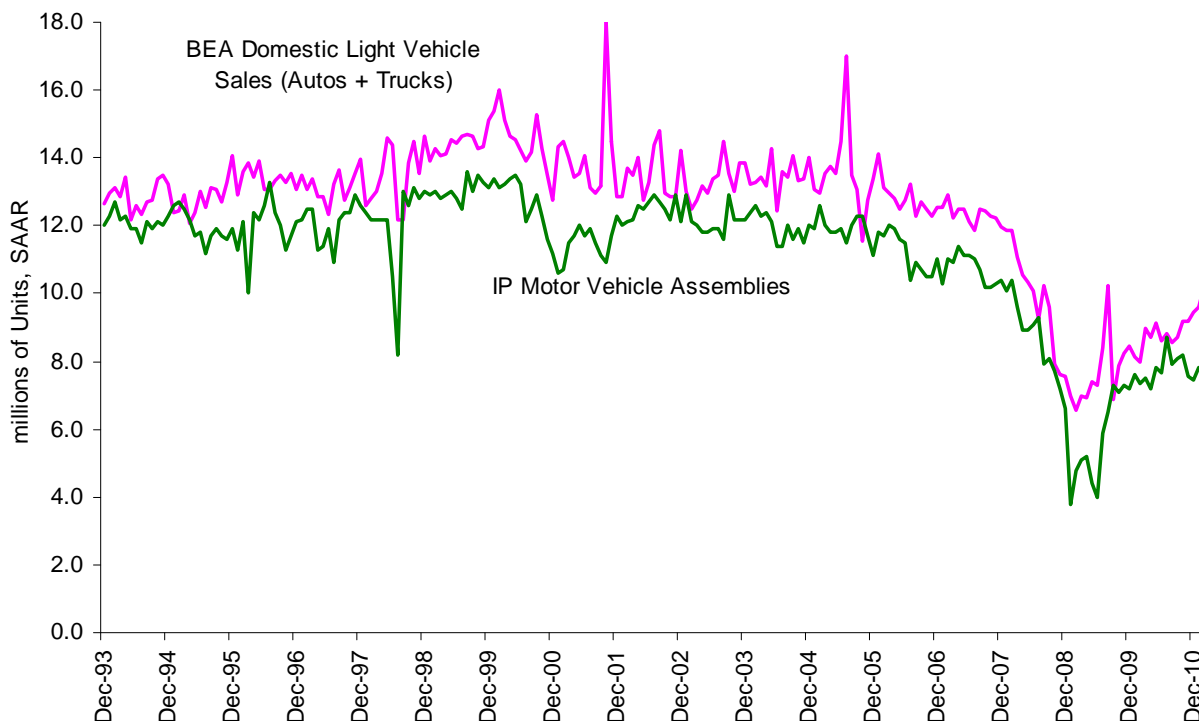


Price Uptrends Intact; U.S. Expansion Builds

Despite the spike in oil prices (we're skeptical it will last), the severe turmoil in North Africa (far from over) and Europe's debt crisis (unresolved), we expect global recovery trends to broaden in 2011.

- Bond yields ended their three-week downturn yesterday, responding more to strong U.S. economic data – February auto sales, ADP employment, ISM, and Chicago PMI – than to the upheaval in North Africa. We're maintaining our 4% first quarter GDP estimate. With February sales of domestically-built vehicles jumping to a 10.2 million annual rate (13.4M total vehicle sales), we think a letdown -- due to the gasoline spike and the partial satisfaction of pent-up demand -- would still leave economic growth beating consensus.

