BEACON ECONOMICS

Is the bounce for real?

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Principal, Beacon Economics

Will the real economy stand up?

- The great downturn of 08-09
  - What was NOT the cause? The credit markets
  - The causes: the big three imbalances: housing, the national asset bubble, and the consumer
- Where are we now?
  - The good news: The recession is over
  - The bad news: we haven't completely fixed the problems, instead the economy is being driven by government policy
  - The worse news: government policy is causing its own set of problems: namely public debt and the potential for inflation
- What next?
  - Fundamentals say weak recovery and a double dip in 2011
  - Policy choices and financial markets can alter this substantially
  - The best advice: enjoy the stability, but be cautious about the future

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Taking stock of the last year

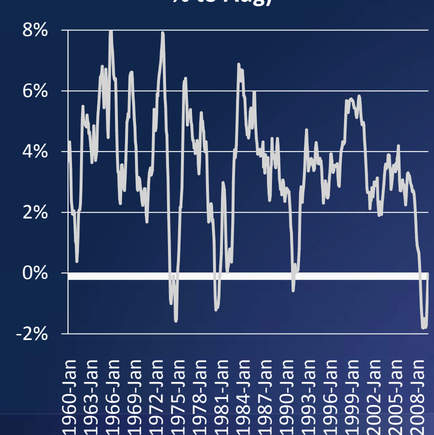
	08-II	09-II	Ch	Cont.
GDP	13415	12901	-3.8%	
Personal consumption	9351	9189	-1.7%	-1.2%
Durable goods	*1175*	*1071*	*-8.8%*	*-0.8%*
Nondurable goods	*2081*	*2025*	*-2.7%*	*-0.4%*
Services	*6092*	*6078*	*-0.2%*	*-0.1%*
Gross investment	2026	1456	-28.1%	-4.2%
Structures	*493*	*400*	*-18.9%*	*-0.7%*
Equipment software	*1097*	*876*	*-20.2%*	*-1.6%*
Residential	*462*	*344*	*-25.6%*	*-0.9%*
Net exports	-476	-330		1.1%
Exports	*1670*	*1419*	*-15.0%*	*-1.9%*
Imports	*2146*	*1749*	*-18.5%*	*-3.0%*
Government	2506	2568	2.5%	0.5%
National defense	*645*	*695*	*7.7%*	*0.4%*
Nondefense	*315*	*328*	*3.9%*	*0.1%*
State and local	*1546*	*1548*	*0.1%*	*0.0%*
Total Inventories	1835.5	1750.2	-4.6%	

Worst 4 Quarter Contractions

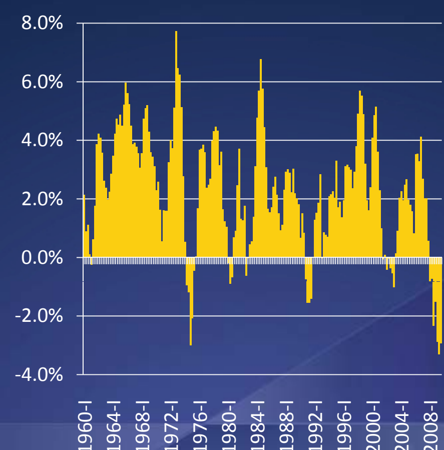
2009-II	-3.8%
1958-I	-3.0%
1982-III	-2.7%
1954-II	-2.5%
1975-I	-2.3%
1980-III	-1.6%
1961-I	-1.0%
1991-I	-1.0%
1970-IV	-0.2%

The consumer pullback

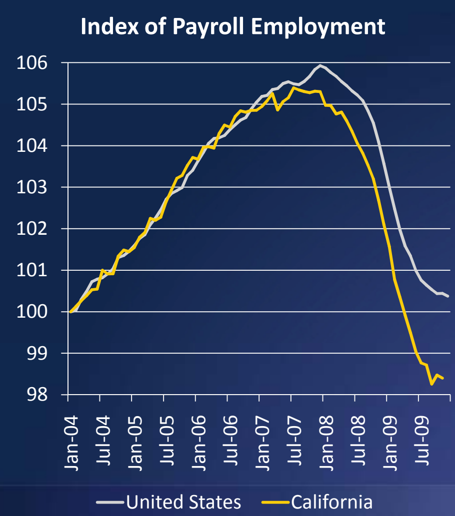
Real Consumer Spending (Y-o-Y % to Aug)

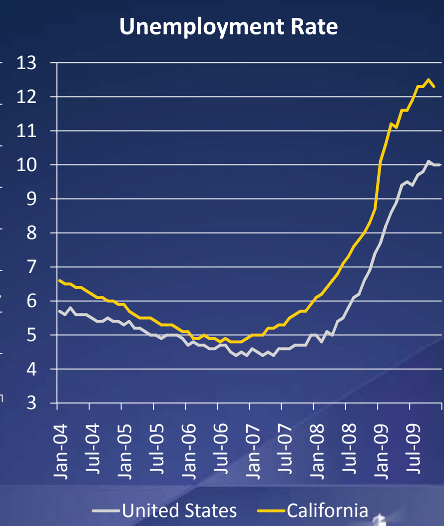


Real Income Growth
(Per Capita, Y-o-Y)



Jobs Jobs Jobs





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California: A widespread hit

	Jan-08	Sep-09		
Riverside-San Bernardino-Ontario MSA	1,256,600	1,139,700	-9.3%	-116,900
Santa Rosa-Petaluma MSA	190,300	176,400	-7.3%	-13,900
Oxnard-Thousand Oaks-Ventura MSA	294,700	274,500	-6.9%	-20,200
Santa Ana-Anaheim-Irvine Metro Div	1,513,000	1,417,500	-6.3%	-95,500
Oakland-Fremont-Hayward Metro Div	1,046,400	981,500	-6.2%	-64,900
San Francisco-San Mateo-Redwood City Metro Div	998,300	945,100	-5.3%	-53,200
San Jose-Sunnyvale-Santa Clara MSA	919,900	870,900	-5.3%	-49,000
Los Angeles-Long Beach-Glendale Metro Div	4,095,800	3,879,600	-5.3%	-216,200
Stockton MSA	208,500	197,700	-5.2%	-10,800
San Diego-Carlsbad-San Marcos MSA	1,308,400	1,240,900	-5.2%	-67,500
Modesto MSA	159,000	150,800	-5.2%	-8,200
Salinas MSA	128,800	123,000	-4.5%	-5,800
Santa Barbara-Santa Maria-Goleta MSA	174,100	168,400	-3.3%	-5,700
Bakersfield MSA	238,000	231,300	-2.8%	-6,700

