# Bridgewater®
## Daily Observations
April 28, 2009 

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# United States

## Swine Flu:

There is a lot we don't know at this stage, and we are certainly not experts on flu transmission, but there appears to be a lot to be concerned about in the swine flu news and how it will add to the problems for the global economy. Data this early in a pandemic is difficult to sort through as there are many false and unreported data points. So it is still too early to say much, but the swine flu appears to be worse than the 2003 outbreak of SARS. The disease appears to be spreading faster than SARS and is killing young adults (the deaths attributed to the swine flu in Mexico have been of young adults) in a pattern that is more typical of pandemic flus. While there is no vaccine for this new strain, at this point, it does appear treatable for those with access to the appropriate antiviral medications. The deaths have been limited to Mexico so far. The following chart shows the speed of reported cases and deaths for SARS and the swine flu. The swine flu is spreading faster so far and killing more than SARS did in the first few weeks of being detected (data accuracy is always a question).

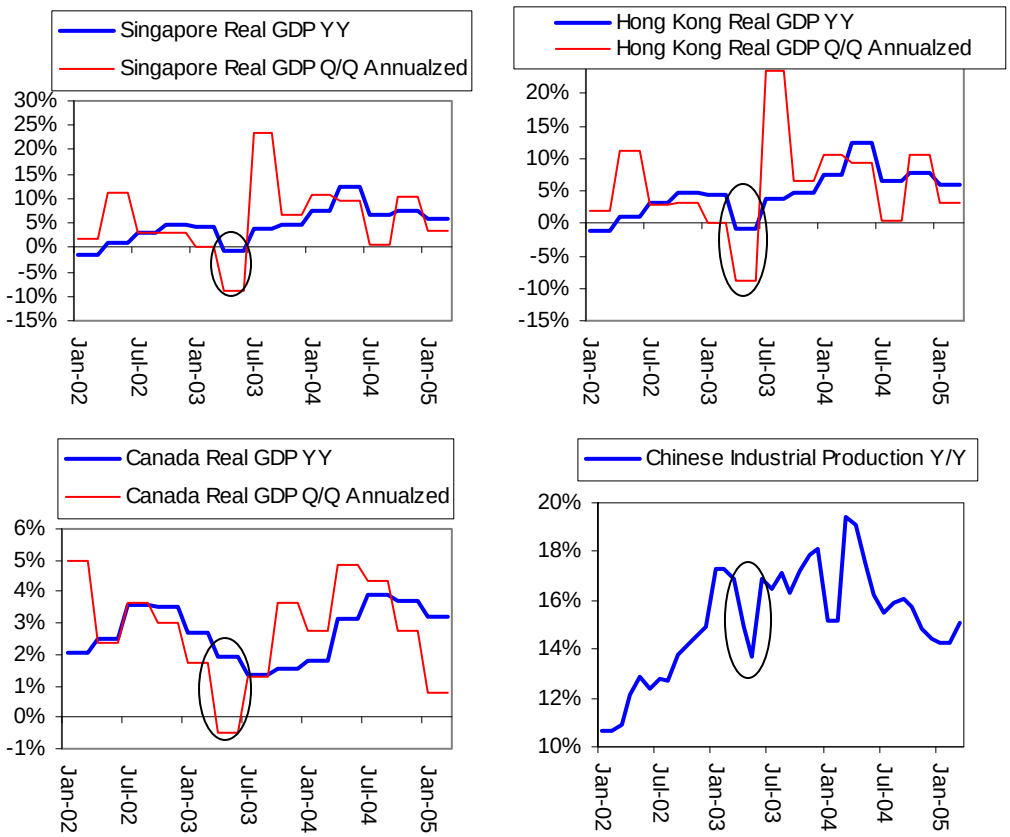
**SARS**
**Cases and Total Deaths**

| | Cases | Deaths |
|---|---|---|
| 3/10/2003 | 167 | 4 |
| 3/22/2003 | 350 | 10 |
| 3/24/2003 | 456 | 17 |
| 3/28/2003 | 1485 | 53 |
| 3/31/2003 | 1622 | 58 |
| 4/28/2003 | 5200 | 317 |
| 7/11/2003 | 8437 | 813 |

