

Monthly Chartbook

January 2006

We are all betting on the Bernanke balancing act!

Here and now

Year to date natural resources have kept up their torrid pace, up 12.42% for the month.

Interestingly, tech stocks have joined the party, up 6.81% for the month. Everybody is piling in on the Japan and Gold trade.

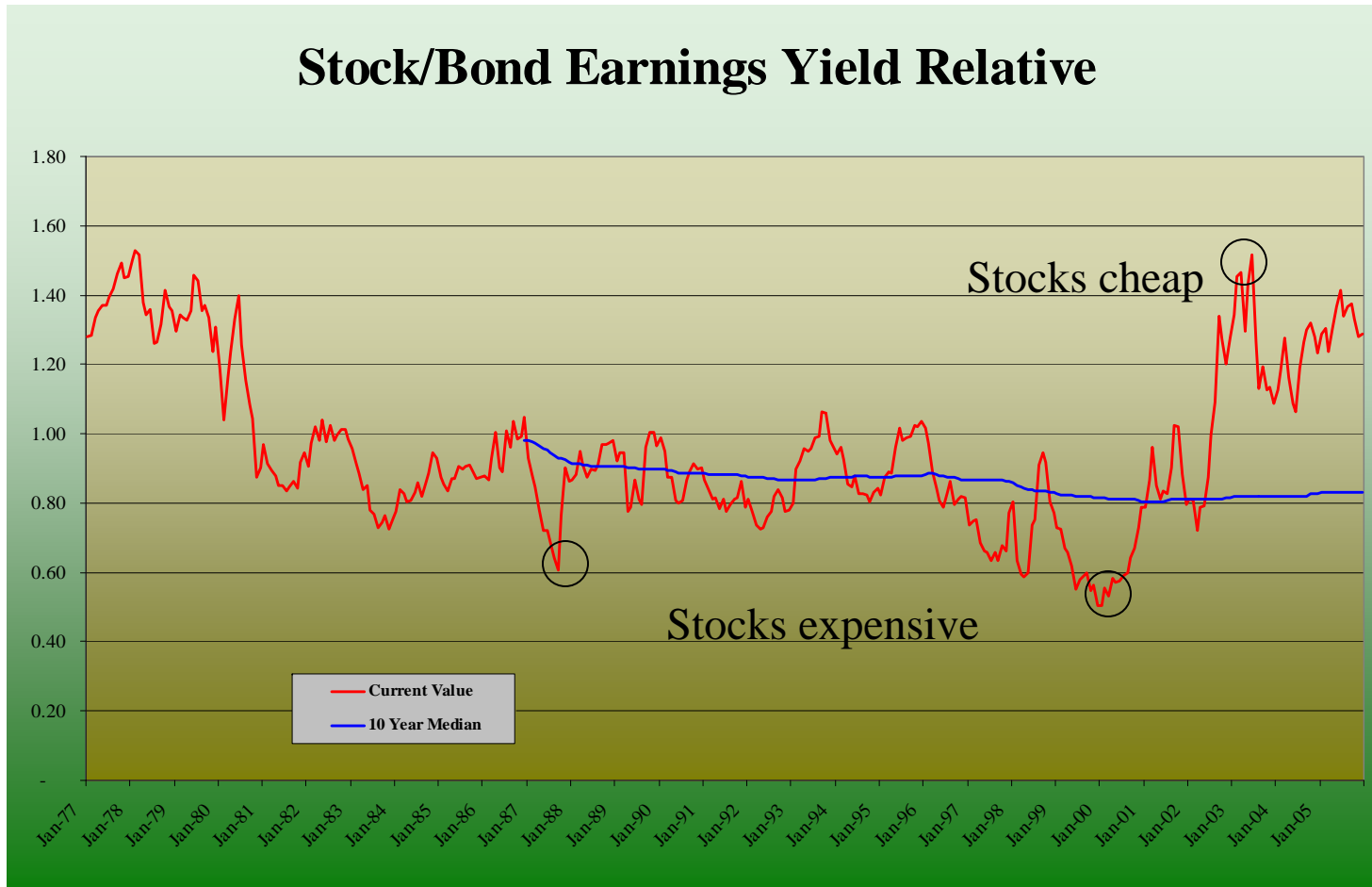
What is a stock jockey to do? If you like to buy cheap and sell dear, watching and waiting might be the best course of action.

Looking ahead...

I'll bet that Bernanke keeps at it to look hawkish and build credibility. How long? All the rate increases to this point really have not had the desired effect, and with jobless claims now under 300,000 for a couple of weeks, a robust jobs report is a risk.

