



Green Shoots and Brown Shoots

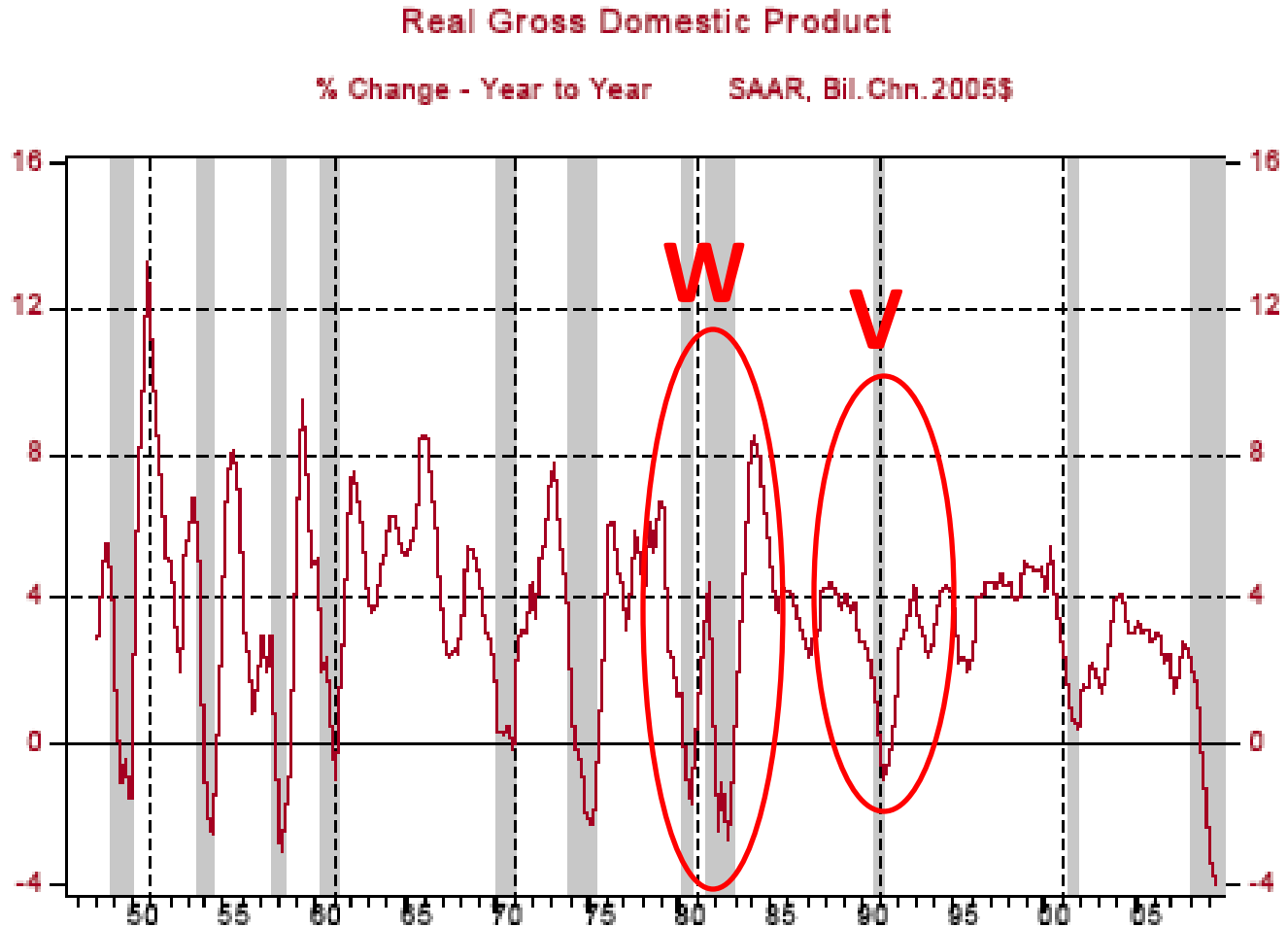
What's Next for the US Economy

Key West, Florida
October 22nd, 2009

Dr. Jim Budzynski, Managing Partner
MacroGain Partners
www.macrogain.com

Where We've Been

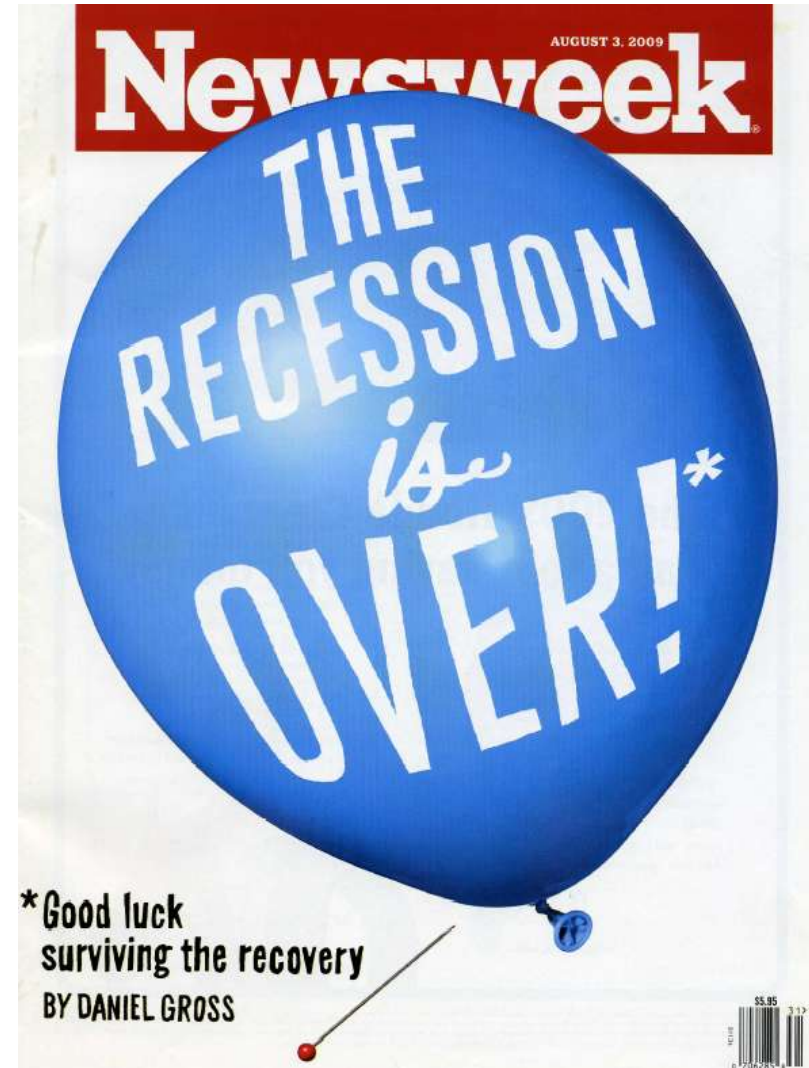
- Deepest and Longest Postwar Recession
- Recovery Options:
 - V
 - W
 - L
 - ww



Source: Bureau of Economic Analysis / Haver Analytics

No Shortage of Optimism

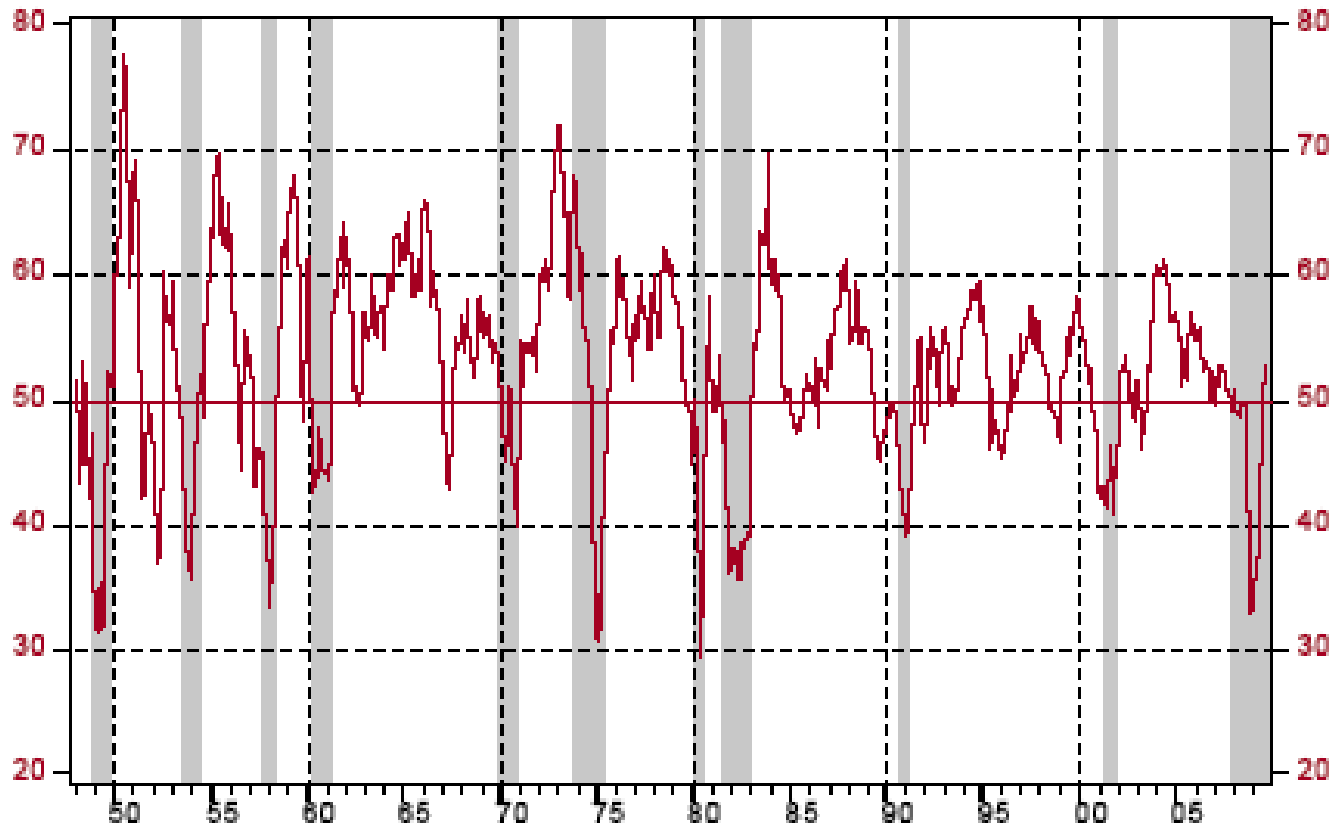
- “Green Shoots” Talk Abounds
- Unprecedented Market Snapback Since March Lows
- The Question is Whether This Growth is Real or Artificial



Green Shoot 1: Manufacturing

ISM Manufacturing: PMI Composite Index

SA, 50+=Increasing

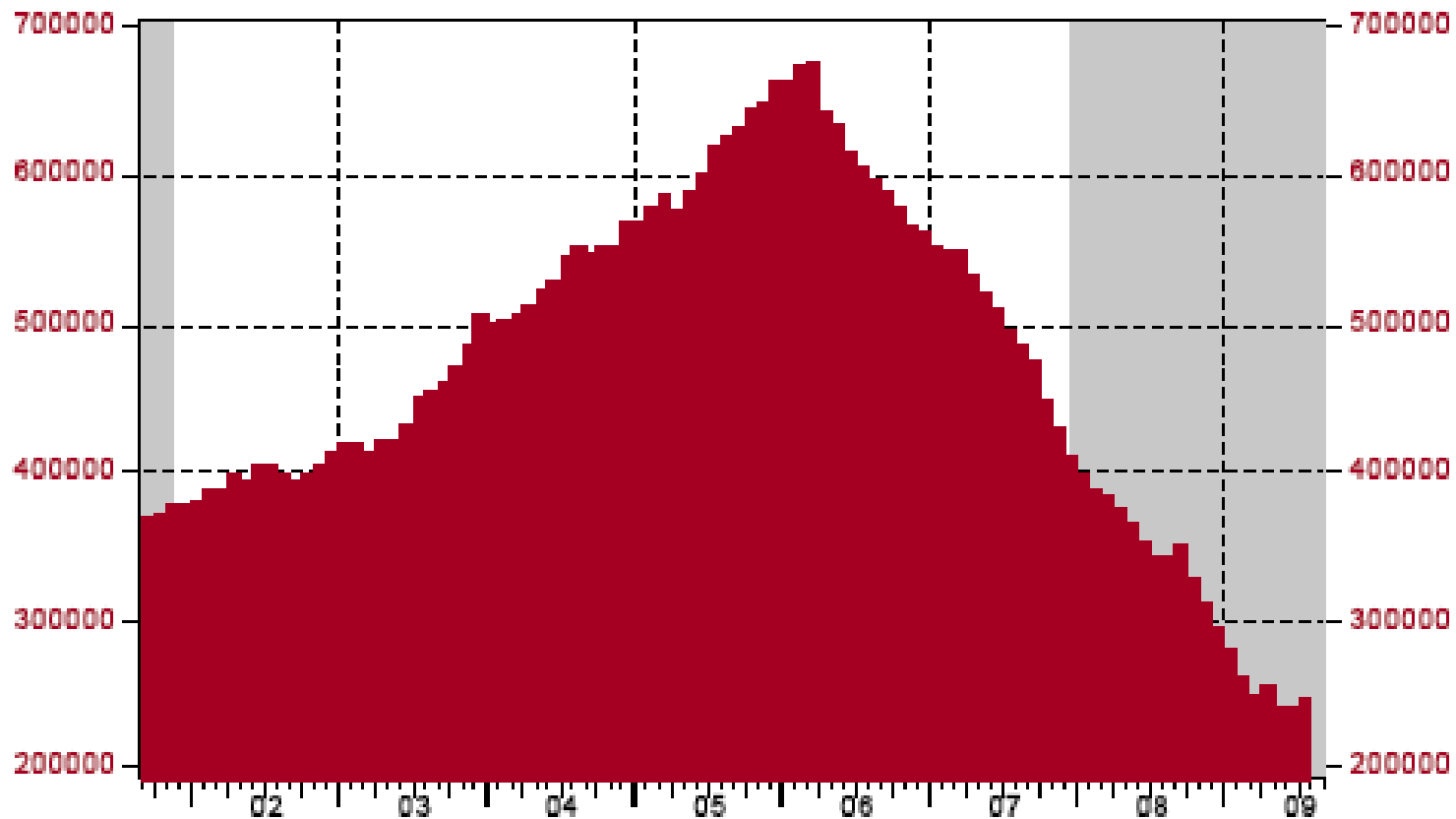


Source: Institute for Supply Management /Haver Analytics

Green Shoot 2: Housing “Rebound”