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Local Markets

Industry Employment for Sacramento

Industry	Nov-09	Nov-07	
Total Nonfarm	826	900.8	-74.8
Construction	40.5	63.2	-22.7
Retail Trade	86.8	99.9	-13.1
Admin Support	39.4	48.1	-8.7
Accommodation	67.2	72.9	-5.7
Prof Sci Tech	50.2	55.9	-5.7
Finance	39.7	45.2	-5.5
Durable Manu	23.3	27.7	-4.4
Wholesale Trade	24.1	27.2	-3.1
Information	17.1	19.8	-2.7
State Gov	108.8	111.3	-2.5
Real Estate	12.7	14.8	-2.1
Logistics	23.5	25.4	-1.9
Arts Entertainment	12.7	14	-1.3
Non-Durable Manu	12	12.4	-0.4
Management	8.2	8.6	-0.4
Other Services	29	29.3	-0.3
Natural Resources	0.6	0.7	-0.1
Federal Gov	12.3	12.3	0
Local Gov	114	113.2	0.8
Education	14.6	13.3	1.3
Health Care	89.3	85.7	3.6

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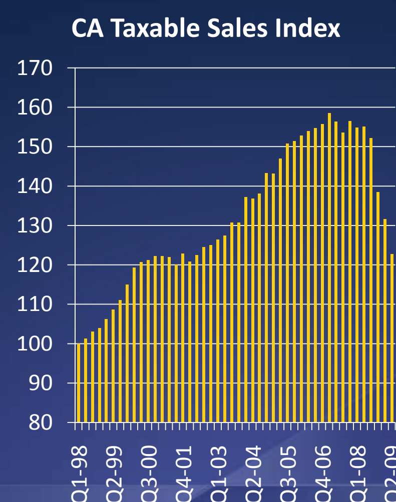
Why the worse downturn?

- Housing
  - Greater price increase / decrease
  - Subprime central
- Exports
  - Goods / tourism / licenses
- Business Spending
  - The IT industry



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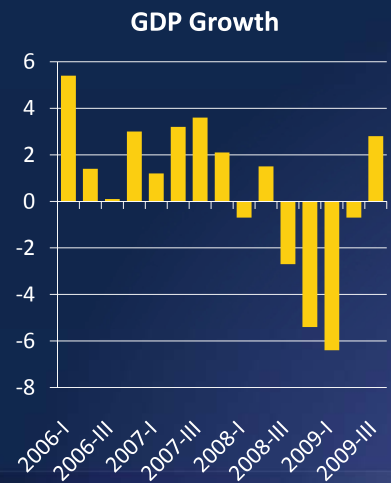
3rd Quarter GDP Update



	2009-I	2009-II	2009-III
Percent change at annual rate:			
Gross domestic product	-6.40	-0.70	2.20
Personal consumption expenditures	0.44	-0.62	1.96
Durable goods	0.28	-0.41	1.36
Nondurable goods	0.29	-0.29	0.23
Services	-0.13	0.09	0.37
Gross private domestic investment	-8.98	-3.10	0.54
Structures	-2.28	-0.69	-0.68
Equipment and software	-3.01	-0.32	0.10
Residential	-1.33	-0.67	0.43
Change in private inventories	-2.36	-1.42	0.69
Net exports of goods and services	2.64	1.65	-0.81
Exports	-3.95	-0.45	1.78
Imports	6.58	2.09	-2.59
Government consumption	-0.52	1.33	0.55
National defense	-0.27	0.70	0.45
Nondefense	-0.06	0.15	0.17
State and local	-0.19	0.48	-0.08

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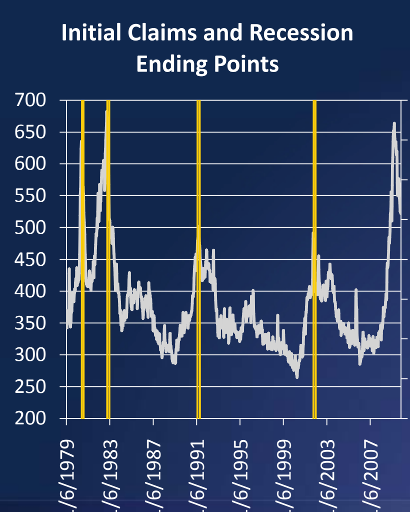
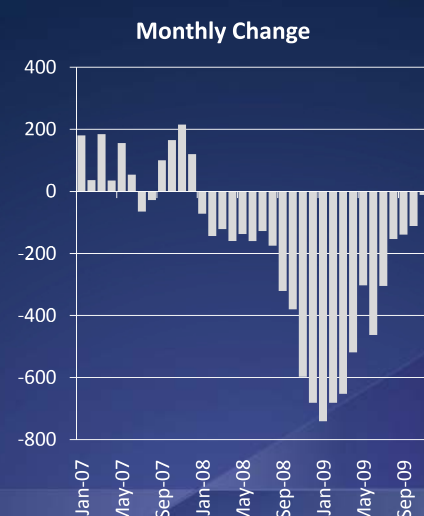
Labor Markets: Recession Over





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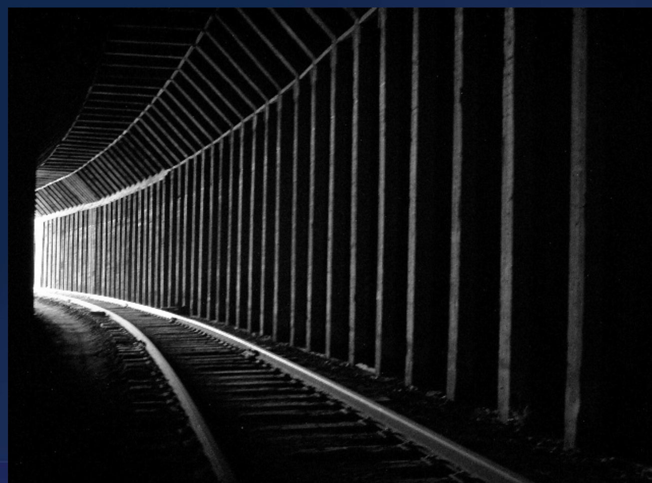
So what does it mean?



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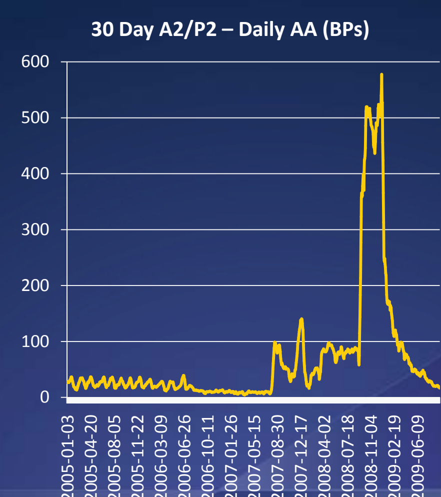
The Financial Markets



