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Ahead Of the Tape

—Today's Market Forecast—

By Gene Colter

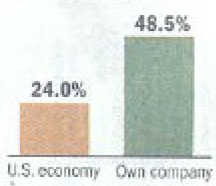
Line in the Sand

■ **Financial officers have little to fear but the Fed itself.**

Investors around the world spent the past few weeks fretting about whether the Federal Reserve will try to nip rising inflation in the bud by raising interest rates in late June. With an increase in the federal-funds rate next week to 5.25% now looking like a certainty, the focus in the days ahead shifts to whether the Fed will signal yet another increase in its benchmark interest rate in August.

Executive Angst

Percentage of CFOs who are more optimistic about the U.S. economy and their companies than a year ago:



Source: Duke University/CFO Magazine

A slew of economist reports out over the weekend say it is a distinct possibility that the federal-funds rate later this summer will hit 5.5%, the line in the sand for many chief financial officers.

CFOs can live with a little inflation—which they like to call pricing power—as long as their earnings are growing, says Campbell Harvey of Duke's Fuqua School of Business. But now they're getting nervous. Duke and CFO Magazine polled almost 1,000 global CFOs through June 1 and found about half had become more pessimistic about the business outlook, even though they were generally upbeat about their own firms.

Translation: They fear factors outside of their control, like the Fed. Rising rates increase the price of new projects and increase costs for customers. Half of the CFOs surveyed said a federal-funds rate above 5.5% would cause net income to suffer.

Fed Chairman Ben Bernanke has talked about a comfort zone of 1% to 2% annual price growth. The Fed's preferred price measure is now up a little more than 2% from a year ago. Other measures are running much higher. Inflation as measured by the overall consumer-price index, for example, has flared to a 6% annual rate in the past three months, enough to send a central banker into a collar-tugging spasm to rival the late Rodney Dangerfield.

CFOs aren't generally card-carrying members of the often-shrill Fed-bashing chorus, which has grown louder since Ben Bernanke started conducting monetary affairs. But many do worry that central bankers may not recognize when they've moved beyond inflation-damping into growth-killing.

Already, some short-term interest rates are above their longer-term brethren, something known as an inverted yield curve. If the Fed does indeed up federal funds another quarter point to 5.25%, that inversion could worsen. Recessions follow such flipped yield curves within three to five quarters, Prof. Harvey argues.

Lean on the CFOs hard enough, and everyone could end up suffering.

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