
From Slow Straggle to Steady Stride: A Hesitant Recovery Assumes New Cadence

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Executive Summary

- × Worst recession since the Great Depression, ended June 2009
- × Growth during 2010 may have approached 3%, 3.5% to 4.0% for 2011
- × Manufacturing slowed somewhat during the summer of 2010
- × Services, consumer sectors need to take the stage

Executive Summary

- × Below-average recovery so far
- × Worry zones: European debt crisis, banks, real wages, geopolitical issues, emerging economies stall as inflation accelerates
- × Bullishness based on consumer, high productivity, limited declines in construction, exports to developing markets
- × Market valuations no longer dirt cheap, but not outrageously priced

Hidden Potential for the Economy to Perform Better than Expectations

My GDP View

2010 (e) 2.9% growth, because:

- × End of inventory draw-down
- × Renewed auto production
- × Bottom in residential construction
- × Exports

2011(e) 3.75% growth

My Inflation Outlook

Inflation 2010 (e) **1.4%**

Inflation 2011 (e) **2.0%**

My Unemployment Outlook

× Unemployment peaked about 10.1%

× Current rate 9.8%

× Potentially under 9% by mid-2011

Source: Morningstar

Where Are We Now?

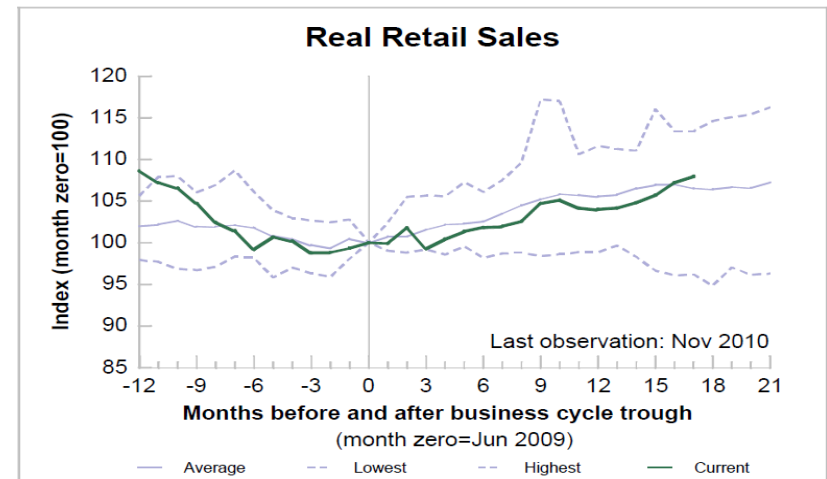
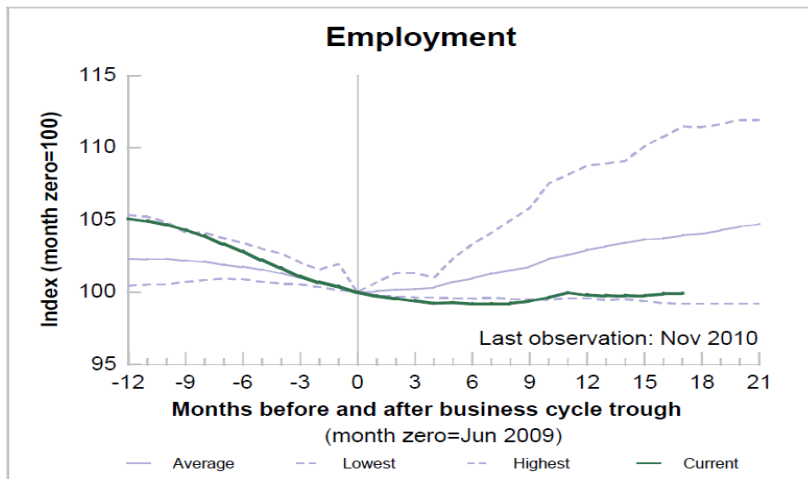
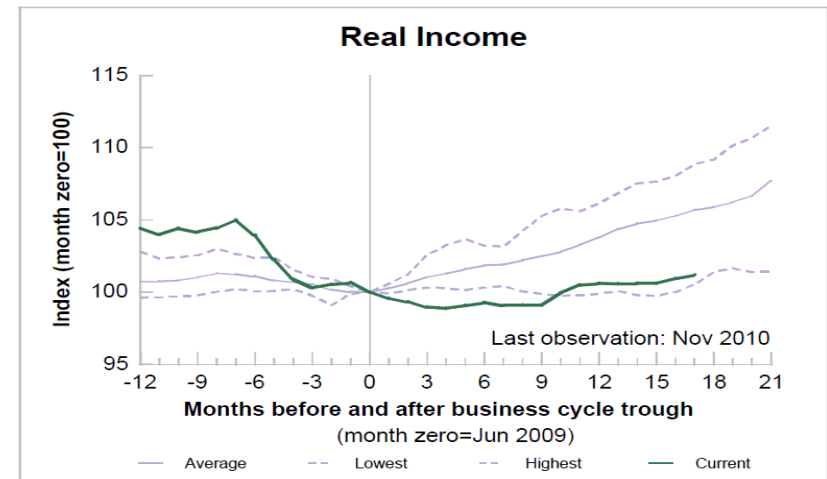
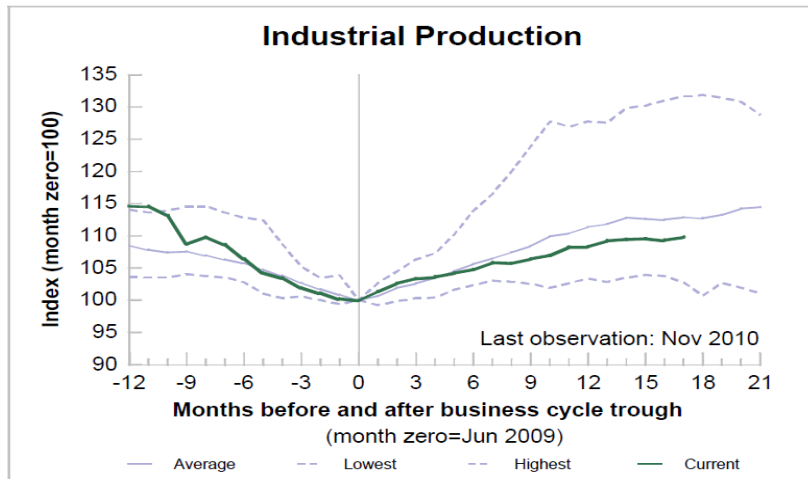


The Harder GDP Falls, the Higher It Bounces-- Usually

Year	After Bottom, 18 Month GDP Growth Rate	Prior GDP Contraction Rate
1981	11.7%	-2.6%
1957	9.8%	-3.7%
1953	9.5%	-2.6%
1960	9.4%	-1.0%
1969	8.8%	-1.1%
1973	7.5%	-3.2%
1990	4.8%	-1.4%
2001	2.6%	-0.3%
1980	1.4%	-2.2%
Average	7.0%	-2.0%
2007	4.7%	-4.1%

Source: BEA, Morningstar
calculations.

