Economic Chartbook

November 2010

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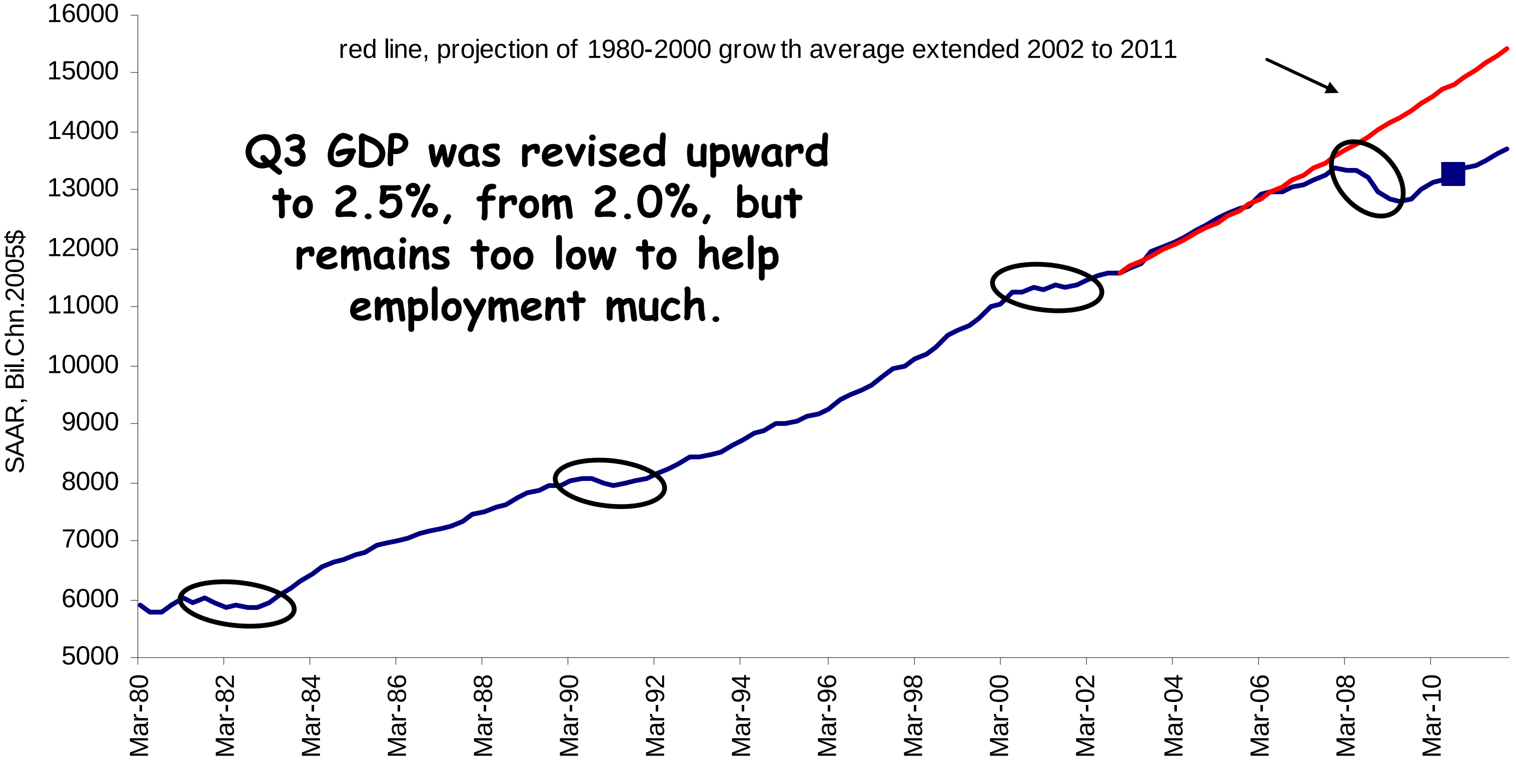
Please read the important disclosure information in the Addendum section of this presentation.

Sustainable Expansion, But Tax Hike Would Hurt

- **We expect 3.5% real GDP in the fourth quarter, helped by pent-up demand, a gradual improvement in the labor market, foreign growth and idle cash.**
- **Structural head winds remain – the massive transfer of capital and know-how abroad; Washington's regulatory crunch on small banks and small businesses; rising prices for manufacturers; and the burden from complex, changing regulations in health care, environment, financial services and labor.**
- **The key variable is the looming U.S. tax increase, which is so large it would slow the global growth outlook. Congressional procedures and animosity make it hard to fix by the Christmas deadline.**

Real GDP

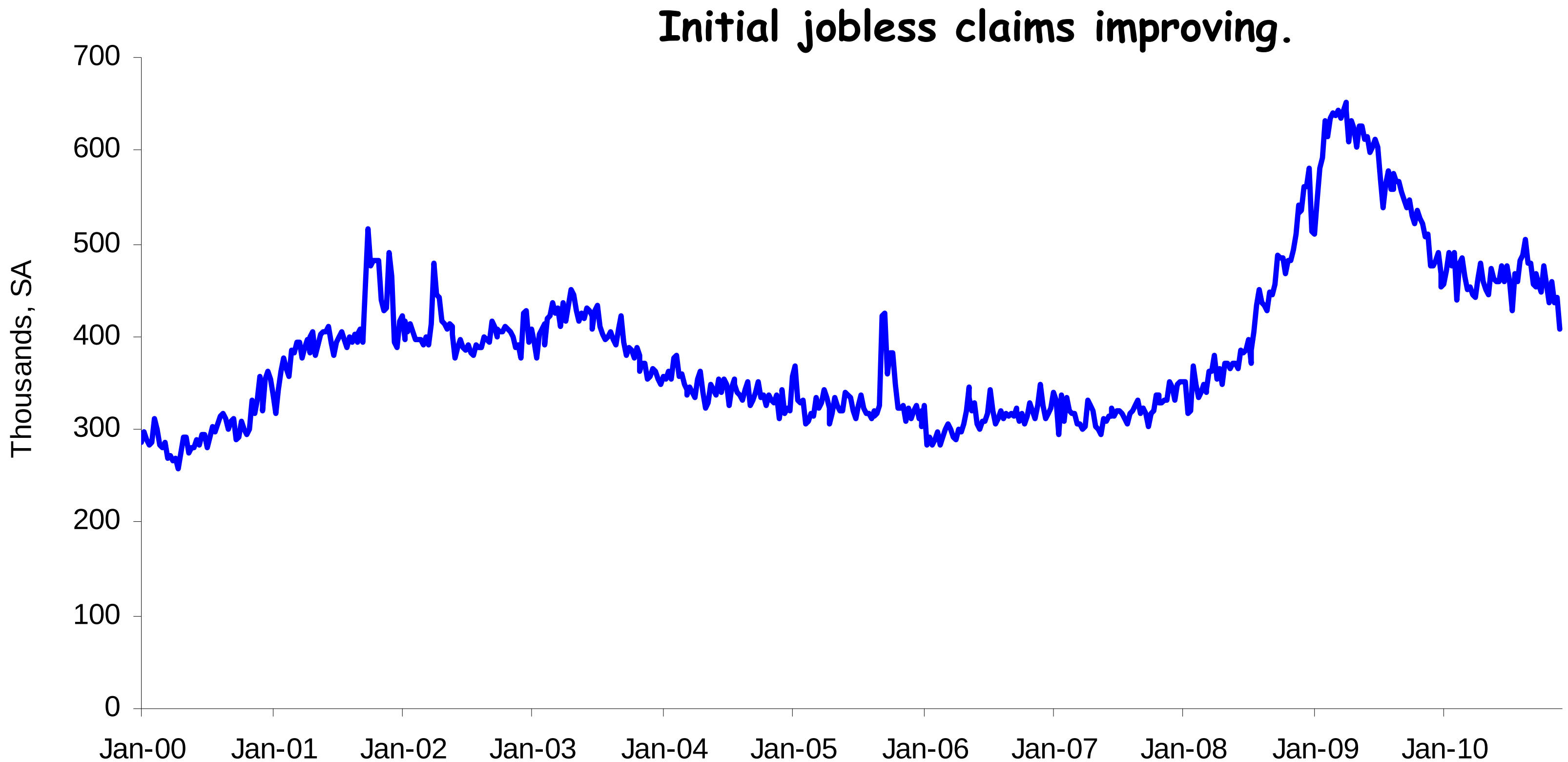
(last obs. blue square Q3 2010, forecast to Q4 2011)



Source: Bureau of Economic Analysis; Encima Global

Initial Unemployment Claims

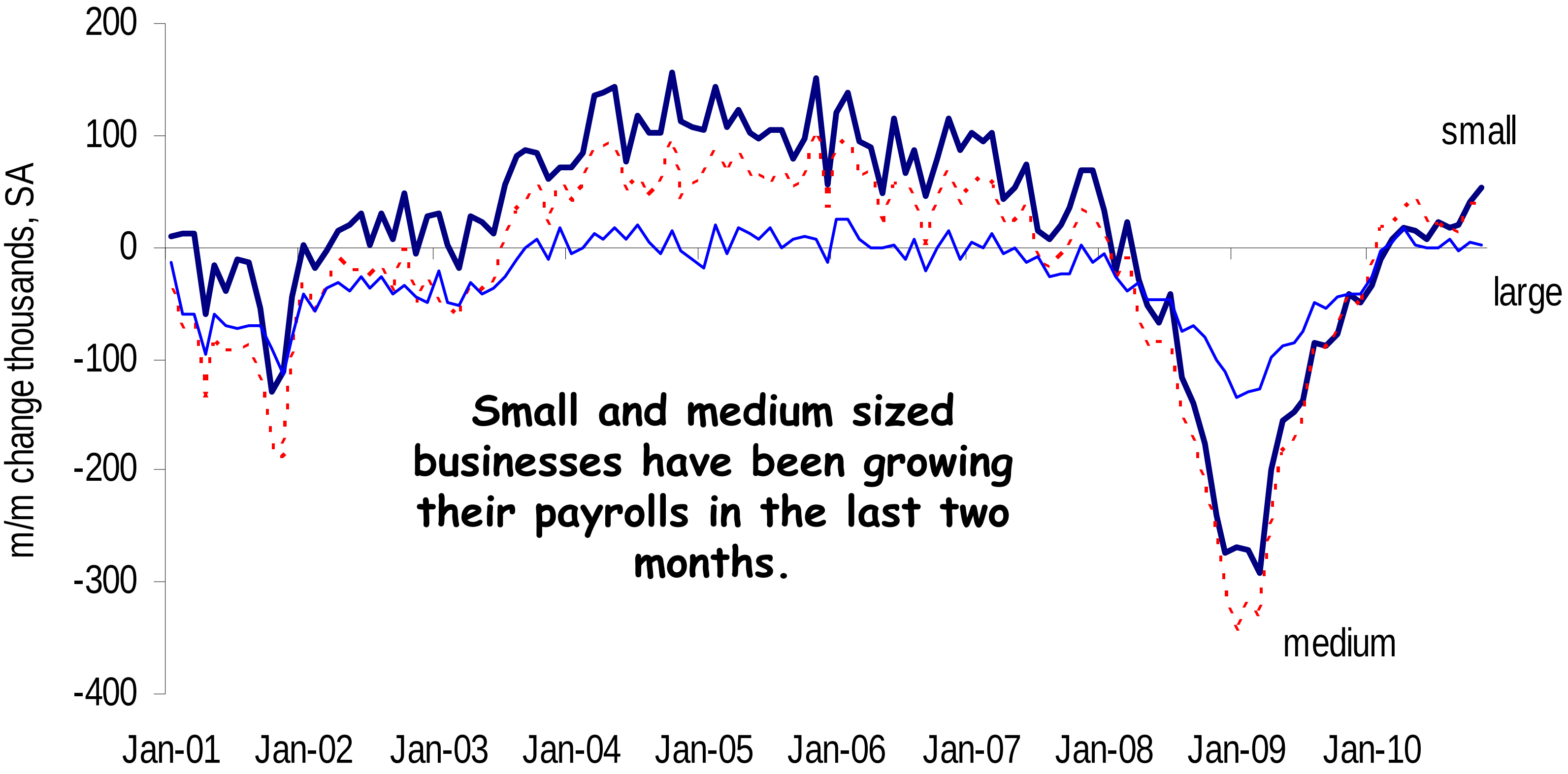
(last obs. November 20, 2010)



