

STOCK WORLD WEEKLY

THE EXECUTIVE'S SUMMARY | OF THE GLOBAL MARKETS

Dow Jones	12,391 (+1.0%)
S&P 500	1,343 (+1.0%)
NASDAQ	2,834 (+0.9%)
NYSE	8,508 (+1.6%)
Russell 2000	834 (+1.5%)
Oil	86.05 (+0.7%)
Gold	1,388 (+2.0%)

THIS WEEK'S NEWSLETTER:

MONDAY MARKET MOMENTUM - PRICES GO PARABOLIC

MIT's Billion Prices Project shows inflation higher than reported

TESTY TUESDAY - DARING US TO BUY THOSE DIPS AGAIN

January Retail Sales report disappoints

WHICH WAY

WEDNESDAY - 1,333 OR BUST

FOMC minutes boost markets

FANDANGO THURSDAY - DOES ANYTHING REALLY MATTER?

Equities and commodities climb as Dollar drops

TGIF - HOLDING THAT 100% LINE WOULD BE NICE

Apple drops on Steve Jobs health rumor

THE WEEK AHEAD

BONUS SECTION: WEDNESDAY'S FOMC MINUTES WITH COMMENTARY BY PHIL

On Wednesday, February 16, the [Federal Reserve Open Market Committee](#) released the minutes of its most recent meeting. The transcript shows that the Federal Reserve is still unconcerned about inflation, in spite of significant evidence to the contrary. In fact, the Fed is so unconcerned about inflation that it needed to mention "inflation" 49 times in its report. The minutes also revealed that the Fed expects the jobless rate to remain "elevated" at the end of 2012, even though it claimed a rising real GDP might slowly reduce unemployment.

Considering the trillions of dollars the Federal Reserve spent continuing its quantitative easing program (the current round being "QE2"), its admission that the jobless rate will remain elevated for the next two years is sobering. The Fed has no means to fix the problem of joblessness, besides trying to stimulate the economy by flooding it with liquidity, or "printing money," thereby devaluing the Dollar. Devaluing the Dollar is contrary to the Fed's mandate for price stability. Printing money decreases the value of the Dollar, and makes saving Dollars less desirable. Instead, those Dollars chase assets such as commodities and stocks, driving up their prices. Moreover, quantitative easing has done little to boost employment.

Instead of creating jobs, Federal Reserve Chairman Ben Bernanke's liquidity tsunami is triggering price inflation in necessities such as food and energy and, as [Stock World Weekly](#) has been reporting, fueling the stock market's "Idiot-Maker Rally." Whether the Fed calls rising commodity and energy prices "inflation" or not, higher prices are higher prices, and hurt lower income people the most.

"For more than 30 years, the Fed has been tasked with a so-called dual mandate, which outlines two important goals: keep prices stable and maximize U.S. employment... Some critics are sick and tired of the Fed prioritizing job creation at the risk of rising prices. They say the juggling act of promoting economic growth while staving off inflation has proven ineffective, and has led to a policy of too much cheap money with dangerous

consequences for the economy.” (Republicans to Fed: Forget about jobs.)

The Fed’s strategy to devalue the Dollar has led to a “backlash among conservatives,” who wish to eliminate the Fed’s mandate to maximize employment. Theoretically, this would allow the Fed to stop pummeling the Dollar, while reining in the price inflation that is wreaking havoc on other countries.

With interest rates at effectively zero, the Fed has no plausible options for addressing unemployment in a stagnating economy. The net result is a situation in which the Fed is committed to continuing quantitative easing, at the expense of the Dollar and its mandate for insuring price stability. It has every motivation to diminish any news that indicates inflation is taking off. Acknowledging inflation would mean the Fed would have to put down its only remaining tool.

Commenting on the Fed’s minutes, Phil wrote, *“It all comes back to inflation. The Fed simply doesn’t believe it exists or, if it does, believes it won’t last. It can’t really*

lose. The Fed can only be wrong this meeting and then do nothing and wait until next meeting and then ‘reevaluate.’ This is how hyperinflation happens, governments don’t want to deal with inflation. They wait and wait until it is so obvious and terrible that drastic action needs to be taken.” (FOMC minutes with Phil’s commentary are in the bonus section at the end of this newsletter.)

Last week, we became more bullish, considering the relentless move up in stocks: “Our market targets, breakout 2 levels, and major breakout levels are providing more bullish fuel to our market thesis.” We pointed out that the U.S. bond markets were reacting to inflationary concerns, resulting in Treasury-bond yields rising and bond prices falling. *“With bond yields climbing, rising commodity prices, and rising food prices causing social and political instability, inflation cannot be ignored. It has become a key factor to keep in mind while considering investment and trade ideas.”* We noted that the Baltic Dry Index had bottomed around February 4. This week, the Baltic Dry Index continued to rise, while Treasuries, and the Dollar, continued to decline.



We also mentioned several trade ideas such as a bullish call spread on Coke (KO) and our “Breakout Defense Part Deux” portfolio. Our bullish positions continue to do well. Coke ended the week at \$64.55, putting our bullish spread on KO into the black.

We remain concerned about the effect of QE2 on the value of the Dollar, but as Phil wrote on Saturday, “the Fed’s current permanent open market operations (POMO) schedule runs through May and we’ve gotten very clear indicators that The Bernank is in ‘Damn the torpedoes and full speed ahead’ mode.”

Monday Market Momentum - Prices Go Parabolic



Monday was a mixed day for the markets, with most indexes we track ending up. The Dow, however, was dragged down by [Wal-Mart being downgraded to neutral from overweight](#) by JP Morgan.

2/14/11	Dow	S&P	NAS	NYSE	RUT
TODAY	12,268	1,332	2,817	8,405	826
PREVIOUS	12,273	1,329	2,809	8,374	822
% CHANGE	-0.04	+0.24	+0.28	+0.36	+0.46

The [Billion Prices Project at the Massachusetts Institute of Technology](#) is an academic project that collects prices from hundreds of online retailers around the world. The project monitors daily price fluctuations of approximately five million items sold by approximately 300 online retailers in more than 70 countries. The goal of the project is not to predict inflationary trends, but to provide real-time information on current trends. It has been publishing daily updates since October of 2007.

The chart below shows that the current online price index for the U.S. is now at 102.377, up from 100.549 just two months ago.

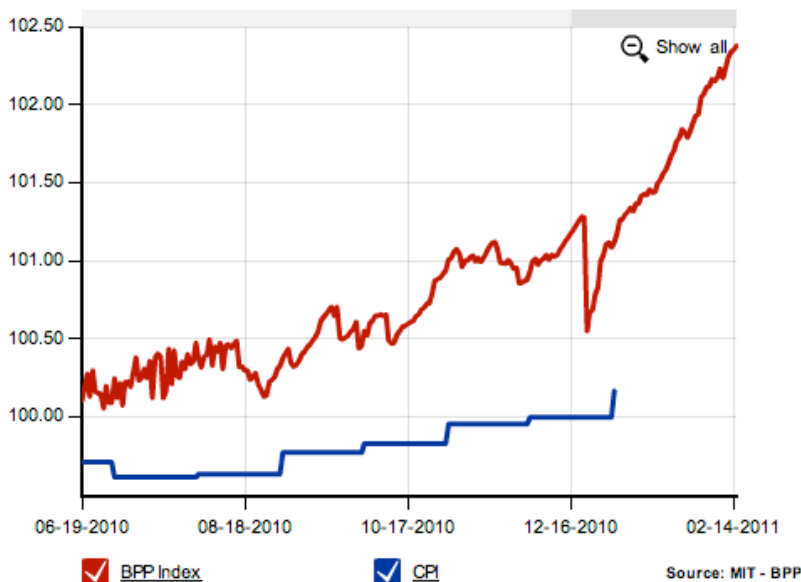
Prices have gone up nearly two percent in two months, which translates to an annual inflation rate of over 10%. This estimate is in contrast to the conclusion reached by Ben Bernanke, who [testified before the U.S. House of Representatives Committee on the Budget](#) last week and maintained that inflation in the United States was not only low, but had actually dropped over the last 12 months, from 2.4% a year ago to a current rate of only 1.2%.

Inflation is the key premise for any plausible bullish argument for the markets. Fundamentals, earnings and valuations of stock are not compelling reasons for continuing the rally. Even on the short side, the best argument against shorting momentum stocks such as Priceline (PCLN), Netflix (NFLX) and Chipotle Mexican Grill (CMG) is the potential effect of inflation upon these positions.

