Northern Trust

DAILY GLOBAL COMMENTARY

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Corporate Equities: If the Supply goes down, the Price is Likely To Go Up

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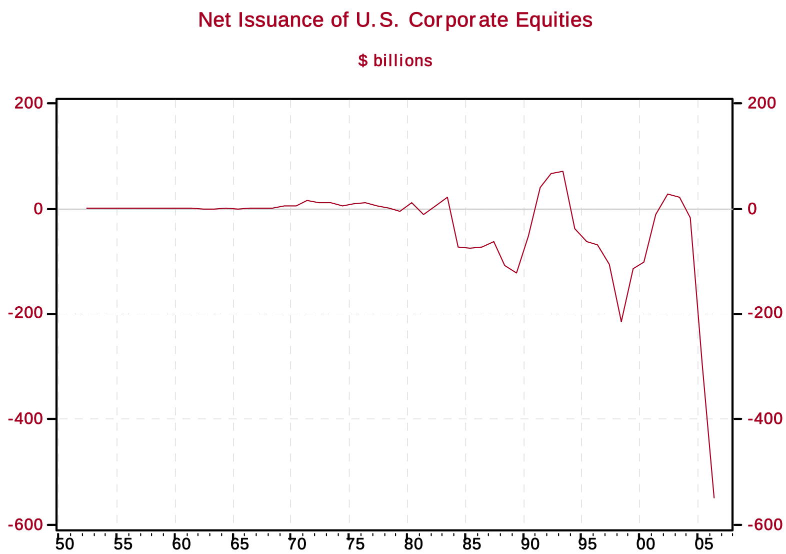
The Fed released its flow-of-funds data today for Q4:2006. These data always provide a surfeit of "nuggets" (as Perry would have said) to fill commentaries. I am going to concentrate on only one of these nuggets here – the supply of U.S. corporate equities in 2006. The history of the annual net issuance of U.S. corporate equities is shown in Chart 1. As one can see, a record $548 billion of equities were "retired" in 2006. This is not only a record retirement in dollar terms but also a record relative to nominal GDP. Rather than engaging in a capital spending boom with their recent profit largesse, corporations have been buying back their publicly-traded equity shares with abandon. In addition, the surge in private equity activity has retired shares. So, with the record contraction in the supply (in flow terms) of shares, is it any wonder that the price of shares rose last year?

Chart 1



Another implication of this retirement of corporate equity is that it, along with mortgage equity withdrawal, helped fund the $503 billion deficit households ran in 2006. Households, either directly or indirectly via mutual funds and pension funds, were net sellers of corporate equities. How do we know this? Because foreign entities were net buyers, as shown in the Chart 2. If the supply of U.S. issued equities fell and foreign entities were net buyers, households must have been net sellers. With mortgage equity withdrawal slowing sharply in 2006 (see Chart 3) and likely to continue doing so in 2007 because of the expected slowdown in the growth of home equity, households might have to curb their spending unless corporate equity retirement and/or personal disposable income grow faster. My bet is households will be slowing the growth in their spending significantly in 2007. Perhaps today's report of frigid retail sales is the beginning of that trend.

