Executive Economic Outlook & Summary

Fall/Winter 2009-2010

By Phillip E. Multop, CPA, CFP®
and the Multop Financial Planning Group

Approach the market with caution. That is our firm's official statement for this Executive Summary. According to the Federal Reserve Board, the economy has most likely begun its recovery from this recession, yet it would be foolish to think that the "once sinking ship" is under full sail quite yet. We have weathered a severe storm but there is still the potential for a wave to capsize the economic ship. Despite the economy's vulnerability, however, we have seen some fairly smooth waters since the market lows. While we may be righting the ship, this unique storm will continue to have lasting effects on our consumer-based economy, especially since our ability to borrow money has been greatly limited.

As discussed in our last Economic Outlook (Spring/Summer 2009) we forecasted that things would be "less bad," and we were correct. While the market has managed to rally from its 12-year low, the Commerce Department reports that the economy shrank 1% from April through June, making this the longest contraction since quarterly records began in 1947. However, consumer spending, which represents 70% of the economy, experienced a rise in retail sales of 2.7% in August - the largest increase in three years. The government program "Cash for Clunkers" certainly helped to revive consumer spending, along with increased gasoline prices - but is this short term growth sustainable? Here are some statistics about the current state of our economy:

- Since the recession began in December 2007, unemployment has risen to 9.7%.
- Real GDP contracted -1% in the second quarter, however, without the Federal Stimulus Package it likely would have contracted -6% in the second quarter.
- The Chicago Board of Options Exchange Volatility Index (VIX) has dropped significantly to what is considered a "normal range".
- The S&P 500 has rallied significantly since the April lows. However, September/October have historically been the worst months for U.S. equities.
- The record-low Federal Funds Rate has remained at 0% to .25% since December 2008 and will likely begin to increase as we receive more concrete evidence the economy is growing once again.
- Gold rallied ahead of the $1,000 per-ounce benchmark for the third time in September, while the dollar index, which measures the greenback against the six major currencies, inversely hit a one-year low - a sign that the dollar may continue to depreciate and inflation may be seen in our near future.

Continue on back

- Consumer confidence index exceeded expectations for September by rising to 70.2, the highest since June, up from 65.7 in August.
- The second quarter Case-Schiller housing index reported its first quarterly rise in three years. New-home sales have increased five of the last seven months, fueled by low interest rates and an $8,000 federal tax credit for “first time buyers”.
- The Institute for Supply Management reported that its manufacturing index for August came in at 52.9 (numbers over 50 indicate growth) citing activity was due in part to depleting inventory levels and the “Cash for Clunkers” program.
- One major indicator that the economy and credit markets may, in fact, be recovering is the recent increase in mergers and acquisitions (M&A); approximately $24 billion worth of merger deals have been announced or proposed within the last days of summer. M&A activity is evidence that large companies are once again beginning to see value in the marketplace.
- Gross domestic product, the broadest measure of the economy's output, fell 5.5% in the fourth quarter of 2008 and the first quarter of 2009, the worst six-month showing in nearly 50 years. But in the second quarter of 2009 the decline slowed to 1%.

  “Even though from a technical perspective the recession is very likely over at this point, it’s still going to feel like a very weak economy for some time,“ said Ben Bernanke on September 15, 2009 at the Brookings Institution in Washington. The expectation is that the recovery will be hindered by high unemployment, which should keep inflation stagnate but the Fed will eventually have to raise interest rates to fight the 0.4 percent increase in consumer prices in August (Bloomberg).

While we are likely emerging from this recession, investors should be prudent and deliberate. In a recovery like this, people often overlook how fragile the economy still is. Generally speaking, consumers are still very strained on the income side, and credit availability is still very limited. We are cautioning clients that investing in bond funds for safety may be a serious mistake if or when the Federal Reserve begins to increase interest rates. International investments should continue to outperform domestic so long as the United States continues to issue stimulus in the manner it currently is – a tactic that causes our dollar to remain weak globally.

We are currently advising clients to begin repositioning out of cash and back into the market within the next six months, while still maintaining some non-market correlated investments, sprinkled with a pinch of tactical reallocations to take advantage of potentially rising interest rates and inflation. Begin moving, but proceed carefully.

* * *