

Central Plains Advisors, Inc.

Economic Consulting and Investment Management 9415 E. Harry Suite 201 Wichita, Kansas 67207

Economic Commentary

September 30, 2004

This is Our Story and We're Sticking With It!

How many times must we say it? There is no sustainable inflation in sight . . . period.

We are going to depart from our usual procedure and summarize a piece done by Gary Shilling and published on John Mauldin's new e-mail newsletter, *Outside the Box*. This is an extremely important paper that needs to be read by all who are hopeful of investing wisely and successfully. But first, a note about our relationship with the above two men, whom we are pleased to call business associates and friends.

Gary Shilling is an economist based in New Jersey, who left Wall Street years ago to form his own economic consulting firm and later become an investment advisor. We have known Gary since 1974 and have been a client of his since that time. He has been, and continues to be, on target over the entire period of our association. He fails only in the timing of certain events, but of course, if he was always correct about that, he certainly wouldn't be fooling around with us, or for that matter anyone else. His greatest distinction in our mind revolves around his being fired by Don Regan (ex-Merrill Lynch chairman) not only once, but twice. Regan didn't believe in his economists publishing recession predictions. After all, Merrill Lynch is always "bullish on America."

John Mauldin is a more recent acquaintance (some ten years or so). John interviewed us for a fixed income manager search concerning a block of money in Austin, Texas. We were successful and over the years have come to appreciate John, not only as a very bright investment advisor, but also a gifted author, his latest book being Bulls Eye Investing. We highly recommend this book.

Is Inflation Truly a Threat?

A. Gary Shilling (Summary by Don Peters)

Most all investors believe inflation is on the rise. Why? Many believe the C.P.I. (Consumer Price Index) is not properly computed and are certain the P.P.I. (Producer Price Index) increase, which has risen over the last several years, is bound to flow through to higher consumer prices. The real facts are that if anything, the C.P.I. remains overstated and producer price increases, by in large, will not flow through to retail prices due to intense competition and the fact that commodities are a miniscule part of the cost of most items. A 1% rise in raw material prices equates to a 0.07% increases in consumer prices. Another reason that inflation seems to be accelerating comes from small budget items going up in price – for example milk. It's up to 10%+, but amounts to only 0.2% of one's purchases. On the other hand, today you can purchase a computer for less than \$1,000, which has twice the power of a \$6,000,000 computer 40 years ago. There are many other nuances in the computation of the inflation increases which, on balance, overstate rather than understate while at the same time giving the impression of trouble ahead.

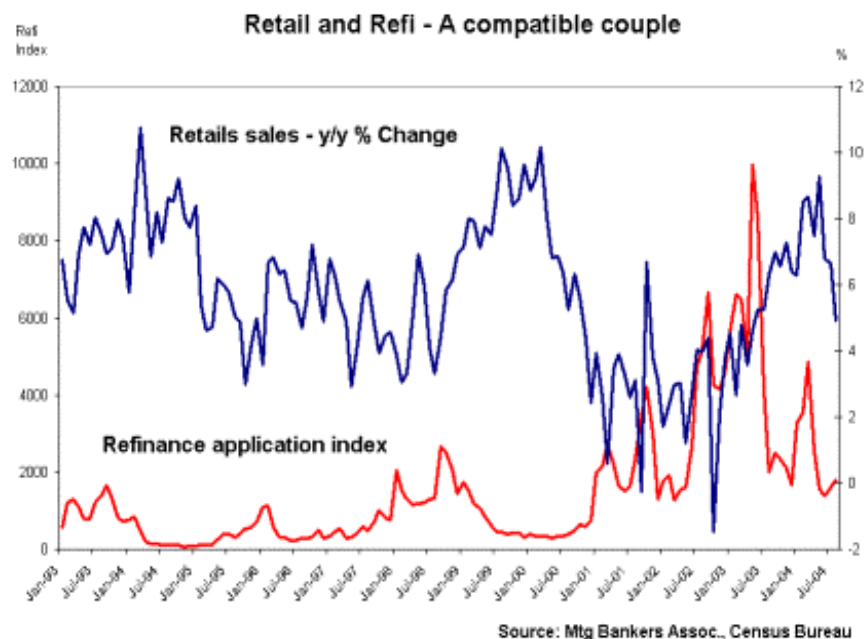
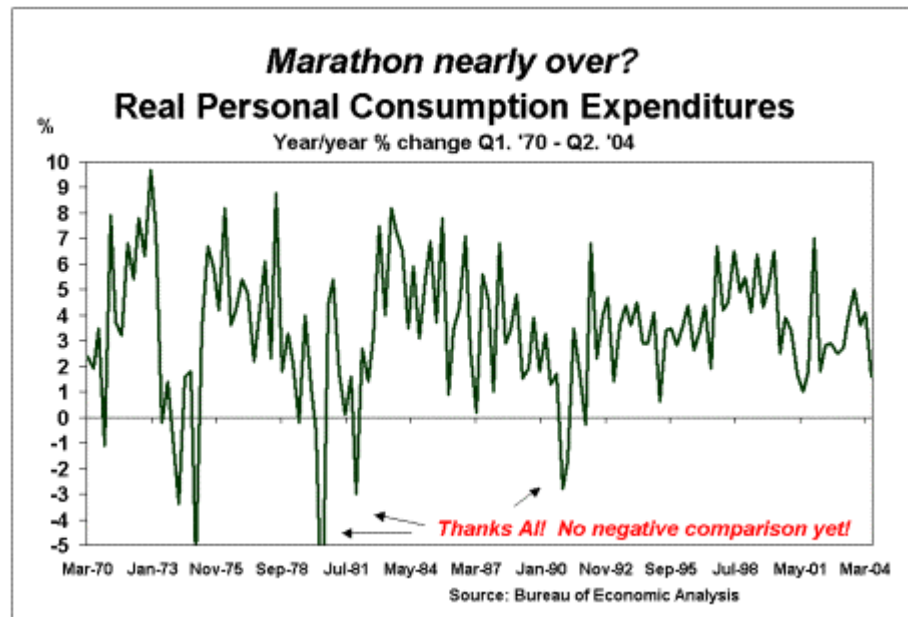
Gary makes the point that inflation is primarily associated with war. What we had in the 1970's was an explosion of inflation due to many things, one of which was the ongoing Cold War with the Soviet Union. Now, some worry about the War on Terror. We all seem to have inflation molded in our psyche just as those in the 1950's and 60's had the deflationary times of the 1930's always in mind. Inflation has become a given – we all expect it and generally act in such a way to protect ourselves against its potential reemergence. What most, if not all, seem not to understand is that we are in a profound deflationary environment. In simple terms, we have too much supply and not enough demand as we go forward. Coupling that with excessive debt at the consumer level adds to the problem.

