TrendMacrolytics

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MACROCOSM

Quick Takes

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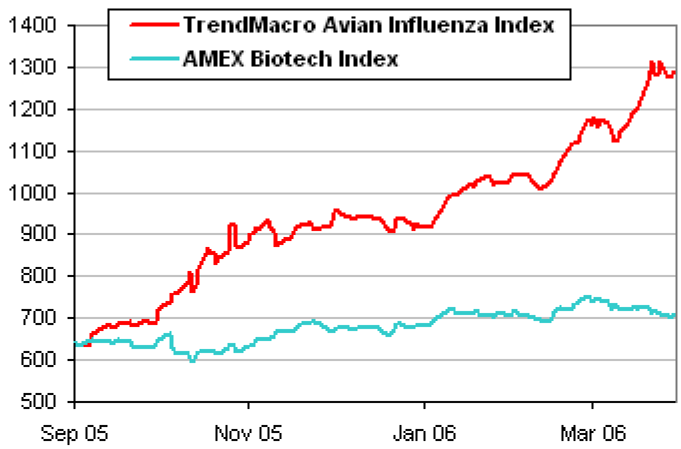
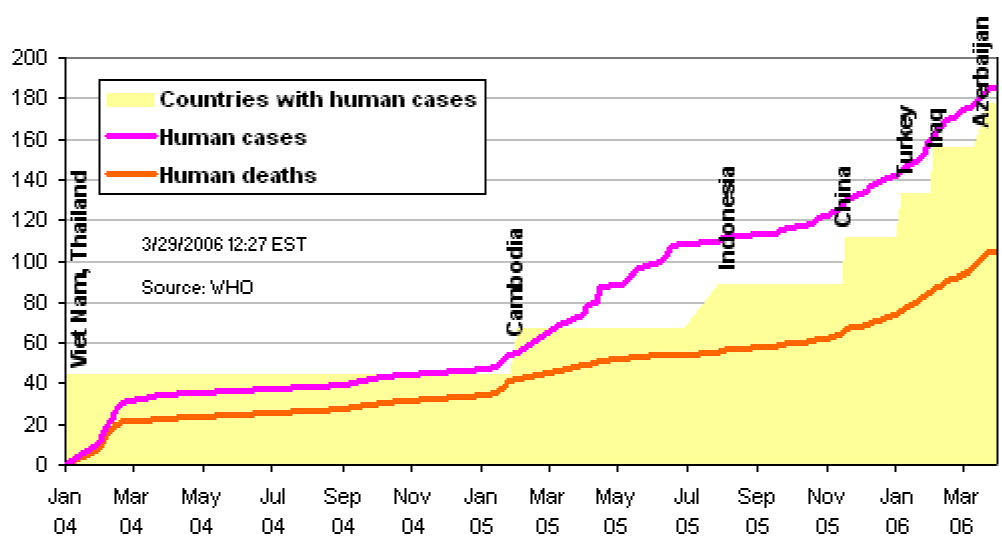
Bird flu theme takes flight, stock-friendly Fed news, protectionism recedes.



BIRD FLU ON THE WING Our **Avian Influenza Index** is now up 10.6% (versus **S&P 500** up 1.9%, and **Amex Biotech Index** down 3.6%) since we introduced this list of stocks engaged in **vaccines, therapeutics and diagnostics** on March 6 (see "Avian Flu: Risk and Opportunity" March 6, 2006). Since then, this sector theme has been the subject of a wave of **publicity**. We are aware that other firms have released related reports shortly after ours, and our Index has been featured on **CNBC**, and in ***USA Today*** and ***Investors Business Daily***. Yesterday there were no less than six stories on avian influenza in the ***New York Times*** alone. For all of it, the conventional wisdom can't seem to decide whether the "narrative" ought to be frantic alarm or comforting nonchalance. Some evidence of the conceptual confusion is a pair of *Times* stories yesterday, one story featuring a **United Nations** official who was deeply worried, but who nevertheless complained that the media had cited only his worst-case human death estimates -- and the other story citing those very same worst-case estimates. From the beginning, we have argued that increasing **public awareness** of the risk of an avian influenza **pandemic** would propel the stocks in our Index higher. After a publicity wave like the one of the last several weeks -- and the associated run in these theme stocks -- we must ask: *is it over?*



