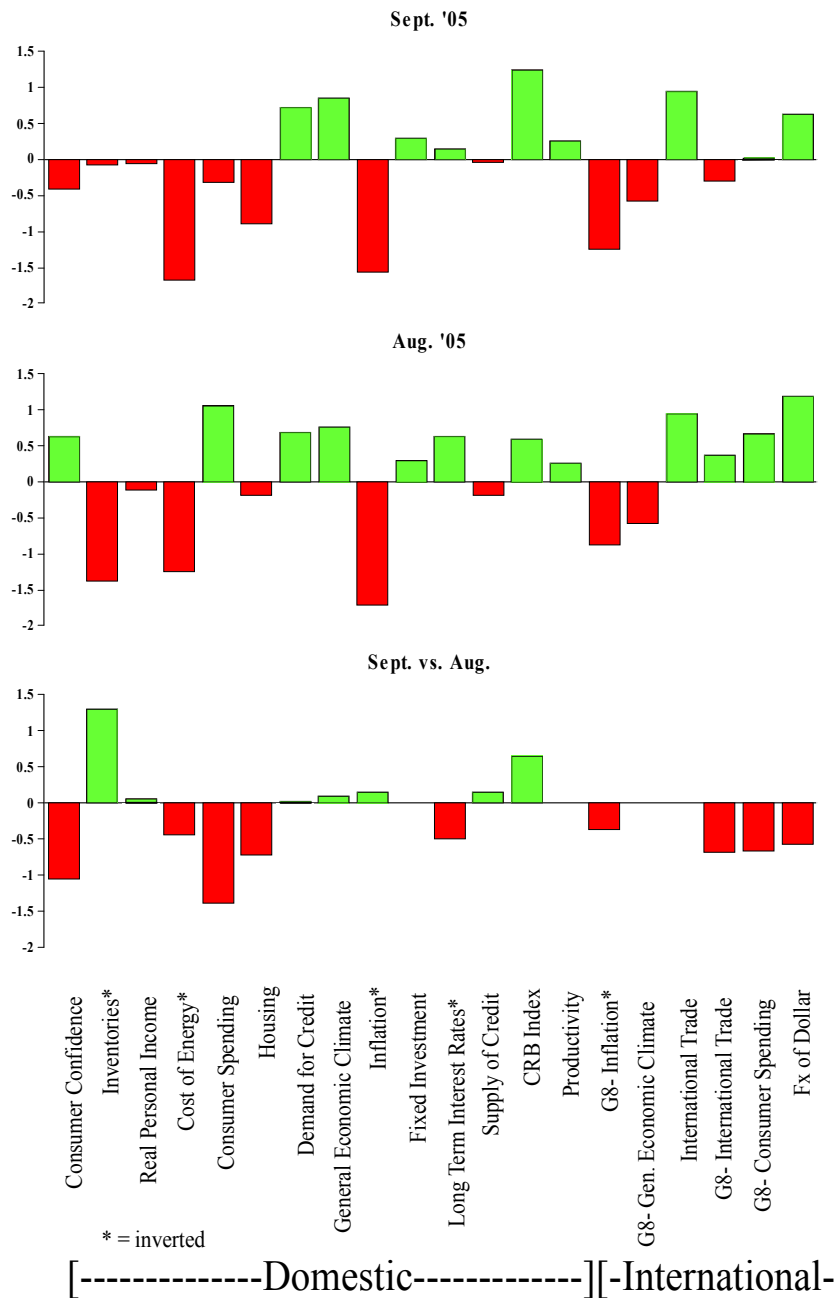


Don't Say You Weren't Warned

September 21, 2005

The following charts show fact based trends in ASC Economic factors as of September 2005 as compared to August 2005 and changes expressed in standard deviations around the norm, hereinafter referred to as "units."



ASC Factor indicators of future activity show that real growth in the US decelerated again last month. Following are significant changes in trends last month expressed in standard deviations around the average rate of change or "units." Initial Unemployment Claims rose by 1.04 units. Inventories fell by 1.3 units. Cost of Energy fell by .44 units. Consumption fell by 1.38 units. Housing fell by .71 units. Long Rates rose by .49 units. The CRB Index rose by .66 units. G8 Exports fell by .67 units. G8 Consumption fell by .66 units. The foreign value of the US dollar fell by .57 units. The summation index is currently at 98 as compared to 101.9 in August 2005, which is consistent with real growth of around 2.5% to 3%. A double whammy depressant on the economy, from Hurricane Katrina and soaring costs of energy, is likely to be temporary. After the recovery is underway, additional fiscal stimulus on top of an economy that was already growing nicely may make for added inflationary pressures.

