



Financial Recovery: When and How?

Monday, April 27, 2009

8:00 AM – 9:15 AM

Moderator

Michael Klowden, President and CEO, Milken Institute

Speakers

Mohamed El-Erian, CEO and Co-Chief Investment Officer, PIMCO

Steve Forbes, Chairman and CEO, Forbes Inc.; Editor-in-Chief, *Forbes*

Kenneth Griffin, Founder, President and CEO, Citadel Investment Group LLC

John Micklethwait, Editor-in-Chief, *The Economist*



Where we are in the current recession

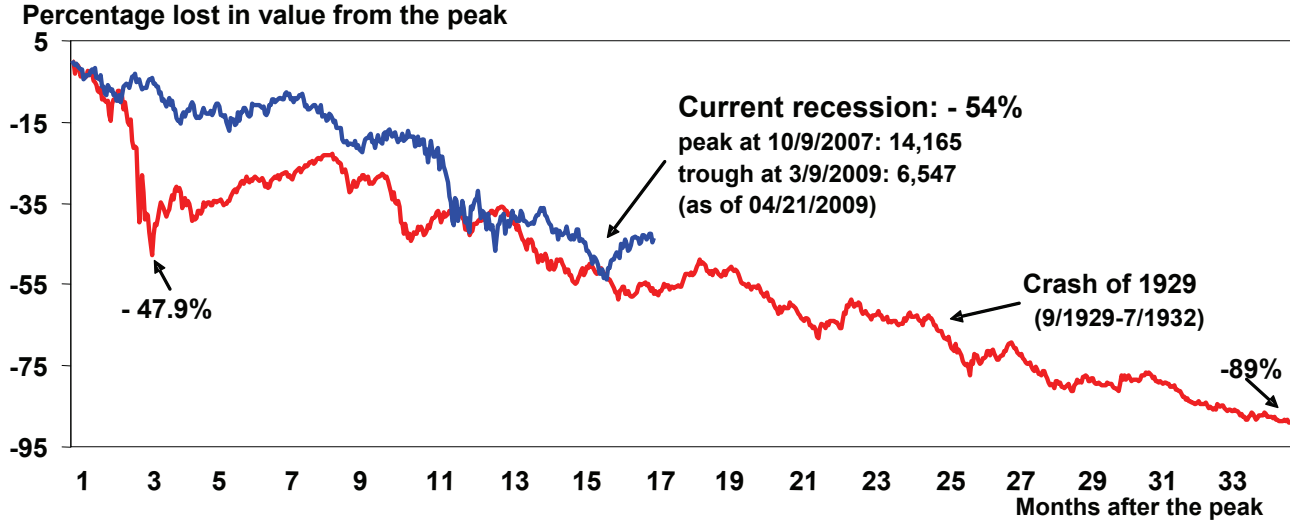
NBER business cycle dates

| Start | End | Duration in months |
|----------------------|----------------------|-----------------------|
| August 1929 | March 1933 | 43 |
| May 1937 | June 1938 | 13 |
| February 1945 | October 1945 | 8 |
| November 1948 | October 1949 | 11 |
| July 1953 | May 1954 | 10 |
| August 1957 | April 1958 | 8 |
| April 1960 | February 1961 | 10 |
| December 1969 | November 1970 | 11 |
| November 1973 | March 1975 | 16 |
| January 1980 | July 1980 | 6 |
| July 1981 | November 1982 | 16 |
| July 1990 | March 1991 | 8 |
| March 2001 | November 2001 | 8 |
| December 2007 | ? | Now: 17 months |

Source: National Bureau of Economic Research.

Dow Jones Industrial Average

Compared to the Great Depression



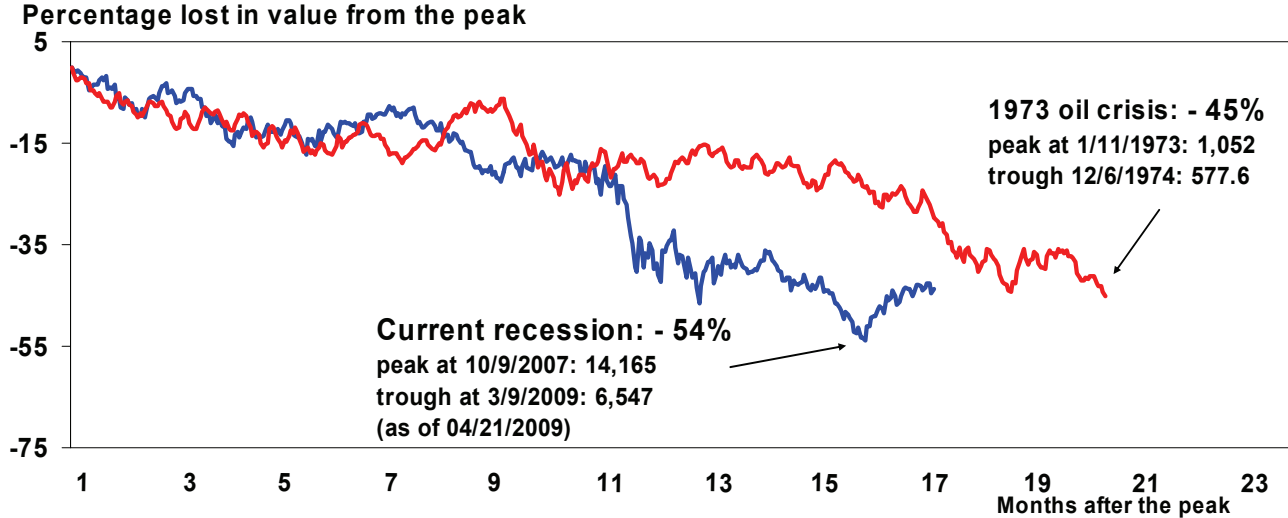
Sources: Datastream, The Milken Institute.

Dow Jones Industrial Average

Compared to the 1973 economic recession



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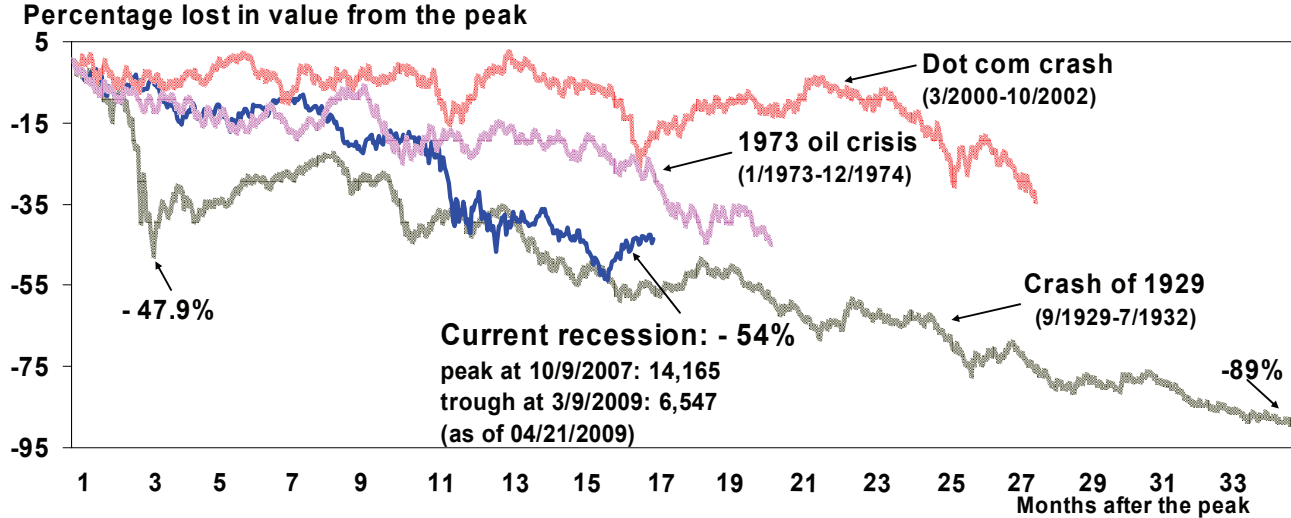
Sources: Datastream, The Milken Institute.

Dow Jones Industrial Average



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Compared to the Great Depression, 1973 oil crisis, and dot-com crash

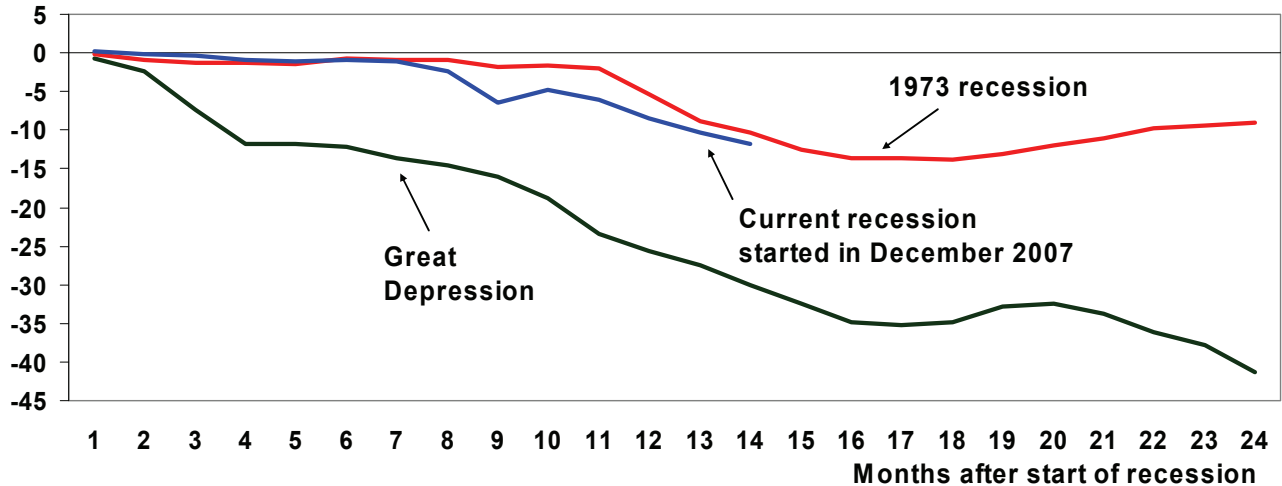


Sources: Datastream, The Milken Institute.

