

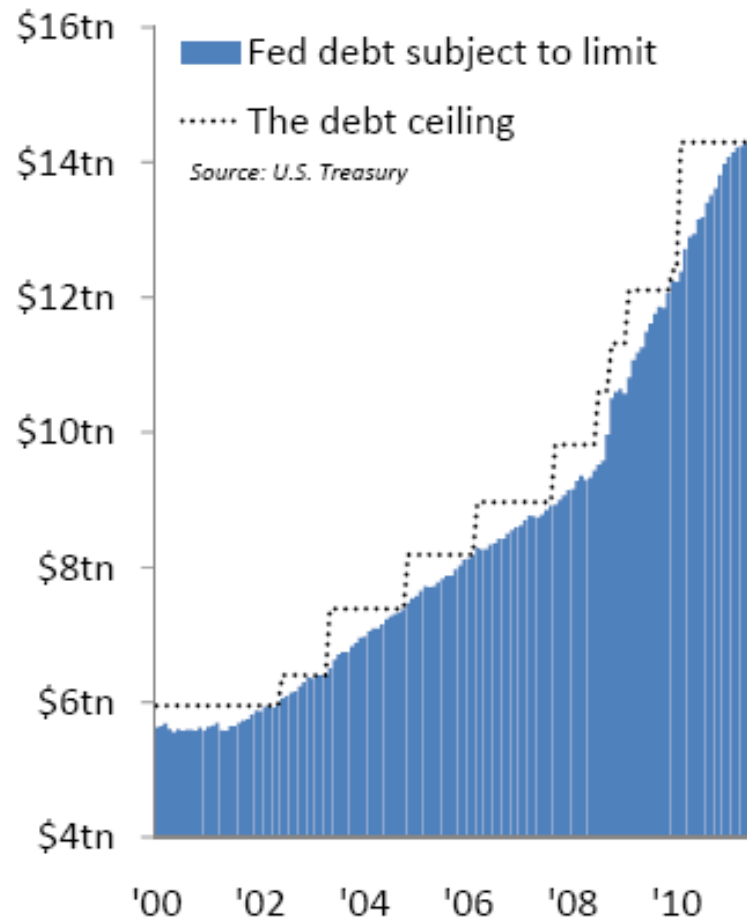
# Economic Outlook

*Where do we go from here?*

Gray Bowles  
Vice President  
Portfolio Strategies Group

October 2011

# Backdrop of fiscal restraint



- Bowles-Simpson, Nov '10



- Rejected in SOTU, Jan '11



- Boehner hints entitlement reform Jan 2011; Backs off.



