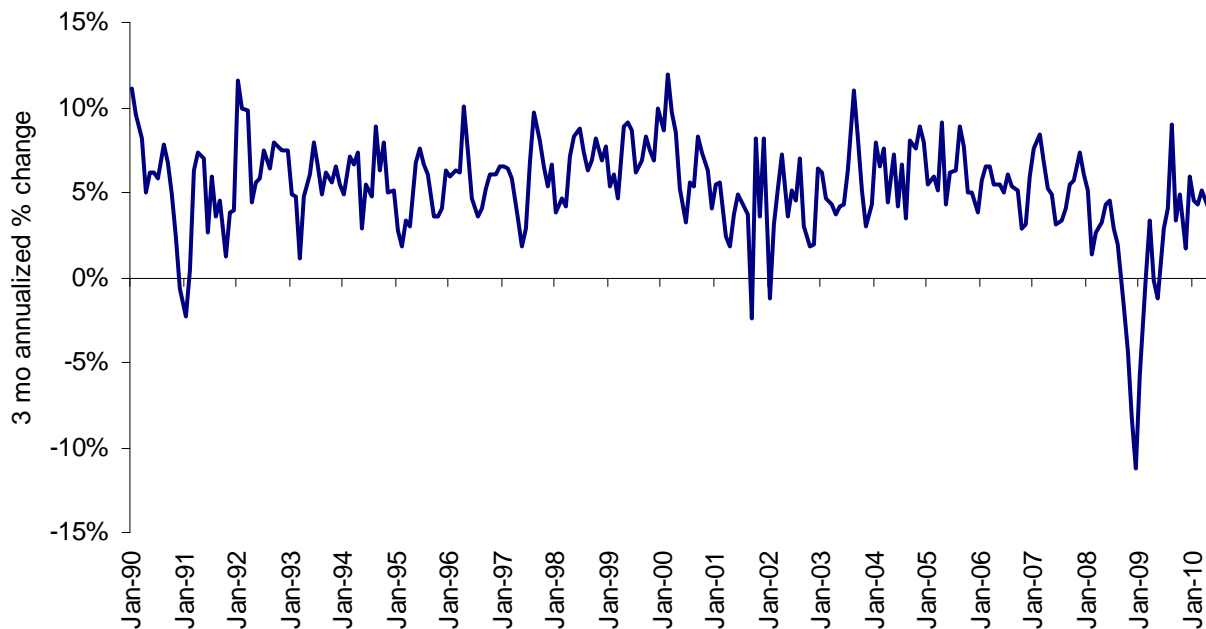


June 28, 2010

Spending Moderating Below Trend; Income Stabilizing

Consumption grew 0.2% in May from April in nominal terms, versus 0.0% growth in April and 0.6% in March. Three-month annualized growth is 3.3% nominal...

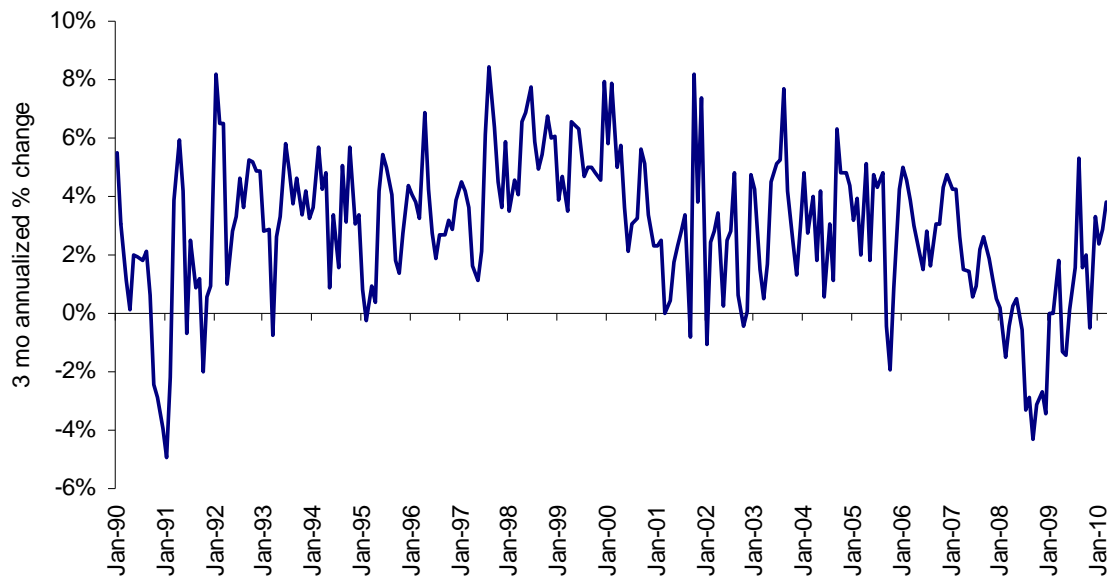
Nominal PCE (3 mo % change annualized, last obs. May 2010)



Source: Bureau of Economic Analysis; Encima Global

...and 2.8% in real terms for the three months ending May 2010.

