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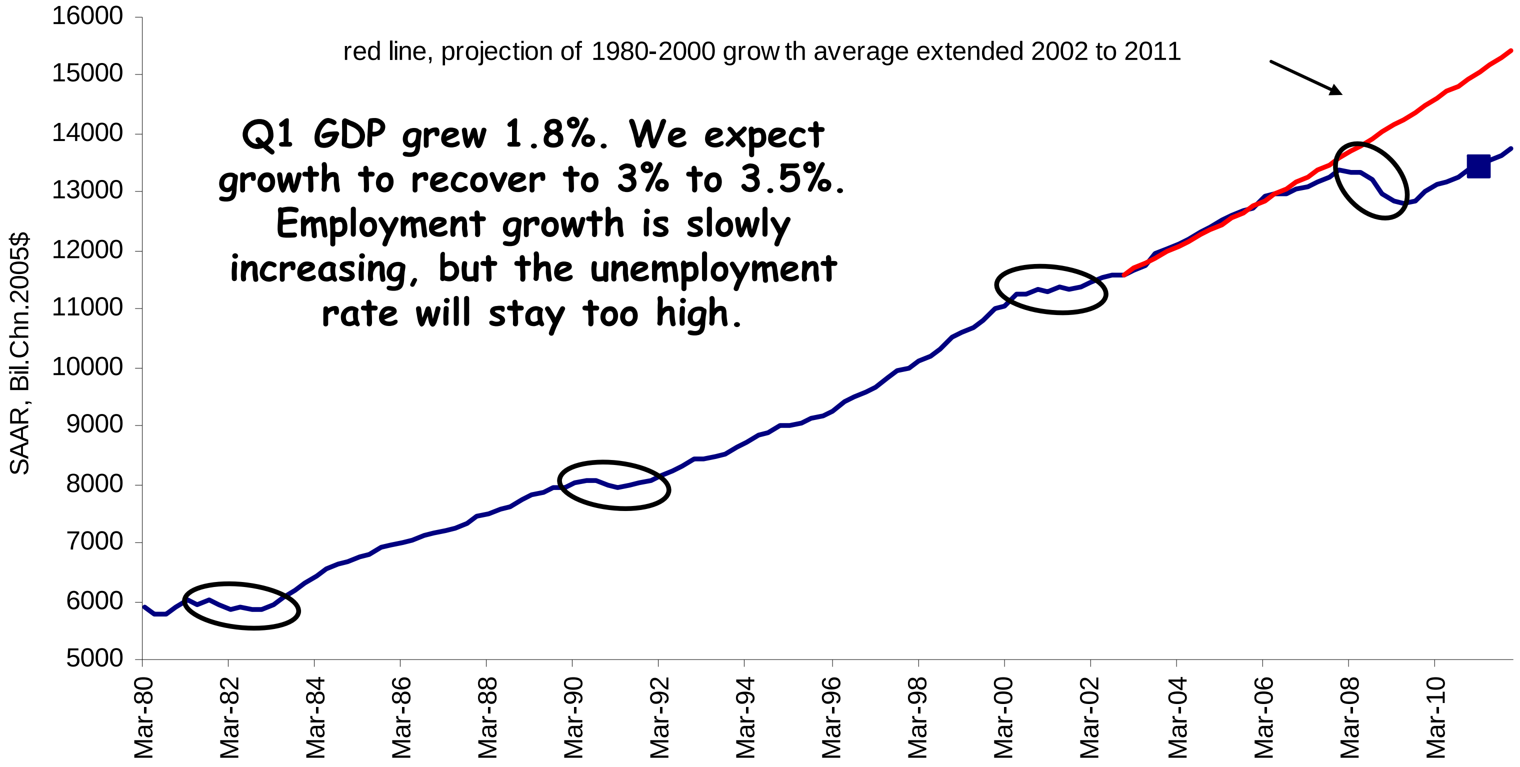
Please read the important disclosure information in the Addendum section of this presentation.

U.S. Economic Outlook

- The first quarter GDP came in weaker than expected at 1.8% due to a decline in defense and other government spending. We look for 3%-3.5% GDP growth in subsequent quarters (a moderate expansion.) Job growth and business investment will be key signposts. Despite the first quarter letdown in GDP, the household survey found over one million jobs in the first quarter, while ADP also began to show job growth for small and medium-sized businesses.
- The basic U.S. policy has been to kick the can hard down the road. Contrasting with most of the rest of the world, the U.S. government has been practicing belt-loosening (increased federal deficits and mandates) rather than belt-tightening. This has been supported by the Federal Reserve's massive debt buy-backs and the maintenance of near-zero interest rates, which hold down government and corporate borrowing costs. It's not an optimal policy, but can-kicking will probably leave economic and market trends intact, allowing an expansion past the 2012 presidential election.
- We think loose fiscal and monetary policy have been harmful but will continue. There are also worries about inflation, high oil, a U.S. double dip, the dollar, the debt limit increase, European debt and China's slowdown. We think these won't stop the expansion, leaving room for a solid improvement in expectations.
- We're constructive on profits and equities in the second half of 2011. Overall corporate profits rose to a new peak at $1.68 trillion annualized in the fourth quarter of 2010. We expect strong increases in 2011, helped by growth abroad, productivity gains and stronger capital spending in the U.S. Bond yields have fallen, but we expect an uptrend in the second half.

Real GDP Growing From a Low Base

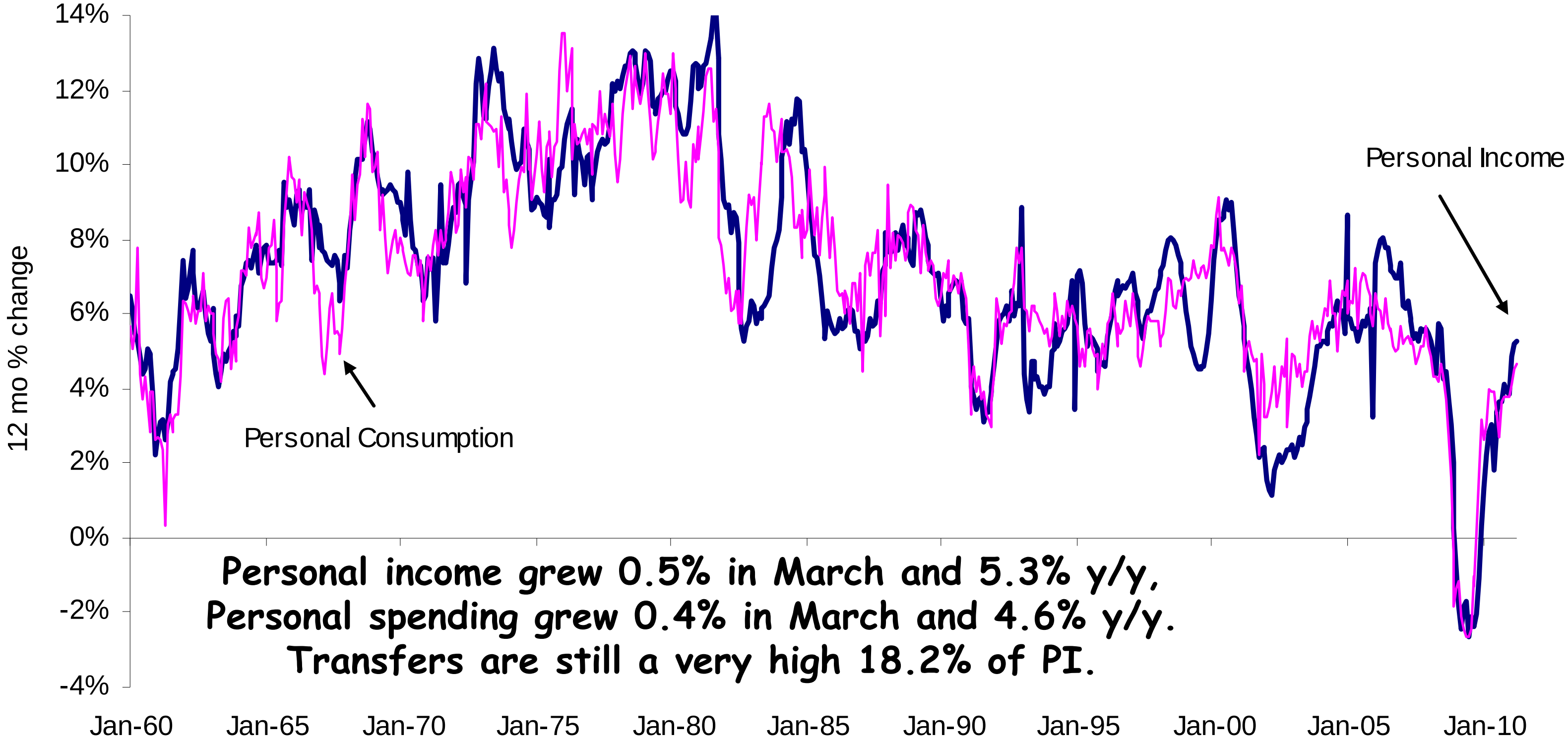
(last obs. blue square Q1 2011, projected to Q4 2011)



Source: Bureau of Economic Analysis; Encima Global

Personal Income and Spending

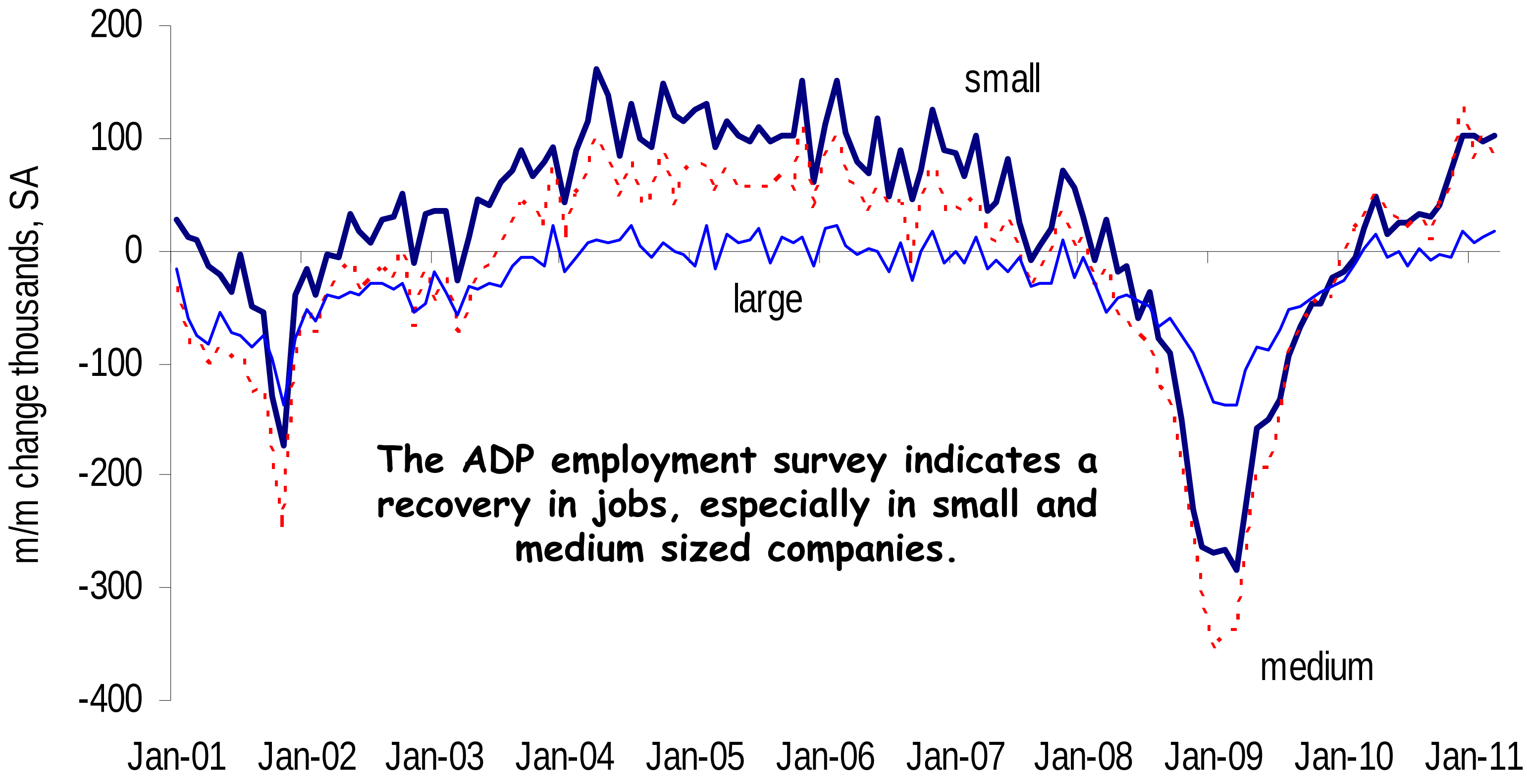
(last obs. March 2011)



Source: Bureau of Economic Analysis; Encima Global

ADP Jobs Survey by Company Size

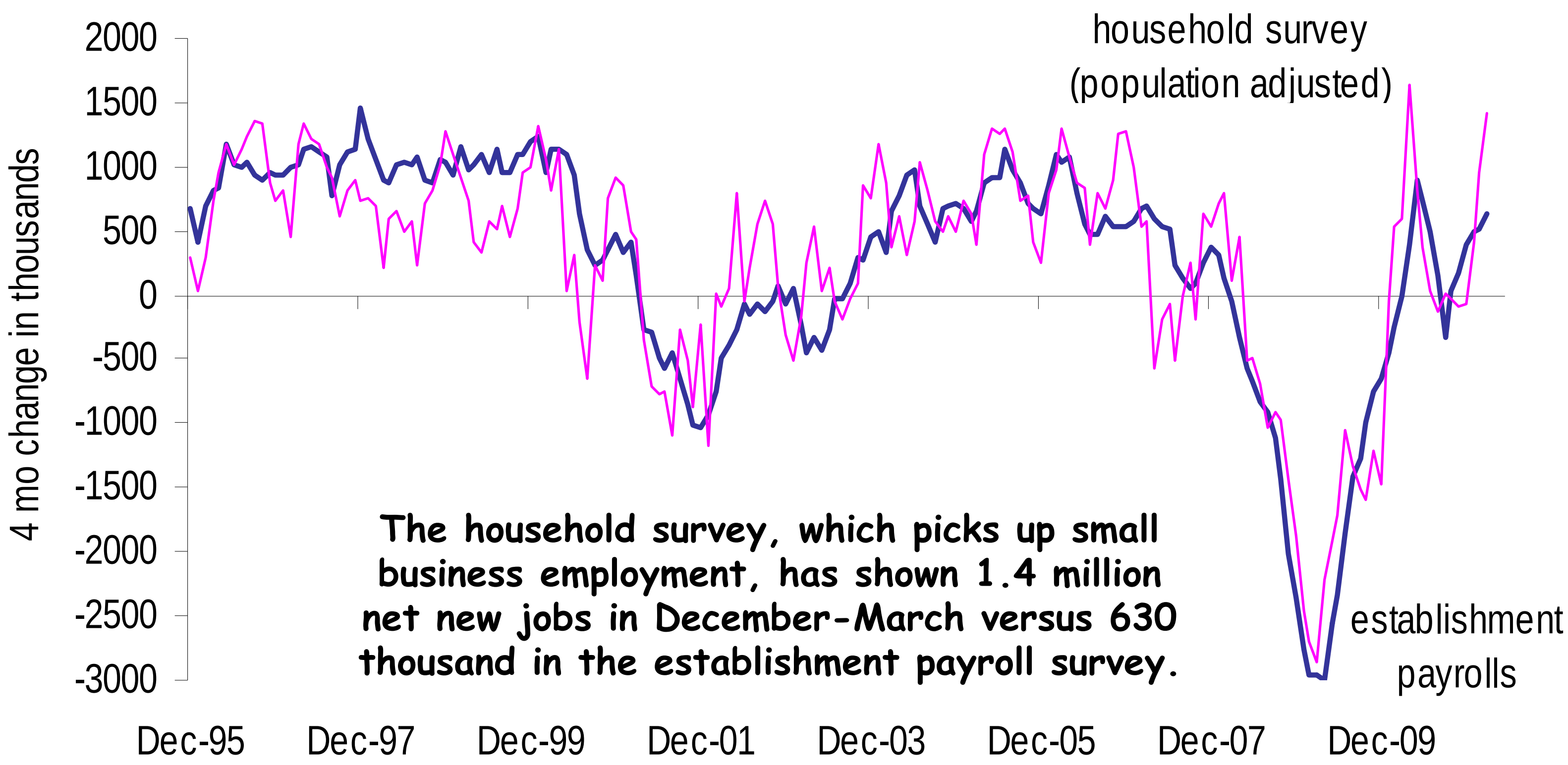
(last obs. March 2011)



