



Weekly

February 6, 2012

ECONOMIC COMMENTARY

IBB INVESTMENT SERVICES GROUP

Conventional wisdom has it that the economy will downshift in the current quarter from the 2.8 percent growth rate it posted in the final three months of 2011. While we concur with that prospect, the slowdown may be less severe than most expect. True, consumers – which account for about 70 percent of total activity – will probably not match the spending pace set in the fourth quarter of last year. One reason is simply based on arithmetic; real personal consumption declined in December, leaving it slightly below the average for the quarter. Hence, consumers will have to climb out of hole before a positive growth rate is reached. That's probable, but the monthly gains won't be large enough to bring the quarterly average up to the 2 percent gain set in the fourth quarter.

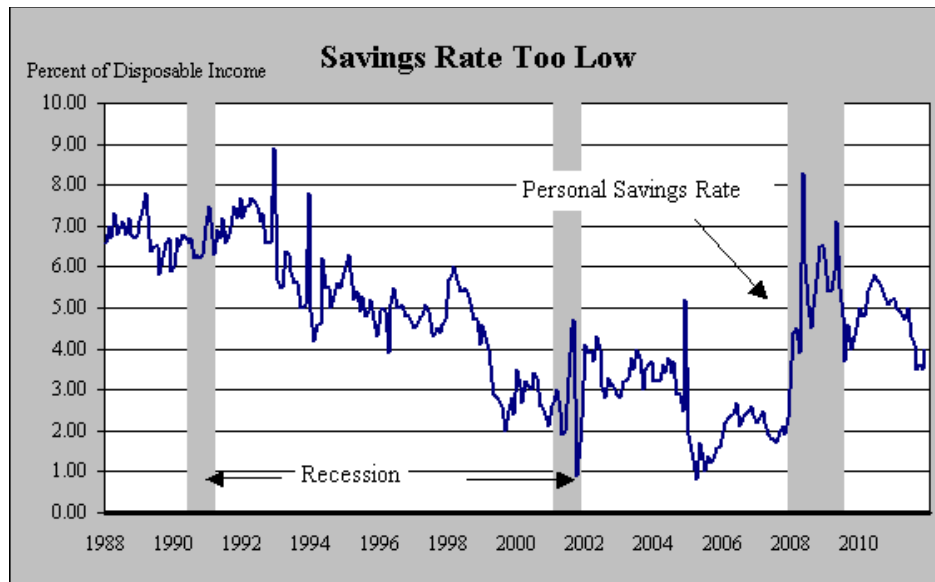
Secondly, an outsize fraction of the fourth-quarter increase in GDP was due to inventory restocking by businesses. Inventory accumulations accounted for more than 1.9 percent of the 2.8 percent overall growth rate during the period, something that is clearly unsustainable. But here is where the conventional wisdom may not hold up. Most believe that companies are now fully stocked and, wary of sales prospects, will meet demand by pulling merchandise off their shelves rather than increase orders for more goods. That line of reasoning would certainly be credible if demand turns out to be as weak as feared. Happily, however, such is not the case. As reported this week, auto sales hit the highest pace since May 2008, exports are holding up surprisingly well according to manufacturing reports, and new orders at factories jumped to a four-month high. The upshot: manufacturing activity as measured by the Institute for Supply Management index, surged to a nine month high in January. What's more, the purchasing managers surveyed in the report said that not only are their companies still adding to inventories, new orders for their goods are rising even faster. From our lens, this does not suggest a major reversal of the inventory buildup that boosted growth towards the end of last year.

To be sure, the case for a slowdown in the early part of 2012 is still compelling. The consumer-spending pullback in December reflected an attempt by households to shore up balance sheets. Recall that holiday purchases were financed largely by drawing down savings and piling on more debt, including padding credit card balances. By all accounts, this was a temporary deviation from a pattern underway throughout the recovery, namely one in which households are focused on paying down debt and rebuilding a savings cushion. We do not have data on consumer borrowing for December yet, but it is clear that consumers decided to stash a larger share of their paychecks into savings during the month. The personal savings rate, which fell from over 4 percent during the summer to 3.5 percent in November, leaped back to 4 percent in December. Odds are, the rate will move higher in coming months, even as households continue to reduce debt from still-high levels relative to incomes. That combination is a recipe for a slower spending pace during the early part of 2012.



