



June 2009

Market Indices <sup>1</sup>	May Change	Year-to-Date (5/29/09)
S&P 500	5.6%	1.8%
MSCI EAFE	11.1%	6.5%
Dow Jones Industrial Average	4.5%	-3.1%
Russell 2000	3.0%	0.4%

## Will “Green Sprouts” of New Growth Turn into “Green Stalks”?

Risk taking continued to grow in May. While this was reflected in stock market gains, improvement in the corporate bond market may be a better indicator of improving investor confidence. Stocks can run up quickly on unreasonable speculative buying, but bond purchases are usually a more reliable confidence gauge as those markets are dominated by longer term-oriented institutional investors, such as pension funds and insurance companies. More institutional buyers have been willing to move away from the safety of Treasury bonds and into less secure corporate bonds. Interest rate spreads, the difference between the returns on Treasuries and more risky types of bonds, has continued to decline reflecting this trend. In addition, there has been a spike in not only investment-grade corporate bond offerings but also high yield bond issuance. Most importantly, included in the new corporate offerings have been a lot of banks that two months ago couldn't have sold new bonds because of worry over their financial conditions. The reenergized bond market has also led to resurgence in companies raising new money from stock offerings, including IPOs. Market analysts attribute this to the growing investor confidence that the worst economic and financial concerns are behind. In turn, the recent resilience of the stock market after strong advances in March and April are signs that the early “green sprouts” of economic growth spotted back then are growing into “green stalks”. But others caution that more hard data of improvement in housing, jobs and retail sales needs to appear soon or a market correction is in order. Expectations can only last so long in pushing a market recovery. Stock prices may have to at least pause while the economy catches up. The latest unexpected “green sprout”, a large jump in consumer sentiment data released this week, needs to grow into actual improving restaurant sales, for example.

## An Alphabet Soup for Forecasting the Recovery

With the consensus developing that the recession is slowly coming to an end, the most pertinent question now is the shape of the recovery. The alphabet has been used to illustrate the contending views of what the most likely shape will be, in particular the letters V, W, U, and L. All have the first part in common — the steep down turn characterized by the beginning stroke of each letter. The forecasted speed and shape of the recovery is illustrated by the remaining structure of the letter. Some economists argue a speedy recovery, spurred by this year's massive government stimulus to revive the consumer, could ensue, similar to some of the most recent past downturns. This argument is symbolized by the letter V. Others believe that the severity of this recession makes that unlikely and, even if consumer spending spiked back up quickly, it would be a temporary fix leading to another quick fall off. Like the letter W it could lead to the need

for another stimulus and longer term instability. Most economic experts believe a more certain recovery should be fashioned like a U where the economy goes through a longer period of needed cleansing before rebirth. This recovery would have a stronger foundation than the stimulus-built V and lead to a longer-lasting rebound. With the global damages caused by the financial crisis this time, most economists believe an extended period is needed in which to rebalance and recover. The biggest concern with the U forecast is the length of that cleansing period. Most analysts believe that the government programs have stopped the downturn and set the stage for a renewal period. But many worry that it does not provide enough support for any meaningful recovery for at least the next year, leading to the more sobering L shaped forecast. They argue that the losses to jobs, income and personal wealth from the recession will produce a prolonged rebuilding of consumer confidence and mean a more gradual recovery in the economy. While this could extend the pain, many economists believe the extended time for a “reset” may be the most beneficial for the longer-term health of the US and global economies.

1. Wall Street Journal, 5/30/2009

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