

Weekly Commentary

July 11, 2011

The Markets

“This is a big bucket of very cold water.”

That was how Ian Shepherdson, chief U.S. economist at High Frequency Economics, described last week’s ugly U.S. employment report.

We know that one month does not make a trend. But, two months in a row, now that starts to raise an eyebrow. Last week’s employment report was stunningly weak, well below market expectations and the second month in a row that employment numbers were distressingly low, according to *The Wall Street Journal*. It’s hard to have sustained economic growth when employment growth is in the doldrums.

To put the employment situation in perspective, private payrolls, which account for about 70% of the work force, are still 6.7 million *below* where they were in late 2007 when the recession began, according to *The Wall Street Journal*. That hurts.

Paradoxically, even though employment growth has been decidedly weak, the U.S. stock market has performed remarkably well. According to a July 9 *Wall Street Journal* article, “Factoring in dividends, the Dow on Thursday (of last week) was only 0.1% below its all-time high, while the S&P 500 was off just 6% from its own highest level ever, according to Morningstar.” On top of that, the Dow Jones Transportation Average hit an all-time high last week, according to Reuters.

With unemployment high, economic growth weak, and the budget out of control, how can stocks hang in there? The short answer is corporate earnings. Companies have slashed expenses, cut staff, and become lean, mean earnings machines. CNBC says second quarter earnings are expected to be strong and, for the year, S&P 500 earnings could hit an all-time high.

At the end of the day, corporate earnings are what matters. This week marks the beginning of second quarter earnings reports and we’ll be watching them very carefully for signs of either growth or weakness.

Data as of 7/8/11	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	0.3%	6.9%	24.7%	1.8%	1.2%	1.1%
DJ Global ex US (Foreign Stocks)	-0.1	2.3	22.7	-0.4	1.5	5.9
10-year Treasury Note (Yield Only)	3.0	N/A	3.0	3.9	5.1	5.3
Gold (per ounce)	3.9	9.3	29.2	18.7	19.8	19.2
DJ-UBS Commodity Index	2.5	-1.0	27.3	-10.6	-1.7	4.6
DJ Equity All REIT TR Index	2.3	14.5	36.5	5.9	3.0	11.3

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does not include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron’s, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

SPECIAL REPORT ON CHINA

Is the “Age of America” about to end? Will China become the world’s largest economy? What does the rise of China mean for investors?

For much of recorded history, China was the world’s largest economy. Even into the early 1800s, it accounted for 30% of the world’s GDP, according to *The Economist*. But, like many empires before it, China spectacularly flamed out over the next century. By the mid-1970s, the disastrous reign of Mao Zedong was coming to an end and China was near rock bottom.

In 1978, new leader Deng Xiaoping laid out a vision of economic reform that has propelled China to unprecedented growth. Since then, China has been massively reshaping the world order as its growth and demand for resources affects everything from auto production, to corn prices, to funding the U.S. budget deficit. Earlier this year, China overtook Japan as the world’s second largest economy behind the U.S.

Given the importance of China in shaping world events, we thought it would be helpful to review some of the facets of China’s phenomenal rise and what that may mean for our clients like you. Today, in the first of a series, we’ll look at demographics.

DEMOGRAPHICS

Incredibly, China’s GDP has grown at an average annual rate of 9.3% since 1989, according to Trading Economics. Yet, for all its might, there are some glaring holes that might trip it up over the coming years -- with demographics being one of them.

You may be surprised to know that between 2000 and 2010, the U.S. population grew faster than China’s (9.7% in U.S. vs. 5.8% in China, according to *Financial Times*). For the past 20 years, China’s economic boom has been partly fueled by urbanization -- rural folks moving to the cities in search of higher paying jobs, plus a supposedly endless supply of cheap young workers. Turns out that supply may be coming to an end.

China has had a one-child policy since 1979 and it resulted in the “non-birth” of about 250 million babies, according to *Time Magazine*. As a result, China’s population is aging rapidly. Today, 12.5% of China’s population is over 60. By 2020, it will hit 20% and by 2030, it will hit 25%, according to *The Economist*.

Worse yet, the working age population will start to decline in about 2015, according to the United Nations. Fewer workers supporting a growing elderly population is not a recipe for economic growth.

Of course, China could reverse its one child policy and rev up population growth, but that would likely cause other problems such as food shortages or environmental issues.

As the demographic shift causes the labor market to tighten, wages have already started to rise, according to *The Economist*. That puts pressure on inflation and makes the country less competitive.

While it's easy to look at China's growth over the past 30 years and extend it for another 30, changing demographics are one of several hurdles that could put the brakes on growth. Next week, we'll look at the challenge of moving China's economy from one led by exports and investments to one led by consumption.

Weekly Focus – Think About It

“Do the difficult things while they are easy and do the great things while they are small. A journey of a thousand miles must begin with a single step.” --*Lao Tzu, Chinese Taoist Philosopher*

- * The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.
- * The DJ Global ex US is an unmanaged group of non-U.S. securities designed to reflect the performance of the global equity securities that have readily available prices.
- * Gold represents the London afternoon gold price fix as reported by the London Bullion Market Association.
- * The DJ Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
- * The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
- * The DJ Equity All REIT TR Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
- * The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.
- * The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
- * Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
- * Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
- * Consult your financial professional before making any investment decision.
- * You cannot invest directly in an index.

* Past performance does not guarantee future results.

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