



2012 Outlook

December 16, 2011

David Malpass
dmalpass@encimaglobal.com

212.876.4400

Please read the important disclosure information in the Addendum section of this presentation.

Global Growth Depends on Europe

- **U.S. jobless claims fell again. We're maintaining our 3.5% expectation for fourth quarter real GDP growth, an acceleration from the third quarter. Corporate profits are still rising.**
 - **China's loosening of monetary policy is a positive. Lowering the reserve requirement frees up bank cash held at the PBOC at a zero interest rate.**
 - **With price-earnings multiples very low and idle liquidity enormous, we think any positive developments in Europe would launch a strong global equity rally. The key issue is whether Europe takes more steps that bring bond yields down in Italy and Spain.**
 - **We've been focused on the burn-off of European bank liabilities and the possible fire-sale of assets exacerbating the European bank undercapitalization. The risk is highly destabilizing in part because Europe's banking system is so big.**
-

World Nominal \$ GDP Growth

(last obs. 2010, forecasts for 2012)

| | 2010 | 2011 | 2012 |
|---|-------|-------|--------|
| Nominal \$ GDP Growth | | | |
| United States (\$ 15.7T, 22% share) | 4.2% | 3.7% | 4.0% |
| European Union (\$ 17.5T, 24%) | -0.7% | 10.6% | -2.7% |
| Emerging and developing (\$ 27.2T, 37%) | 18.9% | 16.5% | 8.2% |
| World (\$ 72.8T) | 9.0% | 11.3% | 4.0% |
| Nominal \$ GDP Growth if euro breaks | | | |
| World (\$ 70.7T) | | | 1.0% |
| European Union (assumes avg euro components = \$1.20) | | | -13.5% |

Source: Encima Global; IMF

Initial Jobless Claims Show Expansion Underway

(last obs. December 10, 2011)

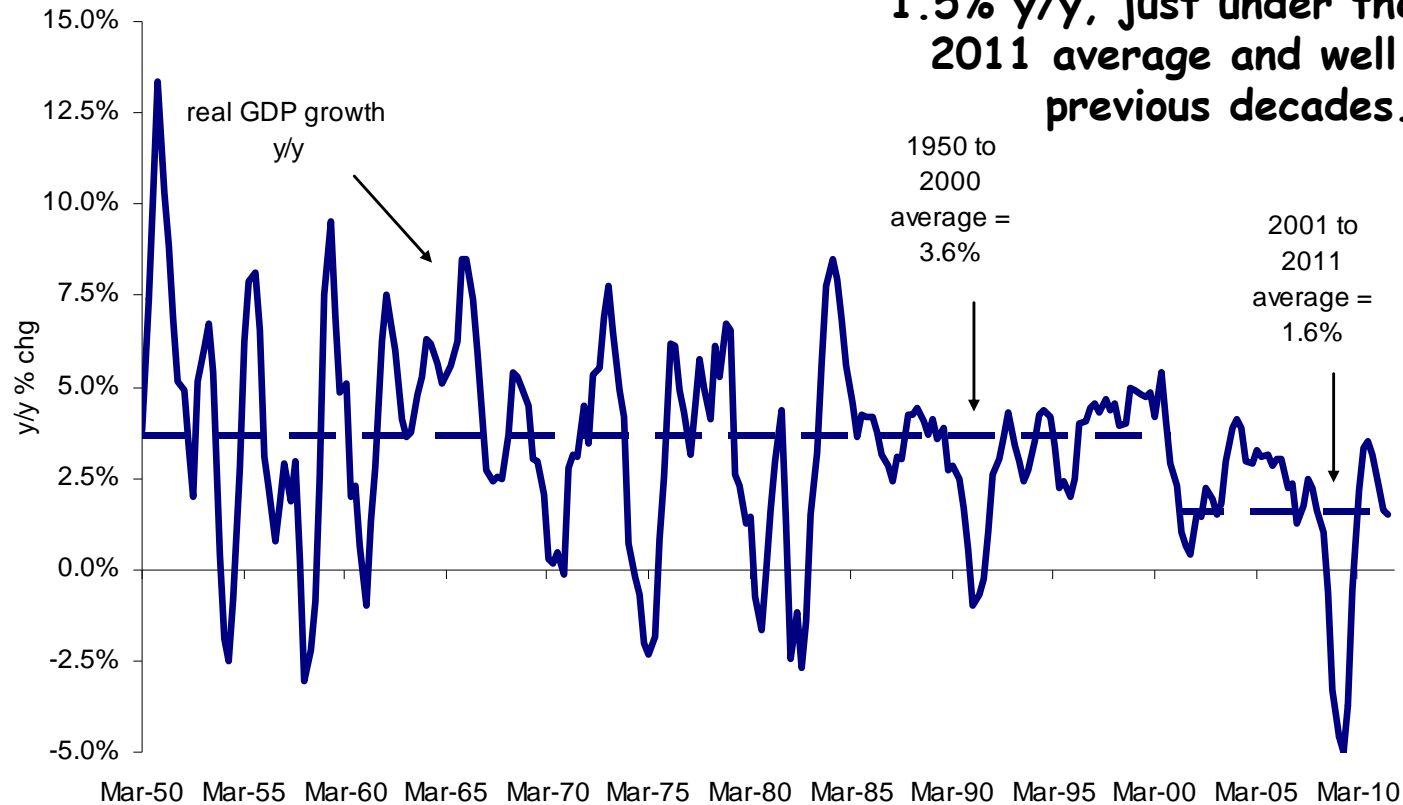


Source: Department of Labor: Bureau of Labor Statistics; Encima Global

Real GDP Stuck in New Norm

(last obs. Q3 2011)

