



Economic Chartbook

June 2011

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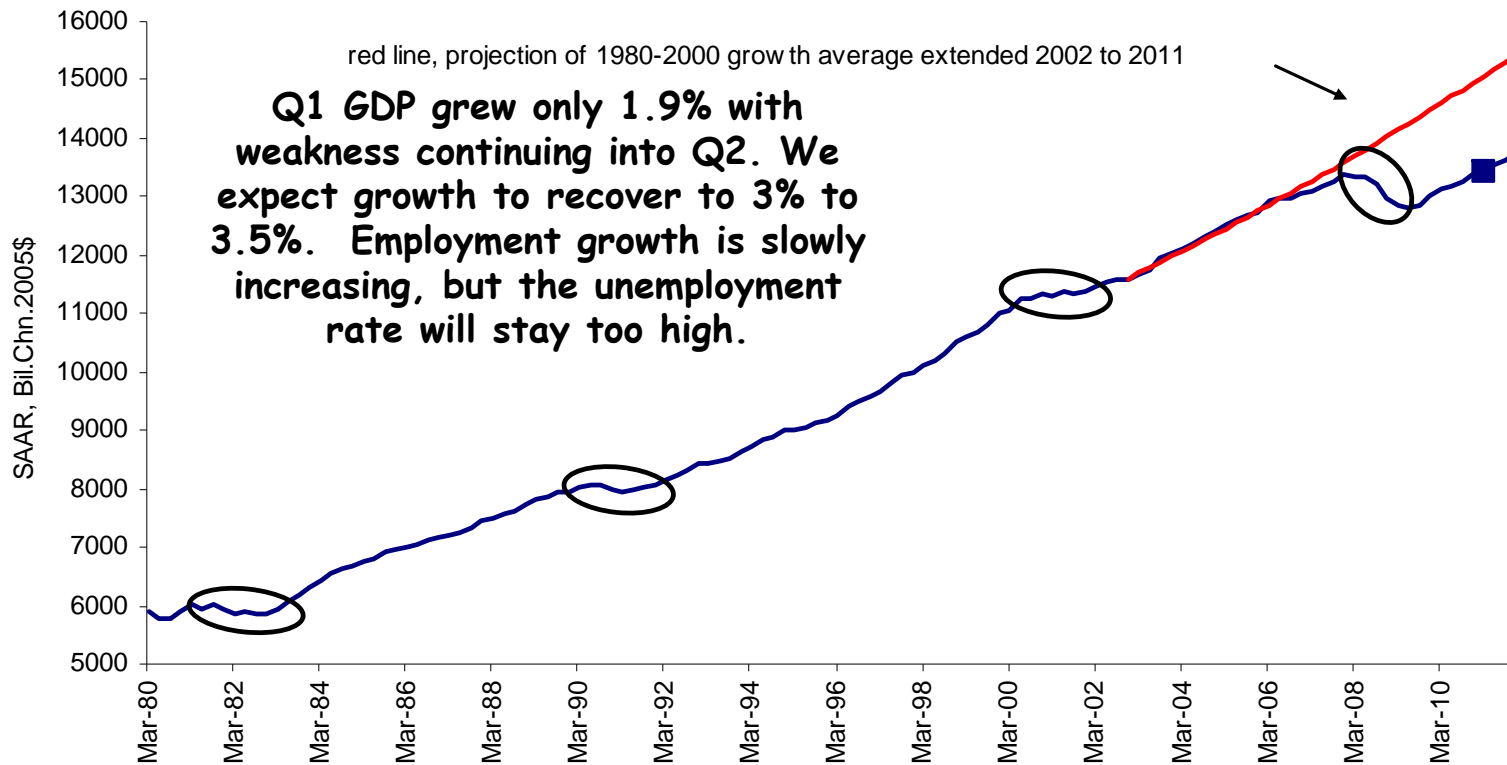
Please read the important disclosure information in the Addendum section of this presentation.

Economic Outlook

- **We expect 3.5% second half GDP growth, causing a sizeable global shift from bonds to stocks. Faster growth is based on increased auto production, corp profit and top line sales growth projections, export growth (emerging markets are enjoying rising living standards and strong capital investment, partly from U.S. capital flight), some job growth, and pent-up demand for business investment and personal consumption.**
- **The end of QE2 bond purchases should be benign, like Y2K, since QE2 was not money printing and didn't add to private sector credit. It didn't have a discernable impact on the economy or, in our view, financial markets (the equity rise in the second half of 2010 reflected growth in profits and GDP following the 2010 soft patch.) We disagree strongly with the flow view of the bond market in which the Fed's reduction in bond purchases will create a shortage of buyers. We're negative on bonds for other reasons – growth, inflation and low yields.**
- **The debt limit increase will get done one way or another. A default of any kind including delayed interest payments would have catastrophic consequences, but is highly unlikely and is mostly under discussion as part of the negotiating process. We expect ultra-loose fiscal policy to continue. The U.S. doesn't have any structural reform process under way yet, either at the federal level or in many of the states.**
- **The Greek debt deal is on track to push the problem into 2012 without a default event. German and French banks are meeting with officials to divide up their share of the current losses and arrange the accounting, bond rating and legal treatment of the bond exchange. A reimposition of local currencies by a euro country would be catastrophic but there's no movement in that direction.**

Real GDP Growing From a Low Base

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

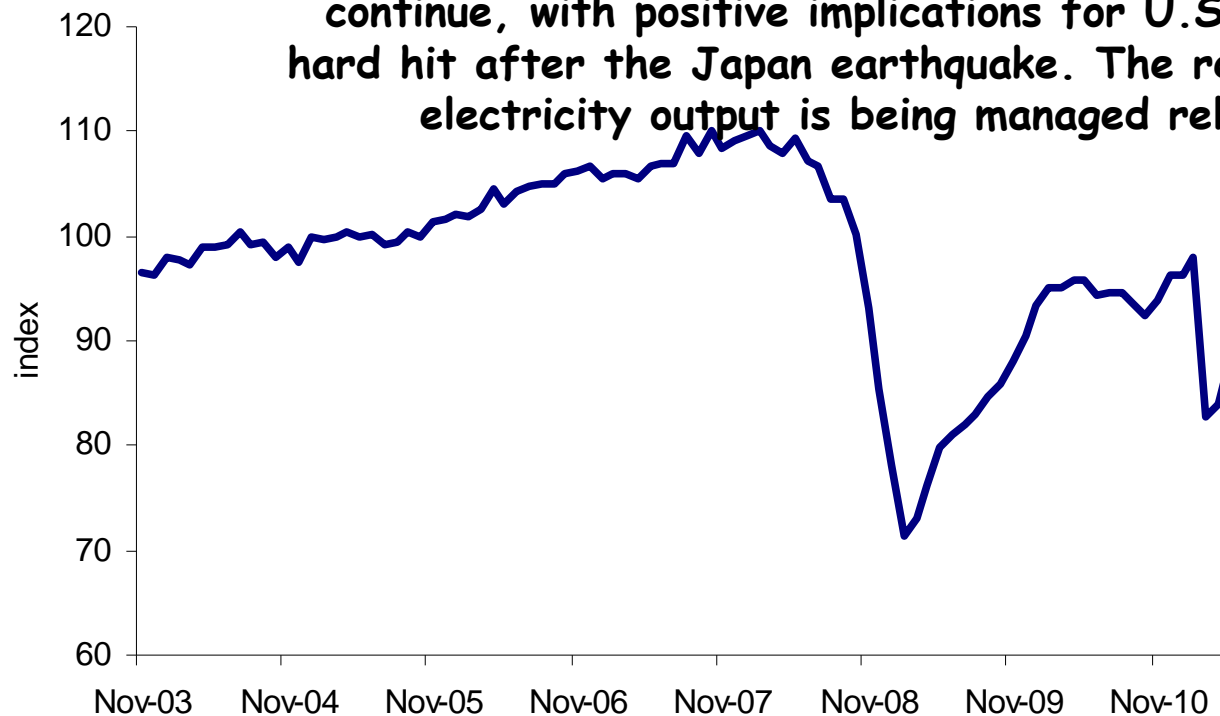


Source: Bureau of Economic Analysis; Encima Global

Japan's Industrial Production

(last obs. May 2011)

We note a solid rebound in Japan's industrial production in May (up 5.7% from April). Japan's industrial production level is still well below the February peak, but we expect the rebound to continue, with positive implications for U.S. manufacturing, hard hit after the Japan earthquake. The reduction in Japan's electricity output is being managed relatively well.

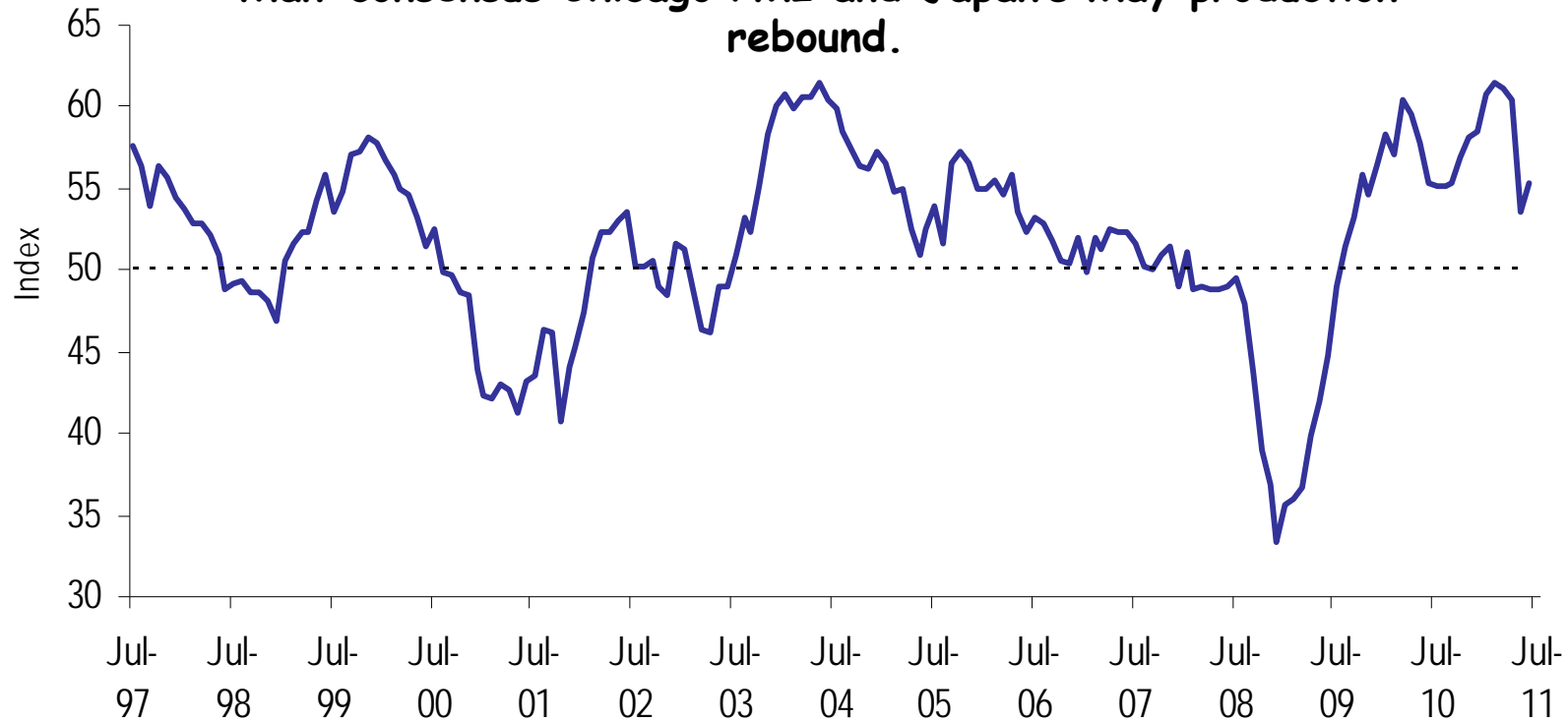


Source: Bloomberg; Encima Global

ISM Manufacturing

(last obs. June 2011)

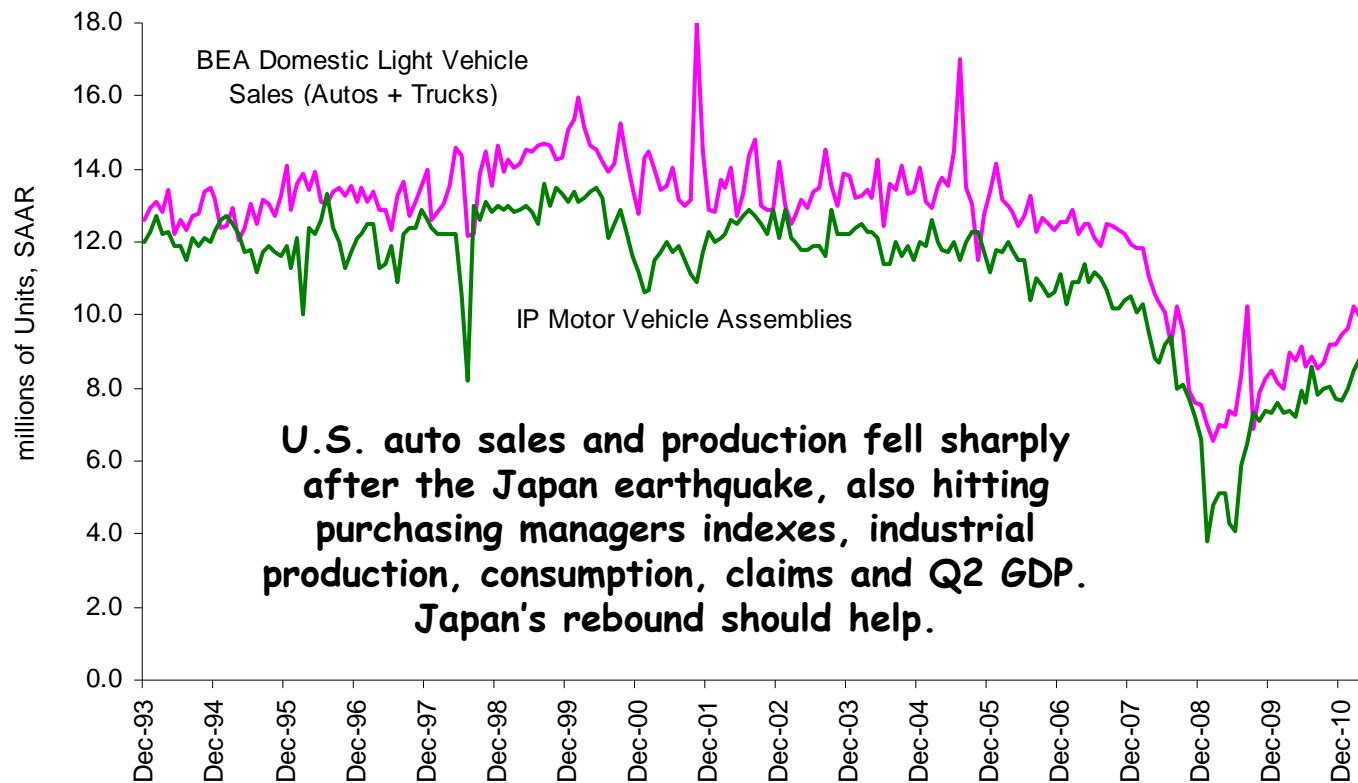
The ISM rose to 55.3 on July 1, paralleling the better-than-consensus Chicago PMI and Japan's May production rebound.



Source: Institute for Supply Management; Encima Global

Auto Sales and Production Rising

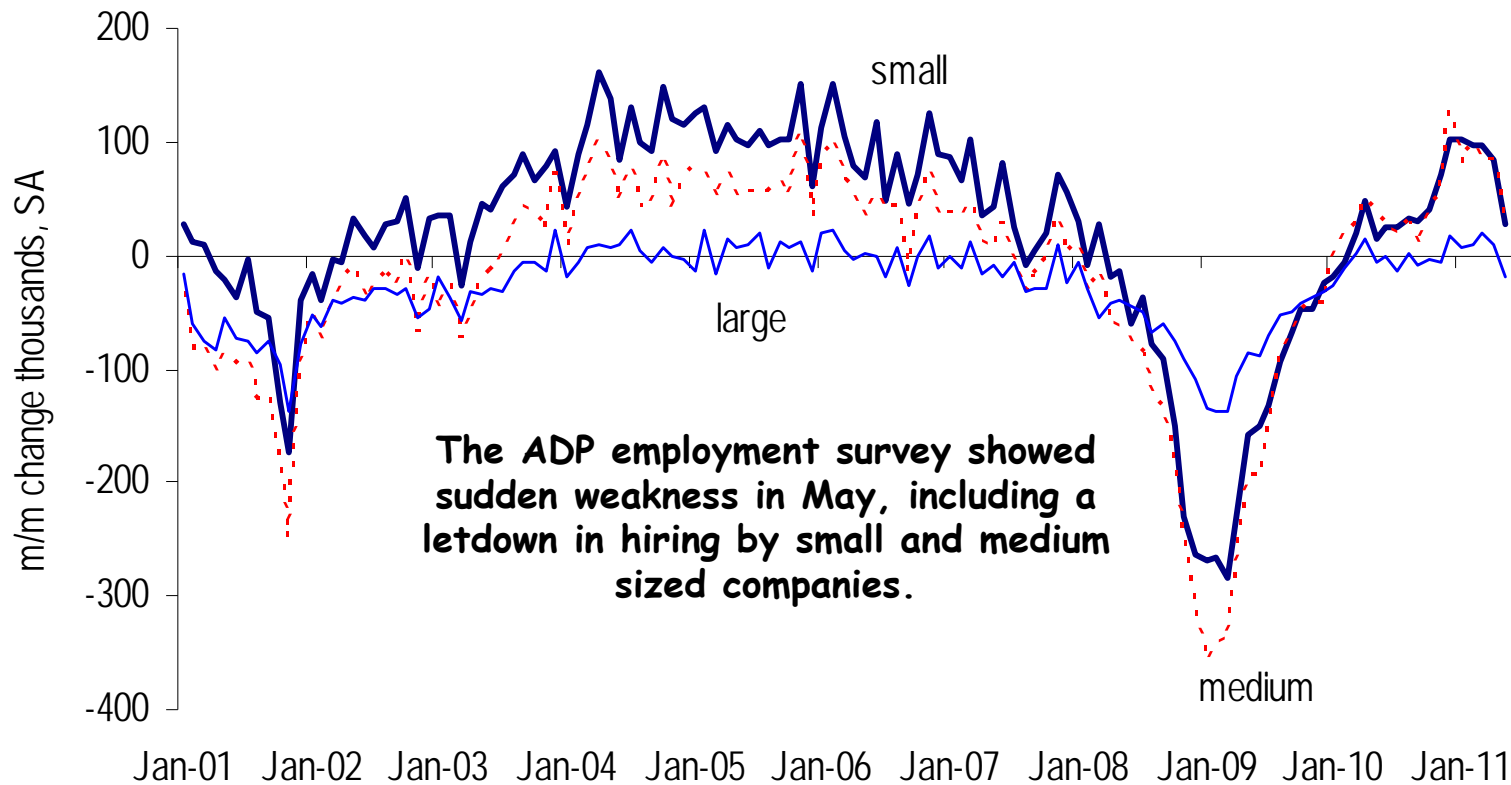
(last obs. May 2011)



