

THE ECONOMY AT A GLANCE

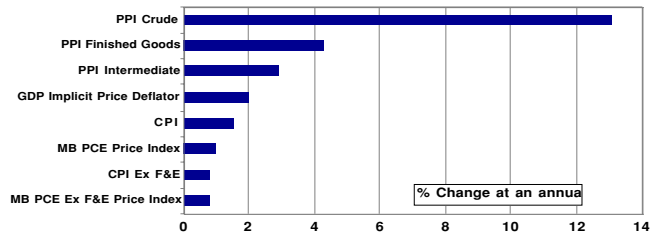
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ECONOMIC HIGHLIGHTS

INFLATION PERCOLATING BELOW SURFACE

Consumer prices have been rising at a 1%-2% annual rate through December. But producer price inflation for finished goods rose at a 4.3% pace over the past year, driven lately by rising energy prices. Deeper in the production pipeline, pricing pressures are even more pronounced. The Federal Reserve's quantitative easing program is designed to push price increases to the 2% range. Central bankers will have to maintain vigilance so they don't overshoot their target.

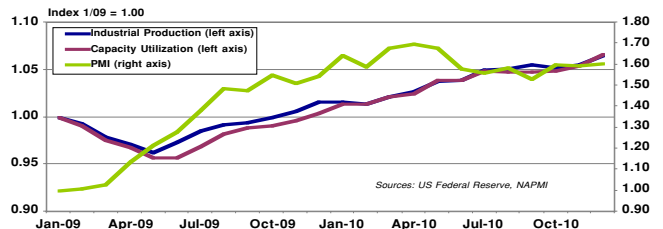
MEASURES OF INFLATION



INDUSTRIAL SECTOR RECOVERY CONTINUES

The Industrial sector appears poised to extend recent positive trends. A downtrend in the U.S. dollar is expected to improve the competitiveness of U.S. goods in global markets. Also, 5%-8% economic growth rates in emerging economies should support demand for U.S. goods. Businesses have been drawing down inventories since 2007. Only recently have business sales picked up. The low level of the sales/inventory ratio suggests that companies will be building stockpiles over the next few quarters.

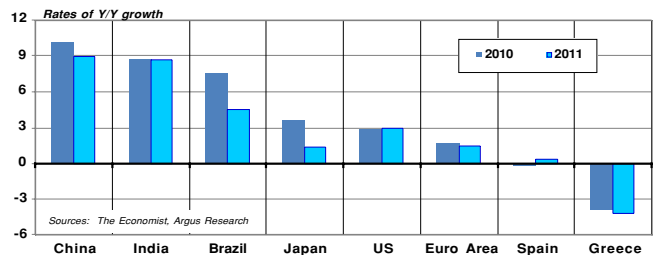
INDUSTRIAL SECTOR METRICS



EMERGING ECONOMIES TOP GROWTH CHARTS

We look for 2011 growth in Emerging Economies to outpace growth in the leading industrialized nations. Estimated growth rates for the BRIC nations are, on average, 6.5% and generally rising. Meanwhile, the estimated growth rate for the U.S., UK, Euro-area and Japan in 2011 is, on average, 2% — though it has been ticking slightly higher in the past month. The commodity-based BRAC nations are forecast to grow 3.6%, suggesting natural-resource exposure alone won't drive the fastest global growth.

GLOBAL GDP FORECAST

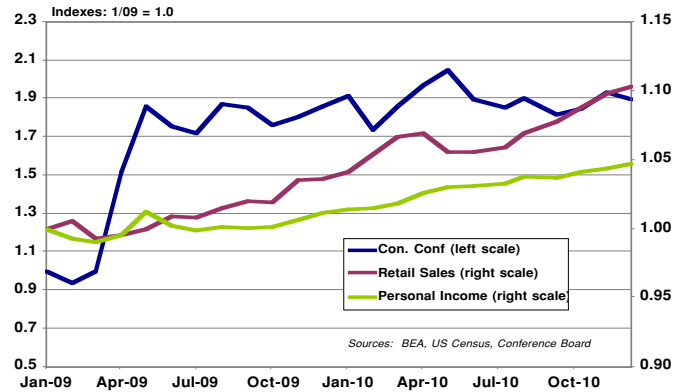


ECONOMIC HIGHLIGHTS (CONTINUED)

CONSUMER METRICS POINT HIGHER

We look for the Consumer sector to grow at a low single-digit pace through 2011. Three of the key metrics we follow – Retail Sales, Consumer Confidence and Personal Income – are generally on the upswing again after a summer slowdown. Auto sales, which were above a 12-million annual run rate in December for the third month in a row, are performing better as well. It is important to note, though, that even as these indicators are higher over the past two years, major segments of the economy have not fully recovered. But from an investment standpoint, we think investment opportunities are better when there is uncertainty or pessimism in the marketplace, as is currently the case.

