First Trust
Monday Morning OUTLOOK
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Hasta La Vista, Soft Patch

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Back in May, before it became the conventional wisdom, we wrote that the US was in for another "soft patch" but the best course for investors was to ignore it (link to May 23 MMO).

At the time, we said the massive drop in production in Japan would cause business disruptions in the US, particularly in the manufacturing sector and for automakers more than anyone else. In addition, the wicked tornado season appeared to have postponed some home building. Our bottom-line was that these disruptions would be temporary. Any weakness in the second quarter, we thought, would be made up in the third and fourth quarters.

When we first mentioned a soft patch, the Dow Jones Industrials Average was 12,512. Within a few weeks, the DJIA fell below 11,900. At the same time, the pessimists came out of the woodwork. They said, "this soft patch is not temporary, in fact it is the beginning of a new down leg in economic activity – possibly a brand new recession."

Fear rose among many investors despite the fact that some key indicators of underlying economic strength were still expanding rapidly. We pointed this out in our June 13th Outlook. As others were getting more worried, we became even more confident the soft patch was temporary.

The debate appears to be over and we say "hasta la vista, soft patch." It's over. That doesn't mean there won't be any more tepid data over the next few months. Real GDP growth in Q2 is going to be weak – and the pessimists will moan and cry about it for months. But more timely reports have already turned for the better.

Japan's industrial output is snapping back from that country's disasters. And so is production in the US. After falling from a red-hot 61.4 in February to a still positive 53.5 in May, the ISM Manufacturing index rebounded to 55.3 in June – a level above every single forecast by the 77 economists who tried to predict this indicator (us included). No wonder the stock market surged more than 6% last week.

Other data have also rebounded. Shipments of "core" capital goods, which exclude defense and aircraft, were up 1.4% in May and up at a nearly 15% annual rate in the past three months.

In addition, housing starts increased 3.5% in May while building permits rose 8.2%. Permits are now 4.6% higher than a year ago. With the exception of late 2009 and early 2010, when that sector got a temporary boost from the homebuyer tax credit, this is the first time since early 2006 that permits have beaten year-ago levels.

The big report this week will be on employment for June, to be released early Friday morning. Private sector payrolls only expanded 83,000 in May. But, given the drop in unemployment claims, we think the job market re-accelerated in June.

It's no surprise to us that the Dow has now fully recovered back to where it was when the soft patch started to materialize. Despite the end of QE2, the economy is going to surprise the consensus to the upside. Monetary policy is loose, tax rates are relatively low, and the technological revolution continues. Stay long and stay positive, the soft patch is fading into the pessimistic abyss.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-5 / 9:00 am	Factory Orders - May	+1.0%	**+0.7%**	+0.8%	-0.8%
7-6 / 9:00 am	ISM Non-Man. - Jun	53.7	**53.2**		54.6
7-7 / 7:30 am	Initial Claims - Jul 2	420K	**420K**		428K
7-8 / 7:30 am	Non-Farm Payrolls - Jun	100K	**115K**		54K
7:30 am	Private Payrolls - Jun	125K	**135K**		83K
7:30 am	Manufacturing Payrolls - Jun	5K	**10K**		-5K
7:30 am	Unemployment Rate - Jun	9.1%	**9.0%**		9.1%
7:30 am	Average Hourly Earnings - Jun	+0.2%	**+0.2%**		0.3%
7:30 am	Average Weekly Hours - Jun	34.4	**34.4**		34.4
2:00 pm	Consumer Credit - May	+$4.0 Bil	**+$6.0 Bil**		+$6.2 Bil