

Monthly Chartbook

May 2006

One and done?

I don't know what that crowd is on, but it must be good!

Consider:

- Gold is soaring
- The dollar's structural weakness is gaining attention
- The beloved PCE is above 2% and climbing

Once we feared deflation. What we have is deep and persistent inflation that is biting purchase power.

Macro-economic research

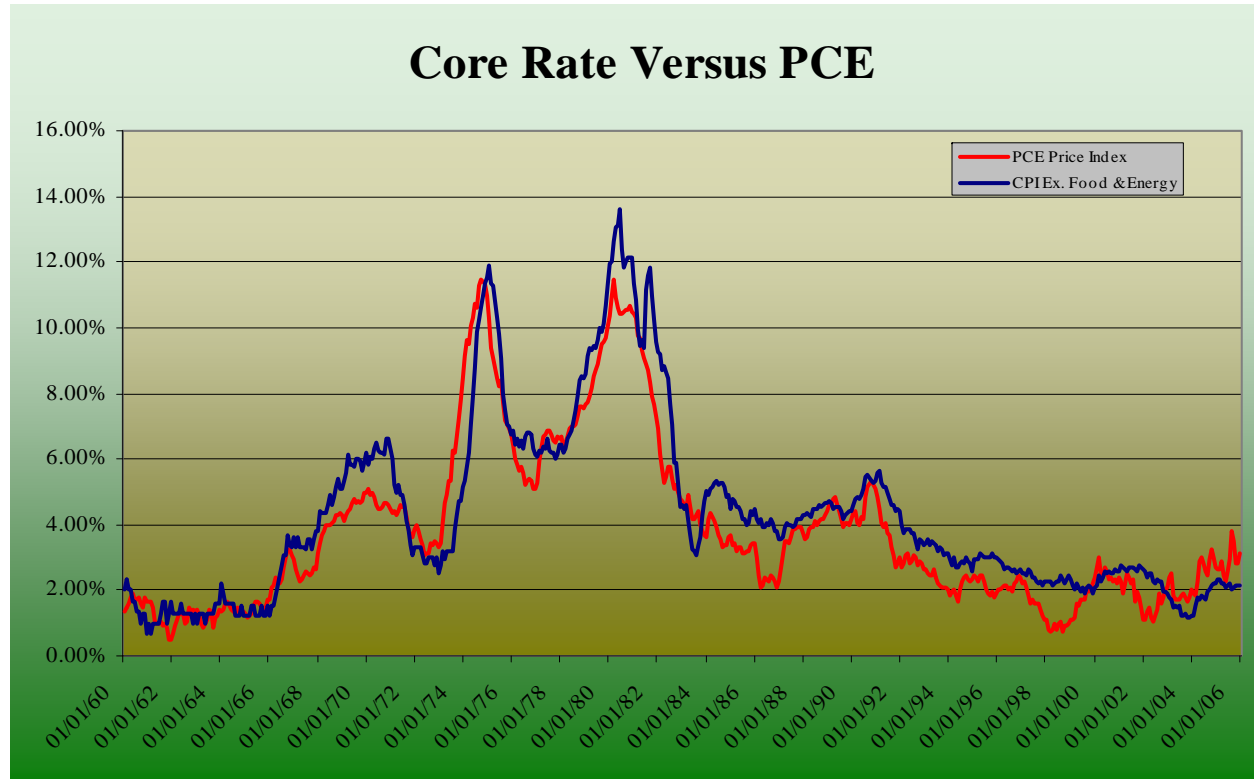
Looking ahead...

Three words, *labor, labor, labor*. That is your #1 input cost in the average US enterprise, large or small.

The “stealth” rally in the labor markets has occurred because the main stream media has been **poor mouthing the good old US economy**.

