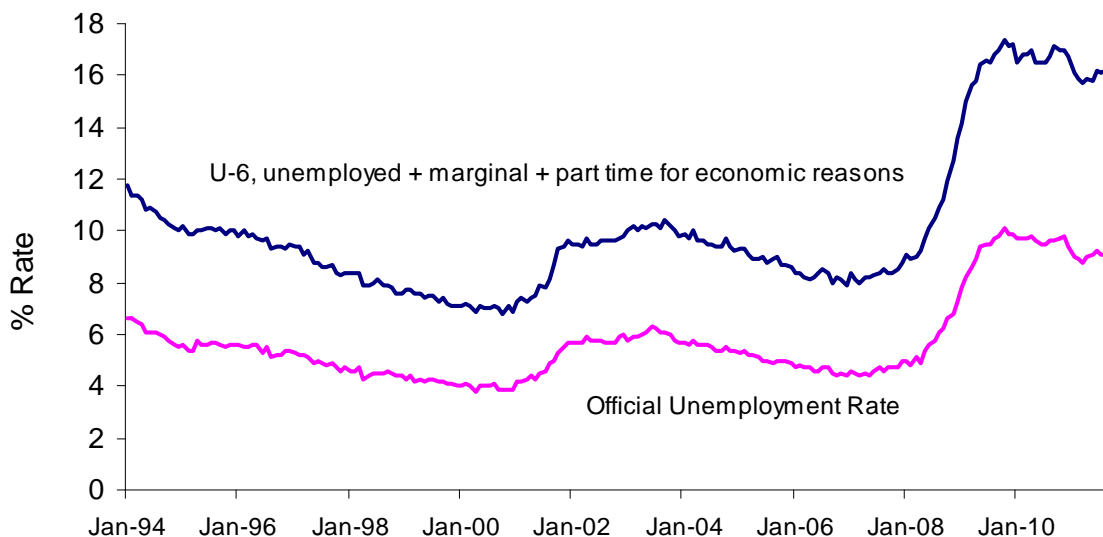


October Cautions: Jobs and Wages Up Too Little; Raising Q3, Lowering Q4

Jobs grew 103,000 in the September establishment survey and 398,000 in the household survey. However, the household survey showed only 27,000 net new full-time workers.

- Private sector employment grew 137,000, helped by a return of 45,000 Verizon workers. Upward revisions to July and August added another 99,000, consistent with our view that the third quarter wasn't as weak as the "recession now" view in the Treasury bond market. We think the Fed's Operation Twist is buying bonds at the very peak price.
- Unemployment stayed at 9.1%, held down by a 444,000 surge in workers employed 'part-time for economic reasons' – meaning they are working but want more hours. These part-time workers are counted as under-employed in the broader U6 unemployment rate, which also includes discouraged workers. It increased to 16.5%, 25.8 million out of a broader labor pool, the highest since December 2010.

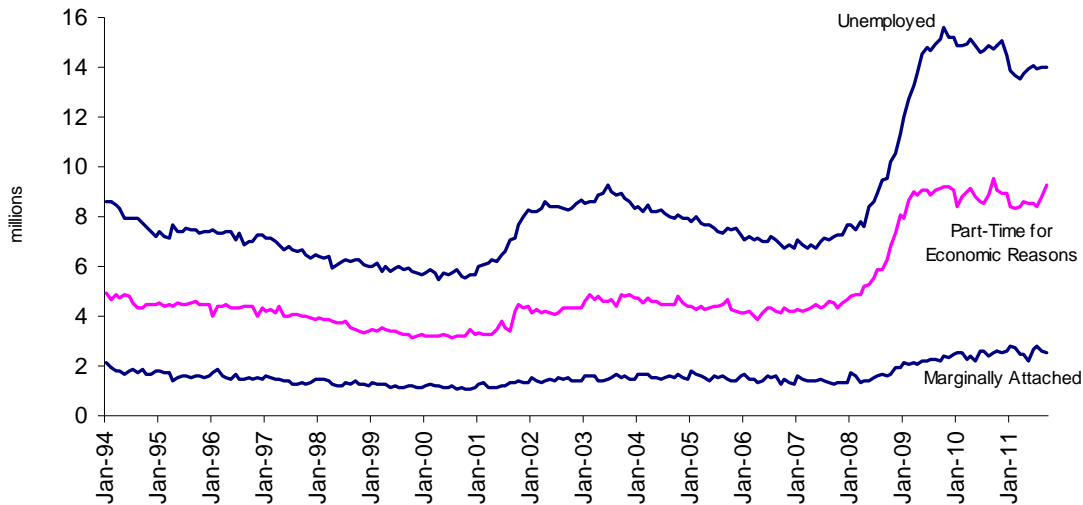
Unemployment and Underemployment Rate (last obs. September 2011)



Source: Bureau of Labor Statistics; Encima Global

- The U6 underemployment rate is made up of 14 million unemployed, 9.3 million working part-time for economic reasons and 2.5 million considered marginally attached (meaning they would like a job and have looked for work some time in the last year.)

