THE TYCOON REPORT

>: How inflation affects your portfolio...

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This is an important week on the ec ? grade on both of these fronts.

I give it a ?D? because the economy d. This has hurt the economy in many ways.

GDP (Gross Domestic Product) for e Fed has been cutting rates (rates now stand at 3%). On the Fiscal poli ny.

This is too little too late. Now stagfl is is a nightmare for the Fed and for the economy.

As far as inflation is concerned, let?

Table A. Monthly and annual percent changes in selected stage-of-processing price indexes, seasonally adjusted

Month	Finished goods: Total	Finished goods: Foods	Finished goods: Energy	Finished goods: Except foods and energy	Finished goods: Change in finished goods from 12 months ago (unadj.)	Inter-mediate goods	Crude goods
2007							
Jan.	-0.1	0.9	-2.0	0.1	0.1	-0.2	-5.7
Feb.	1.2	1.6	3.2	.4	2.4	.8	9.0
Mar.	.9	1.5	3.2	-.1	3.1	1.0	2.5
Apr.	.7	.5	2.6	.2	3.2	1.1	1.0
May	.6	-.7	2.9	.2	3.9	1.0	1.0
June	.1	-.2	-.3	.2	3.3	.4	.8
July	.5	-.1	2.2	.2	4.2	.7	.3
Aug.	-.8	0	-4.2	.1	2.3	-.9	-3.5
Sept.	.5	1.1	1.2	.1	4.4	0	.9
Oct.	.5	1.2	1.4	.1	6.1	.5	3.0
Nov.	2.6	-.2	11.4	.3	7.2	3.1	9.2
Dec.	-.3	1.4	-3.0	.2	6.3	-.2	1.1
2008							
Jan.	1.0	1.7	1.5	.4	7.4	1.4	2.5

As you can see from the RED circle above, PPI (for finished goods) in January was up 1%. From the GREEN circle, you can see that core PPI (for finished goods), which is the PPI excluding food and fuel, was up

The PPI measures the changes in prices that manufacturers and wholesalers pay for goods during the various stages of production.

There exist price indexes for each of the three progressive stages of production: crude goods, intermediate goods, and finished goods.

The crude goods index represents the cost of raw materials entering the market for the first time (e.g. coal, cattle, etc). As you can see from the BLUE circle above, the crude goods index rose 2.5% in January.

The intermediate goods index reflects the cost of commodities that have undergone transitional processing before becoming the final product (e.g. auto parts, leather, etc). As you can see from the BLACK circle above, the intermediate goods index rose 1.4% in January.

PPI and the CPI are, of course, linked. If prices become more expensive for companies, then they will eventually become more expensive for consumers.

The PPI and CPI are linked, but, unlike the CPI, the PPI does not take into account services. This means that over the short term the two don?t move in tandem, but over the long term they do.

How will this statistic affect stocks?

When the PPI goes up, the earnings of a company will generally go down. Some companies are, of course, affected more than others depending on their cost structure, etc..

Some stock investors may say that a little bit of inflation is good as it allows producers to charge more for goods which will increase revenues. The key question is: how much inflation is good?

Let look at a basic hypothetical example:

Joey?s Pizzeria (located in Queens, New York)

Revenue: $100,000

Cost: $60,000

Cost Breakdown:

$40,000 for employee?s salaries
$10,000 for inputs (dough, sauce, fuel etc)
$10,000 for rent
Profit (Revenue-cost) = $40,000

Now, say that Joey?s costs go up by 5%. This will bring his total costs up to $63,000 (1.05x$60,000). This will leave his profit now at $37,000.

This is just the start. As costs go up for Joey?s, less money is left to reinvest in the business or to pay out to the owners of the business (e.g. Joey).

Joey may raise the price of his pizza to offset the increase in his costs, causing an increase in the price for his customers (e.g. an increase in the CPI).

Joey is not the only one out there experiencing these increase costs. Other businesses are feeling the pinch as well, not to mention Joey?s employees. Joey?s employees may soon ask for a raise.

This becomes a vicious cycle. If Joey?s increases its prices to offset the increased cost too much, then he may lose customers and decrease sales and revenues. If he increases prices the right amount, his customers may tolerate it (especially if he has good pizza).