Source: ADP; Encima Global

4 Month Employment Growth in Household Survey

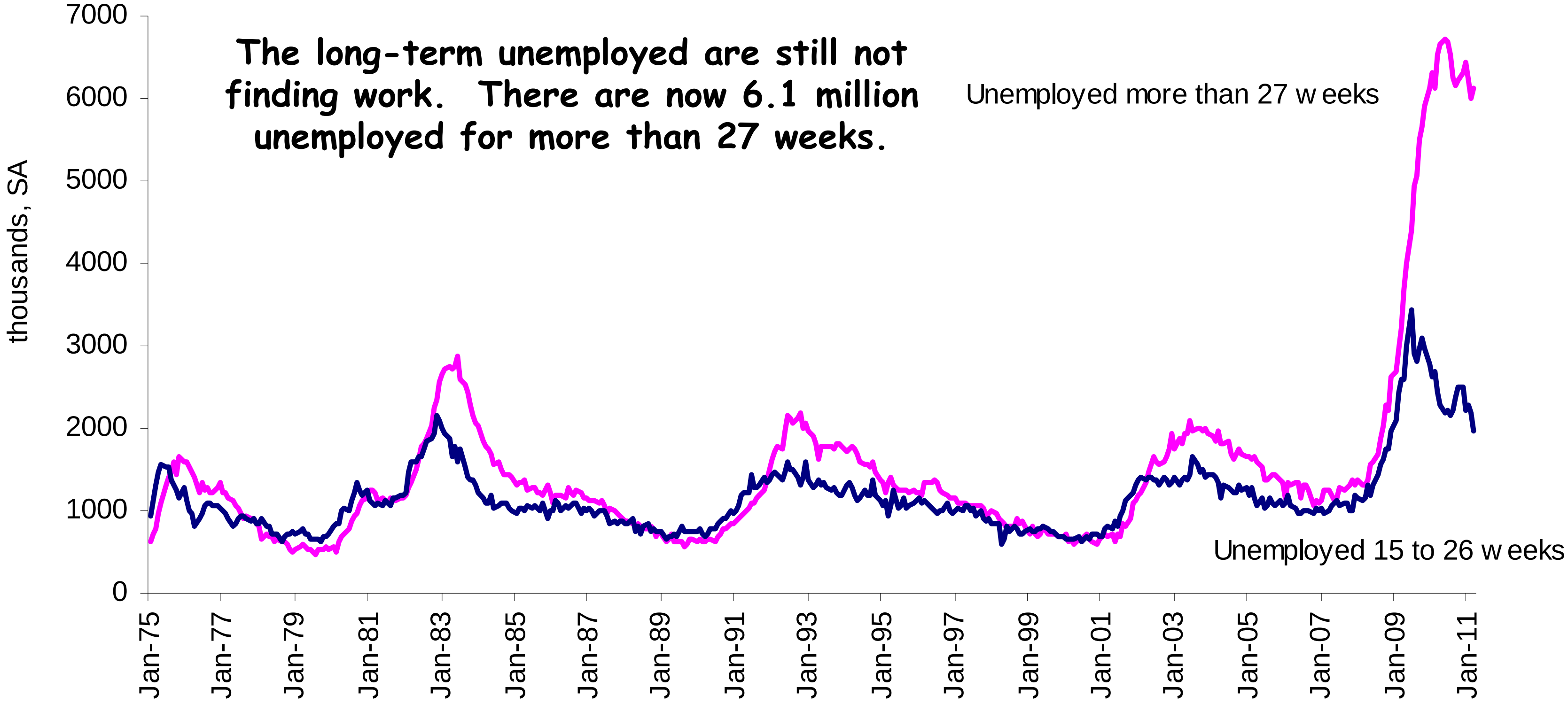
(last obs. March 2011)



Source: Bureau of Labor Statistics; Encima Global

Workers Unemployed More than 27 Weeks

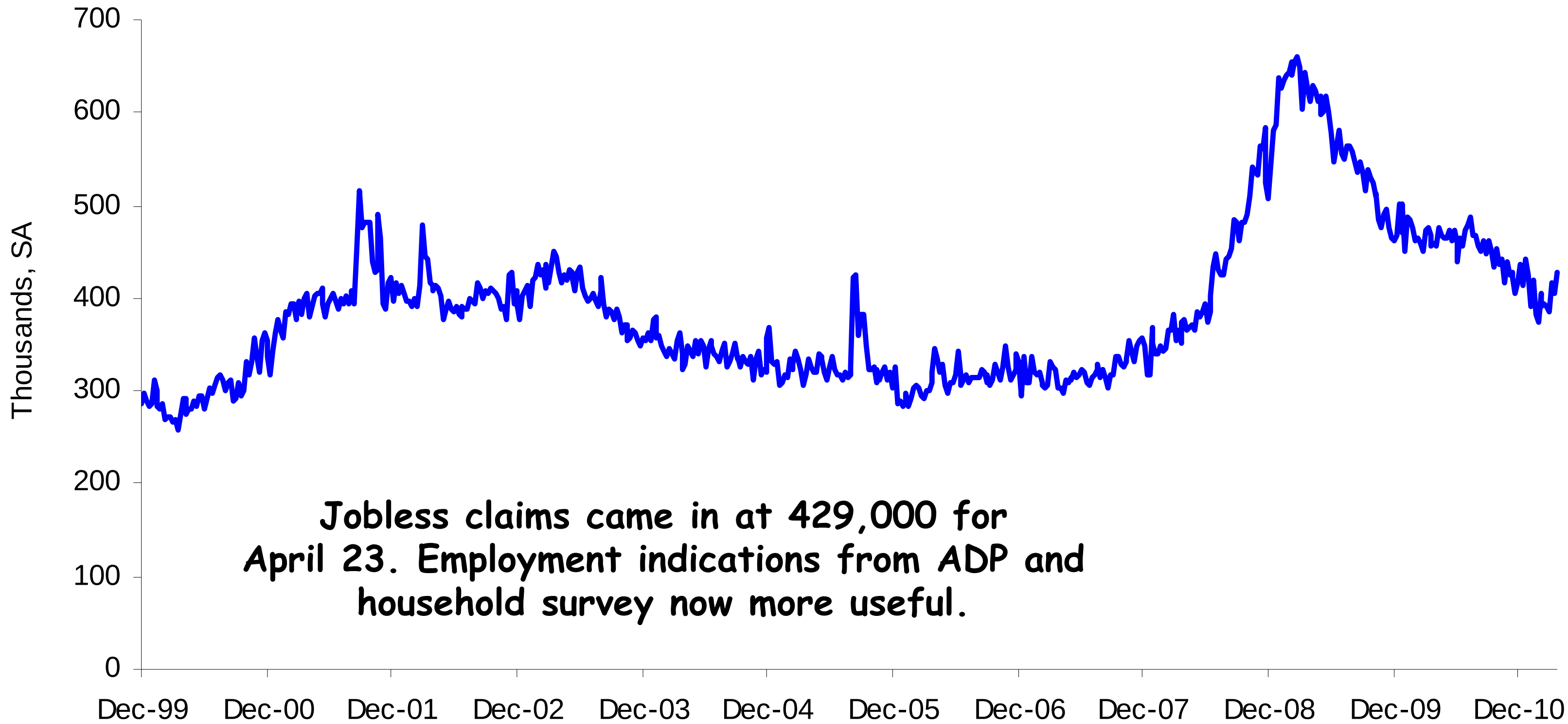
(last obs. March 2011)



Source: Bureau of Labor Statistics; Encima Global

Initial Unemployment Claims

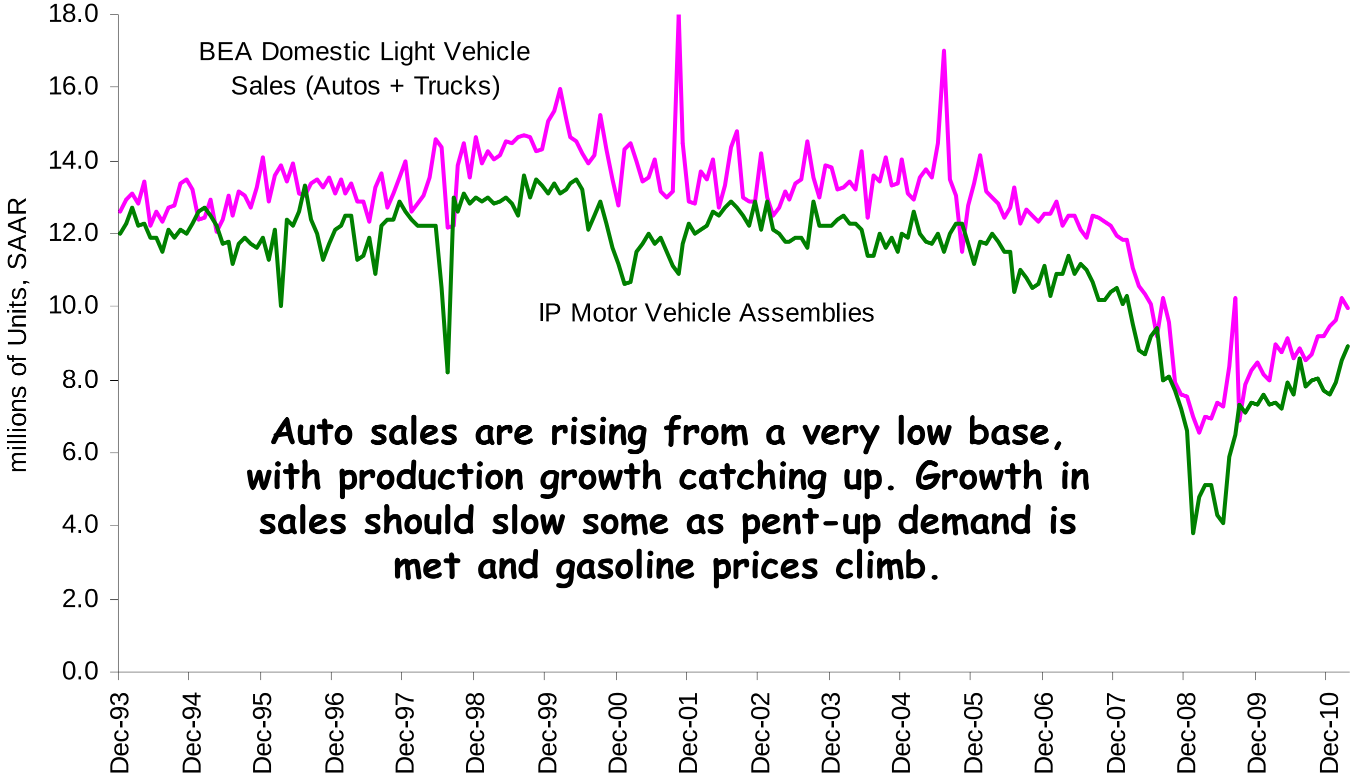
(last obs. April 23, 2011)



Source: Bureau of Labor Statistics; Encima Global

Auto Sales and Production Rising

(last obs. March 2011)

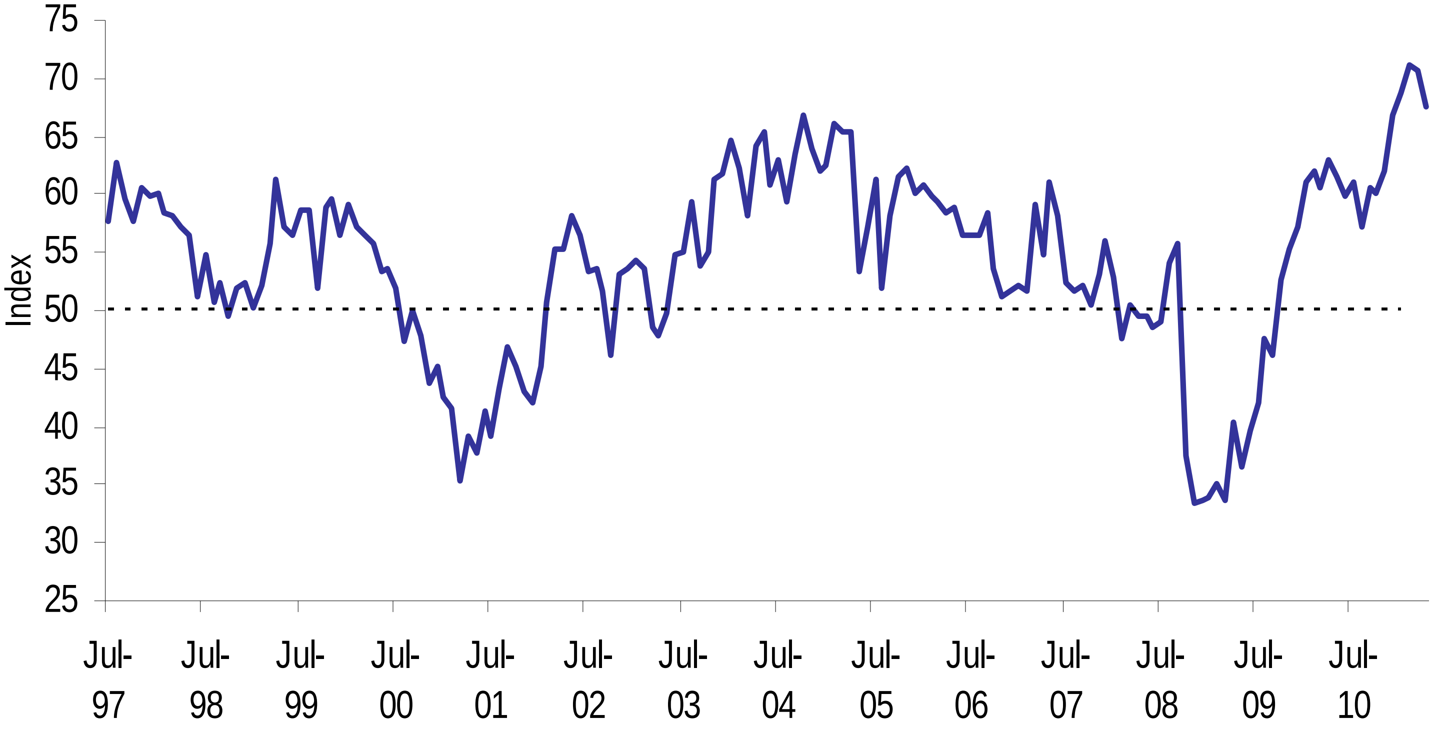


Source: Federal Reserve; Bureau of Economic Analysis; Encima Global

Chicago PMI

(last obs. April 2011)

The Chicago PMI pulled back to a still-strong 67.6 in April from 70.6 in March.

