



L. R. Levin Consulting, L.L.C.

Newsletter

April 2009

We may be still at sea, but is that echo we are hearing possibly the bot- tom of the downturn?

Many economists, based on a few encouraging indicators, are now voicing the belief that the downturn could hit bottom by the last quarter of 2009. **But are these false echoes?**

What are some of the potentially “good” *indicators* that the bottom may be approaching that the economists have seen? Many of the *indicators* are just that the indicators themselves are *not falling as fast* as in the previous month. This could be a false echo. As we suggested in our earlier Newsletters, because of an emotional over reaction on the part of the consumer at the end of 2008, the economy fell much more precipitously than it should have based on the actual economic data.

Now we may be returning to the level of decline the economic factors indicated we should have been at in the first place. By comparison, we are now falling at a rate consistent with the 1980 recession.

Another example of a good *indicator* is *existing home sales* were up 5.1%, month over month. This may be a false echo because that increase resulted from 45% of the sales being distressed foreclosed homes being sold at a fraction of their prior value. In markets with increased sale, like Phoenix, values declined at

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Is China On The Prowl?

China still has in place a variety of mechanisms to control its people and its economy. While experimenting with moving toward a free market economy, it is still a heavily controlled society.

This has permitted China to move more quickly in implementing key policy changes. In the long run these changes may have a continuing affect on the world economy.

China implemented a \$585 billion stimulus program building harbors and infrastructure. It also extended more than \$400 billion in new business loans. Unlike the United States, in China such loans are more like stimulus infusions. That is because China has an 80% default rate on its internal bank loans.

In China what loans and how they are repaid is still based on who you are and who you know. As China’s economy recovers, its consumption of the world’s raw materials will again grow. This could affect the cost of everything from oil to iron ore.

China has also begun a major program of replacing the US dollar as the median of world trade. They are beginning to move their trade over time entirely to the Yuan. Using the Yuan to close transactions would allow China significant control over world trade.

They are starting with Hong Kong and are moving to extend the program to South Korea and

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the steepest rate in 25 years. In Phoenix, home values fell 35% in 1 month.

Another hopeful *indicator* was a slight *uptick* in *retail sales*. As we pointed out before, this was actually due to Wal-Mart experiencing a surge in food sales. Advertising that you could save substantial amounts by buying your groceries at Wal-Mart – “Pay less, live better” - paid off.

The false echo is that Wal-Mart reports its food sales as part of the retail sales numbers, while the food stores from whom Wal-Mart took the business report in a different category which experienced a drop in sales. In March retail sales were down 1.1%.

Mixed readings like these mean we cannot tell if there is a real improvement yet. It will take several months to sort out. That said, The Institute For Trend Research, a premiere economic forecasting organization and our strategic partner, has suggested that ***“because of current leading indicator activity, we have pulled in the projected timing of the recession low from the first quarter of 2010 to September/October 2009.”***

Recently the Federal Reserve revised its data to show the recession starting earlier than the Fed had reported previously and the Fed said the downturn has been more severe than previously reported.

other Asian countries. As the program grows it will have an impact upon the Dollar and our trade.

As the economic downturn has progressed, the world has become more protection oriented and it is having a negative effect on world trade. One element that has facilitated world trade since the end of World War II is that all nations have settled their transactions in US dollars. As China works to abandon the dollar and conduct world trade in the Yuan it will inhibit free trade. If other countries follow China, and trade becomes fragmented, it will stifle world trade and globalization.

A substantial portion of China’s economy is based on exports. For its stimulus and loan package to sustain a recovery its exports must also recover. While March’s decline of 17.1%, year over year, was better than February’s 25.7% decline, the continuing decline is a major weak spot in China’s economy. March was hardly better than January’s 17.5% decline. Its trading partner Japan experienced a 46%, year over year, decline in exports in January and 49% in February.

China’s economy is much closer to recovering than Japan’s. China is still more closely linked economically to the US than it desires. For China to sustain its recovery exports to the US must increase.

Will the Downturn Hit Bottom for All Segments of the Economy in 2009?

