"A monthly survey of supply chain managers"

Welcome to our November report covering October survey results. Our surveys indicate rising inflationary pressures the wholesale level for both regions with a slowing economy for Mid-America but expanding conditions for the Mountain States. Follow my comments at: www.twitter.com/erniegoss

Are Junk Bonds the Next Bubble to Burst? Fed Has Pumped Up Risks and Prices

Not since the Federal Reserve (Fed) was formed in 1913 has the central bank taken such aggressive monetary action to stimulate the nation's economy. They have reduced the funds rate to practically zero percent, pushed long term U.S. Treasury bond rates, adjusted for inflation, into negative territory, and bailed out non-banks, such as Goldman Sachs, with ultra-low interest rate loans. Rather than increasing borrowing and spending by consumers and businesses, it has pushed investors into riskier "junk" bonds. U.S. junk-rated companies issued $46.6 billion of bonds in September representing a 59 percent increase over the previous month. Furthermore, the bond proceeds are going towards riskier ventures like mergers and acquisitions and to pay huge one-time dividends to private-equity owners. For example, private-equity owned Petco recently issued junk bonds in order to pay owners outrageous and unjustified cash dividends referred to as "dividend recapitalizations." What will burst the junk bond bubble and produce massive investor losses? Just as the Fed inflated the junk bond bubble, it will also deflate it as it raises interest rates to combat higher inflationary pressures as early as the end of 2013. As rates rise, bond prices fall generating potentially titanic financial losses for investors. Ernie Goss

Link to video: http://youtu.be/Rvag3jNXPlw

LAST MONTH'S SURVEY RESULTS

Mid-America Leading Economic Indicator Drops to Recession Level: Inflation Gauge Higher

SURVEY RESULTS AT A GLANCE

- The leading economic indicator drops to lowest level since May 2009.
- Employment gauge sinks below growth neutral for the third straight month.
- Fallout from the drought and QE3 pushed the wholesale price index to its highest level since March of this year.
- Supply managers expect 2013 holiday sales to grow by only 2 percent from 2012.

For the third time in the past four months, the monthly Mid-America Business Conditions Index, a leading economic indicator for a nine-state region, declined below growth neutral. The index is pointing to slightly negative growth for the region in the next three to six months. **Overall index:** The Business Conditions Index, which ranges between 0 and 100, slumped to 46.5 from September's tepid 50.4. Growth in the regional economy is definitely moving lower. Surveys over the past several months point to slightly negative growth for the next three to six months. However as in past months, two states with significant dependence on energy, North Dakota and Oklahoma, will continue to expand at a positive pace while the rest of the region pulls back.

Employment: The region's employment gauge remained below growth neutral. The index increased to a weak 47.7 from September's 46.1 but was down from August's 49.5. These are the weakest job readings recorded since shortly after the recession ended in 2009. The manufacturing sector has been shedding jobs over the past several months. U.S. Bureau of Labor Statistics data for September indicate that the region lost more than just manufacturing jobs in September of this year. When this data are released for October later in November, I expect it to show that the region continues to shed jobs but at a slow pace. Job gains in North Dakota and Oklahoma will be more than offset by declines in the rest of the region.

Wholesale Prices: The prices-paid index, which tracks the cost of purchased raw materials and supplies, advanced to 71.5 from 66.0 in September. The Federal Reserve's latest stimulus, quantitative easing 3 (QE3), and regional drought conditions are pushing the wholesale price gauge well above acceptable levels. I expect this to show up in higher consumer prices in the months ahead. This will limit the Fed's options regarding further monetary easing.

Confidence: Looking ahead six months, economic optimism, as captured by the October business confidence index, climbed 58.0 from September's very weak 44.7. Despite less favorable business conditions for their own firms, supply managers are more positive about the overall economy in the months ahead. Even with the looming fiscal cliff, improvements in the national unemployment rate and upturns in the U.S. housing market are boosting the outlook of supply managers.

This month supply managers were asked to gauge the likelihood of a 2013 recession. Almost one-fourth or 23.4 percent think a recession is likely, or very likely for 2013. An almost equal 22.7 think a 2013 recession is unlikely. The remaining 53.9 percent think there is a 50-50 chance of a recession next year.