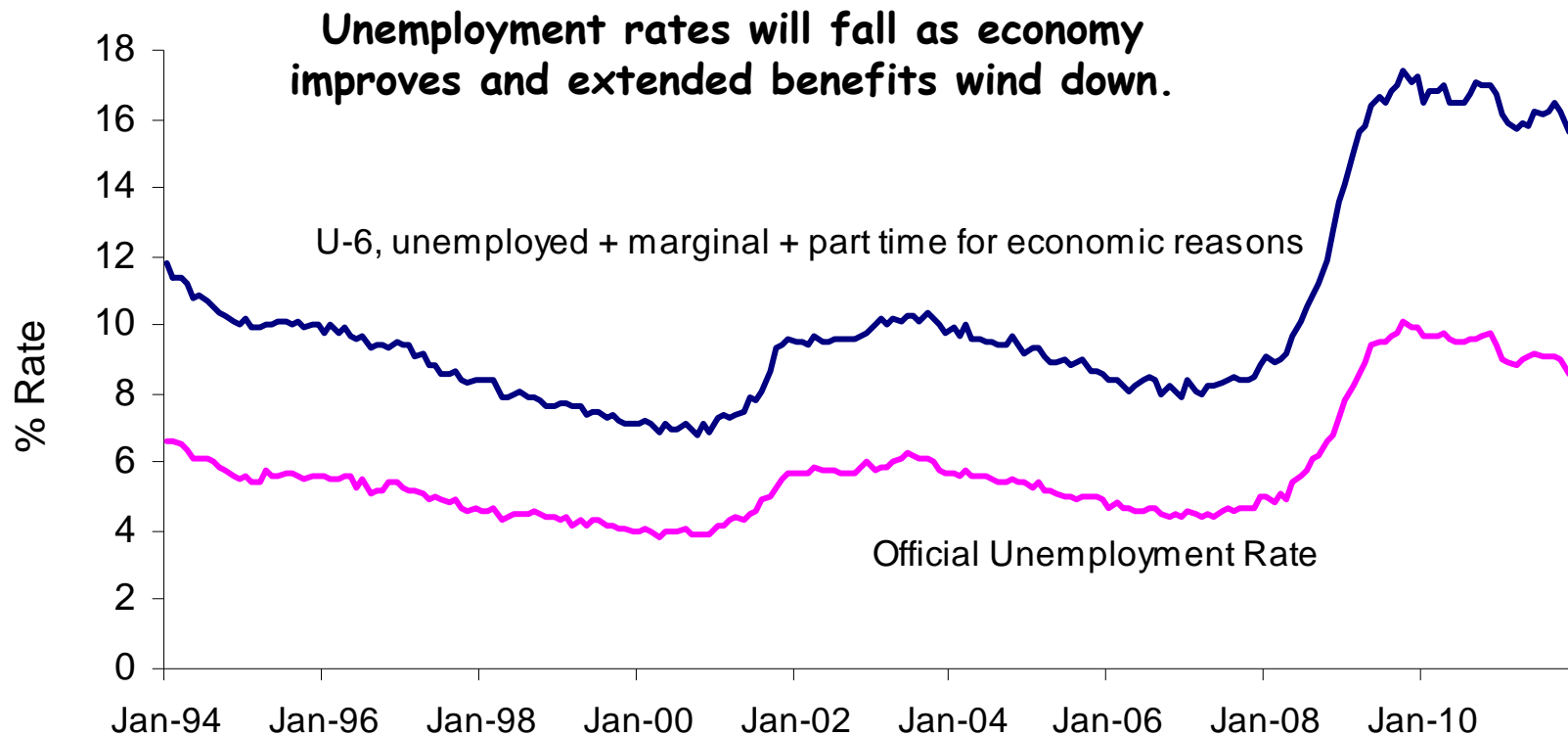
Growth has remained slow at 1.5% y/y, just under the 2001-2011 average and well below previous decades.



Source: Bureau of Economic Analysis; Encima Global

Unemployment and Underemployment Rates Falling

(last obs. November 2011, unemployment 8.6%, underemployment 15.6%)



Source: Bureau of Labor Statistics; Encima Global

Employment Growth; Household Strengthening

(last obs. November 2011)

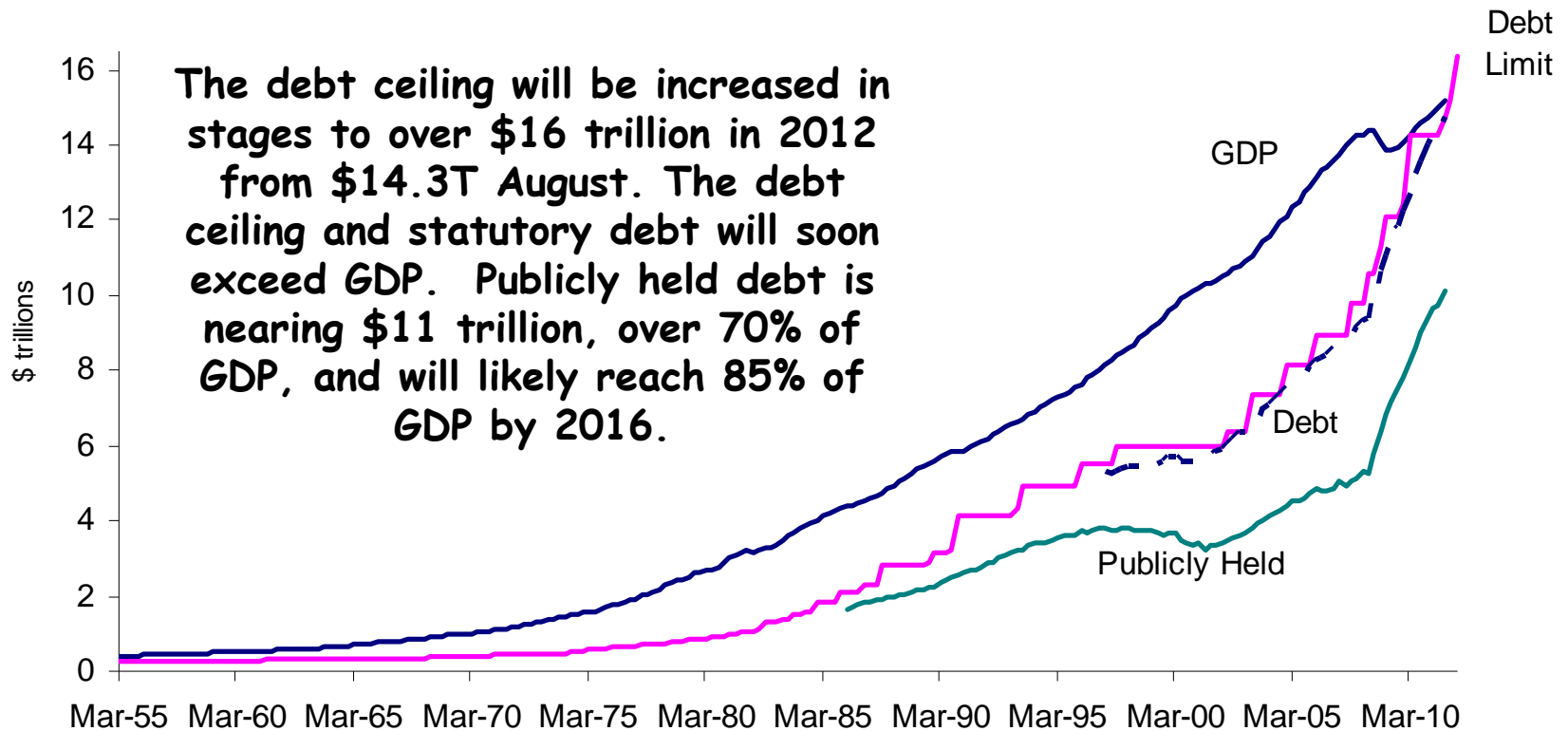
| | <u>ADP</u> | <u>Establishment Payrolls</u> | | <u>Households</u> |
|----------------|------------|-------------------------------|--------------|-------------------|
| | | <u>Private</u> | <u>Total</u> | <u>Pop Adj.</u> |
| January 2010 | -50 | -42 | -39 | 789 |
| February 2010 | 4 | -21 | -35 | 183 |
| March 2010 | 49 | 144 | 192 | 250 |
| April 2010 | 113 | 229 | 277 | 425 |
| May 2010 | 42 | 48 | 458 | -33 |
| June 2010 | 50 | 65 | -192 | -263 |
| July 2010 | 31 | 93 | -49 | -105 |
| August 2010 | 63 | 110 | -59 | 272 |
| September 2010 | 32 | 109 | -29 | 107 |
| October 2010 | 79 | 143 | 171 | -297 |
| November 2010 | 122 | 128 | 93 | -178 |
| December 2010 | 246 | 167 | 152 | 293 |
| January 2011 | 190 | 94 | 68 | 589 |
| February 2011 | 205 | 261 | 235 | 250 |
| March 2011 | 203 | 219 | 194 | 291 |
| April 2011 | 179 | 241 | 217 | -190 |
| May 2011 | 35 | 99 | 53 | 105 |
| June 2011 | 144 | 75 | 20 | -445 |
| July 2011 | 107 | 173 | 127 | -38 |
| August 2011 | 85 | 72 | 104 | 331 |
| September 2011 | 130 | 220 | 210 | 398 |
| October 2011 | 130 | 117 | 100 | 277 |
| November 2011 | 206 | 140 | 120 | 278 |

Source: Bureau of Labor Statistics; ADP; Encima Global

Fiscal Discipline in the U.S.?

