

Inflation Alert

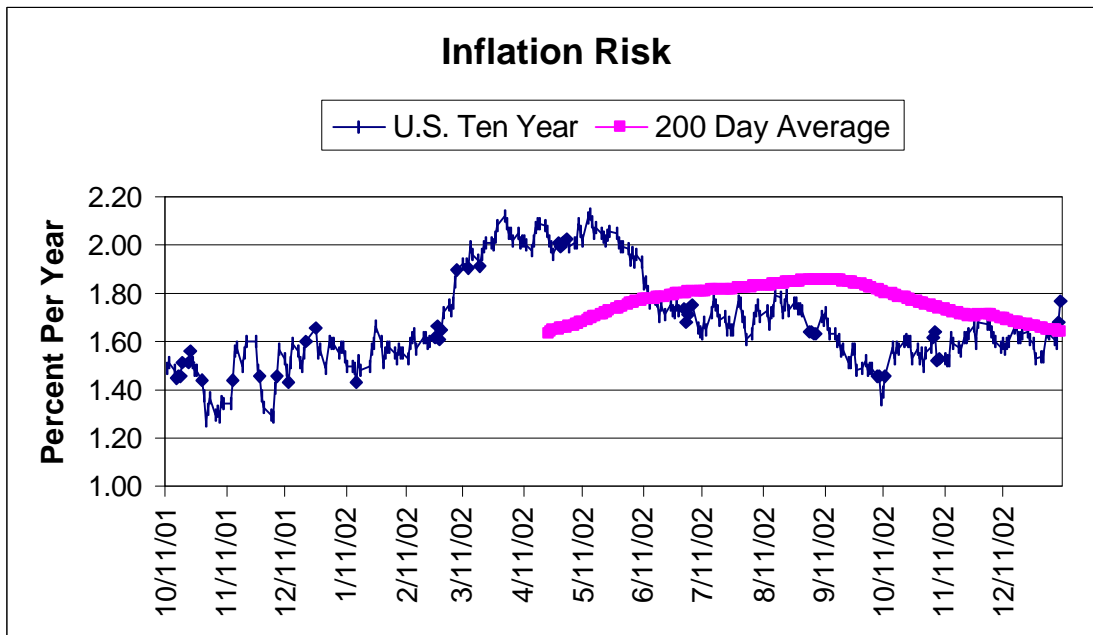
Ten-Year Inflation Expectation Pierces 200 Day Average

Summary and Recommendation

Energy pricing may be helping to fuel a reversal of a six-month down trend in Ten-Year Inflation Expectation. The change in price pattern follows strong demand for U.S. Treasury Inflation Protected Securities (TIPS) auctioned on Wednesday. Undoubtedly, there are monetary and fiscal factors at work too complicated for a humble energy analyst to fully comprehend. Our view is that global supply of higher form value energy for early delivery is tight and that consumers are willing and able to pay more for clean fuel. That makes energy producers an attractive area for investment and it may introduce some inflation in a global economy that otherwise is seeing prices restrained by strong competition in the manufacture of goods. In addition to rising inflation risk, the current trends we can readily measure imply a leveling of deflation resistance, continued decline in real growth expectations and a rising trend for stock prices as represented by the S&P 500 (see charts).

Inflation Risk Rising

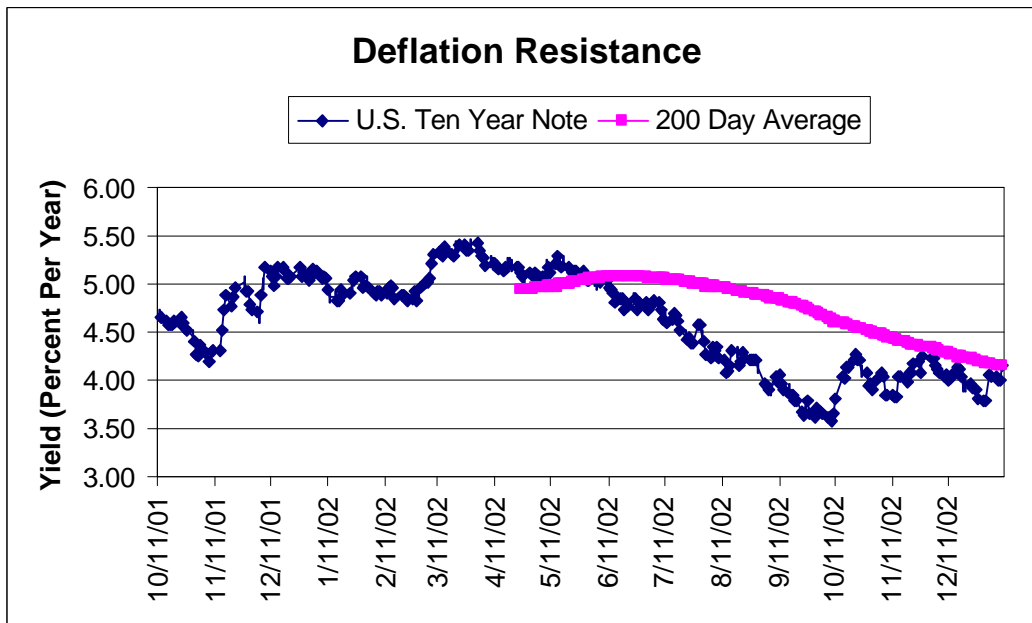
The widely watched measure of inflation expectations, the difference in yield on the U.S. Ten-Year Note and Ten-Year TIPS, reversed trend in the past few days as defined by the current quote moving above the 200-day average.