Underemployment Components (last obs. September 2011)



Source: Bureau of Labor Statistics; Encima Global

As discussed in recent pieces, we think there was a respite in bad news over the last two weeks but not an improvement in the outlook. As expected, the economy enjoyed a cyclical rebound in the third quarter from the second. It was based on U.S. auto production and sales making up for the Japan earthquake. **We're raising our real GDP forecast for the third quarter to 2.5% from 2%.**

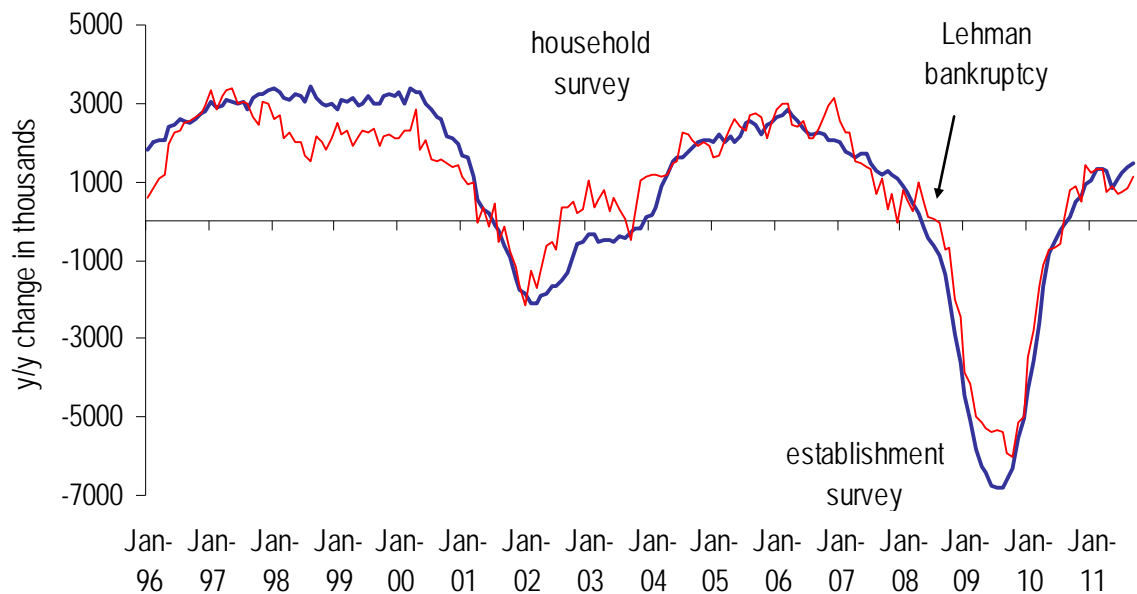
- The various employment measures have converged and are showing a weak labor environment but not yet a recession (see table below). Since the beginning of the year, the household survey shows that the economy added 1.3 million total jobs with the establishment survey showing 1.1 million total jobs. The establishment survey showed 1.3 million private sector jobs, which is a bit more than ADP's 1.2 million private sector gains.
- The two Labor Department surveys differ substantially at times because the establishment survey takes full account of large employers and government whereas the smaller household survey includes jobs from small and new employers along with larger employers. For example, in the early 2000s in the graph below, the household survey showed more growth than the establishment survey (which was initially even weaker than the current data but has been subsequently revised upward.)

Monthly Change in Jobs (last obs. September 2011)

	Establishment Payrolls		Households
	ADP	Private	Pop Adj.
January 2010	-50	-42	789
February 2010	4	-21	183
March 2010	49	144	250
April 2010	113	229	425
May 2010	42	48	-33
June 2010	50	65	-263
July 2010	31	93	-105
August 2010	63	110	272
September 2010	32	109	107
October 2010	79	143	-297
November 2010	122	128	-178
December 2010	246	167	293
January 2011	190	94	589
February 2011	205	261	250
March 2011	203	219	291
April 2011	179	241	-190
May 2011	35	99	105
June 2011	144	75	-445
July 2011	107	173	-38
August 2011	89	42	331
September 2011	91	137	398