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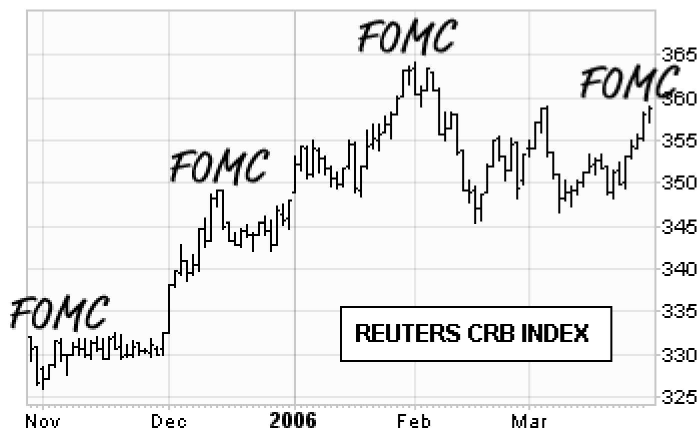
Maybe we're near a short-term climax of publicity (and stock performance) for the avian influenza theme. But the long-term fundamental **event drivers** of the theme are not abating one bit -- so our sense is that there is more publicity (and stock performance) to come. Since our last report on it (see "Quick Takes" March 16, 2006), the number of human cases confirmed by the **World Health Organization** since 2004 has risen to 185, and the death toll has risen to 104. An eighth nation -- **Azerbaijan** -- has joined the list of those with confirmed human infections and deaths. **Egypt** has now reported five human infections and two deaths (these will probably be officially confirmed by the WHO in the next two days). And another European nation, the **Czech Republic**, has confirmed the presence of infected wild birds. Events like these will keep the publicity kettle at least on simmer. It will boil over when infected birds are reported in the **United States** by year-end, an event which the **online futures contracts** at **Tradesports.com** price at an approximately 70% probability.

A NEW STOCK-FRIENDLY VARIABLE FOR THE FED We gave a long list of reasons last week why stocks would continue to be resilient to **rising interest rates**. Our point would seem to be proven by today's recovery of yesterday's losses following what we saw as an unexpectedly hawkish **FOMC statement** (see "Why Rates Can't Clock Stocks" March 23, 2006). In fact, one detail of yesterday's statement adds a new reason to our list.

We highlighted yesterday that the word **"commodities"** appeared in the statement not just once, but twice (see "On the FOMC Statement" March 28, 2006). To our knowledge, this marks the first time that word has appeared in any FOMC statement since there have been FOMC statements. It offers at least a ray of hope that **the Fed's** future **policy deliberations** will take account of **sensitive market-based price signals**, which we believe offer the best possible guides as to whether the Fed is providing the markets with too much or too little **liquidity**.



We've argued that without considering price signals, the Fed has been likely to do "the right thing for the wrong reason" -- that is, use flawed **aggregate demand** rationales to justify higher interest rates which, by sheer coincidence, would address the **inflation risks** borne of the Fed's having been so **easy** for so long (see "Accidentally on Purpose" January 11, 2006). But the risk in *that* framework is that there is nothing to cause the Fed to *stop* raising rates before it forces **the economy** into **recession** (see "Is Ben Bernanke a Phillips Head?" March 1, 2006). The great news for stocks it that price signals from commodities offer a **stopping rule** -- when commodity prices start rolling over, then the inflation-fighting work is done. As the chart above suggests, rising commodity prices had been winning a tug-of-war with the Fed until the January 31 FOMC meeting, since which we have seen a succession of lower tops. It is of some real concern that this pattern is being violated today, with the **Reuters CRB Index** trading higher than its early March highs. But if commodities end up continuing this down-trending pattern -- and if the Fed really is watching them -- then there's hope that the Fed can call an appropriate end to this **rate-hiking cycle**. Of course if commodities don't roll over here, then the Fed would still have even more work to do. But that's fine, too -- provided that the Fed really is watching.

PROGRESS AGAINST PROTECTIONISM As we noted last week, proximate threats of **protectionist legislation** have been lessening (again, see "Why Rates Can't Clock Stocks" March 23, 2006). Indeed, yesterday, after a red-carpet junket to **China**, **senators Chuck**

Schumer and **Lindsey Graham** have once again delayed a vote on their bill that would have slapped a 27.5% **tariff** on Chinese goods. Also, **Senate Finance Committee chair Chuck Grassley** and **ranking member Max Baucus** have now introduced a far milder bill designed to draw support away from Schumer and Graham in the future. The Grassley-Baucus bill would do little more than create a new **Treasury Undersecretary for Currencies** position, and provide him with a framework of mostly symbolic bureaucratic punishments for nations whose currency management policies do not please the **United States**. TM