

Economic & Financial Market Update

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September 2013

WELLS CAPITAL MANAGEMENT



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

1. Slower SPEED LIMIT!

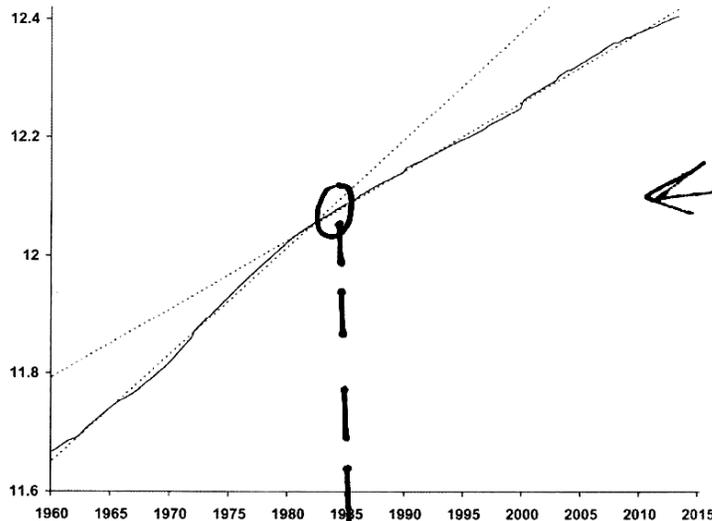
2. Delayed Recoveries!!

“Slow Starters... But, Long FINISHERS”

3. YEAR “4” GEARING!!?

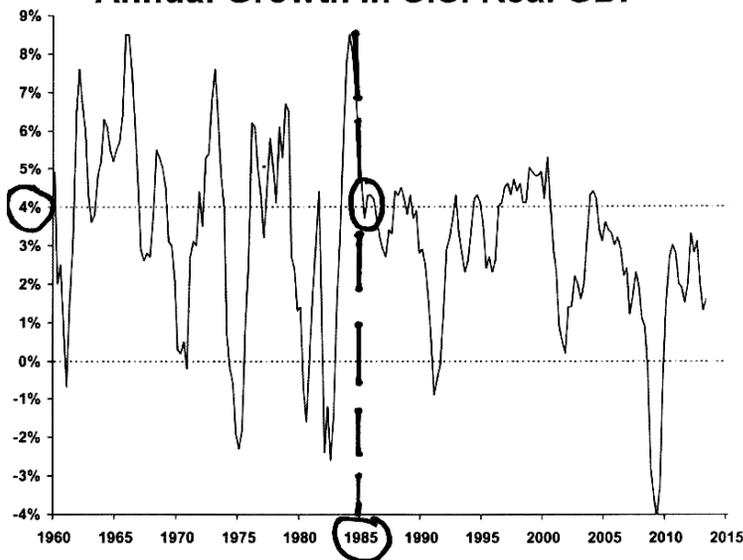
“New-Normal” Working-Age Population Growth!??!

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



← Since WA Population Growth Has Downshifted...

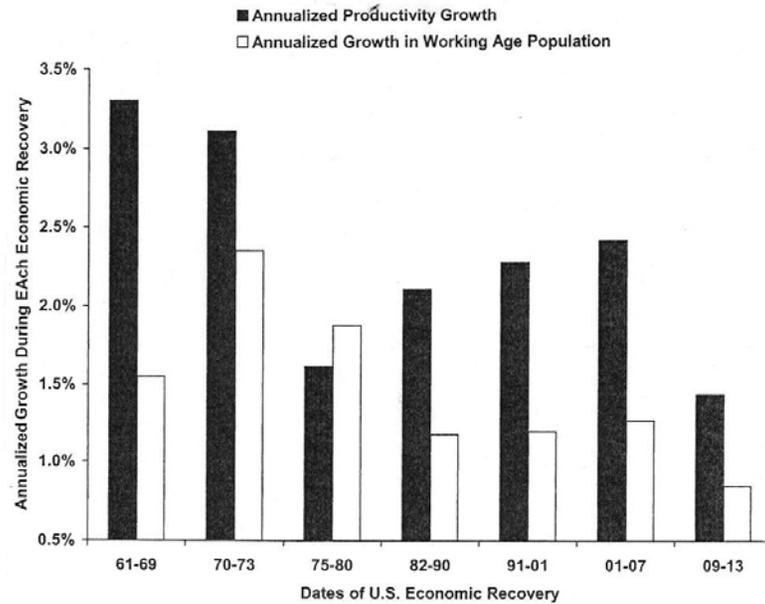
Annual Growth in U.S. Real GDP



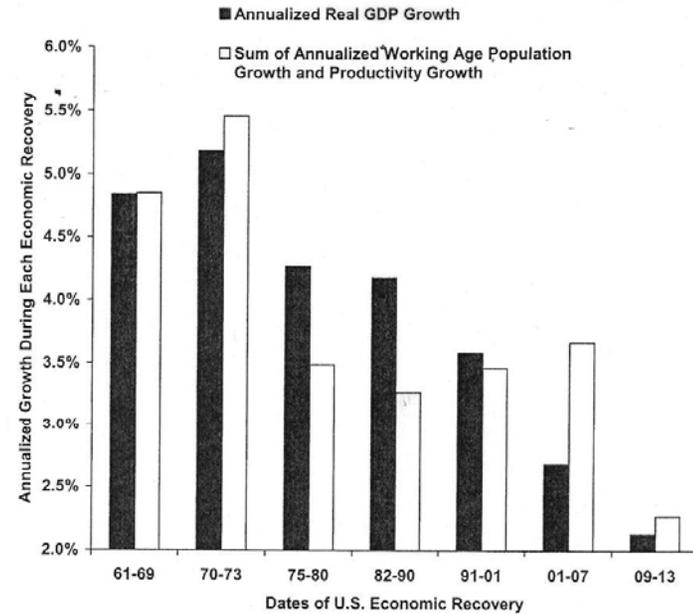
← ... Economic Recoveries Have Been Slower!?!?

Weak Labor Force Growth and Slow Productivity!?!

U.S. Productivity vs. Working Age Population Growth

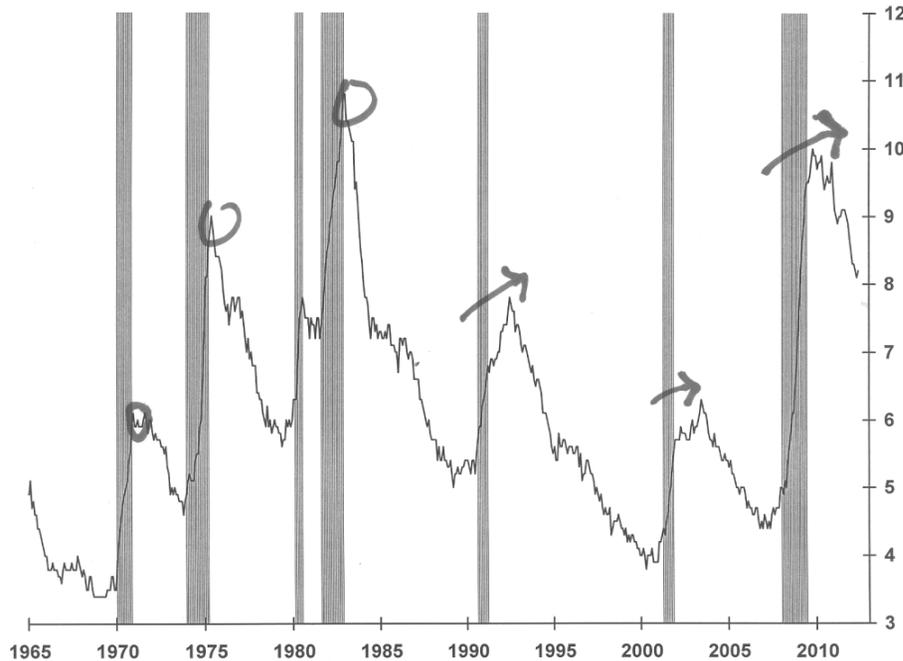


U.S. Economic Growth vs. Labor/Productivity Base



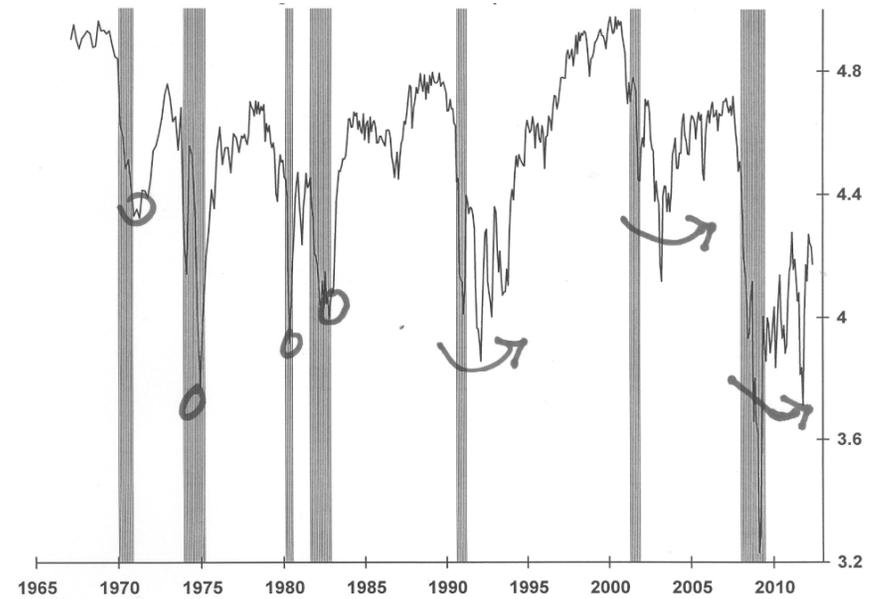
Jobs & Confidence Recoveries Delayed!?!

U.S. Unemployment Rate & Recoveries



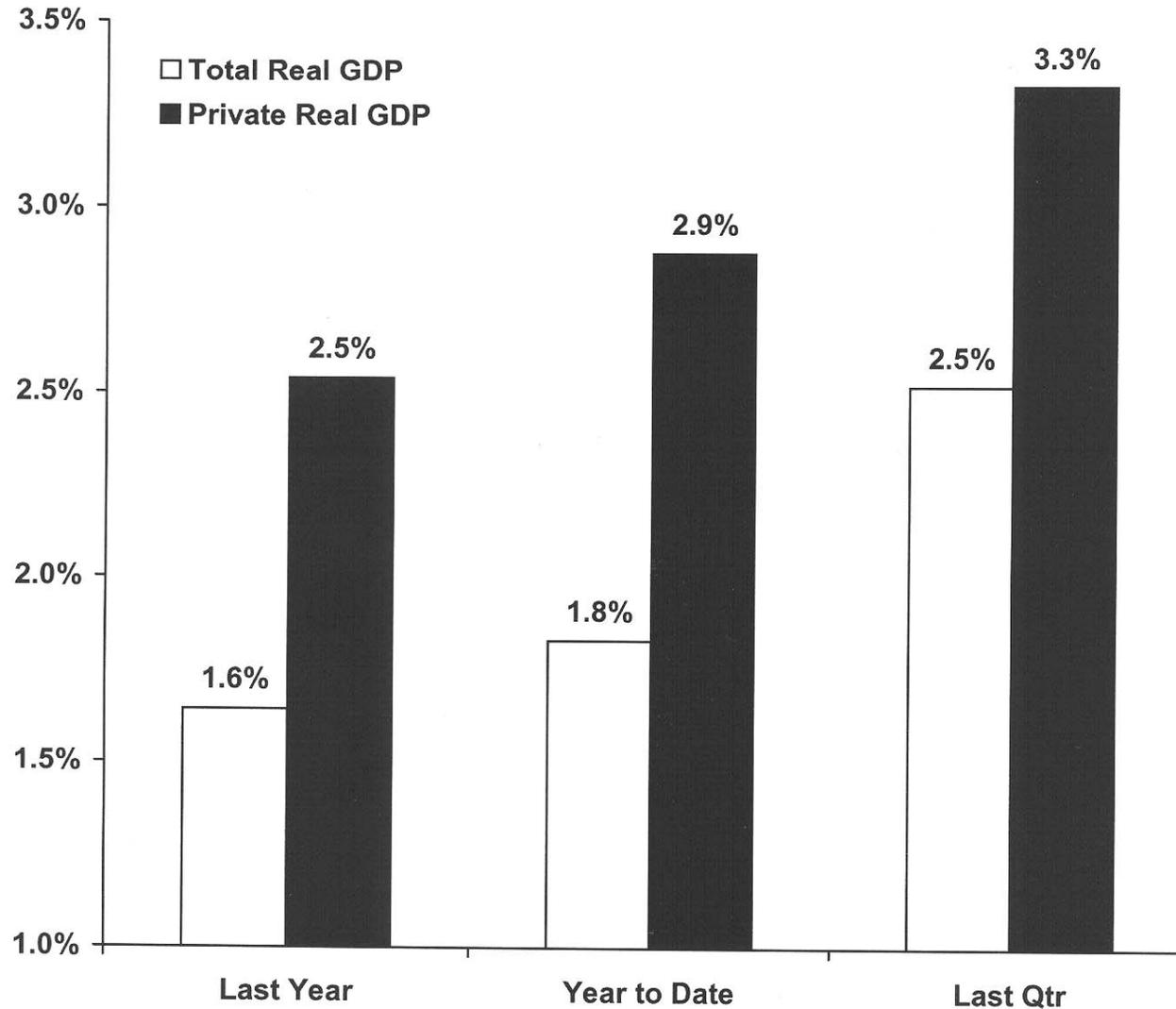
Consumer Confidence Index* & Recoveries

*Confidence Boards Consumer Confidence Index
Shown on a natural log scale



Core Private Economic Growth Better Than Perceived???

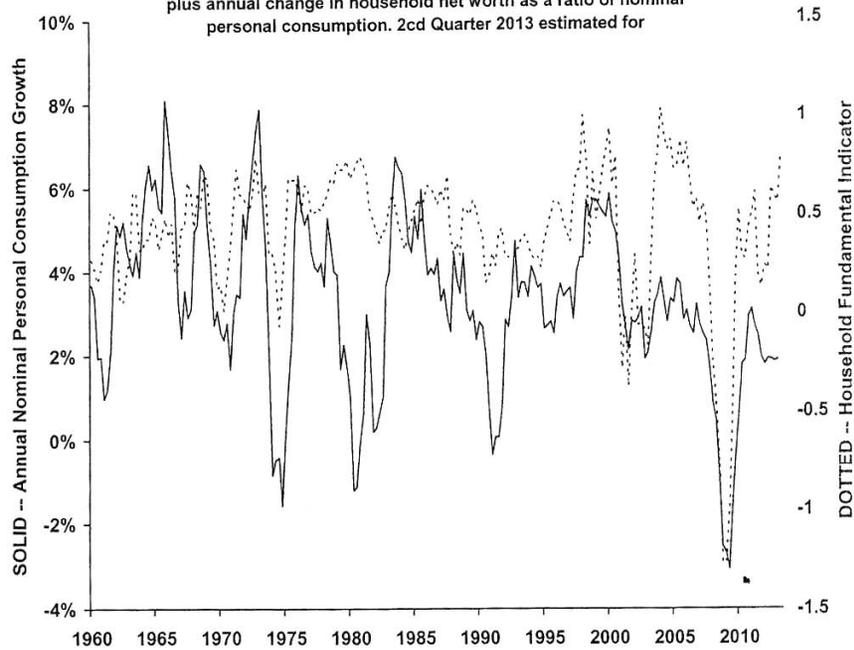
**U.S. Real GDP Growth
Overall vs. Private Sector**



Biz & HH “Fundamentals for the Future” Are Up!?!?

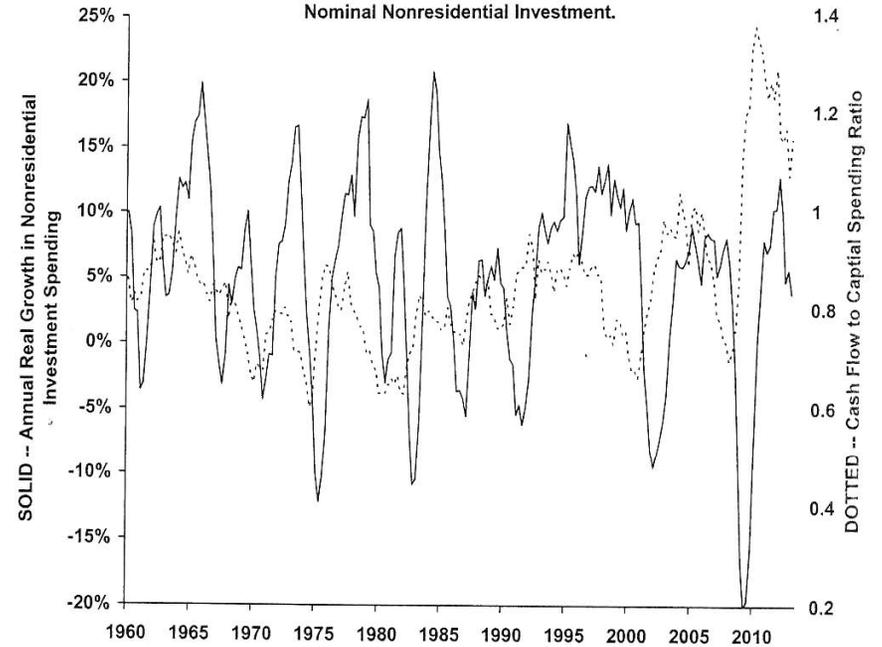
Real Consumption Growth vs. Household Fundamental Indicator*

*Fundamental Indicator: Annual Change in disposable income plus annual change in household net worth as a ratio of nominal personal consumption. 2cd Quarter 2013 estimated for



Real Business Investment vs. Cash Flow To Capital Spending Ratio*

*Corporate Net Cash Flow divided by Nominal Nonresidential Investment.



GEARING → JOBS & BALANCE SHEETS!!

