

September 14, 2010

# Gold Hits New Record; Barbell Trade Still Draining Resources

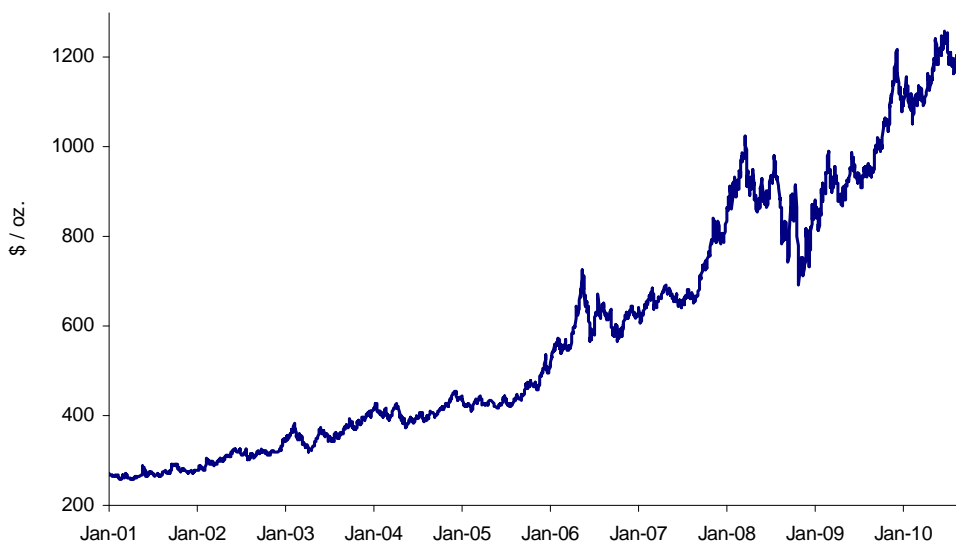
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While many parts of the world are in a reasonably strong recovery after the 2008 crash, the U.S. recovery remains notably weak. We think this owes in large part to structural deterioration in the U.S. business climate that discourages investment and hiring – including complex new laws, the surge in government spending and debt, and the tax train wreck underway.

- From a market perspective, the Washington uncertainty extends deeply into the Fed and its historical gyrations between inflation and deflation.
- A year ago, we noted the market's contradictory passion for gold and long-term Treasury bonds. We called it a barbell trade – investing at opposite extremes to protect against inflation and deflation – and noted that “it's bad for U.S. growth, diverting investment away from the sweet spot for job creation, small businesses.” At that time, the 10-year yield was 3.35% and gold had just passed \$1,000. See Dollar Risk Causing Barbell Trade; Fed's Maturity Mismatch on Sept 10, 2009
- Today gold has made a new high to reach \$1,275, up roughly 25% in the last twelve months.

## Gold Price (last obs. September 14, 2010)

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Source: Federal Reserve Board; Encima Global

- Meanwhile, the 10 year U.S. Treasury yield has fallen to 2.69%, roughly a 10% total return for twelve months.

### 10 Year US Treasury Bond Yield (last obs. September 14, 2010)



Source: Federal Reserve Board; Encima Global

- The S&P 500 has underperformed both gold and Treasuries, returning roughly 9% with dividends (helped by the so-far strong September rally).

### S&P 500 (last obs. September 14, 2010)



Source: Federal Reserve Board; WSJ; Encima Global

- The biggest loser over the last year has been small businesses, as capital is channeled into commodities and bonds. Today, the National Federation of Independent Businesses released its August survey results showing confidence no better than a year ago. Small businesses said their outlook improved to 88.8 (same as September 2009), up by 0.7 points from July after two months of decline. The index remains much lower than troughs of previous recessions.

