

# The Economic Outlook for Investors and Business Decision Makers



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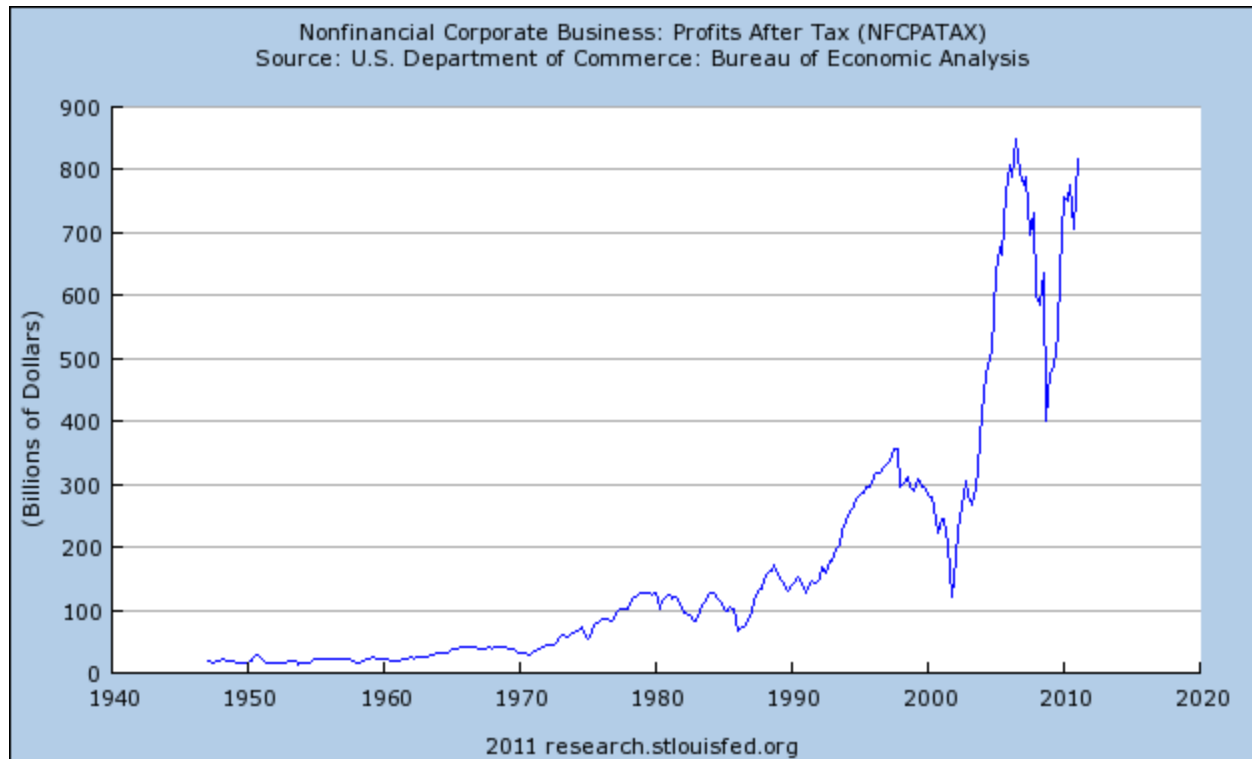
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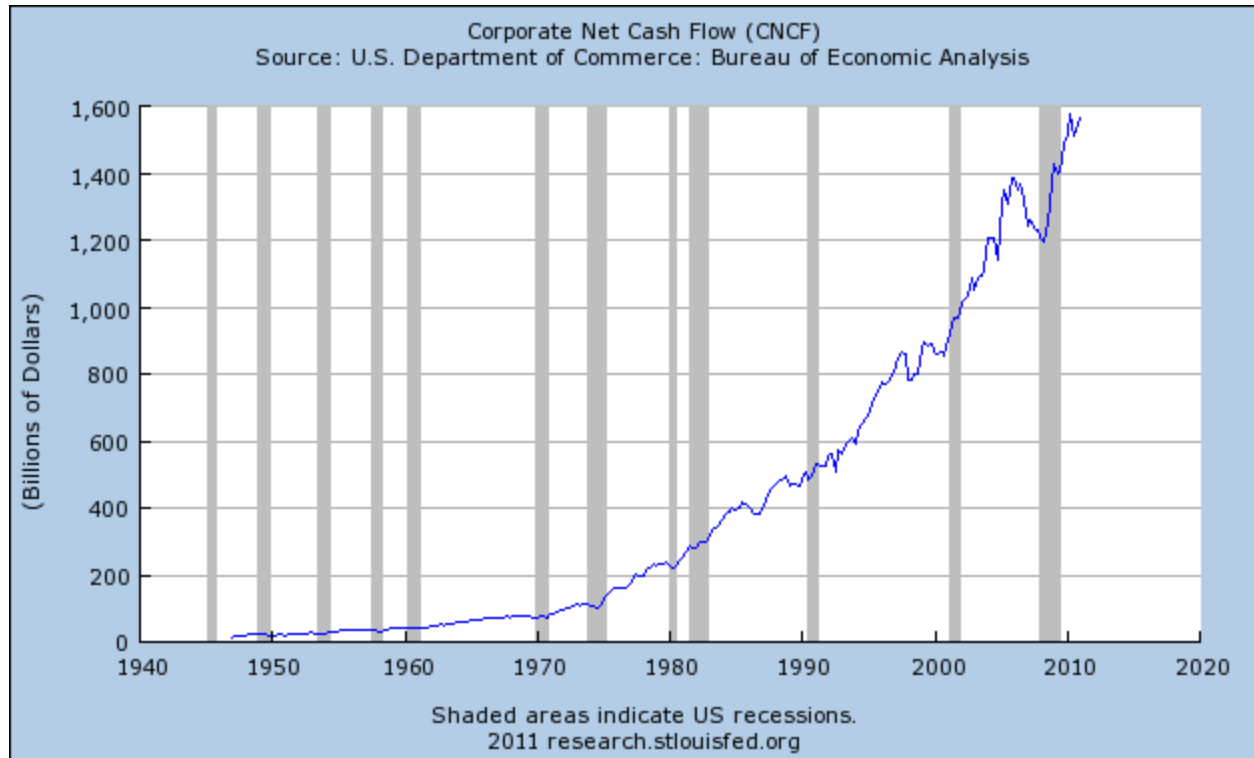
# The Current Business Environment

- Profits are high
- Borrowing costs are low
- Everyone complaining about “regulation”
- Uncertainty about future costs of health care
- Huge cache of cash sitting idle
- Limited hiring
- Signs of a double-dip on the horizon
- Private sector layoffs starting to surface again

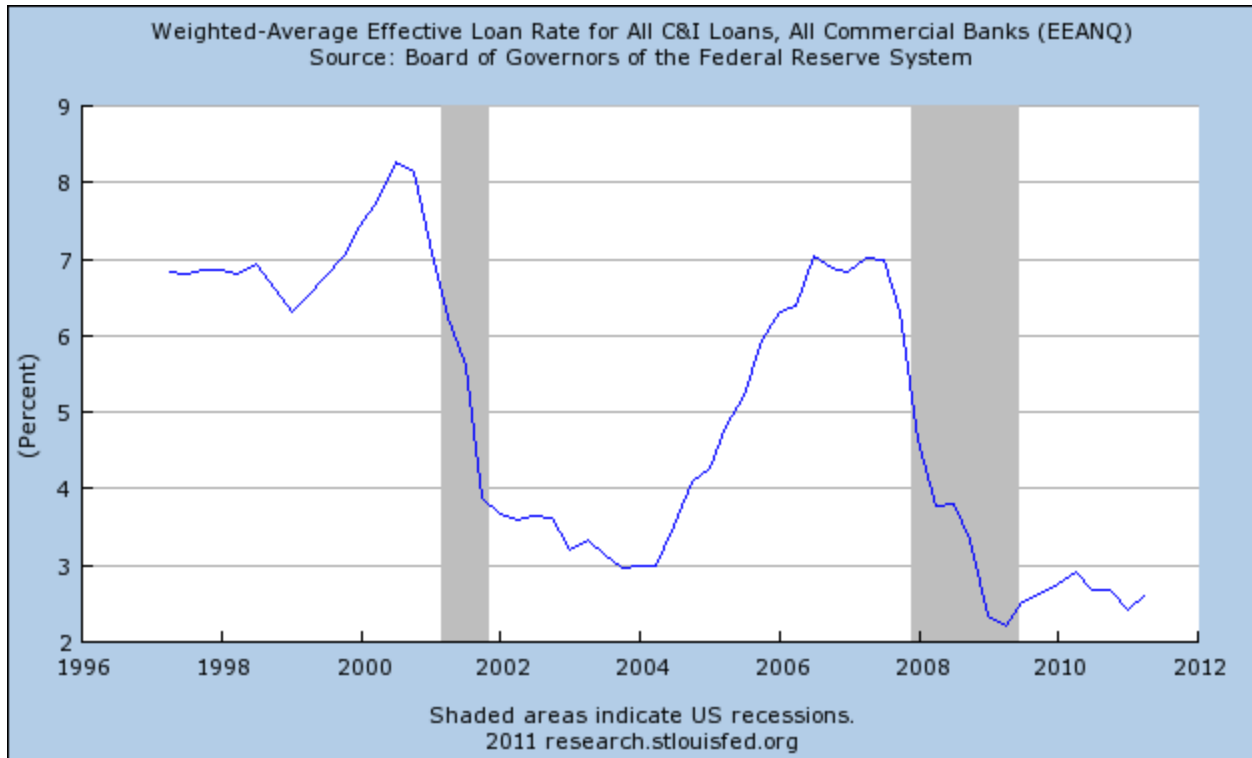
# Corporate Profits Have Rebounded Strongly



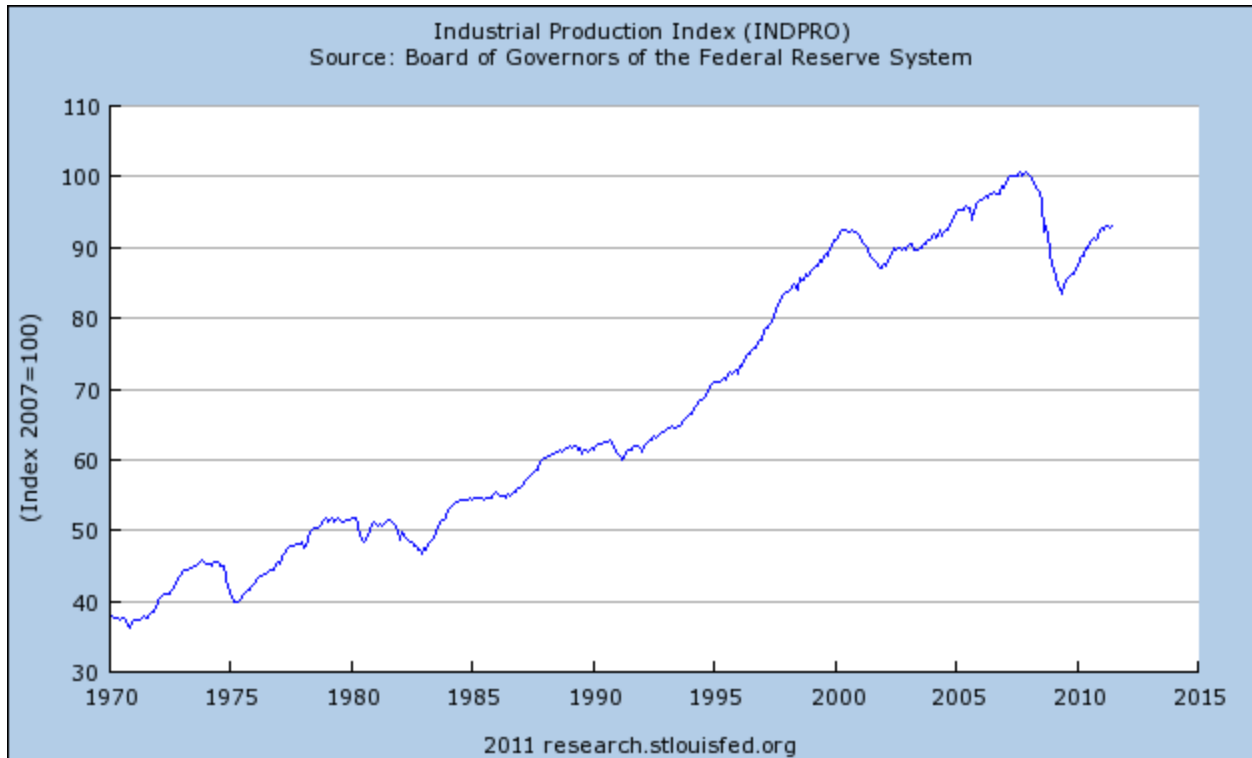
# Corporate Net Cash Flow Strong



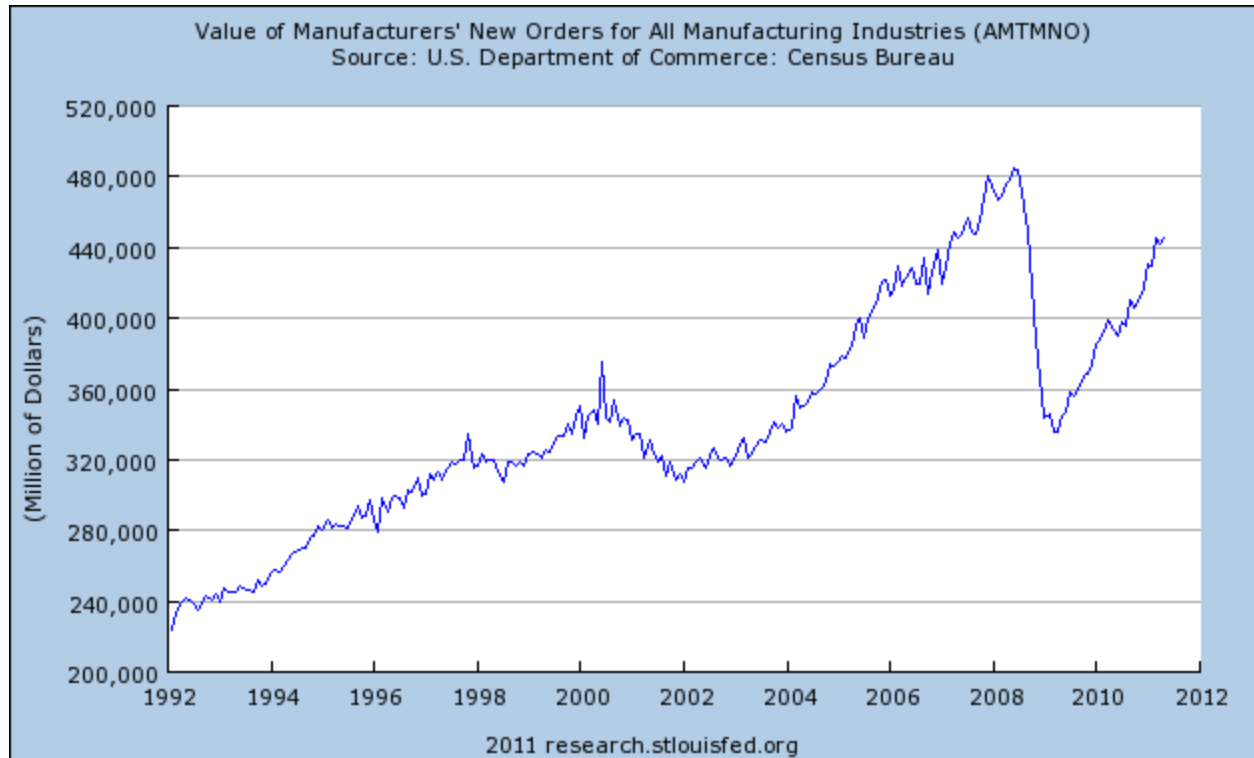
# Low Interest Rates Have Allowed US Businesses to Cut Interest Costs



