



ECONOMIC HIGHLIGHTS

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RECESSION MEASURE HOLDING UP

The National Bureau of Economic Research is the arbiter of business cycle changes. When the group meets to determine if and when the U.S. economy has slipped to recession, it uses several gauges. One, industrial production, increased 0.2% in July, which followed a 0.4% gain in June. This is encouraging because the index had hit the skids from February through May. But the first-half slowdown paled in comparison to the pronounced downturns experienced during confirmed recessions.

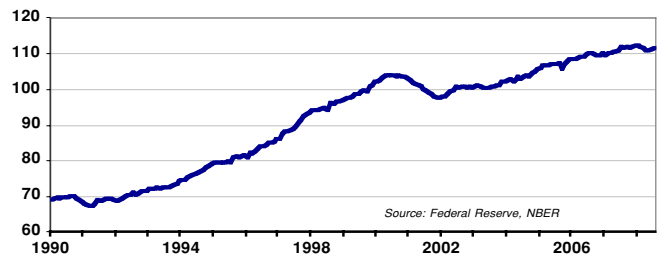
IT'S NOT JUST ABOUT GASOLINE

Mainstream media reminds Americans how economically compromising energy costs have been. But we aren't sure that record prices at the pump are the chief culprit behind the lackluster economic performance and miserable confidence readings. Roughly 17.5% of consumer spending is on medical care, with prescriptions adding another 2.5%. This dwarfs gasoline spending (at 4.7%) and electricity and gas (at 2.5%). You don't need an economist to tell you about the impact of medical costs on the economy.

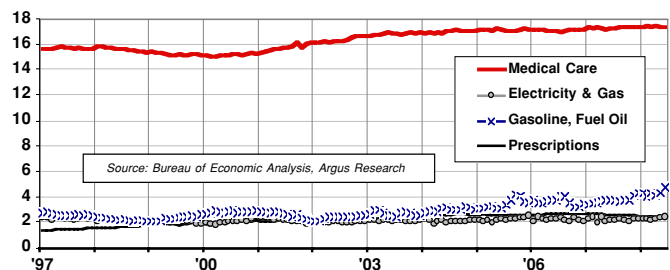
STRONG ORDERS & SHIPMENTS

The pace of new orders for durable goods recently climbed more than the Street expected — by 1.3% in July. Excluding the transportation component, orders jumped a strong 0.7%. Shipments of durable goods rocketed 2.5% in July. These gains suggest capital spending during the third quarter will be positive, and will help boost the overall pace of economic activity. These trends, if sustained, could keep the U.S. economy from faltering as so many on the Street anticipate.

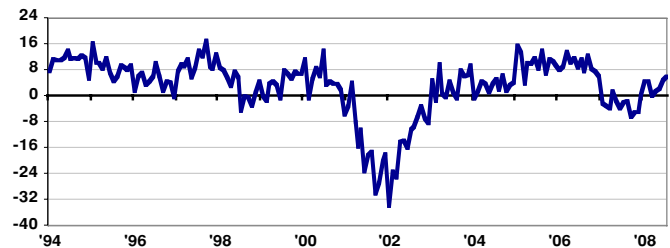
INDUSTRIAL PRODUCTION



CONSUMER BURDENS % OF TOTAL SPENDING



NEW ORDERS NONDEFENSE CAPITAL GOODS EX-AIRCRAFT (YOY%)