Source: Bureau of Labor Statistics; Encima Global

ADP Payroll Employment by Company Size

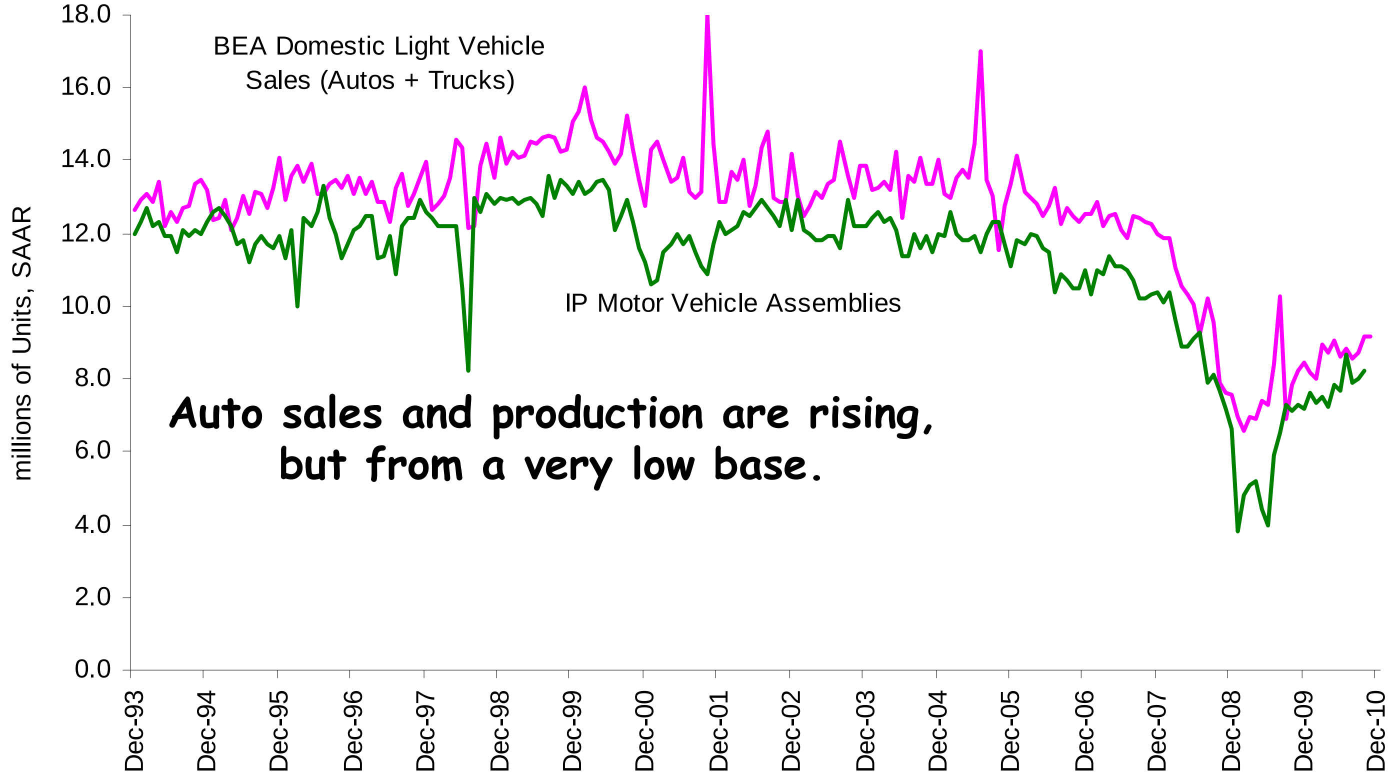
(m/m change, last obs. November 2010)



Source: ADP; Encima Global

Auto Sales and Production Below Replacement Rate

(last obs. sales November 2010; production October 2010)

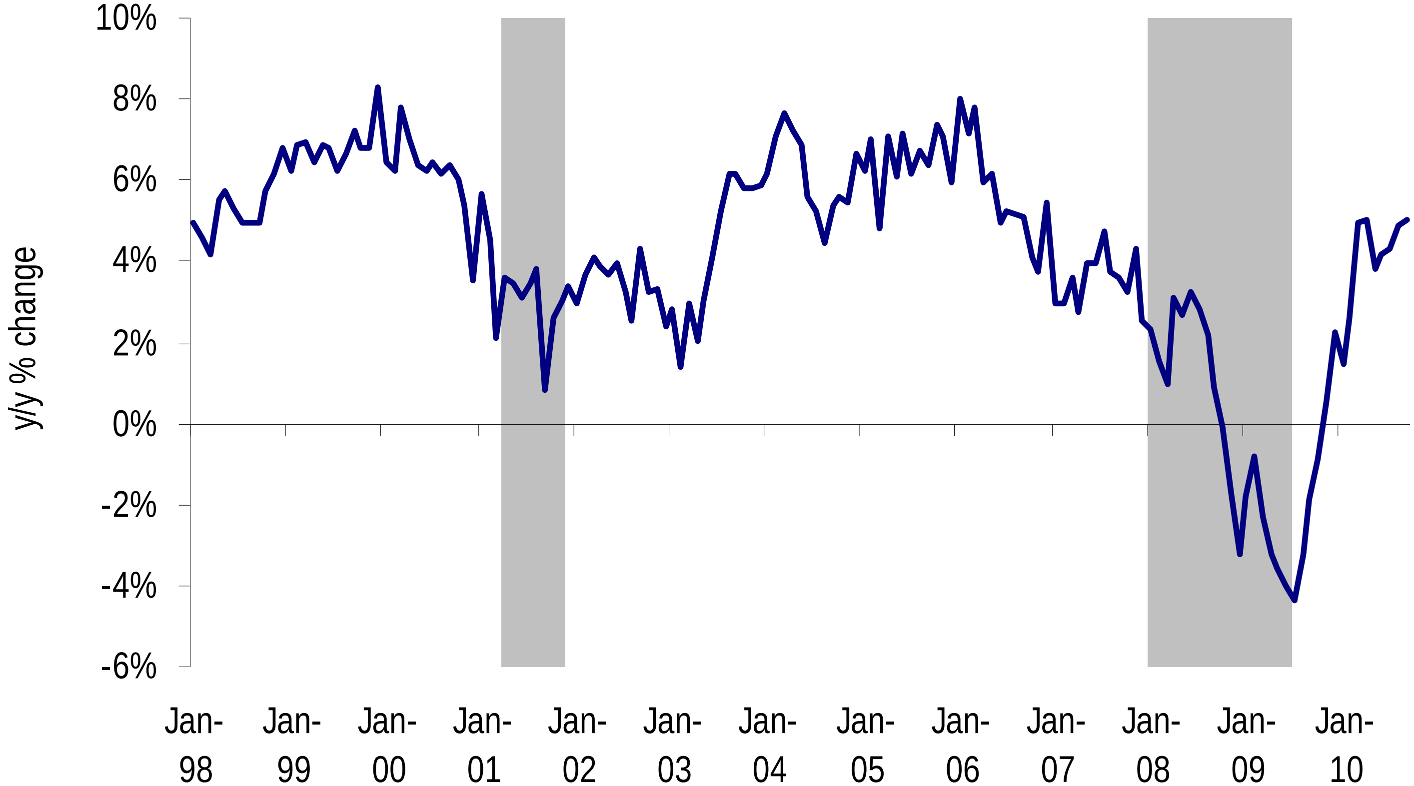


Source: Federal Reserve; Bureau of Economic Analysis; Encima Global

Retail Sales ex Autos and Gas Y/Y

(last obs. October 2010)

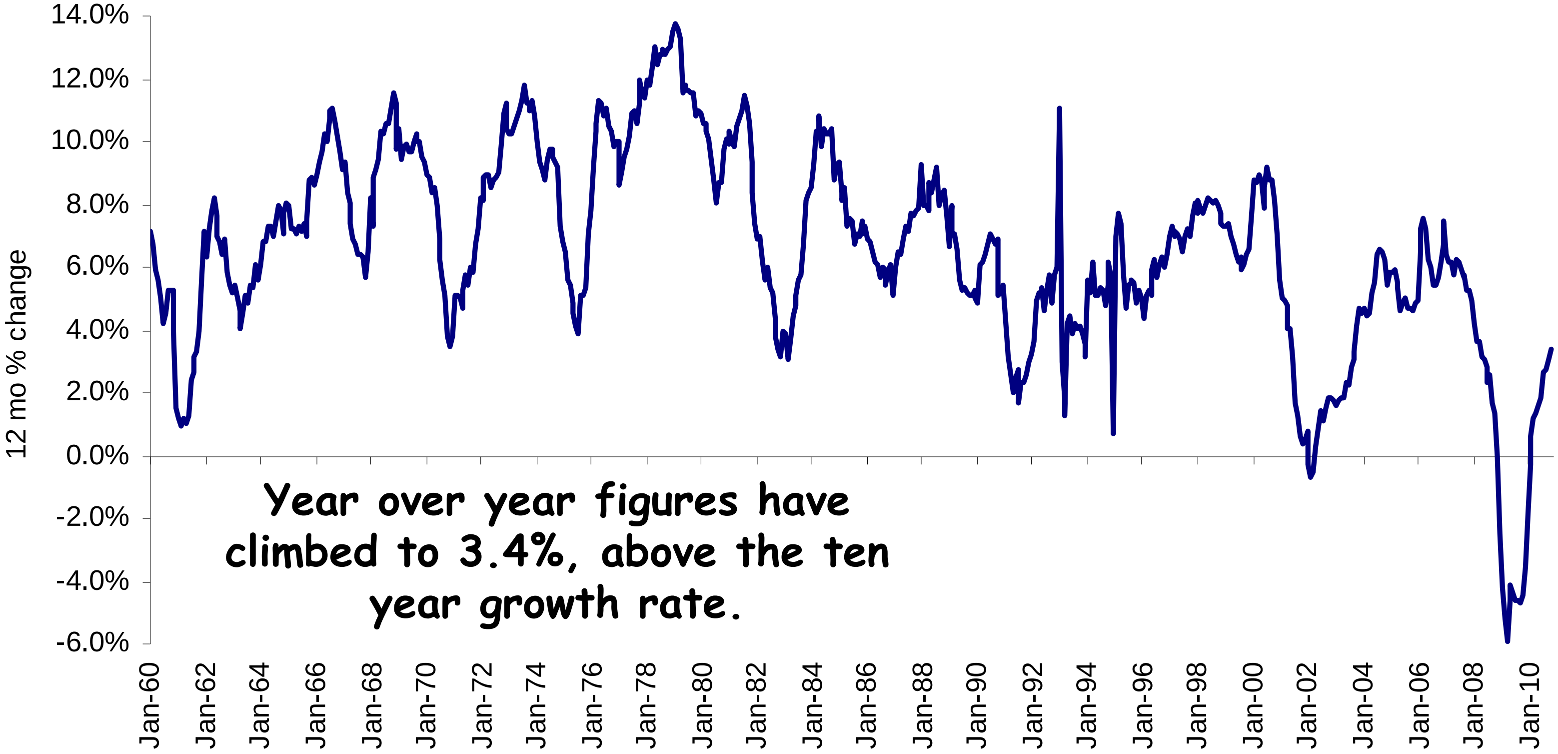
Sales growth has stabilized at a lower than normal recovery level. Given the '08 drop, pent-up demand should add to growth, but US consumers will play less of a role in the world economy than in the '82-'07 period.



Source: Bureau of Census; Encima Global

Wages and Salaries Y/Y

(last obs. October 2010)

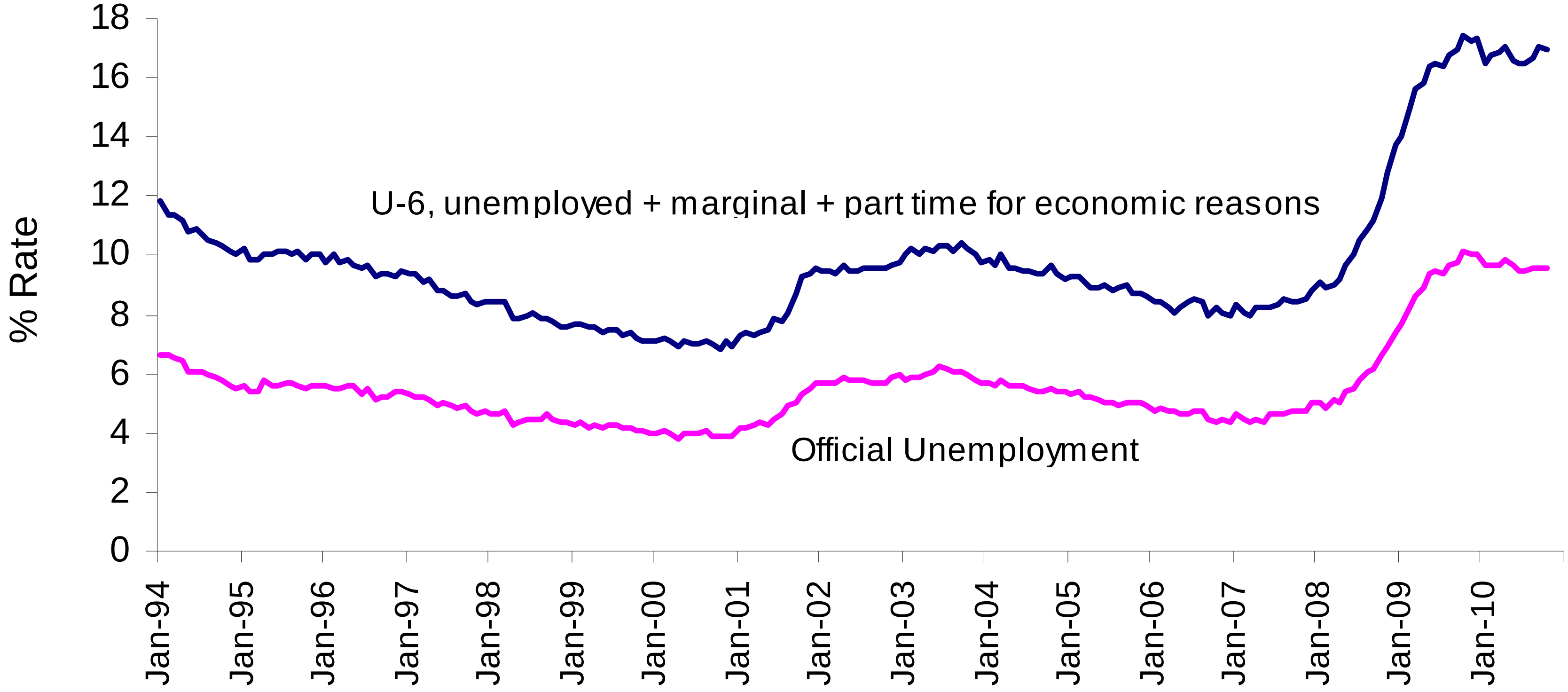


Source: Bureau of Economic Analysis; Encima Global

Underemployment and Unemployment Remain High

(last obs. October 2010)

