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The Recent Rally: A Perspective Going Forward

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From March 9 through April 30 of this year, the DOW gained 25%, the NASDAQ jumped 35%, and the S&P 500 climbed 29%. The markets seemed to defy the odds, climbing in spite of negative news releases offering little in the way of positive catalysts. They were given a boost by economic data that was depressing compared to last year's data but better than the analysts had forecasted. Earnings fell into the same category. Compared to last year they were lousy but for the most part better than predicted. So, in general, the economy is struggling, but not struggling as much as economists had predicted, which really isn't saying much. So the question now is, what lies ahead.

I am not one to predict what shape the market recovery will take and when that will happen. However, I can ask whether it will be a **V-shaped** recovery, a **W-shaped** recovery, or a **square-root** recovery, which is a small **v-shape** recovery followed by months of **flat** markets. Whatever shape they take, markets can be full of surprises.

I would like to bring some perspective to the economic data, such as that for consumer spending. On May 13, the Commerce Department reported consumer spending had dropped 0.4% for April. (Analysts had expected a slight rise.) The markets reacted negatively to this news, pushing the DOW down 184 points; however, this is not necessarily a negative report. Additionally, the Commerce Department also reported that the U.S. Savings Rate for the 4th quarter of 2008 was at its highest since the 3rd quarter of 2001. It's not hard to see the correlation here. Consumer spending data is based on prior months and says nothing about future spending patterns. With the economy faltering over the last year and a half, it's no wonder people's **time preference** has changed. It could be consumers are delaying purchases and saving for future outlays. It's as if they are becoming their own "bank," only making withdrawals for investments and capital outlays and realizing that building a nest egg is important during hard economic times. Didn't we learn in Economics 101 that saving is a good idea? Don't analysts look for companies with enough cash on the books to weather economic storms, acquire other companies, make other capital investments, or reduce debt?

Economies don't grow nonstop, nor do recessions last forever. This one won't last either, but when a banking crisis is involved, recessions tend to last longer. Confidence in the banking system will return; in fact, we are beginning to see signs of that already. The time will come when consumers will begin to draw from their own "bank." Maybe they will be more cautious about debt levels and realize that housing prices, for example, don't rise without limits. Maybe they will be wiser about spending based on income rather than perceived wealth. Caution and wisdom could create a stronger economy in the long run. We need also to consider the spending patterns of the current administration—but that's a subject for another newsletter.