

# Numbers That Count

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# U.S. Economy: Jobs And Oil Are The Primary Drivers

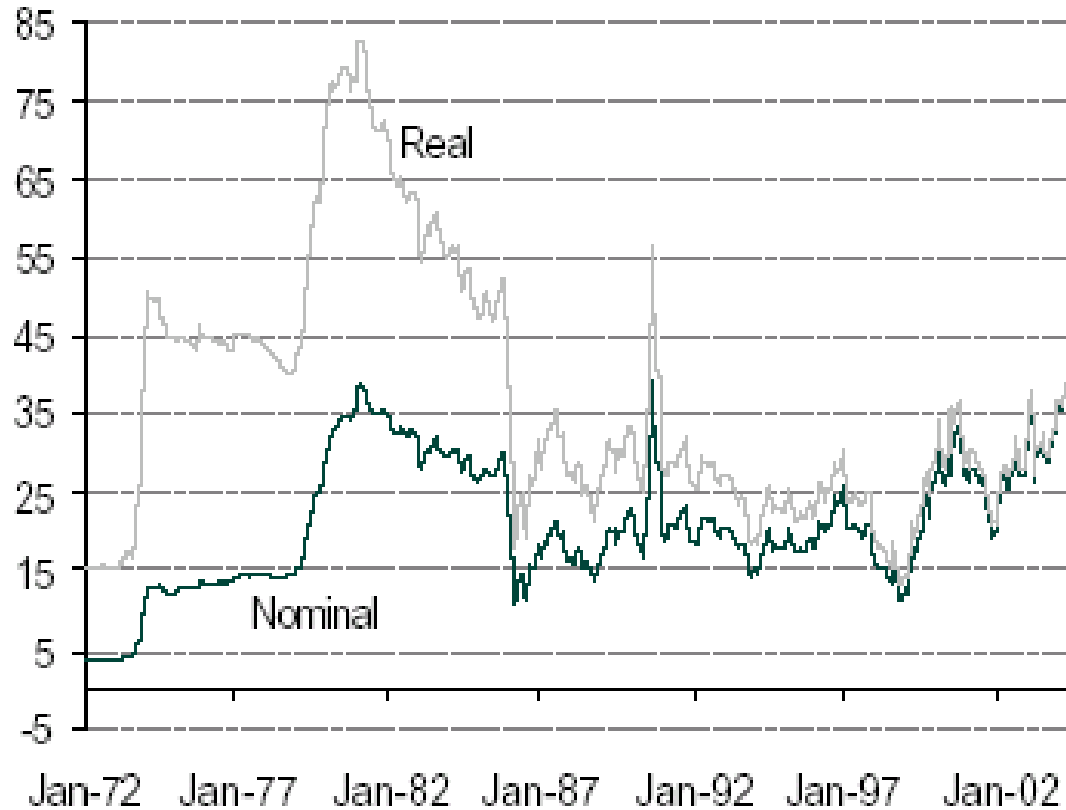
- ▶ The main jobs issue – employment growth very slow to develop in this cycle
  - Non-farm payrolls peaked at 132,507,000 in March 2001
  - U.S. recession trough occurred in November, 2001
  - Non-farm payrolls finally reached a low of 129,789,000 in August, 2003
  - The employment trough occurred 22 months after the recession trough – 1990/1991 only 10 months
  - Non-farm payrolls have now gained 1.7 MM from last August, but are still 1.0 MM below the March, 2001 peak – extremely unusual
  - Bottom line – still too much slack in the labor force!

# Crude Oil – Disruption Or Shock?

- Crude oil prices reached an all time high of \$49.40 per barrel on August 20<sup>th</sup> from \$25.47 a year ago
- Retail gasoline prices reached a national average of \$2.10 per gallon in May
- Crude oil prices averaged \$10.41 in 1974 relative to \$2.83 in 1973 – a 267.8% increase. We might agree this was a “shock”
- Crude oil increased from \$14.55 per barrel in 1978 to \$37.96 in 1980 – an increase of 160.9% and the equivalent of \$86.93 in today’s dollars. Here again the word “shock” might apply

# Crude Oil Prices

\$/barrel



Source: Global Financial Data, BLS, and Lehman Brothers

# “Disruption” Not “Shock”

- We have “disruption” not “shock”
  - No threat of supply disruption
  - U.S. energy consumption a small part of GDP
  - Can’t associate oil price shock with recession
  
- At most the impact on economy was a “soft patch” not an impairment of the cyclical expansion