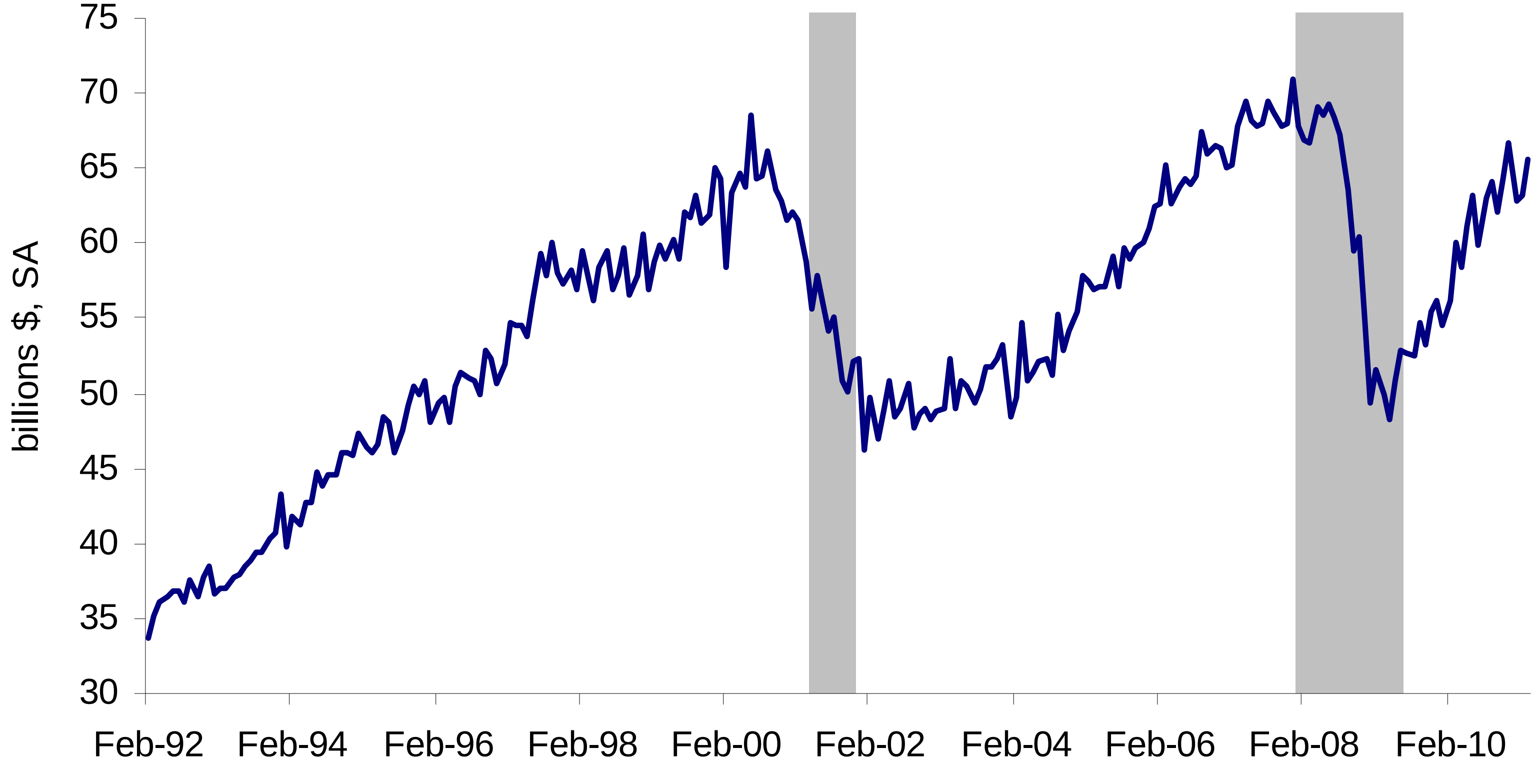


Source: Kingsbury Int'l; Encima Global

Capital Goods Orders A Bit Stronger

(last obs. March 2011)

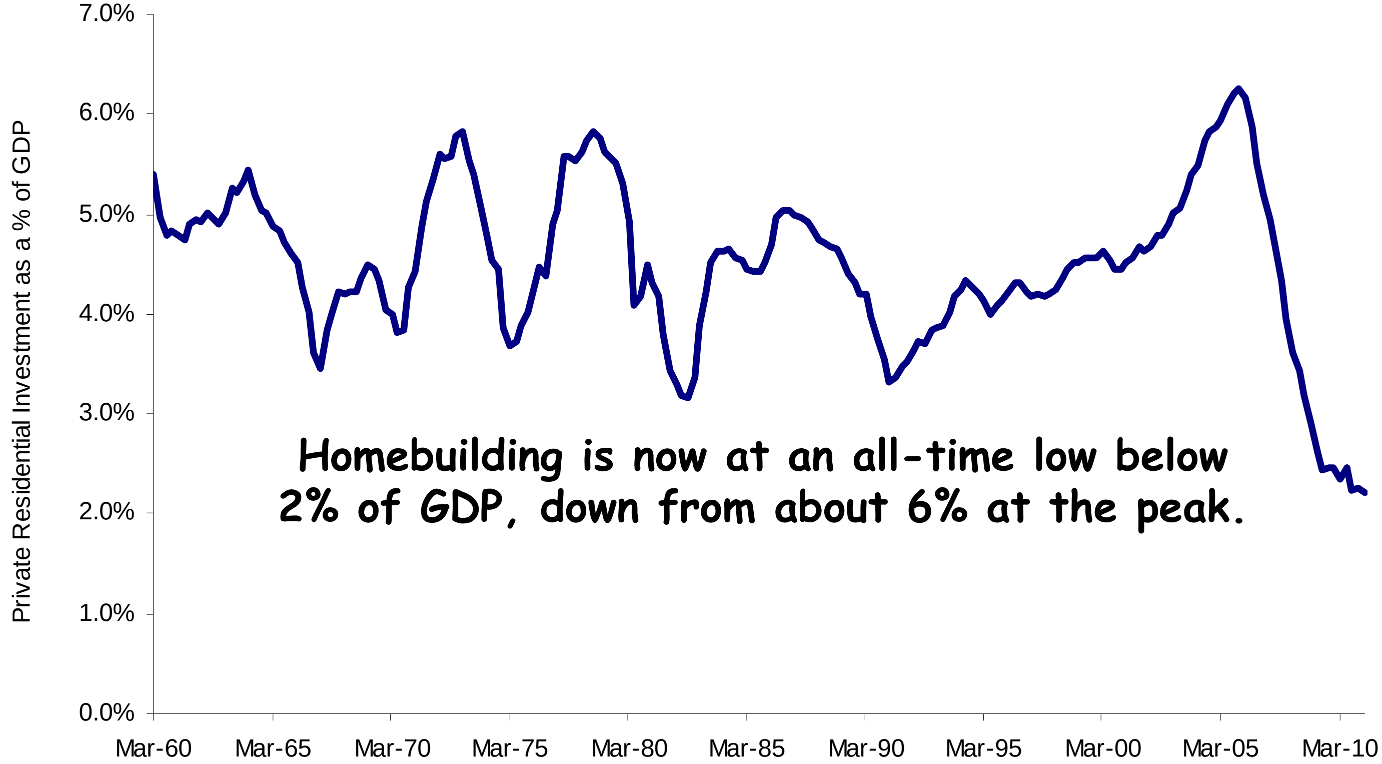
In March, new orders for nondefense capital goods excluding aircraft were up 3.7% from February and 9.2% from March 2010. The weakness in orders in January and February may have been a weather-related letdown rather than a 'soft patch' like 2010.



Source: Bureau of Census; Encima Global

Residential Investment as a % of GDP

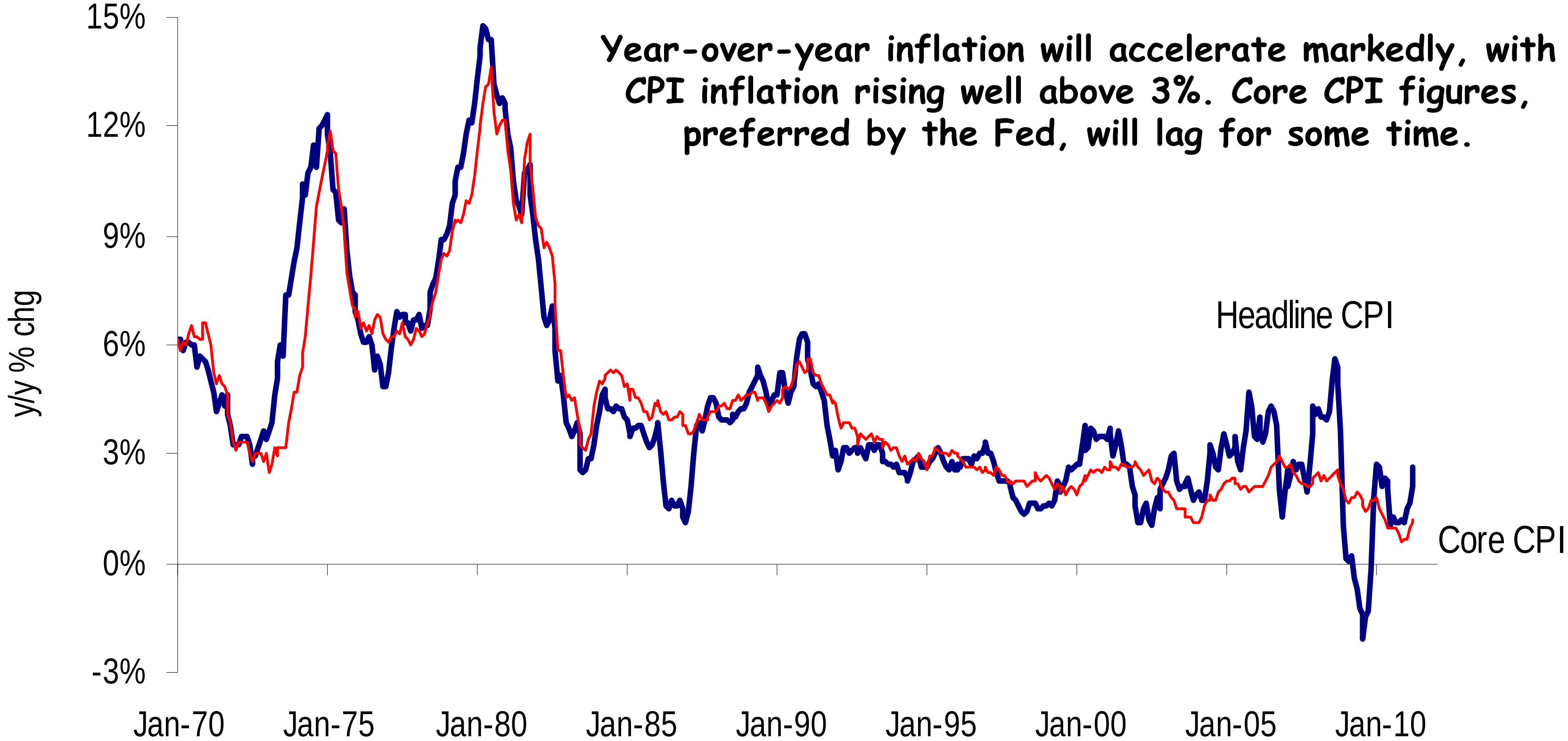
(last obs. Q1 2011)



Source: Bureau of Economic Analysis; Encima Global

Headline and Core Consumer Price Index Y/Y

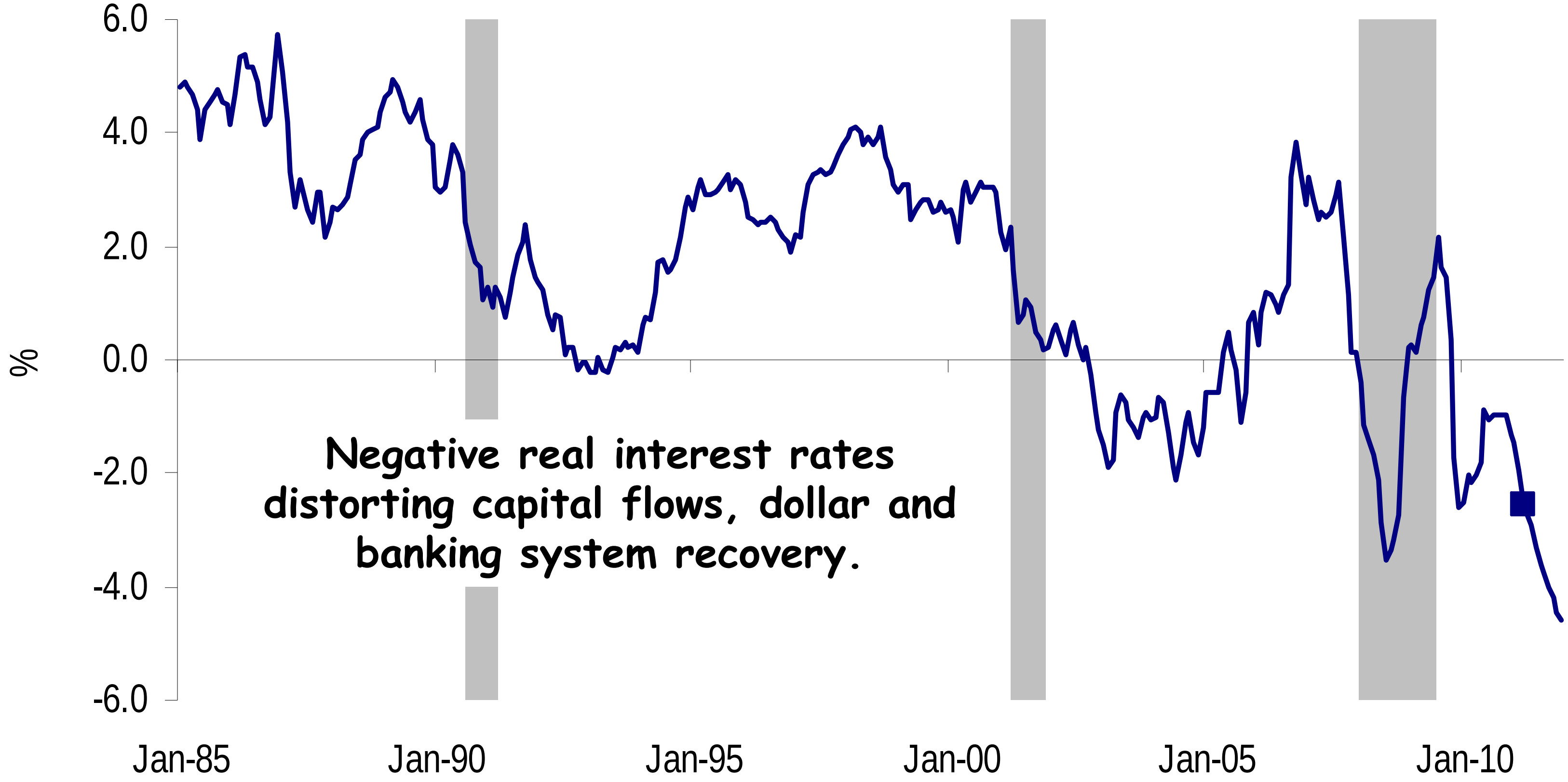
(last obs. March 2011)



Source: Bureau of Labor Statistics; Encima Global

Real Fed Funds Rate

(using headline CPI projected through December at 0.3% m/m; last obs. March 2011)



Source: Federal Reserve; Bureau of Labor Statistics; Encima Global

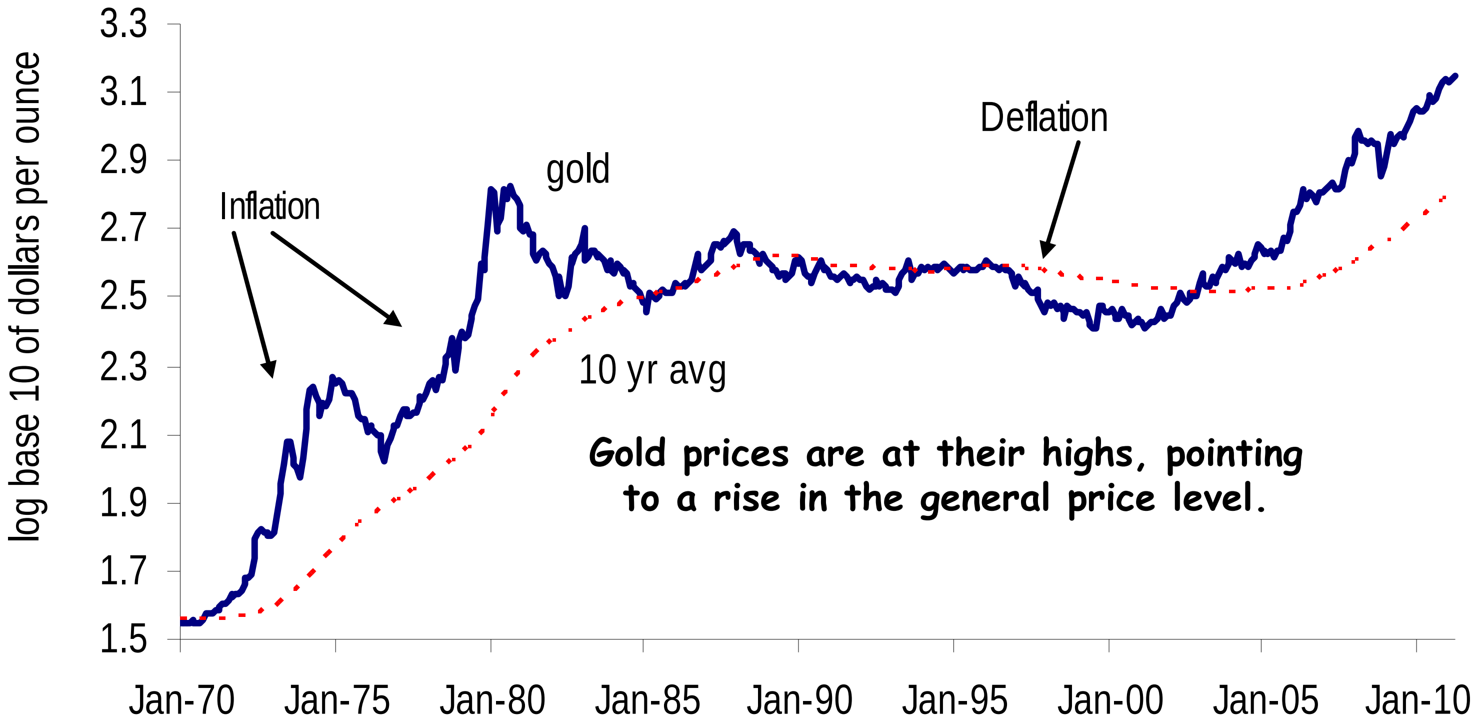
Low Bond Yields Count On Low-Inflation Recovery