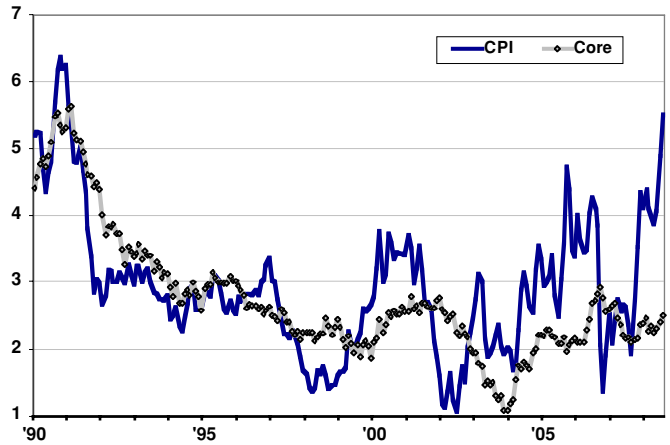


MONETARY HIGHLIGHTS

INFLATION SOARS IN JULY

In July, inflation at the retail level rose at the fastest pace seen in 17 years. During July, the consumer price index rose 0.8% — or 5.6% over the last 12 months. Excluding volatile food and energy, the core rate increased 0.3% — or 2.5% since July 2007. This core rate exceeds the Federal Reserve preferred 1.0%-2.0% “comfort zone.” The gains were widespread, with energy up 4.0% in the month, transportation up 1.7% and food & beverages up 0.9%. Apparel prices jumped 1.2% in July, the largest increase in over a decade. Clothing and accessories are so expensive because transportation costs have surged. In addition, wages in China are escalating, forcing apparel retailers to pass along higher costs. The Fed must be disturbed by this latest report.

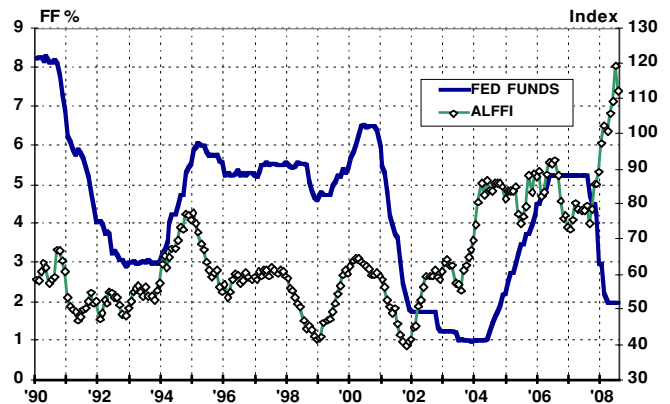
CONSUMER PRICES (YOY%)



ARGUS FED INDEX DROPS

The Argus Leading Fed Funds Index (ALFFI), our internal barometer of changes in the Fed Funds rate, fell more than seven points from an all-time high posting in the previous month. During July, the ALFFI declined to 112.43 from a revised reading of 119.46 in June. Despite the large drop, the level of the index remains at one of the loftiest levels recorded in the 18-year history of the ALFFI. Three of the six components of the index registered gains, with the core intermediate producer price index experiencing the largest increase. Declines in the Institute for Supply Management’s Prices Index and the Reuters CRB Commodity Index led the hefty decline in July. We expect the Fed’s next move to be a rate hike.

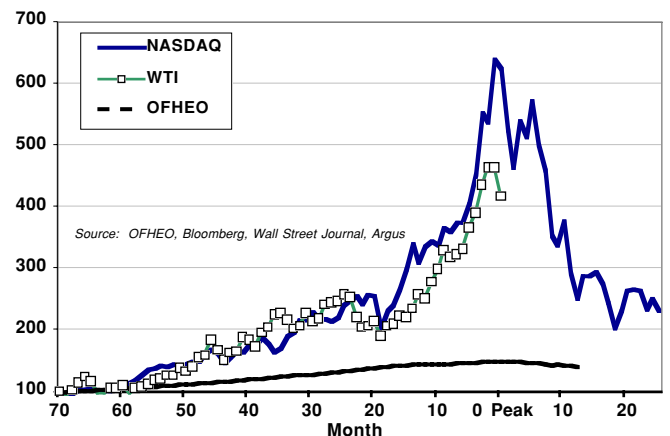
ARGUS LEADING FED FUNDS INDEX



THAT’S A BUBBLE?

