

DAILY GLOBAL COMMENTARY

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Equity Market – Record Increase in Supply Meets Extreme Risk Aversion
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Equity prices, like the prices of everything, are determined by the interaction of supply and demand factors. The latest flow-of-funds data from the Federal Reserve have an interesting factoid on the supply-side of the equities-price equation. In the fourth quarter of last year, net issuance of domestic corporate equities totaled \$986 billion at a seasonally-adjusted annual rate – a record dollar amount of issuance (see Chart 1). This also was a record issuance relative to nominal GDP – 6.9% (see Chart 2).

Chart 1

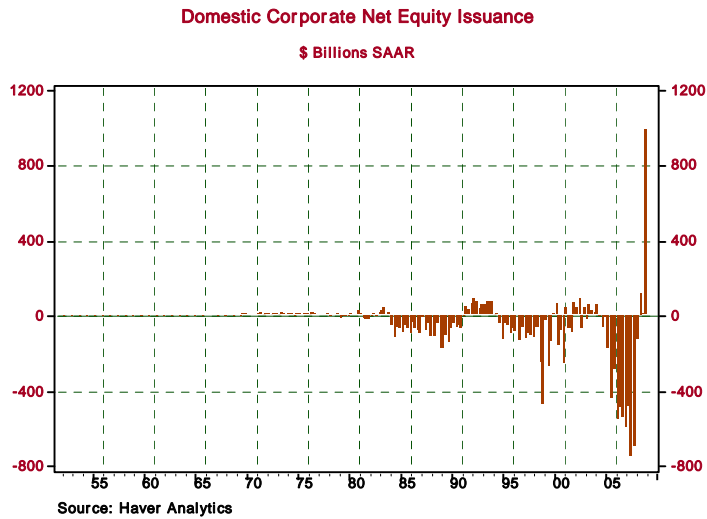
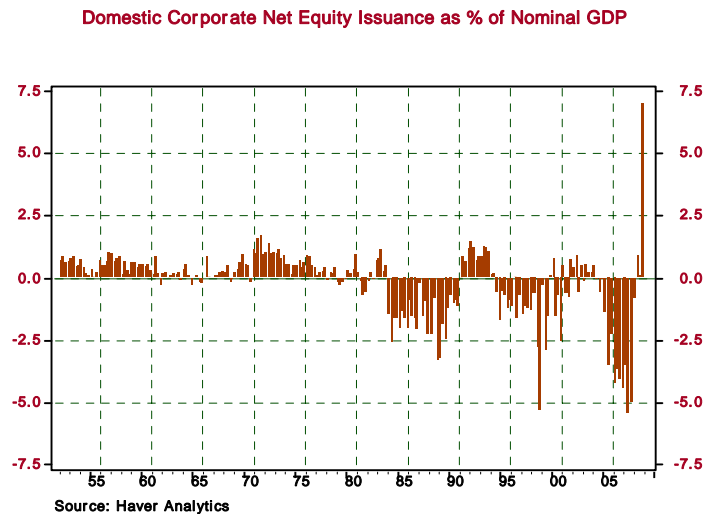