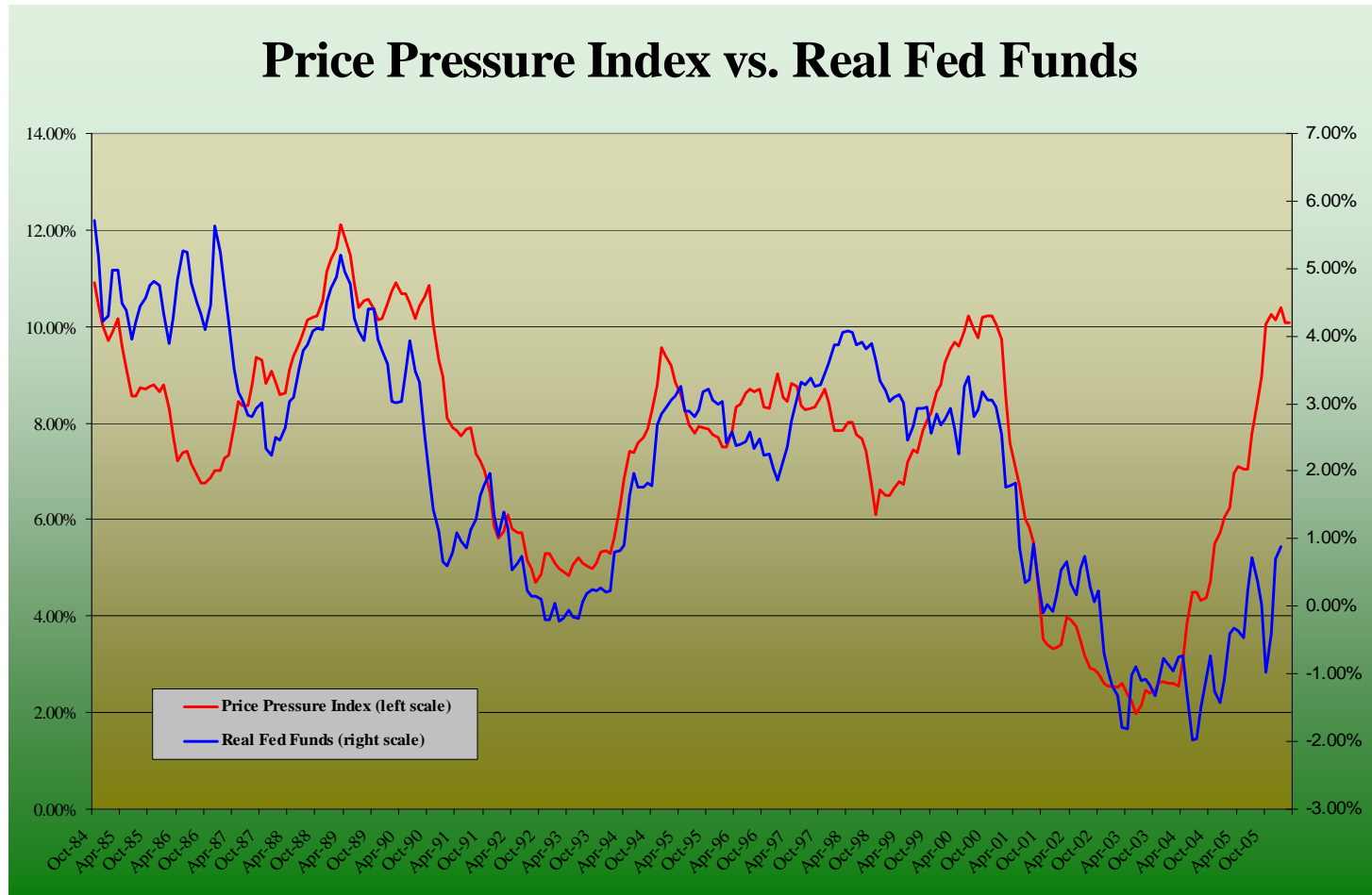
Beware! Given no slack in the labor markets, employees will demand and receive higher wages.

Macro-economic Research



A personal consumption expenditures index of 1-2% is believed to represent price stability to the Federal Reserve. Its up 2.87% Yr/Yr and climbing. Beware!

Macro-economic Research



The gap between the present and the historic normalized spread is **huge**. The risk is a much higher Fed Funds rate than the market anticipates.