(last obs. April 27, 2011)

Source: Federal Reserve; Encima Global

Gold high, dollar low, pointing to rise in other prices

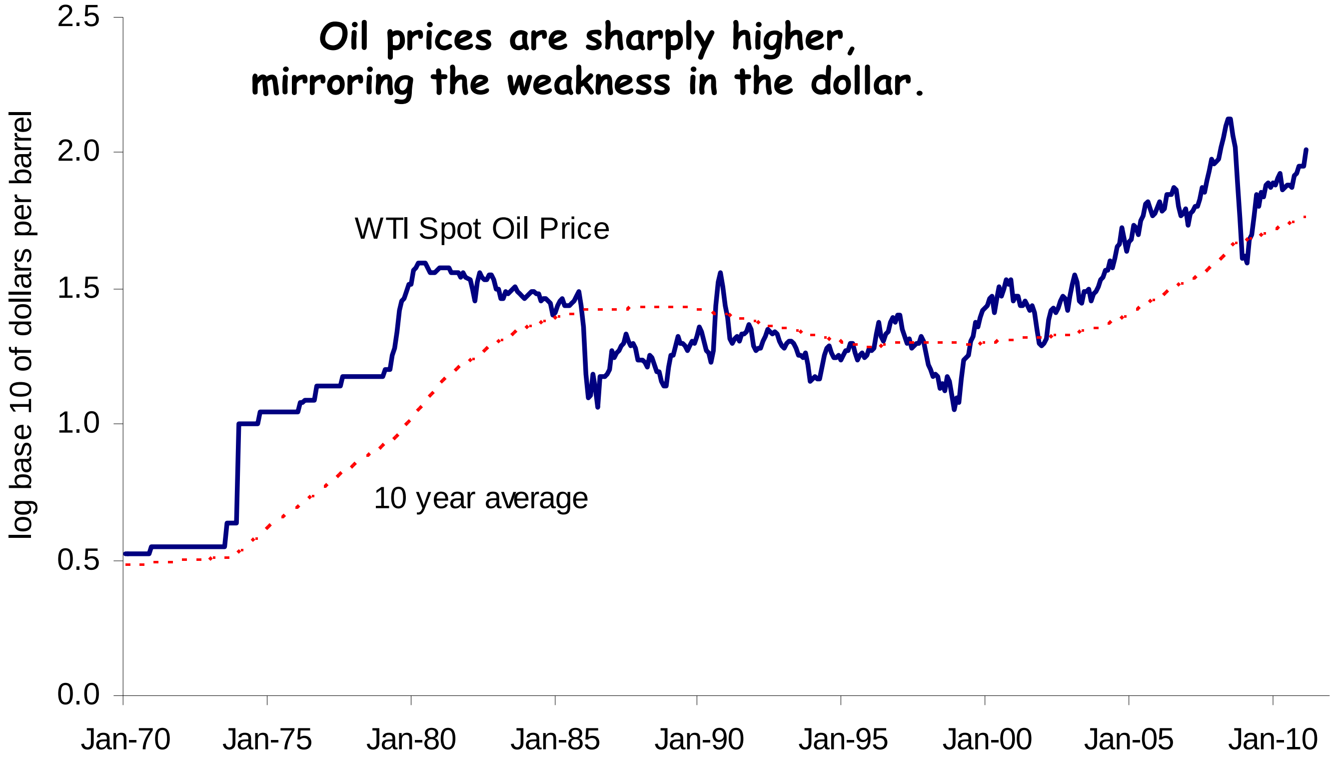
(last obs. April 26, 2011)



Source: Wall Street Journal; Encima Global

High oil prices reflect dollar's weak value

(last obs. April 26, 2011)



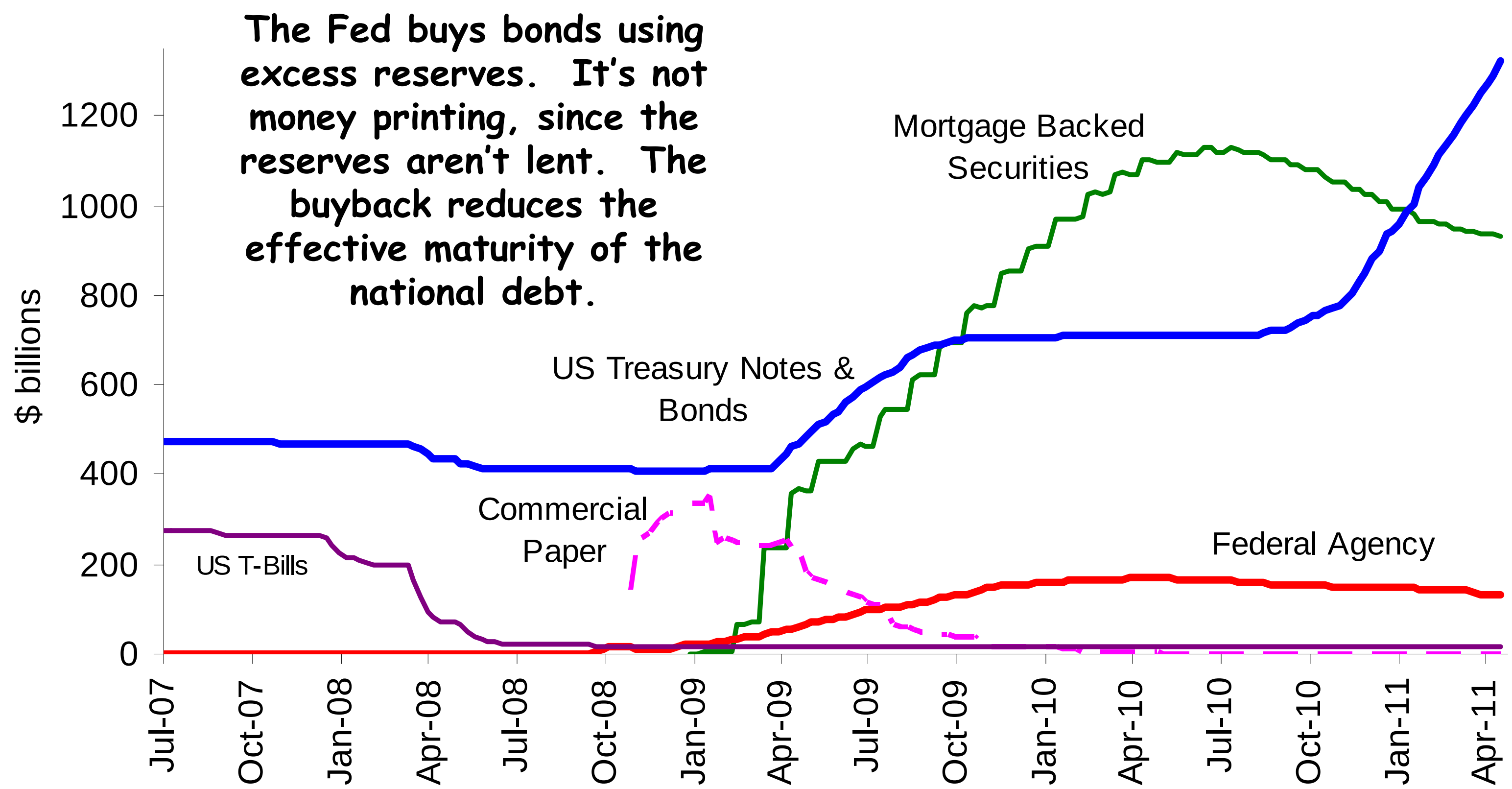
Source: Wall Street Journal; Encima Global

Fed Exit

- The FOMC statement and press conference didn't break new ground on key issues like the weak-dollar policy, rising gold and oil prices or the timing of rate hikes.
- The Fed will complete QE2 in June and continue monetary accommodation after that through the Fed funds rate. We don't think the wind-down of QE2 will have much impact on the economy or markets. The Fed stepping back from Treasuries shouldn't impact yields unless the Fed simultaneously changes monetary policy – the Fed outlook on inflation, the dollar and the Fed funds rate -- which we don't think is likely.
- The Fed is expected to continue buying roughly $40 billion in Treasury bonds after June to offset maturing MBS and Treasuries and maintain the Fed balance sheet at roughly $2.9 trillion. The Fed will probably keep the Fed funds rate near zero at least into the fourth quarter of 2011 despite ECB rate hikes and rising CPI inflation, citing low core inflation and high unemployment. In 2012, we think the Fed will pre-announce a gradual reduction in its Treasury holdings, mostly by attrition.
- During 2012 and 2013, the Fed is likely to gradually raise the Fed funds rate and, in conjunction, the interest rate paid on excess reserves. We think the Fed can maintain sufficient liabilities without too much added expense.

Fed assets are increasingly long term

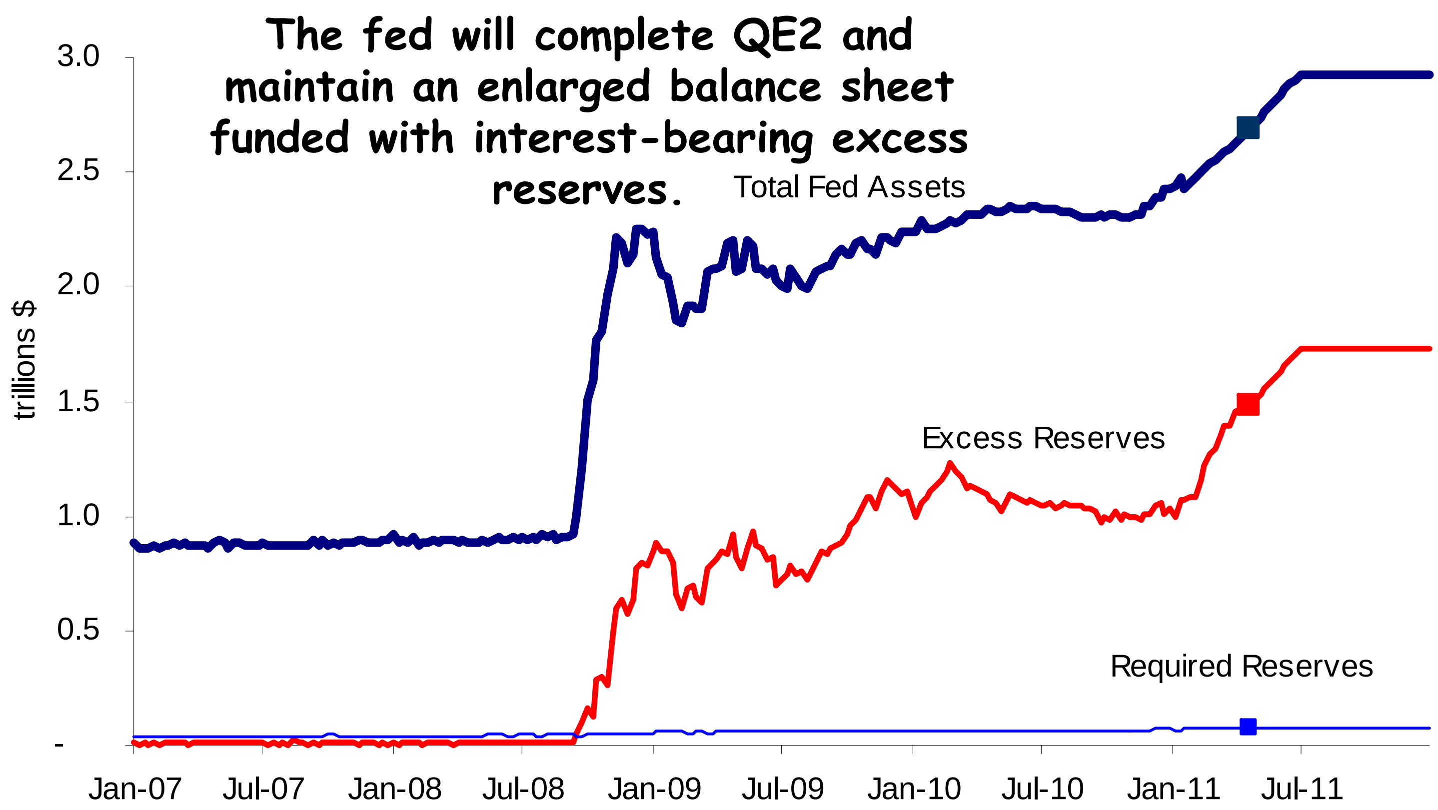
(last obs. April 20, 2011)



Source: Federal Reserve; Encima Global

Fed Assets and Reserves

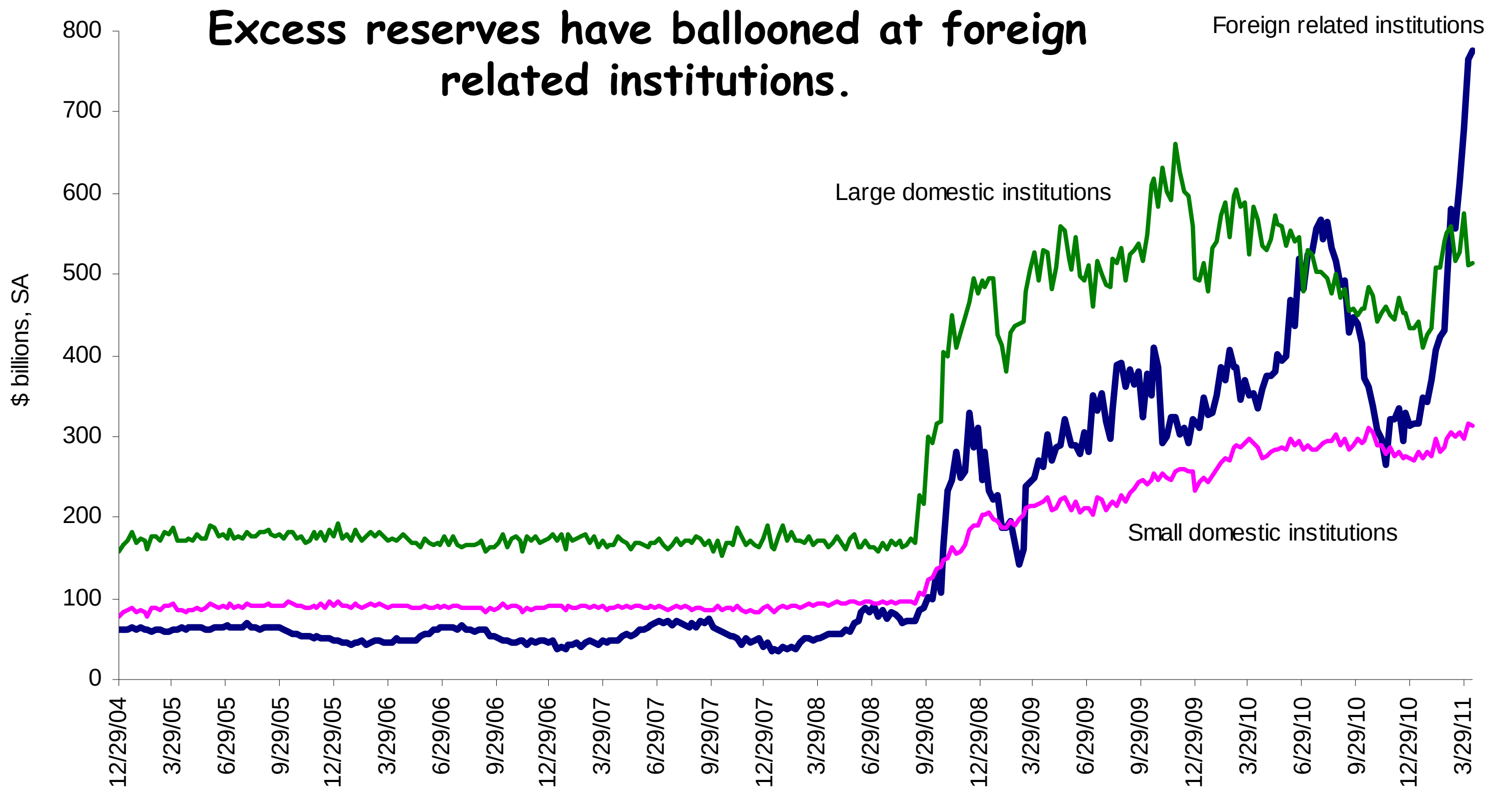
(last obs. April 20, 2011, projected through December 2011)



Source: Federal Reserve; Encima Global

Bank Cash (Mostly Excess Reserves at Fed)

