



BOTTOMS UP: EVERYONE IS TRYING TO FIGURE OUT WHEN THE ECONOMY BEGINS TO BOUNCE BACK

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The brutal recessionary period has lasted so long that investors are now wondering if the economy has already bottomed out. The recession, fifteen months old, is longer than all but two postwar downturns. Yes, as Reuters pointed out, "the Dow industrials ended last week with a 9 percent gain and the S&P 500 shot up over 10 percent from the close on March 6". However, we have yet to see the light at the end of the tunnel. The Dow Jones is struggling, layoffs continue to accumulate and home foreclosures mount unabated. But, somehow, this economy will eventually recover. The vicious cycle will break and economists will announce that the recession has finally ended. By examining jobs, housing and stock indices we, while not fully confident, can look for signs on when the economy has bottomed out. In addition, Washington's greater involvement in the capital markets signifies that decisions made in the corridors of political power will have lasting effects on our major financial institutions.

JOBS

The U.S. unemployment rate hit a 25-year high in February when it reached 8.1 percent. The sobering reality is that 4.4 million Americans have lost their jobs since the recession started in late 2007. Housing and construction layoffs were followed by the near meltdown in the financial industry that wiped out many white-collar positions. Afterwards, it was only a matter of time before layoffs were announced in all industries and income levels.

Unfortunately, there is no end in sight when it comes to layoff announcements. The lack of fluidity in the credit markets does not bode well for the economy. Spending levels are still weak, therefore more jobs will be lost this year. If 2.4 million more jobs are lost this year, the unemployment rate will surpass 9 percent. In fact, the Treasury Department's

"The sun will come out tomorrow"

"stress tests" that measure the viability of the nation's banks assume a nearly unheard of rate of 10.3 percent.

The incredible possibility is that the job market may not return to its robust pre-recession levels for several years. In fact, Moody's Economy.com predicts the unemployment rate will not fall back to 5

percent until 2013. Moody's economist Sophia Koropecyk points out two key factors to watch for when seeking hopeful signs – companies hiring temporary workers and an increase in the number of hours worked for those who stayed at their jobs.

HOUSING

For a variety of reasons, the housing market has become an unmitigated disaster. According to the National Association of Realtors (NAR), the US median price of a home has fallen 26 percent in the last year and a half. Cities like Phoenix and Las Vegas saw housing prices plummet because of a supply glut while Detroit's suffered because of its underlying economic problems. According to NAR, 5.4 million homeowners are in foreclosure or behind on mortgage payments. Nicolas Retsinas, director of Harvard University's Joint Center for Housing Studies, told the San Francisco Chronicle that the jobs market is intricately tied to the housing crisis, "History tells us that as long as we are losing jobs, that's not good news for the housing market." The San Francisco Chronicle's predictions for a housing recovery are tepid; home prices probably won't bottom out before the first quarter of 2010 and price increases will be modest once they arrive.

STOCKS

The daily gyrations of the Dow Jones & NASDAQ have been the best indicators for Americans to understand the dire circumstances the economy has fallen prey to. Major stock

indices have lost about half of their value since peaking in October 2007. The San Francisco Chronicle pointed out that “the S&P 500 has hit bottom an average of four months before a recession ended and about nine months before unemployment hit its peak.” If consumer spending picks up, lending increases, demand for raw materials goes up and bargain hunters rush the stock markets then those are hopeful signs for investors. According to Moody’s, “the S&P 500 has gained an average of 46 percent in the year after stocks have hit a bottom.”

The Associated Press recently highlighted five reasons why the stock markets may have bottomed but also gave five reasons why matters could get worse. Here is a summary:

1. Increased volume – Institutional investors are coming back and rallies have been accompanied by high trading volumes. The AP’s Madlen Read pointed out that “pension funds, mutual funds and insurance funds began snapping up bargain stocks”.
2. This is not your grandfather’s Great Depression – The AP noted that there are many safeguards for the unemployed and that retail sales (excluding autos) rose in January and February.
3. Not zombie banks – Citigroup, Bank of America and JPMorgan Chase were considered to be “zombie banks” until they all announced last week that they are profitable this year.
4. Commodities are back – Crude oil and copper have risen 17 percent over the last three weeks because demand is on the upswing, a positive sign of industrial production.
5. Bargain hunting – The “capitulation” by many investors means that there are great bargains.

On the flipside, indicators the market may not yet have found bottom:

1. Toxic assets – The banks are still a mess. Scott Fullman, director of derivatives investment strategy for WJB Capital Group said, “We don’t believe that the bear market’s over yet. Toxic assets either need to come off the banks’ balance sheets, or they need to improve on the banks’ balance sheets.”
2. Downward trend – Recent retail sales data and uptick in the stock markets don’t mean much. Georgetown University’s Sandeep Dahiya said we should see three months of increases in the consumer confidence index before getting hopeful.

3. Short-covering – Many investors are making short trades these days so a market rally thanks to short-covering can disappear, quickly, once bad news hits.
4. Fear itself – The market fears unanticipated events; natural disasters and terrorist attacks.
5. The Bernie Madoff factor – His ponzi schemes rattled the markets and investors. Without trust, how can markets depend on faithful investors?

Marc Ruiz wrote in the Post Tribune that the “fad” in the investment world is “calling the bottom.” Ruiz dismissed the usual charts and graphs that he said are good for analyzing current trends but not for predicting the future. Ruiz wrote that he looks at “basic investment fundamentals such as dividend yield and fundamental stock value, or book value.” Ruiz explained that book value is “the price of a stock in the context of the company tangible, and intangible assets minus its liabilities.”

WASHINGTON

The Obama Administration is walking a fine line. It rightly points out how it inherited an economic disaster but it must also be the “cheerleader-in-chief” while managing high expectations at the same time. As White House spokesman Robert Gibbs asserted, “we have not unfurled ‘mission accomplished’ banners”. When asked if the economy has hit rock bottom Federal Reserve Chairman Ben Bernanke said, “my forecasting record on this recession is about the same as the win-loss record of the Washington Nationals.” For the record, the baseball Nationals are awful. The Journal Sentinel cited Republican congressman Paul Ryan who argued “let’s not have a financial system where our capital markets run through Washington.” Indeed, as the American people look to Washington to clean up Wall Street’s failures they still fear nationalization and centralized planning.

Citigroup’s chairman, Richard Parsons, urged President Obama to better appreciate the “psychology” of economic revival by telling him at a meeting, “if consumers are confident, they’ll spend. And if they’re fearful, they won’t. If investors are confident, they’ll invest. And if they’re fearful, they won’t. And all of the money of all the governments in the world can’t replace that, right?”

Bernanke did give an optimistic interview to CBS’ “60 Minutes” on March 15th. The Fed chairman confidently predicted that “we’ll see the recession coming to an end probably this year.” He maintained that the recession’s end depends on banks lending more freely and getting the financial markets back in order.

However, Larry Summers, the president's top economic adviser told ABC's "This Week" that "job cuts are probably not going to stop imminently" and "no one can make that judgment" when asked if the economic bottom has arrived.

CONCLUSION

The economic meltdown is a global problem. There have been very few positive signals to mark an economic revival. However, so many people are looking for any glimmer of good news that the rare flashes of recovery may be enough to spur confidence. While it is not obvious (and never will be until well after the fact) that the economy has bottomed out, it is clear that it is cratering at the moment. The lack of new construction projects, the challenges in the manufacturing sector and the issues with capital markets must be solved, on the most part, before we can confidently believe that a recovery is right around the corner.

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