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Economic Evaluation Group, Inc. Presents Monthly Economic Update for August, 2008

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Quote of the month. "Information is not knowledge, knowledge is not wisdom, and wisdom is not foresight. Each grows out of the other, and we need them all." – Arthur C. Clarke

The month in brief. July was a mixed month for the stock market, a poor month for commodities, and a strong month for the dollar. In Europe and the Asia-Pacific region, major stock indexes struggled. The long fingers of the credit crisis grabbed the economy again, as troubles shuttered IndyMac Bank and rumors circled about the stability of Fannie Mae and Freddie Mac. By the end of the month, financial stocks were rebounding ... one could only wish the same for the housing sector. Earnings reports and the odd economic indicator brought pleasant surprises to investors; some of them were considerably better than expected. Still, there was no conclusion that this downturn or recession was ebbing.

Domestic economic health. The opening of July brought mixed indicators: while unemployment stayed flat for June, the service sector did contract, according to a fresh Institute for Supply Management report; the June index came in at 48.2, denoting appreciable contraction.¹

Then three notably positive indicators surfaced in the second week of the month, somewhat lost amid all the

Freddie Mac and Fannie Mae headlines. Retail sales increased by 4.3% in June, with Wal-Mart driving the majority of the gain.² Wholesale inventories rose 0.8% in May, topping the median forecast of economists.³

On the downside, the next week brought news of big jumps in PPI and CPI. The June Producer Price Index showed a huge 1.8% monthly gain (although core PPI only rose 0.2%).⁴ The Consumer Price Index rose 1.1% in June, capping a 5% rise over the past 12 months – when was the last time we saw 5% inflation?⁵

As oil prices eased downward on decreasing demand forecasts and worries eased about the FDIC takeover of IndyMac and the murmurs surrounding Freddie Mac and Fannie Mae, a new round of fairly positive indicators closed out the month. Economists has predicted a drop of 0.4% in June durable goods orders; instead, orders rose by 0.8%⁶ The Reuters/University of Michigan final July consumer sentiment index actually rose to 61.2; when was the last month when that happened?⁷ New home sales only retreated 0.6% in June, whereas analysts had forecast a depressing 1.8% decrease.⁷

Global economic health. In the Eurozone, economists watched as inflation hit 4.1% in July ... and at the top of August, they learned that producer price inflation, or PPI, hit an astonishing 8% in the month of June. Eurozone consumer confidence also declined in July.^{8,9} Even Germany's robust economy felt a pinch, as retail sales in that nation dipped 2.8% for the month.¹⁰ The International Monetary Fund retained

its prediction of 1.7% Eurozone growth for 2008 and inflation falling back to the European Central Bank's 2% target by 2009. Some economists believe Eurozone growth was flat for the second quarter.¹¹

Global manufacturing activity slumped to a five-year low, according to the JP Morgan Global Manufacturing PMI. Manufacturing contracted in 14 out of 15 Eurozone nations.¹² China's manufacturing sector contracted in July for the first time in three years.¹⁰

Inflationary pressures still threatened to put the squeeze on burgeoning Asian economies, but the news was not all bad. In India, inflation was running at 12% in mid-July, the highest mark since February 1995.¹³ As for China, inflation was easing a bit. The June data arrived in July, and it showed inflation down to 7.1% from 7.7% in May; GDP, for that matter, had decreased from 10.6% to 10.1% from 1Q to 2Q.¹⁴ In Japan, inflation was still well above 1% (a level unseen since the late 1990s) and consumer prices were rising at the fastest rate in a decade. Unemployment was at 4.1% (highest in two years).¹⁵

World financial markets. It was a mixed month for major Asian and European indexes. The Dow Jones Stoxx 600 declined 2% in July.¹⁶ The benchmark FTSE 100 fell 3.8% for the month (compared to a 10% drop for June). The CAC 40 in France fell 1% on the month, while Germany's DAX 30 rose 1% for July.¹⁷

Among the major indexes in the Asia-Pacific arena, India's Sensex index rose 6.6% in July.¹⁷ The Hang Seng (Hong Kong) had its best month since April, gaining 2.8% in July.¹⁸ The Nikkei 225 lost 0.8%, giving up ground for the second consecutive month.¹⁹ After falling more than 45% during the first and second quarters of 2008, the CSI 300 Index (China) actually gained 0.5% in July.²⁰ In Taiwan, there was a major development on the trading floor at month's end as the government opened its financial markets to mainland Chinese investors.

