

# BEACON INVESTMENT MANAGEMENT

## THE FRIDAY BRIEF

*Distributed to our clients and friends weekly*

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Friday, April 24, 2009

### The Worst May Be Behind

After six weeks of market gains, we stalled at the beginning of this one. Leading economic indicators released on Monday indicated no clear signals of improvement which promptly sent the S&P 500 down 4.3%. It appeared that investors had lost their willingness to look beyond the bad news toward the possibility of economic recovery. But optimism returned on Tuesday with a significant rally on comments from Treasury Secretary Mr. Geithner that most banks were sufficiently capitalized. Market strength continued throughout the week as one earnings or economic report followed another with enough positive insight to stoke the bulls. State Street's institutional investor confidence index jumped 10 points in April to 79.6. The report, which analyzes trading volumes, said monthly flows into U.S. stocks are in the 98th percentile.

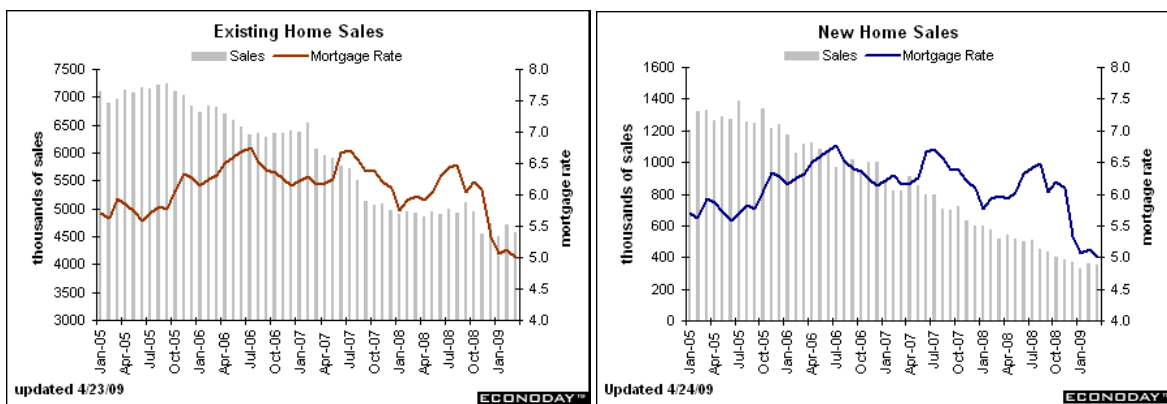
Monday's release of leading indicators, down .3% looked as though it would set a negative tone as its components showed wide declines in building permits, factory workweek, and jobless claims. A significant contributor to the March report was the 20% drop in the stock market during the month of February. Next month's leading indicator report will be just as significantly impacted on the positive side by March's 20% stock market rally. Also improving in March are both the interest rate spread between government debt and corporate debt and the money supply, which show that monetary intervention to stimulate economic activity are working.

Following Monday's market rout, Mr. Geithner's comments that most banks were in good shape created a surge of stock buying. He said that "currently, the vast majority of banks have more capital than they need to be considered well capitalized by their regulators." He also reduced worry about those banks failing the stress tests and needing additional capital by assuring investors that there will be a "series of options" for them. Finally, he suggested that there are signs of "thawing" in credit markets and some indication that confidence is beginning to return. Earnings reports from banks this week and last seem to confirm his assertions.

Sales of existing homes, reported on Wednesday, showed that the decline in housing may be coming to an end. The report from the National Association of Realtors showed purchases fell more than forecast to an annual rate of 4.57 million, but importantly the level of sales is hovering near the level it reached in November as shown in the left-hand graph next page.

Today's release of new home sales was even better, slipping only .6% in March to a higher-than-expected annual unit sales rate of 356,000, shown next page in the right-hand graph. Data for February and January were both revised higher by a total of 30,000. The biggest recovery is in the West adding to indications that the center of weakness is strengthening. Total supply on the market eased to 10.7 months vs. 11.2 months in February and January's

12.5 at what may have been the absolute deepest part of the housing slump, according to Bloomberg.



Prices may be bottoming too, slipping to median a \$201,400 for a 12.2% year-on-year contraction that's an improvement from February's 15% contraction. The average price nationally of \$258,000 is also doing better. It likely reflects a higher share of non-foreclosure discounted sales.

Helping drive sales are historically low mortgage rates. The rate for a 30-year fixed home loan declined to 4.80% from 4.82% a week earlier. Earlier this month the measure hit 4.78%, the lowest in Freddie Mac data going back to 1971.

There is evidence on the manufacturing front that the economy is beginning to turn. Durable goods orders fell .8%, but less than forecast in March. But this area continues very mixed as General Motors plans to idle 13 plants for multiple weeks from May through July, and other companies may continue cutting spending and jobs until demand here and abroad shows sustained gains. Economists do not expect this recovery to be led by business investment.

It appears that analysts' earnings projections now fully recognize the reality of the recession and may even be too pessimistic. The excessive optimism of earlier quarters has given way to more pessimistic projections. Analysts now expect profits at S&P 500 companies to decline 38% from a year earlier, according to Bloomberg which extends the earnings slump to a record seventh quarter. But of the 10% of S&P 500 companies reporting so far, 64% have exceeded estimates. Compared to the start of last earnings season, the ratio has shifted with a significantly larger increase in companies beating rather than missing estimates. This shift might be indicative of a turn for the better.

We clearly have obstacles ahead with bank stress tests coming in early May, disclosures yet to come from automakers, Chrysler's fate growing dimmer with time, and unemployment still growing, but signs of recovery can't be ignored. Investor optimism may be somewhat early, but it seems to be the view of most strategists that the market low is behind us. In fact, investors Mark Mobius, Barton Biggs, and Ken Fisher, are staking a \$40 billion claim that the next bull market has begun. Don't miss it.