



THE ECONOMY AT A GLANCE

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ECONOMIC HIGHLIGHTS

RETAIL SALES STILL RISE

Sales at the retail level actually increased in January. Total retail sales increased 0.3% last month, while those excluding automobiles posted a similar 0.3% gain. This report is based in nominal terms, and is not adjusted for inflation. As such, the results can be difficult to interpret. It seems a safe bet, however, that the 2.0% surge in sales at gasoline stations was largely due to elevated prices at the pump. Still, it is good news that the economy isn't falling off a cliff.

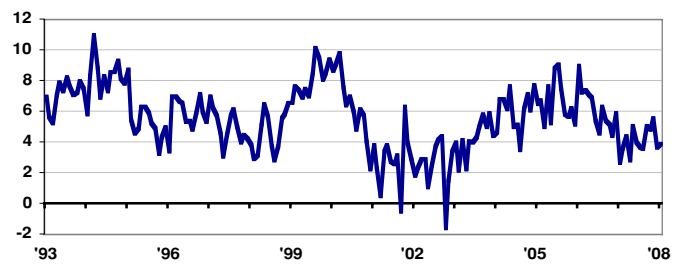
MANUFACTURING REBOUNDS

The January ISM manufacturing report contained encouraging signs. Reversing the contractionary (sub-50) posting of 48.4 in December, the ISM's PMI jumped to 50.7. The headline index was driven by the Production Index, which registered a reading of 55.2 in January — up from 48.6 in December. The ISM said the January PMI of 50.7 on an annualized basis corresponds to a 3.0% increase in real GDP. We don't expect first-half economic growth to be that strong, but view this report as cause for optimism.

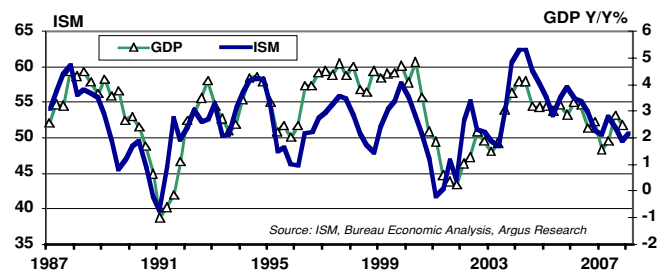
UNION MEMBERSHIP FLAT

The number of workers that were members of unions in 2007 totaled 15.670 million, essentially unchanged from 2006. As a percent of all employed workers, union membership was 12.1% last year — not too far from the 12.0% in 2006, which was the lowest level in over sixty years. Today, a mere 10% of all workers are employed in the manufacturing sector, and over 80% are employed in services-type positions. We can't help but think that this trend will continue for many years to come.

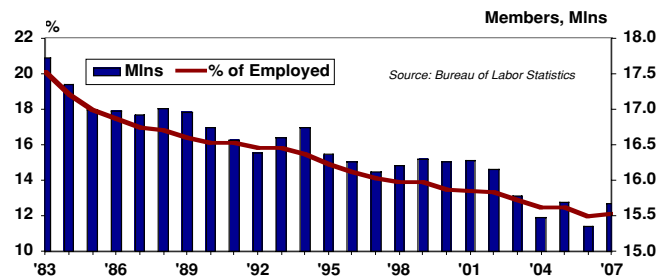
RETAIL SALES (YOY%)



