

February 6, 2012

DR. RATAJCZAK'S WEEKLY ECONOMIC COMMENTARY

ECONOMIC INDICATORS FOR THE WEEK BEGINNING FEBRUARY 6, 2012											
Date	Announcement	Estimate					Last Announcement				
02/07/12	Consumer Installment Debt	5.4%	a.r.	\$	2,488.85	Dec	9.9%	a.r.	\$	2,477.70	Nov
02/10/12	Trade - Deficit			\$	(48,724)	Dec			\$	(47,752)	Nov
02/10/12	Goods - Exports	-0.1%		\$	126,431	Dec	-1.1%		\$	126,558	Nov
02/10/12	- Imports	0.5%		\$	190,685	Dec	1.7%		\$	189,736	Nov
02/10/12	Services - Exports	0.2%		\$	51,384	Dec	-0.1%		\$	51,281	Nov
02/10/12	- Imports	0.0%		\$	35,854	Dec	-0.4%		\$	35,854	Nov

Changes denoted by bold type. All percent changes are from the previous period unless the next column shows a.r. which means the percentage change then is the annual rate. Payroll changes are in thousands, not percentages.

ECONOMIC COMMENTARY FOR THE WEEK BEGINNING FEBRUARY 6, 2012

COMMENTARY - Wow! What an employment report. I will talk about the 266,000 added jobs for the past year, the seasonal adjustments that removed the courier distortion from December before adjusting the employment change upward, the population adjustments that lowered the participation rates (mostly because the undercounting was with those under 24 and over 55 in the Hispanic and Asian populations), and the weather distorted, but still solid, January job gains even as the workweek held its recent gains and temporary employment grew modestly, when I get to the employment section of the report. Although I don't yet know where the added growth is occurring, such strong demand for labor must mean higher growth in the first quarter than I had been assuming (although some of that additional growth is in the construction and durable consumption sectors). Again, that will be discussed below.

Instead, I want to use my commentary to opine on several quarterly reports that deserve more attention than they normally get.

Some of the job growth is coming from reduced productivity gains (though initial hiring almost always leads to lower productivity gains as some productive workers are used for training and the new hires are not yet up to snuff). Following unusually strong productivity gains during the early phases of this recovery as businesses rushed to raise cash and trim their marginal activities, productivity gains have slowed to slightly less than normal in the past two years. Gains for nonfarm business in the fourth quarter were 0.7% at annual rates as manufacturing experienced an actually dip in productivity.

However, continued moderate gains in hourly compensation have contained the gains in unit labor costs (an important inflation measure). For all business, unit labor costs are growing 1.2%, about the same as the year before. In manufacturing, that negative productivity pushed unit labor costs to a gain of 1.6% for the quarter. However, costs remain lower than a year ago per unit produced. I will watch to see if this is the beginning of labor cost pressures and

"Dr. Ratajczak's Weekly Economic Commentary" is prepared by Dr. Donald Ratajczak, PhD., Morgan Keegan's Consulting Economist. This report is a transcript of comments made by Dr. Ratajczak and should be read in that context. Additional information is available upon request.

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reduced competitiveness in manufacturing or if this merely represents that temporary dip in productivity as new workers are trained.

A related report is the quarterly employment cost index. Wages continue to grow about 1.5%, but benefit costs are again intensifying following a rare dip below wage growth in the previous quarter. Compensation for all civilian workers is up 2% for the past twelve months, but benefits have grown 3.2%. On the other hand, the surge in benefit costs for government workers has slowed dramatically. Moreover, with some governments instituting freezes, compensation continues to slow to only 1.3% for the past year in that sector.

Health benefits no longer are the strongest gains in benefits, as their gains have slowed from 5% a year ago to 3.5% in the latest twelve months for private industry workers. (Their benefit growth in the past twelve months is a slightly higher 3.6%.) Overall, there is scant evidence that labor costs are intensifying, though the non-health benefit increases in the private sector are certainly curious in this environment (are they benefits for higher earning workers?).

The conclusion from the quarterly productivity and employment costs is that some upward pressure on labor costs is developing as new workers are being trained and as non-health benefits are rising. Yet, these remain relatively modest changes that should not cause concern about labor induced inflationary pressures at this time. (However, they also probably rule out any fear of deflation.)

The other interesting report is the homeownership report for the quarter. The continued drop in homeownership from its unsustainable highs during the housing boom to a low not seen since 1997 garners headlines, but is less interesting to me than the housing stock and vacancy measures that the report contains. Because of the plunge in housing construction, the total stock of usable housing has increased only half a million in the past year. Despite a plunge in new household formations because of the difficult employment environment, occupied units have increased about 150,000 more. Thus, vacancy rates are falling. Those leaving owner homes on net have slowed to less than 100,000 in the past year. Renters have absorbed an additional 750,000 units.

The conversion of owner homes to rentals as well as some meager additions from rental construction has kept pace with the absorption of rental units. Thus, the vacancy rate remained the same 9.4% as the year before (but down to the lowest rate in a decade.) Even with the conversion of owned to rented, the rental rates are now moving higher though not yet to a new peak.