# U.S. Real GDP Growth 1990-2005

- ▀ Economic growth over the last 4 quarters has been good



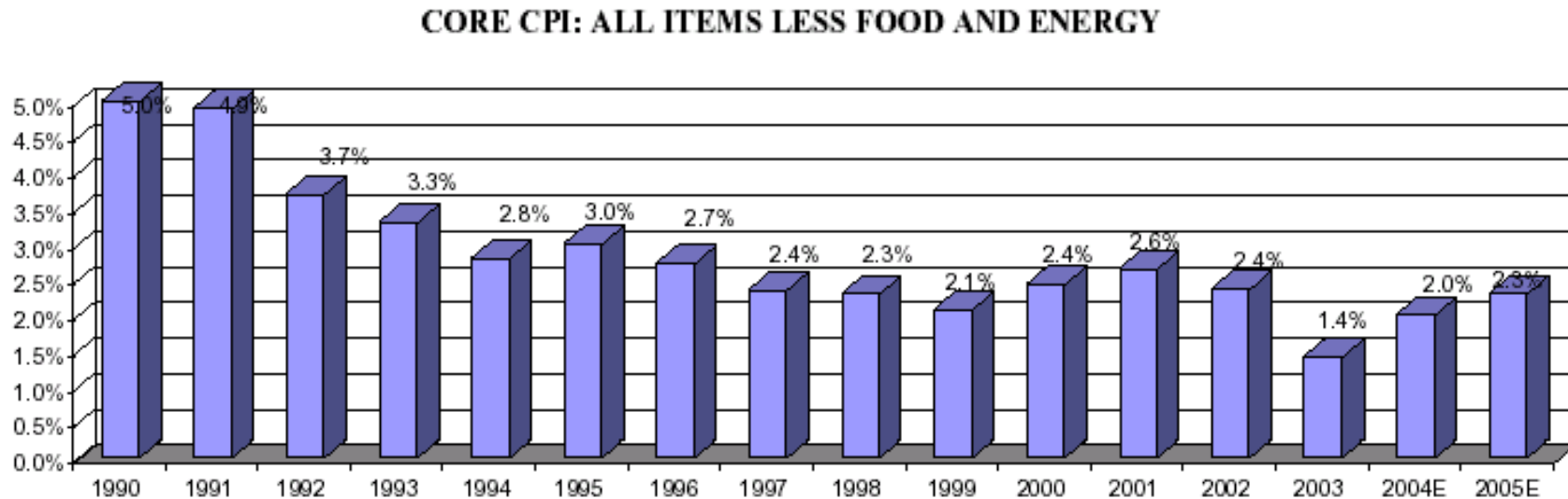
Source: Historical Statistics - U.S. Dept. of Commerce, Bureau of Economic Analysis (<http://www.bea.gov/bea/dn1.htm>),  
Projections - Internal Estimates.

# Forces Driving U.S. Growth Are Still Powerful

- The second quarter slowdown a challenge to our forecast of solid growth in the 2<sup>nd</sup> half of 2004, but usual signs of self growth not present
  - Trend in new claims for unemployment insurance down, not up
  - Manufacturing output and employment up sharply
  - Business investment spending increased at a tremendous pace in the 2<sup>nd</sup> quarter
  - Lower than expected interest rates are keeping housing activity at high levels
  - Personal income growth provides excellent support to consumption
  - Productivity gains are still driving business profits up
  
- Our growth forecasts
  - Real GDP up +4.3% in 2004 and +3.6% in 2005
  - Civilian unemployment rate average 5.4% in 2004 and 5.2% in 2005

# The Inflation Story

- ▀ The secular decline still dominates over the cyclical upturn



- ▀ Headline inflation up +2.7% in 2004 and +2.8% in 2005
- ▀ Core inflation up +2.0% in 2004 and +2.3% in 2005

Source: Historical Statistics - U.S. Dept. of Labor, Bureau of Labor Statistics (<http://data.bls.gov/cgi-bin/surveymost?cu>);  
Projections - Internal Forecasts.