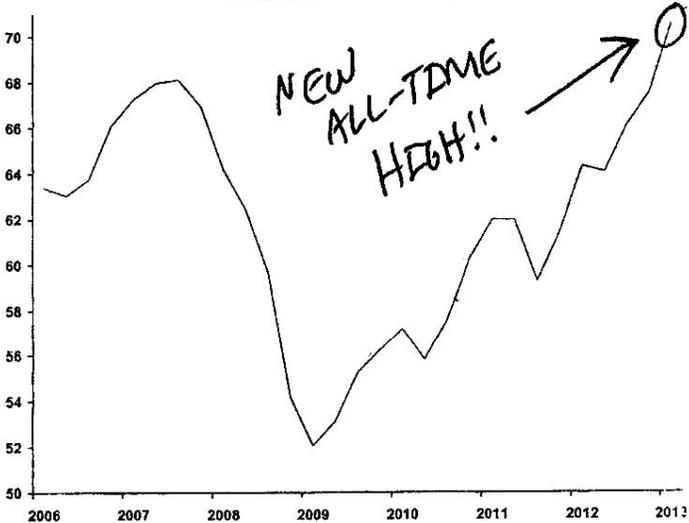
Total U.S. Household Employment



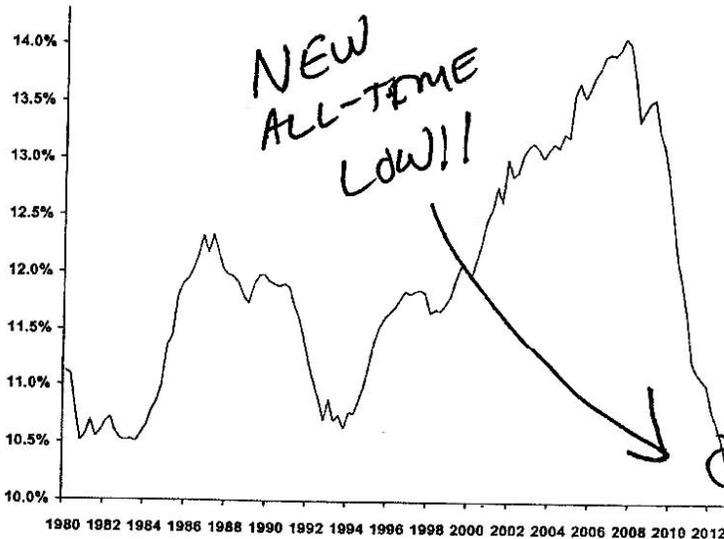
U.S. Labor Force



U.S. Household NET WORTH
Trillions of U.S. Dollars

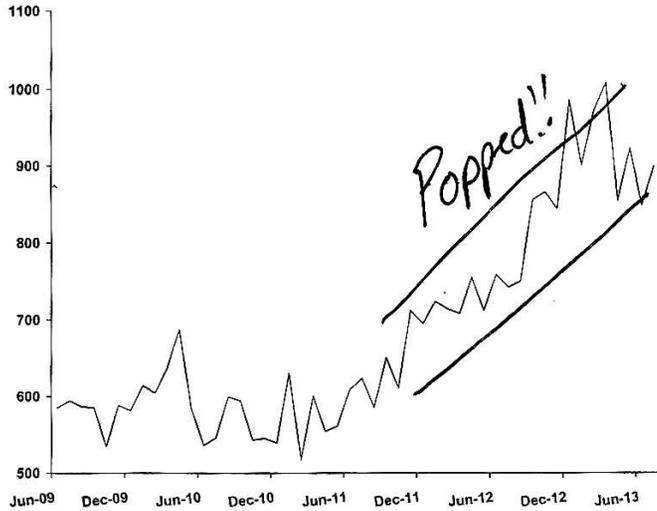


U.S. Household DEBT SERVICE BURDEN

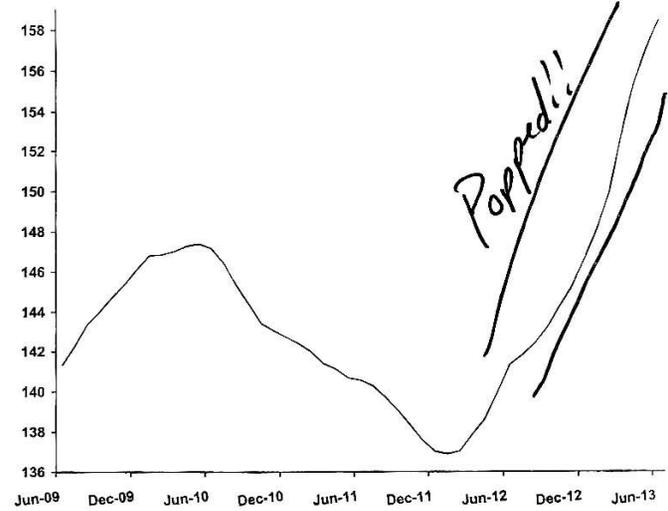


GEARING → Housing, Manufacturing & Confidence!!

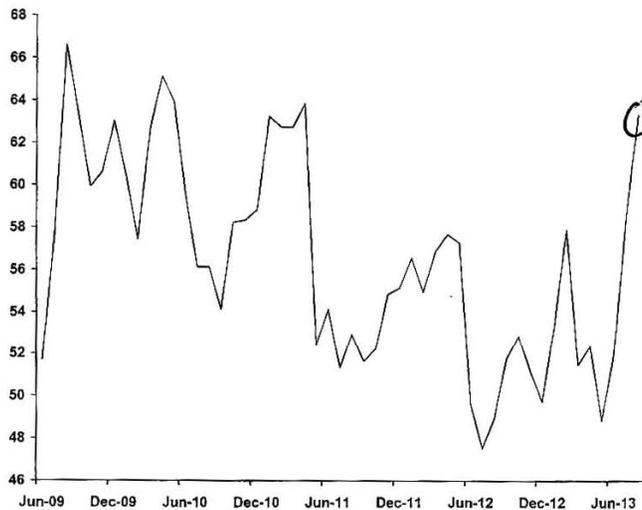
Total U.S. Housing Starts



Case-Shiller U.S. Home Price Index



ISM Manufacturing NEW ORDERS Index



Conference Board U.S. Consumer Confidence Index Present Situation Index



First Time...
 ... Housing
 & Manufacturing
 BOTH
 Rising!!

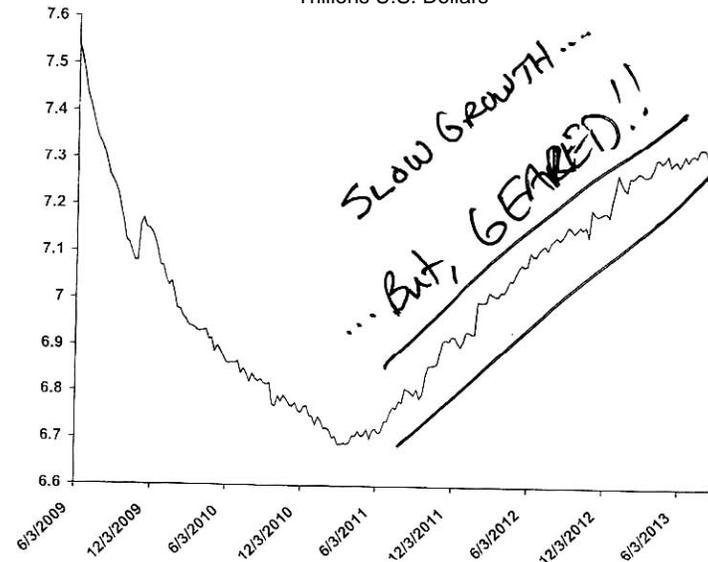
GEARING → Profits, Lending, Stock Market & Fears!!

Total U.S. Corporate Profits



Total U.S. Bank Loans

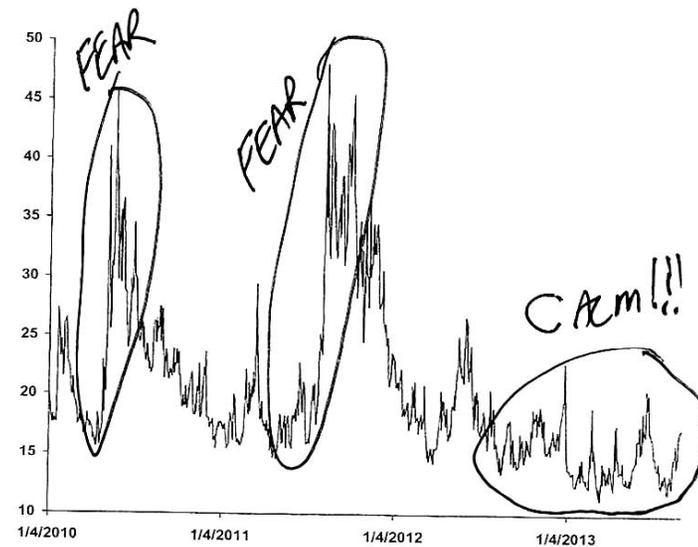
Trillions U.S. Dollars



S&P 500 Composite Stock Price Index



Stock Market VIX Volatility Index

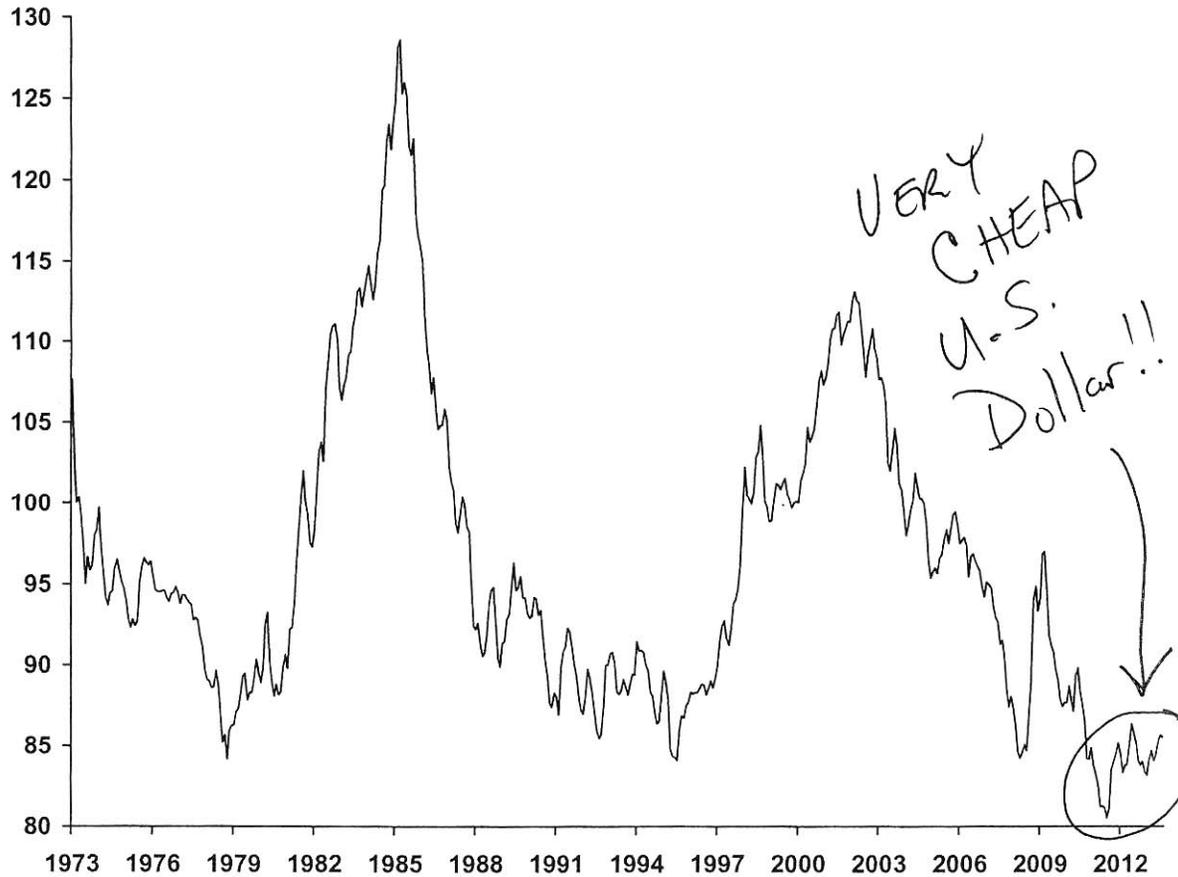


Help For Economic Growth!?!

- **Less Restrictive Fiscal Policy**
- **Steepening Yield Curve**
- **Key Monetary Variable Rising Velocity**
- **Homebuyer Affordability Still Near Record High**
- **Renewed Balance Sheet Strength**
- **Real Broad U.S. Dollar Near All-Time Record Low**
- **Low Inflation Rate Improving Purchasing Power**
- **Energy Independence Dividend**
- **HH & BIZ Pent-up Demands**
- **Global Economic Synchronization**
- **BIGGEST STIMULUS RISING CONFIDENCE**

U.S.A. is a Mighty GOOD BARGAIN!!?

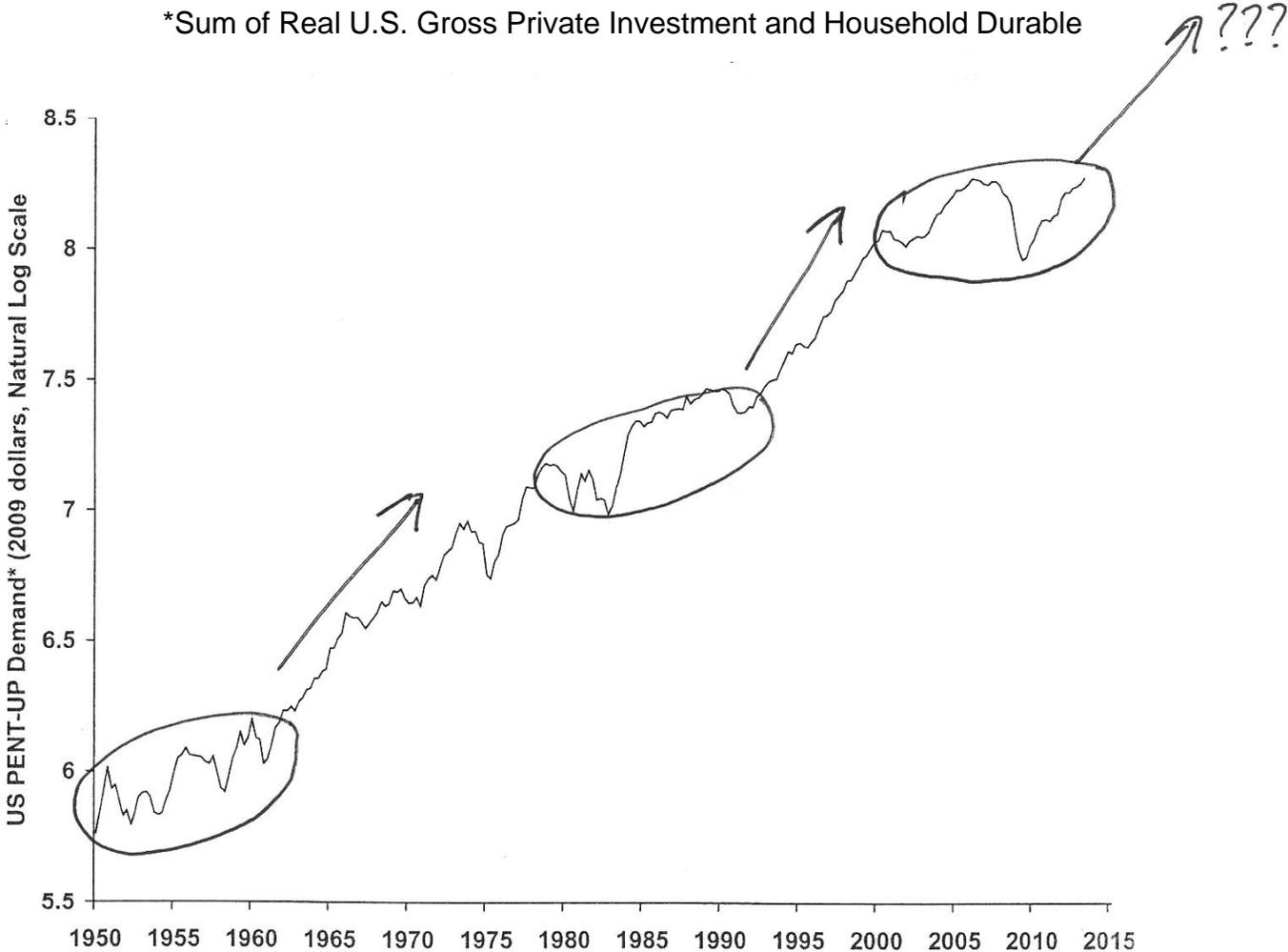
U.S. Real Broad Trade-Weighted U.S. Dollar Index



PENT-UP DEMAND!!!?

U.S. PENT-UP Demand*

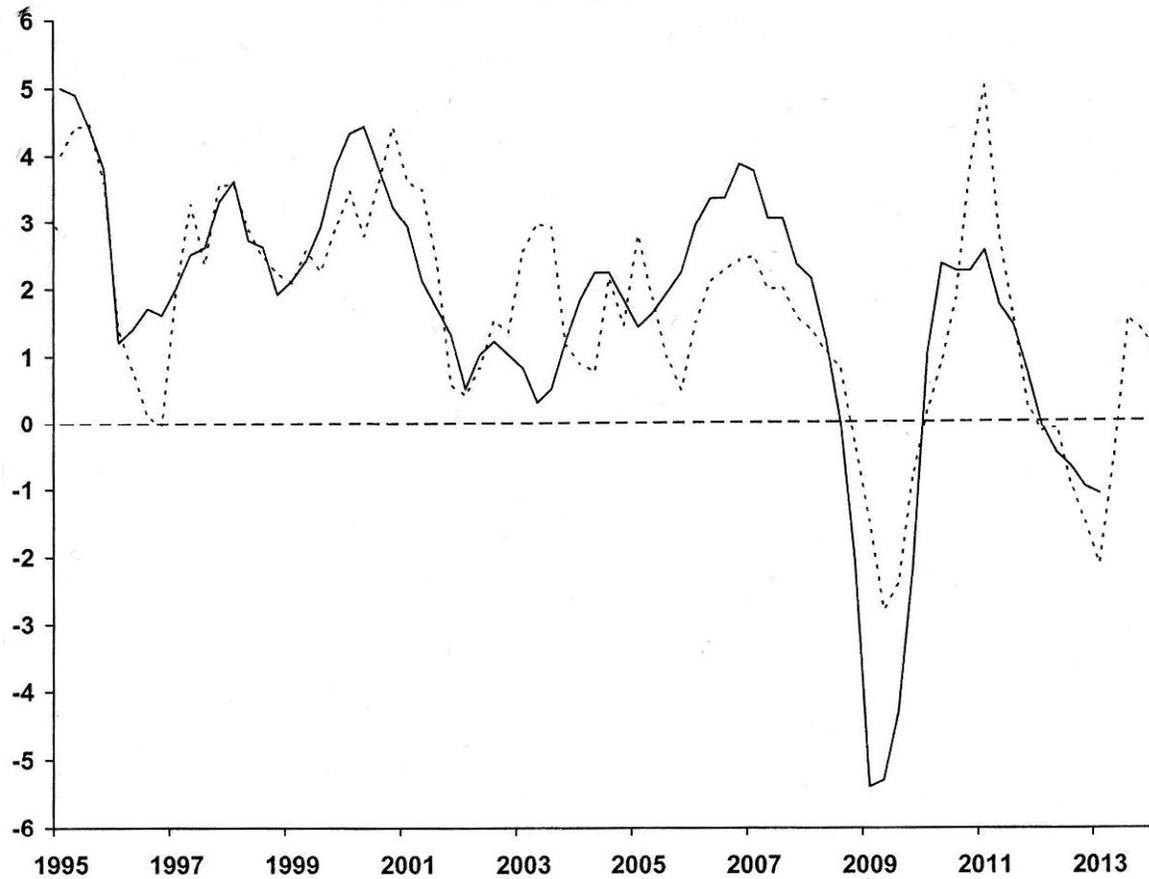
*Sum of Real U.S. Gross Private Investment and Household Durable



DRAGHINOMICS is WORKING!!!