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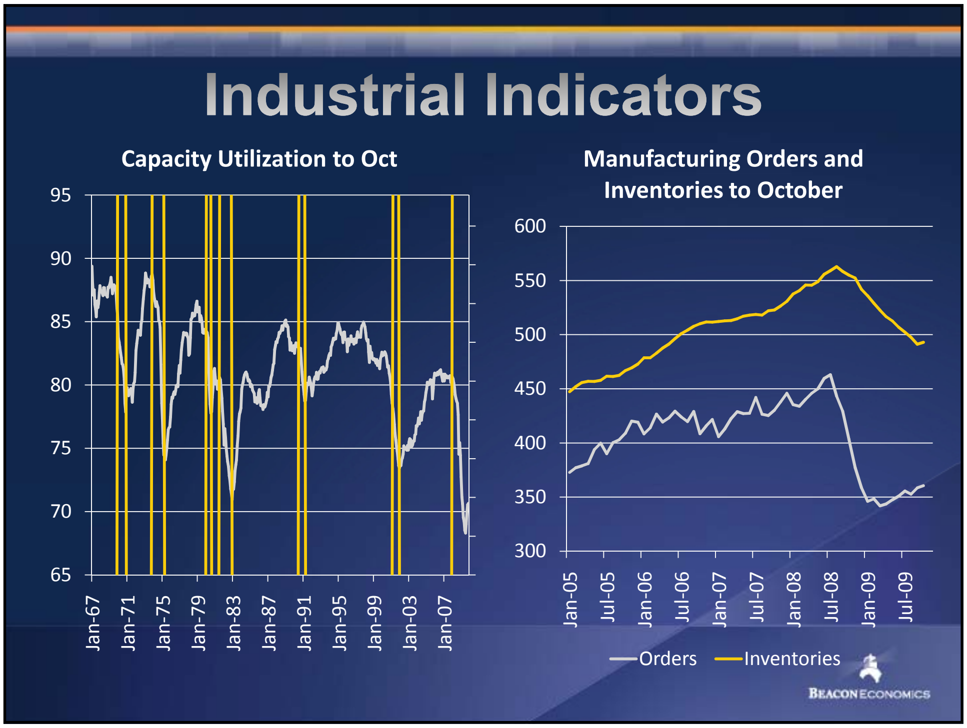
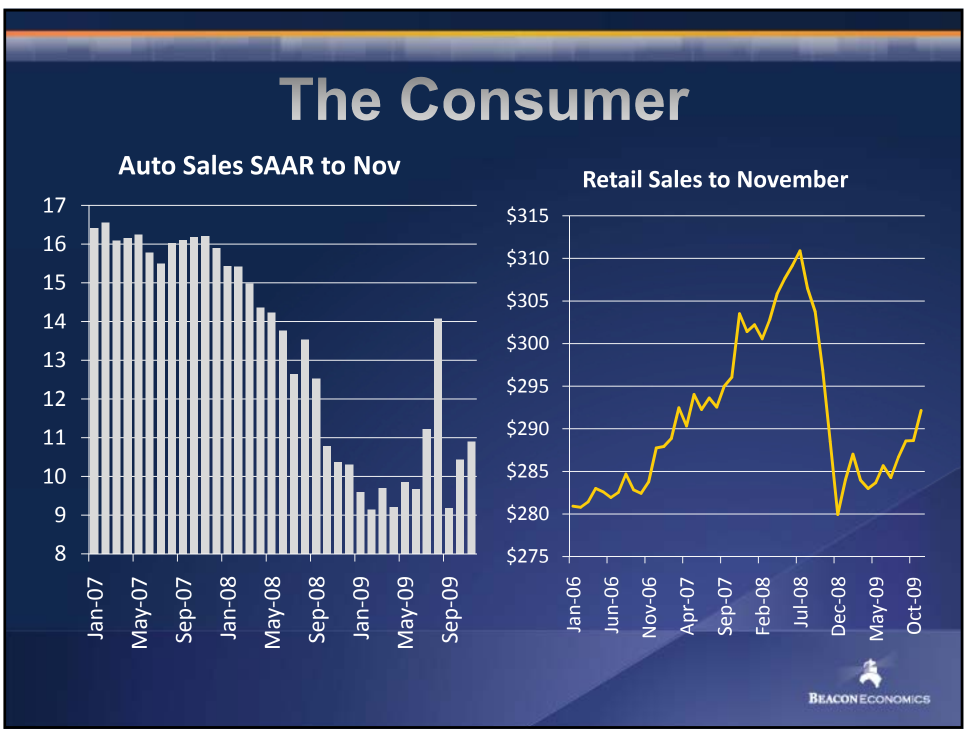
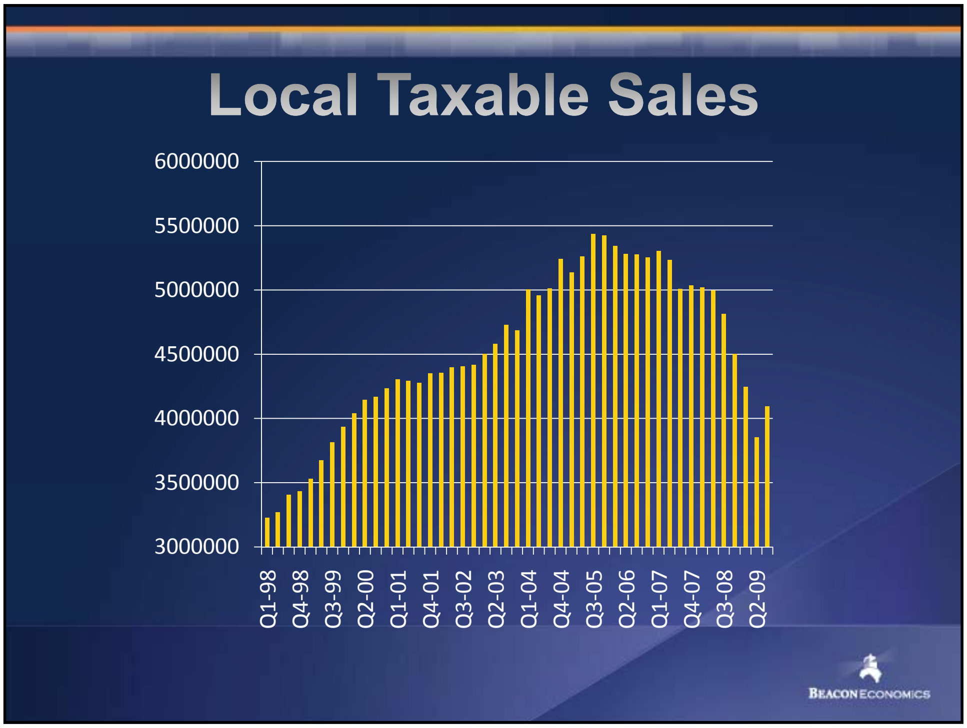

Industrial Indicators
Capacity Utilization to Oct
95
90
85
80
75
70
65
Jan-67
Jan-71
Jan-75
Jan-79
Jan-83
Jan-87
Jan-91
Jan-95
Jan-99
Jan-03
Jan-07
Manufacturing Orders and Inventories to October
600
550
500
450
400
350
300
Jan-05
Jul-05
Jan-06
Jul-06
Jan-07
Jul-07
Jan-08
Jul-08
Jan-09
Jul-09
Orders
Inventories
BEACON ECONOMICS


The Consumer
Auto Sales SAAR to Nov
17
16
15
14
13
12
11
10
9
8
Jan-07
May-07
Sep-07
Jan-08
May-08
Sep-08
Jan-09
May-09
Sep-09
Retail Sales to November
$315
$310
$305
$300
$295
$290
$285
$280
$275
Jan-06
Jun-06
Nov-06
Apr-07
Sep-07
Feb-08
Jul-08
Dec-08
May-09
Oct-09
BEACON ECONOMICS