We’ve charted the growth in three of the most recent bubbles in the financial markets and economy: the Nasdaq/dot.com Bubble of 2000, the increase in home prices as measured by the OFHEO Home Price Index, and the current run-up in oil prices. Our chart attempts to capture the formation of the bubble by scaling the monthly values of each index 70 months prior to a peak. We know the Nasdaq and OFHEO peaks, and for this exercise we assume the peak in oil to be July 2008. There are several interesting trends in this chart, such as the parallel ascents in the Nasdaq/dot.com run-up and crude oil (West Texas Intermediate). What may be more interesting is that the run up in home prices pales in comparison to the other “bubbles.”

PRICE BUBBLES (%)

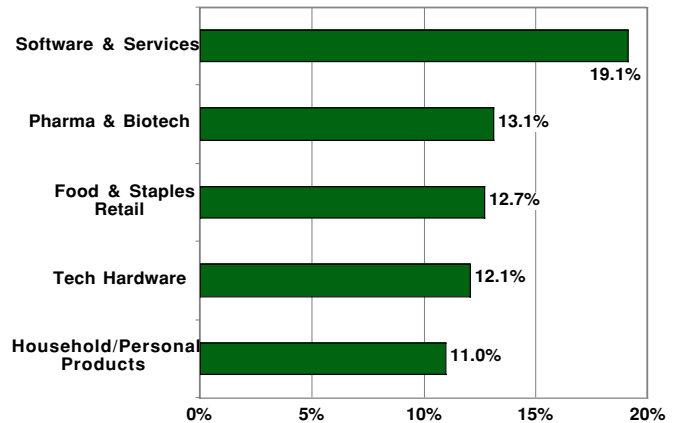


FINANCIAL MARKET HIGHLIGHTS

BEST INDUSTRIES FOR GROWTH IN 2Q08

Back in the 2001/2002 earnings recession, it was the technology sector that dragged down earnings for the S&P 500. This time around, the clouds surround banks and consumer discretionary companies. But there were several non-energy industries that posted double-digit earnings growth in the second quarter and against strong year-ago results. Most of the sectors listed below are focused in less cyclical areas like consumer staples and healthcare. But technology earnings have held up better than we expected thus far in the cycle as well. The technology sector has sold off a bit of late, we believe on the expectation that earnings in that sector will start to come under more pressure as well.

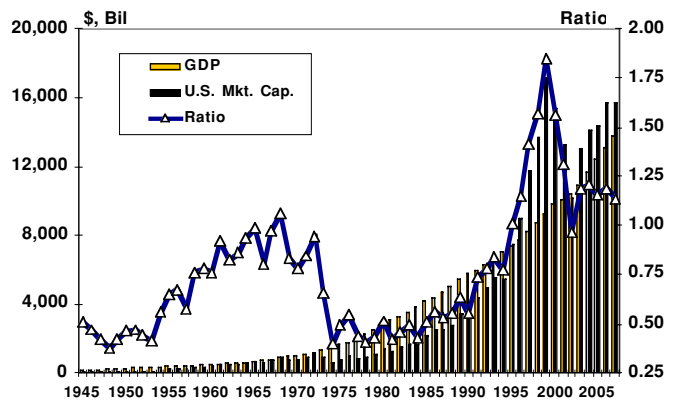
BEST GROWTH INDUSTRIES (2Q08/2Q07)



U.S. MARKET VALUE VS. GDP

Among the tools we use to value U.S. equities, we compare the value of the U.S. stock market to the value of real U.S. GDP. From 1980 through 2007, the average ratio of market cap to GDP was 91%. It wasn't until 1995 that the U.S. market began to trade at a premium to U.S. GDP; it reached a peak of 189% in 1999. Despite the near-bear market that exists today, the U.S. market still trades at 114% of GDP. But an estimated 45% of S&P 500 earnings now come from outside the U.S., nearly twice the percentage as recently as 2001. The S&P 500 accounts for about 80% of the market value of U.S. stocks. Still, bulls have speculated that U.S. stocks are already priced for a U.S. recession. We are not sure of that based on this analysis.

