



Investment Overview

January 2009 • Volume 18, Issue 1

Economic and Markets Summary

by William S. Eastwood CFA, Senior Vice President-Union Investment Management Group

First Quarter 2009

The Economy

The weakening trends in the economy continued with little relief during the first quarter of 2009. After Gross Domestic Product slipped into negative territory only slightly during the third quarter of 2008, the fourth quarter produced the worst quarterly decline for GDP since the fourth quarter of 1982, dropping -6.3%.

There is no reason to expect significant improvement in GDP for the quarter just ended as trends continued negative. The first estimate of GDP for the first quarter of 2009 will be released April 29.

Economists grew more negative as the first quarter progressed. A survey of 52 economists sponsored by the *Wall Street Journal* and released mid-February showed a more bearish outlook. First quarter GDP is expected to be -4.6% as opposed to their prediction last September that GDP would actually grow +1.2% for the quarter just ended. Forecasts for the second quarter show a similar shift from a +1.9% GDP expectation made in September to a -1.5% decline.

The average forecast for the third quarter is growth of +0.7%, less than half the rate expected last fall. The fourth quarter picture is also less rosy, reducing growth to +1.9% from 2.1%. The consensus predicts the recession will end in August; however, there is a growing group of economists that say this outlook is far too optimistic.

"We're in trouble" says Brian Fabbri, chief economist at BNP Paribas. "We don't have sufficient economic plans at present to resolve the banking system or the financial crisis, and the stimulus package seems loaded for 2010." He added that the global nature of the downturn along with U.S. consumers' increased savings and lenders' tightened standards all stand in the way of a quick recovery. Another economist expressed disappointment with the package offering

the view that we are in danger of repeating Japan's mistakes, referring to their policy errors during their lost decade of the 1990s.

Nonetheless, U.S. policy makers made several moves during the first quarter to address the current economic and credit problems. The Fed continued to cut interest rates and pumped a huge amount of liquidity into the financial system in order to restore lending in the frozen credit markets. At the same time Congress appropriated billions of dollars to shore up the financial system and boost economic growth.

On February 10, Secretary of the Treasury Timothy Geithner offered his Financial Stability Plan that was initially met with heavy criticism for lack of specifics. The basics and the intent consists of the following.

- A new Capital Assistance Program to help ensure that our banking institutions have sufficient capital to withstand the challenges ahead, paired with a supervisory process to produce a more consistent and forward-looking assessment of the risks on banks' balance sheets and their potential capital needs.
- A new Public-Private Investment Fund on an initial scale of up to \$500 billion, with the potential to expand up to \$1 trillion, to catalyze the removal of legacy assets from the balance sheets of financial institutions. This fund will combine public and private capital with government financing to help free up capital to support new lending.
- A new Treasury and Federal Reserve initiative to dramatically expand – up to \$1 trillion – the existing Term Asset-Backed Securities lending Facility (TALF) in order to reduce credit spreads and restart the securitized credit markets that in recent years supported a substantial portion of lending to households, students, small businesses, and others.

- An extension of the FDIC's Temporary Liquidity Guarantee Program to October 31, 2009.
- A new framework of governance and oversight to help ensure that banks receiving funds are held responsible for appropriate use of those funds through stronger conditions on lending, dividends and executive compensation along with enhanced reporting to the public.

At about the same time, Congress passed the economic recovery and stimulus plan which called for close to \$800 billion in government borrowing and spending to provide tax relief for some individuals and businesses and spark an infrastructure building boom to boost employment. This was an important piece of legislation heavily favored by the new Obama administration, and a central part of his presidential campaign. In the aftermath of the economy losing 2.6 million jobs in 2008, it is very important that this stimulus plan works.

Job losses continued in the first three months of 2009. The monthly employment reports were dismal with over 500,000 jobs lost each month. Unemployment continued to climb with weekly jobless claims hitting highs for this economic cycle and the unemployment rate rising above 8%.

