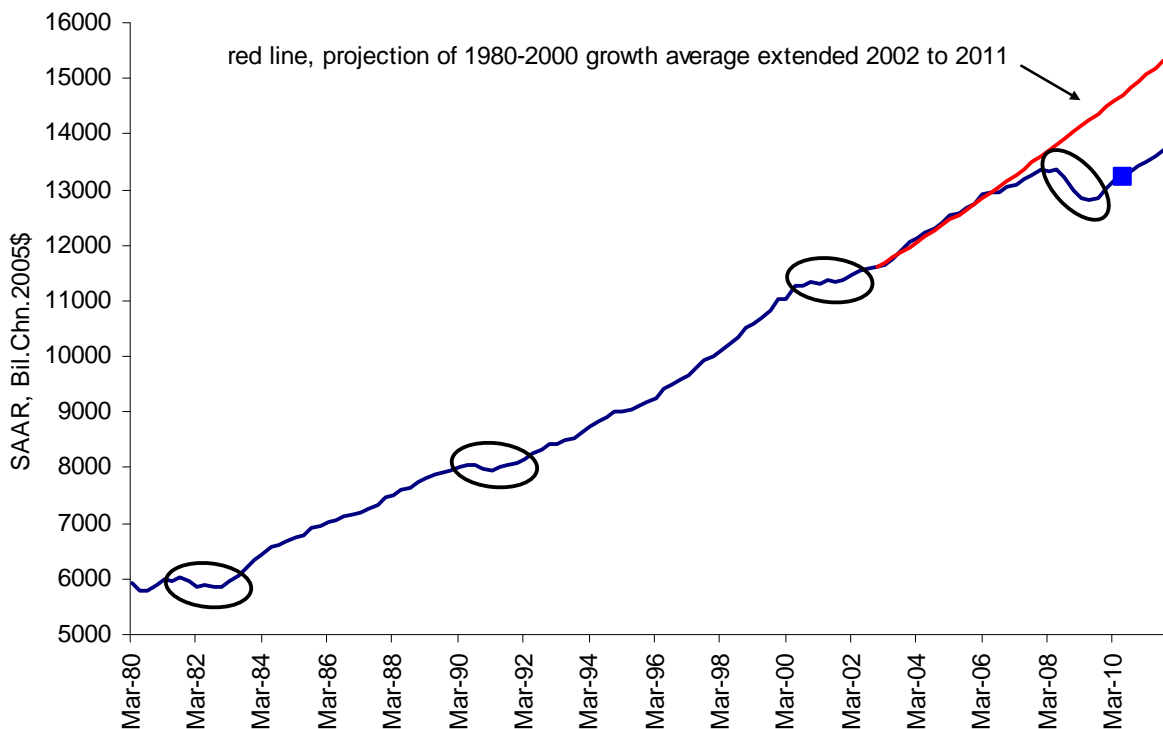


August 2, 2010

GDP Report Shows Lower Start for Second Half Growth

Despite the weak second quarter GDP report, we think the economy is transitioning from recovery to a sustained expansion. However, the expansion is starting from a deeper recession than the previous three (1980s, 1990s, 2000s) and, under current Washington policies, is likely to be weaker in terms of annual growth. Slower growth from a lower base means painfully high unemployment and a series of rolling debt crises.

Real GDP, Slower Growth from Lower Base (recessions circled) (blue line real GDP, last obs. square is Q2 2010, forecast to Q4 2011)



Source: Bureau of Economic Analysis; Encima Global

- On the positive side, business investment is strengthening from the very low base set in 2009. We expect pent-up demand for both investment and consumption to leave shortages and pricing power in many sectors. Global growth and corporate profits are strengthening, arguing for improved private sector job growth in coming months.

- Today's ISM reading, at 55.5, is still high enough to support our expectation of 3% real growth in coming quarters.

