



## Insights from Northern Trust

### Commentary from Katherine Ellis Nixon, Northeast Region Chief Investment Officer

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The Dow Jones Industrial Average breached the psychologically important level of 10,000 on October 14, closing at 10,015.86, the highest level in a year. The moment was fleeting, with equity markets unable to sustain that lofty level. However, that milestone served as a reminder of how far the stock markets have come from the dark days of March. Whether one looks at the capital markets as a gauge or analyzes the economic data for clues, it seems clear that the worst is behind us in terms of the global financial crisis that unfolded in earnest a year ago.

What defined the “worst?” It was the free fall in global economic demand, a seizing up of the global credit markets, widespread declines in asset prices and the rising fear of financial sector bankruptcies. The extreme pessimism that enveloped asset markets in early 2009 reflected this worst-case scenario and in retrospect set the stage for the V-shaped price recovery in the Dow that we have experienced since the fall 2008. The “V” shape also characterizes the price recoveries we have seen broadly across asset classes as investors have been rewarded for taking risk across the capital market spectrum this year. Bonds (both investment grade and high yield), real estate and global equities have all participated in the market recovery. Achieving Dow 10,000 merely captures the continuation of the success in the global risk trade in one simple number.

The rise in the capital markets reflects more than just the joy of economic and financial market survival. Economic indicators across the globe reflect a similarly V-shaped recovery. Various measures of global economic activity, both coincident as well as leading, point to a continued improvement from the standstill of early 2009. Unemployment stands as a notable exception. However, global manufacturing activity has rebounded significantly. In the midst of the third-quarter earnings release season, we are struck by the number of companies posting higher-than-expected earnings (more than 80% of the reports thus far), and in some cases revenue. Clearly, exceeding expectations is a function of the extreme pessimism that took root earlier this year. However, the improvement is very real. This positive feedback loop is affecting corporate psychology as well, with CEO confidence reaching a five-year high.

But back to unemployment. Can we sustain a healthy Wall Street without a healthy Main Street? With unemployment at a 26-year high and many economists – including our own Paul Kasriel – suggesting that 10%+ is a very real possibility, it stands to reason that consumers will be hard-pressed to do their part. This leaves much of the heavy economic lifting to corporate spending and our trading partners. Further, although the rate of job loss has diminished, many of the jobs lost during this recession may represent a more structural change in our economy; hence, the recovery in employment will take quite some time. And the news for even those lucky enough to be employed is



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not exactly heartening: Colorado is the first state to **lower** the minimum wage rate based on falling headline inflation.

Amid the euphoria around third-quarter corporate earnings and Dow 10,000, investors were presented with stark reminders of the continued challenges in the consumer credit market. CitiGroup and Bank of America (BofA) both announced continued deterioration in credit cards and mortgages, with BofA credit losses reaching a staggering \$9.6 billion. True, the consumer has responded to various stimulus measures intended to encourage demand in autos and housing. However, it appears that the environment may be difficult without such support and as we enter the next phase of the recovery, characterized by now-higher expectations and potential stimulus exit strategies.

Despite the challenges, the risk trade has continued to provide return for global investors. However, the next stage of this market cycle may be more discerning in terms of participants, and the “short-U.S. - dollar, long-everything-else” trade may peter out as a result. We remain resolute in our focus on the future state and sustainability of the economic recovery in the face of potentially broad-based reductions in monetary stimulus. With timing of exit strategies uncertain, we continue to stay the course for now. We understand that the rearview mirror always provides a clear picture and can be self-reinforcing over the short term. It is, however, no way to drive.

Katherine Ellis Nixon holds designations as a Chartered Financial Analyst and Certified Investment Management Analyst.

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