



Summer Shocks

QE2, Debt Limit, Europe Debt

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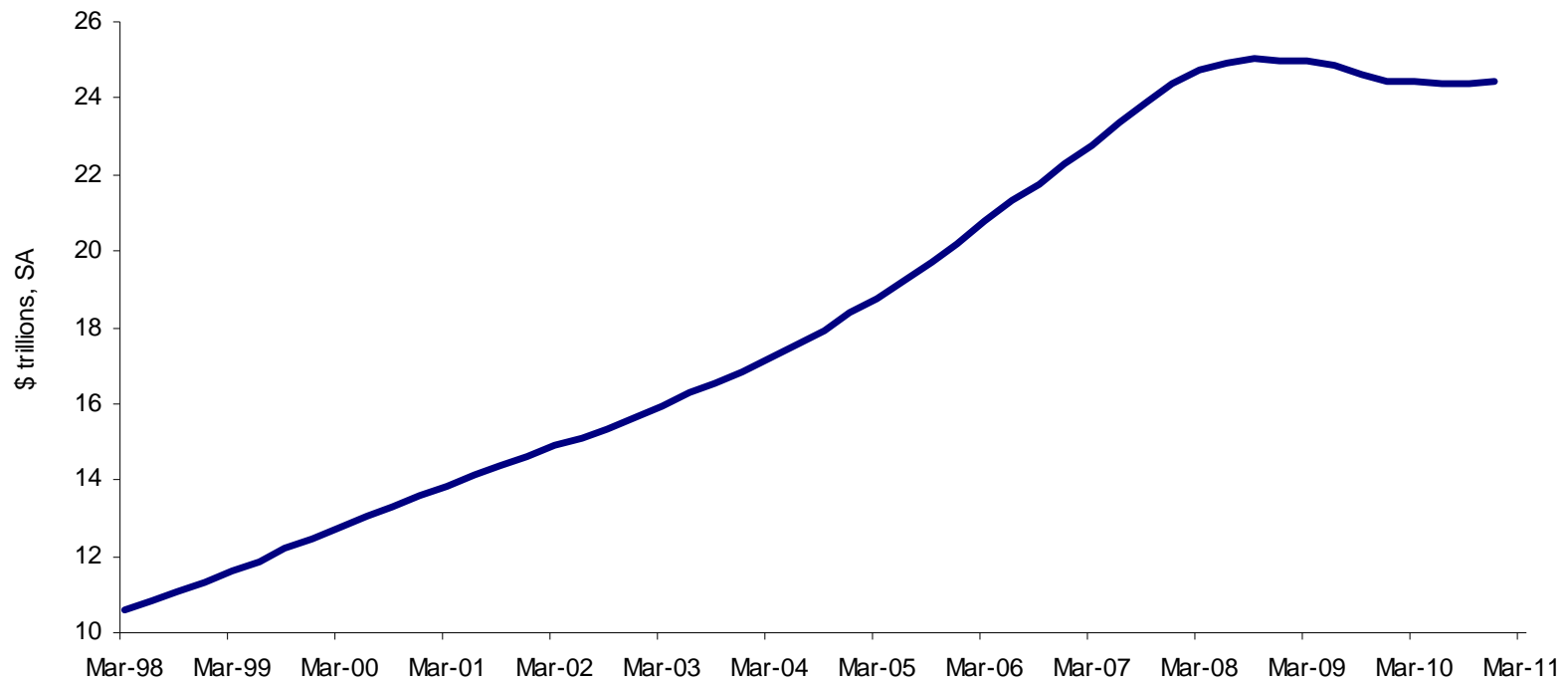
Please read the important disclosure information in the Addendum section of this presentation.

QE2 Ends Like Y2K

- **We think QE2's impact on the economy, markets and inflation has been exaggerated. QE2 isn't money printing and isn't very powerful in its current form. To achieve its balance sheet expansion, the Fed pays an above-market interest rate to commercial banks for extra deposits at the Fed. The result has been a rise in excess commercial bank reserves equivalent to the Fed's balance sheet expansion and little transmission from QE2 to private sector credit growth or to the economy.**
- **The commodity spike and the squeeze on Treasury bonds got overdone in part due to the view that the Fed's QE2 was a new form of printing money that would create a near-term crisis. QE2 has caused substantial distortion in credit markets and artificially depressed the dollar, but we don't think this creates the near-term crisis that's assumed in high gold and commodity prices and low Treasury bond yields.**
- **The market implications are: 1) the completion of QE2 shouldn't be contractionary; we think equities will go up, a sigh of relief, not down as some have argued; 2) similarly, bond yields should rise as worries about post-QE deflation subside; the threat that the debt limit might stop Treasury issuance during the Fed's final QE2 purchases has squeezed yields down, but we think the 10-year Treasury yield may reach 4% toward year-end on evidence of 3% U.S. growth and over 3% CPI inflation; 3) global non-commodity-linked emerging markets (like India and China) should do well after underperforming during the QE2 fascination.**

QE2 Didn't Increase Private Sector Credit Much

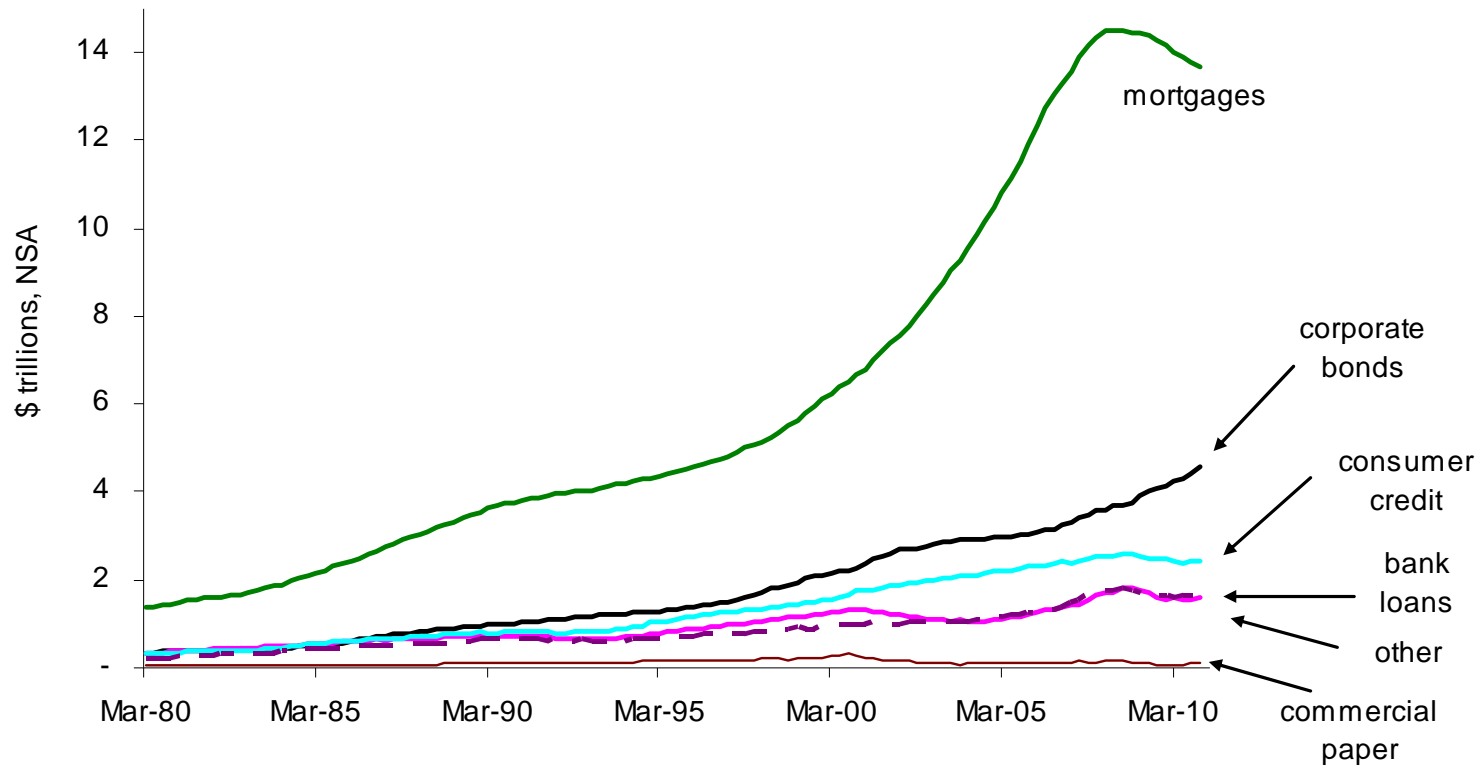
(last obs. Q4 2010)



