



THE ECONOMY AT A GLANCE

October 6, 2008
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ECONOMIC HIGHLIGHTS

INFLATION DIPPED IN AUGUST

Prices on the retail level fell 0.1% in August – the first drop in the general price level since October 2006. Consumer inflation is running at 5.4% since August 2007. The headline inflation gauge is again being driven by changes in the price of energy. Just as record high levels in crude oil and gasoline pulled the consumer price index to a multi-year high, so too is the reversal pulling the overall pace of inflation down. Energy prices fell 3.1% last month. Excluding the food and energy component, prices inched up by 0.2% -- a 2.5% increase over the last 12 months. The core rate continues to trend away from the Fed's comfort zone of 1.0%-2.0%. It hasn't resided in that zone since late 2003. The fear of inflation was part of the reason the Fed did not adjust interest rates on 9/16/08.

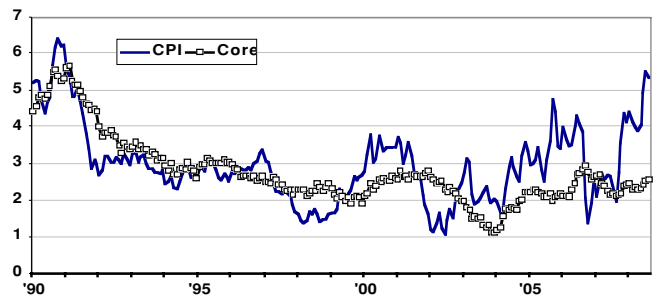
PHILLY INDICES REBOUND

The Philadelphia Fed's index of manufacturing conditions jumped back into expansionary territory with a reading of 3.8 in September, up from a -12.7 in August. This was the first positive posting in the headline index since November 2007. Perhaps more encouraging was the high reading in the Six-Months Forward (SMF) Index, which climbed to 30.8 from 27.6 -- its highest reading since last October. Strong gains were also registered in the SMF New Orders, Shipments, Employees, and Capital Expenditures Indices. This is indeed a flicker of promise in an otherwise frightening macroeconomic landscape. We remain upbeat, and at this time do not see the credit crisis spilling too deeply into the macroeconomy.

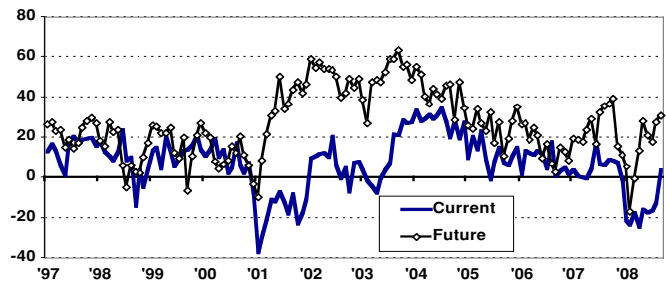
COMMODITY PRICES SINK

Economists like to observe the trends in the Economist's Commodity Price Indices since these trends don't have the volatile influence of crude oil prices. The Economists All Items Index has fallen 7.7% over the last month, but remains 4.9% higher than year-ago levels. Similarly, the Food Index has fallen by 8.4% in the past month and remains 15.3% higher year-over-year. The big drop has been in Industrial commodity prices, which are down 6.8% over the last month and 6.5% over the last 52 weeks. We expect a general continuation in this downward trend, but caution against complacency. There are still a number of emerging economies in need of commodities and we suspect demand will rebound once the crisis and the economic slump has dissipated.

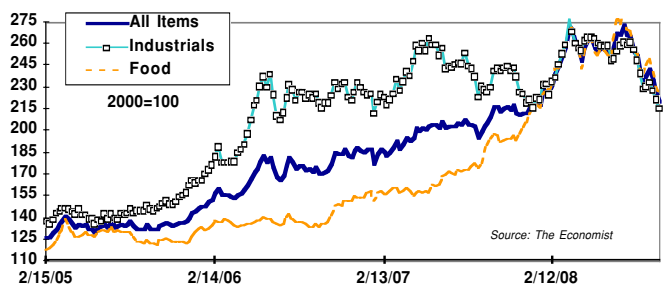
CONSUMER PRICES (YOY%)