Chart 2

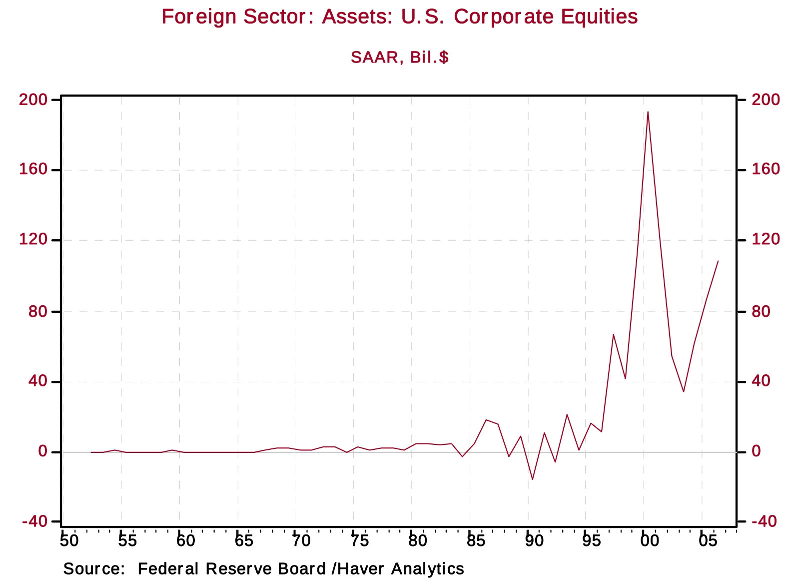
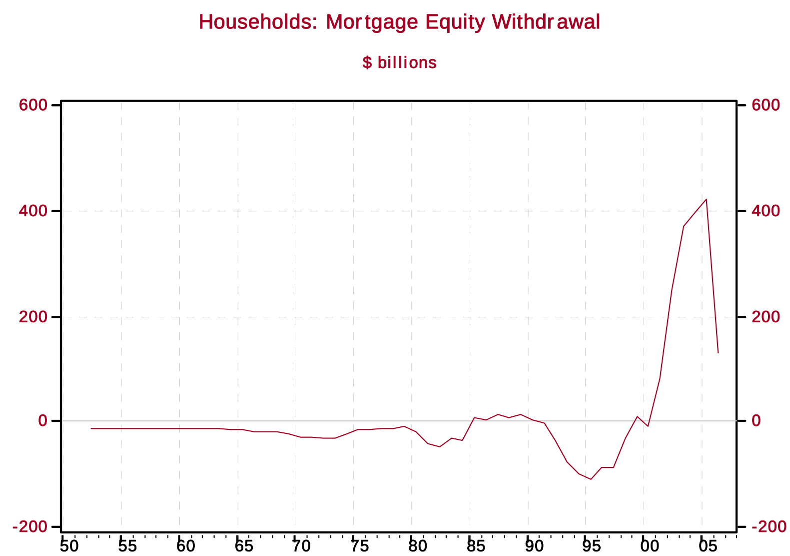


Chart 3



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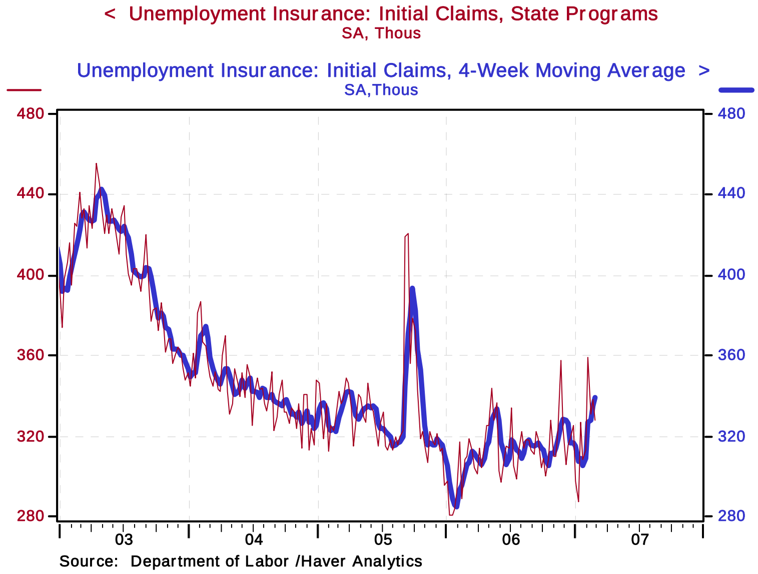
Claims Data Support Expectations of Soft Readings for Employment in February

