WELLS CAPITAL MANAGEMENT

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Economic and Market Perspective

2009-Issue 2

"Bringing you national and global economic trends for over 25 years"

In This Issue:

A new year! New leadership! Same old problem……..FEAR! The economy remains in a very serious recession. Its biggest problems are the same ones which have haunted it throughout this crisis…..chronic uncertainty created by opaque knowledge as to the true nature and magnitude of fundamentally bad debt, by a U.S. leadership which is constantly changing the sand underfoot and by everyone's worst nightmarish impression of the boogeyman in the closet! For many, this boogeyman increasingly has the appearance of a second Great Depression.

While we recognize the economy is currently suffering under the weight of debt problems, many which may take years to fully resolve, we do not believe it constitutes a debt Armageddon. Indeed, debt issues in a recession are nothing new in the post-war experience and in our view, "bad debts" may be no larger in relative size today then they were in the early 1980s or the early 1990s. What has been record-setting, however, has been the national response to these debt issues. Widespread panicky comments and actions by the nation as a whole and particularly by our national leadership has, in our view, promulgated and augmented the severity of this crisis. Despite the harshness of the current recession and despite the unfortunate national emotional breakdown in response to it, we do see the outlines of an escape path beginning to take form. No, not any "silver bullet" government program (although several along the way have and will help some), but rather an old-fashioned solution—the natural and inherently self-correcting mechanisms always at work within a capitalistic system. It will be laissez-faire itself which solves this crisis—the eventual triumph again of Greed over Fear!

A Debt Armageddon???!

From the beginning, this drama has been sold not just as a crisis with debt problems, but a complete debt Armageddon. Although the U.S. faces serious debt problems, we do not think they are many times worse then ever before. The truth is, we don't really know the seriousness of the debt issues facing this country. But it is also a fact that no one else does either! Most have just assumed it must be horrific. There is no central deity which knows the "credit fundamentals" of the vast array of loans on the books of financial companies. Yes, there are writedowns, big writedowns, which are regularly held out as evidence of the debt Armageddon. Certainly, some of these are "write-offs" of truly bad fundamental debts which either are not currently paying or will not pay in full over time. And, yes, the number and types of fundamentally challenged debts will grow as the recession deepens. But this is nothing new. Significant levels of bad debts have been written off in nearly every recession since the 1960s.

What stands out in the contemporary cycle is not the amount of truly "bad debt" being written off as the amount of "fundamentally good debt" being "written down"! A recent law change requiring financial institutions to price assets on a mark-to-market basis (at firesale prices) has produced an unprecedented amount of "write-downs of good debts." Unfortunately, good debt write-downs and bad debt write-offs are often lumped together creating an impression of a historic "debt Armageddon cycle." By contrast, if mark-to-model asset pricing (pricing assets on the basis of long-run fundamental discounted cash flows) was still in force as it use to be, not only would the debt crisis seem far less frightening, but the current perception of a shortage of bank capital would cease to exist. What is really incredible about this crisis is we have allowed a technical "accounting change" to create an impression of an insolvent banking system and to produce a national panic which has and is exacerbating the recession.

Even though nobody really knows, the national psyche has decided the boogeyman in the closet is Big and Bad! We believe if the closet could be opened, the boogeyman would actually prove much smaller and scrawnier than the collective national nightmarish impression. The problem is getting clarity—moving from fears of what is in the closet to actually defining reality. Perhaps

the Obama "bank stress tests" now beginning will shed some light on this issue, but these will take time. In our view, the quickest way to get a better read on the actual state of bank balance sheets is to allow financial companies to report mark-to-model in addition to mark-to-market results. At this point, there would no doubt be great suspicion that companies were artificially overstating mark-to-model results, but we still believe the chasm between the two values would tend to change Wall Street mindsets and begin to reduce widespread fears.

Just how bad are the balance sheets throughout the economy? The U.S. household debt service burden is at a record high today, but was also at a record high (at that time) in both the early 1980s and early 1990s. Then, as now, the consumer had been on a prolonged spending spree and needed a period of reliquification. We expect a period of consumer deleveraging in the next few years similar to both 1980s and early 1990s! Isn't the consumer savings rate far lower today? True, but it didn't have as much in pensions before and it faced much higher inflation and much higher interest rates. Isn't the wealth loss bigger today? Yes, but today's wealth level is many times higher! Moreover, in both the early 1980s and early 1990s, unemployment rates soared, housing values had fallen in many markets, the stock markets were off from highs and the bond markets were hit hard by much higher yields. The household sector is not in good shape today! But is it really much worse in comparison to two other nasty recession periods within the last 30 years which did not end in depression?

Financials with debt problems? Hardly unique! We certainly have financial sector debt issues today, but adjusting for the accounting induced panic, are they any more serious than the savings & loan issues of the early 1990s or the farming, oil and third world debt problems of the early 1980s?

What stands out as far better today compared to either the early 1980s or 1990s is the nonfinancial corporate balance sheet. Currently, the ratio of cash holdings to debt remains near a four-decade high and the debt-to-equity ratio is nearly as low as it was in the late 1960s! Many nonfinancial companies cleaned up after the dot-com meltdown and did not releverage balance sheets during the last recovery. Consequently, the U.S. nonfinancial sector is far stronger today than it was in either the early 1980s or early 1990s.

Although balance sheets around the developed world are similar to those within the U.S., emerging world balance sheets and income statements are much healthier compared to earlier cycles. Even though many emerging countries are close to a recession, their balance sheets, income statements, and most importantly, their economic/capitalistic maturation have never been stronger! By comparison, the emerging world was at the epicenter of the crisis in the early 1980s and they destructed in the early 1990s.

The global economy is in the middle of a very serious debt crisis, but probably no worse than past crises which ultimately were successfully resolved. The common perception this crisis represents a "debt Armageddon" is overblown. Indeed, the biggest contemporary challenge is arresting "fears" rather than solving debt problems. Because this is primarily a confidence crisis, although it is proving very difficult to resurrect, any progress in lessening fears in the months ahead could improve economic and market outlooks far faster than most appreciate.

A Run on Bank Stocks???!

As of this writing, the stock market is retesting the November lows. Many believe this retest has happened because the economy is still deteriorating and simply cannot support current stock market levels. Perhaps, but we believe this retest has more to do with a U.S. leadership created "run on the bank stocks" than it does with worsening economic fundamentals.

Imagine if the president, congressional leaders and policy officials began a public debate about whether they should close the stock market for a week to let things calm down. What would happen? The stock market would plummet! This is exactly what our leadership has done to financial stocks! Beginning early this year, many U.S. leaders began openly discussing whether they should nationalize the banks (which means bankrupting the shareholders). This open public forum eliminated all bidders for financial stocks and accelerated the number who wished to sell at any price above zero! The result has been a "run on bank stocks"—the S&P 500 financial sector index was recently down by about 45 percent since year-end! The fundamentals of the U.S. financial industry have not deteriorated by 45 percent in six weeks. Rather, by openly debating what to do to help the financial industry, U.S. leaders have produced what they were attempting to prevent. Sad!

December is the only month the stock market has risen since the TARP crisis last Fall. Why? In December, the existing U.S. leadership was so "lame duck" they essentially stopped talking about and quit taking action on the crisis. The new leadership had not yet taken control and thus were also noticeably quiet. The result? Crisis policy chatter and policy actions came to a halt, uncertainty lessened and, surprise, the stock market rose! Then, in came the new leaders in January, the fed funds rate was close to zero, arguments ramped up over the second round of Tarp funds, the Obama massive fiscal relief package was introduced and a public debate arose about nationalizing the banks. Policy chatter and actions again spike, investor uncertainly again surges and the stock market plummets. Increasingly, some of the "treatments" aimed at the cure may be worse than the ailment. Maybe U.S. leadership needs to reflect on the number one rule of public service— "First, do no Harm"!

Retesting the November Lows!???

We are watching and worrying just like everyone else as stock markets retest the November low. So far, however, even though some broad-based indexes have established another new low, we think the financial markets are fairing pretty well.

First, the current retest of the lows may not be happening if not for an artificially created "run on the bank stocks." Second, despite renewed fears, equity trading volumes have mostly

remained subdued during this retest. Have sellers already sold? Third, participation in this retest is much narrower compared to last November. A much smaller number of NYSE stocks are at new 52-week lows. Lastly, even though the VIX volatility index remains high, it has not yet spiked as it had in November.

Unlike last November, both the bond market and commodity market continue to show resiliancy. Most bond yield spreads which tightened considerably since November (including Libor spreads, 2-year Treasury swap spreads, investment-grade and junk bond spreads, mortgage-backed bond spreads, emerging market debt spreads and municipal bond spreads) have maintained most of their recent gains. Moreover, there has not been a flight to the safety of Treasury securities. The 3-month T-bill yield remains above the Fed funds rate and the 30-year Treasury yield remains almost 1 percent above last year lows! Most commodity price indexes are also holding up far better—the S&P GSCI nonenergy commodity price index remains almost 10 percent above its low last November!

Finally, a marginal new stock market low is neither tragic nor uncommon. Several historic market bottoms have exhibited multiple marginal lower lows before ultimately recovering. The 1981-82 bear market is the best recent example. The bottoming process during this episode lasted about one year and suffered several marginal "lower lows" after the initial crash. Indeed, the last marginal lower low was just ahead of the biggest bull run in history in August 1982!

