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magazine
presents

In the Aftermath:
Navigating the Sovereign Fiscal Crisis

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The Aftermath: Navigating the Sovereign Fiscal Crisis

Financial Advisor Webinar
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FINANCIAL ADVISOR

presented by
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produced by
Financial Advisor

US economic recovery has begun

- Q4 GDP growth was 5.7%
- Leading indicators have soared
- Job market appears to be stabilizing
- Inventory rebuild should be strong, particularly in tech capital goods

but the economy faces massive headwinds

In our view—

- Consumer: must still reduce debt and save more; housing wealth unlikely to recover
- Commercial Real Estate: more pain as office and apartment vacancies likely keep rising
- Government Spending I: Federal stimulus peaks in 2010, then fades
- Government Spending II: state and local govt. spending must fall to help balance budgets
- Net Trade: benefits from lower dollar limited by oil, China, European demand weakness
- Demographics: potential GDP growth looks likely to slow
- **Recoveries from debt/banking crises typically are slow ('80s UK, '90s Japan)**

transition to sustainable growth and satisfactory real yield looks highly uncertain

- **Fiscal Risks** to Treasury returns from massive bond supply and policy gridlock
- **Inflation Risks** to all bonds from higher core inflation from excessive monetary stimulus if policy gridlock persists
- **Growth Risks** to equities
- **Confidence Risks** to all US dollar assets

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advisors may want to consider: diversify fixed income holdings by currency and quality

GLOBAL BOND FUNDS HOLD:

- Non-US, high quality governments and supranationals (safety)
- Emerging market debt (performance)
- Corporate debt (performance)
- Non-dollar securities (safety *and* performance in a dollar bear market)

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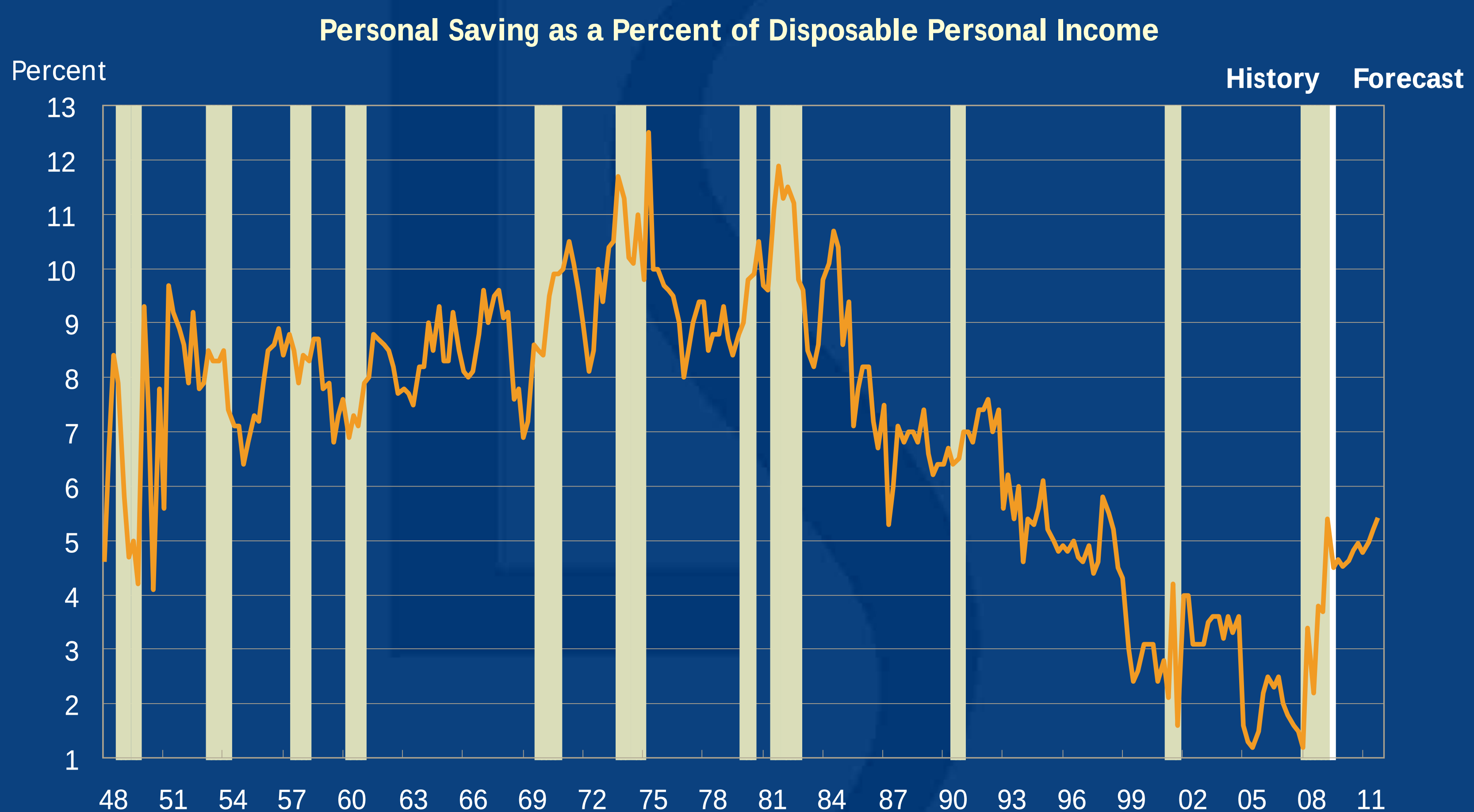
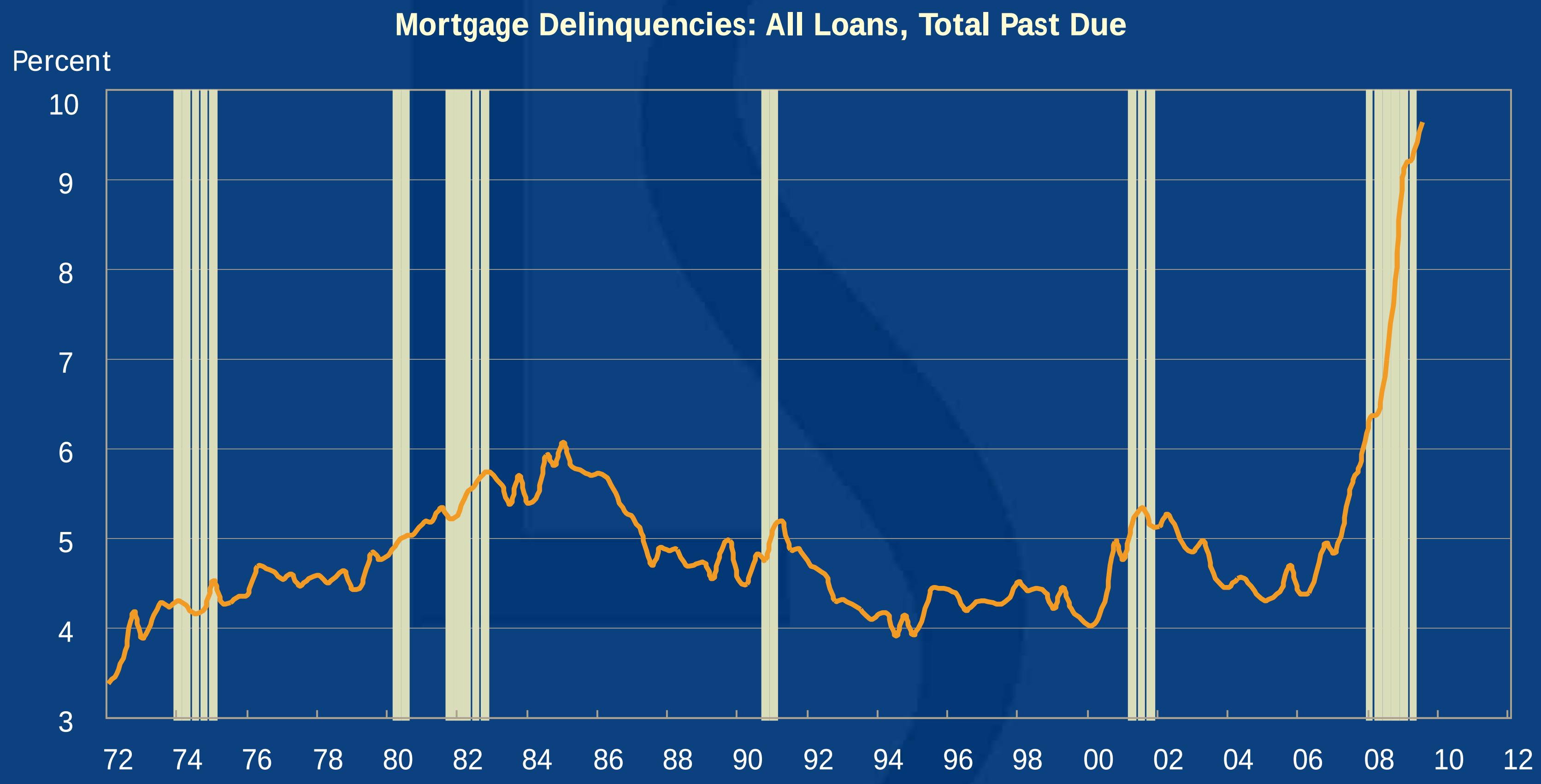
consumer headwind: personal saving rate may rise to replace lost wealth