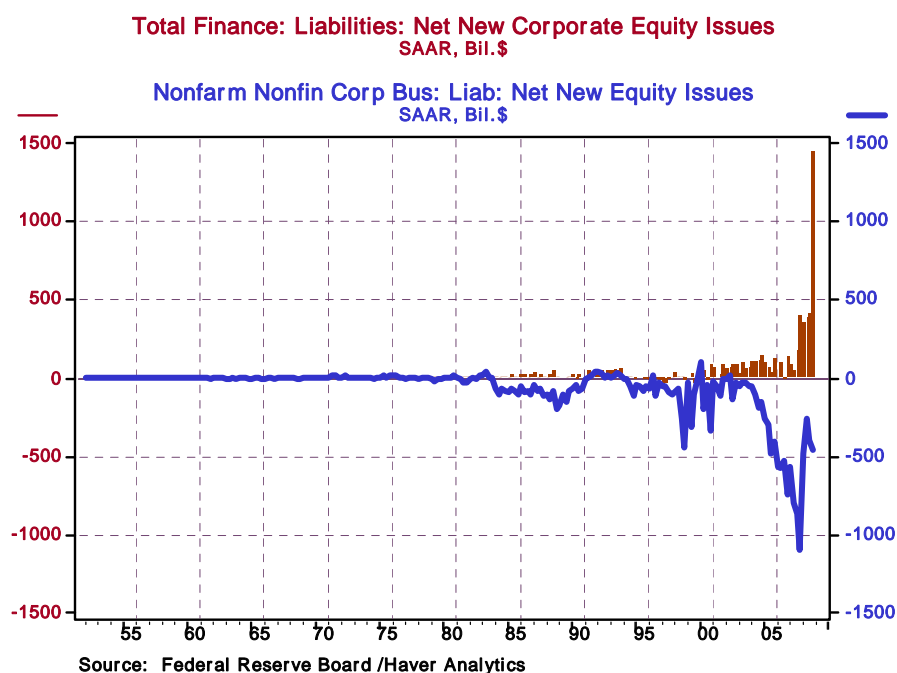
Chart 2



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Who was doing all of this issuing? Chart 3 shows us that it was the financial system, desperate for new capital to replace a huge amount of old “depreciated” capital, that was doing all the issuing. At a seasonally-adjusted annual rate, financial institutions were net issuers of equity to the tune of \$1.4 trillion in the last year’s fourth quarter while nonfinancial corporations were net “retirers” of \$450 billion of equity.

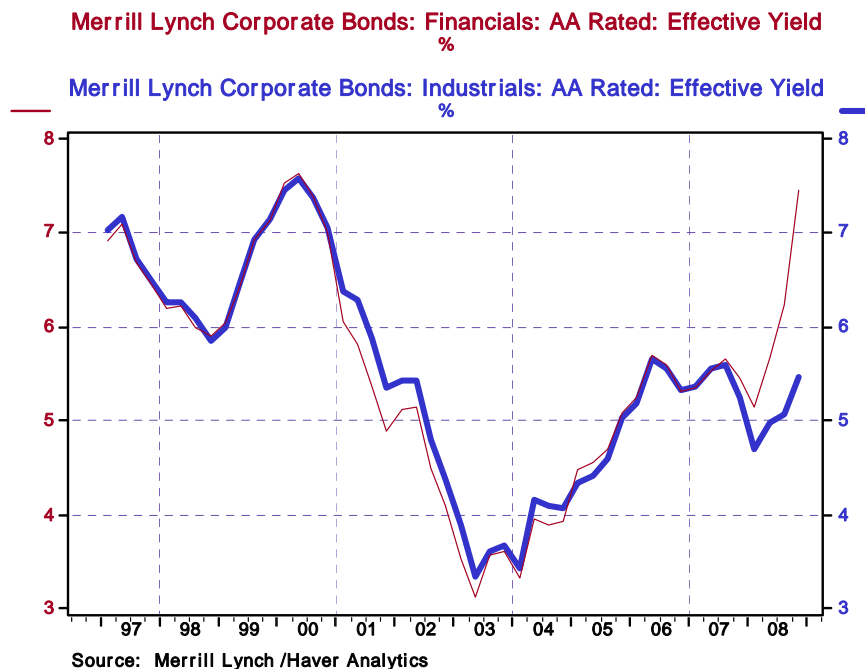
Chart 3



At the same time the financial institutions were issuing record absolute and relative amounts of new equity, I think it is safe to say that investors’ demand for financial institutions’ equities was somewhat inhibited. Chart 4 shows that the yield on AA-rated debt issued by financial institutions was rising sharply in both absolute terms as well as relative to AA-rated debt issued by industrial corporations. If investors were becoming much more risk averse with regard to financial institutions’ investment grade debt, it stands to reason they were more risk averse with regard to financial institutions’ equity capital.

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Chart 4



In sum, there is no mystery as to why the broad U.S. stock indexes took a dive in the fourth quarter of last year. It simply was a matter of an increase in supply accompanied a decrease in demand.