Private Construction: Residential

SAAR, Mil.\$

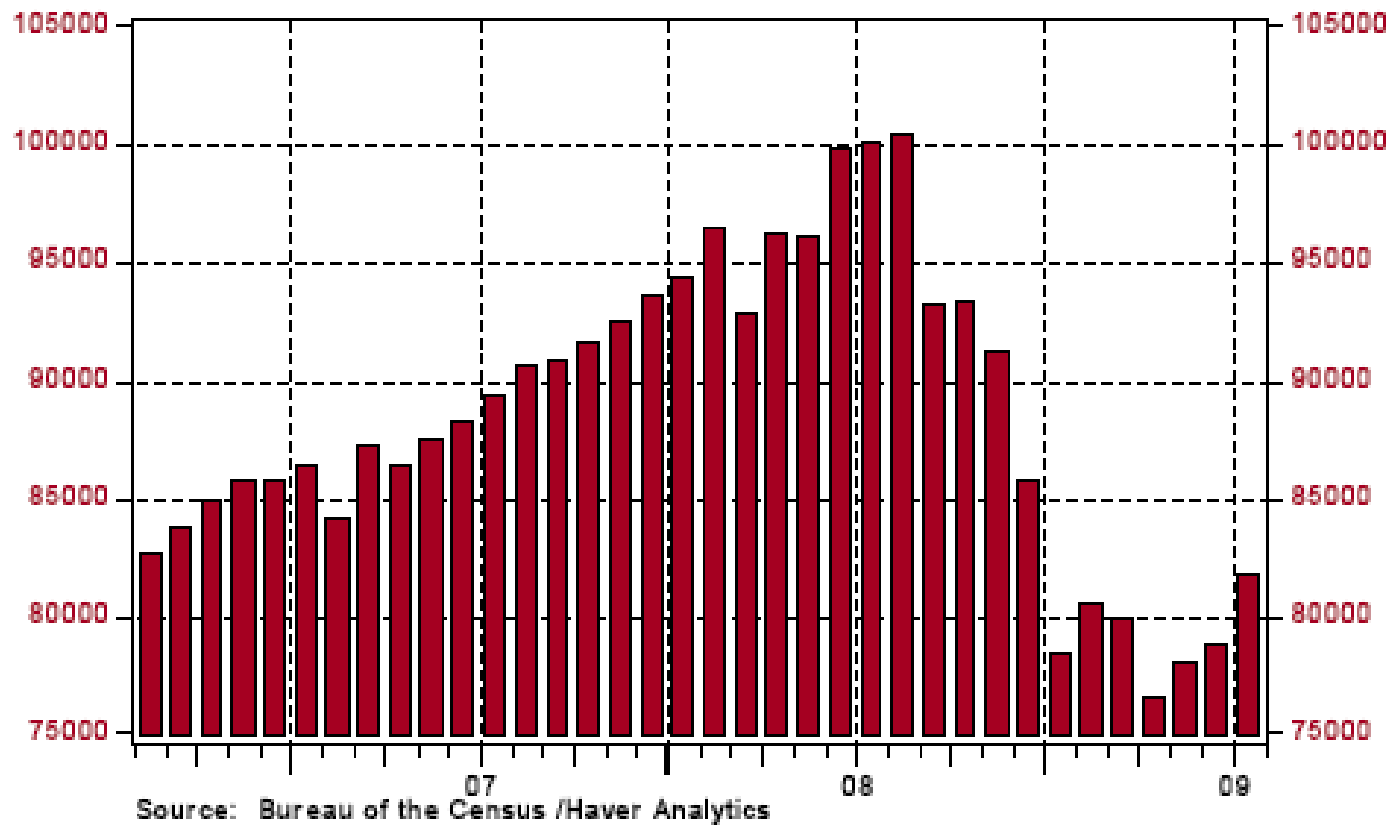


Source: Census Bureau /Haver Analytics

Green Shoot 3: Exports

Exports, f.a.s.

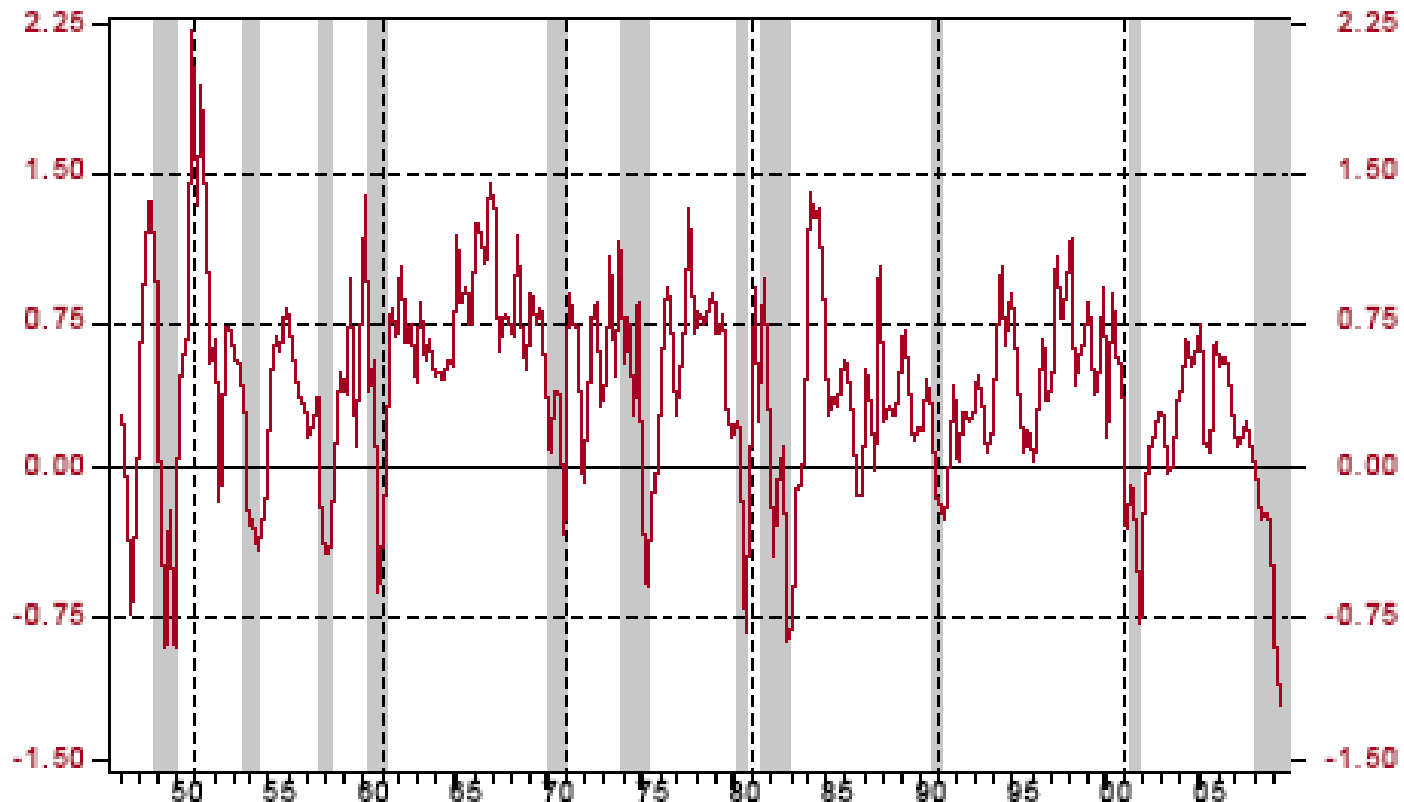
SA, Mil. Chn. 2005\$



Green Shoot 4: Inventory Drawdown

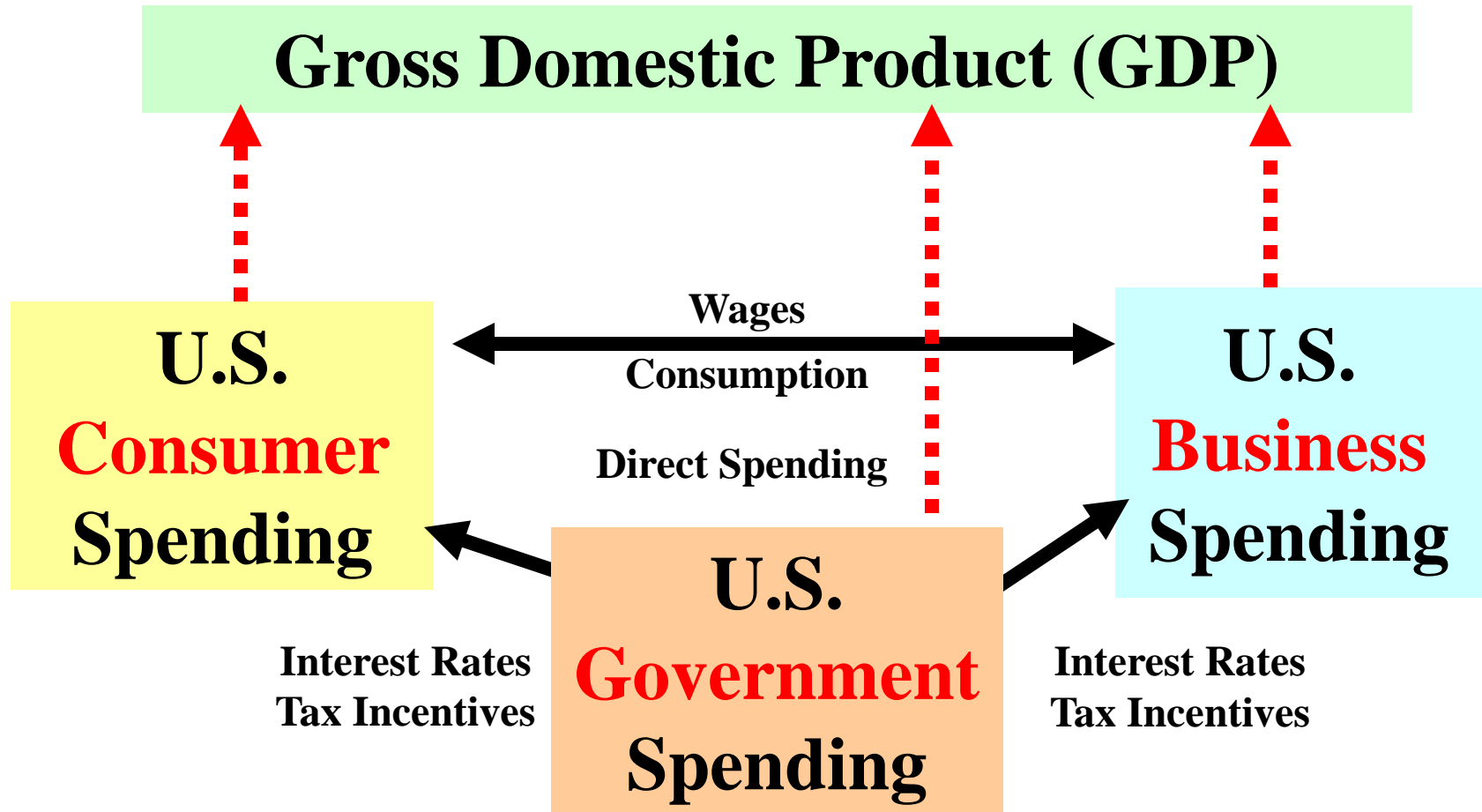
Change in Business Inventories as % of Final Sales of Domestic Product

SAAR, Chn. 2005\$



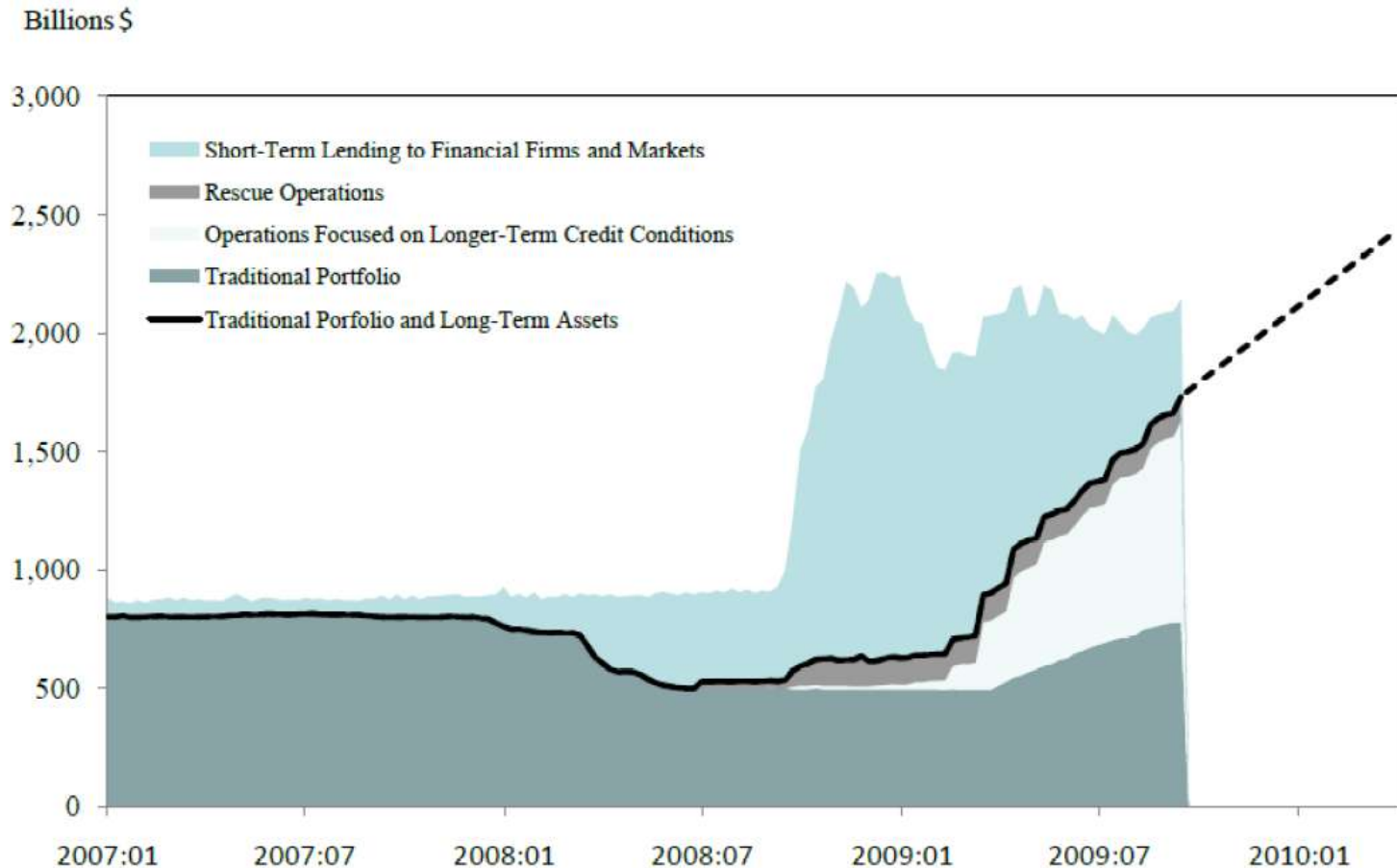
Source: Haver Analytics

Three Drivers of GDP

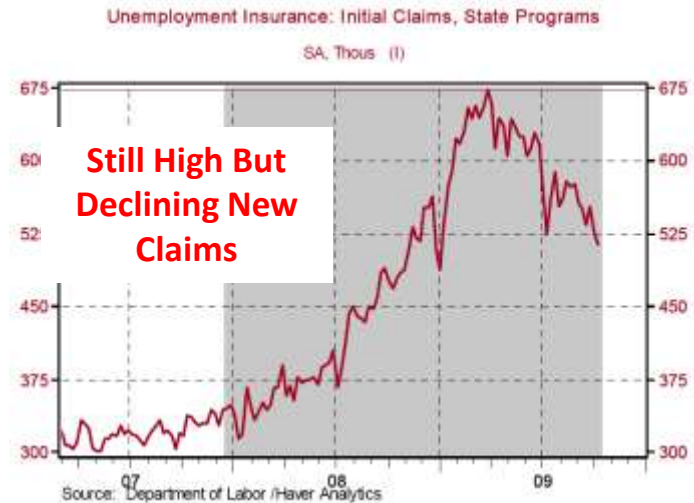


How Did We Get Growth?