In our last Newsletter we looked at previous recessions for guidance on how the government can best facilitate a recovery. How do the current indicators compare to what we know of past recessions? What the indicators show is that the rate of deterioration of economic activity has been steeper than the 1980 recession, but less than 30% of the rate of decline we experienced at this stage of the Great Depression. We should also be encouraged that it is only about 50% as steep as we experienced in the 1974-75 recession.

What may be happening is that different parts of our economy will bottom out at different times. Retail sales may stop falling by September while other areas may not hit bottom until mid-2010. The impact of the

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stimulus program has not yet been felt in the economy. Hopefully as the stimulus kicks in, it will turn the faint echoes into real soundings. Understanding what the bottom of the downturn means for you is more complex than saying the recession may hit bottom by October 2009. For many segments of the economy, bottom may not come in 2009.

What are some of the economic segments that may not hit bottom until 2010? We are experiencing the lowest housing starts since 1946. For a real recovery to begin, housing must stabilize. This includes stabilizing mortgage financing.

Construction of all types is still in trouble and this has been an important employer. Commercial building construction, for example, does not look like it will hit bottom until well into 2010. Nondefense capital goods new orders were down 24.3%, the worst decline in history with 2009 seeing no bottom.

New orders for durable consumer goods have experienced their worst decline since World War II. Metal working machinery often tells where manufacturing is going. That segment is experiencing the biggest drop in 17 years. Durable consumer goods and metal working machinery are expected to continue their decline into 2010.

Another important segment is light vehicle production. All makers in the United States, foreign and domestic, are down substantially with declines expected through 2009. What all of this demonstrates is that the timing of when various important segments of the economy hit their low point will vary and for some certainly drag well into 2010.

What Will the Recovery Look Like?

Whether the economy hits bottom in 2009 or 2010 the real question is “what does the recovery look like?” With the excitement over the possibility that the downturn could be playing out, we may have lost sight of what that means. Economists have two overriding fears. First, the recovery may be flat and second, inflation may further destroy our economic stability!

Was Columbus wrong? In spite of what we learned in school, is the world really flat? Economists are now increasingly concerned that the government’s broad massive economic intervention will prolong the downturn and create a flat recovery. We take for granted a “V” shaped recovery. Normally,

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when economic activity drops, we have unemployment, we reach the low, and the free market system corrects the dislocation.

As the economic dislocation is corrected activity picks up. Pent up demand built up during the downturn fuels a substantial increase in economic activity and jobs are created.

In the depression on the other hand, we hit the bottom and stayed there in effect from 1932 to 1941. It was war time preparation and conflict that brought us out of the depression.

The concern today is that the massive spending programs coupled with substantial tax increases could stifle the pent up demand and prevent increased economic activity and job creation leaving us with a flat recovery. The Institute For Trend Research, for example, has said, while

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Commenting on one of the favorable trend indicators, that “unfortunately *** the trend dynamics of this early turning indicator means that we are going to see a tepid pace to the recovery when it begins in 2010.”

Federal, state and local governments have all experienced declining revenues. *Like a street full of people opening umbrellas against the rain, all levels of government are talking about increasing taxes.* At the federal level there are proposals for substantial increases to take effect beginning about 2010 just as we hit bottom. There are many other changes such as “cap and trade” that are hidden taxes that will increase the cost of key items like electricity that everyone must consume. The cumulative effect of all these federal, state and local actions could have a very negative impact on the economy. Economists are describing an “L” shaped recovery not a “V.” They say this “L” shaped flat period could last 4 or 5 years, or worse, longer.