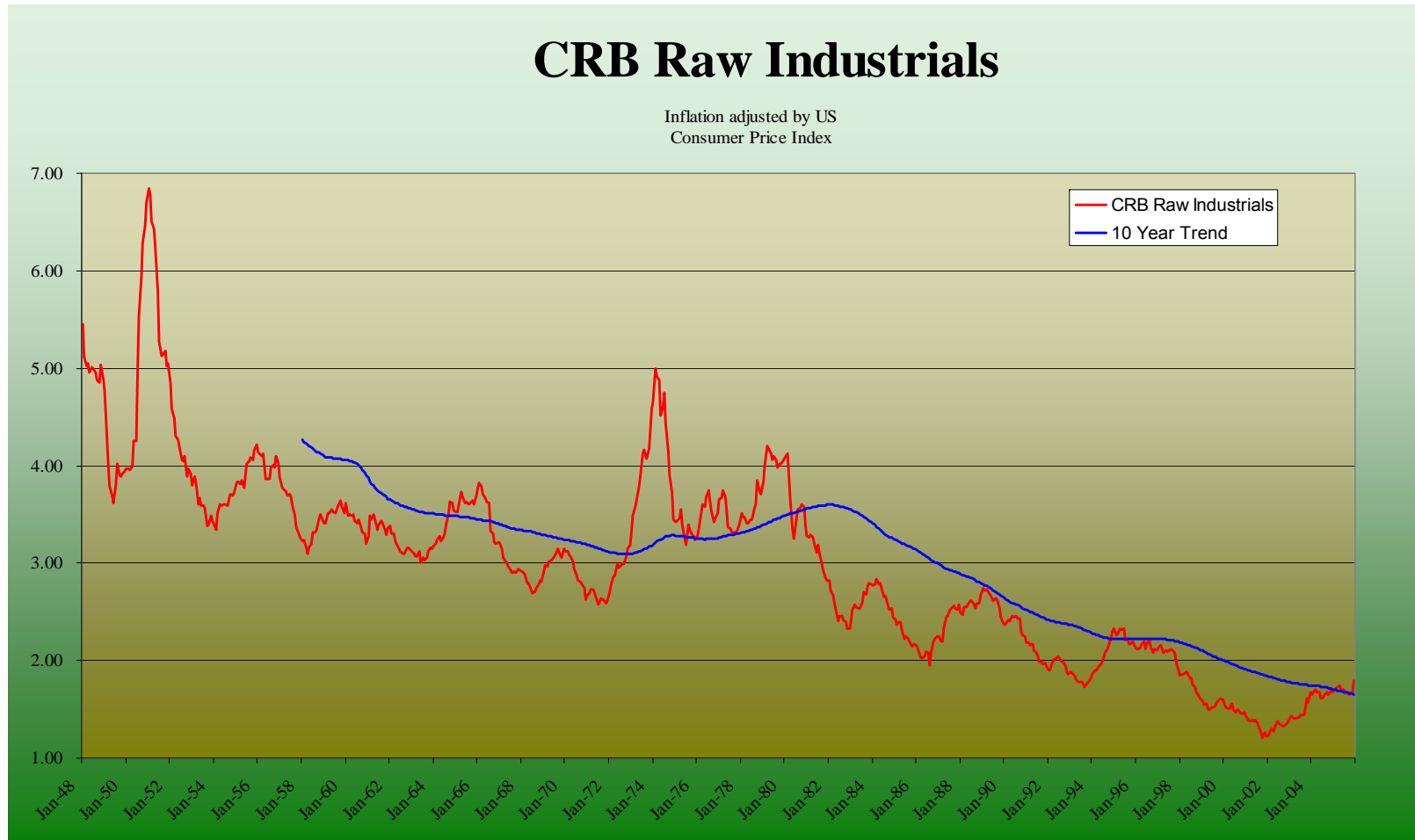
So much for transparency; just like the Super Bowl, we'll have to watch the game to find out what happens.

Macro-economic Research



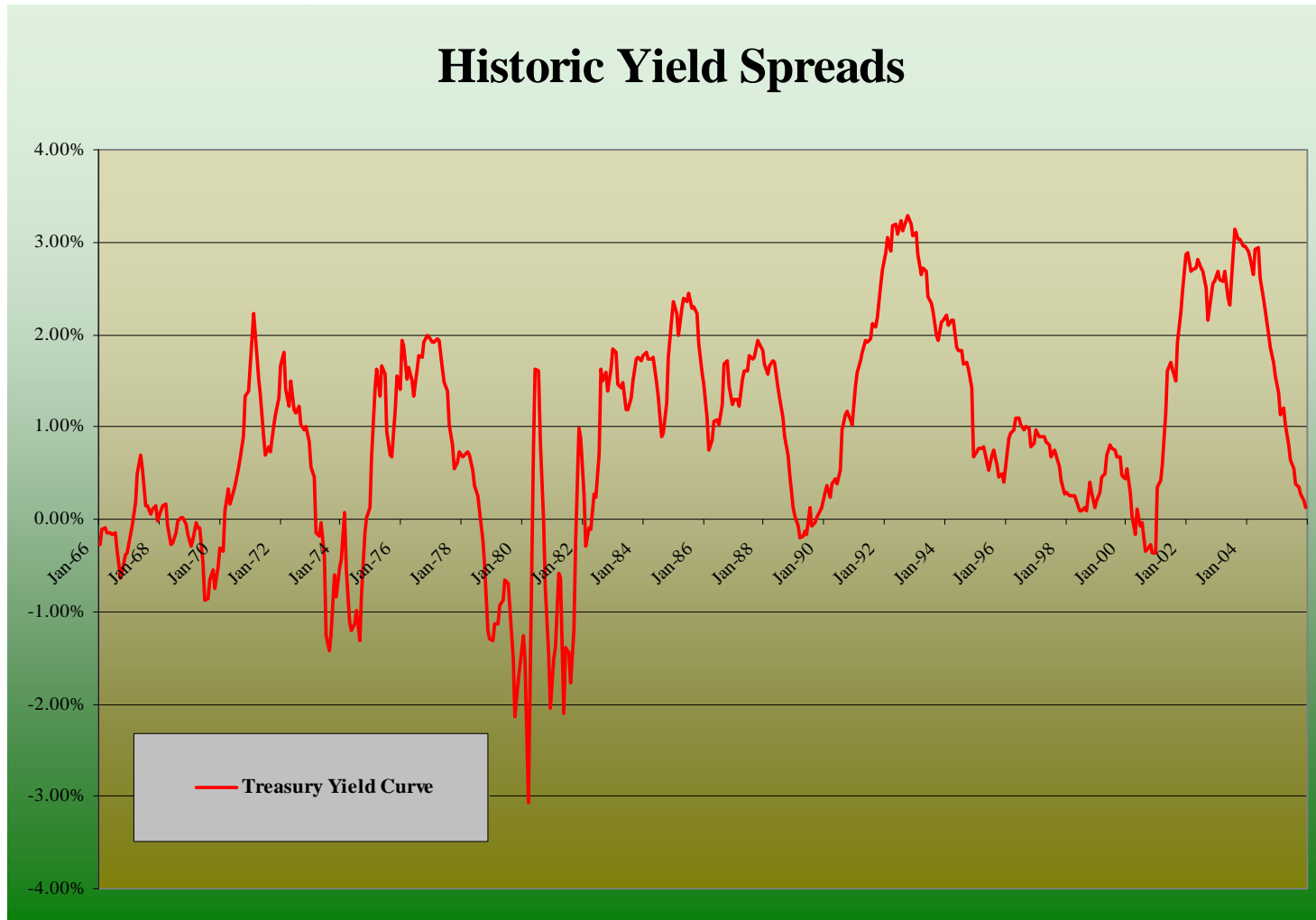
Good grief; to justify being long stocks, we have to bet on rates staying loooooowww. Yikes!