**Swine Flu**
**Suspected Cases and Total Deaths**

| | Cases | Deaths |
|---|---|---|
| 4/12/2009 | 1 | 1 |
| 4/22/2009 | - | 20 |
| 4/24/2009 | 900 | 62 |
| 4/25/2009 | 1300 | 81 |
| 4/26/2009 | 1400 | 103 |
| 4/27/2009 | 2000 | 149 |

In terms of economic impact, it is somewhat useful to look back at the impact of SARS for some perspective. Estimates vary of the actual impact of SARS, but all affected Asian countries saw dramatic declines in 2nd quarter 2003 GDP as a result of the SARS outbreak. Singapore and Hong Kong saw nearly -10% annualized readings, Canada and China slowed significantly as well.




Three times in the last century, similar influenza A viruses have undergone major genetic changes resulting in large, global pandemics.

## The Spanish Flu (1918–19)

This strain was thought to have killed at least 40 million people. It was first discovered on March 11, 1918 at Camp Funston, Kansas, though it was thought to have originated in China. A cook at an army base reported to the infirmary with flu-like symptoms – a low-grade fever and a mild sore throat. By noon, 107 people were sick. Within two days, 522 people were sick. Within a week, every state in the Union was affected. Then it spread across the Atlantic and, by mid-April, had spread to China and Japan. By May, it was virtually everywhere. It infected 28% of Americans and 20% of the world's population. The mortality rate was about 2.5% to 5%. It killed ten times as many people as World War I. After about 18 months, it disappeared.

## The Asian Flu (1957)

In February 1957, the influenza pandemic was first identified in the Far East. Unlike earlier, more devastating pandemics, it was quickly identified and a vaccine was effective in preventing it. It grew slowly in the US and 68,000 people in the United Sates died of it.

## The Hong Kong Flu (1968)

It was first identified in Hong Kong in early 1968 and showed up in the United States in December of that year. It was treatable with medical care and antibiotics. The number of deaths in the U.S. was 33,800, making it the mildest of the epidemics in the 20th century because it was treatable and because the Asian flu left some people with a natural immunity.

In all these pandemics, the flu came and went in a few waves before disappearing. Because it was so contagious, gatherings in public places, especially those involving various modes of transportation, were discouraged. During the Spanish flu epidemic of 1918, for example, some towns required that passengers present health certificates to board railroad cars.

## The Market Impact:

Global markets were impacted modestly Monday by the growing swine flu fears. The following table highlights some markets and equities that were most affected.

| | Mexican Peso | Mexican Equities | GlaxoSmithKline | US Airways | American Airways | Delta | Southwest |
|---|---|---|---|---|---|---|---|
| % Change | -5.1% | -3.3% | 7.6% | -17.4% | -13.3% | -14.3% | -9.4% |

