

Interim Market Update



Central Plains Advisors, Inc. • 200 W. Douglas Ave., Ste. 100 Wichita, KS 67202 • Economic Consulting & Investment Management

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PRICE SYSTEM DESTROYED

“We must look at the price system as a mechanism for communicating information if we want to understand its real function.” – Friedrich A. Hayek

As we have said before, one would have thought that the Federal Reserve’s declaration that they were going to buy \$600 billion worth of government securities would have caused yields to move downward (prices upward). After all, a new buyer emerged which increased the demand/supply equation in favor of demand. Yet just the opposite has happened. Why has this occurred? The answer is that psychology has trampled market and economic fundamentals. The Bernanke monetary policy has led speculators to believe that they can buy more risk assets, which have the possibility of more gain, as the Fed will bail them out. But let’s start at the beginning.

We are in one hell of a mess economically and much of it can be attributed to the action of the Federal Reserve. Let there be no mistake, however; excess spending on the part of government at all levels has likewise distorted the free enterprise system which allocates resources in an efficient manner without discrimination. To do otherwise is to allocate by fiat (command). That, of course, has never worked in the history of mankind and that lesson is being learned right here, right now.

Let’s get back to the Federal Reserve. By controlling short-term interest rates (at this time near 0%) they are sending fiat messages to the public which entices them into making investment decisions they would not otherwise make (longer-term risk assets). It also unleashes the animal spirits of Wall Street, which promptly turns into bubble blowing of the stock market and commodities that always ends badly since at some point there is no longer a greater fool who will buy the crowded asset in portfolio. It has happened twice in the last ten years and will happen again.



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Then, of course, Wall Street is bailed out and those of us who are Main Street are bound to pick up the tab. In our opinion, this is legalized theft. Think of it – Wall Street can borrow at 0% rates, while for most of us it's 6%. They can take on extreme risk due to public policy that shifts their losses to Main Street after having been handsomely rewarded in the short run. We, on the other hand, cannot afford to take much risk and must invest at rates of approximately 1% to 2%.

To make matters worse, the speculation in commodities has driven food prices through the ceiling, which serves as a tax increase for Americans and has made rioters of such countries as Egypt. Oil prices are also escalating, which is another tax on Americans. To top it off, public policy does not allow us to use our God-given resources to become self-sufficient. Again to make things worse, the federal government wastes billions of dollars on pie-in-the-sky alternatives (e.g. ethanol) that the free market would not allow otherwise. We cannot force feed stupidity!

The final result of all this madness is overpriced long risk assets and underpriced long riskless assets. How long will it continue? Until it doesn't. The seeds of destruction are growing. After nearly two years of equity mutual fund outflows, December of last year saw inflows which have continued to date. The bag holders are getting in place. They cannot stand to see stocks going up and them being left behind.

What will tomorrow bring? Wall Street will unload their stock, commodity, and junk bond holdings on Main Street (you and us). Those who are last to sell will be bailed out by Washington. Main Street is dying. Unemployment seems destined to be with us for a long time. The real question becomes how long will Main Street stand for being the dump yard of the Washington elite and Wall Street? In our opinion, the only way to beat this unholy alliance is to invest long with high-quality government bonds. This country, as bad as things are, is still a diamond in the haystack. As someone said, "We are the best looking horse at the glue factory." Patience will be rewarded. Double digit gains using high quality assets (long government bonds) will be our reward.



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