

Back to September

While some forecasters look for a rising jobless rate and more housing foreclosures to kill off a nascent recovery, we believe the panic is over and a V-shaped economic recovery is underway. It is in its earliest stages, which means plenty of economic indicators have yet to turn positive, but the signs of a strong bounce off the panic lows are all around us.

Since bottoming in February, consumer confidence has had the fastest three-month increase on record. The ISM manufacturing index, which fell to historic lows over the winter, has climbed from its hole to signal that the overall economy is now expanding. The Richmond Federal Reserve index, a measure of manufacturing in mid-Atlantic states, is showing growth. Container shipments both into and out of the ports of Los Angeles and Long Beach – key measures of international trade – have traced a V-shaped recovery.

In the financial markets, the yield on the 10-year Treasury note is back up to 3.86%, almost exactly where it was in August 2008, just before the crisis hit. The VIX Index – a measure of stock market volatility and risk – has also traded back to levels not seen since August 2008. Meanwhile, key commodity prices, such as oil, copper, lumber, and gold are well off crisis-period lows.

In general, the economic scene is quickly returning to where it was in September 2008 just prior to the collapse of Lehman Brothers and the ensuing sudden slowdown in monetary velocity. True, the official arbiter of US recessions, the National Bureau of Economic Research, says the recession started in December 2007. But we think that had it not been for the events of September 2008, a recession never would have been declared at all.

In the last full calendar quarter *before* September (the second quarter of 2008), real GDP grew at almost a 3% annual rate. This is exactly what we expect for the third quarter of 2009 – 3% real GDP growth – with even faster economic growth in Q4 and then in 2010.

With Treasury bond yields and the economy returning to pre-panic levels quite quickly, investors are left wondering about stocks. Will they return to the September levels of roughly 11,000 on the Dow and 1200 for the S&P 500? And if they do, how long will it take for them to get there?

Short-sellers, and many money managers who were not ready for the nearly 40% rally of the past three months keep arguing that the stock market will go back to test its lows. Or, they think a sharp correction is in order. But this is more of a wish than a forecast. Any short-seller that did not unwind short positions and any long manager that was not fully invested in March have taken a hit. The only way to climb out of that hole is for the market to offer lower prices to those who missed them.

But having many investors in this position (missing the rally), makes a re-test of the lows less likely. This rally will not be over until the short-sellers fully capitulate. In fact, we expect to see one or two major short-selling hedge funds blow up and liquidate before the rally comes to an end.

As this unfolds in the months ahead, the stock market should rise back to its pre-panic levels. It took seven months for the Dow to fall from 11,000 to 6,500, and it is very possible that it could go back to that level in the same seven months. However, this would be unprecedented. A more reasonable forecast is that it takes until mid-2010 for stock prices to rise back to levels last seen in September 2008.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-10 / 7:30 am	Int'l Trade Balance - Apr	-\$29.0 Bil	-\$26.1 Bil		-\$27.6 Bil
1:00 pm	Treasury Budget - May	-\$181.0 Bil	-\$181.0 Bil		-\$20.9 Bil
6-11 / 7:30 am	Retail Sales - May	+0.5%	+1.3%		-0.4%
7:30 am	"Core" Retail Sales - May	+0.2%	+1.2%		-0.5%
7:30 am	Initial Claims - Jun 6	615K	621K		621K
9:00 am	Business Inventories - Apr	-1.0%	-1.1%		-1.0%
6-12 / 7:30 am	Import Prices - May	+1.5%	+2.8%		+1.6%
7:30 am	Export Prices - May	+0.5%	+0.5%		+0.5%
9:55 am	U. Mich. Consumer Sentiment	69.5	71.0		68.7