

November: Super Bear Arrives

Market Summary

November 2008

The stock market last month consisted of two brutal beat-downs interspersed with fleeting moments of elation, and concluding with vigorous five-day burst to the finish line. The net effect was a bad bruising for stocks and a heyday for long-term bonds.

There is a theory that all the gyrations were merely a tantrum by a market impatient to know President-elect Barack Obama's choice for Treasury Secretary. That would neatly explain the trading on November 21, when the S&P 500 sank to its lowest intra-day mark in precisely 12 years (741.02), then rebounded 59 points on the news that Timothy Geithner, the popular and respected President of the New York Federal Reserve, had been picked for the Treasury nomination.

But, if this was a trading-floor snit, it also was much more than that. The S&P 500 Index fell 253 points (25%) in the 12 trading days following the election, and just prior to the Treasury announcement, it put in a crescendo conclusion to a 548-point cliff dive that had begun just before Labor Day (see chart). The close was 14 points below the nadir of the Y2K bear market and 52% below the all-time high for the index set only 11 months before. All gains from April 14, 1997 were erased — the longest span of wreckage seen

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since the bear market of 1973-74, which was motivated by the concerted effects of the first Arab oil embargo, a stagnating economy, rampant inflation (the original “stagflation”) and the resignation of President Richard Nixon. That S&P 500 closed at 62.28 on October 3, 1974, taking out lows from two previous bear markets and destroying all gains posted since December, 1962.

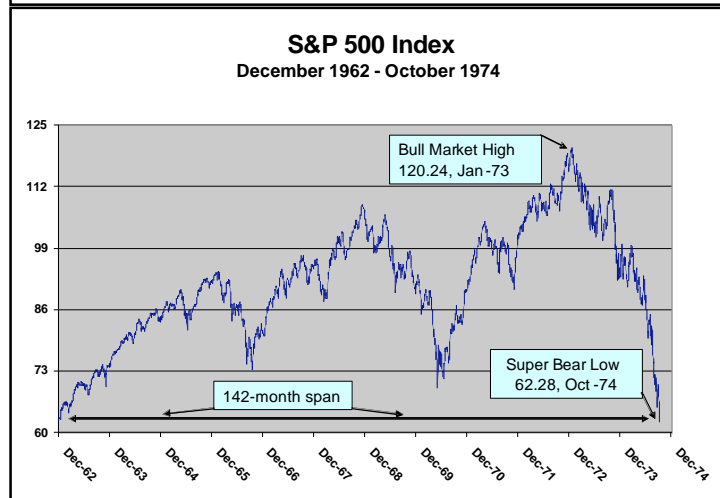
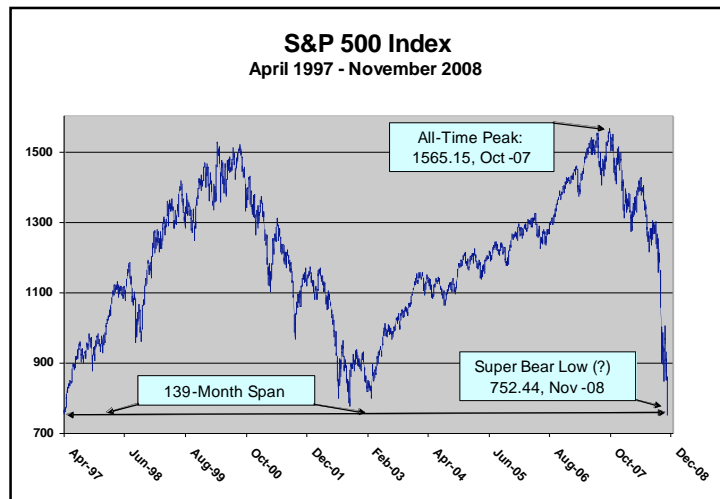
We propose that market events such as these — great landslides that wipe away the work of a

decade or more, and smash everything built through two full market cycles — be dubbed Super Bears. They are a thing apart; meaner by far than the average bear.

