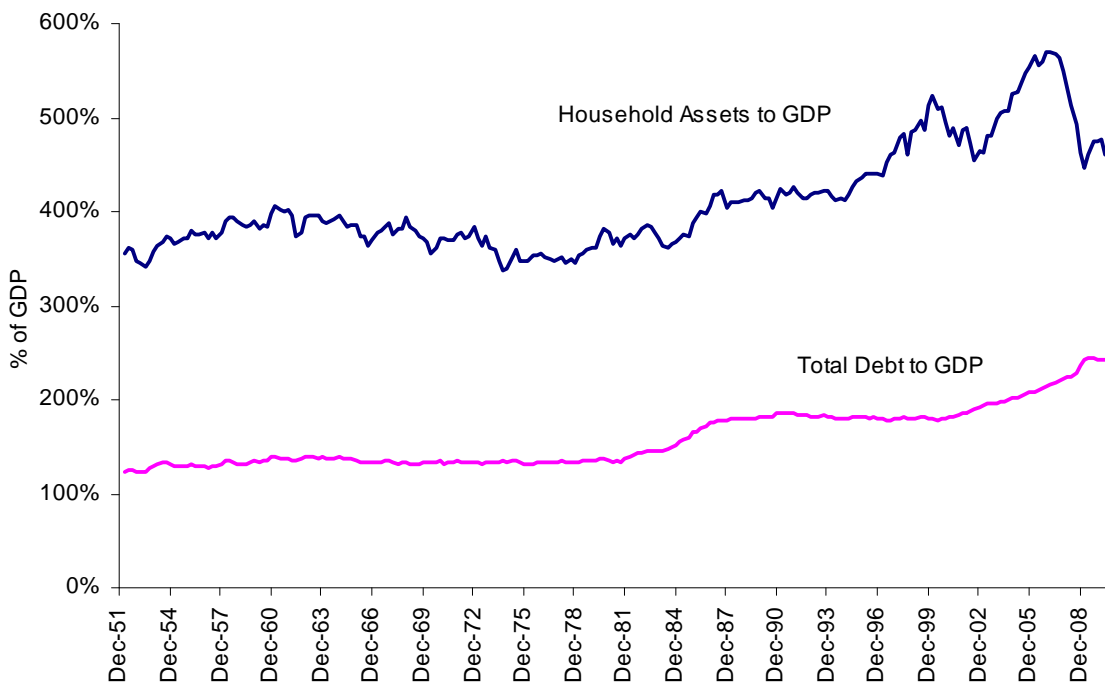


March 10, 2011

U.S. Assets \$70.7 Trillion, Debt \$36.3 Trillion

The Federal Reserve released its quarterly flow of funds report yesterday for the fourth quarter of 2010. It showed household assets in December at \$70.7 trillion or 476% of GDP (up \$2.2 trillion from September), with total debt in the economy at \$36.3 trillion or 244% of GDP (up \$0.5 trillion from September).

Household Assets and Total Debt / GDP (last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; BEA; Encima Global

- The asset ratio has declined from 2.75 times debt in the 1950s through 1990s to 2 times debt now. Even after the decline, the U.S. coverage ratio is better than the weaker European sovereigns, one explanation for their tipping point into sovereign debt crisis.

