

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

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Great Expectations

High hopes for a fresh new year, a new Administration, and a massive new stimulus plan gave the markets new life for a few weeks. We wonder though whether investors' expectations will withstand the continuing drone of bad economic reports, surely to come for the next several months? The early read suggests yes, expectations for recovery late this year are holding.

Today's stock market is handling the news of December's dismal 524,000 job terminations relatively well. We lost more jobs in 2008 than in any year since the end of WWII in 1945. The unemployment rate climbed more than economists forecast, to 7.2% in December, the highest level in almost 16 years. Perhaps investors are betting that the size of the job losses will urge Congress to act quickly and generously on Obama's stimulus plan. Regardless though, significant economic reverberations will follow this news. The consumer will likely further entrench by cutting spending and borrowing while saving more.

The Federal Reserve reported that in November consumer borrowing dropped by a record \$7.9 billion. The debt slump brought consumer credit down to \$2.57 trillion, and capped the first back-to-back monthly decline since 1992, according to the Fed.

Some consumers aren't borrowing because they are scared of losing their jobs, others cannot get the credit they need for cars or housing. Bloomberg reports that analysts say the economy may be in danger of a reinforcing cycle of rising unemployment and declining household spending, what policy makers call a negative feedback loop, which is difficult to snap once it's begun. Lenders are not lending because of falling house prices and rising unemployment numbers and because they cannot sell their loans as securitized assets as they did before the credit crisis. Fed policy makers are creating a new \$200 billion lending program to provide liquidity to lenders willing to lend.

Obama is pulling out all the stops to get his stimulus package passed quickly. He said yesterday that "if nothing is done, this recession could linger for years." The new Administration is reported to be adapting tactics used during their campaign to sell their policy, such as using data from polls and focus groups to shape the debate over the stimulus plan. David Axelrod, Obama's chief political adviser, along with campaign media adviser Jim Margolis, are encouraging lawmakers to use the word "recovery" instead of "recession" and "investment" instead of "infrastructure."

Those recommendations came from focus-group research indicating that such framing would make the package more appealing to voters. Perhaps even an Administration-friendly media will adopt the 'kinder and gentler' more upbeat economic language being requested of Congress. The linguistic approach is wise and certainly cannot hurt

The Fed, doing about all it can on the interest rate front is now down to taking unorthodox steps such as quantitative easing to boost the supply of credit in the economy. There's also the second half of the \$700 billion TARP fund. House Financial Services Committee Chairman Barney Frank favors using some funds to stem mortgage foreclosures, aid issuers of municipal bonds and help homebuyers, but it might also be used to buy mortgages to stimulate home lending.

Our tactical leanings in recent weeks have been towards corporate bonds on the fixed income side and emerging markets on the equity side. Recently we have increased our exposure to oil and natural gas due to bargain pricing in these commodities.

Corporate bond sales soared to \$41 billion this week, the most in almost eight months according to Bloomberg. Companies are taking advantage of investor demand to raise cash and to get a better return on their money than they can get from Treasuries. We also took advantage of the unprecedented low yields on Treasuries in late December to lock-in the large gains on our intermediate and long-term Treasuries. The proceeds were added to our Corporate Bond holdings.

We like emerging markets because we believe that their economies will do better than their stock market prices indicate. Commodities, which represent large components of their exports will not dry up and they will *recover* at some point. Further, as nations *invest* in their infrastructure, demand for commodities will increase. Finally, according to the IMF, the majorities of emerging market exports are actually between themselves.

Lastly, today's purchase of the US Oil & Gas Exploration & Production Index fund is a bet that energy prices are near their lows and that the sector represents a low risk-way to *invest* in eventual *recovery*. But recovery or not, the US is a huge user of natural gas and supplies are dwindling; prices will rise.

That's it for now. We hope you have a nice weekend.