

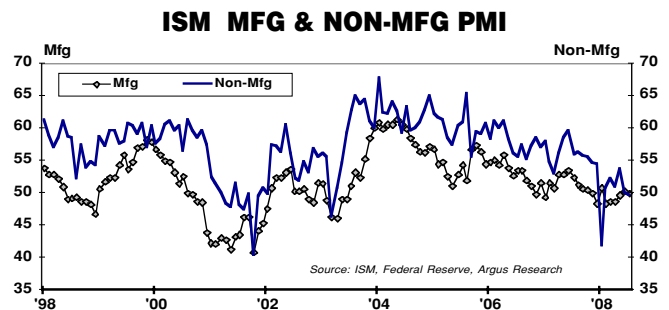


### ECONOMIC HIGHLIGHTS

August 25, 2008  
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#### ISMS BARELY ABOVE WATER

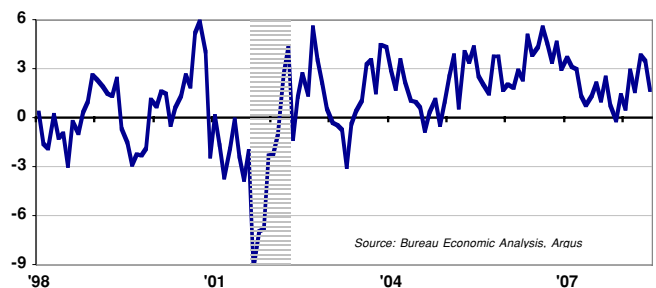
The Institute of Supply Management's (ISM) two business barometers, the Manufacturing Index (MFG) and Non-Manufacturing (N-MFG), were barely clinging to expansionary territory in July. The ISM MFG slipped to a reading of 50.0 (expansionary) from 50.2 in June. In the services sector, the ISM N-MFG increased to 49.5 (slightly contractionary) from 48.2 during June. This is a fair representation of the conditions in the overall economy, representing a close call between expansion and contraction.



#### CONSUMER'S TREAD WATER

Our 'Fab Five' indicators of discretionary spending seem to have held up well over the last few months, despite soaring prices at the pump and ongoing frailty in the jobs market. Two of the five indicators remained in negative territory during June (jewelry & watches and casino gambling). The remaining three (women's clothing, cosmetics & perfumes and dining out) all continued to expand over the last 12 months. We will continue to keep an eye on the Fab Five for signs of recovery or deterioration.

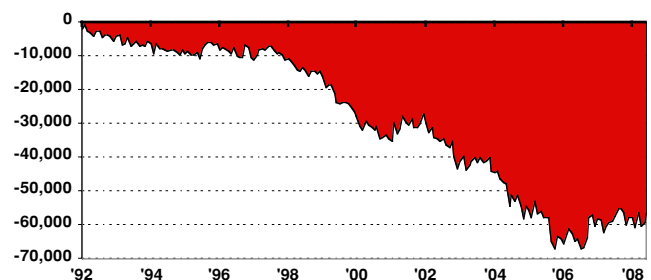
#### REAL SPENDING: COSMETICS & PERFUMES (Y/Y%)



#### TRADE DEFICIT NARROWS

The U.S. trade deficit narrowed by 4.1% during June to \$56.8 billion, the lowest level since March. U.S. imports of record-high-priced oil were no match for the gains in exports of agricultural products. With this latest improvement in the trade deficit, we may see second-quarter GDP revised from its current 1.9% pace to something in the vicinity of 3.0%-plus. Make no mistake about it, trade — particularly in agriculture and related products — is keeping the U.S. from a deep and prolonged recession.