Source: Federal Reserve; Encima Global

Private Sector Credit by Instrument

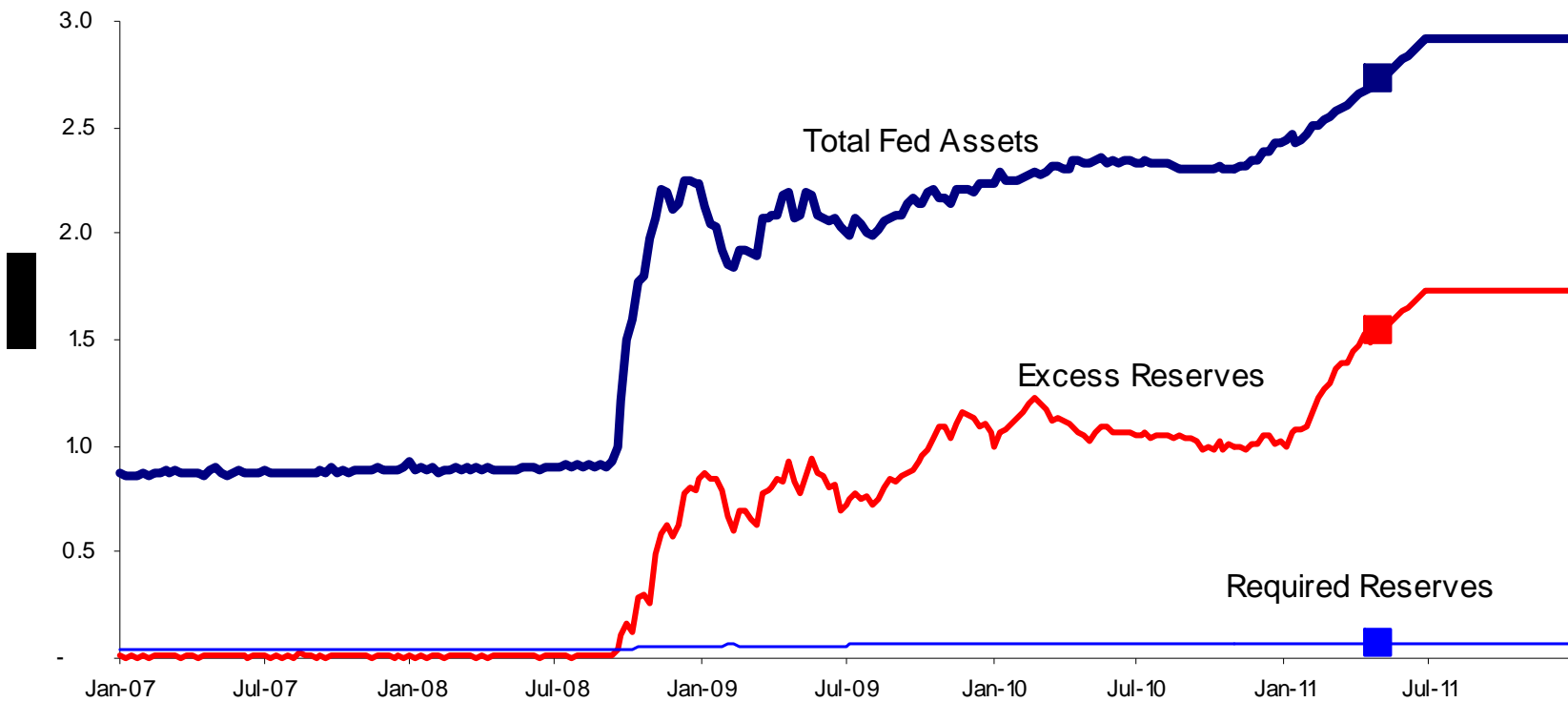
(last obs. Q4 2010)



Source: Federal Reserve; Encima Global

Excess Reserves Rose – Fed ‘Pushing on a String’

(last obs. May 4, 2011, projected through December 2011)



Source: Federal Reserve; Encima Global

M2 Growth Still Sluggish

(last obs. April 25, 2011)



Source: Federal Reserve; Encima Global

M2 Growth Didn't Increase With QE2, Won't Change When It Ends

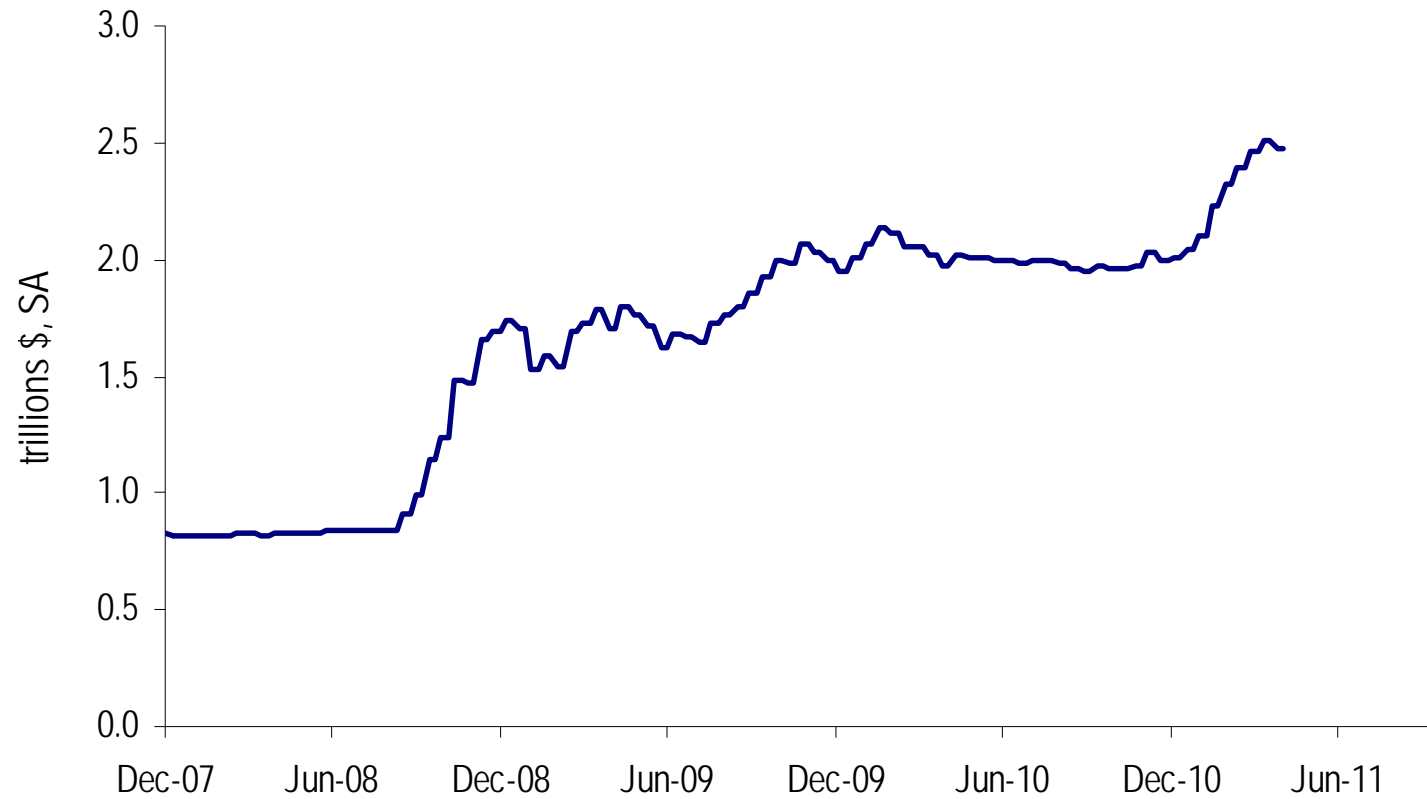
(last obs. April 25, 2011)



Source: Federal Reserve; Encima Global

M0

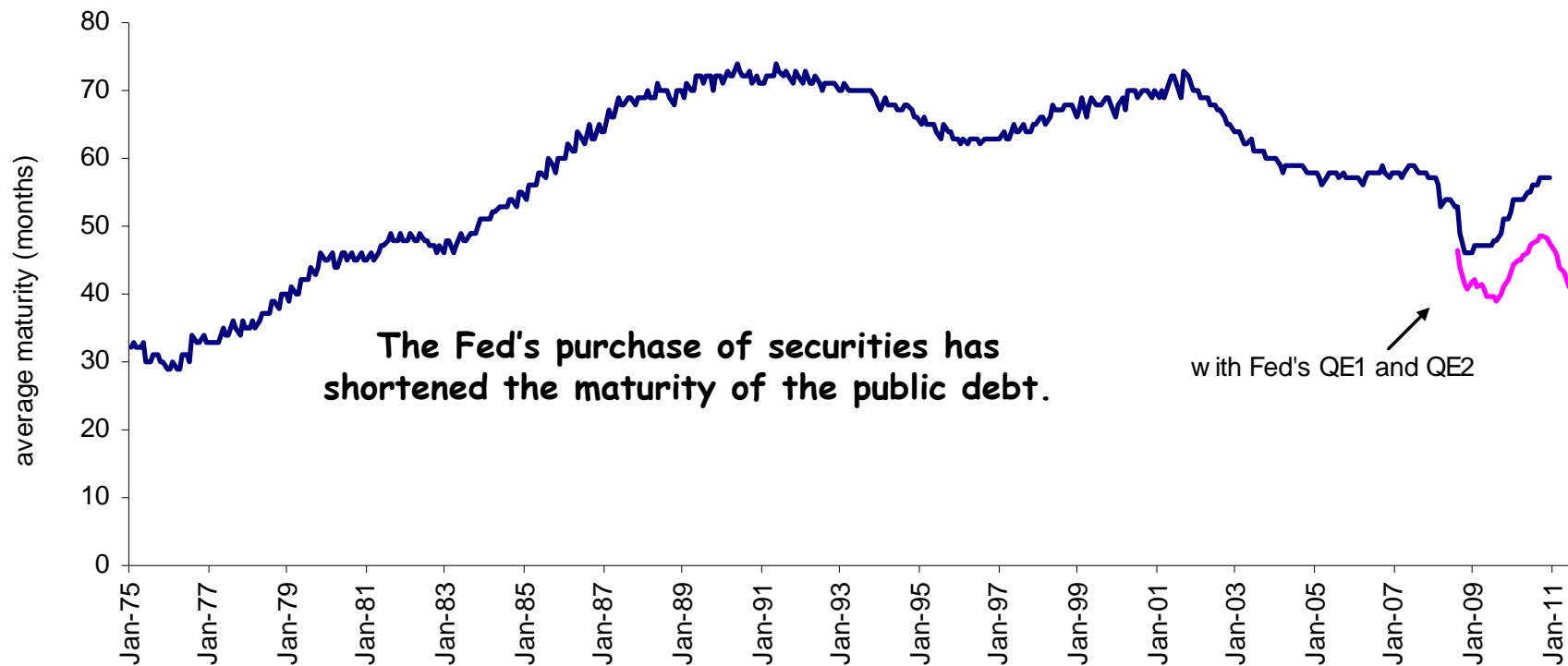
(last obs. May 2, 2011)



