

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

Distributed to our clients and friends weekly

<http://www.beaconinvest.com>

Toll Free 888-621-5885

Friday, November 14, 2008

Shock and Awe

It comes as absolutely no surprise that the massive bankruptcies and bailouts of September and October were enough to freeze both consumers and businesses in their tracks. The government numbers for the next couple of weeks are nothing more than a post mortem exercise to confirm the obvious. However, as we move forward a couple of weeks to get beyond the period of absolute shock, the reports will begin to provide clues about the possible breadth and depth of this recession.

US Retail sales for the month of October dropped 2.8%, the most since recordkeeping began in 1992, according to the Commerce Department today. Purchases excluding automobiles also posted their worst performance. Sales have now fallen for four months in a row, again a first since records began in 1992. Excluding automobiles, purchases decreased 2.2%, almost twice as much as the 1.2% decline anticipated. Sales at 10 of 13 merchant categories dropped last month indicating the degree of shock.

Consumer Confidence for November unexpectedly rose to 57.9 from 57.6 in October, but still remains near a 28-year low. The measure averaged 85.6 in 2007. Needless to say, retailers are bracing for the worst holiday shopping season since the last recession in 2001.

Europe's economy is now officially in recession. Gross domestic product in the 15 euro nations shrank 0.2% from the previous three months, when it also contracted 0.2%, according to the European Union's Luxembourg-based statistics office. This marks the first recession since the euro single currency was introduced almost a decade ago.

The Group of 20 heads of state (who represent almost 90% of the world economy) are all in Washington for a meeting at the White House called by President George W. Bush to try to forge some global cooperation in remedies. Given President Bush's short remaining tenure, any shift toward substantive measures will likely not come until after President-elect Barack Obama takes office. Apparently, most agree on continued use of liberal government spending on economic stimulus. Further rate cuts and additional credit measures are definitely coming.

Earlier this week China announced a \$586 billion stimulus package. The government is also unwinding measures taken just a few months ago to prevent the world's fourth largest economy from overheating. Growth has slowed to 9%, the slowest in five years. Japan, the world's second largest economy is likely in recession

Brazil, Russia, India and China, the so-called BRIC nations, met in Sao Paulo last weekend to coordinate measures to offset the effects of the crisis. The intention was to coordinate their interests in preparation for the Group of 20 Summit this weekend in Washington. As the world's largest economies are projected to shrink .3% next year, the BRIC countries are likely to continue their expansion.

Recessions are the unfortunate consequence of economic excesses, such as inflation, price bubbles, and 'irrational exuberance' (a phrase used by Alan Greenspan in a December 1996 speech). Mr. Greenspan asked the question then, "But how do we know when **irrational exuberance** has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade? Mr. Greenspan we paid little attention to irrational exuberance in technology stocks in 1999 and in housing prices and mortgage securities in 2007. Let's pray that Japan's decade long deflationary cycle is not in our future.

Wikipedia defines 'shock and awe' as follows: "technically known as *rapid dominance*, a military doctrine based on the use of overwhelming power, dominant battlefield awareness, dominant maneuvers, and spectacular displays of force to paralyze an adversary's perception of the battlefield and destroy its will to fight."

The global economy has been paralyzed by fear and uncertainty caused by an unprecedented failure of a large core of the financial system. It will take time to restore confidence and it is likely that significant infrastructure will be re-regulated, remodeled and rebuilt. There are few examples in world history when so much cooperation and energy have been focused in the same direction. There is great hope in just that alone. We are watching every economic report for signs of success against our common foe. In time, we shall prevail.