When asked whether pursuing NFLX as a “focus short” (a short position to stick with and roll along over time), Phil wrote: *“NFLX is NOT a stock you want to press short into inflation. Neither is PCLN. PCLN collects a fee and outsources its labor so costs are relatively fixed. The models can be gamed by inflation.*

CMG, on the other hand, has a wider distribution and suffers margin pressure from time to time. Rising local labor costs can be very painful - that’s the kind of business model where an eventual selloff is likely. But, in a real inflationary environment, it’s hard to bet against anything other than utilities and insurance which have regulated charges and often can’t get increases fast enough to keep up.”

In an email alert to Members Monday morning, Phil wrote, *“David at Sabrient had a good idea in the evening post on Archer Daniels Midland Company (ADM). It*



is lagging its peers in the space and is a solid long-term company with a low p/e (12) and a 1.8% dividend. To play conservatively, you can buy the stock for \$36.65 and sell the Jan 2013 \$30 calls for \$8.75 and the Jan 2013 \$35 puts for \$5 and that's net \$22.90/\$28.95."

This is an example of a buy/write strategy. We get a 37% discount in buying the first round of stock, with a 21% cushion (built in hedge). The trade off is that we limit our upside to 31%. (To learn more about how the buy/write strategy works, click on ["How To Buy A Stock For A 15-20% Discount With Our Buy/Write Strategies."](#) Please visit our [education section](#), and members may also access our [strategy section](#).)

Using the buy/write strategy, we buy the first half of our position (round 1) at the initial discounted price and understand that we may buy the second half (round 2) at the lower price if the stock drops below the strike price of our sold puts.

What does "net \$22.90/\$28.95" mean when discussing a buy/write? \$22.90 is the price of the stock on the first round minus the credit gained by selling the call and the put. In this example, it is \$36.65 minus \$13.75 (sold call for \$8.75 + sold put for \$5 = \$13.75), which equals

\$22.90. This is the initial outlay for the position, the price of the stock minus the options premium credited back to us. If the price of the stock drops below the strike price of the sold put, we will be obligated to buy more stock at a lower price at options expiration - i.e., the stock will be "put to us."

The second number, \$28.95 is the average cost of the two rounds of stock, if the second round is put to us. In this case, the first half, round 1, cost \$22.90, and round 2 will cost \$35. Hence, our average price will be \$28.95 (\$22.90 plus \$35, divided by 2) if ADM closes below \$35 at options expiration. If this scenario plays out, we will have purchased our full position for an average price of \$28.95 even though ADM was trading at \$36.65 when we first entered the position - that's a 21% discount on our full position.

If ADM closes above the call's \$30 strike price at options expiration, our net entry of \$22.90 will be called away at \$30, for a \$7.10 profit. We will make a \$7.10 profit on an initial investment of \$22.90 - a 31% gain on the first round.

What if ADM closes above \$30 but below \$35 at options expiration?

That would cause ADM to be put back to us at \$35. Since we made \$7.10 on the initial round of the stock that was called away, our new net on another round would be \$35 less the \$7.10 profit, giving us a new basis \$27.90 on a new round 1.

ADM had a good week, with the stock closing on Friday at \$37.65, up over a Dollar from where Phil first suggested it.



Testy Tuesday - Daring us to Buy those Dips Again

Some things are seen only on rare occasions, like a “blue moon” or a royal wedding. Tuesday was one of those days. All five indexes we track down were down, even though \$6.689Bn was dumped on the markets through the Fed’s permanent open market operations (POMO).

The Bureau of Labor Statistics reported that the January retail sales numbers came in up 0.3% versus an expected increase of 0.6%. This disappointment, combined with a revision of December’s number to 0.5% from the previously reported 0.6%, weighed heavily on the markets. These numbers are NOT adjusted for price changes (inflation).

2/15/11	Dow	S&P	NAS	NYSE	RUT
TODAY	12,227	1,328	2,804	8,405	820
PREVIOUS	12,268	1,332	2,817	8,405	826
% CHANGE	-0.34	-0.32	-0.46	-0.26	-0.71

The February Empire State Manufacturing Survey also came out on Tuesday, and while the numbers showed a nominal improvement in the economy, further analysis quickly revealed that any gain was attributable to inflation.

The European debt crisis has not disappeared, although with widespread riots and revolutions lately, the Euro story has been pushed to the back pages. On Tuesday, finance ministers in the Euro-zone agreed to create a new “European Stability Mechanism” (ESM) to replace the current “Euro Rescue Fund.” The new ESM fund will be set up in 2013, and will total €500Bn, double the size of the current Euro Rescue Fund. The fact that the U.S. Dollar does not have a similar fund for its 50 states, many of which are experiencing serious financial crises, was not lost on investors, and

helped to knock the Dollar down to 78.4 on Tuesday.

We have been skeptical of this rally, but now that we have confirmation above our breakout lines, we are more comfortable making bullish plays. We even recommended a trade idea Tuesday in Member’s Chat based on going long(!) Netflix (NFLX), albeit a quick in-and-out day-trade that we profitably exited Wednesday morning. We still have no real faith in this stock as a long term investment.

“I’m sorry but I’m laughing while I’m writing because now I’m looking at the February Empire State Manufacturing Survey, which shows 15.43 vs. 15 expected. Wow! That’s cool! Things must be picking up, right? Was it the employment component that gave us a lift? No, sorry, employment was 3.61, down from 8.42 in December. Then it must have been New Orders, right? No, sorry again, new orders fell to 11.8 from 12.39. Well, no prize now as, obviously, it must have been PRICING and yes, prices jumped 6.8% in the last 30 days from 15.79 in January to 16.87 this month. Rising prices overrode the declining employment and orders to give us a 3.3% gain. Isn’t this BRILLIANT? Almost 50% of our inflation drops down to the bottom line. I’ll bet if we can get inflation up over 100% then we can pop the markets a good 50% - what do you say? Who’s with me? Yes, Ben - you can put your hand down, I was already counting on you...” - Phil

Which Way Wednesday - 1,333 or Bust!



Wednesday was an up day for the markets, shaking off Tuesday's losses and powering up in the wake of predictions of upbeat growth forecast by the Fed in its minutes of the Open Market Committee.

2/16/11	Dow	S&P	NAS	NYSE	RUT
TODAY	12,288	1,336	2,826	8,454	828
PREVIOUS	12,227	1,328	2,804	8,405	820
% CHANGE	+0.50	+0.63	+0.76	+0.84	+1.02

1,333 is the number that Art Cashin is using on the S&P 500 as a breakout line, which represents a 100% gain from the low of 666.79. As Art Cashin put it, "Everyone's got this psychological area of 1,333 - they want to prove that we can double where we were from the panic lows. So later in the week, the bulls are going to circle the wagons and take another shot at it, and that will tell us whether it's a rest and recoup or not."

With everyone being very bullish, with every indicator pointing towards the markets being able to go up no matter what, we feel compelled to present Giordano Bruno's explanation of "How to Fake an Economic Recovery."

Giordano Bruno's article presents a step-by-step guide for fabricating an economic recovery out of thin air. One of these steps is to NOT count the unemployed, but instead discount them at every opportunity. Tighten the definition of who is "officially" unemployed, with the sole purpose of reducing the total number counted, then trumpet the results as being "proof" of a "recovery."

It is also important to keep equity markets happy and swimming in free money. As Giordano writes, "QE measures are all 'above the board,' and all is well in Bernanke's Mayberry. A

question arises here though that desperately begs to be answered; if the stock market's meteoric rise from near destruction to the 12,000 point mark is 'real,' and completely in tune with a legitimate recovery, then why is the Fed still keeping interest rates at near zero after almost three years, and why are they continuing quantitative easing measures? Could it be that without constant liquidity injections from the Fed, the stock market would once again collapse like a wet paper sack?"

Inside Member's Chat:

Cap posted: "The Fed's BS makes me want to throw up. If we have a moderately strong recovery, with the Fed's BS creating jobs, and inflation low (ha) and low risk for double dip recession, THEN WHY IS THIS NECESSARY?"

(From the FOMC minutes) "In addition, the Committee reiterated its expectation that economic conditions were likely to warrant exceptionally low levels for the federal funds rate for an extended period."

