Delta Financial Advisors

December 2008

Economic Comments

The bad economic news just seems to keep snowballing in recent weeks. While evidence of a slowing economy has been evident for months, it was only in late November that the current slowdown was made official. A bit belatedly, the organization tasked with officially declaring U.S. recessions (the NBER) announced in late November that the U.S. has been in recession since December 2007. As a result, the current downturn is the longest in a quarter century with the 1981-1982 recession lasting 16 months. At 73 months of duration, the economic expansion that started in November 2001 and concluded in December 2007 was one of the longest periods of uninterrupted national growth on record.

To add an exclamation point to the NBER's belated conclusion, the U.S. Department of Commerce announced that the nation's domestic production shrank in the 3rd quarter with economic output declining by 0.5% relative to the prior year. November's employment data added to the gloom with more than 525,000 jobs disappearing during the month - sharply worse than already low expectations of 350,000 positions being lost.

The economy has not seen such a sharp one month reduction in jobs since December 1974 when the nation was experiencing a severe recession. In addition, prior months' job losses were revised downward to reflect a further loss of 200,000 more positions. Along with the reduction in employment, the national unemployment rate climbed to 6.7%.

In the face of the onslaught of bad news, consumer confidence showed a sharp deterioration as recent index readings hit their lowest level in more than 40 years. As a result, personal spending slammed into a wall in October as consumers spent 1.0% less than in the prior year. This was the first time that spending has declined since 1980 and was the largest decrease since the early 1940s. Due to the reduced consumer outlays, the nation's retailers reported their worst sales numbers since 1969.

With consumers currently representing more than 2/3 of U.S. economic activity, a sharp consumption reduction is lethal for continued economic growth. While the incoming Obama Administration is discussing a substantial stimulus package, this alone might not be sufficient to drive a marked growth in overall consumption.

The global credit crisis continues to take a toll on industry as manufacturing suffered its worst month since 1982 as new orders fell sharply. Auto sales plunged more than 32% year over year, their worst decline in more than 25 years further worsening the existing challenges for Detroit's Big Three which are now teetering on the edge of bankruptcy.

Housing prices continue to fall as home prices declined by a record 16.6% (on a year over year basis) in the 3rd quarter which was an even higher rate of decline than that seen in the prior 2 quarters. Consistent with the housing decline, foreclosure rates in October grew 25% over the same period in 2007 as almost 280,000 residences were then involved in foreclosure proceedings.

There were some small positives to be found as September's trade deficit hit its lowest level in a year in the face of a sharp decline in petroleum imports as the price of crude dropped sharply to sub $50/barrel in the face of sharply slackening demand.

Moreover, core CPI showed a 0.1% reduction, the first decline in more than 25 years. Overall consumer prices plunged by 1.0%, the largest amount since records started being kept in the late 1940s. Driving these reductions were the sharp fall in gasoline and other energy costs along with more muted but widespread declines for other goods.

Looking forward, we anticipate at least another several months of bad news. Despite this expectation, we anticipate the current economic contraction will be finished with its dirty work by next Fall. Driving the economic turnaround will be a reduction in negative news from the housing sector and the positive impact of the government's and central bank's recent moves.

Market Comments

The markets continue to see doom and gloom at every turn. After declining by as much as 22% by late month, the stock market rallied to finish the month off a sharp, but much improved, 7%. Financials yet again led the market downward, having plummeted by more than 55% this year. To the positive, both the telecom and utilities sectors showed modest gains of 6.4% and 2.4%, respectively, for the month.

The market's most recent low, achieved on November 20th, was the lowest level the market has

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Performance as of 11/30/08

	<u>***Close***</u>	<u>***Month***</u>	<u>***YTD***</u>	<u>***1 Year***</u>
DJIA	8829.04	-4.86%	-31.67%	-32.12%
S & P 500	896.24	-7.18%	-37.6683%	-38.09%
NASDAQ Comp.	1535.57	-10.77%	-42.09%	-42.29%

	Month <u>end yld</u>.	***Prior <u>Yr. end yld.</u>***	***12 mo. <u>prior yld.</u>***
10 yr. U.S. Treasury	2.96%	4.03%	3.97%

achieved since the spring of 1997. Despite the U.S. markets' almost 40% plunge this year, Wall Street is one of the best performing major national markets for 2008 – the Japanese Nikkei, the German DAX and the Shanghai Composite have all performed meaningfully worse. Of major global markets, only the British /FTSE 100 is slightly ahead of the S&P for the year with a 34% decline through month end.

In the fixed income market, the flight towards safety continues unabated as the rates on U.S. Treasury securities continued to plunge as buyers continue to seek the relative safety of U.S. government backed securities. Interest rates on the benchmark 10-year Treasury declined to 2.86% - the lowest, as of November end, on record.

In an effort to provide added support to the credit markets, the Federal Reserve announced in late November the creation of two new facilities to purchase up to $800 billion in mortgages and consumer loans with an aim to reduce household borrowing costs.

Looking at overall market levels/values, the key question has been the depth of decline in overall corporate earnings during the current economic malaise. Using the S&P 500 as a market proxy, earnings for the just completed 3rd quarter appear to have already declined by 23% from their peak earnings of the Spring of 2007. Historically, peak to trough earnings declines during recessions have averaged 20% with one outlier (the post WWII recession) showing a 30% reduction in corporate earnings. In the face of the substantial central bank and U.S. government intervention, we believe that the substantial majority of this recession's earnings decline has already been realized. Moreover, we do not believe a sustained P/E ratio of sub 10x is imminent as such previous periods (most recently the mid 1970s and early 1980s) suffered extreme inflationary activity (10%+) which is not evident in the current environment.

Looking forward, our crystal ball continues to anticipate meaningful near term volatility as the markets work through their current travails. However, based on our expectation of the current economic contraction being completed before late 2009, we would expect the market to show meaningful gains in advance of the recession's end.

Analyst Corner

One company that we have followed with interest for quite a while is Air Products and Chemicals (*NYSE: APD*). The company offers and processes atmospheric and specialty gases for industrial uses. While heavily exposed to the economic cycle, the company is somewhat buffered by its plants' locations and their long-term supply contracts. Moreover, the company has heavy exposure to higher growth segments of business.

On a financial basis, we are impressed by their consistent returns on capital as well as their potential to further enhance their operating margins. In tight financial times such as these, we are encouraged by the company having kept its financial leverage relatively modest despite being in a capital intensive business. Even with its sector's inherent volatility, we believe that APD could be an appropriate addition to some portfolios.

Seasons Greetings

We wish all of our clients and friends a safe and joyous Holiday season. We hope that the next year will prove to be better financially for all of us than the tumultuous 2008 has proven to be.

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