Stimulus GALORE!!!?

Since the economy is falling so rapidly, most everyone seems to believe "more needs to be done." We think many are underestimating how much policy stimulus has already been implemented which, by this summer, should produce some positive economic results!

In real terms, the M2 money supply has risen at a record-setting annualized rate in excess of 20 percent in the last six months! Moreover, in the last year, government deficit spending has already been $935 billion, most of which has been introduced only since August! Additionally, the Fed recently lowered the funds rate to zero, Libor rates have finally collapsed, mortgage rates have declined by about 1.25 percent and investment-grade corporate bond yields have declined significantly from peak levels in October. The amount and diversity of economic stimulus introduced since last summer is unprecedented. Many believe it is not working this time, but we think it has not yet had sufficient lag time to produced visible results. By this summer, however, there is reason to hope the policies already in place will begin to surprisingly boost economic activity!

Seeing a Path Out of this Crisis...??????

In this crisis, confidence in any leader, plan or policy action has all but evaporated! Consequently, we believe the only way out of this crisis is a less dramatic, old-fashion method led by Adam Smith! Despite the various bungles and self inflicted wounds along the way, the laissez-faire workings of a mostly free economy is, in our view, already finding a path toward the next recovery. What we envision goes something like this…….

Last fall, Wall Street was in freefall—stock prices and commodity prices were plummeting while bond yield spreads exploded. A few months later and Main Street (the economy) is in freefall! However, despite horrific contemporary daily reports from the front lines of the economy, Wall Street has stabilized since October. Stock prices have remained in a broad trading range during this time. Commodity prices have also flattened and most bond yield spreads have at least partially recovered. Just as the collapse of Wall Street last fall predicted a coming collapse on Main Street, Wall Street stability since last fall is now suggestive of an economic bottoming process perhaps by late spring!

Is a positive feedback loop forming? In the next few months, if economic reports show any signs of bottoming, current Wall Street stability will evolve into a rally! A rise on Wall Street would boost economic confidence improving economic activity which in turn would loop back to rally Wall Street even further. Additionally, any bottoming evidence in the economy would mark the beginning of the end of the banking meltdown story. An economic bottom would put a floor on job loss and provide forecastable peaks in housing price declines, the unemployment rate, loan defaults and delinquencies.

In our view, the best news for Main Street is current evidence of emerging stability on Wall Street. Are early signs of a positive feedback loop developing? Could it be the massive combination of monetary, interest rate and fiscal stimulus introduced since September is beginning to work—at least on Wall Street where it always shows up first?

So Many Bargains!!??

We do not remember another time when virtually "all" risk asset prices seemed as ridiculously cheaply-priced as they do today!

Junk bonds offer yields nearly 15 percent above Treasury yields! Investment grade corporate bonds are offering yields spreads wider than at any time since the middle of the Great Depression! Municipal bonds offer yields 2 percent above treasury yields even "before taxes"! Commodity prices are currently marked down by 50 percent from where they were just six months ago! During the last few years, residential real estate values have experienced their biggest revaluation in the post-war era! Finally, stocks offer some of the most attractive valuations in several decades and offer a dividend yield in excess of treasury yields for the first time in almost 50 years!

Investors take note, while stock markets retest November lows, investor pessimism has exploded, fears of a second Depression are increasingly common and most of all…good quality assets are being given away!

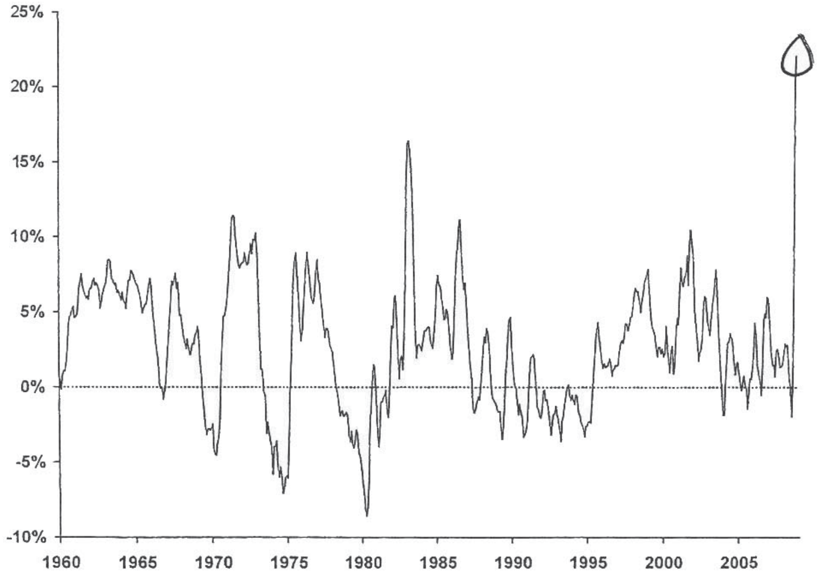
Jim Paulsen

James W. Paulsen, Ph.D.
Chief Investment Strategist, Wells Capital Management

Stimulus GALORE!

Even without the recent passage of the fiscal stimulus bill, policy actions appear sufficient to revive economic growth. In the last six months, the inflation-adjusted M2 money supply has exploded at an annualized pace in excess of 20 percent—a post-war record! Moreover, while the U.S. just passed an almost $800 billion fiscal spending package, federal deficit spending during the last year (January ’08 to January ’09) has already introduced $935 billion of fiscal stimulus! Despite widespread concerns more needs to be done, as these charts illustrate, economic policy stimulus has been unprecedented! And since most of this stimulus has only been introduced since last September it has not yet had sufficient time to show much impact. It is widely recognized economic policy has long lags before noticeable improvement becomes evident in the economy. On average, the lag time between implementation and economic impact probably ranges between six to 18 months. Rather than needing more stimulus, this country needs some patience to allow the massive policies which are incubating in the pipeline to work. Many may yet be surprised by how well the massively aggressive monetary and fiscal policies illustrated on this page eventually “work” on the economy during the second half of this year!??!

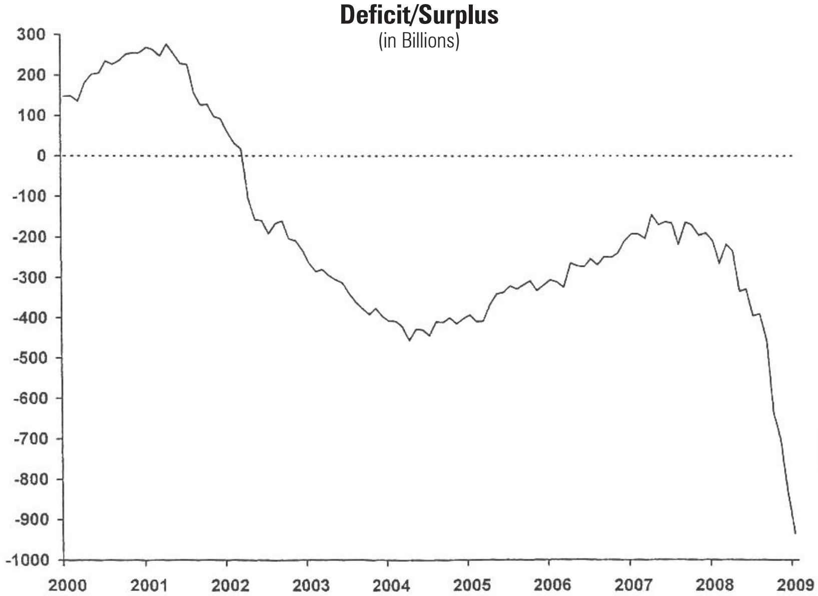
Inflation-Adjusted M2 Money Supply Growth
Annualized Six Month Growth



Massive Monetary Stimulus...

... AND...

Trailing 12 Month Federal Government Deficit/Surplus
(in Billions)



... Massive Fiscal Stimulus...