Phil replied: Excellent point. The Fed contradicts itself, and the mainstream media not only fails to call the Fed out on it, but is perfectly willing to report the conflicting statements in giant headlines on alternating days. And there's another thing about the budget projections - they assume the government continues to pay an average of 2.5% interest on debt rather than the 7% Greece, Portugal and many others pay. At least they are backed by a more solvent Germany. Who is backing us? 7% of \$15Tn is \$1Tn a year in interest payments vs. \$400Bn now. Not that it matters, as we don't pay the \$400Bn either - we just borrow more money. Doesn't that make anyone who is lending us money an idiot?

Fandango Thursday - Does Anything Really Matter?



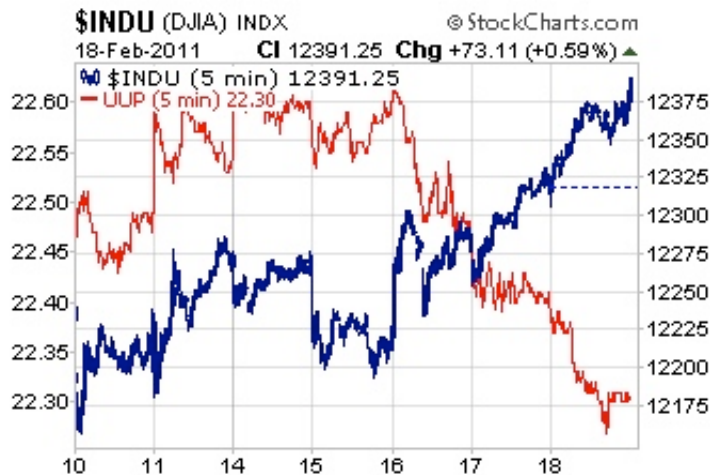
Stocks moved up on Thursday as a strong report from the Philly Fed boosted investor sentiments, outweighing somewhat higher jobless claims and consumer prices. Commodities were also up, with gold, silver and oil all posting gains for the day.

2/17/11	Dow	S&P	NAS	NYSE	RUT
TODAY	12,318	1,340	2,832	8,497	834
PREVIOUS	12,288	1,336	2,826	8,454	828
% CHANGE	+0.24	+0.31	+0.21	+0.52	+0.68

Phil discussed the ramifications of Wednesday’s Fed minutes. The overriding theme was “Inflation? What Inflation?” With the power of POMO in near-daily injections of billions of Dollars, we are now openly wondering if anything at all matters to the equity markets. Has the U.S. Stock market been taken hostage by the Fed’s massive liquidity injections and maniacal crushing of the Dollar?

As we noted in last week’s [Stock World Weekly](#), there was a break from our usual pattern of “when the Dollar pops, the markets drop,” and vice versa, which we interpreted as a bullish signal. However, the pattern seems to have re-established itself this week, with a strong move down in the Dollar being matched by a strong up move in the markets, as you can see in our INDU versus UUP (Dollar Proxy) chart above.

Phil posted a trade idea in Member’s Chat Thursday morning: “Let’s add 5 USO March \$36 calls for .95 (\$475), those were \$1.50 last week and we do want to double down or roll if they go lower.” On Friday Phil followed up with “Well, USO did what it pretty much always does when the Fed is giving away money (as discussed in yesterday’s morning post). It went up all day and those March \$36 calls jumped 26% on the day, finishing at \$1.17.”



We also posted a new trade idea for the \$25,000 to \$100,000 portfolio (AKA \$25KP) based on FAS. As of the close of markets on Friday, the \$25KP was up to \$26,434, a gain of 5.7% since January 31.

“We tend not to have 2 day meetings discussing things that don’t exist. We do have two day meetings *PRETENDING* we have problems under control. Companies do this all the time. Ben would not know this because he has never run a company and neither have the majority of Federal Reserve Members. What they run, at the moment, is a printing press where they can redistribute the nation’s wealth with the stroke of a pen to whoever they choose. *Not surprisingly, given their origin, they choose to distribute our wealth to their own Member Banks who use it like JP Morgan does, to play the stock market and ring up \$19Bn worth of trading profits in 2010. At the same time, they run the price of - well, everything, up 50 to 100% - destroying millions of lives and toppling governments in the process.*” - Phil

TGIF - Holding that 100% Line Would Be Nice

Stocks continued on their upward trajectory on Friday, an options expiration day, as the Dow rallied to levels not seen since June 2008. The Dollar dropped sharply during the day, continuing it's downward trajectory and finishing the week at 77.6, down from Monday's high of 78.8.

2/18/11	Dow	S&P	NAS	NYSE	RUT
TODAY	12,391	1,343	2,834	8,508	834
PREVIOUS	12,318	1,340	2,832	8,497	834
% CHANGE	+0.59	+0.19	+0.08	+0.12	+0.10

The Philadelphia Fed released its [February 2011 Business Outlook Survey](#), noting that, *“Price increases for inputs as well as firms’ own manufactured goods were more widespread again this month. Sixty-seven percent of the firms reported higher prices for inputs, compared with 54 percent in the previous month. The prices paid index, which increased 13 points in February, has now increased 55 points over the past five months. On balance, firms also reported a rise in prices for their own manufactured goods. The prices received index increased 4 points and has steadily increased over the past four months. Twenty-nine percent of firms reported higher prices for their own goods this month, compared to 26 percent in January.”*

In other words, manufacturers are being forced to pass along higher prices as their margins are getting increasingly compressed. The consequent inflation is resulting in food riots, massive demonstrations and destabilization of governments [around the world](#). The political unrest and riots have led to violence and deaths in [Bahrain](#), [Yemen](#), [Libya](#), [Iraq](#) and, still, [Egypt](#). Bernanke's failure to even acknowledge the turmoil that other parts of the world are bitterly experiencing is quite stunning.

Two revolutions have been directly sparked by inflation in food prices (Tunisia and Egypt), as economic pressures help bring long-simmering

grievances into the open. Protests are now breaking out every week. Protesters in Bahrain were [confronted by tanks and shotgun-wielding riot police](#). The conflict claimed at least six lives and left scores of protesters wounded after police fired upon unarmed demonstrators. Protestors also faced off against government forces in Libya, Yemen, Iraq and Iran, as civil unrest unleashed by the forces of inflation rampaged across the globe.

The National Enquirer ran a story showing a [photo of a sickly, frail older gentleman entering a cancer clinic](#). It represented him as possibly being Steve Jobs. It then quoted an opinion from a doctor who, based solely on the picture, concluded that this person had about six weeks to live. Steve Jobs was [later photographed at a dinner meeting](#) with President Obama and several other technology tycoons, so it would appear the rumors of his impending demise are premature.

Regardless of the dazzling array of problems with the story, Apple stock dropped on the rumor, losing \$14 a share from Wednesday's high of \$364.83 to Friday's close at \$350.56. How's that for responsible journalism?

Inside Member's Chat:

Amatta posted: *“Phil what play do you like (long term) on APPL after this nonsense?”*

Phil replied: I like the same spreads we have been doing for weeks, selling long deep puts and buying bull call spreads. You can sell the 2013 \$250 puts for \$19 and buy the 300/360 bull call spread for \$29. That's net \$10 on the \$60 spread which is currently \$53 in the money. Your worst case is owning AAPL at net \$260. How easy is that?

The Week Ahead

Commodity prices have been soaring (see charts below). Critical commodities such as copper, cotton, sugar, soybeans, corn and wheat are all up sharply since last September, with cotton skyrocketing from 20.0 all the way to 49.12, an increase of over 145%!

Inflation is resulting in food riots, massive demonstrations and the destabilization of governments [around the world](#). China has also been hit hard by rising commodities prices. As we reported on [January 16](#), the Chinese character “Zhang,” meaning “rapid price rise,” was voted “[Character of the Year](#)” in an online poll. The New York Times reported that [inflation was taking a toll on Chinese exports](#), as Western buyers are balking at higher prices and cutting back on their purchases.

Chinese exporters are dealing with the twin pressures of growing demands from China’s labor force and rapidly rising input costs. Discussing the source of increasing commodity prices and the latest spike in cotton prices, Sharon Johnson of Penson Futures remarked: *“I cannot say this clearly*

enough...this is not mill buying, mills cannot buy at these prices.” If mills are not driving the price demand, this leaves only speculators as a source. ([Chinese Exporters Going Down, Western Importers Ambushed.](#))

Real estate prices are also rising in China, despite property curbs designed to keep housing prices affordable. These measures include raising the minimum down payment for second-home purchases, instructing local governments to set price targets for new properties, and introducing new taxes for residential homes in Chongqing and Shanghai. The Chinese central bank also [raised interest rates on February 8](#), the third interest rate increase in four months.