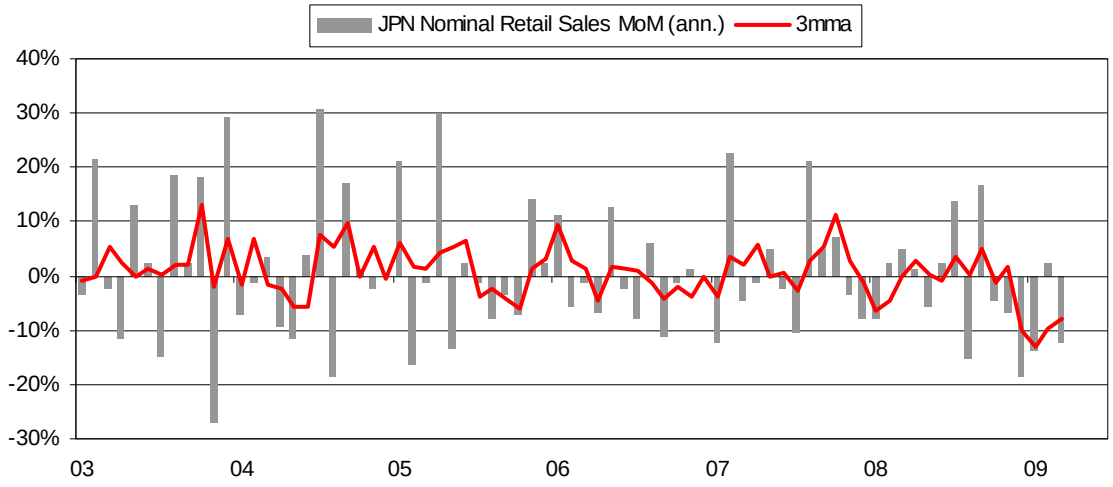
There are elements of this flu that look quite scary, and given the current economic weakness, this may be a big deal as any negative pressure will offset some of the recent modest positives. Within Mexico, the economic hit is most obvious. Public activity in Mexico City and surrounding areas has been, for the most part, suspended. These restrictions are growing across the country. Countries are starting to enact policies that will affect the global economy. Across much of Asia and Europe, restrictions are being placed on travel to Mexico and the US. Quarantine procedures for any passengers with fevers will certainly restrict the desire to travel.. Some modest trade restrictions have been adopted as well. This all certainly requires monitoring.

