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HAS WALL STREET LEARNED FROM 2008?

Some market bears think very little has changed. They could be right.

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Memories of 2008 are still fresh: The credit crisis; the collapse of Lehman Brothers and Washington Mutual; the federal takeover of Fannie and Freddie; the market downturn. There's little doubt Wall Street would like to erase it all from its conscience, and maybe it has.

Part of the anger of the Occupy Wall Street movement comes from the perception that nothing has changed. While the Dodd-Frank Act (designed to make the financial system more accountable and transparent) is now taking effect, the Volcker Rule (intended to stop banks from trading for their own accounts) may be watered down or put off. Beyond that, the U.S. economic recovery from the Great Recession has sputtered and made people question the recent bullish sentiment.

Stocks have rebounded strongly since 2009, but there are still many factors to worry about; this may lead to a little contrarian thinking.

This bull market may be a diversion from a secular bear market. For most of 2011, the S&P 500 has been above 1,200 (a great rebound from the March 2009 low of 676). What was behind that? The short answer: a weak dollar. We haven't exactly had a boom economy in that timeframe.^{1,2}

Some analysts look at Wall Street right now and see a rerun of the 1970s, when you had momentous rallies masking a bear market that went from 1967-82. In addition, researchers at the Federal Reserve Bank of San Francisco are concerned about the possibility of a generational sell off; a potential market "headwind" for 10 or 20 years stemming from greying Baby Boomers getting out of stocks as they get closer to retirement, countered only partly by overseas investment.^{3,4}

What has changed on Wall Street since 2008? Perhaps not much. The general perception that the CEOs of the big investment banks and mortgage companies whose thoughtlessness contributed to the Great Recession met with no real consequence seems to be taking hold, as evidenced by the Occupy Wall Street movement.

By the way, remember the furor directed at risky derivatives trading? In September 2011, the Comptroller of the Currency had recorded an 11% year-over-year increase in

derivatives investment in the banking industry. Banks now hold almost \$250 trillion of the contracts.⁵

A truly severe punishment of Wall Street would come at a dear price for Washington. Some of the biggest names from Wall Street (and the real estate sector) have also been major lobbyists and campaign contributors. According to the nonpartisan Center for Responsive Politics, the National Association of Realtors has contributed more than \$40 million to federal-level political campaigns since 1989; Goldman Sachs has contributed almost \$36 million since then, and Citigroup nearly \$29 million. The financial, insurance and real estate industries have collectively spent over \$4.6 billion in lobbying efforts since 1998.^{6,7}

What is happening with the recovery? Not much. While unemployment is above 9%, underemployment is the real story - in September, 16.5% of Americans worked less than 40 hours a week. No wonder homes sit on the market and consumer spending increases mostly in response to rising food and energy prices. Wages even retreated 0.2% in September and incomes fell 0.1% - the first monthly decrease in income since October 2009. Assorted 2012 forecasts see slow or slowing growth in various European and Asian nations.^{8,9}

Is there a bright side for Wall Street? Actually, there could be. The European Union is making decisive moves to address its debt crisis. Indicators still show that our economy is growing, not contracting; September was the best month for U.S. retail sales since March. Many analysts think that the Dodd-Frank regulations will discernibly impact the Wall Street mindset. Lastly, the strength and duration of seemingly every major bull market has been questioned by the bears; history may record that a secular bull market began in 2009, after all.¹⁰

Only time will tell. Over time, the stock market has faced some great challenges - and risen to meet them again and again. This time around, the hope is that Wall Street's behavior (and behavioral assumptions) won't sabotage the rally.



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Citations.

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