### NFIB Optimism Index (last obs. August 2010)

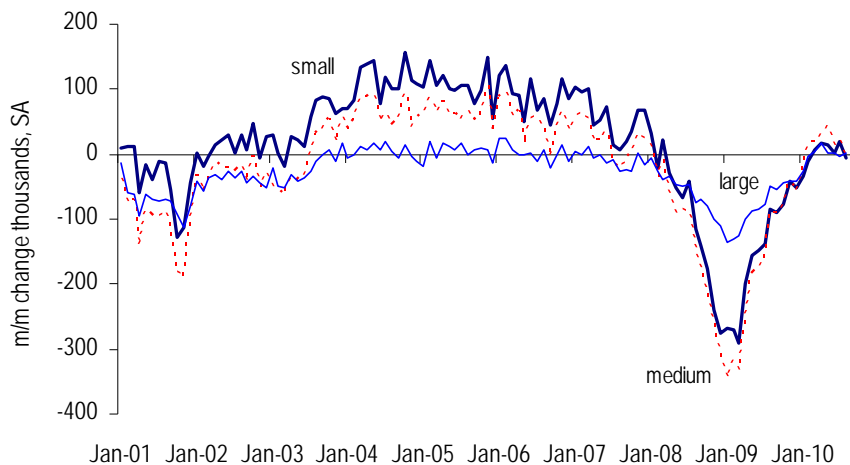
Based on Ten Survey Indicators  
(Seasonally Adjusted 1986=100)



Source: National Federation of Independent Business

- Recent ADP data on payrolls showed that small businesses (with less than 50 employees) lost 6,000 jobs in August. Medium sized businesses (with between 50 to 499 employees) lost 5,000 jobs. In contrast, small businesses saw at least some job growth from the very beginning of the 2001-2002 recovery. Large sized businesses (with more than 500 employees) added 1,000 jobs in the August ADP payroll survey.

### ADP Job Gains by Firm Size (last obs. August 2010)

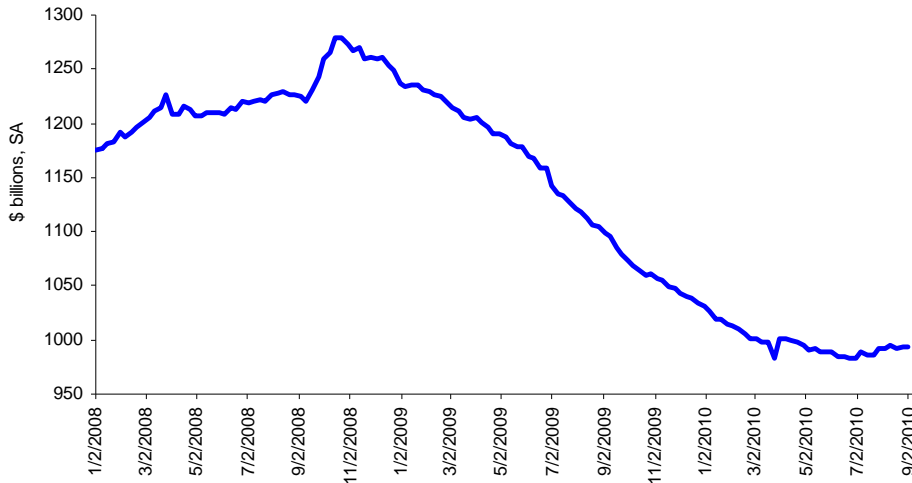


Source: ADP; Encima Global

## C&I Loans Down Sharply

Over the last year of the intense barbell trade, bank holdings of commercial and industrial loans has decreased by \$104.7 billion to 994.2 billion. Since the end of 2008, it's down \$242.4 billion. In recent weeks the level of C&I loans has stabilized.

