



Economic Outlook 2011

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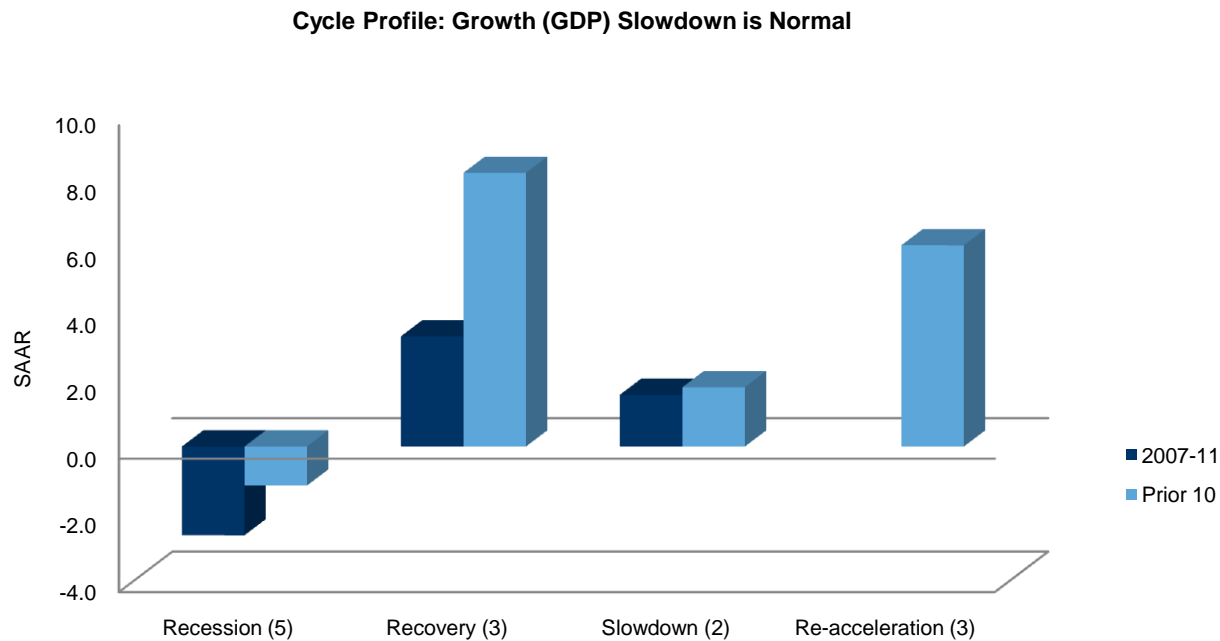
September 2011

SunTrust Outlook Summary

- No Double DIP. US economy slowed in 1H11. That is normal.
- Private Sector Economy is doing fine *under the circumstances*
- Public Sector (Government) is contracting
- Labor Market: AJA treats the symptom but not the cause
- Pass-through Inflation a rising risk
- Interest Rates low until mid-2013. But Fed faces increasing inflation pressure
- Global slowdown a potential positive
- Euro Sovereign Debt: US exposure limited; “No” contagion

Don't Sweat the Sag

- IH11 GDP slowed dramatically following a sub-par initial rebound
- The pattern is standard and does not suggest Double Dip



Real Growth: Rebound, Slowdown, Re-accelerate or Double Dip?

Economic Drivers

- US Private Economy growing 3.5% Public Sector (Government) contracting 1.5%
- Net means Total GDP grows 2.0%
- Production: Cap spending the most important driver; Indicators positive
- Credit transmission: Critical for Sustainability; Slowly gaining momentum
- Exports gain and Imports get cheaper with Global Slowdown
- Corporate profits: Investors betting on re-acceleration; predict 3%+ recovery

Risks to Sustained Recovery

- Credit: Economy not sustainable without credit transmission
- Government: Long-term fiscal imbalances detonate with recession and poor policy choices
- Productivity fails to regain positive momentum

Inflation, Interest Rates, and Noise

Inflation Forecast: 3% by year end; 3.5% in 2012

- Not Oil
- Not Money Supply growth
- Cost-plus pass-through pushes wage inflation
 - Unit labor costs = 5.1% over past two quarters (year-ago = 1.8%)

Interest Rates: Down, until volatility stabilizes

- Fed holds Fed funds at effective zero to mid-2013
- Treasury begins moving auctions toward short end; Fed Twists
- Flight to safety trade: yields lower and yield curve flattens
 - The answer to questions about US position as global leader: When US is at its worst, global economy send its money to US*
- Interest rates Down: 10-Yr US Treasury yield should fall another 25 to 50 BP

“If stupidity got us into this, Why can’t it get us out?”