REAL GDP VS. ISM PMI



UNION ENROLLMENT

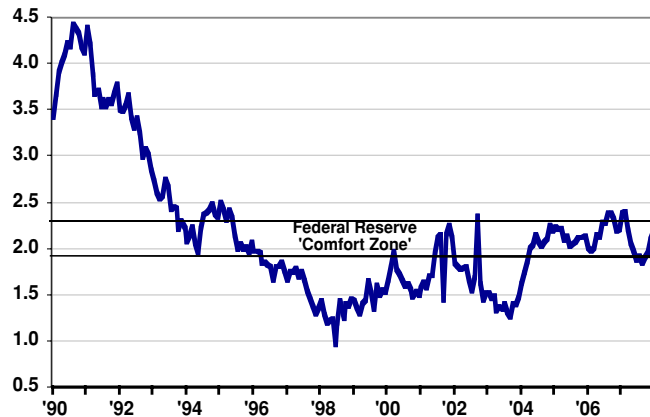


MONETARY HIGHLIGHTS

CONSUMER INFLATION RISING

Disposable personal incomes grew by a nominal 0.5% in December, but were dramatically reduced to a 0.2% gain once adjusted for inflation. Consumer spending increased 0.2% in December, but escalating prices turned real spending into a flat performance. In fact, it was a rising price level that really put a damper on real fourth-quarter consumer spending. The personal consumption expenditure deflator (PCED) climbed 0.2% in December, bringing the 12-month pace of consumer inflation to 3.4%. Meanwhile, the core PCED, an inflation barometer watched closely by the Federal Reserve, inched up 0.2% in December — and is now 2.2% higher than in December 2006. This is higher than the Fed's desired 1.0%-2.0% 'comfort zone.' The aggressive Fed rate cutting should only add to these pressures.

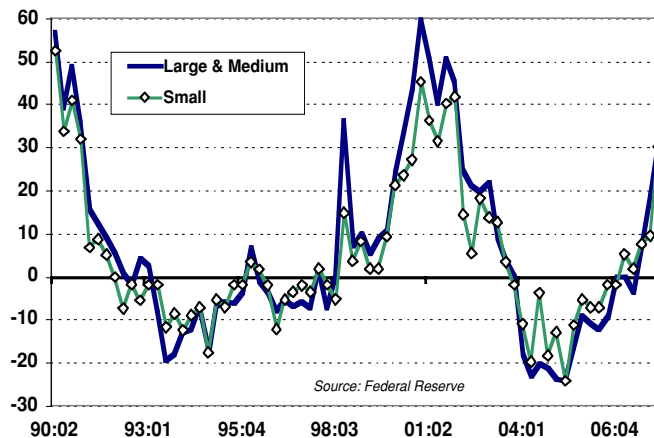
CORE PERSONAL CONSUMPTION EXPENDITURE DEFLATOR (%)



BANKS TIGHTENING CREDIT

According to the latest Federal Reserve Senior Loan Officer Survey on Bank Lending Practices, banks are tightening lending conditions. Apparently, one-third of all domestic institutions reported an increase in lending standards on commercial and industrial (C&I) loans to small, large and middle-market firms during the first quarter. Similarly stronger tightening had occurred on commercial real estate loans as well as for residential mortgage loans. Demand weakened for consumer loans and commercial real estate loans, and slipped just a bit for C&I loans. This report suggests that banks (lenders) are indeed fearful of the credit crisis and are reluctant to lend. Meanwhile, borrowers are also spooked and less willing to borrow. Tighter standards will only dampen future economic activity.