Local Taxable Sales
6000000
5500000
5000000
4500000
4000000
3500000
3000000
Q1-98
Q4-98
Q3-99
Q2-00
Q1-01
Q4-01
Q3-02
Q2-03
Q1-04
Q4-04
Q3-05
Q2-06
Q1-07
Q4-07
Q3-08
Q2-09
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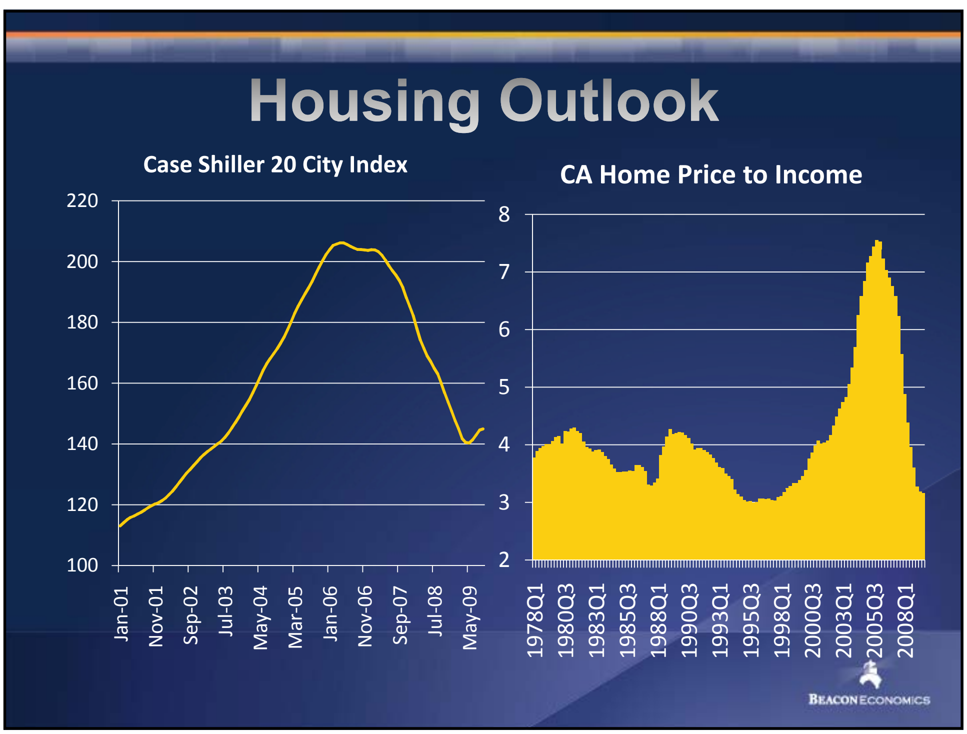
Housing Outlook
Case Shiller 20 City Index
220
200
180
160
140
120
100
Jan-01
Nov-01
Sep-02
Jul-03
May-04
Mar-05
Jan-06
Nov-06
Sep-07
Jul-08
May-09
CA Home Price to Income
8
7
6
5
4
3
2
1978Q1
1980Q3
1983Q1
1985Q3
1988Q1
1990Q3
1993Q1
1995Q3
1998Q1
2000Q3
2003Q1
2005Q3
2008Q1
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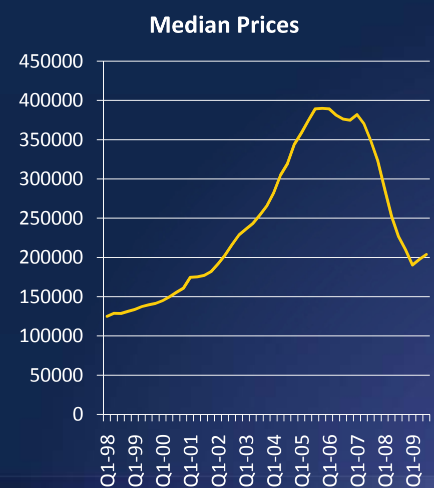
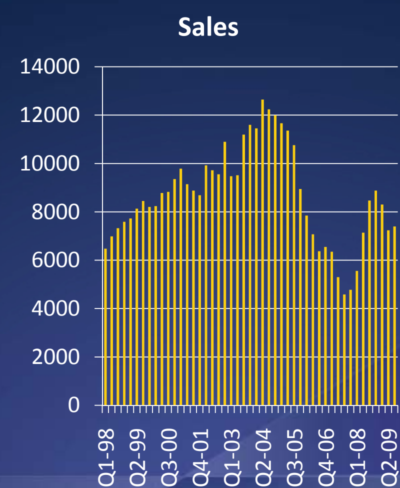
Sacramento Housing





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Real Median Prices

Log Changes, Source: Dataquick / Bureau Labor Statistics / Beacon Economics

	1997 to Peak	Peak to Trough	Current Rally	Sum
California	95.6%	-89.4%	6.4%	12.6%
Contra Costa	95.6%	-105.7%	10.6%	0.4%
San Bernardino	114.5%	-107.0%	2.0%	9.5%
Riverside	112.9%	-93.3%	2.7%	22.4%
Sac (MSA)	93.9%	-75.9%	5.9%	23.9%
Sonoma	89.1%	-69.2%	8.3%	28.2%
Alameda	92.6%	-76.3%	13.3%	29.6%
San Jose	80.2%	-60.2%	15.8%	35.8%
Los Angeles	102.7%	-69.3%	5.2%	38.6%
San Mateo	78.5%	-42.6%	8.0%	43.9%
Marin	72.5%	-37.5%	9.2%	44.2%
San Diego	98.5%	-61.5%	7.8%	44.8%
Orange County	97.5%	-51.1%	9.7%	56.2%
San Fran. (County)	89.2%	-32.6%	5.6%	62.2%