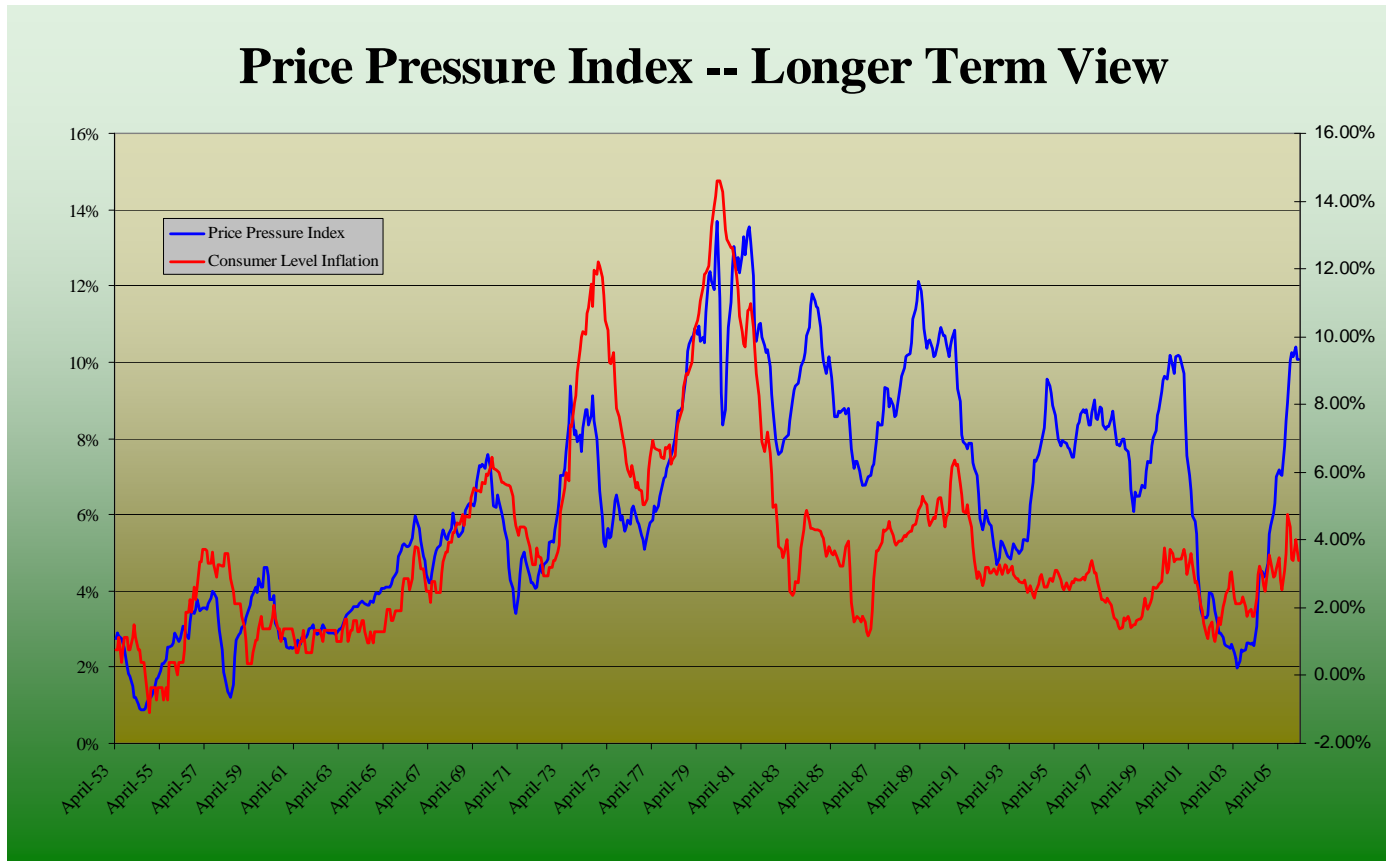
Inflation expectations

Unless the US economy and/or the global economy slows significantly in 2006, trendline inflation will remain higher.

At this point, long-run inflation expectations in the bond market under-discount the risk of higher sustained inflation.

