

# Monthly Chartbook

## November 2005

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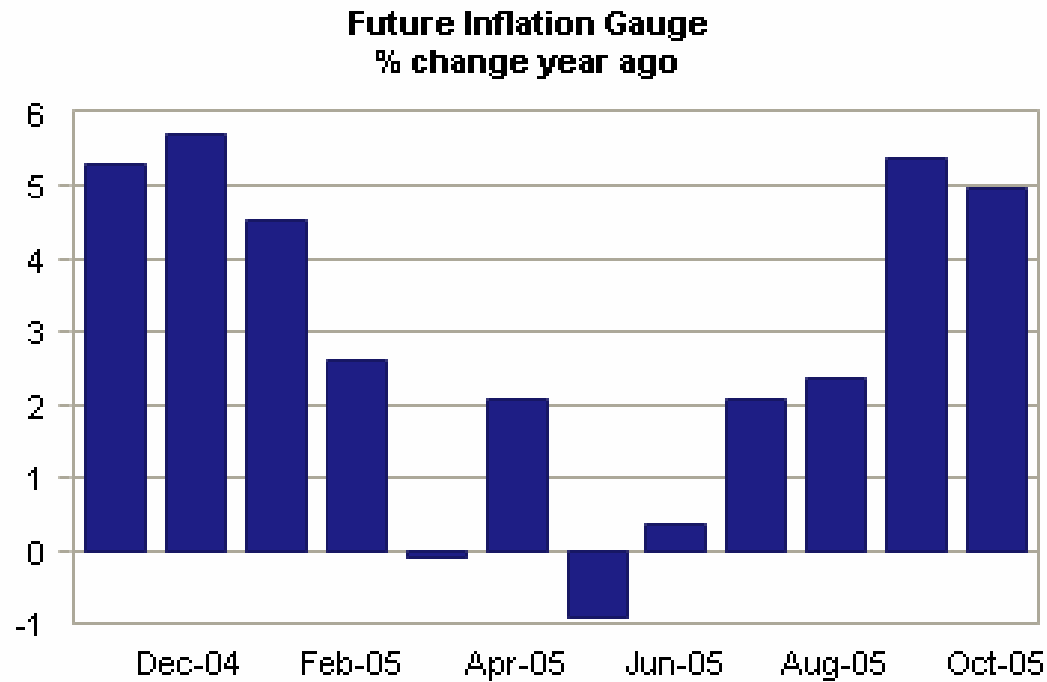
*Macro-economic research*

Our investment thesis for the next month...

**The Fed might soon be done, but inflation is still a risk.**

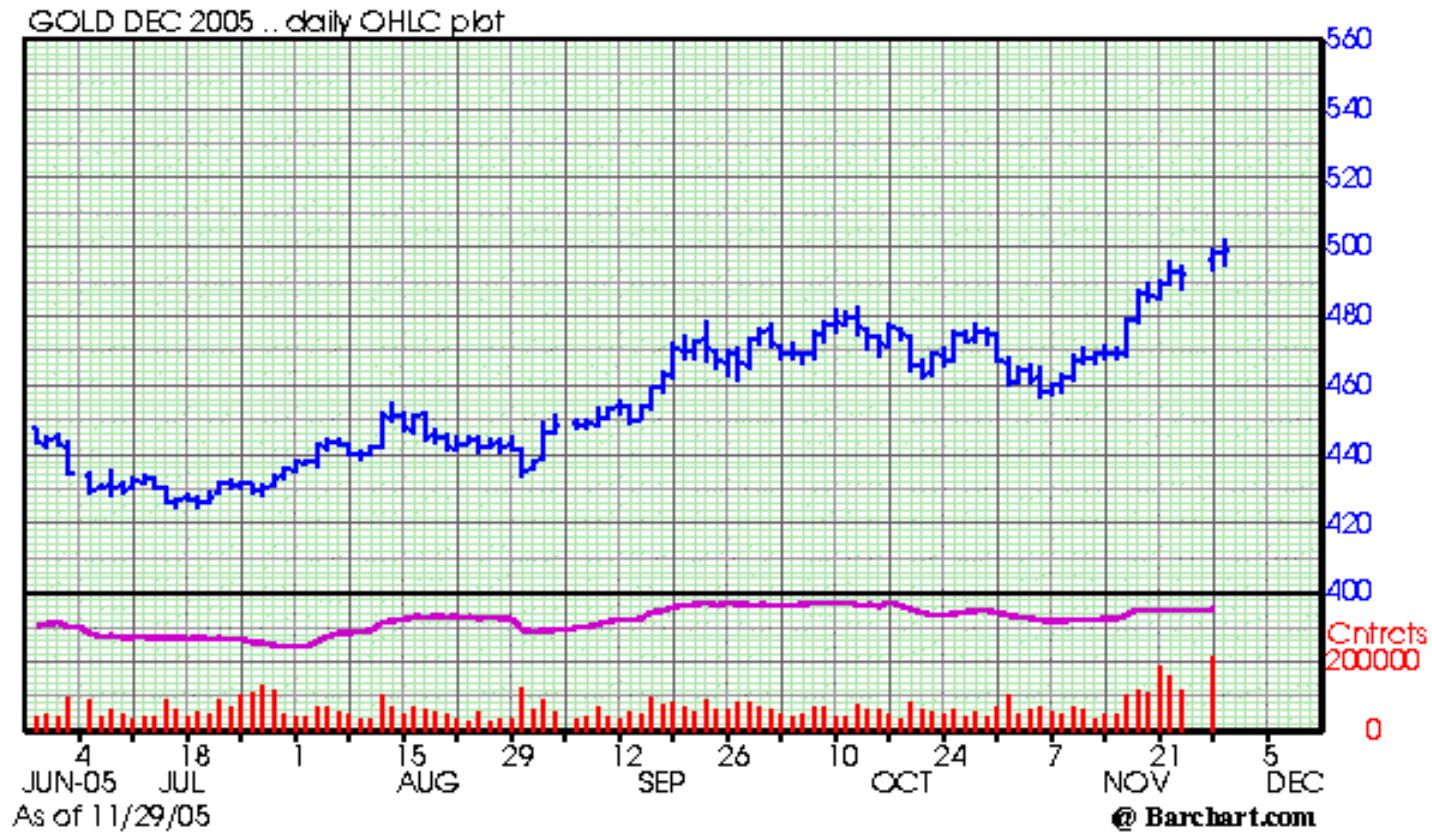
Market participants have been placated into thinking that “the core rate is x.xx % so we are okay, we are not looking at runaway secular inflation.” Well, energy prices have been bleeding into the core rate. Energy prices will moderate and All Urban CPI with it, but that *does not sound the “all clear”*.

