

# BULL AND BEAR BULLETIN

## Road to Recovery

By: The Investment Committee

Volume 1, Issue 3

**A**s additional monthly economic data continues to reflect an improving economy, Main Street may be questioning when it will begin to benefit from the improvement. In this month's edition of the Bull and Bear Bulletin, we will provide an updated analysis of several key economic variables that provide insight into the magnitude of the current economic recovery.

### 1. The growth of the U.S. Gross Domestic Product (GDP):

The initial 2009 fourth quarter GDP figure was a better than expected 5.7% growth on a year-over-year basis. The main force behind the significant year-over-year growth was the restocking of inventories. We had previously touched on the potential for the restocking of inventories to benefit GDP in 2010, but expected the benefit to be short term in nature. The key to sustainable GDP growth is the level of consumer purchases. The Personal Consumption Expenditure (PCE) was a mixed result for the fourth quarter of 2009. While the number was a positive growth value at 1.44%, it declined on a relative basis from the third quarter of 2009. Inventory stockings could continue to benefit GDP during the first half of 2010, but without the PCE growing on a sequential basis it is difficult to expect the GDP growth rate to remain above the long-term growth rate of 3.0%.

### 2. Senior Loan Officer Opinion Survey – % Reporting Easing of Lending Standards:

The willingness and ability for banks to lend to both small business owners and potential property owners is a critical component for the expansion of credit and the growth of GDP. When the housing market bubble popped, lending standards quickly tightened. Banks continued to tighten for nearly four straight years due to over exposure to under-performing loans and concerns surrounding any new loans. However, over the past nine months we have witnessed a growing improvement in the percentage of Senior Loan Officers reporting an easing of their lending standards (Chart 1). While the improvement is very modest in relation to the loose lending terms of the early 2000's, it remains beneficial to the economy.

Chart 1

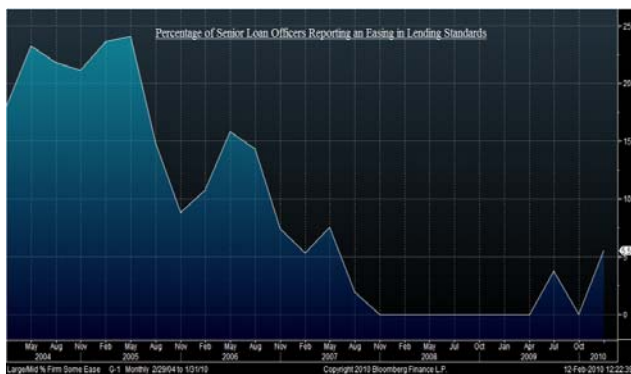
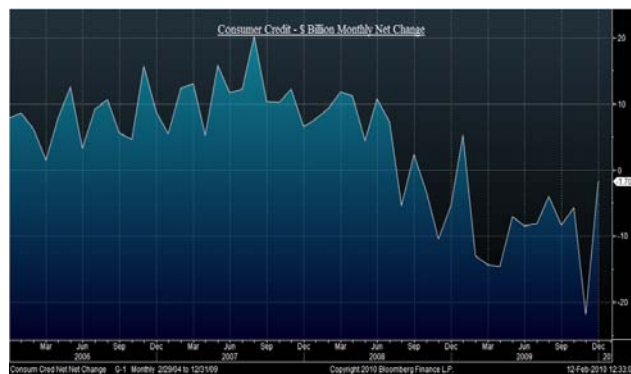


Chart 2

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## 3. Monthly Change in Consumer Credit:

Consumer credit is a significant benchmark for the spending level of consumers. With consumers historically representing over 2/3 of GDP, spending is vital for GDP growth. With consumers facing extreme levels of indebtedness, growing unemployment and economic uncertainty, most consumers attempted to reduce their use and reliance on consumer credit. The monthly reduction in Consumer Credit was meaningful over the past 18 months (Chart 2). While the most recent figure was a modest decline of \$1.7 billion, it is potentially too early to call a change in consumer behavior. The most recent monthly figure was for December 2009, which includes the holiday spending season and still represented a contracting state of spending. So while some consumers may be returning to their previous comfort level for using credit in their day-to-day lives, additional momentum in consumer credit changes is necessary before becoming too optimistic on the health of consumer spending.

## 4. Corporate Earnings – S&P 500 Index Adjusted Earnings Per Share (EPS):

The strength of the global economy can be extrapolated from the earnings of corporations. The S&P 500 consists of the 500 largest corporations on the U.S. stock exchanges and reflects the strength of business activity of both U.S. and foreign regions. While the strength of earnings can vary on a quarter-to-quarter basis due to cost cutting measures and other factors, the long-term trend of an Index's corporate earnings provides a good indication for the level of business activity and profitability in the economy. Corporate earnings declined precipitously in 2008 as the global economy came to a stand still, but earnings started to recover in the second quarter of 2009 and on into 2010 (Chart 3). With global uncertainty declining on a daily basis, business activity continues to improve. The improved business activity around the world should allow corporate earnings to maintain the current growing trend.

Chart 3



Chart 4



## 5. U.S. Privately Owned Housing Starts:

With the number of foreclosed properties and distressed home sales in the U.S. real estate market, there has been a tremendous build-up of housing inventory. The large inventory of homes available for sale, coupled with the tightening of bank lending standards, placed downward pressure on home prices and the need for new homes. With a rebounding in the economy, foreclosure rates and bank lending should improve and home values should stabilize. As the real estate market continues to progress forward and inventories are worked down, there will be resumption in the need for new homes. The past year provided a high degree of stabilization (Chart 4) and some evidence of a recovery in home values, which provides a benefit to both existing home owners and the institutions that hold mortgage-related investments.

While these five data points provide insight to select portions of the economy, they do reflect the aggregate recovery that most citizens read about in the news. Although some citizens are becoming frustrated and may believe this is solely a statistical recovery, each monthly improvement should provide an additional level of relief to Main Street. If the improvement in the housing market and corporate earnings continue, we expect a gradual improvement in consumer activity and on Main Street. As we move forward, our recommended asset allocation strategy will evolve with the strength and duration of the continual economic recovery.