Market Update

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ISM Message

to Bearish Economists: No Recession

The Institute for Supply Management (ISM) June report on US manufacturing continues to stubbornly resist the chorus of economists claiming that the US economy is in recession. The composite index actually rose from 49.6 to 50.2 (below 50 readings indicate potential for a declining economy). As you can see in the chart on the next page, the index has: 1) a pretty good track record as a recession indicator and 2) that in prior recessions (the shaded areas) the index usually drops near or below 40. As of June the index is nowhere near recession levels.

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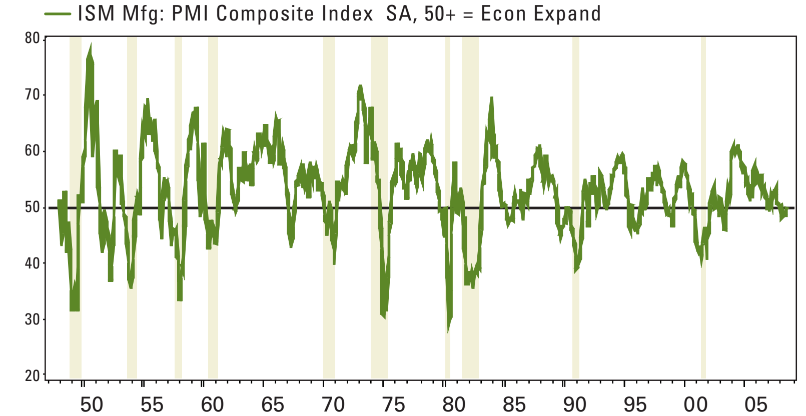
In fact, adding up all the other data used to estimate real GDP growth, we now think the second quarter, just concluded will show real GDP expanded at about a 3% annualized rate, up from 1% in the first quarter. In other words, it looks like the economy reaccelerated in the second quarter, which is what this ISM report is telling us.

The charts below the Composite Index chart show the various components. The Employment Index is the only component in recession territory, all the others – New Orders, Production, Supplier Deliveries and Inventories are nowhere near recession levels. The Prices Paid Index is a moon shot, due to soaring energy prices.

Finally, the Export and Import Indexes show the widest gap on record, with the Export Index at 58.5, while the Import Index has fallen to 46. Rapidly rising exports and falling imports point to an extended recovery in US net exports which we expect will provide considerable support for GDP growth for the foreseeable future.

One caveat – some analysts argue that the ISM has been pushed up somewhat by the Midwest flooding. The thought is that slower vendor deliveries and higher inventories are partly due to disruptions associated with the flooding. While it's possible the disruptions had an effect, excluding these two components completely would yield only a small decline in the Composite Index. Still nowhere near recession territory.

Composite



Source: Institute for Supply Management / Haver Analytics 07/01/2008

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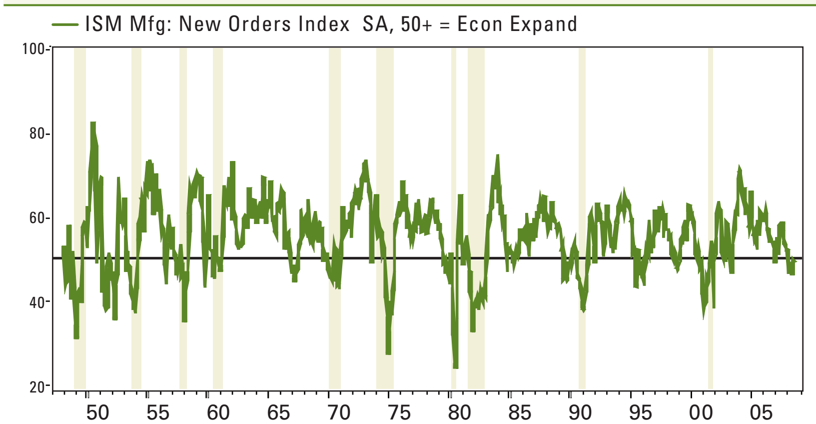
The ISM New Orders Index is only slightly below 50 at 49.6 indicating a marginal decline in new orders.

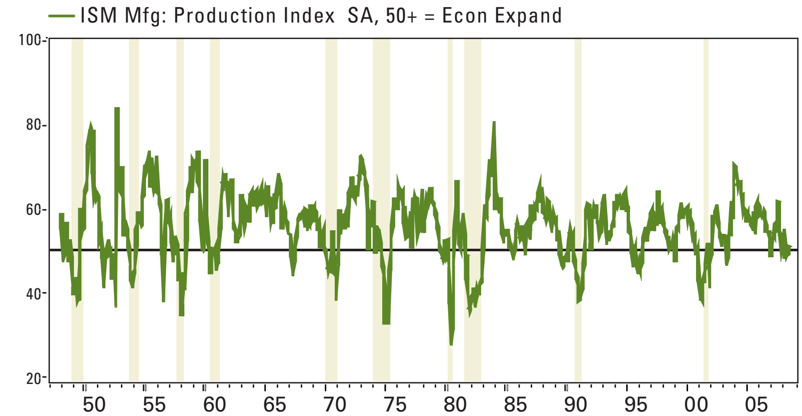
New Orders



Source: Institute for Supply Management / Haver Analytics 07/01/2008

The ISM Production Index is at 51.5 indicating rising production.