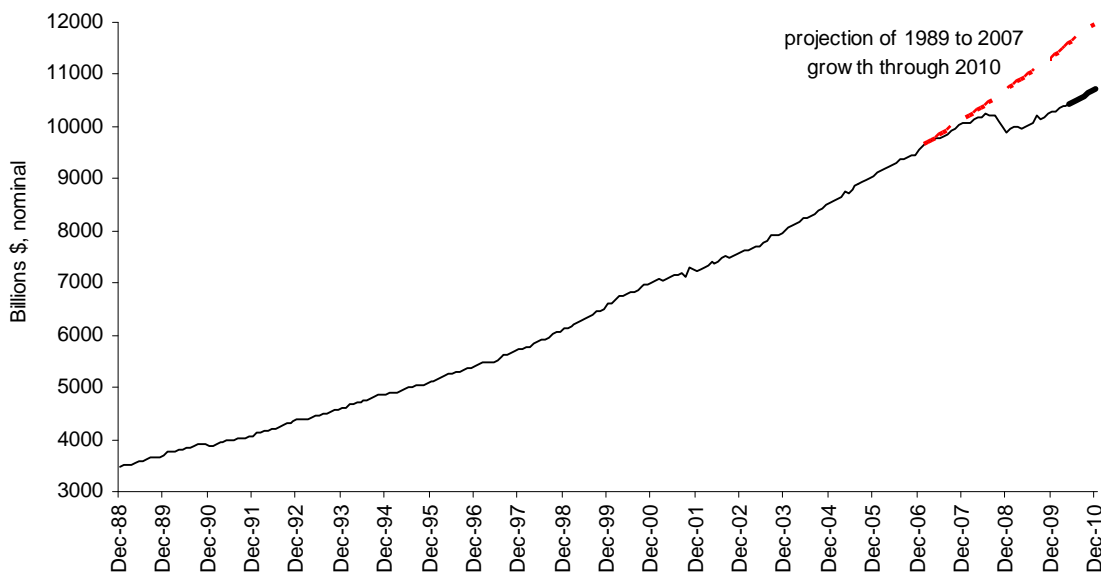
Real PCE (3 mo % change annualized, last obs. May 2010)



Source: Bureau of Economic Analysis; Encima Global

Personal consumption in May reached \$10.43 trillion (nominal, annual rate). We think moderate consumption growth will continue in 2010 as Washington sustains its transfer payments and the labor environment improves (with auto production and some stabilization for small businesses). However, current consumption growth isn't strong enough to recover the post-Lehman loss, leaving consumption still \$1 trillion below the pre-Lehman trend.

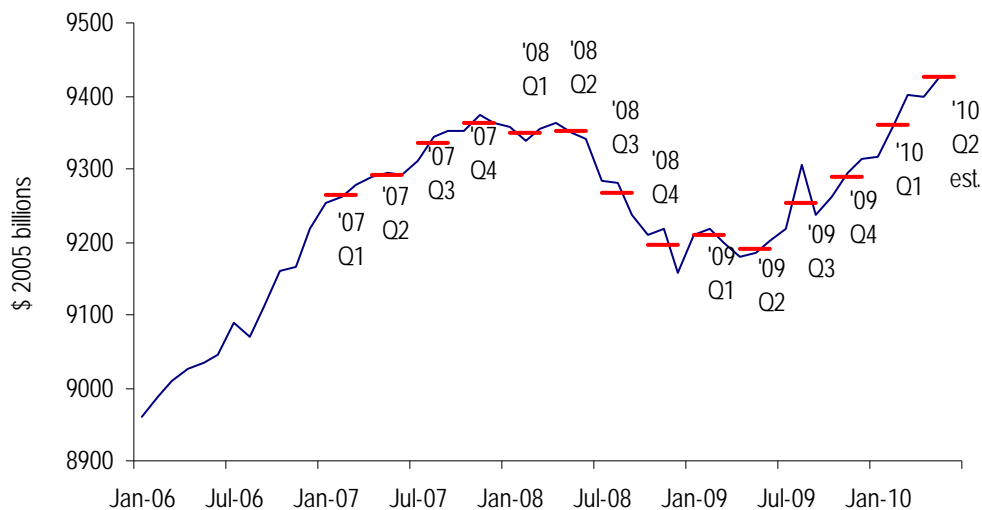
Nominal PCE (last obs. May 2010, broad line projects through Dec 2010)