Weekly Policy Update

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The outcome of the Federal Open Market Committee (FOMC) meeting on March 17-18 in terms of the federal funds rate is already known, the content of the policy statement is the unknown aspect. Chairman Bernanke's remarks during the week focused on the nature of financial reform that will promote a stronger financial structure was essentially a medium term project. The Fed's likely course of action in the weeks ahead to reduce financial market stress is the main issue at hand. The Term Asset-Backed Securities Loan Facility (TALF) will be underway as of next week with the first disbursement of funds on March 25, 2009. The Fed is most likely to watch how this program plays out before engaging in additional support programs.

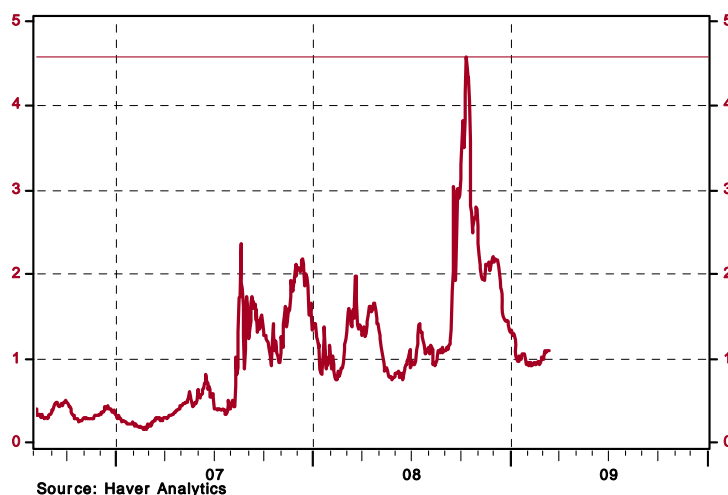
The Fed's views about renewed stress in credit markets as seen in the widening of credit market spreads will be of special interest. At the short end, the spread between the 3-Month Libor and 3-month Treasury bill rate has risen about 20 bps since February 9.

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Chart 5

Spread: 3-Month Libor less 3-Month Treasury Bill Rate

(%)

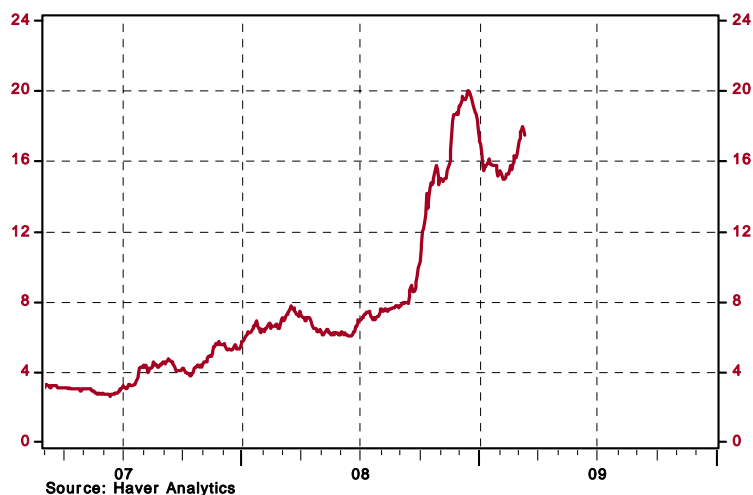


At the long and risky end, the spread between junk bond yield and the 10-year Treasury note yield was 17.46% as of March 11, 2009 vs. 14.95% on February 9, 2009. The spread has narrowed about 45 bps since the high of 17.95% on March 9, 2009.

Chart 6

Spread: Merrill Lynch Junk Bond yield less 10-year Treasury Note yield

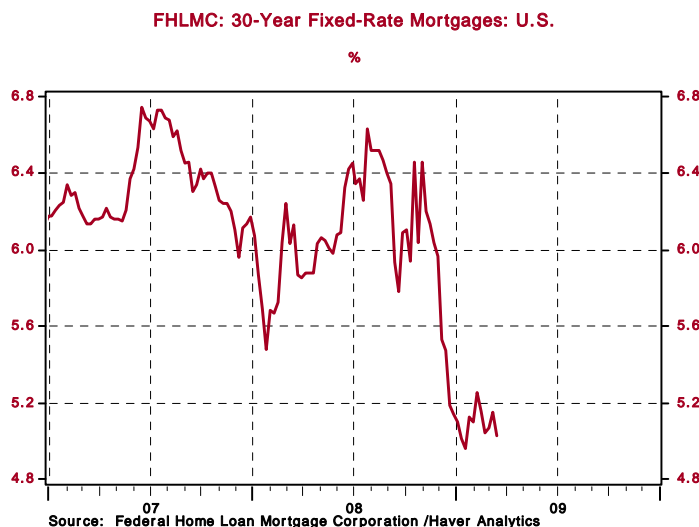
percent



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The Fed's purchases of mortgage securities since January 2009 has succeeded in bringing down mortgage rates (see chart 7).

