



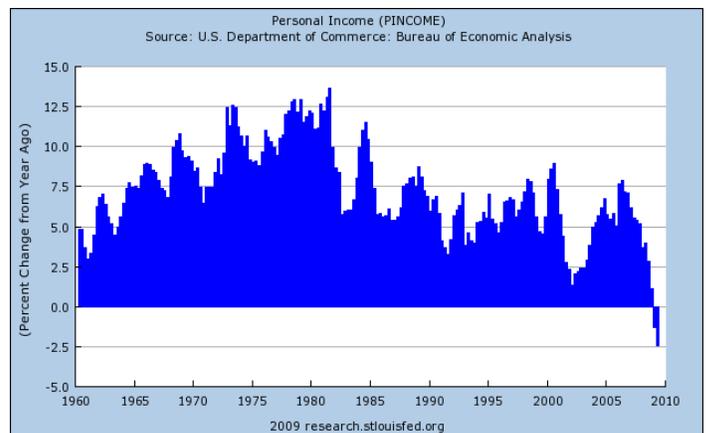
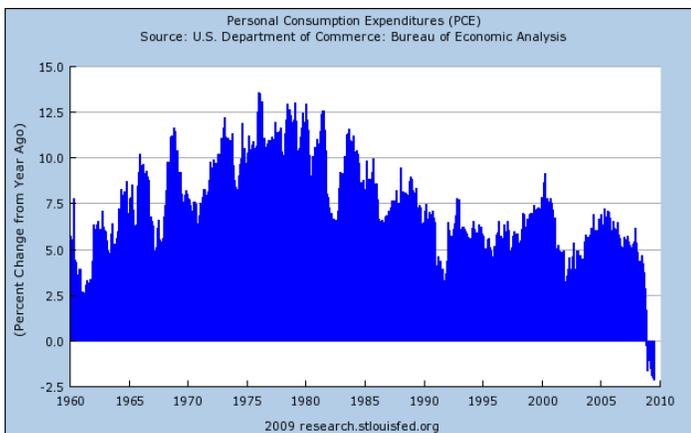
Life After Debt: Consumer Needs Trump Wants in “New Normal” (Part III of IV)
Declines in Net Worth, House Prices, Incomes, and Credit Lead to a Reemergence of Thrift

The buy now, pay later days are over. For over 25-years, U.S. economic growth has been predicated on the use of, and expanding amount of, debt. Over the course of the most recent economic cycle, consumer debt levels rose to heights never previously experienced due to mortgages, car loans and credit card balances. However, as result of the worst recession since the Great Depression, consumer habits appear to be changing. Due to the declining value of stocks and homes, falling wages and tight credit, Americans are reigning in spending on all but the basic needs. The multi-year growth in consumption spending has reversed and should moderate economic growth for some time.

Consumers are beginning to pay down debt and increase savings. According to Federal Reserve data, for the first time since 1952, household borrowing started to decline in the second half of 2008. This trend has continued through mid-2009 at a near-record pace. Moreover, due to the drop in both the stock market and house prices, household net worth contracted by 22% over the trailing three quarters ending in March 2009. The related inverse wealth effect is leading to declines in consumption and giving consumers a greater incentive to save.

As consumers turn inward and begin the process of personal balance sheet repair, we believe that a multi-year reduction in debt levels and a corresponding increase in the savings rate are taking place. After falling to below 2% for most of past five years, the personal savings rate increased to as high as 6.2% in May 2009 and is expected to reach the 8% - 10% level depending on income levels. A weak job market is also clouding the outlook for both discretionary spending and incomes. The unemployment rate, currently 9.4%, could eventually surpass 10% by early 2010. Moreover, bank lending-standards remain tight. In its latest survey, the Federal Reserve reported that in the second quarter, none of the 51 respondent banks eased standards on prime mortgages. The banks also expect to maintain strict criteria on lending until at least the second half of 2010.

While economic growth is returning internationally and economists expect an upturn in U.S. business activity in the second half of 2009, we believe the economic recovery in the U.S. will be gradual due to the structural impacts of its largest segment – consumers. Over the long-term, however, a more financially responsible consumer will become a positive factor for sustainable economic growth.



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