



## THE FOXHALL GLOBAL OUTLOOK



NOVEMBER 16, 2009

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Dear Paul,

**A number of commentators on television keep saying the economy may go up for a while but then could slip into a new recession early next year. Do you think that is possible?**

Anything is possible, but it would be historically contrary to almost every recovery since 1950.

If we were to slip into another recession or if there is a major correction in the stock market, the STOP-LOSS SIGNALS that we use to manage FOXHALL CAPITAL'S client portfolios would trigger and we would move them out of the stock market and back into safe U.S. treasury bonds.

But I don't believe that will happen! At the beginning of every bull market, there are commentators who say it can't last. I especially remember them in 1982.

At the end of 1982, with a long recession ending but the unemployment rate heading toward 10.2%, The NEW YORK TIMES ran an article titled "THE RECOVERY THAT WON'T START."

It quoted prominent economists who worried that "the recovery may amount to nothing more than a few quarters of paltry growth — and possibly not even that." The economists, the article noted, had "growing doubts about whether the mechanisms of economic recovery will — or can — operate as they have in other postwar business cycles."

Over the next two years, the American economy grew at a blistering annual rate of more than 6 percent. This was the beginning of the greatest bull market in U.S. History.

I agree with David Leonhardt who recently wrote this in the NEW YORK TIMES.

"These days, as in the aftermath of every recession, you are again hearing a version of those early 1980s worries: this time, things are different. Consumers are tapped out. Business executives are skittish. Banks remain reluctant to lend.

And maybe things really are different this time. Given the many problems weighing on the economy, a mediocre recovery does indeed seem more likely than a strong one. But history certainly offers pessimists and semi-pessimists some cause for humility.

A week ago, the Labor Department released its monthly jobs report, and the unemployment rate rose to over 10%, some economists now argue that the normal mechanisms of economic recovery have broken down.

So it's a good time to remember that when an economy is just coming out of recession, its weaknesses are always more obvious than its potential strengths.

"Of course, there is a long list of things to worry about," says Robert Barbera, an economist and the author of a recent book on the financial crisis. "But it's ever thus. If that were the reason you didn't have a genuine recovery, you would never have a genuine recovery."

People tend to become overly pessimistic at the end of a recession, partly because they can see that the forces behind the last boom — housing and mortgage lending, in this case — won't be around for the next one. If anything, the excesses from the last boom seem likely to hold back the economy for years to come. People are left to wonder where future growth will come from.

I want to take a stab at that question today. To be clear, I am not predicting a boom over the next two years. I'm just trying to give equal time to the side of the economic ledger that often doesn't get discussed until after the fact.

**"NO ONE HAS A CRYSTAL BALL OR ALL THE ANSWERS, BUT I AGREE IN A FEW YEARS FROM NOW, EVERY ONE WILL BE TALKING ABOUT SOME OBVIOUS ECONOMIC BLESSING THAT ISN'T SO OBVIOUS TODAY.**

### CHINA

For years, economists have been saying that China needs to consume more and the United States needs to consume less. Now it's starting to happen.

The Chinese government has increased spending in the country's impoverished countryside and made it easier for households to borrow money. Meanwhile, the global recession has caused China's export sector to shrink. Its trade



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surplus is on pace to equal about 4 percent of its gross domestic product this year, down from 9 percent in 2007. “Things have moved in a much more positive direction,” says Nicholas Lardy of the Peterson Institute for International Economics in Washington.

But for progress to continue, China will need to stop intervening in foreign exchange markets so aggressively and allow its currency to rise relative to the dollar. That would hurt Chinese manufacturers—by making their goods more expensive—while helping Chinese households—by making imports cheaper. It would also help American companies, because their goods and services would be cheaper to export to China.

Chinese officials have repeatedly said they want to rebalance their economy. Figuring out how to hold them to it is one of the big tasks facing the White House, the State Department and the Treasury.

### PENT-UP DEMAND

Or to put it another way, how much less will Americans be consuming?

The shopping spree made possible by the housing bubble was clearly unsustainable. But no one really knows what the new normal is. It could look not so different from the frugality of 2009, or it could look like something between frugality and froth.

Most economists say they think the second situation is far more likely. Vehicle sales are a good example. Households will buy about 10.5 million new vehicles this year, down from more than 16 million a year for most of this past decade. Taking everything into account — the hangover from the excess sales, population growth, the average life of a car — Rebecca Lindland of the research firm IHS Global Insight said she expected the number to grow to 11.2 million next year, 13.7 million in 2011 and 15.5 million in 2011 and 15.5 million in 2012.

### STIMULUS

Nancy Pelosi, the speaker of the House, said something unintentionally revealing last week: “We do not have plans for an additional stimulus package. But we do have plans to stimulate the economy.”

Even though economists generally say the \$787 billion stimulus bill has been a big success, it has only lukewarm public support, polls show. So the White House and Congress are reluctant to propose another stimulus bill. Yet the economy could use some more stimulus. Too many resources — buildings, machines, workers — are still sitting idle.

The solution may end up being some combination of smaller stimulus measures that dare not speak the name, like extended jobless benefits or the expanded (and misguided) home buyer’s credit. These programs won’t have the punch that the Federal Reserve’s sharp interest rate cuts in the early 1980s did. But the combination of today’s already-low interest rates, any new stimulus and the \$30 billion in original stimulus money that Washington is still spending every month will be supporting the economy well into 2010.



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### THE UNKNOWN

When Bill Clinton convened a conference in the dark economic days after his 1992 election, some of the country's top economists flew to Little Rock, Ark., to share their vision for the future. As Rahm Emanuel, now the White House chief of staff, likes to point out, they didn't spend much time talking about the Internet. They could not see the DOT-COM BOOM coming.

Might there be another pleasant surprise in our future? Maybe cloud computing or some other form of information technology? Maybe a breakthrough in alternative energy?

The point is, no one knows. If someone forced me to make a prediction, I would guess that the economy would not feel truly healthy until at least 2011. Financial crises tend to have long hangovers, and this was the worst crisis since the Great Depression.

But I would also make another guess. A few years from now, everyone will be talking about some obvious economic blessing that isn't so obvious today."

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No one has a crystal ball or all the answers, but I agree that a few years from now, everyone will be talking about some obvious economic blessing that isn't so obvious today.

That's the way it almost always works!

### UNTIL THEN!

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