Chart 7



The policy statement of January 28, 2009 noted that “*conditions in some financial markets have improved, in part reflecting government efforts to provide liquidity and strengthen financial institutions; nevertheless, credit conditions for households and firms remain extremely tight.*” In light of developments after the January meeting, the modifications of this part of the statement is one of the many aspects we will be tracking closely.

The FOMC also noted it is “*also prepared to purchase longer-term Treasury securities if evolving circumstances indicate that such transactions would be particularly effective in improving conditions in private credit markets.*” The Fed could use the new policy statement as an opportunity to elaborate on this issue.

The statement also mentioned that the Fed “*anticipates that a gradual recovery in economic activity will begin later this year, but the downside risks to that outlook are significant.*” The FOMC is most likely to leaves the overall outlook unchanged.

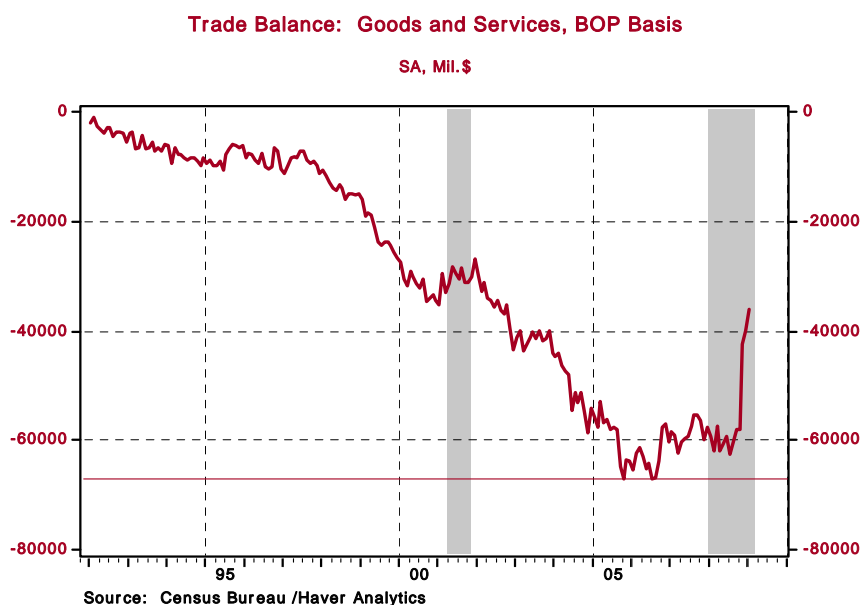
Despite Impressive Improvement in Nominal Terms, Real Trade Deficit Will be a Drag on Q1 GDP

The trade deficit narrowed to \$36.03 billion in January from \$39.9 billion in the prior month. The nominal trade deficit has declined roughly 46% from a high of \$66.97 billion in July 2006 – an impressive improvement in a very short period. In January, the price of imported oil dropped to

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\$39.81 from \$49.93 in the prior month and helped to narrow the trade deficit in addition to a reduction in the quantity of imported petroleum (-1.4%).

