JVL Associates, LLC
NEWSLETTER

MARCH 2009

Government to the rescue?

The first quarter of 2009 brought confirmation that the recession had been deepening. The U.S. Gross Domestic Product (GDP) contracted by 6.3% during the fourth quarter of 2008 and is expected to contract by another 5% in the first three months of 2009. While economists differ on the length and severity of the recession, most agree that the U.S. economy, as measured by GDP, will contract through the second and possibly third quarters of 2009 before mildly expanding by the end of the year.

The Federal Reserve estimates that U.S. households lost $11.2 trillion of net worth in 2008 due to decreases in housing prices and the stock market. (1)

While businesses and consumers have been keeping close watch over their pocketbooks, the Federal Government has opened theirs. The new Administration, the Congress, the Treasury Department, and the Federal Reserve Bank have all implemented or proposed programs to keep the money flowing into the economy.

The current Administration has revamped TARP (Troubled Assets Relief Program), introduced TALF (Term Asset-Backed Securities lending Facility) and announced PIPP (Public-Private Investment Program). Each one of these programs was created to provide a Government solution to a private sector problem.

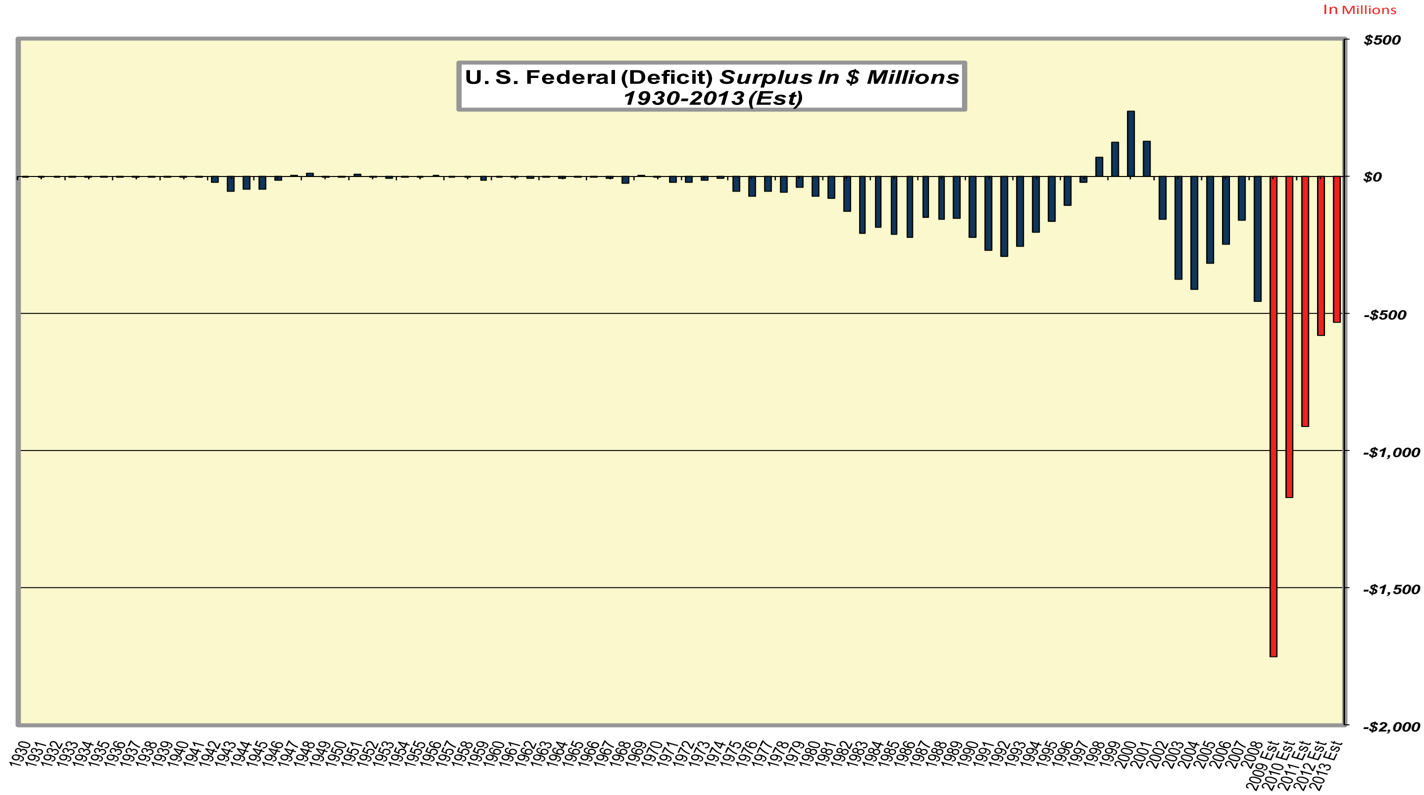
Through April 1, 2009 the Federal Government has directly committed over $12 trillion to prop up the economy. Of the amount, it has allocated $7.7 trillion towards direct purchases and investments in assets, $2.3 trillion towards lending programs and $2.1 trillion towards insuring private debt. (2) In addition, Congress passed a $789 billion stimulus package which combined tax cuts with additional spending programs. (3)