Retail Spending the Most Typical of Past Recoveries



Source: St. Louis Federal Reserve, updated December 23, 2010

Inventories, Exports Drive GDP Overall

% Contribution to GDP Growth by Category

	Recovery Begins							Whole recovery
	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	
Consumer Goods	0.6	-0.7	1.6	0.4	1.3	0.8	0.9	1.3
Consumer Services	-0.1	0.1	-0.2	0.3	0.0	0.8	0.7	0.4
Business Structures	-2.3	-0.7	-0.4	-1.0	-0.5	0.0	-0.1	-0.5
Equipment & Software	-3.0	-0.3	0.3	0.9	1.2	1.5	1.0	1.4
Residential Construction	-1.3	-0.7	0.3	0.0	-0.3	0.6	-0.8	-0.1
Inventory	-2.4	-1.4	1.1	2.8	2.6	0.8	1.6	2.2
Exports	-4.0	-0.5	1.3	2.6	1.3	1.1	0.8	1.8
Imports	6.6	2.1	-2.7	-0.7	-1.6	-4.6	-2.5	-3.0
Government	-0.5	1.3	0.3	-0.3	-0.3	0.8	0.8	0.3
Other								-0.1
Total GDP Growth(annualized)	-6.4	-0.8	1.6	5.0	3.7	1.7	2.6	
Total Recovery GDP growth								3.7

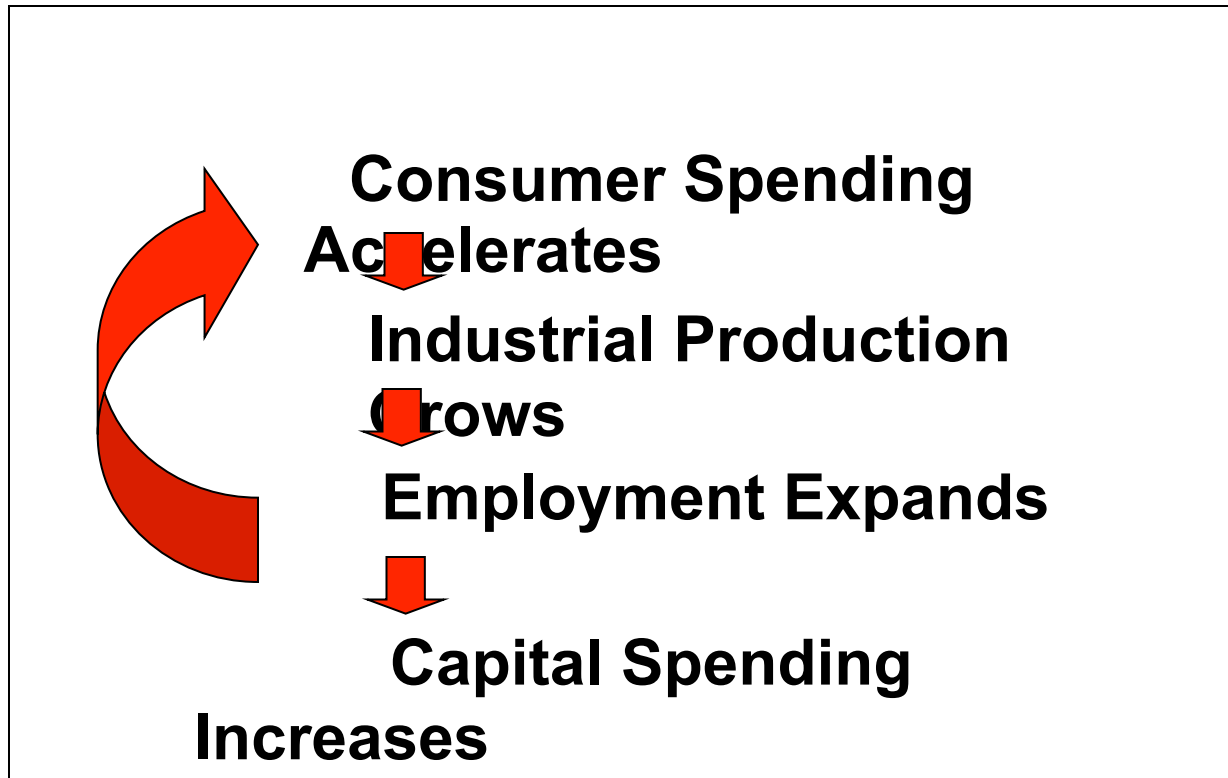
Boxes are two best categories for the period

Source: Bureau of Economic Analysis, Morningstar

Double Dip Not Likely

- × Consumers are the key driver, and they keep spending
- × Average recovery lasts longer than four years
- × Manufacturing always pauses at this stage of the recovery