The Chinese labor market is demonstrating a new militancy over working conditions and wages. [China-briefing.com](#) reported that migrant workers are refusing to return from their New Year vacations unless their demands would be met. Companies are taking note. Premium leather-goods brand [Coach said it would gradually slash production](#) of handbags



and wallets in China and shift to lower-cost countries like Vietnam and India. However, this strategy is problematic. [New Delhi just pushed through wage increases of 17% to 30%](#) for National Rural Employment Guarantee Scheme workers, in a response to food price inflation.

Our major breakout levels are still all in the green, with all five of the indexes we track being solidly above our major breakout level targets. Three of those five indexes, the S&P 500, the Nasdaq and the Russell 2000 are comfortably above our 100% targets.

Inflation is overriding other concerns about the global financial markets. Our investment decisions now have to be looked at through “inflation glasses” to see if they makes sense in an increasingly inflationary environment.

The tidal flows of U.S. Dollars unleashed by quantitative easing have worked their way into the world’s markets, driving up prices with far-reaching and intensifying effects. Inflation has become our number one concern for the global economy.

Going forward into next week, we still see bullish momentum driving stock prices higher in the face of difficult situations brewing all over the world. We are currently allocated at 20% bullish, 15% bearish, and 65% in cash.

Our first trade idea for next week comes from Dark Horse Hedge. The [Dark Horse Hedge \(DHH\) virtual portfolio](#) combines information from [Sabrient's](#) stock ranking system with options strategies devised by Phil. Scott Brown of Sabrient chose to short School Specialty Inc. ([SCHS](#)) in the DHH virtual portfolio on Friday. SCHS is in the bottom quartile of Sabrient’s rankings, and its recent earnings report was not very impressive. Headlines read, “[School Specialty reports higher 3Q loss,](#)” yet investors bid the stock up almost 20%. Reacting to the 20% melt-up, Scott decided SCHS would be a reasonable short to balance with [DHH's virtual long positions.](#)

For our second trade idea, Pharmboy submitted Array BioPharma Inc. ([ARRY](#)) as an interesting long candidate. ARRY is a biopharmaceutical company focused on the discovery, development and commercialization of targeted small molecule drugs to treat patients with cancer and inflammatory diseases. Currently, the stock is trading at 2.81. Pharmboy believes it could gain coverage, particularly over its [EGFR, MEK and other inhibitors](#) in the cancer space. Array has teamed up with the biggest names in the cancer business, including AstraZeneca, Celgene, and Roche/Genentech. Pharmboy is currently long ARRY and thinks it represents a good speculation in biotechnology.

Watching Must Hold Levels

2/20/11	Dow	S&P	NAS	NYSE	Russell
UP 100% (RUT 133%)	12938	1332	2530	8632	800
MAJOR BREAKOUT LEVELS	12000	1300	2750	8250	800
BREAKOUT LEVEL 2 (MUST HOLD)	11600	1260	2675	7935	800
BREAKOUT LEVEL 1	11500	1220	2600	7750	725



Special Bonus Supplement - Wednesday

Fed Minutes and Commentary



Editor's Note: Below is the "Authorization for Domestic Open Market Operations" as released by the Fed on January 12. Phil uses colors in the text of the FOMC minutes to indicate what he sees as positive (green) and negative (red) for the economy. Phil's comments (blue) appear in this section in quotes and bold Italics.

AUTHORIZATION FOR DOMESTIC OPEN MARKET OPERATIONS

(Reaffirmed January 25, 2011)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

A. To buy or sell U.S. government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. government and federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; and

B. To buy or sell in the open market U.S. government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, for the System Open Market Account under agreements to resell or repurchase such securities or obligations (including such transactions as are commonly referred to as repo and reverse repo transactions) in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive

bidding, after applying reasonable limitations on the volume of agreements with individual counterparties.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee **authorizes the Federal Reserve Bank of New York to use agents in agency MBS-related transactions.**

3. In order to ensure the effective conduct of open market operations, **the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. government securities and securities that are direct obligations of any agency of the United States, held in the System Open Market Account, to dealers at rates that shall be determined by competitive bidding.** The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids that could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

“ In other words, they are authorized to give **FREE MONEY** to the Gang of 12, who will then do their bidding.

4. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York and accounts maintained at the Federal Reserve Bank of New York as fiscal agent of the United States pursuant to section 15 of the Federal Reserve Act, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York:

A. For the System Open Market Account, to sell U.S. government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, to such accounts on the bases set forth in paragraph 1.A under agreements providing for the resale by such accounts of those securities in 65 business days or less on terms comparable to those available on such transactions in the market; and

B. For the New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1.B, repurchase agreements in U.S. government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, and to arrange corresponding sale and repurchase agreements between its own account and such foreign, international, and fiscal agency accounts maintained at the Bank.

Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

5. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee **authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate and to take actions that result in material changes in the composition and size of the assets in the System Open Market Account other than those anticipated by the Committee at its most recent meeting.** Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the

Chairman, if feasible, will consult with the Committee before making any adjustment.

By unanimous vote, the Authorization for Foreign Currency Operations, the Foreign Currency Directive, and the Procedural Instructions with Respect to Foreign Currency Operations were reaffirmed in the form shown below. The vote to reaffirm these documents included approval of the System's warehousing agreement with the U.S. Treasury.

“ That is a TREMENDOUS amount of authority for the NY Fed President, Bill Dudley, who spent 21 years at GS before taking this job over from Timmy. There's a very dull section on Foreign Currency exchanges I'm skipping.

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets during the period since the Federal Open Market Committee (FOMC) met on December 14, 2010. He also reported on System open market operations, including the continuing reinvestment into longer-term Treasury securities of principal payments received on the SOMA's holdings of agency debt and agency-guaranteed mortgage-backed securities (MBS) as well as the ongoing purchases of additional Treasury securities authorized at the November 2-3, 2010, FOMC meeting. **Since the first purchase schedule was released after the November FOMC meeting, the Open Market Desk at the Federal Reserve Bank of New York purchased a total of \$236 billion of Treasury securities.** These purchases included \$69 billion associated with the reinvestment of principal payments on agency debt and MBS and \$167 billion associated with the expansion of the Federal Reserve's securities holdings. **The maturity distribution of the Desk's purchases resulted in an average duration of about 5-1/2 years for the securities obtained.** The Manager reported that given the purchases completed thus far, **achieving a \$600 billion expansion of the SOMA portfolio by the end of June 2011 would**

require purchasing the additional securities at a pace of about \$80 billion per month. In addition, the Manager provided projections of the Federal Reserve's balance sheet and income under alternative assumptions. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions over the intermeeting period.

“ They are moving at 50% over that \$80Bn monthly pace and this was 1/25 and they began POMO around 11/15 so 10 weeks = \$236Bn = a lot more than \$80Bn a month now and it's been ACCELERATING since then.

Structural Unemployment

A staff presentation on structural unemployment summarized a broad range of economic research on the topic conducted across the Federal Reserve System. Among the factors cited that could affect the level of structural unemployment were demographics, changes in the intensity of job search and worker screening, differences in the geographic locations of potential workers and vacant jobs, and mismatches in characteristics between potential workers and available jobs. **Most of the research reviewed suggested that structural unemployment had likely risen in recent years**, but by less than actual unemployment had increased.

In discussing the staff presentation, meeting participants mentioned various factors that were seen as influencing the path of the unemployment rate. **Several participants noted that estimates of the contributions of the individual factors depended importantly on the approach taken by researchers, including the models used and the assumptions made.** Participants noted that **many of the factors that contributed to the recent apparent rise in structural unemployment were likely to recede over time.** Some participants stressed that certain determinants of the unemployment rate, such as mismatches in the labor market and firms' hiring practices, were both difficult to measure in real time and not

directly affected by monetary policy. Others emphasized that in the current situation, monetary policy could still play an important role in reducing unemployment.

Staff Review of the Economic Situation

The information reviewed at the January 25-26 meeting indicated that the economic recovery was firming, though the expansion had not yet been sufficient to bring about a significant improvement in labor market conditions. Consumer spending rose strongly late last year, and the ongoing expansion in business outlays for equipment and software appeared to have been sustained in recent months. However, construction activity in both the residential and nonresidential sectors remained weak. Industrial production increased solidly in November and December. Modest gains in employment continued, and the unemployment rate remained elevated. Despite further increases in commodity prices, measures of underlying inflation remained subdued and longer-run inflation expectations were stable.