Inventories: Regional inventory levels continued to decline and at an accelerating rate. The October inventory index declined to 43.5 from 49.2 in September. Supply managers have cut inventories for four straight months. The last time this happened was in 2009 when supply managers were reducing inventories in anticipation of weaker business activity.

This month supply managers were also asked to estimate the percentage increase in 2013 holiday sales from 2012. Overall a very low 2 percent growth is expected. Approximately, 16.5 percent expect a gain of more than 4 percent. On the other hand, almost 15 percent expect a decrease in 2013 holiday sales over their 2012 levels. To be considered healthy, holiday sales should grow in excess of 5 percent from previous year sales.

Trade: New export orders were surprisingly strong for October. The new export orders index soared to 60.8 from September's much weaker 48.7. At the same time, October imports contracted for the month with an index of 44.2 which was down from 48.9 in September. We are seeing some benefits of the Fed's weak dollar policy which has made U.S. goods more competitively priced abroad and foreign goods less competitively priced in the U.S.

Other components: Other components of the October Business Conditions Index were new orders at 43.3, down from 48.7 in September; production or sales at 43.9, down from 51.7; and delivery lead time at 54.1, off from September's 56.4.

The Creighton Economic Forecasting Group has conducted the monthly survey of supply managers in nine states since 1994 to produce leading economic indicators of the Mid-America economy. States included in the survey are Arkansas, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma and South Dakota.

MID-AMERICA STATES

ARKANSAS

The October overall index, or leading economic indicator, for Arkansas fell to 42.3 from September's 49.6. Components of the index from the monthly survey of supply managers were new orders at 34.3, production or sales at 37.3, delivery lead time at 50.1, inventories at 50.2, and employment at 39.5. According to U.S. Bureau of Labor Statistics, even though the state's unemployment rate declined, Arkansas lost jobs in September on a seasonally adjusted basis. Additionally, discouraged unemployed left the work force in September. Our results indicate that this trend continued in October and is likely to persist for the next three to six months.

IOWA

Iowa's October Business Conditions Index declined to 54.2 from 56.5 in September. The overall index, from a survey of supply managers in the state, has remained above growth neutral for the last 34 months. Components of the index for October were new orders at 57.1, production or sales at 50.4, delivery lead time at 53.9, employment at 53.2, and inventories at 52.8. According to U.S. Bureau of Labor Statistics, the state's unemployment rate plunged in September. While our survey of Iowa businesses over the past several months have been positive and pointing to reduced unemployment and job gains, they have not been nearly as robust as BLS data indicate. I expect significant upward revisions to the Iowa unemployment data in the months ahead even as the state continues to grow, but at a very modest pace.

KANSAS

The Kansas Business Conditions Index for October advanced to a weak 47.9 from September's 47.3. Components of the index from the October survey of supply managers in the state were new orders at 42.7, production or sales at 46.6, delivery lead time at 48.4, employment at 63.8, and inventories at 38.0. According to U.S. Bureau of Labor Statistics, the state's unemployment rate plunged in September. Our surveys of Kansas businesses over the past several months have been much less positive and not nearly as robust as BLS data indicate. I expect significant upward revisions to the Kansas unemployment data in the months ahead as the state's economic growth cools in the months ahead.

MINNESOTA

For a fourth straight month, the Minnesota Business Conditions Index slumped below growth neutral. The index, based on a survey of supply managers in the state, dipped to 47.1 from 47.2 in September. This is the first time since the recession that the overall index has been below 50.0 for four straight months. Components of the index from the October survey were new orders at 36.3, production or sales at 39.3, delivery lead time at 61.9, inventories at 50.1, and employment at 47.9. U.S. Bureau of Labor Statistics data show that the state lost jobs in September even as the unemployment rate declined. Our surveys indicate that Minnesota continued to lose jobs in October. I expect these jobs losses to persist, though at a slight pace, in the months ahead. Nondurable goods producers, especially food processors are reporting weakness. Furthermore, I expect the BLS to revise September unemployment rates upward in the months ahead.