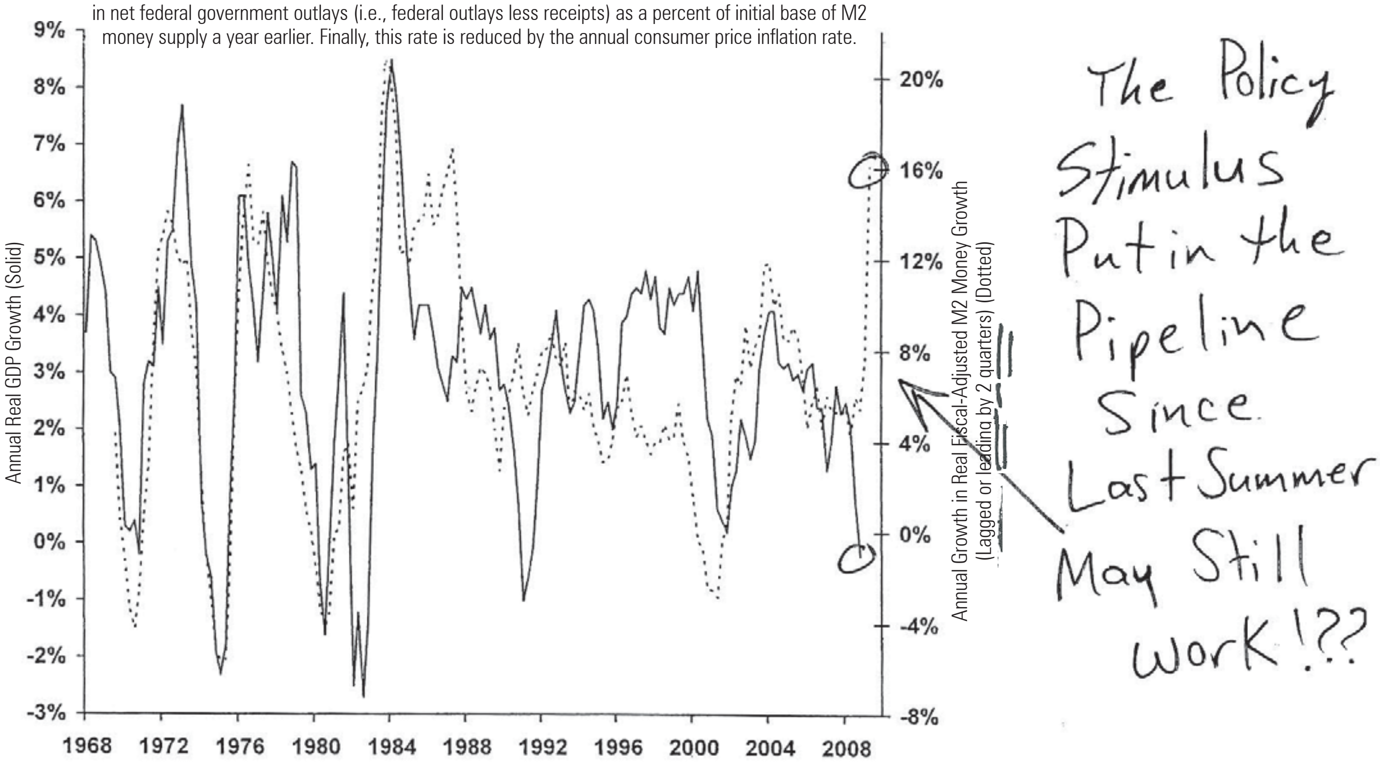
... Most Coming Since Last Fall!!?

Do We Need More Stimulus or "Patience"??!

This chart illustrates a relatively close relationship between the annual rate of real GDP growth and the lagged annual growth (by two quarters) in the government-deficit adjusted U.S. real M2 money supply. Economic stimulus as measured by fiscal-adjusted money growth has been among the strongest in the last 40 years! Although the historical relationship between this policy variable and future real GDP growth is not perfect, it has been fairly close and consistent. This chart suggests a second half economic recovery should not be summarily dismissed!?!

Annual Real GDP Growth vs. "Fiscal-Adjusted" M2 Money Supply Growth*

*Annual change in M2 money supply plus annual increase in federal net outlays or less the annual reduction in net federal government outlays (i.e., federal outlays less receipts) as a percent of initial base of M2 money supply a year earlier. Finally, this rate is reduced by the annual consumer price inflation rate.

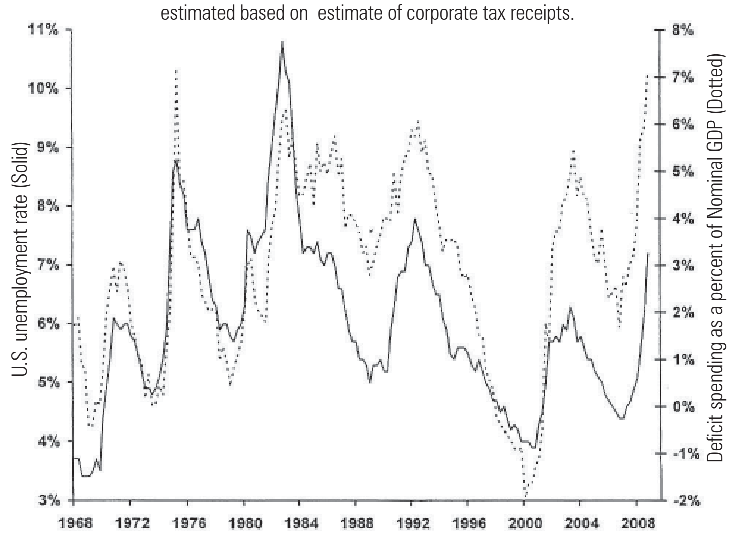


Policy Effectiveness is Always Doubted?!?

Most currently believe additional policy action is necessary to pull the economy out of recession. Actually, it is quite common during recessions for the consensus to question the effectiveness of policy actions. This chart overlays the U.S. unemployment rate (solid line) with the trailing 12-month government deficit as a percent of nominal GDP (a measure of fiscal policy stimulus). Historically, fiscal policy stimulus is generally at its maximum when the unemployment rate is at or near peak levels. That is, adequate policy stimulus is frequently introduced although it shows no immediate improvement in the underlying economy (e.g., the job market). Today is no exception. There has been a massive increase in fiscal stimulus and yet the unemployment rate is still high and rising, causing fears the stimulus is not working or is insufficient. As the chart illustrates, this period is very similar to many past periods, which, in retrospect, ultimately proved to be very close to the beginning of an economic recovery. Doubt in the effectiveness of economic policy frequently spikes just before it begins to show fruit.

U.S. Unemployment Rate vs. Government Deficit Spending

*Total government receipts less expenditures from NIPA Line 39, Table 3.1, as a percent of nominal GDP. Last data paoint on line 39 estimated based on estimate of corporate tax receipts.

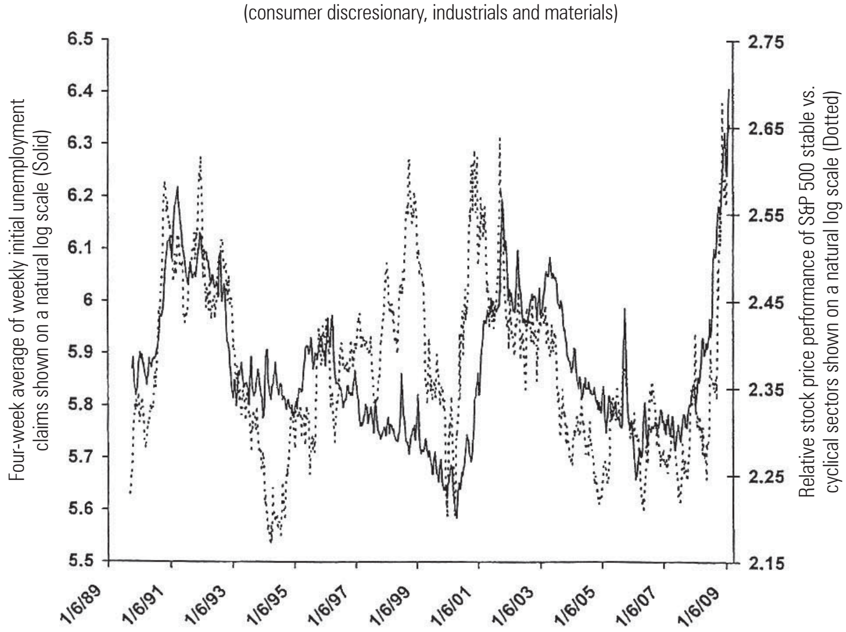


Watching for an Economic Bottom!???

For those watching for an economic bottom, we suggest two important indicators—weekly initial unemployment claims (solid line) and the relative price performance of economically-stable stocks. As this chart shows, this economic indicator and financial market indicator have tended to give similar signals. When the economic cycle finally bottoms we would expect both to peak. In the last few weeks, although unemployment claims have spiked again to new highs, the relative stock price performance of stable stocks has peaked! Stay tuned!

Weekly Unemployment Claims vs. Stable/Cyclical Relative Stock Price Performance*

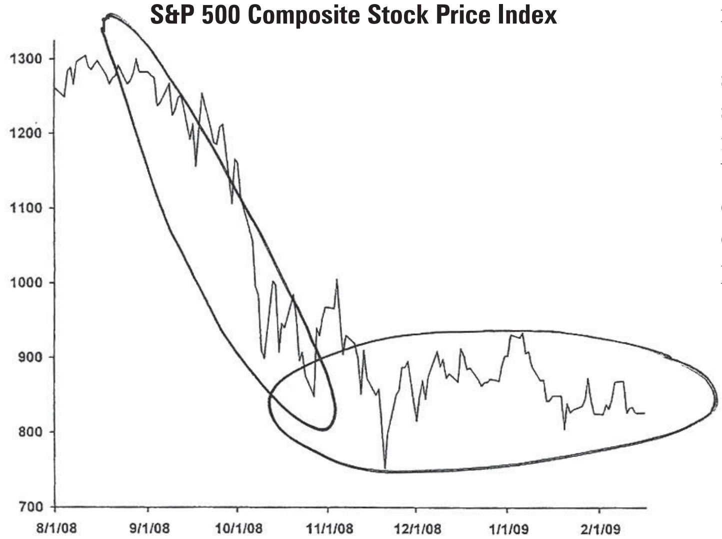
*Geo-weighted index of stable S&P 500 Sectors (consumer staples, health care and utilities) relative to index of S&P 500 Economically-Sensitive Sectors (consumer discresionary, industrials and materials)



Wall Street "LEADS" Main Street!!??