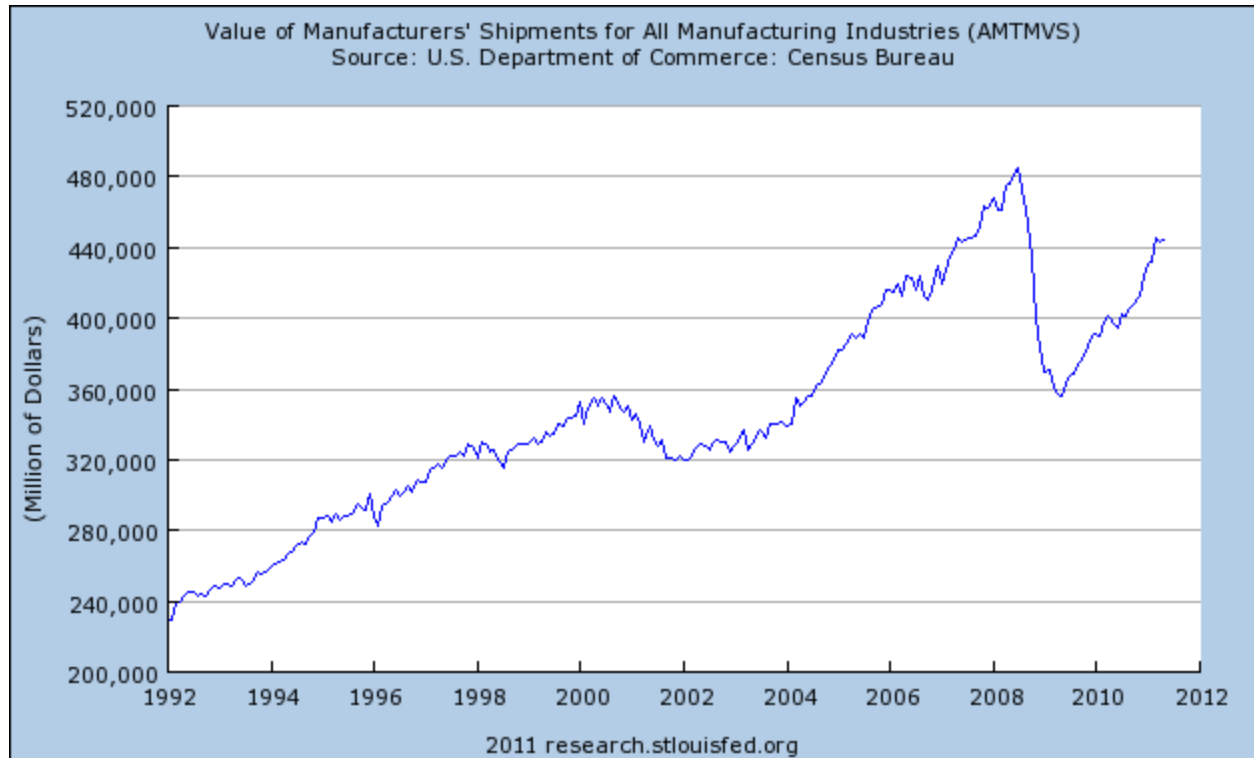
# Industrial Production Has Returned, but Growth Trend is Slowing



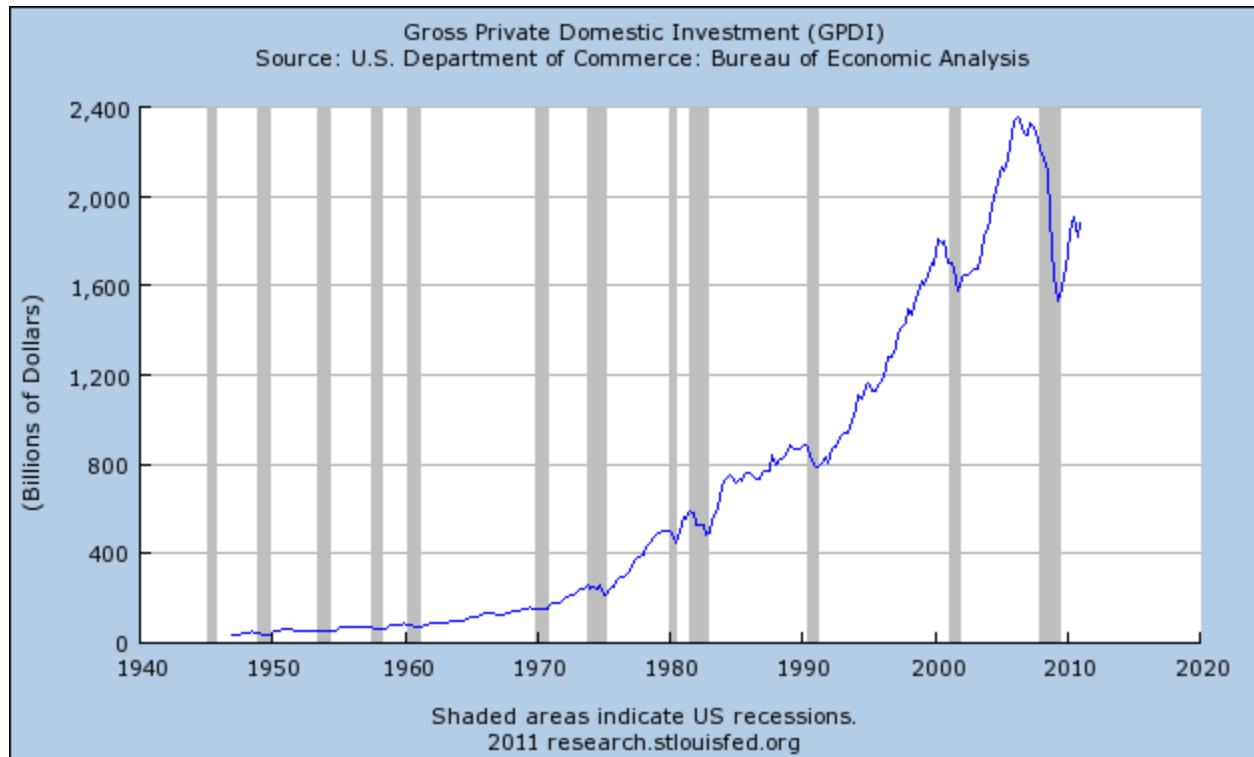
# New Orders Have Rebounded Strongly, but Are Losing Momentum



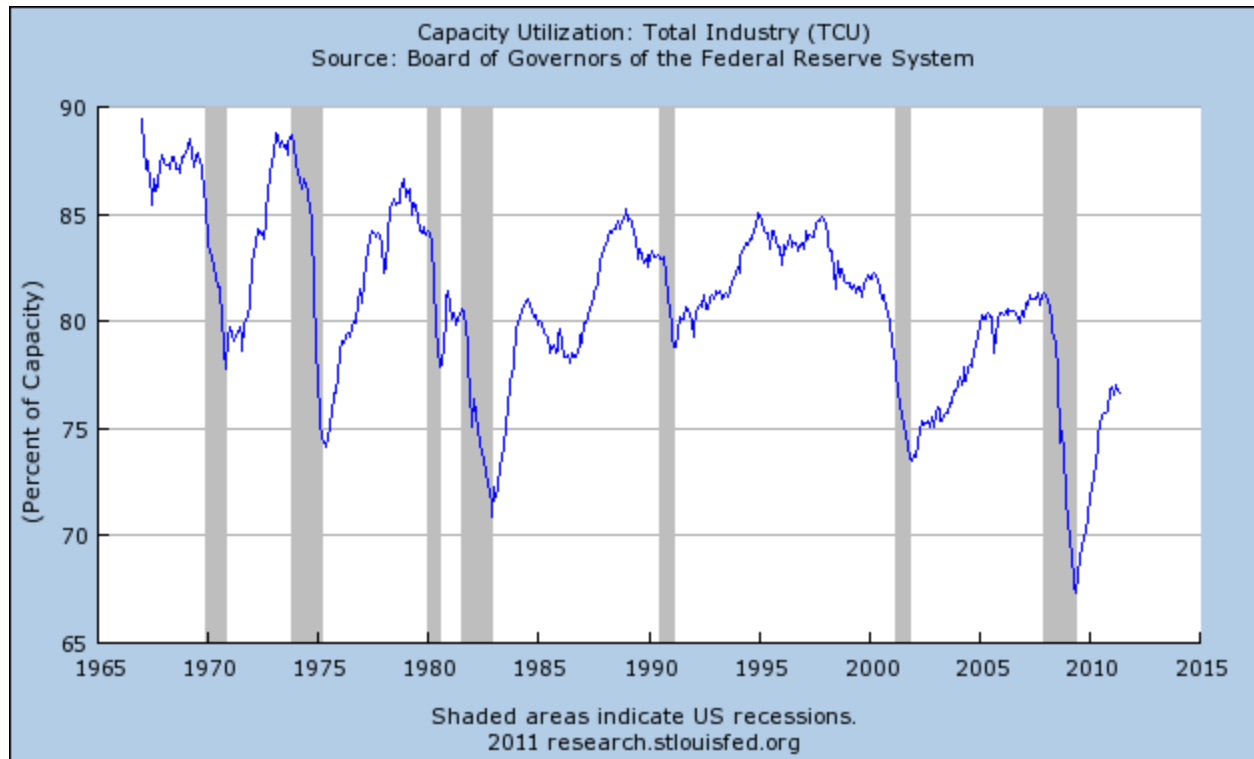
# Value of Manufacturing Shipments has Rebounded, but Losing Momentum



# Gross Private Domestic Investment has Levelled



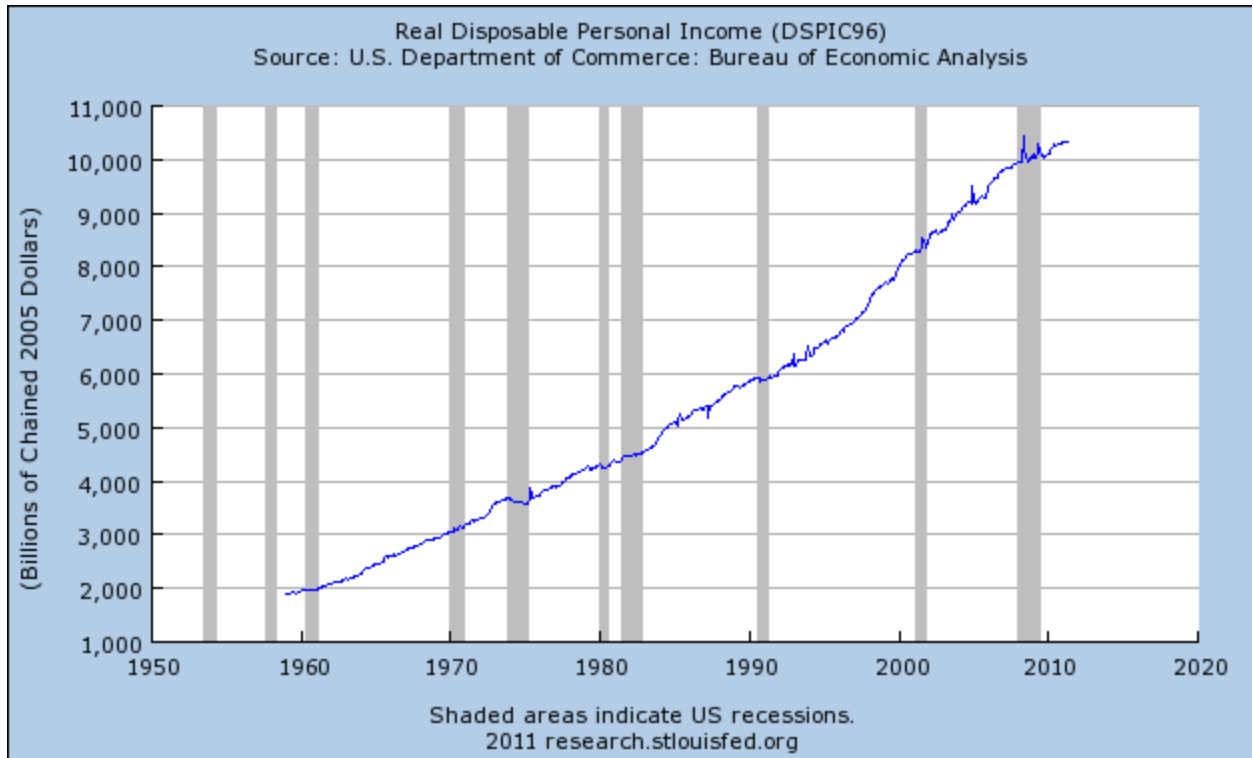
# Still Lots of Spare Manufacturing Capacity



