



Like the Old Mississippi, the Recession “just keeps rolling along.”

Based on all the data we will not see the recession hit bottom until mid 2010. The rate of decline should slow during the second half of 2009, with the bottom occurring during the first 6 months of 2010.

The big unknown is the impact that government actions will have on the length and severity of the down turn.

What does history teach us about what the government should do now?

In the past 100 years we have experienced essentially 4 economic turn down that look like what we are experiencing now. Each resulted from meaningful dislocations in some key areas, just as the present down turn.

In the first, **1921**, production slowed rapidly resulting in an average 11.7% unemployment rate. Industrial production declined 31.2% and the S&P 500 lost over 30% of its value. What did the government do? The government cut corporate, personal, and capital gains taxes. The government also reduced spending and the national debt. The Fed raised target interest rates to record highs.

What happened? In 1922, 2.4 million jobs were created, unemployment fell, prosperity returned, government revenues rose and the S&P 500 recovered and rose above where it had been.

In **1929** we began a down turn. The Fed did not act to alleviate the lack of credit available. ***The government raised taxes and substantially increased spending.*** The depression deepened and became extended. By 1932 the Dow was down 91% compared to July 1929. Industrial production fell 52%.

In **1961**, we were sliding into a deep recession. Unemployment hit 6.7%. President Kennedy after comparing 1921 to the depression, lead the highest tax cut in history and started a long term eco

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The Economic Down Turn, has become truly a global Recession.

25 to 40 million workers have been laid off in China. Tens of thousands of manufacturing operations, with reduced exports, have been forced to close.

As we suggested in earlier newsletters, if you rely on foreign suppliers, for stability, you must be vigilant and seek alternative suppliers. India, China, Mexico, among others, are becoming increasingly less reliable as the recession deepens.

Manufacturing slowed in China for the 6th consecutive month. Look for civil unrest to increase, further complicating China's stability. While official reports may continue to say China's economy is flat, China will continue to experience a recession through 2009.

Brazil is a bellwether of how Latin America is doing. Brazil has experienced a material down turn in exports. Their production decline indicates they will be in recession through 2009.

Southeast Asia is also in recession. The economies in the region experienced drops ranging from 6% to 30%. Japanese manufacturing hit a 21 year low.

2009 will be a recession year for Canada, but 2010 could be better. Mexico on the other hand looks like both 2009 and 2010 will be bad.

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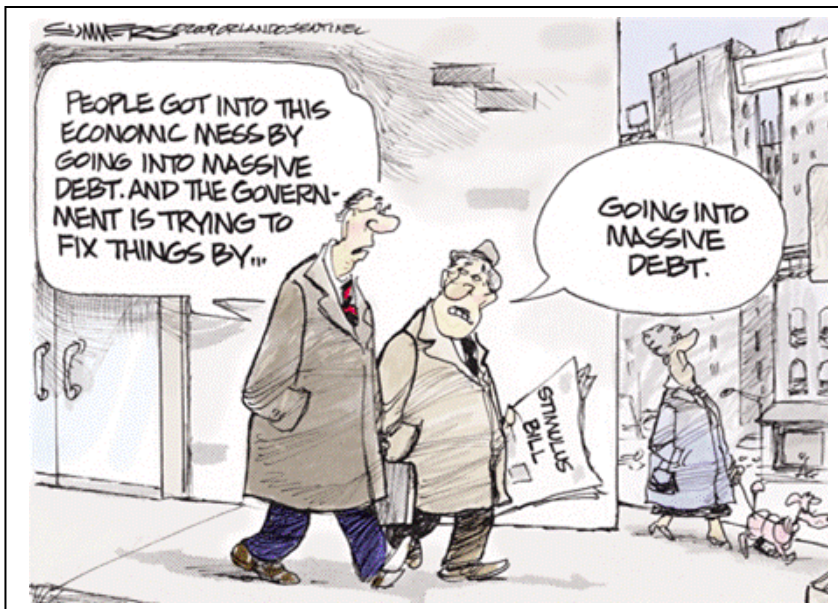
conomic upturn.

In 1982 we had a down turn which statistically looks almost identical to today (high unemployment [10.8%], stock market decline, production decline, etc.). The government again cut taxes and brought spending under control. Its eventual area of increased spending was on defense. These steps began an unprecedented period of economic change and growth that has lasted until last year.

Given these four examples, what actions do you believe have the best chance to shorten the down turn and restore growth? Certainly, acting to maintain credit availability appears to be an important step in keeping the economy working. Reducing taxes in a way that stimulates investment and give immediate liquidity to all taxpayers, including entities that employ others, also appears very important.

There is no doubt that just as there are similarities between the 4 prior down turns and today, there are also many differences.

Recent Cartoon



Is This Really A Repeat Of 1982?

In 1982 the government’s recipe was to cut taxes and many domestic programs, but increased deficit spending on defense. Given the cold war this fueled the economy and addressed a deficiency in our national defense. Today, the government’s approach is some tax cuts, some defense cuts, and increased deficit spending on “domestic infrastructure” items.

