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Economic Evaluation Group, Inc. Presents

Monthly Economic Update for May, 2008

Quote of the month. "Mistakes are the portals of discovery." – James Joyce

The month in brief. April was a terrific, encouraging month for investors. While oil and gas prices did soar to record levels, Wall Street broke out of its first quarter doldrums in impressive fashion – and select indicators gave off subtle hints of an economic rebound.

The S&P 500 had its best month in nearly 4½ years. In fact, all three major indexes gained between 4.5-6% in April.[1] Earnings season brought some pleasant surprises, as many profit levels met or topped analysts' expectations. Consumer confidence hit new lows in the wake of high pump prices, still-rising foreclosure rates, and unsold or even abandoned homes. The Federal Reserve lowered the key interest rate by another quarter of a point on April 30 to 2.0% – the seventh cut since September, and conceivably the last rate cut for a while.[2]

Domestic economic health. The top of each month brings us news about the jobless rate, and we learned that unemployment hit 5.1% in March (a level unseen since September 2005) as the economy lost 80,000 jobs and private-sector payrolls shrank for the fourth month in a row.[3] (At the top of May, analysts expected a 5.2% reading for April.)

It seemed like every week brought us lower and lower readings of consumer confidence. The preliminary April reading on the Reuters/University of Michigan Consumer Sentiment Index was 63.2, the lowest reading in 26 years and well below the 69.0 economists anticipated.[4] The Conference Board's late-April survey resulted in a 62.3 reading – low, but better than the 62.0 foreseen by economists polled.[5] Aside from fuel prices and layoffs, there was another factor affecting the minds of consumers: according to the Labor Department, March costs of energy and imported goods were up 17% and 14.8% from 12 months ago.[6,7]

But there were also some positive signs – or shall we say, at least not so negative. March manufacturing, industrial production and construction numbers were better than expected. The Institute for Supply Management's March manufacturing index read 48.6, better than the 47.5 analysts had forecast. While analysts had predicted a 1% decline in construction spending for March, the Commerce Department reported just a 0.3% drop for the month.[8] The Fed had industrial output rising 0.3% in March, better than the expected 0.1% drop and much better than the 0.7% fall in February.[7]

Global economic health. In late April, the European Commission released its spring economic forecast, which was fairly pessimistic. While the EU economies grew 2.8% in 2007, the new outlook projects growth of 2.0% in 2008 and 1.8% for 2009. The EC also sees 6.8% unemployment and 3.6% inflation for 2008. (EU inflation was 2.4% in 2007; the EC forecast projects inflation falling back to 2.4% in 2009.)[9] Thankfully, the inflation pace in the Eurozone cooled off a bit to 3.3% in April, from the record-setting pace of 3.6% in March. But Eurozone consumer confidence dropped to its lowest level since late 2005.[10]

There were some notable developments within key Asian economies. At the conclusion of April, the Bank of Japan reduced its growth forecast for the next 12 months from 2.1% to 1.5% – and for the first time in two years' worth of semi-annual forecasts, there was no reference to raising interest rates. March industrial output in Japan fell to its lowest level in five years, and consumer prices rose in March at the quickest pace in a decade.[11] South Korea's consumer prices rose in April at the fastest pace in four years; the won has dropped 6.6% against the dollar so far in 2008.[12] India's government reported March inflation at a 41-month high of 7.4%; consensus 2008 GDP forecasts for that nation have been revised to 8%, down from 8.7% for 2007/08.[13] As for China, in April we learned that its economy still managed to grow 10.6% in 1Q 2007, even while suffering from worldwide commodities price increases and a winter that was terrible for commerce and agriculture.[14]

World financial markets. It was a great month for investors overseas as well. Germany's Dax index jumped 6.3, its best month since May 2007; France's CAC 40 had its best month since October 2003, rising 6.1%. Both those indices needed those gains; they were down 14% and 11% for the year through the end of April. In England, the FTSE 100 gained 6.8% for the month. Asia's indexes soared too: the Nikkei 225 shot up 11% in April, its best month since July 1995 – although it is still down 9.5% on the year. India's Sensex 30 rose 11% in April, and the Hang Seng index in Hong Kong rose 13%. Also worth noting: Brazil's Bovespa index was up 11% last month and is up 6.2% for the year.[15]

Commodities markets. Oil notched a new record high on April 22: $119.90 in intraday trading on the New York Mercantile Exchange.[16] By the end of April, oil prices had fallen about 5% from that high – but they still gained an incredible 12% for the month, and prices are up 18% for the year.[15] Comex-traded gold and silver futures, on the other hand, declined for the second straight month: gold fell 6.1% in April, silver 4.7% and platinum 5.3%.[1]

Housing & interest rates. There is still not much in the way of hope or good news in the real estate sector, so let's make it quick and (relatively) painless. The National Association of Realtors index of pending home sales fell 1.9% in February.[17] Foreclosures spiked 57% in March.[18] New home sales slumped 8.5% in March.[19] Existing home sales dropped 2% in March ... but the median residential resale price climbed to $200,700 from $195,600 in February, according to NAR data.[20]

Congress struggled to provide more aid for homeowners facing foreclosure. However, a bill spearheaded by Rep. Barney Frank (D-Mass.) bogged down on Capitol Hill, as legislators were loath to embrace one of its key ideas: asking mortgage lenders and mortgage holders to take losses of about 15 cents on the dollar in exchange for federal repayment guarantees on the reduced loans.[21]