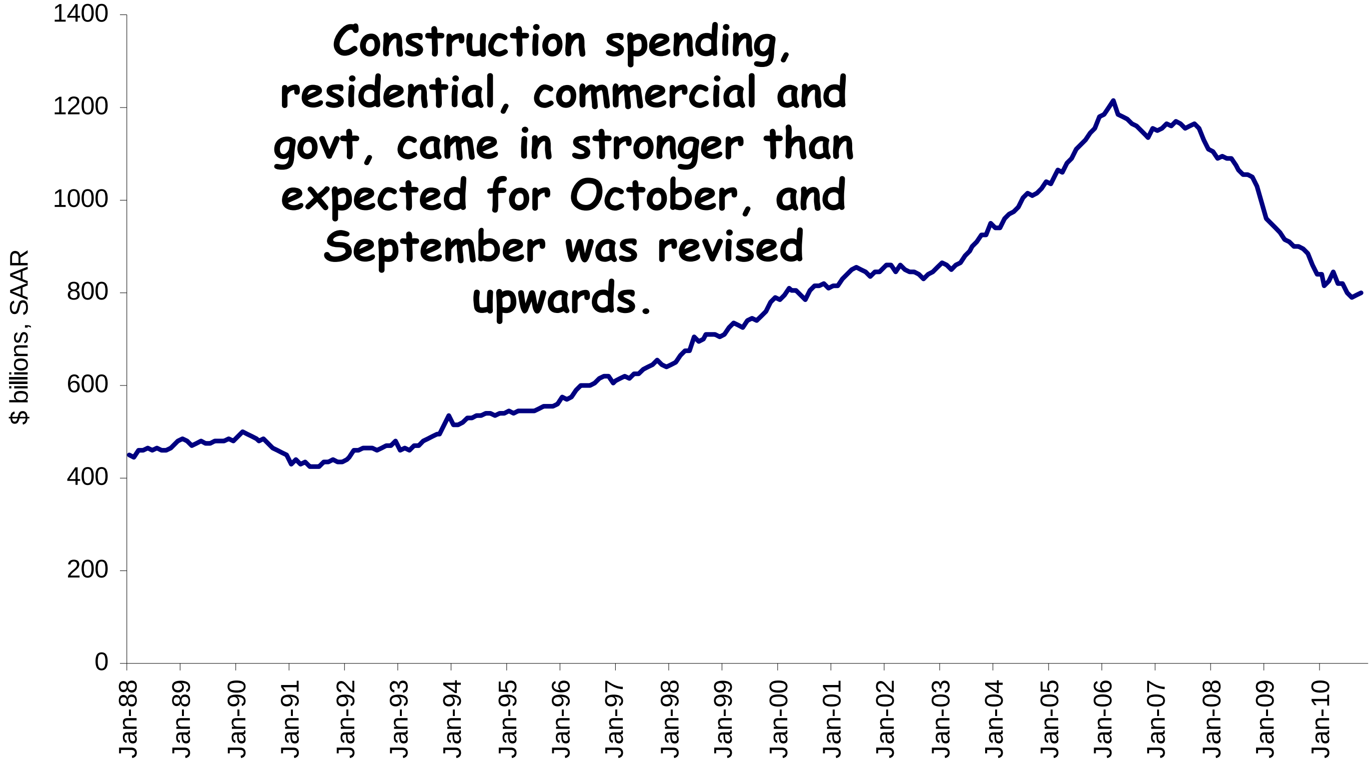
Both measures of labor utilization are elevated as the labor force waits for better times to look for a job.



Source: Bureau of Labor Statistics; Encima Global

Construction Spending

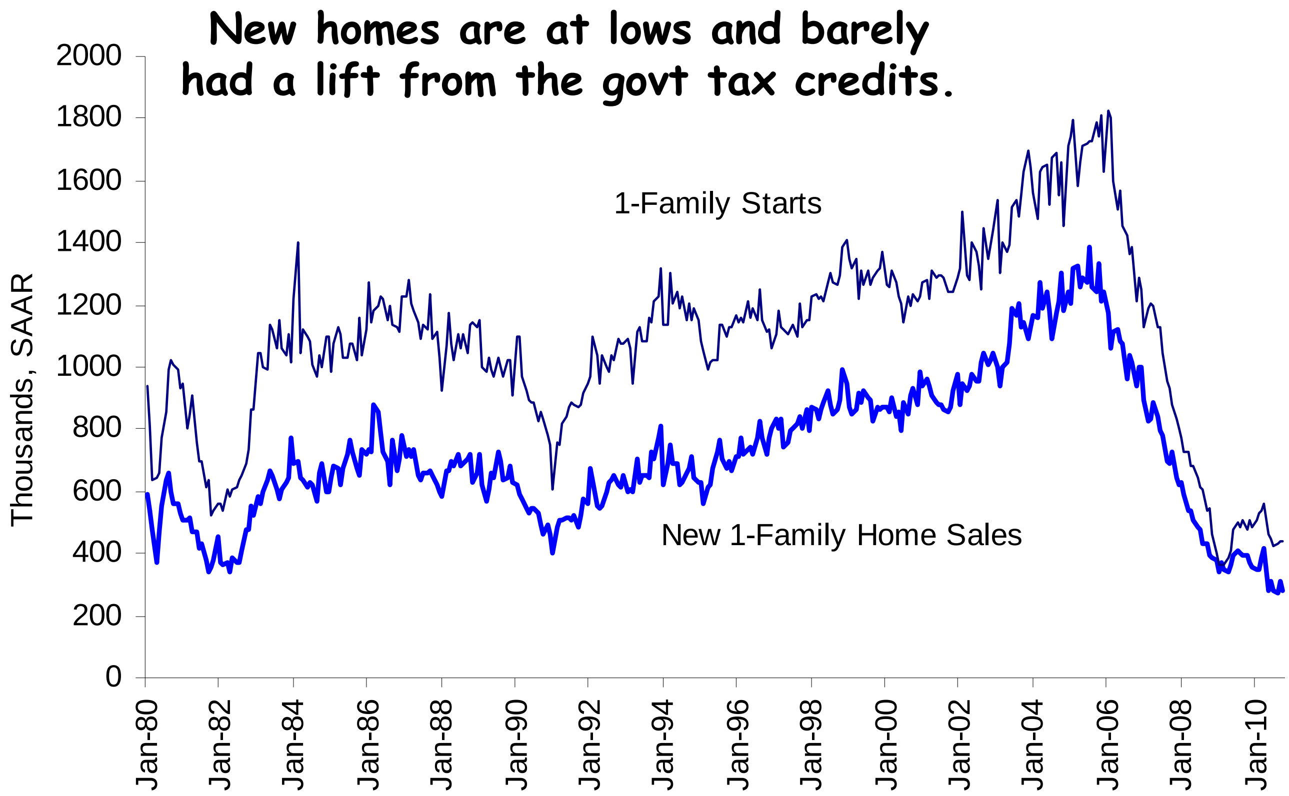
(last obs. October 2010)



Source: Census Bureau; Encima Global

New Single Family Home Sales and Starts

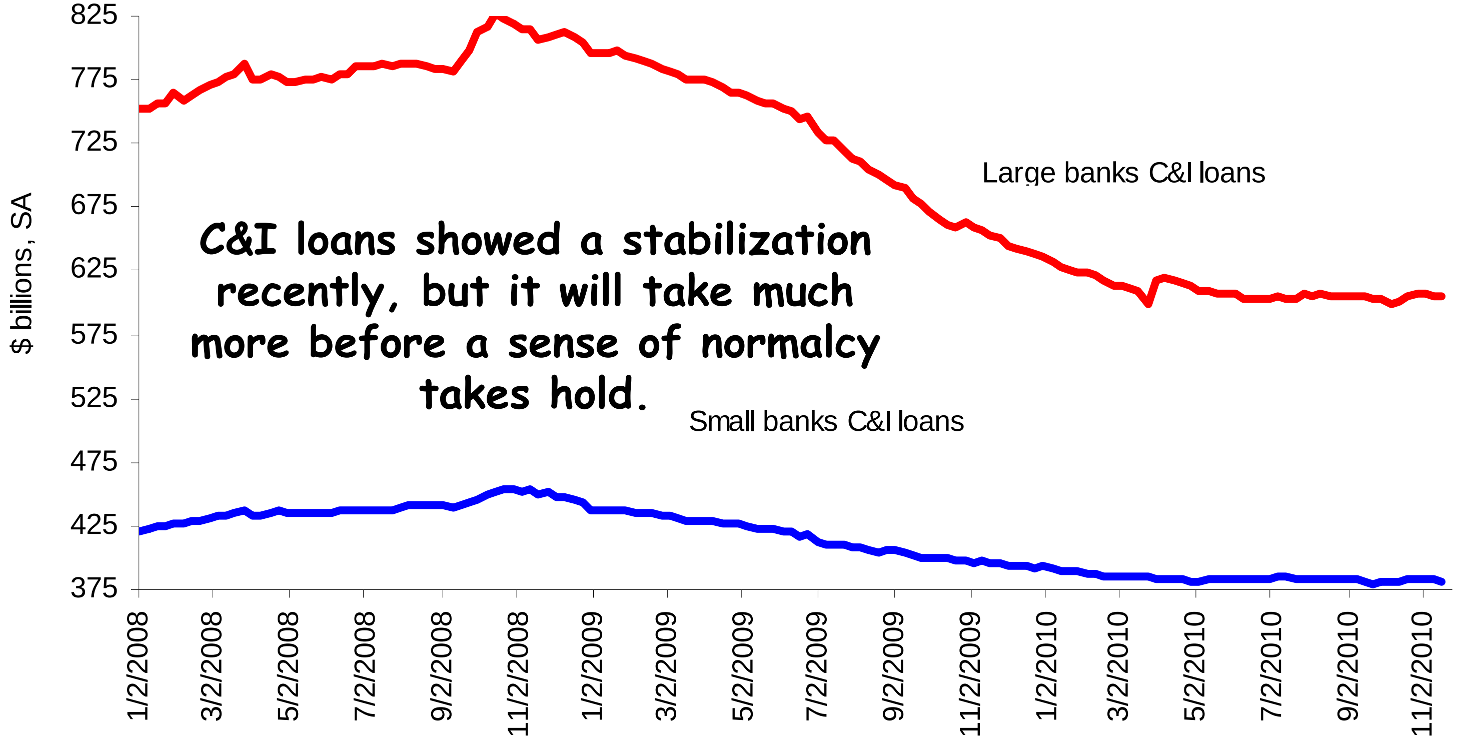
(last obs. October 2010)



Source: Census Bureau; Encima Global

Domestic Banks Commercial & Industrial Loans

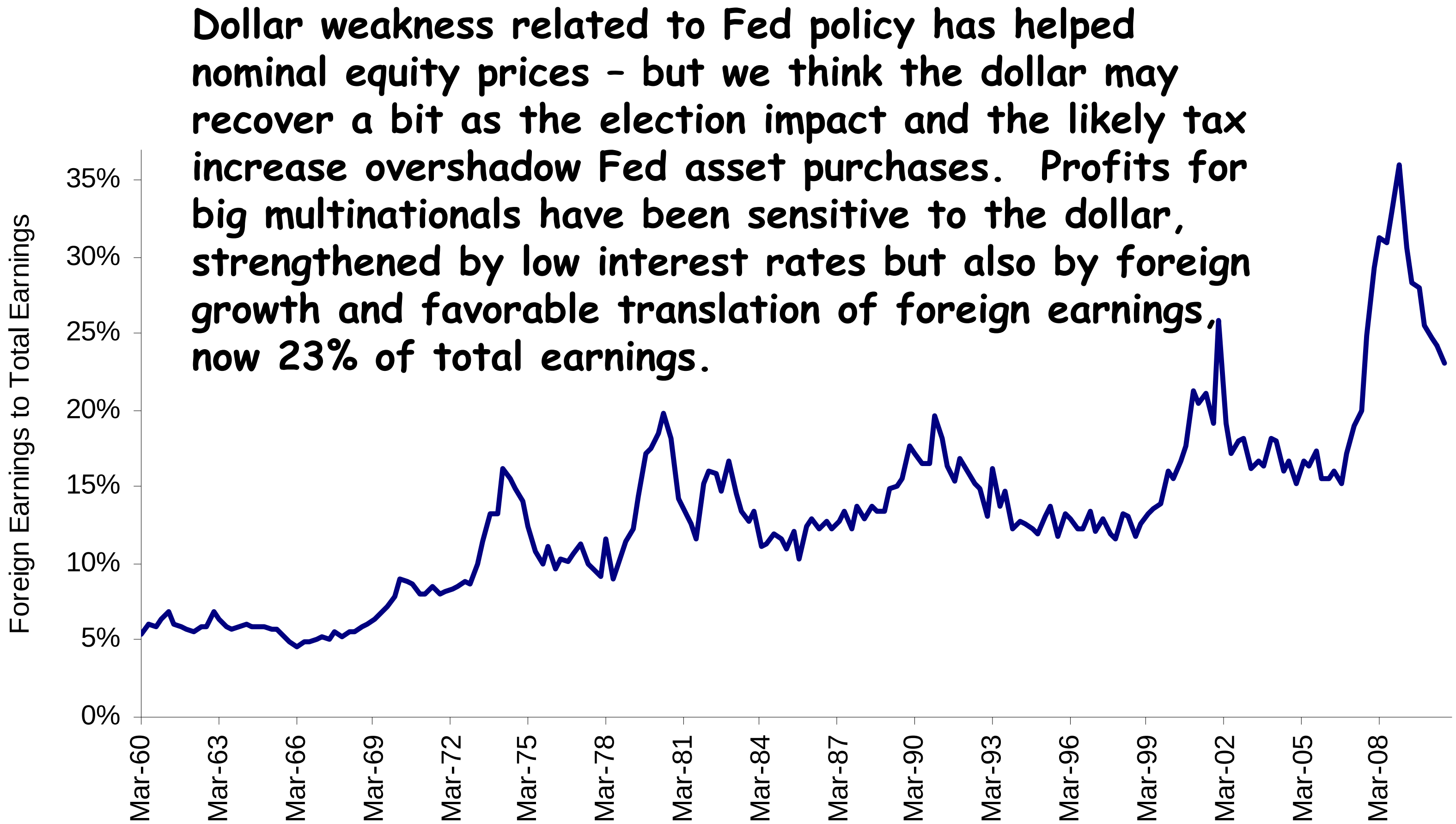
(last obs. November 17, 2010)