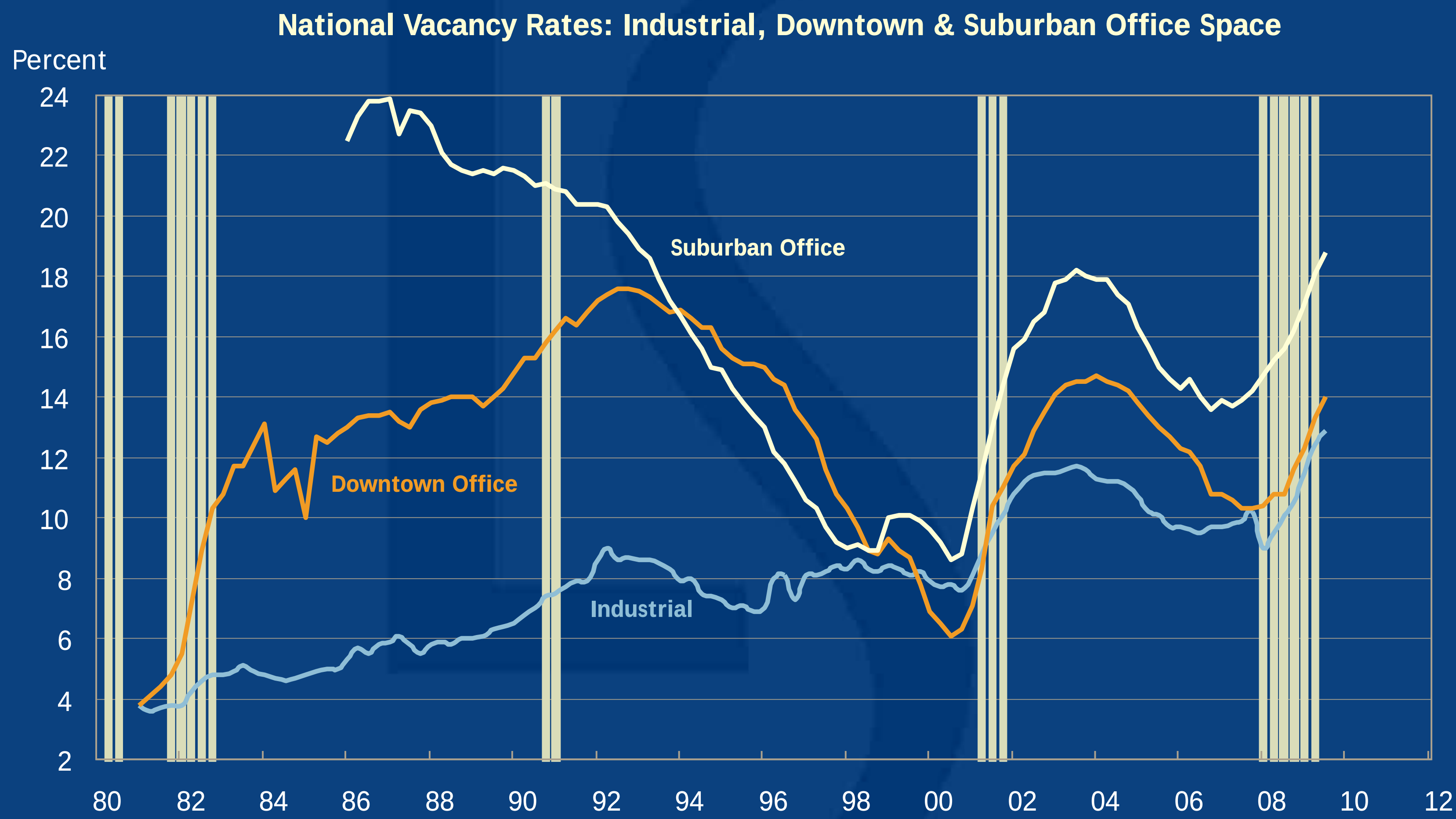
Quarterly data; shaded areas denote NBER-designated recessions. Source: Commerce Department; Loomis Sayles. History through Q32009; forecast through Q42011.

consumer headwind: residential mortgage delinquency rate still rising



Seasonally adjusted quarterly data; shaded areas denote NBER-designated recessions. Source: Mortgage Bankers Association. History through Q32009.

