Of Green Shoots and Second Derivatives

Second Quarter 2009

There is no question last year was one of great investing difficulty and I hope it was a once in a lifetime event. Yet even after that debacle, we started this year on the down side. It wasn't too long ago that the talking heads were discussing a repeat of the Great Depression and the end of investing as we know it. Now, just three months later, the talk is about recovery and how green shoots and second derivatives are pointing in the right direction. ***Green Shoots and Second derivatives?*** What does that mean?

Normally the market recovers about 6 months before the recession is clearly over. What we observed in the first quarter was most likely an over swing of the investment pendulum. Once the market started to rise, (the S&P was up over 36 % on June 30th from the March low),[1] the pundits needed an explanation. So, how do we explain this?

Some companies are suggesting they are seeing signs of a turnaround, like the green shoots flowers put out in early spring. As far as the second derivative is concerned, the talking heads needed an explanation of the rising unemployment we are seeing each month. How can the market rise with people losing jobs every day? Well here comes the magic math. Unemployment was rising each month undeniably, but the amount of increasing unemployment was slowing. The math wizards pulled the second derivative magic out of their hats and said "less bad" equals good. The markets seemed to buy into this logic and we saw one of the best quarters for the major US markets since 2003, which, was the end of the last recession.[2]

In June, CNBC.com interviewed me and we discussed a problem I saw on the horizon; sooner or later "less bad" will not be good enough. At the beginning of this month we observed the markets starting to lose some ground as investors became worried that this season's earnings would be poor and the markets would decline again. As I

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[1] CNBC.com July 15th 2009
[2] CNBC.com July 5th 2009

write this we have received reports from Intel, Goldman Sacks, and others that have been well above expectations. Thus we have seen another uptick in the markets.

As usual, I end these reports with what I believe all this noise means to you. Here is my take on our current position; we are still in a recession. However, there are some real signs we might have seen the worst. But until unemployment becomes employment we must expect choppy markets. I do strongly believe that the recession will end and the future will be brighter. Until then, I will use the ups and downs of the markets to adjust your portfolios to keep them in line with your long-term goals.

In the mean time it seems to have stopped raining (at least figuratively) so let us all enjoy the rest of the summer.

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