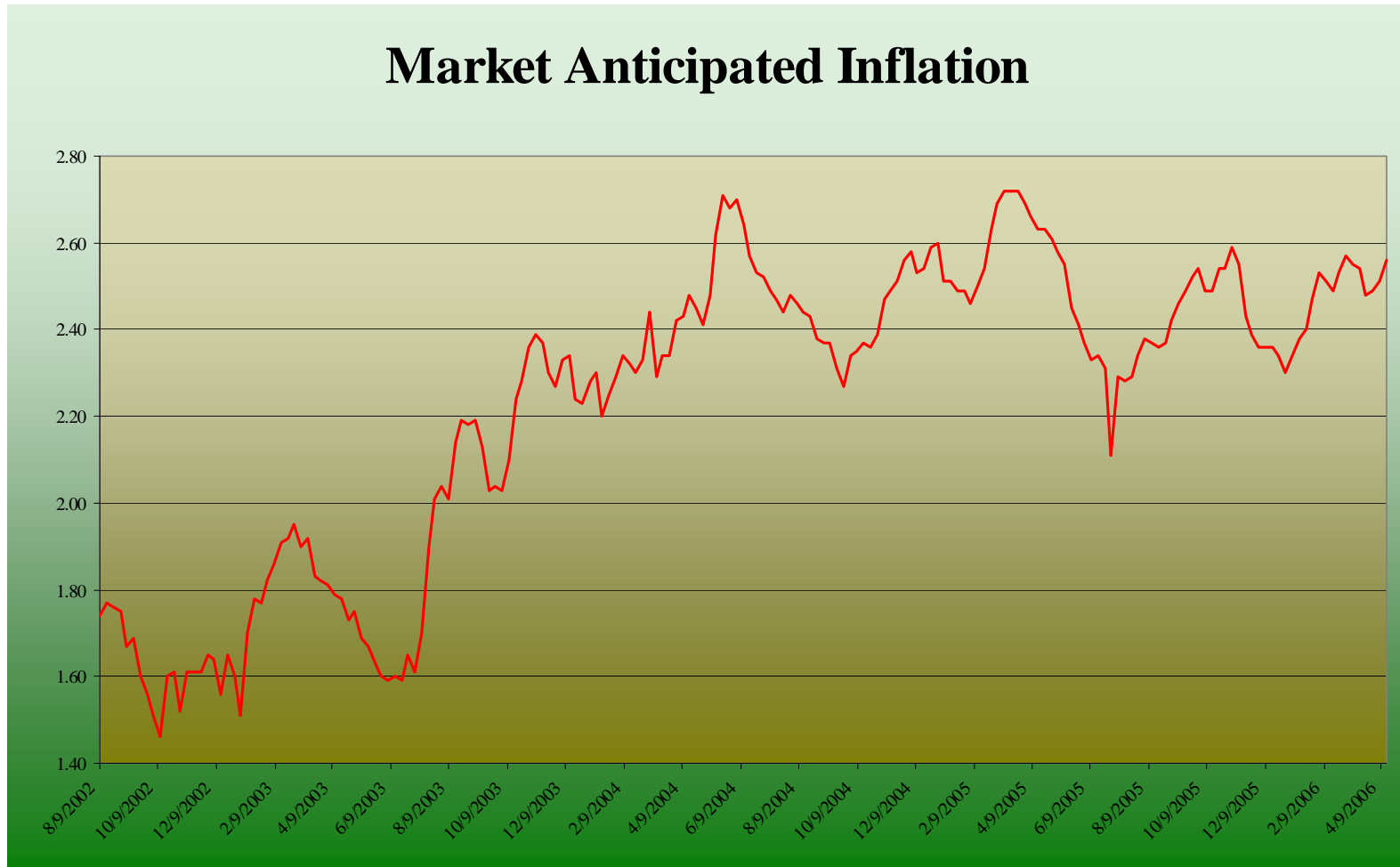
In sum, Mr. Market has it wrong -- inflation is a problem in the current environment.