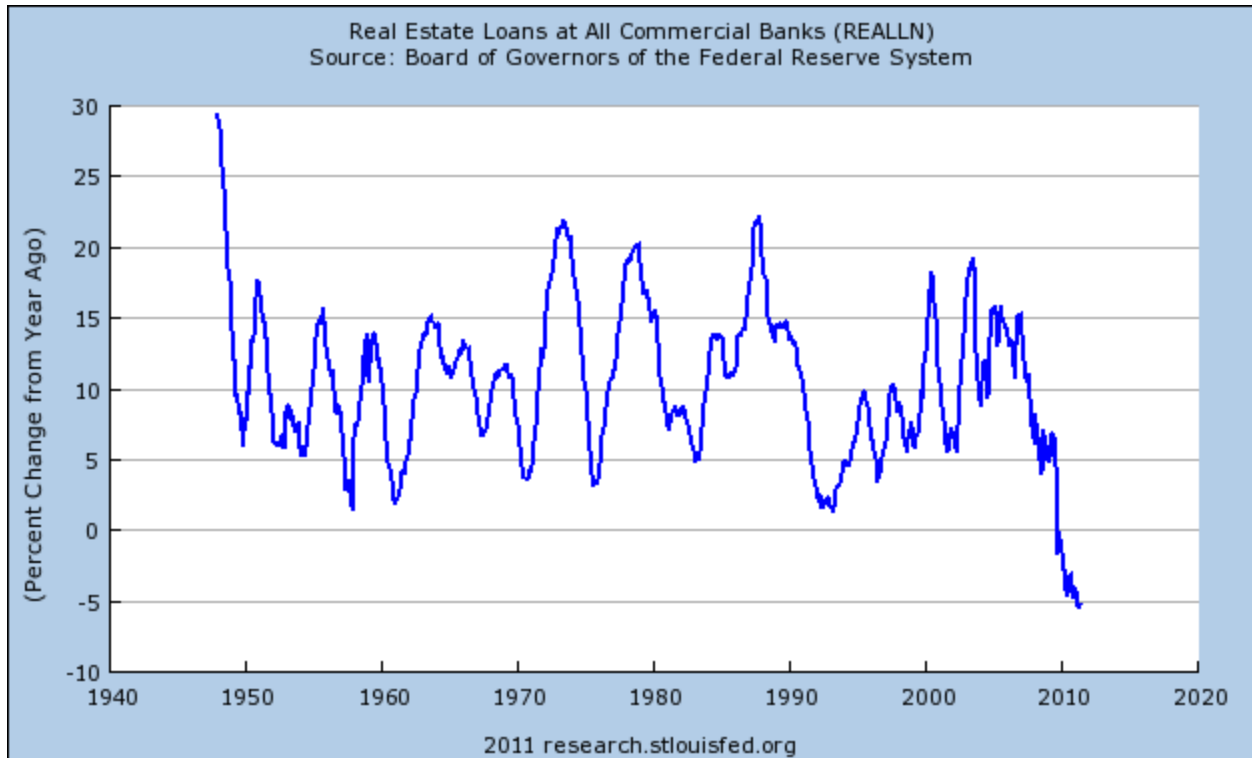
# The Health of Consumers

- Wage growth is minimal
- Still working off heavy debt
- Concerned about losing their job
- Concerned about the value of their house
- Rethinking their retirement plans
- Saving more money

