



V I E W P O I N T

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Investment Themes for a Slow-Growth Economy

The Argus Economics Department has once again lowered its GDP estimates for 2H11 and 1H12, based on stubbornly high unemployment (which is curtailing consumer spending) and expectations of stable-to-lower government spending (given the finances of the U.S. Treasury as well as states and municipalities). Our new forecasts for this period range from 1.7%-2.3%, and average 2.0% — well below the “normal” U.S. GDP growth-rate trend of 3.0%.

Importantly, our estimates do not call for a recession through 2012. We believe there are enough positive signs among key economic indicators to keep the economy on a positive growth track.

Difficult Reading

The Commerce Department has released its second reading of 2Q11 GDP, lowering its estimate of growth to 1.0% from 1.3%. With this revision, the U.S. economy advanced on average 0.7% for the first two quarters of 2011 (please see GDP Table on Page 3). Like it or not, the economy appears to be in a Japan-style long-term slowdown. Consider:

- For the four-year period 2007-2010, real GDP decreased at an average annual rate of 0.3%;
- From the fourth quarter of 2007 to the first quarter of 2011, real GDP decreased at an annual rate of 0.2%.

But we have seen worse. According to the latest revisions, the U.S. economy actually contracted a stunning 8.9% in 4Q08.

In the first half of 2011, growth stalled in personal consumption and government spending turned negative. In addition,

despite a weak dollar, imports to the U.S. advanced — offsetting export growth and reducing GDP. On the positive side, investments in technology spending remained on the upswing, exports increased and the housing market ticked higher.

Looking Ahead

Based on the trends in consumer and government spending — which are two key drivers in a post-recession economy — we have trimmed our estimates for 2H11 (see Chart 1). Previously, we had anticipated below-trend growth of 2.0%-2.5% — but now we are expecting even slower growth of 2.0%.

Here are our key assumptions:

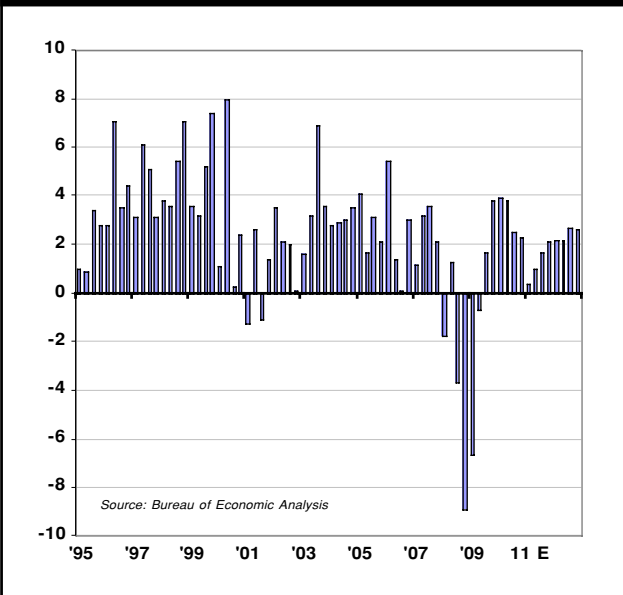
- We look for high unemployment to have a negative impact on Consumer Confidence and, more importantly, Personal Consumption Expenditures. This component of GDP accounts for almost 70% of the economy. Our estimates call for growth of 1%-2% through 1H12.
- As companies continue to refrain from hiring, we anticipate that spending on technology, which drives productivity, will grow at a 5%-8% rate (see Chart 2).
- A low sales-to-inventory ratio implies that companies will continue to invest in inventories, and the Industrial sector will continue to grow. We anticipate that this will provide a boost to the economy in each of the next four quarters.