The vacancy rate for owned homes is elevated, but it has been falling in recent quarters because of that conversion from owned to rented. As a result, the asking price for such homes has begun to stabilize. (However, the Case/Shiller index continues to show declining prices in the metropolitan areas that they serve of nearly 3.5% for the past year.)

The bottom line is that a shortage of rental properties is currently being met by previous owned or expected to be owned but never occupied properties. Some more conversions are likely, but rental rates are beginning to rise. Furthermore, conversions and low construction have caused the supply of homes owned or built for owners to fall by 100,000 in the past year. Soon, housing prices should begin to stabilize. And this is with an unusually low 650,000 growth in households. Current population gains suggest that 1.1 million new households should be formed in normal times. Therefore, as employment grows, we will see more household growth and a reduction in those vacancy rates. Rents already are rising and increases in owned home prices cannot be that far behind.

I should end by saying that I believe a number of Federal Reserve contributors to their interest rate forecasts are probably rethinking their forecasts following the latest employment report. And if they are, so should bond investors.

GDP - I cannot yet say where the additional first quarter growth will be, but such strong labor demand in recent months must mean something. Also, the latest construction report suggests that the dip in nonresidential structures originally reported will be revised to no change (probably pushing the GDP to more than 3% in the next revision). Moreover, there was momentum which suggests that positive contributions from structures should be expected in the winter quarter. In addition, January auto sales appear to be more than 14.1 million at seasonal rates. That should push up retail trade, causing stronger than previously expected gains in consumer durables. For those reasons, I have revised my GDP estimates up to 2.4% for the quarter.

I also mentioned that I might revise down the profit estimates for the fourth quarter. Given the currently reported income components for that quarter, I had to slice my estimates. Of course, if GDP is revised upward, as I suspect, I might be adding the gains back to the profit estimates at that time.

EMPLOYMENT - Why were we wrong? Actually, the error was not as bad as it seems. The BLS revised the benchmark estimates, which added 266,000 jobs for the past twelve months. In addition, new seasonal factors eliminated the spurt in courier service employment that was originally reported for December. Of course, I was assuming that 375,000 initial claims were consistent with 180,000 private payroll jobs and not the 200,000 suggested by the new benchmark. I also was subtracting the 42,000 burst in courier employment, not knowing that new seasonal factors would eliminate that problem (and also suggesting that December was a stronger growth month excluding the courier pop than anyone expected). Together, those adjustments pretty much explain the discrepancy.

I have been asked if these employment gains are for real. Of course they are. However, unusual weather is creating employment changes that won't be sustained when weather returns to more normal conditions. Probably all the growth in construction jobs and some of the mining job growth reflect benefits from the weather. Less than normal weather disruptions also contributed to the growth in manufacturing, although opening auto assembly plants and filling machinery orders also contributed to the gains. Weather also aided trucking, but may have adversely impacted clothing sales. On balance, I estimate that about 40-50,000 January job gains were caused by the unusually mild weather. In some future month, when weather is more normal, the seasonal factors will not allow the gains that otherwise would occur because those to be employed are already working.

Even so, the report was solid. The gains in the workweek during previous months were sustained even as more jobs were created. Temporary employment also expanded, though the gains were not surprising for an economy providing nearly 250,000 new jobs. In other words, more hours still remain to be converted to jobs and more temporaries can be absorbed as permanent workers. Thus, further strong gains in employment should be expected.

Every January, the BLS also adjusts for information provided by the current population surveys. They do not change historical data, but merely adjust at the beginning of the year. Thus, the sharp drop in labor participation did not happen in January, but sometime earlier. Most of the strong employment gains reported for January in the household survey actually happened in the survey (though the survey is subject to very large monthly fluctuations). I already mentioned that most of the adjustment was in low participation populations (e.g., under 24 and over 55). We also discovered that fewer whites, but substantially more Asians and Hispanics, are in the population than expected. Also, most of the undercount was for women. I don't yet know all the significance of these changes, but our potential labor force is different than we had expected.

While recognizing that these job gains cannot be sustained because the weather will become less favorable at some point, these gains certainly are welcome. The 0.2% wage gains (still only up 1.9% for the year) and the 0.2% gains in payrolls with no change in the workweek mean that compensation will grow about 0.4%. Real earnings will be largely unchanged as I suspect that prices climbed in January (they certainly did at the gas pump). These gains are not as robust as in December, but they may allow a 0.4% gain in personal income (though so many other adjustments happen to that report in January).

Some of the employment specifics are as follows:

Mining activities jumped 10,000, or slightly above recent trend growth as support for mining services increased sharply (this usually means well preparations and distribution as opposed to actual extraction). This should grow more slowly in the next few months as gas drilling subsides.