The Consumer Drives the Economy



Average Recovery Lasts About Five Years

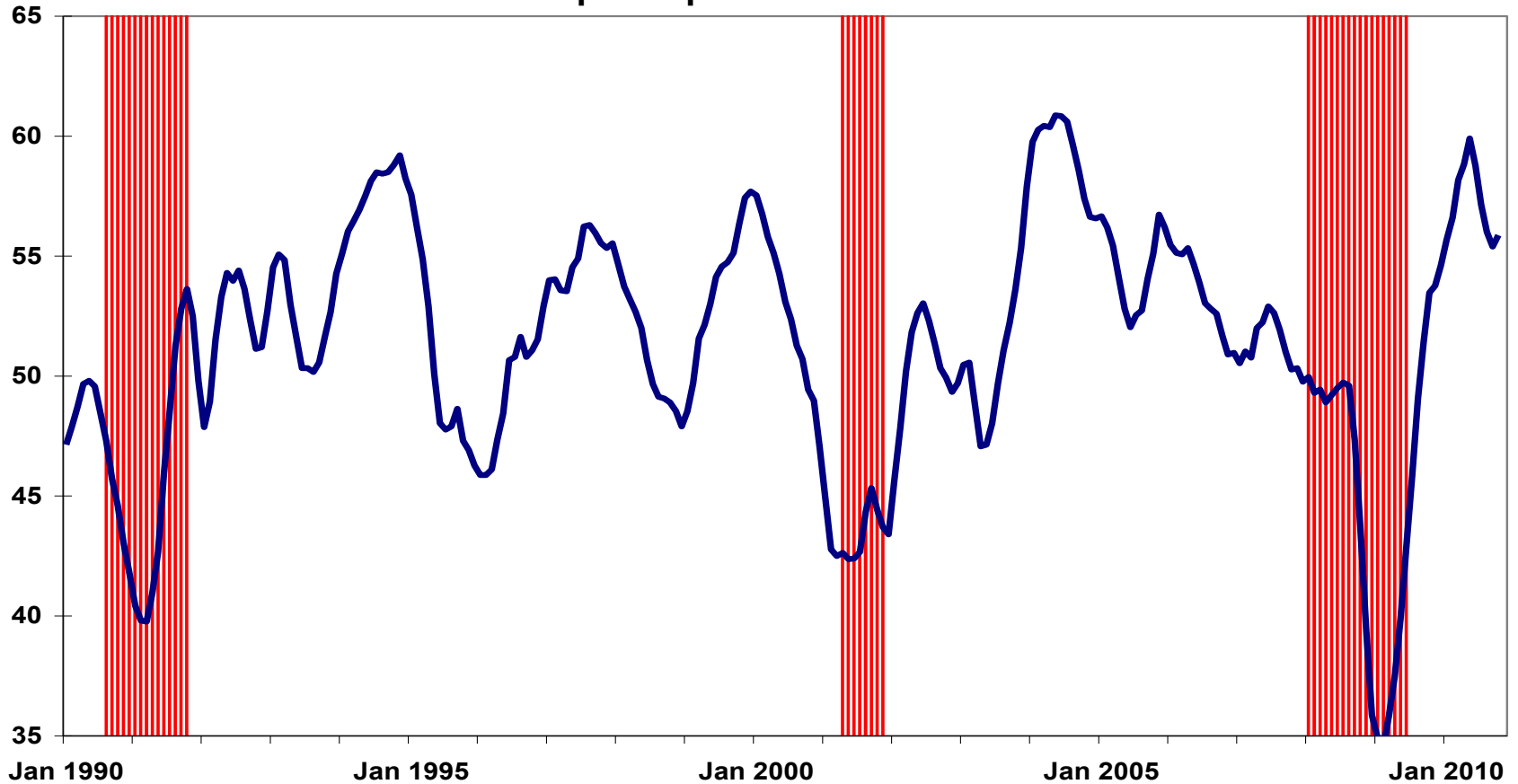
Recovery Duration

Trough	Peak	Months	Comment
Oct-49	Jul-53	45	
May-54	Aug-57	39	
Apr-58	Apr-60	24	
Feb-61	Dec-69	106	
Nov-70	Nov-73	36	
Mar-75	Jan-80	58	
Jul-80	Jul-81	12	Shortest
Nov-82	Jul-90	92	
Mar-91	Mar-01	120	Longest
Nov-01	Dec-07	73	
Average		61	Average
Jun-09	Dec-10	18	Current

Source: National Bureau of Economic Analysis, Morningstar

Manufacturing: PMI Predicts More Recessions than Occur

PMI Composite versus Recessions
(Three Month Moving Average)
Stripes Equal Recessions



Source: ISM, NBER

Employment Poised for Improvement?



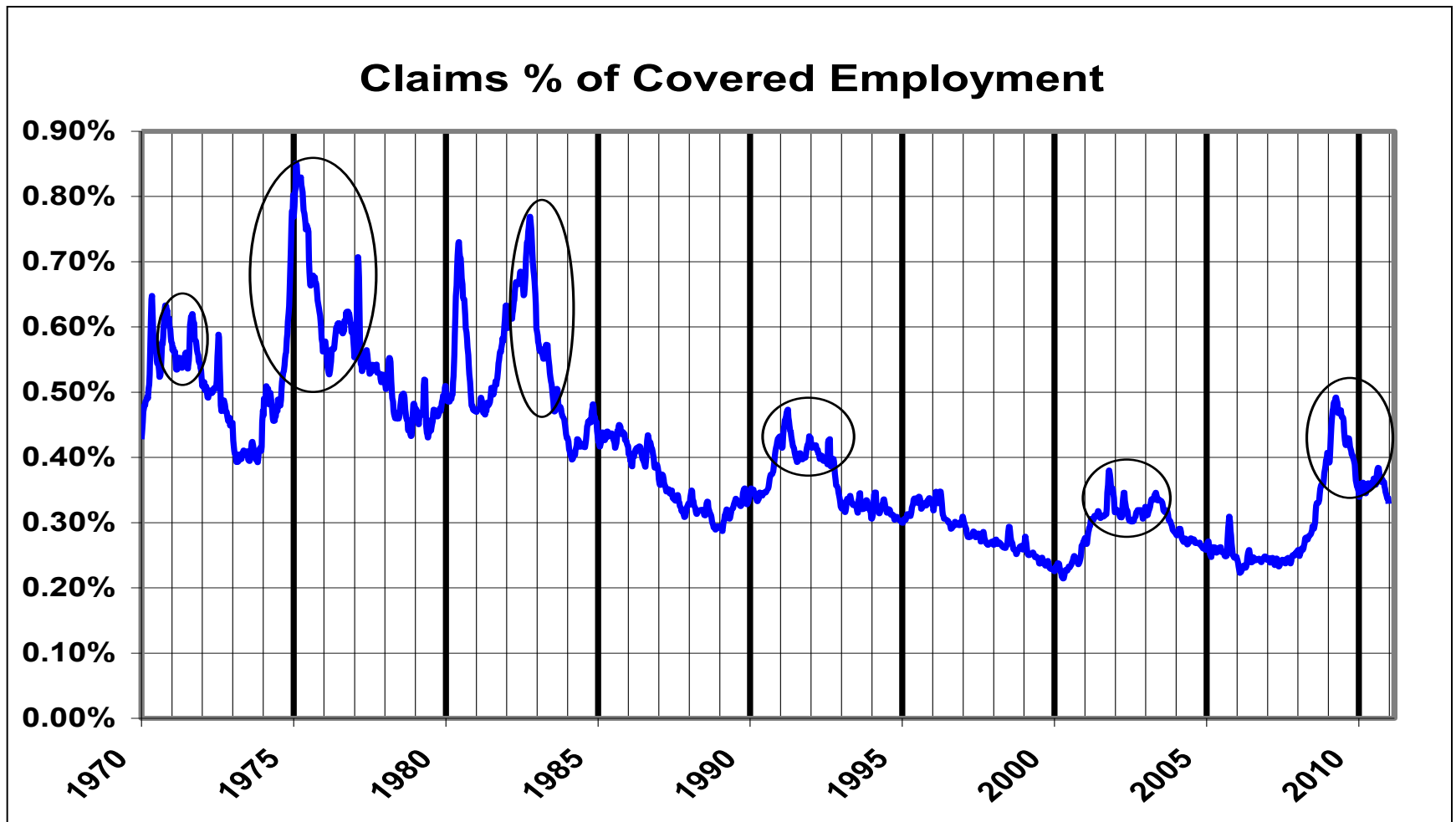
Employment Very Bad, Goods Producing Very Hard Hit