Inflation Expectations



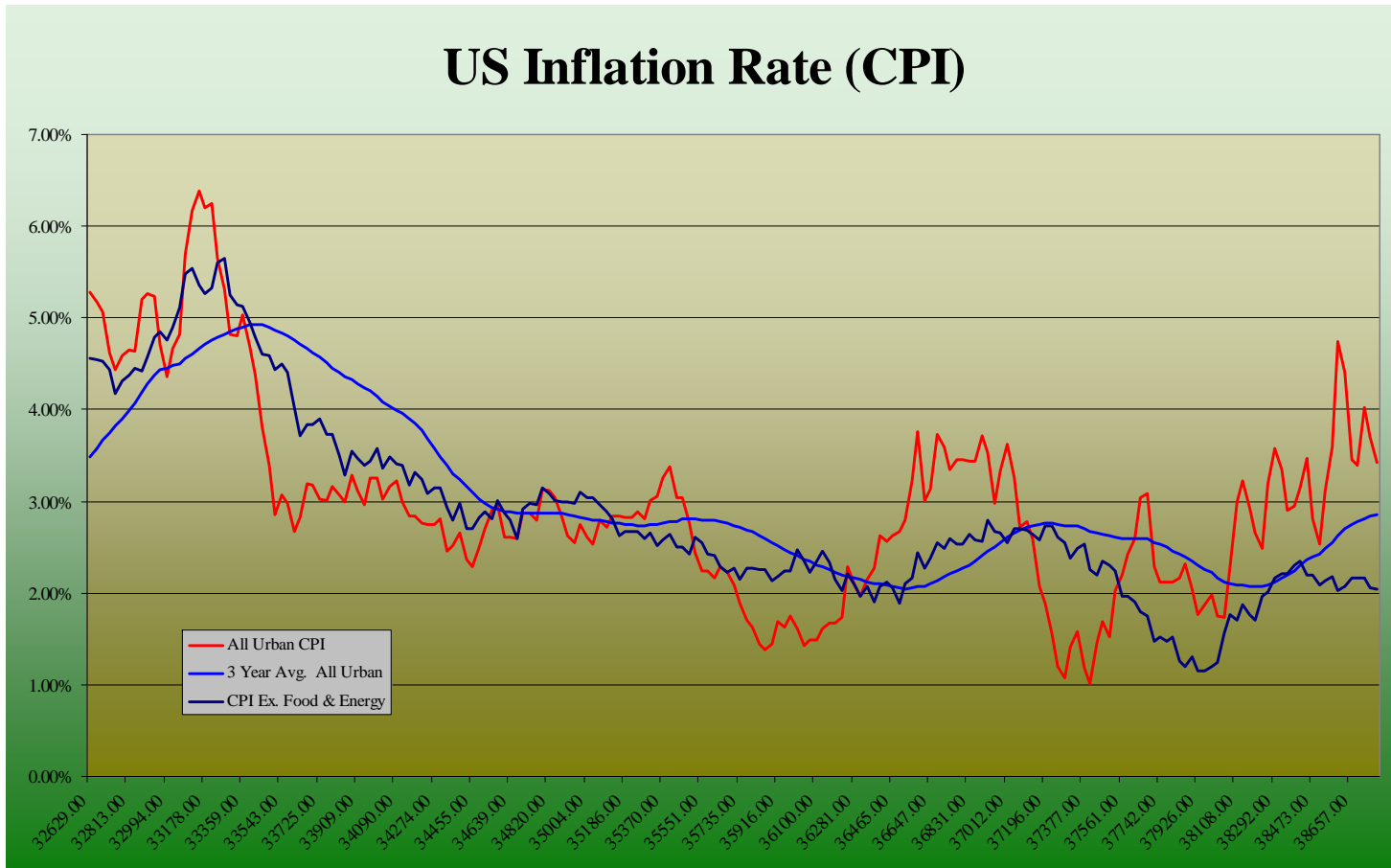
Look at that damn thing go!

Inflation Expectations



Decomposing the TIPS spread to get an implied inflation rate, the markets anticipate long-term inflation of just 2.56%, quite sanguine versus current conditions. Where the &^%! are the bond vigilantes?

