STIFEL NICOLAUS

April 2, 2012

Market Strategy
Macro & Portfolio Strategy

Market Commentary/Strategy

2Q12 Macro Outlook: Bears capitulate in, while wise bulls take a step back

We see the S&P 500 ending 2012 flat at ~1,400 with a mid-2012 10-15% correction followed by ~1,600 in 2013-14 based on a P/E ~16x normalized (and greatly slowing) S&P EPS. By mid-2012 we see QE3 due to slowing growth. Beyond mid-2012, we think the commodity equity trade hibernates for 1+ years as the U.S. dollar has bottomed long term, and although we prefer All-cap Growth we do expect Financials to lead (i.e., "When pigs fly…" or, why would private sector leverage stocks lead the market in a public-for-private debt swap de-leveraging era?) when the S&P rally stalls ~1,600. We view the U.S. rebalancing as favorably being three years ahead of the Eurozone (which exited the lender of last resort stage and is entering the contagion stage) and four years ahead of China (in the post-tightening "we can handle this slow-down" stage).

In Our View:

U.S. Equity Market Outlook [See pages 2-16]

S&P 500 10-15% dip mid-12, ~1,400 year-end, ~1,600 2013-14 then 1,200 in 2015 due to monetary and political issues / commodity stock seasonal Oct-11 to Apr-12E rally is over / U.S. banks beat the S&P ~15% in 2012 (1Q & 4Q loaded) but sell S&P when banks lead / Foreigners a contrary indicator / short-term frothy for all-cap Growth.

Fiscal policy [See pages 17-20]

Deficits "create" profits, so falling fiscal deficit lowers margins to mid-decade / Obama re-elected with a Republican House and close Senate / private de-leveraging is available (only) to the reserve currency / expect a late 4Q tax deal / demographically driven U.S. productivity under-appreciated / "bond vigilantes" revive in U.S. ~2015.

Monetary Policy [See pages 21-24]

Negative real rates "create" profits, so ~0% real rates by 2015 lowers margins / QE3 by mid-12 due to employment & housing / Is QE3 preemptive? Or does market have to first dip? / Central bank risk is "tail" ~2015, exit from 0% with large carry trade hard, i.e., the last bubble is central banks.

Europe & China [See pages 25-30]

Over-extended creditor Germany is in a weak position / EU periphery rebellion this summer / China's top-down growth hit a wall (GDP = C + I + G + Nx, but "C" consumption isn't top-down), rising protectionism affects China.

Housing & Labor [See pages 31-34]

Improving payrolls but with a mid-year pause / mid-2012 fuel shock / unemployment 7.6% by Dec-12 / increasing single-family construction lifts GDP, but we see no real house price appreciation for years.

Hard vs. Paper Assets [See Pages 35-46]

Hard Asset leadership over / non-G7 oil demand to weaken / Shale oil is positive, contributing to a long-term U.S. dollar bottom as the U.S. current account closes.

Appendix [See pages 47-63]

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Changes from our 1Q 2012 Macro outlook – nothing major (Cover page from that 1/3/12 report is to the right).

S&P 500 target hit in Mar-12, now see a 10-15% mid-year correction (~1,200-1,275), then 1,400 again at year-end. We added a 1,600 2013/14 target for the S&P 500 and 1,200 in 2015. We like all-cap growth now, not just large-cap. The "Greenspan Put" provided *upside*, the "Bernanke Put" (QE) is about *downside* protection.

We are somewhat *more* bearish on China's ability to finesse a rebalancing toward consumption within its top-down politico-economic model that is in delicate transition.

We were surprised by the narrowness of the commodity rally (basically, the warm weather effect), but the Oct-11 seasonal low and bounce occurred as we expected.

Source: Stifel Nicolaus.

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January 3, 2012

Market Strategy
Macro & Portfolio Strategy

Market Commentary/Strategy

1Q12 Macro Outlook: Lengthy Global Rebalancing Favors the U.S.

We target an S&P 500 of 1,400 in 2012, yet foresee small caps and "old" commodity industry equities experiencing a final, legacy burst of relative strength versus the S&P in 1Q12. By mid-2012, we expect QE3 as deflation fears re-surge. Beyond 1Q we see large cap growth leading the S&P 500 higher to ~2014/15, with some late cycle Financials participation supported by U.S. GDP traction, deflation being averted, Fed laxity offsetting fiscal tightening and foreign inflows as the EM & EU rebalance.

In Our View:

U.S. Equity Market Outlook [See pages 2-14]

1,400 target for the S&P 500 in 2012 / small caps lead in 1Q12, but not thereafter / commodity stocks have a 1Q12 seasonal outperformance rally / correlation fades in 2012 / U.S. bank stocks beat the S&P 500 ~10% in 2012 but are more a 2H12/2013 story / our core preference is long duration equities, i.e., traditional growth (listed herein).

Housing & Labor [See pages 15-21]

Improved payrolls and unemployment 7.8% in 2012 / rising wages & participation / increasing single-family construction lifts GDP, however as a drag on U.S. rebalancing we see *no real house price increase* for *several years*.

Fiscal policy [See pages 22-27]

The U.S. has chosen to borrow the output gap / we see President Obama's re-election, a Republican Congress, and gridlock that support deficits / Federal leveraging concurrent with private de-leveraging is made possible by reserve currency status / the fiscal deficit offsets the private sector desire for surplus; e.g., this work-out will take years.

Monetary Policy [See pages 28-32]

We forecast U.S. real GDP growth in 2012 of 3% / Quantitative easing (QE3) is probable by mid-year as inflation falls / Fed risks are all back-end loaded, because Fed exit becomes problematic from a zero interest rate base.

Europe & China [See pages 33-38]

Eurozone debt problems reveal a difficult combination of fiscal *and* competitive (current account) North-South disparities / Germany must inflate while the periphery deflates, a *very* long process due to cultural obstacles / the euro role in global currency reserves will slip / fiscal policing and ECB rate suppression are the next eurozone steps we see / euro $1.25-1.40 range in 2012 / China savings and investment peak while income and consumption rise, a natural consequence of growth / we see aggressive 1Q12 China easing that slows - but does not stop – lengthy rebalancing.

Hard vs. Paper Assets [See pages 39-55]

Notwithstanding a seasonal 1Q12 trade, we think hard asset leadership has ended after a decade long run / we believe non-G7 oil demand is ripe for pull-back as EM GDP slows and fuel subsidies become unaffordable / U.S. tight (shale) oil production is a major macro positive / Libyan oil returning rapidly as EU demand slips, lowers Brent.

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U.S. Equity Market Outlook

In our view:

1. Expect a 10-15% decline in S&P 500 in 2Q/3Q12, then a fast rally back to 1,400 at year-end and 1,600 by 2013/14.

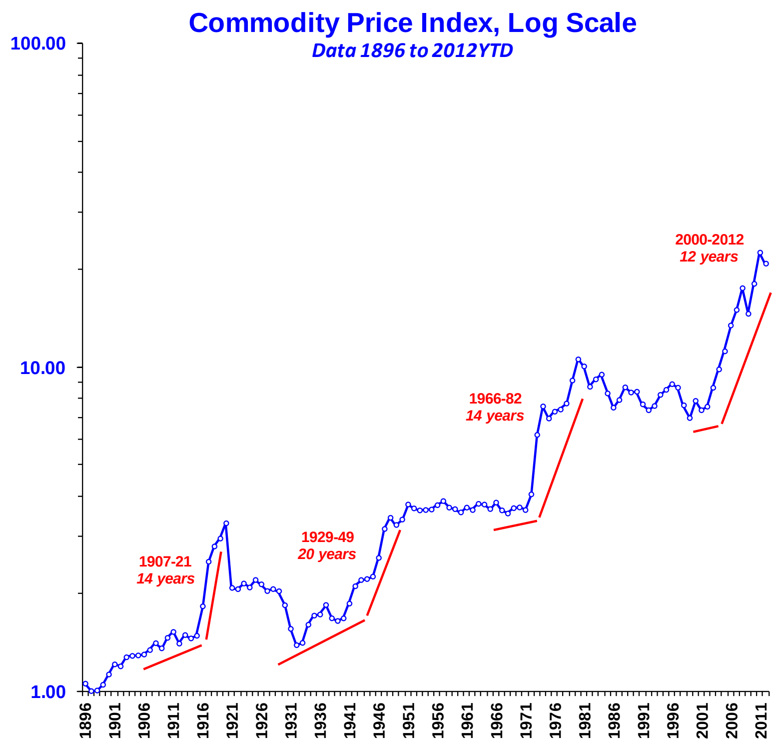
2. The commodity equity trade is over, and probably misses even the seasonal Oct-12 to Apr-13 rally.

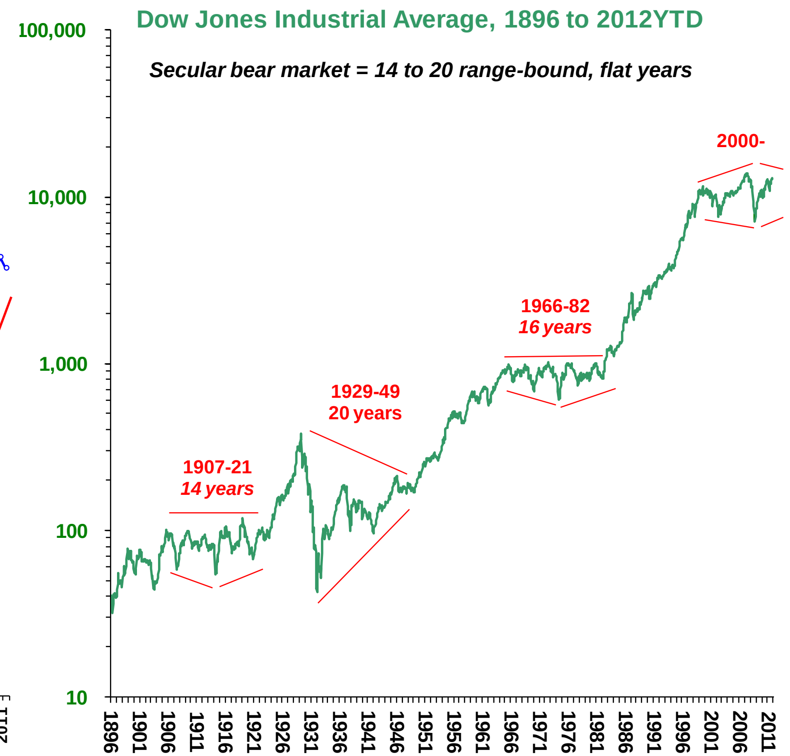
3. The international portion of profits is the most “at-risk” part of S&P earnings through 2015.

4. We prefer all-cap growth (though wary of AAPL, as the “Nifty 1” probably ends about as well as the “Nifty 50” did), but we also like Financials in 4Q12 and 2013.

5. This is ostensibly a private sector de-leveraging accommodated by public sector leveraging, so we would view significant bank stock leadership as a case of “when pigs fly.”

Paper vs. Hard Assets trade-off. **Secular *bull* markets for commodities (left) align with secular *bear* markets for large cap U.S. equity (right), and vice versa. U.S. equity strength corresponds to flat commodities and a strong dollar, and generally <u>not</u> strong commodities or a debased(1) dollar.**





Source: Dow Jones, U.S. Census, 1896 to 1913 is the WPI for Commodities from the BLS and other agencies. 1914-56 is the PPI All Commodities, and 1957-present is the CRB Continuous Commodity Index, now an equal-weighted, front-month index of 17 commodities including most high-use energy & agricultural commodities.

(1) Equity bull market blow-offs can occur in the late stages of private credit creation, when added dollar supply via credit may debase the currency at the same time. But generally a weak dollar environment is not conducive to S&P 500 bull markets.

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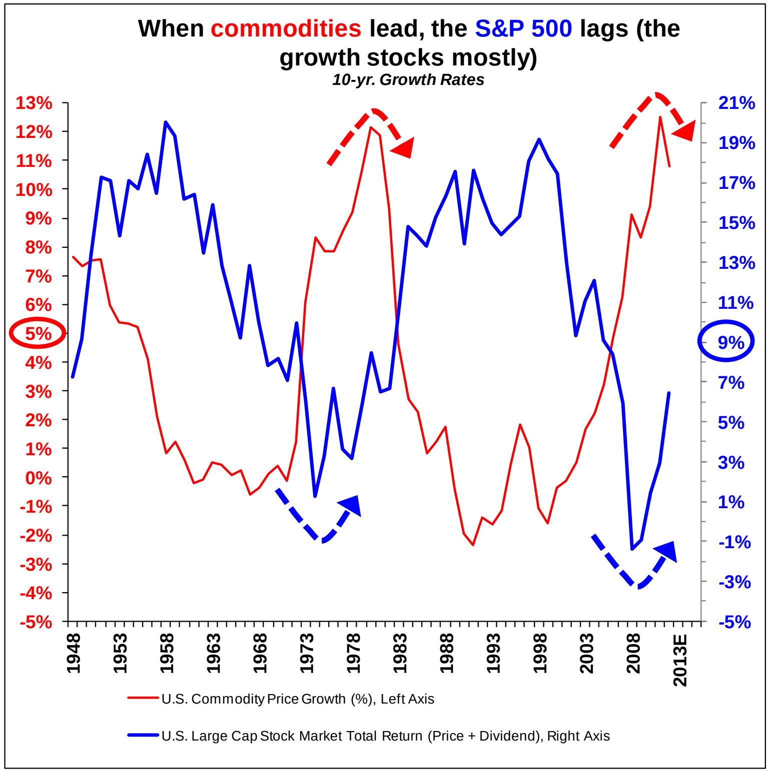
Minerals (and defensives) led since the Secular Bear began in March 2000, **but we see their valuations contracting due to demand[(1)] slowing and the dollar bottoming. We prefer "growth"[(2)] stocks.**

All Domestic Equity, Various Indices,
(Price + Dividends)

Mar-2000 to Mar-2012, CAGR

Non-Energy Minerals..	*13.3%*
Energy Minerals..	*13.0%*
Consumer Non-Durables..	*12.2%*
Health Services..	*11.7%*
Process Industries (Chemical, ag, paper).................	*11.2%*
Transportation..	*9.2%*
Distribution Services..	*9.2%*
Utilities..	*9.0%*
Retail Trade..	*6.9%*
Consumer Services (Media, restaurants, lodging)......	*6.9%*
Industrial Services (Oil svc./equip., E&C, pipelines)...	*6.7%*
Banks & Financial Services..................................	*6.6%*
Consumer Durables..	*5.9%*
Producer Manufacturing..	*4.9%*
Health Technology..	*3.1%*
Commercial Svcs (Fin'l. pub., personnel, advertising)	*-1.7%*
Communications..	*-1.9%*
Electronics (Semis, aero/def., computing, telco eq.)...	*-3.4%*
Technology Services (Software, internet).................	*-3.8%*

We see commodity price growth of ~5%/yr. and the S&P 500 total return ~9%/yr. 2011-21. **We see China fixed investment slowing, the U.S. dollar flat/up, and expanding U.S. "growth"[(2)] stock P/E ratios.**



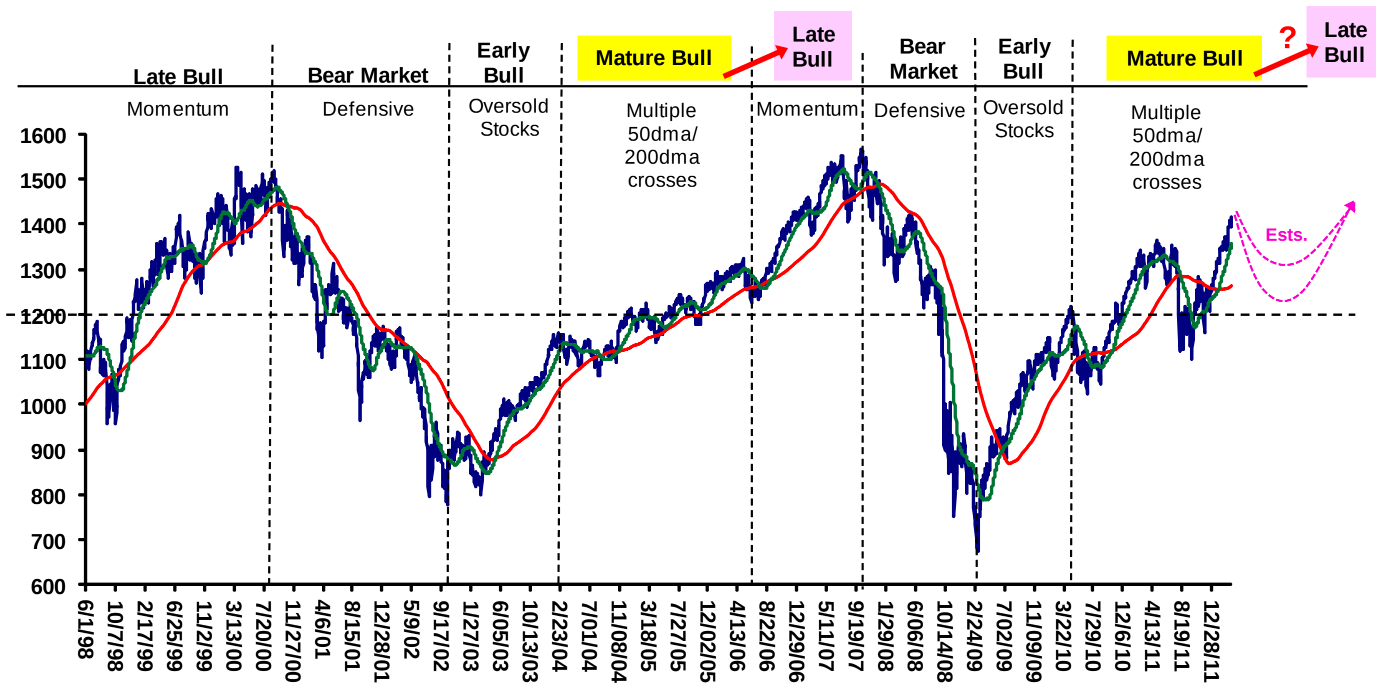
Source: Factset total return indices, Standard & Poor's (Cowles Composite joined to S&P 500), U.S. PPI All Commodities joined to CRB futures (rebased).

(1) The mineral producer stocks and those of companies that serve the industry often experience valuation multiple contraction as commodity price *growth* peaks.

(2) "Growth" stocks typically have low or no dividends, high unit growth with minimal use of pricing power and differentiated, protected products in expanding markets.

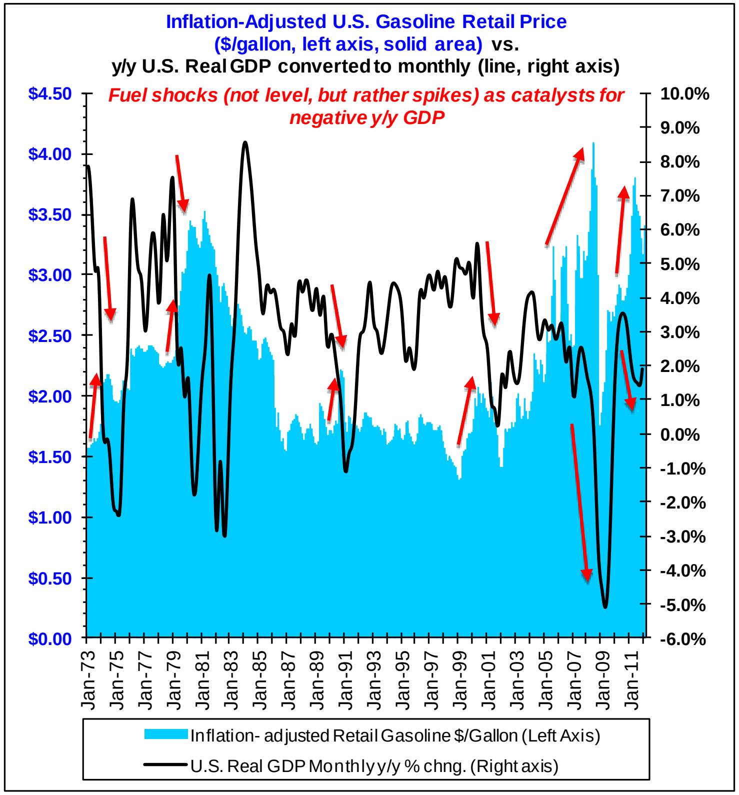
Secular bear markets feature cyclical bull & bear stages. **We expect this one to cross over to "Late Bull" shortly. The stage may be defined by the 50/200dma crosses (or lack of), shown below.**

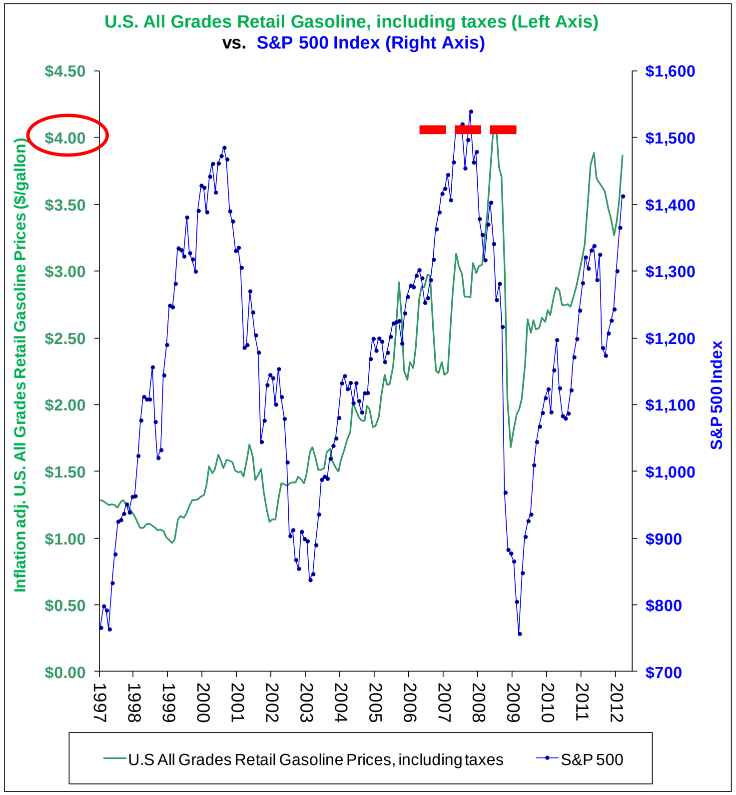
Phases of a Secular Bear Market - The S&P 500 (1,413 intraday 03/27/12)



Source: Stifel Nicolaus chart, Factset prices.

Oil will cap the S&P 500 in 2012, in our view. **We believe a $1 spent in the gas tank has far greater effect on consumers than $1 spent anywhere else. U.S. gasoline prices are returning to recession-inducing levels (left chart). We see ~$4.00/gallon firmly capping the S&P 500 rally (right chart).**





Source: Factset prices, U.S. BEA, U.S. BLS, Stifel Nicolaus format.

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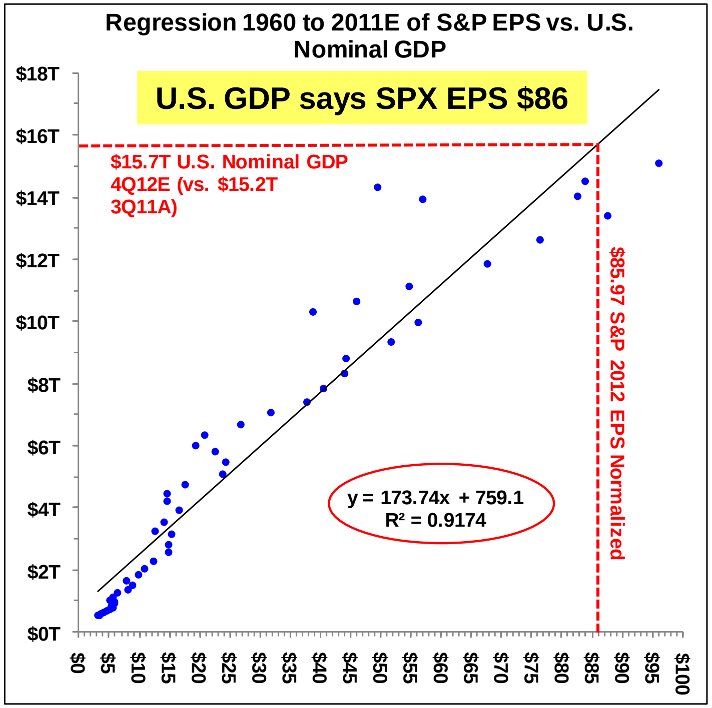
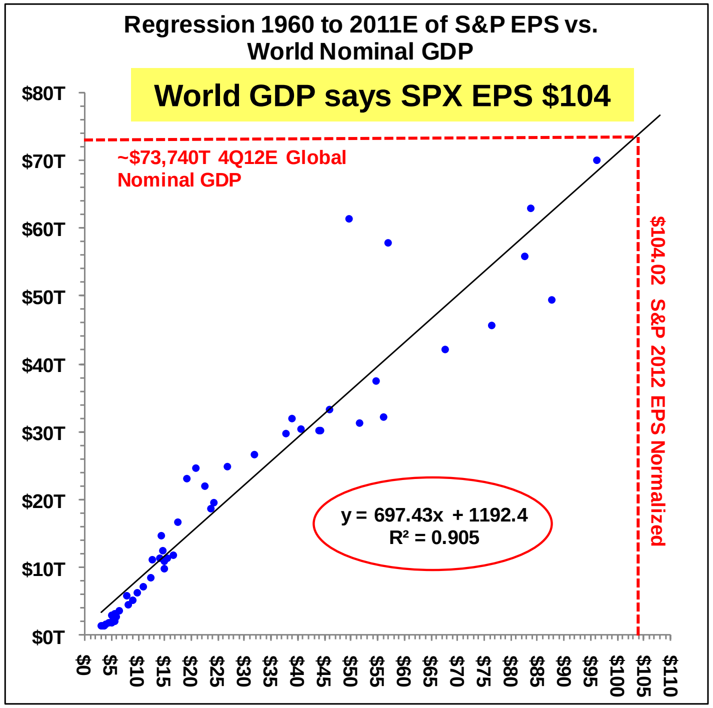
S&P 500 earnings sourced from overseas seems to us the "at risk" portion of profits. **Regressing U.S. nominal GDP to S&P 500 EPS produces normalized EPS of ~$86 in 2012E (left chart), versus $104 EPS when regressed to *world* GDP (right chart). The gap between these figures is about 18%, and we think the international component of EPS are vulnerable.**





Source: Standard & Poor's, BEA, IMF and World Bank world GDP data, Stifel Nicolaus charts.

