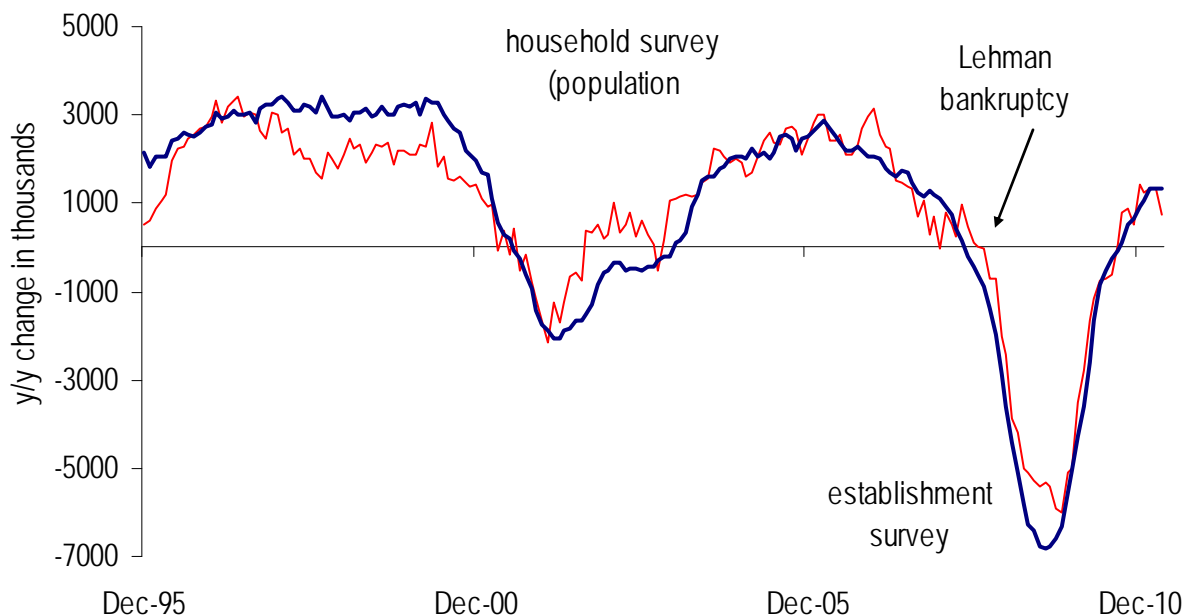


Stronger Payrolls, but Other Weakness Points to Moderate Growth

The establishment survey showed a 244,000 net gain in April payrolls plus a combined 46,000 upward revision to February and March payrolls. Private sector payrolls rose 268,000, the best gain since February 2006.

- The April strength doesn't fully resolve the outlook. In May 2010, the establishment survey was strong (up 458,000 including census). It turned out to be a lagging indicator which had not yet picked up the weakness in jobless claims, auto sales and the household survey that signaled a "soft patch" and drove second quarter 2010 real GDP growth down to 1.7%.
- Today's household survey data showed a loss of 190,000 jobs and a rise to 9.0% in the unemployment rate. This came after four strong monthly gains in the population-adjusted household survey – gains starting in December 2010 of 293k, 589k, 250k and 291k in March 2011. The same happened in 2010 with strong household survey gains in January through April but then a sudden letdown in May, June and July of 2010 that accurately marked the soft patch as did jobless claims and auto sales.

Annual Growth in Employment (last obs. April 2011)



Source: Bureau of Labor Statistics; Encima Global

Outlook for Moderate Growth

We don't think the 2011 letdown is as severe as the 2010 soft patch. In addition to today's stronger payroll survey, we note strength in vehicle sales, personal income, small business sentiment and federal tax receipts, all of which were weaker in the 2010 soft patch than the 2011 letdown. Yesterday's weakness in jobless claims included several technical factors. **We think the 2011 letdown is almost over and will give way to stronger GDP growth in the second and third quarters of 2011, higher bond yields and higher price-earnings multiples for equities.**

- Today's data brings the labor trends from the establishment and household surveys and the ADP data into closer alignment. Over the last five months, the establishment survey added 920,000 jobs (1 million for private sector), the household survey 1.2 million and ADP 1.0 million. These are consistent with an economy that is growing at a moderate 3% trend rate from a very low base.