Source: Federal Reserve; Encima Global

Foreign Earnings to Total Earnings

(last obs. Q3 2010)

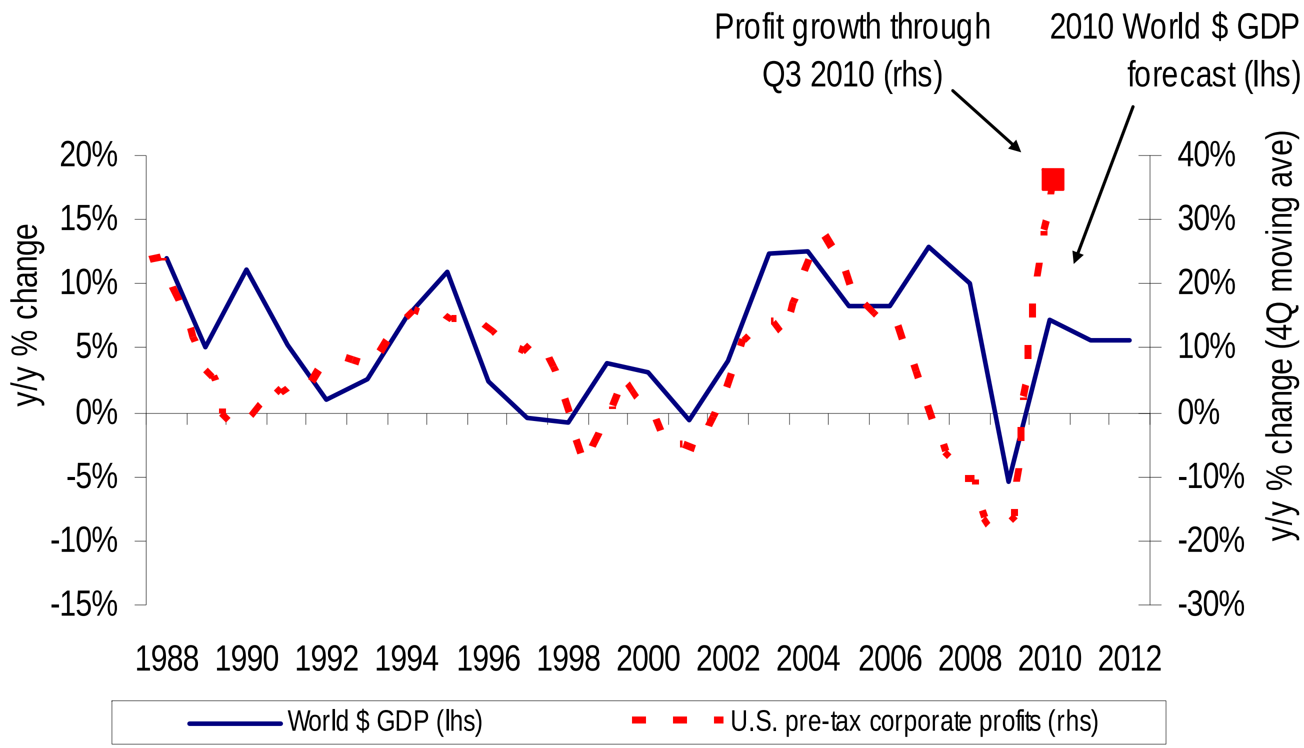


Source: Bureau of Economic Analysis; Encima Global

World Nominal $ GDP and US NIPA Corporate Profits

(last obs. Q3 2010)

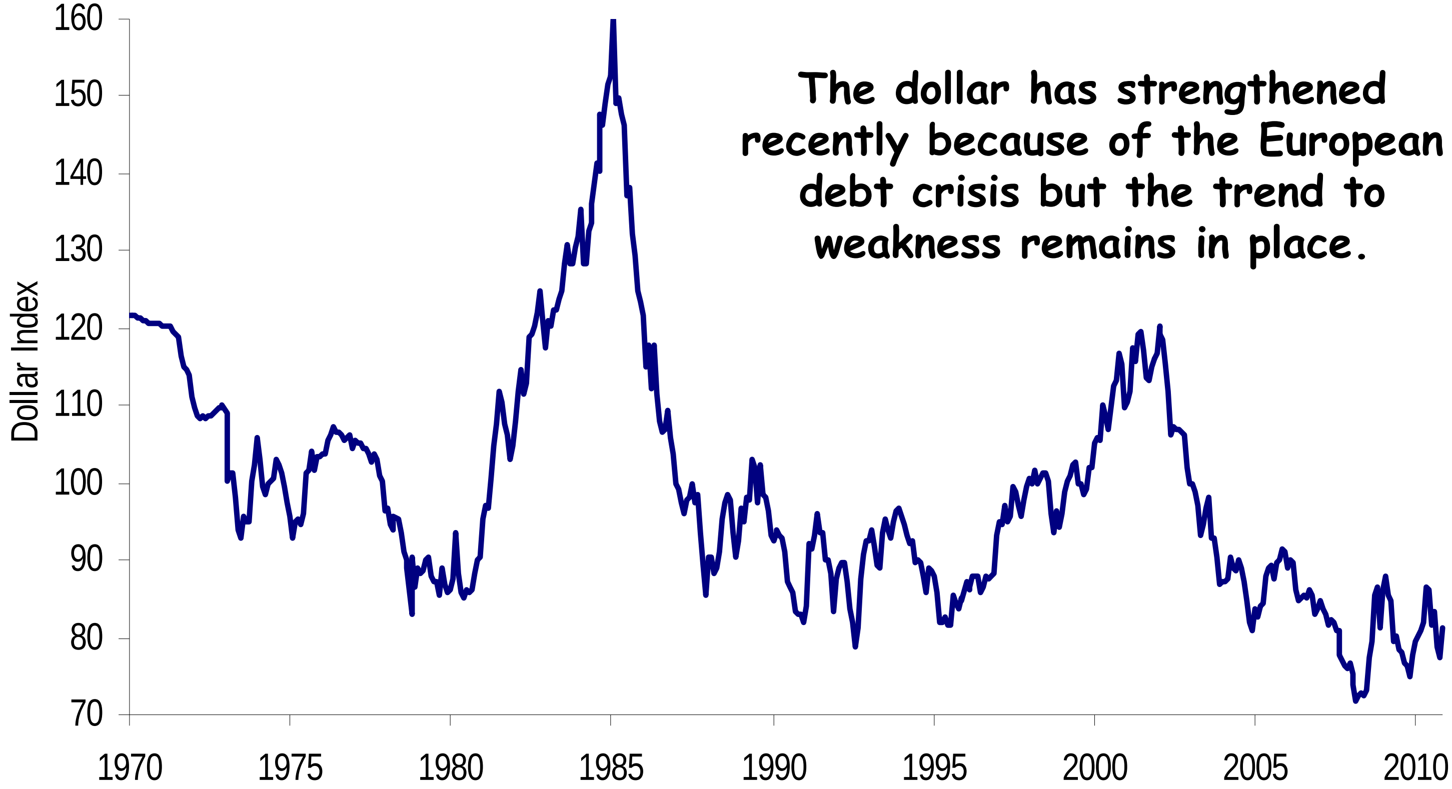
U.S. corporate profits tend to grow double the world $ GDP growth rate -- which looks solid for 2011.



Source: IMF; Bureau of Economic Analysis; Encima Global

DXY – Dollar Index

(last obs. November 30, 2010)



Source: Bloomberg; Encima Global

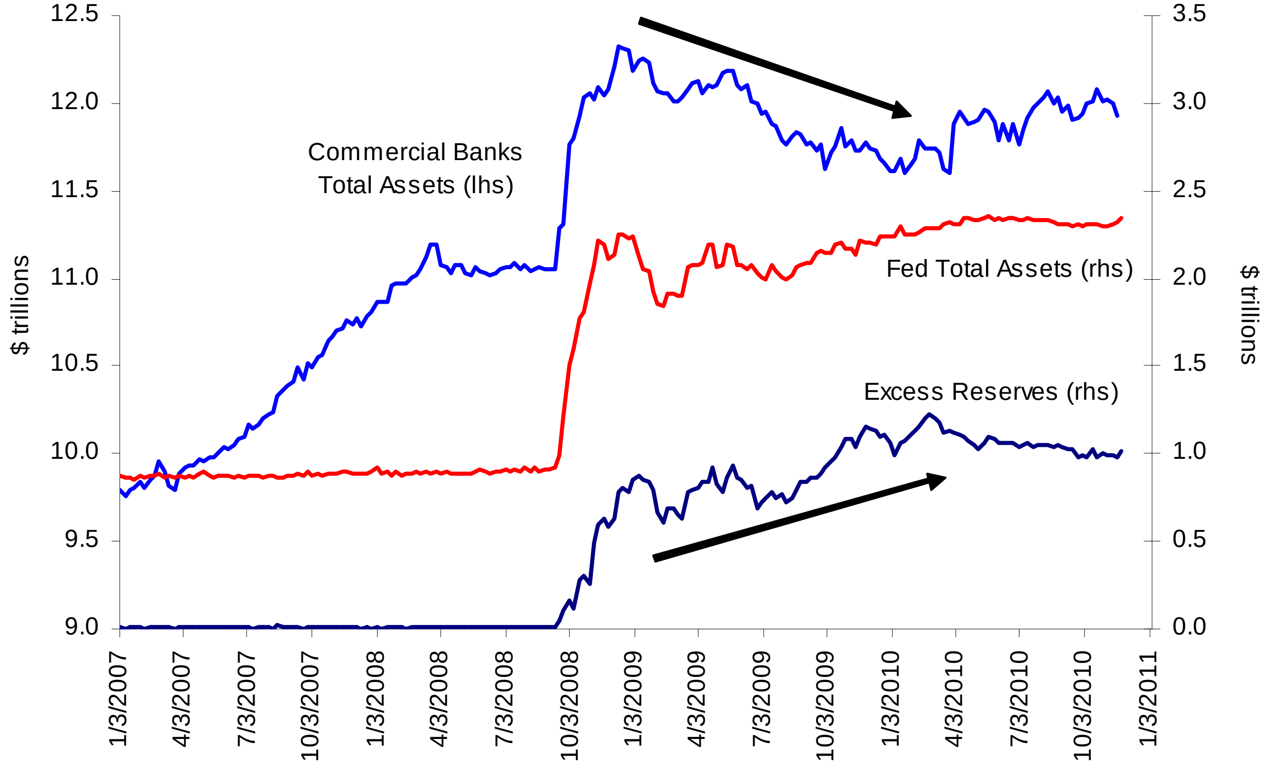
Fed Expansion Won't Cause Growth

- **The Fed funds target is 0% to 0.25% with an average $75 billion per month in net balance sheet expansion offered through June, nearly as large as the fiscal deficit. Gross Treasury purchases will reach $110 billion per month.**
- **This won't have much impact on growth or bank lending – credit is being rationed by regulatory policy rather than price. Like Japan's ineffective QE, Fed purchases will mostly affect the price of the purchased asset while it is being purchased.**
- **The current Fed policy is costly. The near-zero fed funds rate hurts savers and distorts capital flows. Capital allocation is increasingly being determined by governments, regulators and big corporations, a distinct new negative.**

In QE1, Reserves Rose, Commercial Bank Assets Fell

(last obs. November 24, 2010)

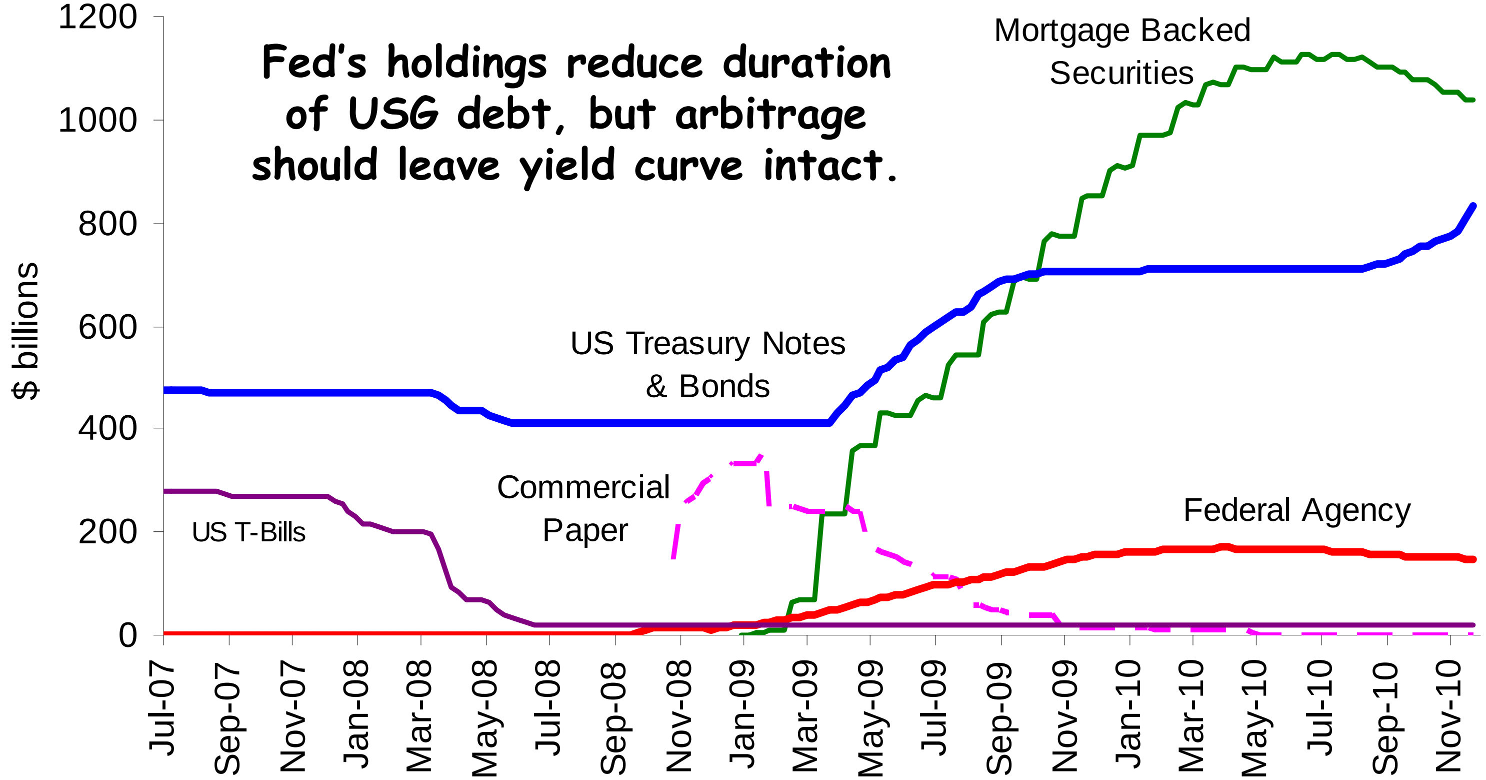
Most of the Fed's new asset purchases will be financed by excess reserves causing no throughput, 'pushing on a string', no implied growth in bank lending.