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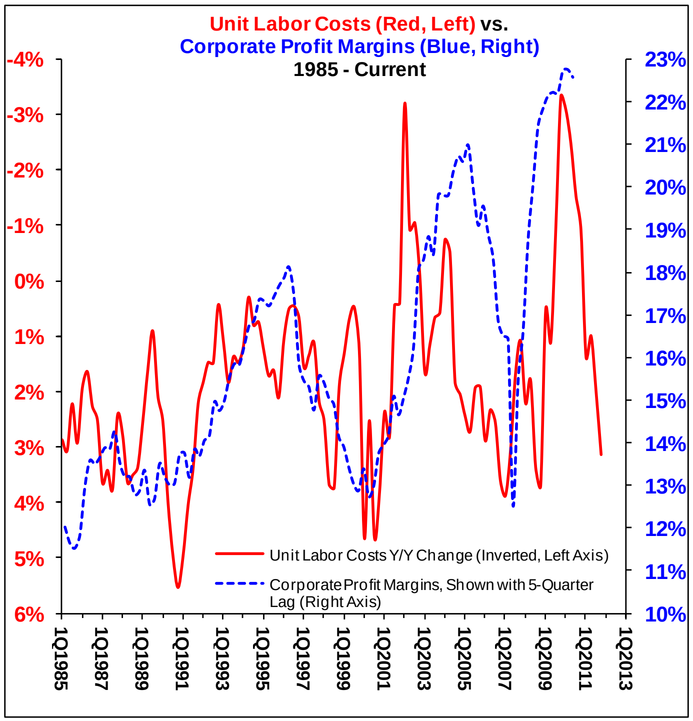
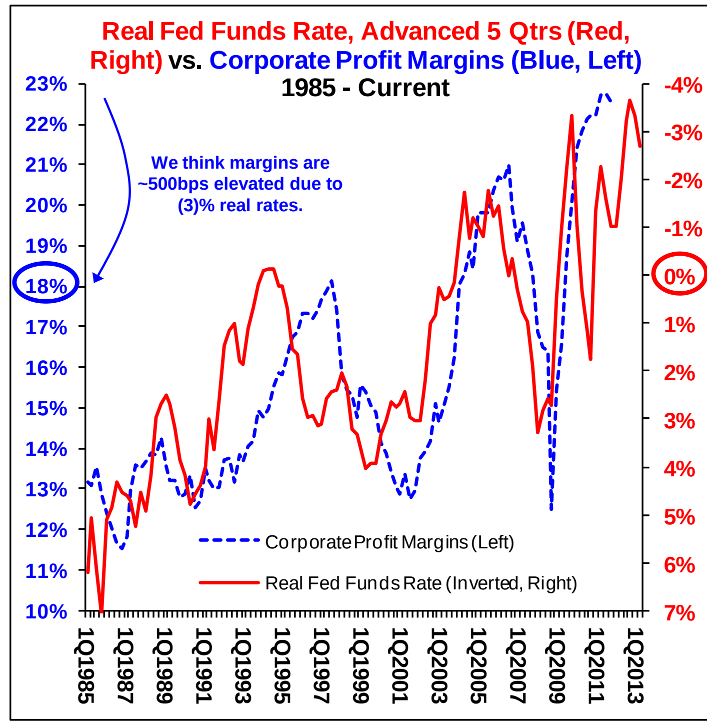
We believe the S&P 500 is "over-earning" by ~20% due to ~(3)% real short rates and fiscal deficits[(1)], and that explains the low P/E in recent years.

Low labor costs boost margins, but unit labor costs are increasing due to cyclical productivity and hours worked factors.

We see the FFR[(2)] after inflation going from ~(3)% to 0% whether we have deflation (0% FFR – 0% deflator) or Fed success (2% FFR – 2% deflator).





Source: BEA, BLS, NIPA Flow of Funds, U.S. Federal Reserve.

(1) Profits are the sum of: [Investment minus Household Savings minus Government Savings minus Foreign Savings plus Dividends], which is the Kalecki Profits Equation. In that way, the deficiency of Investment (housing, *et al.*) is being met with a federal deficit (minus a minus Government Surplus *adds* the deficit to profits in the equation). In that way, fiscal policy adds to profits, though our charts above apply to monetary factors. In the Fiscal Policy section of this report we discuss the deficit's effect on GDP.
(2) FFR is the Federal Funds rate.

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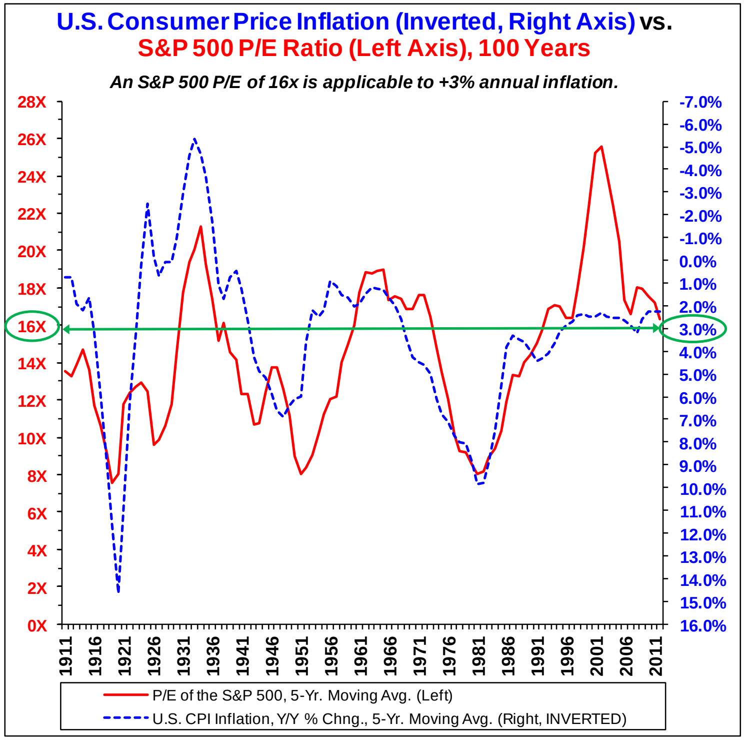
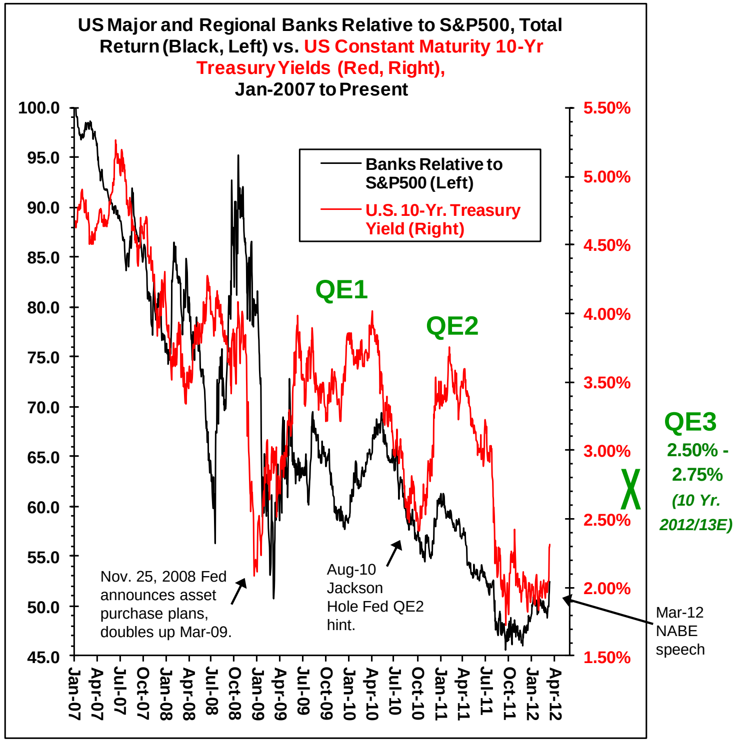
We like All-cap Growth and Financials when markets bottom. **Inflation undermines P/E ratios, whereas deflation undermines EPS(1), but liquidity, GDP traction and ~3% inflation support a P/E (left chart) of 16x 5-year trailing S&P EPS which we see cresting at ~$100(2). Banks would bounce on QE3 (right chart), in our view, but are only a "trade" for *many* years.**





Source: Standard & Poor's price and EPS , U.S. Census and Bureau of Labor Statistics inflation, Stifel Nicolaus format.

(1) Inflation erodes present value and lowers the P/E, while deflation weakens EPS and raises the P/E due to a "trough" EPS effect. Thus, inflation and P/Es move inversely.

(2) Our chart (right) shows trailing 5-year averages. S&P 500 trailing 5-year EPS from 2008 to 2012E is $82.21 ($102.55 in 2012E, $96.94 in 2011, $85.28 in 2010, $60.80 in 2009, $65.47 in 2008). But dropping 2008 of $65.47 and adding 2013E consensus of $111.56 brings the 5-year average to $91.43, just as dropping 2009 of $60.80 by 2014 should eventually bring the average closer to $100, in our view. By 2014 we think 2008-09 may be "forgotten," but amnesia is a dangerous condition, in our view.

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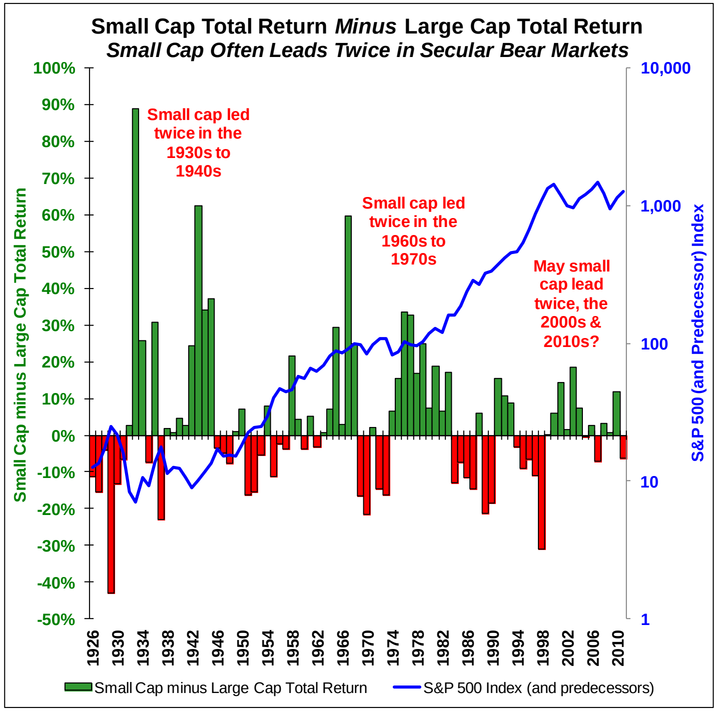
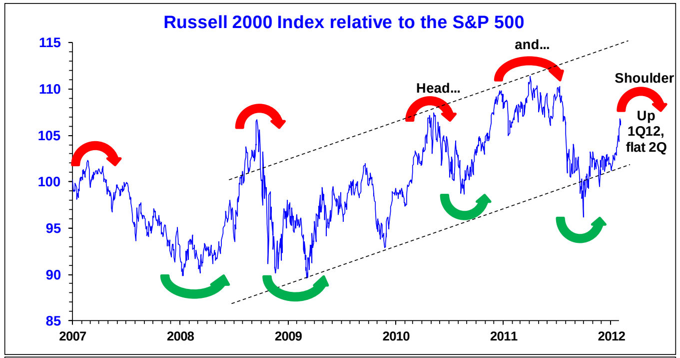
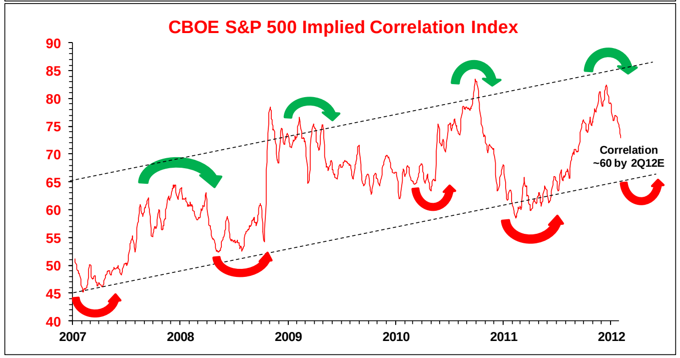
After small/mid cap beat the S&P 500 in 1Q12, we see them dipping mid-year and then continuing the bull run to ~2014. **During secular bear markets (left), small cap avoids deflating "bubble" sectors and is more flexible and domestic. Note also that Small cap does best at the beginning and end of a secular bear market. This may re-occur in the current cycle, in our view.**







Source: Dow Jones, Morningstar/Ibbotson Associates, Russell 2000 Factset total return, U.S. Census, CBOE, Stifel Nicolaus format.

(1) CBOE S&P 500 Implied Correlation compares S&P500 index anticipated option volatility with the aggregate volatilities of its constituents. The volatility of the index is affected by two items: the expected volatility of each underlying stock, as well as the implied correlation between those stocks. By comparing options pricing of the S&P500 with its underlying securities, the CBOE isolates the second component, implied correlation.

Narrow leadership can't sustain a parabolic move, even when it is AAPL. Like the NASDAQ to 2000 (left) and Housing to 2005 (right) bubbles, AAPL stock has been tracking the same pattern since the Mar-09 S&P 500 bottom. Though a cult stock with an un-challenging P/E, the housing stocks charted below only had a P/E of 7.9x in 2002 and 13.9x at the 2005 peak. AAPL is a chimera of a platform company (we favor imputing assets as a form of risk), as well as a high-margin "fashion item" hardware business selling mostly to rich Westerners. The company has had under-whelming recent updates from a technical leap standpoint since Job's passing. Lastly, as a software company, its largest competitor is free and open (Android).

Source: FactSet prices. Home Builder Index comprises PHM, DHI, KBH, LEN, NVR & TOL.

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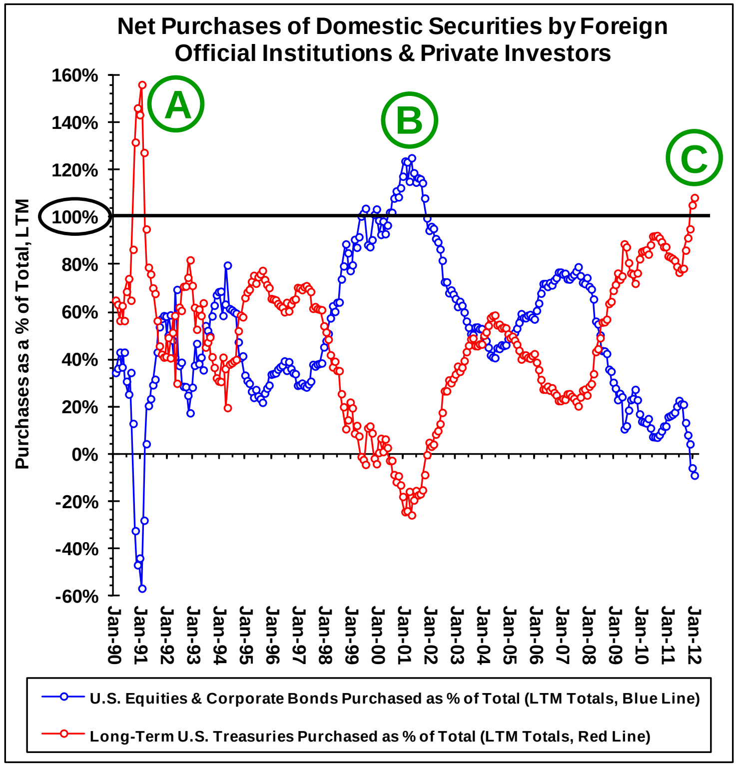
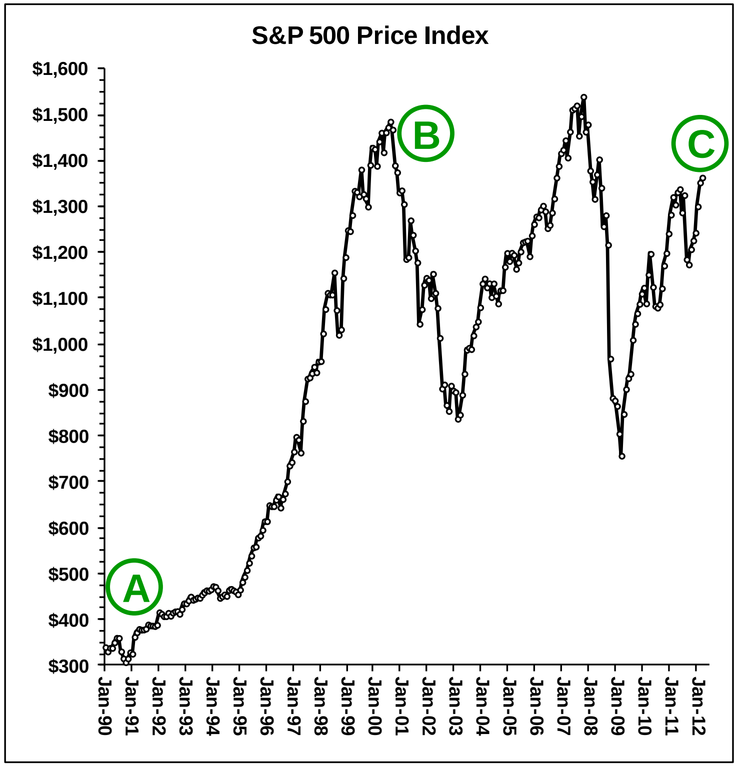
Lopsided foreign inflows into Treasuries as a contrary indicator[1]? **Foreign inflows to U.S. Treasuries were >100% of net foreign inflows to the U.S. in 1991 (Point A), just in front of a *tremendous* decade for stocks. Foreigners piled into U.S. Equities & Corporate Bonds in 2001, right in front of a secular bear market (Point B). Now, (Point C) foreigners again prefer Treasuries.**





Source: U.S. Treasury
International Capital (TIC) system

(1) There is precedent for weakness overseas, domestic GDP traction, a break-down of economic synchronization, capital flows to the U.S., a surging U.S. $, rising U.S. growth stocks with P/E expansion, Europe struggling to create a currency union and cheaper fuel for U.S. cars - it was the late 1990s, and we are on alert for that possibility.

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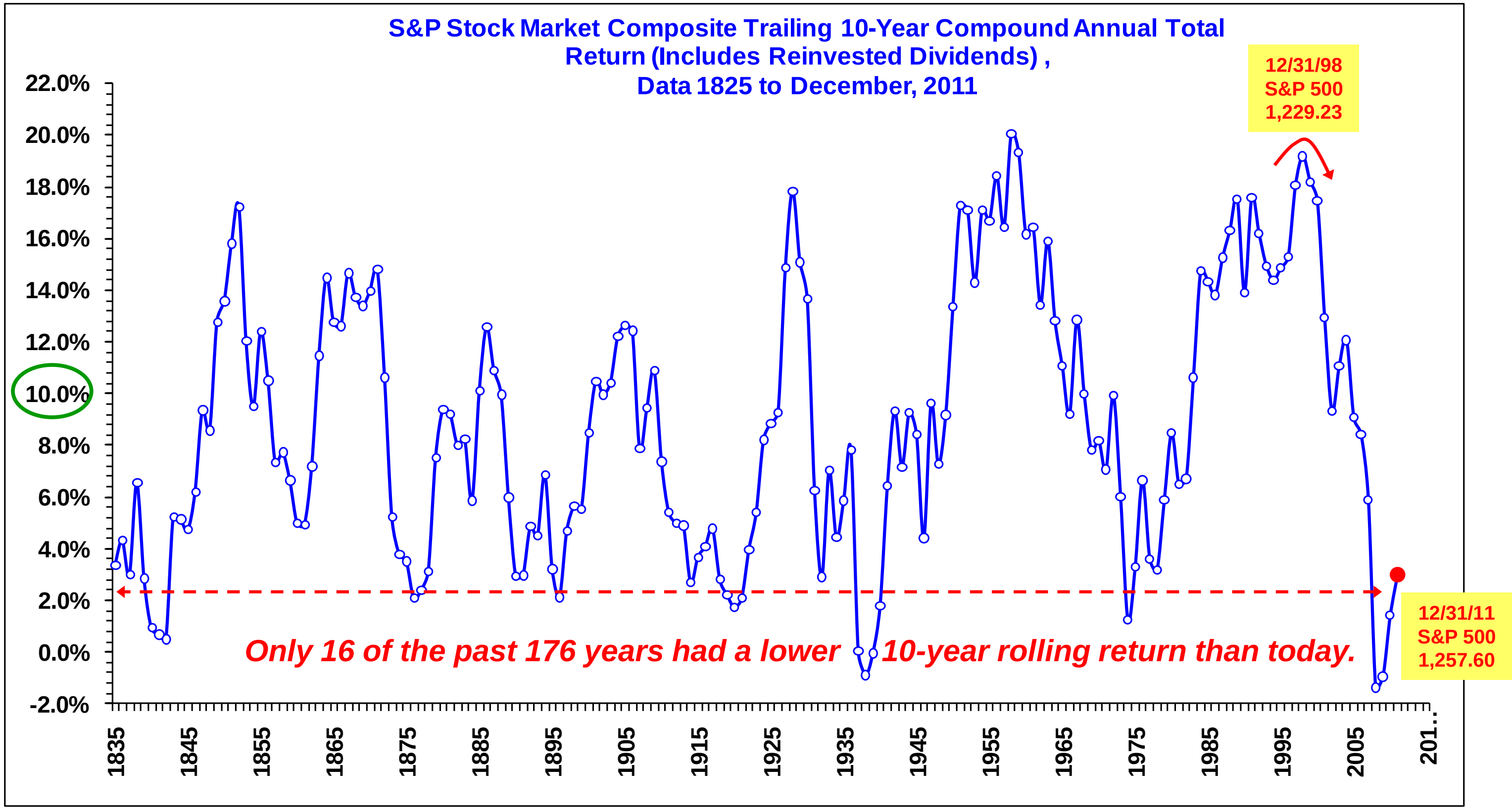
It is too late for bearish epiphanies...what if S&P return mean reverts to ~10%? **Some 91% of *all* 10-year periods for the S&P 500 total return the past 176 years were *higher* than the 10 years ended 2011. Markets "discount," so passage of 13 years *without appreciation* discounted bad news.**



Source: "*A New Historical Database for the NYSE 1815 to 1925: Performance and Predictability*," Yale School of Management, used with permission. Post-1925 data for stocks are Ibbotson/Morningstar and Standard & Poor's for large-cap equity. Note that the stock market return includes dividends. Chart format and annotations are Stifel Nicolaus & Co.

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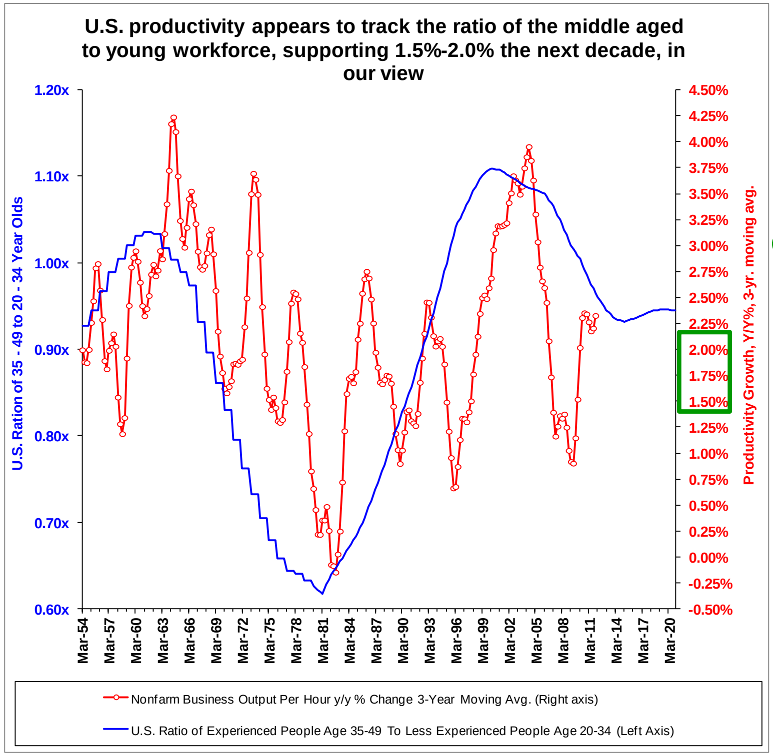
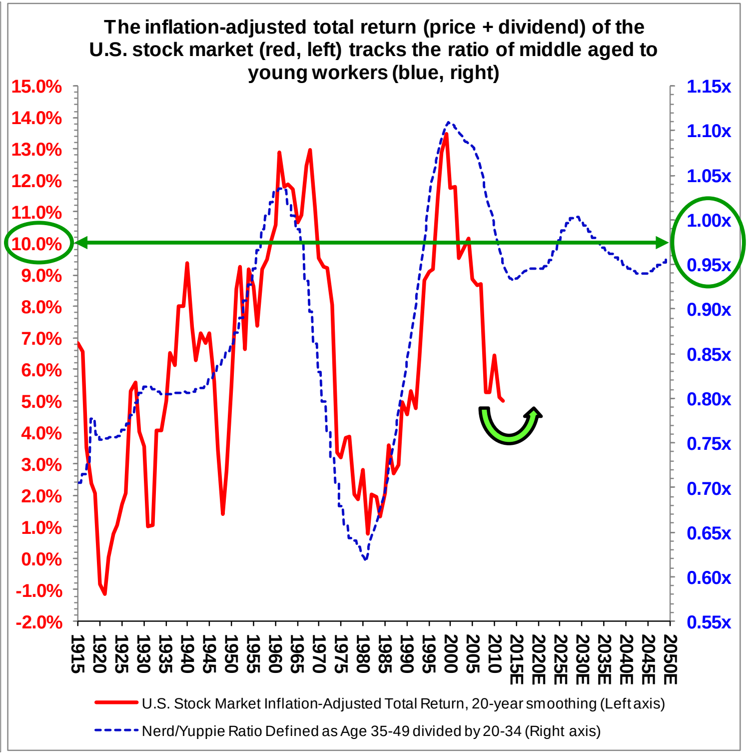
A hidden gem supportive of ~10% U.S. equity returns may be productivity. **Productivity is output per hour worked. The benefit of high productivity is that wages may rise without inflation or diminishment of corporate profits. Productivity follows a cyclical pattern as well as a *secular* trend that tracks the ratio of 35-49 / 20-34 year olds (left chart). This demographic *also* moves with the U.S. stock market (right chart). Yes, high productivity restrains job creation, but with an aging U.S. that is less of an issue. Note that this age ratio appears to be favorable for the U.S. *to the year 2050* (right).**





Source: Bureau of Labor Statistics (BLS), Census data, Ibbotson/Morningstar and Standard & Poor's. Stifel Nicolaus charts.

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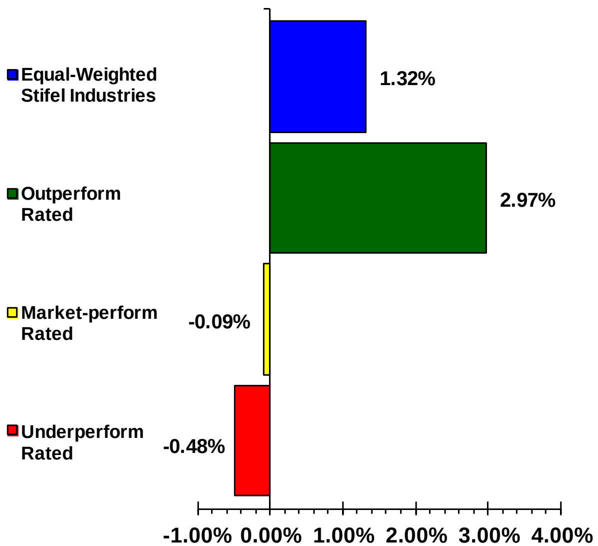
Each quarter we pick industries that fit our macro views (see Appendix). **In 1Q12, our Outperform industry picks achieved 2.97% relative strength (vs. S&P 500) versus -0.09% for Market Perform and -0.48% for Underperform rated industries. Returns are through 03/29/12.**

Stifel Macro Industry Recommendations Relative to S&P 500(1), Annualized YTD



SF Macro-View 2Q2012: Outperform

Please see appendix for our full list of Stifel macro industry recommendations

Industry	Analyst(s)	Industry	Analyst(s)
Business Services	Shlomo Rosenbaum	Enterprise Hardware/Software & Hard Drives	Aaron C. Rakers
Cleantech	Jeff Osborne	Internet Services	George I. Askew & Jordan Rohan
Oil & Gas Exploration & Production	See Appendix	Semiconductors: Analog & Mixed Signal	Tore Svanberg
Oilfield Services & Equipment	See Appendix	Semiconductors: Processors & Components	Keven Cassidy
Utilities & Energy Infrastructure	Selman Akyol & Justin Kinney	Semiconductor Capital Equipment	Patrick J. Ho
Mortgage Finance	Michael R. Widner	Software: Applications	Blair Abernethy & Tom Roderick
Non-Bank Financials	Chris Brendler	Telecom and Cable Services	Christopher C. King
Specialty Finance	G. Mason & T. Ward	Telecom Services	Blair Abernethy & Ben Lowe
Food & Beverages: Beverages	Mark Swartzberg & Mark S. Astrachan	Infrastructure: Electrical & Diversified	Jeffrey L. Beach & Noelle Dilts
Food & Beverages: Food	Christopher Growe	Retail: Auto Dealers	James J. Albertine
Tobacco	Christopher Growe	Retail: Hardlines	David A. Schick
Healthcare Services	Thomas A. Carroll	Retail: Softlines	Richard E. Jaffe
Household & Personal Products	Mark S. Astrachan	Sports & Lifestyle Brands	Jim Duffy
Communications Equipment	Sanjiv Wadhwani	Transportation: Rail	John G. Larkin
Data Centers/Hosting	Todd C. Weller		

Source: FactSet prices, Stifel Nicolaus calculations and format.