Inflation Expectations



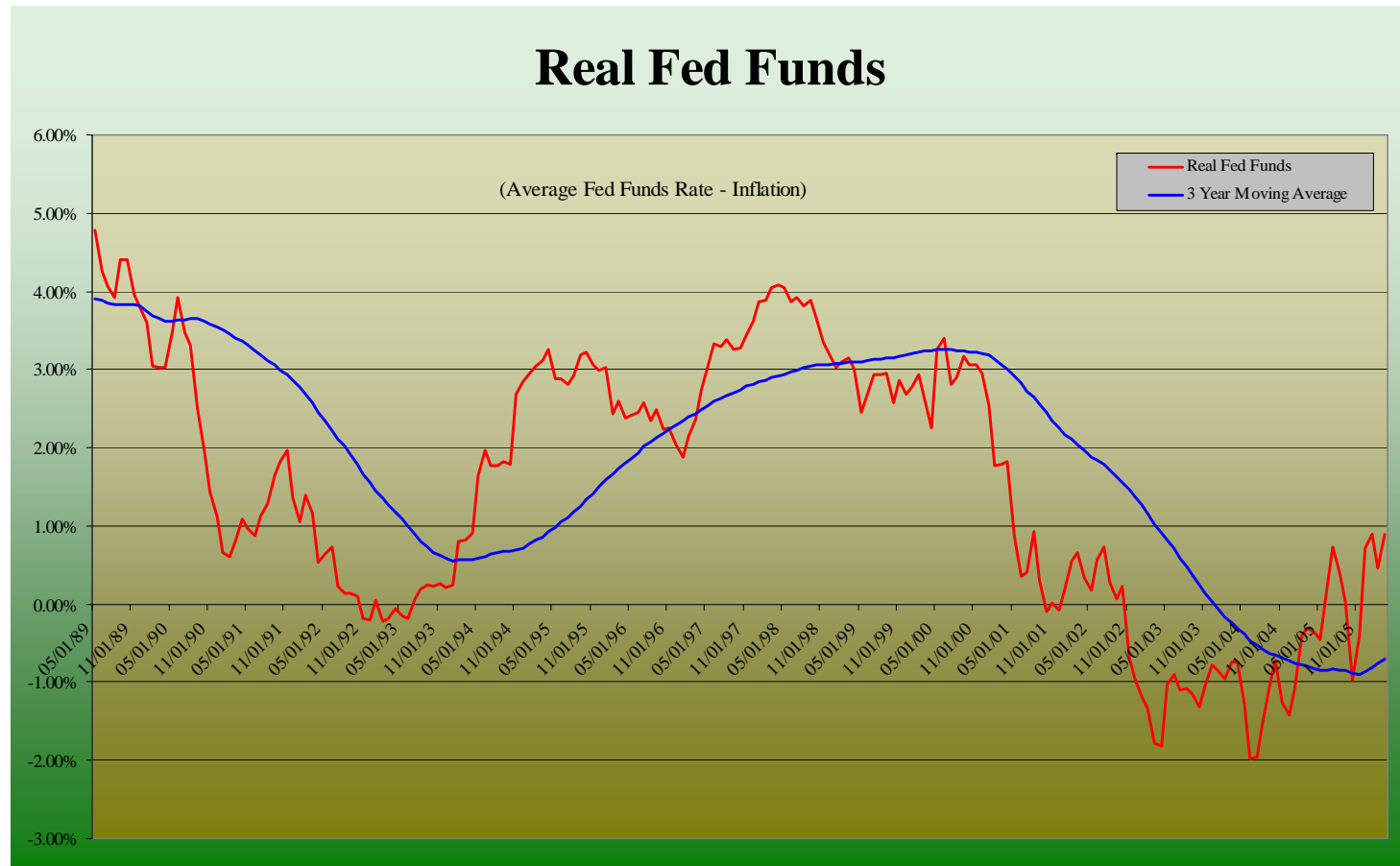
Core rate still above the 2.00% internal Fed target. Beware!

Federal Reserve Watch

Simple is best.