U.S. industrial production

Compared to the Great Depression

Cumulative % decline since start of recession



Sources: St. Louis Federal Reserve, The Milken Institute.

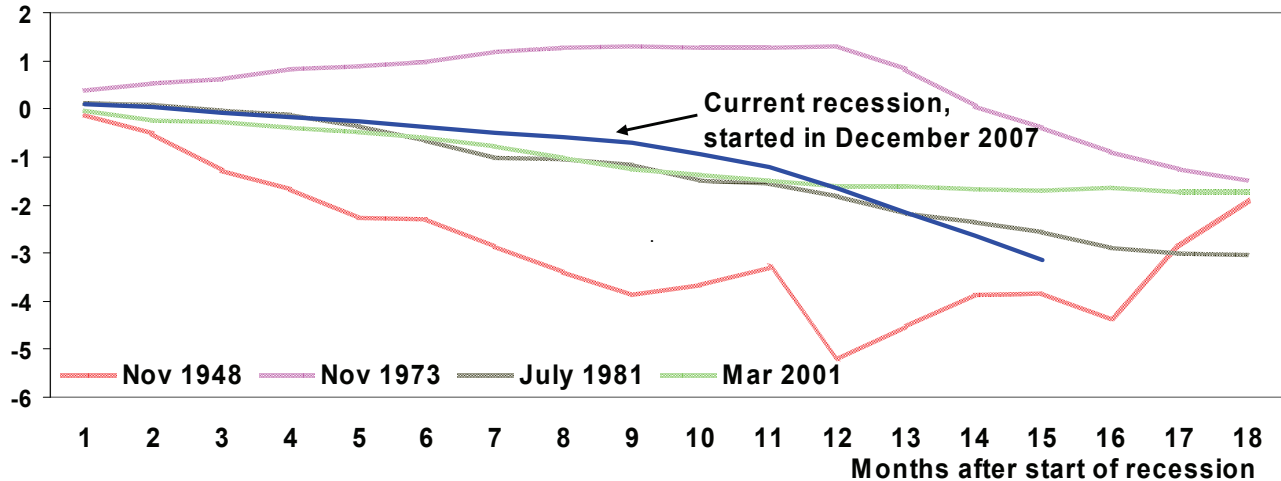
U.S. nonfarm employment

Comparison with previous recessions



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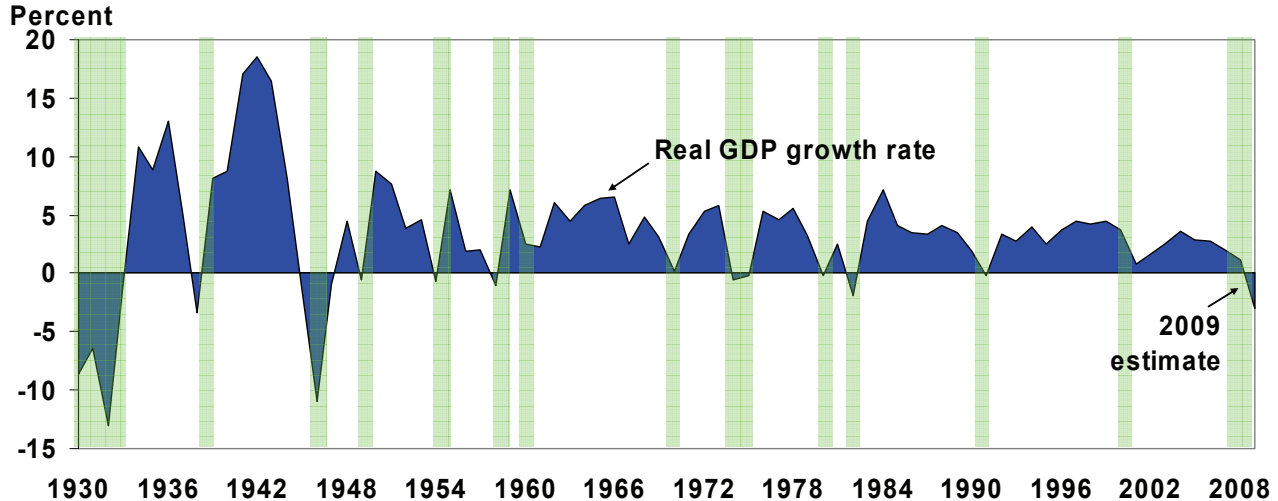
Cumulative % decline since start of recession



Sources: Bureau of Labor Statistics, The Milken Institute.

Deep recession, strong recovery?

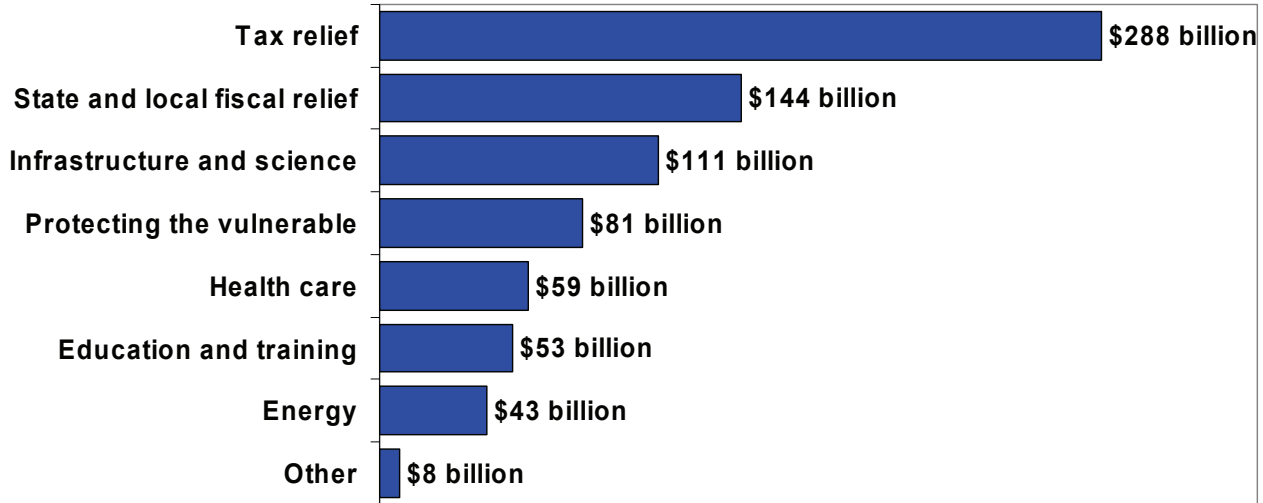
U.S. history shows strong recoveries after many recessions



Note: Shade areas represent the periods of recessions; Sources: Bureau of Economic Analysis, NBER, and The Milken Institute.

American Recovery and Reinvestment Act of 2009

The US\$787 billion stimulus plan is intended to create 3-4 million jobs



Source: Recovery.gov.

Administration estimated aggregate effect of the recovery package on GDP and jobs in Q4 2010

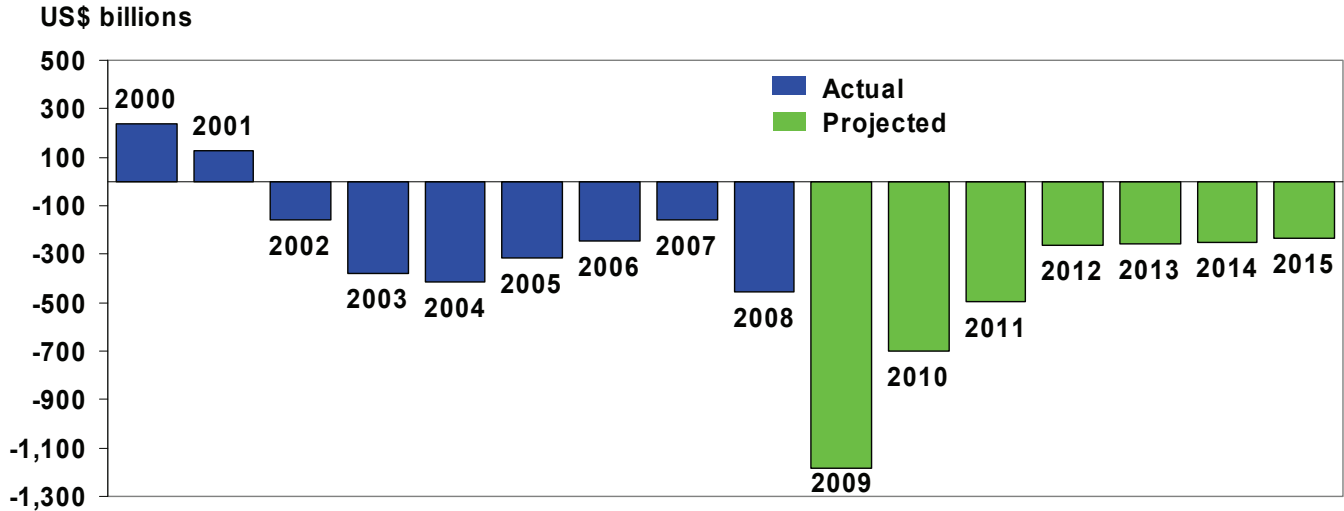
| | Real GDP (US\$ billions) | Payroll employment |
|-------------------|-----------------------------|-------------------------------|
| Without Stimulus | \$11,770 | 133,876,000 |
| With Stimulus | \$12,203 | 137,550,000 |
| Effect of Package | Increase GDP by 3.7% | Increase jobs by 3,675,000 |

Source: Christina Romer and Jared Bernstein, "The Job Impact of the American Recovery and Reinvestment Plan."

