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Market Outlook:

<u>No more falling prices</u>

As the markets punctuated the mid-point of the second quarter last week with exhilaratingly exciting new highs and frustratingly agonizing down-drops in the averages, we are left to consider *"how high is up?"* When is this unabated valuation expansion likely to terminate? Since being safe is better than being sorry, it's probably a good idea to begin rebalancing portfolios away from "exhausted" sectors and into more (potentially) productive areas. My relative strength integers are indicating a short-term upside resistance point for many stocks.

Given our extraordinary appetite for risk-taking, and in stark contrast to many countries that have responsibly migrated *away* from over-consumption of natural resources, the US continues to look for ways to exploit its plentitude and to accelerate industrial production. As a result, domestic consumers and businesses are seeing an increase in prices that is likely to put pressure on pocketbooks for many years to come. In the past twelve months, costs for energy, food, and other "natural" resources scored their largest increase since the recession began six years ago.

No doubt, prices are always volatile, reflecting general conditions within the economy as a whole, and specific pockets of demand, in particular. **What we do know, however, is that a modest inflation trend is taking hold, even if conventional data reporting has not yet acknowledged i**t. Consider what it costs for a shopping cart of foodstuffs and you get the picture right away. (Are graham crackers and mallomars really getting *that* small, or is it my imagination?)

Anecdotally, we can sometimes gauge the condition of the economy by taking the car out for a weekend spin, shopping for groceries, or going to the local movie theatre.

From metals, to fuel, to food, to consumer goods, rising prices are cutting into corporate profit margins and household savings accounts. My cash flow analyses measure *less* discretionary capital in the economy than a decade ago, even as we watch our pennies (or attempt to) on our purchases. Given that stock prices trade predicated upon earnings expectations, these corrosive inflationary factors should have significant influence upon the velocity and duration of current sector trends for many months hence. While a debate might rage about *inflation* or *deflation* in the economy, price pressure is real, and forcing buyers to take a second look.

<u>Change is opportunity</u>

All of this might lead to significant investment opportunities in price sensitive, inflation-related equities, particularly **basic materials** and food/agriculture (**consumer non-cyclicals**). Today's investment landscape will change dramatically, according to my calculus, if/when the economy truly picks up steam; when pockets of good news turn into a full- fledged boom; and when interest rates reverse their monetary induced, "stimulus-driven" decline. We need to recognize, however, that there is a cost to bear, psychologically and remuneratively, for economic expansion. We need science and innovation to bail us out of our insatiable appetite for "stuff" and our moral imbalance of values.

In agrarian times, there was enough water, land, animals, and hunters to keep families fed and clothed. As the limit of food supply nears its limits generations later, we should consider how we make those adjustments to ensure the perpetuation of our current lifestyle.

Today, it's not only food that is dwindling in supply, but energy as well. The explosion in population growth rapidly depletes a finite supply of resources across the board, and forces innovation in science and research/development to make up any shortfall. These are not short-term phenomena. They are, as mentioned, intergenerational. It's not simply enough to get richer, fatter, consume more. It is about *sustaining* the quality of that growth for years to come.

From such discussion comes the seeds for portfolio opportunity. **A permanent feature of our efforts as portfolio managers, bull or bear market, must be to focus upon ideas which foster a better globe**. How we deal with these changing demographics will not only improve our quality of life, but also contribute to our portfolio capital gains potential.

A few weeks ago I asked how much we each might sacrifice, monetarily, for our "soylent-green" moment. Rarer, still, would be to consider how much we would give up *today* to make sure the "next guy" had his chance *tomorrow?*

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