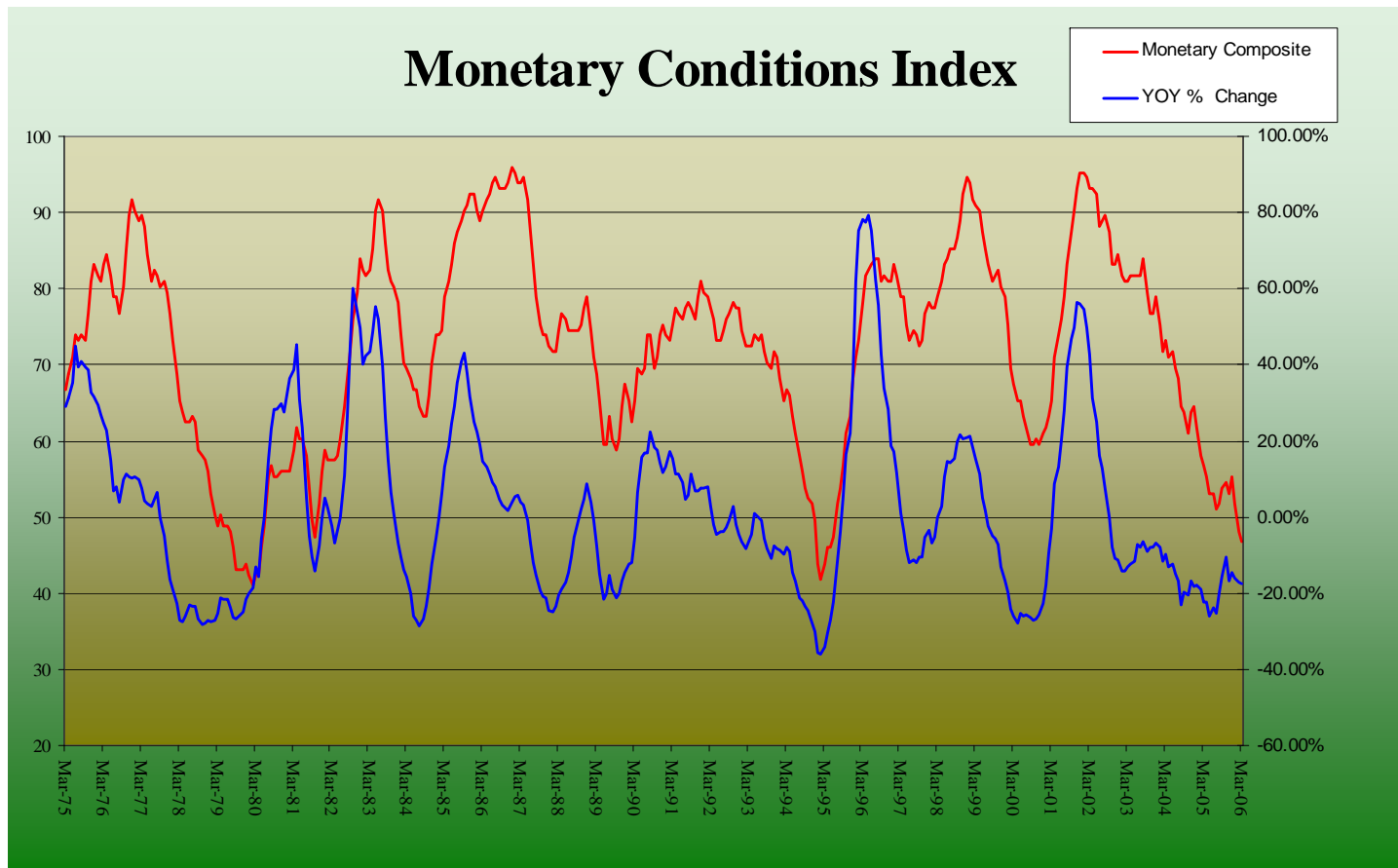
- Let's all hope that the new Fed Chair can defend the purchase power of the dollar *and* keep the economy from running into a ditch.
- Don't forget the traders axiom, *hope is not a investment strategy...*

