

# The Week

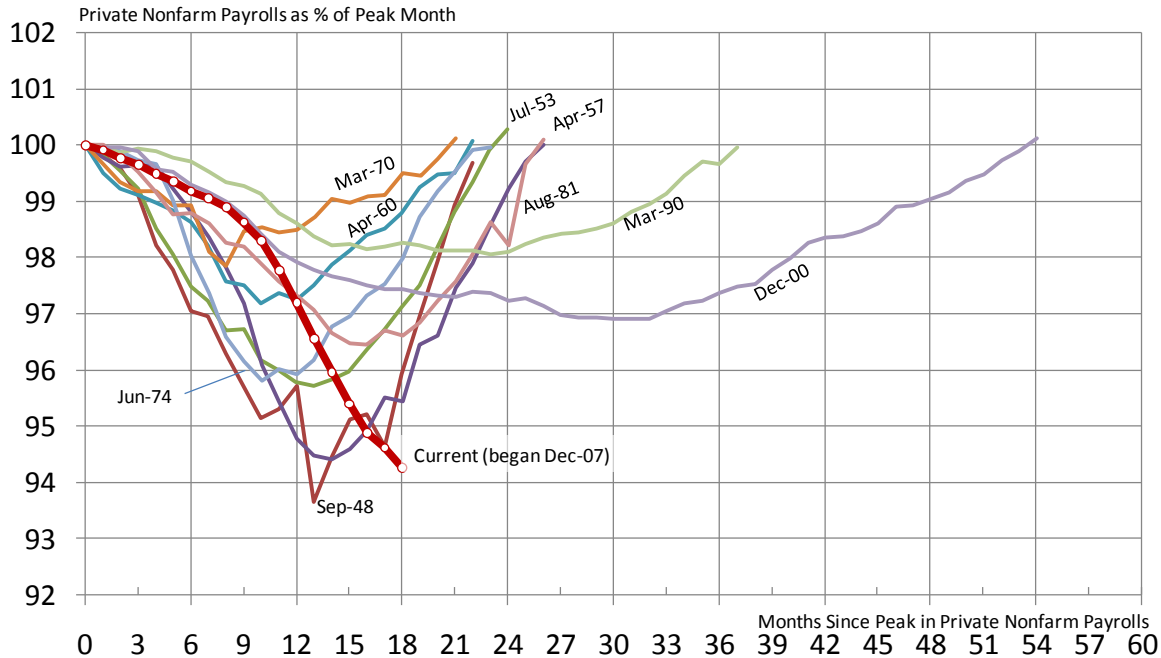
---

Tom McManus, Chief Investment Officer

## The Upcoming Recovery: Not a Carbon Copy of Typical Post War Rebound

- Last week's employment report posed a significant challenge to those economists and other observers who have been interpreting signs of a slowing in the rate of deterioration as evidence of an imminent recovery.
- "Since the recession began, the U.S. economy has lost 6 ½ million jobs — and as that grim employment report confirmed, it's continuing to lose jobs at a rapid pace. Once you take into account the 100,000-plus new jobs that we need each month just to keep up with a growing population, we're about 8 ½ million jobs in the hole," writes Nobel laureate Paul Krugman, in *The New York Times*.
- The economic decline has affected state and local tax revenues so dramatically that even government payrolls — usually considered immune to contraction — are also being cut. For its own part, private industry (not including the farm sector) has shed nearly –6% of the jobs that existed 18 months ago.
- Our chart overleaf shows that the cumulative loss of jobs since the peak of employment in 2007 is now a new record; even after adjusting for the increase in the nation's population and workforce, the decline is the worst in over 50 years. What is more, there is little evidence that the employment picture is getting better soon.
- There have been 10 recessions in the US during the post-War era, and the crises of each of the prior episodes have eventually been surmounted. We are hopeful that our current set of challenges will likewise be overcome, but serious problems take time to fix. Two major sectors of the U.S. economy — autos and housing — have contributed much to our past growth but are unlikely to see a meaningful expansion and hiring recovery for several years.
- Our chart shows that 7 of the recessions were steep, with cumulative job losses amounting to –2% to –6% of pre-recession levels within 12 months. Likewise, the recoveries were impressive, with private nonfarm payrolls exceeding their pre-recession levels about 24 months (plus or minus 6 months) after the peak.
- In two of the 10 cases, however, the recovery took a lot longer. Trouble is, these two instances are the most recent: the recessions of 1990-91 and 2001. In each of these two episodes, job losses were more modest as a percentage of total employment, but the pace of job creation was slow enough for each of them to be called a "jobless recovery."
- In the 1990's, it took over 3 years for the economy to create enough jobs to replace those lost in the recession, and in the first recession of this decade, the dip in payrolls extended over a period of 4 ½ years.
- Of course, the pace and timing of the next recovery is subject to debate, but we are wary of embracing any investment strategies that are based on what has tended to be successful in the "typical recovery," because this recession is already longer and deeper than any of those in the past half century. It seems likely that the decline in employment will continue, perhaps throughout the rest of 2009, and then reverse only gradually, like the path of recent recoveries (see chart).

**Cumulative Job Losses in this Recession Now Worst in the Past Half Century;**  
 Recent Recoveries Have Been Noticeably Less Vibrant in the Pace of Job Creation



Note: Shows the percentage change in private nonfarm payrolls during each economic cycle since 1948, from the peak (indexed to 100) until the number of jobs eventually exceeded that of the peak month. Sources: Bureau of Labor Statistics, National Bureau of Economic Research.

If the optimists are correct, the fact that some of the economic releases in the first half of 2009 were:

- 1) showing a slowdown in the pace of deterioration, and
- 2) not as bad as feared by the consensus

means that real improvements are not too far off. Some of those improvements are already built into earnings projections, which are critical to the near term outlook for the stock market.

Earnings estimates have been rising. Of the 30 companies that make up the Dow Jones Industrial average, only 5 have suffered a decrease in the consensus forecast for 2010 over the past month, and 19 are higher. All but two are expected to show an earnings increase next year as compared to 2009. What is more, the median price/earnings multiple (on 2010 estimates) is a reasonably attractive 11.6x, meaning that stocks may be able to withstand a minor earnings stumble without sustaining a significant correction.

Now, as we brace for an onslaught of earnings results for the second quarter of 2009, we will be listening closely for insights about the depth and the extent of the current decline from the perspective of company management teams. If final demand is weaker than internal forecasts, companies are likely to suggest a lower range for 2010 profits, potentially affecting stock prices.

But if history is any guide, any major resetting of 2010 profit goals is more likely to occur in September and October. We would view a -10% to -15% pullback at that time to be an opportunity to increase our exposure to stocks.

**Investment and Insurance Products: ►NOT FDIC Insured ►NO Bank Guarantee ►MAY Lose Value**

Past performance is not an indication of future results. An index is not managed and is unavailable for direct investment.

Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances.

Wells Fargo Advisors is the trade name under which Wells Fargo & Company provides brokerage services through two registered broker-dealers: Wells Fargo Advisors, LLC, Member SIPC, and Wells Fargo Advisors Financial Network, LLC, Member SIPC. Each broker-dealer is a separate non-bank affiliate of Wells Fargo & Company. ©2009 Wells Fargo Advisors, LLC. All rights reserved.