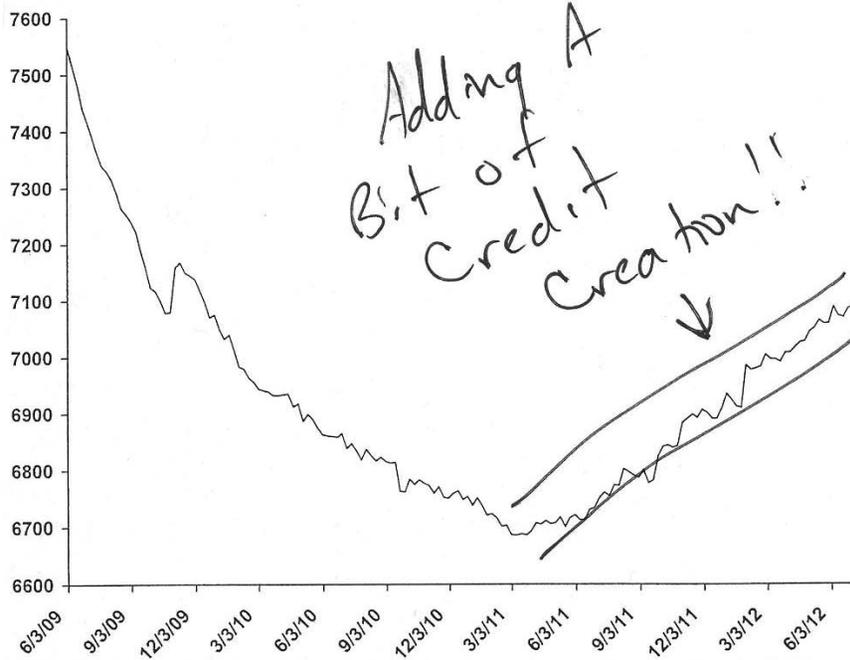
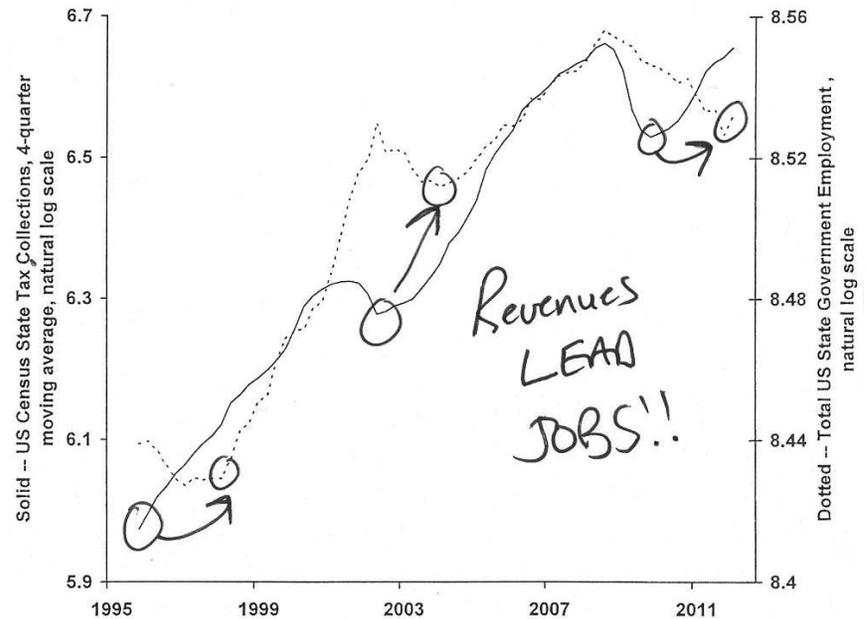