Publicly Held Debt Reaching 70% of GDP

(last obs. Q3 2011, Q1 2012 for debt limit)



Source: Bureau of Economic Analysis; U.S. Treasury; Encima Global

China Loosening

- **China lowered its bank reserve requirement to 21% from 21.5%. The reserve requirement acts as a tax on banks and works in conjunction with top-down lending quotas and the PBOC's fixing of lending and deposit rates. The prospect of a series of reductions in the PBOC reserve requirement is stimulative.**
 - **Inflation is falling rapidly, encouraging more monetary loosening.**
 - **We think China will allow the yuan appreciation to stop to encourage growth and satisfy the export lobby. In combination, these have negative implications for Treasuries.**
-

U.S. Procyclical Bank Lending Policy

(last obs. November 2011)



Source: Federal Reserve; Encima Global

China's Countercyclical Bank Lending Policy

(last obs. November 2011)

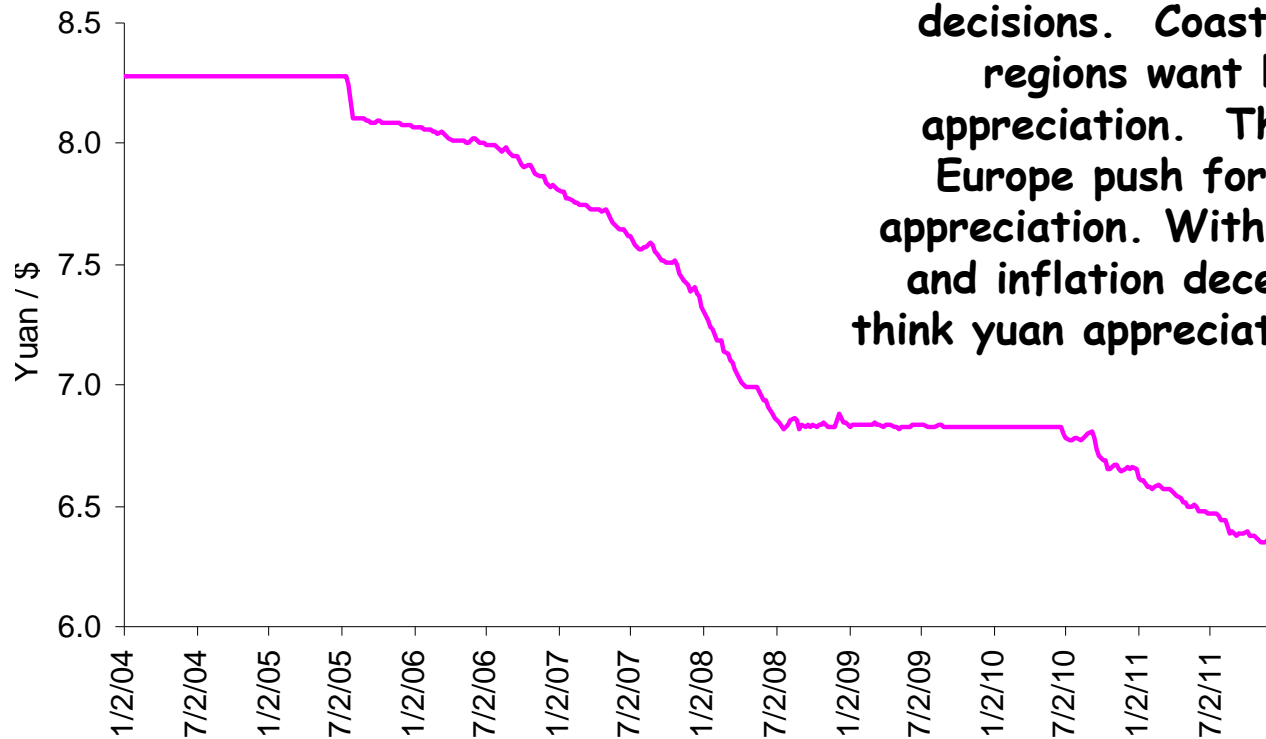


Source: Bloomberg; Encima Global

Yuan / US \$

(last obs. December 16, 2011)

The yuan-dollar exchange rate is mostly based on China's internal decisions. Coastal exporting regions want less yuan appreciation. The U.S. and Europe push for more yuan appreciation. With China slowing and inflation decelerating, we think yuan appreciation may pause.



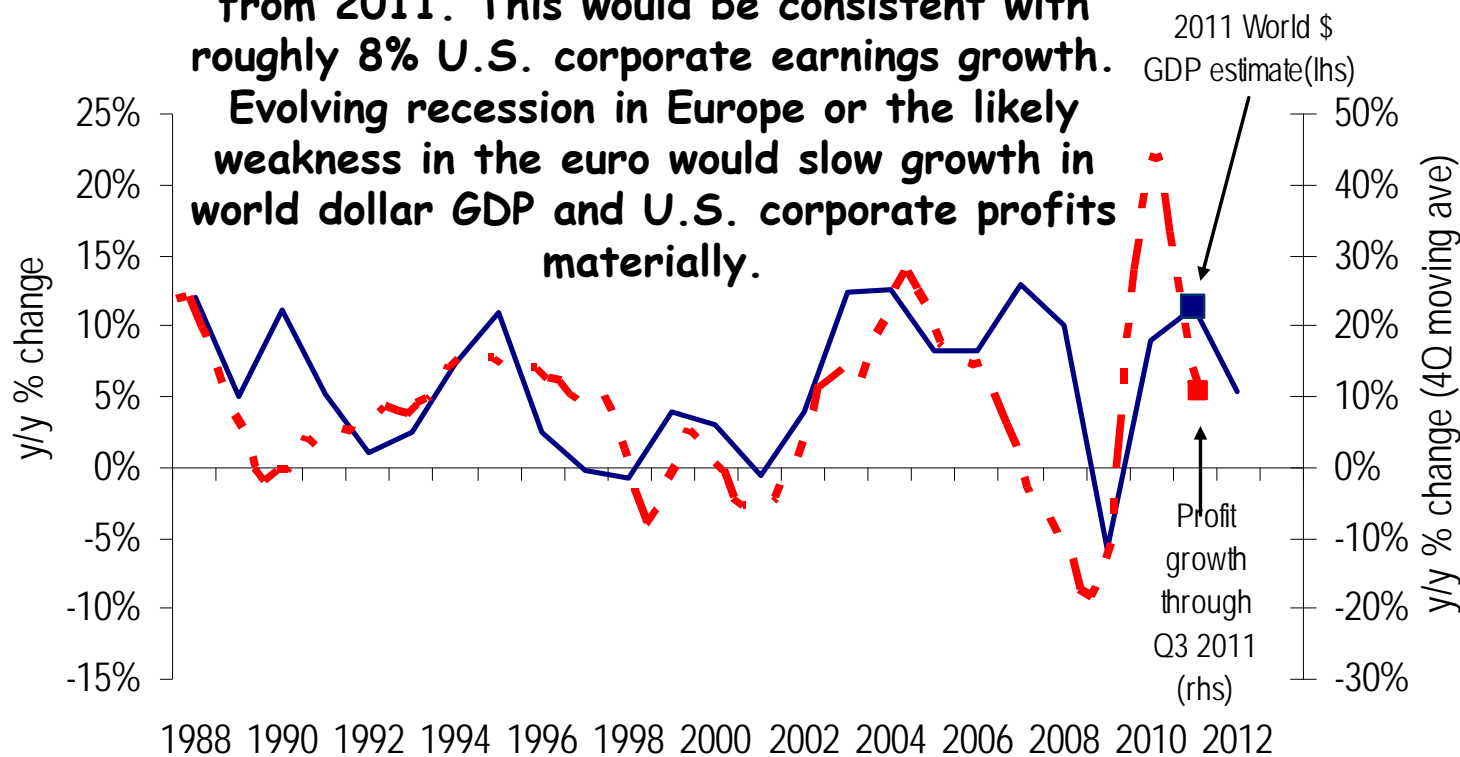
Source: Federal Reserve Board; Encima Global

