Quarterly Economic News

THOMAS FINANCIAL

First Quarter 2009

The first quarter of 2009 was anything but dull or predictable. A new president was sworn into office and the largest economic stimulus plan in United States history was signed into law. Economic news remained bleak as early efforts by the government to stem the recession were generally viewed as ineffective. The unemployment rate continued to rise and even exceeded 10% in some parts of the country. The auto industry remained in flux as the government refused additional aid without more restructuring. The nation was outraged by the financial maneuvering that allowed payment of large bonuses to AIG executives. Bernard Madoff, mastermind behind the largest Ponzi scheme in history, pled guilty to eleven counts of fraud. Despite all this turmoil and doubt, late-quarter economic news was reasonably positive and markets rebounded strongly off their lows. Furthermore, the housing market - spurred by lower prices and lower mortgage rates - showed signs of improvement.

Stock Market Returns

In both January and February, stocks declined at a precipitous pace. On March 9, the Dow Jones Industrial Average (DJIA) hit a low of 6,440, but then started to rebound, ending the quarter at 7,609. Overall, the DIJA lost 13% and the S&P 500 lost 12% for the quarter. The markets agonized most over the government's slow and unorganized response to the continued credit crisis. Treasury Secretary Timothy Geithner's initial appearance before Congress did nothing to allay market concerns. However, the Treasury's detailed plan to add liquidity to the markets late in the quarter, and the Federal Reserve's plan to acquire bonds, helped the market's late-quarter rally. International stocks lost 14%, but emerging markets posted a surprising 0.50% return. The following table shows returns for four major indices:

Index	1st Qrt	1 Year	5 Year	10 Year
S&P 500	- 11.0%	- 38.1%	- 4.8%	- 4.0%
S&P 600	- 16.8%	- 38.1%	3.9%	4.2%
MSCI EAFE	- 14,6%	48.2%	- 4.6%	2.9%
Barclays Agg. Bond	0.1%	3.1%	4.1%	5.1%

Source: Wall Street Journal April 6, 2009

The S&P 500 is a commonly used measure of common stock total return performance.

The S&P 600 is a commonly used measure of small capitalization stocks.

The MSCI EAFE is a commonly used measure of common stock total return performance of international markets.

The Barclay's Aggregate Bond Index (formerly Lehman Brothers' Aggregate Bond Index) is a commonly used measure of the bond market.

All referenced indices are unmanaged and not available for direct investment.

Past performance is not a guarantee of future results.

Government Bond Yields Increase

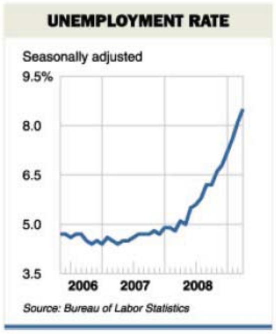
During this financial crisis, investors flocked to the safety of government bonds, pushing government yields down and yields on corporate bonds up. The yield on government bonds increased during the first quarter as worry mounted about the amount of government debt needed to support the financial bailout and economic stimulus. According to Bank of America Securities - Merrill Lynch, the ten-year Treasury lost 3.3% in the quarter, while high yield bonds gained 5.5%, which highlights the easing of credit concerns and the narrowing of credit spreads. At one point, the yield on the ten-year Treasury was over 3%, but dropped after the Federal Reserve announced its planned $300 billion purchase of government bonds.

"Credit Markets Still Navigate in a Choppy Sea of Liquidity", Liz Rappaport, Wall Street Journal, April 1, 2009.

Unemployment Jumps

The recession's impact is most evident in the unemployment figures, which are at a twenty-five year high. Through February, the national unemployment rate was 8.1%, an increase of nearly three-percentage points in just one year. Unemployment is one of the most prominent signs of an economy's health. It is not, however, a leading economic indicator, which means that even when the economy shows signs of improvement, unemployment rates could continue to rise for a period of time.

The following chart shows the most current national unemployment rate:

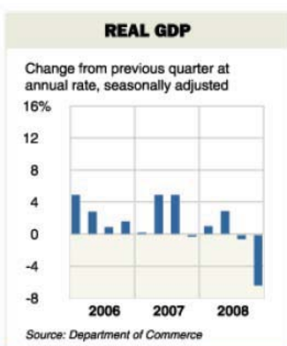


http://online.wsj.com/mdc/public/page/2_3024-ecocharts.html?mod=topnav_2_3024

Seven states, including Michigan, California and Nevada, have posted unemployment rates that exceeded 10%.

Economic Slowdown

Economists expect Gross Domestic Product (GDP) will continue to contract through most of 2009. However, the overall consensus is that the economy will show signs of improvement compared to the 6.3% decline realized in the fourth quarter of 2008. The following graph illustrates recent quarterly GDP figures:



http://online.wsj.com/mdc/public/page/2_3024-ecocharts.html?mod=topnav_2_3024

In response to the dismal economic outlook, a $789 billion stimulus package was passed by Congress and signed into law by President Obama in mid-February with the hope of spurring economic growth. Despite the stimulus, long-term economic recovery is ultimately contingent on the housing market. On a positive note, the housing market showed signs of improvement during the quarter. In February, both new and existing home sales increased, which was unexpected. While sales of foreclosed homes and other distressed properties accounted for a large portion of the transactions, lower home prices are spurring buyer interest. The thirty-year mortgage rate hit an all-time low of 4.85% late in the quarter, which is also attractive to potential homebuyers. Economists are not predicting that the housing slump is over, but these recent signs are encouraging.