--Will Rogers

- Politics and the Press

- If we elected the President based on the honesty of campaign promises, Abe Lincoln would still be in office

- One “Ad” is worth 40 editorials

- Soft data and emotion winning shouting match with hard data, reason, and corporate profits

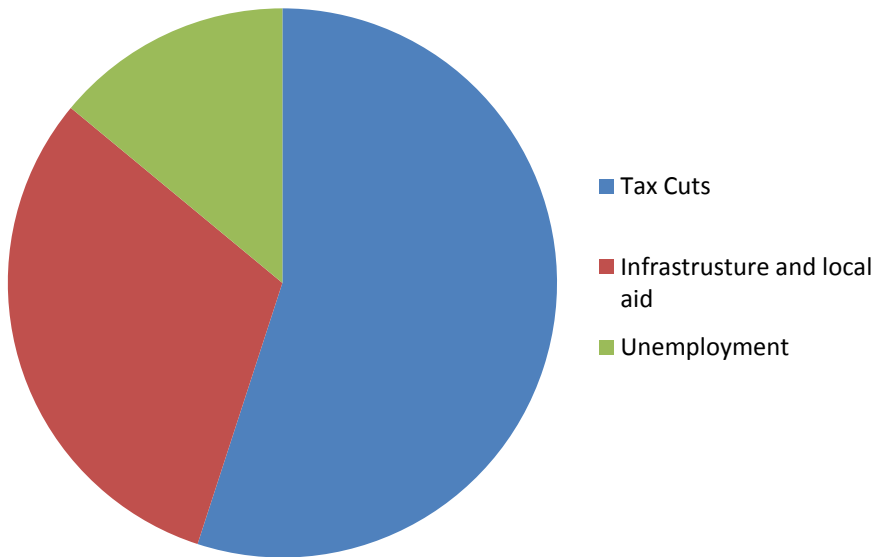
- To Stimulate *Again* or **NOT** to flush another \$450B

American Jobs Act

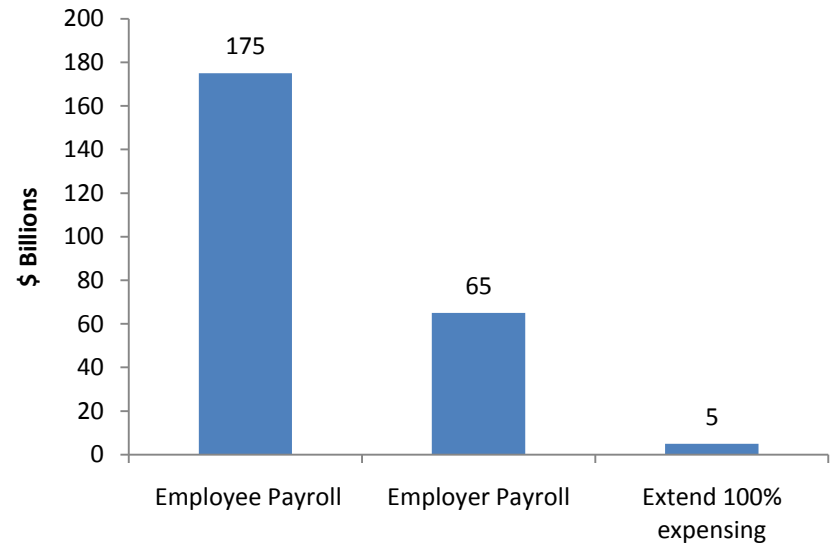
Rome fell because it had a Senate; We have a Senate and a House
-- Will Rogers

- AJA (\$447 Bill) has potential to boost labor market more than ARRA (\$816 Bill)
- ARRA funneled to State and local governments: No Profit Motive
- AJA directed toward Private Employers and Employees: Profit Motive

Total AJA
Total = \$447b



Tax Cuts
Total = \$245B



The Debt Limit: *Only the Worst of Fools*

- The Debt Ceiling is an historic relic that has never produced its intended result
- US Sovereign Debt did not get downgraded because we were near the debt ceiling with a massive budget deficit ...
- ... the downgrade occurred because political leadership has NO CLUE about how to treat those symptoms
- Passed in the Second Liberty Bond Act of 1917 to restrain Federal spending
 - Has never produced any restraint on Federal Spending and none on State and Local spending
 - Increased 70 times since passage
- The Solution: Repeal.