Business spending and consumer spending both reflected the seriousness of the current recession. The problems in the auto industry in particular caused some plants to shut down completely and contributed to extreme weakness throughout the manufacturing and capital spending sectors of the economy. Meanwhile, consumer spending and confidence were on a similar downhill slide. Consumer confidence deteriorated to 28-year lows during the first quarter of 2009.

The questions of whether the recent policy initiatives will work will be the key for the economy going forward. Reversing the trend in job losses, stabilizing housing, and seeing an improvement in the credit markets will be important signs of improvement. Already mortgage rates have shown declines and inter-bank lending markets are working better than in the fourth quarter of 2008. Given a little more time there may be additional signs of progress.

Additional policy measures will undoubtedly be forthcoming if the recently proposed programs do not yield positive results over the near term.

Interest Rates

The yield curve shifted upward for U.S. Treasury securities during the first quarter of 2009. This rise in interest rates occurred even though Treasuries experienced continued heavy demand from investors seeking the safety and liquidity that this class of securities provides.

Even this heavy demand could not push rates lower than those existing near year-end when 10-year U.S. Treasury notes yielded a low of 2.06%. At that time the bond market was heavily over bought setting up a trend reversal that lasted through the first quarter.

The movement of interest rates and the change in the yield curve can be seen in the table below, which shows various rates at the end of 2008 and the end of the first quarter of 2009.

	Treasury Bill		Treasury 5 yr.	Notes & Bonds		FED Funds
	3 mo.	1 yr.		10 yr.	30 yr.	
12/31/08	0.11	0.34	1.56	2.25	2.68	0-.25
3/31/09	0.20	0.55	1.66	2.68	3.55	0-.25

The intermediate and longer end of the yield curve experienced more upward movement in rates than for Treasury bills. Investors were still willing to accept minimal yields on the short end of the curve in order to achieve safety and liquidity. Intermediate and longer term rates have risen for several reasons. The fears of deflation that gripped the markets in the second half of 2008 are abating somewhat. Supply concerns are starting to weigh on the Treasury market. A record amount of new borrowings are hitting the market and will continue to do so to fund the stimulus package, the budget deficit for the coming fiscal year, and current and proposed initiatives to deal with credit market issues.

Bond investors also recognize that many of the programs could be inflationary down the road, particularly if they prove to be successful in turning around the recession. It will be a significant challenge for the Federal Reserve to reverse policies at the appropriate time to prevent inflation from becoming a problem down the road.

The Federal Open Market Committee (FOMC) of the Federal Reserve had two meetings on their schedule during the first quarter of 2009. On January 28 the FOMC concluded a two-day meeting and voted to keep Fed Funds at the range set at the last meeting, 0-0.25%. Their post-meeting comments consisted of the following. The FOMC anticipates exceptionally low levels of Fed Funds to remain for some time. The economy continues to weaken and the global economy is weakening also. The Fed expects an economic recovery to begin later this year, however considerable risks exist. Inflation is well under control. The Fed will use all tools to maintain stability in the financial system.

The FOMC met again on March 17, and again decided to hold Fed Funds at a rate of 0-.25%. The post-meeting comments were more downbeat to those mentioned at the January meeting. They warned of increasing economic slack here and abroad. Following the meeting they announced a program to buy \$300 billion of long-term U.S. Treasury securities and a greater amount in mortgage-backed securities. This resulted in an immediate 50 basis point drop in yields for intermediate and long term Treasuries. This move by the Fed brought mortgage rates down to a record low. During the last week of March the rate for a 30-year mortgage was 4.85% and 4.58% for a 15-year mortgage.

At this time, high-quality corporate bonds offer better yields than U.S. Treasuries, with better capital gains

potential. The opportunities for capital gains in Treasury securities are very low. As with Treasuries, the dollar has been a beneficiary of the flight to safety, rising about 20% from lows made in mid-2008. The U.S. economy and financial system are in disarray, but the same could be said for those overseas. Currencies reflect relative not absolute economic positions, and many countries are in worse shape than the U.S. The dollar's reserve currency role continues to offer protection against rapid decline. No other currency is in a position at this time to challenge the dollar in this regard.

