

Brand New Crisis

2008 was the year of the financial crisis and it appears that 2009 will be the year of the economic crisis. In our December fifth, Weekly Update we suggested that even more dismal economic headlines should be expected in the New Year. We have not lived through much of 2009 yet and these unnerving articles are already appearing in abundance.

The December unemployment rate in Canada was 6.6% and for the United States it was 7.2% for December. January expectations are 6.8% and 7.5% respectively. The average unemployment rates for Canada and the U.S. since 1976 were 8.6% and 6.1%. Canada's current rate is less than average and the U.S. is only marginally above. If you agree that the world is in a worse than average economic situation, it can be expected that unemployment will get worse before it gets better. Evidence of the expected increase runs rampant in financial papers across the country. The list of companies cutting its labour force is extensive. It includes high rollers such as Caterpillar (cutting 22,110 jobs), Starbucks (cutting roughly 7,000 jobs and closing 300 stores), and Microsoft (cutting 5,000 jobs).

Portfolio strategist Vincent Delisle from Scotia Capital recently reminded us that unemployment lags the market both on the way into and the way out of a recession. Consider the following two scenarios:

1) Unemployment at 8% and deteriorating

Most of the 92% of people that are still working are in fear of losing their jobs and are still focused on saving their money. Therefore, confidence is low and the market does not recover.

2) Unemployment peaked at 10.5%

The negative headlines in the newspapers appear less frequently and confidence begins to restore. Although there are less people working, the 89.5% of people feel more secure about their jobs and start spending. Therefore, the market begins to recover before companies have the resources to re-hire the fired employees.

Unfortunately we don't expect this to happen anytime soon, but it is something to keep in mind.

Take refreshing note from the actions of Starbucks' CEO Howard Schultz. He asked the board to cut his base salary of \$1.2 million to an awe-inspiring one dollar. After the cuts and health care deductions he is now making less than four dollars per month (probably not enough to buy one latté from his fine establishment).

Contrast this to President Obama's plan to reprimand the Wall Street bankers for maintaining excessive bonuses while spending the tax-payers' TARP money. Obama described their actions as "shameful" and "the height of irresponsibility."

The American House of Commons approved an \$819 billion stimulus package on Wednesday night. We are of a rather Darwinian mindset in that we believe that stimulus packages only prolong the inevitable. Weak businesses must fail and people must be held accountable for years of overspending. It is not possible to spend our way out of debt. Saving our way out seems a far more believable scenario. From this perspective the most appealing part of the stimulus package is that only \$170 billion is meant to be spent in 2009, \$356 billion in 2010 and the rest is allocated for the following years until at least 2012. We must keep the stimulus package in perspective. This will likely do little to slow the near term economic crisis.

The Canadian federal budget was released on Tuesday. We are owners of Richelieu Hardware here at QV. Although it might not deter the recession, the introduction of the Home Renovation Tax credit encourages spending at stores such as Richelieu on home renovations for a tax credit of up to \$1,350. The budget also included a number of smaller tax adjustments and reductions in attempt to fight the intensifying economic crisis.

The U.S. economy GDP numbers came out at -3.8% for the fourth quarter of 2008. This was the largest decline since 1982 and if inventory build-up was ignored the number would be -5.1%. Trading closed today marking the worst January for the S&P 500 ever. The January effect states that there is a strong correlation between the market movement of January and that of the entire year. Again, this is gloomy news indicating turbulent economic water ahead.

On the lighter side, Superbowl Sunday is this weekend and sports fans around the world are placing their bets. Steve Sapra, a portfolio manager for Analytic Investors LLC has reported that the smart money will be placed on the Arizona Cardinals over the Pittsburgh Steelers. Sapra is working on his doctorate in behavioral finance and uses quantitative or statistical analysis to reach his conclusions. Also Papa Johns plans to sell 1,000,000 chicken wings on Sunday. There are rumors of a chicken wing shortage so the bet on the underdogs and order your wings early. Enjoy the game.

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