U.S. federal budget and projections



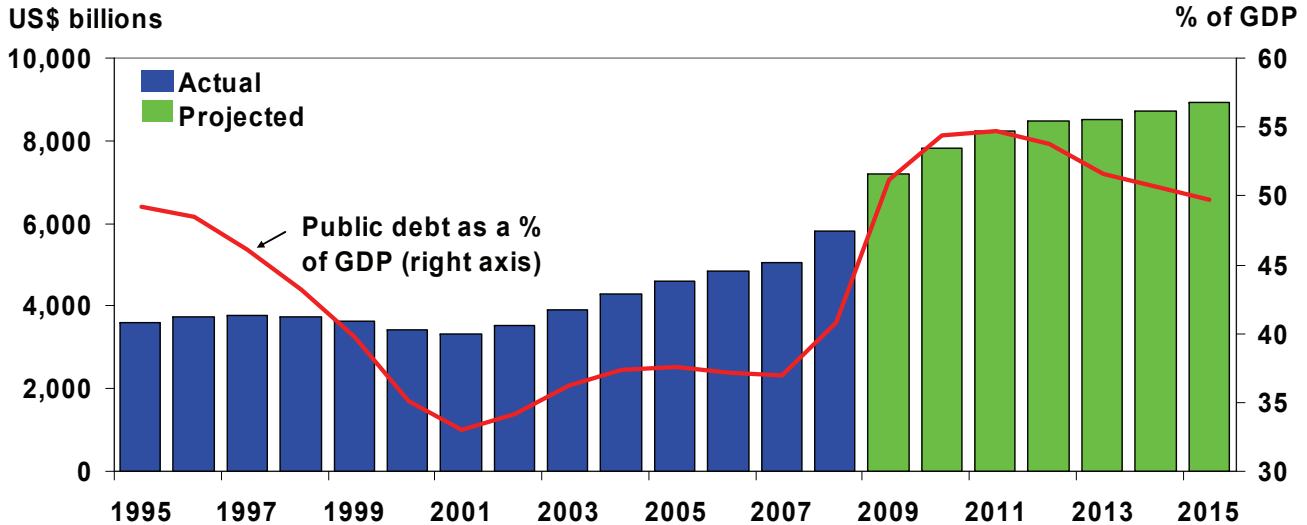
Budget deficit to hit record high in 2009



Source: Congressional Budget Office.

U.S. debt held by the public

FY 2009 (projected): public debt = US\$7.2 trillion = 51.2% of GDP

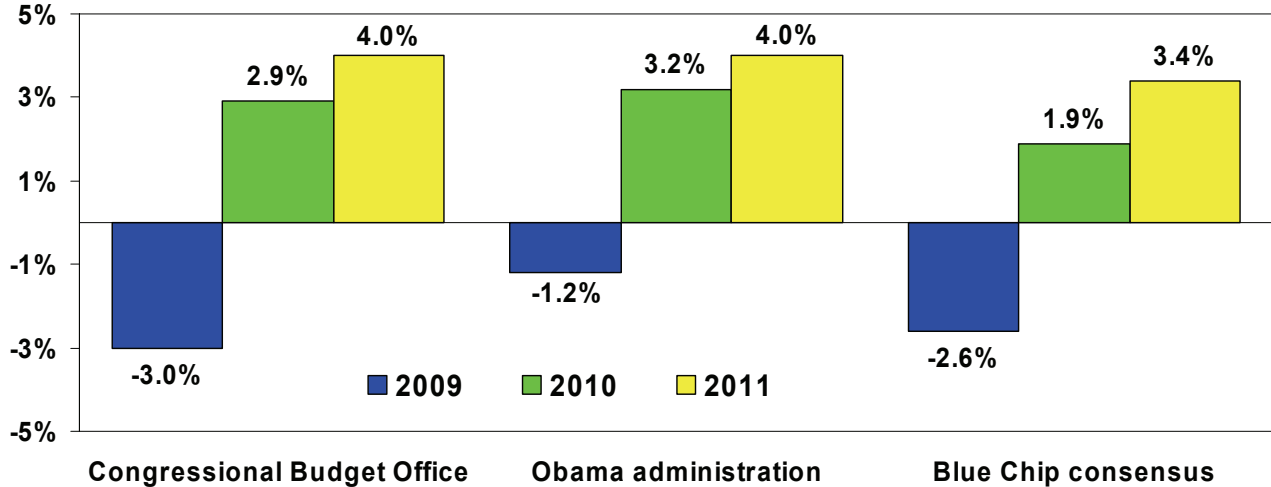


Note: Intergovernmental holdings excluded; Source: Congressional Budget Office.

U.S. real GDP growth forecasts from different sources

Recovery in 2010?

Real GDP growth



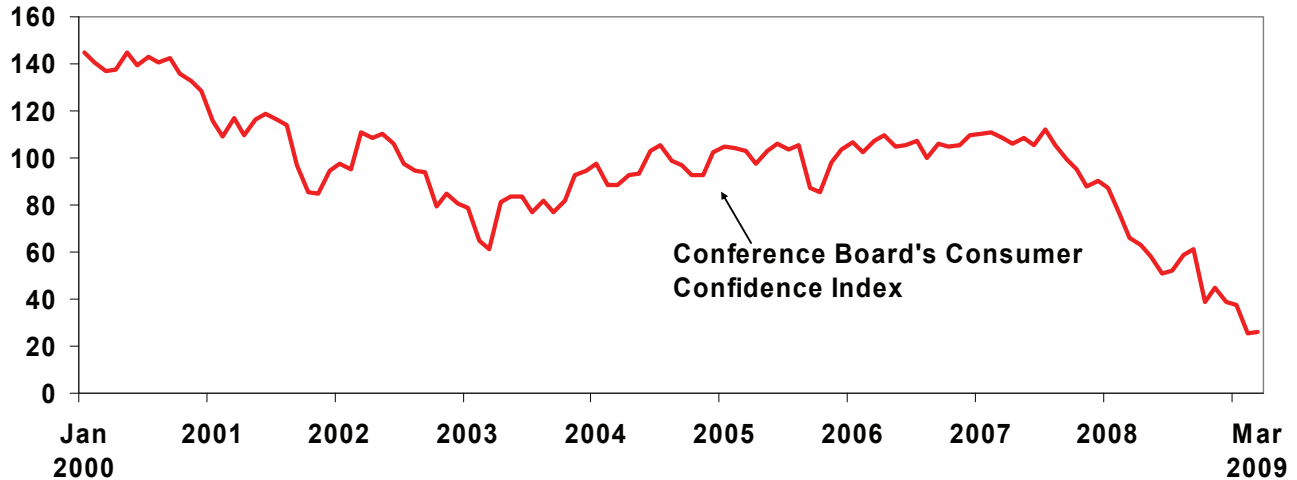
Sources: Congressional Budget Office.

U.S. Consumer Confidence Index

Confidence remains low



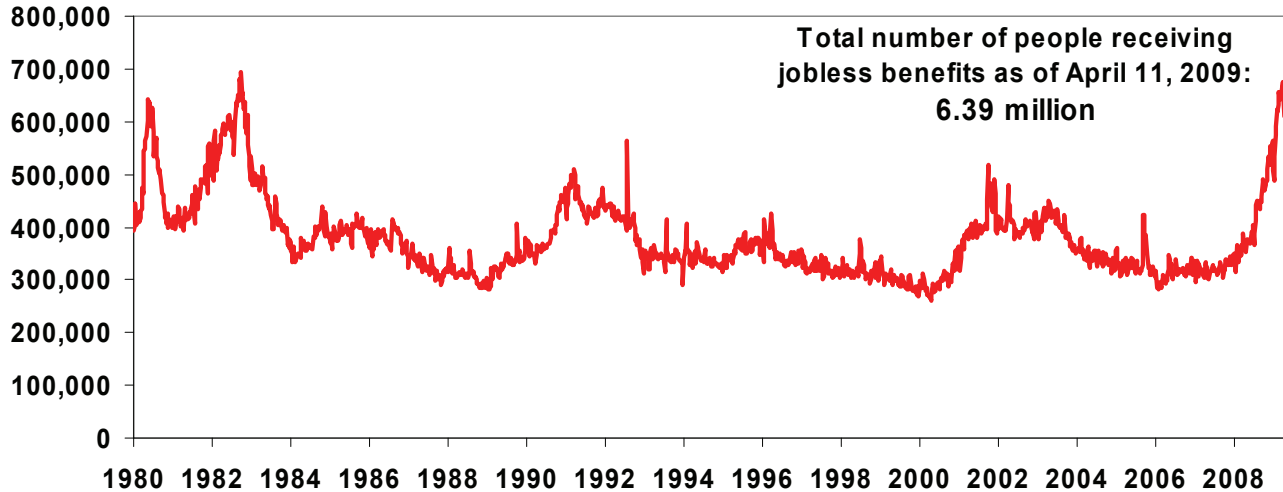
Index (1985 = 100)



Source: Bloomberg.