Source: Federal Reserve; Encima Global

Fed Assets Now Long-term

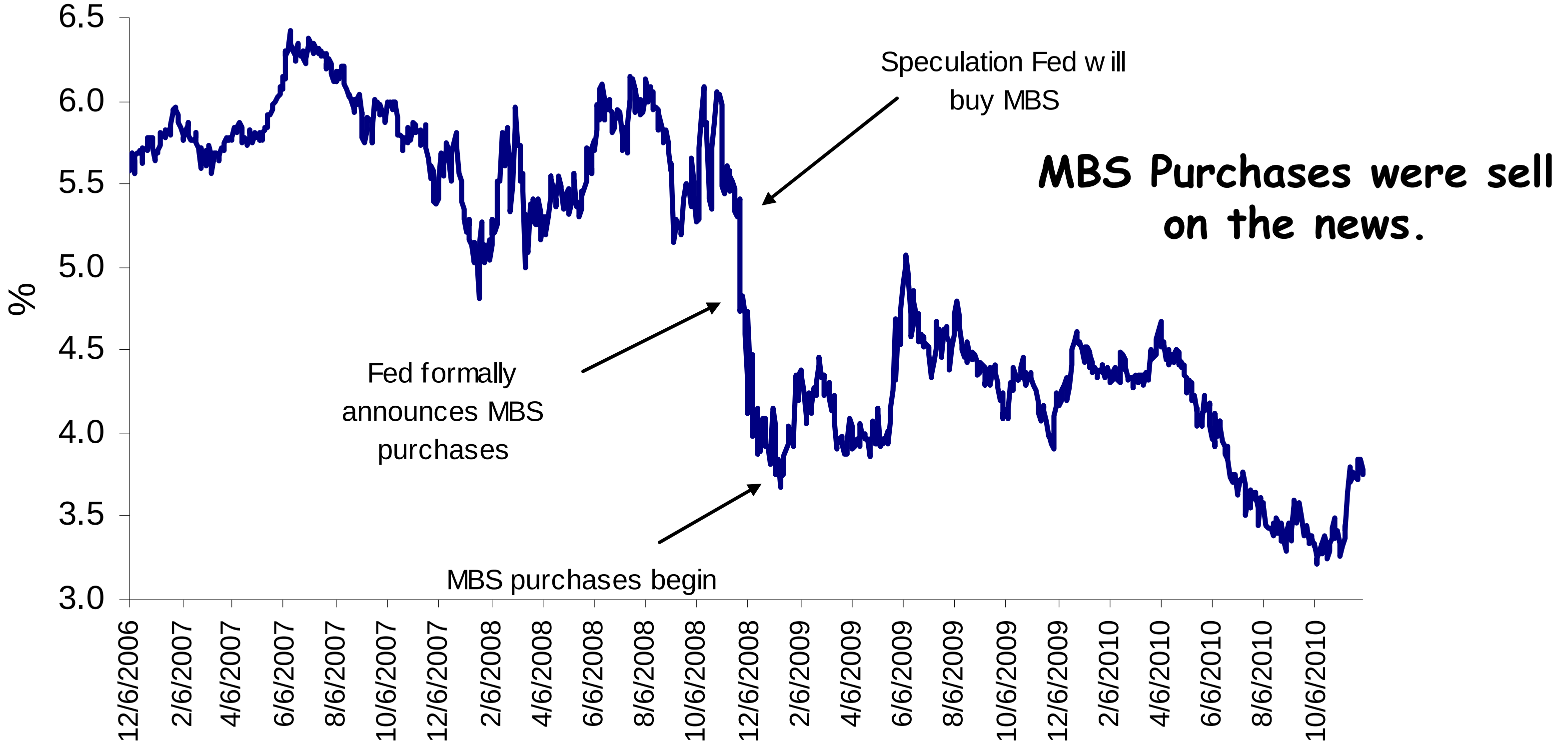
(last obs. November 21, 2010)



Source: Federal Reserve; Encima Global

MBS Yield in QE1; Fed Purchases Marked Bottom

(last obs. November 30, 2010)



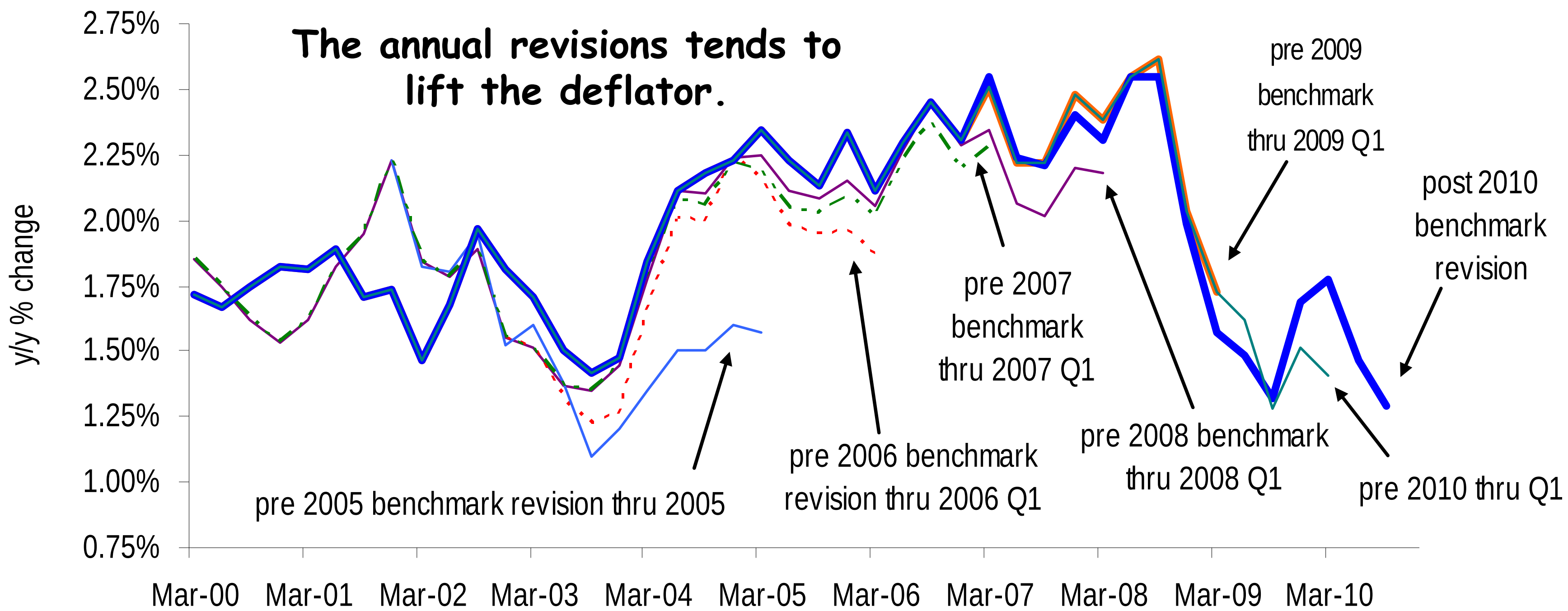
Source: Bloomberg; Encima Global

Fed Causing Asset Bubbles – Not a New Problem

- **Extract from *Fed's Moment of Weakness*: Malpass WSJ 9/25/02**
- **"Three major debates over monetary policy are in full swing -- how to combat deflation, the central bank's role in controlling asset-price extremes, and the proper response to fiscal deficits.**
- **"At the moment (2002) the debates are headed in the wrong direction. They don't offer an explanation for the deflation of the 1990s, let alone a policy bridge to price stability, economic growth and tax reform in the 2000s.**
- **"Fed Chairman Alan Greenspan explained at an Aug. 30 (2002) speech in Jackson Hole, Wyo., that the Fed can't anticipate bubbles and can only hope to soften the blow when they pop.**
- **"Mr. Greenspan is letting himself off the hook here. Instead of the tight-money, strong-dollar response to "irrational exuberance" in the late 1990s, a Fed commitment to currency stability and proper regulation would have allowed market forces to operate better, softening the boom.**
- **"The momentum-based capital inflow to the U.S. would have been smaller. The result would have been less of a U.S. boom, but also less of a bust and a better economy going forward. Global growth would have been more balanced."**

Core PCE Deflator "Moderates" Until Revisions

(last obs. September 2010)



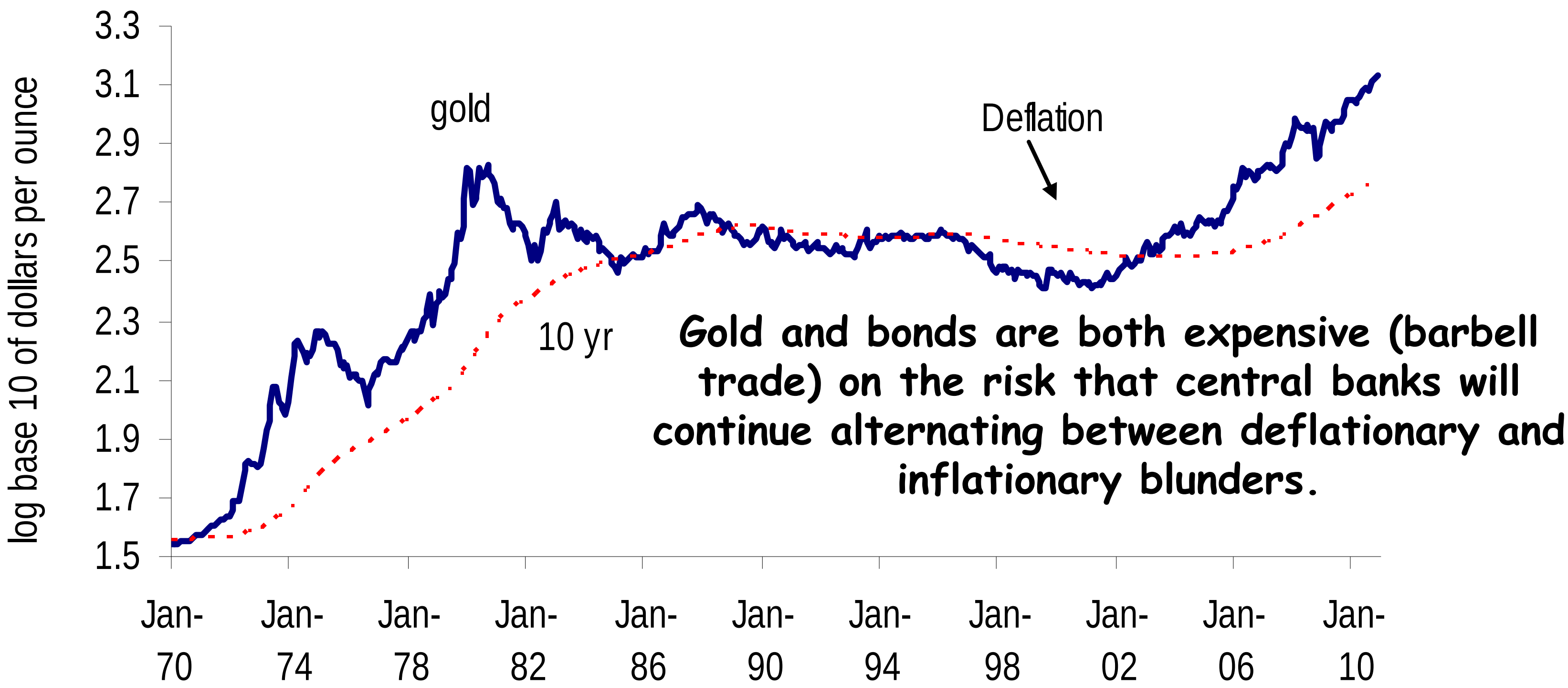
Source: Bureau of Economic Analysis; Encima Global

Gold As International Reference Point

- **“The G20 should complement this growth recovery program with a plan to build a cooperative monetary system that reflects emerging economic conditions… The system should also consider employing gold as an international reference point of market expectations about inflation, deflation and future currency values.”** ***Robert Zoellick, 11/8/10 FT***