# Interest Rates Remain Low






	12/31/2003	3/17/2004 Low*	6/14/2004 High*	6/30/2004	9/24/2004
2-year	1.84%	1.47%	2.93%	2.69%	2.58%
10-year	4.26%	3.68%	4.87%	4.58%	4.03%
2-10-year spread	+242	+221	+194	+189	+147

\*Based on the 10-year Treasury bond

# The Outlook For Rates – Surprisingly Low

- The current low level of rates one of the surprises of 2004 but we still expect that they will move up
  - The Fed will continue to remove accommodation despite more moderate growth and reduced inflation expectations
  - There is no over heating or need to aggressively counteract inflationary tendencies so the reaction of rates to Fed action is muted
  
- The year end outlook for U.S. Treasury rates
  - Federal funds rate target of 2.00%
  - 10-year treasury at 4.75%
  - 2-year treasury at 3.00% – 3.25%
  - 2-10-year slope of +1.50% – +1.75%

# Economic Statistics Of G-7 Countries

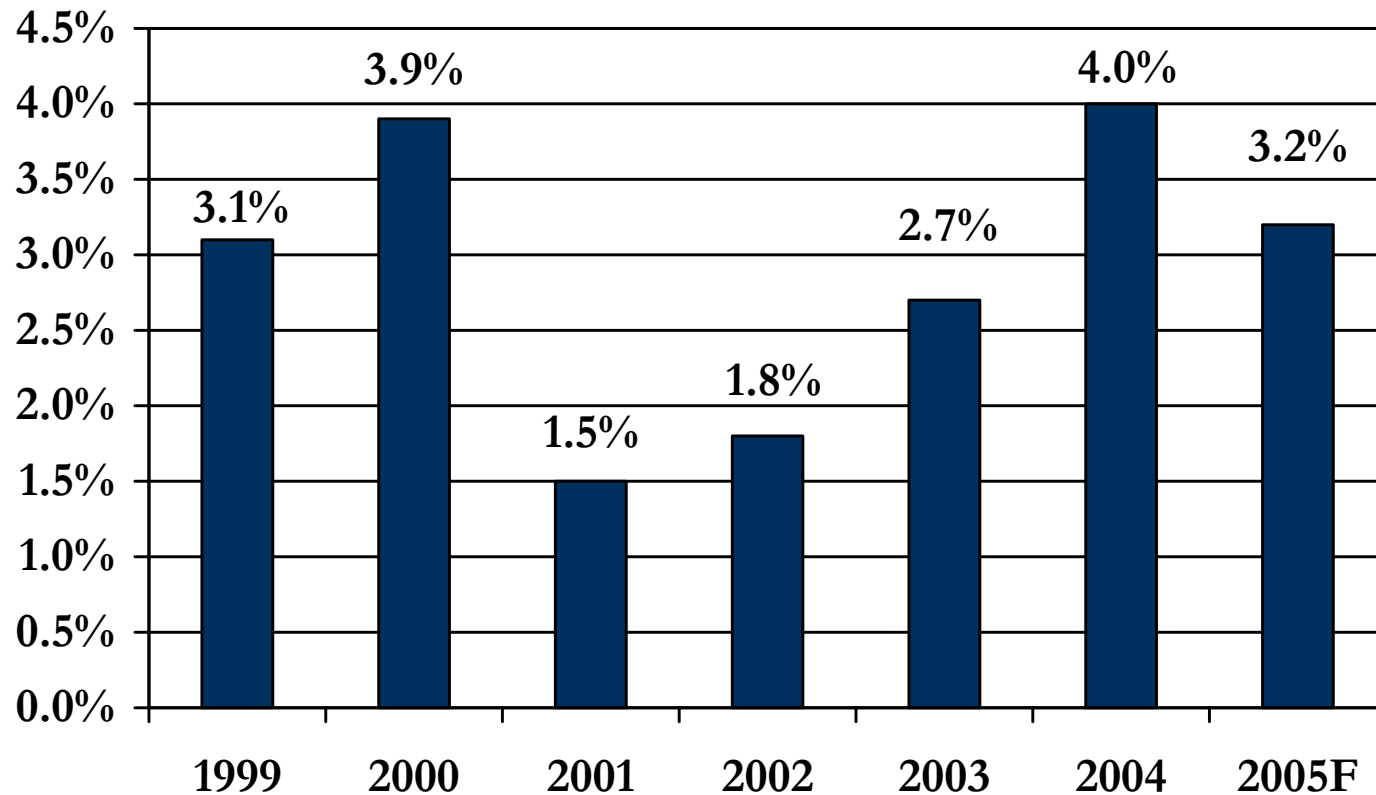
			<u>Real GDP</u>	<u>CPI</u>	<u>Benchmark Rate (EOP)</u>	<u>10 yr. Rate (EOP)</u>
	<b><u>US:</u></b>	2001	0.8%	2.8%	1.75%	5.05%
		2002	1.9%	1.6%	1.25%	3.81%
		2003	3.0%	2.3%	1.00%	4.26%
		2004F	4.3%	2.7%	2.00%	4.75%
		2005F	3.6%	2.8%	3.75%	5.00%
	<b><u>Euroland:</u></b>	2001	1.6%	2.3%	3.25%	5.00%
		2002	0.9%	2.2%	2.75%	4.20%
		2003E	0.5%	1.9%	2.00%	4.35%
		2004F	1.75%	1.9%	2.00%	4.75%
		2005F	2.0%	1.8%	2.50%	5.25%
	<b><u>UK:</u></b>	2001	2.1%	1.2%	4.00%	5.05%
		2002	1.7%	1.3%	4.00%	4.37%
		2003E	2.3%	1.4%	3.75%	4.80%
		2004F	3.3%	1.6%	5.00%	5.50%
		2005F	2.7%	2.0%	5.50%	5.75%
	<b><u>Japan:</u></b>	2001	0.4%	-0.7%	0.10%	1.37%
		2002	-0.4%	-0.7%	0.10%	0.91%
		2003	2.7%	-1.0%	0.10%	1.36%
		2004F	4.5%	-0.1%	0.10%	1.90%
		2005F	2.8%	0.3%	0.10%	1.85%
	<b><u>Canada:</u></b>	2001	1.9%	2.5%	2.25%	5.36%
		2002	3.3%	2.3%	2.75%	4.70%
		2003	1.7%	2.8%	2.75%	4.60%
		2004F	2.9%	1.9%	2.25%	5.10%
		2005F	3.4%	2.0%	3.25%	5.50%

