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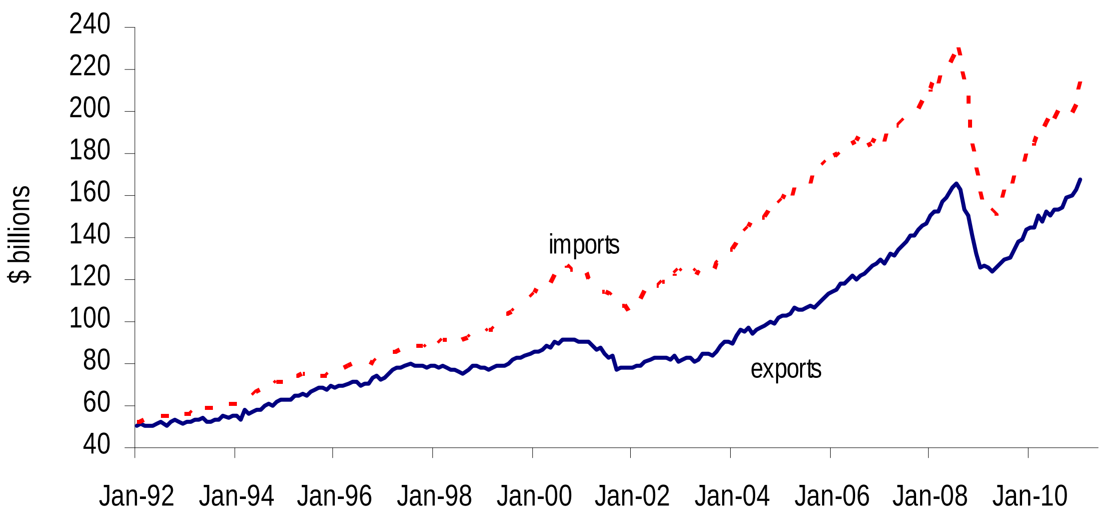
U.S. Exports Hit Record $168 Billion in January

U.S. exports increased to $167.7 billion in January, up 2.7% from December and topping the previous peak in July 2008. Imports increased 5.2% to $214.1 billion, but remain well below the July 2008 peak, reflecting the more sluggish recovery in the U.S. than abroad.

- The combined goods and service trade deficit for January was $46.3 billion, up from $40.3 billion in December and above the consensus expectation for January, in part due to high oil prices boosting imports. The January trade surplus on services was $13.4B ($47B in exports, $34B in imports.) The trade deficit on goods was $59.8B ($120B in exports, $180B in imports.)

U.S. Imports and Exports of Goods and Services (last obs. January 2011)



