

April 22, 2009

## EARLY SIGNS OF SPRING FOR THE ECONOMY

After yet another frightening decline into early March, the stock market staged a stunning, sharp reversal that as of this writing advanced 30% over the last six consecutive weeks. Is this the end of the second most vicious bear market of the last century (only the crash of 1929 was worse) or just another false start? Our prior client communications suggested after the panic decline of October 2008, the markets would go through a volatile, bottoming process that would take time to heal the damage. **We do believe the bottoming process is now complete and a durable bull market has begun.** The stock market is finally anticipating an improving economy. Indeed, Federal Reserve chairman Bernanke recently observed this business recession is long in the tooth, and we should expect an economic bottom later this year with the potential for a new business cycle recovery. We will explain the business cycle sequence and what it means for portfolios.

Are we really near the end of this severe recession? The answer is yes. In an informative March 18<sup>th</sup> interview on “60 Minutes”<sup>1</sup>, Fed chief Bernanke stated the economy is beginning to show signs of improvement or “green shoots”. **This mirrors our own business cycle research showing early signs the next sustainable and durable recovery are slowly falling into place.**

Recessions are self-correcting mechanisms of all business cycles. During each recession, consumers worried about their jobs, postpone purchases for an extended period of time.

Businesses also cut back on production and inven-

“With the upturn in a weekly measure of U.S. future economic growth continuing . . . growth in economic activity will begin to improve in short order.” 4/17/09

*Economic Cycle Research Institute, a leading independent forecast group*

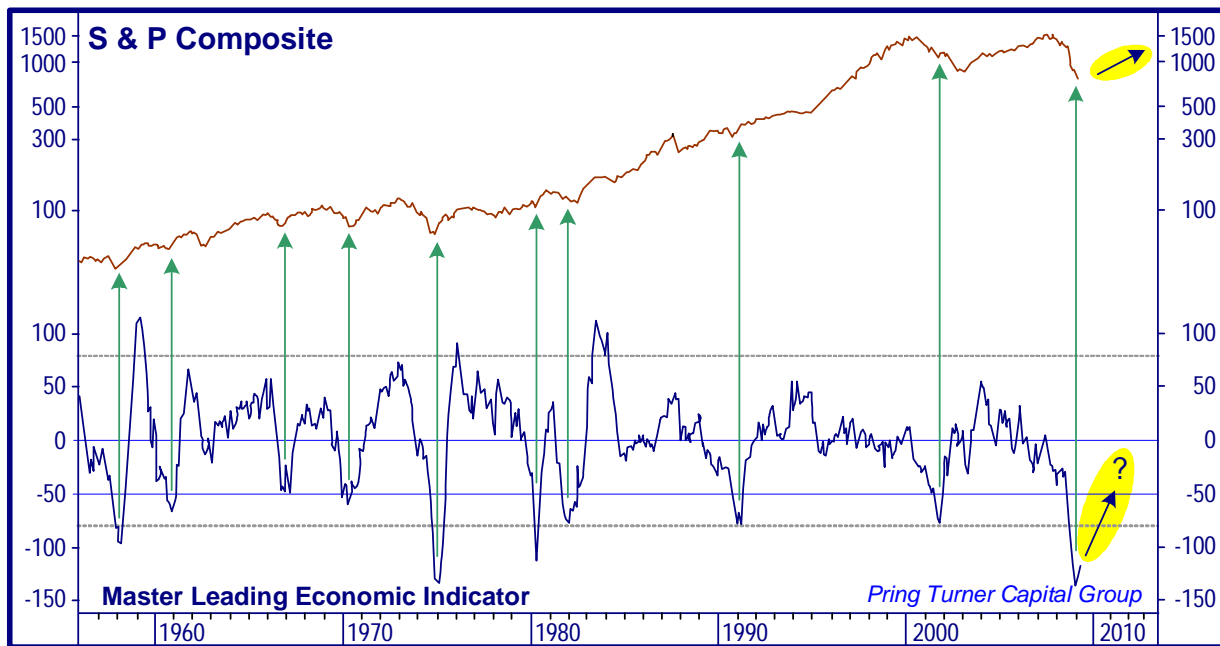
tory. Currently, we are scrapping more cars each day than we are manufacturing. More homes are falling down and being destroyed by fire and flood than we are replacing with new construction. These trends cannot go on forever. At some point, consumers will have to open their checkbook and begin spending again. Businesses will have to gear up to meet pent-up demand from postponed purchases. Even a modest up-tick in demand will kick-start the economy and begin the next recovery phase.

Our proprietary Master Leading Economic Indicator reinforces the economic “green shoots” improvements seen by chairman Bernanke. This blend of important *leading* economic indicators gives reliable signals of *early* economic turning points.

<sup>1</sup>View the interview at: [http://www.npr.org/blogs/money/2009/03/bernanke\\_sees\\_green\\_shoots.html](http://www.npr.org/blogs/money/2009/03/bernanke_sees_green_shoots.html)

Recently, it has turned up from an extremely oversold level – an event that typically occurs around major stock market bottoms (see chart). While not intended to be a precise timing model,

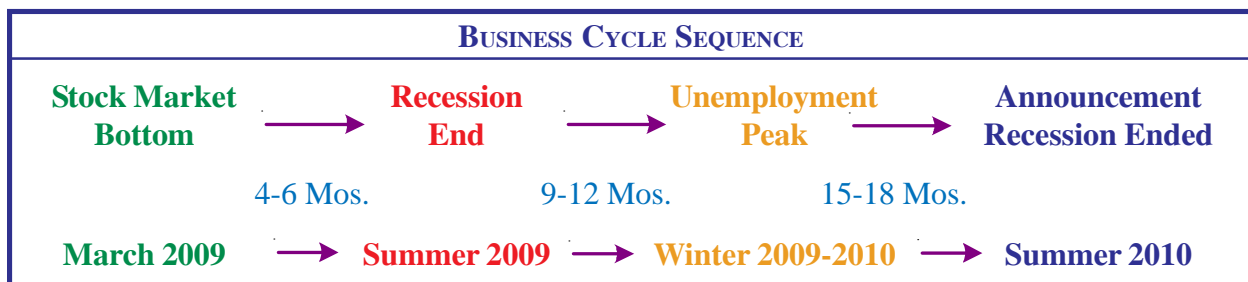
### Leading Economic Indicators Turning For The Better . . .