E - Estimate; F - Forecast

Source: Economic Intelligence Unit, International Monetary Fund, OECD & Sovereign Group

# World Growth 1999-2005F

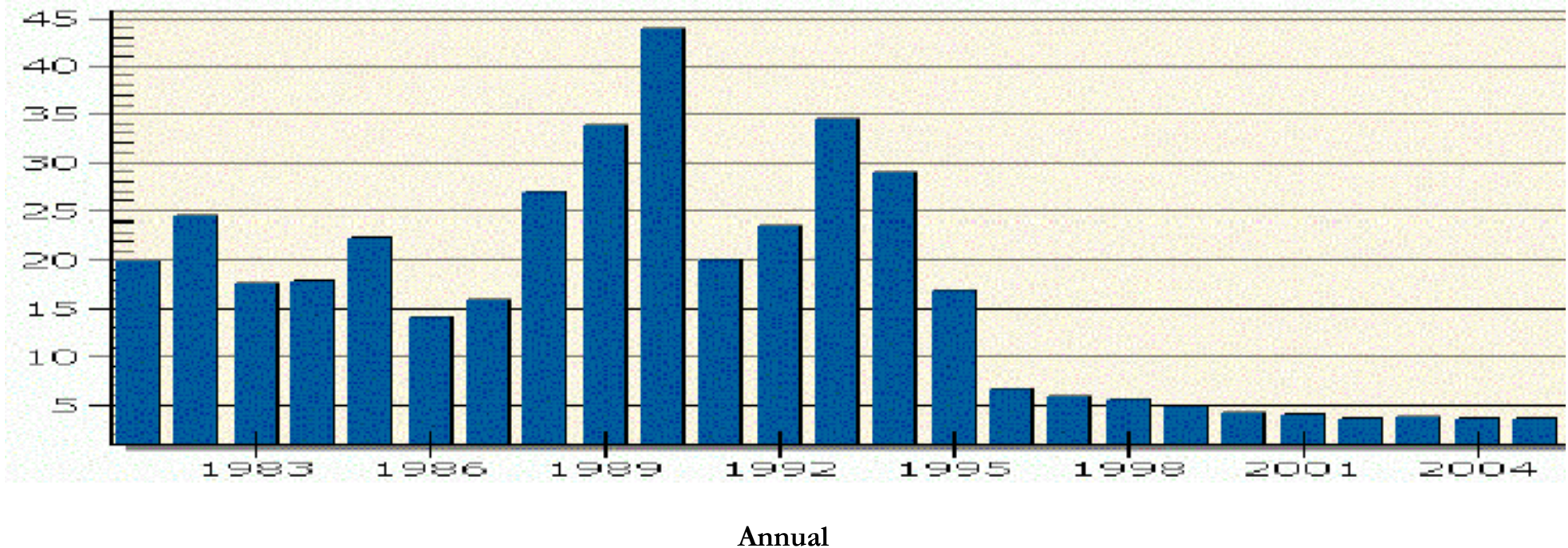
Forecast closing date: August 24<sup>th</sup> 2004