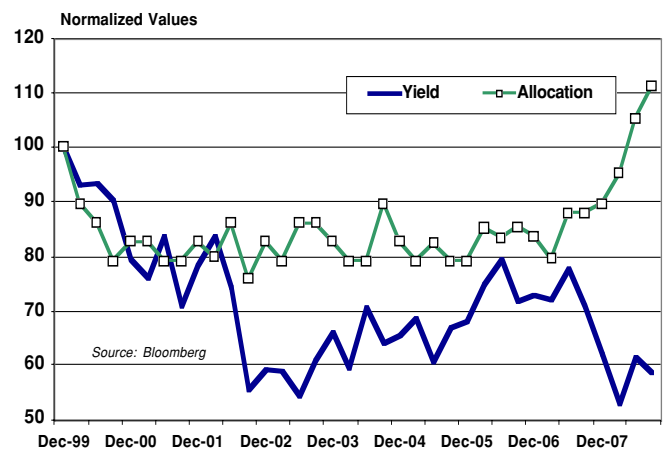
US EQUITY MARKET PRICE/SALES RATIO



BOND BULLS

The chart below shows the normalized trend in 10-Year Treasury yields along with the average recommended bond allocation by strategists at a group of Wall Street firms. For most of this decade, strategists have recommended that investors keep about 25% of a balanced portfolio in bonds. At the end of August, the recommendation was that almost one-third of a portfolio should be in bonds. These strategists are pretty smart and we suspect that some are focusing on safety, amid worries about housing and some financial firms. But as contrarians, we think it is simply worth considering whether bonds deserve a bigger portion of your portfolio when the 10-year Treasury is yielding 3.8% and the inflation rate has surged from 1.3% at the end of 2006 to 5.6% in July, the fastest pace in 17 years.

BOND BULLS?



THE ARGUS ECONOMIC OUTLOOK

	September 3, 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 Annual:	4.8	2.7	0.8	1.5	0.0	4.8	4.8	-0.2	4.8	0.9	3.3	1.3	1.0	2.6	2.0	2.9
Personal Consumption	4.3	2.8	2.2	3.7	3.9	2.0	1.0	2.4	0.9	1.7	1.8	0.7	1.8	1.2	1.3	1.8
Durables	18.9	1.8	3.5	4.2	9.2	5.0	2.3	0.4	-4.3	-2.5	-0.4	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	-0.4	4.2	1.0	0.6	1.2	0.8	3.9	1.7
Services	1.6	2.8	2.0	3.9	3.1	1.4	2.4	1.4	2.4	1.3	1.2	0.7	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	-5.8	-11.9	-11.9	1.7	1.2	2.5	3.3	6.3
Fixed Investment	8.3	-2.5	-4.8	-7.6	-3.4	3.0	-0.9	-6.2	-5.6	-2.5	-4.3	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	2.4	2.2	-1.8	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	8.7	13.6	3.9	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	-0.5	-3.2	1.8	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	-25.0	-15.8	-10.0	-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	-10.2	-49.4	-25.0	-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	5.1	13.2	6.8	5.7	5.6	6.1	6.0	5.9
Exports	18.1	6.6	3.6	10.4	2.1	6.8	21.8	5.1	4.6	16.6	8.0	6.1	4.4	4.6	4.6	5.5
Goods	13.5	2.7	3.2	28.6	-2.7	13.3	26.0	2.7	6.4	5.9	4.0	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	-0.8	-7.5	5.3	2.5	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	-1.9	-7.6	5.9	2.2	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	5.5	-7.6	1.1	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	1.9	3.9	-0.5	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	5.8	6.8	-1.0	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	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	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	2.2	-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	0.9	4.8	0.4	1.0	2.1	2.1	1.9	2.6
Final Sales of Domestic Prod.	4.8	1.6	1.0	1.5	2.2	2.5	1.9	-0.1	0.1	1.5	0.6	0.7	1.6	1.5	1.3	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	3.5	4.6	5.6	4.9	5.7	5.7	5.6	6.0
Personal Con Exp Deflator	1.8	3.3	3.1	-0.5	3.4	3.6	2.5	4.3	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	1.3	4.3	3.8	3.6	3.1	3.5	3.0

Richard Yamarone, Director of Economic Research

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