Unprecedented US Fiscal Stimulus



Brown Shoot #1: Unemployment

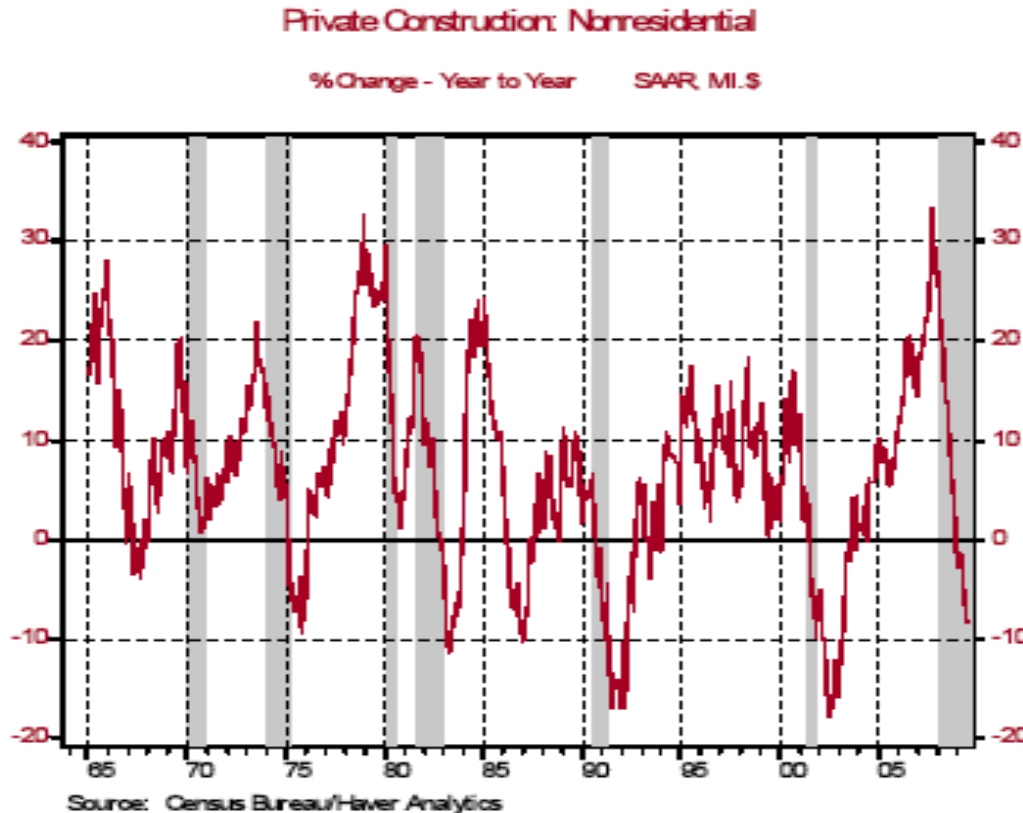


Record Low Capacity Utilization



High Structural Unemployment will Be a Problem for a Long Time!

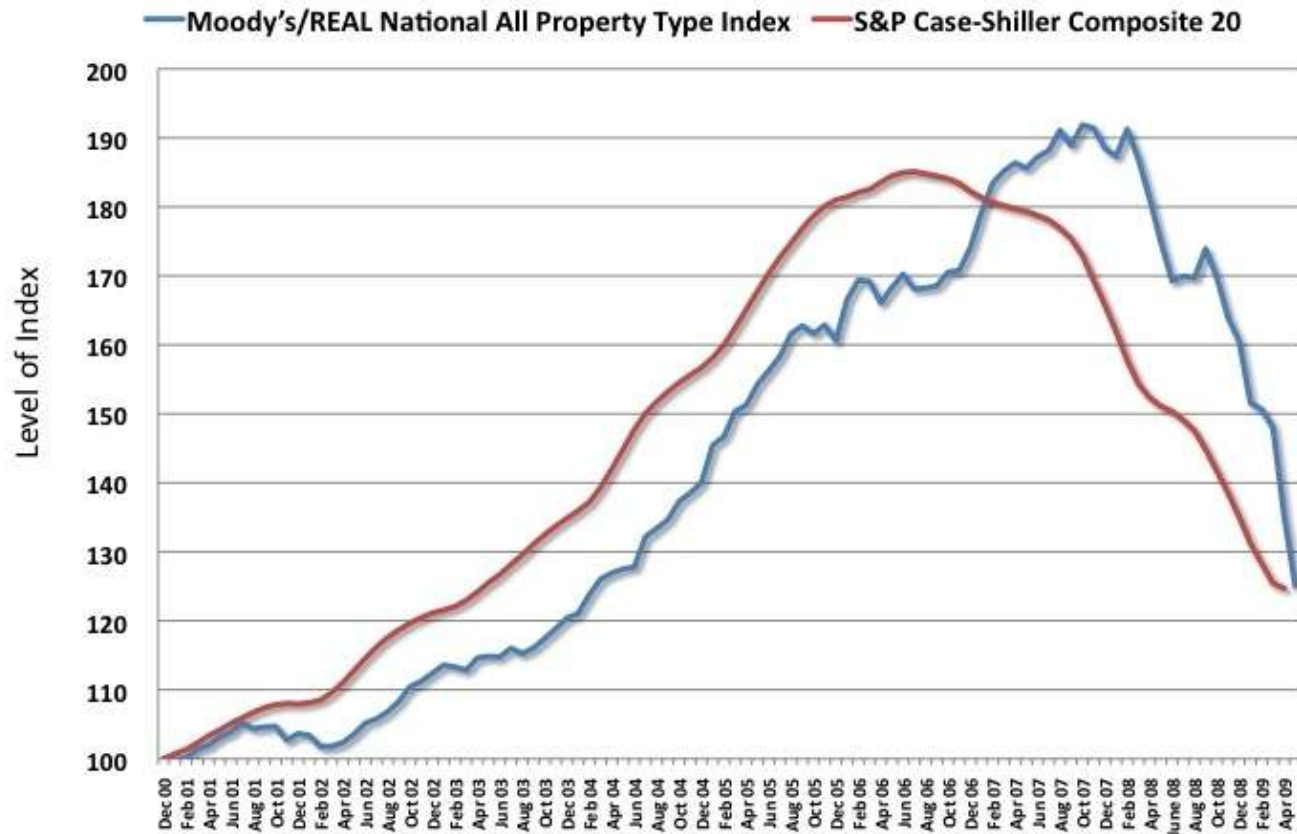
Brown Shoot 2: Commercial Real Estate



Construction and Sales of Commercial Real Estate Have Plummeted

Haven't We Been to this Movie?

Real Estate Prices: Commercial vs. Residential



Sources: Moodys/REAL Commercial Property Price Index,
S&P/Case-Shiller Home Price Index

Even the Fed Fears a CRE Meltdown...

As the industry looks for signs the housing sector is beginning to stabilize, the **threat of a crash in the commercial mortgage market grows**, according to San Francisco Federal Reserve president Janet Yellen.

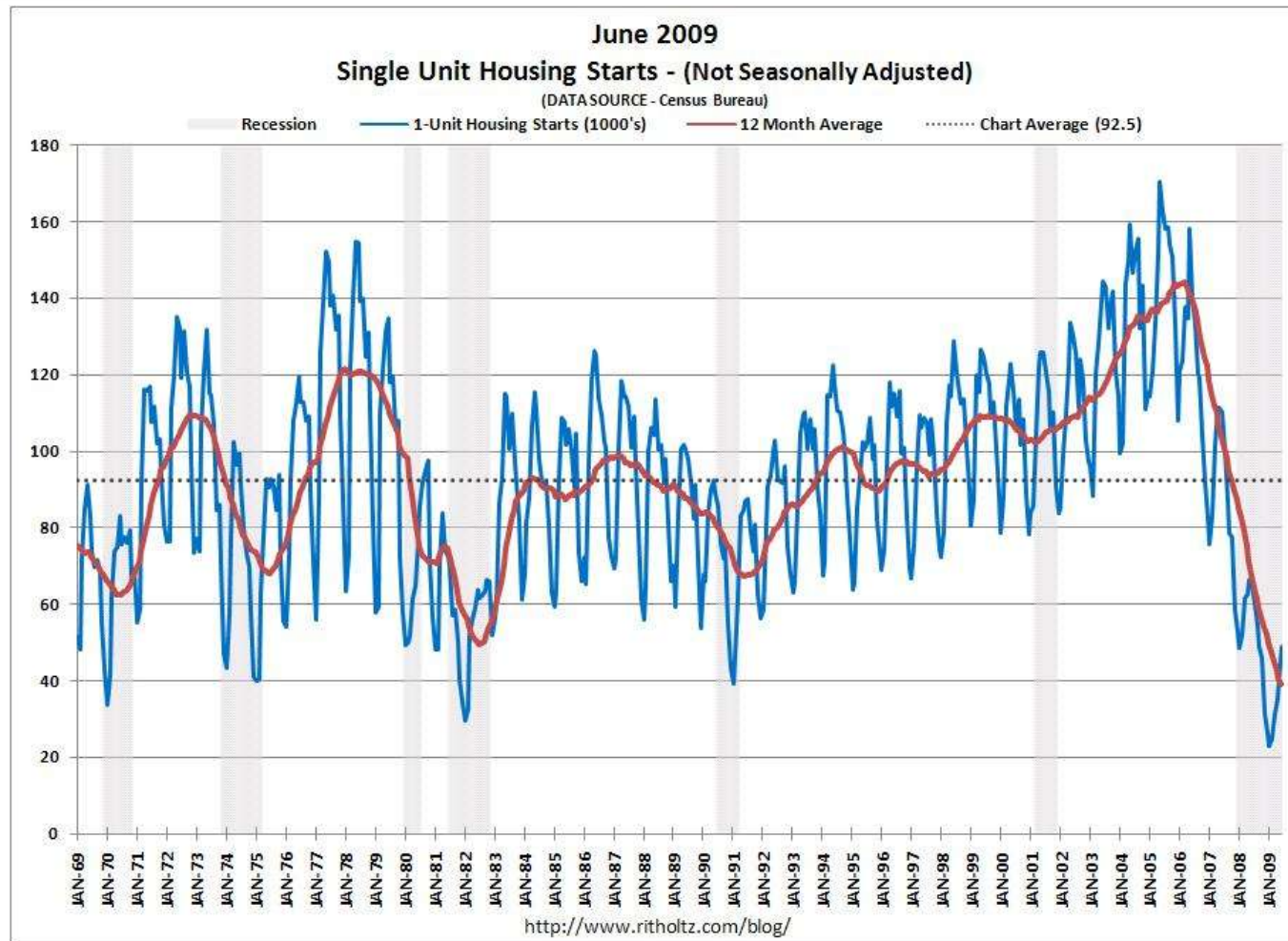
Speaking this week at a bankers convention in Idaho, Yellen said while there are signs that the economic growth is beginning to return — house price declines are abating, consumer spending is stabilizing and new unemployment is lessening — the recovery will be painfully slow and **the Fed believes commercial real estate is the economy's next vulnerable spot.**

The problem, Yellen said, is maturing loans for commercial properties that lost significant value. **“Borrowers seeking to refinance will be expected to provide additional equity and to have underwriting and pricing adjusted** to reflect current market conditions,” Yellen said. “In some cases, borrowers won’t have the resources to refinance loans.”