# ECONOMY is GEARING: #7 Bank Lending & #8 State Jobs !!!

**Total U.S. Bank Loans**

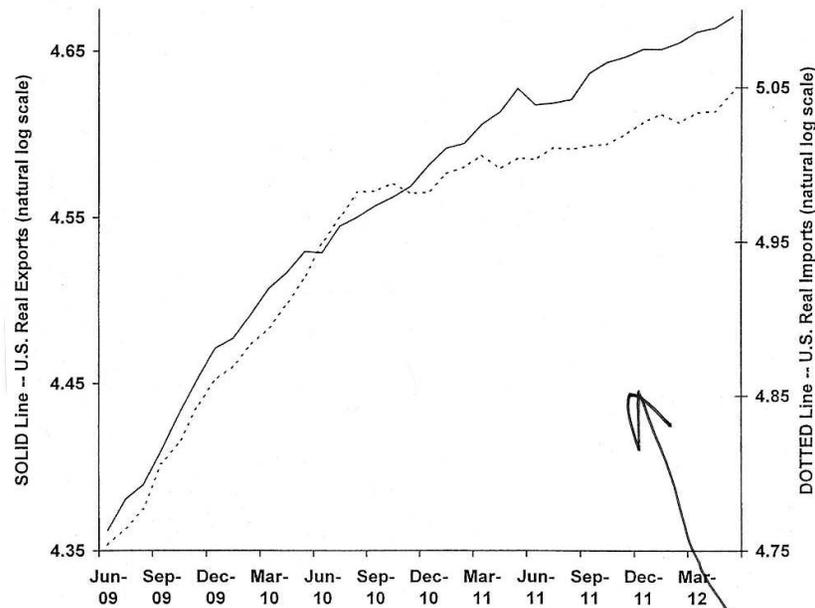


**State Government Total Tax Collections vs. State Government Employment**

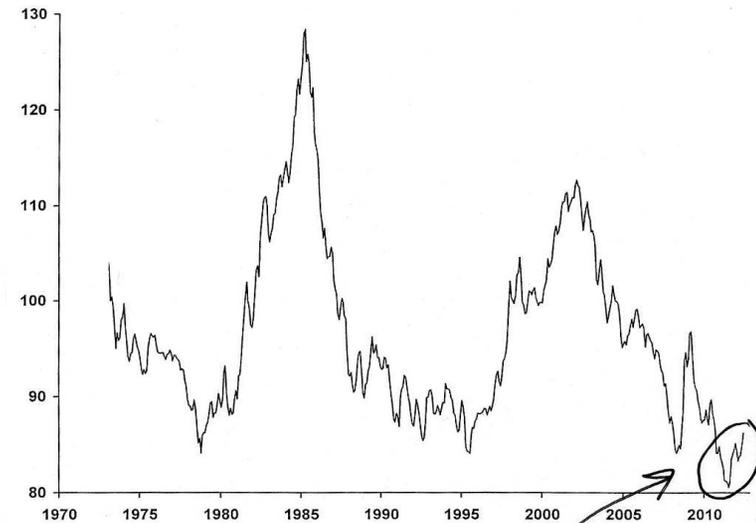


# ECONOMY is GEARING: #9 Net Exports!!!

## U. S. Real Exports vs. Real Imports



## U. S. REAL Broad Trade-Weighted Dollar Index

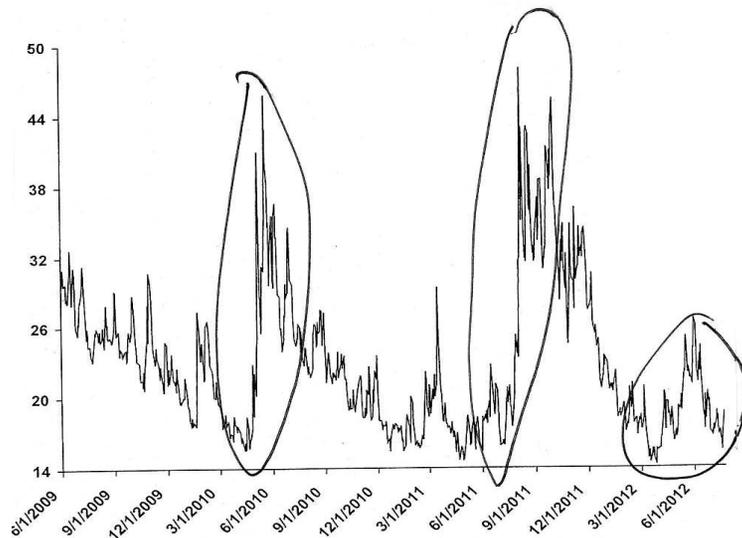


Really Competitive US Dollar  
Should Drive US TRADE!?!