U.S. Corporate Profits Grow with World \$ GDP

(last obs. Q3 2011 for NIPA corporate profits, IMF forecasts for \$ GDP to 2012)

In 2012, world nominal dollar GDP is expected to reach almost \$73 trillion, up 4% from 2011. This would be consistent with roughly 8% U.S. corporate earnings growth.

Evolving recession in Europe or the likely weakness in the euro would slow growth in world dollar GDP and U.S. corporate profits materially.



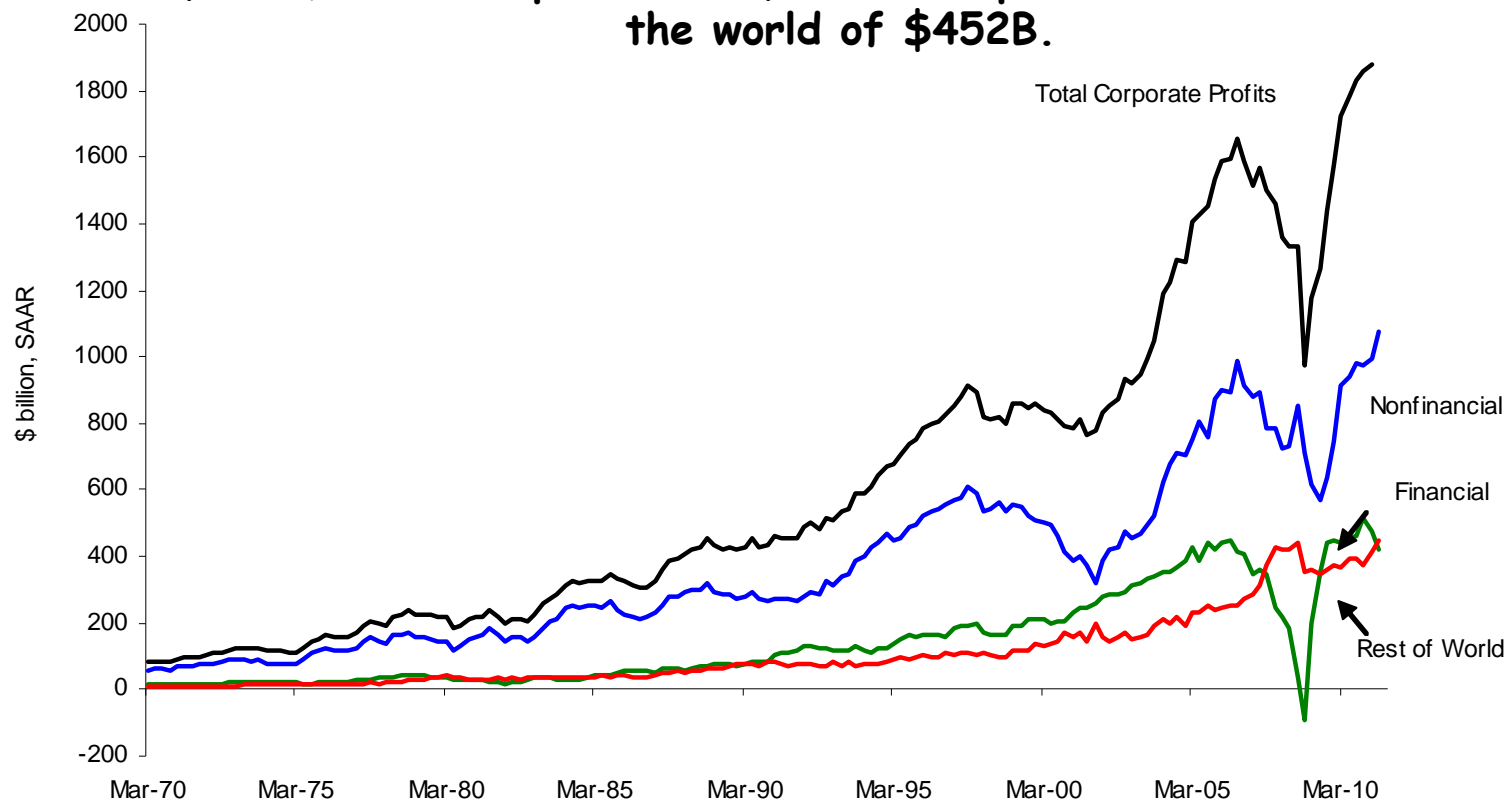
— World \$ GDP (lhs) - - U.S. pre-tax corporate profits (rhs)

Source: Bureau of Economic Analysis; IMF; Encima Global

U.S. Corporate Profits

(pre-tax SAAR, last obs. Q3 2011 for NIPA corporate profits)

Third quarter profits were \$2 trillion annualized and are up 7.9% y/y. That was composed of domestic nonfinancial profits of \$1.1T, financial profits of \$435B and profits from the rest of the world of \$452B.



Source: Bureau of Economic Analysis; IMF; Encima Global

S&P Earnings Yield High

(last obs. December 14, 2011)

S&P earnings yield (last 12 mo earnings divided by price) is well above the 10 Yr Treasury yield, near a historically wide spread.