We hope this gives you a bit of the flavor of Gary's paper. We again urge you to read this thoughtful work. Gary is one of a very few that understands the investment environment and has the landscape well in mind.

Charts That Tell A Story

As you know, we have couched the current economic trend as one that is basically a revival of the industrial sector versus the probable demise of the consumer. The chart to the right depicts the quarterly year-over-year change in real personal consumption expenditures. Please note that there has been only one actual contraction in the last twenty some years – the recession of 1991. Mr. Greenspan is very proud of preventing such during our last recession of 2001. We believe this is a very dangerous pat on the back, as what did greatly expand was consumer debt, which will take away from the future.

The next chart in part explains why the consumer has been able to keep up his spending in spite of the recession of 2001. Note the decline in year-over-year percentage change in retail sales compared to the mortgage refinancing. In essence, people have “sold”



a portion of their homes in order to buy an automobile that they probably didn't need, but couldn't turn down at 0% interest. By the way, did you notice that Ford increased their guidance on profits for the year? Where are the profits coming from? Their financing company. We think it would be nice for them to make a profit manufacturing cars. Frankly, we are quite fearful that Ford may be the next large U.S. corporation to go by the wayside.

We are noticing now that more and more of the mainstream investment community are coming to the conclusion that bonds just may outperform stocks over the next several years. As you may recall this has been our expectation since early summer 2000 (June 29th to be specific). Once this becomes the dominant position, it will in all probability signal the beginning of the end of the bull market in bonds as well as the bear market in stocks. We expect this to happen, but only after there is "blood in the street."

Also, have you noticed how those on CNBC just cannot understand why oil and gold can go up in price while yields on government bonds go down. The reason, in our mind, is the fact that along with food, oil is the most needed commodity in the global economy, plus the fact that oil is denominated in dollars and dollars are suspect. Gold and U.S. government securities on the other hand are safer havens in a world facing the real possibility of a synchronized global slowdown. We believe this is the story being told by the markets. Please note below the similarity of our recent stock and bond markets compared to Japan, lagged by ten years – could this be our future?