Yellen urged the community bankers at the conference to be proactive in preparing for a **potential downturn, which could include, she said, property value drops as high as 30% to 40%.**

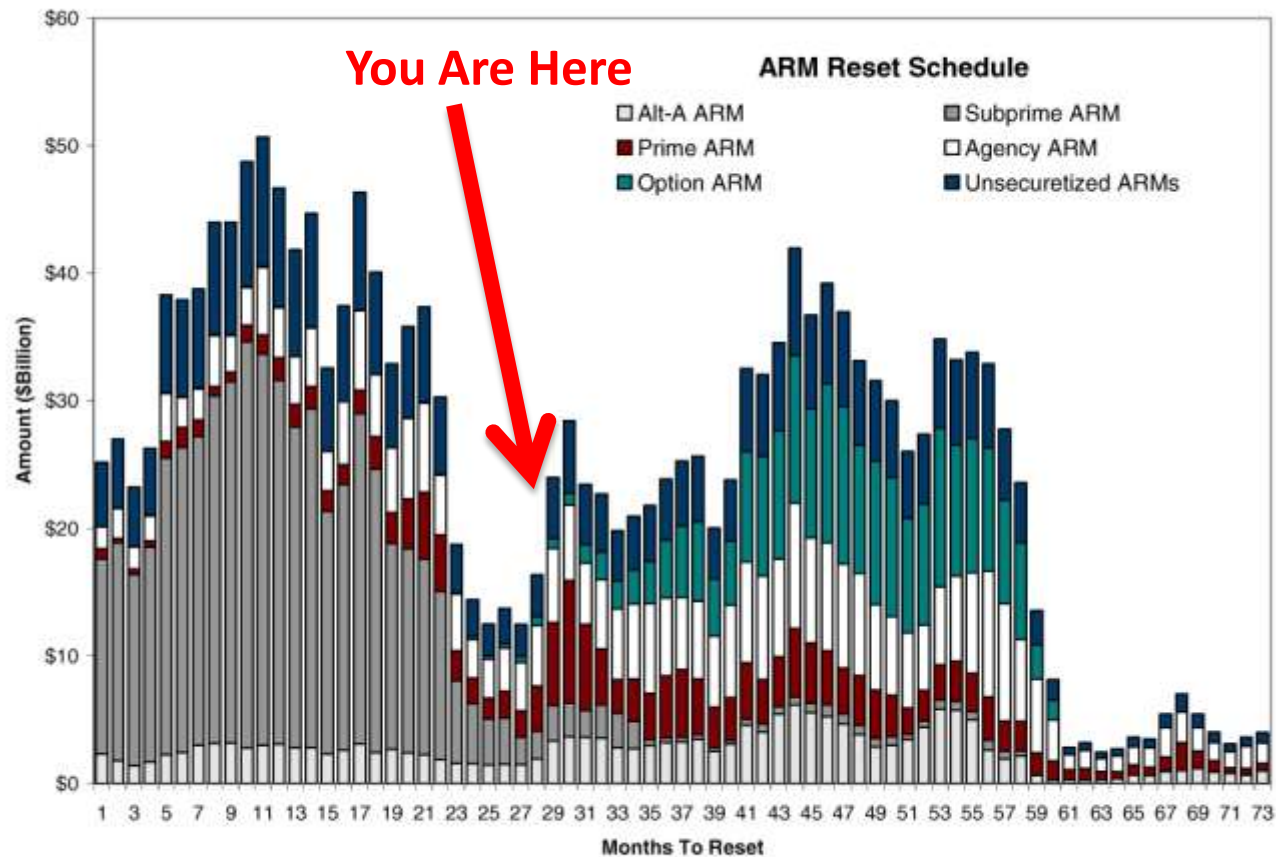
July 29, 2009

Brown Shoot #3 : Housing



So You Thought Subprime Was It....

Exhibit 42: Adjustable Rate Mortgage Reset Schedule



Note: Data as of January 2007.

Source: Credit Suisse Fixed Income U.S. Mortgage Strategy.

No Foreclosure “Supply” Problem!

Percent Loans Delinquent and in Foreclosure by State, All Loans, Q2 2009 Source: MBA

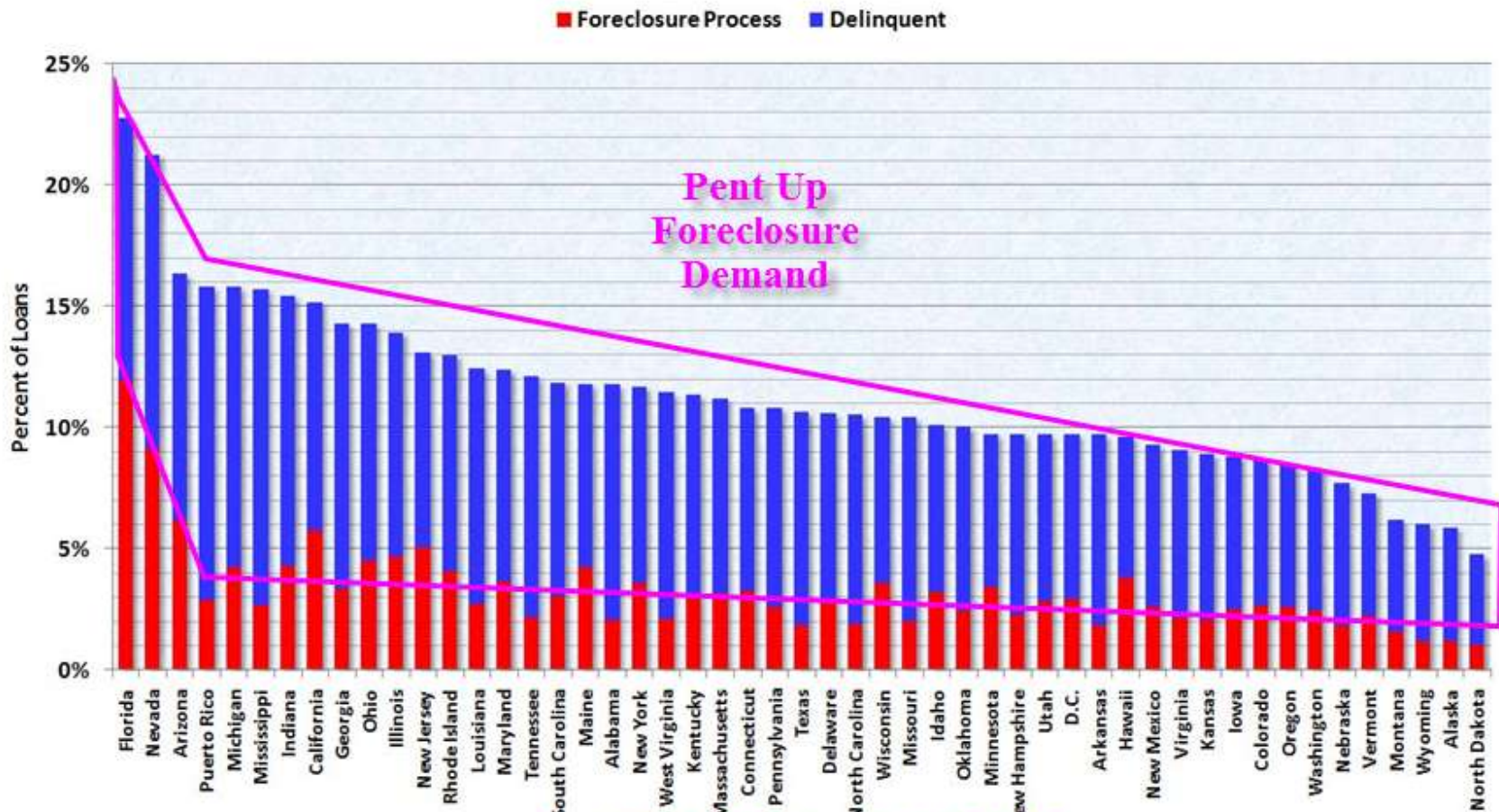
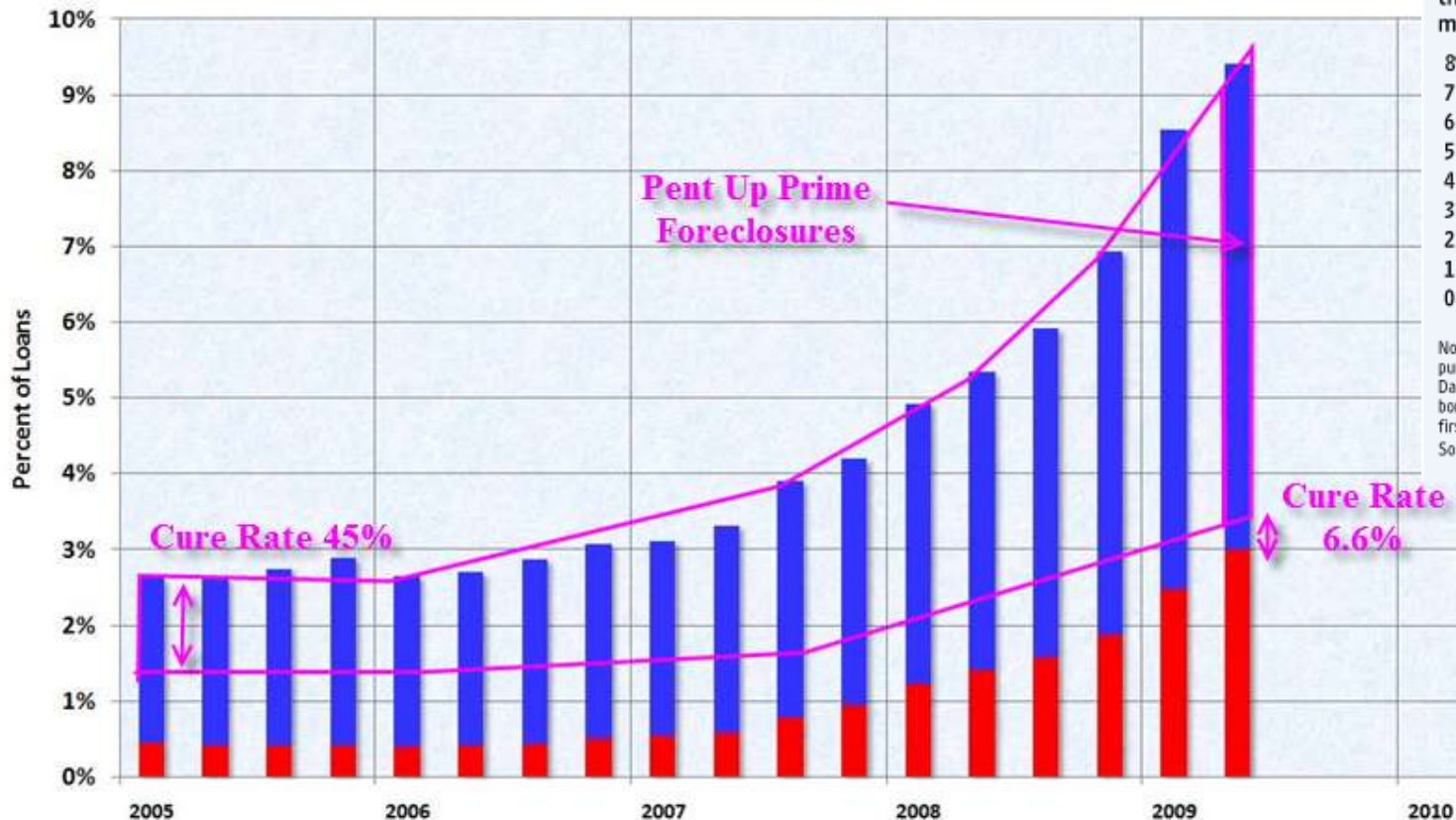


Chart by Calculated Risk - Annotations in Pink by Mish
<http://www.calculatedriskblog.com/>

Big Prime Loans Joining the Parade...

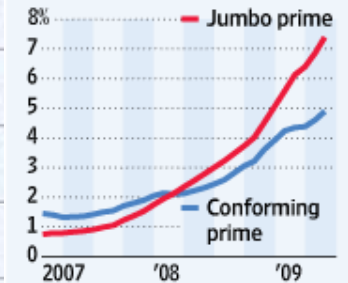
U.S. All Prime Loans Delinquent and in Foreclosure: Source: MBA Q2 2009 Delinquency Survey

■ Foreclosure Process ■ Delinquent



Hefty Problem

Borrowers with bigger prime mortgages are falling behind on their payments by 60 days or more at a more rapid pace

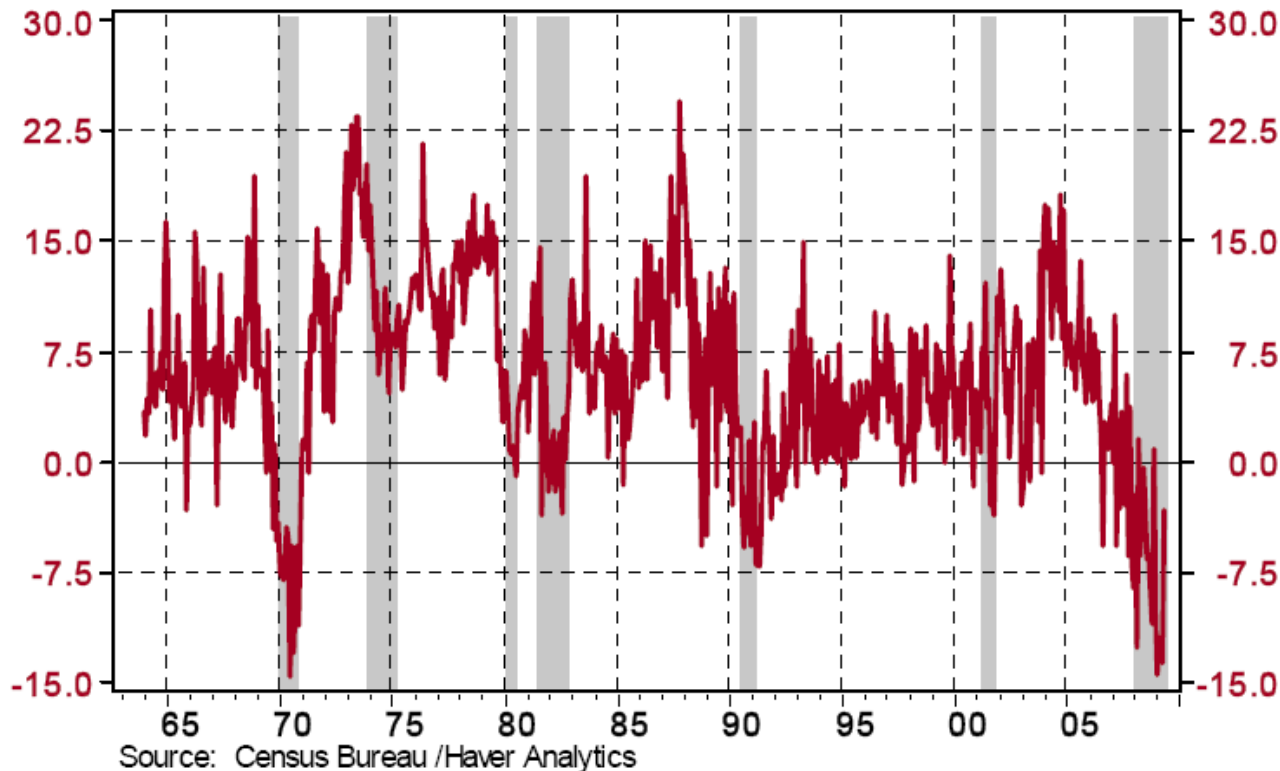


Note: Jumbo loans are those too large to be purchased by Fannie Mae or Freddie Mac. Data exclude option ARMs, which allow borrowers to make minimal payments at first and face sharply higher ones later. Source: First American CoreLogic

Oh, and About That NAR Report...