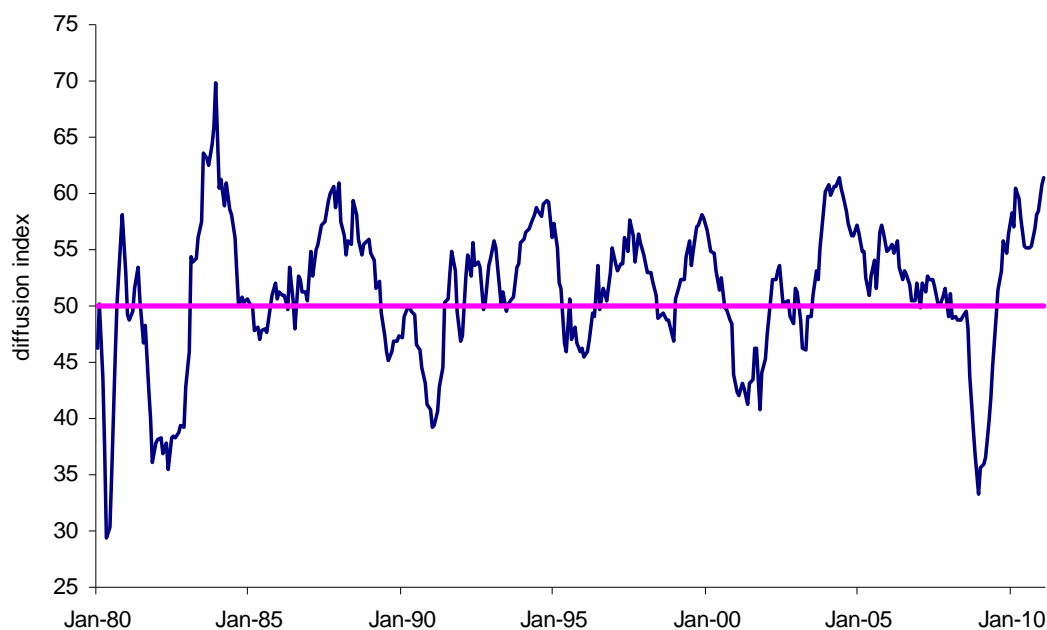
Domestic Auto Sales and Production (last obs. Feb sales, Jan production)



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

- The last time ISM was higher than February's 61.4 was in December 1983.

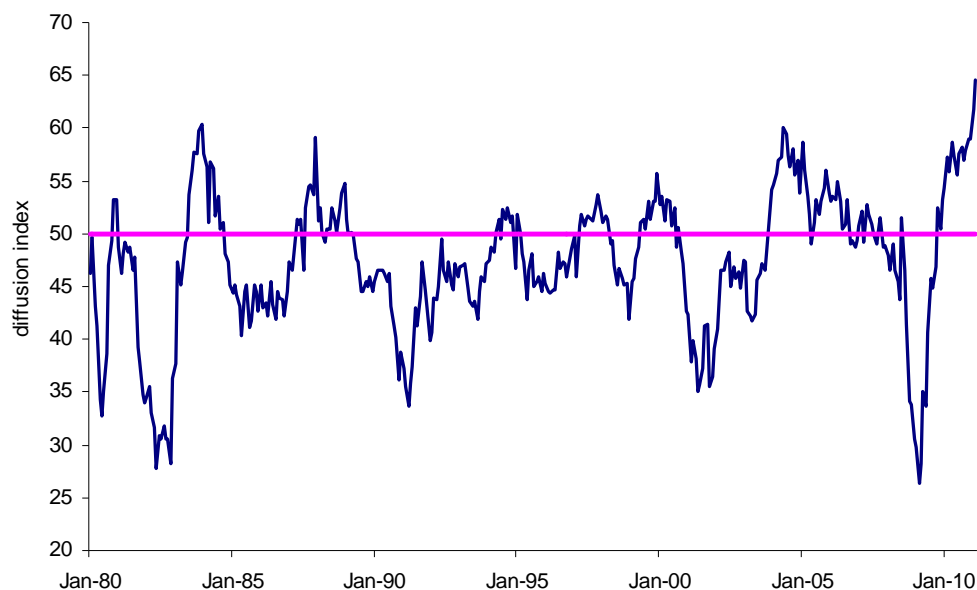
ISM Overall Index (last obs. February 2011)



Source: Institute for Supply Management; Encima Global

- Employment conditions are in a strong uptrend (with the exception of the establishment survey which doesn't pick up turning points). Initial jobless claim have pushed below 400,000. Withholding taxes are up 7.5% year-over-year for December through February, confirming the strong signals from ADP's employment model. **ISM employment, at 64.5 in February, is the highest since 1973.**

ISM Employment Index (last obs. February 2011)

