"On The Money Report"

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The 10 Most Important Indicators to Watch and Why

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Need a fast update on the economy? This handy reference outlines the 10 most common and important indicators, how they are generated, and why they matter—with direct links to the sponsoring agency.

Economic reports and indicators are those often-voluminous statistics put out by government agencies, nonprofit organizations, and even private companies. They provide measurements for evaluating the health of our economy, the latest business cycles, and how consumers are spending and generally faring. Separately and collectively, they provide a report card on how we're all doing, how we did in the past, and a projection about how we'll fare in the future.

Various economic indicators are released daily, weekly, monthly, and/or quarterly.

But knowing when and why economic reports are available is only part of the equation. It's equally imperative to understand what each one means to financial analysts, economists, and strategists.

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Remember that data can change rapidly and that broad trends shouldn't be judged by one isolated economic data point.

"Any economist will tell you that one month of data does not make a trend," says Jane Caron, CFA, senior vice president, portfolio management and economist with Dwight Asset Management of Burlington, Vt. "You have to be careful how much you read into a single data item for a single period."

Just click on the title of each of these 10 vital economic indicators to review what each one measures, how it is generated, when it is published, and why it's important. You will also find a direct link to the government agency or organization that publishes the data.

10 vital economic indicators

1. **Real GDP (Gross Domestic Product)**
2. **M2 (Money Supply)**
3. **Consumer Price Index (CPI)**
4. **Producer Price Index (PPI)**
5. **The Consumer Confidence Survey**
6. **Current Employment Statistics (CES)**
7. **Retail Trade Sales and Food Services Sales**
8. **Housing Starts (formally known as "New Residential Construction")**
9. **Manufacturing and Trade Inventories and Sales**

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10. **S&P 500 Stock Index (a.k.a. the S&P 500)**

1. Real GDP (Gross Domestic Product)

What is it?

The Real GDP is the market value of all goods and services produced in a nation during a specific time period. Real GDP measures a society's wealth by indicating how fast profits may grow and the expected return on capital. It is labeled "real" because each year's data are adjusted to account for changes in year-to-year prices. Real GDP is a comprehensive way to gauge the health and well-being of an economy. Nearly two-thirds of our GDP is driven by individuals' consumption, not by business investment or government spending.

When are data released?

Quarterly data, including any revisions, are released within the last week to 10 days of each month following the end of the quarter. Data are spelled out as being "advance estimates," "preliminary estimates," and "final" numbers. Each data release includes an explanation of why the GDP increased or decreased from the previous quarter. Quarterly data are also annualized.

Why is it important?

The Federal Reserve uses data such as the Real GDP and other related economic indicators to adjust its monetary policy and determine what actions are

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necessary to ensure the health and welfare of the U.S. economy.

Source: U.S. Department of Commerce, Bureau of Economic Analysis

2. M2 (Money Supply)

What is it?

M2 money supply represents the aggregate total of all money a country has in circulation. It takes into account all physical currency such as bills and coins; demand deposit savings and checking accounts; traveler's checks; assets in retail money market accounts and small money market mutual funds (i.e., less than $100,000); individual time deposits and savings deposits such as certificates of deposits; and some repurchase agreements and Eurodollar holdings.

It does not include institutional money fund assets, large denominated (more than $100,000) time deposits, or any special reserves banks are required to maintain.

The money supply is actually measured in three separate units: M1, M2, and M3, which are technically referred to as "Money Stock Measures." Each of these measurements is increasingly inclusive. For example, M1, which includes the fewest components, measures only the most liquid form of currency and some deposits. Conversely, M3 includes all components of M2 plus institutional money fund assets and deposits in large certificates of deposit, (i.e., more than

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$100,000) as well as repurchase agreements and certain liabilities of banks.

When are data released?

Both weekly (on Thursdays) and monthly, during either the second or third week of the month. Monthly data go back to January 1959. Weekly information has been available since January 1975.

Why is it important?