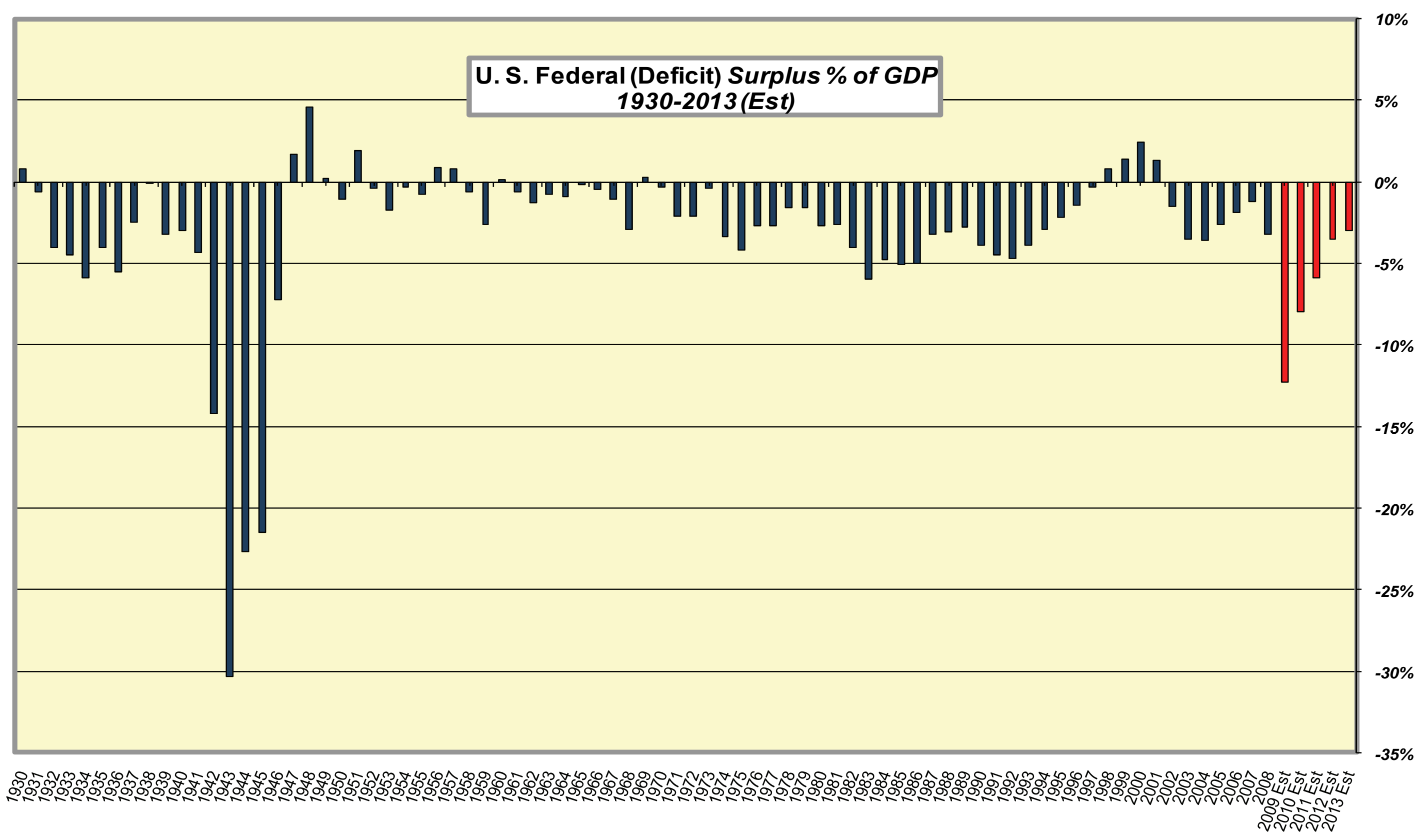
Combining these programs with the Federal Government's normal budget has created an estimated $1.75 trillion budget deficit, more than 12% of GDP, for the 2009 fiscal year. (4) And on top of all that, the President has proposed a budget for the 2010 fiscal year which estimates an additional $1.2 trillion deficit. (5) Annual deficits would continue under proposed plans until "under optimistic White House assumptions for a strong economic rebound, the deficit would drop to $533 billion by 2013." (4)