EUROZONE ANNUAL REAL GROWTH vs. Regression Model*

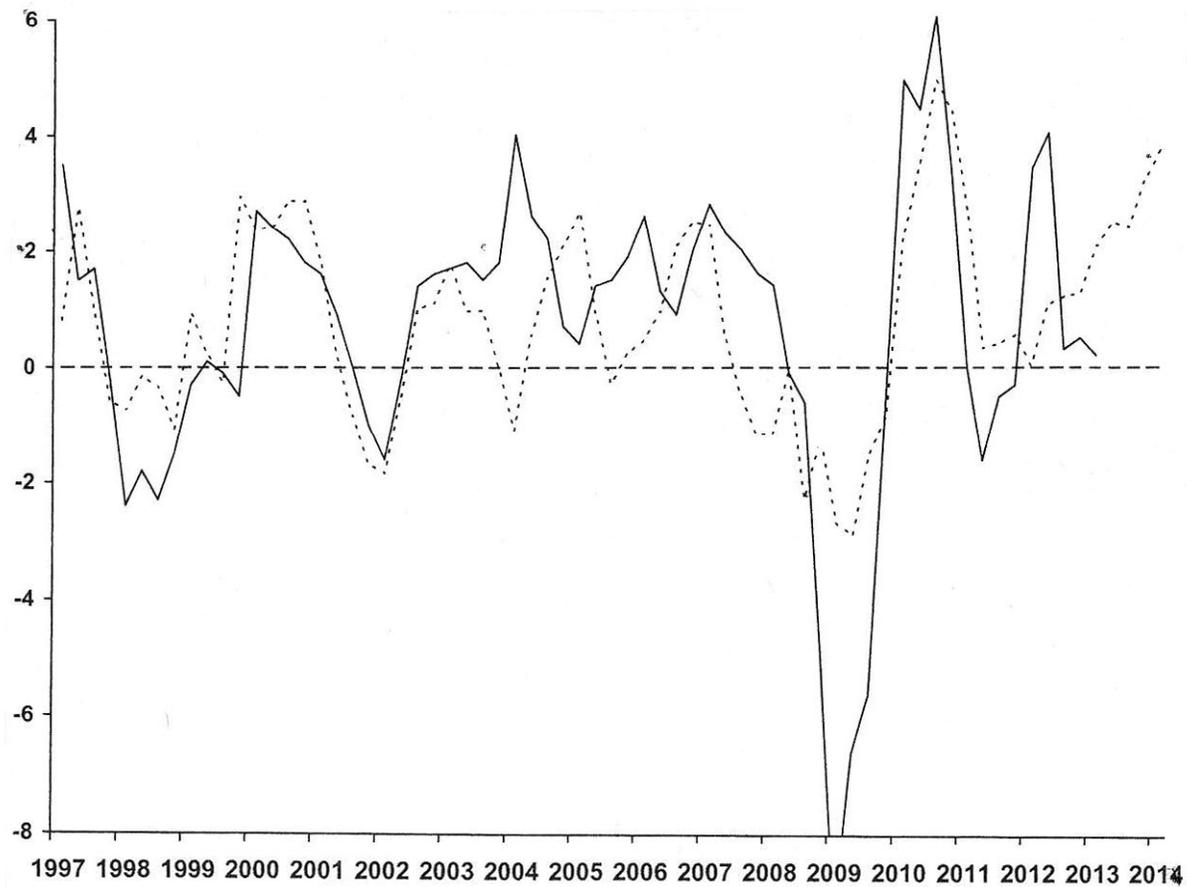
*Based on a one-year relationship with financial, currency and leading indicators



ABEnomics IS WORKING!!!

Japan Annual Real GDP Growth vs. Regression Model*

*Based on a one-year lagged relationship with financial, currency and leading indicators

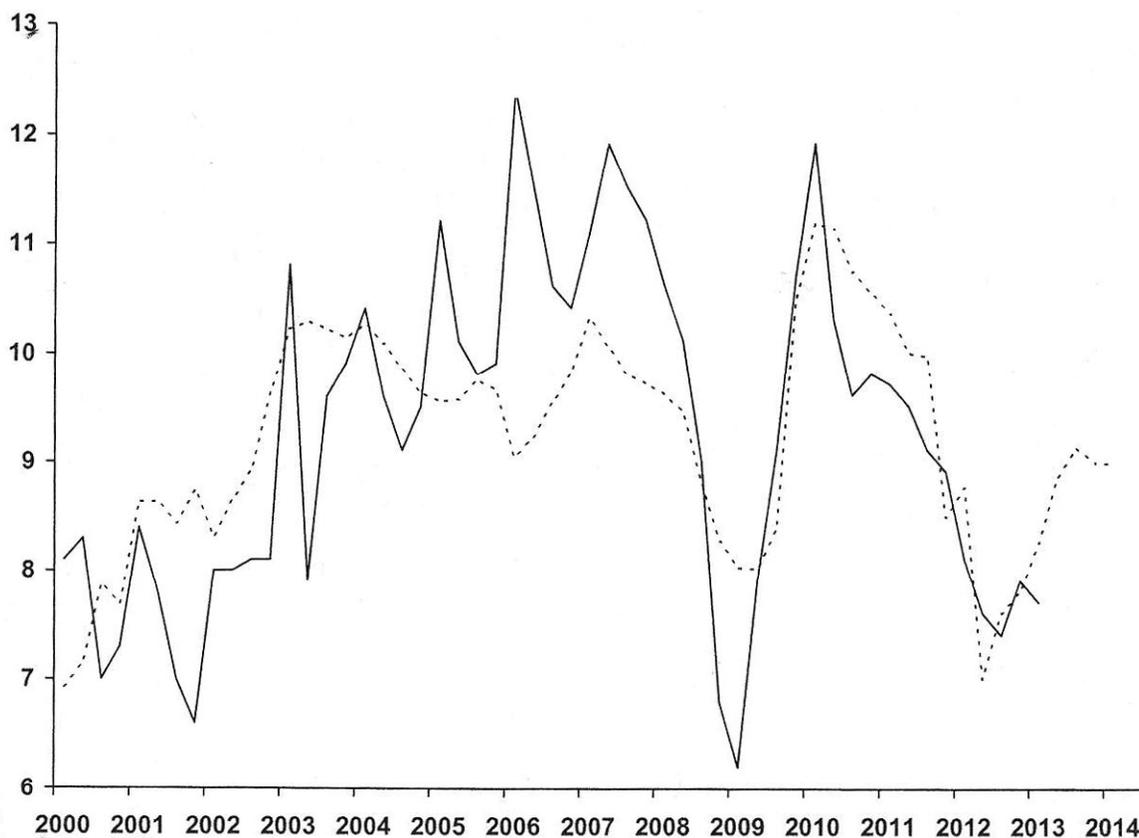


Emerging World Economic Growth “Hopefully” Improves?!?

CHINA

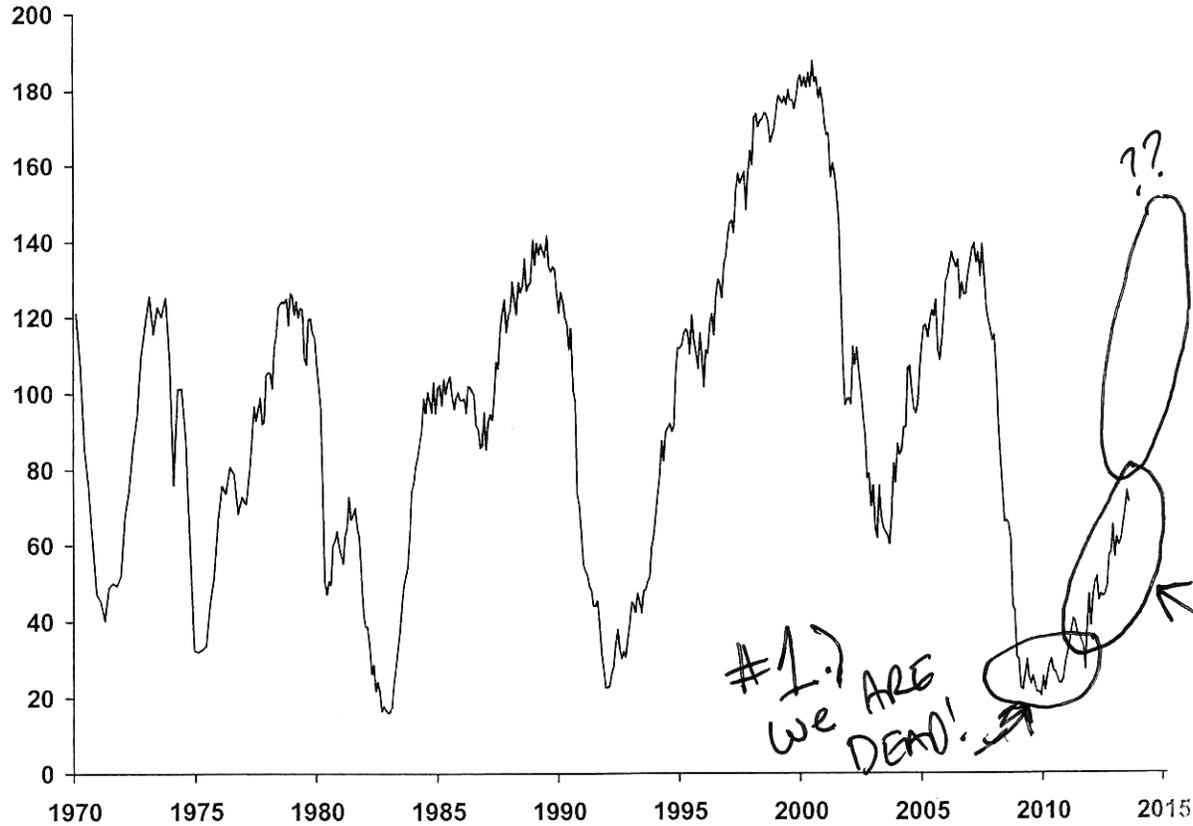
Annual Real GDP Growth vs. Regression Model*

*Model based on lagged M2 Money Supply growth, lagged Shibor Interest Rate
And lagged real trade-weighted China Currency Index



STAGES OF CONFIDENCE?!?

Conference Board Consumer Confidence
Present Situation Index



#1.) WE ARE DEAD!

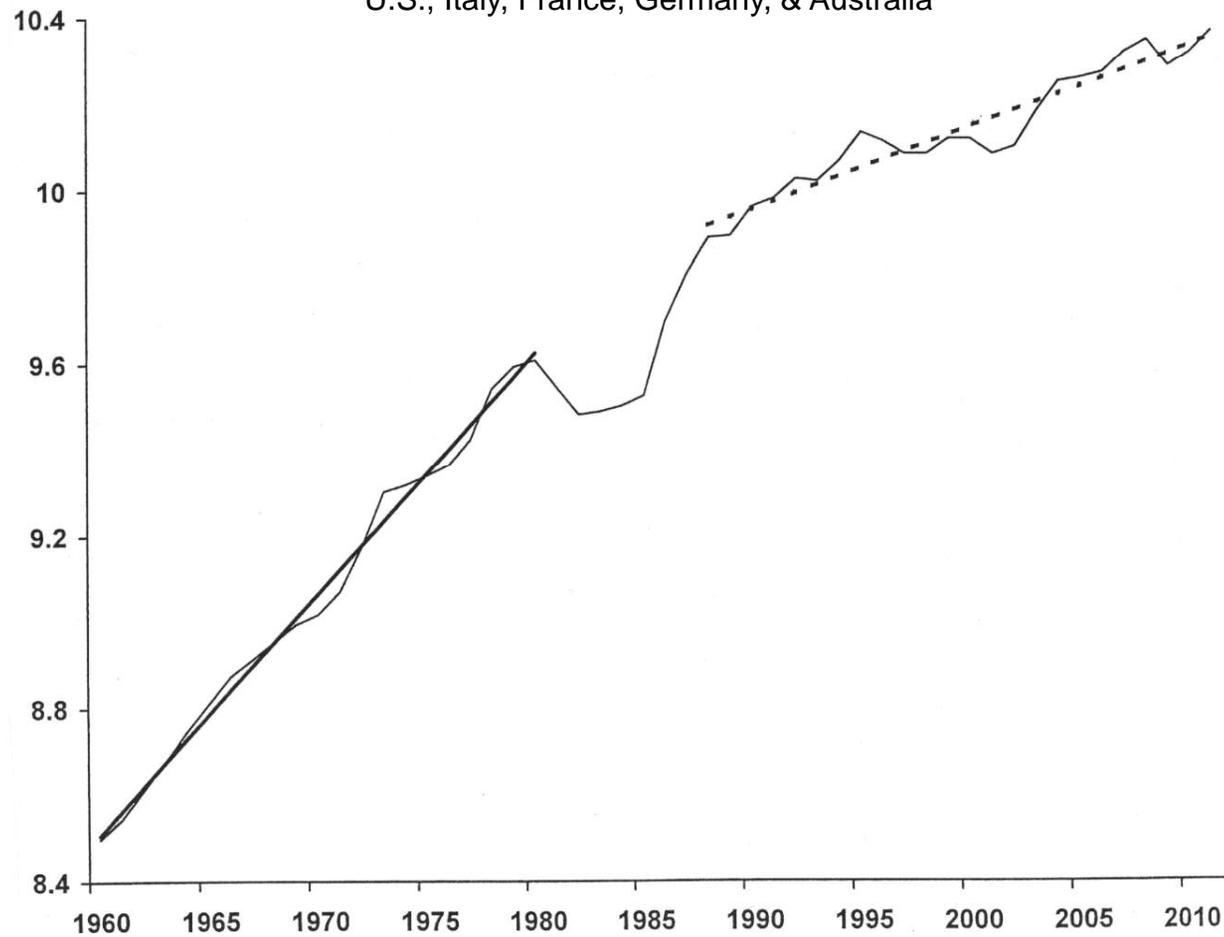
#2.) GIVING UP THE ARMAGEDDON GHOST!!

#3.) EXITING STALL SPEED!!

SAME Demographic New-NORMAL Hits Entire G-10!??

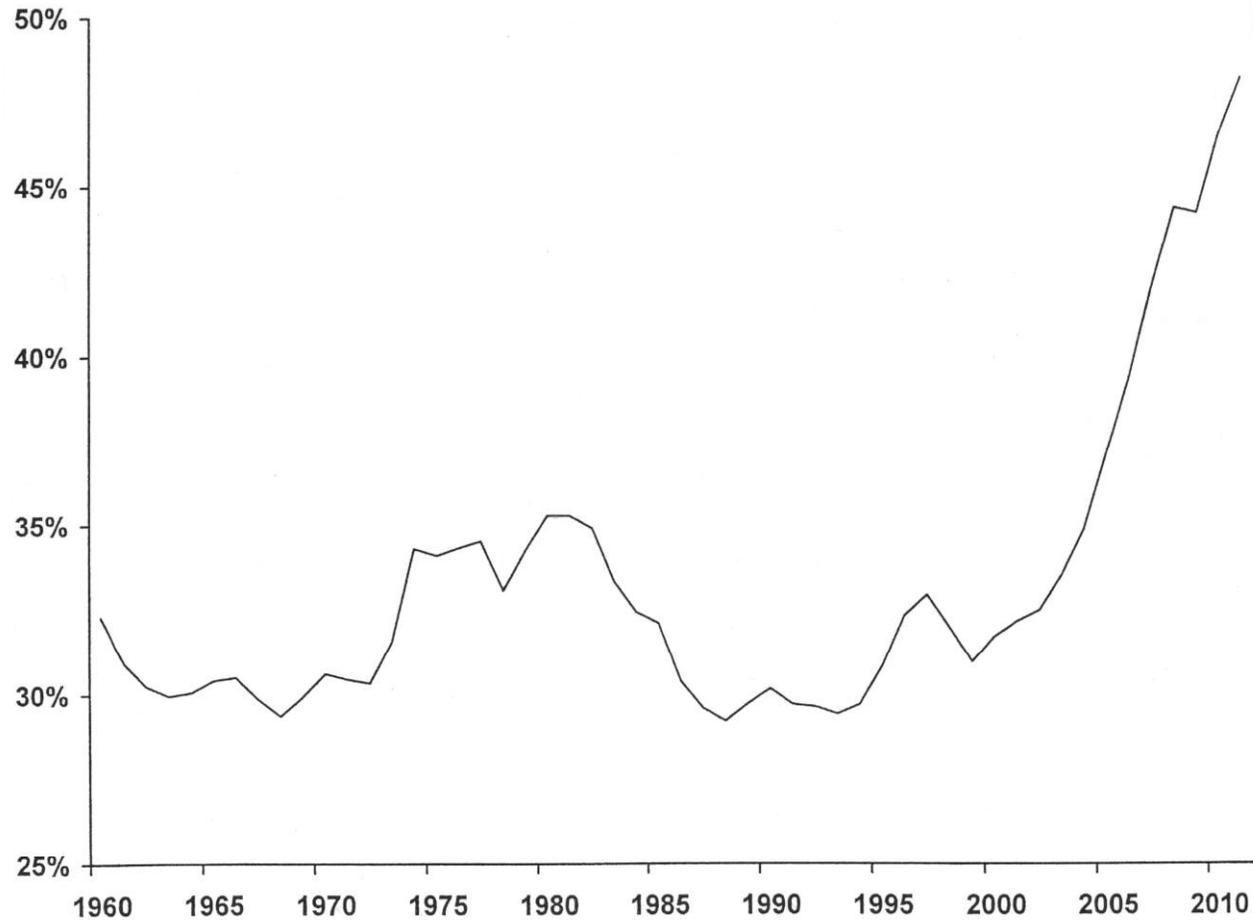
G-10* Global REAL GDP

*Includes Canada, Sweden, Switzerland, U.K., Japan, U.S., Italy, France, Germany, & Australia



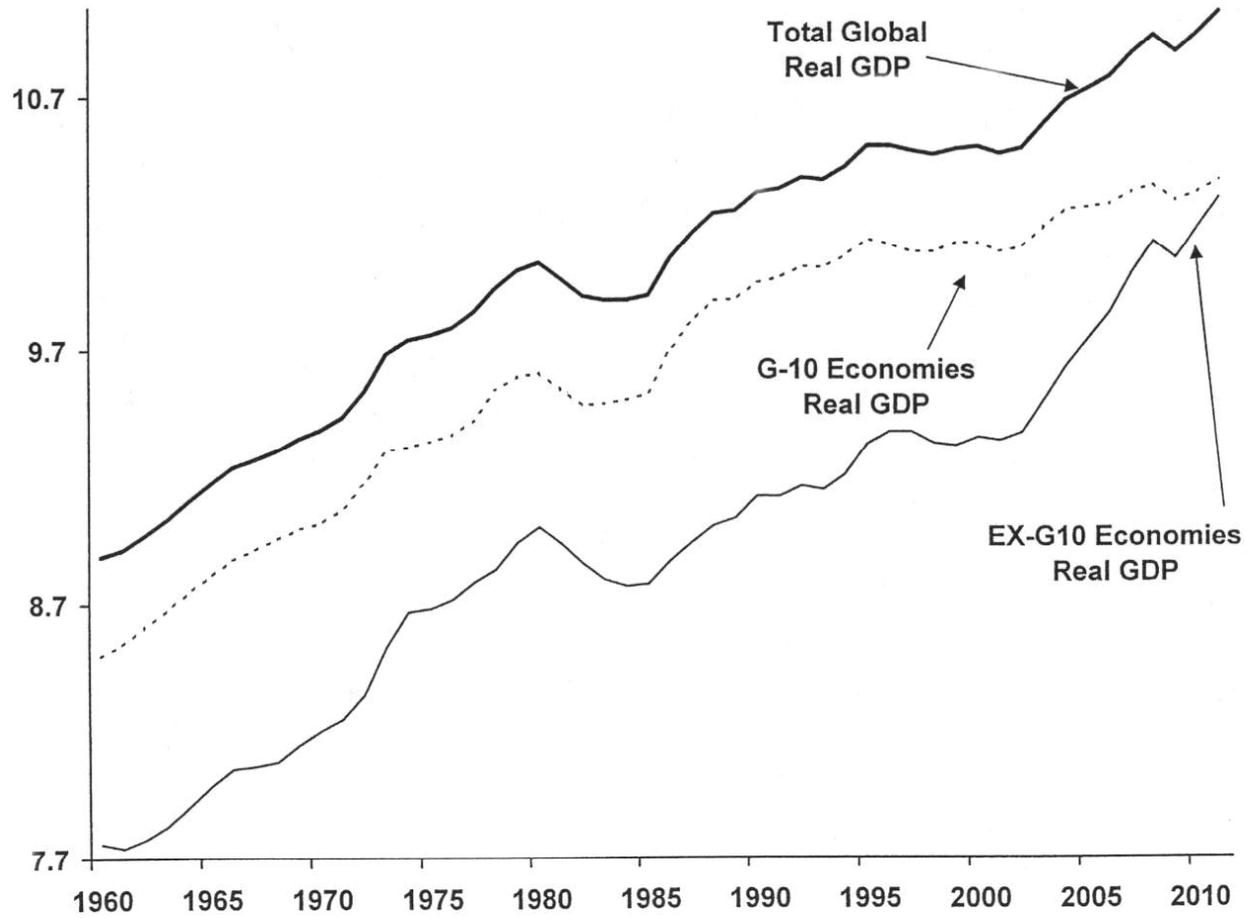
Invisible Hand Enacted the Emerging Market MARSHALL PLAN!!!

