

SLIP SLIDING AWAY 10/30/06

The slowdown in housing and the weakness in auto sales are causing most of the reduction in economic activity so far this year. Most continue to believe, as witnessed by the strength in the stock market, that nothing more serious will come of this situation. Although there is no clear evidence of something worse than just below trend GDP, we continue to project that a recession is in the works.

One of the most telling charts we have seen is highlighted below. Please note that over the last six years, without Mortgage Equity Withdrawal (MEW), real GDP was non-existent in 2001 and 2002, and extremely weak in 2004, 2005, and so far in 2006. Now surely there were, and are, other things that come into play. One cannot escape the fact that using one's home as an ATM has been a major factor in the total spending pattern.

The second chart is one of year over year real auto sales growth going back to the 1970's. Please note that the numbered declines of 1 through 5 have always been followed by a recession. Number 6, which occurred in June of 2006, is yet to be determined. Keep in mind that the U.S. car industry is a lesser percentage of the GDP today than yesterday, but it's no small potatoes.

The 3rd quarter real GDP number was announced on October 27 at 1.6%, which is a weak quote, and well below most economists' estimates of 2% or better. As always,

it's the future that counts, and most believe there will be a sharp rebound in the current quarter. We are not so sure. Much depends, we believe, on the negative wealth effect that may develop from the housing bust. Our position is that it may be much worse than most are willing to admit.

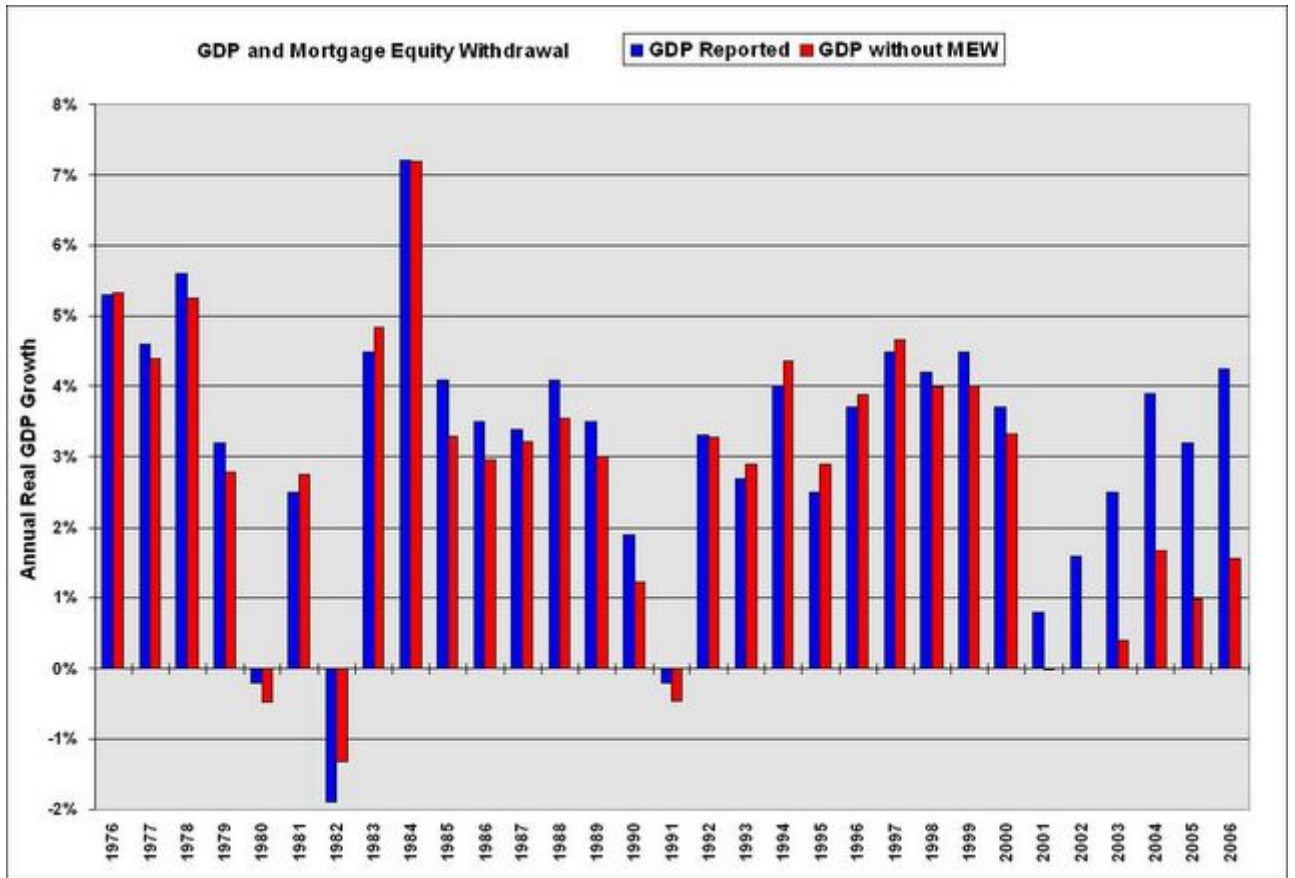


Chart taken from Blogger.com

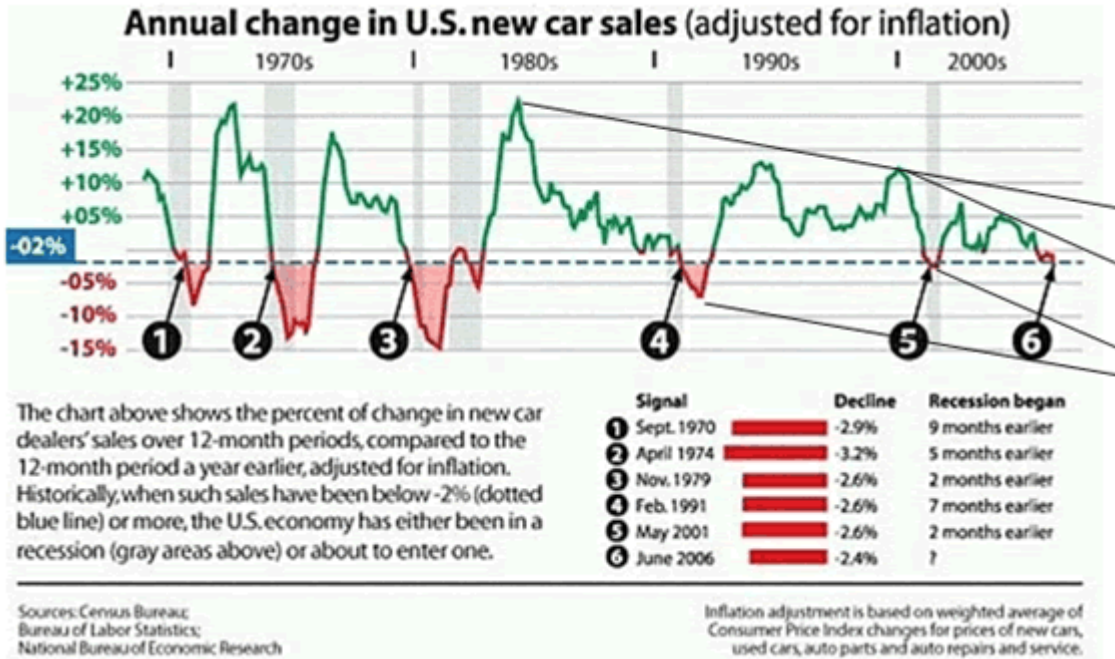


Chart taken from Financialsense.com