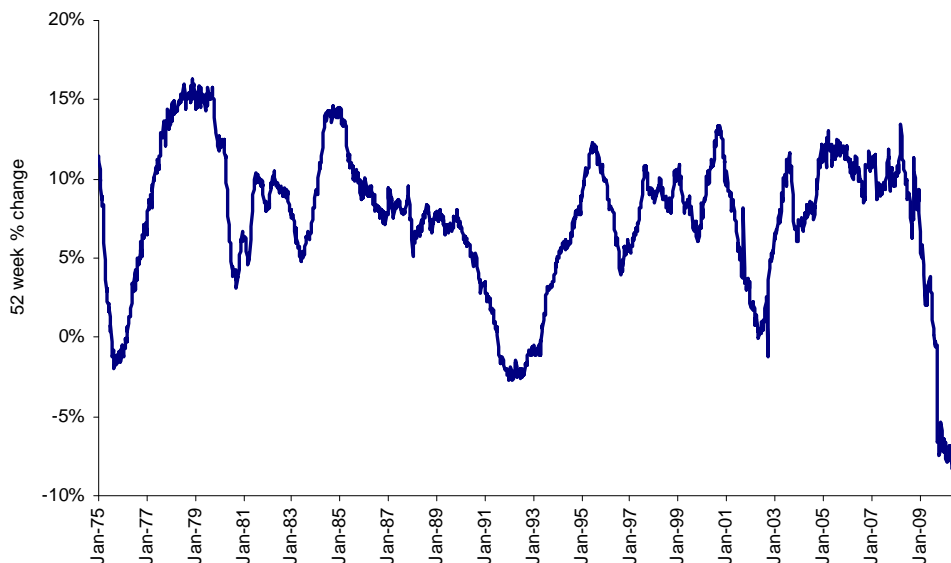
### Domestic Banks Holdings of C&I Loans (last obs. September 1, 2010)



Source: Federal Reserve Board; Encima Global

- Overall bank loans and leases outstanding have fallen to \$5.9 trillion from a peak of \$6.6 trillion in December 2008. Loans and leases outstanding contracted 6% in the last year, just above the worst year-over-year decline on record. We think Washington's accounting, regulatory and tax policies are contributing to this weakness.

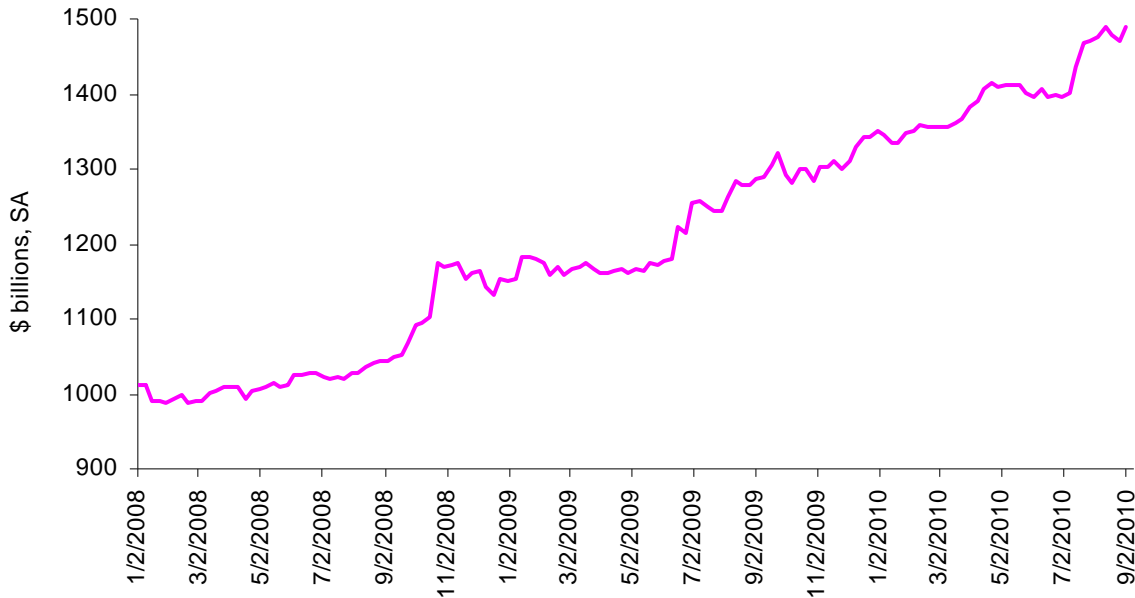
### Loans and Leases at Banks 52 week change (last obs. September 1, 2010)



Source: Federal Reserve Board; Encima Global

- Bank holdings of government securities grew to \$1.49 trillion since the end of 2008, an increase of \$340.6 billion. This more than explains the C&I loan portfolio declines as capital is being rechanneled from small businesses to government bills, notes and bonds.

### Domestic Banks Holdings of Government Securities (last obs. September 1, 2010)



Source: Federal Reserve Board; Encima Global

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