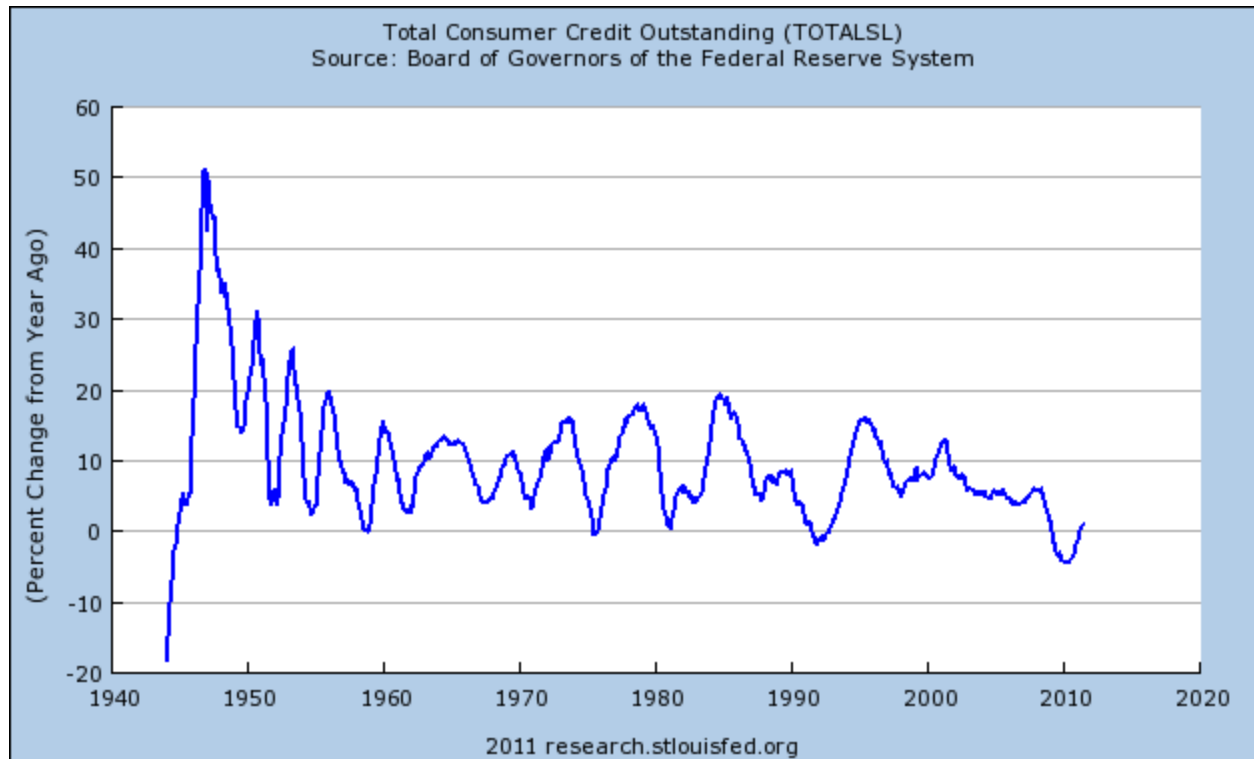
# Personal Income Growth Slow



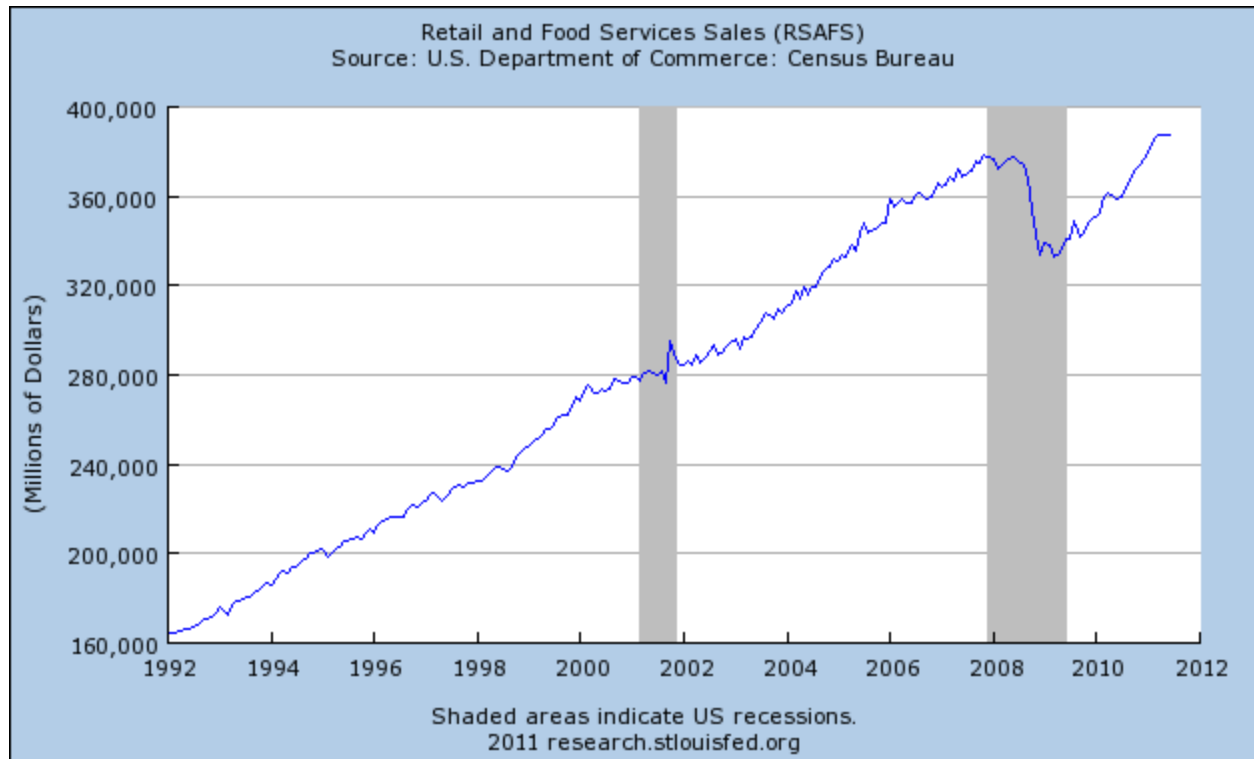
# Mortgage Credit is Still Declining



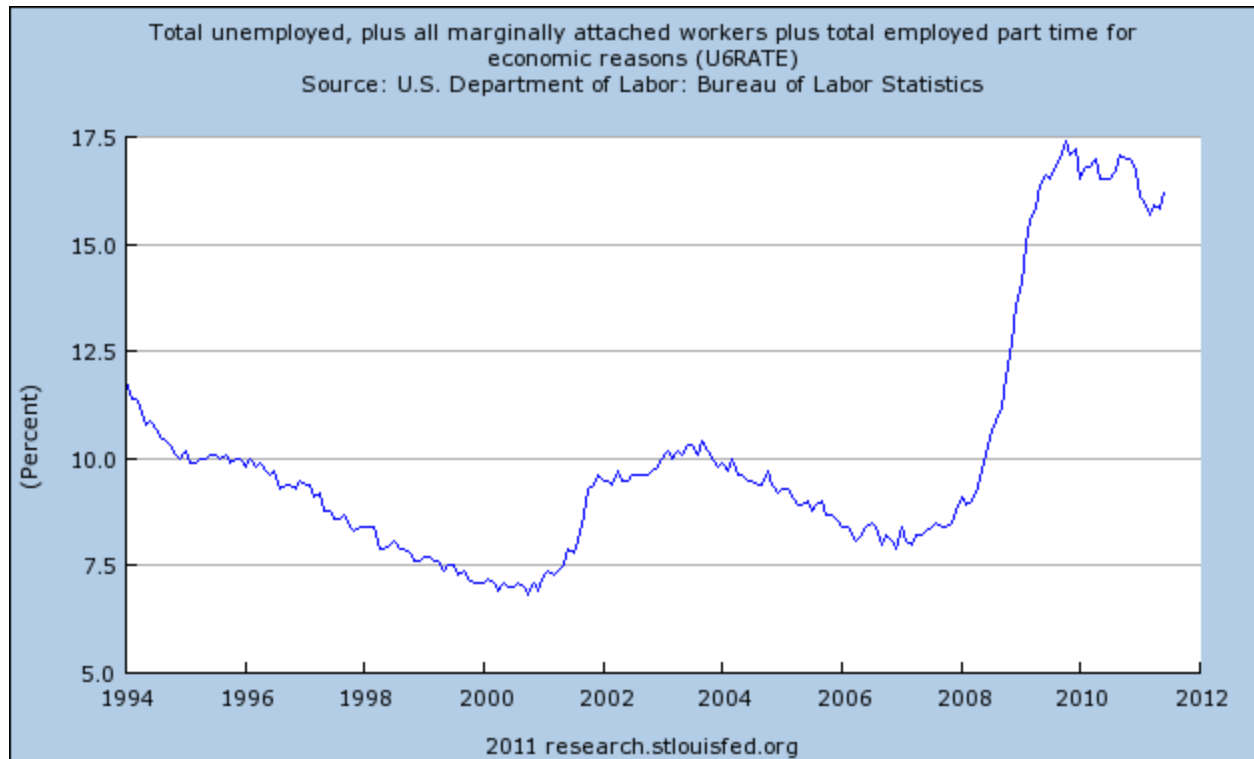
# Consumer Credit Has Stopped Declining



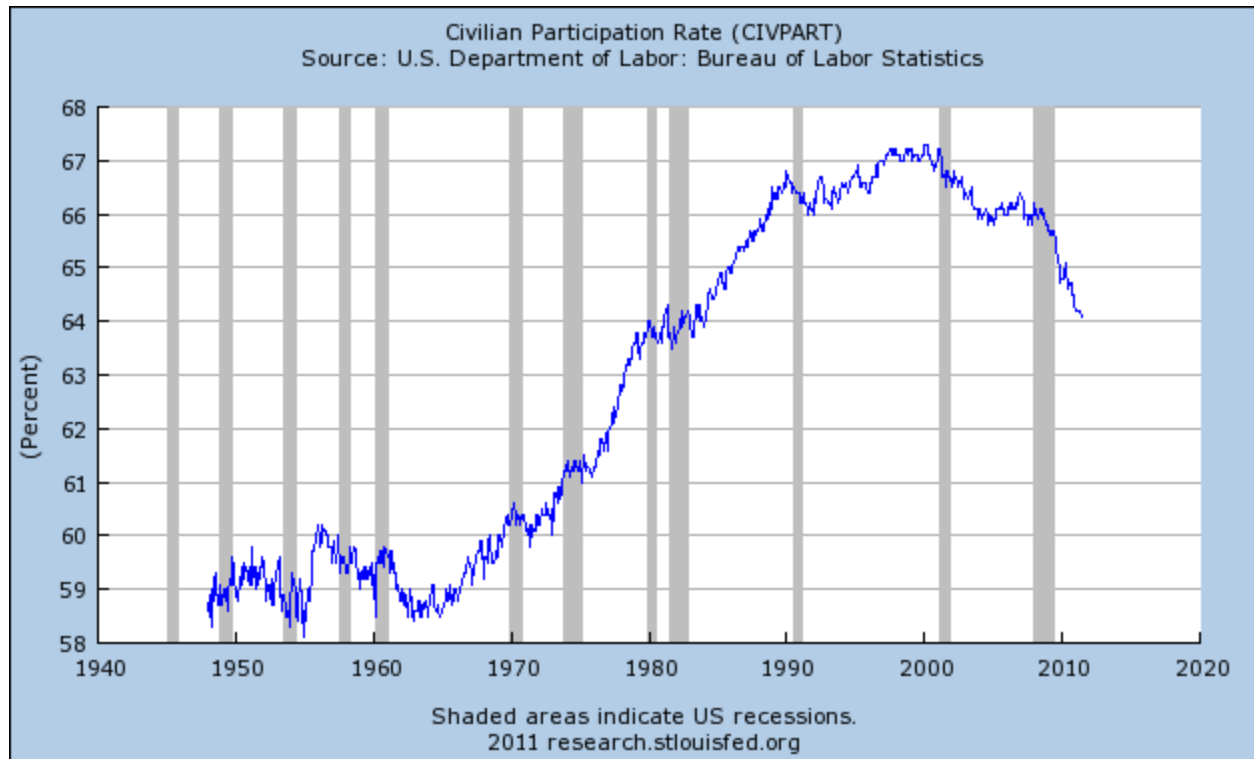
# Retail Sales Losing Momentum



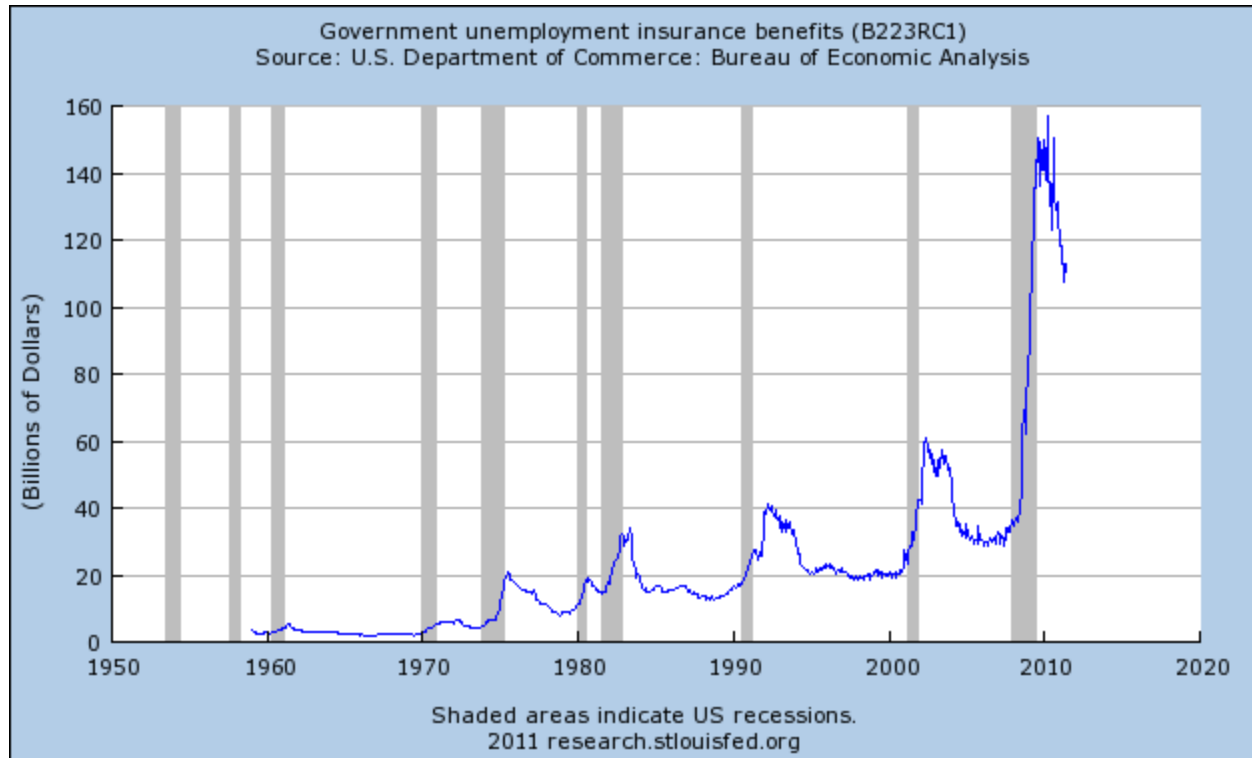
# U6 Unemployment is Over 16%



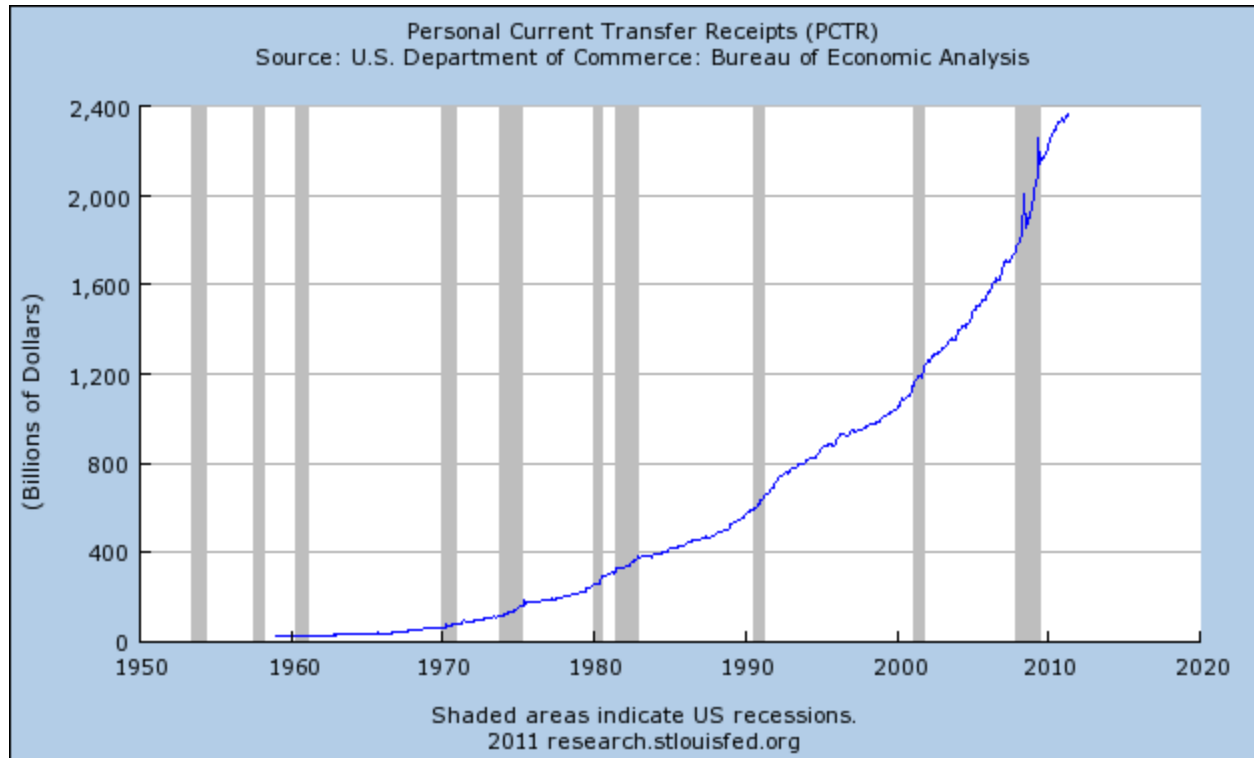
# Amount of Americans Working is Diminishing Rapidly



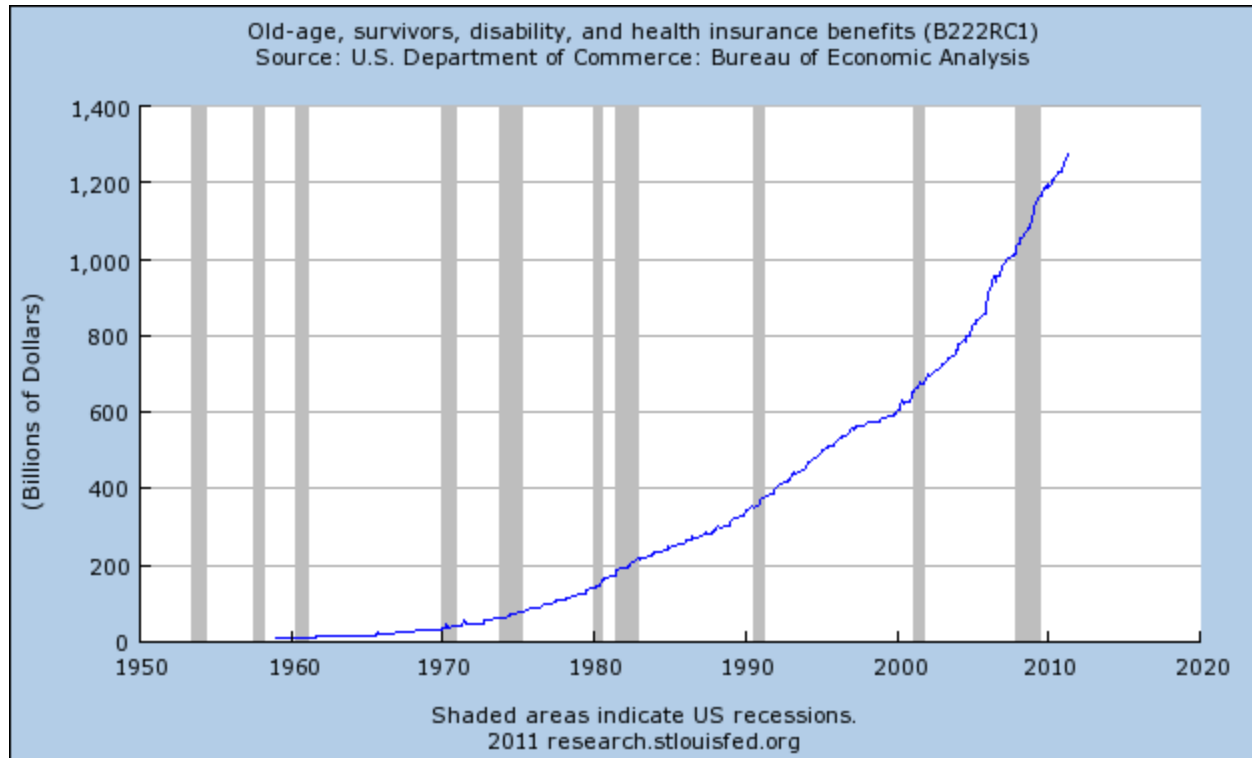
# Unemployment Benefits Plummeting



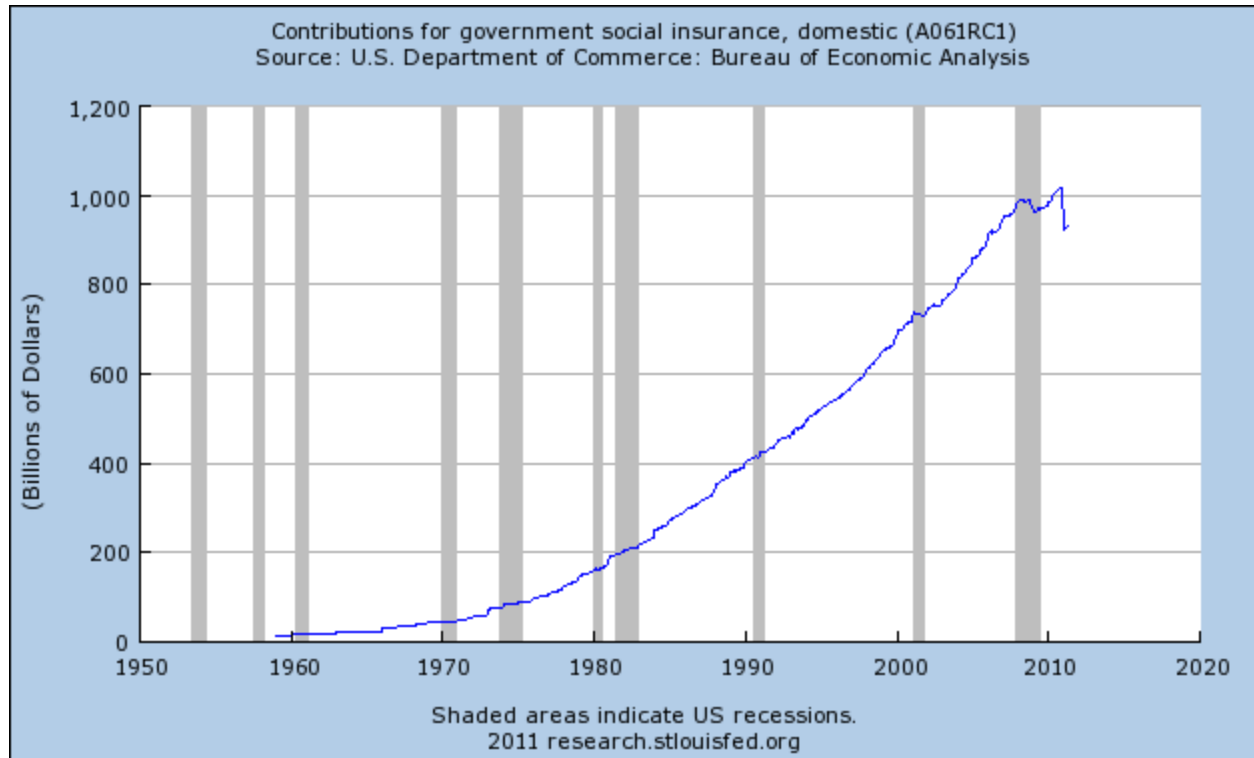
# Transfer Payments Exploding



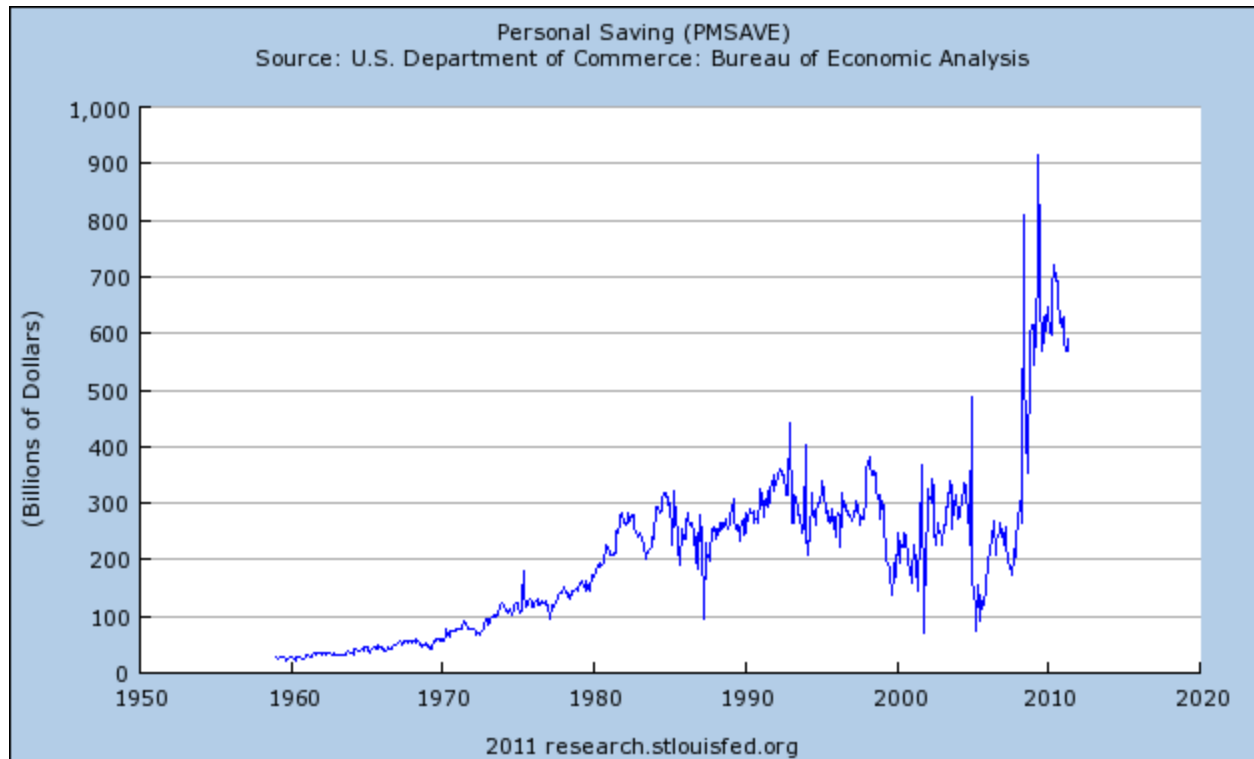
# More Dependence on Government Assistance