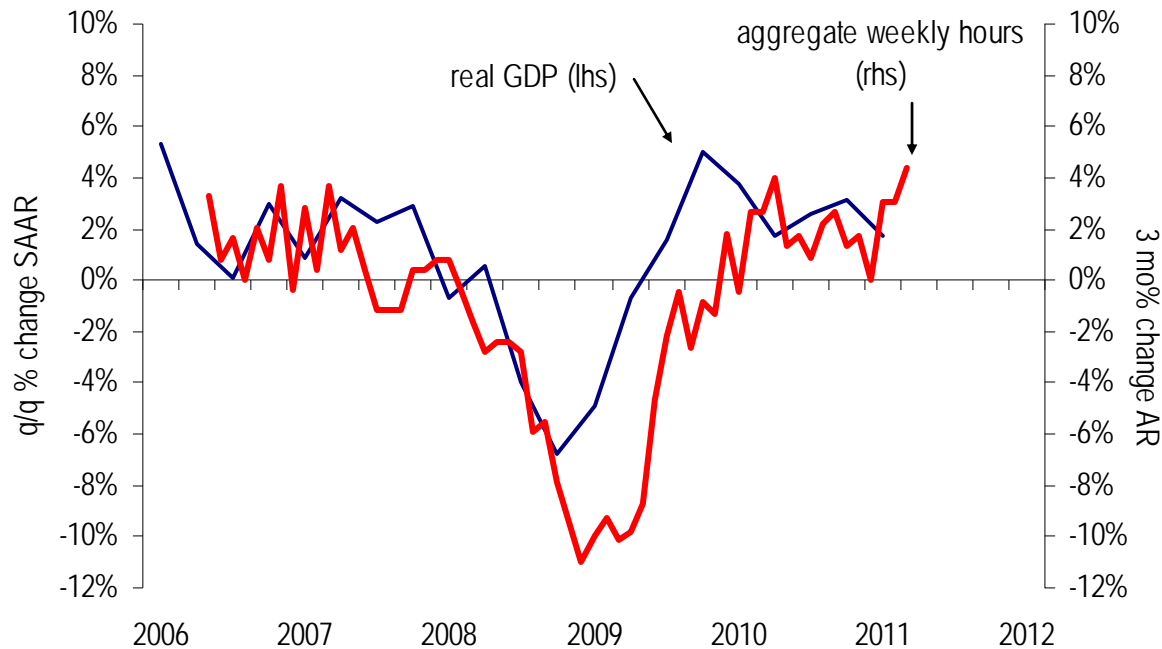
Monthly Change in Jobs (last obs. April 2011)

	ADP	Household	Establishment
Apr-10	113	425	277
May-10	42	-33	458
Jun-10	50	-263	-192
Jul-10	31	-105	-49
Aug-10	63	272	-59
Sep-10	32	107	-29
Oct-10	79	-297	171
Nov-10	122	-178	93
Dec-10	246	293	152
Jan-11	190	589	68
Feb-11	205	250	235
Mar-11	207	291	221
Apr-11	179	-190	244

Source: ADP; Bureau of Labor Statistics (population-adjusted series); Encima Global

- We think GDP growth is picking up some from the first quarter letdown when GDP growth slowed to 1.8%. The weakness in Q1 GDP below consensus was mostly the result of government jobs and spending shrinking from the fourth quarter (especially for the defense department) and weakness in inventory growth, pointing to a re-acceleration in the second quarter. Private sector GDP, including consumption, investment and exports, were above expectations in the first quarter. **We look for 3% real growth in the second quarter and above that in the second half, putting us at the high end of the Fed's 3.1%-3.3% real growth forecast for 2011.**
- In April, the aggregate weekly hours index increased 0.3% and the February-April annualized rate has increased 4.4%, a rough indication of a pickup in real growth. This measure combines average weekly hours, steady at 34.3, with the ongoing increases in payrolls.

Aggregate Weekly Hours suggests stronger real GDP (last obs. April 2011)