#### INTERNATIONAL TRADE BALANCE (\$MLN.)



# MONETARY HIGHLIGHTS

## CREDIT SURGES

The Federal Reserve reported a leap in total outstanding consumer credit in June. When you mix a \$168 billion stimulus plan with heavily discounted merchandise, you get whopping numbers. During June, total outstanding consumer credit soared by \$14.3 billion, or an annualized 6.7%. The pace of revolving – or credit card – debt increased by 6.8%, while nonrevolving credit jumped an equally impressive 6.6% in June. The gain in nonrevolving credit was somewhat perplexing since it includes autos, which experienced a poor performance in June. Unfortunately these robust gains are not likely to continue as there are no more government checks in the mail. Also, the increased pace of unemployment claims suggests there are fewer payroll checks as well.

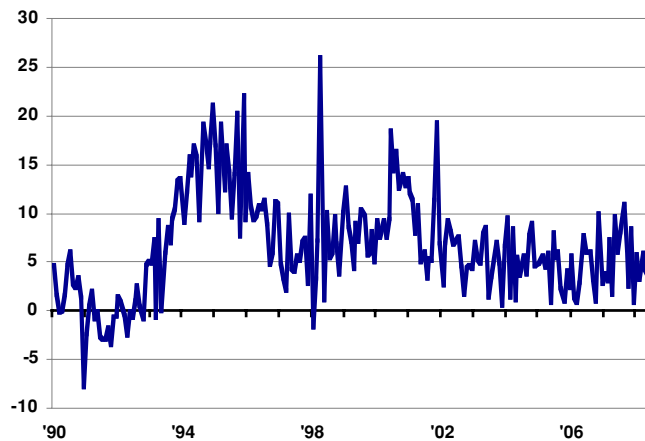
## FED LEAVES RATES UNCHANGED

The Federal Reserve refrained from moving its benchmark borrowing target rate from the 2.0% level. This was hardly surprising since the Federal Reserve has come up against kryptonite in the form of an escalating general price level and the ongoing credit crisis and housing recession. Any near-term policy action — rate cuts or rate hikes — is simply out of the question, and the Superhero is powerless. We're not too sure the Fed has ever sat idle with so many inflation gauges rising to such dangerously high levels. But then again, the central bank didn't have the twin evils of a credit crisis and a deep housing recession to contend with either. It's tough to justify an increase in borrowing costs with an anemic economy teetering with recession.

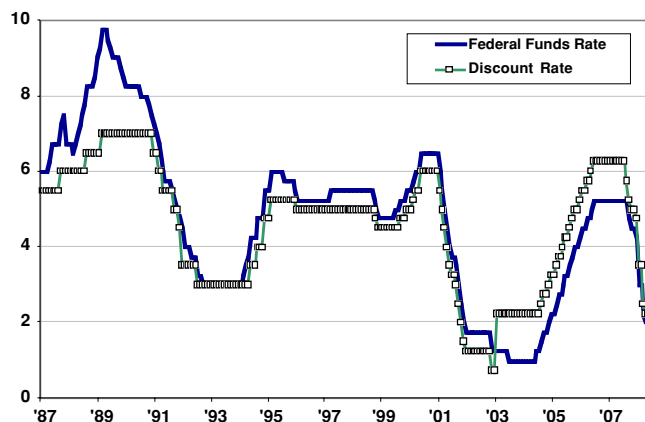
## INFLATION JUMPS

The Bureau of Economic Analysis reported a 0.8% increase in the personal consumption expenditure deflator (PCED) during June – the largest monthly increase since September 2005 (1.0%) when hurricanes damaged infrastructure in the Gulf and sent prices skyward. Over the last 12 months, consumer inflation is up 3.9%. This surge in inflation took a notable toll on the pace of spending. During June, total consumer spending increased 0.6% — but once adjusted for inflation, that figure actually contracted by 0.2%. Meanwhile, the core PCED increased 0.3% in June, and has risen 2.25% since June 2007. This elevated pace of inflation may ultimately result in a Fed rate hike. But at this point, the Fed is in no position to cut or raise its benchmark target rate.