Production

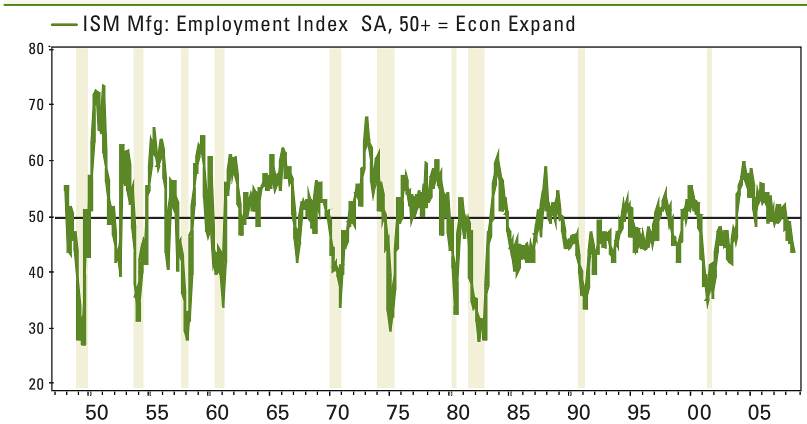


Source: Institute for Supply Management / Haver Analytics 07/01/2008

Production is rising, but employment continues to fall.

The ISM Employment Index is at 43.7, entering recession territory.

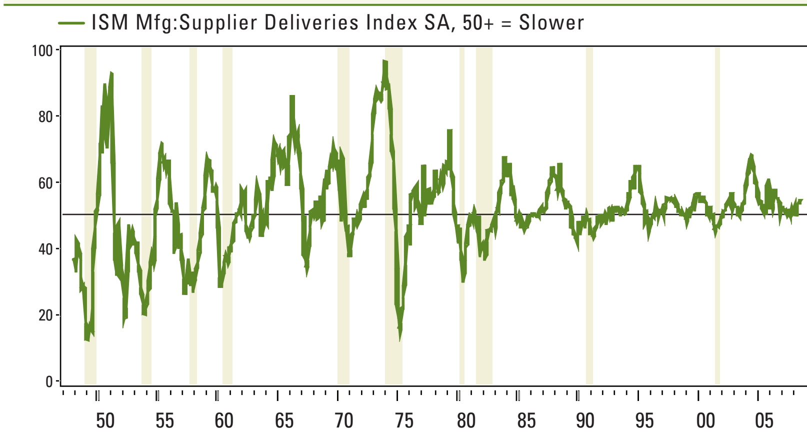
Employment



Source: Institute for Supply Management / Haver Analytics 07/01/2008

The ISM Supplier Deliveries Index is 55.1 indicating slower deliveries.

Deliveries

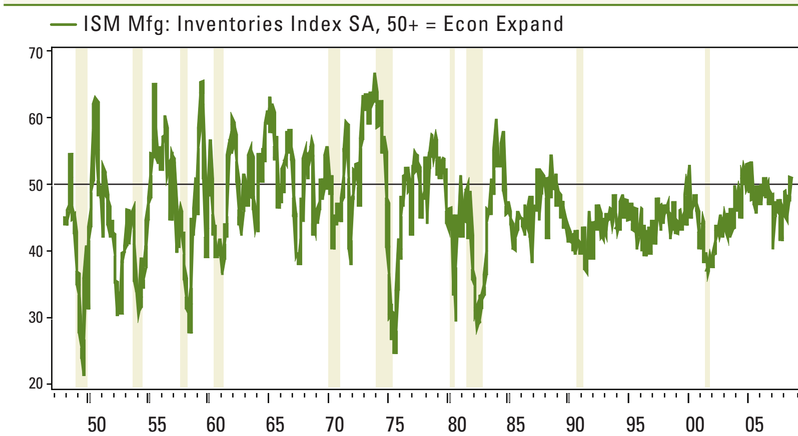


Source: Institute for Supply Management / Haver Analytics 07/01/2008

Midwest flooding may have pushed these components up.

The ISM Inventory Index is at 51.2 indicating tighter inventories.

