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Market Commentary :: November

The Credit Tsunami

In testimony before Congress in late October, former Federal Reserve Chairman, Alan Greenspan, described the current global financial crisis as a "once-in-a-century credit tsunami" that policy makers did not anticipate. That pretty much captures the essence of what the financial markets, investors, and now the economy have been dealing with over the last 12 months. Whether you call it a tsunami, or maybe a category-five hurricane, it has been a destructive force that has left much devastation in its path.

Stock markets around the world have been reeling from the uncertainty and the elevated risk levels that currently exist. In the U.S., stock markets are more than 40% below peak levels reached in mid-October 2007. The housing collapse was the catalyst starting the financial avalanche, which continues to challenge central banks and investors around the world. The housing bubble inflated, as mortgage lenders failed to make prudent loans. Risk was overlooked in the push for higher returns by high-rolling hedge funds, private equity firms, and investors who fell victim to bad advice.

The demise of once-mighty financial giants like Bear Stearns, Lehman Brothers, Countrywide Financial, and Washington Mutual clearly points out the magnitude of the problem. These companies and many others lost their way, perhaps blinded by greed.

Now the effects of the credit crunch and housing crash are showing up in the overall economy. Unemployment is rising and will likely top 7% by mid 2009. Housing starts are running at only about 40% of their 2005 and 2006 levels! Retail sales, industrial production, and the leading economic indicators are clearly pointing to an economic recession that likely began in the third quarter of 2008 — or earlier. Most economists predict that a recovery will begin during the second half of next year. Real Gross Domestic Product is expected to be flat to modestly higher for calendar 2009, after mediocre growth this year.

Skies Should Brighten in 2009

The Federal Reserve Bank and U.S. Treasury, along with their counterparts around the world, are doing all they can to reduce fear and restore confidence. Expanding FDIC insurance, and providing capital infusions into banks, brokers, and insurance companies that were weakened by bad mortgages, appear to be laying the foundation for a recovery by this time next year. The depression of the 1930s resulted from a lack of governmental action to address severe problems. Lessons have been learned and this time the response has been massive and timely. Additional interest rate cuts are likely, as is another stimulus package in the months ahead.

There have already been some positive developments. Energy prices have come crashing back to earth, with oil and gasoline prices falling dramatically. Inflation will not be a concern in 2009, as food and other commodity prices (metals, lumber, chemicals, etc.) tumble from their peaks. Low interest rates will help cash-strapped consumers. The dollar has rebounded by 20% or more compared to the Euro and the Pound. The stronger dollar and reduced demand for energy are major reasons why oil prices are down more than 50% in recent months.

While we all have suffered from the stock market's huge sell-off, United Bank & Trust's above-average quality standards and aversion to high risk have helped contain client losses and avoid disasters, such as the common stock of Fannie and Freddie, Countrywide, Washington Mutual, Bear Stearns, and Lehman. High-quality fixed-income guidelines helped us sidestep poor-quality mortgage-backed bonds, high-yield junk bonds, and preferred stocks. We think stocks are nearing their lows for this bear market (Dow Jones Industrial Average @ 8,175) and should begin to recover before mid-year 2009. Patience, though difficult, is the best advice at this time. ::

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– Franklin D. Roosevelt

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