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Dear Valued Investor:

Here we are with the blessings of spring upon us. In these recent weeks the financial markets have started to rebound from the lows hit this winter. Yet, broad equity price indices remain well below the 2007 peak levels and from a long-term perspective are about 40% to 45% below the peaks hit in 2000 and 2007. So, we have a long road to a full recovery however there are some signs that the market's recovery is progressing.

The first quarter company earnings reporting season is closing and it looks like things are turning around, after generally bad earnings reports for Q408. The earnings turn looks to be partly due to a reduction in bank loan write-offs, but also due to company cost cutting and, despite dire predictions of deflation, some ability to avoid a collapse in the prices of goods and services sold. Excluding energy, the Consumer Price Index (CPI) is up 2.2% over the last year including modest gains over all three months of this year.

Of course cost cutting has its dark side. The worker layoffs have pushed the unemployment rate to 8.5%. Inventory cuts and a drop in spending on plant and equipment by companies accounted for nearly half of the 6.3% decline in fourth quarter GDP. And various monthly data for the first quarter indicate further weakness. However, private sector actions in recessions, while painful, can be the most powerful factor driving recoveries.

On the brighter side, some measures of home prices are showing a rebound in February and March and the sharp drop in home sales appears to be leveling off. With home price declines, lower mortgage interest rates and, amazingly enough, still rising real personal income (due to lower energy prices), the housing affordability index is, by a large margin, at an all-time record high. Speaking of energy prices, we are getting much needed sustained relief for households, with crude oil down about 65% from that terrible peak in July 2008 and natural gas down about 70%. And consumer confidence rebounded strongly in April.

Though we are seeing some improvement, we are by no means out of the woods. Uncertainty is still a factor that can impact market participation, and we still don't know if the Obama administration policy actions, the Federal Reserve, and other agencies' plans will work well. I do think there will be some failures, but we are already seeing some positive results. Many, but not all, of the big banks appear to be recovering and while big bank lending is down recently, smaller banks that stuck to their knitting have been expanding lending. Interest rates on municipal, mortgage, corporate, commercial and other debt, previously viewed as "way too risky to invest in" have come down signaling renewed investor interest, allowing towns, states, home buyers, companies, and other borrowers expanded access to credit markets. It's not business as usual, but to me it looks a whole lot better than the "frozen credit markets" we saw earlier.

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There is an expression “accelerating to the bottom” that means things are getting worse at a faster pace. That would be bad. However, looking across the financial and economic landscape I do not see that acceleration at present. I see a moderate, but still jittery financial recovery, and an economy that is finding a bottom and struggling with a turnaround. People talk about V or U or maybe L-shaped recoveries (though talk about a return to the Great Depression or replicating Japan’s experience is heard much less now). The information on the markets and the economy looks to me to signal more of a U, with the bottom probably behind us in financial markets and the economy headed for a flat summer with recovery starting in the autumn. I am hoping for a better holiday season than last year’s, economically speaking. As always, please call your financial professional with any questions or concerns.

Best Regards,

Lincoln Anderson
Senior Economic Consultant