Jobs Lost During 2007 Recession (in 1,000s)

Employment Data	Service Producing	Goods Producing	Government	Total
Employment December 2007	93,618	21,956	22,377	137,951
Jobs Lost	-3,916	-3,962	+346	-7,532
Percentage Decline	-4.2%	-18.1%	+1.6%	-5.5%

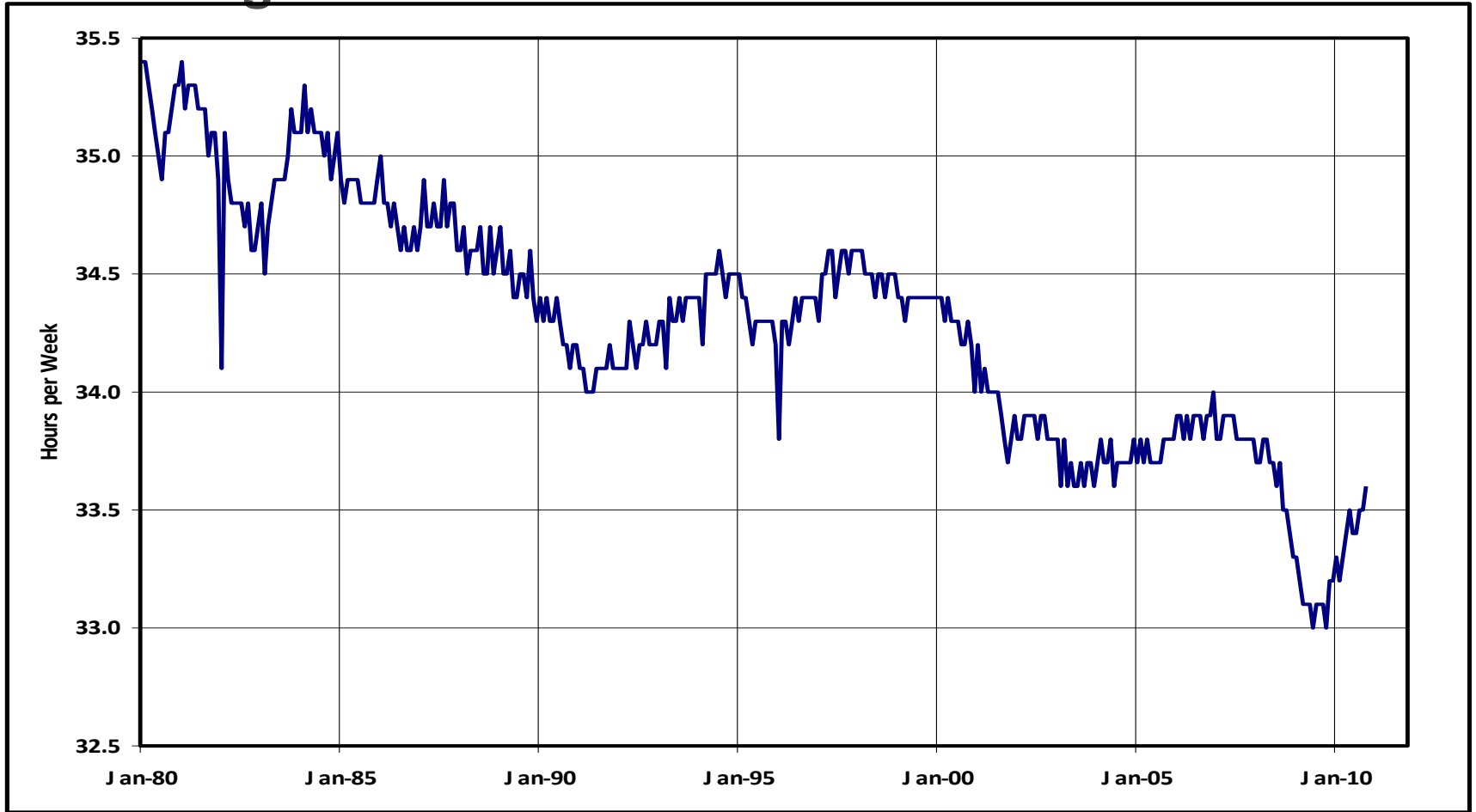
Source: Bureau of Labor Statistics, Morningstar, Jobs Lost Between 12/2007 and 6/2009