## Macro-economic Research



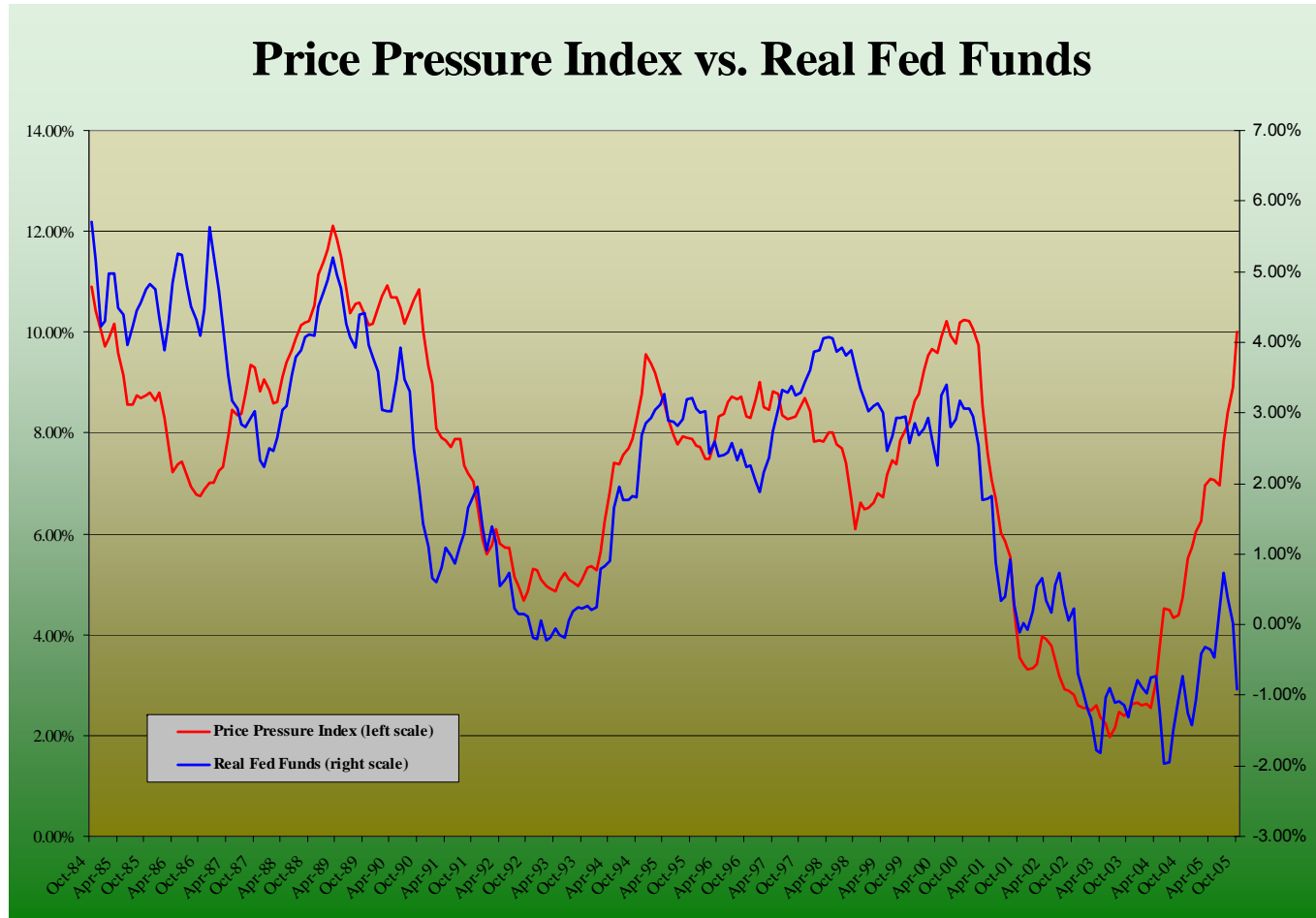
Long term Employment and Income are more important to inflation in a service based economy like the USA than raw commodity prices. It's not just the proprietary Cornerstone **Price Pressure Index** that is heating up, the ECRI's FIG (Future Inflation Gauge) is pointing higher as well. Stay tuned...

