



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

Newsletter

August 2009

Will The Impending Recovery Help Your Business?

Good news reports are breaking out all over; the stock market is reacting with joy and ignoring all signs of possible clouds on the horizon. But will the recovery, when it comes, help your business during the remainder of 2009? The current optimism is still based primarily on what economists call soft indicators, like confidence indexes. The recently released July Conference Board's U.S. Leading Indicator Report is bursting with enthusiasm.

The Index rose for the fourth consecutive month and is at 101.6, up 3.8% from its March low. What are the key factors cited by The Conference Board? Two factors were key in July, improving interest rate spreads and lower initial unemployment claims. Our strategic partner, the Institute For Trend Research's (The "IFTR") rate of change graph shows significant upward movement in the U.S. Leading Indicators.



The IFTR views the rate of change figures as providing “evidence that we will see a viable economic recovery in 2010.” What does this tell us about the timing of the recovery and will your business improve in 2009? There appears too little evidence, even in the soft indicators, that a meaningful recovery will begin in 2009. Even Fed Chair, Ben Bernanke,

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has hedged his words: “After contracting sharply over the past year, economic activity appears to be leveling out, both in the U.S. and abroad, and the prospects for a return to growth *in the next year* appear good.”

In addition to the soft indicators, there are two recent economic trends that have been much welcomed by the press and economists. The Wall Street Journal headlined, “Housing Lifts Recovery Hopes” as it referred to a 7.2% July increase in the sale of existing single family dwellings. The other hopeful, often referenced sign was a modest increase in consumer sales (including Auto).

While these are “hopeful” signs, the actual economic data does not indicate any recovery before 2010. There is no reason to question the IFTR’s prediction that if a “viable” upturn is coming, it will be during 2010 at the earliest.

So for 2009 it does not appear we will see a real improvement for your business. What we are seeing is a slowing of the deterioration of economic activity that should continue through 2009. As we examine what the economic data for July and early August shows, the hope is that we will hit bottom in 2010 and that the bottom may not be too much deeper.

Even interest rates, cited by the July Conference Board’s report, may be questioned for what they really show. Short term rates are at a 119 year low. This is because the Fed has been dramatically increasing the money supply, flooding the banking system with credit. We have seen the most rapid growth in the M2 money supply in over 60 years. At the same time, long term rates have begun to increase.

The Fed has helped to hold even long term rates down with a substantial program of buying long term securities. These two programs have been important factors in its efforts to stabilize the economy. However, there are some dark clouds on the horizon.

Currently, the U.S. must finance \$60 Billion of *increased* debt per week to cover the growing deficit. That means not only refinancing the existing debt as it comes due, but adding \$60 Billion per week more. Just this week, the Office of Management & Budget explained that with tax revenues dropping, if we do nothing more, it expects that in 10 years the national debt will grow, by \$2 Trillion more than previously expected, to \$9 Trillion dollars. This is an extraordinary amount.

This type of debt load will put extreme pressure on long term interest rates. It can only be sustained by the Fed monetarizing the debt by printing money and buying more U.S. securities. The unintended consequences of such an action would include substantial inflation. In the short term, as we look at 2010, the IFTR predicts, even before these recent

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developments, we will see inflation reaching 6% during 2010.

The second factor cited by the Conference Board was lower initial unemployment claims. The more critical question is where is real unemployment now and for the rest of 2009?

As we discussed in our prior **Newsletters**, real unemployment is over 20 million in the U.S. already and continuing to grow. This includes those workers who want work but have exhausted their unemployment benefits. Even if these numbers are growing more slowly, they still mean that retail sales will be affected by this substantial and growing loss of buying power. We do not see improvement in this important factor occurring or helping during the remainder of 2009 or even early 2010.

What about that 7.2% spurt in existing home sales? Does it signal an end to the worst recession in the U.S. since World War II? The headline could have read: "Foreclosed Homes Account for 31% of July Sales, Driving Home Prices 15% below Last Year's Level." There are over 1.8 million homes currently in foreclosure in the U.S., and it appears this will get worse as the affects of unemployment continue to grow.

In Las Vegas, for example, 73% of all single family home sales were of foreclosed homes. As we will discuss below, this increase in home sales may not help 2010. But for 2009 each home sold may or may not give some added retail sales of furnishing and appliances during the remainder of this year. With all of these factors in play, it is understandable why the IFTR suggests we can "expect a rough second half of 2009."

Perhaps the most important question is, if we are going to see bottom in 2010, what will the return to growth, a viable upturn look like? ***How the upturn in 2010 and 2011 takes shape is a critical question for your business planning.***

There are many very real dark clouds on the horizon. But will the storm pass, or will we get a hurricane is not a question that the national weather service can answer.