The hypothetical portfolio is based on 1 unit of investment placed in each recommended industry, where outperform ratings are equivalent to long positions and underperform ratings are equivalent to selling short (market-perform ratings earn a return equivalent to the market because we consider them neither more nor less attractive than the general conditions of the S&P 500). All performance metrics are measured using FactSet industries as shown in the appendix. 1Q12 prices calculated to 03/29/2012 close. Compounded return assumes 3 completed months out of a 12-month calendar year. See appendix for a detailed list of Stifel Macro Industry recommendations.

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Fiscal Policy

In our view:

1. We see Pres. Obama's re-election, a (R) House, and gridlock interrupted by last minute deals. A sudden 2013 tax hike may trigger a recession, so a post-election "phase-in" deal is our view.

2. Fiscal debt offsets private sector surpluses, but a deficit only bootstraps low quality profits. Federal debt concurrent with private *de*-leveraging is made *possible* by reserve currency status.

3. Rising tax receipts and peaking spending should drop the U.S. deficit percent of GDP to 4% by 2015, but thereafter we see Bond Market Vigilantes forcing lower spending and tax hikes.

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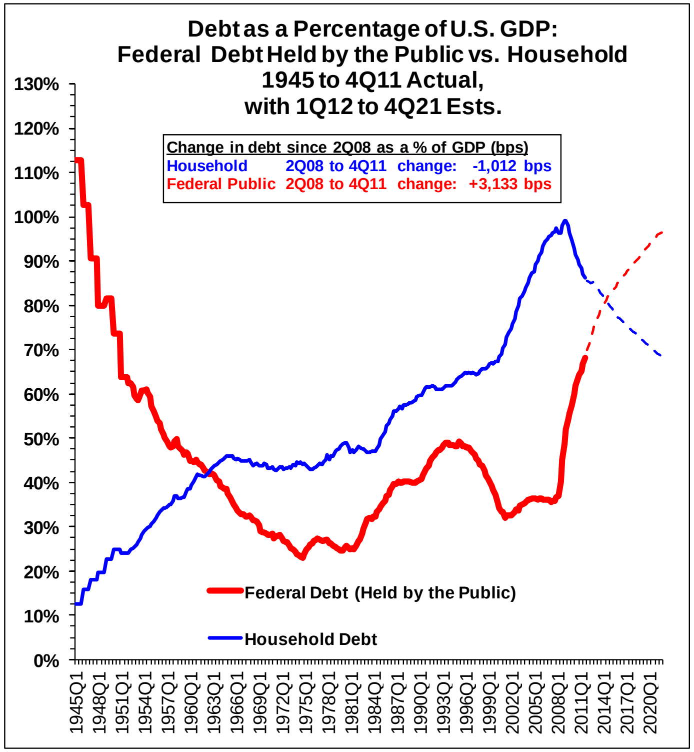
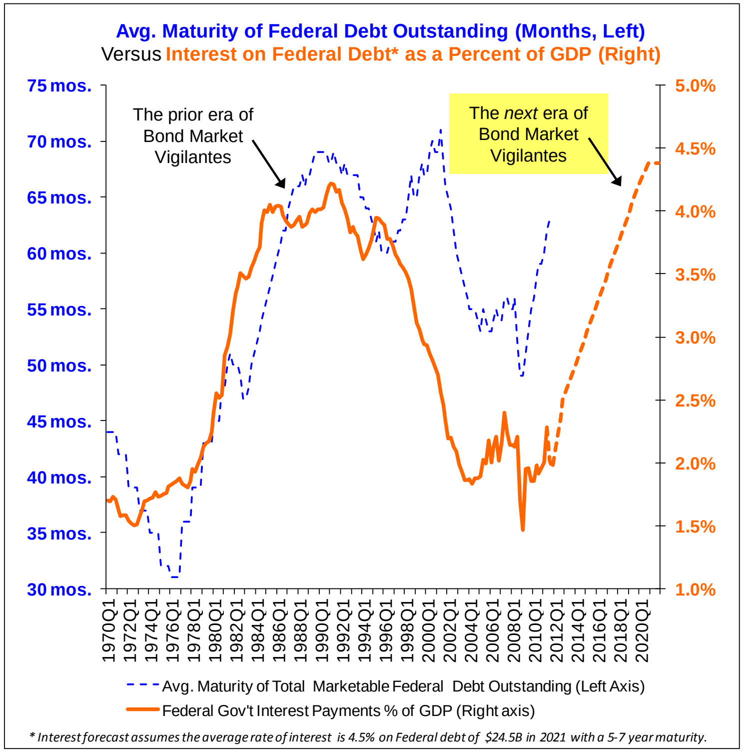
We see Federal leveraging concurrent with private de-leveraging, a Keynesian[1] solution made possible only by reserve currency status. **The cost we see is comparable to W.W. II (left chart), spread over two generations. Between 2015-21E we expect U.S. government interest to rise above 4% of GDP (right chart), resurrecting by ~2015 the late-1980s "Bond Market Vigilantes" to enforce fiscal discipline and prevent a Baby Boomer entitlement spending U.S. fiscal catastrophe[2].**





Source: Fed, BEA.

(1) We see a de facto public for private debt swap that back-fills domestic demand leading to marketable federal debt/GDP that peaks >100% of GDP by the early 2020s. This is a choice available solely to the reserve currency country that can borrow large amounts at an interest rate *below* nominal GDP growth, in our view.

(2) According to the Social Security and Medicare Boards of Trustees, the Medicare Trust Fund will be exhausted in 2024, Social Security in 2038 and Disability in 2018.

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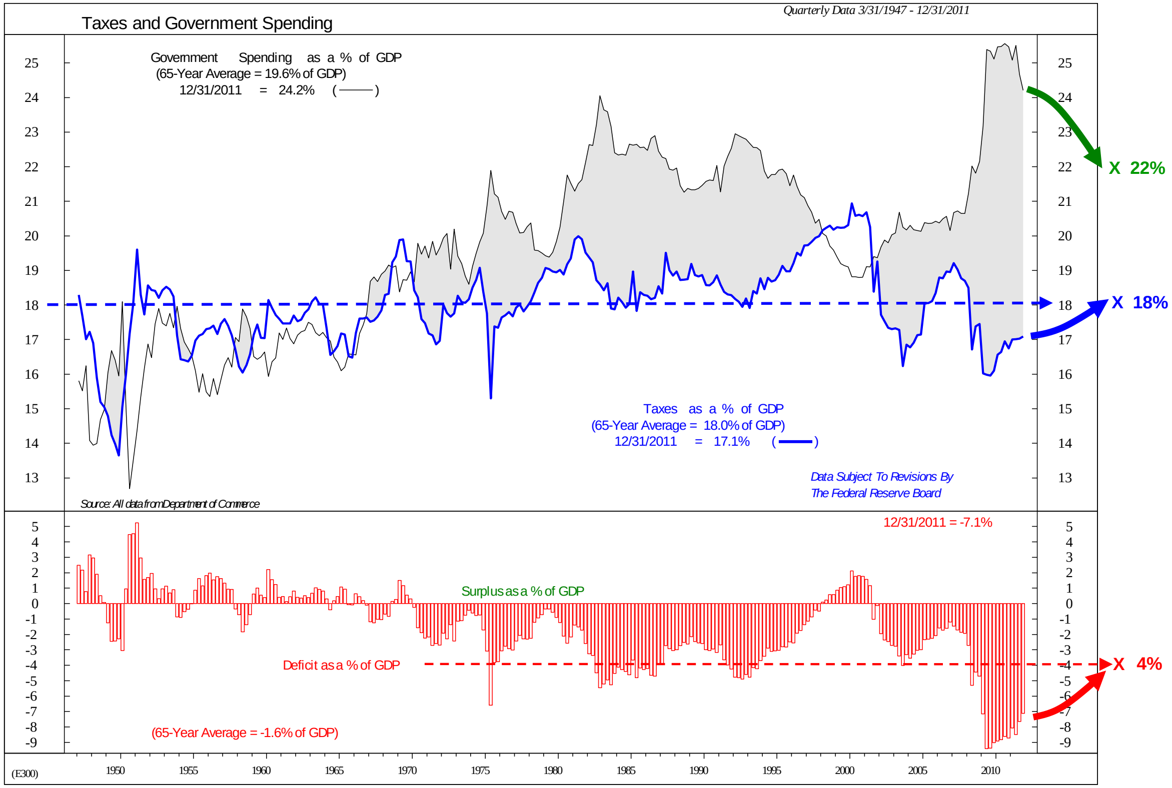
Tax revenue (blue line) is mean-reverting and bottoming, while spending (green line) is counter-cyclical and peaking, so the deficit % GDP (red bars) will fall, in our view. **From 2011-15, we forecast 220bps of spending cuts/program expirations and 90bps of cyclical (not legislative) tax revenue (incl. more corporate tax, which is quite low) that reduce the Federal deficit from (7.1)% of GDP in 4Q11 to (4.0)% by 2015, a level *still near the post-1971 decade high water marks*.**

Note: In the book *"This Time Is Different, Eight Centuries of Financial Folly"* by Carmen M. Reinhart & Kenneth S. Rogoff, the authors found that Advanced Economy real central government revenue growth recovers sharply the third year [e.g., 2011 in the current period] following major banking crises per Figure (10.8) of the book. U.S. tax revenue began to recover on schedule as spending decelerated in fiscal 2011. This is timely since real public debt rises an average 86% in the three years after a financial crisis per Figure (10.10) of the book, which closely matches the publicly held U.S. Federal debt increase of +82.6% the three years 1Q08 through 1Q11. Because the U.S. has a reserve currency, debt can (and we think *should*) rise.



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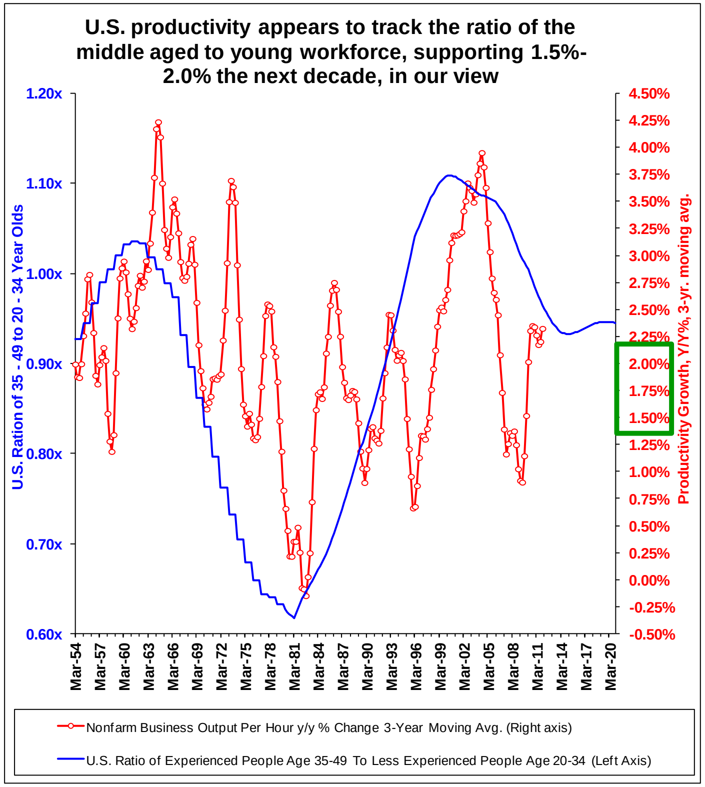
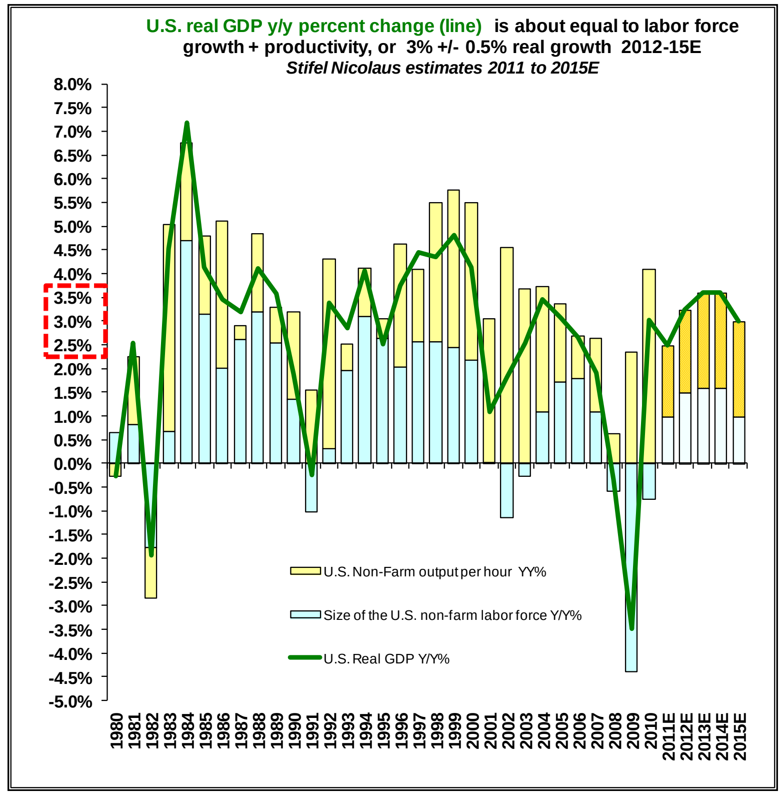
We see U.S. real GDP growth of 3% +/- 0.5% per year through 2015, with productivity over half of yearly GDP. **Low nominal GDP (deflation) remains the risk we see, not inflation. Demographically enhanced productivity (which has held back job creation) plus labor force growth puts our real GDP view at ~3%/yr. to 2015E, and with inflation of ~1-3% that is *nominal* GDP of 4% to 6%.**





Source: U.S. Census, Moody's Economy.com inflation, GDP and productivity data.

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Monetary Policy

In our view:

1. Chinese and German surpluses created excess savings that cheapened money and led to debt. But to escape deflation the U.S. inflated the eurozone and China via QE[1], forcing them to re-balance.

2. QE 1 & 2 stabilized asset prices and raised correlation to forestall a Paradox of Thrift, but we think QE3 may begin in mid-12 in response to sluggish data (housing, employment) or deflationary shocks.

3. U.S. private sector de-leveraging requires 2-3% loan growth and 4-6% nominal GDP, lowering bank credit % GDP. Three years into the process, we think it can be done in the next four years

4. The Fed has a <u>difficult</u> exit mid-decade from 0% rates and its sizable balance sheet "carry trade." But overseas is worse. For example, U.S. trade deficit closure (shale oil) and a tighter world dollar supply probably damages the commodity CRABS[2]

(1) Quantitative Easing: central bank injection of newly created money into the economy via asset purchases. Note that the direct impact of QE was in basic commodity prices, which constituted the bulk of inflation that occurred 2008-2011 in both China and Germany.

(2) The CRABs are Canada, Russia, Australia, Brazil, and S. Africa, traditional commodity exporters with elevated asset markets and currencies.

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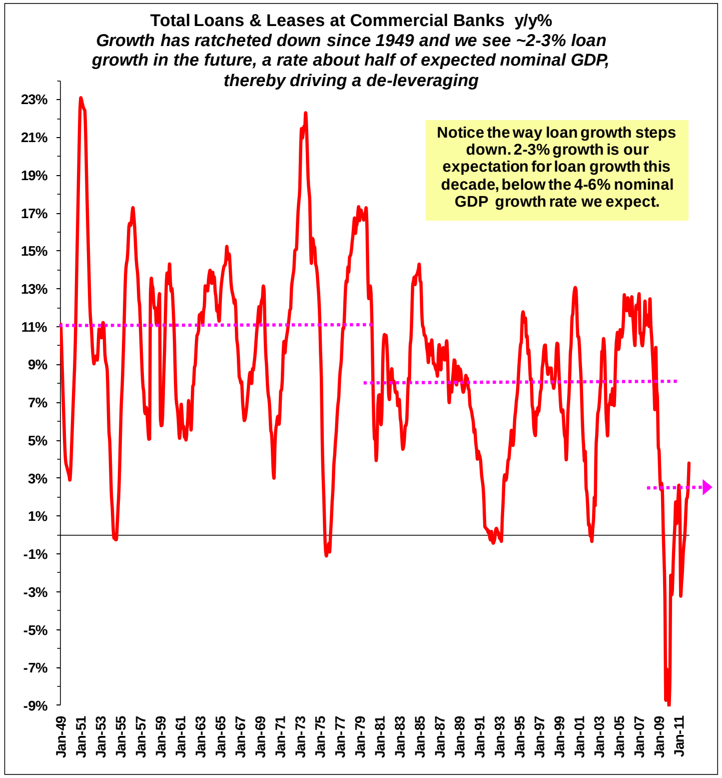
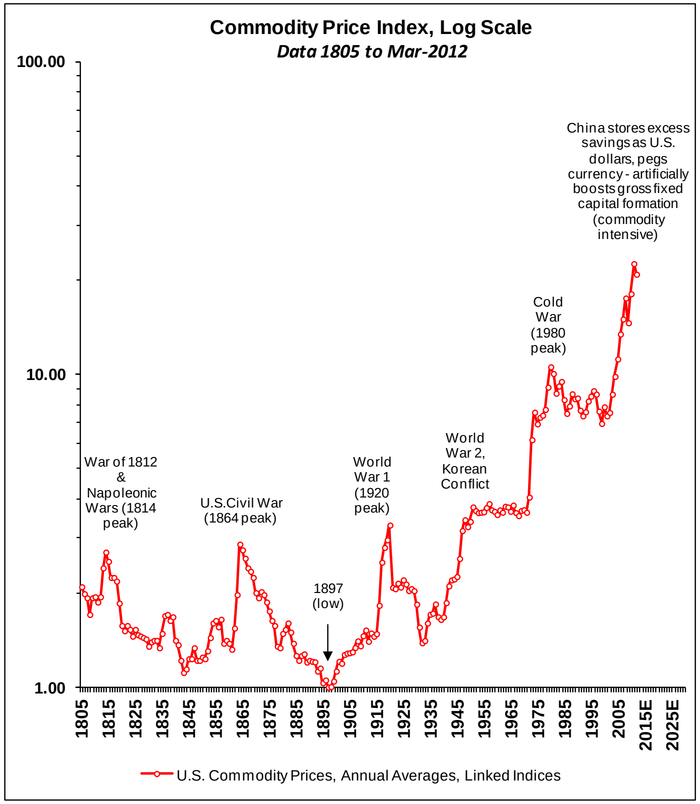
Nominal GDP of ~5%/year (real ~3% + inflation ~2%) vis-à-vis bank loan growth(1) of 2.5%/year (left chart) results in U.S. private sector de-leveraging of 10% of GDP (right chart) in only four years [(5% - 2.5%) x 4]. **Similarly, if loan growth significantly exceeds nominal GDP on a *sustained* basis, causing credit/GDP to rise a good while, we would expect Fed tightening.**

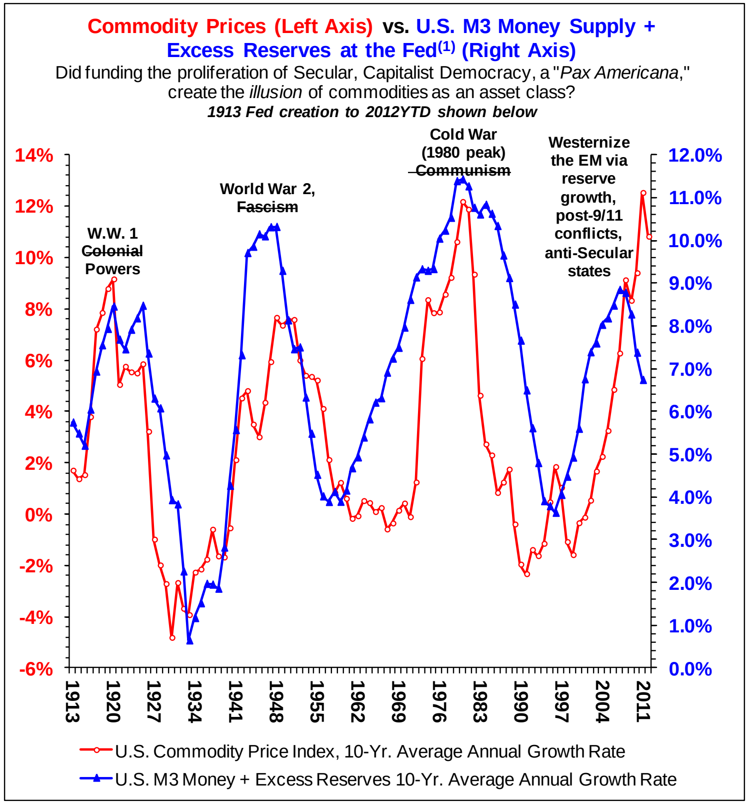


Source: FDIC, St. Louis Fed data, Stifel Nicolaus format.

(1) We see Commercial & Industrial ~5% growth, Real Estate ~1-2%, and Consumer ~3% growth in time. Actual 2/15/12 y/y Commercial Bank loans were +11.3% C&I (possibly skewed by tax incentives to invest), minus 2.2% Real Estate (Home Equity + Residential + CRE), and +0.9% Consumer.

We think commodities roll over if "Pax Americana" (secular, capitalist democracy) takes hold. The fiat dollar in the 20th Century funded a *beneficent* secular, capitalist democracy via W.W.1 & 2, the Cold War, and by democratizing China via enrichment using reserve-enabled(1) growth.





Source: Commodities 1913 to 1956 is the PPI for All Commodities, and 1957 to present is the CRB Continuous Commodity Index, currently an equal-weighted index of 17 commodities including energy and agricultural. Annual values are the average of CRB CCI values for each month, except for the latest decade, which considers all individual trading days of the year. For M3 1897-1958 we use M1 + vault cash + monetary gold stock + bank time deposits + mutual savings bank deposits + S&L deposits. From 1959-2005 the Fed reported M3 (SA). For 2006-Current we use: M2 + large time deposits + institutional money market + Fed Funds & Reverse repos with non-banks + interbank loans + eurodollars (regression-derived). We also add excess reserves at the Fed to M3, which takes into account funds in surplus over those mandated by reserve requirements. We add them to M3 to better reflect high powered money, but realize the Fed could remove those reserves by selling its liquid assets.

(1) Under a gold standard, for example, Chinese growth such as that seen the past 20 years would *not* have been possible because RMB currency appreciation would have slowed Chinese GDP and U.S. credit would not have been available to recycle Chinese savings. Only by having the ability to "store" super-normal growth under a fiat dollar standard was China able to grow at that pace.

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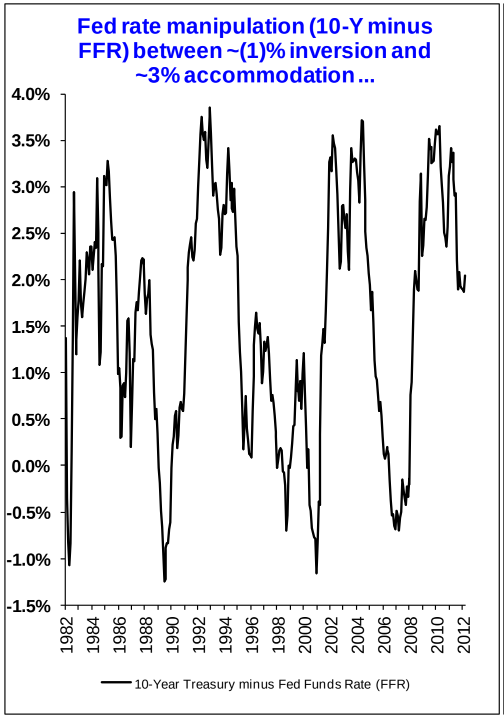
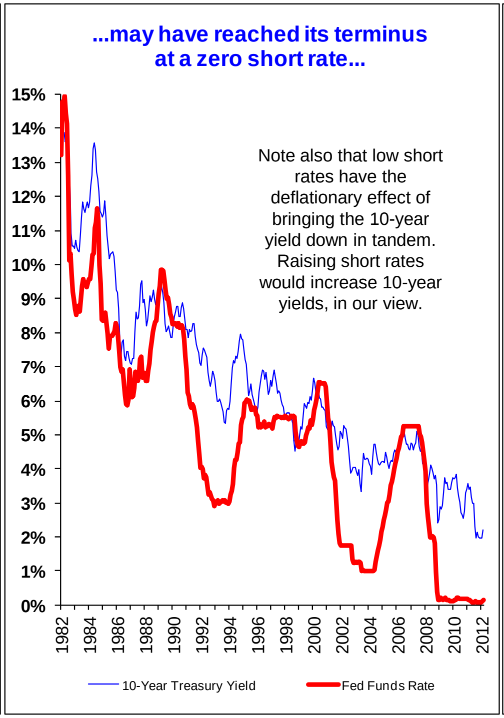
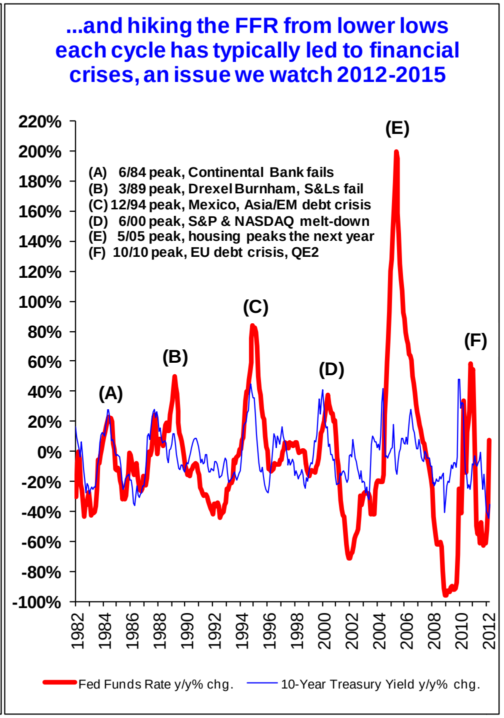
<u>A third Fed exit issue</u> we watch is <u>the large percentage gain associated with raising the Fed Funds (FFR) from a low base</u> (for example, from 1% to 5% was +400% 2004-06). **Fed rate manipulation since 1982 (10-yr. minus FFR) between ~(1)% inversion and ~+3% ease (left chart) may have reached its deflationary terminus at 0% (middle chart). Hiking the FFR from lower lows each cycle has typically increased short-term rate volatility, thereby contributing to financial crises (right chart), and could do so again if rates rise ~1,000% from ~7bps to ~0.75%, in our view.**







Source: Federal Reserve, FactSet. Charts formats and annotations are Stifel Nicolaus & Co.

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Europe & China at Crossroads

In our view:

1. The eurozone debt problem has at its core a competitive North/South disparity that *creates* deficits. Germany seems to us an over-extended creditor(2) demanding a deflationary payment solution.

2. A periphery rebellion is likely this summer, in our view, possibly from Portugal and Ireland. Fiscal policing of the periphery *combined with* ECB rate suppression are the eurozone future we see.

