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# The path ahead

As 2008 draws to a close, we have to ask ourselves whether 2009 will be a continuation of the panic or a year of depression, recession, or return to stability.

## Points to consider

- The first quarter of 2009 is likely to mark the darkest days of this, "the Great Credit Recession of 2008-2009."
- Market sentiment and consumer confidence may hit all-time lows in the coming months.
- Experts never expect bad trends to end and will extrapolate "never ending doom."
- Previous panics have ended.
- The U.S. government will likely become an even bigger actor on the world economic stage.
- The markets have already priced in much of the future pain that the economy is likely to endure.

## Economy

I believe that 2009 will usher in the end of the recession, which began about 12 months ago. I expect future data will show that the last quarter of 2008 and the first quarter of 2009 marked the worst of it, with the economy shrinking by 4% to 5% on an annualized basis. Historically, the worst post-war recessions have lasted approximately 15 months, so we are nearly at the end. In my opinion this will go down in history books as the worst of the post-WWII recessions but not rank with the Great Depression.

I expect that the news flow will reach its bleakest peak in the winter of 2009. However, the worsening data on growth, earnings, labor, defaults, and housing will be offset by a lower cost of living, government offsets, rising demand from a growing population, and a productive, although wounded, corporate sector.

## Highlights

U.S. gross domestic product (GDP) will likely fall 4% to 5%. In the first quarters of 2009, I expect to see troubling data on GDP, probably of negative 3% to 4%. While these projected numbers are bad, they represent an improvement from those we expect to see at the end of 2008. In 2009 I also look for:

- Unemployment to rise to 9% plus.
- Defaults to increase to over 8% as companies, dependent on the credit markets and cornered by falling sales, find themselves unable to raise cash.
- Standard & Poor's 500 companies' earnings to fall 30% from their 2007 calendar year peak, to $60.
- Inflation to decelerate through much of 2009.
- Commodity prices to recover somewhat toward summer; I do not expect prices to reach peaks hit in mid-2008.

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- Housing prices to fall but at a less dramatic pace than in 2008, signaling stability by the third quarter.
- Consumer spending to fall 7% to 8% from peak levels as credit is restricted and jobs losses mount.

### Financial markets

I believe the recovery will be seen first in the financial markets, specifically the lending markets. Risk taking will re-emerge on a limited, cautious scale and will be evident first in the high-quality bond and lending markets. Markets will sense economic stabilization before the actual recovery begins. As for the broader stock markets, they typically move upward five to six months before the economic data hit rock bottom, which I think will be in late winter or early spring.

### Look for

- long-term rates to be higher than short-term rates
- certain bank and insurance stocks to rise from beaten-down lows
- consumer discretionary stocks to begin a steady rise
- late-day trading reversals to dissipate and market closes to be more orderly

### Conclusion

The economic downturn and credit crisis have been awful, but they may include a blessing in disguise. Had we not experienced these crises, American consumers and institutions may have continued to pile up debt, leaving their balance sheets in a precarious state and ready for default.

By 2010, with government actions on a massive scale, a return to saner lending, and the tonic effect of market clearing actions, we should see markets that again respect long-term stability, good balance sheets, well-devised business plans, and sensible, non-debt driven valuations. The return to market normalcy and economic tranquility will be painful, but in the markets, most of that pain has already been endured.

### Look for

- market rewards for companies and consumers that carry low debt levels
- society to return to "spending within means"
- individuals to invest for future stability, not flashy returns
- market craziness to be replaced with a return to fundamentals

Source: MFS research

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