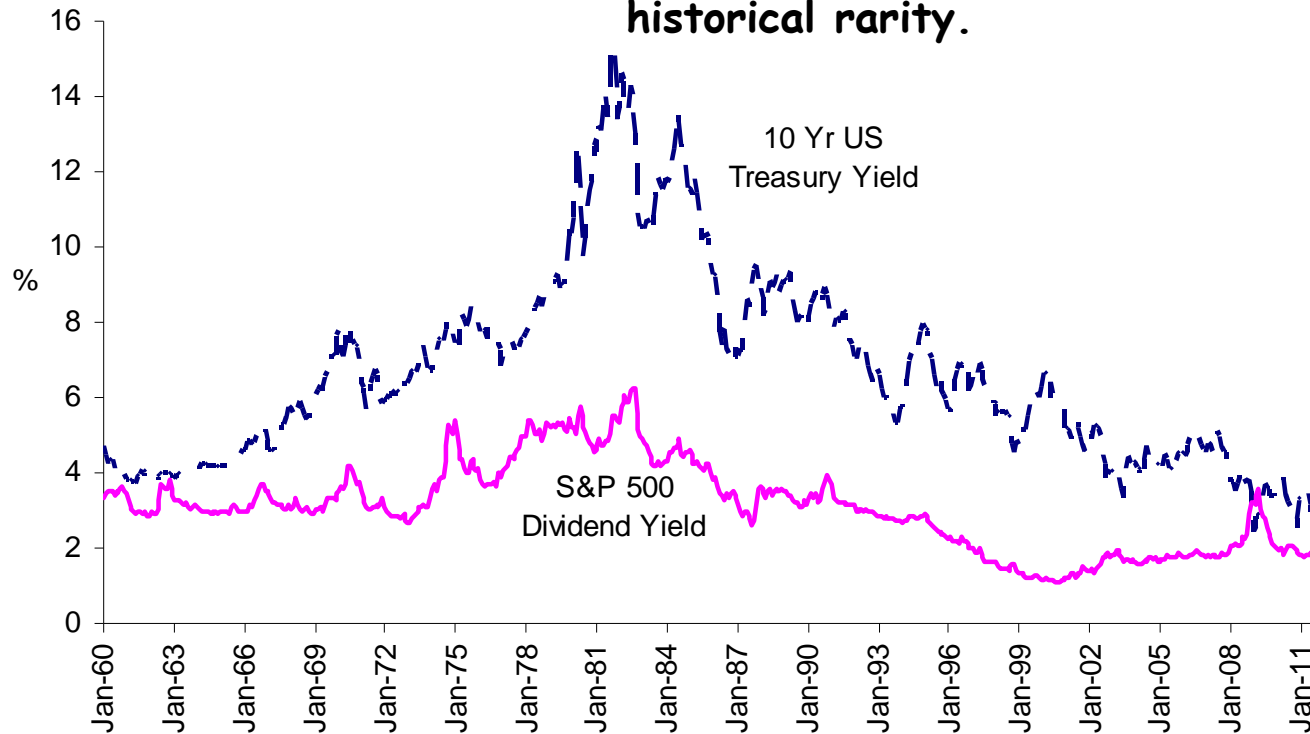


Source: Standard and Poors'; Federal Reserve Board; Encima Global

S&P Dividend Yield Above Treasury Yield

(last obs. December 14, 2011)

S&P dividend yield is above 10 Year US Treasury yield, an historical rarity.



Source: Standard and Poors'; Federal Reserve Board; Encima Global

Fiscal Discipline in Europe?

The euro-zone is working to establish a near-automatic disciplinary procedure when countries are above the 3% deficit limit and 1.5% structural deficit limit. Our concerns:

- Europe needs to cut government spending now; this delays it;**
 - The disciplinary actions won't be enough to force spending cuts;**
 - The focus on deficits (rather than spending and debt) won't work; governments will announce taxes, spend the proceeds and end up with more debt.**
 - As in the U.S., we think Europe should be imposing debt-to-GDP limits that require repeated rounds of government spending cuts when over the debt ratio.**
-

U.S. and Europe Bank Statistics

(last obs. Q3 2011)

| | <u>US</u> | <u>Euro Zone</u> |
|--|-----------|------------------|
| Total Bank Assets | \$ 12.5T | \$ 45.5T |
| Bank Loans to Non-Financial Corporations | \$ 1.3T | \$ 6.4T |
| Bonds Outstanding for Non-Financial Corp. | \$ 4.8T | \$ 1.2T |
| GDP 2011 | \$ 15.2T | \$ 13.4T |

Source: ECB; Encima Global

Selected Bank Assets and Liabilities

(\$ billions, last obs. December 2011)

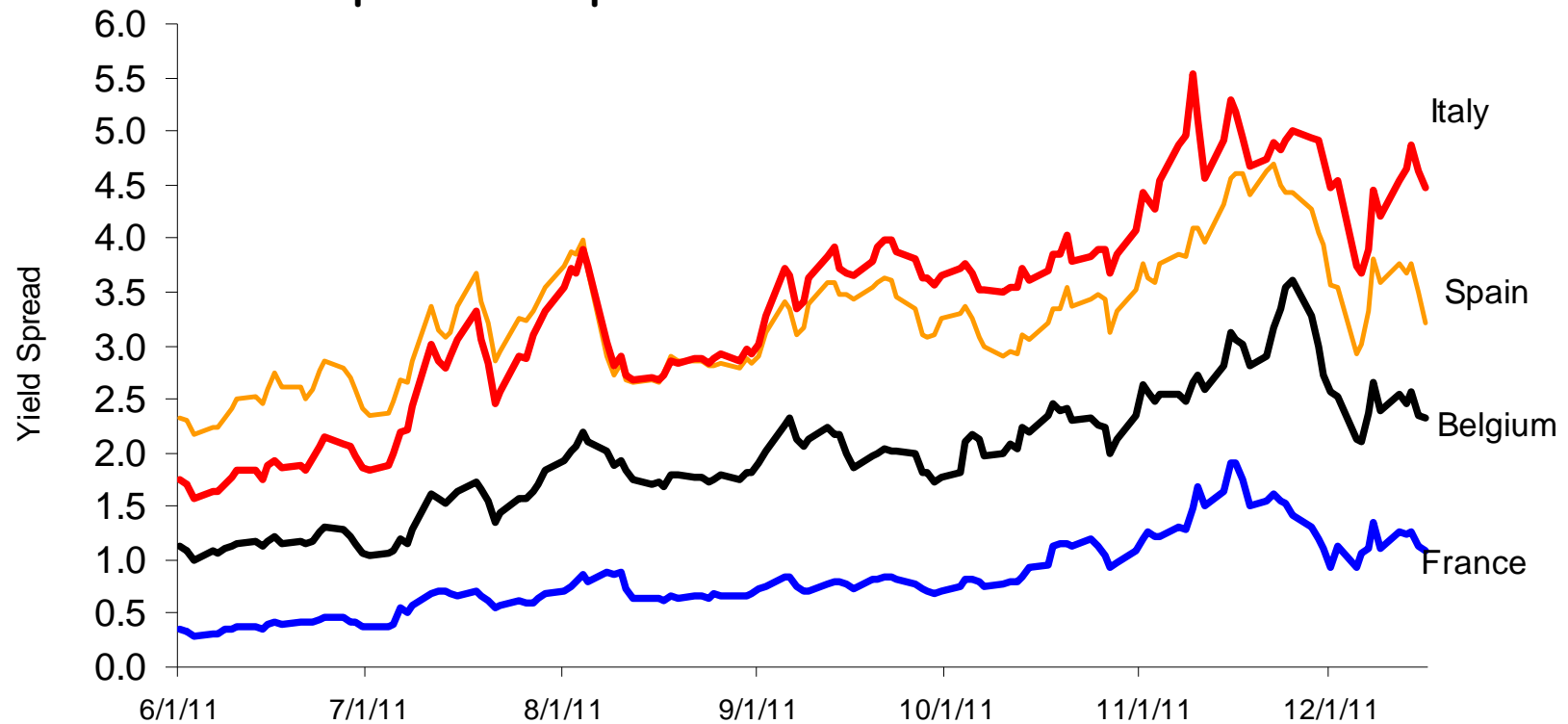
| | Assets | Liabilities | Equity capital | Market capital | Leverage debt/eq | Price/Book MC/Equity |
|------------------|---------------|--------------------|-----------------------|-----------------------|-------------------------|-----------------------------|
| Unicredit | 929 | 862 | 68 | 15 | 13 | 0.2 |
| Barclays | 2,354 | 2,255 | 98 | 32 | 23 | 0.3 |
| DBK | 2,572 | 2,504 | 68 | 34 | 37 | 0.5 |
| BNP | 2,697 | 2,581 | 116 | 46 | 22 | 0.4 |
| CBK | 1,018 | 979 | 39 | 8 | 25 | 0.2 |
| GS | 911 | 833 | 78 | 47 | 11 | 0.6 |
| JPM | 2,117 | 1,941 | 176 | 116 | 11 | 0.7 |
| BAC | 2,265 | 2,036 | 228 | 59 | 9 | 0.3 |