# Macro-economic Research



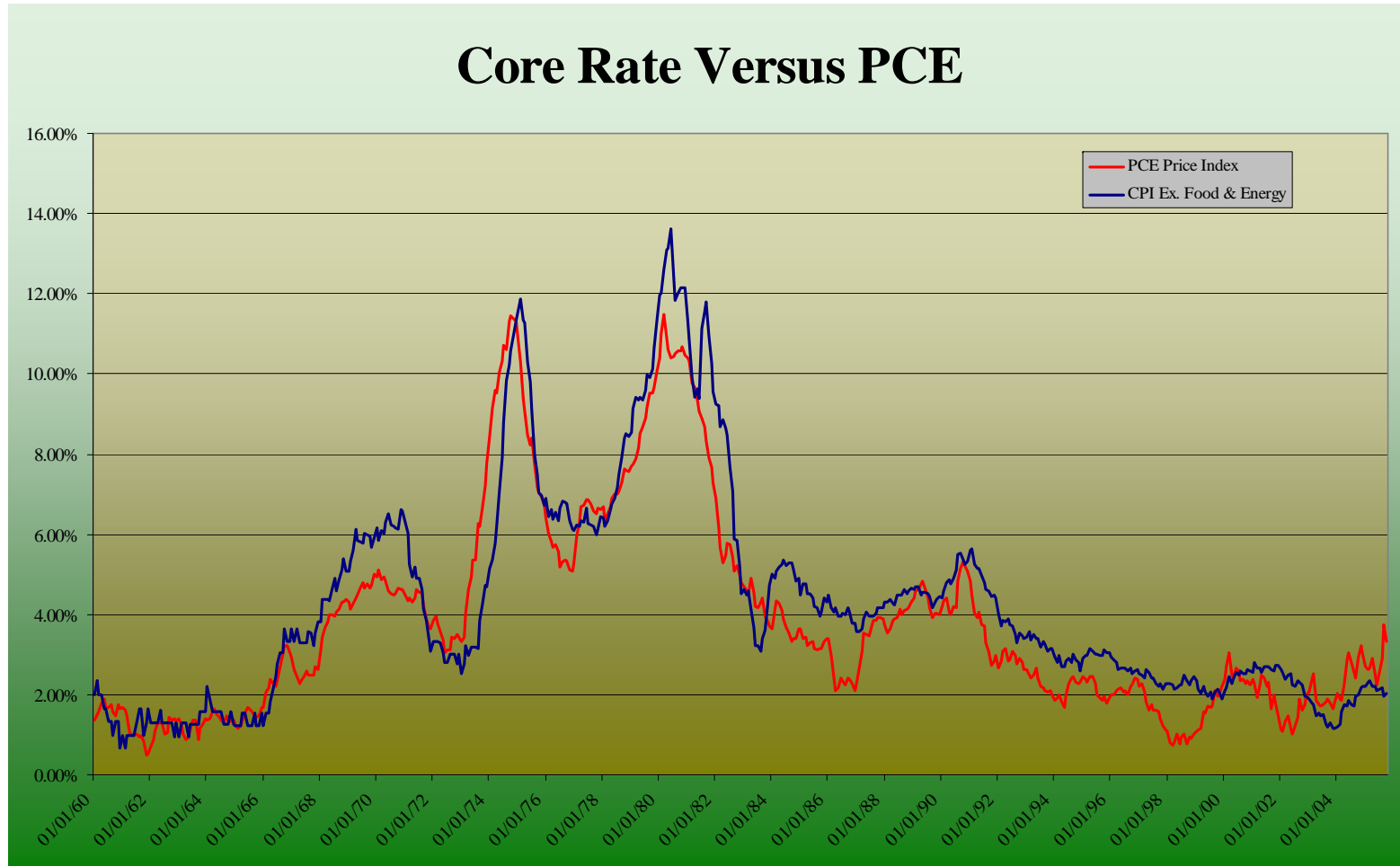
Is Gold really just Chinese jewelry demand? Hardly. It's a store of value in a world awash in cheap fiat money.

## Macro-economic Research



The Fed is really behind the curve here, I don't know if there is any room for a pause or a "clean slate" for Ben Bernanke. The market is convinced that falling gasoline prices equals falling inflation. Not so fast my friend!

## Macro-economic Research



Inflation is not down and not out. Dr Greenspan's favorite PCE, which is supposed to measure the substitution effect is up 3.32% on a Y/Y basis, and is clearly above trendline.