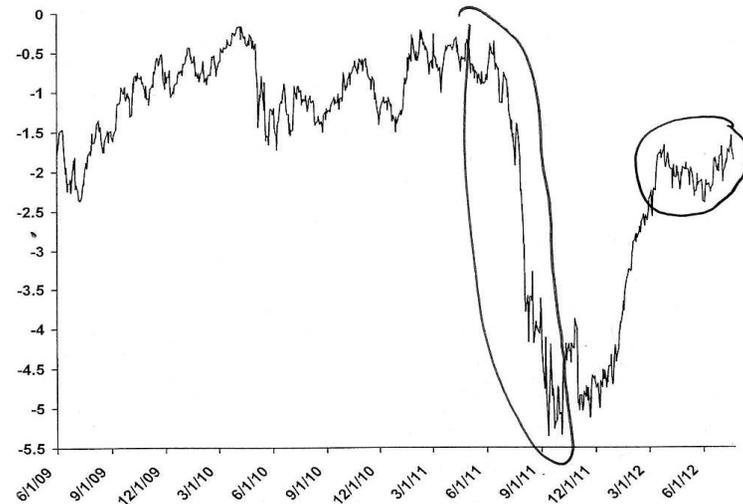


# ECONOMY is GEARING: #10 Sensitivity to Crises!!

CBOE VIX VOLATILITY Index



Bloomberg European Financial Conditions Index

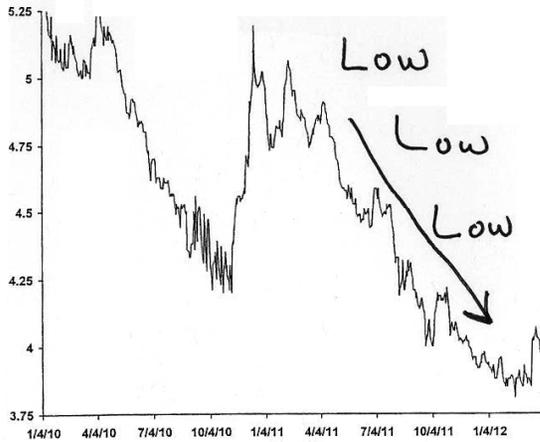


Has the "Boy Cried Wolf"  
Too often??!



# U.S. Economy is Self-Medicating!!!

**30-Year National Average Mortgage Interest Rate**



**Annual Growth in the M2 Money Supply**



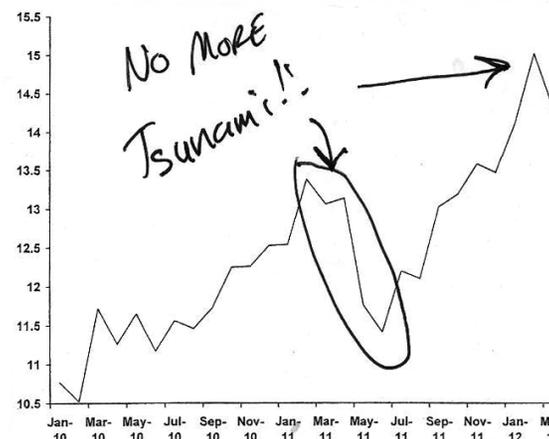
**Trade-Weighted U.S. Dollar Index**



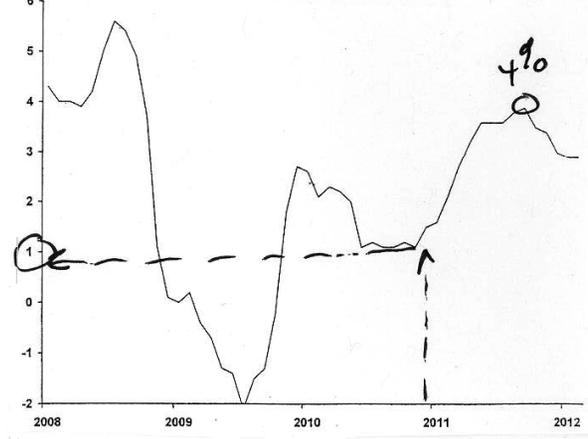
**Commodity Prices  
Crude Oil vs. Non-Energy Commodities**