Percent of Nominal Global GDP (in U.S. Dollars) Comprised by
Economic EXCLUDING the G-10 Economies



Global Growth Is Still O.K.?!?

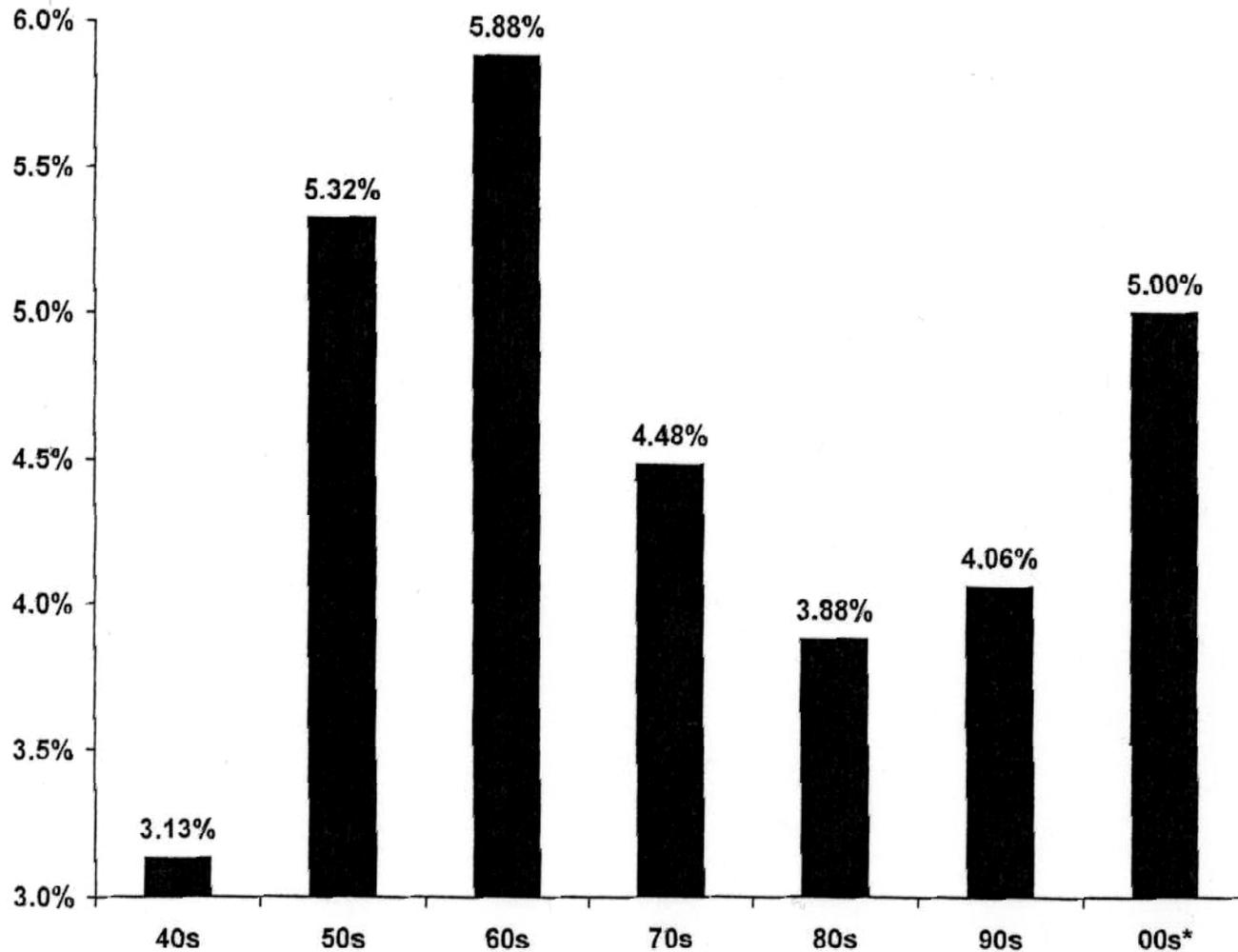
**Global REAL GDP
G-10 Economies vs. Rest of Global Economy**



What? Real Global Growth Has Accelerated???

Annualized Real Gross World Product Growth by Decade*

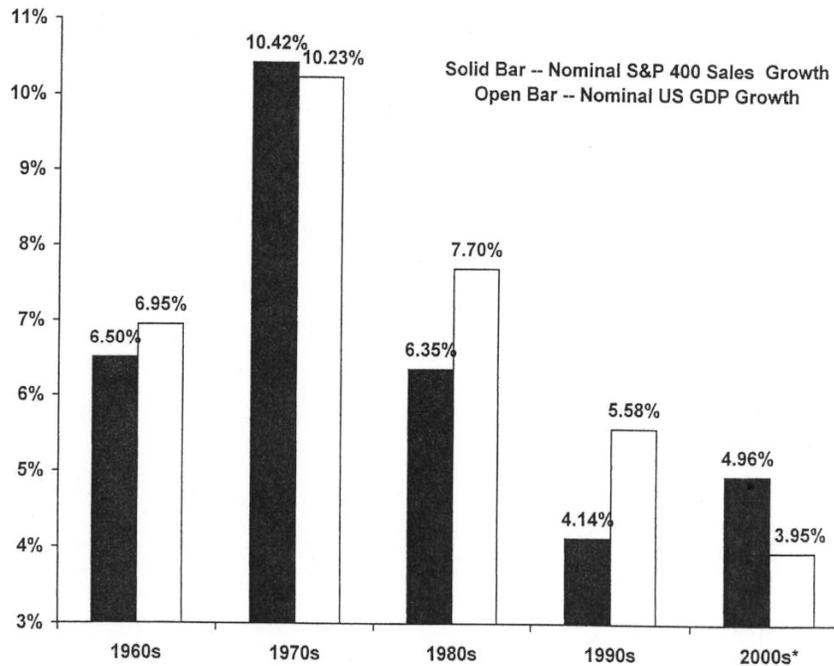
Note: The 00s decade is the annualized growth for 11 years from 2000 to 2011



Finding Top-LINE GROWTH?!?

S&P 400 Nominal Sales Per Share vs. U.S. Nominal GDP Annualized Growth by Decade*

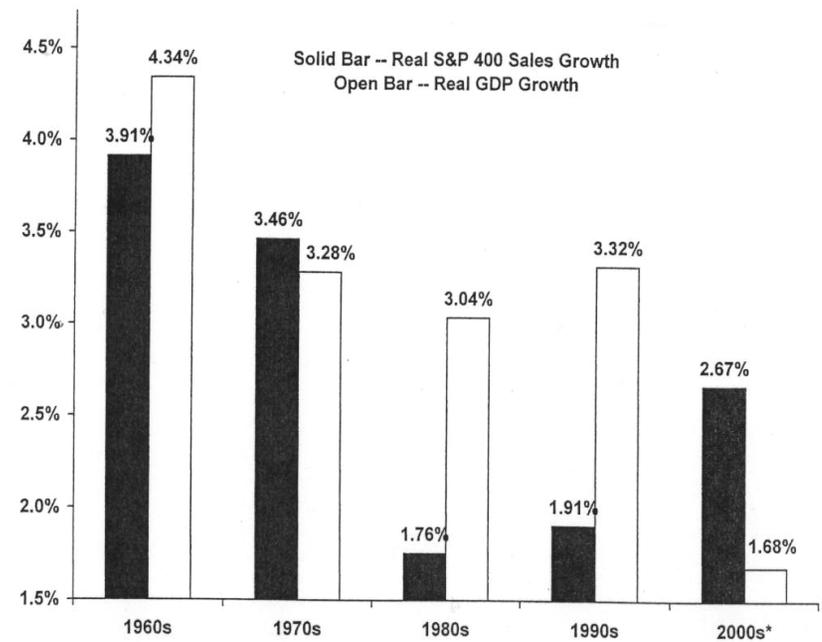
*The 2000s decade is actually from 1999Q4 to 2012Q2



S&P 400 Real Sales Per Share** vs. U.S. Real GDP Annualized Growth by Decade*

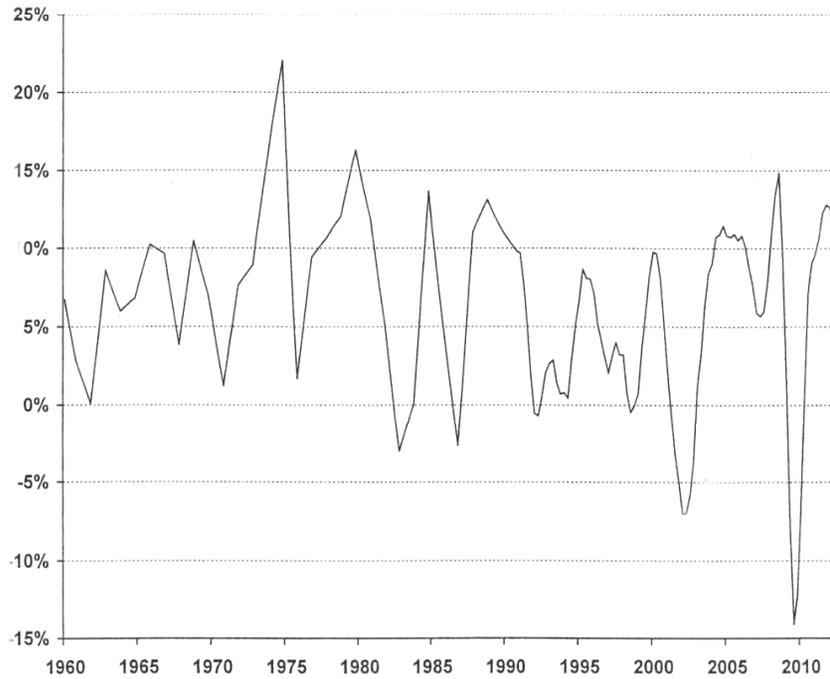
**S&P 400 Sales Per Share Adjusted by GDP Price Deflator Index

*The 2000s decade is actually from 1999Q4 to 2012Q2

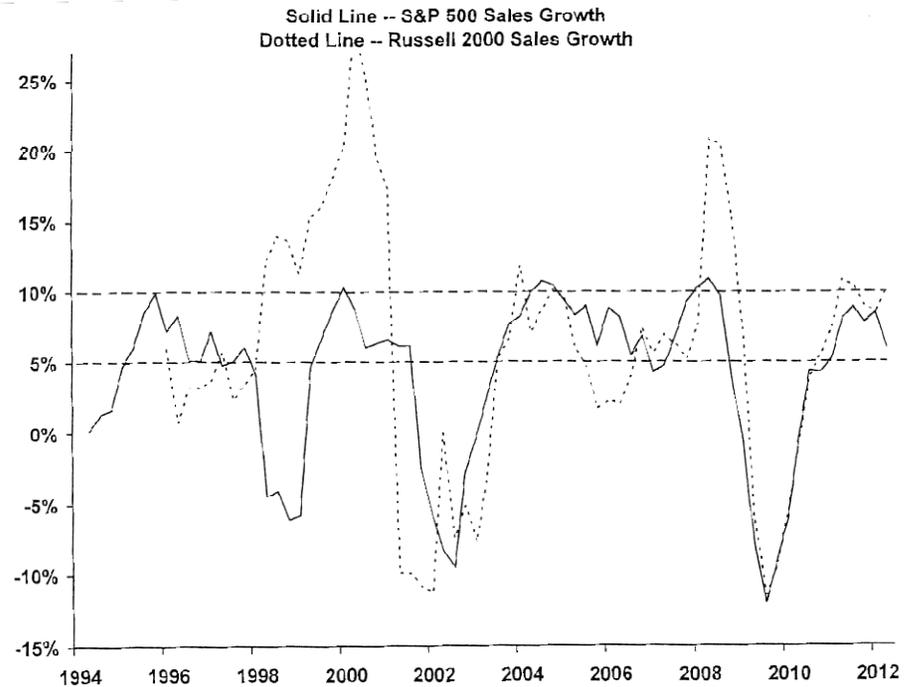


Earnings Story Is Not Just Margins!!?

Annual Growth in S&P 400 Sales per Share

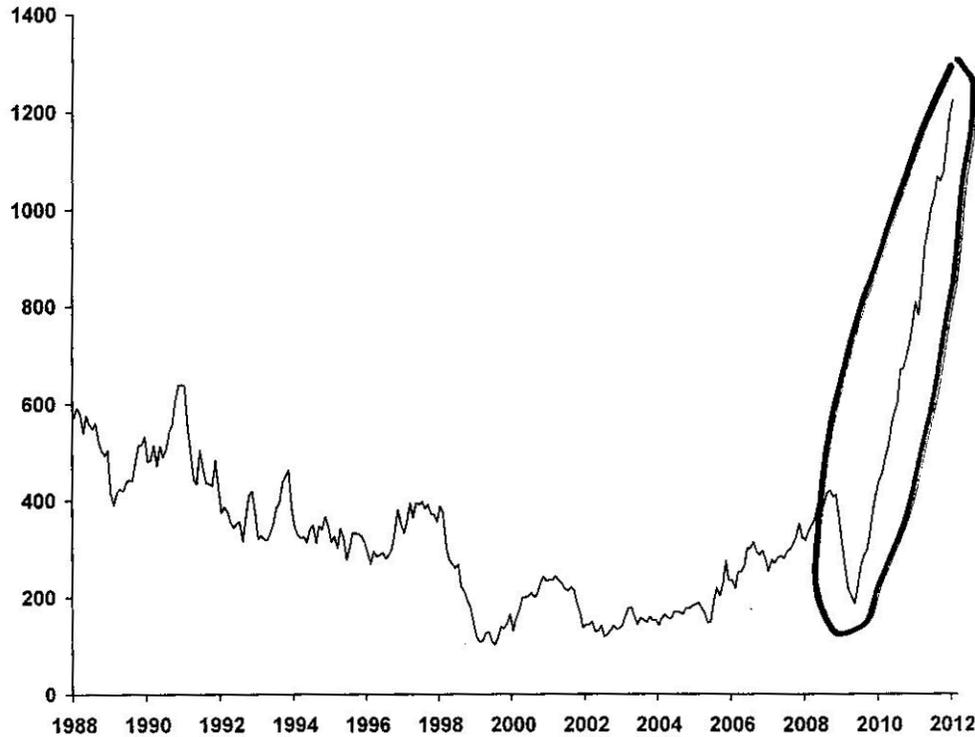


Large Cap (S&P 500) vs. Small Cap (Russell 2000) Per Share Annual Sales Growth



Invisible Hand Making U.S. Energy Independent!!?

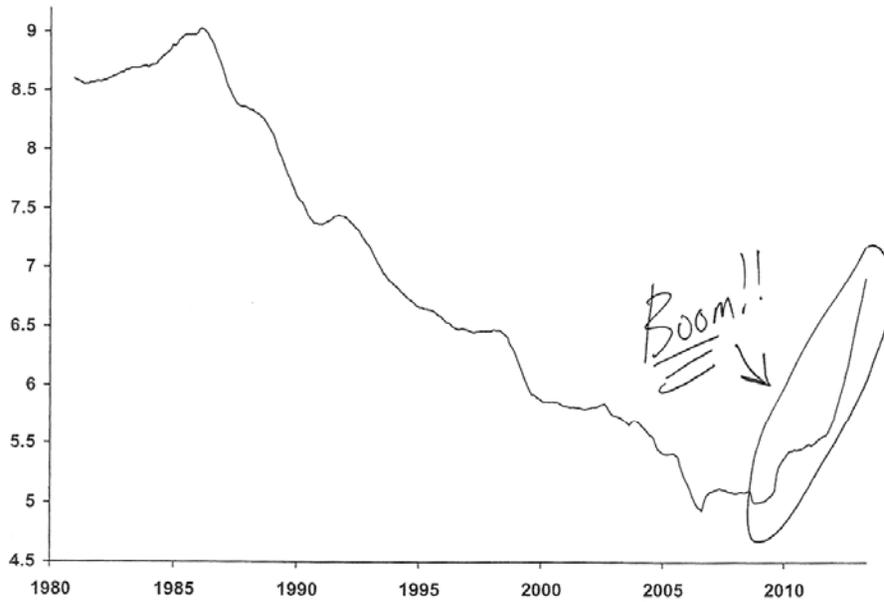
Baker Hughes U.S. Crude Oil Rig Count



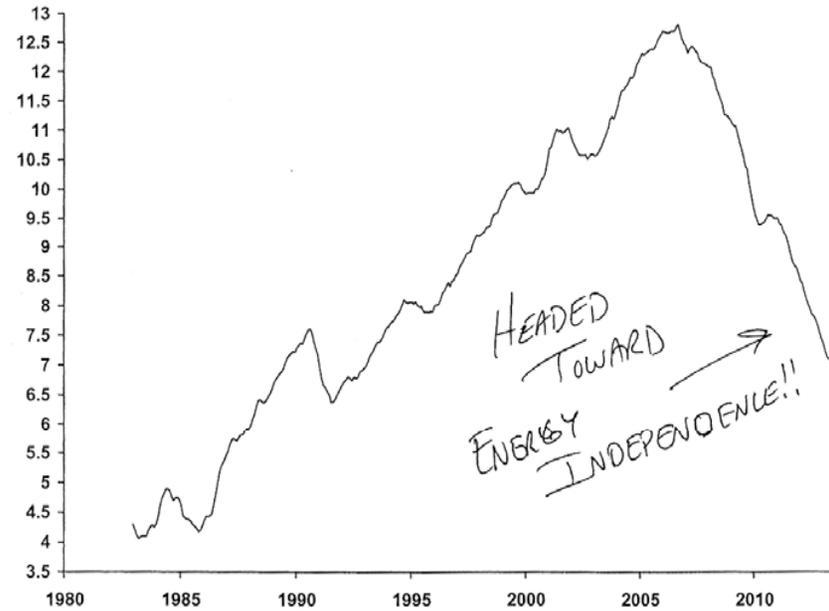
BIG
↑ SUPPLY
RESPONSE!!?