So, how do we put all those numbers – billions and trillions of numbers – into perspective? The annual federal deficit did not exceed $100 billion until 1982, did not exceed $200 billion until 1983, did not exceed $300 billion until 2003 and did not exceed $400 billion until 2004. (6) The largest federal deficit in history was $455 billion which occurred in the 2008 fiscal year. (7)

Ignoring specific people, policies and political parties we need to take a 35,000 feet fly-over view of what is happening. During the last eight years the Federal debt grew by $2 trillion. (6) The largest annual deficit was $455 billion. (7) The current fiscal year deficit is estimated to be almost 90% of the last eight years *combined*. The annual deficit, by 2013, "under optimistic…economic assumptions…is expected to drop to" 118% of the *largest annual deficit in history, so far* . (4) Only in Washington can that be called a "drop".

The following charts (10) show the deficits in dollars and then as a percentage of GDP. No matter which chart one looks at, it is obvious that the U.S. government is entering unchartered waters on its debt load.





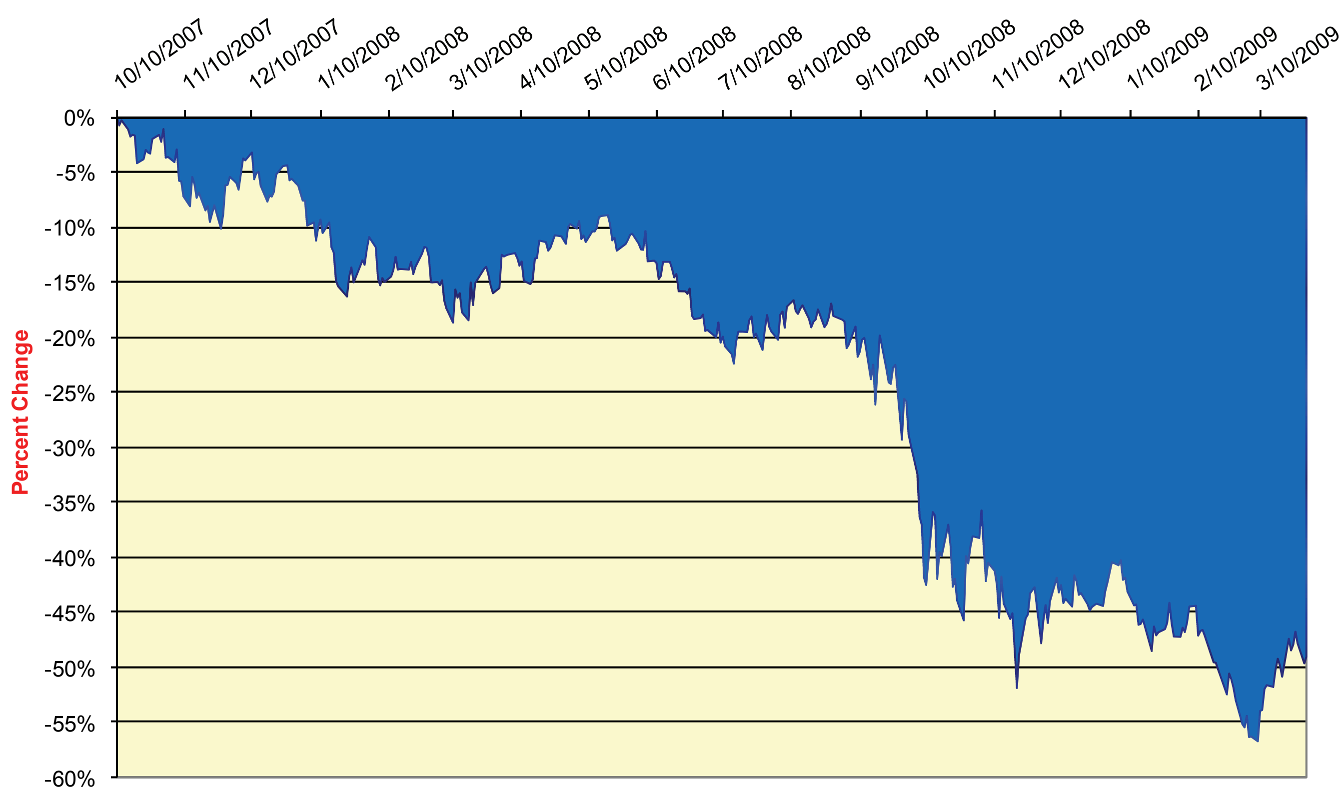
But, who funds those deficits? Where does all that money come from? Who loans us the money? As of March 31, 2009, the U.S. Government was $11.1 trillion in debt. The U.S. general fund owed $4.3 trillion to other U.S. government agencies. (i.e. the right pocket borrowing from the left pocket). The remaining $6.8 trillion was borrowed from the public. (8) Of the $6.8 trillion held by the public $3.2 trillion was held by foreign governments. (9) China, at $744 billion, and Japan, at $661 billion, were the two largest foreign holders of U.S. public debt. (9)