Chart 8



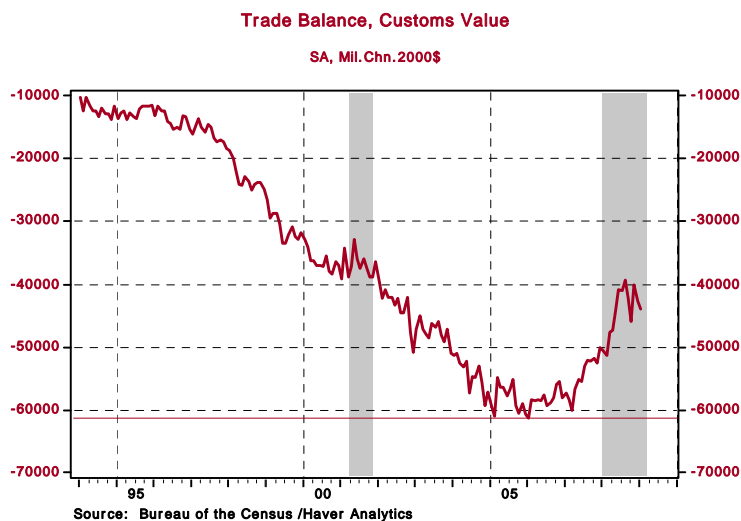
International Trade in Goods and Services – January 2009

	Trade Balance (billions)			Exports (m-o-m % change)		Imports (m-o-m % change)	
	Goods & Services	Goods	Goods - 2000\$	Goods & Services	Goods - 2000\$	Goods & Services	Goods - 2000\$
Aug-08	-60.2	-71.6	-39.5	-1.7	0.0	-2.2	-1.3
Sep-08	-58.1	-70.1	-42.3	-6.6	-8.2	-5.8	-3.7
Oct-08	-58.0	-69.6	-46.0	-2.6	-0.7	-1.9	2.4
Nov-08	-42.5	-53.3	-40.1	-6.1	-3.3	-11.9	-6.6
Dec-08	-39.9	-51.3	-42.9	-5.8	-6.1	-5.8	-1.8
Jan-09	-36.0	-47.0	-44.0	-5.7	-8.6	-6.7	-4.6

More importantly, inflation adjusted trade data give a more accurate picture of the impact of the trade deficit on real GDP. The real trade deficit of goods widened in January to \$44 billion from \$42.9 billion in December (see chart 9), which is not a favorable factor for growth of real GDP in the first quarter, assuming the trade deficit fails to record a noteworthy improvement during February and March. Nonetheless, it is noteworthy, that the real trade deficit of goods has narrowed 28.4% from the widest trade gap in January 2006 (\$61.4 billion).

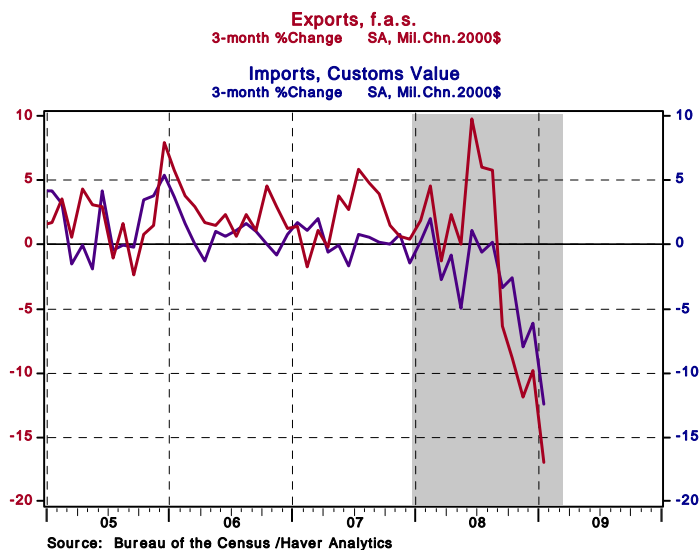
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Chart 9



Exports of goods and services fell 5.7% in January, the sixth consecutive monthly decline. After adjusting for inflation, exports of goods dropped 8.6% in January. Imports of goods and service fell 6.7% in January, also the sixth straight monthly decline. Real exports of goods have fallen more sharply in the three months ended January compared with real imports of goods (see chart 10). The weakness in exports reflects the nature of the current global recession and projections of contributions of exports to real GDP of the U.S. should be mindful of this fact.