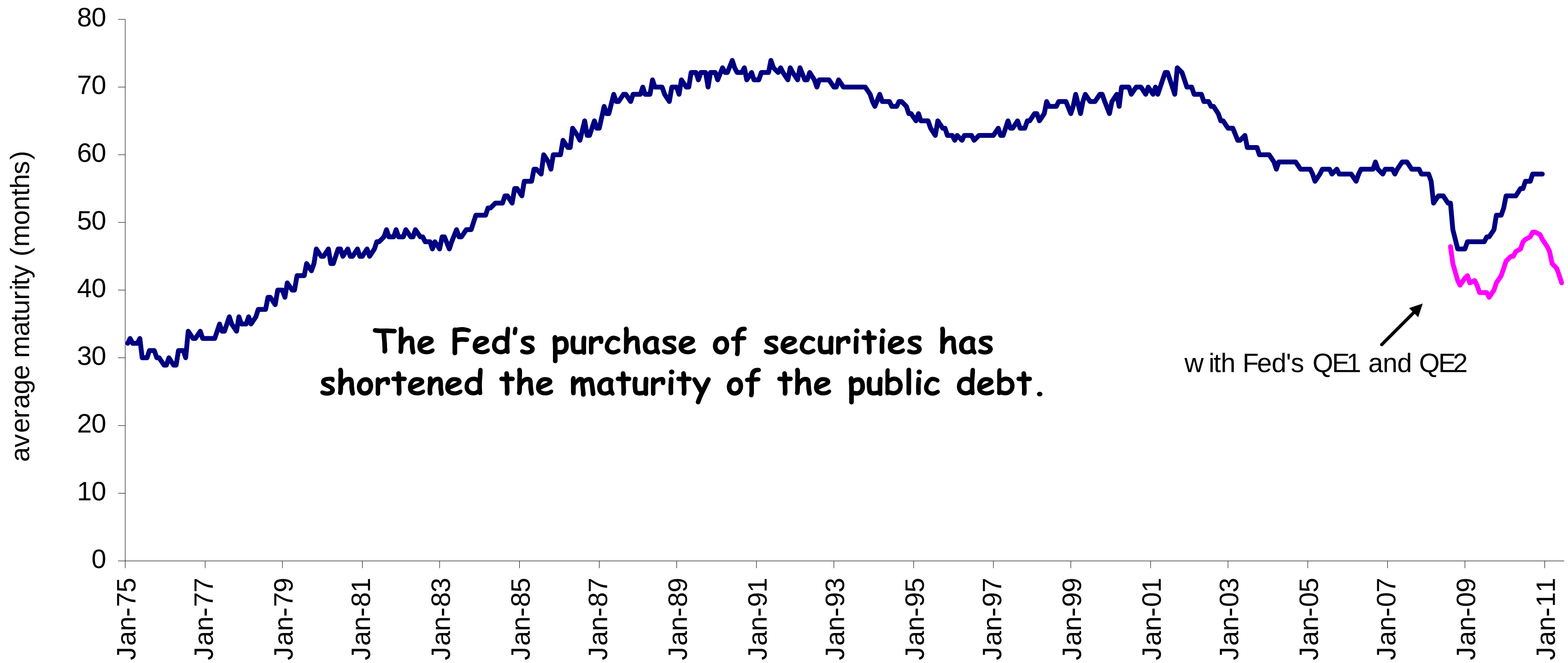
(last obs. April 13, 2011)



Source: Federal Reserve; Encima Global

Average Maturity of Treasury Debt; Effective Maturity with Fed's QE

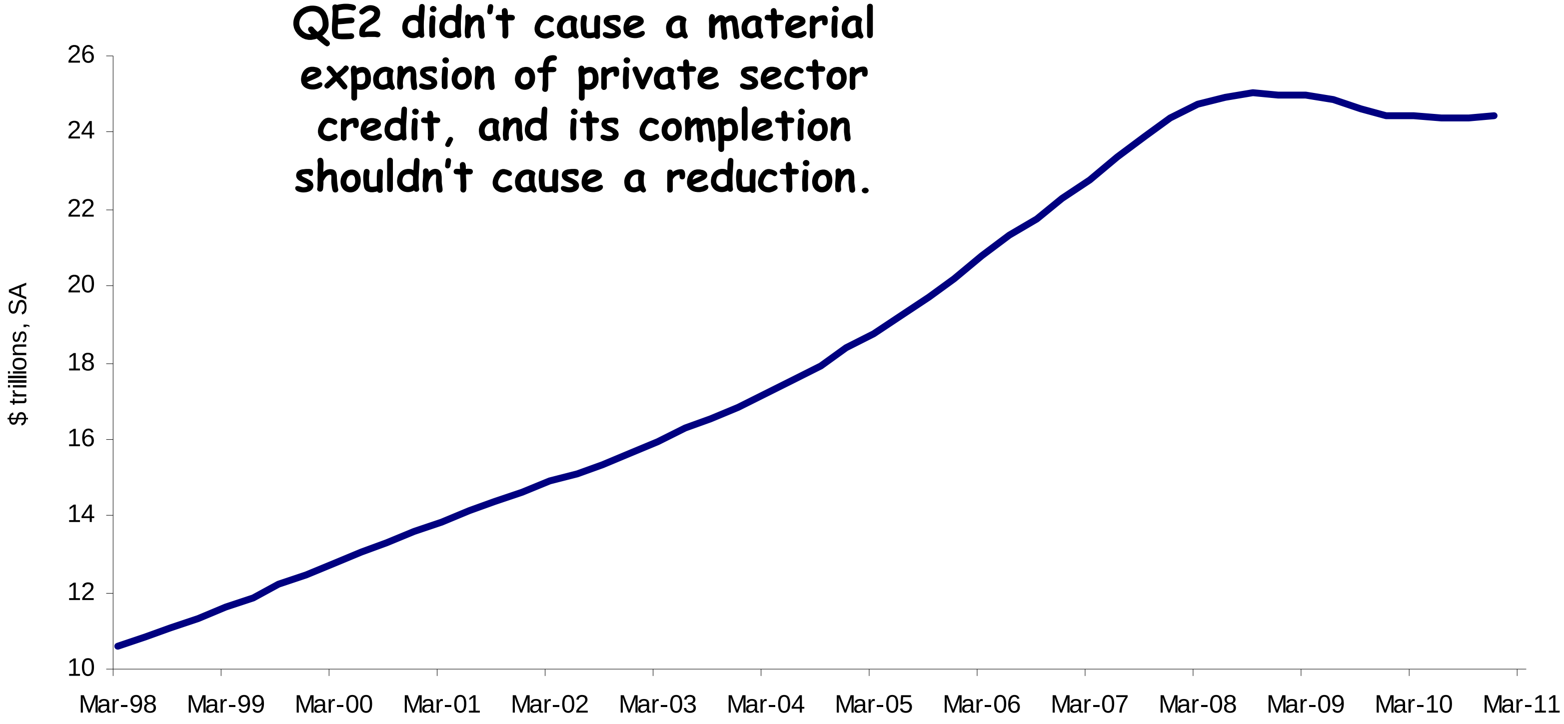
(in months, last obs. Dec 2010; QE2 projected through June 2011)



Source: US Treasury; Federal Reserve; Encima Global

QE2 Didn't Increase Private Sector Credit Much

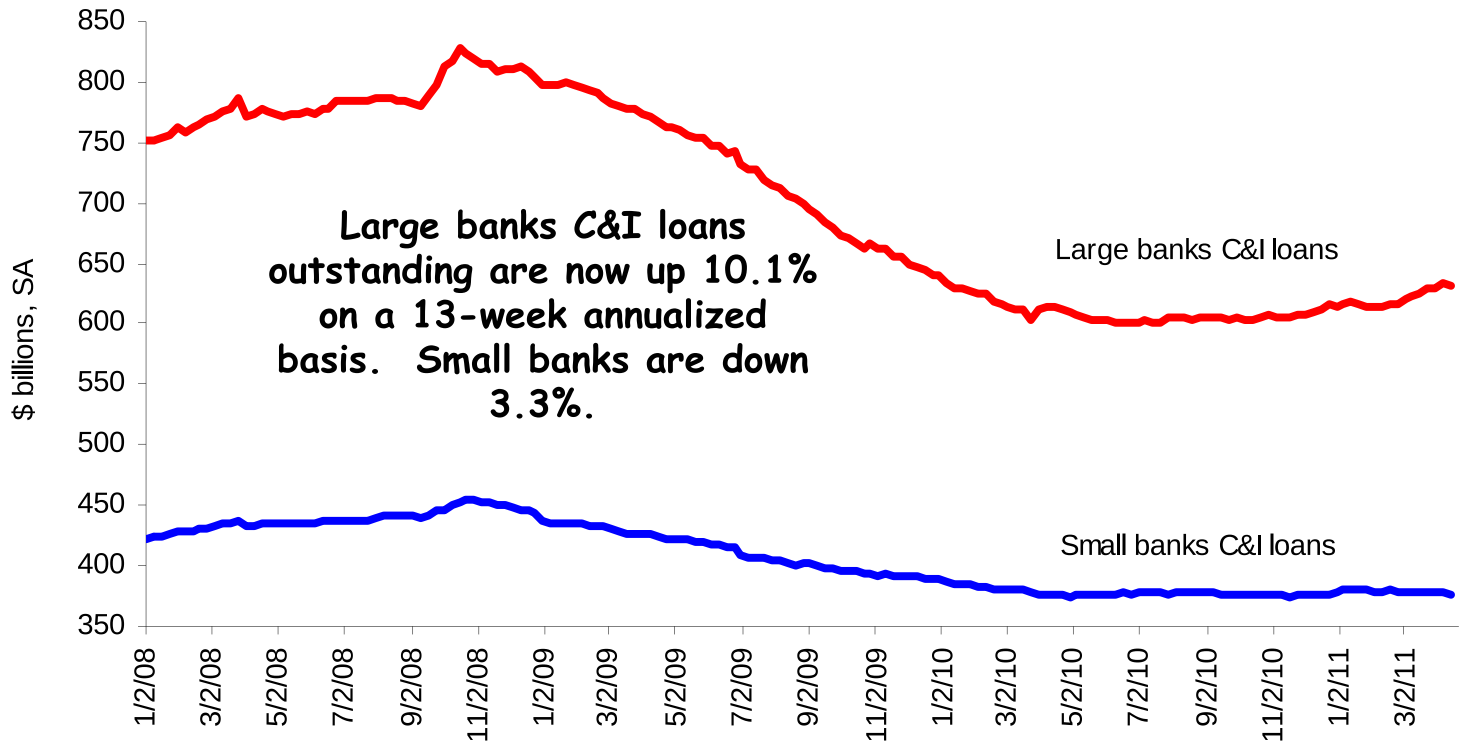
(last obs. Q4 2010)



Source: Federal Reserve; Encima Global

Commercial and Industrial Loans Still Low

(last obs. April 13, 2011)

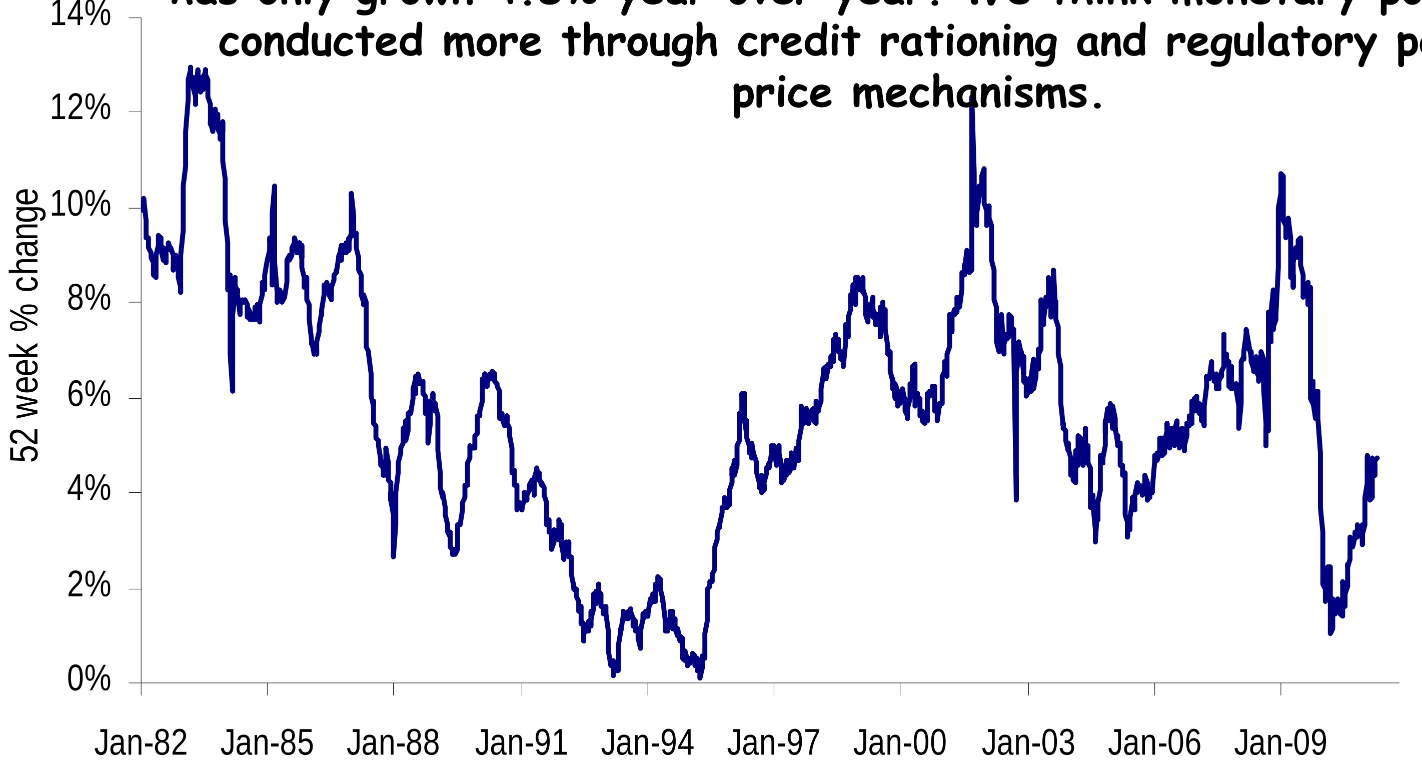


Source: Federal Reserve; Encima Global

M2 y/y

(last obs. April 13, 2011)

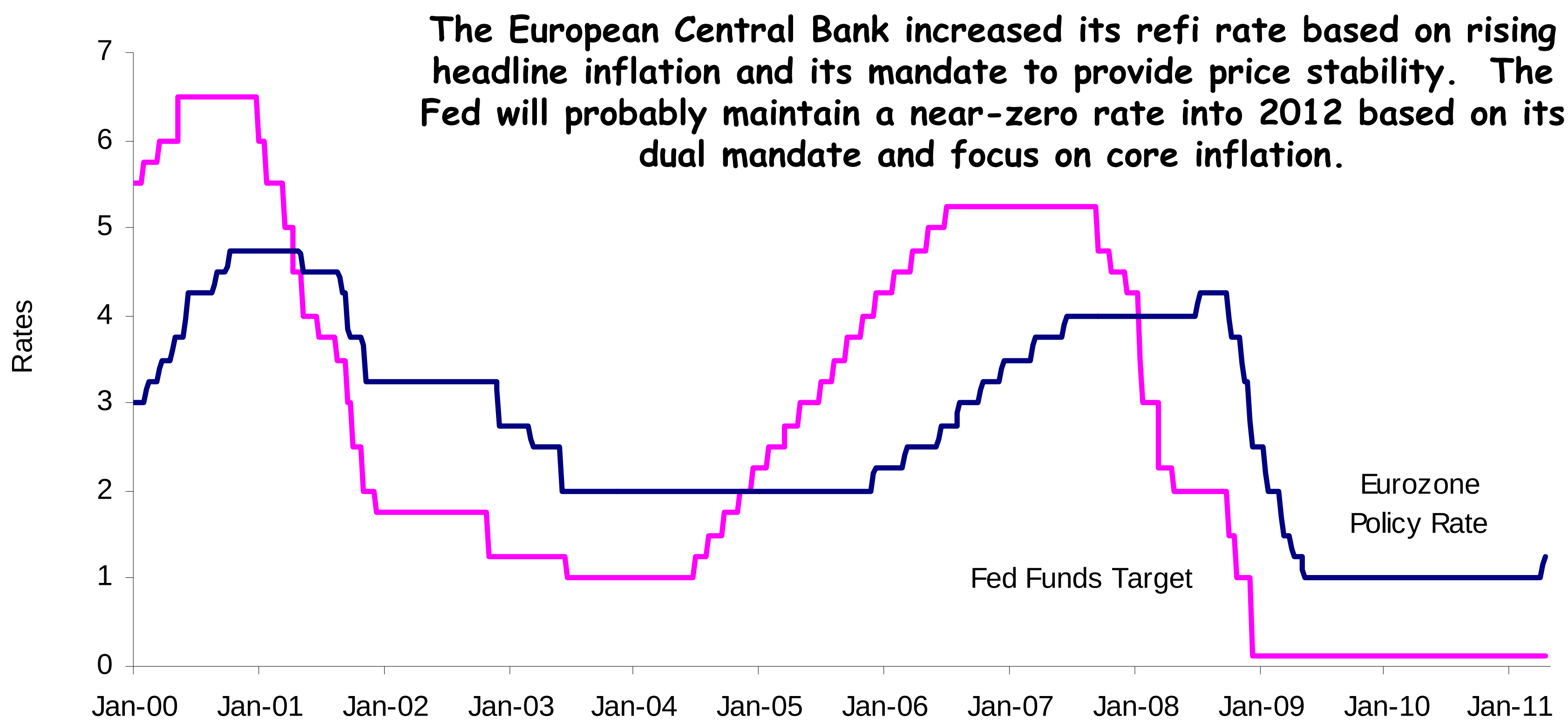
Despite the rapid expansion of the Fed's balance sheet and M0, M2 has only grown 4.8% year over year. We think monetary policy is being conducted more through credit rationing and regulatory policy than price mechanisms.