“ This is the problem language. They base most of their assumptions on "subdued" inflation and if the CPI comes in strong, especially if the core ticks over 0.3, which would be a move from 1.4% to 2.6% and very possible, then there is NO WAY they can continue to say this in March and that's the possibility of cutting off POMO 3 months early.

The labor market situation continued to improve gradually. Private nonfarm payroll employment increased in December at a pace roughly the same as its average for 2010 as a whole, and the average workweek for all employees was unchanged. Services industries continued to add most of the new jobs in the private sector. Initial claims for unemployment insurance trended lower in December and early January, and some indicators of job openings and firms' hiring plans improved. The unemployment rate decreased to 9.4 percent in December, but this decline in part reflected a further drop in the labor force

participation rate. Long-duration unemployment remained elevated, and the employment-to-population ratio was still at a very low level at the end of the year.

Total industrial production posted solid increases in November and December, in part because colder weather boosted the output of utilities. Although motor vehicle assemblies dropped back in those months, **production in the manufacturing sector outside of motor vehicles posted solid gains that were fairly widespread across industries;** as a result, capacity utilization in manufacturing increased further, although it remained below its long-run average. **Most indicators of near-term industrial activity, such as the new orders diffusion indexes in the national and regional manufacturing surveys, were at levels consistent with further increases in industrial production in the near term; in addition, motor vehicle production was scheduled to move up again in early 2011.**

“ Good news for factories, bad news for the humans who work there.

Growth in consumer spending **appeared to have picked up in the fourth quarter from the more modest pace seen earlier in the year.** Nominal retail sales, excluding purchases of motor vehicles and parts, rose again in December, following substantial increases in the previous four months. **In addition, sales of new light motor vehicles climbed further in December after stepping up to a higher level during the preceding two months.** The available data suggested that consumer spending was supported by gains in personal income in the fourth quarter of 2010. Moreover, household net worth appeared to have risen in the fourth quarter, **as the large increase in equity prices more than offset further declines in house values.** Consumer credit started to increase again in October and November after having generally declined since the fall of 2008. However, consumer sentiment only edged up, on net, in December and early January, and it was still at a relatively subdued level.

“ Yeah, I'll bet the people who cashed out their stocks in 2009 to pay the mortgage on their upside down homes when they lost their jobs are just THRILLED that the large increase in the equities they don't have anymore offset the additional decline in the value of the home they can't sell.

Activity in the housing market remained weak in an environment characterized by soft demand, a large inventory of foreclosed or distressed properties on the market, and tight credit conditions for construction loans and mortgages. Starts and permits for new single-family homes in November and December were still near the very low levels recorded since midyear. Sales of new homes rose in December but remained historically low. Sales of existing homes increased in November and December from the more depressed levels seen during the summer and early autumn, but these sales stayed relatively weak as well. Moreover, **measures of house prices declined further in recent months, and survey responses indicated that households remained concerned that home values might continue to fall.**

Real business investment in equipment and software appeared to have increased further in the fourth quarter, although likely at a more moderate rate than in the first three quarters of 2010. After declining in October, nominal orders and shipments of nondefense capital goods excluding aircraft rose in November, and **the level of new orders remained above the level of shipments, indicating that the backlog of unfilled orders was still rising.** Available indicators suggested that **business purchases of software stayed on a solid uptrend, and outlays for computing and communications equipment appeared to have risen briskly.** However, **business spending for transportation equipment, including aircraft and motor vehicles, likely declined in the fourth quarter of 2010** after expanding rapidly earlier in the year. Surveys of purchasing managers reported that firms planned to increase their capital spending this year.

Reports on planned capital expenditures by small businesses showed some signs of improvement in recent months, although they remained relatively subdued. **Business outlays for nonresidential structures stayed weak, reflecting high vacancy rates and low property values for office and commercial properties, as well as tight credit conditions for commercial real estate.** In contrast, **investment in drilling and mining structures increased**, buoyed by rising energy prices.

So the only real bright spot in business spending is caused by massive commodity inflation. You can see why they don't want to tun it off....

Real nonfarm inventory investment appeared to have slowed substantially in the fourth quarter after a sizable increase in the previous quarter. Much of the fourth-quarter downswing was likely associated with a drawdown of motor vehicle stocks after an accumulation in the third quarter. Book-value data for October and November suggested that **the pace of inventory accumulation also was slowing outside of the motor vehicle sector.** Inventory-to-sales ratios toward the end of 2010 were close to their pre-recession norms, and most purchasing managers surveyed in December reported that their customers' inventories were not too high.

Measures of underlying consumer price inflation remained low. In December, the core consumer price index (CPI) edged up, as **goods prices were unchanged and prices of non-energy services rose slightly.** **The 12-month change in the core CPI remained near the very low readings of the previous two months.** **Other measures of underlying inflation, such as the trimmed-mean and median CPIs, also remained subdued.** Despite the steep run-up in agricultural commodity prices over the second half of last year, **increases in retail food prices remained modest.** However, **consumer energy prices moved up sharply in December, and prices of most types of crude oil increased during December and into January.** **The prices of nonfuel industrial**

commodities also continued to rise over the intermeeting period. In December and early January, survey measures of households' long-term inflation expectations stayed in the range that has prevailed for some time.

Available measures of labor compensation showed that **labor cost pressures were still restrained, as wage increases slowed along with inflation and productivity gains appeared to remain substantial.** **The 12-month change in average hourly earnings for all employees continued to be low in December.**

I used purple for the inflation language but imagine that to be rainbow colored smoke letters being puffed out by a caterpillar sitting on a mushroom and THAT is a more realistic view of the World than the Fed has! Also, not I colored the very low wage growth green because the Fed considers it a good thing that prices are rising faster than wages as it's ALL about Corporate profits as we "[Kill, kill, kill,kill, kill the poor.](#)"

The U.S. international trade deficit narrowed slightly in November, as both nominal exports and imports moved up by almost the same amount. **The increase in exports was driven by agricultural goods, in part reflecting higher prices,** as well as by consumer goods. In contrast, **exports of machinery and automotive products fell, reversing their October gains.** The rise in imports reflected an increase in the value of imported petroleum products, mostly explained by higher prices, and of capital goods, which was supported importantly by a jump in computers. At the same time, noticeable decreases were registered for imports of automotive products, services, and consumer goods, which were primarily due to pharmaceuticals. These developments, combined with the substantial narrowing in the trade deficit in October, implied that the trade deficit likely shrank considerably in the fourth quarter of 2010.

Recent indicators of foreign economic activity suggested that the global recovery was strengthening. Much of this strength was centered in the emerging market economies (EMEs), where widespread increases in exports and in manufacturing purchasing managers indexes (PMIs) pointed to a resurgence in economic growth following a slowdown in the third quarter of 2010. For China and Singapore, real gross domestic product (GDP) data for the fourth quarter confirmed a rebound in economic growth. **In contrast, the rise in economic activity in the advanced foreign economies (AFE) remained at a subdued pace.** In the euro area, the incoming economic data were mixed: Industrial production, manufacturing PMIs, and industrial confidence firmed, but **retail sales and consumer confidence softened.** The data also pointed to an uneven expansion across the euro area, suggesting that economic growth in Germany continued to outpace that in the euro-area periphery. **In Japan, exports and household spending were soft, although industrial production firmed. Foreign inflation picked up noticeably in the fourth quarter of 2010, mostly because of an acceleration of energy and food prices.** Measures of core inflation remained much more subdued, although they also moved up in some countries. In the EMEs, concerns about inflation prompted a number of central banks to tighten policy. Some EMEs reportedly took steps to limit the appreciation of their currencies by intervening in foreign exchange markets, and some acted to discourage capital inflows.

