Recovery, what recovery? June nips economic green shoots in the bud

Recovery, what recovery? June, not April, has been the cruellest month in 2009, nipping green shoots in the bud and reminding us that recoveries after financial crises can be slow and fitful affairs.

By Tom Stevenson
Published: 7:47PM BST 24 Jun 2009

Where rediscovered risk appetite was most gluttonous, the indigestion has been most painful. Russia's RTS index fell into official bear market territory this week, 21pc down from its June 2 peak. Brazil's Bovespa index, another beneficiary of the spring re-decoupling story, is 9pc down this month, oil is off 6pc and Dr Copper has fallen 9pc in two weeks.

For a while it looked like a V-shaped recovery was on the cards again. History offered some juicy precedents. Between June 1972 and January 1975, the FTSE All-Share index fell from 228 to 62, but within six months it had bounced to 154, recovering more than half London's most savage bear market in less than half a year. In 2003, the trajectory was flatter but, having turned in March, the market didn't even pause for breath for a year.

This year's recovery lasted barely 10 weeks, an indication that many were unconvinced by the sustainability of the rally. Cash piling up on the sidelines was a sign that if the recovery took root it could grow strong and tall but a reminder too that there were good reasons to remain suspicious.

Stock markets anticipate recovery, which is why they hit bottom when the outlook remains bleak. For this reason, no one should have been surprised by the change of direction in March. It was triggered by early indications that the rate of deterioration in the economy was slowing – things were getting worse less quickly. The pause this month is an acknowledgement that less bad is not the same as good.

It also reflects an understanding that an inventory recovery is not the same thing as growth. You have to remember that the global economy experienced a kind of nervous breakdown last autumn. Everywhere manufacturers stopped making things and used up what they had in the store cupboard. It is not surprising that when people realised that the world had not stopped spinning they should have wanted to rebuild their stocks. But, again, getting back on your feet is not the same as running.

Other reasons not to have bought into the V-shaped recovery have included: rising bond yields as investors fret about the inflationary consequences of emergency government stimulus; still-rising unemployment; the flimsiness of the commodity rally, fuelled as it has been by speculation and strategic hoarding; the millstone of debt around the necks of consumers on both sides of the Atlantic; and record issuance of new shares by companies unable to tap the still malfunctioning credit markets.

Bull markets traditionally climb a wall of worry but this pile of concerns looks like the north face of the Eiger.

It is not just the stock market that got ahead of itself this spring. The flurry of stories about the imminent recovery in Britain's housing market in recent weeks is a classic example of people's ability to believe what they wish to believe. The UK housing market is over-priced by historic standards; there is limited credit available and fixed-interest mortgages are getting dearer; unemployment is rising steadily and can be expected to do so for perhaps another year; and now we learn that one in 10 borrowers have mortgages that are larger than the value of their houses. Now if anyone can tell me why house prices should rise from here, perhaps they would drop me an email.

If you got up close to the chart of the FTSE 100 in March and April you might have seen a V. But take a couple of steps back so you can see the last year or so and a rather different picture emerges, one that will be familiar to Martin Sorrell, the chief executive of advertising agency WPP, who during the recession of the early 1990s talked of a bath-shaped recovery. He meant that after activity fell off a cliff, it would bump along the bottom for an extended period before finally recovering when most people had given up hope.

Twenty years on that seems a reasonable template again both for the economy and the stock market. The V-shaped recovery is implausible because it would require economic problems that took years or decades to develop to be solved in a matter of months. It will take longer to clear up the mess, I fear, and the price we will pay for avoiding financial collapse is a long period of bouncing along the bottom.

The opportunity to stock up at the bottom of the market is sometimes called buying the U. This time, I suspect it will be a case of buying the bathtub.

Tom Stevenson is an investment commentator for Fidelity Investment. The views expressed are his own.

http://www.telegraph.co.uk/finance/comment/tom-stevenson/5626974/Recovery-what-recovery-June-nips-economic-green-shoots-in-the-bud.html