Older Demographics Have Altered Economic Recoveries in Three Major Ways!!!

1. Slower SPEED LIMIT!

2. Delayed Recoveries!!

   “Slow Starters… But, Long FINISHERS”

3. YEAR “4” GEARING!!?
"New-Normal" Working-Age Population Growth!??!

U.S. Working Age Population
Shown on a natural log scale

Since WA
Population Growth
Has Downshifted…

Annual Growth in U.S. Real GDP

... Economic
Recoveries Have
Been Slower!?
Contemporary Recovery Weaker, But Similar to 1991/2001 Pattern!

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Jobs & Confidence Recoveries Delayed!?!
“DELAYED” WAGE/GAINS WILL SOON END?!??
Federal Reserve Following Playbook of Last Two Recoveries!?!
How to GEAR?? Jobs & Confidence!!!

Consumer Confidence vs. U.S. Unemployment Rate
ECONOMY is GEARING: #1 JOB MARKET!!

Total U.S. Household Employment
In Millions

Total U.S. Labor Force
In Millions

U.S Labor Unemployment Rate
ECONOMY is GEARING: #2 CONFIDENCE!!

Conference Board Consumer Confidence
Present Situation Index

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ECONOMY IS GEARING: #3 Net WORTHS & #4 Debt BURDENS!!
ECONOMY is GEARING: #5 Housing Activity & #6 Home Prices!!

National Association of Homebuilders Market Survey Index

FHFA U.S. House Price Index

A NEW Recovery Has Begun!!

This Feels Better!!
ECONOMY is GEARING: #7 Bank Lending & #8 State Jobs !!!

Total U.S. Bank Loans

State Government Total Tax Collections vs. State Government Employment

Adding A Bit of Credit Creation!!

Revenues LEAD JOBS!!
ECONOMY is GEARING: #9 Net Exports!!!
ECONOMY is GEARING: #10 Sensitivity to Crises!!

CBOE VIX VOLATILITY Index

Bloomberg European Financial Conditions Index

Has the “Boy Cried Wolf”
Too Often??!
U.S. Economy is Self-Medicating!!!

- 30-Year National Average Mortgage Interest Rate
- Annual Growth in the M2 Money Supply
- Trade-Weighted U.S. Dollar Index
- Commodity Prices: Crude Oil vs. Non-Energy Commodities
- Total Annualized U.S. Auto Sales
- Annual Consumer Price Inflation Rate
SAME Demographic New-NORMAL Hits Entire G-10!??

G-10* Global REAL GDP
*Includes Canada, Sweden, Switzerland, U.K., Japan, U.S., Italy, France, Germany & Australia
Fortunately, the U.S. Enacted the Emerging Market MARSHALL PLAN!!!
GLOBAL GROWTH IS STILL O.K.?!?

Global REAL GDP
G-10 Economies vs. Rest of Global Economy
What? Real Global Growth Has Accelerated???

Real Global World Product
2011 U.S. Dollars, natural log scale

Annualized Real Gross World Product
Growth by Decade*
Note: The 00s decade is the annualized growth for 11 years from 2000 to 2011
Finding Top-LINE GROWTH?!?

S&P 400 Nominal Sales Per Share vs. U.S. Nominal GDP
Annualized Growth by Decade*
* The 2000s decade is actually from 1999Q4 to 2012Q2

S&P 400 Real Sales Per Share** vs. U.S. Real GDP
Annualized Growth by Decade*
** S&P 400 Sales Per Share Adjusted by GDP Price Deflator Index
* The 2000s decade is actually from 1999Q4 to 2012Q2
Earnings Story Is Not Just Margins!!?

Annual Growth in S&P 400 Sales per Share

Large Cap (S&P 500) vs. Small Cap (Russell 2000) Per Share Annual Sales Growth

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What About Europe???

- Solution is Growth … Not Austerity
- Finally, an “Economic Union”
- Moving Euro zone from “Imminent Calamity” to “Chronic Problem”
- Fallout is Slower/No Growth from Euro zone
- “Financial” Contagion Unlikely
- In 1990, Global Recovery Proceeded Without Japan
- Investor Sensitivity is Decaying
What About CHINA???

China Leading Economic Index vs. Short-Term Policy Interest Rate**

** China CHIBOR 3 month interest rate (six month moving average)
Until 7/2002 and China SHIBOR 3 month interest rate thereafter.
NOTE: Interest Rate LEADS by One Year

China Leading Economic Index vs. Real Annual M2 Money Growth*

NOTE: Annual Real Money Growth (dotted line)
LEADING by Six Months

Economic and Financial Market Update – October 2012
## Inflation Story??

### Unstoppable Forces Meet Immovable Objects!?!?

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<th>Inflation Forces</th>
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Time to Start Normalizing Monetary Policy!!?!?

Fed Funds Rate vs. Business Bank Loans

Nominal GDP Growth vs. Money Supply Growth*
*3-Year Trailing annualized growth rates. GDP is GNP until 1946. Money Supply is M1 through 1958 and M2 thereafter.
Fed Needs to Get Beyond its Crisis Mindset??!

Why are we still employing "Crisis Policies"... when the U.S. economy is no longer in crisis??

Fed funds target rate will remain low until end of 2014

Yesterday evening, the Open Market Committee of the US Federal Reserve signalled that because of the difficult economic situation it will retain the extremely low key rate level substantially longer than expected thus far by the financial markets.

