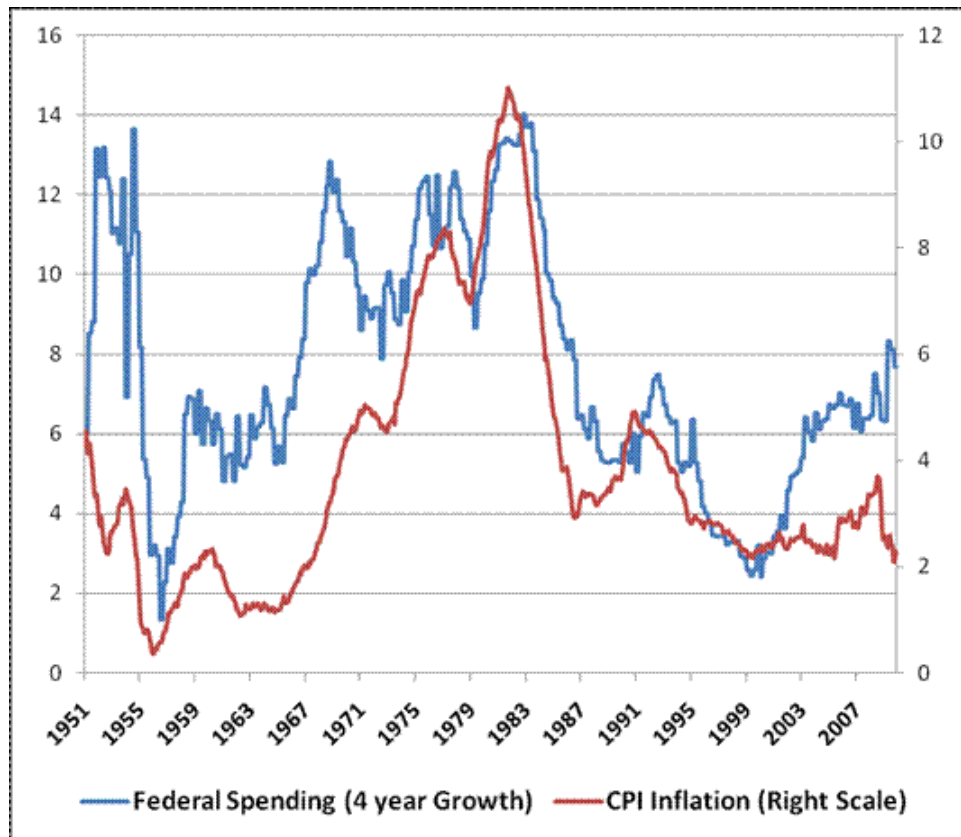


# INFLATION IS A NON-EVENT

## WEB BUZZ 2010.01.25

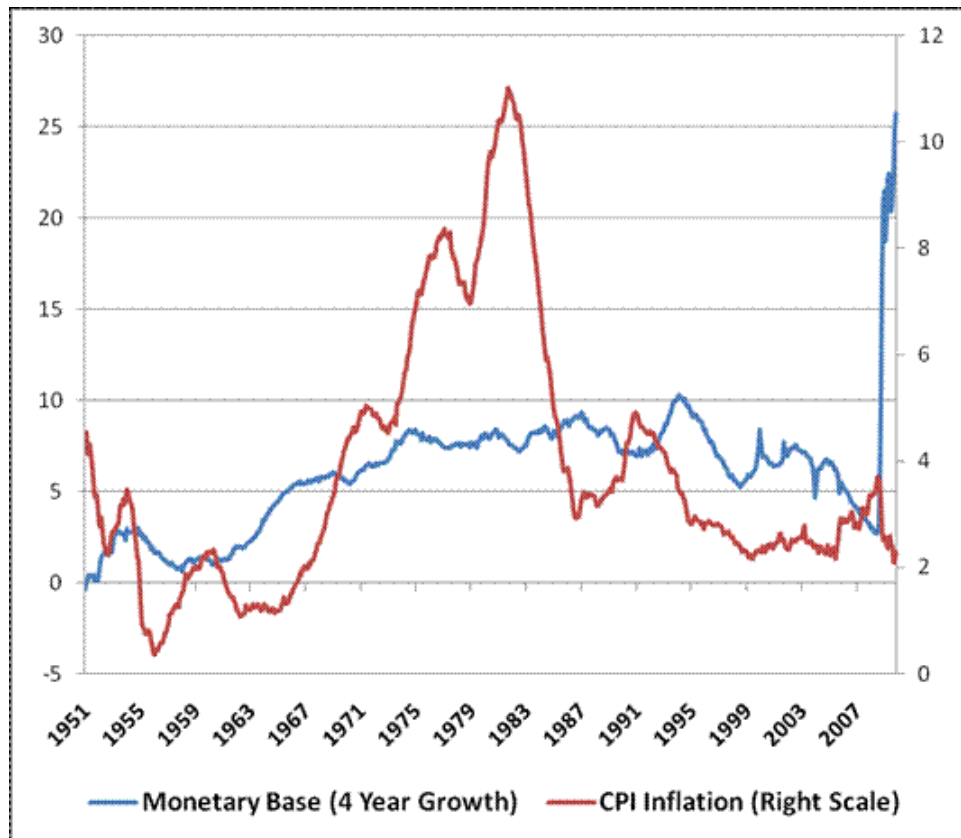
Inflation and how it is created has always been something of a puzzle. Milton Friedman has said that inflation is always a monetary phenomenon. Others have said that growth is the cause of inflation. The infamous Phillip Curve, which blew up in 1974, said there was an inverse relationship between inflation and unemployment. And on it goes.

As one looks at inflation historically, it appears that there may be no single cause, rather a variety of factors that figure into the equation; however, it does appear that government spending may have the most to do with it. The higher the rate of spending, the more likely there will be inflation. Please note the chart below:



Adapted from Hussman Funds

Under today's circumstances, those that are projecting an increase in inflation are looking at the huge increase in the monetary base. See the chart below - there doesn't appear to be a real close correlation. This, of course, is the result of the Fed's action by way of flooding the banks with money (reserves), which is the firepower to increase loans if banks are willing to lend and customers are willing to borrow. Can this take place under today's conditions? We don't think so. Banks are in trouble from a capital standpoint and consumers and small business owners are in a bind because of existing excess debt and/or weak business conditions. Add to this condition the movement of business to China because of cheaper labor. In addition, there is excess capacity in both China and the U.S. Therefore, inflation is a non-event.



Adapted from Hussman Funds

When will market participants come to this conclusion? We don't know, but they surely will at some point.