Staff Review of the Financial Situation

The decision by the FOMC at its December meeting to maintain the 0 to 1/4 percent target range for the federal funds rate was widely anticipated. Both the accompanying statement and the minutes of the meeting were broadly in line with market expectations and **elicited limited price action in financial markets.** Yields on medium- and longer-term nominal Treasury securities increased slightly, on net, over the intermeeting period. Yields rose in response to data releases that generally pointed to some firming of the economic

recovery, but the upward pressure on yields apparently was tempered by **expectations of only a gradual pace of improvement in the labor market, the belief that the Federal Reserve was likely to maintain an accommodative policy stance, and ongoing concerns about fiscal and banking pressures in the euro area.** Futures quotes indicated that the expected path for the federal funds rate did not change appreciably over the intermeeting period. Market-based measures of uncertainty about longer-term Treasury yields, which had risen ahead of year-end, declined on balance, likely in part reflecting **solidifying market expectations regarding the ultimate size of the FOMC's asset purchase program. The purchases of longer-term Treasury securities by the Desk during the intermeeting period reportedly had no significant effects on measures of day-to-day Treasury market functioning.**

“ Again with the purple to reflect drug use by the Fed. The Dow had gone up 1,000 points between POMO in November and the Jan 25th meeting - almost 10% in 2 months. This is what they call "limited price action?" We are up another 300 in 3 weeks since that meeting so THIS is subdued by comparison for the past 3 weeks (only 100 points a week) so imagine what would happen if they do ever stop.

Inflation compensation over the next 5 years based on Treasury inflation-protected securities (TIPS) moved up, likely pushed higher by rising prices for oil and other commodities and by the firming of the economic outlook. Further out, TIPS-based inflation compensation 5 to 10 years ahead edged down slightly on net. Yields on investment-grade corporate bonds were little changed over the intermeeting period, while those on speculative-grade corporate bonds declined a little, leaving both investment- and speculative-grade spreads over yields on comparable-maturity Treasury securities somewhat narrower. In the secondary market for leveraged loans, the average bid price moved up further over the intermeeting period. **The municipal bond market appeared to**

continue to price in an atypically high level of default risk. The ratios of yields on long-term general obligation bonds to those on comparable-maturity Treasury securities moved up to a very high level. Despite these strains, gross issuance of long-term municipal bonds remained strong in December.

Conditions in short-term funding markets remained stable over the intermeeting period. Spreads of dollar London interbank offered rates, or Libor, over overnight index swap rates held fairly steady across the term structure, as the year-end passed without incident. Some modest year-end pressures were observed in repurchase agreement markets, but they dissipated by early January. On net, spreads on unsecured nonfinancial commercial paper remained low, and spreads on asset-backed commercial paper appeared to have stabilized after having been somewhat volatile across year-end. *Anecdotal reports suggested that the modestly rising trend in the use of dealer-intermediated leverage evident in 2010 had continued into 2011, but information from a variety of sources indicated that leverage remained well below the levels reached before the crisis.*

Broad U.S. stock price indexes rose, on net, over the intermeeting period, extending their recent strong performance; bank stock prices modestly outperformed the broader market. The increase in equity prices reflected the apparent firming of the economic recovery and favorable early reports on fourth-quarter corporate earnings. Option-implied volatility on the S&P 500 index remained at a relatively low level. The spread between the staff's estimate of the expected real equity return for S&P 500 firms and the real 10-year Treasury yield—a rough measure of the equity risk premium—narrowed further over the period but remained elevated relative to longer-run norms.

“ They are very pleased with themselves. Stocks and bonds are inflating. Therefore, they are doing a good job.

Overall, net debt financing by U.S. nonfinancial corporations was robust in the fourth quarter of 2010. Net issuance of bonds was particularly strong, supported by heavy issuance in both the speculative- and investment-grade sectors. Meanwhile, nonfinancial commercial paper outstanding decreased slightly over the quarter. Issuance of syndicated leveraged loans, especially those funded by institutional investors, stayed strong. *Measures of the credit quality of nonfinancial corporations continued to improve.* Gross public equity issuance by nonfinancial firms dropped back in December to its average pace in 2010.

Financing conditions for most types of commercial real estate remained tight over the intermeeting period, and *delinquency rates for broad categories of commercial real estate loans stayed elevated.* However, for larger nonresidential properties in strong markets, credit appeared to have become somewhat less restricted, and *prices moved up, on net, from their lows at the beginning of 2010; at the same time, prices of other nonresidential properties continued to trend down.* Issuance of commercial mortgage-backed securities increased in the fourth quarter of 2010 but was *still only a fraction of its pre-crisis level.*

Rates on conforming fixed-rate residential mortgages edged down a bit during the intermeeting period after having risen appreciably in November and early December, leaving their spreads over the 10-year Treasury yield down slightly. Refinancing activity, which had fallen in response to the increase in mortgage rates in November, remained at a low level during the period. Outstanding residential mortgage debt declined further in the third quarter of 2010, reflecting *weak housing activity and tight lending standards.* Serious delinquency rates on prime and subprime mortgages flattened out in October and November after having moved down earlier in the year. *Signs of improvement were evident in the consumer credit market, where issuance of consumer asset-backed securities*

was strong early in the fourth quarter. In addition, delinquency rates on consumer loans continued to trend down toward their longer-run norms.

Banks made a sizable reduction in their holdings of securities in December. Core loans on banks' books—the sum of commercial and industrial (C&I), real estate, and consumer loans—edged down again, but the rate of contraction appeared to be abating. **C&I loans expanded at a robust pace in December.** Despite continued weakness in many residential real estate indicators, closed-end residential mortgage loans held by large banks rose noticeably for the fifth consecutive month in December. By contrast, **commercial real estate loans, home equity loans, and consumer loans decreased during that month.** The behavior of the components of core loans in recent months was broadly consistent with the results of the Senior Loan Officer Opinion Survey on Bank Lending Practices conducted in January. The survey responses indicated that, during the fourth quarter of 2010, modest net fractions of banks continued to ease standards for C&I loans and that larger net fractions eased some terms on such loans. Changes in banks' lending policies for other categories of loans were reportedly mixed and generally small. Meanwhile, moderate net fractions of respondents indicated that demand for C&I loans had strengthened over the preceding three months, and that inquiries from business borrowers for new or increased credit lines had picked up. In contrast, **demand reportedly weakened somewhat, on balance, for residential real estate loans and was little changed for consumer loans.** Respondents indicated that the recent increase in their holdings of closed-end residential mortgage loans reflected the relative attractiveness of such loans compared with other assets and, for some, a desire to expand their balance sheets by adding to this loan category.

“ So, overall, lending is still at a general standstill.

In December, M2 expanded at a rate a bit below its pace in November. **Liquid deposits, the largest component of M2, continued to increase rapidly,** while the contraction in small time deposits and retail money market mutual funds persisted. The ongoing compositional shift within M2 toward liquid deposits likely reflected the relatively high yields on liquid deposits compared with yields on many other components of M2. Currency growth slowed in December, due in part to weather-related transportation difficulties that delayed flows of U.S. bank notes to international destinations.

“ In other words, we are printing dollars and shipping them out so fast that we are maxing out the systems to the point where weather can interrupt the plane/boat-loads of US currency we are flooding the World with.

The broad nominal index of the U.S. dollar declined more than 1 percent over the intermeeting period, depreciating by roughly similar amounts, on average, against the currencies of the AFEs and the EMEs. The dollar's decline appeared to reflect a variety of factors: signs of stronger economic activity abroad, particularly in the EMEs; actual and prospective monetary policy tightening in foreign economies; and increases in the prices of oil and other commodities, which lent support to the currencies of commodity-exporting countries. Benchmark 10-year sovereign yields moved higher in the core euro-area economies and the United Kingdom but were little changed in Japan and Canada. Equity prices increased in the AFEs and in many EMEs as market participants appeared to revise upward their outlook for the global economy.

Financial market strains in the euro area continued during the intermeeting period. **Greek, Irish, and Portuguese sovereign debt spreads over German bunds rose in December and early January as credit rating agencies downgraded the sovereign debt of Ireland and Portugal.**

Subsequently, though, spreads narrowed following some relatively successful sovereign debt auctions by countries in the euro-area periphery, evidence of stepped-up purchases of peripheral sovereign bonds by the European Central Bank (ECB), and reports that the European Union was considering expanding the backstop capacity of the European Financial Stability Facility. Some modest dollar funding pressures developed as year-end approached, but they did not persist into January. To continue to support liquidity conditions in global money markets, on December 21, the Federal Reserve announced an extension through August 1, 2011, of its swap line arrangements with the ECB and the central banks of Japan, Canada, Switzerland, and the United Kingdom. In addition, the Bank of England established a temporary liquidity swap facility with the ECB designed to provide Ireland's central bank with sterling to help meet the potential needs of the Irish banking system.