# Capital Markets Expectations

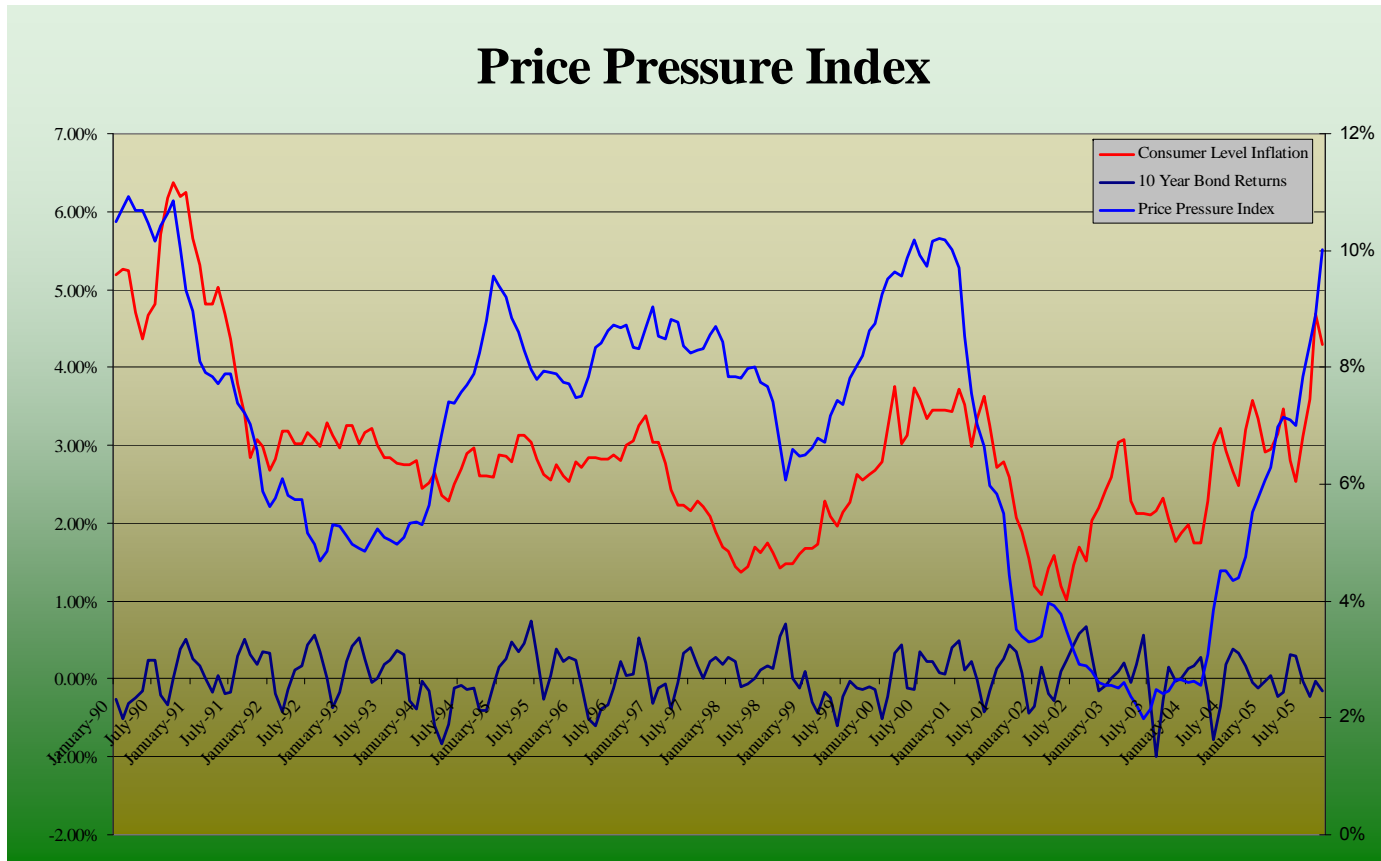
Index	Current	Forecast		Range	Time Frame
<b>S&amp;P 500</b>	<b>1249.48</b>	<b>Trading range</b>	↔	<b>1120-1275</b>	<b>Next 6 months</b>
<b>Ten Year Treasury</b>	<b>4.50%</b>	<b>4.62%</b>	↓	<b>4.25 - 5.00%</b>	<b>6 months</b>
<b>Inflation (all Urban)</b>	<b>4.30%</b>	<b>3.51%</b>	↑	<b>3.00 – 4.00%</b>	<b>6 months</b>
<b>Fed Funds</b>	<b>4.00%</b>	<b>4.50%</b>	↑	<b>3.75 – 4.50%</b>	<b>6 months</b>
<b>S&amp;P 500 Earnings</b>	<b>\$64.75</b>	<b>\$67.25</b>	↑	<b>\$66 - \$70</b>	<b>1Q 2006</b>
	Legend:	↑ Higher	↓ Lower	↔ Indifferent	

# Inflation expectations

Can inflation cool to agreeable levels with just a moderation in energy prices, or is a booming global economy combined with the stealth rally in employment setting us up for a fall?