MISSOURI

The October Missouri Business Conditions Index slipped to 50.0 from 51.0 in September. Components of the survey of supply managers in the state for October were new orders at 48.4, production or sales at 51.0, delivery lead time at 55.9, inventories at 41.7, and employment at 52.9. Missouri is one of four states in the region that did not experience an overall index reading below growth neutral for the month. Strong growth in durable goods manufacturing has more than offset weakness among nondurable goods producers. Even for Missouri, job growth for the next three to six months will be weaker than for the same period one year ago.

NEBRASKA

For the third time in the past four months, Nebraska's leading economic indicator fell below growth neutral. The Business Conditions Index, from a survey of supply managers, slumped to 45.5 from September's 50.3. Components of the index for October were new orders at 39.8, production or sales at 41.1, delivery lead time at 52.9, inventories at 49.5, and employment at 44.0. Stronger growth among durable goods producers prevented the overall index from sinking lower. Nondurable goods producers, including food processors, are experiencing pullbacks in economic activity. Job growth will be slightly negative in the next three to six months according to our recent survey results.

NORTH DAKOTA

The leading economic indicator for North Dakota once again expanded to a regional high. The Business Conditions Index from the survey of supply managers increased to 64.1 from 61.6 in September. Components of the overall index for October were new orders at 68.8, production or sales at 70.7, delivery lead time at 57.1, employment at 67.8, and inventories at 56.3. Each month, employment in North Dakota rises to record levels for the state. We are tracking gains in both durable and nondurable goods producers. Transportation firms are experiencing very strong growth related to the state's very healthy energy sector.

OKLAHOMA

The Business Conditions Index for Oklahoma advanced for October. The leading economic indicator from the supply manager survey climbed to 63.3 from September's 56.6. Components of the October survey of supply managers in the state were new orders at 77.4, production or sales at 74.8, delivery lead time at 39.3, inventories at 71.0, and employment at 54.2. Even as Oklahoma's economy has expanded at a solid pace, we are tracking somewhat weaker, but positive, job growth. Companies in the state report shortages of skilled labor even as some firms cut jobs.

SOUTH DAKOTA

For a fourth straight month, the leading economic indicator for South Dakota remained below growth neutral. The Business Conditions Index from a survey of supply managers in the state slipped to 45.3 from 46.6 in September. Components of the index for October were new orders at 51.4, production or sales at 55.3, delivery lead time at 50.0, inventories at 27.7, and employment at 42.0. Job growth for 2012 has been virtually nil for the state. Our surveys point to slightly negative employment growth for the next three to six months.

THE BULLISH NEWS

- The nation added 171,000 jobs for the month of October (ok but not satisfactory).
- According to the Case-Shiller home price index for August, U.S. home prices (year over year) increased for a third straight month.
- September retail sales increased by 1.1% from August and by 5.4% from September 2011. A lot this growth was due to vehicle sales.

THE BEARISH NEWS

- As a result of new entrants to the workforce, the nation's unemployment rate expanded from 7.8% to 7.9%.
- Annualized and inflation adjusted gross domestic product

increased by only 2.0% in Q3. It should be triple this rate by now.

- The U.S. trade deficit increased to $44.2 billion in August from $42.5 billion in July.

- The national and our regional purchasing management index (PMI) both indicate a very weak manufacturing sector.

WHAT TO WATCH

- PMI's: On Dec. 3, Creighton's releases its regional leading economic indicators (PMIs) and the national Institute for Supply Management releases its national PMI. Any significant declines will be very bearish for the economy.

- Jobs: On Friday Dec. 7, the U.S. Bureau of Labor Statistics (BLS) will release the employment report for November. An increase in the nation's unemployment rate back to 8% and job growth of less than 120,000 will be very negative economic signals.

- Retail Sales: On Dec. 13, the U.S. Census Bureau releases its retail sales estimate for November. An increase of more than 1% from October's will be a very positive signal.

THE OUTLOOK

FROM GOSS:

- I expect Congress and the President to resolve the impending "fiscal crisis" before the end of January 2013.

- Housing prices to continue to improve. The Case-Shiller index for September released at the end of November will increase for the fourth straight month.

