

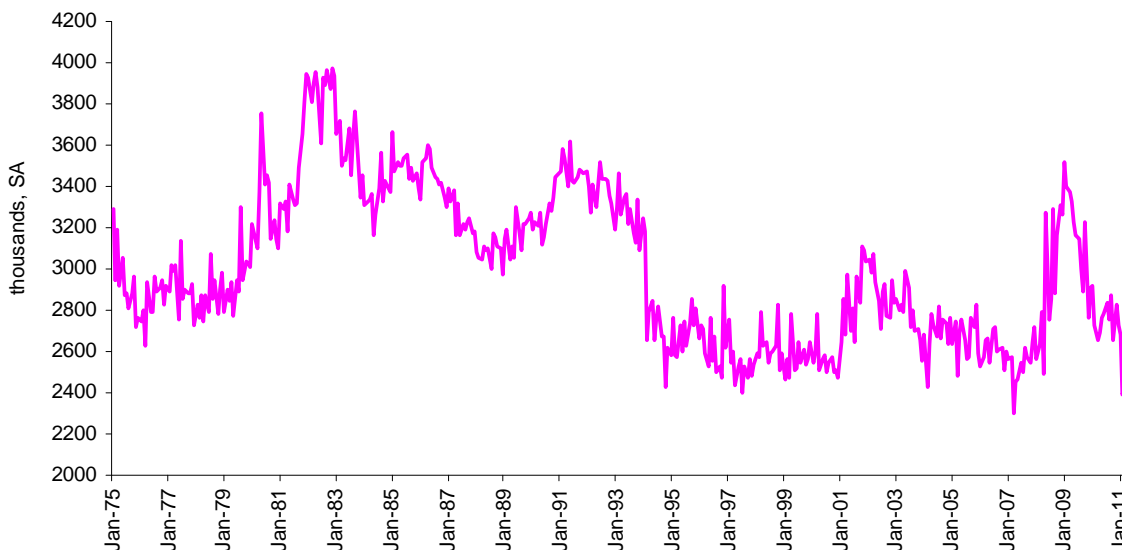
Spike in Recent Unemployment

Today's jobs report was filled with bad news including a loss of 445,000 jobs in the household survey, a 272,000 decline in the size of the labor force, a rise in the unemployment rate to 9.2% and weakness in hours worked and hourly wages (up 1.9% yoy vs 3.6% CPI inflation.)

The issue for markets and the outlook is whether the employment weakness is backward looking and mostly related to supply disruptions after the Japan earthquake (our view).

- We think the weakness in government employment (down 39,000 in June) will continue as some state and local governments downsize. It is probably good for the outlook.
- For the private sector, the payroll survey, oriented toward big business, showed a June gain of 57,000 versus an ADP gain of 157,000. Forward-looking indicators of employment are less unfavorable including business profits, June tax receipts, ISM, non-manufacturing ISM and the Monster survey. They point to a second-half upswing.
- The household survey showed a sharp 412,000 jump to 3.1 million in those unemployed for less than 5 weeks. One explanation is that the Japan-dependent supply chain and related orders exhausted themselves in April and May. If this is temporary, jobless claims elevated since April should fall some in July and August.

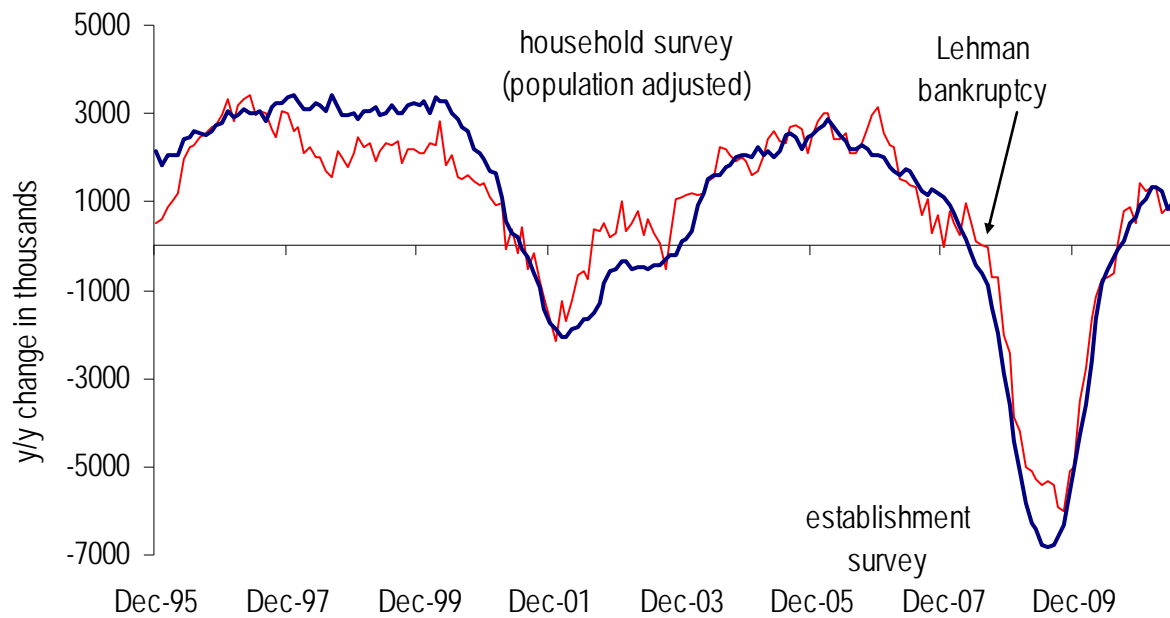
Unemployed Less than 5 Weeks (last obs. June 2011)