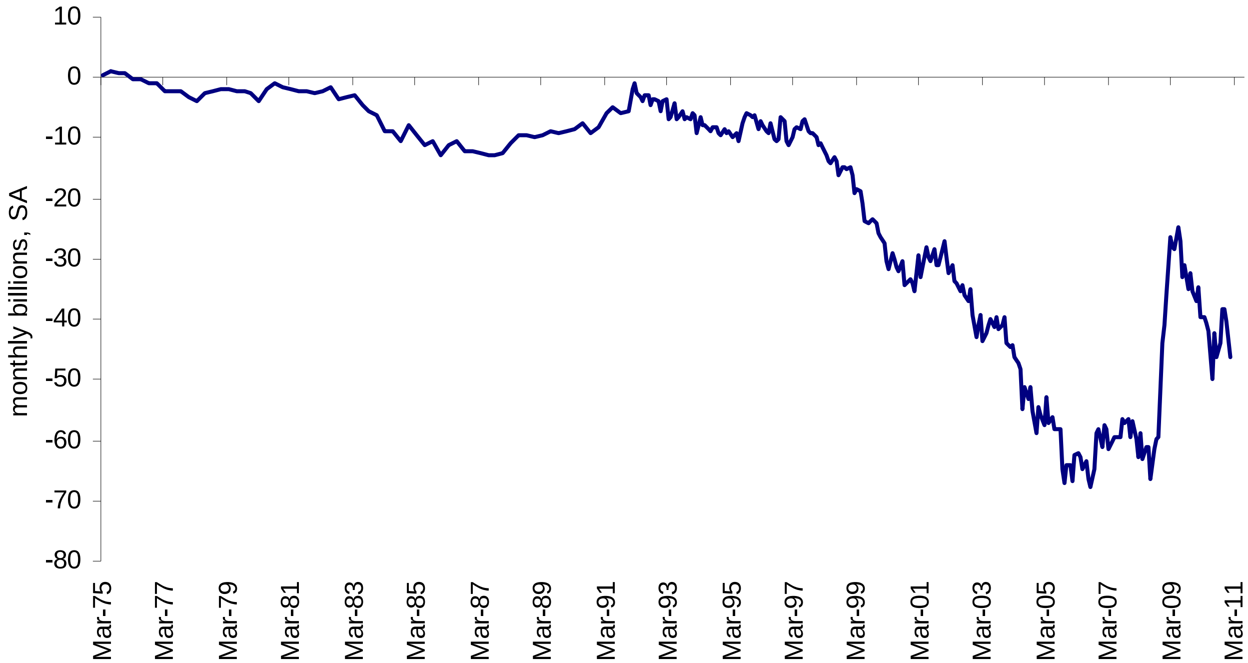
Source: Census Bureau; Encima Global

- We expect the trade deficit to continue widening in dollar terms as the global expansion broadens, with U.S. exports generally responding to growth abroad and imports rising with U.S. growth.

- The 2008-2009 recession narrowed the U.S. trade deficit by reducing imports more than exports. This reflected a combination of the sudden reduction in U.S. demand after the Lehman bankruptcy, the sharp decline in oil prices, and the substantial drawdown in U.S. inventories. The one-month trade deficit narrowed from $66 billion in July 2008 to

$25 billion in May 2009. With the U.S. recovery, the trade deficit has been widening back out. Boosting imports more than exports, oil prices have more than doubled since early 2009, consumption has exceeded the pre-recession peak, and inventories are rebuilding.

U.S. Trade Balance for Goods and Services (last obs. January 2011)

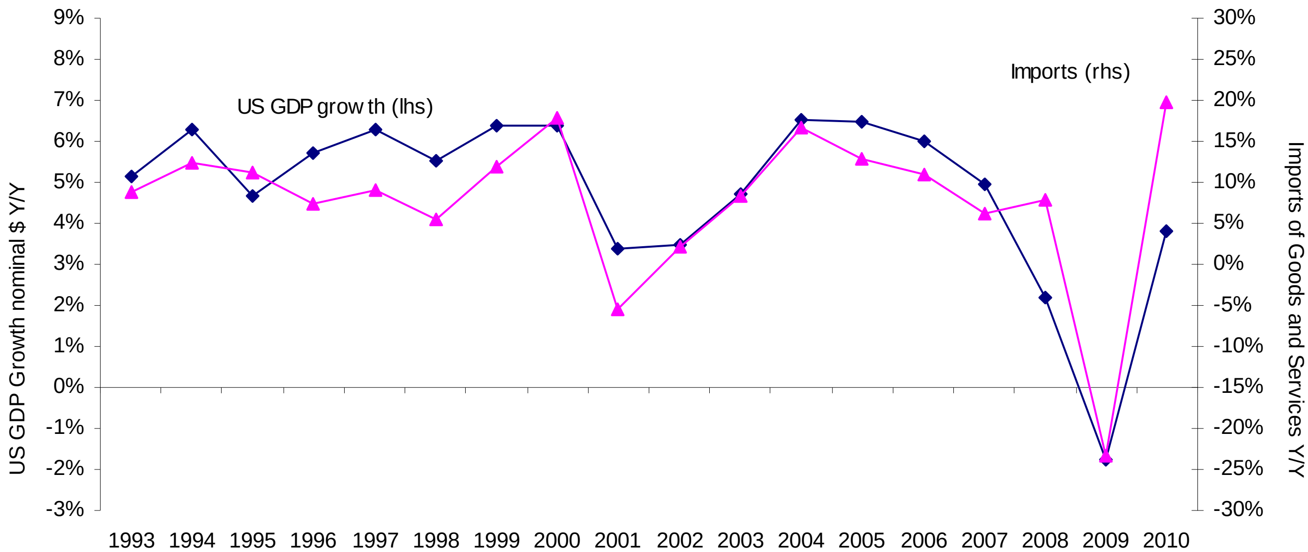


Source: Census Bureau; Encima Global

While some theories suggest that currency weakness might narrow a trade deficit, we think the U.S. trade balance has been more responsive to the growth differential between the U.S. and the rest of the world, oil prices given large U.S. oil imports, and the demographic differential -- faster population growth in the U.S. than in other industrialized countries has tended to increase U.S. imports faster than U.S. exports.