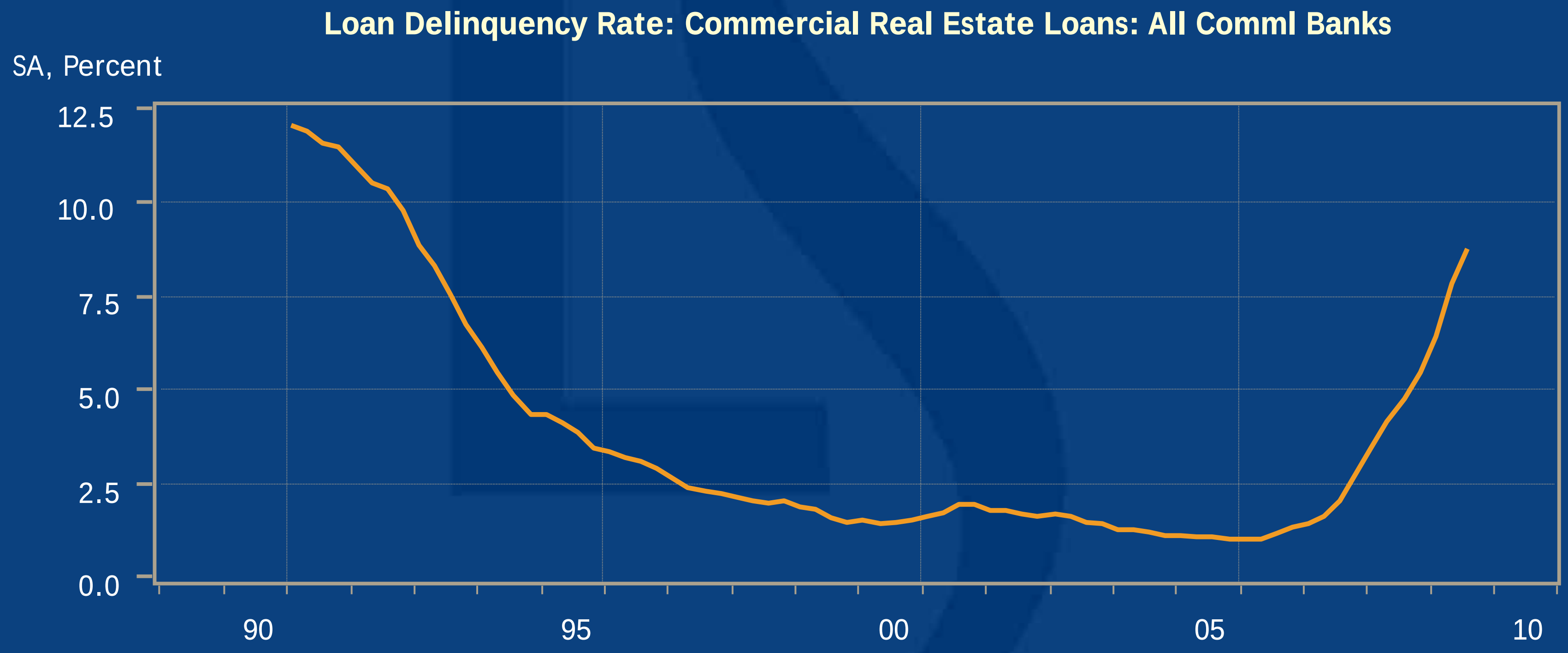
investment headwind: vacancy rates are still climbing



Quarterly data; shaded areas denote NBER-designated recessions. Source: Commerce Department. History through Q32009.

investment headwind

- Credit Suisse: $1.4 trillion of US commercial real estate loans maturing in the next four years
- Foresight Analytics: almost 55% of these are currently "underwater" (1/2010)
- $250 billion in CRE losses? Not good for regional banks, or for regional lending



Source: Federal Reserve Board/Haver Analytics, 1/13/2010.

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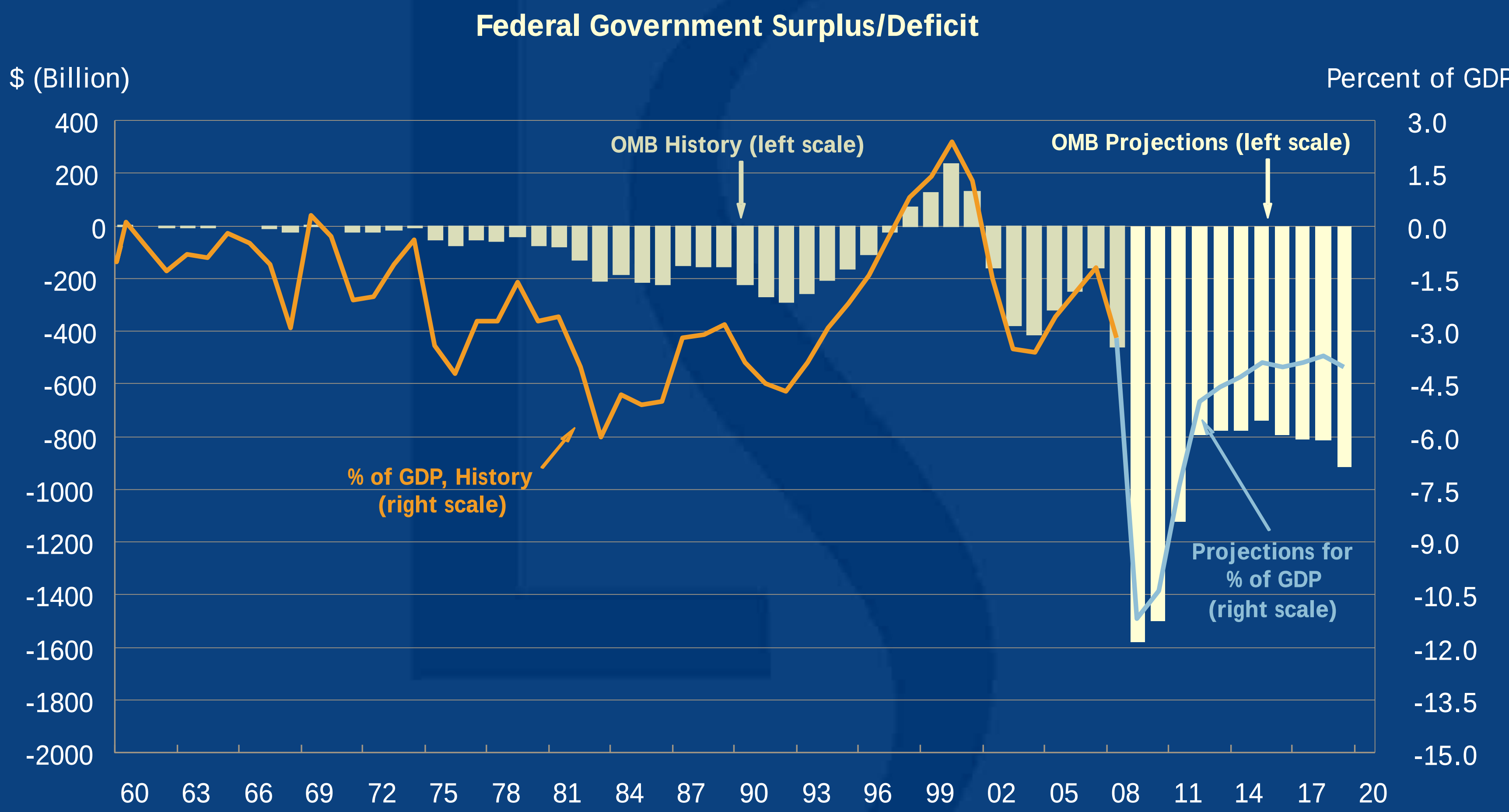
fiscal headwind: OMB projects federal deficits will remain huge



Unified budget basis; fiscal years, annual data. Source: Office of Management and Budget; Commerce Department. Annual history/forecast through FY 2019.