Construction surged by 21,000 jobs though heavy construction usually associated with bridge and other structural work actually sagged. Both residential and nonresidential activity were higher, but weather probably accounted for the vast majority of these gains. (Before seasonal adjustment, jobs actually fell by 280,000.) I would expect little change here next month.

Manufacturing zoomed 50,000 jobs and have created nearly 200,000 new jobs in the past year. The big gains are in fabricated metals, machinery and transportation. An auto assembly plant was restarted and another may come out of mothballs soon. Even nondurables showed some gains in printing, refining and chemicals (suggesting that those Eastern

refinery closings are not so significant). The job weakness was in paper, textiles and electronics, including computers, as the shift from desktops to tablets also means a shift from U.S. to Asian assembly. Further manufacturing growth is expected, but the fabricated metals do not show the orders to justify such employment gains (machinery and transportation do have the orders). This stronger employment gain and an extended workweek should more than overcome weak utility production to push up industrial production for the month.

All sectors of wholesale trade were strong with the electronic markets showing solid growth. Retail, by contrast, was mixed. Higher auto sales clearly required more dealer hires. Health stores, department stores, and nonstores also increased their employment. However, electronics continued to sag and clothing stores shed workers along with their outer clothing in the mild weather. Overall, the retail outlook was mixed, as the monthly store sales suggested (though same store sales were up 4.6% in January, a slight improvement from December). I see little acceleration here until the weather changes or the spring goods arrive.

Transportation was solid in water, trucking and passengers, but not in air nor rail. Courier employment fell, but only marginally following the new seasonal estimates. This is consistent with growing imported goods and a solid increase in goods distribution.

Motion picture production cuts accounted for much of the loss in information jobs as the last season was a dud (ticket sales down more than 11%). Surprisingly, data processing jobs also declined. This probably is the bulk of this year's weakness unless the motion picture is being destroyed by the knock offs, as the industry claims (and not the bad action movies they have been creating).

The rally in financial stocks has not translated into financial employment. Banks, brokerage firms and even rental services all are shedding jobs. Insurance, which had been cutting, apparently has found bottom.

Of course, manufacturing and professional services have been the backbone of this recovery. (Construction and government have been the missing links, explaining the unusually tepid gains in jobs so far in the expansion.) All the professional services showed solid gains. Could the jump in accountants be another seasonal distortion (tax time)? The gains in architectural services are suggestive. Perhaps the construction rebound is about to begin. The gains in temporary help services are encouraging, but not out of line with the current growth in overall employment as they were about a year and a half ago.

Health services are slightly above trend, but, except for the excessive staffing at hospitals, I see no distortions here. The surprise is that day care service employment fell even as so many new jobs were created. Perhaps that will rebound next month.

The rebound in performing arts and gambling suggest that some discretionary income is being earned and used, a good sign for future growth. Lodging slowed, but food services began to surge. With some restaurant sales still falling, such increased investment could be a worry for the industry (unless, of course, the gains are in the surging quick service or fast casual segments).

Once again the drag is government. The December jump in Federal employment was washed away by the new seasonals. Employment continues to shrink at the Federal level as deficit worries tighten budget restraints. State governments appear to have balanced their budgets and are hiring some for universities (which continue to boom though applications for some of the prestige private schools have begun to dip). Local governments continue to struggle with falling revenues, as falling property values especially trim school budgets. The worst of the trimming is over, but some trimming will continue until housing values begin to rise (or the unlikely transfer of funds from other governments occurs).

On balance, some of the construction, manufacturing and transportation may be favored by the weather and should not show such strong gains. However, strong employment gains remain likely in the absence of adverse conditions from government programs or international concerns. I am beginning my February estimates with an employment gain of 193,000, although the workweek may contract modestly, especially in manufacturing. I see no reason for the unemployment rate to change with those gains (we probably will see an increase in job seekers as optimism begins to grow in the labor markets).

BUSINESS ACTIVITY - The hours worked in manufacturing support even a larger gain in industrial output than the upward revised 0.4% I am now projecting. Certainly, auto assembly and transit production should remain strong. However, the very mild January should provide even further weakness to the utility component and I was persuaded by the Eastern refinery shutdowns to lower their activity (though the employment gains do not confirm that move). So, I'll stick with the 0.4% gain or about 5% annually with capacity continuing to grow just over 1%. The utilization rate is approaching levels that suggest new capacity should be built. The \$5 billion spurt in manufacturing construction for January might be the beginning of that accelerator that propels and recovery into a strong expansion, but weather may just be playing tricks on us, as it has in the past. I will wait for more definitive support for the onset of the accelerator (though its presence would dramatically alter most forecasts).

The manufacturing report was supportive of strong gains in manufacturing, though much of the gain in orders reflect the Southwest orders for five months of Boeing production (all of which will be done in another year).

Falling tobacco and petroleum prices held down the shipments of manufactured goods, but the 0.7% gains with no aid from rising prices certainly explains why manufacturing employment is growing (remember, however, this is lagged from the employment report). Remove those aircraft orders and the remainder grew slightly less than recent trend growth. Fabricated metals and computers accounted for some of that slowing. The same culprits along with aluminum and industrial equipment accounted for the slowing in growth of unfilled orders. However, inventory is especially lean so some increase in production can be justified even with the slip in the growth of backlog.