What Oil Crisis???

U.S. Oil Production
Million Barrels per Day – 12 Month Moving Averages

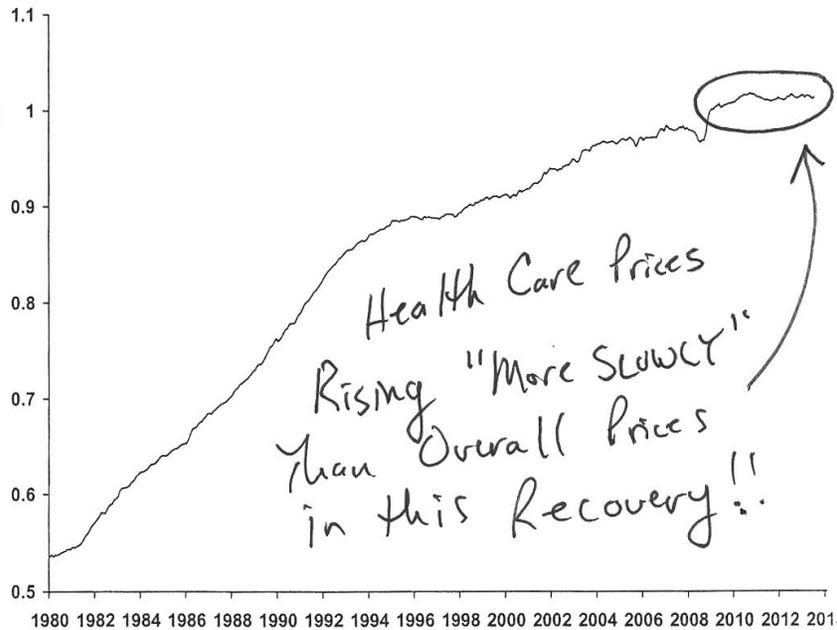


U.S. Net Imports of Crude Oil
Million Barrels per Day – 12 Month Moving Averages

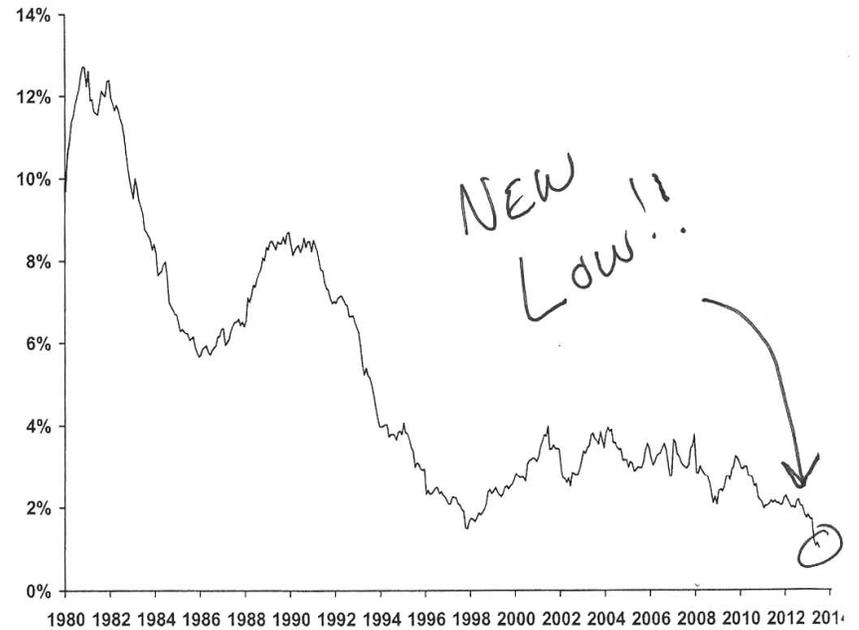


Is "Invisible Hand" Solving Healthcare???

Ratio of Consumer Healthcare Price Index to Overall PCE Consumer Price Index



U.S. PCE Healthcare Deflator Price Index Annual Inflation Rate



What About the FEDERAL RESERVE???

- **Accommodation is O.K....**
...MASSIVE CRISIS-POLICIES ARE NOT OK!

- **Done TREATING FUNDAMENTALS ...**
...Now Needs to TREAT CONFIDENCE!

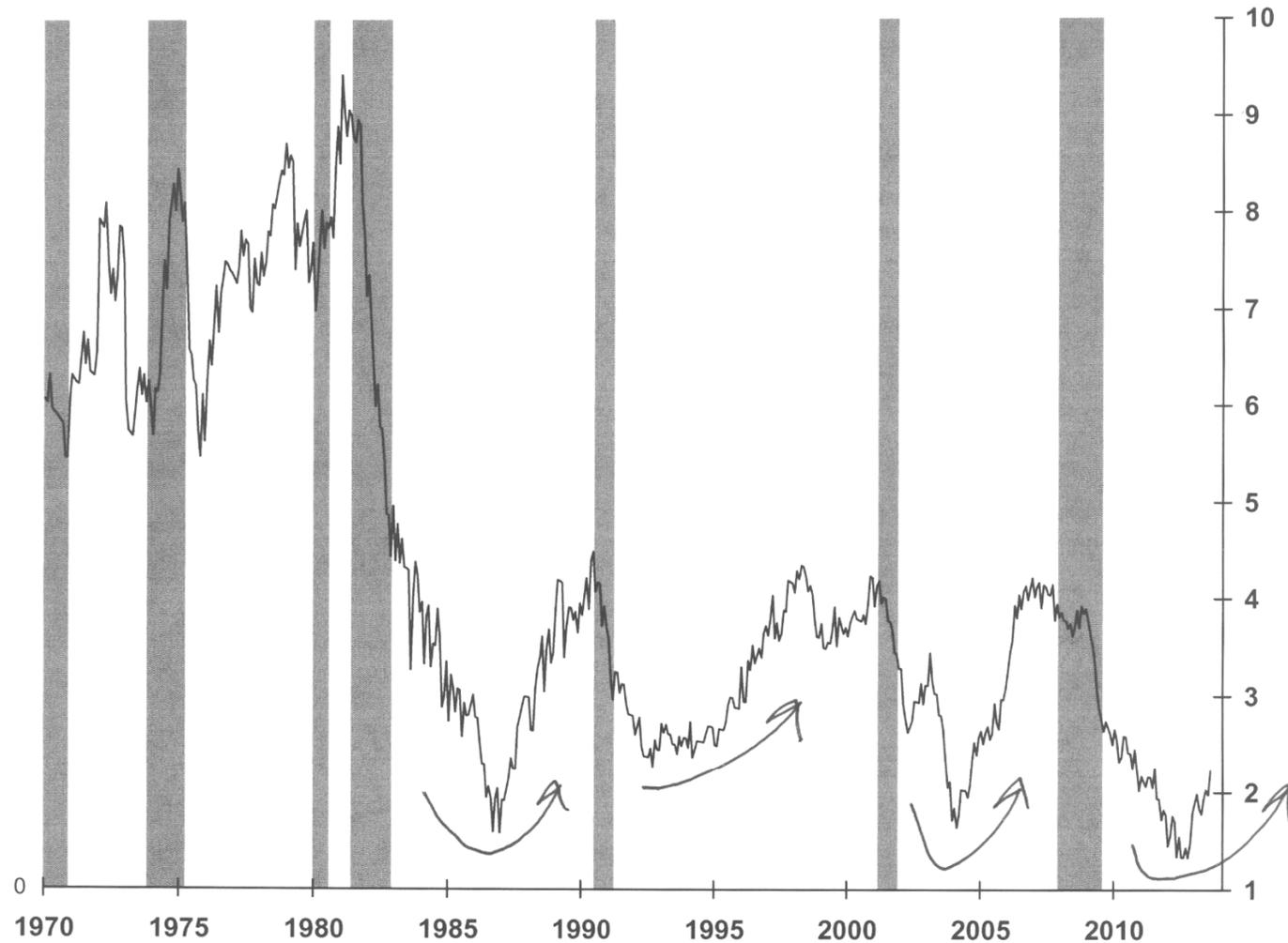
- **The Stock Market is Not Scared of “Tapering”!**

- **Bond Vigilante to “Direct the FED”!**

“DELAYED” WAGE GAINS WILL SOON END?!??

Annual WAGE Inflation Rate

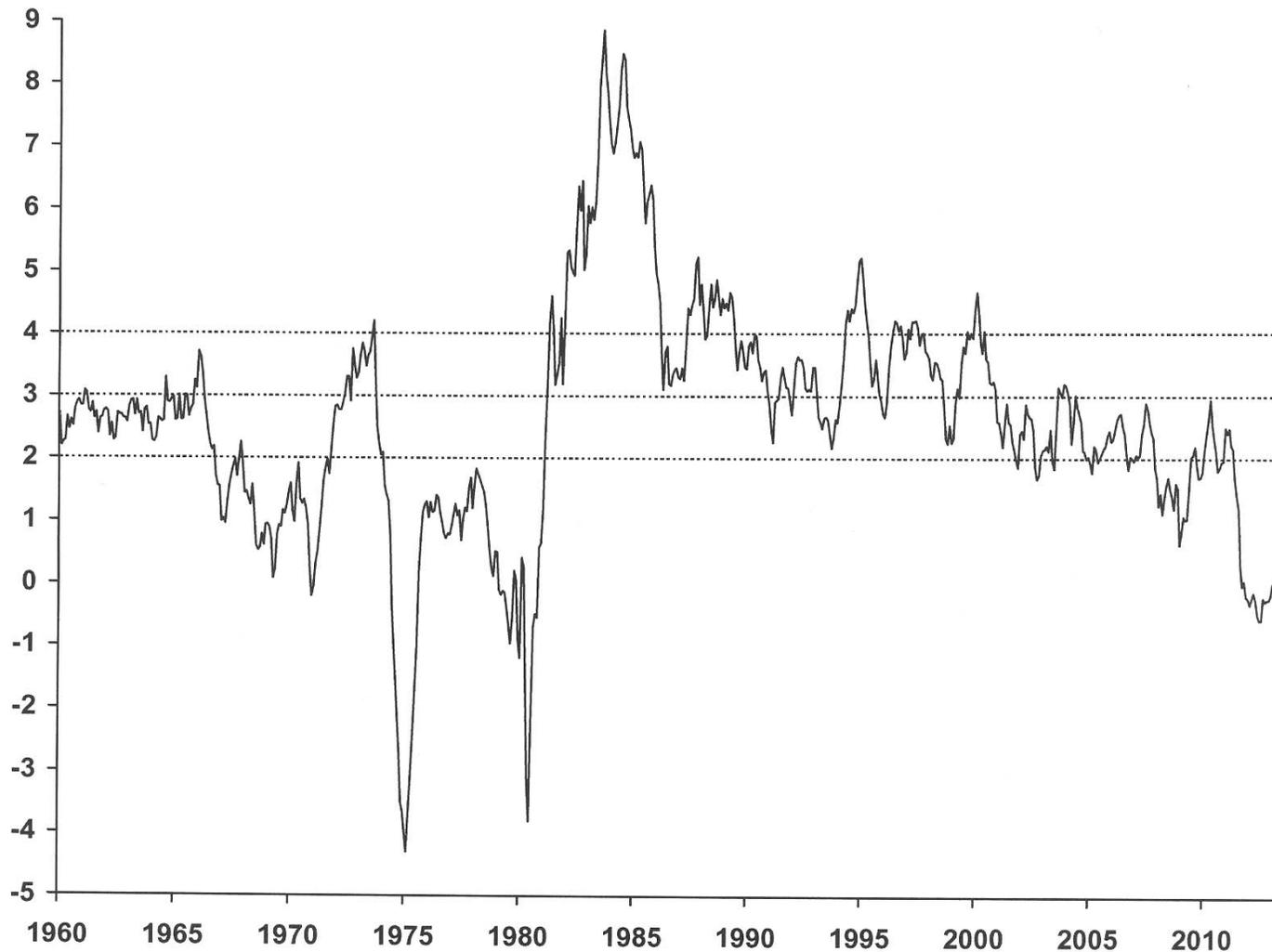
Note: Shaded areas represent recessions.



Repricing Bond Yields Post Armageddon Fears!!!

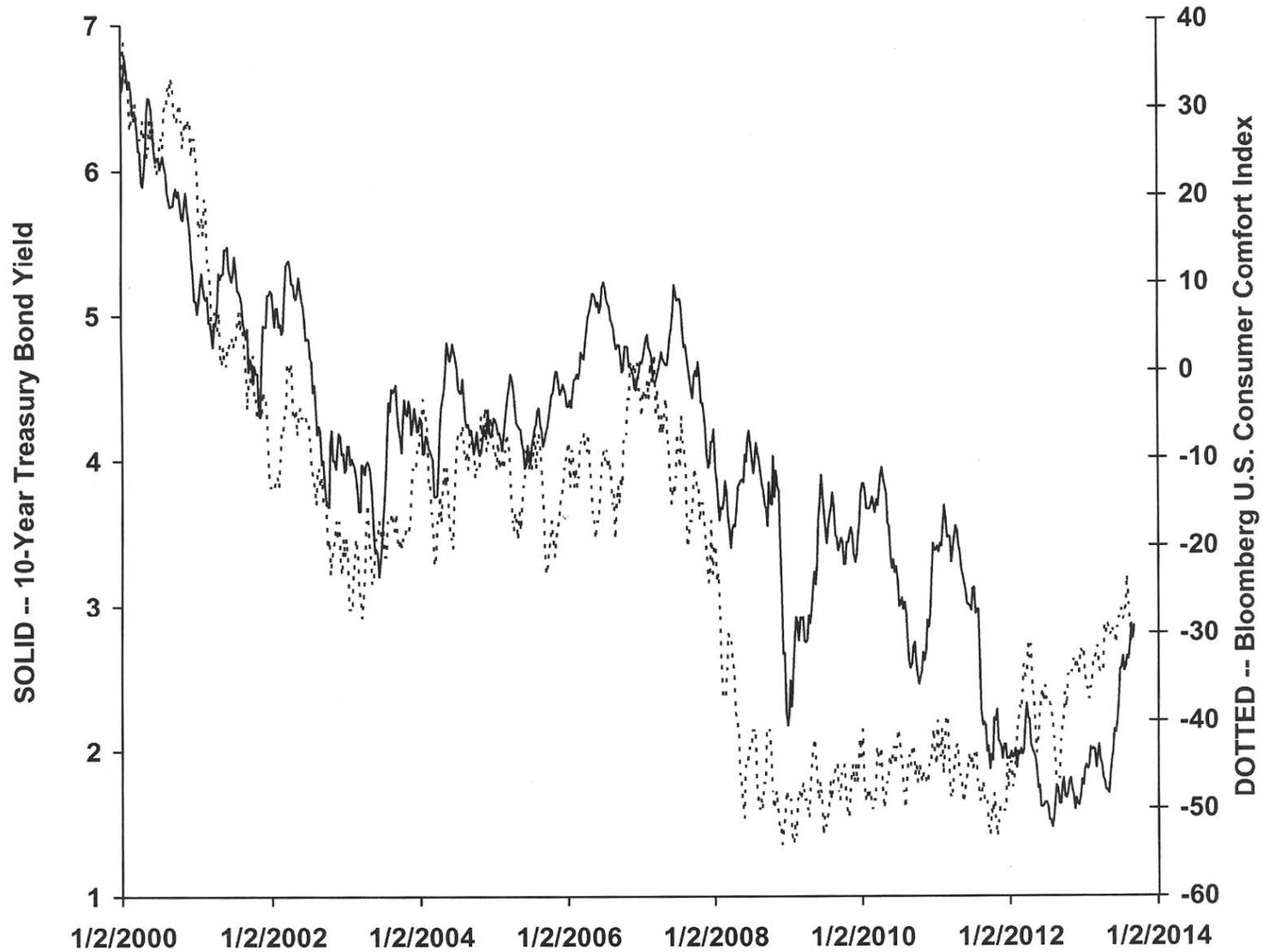
Real 10-Year Treasury Bond Yield*

*10-Year Bond Yield Less Core CPI Inflation Rate.



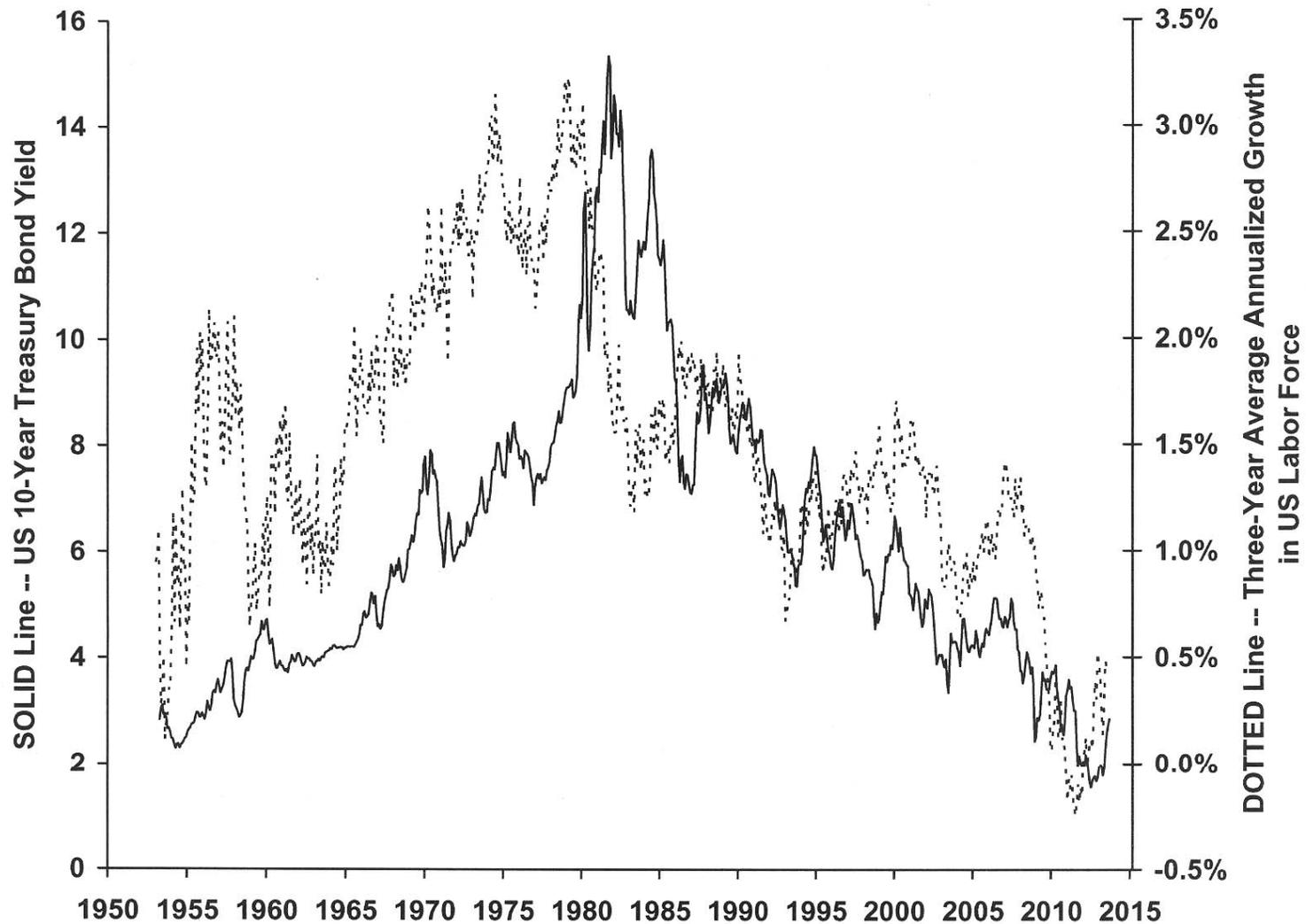
FEAR Has Been Bond Market's Best Friend!!?