New 1-Family Houses: Median Sales Price

% Change - Year to Year Dollars



Now the foreclosure vortex is gripping higher-priced homes. A house that sold for \$600,000 during the boom and \$400,000 in foreclosure will be recorded by the NAR as a \$400,000 sale, lifting the national median but suggesting no real improvement in housing.

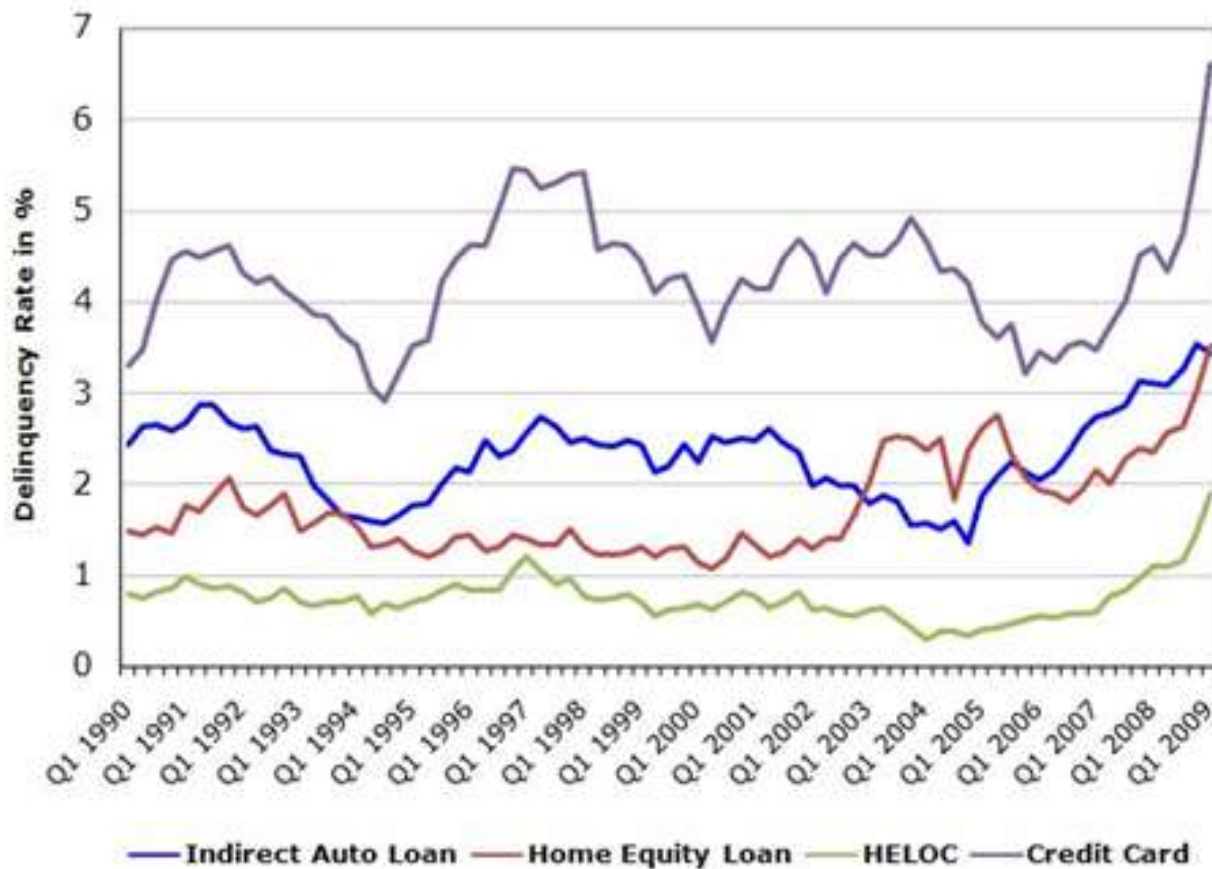
Brown Shoot #4 : Banking

- Banks Have a Major Deleveraging Problem of Their Own
 - They Are Totally Insolvent
- All They Can Do Is:
 - Lie About Asset Quality (Wink Wink)
 - Avoid Committing Money to New Lending
 - Charge Savers and Chargers As Much as Possible



Real Estate Is Not Banks' Only Issue

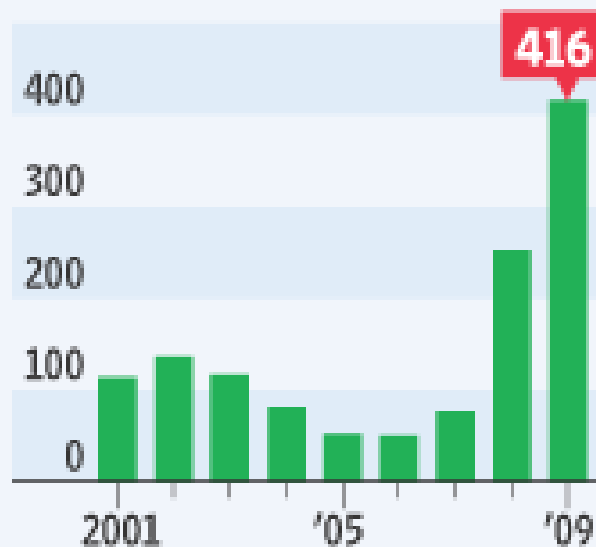
Delinquency rates for several consumer loans hit a record high in Q1 2009



100 Dead Banks This Year So Far

Growing Risk

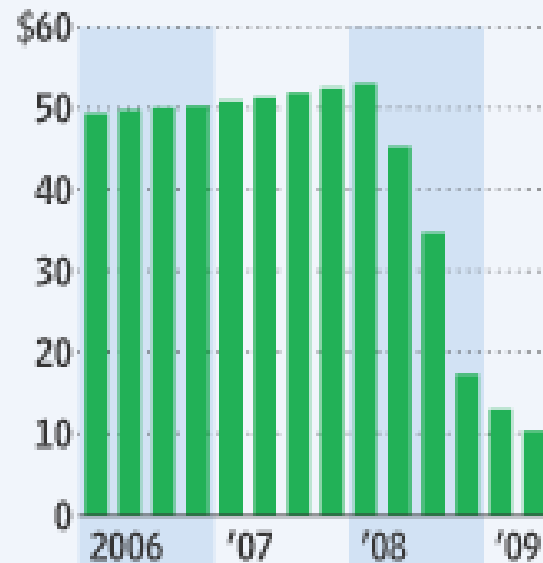
Number of FDIC-insured banks at a high risk of insolvency



Note: 2009 data are as of June 30.
Source: Federal Deposit Insurance Corporation

Dwindling Funds

FDIC's insurance-fund balance, quarterly data; in billions



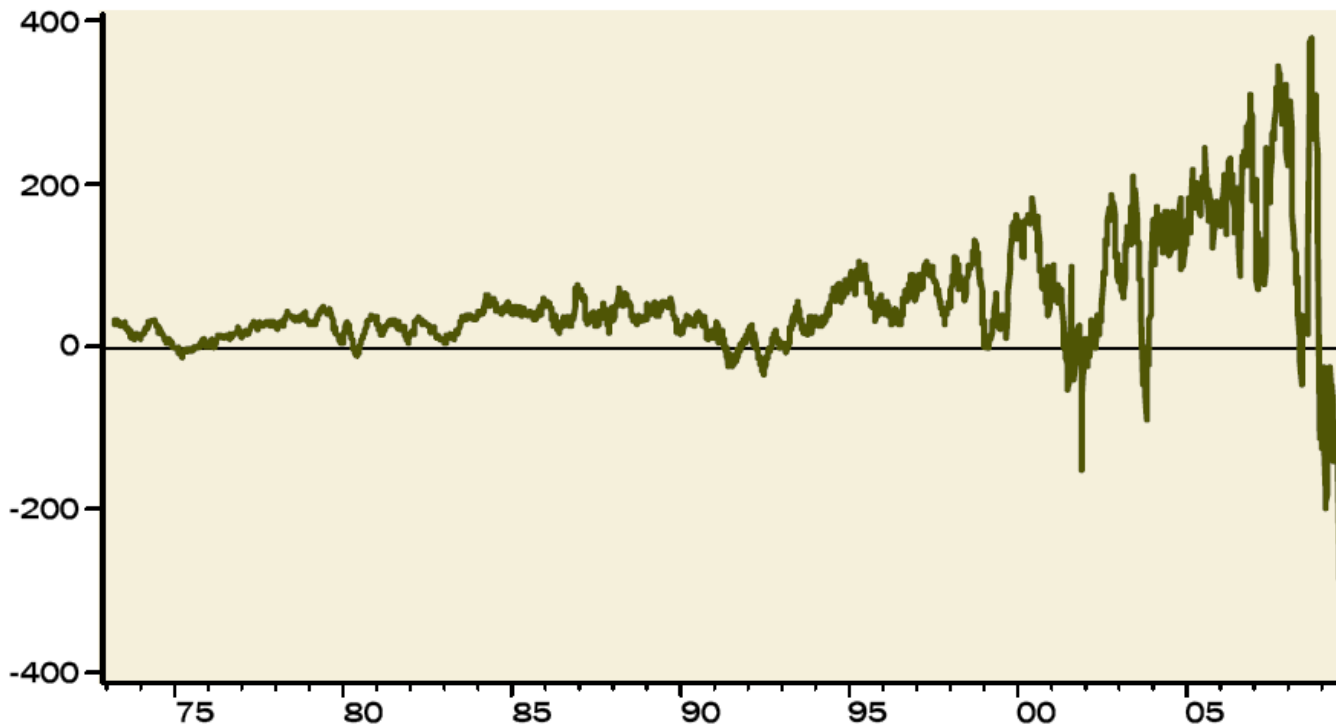
Source: Federal Deposit Insurance Corporation

Collapse in Bank Lending

CHART 1: BANK LENDING DOWN \$400 BILLION SINCE THE END OF MAY

United States: All Commercial Banks: Loans & Leases in Bank Credit

(16-week change, US\$ blns)



Source: Haver Analytics, Gluskin Sheff

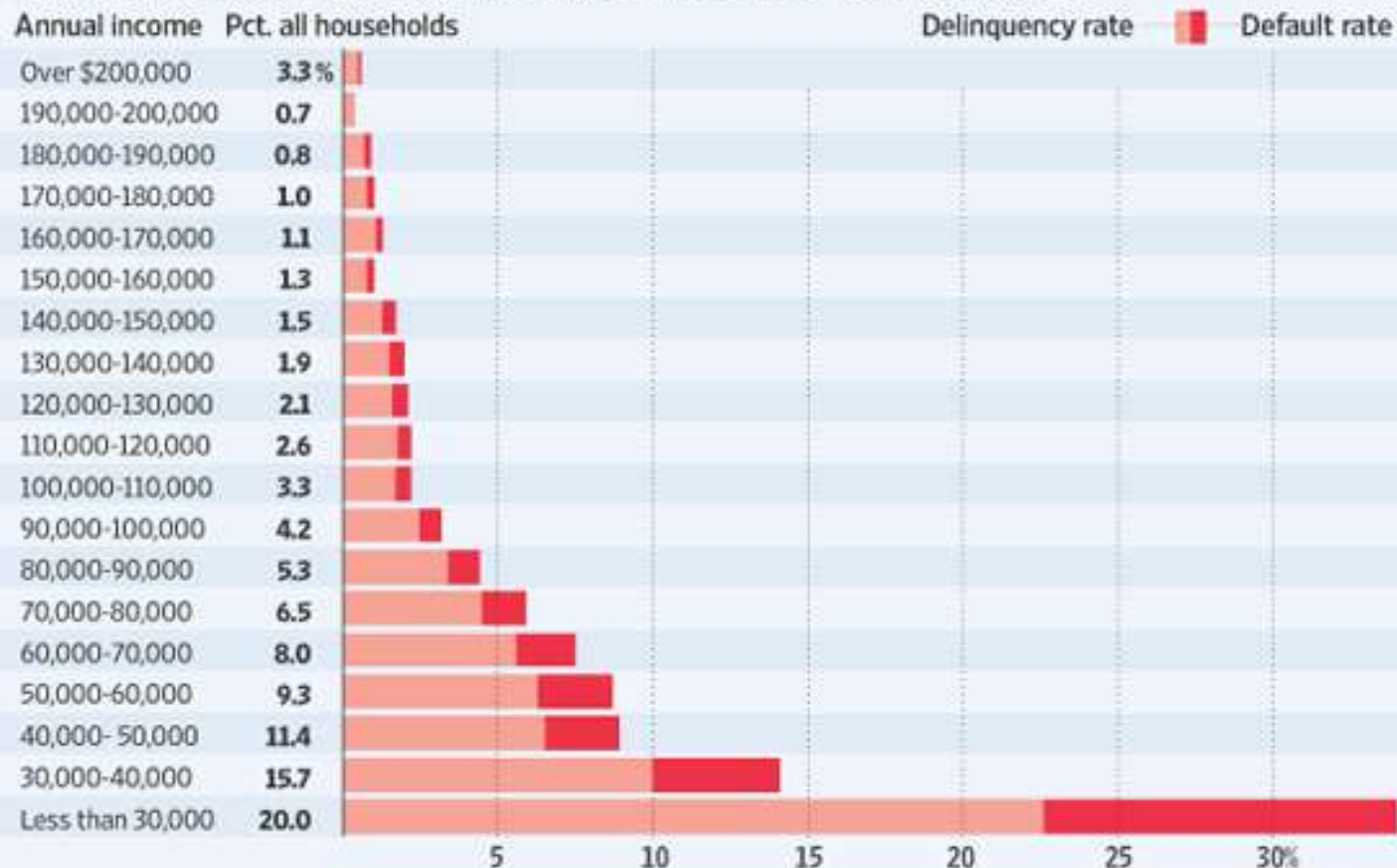
Brown Shoot #5 : Consumer

- Mortgage Troubles
- Job Troubles
- Over Levered
- Starting to Save
- Cutting Up the Cards
- Getting Older



Low Earners' Mortgage Trouble

Falling Behind | Low earners have more mortgage trouble.