Source: Bureau of Labor Statistics; Encima Global

- The establishment survey showed an 18,000 net gain in June payrolls with a combined 44,000 downward revision to April and May payrolls. The household survey has been uneven of late with 105,000 job gains in May after job losses of 190,000 in April which ended four months of strong gains starting in December. **Similar household survey weakness happened in 2010 with strong 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. June 2011)



Source: Bureau of Labor Statistics; Encima Global

- Over the last seven months, the establishment survey shows that the economy added 909,000 total jobs while the household survey shows 893,000 total gains. For the private sector, the establishment survey shows 1.1 million jobs and ADP 1.2 million. Recent data has been weaker than earlier data.

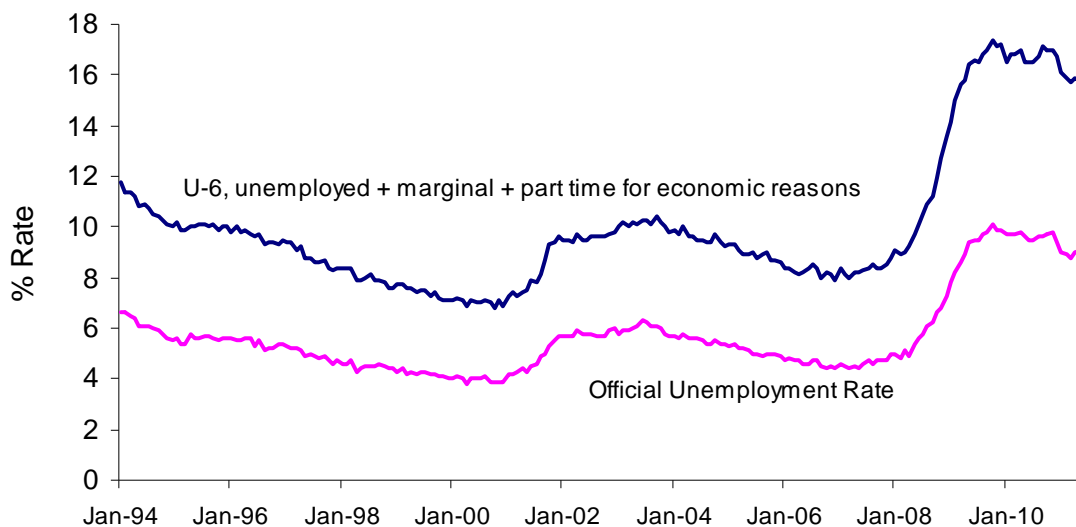
Monthly Change in Jobs (last obs. June 2011)

	ADP	Establishment Payrolls		Households
		Private	Total	Pop Adj.
January 2010	-50	-42	-39	789
February 2010	4	-21	-35	183
March 2010	49	144	192	250
April 2010	113	229	277	425
May 2010	42	48	458	-33
June 2010	50	65	-192	-263
July 2010	31	93	-49	-105
August 2010	63	110	-59	272
September 2010	32	109	-29	107
October 2010	79	143	171	-297
November 2010	122	128	93	-178
December 2010	246	167	152	293
January 2011	190	94	68	589
February 2011	205	261	235	250
March 2011	208	219	194	291
April 2011	188	241	217	-190
May 2011	36	73	25	105
June 2011	157	57	18	-445

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

- Unemployment rose to 14.1 million and 9.2% in June, up from 13.9M and 9.1% in May. The unemployment rate has risen 0.1% or more each month for the last three months. Underemployment rose to 16.2% in June, up 0.3%

