

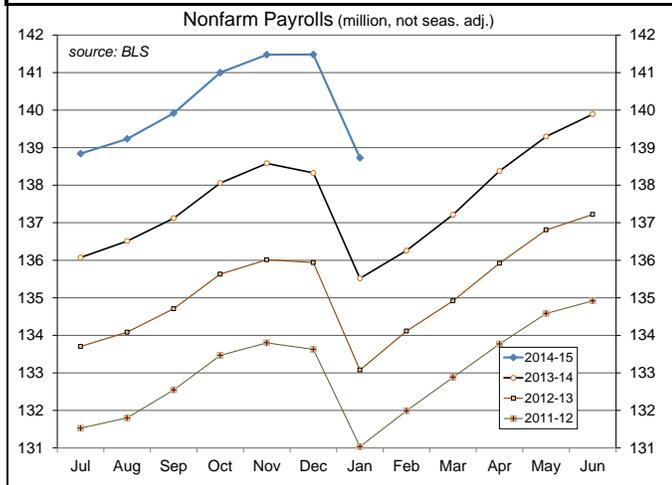
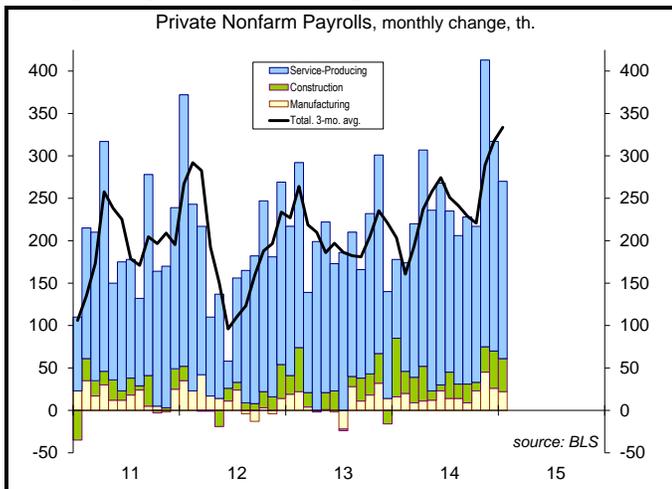
Weekly Market Monitor

January Jobs Data – Good, but Slack Remains

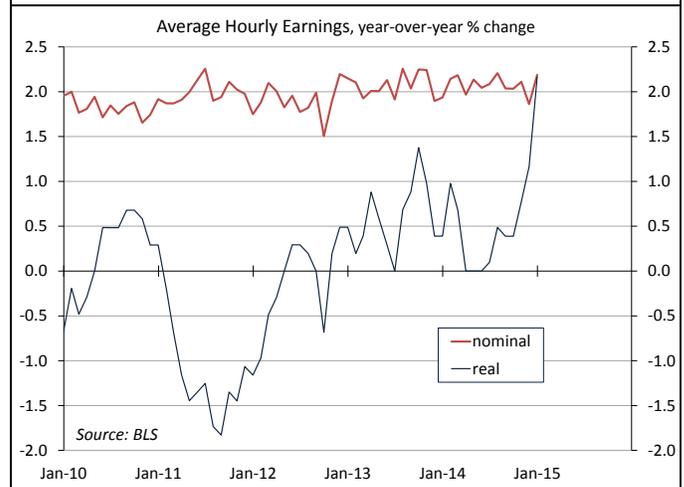
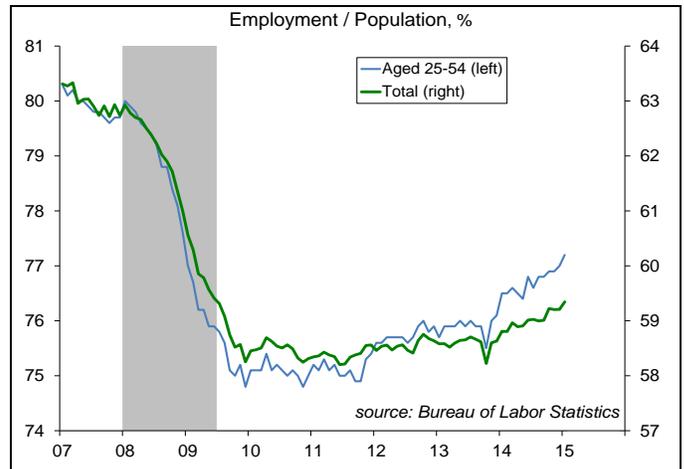
Contrary to what you may have heard, the U.S. economy *did not* add 257,000 jobs in January. That’s the seasonally adjusted figure. We actually lost 2.755 million jobs, which was a smaller decline than the year before (-2.811 million). Yet, while seasonal adjusted figures may often be looked at skeptically, the broad range of labor market indicators suggests solid improvement. These data also suggest that we still have a long way to get to normal. The Fed’s chief tasks will be to make sure we get there and to manage market expectations along the way.