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VIEWPOINT

TABLE 1

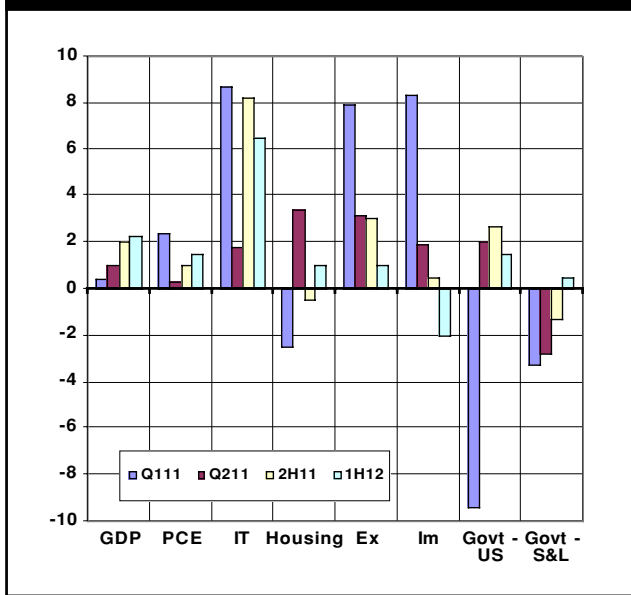
REAL GDP



We anticipate that a constrained consumer will keep U.S. economic growth well below the “normal” rate of 3.0% through 2012.

TABLE 2

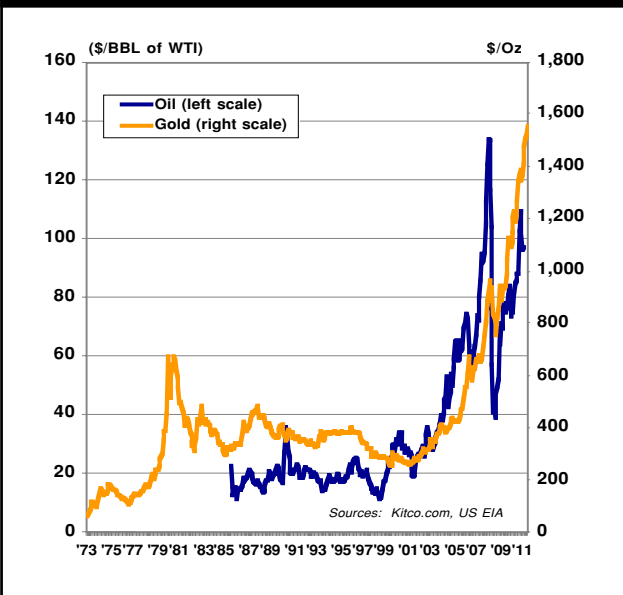
GDP GROWTH DRIVERS



Information Technology and Exports are expected to keep the economy growing.

TABLE 3

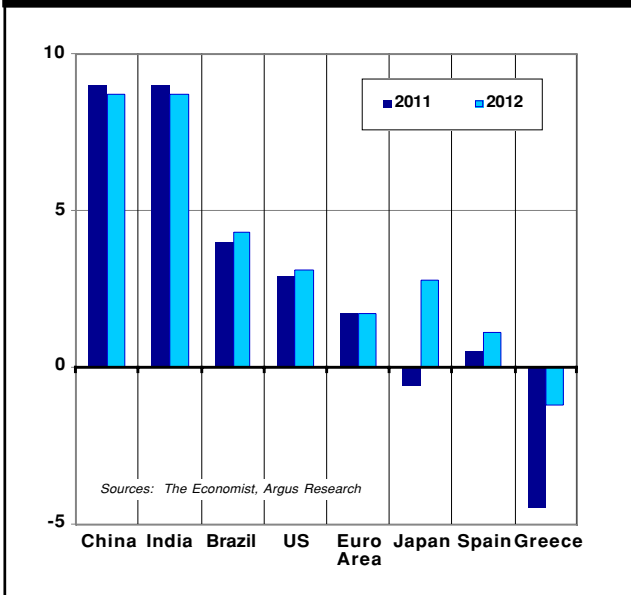
OIL & GOLD TRENDS



A weak dollar is expected to boost commodity prices.

