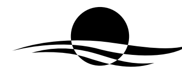
Growth STRATEGIES



LA JOLLA INSTITUTE
Steve PonTell

Dr. Roger Selbert, Editor & Publisher
E-mail: roger@rogerselbert.com

Trend Analysis That Builds Business Decisions

3200 S. Barrington Ave. #4 • Los Angeles, CA 90066
Telephone: (310) 721-6322 • Facsimile: (310) 828-0427

IN THIS ISSUE: MIGHT AS WELL BE OPTIMISTIC

1 – BOTTOMING SIGNS
2 – THE ECONOMIC NEWS ISN'T ALL BLEAK
3 – 2009 COULD BE BETTER THAN YOU THINK
4 – WHAT COULD GO RIGHT IN 2009 …AND WRONG
5 – LOOKING ON THE BRIGHT SIDE

1 – BOTTOMING SIGNS

There are some small signs that the economy is at last bottoming, writes Larry Kudlow – a crucial stepping stone to meaningful recovery:

- The ISM non-manufacturing services report for December came in at 40.6 on the composite index, compared to 37.3 in November. New orders, employment, backlogs, and exports all ticked higher than the previous month. So did the overall-business-activity index. It's still a recession reading, but a small increase is better than a decline.
- November factory orders rose at a 3.9% annual pace, the first increase in four months and the best gain in 10 months. Computer orders surged 12.5%.
- Pending home sales declined again overall, but in the West pending sales continued to increase, and they are up 27% since the August 2007 bottom.
- Commercial construction rose 0.7% annually in November, and is up 12.1% over the past three months.
- Real disposable personal income jumped 1% in November and is up 7.1% at an annual rate over the past three months. Real consumer spending in rose 0.6% in November.
- Inflation is plummeting, largely a function of collapsing oil and retail gas prices. The gasoline drop is probably worth $350 billion as a consumer-purchasing-power tax cut.
- The money supply of liquid assets, as measured by M1 and M2, is growing robustly, fueled by the Fed's gigantic increase in the monetary base.
- The credit freeze continues to thaw. The three-month LIBOR rate is all the way back to 1.4%. Corporate bond rates continue to decline, a signal that private capital markets are starting to function again.

2 – THE ECONOMIC NEWS ISN'T ALL BLEAK

What happened since the collapse of Lehman on Sept. 15 was a global, synchronous cessation of all but nondiscretionary economic activity in the wake of the near-collapse of global credit markets. And it happened over the course of weeks, not years. But if things came to a halt more quickly than ever before, they could also restart more quickly than ever before. So writes Zachary Karabell, president of River Twice Research, who calls attention to some positive signs.

First, we haven't seen war, revolution, the collapse of states and governments, or massive demonstrations sweeping the globe. It is remarkable how relatively stable things are in light of what has happened.

Second, consumers in many parts of the world are in relatively good shape. A third of American

households have no mortgage. The savings rate in China is 50%. The accumulation of wealth is still massive in the US, Europe, Japan, China, the Gulf region, Brazil, India and Russia. Even at its most promiscuous, the credit system didn't allow consumers to take on the obscene leverage that financial institutions did.

People have also reacted swiftly to the current problems, paying down debt and paring back purchases out of prudence or necessity. That's a short-term drag on economic activity, but it will leave consumer balance sheets in good shape going forward. Low energy prices and zero inflation will boost spending power. Even if unemployment reaches 9% or more, consumer reserves in the US and world-wide are deeper than commentary would suggest. Household net worth in the US is down from its highs but is still about $45 trillion. As the credit system eases, historically low interest rates also augur debt refinancing and constructive access to credit for those with good histories and for small business creation in the year ahead. Entrepreneurs often thrive when the system is cracking.

In addition, corporations generally have very clean balance sheets with little debt and lots of cash, unlike the downturns in 2002 and in the 1980s. And government has more creative ways to spend, which both the current Federal Reserve and the incoming Obama administration intend to do.

The last months of 2008 will go down as one of the most severe economic reversals to date, and on a global scale. But it is foolish to assume that this period provides a viable guide to what lies ahead.

3 – 2009 COULD BE BETTER THAN YOU THINK

Here are five good reasons why 2009 could be better than you think, according to Alan Murray:

1. This will be a good year to invest in stocks.

No one can tell you exactly when or where the market will bottom. But most business-cycle experts agree that the bottom will be found sometime this year, and that it probably won't be too far below where the market is today.

2. It will be a good year to invest in real estate.

Fixed-rate mortgages are already at historic lows, and the government is going to use every tool in its bag to get them lower over the course of the year.

3. Americans will learn to live within their means.

The nation has rediscovered that you can't spend what you don't earn. Houses are no longer ATMs, and credit cards no longer come with each day's mail.

4. President Obama will have a historic opportunity to reshape public policy.

The Obama team is busily preparing a stimulus package that, when all is said and done, will total between $750 billion and $1 trillion – far larger than any fiscal stimulus in the history of the world. Roads will be rebuilt, schools will be refurbished, medical records will be computerized, and windmills will be constructed, all across the land. Will some of that money be wasted? Of course. But the sums involved are so huge that there's a good chance someone, somewhere, will benefit.