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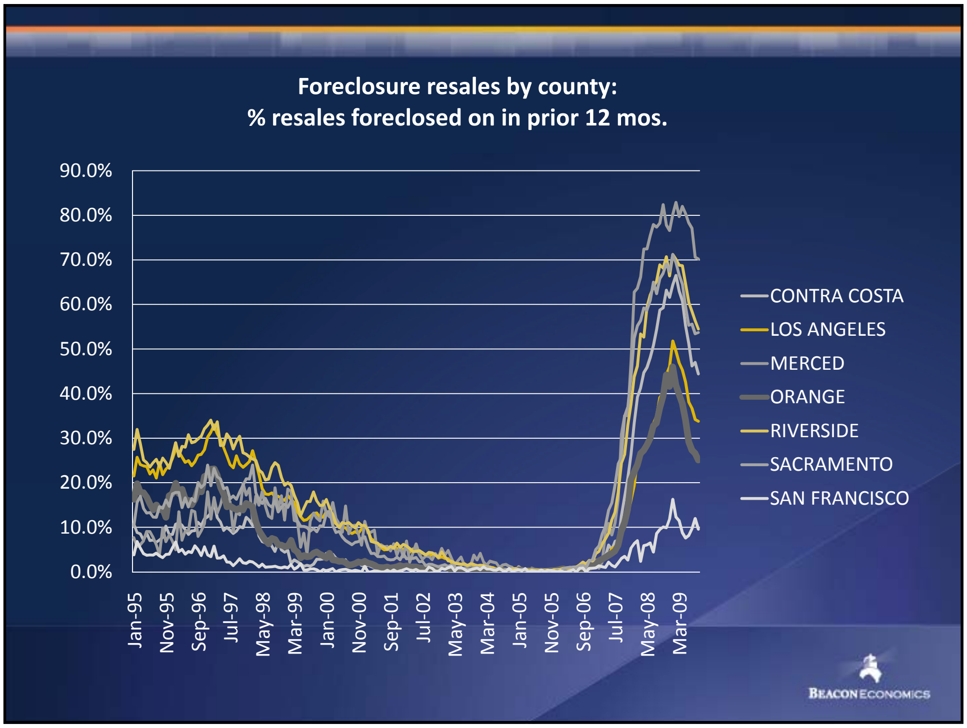
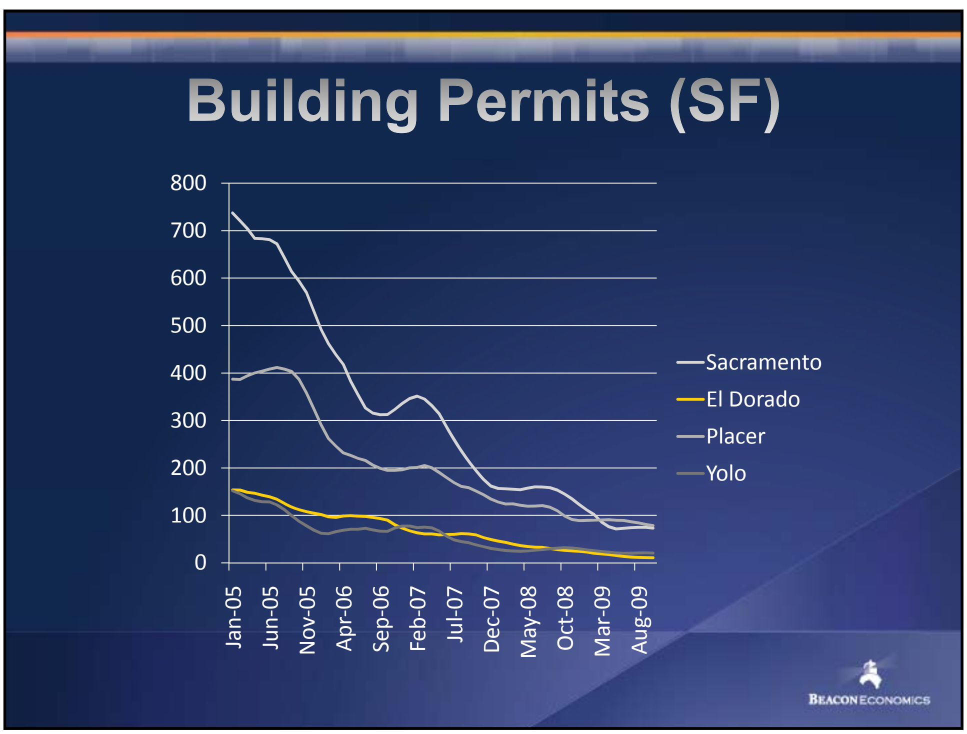

Foreclosure resales by county:
% resales foreclosed on in prior 12 mos.
90.0%
80.0%
70.0%
60.0%
50.0%
40.0%
30.0%
20.0%
10.0%
0.0%
Jan-95
Nov-95
Sep-96
Jul-97
May-98
Mar-99
Jan-00
Nov-00
Sep-01
Jul-02
May-03
Mar-04
Jan-05
Nov-05
Sep-06
Jul-07
May-08
Mar-09
CONTRA COSTA
LOS ANGELES
MERCED
ORANGE
RIVERSIDE
SACRAMENTO
SAN FRANCISCO
BEACON ECONOMICS


Building Permits (SF)
800
700
600
500
400
300
200
100
0
Jan-05
Jun-05
Nov-05
Apr-06
Sep-06
Feb-07
Jul-07
Dec-07
May-08
Oct-08
Mar-09
Aug-09
Sacramento
El Dorado
Placer
Yolo
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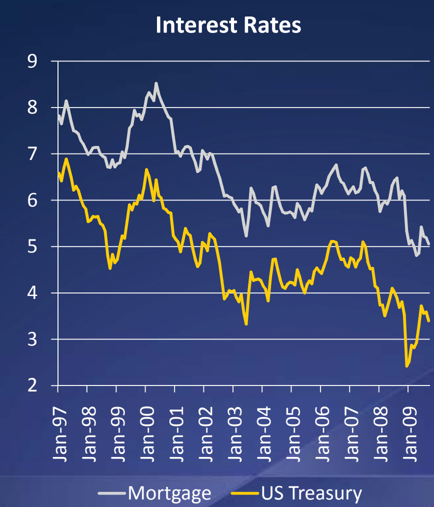
Drivers of Housing Bounce

- Interest Rates
- The FHA
- Hope for Homeowners
- The tax credit



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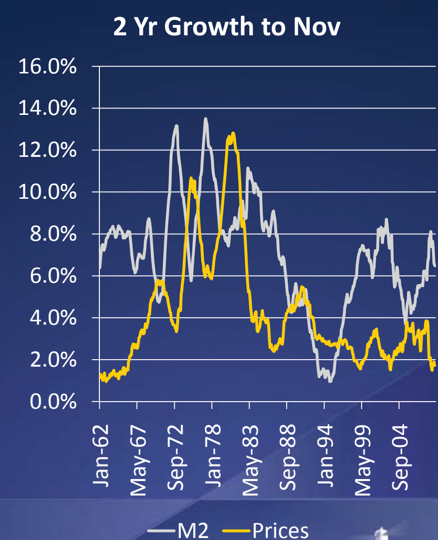
Quantitative Easing