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But like the speculation regarding inventories, the logic for a sharp pullback in consumption may be undercut by emerging developments. Keep in mind that households can shore up balance sheets and still keep their wallets open if incomes are growing fast enough. Sadly, that was not the case throughout most of 2011, particularly when inflation is taken

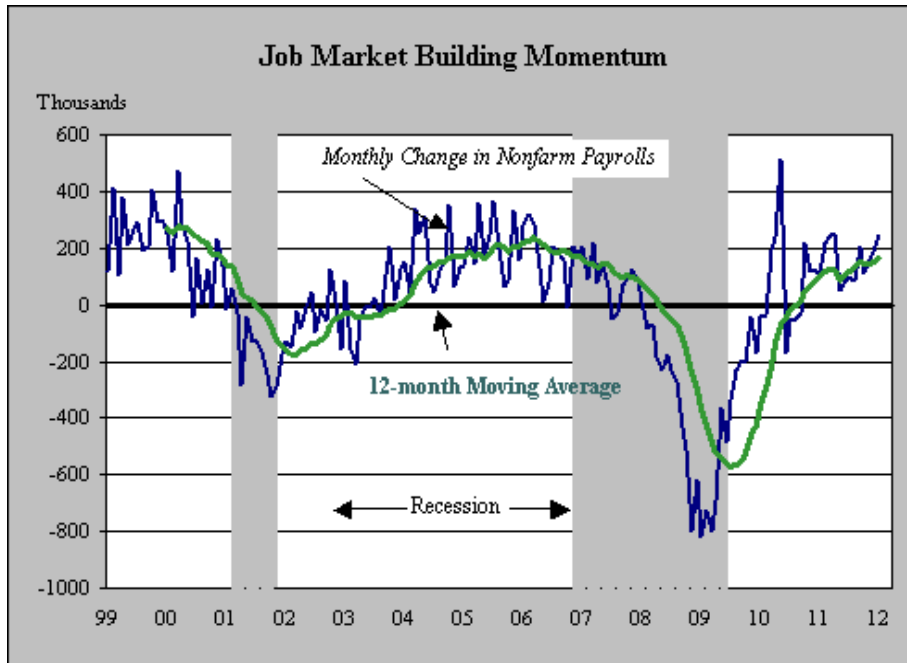
into account. Real disposable incomes edged up by a tepid 0.9 percent during the year, half the 1.8 percent gain registered in 2010 as rising energy, food and commodity prices cut deeply into purchasing power during the spring and summer months. But fortunes started to pick up late in the year, reflecting a combination of slowing inflation and faster income growth, propelled by an improving job market. In the fourth quarter, real disposable incomes turned positive again amid tangible signs that even stronger gains loom ahead.

That brighter prospect received strong support from the government's latest monthly jobs report released on Friday. The report just about blew away the consensus estimate for job creation, which was for a gain of roundly 135 thousand in nonfarm payrolls and for an unemployment rate to remain at a stubbornly elevated 8.5 percent in January. Had the consensus been correct, it would have solidified the notion that the job market is showing steady if slow improvement, with the operative word being "slow". But Friday's report may spur economists to start thinking of different adjectives to describe the job market. In January, the economy generated 243 thousand net new jobs, far stronger than expected even as back figures were revised higher; the revisions added 60 thousand workers to payrolls during November and December. Meanwhile, the separate survey of households shows that the intractably high unemployment rate is not so intractable after all. In January, the jobless rate fell again for the fifth consecutive month, declining to 8.3 percent from 8.5 percent in December. That's the lowest since January 2009 and down by nearly a full percentage point over the past five months.



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It is hard not to wax superlatives over the latest job numbers. Ordinarily, economists like to parse these reports to find reasons for caution, citing the age-old adage that the “devil is in the details.” This time, however, the details are as impressive as the headlines; in some cases, even more so. For one, the outside gain in jobs last month was not skewed by one or two industries. The increase was broad-based, with virtually every super

sector participating in the hiring spree. One measure of industry participation is the diffusion index, which tracks the percentage of private industries expanding payrolls; a number of 50 indicate that as many industries are adding jobs as are shedding them. In January, the index hit 64.1, the highest since last April and a level usually associated with a healthy labor market. Indeed, just about the only sector that continues to retrain is the government, where another 14 thousand pink slips were issued in January. The layoffs here are concentrated mainly among municipal workers, as financially-strapped local governments continue to purge the ranks of teachers and other educational workers. Sadly, this trend shows no signs of easing in the near term.