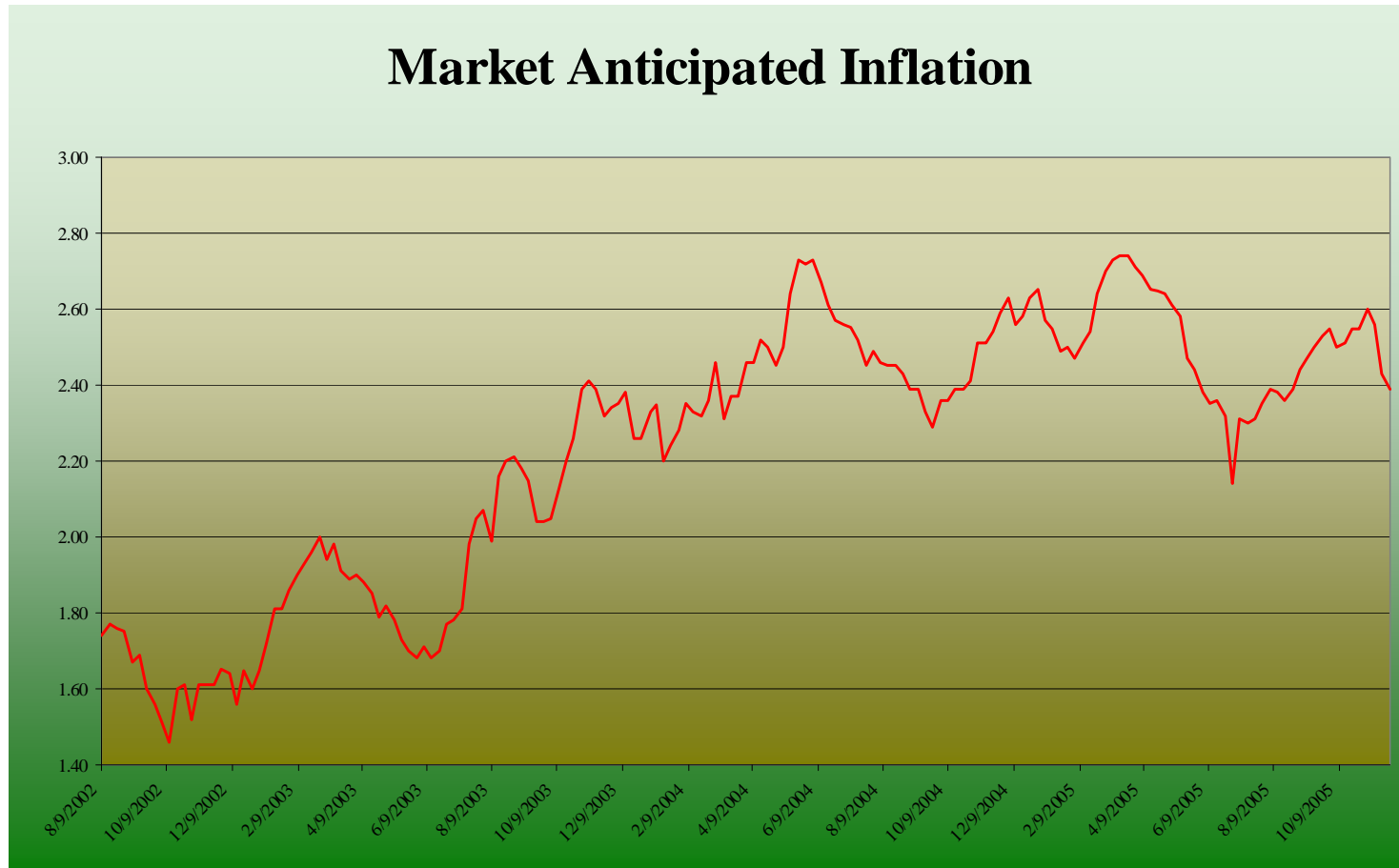
Up until \$2.00 gasoline everyone was fine with inflation, because it meant that their home was appreciating at 15% per annum. Why, that is better than the stock market!

