Tipping Point at Hand
November 7, 2005

It is becoming more and more apparent that the economy is slowing down. This decline in economic activity is developing in the "Old Fashioned Way." By that we mean consumer spending is beginning to slow just as some areas of capital spending are experiencing strength. Antidotal evidence of the capital spending strength is the glowing reports we hear locally (Wichita) about the general aviation industry. We who have watched this industry over the years know that we are a "boom town" almost always during the last phase of the up cycle.

Employment growth, which is vital to consumer spending, has slowed to a pace of 65,000 jobs per month over the last 3 months. Yes some of this weakness is due to Katrina, on the other hand a portion of the very meager 56,000 jobs added in October probably came from the rebuilding of the Gulf Coast area. Employment growth for the 3 months ended July 2005 averaged 193,000. These previous numbers were much better however, keep in mind that it takes an increase of 135,000 jobs per month just to absorb the new entrants into the labor market. Please note chart No. 1, which traces the increase in disposable personal income. It is showing major weakness so far this year. One might ask how can retail sales be up 4.4% in October with such weak availability of income? The answer is the use of credit. Another sign of impending consumer spending slowdown is the CPI adjusted average hourly earnings. Although core inflation (overall less energy and food) is in check, (less than 2%) we all do have to buy gas and eat food. Note Chart No. 2.

Chart 3 will illustrate the overall slowing that is taking place. It has to do with quarter over year ago quarter real GDP. As you probably noticed auto and truck sales for October were terrible. We understand incentives are coming again however, we wonder how long can GM and Ford sell cars at a loss and stay alive?

The housing sector, which has been strong for so long, appears to be topping out. Refinancing has slowed to a snails pace. Inventories of unsold new houses are at an all time high. The median price of new and existing houses are declining and to top it off, mortgage interest rates are increasing.

The Federal Reserve has gone too far. Rates are being increased at the very time economic conditions are deteriorating. Financial markets are due for a change of direction. Expect stock prices to decline and long-term government bond prices to increase in value.

Chart 1

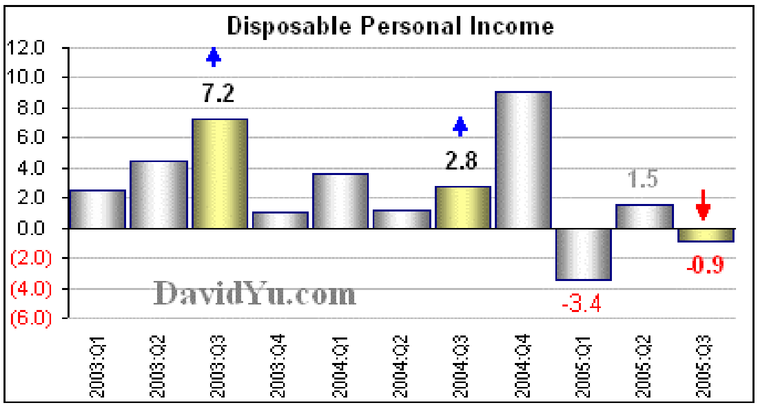

Chart 2

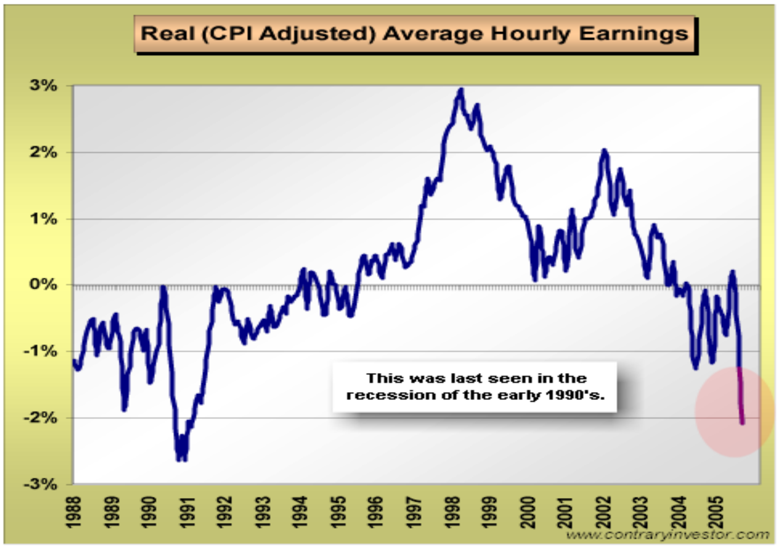
Real (CPI Adjusted) Average Hourly Earnings
3%
2%
1%
0%
-1%
-2%
-3%
This was last seen in the recession of the early 1990's.
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
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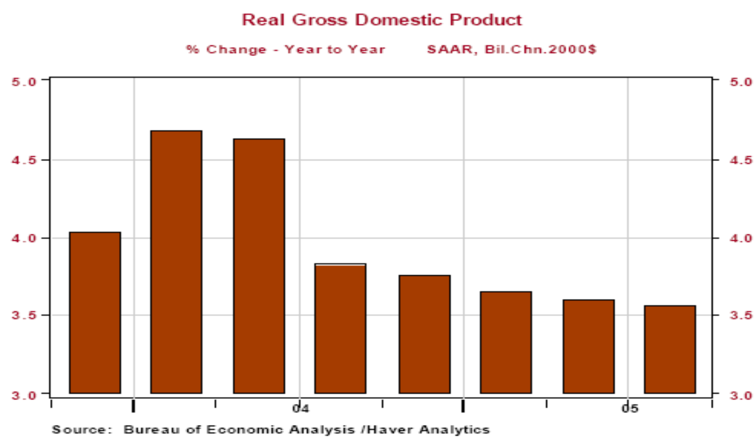
Chart 3


Real Gross Domestic Product
% Change - Year to Year
SAAR, Bil.Chn.2000$
5.0
4.5
4.0
3.5
3.0
04
05
Source: Bureau of Economic Analysis /Haver Analytics