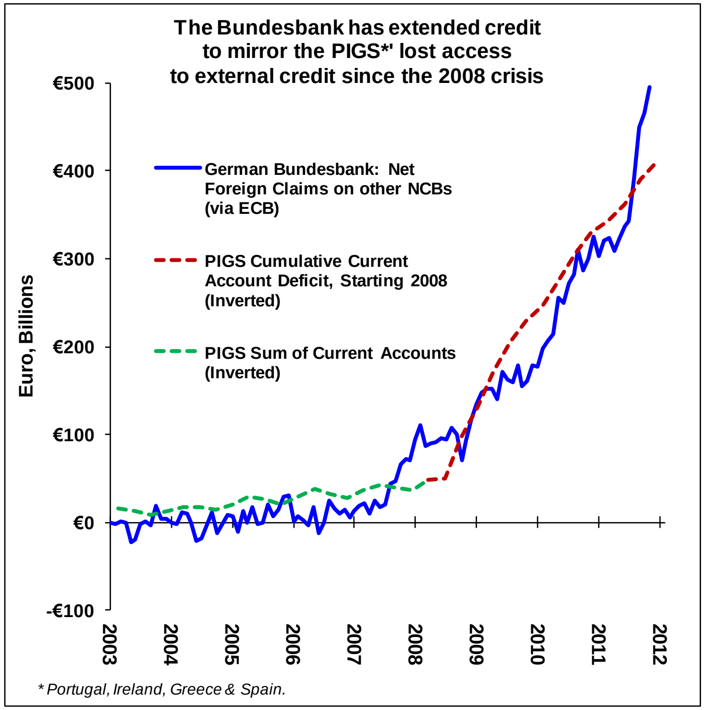
3. Three problems for China are freeing the capital account in the absence of accountable government (i.e., no bond market), excessive fixed investment and vulnerability to protectionism.

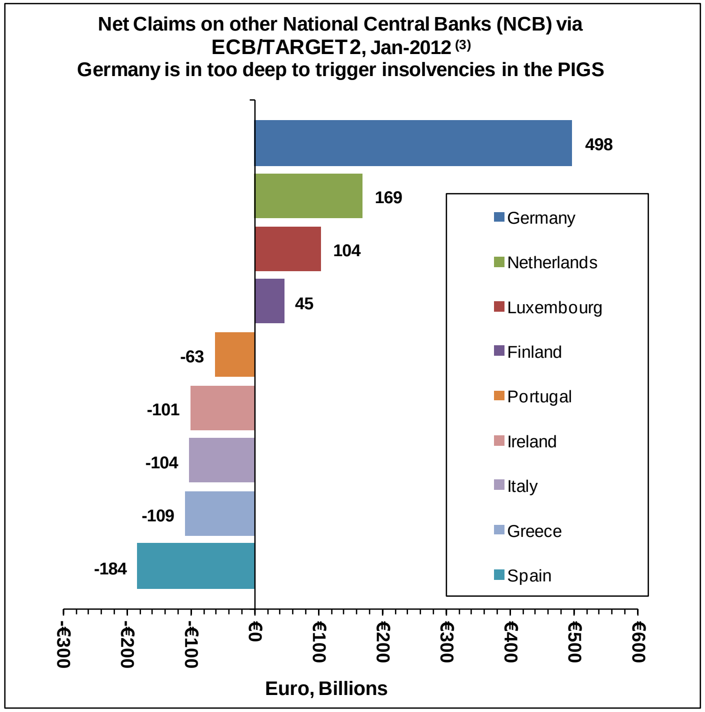
4. China's top-down model favors exports and fixed investment but not consumption, which is bottom-up. CRABs(3) commodity currencies should depreciate as China re-organizes politically and rebalances.

5. In short, dollar demand as a safe haven and vis-à-vis rival currencies is rising as the quantity is restricted from this point forward*, <u>e.g., we think the dollar has bottomed</u>.*

(1) Quantitative Easing: central bank injection of newly created money into the economy via asset purchases.
(2) The old saying that describes Germany's too-much-to-lose situation is "If you wrestle with a pig, you get dirty and the pig just enjoys itself."
(3) The CRABs are Canada, Russia, Australia, Brazil, and S. Africa, traditional commodity exporters with elevated asset markets and currencies.

Bad Romance: German Bundesbank (Buba) central bank credit[1] extended to peripheral Europe is too large to believe that Germany has much bargaining power. **The periphery lost access to external credit in 2008 (left chart), so Buba (Northern Europe *et al.*) filled the void (right chart). Because Buba credit simply replaced private credit, that created the *illusion* of current account[2] prosperity for Germany. Ultimately, we expect minimal cost for *both* debtors and Germany as peripheral spreads to bunds collapse via easily engineered ECB rate suppression (penalizing savers and the euro) and peripheral reforms.**





Source: Charts Stifel Nicolaus, data from respective national central banks & OECD.

(1) Under TARGET2 (Trans-European Automated Real-time Gross Settlement Express Transfer System) the German Bundesbank has lent €498 billion to PIIGS central banks since about 2007 when the global financial crisis cut off much of the peripheral 's access to external credit.
(2) The current account is the sum of the trade balance (exports less imports) plus net income/(expenditure) from overseas investments, receipts, debts and disbursements.
(3) Latest data are Sep-2011 and Nov-11 for Italy and Greece, respectively. Advanced data for Feb-2012 are shown for Ireland and Finland.

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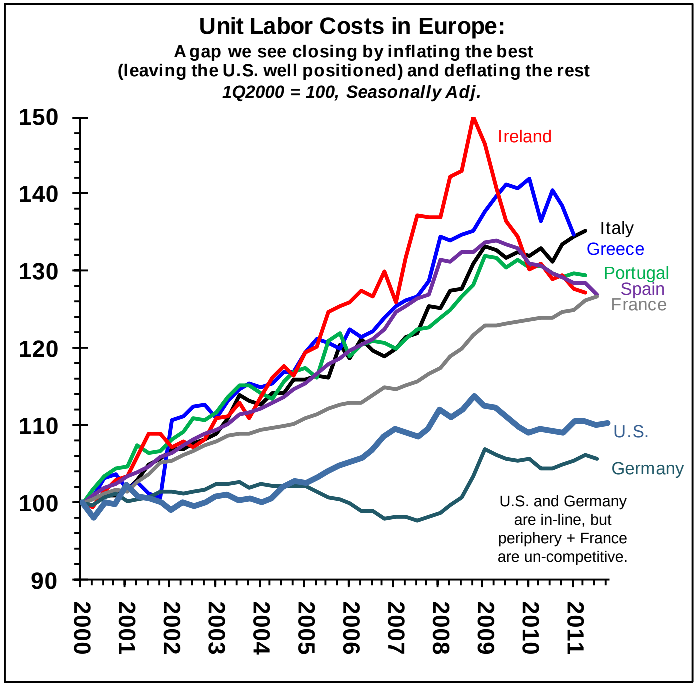
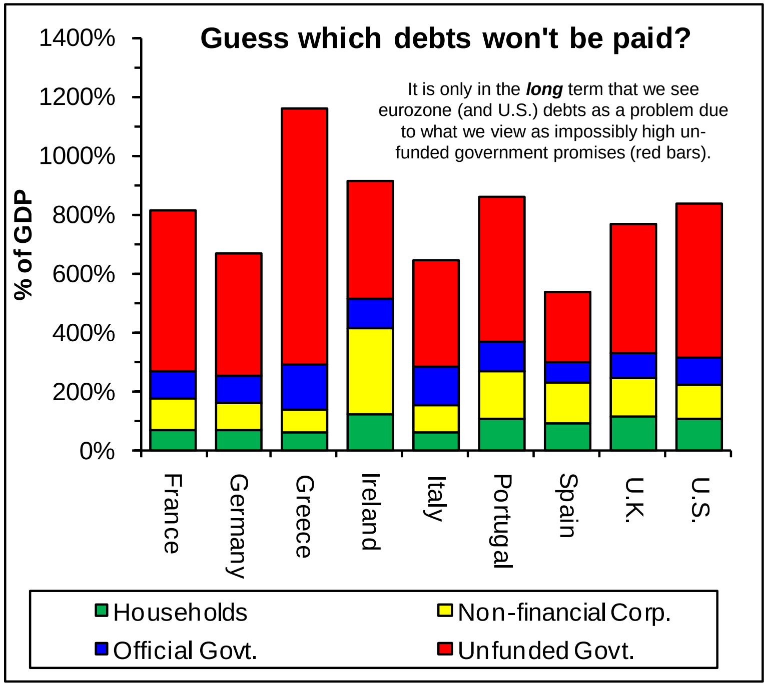
A more pressing issue we see is that the euro periphery will always run a trade deficit so long as unit labor costs[(1)] of the German "export and savings machine" are ~20% lower **(left chart). What is needed is ~3% German wage inflation (tight labor market plus ECB laxity) with peripheral + France flat wages for ~7 years[(2)] (Note, however, the peripheral recession accelerates this process) to close the unit labor cost gap (i.e., ~7 x 3% = ~20%). Peripheral wages *may* rise, but only *sustainably* if met by structural change (regulation, labor, privatization) and productivity, in our view.**





Source: Jagadeesh Gokhal, "Measuring the Unfunded Obligations of European Countries," 2009; OECD, respective state statistical bureaus.

(1) Productivity is output per hour. Unit labor costs are hourly labor costs divided by productivity, or the labor cost per unit of production.
(2) U.S. private de-leveraging may take 4 more years, as described previously. This fits our view that the U.S. rebalancing in 2012 is 3 years ahead of the EU (7-4 = 3 years).

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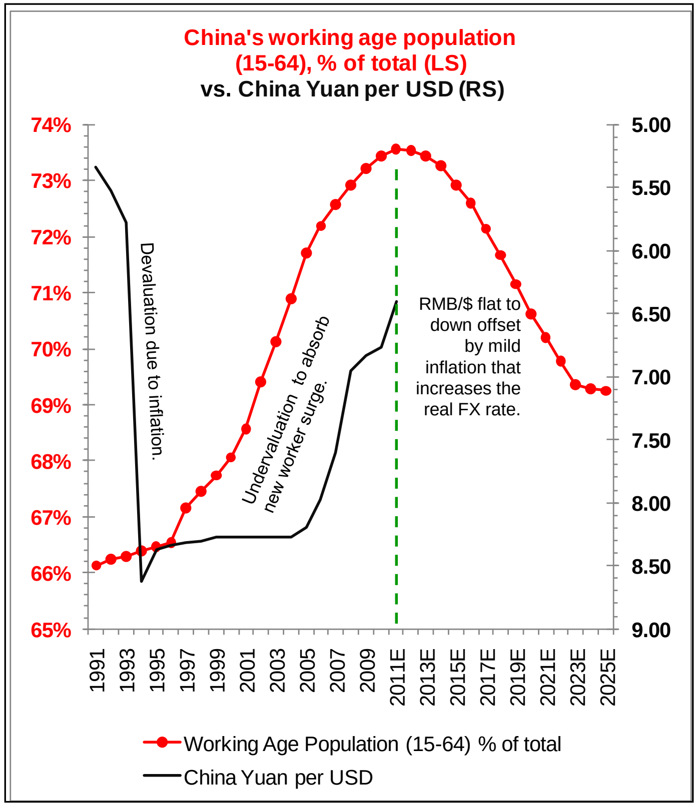
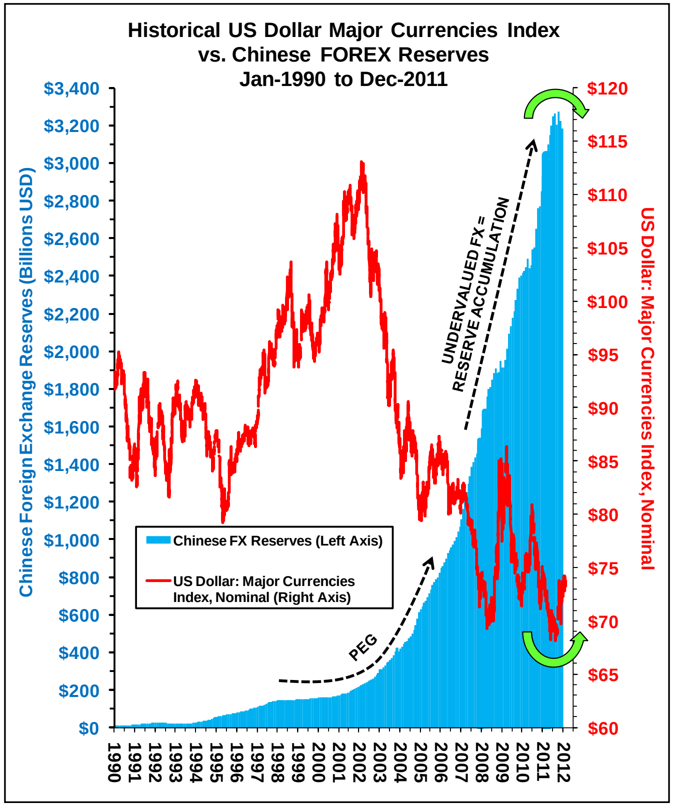
China's worker wave has crested. **China devalued 1993-2011 initially in response to inflation but later to accommodate a surge in working age people, but that issue crested in 2011, and rebalancing is our expectation.**



China's reserve accumulation and the weak U.S. dollar were two sides of the same coin. **China tied to a plunging U.S. dollar[(1)] post-9/11 and post China's WTO entry, but we see that gap (green arrows) closing.**



Source: U.S. Census Bureau International Database forecasts, China Bureau of Statistics, FactSet.

(1) One un-named EU official said it best: *"China got the Treasuries and America got the toys, and we got [another word for severely disadvantaged]."*

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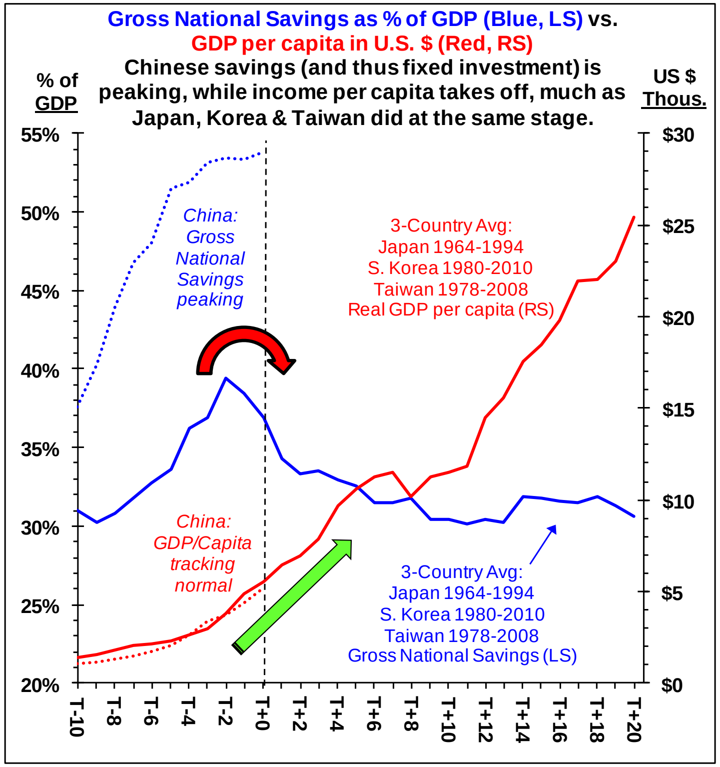
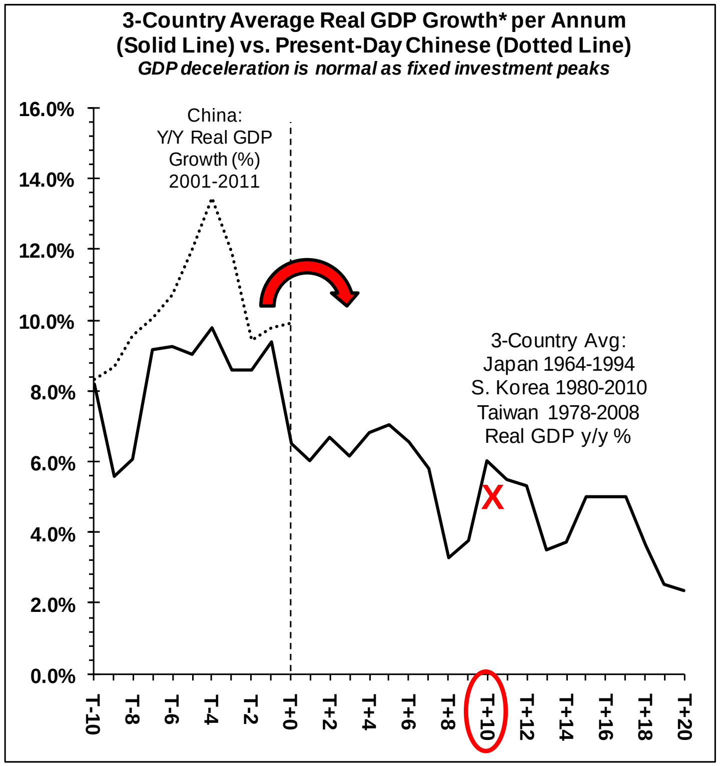
We see Chinese GDP per person doubling by 2021, but that is a slower 7% CAGR versus the 9.4% CAGR since 1992 while commodity intensity, construction and capex sharply slow **due to peaking savings[1] (and thus investment), as occurred in Japan, Korea and Taiwan circa 1974, 1990 and 1988, respectively (left chart, "T+0"). We see Chinese GDP unevenly decelerating from ~9%/year to ~5%/year by 2021 ("T+10" right chart).**





Source: Worldbank, IMF WEO/IFS, OECD.

(1) Gross National Savings is the sum of the government surplus/(deficit) plus personal savings and corporate savings (retained earnings). We see pressure on central government (local bail-outs), personal savings (no upward move in Chinese real rates), and corporate savings (over-capacity leads to lower margins).

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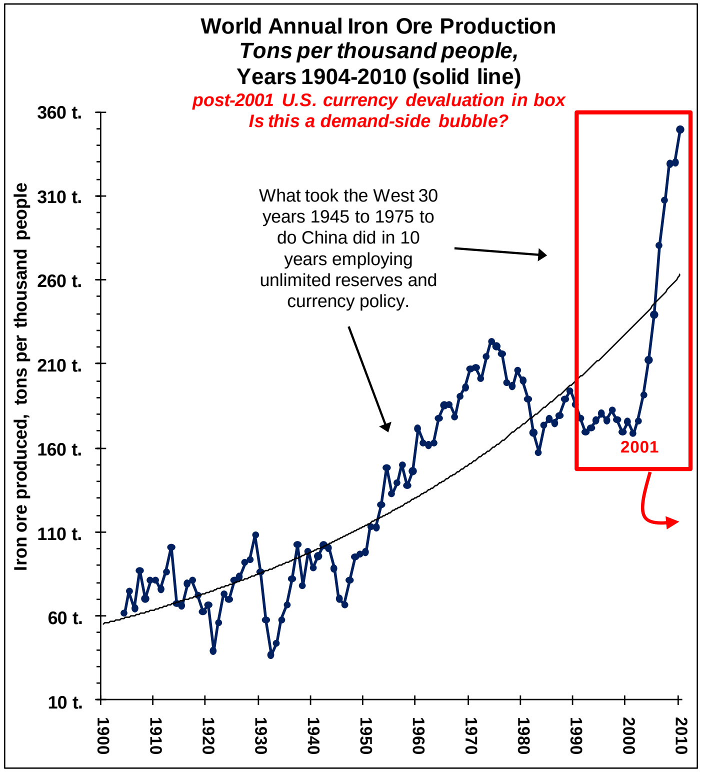
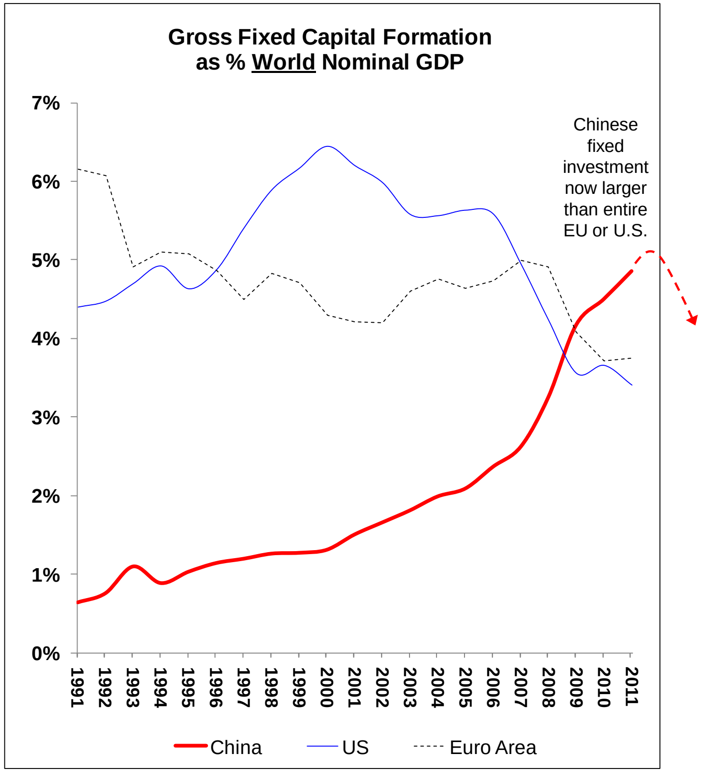
We expect China's steel-intensive fixed investment, as evidenced by iron ore imports (left chart), to result in Chinese over-capacity, trade tensions, and negative "operating leverage" for China's corporate GDP, **a sizable source of domestic savings that funds fixed investment (right chart), thus placing a limit on Chinese GDP growth. Consumption is not compatible(1) with a top-down model, *so China must open political control and the capital account,* in our view.**





Source: US Geological Survey, U.S. Census, U.S. Department of Commerce, Cambridge, FactSet, People's Bank of China.

(1) GDP = Consumption "C" + Investment "I" + Government "G" + Net Exports "Nx" but "C" consumption is self-organizing and bottom-up, and can't be directed top-down the way I, G and Nx may be molded by top-down political authority. In that way, China must relinquish political control to rebalance toward consumption, in our view.

Housing & Labor

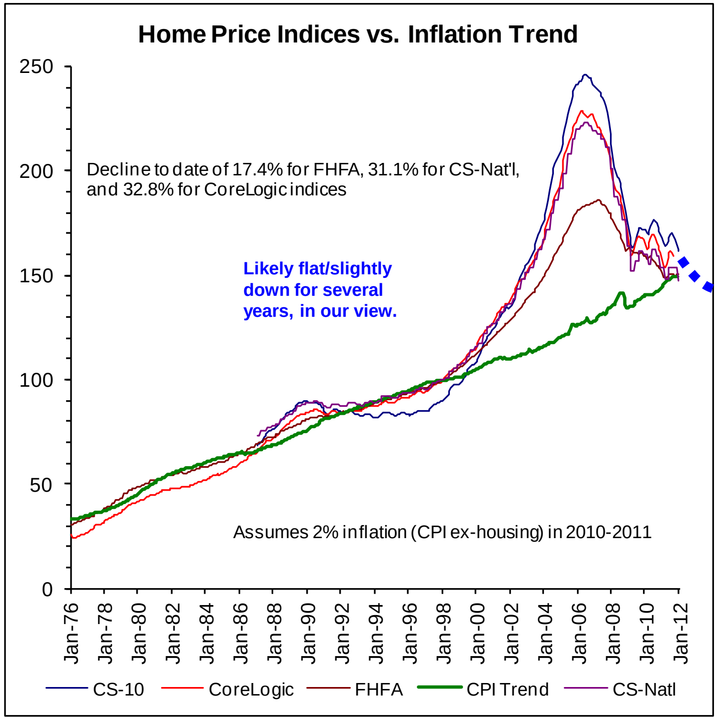
In our view:

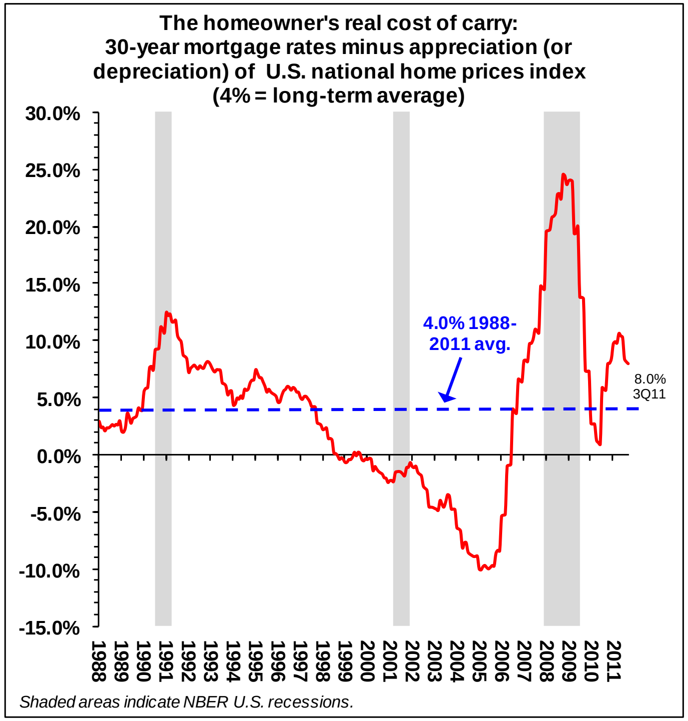
1. The Fed has dropped enough hints that employment & housing are <u>the</u> issues to watch regarding QE3. Though construction should help GDP, we see no nominal or real house price appreciation for years.

2. We see U.S. unemployment 7.6% in Dec-12 but a pause in the improvement in mid-12 that invites QE3. We see 5.7% unemployment in 2015, and payrolls only in-line with '*07* by 2014.

3. China rebalancing from investment to consumption and the dollar flat/up should lift U.S. wages without the need for deflation to lift *real* wages, but that is the challenge.

Though rising home construction should help U.S. GDP, we do not expect real house price appreciation to assist consumers or balance sheets for years. **Inventory over-hang should weigh on home pricing (left chart), while we see the difference between mortgage rates and house appreciation/(depreciation), which is the homeowner's "carry trade," only returning to its long-term 4% average (4% mortgages minus 0% house price change = 4% average, right chart).**





Source: S&P/Shiller price index (left), FHLMC Fixed Rate & National Home Price Indices (right).

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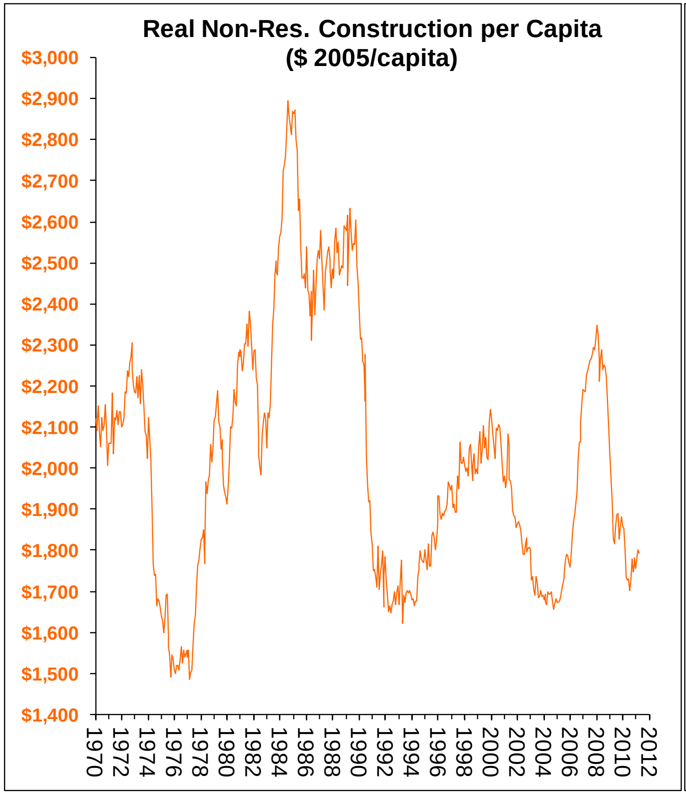
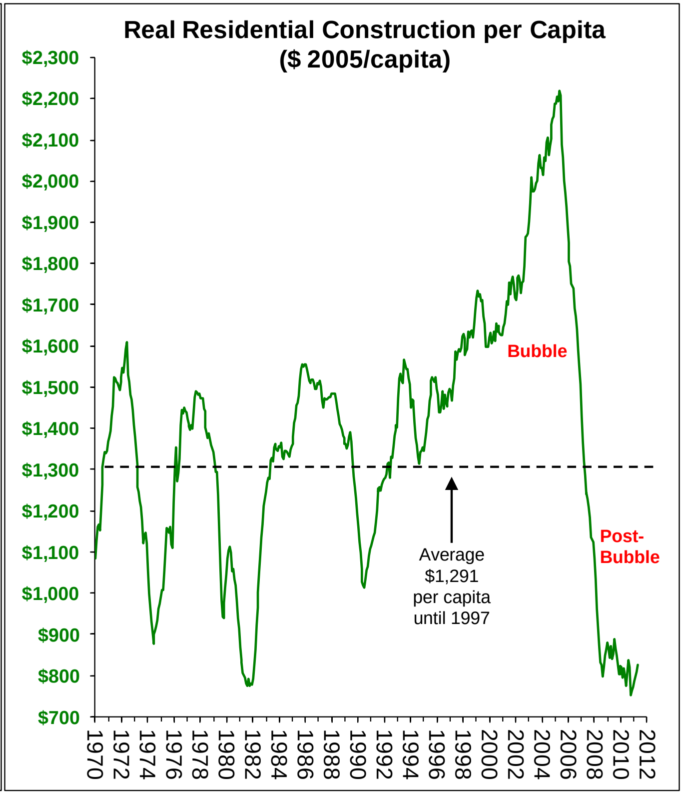
Both residential and non-residential construction have bottomed and will add to GDP in the coming years, in our view. **Mean reversion in non-residential (left chart), which includes both public and private non-residential construction, and absorption of inventory that helps residential construction (right), should result in a construction GDP contribution through 2015, in our view.**





Source: U.S. Census, linked indices to account for changes in classification in 1993.

