The Bottom- 2009
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Since the low of 666 on March 6th, the market has climbed twenty seven percent. There is a slow sea change occurring in the stock market. Stocks seem to take bad news in stride and move up on any news that is better than anticipated. The momentum is finally changing and it now appears as though the lows have been made, with the odds of a retrenchment all the way back to the bottom being very remote. We seem to be running out of new bad news.

Last year at this time the housing market seemed to be finally getting what it deserved. Stocks had backed off but numbers remained solid in the rest of the economy. Economists thought that 2009 would be a very mild decline; perhaps no more than a stall-out. As the year wore on, housing prices continued the relentless decline and finally, the stock market plummeted. At this point, so much wealth had been destroyed that the outlook for consumer spending really changed. It was recognized in September that we were entering a sizable recession.

The housing bubble collapse created the strain on banks as all the financial assets they held, most notably mortgages, went down in price. Low mortgage prices reflected the buyer who speculated on what percent of the pool of mortgages would go bad. There are some regulations that force the banks to write off the entire investment even if only a few credits of the pool look questionable. One bad apple eliminates their ability to call it tier one capital. With asset prices declining, the credit markets seized up. Everyone was a seller to shore up capital.

The turn will occur with housing. Housing starts are at the lowest level in several decades, hitting less than 500,000 units. Previous declines have seen a low in housing starts at 650,000 to 800,000. This will help to rapidly decrease the inventory of houses. Prices and interest rates have made housing, based on current consumer income, more affordable than the previous 25+ years. Sales in California are up 57% year-over-year off a very low trough. The inventory of homes is sixty to eighty percent back to normal. The big builders see a pickup in orders. It appears housing should bottom this summer.

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The consumer has ramped up savings in response to the fear of losing their job. At some point the consumer feels that the level of cash recently put aside warrants a slight pickup in spending and retail sales start to rise. There are signs this is beginning to happen. This is further supported by energy prices declining affecting gasoline, electricity and heating bills. Tax refunds will soon stream in and are supposed to be 14% higher than last year. All told, real consumer income has had a very strong boost.

Recent economic indicators point to a decelerating decline in economic activity, like a plane coming in for a landing. All signs point to an economic bottom later in 2009.The recent stock market rally is based on the realization that the economy was showing signs of flattening out. Cash positions are still high, bears still abound.

We believe that the lows have been made. We expect a pullback from 844 (S&P) down to around 750. A bounce off of 750 would launch this market to new recovery highs, while establishing a higher low and thus an uptrend. From there, expect a slow march to 1200 as the last of the negative news is played out. Unemployment will continue to rise for at least another year but initial unemployment claims should be close to peaking. As they move down towards the 500,000 area, the death knell will sound for the bear market, which ended on March 6th.

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