Source: Federal Reserve; Encima Global

QE2 Shortened Effective Maturity of National Debt

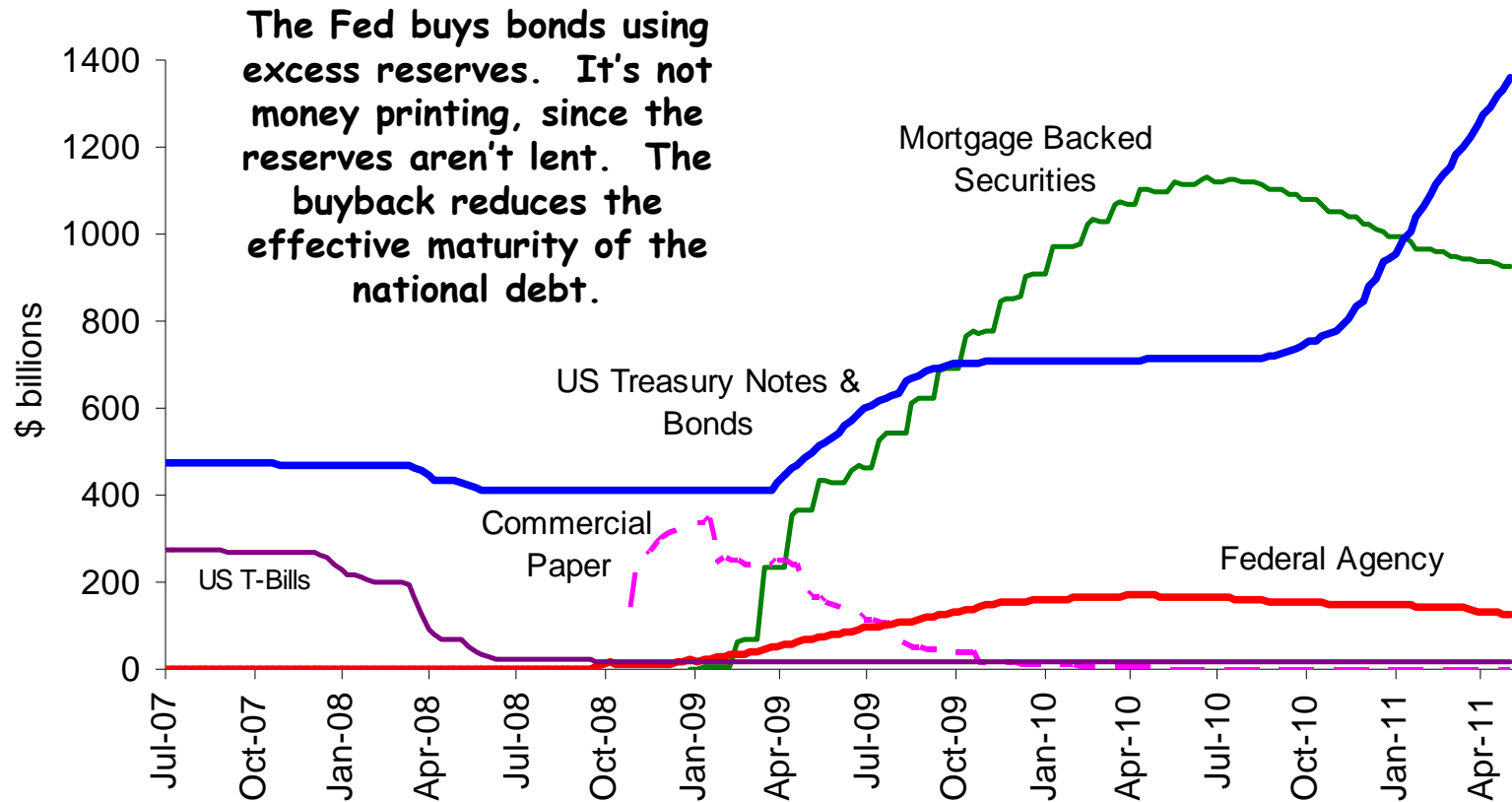
(in months, last obs. Dec 2010; QE2 projected through June 2011)



Source: US Treasury; Federal Reserve; Encima Global

Fed Now a Giant SIV

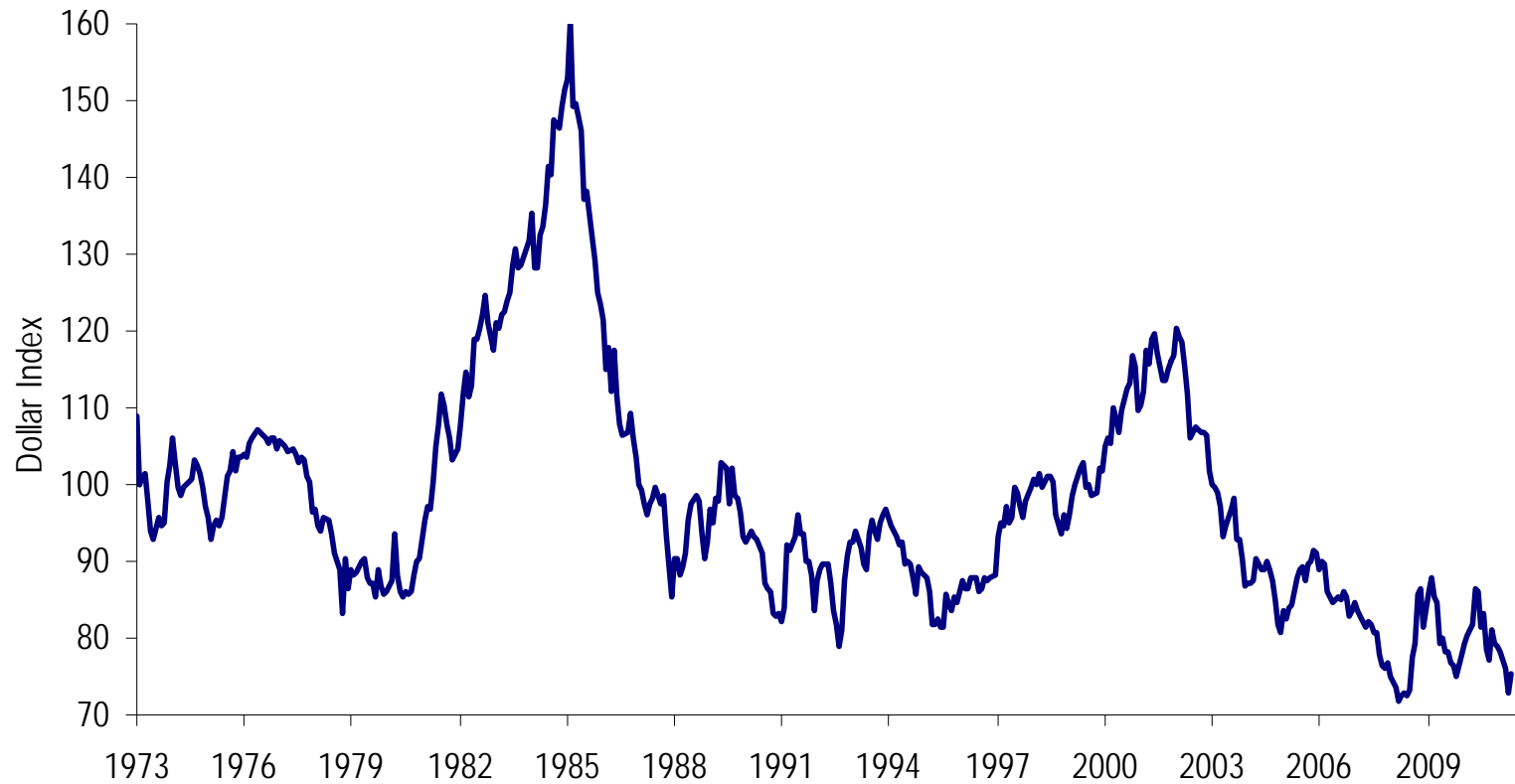
(last obs. May 4, 2011)



