

# Interim Market Update



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March 2006

## The Darkness Before the Dawn

A week or so ago the European Economic Union Monetary Authorities raised their short-term interest rates. At approximately the same time Japan signaled that they might scrap their zero interest rate policy, which has been in effect for some 10 years. All of this happened after Wall Street had become convinced that the US economy was embarking on a new growth phase. The concern on Wall Street was highly influenced by the 2.3% increase in retail sales for the month of January. Interesting enough sales for February appears to have softened considerably. February, however, is considered an aberration due to terrible weather in the northeast while at the same time the warmest January in history supposedly had nothing to do with the above 2.3% increase.

The convergence of these factors have to date created a mini interest rate spike, which is sending shock waves through the speculative “carry trade” community. The unwinding of having borrowed euro’s and yen’s to buy long positions in stocks, bonds, commodities, and housing is now underway. It appears as if a liquidity squeeze is in sight.

How does this effect our position in the long government bond? The answer is it hurts on paper near term for two reasons. There will be some who own these governments as a part of a carry trade, which will need to be reversed. Also as governments are the largest and most liquid market in the world many will need to sell their positions in order to pay down debt on other losing trades. That is the short-term. On a long-term basis this is what we thought might happen. The higher these rates go now, the lower they will be later on. In other words this should be the tipping point on the way too much lower long-term government interest rates.

**Many ask if we expected that these rates might spike upward why did we not sell. The answer is if we knew the actual timing on all such events we would have all the money in the world. We, of course do not, but what we do have is a fix on the economic fundamentals, which has allowed us to have a superior long-term record.** The greatest investor of our time, Warren Buffet, lost over \$300 million betting against the dollar last year. However, you would be hard pressed to find a long-term performance record better than his. Look for stocks, low-grade bonds, commodities, and housing to sharply decline from these levels. When the smoke clears we will be sitting on the premier asset in the world whose profile will consist of higher prices and lower interest rates.



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