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# Economic Data Supports Stocks, Spooks Bonds

June's job report was 'just right' for the stock market, in our view, showing steady improvement in labor markets; but frightened bond investors caused yields to rise. While speculation continues about potential tapering of Federal Reserve asset purchases this year, we think higher rates will cool off economic growth slightly.

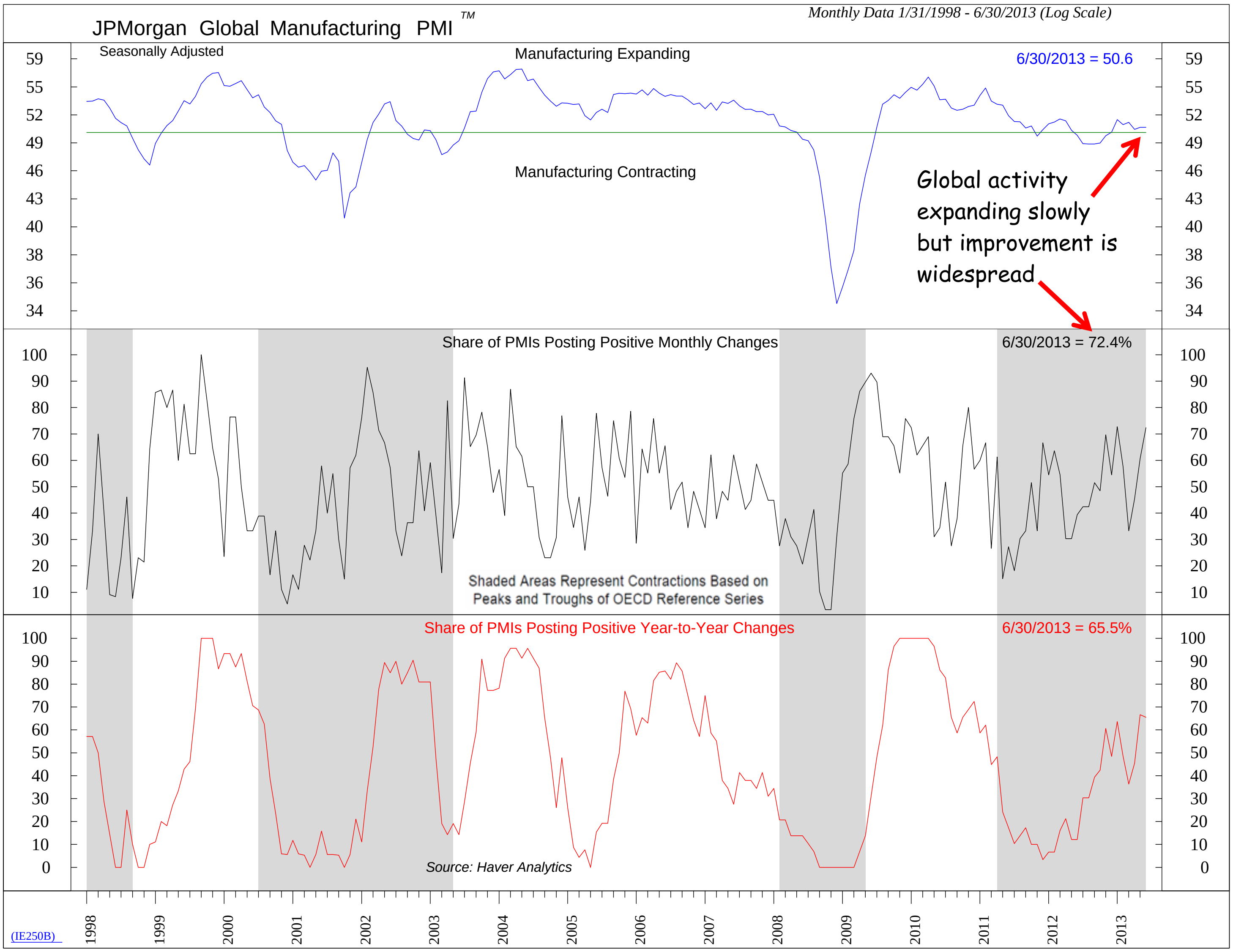
The Bureau of Labor Statistics reported 195,000 jobs were added to employer payrolls in June, ahead of expectations for a 165,000 gain; the prior two months were revised higher by 70,000, bringing three-month average job gains to just over 196,000. Moreover, aggregate payrolls (hours worked times hourly earnings) accelerated to 4.1% year-over-year growth, which suggests ongoing support for consumption and business expansion. Meanwhile, the unemployment rate remained unchanged at 7.6%, versus expectations for a tick down to 7.5%. We think this is good news because of Chairman Bernanke's hint that "when asset purchases ultimately come to an end, the unemployment rate would likely be in the vicinity of 7%." Thus, we think stocks will continue to rise if, as we expect, the Fed continues to expand its balance sheet in response to elevated unemployment, below-trend economic growth, and low inflation expectations.

Evidence of slow but steady growth was also reflected in June US purchasing manager indexes (PMIs) released last week. The manufacturing PMI rose 1.9 points back into expansion territory at 50.9 and the services PMI fell 1.5 points to 52.2. Historically, readings in the low 50s imply GDP growth of around 2%. Manufacturing PMIs internationally also indicate low growth. JP Morgan's Global Manufacturing PMI — which covers more than 10,000 purchasing executives in 32 countries — is at 50.6 (see Weekly Chart). The good news is that most of these countries are showing improvement: more than 70% had positive monthly changes in June (middle panel) and more than 65% are up year over year (bottom panel).

Sluggish growth is prompting more monetary accommodation internationally. While Japan is the most extreme example (the main reason we remain overweight there), monetary authorities in Europe and the UK are becoming more proactive. Last week the European Central Bank (ECB) and Bank of England (BOE) started providing 'forward guidance', which helped lower their bond yields and weaken the euro and pound. The ECB stated that it "expects the key ECB interest rates to remain at present or lower levels for an extended period of time," while the BOE said recent developments in the domestic economy do not warrant the market's expectations for higher policy rates. Until last week, both central banks had refrained from commenting on future interest rate policy. By credibly managing expectations and helping to raise market certainty, we think they can better support the economy and boost investor confidence. Indeed, we believe this process is mutually self-reinforcing.

In contrast with stocks — the S&P 500 was up 1.7% last week — bonds continued to sell off, with the Barclay's US Bond Aggregate down about 1% last week and the 10-year Treasury yield reaching a two-year high of 2.7%. We see yields capped around 3% this year. Rising rates are already dampening activity somewhat, mostly in refinancing and corporate bond issuance. We expect home sales and price growth to slow, but not stop, because affordability remains high and demand strong. Meanwhile, corporations remain flush with cash, which we think bodes well for future investment, hiring, stock buybacks, and/or dividend payouts.

## THE WEEKLY CHART: GLOBAL GROWTH SLOW BUT IMPROVING



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