

The Investor's Outlook

 **OLD NATIONAL**
Wealth Management

The view from the Crow's Nest

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While many people associate the crow's nest on a sailing ship with the best view, it was not a place for the faint of heart or anyone prone to seasickness. As the nest was located at the top of the tallest mast, any small movement on the ship below was greatly amplified. In fact, during rough seas, being sent to the crow's nest was a form of punishment. Despite its perils, it did

offer the best vantage point and a different viewpoint than everyone else on the ship. Land ho!

As we struggle to maintain a clear head from our own perch high above the market fray, we believe we can see a calm horizon. The economy is by no means improved as of today, but data suggests that we may be through the worst of it.

To build our economic forecast, we distinguish between leading, coincident and lagging indicators. Leading indicators, as the name implies, impart their influence on the economy in the future. Changes in the money supply or purchases of raw materials offer a hint of economic activity to come. Coincident indicators, like changes in bond yields, reflect current market sentiment. Finally, lagging indicators provide confirmation of established trends. Monthly unemployment data and changes in Gross Domestic Product (GDP) are examples of lagging indicators.

Lagging Indicators

Economic output peaked in the second quarter of 2007 when GDP grew at a 4.8 percent annual rate. In the third quarter of 2008 the

economy contracted by 0.5 percent and by another 6.4 percent in the fourth quarter. We think economic activity will continue to contract in the U.S. and globally for the remainder of 2009.

	Q1 2009 Est.	Q2 2009 Est.	Q3 2009 Est.	Q4 2009 Est.
Gross Domestic Product (annual rate of change)	-5.0%	-3.0%	-1%	0%

Employment activity peaked in December 2007 and the economy has been shedding jobs at an accelerated pace ever since. A total of 5.1 million jobs have been lost since the beginning of the recession. The unemployment rate is now 8.5 percent.

The good news is that inflation is well under control despite a huge run up in the money supply. Historically, the most common form of inflation has been wage-push inflation. We believe unemployment will continue to rise throughout the remainder of 2009 so we don't expect to see large increases in wage income.

Coincident Indicators

A flight to quality by panicked investors pushed yields down on short-term U.S. Treasury securities by more than 85 percent to 0.25 percent, a 40 year low. At the same time investors were leaving the stock market in droves, holders of bonds other than U.S. Treasury securities were feeling the pinch too. Yields on corporate bonds and government agency bonds shot up and their prices fell as credit markets seized.

Now that bond markets have normalized thanks to government

intervention, yield spreads have narrowed except for banks and other financial paper. Currently, the Federal Reserve is buying bonds and effectively "capping" interest rates at artificially low levels.

The stock market has staged a small rally on expectations that the enormous amount of monetary and fiscal stimulus coming from the government will eventually feed through to GDP growth. We generally share this sentiment, although we expect the market to remain overly sensitive to any bad news.

Leading Indicators

Manufacturing seems to be stabilizing, but we are not seeing any signs of growth. The Institute for Supply Management's manufacturing index has increased for three straight months suggesting that the rate of contraction has reached its maximum and a bottom in the economic cycle is beginning to form.

Orders for dry bulk materials like coal, iron ore, scrap steel and cement, precursors to production that must be ordered months in advance are picking up slightly. A negative factor for global economic growth is the number of container ships sitting idle. More than 450 container ships remain in ports worldwide and fierce competition to fill the remaining ships has driven shipping rates to near zero.

Housing is beginning to show signs of a bottom as well. Housing starts were up strongly in February for the first time in eight months. Sales of existing homes are increasing, but supply is still very high and may move higher as foreclosures increase. Additionally, prices are 30 percent lower on average from the market peak.

Our Economic Forecast

We believe the economy, as measured by GDP, contracted a further 5 percent in the first quarter of 2009. We estimate economic

output will fall another 3 percent for the remainder of the year. Growth in GDP will not occur until 2010.

Unemployment, currently at 8.5 percent, will increase to more than 10 percent by the end of the recession. A weak labor market will keep wage pressure low.

Inflation will remain low throughout 2009 and into early 2010. Interest rates on bonds and certificates of deposit, along with money market yields, will remain low. We are very concerned that inflation will begin to increase at an unacceptably high rate once the economy regains a firm footing in late 2010.

Weak demand for biofuels and near record plantings of corn and soybeans should keep commodity prices low for 2009.

The stock market will look beyond the current economic climate and post positive year over year comparisons in 2009 and 2010. We expect the overall recovery will be muted. Therefore, investors looking for the usual double digit recovery after a prolonged bear market may be disappointed.

The Bottom Line

The magnitude and the sharpness of the downturn in the stock market was unexpected and overdone. Better days are ahead for equities as investors focus on 2010 and beyond. In the near-term, a weak labor market will keep wage inflation near zero. Coupled with economic stimulus by the Federal Reserve, we expect bond yields to remain very low in the short-term. We are concerned that inflation could be a major theme in 18 to 24 months. We are keeping our clients well diversified and fully invested.