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And the Good News is... the Economy's Not Going to End Up in a Depression

Well, it's official as of yesterday — we're in a recession and have been for 11 months. What we're going through, however, in terms of severity, is not unprecedented and will definitely not result in a depression.

Jeremy Siegel, economist and professor at the Wharton School, recently pointed out that we're actually far better off right now than we were back in the 1930s and we're also better off than we were in the 1970s and early 1980s. In the '70s not only did stock prices drop nearly 50% during the 1973-74 bear market (slightly worse than now), but inflation and unemployment were much higher than today. The 1973 oil crisis drove inflation from 3.6% to over 12% and unemployment from under 5% to a postwar record of 9%. After a brief recovery in mid-decade, things got even worse, with oil prices rising significantly and inflation going to almost 15%. In the early 1980s, unemployment hit 10.8% and interest rates went sky high. The prime rate (now 4%) reached 21% and credit was hard to come by; if you were lucky, you might find mortgage financing at 12% to 14%.

Now, as we're in the midst of the interminable credit crunch, inflation is much more benign after hitting a peak of 5.6% earlier this year. Granted, inflation may haunt us in the mid-term, but it has definitely receded for the time being. Oil has dropped 66% from its peak and gasoline has been cut in half nationwide.

This has resulted in a "stimulus" for consumers of around \$300 billion, without the Congress having to pass a stimulus package. If crude oil had stayed up at \$130, that would have cut two percentage points from U.S. gross domestic product, according to Siegel. The fact that it has stayed low should serve to cushion us some in the current recession.

That's not to say we're currently coping with an easy situation. We're definitely going through a complete revamping of the banking system, causing us all to suffer as mortgage foreclosures continue to rise. However, consider that back in the 1930s there was no deposit insurance, so millions of depositors lost the entire value of their accounts, while the government sat idly by. By contrast, incredibly, the government has now guaranteed the value of all deposits, even those over and above the newly established \$250,000 limit. In addition, money market funds held as of September 19th of this year are guaranteed for 1 year. Many more measures have been taken that should help limit the severity of the recession and keep it from morphing into a depression. So as bad as things seem now, we've been through worse in the past and managed to come out the other side and eventually thrive.

Another positive thing is that stocks are now undervalued for the first time in years. They should, as a result, deliver pretty good returns. The manager of Hussman Strategic Growth

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fund, which most of you hold, even projects that annual returns could reach 10% over the next 10 years. As John Hussman points out in this week’s column on the Hussman web site, “investors have already priced in a worst-case scenario – treating a near-Depression with unemployment north of 10% as a certainty.” Yet back in the 1930s, stocks didn’t get this cheap until 1931 when unemployment was above 15%. “Yes, the economy and earnings will probably continue to weaken, but value investors can observe the evolution of the economy here with reasonable comfort that the market has already discounted a good amount of bad news already,” as Hussman puts it.

The bottom line for me is that, even though markets may not yet have hit bottom, it’s a good time to begin gradual and steady buying. There

are plenty of exceptional, consistent mutual fund managers out there who are now scarfing up once-in-a-generation bargains in terms of battered down blue chip stocks and ridiculously cheap bond funds driven into the ground by panic selling.

Any of you with cash should consider deploying some in the coming months into proven mutual funds. In addition, any of you with 401(k) or 403(b) plans available to you should make sure you’re maximizing your contribution every month; it’s easy to get scared away from contributing to retirement plans and buying funds in your taxable accounts, so you must remember Warren Buffett’s saying that “good investors are scared when everyone else is greedy and greedy when everyone else is scared.”

