

Capital Markets Group

9400 Mission Road
Prairie Village, Kansas 66206
1-800-288-5489
www.countryclubbank.com

Byron G. Thompson

Chairman of the Board

Paul J. Thompson

President & CEO

Mark C. Thompson**Robert H. Buckner**

Vice Chairmen

Administration

Steve W. Panknin

Portfolio Management**Kansas City Office**

(800)288-5489

Steve Panknin
George W. Morris, Jr.
Robert Brickson
Louise Clossick
Sean M. Doherty
Kevin A. Doyle
John D. Jones
Lonnie Harris
Larry Russell
B. Christopher Thompson
Mark Trancikino
Robert Worrell
Carola J. Fuller
Anita Kallenbach
Julie Deaver
Josh Kiefer
Barbara Blake
Susan Homan

Tulsa Office

(800)288-1956

Tom Toburen
C. Steven Woodley
Tereasa McVeigh

Oklahoma City Office

(877)300-7076

Ruel Hightower
Robert Schuyler
Candice Culhane

Trading-Taxable

Chuck Raplinger
Mark Adams
Shannon Wilhite

Trading-Tax Exempt

Roger Trancikino
Kevin Easterday
Lisa Roberts

Public Finance

Kevin Easterday
John Harris

Operations

William M. Teiwes
Sandy Hummel
Janet Williams
Jonathan Heim
Stuart Hightower
Sandy Myers
Sally Paris
Cheri Powers

Portfolio Accounting & Analytics

Evelyn D. Richards
Verena Sisson

Asset Management Group

Sean M. Doherty
Lonnie Harris
David Firnhaber
Clay Wells

Portfolio Consultation

Thomas McKernan

MONITORING THE CREDIT CRUNCH WITH ONE MARKET INDICATOR

As most of you know, our approach to “forecasting” is to rely on market indicators, to the extent possible. Of course, we listen to economists and market commentators, but their opinions are considered with two thoughts in mind: 1) Does their opinion “square” with market indicators, and 2) Is the commentator talking his position?

There are several market indicators we follow routinely: Regression Analysis and our Prime Indifference Curve are now market standards in the community banking industry. We also follow the Implied Forward Curve, in an effort to track changes in the direction of rates. Additionally, we watch Swap Spreads and Credit Spreads, as indicators of credit stress and economic activity. For leading indicators of inflation, we monitor the Treasury to TIPS Spread, as well as commodity prices and long-term cycles of credit.

When will we know that the current credit crunch is over and we can return to business as usual? Here is a quick way to monitor the credit crunch: look at the difference between 1-year LIBOR and the 1-year LIBOR swap. What does this tell us? If you are on the funding desk of a big bank, you can borrow 1-year money in two ways: borrow in the LIBOR market for a 1-year term, or borrow in the 3-month LIBOR market with a quarterly roll for the full year (and simultaneously execute a 1-year LIBOR interest rate swap in order to “lock-in” your cost of funds).

As you know, with an interest rate swap, no money changes hands; nothing is bought or sold. It is merely an exchange of a 12-month fixed rate for the 3-month LIBOR rate. In this case, the 3-month LIBOR received on the swap offsets the 3-month LIBOR paid on your liability, leaving the fixed rate payment on the swap as your cost-of-funds.

In a normal market, one would expect the 1-year rate to approximate the 1-year swap rate. However, in an abnormal market, this relationship breaks down because 1-year LIBOR is a 1-year LOAN; the swap-and-roll is a 3-month LOAN rolled for 1 year. Nervous lenders will charge a premium for 1-year of credit risk vs. credit risk that is limited to only 3 months - and that is just what has happened.

As you can see below, the market turmoil started in August, 2007. Please note the 1-year LIBOR/1-year LIBOR swap spread for the six months (end of the month) prior to August, 2007.

	LIBOR	LIBOR SWAP
Feb 07	5.23813%	5.241%
Mar 07	5.22000%	5.244%
Apr 07	5.29500%	5.2985%
May 07	5.39000%	5.395%
Jun 07	5.38000%	5.377%
Jly 07	5.24500%	5.2549%
Aug 07	5.27500%	5.0915%

In August, the spread widened by 18 basis points and has remained in the range of 20-25 basis points ever since. During this period, write-offs and write-downs from subprime loans and other credit spread product have totaled almost a half of trillion dollars. FNMA and FHLMC have been bailed out; Bear Stearns and IndyMac are gone and the future of FDIC is suspect. Countrywide, the nation's largest mortgage lender, has been merged into Bank of America; Washington Mutual, the nation's largest thrift, is on life support; and Lehman Brothers is the subject of constant rumors. When will it stop?

Of course, the ultimate answer is that it stops when all of us save more and spend less. In the short run, however, the market will tell us when it's over - when the 1-year LIBOR and the 1-year LIBOR swap resume their normal relationship. We're not there yet. This morning (July 30, 2008), the spread is 20 bps (3.28750% less 3.086%) - not even close.

We like to think that our basic investment philosophy has been vindicated – that minimizing credit risk in the bond portfolio will ultimately maximize the return on equity. Most financial intermediaries have more than enough credit risk in the loan book anyway. Additionally, riskier bonds require an 8% capital ratio and can suffer a significant impairment of marketability. Recognizing that quality begets liquidity, we've always believed our fixed-income clients are better served by securities with slightly less yield and substantially more liquidity. With respect to municipals, we've never relied entirely on rating agencies and insurance companies, having always examined the underlying credit of the bonds we position and promote.

Better to learn from the mistakes of others.

Tom McKernan
Senior Vice President

The information herein was obtained from sources which Country Club Bank and our suppliers believe reliable, but we do not guarantee accuracy. Neither the information, nor any opinion expressed, constitutes a solicitation to buy or sell securities.

The products offered (1) are not FDIC insured, (2) are not deposits or other obligations of the bank or guaranteed by the bank, and (3) involve investment risks, including possible loss of principal amount invested.