- Ryan budget, Mar 2011



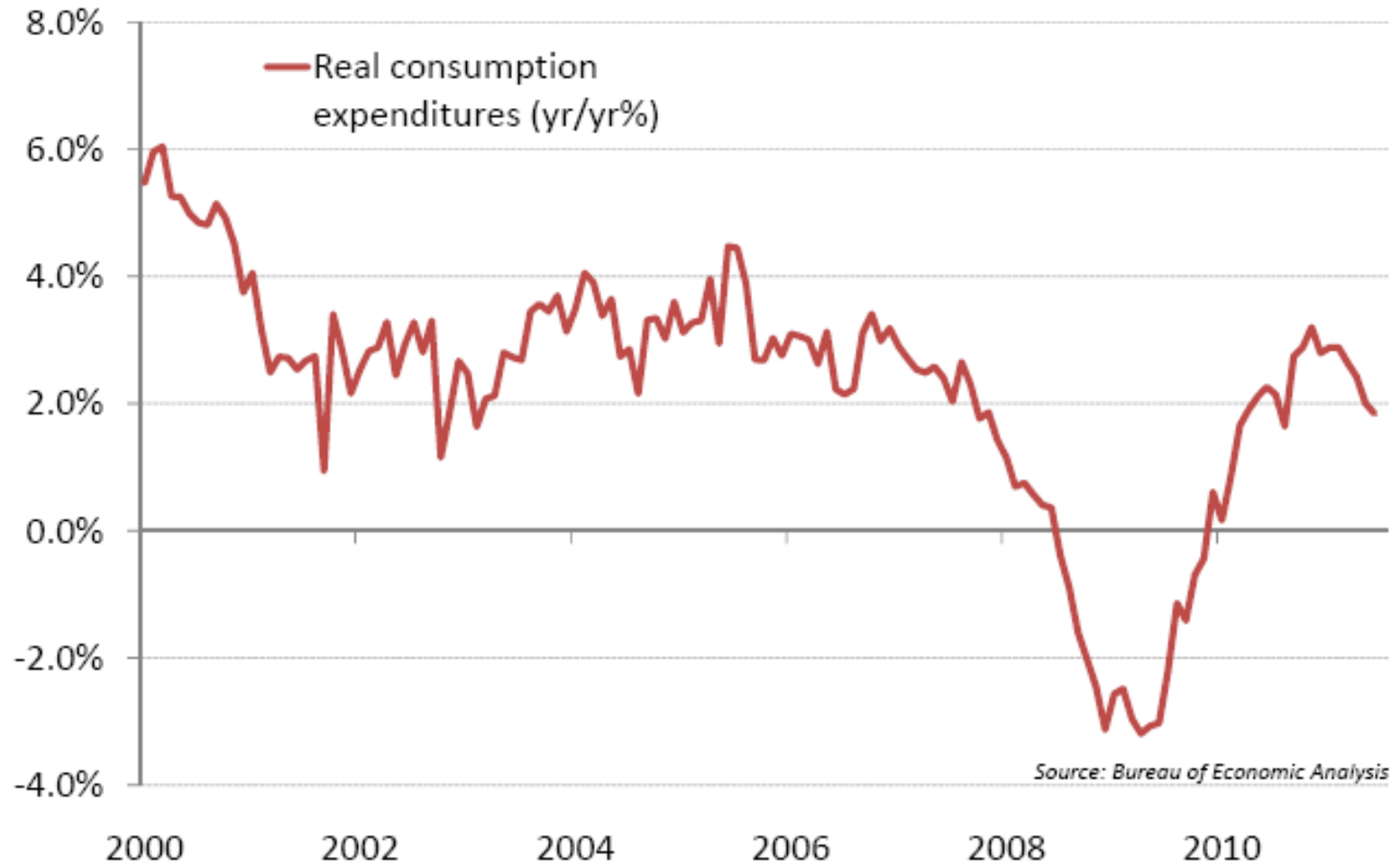
- Biden Commission, Apr 2011



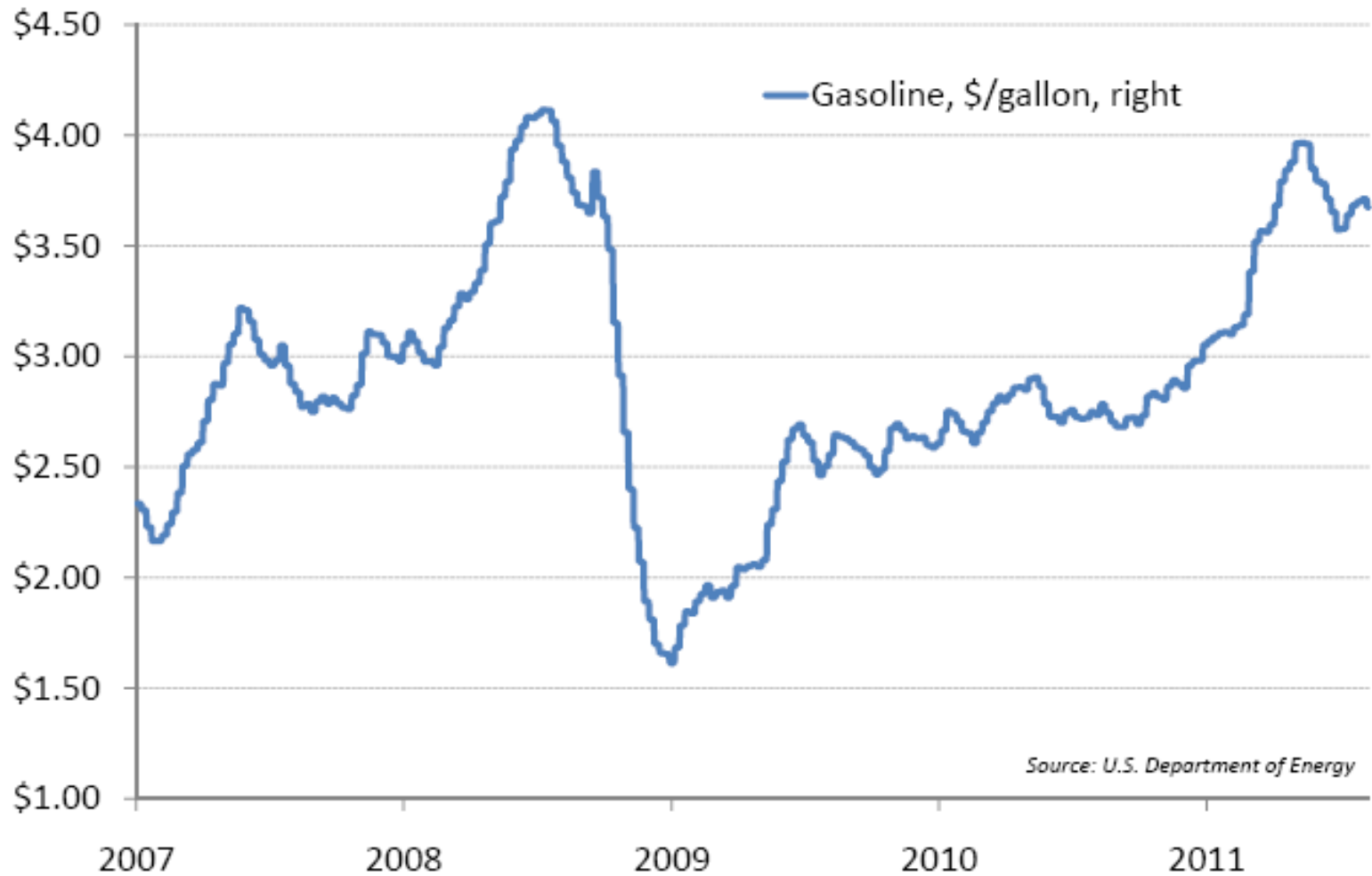
- Budget Control Act, Aug 2011

# Employment and consumption

# Consumption has stalled

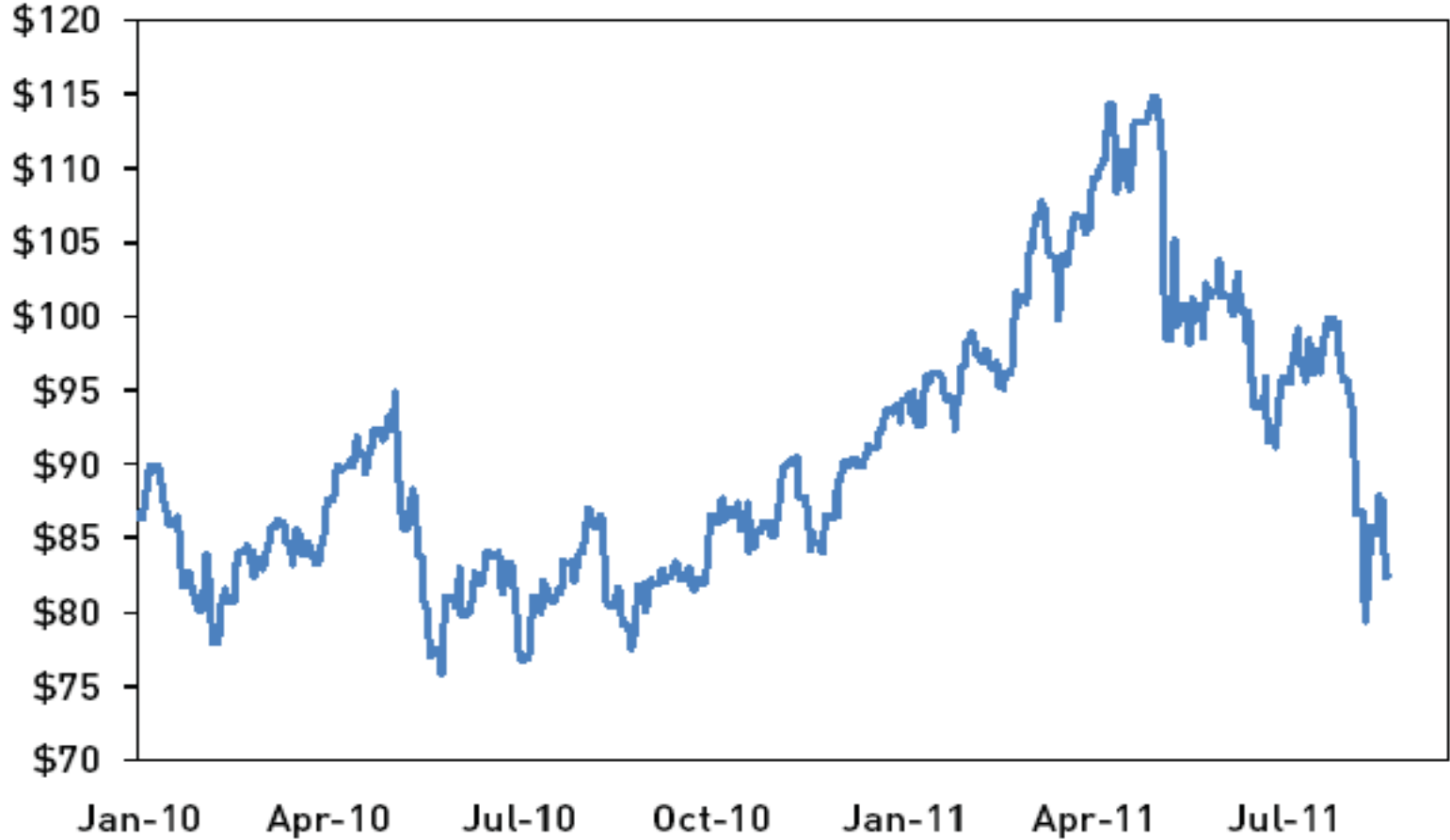


# Gas prices were a big problem



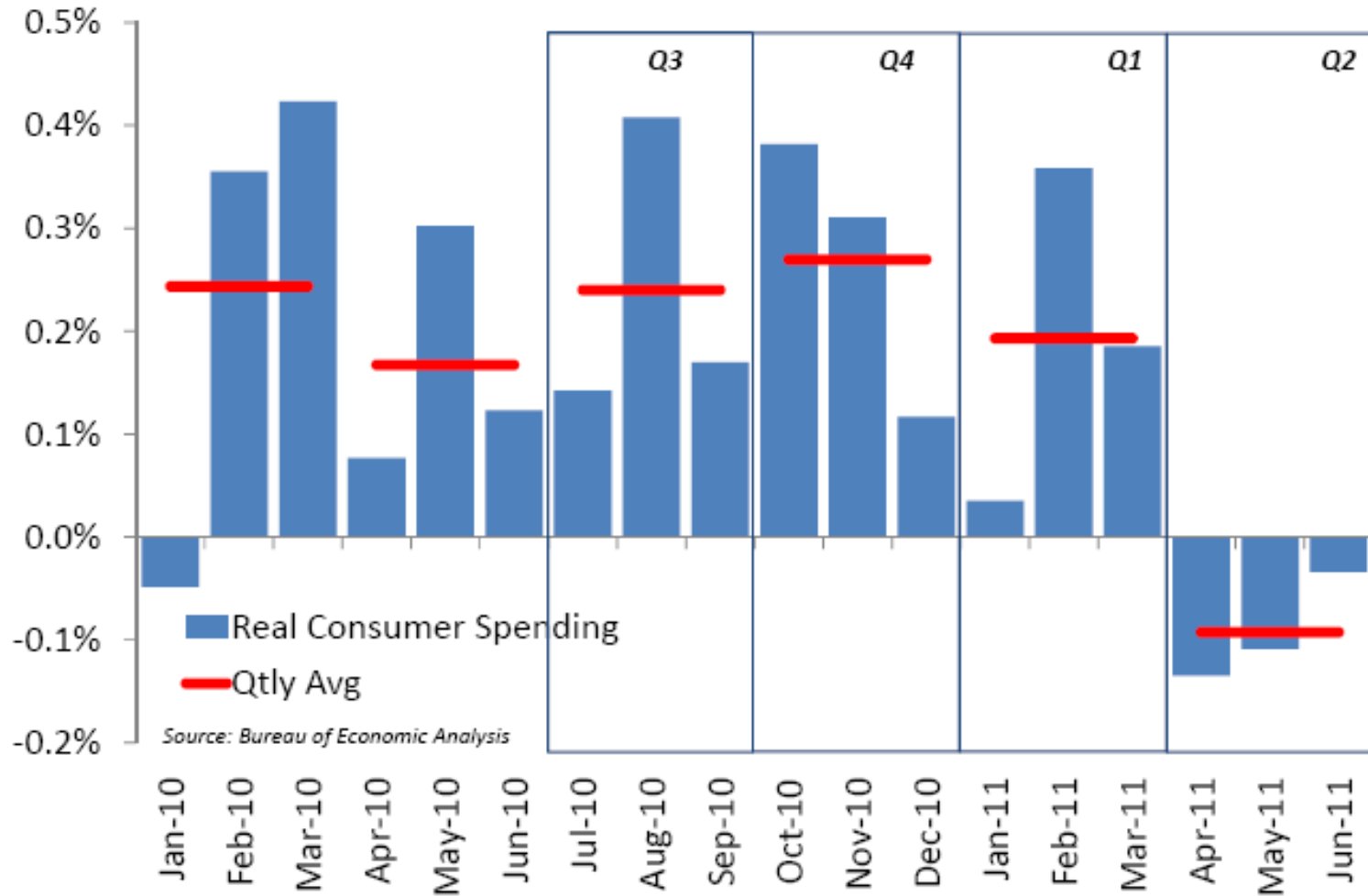
# Crude Oil moving lower

**WTI Crude Oil Active Contract**  
\$/barrel

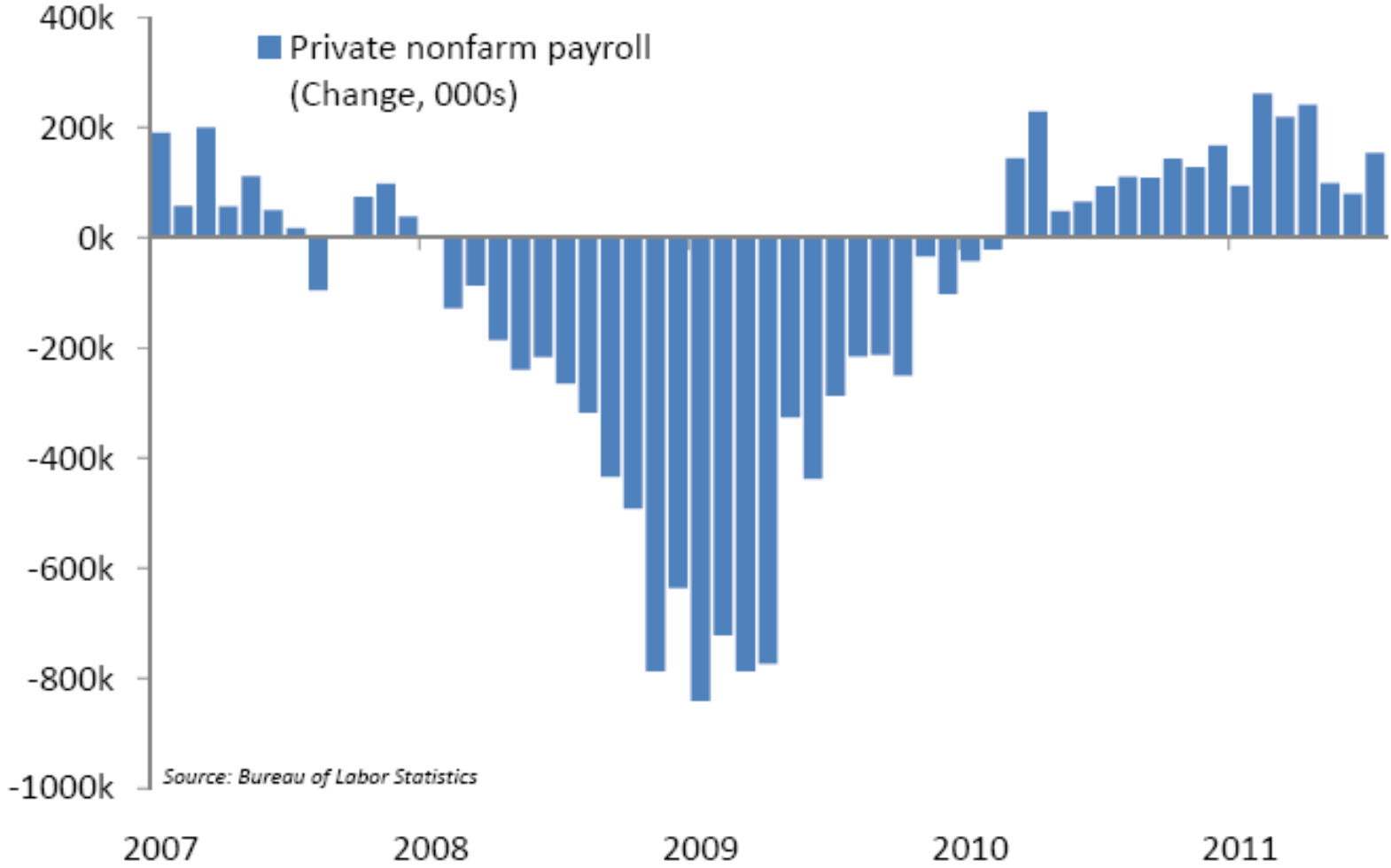


Source: U.S. Department of Energy