Source: Bloomberg

Selected European 10 Yr Yield Spreads

(last obs. December 16, 2011)

European bond spreads retreated.

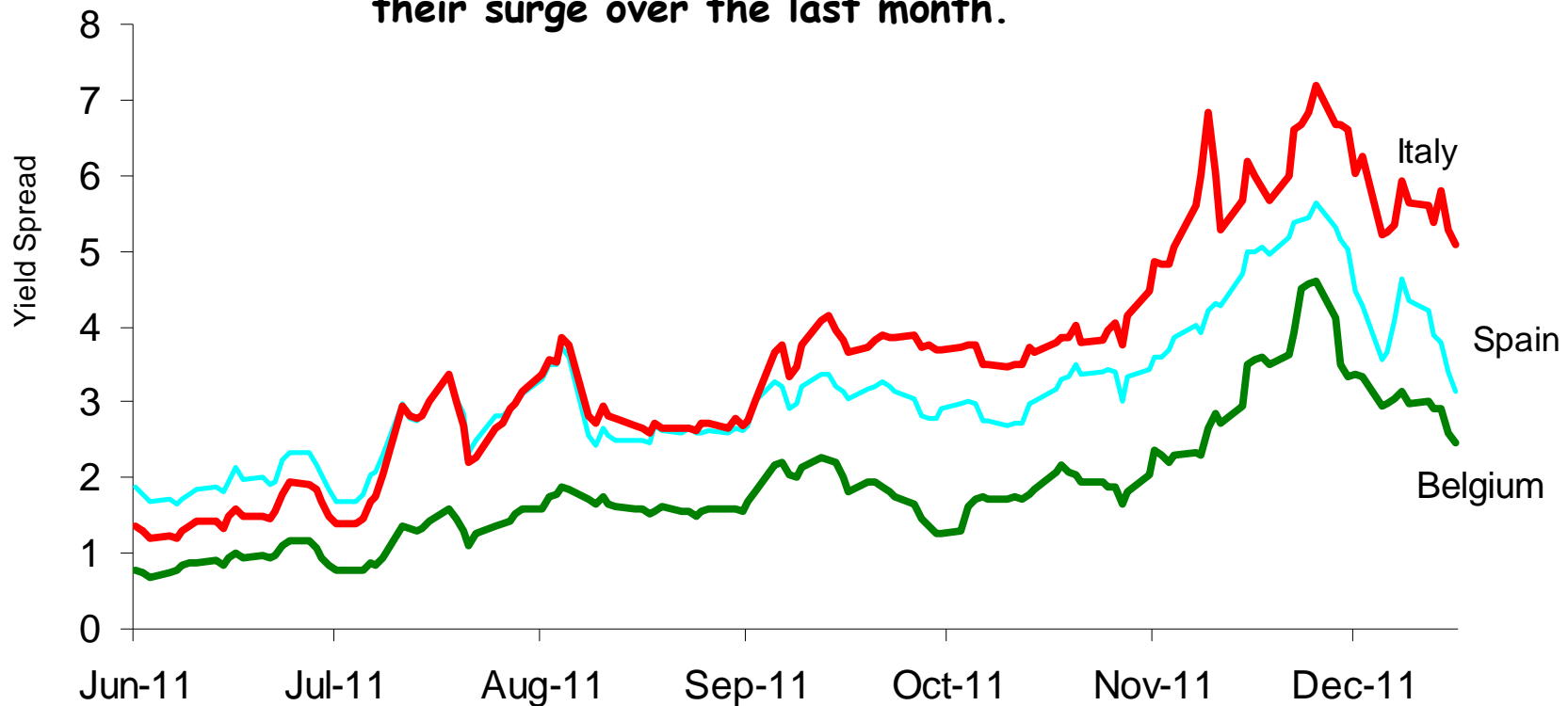


Source: Bloomberg; Encima Global

Selected European 2 Yr Yield Spreads

(last obs. December 16, 2011)

2 year bond spreads have pulled back from their surge over the last month.



Source: Bloomberg; Encima Global

Disagree with Perma-Bear

- **That economies are destined to grow slowly after a deep financial crisis due to deleveraging. Growth depends on policies.**
 - **That the U.S. is near a recession (they said that in Aug '10 too.)**
 - **That the euro has to break up.**
 - **That China will slow hard to 5%. It may slow below 9%, but banks are protected, bubble popping is common, and economy evolves.**
 - **That the Fed printed money, \$ will crash, and fast inflation is near.**
 - **That we're heading for a Lehman crisis or a Japan-style deflation.**
 - **However, U.S. and European debt problems are still increasing. Any additional risk of a breakup of the euro would be a major negative in the global outlook.**
-