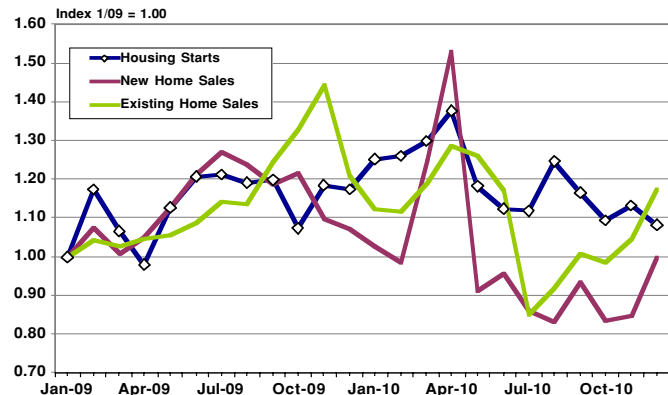
CONSUMER TRENDS



HOUSING MARKET STILL IN FLUX

After a brief recovery in the first half of 2010, the housing industry essentially stalled and trends returned to the levels of the first quarter of 2009 — when the recession touched bottom. Where to from here? We think higher. The industry is all about supply and demand. While reported inventories indicate that current sales trends can clear the market in as few as eight months, the “shadow inventory” of houses on the books of banks likely adds another four months worth of extra homes. However, also on the supply side, housing starts remain low. This bodes well for the future. We suspect the housing market has now formed a double-bottom, and look for slow 1%-2% growth over the next two to three years as unemployment remains above 8%.

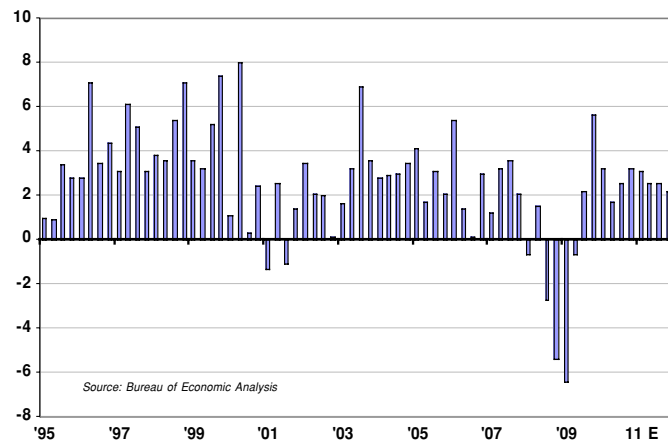
HOUSING INDUSTRY METRICS



GDP GROWTH PICKS UP IN 4Q

The U.S. economic expansion picked up a bit of speed in the fourth quarter, as the Commerce Department has reported GDP expanded at a 3.2% rate. This compares favorably to the 2.6% pace recorded in 3Q, and is essentially in line with our forecast of 3.3% growth. Personal consumption expenditures (PCE) rose at a solid 4.4% pace in 4Q, substantially better than the 2.4% pace in 3Q. Investment in equipment and software increased 5.8%, as the tech expansion continued. Real exports increased an impressive 8.5%, as imports fell 13.5%. On the negative side, a draw-down in inventories constrained growth, and government spending was lower. We are maintaining our above-trend estimates through Q1, though we expect growth may moderate in the second half as interest rates drift higher.

REAL GDP

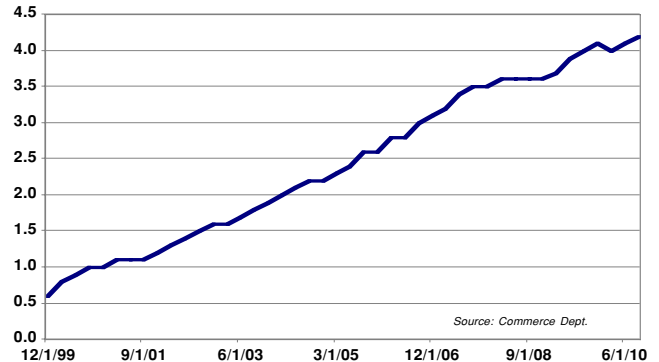


FINANCIAL MARKET HIGHLIGHTS

E-COMMERCE SHINES IN HOLIDAY SEASON

According to SpendingPulse from MasterCard Advisors, retail sales excluding auto were up 5.5% over last holiday season, as measured from November 5 through December 24. E-commerce was the standout sector, with sales rising 15.4% from last year but still representing only about 4.2% of total retail sales. However, e-commerce sales have been rising steadily as a percent of total retail sales. Purchases made on smartphones are still a tiny fraction of e-commerce sales, but we expect this to be the next hot growth area. Telecoms, banks & transaction processors and others are jockeying to develop secure e-payment applications for smartphones.

E-COMMERCE SALES (% OF TOTAL U.S. RETAIL SALES)



BANK STOCK VALUATION

In considering bank stocks, we looked at multiple scenarios for ROE, growth and cost of equity capital to derive fair values for the price-to-book value multiple. The fundamental price-to-book value ratio simply takes projected ROE less projected growth, and divides by the cost of equity capital less projected growth. This model is very sensitive to assumptions used, but we think the most-likely scenario is #3 in our graphic (ROE returning to double-digits, growth in the high single-digits and beta close to 1), which results in a price-to-book value ratio of 1.3 and suggests limited current upside. Still, we believe returns and growth will remain far from historical peaks and, as a result, so will valuation metrics.