Source: Federal Reserve; Encima Global

Fed Funds and Eurozone Policy Rate

(last obs. April 28, 2011)



Source: Federal Reserve; European Central Bank; Encima Global

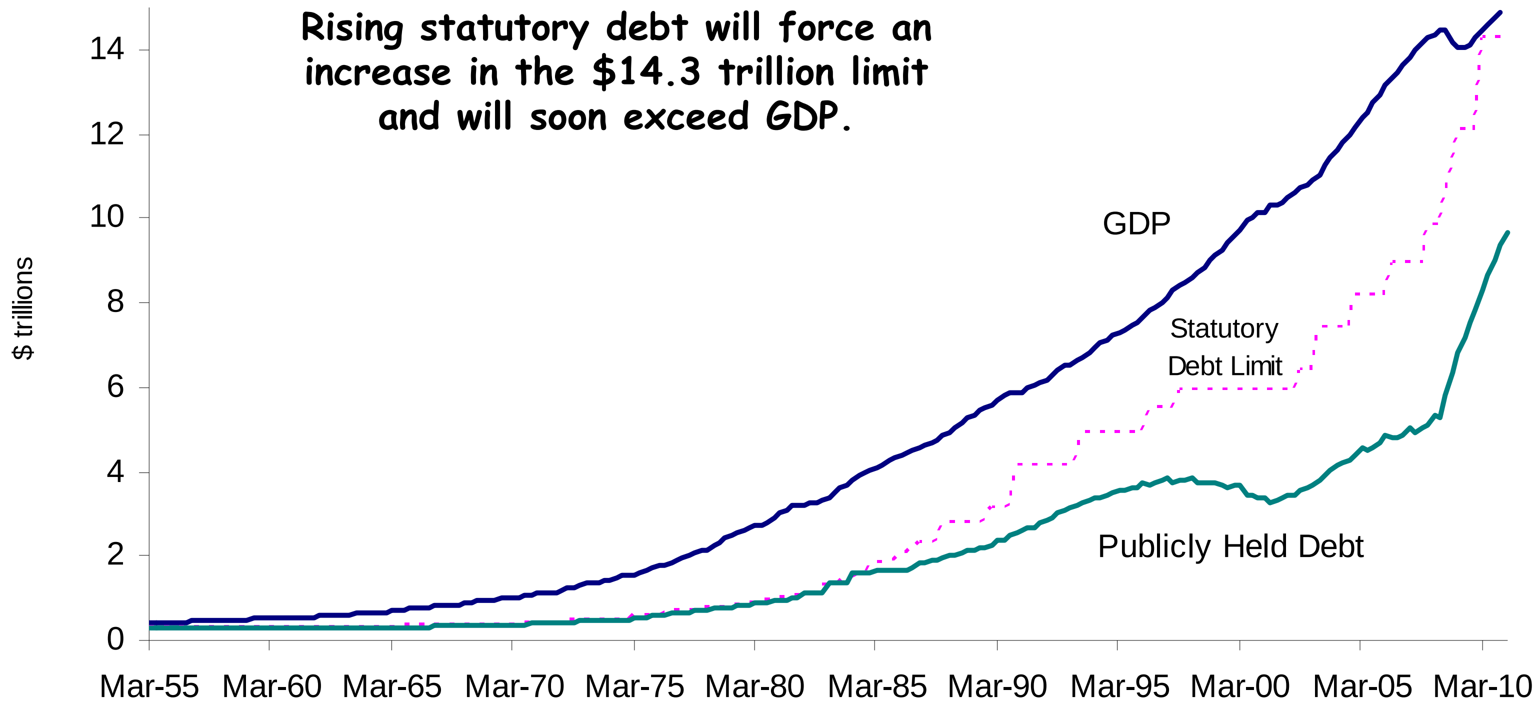
10 Year Treasury Yield To Rise In Second Half

(last obs. April 28, 2011)

Source: Federal Reserve; Encima Global

Marketable Debt Reaching 70% of GDP

(last obs. Q1 2011)

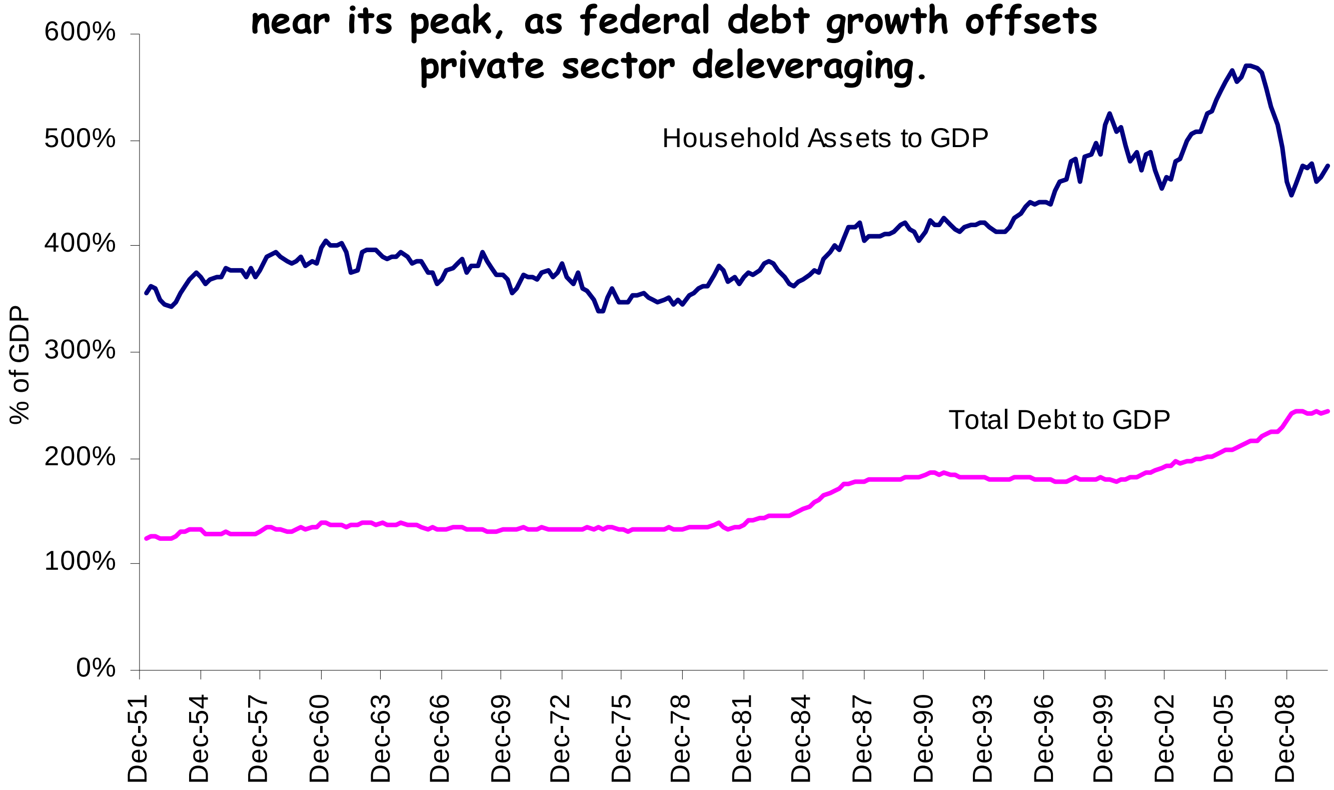


Source: Bureau of Economic Analysis; U.S. Treasury; Encima Global

Household Assets $71 Trillion; Total Debt $36T

(last obs. Q3 2010)

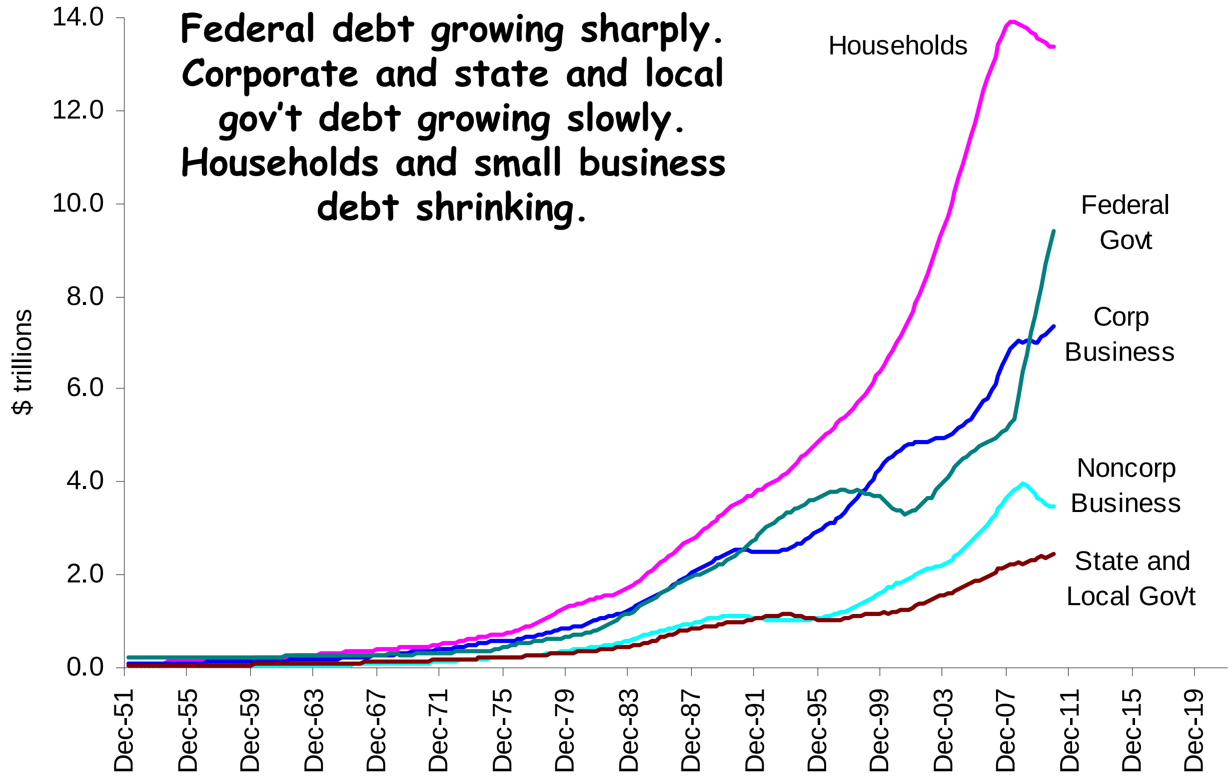
U.S. nonfinancial debt stands at 244% of GDP, near its peak, as federal debt growth offsets private sector deleveraging.



Source: Federal Reserve: BEA; Encima Global

U.S. Debt in $Trillions by Category

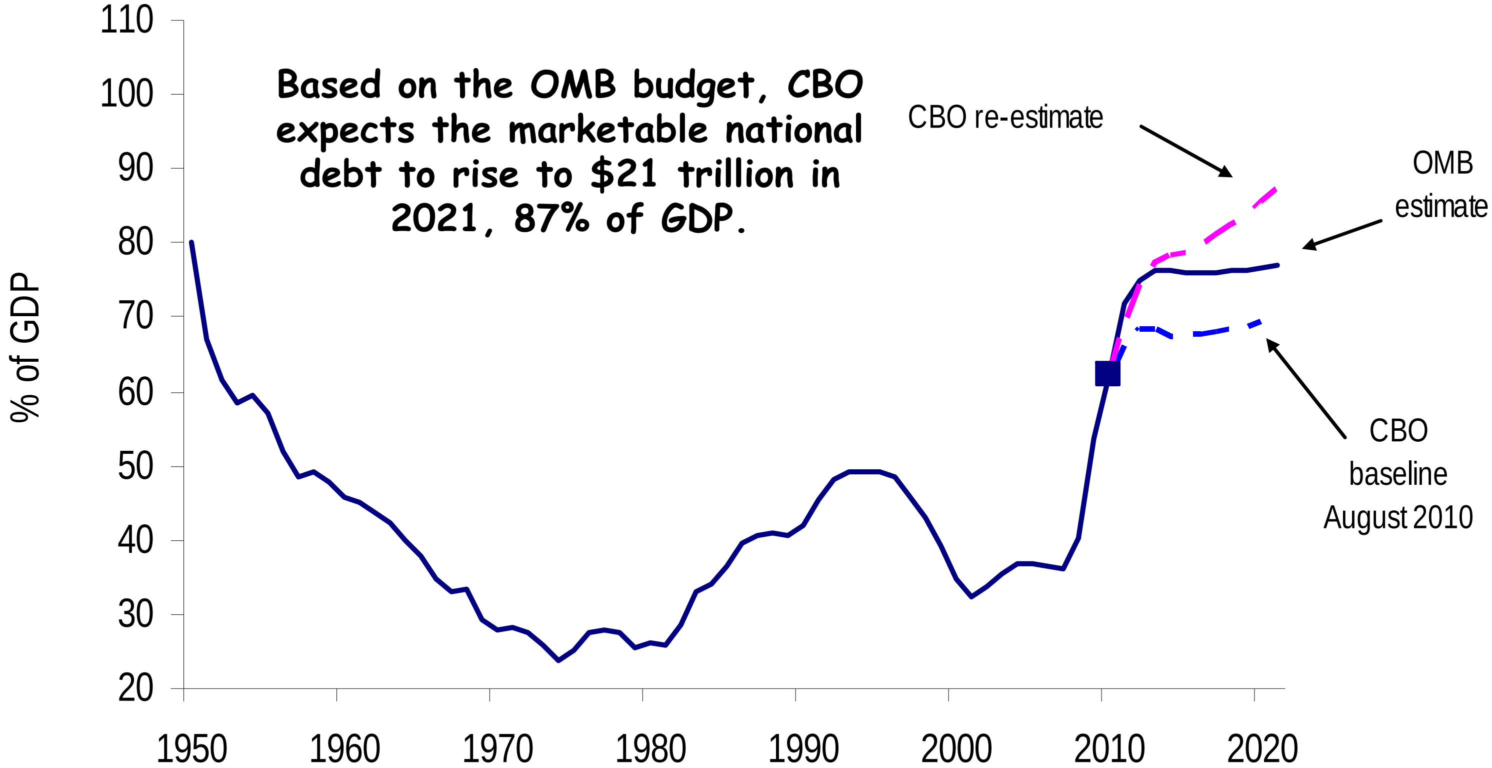
(last obs. Q4 2010)



