

Lowly Analyst Free Newsletter

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Life Style Costs

Additional health care cost of overeating is estimated at \$250,000, smoking adds \$245,000, diet sodas and caffeine \$100,000. Lack of exercise is another big cost.

The Market

The [money supply](#) is [expanding rapidly](#). Inflation is fueled by purchasing and borrowing enabled by a rising money supply. The money supply has reached [gusher proportion](#) but so far the cap has held. The final bill for the credit bubble has not yet been presented.

The outlook for the stock market is positive. Earning prospects are good especially for microcap stocks. As long as the music plays, get up and keep dancing.

Currencies. May, US \$ up 6%, Japan 4%, China 0%, Canada down 5%, Britain -5%, Mexico -6%, Switzerland -7%, Euro -8%, Sweden -8%.

Asset Classes. May, Sml Growth down 6%, Mid Growth -7%, Cap Value -8%, Large Growth -8%, Mid Value -8%, RAFI Sml-Mid -8%, Large Value -8%, Sml Value -8%, RAFI large Cap -8%, Micro -9%.

Sectors: May, Natural Gas up 8%, Gold 3%, Carbon 1%, Intl Communications 0%, Basic Materials down 1%, Silver -1%, Commodity Trends -3%, Telecom -4%, Merger -5%, Real Estate -5%, Utilities -6%, Gbl Infrastructure -6%, Transportation -7%, Healthcare -7%, Technology -7% Lumber -10%, Natural Rsrcs -10%, Intl Real Estate -11%, Biotech -11%, Energy -12%, Private Equity -13%.

Foreign Investments. May, Brazil up 0%, Canada down 5%, Pacific-J -6%, Euro Area -6%, Russia -8%, India Earnings -8%, World-US -8%, Mexico -8%, China Sml Cap -8%, RAFI Dev Mkts -8%, Asia-J -8%, India -9%, S Korea -9%, Australia -9%, Emrg Mkts -9%, Hong Kong -9%, China -10%, So Africa -10%, World -11%, US -11%.

Fixed Income. May, 20+Yr Treas up 4.7%, 10-20 Yr Treas 2.9%, 7-10 Yr Treas 2.6%, 3-7 Yr Treas 1.3%, GNMA 1.1%, US Bonds 1.0%, Municipal Bonds 0.7%, IQ CPI Inflation Hedge 0.6%, 1-3Yr Treas 0.4%, Shrt Term Bonds 0.2%, 1-3 Mo Treas 0%, TIPS 0%, Intermediate Credit down 0.7%, Absolute Strategies -1.4%, Emrg Mrkt Gvmts -2.2%, Preferred -3%, High Yield -5.1%, Utilities -5.8%, BuyWrite -6.5%, Floating Rate -10.9%.

Inflation Protection

1. Introduction

We show some amazing results on how to best protect your purchasing power against inflation by analyzing inflation of various sectors in the three periods of high inflation during the last 100 years.

2. Inflation

Inflation is a rise in money and credit beyond that required for economic growth. Inflation is a function of the [money supply](#). There are two types of inflation: asset inflation and consumer price inflation measured by the [Consumer Price Index \(CPI\)](#).

The CPI does not matter for you. Instead, your cash flow needs depend on your individual spending patterns. For seniors the [cash flow needs change faster](#) than the CPI.

[Inflations are not rare](#); they are a consequence of [money supply regulation](#) and free markets, with the market always winning. In the last 100 years we had 3 [periods of high CPI inflation](#): 1916-20, 1946-48, and 1979-81.

The change of the US from a debtor to a creditor during WW1, and the reduction in bank reserve requirements in 1916 and 1918, led to monetary expansion and inflation of 1916-1920.

The expansion of the US debt during WW2 continued in the postwar years and was aggravated by an expansion of bank credit, leading to the inflation of 1946-1948.

In the 70's the Federal Government expansion, tax increases, and lowered productivity led to a recession. To stimulate the economy the Fed increased the money supply leading to the 1979-81 inflation.

In times of high inflation price volatility increases. Inflation affects different commodities and localities differently depending on supply, demand, technology and government actions. [Historical data](#) on inflation of various sectors is difficult to find.

3. Inflation Effect on Various Real Assets

The graphs below show annual price changes for the Consumer Price Index (CPI) and 10 classes of real assets for three periods of high inflation. The amount of price change varies by asset class and by period. The graphs show that to protect against inflation one must hold a [diversified portfolio of real assets](#). Gold and real estate do not consistently protect against inflation.

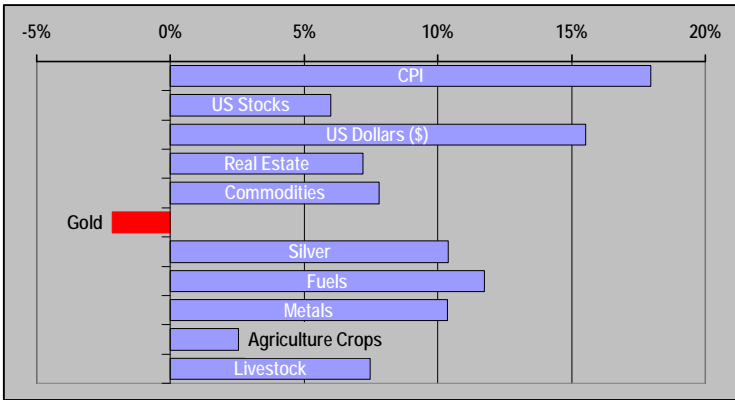


Figure 1 Average Annual Price Change, 1916-20.