Of course, I did not see another Southwest order so I chopped the transportation orders and some of the shipments (though that manufacturing employment may cause me to rethink that). Higher energy prices led to some growth in overall manufacturing shipments and inventory.

The sluggish inventory, but stronger shipments, led to a change down in business inventories and up in business sales for December (the right direction for future growth). The evidence does not yet support that expansion phase in manufacturing, but the gains remain solid and the inventory is lean.

CONSTRUCTION ACTIVITY - The weather clearly was kind to construction, as it should again be in January. This was not anticipated by the BEA, so upward revisions in nonresidential structures will be needed in the next GDP revision. While weather clearly aided the 3.3% gains in nonresidential private construction, the gains were concentrated in the power and manufacturing segments. Nearly \$8 of the \$9 billion gain is in those two segments, so more than weather must be at work. I also do not want to discount the weakness in lodging and office activity during favorable weather. Construction for manufacturing is up 43% in the past year. Some of that is retrofitting as old plants are reopened. However, I see the first signs of capacity expansion, which could mean a higher level of growth in the next few months (although adjusted for degree days).

Public construction shows modest gains, as more street and highway activity is being partially offset by less school construction. Most of the growth is because of the weather and probably will disappear when the weather effect vanishes. However, that is not happening in January.

The construction hours worked are not so robust in January, but they certainly support growth. Indeed, this is one of the sectors that probably will perform better than I thought when I put my preliminary GDP estimates together.

CONSUMER ACTIVITY - The only surprise in the personal income report was the lower than anticipated level of consumer spending. Some of this certainly reflects lower utility bills, which will persist in January. Consumers also spent early on Christmas to get the deals and actually raised their savings in December. With flat auto sales along with discounts, durable consumption slowed. Gasoline consumption is plunging, which aided the drop in nondurables, though clothing also was soft because of the weather. Both of those trends probably persisted in January, though gasoline prices rose with the increase in fear pricing of oil.

Despite pressure on livestock prices, I doubt that farm income fell as much as the BEA estimated. Certainly, I am expecting a bounce in the first quarter. However, so many changes occur in January, that estimates are difficult for the month (the social security tax changes and payouts are adjusted, bonuses are added to compensation, and tax changes are imputed for the year, though they probably will not change the payroll tax collections until the end of February or when the extension is approved). I am assuming the unlikely event that these impacts will wash (they should come close to that) in order to

arrive at my slightly slowing growth in personal income. So far, the growth in rental and dividend income has overwhelmed the decline in interest income, but the changing demographics may suggest a different ownership mix.

Favorable changes in the core early last year make comparisons more difficult. As a result, I am expecting the PCE deflator excluding food and energy to grow gradually and soon exceed the Fed target (I know their forecast is just the reverse). I do not expect that to change their policy this year, but might raise questions about extensions beyond next year.

Despite favorable utility demand in January, slightly higher same store sales, rising gasoline prices, and stronger auto sales (14.1 vs. 13.5 million in December) should contribute to some acceleration in consumer spending. However, I see the gains as remaining slightly less than the growth of income, which supports further consumer growth if it is not snuffed out by rising petroleum prices (which does not seem to be happening in February).

You will notice that I raised my retail sales estimate to reflect the stronger auto sales than I originally expected.

PRICES - Crop prices soared in January as the drought in the Southern Hemisphere (since broken in Brazil and Australia) raised concern about corn and wheat production. At the same time, livestock prices fell modestly as fears of higher feed prices were offset by some greening of pastures and a low winter kill so far this year. Crop prices soared 5.1% in January while livestock prices were off 0.6%. As a result, I raised my export price estimates for agriculture, but did nothing to the other price indices. For the record, farm prices are at 90% of parity, which is a very high level given the relative productivity of agricultural production. That is why I am assuming farm incomes will rise in the first quarter.

Because of some relief from the drought, though we now have flooding in Australia, I am assuming crop prices will fall next month and livestock prices will remain near current levels as there will be less rush to slaughter.

INDICATORS - The strong gains in the manufacturing workweek add almost 0.2 to the leading indicators. Stock prices might add even more, so I have raised my indicator estimates to a strong 0.4% gain.

MONETARY ACTIVITY - The lull in money growth definitely has ended. Almost all monetary aggregates now are growing rapidly. The currency gains suggest concerns with banks, but the growth in savings deposits at commercial banks seems to belie that. Therefore, the currency gains, which are back at double digit growth rates, remain an enigma (could we have a spurt in illegal activity?) While the latest indicators showed no growth in loan activity for December, the gains in checking deposits suggest that something is happening in January. At any rate, money growth for January is excessive, though the 13 week spans that I find more useful remain modest for **M2** even as they are too strong for **M1**. Just a hint for equity investors, precautionary balances are definitely declining, suggesting that purchasing power is coming from the sidelines to support equity values and could be exhausted at some point.