### . . . Reversals From Deeply Oversold Levels Led To Stock Market Recovery.

the indicator is helpful in identifying economic turning points and major stock market reversals. **We are watching this tool closely as continued improvement over the next few months will be a very encouraging long-term sign.**

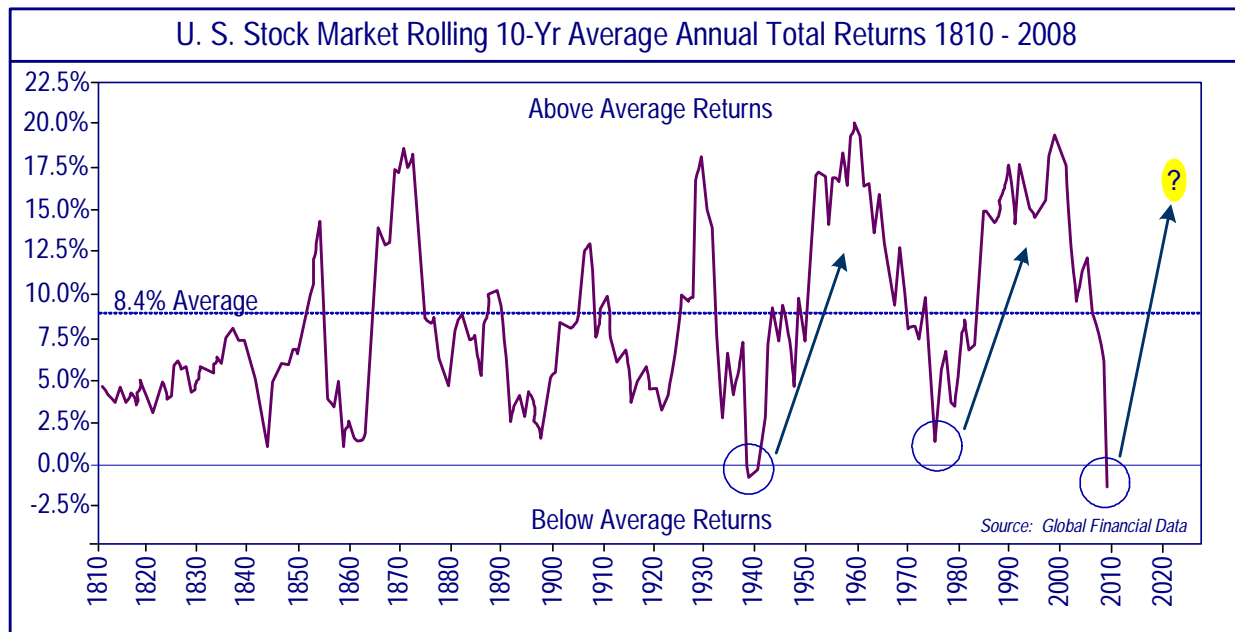
Investors, having braced for the worst possible outcome (in some cases, the end of the world!), may find out that worst outcome is just not going to happen. More likely, a gradual economic rebound will lead to a durable cyclical bull market for stocks. In simplified terms, the sequence of events for a business recovery is first the stock market bottoms (a leading economic indicator). Then the recession ends several months later. Next, the unemployment rate continues higher long *after* the recession ends, until economic expansion eventually brings up job growth. Finally, some time after unemployment peaks, the official end of the recession is announced – long after the stock market has bottomed. (See Table) Investors waiting for the comfort of an “all-clear” signal will have missed a huge portion of the stock market advance.



TYPICAL BUSINESS CYCLE SEQUENCE USING PAST 50 YEARS OF HISTORY SUGGESTS THE ABOVE TIMELINE.

*To be sure, investors have suffered through one of the most difficult periods in financial history.* In fact, looking back over 200 years of market history, the most recent 10-year rolling stock market return is below levels reached even in the difficult decades of the 1930's and 1970's. **The silver lining for investors today is those difficult periods gave way to years of above-average performance.** The recovery periods that immediately followed were very rewarding for investors, as stock prices reverted back to and even exceeded their long-term 8.4% total return. Stock valuations are at their cheapest levels in more than a dozen years. It is easy to envision above-average returns for the next decade as history replays once again.

**Long-Term Cycles Show Alternating Good And Bad Periods . . .**



**. . . Worst 10 Year Returns Will Be Followed By Above Average Performance!**

We believe we have witnessed the end of the second most vicious bear market of the last century. The stock market will climb a “wall of worry” even as unemployment worsens. **History teaches the market will keep moving higher even though more gloomy economic news continues.** We realize the high joblessness rate is a focus of media attention lately, and of concern to all. However, it is important to realize unemployment is a *lagging* economic indicator and will continue to get worse well into the next recovery period. More importantly, the stock market and your portfolio have already begun to improve in anticipation of the end of the recession.

We will seek new opportunities to position your portfolio to best take advantage of the improving stock market and better economy. Please feel free to contact us with any questions regarding your portfolio.

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