Mortgage rates on 30-year FRMs climbed back above 6%, to levels unseen since mid-March; Freddie Mac reported an average of 6.06% at the end of April. As the month closed out, the average rates on 15-year FRMs stood at 5.59%, averages on 5-year ARMs were 5.73%, and averages on 5-year ARMs were at 5.29%.[22]

Major indexes. During the first week of April, the Dow gained 3.2%, the S&P 500 4.2%, and the NASDAQ 4.9%.[23] From that fine start, the indexes maintained their momentum and gave us exactly the kind of month for which we hoped. It was a very strong month for financial, energy and tech stocks. The last month in which the S&P 500 climbed 4.75% or more: December 2003.[1]

% Change	1-Month	Y-T-D
DJIA	+4.54	-3.35
NASDAQ	+5.87	-9.03
S&P 500	+4.75	-5.64

Source: CNBC.com, 5/1/08 [1]
Indices cannot be invested into directly.
Returns do not include dividends.

May outlook. Already, some economists and market professionals are anticipating a 3Q or 4Q recovery from this ... recession? Downturn? Call it what you wish, it will not go away immediately. But increasingly, there is a feeling that we've seen the bottom of it. (The Dow's climb back over 13,000 on May 1 certainly presents a strong signal.) If May brings a few decent-to-encouraging indicators (could something mildly positive about real estate turn up?), it will likely be a very good month for the markets. Is the worst behind us? Pragmatically, it is too early to tell, but that opinion is gaining popularity.

Well, here are the key economic releases for the rest of May: the April ISM services index (5/5), March pending home sales (5/7), March wholesale inventories (5/8), April retail sales and business inventories (5/13), April CPI and core CPI (5/14), April industrial production and the May Philadelphia Fed index (5/15), April housing starts, building permits and the University of Michigan's preliminary May consumer sentiment survey (5/16), April leading indicators, (5/19), April PPI and core PPI (5/20), April 30 FOMC policy minutes (5/21), April existing home sales (5/23), the Conference Board's May survey of consumer confidence and April new home sales (5/27), April durable goods orders (5/28), and April consumer spending, wages and core inflation (5/30).

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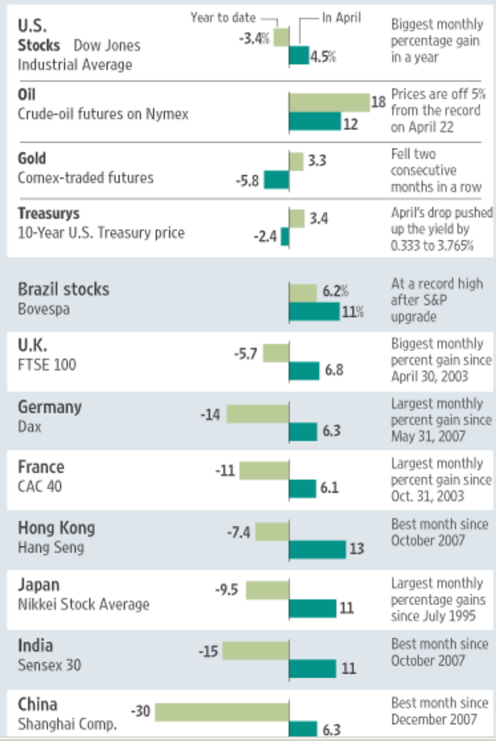
How Markets Did in April

Most global stock markets had a good April, despite the continuing credit-markets jitters. Treasury bonds fell in price—pushing up yields—as investors started to feel the credit crunch has hit its worst. Shown, monthly and year-to-date performance.



stocks world-wide benefited from a month of relative calm, especially in comparison to the fears of systemic breakdown that prevailed in March.

"There is surely more financial debris ahead," noted Kevin Gardiner, head of global equity strategy for HSBC Holdings in a recent report. "But at the very least the

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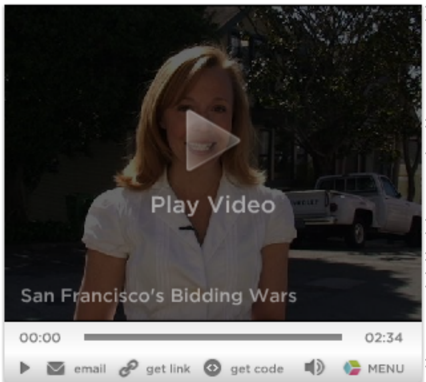
housing-market slump continued, but two gauges of home prices provided a glimmer of hope that the downturn might be easing a bit.



Home sales in San Francisco may be down but competition is hot. Stacey Delo reports on how some homes are seeing 10 or more bidders, and in one case 22.

Existing-home sales fell 2% last month to a seasonally adjusted annual rate of 4.93 million, the National Association of Realtors said. The drop followed an increase of 2.9% in February, the first monthly gain since July. Home sales were down 19.3% from the 6.11-million-unit pace recorded in March 2007.

The languid sales pace has pushed inventories of unsold homes to a 9.9 months' supply at current sales rates. That large overhang has put downward pressure on prices for months, especially in areas hit hardest by the housing crisis.

Now, however, there are signs that prices might be starting to stabilize. The median U.S. home price rose to $200,700 last month from a revised $195,600 in February, the Realtors' report said. And the Office of Federal Housing Enterprise Oversight's home-price index showed prices rising a seasonally adjusted 0.6% in February from January, the first monthly gain since June.

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