Market Comments

April 1, 2009

Looking back at the first quarter, it is difficult to recall a time when we have seen such deep and broad-based downward revisions to the outlook for global economic growth. In the wake of the Lehman bankruptcy last fall, the severe impairment of financial intermediation in general and trade finance in particular led to a sharp and immediate decline in global economic activity that appears to have continued through the first quarter of 2009. In response to such weakness, international forecasting agencies are now expecting the first outright decline in the world economy in 60 years. For example, the Organization of Economic Cooperation and Development now expects the world economy to contract by 2.7% in 2009, with global trade to decline by a shocking 13% and with no economic recovery until 2010.

Such is the impact of letting a too-big-to-fail financial institution actually fail. We can be relatively certain that international policy makers will not make that mistake again any time soon. And in response to the crisis, relatively heroic monetary and fiscal policy initiatives have been announced around the world including huge fiscal stimulus measures in the U.S. and China as well as aggressive interest rate cuts around the world and radical quantitative easing in the U.S. and the U.K. As one indication of the unprecedented policy response, the economics team at ISI Group has counted over 450 recession-fighting policy initiatives announced around the world in the last six months, more than four times as many as in the previous six months.

There is some evidence in U.S. data that stock markets typically bottom when the professional economic forecasting community moves to a consensus recession outlook, so we are currently inclined to look for the silver lining behind the numerous dark clouds. One such positive is an apparent stabilization of some indicators of final demand such as U.S. retail sales data or business confidence in Europe and China. Another positive is the fact that global production is declining at a 14% annual rate compared to a global retail sales decline of 4%. That implies a massive destocking of inventories, which will need to be reversed quickly if there is even a modest stabilization of final demand. We would also note that the internal action of global stock markets in recent weeks has been consistent with the notion that global growth will begin to recover in the second half of 2009 in response to aggressive policy measures. In particular, sectors like materials, financials, information technology and consumer discretionary all posted strong gains in March, suggesting increased investor confidence in prospects for economic recovery. Ironically, by frightening policy makers into adopting unprecedented stimulus measures, the very violence of the downturn in recent months may have increased the odds for a V-shaped economic and stock market recovery as the year progresses.