Macro-economic Research



Commodity prices appear to be in a new bull market, but they could just be playing catch up. The CRB deflated by the CPI is just now breaching the trendline. All that cheap money the Fed printed is flowing into hard assets.

Macro-economic Research



A little history about the yield curve. It does work as a leading indicator, but the depth of the inversion and the duration are *very, very* important to the prediction. A short shallow inversion is nothing to lose sleep over.

Macro-economic Research



We still contend that what the market perceives as slow labor market growth has kept a lid on interest rates. With jobless claims averaging less than 300,000 for a couple of weeks now, the markets could be in for a bitter surprise in the coming jobs report. An upside surprise.

Capital Markets Expectations

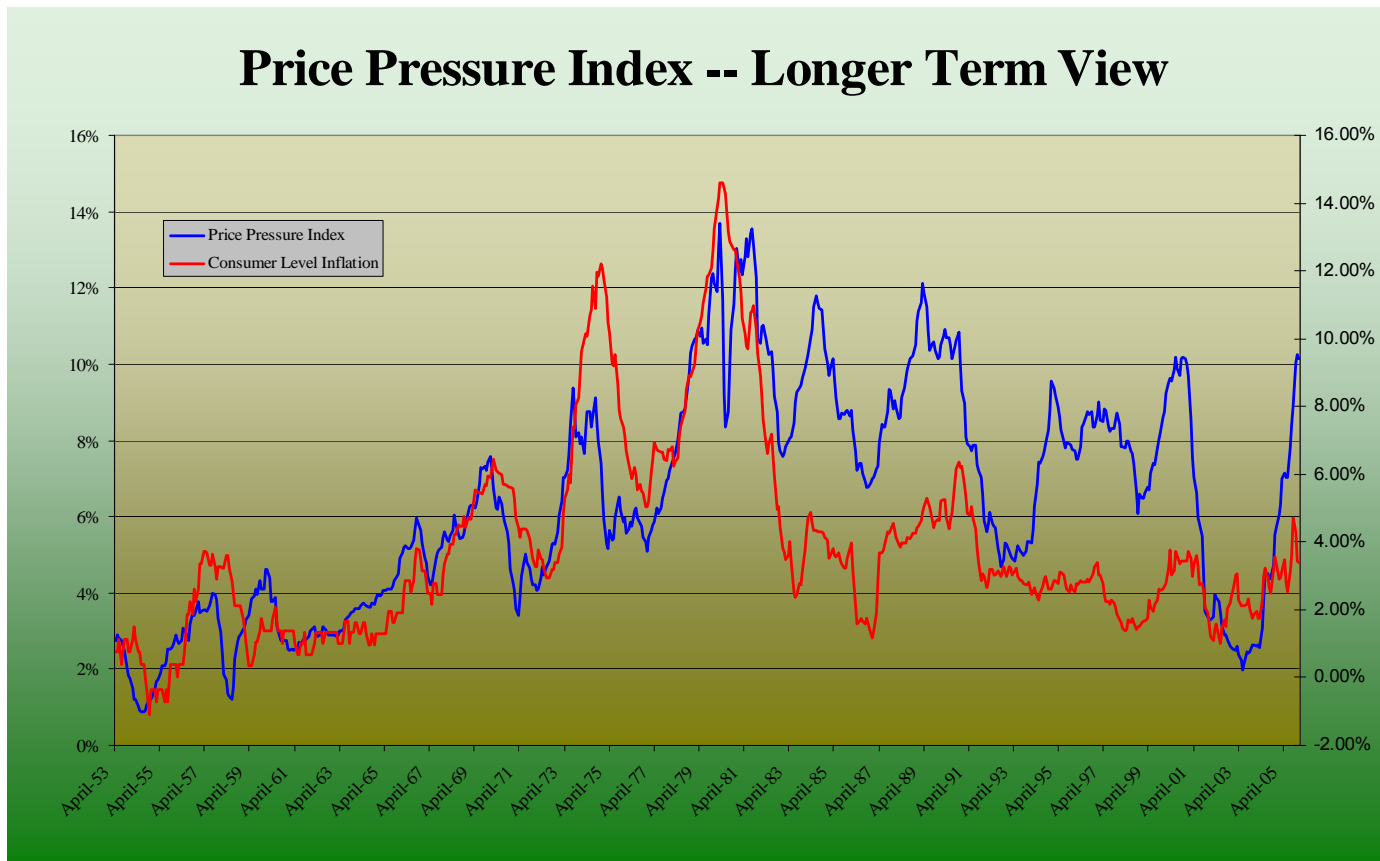
Index	Current	Forecast		Range	Time Frame
S&P 500	1280.8	Trading range	↔	1120-1275	Next 6 months
Ten Year Treasury	4.52%	4.62%	↓	4.25 - 5.00%	6 months
Inflation (all Urban)	3.40%	3.22%	↑	3.00 – 4.00%	6 months
Fed Funds	4.50%	4.75%	↑	4.5 – 5.00%	3 months
S&P 500 Earnings	\$67.49	\$69.31	↑	\$67 - \$71	1Q 2006
	Legend:	↑ Higher	↓ Lower	↔ Indifferent	