# Real spending peaked in 4Q10

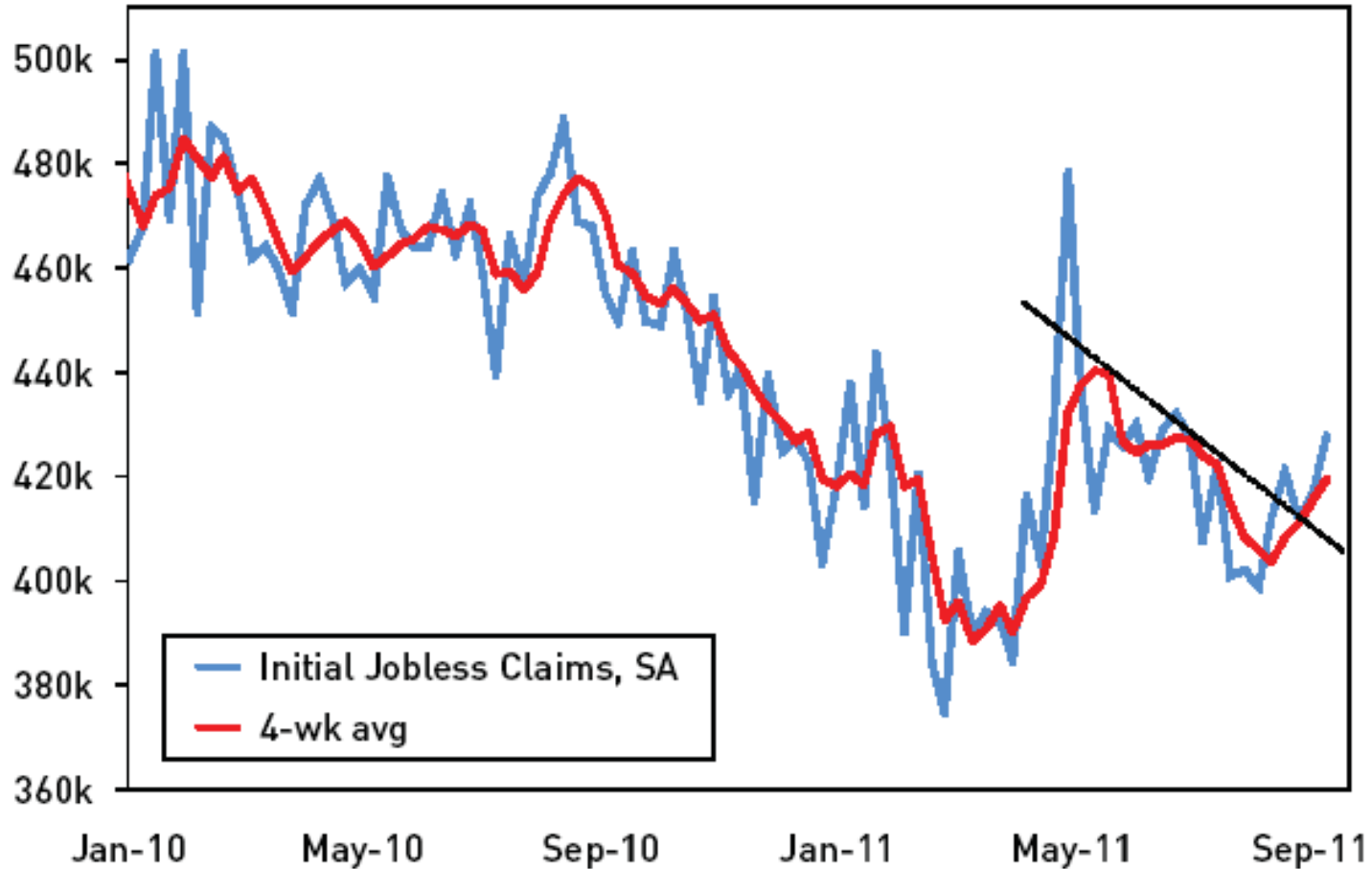


# Payrolls slumped in 2Q10



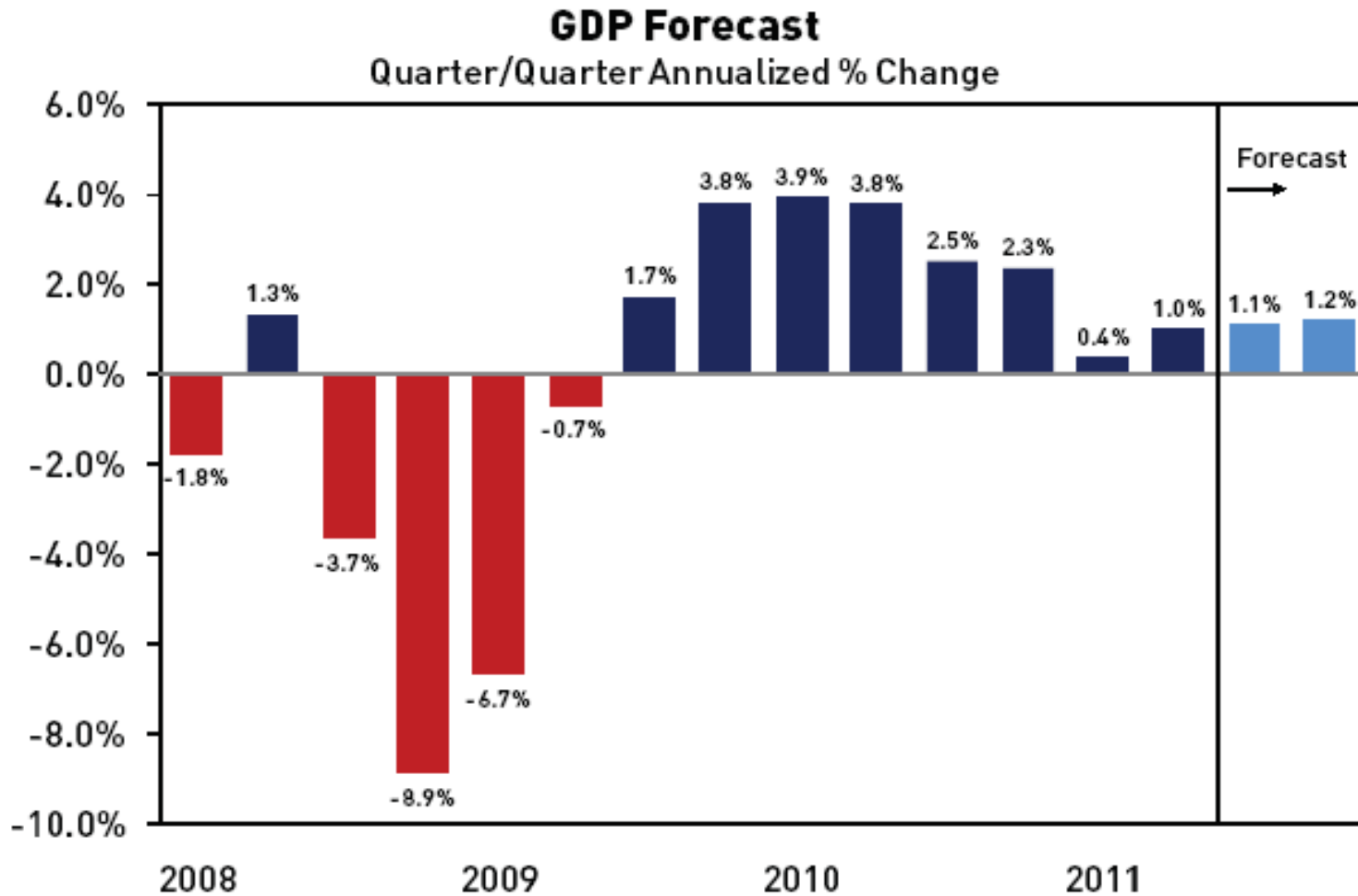
# Jobless claims were falling

## Initial Claims for Unemployment Insurance



Source: Department of Labor

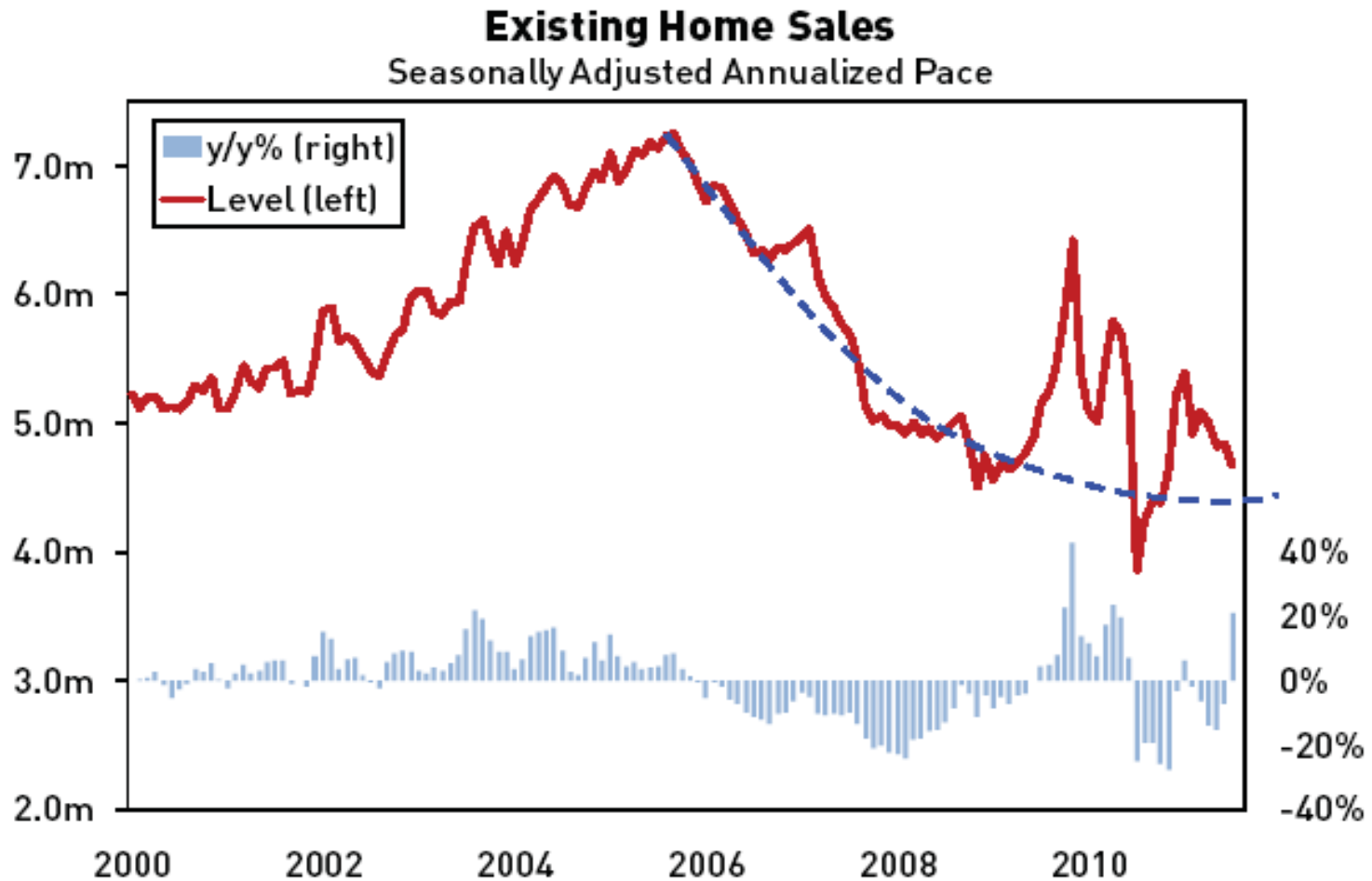
# GDP Forecast



Source: Bureau of Economic Analysis

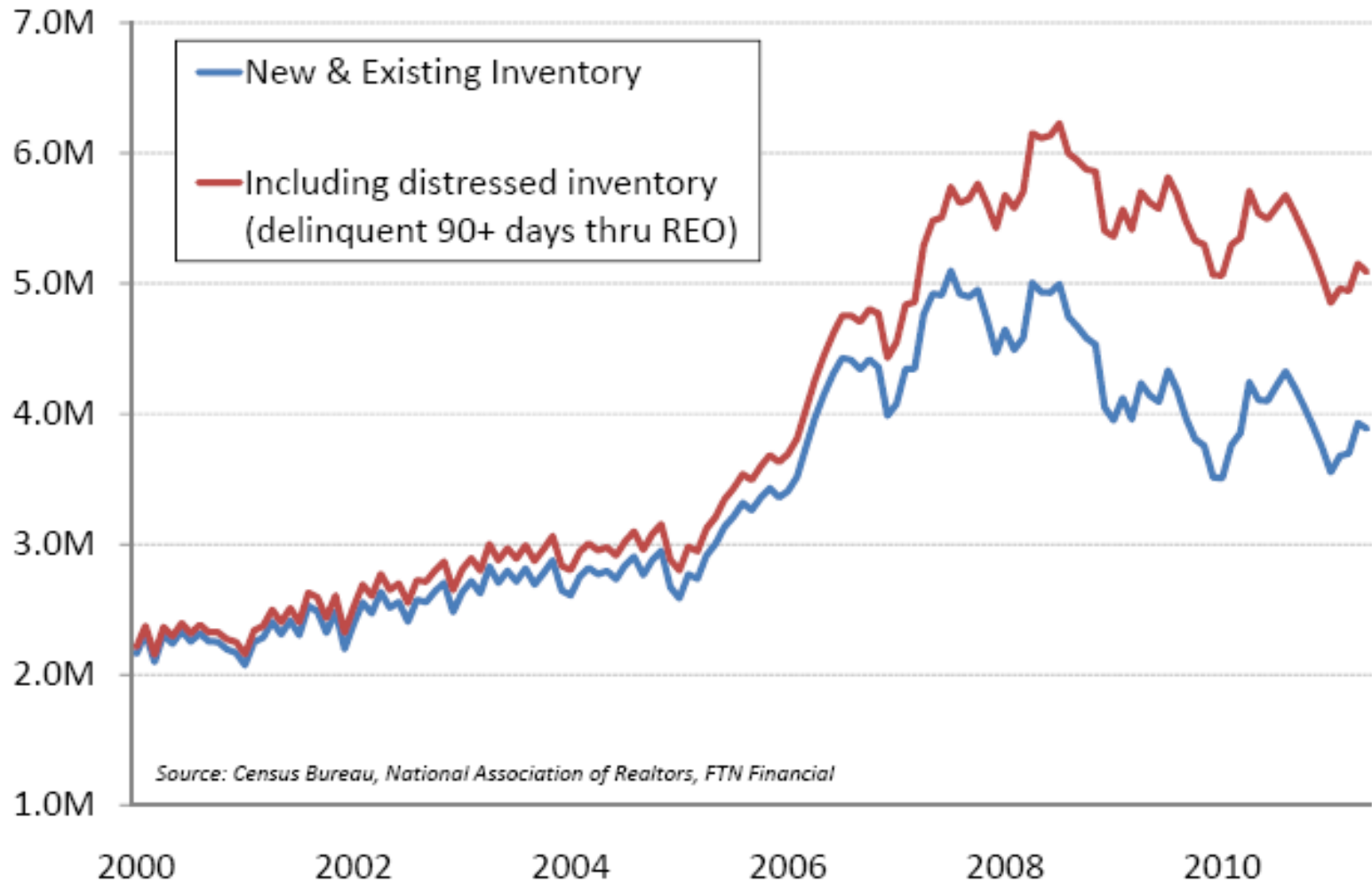
Housing may not recover this cycle

# Home sales still near their lows

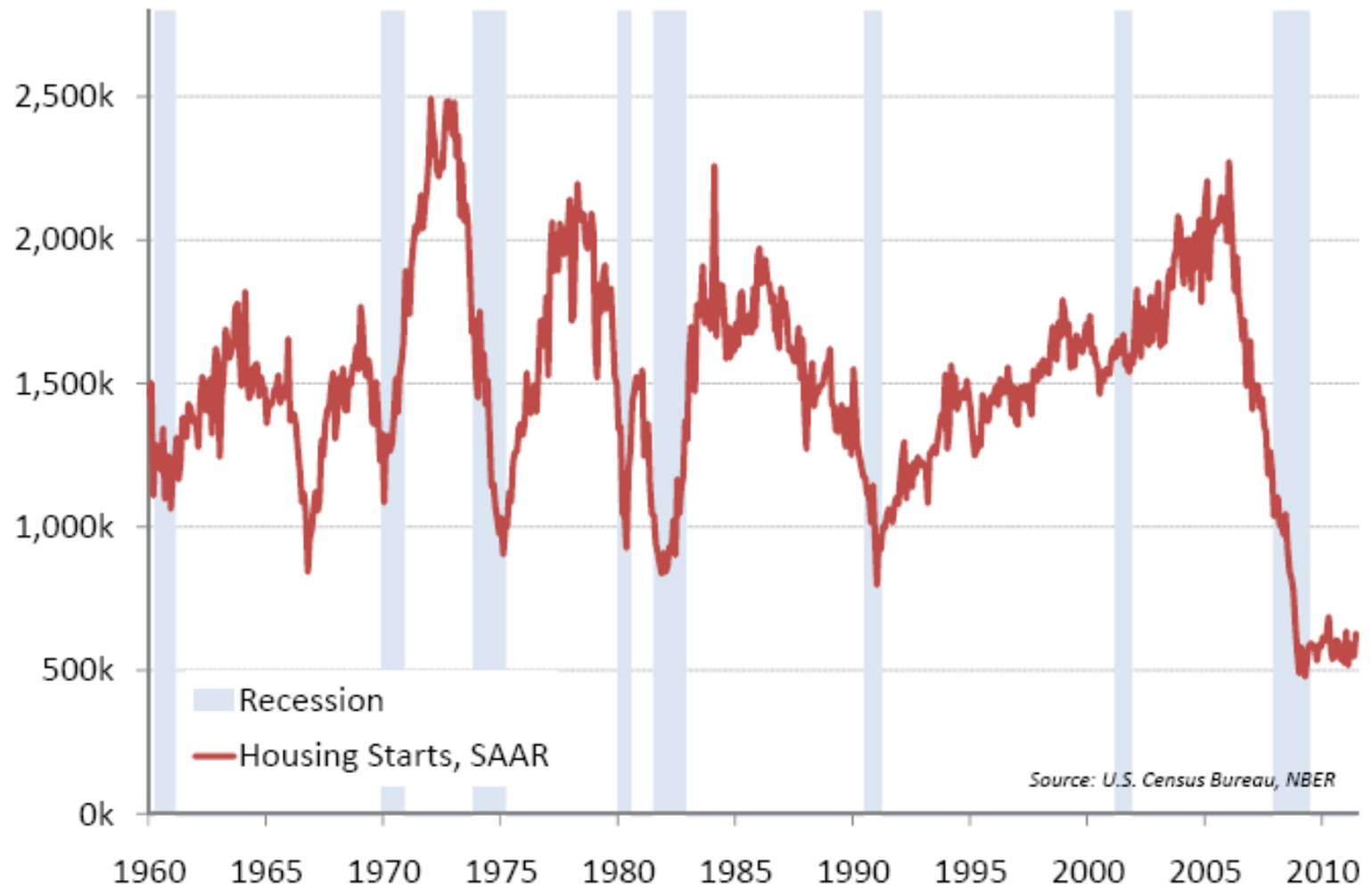


