

# PAPERS CONFERENCE

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presented by

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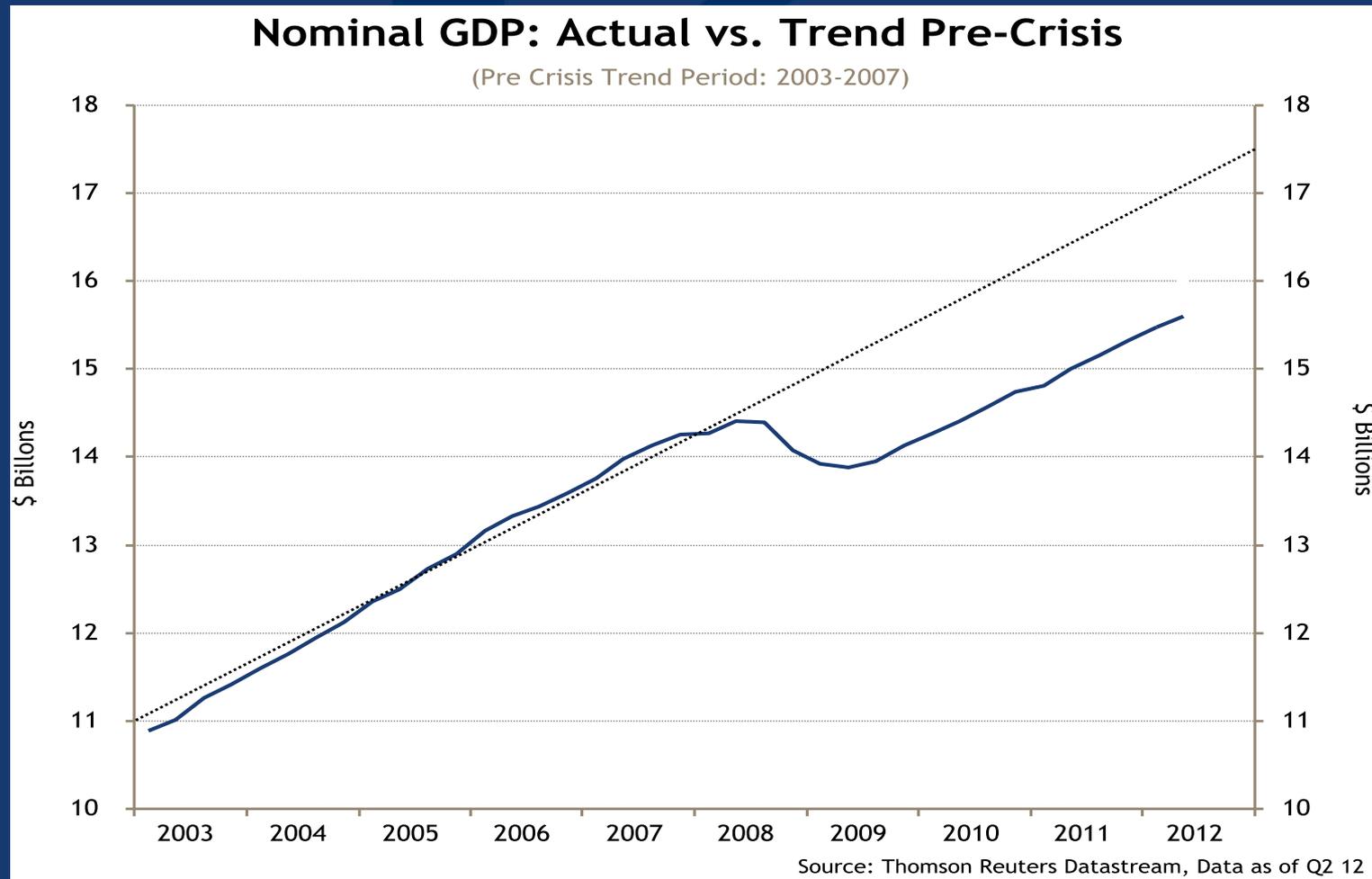
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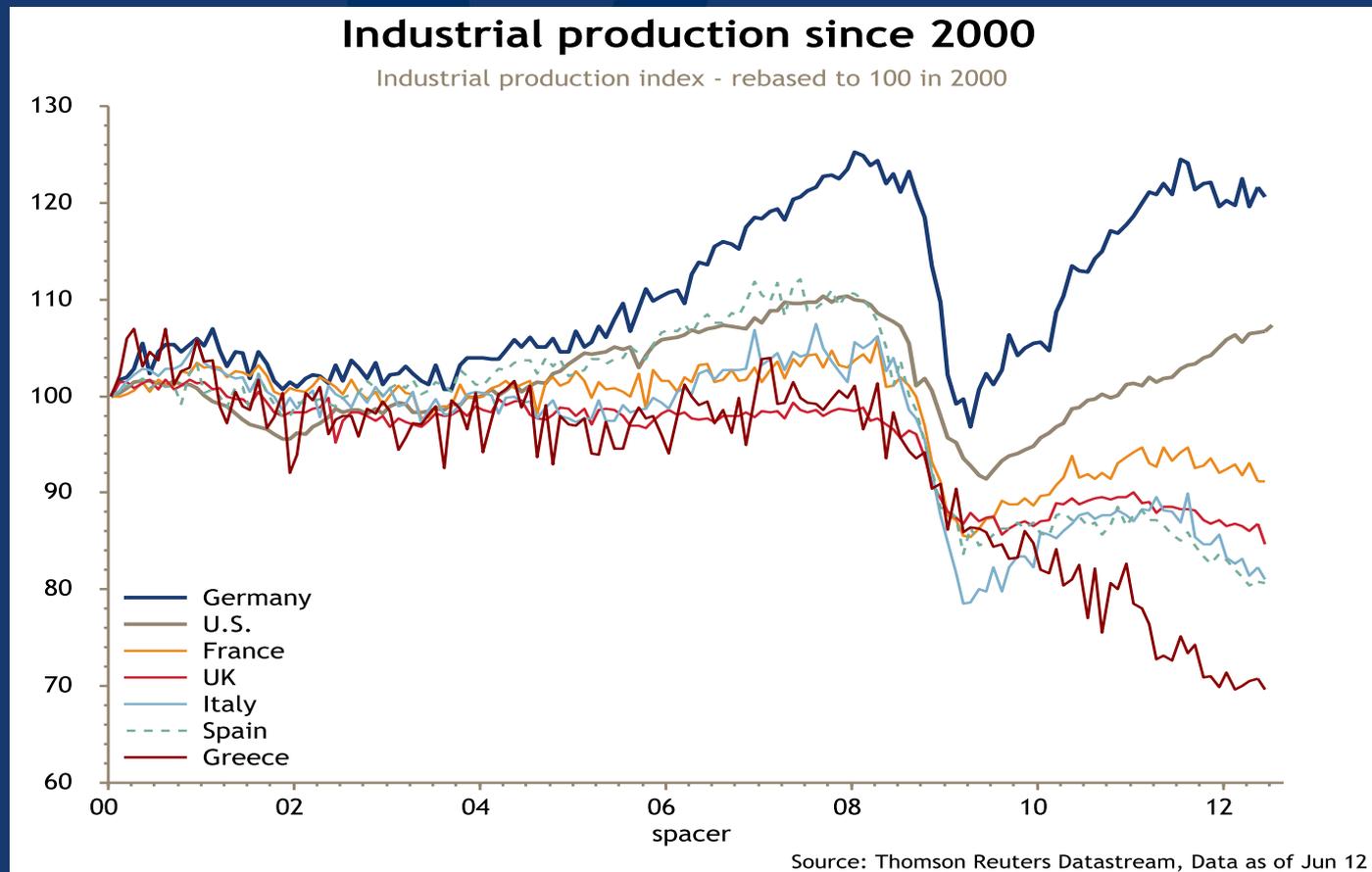
# ALMOST \$2 TRILLION BELOW TREND