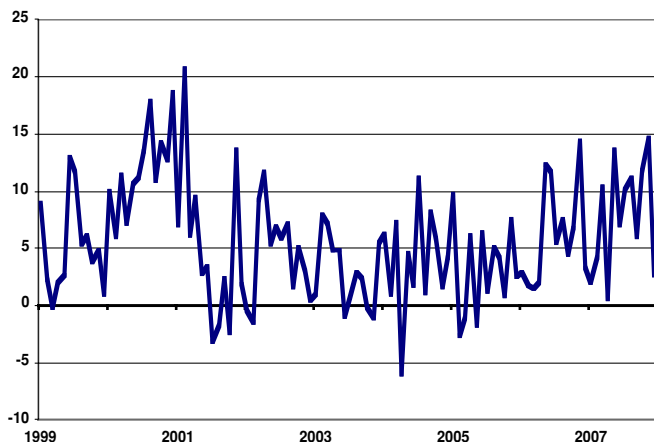
NET % TIGHTENING STANDARDS FOR C&I LOANS



CONSUMERS PULL BACK

Total outstanding consumer credit increased by a relatively soft 2.1% in December, following a robust 8.2% increase in November. A skittish jobs climate combined with restrictive lending standards has resulted in softer consumer credit. Total revolving, or credit card, debt increased an annualized 2.7% — considerably slower than the stellar gains in October (11.1%) and November (13.7%). Apparently the consumer is playing it smart. Since banks are ratcheting up lending standards for loans, some consumers are forced to rely on charge cards as a means for credit. Rather than ringing up debt that they cannot pay off, consumers have cut spending. Otherwise, charging up a storm could be a very dangerous practice if the economy takes a steep turn south.

CONSUMER REVOLVING CREDIT (%)

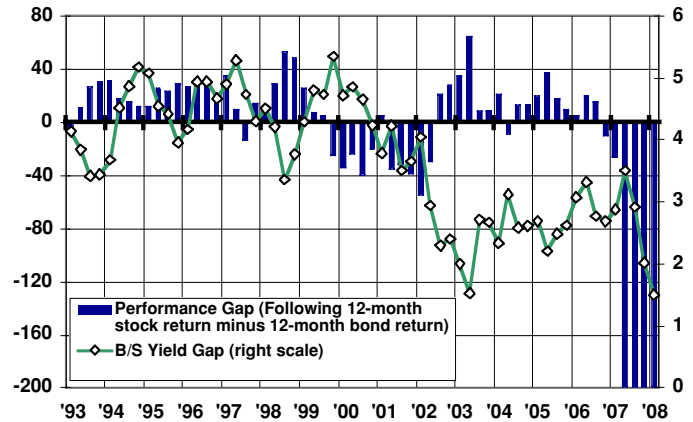


FINANCIAL MARKET HIGHLIGHTS

THE STOCK/BOND YIELD GAP: PREDICTIVE AT THE EXTREMES

We recently examined the gap between the yield on the benchmark 10-year Treasury note and the dividend yield of the S&P 500. Generally, a gap of 400 basis points or less has proven bullish for stocks. More notable, however, is that extreme levels have been very predictive of the market's future. The gap peaked in 4Q99, at 535 basis points, accurately foreshadowing that stocks were quite overvalued relative to bonds. Alternatively, in March of 2003 the gap shrunk to just 150 basis points as bond yields plunged and stock prices sunk to bear market lows (thus pushing up dividend yields). The bull market kicked off shortly thereafter. The current reading is 150 basis points is close to the bear market low of March 2003.

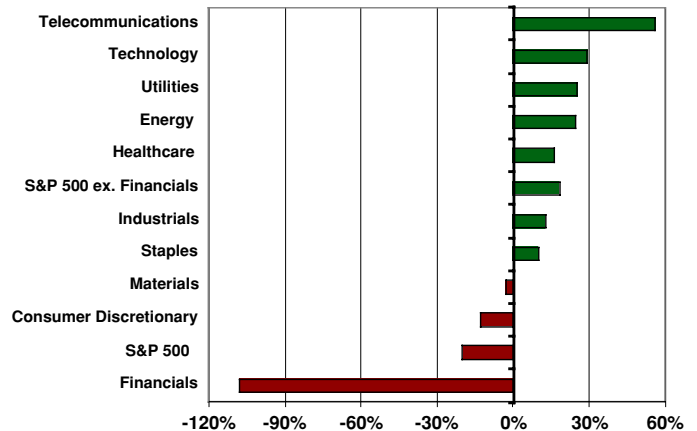
THE STOCK/BOND YIELD GAP



FOURTH-QUARTER EARNINGS UPDATE

As of February 7, S&P 500 earnings were down 20% from 4Q06 – but excluding Financials, earnings are actually up by 18% year-over-year. At the sector level, the picture is even more mixed. Strong global growth continues to bolster sectors such as Technology (+29%), Industrials (+13%) and Energy (+25%) — but there are signs that global growth is starting to weaken as well. Many companies are issuing cautious outlooks for 2008 earnings. Given that, we are surprised that the sum of analyst estimates for 2008 continues to suggest 15% earnings growth over 2007. Indeed, we expect a modest decline (of 2%) in 2008 earnings versus 2007. Earnings for 2007 are on track to be down about 4% from the peak level reached in 2006.