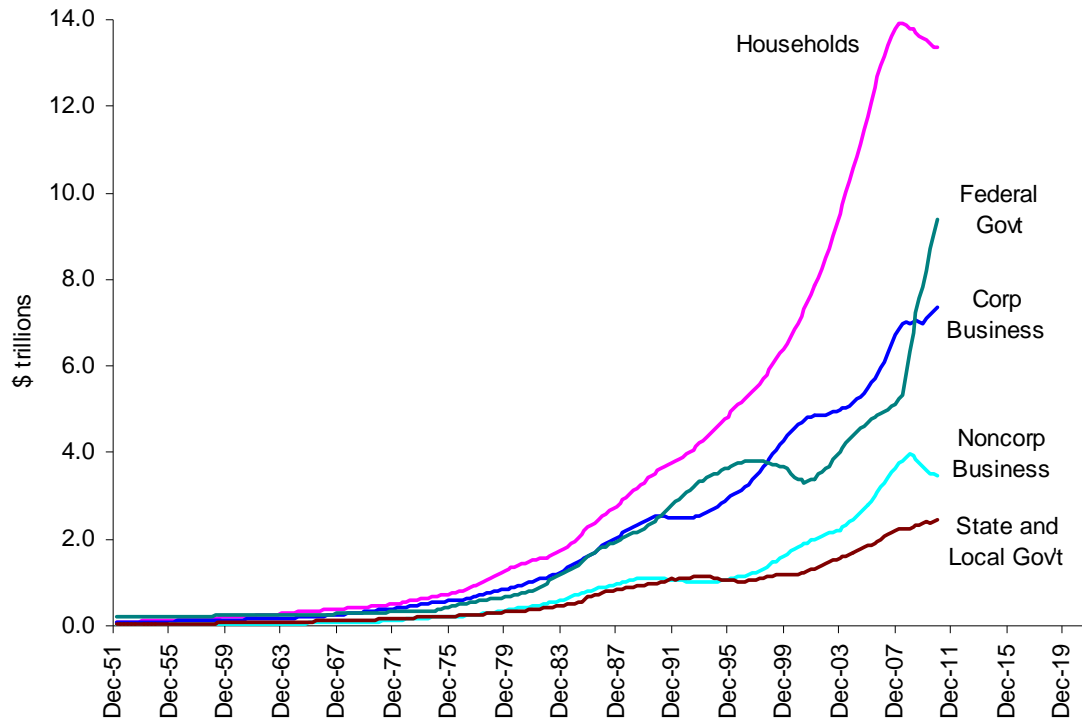
Household Assets / Total Debt (last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

- While debt levels have been declining for households and unincorporated businesses since the Lehman bankruptcy filing, debt has been growing some for corporations and state and local governments and has surged above \$9 trillion for the federal government, which now accounts for 25% of total debt. The Obama budget projects the federal debt-to-GDP ratio to rise to \$19 trillion in 2021, 77% of GDP up from 63% in December 2010. We think current budget trends point to an even higher debt-to-GDP ratio.

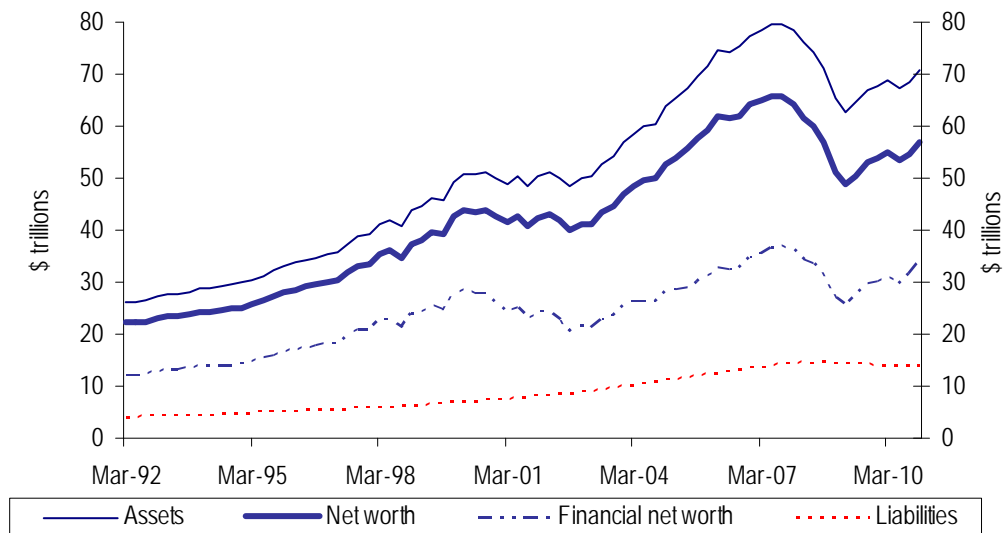
Sector Debt (last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

- Household assets stood at \$70.7 trillion in December, up \$2.2 trillion from September. Household liabilities stood at \$13.9 trillion in December, up \$26.6 billion from September and down \$110 billion from December 2010.