Initial Unemployment Claims: Stalling Out as Usual



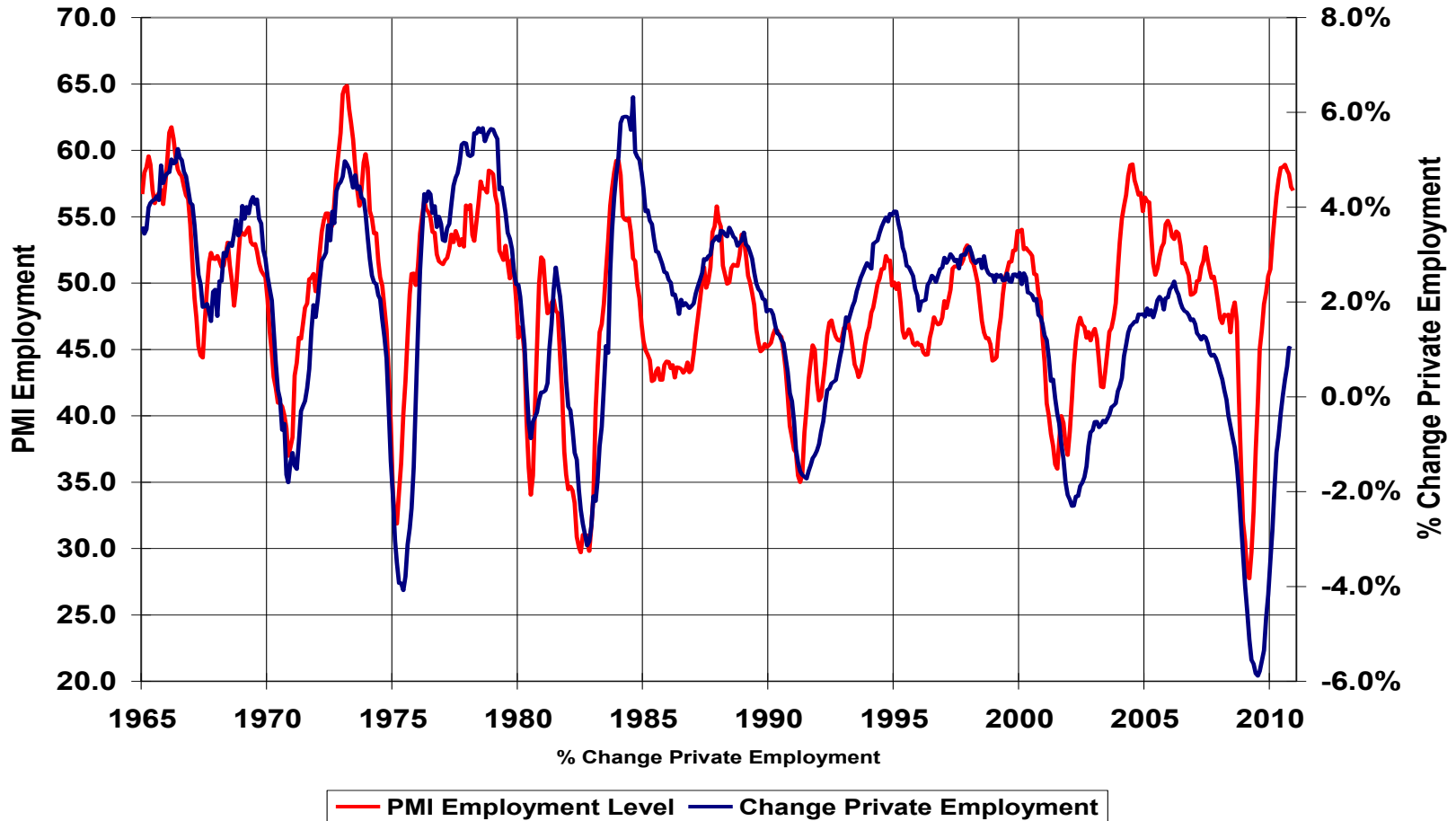
Source: Bureau of Labor Statistics, updated December 30, 2010

Employment Growth Would Have Been Almost 2 Million Higher if Hours Worked Had Remained Constant



Source: Bureau of Labor Statistics

ISM Employment Data Points to Employment Recovery

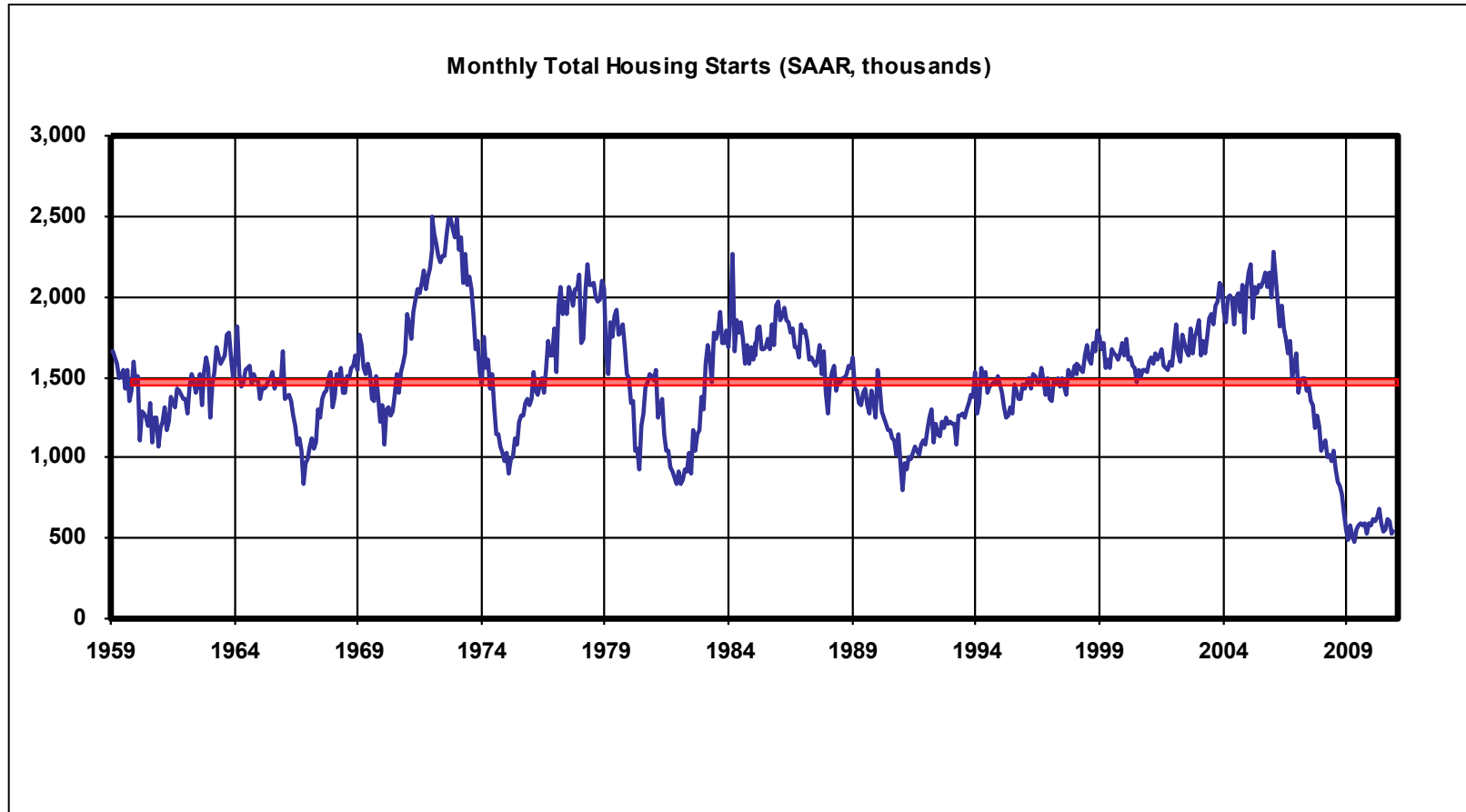


Source: St. Louis Federal Reserve, Morningstar Industrials Team. Updated January 3, 2011