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

ADP Jobs Survey by Company Size

(last obs. May 2011)

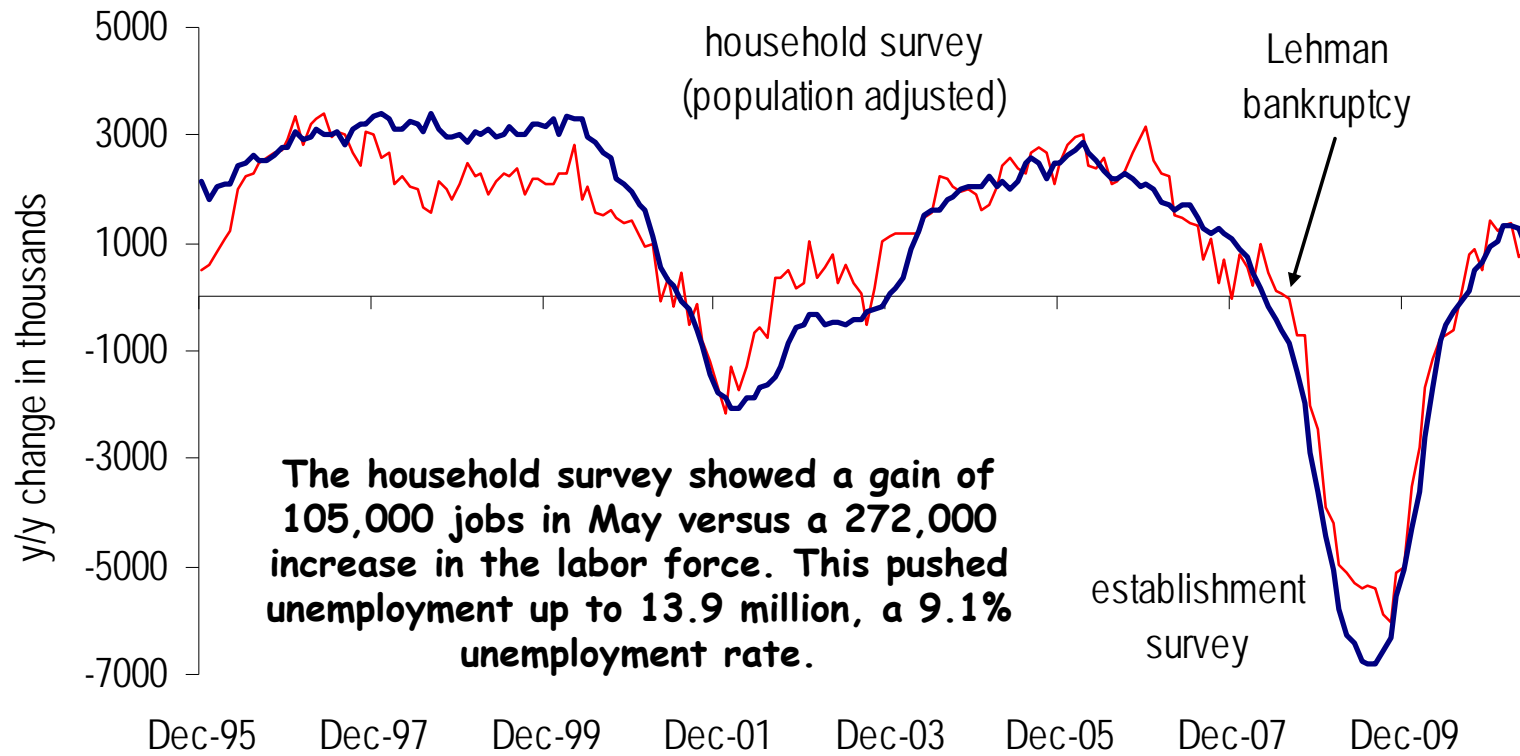


The ADP employment survey showed sudden weakness in May, including a letdown in hiring by small and medium sized companies.

Source: ADP; Encima Global

Annual Employment Growth

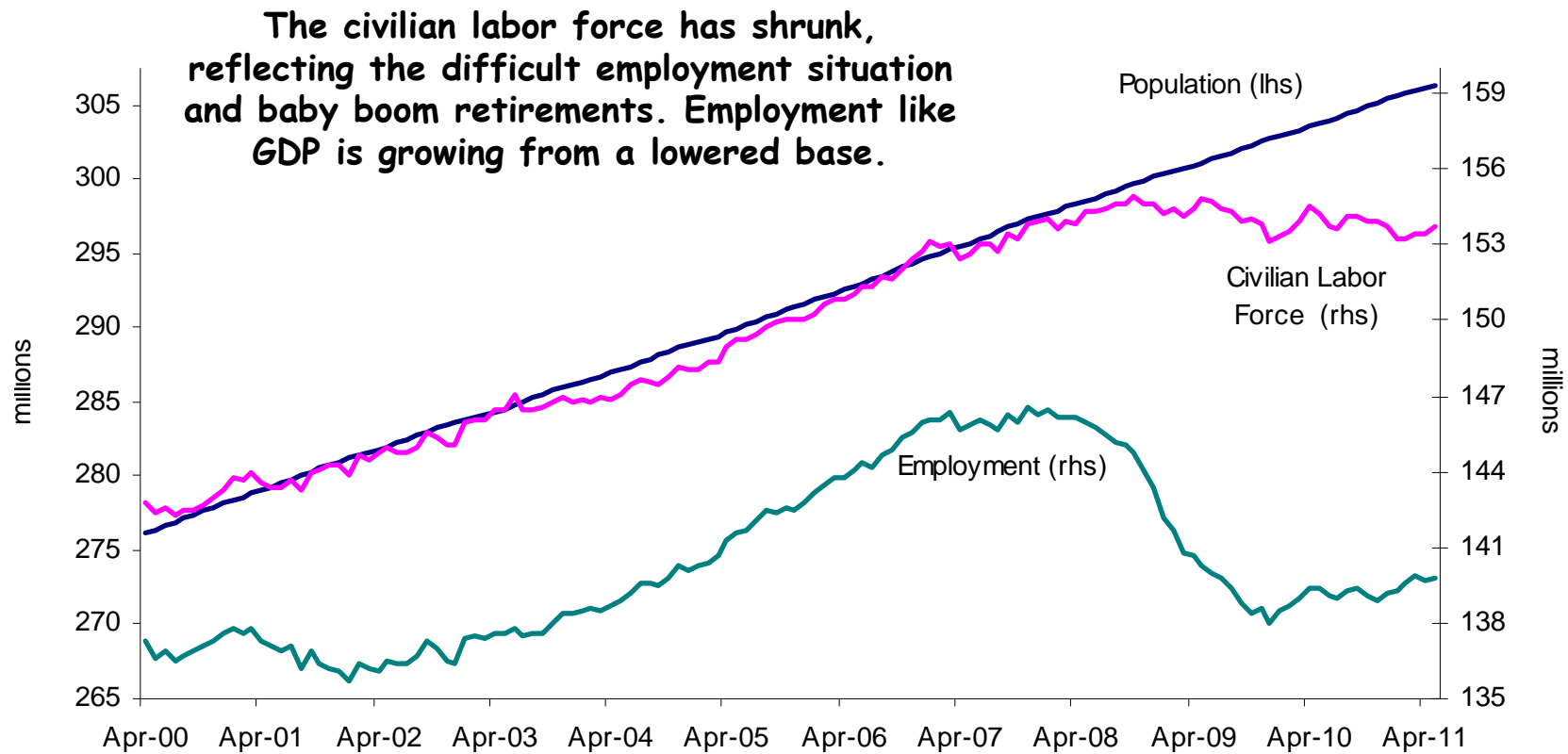
(last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

Population, Labor Force and Employment

(last obs. May 2011)

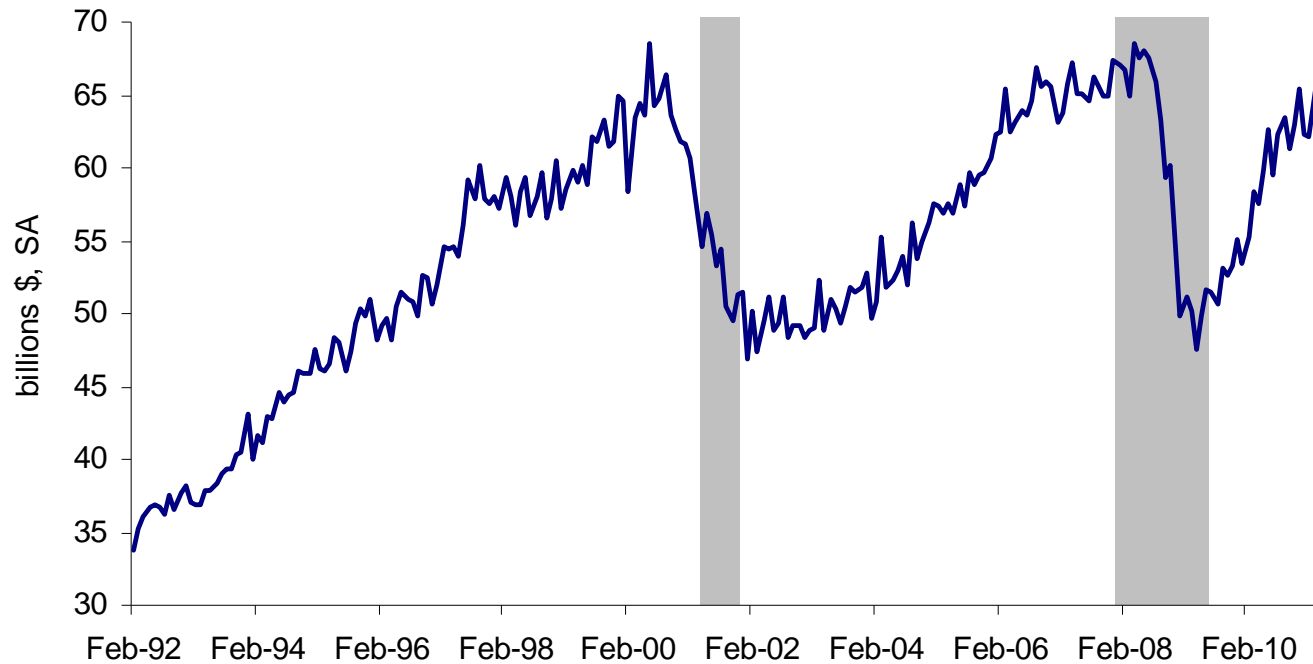


Source: Bureau of Labor Statistics; Encima Global

Nondefense Capital Goods Orders ex Aircraft

(last obs. May 2011)

In May, durable goods orders were better than expected including revisions to the previous month. Pent-up demand for business and consumer investment is a key assumption in our second half outlook.



Source: Bureau of Census; Encima Global

Headline and Core Consumer Price Index Y/Y

(last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

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

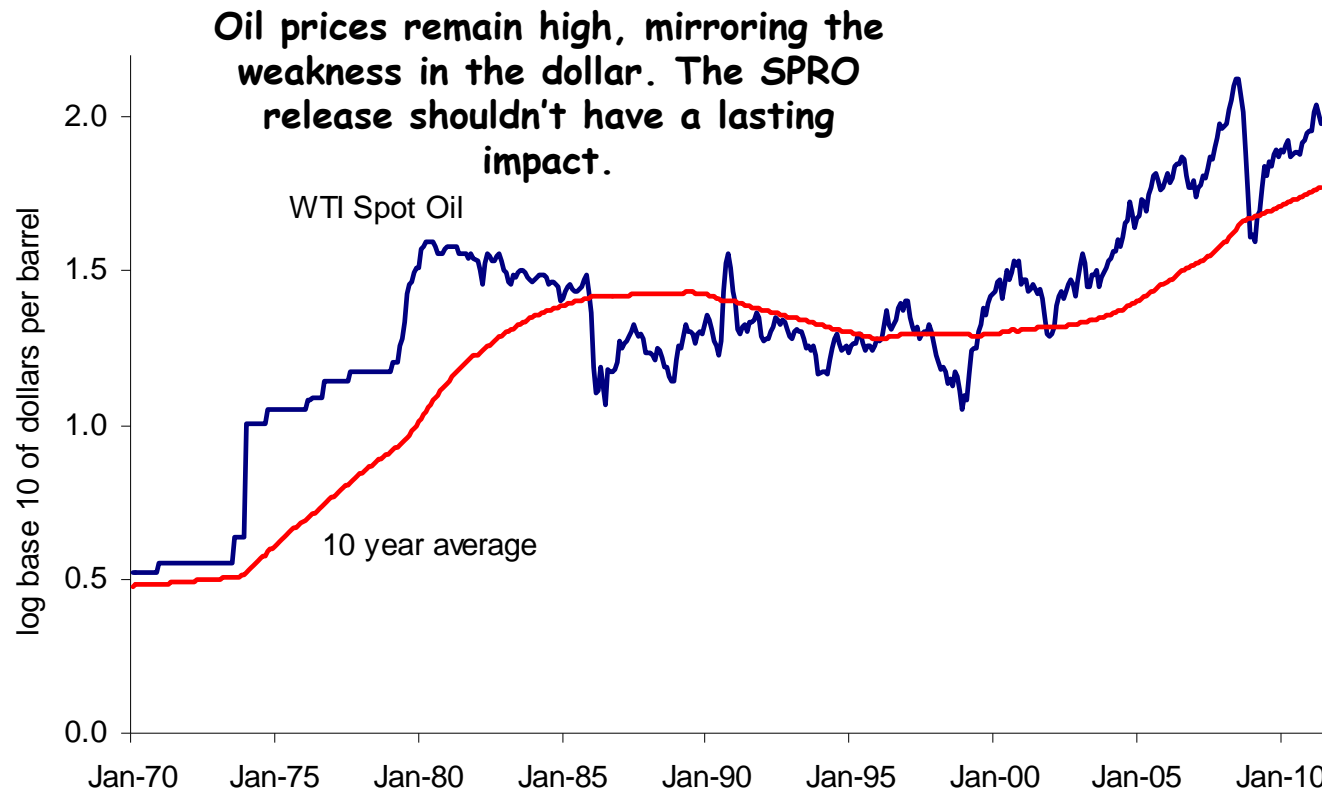
(log scale, last obs. June 30, 2011)



Source: Wall Street Journal; Encima Global

High oil prices reflect dollar's weak value

(log scale, last obs. June 30, 2011)



Source: Wall Street Journal; Encima Global

DXY – Dollar Index

(last obs. June 30, 2011)

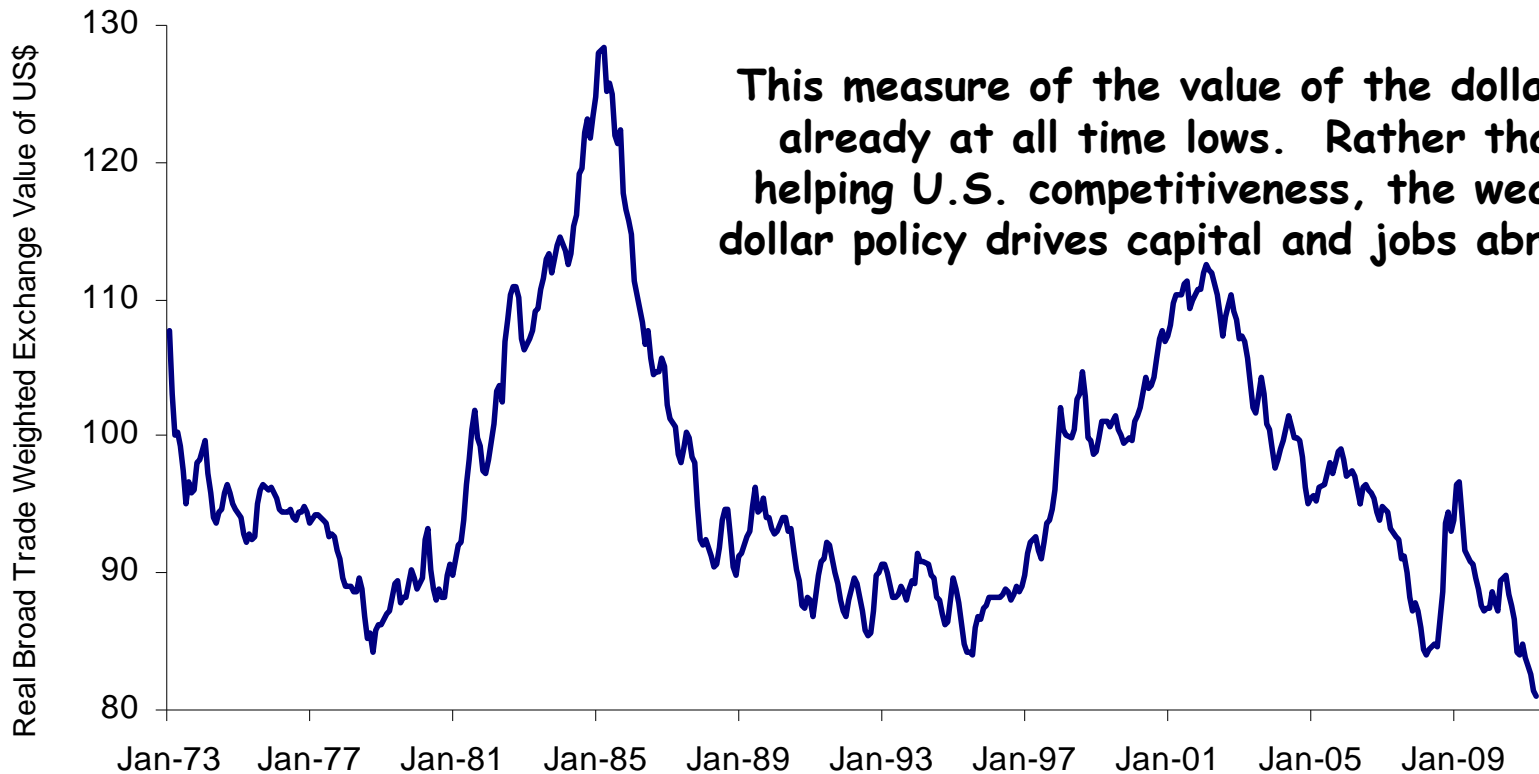
The Fed is giving no confidence about the future value of the dollar, leaving market dynamics to trend-following and momentum and hurting U.S. investment fundamentals. Bernanke's dovish policy and the lack of traction for federal spending hawks provide no floor to the value of the dollar, which we expect to sink to all-time lows.