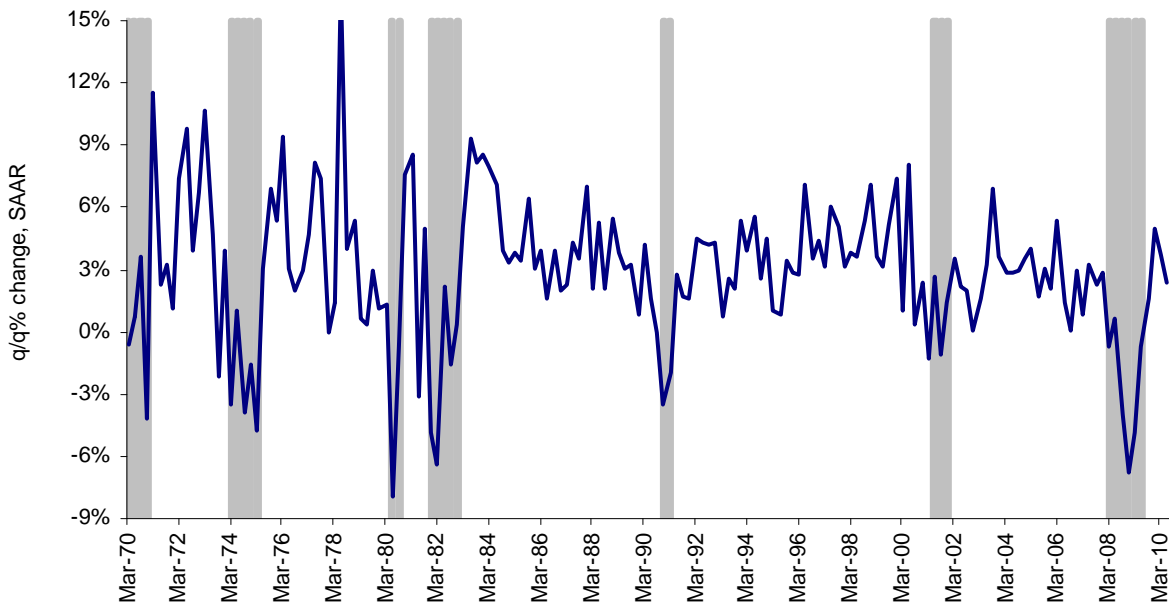
ISM Manufacturing (last obs. August 2010)



Source: ISM; Encima Global

- In the second quarter, real GDP rose at a 2.4% seasonally adjusted annual rate, decelerating from the upwardly revised 3.7% first quarter growth rate (was 2.7%).

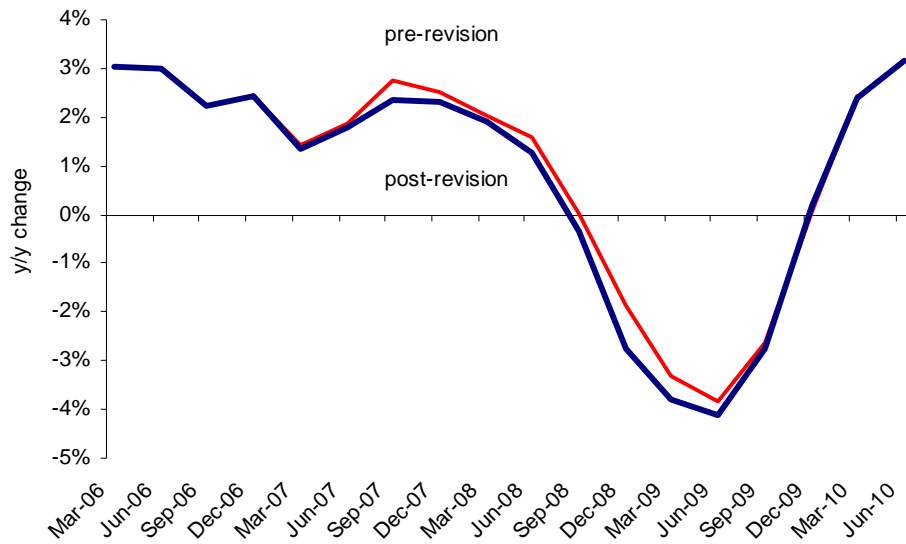
US Real GDP Growth (q/q change, last obs. Q2 2010)



Source: Bureau of Economic Analysis; Encima Global

- The revision was part of the regular annual revision that covered data from the first quarter of 2007 to the first quarter of 2010. The effects were small over the entire period and resulted in a net downward revision of \$99.8 billion (chain 2005\$) for Q1 2010 real GDP. (In the year-over-year chart below the post-revision figure isn't visible for Q4 2009 and Q1 2010 because it lies on top of the pre-revision figure.)