The Federal Reserve uses this data to assess current economic and financial conditions. Economists and others also sometimes use it to predict cyclical economic recessions and recoveries and expected changes in stock prices, not to mention expected changes in the Fed's monetary policy.

The data are used, and closely tracked by analysts, to help the Fed alter its monetary policy, which includes raising or lowering interest rates. The Fed's actions are aimed at bolstering or reducing the money supply.

Some economists look to the six-month growth rate for indications of future economic activity. "If the M2 supply shows a sharp acceleration or deceleration, it can have profound economic and stock market implications," said Clare Zempel, CFA, managing director and director of investment policy, chief investment strategist, and chief economist at Robert W. Baird & Co. in Milwaukee. "Last fall, the six-month M2 growth rate accelerated dramatically, indicating that the Fed was being effective in providing liquidity. That should

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have boosted stock prices, and it did. The sharp decline in M2 money growth from January to April reinforced the stock market's decline in reaction to earnings concerns. The re-acceleration in M2 growth since April should help sustain the economic expansion and support the stock market as summer ends and fall begins."

Some economists believe that M2's relevancy has waned over the past 20 years. For many years this monetary measurement had closely paralleled the growth or contraction of the U.S. economy and overall changes in prices. But over the past two decades, a bevy of changes, such as the introduction of new depository products, the movement of consumer funds from bank deposits to investment accounts, and the internationalization of the economy, has caused the money supply data to fall out of sync with other economic indicators.

Nevertheless, the Fed and some economists and analysts pay attention to the longer-term trends in growth or reduction of the money supply. And the Fed retains its power to increase the money supply by lowering interest rates as a way to counter a sluggish economy and to reduce the money supply by raising interest rates if the economy gets overheated.

Source: Board of Governors of the Federal Reserve System

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3. Consumer Price Index (CPI)

What is it?

The CPI measures changes in the prices paid for goods and services by urban consumers for the specified month. The CPI is essentially a measure of individuals' cost-of-living changes and provides a gauge of the inflation rate related to purchasing those goods and services.

The CPI does not include every item an individual may buy, but instead takes a sampling of several hundred goods and services across 200 item categories. Data are collected through phone calls and personal visits in 87 urban areas across the country.

CPI components are:

- Food and beverages (including food prepared at home and eaten away from home and alcoholic beverages)
- Housing costs (rent, etc.)
- Apparel and clothing
- Transportation (including car insurance, airline fares)
- Education (including college tuition, computer software)
- Medical care (including doctors, dentists, prescriptions, eyeglasses)
- Utilities (fuel and energy used)

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- Recreation (including cable TV, pet products, sports equipment)
- Other (which includes personal services such as haircuts)

CPI does not include income, Social Security taxes, or investments in stocks, bonds, or life insurance. But it does include all sales taxes associated with the purchases of those goods and services.

When are data released?

National CPI, which is an average of all areas sampled, is released monthly, during the second or third week after the end of the measured month. CPIs for three specific metropolitan areas are also published monthly, while CPIs for other specific metropolitan regions are published every other month. Data releases include details about very specific products; e.g., cereal and milk experienced significant price changes.

Why is it important?

"This statistic is the best indicator of inflation that we have to rely on," said Mary Kathryn Campion, CFA, an independent portfolio manager, investment strategist, and economist. "Especially now, financial economists watch this indicator of inflation, as it shows inflation to be at a 16-year low." Changes in inflation can spur the Fed to take action to change its monetary policy.

Source: U.S. Department of Labor, Bureau of Labor Statistics

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4. Producer Price Index (PPI)

What is it?

The PPI is a group of indexes that measure the changes in the selling price of goods and services received by U.S. producers over a period of time. Think of it as the business-side equivalent to the CPI that measures changes in prices paid by consumers: the PPI captures price movements at the wholesale level, before price changes have bubbled up to the retail level.

The PPI tracks price changes in virtually all goods-producing sectors, including agriculture, forestry, fisheries, mining, and manufacturing. The PPI also tracks price changes for a growing portion of the non-goods-producing sectors of the economy as new PPIs are introduced. Prices from 25,000 establishments are tracked monthly.

