

# Central Plains Advisors, Inc.

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## Economic Commentary

December 31, 2003

### Indeflation is Where We Are Now

The U.S. Economy is experiencing “indeflation,” which is a new post World War II economic environment not understood on Wall Street or in the Ivory Towers of Academia. What do we mean by that? It is a term to describe the inflation of asset prices (one after the other), which will ultimately result in a serious bout of deflation. It revolves around credit inflation (easy money, low interest rates, and wide open credit markets), which results in newly created money flowing from one asset class to another, both domestic and foreign. The architect of this cancerous condition, in our view, was and is the Rubin and Greenspan Wall Street and Washington combine of the 1990's. This disastrous bubble domino asset play can have only one final result – debt, default, deflation, and decline. We just see no other way out of this mess, which by the way, has happened several times before throughout world history, the most recent time being the mid 1920's through the mid 1940's. Although it may be a little far fetched, we ask you was the Hitler movement of the late 20's – 1930's anything akin to the present Osama Bin Laden / Sadam Hussein terror? Has France and Germany become the English (Nevell Chamberlain) pacifiers of this era? We don't have the expertise to make these two analogies; however, we do believe we have the economic and financial comparison nailed. If so, this will be the single most important event in your, and my, lifetimes. What investment decisions we make from this point forward are destined to be extremely critical to our future financial well-being.

All of this huge expansion in debt (easy credit) has resulted in extremely volatile asset markets. Volatility, unfortunately, creates emotions, which lead to bad buy and sell decisions. When markets are strong we all become experts; when markets are weak we all become fearful of losing our money. If someone is managing our funds, volatility creates Monday morning quarterbacks who, in hindsight, know exactly what should have been done.

We cannot emphasize enough how important it is for everyone to have at least a portion of their assets in U.S. Government securities. Shorter term government bonds for those who want to come out even, longer term for those who desire to make a few dollars (maybe 60%) in order to have more principal, which at much lower than present rates will provide decent income.

Enough of our preaching, (our thesaurus did not come up with a word that better fit Websters definition of preach – “to pronounce a public discourse on a sacred subject”). Let's look again, as we have in the past, to the amount of debt slouching around world wide markets, emanating primarily from the U.S. Please note the following new issue market numbers as of and through 9/30/03:

**Total Market Debt Issued – Gross**  
**Net Issued Not Yet Available**

<u>Item</u>	<u>9 Months Ended 9/30/03</u>	<u>versus same period 2002</u>
Total	\$5,380.0B	+40.3%
Major Items		
Mortgage related	\$2,580.0B	+67.9%
Federal Agencies	\$1,010.0B	+36.5%
Corporates	\$ 583.2B	+12.9%
Treasuries	\$ 530.3B	+24.9%
Assed backed	\$ 423.4B	+18.6%

Without doubt by year end 2003 another record will be reached. If that be the case, then we will have had 6 straight years of over \$2T of **net** new debt issuance in this economy. The all mighty U.S. economic juggernaut is being leveraged to such an extent that one must wonder how much more weight can be carried. It's always been normal for recessions to create a renewal period in which mistakes of the past are undone and financial balance sheets are repaired – not so this time around. In the corporate area all one can say is that many have moved their debt from short term to long, but interestingly enough, the interest burden has increased, due to more debt being outstanding at lower overall rates. Slow sales gains, no pricing power, and greater interest costs are not conducive to higher profits.

The consumer continues also to burden his financial balance sheet with more debt and saddle his after tax income with higher and higher monthly payments. A recent federal reserve study indicated that individuals on average must commit 18.1% of their after tax income to fixed monthly payments. Another independent survey reports that 57% of families with children under 18 needed their latest paycheck to take care of current needs, and even 34% of those with incomes of \$75,000 are in the same boat.

Most of what is written about debt has to do with the federal debt as the deficit for the year to end 9/30/04 is estimated at \$500B. Don't get us wrong, under normal circumstances these deficits are not good for the economy, however under present conditions, if it was not for the tax cuts and defense spending, this economy would probably continue to be in recession. All in all, with debt levels everywhere high and profits and personal income under pressure, the only way most can spend is by adding more debt to their financial balance sheets. How much longer can that continue?