Source: Bureau of Economic Analysis; Encima Global

- Real consumption growth has been weaker than this stage of previous recoveries. Second quarter real PCE would grow roughly 2.9% real if June consumption growth matched May (we expect it to do better than May.) This is still not strong enough to reach our 4% second quarter GDP expectation, and we may lower that forecast some in coming weeks.
- We continue to expect “moderate growth from a lower base”. This is not a V-shaped recovery and leaves many businesses and governments underwater unless growth strengthens. However, most recent indicators for small businesses, housing and the consumer continue to point to weakness, waiting for a better environment for small businesses in terms of bank lending, taxes and other Washington policies.

Monthly and Quarterly Levels of Real Consumer Spending (last obs. May 2010)



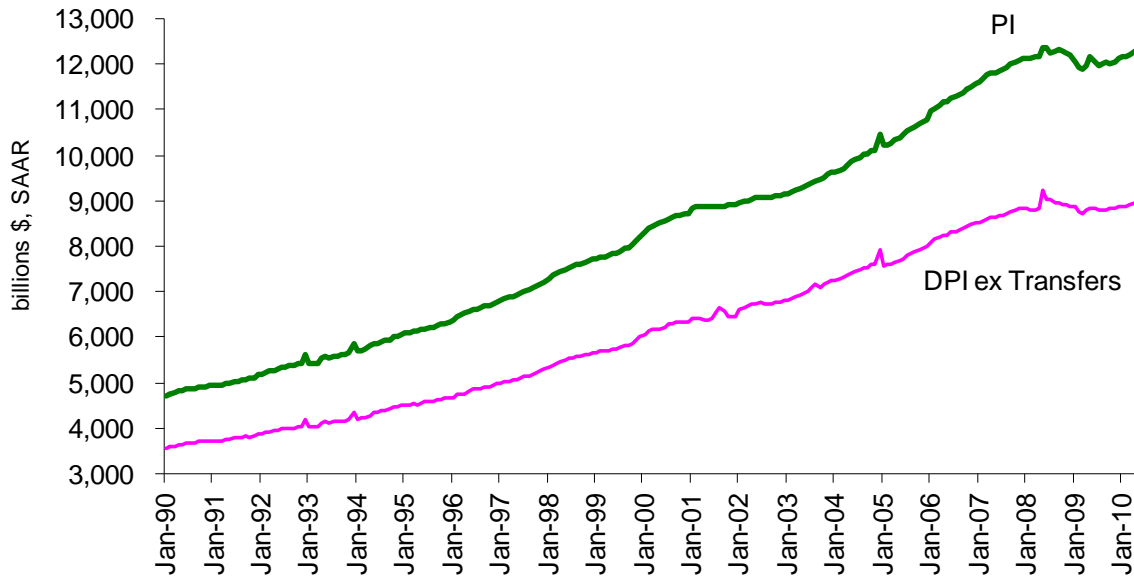
Source: Bureau of Economic Analysis; Encima Global

Personal Income

Personal income grew 0.4%, or \$53.7 billion, to a \$12.34 trillion annual rate in May. Revisions to the previous months' data added \$18.6 billion but it is still \$24.4 billion below the May 2008 peak (all data nominal terms), even as personal consumption expenditures rose to a peak.

- Personal income growth remains a weak spot in the transition from recovery to expansion, and has been disappointing especially given the massive federal transfers propping it up. We think weakness in small-business hiring, optimism and access to credit is a key part of the problem. Disposable personal income excluding transfers grew 0.5% to \$9.00 trillion in May, \$228.6 billion below its 2008 peak.

