

Weekly Trend Watch

March 5, 2010



Inflation/Deflation Timer - Current Indication:

Neutral

The Inflation-Deflation Timer is a trend-following model, and this class of model is incapable of calling tops or bottoms, and therefore its value is in the ability to spot trends. The trends we are looking for are: inflation, deflation and neutral.

This publication is an ongoing monitor of the Inflation-Deflation Timer model, for more information on the model, see:

http://www.qwestfunds.com/publications/newsletters_pdf/newsletter_november_2009.pdf; and
http://www.qwestfunds.com/publications/newsletters_pdf/newsletter_february_2010.pdf

Cam Hui, Board of Advisors, Qwest Investment Management Corp.

Qwest Commentary

Still a Neutral reading

The Inflation-Deflation Timer model remains at neutral, but just barely. The recent recovery in commodity prices was partially spurred by a rally in copper prices due to the possible curtailing of supply because of the Chilean earthquake. As a result, the model is very close to an "inflation" signal. If commodity prices were to stage even a minor rally from current levels, the model would move from a "neutral" back to an "inflation" reading.

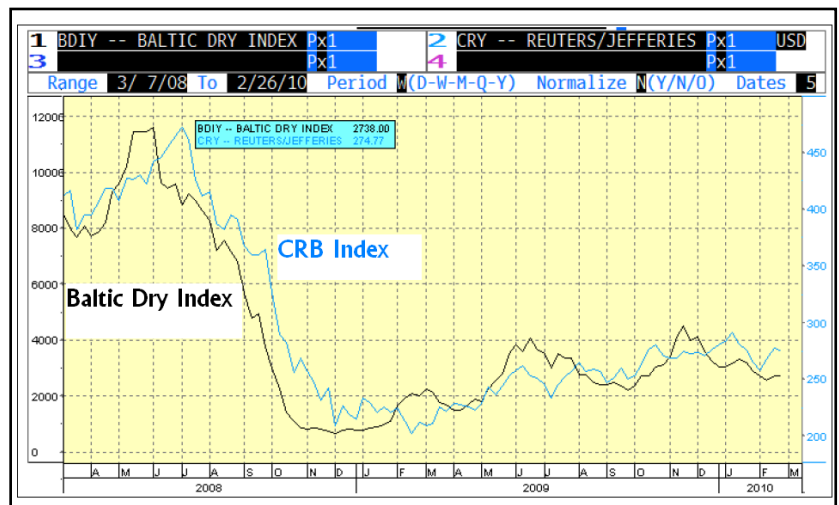
Commodity price fake-out or climbing a "wall of worry"?

Last week, we posed the question "Is the commodity correction over?"

We concluded that excessive bullish sentiment had receded, which negated a contrarian bearish sign, real-time signals from the world economy remain mixed and we remain cautious. In fact, there are indications that the Baltic Dry Index, which measure shipping costs, may in fact lead commodity prices (see chart below).

The continued weakness in real-time indicators like the Baltic Dry Index is bearish for US consumer demand and its key goods supplier, China. Moreover, the weakness is not just showing up in the US and Asia. The recent news from that German February new car registrations was down 30% year-over-year, and down 20% YTD for 2010, is a cause for concern. Auto sales were one of the few bright spots in Europe last year, driven by a "Cash for Clunkers" program. Recent figures for Germany and France show that in the absence of stimulus, the consumer demand evaporates.

The European experience raises questions about the strength of private demand without



fiscal stimulus. In the US, the year-over-year impact of stimulus is set to reverse from being currently positive to negative by the second half of 2010. What happens then?

Why have global commodity markets actually rallied in the past week? There has been precious little "good news" on the commodity front, unless we were to consider the 8.8 Richter scale earthquake that hit Chile on Saturday, February 27th, and the numerous aftershocks which were perceived to have damaged copper production. The trouble was, the earthquake was hundreds of miles away from the Chilean copper mines and the mines were not damaged. Some mines went offline for a few hours because of power failures, but none suffered any physical or structural damage, nor did their export ports or the transportation network to the ports.

Discipline trumps conviction

Whatever the cause of the short-term rise in the commodity market in the face of mainly negative fundamental news, an important investing rule is that discipline in investing and risk management must trump personal conviction.

We therefore will maintain our discipline and move back to buying commodities only when the Inflation-Deflation Timer model returns to an "inflation" reading.

DEFINITIONS (as defined in the American Heritage Dictionary)

Inflation

A persistent increase in the level of consumer prices or a persistent decline in the purchasing power of money, caused by an increase in available currency and credit beyond the proportion of available goods and services.

Deflation

A persistent decrease in the level of consumer prices or a persistent increase in the purchasing power of money because of a reduction in available currency and credit.

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