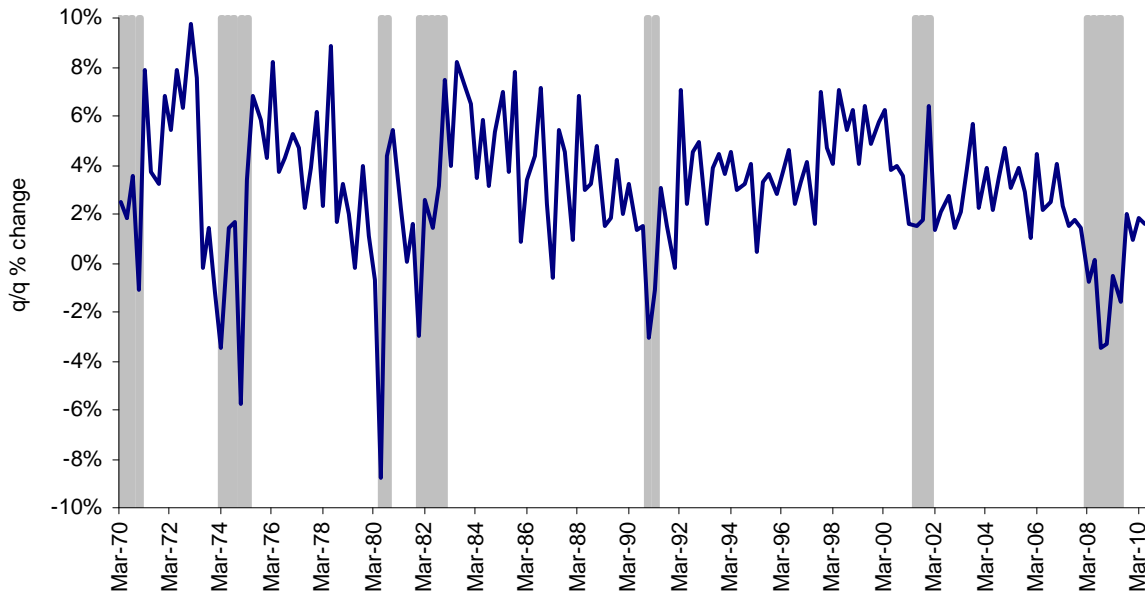
Real GDP Y/Y (last obs. Q2 2010)



Source: Bureau of Economic Analysis; Encima Global

- GDP grew a slow 2.4% in the second quarter of 2010. Most of the gains came from fixed investment, helped by government tax credits for homebuyers, a continuing business recovery and inventory building. Crucial small business hiring and investing show stabilization but not recovery, holding the economy back from the V-shaped recovery that would normally have followed the 2008 economic freefall.
- Growth in real personal consumption slowed to 1.6% in the second quarter, from a downwardly revised 1.9% in the first quarter (was 3%). Sluggish PCE reflects the still-weak labor environment. With the revisions to the historical data, this is the fourteenth consecutive quarter (since Q4 2006) that real PCE growth hasn't reached 2.5%. We think consumption growth in coming quarters may range from 2.5%-3.5%, helped by pent-up demand but tempered by the weakness in the small business and labor environment still weak.

