

THE ECONOMY AT A GLANCE

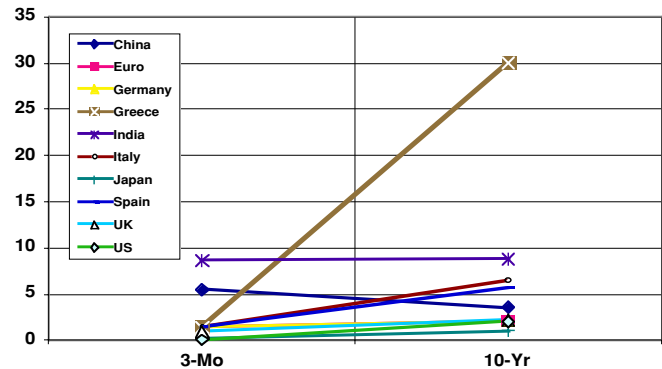
ECONOMIC HIGHLIGHTS

January 9, 2012
Vol. 79, No. 1

BOND MARKET DISTORTIONS

While short-term interest rates in Europe are uniform (they are generally set by the ECB), long-term rates reflect the degrees of sovereign default risk. Greek debt is off the charts, yielding more than 30%. Italian debt yields are above 6%, and Spanish yields have settled above 5%. Meanwhile, German long-term debt yields close to 2%, in line with U.S. yields. The Chinese yield curve is inverted and the Indian curve is flat, as local monetary authorities seek to quell inflation. Unfortunately, interest rate changes don't seem to be a likely way out of the European mess. Budget cuts, austerity programs, tax hikes and debt forgiveness are the likely unpopular answers.

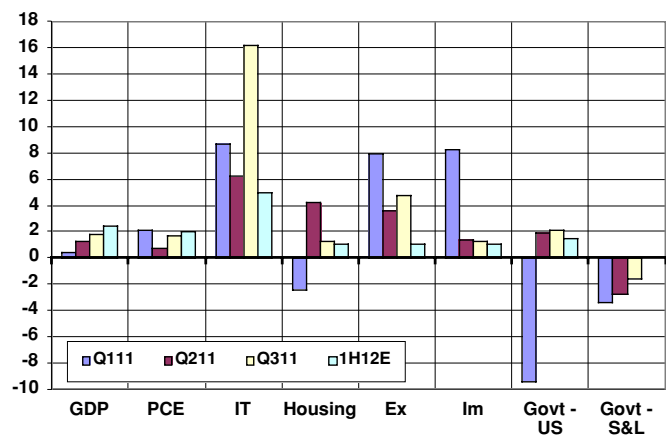
GLOBAL SOVEREIGN INTEREST



3Q GDP GROWTH REVISED SLIGHTLY LOWER

The U.S. Department of Commerce lowered its third and final estimate for 3Q11 GDP growth to 1.8% from 2.0%. Though the overall economy has shown improvement each quarter in 2011, the results have been below trend and generally uneven. In the first quarter, Personal Consumption Expenditures supported GDP. In the second quarter, Housing was positive. In the third quarter, investments into Technology soared. But government spending — a key driver in the past, particularly in the first few quarters out of a recession — has been a non-factor. Looking ahead, we expect to see continued modest improvement in the economy in the first half of 2012. We look for PCE to again be a key driver, based on improving trends in the employment situation.

GDP GROWTH DRIVERS

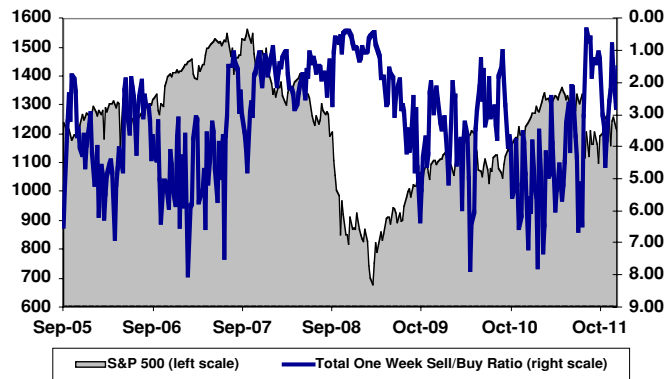


ECONOMIC HIGHLIGHTS (CONTINUED)

INSIDER SENTIMENT BULLISH

Insiders have turned bullish once again. Recent market volatility has given these insiders ample opportunity to adjust their holdings. And when the recent dust settled, the latest reading of insider sentiment (as indicated in the Sell/Buy Ratios maintained by Vickers Stock Research) has once again dropped below two sales per purchase (bullish by historical standards). The number of Form-4 filings registering a purchase has remained relatively stable, while the number of filings reporting a sale has swung wildly on a week-over-week basis lately — but with the current number of sales having declined 36% since last week. We view this steady level of purchasing by corporate insiders as a bullish sign, as those in the corner offices seem to have a positive near-term outlook for the market.