One shouldn’t put too much weight on any particular month of data, but almost all labor market gauges are reflecting improvement. Much of the pickup in job growth appears to reflect growing confidence among small businesses.

The unemployment rate edged back up to 5.7%. That’s just noise. Labor force participation dipped in December, and then rebounded in January. At some point, as the job market improves, a lot of people currently on the sidelines (those wanting a job, but not officially counted as “unemployed”) should re-enter the job market. As a result, the unemployment rate decline is expected to slow. The employment/population ratio is a better measure of labor utilization. This rate is trending gradually higher (more so for the key cohort, those aged 25-54), but we’re still well below pre-recession levels. Moreover, we have a lot of underemployment. As workers move up to positions more commensurate with their education and skills, they leave openings for those coming up the ladder.



Unadjusted payrolls plunge each January, reflecting the end of the holiday shopping season, school year effects, and weather. The January drop this year was smaller than in recent years. In retail, we lost 593,000 jobs (vs. -669,000 in 2014).



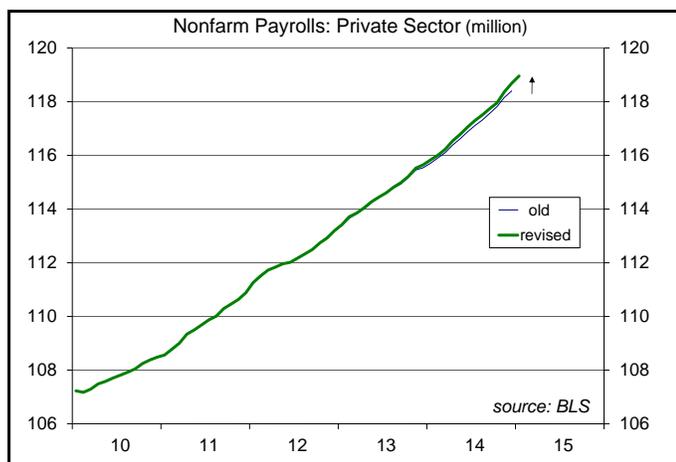
Labor market slack is evident in the lackluster trend in earnings. Average hourly earnings rose 0.5% in January, but that followed -0.2% in December. The Fed should be willing to tolerate a pickup in wage growth. However, some officials are more patient than others. Fed Chair Yellen should bring others to her viewpoint. She will deliver her monetary policy testimony to the Senate Banking Committee on February 24.

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	Treasury Yields									Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	\$/Euro	\$/BP	JY/\$	CD/\$	NASD	SPX	DJIA	
1/09/15	0.02	0.08	0.22	0.59	0.96	1.45	1.98	2.55	1.183	1.515	118.66	1.186	4664.71	2044.81	17737.37	
1/30/15	0.02	0.07	0.18	0.47	0.77	1.18	1.68	2.25	1.129	1.503	117.44	1.272	4635.24	1994.99	17164.95	
2/06/15	0.02	0.06	0.25	0.65	1.02	1.48	1.96	2.53	1.132	1.524	118.99	1.252	4744.40	2055.47	17824.29	

Recent Economic Data and Outlook

The economic data were mixed. January employment figures were strong. Average hourly earnings jumped, but that followed a decline in December. The soap opera in Europe continued. Greece's new prime minister and finance minister toured European capitals making their case for less austerity, but were met with a hardline stance. The ECB tightened a lending channel that the Greek banks don't use much (or even need).