Source: National Assoc. of Realtors

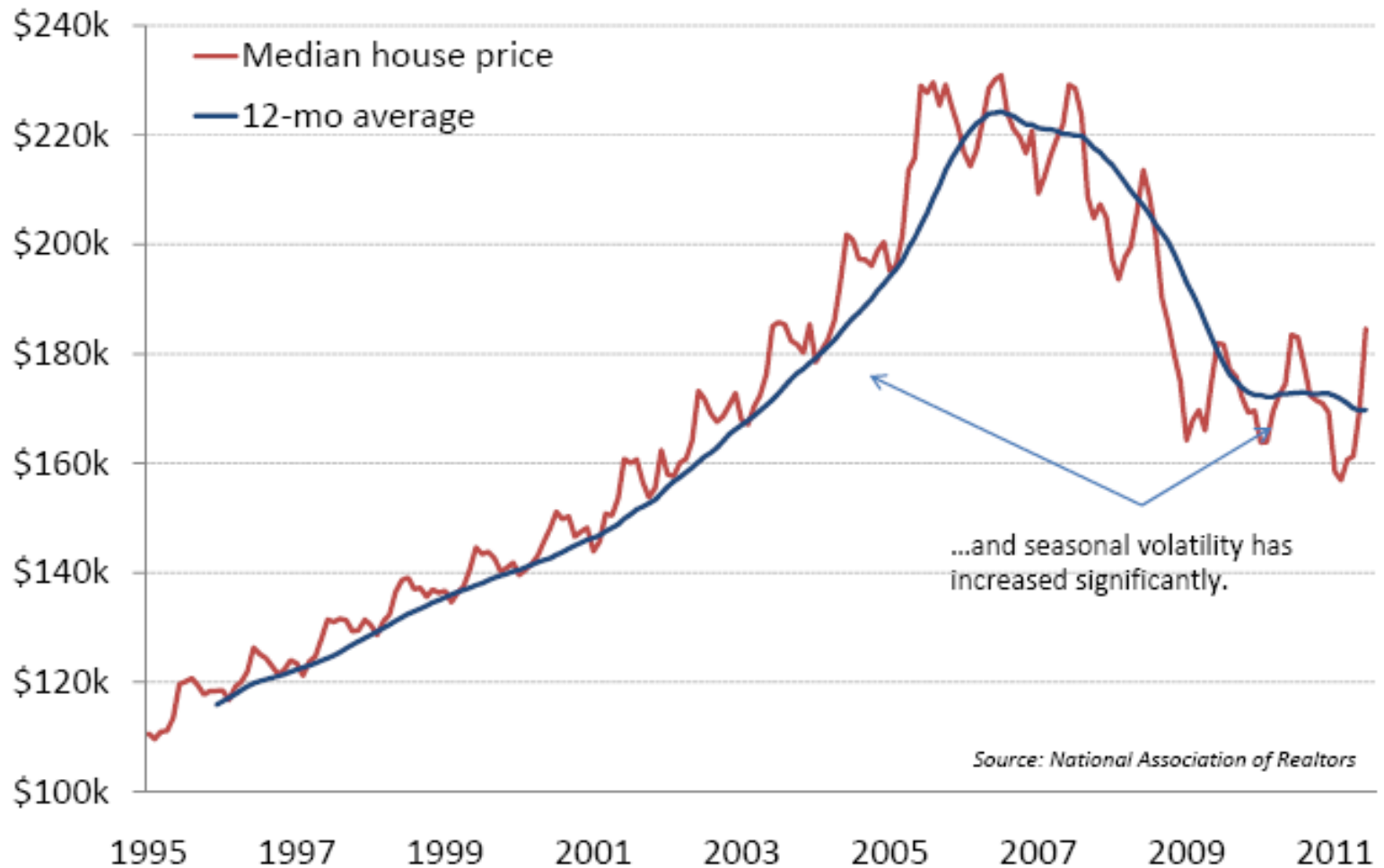
# Inventory of Unsold Homes



# Housing starts

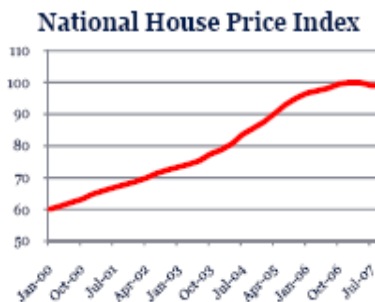
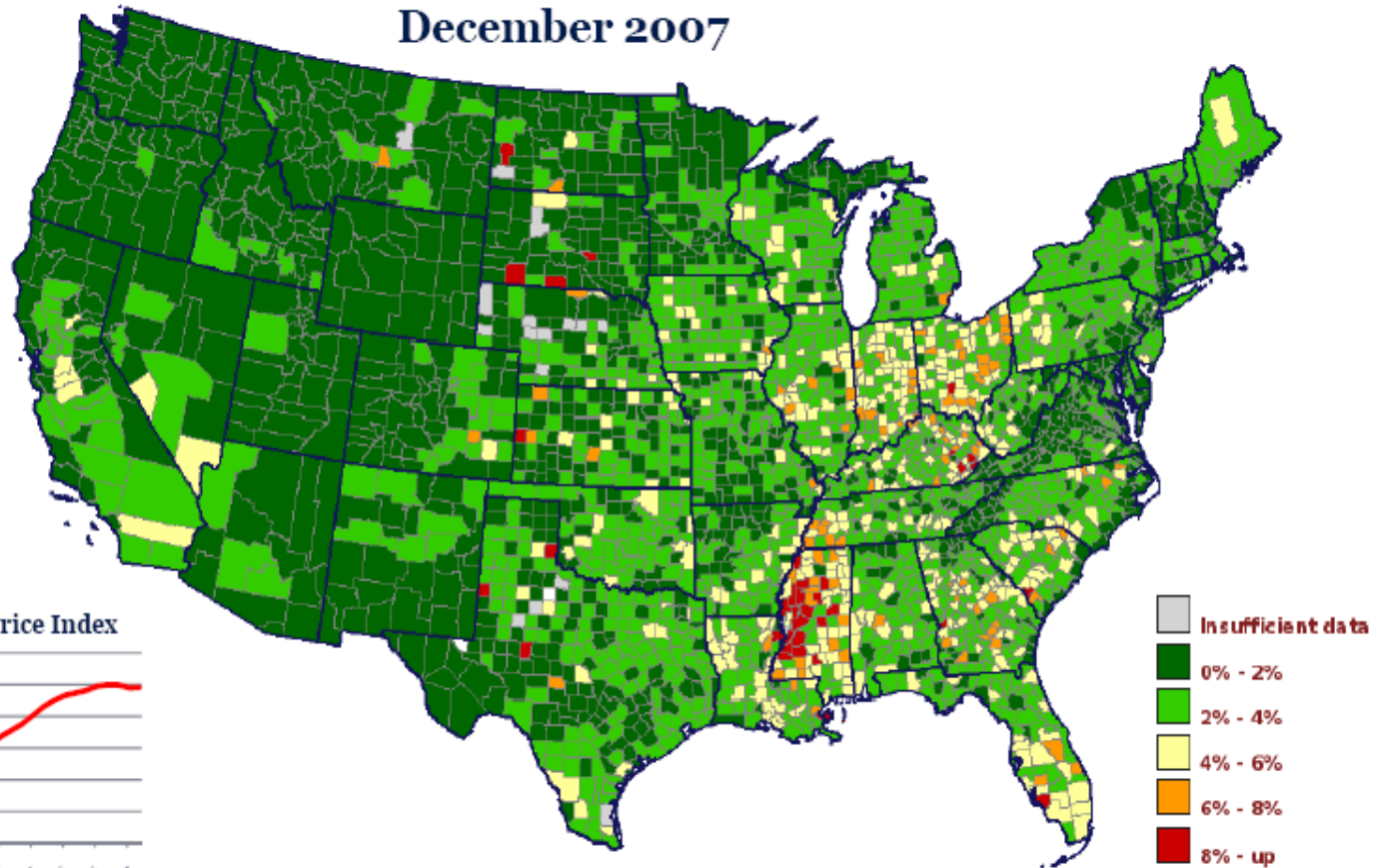


# Home prices under pressure



# Growing levels of mortgages – seriously delinquent or in foreclosure

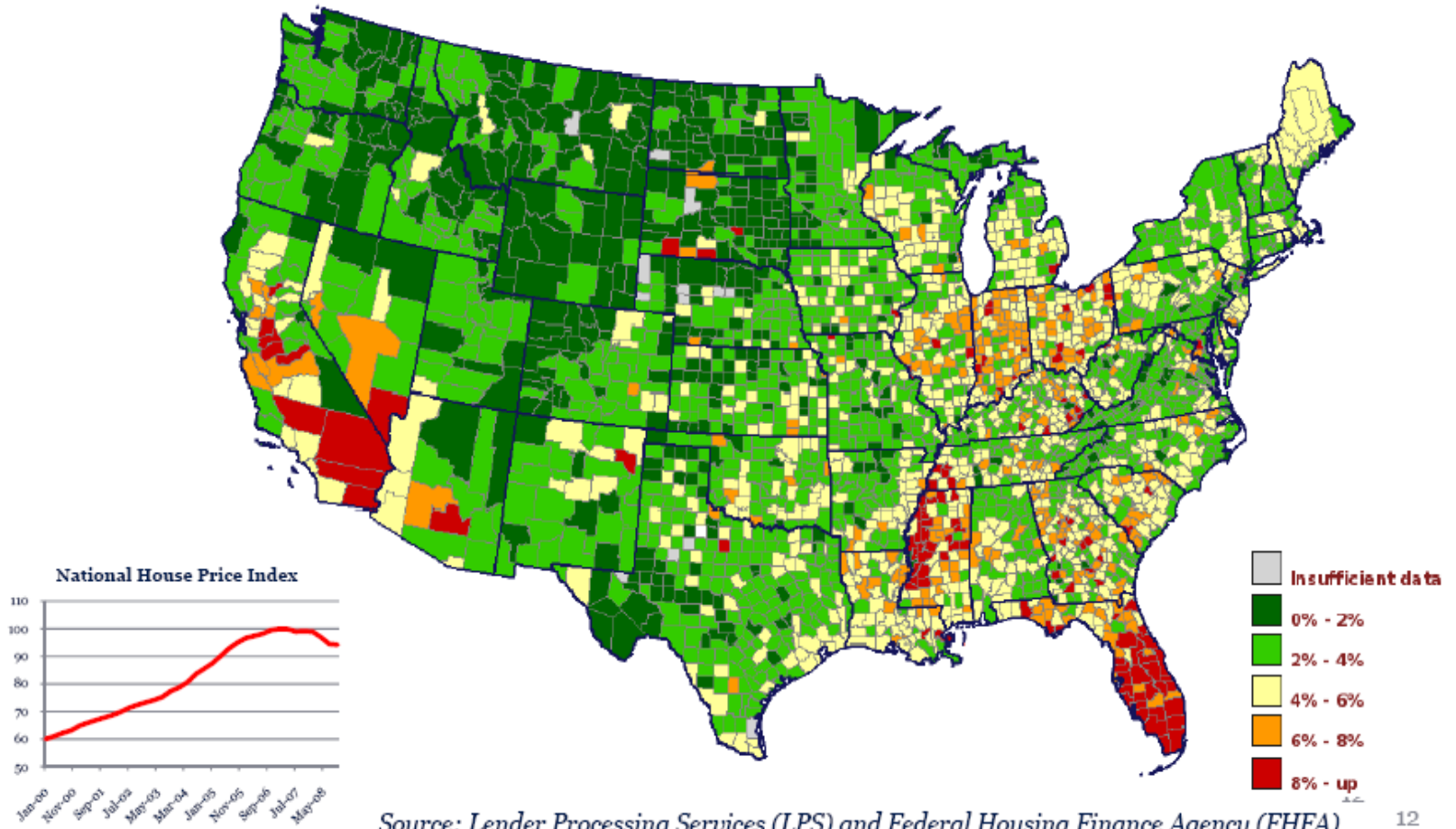
December 2007



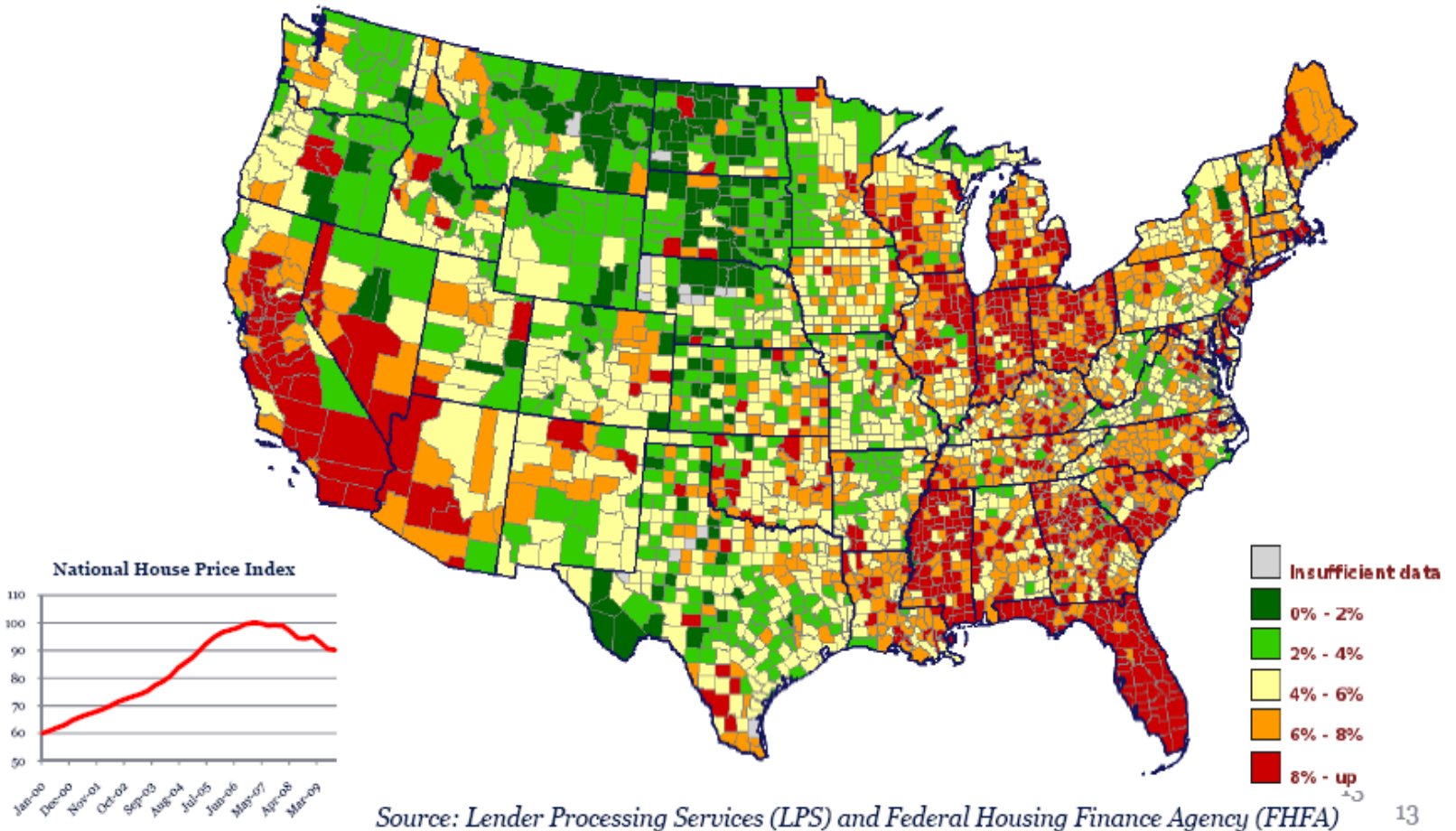
Source: Lender Processing Services (LPS) and Federal Housing Finance Agency (FHFA)