U.S. Household Assets Twice Total Debt

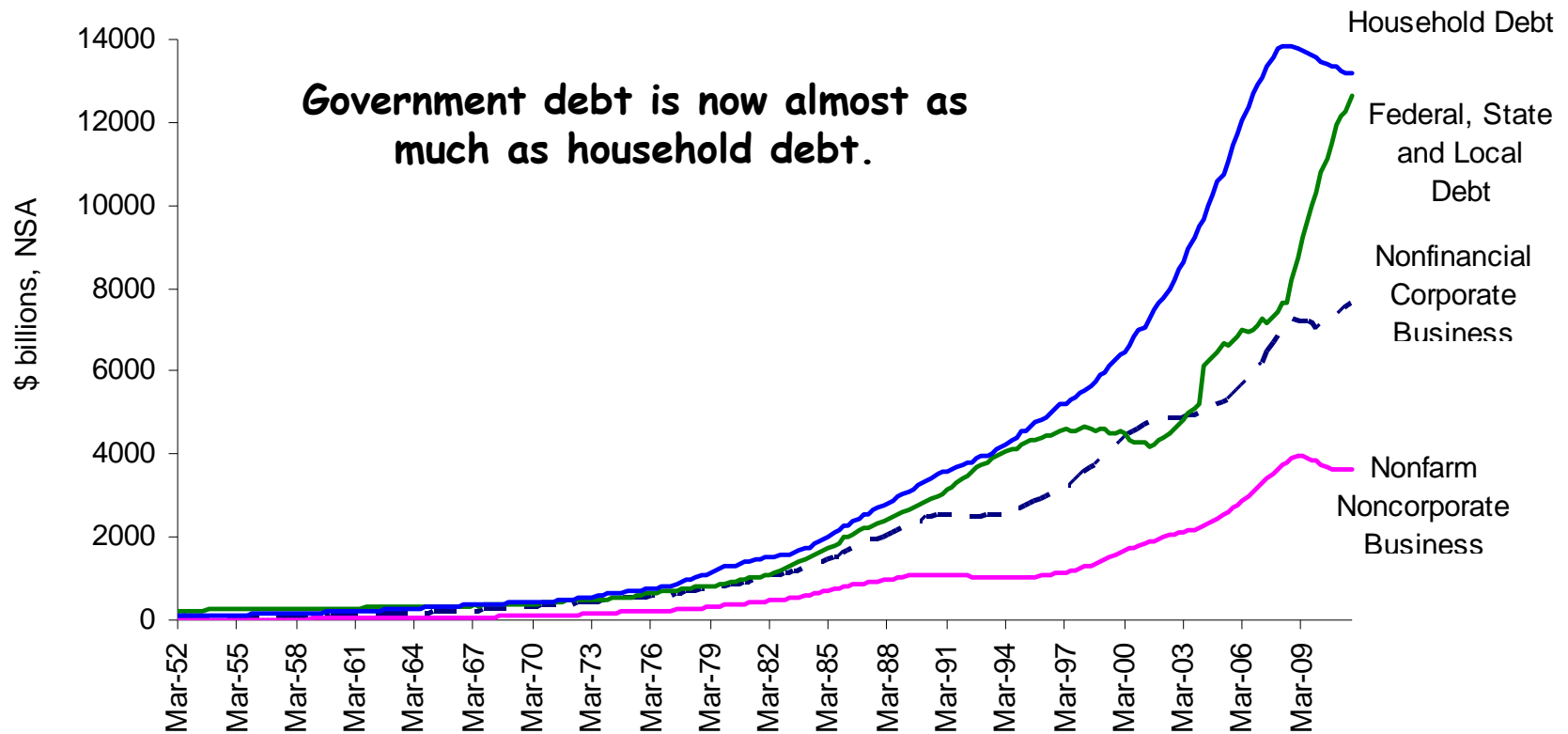
(last obs. Q3 2011, Assets \$71.1T, Total Debt \$37.8T)



Source: Federal Reserve: Flow of Funds; Encima Global

Debt by Major Sectors

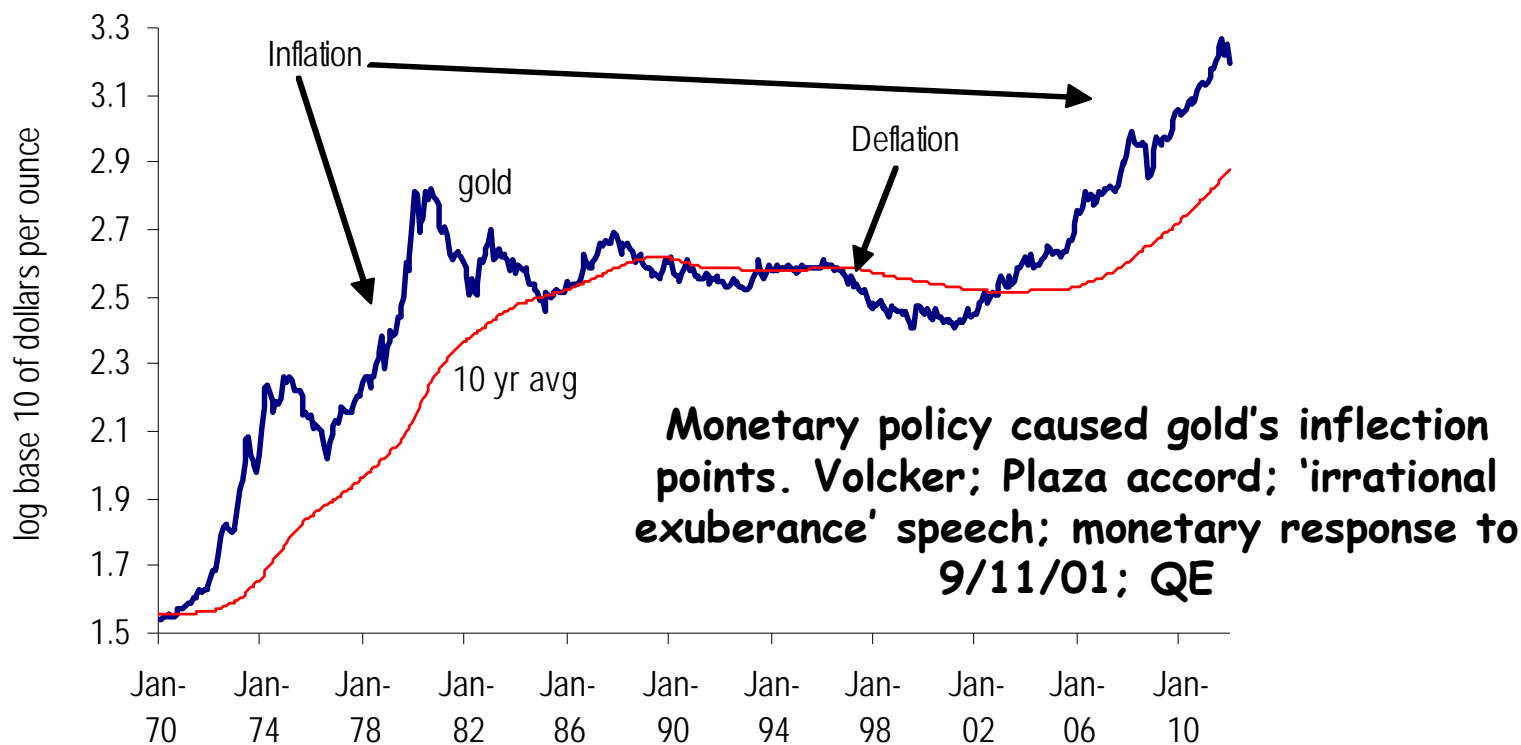
(last obs. Q3 2011)



Source: Federal Reserve: Flow of Funds; Encima Global

Gold Prices in Log Terms

(\$ per gold ounce, last obs. December 16, 2011)

