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Slowing U.S. Economy Doesn't Preclude Investment Opportunities, Panel of Top Financial Analysts Says

Los Angeles – U.S. economic growth is continuing to slow, with additional unpleasant surprises possible in the credit and equity markets, three top financial analysts said in remarks prepared for a panel discussion presented by the CFA Society of Los Angeles.

The panelists differed on the investment outlook, with one bearish on stocks, one bullish and the other cautioning that commodities, which have recently attracted the interest of more individual investors, may be the next "bubble." The analysts were interviewed by Maria Bartiromo, anchor of CNBC's *Closing Bell with Maria Bartiromo*.

The economy has already entered a recession, according to Donald H. Straszheim, Vice Chairman of Roth Capital Partners, former global Chief Economist for Merrill Lynch & Co., and an expert on China and Asia.

"It's clear to me that the U.S. economy is in a recession," Straszheim said in remarks prepared for the society's 2008 Economic & Investment Forecast Dinner at the Biltmore Millennium hotel Wednesday. The CFA Society of Los Angeles is a network of investment management professionals that works to disseminate useful financial information and increase awareness of the value of the Chartered Financial Analyst (CFA®) designation, which is intended to lead the investment profession by setting the highest standards of ethics, education, and professional excellence.

"Recessions come and go and this one will too," Straszheim said. "The decline in housing, the damage done to consumers by falling home and equity prices, and higher energy costs, will sour consumer spending. The turmoil in the financial markets is not over, nor is the ugliness in equities. History tells us that when market sentiment turns as sour as it has, ultimately every stock gets taken apart."

While agreeing that the economy faces further challenges, Alison A. Deans Managing Director and Deputy Head of Private Asset Management at Neuberger Berman, noted that her firm is positive on equities.

"We actually like the stock market at these levels," she said in her prepared remarks. "We're at a point in the Fed's easing cycle that usually bodes well for equities. When the Fed eases, 90% of the time equities do better – the exceptions being when stocks have been significantly overvalued or when we've had a serious recession. Stock valuations are not high at 15 times forward earnings, compared with 20 to 21 in the late '90s. As well, we anticipate slow growth, but not a recession."

The nation's credit markets, which have been the focal point of investor uncertainty, will begin to improve as 2008 progresses, according to Anthony J. Crescenzi, Chief Bond Market Strategist at Miller Tabak + Co., LLC.

"As subprime mortgages age, they will become 'seasoned', which means their future cash flows will become more predictable, which will boost the securitization market," Crescenzi said in his prepared remarks.

"Subprime resets will fall considerably in early 2009, to roughly $5 billion per month from $40 billion per month currently. Rapid expansion of the money supply will help banks to grow their balance sheets and provide significant new capacity to lend. As the economic picture improves, concerns about corporate cash flows will subside, pushing investors out on the risk spectrum."

While noting that economic data may worsen in the coming months, Crescenzi agreed with Deans that most of the bad news is already priced in and added that investors should now be alert for buying opportunities. The key factors to watch, he said, are the nation's production cycle and consumer spending.

"Track whether consumer spending is picking up relative to output, because spending levels that outstrip production will inevitably lead market-share minded companies to raise output, lest they lose market share," he said in his remarks.

"This will turn the production cycle from vicious, where it is now, to virtuous, leading to a renewed period of self-reinforcing economic expansion. By focusing on spending, particularly chain store sales, car sales, and home sales, investors will be able to spot the trough in the economic cycle. I emphasize that it is spending relative to production that is key to watch. When you see a turn, start betting on an economic recovery and don't be deterred by sour news on employment and production, because it will inevitably turn."

When production turns up, Crescenzi explained, payrolls rise and consumer spending follows, leading to increased demand for goods and services – a virtuous cycle.

"More hours worked mean more income, resulting in increases in consumer spending and round and round it goes, a virtuous cycle of increases in production, income, and spending," he said.

"This is the stuff that expansions are made of. A turn in spending is probably a few months away, but it could happen at anytime, so we must be on the lookout for contrasts between spending and production. Spending could pick up for any number of reasons, the most prominent which include the Fed's rate cuts, which are reducing debt burdens and resulting in a boom in mortgage refinancing. Fiscal stimulus will certainly boost growth, although there is a debate about its lasting effects. I am hoping it jumpstarts the production cycle, but much will depend on the mood of the nation at the time. Pent-up demand can also help turn things around."

Deans said investors should be very choosy about stocks, adding that there may be opportunities in the beaten-down financial sector.

"We're being very selective, but we do think financial services and technology shares could do well. We also think large-cap and global industrials -- because they aren't tied only to U.S. demand, which will slow -- will benefit from global demand. The weaker dollar also helps companies that operate globally. Large cap and global are the places to be right now."

Deans said portfolio managers at Neuberger Berman Private Asset Management have adjusted their mix of international stocks.

“Overall, we are evenly split between domestic and foreign equities right now. We had been overweight international, but as the dollar has come down we have become more U.S.-centric,” she said.

“Emerging markets in general, which rely on our consumption, could be soft for a while and are not going to see the kind of growth they’ve enjoyed in the past, although some specific markets have good prospects. As a whole, we are neutral to underweight emerging markets.”

Crescenzi said investors should be wary of the boom in commodity prices.

“If you are looking for the next price bubble, the commodity market is probably where you will find it,” he said. “The price action there fits with the mentality that grips every bubble: "Just buy X and you will make money." In past bubbles, X stood for dot-com stocks, housing, and credit instruments. Now it stands for commodities.”

On other fronts, Straszheim anticipates new economic marching orders in China.

“The news coming out of China is about to change,” he said in his prepared remarks. “Over the last year, the talk has been that China is growing too fast with too much inflation. China has been allowing their currency to appreciate rapidly and raising interest rates to slow growth and to fight inflation. The recession in the U.S. and near recessionary conditions in Japan and Europe will reduce China’s growth rate to less than 9% in 2008 – the lowest rate since 2001. So Beijing’s concern is soon going to shift 180 degrees, with their Number One worry being that the economy is at risk of getting too cold, not staying too hot. Consequently, we see an end to their tightening policy and an end to their rapid currency appreciation by mid-2008.”

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