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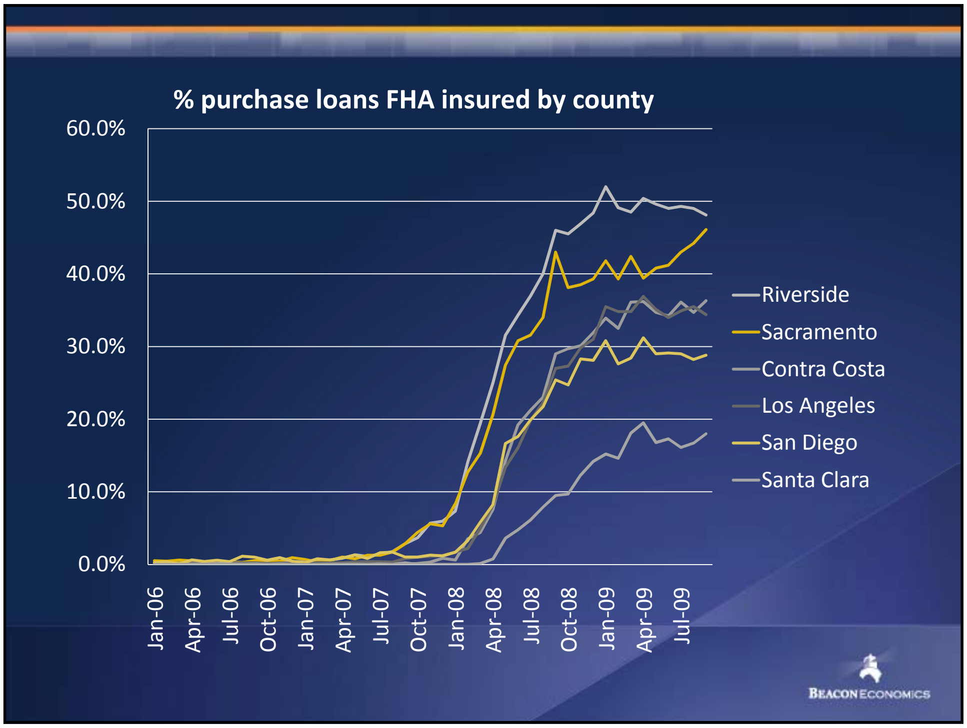
% purchase loans FHA insured by county
60.0%
50.0%
40.0%
30.0%
20.0%
10.0%
0.0%
Jan-06
Apr-06
Jul-06
Oct-06
Jan-07
Apr-07
Jul-07
Oct-07
Jan-08
Apr-08
Jul-08
Oct-08
Jan-09
Apr-09
Jul-09
Riverside
Sacramento
Contra Costa
Los Angeles
San Diego
Santa Clara
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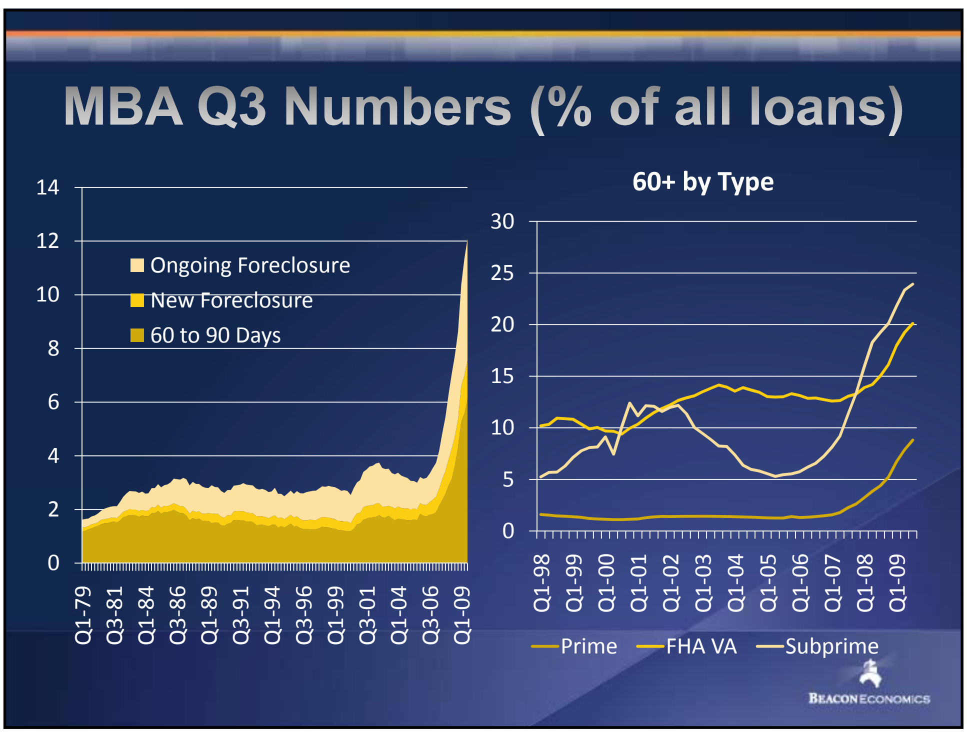
MBA Q3 Numbers (% of all loans)
14
12
10
8
6
4
2
0
Ongoing Foreclosure
New Foreclosure
60 to 90 Days
Q1-79
Q3-81
Q1-84
Q3-86
Q1-89
Q3-91
Q1-94
Q3-96
Q1-99
Q3-01
Q1-04
Q3-06
Q1-09
60+ by Type
30
25
20
15
10
5
0
Q1-98
Q1-99
Q1-00
Q1-01
Q1-02
Q1-03
Q1-04
Q1-05
Q1-06
Q1-07
Q1-08
Q1-09
Prime
FHA VA
Subprime
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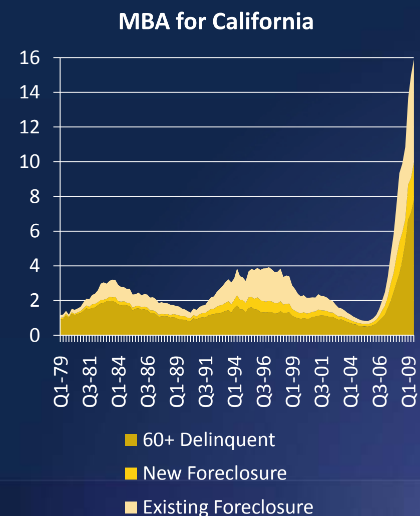
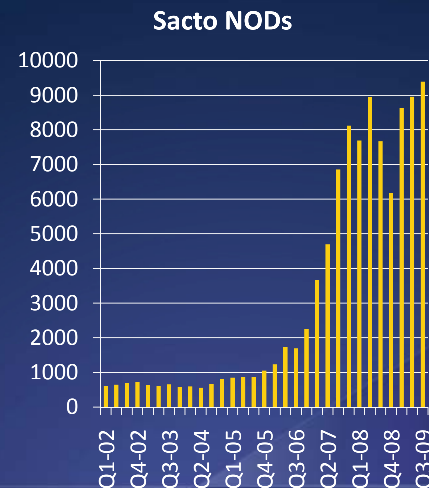
California Trends





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Commercial Troubles

Q3 07 to Q3 09

		Apartment			Retail	
East Bay	2007Q3	4.9%	1,286.32	2007Q3	3.5%	25.94
	2009Q3	7.5%	1,180.18	2009Q3	10.7%	23.31
Sacramento	2007Q3	5.4%	1,028.08	2007Q3	11.0%	20.42
	2009Q3	7.3%	983.80	2009Q3	19.9%	18.00
San Francisco	2007Q3	4.5%	1,910.60	2007Q3	4.6%	28.14
	2009Q3	5.9%	1,853.53	2009Q3	10.8%	26.79