## *Inflation Expectations*



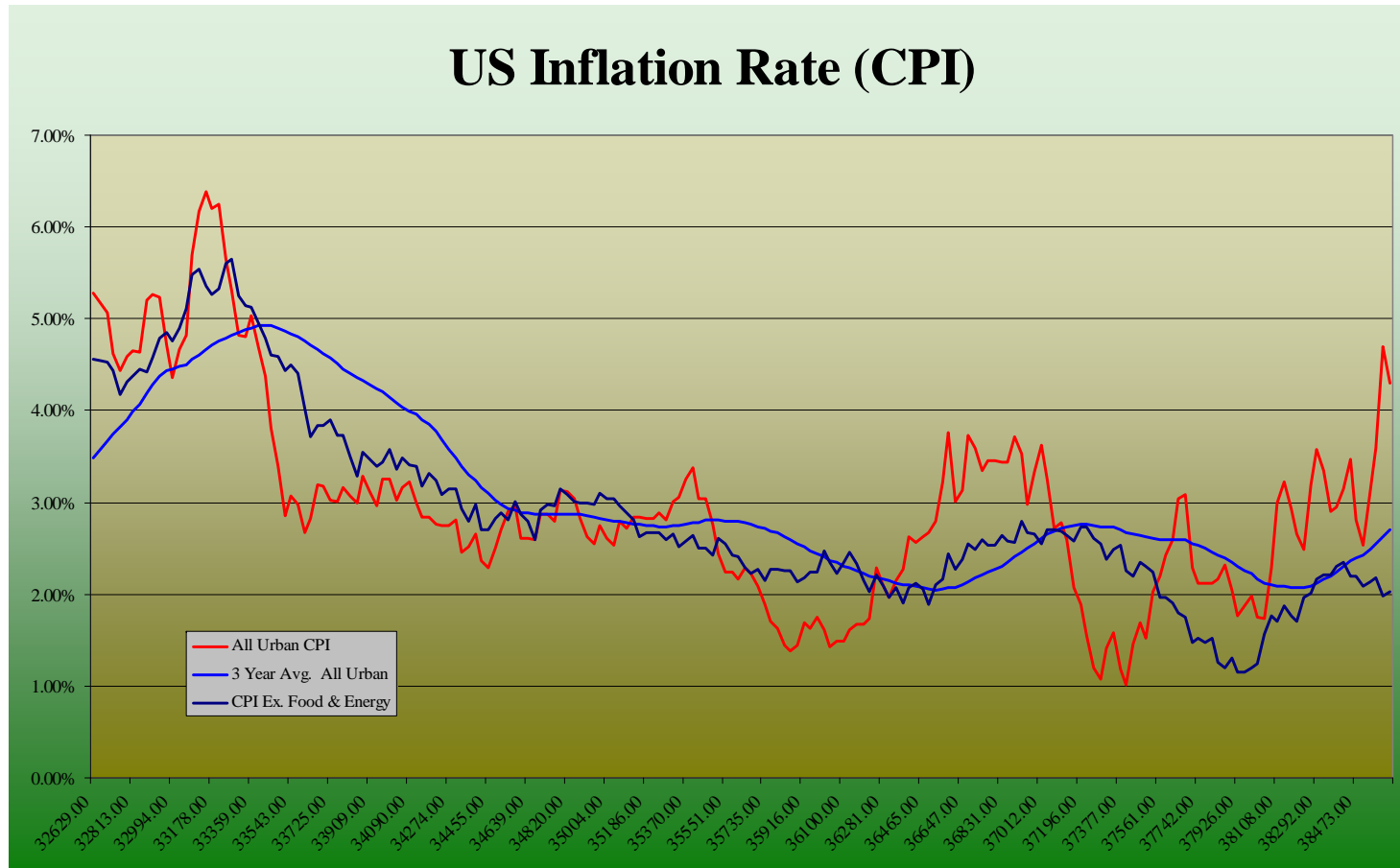
The Price Pressure Index continues to march higher. The longer it stays elevated the higher the risk that inflation remains above trendline.

## *Inflation Expectations*



Over the coming ten years, the market is anticipating inflation of approximately 2.39% per year. This is significantly lower than the current year-over-year rate, and reflects the fact that the markets are *expecting* inflation to moderate.

## *Inflation Expectations*



Prices are rising, period.