Chart 10



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As a result of the improvement of the trade deficit, the trade weighted dollar (see chart 11) has moved up roughly 22% from its low in March 2008

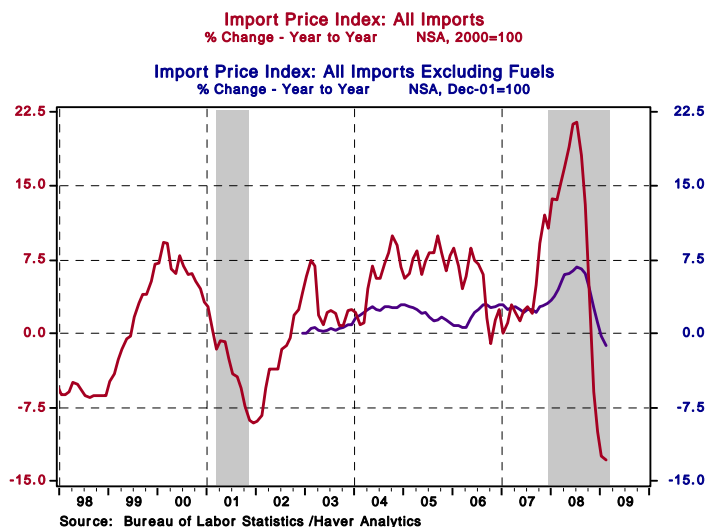
Chart 11



In January, the trade deficit vis-à-vis China widened to (\$20.6 billion vs. \$19.9 in Dec.) but narrowed vis-à-vis Canada (\$2.5 billion vs. \$2.8 billion in Dec.), Japan (\$4.3 billion vs. \$5.3 billion in Dec.), Euro area (\$3.4 billion vs. \$5.7 billion in Dec.), and Mexico (\$2.7 billion vs. \$4.1 billion in Dec.).

In other related news, the import price index of the U.S. fell 0.2% in February, which has dropped each month from August 2008. The main difference in February is that, the import price index of petroleum rose 3.9% following decline in each in the August-January period. Excluding fuels, the import price index dropped 0.4% from the prior month and 1.2% from a year ago.

Chart 12



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Key Interest Rates

	3/13/2009	1-wk. change, bps	4-wk. change, bps	1-yr. change, bps
3-month Libor	1.32	2	8	-145
2-year U.S. Treasury note yield	0.97	6	0	-50
10-year U.S. Treasury note yield	2.89	6	0	-55

Highlights of Next Week: FOMC Meeting March 17-18

Date	Economic Indicator	TNT	Consensus	Previous
3/16/2009	Industrial Production (Feb.)	-1.00%	-1.2%	-1.8%
	Capacity Utilization rate	71.00%	71.1%	72.0%
	NAHB Survey		9.0	9.0
3/17/2009	Producer Price Index (Feb.)	0.4%	0.4%	0.8%
	Core Producer Price Index (Feb.)	0.1%	0.1%	0.4%
	Housing Starts (Feb.)	440,000	450,000	466,000
3/18/2009	Consumer Price Index (Feb.)	0.1%	0.3%	0.3%
	Core Consumer Price Index (Feb.)	0.1%	0.1%	0.2%
	Current Account (2008:Q4)		-\$137 billion	-\$174.1 billion
3/19/2009	Initial Jobless Claims		645,000	654,000
	Index of Leading Indicators (Feb.)	-0.4%	-0.6%	0.4%

