

Recent Positives

Heartening news on a housing bottom... We have long lamented here that Fed funds rate cuts haven't been passed on to the consumer in the form of lowered borrowing costs. So we're encouraged that 30-year fixed-rate mortgages finally fell below 5.5% to a three-and-a-half year low in the wake of the Fed's recent announcement that it will be a large-scale buyer of mortgage-backed debt. As a result, it's not surprising that mortgage applications surged by 112% in the last week of November to the highest level since last March.

... and a surprising sign of housing stability – Ned Davis Research says that pending home sales have remained in a narrow range for more than one year.

Global rate cuts – Central banks worldwide continue to follow the U.S. lead in aggressive easing. International Strategy & Investment (ISI) tells us that nine central banks cut rates last week by an average of 1%. This week was Bank of Canada, which cut a greater-than-expected 0.75% to 1.5%. Furthermore, ISI says that the European Central Bank is open to quantitative easing as the Fed has done. And governments in Europe and Asia are considering huge stimulus plans.

Stocks reaching market-bottom values? – Ned Davis Research says that the median price-to-earnings ratio of U.S. stocks was 12.1 at the end of November, the best reading in over 18 years. And there's good news on the balance sheets for large firms, as the S&P 500's debt-to-equity has been fairly stable since the late 1990s, which points to decent balance sheets in the face of everything else.

The world is awash in liquidity – International non-gold reserves remained near record highs in September at \$7 trillion, up 15% year over year. Meantime, emerging nations' reserves were at a record \$5.4 trillion – 20% more than last year. And advanced nations held a near-record \$1.5 trillion.

What Else?

Saying no to plastic – Cleveland Research says that retailers are amazed at how many holiday shoppers are paying cash, particularly at high-end stores. Credit card traffic has dropped significantly.

Then make it a "Tall" – Coffee prices have reached a five-year low.

Unnecessary roughness? – CNN reports that the NFL is cutting 10% of its staff, leaving the NHL as the only major professional sports league that has not made any significant job cuts.

Careful what you wish for – President-elect Obama has pledged to boost the economy with the biggest public works spending package since the 1950s. But Merrill Lynch notes that the U.S. experienced two recessions in that decade.

The diet "down under" – Just months after being told to save the world from climate change by consuming kangaroos, Australians have been urged to eat more camel to stop the feral animals from damaging the country's ecosystem and water sources, Australian Associated Press reports.

Recent Negatives

Modified mortgages again in trouble – MarketWatch reports that of mortgages modified to help struggling homeowners in the first two quarters of 2008, 58% are already more than 30 days past due.

Vanishing wealth... According to Merrill Lynch, \$12 trillion of equity and real estate value has disappeared over the last 12 months.

... and vanishing retailers – Through October, 52,132 of specialty retailers have declared bankruptcy, which is 21% greater than in all of 2007. And according to The New York Times, nearly 600 of the 20,770 car dealerships nationwide have closed this year. And the number is expected to increase as we move into 2009.

Cars moving slower than in decades – Overall light vehicle sales in November were at an annual pace of 10.2 million, the lowest since 1982. Even worse, domestically manufactured car sales are at historic 50-year lows. Regardless of how you feel about a bailout, if automakers ever needed a rescue, the time seems to be now.

Shipping reveals depth of slowdown – The Baltic Dry Freight Index, which measures commodity shipping costs, is off 94% from peak levels in May and has plummeted to its lowest level since soon after the index was established in 1985. Daily rental rates for the largest carriers have plunged from \$234,000 just two months ago to \$2,320 – a fall of 99% and striking evidence of a severe global recession.

More massive layoffs announced – Strategas tells us that layoff announcements rose 148% year-over-year in November. Don't expect the unemployment outlook to get better anytime soon: GM says it plans to cut another 21,000 to 31,000 jobs by 2012; mining company Rio Tinto says it will cut 14,000 jobs globally; Sony has announced plans to cut 8,000; and Dow Chemical says it will cut 5,000 jobs. Layoff announcements are becoming a daily occurrence, and we can barely keep up.

Implications/Outlook

Deflationary pressures intensify – U.S. retail sales fell in November for a record fifth consecutive month, largely because of lower demand for cars and falling gasoline prices. Strategas points out that the average S&P 500 dividend yield of 3.6% is greater than the 10-year Treasury yield – the first time that's occurred since the 1960s. And Merrill Lynch says Dec. 9 was a historic day, with three-month T-bill yields falling below 0% for the first time since 1940. These are incredible deflationary pressures. Yet through Monday, the S&P was up 21% from its Nov. 20 low, leaving some to declare an end to the bear market. Keep in mind we had four 20%-plus rallies in the Great Depression bear markets of the early 1930s. Ned Davis Research measures the "new bull" in terms of the Dow Jones Industrial Average's percentage advance and time. So either the Dow must gain 13% and stay up for 155 days, or we must see a 30% rally for 50 calendar days. Don't expect to see that duration just yet, as we're still in a bottoming process. It had seemed that the jolly old fat man in the red suit was hearing our plea for a Santa rally. But the S&P 500 failed to move above its 50-day moving average just as the U.S. Senate was rejecting a \$14 billion rescue deal for the auto industry.

Past performance is no guarantee of future results.

Views are as of Dec. 12, 2008, and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security.

Mutual funds are subject to risks and may fluctuate in value.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The Dow Jones Industrial Average (DJIA): An unmanaged index which represents share prices of selected blue chip industrial corporations as well as public utility and transportation companies. Indexes are unmanaged and investments cannot be made in an index.

The Baltic Dry Freight Index is a daily average of prices to ship raw materials. It represents the cost paid by an end user to have a shipping company transport raw materials across seas on the Baltic Exchange, the global marketplace for brokering shipping contracts.

For more complete information, visit FederatedInvestors.com or call 1-800-341-7400 for prospectuses. You should consider the fund's investment objectives, risks, charges, and expenses carefully before you invest. Information about these and other important subjects is in the fund's prospectus, which you should read carefully before investing.

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