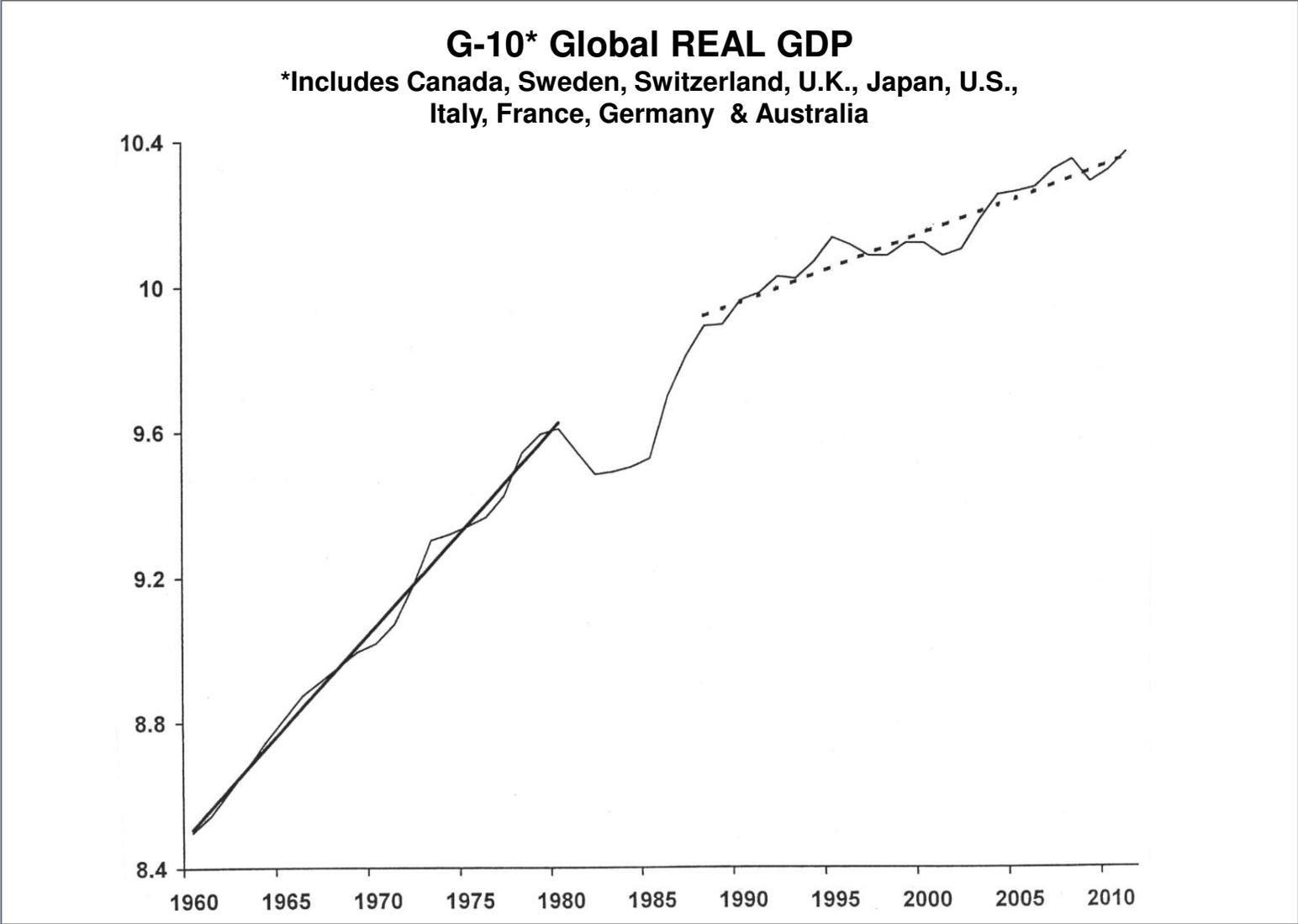
**Total Annualized U.S. Auto Sales**