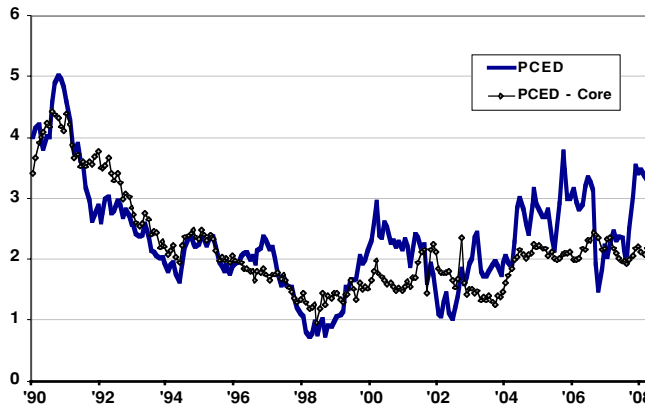
## CONSUMER OUTSTANDING CREDIT %



## FED FUNDS RATE ACTIVITY (%)



## PERSONAL CONSUMPTION EXPENDITURE DEFLATOR (%)

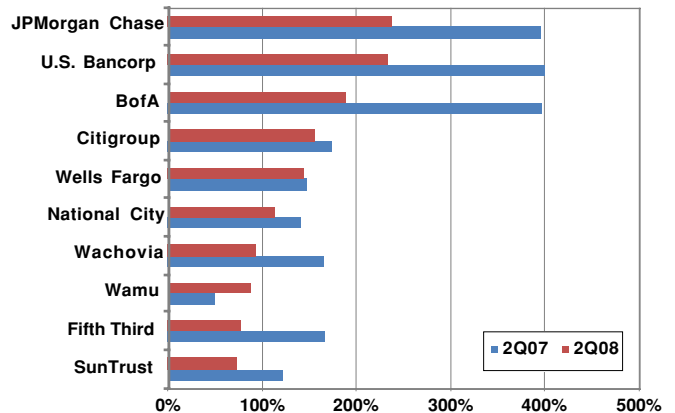


# FINANCIAL MARKET HIGHLIGHTS

## BANK CREDIT LOSS RESERVES

Some banks clearly had much healthier reserves heading into the credit downturn and are therefore at least a step ahead. At this point in a credit cycle, we like to see the reserve cover at least 150%-200% of non-performing assets. Yet several banks have reserves that do not even cover 100% of their non-performing assets. Perhaps not coincidentally, the stocks of these banks — Wamu, Wachovia, SunTrust — have been among the worst performers in recent months. Granted, all of these non-performing assets will not become charge-offs. But in some cases, current reserves are not enough to cover current annualized charge-offs either. We expect reserve building to continue.

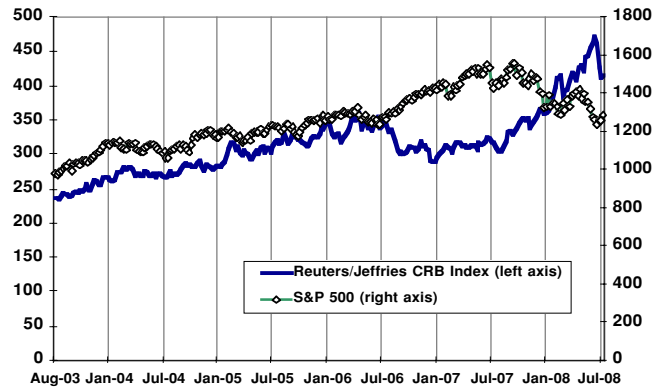
## RESERVES/NON-PERFORMING ASSETS



## COMMODITY PRICES REMAIN ELEVATED

Most broad indices of commodity prices have declined by more than 10% over the past few weeks. Below, we have charted the Reuters/Jeffries CRB Index. Through August 6, this index had lost about 10% from its peak value in early July. The Dow Jones-AIG Commodity Index is also down sharply from its recent peak. (Still, it's important to note that both indices have still increased by more than 15% in 2008.) Recently, investors have tentatively bid up equities — but we believe that the sell-off in commodities may prove short-lived. The U.S. dollar may weaken again as the U.S. economy works through the credit crunch. And demand for commodities from foreign markets still appears to be strong, with long-term supply constrained in many cases.