The U.S. job market remains weak

Initial unemployment insurance weekly claims increased sharply

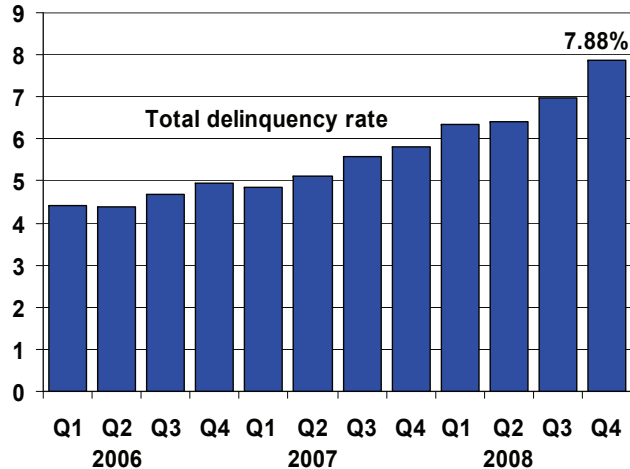


Source: U.S. Department of Labor.

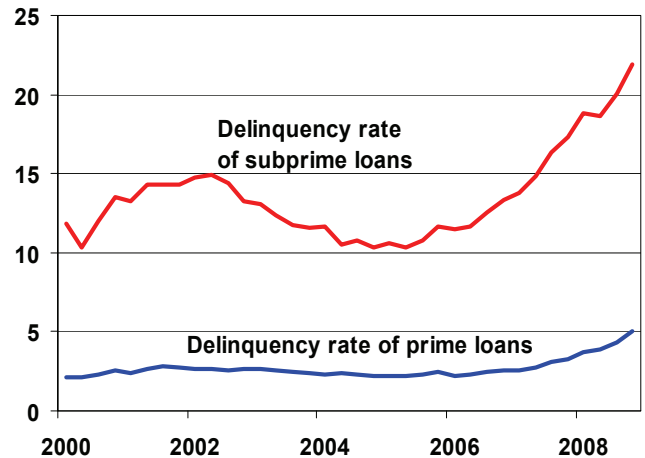
Mortgage delinquency rate

Delinquencies continue to climb in latest survey (Q4 2008)

Percent of total outstanding home mortgages



Percent of total outstanding home mortgages

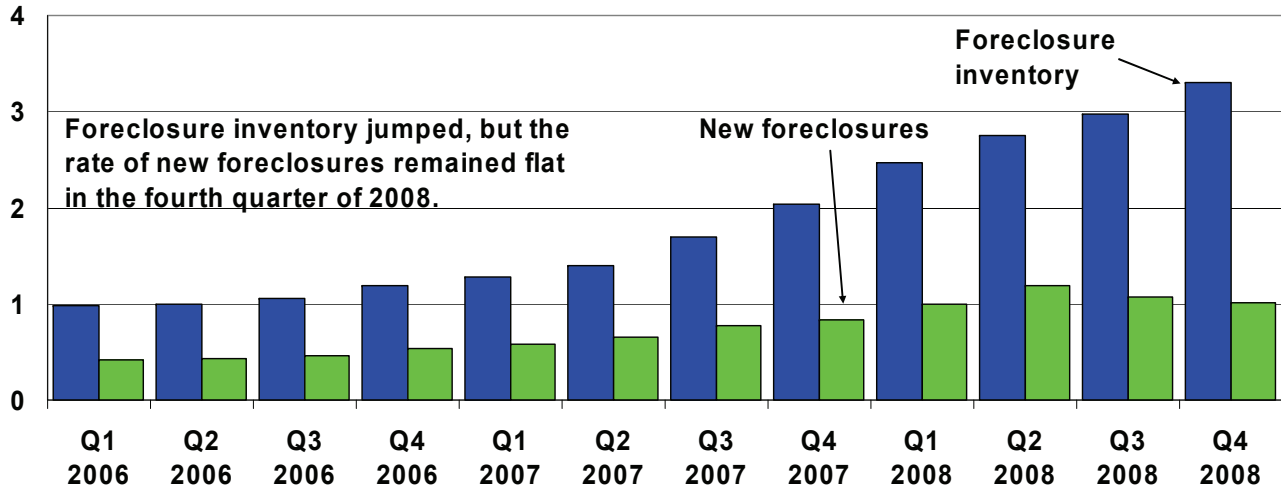


Source: Mortgage Bankers Association.

Mortgage foreclosure rate

The latest survey (Q4 2008)

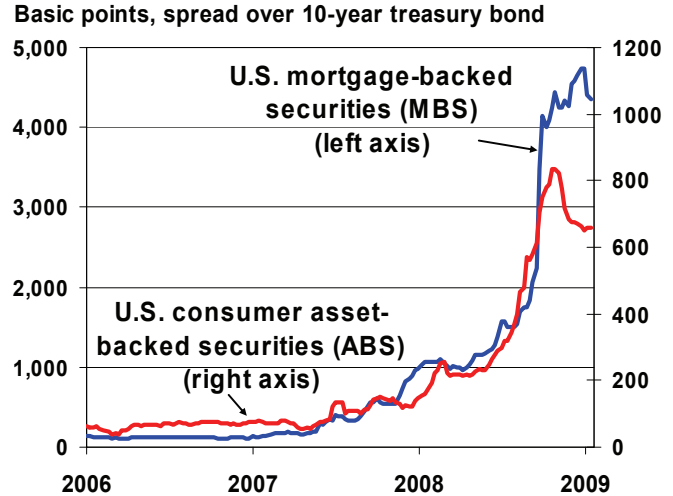
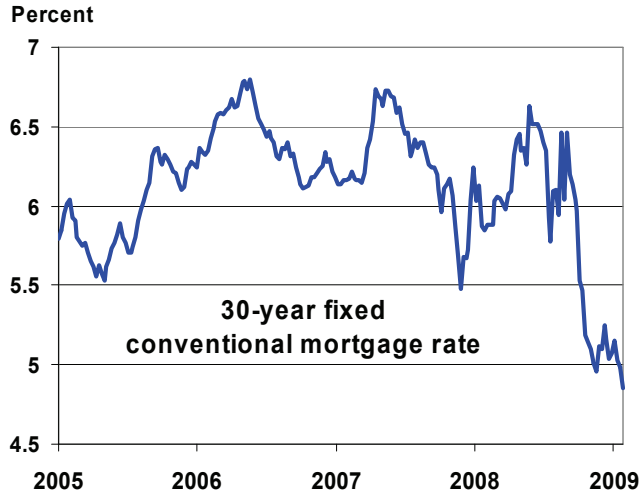
Percent of total outstanding home mortgage loans



Source: Mortgage Bankers Association.

U.S. mortgage and securitization markets

Mortgage rates and agency spreads starting to fall



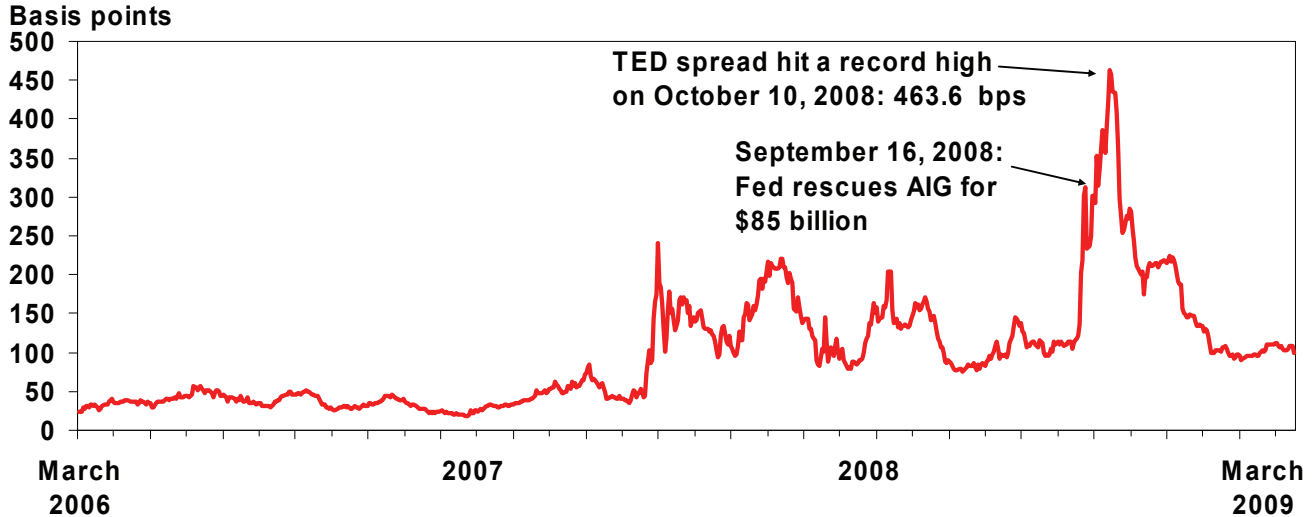
Source: Bloomberg, Merrill Lynch.