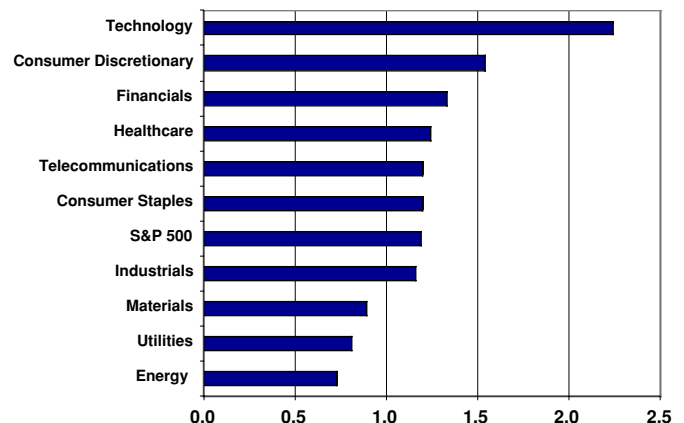
EARNINGS GROWTH (4Q07/4Q06, 72% REPORTED)



DIVIDEND YIELDS LOOKING ATTRACTIVE

Some sectors are offering the most attractive dividend yields in years. Not surprisingly, the hottest sectors in recent years (Energy, Basic Materials, and Utilities) are actually yielding less than their 10-year average. Notable recent laggards (Consumer Discretionary and Financials) have yields well above the 10-year averages. We would focus on the safety of the dividend at this stage in the cycle. The Healthcare and Consumer Staples groups are also yielding about 20% above their 10-year average and offer greater safety than do Financials. Several large-cap banks have already cut their dividend and more could follow. Finally, some of the major European equity market indices now yield about 4% as well.

