



# Collection of Thoughts

## Stimulating Against Time



The S&P 500, 2008 earnings had dropped to \$29.57. David Rosenberg of Merrill Lynch's forecast for reported earnings for 2009 is now down to \$28. That puts the P/E for the S&P 500 at 30.

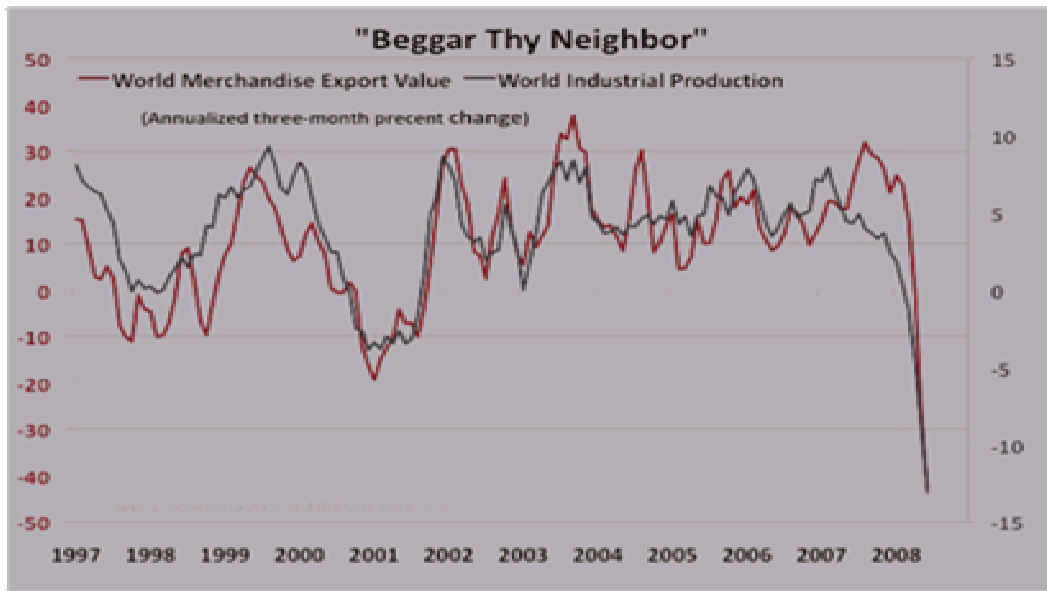
He also projects "operating" earnings to be \$55 for 2010. Applying a classic recession-trough multiple of 12x against a forward EPS estimate of \$55 would imply an ultimate low of 666 on the S&P 500, likely by October.

That is a 20% drop from today's close of 829. That is not what you will hear from "sell-side" managers who want you to invest in their mutual funds and long-only management programs.

40% of the earnings for the S&P 500 are from outside the US. It is hard to see how those earnings are not going to be deeply affected.

The following chart shows World Merchandise Export Values and World Industrial Production falling off a cliff. This is the worst such period since the end of World War II. Consumer represents 60% of world GDP, and it is not just in the US that spending is slowing down. Consumers all over the developed world are in shock, as assets such as stocks and houses, real estate, and commodities fall in value. Unemployment is rising.

It is estimated that almost 2,000,000 lost jobs in the last three months in the US is a catastrophe. China lost a reported 20,000,000 jobs in the last quarter. Unemployment is rising rapidly in Europe, as the demand for goods has clearly been falling since last October.



This means that inventories are too high, not just in the US but in factories all over the world, and that production is slowing down. Look at the recent US trade deficit. Many market analysts rejoiced that it dropped to a six-year low, just below \$40 billion.

But the internal numbers were not as positive. Exports are dropping faster than imports, as seen below. "After growing in every quarter during the last three years, real goods exports fell 34.9% at an annual rate, the worst performance in more than three decades. The falling deficit means that US consumers have to save more to balance out less foreign buying of US debt.



In the US, the leading economic indicators (LEI) continued to decline, but the leading indicators in the rest of the world were much worse. (The chart below from Simon Hunt.) These are results from the OECD's analysis of the leading economic indicators for a variety of countries. Notice in particular how poorly Russia and China are doing! Also remember that the LEI is about how the economy is expected to be doing in six months, not what is going on right now. This argues that there is no real global turnaround in the picture before the end of the third quarter, at the earliest.

Country	November	December YOY % Change
USA	-8.7	-9.5
Japan	-5.5	-7.3
France	-5.7	-5.9
Germany	-10.7	-11.8
Italy	-5.0	-5.6
UK	-6.7	6.8
Korea	-4.4	-4.4
Belgium	-6.9	-8.4
Czech Republic	-10.4	-12.5
Poland	-7.2	-7.7
Spain	-7.4	-7.7
Turkey	-10.5	-13.4
Brazil	-2.9	-5.4
<b>China</b>	<b>-12.9</b>	<b>-14.0</b>
India	-7.7	-7.5
Russia	-13.8	-17.7

China has seen its year-over-year exports drop by 17.5% and imports by 43%. These are not signs of a healthy economy. That being said, China is massively increasing bank loans and other stimulus-type spending to try and offset the effects of the global downturn. But putting 20 million people back to work in a short time is a daunting task.

Japanese GDP was down by 9% (!) last quarter. Many of the largest corporations are seeing exports drop by 20-30% and are engaged in massive layoffs, larger proportionally than in the US. The euro area economy dropped by 6% in the 4<sup>th</sup> quarter, led by an 8.2% contraction in Germany (JP Morgan).

Given the above prognosis one can understand why Tim Geithner's bank bailout plan was lacking details. What if the number that the Treasury and the Fed are looking at is a lot more than the remaining \$350 billion in the TARP program? As in another \$1 trillion more, or even the \$1.5 trillion that Roubini says may be out there (and other independent analysts, like David Rosenberg of Merrill, say there may be another \$2 trillion in losses).

Can you imagine what the market reaction would have been if they had announced that this week? The Dow down 400 points would have seemed like a Sunday walk in the park. Congress would be screaming, and the chances for the stimulus package to pass would have materially diminished.

The "stimulus" that President Obama will sign tomorrow is a band-aid. If Irving Fisher, was right, such a stimulus is useful in that it helps those who are unemployed and replaces some lost consumer spending; but the real work that must be done is to get the credit system flowing again.

The core of the problem today is Keynes vs. Fisher, von Mises vs. Friedman. It is, as Lacy Hunt says, "The Grand Experiment." After 70 years, we are going to see who is right. It is not an experiment that is going to be fun to live through; but when we have the next debt deflation in 70 years or so, our grandchildren may know what to do.

We will see another stimulus package, probably by the end of the year. This time it will hopefully provide real stimulus. Much of the current version is simply an increase in federal spending that will be hard to rein in.

But the heavy lifting is going to be done by the Fed. Watch their balance sheet expand. And watch Treasury and the FDIC come back and ask for massive amounts of money to take over very large insolvent banks. Stay tuned.