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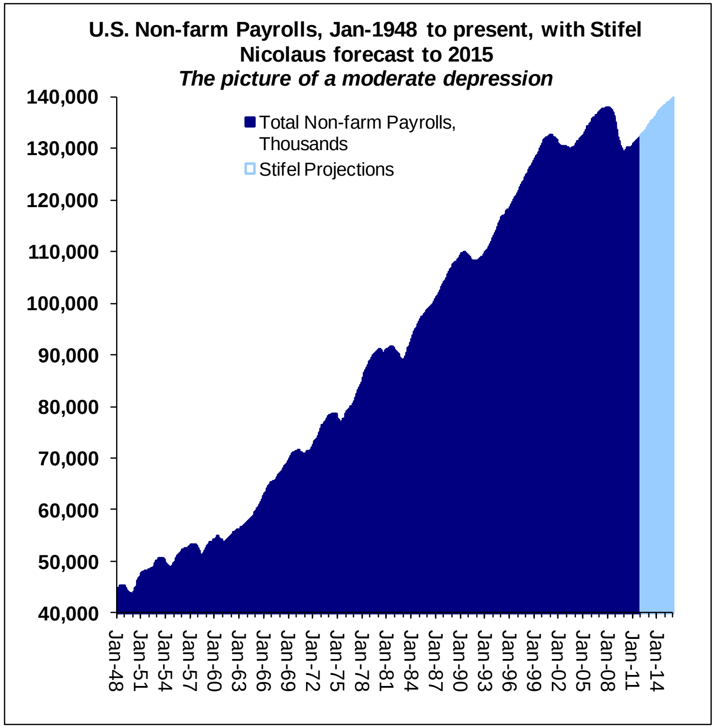
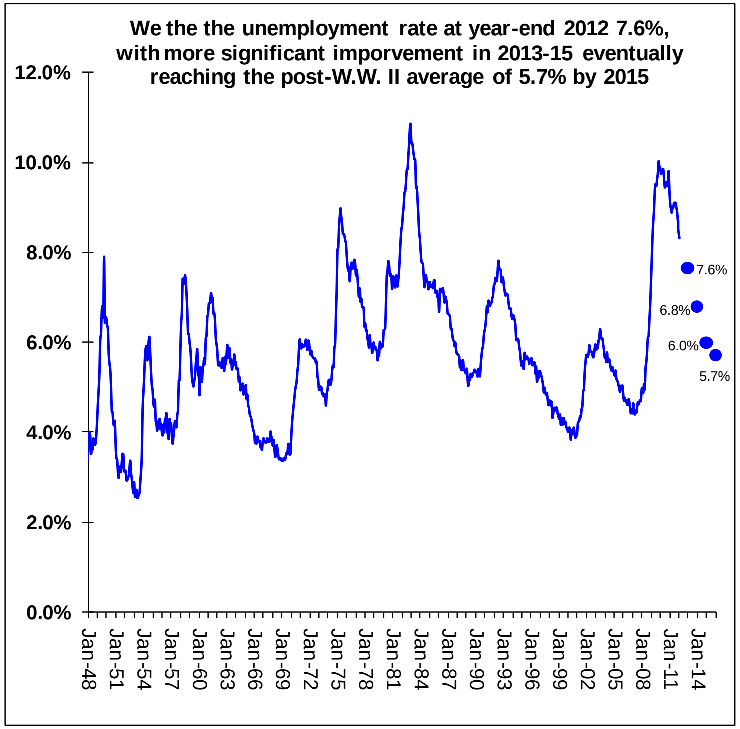
Weighing on jobs are high productivity, the lingering effect of debt deflation and the gradual process of normalizing interest rates and reviving the U.S. dollar*, which we see causing payrolls to peak barely above the 2007 high of 137.6mm by 2014 (left chart). We see the U.S. unemployment *rate* ending 2012 at 7.6%, probably sufficient to assist the current Administration in winning a 2nd term. Thereafter we see more significant improvement in the unemployment rate, *albeit only reaching the post-W.W. II average of 5.7% by 2015 (right chart).





Source: BEA, U.S. Federal Reserve, Stifel Nicolaus.

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Paper vs. Hard Assets

In our view:

1. In Apr-11 click here we said commodity equity leadership since 2002 was over. But viewing hard assets as oversold with a seasonal rally looming, in Oct-11 here we went back into commodities for a seasonal trade.

2. We believe three factors drive commodities: The U.S. dollar, China, and supply/capacity changes. We see a stronger U.S. dollar as the U.S., eurozone and China rebalance, and this undermines the CRABS[(1)] as well.

3. Longer term less demand now (and more supply later) removes Malthusian commodity shortage concerns. Also, creating a costly *Pax Americana*[(2)] since ~1914 produced the illusion of commodities as an asset.

(1) The "CRABS" (Canada, Russia, Australia, Brazil, and South Africa) are the bottom-feeding traditional commodity exporters that have thrived on the Chinese fixed investment (construction + capex) bubble, but we think will suffer as China rebalances due to China's peaking pool of gross domestic savings concurrent with rising Chinese income per capita, the latter more supportive of consumption than commodity intensive growth.

(2) Secular, Capitalist Democracy, a product of the past century, was due to W.W.1 & 2, the Cold War, Post-9/11 conflict and by democratizing China via enrichment using reserve-enabled growth. We do not believe China could have grown at the pace it did the past 20 years without having the ability to store its excess savings in U.S. dollars, and such dollars would not have been available under a gold standard because credit would have been constrained and Chinese currency pegging would have been disallowed.

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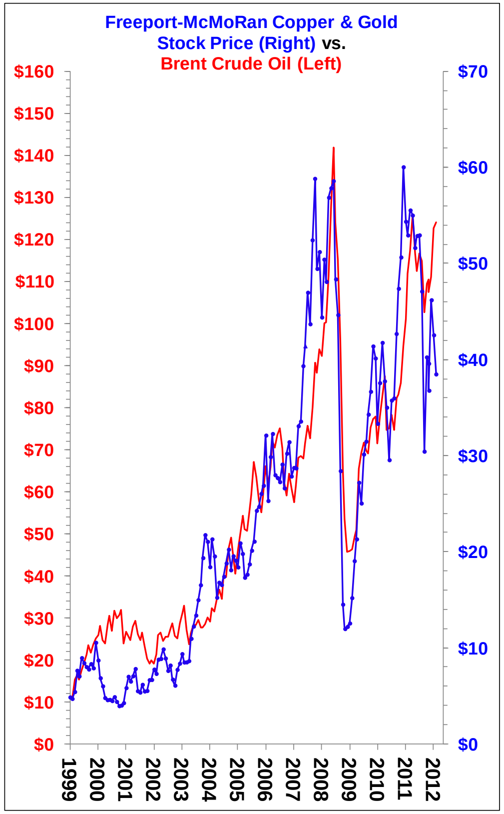
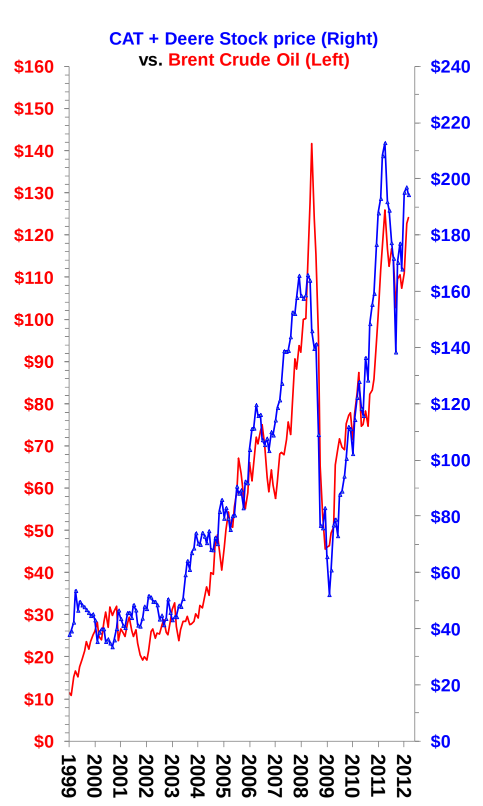
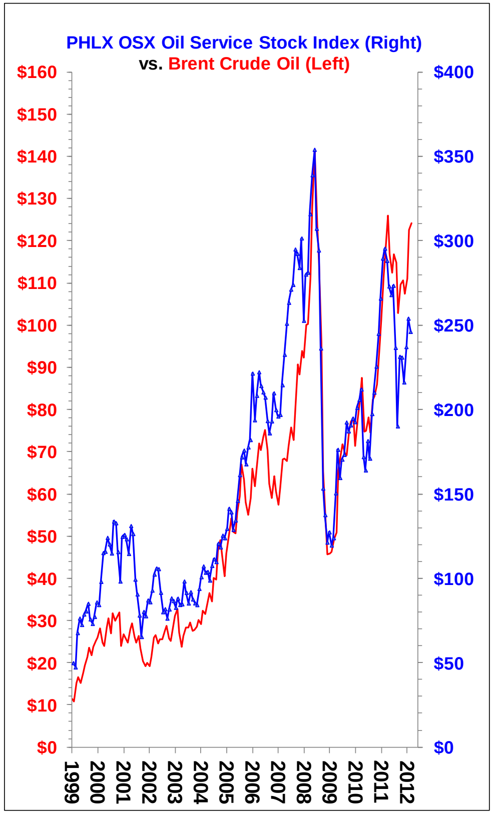
"Got Oil?" Commodity producing <u>or</u> serving equities follow commodity prices, and as this seasonal rally ends we see them as value traps facing P/E compression. **We compare Freeport McMoRan (left), Caterpillar + Deere (middle) and Oil Service OSX (right) to Brent crude oil.**







Source: Factset price history, intraday as of Mar-15, 2012.

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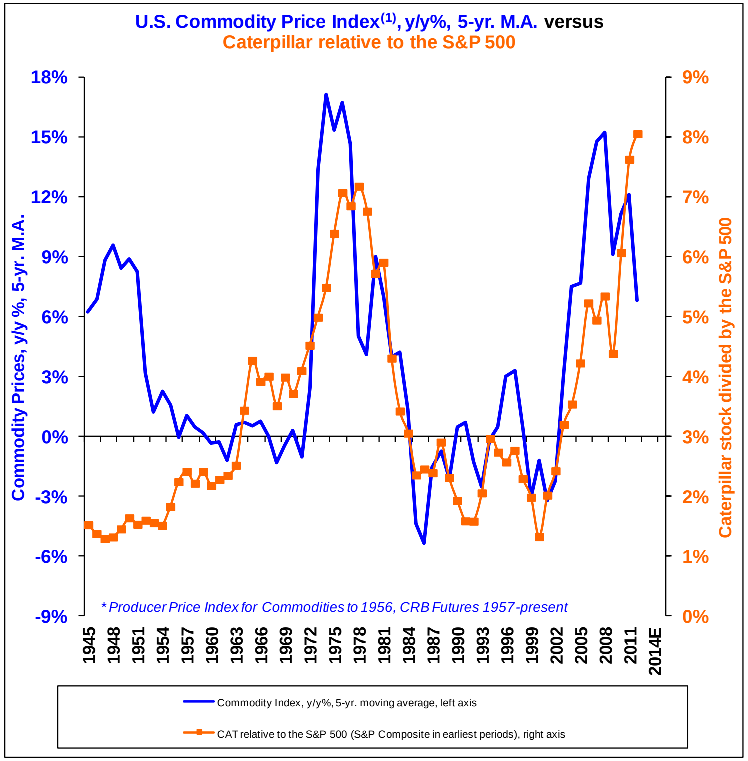
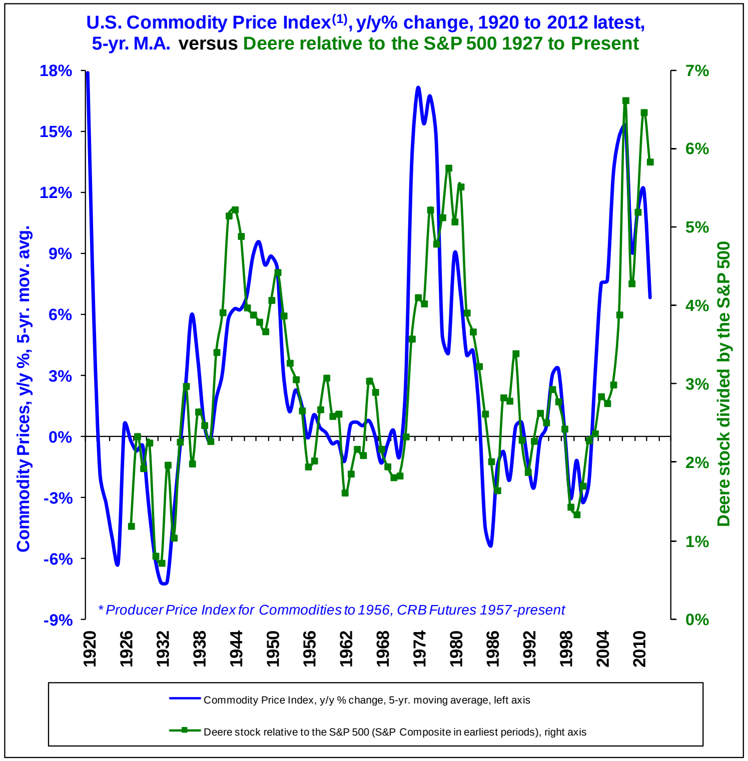
We reiterate that commodity price <u>momentum</u> drives commodity <u>serving</u> equities. **We compare(1) Caterpillar (CAT) (left) and Deere & Co. (DE) (right) relative to the S&P annually to commodity price growth on a 5-year basis.**





Source: S&P, company annual reports, Factset. 1920-56 is the PPI All Commodities, and 1957-2001 is the CRB Continuous Commodity Index, now an equal-weighted, front-month index of 17 commodities including most high-use energy & agricultural commodities. 2001-2011 is the average of daily values. 2012 prices are intraday Mar-6, 2012.

(1) Caterpillar and Deere derive most of their profits or return on capital from commodity serving markets, and have a long history of continuous operations with minimal merger distortion, thus making a long-term analysis such as this more applicable.

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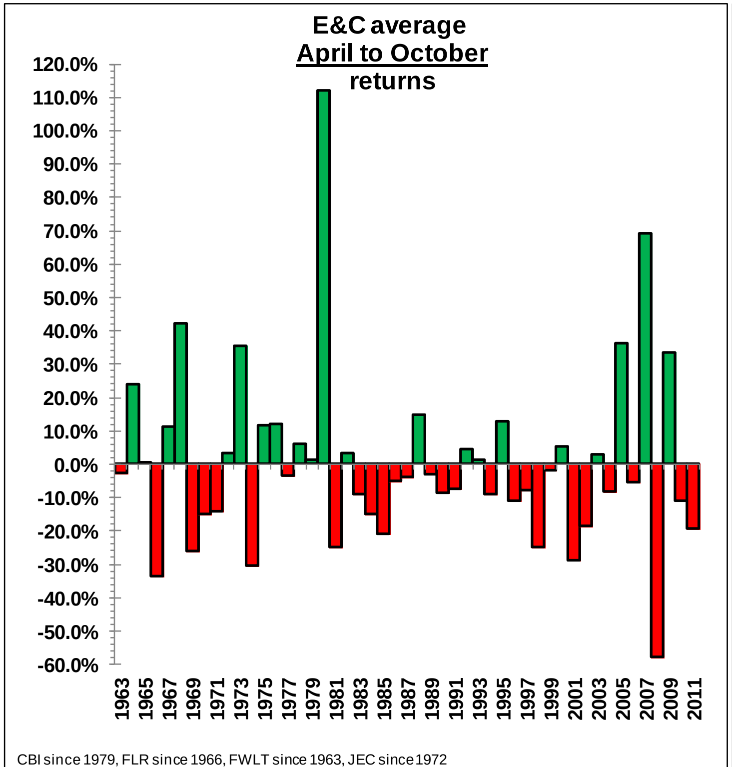
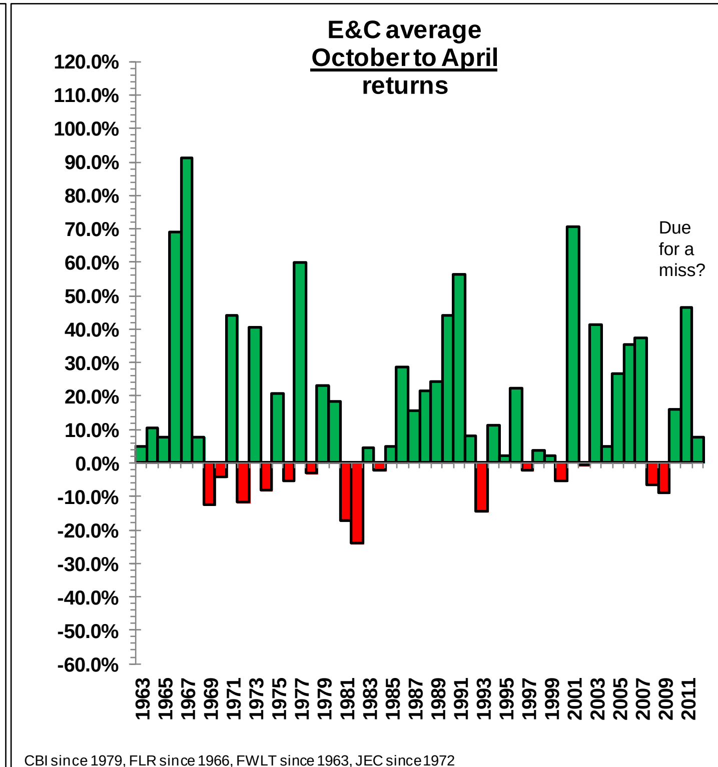
Engineering & Construction stocks[1] with ties to commodities often under-perform from April to October (left) and <u>usually out-perform from October to April (right)</u>, depicted below *for the past 50 years.* We think the stocks may miss the Oct-12 to Apr-13 seasonal rally and underperform for the next year after a string of great seasonal, "normal" trades the past decade.

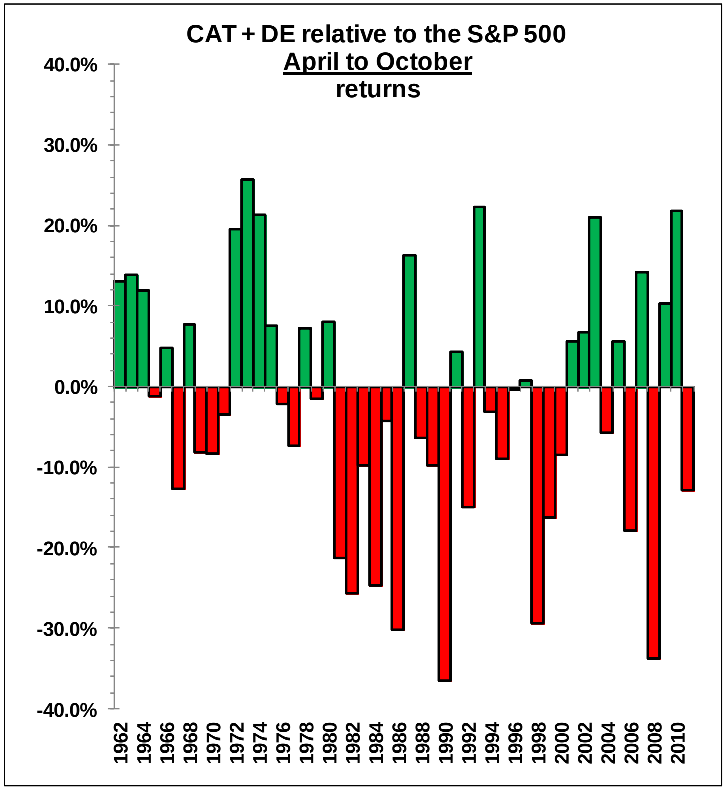


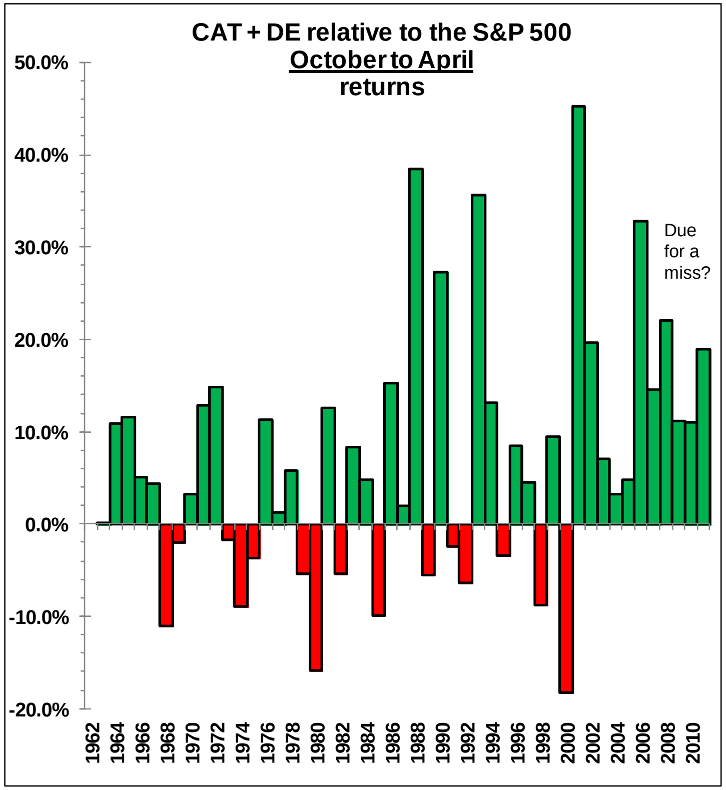


Source: FactSet Prices.

(1) Stocks charted are listed in the bottom of each chart panel, each covered by Stifel Nicolaus E&C analyst Robert Connors, CFA, CPA, and formerly covered by Barry B. Bannister, CFA. We found similar seasonality among Oil Service, Machinery and related commodity sensitive equities. Through 03/07/12 intraday.

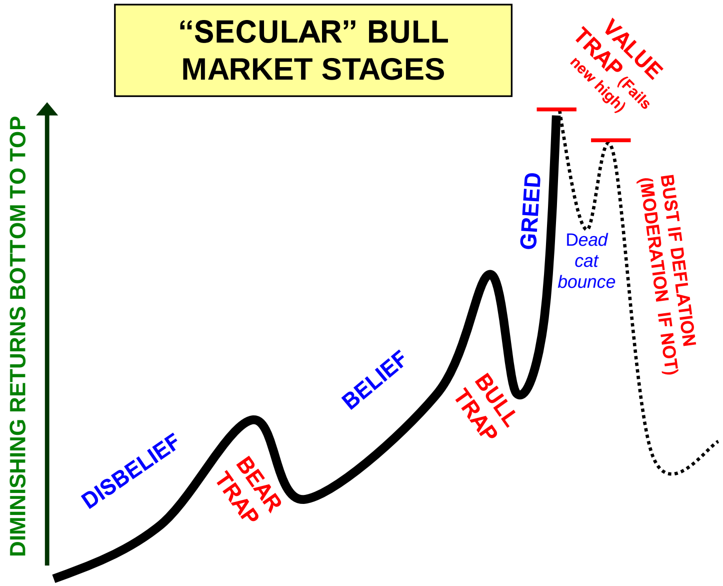
Heavy Machinery stocks[1] with ties to commodities often under-perform from April to October (left) and usually out-perform from October to April (right), depicted below *for the past 50 years. We think the stocks may miss the Oct-12 to Apr-13 seasonal rally and underperform for the next year after a string of great seasonal, "normal" trades the past decade.*





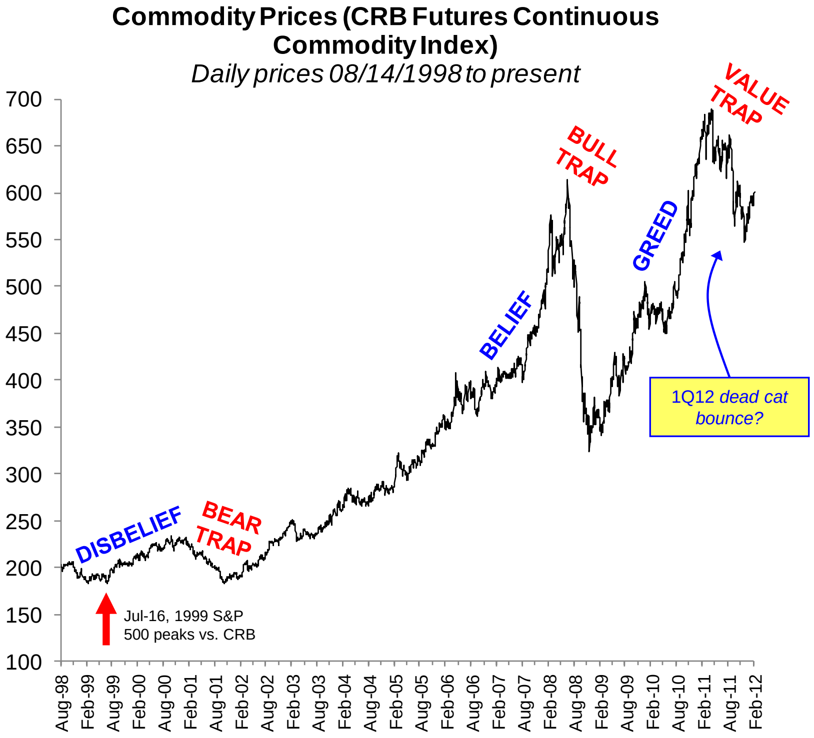
Source: FactSet prices, through 3/23.12 intraday.

Commodities relative to the S&P 500 have followed a classic "bubble pattern" (left chart), and we think may be in a seasonal 1H12 "dead cat bounce" that fails to retake the old high (right chart). **Whether a "bust" or just a slowing for commodities occurs depends on China, but in either case a long-term sluggish period may be termed a "secular bear market." The long term is irrelevant in secular bear markets[(1)], however, so we have been taking fundamentals one quarter at a time.**



Source: Stifel Nicolaus.

