Beacon Investment Management
The Friday Brief
Distributed to our clients and friends weekly
http://www.beaconinvest.com
Toll Free 888-621-5885
Friday, December 12, 2008

Market Resilience

The stock market is showing remarkable strength since its recent bottom November 20th. Since then it is up 15.2% and has made two higher highs and one higher low. Gains continue to hold despite considerable economic concerns and others.

Last night the Senate failed to pass what was sold as a bipartisan bill to save the auto industry. It had been hammered out by the Administration and by the House. Just when it looked as though Wall Street surprises were ebbing, FBI agents arrested Bernard Madoff, the former chairman of the board of directors at the Nasdaq Stock Market. He allegedly confessed that he defrauded investors of $50 billion by running Bernard L. Madoff Investment Securities LLC like a “giant Ponzi scheme” and “paid investors with money that wasn’t there,” according to Bloomberg.

Sales at US retailers dropped 1.8% in November, smaller than forecast, but extended the longest string of declines (five months) since records began in 1992, according to the Department of Commerce. Increases in electronics of 2.8% and department stores of 2.1%, spurred by big discounts, were not enough to offset stalled auto sales and a record 15% drop at service stations as fuel costs plummeted. While the bounce in spending at department stores, the highest in three years is very encouraging, it will likely not hold up in the face of rising unemployment and falling home prices.

Falling gasoline prices not only freed up money for consumers to spend, they also resulted in a larger drop in prices paid to US producers than was predicted by economists. The 2.2% decrease in the producer price index follows a record 2.8% drop in October. The measure that excludes fuel and food gained 0.1%, and follows a rise of 0.4% in October.

GM has said that it will be out of cash for monthly bills by the end of the year if it didn’t receive government money. The next possibility for rescue is in the hands of President Bush who can authorize the use a portion of the $700 billion bank rescue funds (TARP). That he will likely do so explains some of the market’s resilience in the face of otherwise dire news.

On Thursday the Labor Department reported that initial applications for jobless benefits in the week ending Dec. 6th rose to a seasonally adjusted 573,000 from an upwardly revised figure of 515,000 in the previous week. That was far more than the 525,000 claims Wall Street economists expected. The four-week average, which smoothes fluctuations, was a seasonally-adjusted 540,500, the highest since December 1982, when the economy was emerging from a steep recession. The government also announced separately that the US trade deficit rose unexpectedly in October. US exports were the last remaining stronghold in the economy.

Looking to 2009, economists expect household spending to drop 1% which would mark the largest drop since the attack on Pearl Harbor in 1942. It appears doubtful that the US consumer alone will pull us from this slump as in previous slowdowns. Personal balance sheets are wrecked by falling stock and house prices and confidence is short as unemployment rises and pay increases stall.

This is indeed a serious recession which will likely break the two 16-month records set in March 1975 and November 1982. We have officially been in this one for nearly 12 months now. Economists are predicting the longest slide since quarterly records began in 1947. They expect the spending slump to continue into the first half of 2009 and expect the unemployment rate to rise to 8.2%. That would mark a 25-year high.

Remedies continue to be announced. A huge new stimulus package is coming early next year with Mr. Obama's new Administration. What we know so far is that it will be the largest public works spending package since 1950 when President Eisenhower commissioned the construction of the nation's interstate system. We also look for the Fed to cut rates next week and to continue to find ways to stimulate credit. Critical keys to economic recovery are re-opening credit lines, putting a floor under home values, stemming the rising tide of job losses, and restoring general confidence in the economy.

All of these things can be done, but they will clearly take time. Mr. Obama has put together a formidable economic team and he is an energizing speaker. We are betting that all of the pieces will fall into place, but not without some time and further pain. If economists are right, we are in for a 20-24 month recession, well short of the Great Depression, but considerably longer than typical post-WWII recessions. We are up to the challenge and will be better for it on the other side.

Have a good weekend.