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**Weekly Wrap: Inflation Fears Slam Markets**

Friday October 7, 11:25 pm ET

By ETFzone Staff

Fear took hold of ETF investors this week, as inflation, economic impact from Katrina and Rita, and continuing damage to the Bush presidency unsettled investors and hit the markets hard. On Friday, the market moved slightly higher on a strong employment report. Although the employment numbers halted the selling, it did not undo the losses; most ETF investors had a bad week. The chart below shows this week's returns of three broad market ETFs: the Standard and Poor's Depository Receipts (AMEX: [SPY](#) - [News](#)), the Diamonds Trust (AMEX: [DIA](#) - [News](#)) and the Nasdaq 100 Trust (Nasdaq: [QQQQ](#) - [News](#)).



The specific catalyst to the selling appeared to be President of the Federal Reserve Bank of Dallas Richard Fisher's remark Tuesday afternoon that the Fed "can't let inflation poison the system." The chart above shows that the market was flat to higher before these remarks. The VIX (Market Volatility Index), which measures the volatility of the S&P 500 Index, and is known as the fear index because it spikes in times of fear, spiked on Fisher's inflation comments.

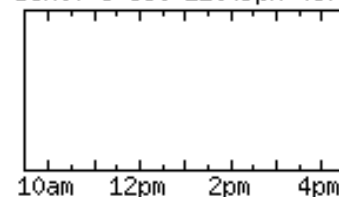
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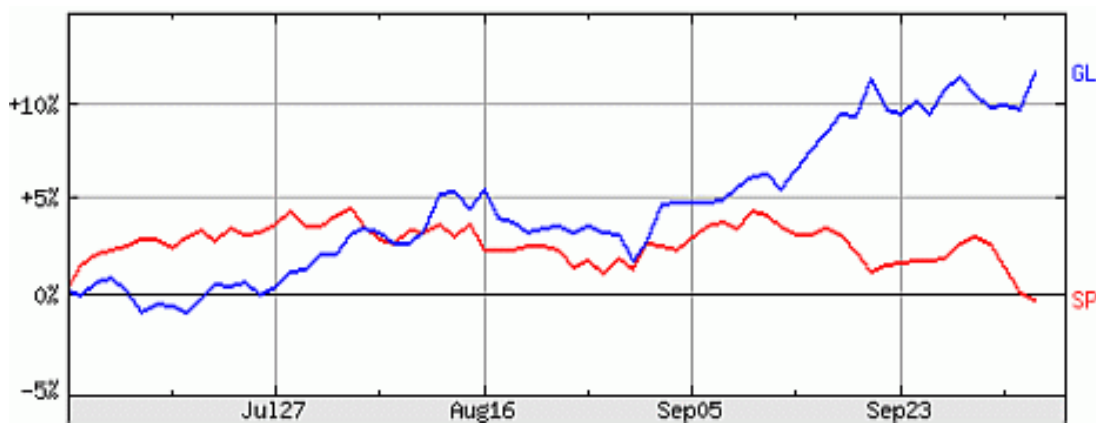
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Fisher's remarks had an impact in part because they articulate many investors' concerns about inflation. One of the best-performing ETFs in the last couple of weeks is streetTRACKS Gold Shares (NYSE:[GLD](#) - [News](#)). GLD was up again this week. The chart below shows the inverse relation of GLD and the benchmark SPY since mid-September.



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One of the remarkable stories this week was that the concern about inflation coincided with the collapse in the cost of a key contributor to inflation: crude oil. Crude fell 6.6% this week, to \$61.84 a barrel. Energy ETFs followed, closing the week down 6% or more. The chart below compares the returns of the Energy Select Sector SPDR (AMEX:[XLE](#) - [News](#)), the iShares Global Energy Sector (AMEX:[IXC](#) - [News](#)), and the alternative energy fund Powershares Wilderhill Clean Energy (AMEX:[PBW](#) - [News](#)).

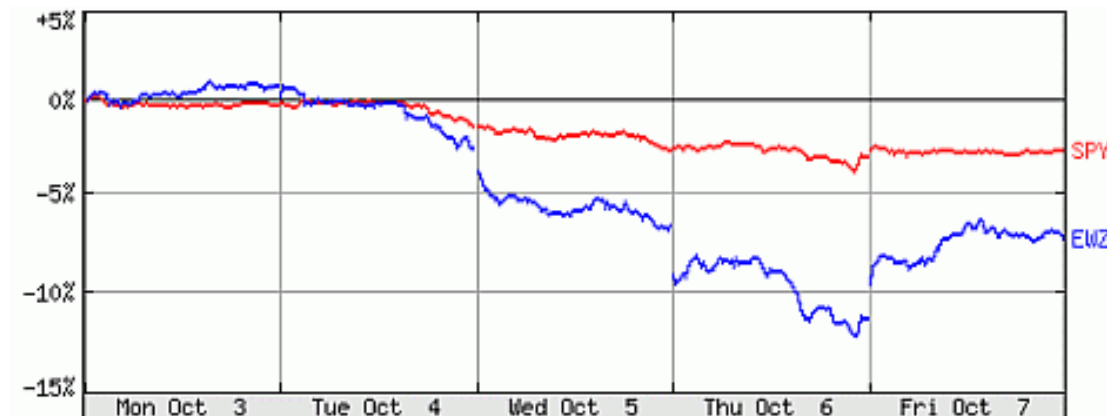


The combination of lower energy prices and lower prices for the broad market suggests that investors may be in the process of re-evaluation. Fixed income ETFs this week struggled for direction. The chart below shows this by comparing the returns of short and long term treasury funds, the short term bond fund iShares Lehman 1-3 Year Treasury Bond (AMEX:[SHY](#) - [News](#)), and iShares Lehman 20 Year Treasury Bond Fund (AMEX:[TLT](#) - [News](#)).



The move higher in TLT overnight Monday reflects a dividend pay-out. The drop on the open Friday reflects the strong nonfarm payrolls report, which came in pre-market Friday at -35K compared to an expected -150K.

Internationally one of this week's worst performers was an ETF that has been among this year's strongest, iShares MSCI Brazil (AMEX:[EWZ](#) - [News](#)). Brazil's stock market is very sensitive to the U.S. equity markets. Higher rates in the U.S. mean that Brazil may have a harder time attracting foreign capital. EWZ was also hurt by lower energy and long-postponed profit-taking. Brazil's Ibovespa index hit all-time highs just last week. The chart below, comparing EWZ with the domestic benchmark SPY, shows the volatile EWZ down 12% Thursday before rebounding Friday.



**NEXT WEEK:** The September Consumer Price Index is due out Friday, October 14, at 8:30, before the bell. The market is looking for 0.9% on CPI compared to a 0.5% in August, and 0.2% compared to 0.1% on Core. September retail sales is also due Friday before the bell. The market is looking for 0.2%, compared to a -0.1% in August, and 0.6% on ex-autos, compared to a prior 1.0%. The market may also trade on the FOMC minutes from September 20th, scheduled to be released Tuesday, October 11.

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