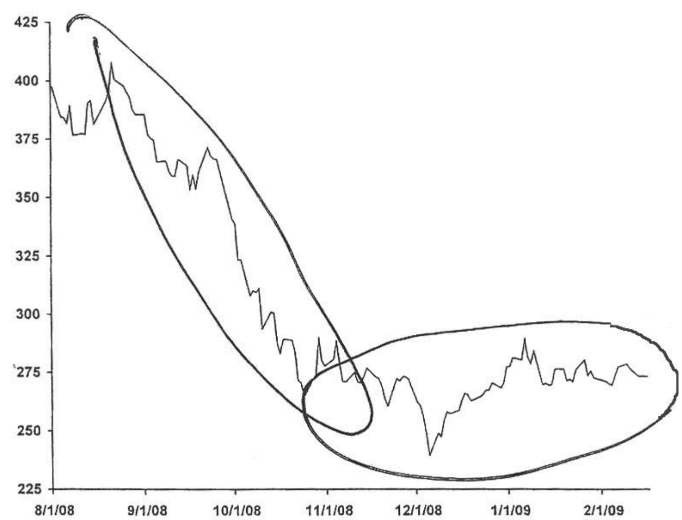
Currently, the best news on Main Street (economy) may be Wall Street (the financial markets). Wall Street (stock prices, commodity prices and bond yield spreads) was in freefall last September and October and now, a few months later, Main Street is freefalling. However, Wall Street has been essentially flat during the last several months suggesting Main Street may be bottoming by late spring or early summer. This crisis will not end with some government action or announcement. Rather, it seems increasingly likely it will simply end on its own. Wall Street has shown signs of stabilizing since Fall even though news on Main Street has worsened and remained persistently horrific. This show of stability in the ongoing face of economic adversity is slowing beginning to improve confidence. Should signs of an economic bottom begin to emerge on Main Street (perhaps due in part to the lagged positive impact of past policy stimulus) confidence on Wall Street will improve, producing a rally in the financial markets. If stock and commodity prices actually sustain some rise while bond yield spreads tighten even further, Main Street confidence will rise boosting economic activity. With stability on Wall Street more noticeable today than at any time since the markets melted last September, maybe a "positive" feedback loop is starting to develop? Wall Street stability begets economic confidence, which produces improved economic reports, which in turn boost the Wall Street recovery even further. Too Pollyanish? Perhaps, but something worth pondering!?!

S&P 500 Composite Stock Price Index

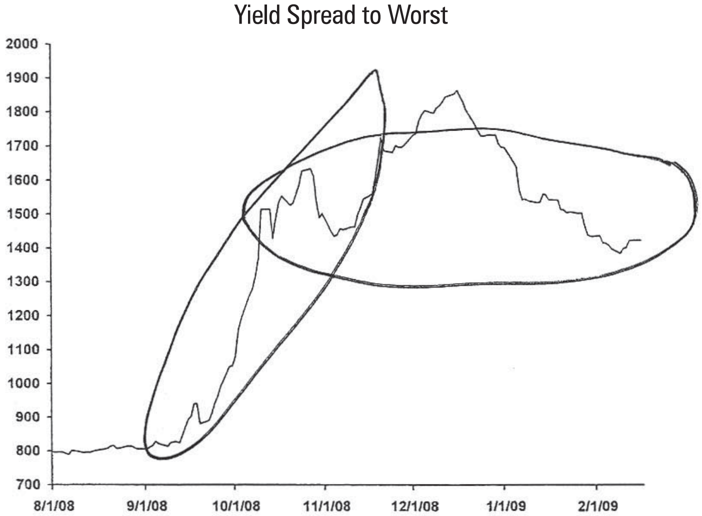


Wall Street Collapsed Last Fall...
... Main Street is Collapsing Today!?!

S&P GSCI NonEnergy Spot Commodity Price Index



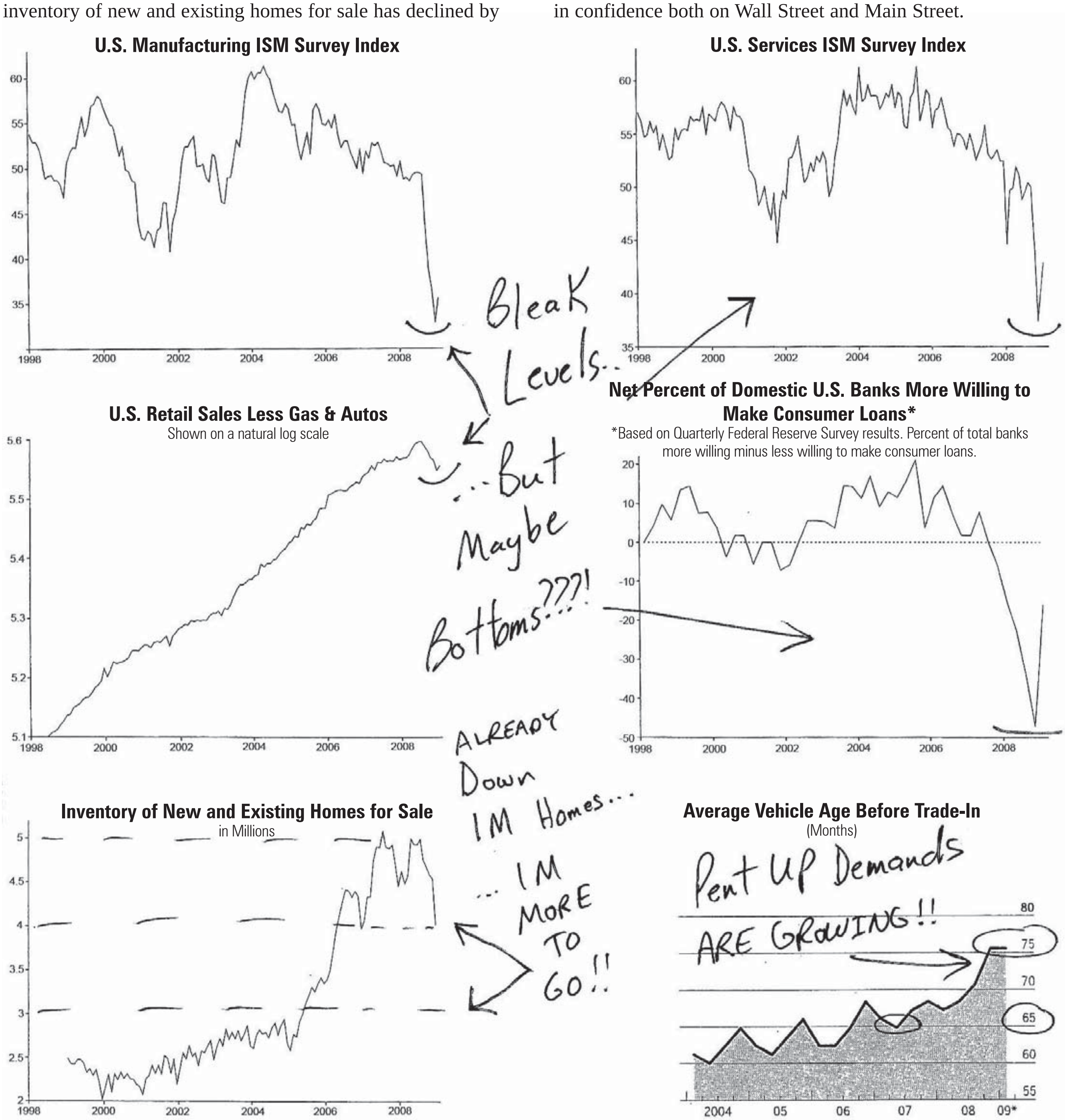
JP Morgan High Yield Bond Index
Yield Spread to Worst



Wall Street Flat Since October...
... Main Street Bottoms in the Spring??

A “Very Few” Bright Spots in a “Very Dark” Economy!!!?

Current conditions on Main Street are dark! There is nothing to point to which is “good” and very little to suggest a bottom is nearing. However, a few bright spots may be starting to suggest the pace of economic freefall is easing. Both the ISM manufacturing and services survey indexes rose in January even though both remain in contractionary territory. Consumer lending surveys show some improvement in the 1st quarter from very depressed readings late last year. Retail sales posted their first monthly advance in January since last June! The inventory of new and existing homes for sale has declined by 20 percent from peak levels just a few months ago. Finally, the average age of cars on the road has risen by about ten months (65 to 75) since mid-2007 suggesting pent-up demand for cars and other durable items may be getting quite pronounced. While signs of economic improvement are hard to come by today, we will be watching for further signs in the next several months. We do not believe the economy has to recover before confidence broadly improves. Simply evidence supporting a bottom in the economy would likely cause a substantial jump in confidence both on Wall Street and Main Street.

