



Groundhog Day: A Longer Winter for the Economy?

We regrettably have to start with bad news today: Punxsutawney Phil, the Pennsylvania groundhog, saw his shadow on February 2 when he emerged from his burrow. This means that we have six more weeks of winter in front of us—an unfortunate fact, unless you happen to be in the business of selling heating oil.

We mention this only because we see it as a useful allegory to the present state of the economy. There are several “groundhogs” out there who will determine over the next several months whether our economic winter will be bitterly cold or comparatively mild.

The first is the American consumer. As you are no doubt aware, consumers snapped their wallets shut in late 2008 and kept them closed tight until the end of 2009. But even now, wallets are cracked open just enough to let the occasional dollar slip out; consumers have certainly not returned to their pre-bust free-spending ways.

One of the reasons—and this brings us to our second groundhog—is that unemployment remains at generational highs. The official unemployment rate quoted by the U.S. Bureau of Labor Statistics is 10%. But this doesn’t tell the whole story. The Bureau has an alternative measure, U-6, that includes “total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons.” By this measure, unemployment is over 17%. If you include workers that are underemployed—i.e. working in full-time jobs below their skill level for lack of better alternatives—the number would no doubt be higher, though this is hard to quantify.

With more than 1 in 6 workers classified as unemployed or underemployed even by government estimates (which many private economists consider far too rosy), it’s difficult to see consumer spending mounting a sustained recovery.

The President knows this, which is why he has made job creation a top priority. But will Mr. Obama’s efforts be successful? Again, we unfortunately have to say no. The President has proposed a \$5,000 tax credit per new worker hired. But does it make sense to hire a \$50,000 employee in order to get a \$5,000 credit? Unless your business already has enough demand to justify a new hire, Mr. Obama’s plan is a money-losing proposition.

Meanwhile, the economy needs to create more than 125,000 jobs per month just to make room for the Echo Boomers currently leaving high school and college and joining the workforce. Bottom line: the unemployment rate should remain elevated for quite some time.

There is one final groundhog we’d like to mention: the American homeowner. Deutsche Bank estimates that 48% of Americans with mortgages will be “underwater” by 2011, meaning that their mortgage is larger than the value of the house. This raises the specter of a large, new wave of “strategic defaults” in which homeowners who can afford to continue paying their mortgages simply choose not to. Even if this wave does not happen—and we believe that it will—the fear that it *could* happen is significant enough to make banks worry. This is another factor that will likely lead banks to continue their tight lending policies.

So, with consumers who don't have the means or the desire to spend, workers who are unemployed or underemployed in high numbers, and a financial system that is still highly at risk due to the housing bust, it looks like economic winter is likely to continue. We think that Punxsutawney Phil will prove to be a good indicator.

Sincerely,

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