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Look Behind the Numbers

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Each day we are inundated with facts and figures about what the economy is doing, much of it seemingly contradictory. Initial jobless claims are down but unemployment is up. Discretionary income is up but retail sales are down. It is tough to keep up with it all, and even tougher to determine which statistics to base investment decisions on.

Our recommendation is this: take these numbers with a grain of salt.

The reason is that final statistical numbers do not always tell the whole story. You have to understand what goes into them and how they are put together before you can analyze their results. You might be surprised to see how some of these numbers are calculated. For example:

1. Unemployment

In August of this year, the number of unemployed people rose by 216,000. While this is terrible for each of the families directly affected, it was heralded as good economic news. The number was not as high as previous months, and also not as bad as expected. However, when you look behind the number, the situation is seemingly much worse than reported.

It is standard practice for the Bureau of Labor Statistics to include in the reported figure an estimate of how many jobs were created by new companies and how many jobs were lost due to companies closing. This is known as the "birth-death ratio" and is based on a five-year historical average. The ratio is estimated, as it is not feasible to conduct polling on all of the small businesses in the country.

The problem is that this ratio will always overstate the number of jobs created when the economy is in a slowdown. The August numbers included 118,000 "new" jobs that were due to the birth-death ratio estimate. It is doubtful that there were enough new businesses started in August to generate this many new jobs. That means that the actual number of job losses was probably closer to 300,000 – 325,000, which is not nearly as positive of a sign.

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2. U.S. Personal Savings Rate

There have been many headlines bemoaning the fact that the U.S. personal savings rate is so low, especially compared to other countries. While the U.S. savings rate is now 6.9%, not so long ago it was even lower (-0.5% in 2006). Japan, for instance, has an average personal savings rate of 13%, which is more than double that of the U.S..

Here again, you must understand how the savings rate is calculated. The U.S. Commerce Department's Bureau of Economic Analysis (BEA) takes the aggregate Disposable Personal Income (wages, interest, transfer payments, etc.) and subtracts consumption expenditures. Whatever is left over is savings.

However, the BEA acknowledges that there are certain things that are not taken into consideration when determining the savings rate. For example, capital gains on stocks or real estate are not included. This explains why savings was so low in the late '90s (the internet bubble) and in the mid 2000s (real estate bubble).

Also, baby boomers are starting to retire. Most retirees have a low or even negative savings rate because they have stopped working and are now spending more than they make. As more and more people retire, the percentage of the population that is retired will increase and push down the savings rate by default.

3. Personal Income

A couple of months ago there was much to do over a BEA report that personal income was up in May. This was pointed to as evidence that the recession was over. Not so fast. The BEA defines personal income as "income received by persons from *all sources*" (my emphasis added). Take a look at some of the items that go into this calculation:

- Compensation
- Supplements to wages
- Personal Transfers (Gifts)
- Personal taxes (negative)
- Rental Income and Interest
- Government Transfers (Welfare)

Notice that two of these items, "Personal Taxes" and "Government Transfers," are directly controlled by the U.S. Government. If you remember back in April and May, the American Recovery and Reinvestment Act of 2009 had provided payments of $250 to people on social security. In addition, the Making Work Pay credit

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went into effect, reducing personal taxes by an annual rate of almost $50 Billion. The first was a one-time event, and the second will run out by April of next year. Neither of these had much of an impact on consumer spending, and no increase in customer spending means no improvement in the economy. There is a great article in the September 17th issue of the Wall Street Journal called "The Stimulus Didn't Work" that explains this in great detail.

What the economy is doing, and will do, has an enormous affect on the markets and your investments. When you listen to the people on cable or the radio, or read an article in the paper, they will use official sounding government numbers to solidify their case. Just keep in mind that there is context behind every statistic that may or may not actually support their case.

We have seen a nice run in the stock market over the last few months. We have also had many companies report better than expected earnings, which have led some in the media to declare that all is well with the economy. While there is proof that some areas of the economy are improving (i.e. home prices), now is the time to look behind the numbers. By understanding how the numbers are calculated, you will have a better idea if this is a true market recovery or simply a temporary rally.

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