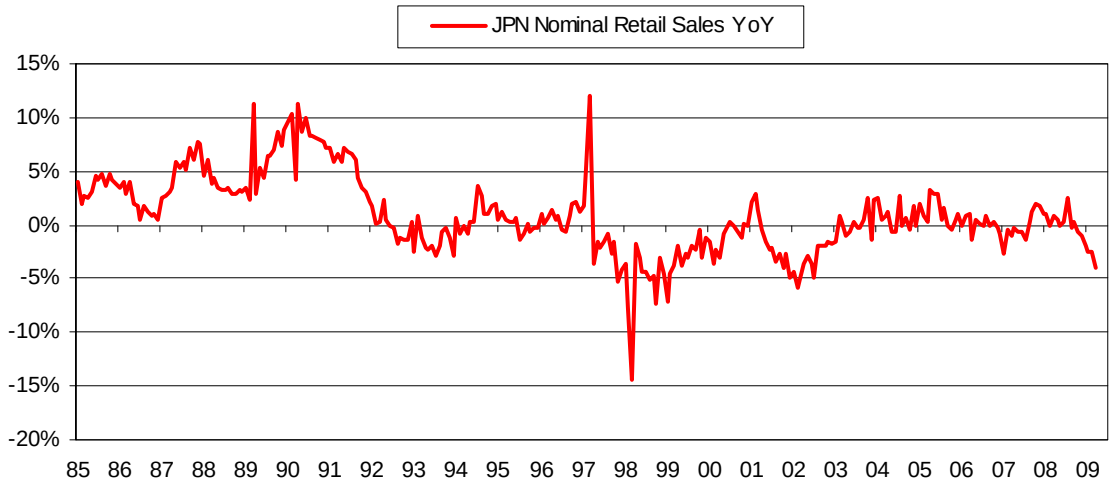
# Other Industrialized Countries

## Japan Retail Sales & Employment Conditions

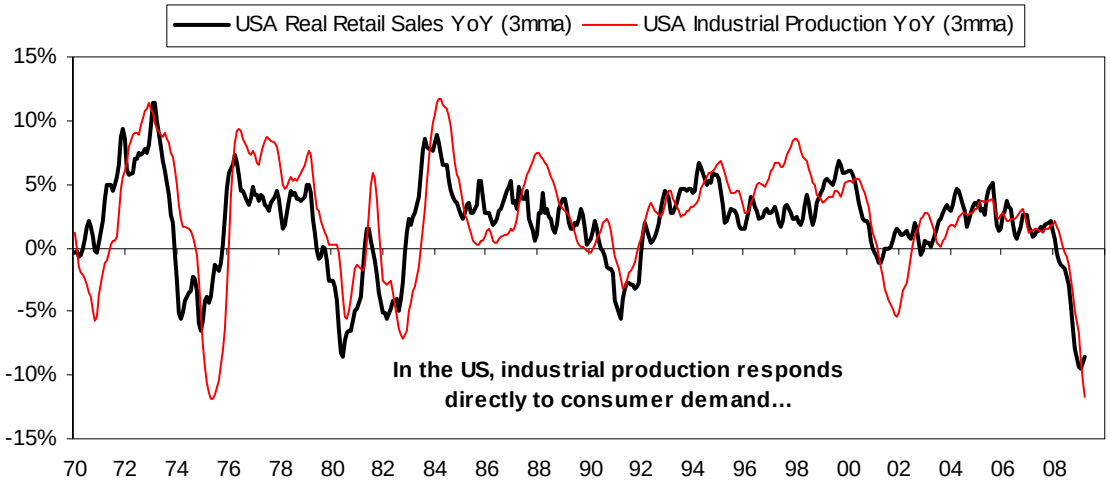
Japanese retail sales contracted 1.1% in March and are down 3.9% compared to a year ago. The demand numbers have started to deteriorate more significantly in the last six months, but it is still milder than at prior times in the last fifteen years. Given how bad the external demand and production numbers are, the domestic demand story is likely to continue to get a lot worse. Exports are down about 45%, production is down by over a third. This drop is increasingly flowing to labor markets, and in turn, should flow to incomes and spending.

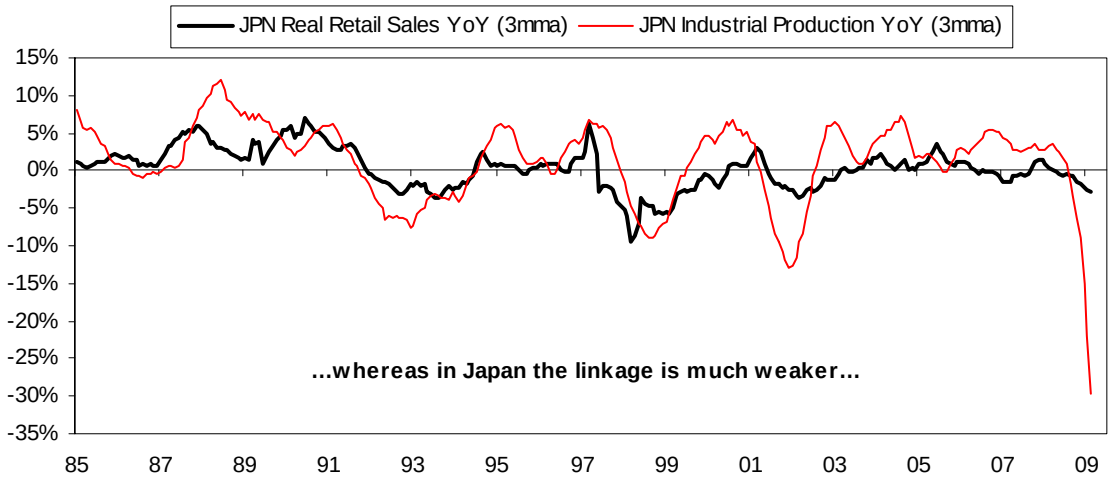
While the Japanese unemployment rate has risen less than 1% from its cyclical lows (compared to more than 4% in the US), companies in Japan have a greater pressure to reduce costs. The difference is that this cost cutting is happening through fewer hours worked and lower wages. As a result, Japanese households have actually experienced a greater drop in income than households in the US. This should translate into weaker retail sales in the near future. Below we show Japanese retail sales both in a short-term and long-term perspective. The first chart shows monthly changes (annualized) and the three-month average. The second shows a longer-term yearly change in retail sales.