Source: Federal Reserve; Encima Global

DXY – Dollar Index

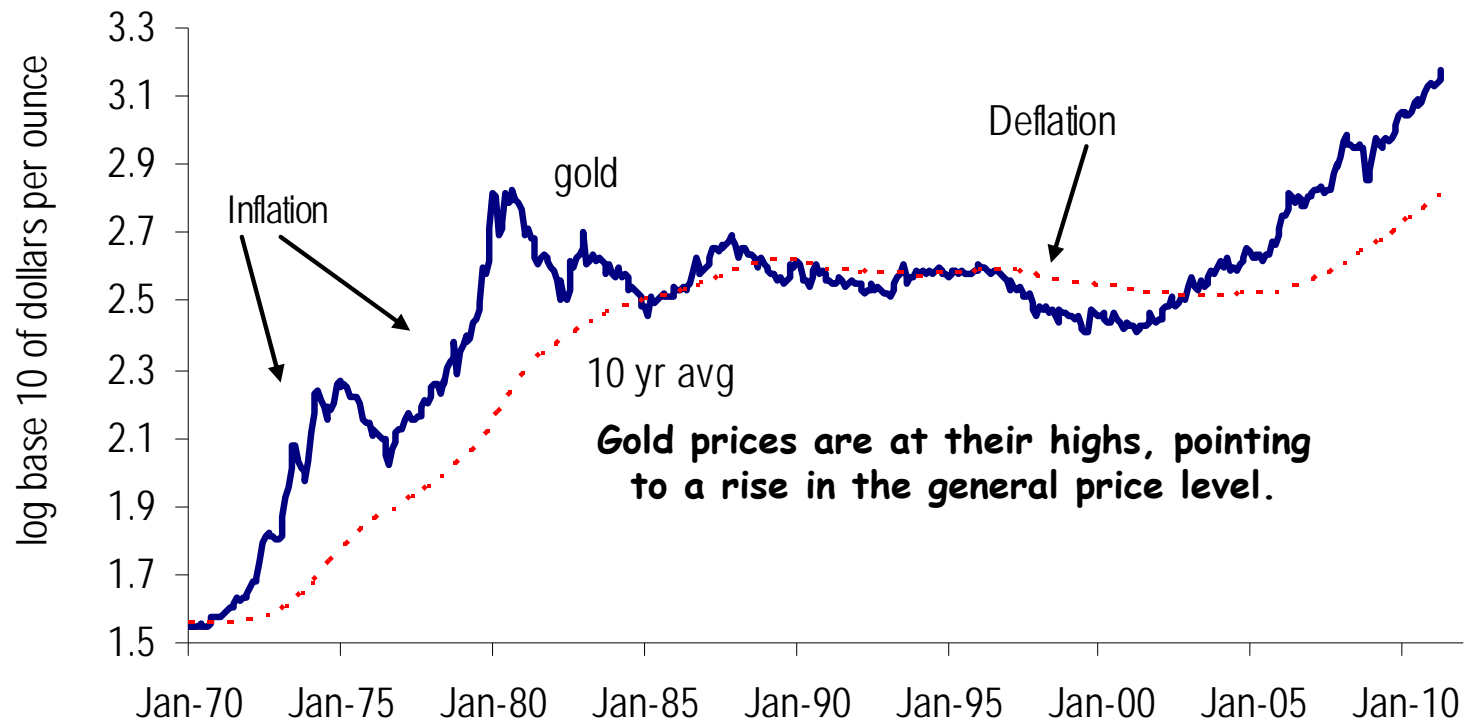
(last obs. May 12, 2011)



Source: Bloomberg; Encima Global

Gold high, dollar low, pointing to rise in other prices

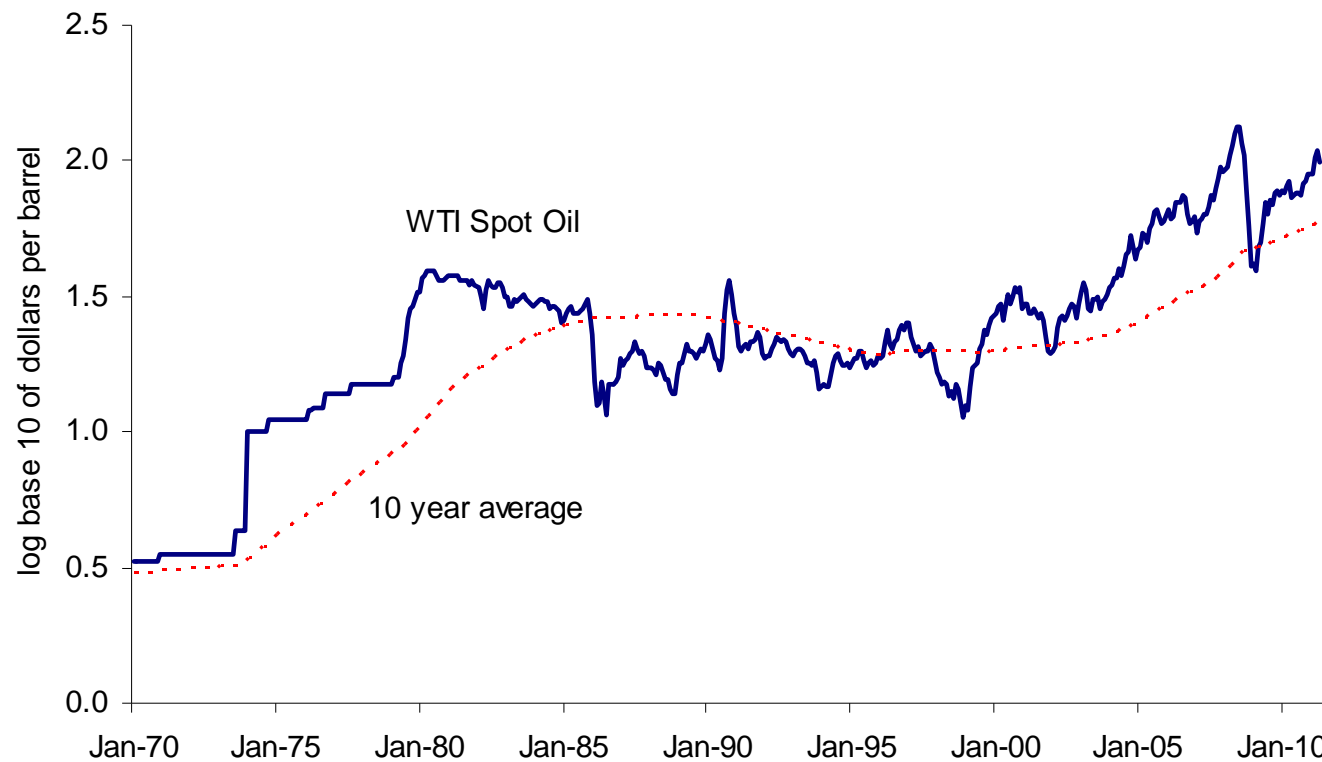
(last obs. May 12, 2011)