The effects of Hurricane Katrina are likely to be a temporary negative, a damper on growth in the third quarter until production of oil and gas is brought back on line. As production returns and the rebuilding efforts get underway, a firming up should occur beginning some time in the fourth quarter. The experience with Hurricane Andrew was net, net a positive for growth. While damage in New Orleans is more extensive, the stimulative effect of the rebuilding effort is likely to be greater. Given the political backlash resulting from the poor people who could not evacuate and were left stranded, a politically motivated over reaction is likely.

Several economic services are expressing caution and advising the Fed to pause in raising the federal funds rate. They seem to be basing their concern about the sustain-

ability of this recovery on consumer sentiment that just dropped sharply from 84 to 76.9 on the University of Michigan survey. Our studies have shown that it is not what consumers say they are going to do but what in fact they actually do that is reliable. While survey figures are suspect, there are other indicators that we are watching very closely. So far, there does not appear to be any reason for heightened concern. In general, the greatest threat of a slow down occurs when confidence is very high and consumer and business behavior reflects that confidence. Businesses have been and still are somewhat cautious. Nonetheless, if there is a meaningful sign of a significant slow down, we will be monitoring it very closely.

Crude oil, after being boosted by Hurricane Katrina, appears to be resuming its topping pattern. High gasoline prices, now a significant negative for consumers, are also likely to be somewhat of a stimulant once they begin to fall in a meaningful way. Higher prices have dampened consumption. One should not be surprised to see gasoline inventories rebuilding significantly, not so much from increased supply but from weaker demand.

The other positive for growth in the fourth quarter is the large draw down in inventories in the second quarter. The smaller increase in inventories led to a 1.9% reduction in GDP growth in the second quarter. Now that auto inventories are brought more into line, the negative inventory change is not likely to be continued. Increments in inventories are another reason for growth to remain healthy.

Last month's .5 % increase in the CPI brings the year over year increase to 3.6%, or 2.1% on a core basis. Despite the convenient elimination of the effects of food

and energy, there are signs that the core rate may not be as tame as government officials would have us believe. Providers of services such as electricians, plumbers and other tradesmen have no choice but to raise rates to offset higher fuel prices. Even though the core rate excludes food and energy, sustained increases as we have experienced are likely to have ripple effects. Supply disruptions caused by Hurricane Katrina may have a longer than usual effect on prices. In addition, a fiscal stimulus is not quite the medicine to keep inflation under control in an economy that is already growing on its own.

Recent elections in Japan and Germany appear to favor adoption of pro growth policies. Merkel, the Margaret Thatcher of Germany, advocated opening up markets and cutting the cost of social programs but made many mistakes in the final month of the campaign. Even though neither major party received a clear mandate, Germany appears to be headed toward reform no matter which party is able to establish a coalition and form a government. Schroeder is likely to remain Chancellor if a coalition between the two major parties occurs. In Japan, Koizumi has been instrumental in reforming its banking system and is now poised to reform the Postal Saving Bank. Among other major G8 countries, Japan, at least, is making progress. The prospect of a synchronized world recovery appears to be improving, thereby reducing the dependence of the world recovery on the US and China. In addition, the outlook for US exports is improving.

Finally, some of the interest sensitive areas are getting hit. This appears to be a case where the home builders are discounting future events more accurately than the long Treasury bond. After all, the major buyers of Treasuries, the Asians, do not

seem to think they have much choice but to buy whatever is offered. After all, in their environment, deflation has been the problem. We appear to be at a significant turning point, the bond market needs to catch up with reality. Core inflation of 2.1% is getting more and more of a stretch. Normally, the 10 year Treasury rate is close to nominal GDP growth, which currently is north of 5.5%.

### Investment Strategy

#### Equities:

The industries that are well positioned are electronics and health care, in particular, the pharmaceuticals. Over weights in S&P groups are advised in Health Care, Information Technology and Materials. Market weights are advised in Energy and Industrials. Underweighted are Consumer Staples, Utilities, Financials and Consumer Discretionary.

#### Fixed Income:

With the US economy stabilizing and somewhat higher inflation, a cautious stance on long bonds appears warranted. Over the intermediate to longer term, the yield on the long bond is likely to continue heading higher. Regarding the issue of duration, on a scale of 1 to 10, with 10 representing a maximum position in shorter term debt and 1 representing a maximum position in Long Treasuries, we would rate the current environment as a 10, the same as last month, suggesting an average maturity of 2-3 years.

#### Hedge Funds:

We are going to stay with our shorts in Financials and Consumer Discretionary. We are long and over weighted in Health

Care (primarily pharmaceuticals), Information Technology and Materials (excluding steel & copper stocks).

As for Global macro bets, we are staying with Indonesia, Thailand and Malaysia. We are still short the 20 year US Treasury and long Australian Treasuries. It appears that US long bond yields are headed higher. The interest sensitive sectors of the market are likely to under perform with a tightening Fed and higher rates.

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