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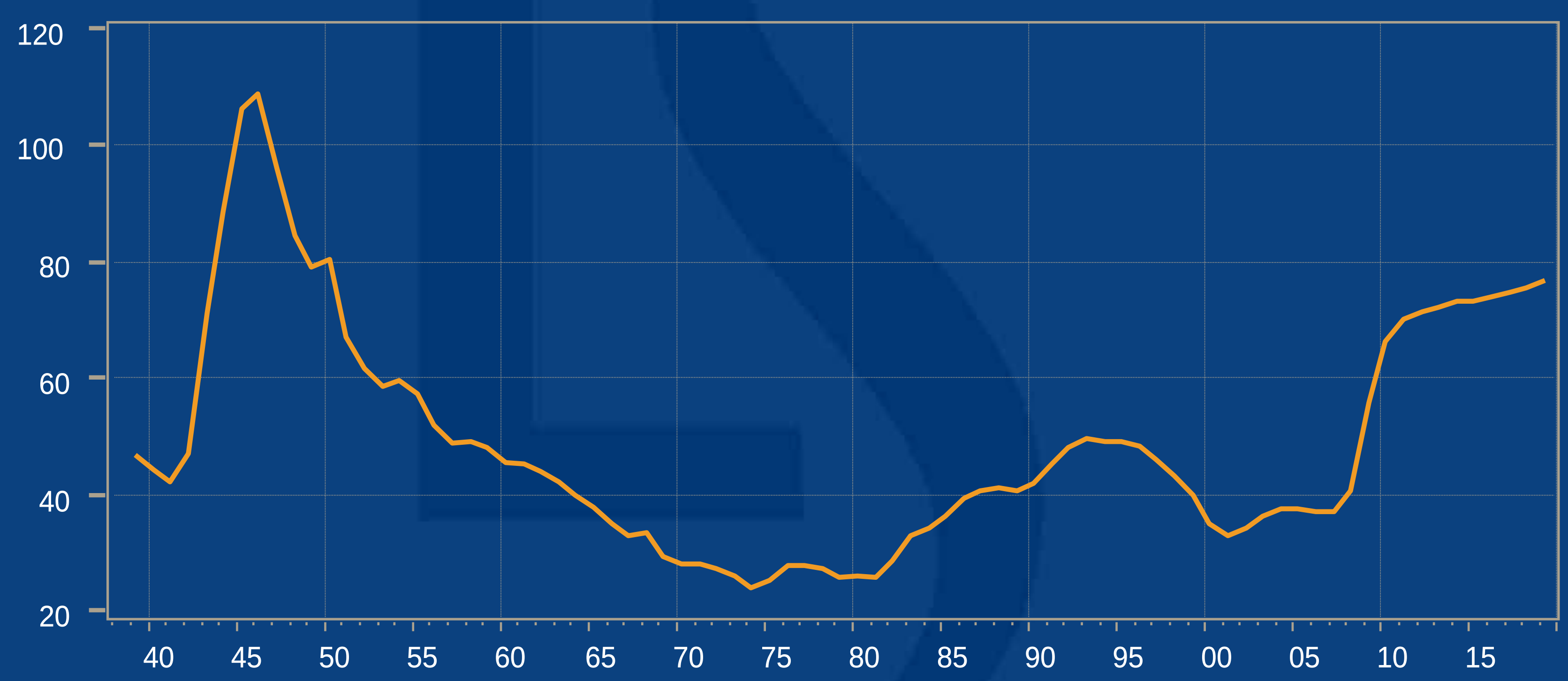
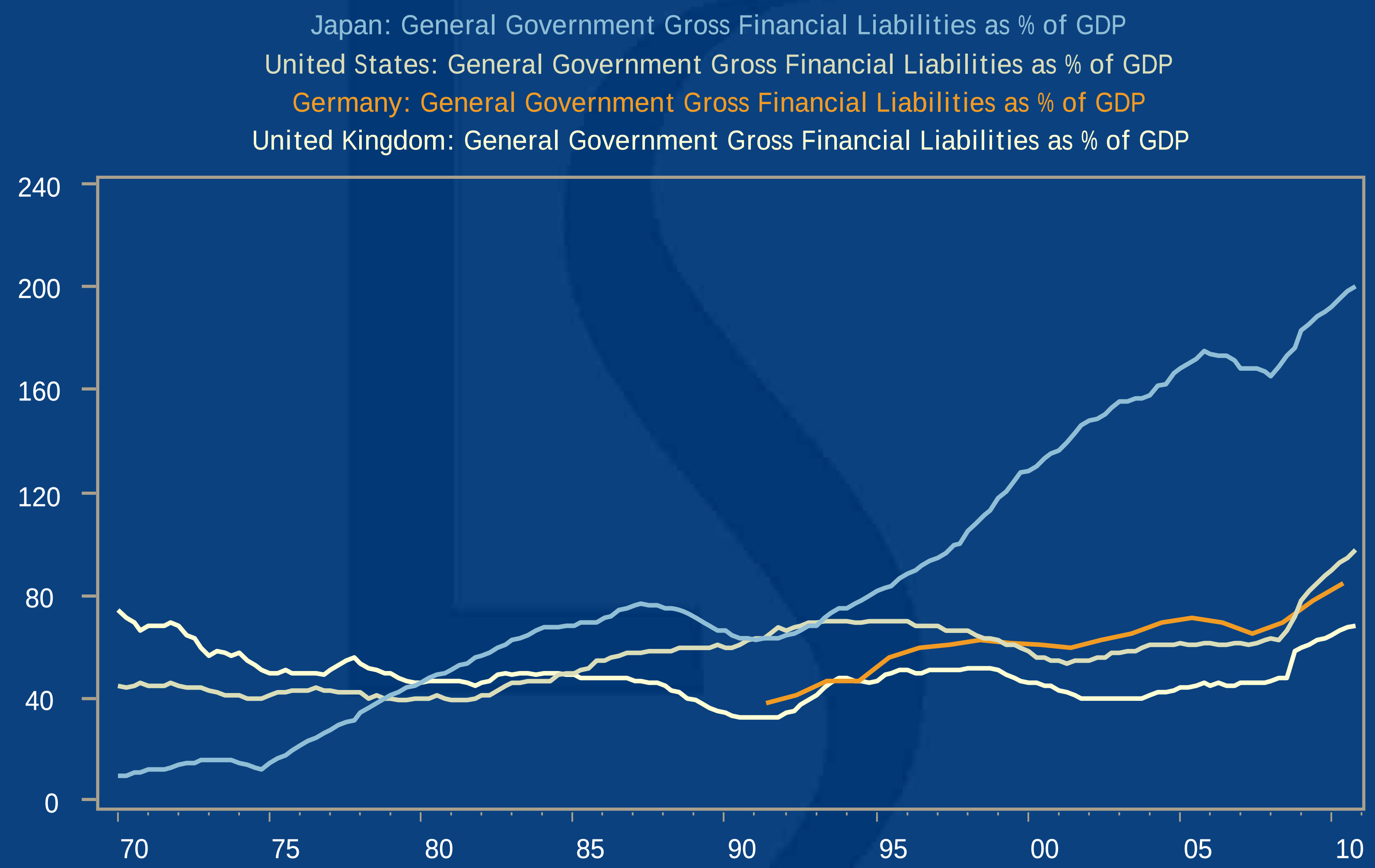
- OMB: net federal debt held by public, up $2.1 trillion in FY 2009
- Up $9.6 trillion FY 2010 – FY 2019
- Debt-GDP ratio rise to 76.5%, highest since 1950
- May get worse in very long run

Federal Debt Held by Public as a Percentage of GDP



Source: Office of Management and Budget/Haver Analytics, 8/26/2009.

government debt stocks are soaring



Source: OECD/Haver Analytics; 8/19/2009.