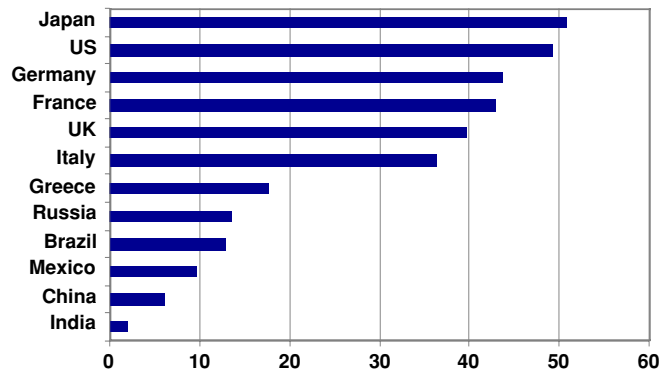
ONE WEEK SELL/BUY RATIO



HAVES VS. HAVE NOTS

Consider that as fast as China has been growing over the past five years (it is now the second-largest economy in the world), GDP/per capita is still 12% of the level of the U.S. In short, we think the outsourcing trend is likely to continue for decades, as the U.S. favors lower-cost goods and China attempts to increase its standard of living. In Europe, wealth standards in Greece are less than half the standards in Germany. This disparity helps explain the environment of unrest in Greece, as Northern nations insist on austerity measures for Southern countries. To make the currency union work, the Northern nations are going to have to implement programs that ultimately reduce the prosperity gap over the long term.

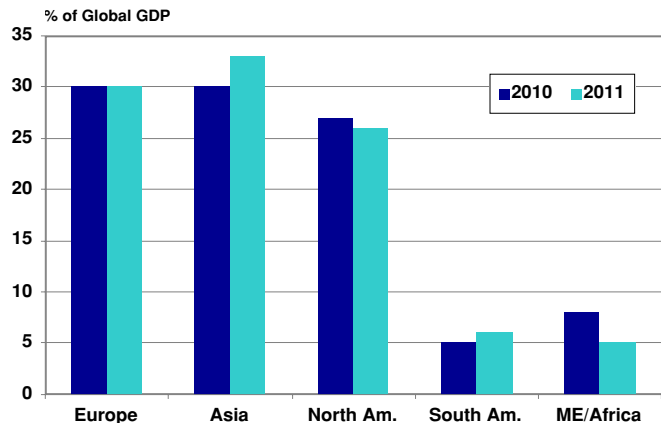
GDP/CAPITA (\$,000)



ASIA CONTINUES TO GROW

A year ago, both Europe and Asia accounted for 30% of global GDP; in 2011, Asia's stake rose to 33%. According to our analysis, North America slipped from 27% to 26%, and the Middle East/Africa region declined from 8% to 5%. The other growth region in 2011 was South America, which increased its share to 6% from 5%. Looking ahead, we suspect that Europe's stake will decline in 2012, as many of the economies decline due to the Euro crisis. We would not be surprised to see the North American share increase, given improving trends in the U.S. economy. That said, Asia once again looks primed to increase its stake of global GDP, given falling interest rates in China and an expected recovery in Japan after the earthquake/tsunami in March.

GLOBAL ECONOMIC BREAKDOWN

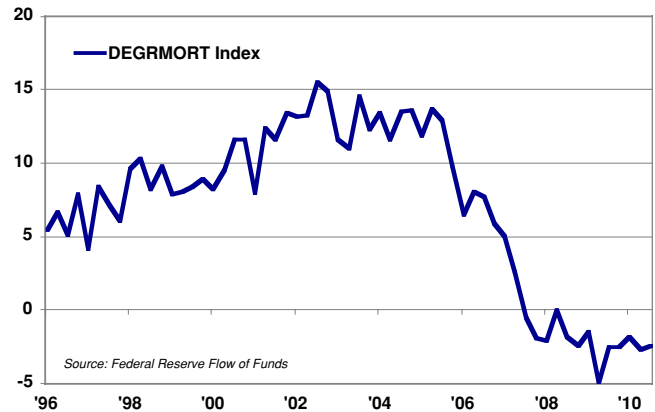


FINANCIAL MARKET HIGHLIGHTS

HOUSEHOLD DEBT STILL FALLING

Household debt grew at high single-digit to low double-digit growth rates for many years until the bottom fell out. Growth rates slowed sharply starting in mid-2006 and turned negative in the summer of 2008. Debts are being slashed mostly because of write-offs by banks, but the surge in debit-card usage over the past few years also indicates to us that consumers are afraid to put money on credit cards. Credit is also much less available because banks have slashed credit lines and tightened underwriting — but also because of the precipitous decline in home equity available to borrow against. The reduction in consumer leverage is a long-term positive — but if consumers are going to shun credit and increase spending, then the spending will have to be funded by income growth.

