

Insight Financial Services Presents

Quarterly Economic Update for 4Q 2008

Quote for the quarter. “Never doubt that a small group of thoughtful, committed citizens can change the world. Indeed, it is the only thing that ever has.” – Margaret Mead

The quarter in brief. Was that the worst of it? Maybe that is what the fourth quarter of 2008 represented – the trough of a very rough recession. Some economists feel that way. Wall Street endured some serious pain in the fourth quarter. On November 20, the S&P 500 closed at 752.44, a low unseen since 1997; the Dow Jones Industrial Average closed at 7,552.29.¹ Only 14 months earlier, both indices had hit all-time highs. Fortunately, the S&P 500 and the DJIA respectively ended the year at 903.25 and 8,776.39; Santa Claus was a little late, but the DJIA did pull off a 284-point rally across December 30-31.²

The \$700 billion bailout rolled out, but the Treasury Department’s mission changed; instead of buying up bad assets, it poured cash into private banks. The Federal Reserve announced a new relief program to do what the Treasury originally wanted to do. The Fed slashed the key interest rate to a target of between 0% and 0.25% and announced a program to heal the consumer credit market. Statistics bore out that consumers were less confident and spending less. Oil prices fell to their lowest level in four years, and retail gas prices followed. Mortgage rates and consumer prices fell. Detroit automakers sought bridge loans from the federal government. The housing and commodities sectors hoped relief would come in the coming quarter, as did Wall Street.

Domestic economic health. On October 3, President George W. Bush signed the \$700 billion bailout plan into law, incorporating \$149 billion in tax breaks for the consumer.³ Over three weeks, the Fed cut the benchmark interest rate by a full point down to 1.0.⁴ The Treasury Department injected \$125 billion into nine major banks in exchange for ownership stakes – shares paying a 5% dividend to taxpayers for the next five years.⁵ The Fed announced it would buy large quantities of commercial paper in the coming

months.⁶ Key indicators for October revealed core problems. The Reuters/University of Michigan survey of consumer confidence went from 70.3 in September to 57.5.⁷ The jobless rate jumped .4% in October to 6.5%, the highest level in 14 years.⁸ America’s manufacturing sector saw its biggest monthly contraction since 1982.⁹ Retail sales dropped 2.8% in October, the biggest monthly decline since the Commerce Department began keeping track in 1992.¹⁰

Days after an especially volatile month ended on Wall Street, Sen. Barack Obama (D-IL) won the presidency. In November, he selected New York Fed president Tim Geithner as his Treasury Secretary, and former Treasury Secretary Larry Summers to head the National Economic Council.^{11,12}

The Fed announced the creation of TALF, the Term Asset-Backed Securities Loan Facility, which would buy \$600 billion in troubled assets from Fannie Mae, Freddie Mac and Ginnie Mae and another \$200 billion in asset-backed securities to help get credit to consumers.¹³ Assorted reports brought disparaging news. The U.S. lost 533,000 jobs in November, the most since December 1974.¹⁴ A report showed November retail sales down 1.8%.¹⁵ Another showed consumer spending down 0.6%, but it rose 0.6% when adjusted for inflation.¹⁶

December brought Chrysler and General Motors a gift: \$13.4 billion in loans from Congress, with \$4 billion more potentially available.¹⁷ We saw the fifth straight month of contraction for the manufacturing sector – the ISM index came in at 35.4.¹⁸ The malls didn’t fare so well either: MasterCard Inc.’s SpendingPulse data service recorded total store sales down approximately 3.0% across November and December.¹⁹ By the end of the year, KB Toys, Linens ‘n’ Things, Shoe Pavilion, Steve & Barry’s, and Whitehall Jewelers had all gone out of business.