It is how the government balances all these intricate ingredients, of course, that will determine how the omelet turns out. That is why two different chefs can cook with the same ingredients with such different results. Will the 2009 tax cuts result in a broad based increase in disposable income and business investment, and will the spending be controlled and focused? That is why what and how much Congress decides to spend matters. It will affect your next 15 months.

Bailout & Debt

We are seeing the biggest spending increase in history:

- 1. Stimulus Bill \$787,000,000,000 (Passed)
- 2. Omnibus Bill \$410,000,000,000 (Proposed)
- 3. Supplemental Bill \$200,000,000,000 (Proposed)

Total spending of:

\$1,397,000,000,000

Proposed budget for next year:

Spend	\$3,606,000,000,000
Tax	\$2,428,000,000,000
Borrow	\$1,178,000,000,000

Plus, there are proposals for “TARP II”, auto bailouts, mortgage relief, and nationalized health care.

The current spending plans would require the Bureau of the Public Debt to borrow \$150 billion a week to service and expand the debt of the United States. The Stimulus bill triggered the largest borrowing requirement ever for the United States. It appears this year we will sell more than 4 times the amount of debt ever sold in the United States before.

Who buys our debt has shifted. We used to have 40 primary purchasers, now there are only 16 or 17. In 2003 it was mainly Americans, but now it is foreigners, topped by China. China’s purchases of U.S. debt will decline from over \$400 billion last year to just \$177 billion this year. Currently many foreign governments are themselves entering the debt market with their own bailouts.

About \$4 trillion of our debt is owned by government trust funds, mainly Social Security. It is possible that the Fed may have to intervene and buy a major portion of the new debt.



Our prior Newsletters suggested 8 key drivers to track the economy.

+ Petroleum Prices

Petroleum prices have risen slightly with increased consumption over the past few months. They are at or near their expected lows. As summer approaches consumption will increase. It is not expected that disposable income will be further enhanced by lower prices during the next 6 months.

+ Natural Gas Prices

Like petroleum we do not expect further relief from falling prices. The reduction from early 2008 was especially positive during the winter months. As the government's program of reducing the use of coal by utilities gains momentum this will have a negative impact on the economy.

+ Exports

The global recession and strength of the dollar is expected to continue to negatively affect exports and hurt manufacturing.

+ Retail Sales

In February we saw a slight upturn in retail sales due to Wal-Mart's sales. Much of this sales gain reflected Wal-Mart's increased food sales which came at the expense of other sectors such as restaurants and supermarkets. Retail sales will continue to be hurt by the downturn through 2009.

+ Strength of the Dollar

The flight to quality has about run its course. For the time being the dollar should remain stable.

+ M2 Money Supply

Continues to increase.

+ Industrial Production

Continues to fall. This reflects the deepening recession and is pressuring layoffs in the service sector.

+ Raw Material Prices

Stable.

The concern now is what form will the downturn take over the next 12 months?

Which of the 5 basic scenarios will we see?

1. Depression

Increasing unemployment, severe deflation, and low interest rates.

2. Severe recession

Increasing unemployment, mild deflation, and high interest rates.

3. Mild recession

Increasing unemployment, both level cost of living and interest rates.

4. Stagflation

Increasing unemployment, mild inflation, and low interest rates.

5. Severe Stagflation

Increasing unemployment, high inflation, and high interest rates.

There is a growing global need to borrow in order to fund various countries' stimulus programs. This could substantially reduce purchasers available to buy our growing government debt. Should the Fed be forced to turn on the printing presses to keep up with our increasing need to borrow, we could also see substantial inflationary pressures coupled with increasing interest rates here in the United States. Credit markets are again tightening resulting in higher borrowing costs and less availability of credit.

Moreover, increasing taxes, stock market erosion, tight credit, and similar factors could lead to reduced capital availability and declining business activity. While at present we are still in the mild recession circumstances, these other factors could quickly tip us toward either end of the downturn spectrum. For now we can expect increasing unemployment with contained inflation and low interest rates. The drop in the stock market and value of other asset classes will require higher funding levels for both corporate and government pension funds. For State and Local governments this will increase pressure for tax hikes. For companies this will hurt margins.

Whether we are headed for **Recovery**, **Stagflation**, or **Depression**, or all three over the next 15 months for that matter, is not clear. What is clear is the need to take the potential alternatives into account in your planning and actions as conditions develop.



The Wise Old Owl

You should have a scenario-based strategic plan that lets you adjust your business model very rapidly as this economic cycle develops.

- *You need to watch your customer's credit very carefully.*
- *Talk to your customers and know what is happening in their business and how you can help them.*
- *Develop a financial dashboard that gives you a picture of your key business drivers each week.*
- *Insure you have the financing available for what lies ahead.*
- *Share your strategic plan with your bank and show how prepared you are for what lies ahead and demonstrate why there will be no surprises for them.*
- *This is a time when paying close attention to your branding is critical.*