5. Your (federal) taxes won't rise.

Never mind those campaign calls for higher taxes on the wealthiest Americans. Truth is, no politician is going to push for general tax increases in the midst of a severe recession.

4 — WHAT COULD GO RIGHT IN 2009… AND WRONG

Superstrategist Ed Yardeni is quoted by James Pethokoukis in *US News & World Report*:

WHAT COULD GO RIGHT

(1) In the US, lower mortgage rates should fuel a refinancing boom which should lift consumer spending.

(2) Lower mortgage rates, if combined with more mortgage funding provided by the US Treasury, should increase home sales and stabilize home prices.

(3) Easier credit conditions thanks to government funding for auto loans should increase auto sales.

(4) The drop in fuel prices should also boost consumer spending. The unemployment rate should peak below 8%.

(5) Massive spending on infrastructure by the US government should offset weakness in such spending by state and local governments.

(6) The money supply is likely to grow rapidly. Indeed, M1 is up 16.5% year-over-year through the week of December 22, little changed from the prior week's 17.9%, which was the fastest pace since 1987. M2 is up 9.6% y/y, the fastest since 2002.

(7) Stimulative monetary and fiscal policies overseas should revive global economic activity and US exports.

(8) Depleted inventories and improving sales could trigger a big jump in industrial production.

(9) Credit quality spreads should narrow significantly and rapidly as investors seek better returns than available in Treasury securities.

(10) Stock prices should rise 30%-40% in anticipation of better earnings during the second half of 2009 and in 2010.

(11) Inflation should remain subdued, as it typically does when productivity pops when the economy begins to recover.

WHAT COULD STILL GO WRONG

(12) The credit crunch worsens. Corporations and municipal governments are unable to rollover their maturing debts. The jobless rate peaks between 10% and 15%.

(13) Home prices continue to fall in the US. Despite lower mortgage rates and more credit availability, would-be homebuyers are put off by mounting unemployment and falling home prices.

(14) Any windfalls from mortgage refinancing are saved rather than spent.

(15) Widespread deflation occurs and Treasury bill yields turn negative. The 10-year Treasury falls to 1.0%.

(16) Congress passes, and President Obama signs, the Card Check bill.

(17) The DJIA plunges down to 5000.

In the first scenario, a V-shaped recovery during the second half of the year is likely to be followed by lackluster growth in 2010. During Japan's "lost decade" of the 1990s, Japan's economy remained depressed despite near-zero interest rates. The US economy should respond much better to near-zero interest rates because mortgage refinancing is a bigger deal here than it was over there. The second scenario is a depression, writes Yardeni: "We all have lots of time to think about

the meaning of life, and I go to see more movies, hoping I can find a job as a movie reviewer. Call me an optimist, but my subjective odds are 70% for the first scenario and 30% for the second."

5 – LOOKING ON THE BRIGHT SIDE

The recession is going global, the markets are tanking again, the central banks are slashing interest rates in ways that smack of desperation. The latest US unemployment figures show that the economy has now lost over a million jobs this year already. But Martin Walker, Senior Director of AT Kearny's Global Business Policy Council, is not down-hearted, for the following reasons:

First, the financial crisis is starting to ease.

- The LIBOR rate, which is the interest rate at which banks offer to lend unsecured funds to other banks in the wholesale market, is back down below the panic level.
- Credit Default Swaps look much less worrying. The net cost of resolving these trades will be large, but not fatal.
- We have never seen such levels of international coordination in cutting interest rates and in mutual guarantees.
- China has taken a strategic decision to become a responsible stakeholder in the global economy. It is undertaking a huge state investment program that will increase domestic demand, ease the slump in commodity prices, and increase imports.

Second, we now have a reasonable sense of how grim and how long the recession is going to be. The good news is that while there is still a long way to go, the worst of the financial and banking crisis appears to be over. We are now in a deep but fairly conventional global recession; it started in the third quarter of last year, will last for at least 18-24 months, and will see a decline in GDP among the G-7 countries of 2 to 3 percent.

The BRIC economies – Brazil, Russia, India and China – will slow to a growth rate of as low as 3% next year (for Russia) to perhaps 6% (for China). That would means halving China's growth rate last year, which will feel like a hard landing. The new state investment measures should help ease the damage. In 2006, the collective growth rates of the BRICs added more than $600 billion to global GDP; in 2009, they will be hard-pressed to add $350 billion. But they will still be growing.

There is a group of middle-income countries whose GDP is in the range of $400 to $900 billion: Mexico, Australia, Turkey, Taiwan, Indonesia, Saudi Arabia and South Korea. The collective GDP of those seven countries is equivalent to that of Japan; their potential and dynamism will be crucial. In 2006, their collective growth rates added nearly $300 billion to global GDP. Next year, they will probably add less than $100 billion. But they will still be growing.

Third, there is some very good news on innovation which points to a much brighter future. All previous predictions of gloom and despair – from Thomas Malthus in 1798 predicting that human population explosions would overwhelm food supplies to the Club of Rome's 'Limits to Growth' in the 1970s – have been proved wrong by human ingenuity and technological progress. This pattern of brains overcoming threats is likely to continue.