

# Insight Financial Services Presents Monthly Economic Update for December, 2008



**Quote of the month.** “We are continually faced with a series of great opportunities brilliantly disguised as insoluble problems.” – John W. Gardner

**The month in brief.** The month was less momentous than October, but still offered plenty of news. We elected a new President; some investors welcomed the change, while others were deeply troubled by it. The Federal Reserve augmented the Troubled Asset Relief Program (TARP) with the Term Asset-Backed Securities Loan Facility (TALF). Domestic automakers came to Washington, D.C. to ask for federal aid. The stock and commodities markets had another rough month ... but stocks pulled off an amazing rally across the last five trading sessions of November. At the national level, there were no signs of a real estate recovery. At the malls, consumers spent more than economists anticipated on Black Friday.

**Domestic economic health.** Nearly all signs pointed to recession, as nearly all October indicators were subpar. Unemployment had hit 6.5% in October, the highest level since 1994 and up from 6.1% in September.<sup>1</sup> The Institute for Supply Management’s October service-sector index read 44.4, and its October manufacturing index came in at 39.0; both numbers meant contraction. In fact, the manufacturing sector had contracted at the fastest pace since 1982 in October.<sup>1,2</sup> Jobless claims pushed a 25-year high the week of Nov. 15.<sup>3</sup> Retail sales fell a troubling 2.8% in October, a record month-over-

month dip.<sup>4</sup> Consumer spending fell 1.0% in October and durable goods orders dropped 6.2%.<sup>5</sup>

But all was not gloomy. The Conference Board’s November survey of consumer confidence went up to 44.9, recovering from a post-1974 trough of 38.8.<sup>6</sup> (Maybe falling gas prices had something to do with that.) Personal incomes went up 0.3% in October, topping the 0.1% gain economists had forecasted.; real income grew by 1%.<sup>7</sup> In the third full week of November, jobless claims decreased by 14,000 from the second week.<sup>7</sup>

In Washington, the Federal Reserve unveiled a new strategy to stimulate lending: the Term Asset-Backed Securities Loan Facility (TALF). Not TARP – TALF. TARP had been created to buy bad debts, but it spent the first \$290 billion of its assigned \$700 billion to buy bank stocks and help AIG.<sup>8</sup> Following up on Treasury Secretary Henry Paulson’s thoughts that the second stage of TARP should focus on consumer credit, the Fed created TALF to try to do much of what the Treasury first sought to do. TALF will buy up to \$600 billion in mortgage-linked securities and debts from Fannie Mae, Freddie Mac and Ginnie Mae, and use up to \$200 billion to buy asset-backed securities to help get credit to consumers.<sup>9</sup> Market watchers wondered if the Fed would cut interest rates to all-time lows, maybe even 0% – but the Fed left rates alone in November. The National Retail Federation said that Black Friday 2008 saw U.S. consumers spending \$41 billion, an 18% increase over 2007; the average shopper spent more than 7.2% than he or she did a year ago.<sup>10</sup> The Detroit Three, on the other hand, came to the nation’s capital seeking \$25 billion or more in bridge loans – sales of domestic autos fell 31.9% in October.<sup>11</sup>

President-elect Barack Obama announced New York Fed president Timothy Geithner as the next Treasury Secretary.<sup>12</sup> Larry Summers, Treasury Secretary from 1999-2001, was appointed as director of the National Economic Council – and some think he could become

the next Fed chairman when Ben Bernanke's term ends in early 2010.<sup>13</sup>

**Global economic health.** Why did the United Nations call for “massive economic stimulus packages” worldwide on December 1? Economies around the world were slowing. The UN's *Report on World Economic Situation and Prospects 2009* predicted the U.S. economy shrinking by 1% in 2009, and the economies of the Eurozone and Japan respectively contracting by 0.7% and 0.3% next year. Growth for India, Brazil and Mexico was respectively projected at 7%, 2.9%, and 0.7% for 2009.<sup>14</sup>

The European Commission rolled out a stimulus package in late November: €200 billion that Eurozone member nations could use as they desired, plus a number of suggestions for tax cuts.<sup>15</sup> The Eurozone unemployment rate hit 7.7% in October – the highest in almost two years. The Eurozone annual inflation rate – a prime concern only months ago – dropped 1.1% last month to 2.1%.<sup>16</sup>

Signs of a manufacturing slowdown were evident: Great Britain's PMI fell to a record low in November, as did PMI for the Eurozone. In China, November brought the sharpest contraction in manufacturing activity on record.<sup>17</sup>

Japan's industrial output fell by 3.1% in October, as consumer spending diminished by 3.8%. Its Trade Ministry forecast an appalling 12% contraction in business output between September and December. South Korea's industrial output contracted by 2.3% in October, and India revealed economic growth of 7.6% in the third quarter compared to 7.9% in 2Q 2008. China's State Information Centre reduced its growth forecast for 4Q 2008 to 8% from 9%.<sup>16</sup>