Inflation expectations

Moderating energy prices alone will not take the inflation issue off the table.

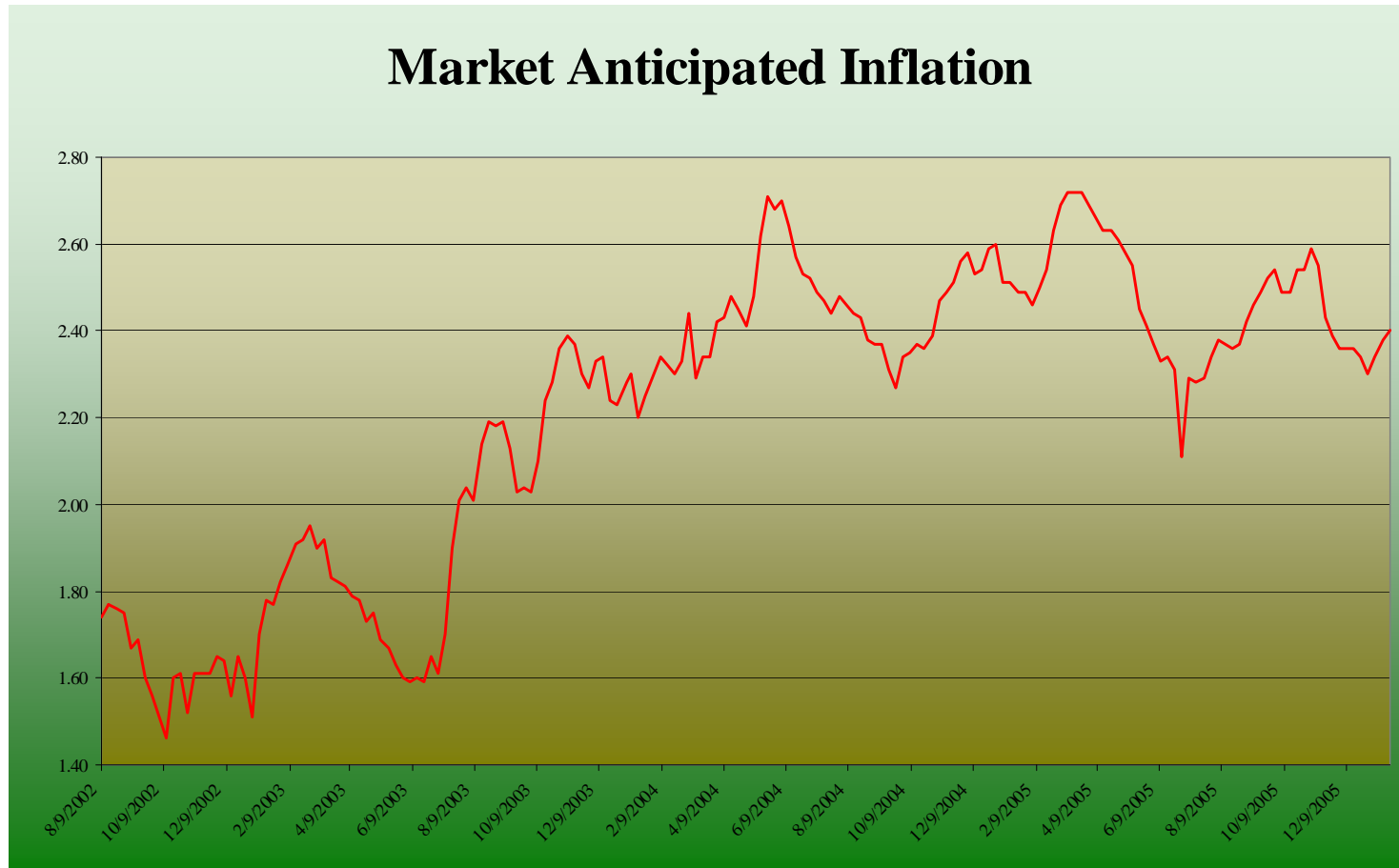
Oops, maybe energy won't moderate. Supply build is there, but the raw commodity prices are hanging in like a champ. Continued strength in the labor markets may present the Fed with a problem, which will be compounded by commodity prices. *Remember, in a service based economy, labor cost is the highest input cost category.*