INTEREST RATES - Investors clearly were confused by the increased transparency at the Fed. Their forecasts suggested that ZLB could persist through 2014, though the median forecast for that year was actually 0.75%. Their equilibrium rate forecast was very close to mine at 4.25%, though no hint was made for when that would be achieved. Everyone ignored the equilibrium forecast, which should be achieved when growth is consistently above sustained growth rates, and seemed to assume that the forecast was a new policy statement. As the plurality was ZLB in 2014, investors assumed the ten year would be competing with zero through 2014. As they originally thought the ZLB was only through 2013, this immediately lowered yields on the long term bond.

But the forecast was not a policy statement. It was a forecast. When employment showed greater strength than assumed in the Fed's macro forecasts, investors returned to the forecasts and began to wonder how this new information would change forecast assessments. The wondering was only one way: how much sooner would ZLB be abandoned than the 2014 assumption? I believe this new thinking is appropriate even as it pushed up yields on treasuries. I would also suggest that the current 10 year does not reflect competition with ZLB through 2013 and then rising rates to equilibrium, e.g., 4.25% by the end of 2015, which is consistent with the Fed's macro forecasts. For that reason, I see considerable increases in long yields in the next six to twelve months and that is reflected in my current interest rate tables. I also have added near certainty to my expectations that rates will rise to an average of 0.75% by the end of 2014.

In short, the bond bull is over. While short term opportunities can develop as fear rises and falls and the world flees to treasuries and then out of them again, holding bonds for the long run is no longer a good proposition. Instead they should be increasingly traded to assure that when policy rates rise in 2014 and more so in 2015, the current portfolio is ready to

be rolled over into much higher yielding instruments. I realize the regulators do not like this type of action, but they need to go back to the second reason why banks hold large investment portfolios (the first is to park funds while loan activity is being developed, but the second is to hedge risks in the institutions, and changing risk environments require active investment management).

CURRENCY MARKETS - Muddling through has become the preferred European forecast, and it may be right. Only the UK and the Czech Republic have not agreed to a new treaty that would provide Union oversight for sovereign budgets, a missing link in the Union's controls. The UK probably is now fully out of the Union and will never join. The Czechs are the second best performer and don't want to give up their sovereignty (the best performer since the crisis is Poland, but they relish being part of the new Europe). While this is not unanimity, it provides a working plan.

However, the Greek mess has not yet been contained. Greece needs more support in March, as much of its debt needs to be repriced at that time. They cannot accept the market terms, as the interest burden would rapidly bankrupt the country. Every week the word is that an agreement is near, but no agreement is in place. As a Greek default is increasingly likely, the banks holding such sovereign debt have been rapidly tightening lending criteria to manage risk on the loan side to offset the investment risks. This has created a liquidity squeeze in Europe.

So far, the three year loans provided to banks by the ECB have contained the liquidity squeeze, but more almost certainly will be needed. Nevertheless, the favorable short term auctions by other countries have encouraged investors who are slowly returning to Europe, causing the dollar to fall the euro to rally. As this tends to raise resource prices, resource currencies have done especially well. Unfortunately for Brazil, they also have substantial manufacturing exports and the rising real (9% in the past year) has dampened their competitiveness. A rising yen is putting profit pressure on their manufacturers as well. Brazil may respond with lower rates and more foreign transactions taxes. Japan can do little about rates and still has not learned the Swiss solution. (They are quick to copy engineered products, but very slow to copy policy solutions.)

Anyway, the bottom line is that Europe is holding, though not yet with a firm solution. The dollar has weakened, causing some support for commodity prices and substantial gains for resource currencies, such as Canada. The loonie is again above par to the dollar, (does anyone want any more Canadair's and should auto assembly remain in Windsor?). I don't see much deterioration in the dollar, but the trend currently is for a stronger euro, yen and especially pound and loonie.

EQUITIES - For the year to date, equities are up almost 7% as measured by the S&P. As my target is high single digits, I must either assume I am wrong or that this rally is about to end. The rally has been supported not only by precautionary balances being converted to equities, but also by international investors still seeking dollar assets but already loaded with treasuries looking for something more. The dollar's recent weakness may stem that flow, though any negative news from Europe can only add international flows to our equity markets. Frankly, the earnings season has been the weakest since the bull market began. Only slightly over 60% of the announcements have been over estimates, though some, such as Apple, have been spectacularly so. Unless GDP is revised sharply higher, profit growth in the fourth quarter has been the weakest of this entire rebound and very few have revised upward their high single digit profit estimates for the S&P.

So, why buy equities. They are cheap, although some of the emerging market is cheaper. Even Europe is as cheap, if their banking system doesn't collapse. And that explains part of why American equities are being favored. Earnings are cheaper elsewhere, but the risks also are greater. I am sensing that investors are beginning to overcome their fears in emerging markets (along with some evidence that restrictive policies are being reversed, even in China and India). Nevertheless, they are most encouraged by U.S. equity markets, which historically are selling earnings at low prices.