Treasury Bond Yield and CONFIDENCE



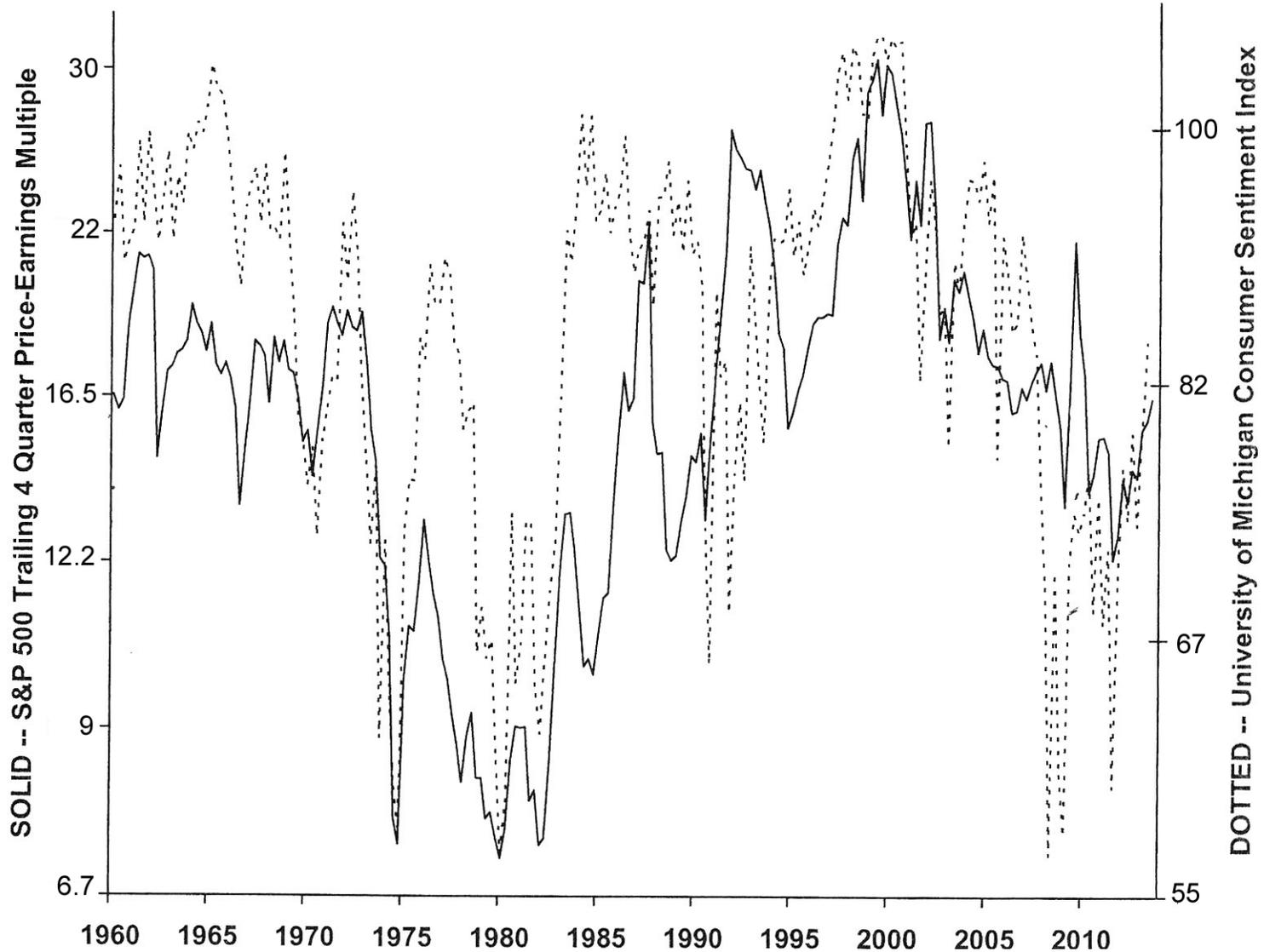
AGING Demographics & the Bond Market?!?

U.S. 10-Year Treasury Bond Yield
vs. U.S. Labor Force Growth



CONFIDENCE Is Key For Stock Market!?!

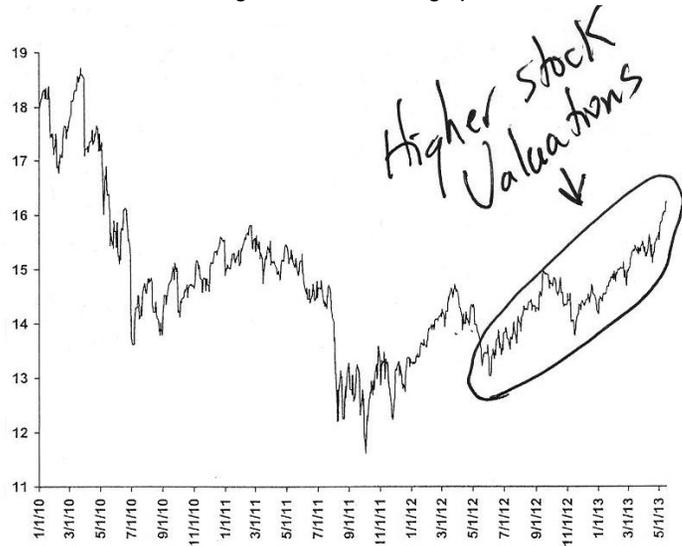
S&P 500 Trailing PE vs. Consumer Confidence



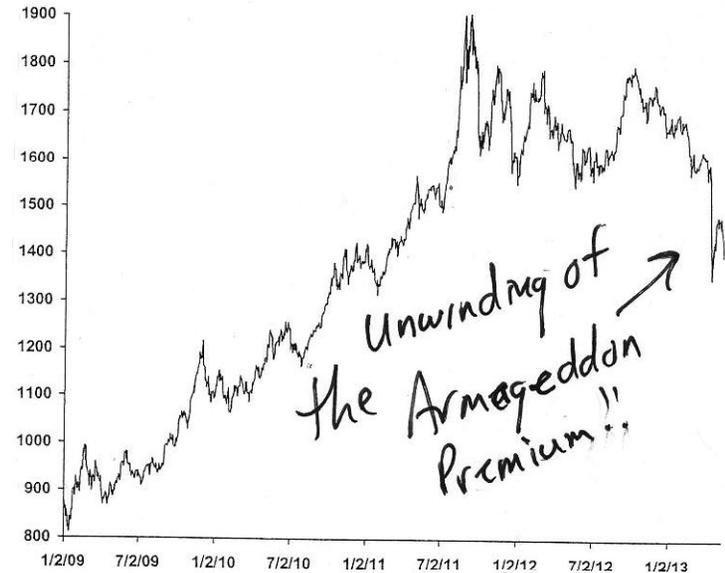
Confidence Runs Through the Financial Market!!!

S&P 500 Price Earnings Multiple*

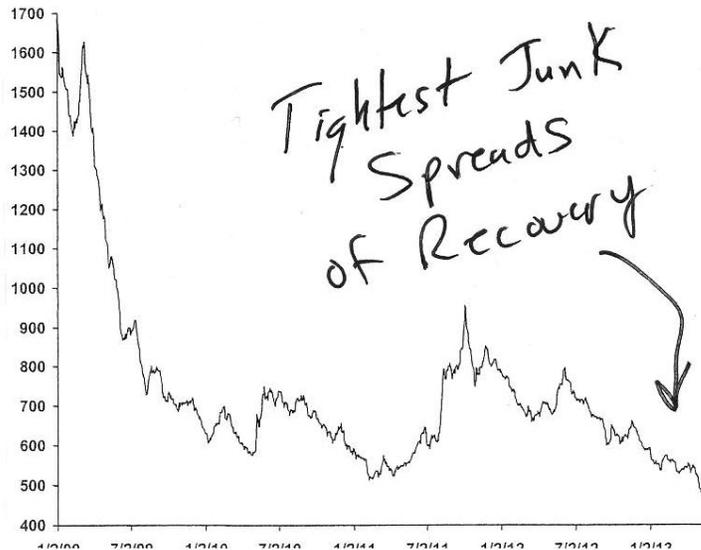
*Based on Trailing 12-month earnings per share



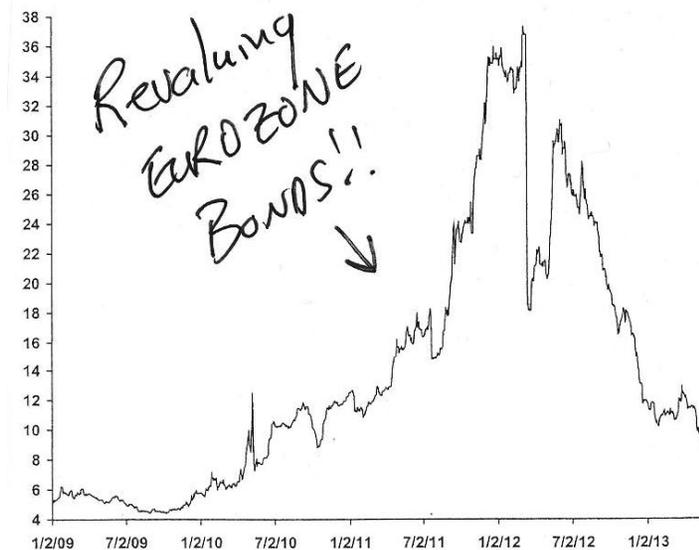
Gold Price



Chase High Yield B Bond Yield Spread

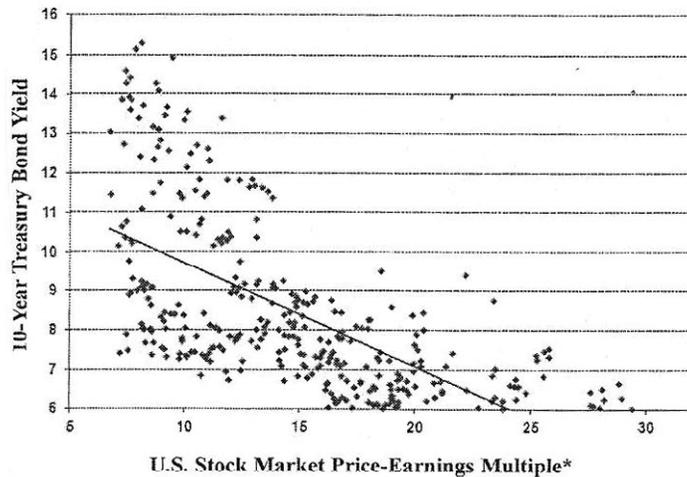


Greece 10-Year Government Bond Yield

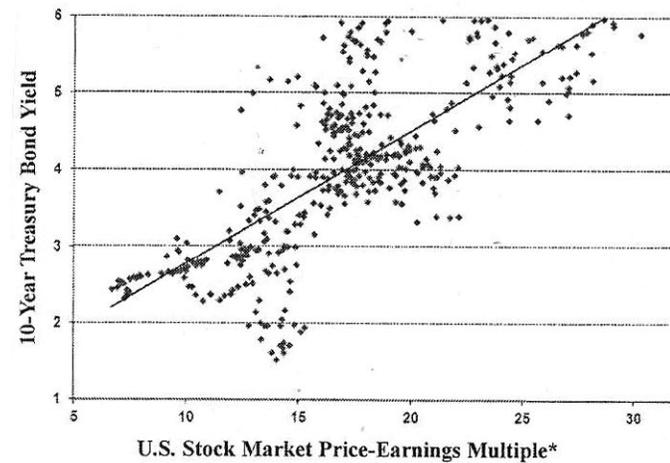


Stock Investors Need Not Fear Bonds ... For a While?!?

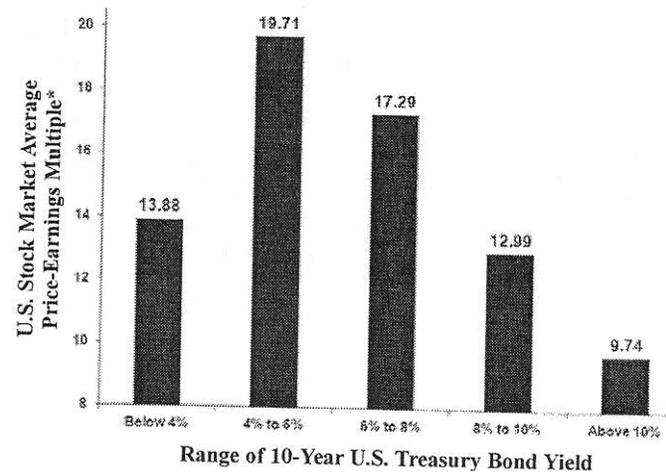
**Price-Earnings Multiples and Treasury Yields
When Yields are ABOVE 6 Percent
Scatter Plot
1950 to 2013**



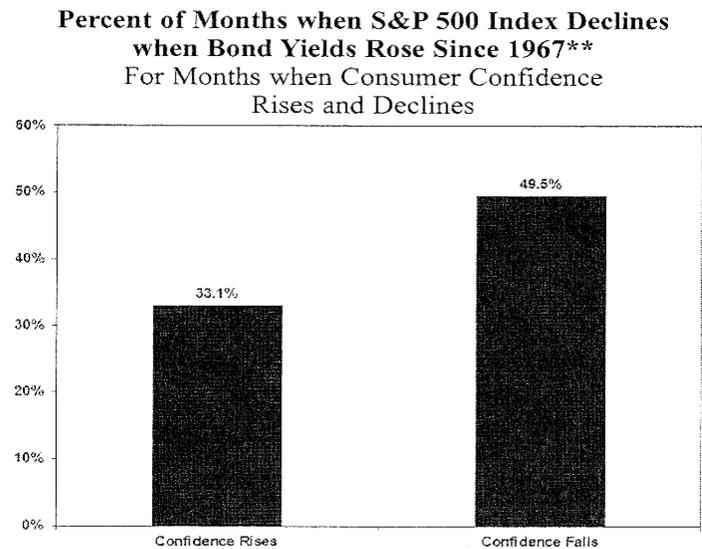
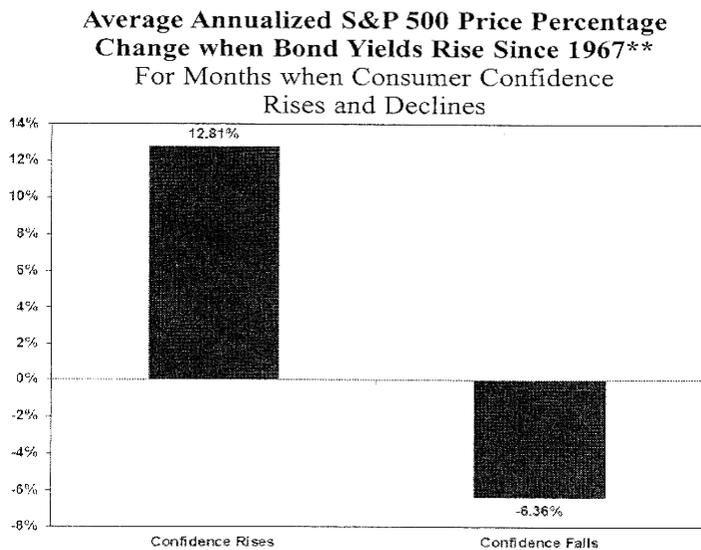
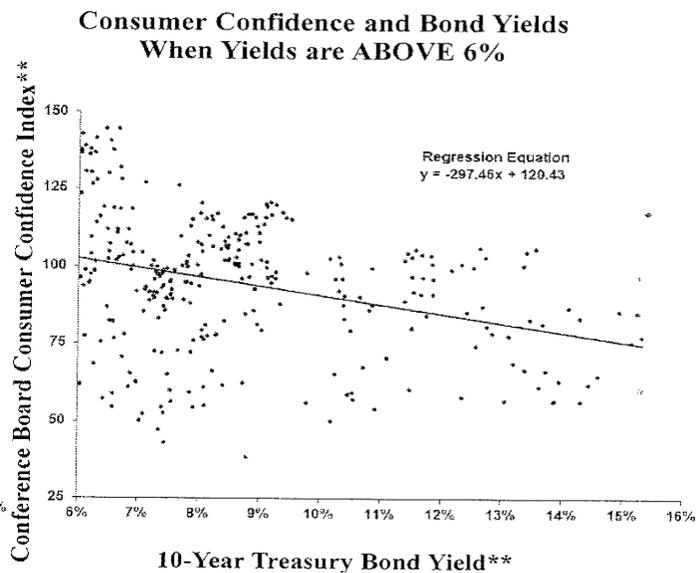
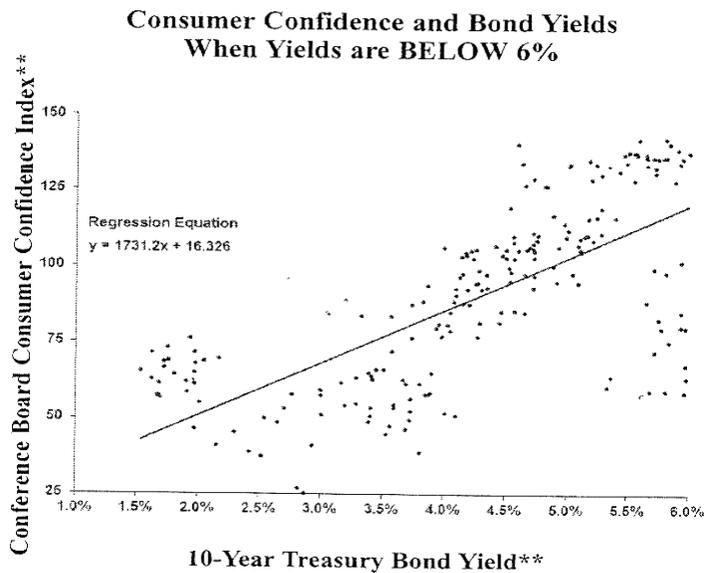
**Price-Earnings Multiples and Treasury Yields
When Yields are BELOW 6 Percent
Scatter Plot
1950 to 2013**