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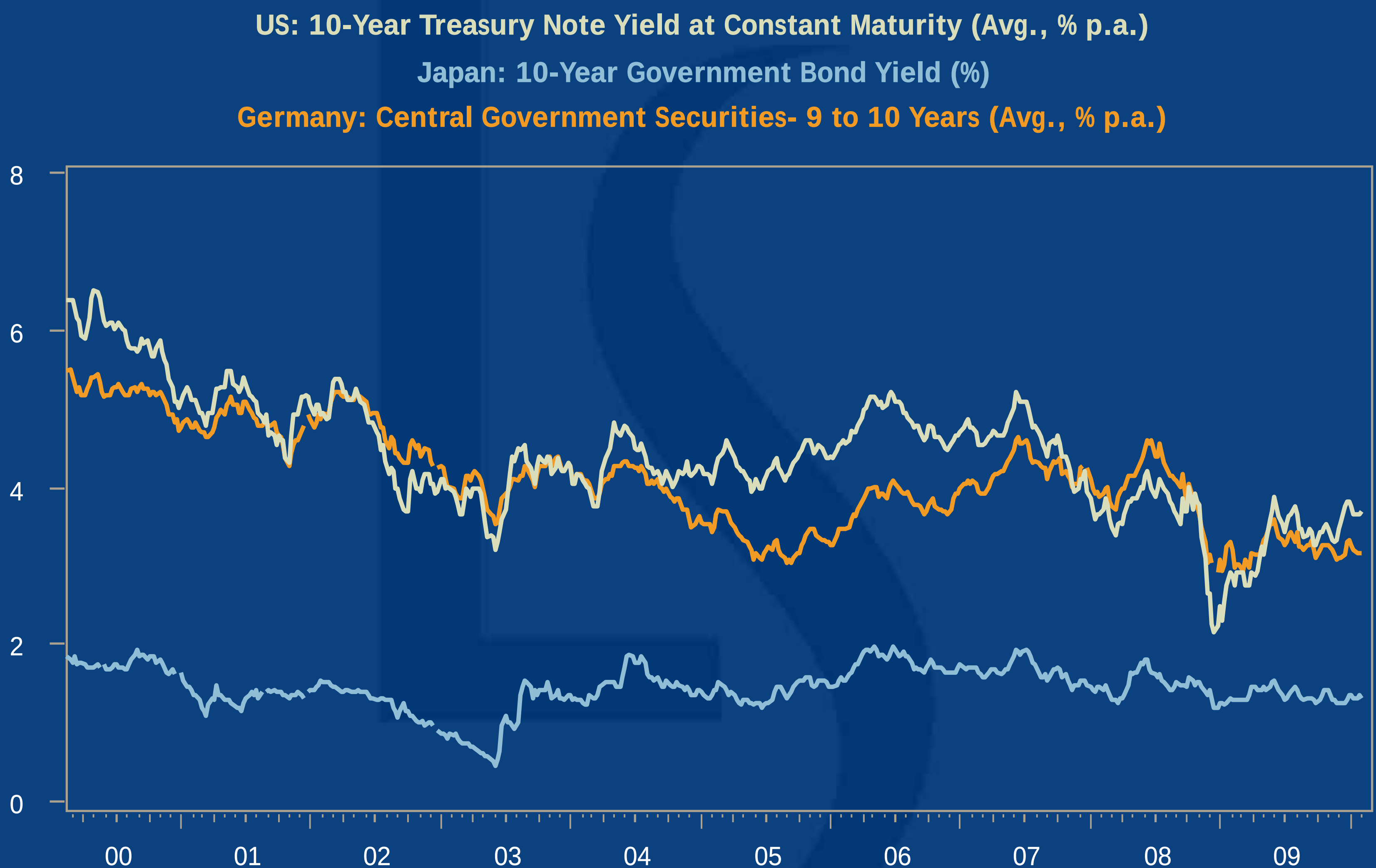
but G3 yields are little changed



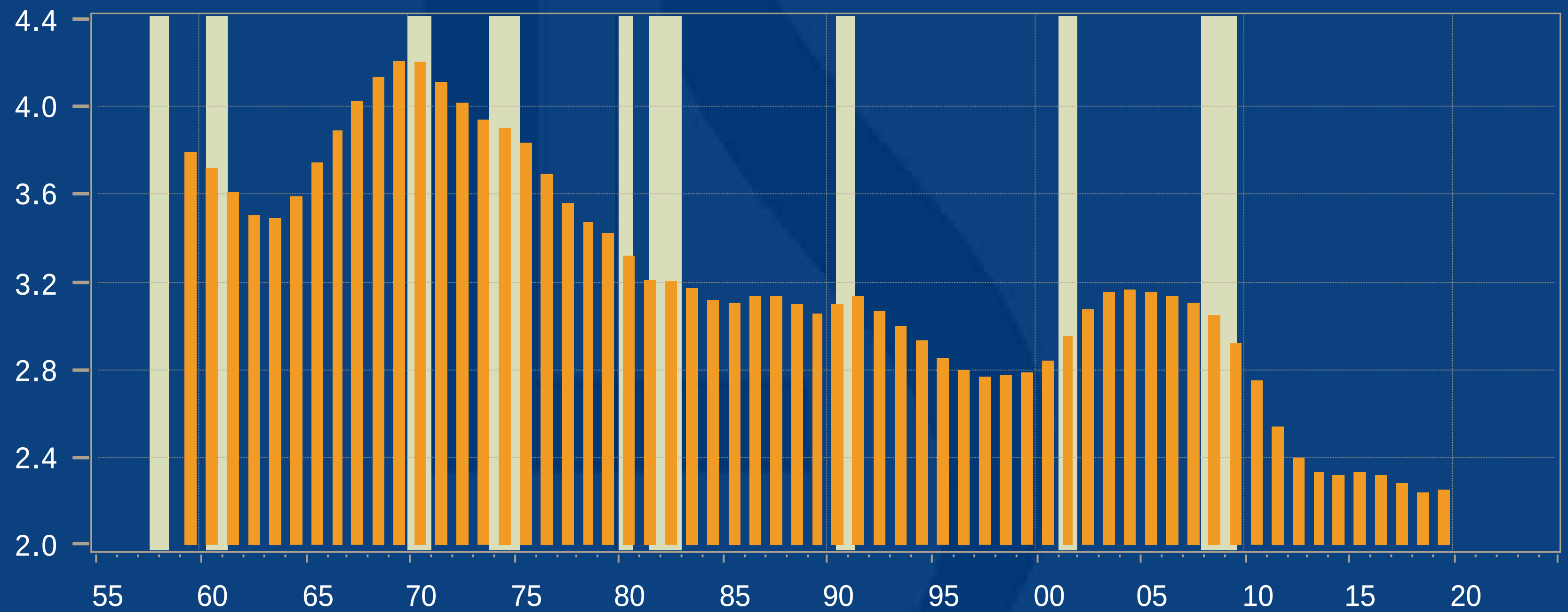
Source: FRB, FT, Bbk/Haver.