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

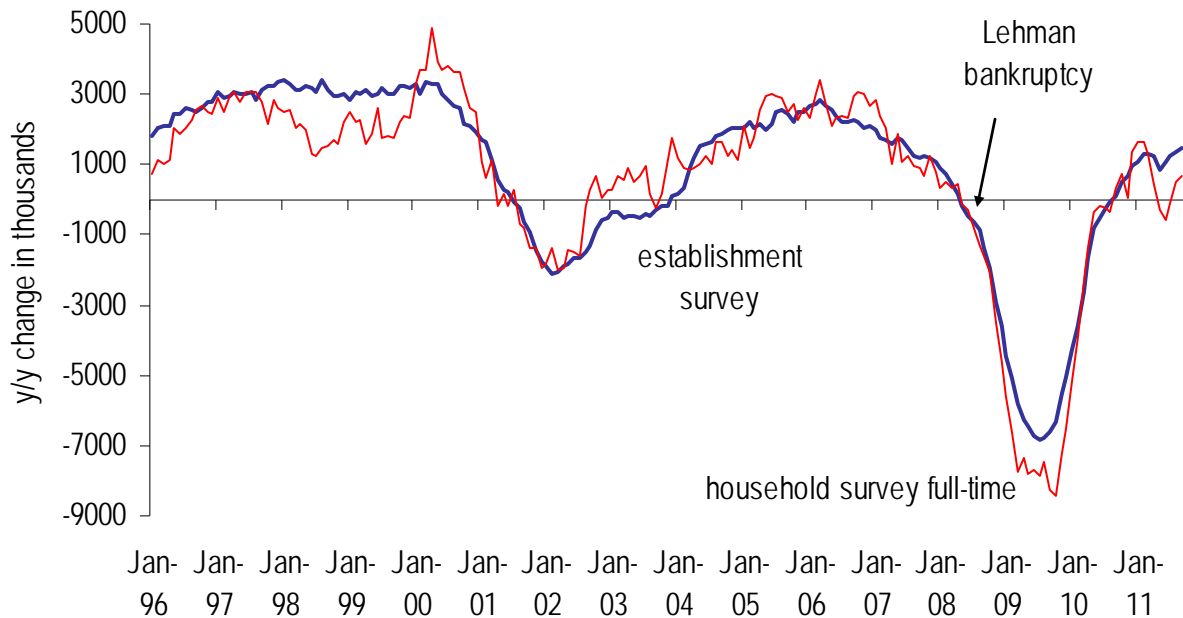
Annual Growth in Employment (last obs. September 2011)



Source: Bureau of Labor Statistics; Encima Global

- Looking at just the full-time component of the household survey shows a weaker recovery in full-time job growth now than the 2002-2003 recovery. One factor may be the added cost of health care, which discourages employers from offering full-time employment.

Annual Growth in Employment with Full-Timers (last obs. September 2011)



Source: Bureau of Labor Statistics; Encima Global

October Cautions

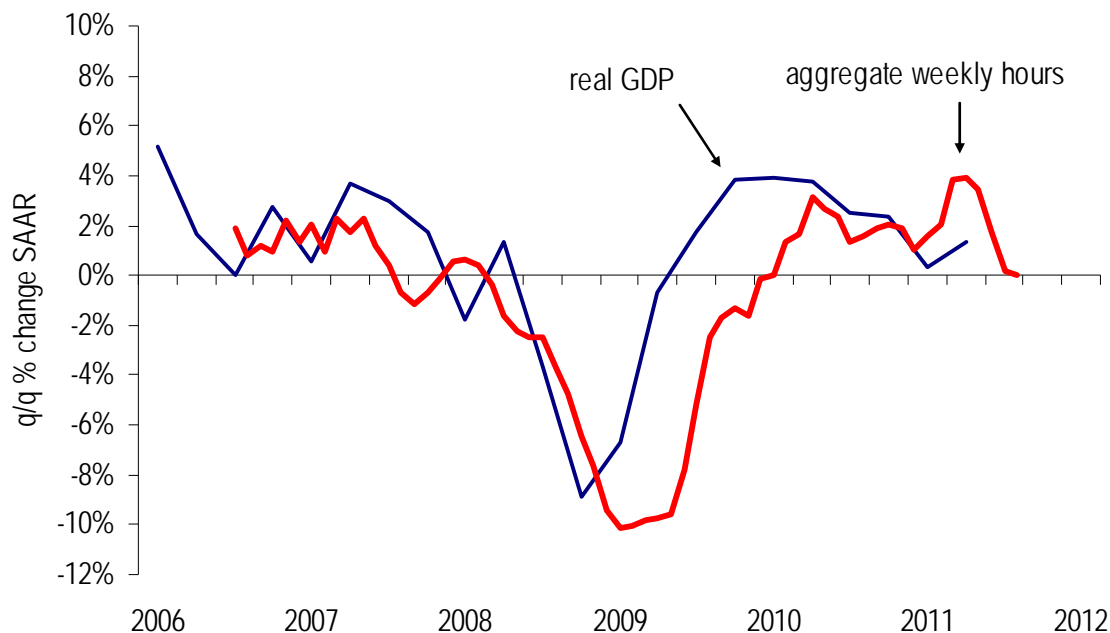
While all the surveys showed decent job gains in September, the average year-to-date private sector gain of 149,000 jobs in the establishment survey isn't enough to bring down the unemployment rate (9% in January, 9.1% in September.) The U-6 underemployment rate has increased from 16.1% in January to 16.5% in September.

