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Big quarter may not salvage S&P's decade

The market has performed well recently, but that doesn't mean everything is turning up roses

SUMMING IT UP

William Rutherford

The quarter that ended on Sept. 30 was one of the best quarters in years for the market. The Dow averages, the Standard & Poor's index and NASDAQ all added about 15 percent even though the averages fell .31 percent on the last day of the month. These gains came on top of similar gains in the previous quarter.

Despite a sharp swoon at the beginning of the year, since the start of 2009 the Dow Jones Industrial Average has increased 13.5 percent, the S&P 500 has jumped more than 19 percent, and the NASDAQ Composite has gained almost 35 percent.

So, things are looking up, right? Well, not so fast. On the first day of the quarter, new job data revealed that 236,000 people – more than expected – joined the ranks of the unemployed, and the official jobless rate moved to 9.8 percent with many believing that the real rate was over 16 percent. In addition, data from the Institute for Supply Management showed that the Purchase Managing Index slipped back into negative territory, signifying a weakening economy. Investors were left to contemplate the large run-up since the March 9 lows, and the earnings season that is about to begin.

That data came after a drop in sales of previously owned homes and a decline in orders for manufactured goods. But the Department of Commerce reported that the GDP had shrunk by a .7-percent annual rate instead of the 1 percent expected. Yet this was better than the decline of 6.4 percent in the first quarter of 2009.

Personal spending fell at a rate of .9 percent as people worried about job losses and their personal finances. Personal spending represents about 70 percent of the economy, so that was especially significant. Of course, spending by federal, state and local governments, and the $787 billion stimulus package aided the economy. Military spending rose, and spending on business equipment and software was better than expected. While many expect the economy to bounce back, economists and government officials believe the jobless rate will continue to stay high for some time.

Meanwhile, Federal Reserve Bank President Richard Fisher of Dallas reported in a research paper what we have been saying in this column: the banks have eaten the Fed's monetary policy.

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Fisher, according to the Wall Street Journal, reported, "... banks with the greatest asset losses were the quickest to freeze or reduce lending activity. Their borrowers faced higher interest rates and restricted access to funds…" and a threat of inflation, even though the Federal Reserve reduced bank borrowing costs to nearly zero.

Some parts of the economy benefited from the decline in commodity prices as the threat of inflation receded. Wheat is down 47 percent and corn is down 14 percent since the beginning of the year. Milk and eggs are in surplus. Declining oil prices have reduced the cost of transportation and plastics. Metals prices are down as well. The price reductions will benefit consumers, processors and distributors, but at the cost of producers such as farmers.

Low bond yields suggest that deflation is a bigger threat than inflation, and add to the skepticism over a recovery in the economy.

In spite of the robust run-up of this year, the S&P, which dates to 1927, is on track to have its worst decade ever. Its previous worst decade was the 1970s, when it fell 13 percent – including dividends. With three months left in this decade, the decline is 33 percent. It would take a monster rally in the next three months for the S&P to even equal its worst decade ever. That monster rally may not happen, but the markets could be higher by the end of 2009.

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William Rutherford is the founder and president of the Portland company Rutherford Investment Management, listed in Barron's as one of the nation's leading separate account managers. He is also the author of a critical appraisal of Alan Greenspan's term as Fed chief, "Who Shot Goldilocks?" Contact him at 888-755-6546 or wrutherford@rutherfordinvestment.com.