National Summary

An Overview of National and Local Conditions

July 2006

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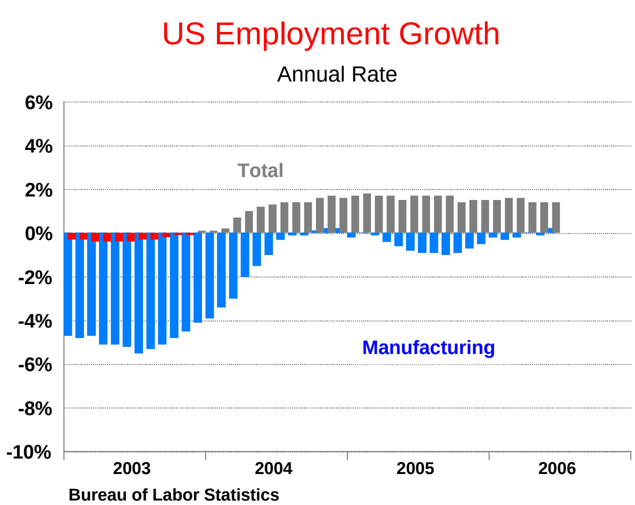
Economy: After a long period of strong growth, the economy is showing signs of fatigue. Most worrisome, to my eye, is that **consumer credit** has hit a peak and is apparently headed downward. As you can see in the chart on the next page, every time in the past 35 years that consumer credit has turned down, a **recession** has followed.

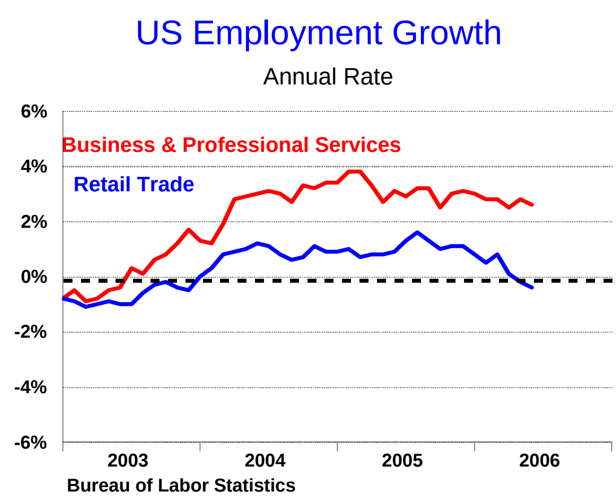
Consumer credit is mainly credit card debt and automobile debt, and it grew rapidly in the past 10 years as consumers spent more money than they earned. I think they were willing to do this because their wealth was increasing—first as the rising **stock market** blessed their 401K mutual funds, and then as rising **home prices** increased the equity they held in their homes.

Even though home prices are still rising in many markets—on average they're up 13 percent since last year—consumers see that the party will soon be over as **interest rates** continue to rise. So they've decided to spend a bit less. You can already see the effect in the chart below. Retail jobs are no longer growing and it looks like some will soon be cut.

I don't think that a recession is just around the corner. Delinquency rates on home loans, credit cards, and business loans are still low. Industrial production and total jobs are still growing at a reasonable clip. But it is clear to me that the economy will be growing at a more moderate rate in the next few years because consumers have gone into debt just about as far as they're willing to go and therefore aren't going to be spending as much money as they did in the last decade.

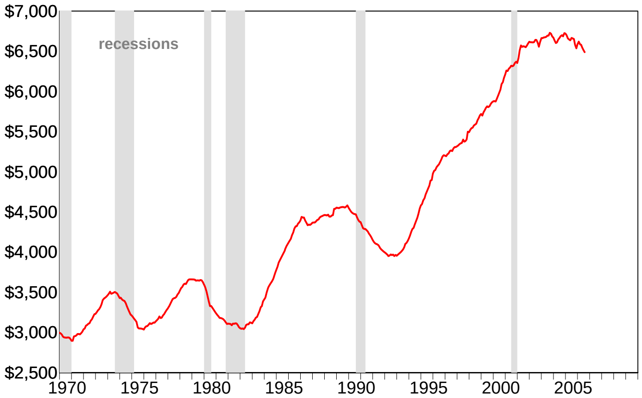
A longer period of slow or even stagnant economic growth will result if it turns out that consumers already spent all the equity they took out of their homes when they refinanced their mortgages. In that case, consumers' wealth has decreased and their spending will be cut much more sharply.





Consumer Credit

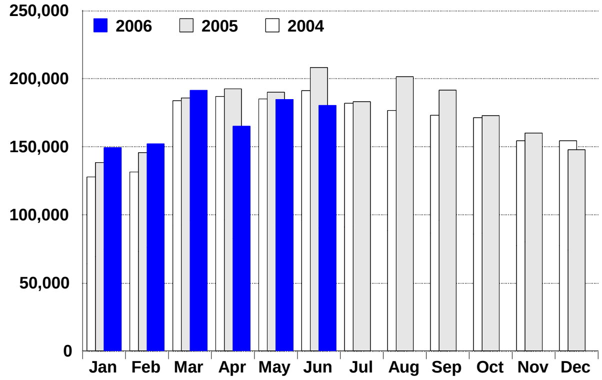
Per Capita - Inflation Adjusted



Federal Reserve

US Home Building Activity

New Housing Permits Issued



Bureau of the Census

Housing: Because their home is typically the largest part of their wealth, developments in the housing markets will have an outsized effect on consumers in the next few years.