Source: Wall Street Journal; Encima Global

High oil prices reflect dollar's weak value

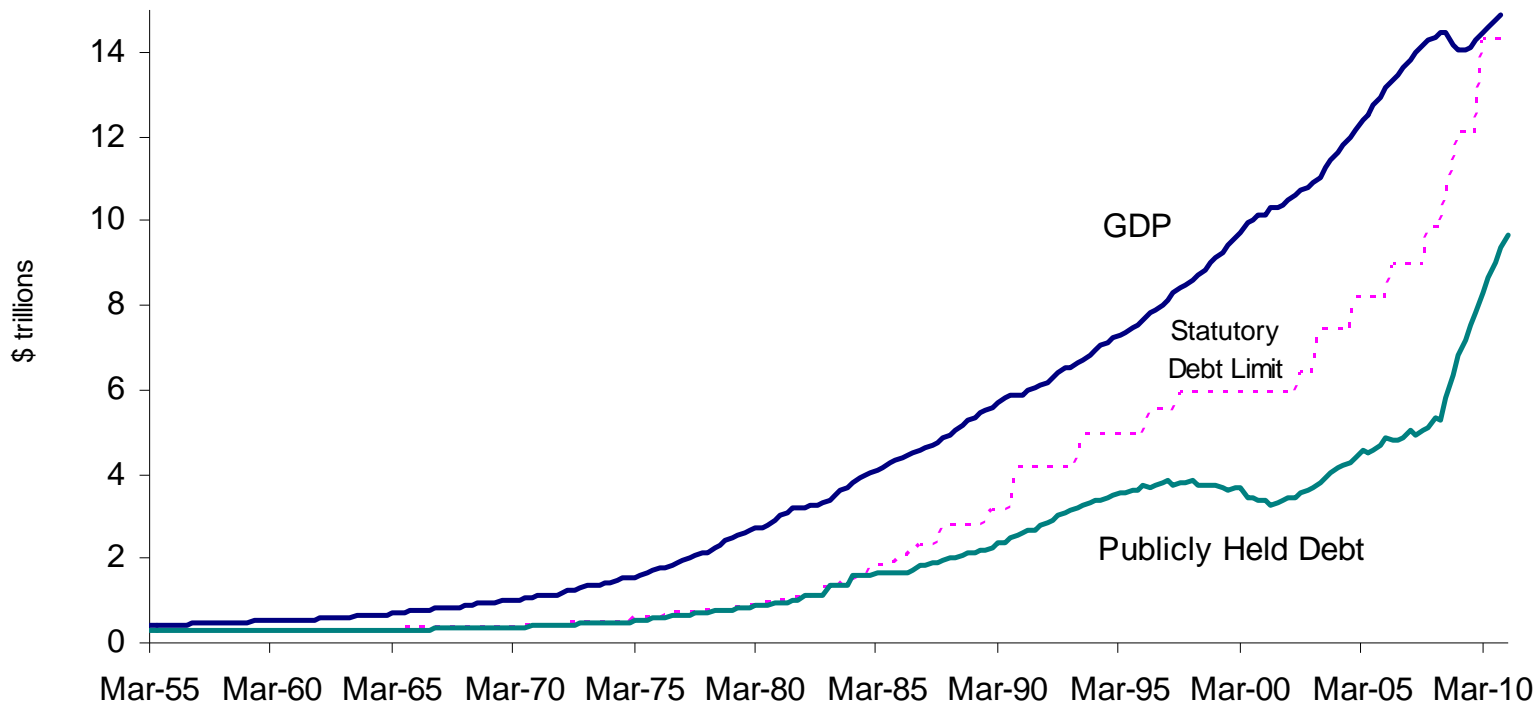
(last obs. \$98.2 on May 12, 2011)



Source: Wall Street Journal; Encima Global

Publicly Held Debt Reaching 70% of GDP

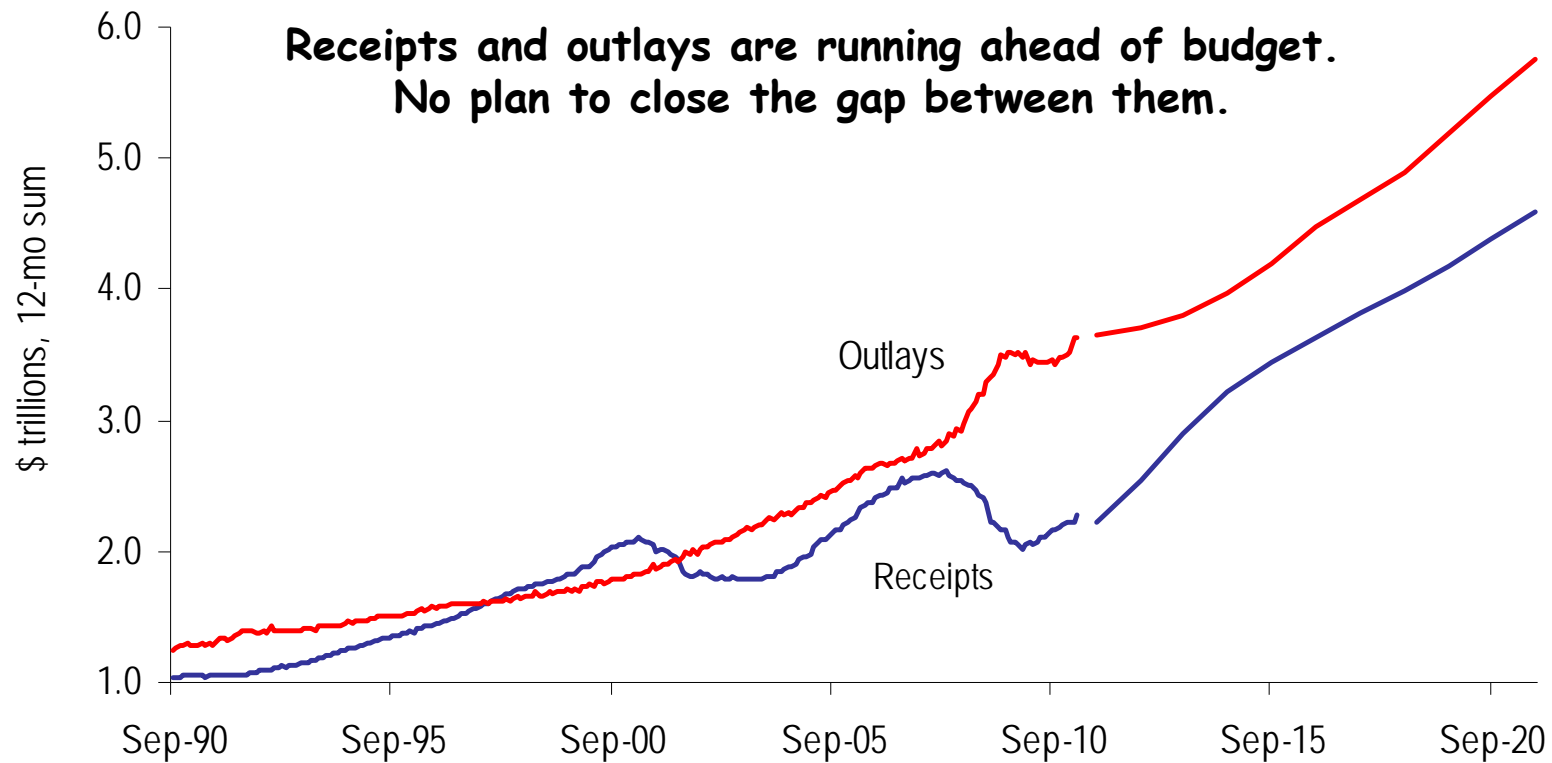
(last obs. Q1 2011)



Source: Bureau of Economic Analysis; U.S. Treasury; Encima Global

Federal Receipts and Outlays

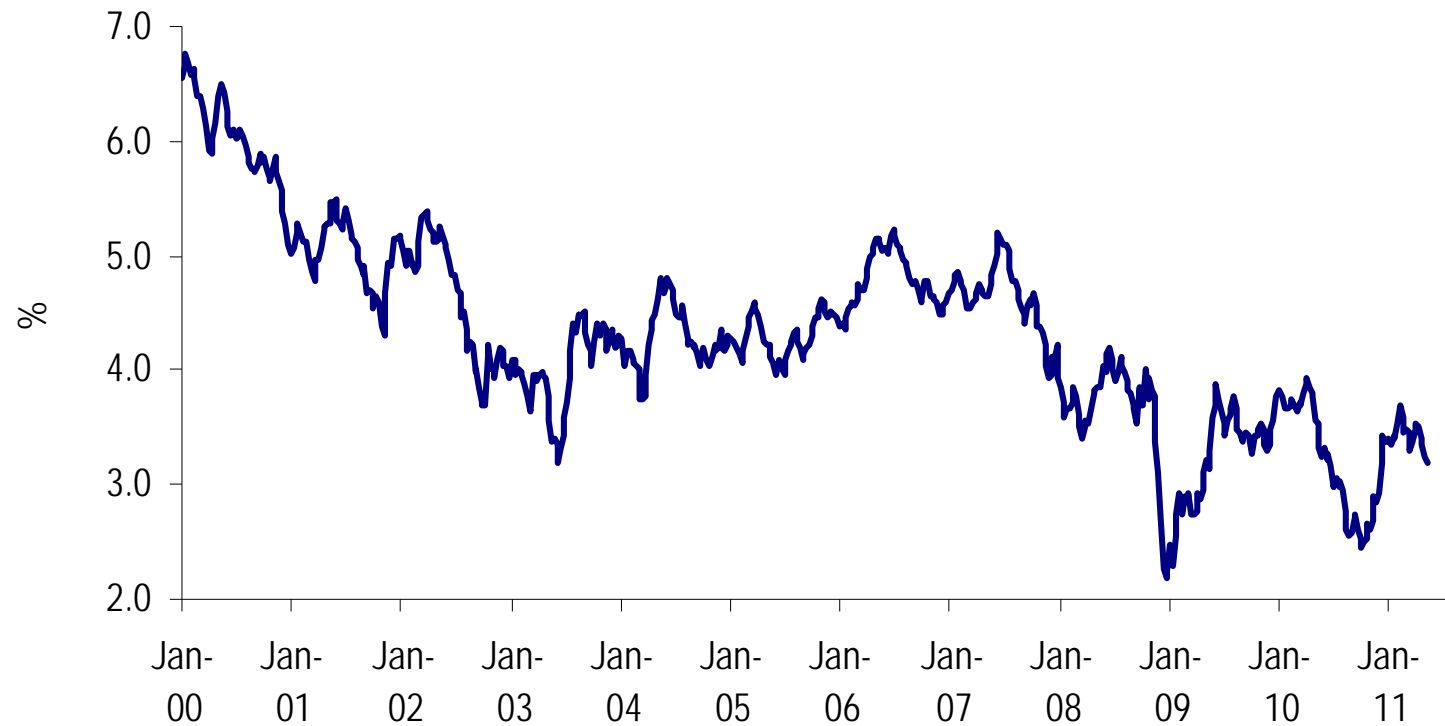
(last obs. April 2011, CBO re-estimate of the President's budget FY2011-2021)



