

By Jeffrey G. Johnson

## Green Sunglasses

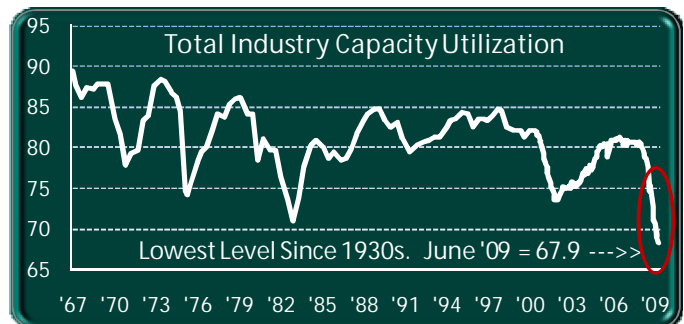
*"What many see as the first promising sprouts of economic recovery are, in reality, the artificially generated, short-term gains from the most massive dose of fertilizer (government stimulus) that the country has ever seen." – Peter Schiff*

As the second quarter bounce reacted to ideas of “green shoots” or “less bad” economic news, the addition of exaggerated misconceptions trumpeted by the green sunglass wearing crowd further aided the equity market’s illusory climb. Despite the fragile, yet extremely persistent rebound from March lows, the major indexes barely managed to recover earlier losses. Finishing mixed through the first six months of 2009, the Dow Jones Industrial Average is still down 2.01% while the S&P 500 Index is ahead 3.16%.

On the surface, the recent advance has created a growing optimism that a new bull market is brewing. In comparison, imagine constructing a building but not waiting for the foundation to dry, not using the right materials, frantically adding story after story despite failing inspections. Are you ready to move into the penthouse? In a similar manner, the technically weak underpinnings of the market’s latest action has so far proved to be typical of a bear market retracement, rather than a fresh high-sponsorship (structurally sound) bull market.

The second quarter generally marked a perceived period of healing for financial markets around the globe as the credit markets, which had been the epicenter of the financial crisis, improved somewhat. However, as reality sinks in that this is no ordinary recession and “less bad” doesn’t necessarily translate into a quick recovery, a situation is developing where investors now require favorable developments to prevent significant disappointment in the coming months. To even justify current market values, corporate profits alone will need to at least match exceedingly optimistic forecasts for an upswing through the remainder of the year.

Looking at just one example for a predictive signal of a healthy economy and strengthening consumer demand, the critical total industry capacity utilization level must turn around and rise back above 80%. In the face of the lowest level of production relative to potential since the 1930s, businesses are still not seeing demand and not expanding capacity yet. (Please refer to the chart to the right)



The key fact remains that we have significant economic headwinds before us and no single piece of news will just flip a switch to make the problems all go away. Unfortunately, by late this year, we will begin a substantial second-wave of adjustable mortgage rate resets, which will likely result in greater foreclosures, debt loses, and localized housing market pressures.

Today the U.S. consumer dominated economy generates approximately 70% of GDP growth. Furthermore, not only is the economy currently shedding +600K jobs per month, but the number of people whose unemployment benefits are expiring is now running over +500K a month as well. (The chart on the back of this page illustrates the total job losses in comparison to previous recessions.) With the ability to consume largely dependent upon ones income, it becomes apparent that debt burdens and employment difficulties will play a vital role on the road to recovery. During this credit crisis recession, debt-ridden consumers who become unemployed could trigger another domino effect of further defaults, additional joblessness, and continued economic weakness.