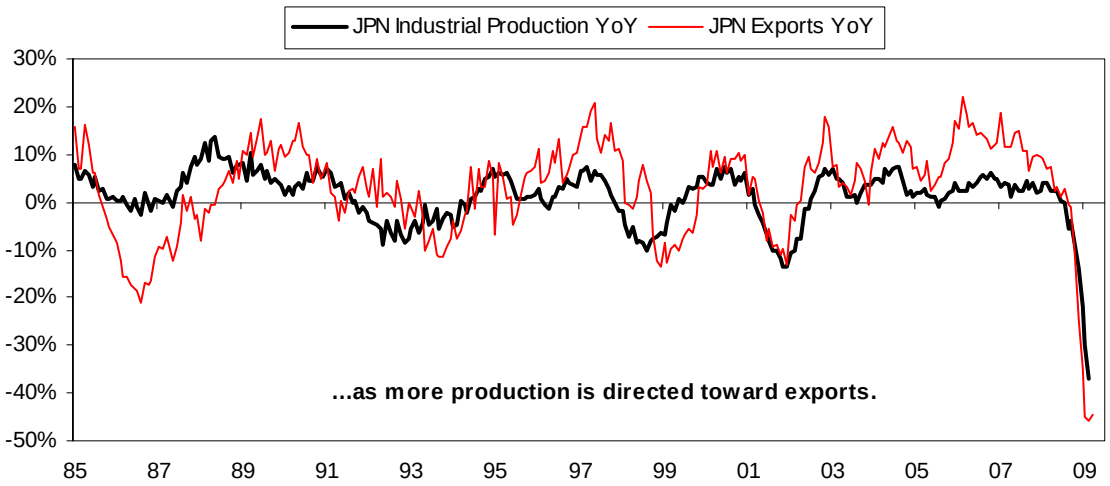


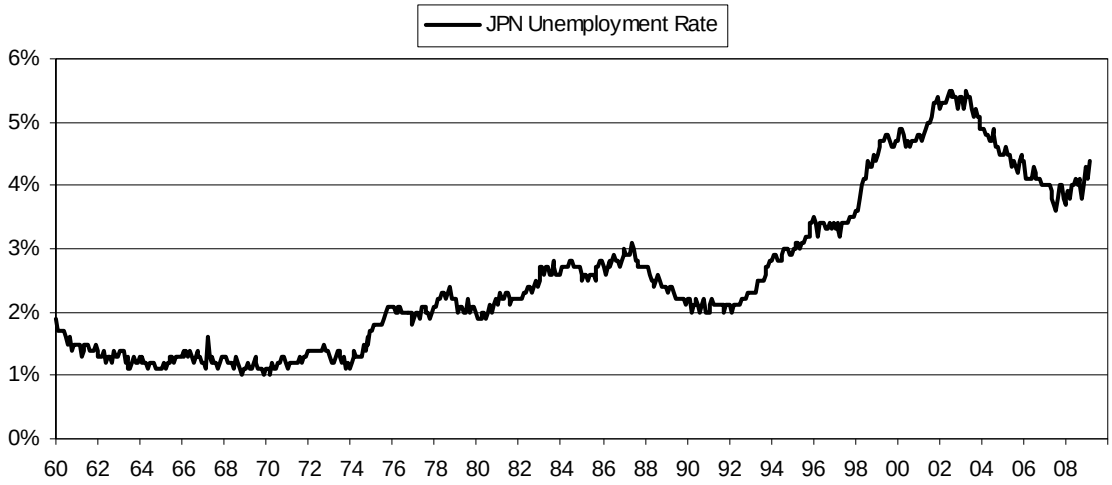

Japanese consumer spending is actually not that bad given the extremely weak conditions. In the US, retail sales tend to lead domestic conditions as businesses generally increase or decrease production in response to swings in domestic consumer demand. This has not been the case in Japan, as swings in external demand have been much greater and therefore much more of a driver of production. As a result, the linkage tends to work in the opposite direction and is not as tight, with increases in export-driven manufacturing leading to higher incomes for Japanese households and ultimately increases in retail spending. With Japanese industrial production and exports both down about three times more than in any recent contraction, and with consumer confidence at an all-time low, retail sales have actually been resilient. The charts below show the relationship between industrial production, retail sales, and exports for the US and Japan.