TED spread dropped below 1% in Feb 2009



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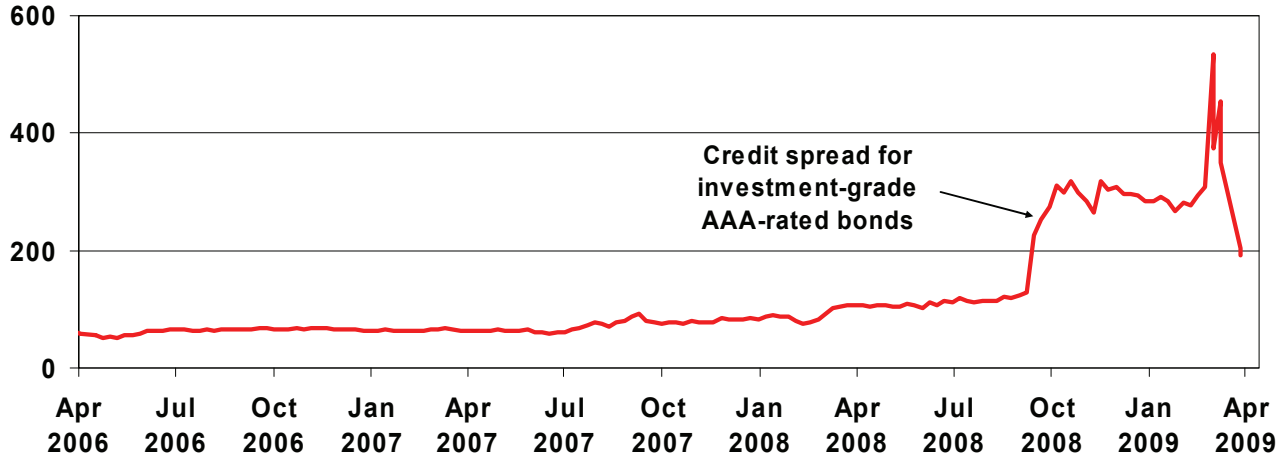
Measures the premium banks charge each other over U.S. T-bill rate



Sources: Bloomberg, Milken Institute.

Credit spread for U.S. investment-grade corporate bonds started to narrow (as of April 17, 2009)

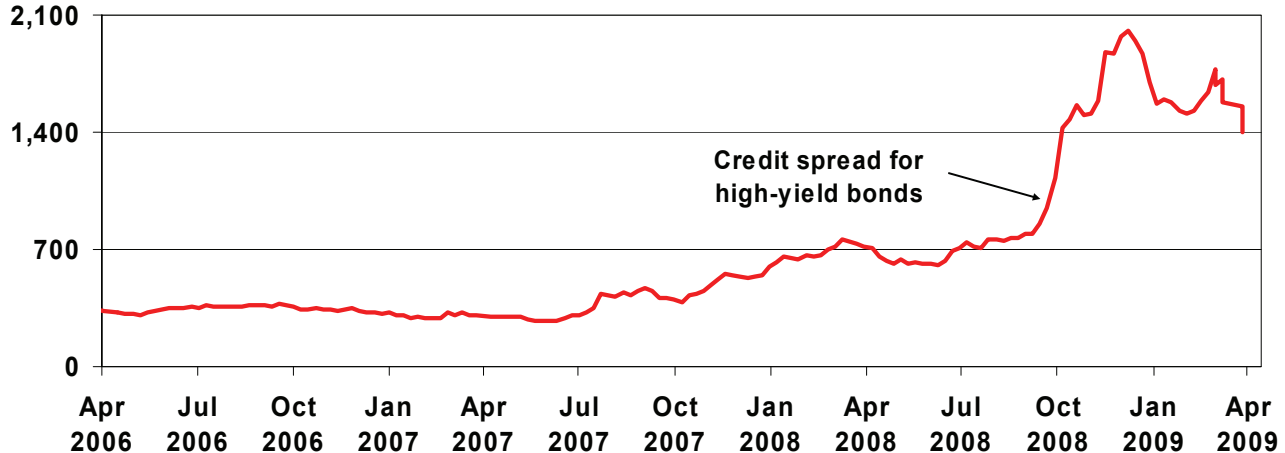
Basis points, spread over 10-year Treasury bonds



Source: Bloomberg.

Credit spread for U.S. corporate high-yield bonds is slightly narrower (as of April 17, 2009)

Basis points, spread over 10-year Treasury bonds



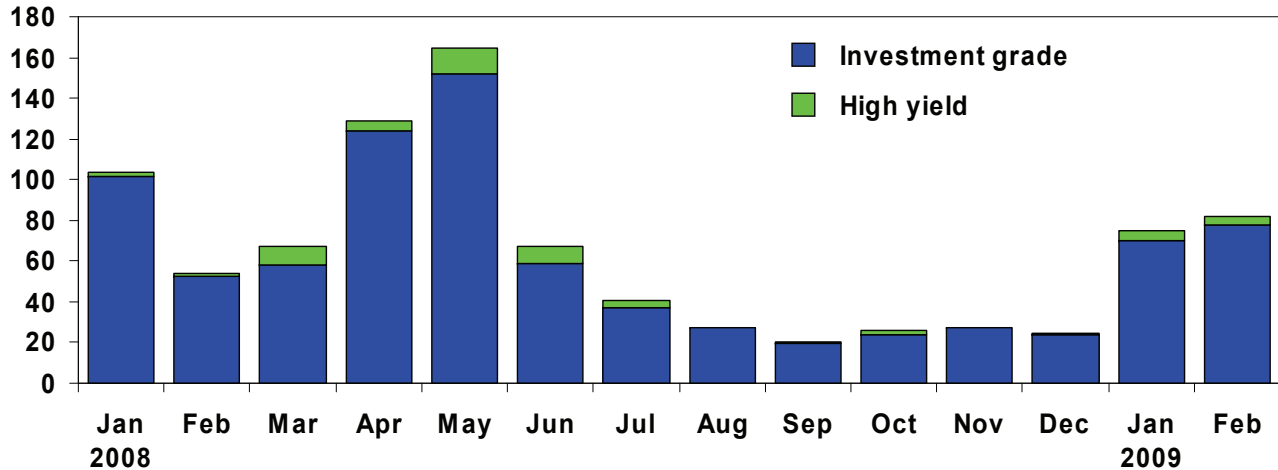
Source: Bloomberg.

U.S. bond issuance

Started to increase in 2009



Total issuance (US\$ billions)

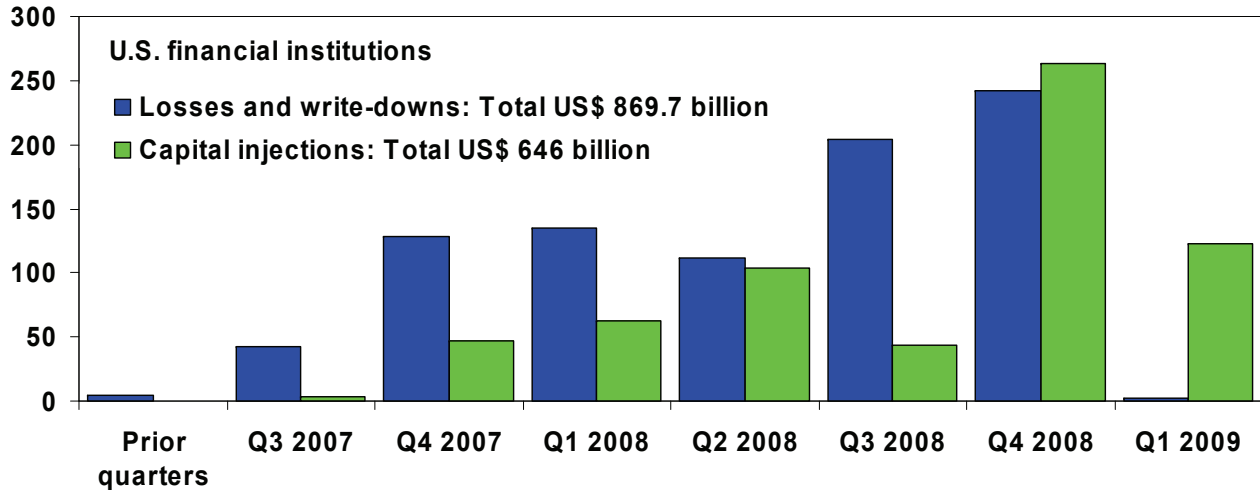


Source: Securities Industry and Financial Markets Association.

U.S. capital injections and write-downs

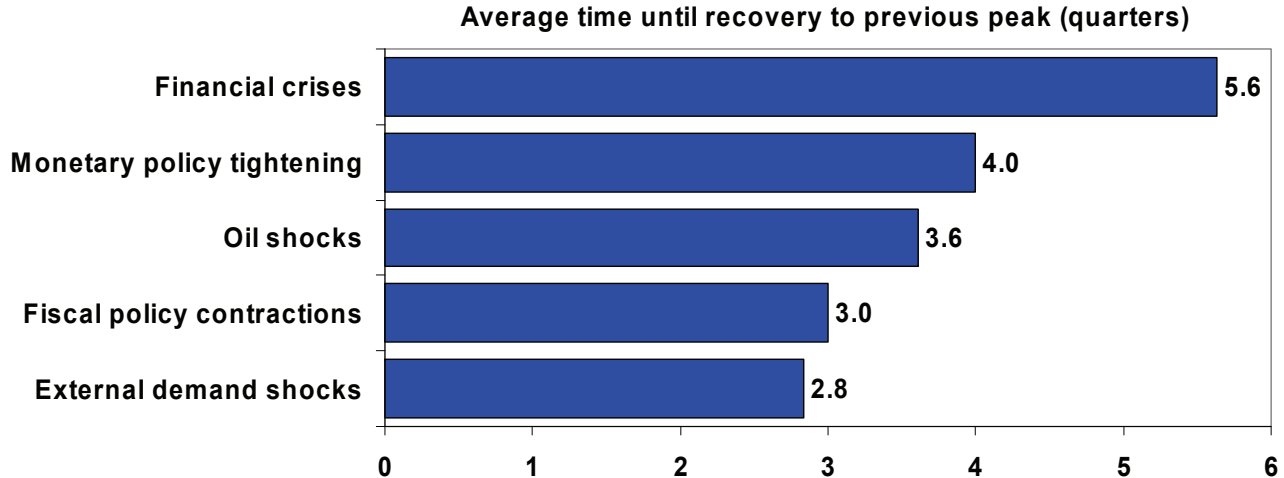
Will the massive write-down continue to decline?