Consonant with the emergence of the Super Bear, the National Bureau of Economic Research (NBER) decided at long last that the present contraction not only is a recession, but that it has been one since last December.

Those 11 months made our recession — on very the day of its formal debut — the longest in more than a generation and tied

for third-longest since 1933. Recessions lasting 16 months began in 1973 and 1981, which is why 1974 and 1982 have recurred continuously this year in “worst-since” econometric comparisons. There were no successive quarters of economic shrinkage this year — the common definition of a recession — but the NBER's Business Cycle Dating Committee ended all quibbling with a decree that the essential feature is “a significant decline in economic activity spread across the



economy, lasting more than a few months,” a standard by which our current predicament resoundingly qualifies. The committee noted that non-agricultural payrolls peaked last December and the economy has hemorrhaged jobs every month since. That fact resonated in the Department of Labor’s November payroll report, which showed the loss of 533,000 jobs, more than in any month since December 1974 (that year again). More than 1.8 million jobs were lost through the first 11 months of 2008.

Unsurprisingly, manufacturing activity has fallen along with the payroll numbers. The Institute for Supply Management reported that its index fell to 27.9 last month from an already dismal 32.2 in October, and now is at the lowest level since 1982.

Consumer confidence nevertheless bounced a bit in November, rising more than six points to 44.9 from its worst-ever level of 38.8 in October. The Conference Board reported that its Expectations Index jumped a full 10 points, to 46.7, suggesting an uptick in optimism following the national elections. However, the survey data show no improvement in the Present Situation Index, which declined from a glum 43.5 to a glummer 42.2.

More Glum is More Correct

The glummer outlook ought to apply both to now and next year, according to Jeffrey Frankel of the NBER’s Business Cycle Dating Committee. “The economic outlook looks fairly bleak,” he told the Wall Street Journal. Forecasts of a “trough” in the downturn before the middle of next year “don’t strike me as pessimistic,” he said. “Pessimistic” here being econ-speak for “realistic.”

If there is a bright side to economic weakness, it is the collapse in energy prices it has prompted. Energy costs fell by a compounded 43.1% from August through October, bringing the price index for all items down by 4.4%, according to the Department of Labor. The monthly index fell 1.0% in October, the most since its publication began in February 1947.

Governments: Stimulation and Bailout

The contraction in the economy this year was interrupted in the second quarter by an anomalous 2.8% gain in the GDP, now attributed to the fattened tax refund checks doled out in May

through President Bush’s stimulus package. There were concerns about inflation at the time, but that’s all out the window now, as most of the industrialized world is officially in recession. Correctly or not, this kind of bottled lightning (or white lightning) is being sought eagerly by governments and central banks from London to Tokyo, who are cacophonously announcing rate cuts, rescues, recapitalization schemes and straightforward stimulus packages – a kind of universal hosanna to the memory of economist John Maynard Keynes that in the aggregate measures well into the trillions (USD) in committed funds. Chairman Ben Bernanke said the Federal Reserve might step up purchases of Treasury bonds in order to curb long-term interest rates, and pump needed reserve capital into an ailing banking industry.

Returns

That would boost the price of long Treasury bonds, which already are in a skyrocket mode; the Lehman Long Government Bond Index gained 11.70% in November while other types of asset were bashed without respite. The Lehman Treasury Index gained second-most in the fixed-income category, with 5.31%. Junk fared badly, as spreads continued to widen; the Citicorp High Yield Index fell 9.31%. The Citigroup World Government Bond Index rose 3.70%; the JPM Emerging Market Bond Index rose 1.78%.

All stock indices lost value in November, generally in inverse proportion to capitalization. The S&P 500’s closing rally reduced its loss to 7.18%; the Dow Jones Industrial Average dropped 5.32%; the Russell 2000, -11.83%.

November closes for other indices: MSCI EAFE, -5.41%; MSCI Emerging Markets, -7.53%; Dow Jones-Wilshire REIT, -24.55%; Goldman Sachs Commodities, -6.96%;



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