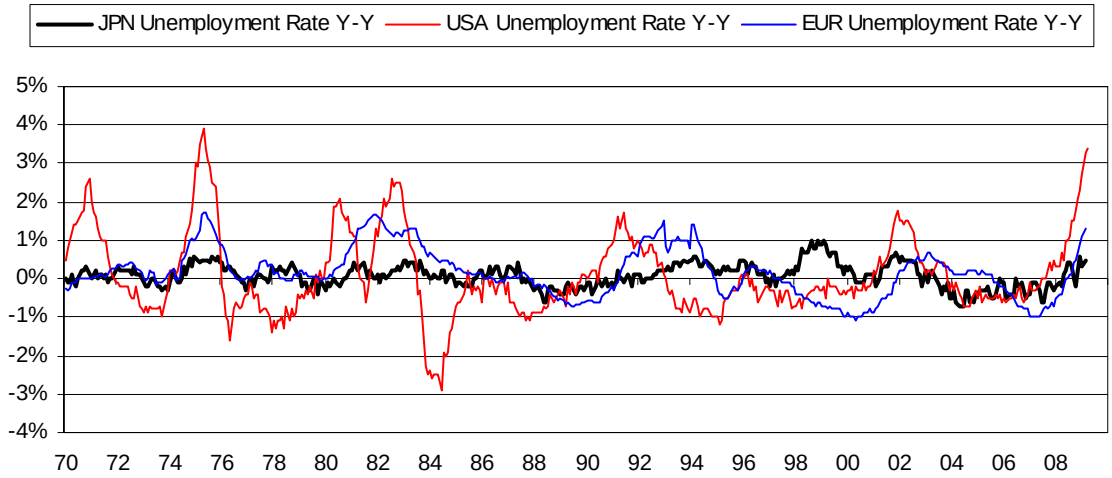


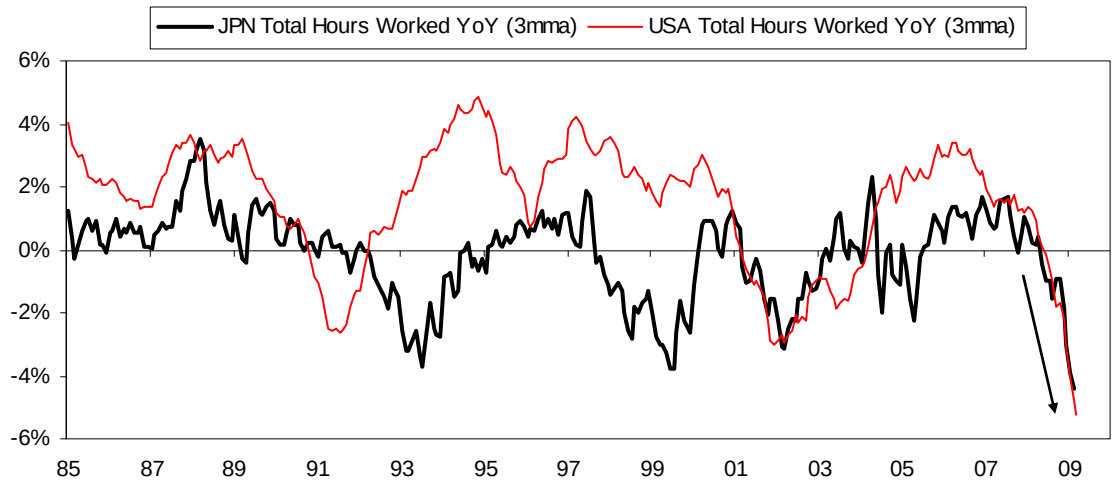




The collapse in domestic production has not yet led to significant job losses in Japan, especially relative to the job losses in other developed countries where conditions are less severe. This difference is mostly due to stricter labor laws in Japan which make it difficult for Japanese businesses to fire workers. The charts below show both the level and change of the unemployment rate in Japan. It is easy to see that the unemployment rate in Japan has historically had smaller cyclical swings than those occurring in the US and even Europe.