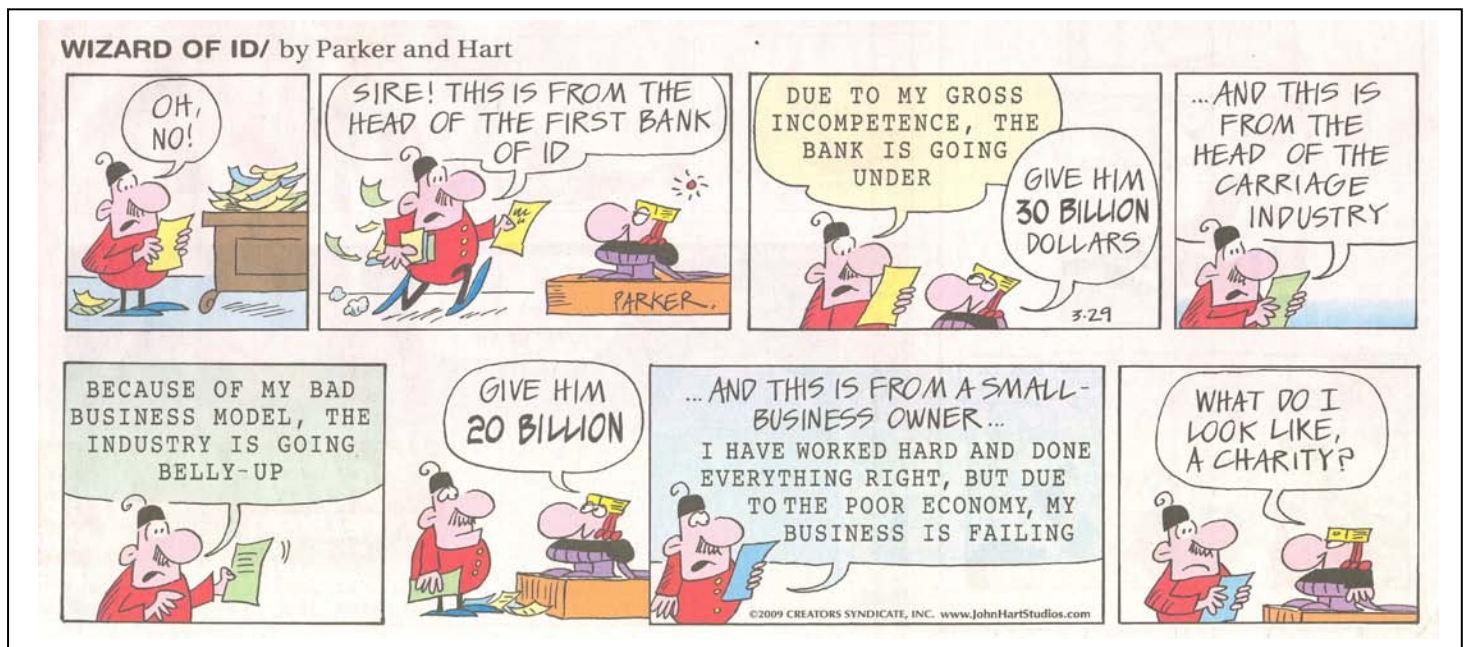
The second concern is extremely high deficit spending and the Federal Reserve’s dramatic increase

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in the supply of money. Economists are suggesting that the cumulative effect of these two government driven behaviors could include substantial inflation by 2010 or 2011. The core rate of inflation was up 3.8% in March. One form the downturn could take, discussed in our prior Newsletters, is Severe Stagflation. If we have an “L” shaped recovery, we will not see job creation and increasing employment. The need to borrow large sums, the cost of debt service, and aggressive monetary policy could cause both inflation and high interest rates. The value of the dollar could be impaired at the same time our exports remain flat. Other unintended consequence may make the situation even worse.

While we all hope we avoid this perfect storm, we must plan for the next 12 months taking into account all 5 basic scenarios the downturn could take, including Severe Stagflation. Now that insurance, financial institutions, unions, and auto companies “benefited” from direct government help, one thing seems certain, most businesses cannot count on government bailing them out.

Recent Cartoon



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The Wise Old Owl

To survive and grow, focused, scenario-based action planning is what will make the difference now. The timing of when market segments hit bottom clearly will vary by industry. How inflation impacts raw material or other costs will also vary by industry segment.

What is clear is that your company and your segment will go through this downturn with different timing from other segments of the economy. How Latin America, Europe, Asia, India, and China handle this downturn will have different effects on different portions of our economy. Thus, each of you must act based on the factors and timing unique to your business's part of the economy.

Knowing when and what recourses to lock in and how and where to focus your efforts is critical and will be company specific.

Albert Einstein was right when he said,



“Insanity is doing the same thing over and over again and expecting different results.”

It is the actions you take now that will create your success over the next 15 month as the downturn develops and evolves.



Reminder

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