



## Perspective on the Latest Market Events

### Message from Jim McDonald, Director of Equity Research

February 9, 2009

After posting the worst January on record, the U.S. stock market regained some footing last week, with the Standard and Poor's (S&P) 500 index rising 5.3%. Stocks most dependent on global growth, such as technology and materials, led the recovery while defensive groups such as consumer staples companies lagged. As we will discuss later, the improved performance wasn't driven by a string of improving economic news or demonstrated progress on the policy front. Rather, the selling in January that led to the 8.4% decline in the S&P 500 appeared to simply have exhausted itself in early February, setting up the markets for a better tone. Interest rates, the U.S. dollar and oil prices all have been trading in relatively tight ranges during this period. Looking forward, all eyes are on the economic outlook and the plans for stimulus and financial system repair being constructed in Washington.

Recent economic news is consistent with the view that the U.S. economy is contracting further in the first quarter of 2009, with companies rapidly cutting inventories as well as labor and overhead costs. While the U.S. Gross Domestic Product (GDP) report for the fourth quarter 2008 was not as bad as expected (-3.8%), the depth of the downturn was cushioned by the lack of inventory liquidation. This will likely increase pressure on production plans in the first quarter and have a negative impact on growth. Meanwhile, the deceleration in some international economies is startling. In export-heavy Japan, for example, fourth quarter 2008 GDP is estimated to have dropped 12%. China recently implemented further stimulus plans to bolster growth and address their unemployment challenges. Recent bank lending and purchasing manager data indicate that some improvement in Chinese growth may be on the horizon.

With labor being the largest component of the cost structure of most enterprises, managers are aggressively cutting payrolls. The January 2009 jobs report showed a loss of 598,000 jobs, and along with increased estimates of prior monthly job losses, the unemployment rate jumped to 7.6% from 7.2%. The U.S. economy now has shed 4.2 million jobs since January 2008, with more than 40% of those losses occurring during the last three months. We expect the unemployment rate to continue to rise throughout the recession and remain a considerable weight on consumer confidence. In the most recent surveys, only 10% of Americans believe their income will be higher six months from now than today. That belief results in the poor retail sales numbers currently being reported. Unemployment is a lagging indicator, so the stock market will improve before the jobs market, but the current pressure on consumer spending is acute.

The depth of the current credit market crisis has turned what could have been a garden-variety recession into one that might someday be called The Great Recession. Policymakers are focused on trying to address both aspects of the crisis: unlocking the credit markets and stimulating economic growth to



stem the deterioration in the labor markets. As this goes to press, Treasury Secretary Timothy Geithner is preparing to announce his plan to help the banking system. Congress is set to begin negotiations to reconcile the roughly \$820 billion plans emanating from the House and Senate, with the hope of passage by Presidents Day. Our hope is that these plans are effective in addressing the significant challenges our economy faces. Until there is evidence of a sustained repair of credit markets and an ability to forecast a durable economic recovery, we continue to believe a defensive asset allocation is warranted.

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