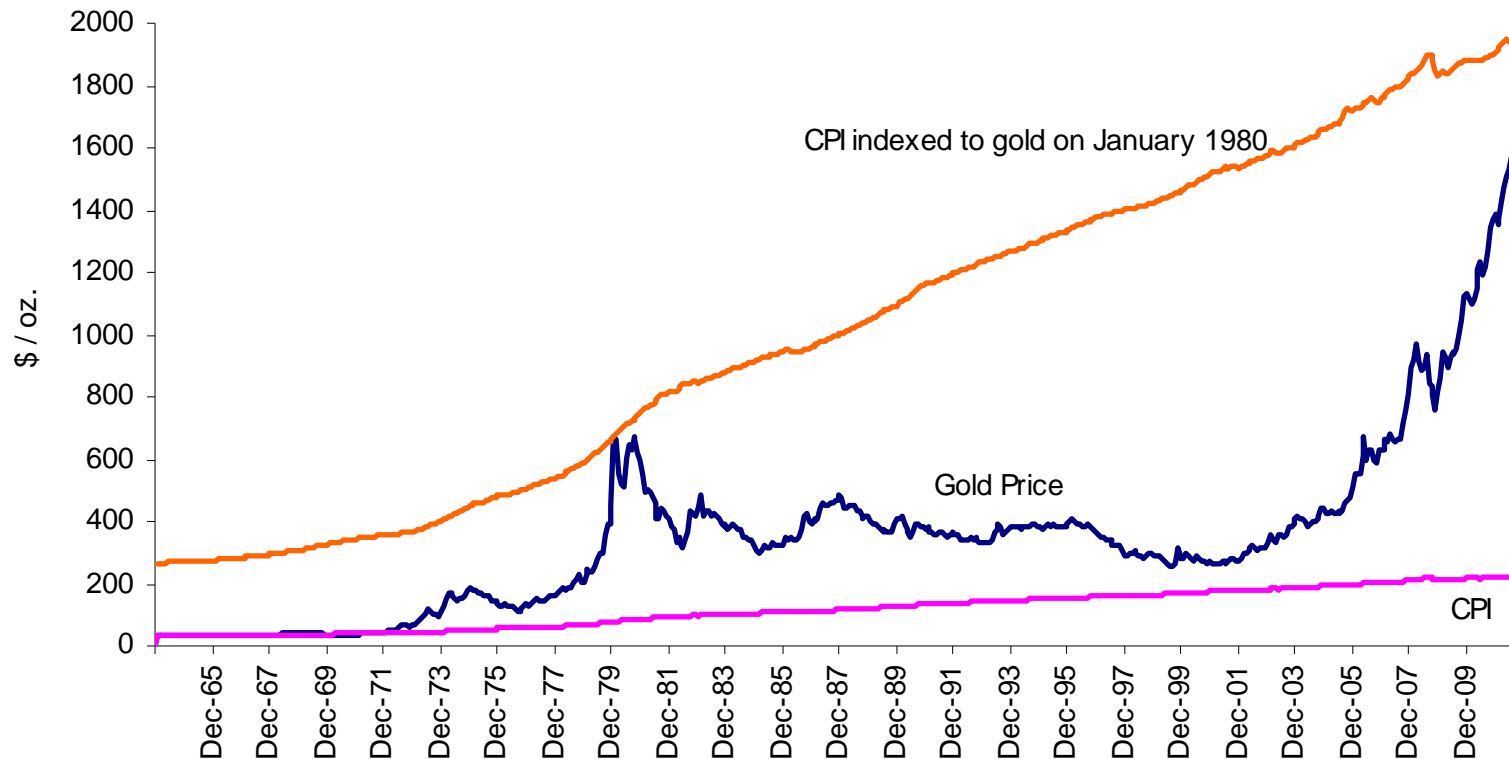


Source: Wall Street Journal; Encima Global

Gold Prices Very High In Real Terms; Like 1980

(last obs. November 2011)

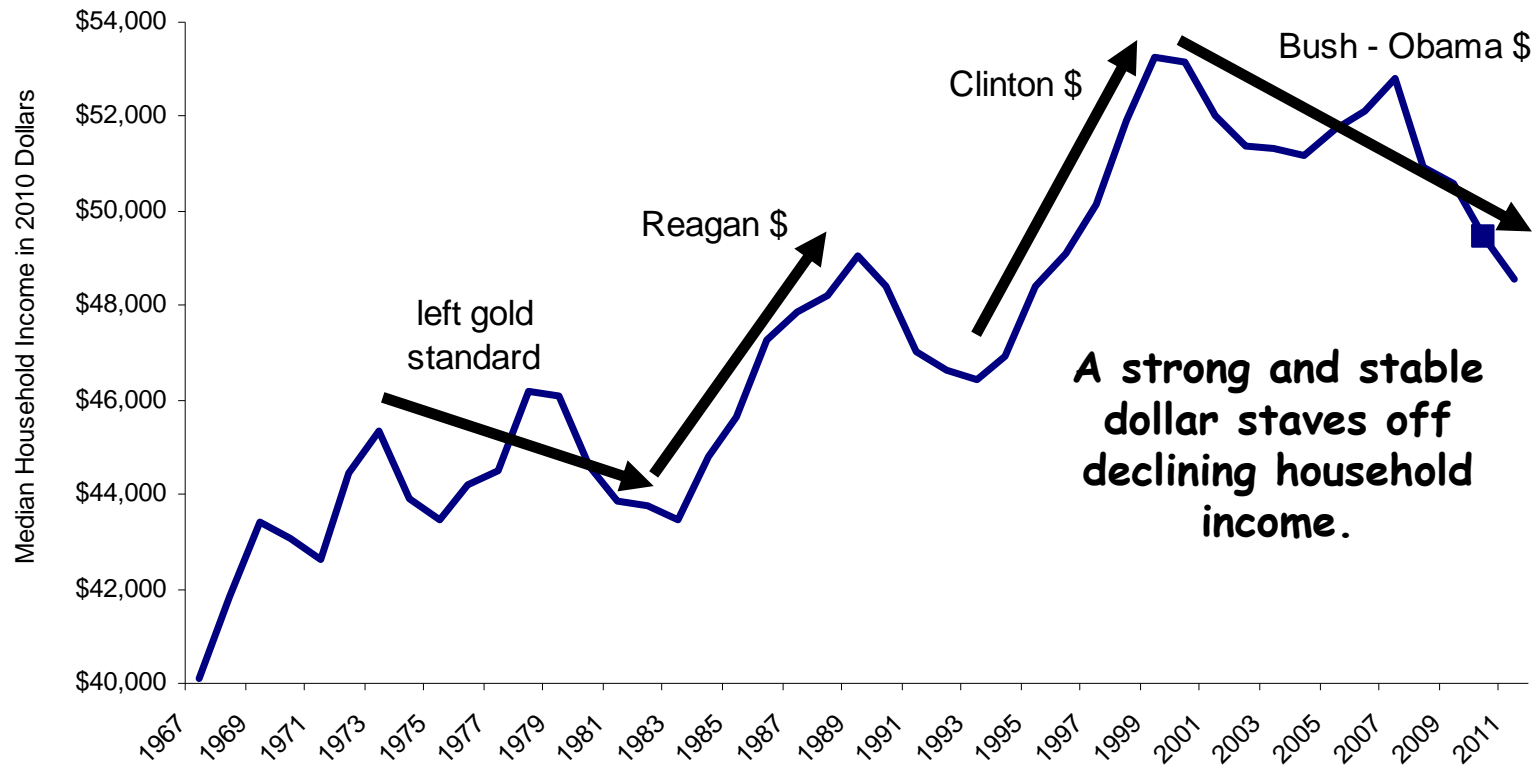
Neither the Fed nor ECB are causing the expansion of credit needed to justify high gold prices. If banks begin lending wildly as in the 1970s and 2000s, then inflation risks will support high gold prices.



Source: Wall Street Journal; Bureau of Labor Statistics; Encima Global

Median Household Income Falling

(inflation adjusted 2010 \$, last obs. 2010, forecast for 2011)



Source: Census Bureau; Encima Global



Note: This document is confidential and intended solely for the use of the individuals to whom it is presented. Encima Global LLC does not accept liability for the content or for the consequences of any actions taken on the basis of the information provided. The information is not necessarily complete, and we make no warranty as to its accuracy.