11

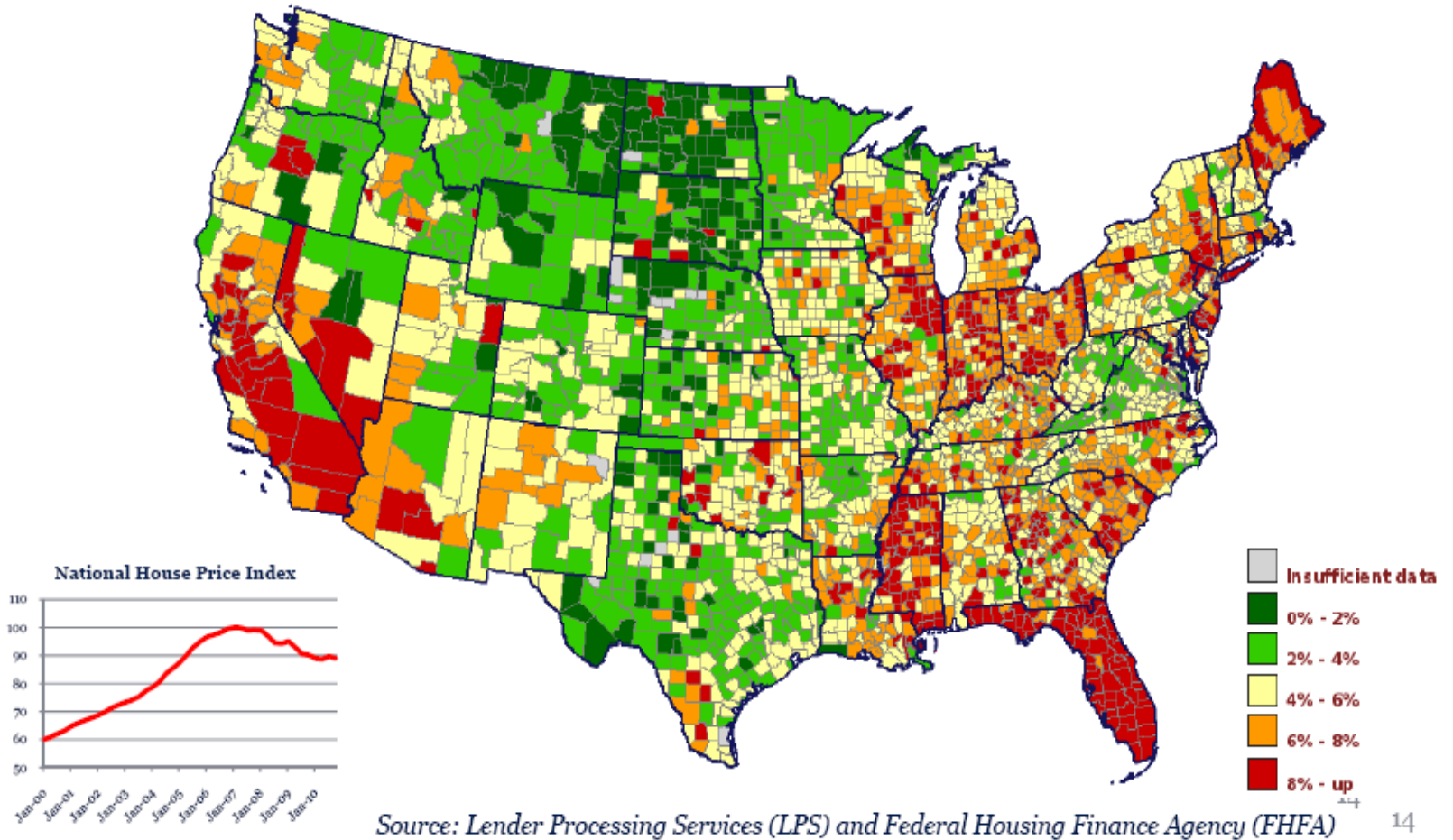
# December 2008



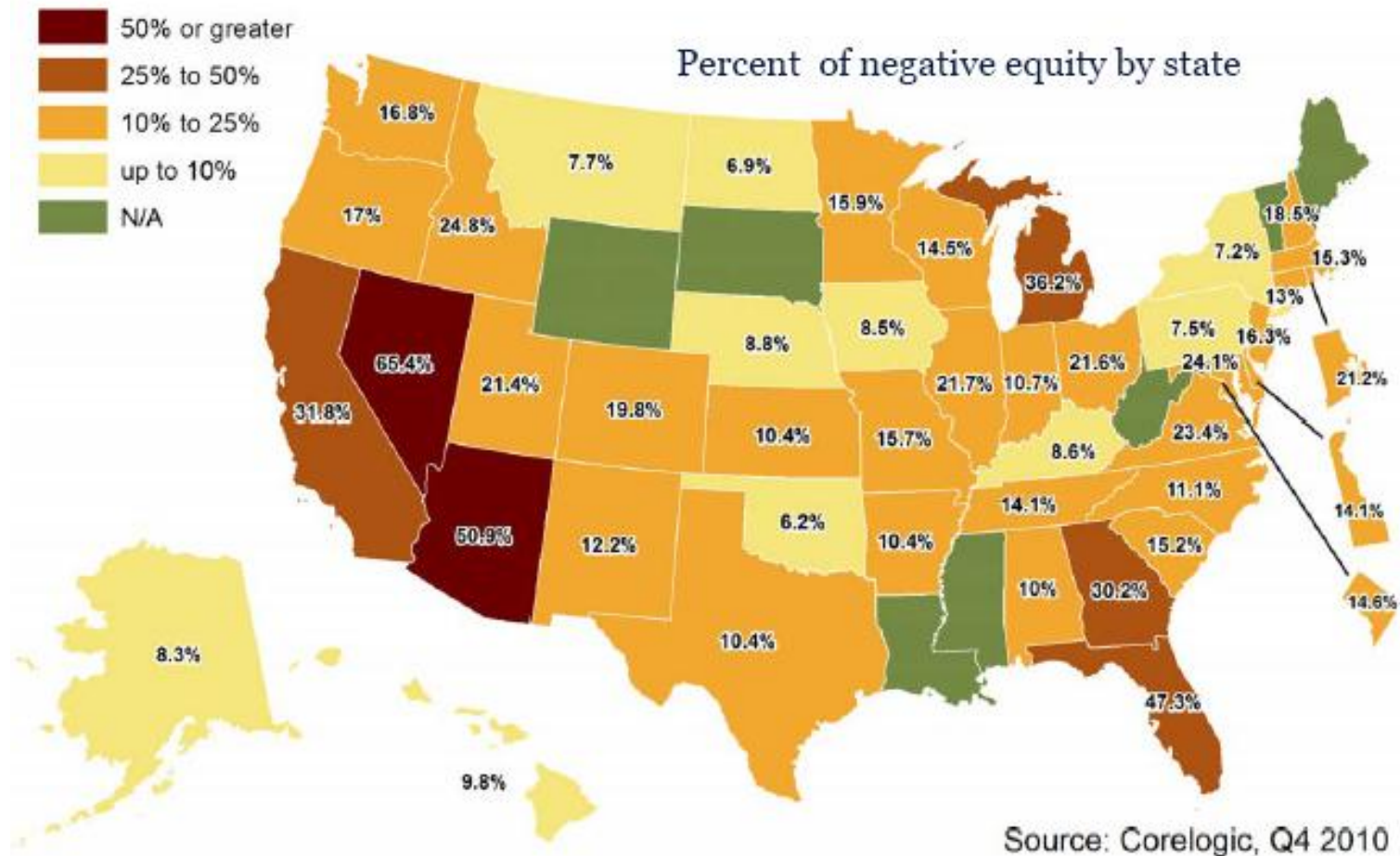
# December 2009



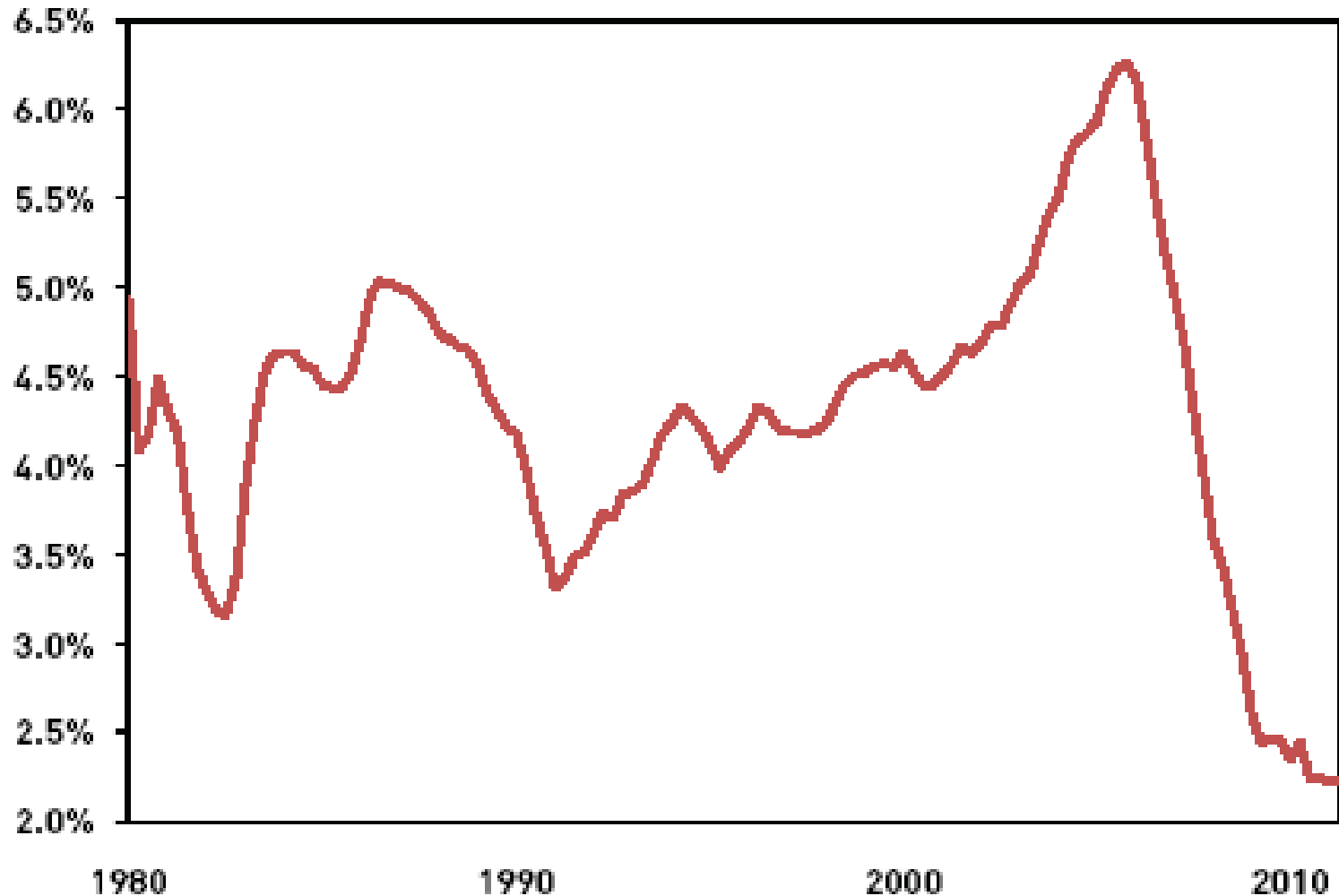
# December 2010



# Households with negative equity



# Residential Investment as a % of Nominal GDP



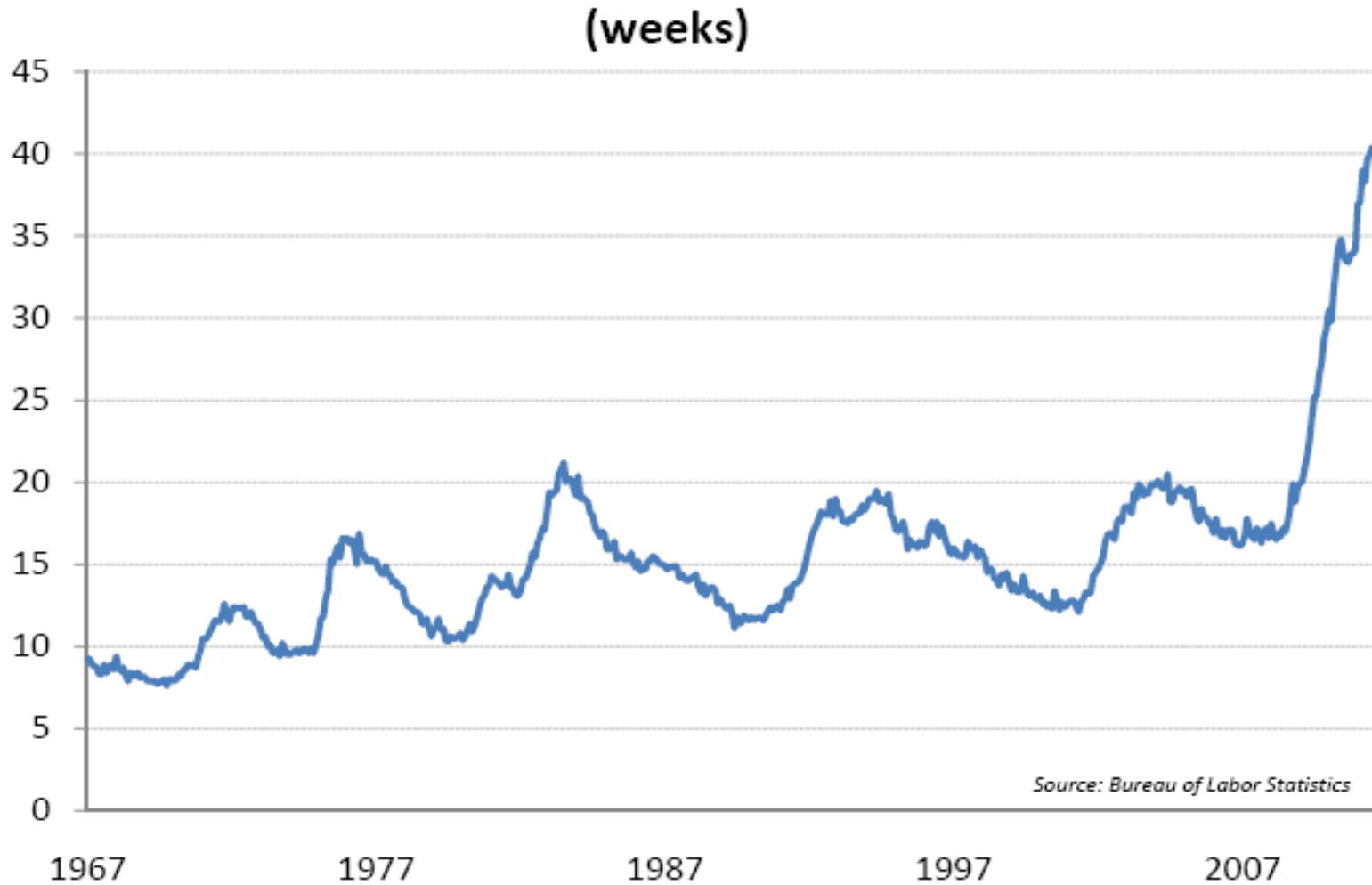


What keeps the Fed on hold?