**A Note From The Heartland**

Guess what? Although Wichita is in the dumps due to the aircraft industry being in recession, the rest of the state is booming. We are one of the few states in which tax receipts are ahead of budget. The reason is that cattle prices along with grains (wheat, milo, corn and soybeans) are booming. Hooray for us, but there is a serious catch to our prosperity. Cattle prices will probably stay rather high due to 5 years of poor prices and herd cutbacks; however, county-wide there has been record to near record harvests for the grains. Why high prices after huge crops? Bubble Bubble Boil and Trouble. The flooding of the world with dollars on the part of the Fed (mentioned earlier), we believe has inflated the asset prices of farm commodities. The last time wheat approached \$5 back in the late 70's, farmers here in Kansas wouldn't sell because wheat was sure to go to \$10. That was about at the time oil was \$30 and going to \$100. Ha!! There probably will be similar thoughts again

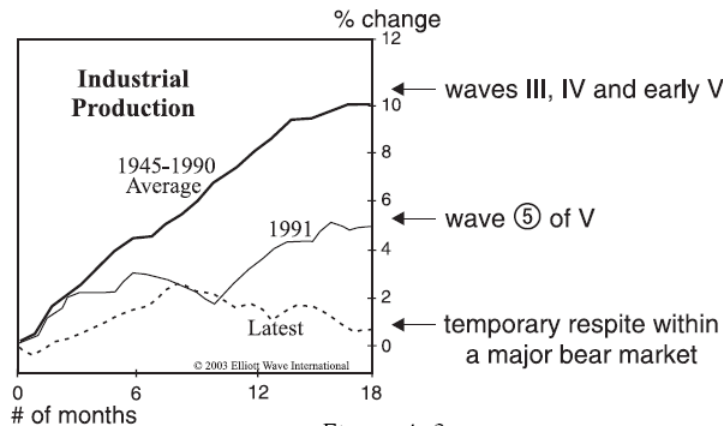
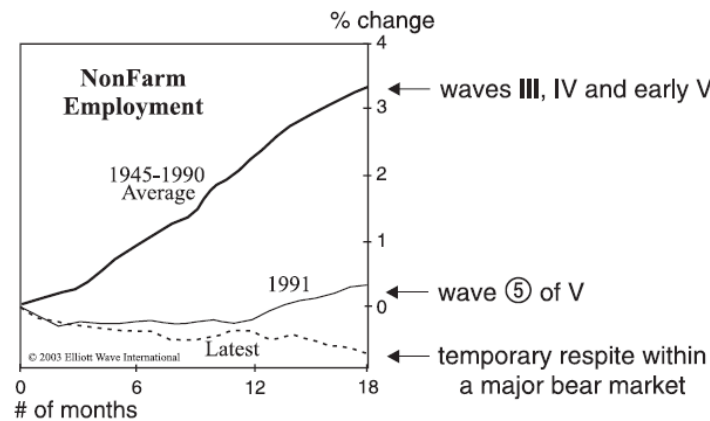
this time due to all the inflationary talk we hear day after day. Our advise – Don't believe it! Again with indeflation we are having asset inflation coupled with retail goods disinflation plus massive increases of debt. There can be only one ultimate result in this – deflation both in asset prices along with inflation in the amount of debt. By inflation in debt we mean the dollar amount remains the same, but the where withal to obtain the funds to pay the debt is less. No job, no income, and no willing bank to refinance can be a problem.