# We've Partially Defunded Social Security



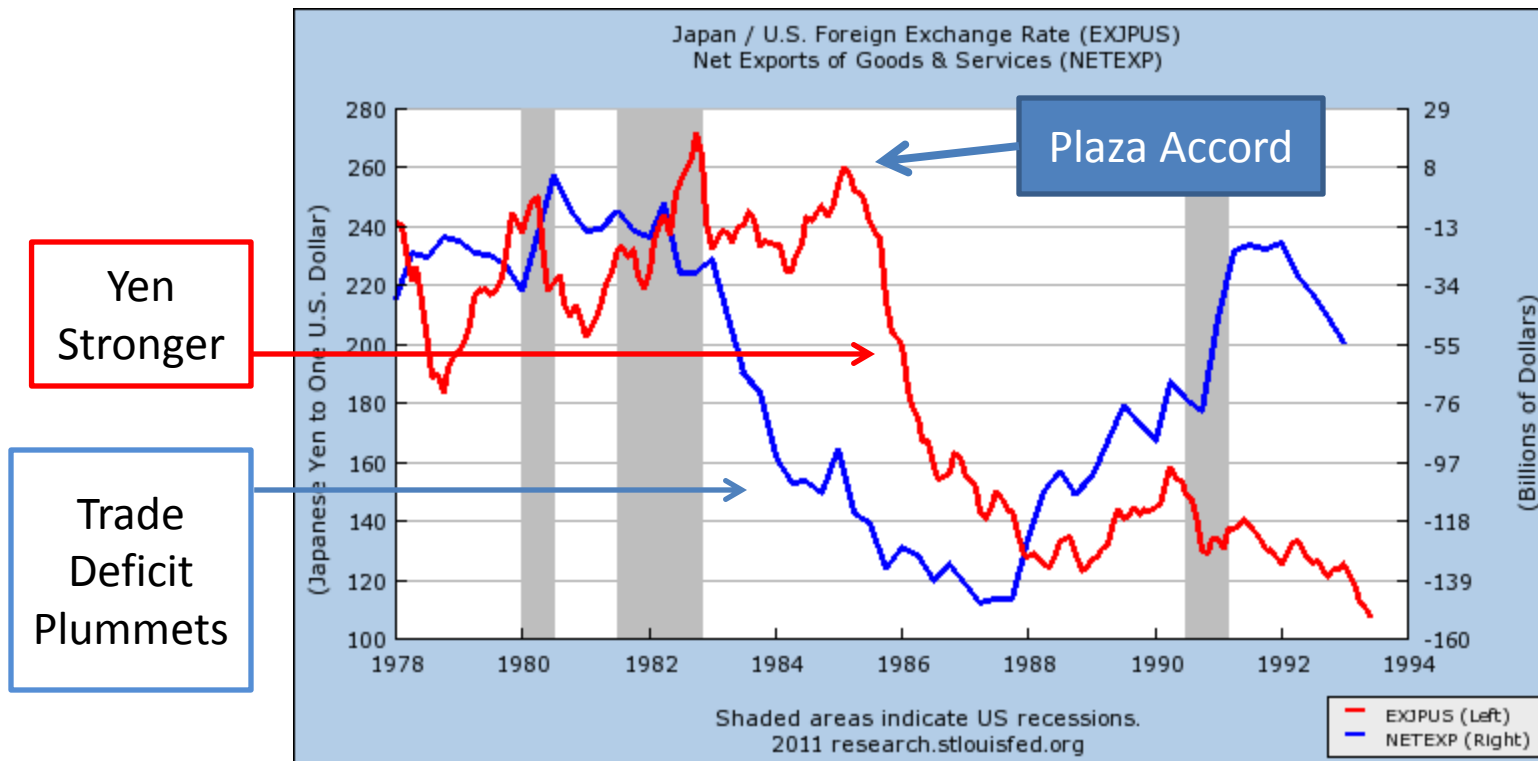
# Consumers Saving More to Offset Wealth Losses from Housing



# China

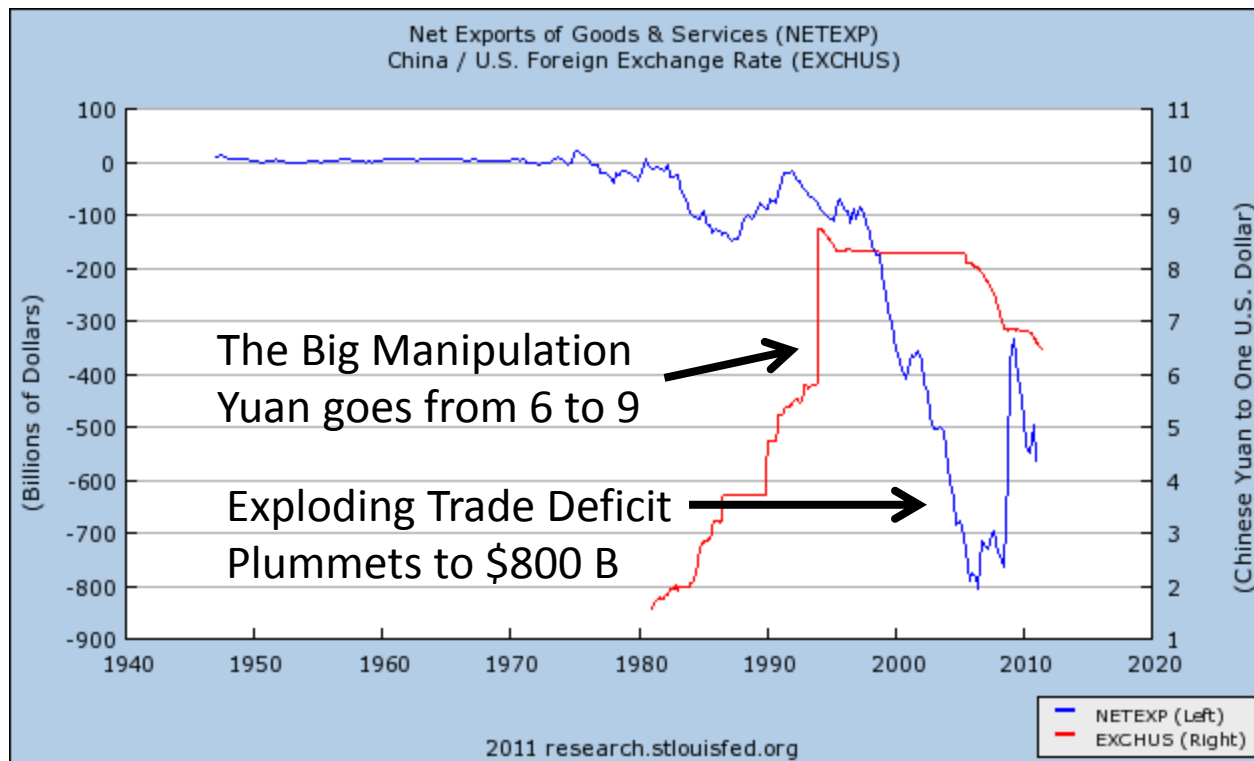
- Dumping steel in the U.S.
- Manipulating their currency to underprice American firms
- Lack of enforcement of intellectual property laws
- Massive printing and lending of money to build housing, factories, roads, shopping
- 200 million migrant workers hoping to get the next construction job building condos

# Japanese Currency Manipulation Hurt the US in the 1980's



Red Line: After Plaza Accord in September, 1985, dollar was devalued 51% against the yen.  
Blue line: Massive trade deficit in the 1980's started improving a year later.

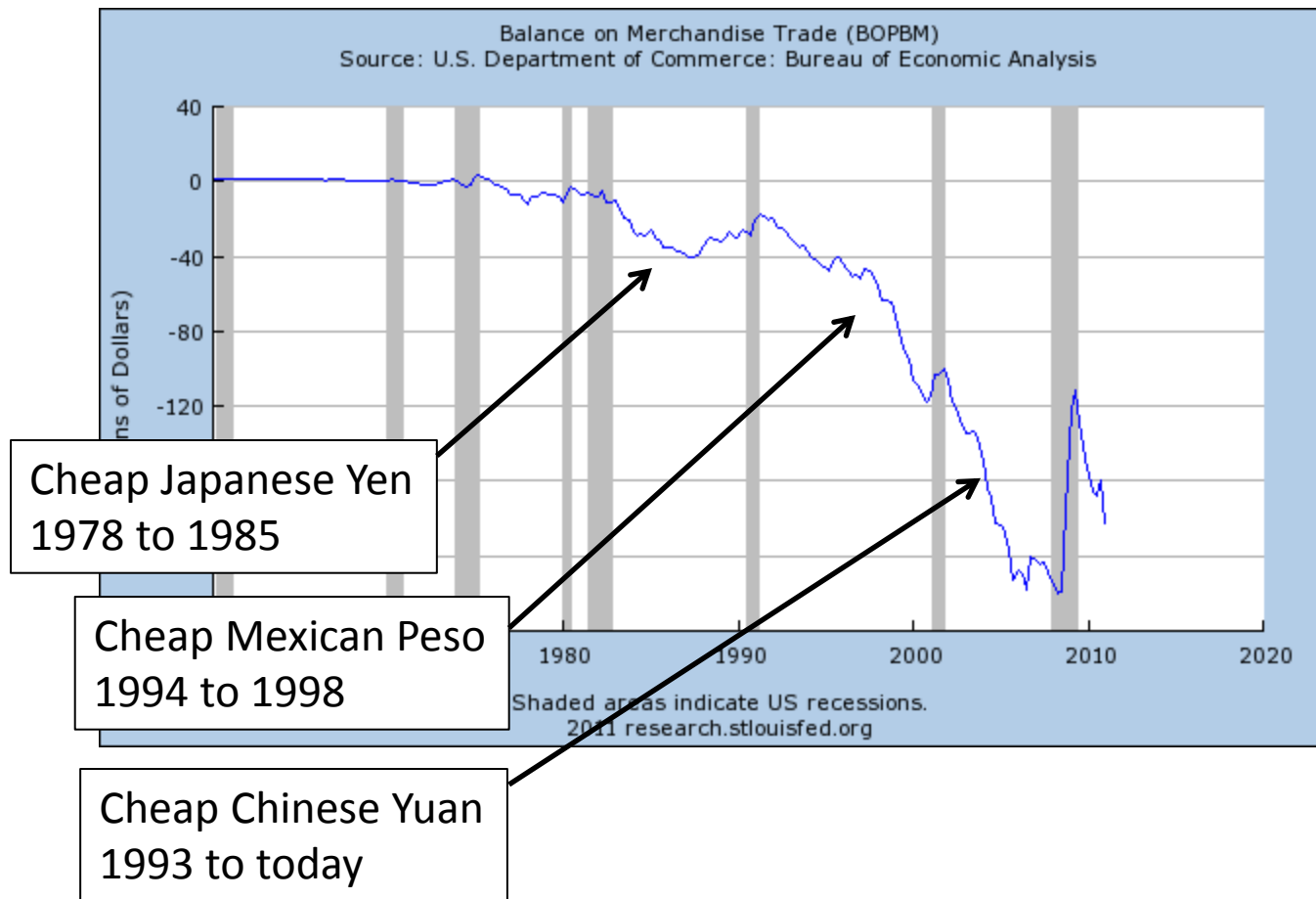
# This is What Chinese Currency Manipulation Looks Like



Red Line: In 1993, China devalued the Yuan from 6 to almost 9 Yuan per dollar.

Blue line: Within a few years, our trade deficit went from \$100 billion to \$800 billion.