THE US RECOVERY FEELS LOUSY BECAUSE WE ARE FAR BELOW TREND



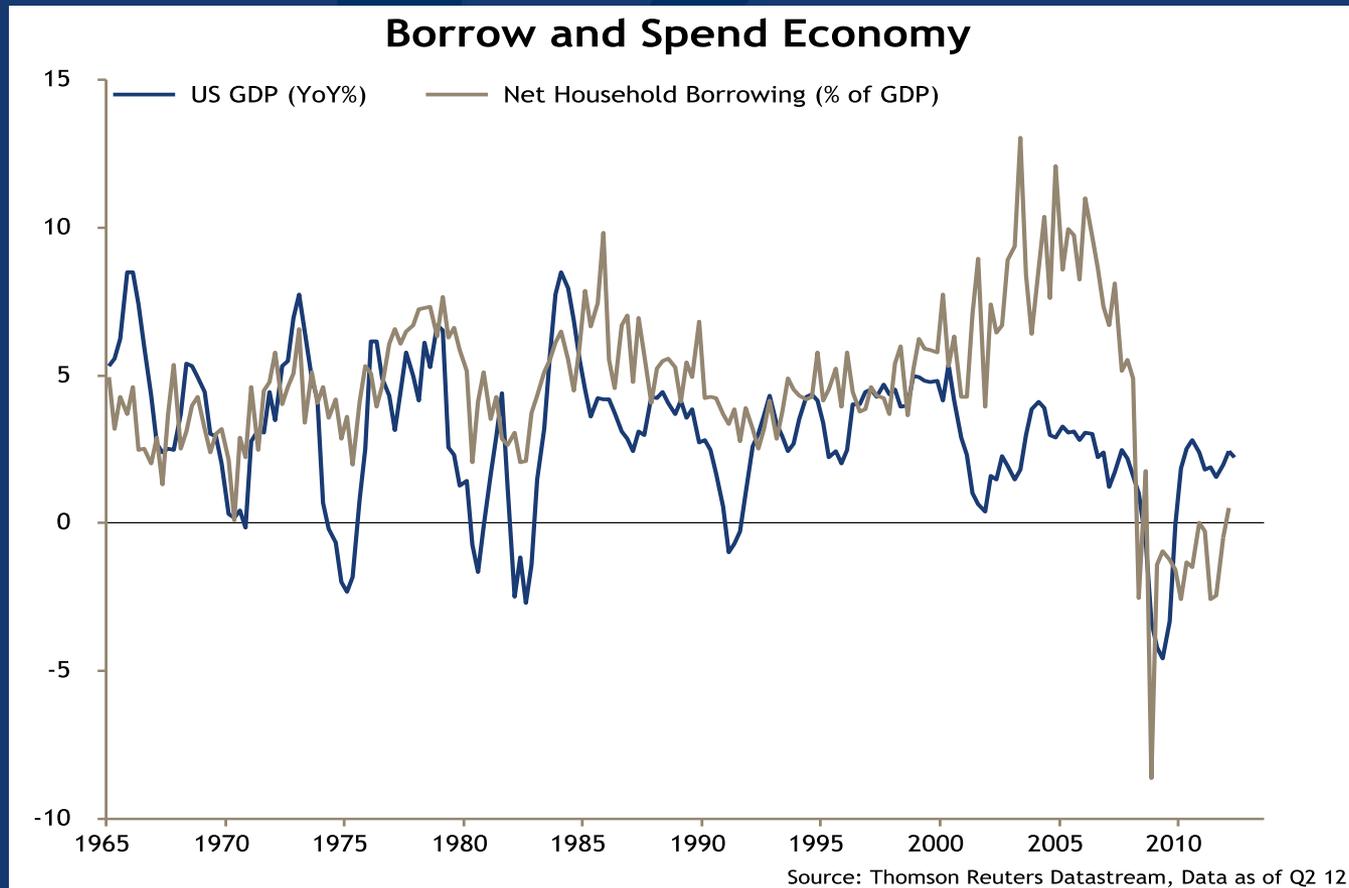
# EUROPE IS NOT DOING VERY WELL EITHER

EVEN THOUGH THE US IS HAVING A WEAK RECOVERY BASED ON THE PAST, THE US LOOKS GOOD COMPARED TO EURO AREA COUNTRIES



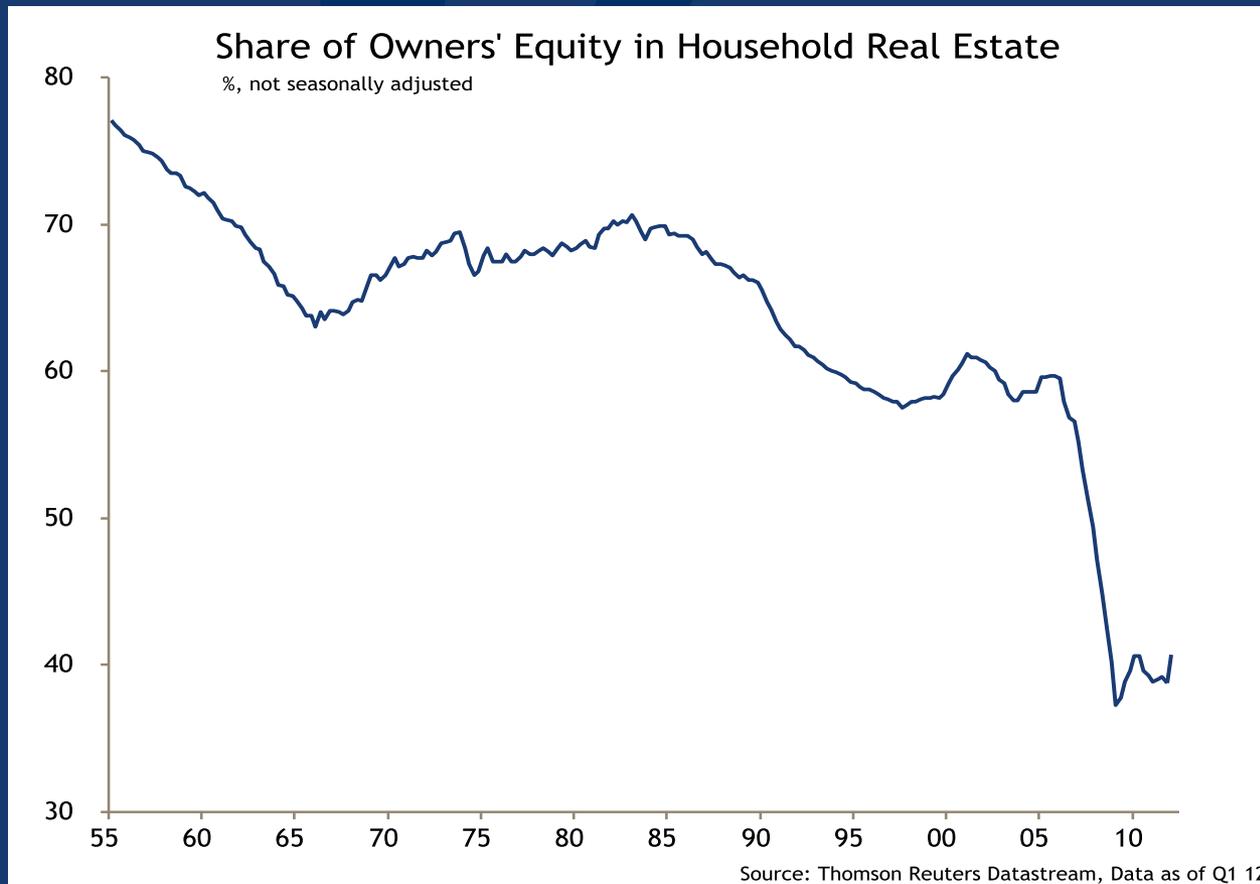
# ABILITY TO BORROW AND SPEND REMAINS IMPAIRED

THE US CONSUMER USED TO BE A GLOBAL GROWTH LOCOMOTIVE



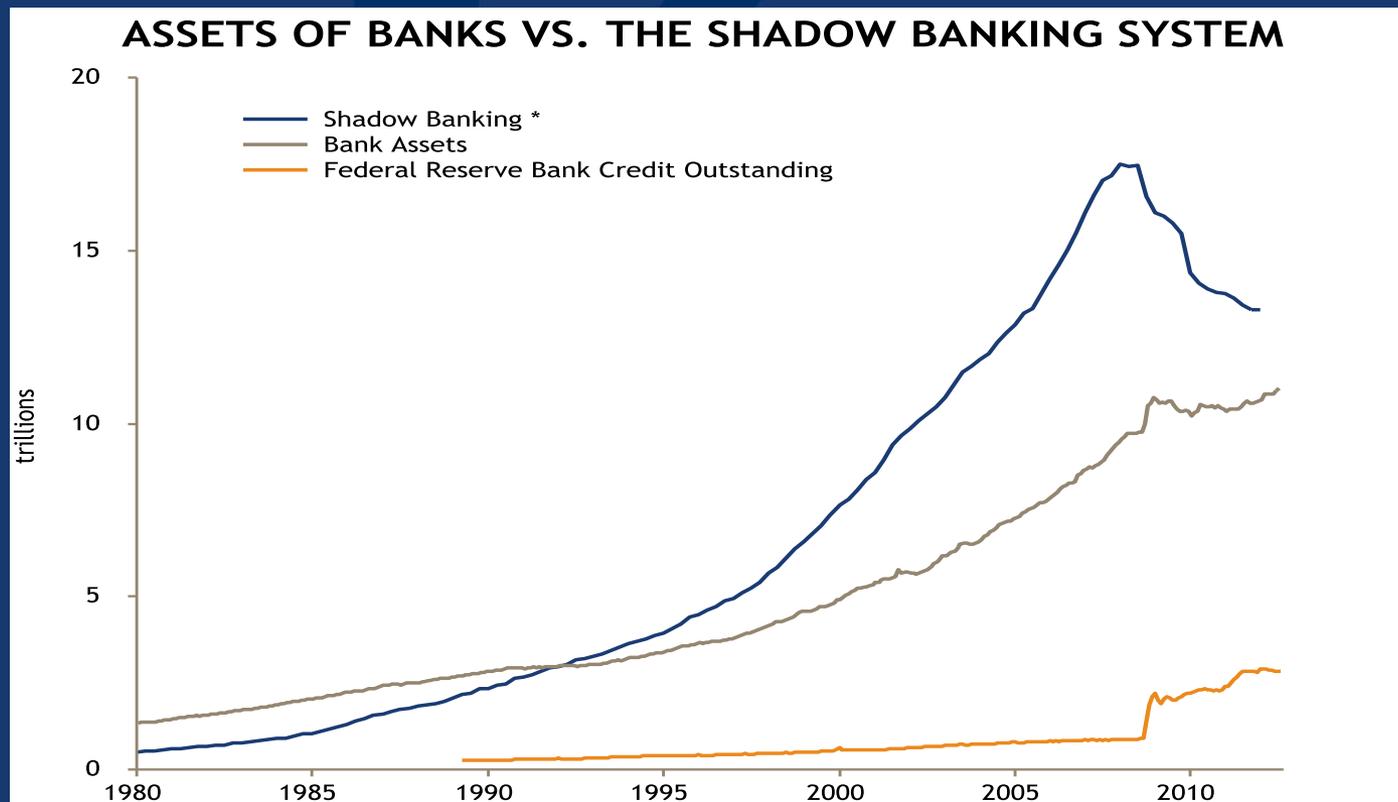
# NOT A LOT OF COLLATERAL LEFT

DROP IN HOME EQUITY DIMINISHES HOUSEHOLDS ABILITY TO BORROW AND SPEND



# PUMPING AIR IN A LEAKY BALLOON

## THE SHADOW BANKING SYSTEM HAS COLLAPSED



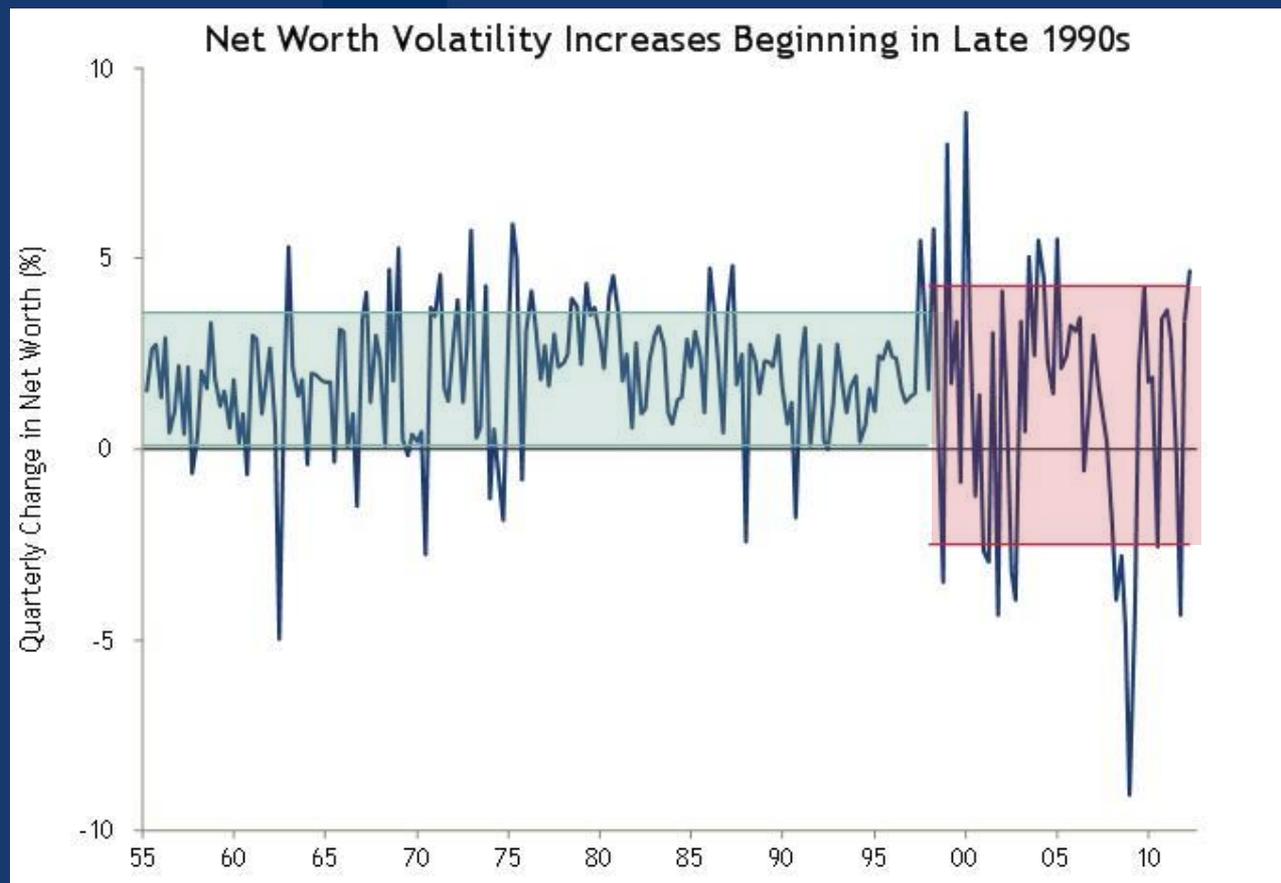
*\*Includes GSEs, mortgage pools, brokers and dealers, finance companies, ABS issuers.*

*Source: Thomson Reuters Datastream, data as of Q2 2012.*



# VOLATILITY OF NET WORTH

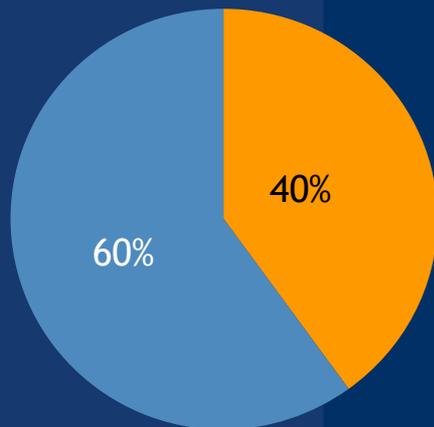
## HOUSEHOLDS MAY NOW UNDERSTAND THE MEANING OF RISK



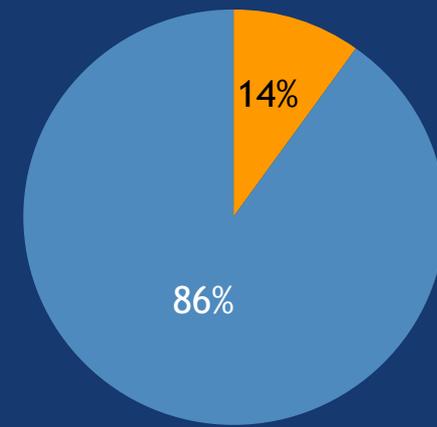
*Quarterly changes (%), bands mark  $\pm$  one standard deviation from the mean. All indexes are unmanaged and do not incur fees. You cannot invest directly in an index. Source: Thomson Reuters Datastream, Federal Reserve. Flow of Funds Balance Sheet: Households and Nonprofit Organizations. Net worth, data as of March 30, 2012. Net worth refers to the amount by which assets exceed liabilities. In the business context, net worth is also known as book value or shareholders' equity.*

# RISK PARITY - 60% EQUITY/40% BONDS $\approx$ 90% EQUITY RISK

Asset Allocation



Risk Allocation



	Allocation	Risk (volatility)	Contribution to Portfolio Risk
Stocks	60%	20%	86%
Bonds	40%	5%	14%
Portfolio	100%	14%	100%

Source: Loomis Sayles, as of 6/8/12. Simple calculation not including correlation. Illustration shows a traditional 60/40 asset allocation mix is comprised of about 90% equity risk. Because stocks (in general) are 4x more volatile than bonds, chart/calculation is used to show that the risk exposure under the traditional portfolio would be 90/10. This is not based on any particular index.