demographic headwind

- US working age population to slow from aging, lower fertility & less immigration
- Potential real GDP growth estimated to slow from 2.9% in 2000s to 2.2% in 2010s

Real Potential Gross Domestic Product (CBO)

10-year % Change (Annual)
Bil. Chn. 2000 $



Source: Congressional Budget Office/Haver Analytics, 1/14/2010.

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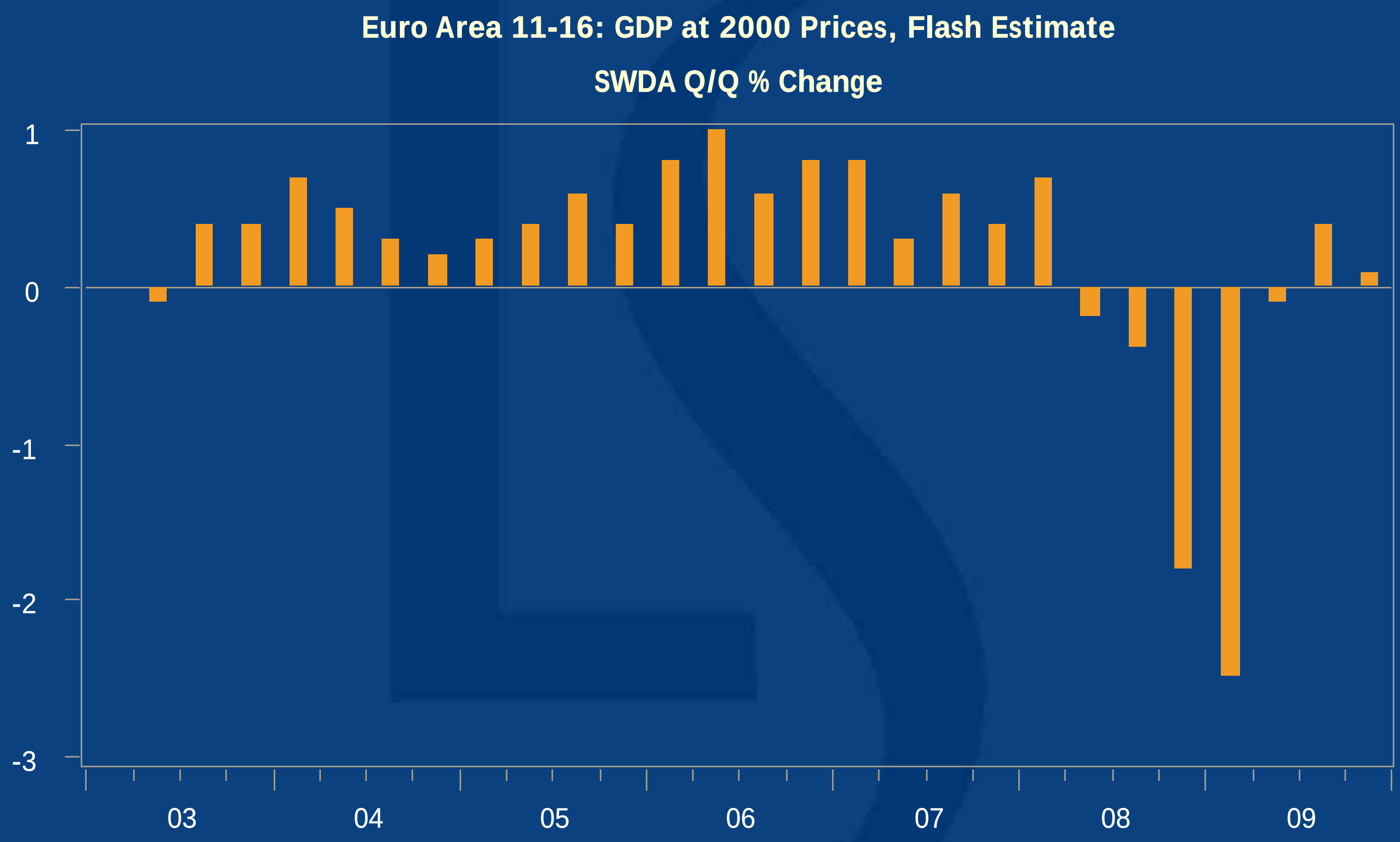
trade headwind: eurozone GDP slowed in Q4



Source: Statistical Office of the European Communities, Haver Analytics.

