

# FirstMerit Market Message

A quarterly newsletter for  
FirstMerit Wealth Management Clients

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## Is It Different This Time?

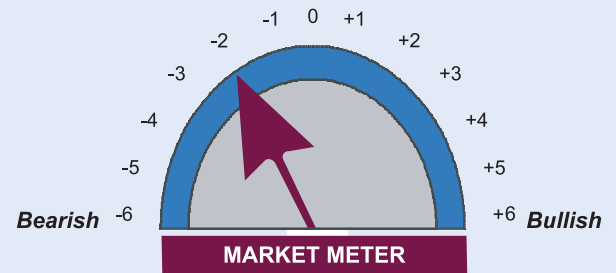
All forecasters struggle with the allure of the title of this issue even though we know the four most dangerous words to write are “it’s different this time”. That’s because those words generally mean the forecaster has given in to the urge to go with the flow and assume that a trend in place will continue forever. This led many people to make foolish statements, such as “technology stock earnings will never

peak” or “housing prices only go up”. The sudden bursting of the 1990’s stock bubble and the 2000’s housing bubble are proof of the danger of such assumptions.

Now it seems we are at the opposite end of the spectrum. We have hardly been optimists on the economy but we often wonder how people can equate the current recession to the horrors of the Great Depression, a period that saw GDP drop over 40% in three years, unemployment reach 25%, and 8,000 banks fail. As we have often stated, **a Depression cannot occur without egregious and continuous Federal Government policy errors.** We’ve seen some errors, but they don’t include the most dangerous one, which is sitting idly on the sidelines.

Referring to our title, our opinion is that “different” would mean the most dynamic and entrepreneurial nation the world has ever known has become a basket case. We reject that notion. So if it’s not different and **the economy will eventually improve**, what will that improvement look like and how will it affect the financial markets?

It is true that we all want to peek around the corner into the future to catch a glimpse of what is to come. Unfortunately, despite our great desire to have someone (who, me?) foretell the future of the economy or the markets, most people recognize that human beings simply cannot look beyond today’s date with certainty.



**Current Reading is -2**

- |                        |                           |
|------------------------|---------------------------|
| <b>0 MAJOR TREND</b>   | <b>+1 FEDERAL RESERVE</b> |
| + Nominal new highs    | + Easy monetary policy    |
| - “Real” new lows      |                           |
| <b>-2 FUNDAMENTALS</b> | <b>-1 TECHNICAL</b>       |
| - Recession bottoming  | - Downtrends in place     |
| - Valuations are cheap | = Momentum is turning     |

As an investment strategist, I think **my key responsibility is to interpret the past and present and to have a disciplined framework for applying that understanding** to better position our clients for different tracks the future may take.

To succeed at that modest goal, I must have a disciplined process that eliminates judgmental and emotional biases. That process is based on analyzing the underlying inputs to our Market Meter. The FirstMerit investment team reviews these inputs every month and this month, for the first time since September 2007, **the Meter is showing an uptick.** As you can see on this page, it is still on the cautious side at -2 but we think it’s more likely to improve further than to roll back in coming months.

At FirstMerit, we utilize disciplined approaches such as our Market Model precisely because we know we cannot predict the future. One of my beliefs is captured by a line I paraphrase from Mark Twain: **the future doesn’t repeat exactly, but it often rhymes.** Our methods for understanding the past and present help us to identify potential significant rhymes that give us insights into the future.

In other words, if we can spot a few couplets before the full poem is written, we can better position client portfolios.

We still think today’s rhymes are part of an epic poem that tells a dramatic tale of woe. The deleveraging of consumers, financial institutions and investors may be offset in the

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*Is It Different This Time? continued from front*

short term by the leveraging-up of governments around the world, but we have not likely seen the end of it.

As we have said many times, our analysis suggests the below-trend growth rates of this decade will be followed by even slower growth over the next several years which will not create a strong secular backdrop for optimism on long term earnings and dividend growth. We expect that will limit stock market potential returns over the next several years.

**One rhyme we see is that the shorter term cycle will not be different this time.** The depth of this recession is performing its normal function – creating pent-up demand that should cause a solid (but likely brief) economic rebound later this year into 2010. We cannot yet attempt to predict whether that will lead to increased inflation or fears of a double-dip recession, but we don't expect "different" which would be a smooth shift to a Goldilocks economy.

If we are correct, **buy-and-hold investing will continue to be a very frustrating experience.** The most likely way to increase your wealth in the stock market will be to apply the strategy we discussed in our Winter issue, Tactical Asset Allocation. The underlying strategy is straightforward: sell into strength, buy after weakness and always know how much risk you are taking.

For now, we do not plan to shift from our focus on capital preservation, high quality and diversification, but a bottoming process appears to be forming. If that is the case, the Market Meter will help us integrate it into our portfolio strategies. **It'll likely be tricky, which means this time is not different from the past!**

## For More Information:

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<b>Canton</b> - Bob Stark . . . . .	330 498-1551
<b>Cleveland</b> - Tom Anderson . . . . .	216 694-5678
<b>Columbus</b> - Curt Ramkissoon . . . . .	614 570-7570
<b>Elyria</b> - Dan Munro . . . . .	440 329-3269
<b>Medina</b> - Don Miksch . . . . .	330 764-7263
<b>Mentor</b> - Karen Manning . . . . .	440 953-2179
<b>Toledo</b> - Mickey Cooper . . . . .	419 720-1521
<b>Wooster</b> - Linda Litman . . . . .	330 263-3208

## Investment Management 101

### Economic Cycle Forecasting

Economic cycles consist of alternating periods of expansion and contraction in economic activity. There are also growth rate cycles, which are alternating periods of upswings and downswings in the economy's rate of growth. The status of the economic cycle is important not only as an input to the Market Meter, but also for our fixed income strategies.

We do not run macroeconomic models although we pay attention to several economists who do so. The output of those models works its way into our economic forecasts. Economic cycle forecasting is important to our process.

We read economic research, analyze the government's data releases and talk with folks who spend all of their time trying to understand the economy. We have internal debates on economic topics – yes, it is possible to passionately defend an opinion about something as seemingly-dry as: inflation or deflation; slow economy or recession; or the long term impact of high budget deficits.

The key for us is to boil the masses of information down to where we can use it to make strategic decisions. In August of 2007, we went through a lot of data analysis and debate to create the Recession Checklist. Although it showed only 2 of 10 Recession indicators when we created it, we steadily checked off the indicators. When it hit 7 of 10 in May 2008, we knew recession was a high risk and took greater defensive steps in client portfolios.

Now we are on the opposite end of the spectrum and in February, we established a new Economic Expansion Checklist. As with our previous effort, it began with only 2 of 10 indicators in place. Here in April, it is beginning to show positive signs of the inevitable end of the recession as another Expansion signal switched on. We will closely watch for stronger signs that the Economic Cycle is turning!

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