The Deficit Has Two Faces

- Deficit is a function of Expenditures and Receipts
- It is supposed to rise during recession
 - Recession 2007/09
 - Then: Expenditures: Increased 11.5%; Receipts: Decreased 17.2%
 - Now: Expenditures: Increasing 2.4%; Receipts: Increasing 10.1%
- Roots in Reagan Error (you thought I meant Era, didn't you?)
- Recent fragging:
 - Bush Tax Cuts
 - ARRA and other failures to launch
 - Obama Failure to Sunset
 - AJA

Key Economic and Investment Themes

- **The 1H11 US economy decelerated driven by exogenous forces**
 - Forecast: 2H11 rebounds to 3.5%
 - Tornadoes and floods, Japan's tsunami, earthquake, and nuclear crisis, and \$4.00 gasoline each displaced some measure economic activity in 1Q and 2Q11
 - But, not everything about a "slowdown" is bad
 - Consumer show little sign of slowdown and Household wealth recovery continues
 - Job gains now total 1.2 million since recovery began vs. an average -715 million eight month gains following the last two recession.
 - Credit measures continue to improve
- **Inflation risk rising, as growth risk declines**
 - Previous potentially inflationary growth rates in retail sales and industrial production suggest that the soft patch may have a silver lining
 - Cost pass-through remains a risk
 - Slowing productivity risks wage reversal
 - Crude oil prices dropped 18% to beneath \$100/ bbl. Gasoline reverses to \$3.60/ gallon
- **Interest rates and monetary policy**
 - QE2 completion by the end of June. Fed offers a road map to tightening and No QE3 commitment (MAYBE)
 - US Treasury yields continue higher with extremely wide 2/10 yield curve

Appendix

- **Bad Events: Blizzards, Hurricanes, Floods, Tornados,Tsunami**
- **Sovereign Debt**
- **Selected Global Interest Rates**
- **US Equity Markets**

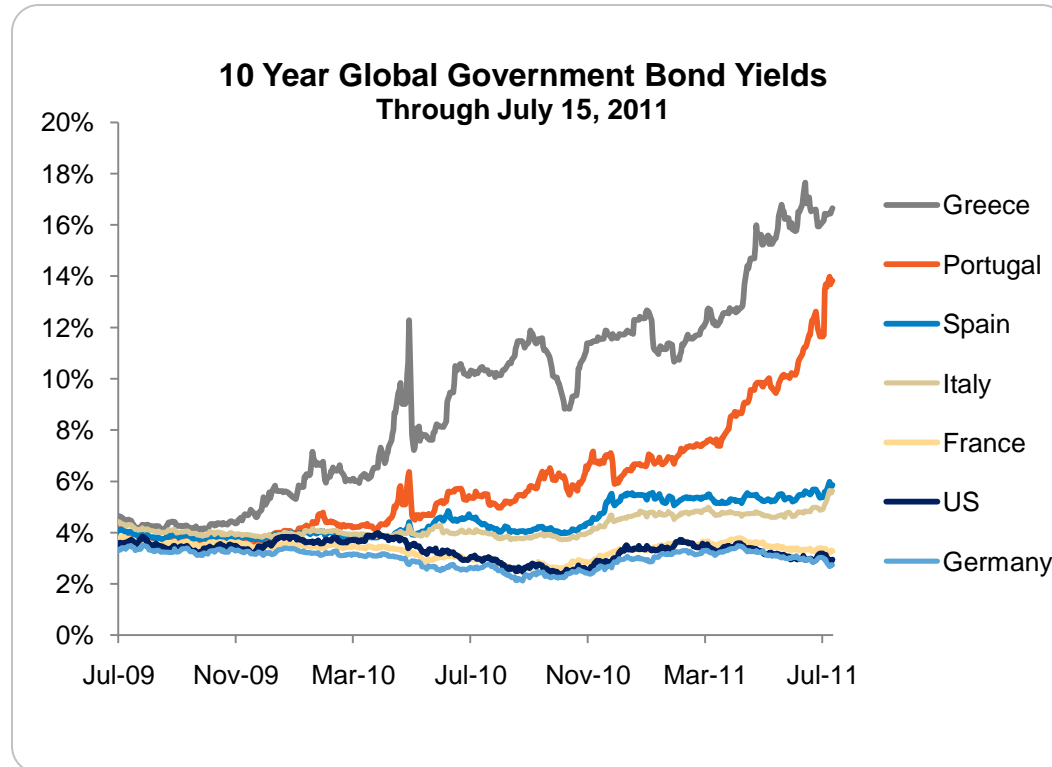
“Bad Events”: the object changes, the logic remains the same