Inflation Fear: Gold Prices Hitting New Highs

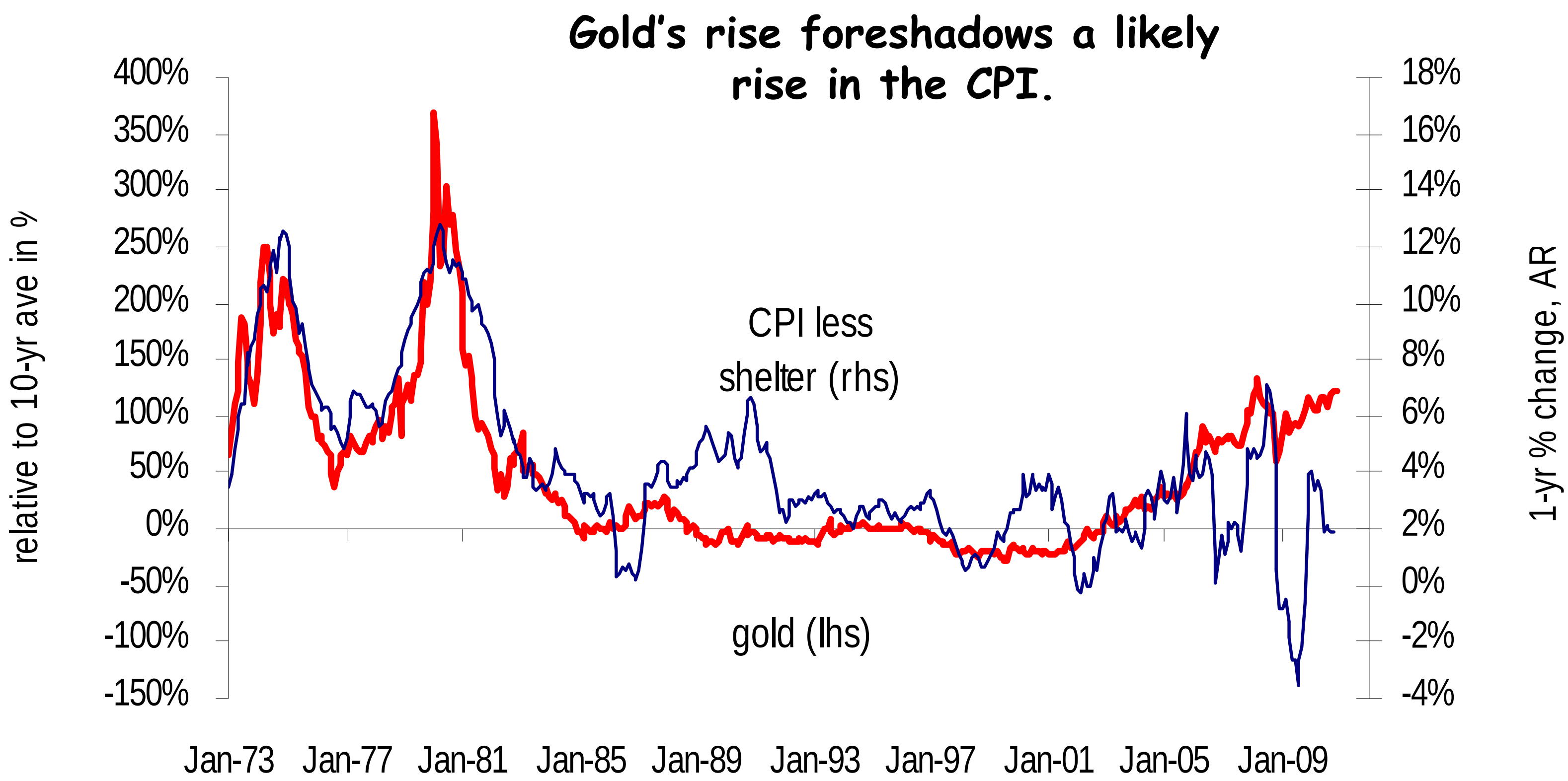
(log scale; last obs. November 30, 2010)



Source: Wall Street Journal; Encima Global

Spot Gold/10 Yr Avg Gold; CPI less Shelter

(last obs. October 2010)



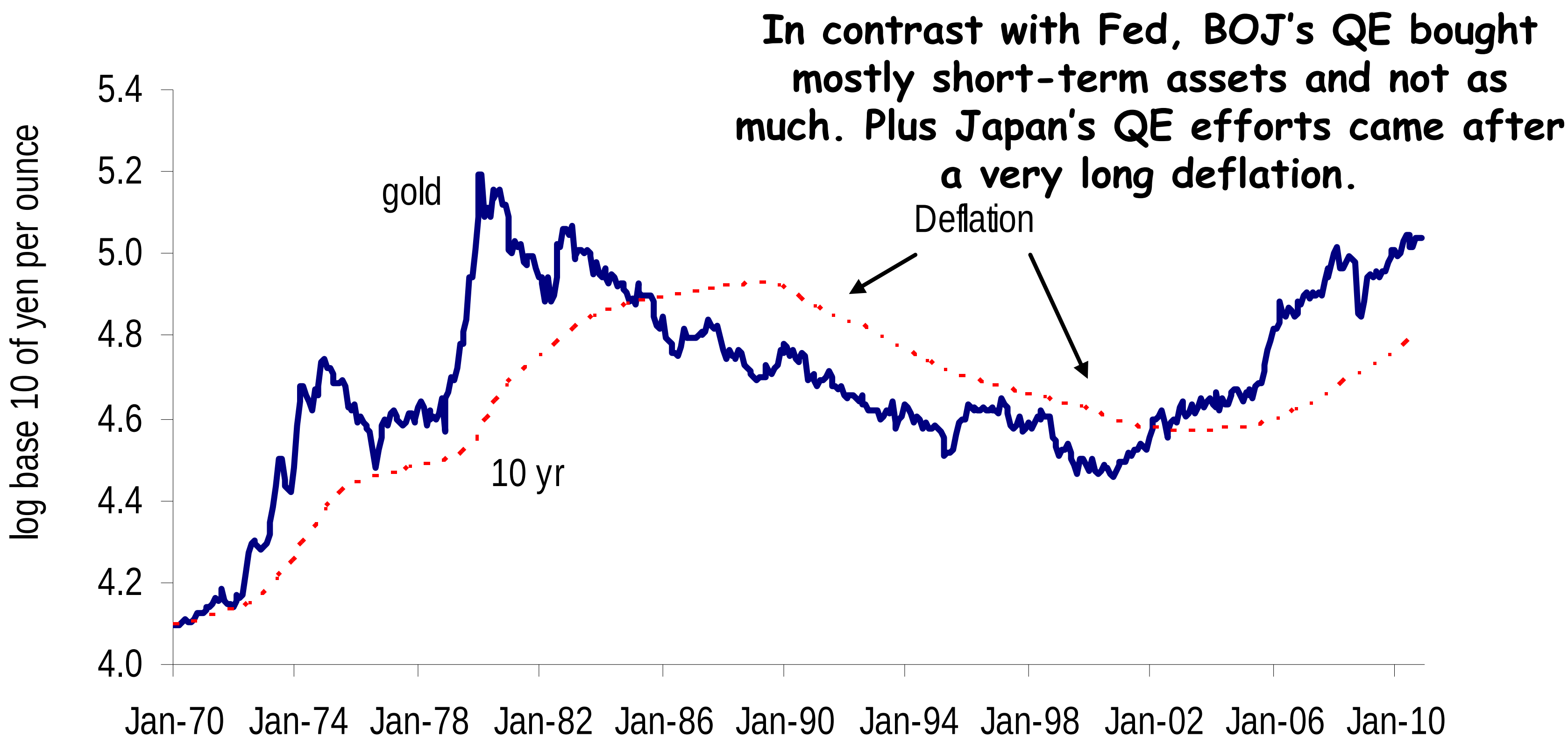
Source: Bureau of Labor Statistics; Wall Street Journal; Encima Global

U.S. Not At Risk of Japan Deflation

- **The BOJ QE was roughly 15% of GDP, slower than the Fed's QE but about the same size.**
- **However, Japan had suffered over a decade of strong-yen deflation before undertaking quantitative easing.**
- **Japan's CPI was zero or negative before and during the QE.**
- **Japan's banks hampered by very low, often negative nominal GDP prior to QE. (Pre-2008, weakest U.S. yoy nominal growth was 2.4% in 2001. Since crisis, nominal GDP was -3% in Q2 of 2009, already 4.4% yoy in Q3 of 2010.)**
- **Japan's asset purchases consisted of short-term repos.**

Gold Price in Yen

(last obs. November 30, 2010)



Source: WSJ; Federal Reserve ; Encima Global

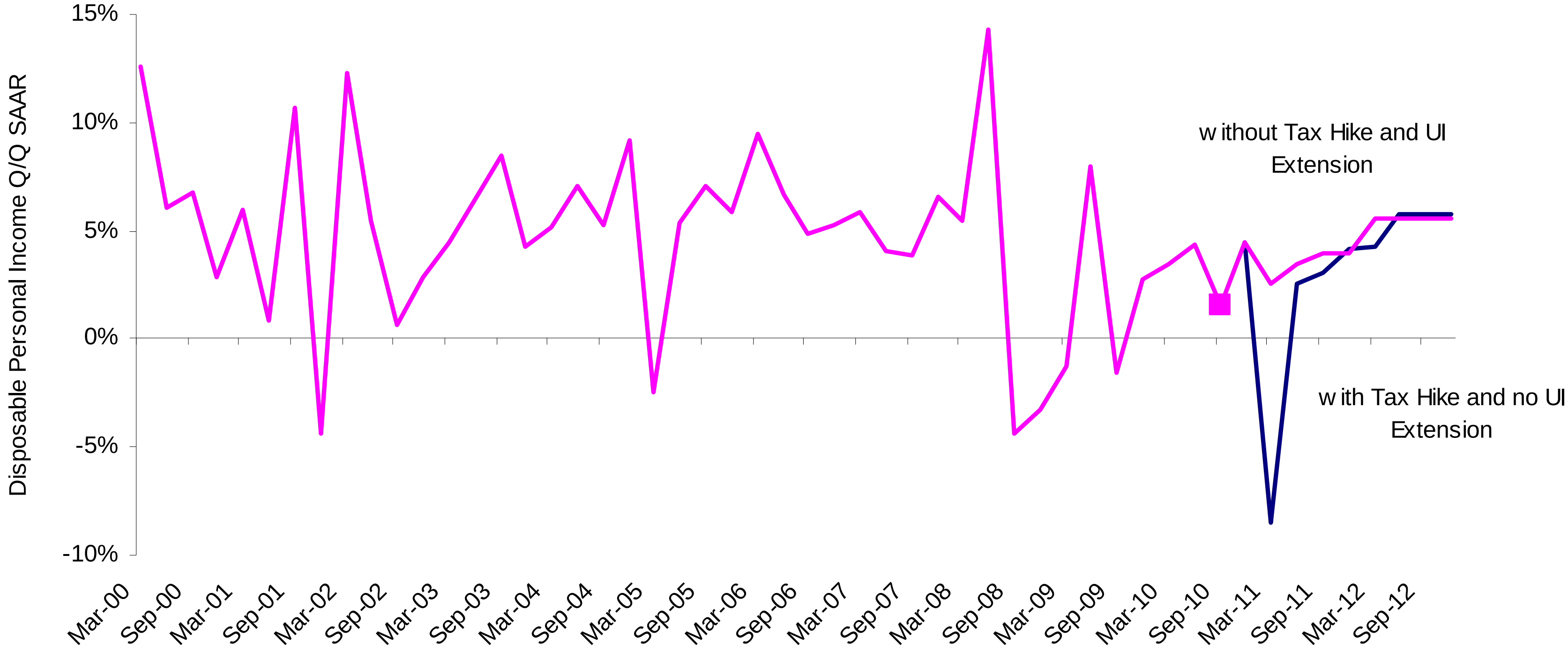
Get Ready for Tax Chaos

- **We think there's a substantial risk that Congress will not agree on tax extensions in the lame duck, allowing many tax rates to go up on January 1. If so, it's unlikely that Congress will be able to quickly reverse expirations given the divided Congress, legislative procedures, the President's views, and the big deficit impact under CBO scoring rules (which explicitly ignore the positive impact of lower tax rates on economic growth).**
- **We think the resulting tax chaos that would emerge in December and extend into 2011 will be a major negative for both the U.S. economy and markets, with several aspects not yet fully priced in.**
- **While Congress might still act in December, the legislative obstacles are high -- need 60 sitting Senators to vote for a much bigger tax-cut-related fiscal deficit even though there's no agreement between the two parties on tax policy.**

Disposable Personal Income Q/Q

(last obs. to Q3 2010, projected to Q4 2012)

