



Brookmont Capital Management Weekly Market Review

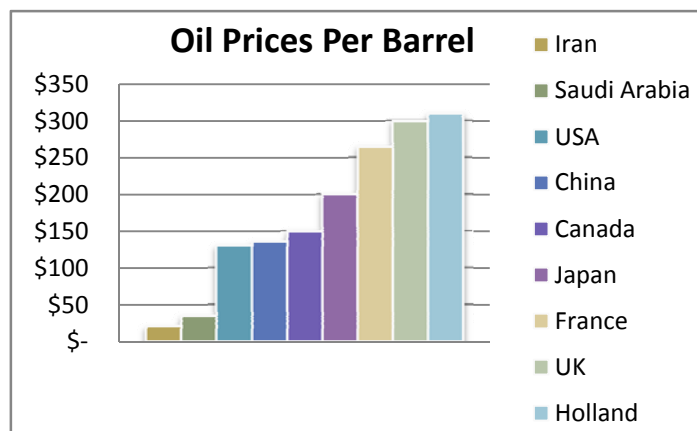
June 16, 2008

All About Prices

You may recall that only a few years ago, Alan Greenspan and Company was more worried about price DE-flation than economic growth, sub-prime mortgages, or overly optimistic home construction. Their fear was that the U.S. could fall into the same economic environment as the Japanese – years of very slow growth and ongoing consumer price deflation (stagnation). In retrospect, the Fed should have concentrated more on sub-prime mortgages, a giant bubble in housing prices, and how very short-term interest rates were not necessary to spur price inflation.

Fast forward to 2008 and we have become a nation that is obsessed about gas prices. It is mentioned non-stop on the TV news, on the front page of the paper, in conversations with friends and coworkers, and debated by Political Parties on who is to blame. A lot of collective energy (excuse the pun) goes into our complaints and worries about energy prices when we have ourselves to blame for much of the increase. The U.S. currently consumes 25% of the world's daily consumption of oil, yet we blame much of the problems on increased consumption by the Chinese. This is partly true as China now represents 15% of world demand for energy (oil, coal, etc) and will surpass the U.S. within five years as world leader in energy consumption.

In reality, we are blaming a country that is in a similar political environment that the U.S. witnessed a few decades ago. In the 1970's, the U.S. installed price controls on domestic oil production as a response to spiraling oil prices coming from OPEC countries. U.S. consumers faced much lower gas prices than did the rest of the world and had little incentive to conserve energy, buy gas efficient cars, use alternative sources of energy, etc. The Chinese economy and consumers are living under a similar environment today. State ceilings on domestic oil products in China led to a 15% increase in demand for gasoline during the first quarter of 2008. Just as U.S. consumers had little incentive to conserve energy in the 1970's, the Chinese populace sees little reason to do so in 2008.



% of U.S. Wages	
Japan	91.4%
Korea	80.4%
Hungary	25.3%
Mexico	11.8%
Brazil	10.7%
Peru	8.2%
China	4.9%
Thailand	4.6%
India	0.8%

Source: Smith Barney, GTZ, Int'l Fuel Prices

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While the Chinese economy continues to grow by leaps and bounds, its citizens are not sharing in the prosperity. More than 100 million Chinese citizens have become migrant workers since 1992 and earn far less than residents who live along the China Sea. In the most recent wage data, Chinese workers find themselves far below compensation levels in other Asian countries, as well as those in Latin America.

With the dramatic increase in commodity prices over the past year, we have to ask whether this is another bubble in asset prices or if this is the beginning of a long-term trend. It would not be the first time that oil prices have seen such a dramatic rise in a relatively short-time period. Oil prices jumped 400% (\$2 to \$12/barrel) between 1972-74 after the Yom Kippur War and the Arab Embargo. By 1981, the Iraq-Iran War pushed oil prices to \$42/barrel. Over the next 18 years, oil prices slid back to \$14/barrel as housing and cars became more energy efficient and a glut of oil supplies hit the global economies. There is no economic law that says it cannot happen again.

Commodities		Stocks			Housing		
	<u>1-Yr</u>		<u>1999</u>	<u>Since 01/00</u>		<u>Rise</u>	<u>Fall</u>
Oil	92%	Sprint	343%	-83%	L.A.	173%	-25%
Gold	68%	Nortel	304%	-97%	Phoenix	137%	-26%
Soybeans	63%	Yahoo	265%	-82%	San Fran	150%	-26%
Wheat	68%	Sun Micro	261%	-91%	Miami	180%	-35%
Corn	55%	LSI Logic	318%	-77%	Vegas	134%	-27%

In effect, our economy appears to move from one asset bubble to another. In the 1990's, it was technology and internet stocks. From 2001 to 2006, it was real estate. Since 2006, it has been energy and commodity prices. Each of these bubbles has created tremendous wealth for those who are early to the party and who know when it is time to go home. For the unfortunate investor who arrived fashionably late and overstayed his welcome...let's just say that's not a role to play in real life or with your portfolio.

Equity Markets

The markets were driven during the week by fluctuating oil prices, increased inflation fears, and renewed concerns coming from the Finance sector. The Dow Industrials posted a slight gain for the week as a positive report from McDonald's and Microsoft's failed merger attempt with Yahoo drove their stocks higher.

<u>Index</u>	<u>1 Week</u>	<u>YTD</u>	<u>1-Yr</u>
Dow Jones	0.8%	-7.2%	-9.8%
S&P 500	-0.4%	-7.4%	-11.1%
NASDAQ	-0.8%	-7.5%	-6.6%
S&P Mid-Cap	-0.9%	0.9%	-5.1%
S&P Small-Cap	-1.3%	-2.0%	-12.1%
EAFE (World)	-4.4%	-10.5%	-11.0%

The other indices were pushed lower during the week as specific company news (on average) was negative. Lehman Brothers reported dismal quarterly earnings and Key Bank drove all of the Regional Banks down when it was forced to cut its dividend by 50%. In the Health Care sector, Merck dropped another 5% and Bristol-Myers Squibb fell to a six-year low as concerns grew over its diabetes drugs.

U.S. Economy

The upcoming week includes several important reports on the U.S. economy. The markets are not expecting much from new home sales and the Leading Indicators report should show further weakness in the economy. The Producer Price Index will be the wildcard for the week. Economists predict that wholesale prices jumped 0.8% during the month, driven almost entirely by food and energy prices. If that number comes in above 0.8% (or above 0.2% core inflation), look for the Fed's

Upcoming Economic Data	
<u>Date</u>	<u>Item</u>
17-June	Producer Price Index
	New Home Starts
	Industrial Production
19-June	Leading Indicators
	Initial Jobless Claims

warnings that interest rate hikes are just around the corner.