(1) We believe secular bear markets cause investors to be "long term" when they should be short-term and opportunistic. Conversely, secular bull markets cause investors to be short term, selling too soon, such as commodities 2000-11 above (or Tech stocks 1991-2000), when they should be long term and practice buy-and-hold until the trend fails to over-take the previous high, signaling secular bull market's end.



Source: Stifel Nicolaus, CRB Futures from Factset.

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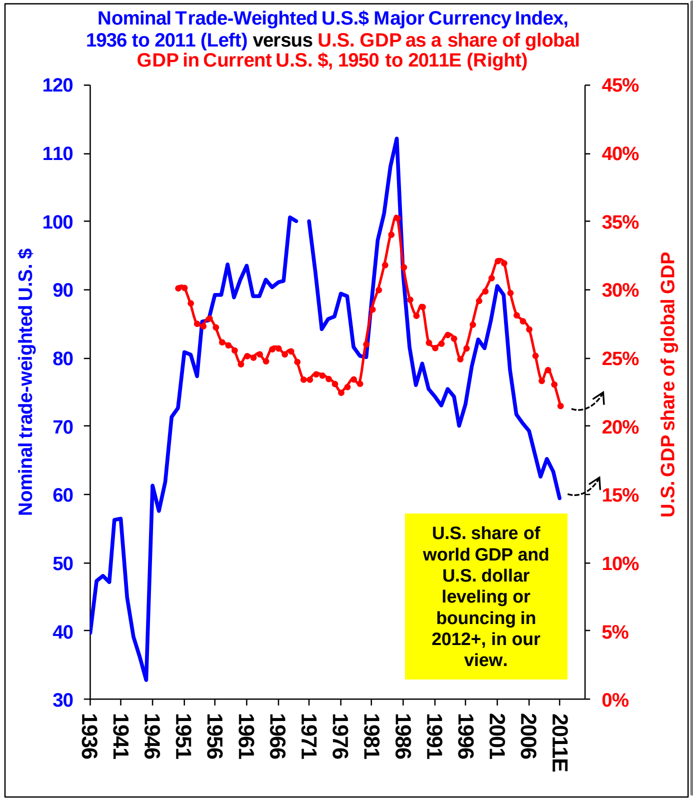
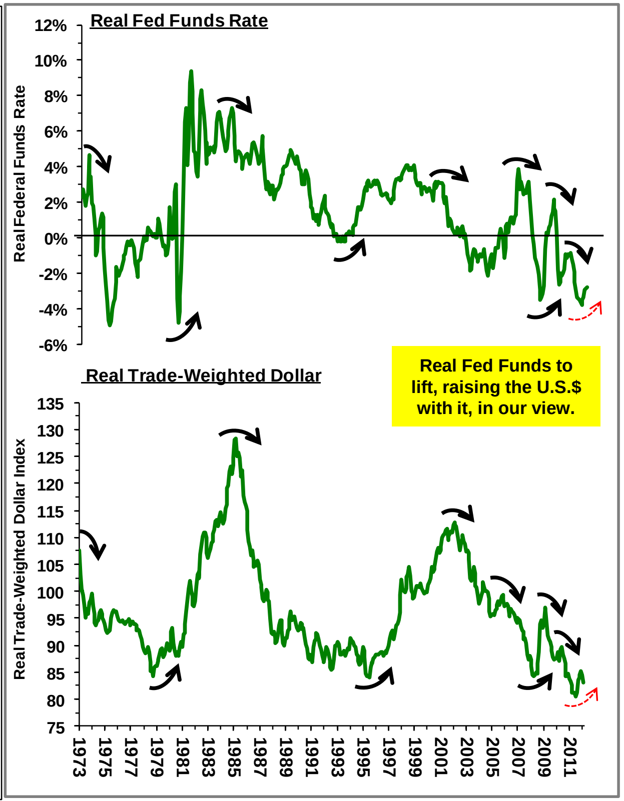
We think U.S. GDP traction relative to the EU and China, the latter of which are late to the rebalancing game, supports the dollar (left), as does the outcome of Fed success or failure. **If the Fed is out-gunned by deflation and the real Fed Funds Rate (FFR) goes from (3)% currently (*i.e.*, 0% minus 3% inflation) to 0% (0% FFR minus 0% deflator), or if a successful Fed normalizes rates (2% FFR minus 2% deflator = 0%), then either way the real FFR (and thus U.S. dollar) lifts, in our view.**





Source: World Bank, IMF, U.S. Federal Reserve, Stifel Nicolaus estimates pre-1971 based on U.S. trade balances and applicable cross-currency rates.

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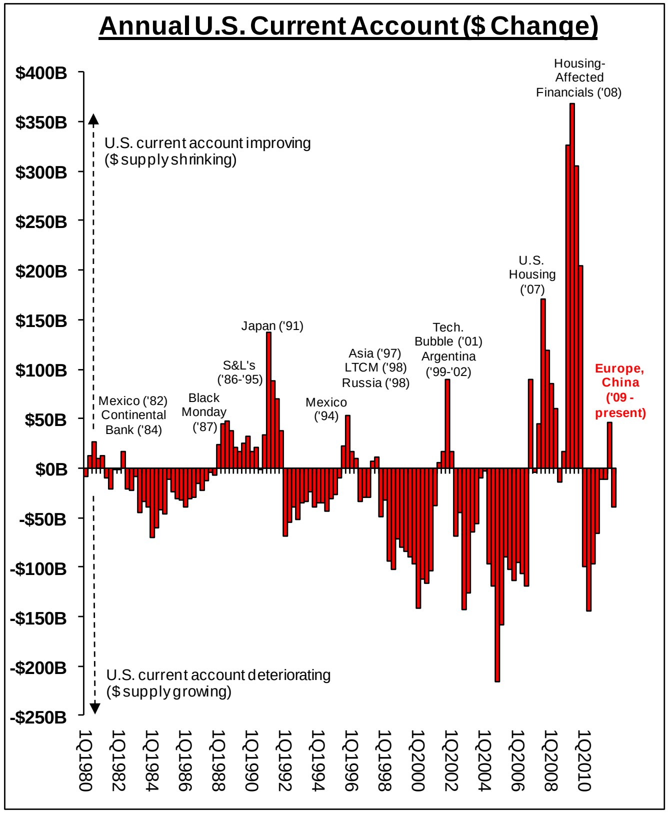
Whenever the U.S. as de facto provider of the world currency reduces dollar supply, someone (often overseas) in need of liquidity has a crisis (left chart). **A large part of U.S. current account closure will come from domestic oil production, in our view. Additional U.S. oil production of only 3 million barrels/day by 2022 (table, right) would service about $6 trillion of cumulative Federal debt by 2022.**



Under various interest rate and WTI oil price assumptions below, if U.S. tight oil (shale oil) production (plus GOM deepwater) by 2022 reaches a net 3 million barrels/day addition from the Bakken, Eagle Ford & Niobrara formations, which we believe to be a realistic figure, then 1.1 billion barrels per year (365 days x 3 mb/d) of added domestic output (assuming offsets to declining production in Alaska, etc.) could service all or much of the cumulative U.S. fiscal deficit incurred to "close" the output gap, which is actual vs. potential GDP, to the year 2022. That would shield the public from the worst effects of the ongoing mini-depression, in our view.

Assumed WTI Oil Price in 2022

Est. 5-year Treasury rate in 2022	$85/bbl.	$95/bbl.	$105/bbl.	$115/bbl.	$125/bbl.	$135/bbl.
1.00%	$9.31 tril.	$10.40 tril.	$11.50 tril.	$12.59 tril.	$13.69 tril.	$14.78 tril.
1.25%	$7.45 tril.	$8.32 tril.	$9.20 tril.	$10.07 tril.	$10.95 tril.	$11.83 tril.
1.50%	$6.21 tril.	$6.94 tril.	$7.67 tril.	$8.40 tril.	$9.13 tril.	$9.86 tril.
1.75%	$5.32 tril.	$5.94 tril.	$6.57 tril.	$7.20 tril.	$7.82 tril.	$8.45 tril.
2.00%	$4.65 tril.	$5.20 tril.	$5.75 tril.	$6.30 tril.	$6.84 tril.	$7.39 tril.
2.25%	$4.14 tril.	$4.62 tril.	$5.11 tril.	$5.60 tril.	$6.08 tril.	$6.57 tril.
2.50%	$3.72 tril.	$4.16 tril.	$4.60 tril.	$5.04 tril.	$5.48 tril.	$5.91 tril.
2.75%	$3.38 tril.	$3.78 tril.	$4.18 tril.	$4.58 tril.	$4.98 tril.	$5.38 tril.
3.00%	$3.10 tril.	$3.47 tril.	$3.83 tril.	$4.20 tril.	$4.56 tril.	$4.93 tril.

We foresee outward U.S. funds flows shifting from funding oil imports via the current account (trade deficit) to instead servicing debt under the U.S. capital account (capital outflows).

Source: For the chart, Congressional Budget Office (CBO), Bureau of Economic Analysis (BEA), and for the table Stifel Nicolaus Projections.

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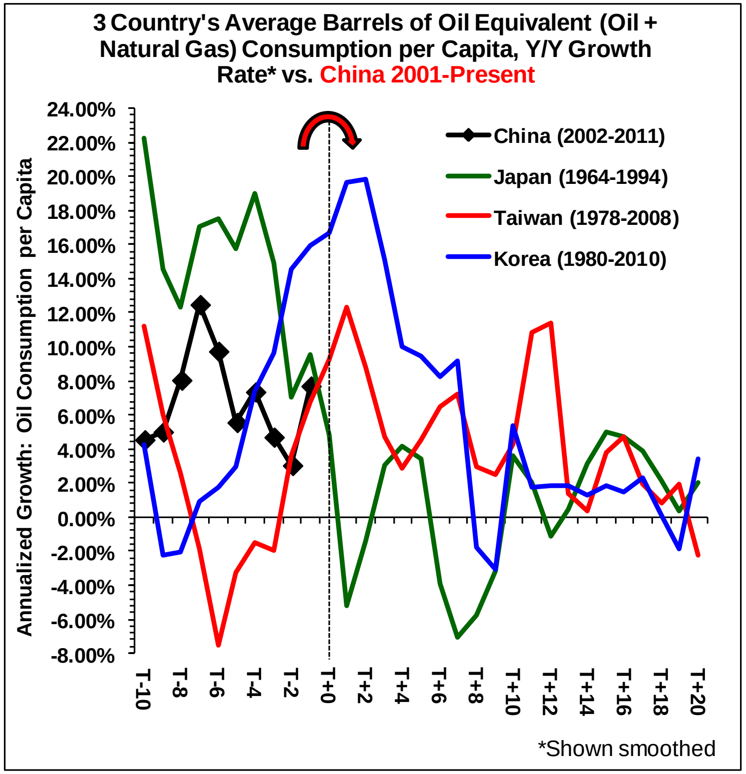
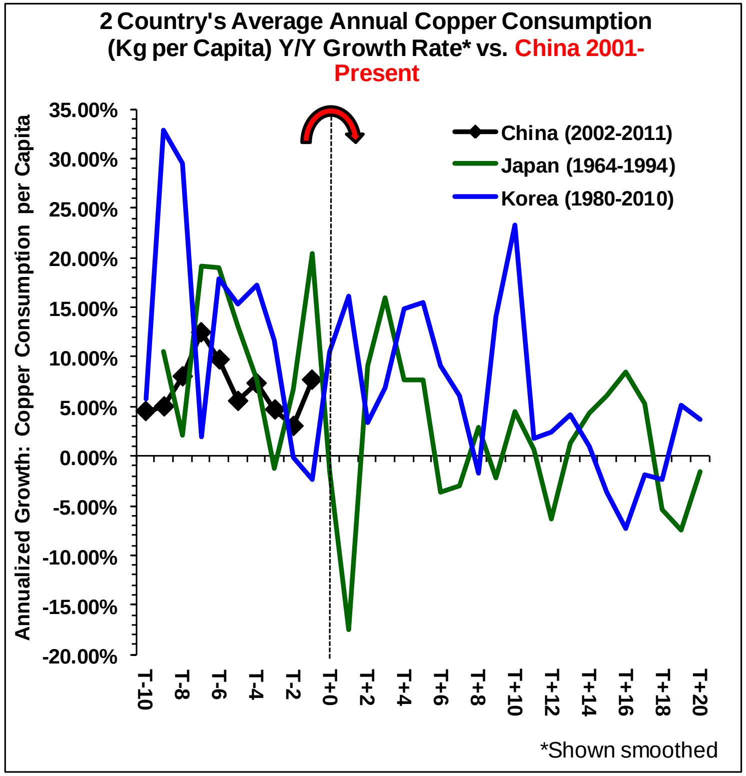
We think China is following the path up to and after Japan in 1974(1), Korea in 1990 and Taiwan in 1988 in terms of a peaking fixed investment contribution to GDP growth, so commodity usage growth should slow. **Both petroleum (left chart) and copper (right chart) demand *growth* should shrink, especially copper, in our view.**





Source: BP Annual Review, IEA, UN, Japanese Ministry of Internal Affairs and Communications, OECD, IMF.

(1) Although Japanese demand for both oil and copper was dramatically reduced by the 1973-74 Oil Shock, Korea after 1990 and Taiwan after 1988 both slowed, yet they were not affected by a similar resource price shock. We attribute slowing demand to reduced fixed investment as a percent of GDP and rising consumer economies.

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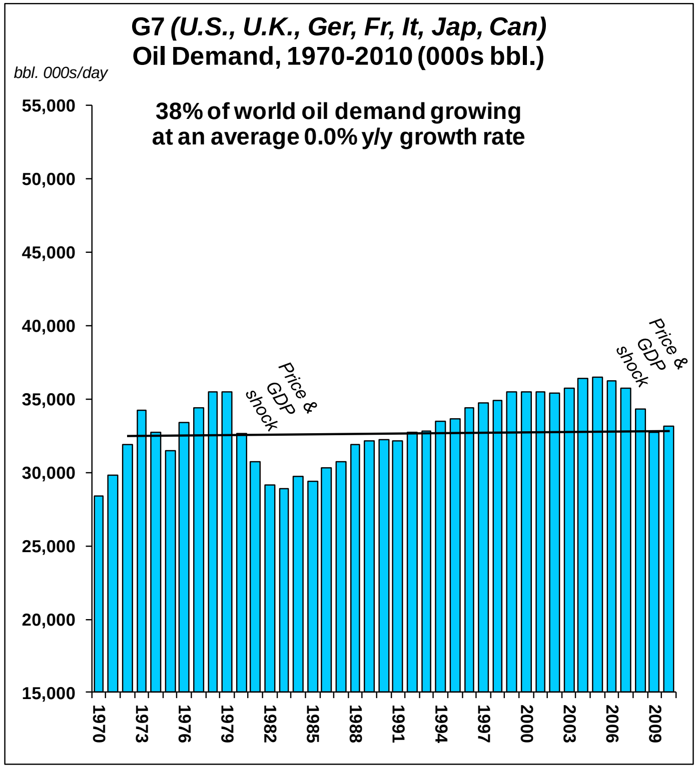
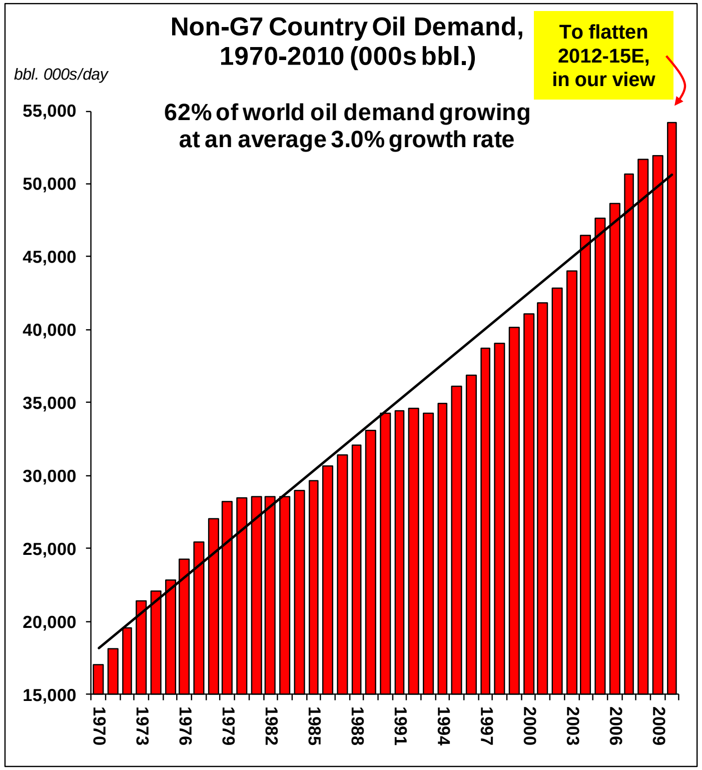
We think <u>non-G7</u> oil demand is ripe for pull-back as GDP slows and non-G7 oil/fuel subsidy distortions are perhaps rolled back due to budget woes **we expect in that area. G7 country(1) oil demand, which is 38% of the world total, is likely to remain weak (left chart), having experienced in 2007-09 an oil shock similar to 1979-81. In contrast, <u>non</u>-G7 country oil demand has grown at ~3%/yr., is 62% of world oil demand, and is precariously *above trend.***





Source: EIA, BP Statistical Review, United Nations, IEA, Stifel Nicolaus.

(1) G7 is the U.S., U.K., Germany, Japan, France, Italy and Canada. Non-G7 is the remainder of the world.

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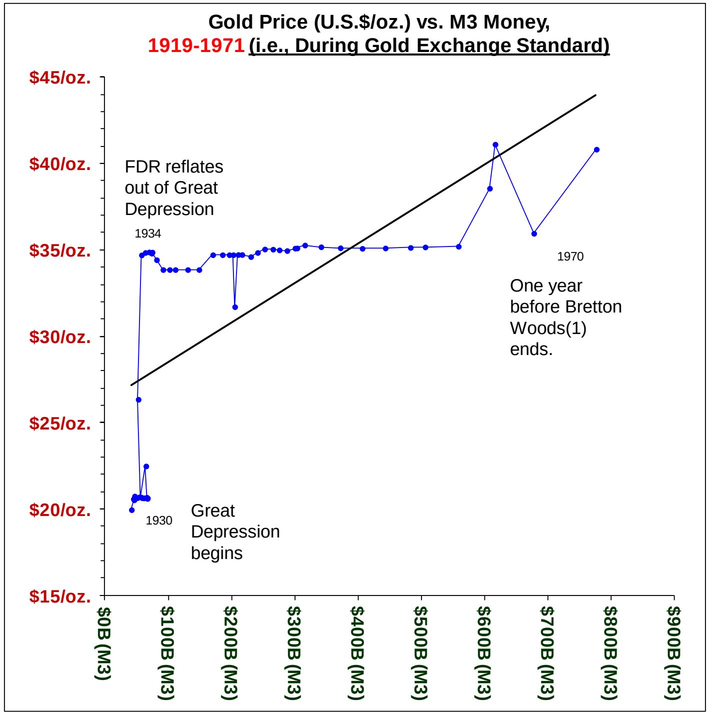
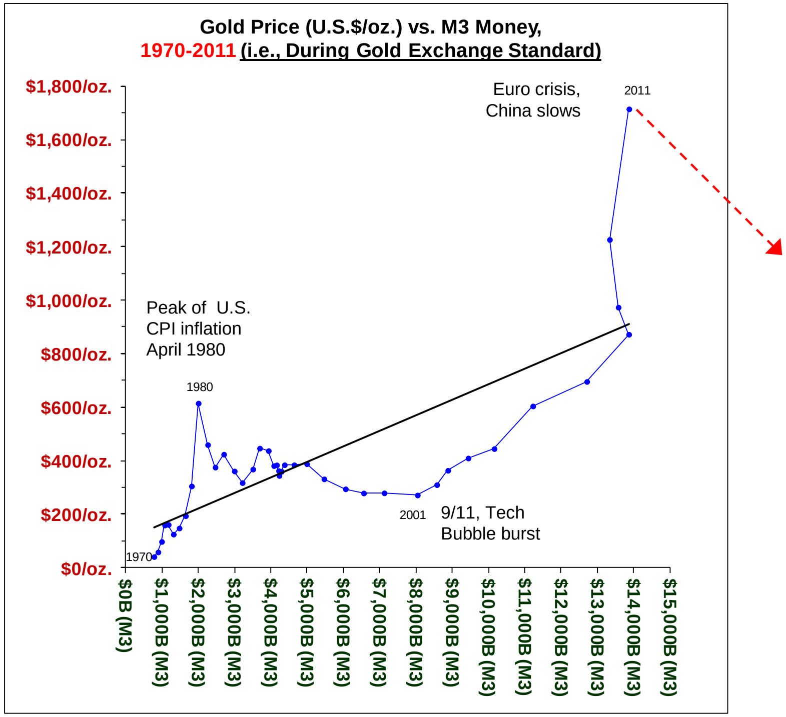
As money (credit) grows more slowly, and fears subside of "tipping over" into either deflation or inflation (gold's sweet spot is in those two extremes), we see the U.S. dollar gold price coming under pressure. **Whether we examine the period before the end of the U.S. gold standard (left), or after (right), changes in money *supply* (horizontal axes below) drive *great swings* in the price of gold (vertical axes). If money (which is credit) growth slows as we expect, we would expect the gold price (in U.S. dollars) which is elevated relative to U.S. M3 Money Supply, to fall.**





Source: Stifel Nicolaus analysis, U.S. Federal Reserve, Bloomberg.

(1) Bretton Woods was the 1945-71 agreement in which the U.S. dollar fixed to gold price at $35/oz. (for foreigners) and foreign currencies loosely fixed to the U.S . dollar.

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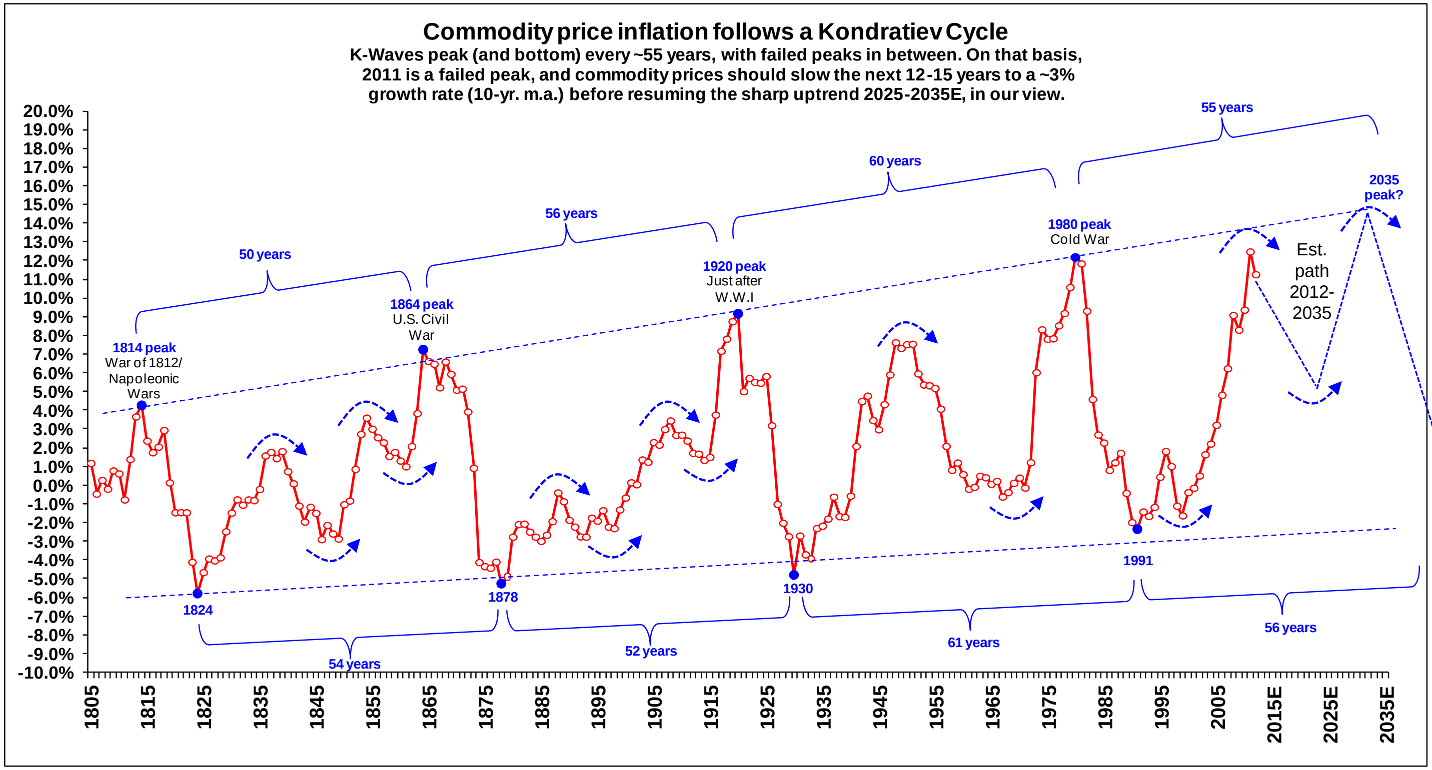
The ~55 year peaks between Kondratiev peaks and bottoms (chart) signal a respite in commodity prices to about 2025, but 2025-35 could be a shocker if the historical trend holds. **A respite could be attributable to more supply, China re-balancing, and western deflationary de-leveraging/U.S. dollar strength.**



Source: Commodities 1795 to 1890 are the Warren & Pearson U.S. commodity index constructed with farm products, foods, hides & leather, textiles, fuel & lighting, metals & metal products, building materials, chemicals & drugs, household furnishing goods, spirits and other commodities. 1891 to 1913 is the Wholesale Commodities Price Index from the BLS and other agencies. 1914 to 1956 is the PPI for All Commodities, and 1957 to present is the CRB Continuous Commodity Index, currently an equal-weighted, front-month index of 17 commodities including most high-use energy and agricultural commodities. Prior to 2002, annual data are the average of monthly values. For the trailing decade, all daily closing values for the CRB CCI index are considered.