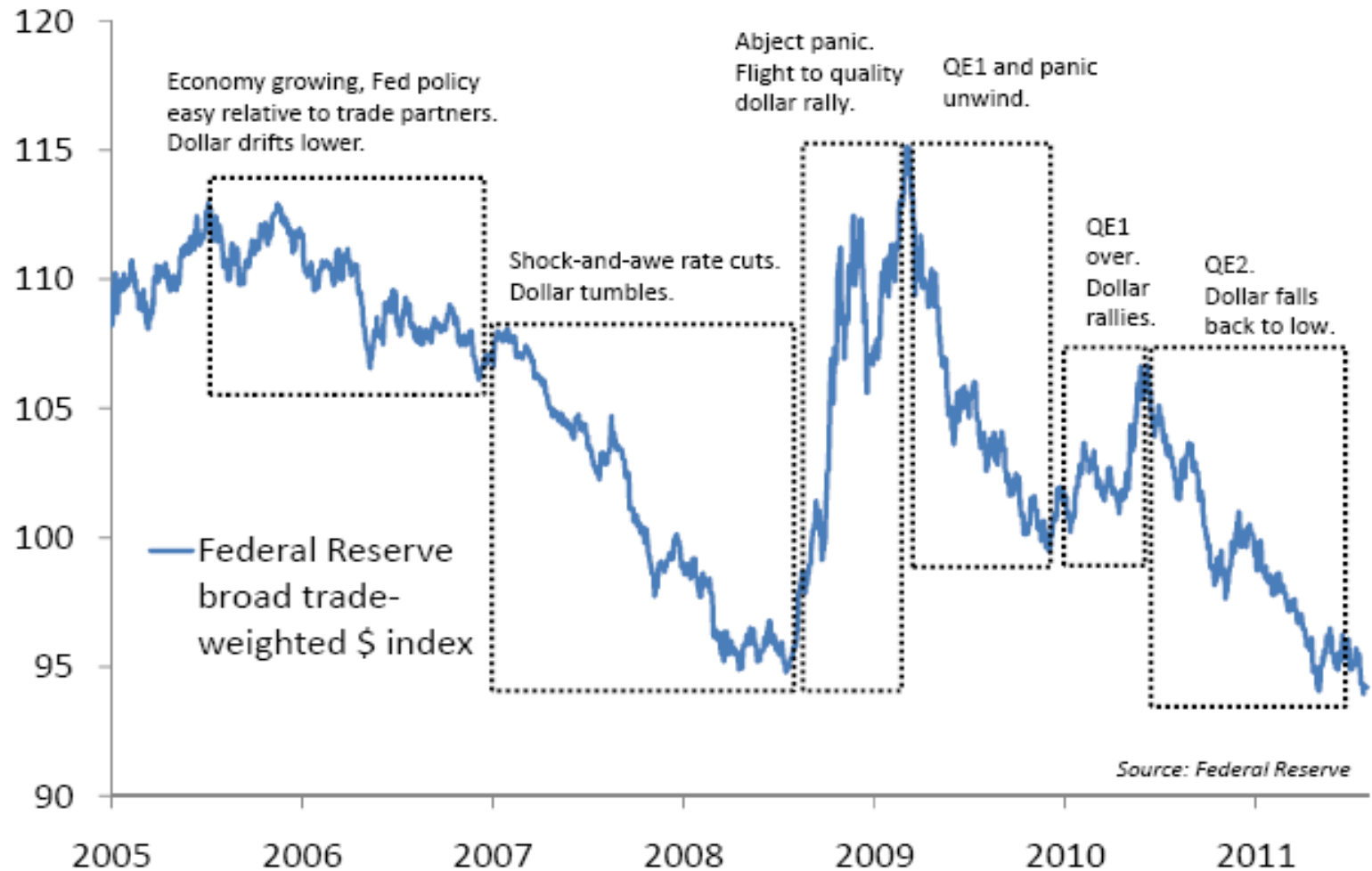
## Unknowns keep Fed on hold

- Japan
- Peripheral European sovereign debt crisis
- Middle East, Africa and oil
- Sudden outbreak of fiscal responsibility
- Structural unemployment

