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Economic Commentary

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Brief But To The Point

We have been in constant contact with you by updates since our last newsletter. You all know our position but for emphasis, let us summarize.

1. The events of September 11th have caused the recession to be deeper and maybe even longer than we originally thought.
2. The mountain of debt which is being carried by the corporate sector, as well as that carried by individuals, will need to be liquidated to a significant degree before a lasting recovery will occur.
3. We expect a regression to the mean in common stock returns over the next three to five years.
4. Bonds represent a startling mixed bag as suggested below:
 - (1) High yield bonds will suffer. Many will default.
 - (2) Municipal bonds in general will be under pressure. Governments less than Federal will face fiscal problems.
 - (3) Most high quality corporate bonds will be refunded robbing investors of their capital gains. This will force reinvestment of original principal at much lower rates. For the lenders (investors) a typical lose, lose scenario.
 - (4) Short to Intermediate Governments are not attractive. Their prospects are good only for safety.
 - (5) Government bonds of long maturity will bring handsome total returns to those with patience.

Just as location, location, and location govern real estate; so too will quality, quality, and quality govern investments over the next several years. In addition, as it pertains to bonds, duration, duration, and duration will also be of paramount importance.

Do not let the inflation monsters steer you wrong. Deflation is our problem. War is inflationary, but the effects thereof are well in the future. We believe we will know if and when the problem commences festering. It will happen when everyone is convinced deflation is here forever.

We hear many believe that because the Federal surplus is shifting to deficit a move upward in interest rates is bound to occur. This is nonsense. As a matter of fact, the U.S. Treasury recently sold \$6 billion in 10-year notes just to relieve a shortage (see Bloomberg article 10/04/01). It wasn't done to raise cash but to help fill demand for high quality paper in the market place. Just as are men, a good asset is hard to find.

Don Peters

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