We don't see positive implications for the fourth quarter in today's number and are **lowering our fourth quarter outlook to 1% from 1.5%. We think current fiscal, monetary and regulatory policy point toward a shallow recession in 2012.** The growth climate deteriorated materially in August and September in the U.S. and Europe and will begin to show up in the data, with China still not able to begin its monetary easing cycle.

- Washington animosity is deepening -- see the media Q&A with President Obama at yesterday's press conference. This practically rules out structural improvements for more than a year in the world's largest economy. In coming months, we expect harmful confrontations on the payroll tax, AMT, the debt limit and the continuing resolution (which expires November 18.)

- Europe isn't making meaningful progress on lowering Italy's bond yields, pointing it toward a near-term recession in most of Europe, with Germany following into recession in 2012 if global growth slows.
- In September, average weekly hours worked rose 0.1 to 34.3. That leaves growth in the July-September aggregate hours index flat, meaning hours worked times number of workers was the same in Q3 as in Q2. This measure gives a rough indication of real growth and implies sluggish output in Q3 despite growth in consumption and auto production.

Aggregate Weekly Hours suggests weaker real GDP (last obs. September 2011)

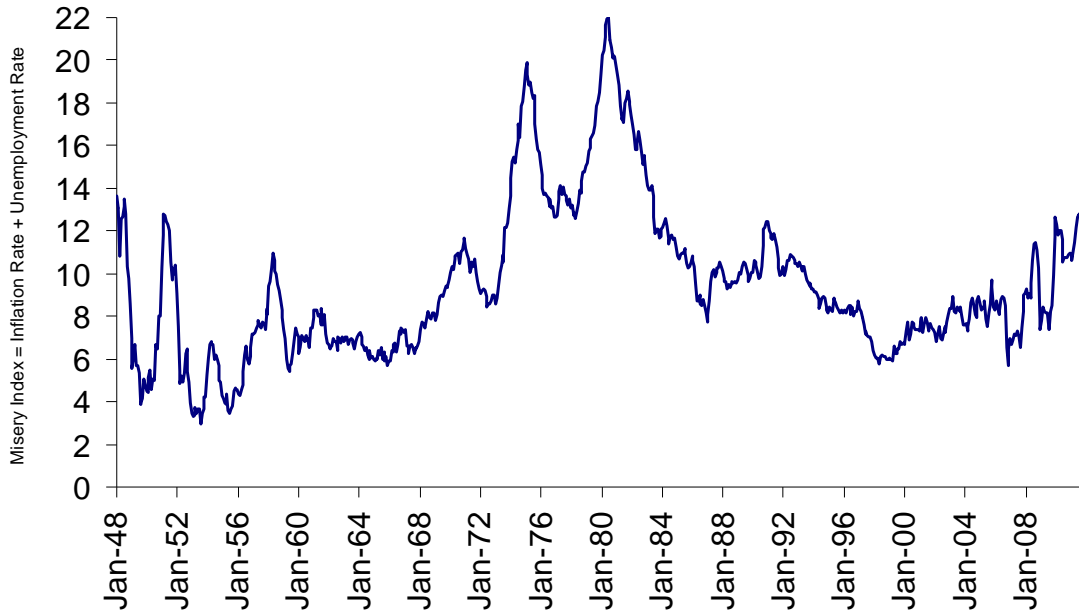


Source: Bureau of Economic Analysis; Bureau of Labor Statistics; Encima Global

- An indication of nominal growth comes from the combination of the aggregate weekly hours index (above) times average hourly earnings, which rose 0.2% in September to \$23.12. **The quarter-over-quarter annualized growth for this nominal measure is 2.1%, the slowest rate since February 2010.**
- On a year-over-year basis, average hourly earnings increased only 1.9%. This lags behind the inflation rate of 3.8% 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, some of that is coming from the increase in federal debt -- an individual worker earning average wages isn't keeping up with inflation.**

- The misery index, which adds the unemployment rate to the inflation rate, has been continuing to rise as inflation and unemployment remain elevated. It now stands at 12.9, the worst since 1983.

The Misery Index (last obs. August 2011)



Source: Bureau of Labor Statistics; Encima Global

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