Delta Financial Advisors

June 2008

Economic Comments

Showing increasing awareness of growing inflationary pressures, Federal Reserve Chairman Bernanke has recently signaled that the central bank's rate cutting is likely over.

Driving the Fed's concern has been recent reports such as the Reuters/Michigan survey which indicated that households anticipate inflation to rise at greater than a 5% rate over the next year, the fastest projected growth rate in over 15 years. The key to having rapidly accelerating inflation, an issue that last arose in the United States during the late 1970s, is the belief by consumers that inflation is going to continue going up. This cycle is largely self re-enforcing as consumers factor these expectations into their purchasing decisions. It is crucial therefore, that the Federal Reserve takes action to ensure that this belief in accelerating prices does not become a key consumer assumption.

The above being said, the current inflationary environment remains interesting. Unlike the 1970s, current inflationary pressures are almost exclusively seen in energy and food prices. Core inflation (which expressly excludes historically volatile food and energy prices) remains at the same levels of 12 months ago and lower than reported rates of 2 years ago.

Over the last quarter, core inflation has slowed to a 1.2% annual rate suggesting that weak demand is having an impact on overall prices. With households having to expend sharply greater amounts on food and energy, simply put, there are fewer dollars available to spend on other goods. Also, we should keep in mind that the single largest component of inflation, as measured by the government's Consumer Price Index, is owners' equivalent rent, i.e. housing. With housing prices down nationwide more than 15% from their 2006 highs, a meaningful component of consumers' normal outlays has declined substantially.

In looking at other economic activity, U.S. productivity rose sharply to 2.6% in the first quarter as companies responded quickly to soft demand by shedding workers and cutting back on workers' hours. With much of the economy's current growth being generated by exports, productivity numbers were particularly influenced by exporting firms as these companies are typically more productive than the economy wide average. Meanwhile, labor costs grew at their slowest annual pace since 2004 giving some comfort to the Federal Reserve about wage inflation.

Gross domestic product estimates for the 1st quarter were revised upwards to a still anemic 0.9% growth. Driving the revision was a better than expected trade balance and increased business spending. Durable goods continued to act as a drag on the economy as they showed a 0.5% decline in April. This news, however, was not as bad as originally expected. Excluding transportation items, production of these long lived assets actually showed its largest gain in nine months.

One key piece of economic news has recently turned ugly with May's unemployment rate jumping by ½ percentage point to 5.5%. The month's move was the largest jump since February 1986 and left joblessness at the highest level since October of 2004. While payroll losses of 49,000 positions were not as bad as expected, employers have now cut their headcount for five consecutive months. The collapse in the housing market continued to have its way as housing related sectors showed the steepest job losses.

Echoing the recent unemployment report was the reading from the University of Michigan consumer confidence index which hit its lowest level in 28 years. An important component of this pessimism has been resurgent energy prices with oil now costing in excess of $130/barrel, or up more than 100% over last year's levels. Driving recent increases has been the inability of oil consumers to sharply reduce demand in the short-term. However, the impact of current prices on consumption is starting to be seen as U.S. domestic consumption of oil for the 1st quarter showed its first decline in more than 10 years.

The economy remains in uncertain waters. The recent jobless report casts new doubts on our ability to avoid a recession. The recent surge in oil prices is doing naught to help the situation. Despite these current issues, we remain confident that the economy will successfully weather the storm over the next several quarters and re-commence its historical trend of robust growth.

Market Comments

During May, the S&P 500 and NASDAQ showed modest gains while the Dow Jones Industrials lost some ground. Financials remained the month's dark horse with meaningful losses as all other sectors showed at least slight gains. Leading the

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Performance as of 05/31/08

	Close	***Month***	***YTD***	***1 Year***
DJIA	12638.32	-1.10%	-3.71%	-5.03%
S & P 500	1400.38	+1.30%	-3.80%	-6.69%
NASDAQ Comp.	2522.66	+4.55%	-4.87%	-3.14%

	Month end yld.	***Prior Yr. end yld.***	***12 mo. prior yld.***
10 yr. U.S. Treasury	*4.05%*	*4.03%*	*4.89%*

pack were the technology and materials sectors as some of investors' recent pessimism waned.

Bond yields showed some improvement as fixed income investors started to give additional focus on inflationary pressures with intermediate Treasury yields rising to their highest levels since late last year.

Reported inflation, while not at historically high levels, is still above those levels seen in recent years. A frequent concern of investors is the impact of rising prices on their portfolios. The issue to keep in mind is that the presence of inflation usually indicates that companies are successfully being able to pass along price increases to their customers RATHER than having to absorb the cost increases and the associated diminished profit margins.

A second key point is that while inflation is not necessarily good news for stocks, it is far less good news for bonds. Since 1926, stocks outperformed bonds by more than 4 percentage points (6.9% versus 2.8%) in those years where inflation was measured to be greater than 4%. This statistic, in our opinion, is more important in highlighting the benefit of a diversified portfolio rather than the superiority of stocks over bonds.

While recessionary concerns have slightly abated, there are meaningful issues continuing to face the market from the continued credit crunch, increased unemployment and soaring energy prices. Nonetheless, we believe that now is a good time to be investing. The crucial caveat is that investing requires a long-term horizon and clearly articulated goals.

Analyst Corner

As alluded to earlier, the financial sector continues to struggle with the enormous mortgage/credit related losses being incurred by financial institutions. Through month end, the sector's stock market losses of 15% were more than 50% greater than the next worst performing market sector.

Driving financials' exceptionally poor stock performance has been the expected 18% decline in the sector's earnings for fiscal 2008. We continue to evaluate our clients' holdings in this area and will take those actions that we feel most appropriate.

Planning Thoughts

In assessing their financial risks, people usually move to insure their largest financial risks, typically related to their houses, dying (i.e. life insurance) or medical care. Often however, an individual's largest asset, their future earning power, remains uninsured.

The means of insuring this loss is through long-term disability insurance. While many people purchase life insurance, they are not aware that during their working years they are several times more likely to leave the work-force due to disability than death.

Many large employers offer this insurance but it is much less common in smaller firms. If premiums are purchased with after-tax dollars, all insurance payments in the event of disability are tax free. With taxes typically running (including Social Security and income taxes) at least 30% of earned income, most disability policies are written to have annual benefits equal to 65%-70% of pre-disability earnings. If your employer does not offer this benefit, it can be purchased through insurance agents on a stand alone basis.

If you do not currently have this type of insurance coverage and would like our help in evaluating your potential needs, please give us a call.

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