

October: Too Ridiculous

Market Summary October 2008

so we're dusting off a word we don't like using in reference to financial markets: Ridiculous. The two largest point moves in the history of the Dow Jones Industrial Average came in October — both, quite uncharacteristically, to the upside (936.42 and 889.35, on Oct. 13 and 28). Sellers also made history, however, sprinkling three down-days through the month that averaged 640 points on the Dow and 75 on the S&P, rendering the whole roller coaster ride a net-negative exercise. Altogether, the DJIA in October had 7 of its 11 biggest one-day point moves, and the S&P 4 of its 6 biggest, and in the process, they shed 13.8% and 16.8% of their value, respectively.

Perhaps on the principle that climbing a mountain is a gradual process, whereas a descent can be rather abrupt, the DJIA never before had had its biggest one-day move (much less the two biggest) register on the upside. Abhorring such asymmetry, the Dow came hurtling down after Election Tuesday with the worst two-day drop in its history, burning off 929.49 points (9.7%). Following suit, the S&P dropped 100.87 points (10.1%). So the Dow's biggest one-day move still is to the upside, but the biggest two-day moves for both indices are to the downside. Call it symmetry restored, fearfully.

The ugliest-ever tandem of trading days remains the gruesome twosome of October 16 & 19, 1987, when the big-cap indices dropped a much larger portion of their value (26% from the Dow; 25% from the S&P 500) than this year, though far fewer points (616.35 and 73.24). Taken in full, however, the '07-'08 bear market has been

Name it, and October had it, and probably in gross over-abundance. Raucous does not begin to describe the events of last month,

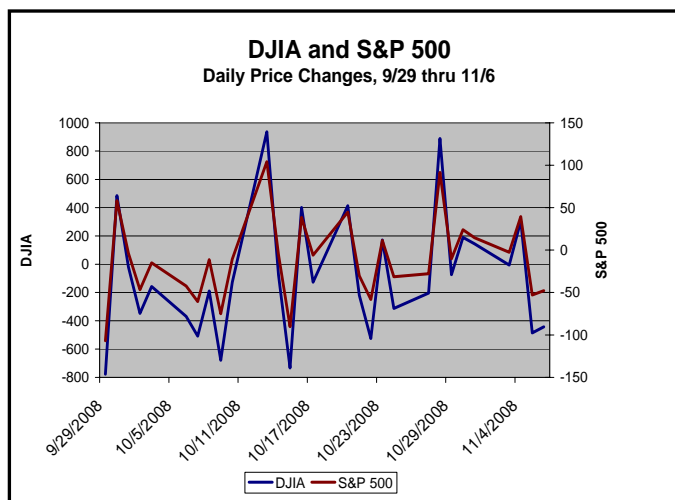
markedly bloodier than that of 1987, as well as much more protracted. After cresting together on October 9, 2007, at 14,164.53 and 1565.12, the Dow fell 38.6% and the S&P 500 42.2% over the next 13 months (and counting) through Nov. 6.

What happens next? Well, after the bear had eaten its fill in 1987, the market embarked on a 13-year fling that powered the DJIA from 1738.74 to above 11,300. Like a compressed spring, market contractions store energy that eventually must find release. But no one can reliably say when.

The cause for these heavy losses in the capital markets clearly is the international crisis in banking. But the source of some of the violently zigzagging volatility (see chart) is traceable to politics. The stock market hitched its hopes of recovery to the promise of a massive rescue of the banking sector by the U.S. Congress. That ground is shaky enough in the best of times, but this came at the worst: October of an election year. For showcasing partisan rancor, it was an historic opportunity that Congress would not miss. Bitterly disappointed by the (temporary) rejection of the \$750-billion bail-out bill, the stock market took a suicide leap September 29, creating the biggest drop ever by the DOW (777.68 points) and the biggest-ever

move of any kind by the S&P 500 (-106.85). The tantrum continued through the first 8 days of October, as a gauntlet of consecutive losing days hacked another 1914.26 points from the DJIA, and 265.52 from the S&P 500.