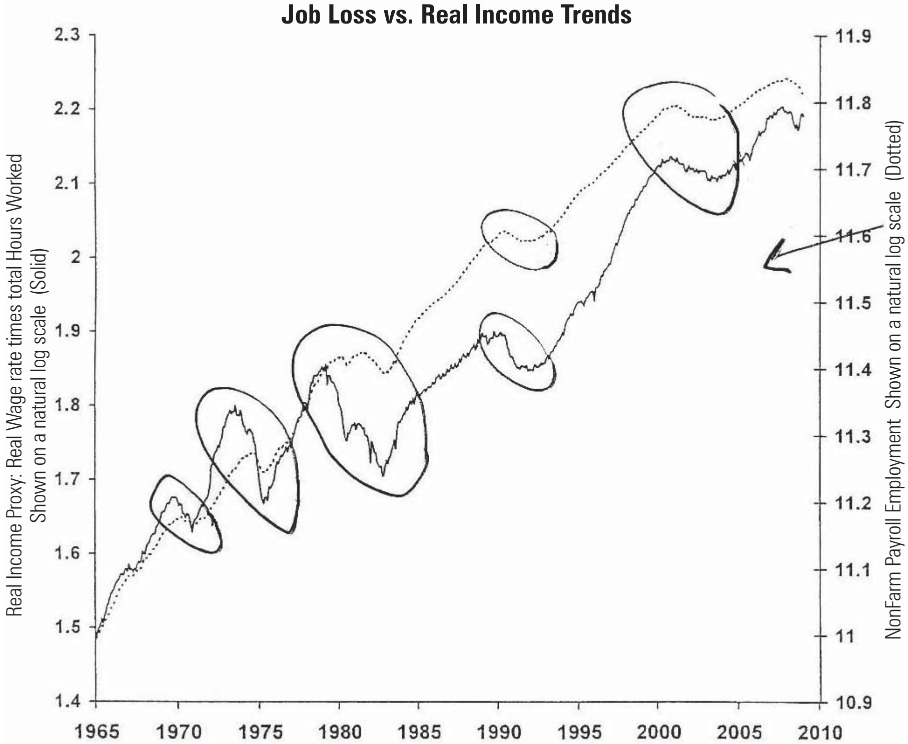


Source: JD Power Associates, Power Information Network *Jan 1 - 25 only

Jobs Loss Worse than Real Income Loss!?!?

Losing 600,000 jobs a month for three consecutive months is devastating! However, a slight consolation is found in a rather odd divergence in recent months between massive job losses and a relatively mild decline in real incomes. The top chart overlays nonfarm payroll employment (dotted line) with a proxy for U.S. real income (i.e., aggregate hours worked multiplied by the real wage rate). Both series are shown on a natural log scale so that equal vertical movements record equal percentage changes. Historically, percentage declines in real income have always been greater than the percentage loss in the job market. Despite near record-setting job losses in this cycle, the decline in real income has been remarkably modest. Why? First, real wages have surged in recent months as wages have continued to grow while consumer prices have declined due to lower energy cost. Second, unlike past job market collapses, productivity has remained amazingly strong (it rose at a 3.2 percent pace in the fourth quarter) implying those that still have a job are worthy of strong wages! None of this diminishes the severity of the collapse currently unfolding in the job market. However, the current record-setting job collapse is being at least somewhat buffered by a relatively modest decline in real incomes!?!

Job Loss vs. Real Income Trends

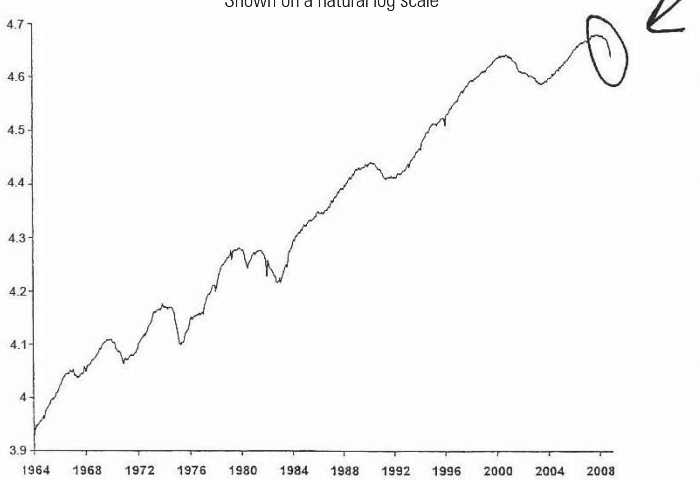


Real Income Loss Typically Greater than Job Losses!?!...

Although Jobs and Hours WORKED Have Collapsed

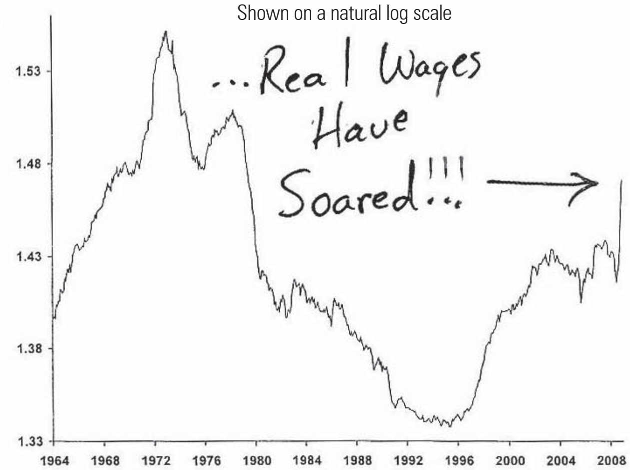
Total Private U.S. Aggregate Hours Worked*

*Shown on a natural log scale



U.S. Real Wage Rate*

*Average Hourly Earnings Index divided by Consumer Price Index. Shown on a natural log scale

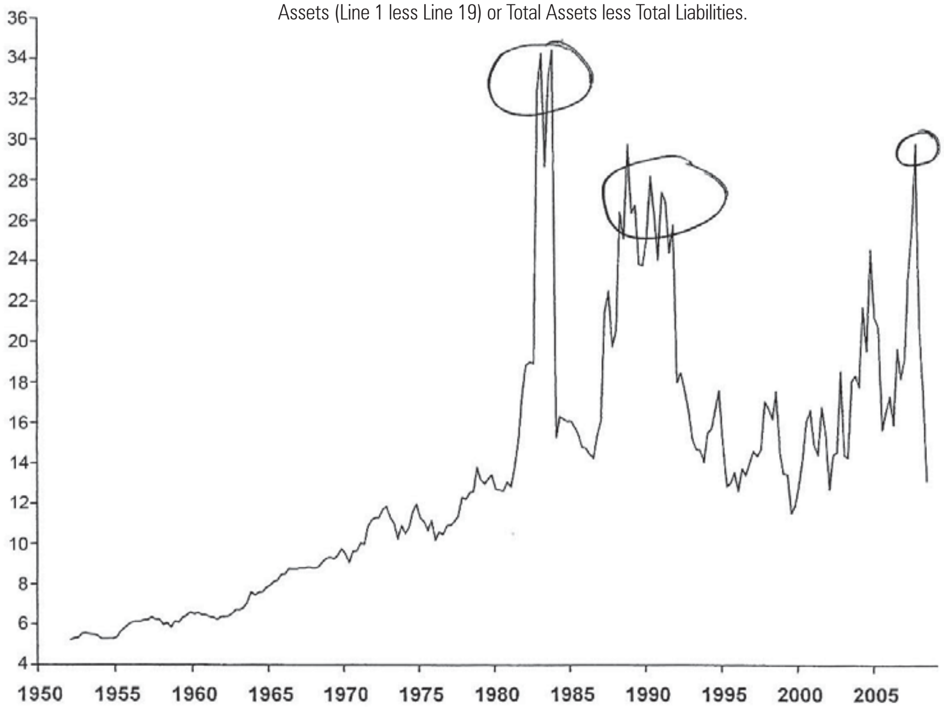


Commercial Banks No More Leveraged than Before!!!?

This chart examines "loan leverage" in the U.S. commercial banking industry since 1950. It records the ratio of total U.S. bank lending (including bank loans, mortgages, consumer credit and security credit) to net banking assets (total financial assets less total financial liabilities). Although the leverage ratio did spike to almost 30 times net assets at the top of the last recovery, this is no higher than it was at the top of late-1970s economic recovery or at the top of the 1980s recovery. A common tale promulgated throughout this crisis is the U.S. banking industry leveraged up balance sheets more than ever before. While the level of banking loan leverage was indeed high in this cycle at least by this measure, it was no higher than it was in two other major cycles since 1970. Both of these previous cycles resulted in significant "debt problems" which we are also experiencing today. However, neither previous recessionary cycle, emanating from a similar banking "loan leverage" ratio, produced such widespread and intense Depressionary fears. Why? The lower charts shows although neither delinquency nor charge-off rates are yet higher than they were in the early 1990s, current fears of a "debt Armageddon" are far more pronounced. Why? We certainly are in the middle of a serious debt-induced recessionary cycle. But we think the contemporary common fears of "Depression," "Catastrophe" and "a lost decade" are very much over exaggerated!??!

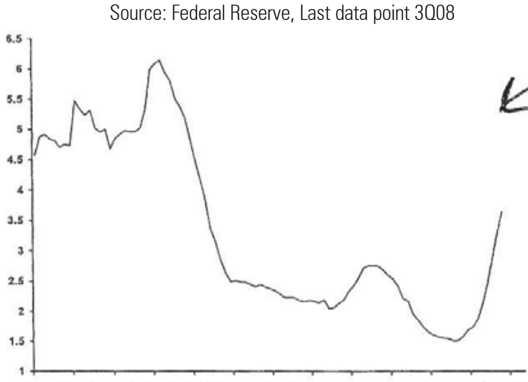
U.S. Commercial Bank Loan Leverage*

*Total U.S. Bank Loans (Lines 11 - 14 from Fed Flow of Funds L.109) including bank loans, mortgages, consumer credit and security credit as a ratio of Net Assets (Line 1 less Line 19) or Total Assets less Total Liabilities.