		Office			Warehouse	
East Bay	2007Q3	16.9%	26.49	2007Q3	6.2%	5.34
	2009Q3	20.8%	23.54	2009Q3	11.4%	4.85
Sacramento	2007Q3	12.8%	22.06	2007Q3	8.3%	4.72
	2009Q3	18.1%	19.86	2009Q3	10.6%	4.35
San Francisco	2007Q3	14.2%	34.97	2007Q3	5.8%	9.11
	2009Q3	19.8%	29.99	2009Q3	10.4%	8.39

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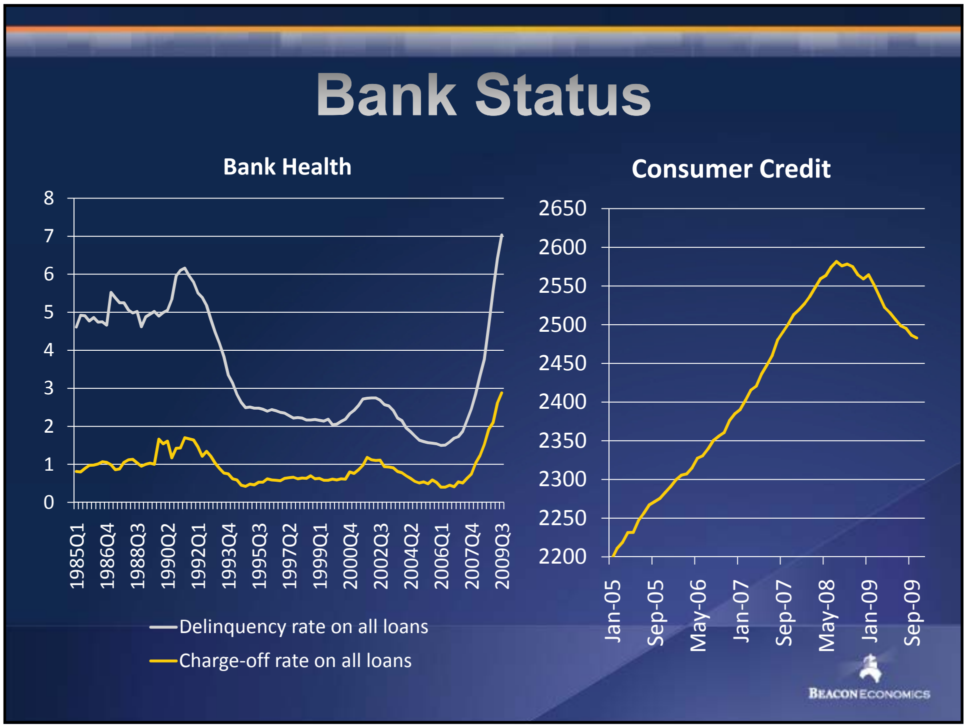

Bank Status
Bank Health
Delinquency rate on all loans
Charge-off rate on all loans
Consumer Credit
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The National Bubble
National PE Ratio
Debt as Share of GDP
Financial
Other
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Financial Re-Regulation?

- The problem…
  - is not fat tails, bad math, black swans or even white ones
  - is one of incentives: big bonuses for short run scores
- The solution…
  - is not market based—since this relies on efficient markets
  - is not the current package put forward by the president
  - is what the Fed is proposing
- But what about financial innovation?
  - Like LTCM, S&L deregulation, dot bombs, junk bonds and asset backed securities?

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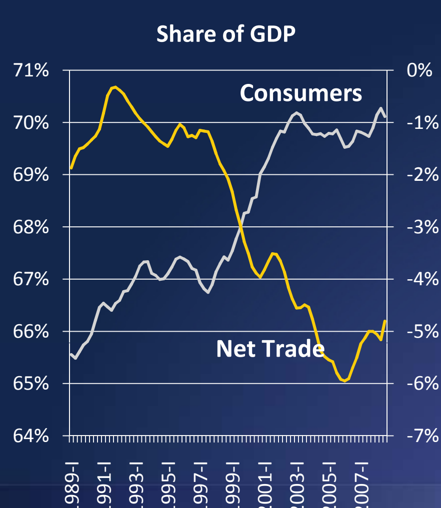
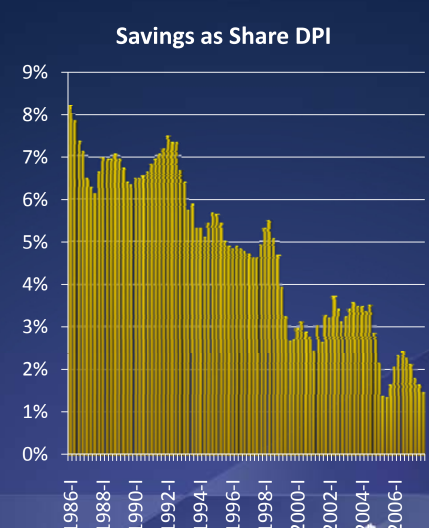
The Consumer Imbalance





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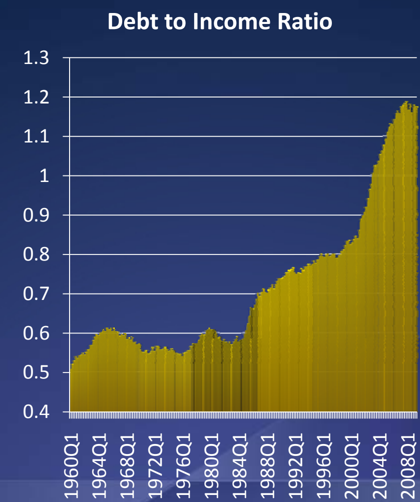
Wealth Effects



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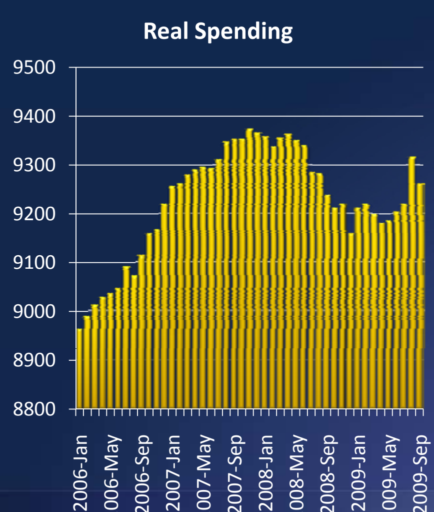
Consumer Indicators



	1993-II	2008-I	2009-III
Real Income	7069	11246	10912
Savings	386	117	333
	5.5%	1.0%	3.0%
Consumption	5671	9350	9265
	80%	83%	85%
Taxes	816.9	1418.7	979.3
	11.6%	12.6%	9.0%

