

September 18, 2009

## One year after Lehman

*The stock market confirms the end of the recession --- will it stick?*

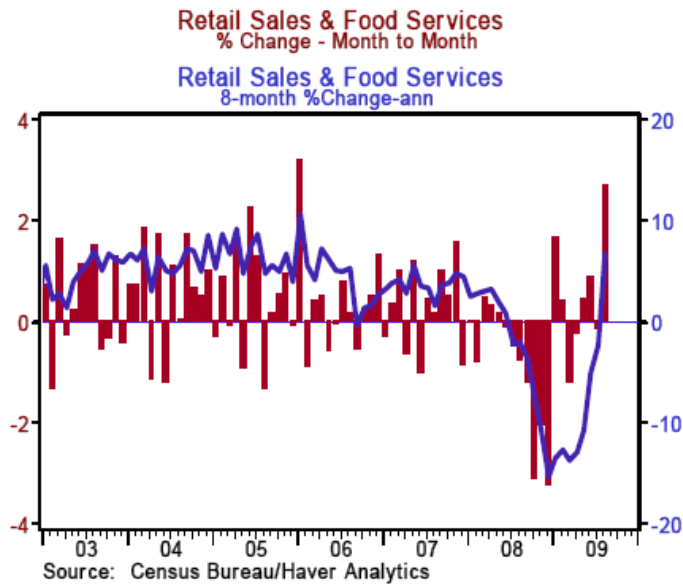
What a difference a year makes. Exactly 12 months ago the market was in free fall following the collapse of Lehman Brothers and the rescue by government of several financial giants.

But worry over the length of the Great Recession has given way to debate about the durability and shape of the recovery. This from Barclays Capital just this morning:

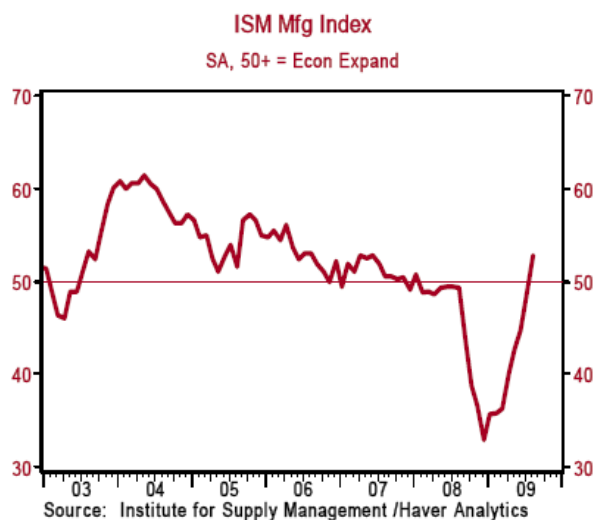
**Economics - D Maki - Raising GDP Forecast - Raising Q4'09 GDP from 3.5 to 4.0 & 1Q'10 from 3.0 to 5.0; now expect the first Fed rate hike to occur in Q3 '10;** our new forecast is more in line with previous recoveries from deep recessions. Due to the stronger growth outlook, we **now expect the unemployment rate to fall more rapidly next year, reaching 8.8% by Q4 10.**

The debate about the shape has been settled---it's "V", but now the issue has shifted to next year. Will the "V" turn into a "W"?

Before we answer that, let's look at where we are now. Retail sales are bouncing back strongly---even after subtracting the Clunkers program.



The Purchasing Manager's Index, now known as the ISM, is firmly out of recession territory. (Below)



None of this was supposed to happen and for that reason the stock market has surprised everyone by staging the strongest rally since 1982.

But what about that “W”? It’s possible, but in our view, not likely in 2010. Every recession since 1982 has ended with fears about a double-dip, mainly because that’s what happened in 1982. It was then when Paul Volker took interest rates to 17% and successfully killed inflation.

If the Fed suddenly took rates higher in 2010, then the chance of a relapse would increase. But Bernanke has told us that he understands the risk and will not raise rates until unemployment falls significantly. He knows his history, he just got rehired, and we take him at his word.

That takes us to 2011, a year that might present us with some problems in the stock market. First, taxes are scheduled to go up that year and there’s no reason to think that won’t happen. Second, the Fed will begin to tighten assuming the economy continues to grow. Those two events, if handled badly, could tip us back into a recession, but that’s a long way off.

DOCK STREET ASSET MANAGEMENT

Until then we are in the sweet spot for stocks:

- interest rates are low
- growth is returning
- earnings estimates are rising
- still a lot of cash on the sidelines

All those conditions will get worse over the next year, but until that happens market corrections are likely to be short and shallow as investors realize that the train is leaving the station.

It is very possible that we've made all the money to be made in 2009---the short-term is always impossible to predict. But the next 12 months in stocks should be rewarding for investors and we plan to make the most of it.

Best regards,



Daniel A. Ogden