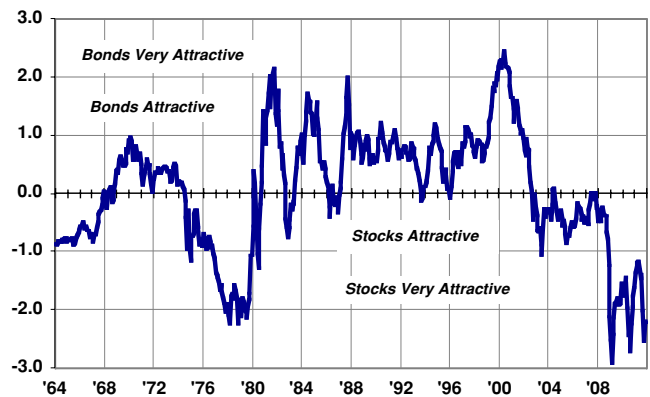
TOTAL HOUSEHOLD DEBT GROWTH



STOCKS REMAIN CHEAP

We favor equities over fixed income securities for relative outperformance in 2012 based on earnings trends, the historically low level of interest rates and an expected downtrend in the dollar (which we think will drive investors, over time, toward riskier assets). Our Bond/Stock mix barometer is now indicating that stocks are undervalued compared to bonds by more than two standard deviations. We recommend a 65% weighting in equities and a 25% weighting in bonds. Within equities, we suggest 25% exposures to global equities and small/mid-caps. Within bonds, we favor TIPS as an inflation hedge. Our Asset Allocation model also recommends a 5% weighting in cash and a 5% weighting in commodities (where we favor precious metals, industrial metals and agriculture).

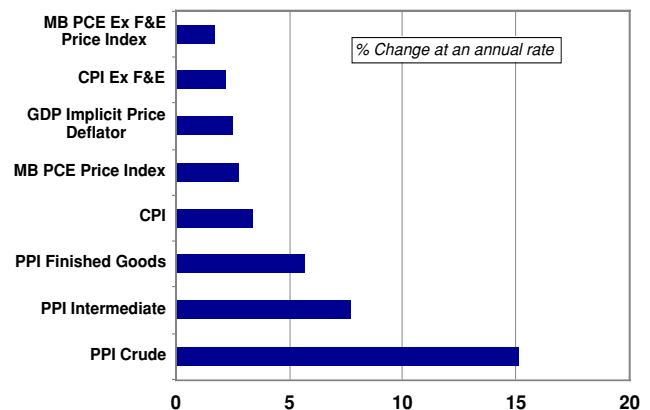
BOND / STOCK MIX BAROMETER



PPI CRUDE TICKS HIGHER

Rising energy prices caused a spike at the PPI Crude level in November. Prices at the base of the U.S. economy rose 3.8% in November, driven by a 10.5% increase in energy prices. For the trailing 12 months, PPI Crude prices have climbed 15% — up from a 12.5% rate last month. Will this pricing pressure ultimately affect the consumer? The recent trend has been in the other direction, as for the past three months, pricing pressures at the consumer level have been declining. On average, our main consumer-oriented inflation measures (core CPI, the GDP Implicit Price Deflator and the Market-Based ex-Food & Energy PCE Price Index) have increased 2.1% year-over-year, flat month-to-month. This backdrop of modest pricing pressure but no deflation may give the Fed a bit of room to maneuver.

MEASURES OF INFLATION



ECONOMIC CALENDAR

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
Tue. 1/3	ISM Manufacturing	December	53.00	54.00	53.40	N/A
	FOMC Minutes	N/A	N/A	N/A	N/A	N/A
	Construction Spending	November	0.8%		0.4%	N/A
Wed. 1/4	Factory Orders	November	-0.8%	-1.0%	2.0%	N/A
	Total Vehicle Sales	December	13.59M	13.8M	13.5M	N/A
Thur. 1/5	ISM NonManufacturing	December	52.00	52.50	53.00	N/A
Fri. 1/6	Nonfarm Payrolls	December	120k	125k	150k	N/A
	Private Payrolls	December	140k	150k	170k	N/A
	Manufacturing Payrolls	December	2k	5k	5k	N/A
	Unemployment Rate	December	8.6%	8.6%	8.7%	N/A
	Average Hourly Earnings	December	-0.1%	0.2%	0.2%	N/A
	Average Workweek	December	34.3 hrs,	34.3 hrs	34.3 hrs	N/A

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
Tue. 1/17	NY State Manufacturing	January	9.53	NA	N/A	N/A
Wed. 1/18	Producer Price Index	December	0.3%	0.5%	N/A	N/A
	PPI ex-Food&Energy	December	0.1%	0.3%	N/A	N/A
	Industrial Production	December	-0.2%	0.5%	N/A	N/A
	Capacity Utilization	December	77.8%	78.0%	N/A	N/A
Thur. 1/19	Consumer Price Index	December	0.0%	0.2%	N/A	N/A
	CPI ex-Food&Energy	December	0.2%	0.2%	N/A	N/A
	Housing Starts	December	685k	675k	N/A	N/A
	Philadelphia Fed.	January	10.30	NA	N/A	N/A
Fri. 1/20	Existing Home Sales	December	4.42M	4.5M	N/A	N/A

* Preliminary

** Advance

^Final

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