US\$ billions, most recently available data, as of March 2009



Source: Bloomberg.

Recoveries from financial crises take longer than other types of crises

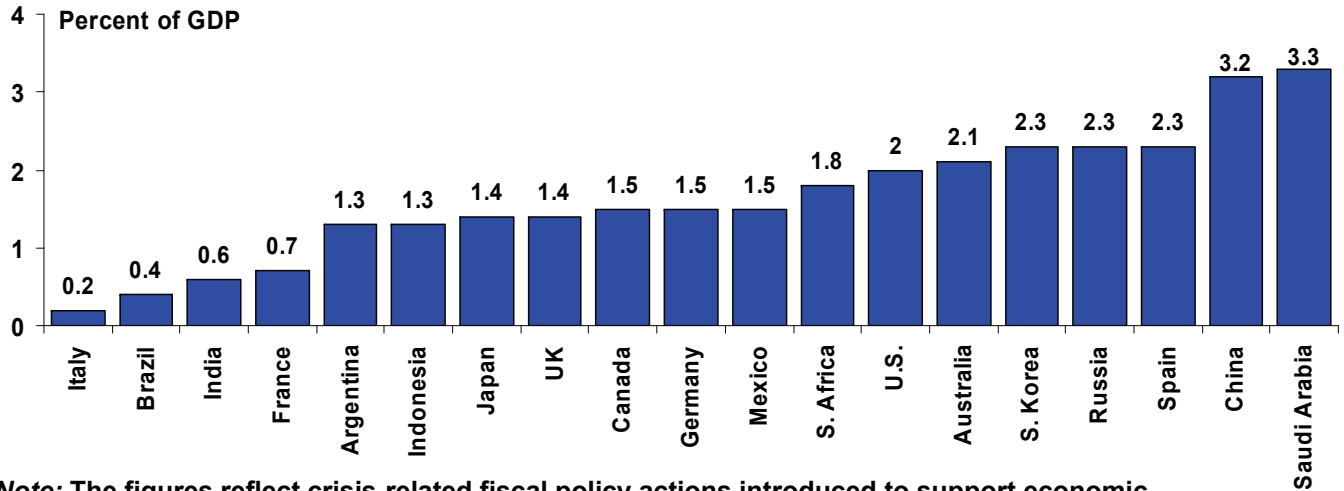


Notes: Estimates are based on 122 recessions in 21 advanced economies.

Sources: International Monetary Fund.

G-20 fiscal stimulus in 2009 (as % of GDP)

Many countries have announced plans for a sizable fiscal stimulus

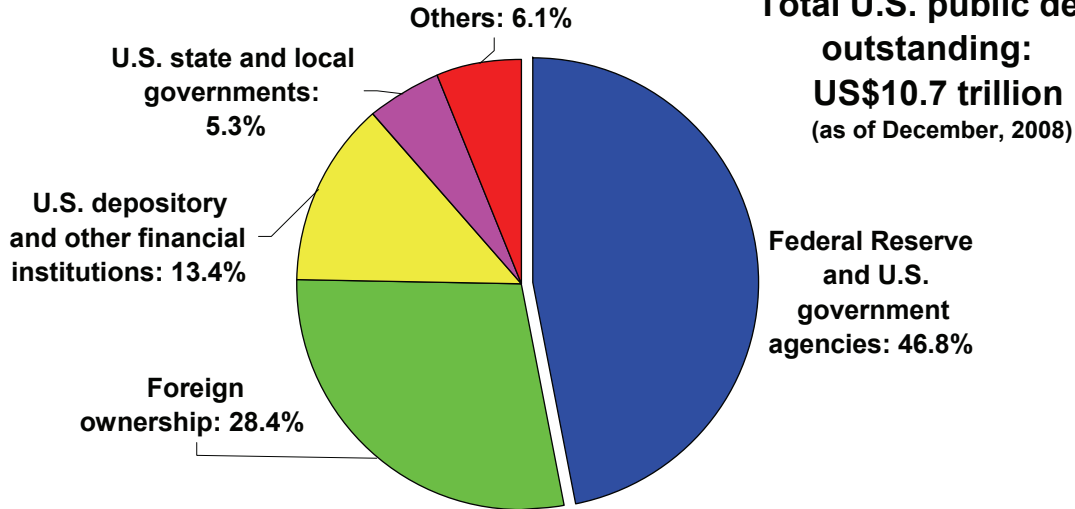


Note: The figures reflect crisis-related fiscal policy actions introduced to support economic activity. These discretionary measures in 2009 are compared to 2007 (the pre-crisis base line).

Source: Group of Twenty, International Monetary Fund, March 2009.



Ownership of U.S. public debt

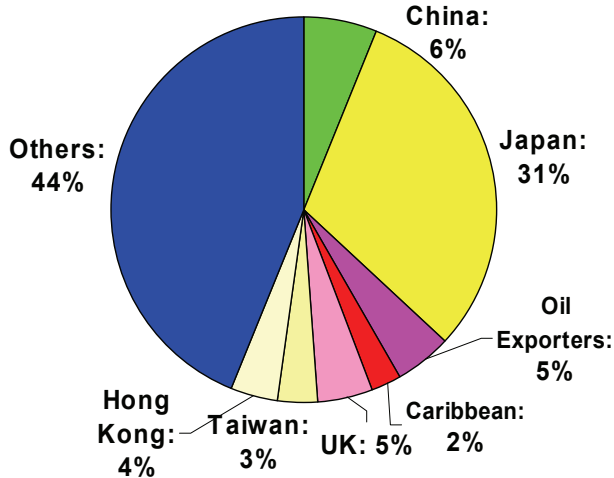


Source: U.S. Treasury.

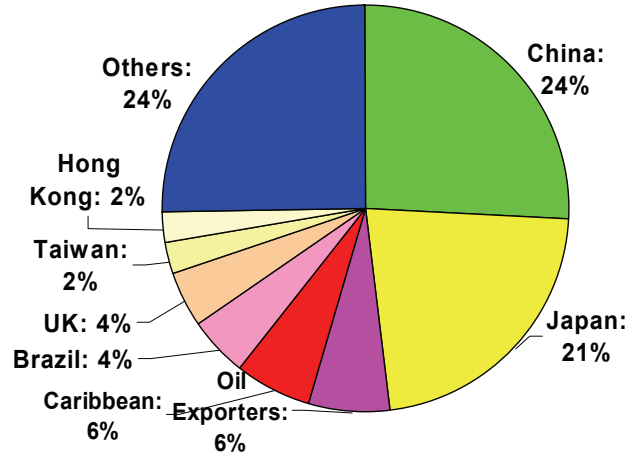
Foreign ownership of U.S. Treasury securities

China and Japan held 45% of foreign-owned Treasury securities (as of Jan 2009)

Jan 2001: Total US\$1 trillion



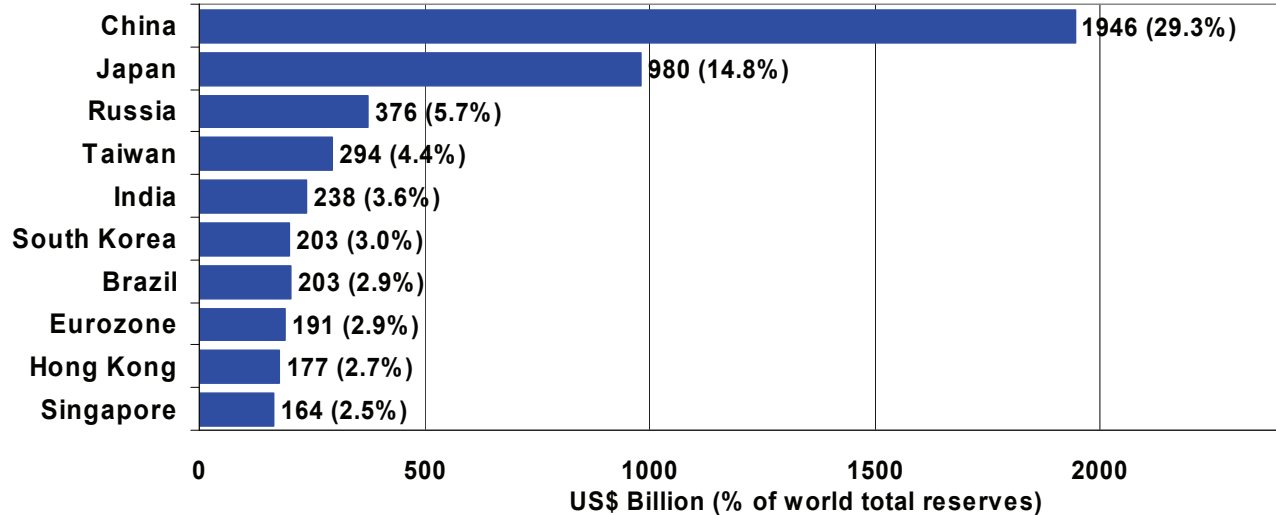
Jan 2009: Total US\$3.1 trillion



Source: U.S. Treasury.