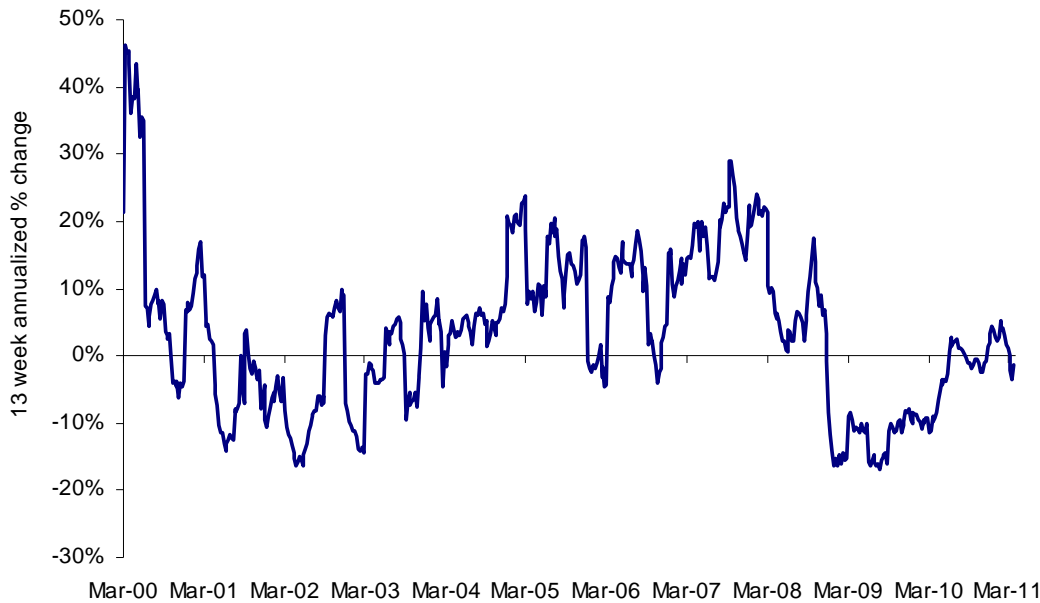
Source: Bureau of Economic Analysis; Bureau of Labor Statistics; Encima Global

- An indication of stronger nominal growth comes from the combination of the aggregate weekly hours index times average wages. The three-month annualized growth for this nominal measure is 5.7%, an improvement on the 3.7% first quarter annualized nominal GDP growth rate.

Still Weakness in Small Business and Labor Environment

Despite the improvement in today's headline payroll data, other data points caution against expecting a normal V-shaped small-business-led rebound from the deep 2008-2009 recession. Jobless claims are rising. Small business optimism is still at only 91.9 for March (and rising only grudgingly so far in the expansion). ISM measures have downticked. And there's been a 1.3% annual rate decline in commercial and industrial lending by small banks, which often service small businesses.

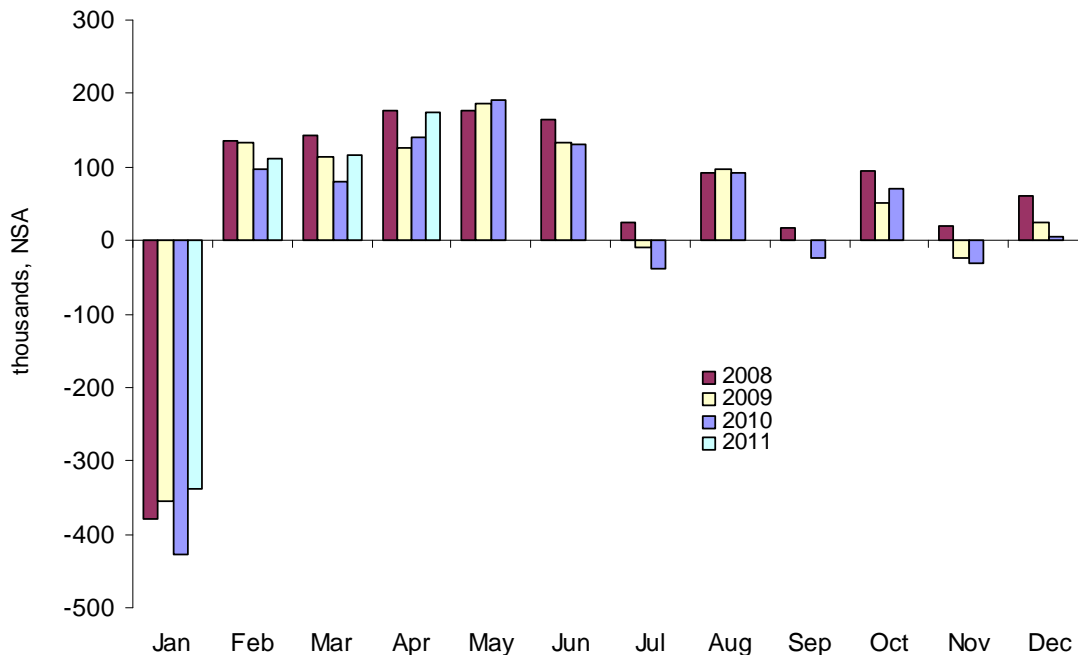
C&I Loans By Small Banks, (last obs. April 20, 2011, 13 week annualized % change)



Source: Federal Reserve; Encima Global

- In April, the net birth death model added 175,000 jobs on a not seasonally adjusted basis versus the 1.2 million NSA payroll gain and the 244,000 SA gain. Next month's birth death model is expected to add even more jobs (see bar graph for the history of the large May birth-death gain.)

