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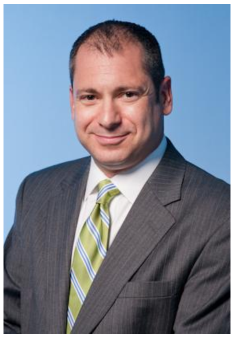

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Inflation spiraling out of control? 7 Reasons to Fear Not

To tune out the noise and focus on what really should matter to investors; **it is all about inflation.** And this debate is raging. The direction of inflation isn't as important as is its rate of acceleration. Well, the acceleration has been near vertical. The question about whether or not we actually have inflation has already been answered; we do. **If it costs you more money to fill your gas tank and to fill up your grocery cart, then we have inflation.** But the debate rages on within the chamber whose opinion counts the most, the Federal Reserve Open Market Committee.

The Bernank sees the recent rise in food and energy as **"transient"** or temporary (Reuters). He prefers to look at wage push inflation, of which there is none. **Since employment costs are the biggest part of inflation, he places far more emphasis on this over commodities inflation.** That is why he is such a dove and that is what investors need to understand about him. Especially since he is the arbiter of whether or not we have lasting or transient inflation.

To further drive this point home, investors must understand that the Fed has a **"duel mandate".** This means that the Fed has two goals; fighting inflation while simultaneously maximizing employment. (This is not the case for the European Central Bank, which has a singular mandate to fight inflation) My own interpretation and that of many others is that The Bernank is willing to accept higher rates of inflation if he sees an improvement in the employment picture. Witness the last 6 week trend of improving First Time Unemployment Claims which is released 8:30 AM every Thursday/Dept. of Labor). The strategy is working, at least according to him.

But what about commodities inflation? The spread between TIPS (Treasury Inflation Protected Securities) and the 10 Year Treasury Note is at a 3 year high. Gold has been hitting highs. We needn't mention food and energy. Shouldn't we be terrified of it all? Well, not right now. **Inflation has headwinds, just like the global economy and our**

own domestic economy. Here are my top 10 reasons why you should not fear inflation too much and why it may not get as bad as some pundits would lead you to believe.

1. The ECB just raised rates and the Bank of China has raised rates for the 4th time since this past December '10. This should take pressure off the Fed since the other major central banks are doing the heavy lifting in combating inflation. **We get to enjoy low interest rates for some time to come while foreign economies fight inflation for us.** Nice.
2. The end of QE2 is a subject that will dominate the conversation among investors and economists through June. But I feel that this program gets too much credit for both the economy and for inflation. With 14 Trillion Dollars of outstanding Treasury's, an additional 600 Billion Dollars just wasn't the big bazooka missile that I would've expected. Now, with barely 100 Billion left in the program until it self terminates, we shouldn't overstate the remainder. **Its end could actually strengthen the Dollar.** You know that big run in oil and gold? A stronger Dollar, which is what I expect, could tame those inflationary indicators in a hurry. Many investors who haven't ordinarily played in the commodities markets have poured money into commodity pools, ETF's, hedge funds, and mutual funds. A stronger Dollar could wreak havoc in such a lopsided trade; witness oil sliding from 147 to 33/brl during the second half of '08.
3. **State budget gaps are a drag on the economy**, especially since so many states are straining with budgetary forces beyond their ability to quickly tame. Trimming services on the municipal level is a dampener on inflation and the economy. Anything that is a drag on the economy is a drag on inflation too, so, there is another headwind against inflation.
4. Austerity measures in European countries will act to slow the entire continent. Sure, I am speaking of PIIGS nations, but their **budgetary constraints are enough to drag down growth in Germany**, the economic force in Europe.
5. **Housing is still weak** and struggling to build on pockets of strength while getting slammed by short sales and foreclosures. This drag on the economy will tamp down inflation too.
6. **High oil prices really do lead to demand destruction in both fuel consumption and discretionary goods and services.** I caught a few items on CNBC.com during my daily prep for the trenches today: Janet Yellin, Vice Chair of the Federal Reserve, commented that she sees higher commodities prices as a slowing effect on the overall U.S. economy. Call it a "tax" on consumers or whatever you like, it still means consumers will tend toward cutting spending. "I anticipate that recent increases in commodity prices are likely to have only transitory effects on headline inflation" Yellin said today (Monday, April 11, 2011) in Washington, DC. According to MasterCard Spending Pulse, gasoline sales have fallen for 5 straight weeks. I'll take that as proof of demand destruction.
7. Japan's economy is weakened immensely. While a "rebuilding" investment theme is making the rounds currently, it will be a very long time until that actually begins and even them, it will take still longer for it to kick into high gear. **The**

global economy will simply be functioning without some of the worlds' most durable companies and consumers for years.

Bottom line, inflation currently has more bark than bite. The macro headwinds against the global economy, while potentially unnerving for investors, are keeping inflation in check. All the while ***this gives The Bernank cover to maintain a very accommodative monetary policy for some time to come.***

To repeat my mantra of the last 2+ years; as long as large domestic companies can keep cutting costs in developed markets and reinvest in emerging economies, their earnings should continue to grow and that should help keep the major domestic averages to continue climbing.

Thanks for reading this. Please forward this to anyone you know who may find it interesting. Please reply me if you'd like to comment.

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