PHILADELPHIA FED BOS



THE ECONOMIST COMMODITY PRICE INDEX

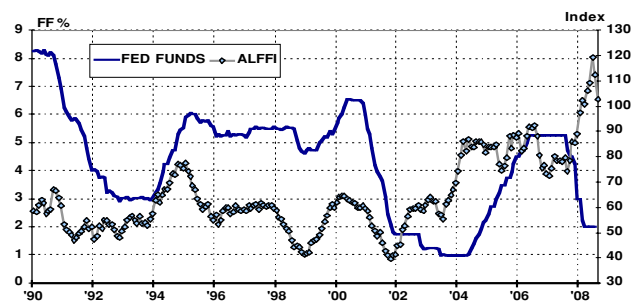


MONETARY HIGHLIGHTS

ARGUS FED INDEX PLUNGES

The Argus Leading Fed Funds Index (ALFFI), our internal barometer of changes in the Fed Funds rate, fell almost ten points in August to 102.67. The massive drop suggests the Fed will have some breathing room. While the ALFFI remains in high territory, it is clear that prices of most commodities, energy, and food are in a decline. We still believe the Fed's next move should be a rate hike since monetary policy remains quite stimulative by historical comparison.

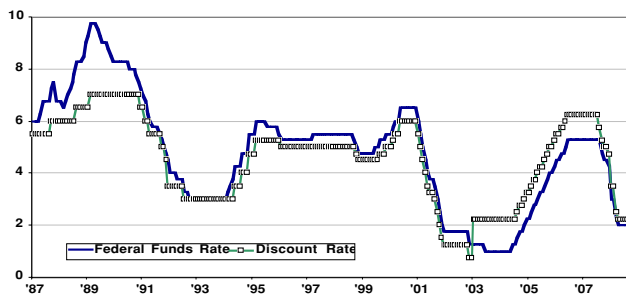
ARGUS LEADING FED FUNDS INDEX



FED LEAVES RATES UNCHANGED

The Fed refrained from reducing its benchmark borrowing target rate. Rather than “waste” a policy move, the Fed opted to keep the cut in its holster. To be sure, a move would have been counterintuitive. A reduction of borrowing costs is generally executed to inject necessary stimulus for the economy 12 to 18 months down the road. Since the current pace of monetary policy is as stimulative as it has been in over a decade, the need to further prime the pump isn't a legitimate policy prescription.

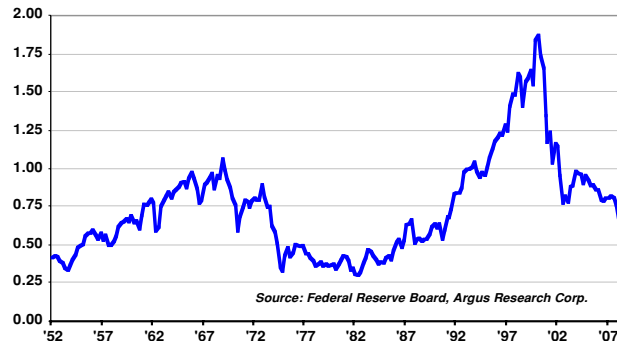
FED FUNDS RATE ACTIVITY (%)



TOBIN'S 'Q' AT 0.68 IN QII

According to Nobel Laureate James Tobin, the ratio of total stock market value to the stock market's net worth is a reliable indicator of market valuation. When the stock market trades at a 'discount' to the replacement cost of its assets, the market is inexpensive. This discount possesses 'q' ratios that are less than 1.0. Conversely, when "q" exceeds 1.0, the market trades at a premium. Encouragingly, the most recent (2Q08) level of 0.68 implies a reasonable valuation of market conditions.

TOBIN'S "Q"



FINANCIAL MARKET HIGHLIGHTS

HAVE BANKS HIT BOTTOM?

As of this writing, the market awaits the details of the Fed's plan to buy bad mortgage debt from the banks, the latest in a series of moves designed to stabilize the financial markets. Friday's news of a \$2 trillion backstop for money market mutual funds clearly had a calming effect. Libor and other short-term rates that had spiked to abnormal levels earlier in the week also settled back. As for the Financials, we expect investors to book some profits this week after the sharp gains of Thursday and Friday. The most troubled mortgage-focused banks, such as Wamu, may still need to sell. Again, however, we'll for the details of the Fed's plan before we assess the consequences for individual banks.

