

Chapin Hill Advisors, Inc.
Market Comment 4-2-07

The Bernanke Bind

Ben Bernanke's testimony to Congress last week illustrated the conundrum he is facing or the "Bernanke Bind". Mr. Bernanke is a firm believer in fighting inflation via Federal Reserve policy. His target comfort zone for inflation is between 1-2% while our current rate is 2.4%, well above his target. Yet a declining housing market, slowing economy and possible sub-prime bubble would indicate a need for a more accommodating Fed. We will continue to see Wall Street focus on every word from the Fed to determine if they are more concerned about inflation or the economy.

Last week oil hit a 7 month high as the capture of British sailors by Iran and the continued stand-off sent fears of increased violence in the Gulf. While the US does not use oil from Iran, the country does export 2.5 million barrels a day and cutting off this export would create havoc in that country. Oil hit \$66 mid-week and closed up 6% for the week while gasoline at the pump went past \$3.00 in many areas. Higher oil prices combined with a slower housing market and increased rates on home equity may be enough to finally dampen consumer spending.

However, betting against the American consumer in the past has been a fool's game. Many economists feel that as long as people have jobs, they will incur debt and keep spending. Employment historically follows housing starts by 12-15 months and we have had weaker housing starts for almost a year. If our employment picture starts to weaken, there will be concern that the ever-resilient consumer will tighten their pocketbooks, yet another concern for the economy.

Personal spending was up 0.6% and GDP grew faster than expected with a 2.5% rate in the last quarter of 2006. But corporate profitability was down to 0.8% and durable goods were revised to -9% for January and ex-aircraft a -1.2% for February. Our total debt as a nation grew to \$44.5 trillion or 331% of GDP. That is twice the ratio we had 30 years ago and the last time it approached this level was a 250% level during the Great Depression.

On Friday, the U.S. imposed sanctions on paper imports from China. The immediate effect was a large drop in the dollar. This will add to the challenge Bernanke faces as a weakening dollar makes our treasuries less attractive to China who presently hold \$350 billion of our IOU's.

The Dow Jones finished the week -1% while the S&P 500, the Nasdaq and Russell 2000 all finished -1.1% for the week. Most of the indices managed to eke out a small gain for the quarter. We are coming in to earnings season once again and the first quarter estimate is for 3.8% growth, the smallest since second quarter

2002. If estimates are revised down, stocks quickly become expensive a sales begin.

A Barrons' interview this past weekend with Larry Jeddelloh, the founder of The Institutional Strategist, an independent research group in Minneapolis, noted his insights into our markets. He is anticipating a 15-20% drop in US stocks this year beginning quite possibly in May.

Mr. Jeddelloh's concerns are similar to those I've written about in the past few weeks. The biggest concern is U.S. Credit, followed by an increasing energy crisis and Central Banks worldwide raising rates. He feels there will be no place to hide if a big correction happens – more than 3-5% - as we have highly correlated markets in the U.S. and overseas.

He states that in his experience working as a volunteer through his church with folks who got into financial trouble was that they would do anything to save their home. This colors his outlook and he believes that if we begin to see an increase in mortgage delinquencies, it means other areas of credit have already been hit – auto loans, student loans, credit cards. By the time the homeowner faces the prospect of losing their home, they have fallen very far behind on all their other debts. This will have a dramatic effect on creditors of all types.

On Monday morning, The Institute for Supply Management (ISM) reported slowing growth in manufacturing while price pressures continued. The ISM reported February manufacturing growth at 50.9 down from 52.3 in January and lower than the 51.4 consensus. The sub-index of prices grew to a 7 month high while employment and new orders slowed.

This continues to paint a picture of a slowing economy with rising inflation, adding to the Bernanke Bind. Stocks initially reacted negatively to the news and flip-flopped all day with a slight rise in most indices for the day.

As always, please call us or email us with questions or comments.

Who is Chapin Hill?

Chapin Hill Advisors, Inc. is a boutique financial planning and investment advisory firm, providing our services to high net worth individuals or business owners. We use the full range of investment products and employ a core and satellite strategy to better facilitate the implementation of specific strategies.

We pride ourselves on the delivery of great service. Our delivery of service is customized to the clients needs and includes quarterly reviews as well as regular communication based on what you desire.

The Chapin Hill Advantage

A unique, process-driven approach to financial advice that combines expert financial knowledge with high-touch service, resulting in a personal investment strategy that

leaves clients feeling confident and having “peace-of-mind”. We take the time to understand you prior to making any recommendations. Our planning process covers *The Seven Tenets of Planning*: retirement, education funding, risk management, cash flow/debt management, taxation, estate planning and investment management. Our process can determine your probabilities of success based on the most appealing scenario of your choice.

The Chapin Hill Advantage was created by our founder Kathy Boyle. She has over 15 years’ experience within national and regional investment banking and brokerage firms prior to founding Chapin Hill in 2000. Kathy is a regular commentator and guest on national television shows such as **CNBC’s** *Power Lunch*, **NBC’s** *Nightly Business News*, **ABC’s** *Businessweek TV*, **Fox’s** *Your World with Cavuto* and **Bloomberg** radio and personal-finance shows.

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