Source: Bloomberg; Encima Global

Record Low for 'Real' Value of \$

(last obs. May 2011)



This measure of the value of the dollar is already at all time lows. Rather than helping U.S. competitiveness, the weak-dollar policy drives capital and jobs abroad.

Source: Federal Reserve; Encima Global

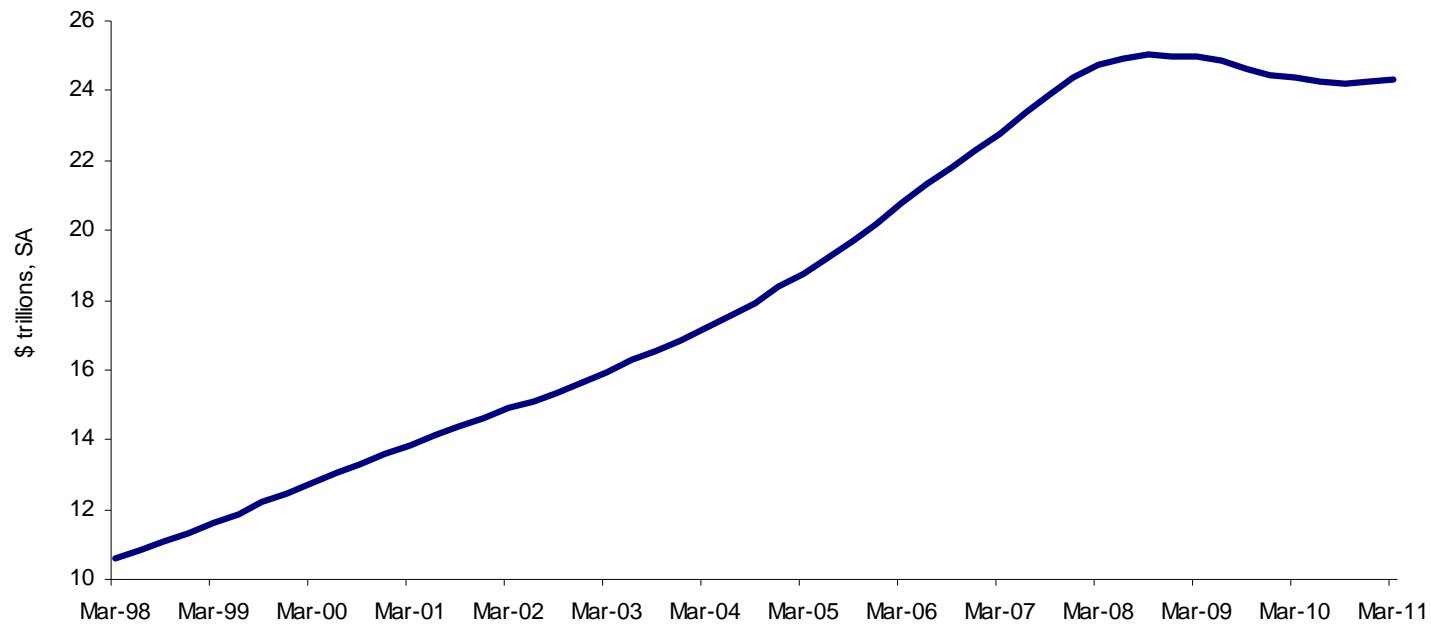
QE2 To End Like Y2K

- **We think QE2's impact on the economy, markets and inflation has been exaggerated. QE2 isn't money printing and isn't very powerful in its current form. To achieve its balance sheet expansion, the Fed pays an above-market interest rate to commercial banks for extra deposits at the Fed. The result has been a rise in excess commercial bank reserves equivalent to the Fed's balance sheet expansion and little transmission from QE2 to private sector credit growth or to the economy.**
- **The commodity spike and the squeeze on Treasury bonds got overdone in part due to the view that the Fed's QE2 was a new form of money printing that would create a near-term crisis. QE2 has caused substantial distortion in credit markets and artificially depressed the dollar, but we don't think this creates the near-term crisis that's assumed in high gold and commodity prices and low Treasury bond yields.**
- **The market implications are: 1) the completion of QE2 shouldn't be contractionary; we think equities will go up, a sigh of relief, not down as some have argued; 2) similarly, bond yields should rise as worries about post-QE deflation subside; we think the 10-year Treasury yield may reach 4% toward year-end on evidence of 3% U.S. growth in 2011 and over 3% CPI inflation; 3) commodity-importing emerging markets (like India and China) should do well after underperforming during the QE2 fascination.**

Private Sector Credit

(last obs. Q1 2011)

QE2 didn't increase private sector credit much.

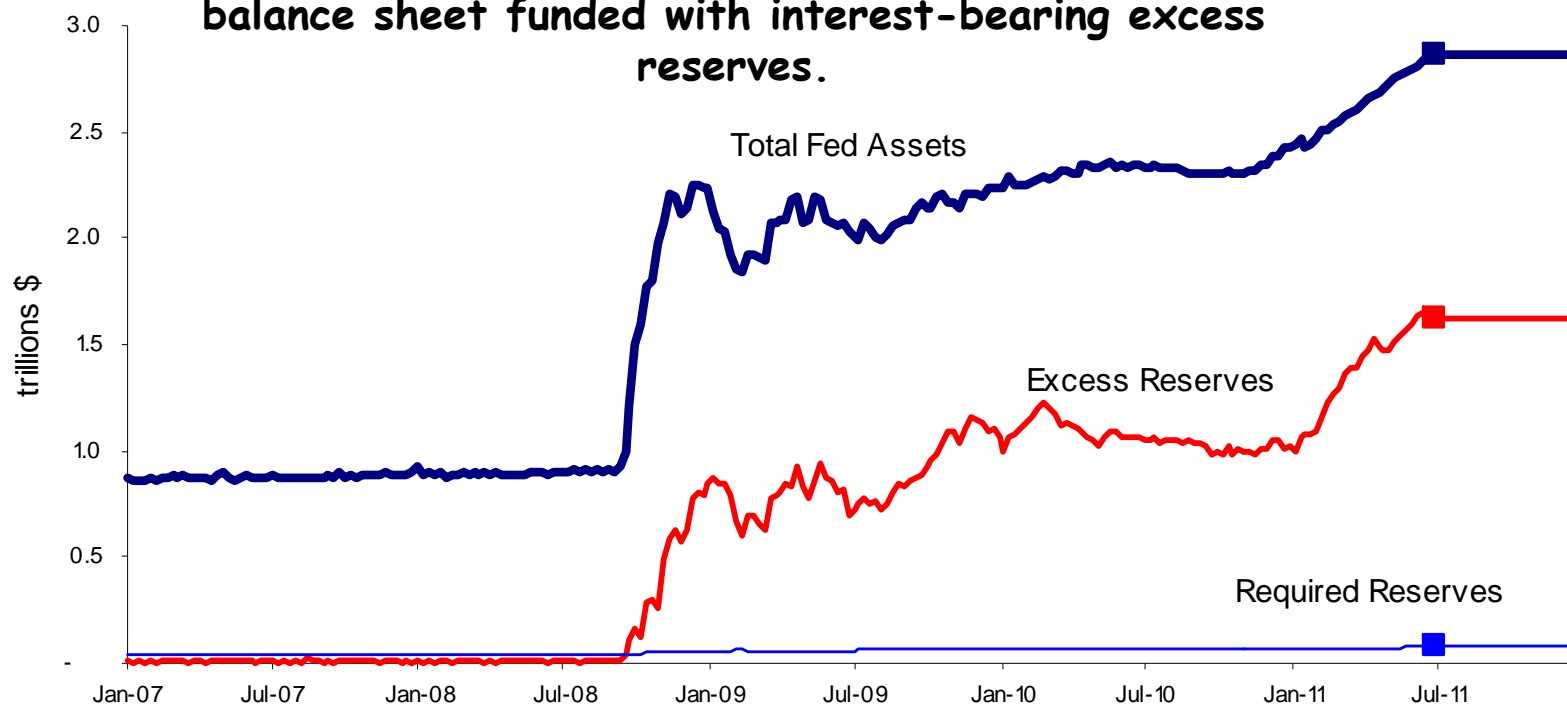


Source: Federal Reserve: Flow of Funds; Encima Global

Excess Reserves Rose – Fed ‘Pushing on a String’

(last obs. June 29, 2011)

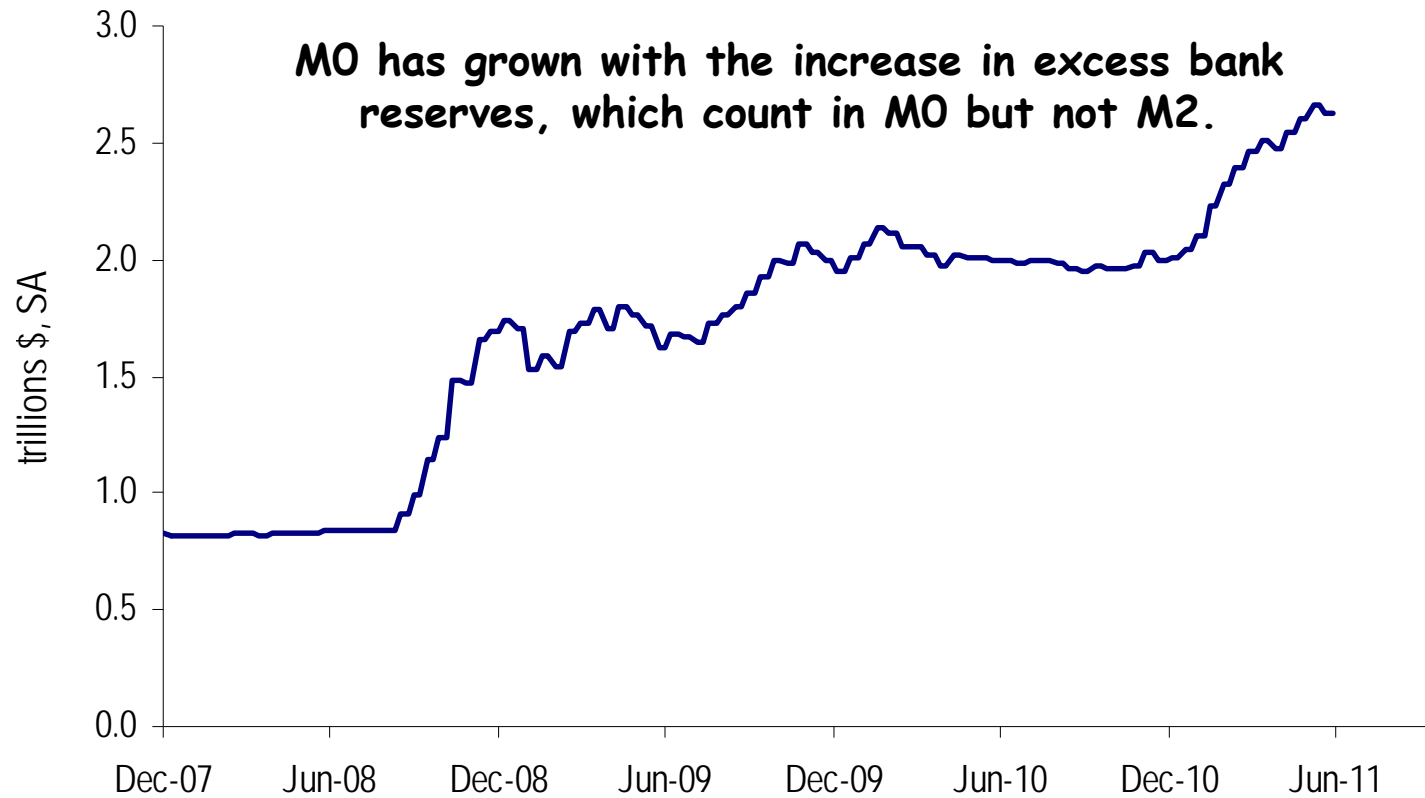
The fed will complete QE2 and maintain an enlarged balance sheet funded with interest-bearing excess reserves.



Source: Federal Reserve: Encima Global

M0

(last obs. June 27, 2011)

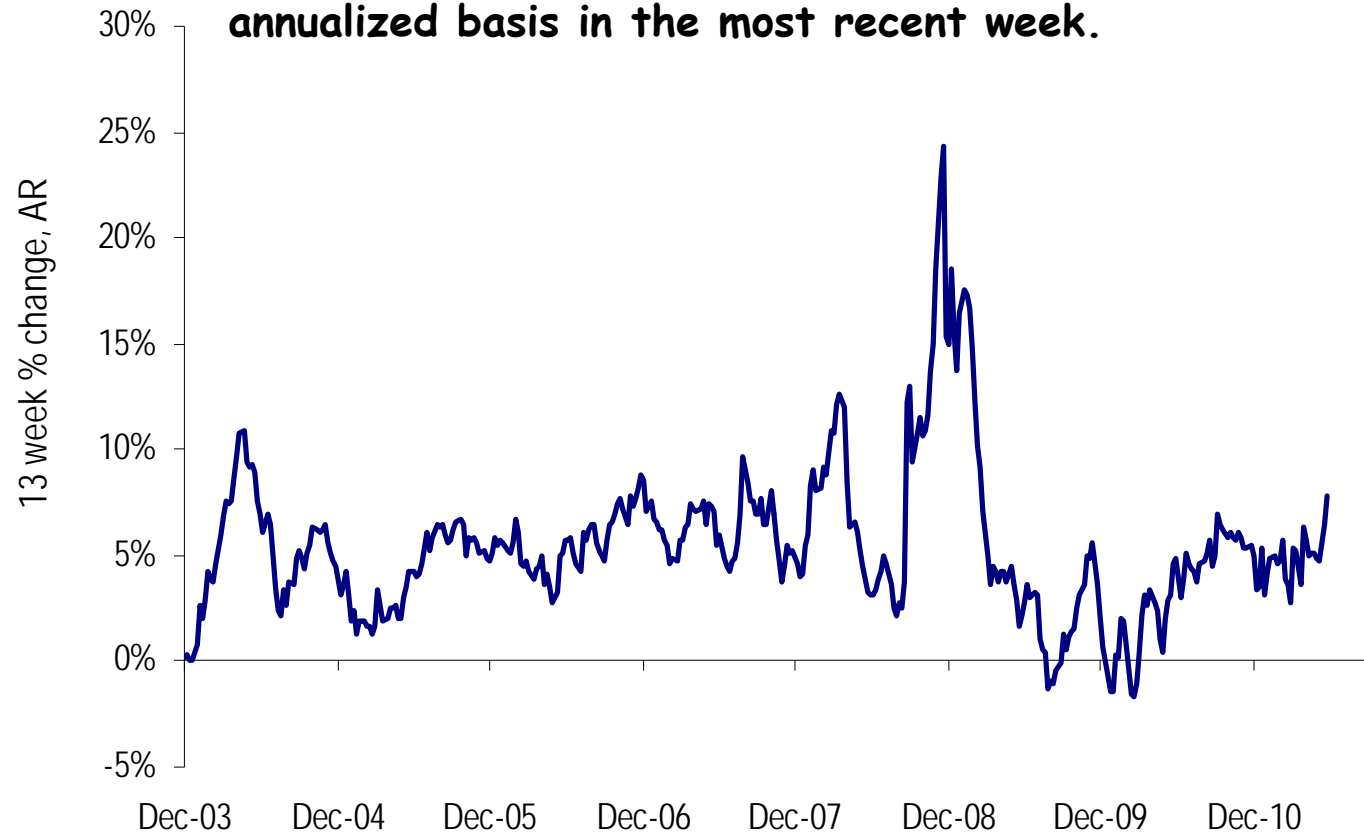


Source: Federal Reserve; Encima Global

M2 13 Week change annualized basis

(last obs. June 20, 2011)

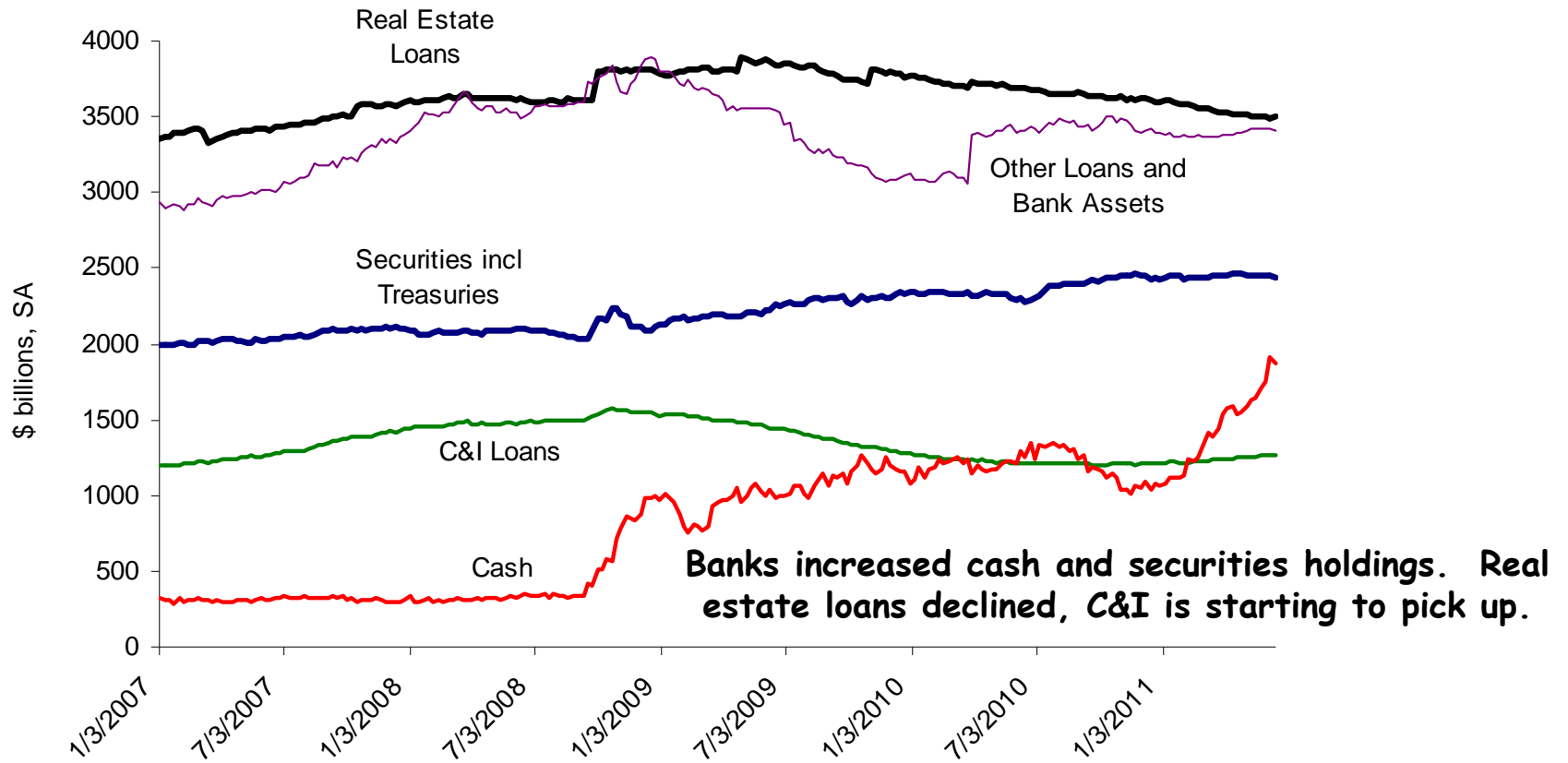
M2 growth jumped to 7.8% on a 13 wk annualized basis in the most recent week.



