

Gentle Ben?

What, no helicopters? Say it ain't so, Ben. Everyone was settling into the idea that Fed Chairman Ben Bernanke was going to be the kinder gentler Fed boss who would ease interest rates back down and save the US consumer and home owner. Then he had to go and spoil the script. The markets turned jittery again last week when the US CPI came in with an annual increase of 3.2%. That's above the 2% core rate the Fed would like to see and with oil prices above \$70 few people believe inflation rates are going to fall any time soon. The markets were already jittery about slowing growth and unhappy about the last 25 basis point rate increase that many didn't expect (we did).

Just when traders thought it was safe to go back to the market Bernanke shocked people with comments about inflation and the potential for further rate increases. Bernanke made himself famous (if that's the word) earlier in his Fed career by promising to print dollars by the bushel and drop them from helicopters if that's what it took to forestall the threat of deflation. That wasn't necessary but comments like that did give the doyens of Wall St. a warm fuzzy feeling and comfort that Bernanke would be an accommodating kind of guy.

That's the reason the market was shocked by the Fed Chief's hawkish comments but, really, what did you expect? The major task of the Federal Reserve is attending to the health of the currency and the banking system. Nothing hurts either more than a dose of high inflation. Bernanke has to earn his chops by playing the tough guy when it comes to nascent inflation concerns. Remember that a Central Bank's main weapon is really moral suasion. Not so much acting, as making sure the markets believe he will act in a manner that ensures inflation stays under control.

So should we all panic? No. Understand, we're *not* saying there are no risks out there. We've been telling our readers for three months to prepare for a pullback, probably a nasty one. Well, we've had that now. We also have concerns about the US housing market and, by extension, consumer spending and the overall health of the economy. Those concerns haven't dissipated and it seems obvious to us that there will be significant slowing in the US economy. That could hurt base metals though how much more they fall depends on how much spec money has been washed out of the metals markets in the past three weeks. We suspect a fair percentage of the hedge money is gone for now and that the long funds are not in a rush to liquidate unless they see a major economic slowdown coming. Physical markets for most metals preclude a large amount of short activity. The Chinese tried that with copper last fall and it cost them \$700 million. Most metals could ease through the summer and some of the movements will be violent but stocks have already priced in much lower values.

As far as gold and silver go, the selling has been overdone. Much of the concerns come from fear that the Fed will raise rates enough to lift the Dollar significantly. The old gold/Dollar cross trade has reared its head again. Our take on things is that we will not see significant rate increases. The US is already slowing. Inflation may rise some more, but we expect economic stats to be weak enough to stay the Fed's hand. We think Bernanke knows he (or rather, his predecessor, Easy Al) missed the window to really push rates without cratering the economy. As much as he talks tough on inflation, we don't see him moving rates much unless the US growth rate spurts again, which it probably won't. Without rising rates the greenback will again lose the only real support it

has and its long term bear market will resume. That alone would be enough to turn gold and silver prices upwards, and soon.

And if we're wrong? The only other probable scenario we see is a mild version of stagflation. That concern has a lot of traders selling commodities. Apparently traders with short memories. We'll go into this in a later comment but will leave you with this thought. We'll probably have a slow summer for the first time in three years which makes it a good time for patient bargain hunting. And stagflation? That might scare some, but our memories are longer. The last bout of stagflation in the 1970's was also the last secular bull market for commodities. Don't forget that.

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