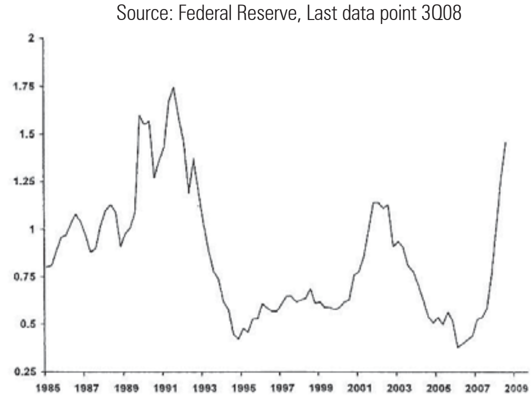


While these will both Climb Higher...
...they are Hardly Depressionary!!!

U.S. Total Delinquency Rate
Total for all U.S. Bank Loans
Source: Federal Reserve, Last data point 3Q08



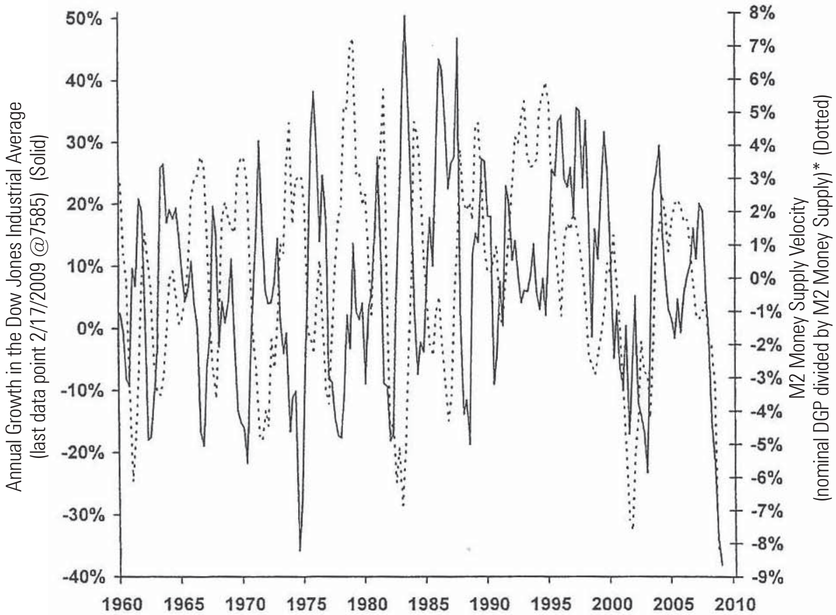
U.S. Total Charge Off Rate
Total for all U.S. Bank Loans
Source: Federal Reserve, Last data point 3Q08



A Confidence/Velocity Crisis!???

The top chart overlays the growth in the stock market with growth in money velocity. Some stock market declines are not associated with collapsing velocity (e.g., 1970 and 1973-74). However, declining velocity seems to play a significant role in other bear markets (e.g., 1981-82 and the dot.com meltdown) including the contemporary crisis. Historically, the relationship between money velocity and stock prices appears closely related to whether consumer confidence and money velocity become linked. In both the dot-com crisis and throughout the contemporary crisis, confidence and velocity have been importantly linked and stock prices have been very closely related to movements in money velocity. The problem is not currently a lack of liquidity or stimulus—there are plenty of both. The problem is a lack of confidence. However, should fears begin to abate and confidence slowly improve, the stock market and economic growth could experience a sharp recovery.

Stock Market vs. Money Velocity
Annual Growth

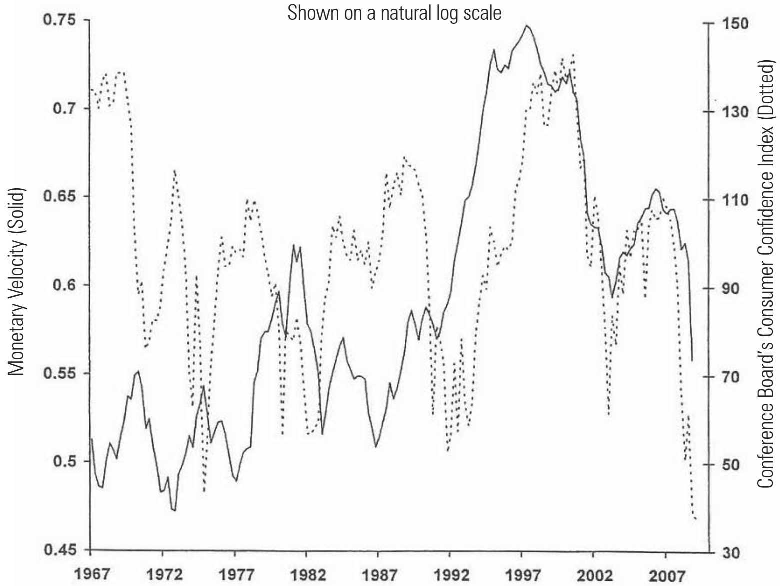


The Stock Market Could Do Well...

...when/If...

... Confidence and Velocity Improve!?!

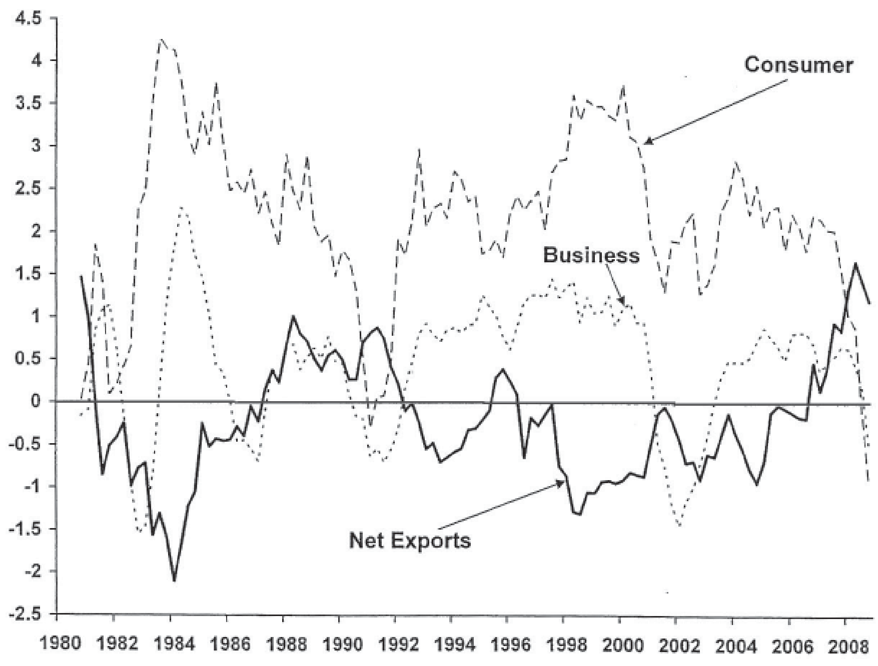
Monetary Velocity* vs. Consumer Confidence Index
*Nominal GDP divided by M2 Money Supply
Shown on a natural log scale



A New Composition for Future U.S. Growth??

Because of continued household deleveraging, is the U.S. doomed to a prolonged period of sluggish economic growth even once recession finally ends? We agree households are in a deleveraging phase which may last for several years as it did after both the 1982 and 1991 recessions. However, we do not necessarily believe economic growth will prove as punk as it did in the first half of those two decades. Why? Because in the contemporary period, the U.S. will likely benefit from a "growth booster" which did not exist in the past—"Net Exports"! This chart shows the contributions to annual real GDP growth from its three main private sectors—household, business and net exports. It is interesting to examine the composition of U.S. growth during the 1990s expansion. From the early 1990s to 2000, the household contributed about 3 percent growth, the business sector about 1 percent, while trade "subtracted" about 1 percent. Overall, real GDP growth averaged about 3 percent comprised by about 4 percent private sector spending (business and consumers) reduced by a chronic 1 percent trade bleed. Many currently fear a lost or sluggish decade as private consumption growth remains permanently weaker. We think it is possible, even with chronically weaker consumption, for overall U.S. real GDP growth to prove similar to its pace during the 1990s expansion. How? Assume because U.S. households are too old, too under-saved and too overleveraged, that real consumption only contributes approximately 1 percent annually to overall real GDP growth—a nasty 2 percent reduction from its 1990s contribution. However, business spending continues to add 1 percent growth and net exports, rather than subtracting 1 percent, actually "adds" about 1 percent annually. One from households, one from business and one from trade delivers the same 3 percent overall real GDP growth which was enjoyed during the last expansion! While the consumer is probably headed for a prolonged period of deleveraging, this does not necessarily imply a sentence of much weaker overall real GDP growth. Rather, it may simply suggest a change in the composition of real GDP growth—one less driven by domestic consumption and more driven by international trade!??