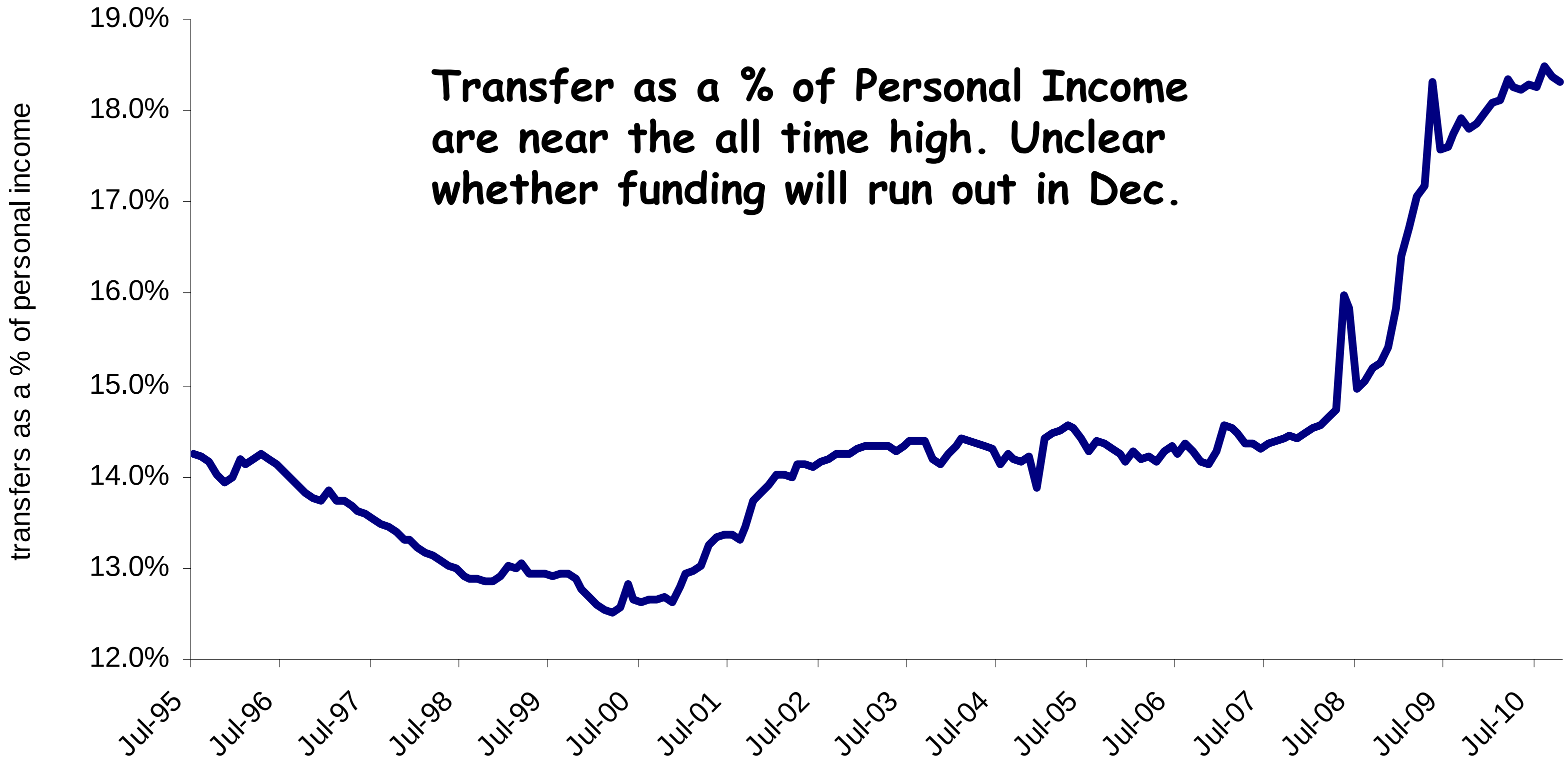
Disposable Personal Income will fall sharply to -8.8% q/q annualized rate if the Bush Tax Cuts are not extended.



Source: Bureau of Economic Analysis; Encima Global

Transfers as % of Personal Income

(last obs. October 2010)

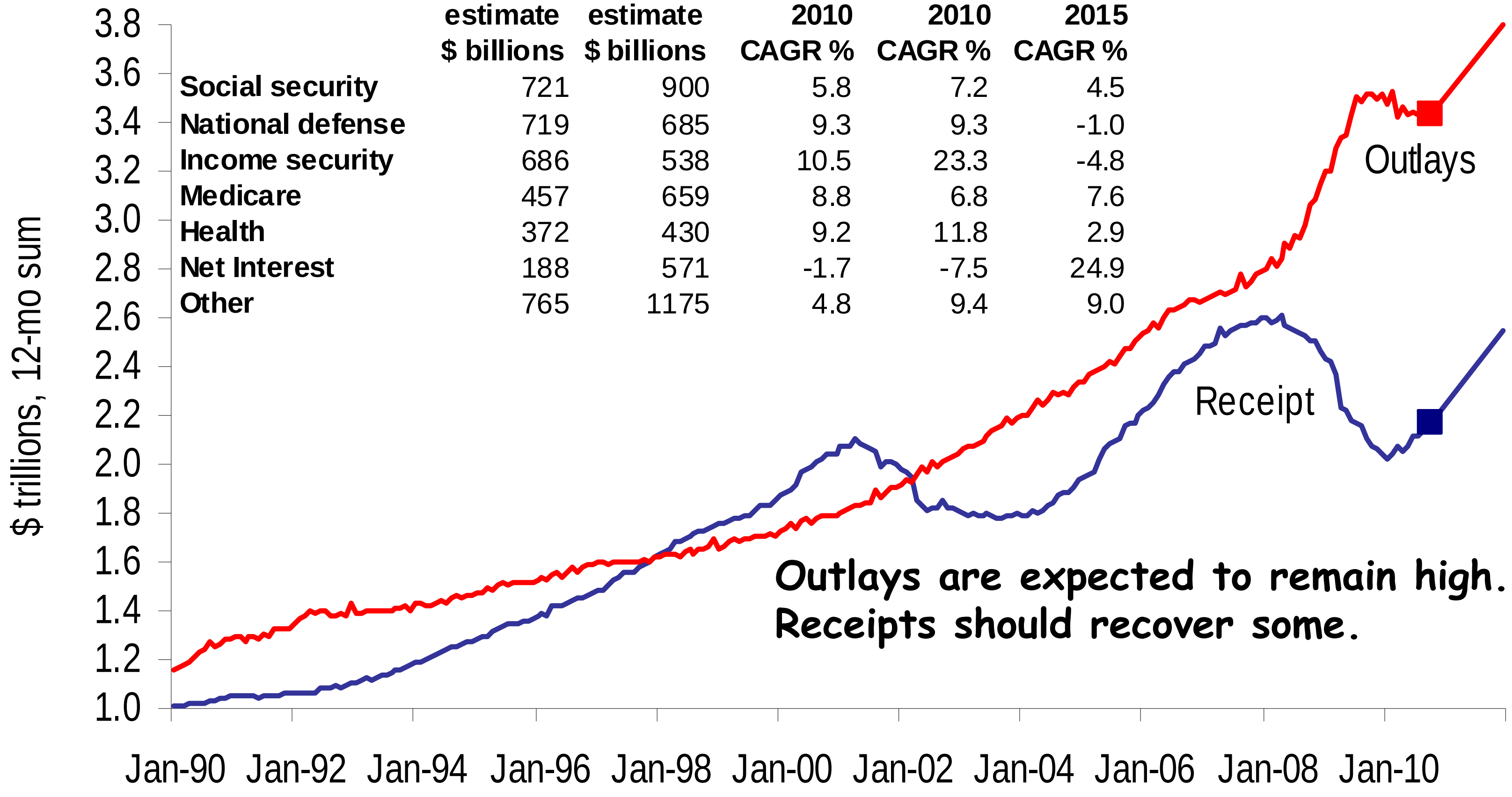


Source: Bureau of Economic Analysis; Encima Global

Federal Government Receipts and Outlays

(last obs. October 2010, CBO and OMB forecasts)

	2010 estimate $ billions	2015 estimate $ billions	2000 to 2010 CAGR %	2007 to 2010 CAGR %	2010 to 2015 CAGR %
Social security	721	900	5.8	7.2	4.5
National defense	719	685	9.3	9.3	-1.0
Income security	686	538	10.5	23.3	-4.8
Medicare	457	659	8.8	6.8	7.6
Health	372	430	9.2	11.8	2.9
Net Interest	188	571	-1.7	-7.5	24.9
Other	765	1175	4.8	9.4	9.0



Source: US Treasury; CBO; OMB; Encima Global

Taxes Impact Asset Values – Bush Cuts Added In ‘03

(last obs. November 30, 2010)

The scheduled tax increases are unusually harmful for risk-taking ventures, higher earners and equities, possibly reversing the favorable equity market impact of the original tax cuts (circled).

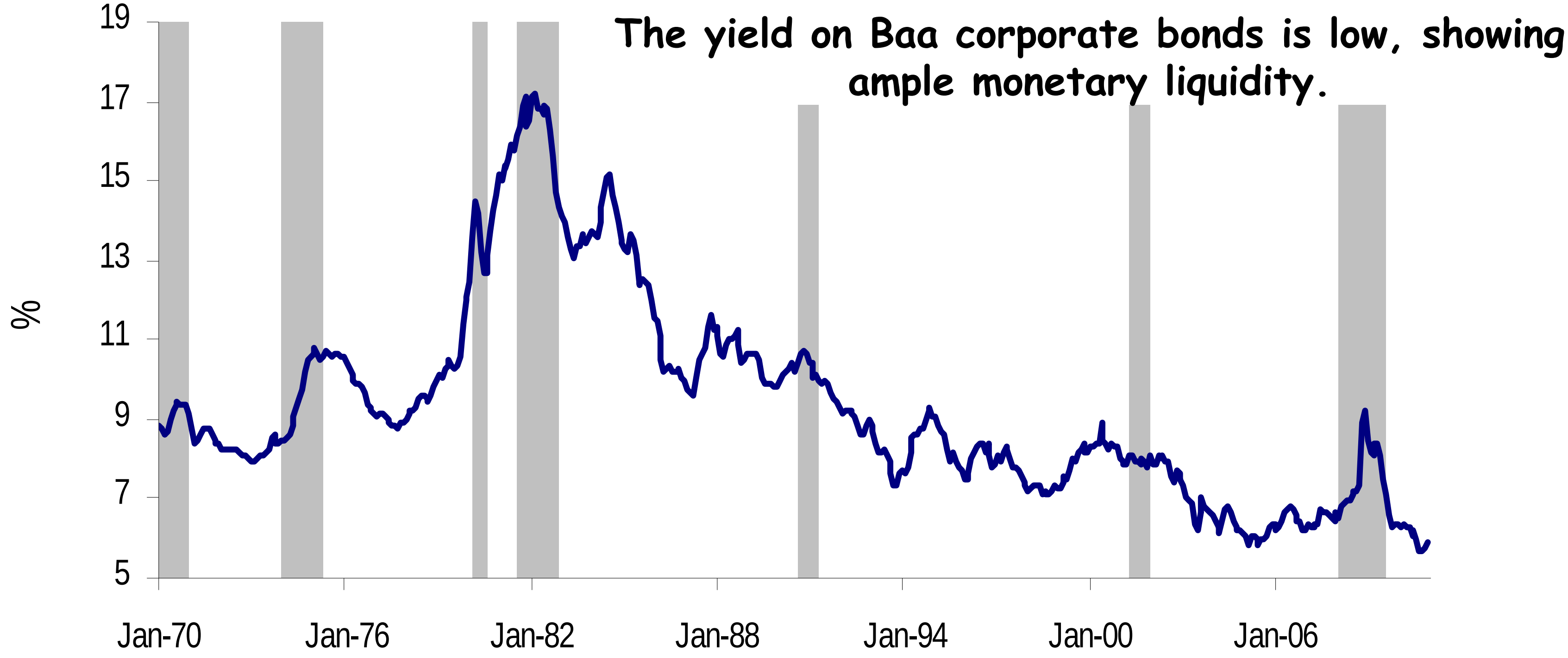
Source: Wall Street Journal; Encima Global

Favorable News Priced into Markets

- We think markets have been too optimistic about quantitative easing and taxes.
- The Fed's asset purchase plan distorted the bond market, pushing yields artificially low and contributed to higher equity prices (along with improving growth, earnings and election.)
- The scheduled tax increases are unusually harmful to growth and equities and will be hard to reverse both in the lame duck and in 2011.
- Winding down QE will disappoint markets but not have much impact on growth. The Fed isn't creating extra credit and a wind-down wouldn't reduce credit. Dollar would strengthen, weakening equities at first.