Source: Congressional Budget Office; Encima Global

10 Year Treasury Yield To Rise In Second Half

(last obs. May 12, 2011)



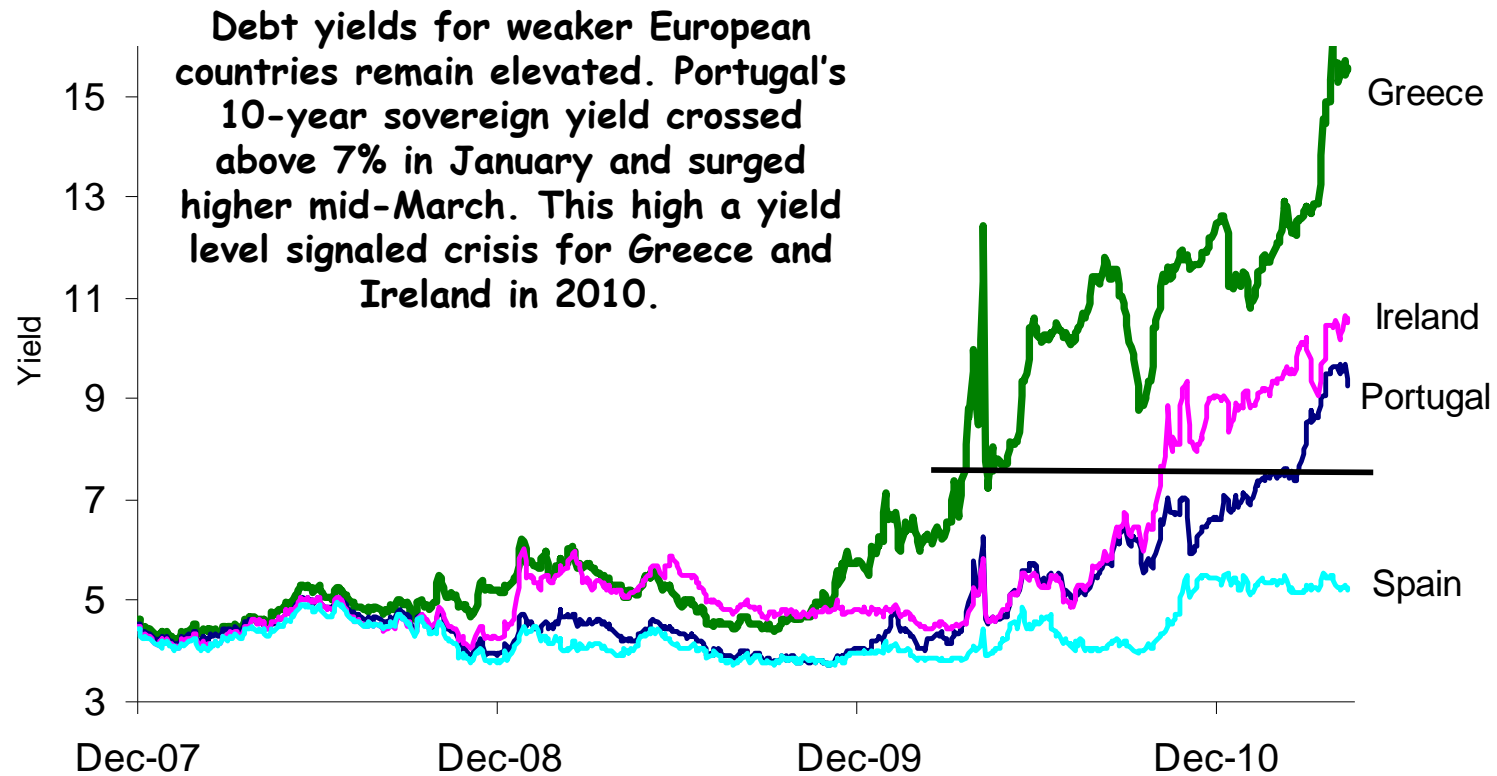
Source: Federal Reserve; Encima Global

European Debt Crisis

- **Key variable is devaluation. We don't think any country will exit the euro. Euro-zone growth increasing with improved capital allocation.**
 - **We expect sweeter bailout packages through continued IMF disbursements, lower interest rates and longer maturities on official loans.**
 - **Debt restructurings with reduced net present value shouldn't be too traumatic once they occur because debt holders will either be taxpayer-based or will be prepared for the loss.**
 - **The sooner the restructuring, the better for the debtor countries and European taxpayers, but worse for banks. We don't agree that a near-term debt restructuring for Greece would be catastrophic for many banks or for the financial system.**
 - **ECB now owns big share of peripheral sovereign debt but won't take a haircut. This limits the restructuring options. Trichet leaves in October.**
-

Select European 10 Yr Yields

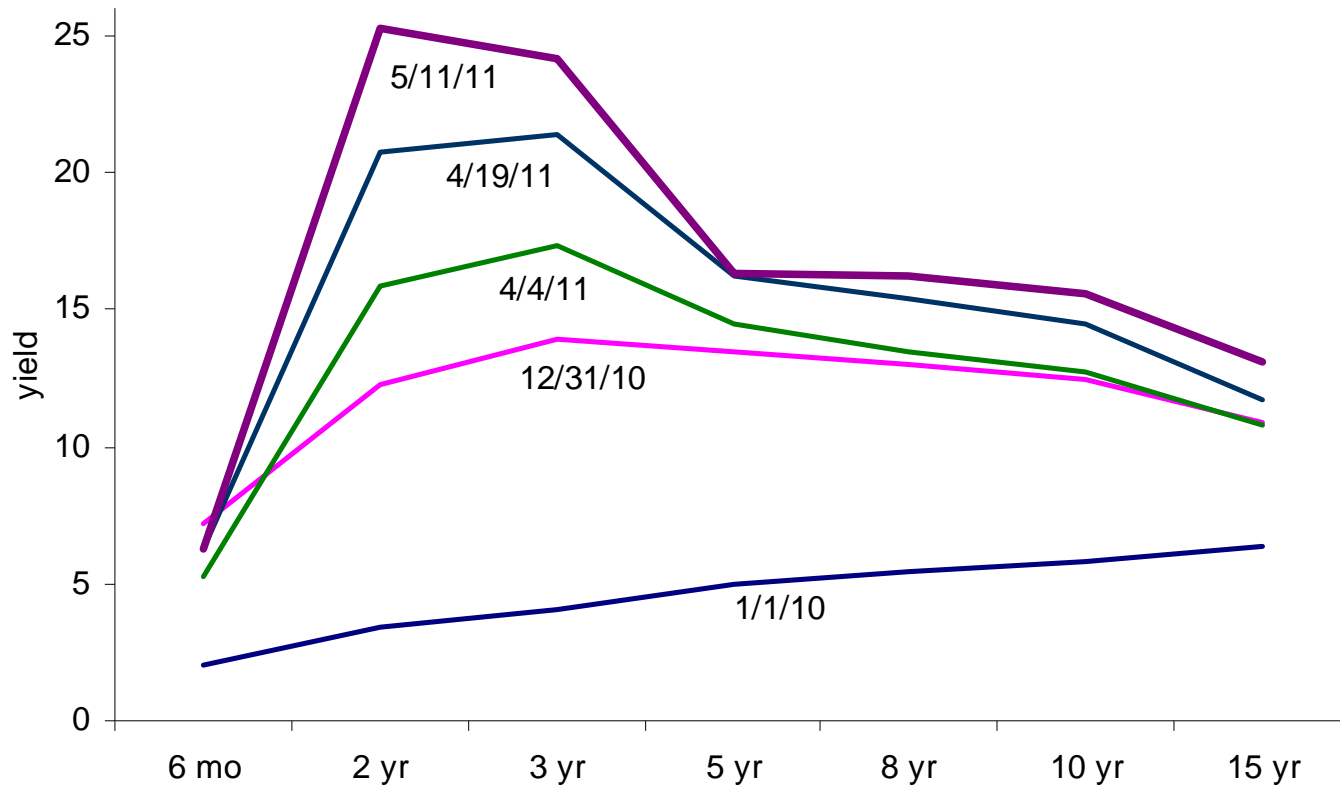
(last obs. May 12, 2011)



Source: Bloomberg; Encima Global

Greek Yield Curves

(last obs. May 11, 2011)