On October 13, politics turned sweet again, as the markets were bowled over by the announcement that the G7 nations would launch a concerted mega-billion-dollar assault on the banking mess. Exultation propelled the Dow and the S&P 500 to the record one-day advances mentioned above. These evaporated in ensuing weeks, however, as



pessimism again took hold. Altogether, the markets' flirtation with Capitol Hill comprised 29 trading days during which the DJIA gained 3937 points and lost 6384, for a net drop of 2447.34 (22.0%). The S&P 500 lost 308.39 points, (25.4%). As the fictional saloon keeper, Mr. Dooley, often observed, politics ain't beanbag.

All of this roller-coastering could have anything but a decidedly negative effect on consumer confidence. However, the dimension of the damage was such that economists surveyed by the Wall Street Journal missed by more than half in their forecast. The Conference Board's index fell by 23.4 points—third most in the 23 years of the survey—to an all-time low of 38.0. The WSJ's economists had predicted a drop of 9.9 points.

Unconfident consumers are bad for the economy, and the GDP data reported by the Commerce Department affirmed that fact. The economy contracted at an annual rate 0.3% in the 3rd quarter, dragged down by a 3.1% drop in consumer spending. It was the worst GDP performance since the 3rd quarter of 2001, which was punctuated with terrorist attacks.

Employment data followed suit, as the Labor Department reported the loss of 240,000 jobs in October. Payrolls have been down for all 10 months of 2009, and the total jobs lost for the year is now 1.2 million. Unemployment is at 6.5%.

Inflation data showed a 5.4% year-over-year price gain for all personal expenditures in September, the biggest spike since 1990. However, as collapsing energy prices are expected to dampen inflation through the remainder of 2008.

Manufacturing activity contracted to an index reading of 38.9 in October, down from 43.5 in September, said the Institute of Supply Management. It is the third consecutive month the index has been below the 50.0 break-even mark.

The Federal Reserve, joining the other G7 central banks, took aggressive action in October, cutting its target rate for overnight lending by 50 basis points to 1.0%—a level last seen in June 2003-04.

The Bank of England cut its key interest rate by a surprising 150 basis points, to 3.0%. Japan, where the overnight rate already was only 0.5%, cut it to 0.3%, in large part because appreciation in the yen

has caused much grief among Japanese exporters. The Reserve Bank of Australia and the European Central Bank also have cut rates. China has had a series of rate cuts, and also announced a gargantuan \$586 billion stimulus package. The U.S. implemented a \$168 billion bundle in May.

Very Ugly Month for Stocks

The DJIA's -13.8% performance actually was the best of all major stock indices in October. All benchmarks showed double-digit losses for the month, the largest being that of the MSCI Emerging Markets Free Index (-27.4%).

High Quality Bonds a Haven

Short term, high quality bonds provided the only haven anywhere in the world's capital markets in October. U.S. T-Bills rose 0.1% and the Lehman Intermediate Government Bond Index moved up a comparatively healthy 0.4%. The Citigroup World Government Bond Index (hedged) turned in a downright robust gain of 1.0%. High yield issues were punished heavily, the Citigroup High Yield Index losing 17.8%, the JPM Emerging Market Bond Index dropping 13.8%.

REITS, Commodities Hit Hard

The Dow Jones Wilshire REIT Index was sandblasted in October, losing 32.4%; the NAREIT (All REIT's) index lost 30.2%. The Goldman Sachs Commodities Index dropped 28.2%.

Hedge Funds Scattered

The Hedge Fund Research indices all fell in October; the Merger Arbitrage Index faring best with a loss of 1.7%; Convertible Arbitrage fell hardest: -19.2%. Fund of Funds dropped 7.3%.

All benchmarks in all categories now are under water year-to-date, with the exception of U.S. T-Bills, Lehman Intermediate and Long Government Bonds and the Citigroup World Government Bond Index Non U.S. (hedged).



Dennis Hannon
New Markets Analyst
Hammond Associates
101 S. Hanley Rd, 3rd Floor
St. Louis, MO 63105
314-746-1600
www.hammondassociates.com

Copyright © Hammond Associates, 2008. All rights reserved