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AHEAD OF THE TAPE

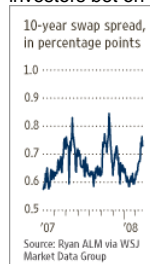
## Mind the Gap Between Stocks And Bonds

By MARK GONGLOFF

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The stock market is peppier than the credit market. One of them might be in denial.

The Dow Jones Industrial Average has fallen about 8% since credit problems first started bubbling up last June, but has rebounded lately as investors bet on a recovery in the second half.



The credit market's pain, meanwhile, has been far deeper and is getting worse. Markit's CDX investment grade index, which tracks the cost of insurance against investment-grade corporate defaults, has swollen more than 330% since June. Spreads on leveraged loans, which are made to companies with junk ratings, are at their worst levels of the crisis, having widened by about 184% since June, according to the Standard & Poor's/LSTA Leveraged Loan Index.

Swap spreads, another measure of risk aversion in credit markets, are pointing in the same direction. Swap spreads are essentially a measure of the difference between buying a safe government bond and making a riskier loan to a bank. The gap widens when lenders are pulling in their horns.

For example, the 10-year swap spread -- the gap between 10-year Treasury yields and market rates derived from the London interbank offered rate -- has ballooned above three-quarters of a percentage point, what Michael Darda, chief economist at MKM Partners, calls "crisis" territory. The spread hit that level last July and November, heralding credit-market meltdowns and, a little later, stock-market swoons.

That chain of events may not unfold again this time, Mr. Darda suggests, saying stock prices already reflect fairly dismal credit conditions. The Federal Reserve has flooded the system with money, and a viable bond-insurance rescue plan could shrink

spreads and improve credit conditions.

The trouble is that neither the Fed nor would-be bond-insurance rescuers can magically make lenders feel giddy about lending money again. Big bubbles tend to end badly, take time to unwind, and claim a lot of victims. That applies to credit bubbles, too.

The credit market could be ringing false alarms. But it could also be foreshadowing more damage yet to come in stocks.

### Inflation Starts to Creep Into Your Grocery Bag

Inflation is back on investors' long list of worries after yesterday's consumer-price index showed widespread increases in January. Oil prices hovering around \$100 a barrel won't help. Soaring food prices are an added concern.

Prices for the food consumers buy at supermarkets and other stores were up 5.7% from a year ago in January, according to the Labor Department, the biggest increase since 1990.

An earnings report from grocery chain Safeway today could show how this is eating into consumer spending power.

Rising costs for food items such as cheese, milk and chicken have crimped the profit margins of grocery chains in the past year. But grocery retailers are pushing back. UBS analysts recently upgraded shares of Safeway based in part on its ability to "pass [price] increases through to consumers," which could help cushion its bottom line.

Food retailers from Kellogg to Sara Lee to Campbell Soup have committed to boosting prices to offset rising input costs. That means more food inflation for consumers.

--Scott Patterson