So far, the markets have exhibited a reversal of fortune, which usually occurs early in an upturn. By this I mean that the leaders begin to lag and the laggards take over the leadership. For example, the three best S&P sectors last year: utilities, telecommunications services, and consumer staples; are now the only sectors failing to gain this year. By contrast, the two biggest laggards: finance and materials, are tied for the leadership this year. They only difference is technology, which was a solid performer last year and a leader this year so far. The REITs, also a laggard last year, was a laggard this year as well until the past week, when it became the leader.

So what can we expect from here:

I do not see the orders growth to justify continued expansion in materials values. Indeed, backlogs in aluminum are falling, though ferrous metals show significant backlogs. A little more analysis may separate the favorable from the unfavorable at this time in this sector.

Only the dollar is holding up energy values. If the dollar stabilizes, as I project, then some weakness could come to energy, though some of the oil service companies still may show strong profit gains.

Consumer staples may have been dumped too rapidly. They certainly are low beta stocks, but if the stock market's growth is about to slow, their dividends may supply gains while the market digests its gains.

Unlike last year, when the consumer clearly was overextended, earnings now are justifying consumer spending. Furthermore, stronger employment growth is exactly what is needed for the restaurant industry (more household paychecks usually mean more dining out). The sector already is leading the market, but could easily continue to do so.

Financials are the wild card. Are their problems behind them in the loan portfolios? In this low interest rate environment, their rate spreads continue to narrow. Thus, the profitability of bank activities is being eroded even as Congress is limiting opportunities for fee income. In the short run, solving their loan quality problems adds more than the environment detracts, so I see gains. However, this low interest environment will need to change to allow more operating profits at banks. A near term rebound, but don't hold for the long run unless the regulatory and interest environment changes.

I probably could say the same about healthcare. At some point, costs will overwhelm the sector. Hospital fees cannot continue growing twice inflation (and purchasing power capacity) indefinitely. Hopes that the worst of the reform regulations will be repealed have encouraged investors, but the uncertainty in this sector remains huge.

Consumer based technology has been hot though retailing has been less spectacular. Smart phones are rapidly becoming a commodity. The next wave probably is at the corporate level, but that might include tablets. In short, large winners and losers will appear in this sphere, but the group should only maintain its 20% share of the S&P value.

Telecommunications services continue to face technological challenges from other channels. Some will remain viable, but some probably will disappear. This is a sector in transition, which normally is not a good thing for long term investors.

On the other hand, we always will use utilities. The weather has dramatically lowered their production and profitability, but some of their energy costs are falling. We could have a rebound this summer if the weather is hotter than normal, as some long term weather forecasters are suggesting.

I cannot say when the correction will surface, but one surely is likely to happen. Perhaps, the 1380s that some chartists have identified may be the resistance point. I would begin putting stops under my winners and wonder why my losers are not joining this upturn. The upturn is strong, but this is not the beginning of a recovery when double digit uplegs are the norm. This is a reinvigorated long distance runner who can only sustain these spurts so long. Ride the spurts, but look for some rest if a pullback begins.

MORGAN KEEGAN UNIVERSE - When the rebound began, small stocks again came to the fore. Not surprisingly the MK universe nearly doubled the gains of the S&P. Since the year began, every segment of the universe had gains with double digits widespread among the transportation, technology, industrials, healthcare and consumer services. While the rally remained strong in the past week, a few dips surfaced for the week. They included: maritime shipping, transportation leasing, healthcare information technology, and energy exploration. The only double digit weekly gain was in communications components, although all the technology offering segments did very well.

Our restaurants, convenience stores, and consumer special situation all showed strength so far this year and all but the convenience stores sustained strong gains early in February. The specialty retailing lagged, possibly because weather impacted sales. While nothing seems overpriced using profit growth to determine premium to market PE ratios, no real bargains stand out either. Perhaps some of the specialty retailing could perform if the weather begins to cooperate.

The value in energy remains in the oil service sector. I still see greater likelihood of lower rather than higher oil prices this year, which tempers my enthusiasm.

I already mentioned the pros and cons of finance, though the stability of insurance employment suggests that some value may exist in the specialty finance even if profit growth is minimal.

Even without the uncertainty, value is hard to find in the healthcare sector at this time. Perhaps the medical devices have value here.

Security and defense stocks are undervalued, but their customers are governments, which are not expanding their spending at this time. If you have a long horizon, some buying might be justified.

If the accelerator kicks in, the industrials will be cheap. While I am not certain that it will, I also can no longer assume it will not. The nonresidential offers the best values, but I would not totally ignore the residential even at their slightly elevated prices, as their earnings could turn rapidly.

Finally, the REITs are again performing. Perhaps they're like a quarter horse - a lot of early speed but then becoming spent in the second half of the year. At any rate, they currently are showing strength, again.