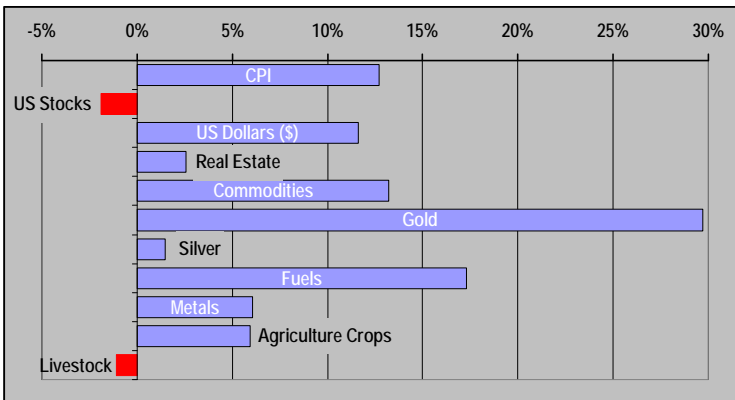


Figure 2 Average Annual Price Change, 1946 - 1948.

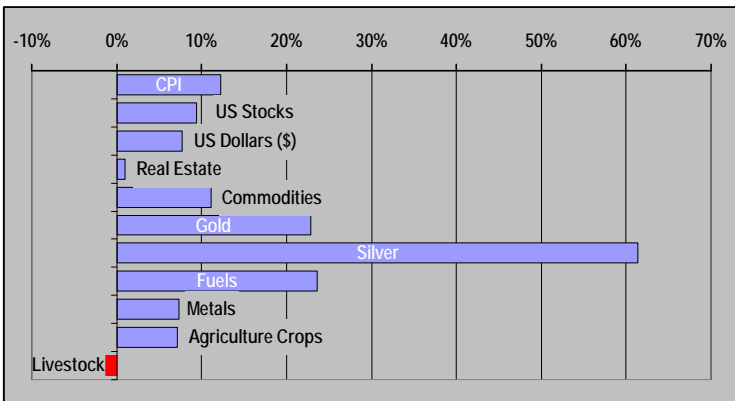


Figure 3 Average Annual Price Change, 1979 - 1981.

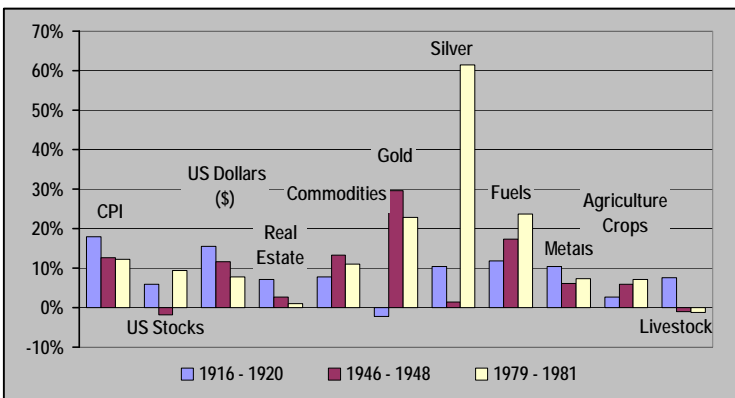


Figure 4 Average Annual Price Change, 20th Century Inflationary Periods.

4. The Outlook for Inflation

The current state of the money supply can be compared to the oil spill in the Gulf of Mexico. The large asset purchase pumped up the pressure on the money supply and it spilled out of control, [creating a situation never seen before](#). The Fed and the Government are trying measures never tried before. A temporary blowout preventer is in place, but no one knows if it will stem the flood. Investors should be prepared for the worst case by holding part of their assets in a diversified portfolio of real assets.

Similar to the 70's there is a frenzy to provide further stimulus - but this time coupled with the inability to use conventional interest rate policy. This desire led to large-scale asset purchases to reduce long-term interest rates. In March 2009, the Federal Reserve announced plans to purchase up to \$300 billion of [long-term Treasury debt](#); up to \$200 billion [Federal Home Loan Bank](#) debt, and up to \$1.25 trillion [Fannie Mae](#), [Freddie Mac](#), and [Ginnie Mae mortgage-backed securities](#).

One effect of the Federal Reserve's untried policies has been an enormous expansion of the quantity of assets on the Federal Reserve's balance sheet. Asset holdings nearly tripled between July and November of 2008.

The flip side of the large purchases of assets by the Federal Reserve is a large increase in the quantity of funds the Fed has supplied to the financial system. Some observers have expressed concern that the large expansion in reserves will lead to inflation.

The Fed can drain money from the financial system through the old standby of asset sales or its new, untried power to raise the interest rate it pays on reserves. It got this power to induce banks to increase their deposits with the Fed.

Fortunately, despite the weak state of the economy, an improving economy is leading to some natural unwinding of the exceptional borrowing and the credit market is returning toward more normal conditions.

There is currently very little borrowing and purchasing; hence there is no inflation. But this temporary situation has an end-point by definition. Purchases and bank lending could increase at any time and lead to inflation.

5. Financial Bottom Line

- Inflation is a consequence of expansion of the money supply.
- Currently the money supply has been capped but the pressure of Government debt makes future inflation likely.
- To protect against inflation, hold a [diversified portfolio of real assets](#).