- Long term interest rates will begin to rise as early as the middle of 2013 as higher inflationary pressures push investors to demand higher rates.

- The November U.S. unemployment rate will rise as more discouraged workers begin looking for seasonal work.

OTHER FORCASTS:

- "Creating a reliable, profitable supply chain: navigating exchange rate, working capital and business uncertainties." Companies doing business overseas must be prepared to navigate an obstacle course that includes exchange rate shifts, supply chain disruptions, tight credit markets and nearly unprecedented economic volatility. But which hurdles are companies most concerned about? Grant Thornton's recent survey, conducted in partnership with World Trade Magazine, points to some interesting success strategies. With many banks reducing the amount companies may borrow against their assets, asset-based lending is tighter than ever, which makes optimizing working capital all the more critical within the supply chain. At the same time, as the supply chain continues to stretch around the globe, companies are inevitably faced with increased risks of supply disruption. Today companies must be prepared with a plan to handle these potential disruption risks.

- Conference Board, November, 2012. "The global economy continues to slow, led by continued contraction in the global manufacturing sector. The Federal Reserve's third round of quantitative easing (QE3) at best would work with a lag and the channel by which it would stimulate the economy is primarily via the wealth effect and housing sector. The U.S. housing market and the consumer balance sheet are the two areas of the U.S. economy that are showing improvement. The largest problem for the economy is that businesses continue to keep tight reins on spending on new investments and hiring; notwithstanding the surprising drop in the unemployment rate to 7.8%. The pace of job growth remains too slow to generate strong increases in personal income, which is the main driver of consumer spending. In the near-term, we do expect the U.S. to partially fall off the 'fiscal cliff' as politicians allow the payroll tax cut and the extended unemployment benefits to expire at the end of this year. This will depress growth in the first half of 2013, lowering it to below 1%. However, we forecast that growth will rebound back to a slightly above 2% pace in the second half of 2013 based on the continued strengthening in the housing market, steady but slow employment gains, improving consumer balance sheet, and removal of some of the political uncertainty surrounding the upcoming election."

Goss Eggs (Recent Dumb Economic Moves)

- On Nov. 6, Californians voted for Proposition 30 which increases the sales tax by a ¼% and elevates the income tax rate to 12.3% for those earning more than $250,000. This is a great economic development tool, but for neighboring states that will now be even more successful at recruiting California businesses and workers to their area.

Survey results for November will be released Dec.3.

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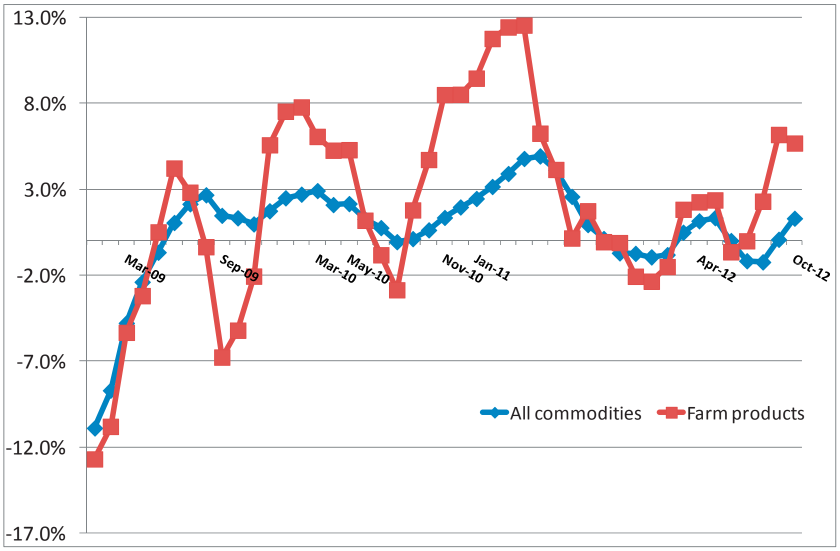
PRICE DATA

ALL COMMODITIES/FARM PRODUCTS 2007-2012
FUELS & RELATED/METALS & METAL PRODUCTS

Price changes, 3 month moving average, 2009-2012



Price changes, 3 month moving average, 2009-2012