# Duration of Unemployment



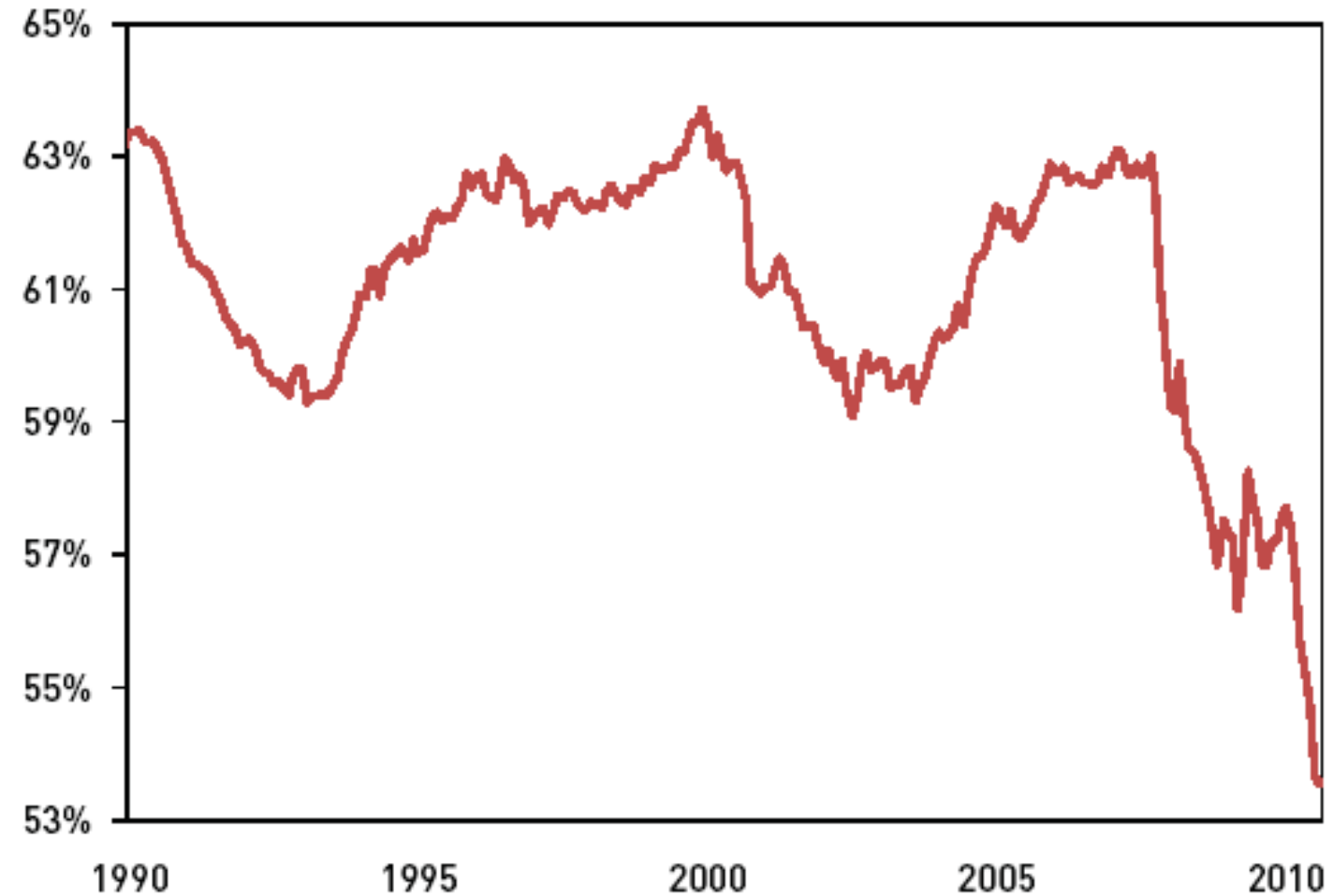
# Weak dollar argues against QE3



Credit not following its usual path

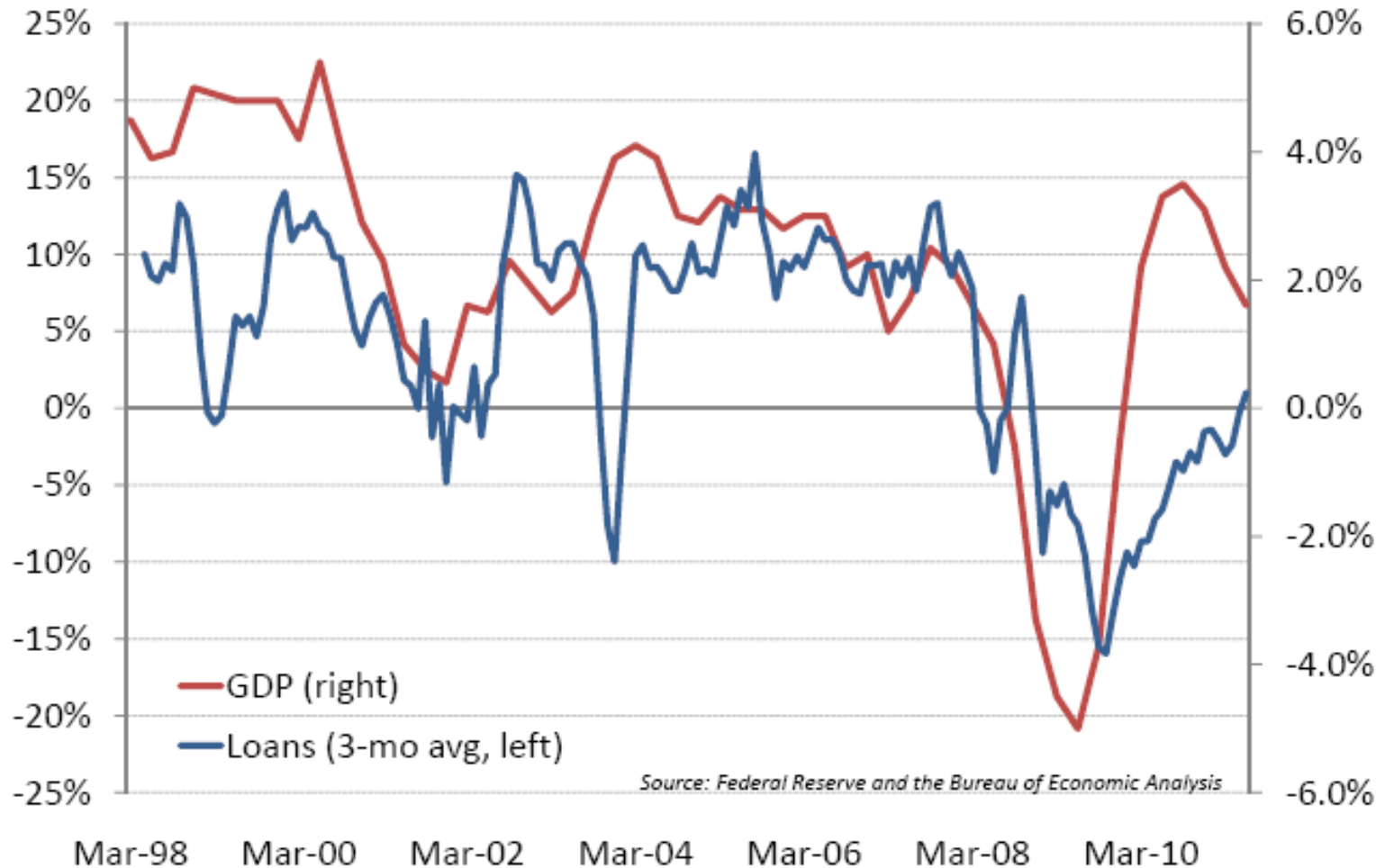
# Credit Demand

## Loans as a Percent of Bank Assets

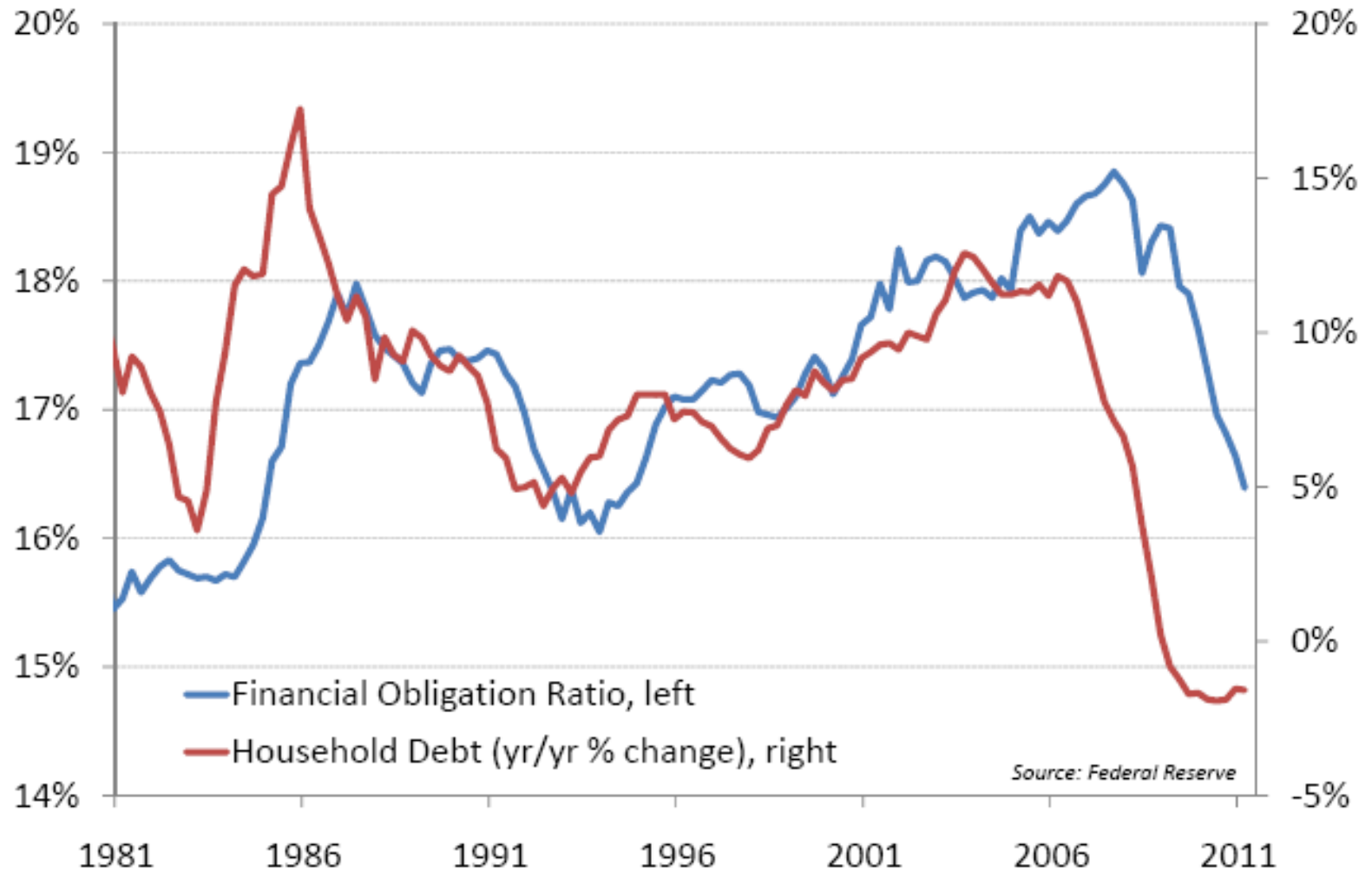


Source: Federal Reserve

# GDP growth vs. Bank loan growth

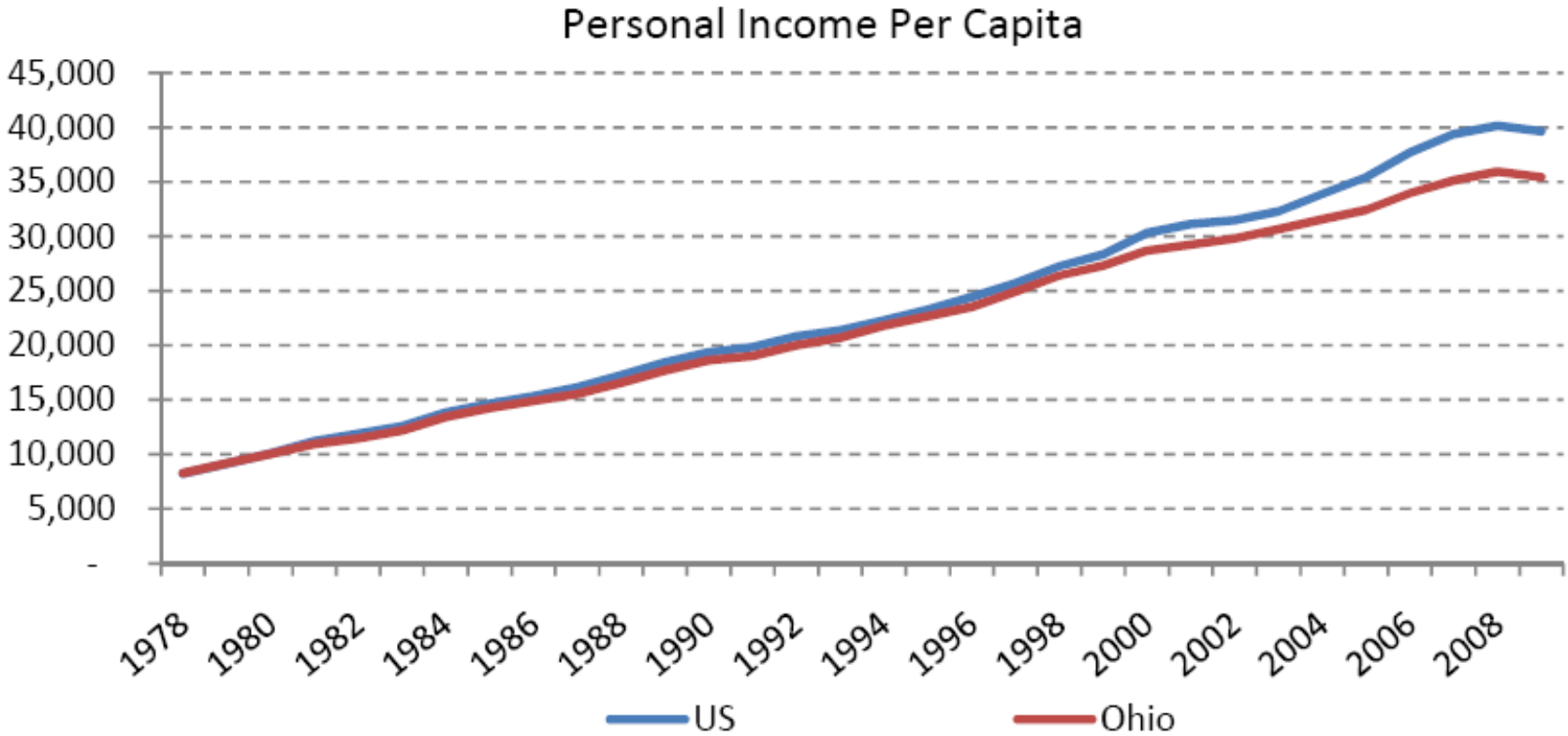


# Household Balance Sheet

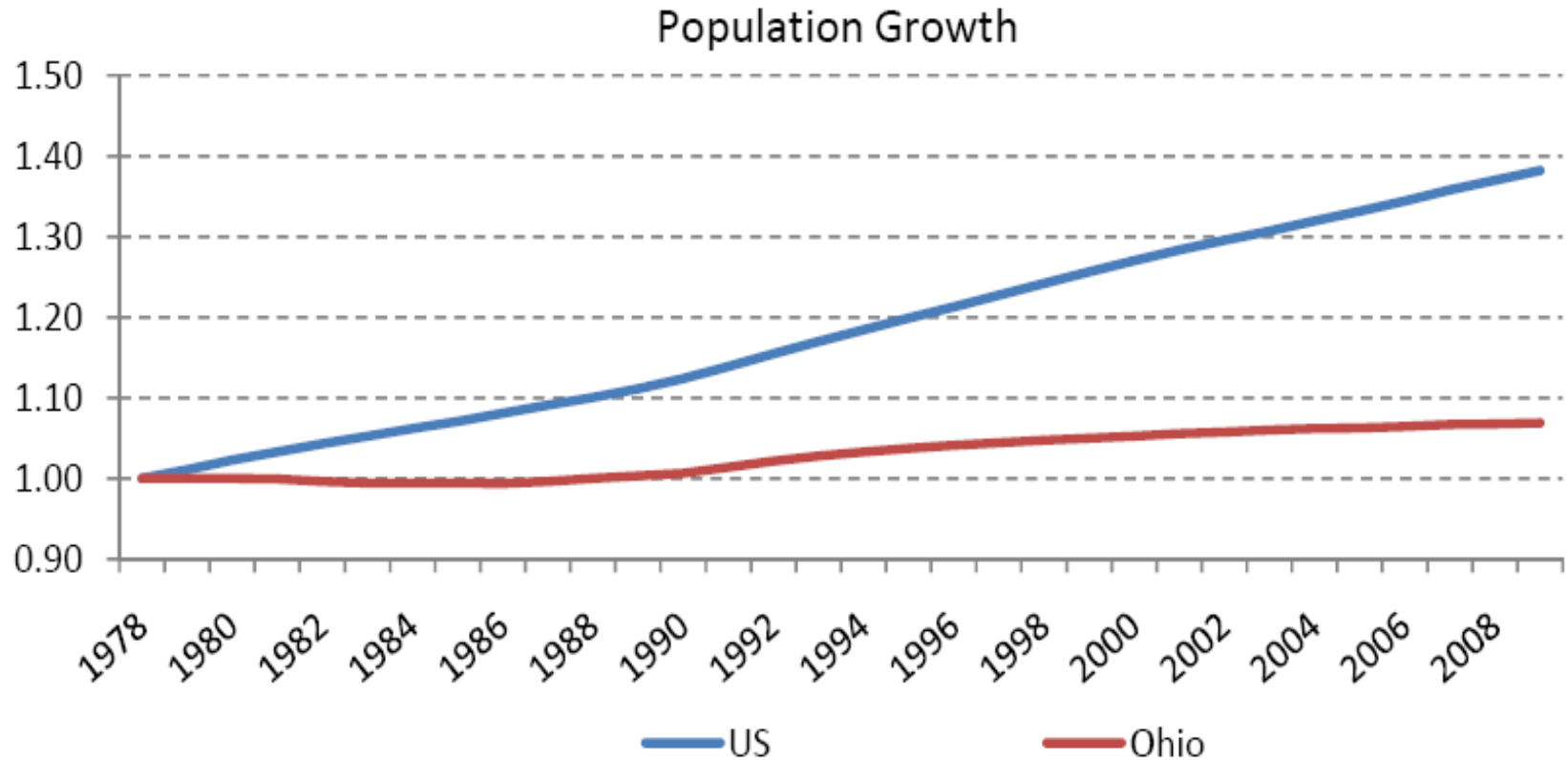


# Ohio's Economy

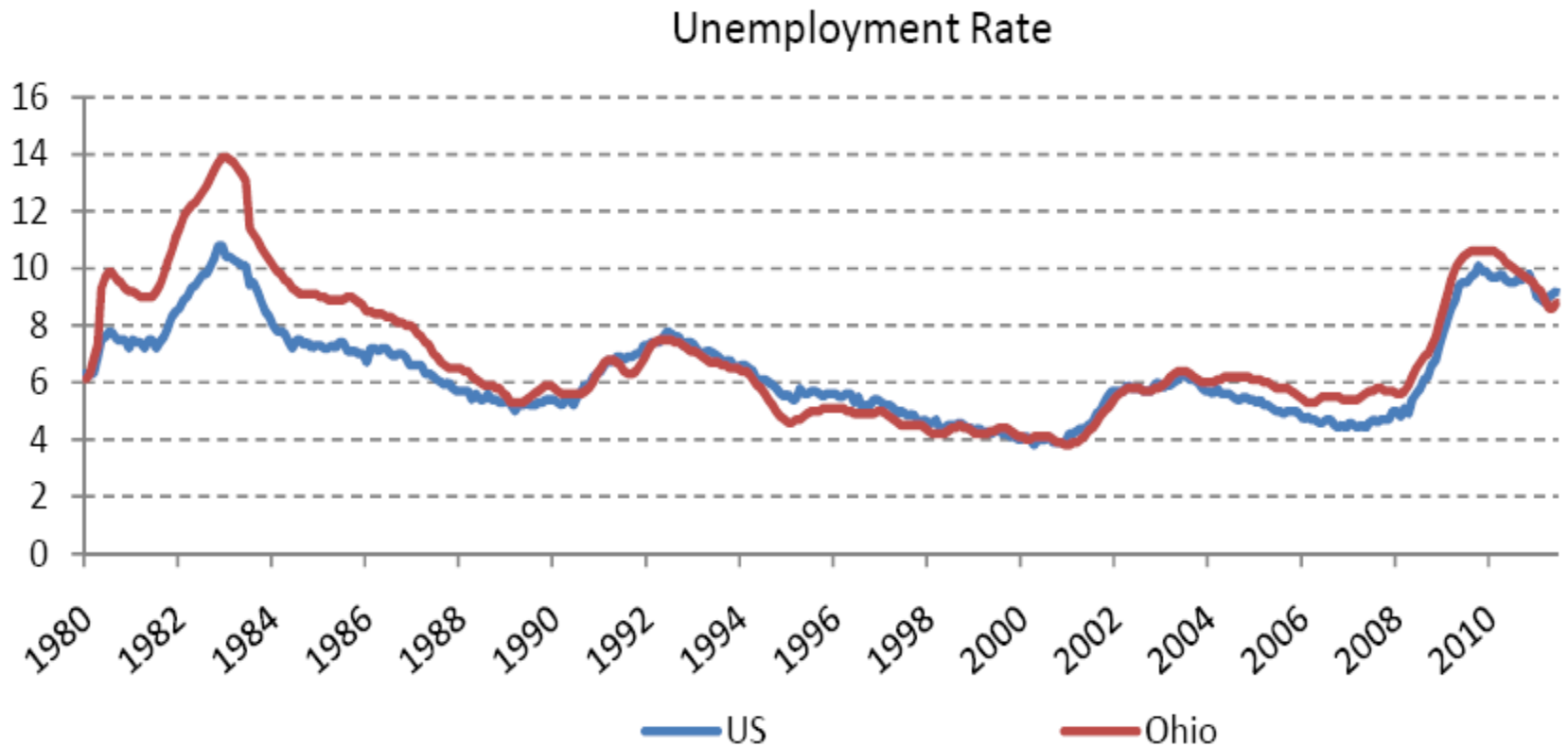
# Personal Income Per Capita



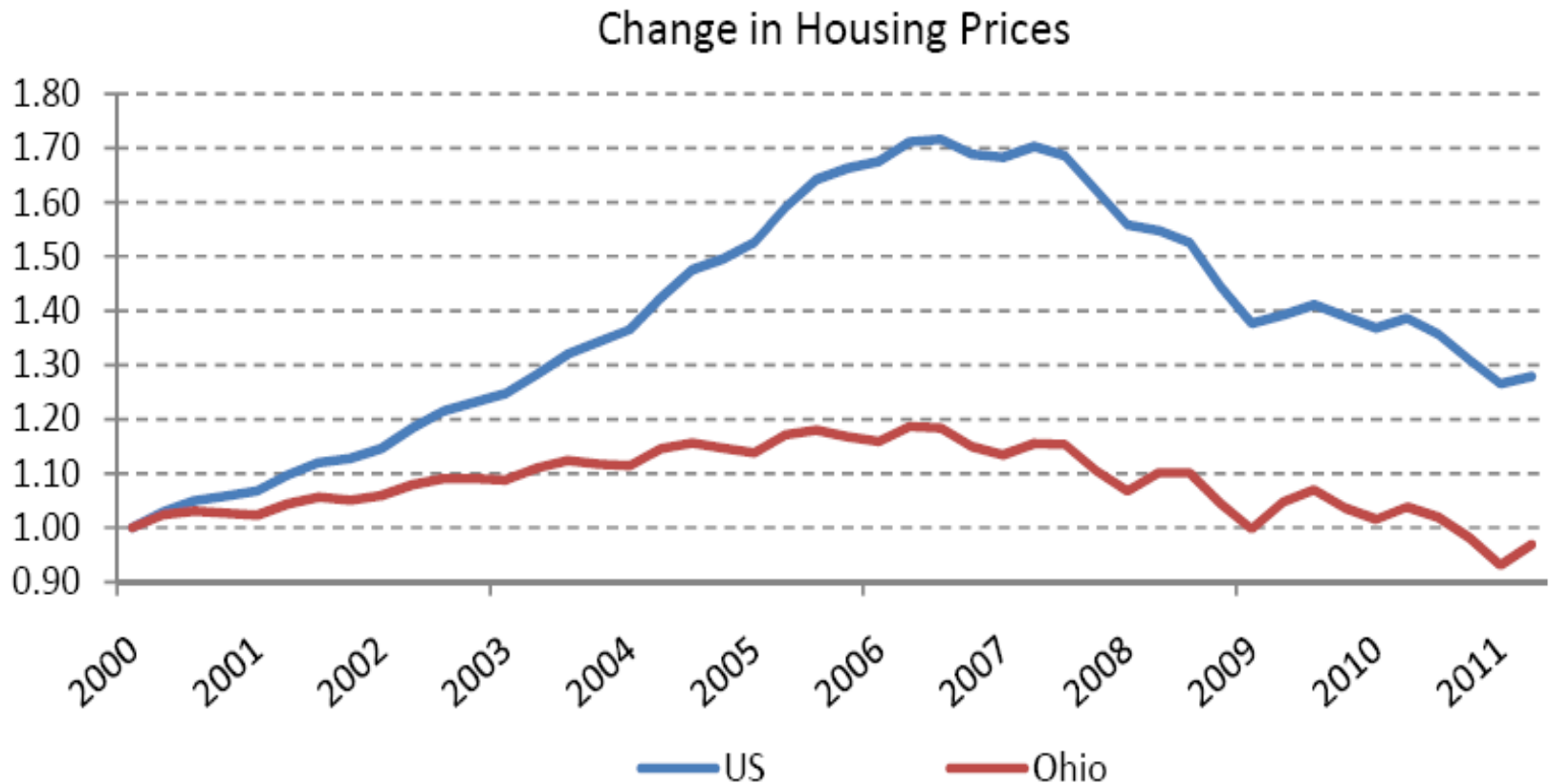
# Population Growth



# Unemployment Rate



# Change in House Prices

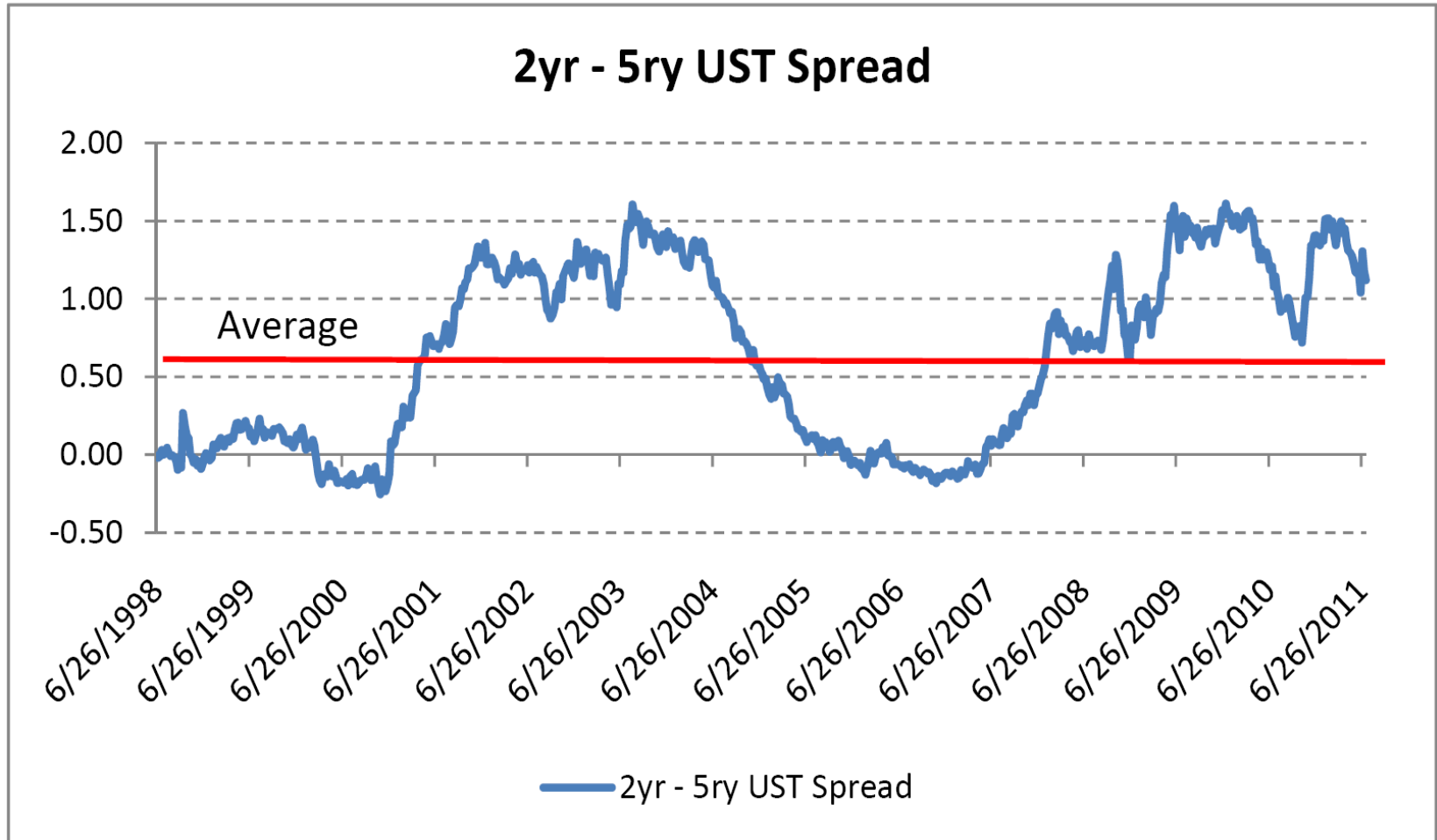


# Current Interest Rate Environment

## Yield Curve 6 Month Horizon

	<u>Mar-11</u>	<u>Sep-11</u>	<u>Change</u>
3 Month	0.122	0.015	-0.107
6 Month	0.151	0.046	-0.105
1 Year	0.232	0.097	-0.135
2 Year	0.688	0.200	-0.488
3 Year	1.174	0.313	-0.861
5 Year	2.171	0.889	-1.282
7 Year	2.874	1.436	-1.438
10 Year	3.470	2.060	-1.410
30 Year	4.566	3.395	-1.171

# 2yr – 5yr UST Spread



# Economic Forecast

	Quarterly percent change, unless otherwise indicated										run year to run year percent change, unless otherwise indicated		
	2011				2012				2013		2010	2011	2012
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
<b>Growth indicators</b>													
<b>GDP</b>	0.4	1.0	1.1	1.2	1.9	1.9	1.9	2.0	1.8	1.9	3.0	1.5	1.6
Final sales	0.0	1.2	1.7	1.2	1.7	1.8	2.0	2.0	1.8	1.8	1.4	1.7	1.7
Consumer spending	2.1	0.1	2.0	2.0	2.3	2.5	2.7	2.8	3.0	3.0	2.0	2.2	2.2
Fixed investment	1.2	8.6	0.4	3.8	4.1	4.3	4.4	4.4	4.4	4.5	2.6	5.0	4.0
Nonresidential	2.1	9.9	0.2	4.1	4.5	4.5	4.6	4.6	4.7	4.6	4.4	6.7	4.2
Structures	-14.4	15.8	-3.9	4.7	5.7	5.5	5.0	4.2	4.0	3.3	-15.8	1.5	4.6
Equipment	8.7	7.8	2.1	4.2	4.4	4.5	4.7	4.7	5.0	5.1	14.6	8.7	4.4
Residential	-2.5	3.4	1.3	2.0	2.6	3.0	3.3	3.5	3.6	3.7	-4.3	-2.0	-9.7
Inventory investment (\$bn)	49.1	40.6	20.0	20.0	25.0	30.0	30.0	30.0	30.0	30.0	58.8	32.4	28.8
Foreign trade (\$bn)	-424.4	-421.3	-423.3	-437.1	-445.1	-461.4	-478.0	-495.0	-512.4	-530.2	-421.8	-426.5	-469.9
Government spending	-5.9	-0.9	2.0	-1.0	-0.5	0.0	0.0	0.0	-2.0	-2.0	0.7	-1.7	-0.1
Treasury budget (fiscal yr, \$bn)	-369.0	-460.5	-141.1	-291.2	-360.7	-456.1	-104.2	-269.9	-343.3	-447.3	-1,294	-1,262	-1,191
Housing starts, (thousands)	582	565	605	607	610	614	619	625	632	638	585	589	617
Unemployment rate (qtr avg)	8.9	9.1	9.1	9.1	9.1	9.0	8.9	8.7	8.6	8.5	9.6	9.0	8.4
<b>Inflation indicators (quarter on previous year's same quarter, at an annual rate. Annual figures are Dec. change from prior Dec.)</b>													
PCE	1.6	2.5	2.6	2.2	1.5	1.0	1.1	1.5	1.7	1.8	1.1	2.1	1.6
Core PCE	0.9	1.3	1.7	2.0	1.9	1.6	1.2	1.1	1.1	1.2	0.7	2.1	1.0
PPI	5.6	7.0	6.2	4.4	1.6	1.4	2.0	2.5	2.9	3.0	4.1	6.9	2.7
Core PPI	2.0	2.3	2.3	2.5	1.8	1.5	1.6	2.1	2.4	2.5	1.3	3.6	2.4
<b>Interest rates (end of period)</b>													
Federal funds rate (hist. is qtr avg)	0.16	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.19	0.10	0.10
Interest paid on excess reserves	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-month LIBOR	0.30	0.25	0.35	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.25	0.25
3-mo Treasury bills	0.10	0.04	0.00	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.14	0.05	0.05
2-yr Treasury notes	0.70	0.41	0.20	0.20	0.20	0.25	0.30	0.35	0.40	0.40	0.62	0.20	0.35
5-yr Treasury notes	2.11	1.58	0.90	0.85	0.80	0.80	0.85	0.90	0.95	1.00	1.93	0.85	0.90
10-yr Treasury notes	3.41	3.00	2.00	1.90	1.90	1.95	2.00	2.10	2.25	2.50	3.29	1.90	2.10
Fed primary credit (discount rate)	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Prime bank rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Avg. fixed mortgage rate	4.86	4.60	3.80	3.70	3.70	3.75	3.80	3.90	4.05	4.30	4.86	3.70	3.90

# Investment Opportunities

# Current Investment Spectrum

- Treasuries
- FDIC Guaranteed Debt
- US Agency Bonds
- US Agency MBS and CMOs
- Bank Qualified Municipals
- Private / Whole Loan CMOs
- Corporate Bonds

Less Risk



Credit  
Spectrum

More risk

# Sectors for Public Fund Investors

- Treasuries
  - US Agency Bonds
  - Agency MBS Pools
  - Agency CMO Structures
  - Corporate Sector
- 

# Agency Focus

Strive for balance with overall portfolio:

- Step-up and Cushion bond yields have fallen but still provide good tradeoff between yield and defensiveness
- 1x calls help to reduce overall portfolio optionality
- Off-the-run bullets often approach callable yields
- Important to manage optionality of portfolio

# Agency MBS Pools

- Monthly principal and interest can be used to participate in eventual rising rate environment
- Variety of maturities and cash flow profiles to meet different liquidity needs
- Interest in seasoned structures