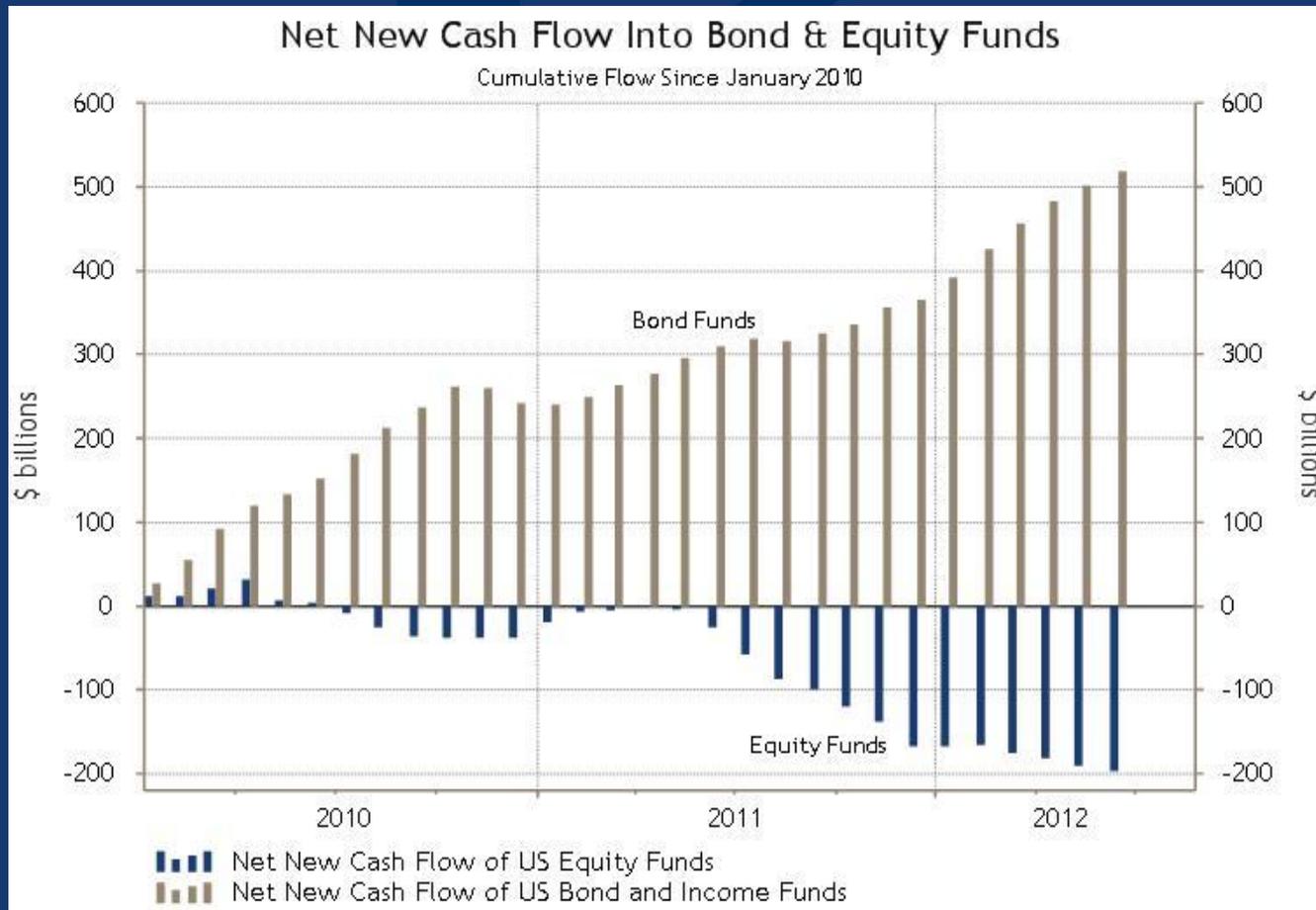
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# SEEKING FIXED INCOME

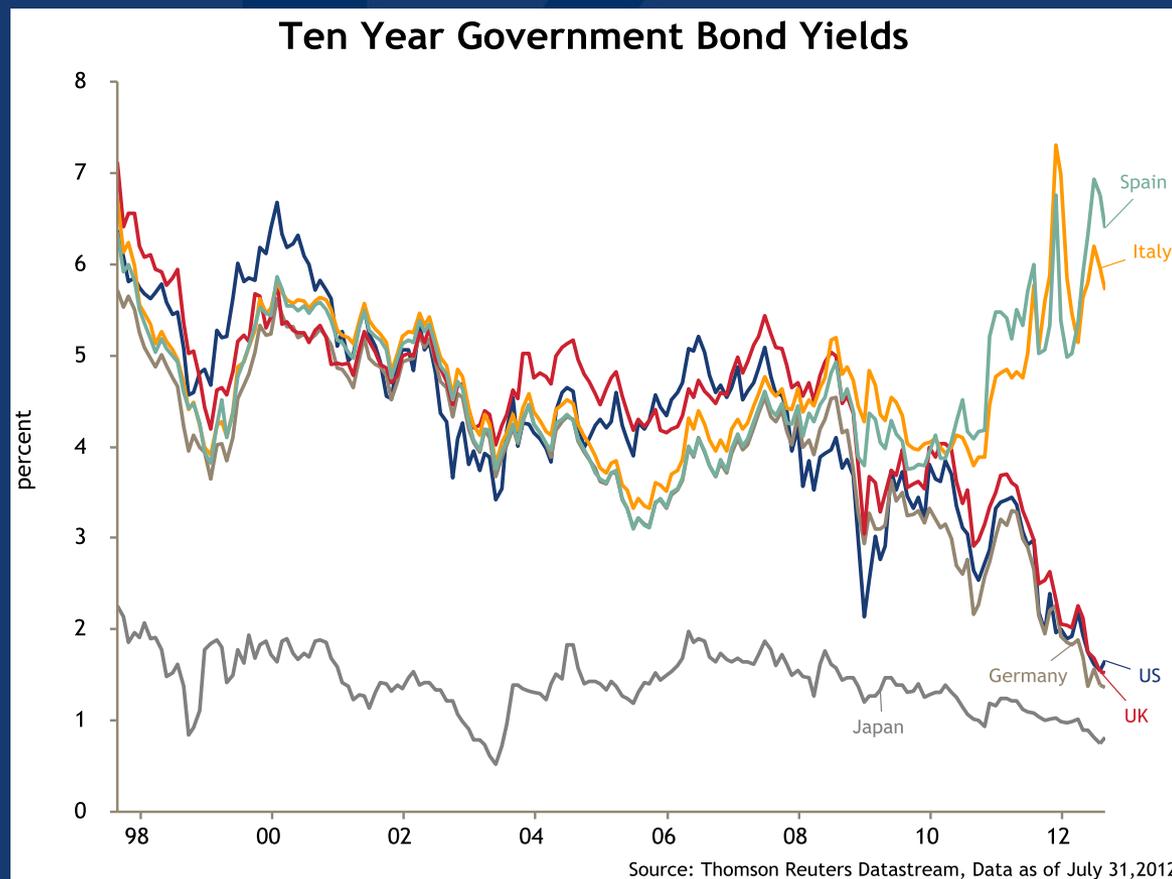
## PORTFOLIOS CONTINUE TO REBALANCE TOWARDS LESS RISKY ASSETS



Source: Thomson Reuters DATASTREAM, Investment Company Institute (ICI); net new cash flows into all equity and bond/fixed income mutual funds.  
Data as of June 15, 2012.