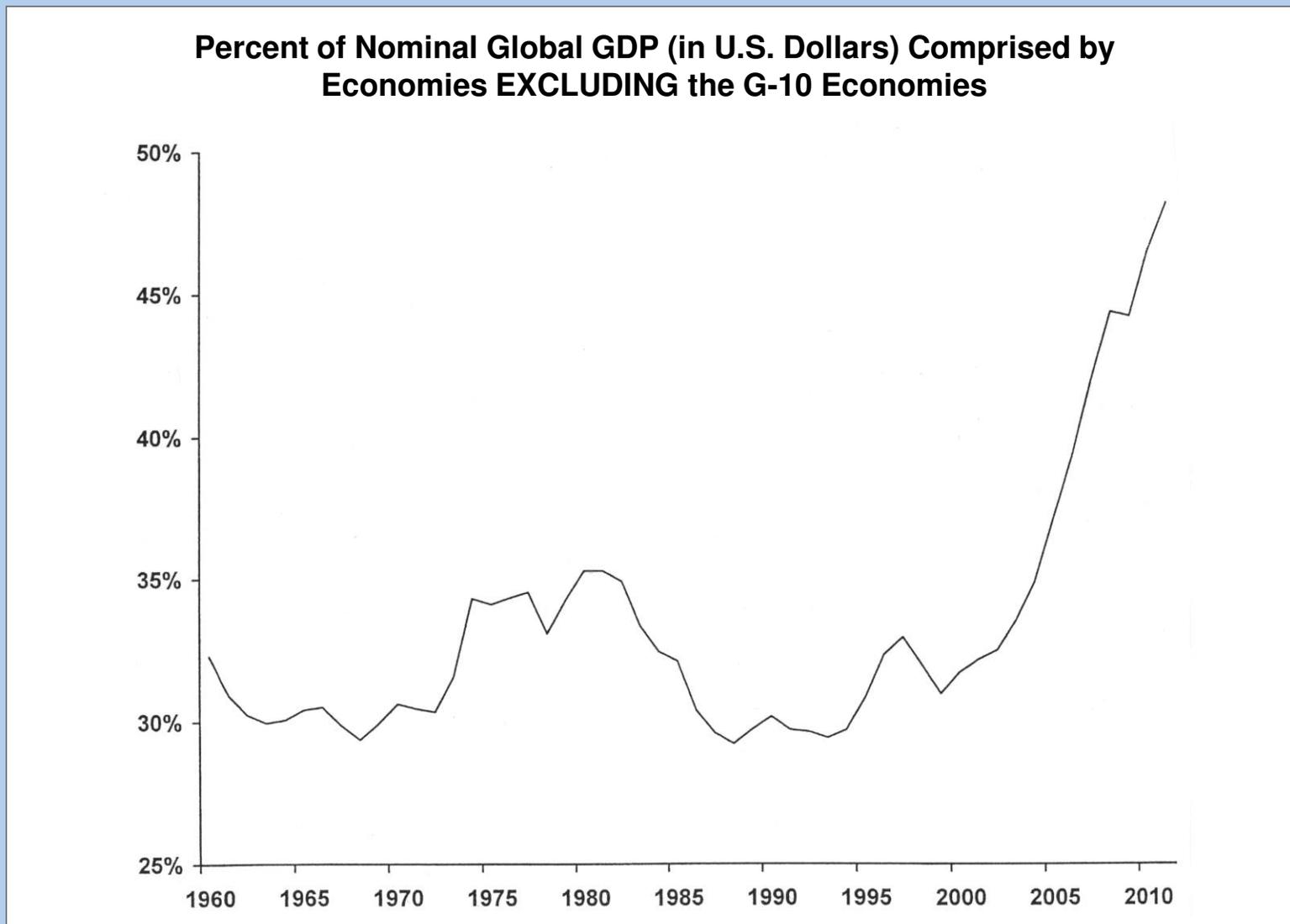
**Annual Consumer Price Inflation Rate**