Inventories

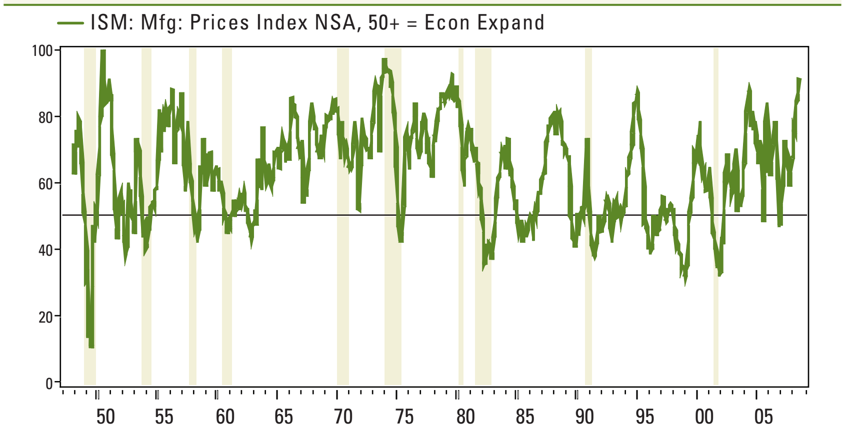


Source: Institute for Supply Management / Haver Analytics 07/01/2008

The ISM Prices Paid Index is 91.5, near record highs due to energy prices.

Rapidly rising exports and falling imports point to an extended recovery in US net exports which we expect will provide considerable support for GDP growth for the foreseeable future.

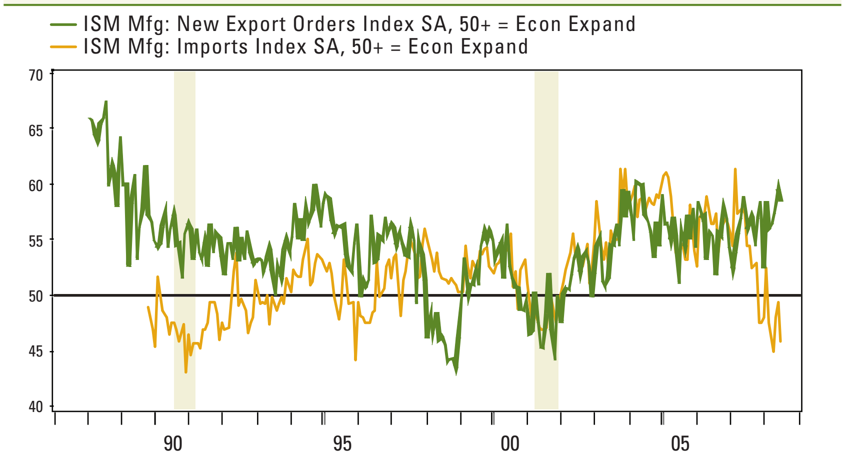
Prices



Source: Institute for Supply Management / Haver Analytics 07/01/2008

The ISM New Export Orders Index at 58.5 is way above the Import Index at 46.

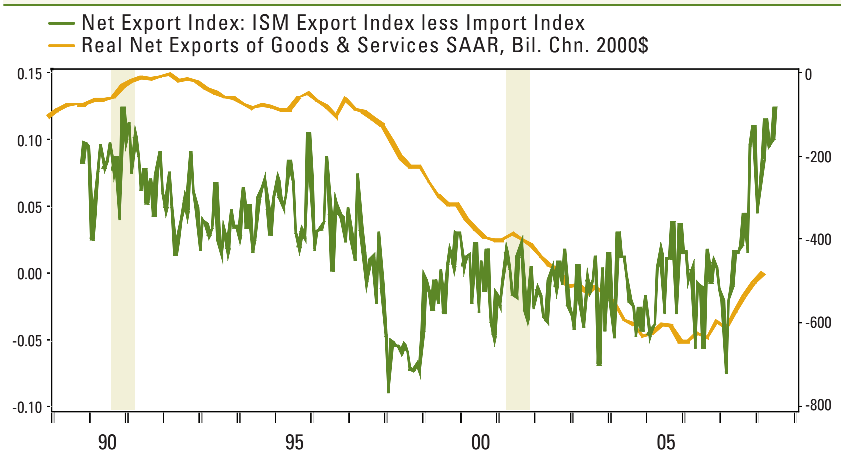
Exports and Imports



Source: Institute for Supply Management / Haver Analytics 07/01/2008

The net of the two - Exports minus Imports is at a record high, indicating that the upturn in the real trade balance is likely to continue.

"Net Exports"



Source: Institute for Supply Management / Haver Analytics 07/01/2008

In summary, the ISM manufacturing report has a lengthy and well respected history as a recession indicator and it does not indicate that the US is in a recession, not even close.