**World financial markets.** November shaped up to be a poor month for stocks worldwide, as indexes flirted with lows not seen since the last bear market. But overseas indexes rallied at month's end along with their U.S. counterparts to make the month's losses a bit better. Some numbers: the MSCI World Index fell 7.3% in November, and the Dow Jones Stoxx 600 lost 7.1%.<sup>18</sup> In Europe, the FTSE 100, DAX and CAC 40 respectively lost 2.4%, 6.4% and 6.8% for the month. The Shanghai Composite Index gained 8.2% last month, as investors were wowed by the stimulus package offered by the government.<sup>19</sup>

**Commodities markets.** Most commodities lost ground last month. Even gold did: gold futures fell 2.60% in November. Silver lost 31.74% and platinum lost 42.16%. Oil futures sank 20.52% for the month; with oil prices so low, retail gas prices went below \$2 a gallon in many parts of the country for regular unleaded. Natural gas futures were down 7.95% for November. Corn lost 23.27%, wheat 38.70% and soybeans 27.28%. Sugar, however, gained 10.35%, cocoa gained 12.29% and pork bellies 7.39%. The U.S. Dollar Index was up roughly 1.0% for the month as the last trading day of November drew to a close.<sup>20</sup>

**Housing & interest rates.** After an August gain, the National Association of Realtors' pending home sales index sank 4.6% for September.<sup>21</sup> October housing starts fell 4.5%, and building permits fell during the month by 12%.<sup>22</sup> As for new and existing home sales, the National Association of Realtors had residential resales down 3.1% for October with the median resale price 11.3% underneath one year ago.<sup>23</sup> New home sales were down 5.3% in October, but the Commerce Department also said that the inventory of unsold new homes shrank by 8.0%.<sup>24</sup>

The announcement of the Fed's TALF plan helped to bring mortgage rates down a bit lower at month's end. Freddie Mac's November 26 survey had rates on 30-year FRMs averaging 5.97%, averages on 15-year FRMs at 5.74%, averages on 5-year ARMs at 5.86%, and average rates on 1-year ARMs at 5.18%.<sup>25</sup> As December began, rates on 30-year and 15-year FRMs were about .2% lower than the late-November numbers above.<sup>26</sup>

**Major indexes.** Things looked pretty bleak there for a while: on November 19, the S&P 500 touched an 11-year low, and the Dow Jones Industrial Average flirted with a 5-year low.<sup>27</sup> But then reports that New York Fed president Timothy Geithner would be named Treasury Secretary possibly started a rally, and momentum built – the last five trading sessions of November were all winning days for the Dow, and in fact, they represented the best five days for the Dow and S&P 500 since 1933; the Dow rose more than 17% in that stretch, and the S&P shot up by more than 19%.<sup>20</sup>

% Change	1-Month	Y-T-D
<b>DJIA</b>	<b>-5.20</b>	<b>-33.36</b>
<b>NASDAQ</b>	<b>-10.77</b>	<b>-42.10</b>
<b>S&amp;P 500</b>	<b>-7.48</b>	<b>-38.96</b>

Source: CNBC.com, 11/28/08<sup>20</sup>

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

**December outlook.** December is normally a good month for stocks. We may see a Fed rate cut this month as well. The month hasn't started well – the National Bureau of Economic Research confirmed that a recession started in America in December 2007, and the stock market also responded negatively to a 26-year low for the Institute for Supply Management's manufacturing index.<sup>28</sup> The news that we have "officially" been in a recession for a year might backhandedly offer a glimmer of hope (after all, only two post-WWII recessions have lasted longer than 12 months), and it could prompt more than one kind of economic stimulus measure (in addition to the

package President-elect Obama wants to sign into law as soon as he takes office). The Fed and the Treasury are considering even further rescue programs – Secretary Paulson stated that TARP funds could optionally be used for foreclosure relief, and Chairman Bernanke indicated on December 1 that the Fed might buy Treasuries and use quantitative easing to improve liquidity if interest rates fall to zero. (Analysts widely expect the Fed to halve the benchmark interest rate to 0.5% at its December policy meeting.)<sup>29, 30</sup>

Now a rundown of the important economic releases across the rest of December: November auto sales (12/2), the November ISM services index (12/3), October factory orders (12/4), November unemployment and wages (12/5), October pending home sales (12/9), November retail sales, PPI and core PPI and preliminary December consumer sentiment (12/12), November industrial production (12/15), the December FOMC policy statement, October housing starts, and November CPI and core CPI (12/16), November new and existing home sales (12/23), November durable goods orders and consumer spending (12/24), and the Conference Board's December survey of consumer confidence (12/30).

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