

## January 2008

- I. The Economy
  - a. Contracting Quickly
    - i. From 4.9% GDP in 3<sup>rd</sup> quarter 2007 to maybe 0.5% in 4<sup>th</sup> quarter 2007
    - ii. The economy added on 18,000 new jobs in December vs. an average of +120,000 per month in 2007
    - iii. Food and energy inflation remain stubbornly high
      1. Look for oil to remain around \$100/barrel. No room here for supply disruptions.
  - b. Probably no recession . . . Just barely
  - c. 1.0 to 1.5% growth in the 1<sup>st</sup> & 2<sup>nd</sup> quarters of 2008
  - d. Thanks to continued robust exports
- II. Interest Rates
  - a. The Fed needs to cut rates now by 50 basis points and another 50 bps in February to get ahead of the slowing economy.
  - b. Banks are still functioning normally but it has become very hard to finance in the credit markets.
    - i. Nobody will buy corporate debt right now
  - c. If the credit markets remain frozen, this would have real bad implications for the broad economy. 1.3% fed funds and 2% money markets would free up cash again
  - d. I don't think the Fed understands the deflationary effects of a collapsing real estate market
    - i. The effects are much worse than \$100/barrel of oil in my opinion
- III. The Stock Market
  - a. In 2007 the average stock represented by the Value Line index (broadest measure) gained +1%
  - b. The S&P 500 was + 3.5 %, the Dow was +6.4% and the Nasdaq was +9.8% in 2007

- c. The Russell 2000 was  $-2.7\%$ , the Russell 2000 Value was  $-11.5\%$  and the S&P 500 Small Cap was  $-1.2\%$  in 2007
- d. YTD – Jan 8, 2008 the Nasdaq is  $-9.0\%$ , the S&P 500 is  $-5.50\%$  and the Dow is  $-5.8\%$ 
  - i. The market is pricing in drastically slower earnings growth in 2008
- e. Over the last 70 years there have been 12 recessions. The average price change of the S&P 500 was  $-4.2\%$  and the median decline was  $2.6\%$ 
  - i. One half of the recessions produced S&P returns of  $+10\%$ . The other  $\frac{1}{2}$  of recessions produced average declines of  $-18.4\%$
  - ii. So, you can have bear markets without recessions and recessions without bear markets
- f. Bottom line – if the Fed is hopelessly behind the recession curve then 2008 could be a tough year for the market
  - i. If they cut rates aggressively in 1<sup>st</sup> quarter of 2008 then stocks could rise by 8 to 10% this year