Baa Yields Low Now; In '78 Yields Increased Late

(last obs. November 30, 2010)



Source: Federal Reserve; Encima Global

In '77-'79, Equities Volatile as Inflation Risks Rose

(1970 to 1985)

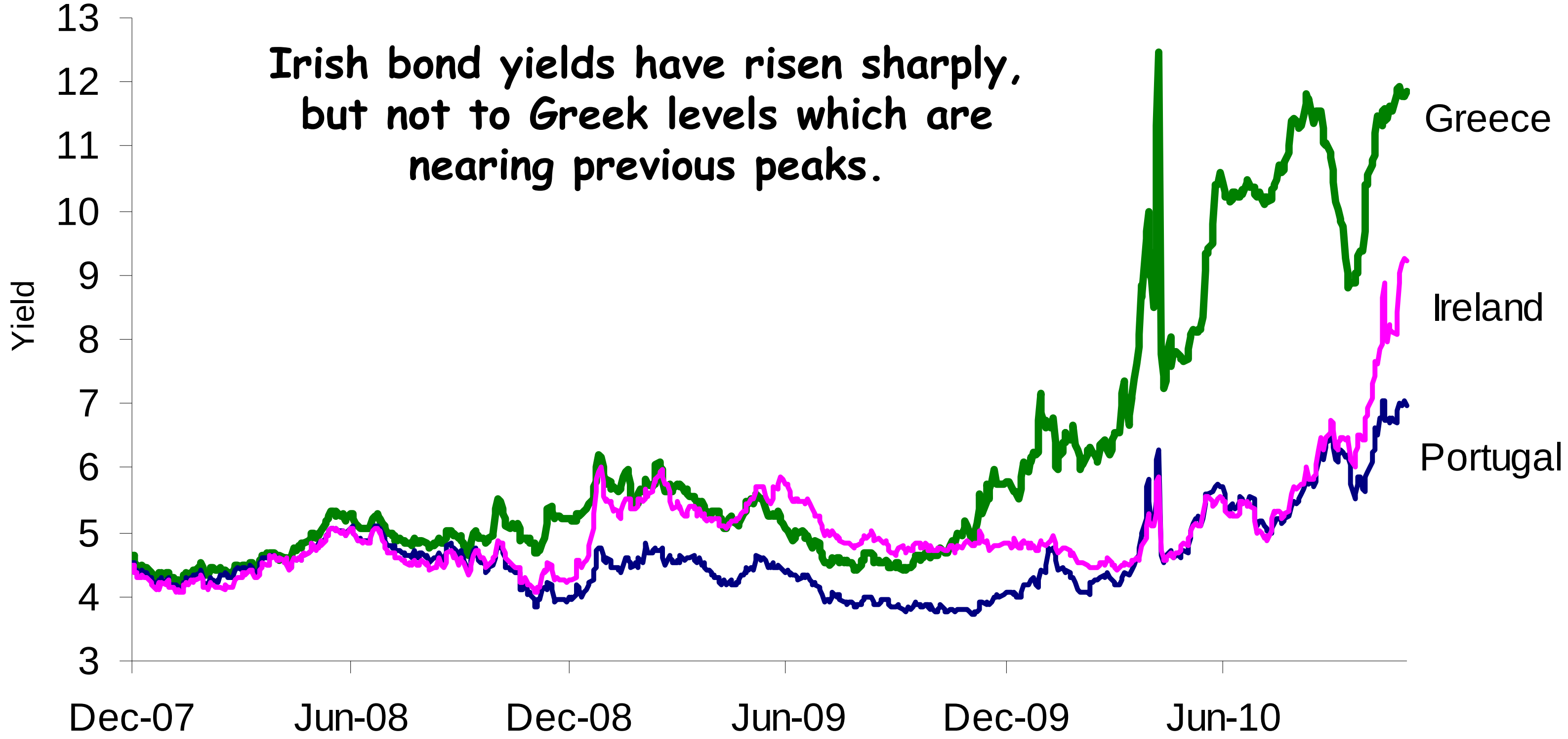
Source: Wall Street Journal; Encima Global

Europe Debt Crisis Not Key Variable

- **The Europe debt fight is over splitting the austerity -- between pensioners, sovereign bondholders, bank creditors, public sector workers, courtiers, home owners and other stakeholders. Almost all are based in Europe.**
- **From a systemic standpoint, many countries have restructured their debts in the past, so there's no reason to think that a Greek debt restructuring (we're expecting one) will be traumatic.**
- **The debt crisis won't slow Europe's growth all that much. Investment will be diverted from weaker European countries to stronger ones, with net growth about the same. In April, the IMF forecast 2010 Euro-zone growth at 1%, with Germany at 1.2%. In October, the IMF's 2010 Euro-zone forecast, even after the global softpatch, is for 1.7% growth, with Germany at 3.3%.**
- **The upside or downside for Europe depends on the structural reforms achieved during the crisis.**
- **Europe's debt crisis won't cause as much loss as the Asia crisis because the euro has a clear mandate for price stability.**

Select European 10 Yr Yields

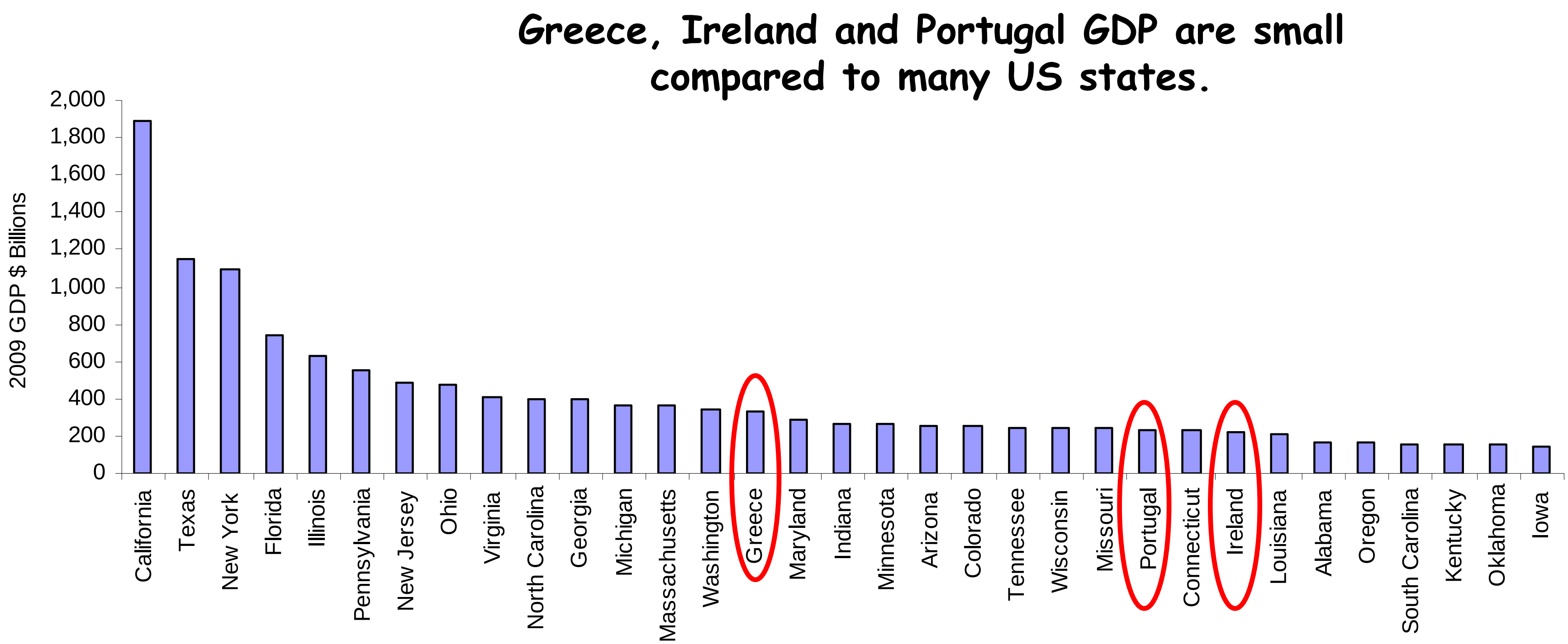
(last obs. November 30, 2010)



Source: Bloomberg; Encima Global

GDP in USD: Greece, Ireland, Portugal and Largest States

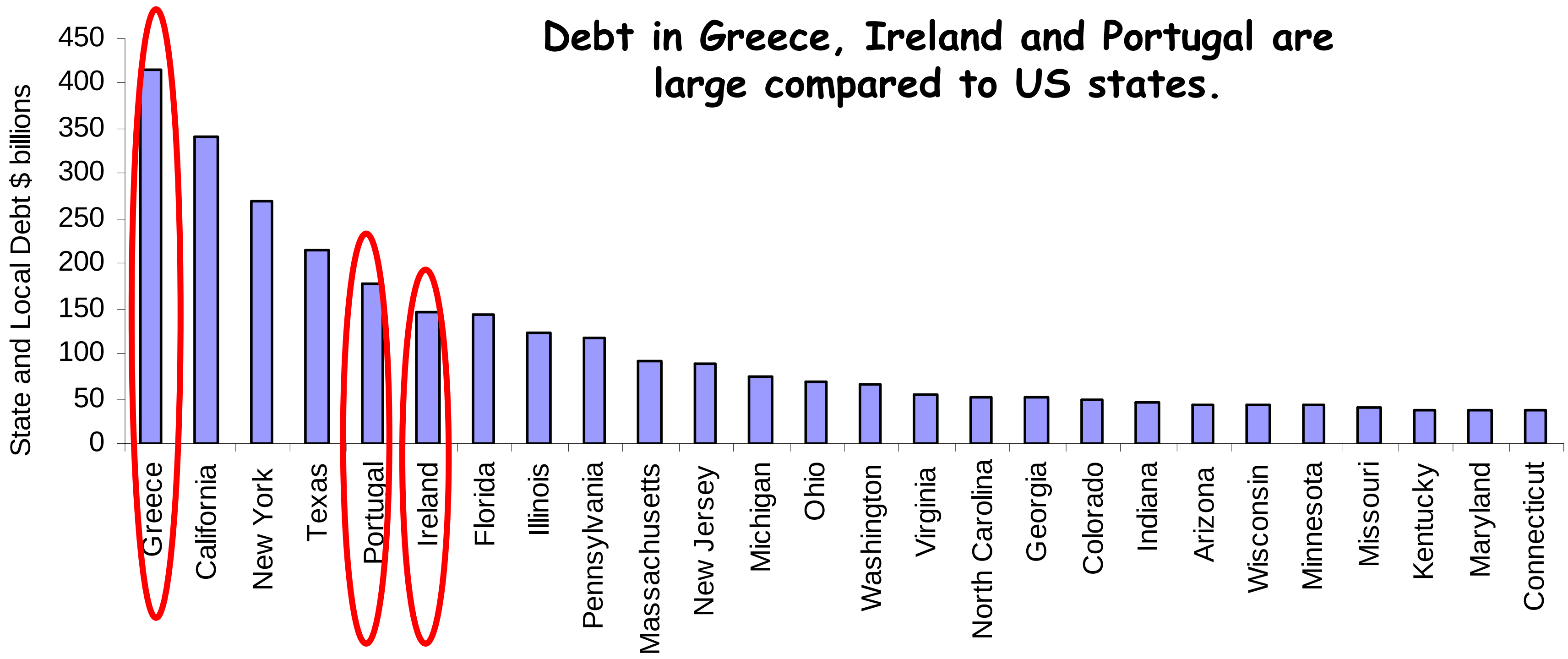
(last obs. to 2009)



Source: Bureau of Economic Analysis; IMF; Encima Global

Debt in USD: Greece, Ireland and Portugal and Largest States

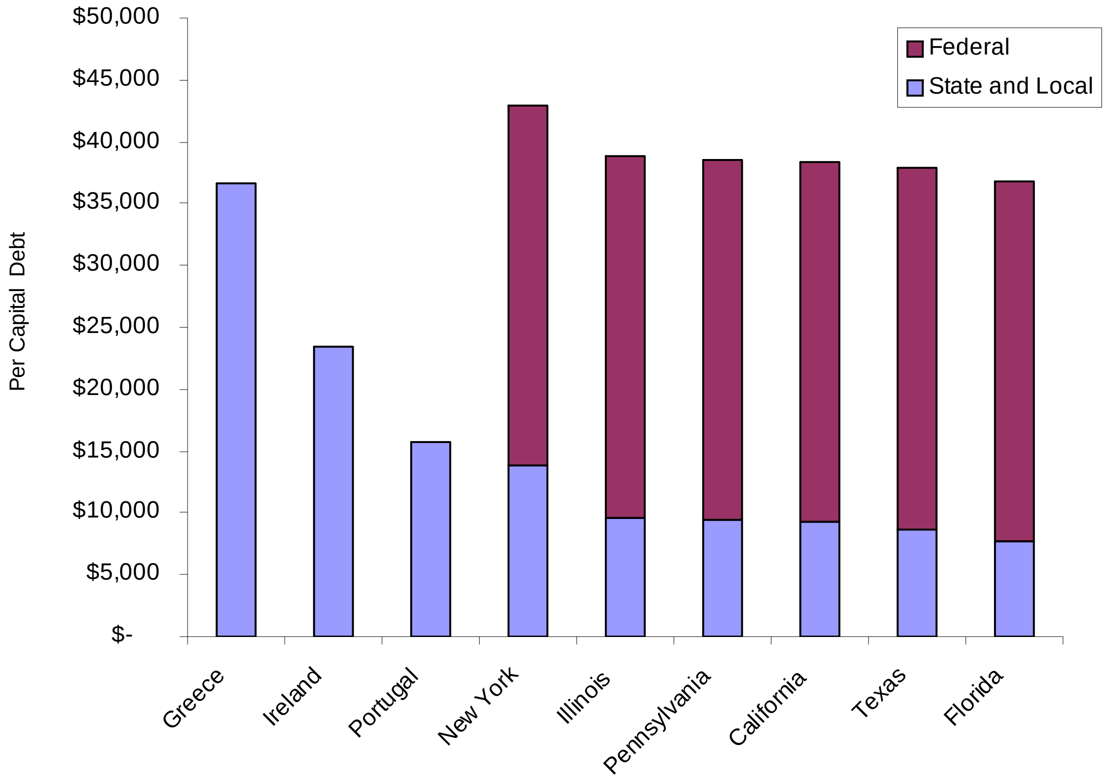
(last obs. to 2008 for states, 2009 for EU nations)



Source: Bureau of Census; IMF; Encima Global

Per Capita Debt

(last obs. to 2008 for states, 2009 for EU nations)



But when you include the US federal government debt, the US per capita debt burden averages $37,000.

Source: Bureau of Census; IMF; Encima Global

Global $ GDP

($ billions, October 2010 IMF forecast)

	2008	2009	2010	2011	2012
World	61,187	57,843	61,963	65,417	69,125
United States	14,369	14,119	14,624	15,157	15,825
Latin America	4,264	3,965	4,700	5,014	5,306
Developing Asia	7,436	7,876	9,136	10,174	11,257
Eurozone	13,616	12,484	12,067	12,187	12,520
World with pessimistic EUR exchange scenario			61,963	64,147	67,877

Y/Y Growth Rates	2009	2010	2011	2012
World	-5.5%	7.1%	5.6%	5.7%
United States	-1.7%	3.6%	3.6%	4.4%
Latin America	-7.0%	18.5%	6.7%	5.8%
Developing Asia	5.9%	16.0%	11.4%	10.6%
Eurozone	-8.3%	-3.3%	1.0%	2.7%
World with pessimistic EUR exchange scenario			3.5%	5.8%

Source: IMF; Encima Global