Appendix

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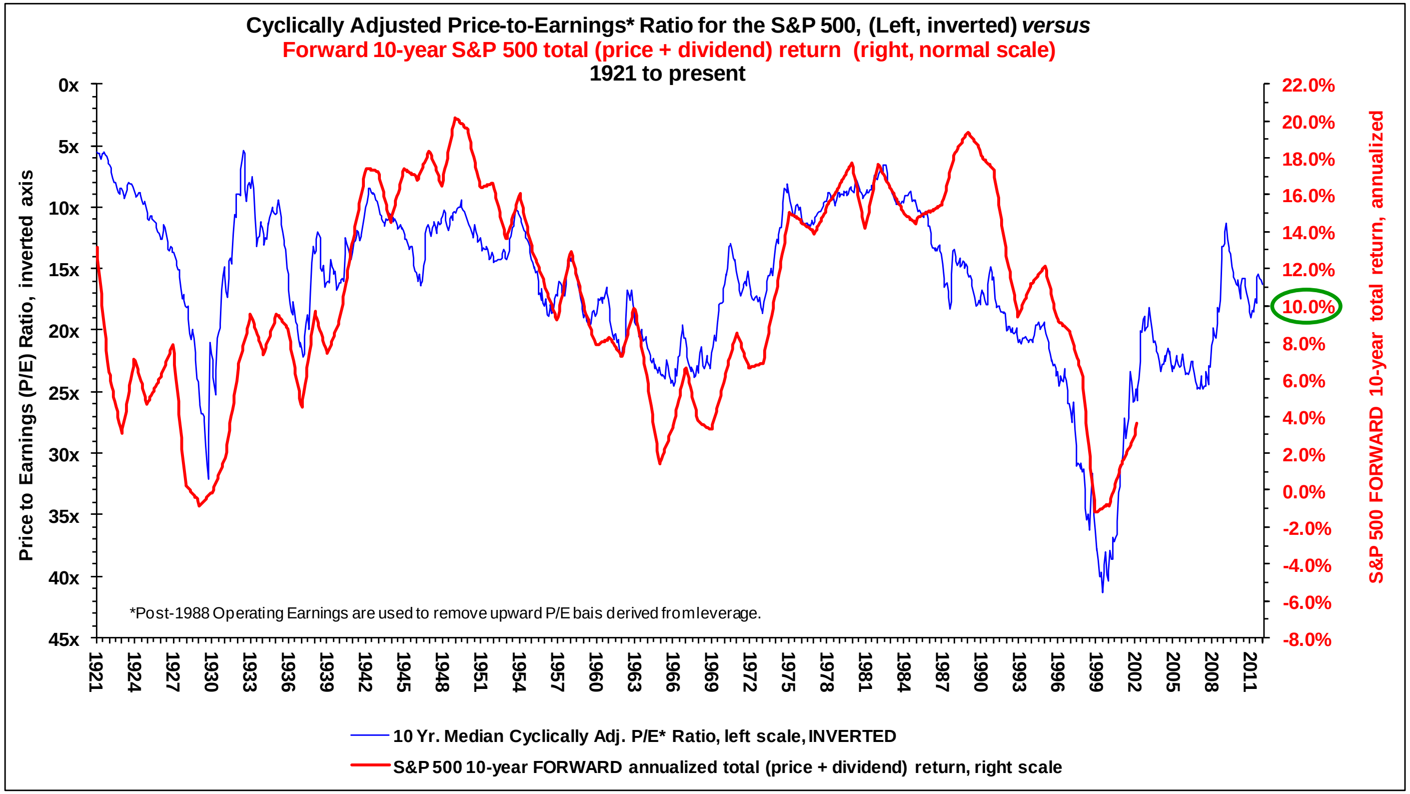
Another objective measure supportive of ~10% U.S. equity returns is the implicit information content of a lower smoothed P/E. **As stated in this report, U.S. EPS are (and have been) supported since the 1990s by productivity demographics, reserve currency status, deficits and the liquidity salve for debt. The chart below of the *inverted* S&P smoothed P/E ratio vs. forward S&P 500 total return (price + dividend) indicates that the forward S&P return *could be double-digits.***



Source: Shiller historical data, Standard & Poor's operating earnings data, Stifel Nicolaus format.

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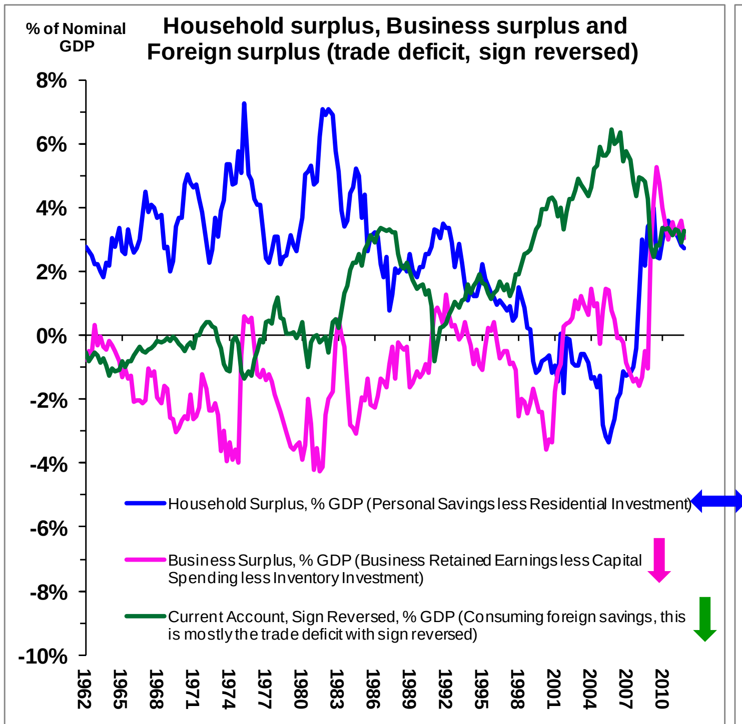
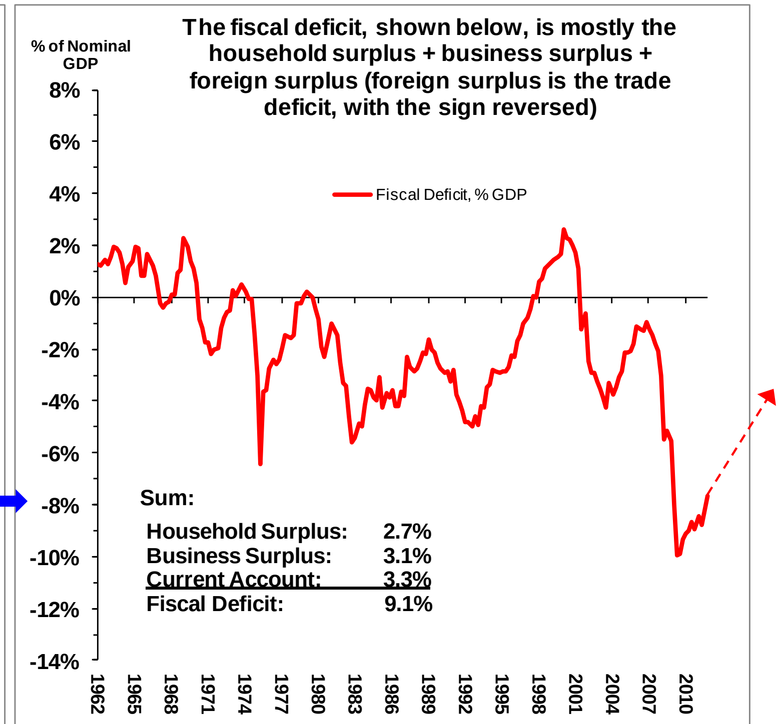
Fiscal deficits have simply reflected the private sector lack of capital investment and have boosted profits for U.S. corporations via the Profits Equation(1). **Even if housing slowly recovers, we expect personal savings to rise, keeping the Household Surplus (blue line, left chart) *flat* with the 50-year average. Where we *do* see fiscal progress is in reducing the Trade Deficit (green line, left, inverted, i.e., we expect net imports to fall) and shrinking the Business Surplus (pink line, left), as margins fall due to rising wages, a bottoming dollar and a falling fiscal deficit.**





Source: BEA, NIPA Flow of Funds, U.S. Federal Reserve.

(1) Profits are the sum of [Investment *minus* Household Savings *minus* Government Savings *minus* Foreign Savings *plus* Dividends], which is the Kalecki Profits Equation. In that way, the deficiency in Investment (housing, *et al.*) is being met with a federal deficit (minus a minus Government Surplus means that the deficit is added to profits in the equation). In that way, fiscal policy adds to profits in addition to the monetary policy (negative real rate, dollar depression) aspects described earlier.

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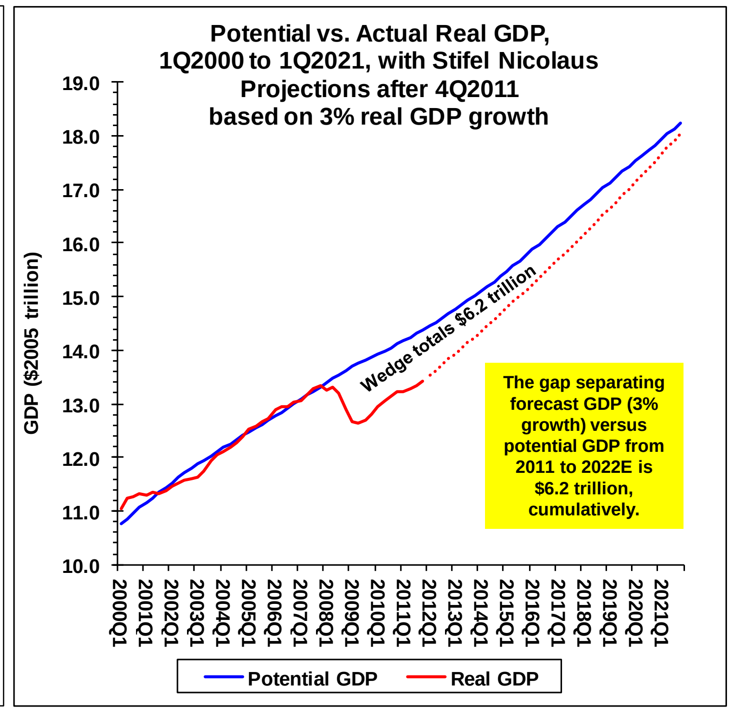
U.S. voters have chosen to anesthetize themselves from feeling much economic pain by borrowing ~$679 billion/year (left chart) more than they did 10 years ago in social benefits, **thereby insulating themselves from the effects of the ongoing debt deflation mini-depression. This effectively insulates them from much of the gap between actual and potential[(1)] GDP (right chart). We expect such fiscal largesse along with cyclical recovery to help Pres. Obama win a 2nd term.**



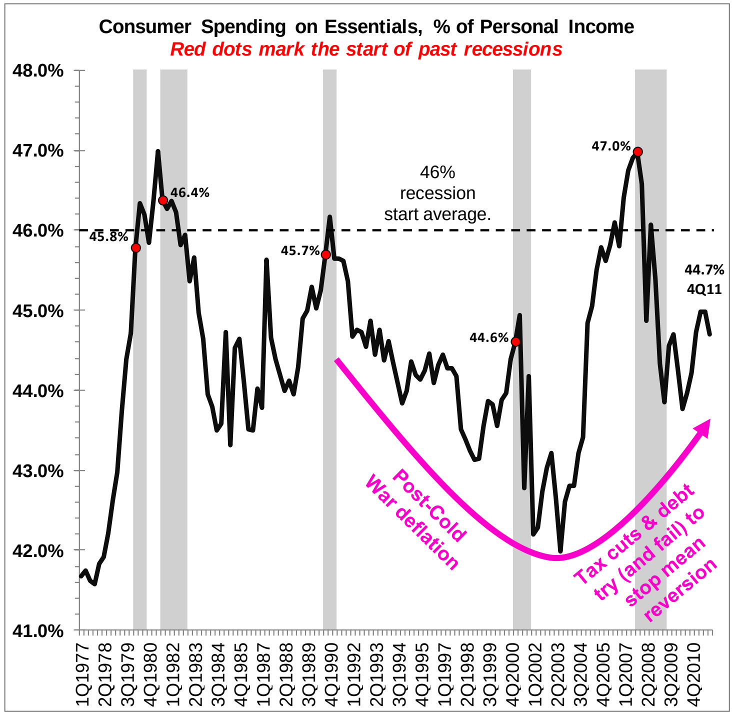
Source: Congressional Budget Office (CBO), Bureau of Economic Analysis (BEA), & Stifel Nicolaus Projections.

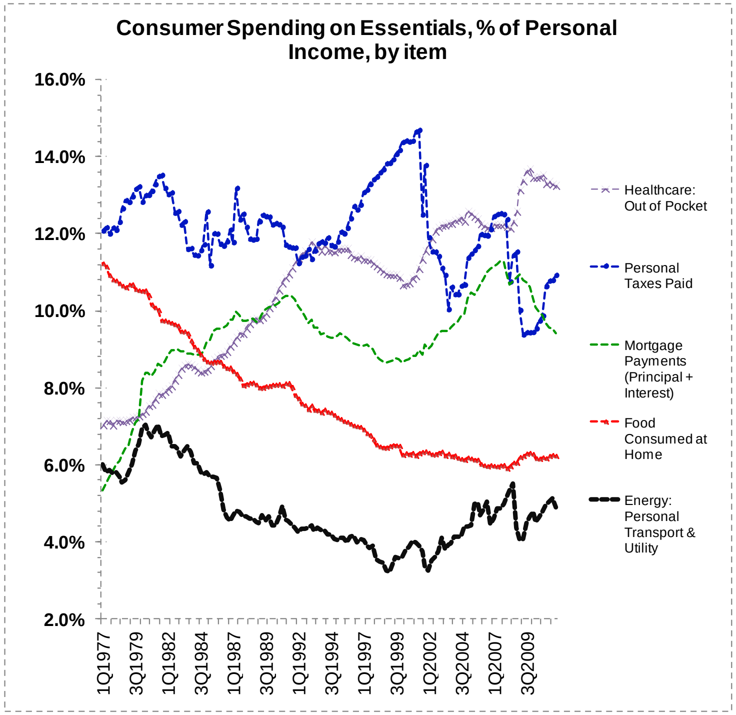
(1) "Potential GDP" is the highest level of long-term real gross domestic product attainable under natural and institutional constraints. Limited resource utilization is assumed to be absent of any cyclical contribution, as are labor, working hours, capital equipment, raw goods, technology and managerial skills.

(2) Listed in the inlay box of the chart. The "Other" government social benefits category in the box includes SNAP (i.e. food stamps), FEMA response, the earned income tax credits, pension benefit guarantees, railroad retirement benefits, black lung benefits, workers' compensation, direct relief benefits, and others.

STIFEL NICOLAUS

A sudden 2013 tax hike or oil shock may tip the U.S. into recession, in our view. **U.S. consumer spending on essentials (as a % of income) plunged after the Cold War ended in 1992 (left chart), a typical post-war deflation. But when essentials began to turn back up in 2001 taxes were cut and interest rates were held low to inflate housing, *perhaps a futile attempt to hold back the tide*. Eventually, energy, health care and food costs began to close the gap, although they remain below (as a percent of personal income) what has historically been a recession-inducing level.**





Source: National Income and Product Accounts, U.S. Bureau of Economic Analysis, Freelunch, Federal Reserve data including the Financial Obligations Ratio (Homeownership – Mortgage) after 1980 and estimated from 1Q1977-4Q1979 using regression analysis of federal interest data.

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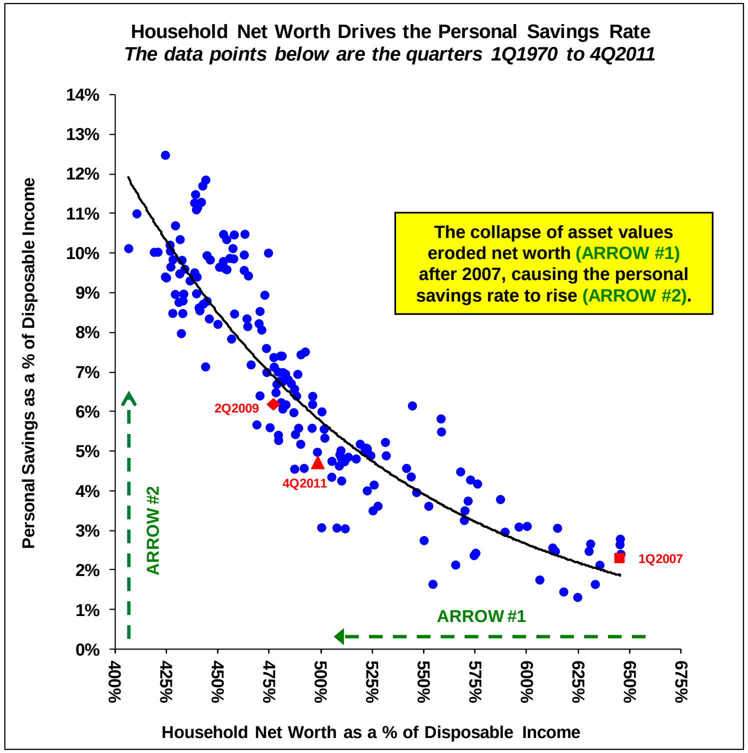
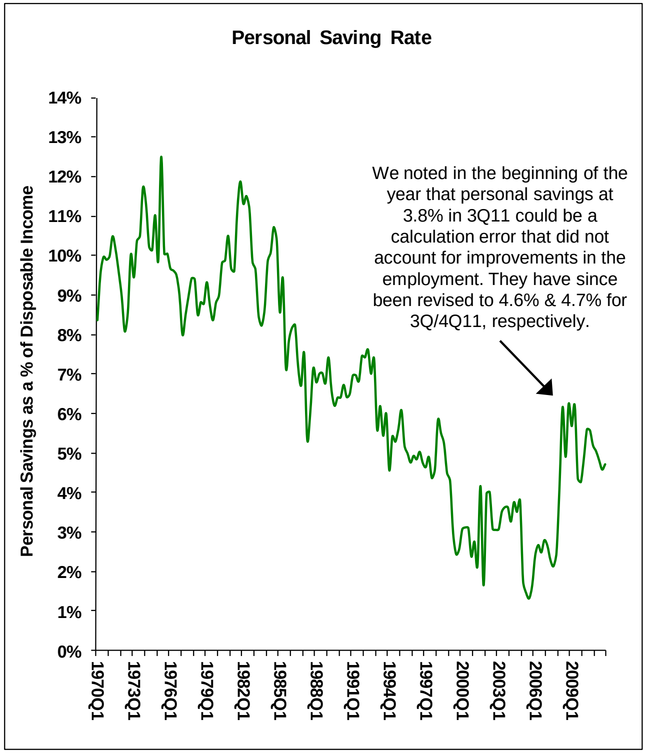
We believe a new round of quantitative easing, or QE3, is likely by 2Q12, this time targeting housing or in response to weaker data (employment, housing) or deflationary shocks from overseas. **Falling assets triggered rising savings (left chart, arrows) and pressured GDP (consumption is ~2/3 of GDP), so we think QE1 & 2 targeted asset values.**





Source: Fed, BEA. Stifel Nicolaus format.

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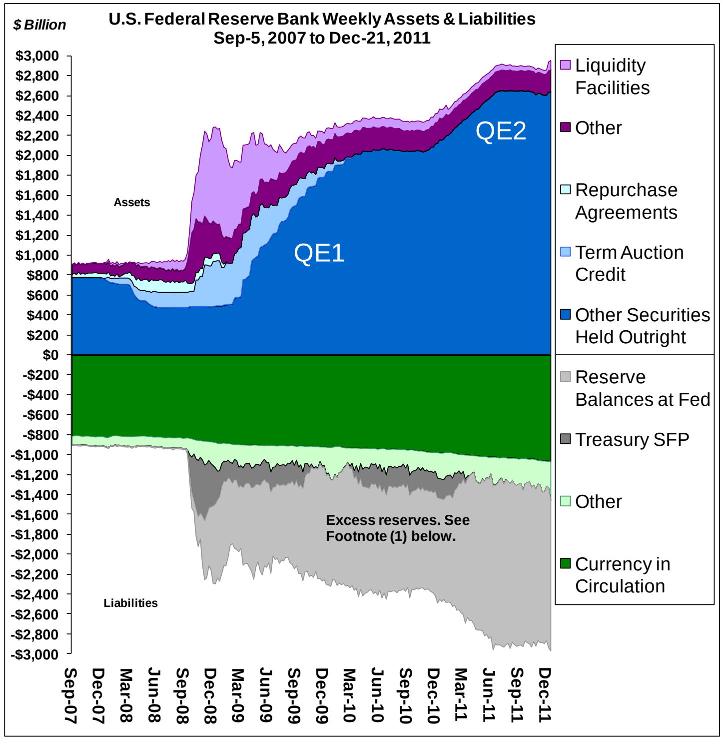
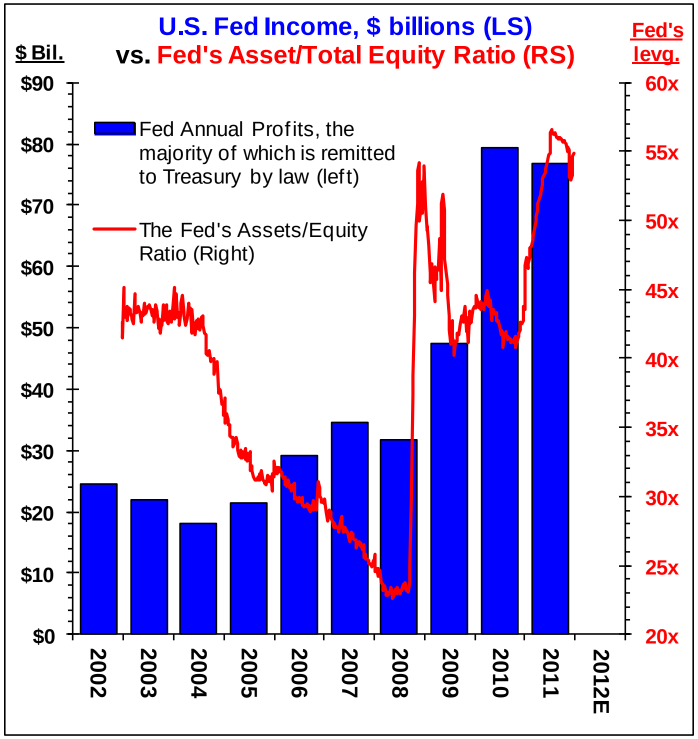
Two Fed exit issues we expect are the <u>loss of rate setting power</u> and possible <u>carry trade problems</u>. **By creating excess reserves the Fed may have lost control of short rates(1) and must sell assets to tighten policy. In addition, Fed profits via the carry trade *(i.e., a low cost of funds and appreciating bonds)* have been rewarding for the U.S. Treasury(2) but could go into reverse forcing the Fed to sell into a weak bond market and require recapitalization, in our view.**



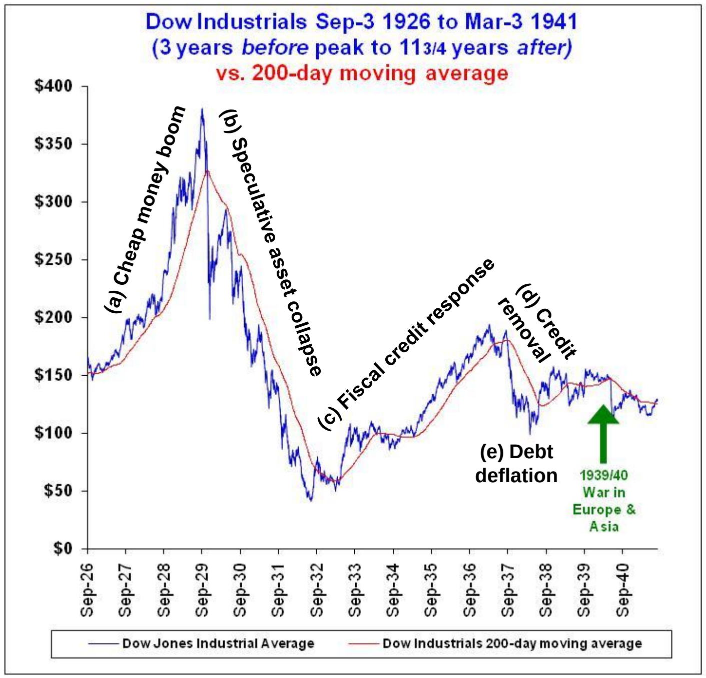


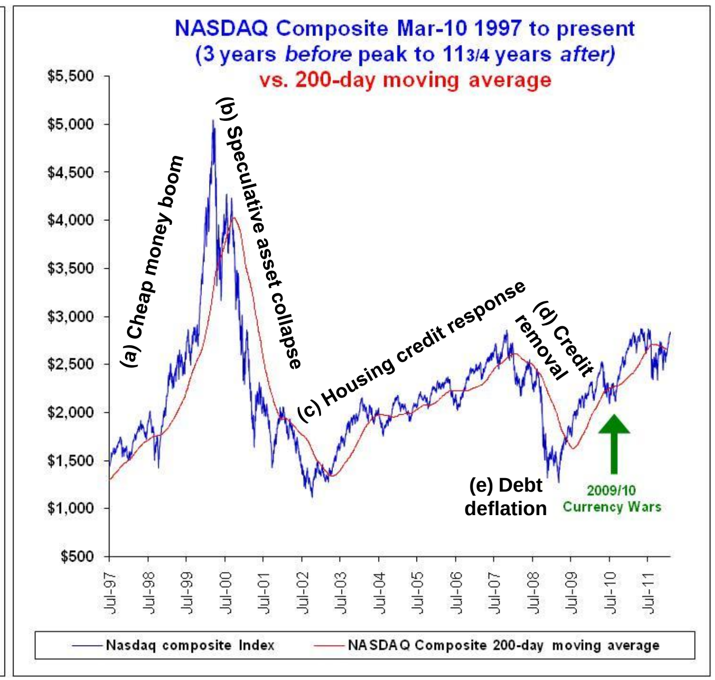
Source: Federal Reserve, NBER, FactSet. Charts formats and annotations are Stifel Nicolaus & Co.

(1) Since the Fed must out-bid market rates via term auction facilities to keep newly created excess reserves at the Fed, the Fed may have lost control of short term rates and must manage its balance sheet to tighten/loosen. We view this as positive, however, since market-based rate discovery is preferable to Fed intervention.

(2) By law the Fed contributes its profits to the U.S. Treasury each year. The Fed earned $81.7 billion in 2010 and contributed $79.3 billion to the Treasury, and in 2011 the Fed earned $78.9 billion and contributed $76.9 billion to the Treasury.

To escape deflation the U.S. inflated surplus countries (Germany, China) **post-2009, forcing them to tighten (and re-balance). Just as the 1930s-40s equity[(1)] pattern was: *(a) cheap money boom*, *(b) speculative asset and investment bubble bursts, (c) credit inflation remedy is applied, (d) credit is removed some years later, and (e) debt deflation that leads to conflict* (left), we believe 2000-11 has followed that pattern (right chart), up to QE 1 & 2 and China's currency peg.**





Source: Dow Jones prices, Bloomberg.

(1) The comparable market in terms of speculation to the 1920s-30s Dow (left) is the NASDAQ (right) today. Just as 1932-37 was supported by federal debt, 2002-07 benefited from housing debt. In both cases, 1938 and 2008, removal of support was detrimental, leading to unilateral actions by struggling states in 1939-40.