Foreign exchange reserves (in US\$ billions)

Most recently available data, as of March 2009

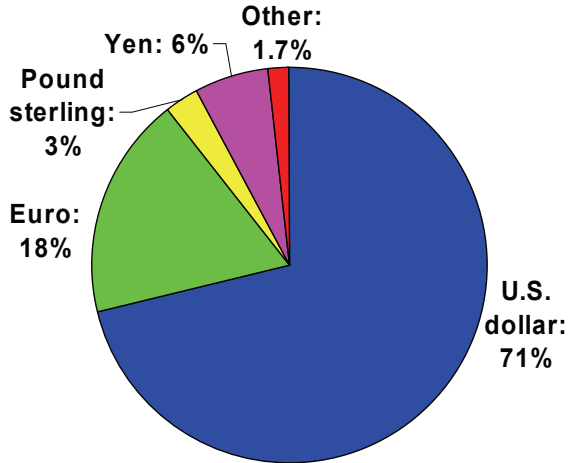


Source: Bloomberg.

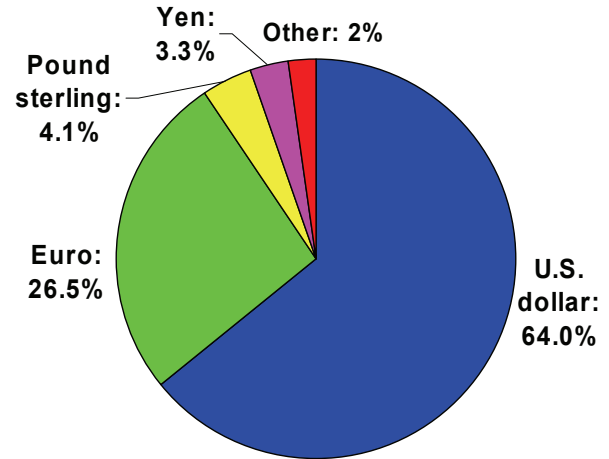
Increasing competition to the U.S. dollar

Foreign exchange reserves held in different currencies

2000: Total US\$1.9 trillion



2008: Total US\$6.7 trillion



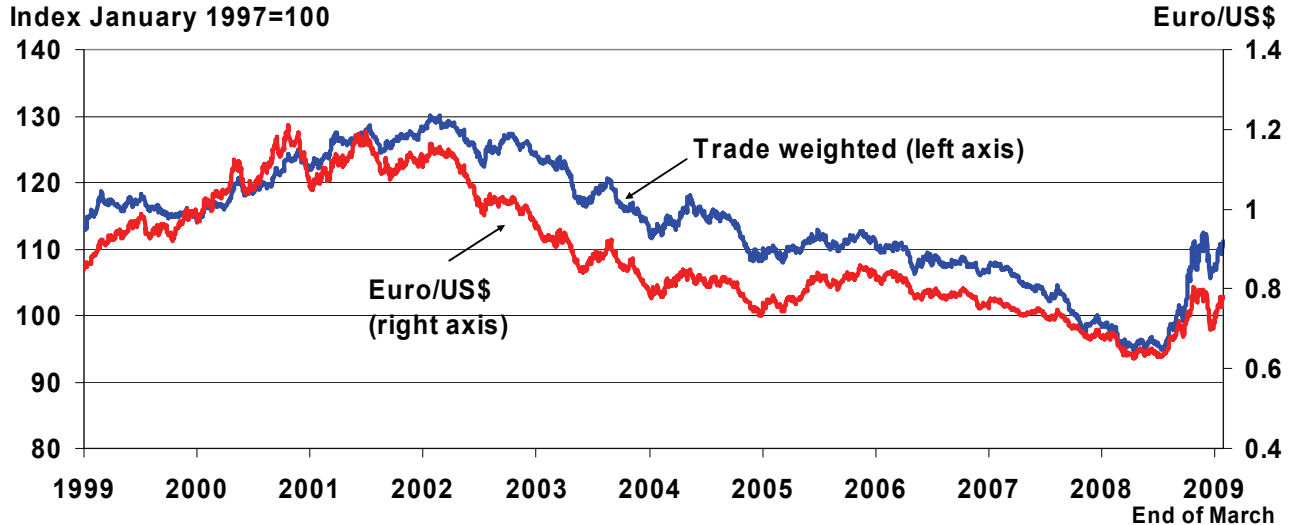
Note: Unallocated foreign exchange reserves excluded; Source: Bloomberg.

The U.S. dollar

Strengthening after mid-2008



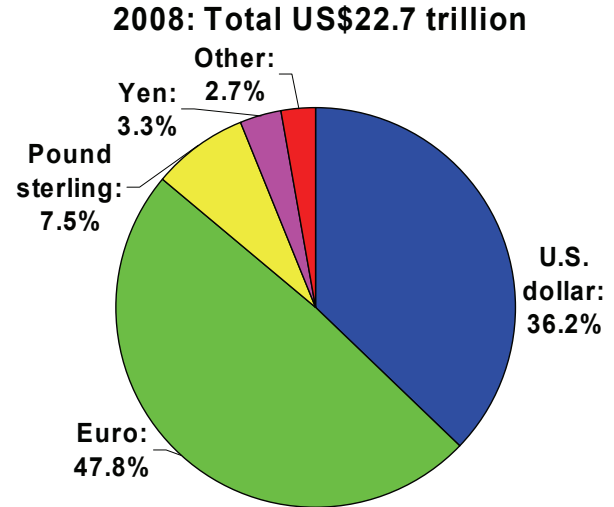
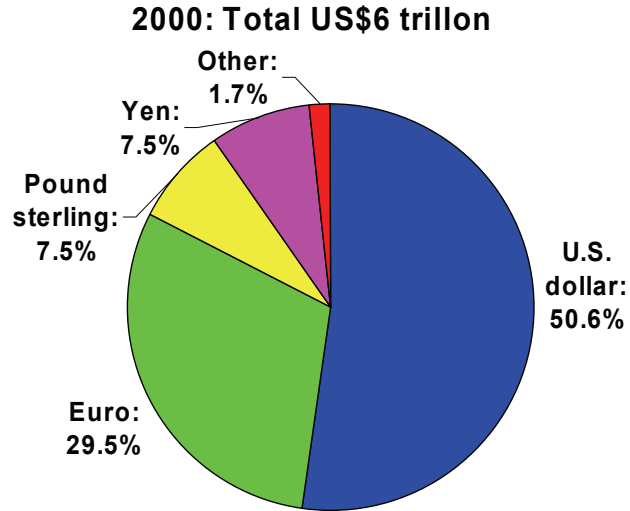
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Source: Federal Reserve Board.

Declining role of U.S. dollar

International debt issuance by currency



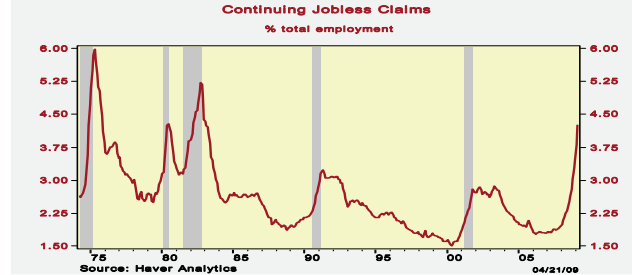
Source: Bank of International Settlements.



Kenneth Griffin's Slides



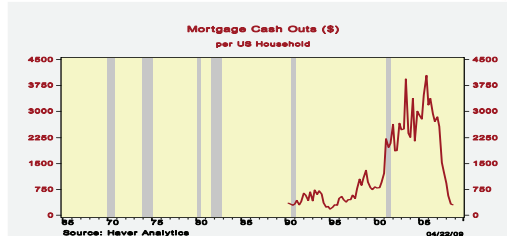
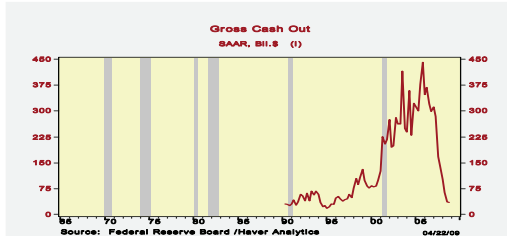
Bleak employment picture, but are we close to peaking?



- Initial jobless claims have gone vertical. Continuing claims at '80 / '82 recession levels.
- The unemployment rate is a lagging indicator and will likely march higher.
- A level of 400k on claims would be consistent with no job contraction.