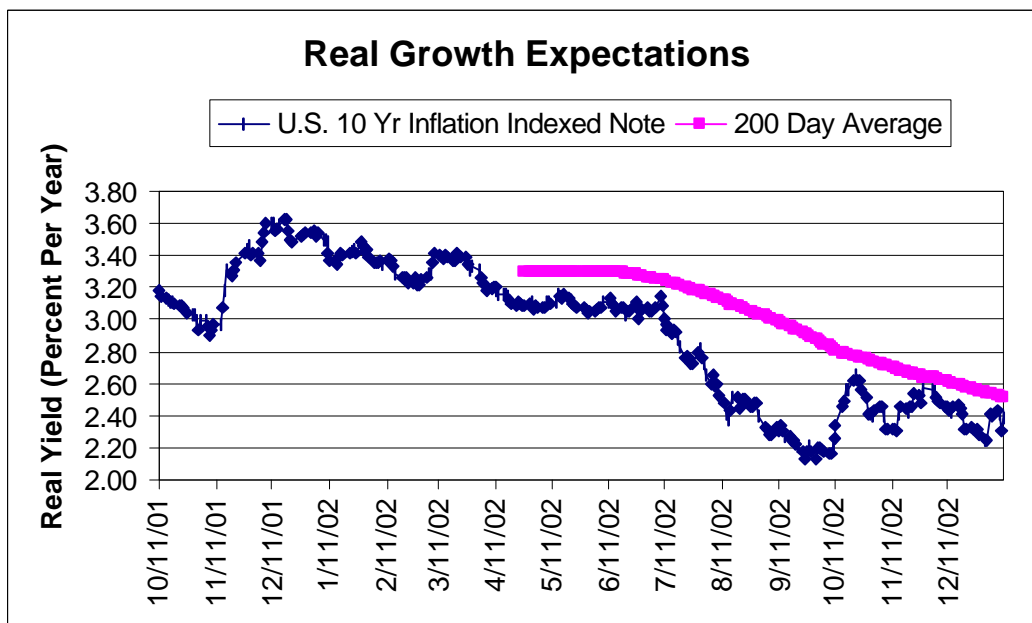
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Deflation Resistance Leveling

The yield on the Ten-Year Note has leveled and has now met the 200-day average. We think of that yield as the main measure of deflation concerns. When the yield is declining, deflation resistance is weakening and investors buy government bonds as protection from a weak economy. When the yield is increasing, the reverse is true.



Real Growth Expectations Still Declining

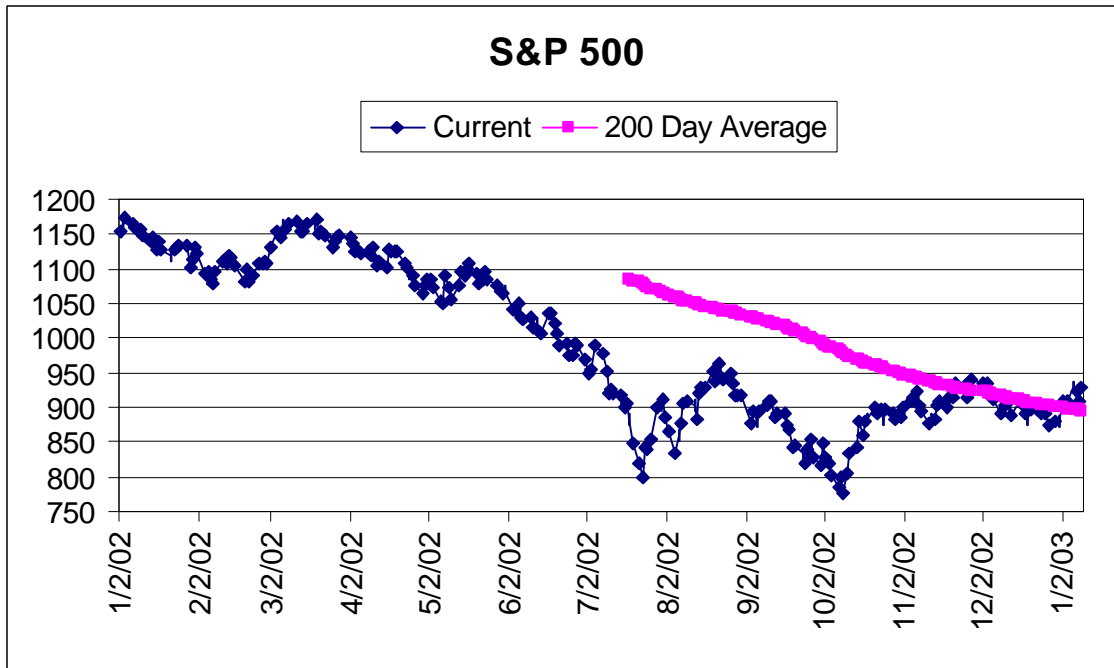


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Stock Market Rising

Though we do not know what future stock prices will be we can see that the S&P 500 is in a rising trend as defined by the current quote being above the 200-day average. The combination of rising inflation expectations and a rising stock market seems favorable for investment in energy producers.

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