- Availability of shorter cash flow, average life, and maturity profiles for short-term investors

# Agency CMO Sector

- Monthly principal and interest can be used to participate in eventual rising rate environment
- Pay windows / lockout can direct cash flow to medium-term range
- Good structure can be found PAC and sequential structures

# Corporate Sector

- Attractive yield levels
- Large supply of shorter maturities
- Noncallable
- Credit standards
- Diversity of issuers
- Investment policy parameters

# Current Strategy Thoughts

- Stay invested
- Seek balance in every layer of the portfolio
- Proactively manage extension and reinvestment risk
- Too much and too little cash flow are both costly
- Take advantage of yield pick-up opportunities
- Structure cash flow profile to meet liquidity needs
- Diversification is important on every level

# Important to Stay Invested

## Annual pickup in thousands if invest at:

<b>Amount</b>	<b>0.75%</b>	<b>1.00%</b>	<b>1.50%</b>	<b>2.00%</b>	<b>2.50%</b>	<b>3.00%</b>
<b>10 mill</b>	<b>55</b>	<b>80</b>	<b>130</b>	<b>180</b>	<b>230</b>	<b>280</b>
<b>20 mill</b>	<b>110</b>	<b>160</b>	<b>260</b>	<b>360</b>	<b>460</b>	<b>560</b>
<b>30 mill</b>	<b>165</b>	<b>240</b>	<b>390</b>	<b>540</b>	<b>690</b>	<b>840</b>
<b>40 mill</b>	<b>220</b>	<b>320</b>	<b>520</b>	<b>720</b>	<b>920</b>	<b>1,120</b>
<b>50 mill</b>	<b>275</b>	<b>400</b>	<b>650</b>	<b>900</b>	<b>1,150</b>	<b>1,400</b>

# Striking the Right Balance

- Diversification important in many aspects
  - Sector
  - Structure
  - Coupon mix
  - Credit
  - Purchase timing
- Make changes through new cash where possible
  - Most have ample cash / rolloff
  - Sales can exacerbate purchase “time” concentrations

## Core sectors:

- US Agency Bonds
- Agency MBS Pools
- Agency CMO Structures

# Investment Final Thoughts

- Liquidity is the primary focus
- Consider alternative sources of revenue to offset economic shortfalls
- Take advantage of relative yield opportunities
- Defend against reinvestment risk
- Monitor extension risk
- Diversification is important on every level

This material was produced by an FTN Financial Strategist and is not considered research and is not a product of any research department. Strategists may provide information to investors as well as to FTN Financial's trading desk. The trading desk may trade as principal in the products discussed in this material. Strategists may have consulted with the trading desk while preparing this material and the trading desk may have accumulated positions in the securities or related derivatives products that are the subject of this material. Strategists receive compensation which may be based in part on the quality of their analysis, FTN Financial revenues, trading revenues, and competitive factors.

Although this information has been obtained from sources which we believe to be reliable, we do not guarantee its accuracy, and it may be incomplete or condensed. Ratings on all securities are subject to change. Opinions, historical price(s) or value(s) are as of the date and, if applicable, time, indicated. FTN Financial does not accept any responsibility to update any opinions or other information contained in this communication. FTN Financial is not providing investment advice through this material. This is for information purposes only and is not intended as an offer or solicitation of any product. Securities, financial instruments, products or strategies mentioned in this material may not be suitable for all investors. Before acting on any information in this material you should consider whether it is suitable for your particular circumstances. Further information on any of the securities or financial instruments mentioned in this material may be obtained upon request.

FTN Financial Group, FTN Financial Capital Markets, and FTN Financial Portfolio Advisors are divisions of First Tennessee Bank National Association (FTB). FTN Financial Securities Corp (FFSC) and FTN Financial Capital Assets Corporation are wholly owned subsidiaries of FTB. FFSC is a member of FINRA and SIPC—<http://www.sipc.org/>. FTN Financial Group, through First Tennessee Bank or its affiliates, offers investment products and services. FTN Financial is not registered as a Municipal Advisor.

This message is intended only for the use of the individual or entity to which it is addressed and may contain information that is privileged, confidential and exempt from disclosure under applicable law. If the reader of this message is not the intended recipient, employee or agent responsible to deliver it to the intended recipient, you are hereby notified that reading, disseminating, distributing or copying this communication is strictly prohibited.