Economic Update

Broadleaf Partners, LLC

Storms, Steroids and Sunnier Skies

April 25th, 2008

The Fed will meet next week to discuss their next move with interest rates and most believe it will be their final adjustment downward, by 25 basis points. In reaction to the expectation, the dollar firmed yesterday and with it, many commodities and commodity oriented stocks came under pressure. Many distressed areas of the market, particularly the financials and consumer discretionary stocks rallied with the apparent view that if the Fed is getting close to being done, then perhaps the economy has stabilized and the storm has passed. This is a key change in sentiment; if there had been an expectation that the Fed was finished a month or two ago, the stock market would surely have tanked.

Strong earnings reports have been the key news over the last two weeks, giving the markets what they need to perceive a final rate cut in a positive light. The good earnings news also lends credibility to the view that the troubled areas for the economy had been concentrated in a narrow group of stocks, a situation which has become increasingly commonplace given the prevalence of asset bubbles in places like technology and housing over the last ten years or so. This, of course, doesn't mean that the Fed should have done nothing over the last two quarters. By doing something, the psychology of fear was kept at bay and the risk of infection to other areas minimized. The Fed gave us the necessary injection of steroids right when we needed it the most.

The professional traders we spoke to yesterday indicated that they saw large amounts of aggressive money moving out of the hot commodity sectors and into areas that had been beaten down of late, particularly the financials. The trade shift mentality was specifically acute among hedge funds, which had been increasingly crowding the commodity trade, perhaps as an inflation hedge or more than likely, simply because it was working. If the Fed is now done, perhaps the thinking is that the trade is over, and that the recent parabolic moves will settle back to longer term, more sustainable levels driven less by speculation and more by emerging market demands.

While we are a believer in improving commodity fundamentals, it certainly isn't showing up in our inflation and interest rates, as it did in the 1980's. (See Wednesday's blog entry, **Inflation, 1980's Style**.) The same thing can't be said for the inflation rates currently being experienced by many countries overseas, including Saudi Arabia and China, where it is running in the double digits. While I'm not entirely sure what this all means, it does suggest, at least for now, that we may be discounting the resiliency of our own economy.

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Among capitalist boys in faraway places, the United States may very well be a grandfather, older for sure, but perhaps wiser as well.

The sun isn't setting, after all. In fact, it may be shining.

Kindest Regards,

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