**Price-Earnings Multiples
And Treasury Bond Yields
1950 to 2013**

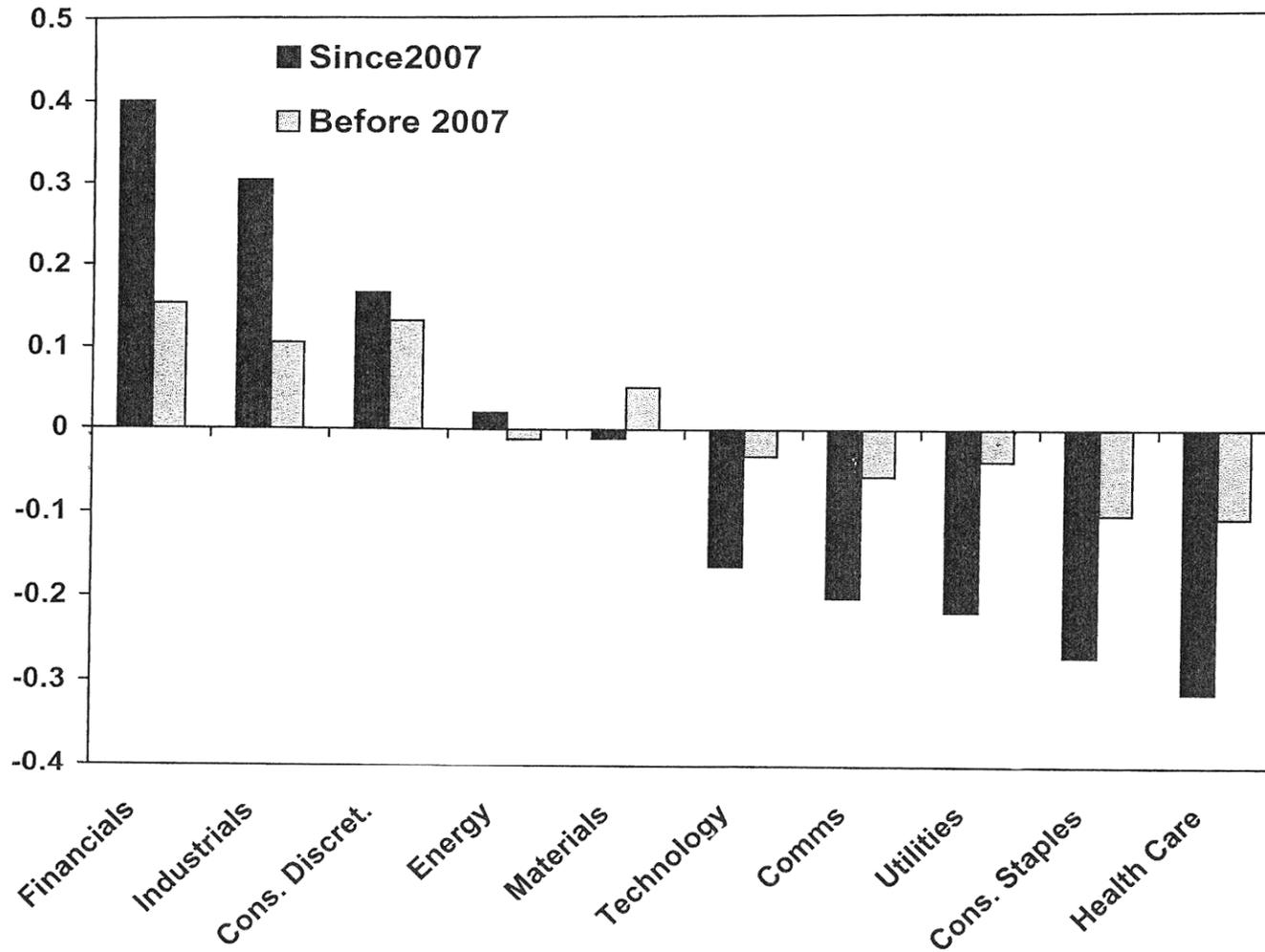


Will Rising Yields Hurt Economy & Stock Market ???



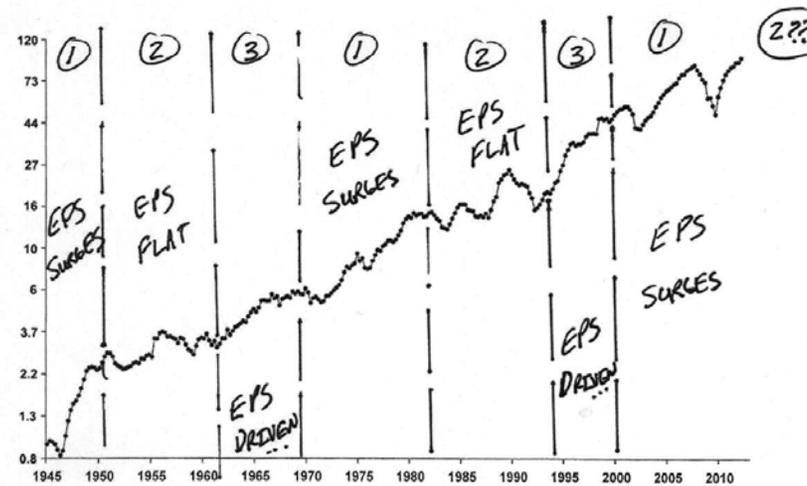
Confidence & Sector Performance??!

Relative S&P 500 Sector Performances*
vs. Consumer Confidence Index
Correlation Coefficients of Monthly Percent Changes

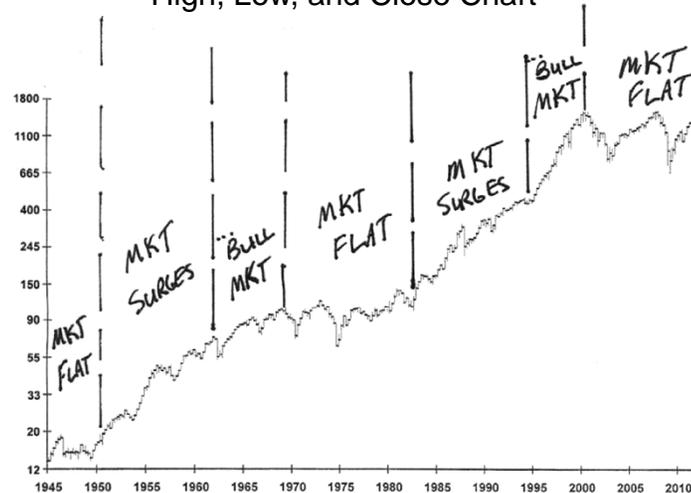


It Is Not About Earnings?!?

S&P 500 Trailing Reported Earnings Per Share
Natural Log Scale



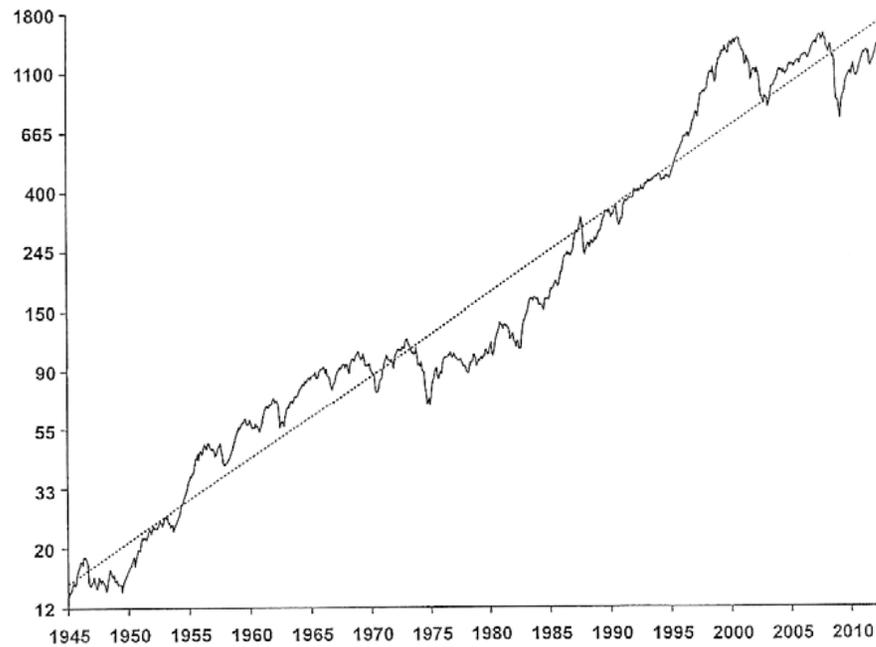
S&P 500 Composite Stock Price Index
High, Low, and Close Chart



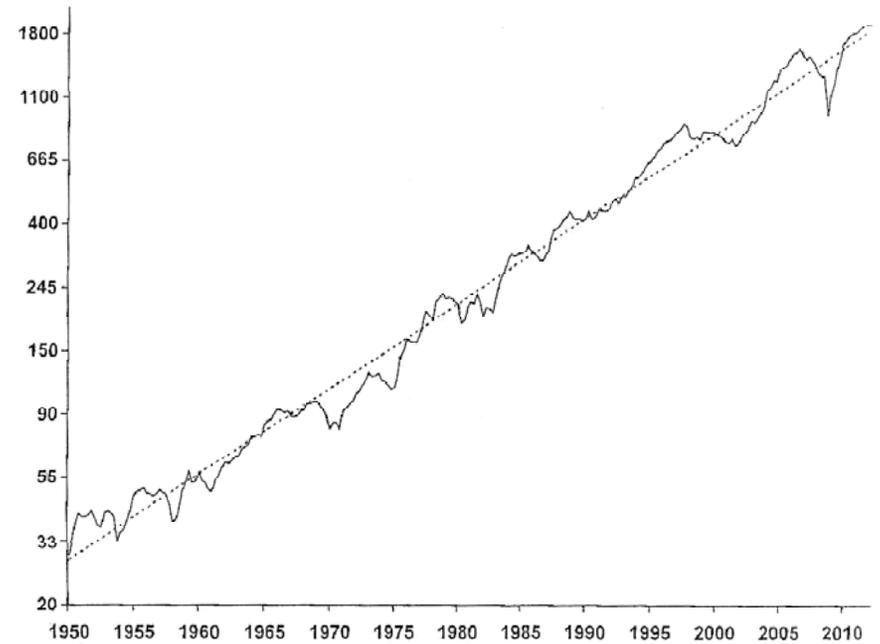
POST-WAR STOCK MARKET STORY!??!

U.S. Stock Market vs. Long-Term Trend line Level

S&P 500 Stock Price Index (Solid)
Trend line Level (Dotted)

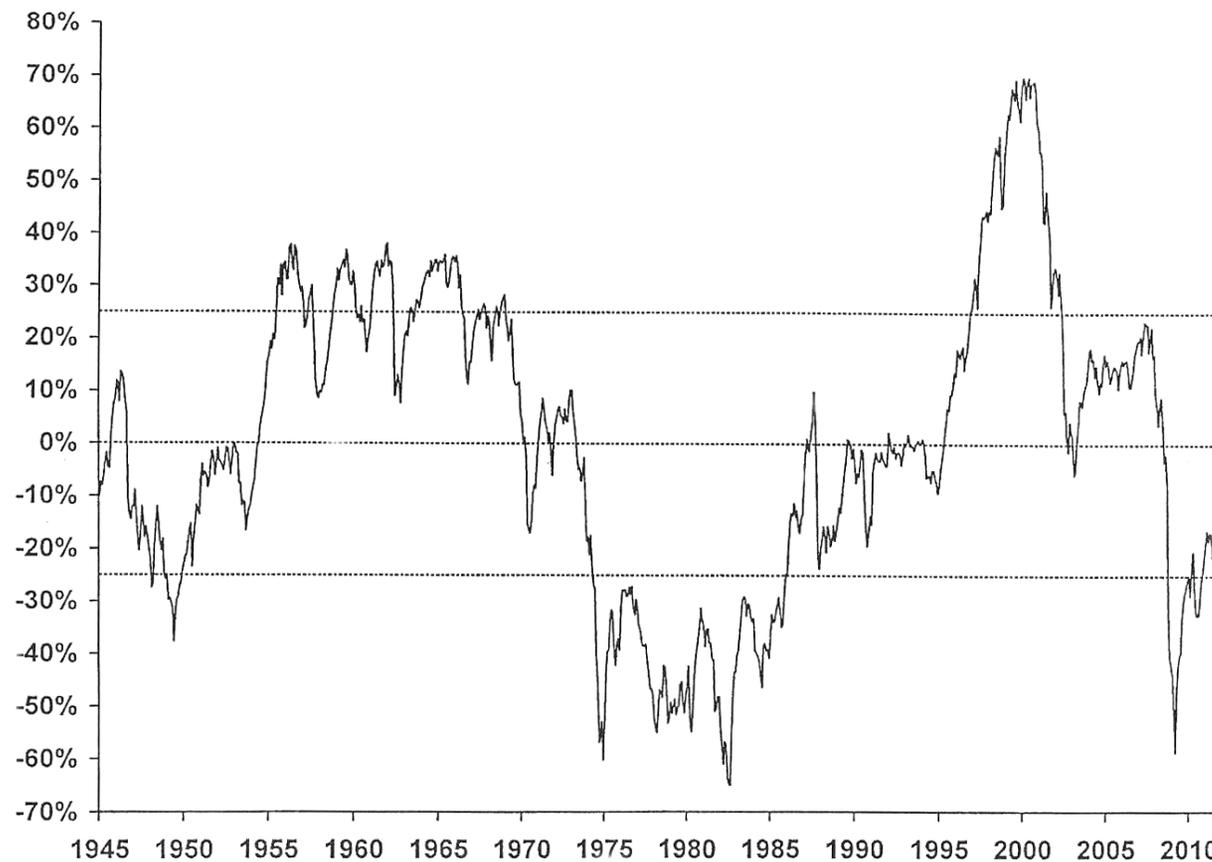


Total U.S. Corporate Profits Actual Level (Solid) vs. Trend line (Dotted)



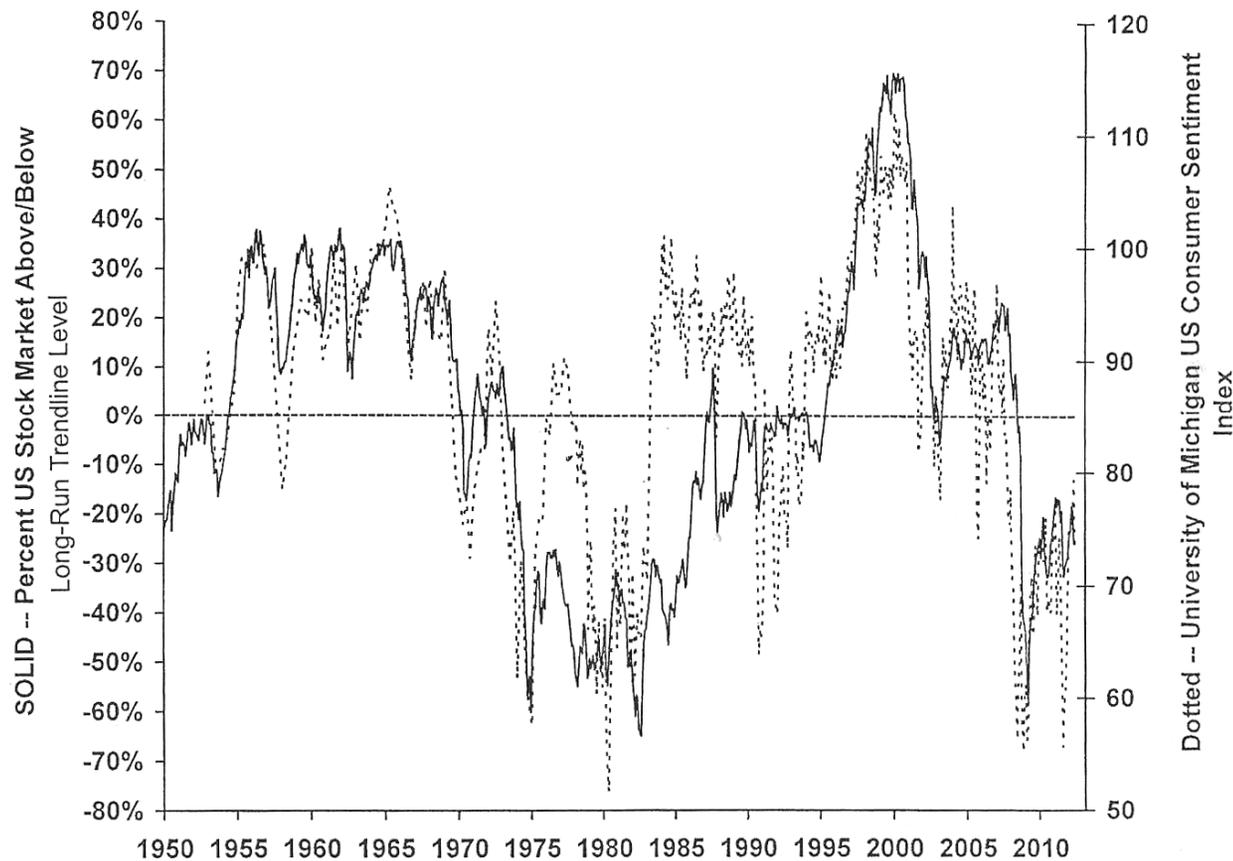
CULTURAL “GLOOM TO GLEE” CYCLE!?!?

**U.S. Stock Market
Percent Above/Below Long-Term Trend Line**



Could A Return To “NORMAL CONFIDENCE” Double the Stock Market???