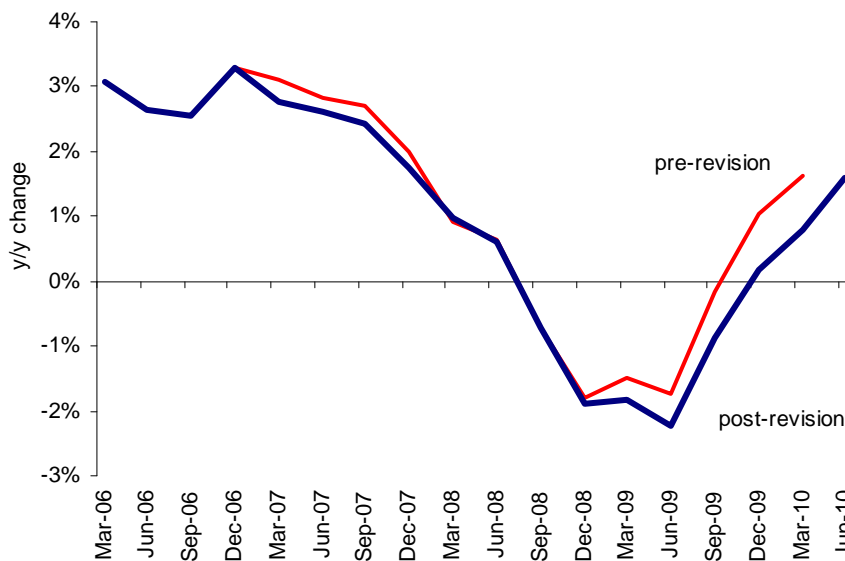
Real PCE (q/q change, last obs. Q2 2010)



Source: Bureau of Economic Analysis; Encima Global

- The benchmark revision to GDP included a large downward revision to consumption, which knocked almost \$134 billion off Q1 real consumption (2005 dollars).

Real PCE Y/Y (last obs. Q2 2010)



Source: Bureau of Economic Analysis; Encima Global

- Second quarter growth was helped by strong gross private domestic investment in both residential investment, up 27.9% (QoQ, SAAR) and business equipment, up 21.9%.

Business structures grew a more modest 5.1%. Federal non-defense spending grew 13.0%.

Real GDP Q/Q SAAR (last obs. Q2 2010)

	2Q 09	3Q 09	4Q 09	1Q 10	2Q 10(a)
Real GDP	-0.7%	1.6%	5.0%	3.7%	2.4%
Personal Consumption	-1.6%	2.0%	1.3%	1.9%	1.6%
Durables	-3.1%	20.1%	-1.1%	8.8%	7.5%
Nondurables	-0.7%	1.7%	3.1%	4.2%	1.6%
Services	-1.7%	-0.5%	0.5%	0.1%	0.8%
Residential Investment	-19.7%	10.6%	-0.8%	-12.3%	27.8%
Business Structures	-20.2%	-12.4%	-29.2%	-17.8%	5.1%
Business Equipment	0.2%	4.2%	14.6%	20.5%	21.9%
Government Purchases	6.2%	1.6%	-1.4%	-1.6%	4.4%
Federal	14.9%	5.7%	0.0%	1.9%	9.1%
State/Local	1.0%	-1.0%	-2.3%	-3.8%	1.3%
Note: Final sales	0.3%	0.5%	2.2%	1.1%	1.3%
Nominal GDP	-0.4%	2.3%	4.7%	4.8%	4.3%

Source: Bureau of Economic Analysis; Encima Global

- The change in inventories in the second quarter contributed 1.0% of the 2.4% real growth. Consumption contributed 1.2%. Imports subtracted 4.0%, while exports contributed 1.2%, resulting in net exports contributing -2.8%. Government purchases contributed 0.9% to GDP.

