Economic Update

Broadleaf Partners, LLC

All Aboard!

July 14, 2009

Over the last few weeks, the market has dropped its hyperactive fear of inflation (a fear we did not share) and has recently been obsessing over deflation. During the former period, we suggested that inflationary concerns weren't the reason for the backup in government bond yields as corporate bond yields hadn't experienced a similar increase. After all, inflation would affect the value of any investment dollar -- corporate or government in orientation. Instead, our view was that government debt yields had likely risen as a reflection of improving economic prospects and a resumption in the willingness to take risk, especially in the face of minuscule risk free yields.

Ever since new unemployment claims came out a couple of weeks ago and were higher than expected, the tone has changed. The stock market has been weak and government bonds have rallied. Now, the concern doesn't seem to be over inflation, but deflation.

Once again, we believe this concern is misplaced. Near term economic prospects are far more important for the stock market at this stage of the game, while inflationary and deflationary concerns may be more correlated to one's political views. As we have said before, a little inflation might be a good thing as it would be a sign of an improving economy.

The real reason for the pullback in the markets is likely that we are on the verge of earnings season, which started with Goldman Sachs this morning, continues with Intel tonight, and then Google on Thursday. After such a huge run off the lows, trading volumes have dried up and the markets have pulled back as investors await this quarter's message from those in the trenches -- the management teams of corporate America. Will the message remain status quo - that the environment has stabilized - or is the recent unemployment claim number a sign that a more sinister picture is about to emerge?

I personally believe in the status quo view, consistent with what Goldman Sachs said today, what it appears that Intel is now saying after the close, and a few other companies that made comments at various conferences in the past week. Things have likely stabilized, but aren't yet improving. I think this simple acknowledgment will be powerful enough to push the markets back to their recent highs, giving those who remain under invested a unique opportunity to climb aboard the equity train before it once again leaves the station.

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After such weak GDP numbers in recent quarters, substantial draw downs in inventories across most industries, and unprecedented stimulus, I don't see how production numbers could do anything but go up from here, if not this quarter then certainly the next.

All Aboard!!!

Kindest Regards,

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