The Gammer Report

BUSINESS IN VANCOUVER

2009: An Inconvenient Recovery

Through the 2nd half of last year I had investors asking me “where are the deals?” They looked around at what was happening in the stock market, and reading about the bloodbath in the US and figured there were going to be deals to be had, left and right. Right here in their backyard.

Instead of the bottom falling out of the economy in 2009 as it was looking like it might at the end of 2008, we found governments and central banks taking decisive action to avoid catastrophe. Business people held their breath, reined in their spending, decreased inventories, remained calm and most people didn’t panic. Interest rates dropped, the money supply increased, governments went back into deficit; and in the US, the government bailed out certain mega-companies they felt the country couldn’t afford to lose. By the end of the 2nd into the 3rd quarter the US was coming back and Canada avoided taking a major economic hit.

Central Banks in the western world set their short term lending rates at historic lows in order to assist in restoring liquidity to the markets. Canada said it will keep its short term lending rates low at least until June 2010, currently the Bank of Canada Rate is at 0.25%. And in the US for most of last year the Federal Reserve has been set between 0 to 0.25%.

In addition to this, western governments have been putting stimulus back into their economies as quickly as they can, going back into deficit. Canada’s deficit in 2009 is somewhere around $34 billion, in the US it is $1.2 trillion. To put that in perspective, the US deficit for 2009 is almost equal to Canada’s entire economic output.

And what did we receive for those policies and expenditures: Canada’s 3rd quarter economic growth was just under 0.6% and in the US for the same quarter it was 2.2%; unemployment rates in Canada we are at 8.5%; and in the US it is at 10%, which is more than double what it was in December 2007.

For all the gas governments are pouring into our economic engines, there remains a real dichotomy in the economy, while GDP growth is low, the stock market is not.

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In the US, there are entire shopping malls that have turned off their lights and closed their doors, brand new apartment buildings are empty and up for sale, and 1 in every 136 households in the US received a foreclosure notice in the 3rd quarter of 2009.

While at the same time the stock markets are at 15 month highs, the Canadian dollar is very strong, and the prices of commodities relative the US dollar are also strong. So which way are we going?

So far, we've avoided a painful recession and long stagnation like Japan of the late 1980's and 1990's. What we are seeing is a very fragile recovery, and a thin one at that. Governments and Central Banks do not want to jeopardize the marginal economic recovery we are experiencing. If all the money governments are putting into their economies and increasing liquidity is only providing marginal growth, don't expect them to change their economic policies any time soon.

So to get back to the central question investors are asking: where are the deals? Here are the things to watch: the unemployment rate, GDP growth, and the Bank of Canada rate. Commercial real estate lags behind the labour market so when unemployment numbers are levelling off and start their way back down, AND stronger growth in Canada's GDP, AND the central bank rates heading back up – over 100 basis points, that's when my crystal ball says we'll see some investment deals. At least for a period of time. When these factors combine it is going to catch some businesses and property owners flat footed where they are over leveraged and need to sell, others are going to be nervous and bail on underperforming assets.

When there is a shift away from cheap money, deals will be out there. Demand loans may get called and creditors are going to be protecting their interest in assets and they won't care about the impact it has on the businesses or employment because they are only going to be interested in protecting their investment. This isn't to say the economy will be doing better, most likely we'll be getting more mixed economic messages, but this is the time where investors who are sharp, quick on their toes, and have their financing ready are going to be able to make plays in the market. It won't be for the faint of heart, or for people with shallow pockets.

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