Inflation Expectations



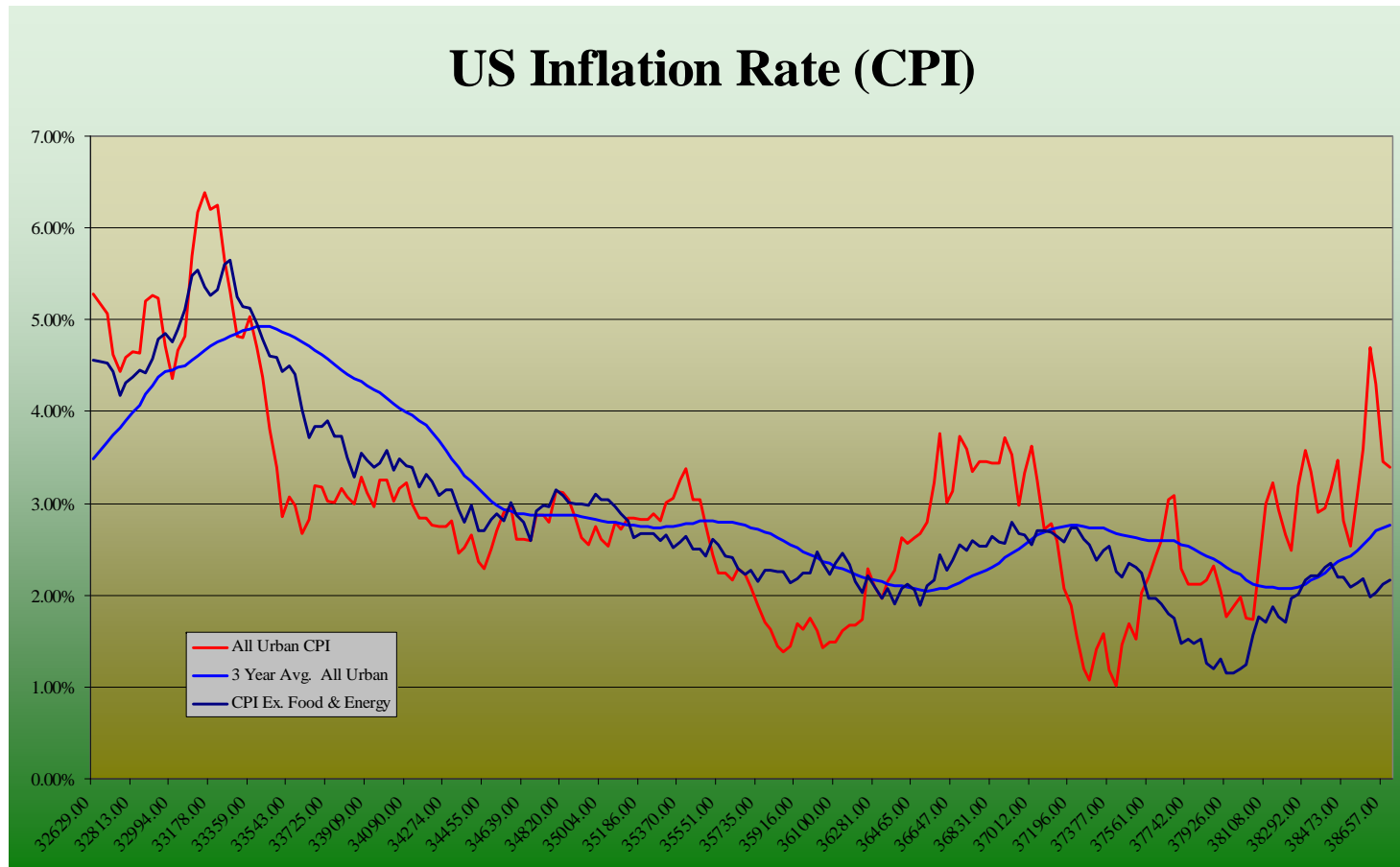
The Price Pressure Index *continues* to march higher. Though falling crude oil cooled consumer prices for a month, it is hard to see the price pressure index moderating without much slower growth. While US GDP growth slowed in the 4th quarter, the price pressure index did not.

Inflation Expectations



Decomposing the TIPS spread to get an implied inflation rate, the markets anticipate long term inflation of just 2.40%, quite sanguine versus current conditions. What has happened to the storied bond vigilantes?

Inflation Expectations



Don't call me chicken little, I am just telling it like it is... the core rate is above 2% and rising--a clear warning to the Fed based on their internal "targets".