Technology shows profit gains that clearly justify higher PE ratios, but their PE ratios are not that much higher than the market. If anything is overpriced, it probably is the e-commerce, but investors clearly believe our earnings estimates are too low.

With the Baltic freight rates at 25 year lows, I wondered when our maritime would begin to stutter. I realize there are special protections for American maritime, but the excess supply of space must impact the entire industry. The latest weakness in transportation leasing is a bit more difficult to determine. Transportation stocks continue to perform, but they are flowing back to the pack, suggesting that the economy may be spurting rather than sustaining higher growth.

While I cannot say a correction is near, one is likely sometime soon. Could it wait until May? I don't know. Europe can again be a problem, as the Greek problem needs a solution by March and does not yet have one. We might be surprised by further declines in Chinese growth, though I think the worst of that moderation is over. So, enjoy the rally, but put in stops and be prepared to take profits and rest a bit, for this market is ascending too rapidly at this time.

ECONOMIC INDICATORS FOR THE WEEK BEGINNING FEBRUARY 6, 2012													
	2011	2012				2013				Ann.	Ann.	Ann.	Ann.
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2010	2011	2012	2013
91-Day Bills	0.01	0.07	0.10	0.13	0.16	0.20	0.22	0.25	0.28	0.09	0.05	0.12	0.24
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Fed. Funds	0.07	0.10	0.12	3.14	0.16	0.18	0.21	0.25	0.25	0.15	0.11	0.88	0.22
2-Yr. Note	0.26	0.23	0.24	0.26	0.30	0.36	0.43	0.52	0.58	0.52	0.45	0.26	0.47
5-Yr. Note	0.95	0.79	0.81	0.86	0.93	1.02	1.08	1.17	1.31	1.56	1.50	0.85	1.15
10-Yr. Note	2.05	1.95	2.09	2.16	2.24	2.30	2.43	2.57	2.86	3.02	2.79	2.11	2.54
30-Yr. Bond	3.03	3.13	3.21	3.29	3.40	3.49	3.63	3.76	3.93	4.04	3.85	3.26	3.70
Aaa	3.93	3.90	4.01	4.10	4.22	4.29	4.40	4.52	4.73	4.86	4.63	4.06	4.49
Baa	5.25	5.21	5.31	5.38	5.46	5.51	5.60	5.68	5.86	5.81	5.66	5.34	5.66
S&P	1226	1385	1443	1489	1520	1545	1591	1625	1652	1140	1269	1459	1603
Dow Jones	11799	13043	13429	13886	14147	14443	14927	15328	15642	10663	11966	13626	15085
NASDAQ	2601	2964	3123	3255	3406	3520	3649	3702	3794	2350	2681	3187	3666

Aaa and Baa corporate bond yields represent Dr. Ratajczak's forecast of Moody's index of longer-dated seasoned corporate bonds with maturities ranging between 20 and 30 years.

SHORT TERM FINANCIAL PROJECTIONS				
	Past Week	This Week	30 Days	60 Days
Federal Funds	0.10	0.11	0.13	0.14
Commer. Paper	0.14	0.15	0.16	0.18
10-Yr Treasury	1.88	1.95	2.02	2.07
30-Yr Treasury	3.02	3.16	3.20	3.24
Aaa	3.78	3.88	3.94	3.97
Baa	5.14	5.19	5.23	5.25
Blm. 20 Yr Muni	2.98	3.01	3.05	3.08
Blm. 30 Yr. Mtg.	3.85	3.88	3.93	3.98
Dow Jones	12861 *	12984 *	13246	13425
S&P	1343 *	1365 *	1403	1426
NASDAQ	2907 *	2956 *	3031	3092

*Friday Estimates

CURRENCY MARKETS				
	Friday	This Week	End of 2012	End of 2013
Euro	1.314	1.311	1.298	1.278
Pound	1.581	1.585	1.580	1.559
Yen	76.6	76.5	75.5	73.4
Canadian	0.994	0.995	1.011	1.035
Broad Index	98.2	98.2	98.6	99.5

MONEY MEASURES			
M-1	13.2	-7.8	13 week annual rate 11.9%
M-2	4.5	6.8	13 week annual rate 6.2%