# THREE DIFFERENT STORIES IN GLOBAL FIXED INCOME

SOME CONVERGING TO JAPAN'S LEVEL OF YIELDS WHILE OTHERS ARE GROWING WIDER



*Past performance is no guarantee of future results.*



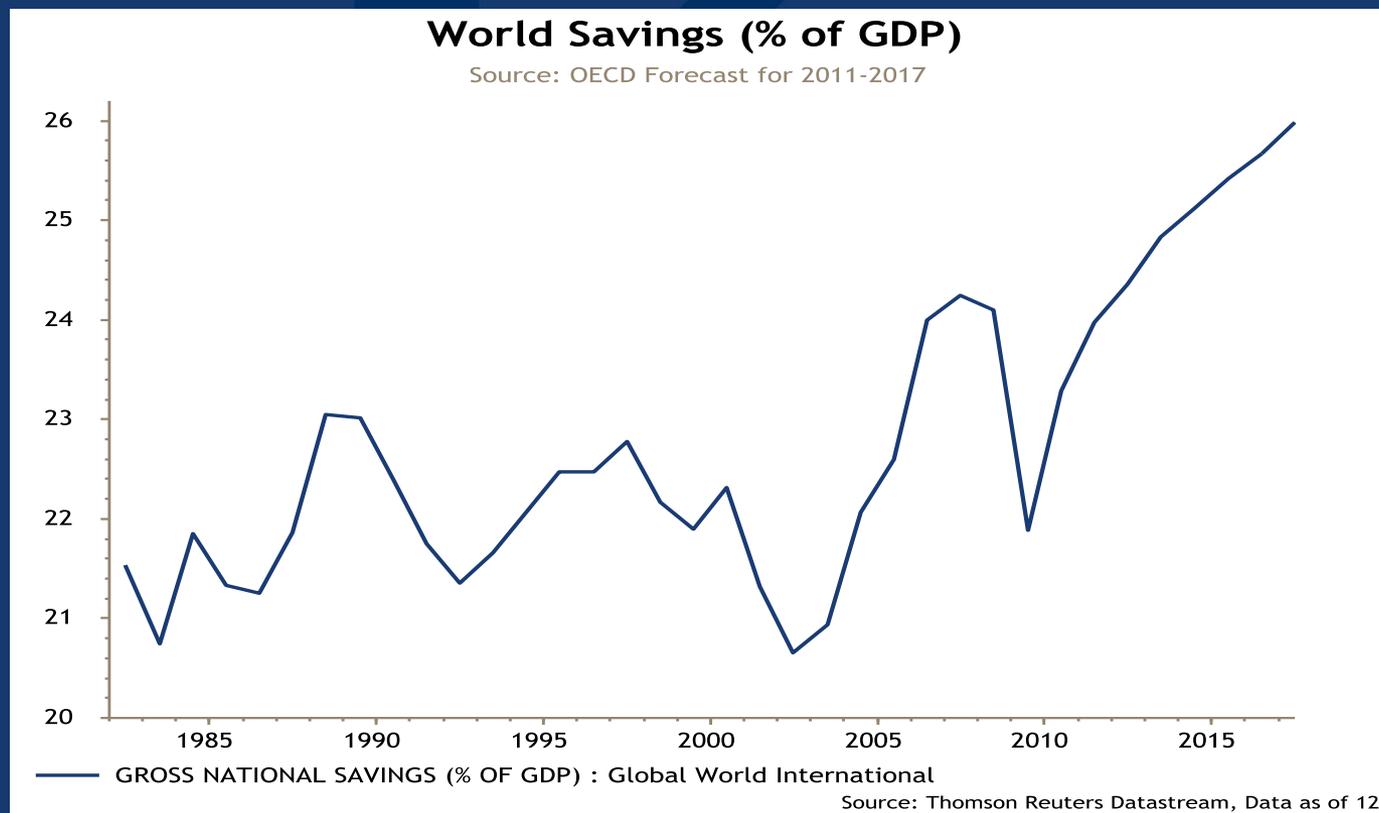
# INTEREST RATES EQUILIBRATE

INTEREST RATES ARE A FUNCTION OF SAVINGS & INVESTMENT BALANCE

$$r = f(S, I)$$

# THE GLOBAL SAVINGS GLUT

SAVINGS ARE A DRAIN ON DEMAND. FOR EVERY SAVER THERE MUST BE A BORROWER.

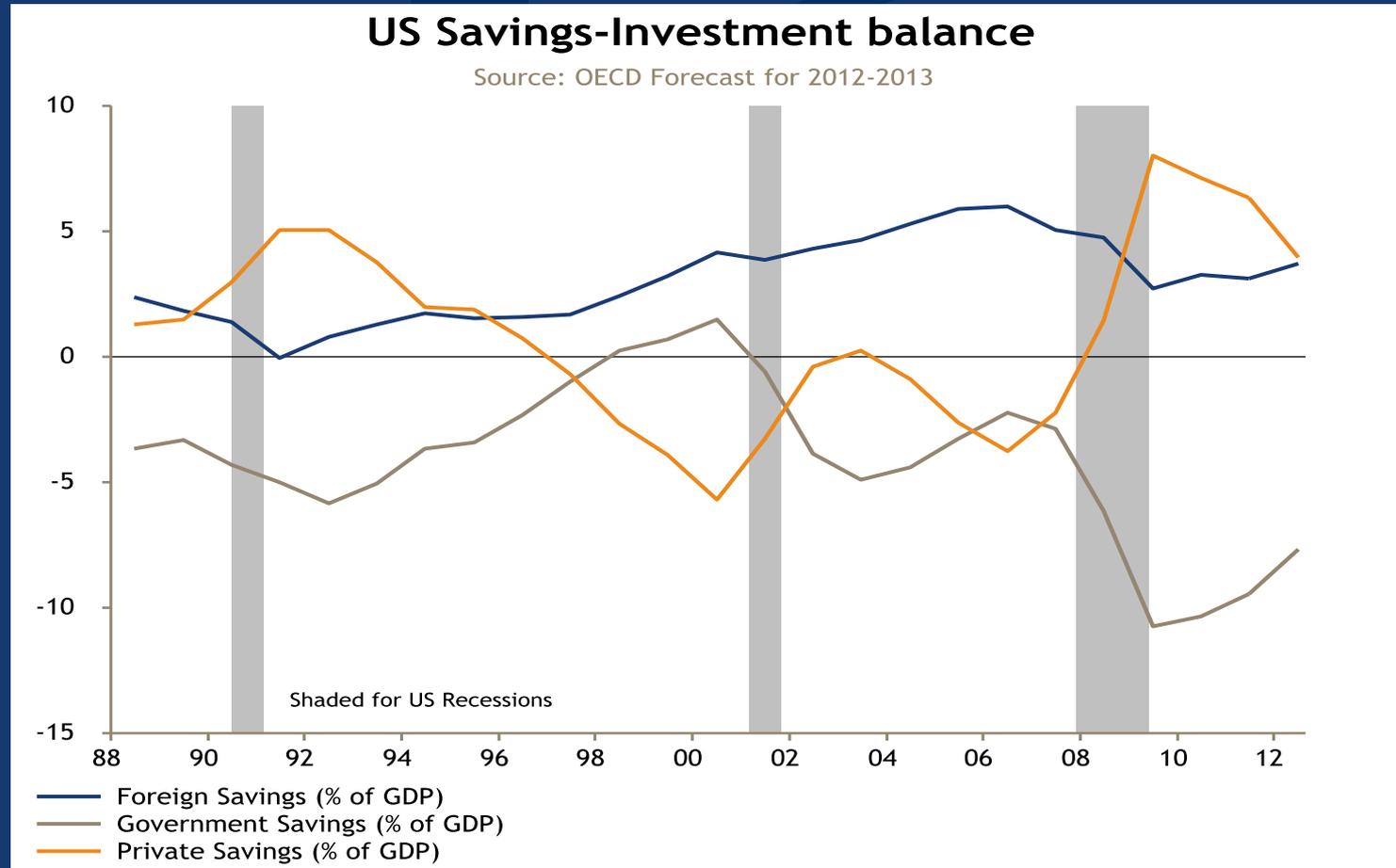


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# US PRIVATE SECTOR HAS SHIFTED TO SAVING