The movement in interest rates created mixed returns for various bond fund categories during the first quarter of 2009. Below are some examples of different bond fund returns according to the *Wall Street Journal*.

Year-to-Date Percentage Returns			
U.S. Corporate Bonds	-1.90	Investment Grade - Short	+1.20
Long-term U.S. Gov't	-0.70	High Yield Taxable	+5.00
GNMA	+3.10	Municipal Bond Index (7-12yr.)	+2.20

During the first quarter commodity prices were not as volatile as those experienced in 2008. The recessionary tone to the economy kept prices under pressure for most commodities. The price of oil, which stood at \$101.00 per barrel at the end of the third quarter began the year at \$44.60. On March 31 the price of oil stood at \$49.66 per barrel.

Gold also experienced lower volatility during the first quarter of 2009. After hitting a March 19, 2008 high of \$1,003 per ounce, gold started the current year at \$844 per ounce. At the end of the first quarter an ounce of gold closed at \$923.

The Stock Market

The optimistic case for the stock market resides with the thought that the economy will bottom out and start to recover toward the end of the third quarter. Necessarily there is also the belief that the stock market leads the economy by approximately six months. Therefore the stock market bulls are looking for the stock market to bottom out in the near term based on the economy turning up during the latter part of 2009.

However, little optimism existed for the first quarter of 2009 until the last few weeks of March. The recession, far from ending, appeared to worsen to the extent that the "D-word," depression, was being bandied about. Most monthly economic indicators released were more downbeat than expected, and this had a very negative effect on the stock market through most of the first quarter until mid-March when a powerful rally ensued.

January saw the stock market decline, continuing from the dismal performance from the fourth quarter of 2008. One would think some sort of rally would occur after a decline in excess of 20% for the fourth quarter. But January turned out to be the worst January in history with

the Dow Jones Industrials falling -8.4% and the Standard and Poors 500 losing -8.65%.

The worst January on record gave way to the worst February since 1933 as the stock market ended the month at a 12-year low. The liquidation of stocks was relentless, as the DJIA closed at slightly above 7,000. As a point of reference, the DJIA closed at 7,086 on May 7, 1997. At the end of February the Dow had declined six months in a row and had fallen more than 50% from its all-time high recorded on October 9, 2007 at 14,164.

March started out in a similar negative manner dropping to 6,547 on March 9. For the balance of the month stocks rallied off that low. The next 13 trading days saw the DJIA rally an unprecedented 21%, the sharpest rally since 1938. On March 31 the DJIA closed at 7609.

Compounding the problems for the stock market, in addition to this recession, has been the sizable wealth contraction occurring over the past year. For a number of years the growing "wealth effect" was a positive factor for the economy and investment markets. The "wealth effect" is now a negative as determined by a study conducted by the Federal Reserve. The recession has cut many Americans net worth by more than 20% as the value of their homes, stock portfolios and businesses have plummeted in value. This percentage drop only included data from December 2007, the point at which the recession began, through October 2008, when the report was prepared. This percentage drop would be significantly higher as of 2009 given the continued drop in the stock market and falling home prices.

The impact has disproportionately fallen on the wealthiest households and those between the ages of 55 and 64 according to the Federal Reserve. Net worth tends to peak in that age bracket, as retired Americans begin to spend down their savings.

One would think the tremendous decline in stock prices has created a lot of bargains in the stock market. While this may be so, this is being offset by sizable revisions downward in corporate profits, thanks to the economic recession. Near the end of February, Citigroup cut their estimates for operating earnings for the S & P 500 in 2009 by 23% from a much lower 2008 base. The earnings per share estimates have been cut from \$62 to \$51 and from \$65 to \$54 in 2010. The yearly progressions of S & P earnings per shares are shown at right.

