

## IS THIS THE REASON WHY?

WEB BUZZ 2010.06.21

We noticed in our local newspaper that one of the leading real estate men in this area made the comment, "We're living in a rather unique period of time where things are very flat." He was making reference to the valuations made on downtown Wichita properties for real estate tax purposes. In other words, the old idea of everything going up in value, a la inflation, for the last 50+ years just may be over. Why is this important? We believe that this is yet another sign that inflation is as dead as a doornail going forward. Gary Shilling has taught us that there are two kinds of deflation - one being the good kind in which prices decline, say, 1% or 2% per year; however, in this scenario there is no overhang of debt that needs to be liquidated, therefore no vicious cycle of economic destruction. There also is the bad kind where there is a debt reduction cycle that takes place. It is this latter scenario that we believe is taking place and will accelerate into an on-going recessionary period, which will benefit high quality bonds and destroy equity prices.

Equity prices seem to be in a trading range now, after a sharp rally off of the low of March 9, 2009. As this is being written, the market has just sustained a 10% correction and is now awaiting, we believe, the outcome of the two separate deflation scenarios. We believe this is the reason why the market has not yet corrected as much as we have expected. Government bond prices have been quite strong recently, yields having declined some 50 basis points. They now also seem to be in a holding pattern awaiting the deflation outcome. We remain negative on equity prices and positive on high quality bonds.