Staff Economic Outlook

Because the incoming data on production and spending were stronger, on balance, than the staff's expectations at the time of the December FOMC meeting, the near-term forecast for the increase in real GDP was revised up. However, the staff's outlook for the pace of economic growth over the medium term was adjusted only slightly relative to the projection prepared for the December meeting. Compared with the December forecast, the conditioning assumptions underlying the forecast were little changed and roughly offsetting: Although higher equity prices and a lower foreign exchange value of the dollar were expected to be slightly more supportive of economic growth, the staff anticipated that these influences would be about offset by lower house prices and higher oil prices.

In addition, the staff's assumptions about fiscal policy changed little-the fiscal package enacted in December was close to what the staff had already incorporated in their previous projection. In the medium term, the recovery in economic activity was expected to receive support from

accommodative monetary policy, further improvements in financial conditions, and greater household and business confidence. Over the projection period, the rise in real GDP was expected to be sufficient to slowly reduce the rate of unemployment, but the jobless rate was anticipated to remain elevated at the end of 2012.

The underlying rate of consumer price inflation in recent months was in line with what the staff anticipated at the time of the December meeting, and the staff continued to project that increases in core PCE prices would remain subdued in 2011 and 2012. As in previous projections, the persistent wide margin of economic slack in the forecast was expected to maintain downward pressure on inflation, but this influence was anticipated to be counterbalanced by the continued stability of inflation expectations and by increases in the prices of imported goods. The staff anticipated that brisk increases in energy prices would raise total consumer price inflation above core inflation this year, but that upward pressure from energy prices would wane by next year.

“ It all comes back to inflation. They simply don't believe it exists or, if it does, they think it won't last - so they can't really lose, can they. They can only be wrong this meeting and then do nothing and wait until next meeting when they will "reevaluate." This is how hyperinflation happens, Governments don't want to deal with inflation and they wait and wait and wait and wait until it is so obvious and so terrible that drastic action needs to be taken.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, all meeting participants-the six members of the Board of Governors and the presidents of the 12 Federal Reserve Banks-provided projections of output growth, the unemployment rate, and inflation for each year from 2011 through 2013 and over the longer run. Longer-run projections represent each

participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks. Participants' forecasts are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In the discussion of intermeeting developments and their implications for the outlook, **the participants generally expressed greater confidence that the economic recovery would be sustained and would gradually strengthen over coming quarters.** Their more positive assessment reflected both the tenor of the incoming economic data and information received from business contacts since the previous meeting. **Spending by households picked up noticeably in the fourth quarter, business outlays continued to grow at a moderate pace, and conditions in labor and financial markets improved somewhat over the intermeeting period.** Although business contacts remained somewhat cautious about the economic outlook, they generally indicated greater optimism regarding their own prospects for sales and hiring than at the time of the previous meeting. While participants viewed the downside risks to their forecasts of economic activity over the projection period as having diminished, **their assessment of the most likely outcomes for economic activity and inflation over the projection period was not greatly changed.** Most participants raised their forecast of real GDP growth in 2011 somewhat and continued to anticipate stronger growth this year than in 2010, with a further gradual acceleration during 2012 and 2013. The unemployment rate was still projected to decline gradually over the forecast period but to remain elevated. **Total inflation was still expected to remain subdued, and core inflation was projected to trend up slowly over the next few years as economic activity picks up but inflation expectations remain well anchored.**

Participants' judgment that the economic recovery was on a firmer footing was supported

by the strength in household spending in the fourth quarter. The incoming data indicated that households stepped up sharply their purchases of durable goods, particularly automobiles, last quarter. Spending on luxury goods also increased, and the pace of holiday sales was better than in recent years. However, some participants noted that it was not clear whether the recent pace of consumer spending would be sustained. On the one hand, the additional spending could reflect pent-up demand following the downturn or greater confidence on the part of households about the future, in which case it might be expected to continue. On the other hand, the additional spending could prove short lived given that a good portion of it appeared to have occurred in relatively volatile categories such as autos.

Activity in the business sector also indicated that the economic recovery remained on track. For instance, indicators of business investment in equipment and software continued to rise. Industrial production posted solid gains, supported in part by U.S. exports that appeared to have been noticeably stronger in the fourth quarter. A wide range of business contacts expressed cautious optimism about the durability and strength of the recovery, and some were planning for an expansion in production in order to meet an anticipated rise in sales. In addition, although residential construction spending remained weak, spending on commercial construction projects showed some tentative signs of bottoming out.

Participants noted that conditions in labor markets continued to improve gradually. Payroll employment increased at a modest pace, and, although the data had been somewhat erratic, a slight downward trend was apparent in the recent pattern of weekly initial claims for unemployment insurance. In addition, some surveys of employers suggested a somewhat more upbeat outlook for employment. Business contacts provided a range of information regarding hiring intentions, with some indicating that **workers at all skill levels were**

readily obtainable, while others reported that they had upgraded skill requirements and that some of the currently unemployed did not meet those new requirements. Some businesses remained reluctant to add permanent positions and were planning to meet their labor requirements with temporary workers. **Overall, meeting participants continued to express disappointment in both the pace and the unevenness of the improvements in labor markets and noted that they would monitor labor market developments closely.**

“ Don't forget though - no jobs = more POMO!!!

Conditions in financial markets improved somewhat further over the intermeeting period. *Broad equity prices rose, adding to their substantial gains since the middle of 2010.* Yields on longer-term nominal Treasury securities were little changed, on balance, over the period, but they had increased quite a bit in recent months, *leaving the Treasury yield curve noticeably steeper.* Some participants noted that a steep yield curve is a typical feature of an economy in recovery, and that much of the steepening appeared to have occurred in response to stronger-than-expected economic data. *Market-based measures of inflation compensation over the next few years increased further over the intermeeting period, extending the rise that occurred over recent months.* Some participants suggested that the increase likely reflected, in part, a decline in investors' perceptions of the near-term risk of further disinflation. At the same time, longer-term inflation expectations had remained stable. *Credit spreads on the debt of nonfinancial corporations continued to narrow over the period, reaching levels noticeably lower than those posted several months ago, with the largest declines coming on speculative-grade bonds.* However, credit conditions remained tight for smaller, bank-dependent firms, although bank loan growth had clearly picked up in some sectors. Some participants noted that, *taken together,*

these financial developments were consistent with a more accommodative stance of monetary policy since last summer or a reduction in risk aversion on the part of market participants.

“ No more policy would lead to all this stuff unwinding - keep that in mind.

Meeting participants noted that headline inflation had been boosted by higher prices for energy and other commodities, as well as by increases in the prices of imported goods. Some participants indicated that while unit labor costs generally had declined and profit margins were wide, the higher commodity prices were boosting costs of production for many firms. Some business contacts indicated that they were going to try to pass a portion of these higher costs through to their customers but were uncertain about whether that would be possible given current market conditions. Many participants expected that, with significant slack in resource markets and longer-term inflation expectations stable, *measures of core inflation would remain close to current levels in coming quarters.* However, the importance of resource slack as a factor influencing inflation was debated, and some participants suggested that other variables, such as current and expected rates of economic growth, could be useful indicators of inflation pressures.

Overall, most participants indicated that the somewhat better-than-expected economic data and anecdotal information from business contacts had importantly increased their confidence in the continuation of a moderate recovery in activity this year. Accordingly, participants generally agreed that the downside risks to their forecasts of both economic growth and inflation-as well as the odds of a period of deflation-had diminished. Participants also generally agreed that the recent data had not led them to significantly change their outlooks for the most likely rates of economic growth and inflation in coming quarters. Participants noted that some of the strength in the recent data reflected factors that could prove temporary,

such as the large contribution from net exports, a volatile category, and the sharp step-up in auto sales. **Most participants continued to anticipate that the recovery in economic activity was likely to be restrained by a variety of economic factors, including still-high unemployment, modest income growth, lower housing wealth, high rates of mortgage foreclosure, elevated inventories of unsold homes, and tight credit conditions in a number of sectors.** In addition, although many business contacts expressed more optimism about the economic recovery, **a number had aimed their recent investments primarily at enhancing productivity rather than expanding employment, and hiring for some businesses reportedly was focused on temporary workers.** Some participants noted that incoming data on production, spending, and employment would need to be solid for a while longer to justify a significant upward revision to their outlook for the likely pace of the recovery.

“ So, even if they see improving jobs numbers, they are prepared to ignore it along with inflation numbers. All of this is just an apologist’s document to lay a groundwork for why they kept pouring money into the markets despite inflation risks.

