

Weekly Commentary June 16, 2008

The Markets

There was lots of gurgling beneath the surface, but by the end of last week, the Dow Jones Industrial Average eked out a welcome gain.

Helping the cause was a report from the Commerce Department, which showed a 1% increase in retail spending in May. It was the fastest increase in six months and due, in part, to consumers trading their stimulus checks for tangible goods. Ironically, in a June 13 article, Reuters reported that the Reuters/University of Michigan survey of consumer confidence dropped to 56.7 in early June, which was a 28-year low. Apparently, consumers tried to shake off their gloom by engaging in one of their favorite activities—shopping.

Inflation concerns plagued the bond market last week as the yield on the 2-year Treasury note climbed 60 basis points. That was the largest weekly gain in nearly seven years, according to MarketWatch. Also, according to MarketWatch, yields rose as investors became more convinced that the Federal Reserve may raise interest rates later this year to help combat rising inflation. On the positive side, higher interest rates may cool inflation and help strengthen the dollar, but it could put a damper on a housing recovery. Like just about everything the Federal Reserve does, there's a tradeoff.

A barrel of oil closed last week at about \$135, down from a record high of about \$139 per barrel on June 6, according to Bloomberg. Airlines, of course, have been hard hit by this rise in energy prices and now some people are calling for the industry to be re-regulated. Bob Crandall, the former CEO of American Airlines, said in a June 10 speech, "Our airlines, once world leaders, are now laggards in every category, including fleet age, service quality, and international reputation." He said, "a dollop of regulation, along with new government policies and appropriate investment, would help the carriers get back on the right track."

The airline industry was deregulated back in 1978 and according Portfolio.com on June 12, the industry has a net loss of more than \$13 billion since that time. The stock prices of some of the major airlines also reflect the dire state of the industry. United, Northwest, Delta, and American all closed at less than \$7 per share as of the end of last week, according to Yahoo! Finance.

The high cost of energy is creating winners and losers in the stock market. Airlines have been one of the losers. We continue to work hard on your behalf to try to find the winners.

Returns through 6/13/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	0.8	-7.2	-9.8	5.4	6.2	3.6
NASDAQ Composite	-0.8	-7.5	-6.6	5.9	8.6	3.6
Standard & Poor's 500	-0.1	-7.4	-11.3	4.2	6.6	2.4

Sources: Yahoo! Finance, Barron's. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. Three-, Five-, and 10-year returns are annualized. Assumes dividends are not reinvested.

IF ATTENDEES of the Federal Reserve Bank of Boston's 52nd Annual Economic Conference held last week in Chatham, Massachusetts, were looking for an inflation sound bite in Federal Reserve Chairman Ben Bernanke's speech, it's likely they settled on: "The Federal Open Market Committee

will strongly resist an erosion of longer-term inflation expectations, as an un-anchoring of those expectations would be destabilizing for growth, as well as for inflation.” What the heck does that mean?

The Chairman may be setting the stage for an increase in interest rates. Some Fed observers believe we’ve reached the end of the rate-cutting cycle. Yet, Bernanke finds himself in the quintessential Catch 22. Drop rates lower and he delivers another blow to the plummeting global value of the U.S. dollar and opens the door for inflation here at home. Yet, can the weakened U.S. economy grow if he decides to let rates stay put?

Bernanke’s speech may signal that inflation worries have begun to offset concerns on how to fuel economic growth. For the consumer, however, the Chairman’s take away message was: Inflation has remained high largely due to sharp increases in the prices of globally-traded commodities, and likely will be accelerated by the latest round of increases in energy prices. Yet, according to Bernanke, the Fed is paying close attention to the extent to which consumers believe prices will rise in the future. That is, if consumers, investors, and business owners become overly concerned about inflation, they might change their purchasing decisions in ways that aggravate inflation, turning their worries into a self-fulfilling prophecy.

What does all the attention on inflation mean for the future of interest rates? Economic pros and cons aside, it’s a political factor that may impact the Chairman’s thinking most strongly. Americans head to the polls in November and, historically, Fed chairmen do not like to be seen as influencing the presidential elections. Accordingly, while interest rate increases could be on the horizon, they may not happen until after the new president takes office.

Weekly Focus – Financial Capital of the World

No, it’s not New York. According to the 2008 MasterCard Worldwide Centers of Commerce Index, London takes the top spot followed by New York, Tokyo, Singapore, and Chicago. Los Angeles slipped to #17 from #10 in 2007. Western Europe led the list regionally by claiming 10 of the top 25 cities. The cities were rated on the following seven key dimensions: legal and political framework, economic stability, ease of doing business, financial flow, business center, knowledge creation, and information flow.

Best regards,

The Advocate Group

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

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* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

- *Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
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