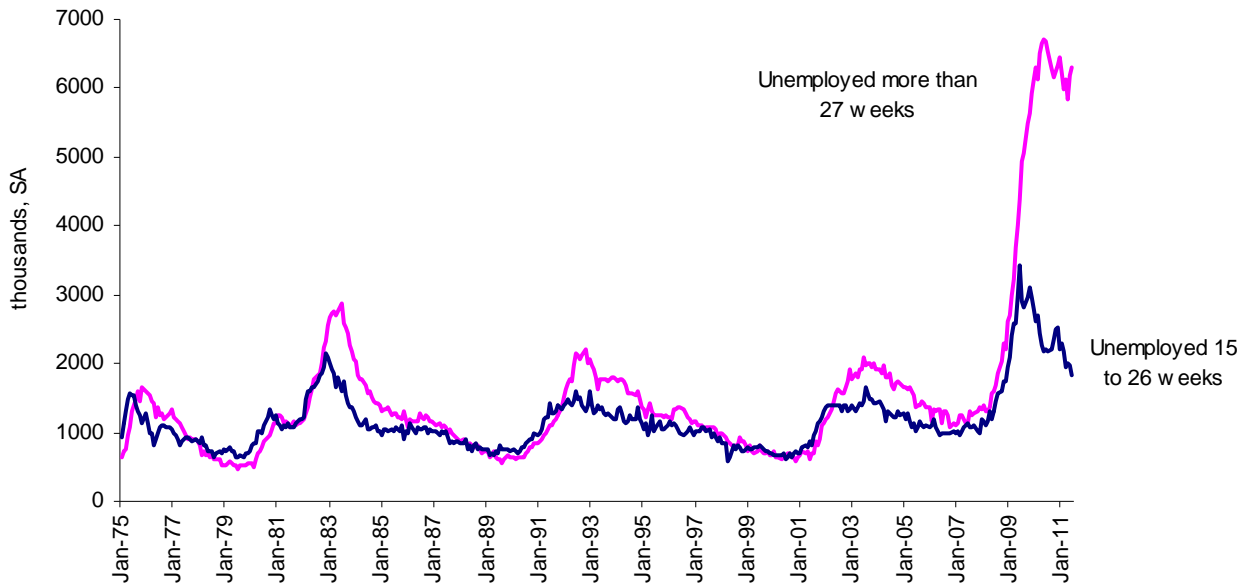
Unemployment and Underemployment Rate (last obs. June 2011)



Source: Bureau of Labor Statistics; Encima Global

- There are now 6.3 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 1.8 million, well below the peak of 3.4 million in June 2009.

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

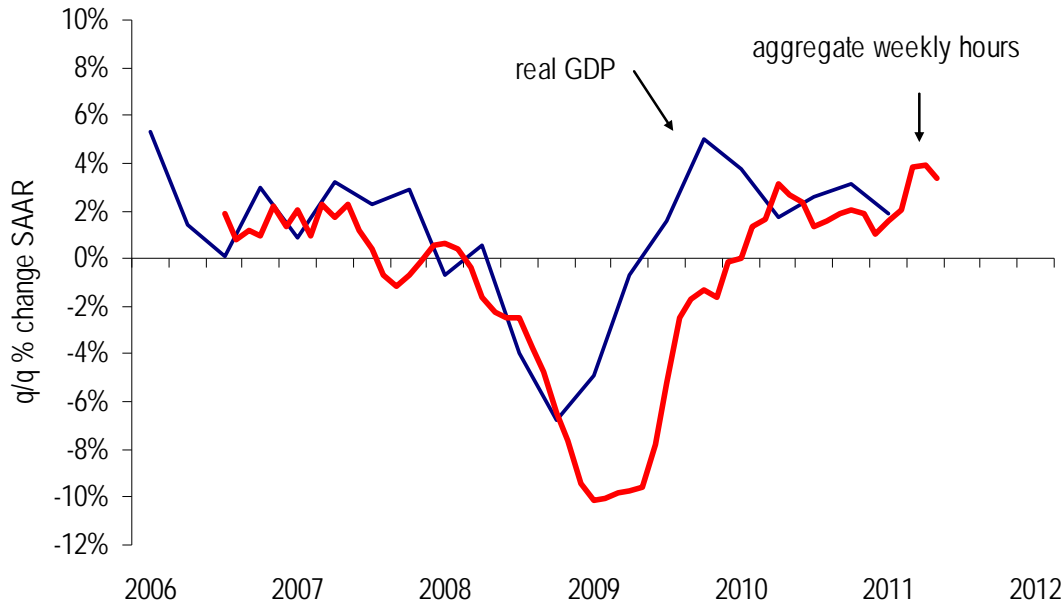


Source: Bureau of Labor Statistics; Encima Global

- The average duration of unemployment is particularly long at 39.9 weeks, while the median duration of unemployment rose to 22.5 weeks. 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.
- **Even if job growth becomes fast, however, 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 of unemployment. And in pursuing its price stability mandate, the Fed watches out for red flags in labor inflation which 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.**

- In June, average weekly hours worked were down 0.1 to 34.3. The April-June aggregate hours index (which includes hours worked times number of workers) grew at a 3.3% annualized rate. This measure gives a rough indication of real growth and implies a soft patch but not a double dip into recession. We expect 1.8% real growth for the second quarter.

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



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

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