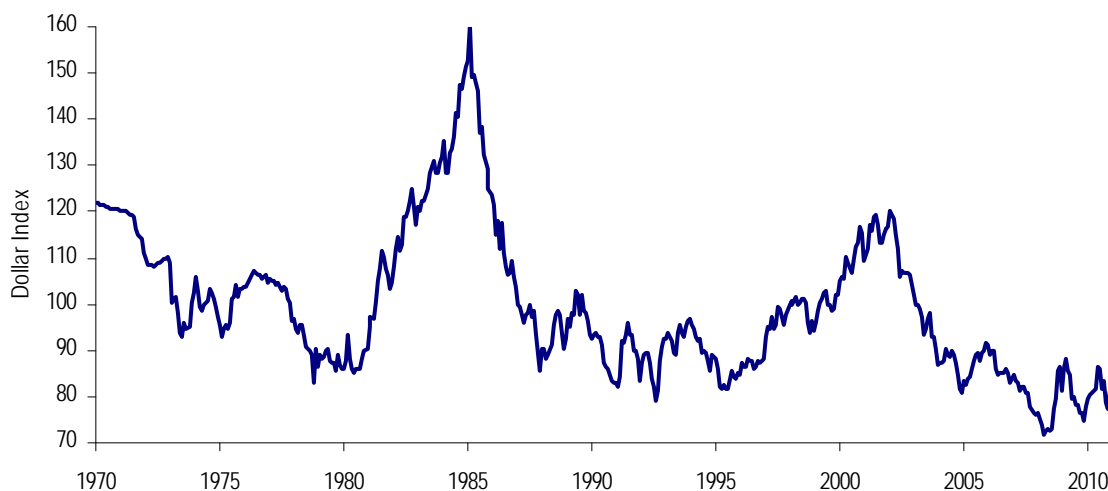


Source: Institute for Supply Management; Encima Global

We expect continued ultra-loose U.S. fiscal and monetary policy and dollar weakness to support the general uptrend in commodities. These policy factors should outweigh China's gradual tightening and the rate hikes and belt-tightening going on outside the U.S. We note other developments supporting the price uptrends:

- The Fed is giving no confidence about the future value of the dollar, forcing market dynamics toward trend-following and momentum rather than fundamentals. Bernanke's ultra-dovish worldview and the lack of traction for federal spending hawks provide no floor to the value of the dollar, which is weakening again...

DXY – Dollar Index (last obs. March 2, 2011)



Source: Bloomberg; Encima Global

- ... and no ceiling on commodity prices. Commodities are in their sharpest upturn since the 2007-2008 blowout, while the U.S. weak-dollar policy is as entrenched as it was then.

CRB Futures Index (last obs. March 2, 2011)



Source: CRB; Encima Global

- The large amounts of cash on the sidelines (especially relative to commodities) and the availability of commodity ETFs argue for sudden momentum-based rotations among commodities as part of a general uptrend. Silver levitated in recent months (nearly doubling since September), catching the wave of liquidity.
- The strong uptrend for emerging markets paused late in 2010, but we think conditions are still generally favorable for growth and earnings. High commodity prices are creating inflation and rate-hike problems, but we don't think those stop the underlying uptrend.

This isn't a growth-maximizing set of macro-economic conditions and market dynamics, but we don't think we're at an end point. The U.S. is kicking the can down the road, combining huge federal debt increases with massive transfer payments and no-interest auto loans to pump up the economy. And an increasing portion of credits are being borrowed by sturdier debtors (sovereigns, bonds, IMF, Europe's EFSF Facility) rather than weak countries and small businesses. This process is rapidly changing the credit structure in the U.S. and Europe, providing near-term stability though less dynamism. (For example, as the FDIC takes over a bank, the U.S. government takes the place of the bank in the bank's liabilities. The depositor or other creditor of the bank is safer. The bank's assets migrate to other banks and the system is more stable in the short run.)

- **Europe's debt crisis is far from over, creating the potential for negative surprises** – a failed stress test at a German bank, an Irish refusal to pay debt service, etc. But we think there are enough global mechanisms in place to protect the

international financial system as European debt is restructured. There's a possibility of second-half ECB rate hikes -- to demonstrate its inflation-fighting credentials post-Trichet – but we don't think that will hurt northern Europe's growth prospects or derail a global recovery.

- **Geopolitical conditions are a constant risk** – a naval confrontation in the Mediterranean, a flare-up in Saudi Arabia or Pakistan, a terrorist attack – but, on the positive side, Iran has had setbacks in its quest to become a nuclear power. We're not arguing that the world is safer or more growth-oriented due to North Africa, but the developments are not so negative as to break the global uptrend.

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