

BCA Fourth Quarter 2008 Market Review ©

Heightened Fears and Aversion to Risk

The Repricing of America

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The repricing of America is affecting every asset class. What began with residential real estate in 2007 spilled over to commodities and equities in 2008. The herd of investors believe that all asset values will fall and bankers would agree. Investors ran for the fire escape doors in 2008 in every major trading market. Panic selling of stocks and commercial notes was followed by the largest observed herd of investors buying government backed paper and certificates of deposit. This capital rotation has only deepened the global recession. Fear has slowed consumers to a crawl, which in turn has caused companies to lay off employees. Falling stock prices invariably results in the lowering of credit ratings, which freezes out a firm's borrowing ability. It is a self fulfilling prophecy. Investor fear has accelerated and deepened the current recession and caused the largest repricing of assets since the Great Depression.

The spread between corporate and government bond yields has reached an historical high, reflecting the high risk premium demanded of investors.



Expected risk determines the price of every asset. Capital is attracted to assets that are expected to achieve an expected return and risk premium. Expected risk premiums drive the bidder's price. As bidders become less abundant for a particular asset, the price is driven down and buyers disappear.

The restoration of asset values will attract risk capital once again. The public is watching closely for changes in fiscal policy. BCA believes that investment tax credits and other targeted tax incentives will stimulate growth beginning in late 2009. Until that begins, Washington and the media will greatly influence investor sentiment.

