

Market Research

The Feds Have Chosen Inflation

Since Oct07, the US stimulus from Fed fund rate cuts, Fed discount rate cuts, tax rebates, tax code adjustments, mortgage refinancing legislation, and the recent \$700B TARP legislation total over \$2 trillion. And that's just the US. To put this in perspective, \$2 trillion is far greater than the sum of economic stimulus provided during the Long Term Capital Management event (1987), Y2K (1999), and 9/11 (2001). Is that much freshly minted coin inflationary?

The CIA Factbook estimates the market cap of US publicly traded shares in 2005 was \$17 trillion. The DJIA closed at 10,717 in 2005. Last night the DJIA closed at 8,980. If I may be so bold, on a straight line basis, that converts to a market cap of publicly traded shares of \$14 trillion. A \$ 2 trillion injection against a \$14 trillion market cap are you thinking inflation?

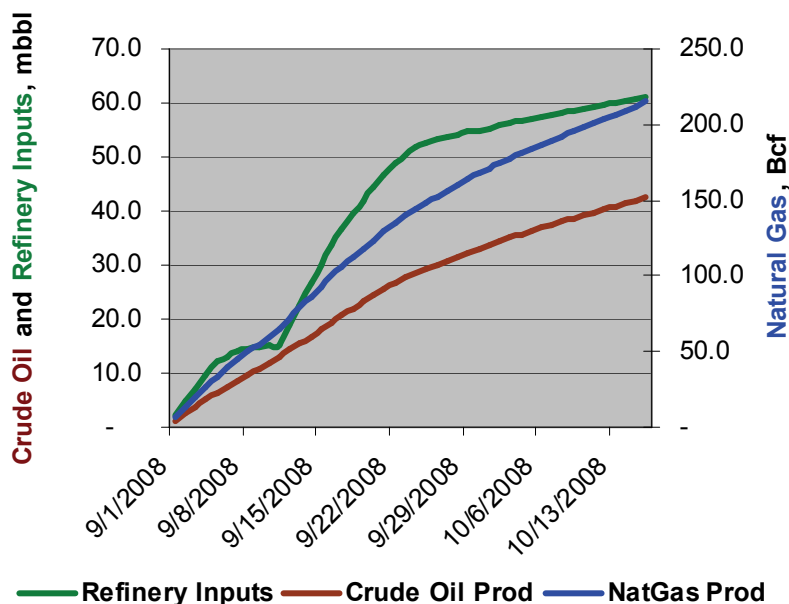
Most recently we've been in a deflationary environment as the value of most assets have been falling. Real estate, equities and commodities are examples. This deflation is caused by the sudden and significant reduction of credit. Cash is King. Portfolio liquidation becomes prevalent. Deflationary cycles following a severe reduction in credit are not pleasant. The Fed and the Treasury Dept essentially had a choice between unemployment and inflation, they have chosen inflation.

US interest rates are already so low that further reduction of Fed rates provide little stimulus. In addition, very little rate reduction is actually making it to the consumer, instead being absorbed in margins at the banking level. The Fed finds itself at the zero real rate boundary, and virtually powerless to fight deflation. Failure to stimulate the economy would translate into serious unemployment. Hence the arrival of the Treasury Dept and TARP. Preferred stock purchases, loans, guarantees and tax code changes will stimulate the economy. Look for more federal programs in the future. The printing press is in full gear. Deflation will slow, and eventually reverse.

Inflation is often defined as "too much money chasing too few goods". The goods to watch are agricultural, metals and energy commodities.

Changing topics, the chart to the right identifies the estimated cumulative impact of storm related outages from US GOM production as of 16Oct08. Lost natural gas production totals 215 Bcf, lost crude oil production totals 42 mbbl, and lost refinery inputs totals 61 mbpd. These volumes continue to rise. Damage from the 2008 hurricane season now exceeds that from Katrina and Rita in 2005.

Estimate of Cumulative US Gulf of Mexico Storm Related Production Outages



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