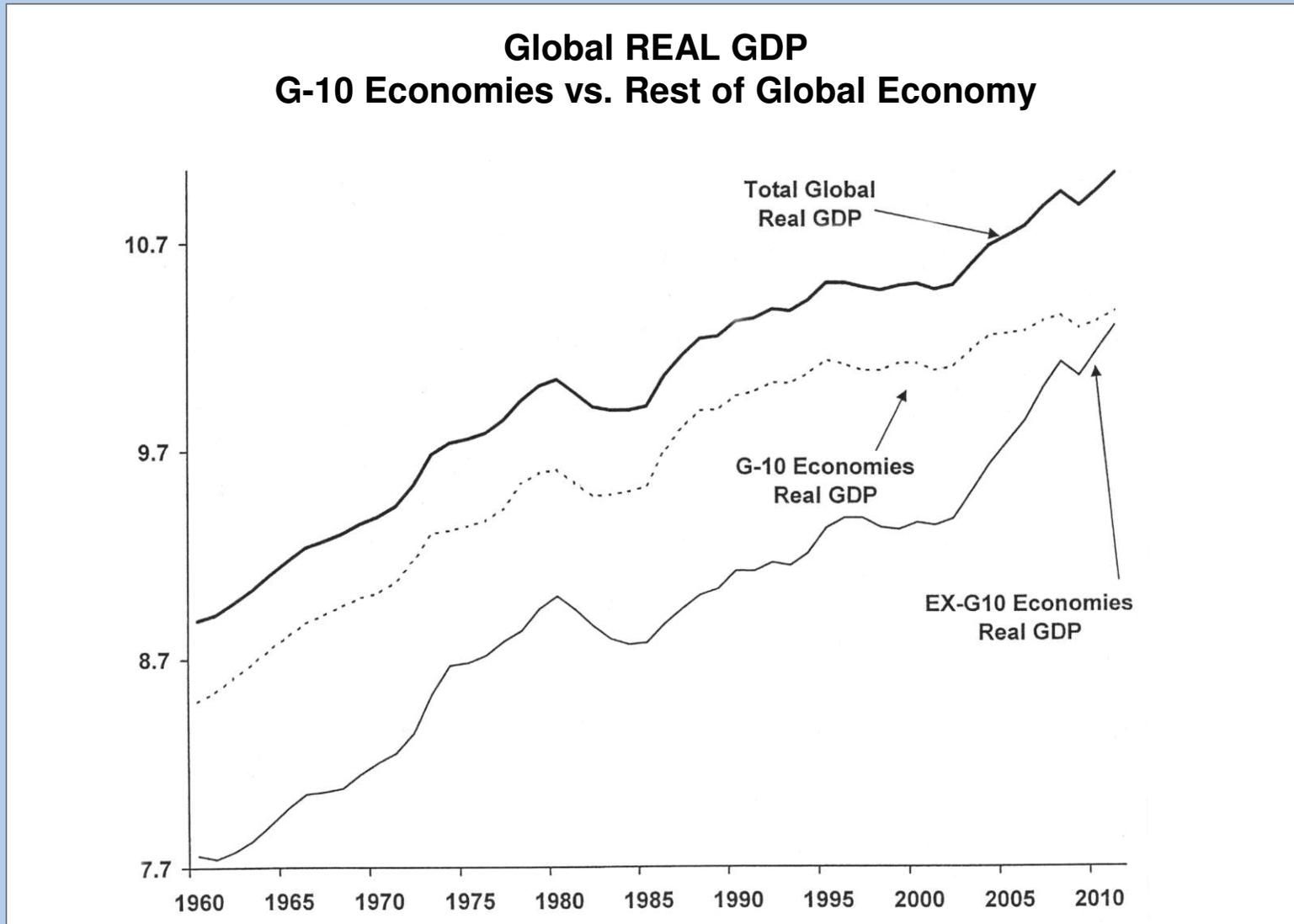
# SAME Demographic New-NORMAL Hits Entire G-10!??