As is plain in the chart above, home building activity has **slowed** as builders have seen inventories of unsold homes rise. Demand for new housing is a strong indicator of total home sales and of pressure on home prices. The amount by which housing construction has dropped in various markets shows where downward pressure on prices is likely to be greatest.

Compared to last June, home building was down 20 percent in the **Northeast,** 18 percent in the **Midwest**, and 15 percent in the **West**. In the **South**—excluding Florida—home building was down just 2 percent.

In **Florida**, building activity was down a sharp 30 percent—suggesting a big slowdown in demand and future downward pressure on home prices. In a couple of other boom markets, **Arizona** and **Nevada**, activity was down 25 and 35 percent, respectively.

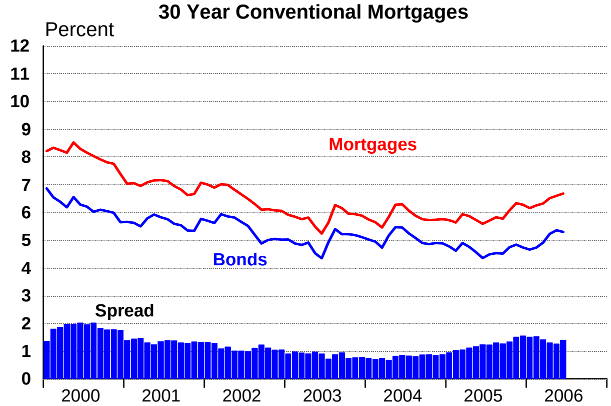
In California, home building was down 15 percent, and in **Texas** home building **increased**—15 percent.

Reminder: I believe that we are near the end of the national real estate boom that started in the late 1990s. Home buyers, home builders and mortgage lenders must become more cautious. The value of homes will drop in some markets, the number of home sales will decrease, and the number of mortgage foreclosures will rise in the next few years.

Interest Rates

20 Year Treasury Bonds

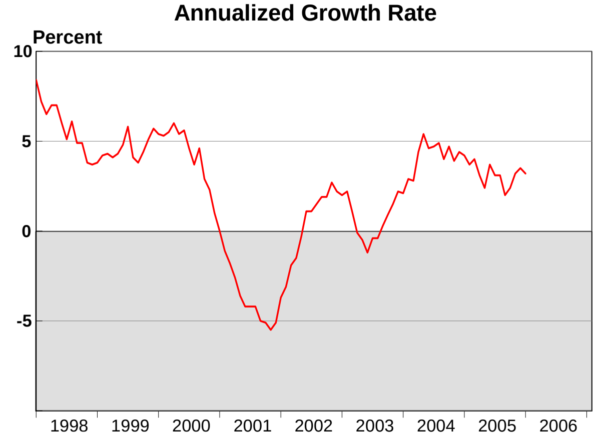
30 Year Conventional Mortgages



Federal Reserve

Industrial Production

Annualized Growth Rate



Federal Reserve

Quick Review

Economic Growth

May 2005 - May 2006

Best Employment Growth

1.	Boise City IE	3.0%	5.4%	**6.0%**
2.	Las Vegas I	6.8%	7.2%	**5.6%**
3.	Cape Coral-I	6.7%	8.4%	**5.5%**
4.	Myrtle Beacl	3.7%	6.5%	**5.4%**
5.	Phoenix-Mes	6.2%	6.2%	**5.3%**
6.	Reno NV	3.5%	5.8%	**5.1%**
7.	Naples FL	6.4%	5.4%	**5.1%**
8.	Salt Lake Cit	4.1%	4.5%	**4.5%**
9.	Greeley CO	3.2%	2.7%	**4.5%**
10.	Provo-Orem	5.0%	4.8%	**4.3%**
11.	Raleigh NC	3.8%	4.1%	**4.2%**
12.	Charleston S	3.4%	1.7%	**4.1%**
13.	McAllen-Edi	5.1%	5.4%	**4.1%**
14.	Sarasota-Br	6.4%	5.5%	**4.1%**
15.	Baton Rouge	1.6%	2.8%	**4.0%**
16.	Seattle-Tacc	3.0%	4.2%	**4.0%**
17.	Tucson AZ	1.6%	4.1%	**4.0%**
18.	Orlando FL	6.1%	5.0%	**3.8%**
19.	Greenville S	0.3%	0.6%	**3.7%**
20.	Wilmington N	5.2%	5.5%	**3.6%**
21.	Jacksonville	2.9%	4.1%	**3.5%**
22.	Fayetteville-	3.4%	5.3%	**3.4%**
23.	Deltona-Day	3.9%	4.2%	**3.4%**
24.	Brownsville-	1.0%	0.8%	**3.3%**
25.	Dallas-Fort \	1.1%	2.5%	**3.2%**