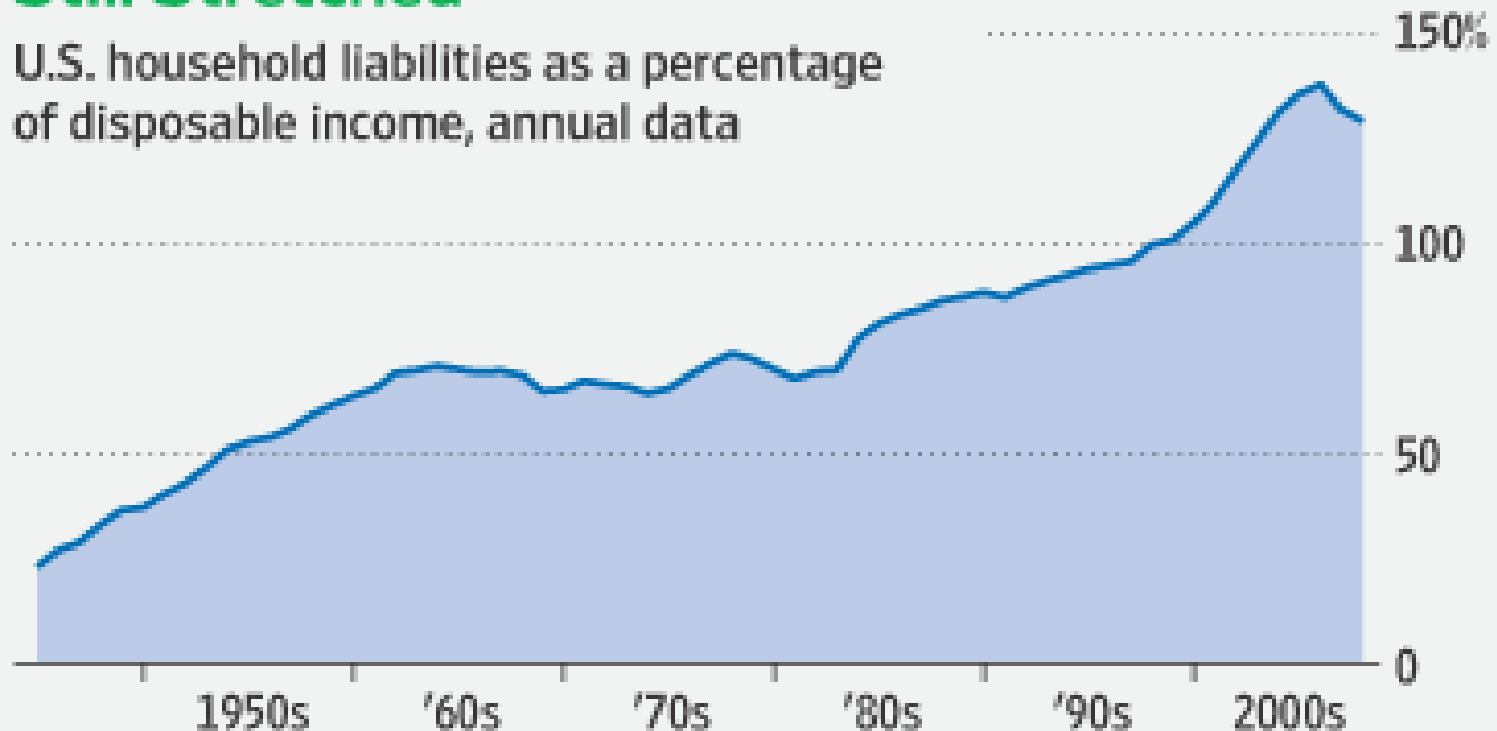
Note: First mortgages as of January 2009. Delinquent means 60 days or more past due.

Sources: Equifax, Moody's Economy.com

Stretched Consumers

Still Stretched

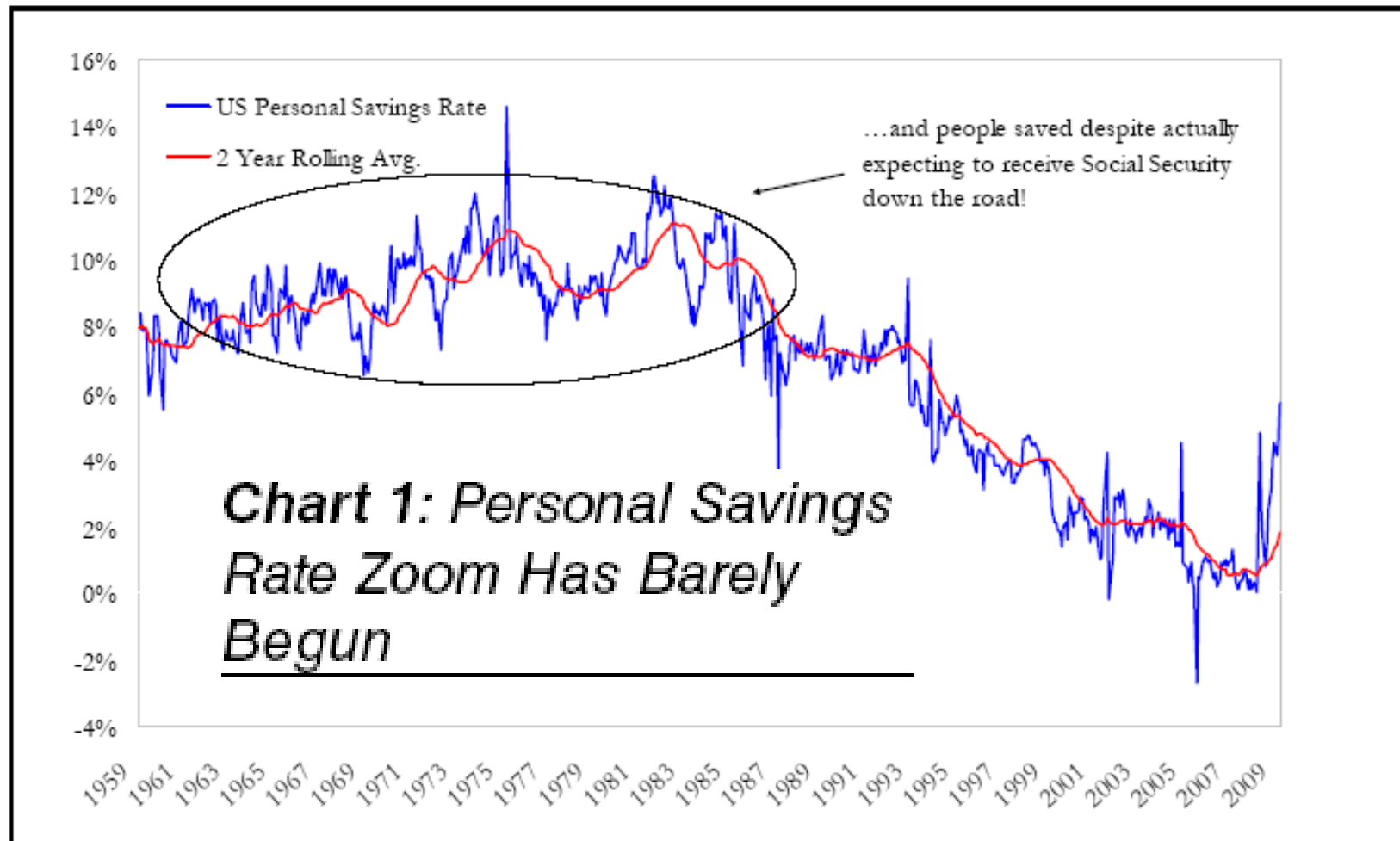
U.S. household liabilities as a percentage of disposable income, annual data



Notes: Includes nonprofit organizations; 2009 figure is for the second quarter

Source: U.S. Federal Reserve

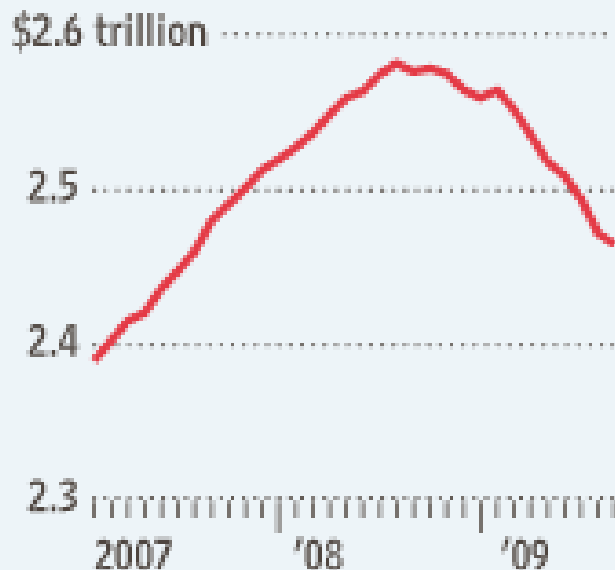
Consumer Savings



Rise of the Frugal Consumer

Cutting Up the Cards

Consumer credit outstanding,
seasonally adjusted



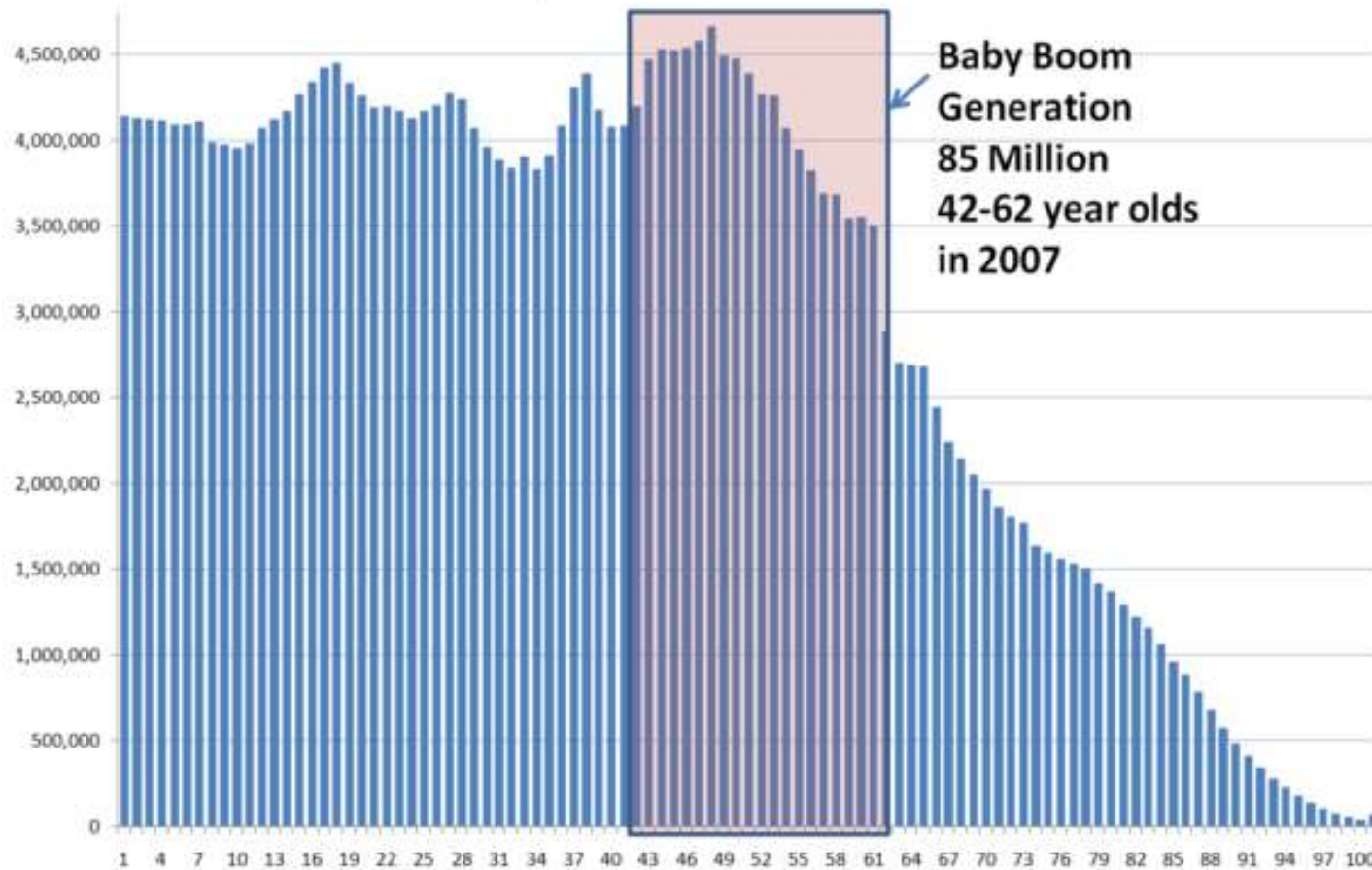
Note: Aug. '09 from Dow Jones Newswires
Economists Survey Source: Federal Reserve

"People have recognized they have to live within their means," said David Brownlee, who invests in government securities at Montpelier, Vt., fund firm Sentinel Asset Management.

"You can't spend what you don't have," Mr. Brownlee said. "You used to be able to."

Frugal for Life?

U.S. Population Distribution, 2007

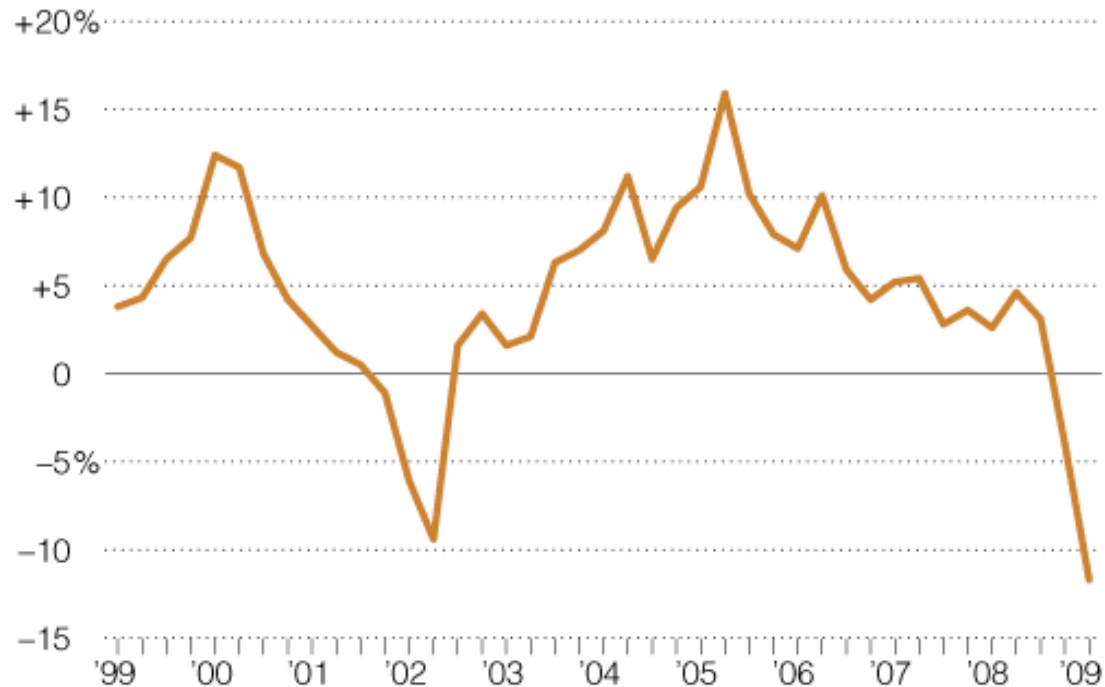


Brown Shoot #6: State & Local Government

A Sharp Decline

State tax collections dropped by 11.7 percent during the first quarter of 2009, compared with the same period a year earlier.