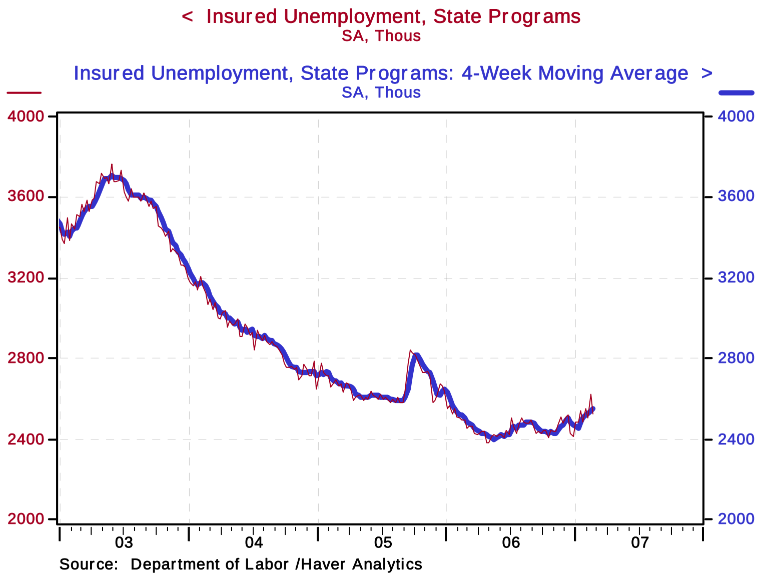
Initial jobless claims dropped 10,000 to 328,000 during the week ended March 3. The four-week moving average, however, rose to 339,000, the highest since April 9, 2005, excluding the spike related to Katrina. Seasonally unadjusted initial jobless claims rose 5.3% from a year ago, marking the eighth consecutive weekly increase.

Chart 1



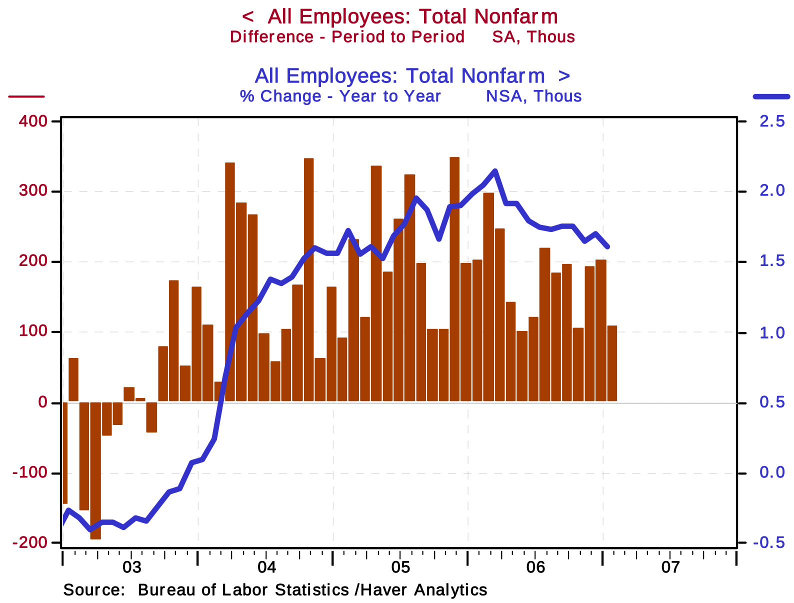
Continuing claims, which lag initial claims by one week, fell 98,000 to 2.526 million. The four-week moving average advanced to 2.522 million, the highest since February 4, 2006. The insured unemployment rate was down one notch to 1.9% from a revised 2.0% reading in the week ended February 17.

Chart 2



The basic message is that there is no robust hiring in place. We are predicting a gain of 100,000 in payrolls and an unchanged unemployment rate at 4.6%, which matches the consensus forecast. Given the message from the jobless claims report, it would not be surprising to see an increase in payrolls that is lower than our forecast. Payroll employment rose 111,000 in January, with favorable weather raising hiring. On a year-to-year basis, payrolls rose only 1.6% in January, down from a 2.0% gain in January 2006.

Chart 3



Hourly earnings in February will be another piece of information of special interest. Hourly earnings rose 4.02% on a year-to-year basis in February, down from a possible peak of 4.22% in December. Bullish readings will be viewed to support the current hawkish stance of the FOMC.

Chart 4