From an industry sector standpoint operating profits for materials and basic industry are forecast to drop by 65% in

Year	Citi Estimate	Y/Y % Chg
2006	88.08	+15.5
2007	84.46	-4.1
2008	66.60	-21.1
2009	51.00	-23.4
2010	54.00	+5.9
2011	63.00	+16.7

2009. Energy profits are expected to fall by 55% and 35% for industrials. Doing relatively better, health care should grow about 7% in 2009, while consumer staples and utilities are forecast to be flat or up slightly.

Regarding the domestic stock market, below is a chart of industry sectors ranked by percentage change by Bloomberg Research at the end of the first quarter.

Percentage Gain by Stock Sector		1st qtr.
1.	Technology	+3.96
2.	Basic Industry	-2.82
3.	Telecommunications	-8.47
4.	Health Care	-8.52
5.	Consumer Discretionary	-8.61
6.	Consumer Staples	-11.31
7.	Utilities	-11.86
8.	Energy	-12.08
9.	Industrials	-21.77
10.	Financials	-29.49

Below is a table showing percentage returns for the first Quarter of 2009, for various equity sectors and investment styles as computed by Lipper Inc., and featured in the *Wall Street Journal* on a daily basis.



Stock Fund Indices

As of 3/31/09

Large-Cap Growth	-3.74%
Large-Cap Core	-9.63%
Large-Cap Value	-11.75%
Multi-Cap Growth	-5.06%
Multi-Cap Core	-8.86%
Multi-Cap Value	-11.56%
Mid-Cap Growth	-4.36%
Mid-Cap Core	-6.89%
Mid-Cap Value	-9.54%
Small-Cap Growth	-6.18%
Small-Cap Core	-11.45%
Small-Cap Value	-13.80%
Equity Income Fund	-12.42%
Science & Tech Fund	+4.36%
International Fund	-12.36%
Balanced Fund	-5.84%

Fund Results | as of March 31, 2009

Equity Funds

	Quarter Return	12-Month Return
Allianz NFJ Large Cap Value	-18.74%	-47.61%
Allianz RCM Mid Cap	-1.15%	-35.53%
Fidelity Adv Eqy Income	-14.59%	-43.66%
Goldman Sachs Mid Cap Value	-9.28%	-37.47%
Janus Adv Intl Growth	3.30%	-43.49%
JP Morgan Mkt Exp Idx Select	-11.59%	-37.87%
Lazard Emerging Markets	-2.21%	-45.15%
Stratus Growth Portfolio	-9.44%	-34.31%
Templeton Inst Foreign Equity	-13.56%	-43.98%
Thornburg Int'l Value	-10.55%	-41.58%
Vanguard 500 Index	-11.01%	-38.09%
Vanguard Morgan Growth	-4.40%	-36.94%
Vanguard Small Cap Index	-13.49%	-39.11%
Vanguard Strategic Equity	-12.99%	-43.57%
Idx: S & P 500	-11.01%	-38.09%
Idx: Russell 2000	-14.95%	-37.50%
Idx: EAFE	-13.97%	-46.34%
Idx: NASDAQ Composite	-2.79%	-32.25%

Fixed Income Funds

PIMCO Total Return	1.49%	2.96%
Stratus Gov't Secs	1.41%	4.60%
Templeton Global Bond	0.22%	-0.10%
Vanguard GNMA	1.98%	6.96%
Vanguard Infl-Prot Secs	5.25%	-2.90%
Vanguard Total Bond Idx	0.35%	3.16%
Idx: M.L. Int Term Bond	-0.03%	5.16%

Past performance is no guarantee of future results.



The Investment Overview newsletter is published quarterly by the Union Investment Management Group of Union Bank & Trust Company. Please address correspondence to Union Bank & Trust Company, Union Investment Management Group, P. O. Box 82535, Lincoln, NE 68501-2535.

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