Do we really "borrow from China" like the media says? Well, not really. The U.S. Treasury holds auctions throughout the year selling U. S. Government securities (debt) to the public. The auction insures the Treasury gets the best price based on a functioning Bid / Ask process. The highest bidders get to purchase our debt and if it is China it is because they placed one of the highest bids. As long as there is a willing market of buyers the U. S. will continue to be able to sell its "debt".

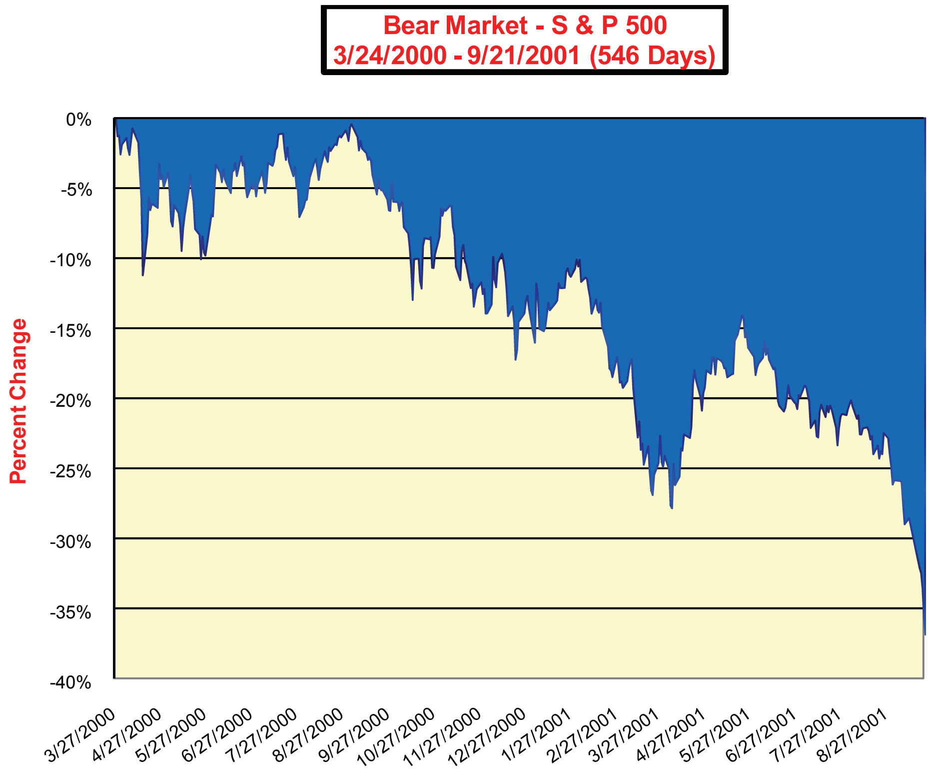
Whether it will be able to service that debt depends on the strength of future economies.

The U.S. stock market has been bouncing around trying to develop the legs for a sustained advance. After bottoming out on November 20, 2008, the market, as measured by the S & P 500, rose 24% by early January, only to fall 27% from its January 6 high to establish a new low on March 9. Since then it has advanced over 20%.