Major indexes. October’s big dive turned 4Q 2008 into a dire one for stocks. But there was a rebound: the S&P 500 rose 20.04% between the

close of trading on November 20 and the end of 2008.²⁰

% Change	4Q 2008	2008
DJIA	-19.12	-33.84
NASDAQ	-24.61	-40.54
S&P 500	-22.56	-38.49

Source: CNBC.com, 12/31/08²

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

Global economic health. It was a bad quarter for the industry worldwide. Eurozone manufacturing activity contracted in each month of 4Q 2008, extending a “losing streak” to seven months; in December, it contracted at the most alarming rate in 11 years. In December, the U.K.’s manufacturing sector had its second worst month since 1992. China’s manufacturing sector contracted for the fifth consecutive month in December.²¹

The bulk of European economies officially entered a recession in the fourth quarter, along with the economy of Japan.²² China, India and Thailand announced economic stimulus packages to counter presumed or confirmed recessions. India’s exports fell a sharp 9.9% in November; however, inflation cooled from a 16-year high of 12.91% in August. China made five interest rate cuts in a three-month period ending December 22.²³ Economists surmise that China’s fourth quarter growth may come in as low as 2%.²⁴

World financial markets. Markets suffered around the world during the fourth quarter, although quite a few gained following the Dow/S&P 500 low point of November 20. For example, the MSCI World Index and MSCI Emerging Markets Index gained 18.7% and 21.9% between November 21 and the end of the year.²⁵ But the year-end numbers were not helped by a quarter marked by mid-November’s enormous descents. At year’s end, the Shanghai Composite Index was down 65.4%, the Nikkei 225 down 42.1%, the Hang Seng down 48.3%, and the Sensex down 52.4%. In Europe, indexes also lost big ground in the fourth quarter: the FTSE 100 wound up losing 31.3% on the year, still better than any of the big three U.S. indices and better than the German DAX index (-40.4%), the Dow Jones Stoxx 600 (-46.0%) and France’s benchmark CAC 40 (-42.7%).²⁶

Commodities markets. This sector offered no sanctuary from the market downturn. Oil ended the quarter at \$44.60 per barrel, and it had to rally on December 31 to get there; oil futures were \$100 higher in July and fell to the \$35 level in late December. Gasoline futures ended the quarter down 59.2% for the year.²⁷

Gold finished the quarter at \$883.60, rising 5.4% for 2009, but silver and copper lost ground and respectively lost 35.6% and 56.5% for 2008. Despite rallies at the end of the quarter, corn finished down 10.6%, soybeans down 18.3% and wheat down 31.0% for 2008.²⁷

Housing & interest rates. Again, no upturn here. October data showed housing starts down by 4.5%, building permits down by 12%, existing home sales down 3.1% and new home sales down 5.3%.^{28, 29} Available November data wasn’t much better: the National Association of Realtors said residential resales fell by 8.6% for the month, and the U.S. Census Bureau November survey had new home purchases 2.9% below October levels.³⁰

As a byproduct of the Fed’s radical cuts, mortgage interest rates really diminished over the fourth quarter. Prime opportunities emerged for those who could refinance. By the last week of December, Freddie Mac’s national survey had 30-year FRMs at historic lows, averaging 5.10%. 15-year FRMs came in at 4.83%, 1-year ARMs at 4.85% and 5-year ARMs at 5.57%.³¹

First quarter outlook. Traditionally, stock market analysts have viewed the opening trading days of a year as a barometer of the quarter (and year) to come. So perhaps we should watch closely. We saw a powerful rally on the first trading day of 2009, though volume was light; in the first full week of the month, we will see how investor optimism holds up in the wake of new unemployment and wage numbers, and gauges of factory orders, wholesale inventories, construction spending and the health of the service sector.

Much has been written already about the low point the markets hit on November 20; that bad trading day may eventually be remembered as the bottom of this bear market, if we evade economic upsets of the kind that marked last year. Has the market more or less stabilized? Might housing, corporate earnings and consumer spending take a turn for the better?

Realistically, those are second and third quarter (some might say third and fourth quarter) questions. This quarter presents a test for the economy and the market – a test of the government rescue plan, a test of investor and consumer confidence. We are

investing for the long run rather than the next two or three quarters. Please keep that in mind. Perhaps three months from now, we will look back on a first quarter that was better than projected.

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