ECONOMIC INDICATORS FOR THE WEEK BEGINNING FEBRUARY 6, 2012

Date	Announcement	Estimate				Last Announcement			
02/07/12	Consumer Installment Debt	5.4%	a.r.	\$ 2,488.85	Dec	9.9%	a.r.	\$ 2,477.70	Nov
02/10/12	Trade - Deficit			\$ (48,724)	Dec			\$ (47,752)	Nov
02/10/12	Goods - Exports	-0.1%		\$ 126,431	Dec	-1.1%		\$ 126,558	Nov
02/10/12	- Imports	0.5%		\$ 190,685	Dec	1.7%		\$ 189,736	Nov
02/10/12	Services - Exports	0.2%		\$ 51,384	Dec	-0.1%		\$ 51,281	Nov
02/10/12	- Imports	0.0%		\$ 35,854	Dec	-0.4%		\$ 35,854	Nov
02/14/12	Business Inventories	0.2%		\$ 1,553.23	Dec	0.3%		\$ 1,550.13	Nov
02/14/12	- Sales	0.4%		\$ 1,225.74	Dec	0.3%		\$ 1,220.85	Nov
02/14/12	Retail Sales	0.6%		\$ 403.02	Jan	0.1%		\$ 400.61	Dec
02/14/12	Nonauto Retail Sales	0.4%		\$ 330.06	Jan	-0.2%		\$ 328.74	Dec
02/14/12	Import Prices	0.3%		142.6	Jan	-0.1%		142.2	Dec
02/14/12	- Less Fuel	0.0%		120.4	Jan	0.1%		120.4	Dec
02/14/12	Export Prices	0.2%		132.4	Jan	-0.5%		132.1	Dec
02/14/12	- Less Food and Fuel	0.0%		102.4	Jan	0.0%		102.4	Dec
02/15/12	Industrial Production	0.4%		95.7	Jan	0.4%		95.3	Dec
02/15/12	Capacity Utilization rate	0.3%		78.3	Jan	0.4%		78.1	Dec
02/16/12	Housing - Starts	1.6%		0.667	Jan	-4.1%		0.657	Dec
02/16/12	- Single Family	0.5%		0.472	Jan	4.4%		0.470	Dec
02/16/12	- Multi Family	4.3%		0.195	Jan	-20.4%		0.187	Dec
02/16/12	- Permits	0.9%		0.685	Jan	-0.1%		0.679	Dec
02/16/12	Producer Price Index	0.4%		193.5	Jan	-0.1%		192.7	Dec
02/16/12	PPI less food and energy	0.1%		181.3	Jan	0.3%		181.1	Dec
02/16/12	Monthly - M1	2.3%		\$ 2,223.90	Jan	0.7%		\$ 2,173.90	Dec
02/16/12	- M2	1.3%		\$ 9,760.70	Jan	0.5%		\$ 9,640.20	Dec
02/17/12	Real Weekly Earnings	-0.1%		\$ 352.23	Jan	0.5%		\$ 352.58	Dec
02/17/12	Consumer Price Index	0.3%		227.5	Jan	0.0%		226.8	Dec
02/17/12	CPI less food and energy	0.2%		227.6	Jan	0.1%		227.1	Dec
02/17/12	Leading Indicators Index	0.4%		94.7	Jan	0.4%		94.3	Dec
02/24/12	New Single Family Sales	2.5%		0.315	Jan	-2.2%		0.307	Dec
02/28/12	Durable Goods - Shipments	-0.8%		\$ 205.82	Jan	2.2%		\$ 207.48	Dec
02/28/12	- Orders	-4.3%		\$ 205.09	Jan	3.0%		\$ 214.31	Dec
02/28/12	Nondefense Capital Orders	-6.1%		\$ 79.18	Jan	6.0%		\$ 84.32	Dec
02/29/12	GDP - Real (Q)	2.4%	a.r.	\$ 13,502.93	I	2.8%	a.r.	\$ 13,422.40	IV
02/29/12	Implicit Price Deflator (Q)	1.5%	a.r.	114.4	I	0.4%	a.r.	113.9	IV
02/29/12	Chain-Type Price Index (Q)	1.6%	a.r.	114.4	I	0.4%	a.r.	113.9	IV
02/29/12	After-Tax Corp. Profits (Q)	0.2%		\$ 1,504.50	IV	2.1%		\$ 1,501.50	III
02/29/12	After-Tax Oper. Profits (Q)	0.5%		\$ 1,567.50	IV	2.7%		\$ 1,559.70	III
02/29/12	Agricultural Prices	-0.6%		185.0	Feb	3.9%		186.0	Jan
03/01/12	Construction Spending	1.1%		\$ 825.36	Jan	1.5%		\$ 816.38	Dec
03/01/12	Personal Income	0.4%		\$ 13,158.02	Jan	0.5%		\$ 13,105.60	Dec
03/01/12	Personal Consumption	0.3%		\$ 10,893.08	Jan	0.0%		\$ 10,860.50	Dec
03/01/12	Core PCE y/y	1.9%			Jan	1.8%			Dec
03/05/12	Manufacturers' - Shipments	0.8%		\$ 463.07	Jan	0.7%		\$ 459.39	Dec
03/05/12	- Inventories	0.4%		\$ 612.52	Jan	0.1%		\$ 610.08	Dec
03/05/12	- Orders	-1.3%		\$ 460.16	Jan	1.1%		\$ 466.22	Dec
03/09/12	Payroll Employment	193		132,602	Feb	243		132,409	Jan
03/09/12	Civilian Unemployment Rate			8.3%	Feb			8.3%	Jan

changes denoted by bold type

all percent changes are from the previous period unless the next column shows a.r. which means the percentage change then is the annual rate

Payroll changes are in thousands, not percentages