The January **Employment Report** was strong. Nonfarm payrolls rose by 257,000 (median forecast: +235,000), with a net upward revision of 147,000 to the two previous months. Payrolls fell by 2.76 million before seasonal adjustment (vs. -2.81 million in January 2014). Annual benchmark revisions were relatively modest. Payrolls rose by 3.21 million over the last 12 months. The unemployment rate edged up to 5.7% (from 5.6%), reflecting a rebound in the labor force participation rate. The employment/population ratio edged up to 59.3% (from 59.2% in November and 58.8% a year ago). Average hourly earnings rose 0.5%, following a 0.2% decline in November (+2.2% y/y).

The **ADP Payroll Estimate** rose by 213,000 in the initial estimate for January (+2.3% y/y), while figures for November and December were revised a net 59,000. Strong gains continued in small and medium-size firms.

Personal Income rose 0.3% in December (+4.6% y/y). Wages and salaries edged up 0.1% (vs. +0.6% in November, +4.8% y/y). **Personal Spending** fell 0.3% (+3.6% y/y), reflecting lower gasoline prices (ex-gasoline sales slipped 0.1%, +4.4% y/y). The **PCE Price Index** dipped 0.2% (+0.7% y/y), unchanged again ex-food & energy (+1.3% y/y, vs. a Fed goal of 2.0%).

Unit **Auto Sales** edged down to a 16.6 million seasonally adjusted annual rate in January, vs. 16.8 million in December and 15.3 million a year earlier.

Factory Orders fell 3.4% in December, following a 1.7% drop in November. Durable goods orders fell 3.3%, vs. -2.2% in November, partly reflecting a drop in aircraft orders. Shipments of nondefense capital goods ex-aircraft were somewhat higher than before the GDP report (implying a slight upward revision to the fourth quarter growth estimate).

The **ISM Manufacturing Index** slipped to 53.5 in January, vs. 55.1 in December and 58.7 in November. Growth in new orders slowed (still positive). Production was moderate. Employment growth slowed slightly. Input prices sank. Comments from supply managers were mostly positive, although there were some concerns about labor issues at West Coast ports.

The **ISM Non-Manufacturing Index** edged up to 56.7 in January, vs. 56.5 in December. Business activity increased. Growth in new orders remained strong. However, employment growth slowed (still positive). Input price pressures fell. Comments from supply managers were mixed, but mostly positive.

The U.S. **Trade Deficit** widened more than expected in December, to \$46.6 billion (vs. \$39.8 billion in November). In the advance GDP report, the Bureau of Economic Analysis had assumed a deficit of \$44.2 billion. Hence, the revised data suggest (all else equal) that the fourth quarter growth estimate will be revised somewhat lower.

The **Bank of Australia** lowered its benchmark interest rate by 25 bps, to 2.25%, citing below-trend growth and low inflation.

Economic Outlook (1Q15): Real GDP growth of 2.5-3.0%.

Employment: Job growth is strong. Small firms are hiring.

Consumers: Strong job growth and lower gasoline prices should support spending growth in 1H15. Confidence is rising, but we'll eventually need to see a pickup in wages.

Manufacturing: Mixed. A stronger dollar and weakness in the global economy are expected to restrain exports, but domestic demand should strengthen in the months ahead.

Housing/Construction: Supply constraints have eased and affordability has improved. Look for a better balance in 2015 (less speculative buying, better consumer fundamentals).

Prices: The PCE Price Index remains well below the Fed's 2% goal – and the core rate is moving in the wrong direction. Pipeline pressures are mild. Wage pressures are limited. Inflation expectations remain well-anchored, but may decline.