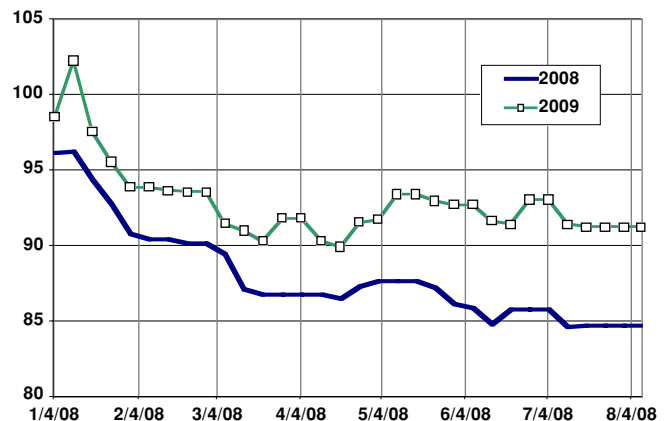
## COMMODITIES VS. STOCK PRICES



## PROFIT ESTIMATES STILL FALLING

The current mean of S&P 500 profit estimates from market strategists is \$84.77 per share for 2008 and \$91.21 for 2009. Our current estimate is \$80 per share for 2008 and \$90 for 2009. We note, however, that estimates of strategists seem to have stabilized. We continue to believe that EPS estimates for the banks are too high and we are starting to see signs of weakness in other sectors. We are waiting to incorporate second-quarter earnings from retailers into our model and we may lower our earnings estimates once again for both 2008 and 2009. The current strategist consensus of \$84.77 implies a slight decline for earnings in 2008 versus 2007. In 2007, earnings were down only slightly from the record 2006 level. We think that such a modest peak-to-trough decline is too optimistic.

