

Musings from the Chief Economist

Is it Different This Time?

Arthur A. Micheletti, CFA
Chief Economist and
Investment Strategist

FEBRUARY 3, 2009

In every stock market boom, the bulls tell us why “this time is different” – claiming the bubble won’t burst because this time the markets are more stable or earnings multiples are justified because perpetual prosperity is upon us. Today, the pessimists tell us the world faces unprecedented disaster. Rather than recession turning into recovery as it typically does, the pessimists believe “this time is different” and that we will continue to slide into the economic abyss. The pessimists argue the slide is being triggered by an “unprecedented” credit crunch caused by years of rapid debt expansion, rising defaults on that debt and staggering writedowns by our financial institutions.

Survey after survey shows historically low levels of confidence in the future. The stock market, which is the ultimate survey, is also pricing in such economic extremes.

Recessions are always caused by some “unprecedented event” that will supposedly lead to the demise of the economy as we know it. In the 1970’s, it was unprecedented oil shocks and double-digit inflation. In the 1980’s, it was “unprec-

edented” heights in interest rates and a collapse in stock prices in 1987. In the 1990’s, it was the demise of Japan, the Savings & Loan crisis, the Asia Crisis and the hangover from German reunification. After each of these “unprecedented events”, the perma-bears declared that perpetual darkness had fallen on the economic landscape and that we were headed for another Great Depression. Somehow, every time we survived and the world economy recovered.

As an example, consider the following media quotes from a recent write up by Dennis Gartman (one of our research sources): “There is no question that this is the worst economic time since the Great Depression” ... “The worst retail sales figures since the Great Depression” ... “The banking industry has plunged to the lowest point since the Great Depression” ... The recession is hitting white-collar workers more heavily than any since the Great Depression in the 1930’s”. These kinds of quotes are echoed everywhere today, yet all these quotes came from the low point of the 1990-91 recession. As we know now, rather than being the deepest and longest recession since the 1930’s, the

1990 recession was actually the shallowest and shortest lived.

This is not to say that the economic decline we are in is not severe, painful or unique; only that, even in minor downturns, it is easy to run wild and to extrapolate bad times well into the future. Like all declines, this one has its unique characteristics. The financial panic triggered by the banking crisis is undeniably the worst we have experienced in over thirty years.

However, while there is tremendous deflationary pressure on the economy caused by the deleveraging process, there are also powerful countervailing forces being brought to bear. Currently the Fed is conducting a truly unprecedented expansion in monetary policy. The Fed and Treasury have injected large amounts of liquidity into the financial system through the discount window, various lending facilities, money market fund supports, deposit guarantees and capital infusions into banks. This monetary effort is global in nature, with governments and central banks around the world printing money, rescuing banks, providing guaran-

continued on page 2

Bailard

INVESTING. REDEFINED.®

Musings from the Chief Economist

continued from page 1

tees and passing fiscal stimulus packages. In addition, we have had the fastest and greatest decline in oil and commodity prices ever. That decline should provide a huge stimulus to consumers and most businesses. There is also the potential of a tailwind from developing economies that are in much stronger financial shape than the U.S., and that have growing populations and improving productivity trends. Stronger growth from these countries could support U.S. exports. Finally, whether needed or not, the government is about to dump almost \$1 trillion in spending into the economy.

While no one knows precisely when the economy will turn, we can see the preconditions for growth being put into place. We would point out that both fiscal and monetary policies work with long and variable lags and that the most aggressive anti-deflationary policies have only been in place since October. There are also signs that these policies are working. U.S. Treasury Bill rates are at the lowest level since the Great Depression. After spiking in October at the height of the credit crunch, the LIBOR rate and commercial paper rates have plunged to record lows. Junk bond yields, after climbing to 23%, have fallen to 18%. Corporate credit spreads across the quality spectrum have narrowed, oil prices are a bit firmer, stock market volatility has declined, and the dollar has strengthened. All these indicators are signaling that the willingness to take on risk has improved and that the stage is likely being set for an economic recovery.

Sources: Bailard Research, GaveKal Research, Bloomberg LLC, Dennis Gartman

Disclaimer

This piece has been distributed for informational purposes only and is not a recommendation of, or an offer to sell or a solicitation of an offer to buy, any particular security, strategy or investment product. This piece does not take into account the particular investment objectives, financial situations or needs of individual clients. The performance information portrayed in this report is not indicative of the past or future performance of any Bailard product. Past performance is no indication of future results. This piece contains the current opinions of the author and such opinions are subject to change without notice. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. Bailard will not offer investment advice in any jurisdiction where it is prohibited from doing so.

© 2009 Bailard, Inc. Foster City, California