Interest Rates: With low inflation and a still-high elevated level of slack in the economy, the Fed can be patient in deciding when to begin raising short-term interest rates. Global financial conditions are also a consideration (along with the outlooks for inflation and the job market). The hard part for the Fed will be managing financial market expectations.

This Week:					<i>forecast</i>	last	last -1	comments
Monday	2/09		no significant data					
Tuesday	2/10	7:30	Small Business Optimism	Jan	NF	100.4	98.1	trending higher
		10:00	JOLTS: hiring rate	Dec	NF	3.6%	3.7%	a gradual trend higher
			JOLTS: quit rate		NF	1.9%	1.9%	but still below normal
		1:00	Treasury Note Auction					3-year notes
Wednesday	2/11	1:00	Treasury Note Auction					10-year notes
		2:00	Treasury Budget, \$bln	Jan	NF	-10.3	+2.9	seen moderate
Thursday	2/12	8:30	Jobless Claims, th.	2/07	292	278	267	a low trend
		8:30	Retail Sales	Jan	+0.3%	-0.9%	+0.4%	moderate (watch for revisions)
			ex-autos		+0.4%	-1.0%	+0.1%	lower gasoline prices
			ex-autos, bld mat, gasoline		+0.7%	-0.2%	+0.5%	expected to rebound
		10:00	Business Inventories	Dec	+0.1%	+0.2%	+0.2%	reduced by lower oil prices
		1:00	Treasury Bond Auction					30-year bonds
Friday	2/13	8:30	Import Prices	Jan	NF	-2.5%	-1.8%	falling oil prices
			ex-food & fuel		NF	-0.1%	-0.2%	but disinflationary pressure otherwise
		9:55	UM Consumer Sentiment	m-Feb	100.0	98.1	93.6	trending higher
Next Week:								
Monday	2/16		Presidents Day Holiday					markets closed
Tuesday	2/17		Mardi Gras					<i>laissez les bons temps rouler</i>
		8:30	Empire St. Manf. Index	Feb	3.5	10.0	-1.2	weather impact?
		10:00	Homebuilder Sentiment	Feb	59	57	58	should trend higher
Wednesday	2/18	8:30	Producer Price Index	Jan	-0.3%	-0.3%	-0.2%	lower gasoline
			ex-food & energy		+0.0%	+0.3%	+0.0%	a low trend
			ex-f, e, & trade services		+0.1%	+0.1%	+0.0%	mild "new" core reading
		8:30	Building Permits, th.	Jan	1075	1058	1052	likely higher
			% change		+1.6	+0.6	-3.7	but spring figures will be more important
			Housing Starts		1070	1089	1043	choppy, but expecting a higher trend
			% change		-1.7	+4.4	-4.5	watch for revisions
		9:15	Industrial Production	Jan	+0.6%	-0.1%	+1.4%	colder temps
			Manufacturing Output		+0.4%	+0.3%	+1.3%	aggregate hours reported at +0.2%
			Capacity Utilization		80.1%	79.7%	80.0%	still relatively low
			Manufacturing		79.5%	79.3%	79.2%	no threat of higher inflation
		2:00	FOMC Minutes	1/28				insight into what the Fed worries about
Thursday	2/19	8:30	Jobless Claims, th.	2/14	288	292	278	a low trend
		10:00	Philly Fed Index	Jan	12.5	6.3	24.3	choppy, but likely moderate
		10:00	Leading Econ Indicators	Jan	+0.1%	+0.5%	+0.4%	components more mixed in January
Friday	2/20	9:45	Markit US Manf PMI (flash)	Feb	NF	53.9	53.9	moderate

This Week...