The extremely low level for the federal funds rate will presumably be retained until the end of 2014. Since August 2011, the Fed had committed to holding the fed funds target rate at its low level until at least mid-2013 to steer market expectations.
Oil? Supply Catching Demand???
What Oil Crisis???

U.S. Oil Production (Mil. Barrels per day)

- 2011: 7.84

U.S. Net Imports Crude Oil (Mil. Barrels per day)

- 2011: 8.48
So ... You Like Gold, Huh??!? 

Price of S&P 500 Stock Index in Ounces of Gold*  

Price of Gold Relative to U.S. Treasury Bond*  
*Price of gold divided by Long-term U.S. Treasury Bond Prices. Bond Price set at $100 in December 1962 and then rose or fell each month based on Ibbotson’s estimate of price-only return.

Price of Gold Relative to U.S. House Price*  

Price of Gold Relative to Consumer Price Index  

Price of Gold Relative to Overall Commodity Prices*  
*Price of Gold divided by S&P GSCI Spot Commodity Price Index.

Number of Hours of Work Required to Purchase an Ounce of Gold*  
*Price of Gold Price divided by the Average Hourly Earnings Index.
Will Bonds Be Bloodied??

Real 10-Year Treasury Bond Yield*

*10-Year Treasury Bond Yield Less Annual Core Consumer Price Inflation Rate

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FEAR Has Been Bond Market’s Best Friend!!?

Real Treasury Bond Yield and CONFIDENCE

SOLID – 10-Year Treasury Yield Less Annual Core Consumer Price Inflation Rate

DOTTED – Average of University of Michigan and Conference Board Consumer Expectation Indexes

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AGING Demographics & the Bond Market?!?

U.S. 10-Year Treasury Bond Yield vs. U.S. Labor Force Growth
U.S. Deficit… More Cyclical Than Structural?!?!

U.S. Federal Deficit/GDP Ratio vs. Detrended Real GDP*

*Detrended by 1965 to 1984 average annualized growth of 3.25% and by 1985 to 2012 average annualized growth of 2.6%.
Huh.... Best Post-Recession Stock Market Rally Ever???

Post-War Stock Market Rallies
Cumulative Price-Only Percent Returns From Recession Low During First 870 Days

Post-War Stock Market Rallies
Cumulative Percent Price Only Return from Recession Low

NOTE: BOLD Line is the Current Recovery Stock Market Rally

Wells Capital Management

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“DOA” Sectors LEAD Stock MARKET!??

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IF INFLATION STAYS LOW...LOTS OF VALUATION ROOM!?!
POST-WAR STOCK MARKET STORY!??!

U.S. Stock Market vs. Long-Term Trendline Level
S&P 500 Stock Price Index (Solid)
Trendline Level (Dotted)

Total U.S. Corporate Profits
Actual Level (Solid) vs. Trendline (Dotted)
CULTURAL “GLOOM TO GLEE” CYCLE!!?
Could A Return To “NORMAL CONFIDENCE” Double the Stock Market??

Detrended U.S. Stock Market vs. U.S. Consumer Confidence
Mania to Mania!!?

New-Era $\rightarrow$ Mania of OPTIMISM

New-Normal $\rightarrow$ Mania of PESSIMISM
A “Confidence-Driven” Secular Bull à la 1950s-60s!!

U.S. Stock Market vs. Long-Term Bond Yields*

*Sources: Robert Schiller’s database, Bloomberg.
Stay With Cyclical Stocks?!?

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 cyclical sectors (consumer discretionary, industrials, and materials).
Wait for the Flow!!!?

Net New Monthly Mutual Fund Cash Flows
Stock Funds Less Bond Funds vs. Relative Price
Performance of Stocks Over Bonds
*3-Month Moving Average of Monthly Flows

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BUY & “HOLD YOUR NOSE” !!??

Rolling 10-Year Standard Deviations of Daily Percent Stock Market Changes

Dow Jones Industrial Average – 1900 to 2012
Shown on a Natural Log Scale
A Lost Decade?? Hardly!!!

Emerging World Economies’
Nominal U.S. Dollar GDP
Percent of U.S. Nominal GDP
2000 vs. 2010

Real Corporate Profit Per Job*
*Total U.S. corporate profits adjusted for GDP deflator inflation index and divided by nonfarm private payrolls. Shown on a natural log scale.

Real U.S. Wage Rate*
*U.S. average hourly earnings index divided by consumer price index.
Shown on a natural log scale.

Inflation-Adjusted Total Global GDP
Real U.S. Dollars

*1. CREATION OF EMERGING WORLD!!

*2. BIGGEST TECHNOLOGICAL LEAP IN U.S. HISTORY!!

*3. GLOBAL EMBRACEMENT OF CAPITALISM!!
### 2012-2013 Possibilities???

- **U.S. Economy has a “GEAR YEAR”**
  - Real GDP Rises by 3%ish
  - U.R. Exhibits “Slow but Steady” Decline
  - H.H. & Biz Confidence Improve
  - Housing Market “Pops” a Little
  - Biz Spend Some of $2 Trillion Cash Hoard
- **Euro Crisis Mutates from “Imminent Calamity” to “Chronic Problem”**
- **Emerging World Soft Landing… Accelerates in 2nd Half**
- **U.S. Politics Moves to a “Happier Middle”**
- **Talk of a “New All-Time” Stock Market High**
- **T-Bond Market Gets Drilled**
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