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Global Economic Data

	Real GDP		CPI		Unemployment Rate			Central Bank Rate		
	SAAR, yoy %		NSA, yoy%		% year-ago			% year-ago		
United States	-0.8	Q3-08	0.0	Jan-09	8.1	Feb-09	4.8	0.13	Feb-09	3.00
Euro-Area	-1.3	Q3-08	1.1	Jan-09	8.2	Jan-09	7.3	2.00	Feb-09	4.00
Japan	-4.3	Q3-08	0.0	Jan-09	4.1	Jan-09	3.8	0.10	Feb-09	0.50
UK	-1.9	Q3-08	3.0	Jan-09	3.8	Jan-09	2.5	1.00	Feb-09	5.25
Australia	0.3	Q3-08	3.7	Q3-08	5.2	Feb-09	3.9	3.25	Feb-09	7.00
Canada	-0.7	Q3-08	1.1	Jan-09	7.7	Feb-09	5.9	1.00	Feb-09	4.00
China	6.8	Q4-08	-1.7	Jan-09	4.2	Q4-08	4	0.86	Jan-09	1.98
India	5.4	Q3-08	10.4	Jan-09	--	--	--	4.00	Feb-09	6.00
New Zealand	-1.4	Q3-08	3.4	Q3-08	4.6	Q4-08	3.4	3.50	Feb-09	8.25
Norway	0.8	Q3-08	2.5	Jan-09	2.9	Q4-08	2.5	2.50	Feb-09	5.25
Singapore	-4.0	Q3-08	3.0	Jan-09	2.6	Q4-08	1.7	0.30	Feb-09	1.18
South Korea	-3.6	Q3-08	4.1	Feb-09	3.4	Jan-09	3.1	2.00	Feb-09	5.00
Sweden	-4.4	Q3-08	0.9	Jan-09	6.8	Jan-09	6.0	1.00	Feb-09	4.25
Switzerland	-0.1	Q3-08	0.2	Jan-09	3.1	Feb-09	2.5	0.50	Feb-09	2.80
Taiwan	-7.9	Q3-08	0.0	Feb-09	5.3	Jan-09	3.9	1.25	Feb-09	3.38
Thailand	-4.3	Q3-08	-0.1	Feb-09	2.0	Jan-09	1.2	2.00	Feb-09	3.50

* UK - Claimant Count Unemployment Rate
 * Thailand - GDP Non-Seasonally Adjusted
 * EA-13, UK, Sweden - Harmonized Unemployment