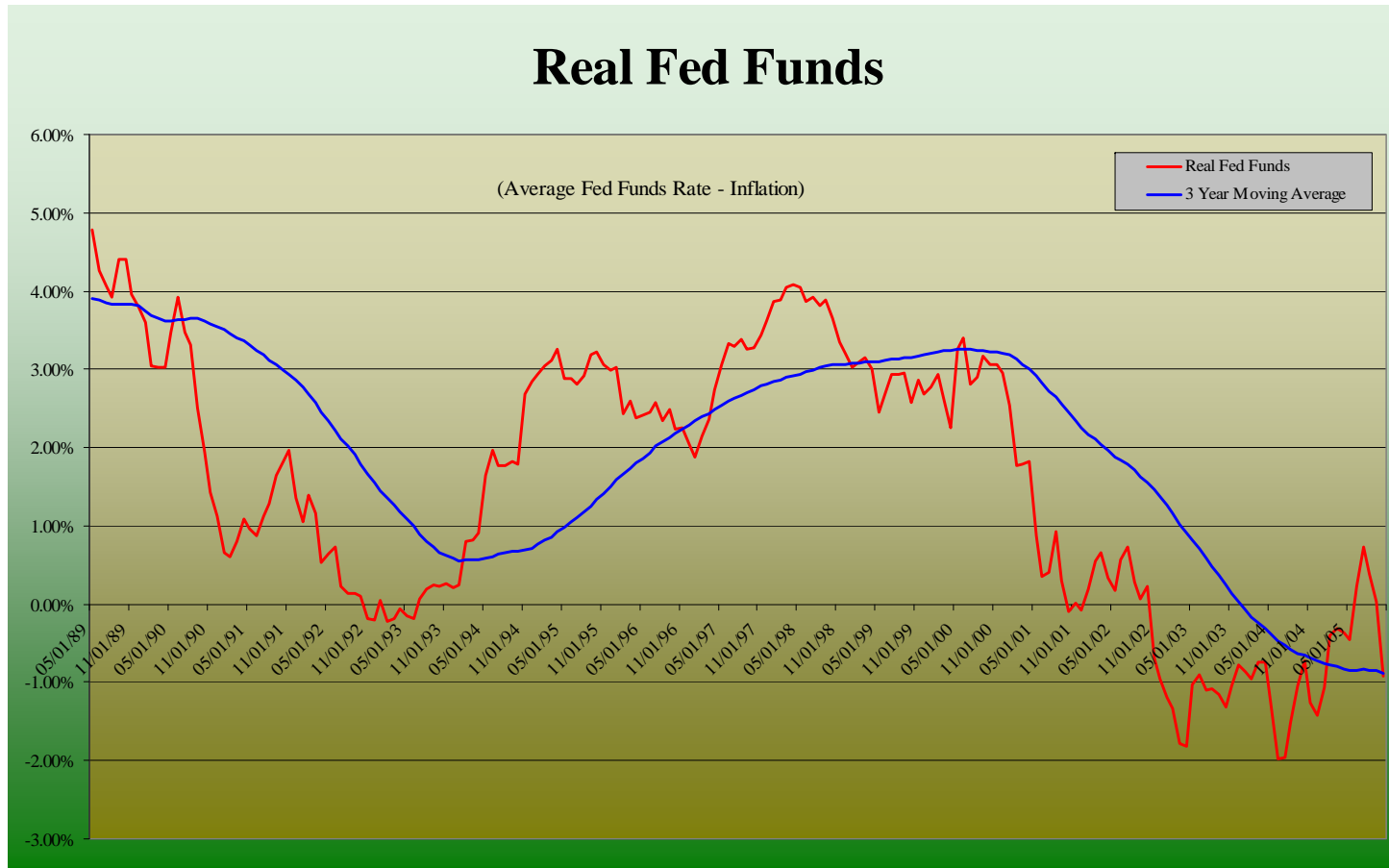
## Federal Reserve Watch

The Fed is working to gain control over their primary tools for economic stimulus – monetary growth and interest rate changes – by clearly and consistently moving short term interest rates higher. But...

Long term interest rates have not responded in kind, and we are changing horses mid-stream with a brand new Fed Chair, Ben Bernanke.

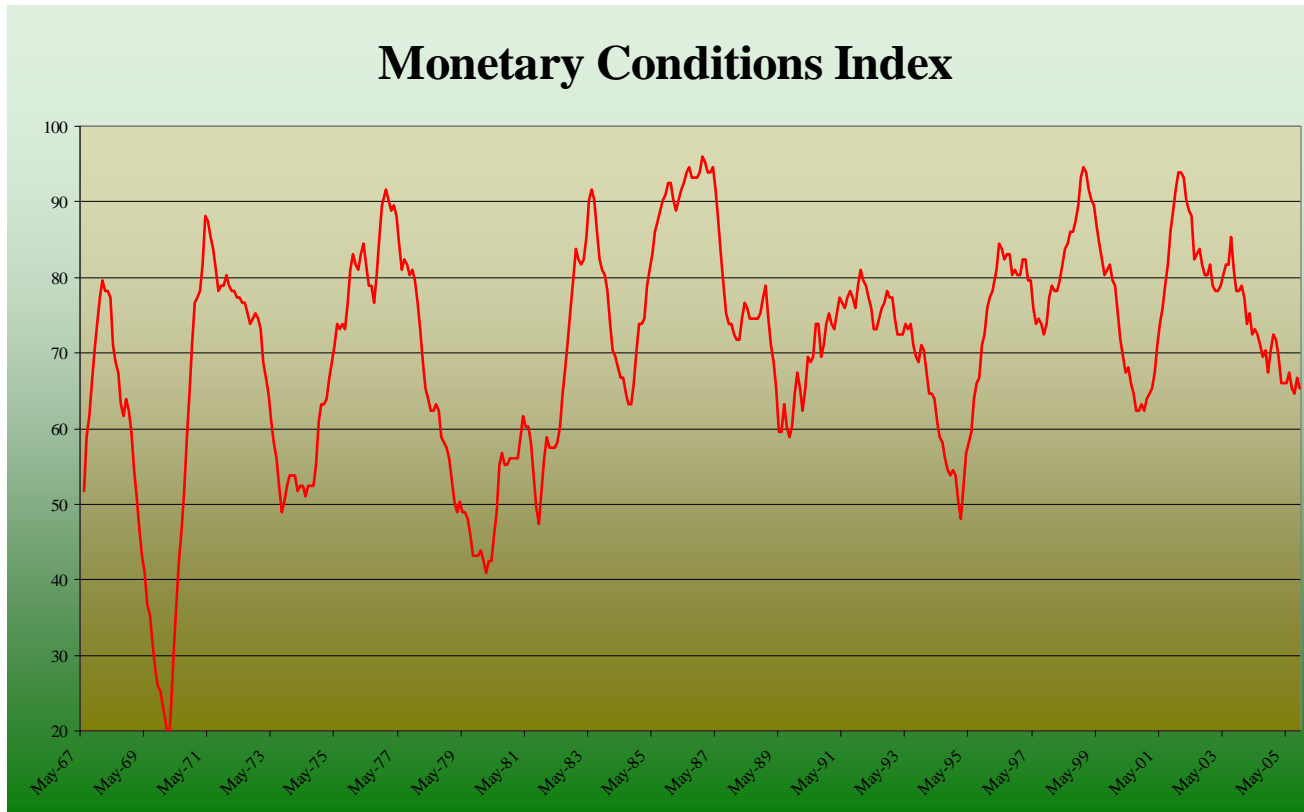
Remember, kids, we changed Fed Chairs August of 1987. Now, we are not calling for a crash, but we won't know the man's mettle until it is tested in a crisis.

