

Second Quarter 2008

“A handful of patience is worth more than a bushel of brains.” - Dutch Proverb

It is said that the most valuable knowledge is “to know what you don’t know”. So we are spending a lot of time examining the questions to see if we can find answers.

A key question is: are we moving into inflationary times?

Inflation in the classic definition refers to a rise in the prices of a specific set of goods or services. However, a rise in prices of one set (such as food or oil) without a rise in others (such as wages) is not included in the original definition. We are seeing consumer spending constricting as Americans deal with the fact that two necessities are going up in price (oil and food) while real wages have remained stagnant. Under this definition: we are not in highly inflationary times.

Inflation as measured by mainstream economists, however, is defined as high rates of growth in money supply. One of the ways that the Fed has dealt with the current financial/banking crisis is to increase money supply in order to loan banks money to shore up their balance sheets. In the United States since 1995, the Federal Reserve has increased the broad money supply - whether measured by M2 or by MZM - almost 4% per annum faster than the growth rate of nominal GDP. Under this definition: we are in inflationary times.

GDP continues to grow, albeit very slowly. American industry continues to be profitable, certainly less so than a year or two ago, but considerably ahead of the profit levels reached in the “bubble years” prior to 2000. Exports are up and imports are down, helping our balance of payments. The Fed will probably not lower interest rates again in the foreseeable future. The weak dollar has caused oil prices to increase more in the USA than in Europe; the Saudi’s (etc) sell oil in dollars so they want to protect their purchasing power by getting more dollars relative to the euro.

American manufacturing orders are stronger than expected. We, in the USA, are adjusting to new times: towns in the Midwest are putting employees on 10-hour days to cut one day out of the commuting week. Commodity prices have increased to the extent that recycling “almost” pays for itself...and if the trend continues soon will. The yield curve has turned positive (banks get paid more for lending money long term than short term) and that has, historically, meant the economy is turning up.

But with the markets volatile and faced with so many conflicting indicators, FBB Capital Partners will continue to be cautious, and patient.

With “inflation” in mind this quarter FBB Capital Partners has made a donation to Metro Ferals, a volunteer organization established in 1997 to promote a non-lethal alternative to the “inflation” of the feral cat population, specifically “trap-neuter-return” in Virginia, Maryland and DC. www.metroferals.com.

Truly yours,

Susan Fulton