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Central Plains Advisors, Inc.

June 13, 2007

Dear Client/Friend,

Here is an additional paper we promised. No one has done a better job of analyzing the consumer's financial condition than Stephen Church of Piscataqua Research, Inc. His original work is innovative and not available anywhere else that we have seen. It is extremely well done.

The U.S. economy is eating its own seed corn, and when that is completed, we are in for a long, difficult winter. The eater of that corn is now running out of the means to consume. With little or no help from any other economic sector, the consumer is dead in the water. Please study the enclosed document. We are here for your call.

Sincerely,

Central Plains Advisors, Inc.

Enclosure

"Investing in Your Future"

Fixed Income Management Employing Behavioral
Investment Strategies



CONSUMER CASH FLOW*

<u>Year</u>	<u>Total</u>	<u>Operations</u>	<u>Debt</u>	<u>Operations</u>	<u>Debt</u>
2003.....	\$1,683.8B	\$357.3B	\$1,326.5B	21%	79%
2004.....	\$2,025.5B	\$365.4B	\$1,660.1B	18%	82%
2005.....	\$2,005.6B	\$233.1B	\$1,772.5B	12%	88%
2006.....	\$1,763.0B	\$208.4B	\$1,554.6B	12%	88%
2007(E)	\$1,524.0B	\$184.0B	\$1,340.0B	12%	88%

(Prior to 2000, % operations and debt 50%-50%.)

Consumer cash flow is now estimated to be below 2003. Cash flow peaked out in 2004. Debt increases topped out in 2005. Cash flow from operations (income and non-cash items in excess of personal consumption minus savings reductions) has declined 46% since 2003.

CONCLUSION

It's all over—the consumer is withdrawing from the marketplace. Retail sales will decline, and corporate profit margins have peaked. Recession seems imminent.

**Taken from Stephen Church Research*

Interim Market Update



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June, 2007

FINALLY, THE BRICK WALL

Based upon the Federal Reserve's flow of funds statement published June 8th, crunch time has finally come for the consumer after over twenty-five years of spending beyond his means. Please note the following tables taken from Stephen Church's *The Consumer Crush–June 2007 Update*. We have reformatted his tables in order to make it somewhat easier to follow. All the numbers come from the Fed's analysis of 2007's first quarter annualized data, compared to full year 2006.

It is shocking in its implications. The recent spike in mortgage rates has sealed the fate of the consumer. His source of debt accumulation to offset lagging income, coupled with an insatiable desire to spend, has hit the proverbial brick wall. Please note the following tables, which summarize changes.

Table 1

Spending Flows

Personal Income Increase.....	\$585.4B
Personal Consumption and Other	\$529.6B
Debt Service	<u>\$105.0B.....\$634.6B</u>
Overspent.....	\$49.2B

How Funded

Savings Reduction.....	\$48.8B
Reduction in Checking Accounts.....	<u>\$0.4B.....\$49.2B</u>
Balance	<u>\$0</u>



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Interim Market Update



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Table 2

Asset Change Flows	
Increase in Money Balances (M₂)	\$141.4B
Decline in Debt Flow	\$214.0B
Decline in Savings	<u>\$48.9B</u>
Total	\$404.3B
Reduction in New Homes and Remodeling	\$111.7B
Reduction in Existing Homes and Financial Assets.....	<u>\$292.6B</u>
Total	\$404.3B
Balance	<u>\$0</u>

According to Stephen Church—and we believe he is right on—the liquidity of the consumer is the critical financial variable in determining the economic outlook. His liquidity has been under pressure, and it appears that at last, having been cut off using his home as an ATM, he must rebuild such by liquidating assets and/or reducing consumption. A little of both seems to be currently occurring. It seems sure to get worse.

The role of the Federal Reserve has been critical during this entire period of overspending by the consumer. They have, time and time again, come to the rescue of large (too large to fail) speculative Wall Street institutions and players. This has created a “moral hazard” whereby speculations pile up. The consumer feels the Fed has stopped recessions . Risk becomes the path to riches for Wall Street investors, which attracts mathematicians and computer wizards to create financial instruments, which very few of us mere mortals can understand. The result of these goings-on: Main Street is bagged, Wall Street is bailed out, and the economy goes to pot! That’s where we appear to be right now.



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Stephen Church believes that the Fed, through its recent actions, has inadvertently caused the spike in long-term rates. We do not share that view. It is our opinion that the unraveling of the speculative excesses, which have been rampant the last few years, commenced in the middle of May and has a long, *long* way to go. When deals go bad, speculators need to raise cash, and the easiest way to accomplish that is to sell government securities. Also, the holders of large mortgage portfolios will sell assets and/or short long-term government bonds in order to reduce their portfolio duration, as there will be no early mortgage payoffs due to much higher mortgage rates. In actuality, it makes little difference whether this spike in long rates was caused by the Fed or private investors. The results will be the same, i.e. severe financial dislocation and economic recession. Perceived inflation problems will soon turn to deflation, requiring the Fed to cut rates. We doubt a cut in the Federal Funds rates will rescue the economy this time. Financial institutions need to cooperate in order for lower rates to work their magic. Who will lend to whom? Commercial banks could be in trouble. Investment banks may be in even worse trouble. Corporations won't need more money to expand, and the consumer could be near broke.

Surely things will not be as bleak as painted above. It could be that we will be in for a *long, grueling, slow economic period* with declining common stock P/E multiples, and extremely low interest rates with nobody to lend and nobody to borrow but very happy U.S. government bond holders.



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