The Triad Perspective

TRIAD WEALTH STEWARDSHIP

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Enjoying the hot summer sun brings back memories of going to camp as a child. One of my memories is of the game, "Tug-O-War". The strain and effort of both sides pulling with all of their might and in the middle was a wet sticky pit of mud. Sweat dripped off our brows while the sun beat down. One small factor of differential created a disastrous outcome for one side and heroic cheers for the other.

The game of "Tug-O-War" is an excellent visual for what is happening with our economy. The pundits on one side see the widespread notion that inflation is back, and back with a vengeance. The relative price stability of the past two decades has been shattered by the surging price of oil combined with the demand of improved standard of living of developing countries, which creates higher cost of basic materials, production and food prices. The analysts believe our economy will have the tension of contraction, withdrawal, and inflation causing not only a recession but stagflation.

On the other side, there is a building supply of cash, aggregate supply and demand, and a significant correction in the equity market, which have these analysts believing an economic expansion and stock market rally is pending.

<u>Our Thoughts:</u>

The prior year annual CPI increase was 2.6%, today it is 4.1% and rising. The Reuters CRB spot index (commodities) had a 12 month increase of 36%. Nevertheless, the 30 year bond yield also fell to 4.5% in June of this year, down almost 5.1% from a year ago.

We pose the question; how is it possible for bonds, which are the ultimate indicator of inflation, to decline in yield and rise in price in such an inflationary environment? The short answer is supply and demand. Will this overwhelm inflationary forces creating deflation instead of inflation?

Fiscal policy of the Treasury issuing billions in checks created nothing but an increase in the deficit. The treasury had to raise funds by selling debt securities which takes away funds from the general marketplace, hence exacerbating the problem of available credit.

Historical experiences show that increasing deficits rarely have a beneficial effect on the economy. More evidence indicates that transitory tax rebates produce no lasting benefit and these rebates simply add to our deficit.

Triad Points of Interest

- The stock market has now clearly violated the important low set earlier this year creating a bear market panic. Even Warren Buffet's hard time resilient, “Berkshire Hathaway” is down approximately 15% for the year.
- From the peak of 2006, home prices have fallen 17.8%, and stock prices have decreased 15% to 20% providing a combined loss of capital in America of $5.2 Trillion.
- The deterioration of consumer expectation creates another significant event. Based on the University of Michigan's Consumer Expectation survey, it has slumped to a 20 year low. The world index has never fallen sharply without a recession occurring.
- The total hours worked in the US has declined for the third month in a row, and now stands at -0.6%. This has also coincided with recessionary cycles.
- During an economic contraction; inflationary relief is not an untended beneficial circumstance that sets the stage for our next expansion.
- Due to a recent survey of the National Energy Association there has been more money invested in alternative energy solutions in the last 12 months than in the last 10 years. Will this unfortunate swing in energy cost have created a positive outcome?

The energy Information Administration has projected by the year 2030 that 20% of our power for electricity will be from wind production and has the potential of doubling to 40% in California from geothermal solutions. Oil and the oil related services companies have broken through support levels and give indication for potential negative momentum (in other words, the price of oil may continue down).

Our suggestive conclusion is, much like an equally balanced team playing multiple games of “Tug-O-War” , they both may have a chance to win. In the short to intermediate term, the above data combined with aggregate supply and demand analysis, CPI increasing significantly by an additional 3.6%, and demand pressures from investors causing oil and commodities to increase, all have a potential for creating core inflationary pressures and moderately short recession. Together causing what we spoke about in our previous “newsletter -Stagflation”.

We also believe this will occur over a moderate time frame, after which the other side has a chance. We believe the forecast after this initial period will cause an economic acceleration. The public’s current impressions of things are far worse than the underlying reality. But, as they say, sometimes impressions are reality. Sometime, in the near future, the outcome will reverse itself and it is likely we will not be mired in a slowdown for an extended period of time. The equity market is nearing a technical low support level, the financial and credit crisis although far from over is starting to have signs of correction. A combined solution of an increase of oil supply, decrease in demand, introduction of improved alternative energy and conservation, will all revise the spiraling cost of oil. Investors will rediscover their confidence in the economy and we will have an economic recovery. In round one, inflation and recession will win. In round two, recovery and growth will dominate.

Positioning Your Portfolio

As we discussed recently, we have been moderately defensive while positioned to reallocate as the trends suggest opportunity and your model percentages are affected by pricing. We have continued to overweight the alternative “non-correlating” asset class and slightly overweight fixed income. The fixed income category with current yields and pricing have a unique opportunity as well. We have been focusing on fixed income sectors that have opportunity when the credit crisis abates, including high yield municipals and floating rate/convertible bonds.

With the severe pull back in the price of oil this week and resulting slide in the oil and commodity stocks, we have seen the huge bounce-back potential in the banking, retail, and consumer areas come to life. We see this as a positive, but are remaining cautious of it being only a temporary rally within a continued bear market. If the short term rally reverses, we will get another buying opportunity. If it doesn’t, we feel our portfolios are positioned to participate in the long awaited rally.

We hope you enjoy the rest of your summer and please feel free to contact our office if you have any questions.

Sincerely,
Larry Knudsen and Dan Stober