- In general, U.S. imports reflect growth in the U.S. economy.

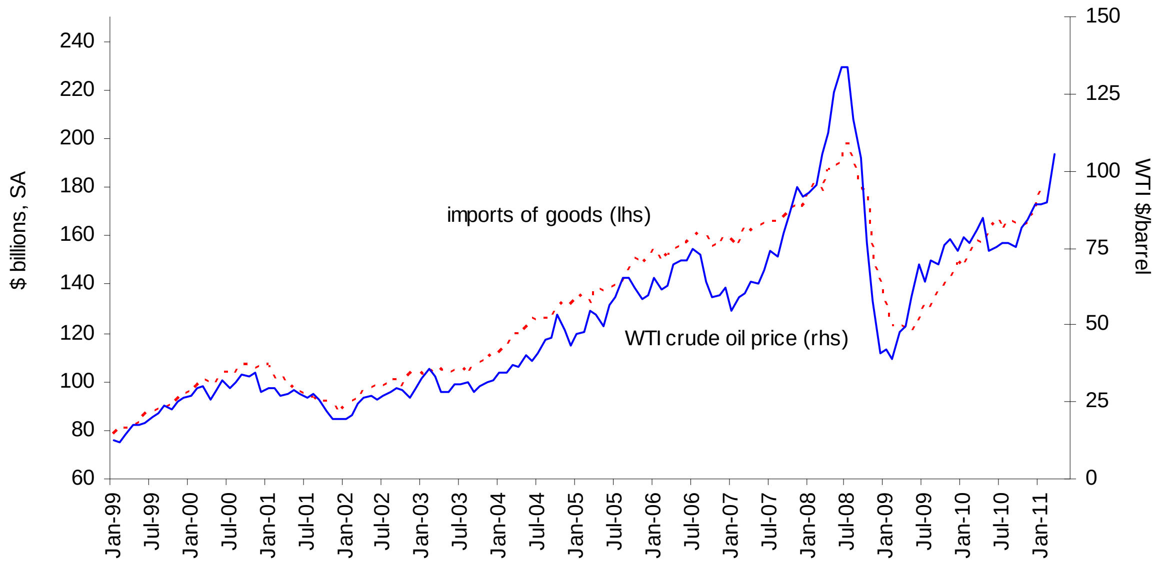
U.S. Imports of Goods and Services and US Nominal GDP (last obs. 2010)



Source: Census Bureau; IMF; Encima Global

- Instead of adding to general U.S. competitiveness, the weak dollar trend has tended to add to the cost of U.S. imports, especially oil, and channel capital away from the U.S. into emerging markets. This adds to their production, spurring our imports more than our exports. This culminated in 2008 when the record trade deficit coincided with a super-weak dollar.

U.S. Imports of Goods and WTI Price (last obs. imports Jan 2011, WTI price Mar 2011)

