

MONEYLETTER

hotline

September 30, 2008

-- A Special Message from Chief Economist Walter S. Frank --

What Now?

Here is where we stand: The House rejection of the financial rescue package stunned everyone, not least the stock market. The losses today were devastating, equaling some of the largest one-day losses our stock market has ever experienced. Economically, the House action, if it stands, threatens to throw us into a serious recession. The economy is already sliding into a mild recession, caused primarily by the very conditions the package was designed to relieve.

From everything we can gather, it seems very likely that an attempt will be made by the House leadership to have a revote later this week. Whether this will succeed or not, we do not know. We expect today's market debacle will cause some Congressmen or women to reconsider their vote. A ten-vote swing is all that is needed.

Revote or no revote, we know that all of you have been subject to painful losses. We also know that some may be wondering whether the time has come to abandon the stock market in favor of cash or Treasury bonds. This is a difficult time emotionally for all equity investors.

Yet this is also exactly the time when reason should trump emotion. The selling we saw today was something close to capitulation. Emotion, not reason, was in control of the stock market. Considerations of value played no role in the selling we saw.

Aside from the disappointment over the House vote, the market was also experiencing selling from hedge funds, who were dumping stocks to meet heavy redemptions (so we are told). As a consequence, today's prices do not represent anything resembling "normal" market prices.

As we said, the economy is sliding into a recession. With a package we expect the recession to be mild. Without it, the recession will be deeper. In either case, we expect action from both the Federal Reserve and the new administration to counter the recession.

We look for a cut in interest rates by the Fed before the year is out. We also expect a stimulus package from the new administration, of whatever party. The size of the rate cut and stimulus will depend on the economic outlook as we move forward.

The market has suffered a shock and we expect only a slow recovery over the next few weeks at best. As we move toward yearend we believe the market will begin to discount the expected rate cut and stimulus package. As we see it, now is certainly not the time to be selling.

It is a time to keep cool.