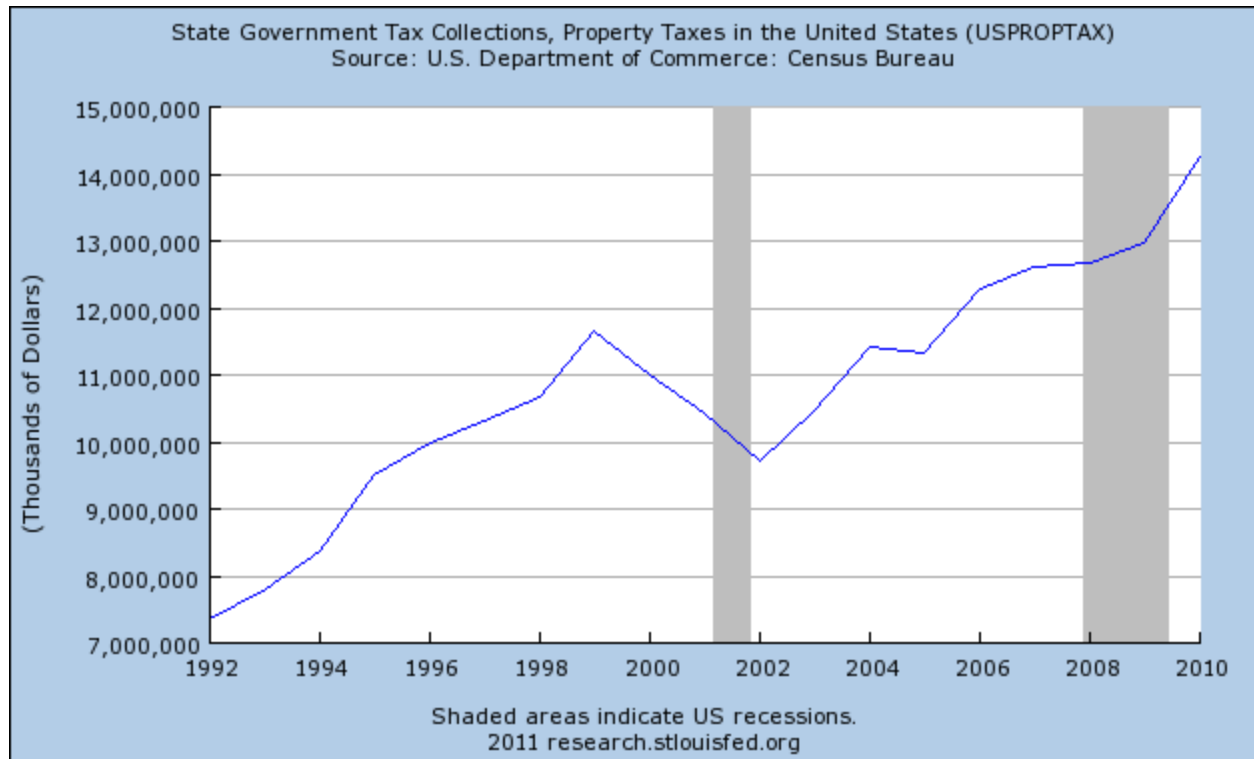
# As We Come Out of Recession, Our Trade Imbalance Gets Worse Again



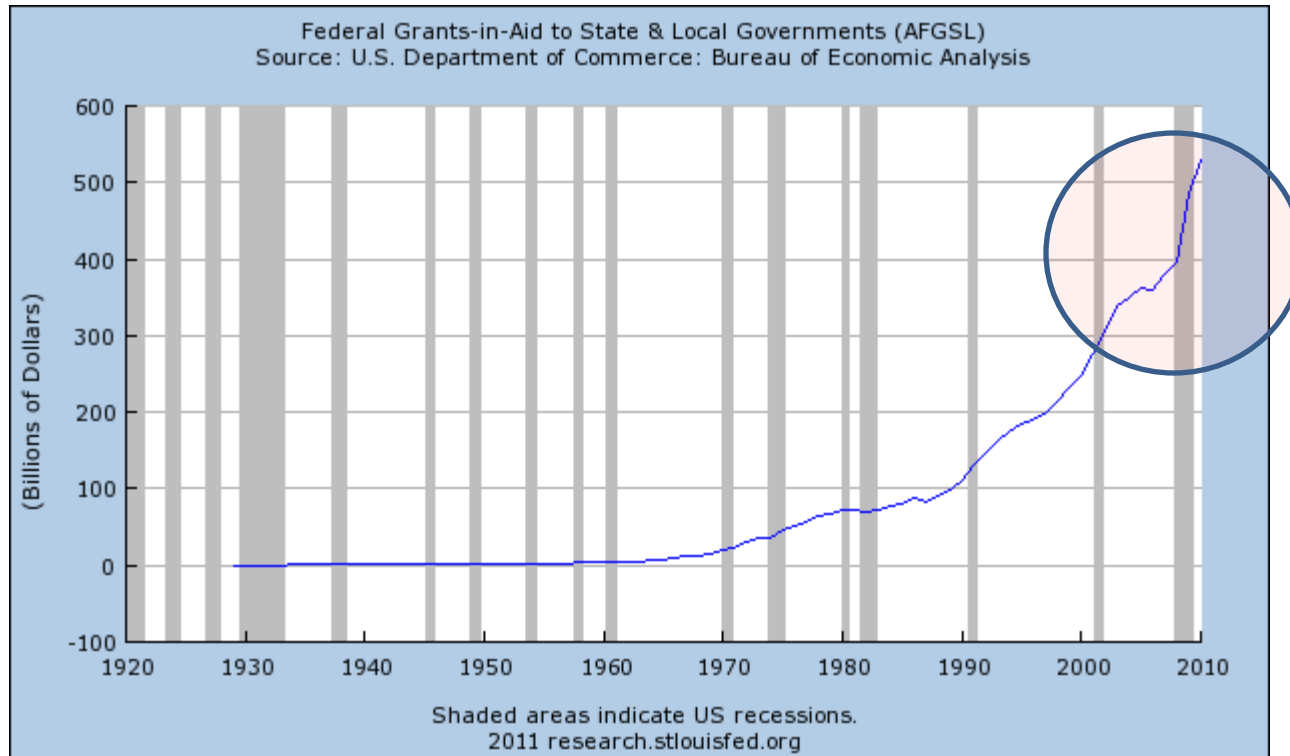
# Government

- State and local governments cutting expenses
- Pension liabilities are a big problem
- Tax revenues are coming in higher than expected
- The “stimulus” money transferred to states and cities has run out
- Reduced government spending can have negative impact on private businesses

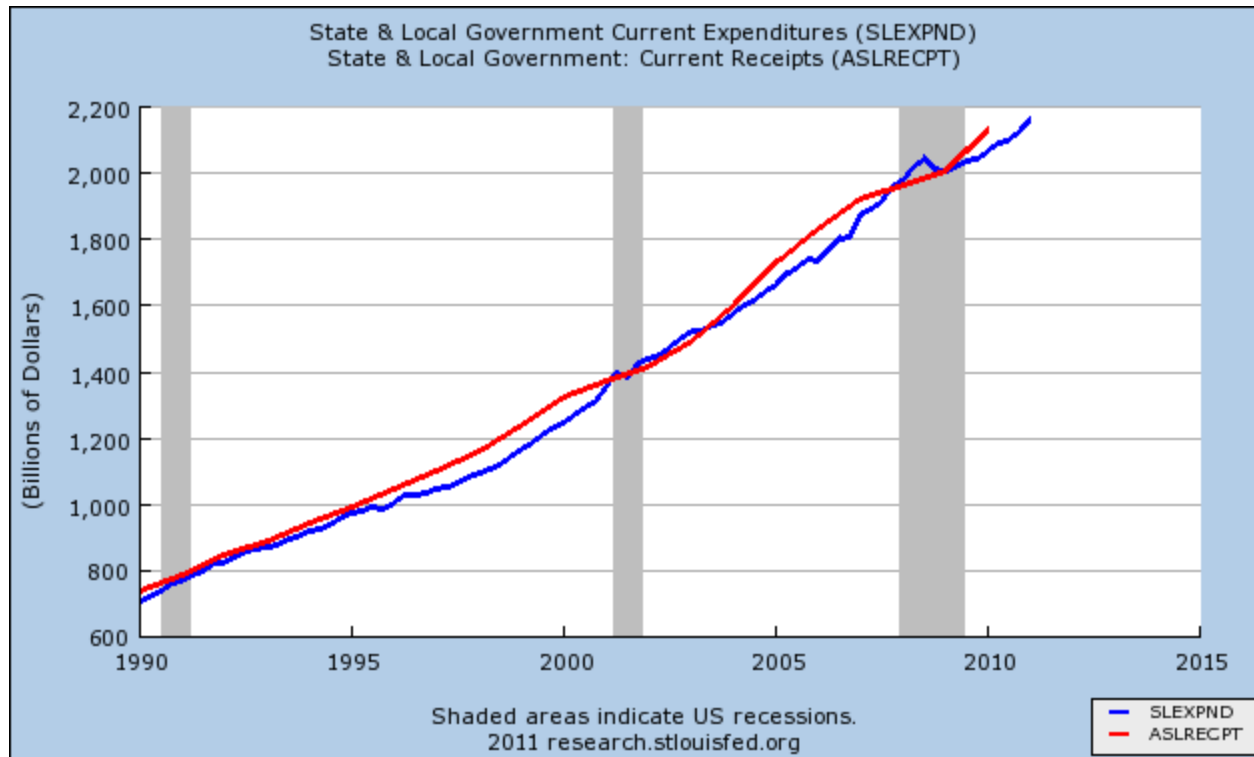
# Property Taxes Still Increasing



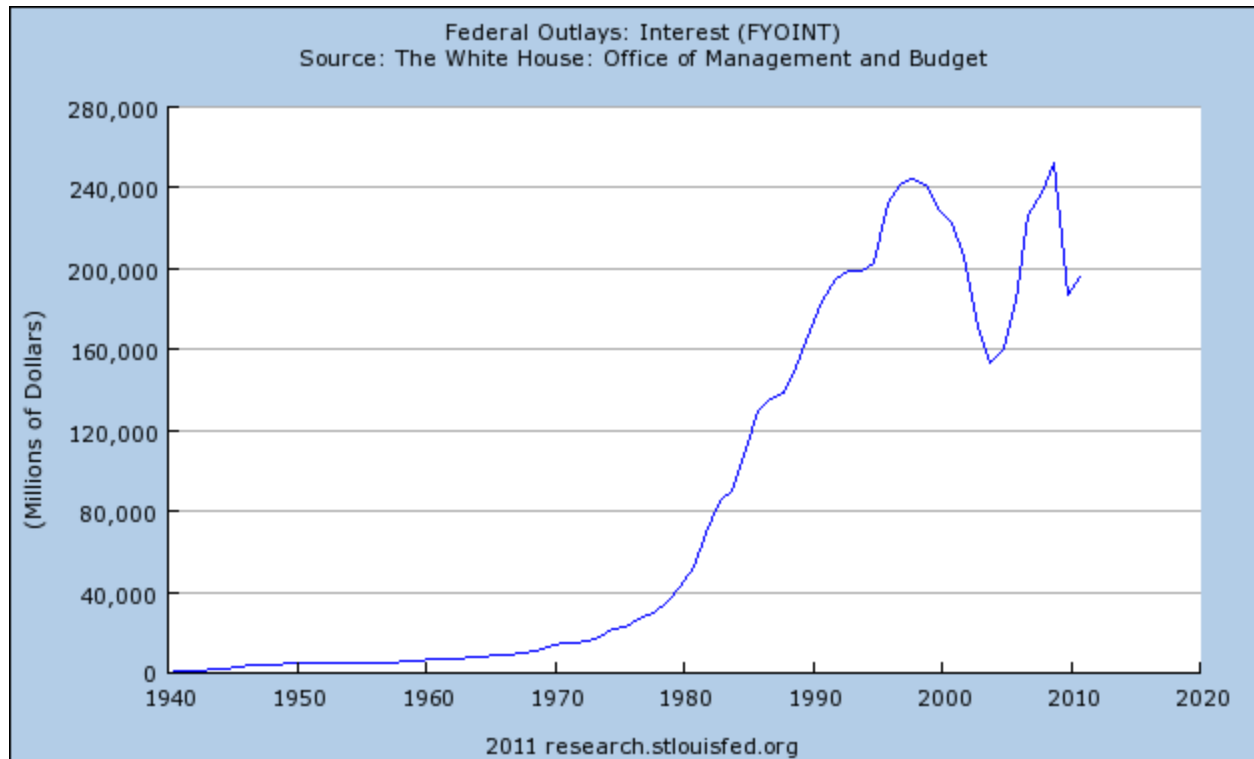
# Stimulus Sent \$200 billion to States and Cities