# Fortunately, the U.S. Enacted the Emerging Market MARSHALL PLAN!!!

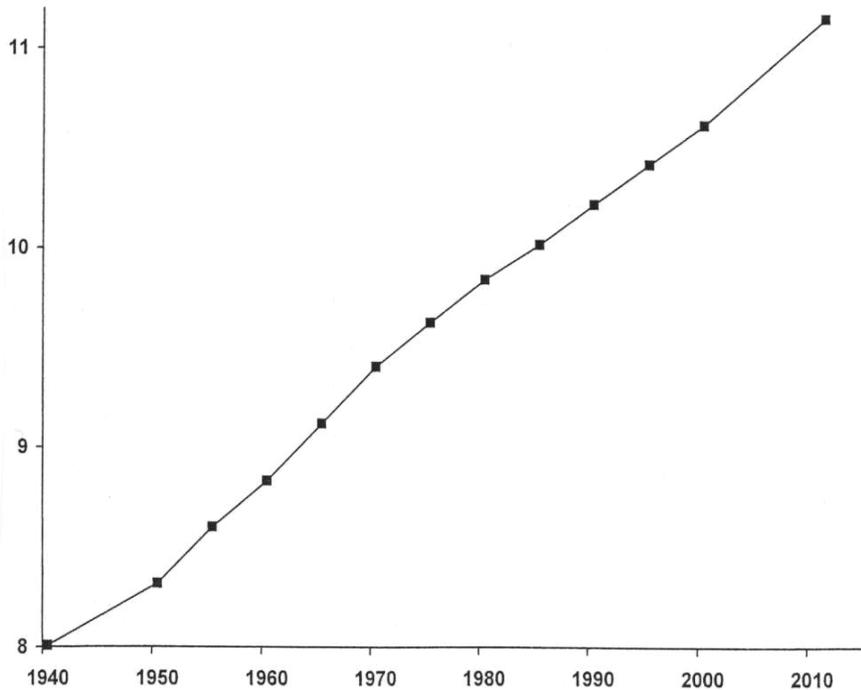


# GLOBAL GROWTH IS STILL O.K.?!?



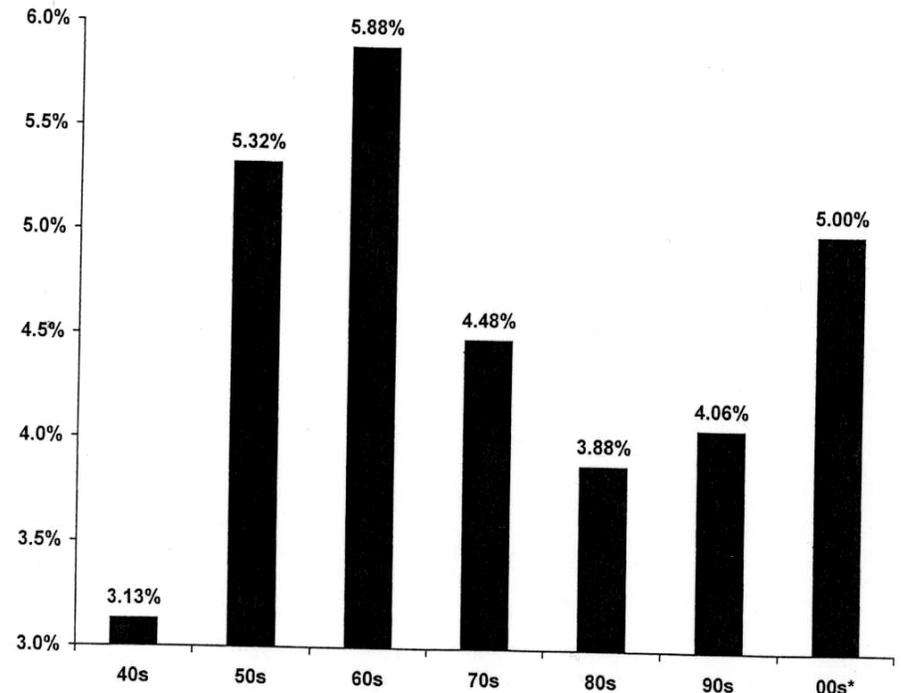
# What? Real Global Growth Has Accelerated???