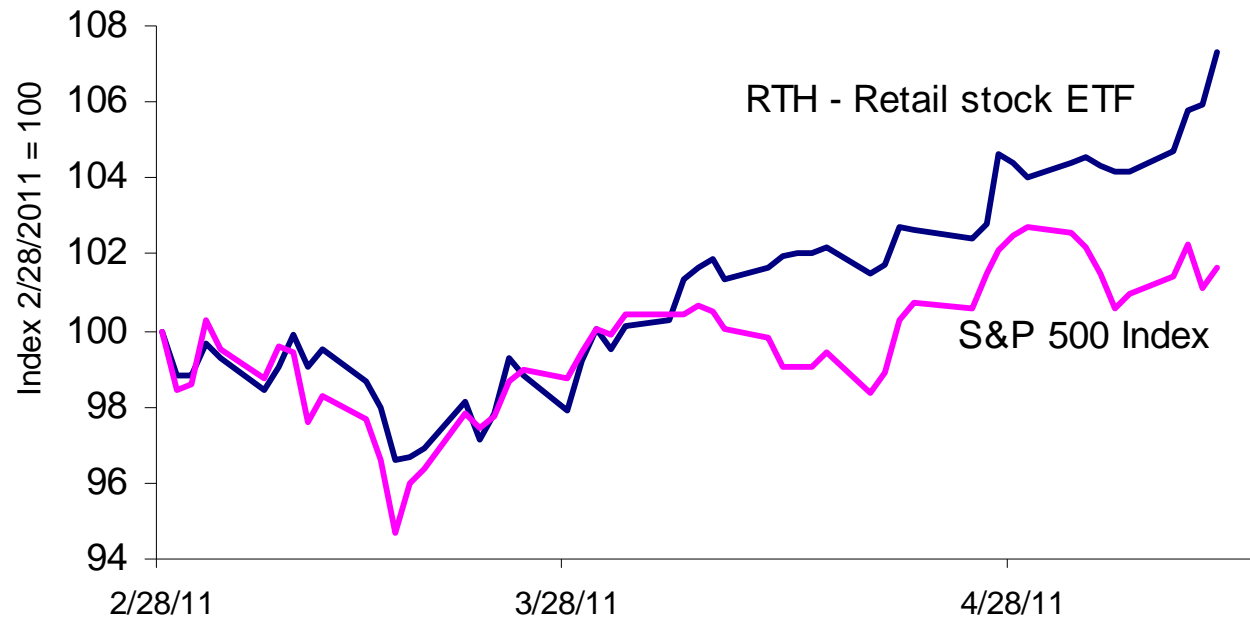
Source: Bloomberg; Encima Global

U.S. Economic Outlook

- **We expect the U.S. to continue very loose monetary and fiscal policy – meaning a near-zero Fed funds rate and over \$3.7 trillion per year in federal spending.**
- **We look for a moderate 3%-3.5% U.S. growth rate in coming quarters -- that's disappointing given the severity of the recession and won't create the surge in small-business jobs needed to pull the unemployment rate quickly below 8% but is fast enough to dispel the QE2 fears and QE3 predictions.**
- **April payrolls and tax receipts were strong. April retail sales were 7.6% higher than April 2010.**
- **We expect the consensus outlook to improve as it did in the face of Y2K. We expect a substantial flow from bonds to equities in coming months as the growth outlook improves, inflation rises and the uncertainty over the end of QE2 and the debt limit increase are finally resolved.**

RTH - Retail Stocks ETF Outperforming Market

(last obs. May 12, 2011)



Source: Bloomberg; Encima Global

Headline CPI Rising Above 3%, but Core CPI Low

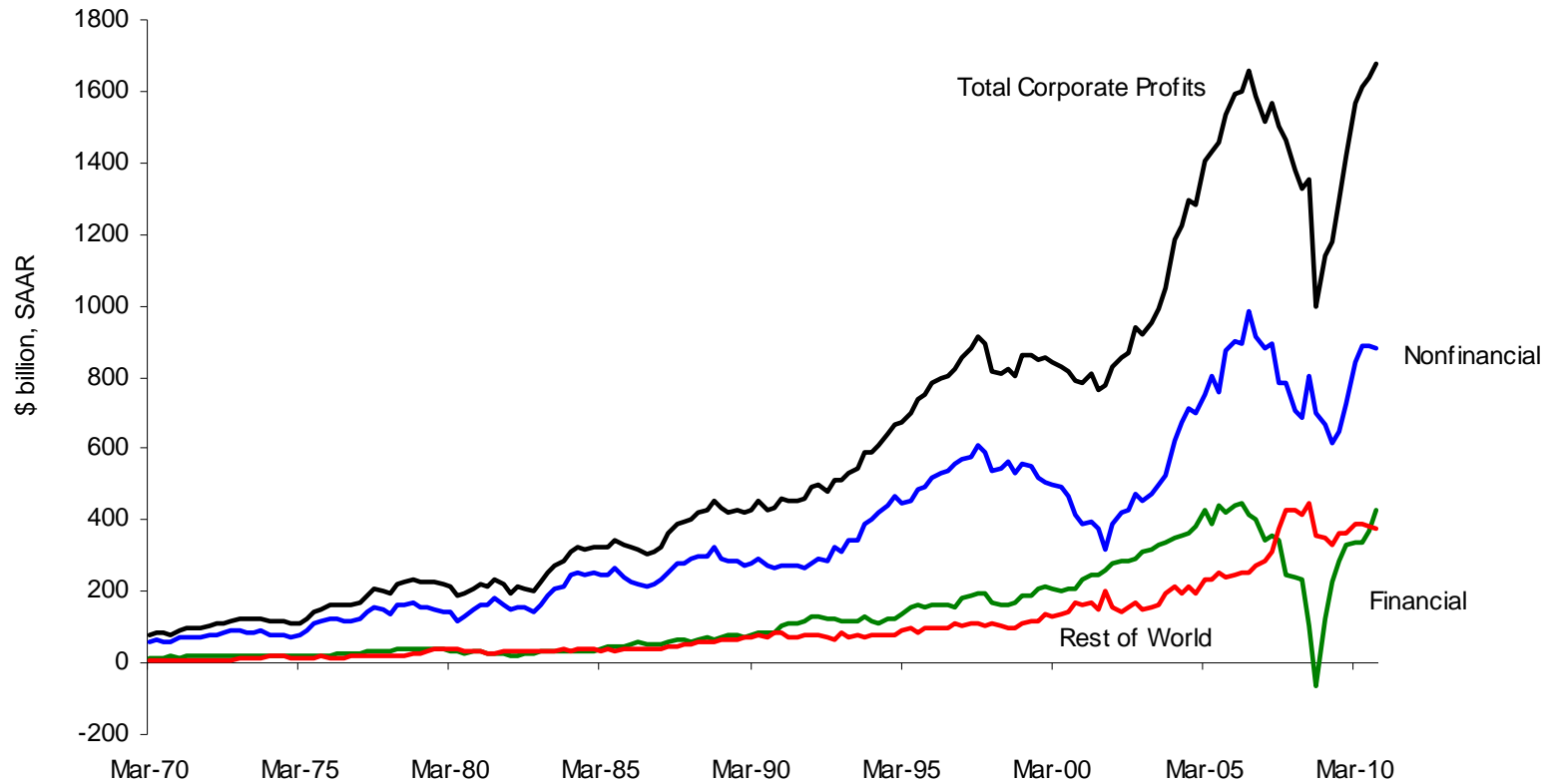
(last obs. April 2011, estimate to December 2011 using 0.3 m/m)



Source: Bureau of Labor Statistics; Encima Global

Corporate Profits before Taxes with IVA & CCAdj

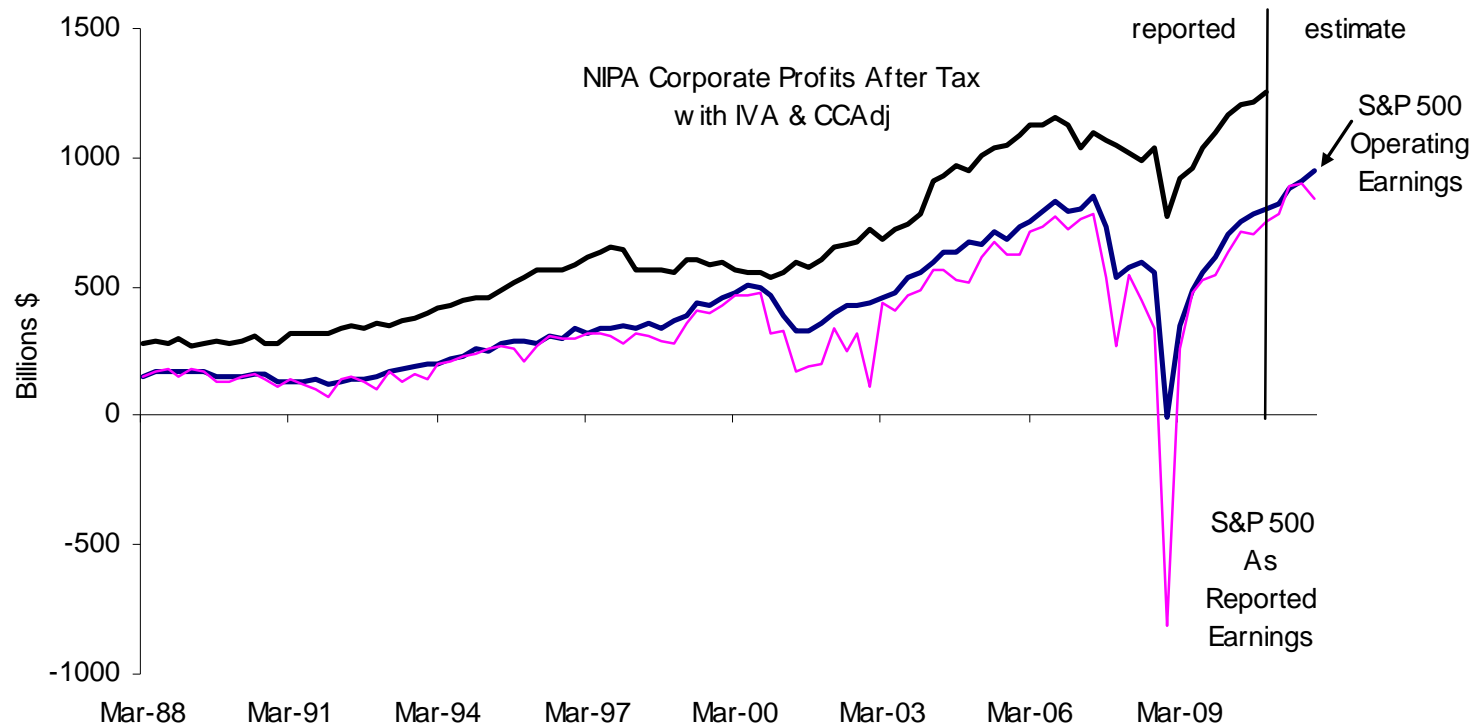
(last obs. Q4 2010)



