains depressed and will remain so as evidenced by the jump in inventory. The silver lining is that the pace of home sales declines is slowing, which is an attribute of a bottoming process, although a significant rebound is still a long way off.

Thursday, Sept 25

8:30 Durable Goods Orders

- * Importance (A-F): This release merits a B.
- * Source: The Census Bureau of the Department of Commerce.
- * Release Time: 8:30 ET around the 26th of the month (data for month prior).
- * Raw Data Available At: <http://www.census.gov/ftp/pub/indicator/www/m3/index.htm>.

The durable orders release measures the dollar volume of orders, shipments, and unfilled orders of durable goods (defined as goods whose intended lifespan is three years or more). Orders are considered a leading indicator of manufacturing activity, and the market often moves on this report despite the volatility and large revisions that make it a less than perfect indicator. These problems can be minimized by looking at the breakdown of orders. The total number is often skewed by huge increases in aircraft and defense orders. An

increase based solely on strength in one sector tends to be discounted, while the market is more impressed with broad-based increases in orders.

Also notable in this report is the narrow category of nondefense capital goods. These goods mirror the GDP category producers' durable equipment (PDE) -- the largest component of business investment. Shipments of nondefense capital goods are a good proxy for PDE in the current quarter, while nondefense capital goods orders provide an indication of PDE growth in the quarters ahead.

Highlights

- * Durable goods orders were strong across the board in July. There is no evidence of a weakening manufacturing sector in the data. In fact, the trends suggest that manufacturing overall may pick up through the end of the year.
- * Excluding transportation, orders were up 0.7%. Transportation orders were up 3.1%.
- * Excluding defense, orders were up 2.8%. Defense capital goods orders fell 25.7%.
- * Machinery orders were up 4.6% and primary metals 2.2%. Computer and electrical orders fell 1.3%.
- * Nondefense capital goods orders excluding aircraft rose 2.5%. This is considered a barometer of underlying business investment trends.
- * Shipments, which are the fulfillment of orders and correlate with GDP components, surged 2.5%. Unfilled orders rose 0.8% to record levels.
- * These data are strong across the board and very positive from an economic standpoint.

Big Picture

Durable goods orders, and total factory orders (which include nondurables orders), continue to show surprising strength given overall economic conditions. Orders are near flat to up a bit on a year-over-year basis and the backlog of orders is at record highs. Manufacturing has been very resilient and has yet to move into recessionary mode even as the housing market and consumer sectors remain depressed. The weakness in manufacturing has been greatly exaggerated.

8:30 New Home Sales

- * Importance (A-F): This release merits a C .
- * Source: The Census Bureau of the Department of Commerce.
- * Release Time: 10:00 ET around the last business day of the month (data for month prior).
- * Raw Data Available At:<http://www.census.gov/const/newressales.pdf> .

The report indicates the level of new privately owned one-family houses sold and for sale. New home sales usually have a lagged reaction to changing mortgage rates. They also tend to be stronger early in the business cycle when pent-up demand is strong, and they fade later in the cycle as the demand for housing is sated. In addition to home sales, the market monitors the number of homes for sale relative to the current sales pace. As this inventory measure falls (rises), housing starts tend to rise (fall). Finally, the median home price provides an indication of inflation in the housing sector, though only year/year changes provide any meaningful information.

The home sales report is quite volatile and subject to huge revisions, making any one month's reading very unreliable. The report rarely prompts a market reaction. The market prefers the existing home sales report, which has a sample data pool four times as large and is released earlier in the month.

Big Picture

There are signs that new home sales are bottoming. The 515,000 annual rate of sales for July is essentially unchanged from the level of four months prior in March. Furthermore, new home sales run about 10% of the level of existing home sales, which have also levelled off the past half year. The June sales rate for new homes is still down 33% from the year-ago level, so a "recovery" of any sort is a long way off. Nevertheless, there is a good chance that sales hold near the current level for a few more months before rebounding slightly in the fourth quarter. Moderate economic growth and stable interest rates should lend modest additional support to demand. The rate of decline in prices for new home has also stabilized somewhat as demand has steadied. The median price is now down only 6% over the past year. The improved trends in new home sales do not represent a positive for the economy, but the lack of continued sharp declines does eliminate a negative.

Friday, Sept 26

10:00 GDP: Gross Domestic Product

- * Importance (A-F): This release merits a B.
- * Source: Bureau of Economic Analysis, U.S. Department of Commerce.
- * Release Time: Third or fourth week of the month at 8:30 ET for the prior quarter, with subsequent revisions released in the second and third months of the quarter.
- * Raw Data Available At: <http://www.bea.doc.gov/bea/dn1.htm>.

Gross Domestic Product (GDP) is the the broadest measure of economic activity. Annualized quarterly percent changes in GDP reflect the growth rate of total economic output. The figures can be quite volatile from quarter to quarter. Inventory and net export swings in particular can produce significant volatility in GDP. The final sales figure, which excludes inventories, can sometimes be helpful in identifying underlying growth trends as inventories represent unsold goods, and a large inventory increase will boost GDP but might be indicative of weakness rather than strength. The broad components of GDP are: consumption, investment, net exports, government purchases, and inventories. Consumption is by far the largest component, totaling roughly 2/3rds of GDP.

In addition to the GDP figures, there are GDP deflators, which measure the change in prices in total GDP and for each component. Though the consumer price index is a more closely watched inflation indicator, the GDP deflator is another key inflation measure. Unlike CPI, it has the advantage of not being a fixed basket of goods and services, so that changes in consumption patterns or the introduction of new goods and services will be reflected in the deflator.

With both GDP and the deflator, the market tends to focus on the quarter/quarter change. Year/year changes are also cited frequently, though they do not provide the most timely indications of economic activity or

inflation. The bond market often reacts to GDP, though the price moves are typically small, as much of the GDP data is easily predicted using monthly economic releases such as personal consumption, durable goods shipments, construction spending, international trade, and inventories.

Quarterly GDP reports are broken down into three announcements: advance, preliminary, and final. After the final revision, GDP is not revised again until the annual benchmark revisions each July. These revisions can be quite large and usually affect the past five years of data.

Big Picture

Economic growth is much stronger than generally recognized. Net exports have been a major contributor to growth but this category gets far less attention than deserved. Net exports have added more to GDP growth than housing has subtracted in recent quarters. Consumer spending has also continued to increase. Higher gas prices simply do not subtract enough from consumer spending power given steady (though modest) income gains to produce a decline in spending. Business investment also continues to rise at a steady pace. The manufacturing sector is holding up surprisingly well. Second quarter real GDP growth was near the long-term trend, and third quarter real GDP will be near 3% as well. High gas prices and lower home prices are important negatives for the economy, but GDP, which measures the quarterly change in output, will rise despite the press obsession over these factors.