Federal Reserve Watch



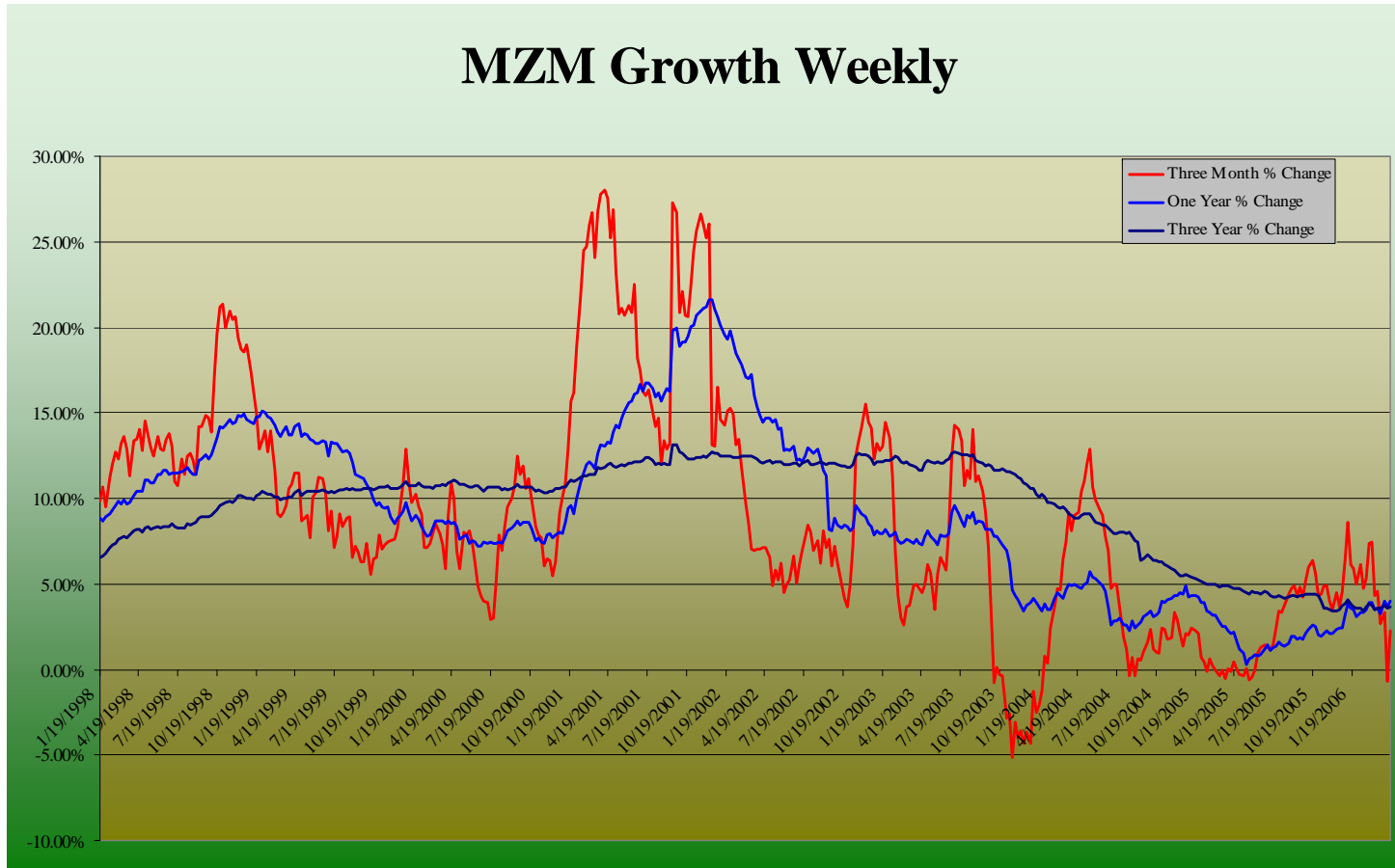
We are a long way away from a level that we called “normal” just a few scant years ago. Read: short term rates could go much, much higher.

Federal Reserve Watch



The monetary conditions index has fallen out of bed.

Federal Reserve Watch



Just look at that 52 week number (blue line) climbing out...in the face of higher rates.

Outlook

Nervous bull thesis continues: keep umbrella and rain coats handy.

Getting this expansion balanced without tipping into recession is going to be tricky.

Good luck Dr. Ben, the honeymoon is over...