Trailing 4-Quarter Contributions to Total Real GDP Growth

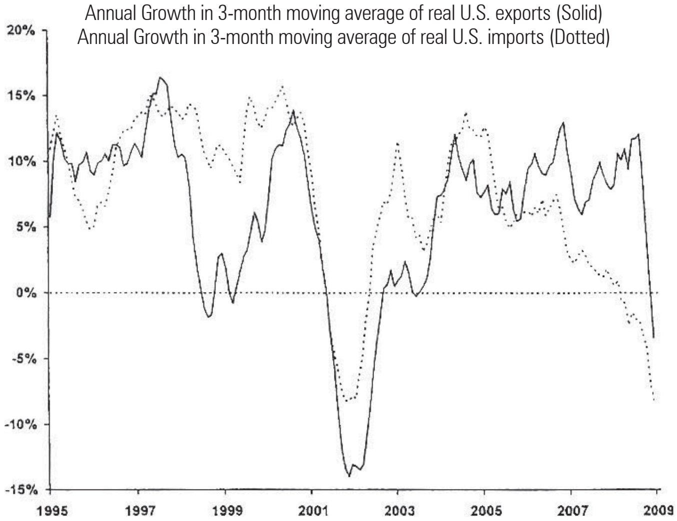


"Net Exports" Still Contributing!?!

Net exports have continued to add to real GDP growth throughout this crisis. We do not think the U.S. will lose this positive force anytime soon. This contribution is not simply about export growth. It comes from the "difference" in growth between exports and imports. Even though export growth has collapsed worldwide, so has domestic import growth, leaving net exports in a contributing position. Even if global export trends remain weak in the next year, "net exports" may continue to add to U.S. real GDP growth!??

U.S. Real Exports & Imports Annual Growth

Annual Growth in 3-month moving average of real U.S. exports (Solid)
Annual Growth in 3-month moving average of real U.S. imports (Dotted)



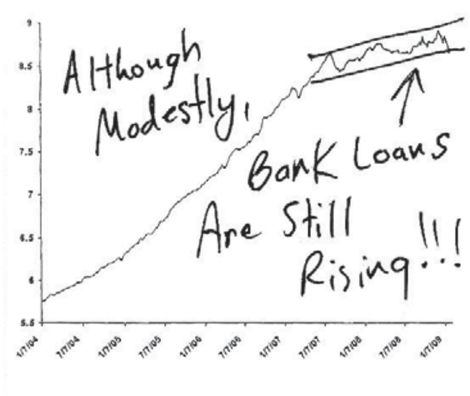
U.S. Real Net Exports

There is Some Borrowing & Lending!!??

Credit creation is not totally frozen! Bank loans have not contracted! They are still rising albeit at a very sluggish pace. And, in the last couple months, corporate bond issuance has been accelerating! Year to date, bond issuance among both investment grade and junk issuers is nearly double what it was a year ago!!! Just FYI……

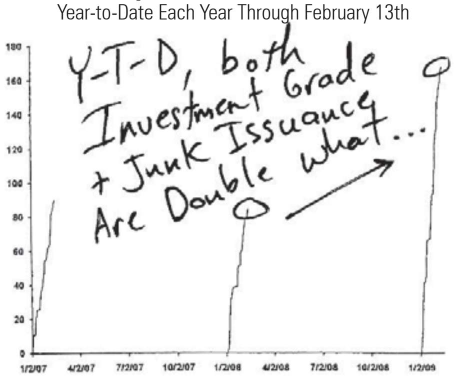
Total U.S. Bank Loans Plus Commercial Paper

In Trillions



Total U.S. Investment Grade Corporate Bond Issuance

Year-to-Date Each Year Through February 13th



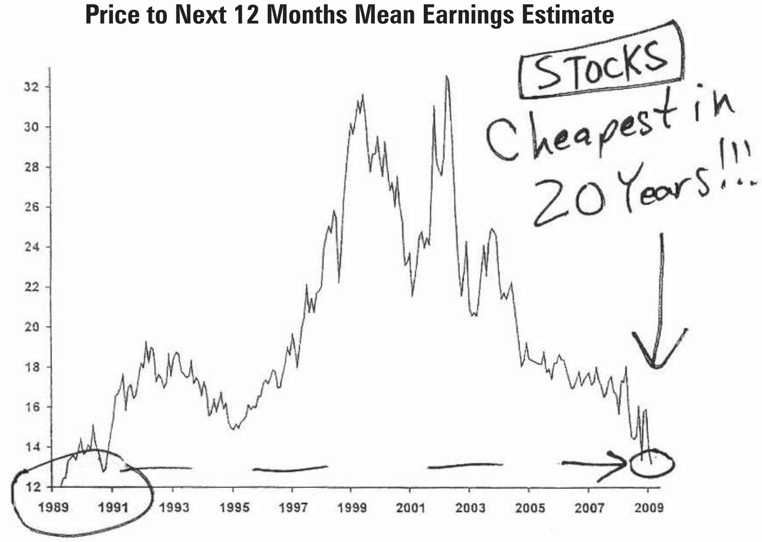
Total U.S. High Yield Corporate Bond Issuance

Year-to-Date Each Year Through February 13th

“RISK ASSETS” Are a Bargain!!??

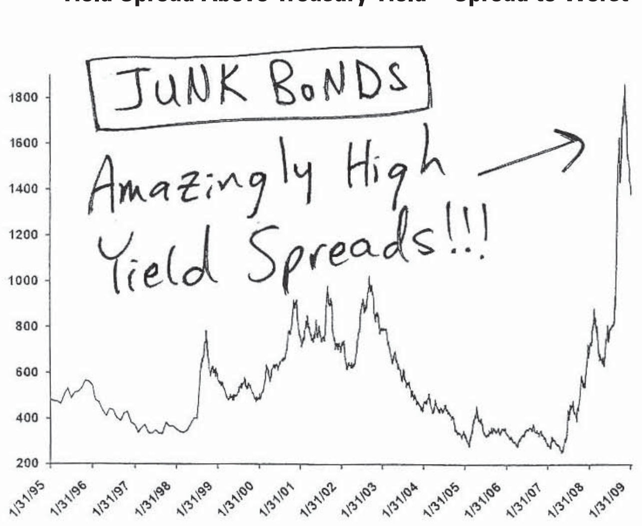
This crisis has repriced “risk assets” across the investment spectrum to very attractive levels. Take your pick…….. but pick something! As shown on this page and on the top of the next page, contemporary fears notwithstanding, the “investment deals” are spectacular! The U.S. stock market offers investors a dividend yield in excess of long-term Treasury bond yields for the first time in 50 years and is selling at the lowest price-earnings ratio in two decades! Commodity prices are being priced 50 percent cheaper than they were six months ago! Junk bonds offer investors yields 15 percent above treasury bonds! Investment grade corporate yield spreads are the widest they have been since the middle of the Great Depression! More deals on the next page…….

S&P 500 Composite Stock Price-Earnings Multiple
Price to Next 12 Months Mean Earnings Estimate



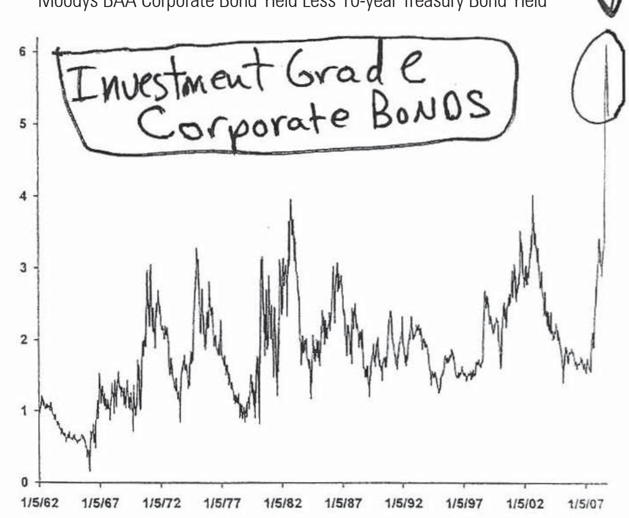
CRB Commodity Price Index
Shown on a natural log scale

JP Morgan High Yield Bond Index
Yield Spread Above Treasury Yield—Spread to Worst



Highest Spread Since Middle of Great Depression!

Investment Grade Corporate Bond Yield Spread*
*Moodys BAA Corporate Bond Yield Less 10-year Treasury Bond Yield

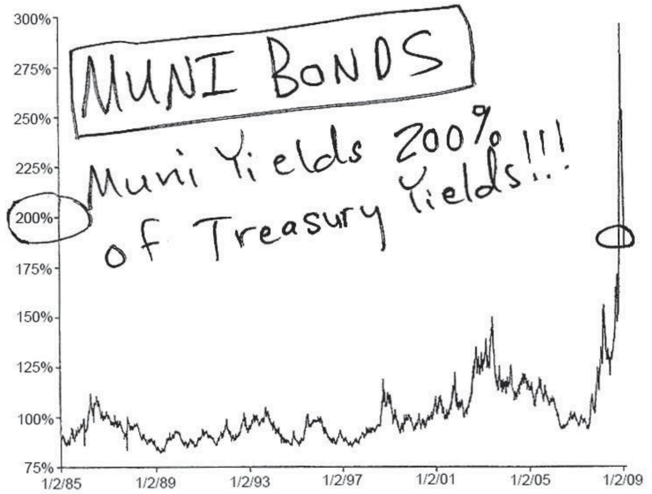


Buy Some "RISK" ... Continued!!?