Source: Federal Reserve: Encima Global

Bank Assets – Cash Includes Excess Reserves at Fed

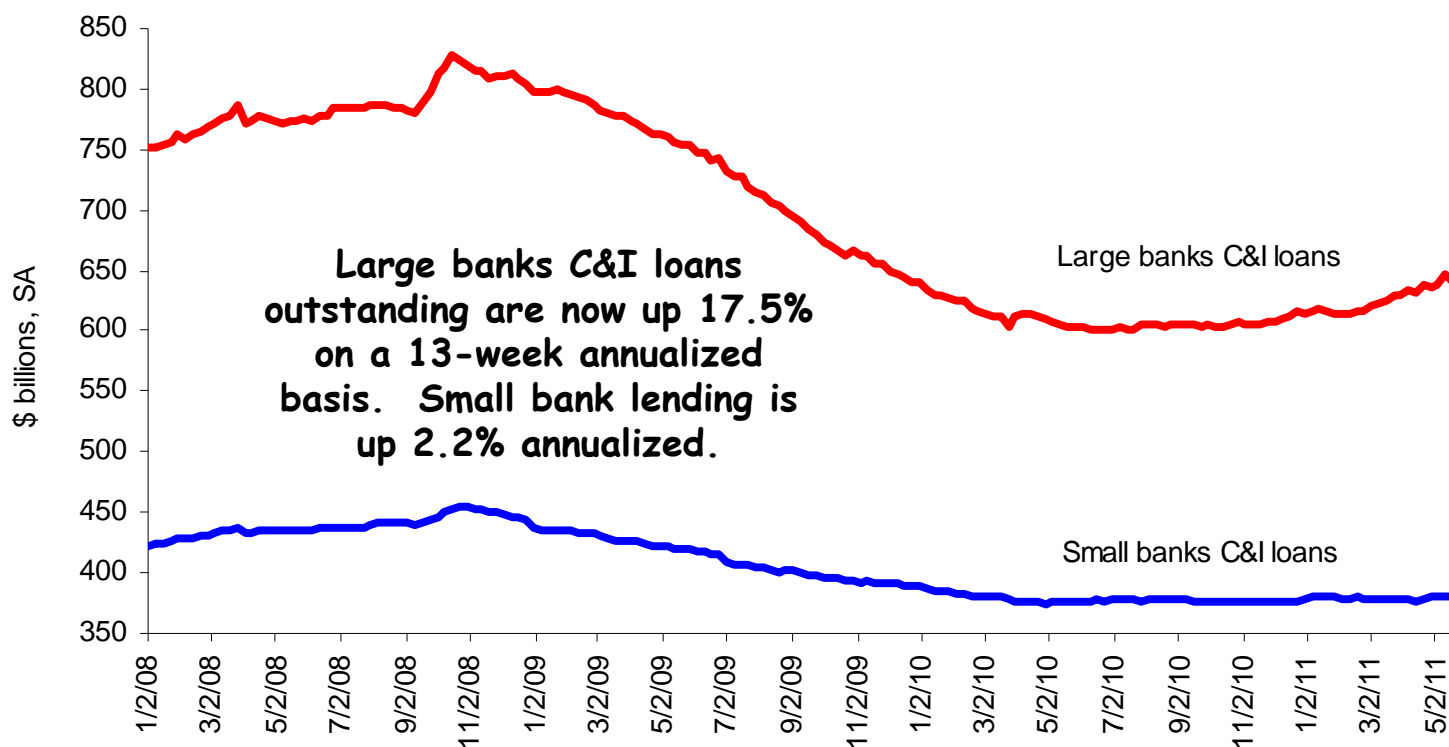
(last obs. June 15, 2011)



Source: Federal Reserve: Encima Global

Commercial and Industrial Loans Beginning to Rise

(last obs. June 15, 2011)

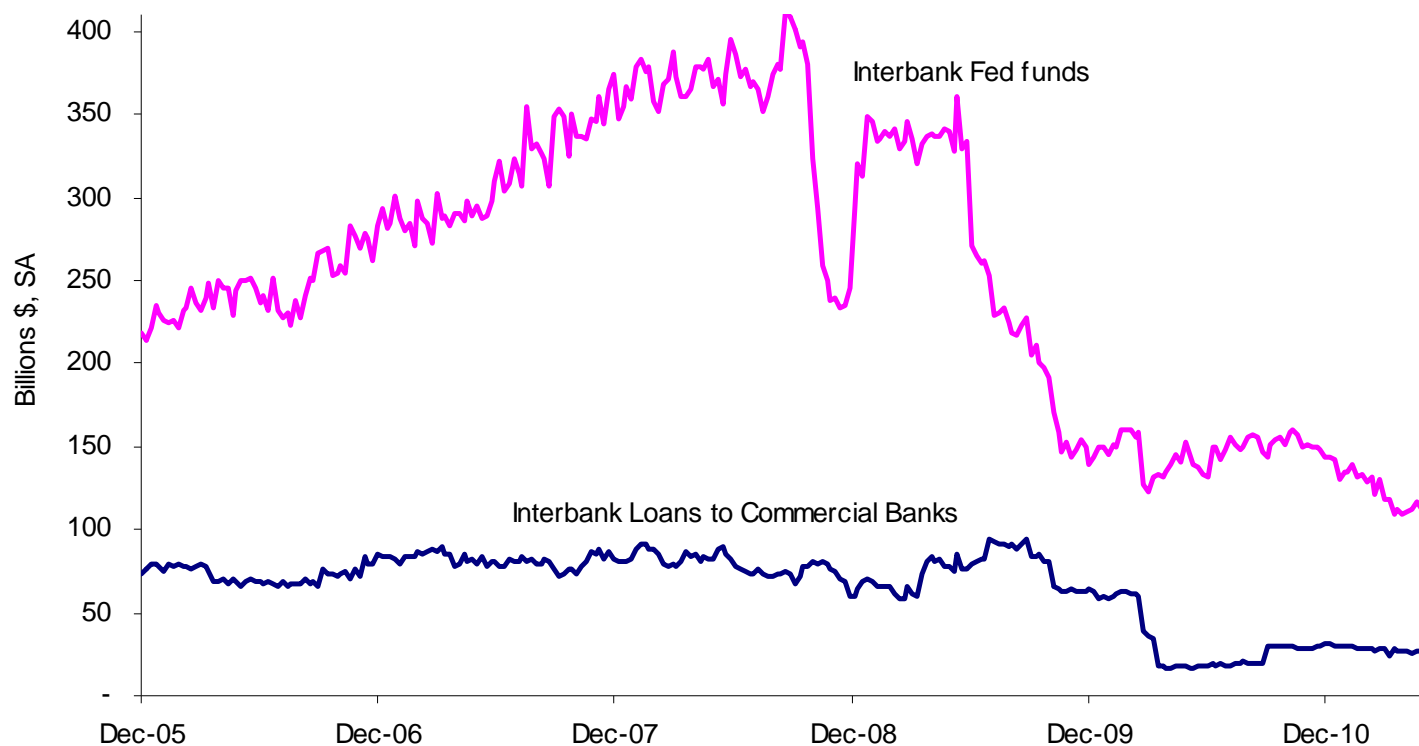


Source: Federal Reserve; Encima Global

Interbank Loans – through Fed Funds and direct

(last obs. June 17, 2011)

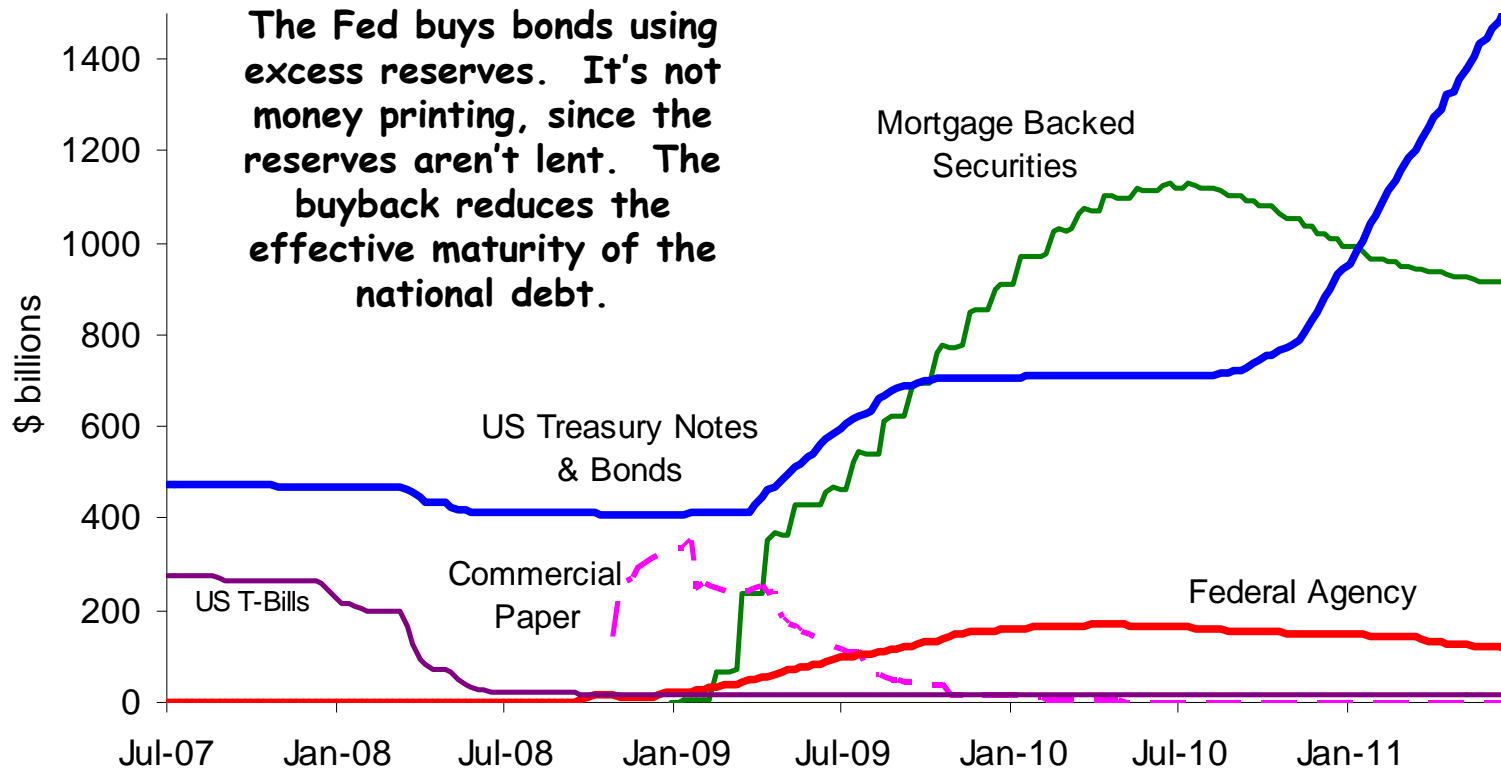
Interbank lending has fallen significantly since the Fed Funds rate has been held near zero.



Source: Federal Reserve; Encima Global

Fed Balance Sheet

(last obs. June 22, 2011)



Source: Federal Reserve: Encima Global

10 Year Treasury Yield To Rise In Second Half

(last obs. June 30, 2011)

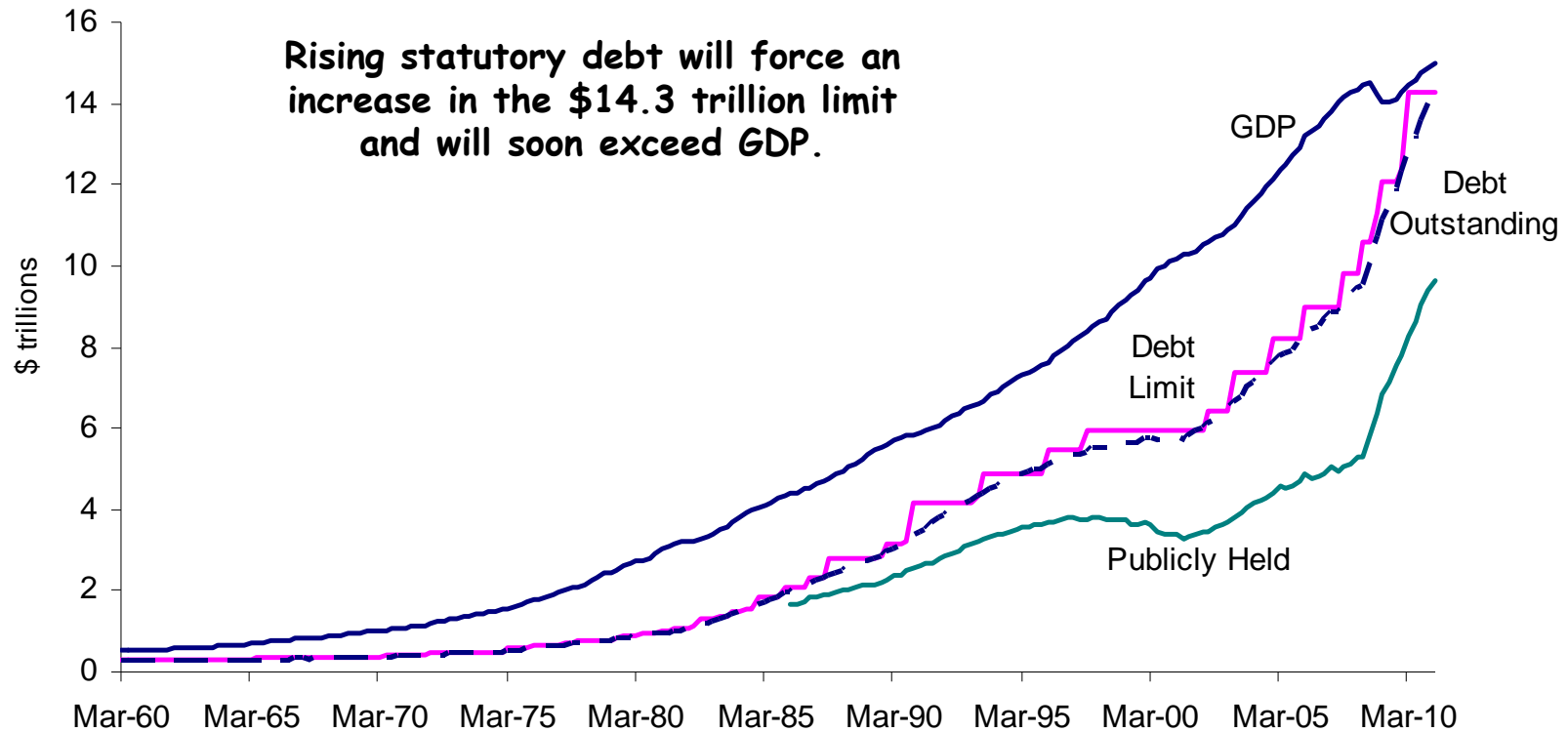
Bond yields were pushed down in May and June but should go higher in the second half due to growth and inflation. While some of the dip in yields is growth related, we think it also reflected a temporary bond squeeze due to: 1) the Fed's decision not to taper its final May and June QE2 purchases whatever the yield; 2) hope that the debt limit will delay Treasury auctions; and 3) widely-reported short positions in Treasuries. Aging demographics should contain the rise.



Source: Federal Reserve; Encima Global

Publicly Held Debt Reaching 70% of GDP

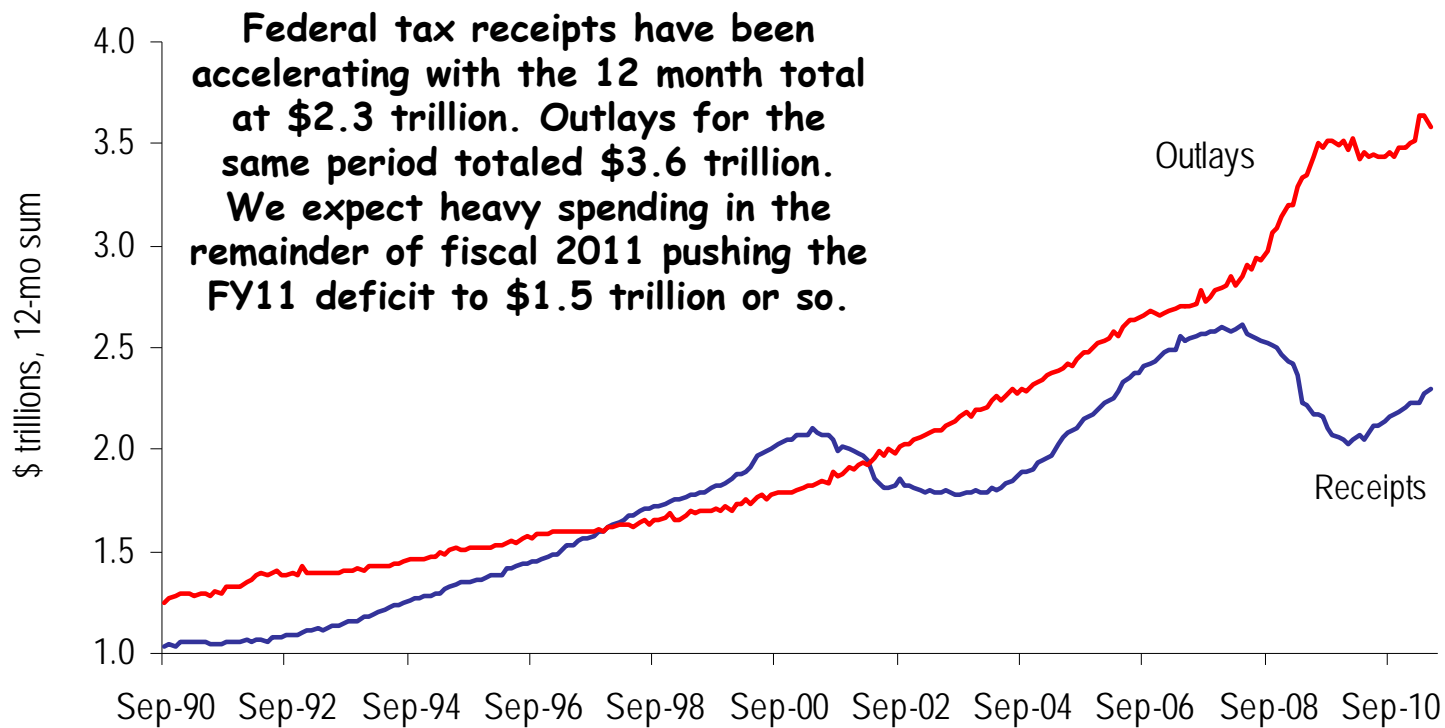
(last obs. Q1 2011)