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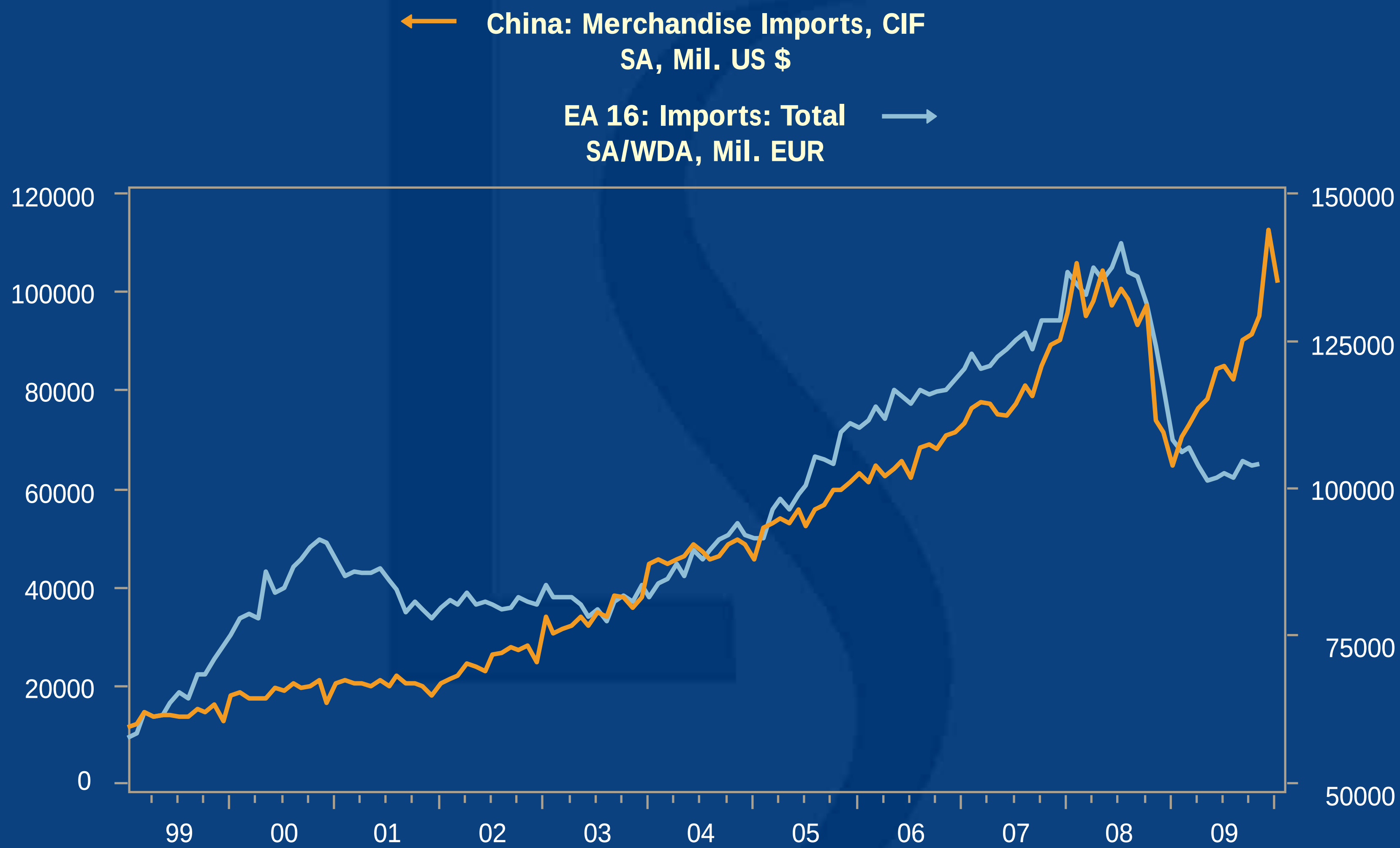
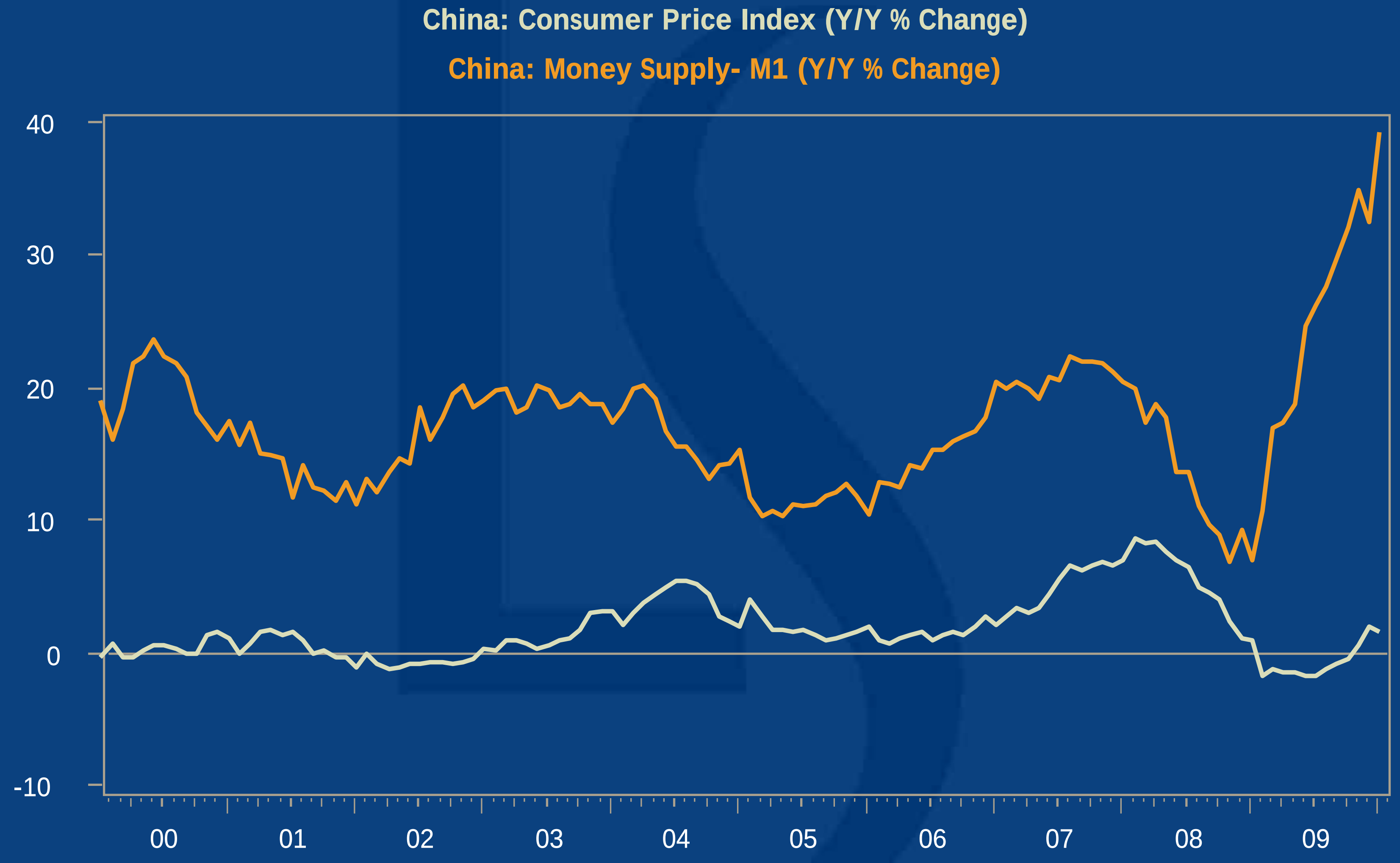
china's imports are growing, europe's are not



Source: CC, Eurostat/Haver.

is china's 39% M1 growth an inflation risk?



Source: CNBS, PBC/Haver.

