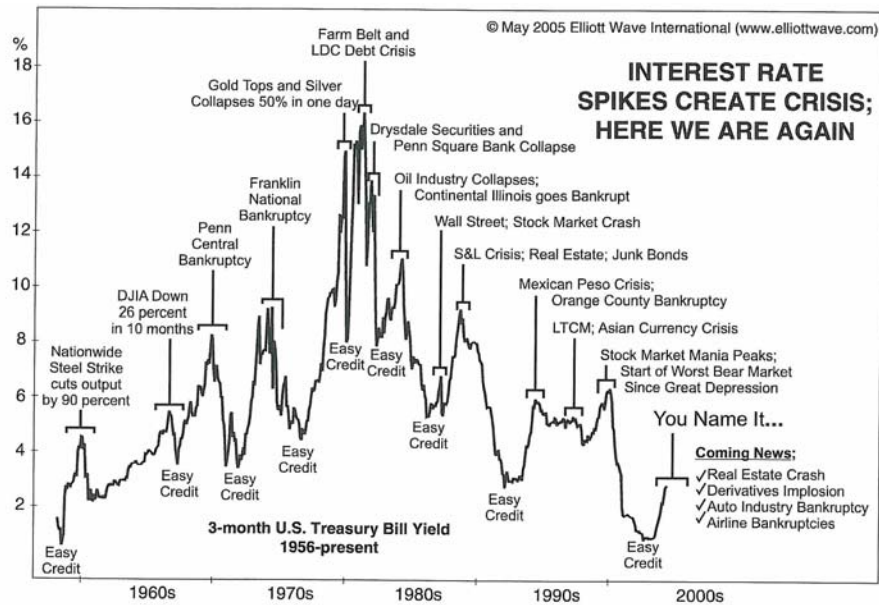


# The Chart That Tells It All

May 2, 2005



Note the left-hand side of the chart above. The U.S. had just come out of the depression of the 30's and the World War of the 40's. Other than the Federal debt created by the war, there was none. Everyone had savings and were very careful with their money. However, as business expanded and the greatest generation spoiled their offspring (boomers), conservatism was gradually replaced with a free spending attitude that required higher and higher nominal interest rates to stop the inflation created by such prodigal activity.

Now move to the right hand side of the chart. Since the peak in 3-month Treasury Bills yields in 1981, it has taken lesser and lesser nominal rates to halt the rise in inflation. Why? First, we spent our savings, bought votes with the War on Poverty, and then spent money we didn't have. Today we, as a country, have somewhere between \$37-\$40 trillion of debt – Federal, state and local, corporate, and individual. From practically no debt in the 50's to the present crushing level, just a small up tick in nominal rates is enough to bring the party to a close. In our opinion, unless the Fed soon halts the increase in the Federal Funds Rate (3% would be a good place to stop) the economy is in for a heap of trouble.

One should be looking at one's hole card. Common stocks, real estate (primarily housing), and all forms of debt less in quality than government bonds should be carefully scrutinized. Please keep in mind that there are no municipal bonds whose quality is as good as governments. A bunch of people are destined not to make it through what we see coming.