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

Federal Receipts and Outlays

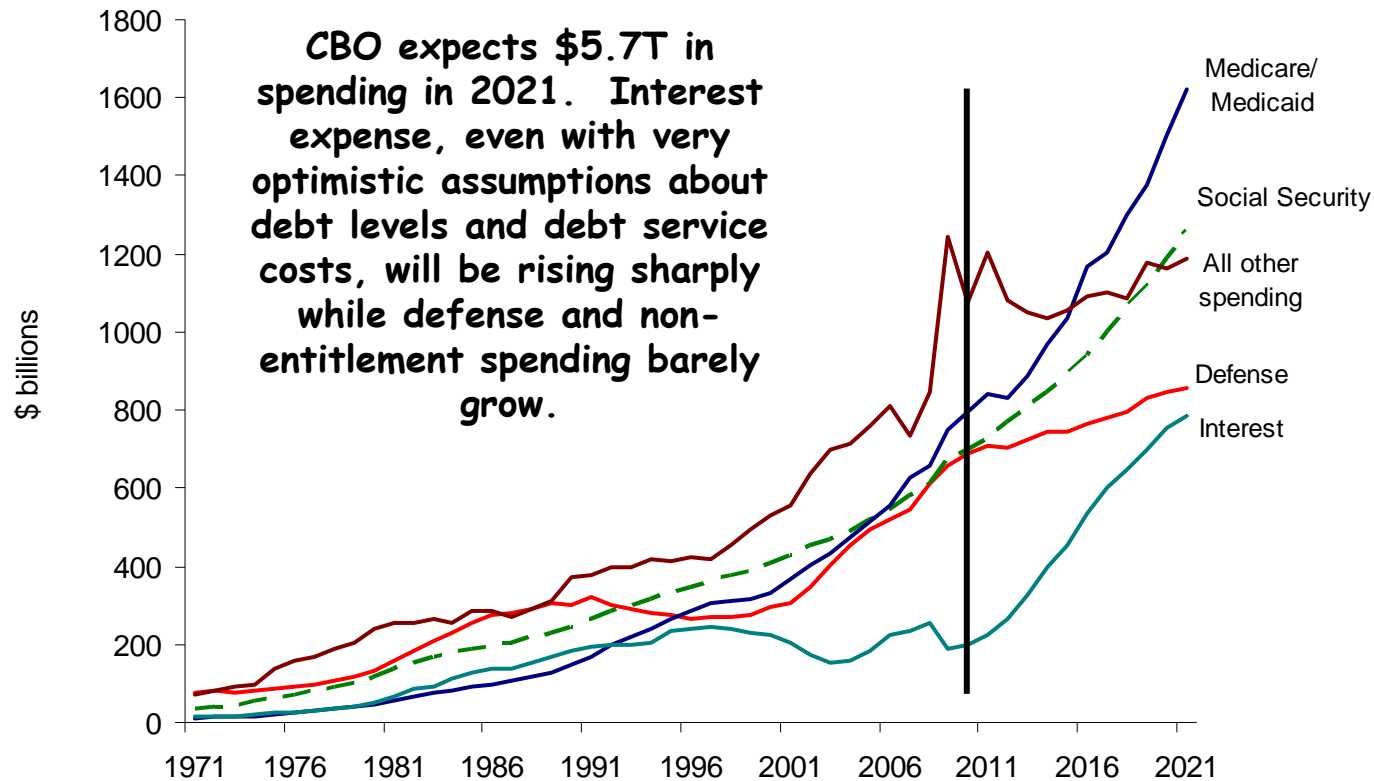
(last obs. May 2011)



Source: U.S. Treasury; Encima Global

Expenditures in \$ billions by Major Category

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



Source: CBO; Encima Global

Budget Variations

	FY 2012			FY 2012 - 2021		
	Outlays (\$ trillions)	Deficit (\$ trillions)	Debt per GDP	Outlays (\$ trillions)	Deficit (\$ trillions)	Debt per GDP
CBO March Baseline	3.6	-1.1	73.4%	45.8	-6.7	75.6%
CBO Alternative Baseline*	3.6	-1.1	74.5%	46.1	-12.6	101.3%
White House Re-Estimated	3.7	-1.2	74.3%	46.2	-9.5	87.4%
Ryan Budget	3.5	-1.0	72.8%	40.0	-5.1	67.5%
Debt Limit Deal?*	3.6	-1.1	74.5%	44.1	-10.5	95.0%

* The two lines marked with an asterisk assume current tax rates are extended, i.e. no tax increase for AMT, Bush rates, subsidy reduction

We don't think the deal on the debt limit increase will have much impact on spending or debt. They are arguing over \$2.4 trillion in spending over ten years. In rough terms that would mean at best agreeing to slow the compound annual growth rate in spending from 5% to 4% -- after accepting the elevated starting point for spending. We think the CBO March alternative baseline is the most plausible under the current political trajectory leaving marketable debt-to-GDP over 100% in 2021 (should be 50% or less to allow the private sector to increase median per capita living standards.) If there's an agreement on \$2.4 trillion in spending cuts in the debt limit deal, the CBO scoring of the ten-year outlook, based on rosy assumptions, might look something like the bottom line on the table.

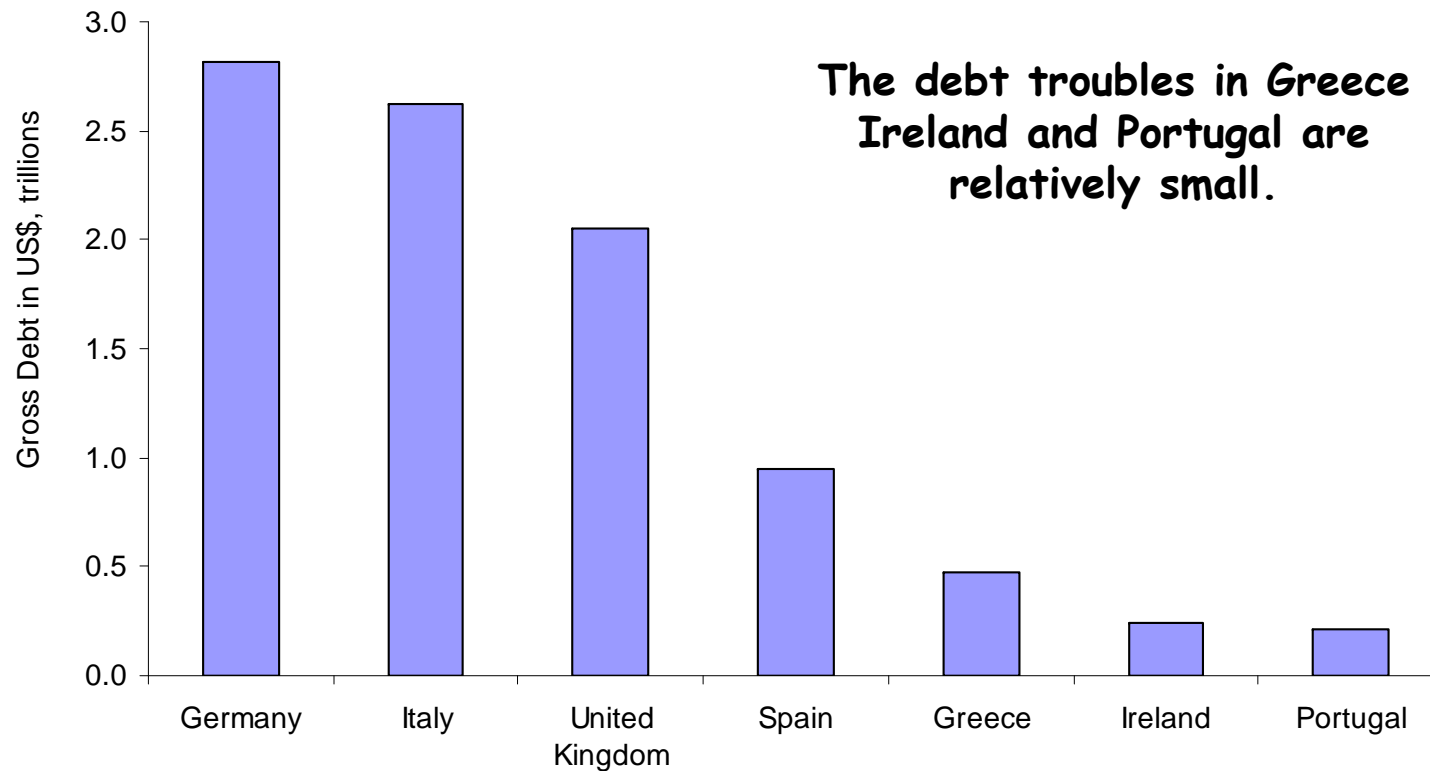
Source: CBO; House Budget Committee; Encima Global

European Debt Crisis

- **The Greek debt deal is on track to push the problem into 2012 without a default event and a devastating CDS payout. German and French banks are meeting with officials to divide up their share of the current losses and arrange the accounting, bond rating and legal treatment of the bond exchange. A reimposition of local currencies by a euro country would be catastrophic but there's no movement in that direction.**
- **There will probably be more such restructurings over time (e.g. Portugal.) As with the Latin debt crisis, the menu of bank options will vary country to country and the country outcomes will range from good to bad. As in the Latin crisis, delay in Europe is necessary for political reasons and to reduce and postpone bank losses. It causes extra payments to creditors and hurts new investment in Greece and probably in all the peripherals including Spain.**
- **The debt negotiation underway is the sharing of the losses, important but not vital to the global outlook. The losses are large by Greek standards but not large relative to the economies and banking systems of northern Europe. In the end, we expect the net present value of Greece's debt to be reduced (probably in 2012) with a substantial portion of the reduction absorbed by public sector debt holders (like German, French and Greek government-owned banks), but not by the ECB or IMF which don't take haircuts.**

General Gov't Gross Debt (\$ trillions)

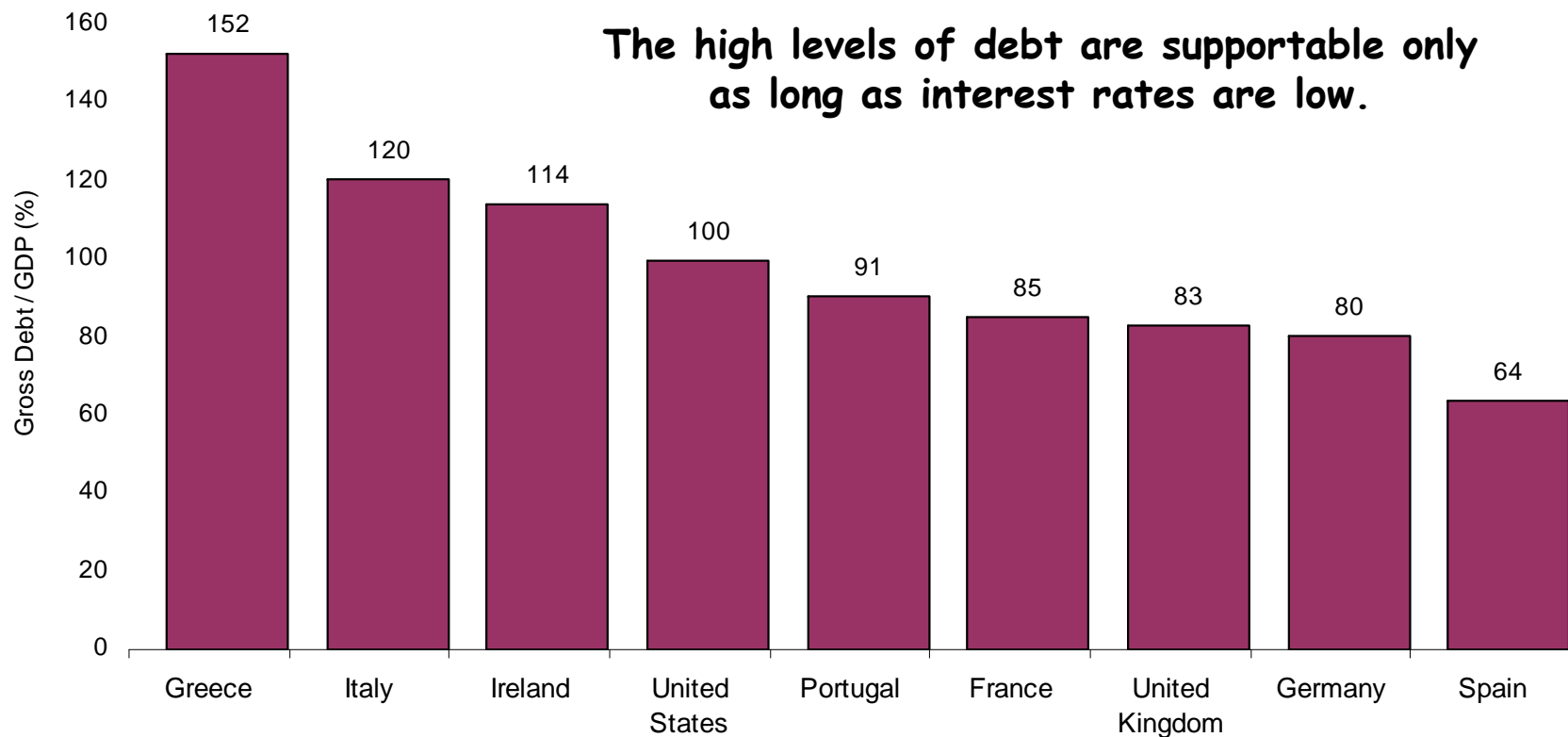
(last obs. IMF's WEO forecast for 2011, U.S. at \$15.2T)



Source: IMF; Encima Global

General Gov't Gross Debt / GDP Percentage

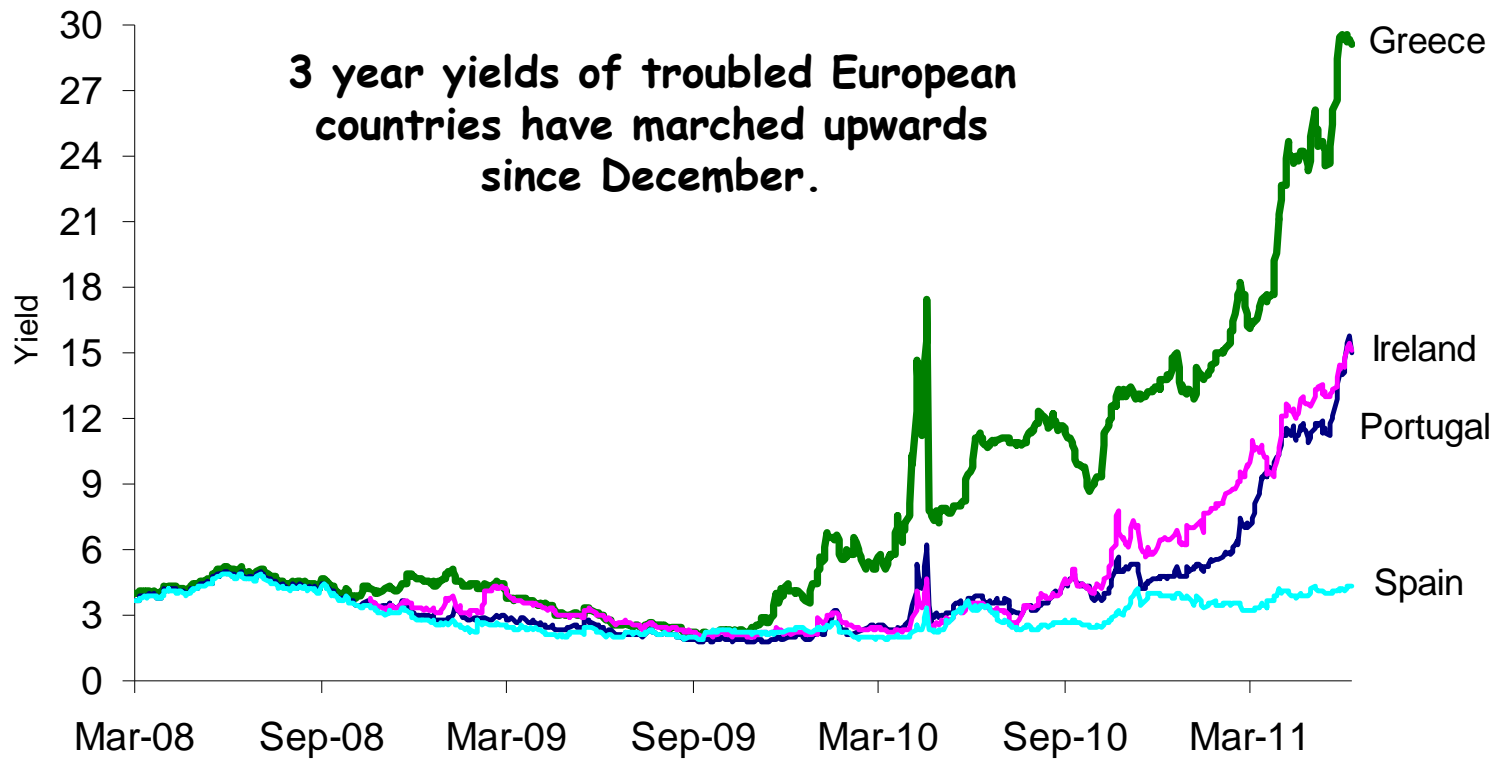
(last obs. IMF's WEO forecasts for 2011)