## MEAN OF STRATEGIST ESTIMATES FOR S&P 500 (\$ PER SHARE)



# THE ARGUS ECONOMIC OUTLOOK

	2006 A				2007 A				2008 E				2009 E				August 20, 2008
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	
Real Gross Domestic Product	4.8	2.7	0.8	1.5	0.0	4.8	4.8	-0.2	1.7	0.9	1.9	1.0	1.7	2.1	2.5	2.5	2.9
Annual:																	
Personal Consumption	4.3	2.8	2.2	3.7	3.9	2.0	1.0	1.0	0.7	0.9	1.5	1.5	0.7	1.5	1.2	2.0	1.8
Durables	18.9	1.8	3.5	4.2	9.2	5.0	2.3	0.4	0.5	-4.3	-3.0	0.1	0.5	1.6	1.0	1.2	2.3
Non-Durables	4.4	3.1	2.3	3.1	3.5	1.9	1.2	0.3	0.7	-0.4	4.0	1.4	0.7	0.8	0.8	3.9	1.7
Services	1.6	2.8	2.0	3.9	3.1	1.4	2.4	1.4	1.1	2.4	1.1	1.1	1.1	2.1	1.4	1.2	1.7
Gross Domestic Investment	6.2	-0.4	-5.3	-15.0	-9.6	6.2	3.5	-11.9	3.6	-5.8	-14.8	2.6	3.6	2.5	8.1	3.3	6.3
Fixed Investment	8.3	-2.5	-4.8	-7.6	-3.4	3.0	-0.9	-6.2	1.2	-5.6	-2.4	-4.4	1.2	2.5	4.4	2.1	3.9
Non-Residential	15.9	6.4	5.4	-1.0	3.4	10.3	8.7	3.4	2.7	2.3	2.3	-1.9	3.5	5.9	5.7	3.6	4.5
Structures	15.5	19.7	14.3	2.5	11.2	18.3	20.6	8.6	6.4	8.7	14.3	3.2	6.4	8.6	6.6	7.1	8.5
Equip. & Software	16.3	1.8	2.0	-2.4	0.0	6.9	3.6	1.0	2.6	-0.5	-3.4	1.9	2.6	5.1	5.4	2.5	3.3
Residential	-3.6	-16.6	-21.5	-19.5	-16.2	-11.6	-20.6	-27.0	-7.9	-25.0	-15.6	-10.2	-7.9	-11.0	-1.5	-4.3	0.6
Change in Pvt. Inventories	45.9	56.9	53.3	13.1	-15.0	-2.8	16.0	-8.1	-25.0	-10.2	-62.2	-35.0	-25.0	-25.0	-10.0	-5.0	5.0
Net Exports	16.7	5.4	3.5	15.6	0.6	8.8	23.0	4.4	6.7	5.1	9.2	4.9	6.7	7.0	5.2	5.9	6.2
Exports	18.1	6.6	3.6	10.4	2.1	6.8	21.8	5.1	7.5	4.6	11.9	4.4	7.5	6.4	3.4	4.4	5.9
Goods	13.5	2.7	3.2	28.6	-2.7	13.3	26.0	2.7	4.7	6.4	3.5	6.4	4.7	8.6	9.7	9.4	6.9
Services	10.3	0.1	3.1	2.0	7.7	-3.7	3.0	-2.3	5.5	-0.8	-6.6	5.5	1.4	2.3	2.0	1.7	1.6
Imports	9.0	0.5	3.8	-0.8	8.4	-4.0	2.4	-2.6	5.8	-1.9	-6.3	5.8	0.9	1.5	1.5	1.3	1.3
Goods	17.8	-2.0	-0.3	18.4	4.2	-2.0	6.3	-0.8	4.2	5.5	-8.5	2.0	4.2	6.5	4.6	4.1	3.0
Services	3.9	1.3	1.7	1.6	0.9	3.9	3.8	0.8	0.3	1.9	3.4	-0.1	0.3	0.3	0.6	0.6	0.9
Gov't Purch. of Goods & Svcs.	10.0	-1.6	1.9	1.8	-3.7	6.7	7.2	-0.5	1.0	5.8	6.7	-0.9	1.0	0.6	1.0	1.1	2.1
Federal	8.8	1.9	-0.9	7.1	-5.9	8.4	10.1	-0.9	0.7	7.2	7.4	0.2	0.7	0.5	0.9	0.9	2.4
National Defense	12.4	-8.1	7.6	-8.1	1.3	3.1	1.1	0.5	1.6	2.7	5.5	-2.5	1.6	0.8	1.3	1.4	1.4
Non-Defense	0.5	3.0	1.6	1.5	3.6	2.4	1.9	1.6	0.3	-0.3	1.6	0.3	-0.2	0.2	0.3	0.3	0.2
State & Local	5.1	2.3	0.9	2.9	1.1	4.3	4.0	0.8	1.4	0.9	3.9	0.0	1.4	2.1	2.0	2.3	2.6
Final Sales of Domestic Prod.	4.8	1.6	1.0	1.5	2.2	2.5	1.9	-0.1	0.7	0.1	1.3	0.5	0.7	1.5	1.5	1.8	2.0
Final Sales to Dom. Purch.																	
Addendum:																	
Nominal GDP	8.6	5.5	3.6	3.7	4.3	6.9	6.4	2.3	5.6	3.5	3.0	5.4	5.6	5.7	5.6	6.1	6.1
Personal Con Exp Deflator	1.8	3.3	3.1	-0.5	3.4	3.6	2.5	4.3	3.6	3.6	4.2	4.0	3.6	3.3	2.9	3.2	2.9
GDP Price Deflator (implicit)	3.6	2.7	2.7	2.2	4.2	2.0	1.5	2.5	2.6	2.6	1.1	4.3	3.8	3.6	3.1	3.5	3.0

Richard Yamarone, Director of Economic Research

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