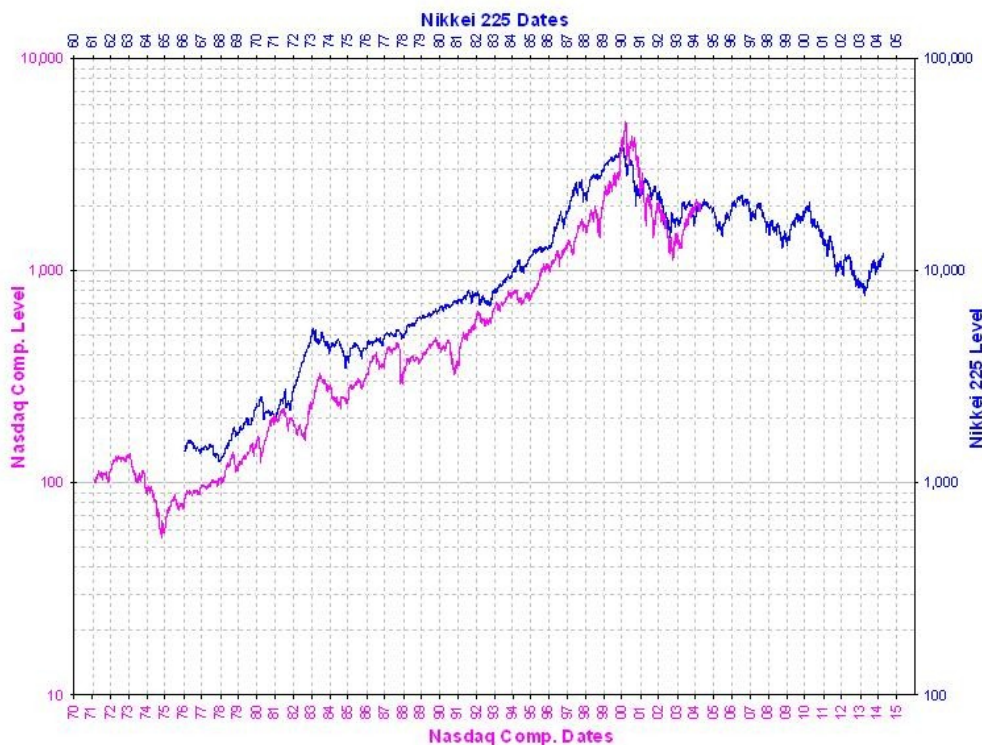
Stocks vs. Bonds

A Smith Barney study via the website of Bill Bonners, dailyreckoning.com:

Here's something very interesting.

A recent report from Smith Barney includes two charts. The charts show the similarities between the United States and Japan over a 25-year period. As you will see, and as we highlighted in our book, the two markets seem to run in parallel – separated by a 10-year gap.

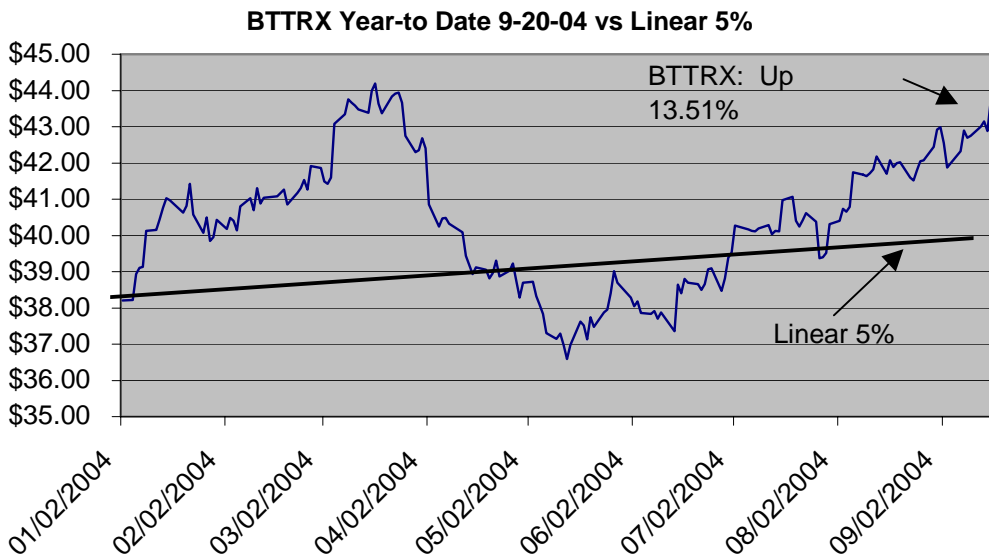
We don't believe the comparison is perfect, but the investment environment is quite similar. This fits right with our optimism that future returns from paper assets are destined to be low and that some bonds (long governments) will outperform stocks.





A Final Note

A good bit of our time is spent in attempting to keep our clients hitched to our investment program. Every investment manager has the same problem as the myopic fear of loss keep people from achieving good long-term investment results. Please note the following BTTRX mutual fund chart that we use in our Bison Bond I program. Please, please call us at 888-735-CPAI (2724) and visit with John Parker about this. Your understanding of this chart and what it shows may be the most important thing you do over the next several years.



Central Plains Advisors

Information contained in this commentary is based upon information obtained from sources both external and internal which we consider to be reliable, but the accuracy of the information and the recommendations contained herein cannot be guaranteed, nor do they constitute a solicitation for the purchase or sale of any securities mentioned herein. Information contained in this commentary may not be reproduced in any form without written permission from Central Plains Advisors, Inc.