Source: IMF; Encima Global

Select European 3 Yr Yields

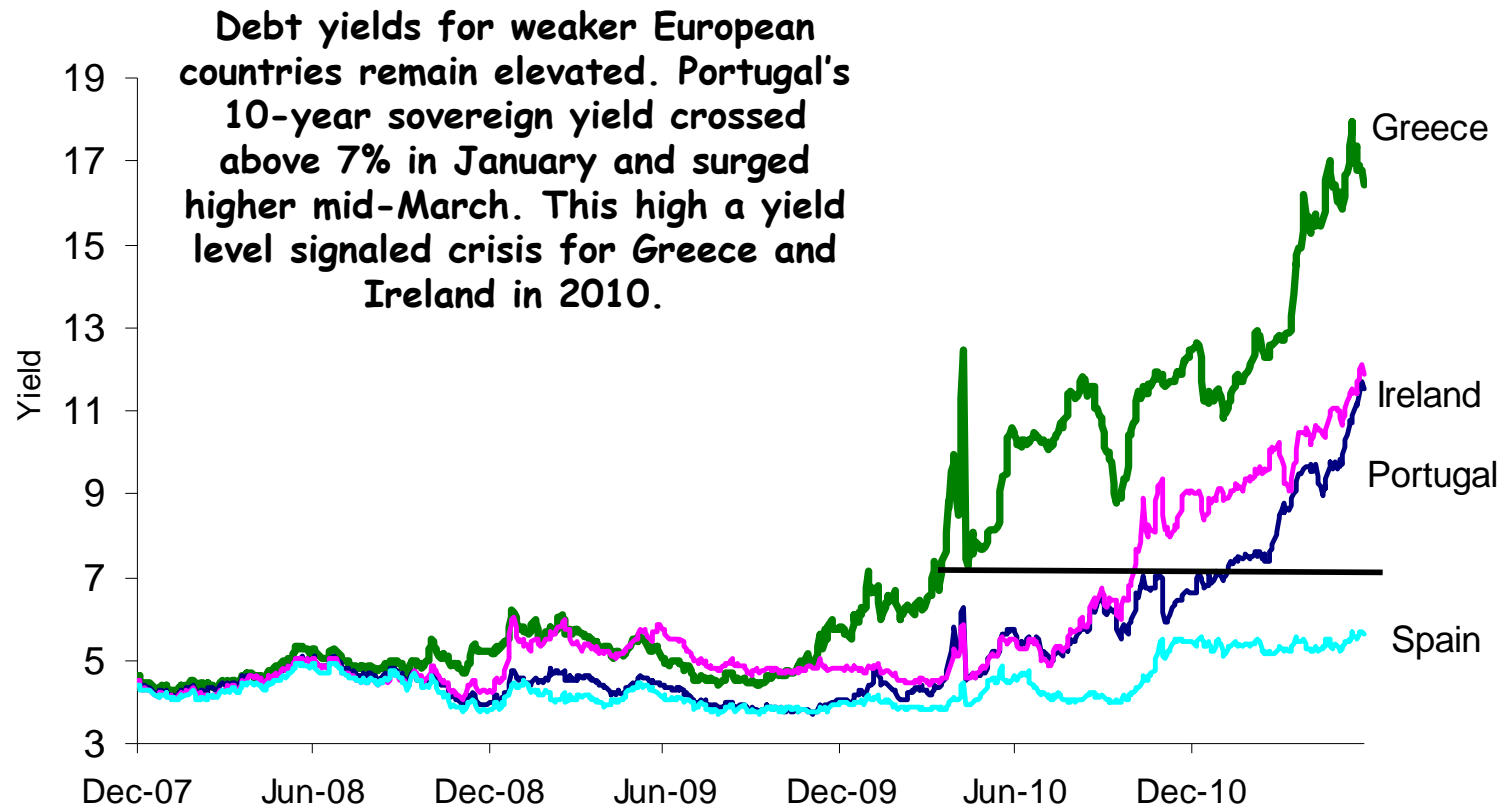
(last obs. June 29, 2011)



Source: Bloomberg; Encima Global

Select European 10 Yr Yields

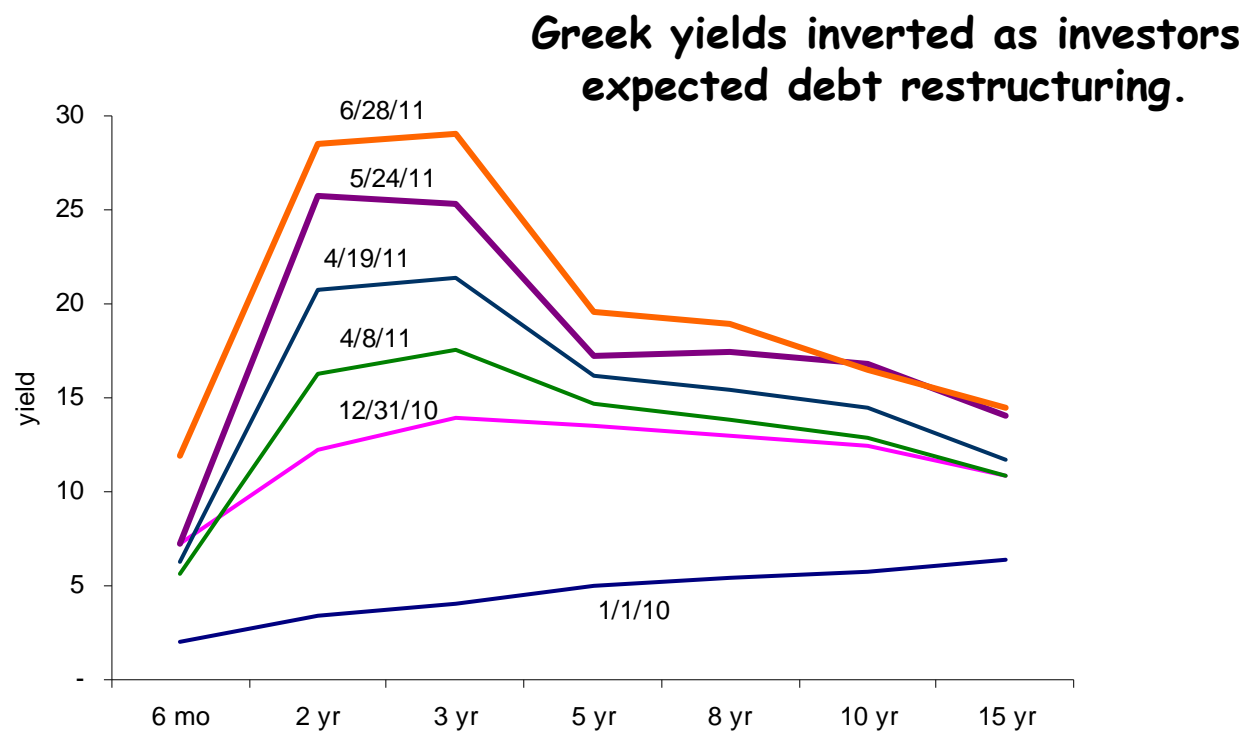
(last obs. June 29, 2011)



Source: Bloomberg; Encima Global

Progression of Greek Yield Curve At Tipping Point

(last obs. June 28, 2011)

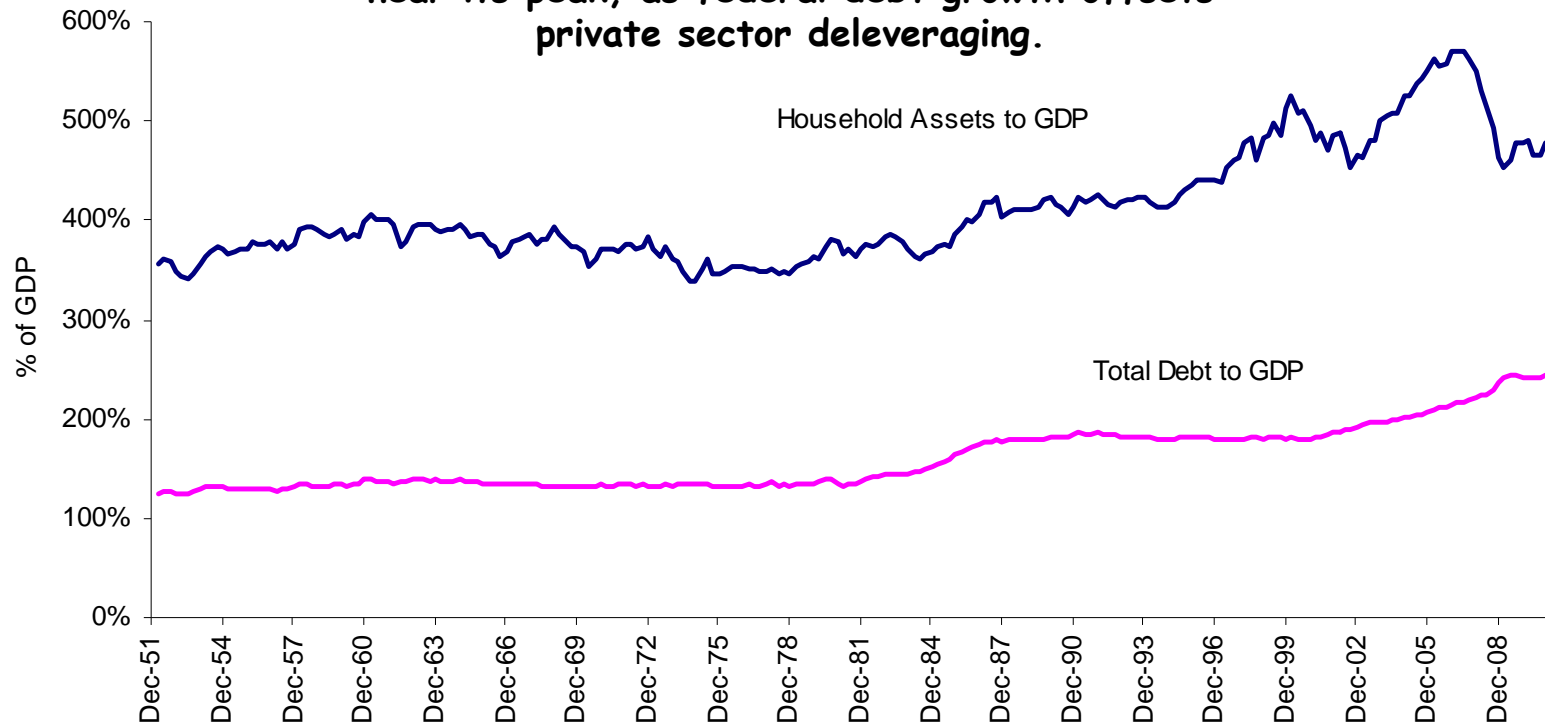


Source: Bloomberg; Encima Global

U.S. Household Assets \$72 Trillion; Total Debt \$36T

(last obs. Q1 2011)

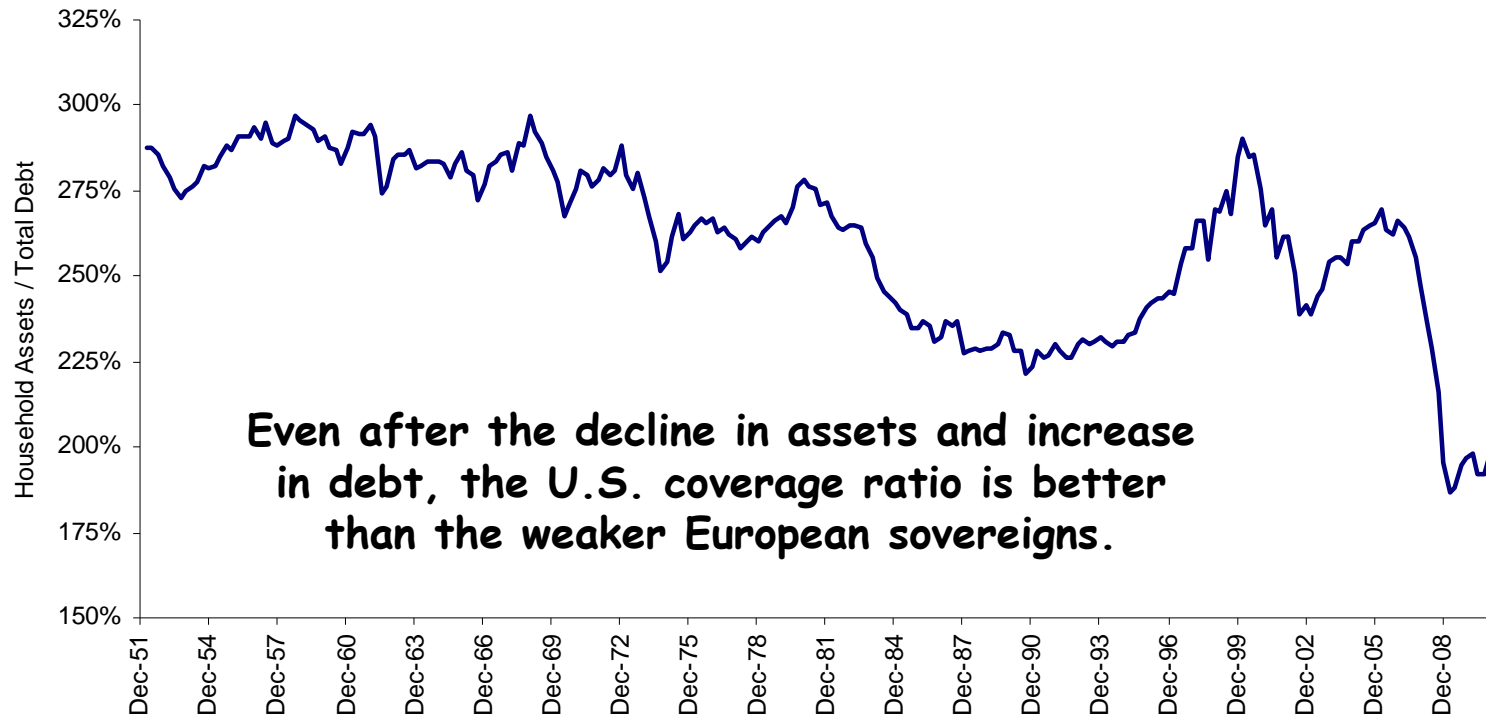
U.S. nonfinancial debt stands at 240% of GDP, near its peak, as federal debt growth offsets private sector deleveraging.



Source: Federal Reserve; BEA; Encima Global

Household Assets / Total Debt

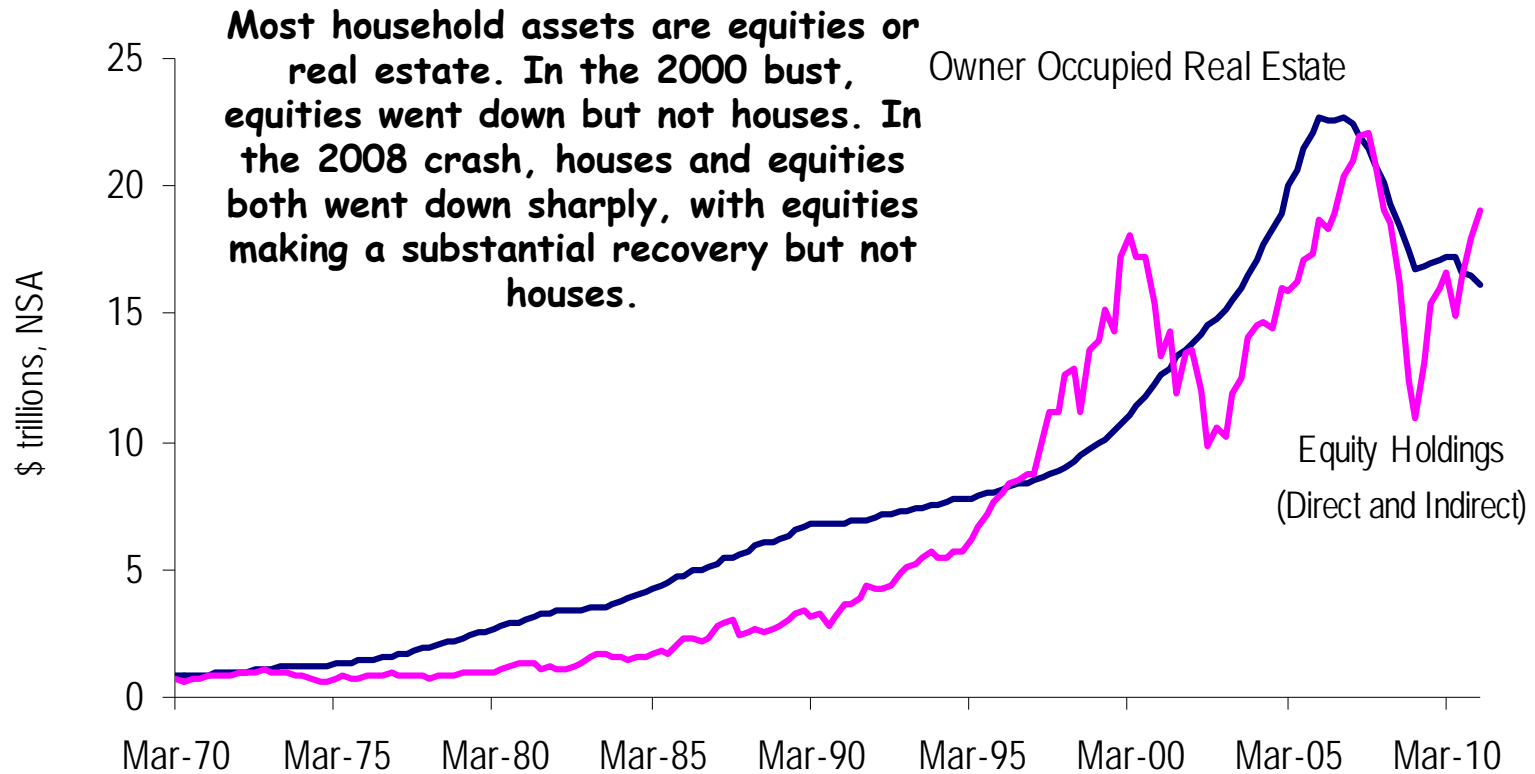
(last obs. Q1 2011)