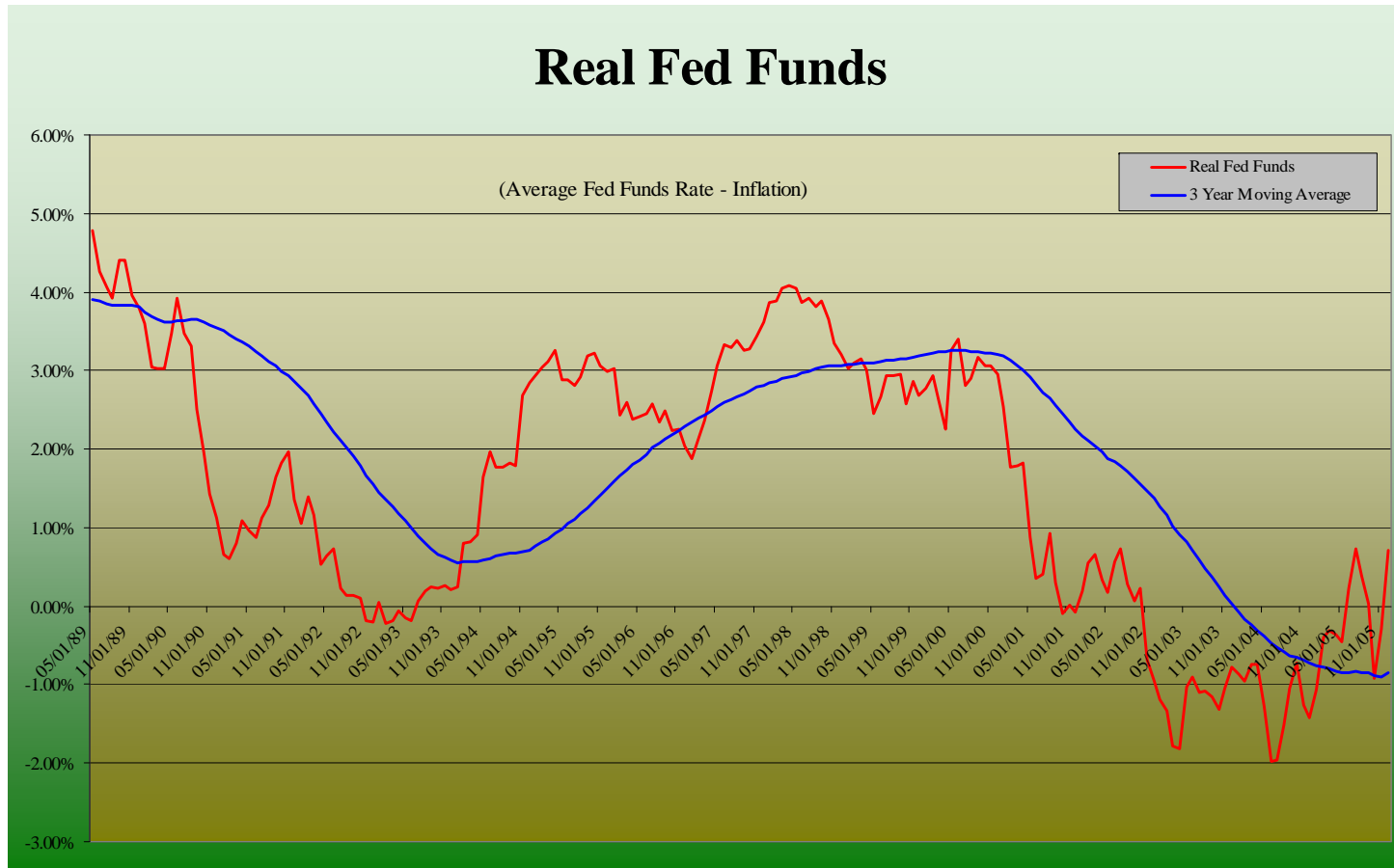
Federal Reserve Watch

For the first 18 months of the Bernanke Fed the big question to us is this: Will the Fed rattle the markets, or will the markets rattle the Fed?

One of the two *is* going to happen, if we only knew which. Prior to Y2K we joked with clients who were concerned that if they thought the “jig was up” they needed to stockpile Deutschmarks, Spam, Ammo and small silver coins.