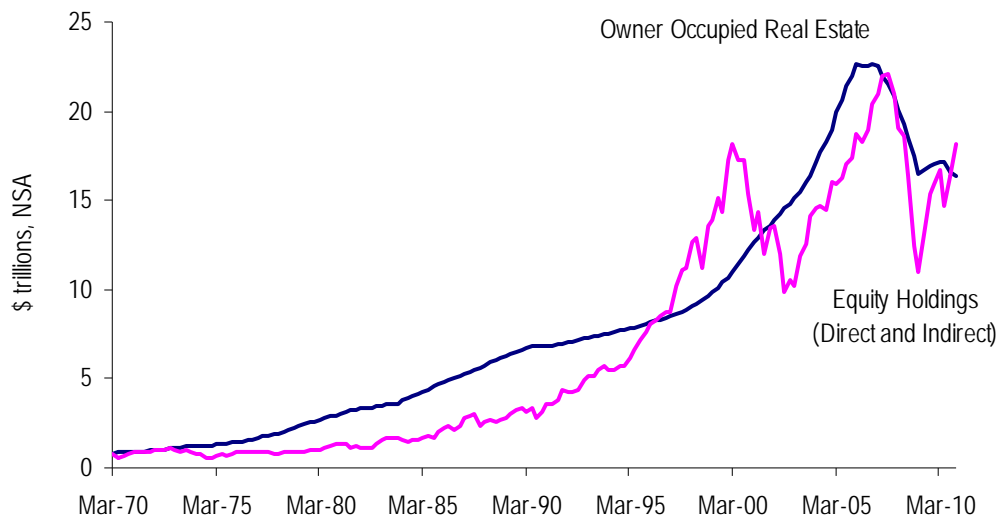
Household Balance Sheet (last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

- Fourth quarter household net worth stood at \$56.8 trillion, up from the \$54.7 trillion in the third quarter, but still down \$8.8 trillion from the 2007 peak. The \$2.1 trillion gain in household net worth was mostly due to equity gains (direct gains of \$0.9 trillion and indirect gains, also \$0.9 trillion, through pension reserves, life insurance, retirement and mutual fund holdings.) Houses declined \$0.3 trillion. In the 2000 bust, equities went down but not houses. In the 2008 crash, houses and equities both went down sharply, with equities making a substantial recovery but not houses.

Equity Market Assets and Owner Occupied Real Estate (last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

- Those with large net worth in their homes have suffered the biggest loss, but in many cases had high net worths to start with. Our view is that fluctuations in household net worth are not as critical to consumption as is the labor environment. Jobs are most people's biggest asset. Despite relatively slow growth in net worth in 2009 and 2010, U.S. consumption growth met our expectations. We think this was due to the improvement in the labor environment (e.g. falling jobless claims) more than to the equity market gains.
- U.S. household liquid assets totaled \$25.5 trillion on December 30, still somewhat below the \$26.1T peak in the third quarter of 2007. The December total included \$6.4T of time deposits, \$8.5T of directly owned equities, \$4.7T of mutual funds, and \$5.9T of checking deposits, money funds and credit market instruments. U.S. liquid assets are large relative to other countries, making U.S. asset allocation decisions a key variable in global capital flows and financial market performance.

Selected Components of U.S. Household Balance Sheet (last obs. Q4 2010)

	2010 Q4 (\$ trill)	2010 Q3 (\$ trill)	Yr/Yr % chg 2010 Q4	Yr/Yr % chg 2009 Q4	Yr/Yr % chg 2008 Q4
Total assets	\$70.7	\$68.6	4.5%	3.3%	-16.6%
Tangible assets	\$23.1	\$23.3	-2.0%	-3.2%	-13.0%
Real Estate	\$18.2	\$18.4	-2.9%	-4.2%	-16.1%
Other tangible assets	\$4.9	\$4.9	1.6%	0.8%	2.6%
Financial assets	\$47.6	\$45.3	8.0%	7.2%	-18.6%
Checkable deposits & money funds	\$1.5	\$1.4	-12.4%	-10.8%	27.1%
Time and savings deposits	\$6.4	\$6.4	4.0%	1.5%	3.3%
Credit market instruments	\$4.4	\$4.2	6.1%	3.5%	-2.6%
Equities (direct)	\$8.5	\$7.6	16.3%	26.7%	-40.0%
Mutual funds	\$4.7	\$4.4	12.7%	25.6%	-27.6%
Pension reserves/life insurance	\$14.4	\$13.6	9.1%	13.5%	-20.6%
Equity in unincorporated business	\$6.3	\$6.2	4.0%	-14.1%	-19.5%
Other financial assets	\$1.5	\$1.5	5.0%	-3.5%	-4.4%
Total Liabilities	\$13.9	\$13.9	-0.8%	-1.3%	-1.0%
Mortgages	\$10.1	\$10.1	-2.6%	-1.5%	-0.4%
Credit card	\$0.8	\$0.8	-7.6%	-9.6%	1.7%
Nonrevolving consumer credit	\$1.6	\$1.6	1.4%	-1.4%	1.4%
Other	\$1.4	\$1.4	16.4%	7.1%	-10.9%
Net worth	\$56.8	\$54.7	5.9%	4.6%	-20.1%
Financial net worth (financial assets minus total liabilities)	\$33.7	\$31.4	12.1%	11.6%	-25.5%