Source: Federal Reserve: Flow of Funds; Encima Global

Equity Market Holdings and Owner Occupied Real Estate

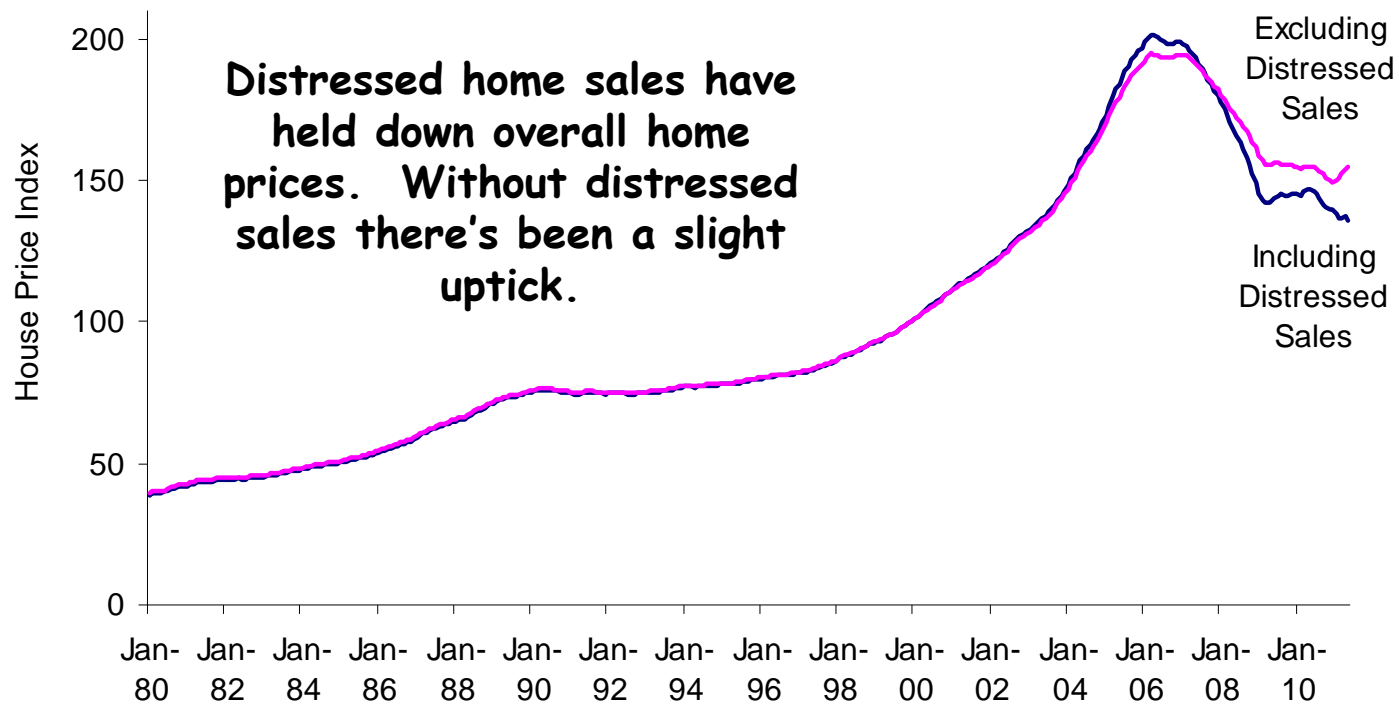
(last obs. Q1 2011)



Source: Federal Reserve: Flow of Funds; Encima Global

CoreLogic Home Price Indexes

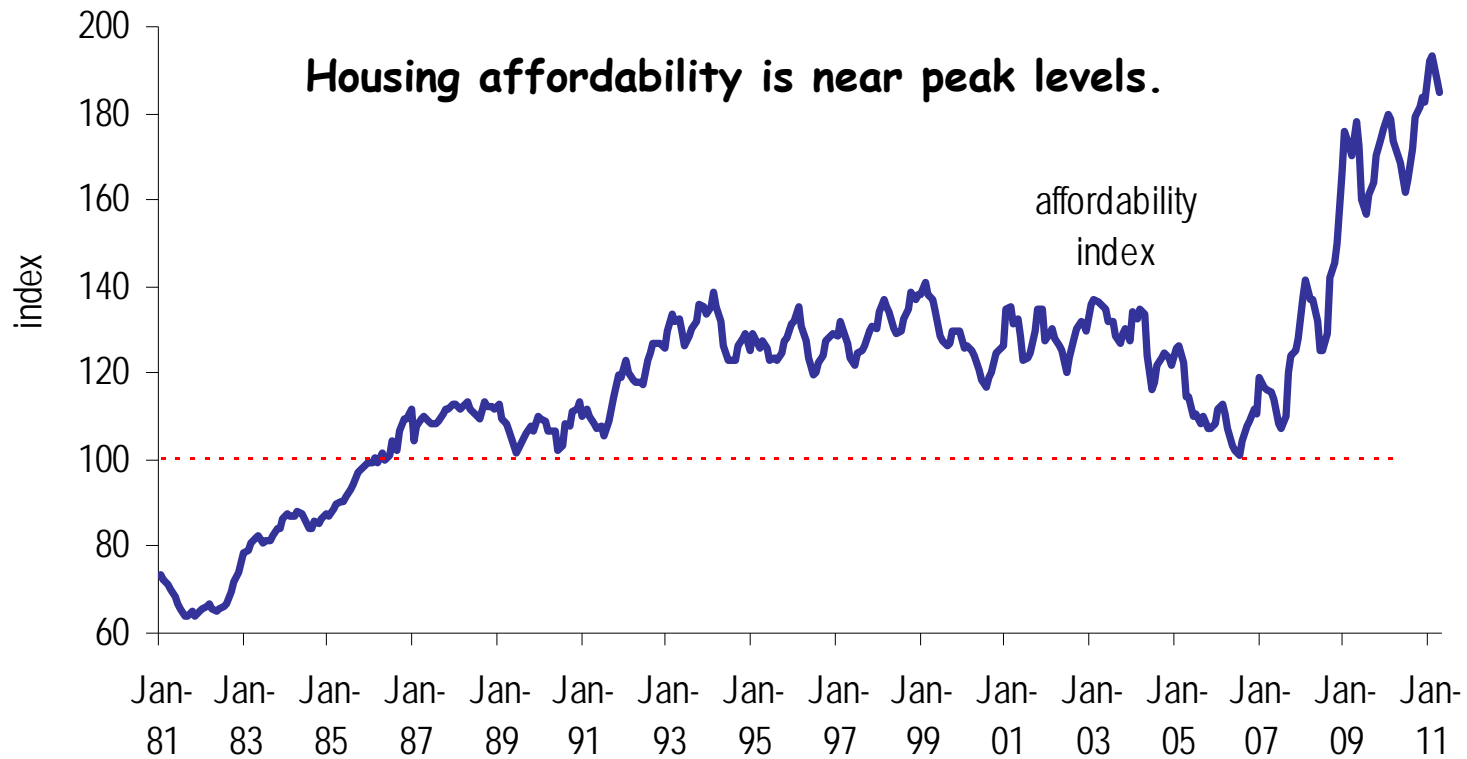
(last obs. May 2011)



Source: CoreLogic; Haver; Encima Global

Home Affordability Index

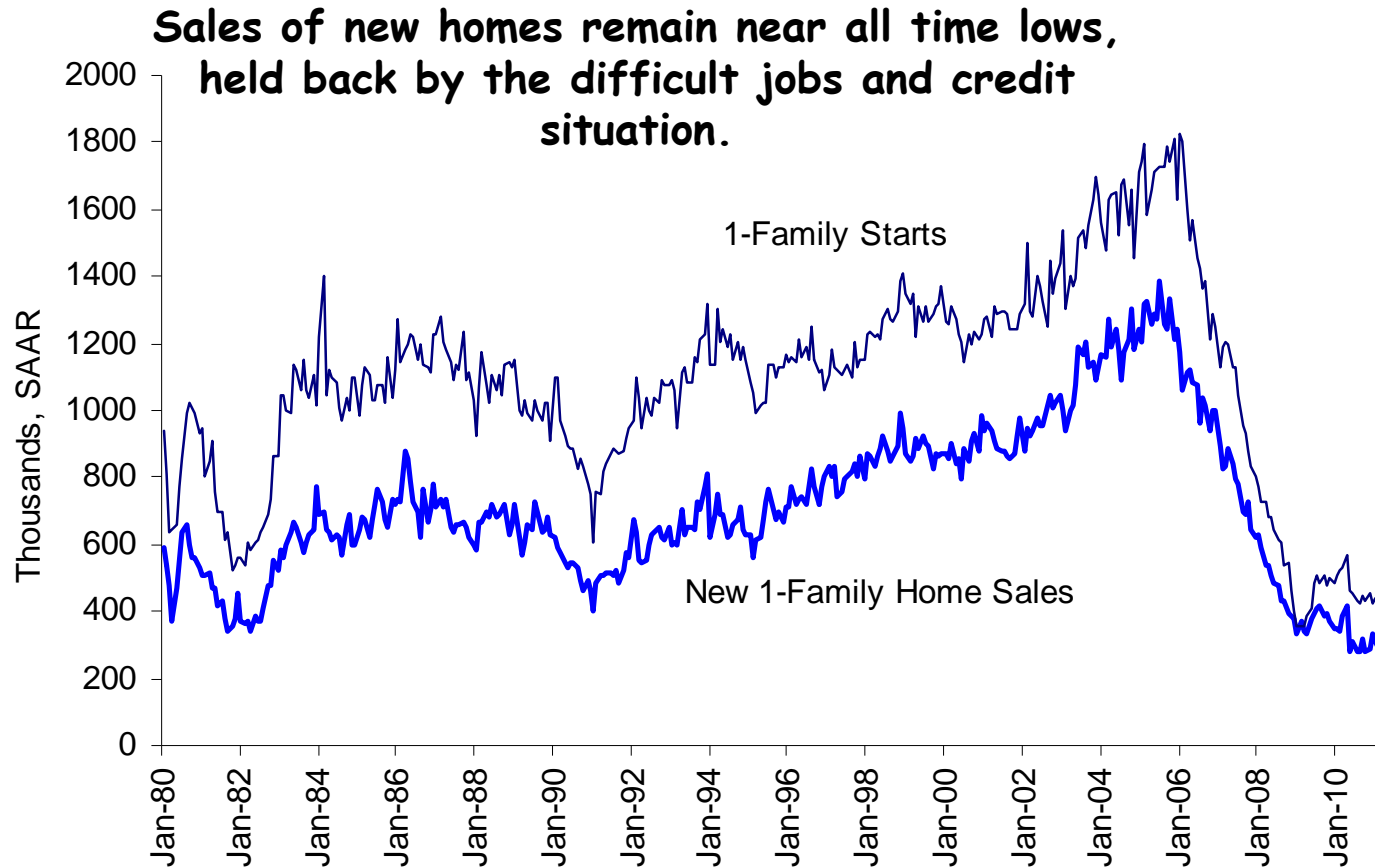
(last obs. April 2011)



Source: National Association of Realtors; Encima Global

Single Family Home Starts and Sales

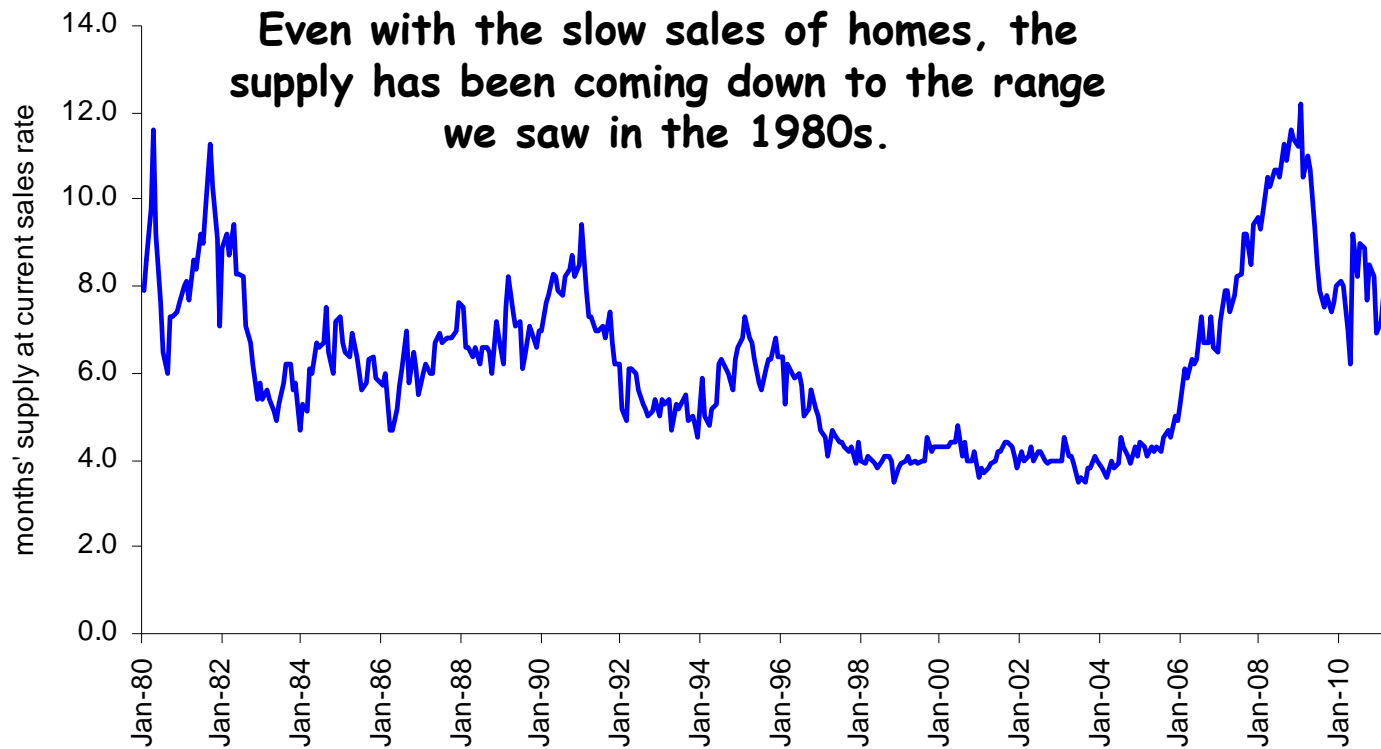
(last obs. May 2011)



Source: Bureau of Census; Encima Global

Months' Supply of New 1 Family Homes at Current Sales Rate

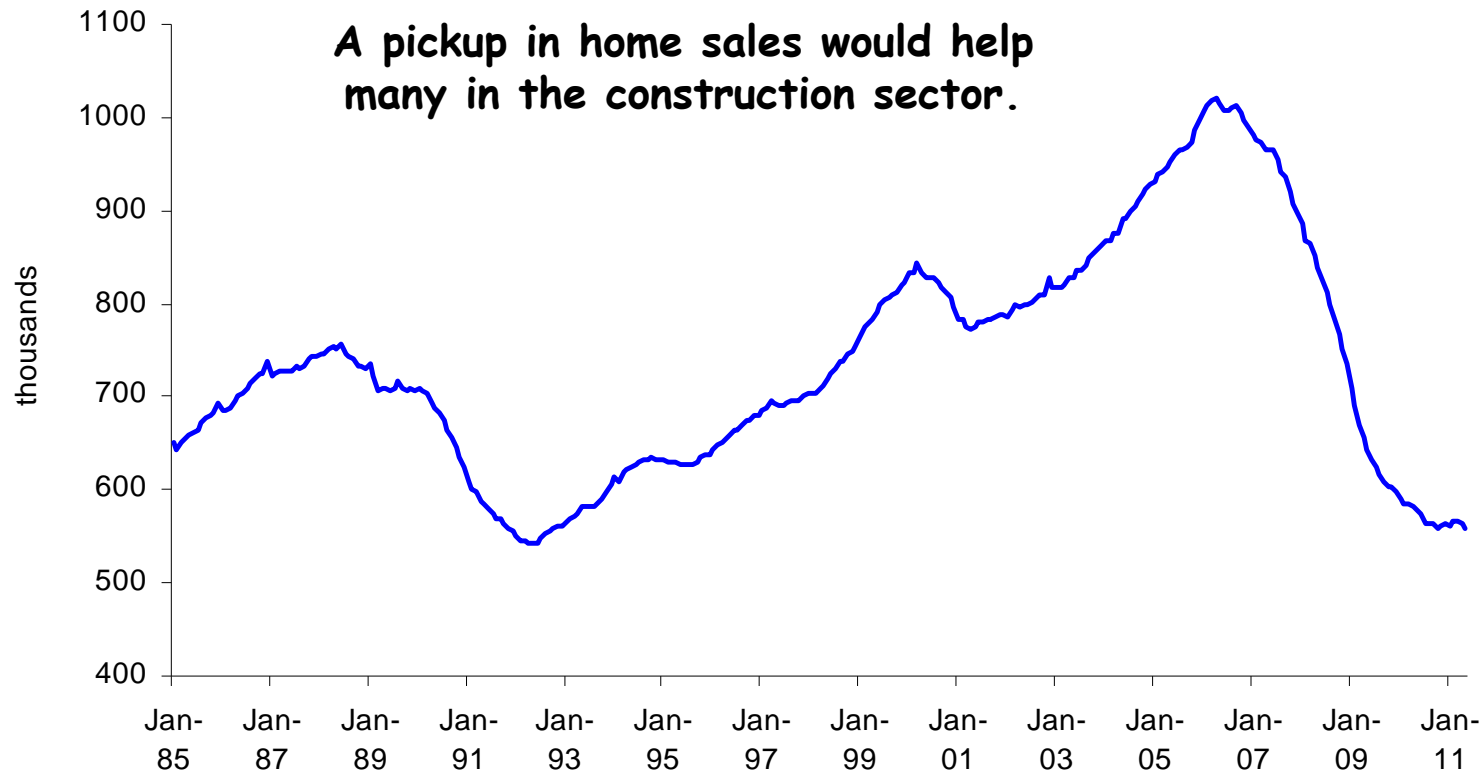
(last obs. May 2011)



Source: Census Bureau; Encima Global

Employees in Residential Construction

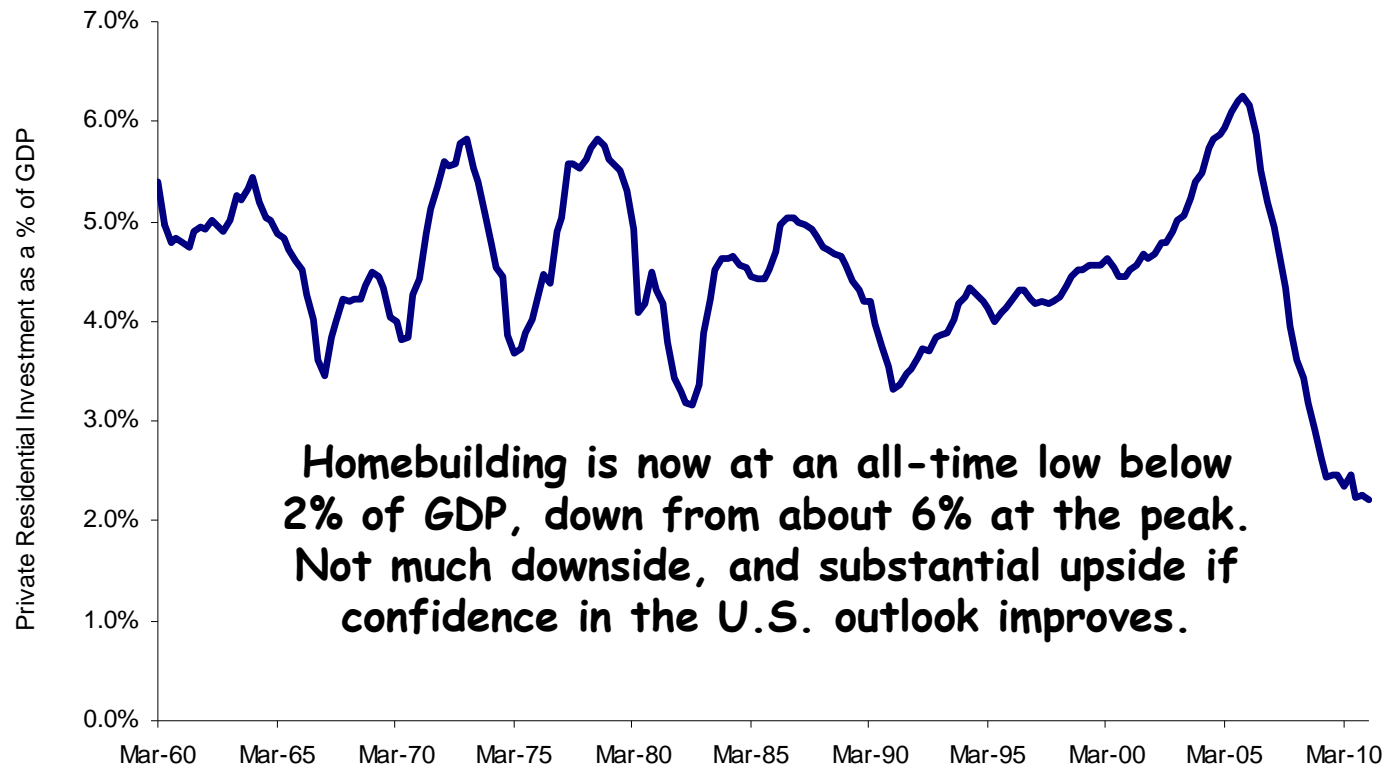
(last obs. May 2011)