Source: Federal Reserve: Encima Global

CBO Forecasts of Federal Debt Per GDP

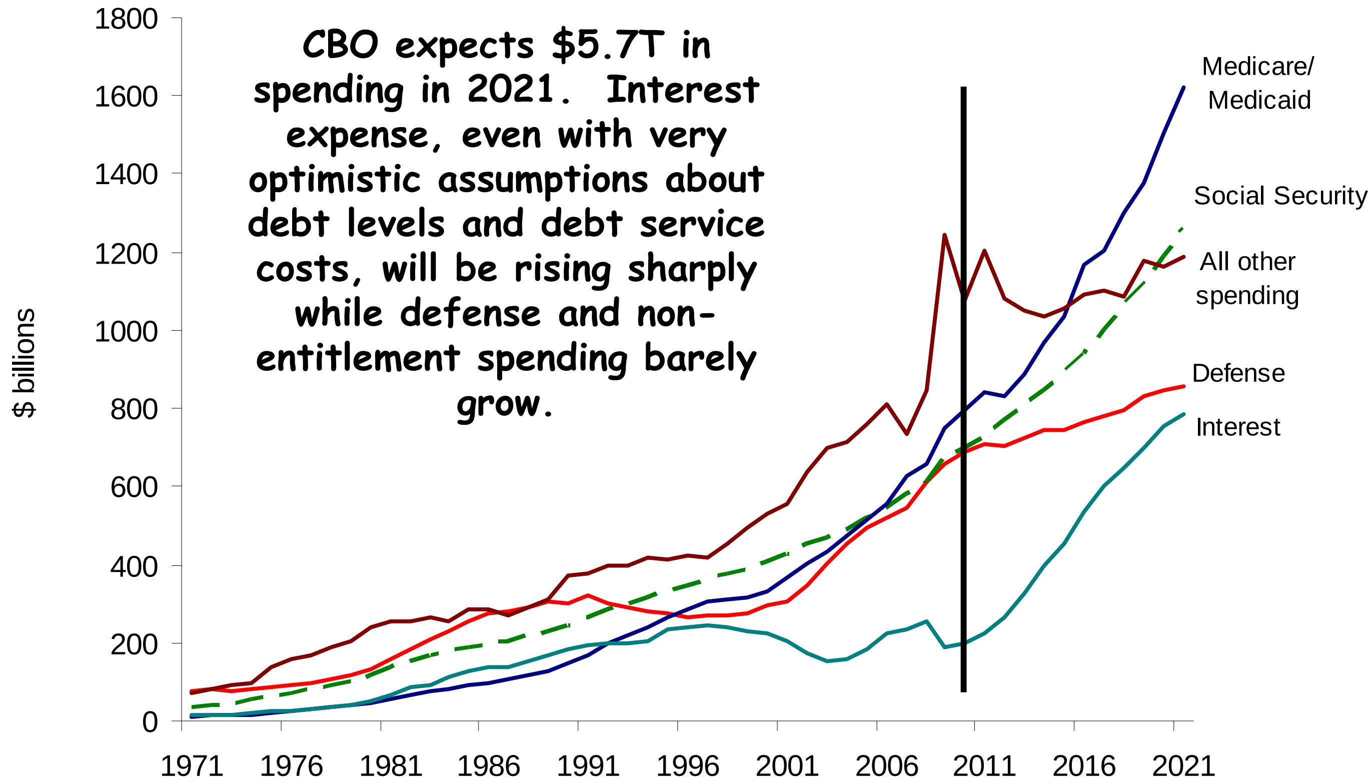
(square is last obs. 2010, CBO forecasts to 2021)



Source: CBO; Encima Global

Expenditures in $ billions by Major Category

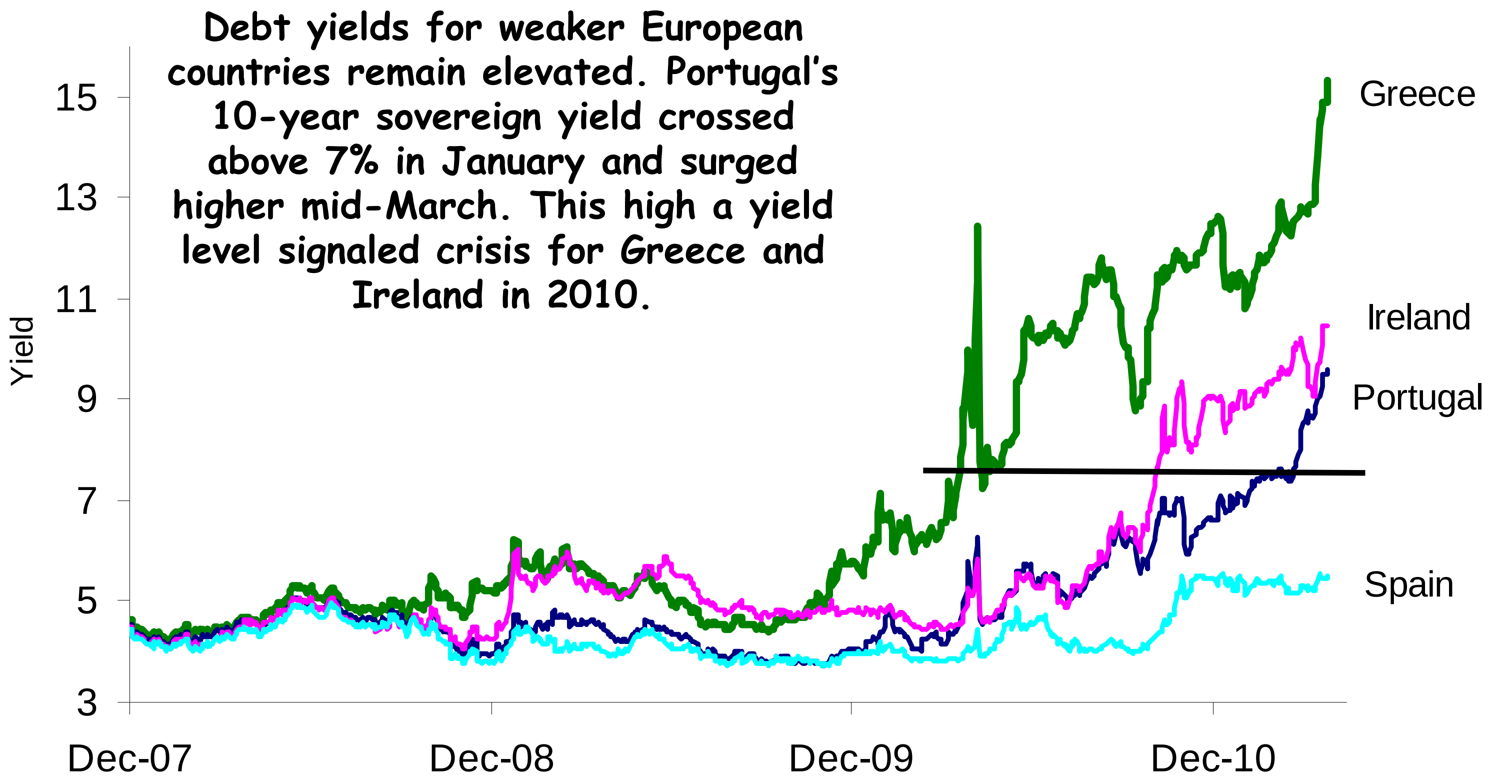
(last obs. 2010, CBO baseline projections to 2021)



Source: CBO; Encima Global

Select European 10 Yr Yields

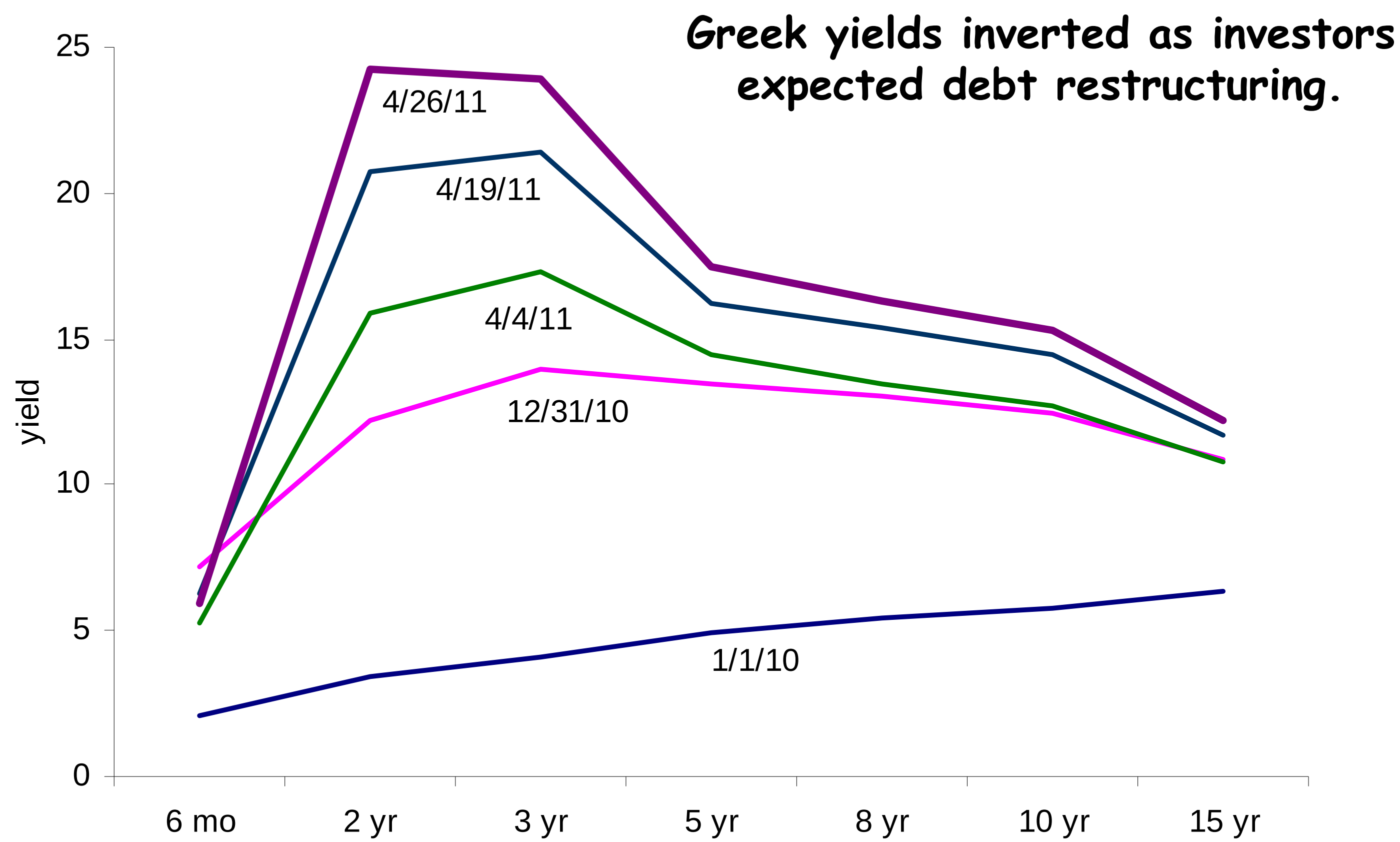
(last obs. April 26, 2011)



Source: Bloomberg; Encima Global

Greek Yield Curves

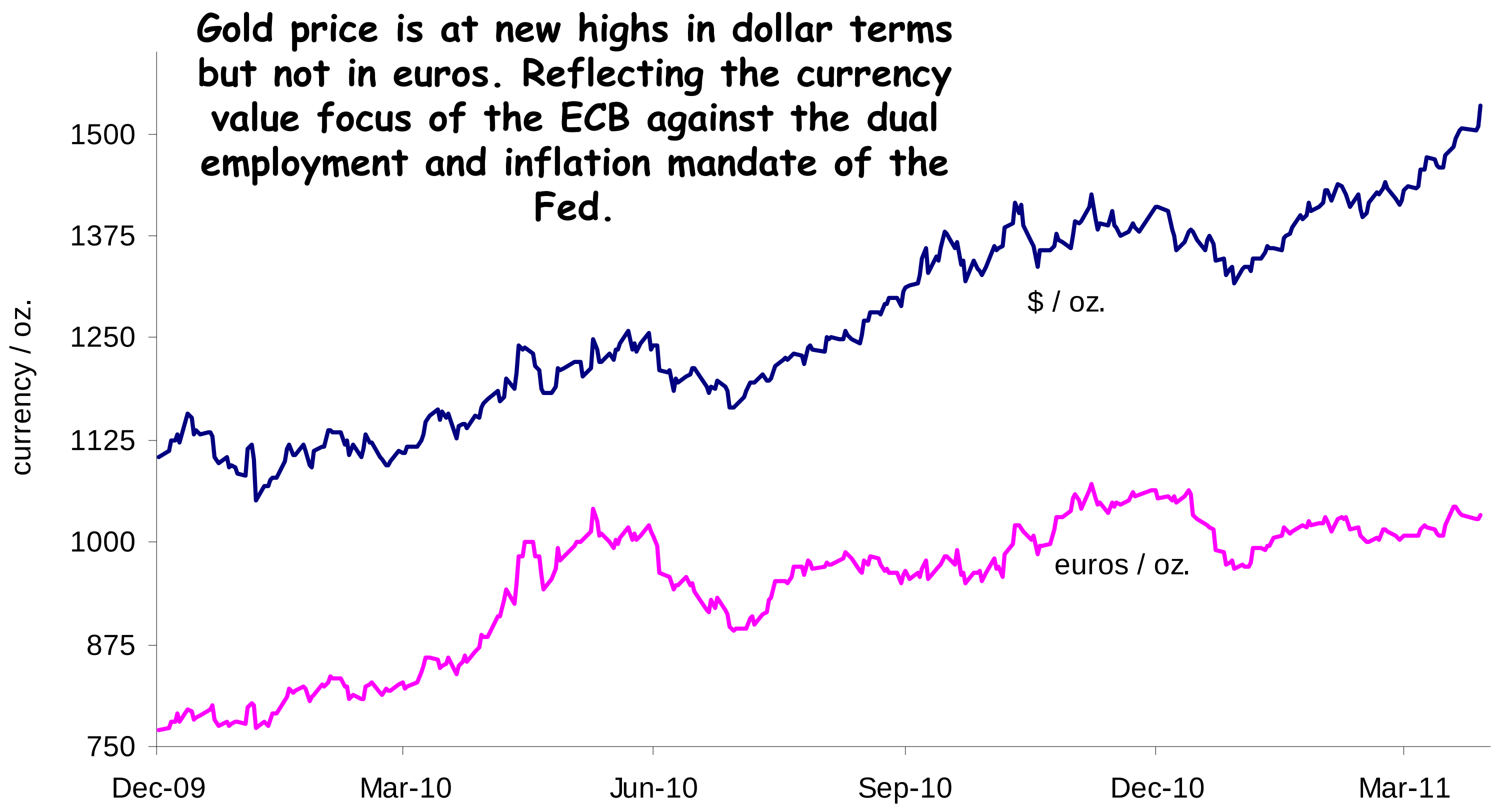
(last obs. April 26, 2011)



Source: Bloomberg; Encima Global

Gold Price in $ and Euros

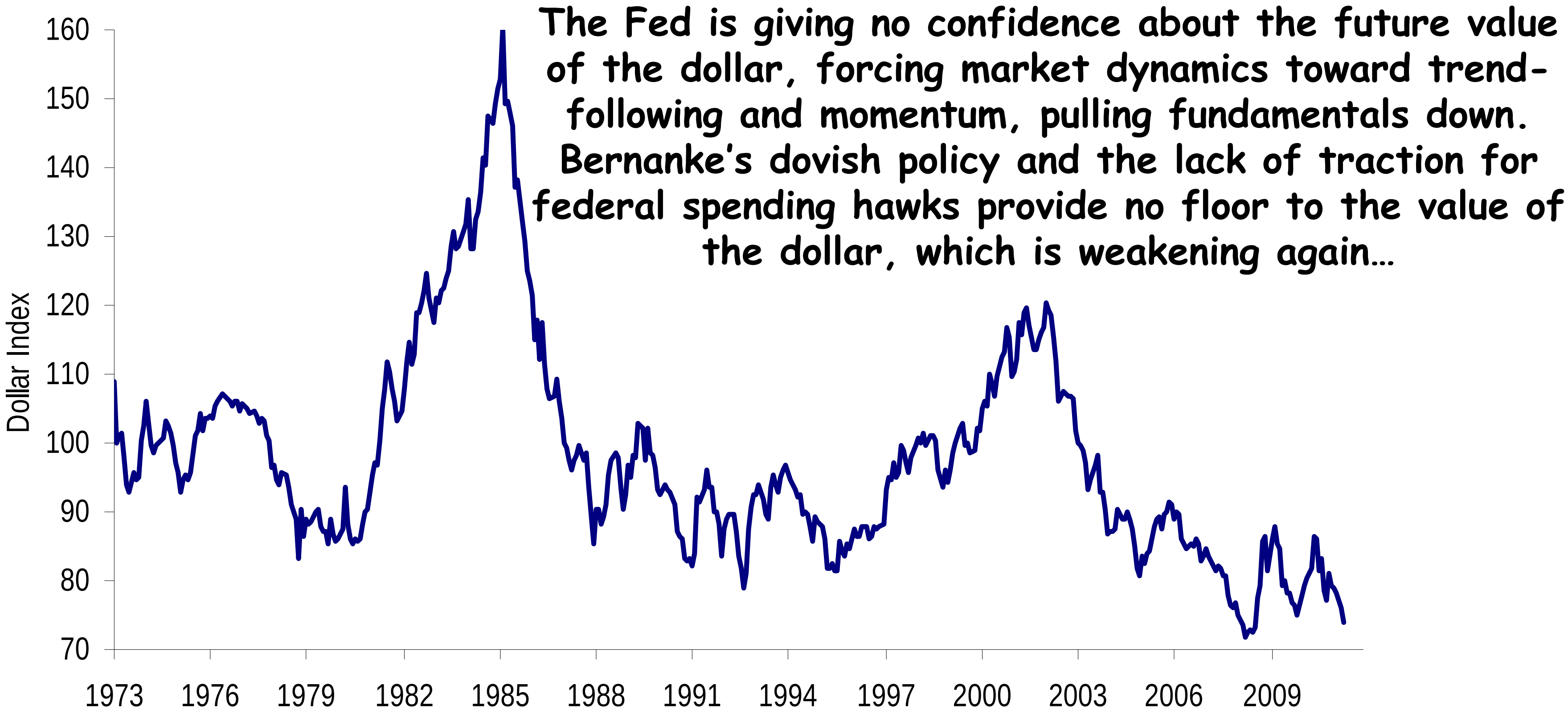
(last obs. April 28, 2011)



