



## Allen Sinai: An Economy in “the Holy Terror Stage”

October 21, 2008

The US and global economies are in a full-fledged recession, Allen Sinai told an audience of about 250 on Sunday. The US has been in recession since the beginning of this year, he added, and he was pessimistic on prospects for recovery. His personal 401(k) portfolio is 100% cash and has been that way for some time, he said.



“The economy could get a lot worse before it gets better,” said Sinai, the founder, Chief Global Economist and President of Decision Economics, Inc.

“Airline pilots describe their job as 99% boredom and 1% holy terror,” said Sinai. “We are now in the holy terror stage.”

Sinai said the economy is in the 11<sup>th</sup> month of the recession, and noted the average recession duration since World War II has been 10.5 months. “It is not over — the patient is not healed,” said Sinai.

The current recession, he explained, most closely resembles those of 1981-82 and 1973-75, each of which lasted 16 months. He said 16 months was his minimum estimate for the current recession, but offered no more specific forecast for how long it would last.

He also sees similarities to the early 1930s, he said. He did not rule out another Great Depression.

From Sinai’s perspective, consumer spending is the fundamental problem confronting the economy. “The consumer has hunkered down,” said Sinai, noting that consumer spending data declined more than 3% in the third quarter. While the financial condition of American households is deteriorating, Sinai said, the slowdown in consumer spending has yet to transition to the business sector. That means there could be “huge declines” in capital spending once businesses adjust to reduced consumer demand.

Consumer spending and capital expenditures are 80% of GDP. A contraction in these two components would invariably translate to negative growth in GDP.

Sinai expects a Democratic victory in the presidential election and voiced his support for Obama. But he cautioned that neither candidate would likely bring about a quick



solution to the economy's problems, which are the biggest a president has faced since FDR.

He expects significant infrastructure spending as part of a stimulus package from the next administration. But deficit spending will not come without a price, he warned, and the ultimate price could be a steep decline in the dollar, to the extent that other governments would not be willing to lend to us. Such a scenario — Sinai called it his worst fear — would result in rapidly escalating interest rates.

On the subject of housing, Sinai said the Case-Shiller index could decline by another 20%, on top of the peak-to-trough contraction of 20% already experienced. He said commercial real estate will be the next victim of oversupply, as consumer spending slows down and retailers face declining profits. "But housing is not the story," Sinai said. "It is all the consumer."

State and local governments are under a lot of financial stress, and Sinai said that more than 30 states are faced with huge deficit problems. "The line for Federal assistance is getting very long," he said, "with troubled corporations as well as states seeking aid."

### **Not a Toe in the Market**

Sinai said the current market is the 5<sup>th</sup>-worst of the 12 bear markets he has tracked. He cautioned against buying at today's levels. "Just because the market has reached previous lows, it is not necessarily a buy signal," he said.

He expects further trouble to show up in corporate earnings — the result of reduced consumer spending. He said corporate balance sheets are now relatively strong, but this masks an underlying problem. He believes market prices do not properly reflect a contraction in earnings which is sure to come.

At a sector level, Sinai is bullish on some parts of the health care industry, particularly the technology side. He also said education represents good opportunities, but noted that "it is hard to participate as an investor." He cautioned against investing in sectors dependent on consumer spending or the technology sector itself, because it will suffer as businesses reduce spending.

On the fixed-income side, he advocated short-term high-credit investments. His own 401(k) is in short-term US Treasury securities. But he noted that Treasury bonds may someday be downgraded by the rating agencies, as the Fed has taken on a lot of questionable debt on its balance sheet, ranging from Bear Stearns's assets to the commercial paper it is about to issue.



On a global level, over the long term, Sinai is “still willing to bet on China, but is less willing to bet on the US.” But he is not willing to place those bets now.

Before believing a recovery has begun, Sinai said he would need to see a fall in inflation, interest rates, and the value of the dollar, along with free-flowing credit. But the biggest indicator would be a signal of pent up consumer demand — something which he says is completely non-existent in today’s environment.

The sobering tone of Sinai’s talk was underscored by perhaps his most poignant comment: “I am plenty scared about what is going on,” he said. “It is the longest list of economic problems I have seen in my professional life, probably since the 1930s.”

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