2008 Recession. 2009 Recovery?

"Out with the old and in with the new!" The traditional New Year's melancholy farewell by reflecting, recapping and reliving the old one will be more dismal this year. Stocks enter 2009 after one of the most brutal years ever! 2008 will be remembered as the stock market's steepest decline since the Great Depression.

The Standard and Poor's 500 Index, one broad measure of the US stock market, was down over **38%** for the year, while the NASDAQ relinquished **40%** of its value. Preliminary results from investment researcher Morningstar Inc. suggest the average U.S. diversified stock mutual-fund tumbled **39%** for the year. An average decline of **24%** in the fourth quarter alone was the nail in the coffin. Eulogies for 2008 are in order.

2008 will also make history in stock market volatility. Although September, October and November made up one of the worst three month periods, October actually enjoyed two of the six biggest single day percentage gains on the Dow. These gains were soon lost, as in the last four months of the year, the Dow had four of the 20 worst percentage losses and the first full week in October was the worst percentage decline on record.

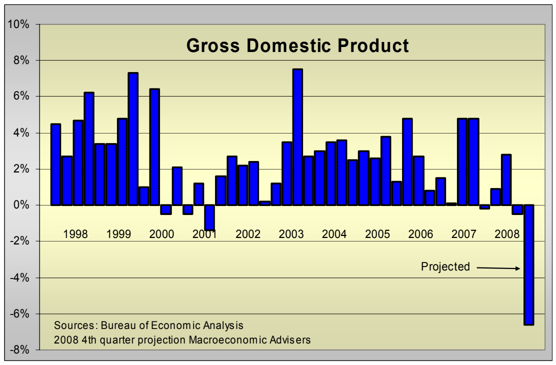
The bond market, usually the security blanket in most portfolios, had a tumultuous year as well. The freezing of the credit markets and near collapse of our investment banking system drove investors away from corporate and mortgage bonds to the security of US Treasury bonds.

As prices of Treasuries were bid-up, yields declined to near zero for shorter maturities. Conversely, the prices on corporate and mortgage bonds sank to new lows causing the yields to skyrocket. The spread or difference between the yields on Treasuries and investment grade corporate bonds tripled to 6% from 2% during 2008.

The Federal Reserve has employed drastic measures to ease the credit crisis, prop-up the housing market and keep the economy afloat. During 2008, the Fed cut its key interest rate target from 4.25% to a historic low of 0% to 0.25%! In its December 16th statement, the Fed, *"...anticipates that weak economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time."*

The Federal Reserve is fighting a long battle to support (or reflate) the housing market. Because of its illiquid nature, a real estate "crash" is a slow decline rather than a bubble popping. Because the balloon is still deflating, the Fed knows it must keep rates low *"for some time."* Also the Fed plans to buy half a trillion dollars of mortgage-backed securities to support the housing market. It's beginning to work, as reflected by the decline in mortgage rates. The 30-year fixed mortgage rate has fallen from well above 6% to 5.1% in 2008.

The Fed is also struggling to revive the US economy. The *"weak economic conditions"* manifested themselves in a severe downturn in the fourth quarter of the year. We all felt it, but the statistics now confirm it.



National Bureau of Economic Research officially announced that the US has been in **recession** for over a year since December 2007. Merriam Webster defines a recession as a period of reduced economic activity. Statisticians usually define a recession by two consecutive quarters of negative growth.

The Bureau of Economic Analysis (BEA) keeps the tally on economic activity, Gross Domestic Product (GDP) and the BEA's numbers didn't look that bad through the third quarter. As can be seen, we didn't meet the statistical definition of a recession, two consecutive quarters of negative growth, as of 09/30/08. In fact, the GDP increased by 2.8% in the second quarter, buoyed by the economic stimulus checks.

The BEA won't publish the 4th quarter's GDP until the end of January, but Macroeconomic Advisers projects a GDP decline of 6.6%! Since 1947, GDP has only twice fallen this much: down 7.8% in 2nd quarter of 1980 and down 10.4% in the 1st quarter of 1958. Although the WSJ survey of economists estimates the 4th quarter's decline at 4.3% rather than 6.6%, it is clear that US economic activity fell off a cliff.

US manufacturing activity dropped to a 28-year low in December as reported by the Institute for Supply Management (ISM). The ISM's weakest reading since 1980 bears out the 2008 increase in the unemployment rate from under 5% to almost 7%. Over two million jobs have been cut since the beginning of 2008.

2008's Historic Infamy

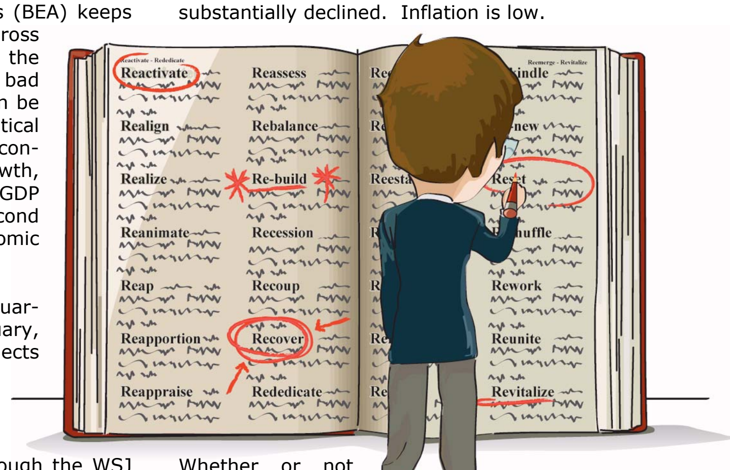
- Subprime and Housing Crisis
- Stock market's 3rd worst year in 100 years
- Wall Street investment bank model died
- AIG and auto makers bailout
- Fannie Mae and Freddie Mac nationalized
- Two million jobs lost
- Oil tops $145 and gas over $4/gallon
- US and world in **recession**

The frightful end to 2008 doesn't bode well for the start of the New Year. Many economists believe that the current contraction will continue and deepen well into 2009 - a recession that could be the longest since World War II. However, the government is using all of its vast and powerful resources to alter our downward course:

- Near zero Fed funds rate
- Half-trillion dollar mortgage debt purchase
- $200 billion for credit-card and car loans
- Consolidated effort to reduce foreclosures
- Treasury taps $350 billion more for banks
- Federal Tax cuts
- The new administration's $750 billion+ economic stimulus plan

These enormous U.S. stimulus efforts have been joined by similar efforts by governments around the world which should revive global economic growth. Whether this happens in 2009 or is delayed until 2010 is being debated.

For those looking for a 2009 Recovery, there are few signs of economic life. The mortgage rates are falling and, due to Fed monetary policy are anticipated to continue to fall. Low mortgage rates may bring out buyers. Credit markets are beginning to ease. Banks are less leery of lending to one another as born out by a 4-year low Libor rate. Due to the economic slowdown, oil and commodity prices have substantially declined. Inflation is low.



Whether or not the US recovery occurs in 2009 or later, a recovery will occur. Uncertainty and navigating uncharted waters will define 2009. Fear of these unknowns can impair judgment.

Readdress and reaffirm your feelings. Refocus and recharge yourself. Rededicate yourself to attaining your long term goals. Although not easy, now is the time to begin to rebuild.

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