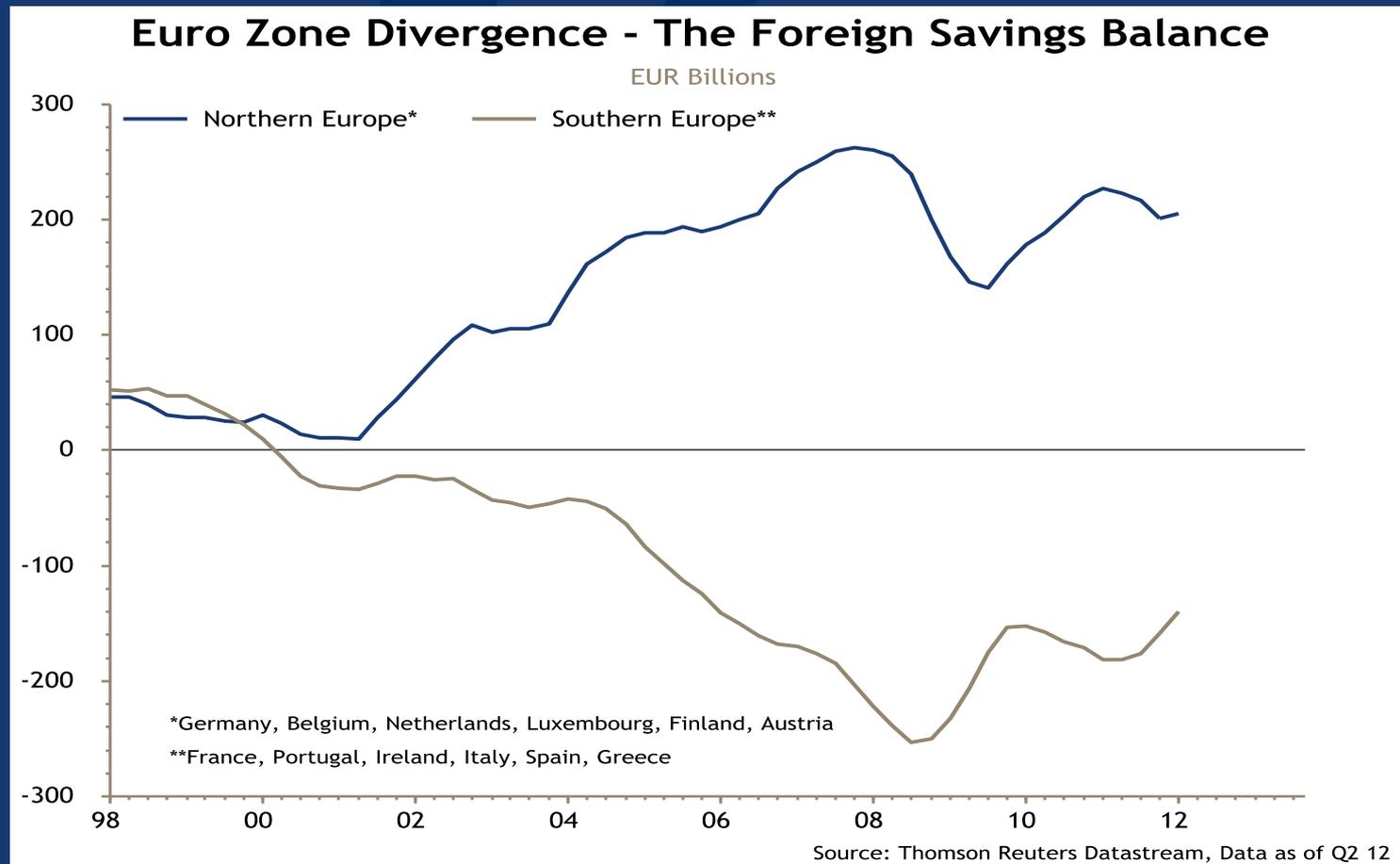
## WHAT SECTOR WILL BORROW AND SPEND?



Source: Thomson Reuters Datastream. Data as of August 28, 2012. Foreign Savings line represents the inverse of the US current account balance as a % of GDP. When US has a current account deficit, it is a net debtor to the rest of the world.

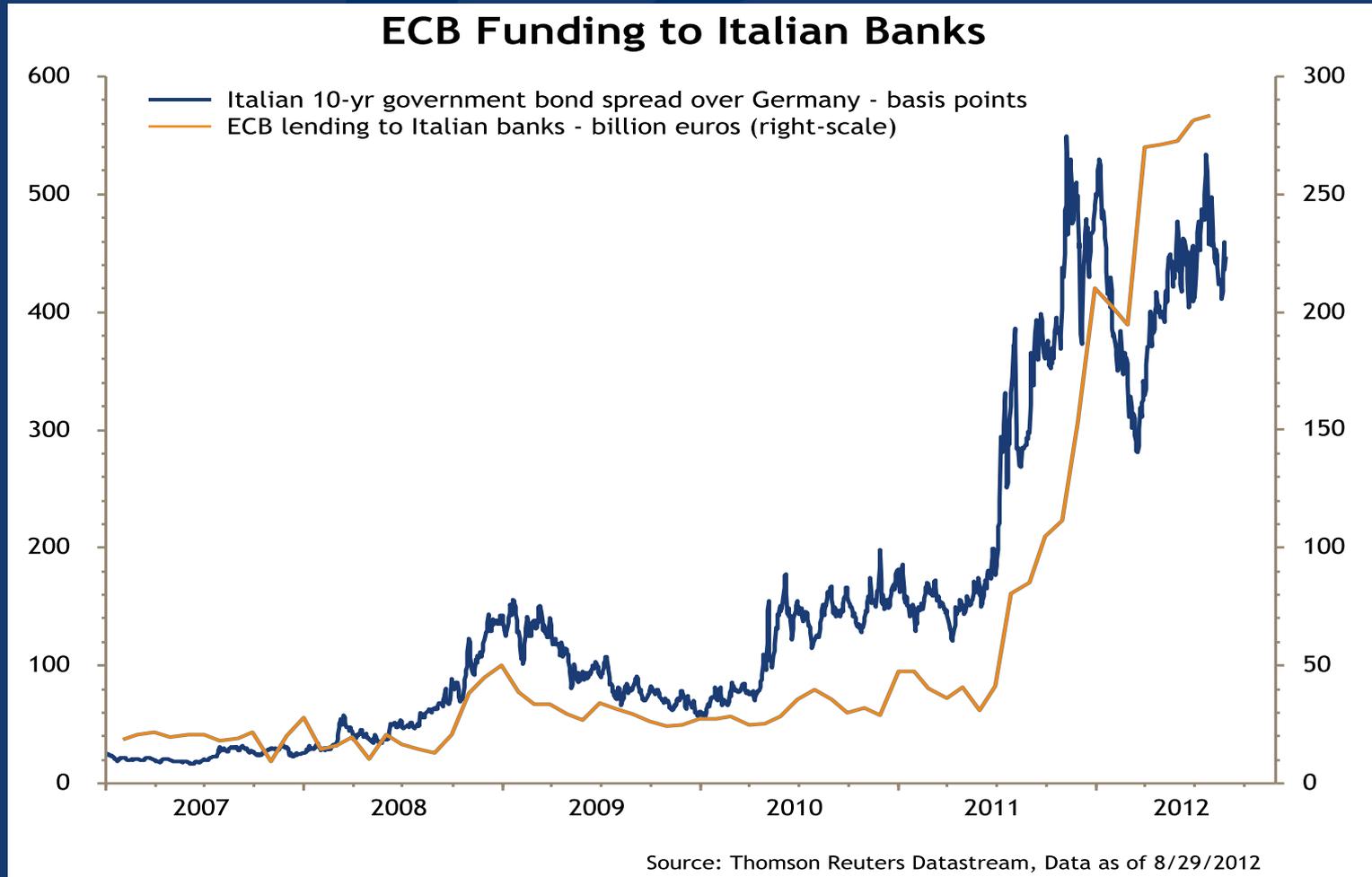
# NORTHERN SAVERS STOPPED LENDING

ONCE NORTHERN PRIVATE SECTOR SAVERS STOPPED LENDING, A FUNDING CRISIS OCCURRED AND PUBLIC INSTITUTIONS HAD TO START FUNDING