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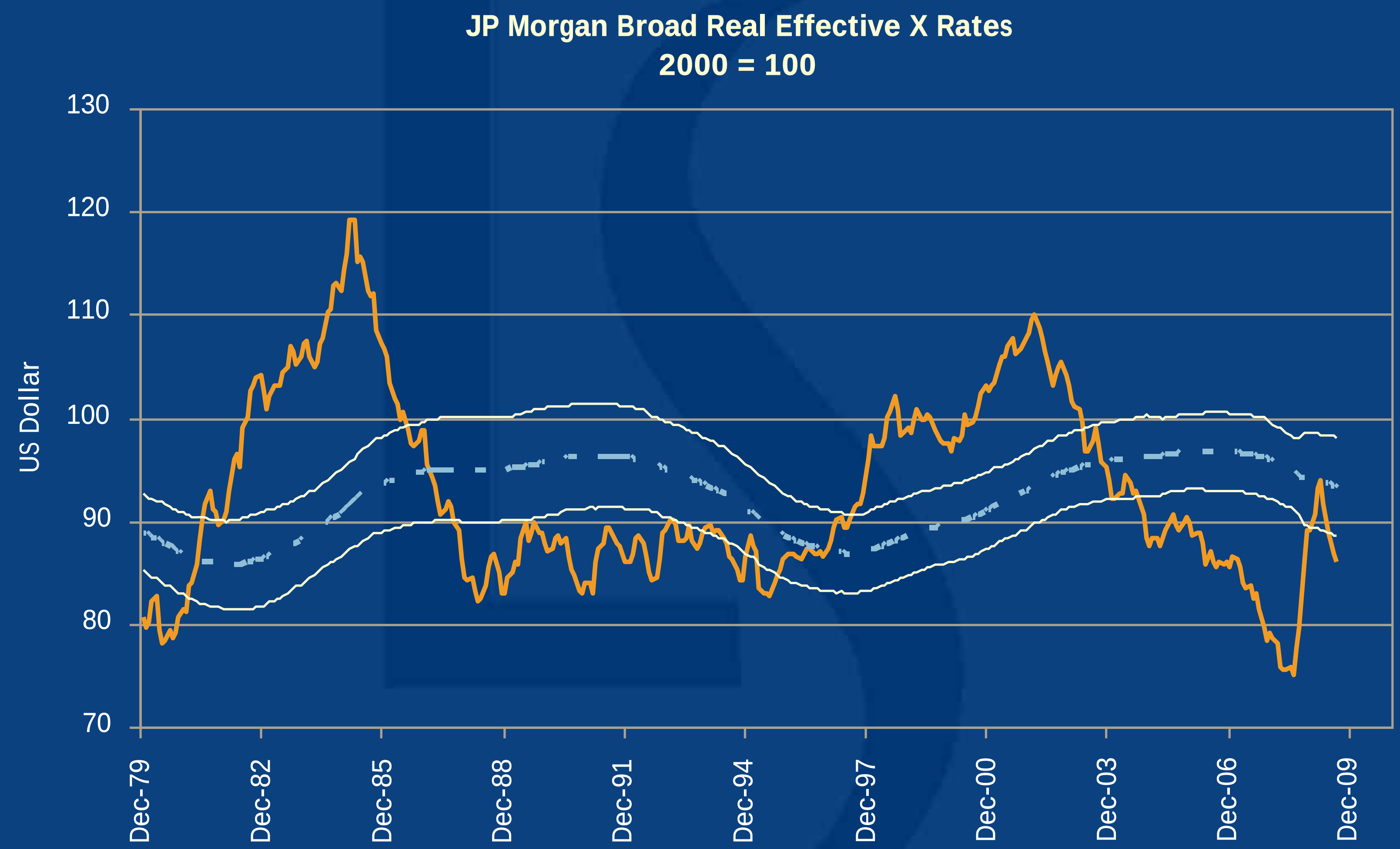
US dollar remains vulnerable to sentiment, carry



Source: JP Morgan; monthly data ended 8/31/2009.

the weak dollar thesis

- US growth will require positive net trade to replace the consumer
  - Dollar weakness is more export-friendly
- Higher oil and metals, weaker finance implies adverse us terms of trade
- US dollar is now a funding currency
  - Delayed tightening from the fed to foster global rebound
- Asian currencies will need to appreciate
- Commodity and EM currencies may be pulled along

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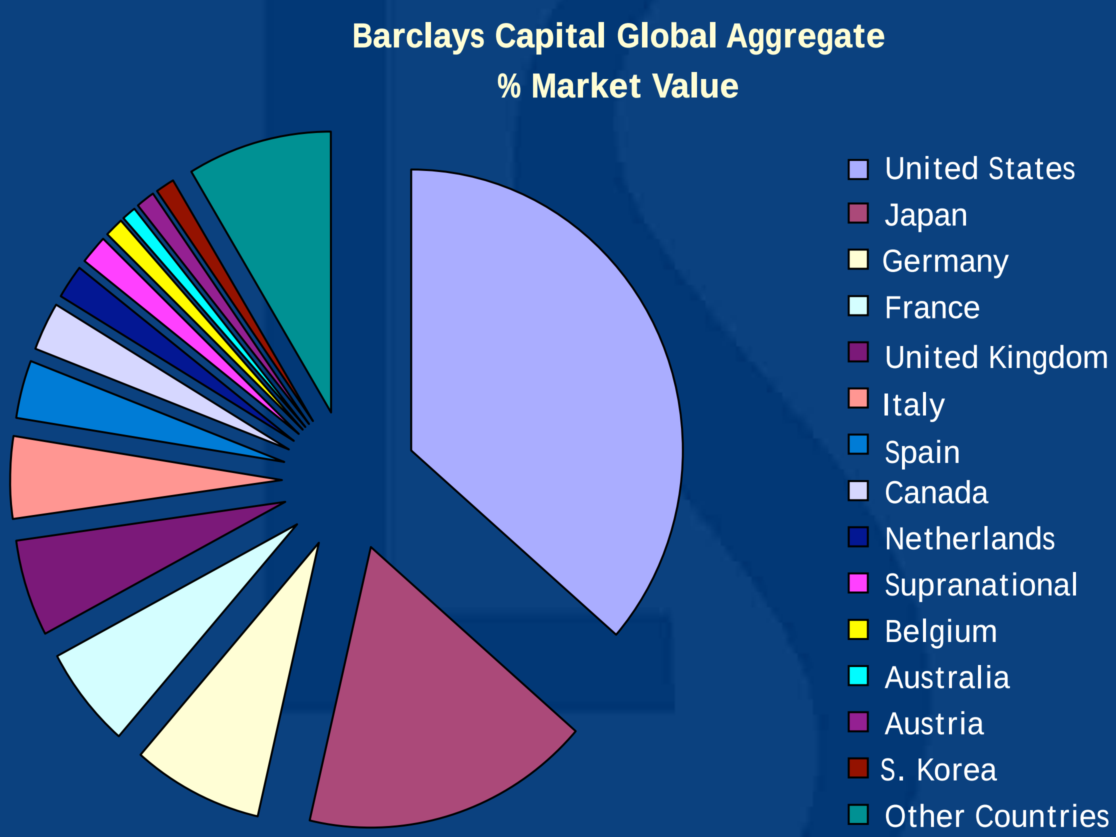
consider an expanded opportunity set: US is less than 40% of the global bond market



Source: Barclays Capital, as of 12/31/2009.

compelling correlations: BGA & BGA Ex-US are weakly correlated to both S&P500 and MSCI EAFE

January 2000 - December 2009	Barclays Global Aggregate Ex-US Index	Barclays Global Aggregate Index
Barclays Global Aggregate Ex-US	1.00	0.98
Barclays Global Aggregate	0.98	1.00
Barclays US-Only Aggregate	0.60	0.75
Barclays US Govt/Credit	0.60	0.75
Barclays US Corp High Yield	0.21	0.22
JPMorgan Emerging Mkt Debt	0.37	0.43
MSCI EAFE	0.39	0.34
S&P 500	0.17	0.14

Source: Zephyr, data from January 2000-December 2009

questions & answers

thank you for attending

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