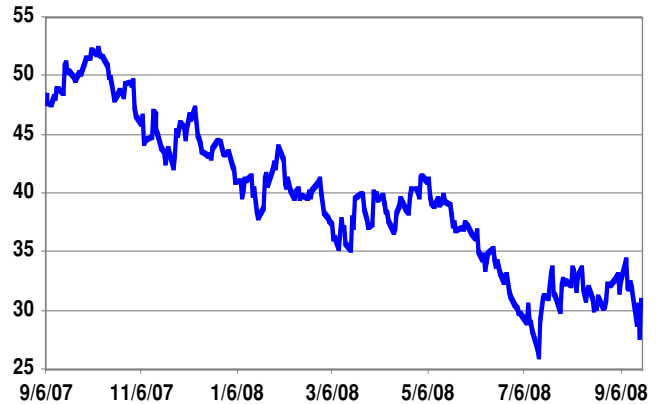
DEBT LEVERAGE DOWN IN MOST INDUSTRIES

The deleveraging of the finance sector has been painful thus far, with likely more bad news ahead. But an analysis of debt ratios across other sectors reveals that leverage is currently well below the five-year average for some. The ratio of long-term debt to common equity is above the recent averages in Technology and Healthcare, but debt ratios in these sectors remain in the 20%-30% range -- well below those of most other sectors. With the economy slowing and with credit less available (and on less-favorable terms), the above-average current leverage in the Industrials sector bears watching, however. Still, it's clear from our analysis that most of the increase in the S&P 500's overall leverage comes from the Financials sector.

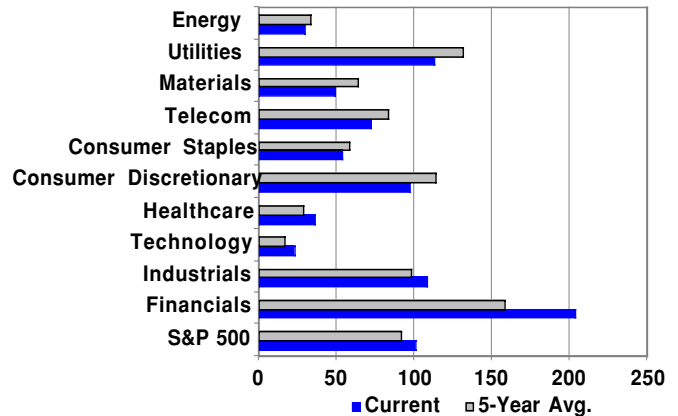
THIRD-QUARTER EARNINGS EXPECTATIONS

We expect the third quarter will mark the fifth consecutive quarterly decline in year-over-year earnings for the S&P 500. The sum of analyst estimates currently suggests about a 5% decline, down sharply from the mid-teens earlier this year. Year-over-year comparisons start to get much easier for the banks and retailers in the fourth quarter, but both of these industries are staring at continuing pressure on earnings. We also note that earnings weakness is spreading to other sectors now. Only marginal growth, if any, is expected in all other sectors except Energy. Despite these negative trends, however, analysts still expect about 23% growth in earnings next year including a 130% increase from the Financials. We think both of these assumptions are far too optimistic.

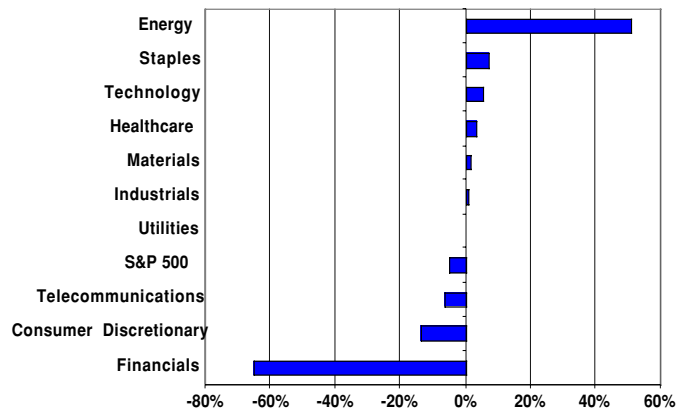
S&P 500 FINANCIALS



LONG-TERM DEBT/COMMON EQUITY (%)



ESTIMATED EARNINGS GROWTH (3Q08/3Q07)