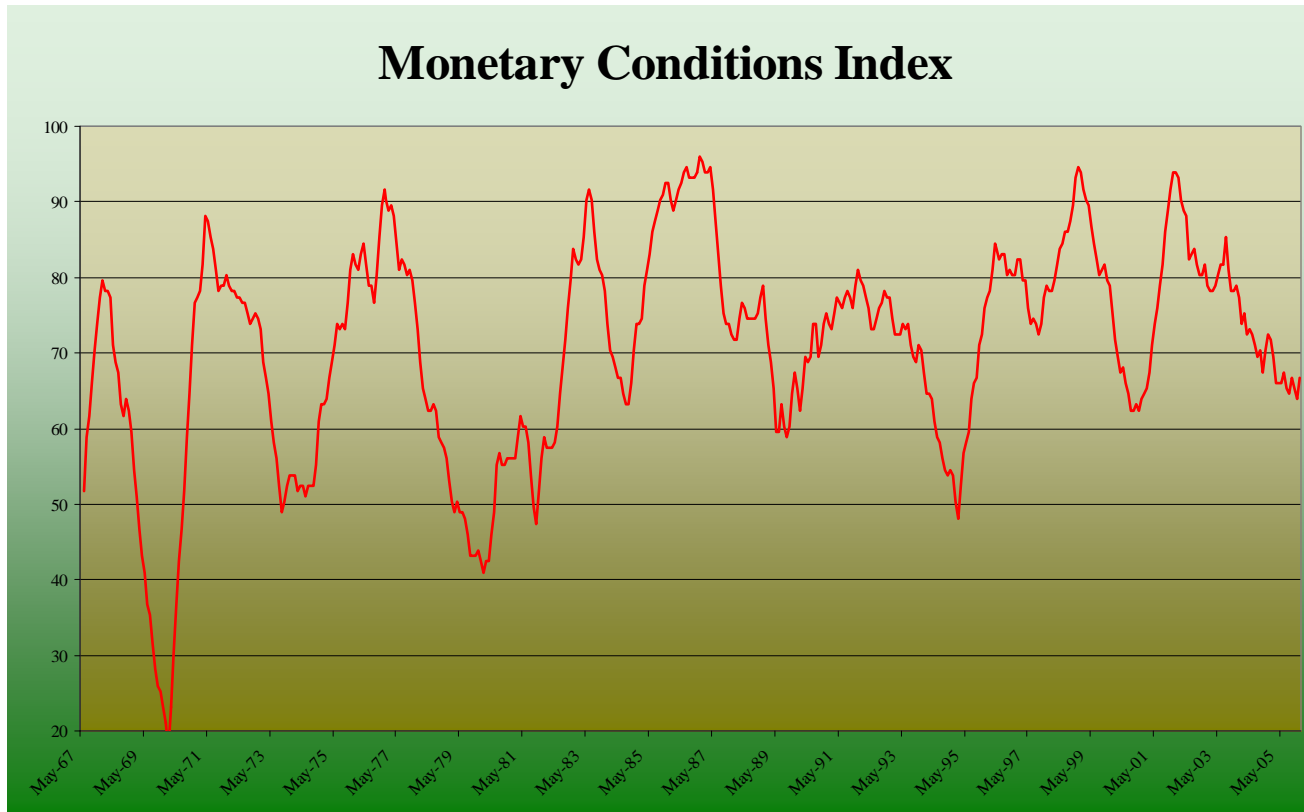
Now it is currently not *that* bad, but owning asset classes that have soared in the past five years might not be the best course of action.

Federal Reserve Watch



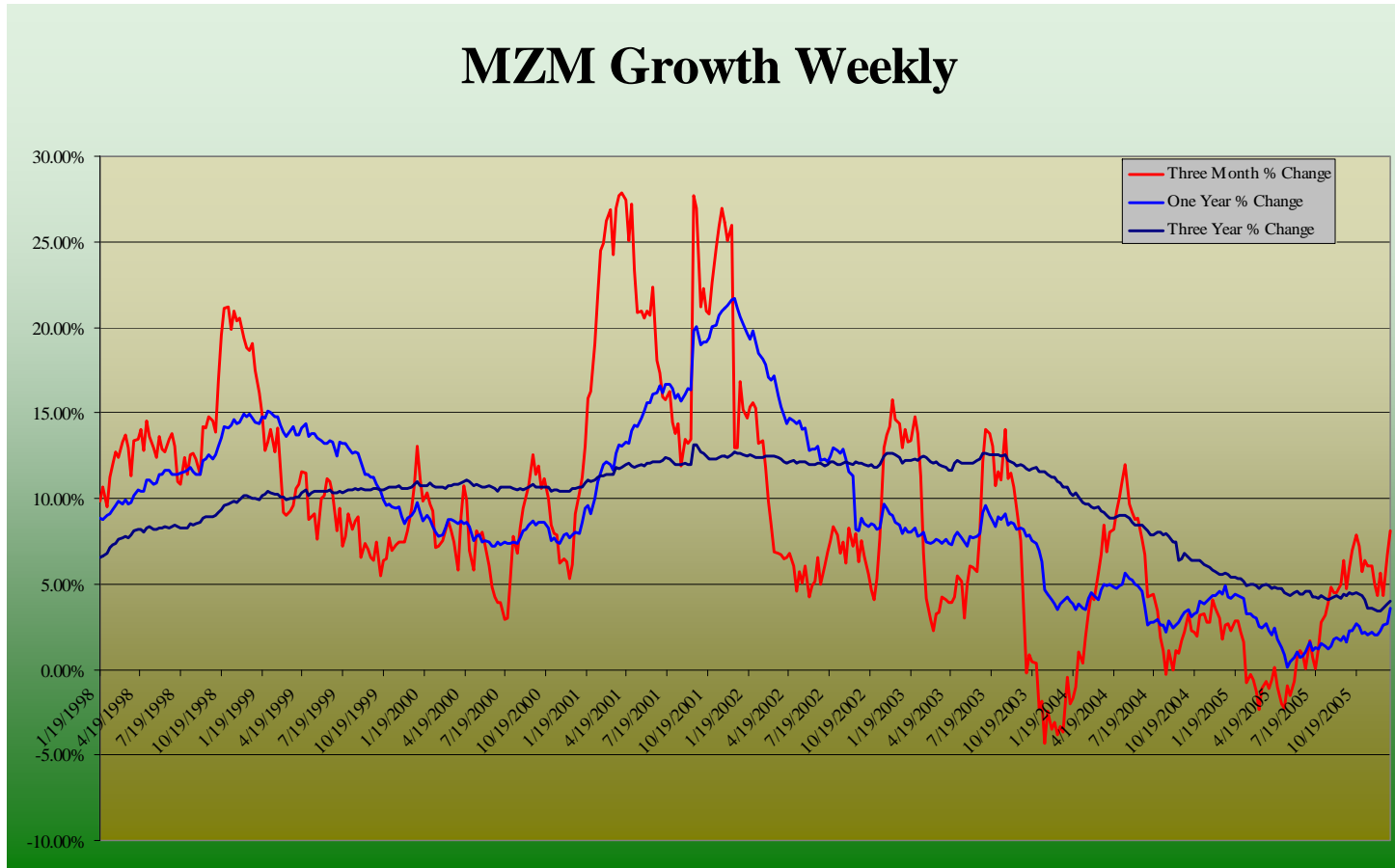
Maybe zero or close to it is the “new normal.” At least money market funds are keeping up with inflation pre-tax, a change for the better.