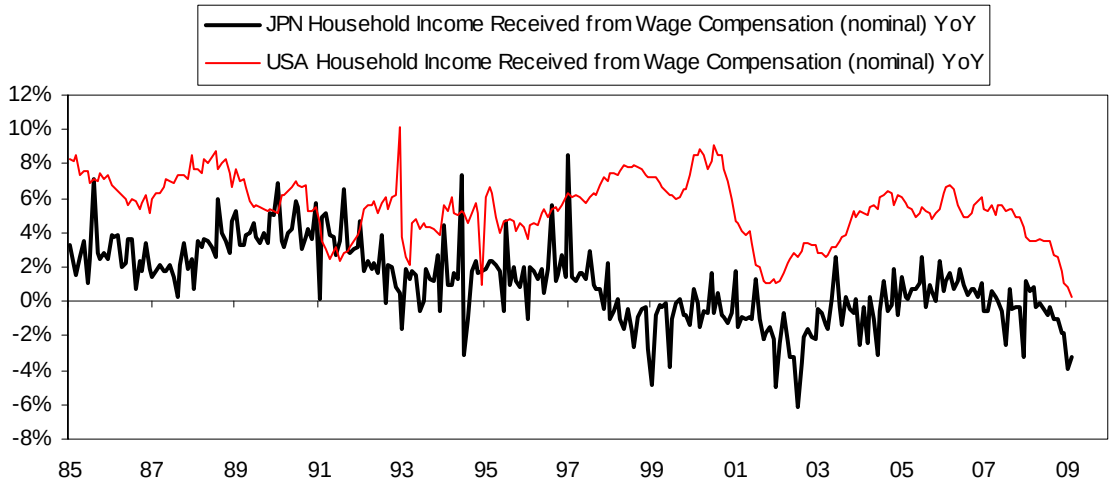



For this reason, the headline unemployment rate provides a somewhat misleading picture of labor conditions in Japan. Businesses in Japan are operating way below capacity, putting pressure on profit margins as revenues continue to fall quicker than companies can cut costs. Typically businesses react to these circumstances by eliminating excess capacity, and firing employees is one of the quickest and most effective ways to do this. Japanese businesses lower labor costs by lowering hours worked instead. The first chart below shows the total hours worked by Japanese workers compared to the total hours worked by American workers. While Japanese headline unemployment has risen far less than that in the US, the number of hours worked across the economy is falling at the same pace.




In addition to working fewer hours, Japanese workers are also once again experiencing significant nominal wage deflation, causing household incomes to fall at a pace of 5% YoY whereas incomes in the US have essentially been flat.




Japanese demand numbers have started to contract at a more significant pace in recent months. Given the contraction in external demand, the drop in production, and the reductions in incomes, the decline in demand is far from over. While the translation of lower revenues to incomes is not very evident in the unemployment numbers, it is evident in lower hours worked and compensation. Even more than other developed countries, the drop in revenues has been extreme and there is even more pressure to cut costs. This will continue to flow through to domestic demand in a significant way.

# Conclusions

**Credit Markets**

**N. America**

| *US Bonds* | *US Euro$* | *Canadian Short rates* |
|---|---|---|
| Strongly Bullish | Moderately Bullish | Strongly Bullish |

**Europe**

| *UK Gilts* | *Euroland Bonds* | *UK Euro£* | *Euroland Short rates* |
|---|---|---|---|
| Strongly Bullish | Strongly Bullish | Strongly Bullish | Strongly Bullish |

**Asia**

| *Japanese Bonds* | *Australian Bonds* | *Japanese Euro¥* | *Australian Bank Bills* |
|---|---|---|---|
| Moderately Bullish | Strongly Bullish | Neutral | Strongly Bullish |

**Currency Markets**

| *CAD v USD* | *EUR v USD* | *GBP v USD* | *JPY v USD* | *AUD v USD* |
|---|---|---|---|---|
| Neutral | Moderately Bearish | Neutral | Moderately Bullish | Neutral |

**Equity Markets**

| *US Equities* | *Japanese Equities* | *German Equities* | *UK Equities* | *French Equities* | *Canadian Equities* | *Australian Equities* |
|---|---|---|---|---|---|---|
| Neutral | Neutral | Neutral | Neutral | Neutral | Neutral | Neutral |