Participants generally saw the risks to their outlook for economic growth and employment as having become broadly balanced, **but they continued to see significant risks to both sides of the outlook.** On the downside, participants remained worried about the possible effects of spillovers from the banking and fiscal strains in peripheral Europe, the ongoing fiscal adjustments by U.S. state and local governments, and the continued weakness in the housing market. On the upside, the recent strength in household spending raised the possibility that domestic final demand could snap back more rapidly than anticipated. If so, a considerably stronger recovery could take hold, more in line with the sorts of recoveries seen following deep economic recessions in the past.

Regarding risks to the inflation outlook, some participants noted that increases in energy and other commodity prices as well as in the prices of imported goods from EMEs posed upside risks. Others, however, noted that the pass-through from increases in commodity prices to broad measures of consumer price inflation in the United States had generally been fairly small. **Some participants expressed concern that in a situation in which businesses had been unable to raise prices in response to higher costs for some time, firms might increase them substantially once they found themselves with sufficient pricing power.** In any case, the factors affecting the ability of businesses to pass through higher prices to consumers were viewed as complex and hard to monitor in real time. Most participants saw the large degree of resource slack in the economy as likely to remain a force restraining inflation, and while the risk of further disinflation had declined, **a number of participants cited concerns that inflation was below its mandate-consistent level and was expected to remain so for some time.** Finally, some participants noted that if the very large size of the Federal Reserve’s balance sheet led the public to doubt the Committee’s ability to withdraw monetary accommodation when doing so becomes appropriate, the result could be upward pressure on inflation expectations and so on actual inflation. To mitigate such risks, it was noted that the Committee should continue its planning for the eventual exit from the current exceptionally accommodative stance of policy.

“ Man, there is not a deep enough purple for this BS! They have no intention of actually changing policy to prevent inflation but they do plan on telling the public they have a plan to do so, so the people will BELIEVE that they are able to withdraw accommodation "when appropriate." Well, it’s not appropriate now with \$90 oil and record corn, rice, copper and wheat prices. Airlines are raising their fares and it’s not appropriate, silver is at 30-year highs and it’s not appropriate, gas is

\$4 a gallon and it's not appropriate. Oh well, maybe next meeting, right?

Committee Policy Action

*In their discussion of monetary policy for the period ahead, members agreed that no changes to the Committee's asset purchase program or to its target range for the federal funds rate were warranted at this meeting. While the information received over the intermeeting period increased members' confidence in the sustainability of the economic recovery, **the pace of the recovery was insufficient to bring about a significant improvement in labor market conditions, and measures of underlying inflation had trended downward.** Moreover, the economic projections submitted for this meeting indicated that unemployment was expected to remain above, and **inflation to remain somewhat below, levels consistent with the Committee's objectives for some time.** Accordingly, **the Committee agreed to continue to expand its holdings of longer-term Treasury securities as announced in November in order to promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with the Committee's mandate.***

“ This is a policy to RAISE inflation. They are operating under the assumption, still, that inflation (if it exists at all) is TOO LOW and their policies are aimed to gain solid and lasting growth in inflation. That's our Fed!

The Committee decided to maintain its existing policy of reinvesting principal payments from its securities holdings and reaffirmed its intention to purchase \$600 billion of longer-term Treasury securities by the end of the second quarter of 2011. A few members remained unsure of the likely effects of the asset purchase program on the economy, but felt that making changes to the program at this time was not appropriate. Members emphasized that the Committee would continue to regularly review the pace of its securities purchases and the overall size of the asset purchase program in light of

incoming information-including information on the outlook for economic activity, developments in financial markets, and the efficacy of the purchase program and any unintended consequences that might arise-and would adjust the program as needed to best foster maximum employment and price stability. A few members noted that additional data pointing to a sufficiently strong recovery could make it appropriate to consider reducing the pace or overall size of the purchase program. However, others pointed out that it was unlikely that the outlook would change by enough to substantiate any adjustments to the program before its completion. In addition, the Committee reiterated its expectation that economic conditions were likely to warrant exceptionally low levels for the federal funds rate for an extended period. With respect to the statement to be released following the meeting, members agreed that only small changes were necessary to reflect the improvement in the near-term economic outlook and to make clear that the policy decision reflected a continuation of the asset purchase program announced in November.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to 1/4 percent. The Committee directs the Desk to execute purchases of longer-term Treasury securities in order to increase the total face value of domestic securities held in the System Open Market Account to approximately \$2.6 trillion by the end of June 2011. The Committee also directs the Desk to reinvest principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities. The

System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in December confirms that the economic recovery is continuing, though at a rate that has been insufficient to bring about a significant improvement in labor market conditions. Growth in household spending picked up late last year, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising, while investment in nonresidential structures is still weak. Employers remain reluctant to add to payrolls. The housing sector continues to be depressed. Although commodity prices have risen, longer-term inflation expectations have remained stable, and measures of underlying inflation have been trending downward.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Currently, the unemployment rate is elevated, and measures of underlying inflation are somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate. Although the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, progress toward its objectives has been disappointingly slow.

To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today to continue expanding its holdings of securities as announced in November. In particular, the Committee is maintaining its existing policy of reinvesting principal payments from its securities holdings and intends to

purchase \$600 billion of longer-term Treasury securities by the end of the second quarter of 2011. The Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of incoming information and will adjust the program as needed to best foster maximum employment and price stability.

The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period.

The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate."

Voting for this action: Ben Bernanke, William C. Dudley, Elizabeth Duke, Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, Charles I. Plosser, Sarah Bloom Raskin, Daniel K. Tarullo, Kevin Warsh, and Janet L. Yellen.

Voting against this action: None.

Next, the Committee turned to a discussion of its external communications, specifically the importance of communicating both broadly and effectively. FOMC participants noted the importance of fair and equal access by the public to information that could be informative about future policy decisions, and they considered approaches to address this issue. Several participants noted that increased clarity of communications was a key objective, and some referred to the central role of communications in the monetary policy transmission process. A focus of the discussion was on how to encourage dialogue with the public in an appropriate and transparent manner

Next Week's Economic Calendar

Monday 21	Tuesday 22	Wednesday 23	Thursday 24	Friday 25
US Holiday: President's Day. All Markets Closed	9:00 AM: S&P Case-Shiller House Price Index	7:00 AM: MBA Purchase Applications	8:30 AM: Durable Goods Orders	8:30 AM: GDP
	10:00 AM: Consumer Confidence	7:45 AM: ICSC-Goldman Store Sales	8:30 AM: Jobless Claims	9:55 AM: Consumer Sentiment
	10:00 AM: Richmond Fed Manufacturing Index	8:55 AM: Redbook	8:30 AM: Chicago Fed National Activity Index	
	10:00 AM: State Street Investor Confidence Index	10:00 AM: Existing Home Sales	10:00 AM: FHFA House Price Index	
	11:00 AM: 4-Week Bill Announcement	11:30 AM: 4-Week Bill Auction	10:00 AM: New Home Sales	
	11:30 AM: 3-Month and 6-Month Bill Auctions	1:00 PM: 5-Year Note Auction	11:00 AM: EIA Petroleum Status Report	
NO POMO	POMO DAY (\$5Bn - \$7Bn)	POMO DAY (\$1.5Bn - \$2.5Bn)	POMO DAY (\$4Bn - \$6Bn)	POMO DAY (\$6Bn - \$8Bn)

Note: The material presented in this commentary is provided for informational purposes only and is based upon information that is considered to be reliable. However, neither Philstockworld, LLC (PSW) nor its affiliates warrant its completeness, accuracy or adequacy and it should not be relied upon as such. Neither PSW nor its affiliates are responsible for any errors or omissions or for results obtained from the use of this information. Past performance, including the tracking of virtual trades and portfolios for educational purposes, is not necessarily indicative of future results. Neither Phil, Oprader, Oxen Group or anyone related to PSW is a registered financial adviser and they may hold positions in the stocks mentioned, which may change at any time without notice. Do not buy or sell based on anything that is written here, the risk of loss in trading is great.

This material is not intended as an offer or solicitation for the purchase or sale of any security or other financial instrument. Securities or other financial instruments mentioned in this material are not suitable for all investors. Any opinions expressed herein are given in good faith, are subject to change without notice, and are only intended at the moment of their issue as conditions quickly change. The information contained herein does not constitute advice on the tax consequences of making any particular investment decision. This material does not take into account your particular investment objectives, financial situations or needs and is not intended as a recommendation to you of any particular securities, financial instruments or strategies. Before investing, you should consider whether it is suitable for your particular circumstances and, as necessary, seek professional advice.