Source: Bureau of Labor Statistics; Encima Global

Residential Investment as a % of GDP

(last obs. Q1 2011)



Source: Bureau of Economic Analysis; Encima Global

Mortgage Debt Holdings

(last obs. March 31, 2011)

	2011 Q1 (\$ trill)	2010 Q4 (\$ trill)	Yr/Yr % chg 2011 Q1
Total Mortgages	\$ 13.7	\$ 13.8	-3.0%
Commercial Banking	\$ 3.6	\$ 3.7	-5.6%
Government Sponsored Enterprises	\$ 5.1	\$ 5.0	-1.0%
consolidated mortgage trusts	\$ 4.3	\$ 4.2	-4.4%
Agency mortgage pools	\$ 1.2	\$ 1.1	21.1%
ABS Issuers	\$ 1.8	\$ 1.9	-12.6%
Other Financial Institutions	\$ 1.6	\$ 1.7	-5.2%
Other	\$ 0.4	\$ 0.4	-2.7%

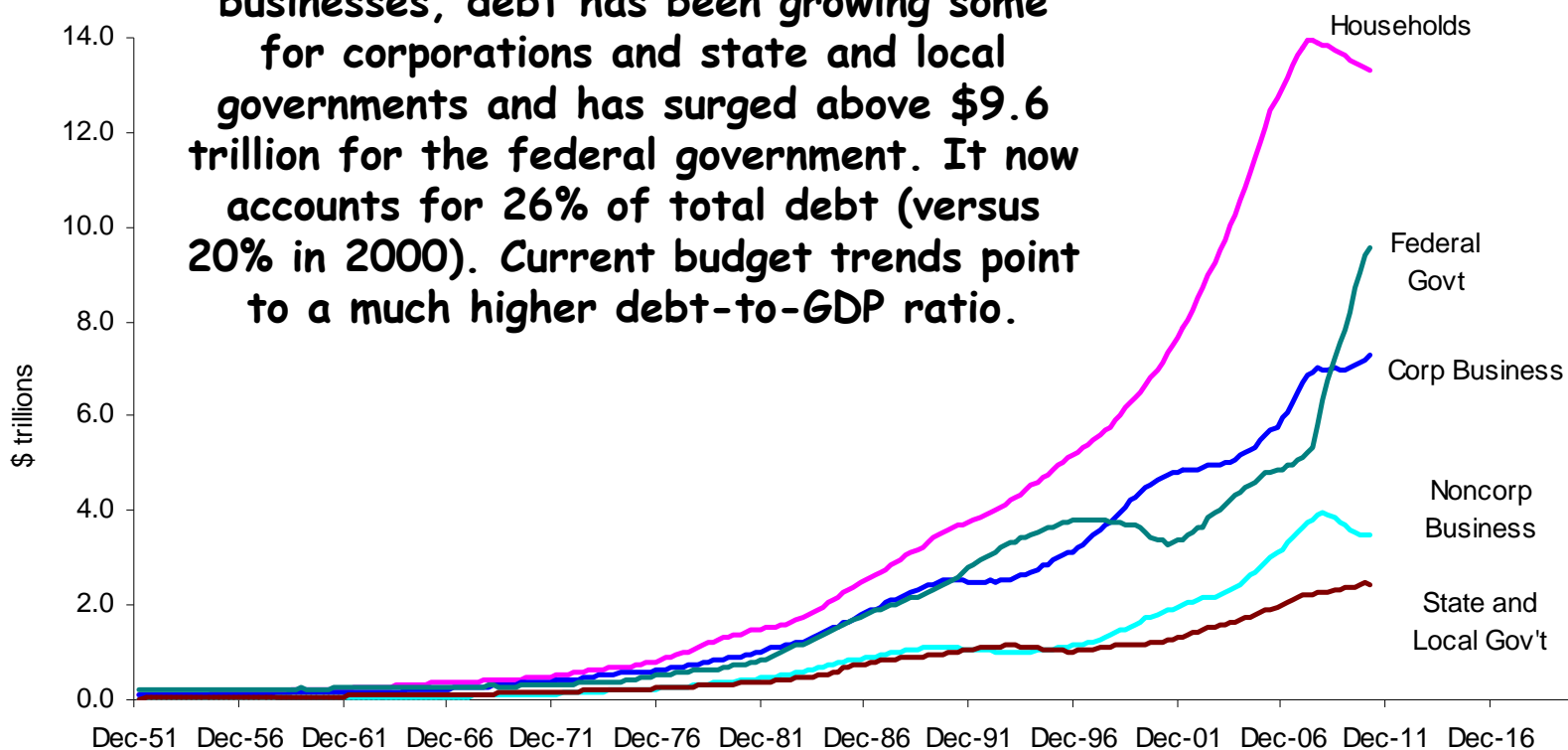
GSE consolidated trusts (conventional MBS) are the holders of about a third of all mortgage debt. Bank holdings have declined while Ginnie Mae mortgage pools grew 21% yoy.

Source: Federal Reserve: Flow of Funds; Encima Global

Sector Debt

(last obs. Q1 2011)

While debt levels have been declining some for households and unincorporated businesses, debt has been growing some for corporations and state and local governments and has surged above \$9.6 trillion for the federal government. It now accounts for 26% of total debt (versus 20% in 2000). Current budget trends point to a much higher debt-to-GDP ratio.



Source: Federal Reserve: Flow of Funds; Encima Global

Domestic Nonfinancial Debt

(last obs. March 31, 2011)

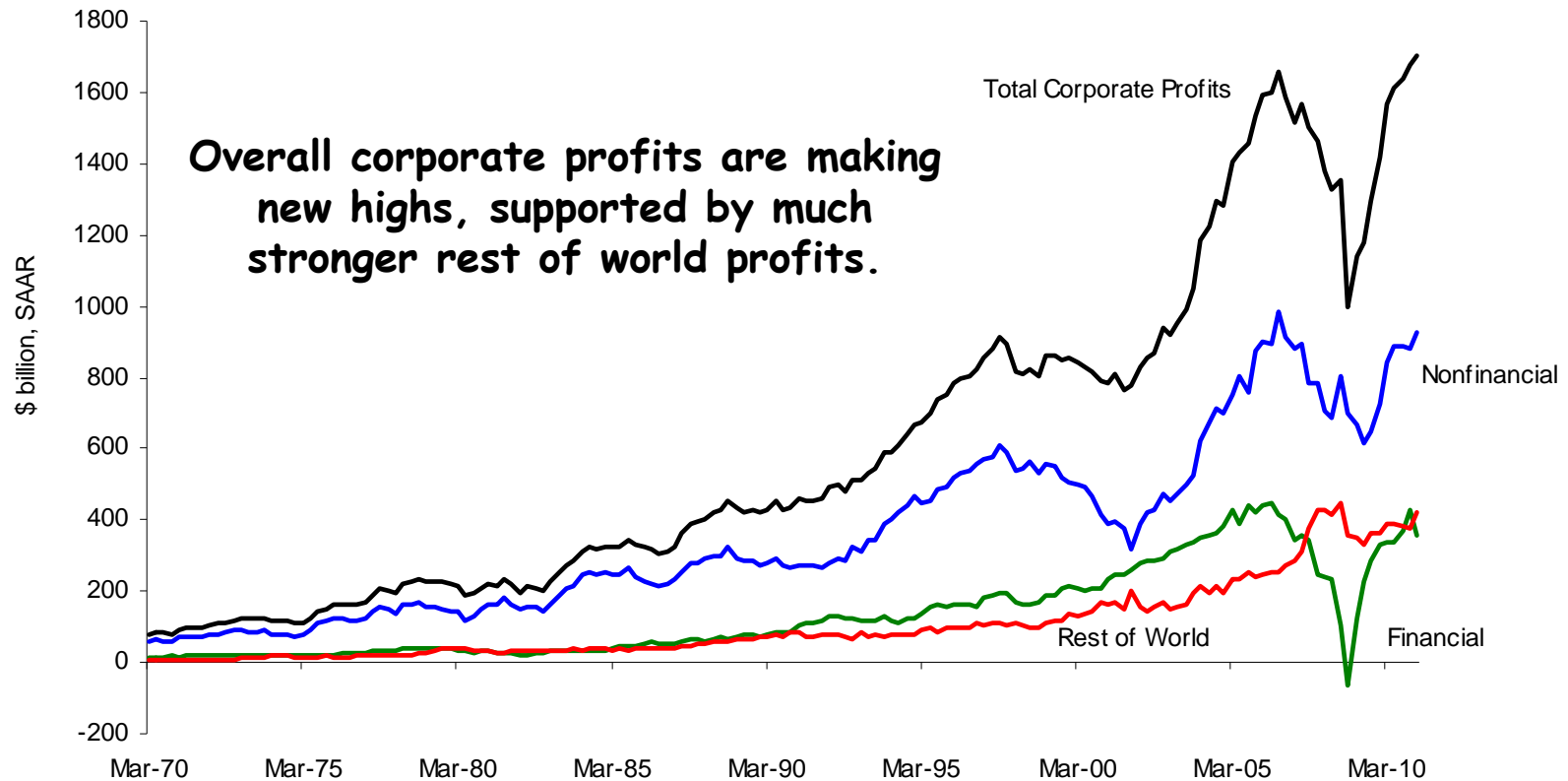
	2011 Q1	2010 Q4	Yr/Yr % chg	Yr/Yr % chg
	(\$ trill)	(\$ trill)	2011 Q1	2010 Q1
Domestic Nonfinancial Sectors	\$ 36.3	\$ 36.1	3.9%	2.9%
Households	\$ 13.3	\$ 13.4	-1.7%	-1.9%
Corporate Business	\$ 7.3	\$ 7.2	4.2%	0.3%
Noncorporate Business	\$ 3.5	\$ 3.5	-3.4%	-8.8%
State & Local Govts	\$ 2.4	\$ 2.5	2.2%	4.9%
Federal Government	\$ 9.6	\$ 9.4	16.5%	21.3%
of which Fed Holds	\$ 1.3	\$ 1.0	72.6%	57.8%
as of June \$1.54 trillion				
memo:				
Federal Govt Trust Funds	\$ 4.6			
of which Soc Sec	\$ 2.6			

Not counting government spending promises or future losses on GSEs

Source: Federal Reserve: Flow of Funds; Encima Global

Corporate Profits before Taxes with IVA & CCAdj

(last obs. Q1 2011)

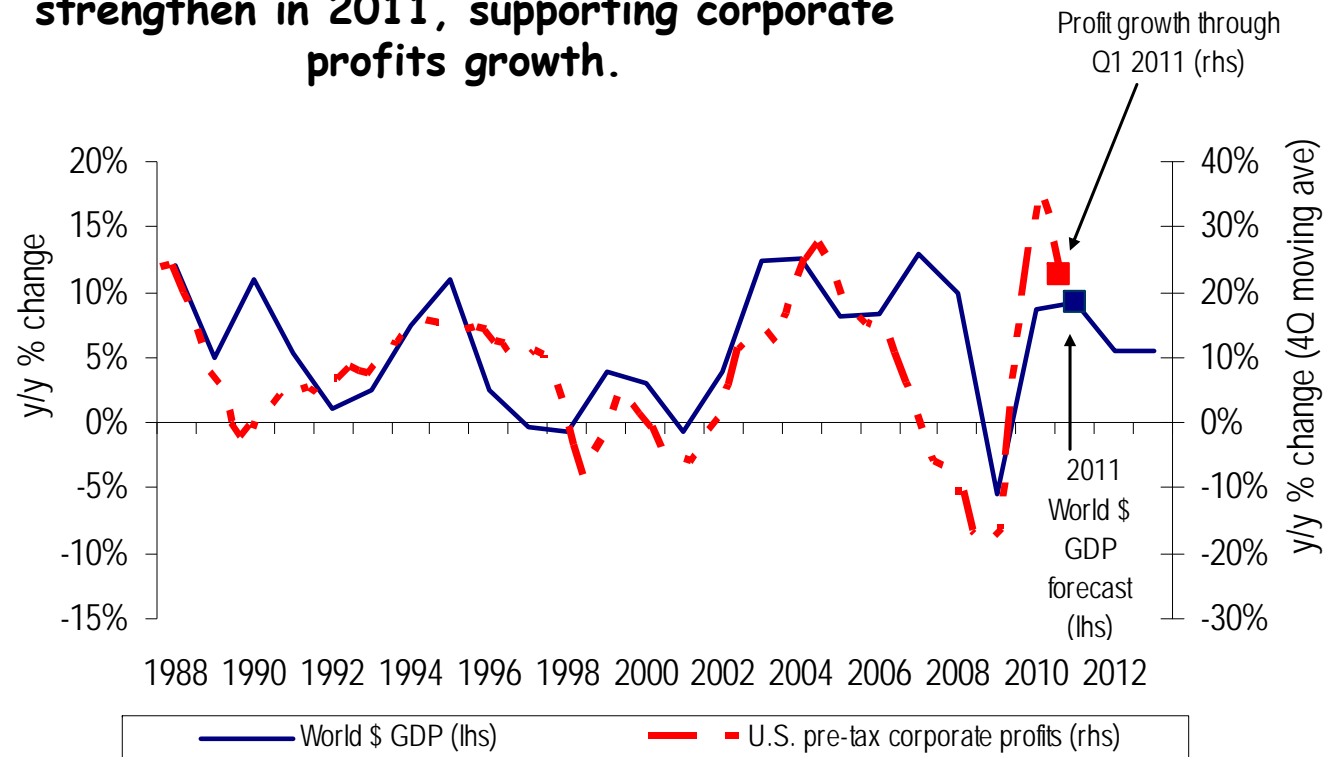


Source: Bureau of Economic Analysis; Encima Global

Corporate Profits Growth and World \$ GDP

(last obs. Q1 2011 for NIPA corporate profits, IMF forecasts for \$ GDP to 2013)

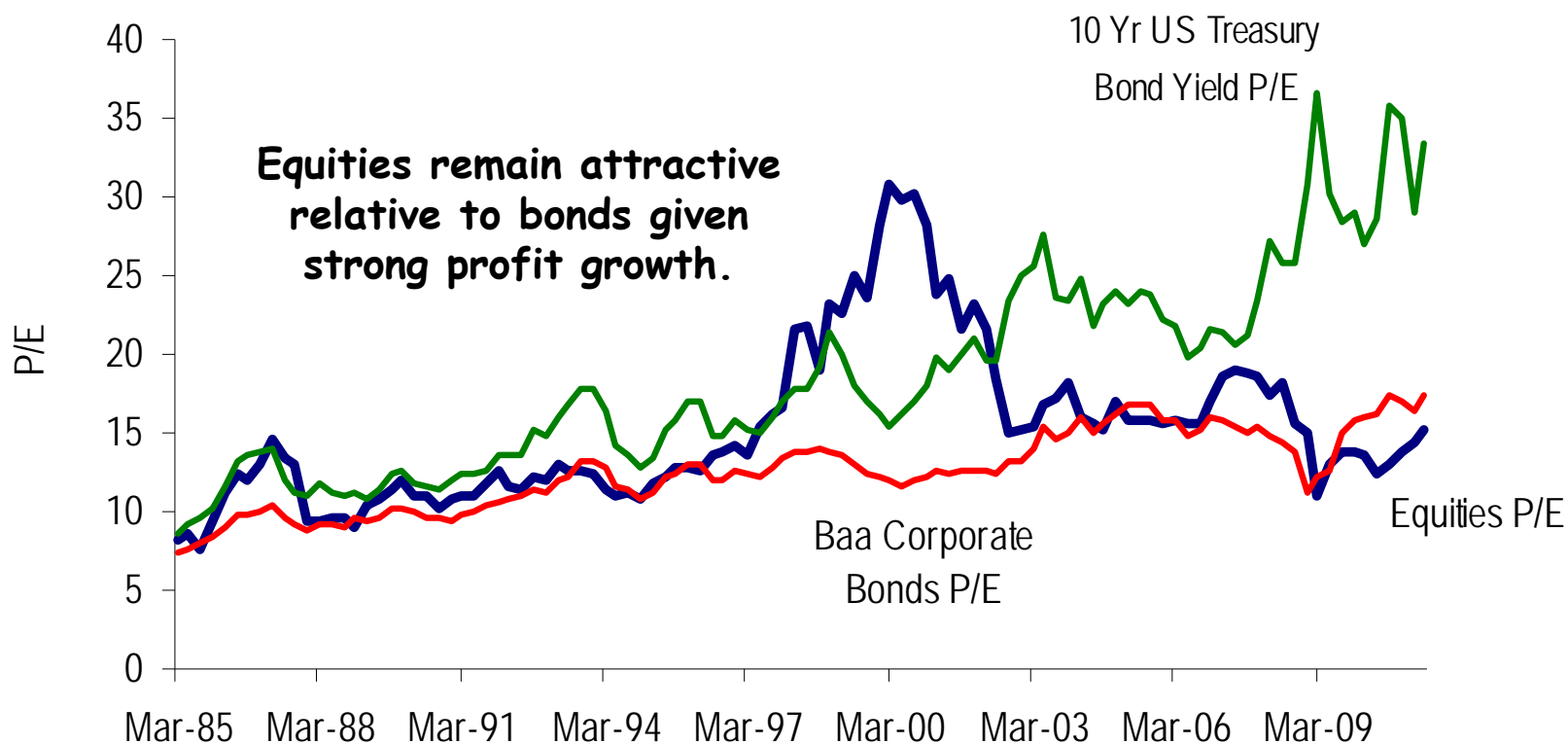
World \$ GDP forecast is expected to strengthen in 2011, supporting corporate profits growth.



Source: Bureau of Economic Analysis; IMF; Encima Global

Based on P/E, Equities Attractive Relative to Bonds

(last obs. Q1 2011, estimated Q2 2011)



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



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