

June 30, 2009

Better Times

There has been much discussion over the past few months about the stock market and the economy and whether or not they are recovering or whether there are still dangers lurking. While both are still on shaky ground, it does appear that things are improving for our economy, although at a slow pace. We will likely continue to shed jobs and see the unemployment rate climb through the first stages of economic recovery. The stock market has also recovered over the past four months, although it remains well off of its highs.

We have often pointed out that during a recession the stock market normally bottoms out well before the economy does. As bad as the market was during the first quarter of this year, over the past sixteen weeks the S&P 500 has risen over 35%. To continue this momentum, we will need to see continued economic improvement over the remainder of this year. History suggests that this should be a good time to invest in equities. Since 1957, the S&P 500 has averaged a return of 35% in the first year following a bear market and 8% in the year following a down year for the index. As is the case with most bear markets, panic selling last fall has provided opportunities for long term investors to buy quality companies at reduced prices.

To illustrate how bad the economy has been over the past year: Earnings for the S&P 500 companies for the second quarter are expected to be down 34% from the second quarter of last year, while actual profits on a trailing one year basis are off 88% over a year ago. Five of the eight largest corporate bankruptcies in US history have occurred in the last nine months. Through the end of the first quarter of this year, the US economy had contracted for three consecutive quarters, which has not happened since 1975. Also, over the past eighteen months, the unemployment rate has doubled, to 9.4%. As recessions go, this is a long one and a deep one, and one that seems destined to be studied for many years.

Barring any unforeseen setbacks, we think we have seen the worst in both the economy and the capital markets. It is very difficult to predict the pace of recovery for both, but it is likely we will see an increased level of volatility as the markets search for direction. Seven of the top eight best percentage gain days for the S&P 500 over the past fifty years have occurred during this recession. Given the large sell off we have seen this is an amazing statistic. The markets will be watching economic news closely over the remainder of this year. Improvement in the economy will lead to further improvement in the markets and we think both are likely over the rest of this year.

Wabash Capital