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Yes Virginia, There is a Recession

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These guys are good, Bernanke, Paulson, and the rest. They are smart and they know their history. They know the mistakes of prior economic slowdowns. They know what didn't work then, and they have the best insight into what needs to be done now.

Bernanke in particular draws contrasts with the 1930s. At the time, the Fed was too tight and banks were allowed to fail. Tight monetary policy accentuated that depression. Bernanke is not repeating those errors. The growth in the Fed's own balance sheet is testimony to the flooding of markets with liquidity.

On the fiscal side in the 1930s, policy makers initially strived to balance the budget, a step that suppressed economic activity. Today, Congress, Paulson and other policymakers have thrown money at the problem and have done what they can to keep the money and banking system viable. The economy isn't going to get fixed unless the finance system is working.

GDP growth is made up of contributions from consumption, investment, net exports and government spending. Policymakers expect consumption to be weak as consumers have pulled back in light of a loss of wealth and a poor employment outlook. Investment is likely to be anemic too, as capital spending sags in the midst of a surplus of almost everything; autos and real estate are prime examples. And it is assumed that foreign trade - net exports were supportive of growth in 2008 - will fade as the rest of the world's economies weaken. That leaves government spending. Certainly we have witnessed plenty of that lately, but either it's not working or the problem is just too severe.

Overall there is disappointment for market participants as they look at the screens each day and expect the usual mathematical equations to work – namely money is dumped

into markets and out comes asset price appreciation. The truth is that the official government actions are only holding together a system that many now doubt.

In safe Treasuries, the insulting yields offered are only attractive given investors' anxieties over other choices. One would think that fear needs to exit the equity markets and the economic darkness has to have a morning after before Treasuries are abandoned. The destruction of wealth has gone to a tipping point and it will take time and probably even more money to deal with distressed asset prices in the light of continued selling by so many market participants.

Investors never garner reasonable returns if they always believe it's "different this time". But it is. A housing bubble is unwinding, the risk models were all wrong, and the situation is compounded with too much leverage at a time when global savings and investment imbalances have been too extreme. Colleagues that "called this" tell me they never thought it would get this bad. And it's still getting worse.

As history and experience allows us to smirk at the misplaced policy approaches during the 1930s, we have to wonder how future students of economics will view the strategy today. Knowing all we do, understanding the history, will this generation be scorned for missing some element that will later be deemed obvious?

The safest and most liquid portfolios have had a good year. At some point, risk will be rewarded, but it does not yet appear that time has come. ■

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