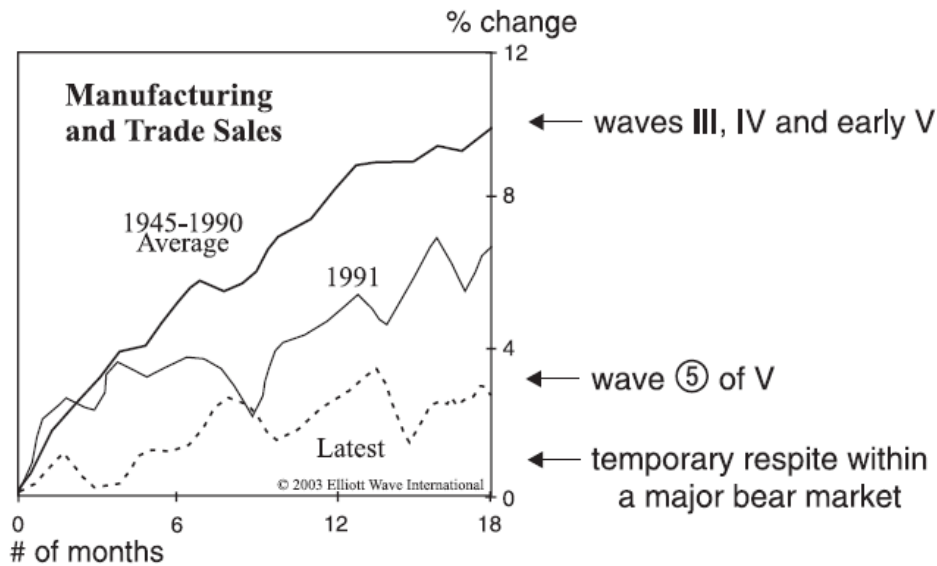
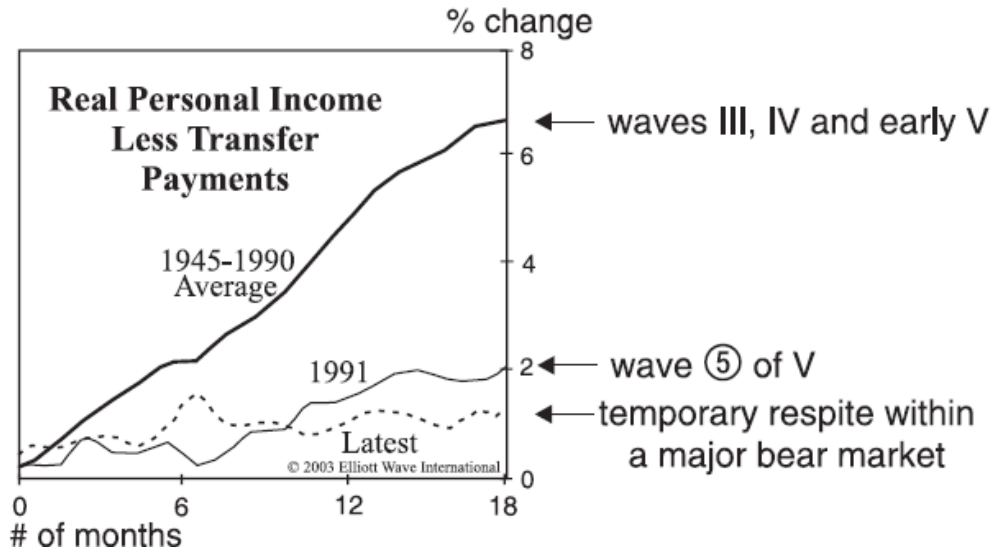
### Economic Outlook

The times are perplexing. The good GDP numbers are indicating a robust U.S. economy and Alan Greenspan is becoming a hero again. In our opinion, increased use of debt at all levels is masking over the problems that are growing day by day. How much longer we can go on like this we don't know. As my mother used to tell me: "A fool and his money are soon parted". We believe that applies today more, maybe, than ever before. It takes today something like \$7 in debt in order to increase GDP by \$1 (that's what it was last year). Will it be more this year and again more next year? If GDP is our country's total income, and many say that it is, then does it make sense to continue to borrow \$7 to make \$1?

There are some early signs that the growth in debt may be slowing – mortgage applications are down, bank loans are down, money supply is moving sharply lower, and it seems only the housing industry force feeders (Fannie Mae and Freddie Mac) are still adding money (debt) into the system.

We are sure that you can tell from the above that we have little faith in this economy growing strongly from here. We suggest you look at the following charts that come from Elliot Wave International. Does this look like something special?





### Postscript

Since the above was written, “Mad Cow Disease” came to the U.S., and the cattle market has declined sharply. At this time, some 30 nations have shut their doors to our beef exports. Hopefully this will not be a long-term condition. Kansas, which is the second largest producer of cattle (after Texas) in the U.S., is sure to suffer and the increase in tax receipts by the state is certain to diminish if this boycott last much longer. The long-suffering cattleman, who at last was making a profit, just can’t seem to catch a break.

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