- The Sovereign Debt Crisis in Greece has taken the headlines, displacing other weak Euro countries, Japan’s tsunami/nuclear disaster, political strife in the Middle East, and floods and tornadoes in the US heartland.
- Global investors respond by continuing to buy the safety of US treasury debt – driving prices higher and yields lower, and directing liquidity toward the US
- There is a linkage, a low probability linkage, but a link nonetheless, through which Greek default might seep into US markets. Although US direct exposure to Greek sovereign debt is limited, US banks and institution do have material exposure to German sovereign debt. Should Germany get caught hold the bag after a Greek sovereign default, Some US institutions would absorb a piece of the outcome.
- The Greek Prime Minister won a confidence vote in Parliament, paving the way for approval of a package of austerity measures and a second aid package for the beleaguered euro-zone nation.

The uneven recovery raises the risk for countries with a heavy debt burden

Fallout from the fiscal crisis in the Euro Zone shows up in global interest rate structure

In spite of high yields in Euro denominated bonds, high risk keeps cash flowing to US Debt. At our worst, the US remains the default place to invest.

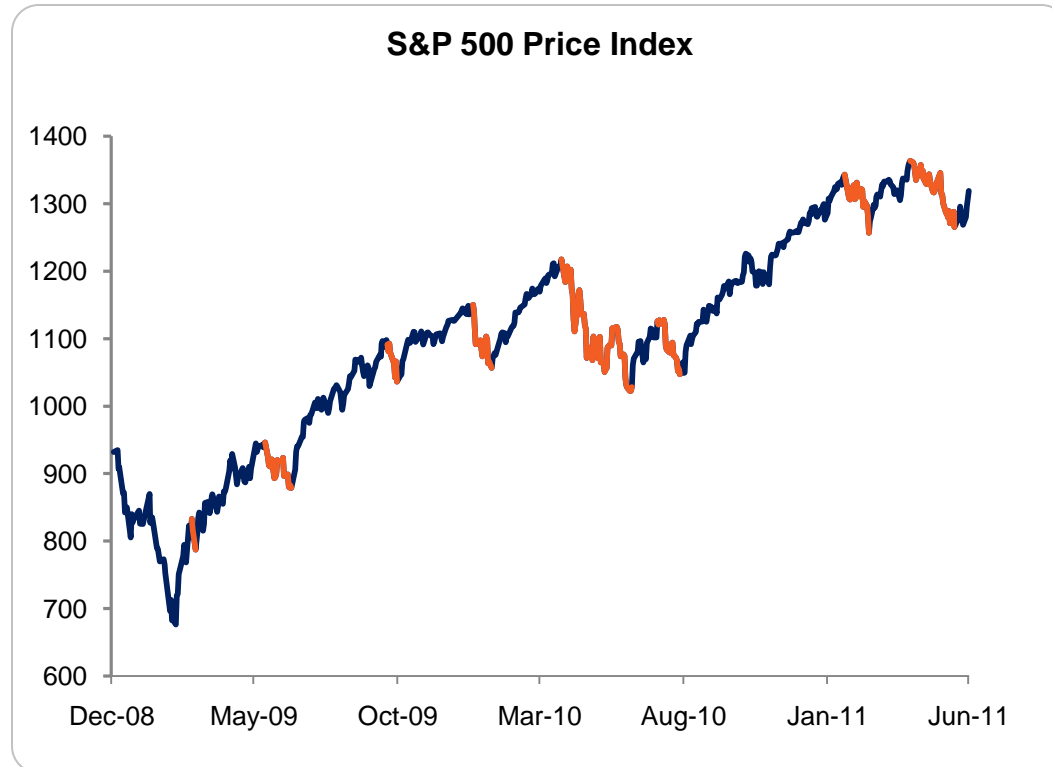


Source: Factset

Recent equity volatility is not surprising given increased uncertainty

The second quarter saw the eighth bull market correction of more than 5%

US equities, which had been leading the global markets higher, corrected more sharply in May and early June on global macro headlines.