TABLE 4

GLOBAL GDP FORECAST (RATES OF Y/Y GROWTH)



We look for global growth to remain steady for most trading partners, though Europe will likely lag as the Euro-nations work to resolve their sovereign debt problems.

GDP FORECAST

Revised as of August 29, 2011

	2009 A				2010				2011 E				2012 E			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Real Gross Domestic Product	-6.7	-0.7	1.7	3.8	3.9	3.8	2.5	2.3	0.4	1.0	1.7	2.3	1.8	2.3	2.7	2.6
Annual:				-0.5				3.1								2.3
Personal Consumption	0.6	-0.9	2.2	1.9	1.9	2.8	2.8	3.9	2.4	0.3	0.5	1.5	2.4	0.8	1.1	1.1
Goods	2.5	-3.1	7.2	2.9	5.7	3.4	5.1	8.9	5.3	-1.7	0.9	3.2	1.7	1.0	1.8	1.8
Durables	3.9	-5.6	20.4	0.4	8.8	7.8	8.8	17.2	11.8	-5.1	2.5	6.1	1.4	0.9	3.1	3.1
Non-Durables	1.9	-1.9	0.0	5.6	4.2	1.9	3.0	4.3	1.6	0.4	-0.1	1.5	1.9	1.0	1.0	1.0
Services	-0.3	0.2	0.8	1.0	0.1	2.5	1.6	1.3	0.8	1.4	0.3	0.5	2.7	0.7	0.7	0.7
Gross Domestic Investment	-50.5	-23.7	-7.0	66.1	29.1	26.8	9.0	-5.3	4.5	6.1	-0.3	5.5	3.8	9.0	6.6	5.4
Fixed Investment	-39.0	-12.5	-14.4	20.2	3.3	22.8	2.4	7.4	2.0	8.4	4.4	5.6	5.0	6.8	6.7	5.5
Non-Residential	-39.2	-9.6	-8.5	6.7	7.8	21.9	11.8	8.6	3.0	9.5	5.9	6.8	5.9	7.0	8.2	6.7
Structures	-43.6	-17.3	-18.4	-18.1	-17.8	7.4	4.2	10.6	-14.4	15.8	-1.7	1.9	6.2	6.3	0.0	6.2
Equip. & Software	-36.4	-4.9	1.5	19.0	20.4	23.2	14.2	8.0	8.7	7.8	8.2	8.2	5.8	7.1	10.7	6.8
Residential	-38.2	-23.2	18.9	3.7	-12.3	22.8	-27.7	2.5	-2.5	3.4	-1.9	0.4	1.2	6.3	0.0	0.0
Change in Pvt. Inventories (\$BIL)	-113.9	-160.2	-139.2	-19.7	44.1	68.8	92.3	38.3	49.1	40.6	20.3	20.3	30.0	40.0	40.0	40.0
Net Exports																
Exports	-29.9	-4.1	8.4	-2.5	11.4	10.0	10.0	7.8	7.9	3.1	4.3	1.4	0.7	1.6	1.6	1.8
Goods	-36.9	-6.3	17.5	23.1	14.0	11.8	9.0	9.2	10.6	2.7	4.7	0.7	0.8	0.6	0.6	0.9
Services	-13.6	0.2	24.6	34.1	5.8	6.1	12.5	4.7	1.7	3.9	3.1	3.4	0.4	3.8	3.8	3.8
Imports	-36.4	-14.7	5.6	2.7	11.2	21.7	12.3	-2.3	8.3	1.9	2.5	-0.8	-0.9	-3.6	-3.6	-7.2
Goods	-41.0	-16.5	21.2	16.1	12.0	26.0	12.4	-0.5	9.6	1.9	2.1	-0.8	-0.7	-4.3	-4.3	-8.6
Services	-11.5	-7.5	25.1	20.6	7.8	3.2	11.6	-10.4	2.2	1.6	4.6	-0.7	-2.0	0.0	0.0	0.0
Gov't Purch. of Goods & Svcs.																
Federal	-2.6	6.7	3.2	-1.3	-1.6	3.8	1.0	-2.8	-5.9	-0.8	-0.3	1.0	1.0	0.8	1.0	0.3
National Defense	-4.3	11.4	7.9	0.1	1.8	8.8	3.1	-3.0	-9.4	2.0	4.3	1.0	1.0	1.9	2.2	0.7
Non-Defense	-5.1	14.0	8.4	-3.6	0.4	6.0	5.7	-5.9	-12.6	7.1	3.2	1.6	0.3	1.7	2.2	0.0
State & Local	-2.4	6.1	7.0	8.3	5.0	14.6	-1.8	3.0	-2.7	-7.5	6.7	-0.3	2.2	2.2	2.2	2.2
	-1.6	3.9	-0.6	-2.2	-3.8	0.4	-0.5	-2.7	-3.3	-2.8	-3.5	0.9	1.0	0.0	0.0	0.0
Addendum:																
GDP Price Deflator (Implicit)	1.0	0.3	0.7	-0.3	1.1	1.6	1.6	1.9	1.8	2.0	2.1	2.1	1.8	2.0	2.0	2.0