Take the 7.2% increase in home sales, for example. In prior **Newsletters** we have spoken of the importance of real stimulus, such as tax cuts lasting for several years. One very important factor in home sales has been the federal tax credit for first time new home buyers. That stimulus measure is due to expire in 3 months on November 30. Compare it to the tremendous buying spurt in new cars that came with "cash for clunkers."

Will new car sales fall off for the rest of this year, if the government lets it expire? Many economist fear that the consumer spending diverted by this program will appreciably take away funds that otherwise would have gone into other retail sales. A "robbing Peter to

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pay Paul” effect. Will back to school sales suffer? There are several key times each year, when a substantial amount of retail sales occur in the U.S.

One is the Christmas Holiday season and another is back to school time. Many economists are concerned that the timing of cash for clunkers will take needed dollars away from this important season as consumers stretch to buy cheaper new cars. If retailers are left with unsold inventory, this could affect the remainder of 2009 and early 2010.

Another cloud over 2010 is the recent realization that falling federal revenues may push our national debt to over \$9 Trillion dollars. Many economist think this means we will be forced to substantially raise taxes, perhaps a national value added tax of 10% or 15%.

A large tax increase at a time when our economy is in such fragile shape could arrest any upturn and flatten the economy. Worse, it could renew the down turn and prolong the increase in unemployment. With the prior Bush tax cuts due to expire by 2011 and the addition of a value added tax, the double impact could have a substantial negative effect on 2010. Increasing Medicare premiums without a cost of living increase in social security will also have the effect of a tax increase for seniors in 2010.

Similarly, the drops in petroleum and natural gas prices have run their course. In prior **Newsletters** we explained that this drop, like a tax cut for 2009, has had the effect of a major stimulus. That stimulus has ended and any increase in petroleum and natural gas prices in 2010 will have the same effect as a tax increase.

The so called cap and trade bill would raise prices and act like a tax increase in 2010. Farmers are already expressing this fear. Similarly, Health reform may requiring further tax increases that could adversely affect the economy in 2010. Either of these measures could have a broad tax impact, cutting purchasing power at all levels.

These are just some of the unknowns for 2010. It is not clear whether any of the government’s spending, financed out of increased debt, will have a counter balancing impact. What does the current economic data show as to the state of the economy?

At a glance, here is some of the economic data from July. All of the following, among others, have continued to **decline**:

- | | |
|--------------------------------------|---|
| Housing Starts | Information Technology Sales |
| Office Building Construction | Retail Sales (excluding Autos) |
| Commercial Building Construction | Nondefense Capital Goods (without Aircraft) |
| Durable Consumer Goods Production | US Total Industrial Production |
| Nondurable Consumer Goods Production | Light Vehicle Production |
| Electrical Equipment Production | Heavy Duty Truck Production |

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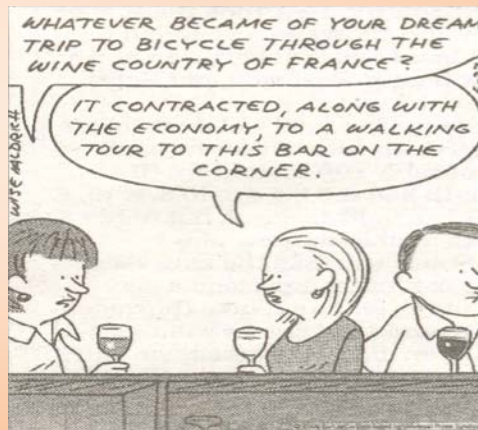
Mining Production (without Oil & Gas)
 General Purpose Machinery Production
 Chemicals & Products Production

Iron & Steel Products Production
 Paper & Paper Products Production

The economy clearly still has a long way to go for a true recovery. To illustrate, Commercial building permits were down over 43%, with construction machinery down 73% so far in 2009. General machinery production is at a 26 year low. Consumer spending is declining at a rate not seen for more than 29 years and forecast to be 29% below last year. Next year is expected to be at least 10% below 2009. While we seem to be overwhelmed with encouraging news in the press, we need to be very careful in our business planning for the rest of 2009 and 2010.

Recent Cartoon

**A real life
 adventure**



**Intruded upon
 by reality**

THE WISE OLD OWL

With so many variables for the economy during the next 15 months, this is the time to begin your strategic planning process for 2010. There is a great deal of preparation that should precede the actual strategic planning team meetings, if your multi-dimensional assessment of your current and desired state for 2010 is to be successful. Among the things to keep in mind is the need for information on the current and potential products, suppliers, customers, competencies, strategic partners, and competitors.

Our successful clients add a workshop to determine the action steps each economic scenario requires for them to grow and prosper in the coming year. [Click Here For More Information On Action Steps Workshops](#)



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