Federal Reserve Watch



Are we putting in a bottom? Isn't that contrary to all the other indicators? What's up?

Federal Reserve Watch



Is the fed really tightening monetary policy? Once again I feel like Alice in Wonderland.

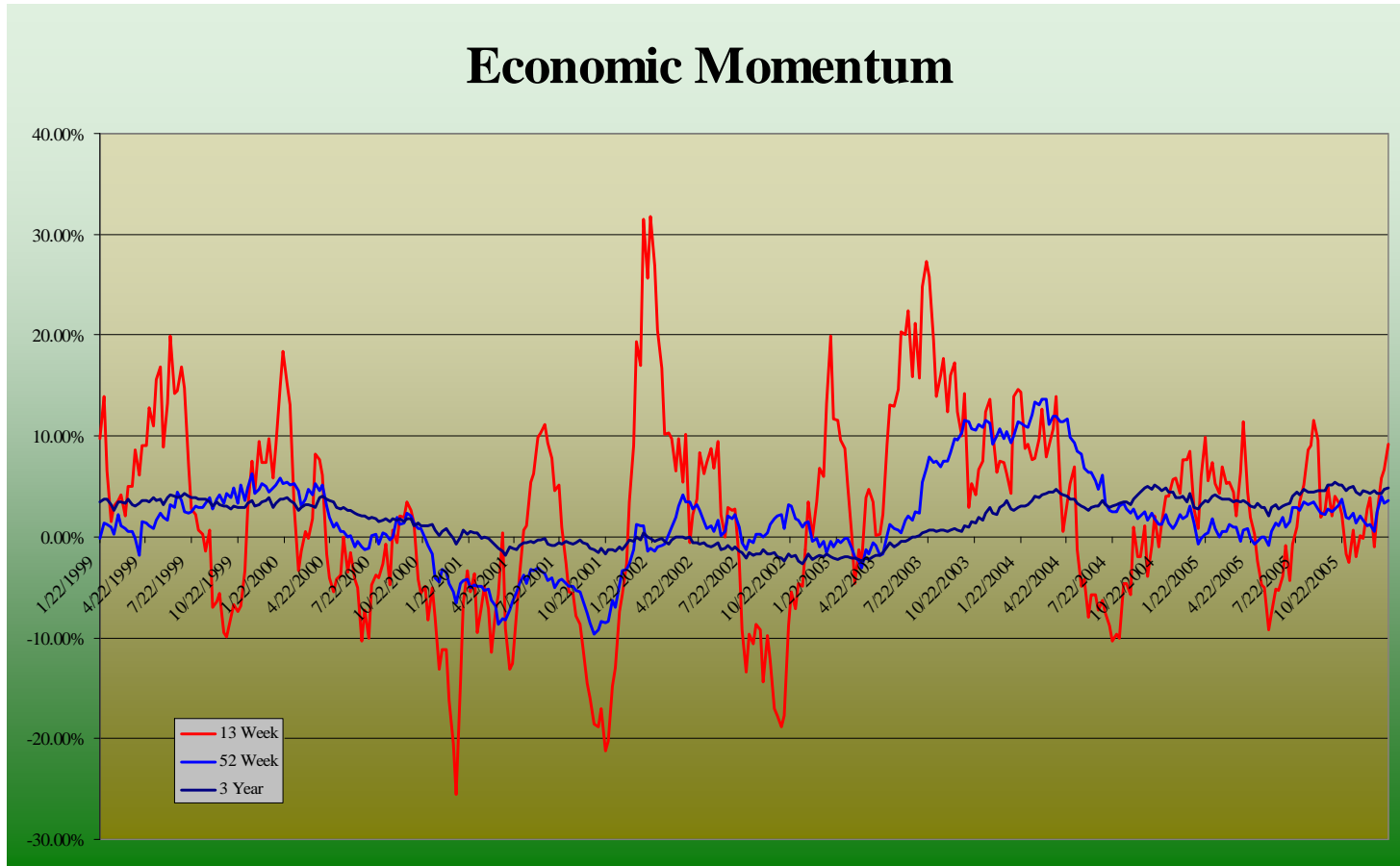
Outlook

Okay let's build up our *nervous bull thesis*:

Stocks are cheap because rates are sooooo loooow. Rates are low because labor markets are weak (or perceived as being weak).

So here is the kicker, don't ask for a raise because of the change in cost of living. If you do, you'll tip the whole dang apple cart over.

Outlook



Yield curve notwithstanding, forecast growth continues...