Commodities markets. Crude prices finally fell. In fact, crude oil had its poorest month since December 2004, dropping 11.7% across July.²² Oil prices hit a new record of \$147.27 a barrel on July 11, then sank \$24 by the end of the month (and one commodity markets fund manager felt they would "correct" to the "\$100 to \$110 range" during the next

six months.²² The price of a gallon of regular unleaded averaged below \$3.95 per gallon by the end of the month, according to AAA data.²²

As for natural gas, precious metals and other notable commodities ... well, there have been better months than July. Sugar was the bright spot in the broad commodities market, gaining 5.9%. Natural gas fell 32%. Gold was down 1.6% to close the month at \$913.90 per ounce, and silver gained 1.6% to close July at \$17.79 per ounce. Platinum fell 15% and palladium 17.5%. Corn was down 19.8%, oats 16.1%, wheat 8.7% and soybeans 10.8%.²³

Housing & interest rates. Days into July, the entire housing sector jittered as headlines and market analysts weighed the validity of the gossip swirling around Freddie Mac and Fannie Mae, collective owners and/or guarantors of about half the nation's home mortgages.²⁴ The Fed offered a special lending option to help both Fannie and Freddie, and the Treasury Department proposed to put cash into both mortgage giants through the purchase of newly issued stock. The Securities and Exchange Commission quickly gave Freddie Mac permission to issue stock, which could help generate about \$5.5 million in new capital. Fannie and Freddie shares both subsequently rebounded from 17-year lows.²⁵

New home sales dropped 0.6% in June; not good, but much better than the 1.8% slide analysts had predicted.⁷ On the other hand, it was another poor month for residential resales. The Commerce Department reported that existing home sales fell by 2.6% in June, and that put the pace of existing home sales at 15.5% under June 2007. Not since the first quarter of 1998 had sales been that sluggish. The inventory of existing homes for sale rose by 0.2%.²⁶

Foreclosures kept mounting: according to RealtyTrac, the American foreclosure rate for the second quarter of 2008 was 121% higher than 2Q 2007.²⁷ With hardly any fanfare, President Bush put his signature on a housing bill designed to help roughly 15% of U.S. homeowners poised to face foreclosure. Among the key provisions: it allows up to 400,000 homeowners to trade mortgages for new and cheaper home loans with the help of the Federal Housing Administration, and it includes \$3.9 billion for communities to fix up foreclosed properties and \$15 billion in tax cuts for certain homeowners.²⁸

Elsewhere, we learned that the National Association of Realtors' Pending Home Sales Index – up 6.3% for April – fell 4.7% in June.²⁹ Housing stats did jump in June, but it was mostly due to a technicality - a change in New York City construction rules prompted a wave of new apartment projects in the five boroughs before a deadline, so U.S. housing starts soared 9.1% in June. But single-family housing starts fell 5.3% from May, the Commerce Department noted.³⁰

At the end of July, mortgage rates actually fell slightly: the national average for a 30-year fixed rate mortgage was 6.52%, down from 6.68% a year earlier. As for the other common mortgage types, 15-year FRMs and 5-year ARMs were both averaging 6.07% at the end of July (respectively down from 6.32% and 6.29% a year before), and 1-year ARMs were averaging 5.27% versus 5.59% a year ago.³¹

Major indexes. The stock market dipped and soared wildly across the month, reacting to the Fannie Mae/Freddie Mac worries, the price of oil, and assorted housing, retail and manufacturing indicators; after all that volatility, the month saw only mild gains or losses for the big three U.S. indexes. Two S&P 500 sectors rallied strongly during July: financials rose 6.8%, and healthcare rose by 5%.³²

% Change	1-Month	Y-T-D
DJIA	+0.25	-14.22
NASDAQ	+1.42	-12.32

S&P 500	-0.99	-13.69
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Source: CNBC.com, 7/31/08³²

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

August outlook. We have already learned that unemployment rose to 5.7% in July; we know 2Q 2008 GDP was 1.9%.³³ So are we now about to experience some kind of upturn? Some positive indicators have accumulated lately, suggesting that the American economic engine is sluggish, but not stalled. Or will the credit crisis linger over the economy for another quarter or two? Are the stock market and the broad economy actually dependent on the real estate sector to improve before they can improve? Or will a surge in optimism and belief in opportunity drive Wall Street forward again? This is the question; this month, we may start to discern an answer.

And now, the roll call of economic releases for the rest of August ... the Fed policy meeting and the July ISM services index (8/5), June pending home sales (8/7), June wholesale inventories (8/8), July retail sales and business inventories (8/13), July CPI and core CPI (8/14), July industrial production and preliminary August consumer sentiment (8/15), July PPI, core PPI, housing starts and building permits (8/19), July existing home sales (8/25), the Conference Board's August survey of consumer confidence, the August 5 FOMC minutes, and July new home sales (8/26), July durable goods orders (8/27), and July personal income and consumer spending (8/29).

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