"US Economy Slumps 6.3% Before Possible 'Turnaround'", Bloomberg.com, Shobhana Chandra, March 26, 2009.

"Obama, Geithner Get Low Grades From Economists", Phil Izzo, Wall Street Journal, March 11, 2009.

"New Home Sales Rise 4.7%", Kelly Evans, Wall Street Journal, March 26, 2009.

"US Fixed Mortgage Rate Falls to Lowest on Record", Brian Louis, Bloomberg.com, March 26, 2009.

Easing the Credit Crisis

Financial sector stability is another key to economic recovery. Treasury Secretary Geithner's initial outline of a plan to help troubled banks was short on specifics. Citigroup and Bank of America stock sank, and there was speculation that major banks would be nationalized. In mid-March, the Treasury and the Federal Reserve announced separate plans to enhance credit markets. The Treasury announced its Public / Private plan to buy distressed assets from banks to improve their balance sheets, which would in turn allow banks to raise new capital, improve liquidity and resume lending activities. The Federal Reserve announced plans to keep interest rates low by acquiring $300 billion of government bonds and hundreds of billions of mortgage-backed securities through the first half of 2009. These actions, as well as announcements from several major banks that operating results for the first two months of the year were encouraging, led to improvements in the financial sector.

"Fed in Bond-Buying Binge to Spur Growth", Jon Hilsenrath, Wall Street Journal, March 19, 2009.

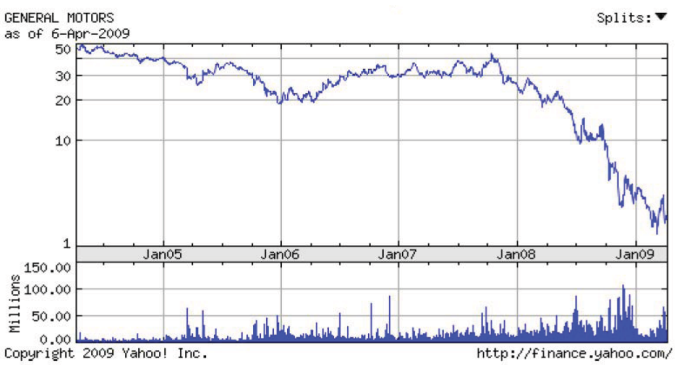
Ruse Gallery

There were plenty of financial ruses in the first quarter. Unseemly bonuses for bank and insurance executives at the center of the financial crisis angered taxpayers and sparked talk of compensation reform. Bernard Madoff pled guilty to eleven counts of fraud related to his estimated $50 billion Ponzi scheme and was immediately ordered to jail pending sentencing later this year. The SEC charged Sir R. Alan Stanford with $8 billion of fraud for improper sales of CDs through his various banking entities. Stanford hooked investors with his fabricated return figures and they flocked to his offshore banks in an attempt to earn 10% or more on “safe” CD investments.

“SEC Accuses Texas Financier of ‘Massive’ $8 Billion Fraud”, Wall Street Journal, February 18, 2009.

Automaker Realignment

Late in the quarter, the Obama administration’s auto task force determined that the restructuring plans put forth by both GM and Chrysler were not viable. GM’s chief executive, Rick Wagoner, was forced to resign along with most of GM’s board of directors. Chrysler was given a month to announce a tentative alliance with Italy’s Fiat, and if an agreement is reached, the government would consider investing another $6 billion in Chrysler. The chart below shows the past five years’ stock performance for GM:



http://finance.yahoo.com/q/bc?s=GM&t=5y&l=on&z=m&q=l&c=

The task force did not rule out the possibility of bankruptcy for both companies, the idea of which was viewed as an impossibility last fall when the automakers first approached the government for help. The government gave GM sixty days of working capital for it to create a more comprehensive recovery plan. The Obama administration is walking a fine line in balancing the interest of taxpayers and entering a long-term commitment to operate the two automakers.

“Government Forces Out Wagoner at GM”, Neil King, Jr. and John D. Stoll, Jeff Bennett, Wall Street Journal, March 30, 2009.

Conclusion

The outlook for most of the first quarter was disheartening. The Obama administration seemed unable to stop the economy’s downward spiral, and some questioned the competency of the new Treasury Secretary, Timothy Geithner. On a positive note, the last three weeks of the quarter saw a strong market rally (up nearly 20% from the DIJA’s lows). This rally seemed to be triggered by several factors: the market’s approval of Treasury’s plan to help banks rid themselves of toxic assets, the Federal Reserve’s actions to spur the economy through government bond purchases, positive announcements from banks at the center of the credit crisis, and hopeful signs from the housing market. It is impossible to know whether the worst of the recession is over, but recent economic indicators are encouraging.

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