

Business Transaction Marketplace

Information about Business Valuations, M&A and Corporate Finance September 2010

Economic Indicators

In the June 2010 Issue of *Business Transaction Marketplace*SM, we discussed prospective financial statements (PFS) and how no one can predict the future with absolute accuracy. Users therefore gauge the reliability of PFS by the quality of the underlying assumptions. External events – like current and anticipated economic conditions – must be understood and incorporated into PFS in support of assumptions.



In this issue of *Business Transaction Marketplace*SM, we'll summarize the three categories economic indicators. The newly enacted *Small Business Jobs Act of 2010* will also be discussed since it too is an external measure taken by the U.S. Government to stimulate economic activity for small businesses.

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Three Categories of Economic Indicators

The Composite of *leading*, *coincident* and *lagging* indices were created by the Conference Board to be used to forecast changes in the direction of the overall economy of a country. They can be used to confirm or predict the peaks and troughs of a business cycle, and are published for the U.S., Mexico, France, the U.K., South Korea, Japan, Germany, Australia and Spain.

Leading Indicators

This index is used to predict the direction of the U.S. economy's movements in the months to come. The index is made up of ten economic components, whose changes tend to *precede* changes in the overall U.S. economy. The ten components include:

- The average weekly hours worked by manufacturing workers
- The average number of initial applications for unemployment insurance
- The amount of manufacturers' new orders for consumer goods and materials
- The speed of delivery of new merchandise to vendors from suppliers
- The amount of new orders for capital goods unrelated to defense
- The amount of new building permits for residential buildings
- The S&P 500 stock index
- The inflation-adjusted monetary supply (M2)
- The spread between long and short interest rates
- Consumer sentiment

The Conference Board Leading Economic Index[®] (LEI) for the U.S. increased 0.3 percent in August 2010 to 110.2 (2004 = 100), following a 0.1 percent increase in July 2010, and a 0.2 percent decline in June 2010.

Coincident Indicators

This Index measures current U.S. economic conditions which helps economists and investors determine which phase of the business cycle the U.S. economy is *currently* experiencing. The Composite Index of Coincident Indicators comprises four cyclical economic data sets:

- The number of employees on non-agricultural payrolls (released by the Bureau of Labor Statistics)
- The Index of Industrial Production
- The level of manufacturing and trade sales
- The aggregate amount of personal income excluding transfer payments

Coincident Indicators (cont)

The Conference Board Coincident Economic Index® (CEI) for the U.S. was unchanged in August 2010, remaining at 101.3 (2004 = 100), following a 0.1 percent increase in July 2010, and no change in June 2010.

Lagging Indicators

This index is used to confirm the direction of the U.S. economy's movements in past months. The index is made up of the following seven economic components, whose changes tend to come *after* changes in the overall economy:

- The value of outstanding commercial and industrial loans
- The change in the Consumer Price Index for services from the previous month
- The change in labor cost per unit of labor output
- The ratio of manufacturing and trade inventories to sales made
- The ratio of consumer credit outstanding to personal income
- The average prime rate charged by banks
- The inverted average length of employment

The Conference Board Lagging Economic Index® (LAG) increased 0.2 percent in August 2010 to 108.1 (2004 = 100), following a 0.4 percent increase in July 2010, and a 0.1 percent increase in June 2010.

What the Experts are Saying About the Economy (September 23, 2010)

"While the recession officially ended in June 2009, the recent pace of growth has been disappointingly slow, fueling concern that the economic recovery could fade and the U.S. could slide back into recession. However, latest data from the U.S. LEI suggest little change in economic conditions over the next few months. Expect more of the same – a weak economy with little forward momentum through 2010 and early 2011." (Comment by Ken Goldstein, economist at The Conference Board)



"The U.S. LEI, which began rising three months before the end of the recession, remains on a general upward trend. However, the pace has been slowing. Correspondingly, current economic conditions, as measured by The Conference Board CEI, have been essentially flat since May, after reaching a bottom in June 2009. Taken together, the composite indexes are consistent with a slowly expanding economy in the near term." (Comment by Ataman Ozyildirim, economist at The Conference Board)

Here's what the *Street* is saying: **"Flat is the new up!"**

Small Business Jobs Act



The recently passed Small Business Jobs Act of 2010 expands loan programs through the Small Business Administration (SBA), strengthens small business preference programs for federal government projects, provides incentives for exporters, offers a variety of small business tax breaks and includes some revenue raisers. Here are two features of this new Bill:

- **Increases SBA Loan Limits.** The bill raises total SBA 7(a) gross loan amount from \$2 million (75% SBA guaranteed) to \$5 million (90% SBA guaranteed). The increased government guarantees and outstanding loan commitments are effective until January 1, 2011, when the percentage guarantees will revert to the original percentages and the total outstanding loan commitment will be reduced to \$3.75 million.
- **Tax Relief.** Increases the \$179 expensing to \$500,000 and extends the 50% bonus depreciation. Beginning in 2011, the holding period to avoid S Corp build-in gains is reduced to five years.

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