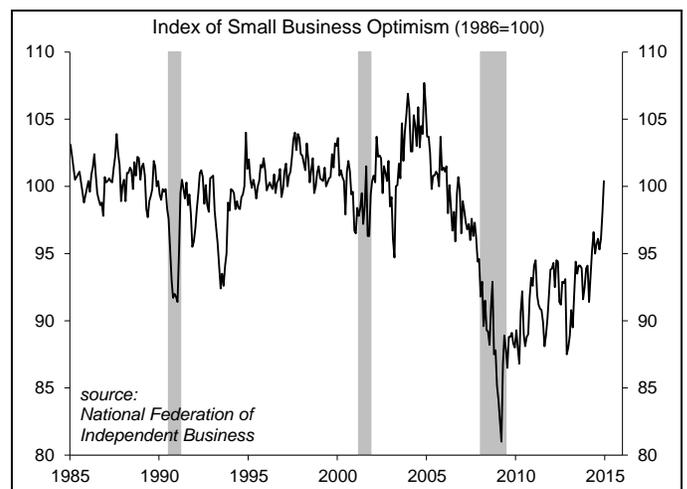
The economic calendar is relatively light, which may lead investors to focus on other things (such as developments overseas). January is not a critical month for most retailers, but there should be a lot of interest in this report. December retail sales figures were unexpectedly soft. We should see either a sharp rebound in January or revisions to the previous data. But why should we worry about statistical anomalies and seasonal adjustment noise in the retail sales data? We can be certain that strong job growth and lower gasoline prices will drive consumer spending significantly in the first half of 2015.

Monday

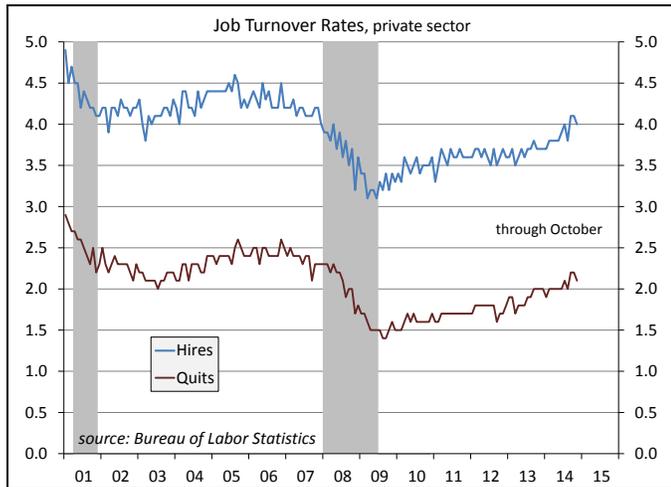
Nothing significant on the calendar.

Tuesday

Small Business Optimism Index (January) – Confidence among small business owners has risen sharply in recent months, which is consistent with a broad pickup in hiring (hence, the strong payroll figures over the last year). Lower gasoline prices should be a huge benefit for small firms in the first half of 2015.



Job Openings and Labor Turnover Survey (December) – Fed Chair Yellen highlighted hiring and quit rates as important gauges of labor market slack. Both have been gradually improving, but still are a bit short of “normal.”