Net Birth / Death Model (last obs. April 2011)



Source: Department of Labor; Encima Global

- Given the turbulence in the business climate, it's quite possible that the birth-death model is over-optimistic on new and small-business job gains, as it has been in recent years. This will get resolved in coming years through revisions to the establishment survey. In recent years, they have often been downward, bringing the establishment survey into closer alignment with the trend in the household survey.
- Average hourly earnings remain weak, increasing \$0.03 in April to \$22.95. This is partly due to the 9% unemployment rate. Over the last year, this measure of earnings increased only 1.9%, lagging behind the inflation rate of 2.7% and the growth in broader personal income which includes job growth, dividend increases and the bulge in transfer payments. **While the economy as a whole is generating gradually more income and taxes, partly through federal debt, an individual worker earning average wages isn't keeping up with inflation.**

Average Hourly Earnings y/y (last obs. April 2011)

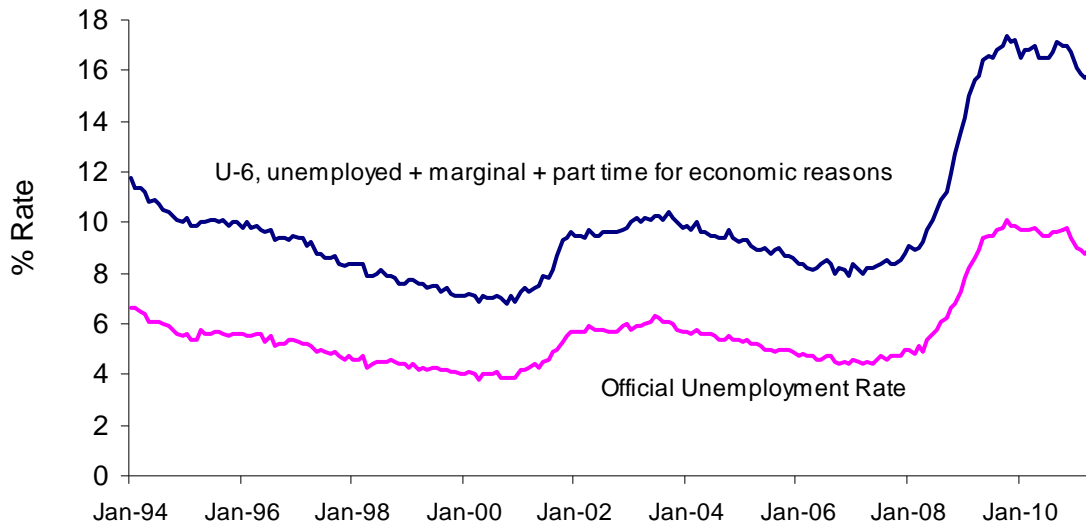


Source: Bureau of Labor Statistics; Encima Global

Changes in the Labor Force

Unemployment rose to 9.0% in April, up 0.2% from March. Underemployment rose to 15.9%, also up 0.2%. Hardest hit in April: Unemployment among blacks increased to 16.1%, up 0.6%. Teenage unemployment rose to 24.9%, up 0.4%. Workers over 25 without a high school diploma had 14.6% unemployment, up 0.9% from March. Some of these grim jumps might be related to the tornados and floods in the southern part of the country.

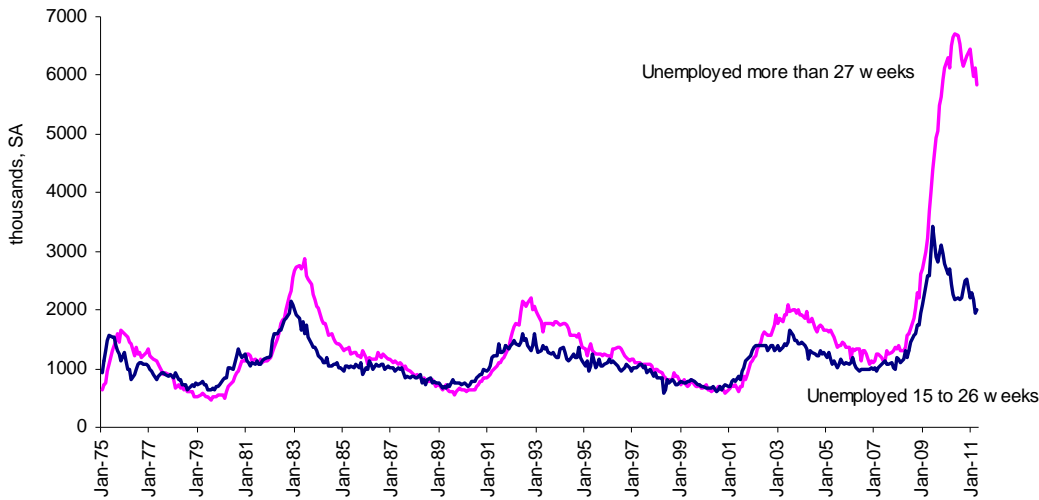
Unemployment and Underemployment Rate (last obs. April 2011)