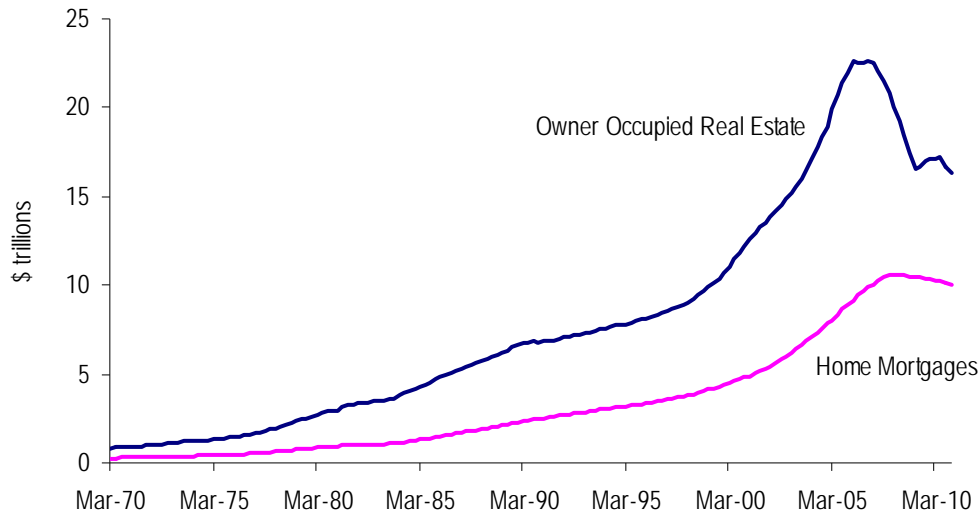
Source: Federal Reserve: Flow of Funds; Encima Global

Fall in Home Equity in Fourth Quarter

In the Fed data, owner-occupied real estate fell to \$16.4T in December, down \$260 billion from September. Home mortgages stood at \$10 trillion in December, down \$55 billion from September.

- Owner-occupied real estate peaked at \$22.7T in December 2006. Since then, the asset side has fallen \$6.3T, or 27.8%, while home mortgages are being reported as up \$0.2T or 2.1% (to \$10.1T from \$9.9T at the asset peak.)

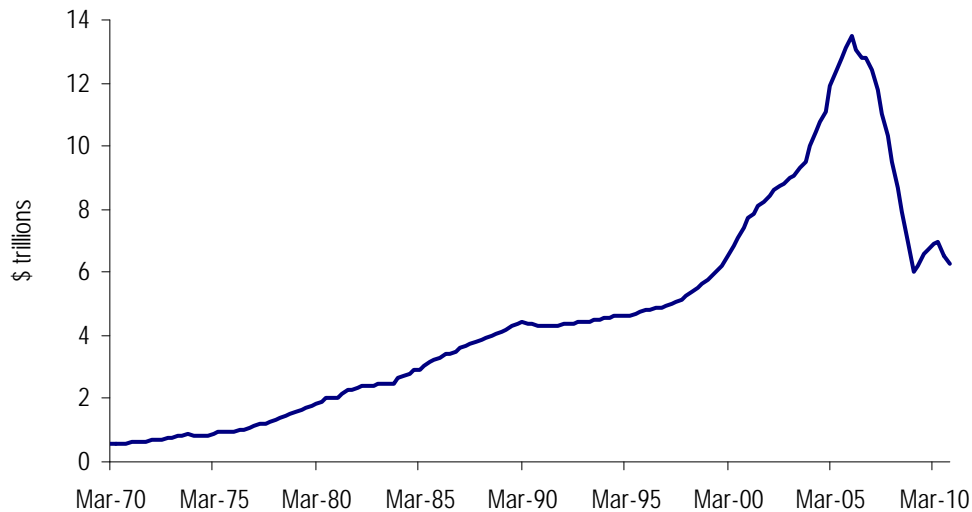
Owner Occupied Real Estate and Mortgages (\$ trillions, last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