Real GDP Q/Q Contributions (last obs. Q2 2010)

	2Q 09	3Q 09	4Q 09	1Q 10	2Q 10(a)
Real GDP	-0.7%	1.6%	5.0%	3.7%	2.4%
Personal Consumption Expenditures	-1.1%	1.4%	0.7%	1.3%	1.2%
Durables	-0.2%	1.4%	-0.1%	0.6%	0.5%
Nondurables	-0.1%	0.3%	0.5%	0.7%	0.3%
Services	-0.8%	-0.2%	0.3%	0.0%	0.4%
Residential Investment	-0.5%	0.3%	0.0%	-0.3%	0.6%
Business Structures	-0.8%	-0.4%	-1.0%	-0.5%	0.1%
Business Equipment	0.0%	0.3%	0.9%	1.2%	1.4%
Government Purchases	1.2%	0.3%	-0.3%	-0.3%	0.9%
Federal	1.1%	0.5%	0.0%	0.2%	0.7%
State/Local	0.1%	-0.1%	-0.3%	-0.5%	0.2%
Inventories	-1.0%	1.1%	2.8%	2.6%	1.1%
Net Exports	1.5%	-1.4%	1.9%	-0.3%	-2.8%
Exports	-0.1%	1.3%	2.6%	1.3%	1.2%
Imports	1.6%	-2.7%	-0.7%	-1.6%	-4.0%

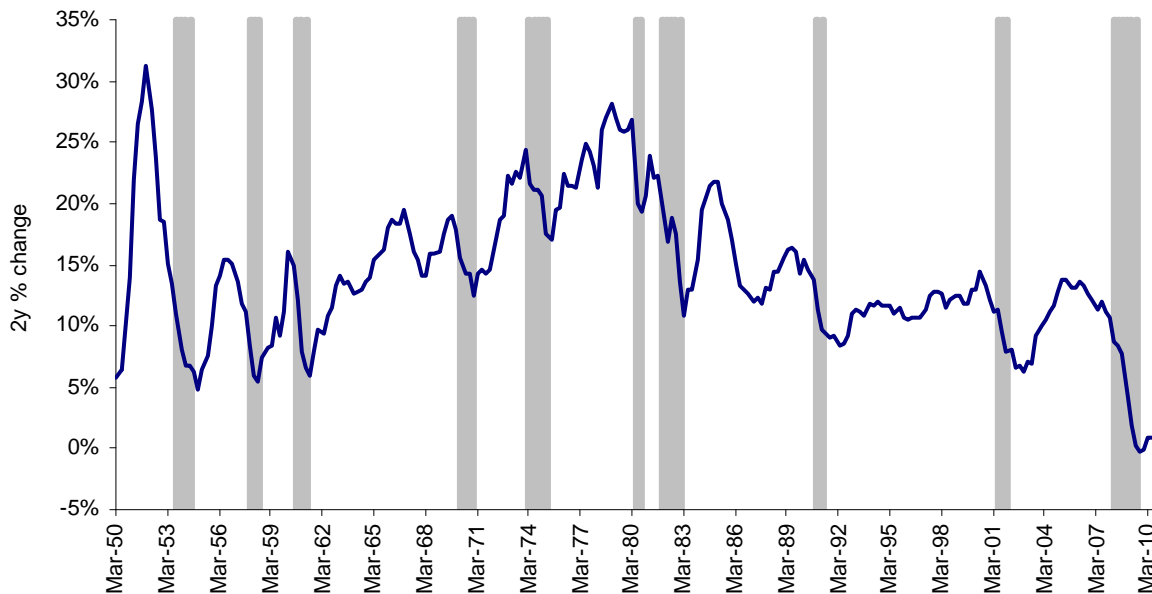
Source: Bureau of Economic Analysis; Encima Global

Nominal GDP Finally Tops 2008 Peak

Nominal GDP (the platform for corporate earnings) increased 4.3% annualized in the second quarter from the first, reaching a \$14.6 trillion seasonally-adjusted annual rate, a new peak. The previous peak was \$14.5 trillion in the third quarter of 2008.

- The nominal two-year growth rate has been rising for three quarters, reaching 0.9%, but remains well below all the previous troughs. The -0.3% (revised) rate registered at the two-year trough in the third quarter of 2009 was by far the weakest two-year nominal growth since these records started in 1949.

Nominal U.S. GDP: Deep Trough (2-yr change, last obs. Q2 2010)



Source: Bureau of Economic Analysis; Encima Global

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