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Interim Update

The Keynesians Strike Again

There they go again. The Bond Vigilantes who can't seem to stand prosperity have halted, for now, the Government Bond Bull Market for the umpteenth time in the last 20-plus years. Although not on purpose they once again have given us an additional chance to enhance the value of our portfolio. What took six months to accomplish, they on paper have taken away in six weeks. But that's OK. For, once again, we can acquire a 5% return during a period of income drought. And to boot we should be able to "double the coupon" if one can withstand the volatility. In other words, a possible 10% annual total returns are well within in reason. But again, they won't and don't occur on a linear basis. Markets do not work that way. We wish they did.

What happened?

The main reasons and action, **invalid as they may be**, are as follows.

1. The large Federal deficit will cause interest rates to rise.
2. A recovery of significant strength is finally underway.
3. Deflation has been cancelled. Inflation prevails.
4. The Federal Reserve has withdrawn their expressed "non-traditional" plan to buy long treasury bonds.
5. The leveraged hedge funds and bond speculators have reversed their long positions from (borrow short and buy long) to (sell long and pay down short debt).

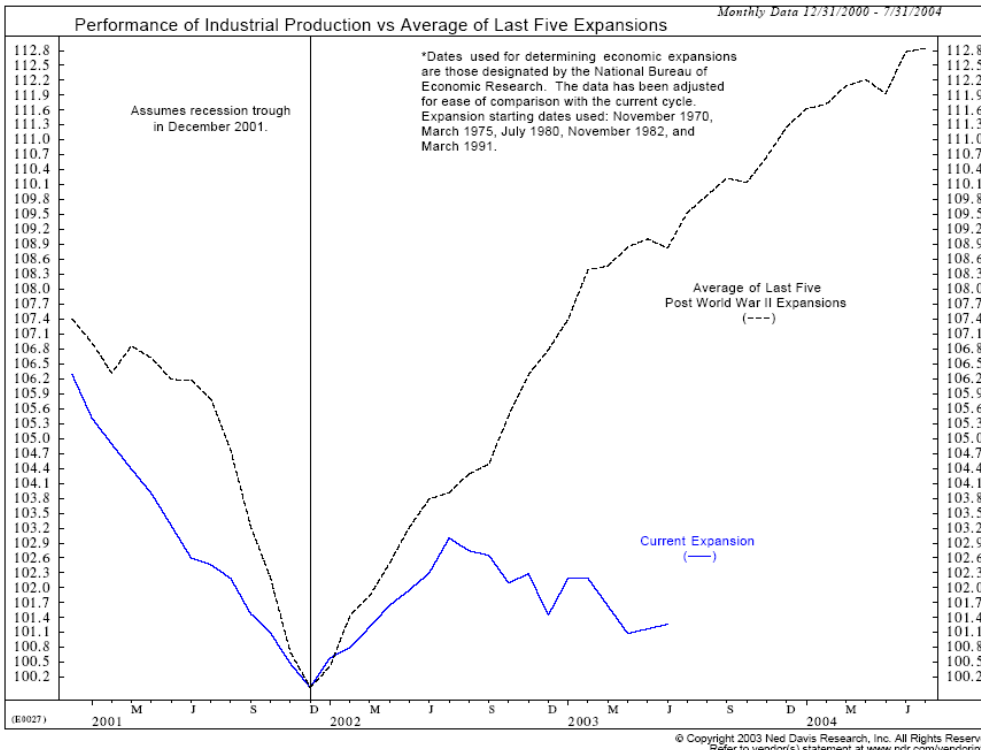
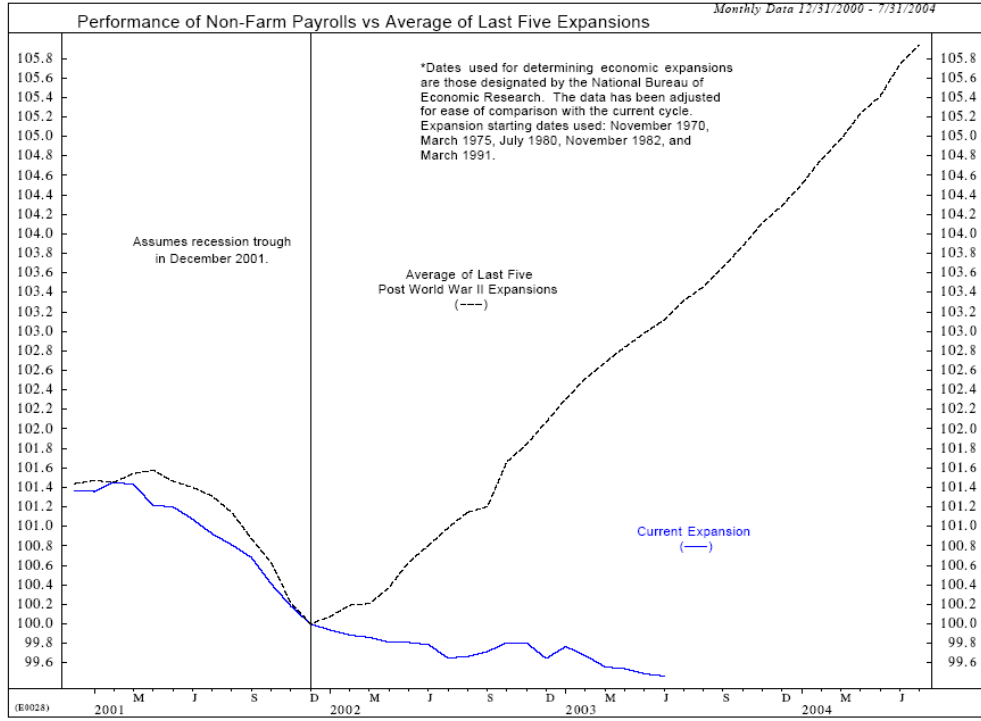
Of the above, the first four are incorrect and the fifth is the action taken because of those feelings. As mentioned previously, this has happened time and time again over the last 20-plus years. Each and every time it has represented a buying opportunity – IT IS NO DIFFERENT THIS TIME. The Federal Government is in much better financial shape than corporations and individuals. There is no direct connection between government deficits and interest rates. Huge corporate and consumer debts equals deflation and any case to the contrary is misguided and the incorrect interpretation of the economic landscape as it stands today. The drumbeat from Wall Street since March this year has been – recovery, recovery, recovery and inflation mongers using their rear view mirrors as a guide have once again declared mounting inflation as our future.

Do the charts on the back of this page indicate a recovery that will cause inflation? Are you kidding me?

PS: Do you remember the stock market crash of 1987? This counter move in bonds is very reminiscent of the third quarter of that year. Government bonds should be bought and common stocks sold. Be careful!

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