Source: Economist Intelligence Unit

# World Inflation Remains Subdued

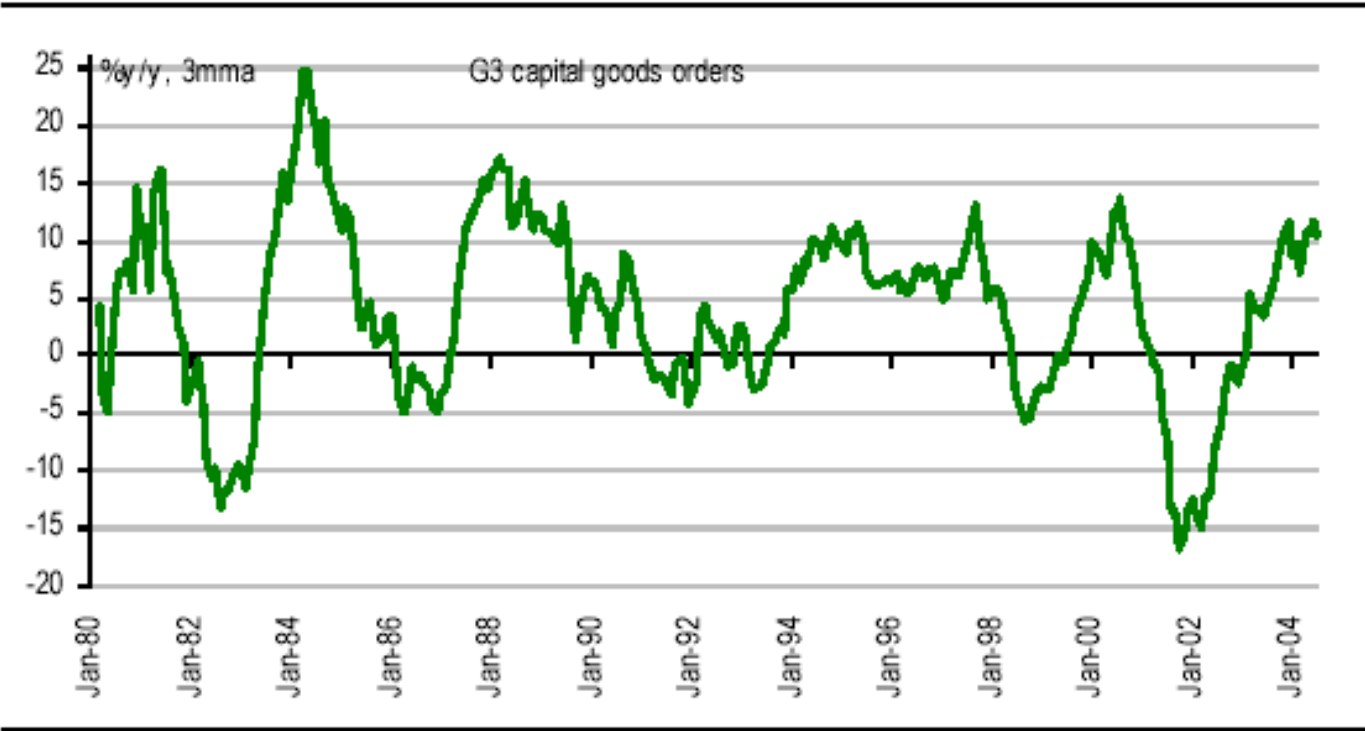
World – Consumer Prices (% change pa; av)