Change in state tax revenue, not adjusted for inflation



Source: *The Nelson A. Rockefeller Institute of Government*

THE NEW YORK TIMES

Political Pendulum

Swinging Past the Middle

- Class Warfare
 - Demonization of Capitalism
- US-China Relations
 - Don't Irritate Your Banker
- Regulation
- Higher Taxes
 - Cap & Trade = Energy Taxes!
 - Government Health Care = Higher Taxes
 - Soak the Rich
 - Marginal Tax Rate Diminishing Returns



Class Warfare



If China Stops Buying Our Paper....

THE WALL STREET JOURNAL

WSJ.com

JULY 29, 2009

Chinese Convey Concern on Growing U.S. Debt

At Joint Meeting, Geithner Plays Down Worries, Saying That Both Countries Agree on Need to Maintain Stimulus Spending

By TOM BARKLEY and DEBORAH SOLOMON

WASHINGTON -- A show of unity from the U.S. and China at the end of a high-profile two-day conference was overshadowed by continuing Chinese concerns about the U.S.'s growing pile of debt.

The U.S.-China Strategic and Economic Dialogue, a forum designed to foster closer cooperation, closed on a similar note to that set at the start by President Barack Obama, who stressed the countries' "mutual interests."

The two powers vowed to maintain efforts to pull the global economy out of recession and shore up financial markets. They also agreed on a plan to create more-balanced global growth in the future.



Hillary Clinton, Chinese State Councilor Dai Bingguo, U.S. Secretary of Energy Steven Chu and Zhang Guobao, also a vice chairman of the National Development and Reform Commission, look on.

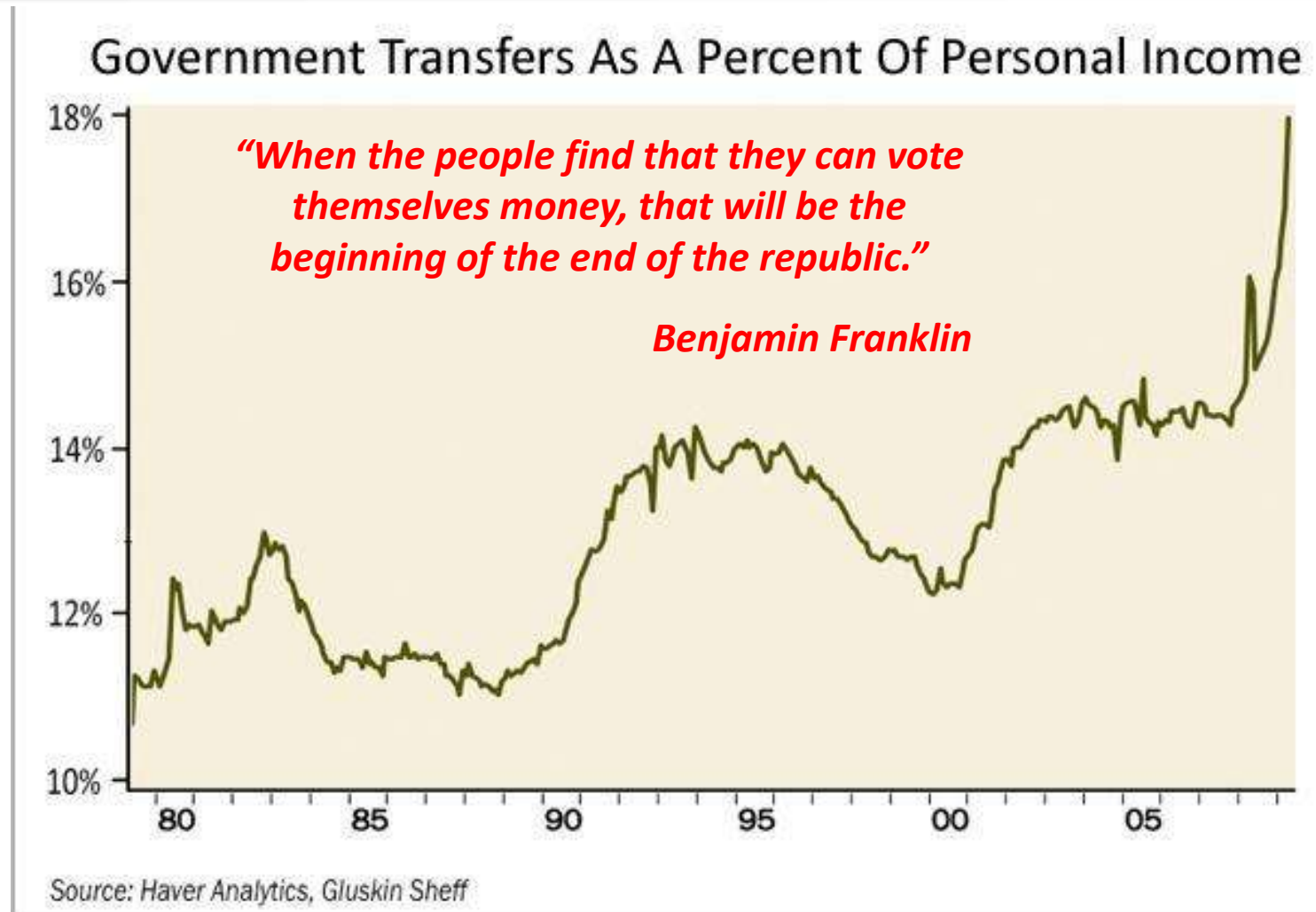
But like a banker visiting an overextended borrower, Chinese economic leaders repeatedly conveyed to their U.S. hosts the importance of managing the U.S. debt. Chinese Vice Premier Wang Qishan, in talks with Treasury Secretary Timothy Geithner and other officials, urged the U.S. to protect the value of the dollar.

"As a major reserve currency-issuing country in the world, the U.S. should balance and properly handle the impact of the dollar's supply," Mr. Wang said through an interpreter Tuesday.

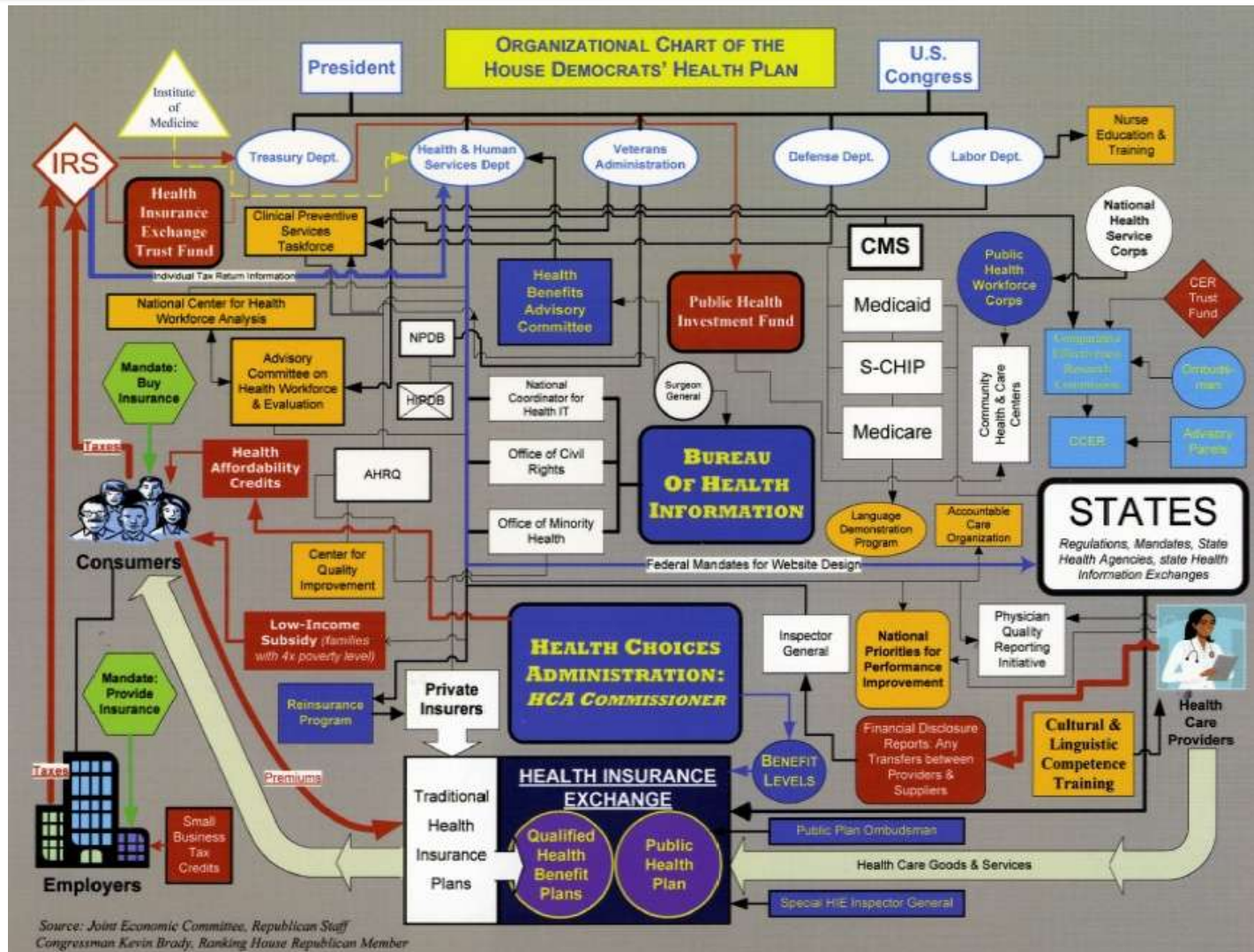
China's Finance Minister Xie Xuren said the delegation "expressed the view that credible steps should be taken to prevent fiscal risks and to ensure sustainability" and that "high attention should be given to fiscal deficits." He said Mr. Geithner "stated clearly" that the U.S. is placing "a lot of importance" on the deficit.

Mr. Geithner, speaking at the summit's close Tuesday, said he wasn't concerned about China's focus, saying he believes the two countries are in "a very similar place"

Government Percent of Personal Income



Government Run Health Care?



200 Years of Contract Law.....

NEW GM STAKEHOLDERS ACTIONS AND ROLES

Stakeholders	Restructuring Actions	Role with New GM
UAW (VEBA)	<ul style="list-style-type: none"> Make concessions on compensation and retiree health care 	<ul style="list-style-type: none"> 17.5% equity share of New GM Warrants to purchase an additional 2.5% share of New GM Select one initial director
Bondholders	<ul style="list-style-type: none"> Give up \$27.1 billion of unsecured debt 	<ul style="list-style-type: none"> 10% equity share of New GM Warrants to purchase an additional 15% share of New GM
GM Pension Plans	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> Transferred to New GM
United States Treasury	<ul style="list-style-type: none"> Provide \$30.1 billion in DIP financing to support GM through bankruptcy Contribute the \$19.4 billion pre-bankruptcy loan 	<ul style="list-style-type: none"> \$7.1 billion in debt assumed by New GM \$2.1 billion of preferred stock in New GM 61% equity share of New GM Select 10 initial directors
Governments of Canada and Ontario	<ul style="list-style-type: none"> Lend \$9.5 billion 	<ul style="list-style-type: none"> \$1.7 billion in debt and preferred stock in New GM 12% equity share of the New GM Select one initial director

Notes: Numbers affected by rounding. Treasury did not publish pro forma data on equity ownership.

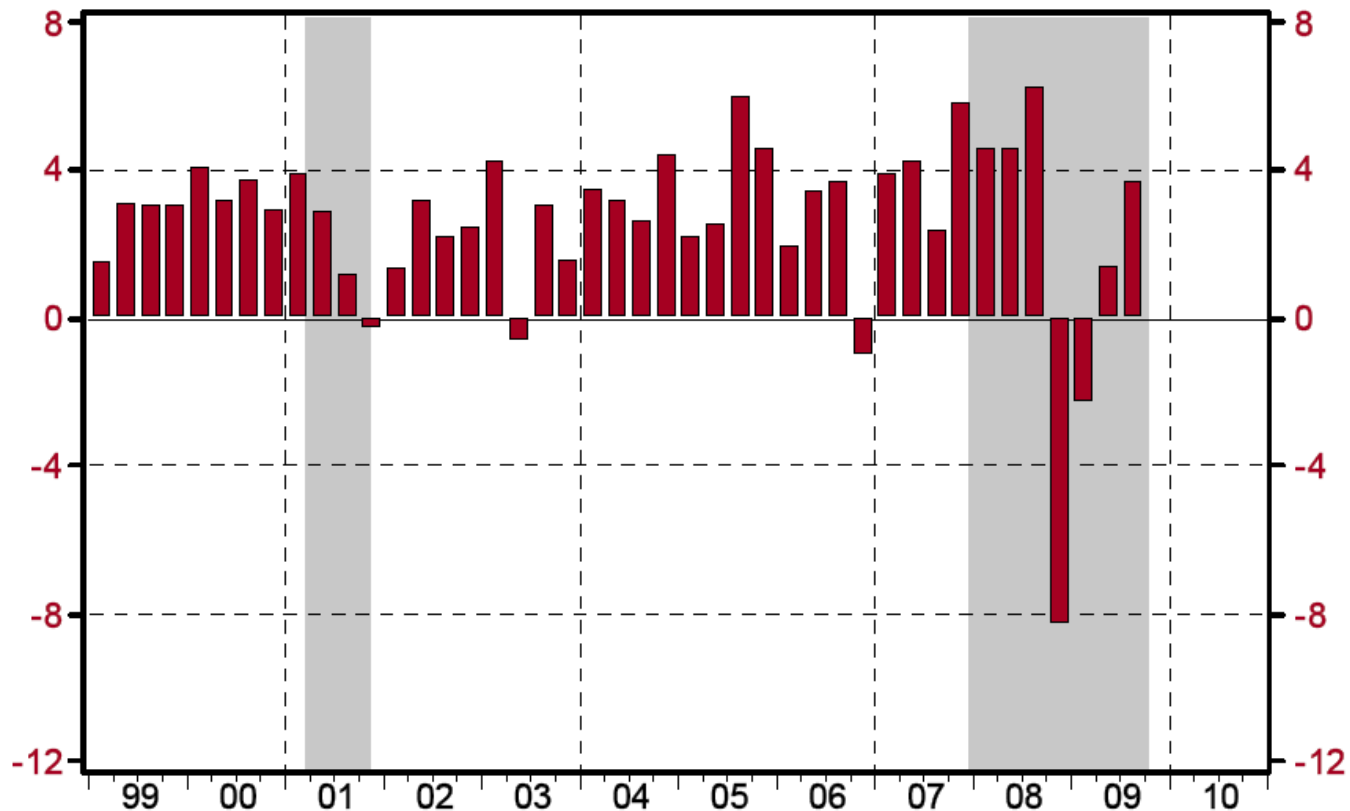
Sources: Treasury, "Obama Administration Auto Restructuring Initiative: General Motors Restructuring," 6/1/2009, www.financialstability.gov/latest/05312009_gm-factsheet.html, accessed 6/10/2009; Treasury, responses to SIGTARP draft reports, 7/9/2009 and 7/13/2009.