Source: Bureau of Economic Analysis; Encima Global

Corporate Profits after Taxes with IVA & CCAdj and S&P 500 Operating and Reported Earnings

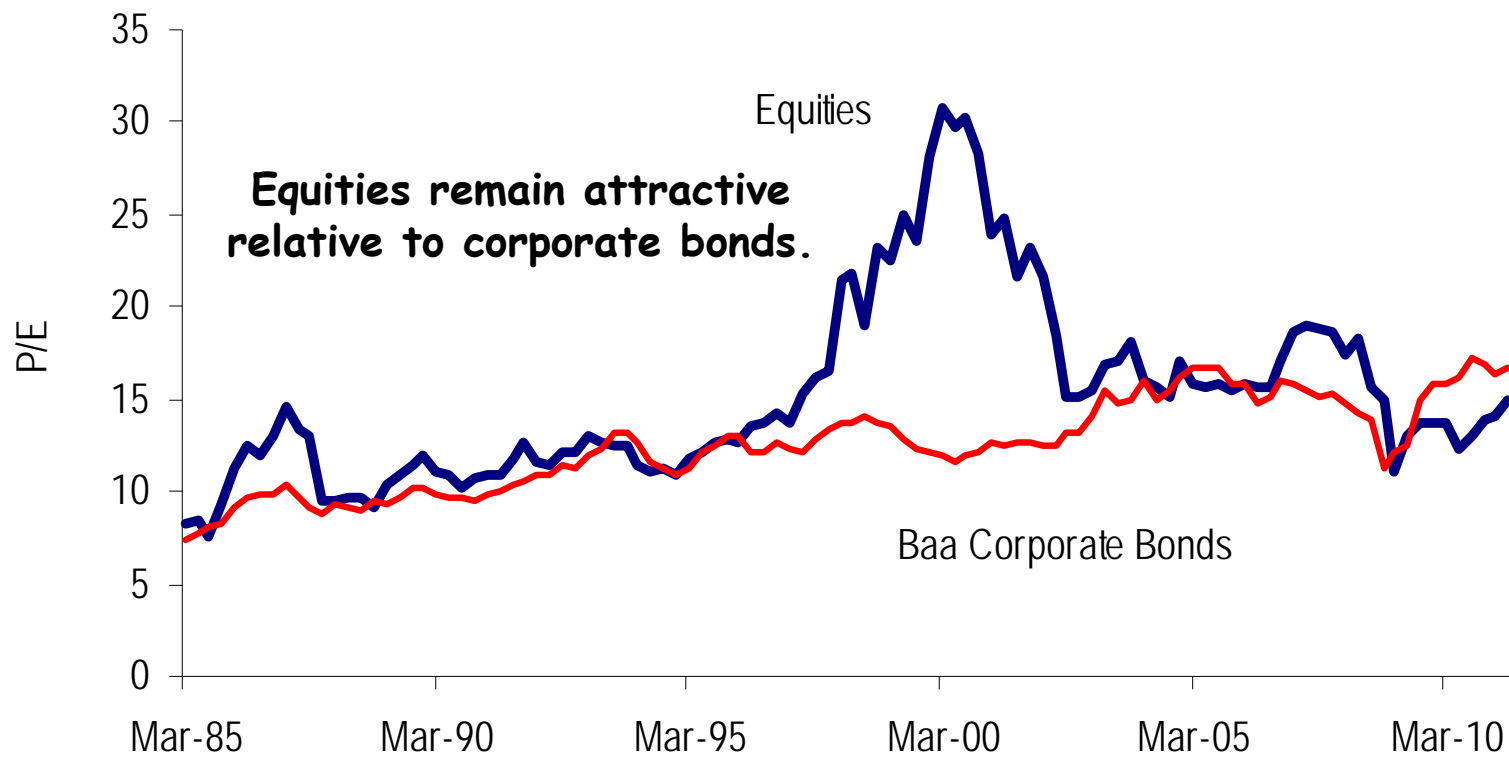
(last obs. Q4 2010, estimates to Q4 2012)



Source: Bureau of Economic Analysis; Standard and Poors'; Encima Global

Based on P/E, Equities Attractive Relative to Bonds

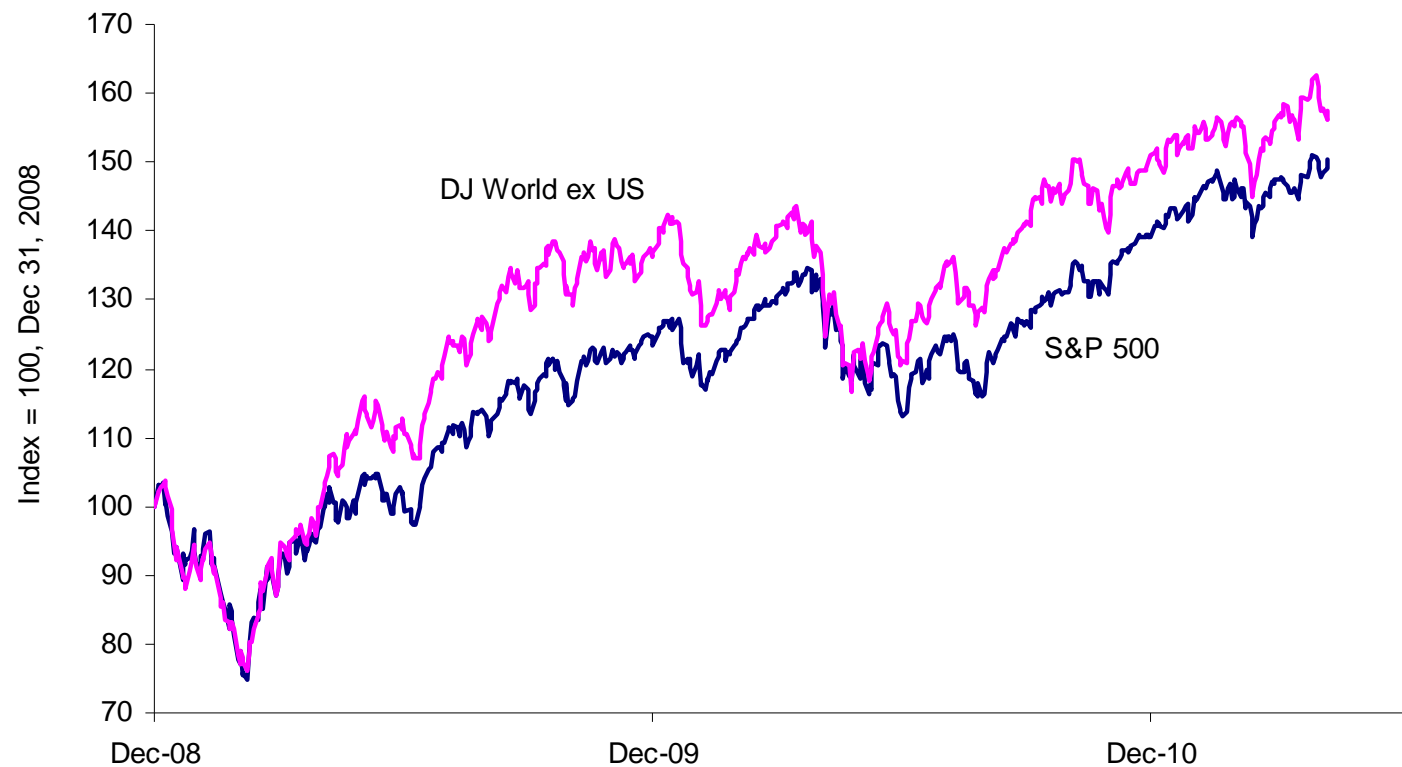
(last obs. Q4 2010, estimated Q2 2011)



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

US and Rest of World Stock Market

(last obs. May 12, 2011)



Source: Wall Street Journal; Encima Global



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