

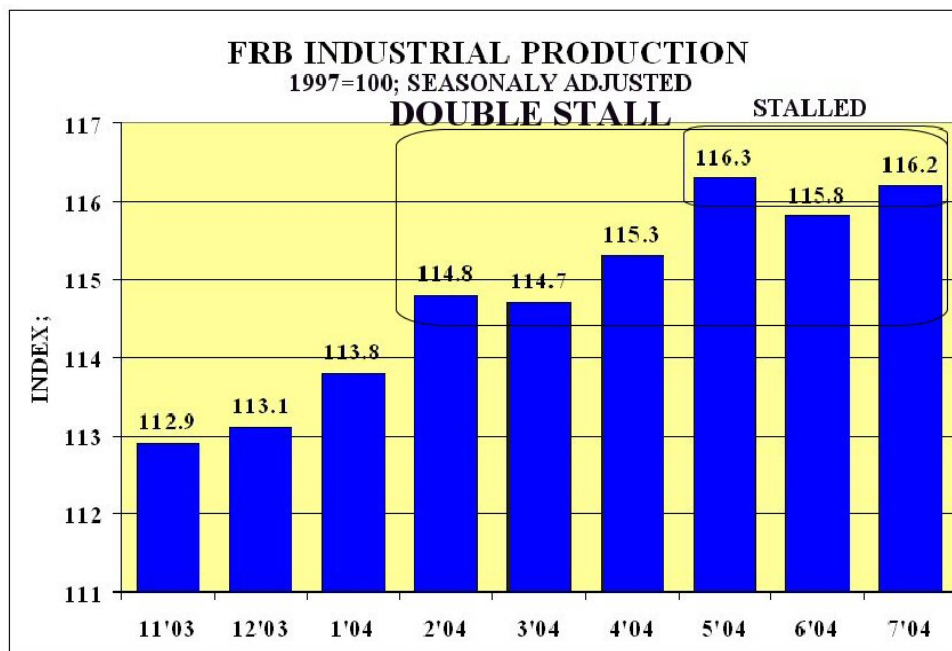
Probable Weakness Ahead

September 7, 2004

It has always been after Labor Day that most believe the real state of the economy can be determined. That being the case, we should soon know if Mr. Greenspan's "soft patch" is just that or something worse. The chances, in our opinion, are much greater than 50/50 that it will be something worse. The Fed is doing its very best to talk up a recovery, while at the same time raising short-term interest rates. Why you ask? In order to be able to lower them again and by so doing stimulate the economy as we fall into recession sometime next year.

Our expectations are that they will raise the Federal Funds rate two times more before the end of the year. This assumes that the economy doesn't just fall off a cliff. From what we can gather, there remains a struggle between the revival of the industrial area (replacing worn out equipment) and the spending of the consumer. The markets reacted rather favorably to the recent jobs creation number for August, which indicated the economy added 144,000 new positions. As you know, these numbers are at best a good estimate, but they are the best available. Keep in mind two things: (1) It takes approximately 135,000 jobs each month just to absorb new entrants and (2) The reduction of the unemployment rate from 5.5% to 5.4% was a result of people dropping out of the search for new jobs – discouraged workers, if you please. Again, it's not the end of the world, but it is difficult for us to see any expansion of meaningful strength.

Please note the following chart from Pierre Rinfret's website depicting the industrial side of the economy. The FRB's Industrial Production Index is a coinciding indicator and it appears to be topping out, or at least stalling. If this is the case, and we believe it is, then it may soon join the consumer in being a drag on the economy.



A final note. We expect many of the talking heads will be saying “The hurricanes in Florida were awful, but it will create a lot of business.” If that’s the case, then why not plan to have a hurricane in every state. Is that really the way to grow our economy?