Demand Deferred, Not Lost: The Rubber Band Effect



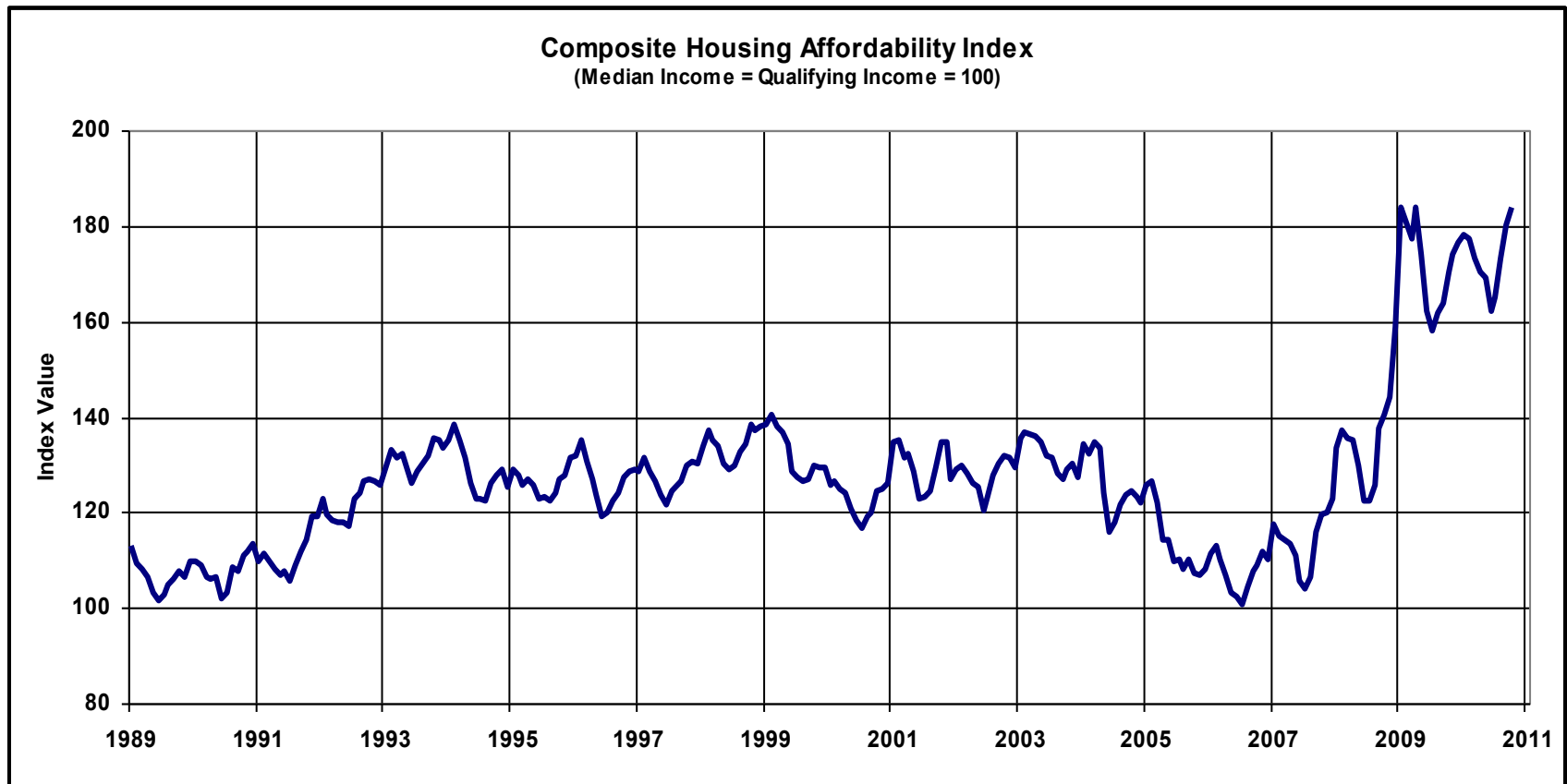
Starts Far Below Natural Demand, Improvement Stalled