Source: Wall Street Journal; Federal Reserve; Encima Global

DXY – Dollar Index

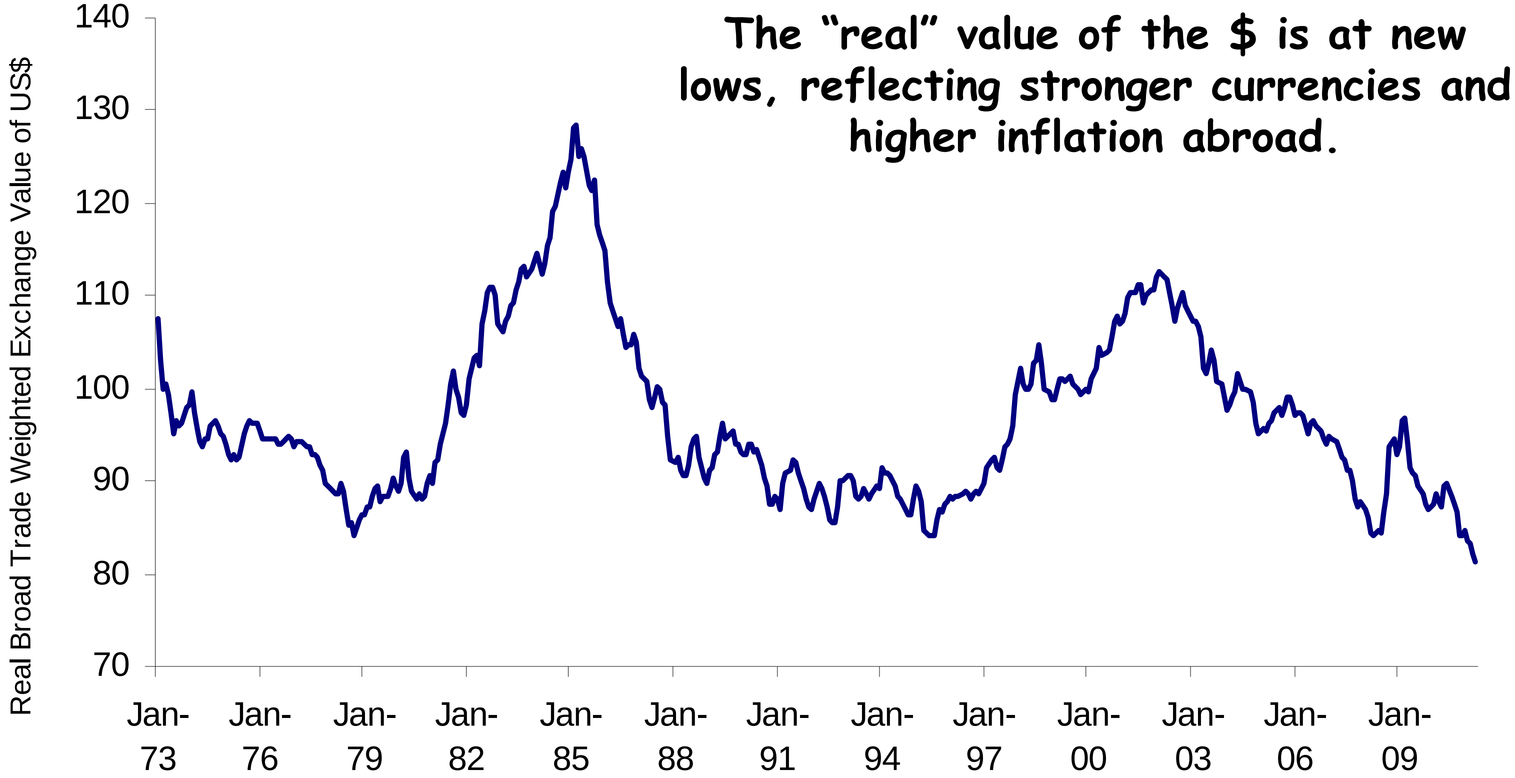
(last obs. April 28, 2011)



Source: Bloomberg; Encima Global

Record Low for 'Real' Value of $

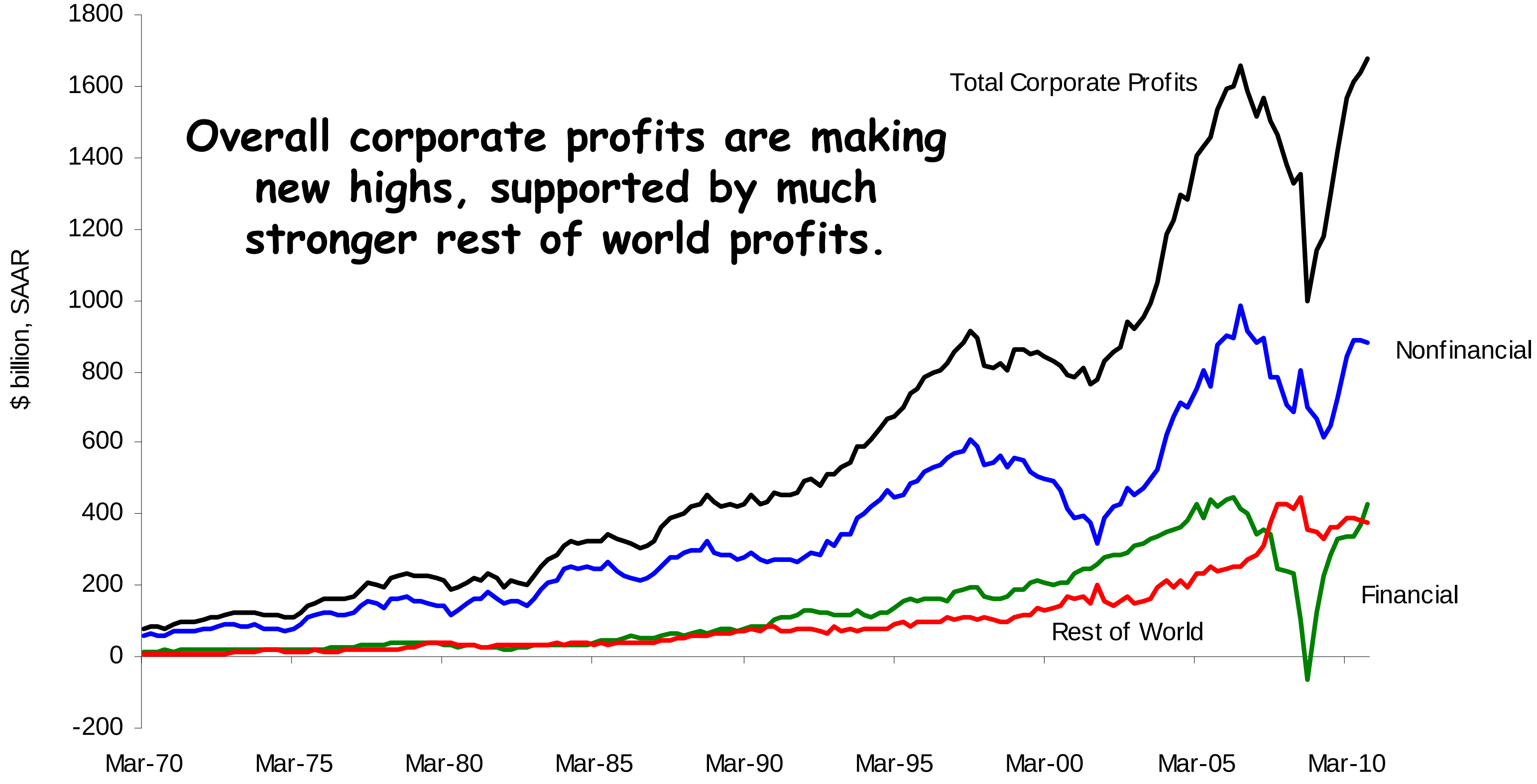
(last obs. March 2011, estimated for April 2011)



Source: Federal Reserve; Encima Global

Corporate Profits before Taxes with IVA & CCAdj

(last obs. Q4 2010)

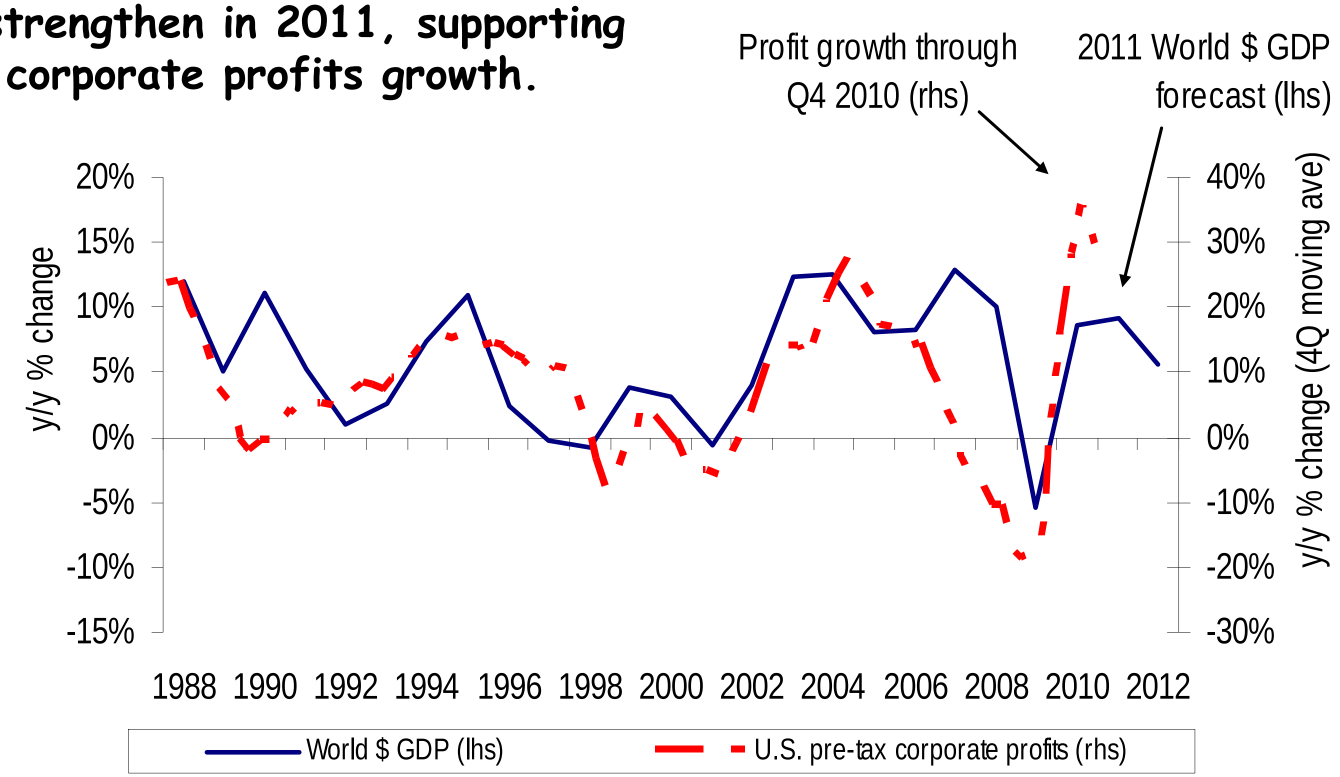


Source: Bureau of Economic Analysis; Encima Global

Corporate Profits Growth and World $ GDP

(last obs. Q4 2010 for NIPA corporate profits, IMF forecasts for $ GDP to 2012)

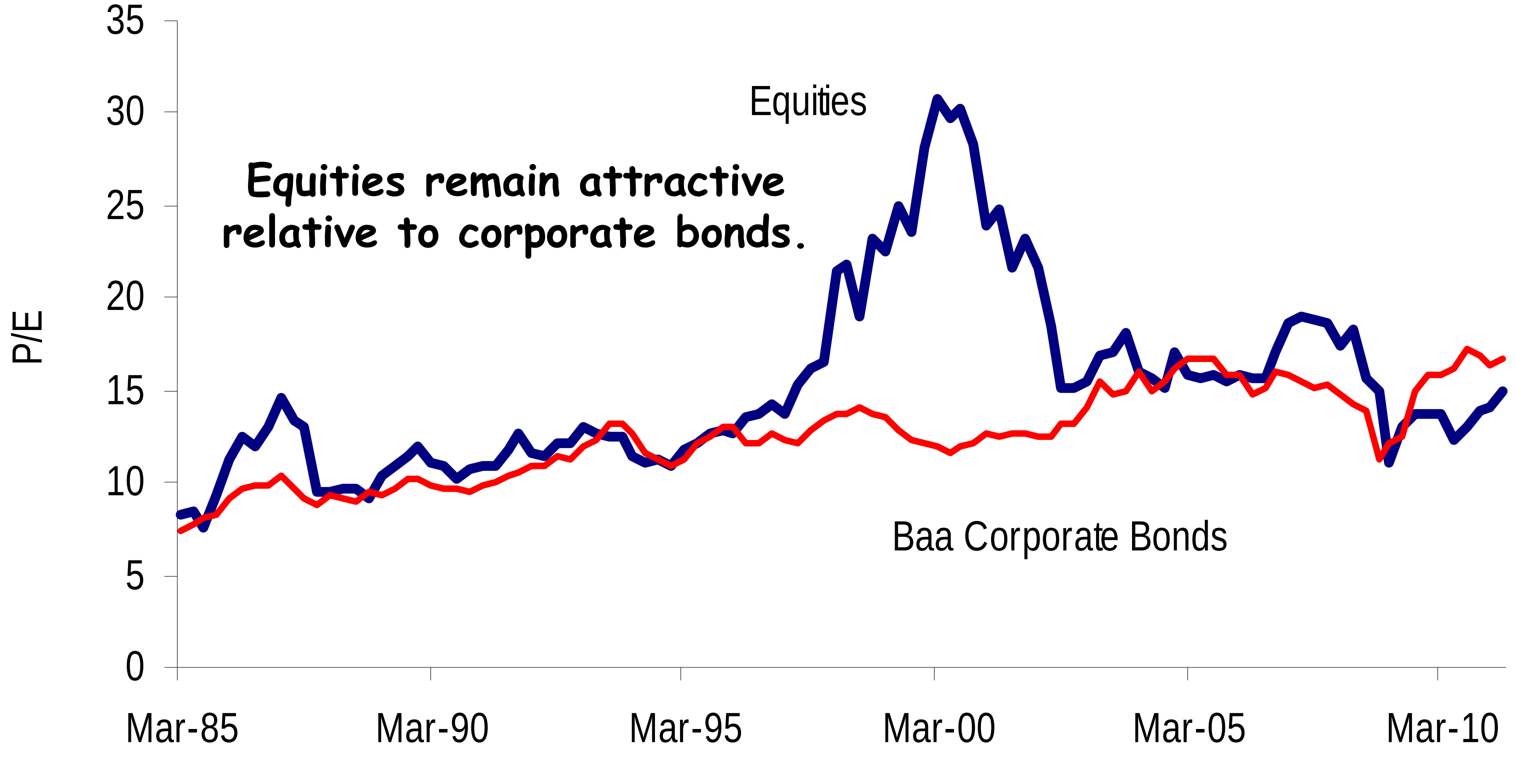
World $ GDP forecast is expected to strengthen in 2011, supporting corporate profits growth.



Source: Bureau of Economic Analysis; IMF; Encima Global

Based on P/E, Equities Attractive Relative to Bonds

(last obs. Q4 2010, estimated Q2 2011)



Source: Haver; Bureau of Economic Analysis; Federal Reserve; Encima Global