This report measures prices for goods at three stages of production: finished goods, intermediate goods, and crude goods.

This was called the Wholesale Price Index from 1902 until 1978.

When are data released?

Monthly, during the second full week of the month following the reporting month.

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Why is it important?

"This index is timely in that it is the first inflation measure available in the month," said Caron of Dwight Asset Management. "The index for finished goods is what gets the most attention, but the other measures also provide useful information." Changes in crude prices translate into changes in intermediate goods, which translate into eventual changes in finished goods. By watching crude prices, which are first in the chain of production trends, one can sometimes spot "inflation in the pipeline," Caron said.

There has also been a strong correlation between movements in crude prices and corporate earnings, according to Caron. As crude prices increase, corporate profits rise; conversely, as those prices decrease, corporate earnings fall.

Source: U.S. Department of Labor, Bureau of Labor Statistics

5. The Consumer Confidence Survey

What is it?

A gauge of the public's confidence about the health of the U.S. economy that reflects the public's optimism or pessimism and the nation's mood.

Five questions are asked of a random sampling of 5,000 individuals, of whom about 3,500 respond. The survey asks their thoughts and feelings about business conditions, the labor market, consumer spending and economic growth, and their

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financial and employment expectations six months into the future. Survey participants select from three categories of response: positive, negative, and neutral.

When are data released?

Monthly, the last Tuesday of each month.

Why is it important?

"This statistic is especially important during times of political and economic crises," Campion said. "It remains an excellent leading (predictive) indicator of consumer spending. Consumers are more inclined to spend when they feel confident about their financial and employment prospects."

Source: The Conference Board, Consumer Research Center

6. Current Employment Statistics (CES)

What is it?

CES provides comprehensive data on national employment, unemployment and wages, and earnings data across all non-agriculture industries, including all civilian government workers. Information is disseminated in many different ways, e.g., employment/unemployment rates among men and women, varied ethnic

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groups, and teens.

Employment data are based on a survey of 300,000 establishments across 600 industries, which account for approximately one-third of all payroll employees. Industries include retail trade, manufacturing, and construction. CES provides details on numbers of hours worked and earnings of all surveyed across the nation.

"Employed" are defined as all full- and part-time workers and temporary and intermittent employees who received pay for the cited period. It includes those on paid vacation or sick leave, and it excludes business proprietors, the self-employed, unpaid family members, and volunteers.

Unemployment data includes duration of employment and reason for unemployment.

When are data released?

Monthly, usually on the first Friday following the reference month, but always within first 10 days after month-end.

Why is it important?

This is the earliest indicator of economic trends released each month. Employment rates indicate the well-being of the economy and labor force. Changes in wages point to earnings trends and related labor costs. Economists

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focus on the monthly change in total non-farm payrolls and the sectors in which jobs were gained or lost.

"The employment rate statistic is considered the best concurrent indicator of the level of business activity and is watched carefully by financial economists," Campion said.

"Something I am keeping a close eye on now is the change in temporary workers," Caron said. "An increase in this category typically indicates that the labor market is strengthening, since firms will hire temporary help previous to permanent help."

Interesting trends can also be derived from the payroll data, such as the average number of hours per week worked and the average hourly earnings, Caron added.

"This data gives an indication about how tight the labor market is," she said. Tight labor markets can translate into wages being forced higher (something called "wage inflation"). And longer workweeks, which we have been seeing recently, can point to personal income growth, Caron noted.

Source: U.S. Department of Labor, Bureau of Labor Statistics

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7. Retail Trade Sales and Food Services Sales

What is it?

The index tracks monthly U.S. retail and food service sales, and details changes from previous periods. It identifies in which sectors sales increased and/or decreased.

The data are derived from a random sampling of 5,000 retail and food service firms. Figures are broken out to both include and exclude sales of automobiles. Sales are weighted and benchmarked to represent the nation's three million retail and food services firms.