Red bar represents average natural demand, Morningstar estimate

Source: Census Bureau, Morningstar, updated December 16, 2010

Housing Affordability at Record High



Source: National Association of Realtors, updated December 1, 2010

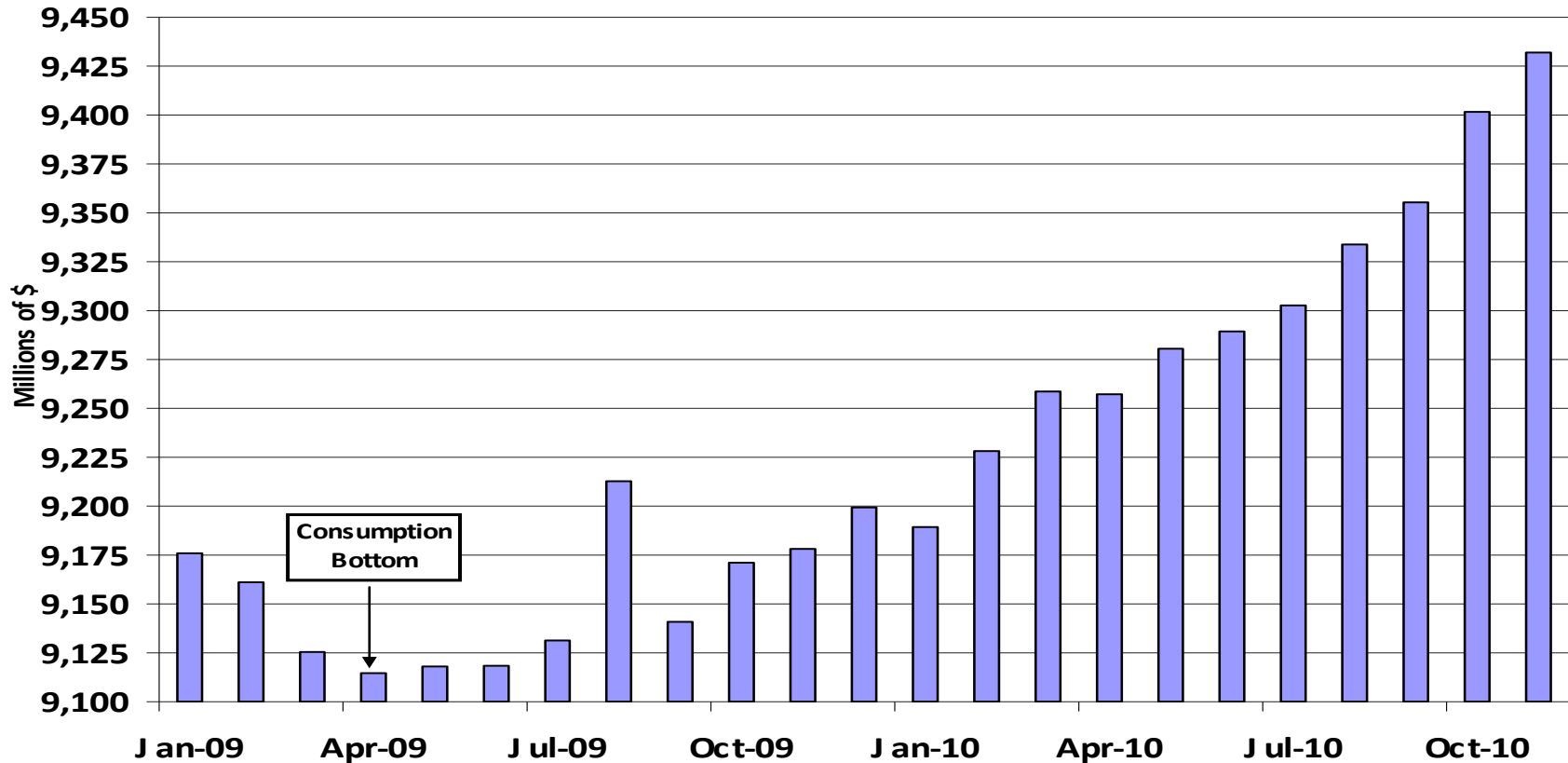
Consumer Takes The Stage



Source: topnews.net.nz

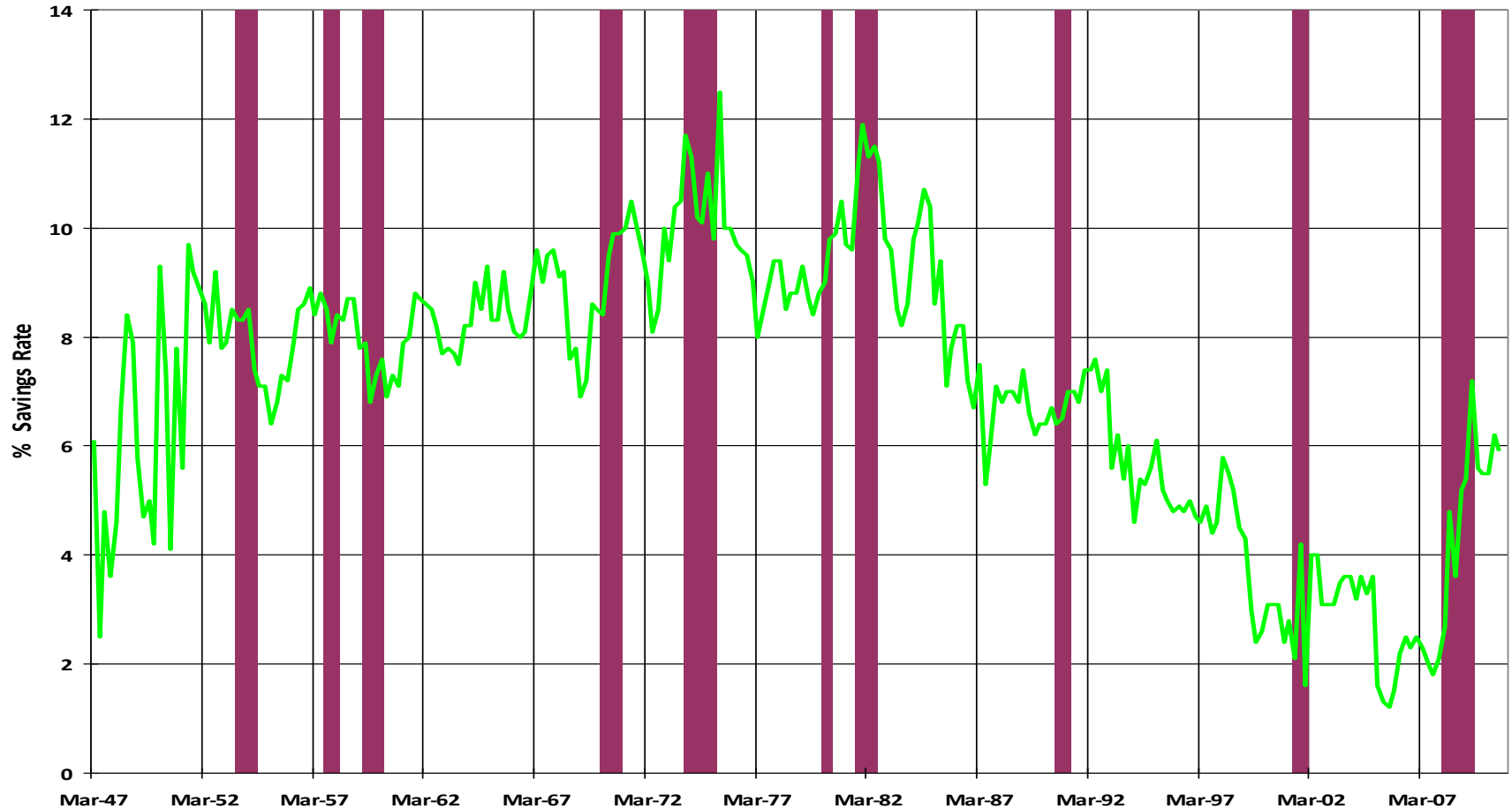
Consumption Establishes Uptrend

Real Personal Consumption



Source: Bureau of Economic Analysis, updated December 23, 2010