Worst Employment Growth

New Orleans LA	**-30.1%**
Greensboro NC	**-1.2%**
Detroit MI	**-0.9%**
Ann Arbor MI	**-0.5%**
Santa Barbara-Santa Maria CA	**-0.2%**
Milwaukee WI	**-0.1%**
Cleveland OH	**0.0%**
Fresno CA	**0.4%**
Indianapolis IN	**0.5%**
Grand Rapids MI	**0.5%**
Pittsburgh PA	**0.6%**
St. Louis MO	**0.6%**
San Jose CA	**0.7%**
Winston-Salem NC	**0.8%**
New York-North New Jersey NY	**1.0%**
Columbus OH	**1.0%**
Boston MA	**1.0%**
Louisville KY	**1.0%**
Lexington KY	**1.0%**
Cincinnati OH	**1.1%**
Chicago IL	**1.1%**
Augusta GA	**1.2%**
Kansas City MO	**1.2%**
Los Angeles-Anaheim CA	**1.2%**
Richmond VA	**1.2%**

Home Building Activity

Latest Six Months to May 2006

Largest Increase in Permits

1.	Lakeland FL	**55%**
2.	Sebastian-Vero Beach FL	**46%**
3.	Austin TX	**44%**
4.	Knoxville TN	**35%**
5.	Raleigh NC	**34%**
6.	Memphis TN	**30%**
7.	Las Vegas NV	**23%**
8.	San Francisco-Oakland CA	**21%**
9.	Ocala FL	**19%**
10.	Provo-Orem UT	**19%**
11.	Charlotte NC	**19%**
12.	Tulsa OK	**17%**
13.	Houston TX	**16%**
14.	Portland-Vancouver OR	**14%**
15.	Brownsville-Harlingen TX	**13%**
16.	Chicago IL	**12%**
17.	Panama City FL	**12%**
18.	Myrtle Beach SC	**12%**
19.	Denver CO	**12%**
20.	Seattle-Tacoma WA	**11%**
21.	Baton Rouge LA	**10%**
22.	Dallas-Fort Worth TX	**9%**
23.	Los Angeles-Anaheim CA	**9%**
24.	Columbia SC	**7%**
25.	Atlanta GA	**6%**

Worst Increase in Permits

Vallejo-Fairfield CA	**-55%**
Louisville KY	**-45%**
San Diego CA	**-43%**
Sacramento CA	**-40%**
Detroit MI	**-39%**
Stockton CA	**-39%**
Ann Arbor MI	**-38%**
New Orleans LA	**-34%**
Santa Barbara-Santa Maria CA	**-33%**
Pensacola FL	**-27%**
Grand Rapids MI	**-26%**
Columbus OH	**-26%**
Colorado Springs CO	**-25%**
Omaha NE	**-23%**
Modesto CA	**-22%**
Minneapolis-St. Paul MN	**-22%**
Deltona-Daytona Beach FL	**-22%**
Milwaukee WI	**-22%**
Port St. Lucie-Fort Pierce FL	**-21%**
San Jose CA	**-21%**
Madison WI	**-18%**
El Paso TX	**-18%**
Des Moines IA	**-16%**
Kansas City MO	**-16%**
Cleveland OH	**-15%**

Quick Review

Overpriced Home Markets

Santa Barbara-Santa Maria CA	**80%**	Deltona-Daytona Beach FL	**33%**
Naples FL	**74%**	Boston MA	**30%**
Modesto CA	**69%**	Las Vegas NV	**28%**
San Diego CA	**65%**	Phoenix-Mesa AZ	**28%**
Stockton CA	**65%**	Tucson AZ	**28%**
Riverside-San Bernardino CA	**63%**	Orlando FL	**24%**
San Jose CA	**61%**	Pensacola FL	**24%**
Port St. Lucie-Fort Pierce FL	**59%**	Honolulu HI	**23%**
Miami-West Palm Beach FL	**57%**	Provo-Orem UT	**22%**
Vallejo-Fairfield CA	**57%**	Jacksonville FL	**20%**
Los Angeles-Anaheim CA	**56%**	Wilmington NC	**18%**
Sacramento CA	**56%**	Ocala FL	**16%**
San Francisco-Oakland CA	**53%**	Baltimore MD	**16%**
Fresno CA	**51%**		
Sarasota-Bradenton FL	**47%**		
Vero Beach FL	**47%**		
Atlantic City NJ	**44%**		
New York-North New Jersey NY	**42%**		
Palm Bay-Melbourne FL	**39%**		
Cape Coral-Fort Myers FL	**37%**		
Bakersfield CA	**37%**		
Panama City FL	**36%**		
Washington-Arlington DC	**35%**		
Reno NV	**34%**		
Tampa-St. Petersburg FL	**33%**		

High Foreclosure Risk Rating

Detroit MI
Greensboro NC
New Orleans LA