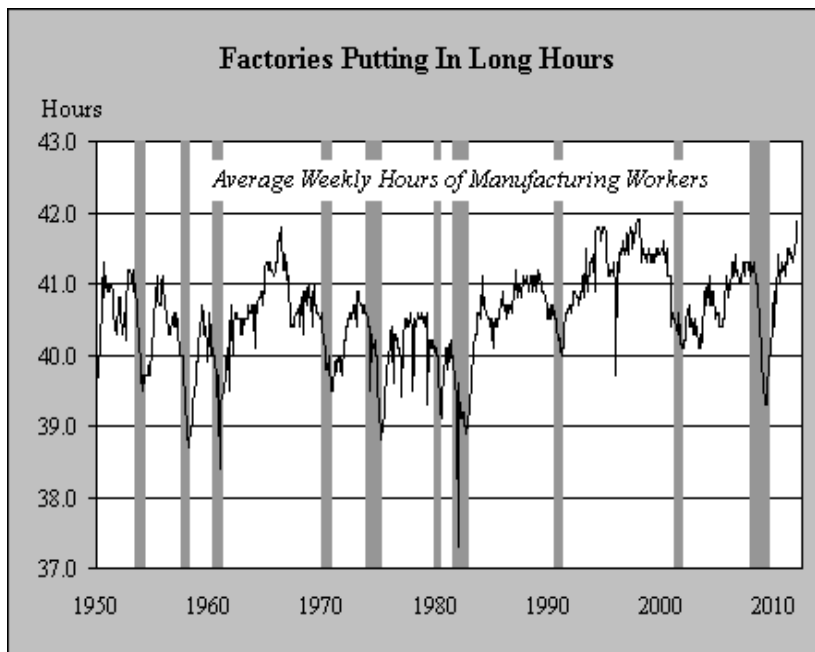
Elsewhere, however, the positive surprises were in abundance. The factory sector, which is supposed to be feeling the heat from the global slowdown and the aforementioned inventory pullback, added a robust 50 thousand jobs on top of the 32 thousand gained in December. Autoworkers are benefiting immensely from the sudden revival in car and truck sales, but the factory floors are humming due to solid orders from overseas as well as from domestic companies revving up capital outlays. Clearly, manufacturers have stressed productivity over the years, finding that they can produce goods with far fewer workers than in the past. Hence, although more than 400 thousand manufacturing jobs have been created during the recovery that pales in comparison to the 2.3 million jobs lost during the recession. Those jobs will never be fully recovered, but even a more productive manufacturing sector will need more labor as output increases.



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Indeed, the objective of operating with as mean and lean a staff of workers may have gone as far as it can go in this cycle. Not only have manufacturers added a robust 50 thousand net new jobs in January, they are requiring workers to put in much longer hours. During the month, the average workweek on the factory floor jumped to 41.9 hours from 41.6 hours in December. This is a huge monthly increase and, as the chart shows, the workweek now matches the longest for any month in more than sixty years. Needless to say, you can squeeze just so much output out of given workforce; with hours stretched to such lengths, future production gains will require companies to take on a proportionately larger number of new workers.



Even the ailing construction industry is starting to pick up hiring again. For the first time since 2006, hiring has exceeded layoffs for three consecutive months. In January, construction payrolls increased by 21 thousand following a 31 thousand gain in December and a much smaller 1 thousand increase in November. The December/January increase was the largest for a two-month period since March/April 2006, the tail end of the housing bubble. To be sure, like manufacturing the 2.2 million construction jobs that evaporated during the housing bust will not be recovered in the foreseeable future. But the long drought seems to be over for these beleaguered workers. And, while the shrunken housing sector has a much smaller influence on the overall economy than it did at the peak of the housing bubble five years ago, it still has knock-on effects on other industries. One example: the rebound in light truck sales in recent months may well be a direct result of newly-employed contractors in the construction industry needing vehicles to transport supplies and materials.

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Crossing over to the household survey, which generates the unemployment rate, the news is just as positive as it is in the establishment survey. The headline drop to 8.5 percent will, no doubt, garner most attention in the business media, but it is important to note that the decline occurred for the right reason. In recent months, skeptics pointed out – rightly so – that the fall in the unemployment rate was due less to a pickup in job growth than an increase in the number of workers dropping out of the labor force. That charge cannot be leveled at the January report. True, the labor force





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participation rate fell again, but only because the Labor Department adjusted the composition of the labor force to account for new population controls coming out of the latest Census count. In effect, more workers aged 55 and over are now included, an age group that has a lower proportion in the labor force.

Looking at the larger picture, the employment/population ratio remained unchanged from the previous months and the labor force actually increased by 508 thousand in January. The good news is that under the household survey employment jumped by an even larger 847 thousand, moving 339 thousand workers off of the unemployment rolls. The Labor Department also adjusts its measure of household employment to more closely mimic the definition of nonfarm payrolls generated in the establishment survey. According to this adjusted gauge, employment surged by over 1 million workers last month, far greater than the 243 thousand gain posted in the establishment survey. The household gains have been stronger for the past six months, leading many to believe that the establishment figures have some catching up to do.

