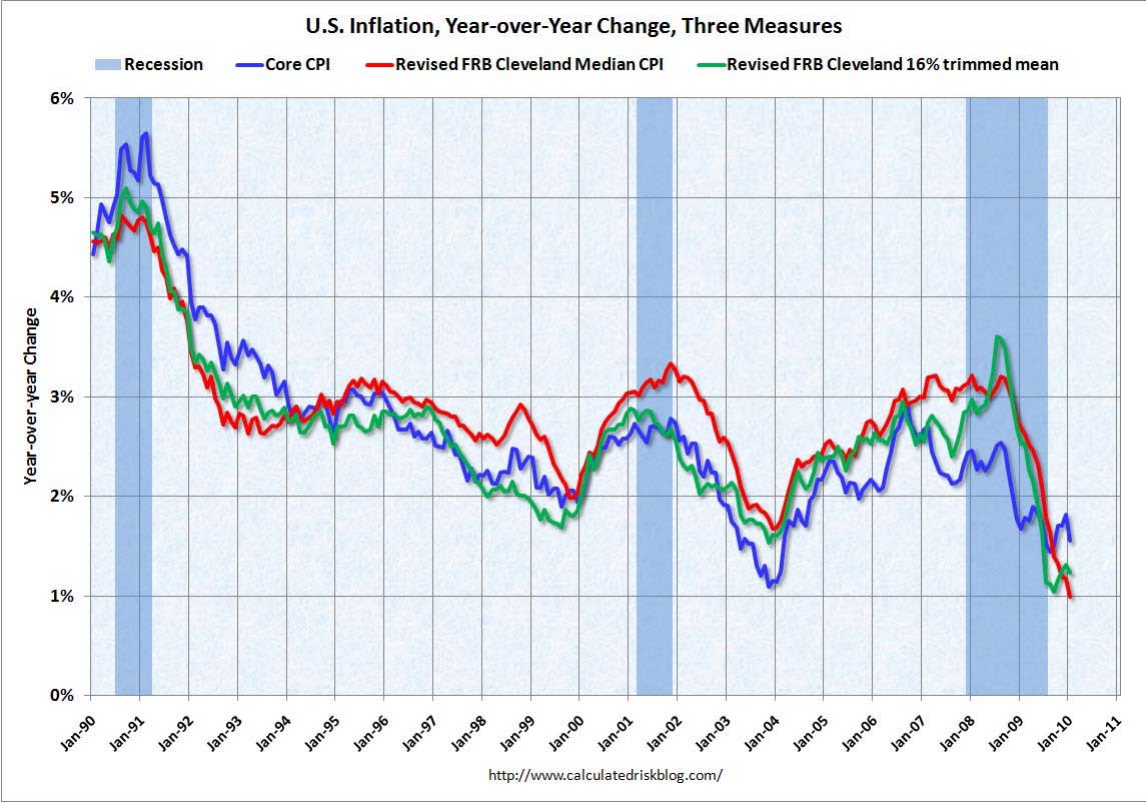


THE FIRST GLIMPSE OF THE FUTURE

WEB BUZZ 2010.03.01

The week of February 14-20 witnessed several events we believe represent the beginning of the end of the inflation/deflation debate that has been roaring over the last several years. As we are all well aware, inflation is what most market participants expect in the future. Faith in the Federal Reserve to manage the economy and keep us out of deflation is almost universal. After all, Helicopter Ben has let us know that the printing press is the ultimate weapon and he will use it if need be. On February 18th, he announced an increase in the discount rate from 0.50% to 0.75%. Many see this as the first step in a tightening of money in order to stop potential inflation from taking hold. We think otherwise. We see it only as a first step in returning the Fed's operating model back to normal by making the banks rely on the federal funds market for their overnight funding needs. Also, as so many fear inflation, it may serve to assure the market that the Fed understands their concerns. This "vigilance" makes deflation all the more probable. That was the first event. The second was Walmart's release of their 4Q results as of 1/31/10. Their same store sales were down 1.6%. This is a big, big deal. Why? Because they are cutting prices hand over fist. Others must follow if they are to survive. That spells deflation.

The third event was the report that the core CPI (which excludes energy and food) was down 0.1%. This is the second time this has happened over the last several months and before that back in 1982. We expect this CPI trend to continue (but of course not every month) for a long time to come. This means much lower long-term government rates.



Adapted from CalculatedRiskBlog.com