When are data released?

Monthly, during the second week of each month.

Why is it important?

The numbers measure consumers' personal consumption across retail industries, and track growth or deceleration of personal consumption spending. Personal consumption makes up approximately two-thirds of the annual U.S. GDP.

The index provides a picture of consumers' behavior, and analysts and strategists use it to help track consumer spending trends and forecast the direction and

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magnitude of future spending.

According to Campion, automobile sales are separated from the data because of their volatility, which can sometimes obscure the underlying pattern of spending.

Source: U.S. Department of Commerce, U.S. Census Bureau

8. Housing Starts (formally known as "New Residential Construction")

What is it?

Housing starts represent the approximate number of housing units on which some construction was performed during the month. Data are provided for single-family homes and multiple-unit buildings, e.g., those with five or more units. Data indicate how many homes were issued building permits, how many housing construction projects were initiated, and how many home construction projects were completed.

When are data released?

Monthly, within two to three weeks after end of the reporting month.

Why is it important?

Housing starts are highly sensitive to changes in mortgage rates, which are

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affected by changes in interest rates. Although this indicator is highly volatile, it represents about 4% of annual GDP, and can signal changes in the economy and the effects of financial conditions.

Analysts and economists know to watch for longer-term trends in housing starts. The U.S. Census Bureau notes that it may take four months to establish a trend in building permits volume, five months for a trend to emerge in new housing construction numbers, and six months to develop a trend based on figures for housing construction project completions.

Source: U.S. Department of Commerce, U.S. Census Bureau

9. Manufacturing and Trade Inventories and Sales

What is it?

This index combines the value of trade sales and shipments by manufacturers in a specific month, as well as the combined values of inventories in the wholesale and retail business sectors and manufacturing.

The current and most recent past month's inventory/sales ratios are also provided. Information is provided across 17,000 manufacturing, retail, and wholesale companies within 160 industries.

Interestingly, recent data (May) report that because so many semiconductor companies refused to supply sales and inventory numbers, that industry was

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omitted from the current statistics report.

When are data released?

Monthly, approximately six weeks after the end of the subject month.

Why is it important?

The data are the primary information about the state of business inventories and business sales. Inventory rates often provide clues about the growth or contraction of the economy. A growth in business inventories may mean sales are slow and the economy's rate of growth is also slowing. If sales are slowing, businesses may be forced to cut production of goods, and that can eventually translate into inventory reductions.

Source: U.S. Department of Commerce, U.S. Census Bureau

10. S&P 500 Stock Index (a.k.a. the S&P 500)

What is it?

The Standard & Poor's 500 is a market value–weighted index of 500 public stocks that are combined into one equity basket. This basket of stocks has become the industry standard and benchmark for the overall performance of the U.S. equity market.

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The S&P Index Committee chooses the indexed stocks based on market size, liquidity, and industry group representation. Component companies are periodically replaced. Companies are most often removed because of a merger with another company, financial operating failure or restructuring. The Committee considers companies for inclusion in the index based on quantitative screening and fundamental analysis. Prospective companies are placed in an index "replacement pool" and vacancies are filled from that pool.

When are data released?

Real-time information is available daily from financial news organizations and publications, as well as Standard & Poor's.

Why is it important?

The index is designed to measure changes in the stock prices of component companies. It is used as a measure of the nation's stock of capital, as well as a gauge of future business and consumer confidence levels. Growth of the S&P 500 can translate into growth of business investment. It can also be a clue to higher future consumer spending. A declining index can signal a tightening of belts for both businesses and consumers.

Economists tend to look for long-term trends rather than short-term fluctuations in the S&P 500. The S&P 500's 10-year total return, for example, has become a common indicator of longer-term trends.

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Source: Standard & Poor's is solely responsible for compilation of the S&P 500.

Web Sources

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The Association for Investment Management and Research AIMR(www.aimr.com) is a global, nonprofit professional organization that administers the Chartered Financial Analyst (CFA) curriculum and examination.

Source: Horsesmouth.com

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