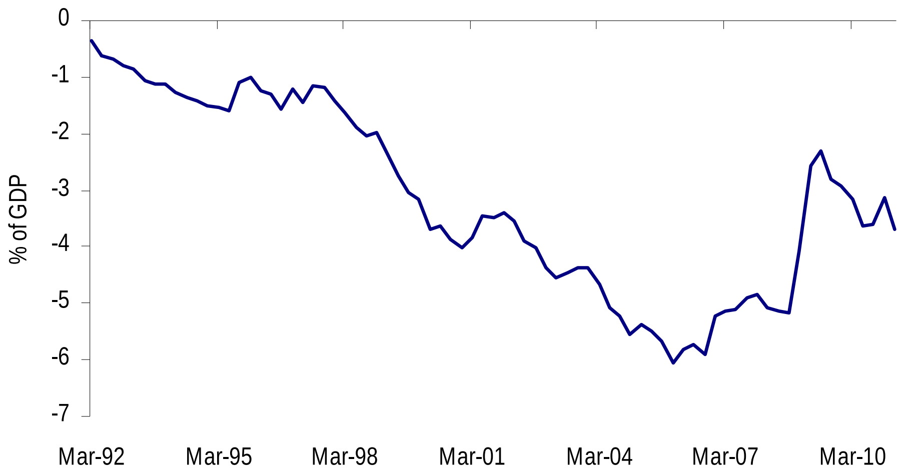


Source: Census Bureau; Encima Global

Given similar economic growth rates in the U.S. and abroad, we expect U.S. exports to grow about as fast as imports in percent terms. This would leave the U.S. trade deficit widening gradually in dollar terms and exceeding the July 2008 one-month record of $66 billion at some point in the next several years.

- Relative to GDP, the trade deficit would stay below the 2006 peak, stabilizing in the 4%-5% of GDP range, if the U.S. export growth rate kept up with import growth.

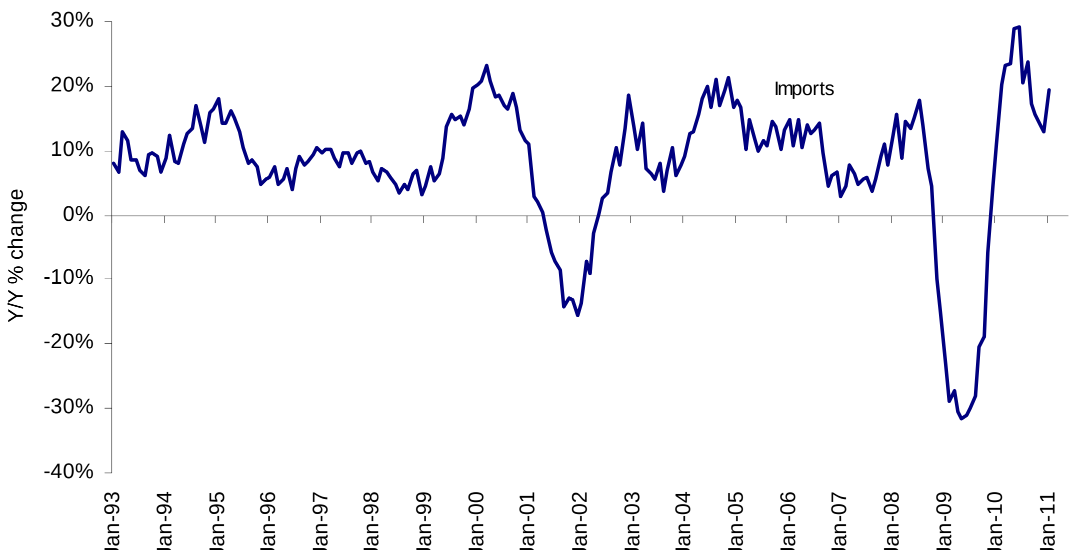
U.S. Trade Balance as a % of GDP (last obs. Q4 2010, estimate for January 2011)



Source: Census Bureau; Encima Global

- The percentage growth in imports has slowed toward exports as pent-up import demand for consumption and inventories is fulfilled.

Growth in Imports Year-over-Year (last obs. January 2011)



Source: Census Bureau; Encima Global

- To balance the trade deficit would require a shrinkage in imports (i.e. a sharp U.S. recession) combined with fast growth in U.S. exports, an unlikely combination. Labor force growth in the U.S. spurs imports while labor force contraction in Japan and other industrialized countries, and soon China, holds down their imports. Other emerging markets will gradually have more impact, but that will take a decade or more of fast emerging market growth. In the meantime, we expect the U.S. trade deficit to remain wide until the demographic differential subsidies (probably when labor forces in the industrialized countries stop shrinking, which will take many years.)

Growth in Exports Year-over-Year (last obs. January 2011)

Source: Census Bureau; Encima Global