- As a result, owners' equity in real estate fell to \$6.3T in December, down from \$6.5T in September. **Owners' equity in real estate is down 53% from the \$13.5T equity peak in March 2006.**

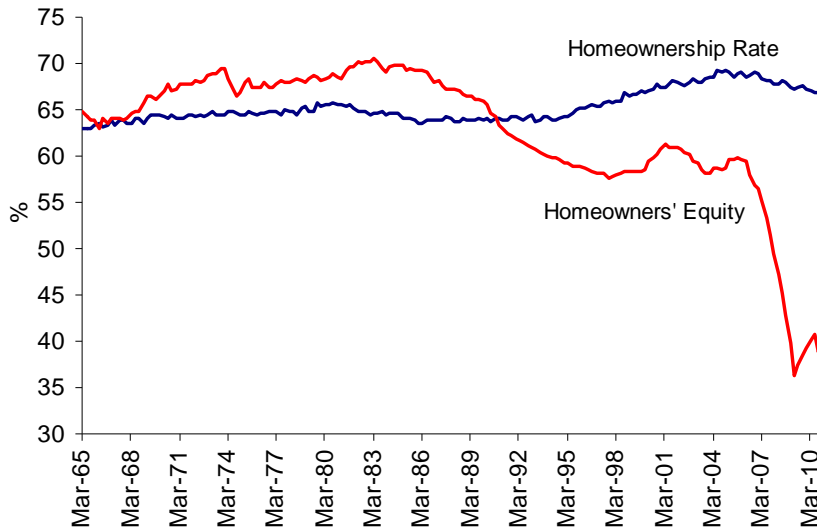
Equity in Homes (\$ trillions, last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

- The aggregate homeowners' equity percentage (value of houses minus mortgages all divided by value of houses) stood at 38.5%, down from a 50%-60% level pre-crisis. The homeownership rate fell to 66.5% in December from 66.9% in September and a peak of 69.2% in 2004.

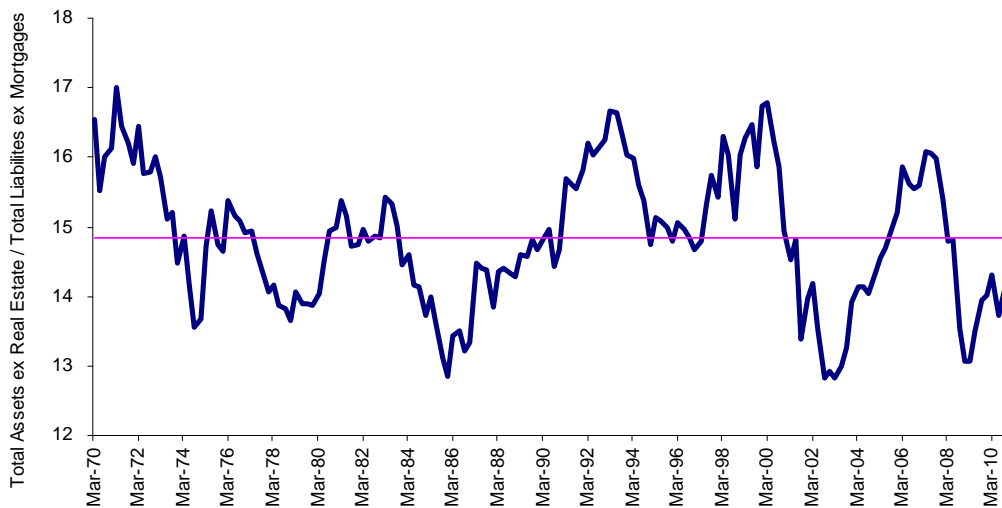
Homeowners' Equity and Homeownership Rate (last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Census Bureau; Encima Global

- Almost all of the aggregate leveraging of the household sector was in home mortgages (which grew at a faster rate than the value of houses.) Excluding houses from assets and mortgages from liabilities, the household sector has increased assets and liabilities at about the same rate over the last four decades – for every \$1 in non-mortgage debt, non-house assets grew about \$14.

Assets ex houses / Liabilities ex mortgages (last obs. Q4 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

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