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Historical US Economic Data

	Feb-09	Jan-09	Dec-08	Nov-08	Oct-08	Sep-08	Aug-08	Jul-08	Jun-08	May-08	Apr-08	Mar-08
Payroll Employment (000)	-651	-655	-681	-597	-380	-321	-175	-128	-161	-137	-160	-122
% Change, Year Ago *	-3.0	-2.7	-2.2	-1.6	-1.1	-0.7	-0.4	-0.3	-0.2	-0.1	0.2	0.3
Unemployment Rate (%)	8.1	7.6	7.2	6.8	6.6	6.2	6.2	5.8	5.6	5.5	5.0	5.1
Avg. Hourly Earnings (% Chg.)	0.2	0.2	0.3	0.3	0.4	0.2	0.4	0.3	0.3	0.3	0.2	0.4
% Change, Year Ago	3.6	3.8	3.9	3.9	3.9	3.6	3.8	3.5	3.6	3.7	3.8	3.9
PPI (% Chg.)		0.8	-1.9	-2.5	-2.7	-0.1	-0.5	1.3	1.3	1.5	0.2	0.9
% Change, Year Ago *		-1.0	-0.9	0.4	5.2	8.8	9.7	9.9	9.1	7.3	6.4	6.7
CPI (% Chg.)		0.3	-0.8	-1.7	-0.8	0.0	0.0	0.7	0.9	0.5	0.2	0.4
% Change, Year Ago *		0.0	0.1	1.1	3.7	4.9	5.4	5.6	5.0	4.2	3.9	4.0
ISM Diffusion Index (%)	35.8	35.6	32.9	36.6	38.7	43.4	49.3	49.5	49.5	49.3	48.6	49.0
Industrial Production (% Chg.)		-1.8	-2.4	-1.2	1.6	-4.1	-1.3	0.0	0.1	-0.2	-0.5	-0.2
% Change, Year Ago		-10.0	-8.2	-5.9	-4.3	-6.2	-2.0	-0.7	-0.1	0.2	0.4	1.5
Capacity Utilization (%)		72.0	73.3	75.2	76.1	75.0	78.3	79.4	79.6	79.6	79.9	80.4
Nondefense Cap. Goods ex Aircraft												
- Orders (% Chg.)		-5.7	-5.9	1.1	-6.7	-3.4	-2.3	0.3	1.6	-0.3	3.1	-1.0
% Change, Year Ago *		-20.4	-14.7	-7.9	-7.2	0.1	-0.2	6.6	3.4	3.4	2.6	-1.1
- Shipments (% Chg.)		-6.7	0.1	-1.3	-3.7	1.7	-2.1	0.3	0.6	0.2	1.0	0.8
% Change, Year Ago *		-10.9	-4.7	-5.2	-2.2	2.7	-1.6	6.1	2.0	2.7	3.7	1.0
Retail Sales (% Chg.)	-0.1	1.8	-3.1	-2.4	-3.4	-1.6	-0.7	-0.6	0.1	0.8	0.2	0.2
% Change, Year Ago	-12.3	-8.3	-8.6	-10.0	-4.0	0.1	-0.4	4.1	1.4	2.5	3.7	0.3
Real Personal Consumption (% Chg.)		0.4	-0.5	0.3	-0.8	-0.5	-0.1	-0.6	-0.2	0.2	0.1	0.3
% Change, Year Ago		-1.6	-1.9	-1.4	-1.3	-0.6	-0.2	0.2	1.1	1.4	1.3	1.5
Personal Income (% Chg.)		0.4	-0.2	-0.4	0.0	0.1	0.3	-0.8	0.1	1.8	0.0	0.4
% Change, Year Ago		1.9	1.6	2.2	3.1	3.4	3.9	4.0	5.3	5.6	4.0	3.9
New Home Sales (SAAR, mn)		0.31	0.34	0.38	0.40	0.43	0.45	0.51	0.50	0.52	0.54	0.51
% Change, Year Ago *		-47.7	-45.5	-40.0	-43.9	-34.0	-36.7	-36.8	-38.4	-38.0	-41.0	-38.8
Existing Home Sales (SAAR, mn)		4.49	4.74	4.54	4.94	5.10	4.93	4.99	4.90	4.95	4.85	4.92
% Change, Year Ago *		-7.6	0.3	-17.0	-1.9	6.8	-15.0	-11.3	-16.7	-16.3	-15.7	-22.5
Housing Starts (SAAR, mn)		0.47	0.56	0.66	0.77	0.82	0.85	0.95	1.09	0.98	1.00	0.99
% Change, Year Ago *		-57.3	-44.4	-46.5	-40.7	-27.2	-37.0	-32.2	-25.6	-32.8	-34.0	-33.6
International Trade (Bils \$)		-36.0	-39.9	-42.5	-58.0	-58.1	-60.2	-62.5	-59.1	-60.5	-61.8	-57.4
	Q4-08	Q3-08	Q2-08	Q1-08	Q4-07	Q3-07	Q2-07	Q1-07	Q4-06	Q3-06	Q2-06	Q1-06
Real GDP, Chain Weighted, SAAR	-6.2	-0.5	2.8	0.9	-0.2	4.8	4.8	0.0	1.5	0.8	2.7	4.8
% Change, Year Ago	-0.8	0.7	2.1	2.5	2.3	2.8	1.8	1.3	2.4	2.4	3.2	3.1
Chain-Weighted Price Index, SAAR	0.5	3.9	1.1	2.6	2.8	1.5	2.0	4.1	2.2	2.8	2.7	3.5
% Change, Year Ago	2.0	2.6	2.0	2.3	2.6	2.5	2.8	2.9	2.8	3.2	3.5	3.4
Nominal GDP, SAAR	-5.8	3.4	4.1	3.5	2.3	6.4	6.9	4.3	3.7	3.6	5.5	8.6
% Change, Year Ago	1.2	3.3	4.1	4.7	4.9	5.3	4.6	4.3	5.3	5.7	6.8	6.6
Employment Cost Index (%)	0.5	0.7	0.7	0.7	0.8	0.8	0.9	0.8	0.8	1.0	0.9	0.6
% Change, Year Ago	2.6	2.9	3.1	3.3	3.3	3.3	3.3	3.5	3.3	3.3	3.0	2.8
Productivity Nonfarm, SAAR	-0.4	2.2	4.7	2.6	-0.5	7.0	4.8	-0.6	-0.4	-1.6	2.4	1.9
% Change, Year Ago	2.2	2.2	3.4	3.5	2.6	2.6	0.5	-0.1	0.6	0.3	1.7	1.3
Unit Labor Costs, Nonfarm, SAAR	5.7	3.5	-2.8	1.1	5.0	-2.5	-3.3	4.8	9.6	3.9	-1.1	2.6
% Change, Year Ago	1.8	1.6	0.1	0.0	0.9	2.0	3.6	4.2	3.7	2.6	2.2	2.9

Source: Haver Analytics

* NSA

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