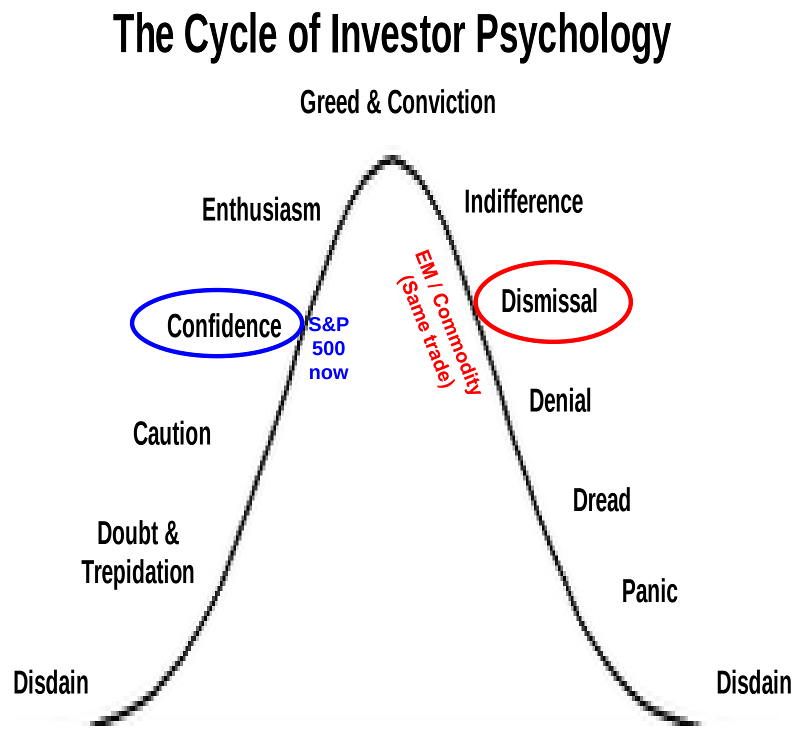
Bubbles are easy to spot after they burst but not before. **Edward Chancellor[1] *anticipates* bubble tops with this list; we think China in 9 for 9 on this check list:**

Characteristics that identify bubbles *before the fact* are:

1. A compelling, revolutionary growth story *(Rails 19th Century, Internet, biotech 1990s, China today)*
2. A blind faith in the competence of authorities *(Maestro Greenspan, Politburo's 5-year Plans)*
3. Excessive fixed investment *(Fiber Optic 1990s, China today)*
4. Corruption overlooked due to profits *(Madoff, BRICS low Transparency Int'l. scores)*
5. Growth in money supply in excess of GDP *(China, U.S. 2000s housing bubble)*
6. Artificially low interest rates and/or fixed currencies *(U.S. Roaring 1920s before 1929 Crash, China today)*
7. Growing moral hazard combined with nationalism (U.S. in the 2000s wars, the made-up "BRICs" acronym and summit meetings)
8. High leverage/low return models raise sensitivity to rate movement *(Telecom sector 1990s, China today)*
9. Asset-based lending rather than cash flow based *(1970s Farm sector and oil patch in U.S., China today)*

(1) From the work of author and FT columnist Edward Chancellor, author of *"Devil Take the Hindmost: A History of Financial Speculation."*

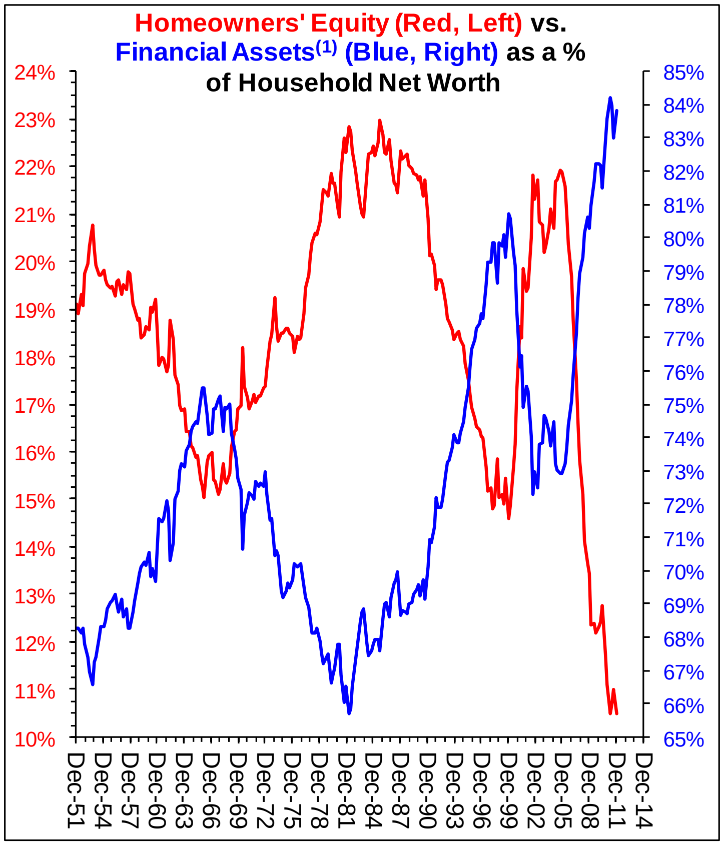
We think most China/commodity views are precarious at best and in the "dismissal" stage of psychology. **Conversely, the S&P 500 strikes us as having upside to 2013/14 as investors gain "confidence."**

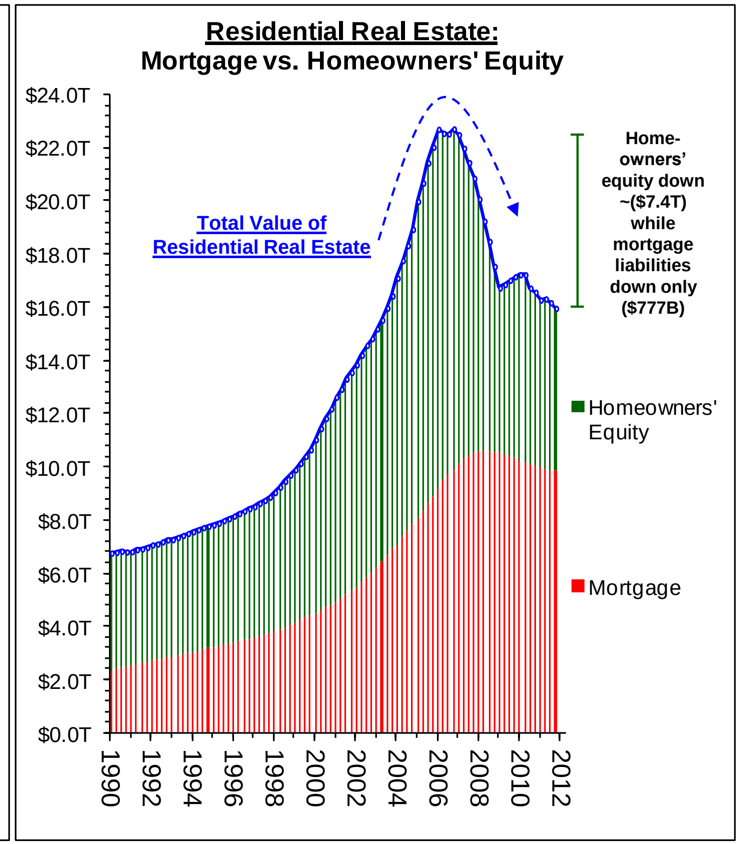


Source: Stifel Nicolaus adaptation chart, conventional wisdom.

STIFEL NICOLAUS

The U.S. household net worth rotation from home equity to financial assets accelerated the past 5 years. **This rotation (left chart) occurred because of the leveraged nature of residential real estate for which mortgages remain but equity has taken a costly $7.4 trillion hit (right chart).**

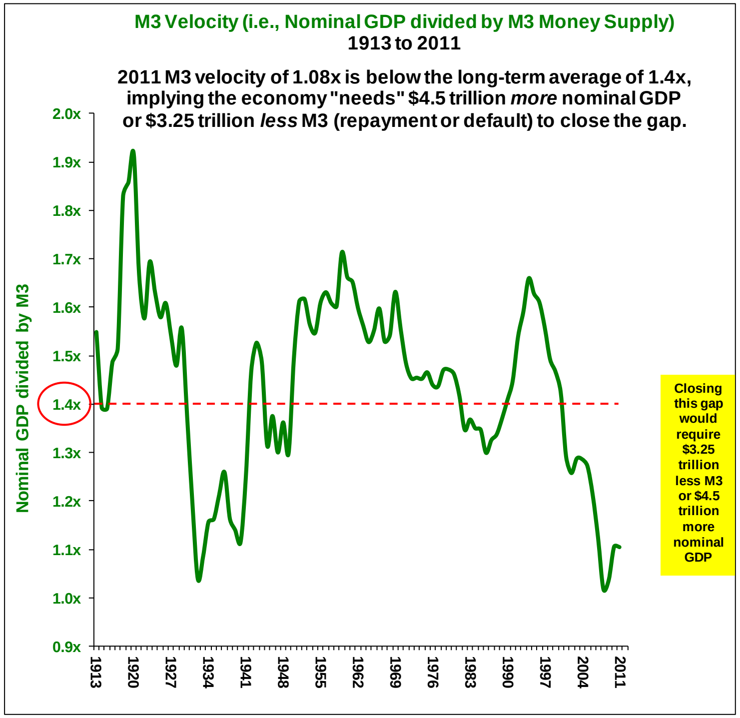


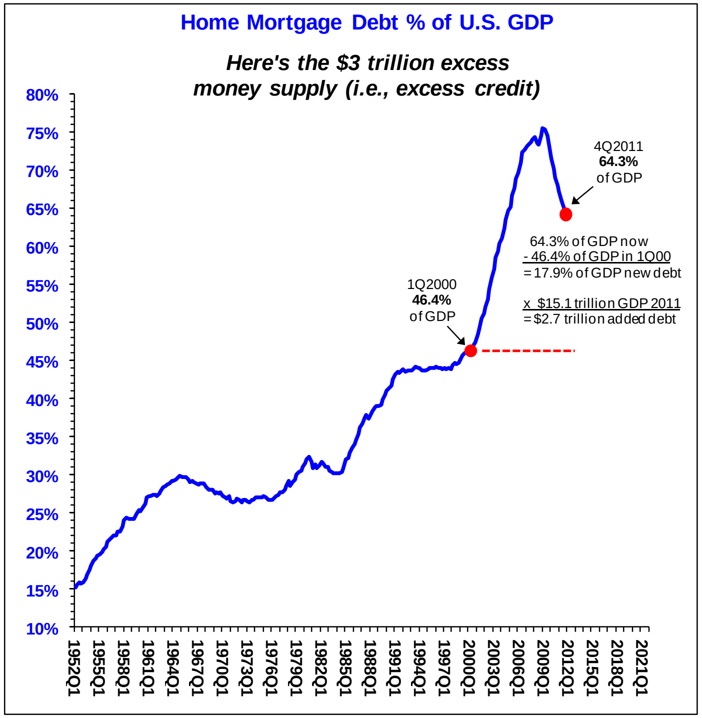


Source: Federal Reserve data, Stifel Nicolaus format.

(1) Financial assets include currency, foreign deposits, savings deposits, money market shares, treasuries & GSE's, U.S. savings bonds, stocks, bonds, mutual funds, life insurance reserves, pension fund reserves, security credit, proprietors' equity in non-corporate business & syndicated loans to nonfinancial business.

Velocity is the key to the massive U.S. private debt adjustment, and housing was the locus of the debt deflation problem. **Nominal GDP divided by M3 Money(1) (i.e., *velocity*) is ~1.1x versus an average of 1.4x (left chart). That implies the need for either $3.25 trillion (T) or 23% *less* money denominator (i.e., de-leveraging) *or* $4.5T or 30% more *nominal* (real + inflation) GDP numerator. Mortgages inflated credit (money) by $3T *after* the secular bear market began in 2000 (right chart). *We think the weak S&P 500 since 2000 has simply written-off housing derived GDP as ephemeral.***





Source: U.S. Federal Reserve, Census, Stifel Nicolaus interpretation and annotations.

(1) We view M3 is "seasoned money" having likely passed from consumers to businesses and institutions. For M3 1913-1958 we use M1 + vault cash + monetary gold stock + bank time deposits + mutual savings bank deposits + S&L deposits . From 1959-2005 the Fed reported M3 (SA). For 2006-present we use: M2 + large time deposits + institutional money market + Fed Funds & Reverse repos with non-banks + interbank loans + eurodollars (regression-derived).

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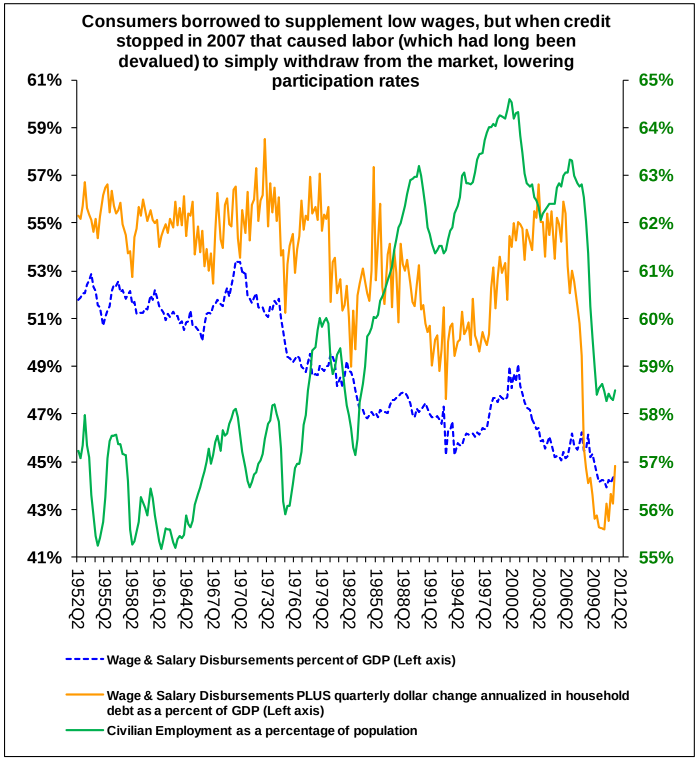
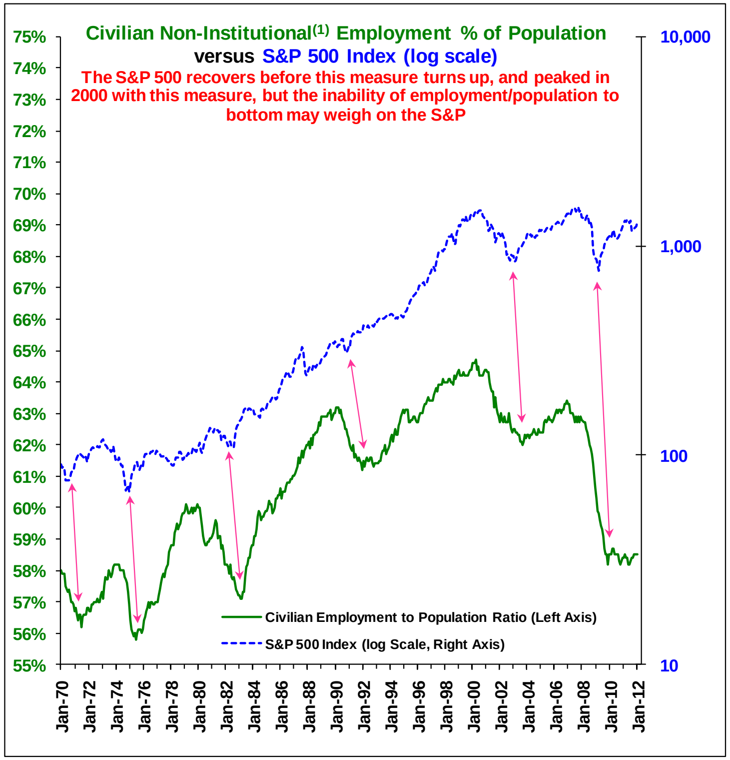
***If labor is devalued, less supply will result, and income alternatives (i.e., personal debt, government transfers) will weaken labor participation* (left chart). In turn, this weighs on equities (right chart). But China rebalancing and the dollar bottoming should lift U.S. wages, in our view.**

Declining wage share of GDP was supplemented by debt until the financial crisis, then labor exited.



We see rising wage share of GDP stabilizing labor participation, which is supportive of stocks.



Source: BEA, U.S. Federal Reserve, Stifel Nicolaus.

(1) The civilian non-institutional population consists of persons 16 years of age and older residing in the 50 States and the District of Columbia who are not inmates of institutions (for example, penal and mental facilities and homes for the aged) and who are not on active duty in the Armed Forces.

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Stifel Macro-rated Q2 2012 Outperform, Market-Perform and Underperform Industries and covering Stifel analysts - Conforming to our macro-views, with seasonal, valuation, momentum and cyclical factors considered (Alphabetical).

A combination of macro, seasonal, relative strength, and valuation, with rankings versus S&P 500.

O = Outperform
M = Market Perform
U = Underperform

Stifel Coverage Industry ALPHABETICAL	Analyst(s)	Analyst E-mail(s)	Closest FactSet Index	SF Macro-View 2012: Q1	Q2	Q3	Q4
Outperform (versus the S&P 500) Macro-rated Sectors:							
Business Services	Shlomo Rosenbaum	shrosenbaum@stifel.com	Misc. Commerical Services	O	O		
Energy: Cleantech	Jeff Osborne	josborne@stifel.com	Alternative Power Generation	M	O		
Energy: Oil & Gas Exploration & Production	Kurt Molnar, Michael Zuk, Michael Scialla, Amir Arif & Justin Kinney	kmolnar@stifel.com, mzuk@stifel.com,	Oil & Gas Production	O	O		
Energy: Oilfield Services & Equipment	Lara King, Kurt Molnar & Robert Connors	kingl@stifel.com, kmolnar@stifel.com,	Oilfield Services/Equipment	M	O		
Energy: Utilities & Energy Infrastructure	Selman Akyol & Justin Kinney	akyols@stifel.com, kinneyj@stifel.com	Oil & Gas Pipelines	M	O		
Finance: Mortgage Finance	Michael R. Widner	widnerm@stifel.com	Real Estate Investment Trusts	U	O		
Finance: Non-Bank Financials	Chris Brendler	ccbrendler@stifel.com	Finance/Rental/Leasing	O	O		
Finance: Specialty Finance	G. Mason & T. Ward	masong@stifel.com, wardt@stifel.com	Finance/Rental/Leasing	M	O		
Food & Beverages: Beverages	Mark Swartzberg & Mark S. Astrachan	mswartzberg@stifel.com, msastrachan@stifel.com	Beverages: Non-Alcoholic	O	O		
Food & Beverages: Food	Christopher Growe	growec@stifel.com	Food: Major Diversified	M	O		
Food & Beverages: Tobacco	Christopher Growe	growec@stifel.com	Tobacco	U	O		
Healthcare: Services	Thomas A. Carroll	tacarroll@stifel.com	Managed Healthcare	M	O		
Household & Personal Products	Mark S. Astrachan	msastrachan@stifel.com	Household/Personal Care	O	O		
I.T.: Communications Equipment	Sanjiv Wadhwani	wadhwans@stifel.com	Telecommunications Equipment	O	O		

Source: Factset, Stifel Nicolaus analysis.

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Stifel Coverage Industry ALPHABETICAL	Analyst(s)	Analyst E-mail(s)	Closest FactSet Index	SF Macro-View 2012: Q1	Q2	Q3	Q4
Outperform (versus the S&P 500) Macro-rated Sectors (continued…):							
I.T.: Data Centers/Hosting	Todd C. Weller	tcweller@stifel.com	Internet Software & Services	O	O		
I.T.: Enterprise Hardware/Software & Hard Drives	Aaron C. Rakers	rakersa@stifel.com	Computer Peripherals	M	O		
I.T.: Internet Services	George I. Askew & Jordan Rohan	giaskew@stifel.com, jrohan@stifel.com	I.T. Services	O	O		
I.T.: Semiconductors: Analog & Mixed Signal	Tore Svanberg	tsvanberg@stifel.com	Semiconductors	O	O		
I.T.: Semiconductors: Processors & Components	Keven Cassidy	kcassidy@stifel.com	Semiconductors	O	O		
I.T.: Semis: Semiconductor Capital Equipment	Patrick J. Ho	pjho@stifel.com	Electronic Production Equipment	O	O		
I.T.: Software: Applications	Blair Abernethy & Tom Roderick	abernethyb@stifel.com, troderick@stifel.com	Packaged Software	O	O		
I.T.: Telecom and Cable Services	Christopher C. King	ccking@stifel.com	Major Telecommunications	O	O		
I.T.: Telecom Services	Blair Abernethy & Ben Lowe	abernethyb@stifel.com, loweb@stifel.com	Major Telecommunications	O	O		
Infrastructure: Electrical & Diversified	Jeffrey L. Beach & Noelle Dilts	beachj@stifel.com, diltsn@stifel.com	Electrical Products	O	O		
Retail: Auto Dealers	James J. Albertine	albertinej@stifel.com	Specialty Stores	O	O		
Retail: Hardlines	David A. Schick	dschick@stifel.com	Electronics/Appliances Stores	O	O		
Retail: Softlines	Richard E. Jaffe	rejaffe@stifel.com	Apparel/Footwear Retail	O	O		
Sports & Lifestyle Brands	Jim Duffy	jduffy@stifel.com	Apparel/Footwear	O	O		
Transports: Rail	John G. Larkin	jglarkin@stifel.com	Railroads	O	O		

Source: Factset, Stifel Nicolaus analysis.

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Stifel Macro-rated Q2 2012 Outperform, Market-Perform and Underperform Industries and covering Stifel analysts - Conforming to our macro-views, with seasonal, valuation, momentum and cyclical factors considered (Alphabetical).

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M = Market Perform
U = Underperform

Market Perform (versus the S&P 500) Macro-rated Sectors:

Stifel Coverage Industry ALPHABETICAL	Analyst(s)	Analyst E-mail(s)	Closest FactSet Index	SF Macro-View 2012: Q1	Q2	Q3	Q4
Aero/Defence: Specialty Def. & Homeland Sec.	Stephen E. Levenson	steve.levenson@stifel.com	Aerospace & Defense	U	M		
Aerospace & Defense: Commercial & Military	William R. Loomis	wrloomis@stifel.com	Aerospace & Defense	U	M		
Education & e-Learning	R. Craig & J. Herman	rlcraig@stifel.com, jrherman@stifel.com	Other Consumer Services	M	M		
Energy: Coal Mining	Paul Forward	pforward@stifel.com	Coal	M	M		
Finance: Asset Management/Investment Services	J. Jeffrey Hopson	hopsonj@stifel.com	Investment Managers	O	M		
Finance: Banks - Community & Conversions	Collyn Bement Gilbert	collyn.gilbert@stifel.com	Savings Banks	M	M		
Finance: Closed-End Funds	Alexander Reiss	alex.reiss@stifel.com	Investment Managers	M	M		
Finance: Market Structure	Chris Brendler & Matthew S. Heinz	ccbrendler@stifel.com, heinzm@stifel.com	Investment Banks/Brokers	O	M		
Finance: Non-Bank Consumer Finance	Chris Brendler	ccbrendler@stifel.com	Data Processing Services	M	M		
Gaming & Leisure	Steven Wieczynski	smwieczynski@stifel.com	Casinos/Gaming	U	M		
Healthcare: Biotechnology	Stephen Willey & Joel Sendek	swilley@stifel.com sendekj@stifel.com	Biotechnology	O	M		
Healthcare: Pharmaceuticals: Specialty	Annabel Samimy	asamimy@stifel.com	Pharmaceuticals: Other	O	M		
Home Furnishings	John A. Baugh	jabaugh@stifel.com	Home Furnishings	M	M		
I.T.: Applied Technologies	Ajit Pai & Patrick M. Newton	apai@stifel.com, newtonp@stifel.com	Electronic Equipment/Instruments	O	M		
I.T.: Electronic Supply Chain	Matthew Sheerin	msheerin@stifel.com	Electronic Components	M	M		
I.T.: Government IT Services	William R. Loomis	wrloomis@stifel.com	I.T. Services	M	M		
I.T.: Information & Financial Technology Services	David Grossman	dgrossman@stifel.com	Information Technology Services	U	M		
I.T.: Software & Internet Infrastructure	Todd C. Weller	tcweller@stifel.com	Internet Software & Services	O	M		
Infrastructure: Engineering & Construction	Robert Connors	rvconnors@stifel.com	Engineering & Construction	O	M		

Source: Factset, Stifel Nicolaus analysis.

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Stifel Macro-rated Q2 2012 Outperform, Market-Perform and Underperform Industries and covering Stifel analysts - Conforming to our macro-views, with seasonal, valuation, momentum and cyclical factors considered (Alphabetical).

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Market Perform (versus the S&P 500) Macro-rated Sectors (continued…):

Stifel Coverage Industry ALPHABETICAL	Analyst(s)	Analyst E-mail(s)	Closest FactSet Index	SF Macro-View 2012: Q1	Q2	Q3	Q4
Insurance: Insurance Brokers	Meyer Shields	mshields@stifel.com	Insurance Brokers/Services	M	M		
Insurance: Property/Casualty	Meyer Shields	mshields@stifel.com	Property/Casuality Insurance	M	M		
Insurance: Specialty Insurers	Meyer Shields	mshields@stifel.com	Specialty Insurance	O	M		
Lodging	Rod Petrik	rpetrik@stifel.com	Hotels/Resorts/Cruiselines	M	M		
Media & Entertainment	Benjamin Mogil & Drew E. Crum	bmogil@stifel.com, decrum@stifel.com	Media Conglomerates	O	M		
Metals: Base Metals	Paul Forward, George Topping & Paul A. Massoud	pforward@stifel.com, gtopping@stifel.com, massoudp@stifel.com	Other Metals/Minerals	O	M		
Metals: Gold & Precious Metals	George Topping, Josh Wolfson & Craig Stanley	gtopping@stifel.com, jwolfson@stifel.com, stanleyc@stifel.com	Precious Metals	M	M		
Metals: Iron Ore	Paul A. Massoud & Michael Scoon	massoudp@stifel.com, mscoon@stifel.com	Steel	O	M		
REITs: Apartments	Rod Petrik	rpetrik@stifel.com	Real Estate Investment Trusts	M	M		
REITs: Diversified	Joshua A. Barber	jabarber@stifel.com	Real Estate Investment Trusts	M	M		
REITs: Office	John W. Guinee	jwguinee@stifel.com	Real Estate Investment Trusts	M	M		
REITs: Retail	Nathan Isbee & Joshua A. Barber	bee@stifel.com, jabarber@stifel.com	Real Estate Investment Trusts	M	M		
REITs: Self-Storage	Rod Petrik	rpetrik@stifel.com	Real Estate Investment Trusts	M	M		
REITs: Timber	Joshua A. Barber	jabarber@stifel.com	Real Estate Investment Trusts	M	M		
Senior Housing	Daniel Bernstein	bernsted@stifel.com	Hospital/Nursing Management	U	M		
Transports: Airfreight/Logistics	David G. Ross	dross@stifel.com	Air Freight/Couriers	M	M		
Transports: Trucking/Logistics	David G. Ross & John G. Larkin	dross@stifel.com, jglarkin@stifel.com	Trucking	O	M		

Source: Factset, Stifel Nicolaus analysis.

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O = Outperform
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Stifel Coverage Industry ALPHABETICAL	Analyst(s)	Analyst E-mail(s)	Closest FactSet Index	SF Macro-View 2012: Q1	Q2	Q3	Q4
Underperform (versus the S&P 500) Macro-rated Sectors:							
Finance: Banks - Large Cap	Christopher M. Mutascio	mutascioc@stifel.com	Major banks	M	U		
Finance: Banks - Mid Atlantic	P. Carter Bundy	cbundy@stifel.com	Regional Banks	M	U		
Finance: Banks - Mid Cap	Anthony R. Davis	tony.davis@stifel.com	Regional Banks	M	U		
Finance: Banks - Mid West	Stephen Geyen	geyens@stifel.com	Regional Banks	M	U		
Finance: Banks - Northeast	Collyn Bement Gilbert	collyn.gilbert@stifel.com	Regional Banks	M	U		
Finance: Banks - Southeast/Southwest	David J. Bishop	bishopb@stifel.com	Regional Banks	M	U		
Finance: Banks - West & Thrifts	Brian J. Zabora	zaborab@stifel.com	Regional Banks	M	U		
Healthcare : Providers	Daniel Bernstein	bernsted@stifel.com	Medical/Nursing Services	U	U		
Healthcare: Real Estate	Daniel Bernstein	bernsted@stifel.com	Real Estate Investment Trusts	M	U		
Homebuilding	Michael R. Widner	widnerm@stifel.com	Home Building	M	U		
Infrastructure: Building Products	John A. Baugh	jabaugh@stifel.com	Construction Materials	O	U		
Insurance: Standard Insurers	Meyer Shields	mshields@stifel.com	Property/Casuality Insurance	M	U		
REITs: Commercial Finance	Joshua A. Barber	jabarber@stifel.com	Real Estate Investment Trusts	U	U		
REITs: Industrial	John W. Guinee	jwguinee@stifel.com	Real Estate Investment Trusts	M	U		
Transports: Barge	John G. Larkin	jglarkin@stifel.com	Marine Shipping	O	U		

Source: Factset, Stifel Nicolaus analysis.

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HOLD -For U.S. securities we expect the stock to perform within 10% (plus or minus) of the S&P 500 over the next 12 months. For Canadian securities we expect the stock to perform within 10% (plus or minus) of the S&P/TSX Composite Index. For other non-U.S. securities we expect the stock to perform within 10% (plus or minus) of the MSCI World Index. A Hold rating is also used for yield-sensitive securities where we are comfortable with the safety of the dividend, but believe that upside in the share price is limited.

SELL -For U.S. securities we expect the stock to underperform the S&P 500 by more than 10% over the next 12 months and believe the stock could decline in value. For Canadian securities we expect the stock to underperform the S&P/TSX Composite Index by more than 10% over the next 12 months and believe the stock could decline in value. For other non-U.S. securities we expect the stock to underperform the MSCI World Index by more than 10% over the next 12 months and believe the stock could decline in value.

Of the securities we rate, 51% are rated Buy, 47% are rated Hold, and 2% are rated Sell.

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