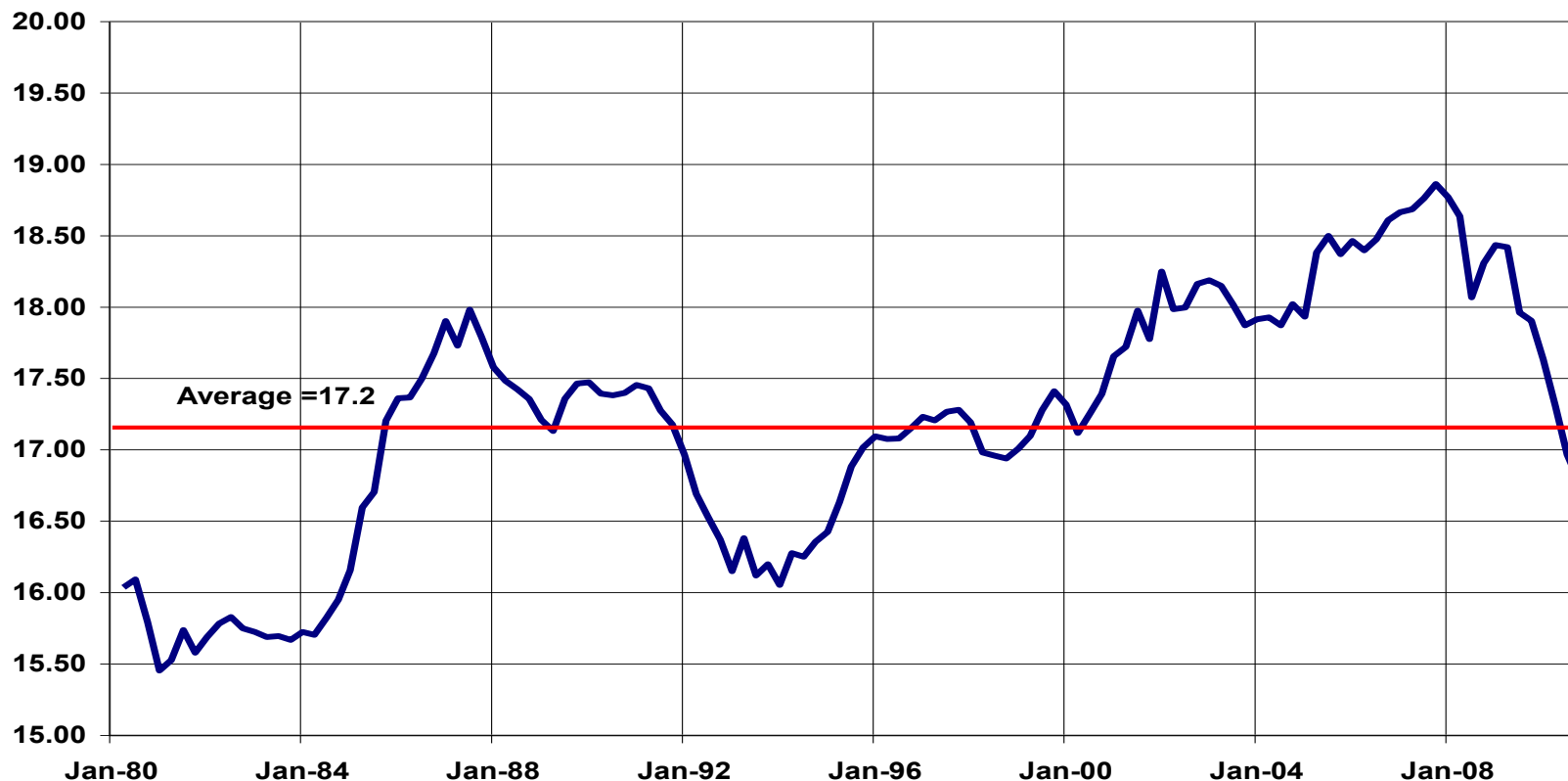
Savings Rate Peaked for this Cycle?



Source: U.S. Bureau of Economic Analysis, updated December 23, 2010
Red bars denote recession

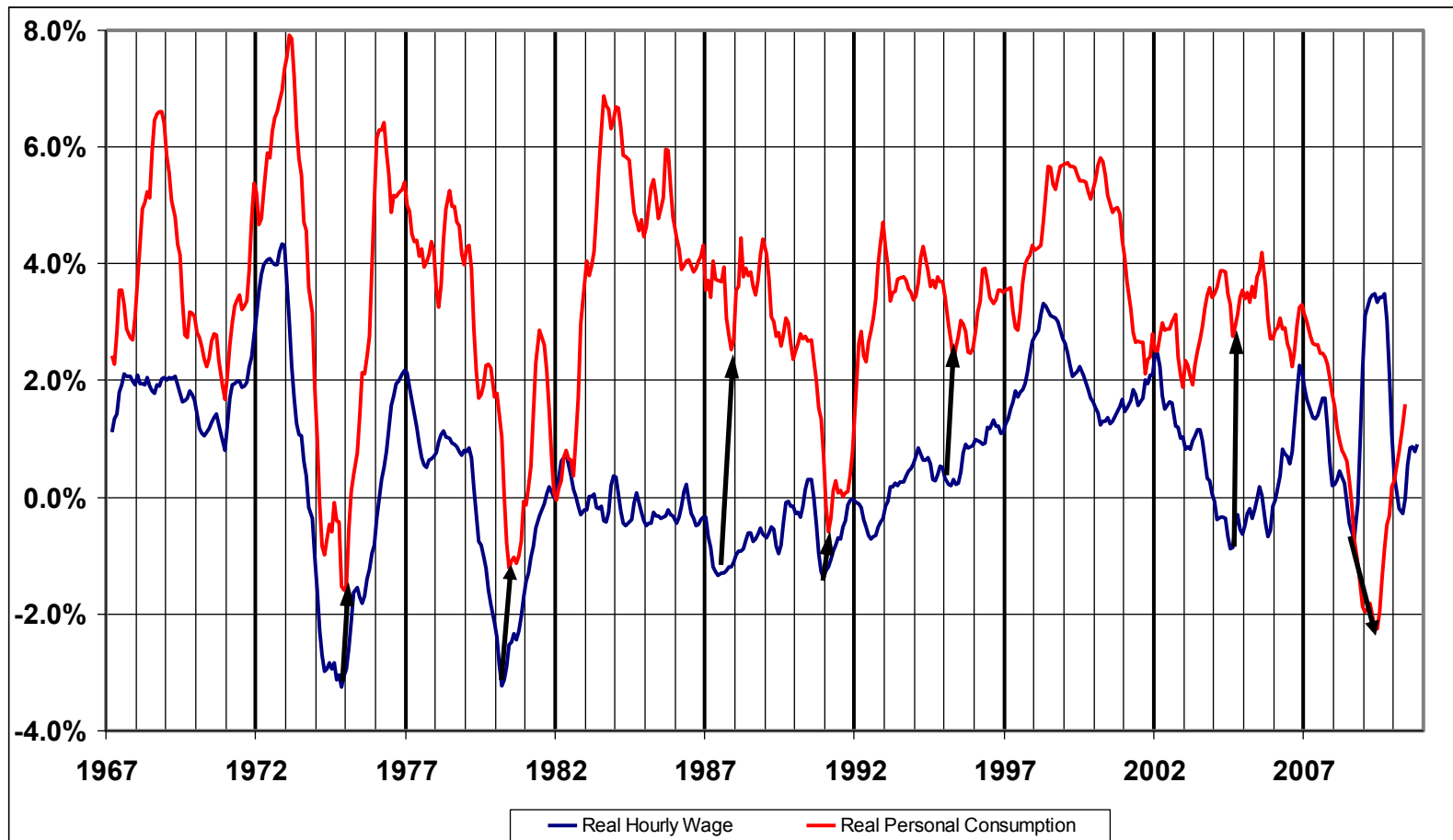
Consumer Fixed Payments Improved Sharply

Financial Obligations Ratio



Source: U.S. Federal Reserve, Morningstar, Updated
December 21, 2010

Real Hourly Wages Looking Up Again



Source: Morningstar, Bureau of Labor Statistics, Bureau of Economic Analysis, updated December 23, 2010