Capital Market Consultants, LLC
Building Business Together

April 2008 – Skirting the Recession

By the time officials are able to formally declare a recession, there's a good chance we may have avoided it altogether thanks to low interest rates.

Consumer confidence and consumer sentiment have trailed off considerably this past quarter, yet retail sales are up. How can these two seemingly contradictory results be reconciled? What's more believable—what people say or what they do? We believe it is the latter that tends to reflect itself in market action and measurable data.

The Consumer Price Index was up 4% year-on-year for the month of March, while the Producer Price Index was up 6.9% for the same time period. This is continuing to cause a squeeze on corporate profits that will likely continue for the next few months.

Corporate net income from continuing operations was down from the fourth quarter of 2006 to the fourth quarter of 2007. First-quarter 2008 profits are down significantly, especially in the financial, industrial, and consumer discretionary sectors. From an employment perspective, this means the unemployment rate could creep up.

From an investment perspective, that means markets have probably already priced in a recession.

Traditionally, a recession is defined as two consecutive quarters of a decline in real gross domestic product. The timing of when to call a recession is a challenge, because we often don't have official statistics on real GDP until well after a quarter has ended. "Advance" GDP results are released one month after the end of a quarter. The next month, "preliminary" GDP results are released. Finally, three months after the end of a quarter, the "final" GDP results are released. So it actually takes nine months to determine whether we are in a traditionally defined recession.

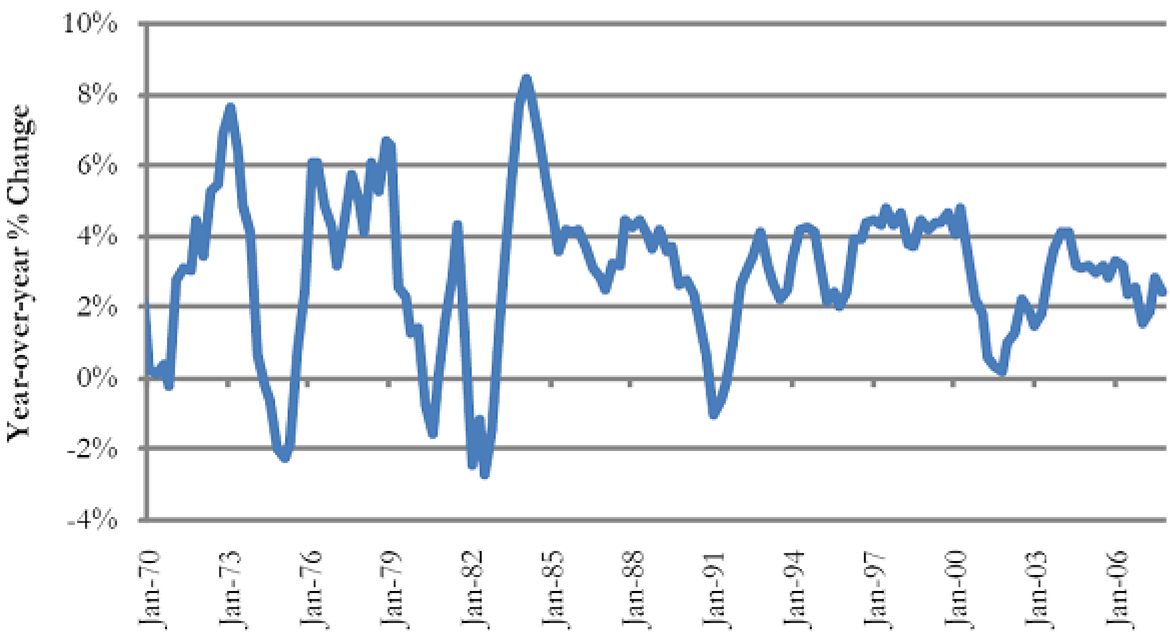
Since 1981, the average recession has lasted only 11 months. In reality, we feel a recession before it can be declared. And clearly some sectors of the economy have been contracting for some time, like consumer-related housing, autos, and the financial sectors. Others have continued to expand, but at a slower pace, like energy and materials.

We guess it's not much comfort to know that by the time we figure out we are officially in a recession we may only have about two months left to go! The final numbers for the fourth quarter, as of March 27, showed an official increase of 0.6% in GDP. Looks like we may not know we have been in a recession until September of 2008.

Capital Market Consultants, LLC

Building Business Together

Gross Domestic Product



Source: CMC EResearch

While growth in the fourth quarter of 2007 was slightly positive, it may dip during the first quarter. The aggressive rate cutting the Fed began on September 18, 2007 will likely have had the desired effect by summertime: lower costs of capital for business and investment, supporting the housing market and alleviating some of the excessive use of credit by consumers over the past five years. Even though corporate profits for the first quarter of 2008 are likely to dip dramatically, the second quarter is likely to be stronger, because the benefits of a more benign rate environment will start taking hold. In short, we expect the "recession of 2008" is likely to be a widely anticipated non-recession.