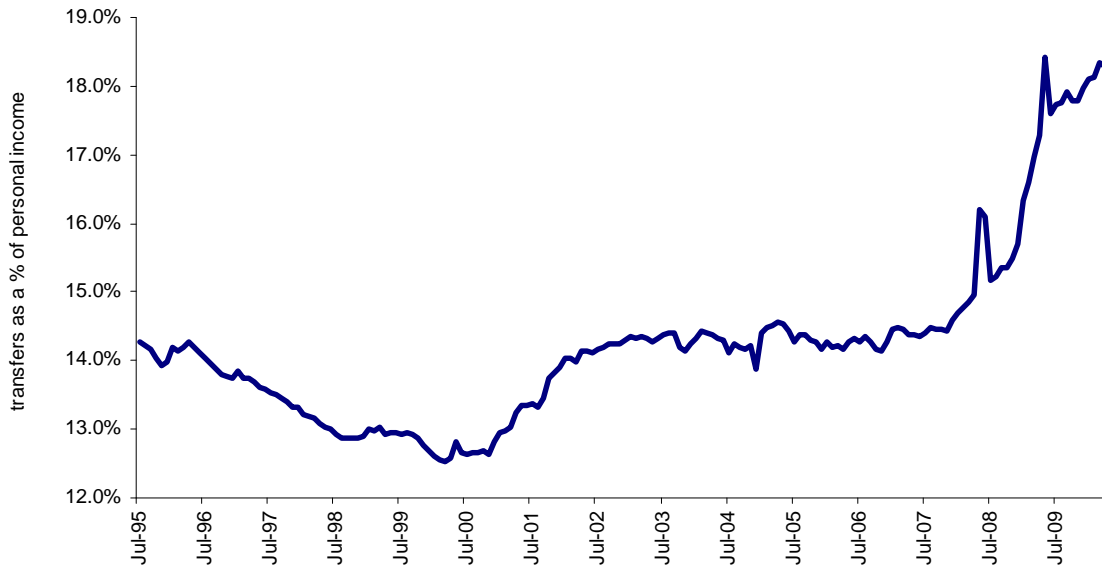
Personal Income and DPI (last obs. May 2010)



Source: Bureau of Economic Analysis; Encima Global

- In May, transfers supplied \$2.25 trillion (annual rate) or 18.2% of total personal income.

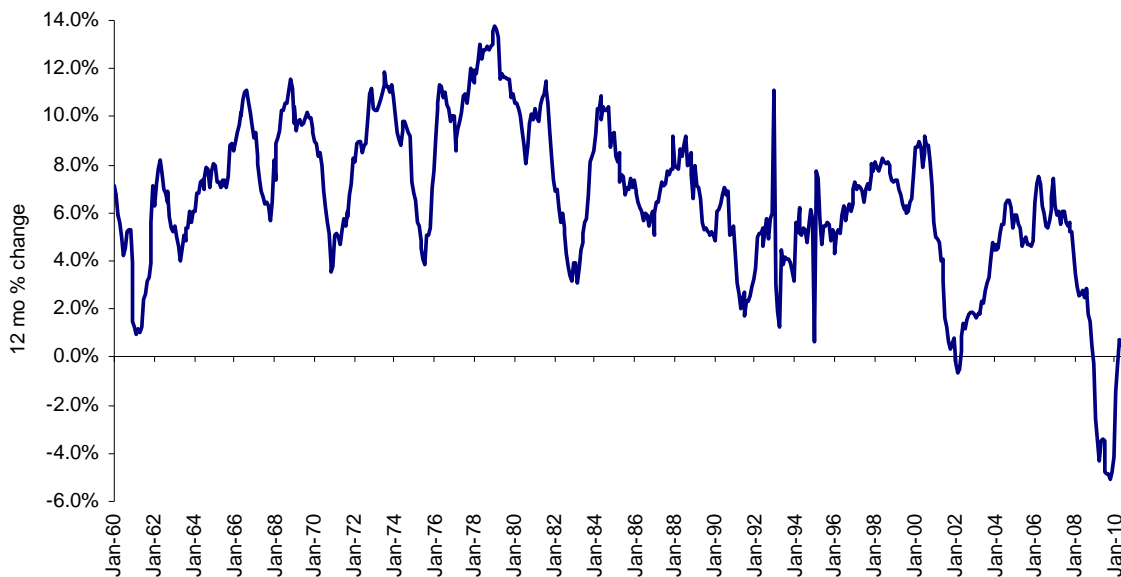
Transfers as a percentage of Personal Income (last obs. May 2010)



Source: Bureau of Economic Analysis; Encima Global

- The May data showed that income from wages and salaries (which don't include transfer payments) rose 0.5% to \$6.36 trillion annual rate. On a year over year basis, wage and salary income is now up 0.7%, having suffered a much deeper decline than in previous recessions. The stabilization in the year-over-year data reflects an improving employment situation from a reduced base, consistent with our outlook for a moderate expansion from the economy's lower base.

