



# Views From The Heartland

*Investment Perspective of Buena Vista Investment Management*

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## Commodity Pricing Increases Risk of Inflation

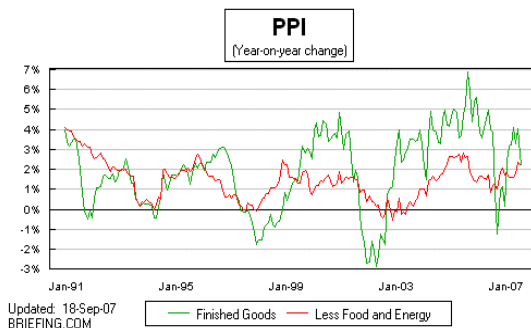
### Economics 101 and Your Investments

By John Moffat and Joel Sullivan, Partners

The price of a barrel of oil crossed \$80 for the first time in September, the price of gold moved back above \$700 per ounce, prices not seen in 35 years. The Goldman Sachs Precious Metals Index has increased over 200% in last seven years. The Goldman Sachs Agricultural Index after bottoming in 2002 has increased 132%. The Industrial Metals Commodity Index is up over 300% in the last five years. Then there is copper, a commodity used heavily in automobiles (60 lbs per car/ 120 per hybrid) and housing (439 lbs in an average home), up over 500% in the last five years. With commodities rising so dramatically, how should investors interpret and use this data to improve long-term investment returns?

First, a large percentage of the commodity price increases can be traced to rising demand from the global economy, more specifically, the emerging markets. Economics 101 tells us that a rise in demand without a corresponding increase in supply will cause prices to increase and continue to rise until either more supply becomes available or demand wanes. In the case of industrial metals, it literally takes years for new supplies to be brought to the market. Rising prices for commodities is a long-term trend that we believe will continue for the foreseeable future, as we look for growth in the emerging markets to continue.

Second, if commodity prices are in a long-term uptrend will this lead to increasing consumer prices? Unfortunately there is no easy answer to this question as the global economy is extremely complex, but it would be our position that the simple answer is “yes”. The commodity price increases we are now experiencing will eventually work their way down to the consumer.



Today, the commodity price increases are very apparent when we fill up at the gas pump. Less apparent but just as important is the Producers Price Index (PPI) (see chart), which indicates that the prices paid by business are rising at a faster rate than the headline inflation numbers. This means businesses have to increase productivity, raise prices, or reduce profitability or a combination of all three.

The Consumer Price Index (CPI) which represents prices paid by the consumer for everything from housing to clothing has remained fairly stable. But in the reporting of these numbers Wall Street and/or the US Government at times excludes food and energy. It would be our position that if you are discussing inflation, you must include food and energy in the calculation, as they make up two of the larger components of the CPI index. If you do include those two important components, you get a higher and more accurate inflation number.

We are not advocating that we will see a return to the type of inflation we saw late 70's and early 80's but rather inflation specifically tied to commodities and other industries where demand exceeds supply. The health care industry is one industry where this is also evident.

## Commodity Pricing Increases Risk of Inflation (continued)

Global growth, coupled with the complexity of the global economy, is creating numerous changes that investors must deal with. But change creates investment opportunity! We have invested in a relatively low inflation environment for the last 20 years, but that may now be changing. Investments in natural resources, emerging markets and new energy technologies should be winners, while fixed income investors will not fare as well. As always there will be new winners and new losers. We will diligently monitor this emerging trend and we will make strategic adjustments to our portfolios in order that we may generate consistent, quality long-term investment returns for our clients.

### **BUENA VISTA INVESTMENT MANAGEMENT LLC INVESTMENT STRATEGY UPDATE**

During the first half of 2007, we moved approximately 20% out of stock investments and into guaranteed money market fund investments. Several indicators we follow were issuing warning signals about a possible market correction. The S&P 500 stock index did experience a 10% correction with the index bottoming in August. Since then S&P 500 stock index has rallied and is now within 2% of its July high.

At this time, we will continue to maintain a higher than normal allocation to money market investments. Keep in mind, that money market investments are guaranteed and are currently earning about 4.8%. However, if our indicators turn more positive between now and the end of the year, we will move back into stock investments. Clients with taxable portfolios may see an investment into an S&P 500 Index fund or an Exchange Traded Fund (ETF) tied to the S&P 500, rather than our current mutual funds. These investments will be used for tax efficiency purposes, as your typical mutual fund makes annualized capital gains payments to holders of record on a specified date in the fourth quarter. Taxable accounts would then be subject to adverse capital gains consequences on those distributions. To avoid these potential negative tax consequences, we will utilize an index fund or ETF for a short period of time, as these investments rarely distribute large capital gains.

#### **LONG-TERM MARKET INDICATORS**

Buena Vista Conservative Buy/Sell Discipline:	Buy
Leuthold Major Trend Index:	Negative (moved to negative in July 2007)
S&P 500 Stock Index:	1,526.75 (+7.65% thru 9-30-07)
Wilshire 5000:	15,362.02 (+7.75% thru 9-30-07)

#### **DIVERSIFIED MUTUAL FUND PROGRAM INVESTMENT PERFORMANCE**

Income and Growth Strategy: YTD 2007: 6.65%	Total Return Strategy: YTD 2007: 13.04%
Conservative Equity Strategy: YTD 2007: 7.37%	Absolute Return Strategy: YTD 2007: 5.89%

**Important Disclosure** – The performance numbers contained on this page are provided for informational purposes only. Returns may vary depending on personal objectives and timing of invested dollars. The performance numbers contained on this page are based on investments that have been in place since 1-1-04. Contact Buena Vista Investment Management LLC for more specific information concerning performance and market data. Do not rely on this information to make investments. The Buena Vista Investment Management Conservative Buy/Sell Discipline and the Leuthold Major Trend Index are tools used only to assist us in our investment decision making process. These tools do have inherent limitations as to forecasting future market movements or direction.

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