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Whale Wisdom Commentary

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So just what is a recession and in the US economy in one? The classic economical definition of a recession is two straight quarters of negative growth as measured by the Gross Domestic Product (GDP). In the fourth quarter of 2007 GDP grew, so while many people may feel like we are in a recession, the official statistics have yet to confirm a recession has started. Has the *rate of growth* of the economy slowed? Yes, and it is important to distinguish between a slowing rate of growth and negative growth. As much as all of us like for the party to go on forever, it never does. All good things must end. The economy like many events in life goes through cycles. If is foolish for anyone to think our economy will not go through periods of prosperity and periods of decline.

While it may feel like the party has ended, we will not know for sure until late summer. In fact, on balance, the party may only be slowing down. If we look at the economy on balance, it may not be all doom and gloom as the media would like to have us believe. Let's start with the negatives.

First and foremost, we see residential real estate prices softening. Well, as any real estate expert will tell you, all real estate is local. More speculative areas such as Las Vegas, Florida, California, and Colorado are seeing prices cool and more foreclosures. Yet, a large portion of middle America and the Northeast have seen stable prices or only very modest price softening. Keep in mind that the media center of the US is based in New York and Los Angeles. Many of these folks view the rest of America as "fly over country". Real estate in New York City is likely to further soften as Wall Street layoffs and reduced bonuses work into the system.

Next, we have a financial crisis with high rates of loan defaults and a coming wave of mortgage interest rate adjustments coming due. The problems associated with sub-prime loans (a nice politically correct term to describe loans made to people who were likely not to be able to repay these loans) has largely been identified and is being worked through the financial system via massive write-offs of these loans. There is however another potential storm on the horizon. Millions of people who either purchased or refinanced mortgage debt between 2003 and 2005 with adjustable rate mortgages are due to have those interest rates reset in the coming months. While interest rates (measured by US government debt) have fallen, mortgage rates are higher than when these loans were originated. Meaning that the borrower will likely see an interest rate increase and a higher monthly payment. Factor in higher consumer debt levels and increased food and energy costs, this will likely strain the consumer ever further. Many people may be forced cut back on discretionary spending or to sell a home they can no longer afford in what is an already slowing economy.

Commodity prices, especially in the food and energy areas, continue to rise putting inflationary pressure on the economy. It is difficult to gage what exactly is happening in commodity markets. How much of the rising prices is due to worldwide demand? How much of the increased prices is due to speculation? Add in the US trade deficit and the decline of the US dollar which creates for greater financial uncertainty.

So the question is what is an investor to do, given the uncertainty that lies ahead? First, each investor should stick to his or her long-term plan. Timing markets and what will happen in the short-term is a risky proposition. There is often a disconnect between the economy and financial markets. Financial markets tend to be more forward looking. Stock prices are driven largely by earnings expectations. Interest rates for bond investors are driven by central bankers (the Federal Reserve in the US) and there outlook for maintaining a stable economy. The US economy with a slowing rate of growth and a possible recession is not likely headed for anything catastrophic such as a depression. Other world economies are likely to slow, including China after the summer Olympics. However, there are still economies, industries, and companies that will prosper in challenging economic times, so there is no need to place all one's money in the mattress.