We hate to end an otherwise sterling jobs commentary on a down note, but it would be remiss of us not to point out that the wounds in the labor market still run deep and the healing process is only in its early innings. The most troubling element continues to be the plight of the long-term unemployed, which hardly improved last month. There remain 5.5 million workers who have been out of a job for more than six months, which is a whopping 43.3 percent of unemployed people. This is the same share as two years ago, and off only slightly from the record 44.7 percent of last May. When Fed chairman Bernanke says progress on the labor front has been frustratingly slow, this is the metric he is most concerned about. Hopefully if the surprisingly vigorous increase in job creation in January continues, it will start to trickle down to the hardest cases as well. ♦

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FINANCIAL INDICATORS

U.S. TREASURY INTEREST RATES	February 2nd	1-Week Ago	1-Month Ago	1-Year Ago
3-Month U.S. Treasury Bill	0.07%	-0.05%	0.01%	0.15%
6-Month U.S. Treasury Bill	0.08%	0.08%	0.05%	0.17%
3-Month LIBOR	0.53%	0.55%	0.58%	0.31%
2-Year U.S. Treasury Note	0.23%	0.21%	0.26%	0.74%
5-Year U.S. Treasury Note	0.77%	0.75%	0.85%	2.26%
10-Year U.S. Treasury Bond	1.92%	1.89%	1.96%	3.64%
30-Year U.S. Treasury Bond	3.12%	3.06%	3.01%	4.73%

TAX-EXEMPT REVENUE BONDS (AAA)	February 2nd	1-Week Ago	1-Month Ago	1-Year Ago
5-Year	0.77%	0.84%	0.94%	1.91%
10-Year	1.74%	1.89%	1.88%	3.52%
30-Year	3.36%	3.47%	3.71%	4.93%

MORTGAGES	February 2nd	1-Week Ago	1-Month Ago	1-Year Ago
30-Year Fixed Mortgage Rate	3.87%	3.98%	3.91%	4.81%
15-Year Fixed Mortgage Rate	3.14%	3.24%	3.23%	4.08%
1-Year Adjustable Mortgage Rate	2.76%	2.74%	2.80%	3.26%

STOCK MARKET	February 2nd	1-Week Ago	1-Month Ago	1-Year Ago
Dow Jones Industrials	12862.20	12660.50	12359.90	12092.20
S&P 500	1344.90	1316.32	1277.81	1310.87
NASDAQ	2905.66	2816.55	2674.22	2769.30

COMMODITIES	February 2 nd	1-Week Ago	1-Month Ago	1-Year Ago
Gold – \$U.S./Troy Ounce	1728.00	1741.70	1617.80	1349.80
Oil – \$U.S./Barrel – Crude Futures	97.76	99.77	101.80	89.05

KEY ECONOMIC INDICATORS

INDICATOR (Latest Month/Quarter)	Current Month/Qtr.	Previous Month/Qtr.	Two-Months/ Qtrs. Ago	Avg.-Past 6 Mo. or Qtrs.
ISM Manufacturing Index (January)	54.1	53.1	52.2	52.2
ISM Nonmanufacturing Index (January)	56.8	53.0	52.6	53.6
Consumer Confidence (January) – Index	61.1	64.8	55.2	52.2
Personal Income (December) - % of change	0.5	0.1	0.4	0.2
Nonfarm Payrolls (January) – 000's	243.	203.0	157.0	167.0
Unemployment Rate (January)	8.3	8.5	8.7	8.8



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SELECTED CD RATES

IBB CD's		IBB FED FUNDS		LIBOR		
TERM	Rate	DATE	Rate	TERM	Rate	Last Week
30 Days	0.25 %	01/30/2011	0.05	30 Days	0.26 %	-0.01
60 Days	0.25 %	01/31/2011	0.05	60 Days	0.38 %	-0.02
90 Days	0.25 %	02/01/2011	0.05	90 Days	0.52 %	-0.03
120 Days	0.25 %	02/02/2011	0.04	120 Days	0.61 %	-0.02
150 Days	0.30 %	02/03/2011	0.05	150 Days	0.69 %	-0.01
180 Days	0.30 %			180 Days	0.77 %	-0.01
270 Days	0.35 %			1 Year	1.08 %	-0.02
1 Year	0.40 %					
2 Year	0.65 %					



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INDICATIVE BROKERED CD RATES

For the Week of February 6, 2012

TERM	COUPON	INTEREST PAYMENT	ALL IN COST	Spread to LIBOR
3 month	0.10 – 0.15%	At Maturity	0.25 – 0.30%	-0.27
6 month	0.15 – 0.20%	At Maturity	0.25 – 0.35%	-0.52
9 month	0.20%	At Maturity	0.30%	-0.62
1 year	0.25 – 0.40%	Monthly	0.35 – 0.50%	-0.73
18 month	0.35 – 0.40%	Monthly	0.50 – 0.55%	N/A
2 year	0.40 – 0.50%	Semi-Annual	0.60 – 0.65%	0.08
3 year	0.50 – 0.60%	Semi-Annual	0.75 – 0.85 %	0.13

Settlement dates can vary based on issuer needs.
Odd maturity dates are available upon request.

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800.275.4222
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