DIVIDEND YIELD/10-YEAR AVG. YIELD



THE ARGUS ECONOMIC OUTLOOK

	February 19, 2008															
	2006 A				2007 A				2008 E				2009 E			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Real Gross Domestic Product	4.8	2.4	1.1	2.1	0.6	3.8	4.9	0.6	1.5	1.9	3.2	3.0	3.0	2.5	2.3	1.9
Annual:				2.6			2.5					2.4				2.4
Personal Consumption	4.4	2.4	2.8	3.9	3.7	1.4	2.8	2.0	2.0	1.6	2.2	2.6	2.1	2.1	2.1	2.1
Durables	16.6	0.8	5.6	3.9	8.8	1.7	4.5	4.2	-1.5	2.0	1.8	4.2	4.3	2.2	4.6	3.7
Non-Durables	4.5	2.3	3.2	4.3	3.0	-0.5	2.2	1.9	1.3	1.9	1.8	2.1	0.4	1.8	1.1	1.5
Services	2.1	2.7	2.0	3.7	3.1	2.3	2.8	1.6	0.9	1.4	2.6	2.5	2.4	2.2	2.0	1.9
Gross Domestic Investment	4.3	0.6	-4.1	-14.1	-8.2	4.6	5.0	-10.2	5.4	0.5	4.9	3.8	6.7	3.4	3.5	2.1
Fixed Investment	7.9	-1.9	-4.7	-7.1	-4.4	3.2	-0.7	-2.6	3.4	0.5	4.9	3.8	4.5	3.4	3.6	2.1
Non-Residential	13.3	4.2	5.1	-1.4	2.1	11.0	9.3	7.5	4.4	4.4	7.7	5.4	5.1	3.3	4.1	2.4
Structures	15.0	16.4	10.8	7.4	6.4	26.2	16.4	15.8	7.4	3.7	3.2	7.9	5.6	5.1	3.6	2.2
Equip. & Software	13.0	-0.1	2.9	-4.9	0.3	4.7	6.2	3.7	2.7	4.7	9.1	4.7	5.0	2.8	4.2	2.4
Residential	-0.7	-11.7	-20.4	-17.2	-16.3	-11.8	-20.5	-23.9	-19.3	-12.4	-4.6	-2.1	2.1	4.0	1.6	1.2
Change in Pvt. Inventories	38.4	51.4	53.9	17.4	0.1	5.8	30.6	-3.4	5.0	5.0	5.0	5.0	15.0	15.0	15.0	15.0
Net Exports																
Exports	11.5	5.7	5.7	14.3	1.1	7.5	19.1	3.9	3.1	5.1	7.1	5.3	5.2	4.1	2.5	3.3
Goods	15.5	6.5	7.4	9.6	0.9	6.6	26.2	2.4	2.6	5.4	7.1	5.2	4.3	2.6	2.2	2.0
Services	2.9	3.9	2.0	28.0	1.6	9.6	4.0	7.6	3.9	4.3	6.9	5.7	7.5	8.0	3.2	6.5
Imports	6.9	0.9	5.4	1.6	3.9	-2.7	4.4	0.3	7.6	2.1	2.2	1.9	3.4	2.0	2.0	2.8
Goods	6.5	1.1	6.2	-0.6	4.2	-2.9	4.8	0.3	8.0	2.0	2.1	1.8	2.9	1.5	2.1	2.4
Services	9.5	-0.1	1.3	14.2	2.3	-1.7	1.7	0.5	2.3	3.2	2.9	2.0	5.8	5.1	2.0	5.1
Gov't Purch. of Goods & Svcs.																
Federal	4.9	1.0	0.8	3.5	-0.5	4.1	3.8	2.6	0.4	2.1	1.7	1.3	1.9	1.6	1.5	1.1
National Defense	8.4	-1.6	0.9	7.3	-6.3	6.0	7.1	0.3	2.4	3.3	2.1	2.1	3.5	1.7	2.4	0.9
Non-Defense	6.8	2.3	-1.5	16.9	-10.8	8.5	10.1	-0.6	1.1	1.6	1.2	2.2	2.8	0.8	3.2	0.2
State & Local	11.9	-8.8	6.0	-10.0	3.8	0.9	1.1	2.3	5.7	6.8	3.9	1.9	5.0	3.5	0.7	2.4
Final Sales of Domestic Prod.	2.9	2.5	0.7	1.3	3.0	3.0	1.9	4.0	-0.7	1.4	1.4	0.8	1.0	1.5	1.0	1.2
Final Sales to Dom. Purch.	5.4	2.0	1.0	3.5	1.3	3.6	4.0	1.9	1.2	1.9	3.2	3.0	2.6	2.5	2.3	1.9
Final Sales to Dom. Purch.	5.0	1.5	1.2	2.1	1.7	2.1	2.5	1.4	2.1	1.5	2.5	2.6	2.4	2.2	2.2	1.9
Addendum:																
Nominal GDP	8.4	6.0	3.4	3.8	4.9	6.6	6.0	3.2	4.8	5.1	6.4	6.2	6.1	5.6	5.4	5.0
Personal Con Exp Deflator	1.7	4.3	2.6	-0.9	3.5	4.3	1.8	3.9	3.7	3.7	3.2	3.7	3.0	2.9	3.2	2.9
GDP Price Deflator (implicit)	3.4	3.5	2.4	1.7	4.2	2.6	1.0	2.5	3.2	3.2	3.1	3.1	3.1	3.1	3.0	3.0

Richard Yamazone, Director of Economic Research

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