Inflation or Deflation

CPI-U: All Items

% Change - Annual Rate

SA, 1982-84=100



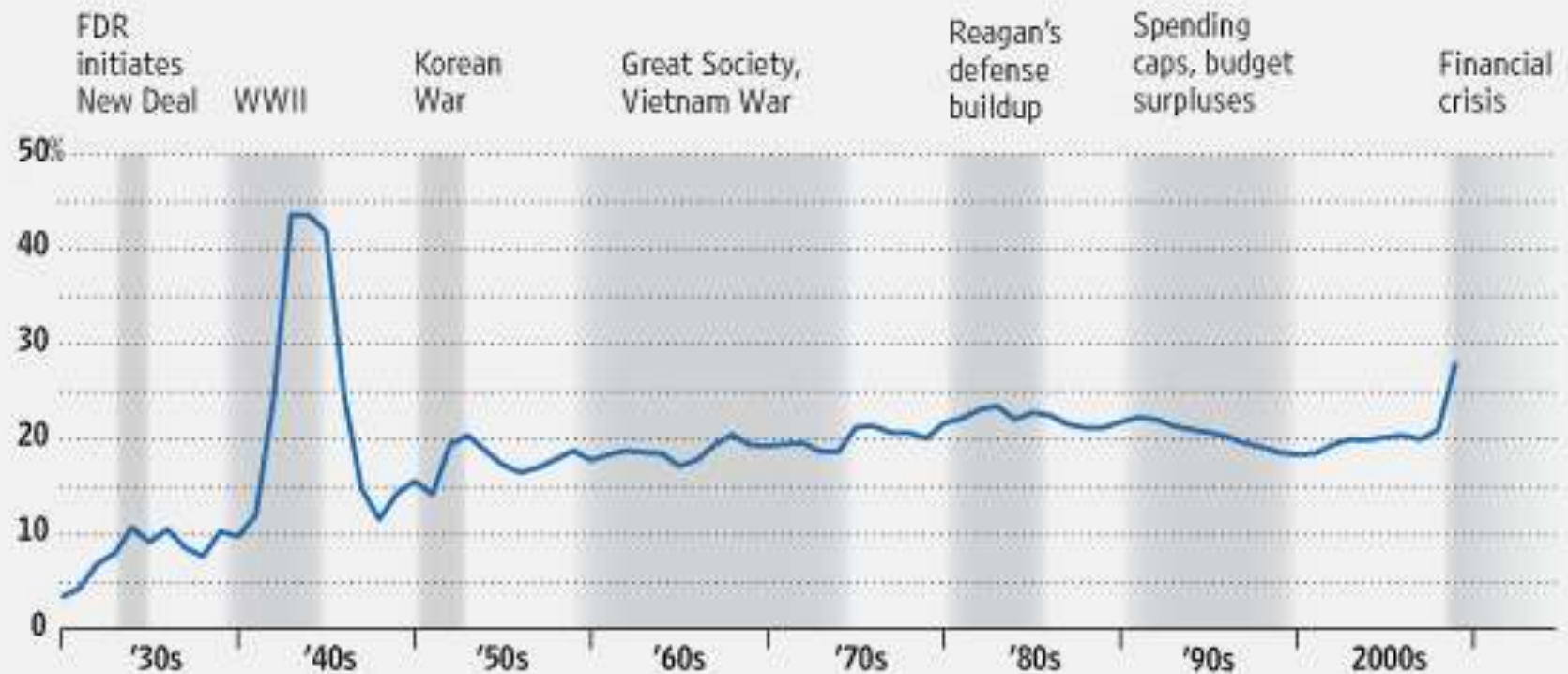
Source: Bureau of Labor Statistics /Haver Analytics

Monetary Base is Expanding Rapidly



You'd Better Like BIG Government

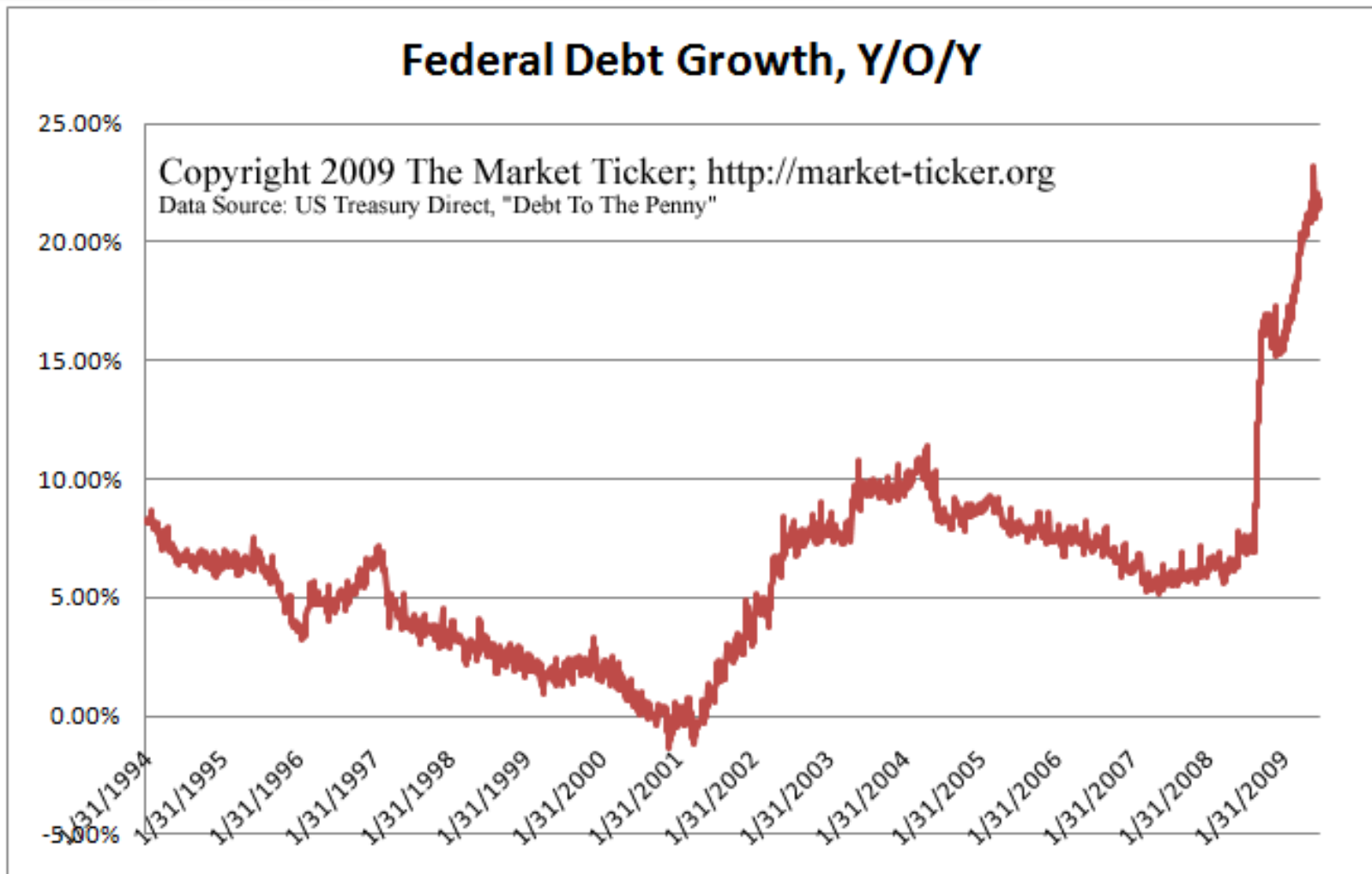
Big Bills | Government spending as a percentage of GDP



Note: Prior to 1977, fiscal year ended in June; 1977 to present, fiscal year ends in September

Source: Office of Management and Budget

Obscene Federal Debt Growth



TARP Is a Down Payment!

TOTAL POTENTIAL FUNDS SUBJECT TO SIGTARP OVERSIGHT, AS OF 6/30/2009 (\$ BILLIONS)

Program	Brief Description or Participant	Total Projected Funding at Risk (\$)	Projected TARP Funding (\$)
Capital Purchase Program ("CPP")	Investments in 649 banks to date; 8 institutions total \$134 billion; received \$70.1 billion in capital repayments	\$218.0 (\$70.1)	\$218.0 (\$70.1)
Automotive Industry Financing Program ("AIFP")	GM, Chrysler, GMAC, Chrysler Financial; received \$130.8 million in loan repayments (Chrysler Financial)	79.3	79.3
Auto Supplier Support Program ("ASSP")	Government-backed protection for auto parts suppliers	5.0	5.0
Auto Warranty Commitment Program ("AWCP")	Government-backed protection for warranties of cars sold during the GM and Chrysler bankruptcy restructuring periods	0.6	0.6
Unlocking Credit for Small Businesses ("UCSB")	Purchase of securities backed by SBA loans	15.0	15.0
Systemically Significant Failing Institutions ("SSFI")	AIG investment	69.8	69.8
Targeted Investment Program ("TIP")	Citigroup, Bank of America investments	40.0	40.0
Asset Guarantee Program ("AGP")	Citigroup, ring-fence asset guarantee	301.0	5.0
Term Asset-Backed Securities Loan Facility ("TALF")	FRBNY non-recourse loans for purchase of asset-backed securities	1,000.0	80.0
Making Home Affordable ("MHA") Program	Modification of mortgage loans	75.0	50.0
Public-Private Investment Program ("PPIP")	Disposition of legacy assets; Legacy Loans Program, Legacy Securities Program (expansion of TALF)	500.0 – 1,000.0	75.0
Capital Assistance Program ("CAP")	Capital to qualified financial institutions; includes stress test	TBD	TBD
New Programs, or Funds Remaining for Existing Programs	Potential additional funding related to CAP; other programs	131.4	131.4
Total		\$2,365.0 – \$2,865.0	\$699.0

FINANCIAL STIMULUS



"Stimulus is like shaving - next morning you have to get up and do it all over."

Where Will the Wave of Liquidity Go?

Sector	Inflation Potential	Rationale
Buildings and Equipment	Unlikely	Currently, very low capacity utilization and lots of excess capacity that will need to be “soaked up”
Higher U.S. Wages	Unlikely	Blue collar workers around the world are likely to see higher wages in dollar terms but will still be significantly below the U.S. - this will continue to pressure U.S. wage and income gains
Residential Real Estate	Unlikely	A generation chastened by a massive housing meltdown and will be highly cautious before embracing another one
Commercial Real Estate	Unlikely	A huge deleveraging is underway and excess capacity is likely to persist for some time
Commodities/Ag/Food/Energy	Highly Likely	Priced in dollars and relatively liquid; in demand globally, especially in developing markets with growing middle classes

After Retiring Debt, Liquidity Will Drive the Price of “Real Things” Higher

Four Scenarios for Global Business

Scenario	US Growth Rate	Global Growth	US Dollar	US Inflation
GEM	Low	Low	Stronger	Low
Japan	Low	Med-High	Weaker	Moderate
70's Show	Low	High	Much Weaker	High
Reflation	Med-High	High	Slightly Weaker	Med-High

1. **“GEM” (Global Economic Meltdown)** – Synchronized and protracted global economic downturn increasingly unlikely. **20% Odds**
2. **“Japan”** – The U.S. mimics Japan’s two decades of weak growth after the collapse of their epic housing and stock market bubbles. **30% Odds**
3. **“That 70’s Show”** – Strong global demand for commodities from emerging markets (especially Asia) will drive commodity prices dramatically higher despite weak U.S. growth...a return of Carter’s “Misery Index”. **35% Odds**
4. **“Reflation”** – The economic equivalent a successful “Hail Mary” pass, global central banks will stimulate a synchronized global recovery and deftly remove excessive monetary stimulus before inflation takes hold. High growth rates will push commodity prices higher. **15% Odds**

Japan's Two Lost Decades

\$NIKK (Tokyo Nikkei Average (EOD)) INDX

© StockCharts.com

18-May-2009

Open 8848.84 High 9503.91 Low 8827.13 Close 9038.69 Chg +210.43 (+2.38%) ▲

\$NIKK (Monthly)



Hyperinflation Risk?



Oct. 6, 2009 (Bloomberg) -- [Kyle Bass](#), the hedge-fund manager who made \$500 million in 2007 betting against subprime securities, is buying shorter-term debt and precious metals, anticipating **hyperinflation will lead to higher interest rates.**

Bass compared central bankers' efforts to combat the global recession to **a game of "Monopoly," in which new money is introduced halfway through.** Inflation is likely to result as investors fret that the central bankers which have enabled governments worldwide to sell record amounts of debt at low rates, will be too slow to reverse their actions, he said.

"We are today in the midst of what economists often refer to as the 'Golden' period where everything feels good and the long-term effects of deficit spending and money printing have not yet been realized," he said. "This period typically lasts 12 to 18 months."

In Summary.....

FAMOUS LAST WORDS