## Federal Reserve Watch



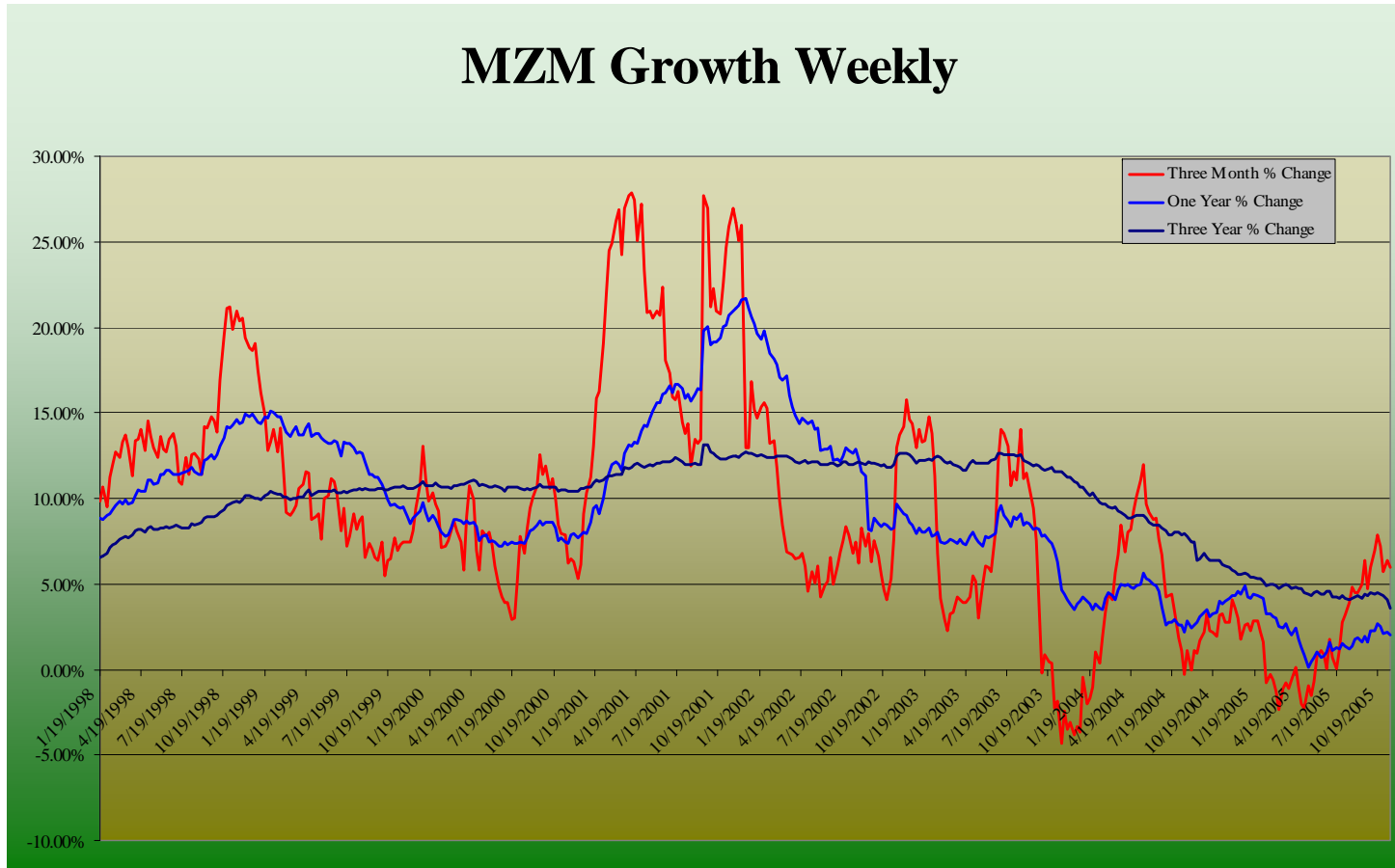
Soaring All Urban CPI has tipped Real Fed Funds negative again, hardly a neutral policy stance.

## Federal Reserve Watch



The monetary conditions index isn't at bearish levels, but after being at such high levels current conditions don't look all that good.

## Federal Reserve Watch



That one year number has really, really moderated...

## Outlook

We have to look back to look forward, November 2005 wound up being a decent month. Consider, though, that the S&P 500 is still negative for the five year trailing period.

To us, the current bullish sentiment is just that *sentiment*; 2006 might be a great year, but we still seem to be range-bound on the S&P 500, and we are at the upper end of that range.

We would buy dips; chasing this market may not be wise.