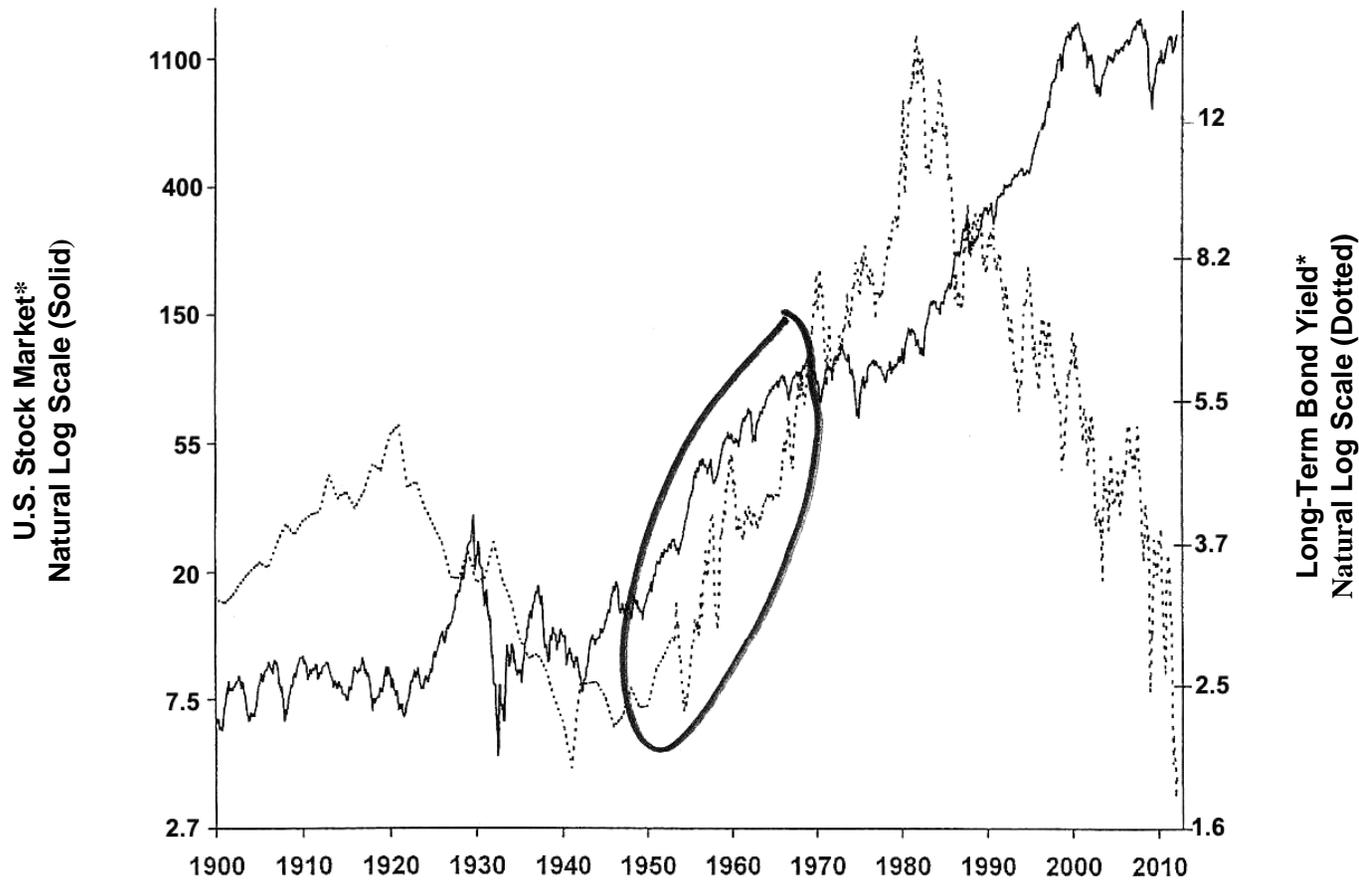
De-trended U.S. Stock Market
vs. U.S. Consumer Confidence



A “Confidence-Driven” Secular Bull à la 1950s-60s!??!

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

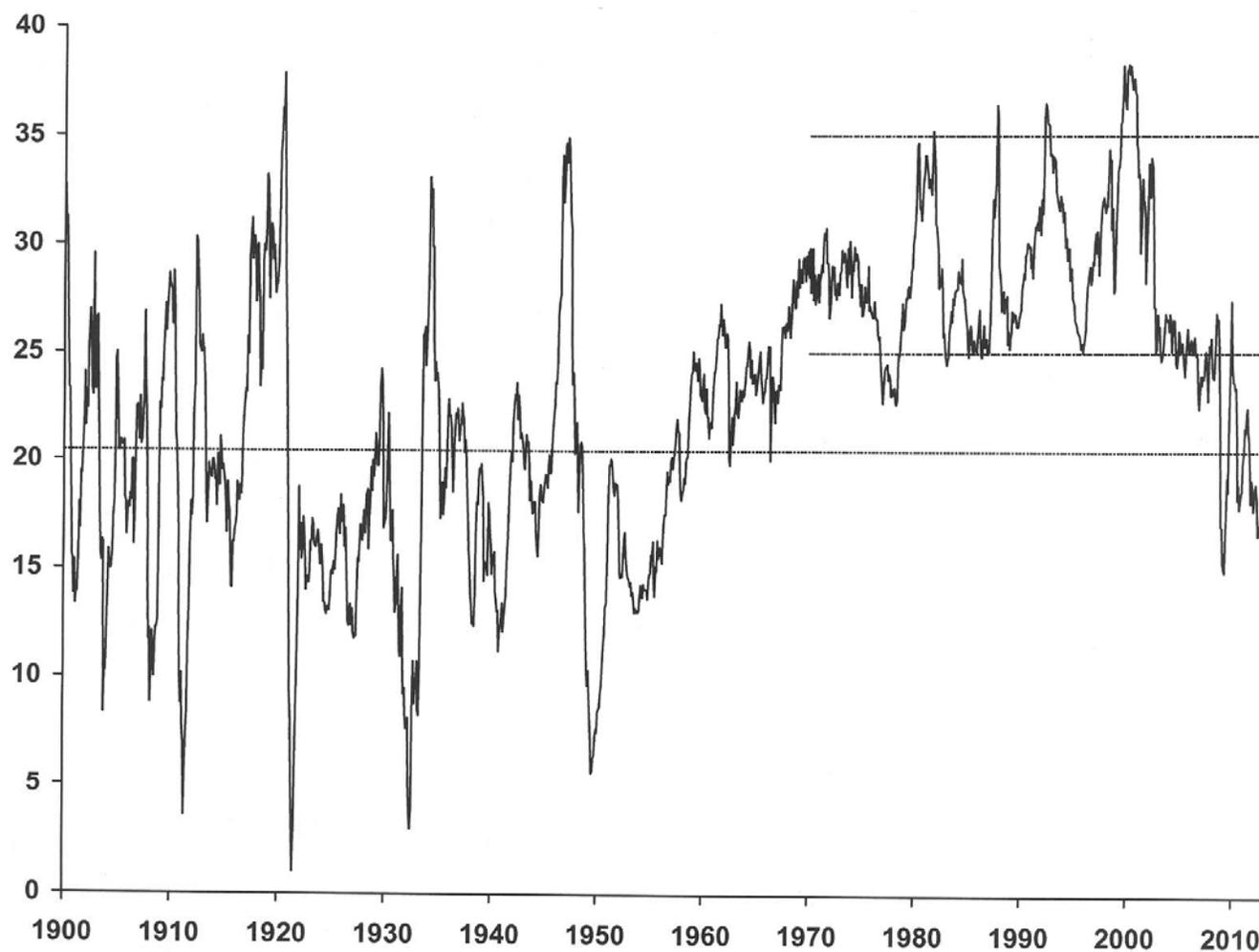
*Sources: Robert Schiller’s database, Bloomberg.



IF INFLATION STAYS LOW ... LOTS OF VALUATION ROOM!?!

U.S. Stock Market Environmental PE Valuation*

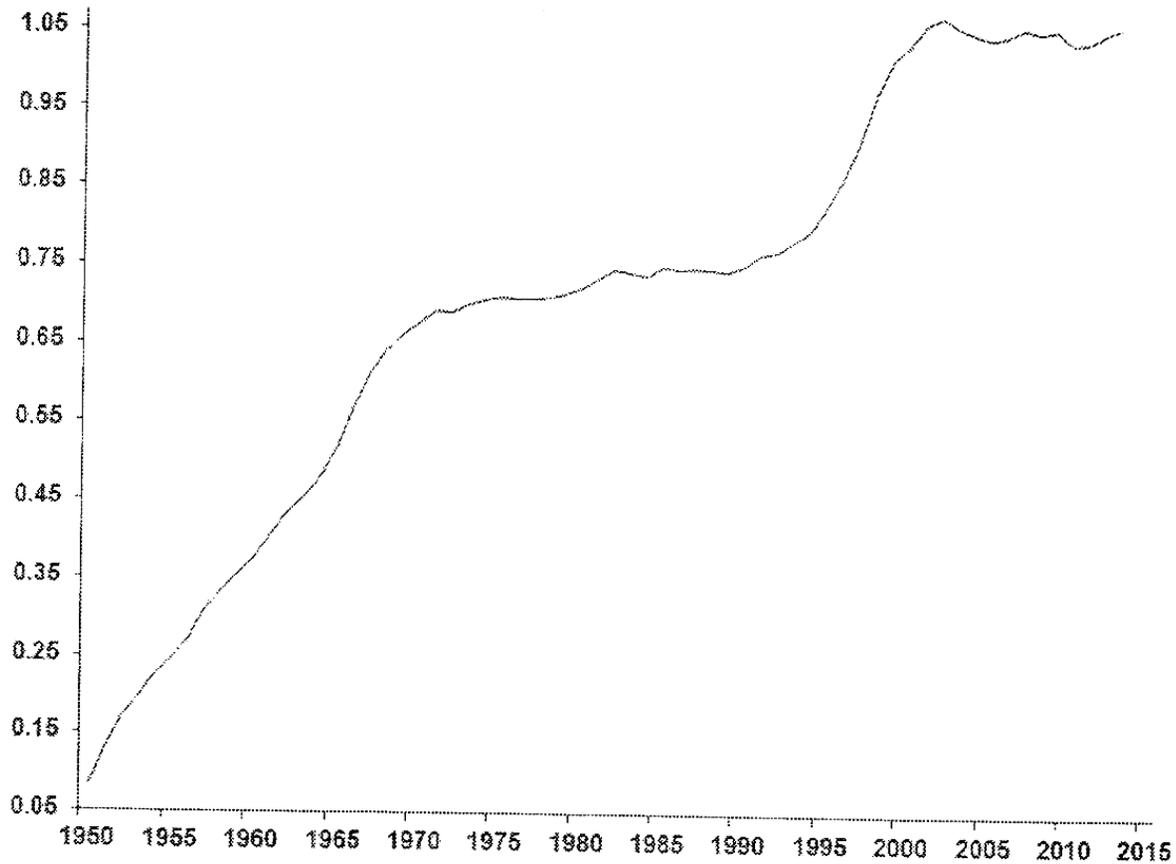
*Sum of PE ratio (based on trailing 12-month eps),
10-year Treasury bond yield and Annual CPI Inflation Rate



Where Wall Street Meets Main StreetCorner of Capital & Labor?!

U.S. Capital-Labor Ratio*

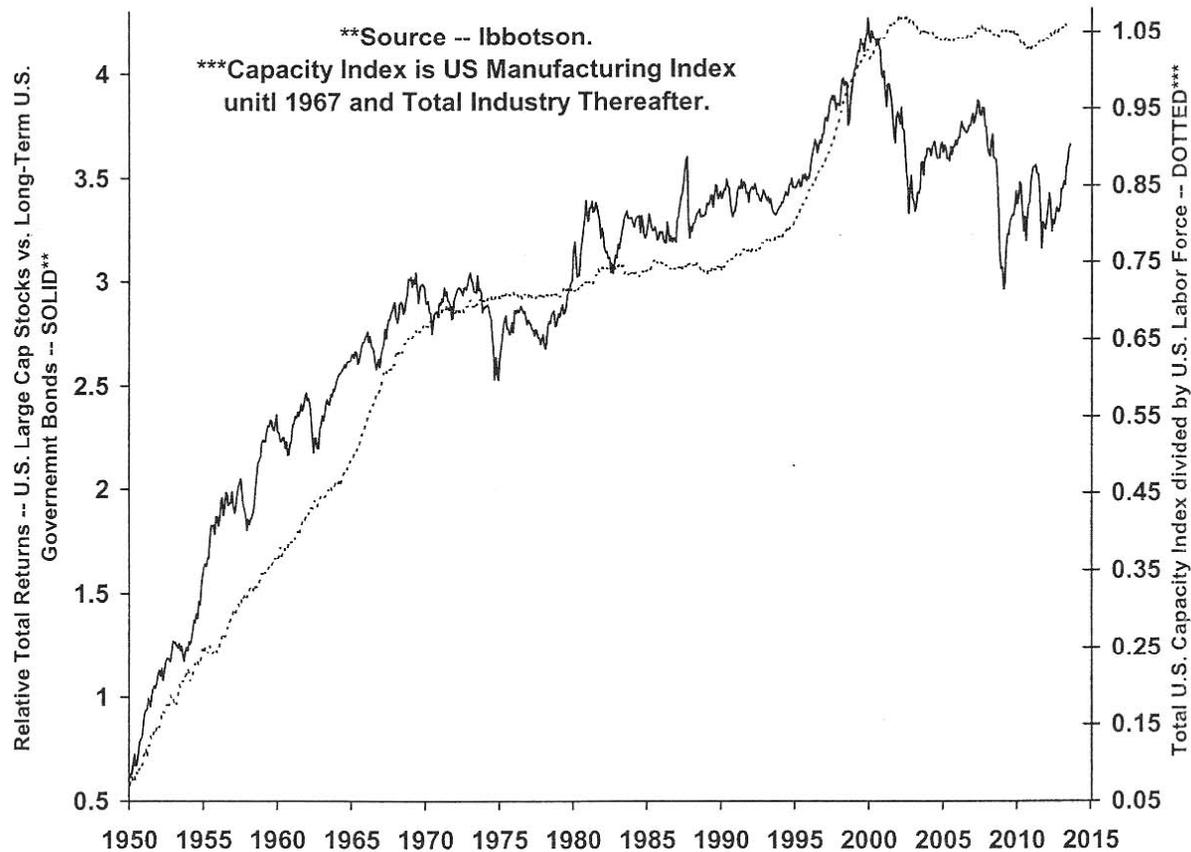
*Annual Average of Monthly Series
Total Capacity Index divided by U.S. Labor Force
Natural Log Scale



A Rising K/L Ratio is Good For Stocks!!

Relative Stock-Bond Return Performance vs. Capital-Labor Ratio*

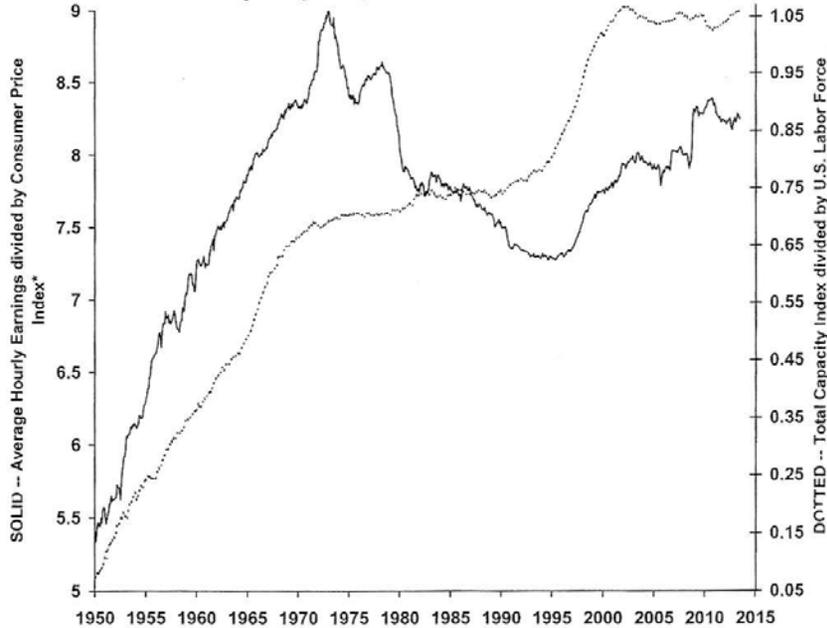
*Both Series are shown on a Natural Log



A Rising K/L Ratio Also Good for Main Street!!

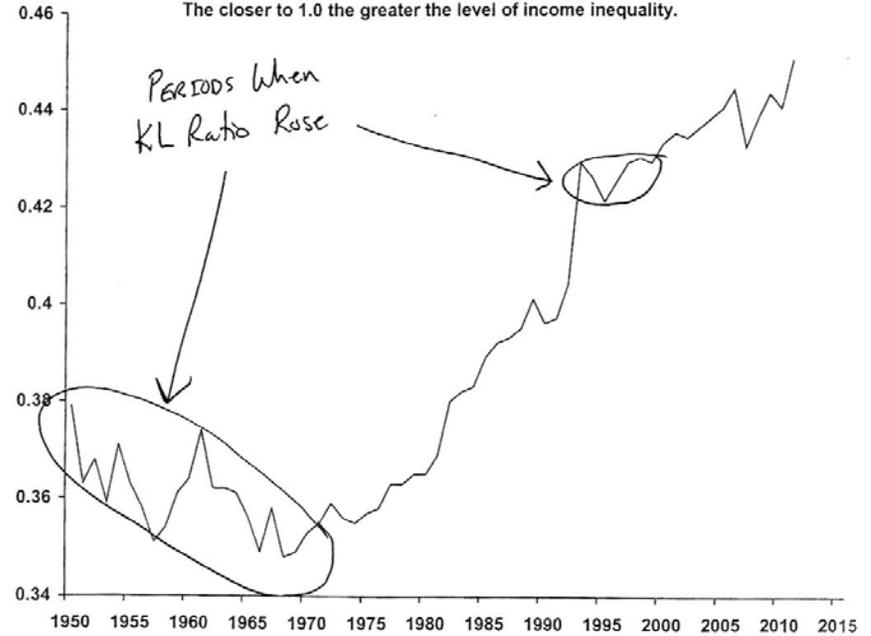
Real U.S. Wage Rate* vs. Capital-Labor Ratio

*1950 to 1963 -- Av. Hourly Earnings of Manufacturing Industry divided by CPI Index.
1964 to date -- Average Hourly Earnings of Total Private Nonfarm Payrolls divided by CPI Index.



Gini Ratio of Income Inequality*

* Ratio ranges from 0 to 1.
The closer to 1.0 the greater the level of income inequality.



Investment Themes???

- **10-Year Bond Yield to 3% in 2013 Then 4%ish in 2014**
- **S&P Pauses for Rest of 2013 Another up-leg in 2014**
- **U.S. Dollar “WEAKNESS” in Next Year**
- **Commodities Get A Bid**
- **Overweight International Developed & Emerging Markets**
- **Favorite U.S. Sectors**
 - **Manufacturing ... Industrials & Materials**
 - **Technology**
 - **Financials**

2013-14 Possibilities???

- **U.S. Economy Enjoys “GEAR YEAR”**
- **Real GDP to Rise by 3%ish**
- **U.R. Exhibits “Slow but Steady” Decline**
- **H.H. & Biz Confidence Improve**
- **Both Manufacturing Industry and Housing Market Add to Growth**
- **Japan Returns**
- **Euro Crisis Calms and Euro Zone Economy Improves**
- **Emerging World Growth Improves**
- **National Conversation Moves from Fiscal to Monetary Issues**
- **Stock Market Driver Changes from “Better than Feared” to “Better than Expected”**
- **Rising Confidence also Runs through Bond MARKET...10yr @ 3%ish and then to 4%ish??**

Questions?

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