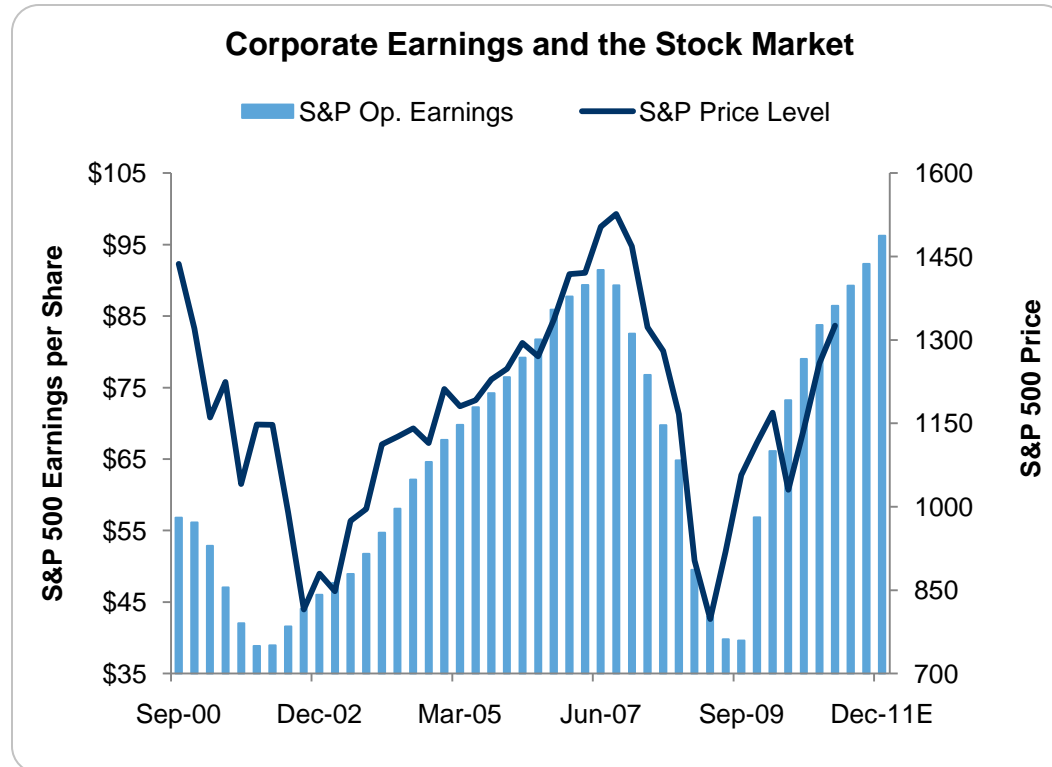


Source: Factset

The strong recovery in corporate profits provides a solid foundation for stocks

The second quarter saw the eighth bull market correction of more than 5%

The second quarter earnings reports will provide important clues regarding the sustainability of corporate profits. Analysts will be looking for confirmation that higher raw material prices are eroding margins.



Source: Factset

Economic Summary: Recovery Hits Exogenous Soft Patch; Inflation Rising

- **The 1Q11 US economy decelerated to 1.8%, driven by exogenous forces**
 - 2Q11 could slow to 1.4%. Expect “catch-up activity” in 2H11
 - Tornados and floods, Japan’s tsunami, earthquake, and nuclear crisis, and \$4.00 gasoline each displaced some measure economic activity in 1Q and 2Q11
 - But, not everything about a “slowdown” is bad
 - Consumer show little sign of slowdown and Household wealth recovery continues
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- **Interest rates and monetary policy**
 - QE2 completion by the end of June. Fed says, “no plans for a QE3” and “*Promises*” no tightening until 2013
 - Global risk keeps US Treasury yields low, but expect reversal by year-end

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Financial Resources for All Your Personal and Business Needs

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Hedge funds may involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager.

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