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Is it really different this time? This recession does feel different than the others before it, but the numbers are not significantly different. Unemployment has been higher. In 1974 unemployment peaked at over 12%, so we are a few points below that at 10%. In March of this year the market had declined by a little more than 50% compared to 2002 when the market was down about 50% from its high in 2000. Not significantly different. So why does this one feel much worse?

The simple answer is correlation. Financial institutions rely on complicated models to assess the risk that is in their portfolios, and these models are almost all based on the capital asset pricing model, or CAPM as it is commonly referred to. The simple assumption built into CAPM is that all assets are not alike. Assets perform differently based on their risk, and they don't all move together, so 'uncorrelated' assets actually lower the risk of your portfolio. Every finance student in the country that has received a graduate degree in finance has been exposed to CAPM. It is the foundation of the Chartered Financial Analysts program. The only problem was that last year it didn't seem to work when our financial system needed it most.

One day last fall, financial institutions around the world woke up and realized their entire portfolio was in the tank, and it was getting worse by the day. They called in their MBA's and PH. D's to try and figure out what was happening, and the financial brains said not to worry, because the models say this isn't happening. We cannot lose money in everything on the same day. This is obviously oversimplified, but it is basically what happened. The

scary part was that nobody knew what was coming next.

In past recessions, there is usually at least one asset class that is working even when everything else is not. In the recession of 2000 to 2002, value stocks did well even though technology and growth stocks were getting hammered. In the 70's, companies that benefited from inflation outperformed as the broader economy struggled. There was no place to hide in this decline. A diversified portfolio only lost 45% instead of the market declining 55%. Even the insurance that insures US treasury bonds against default spiked up, while the price of the bonds was going up at the same time. It made no sense because if an asset is perceived to be more risky, its value should decline. If it costs more to insure an asset against loss, the value of the asset should not go up. But treasury bonds were increasing in value as their insurance cost went up. This is the world we just lived through.

Correlation may also help explain why the bounce of the bottom has been so dramatic, even though the real world doesn't seem much improved. The global liquidity created by the world center banks has created an effect that is just opposite of one year ago. Now, all the asset groups are moving up together. However, at least for the moment, this is a problem that is much more palatable to deal with. Eventually, we all find out Santa Claus doesn't exist, and we will have to pay for all this. Until center banks rein in the liquidity, it looks like we are going to all enjoy a Merry Christmas.