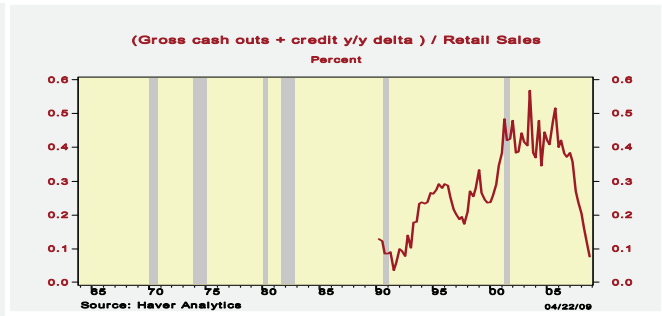
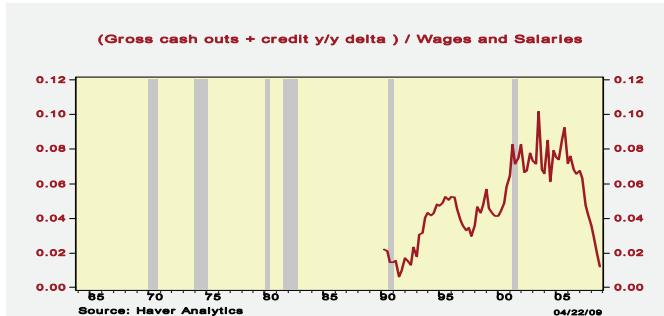
Mortgage equity withdrawal (MEW) was enormous



- At its peak, equivalent to handing a \$3,800 check to every household in America. Contrast that with the \$600 stimulus check from 2008
- MEW was 8 to 10% of retail sales in the '06 time frame
- **Equivalent on average to a 7% pay raise for every worker in America**



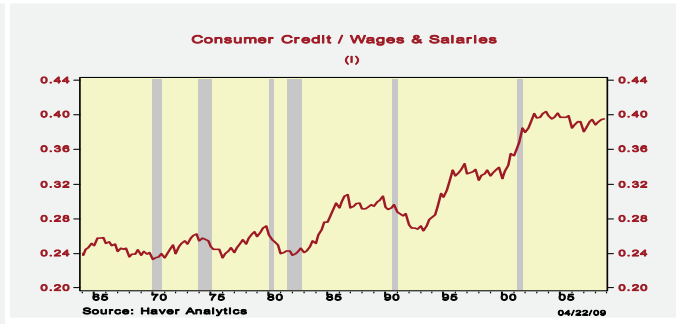
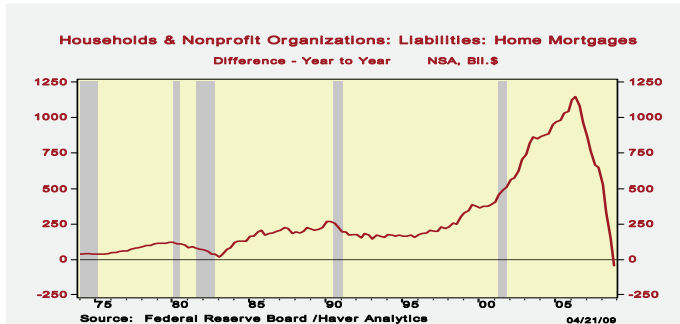
Measuring the Magnitude of MEW



- The combined sum of MEW and the amount by which consumer credit (ex-Mortgage) increased year over year (Gross Cash Outs + Credit Y/Y Delta), equated to an effective pay raise of 8% to the US labor force during the spending boom of 2004 to 2006
- The same figure was roughly 40 to 50% of the growth of retail sales during that period
 - Not to suggest that all MEW was spent at retail.



Balance sheet ramifications

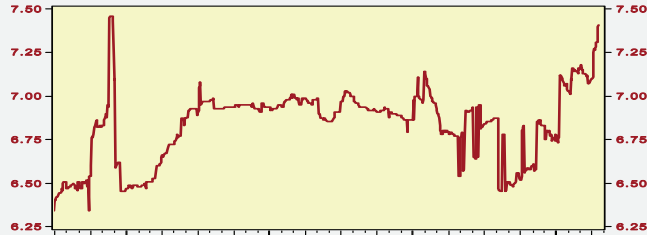


- For the first time the value of outstanding mortgage debt is contracting.
- Consumer credit has not yet declined as a % of wages and salaries, but significant credit tightening efforts are underway



Rates on new car loans spike, sales crash

New Car Loans rate: 48 Month Duration
% (I)



Source: Wall Street Journal /Haver Analytics 04/21/09

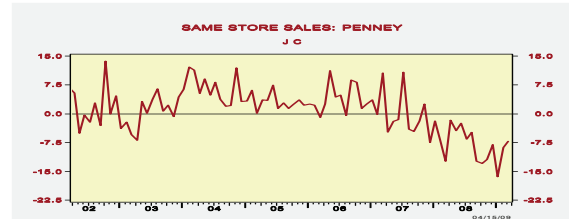
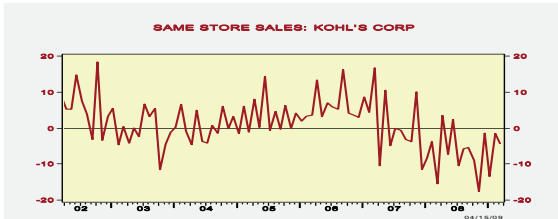
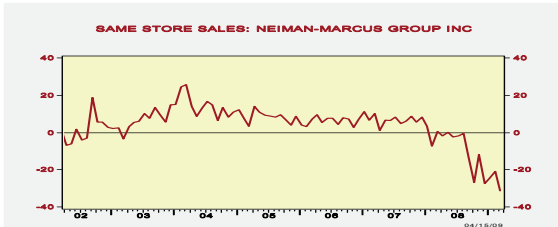
Light Weight Vehicle Sales (Autos+Light Trucks)
SAAR, Mil.Units



Source: Bureau of Economic Analysis/Haver Analytics 04/22/09



A tale of two consumers



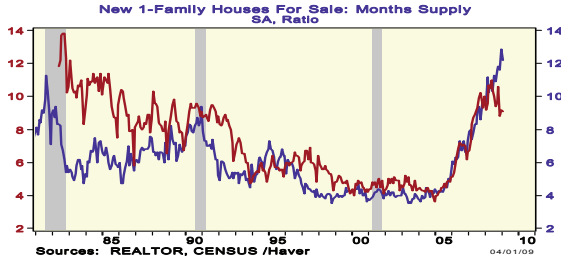
High-end retailers are NOT seeing the bounce that the mid-range “soccer mom” retailers are seeing

- High end has been disproportionately affected
- Is life starting to go on for low-end and middle America?

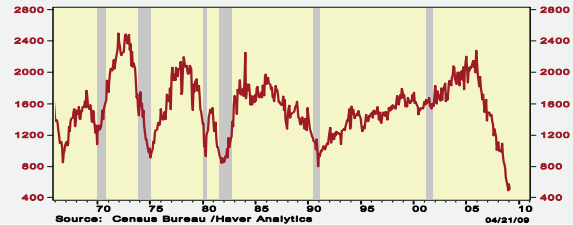


Too many houses for sale

NAR Months' Supply of Single Fam Homes on the Market, United States
Months



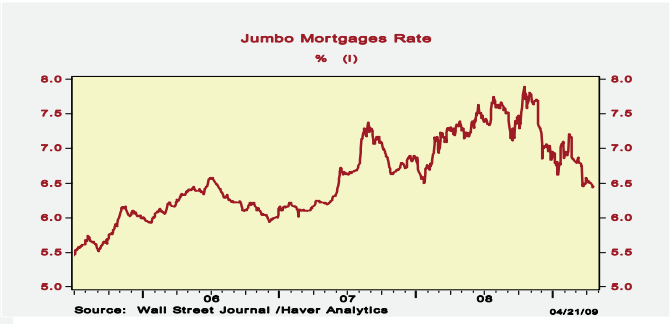
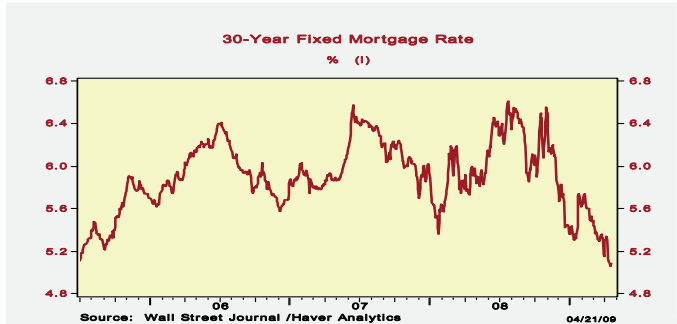
Housing Starts
SAAR, Thous.Units



- Existing home supply has recently begun to decline while month's supply of new homes is still growing
 - Last month existing home sales were up 5%, driven by the sales of foreclosed homes
 - There are currently 650k foreclosed homes which have not hit the market yet.
- Until month's supply falls, prices are likely to remain under pressure
- Good news: housing starts have reached multi-decade lows



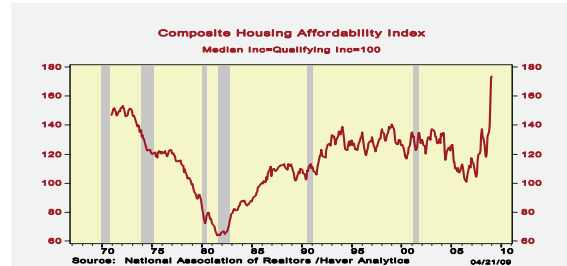
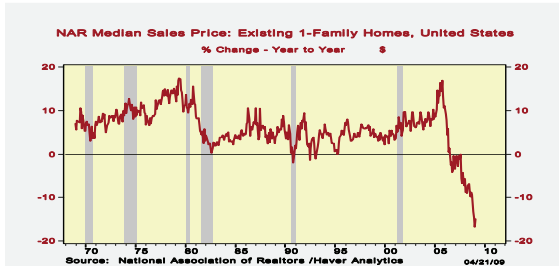
Mortgage rates on the decline



- Rates for conforming loans are falling
- Jumbo rates falling, albeit at a slower pace



Housing affordability through the roof (sort of)



- The combination of falling home prices and lower rates have contributed to a surge in the affordability of homes
- Could low-end housing be close to finding a bottom?