Wages & Salaries (y/y change, last obs. May 2010)



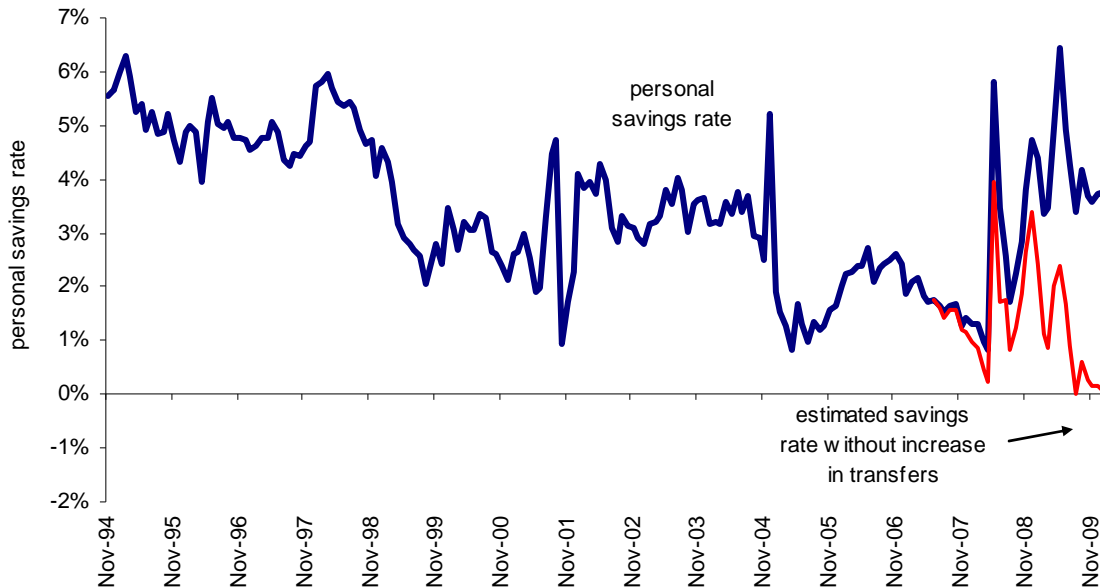
Source: Bureau of Economic Analysis; Encima Global

Transfers Puff Up Personal Savings Rate; Consumption Linked to Jobs

The personal savings rate rose to 4.0% in May from 3.8% in April. Without the increase in federal transfer payments since the end of 2007, however, we estimate the PSR in May would have been 0.2%.

- In effect, higher transfer payments are showing up as higher personal income and a higher personal savings rate at the expense of a rapidly growing national debt. It's a circular process – federal debt is growing enough to provide some household sector savings and some increase in consumption. On a combined basis, however, total U.S. borrowing and the dependence on debt is still growing.

Personal savings rate, excluding increase in transfers (last obs. May 2010)