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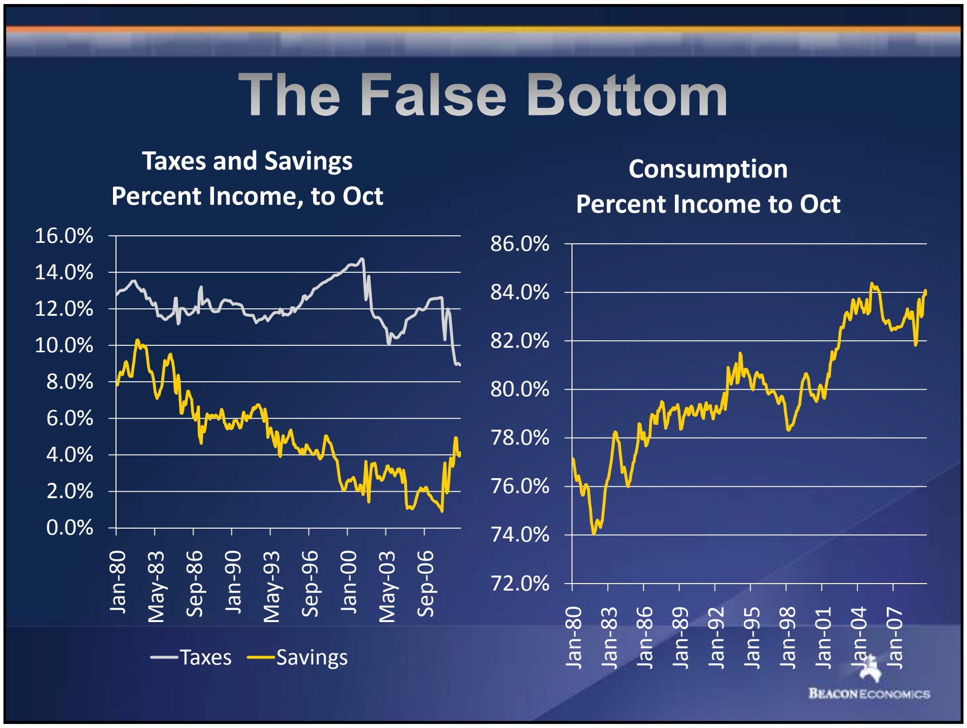
The False Bottom
Taxes and Savings
Percent Income, to Oct
16.0%
14.0%
12.0%
10.0%
8.0%
6.0%
4.0%
2.0%
0.0%
Jan-80
May-83
Sep-86
Jan-90
May-93
Sep-96
Jan-00
May-03
Sep-06
Taxes
Savings
Consumption
Percent Income to Oct
86.0%
84.0%
82.0%
80.0%
78.0%
76.0%
74.0%
72.0%
Jan-80
Jan-83
Jan-86
Jan-89
Jan-92
Jan-95
Jan-98
Jan-01
Jan-04
Jan-07
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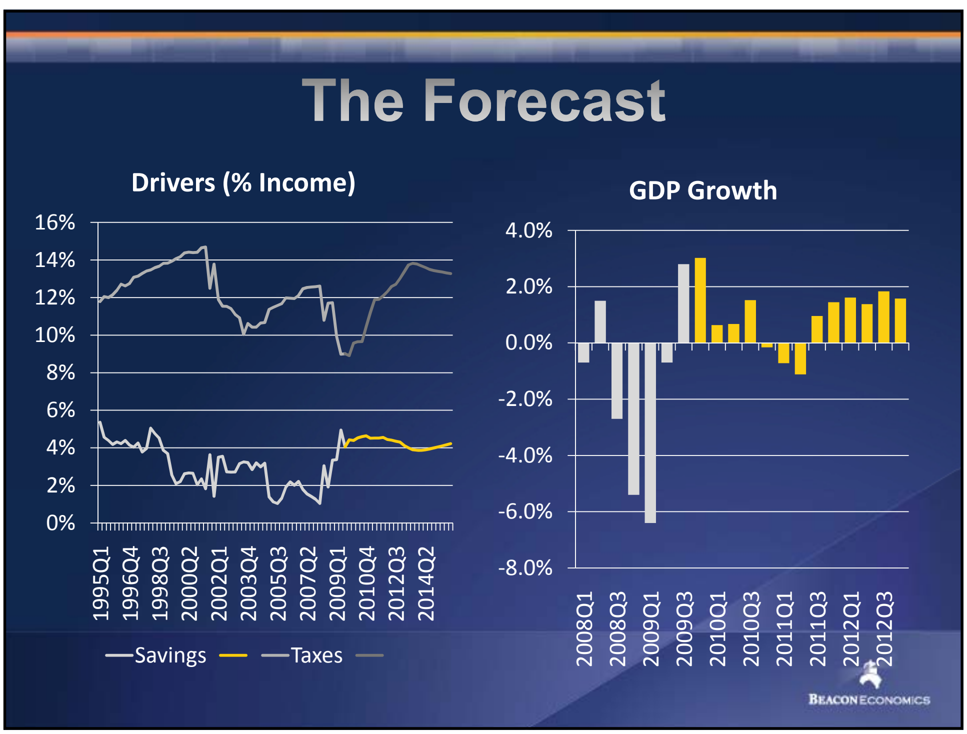
The Forecast
Drivers (% Income)
16%
14%
12%
10%
8%
6%
4%
2%
0%
1995Q1
1996Q4
1998Q3
2000Q2
2002Q1
2003Q4
2005Q3
2007Q2
2009Q1
2010Q4
2012Q3
2014Q2
Savings
Taxes
GDP Growth
4.0%
2.0%
0.0%
-2.0%
-4.0%
-6.0%
-8.0%
2008Q1
2008Q3
2009Q1
2009Q3
2010Q1
2010Q3
2011Q1
2011Q3
2012Q1
2012Q3
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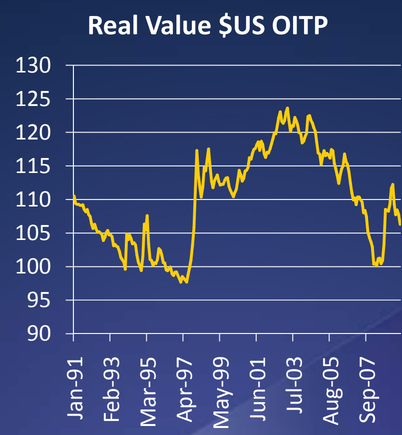
Big Questions

- Positive Potential Changes
  - Strong export growth
  - Strong recovery in business spending
- Potential Policy Changes
  - Extend tax cuts / more stimulus
- A New Bubble?
  - Savings rates stall at lower level
  - Real double dip?
- Fed policy
  - Will weak labor markets force the Fed to maintain excessively loose policy?



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Bullish on CA

- Long run
  - State has grown faster than the US since 1994 in terms of GSP, Income, Employment and Population
  - Every sector has grown faster except Admin Support, Mgmt, and Logistics
- On the back end of the downturn
  - A weaker $US: good for export heavy CA
  - Cheaper Homes
- But don't expect a fast recovery

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Remember…

It doesn't get much more 'business-unfriendly' than this!

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Summary

- The Recession is Dead… Long Live the Recession?
  - Consumer weakness will likely continue
  - Businesses are a wild card
  - Housing bounce won't last
  - Banks not out of the woods yet
  - Commercial trouble to continue
  - Significant chance of a double dip
  - Higher Rates coming down the pike
- Its not permanent
  - Its just going to take some time—PATIENCE!!

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Analysis. Answers.

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- *Regional Intelligence Reports*
- *Business & Market Analysis*
- *Real Estate Market Analysis*
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