(continued from page 1)

- The \$320 billion U.S. housing industry has been flat-to-lower in recent quarters, and we expect stability (if not 1%-2% growth) into next year.
- A weak dollar – courtesy of the dismal financial condition of the U.S. government – should make U.S. goods, including commodities, more attractively priced in global markets (see Chart 3). We anticipate mid-single-digit growth on average in exports over the next three-to-four quarters, as foreign economies continue to grow (see Chart 4).
- Federal government spending rose at a 2.1% pace in 2Q, after having declined for the previous two quarters. Heading into an election year, we anticipate low-single-digit growth, despite the heated rhetoric from both parties about spending cuts.
- State & local government spending dropped 2.8% in 2Q, and has declined in seven of the past eight quarters. This is an important support of the economy – particularly in the early quarters after a recession – that is (and will likely remain) missing in action.

Positive Signals

We mentioned earlier that we see enough positive momentum in the economy to conclude that the risk of recession in the next few quarters is low. Here are some of the factors we are following:

- **Money Supply.** The monetary base, M1 and MZM, are all on the upswing. Based on our conversations with Federal Reserve officials and our reading of Fed speeches, we think the central bank remains poised to take action to keep the U.S. out of a long-term period of deflation.

- **Unemployment Claims.** A year ago, claims totaled 467,000 per week and were rising. In a recent week, claims were below 410,000. While the current level of claims is still higher than we would like to see, we think it is consistent with jobs growth, on average, of 75,000-125,000 per month.
- **Industrial Prices.** The CRB Raw Industrials and CRB Metals Spot Indices have been trending sharply higher over the past six months. These increases suggest that emerging market demand may be poised to recover from a period during which high interest rates in India and China have caused concern among investors and economists that growth in these regions has slowed.
- **Commercial Credit.** Over the past six months, C&I business loans, non-financial commercial paper and the Loans Plus indicator have been trending higher. A year ago, when the U.S. economy also endured a soft patch, these measures were pointed downward.

At the same time, of course, there are risks that our forecasts may be too optimistic. The biggest risk, in our view, is that foreign governments and investors decide the U.S. dollar is too risky as a base currency and the greenback endures a free-fall. This would lead to higher U.S. bond yields — which would provide a further headwind to stocks.

The ongoing debate in Washington, DC, also has important implications for the economy. The recent S&P credit rating downgrade hasn't yet led to higher interest rates for the U.S. government or for corporations at the low end of investment grade or below investment grade. But the downgrade has sapped confidence from purchasing managers and consumers. This confidence will need to be restored to lift economic growth rates back to normal.

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