Source: Bureau of Labor Statistics; Encima Global

- Even if job growth becomes fast, the unemployment rate is likely to stay higher than could be considered “full employment” under the Fed’s dual mandate. This has implications for the conduct of monetary policy and the value of the dollar (which is not taken into consideration in the Fed’s current interpretation of its price stability mandate). The Fed has a mandate to achieve full employment, which will be hard to accomplish given the overhang; and in pursuing its price stability mandate it watches for red flags in labor inflation. These may be delayed well into the expansion because of the overhang of unemployed workers and the normal long lag between dollar weakness and general price inflation.**
- The average duration of unemployment is particularly long at 38.3 weeks, while the median duration of unemployment has fallen to 20.7. This shows a bifurcation – long-term unemployed are not finding jobs as readily as those who lost their jobs more recently. Given this dynamic, many longer-term unemployed will receive unemployment benefits through the 99 week limit at which point some will find work and many will drop out of the labor force, reducing the unemployment rate. Roughly 3.6 million long-term unemployed will reach the 99 week limit during 2011, with roughly another million losing federal unemployment benefits in January 2012 assuming federal benefits are discontinued then, creating substantial downward pressure on the unemployment rate partially offset by the overhang in the labor force discussed below.
- There are now 5.8 million workers unemployed for more than 27 weeks (peak was 6.7M in May 2010). The number of unemployed between 15 and 26 weeks stands at 2.0 million, well below the peak of 3.4 million in June 2009. There is clear improvement, but from very high levels.

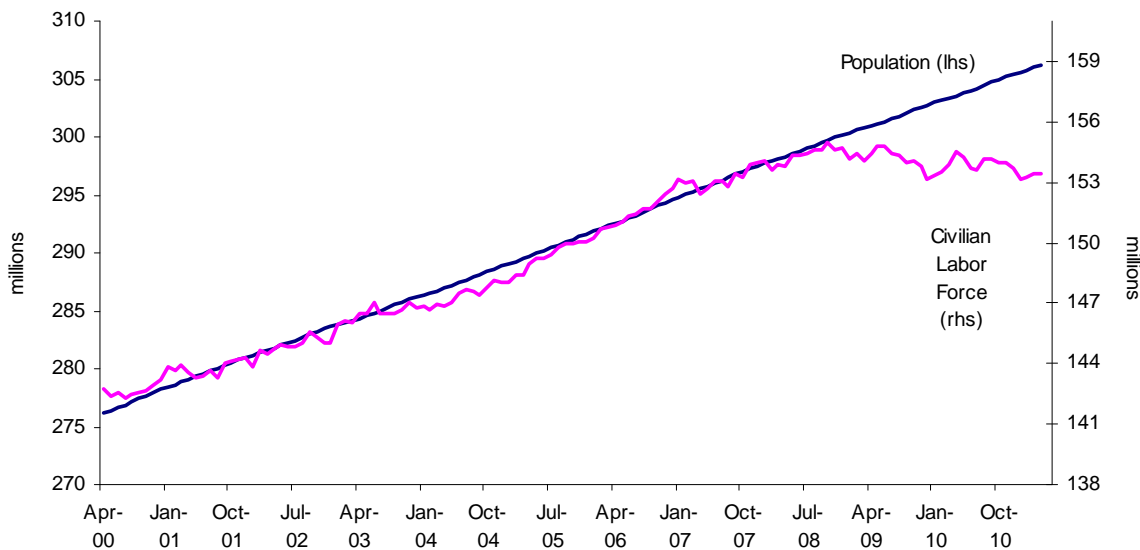
Unemployed Longer than 27 Weeks (last obs. April 2011)



Source: Bureau of Labor Statistics; Encima Global

- The civilian labor force peaked at 155 million in October 2008 and stood at 153.4 million in April. With the baby boom entering retirement, we expect only slow labor force growth in coming decades. Japan has been seeing a decline in its labor force since the late 1990s, while China’s labor force is expected to peak late this decade and decline sharply in the 2020s and 2030s. In contrast, the U.S. labor force, after a pause over the next two decades is expected to grow slowly into the middle of the century, setting the U.S. apart from other industrialized countries and from China.

Civilian Labor Force and Population (last obs. April 2011)



Source: Bureau of Labor Statistics; Encima Global

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