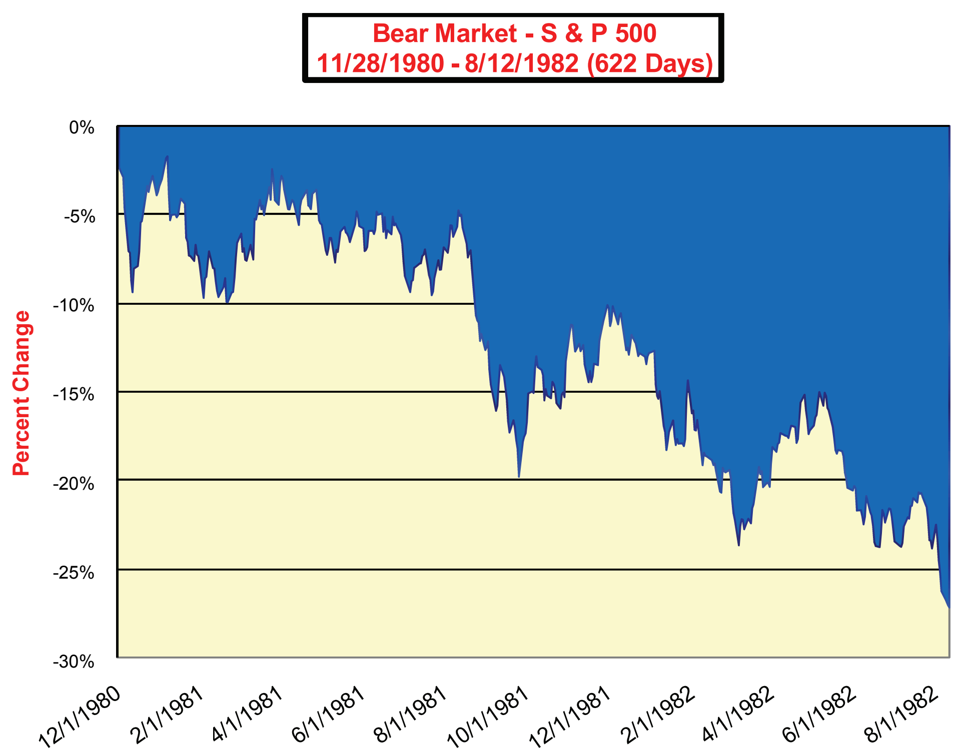
Bear Market - S & P 500
10/10/07 - 3/31/09 (538 Days)



Looking at past bear markets can give us insight into how the stock market looks as it starts a new bull run. The following charts demonstrate the volatility that various bear markets have experienced before hitting their bottom – which becomes the starting point of the next bull market!



The 2000 – 2001 bear market dropped 28% before bouncing back 19% and then dropped 26% before bottoming out.



The 1980 – 1982 bear market dropped 20%, bounced back 11%, dropped 15%, bounced back up 11% and then dropped 14% before bottoming out.

It is always important to remember that the economy affects the market, but the economy is NOT the market. Stocks have historically rebounded before the recession ends. There are many headwinds ahead for the economy. At JVL Associates, LLC our role is to keep focused on what the economy is telling us, how to position your assets to best withstand the headwinds, and to provide you with the confidence that we can navigate the investment waters and get to the "other side".

I am always available to talk with you in more detail. Please know you can call me at any time.

By: Jerry VanderLugt CPA CFP®

References

[1] Advisors Asset Management, *Weekly Economic Commentary*, week of March 13, 2009, website: www.aam.us.com

[2] The New York Times, website: www.nytimes.com , Feb. 4, 2009. *"Adding up the government's total bailout tab".*

[3] Wall Street Journal , *February 12, 2009, pg. A-2*

[4] Wall Street Journal , *February 27, 2009, pg. A-1*

[5] Wall Street Journal , *February 27, 2009, pg. A-6*

[6] Budget of the United States Government – Executive Office of the President of the United States – Historial Tables

[7] www.earthtimes.org, Oct 15, 2008, *"2008 U.S. Federated deficit was record 455 billion dollars".*

[8] www.treasurydirect.com, *"Monthly Statement of the Public Debt of the United States, March 31, 2009".*

[9] www.treas.gov, *"Major Foreign Holdings of Treasury Securities",* Holdings through February, 2009.

[10] Information obtained from: Budget of the United States Government – Executive Office of the President of the United States – Historical Tables and Office of Budget & Management – A New Era of Responsibility – Renewing America's Promise.