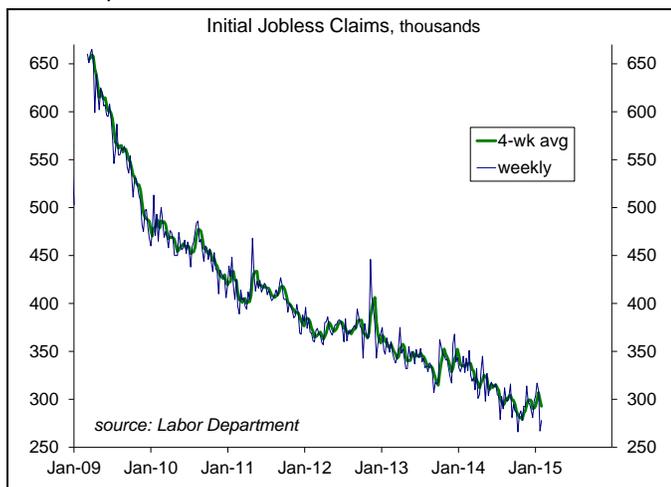


Wednesday

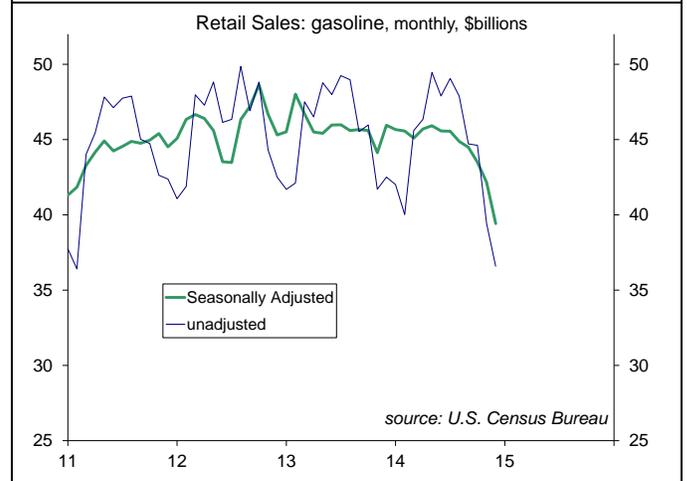
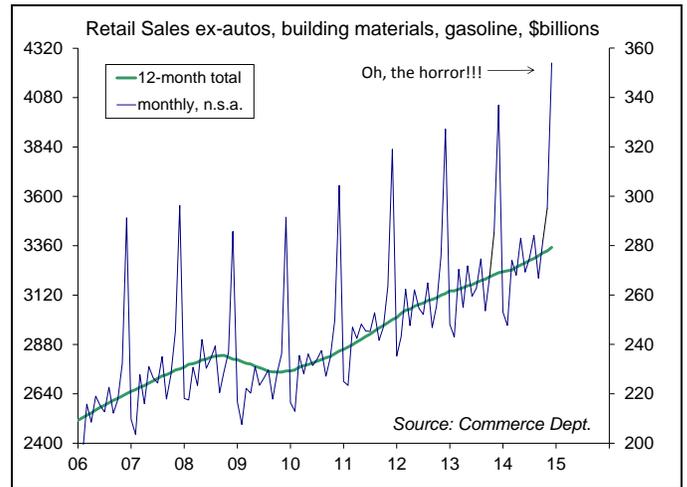
Treasury Budget (January) – Not market-moving.

Thursday

Jobless Claims (week ending February 7) – Claims are largely a measure of job destruction, which hasn't been a big issue for the economy in the last few years. However, claims are also influenced by job market strength. Someone newly laid off is more likely to find a new job right away (and therefore is less likely to file a claim for unemployment benefits). Seasonal noise should be fading as we move into February. The underlying trend is expected to remain low.



Retail Sales (January) – Sales fell sharply in December, which may have reflected seasonal strength being pulled into November (quarterly figures were strong), or there could have been some problems with the data (hence, watch for revisions). The headline figure should be biased lower due to the drop in gasoline prices, and it usually takes some time for consumers to recognize the "savings" and begin spending money on other things. Seasonal adjustment of the headline figures is huge in January. Core sales typically fall about 25% m/m, reflecting the end of the holiday shopping season. The bigger boost to sales is likely to come in March, when consumers will more fully realize the impact from lower gasoline prices (note that gasoline prices normally rise in the spring, but it's all relative).



Business Inventories (December) – Assumed (in the advance GDP report) to have risen modestly.

Friday

Import Prices (January) – Lower petroleum prices.

UM Consumer Sentiment (mid-February) – Lower gasoline prices should continue to fuel gains into February.

Next Week ...

Monday's a holiday. The economic data bunch up on Wednesday, perhaps with a focus on the FOMC minutes.

Coming Events and Data Releases

February 24	Yellen Monetary Policy Testimony (Senate) Consumer Confidence (February)
February 26	Consumer Price Index (January)
February 27	Real GDP (4Q14, 2 nd estimate)
March 6	Employment Report (February)
March 18	FOMC Policy Decision, Yellen press conference
March 6	Employment Report (February)
April 29	FOMC Policy Decision (no press conference)
June 17	FOMC Policy Decision, Yellen press conference