# Without Stimulus, States and Cities Still Running Large Deficit

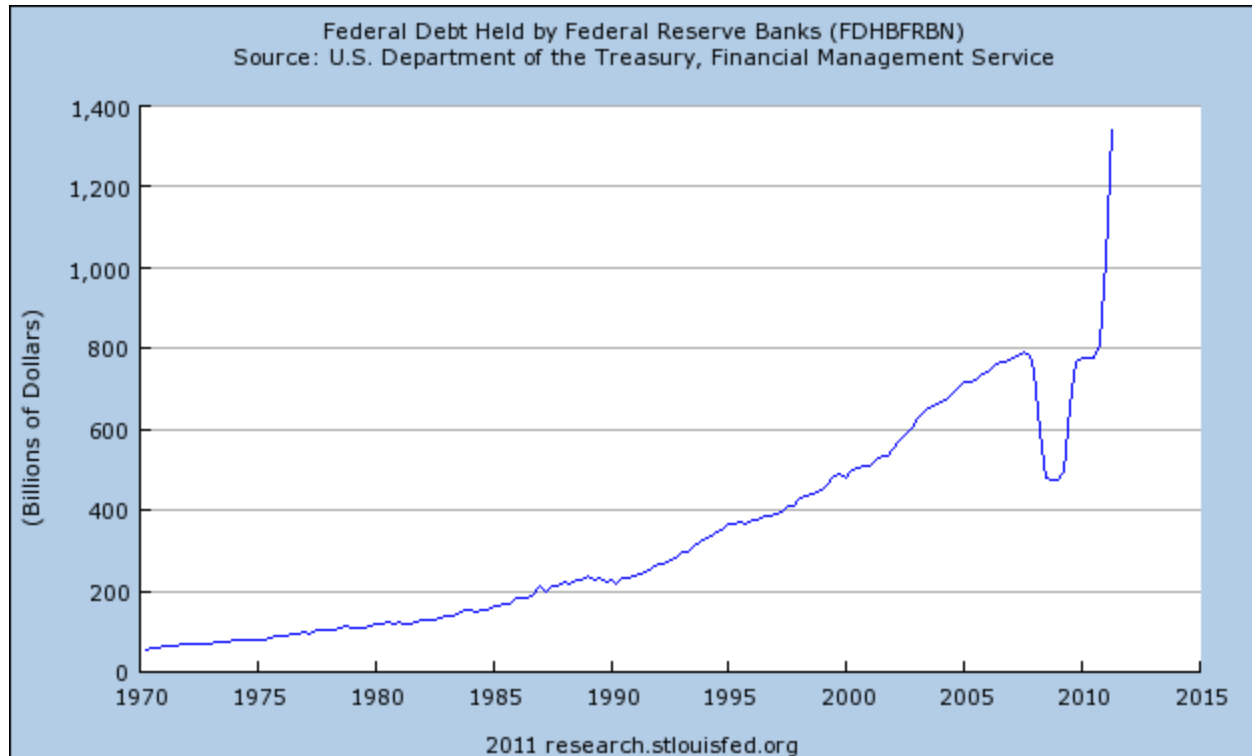


# Low Interest Rates Reduce Federal Outlays for Interest

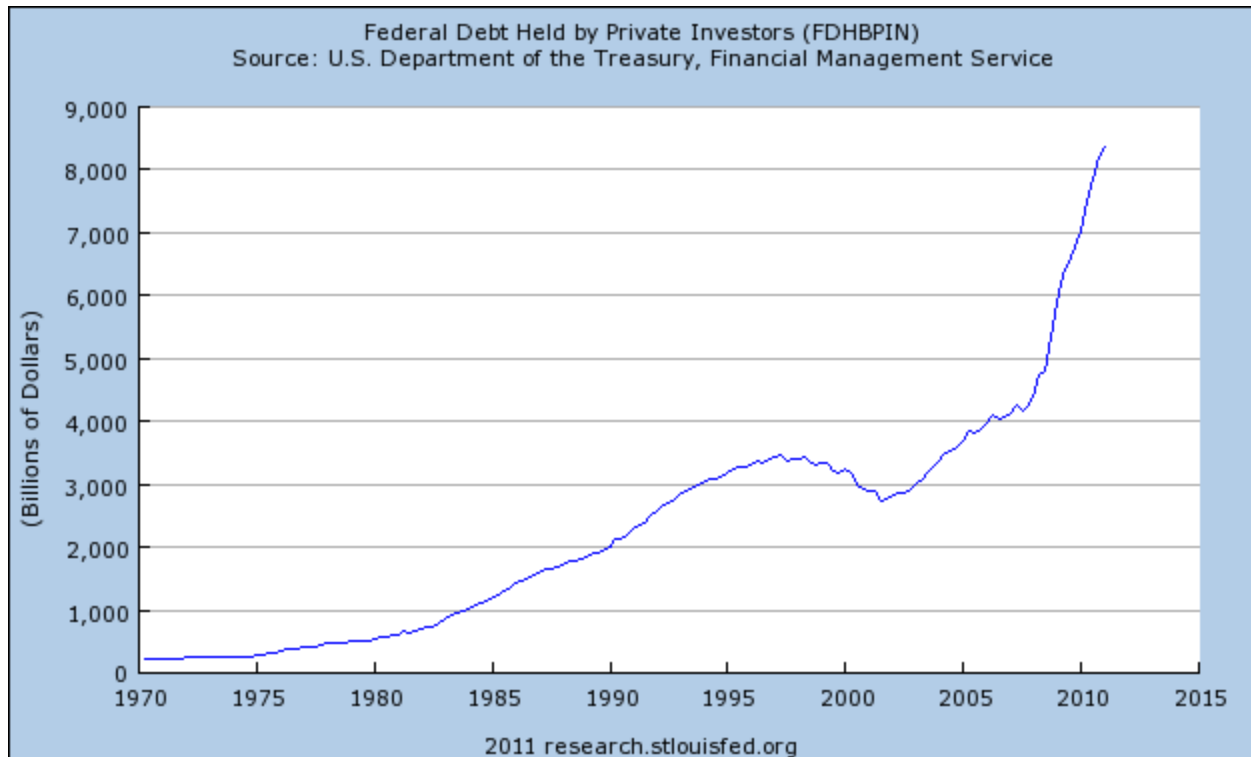


Federal Reserve enables Congress to spend more, because their cost of borrowing is almost nothing.

# The Federal Reserve Has Purchased Over \$800 Billion in Treasuries Since 2008



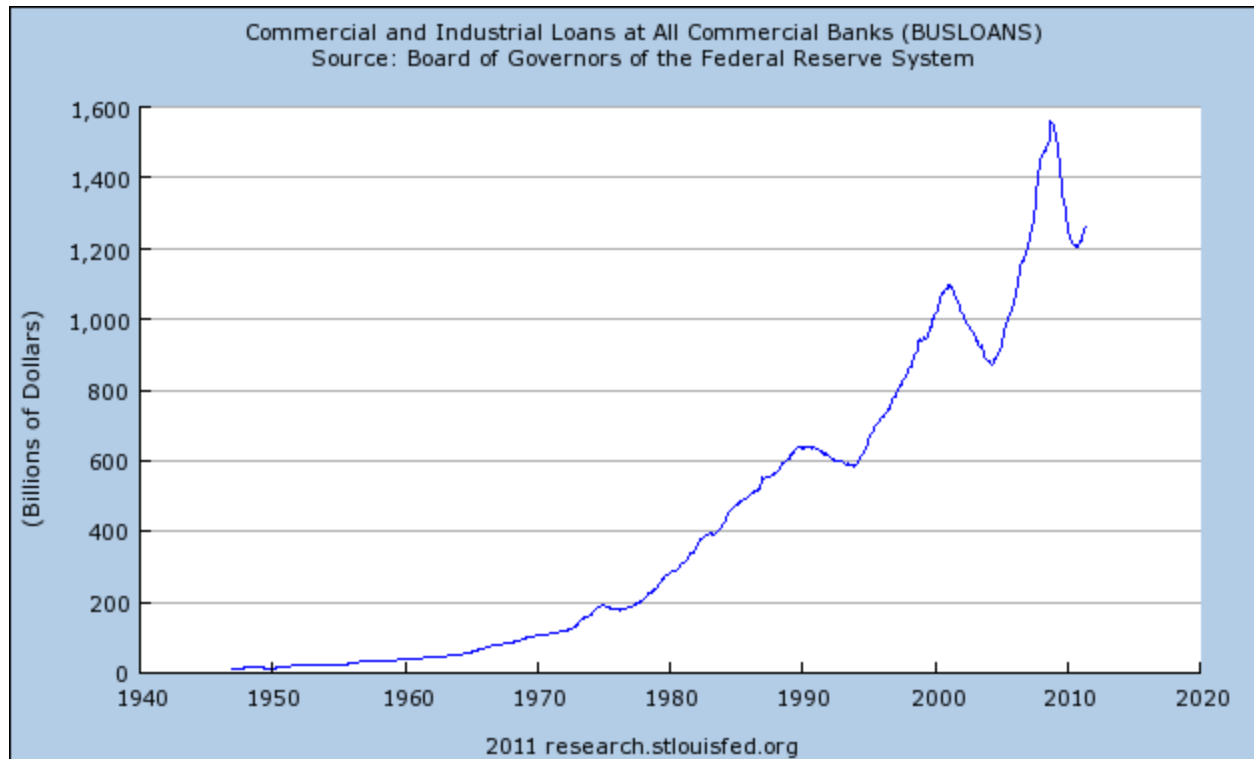
# Private Investors Have Purchased About \$4.5 Trillion in U.S. Debt Since 2008.



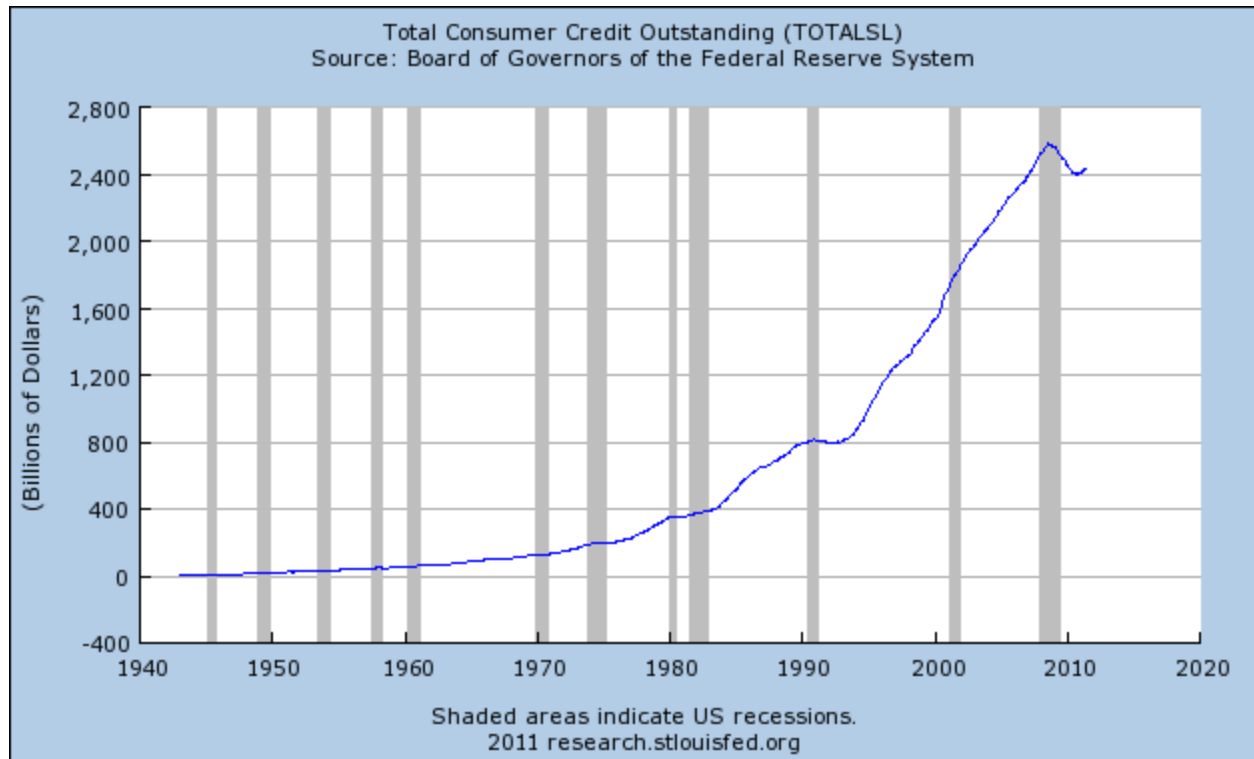
# Banking

- Still over 800 banks on the FDIC problem list
- FDIC Deposit Insurance Fund is \$8 billion in the hole.
- OCC reports 20% delinquency rate on \$2.6 trillion mortgage portfolio.
- 4.1 million loans are delinquent 90 days or in foreclosure
- At current rate, it will take 50 months to sell seriously delinquent and foreclosed homes.
- 33% of loans in foreclosure haven't made a payment in two years.

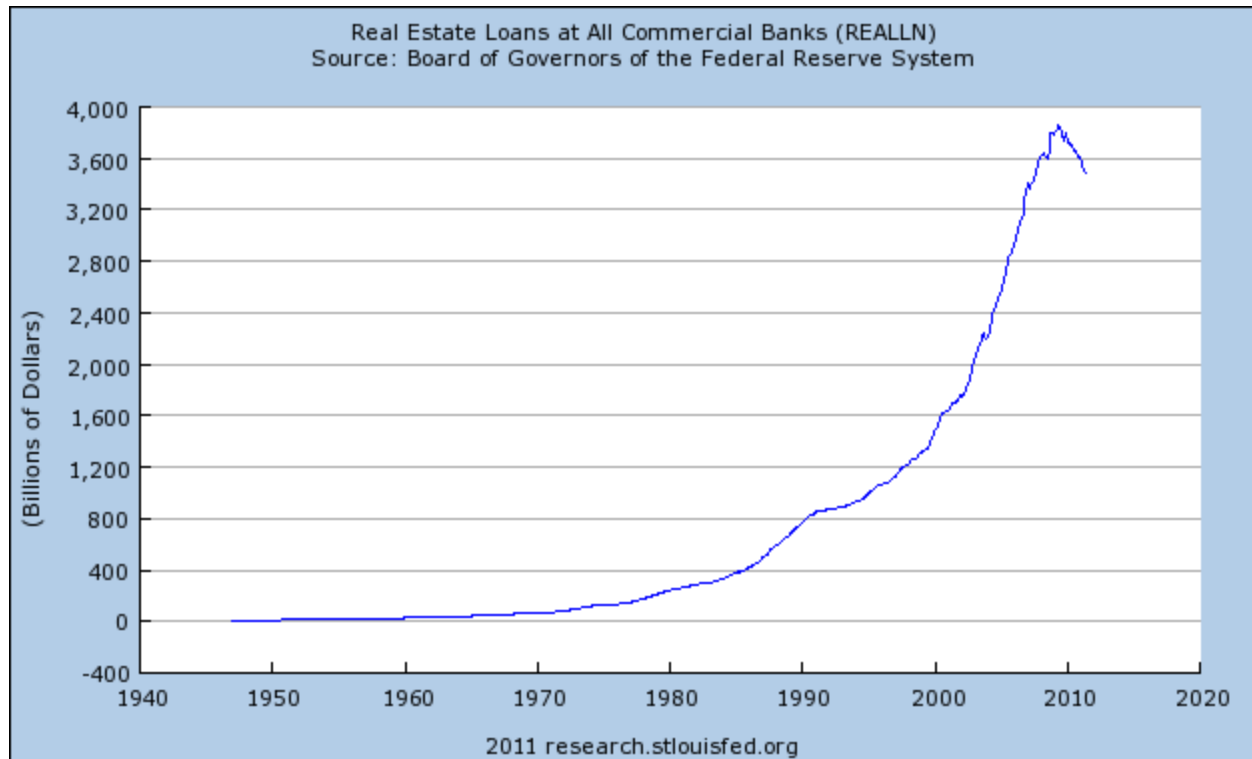
# Commercial and Industrial Loans Finally Increasing Again



