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Economic Evaluation Group, Inc. Presents **Monthly Economic Update for November, 2007**

Quote of the month. “Next to doing the right thing, the most important thing is to let people know you are doing the right thing.” – John D. Rockefeller

The month in brief. Even with the headlines trumpeting rising oil prices and falling home prices, October was far less scary than preceding months for Wall Street investors. While the Dow Jones Industrial Average sank 367 points on October 19th, Halloween brought the best news of the month – another interest rate cut from the Federal Reserve, and the announcement of a 3.9% GDP for the third quarter. The NASDAQ had a fine month while the Dow Jones Industrial Average was practically flat (it did reach a new record close of 14,164.53 on October 9th).

Major indexes. Even with all the turmoil on Wall Street this summer, we are looking at a very positive year for the stock market. The NASDAQ had a terrific month to start the fourth quarter, hitting a 6-year high to start October. The Dow and S&P 500 also hit new record highs during the month.

% Change	1-Month	Y-T-D
DJIA	+0.11	+10.52
NASDAQ	+5.41	+15.52
S&P 500	+1.43	+8.48

Source: CNNMoney.com, 10/31/07

Domestic economic health. There was plenty of troubling news when one looked away from a healthy stock market. Oil prices rose into the low nineties per barrel; jobless claims shot up 28,000 at mid-month, but it was too soon to tell if it was an aberration or a new trend. The median resale price of existing homes dropped 4.2% in September. The euro traded at \$1.44 against the

dollar by October’s end. But the Federal Reserve offered a treat on October 31st, cutting the federal funds rate by 0.25% to 4.5% and spurring a market rally.

Also on Halloween, the Commerce Department announced a 3.9% GDP reading for 3Q 2007, following a 4.0% second quarter. Most analysts were expecting about 3% growth (or lower) for 3Q 2007. Importantly, personal spending rebounded to 3.0% during the quarter, twice the pace of 2Q 2007. Residential investment dropped 20% in 3Q 2007, the biggest dip in a year.

Some troubling earnings reports sparked market jitters early in the month. The world’s #1 brokerage (Merrill Lynch) posted its first quarterly loss in six years, and America’s #1 savings and loan (Washington Mutual) reported its lowest earnings in almost nine years. Later in the month, Bank of America, Wachovia and Citigroup reported 3Q profit declines, the CEO of Caterpillar Inc. characterized the housing slump as the worst in 60 years, and Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke both expressed concerns that the housing crisis was likely to last into 2008.

Global economic health. In October, the gap between American and European interest rates began to widen; in America, as they fell to 4.5%, the Bank of England kept rates at 5.75% (with a policy meeting scheduled for November 8th) and the European Central Bank kept rates at 4.0% on October 4th. Will this gap last? In one scenario, U.S. growth slows down due to the weakness in housing and the credit crisis, and the ECB holds interest rates. In another scenario, the ECB has to raise rates: Eurozone inflation hit 2.6% in October (a 25-month high) with pressure from oil and energy prices.

On Halloween, the Bank of Japan held its key interest rate at 0.5%, and stocks climbed and the yen advanced

0.7% in the wake of the U.S. rate cut. In China, the news that the nation's trade surplus increased 56% in September put pressure on the central bank to increase borrowing costs and strengthen the yuan. India's industrial production surged 10.7% in August data, and the rupee hit new highs against the dollar; Standard and Poor's predicts roughly 9% economic growth for India through 2008. ¹

World financial markets. Most Asian stock markets rebounded within days from the mid-month dive they took after the Dow plunged 367 points on October 19th. The region still embraced a bull mindset, with the Hang Seng, CSI 300 and other indexes showing strong volume even with moderate declines. India's stock funds achieved their best monthly gains in four years during October, as the country's benchmark index hit two record highs in the last week of the month. While Asian investors remained cautious about U.S. economic trends, many analysts feel Asian markets can weather any stateside slowdown as demand from China and India could pick up the slack if export orders lessen from America. European stocks advanced for the second straight month. The FTSEurofirst 300 index of top European shares gained 2.8% for the month of October, as did the Dow Jones Stoxx 600 index. The FTSE 100 in London advanced +0.93% on the month, the DAX in Frankfurt climbed +0.51%, and the CAC 40 in Paris gained +0.75%.

Commodities markets. When will oil prices hit \$100 a barrel? For many economists and oil industry analysts, that is the question – not if, but when. (It was only on September 12th that oil hit a then-record high of \$80 a barrel.) Crude oil prices rose 18% during October and are up nearly 50% since the start of 2007. Gas prices have risen more than \$0.15 since mid-October. During the month, the same story repeated itself: just when analysts thought prices couldn't go any higher, a new headline boosted prices and invited speculators. During October, the triggers were Turkey's possible incursion into northern Iraq and the low, low levels of U.S. oil inventories. Soybean prices, often correlated to oil prices, hit a three-year high at the end of the month.

Gold often moves in the opposite direction of the dollar, and move north it did during October, as a climb of \$100 per ounce over the last few months continued. Gold topped \$800 an ounce in intraday trading on the New York Mercantile Exchange on Halloween. Through the end of October, gold prices had increased 25% for the year and silver prices 11%.

Housing & interest rates. Mortgage rates descended in October, and new home sales rose 4.8% in September

partly due to builder incentives, and the median new home sales price rose to \$238,000. The National Association of Realtors reported that residential re-sales dropped 8% in September – nearly twice as much as economists had forecast. (In fact, new home sales are down 23% from a year ago, even with the 4.8% month-over-month gain.) The median existing home resale price dropped 4.2% for the month to \$211,700. Data showed that housing starts hit a 14-year low in September, dropping 10.2% from August, and building permits hit their lowest level since 1995 during the month.

The National Association of Homebuilders housing market index fell two points to an all-time low of 18 in October.

Mortgage rates fell sharply toward the end of the month in reaction. The average interest rate on a 30-year fixed-rate mortgage dipped to 6.26% at the end of October, the lowest average since mid-May. Averages on 15-year FRMs, 5-year ARMs and 1-year ARMs were all below 6% at month's end.

November outlook. It appears we now have a resilient (and growing) economy rather than a crawling, stagnant economy; the second strong GDP reading in a row bears this out. But this month, and this quarter, will certainly test that resilience. The housing correction and the mortgage credit crisis still have fingers on the throat of the economy, and the consensus is that the Fed is done tinkering with interest rates for the near future. As for the dollar, most analysts polled expect it will strengthen gradually across the rest of 2007 and 2008.

However, the fourth quarter has recently proven a good quarter for the stock market investor – a *USA Today* article from September 30 notes that the S&P 500 has only lost ground in two fourth quarters in the last 15 years, and the average gain in those 13 positive fourth quarters has been 6.3%.²

Here's a list of the major reports coming out during the rest of November. We have October unemployment and wages (11/2), October factory orders (11/2), September pending home sales (11/13), October retail sales and business inventories (11/14), October industrial production (11/16), October leading indicators (11/19), October housing starts (11/20), and then a whole bunch of data at the end of the month: October existing home sales and November consumer confidence (11/27), October durable goods orders (11/28), October new home sales (11/29), and finally October personal income, personal spending and construction spending (11/30). And, of course, we'll keep an eye on the weekly Energy Department report of crude inventories (11/7, 11/14, 11/21, 11/28).

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Documentation. ¹ <http://www.financialexpress.com/news/Economy-to-grow-by-9-in-07-SP/226378/>
² usatoday.com/money/markets/2007-09-30-stocks-outlook_N.htm.