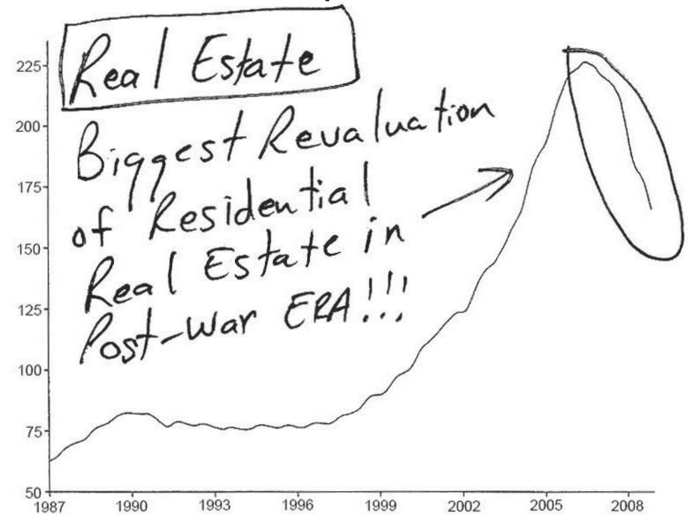
How about a municipal bond offering a yield 2 percent above Treasuries "before" taxes….amazing! Finally, investors have the opportunity today to consider real estate investments after arguably the largest reliquification of this marketplace in post-war history! It's too late to get conservative, too late to hide in cash or Treasury bonds or steady-eddy stocks like consumer staples or utilities. Don't let "fear" keep you away from the amazing sales prices available today on "risk assets"!!!?

Municipal Bond Yield as a Percent of Treasury Yield*

*Bond Buyer U.S. 40 Municipal Bond Yield as a Percent of 10-Year Treasury Yield



S&P/Case-Schiller Composite 10-Home Price Index

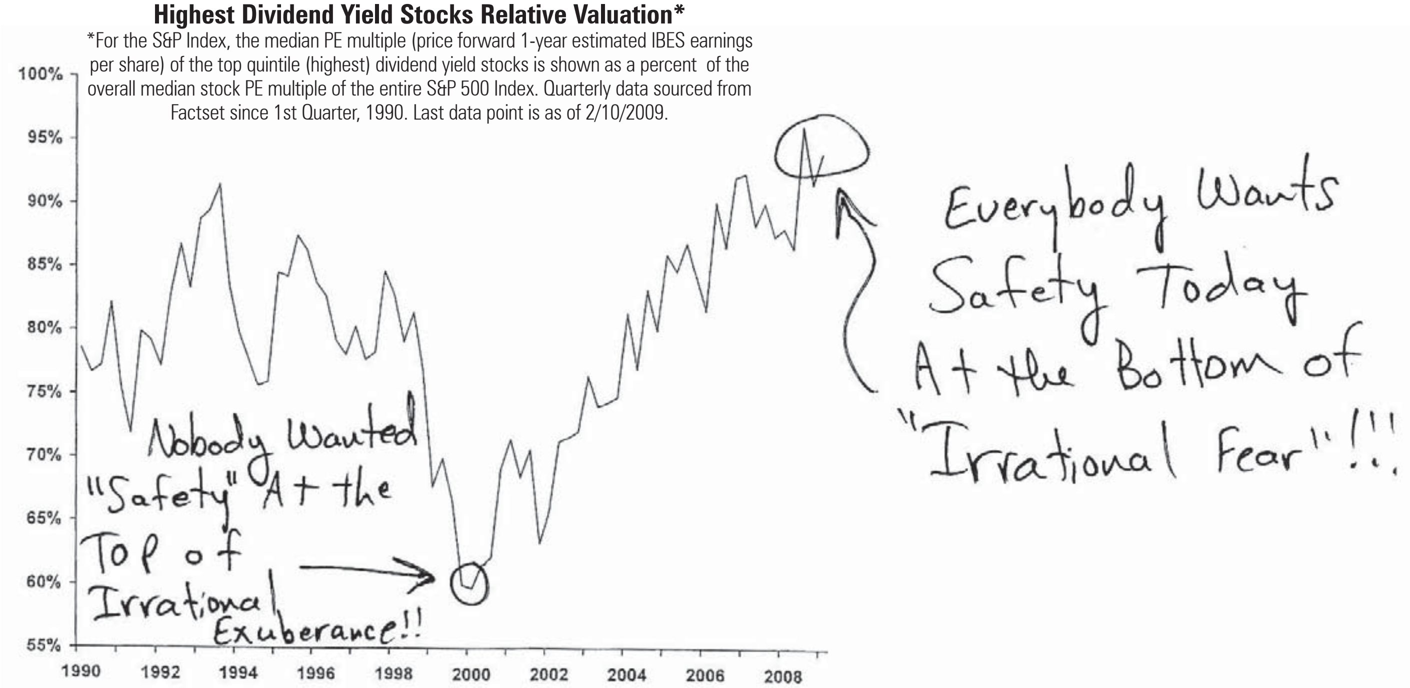


Safety is EXPENSIVE!!!?

The investment culture has come full circle in this decade. This chart shows the median price-earnings (PE) multiple of the highest yielding quintile stocks within the S&P 500 Index as a percent of the overall stock market PE. High dividend yield stocks are often perceived as "safe stocks" which offer an income flow during difficult stock market periods. At the top of the dot-com stock market in early 2000, even though the price of safety was extremely cheap (its relative PE multiple was less than 60 percent of the overall market), virtually nobody was buying dividend stocks since all knew the road to riches was fast growth tech stocks! Today, by contrast, high dividend paying stocks are all the rage even though they are more expensively priced than they have ever been since at least 1990. Irrational exuberance caused investors to ignore tremendous value in 2000 and today irrational fear is similarly causing many investors to buy an overly expensive "safety reassurance"!

Highest Dividend Yield Stocks Relative Valuation*

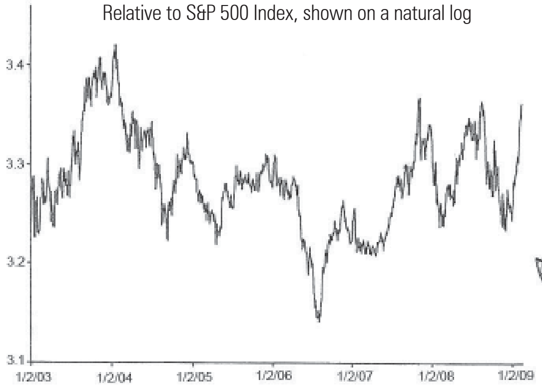
*For the S&P Index, the median PE multiple (price forward 1-year estimated IBES earnings per share) of the top quintile (highest) dividend yield stocks is shown as a percent of the overall median stock PE multiple of the entire S&P 500 Index. Quarterly data sourced from Factset since 1st Quarter, 1990. Last data point is as of 2/10/2009.



Weird Leadership for "Depression-Crisis"???

Why are technology stocks outperforming in an economy widely perceived as collapsing? Why have small cap stocks held up so well throughout what is widely perceived as the worst crisis since the Great Depression? Why is the relative price of emerging market stocks essentially the same today as it was when this crisis began in 2007? If the U.S. consumer is in such bad shape and they have been driving the emerging world economies, why aren't these stocks collapsing? Even domestic retail stocks relative to the overall stock market are currently no lower now than they were at other times throughout the expansion. Shouldn't they be getting clobbered if retailing is so bad? Finally, why are transport and materials sector stocks relative price performance little different today than where they traded at the start of this crisis? Don't these sectors represent the manufacturing sector which supposedly is being destroyed? Not sure what to make of this page. Much of the internal performance of the stock market does not jive with the widely accepted "worst ever crisis since the Great Depression" mentality! Why? What is the stock market saying about the "economic reality" hidden under layers of contemporary fears????!

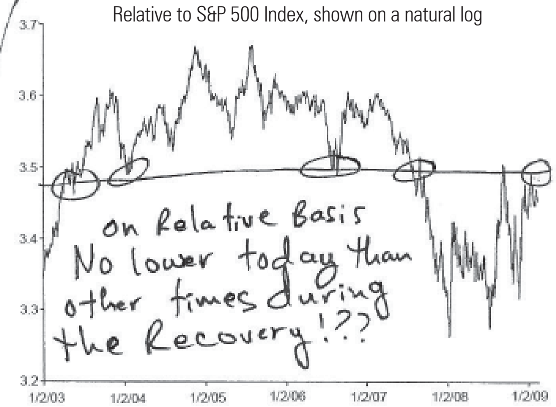
S&P 500 Technology Sector Stocks
Relative Stock Price Performance
Relative to S&P 500 Index, shown on a natural log



Russell 2000 Small Cap Stocks
Relative Stock Price Performance
Relative to S&P 500 Index, shown on a natural log

Emerging Market Stocks
Relative Stock Price Performance
Relative to S&P 500 Index, shown on a natural log scale

S&P 500 Retail Sector Stocks
Relative Stock Price Performance
Relative to S&P 500 Index, shown on a natural log



Dow Jones Transportation Sector Stocks
Relative Stock Price Performance
Relative to S&P 500 Index, shown on a natural log

Outperforming Over the Whole Cycle Despite Recession + Depression Fears!!??

S&P 500 Materials Sector Stocks
Relative Stock Price Performance
Relative to S&P 500 Index, shown on a natural log