THE ARGUS ECONOMIC OUTLOOK

	September 30, 2008															
	2006 A				2007 A				2008 E				2009 E			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Real Gross Domestic Product	4.8	2.7	0.8	1.5	0.0	4.8	4.8	-0.2	1.0	0.9	3.3	1.3	1.0	2.1	2.0	2.9
Annual:				2.4				2.4					1.6			2.4
Personal Consumption	4.3	2.8	2.2	3.7	3.9	2.0	2.0	1.0	0.9	1.7	1.8	1.8	0.7	1.8	1.3	1.8
Durables	18.9	1.8	3.5	4.2	9.2	5.0	2.3	0.4	-4.3	-2.5	-0.4	0.5	0.5	1.6	1.2	2.3
Non-Durables	4.4	3.1	2.3	3.1	3.5	1.9	1.2	0.3	-0.4	4.2	1.0	0.6	0.6	1.2	3.9	1.7
Services	1.6	2.8	2.0	3.9	3.1	1.4	2.4	1.4	2.4	1.3	1.2	0.7	0.7	2.1	1.4	1.7
Gross Domestic Investment	6.2	-0.4	-5.3	-15.0	-9.6	6.2	3.5	-11.9	-5.8	-11.9	1.7	1.7	1.2	2.5	8.1	6.3
Fixed Investment	8.3	-2.5	-4.8	-7.6	-3.4	3.0	-0.9	-6.2	-5.6	-2.5	-4.3	1.2	1.2	2.5	4.4	3.9
Non-Residential	15.9	6.4	5.4	-1.0	3.4	10.3	8.7	3.4	2.4	2.2	-1.8	3.5	5.9	5.7	3.6	4.5
Structures	15.5	19.7	14.3	2.5	11.2	18.3	20.6	8.6	8.7	13.6	3.9	6.4	8.6	6.6	7.1	8.5
Equip. & Software	16.3	1.8	2.0	-2.4	0.0	6.9	3.6	1.0	-0.5	-3.2	1.8	2.6	5.1	5.4	2.5	3.3
Residential	-3.6	-16.6	-21.5	-19.5	-16.2	-11.6	-20.6	-27.0	-25.0	-15.8	-10.0	-7.9	-11.0	-1.5	-4.3	0.6
Change in Pvt. Inventories	45.9	56.9	53.3	13.1	-15.0	-2.8	16.0	-8.1	-10.2	-49.4	-25.0	-25.0	-25.0	-10.0	-5.0	5.0
Net Exports																
Exports	16.7	5.4	3.5	15.6	0.6	8.8	23.0	4.4	5.1	13.2	6.8	5.7	5.6	6.1	6.0	5.9
Goods	18.1	6.6	3.6	10.4	2.1	6.8	21.8	5.1	4.6	16.6	8.0	6.1	4.4	4.6	4.6	5.5
Services	13.5	2.7	3.2	28.6	-2.7	13.3	26.0	2.7	6.4	5.9	4.0	4.7	8.6	9.7	9.4	6.9
Imports	10.3	0.1	3.1	2.0	7.7	-3.7	3.0	-2.3	-0.8	-7.5	5.3	2.5	2.3	2.0	1.7	1.6
Goods	9.0	0.5	3.8	-0.8	8.4	-4.0	2.4	-2.6	-1.9	-7.6	5.9	2.2	1.5	1.5	1.3	1.3
Services	17.8	-2.0	-0.3	18.4	4.2	-2.0	6.3	-0.8	5.5	-7.6	1.1	4.2	6.5	4.6	4.1	3.0
Gov't Purch. of Goods & Svcs.	3.9	1.3	1.7	1.6	0.9	3.9	3.8	0.8	1.9	3.9	-0.5	0.3	0.3	0.6	0.6	0.9
Federal	10.0	-1.6	1.9	1.8	-3.7	6.7	7.2	-0.5	5.8	6.8	-1.0	1.0	0.6	1.0	1.1	2.1
National Defense	8.8	1.9	-0.9	7.1	-5.9	8.4	10.1	-0.9	7.2	7.4	0.2	0.7	0.5	0.9	0.9	2.4
Non-Defense	12.4	-8.1	7.6	-8.1	1.3	3.1	1.1	0.5	2.7	5.5	-2.5	1.6	0.8	1.3	1.4	1.4
State & Local	0.5	3.0	1.6	1.5	3.6	2.4	1.9	1.6	-0.3	2.2	-0.3	-0.2	0.2	0.3	0.3	0.2
Final Sales of Domestic Prod.	5.1	2.3	0.9	2.9	1.1	4.3	4.0	0.8	0.9	4.8	0.4	1.0	2.1	2.1	1.9	2.6
Final Sales to Dom. Purch.	4.8	1.6	1.0	1.5	2.2	2.5	1.9	-0.1	0.1	1.5	0.6	0.7	1.6	1.5	1.3	2.0
Addendum:																
Nominal GDP	8.6	5.5	3.6	3.7	4.3	6.9	6.4	2.3	3.5	4.6	5.6	4.9	5.7	5.7	5.6	6.0
Personal Con Exp Deflator	1.8	3.3	3.1	-0.5	3.4	3.6	2.5	4.3	3.6	4.2	4.0	3.6	3.3	2.9	3.2	2.9
GDP Price Deflator (implicit)	3.6	2.7	2.7	2.2	4.2	2.0	1.5	2.5	2.6	1.3	4.3	3.8	3.6	3.1	3.5	3.0

Richard Yamarone, Director of Economic Research

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