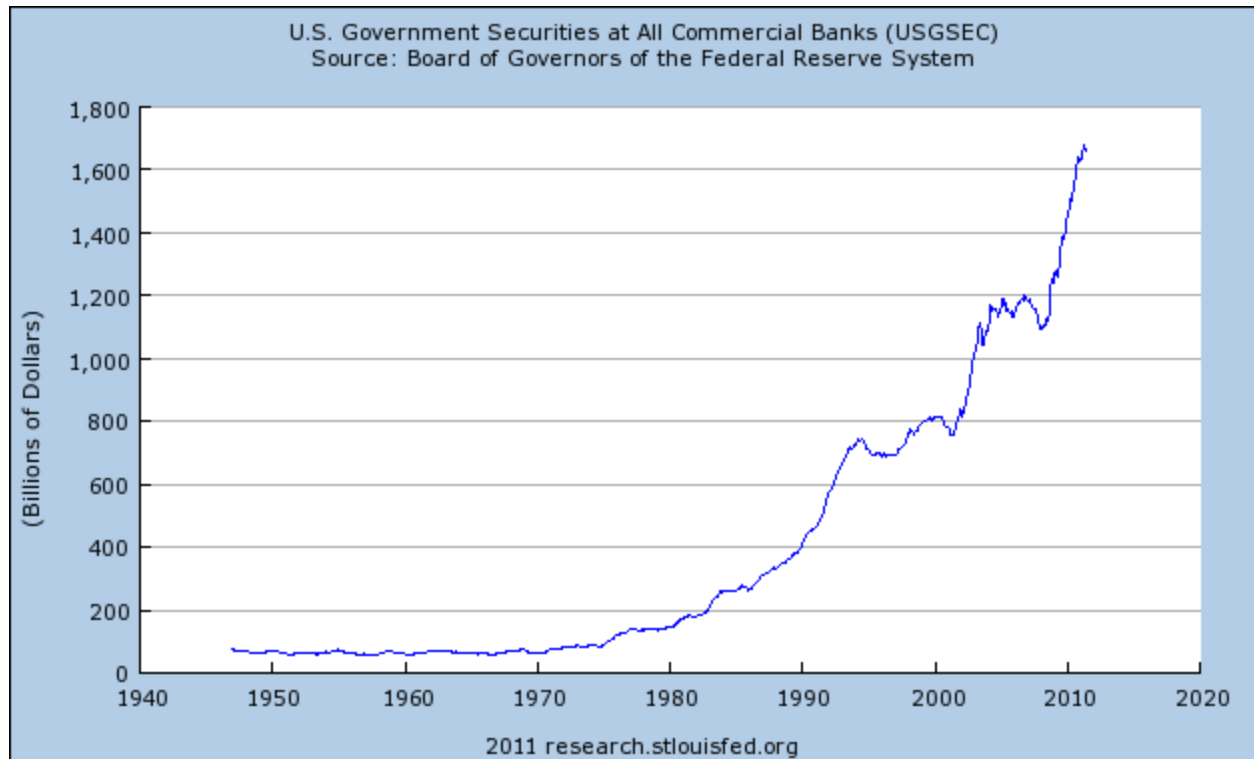
# Consumer Credit Rebounding



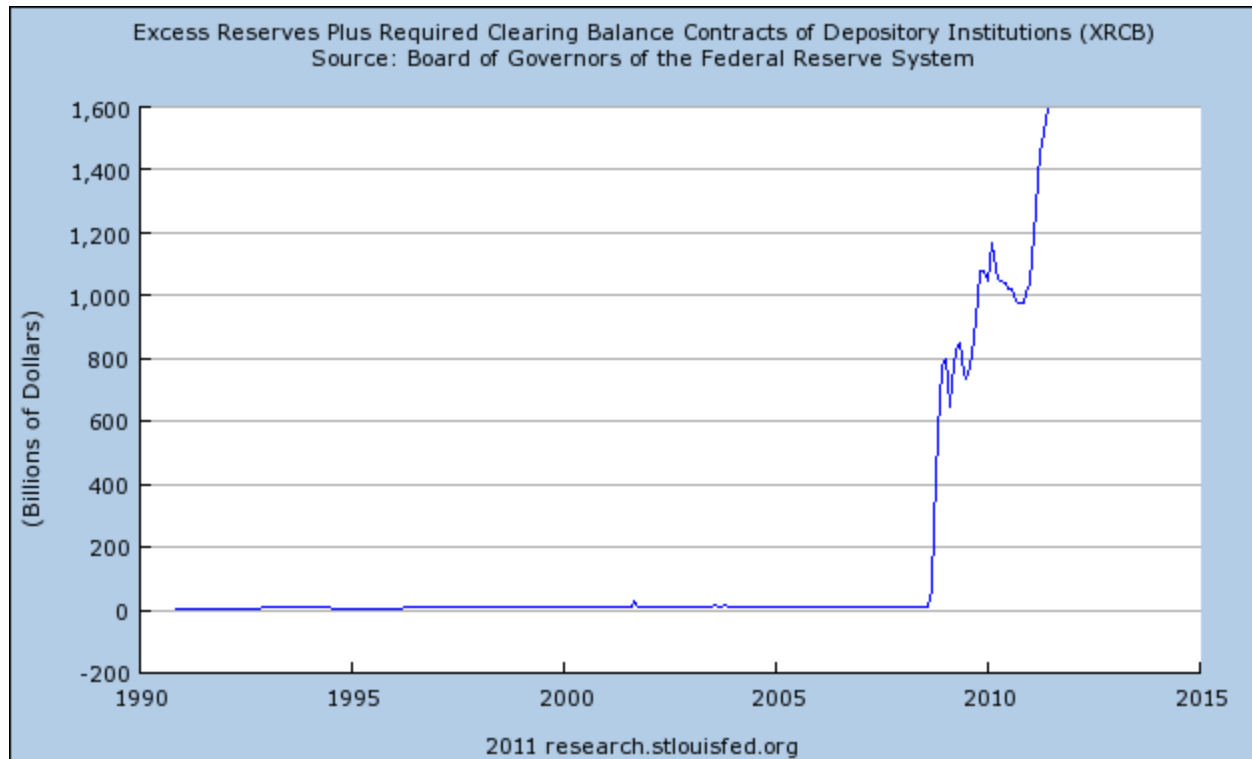
# Real Estate Loans Still Falling



# Banks Still Buying U.S. Treasuries

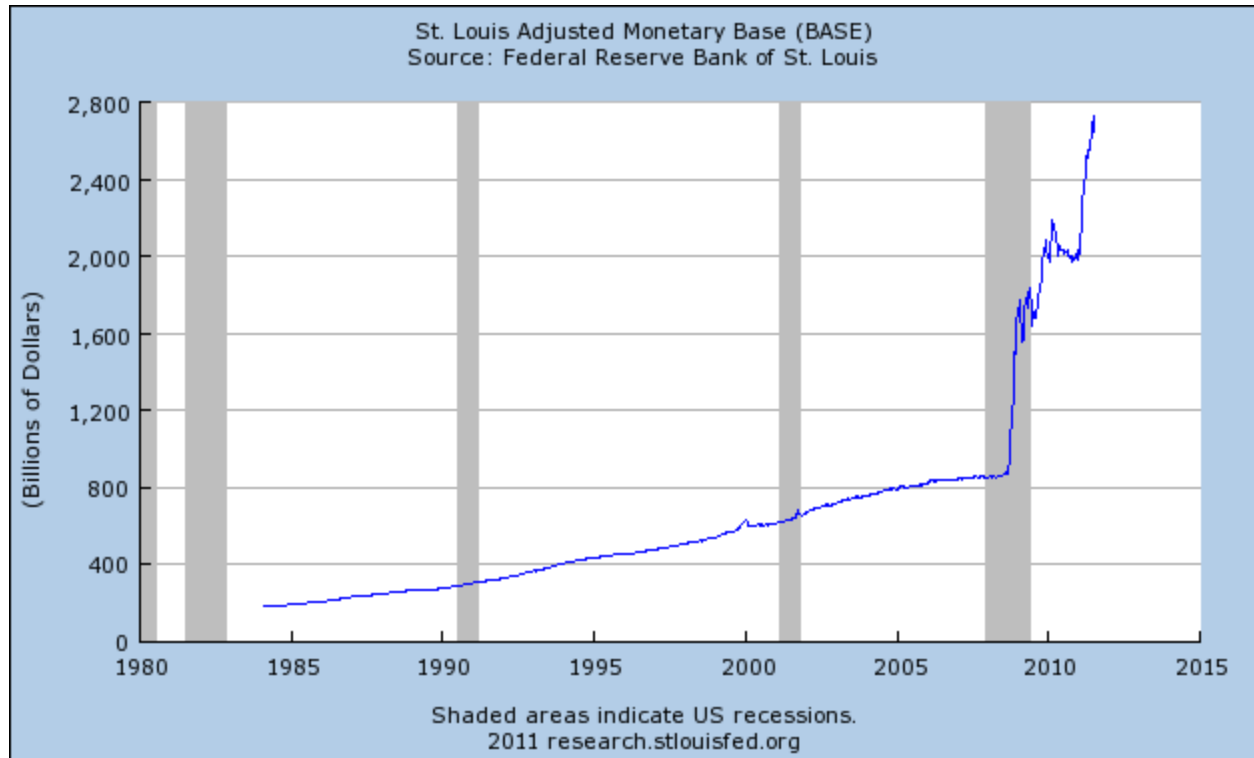


# Excess Reserves Creates Enormous Lending Capacity

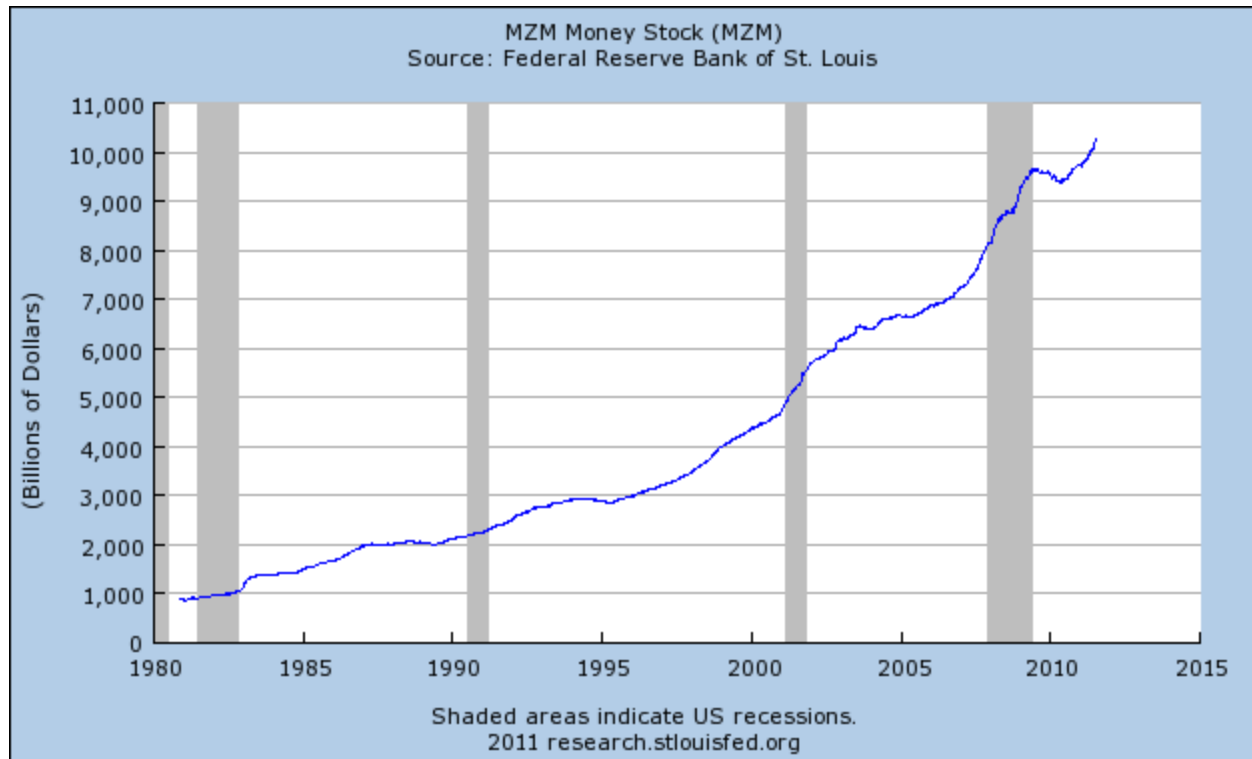


But the Fed pays banks interest on these reserves.

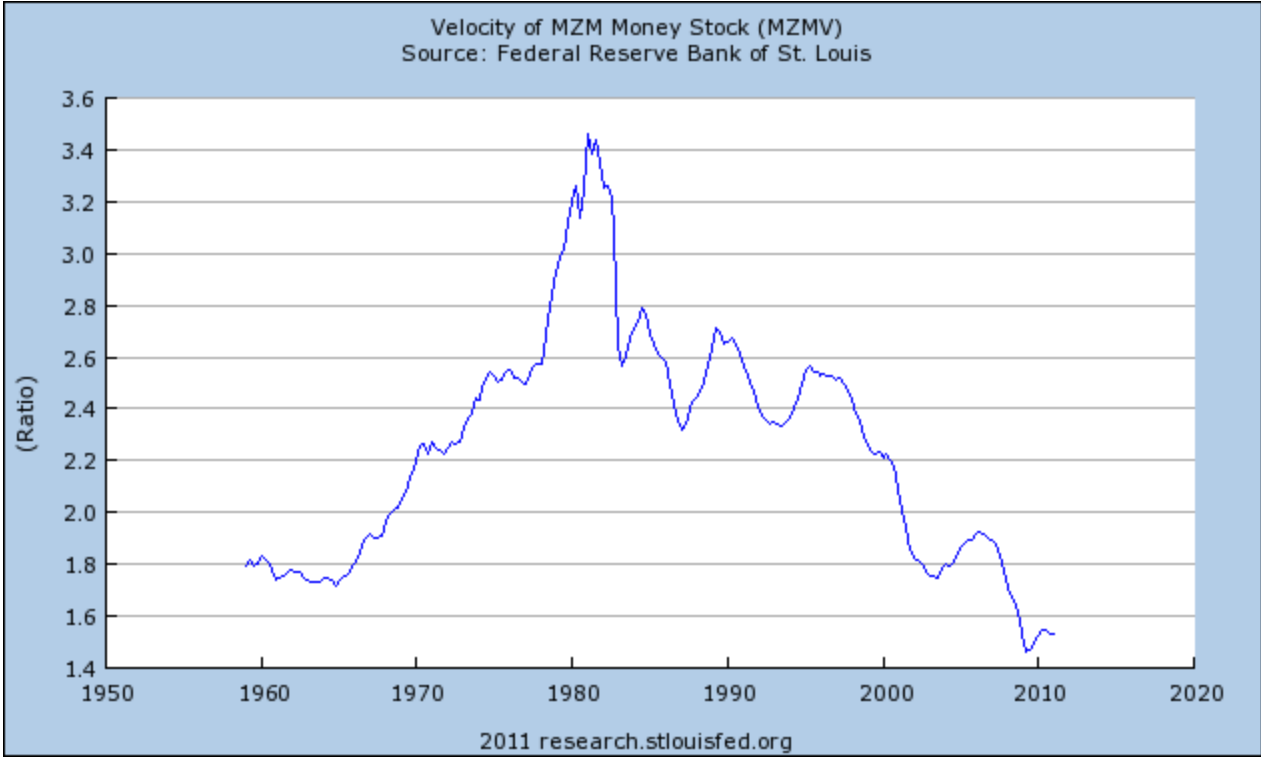
# Monetary Base Has Tripled in Three Years



# MZM Money Stock is Growing but Not Exploding



# Velocity of Money is Very Low



# Conclusions

- It appears that major business and investment decisions will be postponed until after the 2012 election.
- Hence sluggish job growth expected into the first quarter of 2013.
- If the stock market swoons, look for more QE.
- Interest rates likely to stay low through the election.
- Could be some enthusiasm in the spring and summer of 2012 if polling data is encouraging.
- Major inflection point in first quarter of 2013.



# Conclusions

- A big selloff in the stock market will likely lead to more QE.
- A bond market crisis may have to occur before the US gets the motivation to balance their budget.

# Major Inflection Point Coming in the Spring of 2013

- We are getting de-sensitized to large numbers.
  - \$700 billion TARP was unimaginable
  - Now \$1.2 quadrillion in notional amount of CDS
  - Japanese debt now at 998 trillion

If you get a Republican president and a republican Congress and they don't stop the spending, then beware of a loss of confidence in the US debt.