BANK STOCKS: BOOK-VALUE VALUATION SCENARIOS

Assumptions		
ROE	Growth Rate	CAPM Cost of Equity
20%	12%	15%
15%	10%	13%
12.5%	8%	11.5%
10%	7%	10%
8%	5%	10%

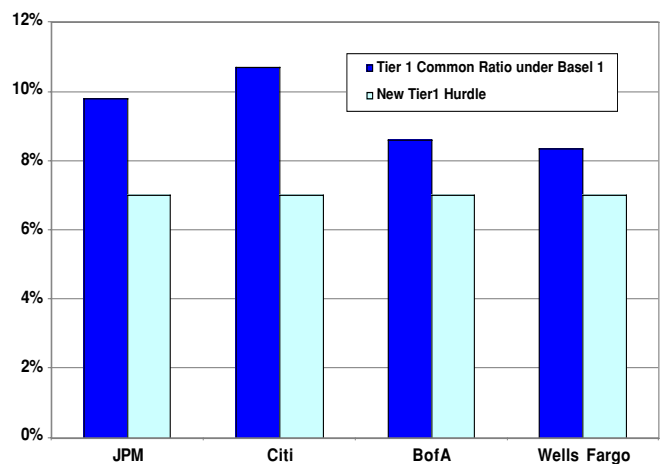
Scenarios	Justified Price-to-Book Ratio
1 High ROE, High Growth, High Beta	2.7
2 15% ROE, 10% Growth, Beta still above average	2.0
3 12.5% ROE, 8% Growth, Beta lower still	1.3
4 10% ROE, 7% Growth, Beta near 1	1.0
6 Low ROE, Low Growth, Beta near 1	0.6

Source: Argus Estimates, CAPM assumes 11% market return and current 10-year T-Note Yield

BANK CAPITAL CONTINUES TO INCREASE

In September, the Basel Committee on Banking Supervision agreed to a global framework for bank capital standards. The accord will nearly double the required capital ratios for banks but banks will have until Jan. 1, 2015, to comply with the new minimum capital ratios (4.5% for the ratio of common equity to risk-weighted assets and 6% for Tier 1 capital to risk-weighted assets). By Jan. 1, 2019, banks must have an additional 2.5% “conservation buffer” of common equity in place bringing the total ratios up to 7% for common equity and 8.5% for Tier 1. The largest U.S. banks already stack up well against the agreed upon capital ratios. What remains to be seen is which banks U.S. regulators will deem “systemically important” and thus subject to an additional capital buffer.

BANK CAPITAL VS. BASEL 3 RULES



ECONOMIC CALENDAR

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
Mon. 1/31	Personal Income	December	0.4%	0.5%	0.4%	0.4%
	Consumer Spending	December	0.3%	0.6%	0.5%	0.7%
	Chicago PMI	January	68.6	69	64	68.8
Tue. 2/1	Construction Spending	December	-0.20%	0.40%	0.20%	-2.50%
	ISM Manufacturing Survey	January	57	57.2	57	60.8
	Total Vehicle Sales	January	12.53M	12.5M	12.6M	N/A
Thur. 2/3	Nonfarm Productivity*	Q4	3.1%	3.1%	2.0%	N/A
	Unit Labor Costs*	Q4	-0.1%	1.0%	0.4%	N/A
	ISM Nonmanufacturing Survey	January	57.1	57.5	56.8	N/A
	Factory Orders	December	0.7%	1.0%	1.7%	N/A
Fri. 2/4	Nonfarm Payrolls	January	103k	120k	138k	N/A
	Manufacturing Payrolls	January	10k	25k	N/A	N/A
	Unemployment Rate	January	9.4%	9.5%	9.5%	N/A
	Average Hourly Earnings	January	0.1%	0.1%	0.2%	N/A
	Average Workweek	January	34.3hrs	34.6hrs	34.4hrs	N/A

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
Tue. 2/15	NY State Manufacturing Index	February	11.92	NA	N/A	N/A
	Import Price Index	January	1.1%	1.2%	N/A	N/A
	Advance Retail Sales	January	0.6%	0.4%	N/A	N/A
	Retail Sales ex-Autos	January	0.5%	0.3%	N/A	N/A
	Business Inventories	December	0.2%	0.2%	N/A	N/A
Wed. 2/16	Housing Starts	January	529k	500k	N/A	N/A
	Producer Price Index	January	1.1%	1.1%	N/A	N/A
	PPI ex-Food & Energy	January	0.2%	0.4%	N/A	N/A
	Industrial Production	January	0.8%	0.8%	N/A	N/A
	Capacity Utilization	January	76.0%	76.2%	N/A	N/A
Thur. 2/17	Consumer Price Index	January	0.5%	0.5%	N/A	N/A
	CPI ex-Food & Energy	January	0.1%	0.2%	N/A	N/A
	Leading Economic Indicators	January	1.0%	1.0%	N/A	N/A
	Philadelphia Fed	February	19.3	NA	N/A	N/A

* Preliminary

** Advance

^Final

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