Source: Economist Intelligence Unit

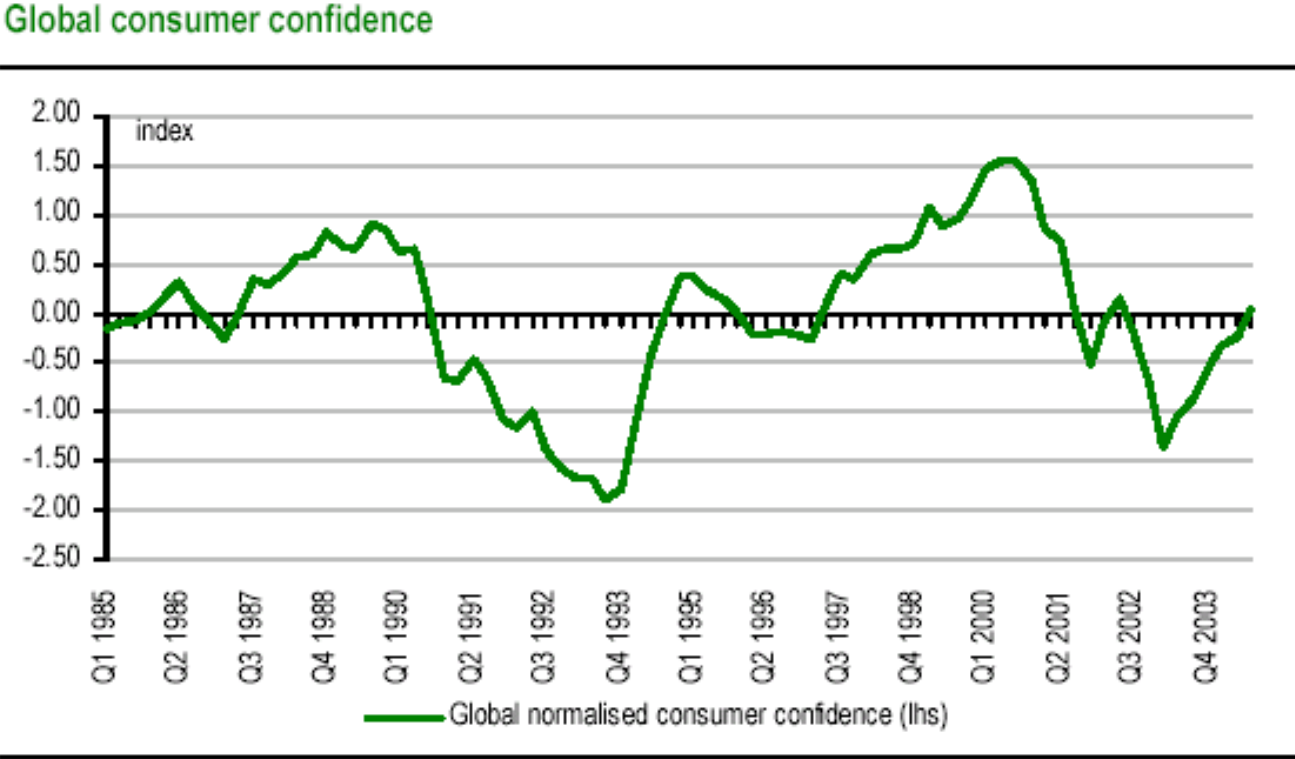
# Business Investment Continues At A Moderate Rate

G3 capital good orders still suggest recovering capex momentum



Source: Thomson Financial Datastream/UBS

# Household Optimism Remains High



Source: Thomson Financial Datastream/UBS calculations. An aggregation of consumer confidence indices in the US, the eurozone and Japan. Q3 observation is based on average monthly outturns so far.

# The "Election Effect" For U.S. Bond And Equity Returns 1945 To 2004

	Total Returns			10-year Treasury Yield
	Gov't	Corp	Equity	
<b>1945-2003</b>				
<b>Democrats Overall</b>	<b>3.50%</b>	<b>4.62%</b>	<b>15.16%</b>	<b>4.46%</b>
Year 1	5.50%	6.37%	19.95%	5.60%
Year 2	2.32%	2.96%	5.42%	4.11%
Year 3	2.49%	2.81%	22.58%	2.16%
Year 4	3.70%	6.36%	12.68%	5.97%
<b>Republican Overall</b>	<b>8.75%</b>	<b>9.23%</b>	<b>10.95%</b>	<b>4.52%</b>
Year 1	8.39%	9.04%	1.06%	4.25%
Year 2	14.23%	11.56%	9.47%	3.34%
Year 3	4.19%	6.50%	21.45%	4.57%
Year 4	8.13%	9.91%	11.97%	6.10%

Source: Lehman Brothers



# Average Movements During Each Year Of A Presidency Since 1948

	1 <sup>st</sup> yr	2 <sup>nd</sup> yr	3 <sup>rd</sup> yr	4 <sup>th</sup> yr
S&P 500	12%	18%	4%	6%
Change in unemployment	-0.39%	-0.12%	0.28%	0.24%
Change in real per capita disposable income	3.01%	1.88%	2.15%	2.03%
GDP	3.70%	3.83%	2.76%	3.51%
CPI	4.08%	3.83%	3.99%	3.46%
Change in 10yr (bp)	10	33	-14	-17
Change in slope (bp)	-7	2	9	-6

Source: DB Global Markets Research

# University Of Iowa Electronic Markets Future Contracts

As of September 24, 2004