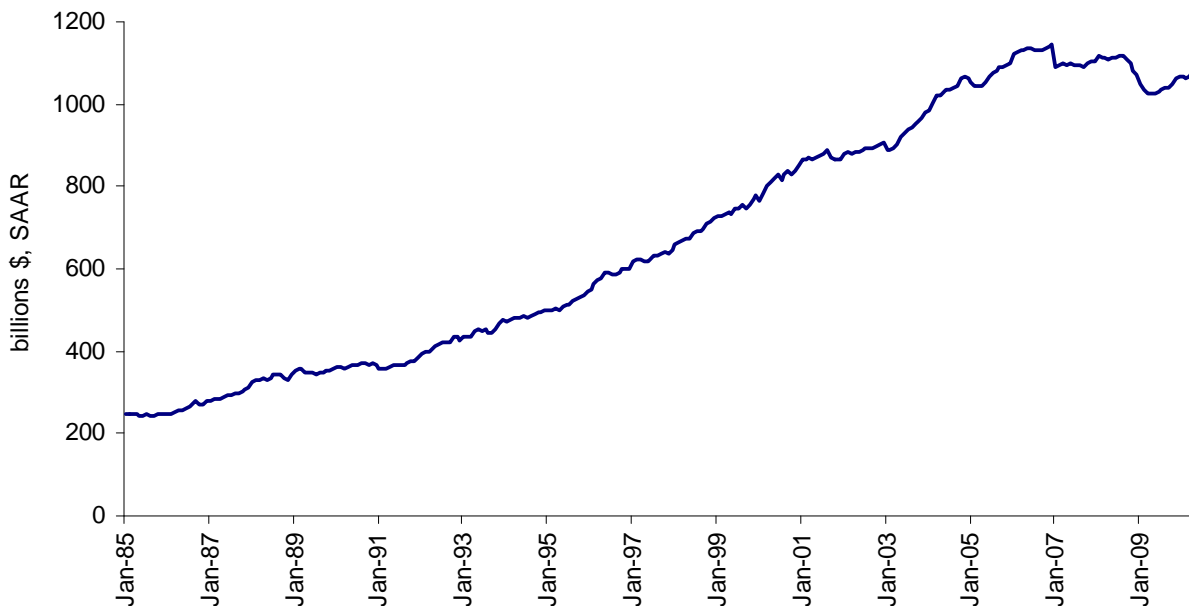


Source: Bureau of Economic Analysis; Encima Global

Small Business Income Rises

- Proprietors' income rose \$6.5 billion or 0.6% to \$1.09 trillion in May from April. On a year over year basis, it's up 5.9% but it is still down 5.2% from the peak in December 2006.

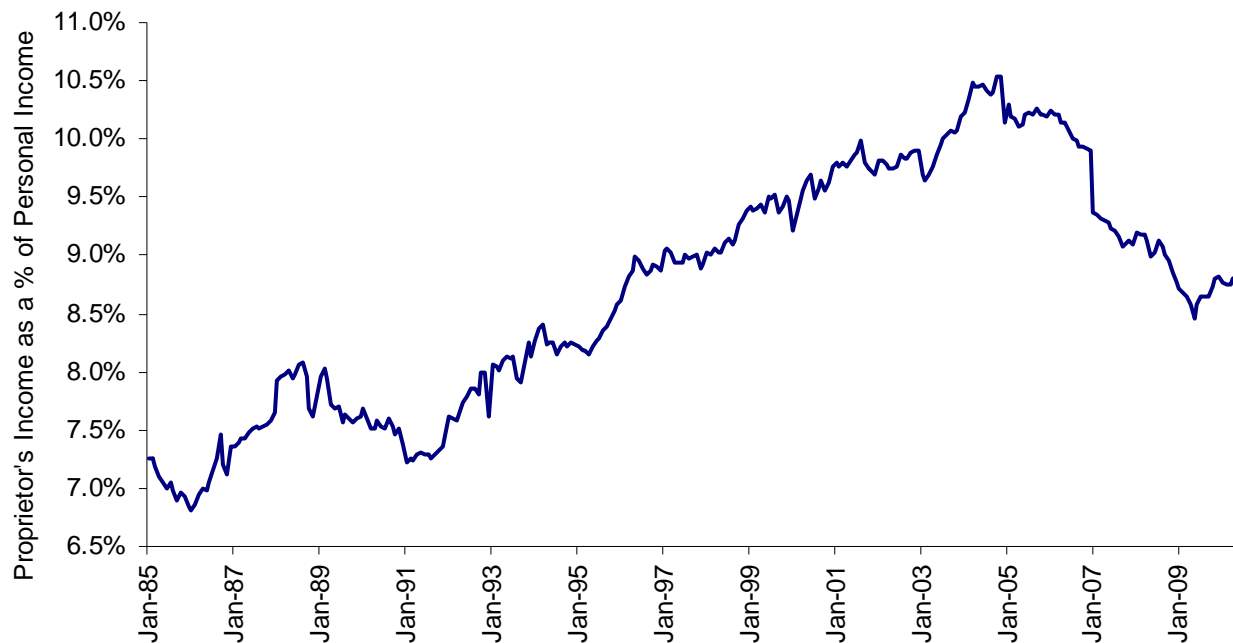
Proprietors' Income with IVA and CCAdj (billions, last obs. May 2010)



Source: Bureau of Economic Analysis; Encima Global

- While governments, big corporations and especially banks are doing well, small businesses have lost a major part of their share in the economy. As a percentage of personal income, proprietors' income stood at 8.8% in May, about the same proportion as in the 1990s. It had peaked in November 2005 at 10.5%. With the economy less dynamic as the federal government expands into new businesses, we expect a sustained expansion, but not enough growth to rapidly lower unemployment.

Proprietors' Income with IVA and CCAdj to Personal Income (last obs. May 2010)



Source: Bureau of Economic Analysis; Encima Global

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