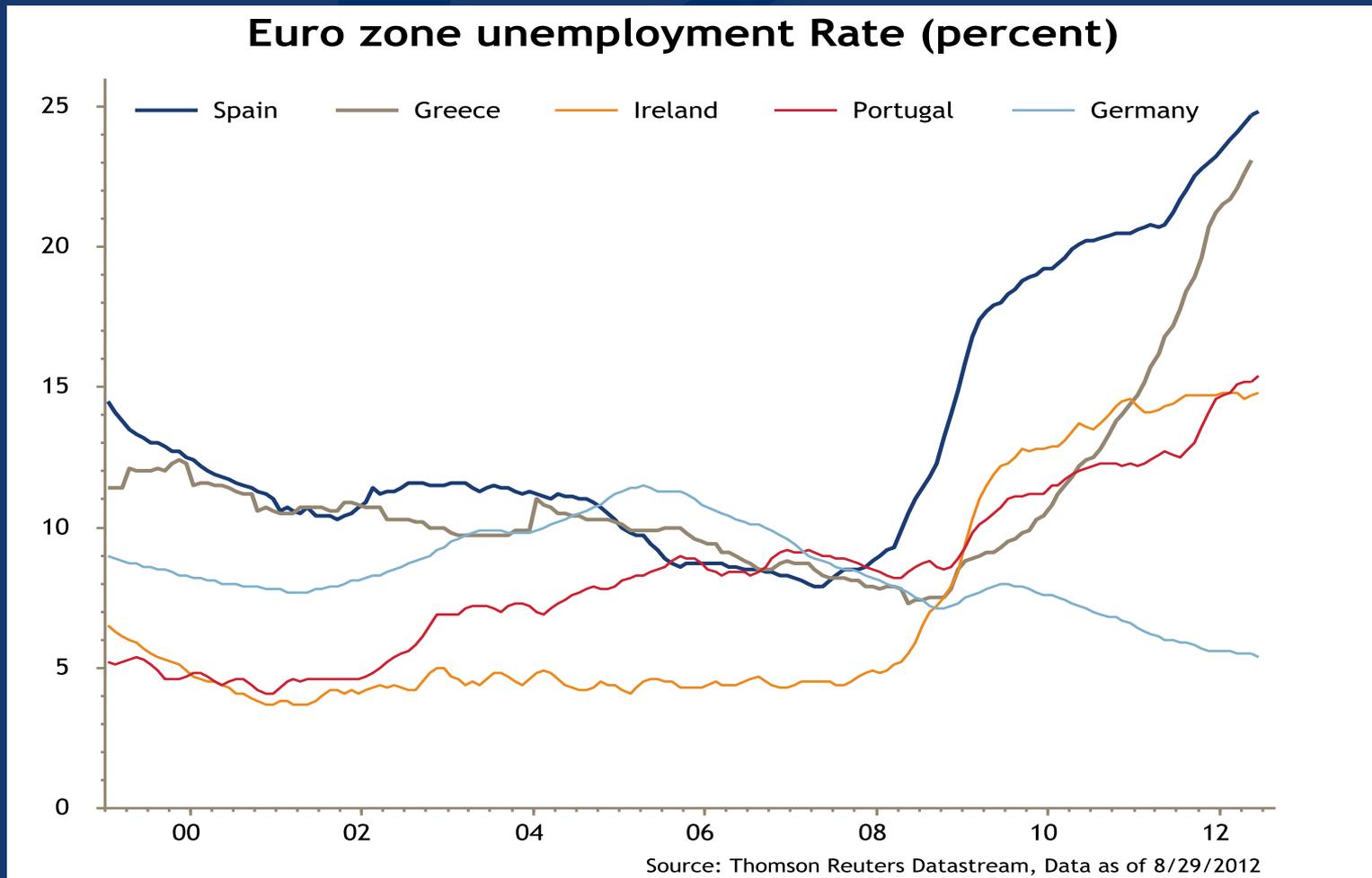
# OFFICIAL HELP NEEDED

PRIVATE CAPITAL DRIED UP FOR ITALY AND OFFICIAL INSTITUTIONS, LIKE THE ECB HELPED FILL THE VOID



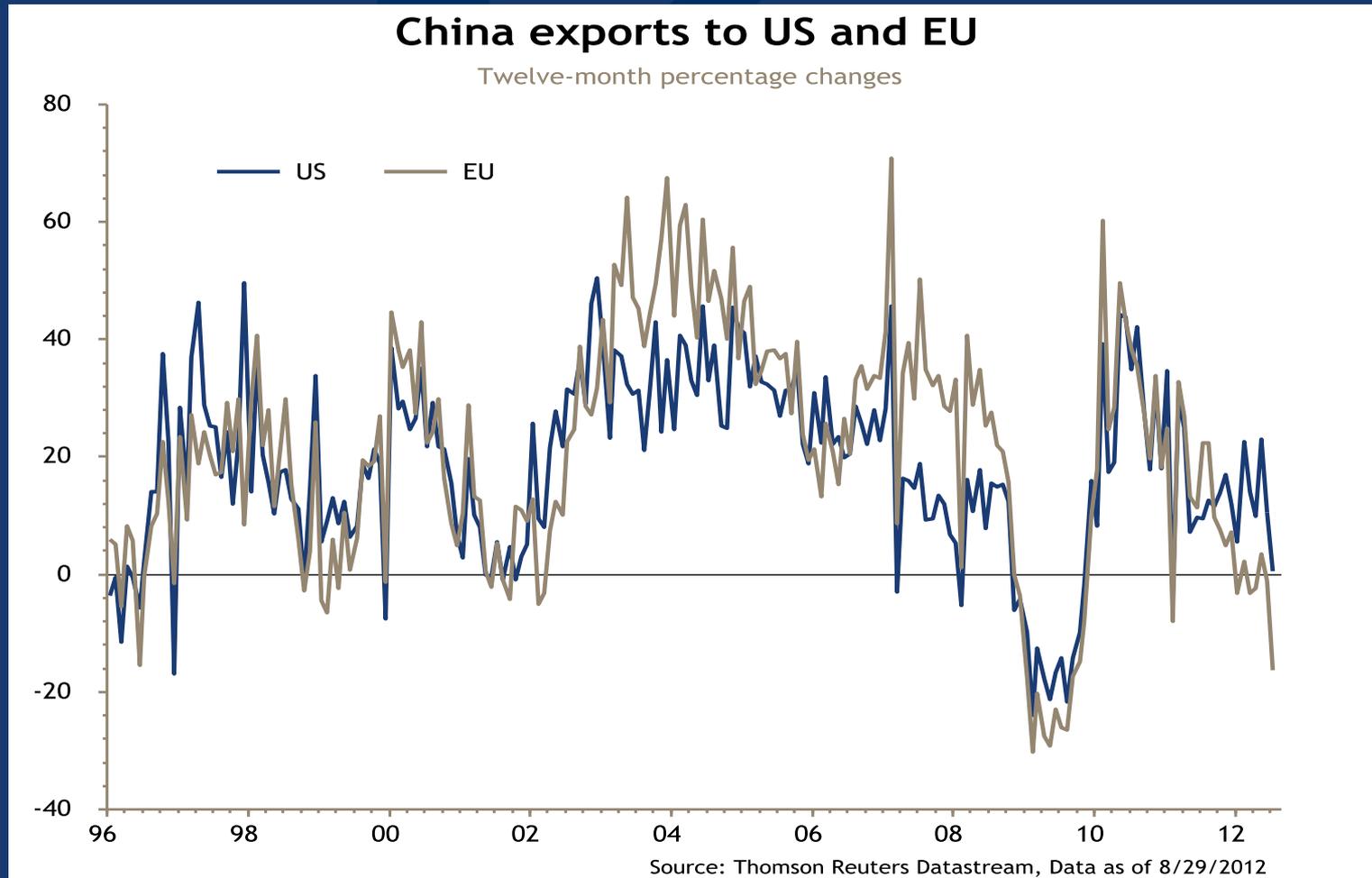
# A LONG ROAD TO RECOVERY

THESE UNEMPLOYMENT RATES ARE AT DEPRESSION ERA LEVELS



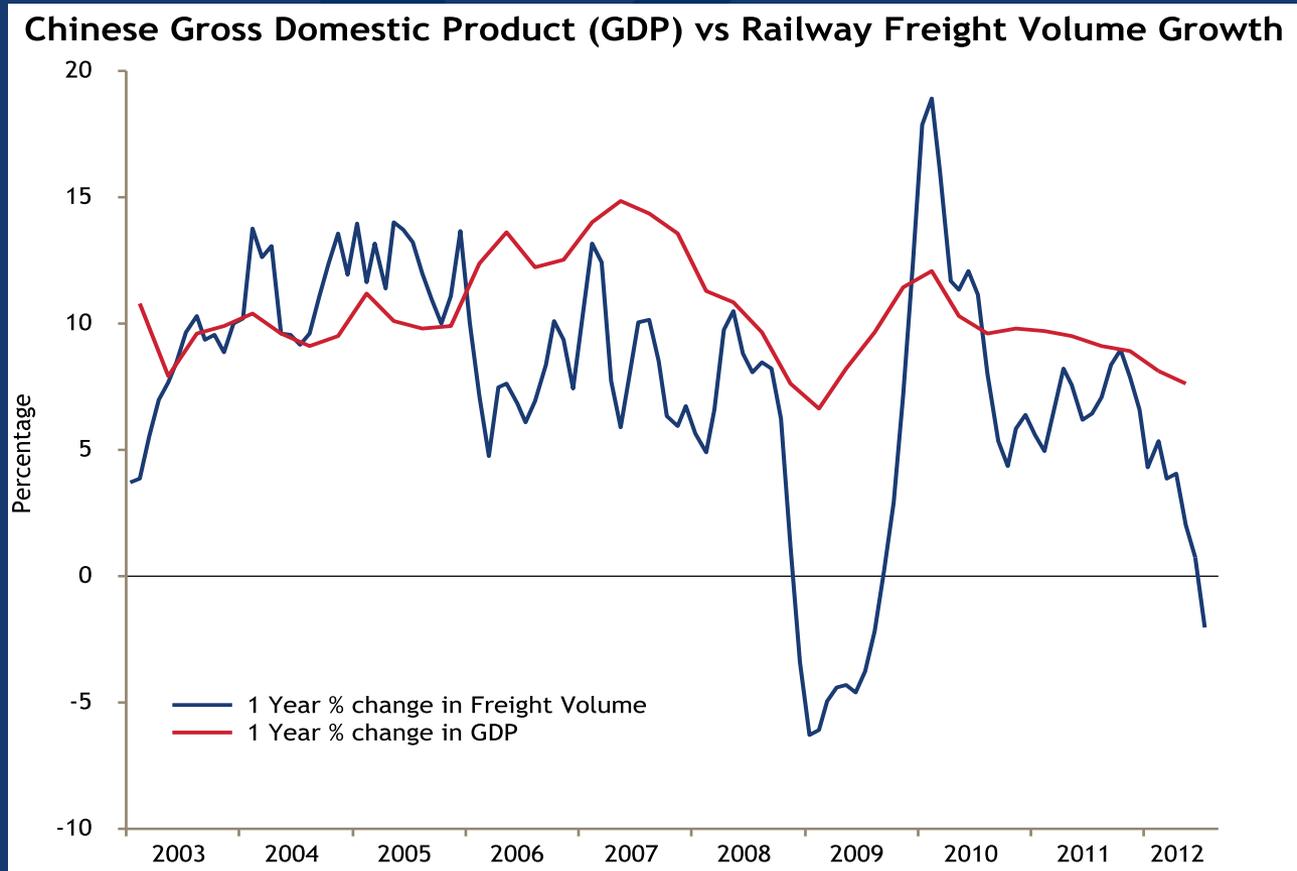
# EUROPEAN WOES HITTING CHINA

CHINA IS EXPORT SENSITIVE — EUROPEAN RECESSION IS HAVING AN IMPACT



# CHINA SLOWDOWN INTERNALLY DRIVEN AS WELL

CHINA'S GDP NUMBERS ARE 'MAN MADE' SO LOOK FOR MORE TIMELY DATA LIKE RAILWAY FREIGHT VOLUME FOR ECONOMIC MOMENTUM



Source: Thomson Reuters Datastream, National Bureau of Statistics: China. Data as of June 15,

2012

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# WILL CHINA PROVIDE THE LIQUIDITY BOOST?

WE DO NOT BELIEVE CHINA IS WILLING TO STIMULATE LIKE 2008-2010



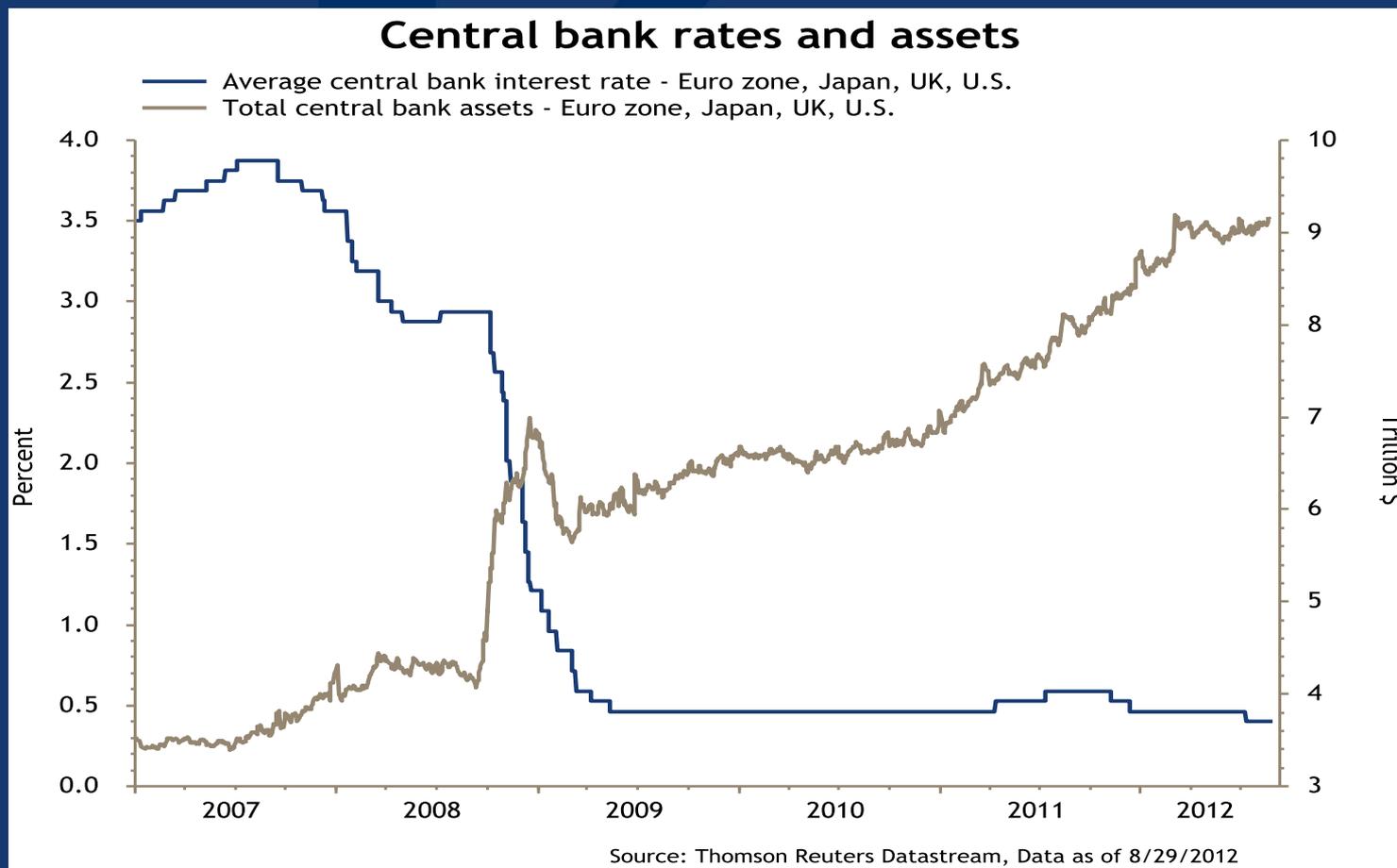
\*M1 is a category of the money supply that includes all physical money such as coins and currency; it also includes demand deposits, which are checking accounts, and Negotiable Order of Withdrawal accounts.

\*\*M2 is a category of the money supply that includes M1 in addition to all time-related deposits, savings deposits, and non-institutional money-market funds.



# MORE UNCONVENTIONAL EASING ON THE WAY

**SLOW GROWTH MOMENTUM SUGGESTS MORE EASING IS REQUIRED, ESPECIALLY WHEN FACING FISCAL TIGHTENING**



# RISK-ON RALLY WITH THE HELP OF CENTRAL BANK LIQUIDITY

WITH HIGH YIELD “YOU GET PAID TO WAIT” UNTIL WE REACH ESCAPE VELOCITY



*All indexes are unmanaged and do not incur fees. You cannot invest directly in an index.*



# CONCLUSIONS

## WE BELIEVE:

- Private sector deleveraging, government austerity likely dampens future growth
- Central bank liquidity injection, quantitative easing is the primary offset
- Low growth, low yield environment for the near term
- Push /pull between fiscal tightening and liquidity injections – VOLATILITY
- Global growth recovery will likely be delayed and below trend
- Near-term global treasuries range-bound, yields can only rise when nominal growth picks up
- Portfolio management will rely on timely and effective use of “tool kit”

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