

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

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Taking the Good with the Bad

With oil and gasoline prices rising to new highs daily it would be easy to paint a bleak picture for the future, particularly if energy was a large part of your expenses. Industries such as airlines, parcel delivery, and small businesses where transportation figures largely, are in a vise-like squeeze without signs of relief.

While tight supplies and stronger demand from Asia are forcing prices higher, speculation, and the talk that drives it, contributes to the rise. Goldman Sachs has been the most vocal of late. This time they're saying that Chinese diesel purchases will strain supplies, forcing prices higher. Goldman boosted its price outlook for the second half of this year to \$141 a barrel, from \$107, citing supply constraints. They say that China may increase fuel imports to generate power after the May 12th earthquake. You will recall that Goldman analyst Arjun Murti said "the possibility of \$150-\$200 per barrel seems increasingly likely over the next six to 24 months." But we know that speculation eventually ends in bubble bursts, whatever the market. Supply will eventually swamp demand and prices will tumble. Saudi Arabia didn't offer immediate relief today as they denied President Bush's in-person request to increase oil production and to use their considerable influence over OPEC to do so. They responded that their customers are not asking for more oil. The response does validate the claim that recent price rises are driven by speculation.

Consumer confidence fell to the lowest level in almost 28 years amidst record high fuel prices, rising food costs, and lower home values. The University of Michigan survey fell to 59.5, the weakest since June 1980, according to Bloomberg News. It averaged 85.6 in 2007. Economists and investors worry that consumer spending will follow the drop in confidence. The index of consumer expectations for six months from now, which more closely projects the direction of consumer spending, dropped to 51.7 from 53.3. Remember though, the consumer surprises on the spending side far more often than the savings side.

A sign that housing may be nearing a bottom came this morning as the Commerce Department reported that total housing starts jumped 8.2% to a 1.032 million rate. Construction of multifamily units rose 36% following a 35% drop in March. The report also showed that construction of single-family houses in April dropped to the lowest level in 17 years. Building permits, a sign of future construction, rose 4.9% to a 978,000 pace, reflecting gains in both single and multifamily homes.

Last week the Labor Department announced that productivity increased at an annual rate of 2.2% in the first quarter. It is a measure of the efficiency with which US workers produce goods and services. As more is produced with less labor, wages can rise without pressure on prices, keeping inflation in check.

The government reported on Wednesday that consumer prices rose less than forecast in April as non-food items fell declined enough to offset the largest increase in food prices in 18 years. Core prices which exclude food and energy eked up only .2% for the month of April following a .3% increase in March. Manufacturers and sellers of non-food items are marking prices down to maintain sales. The reductions are impacting earnings as first-quarter reports from S&P 500 companies shows that companies that depend on consumers' disposable income have slumped 8% on average.

Today's consumer news took its worst toll on banks and retail stocks. But on the whole it has been a good week for stocks as the S&P 500 is up 2.6% and the NASDAQ 3.6% for the past five days. The VIX, which measures volatility, has climbed on the latest surge of bad consumer news by 8.5% to 17.50 after falling to its lowest level since October yesterday.

It would be easy to get swept up in the tide of bad economic news pouring from the media. Positive aspects of government reports are often buried in the stories while headlines proclaim the negative. The bad certainly should not be ignored, but one missed the whole story if he focuses only on the bad. There are positive trends that should encourage the forward-sighted. American exports are supplying jobs and driving down the US trade deficit. Asian countries including China are proving resilient to the slowdown of western developed economies. The US consumer is finding ways to make ends meet as with the help of retailers such as Wal-Mart and Costco.

There is good news buried among the bad and we work hard to find it, weighing as we go to determine the best course in the months ahead. The stock market remains positive and we see little reason to expect a bear over the hill.

Have a nice weekend.