**Real Global World Product**  
2011 U.S. Dollars, natural log scale



**Annualized Real Gross World Product Growth by Decade\***

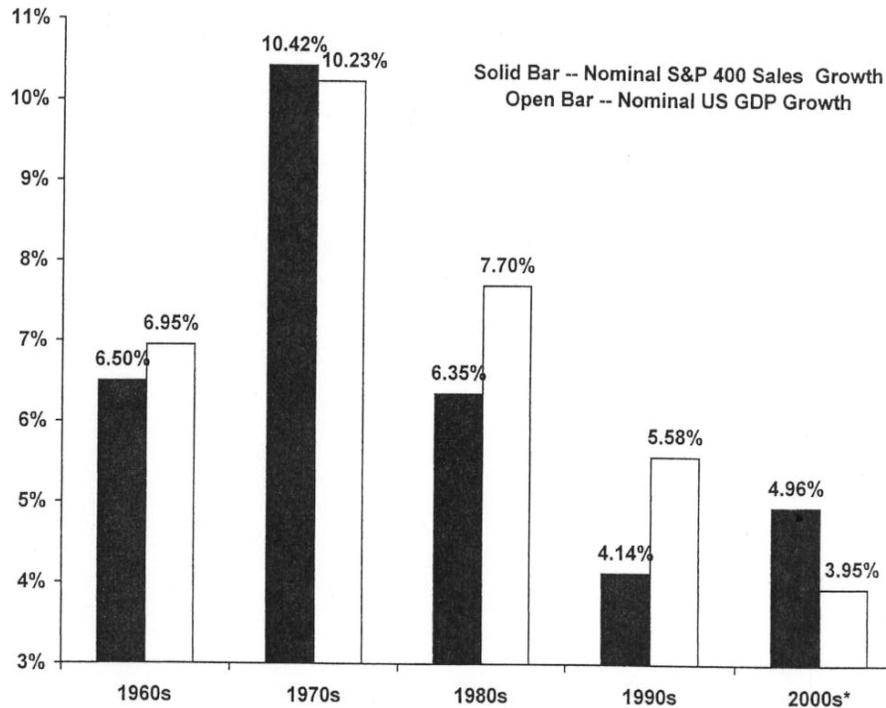
Note: The 00s decade is the annualized growth for 11 years from 2000 to 2011



# Finding Top-LINE GROWTH?!?

**S&P 400 Nominal Sales Per Share vs. U.S. Nominal GDP Annualized Growth by Decade\***

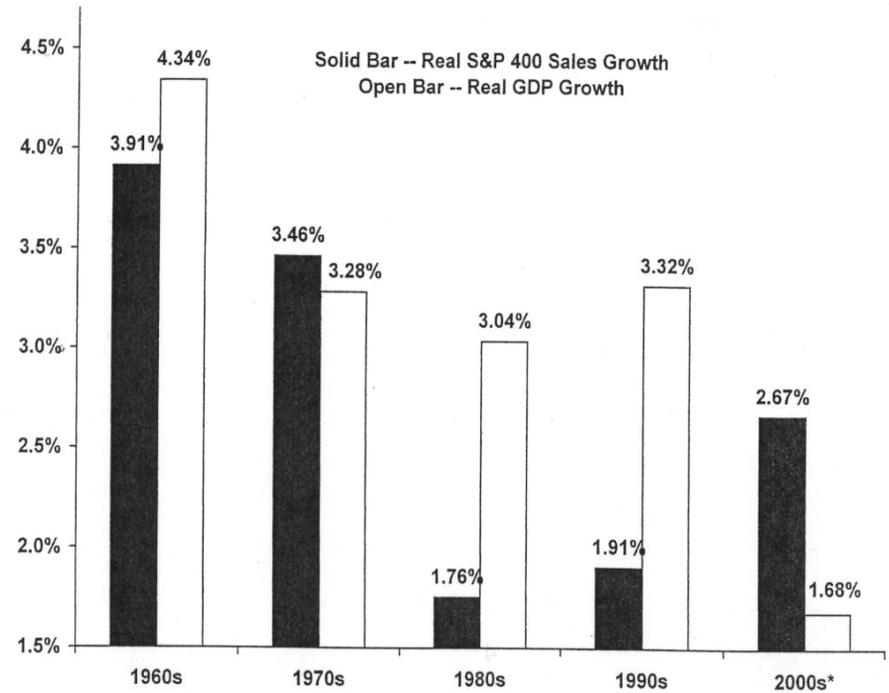
\* The 2000s decade is actually from 1999Q4 to 2012Q2



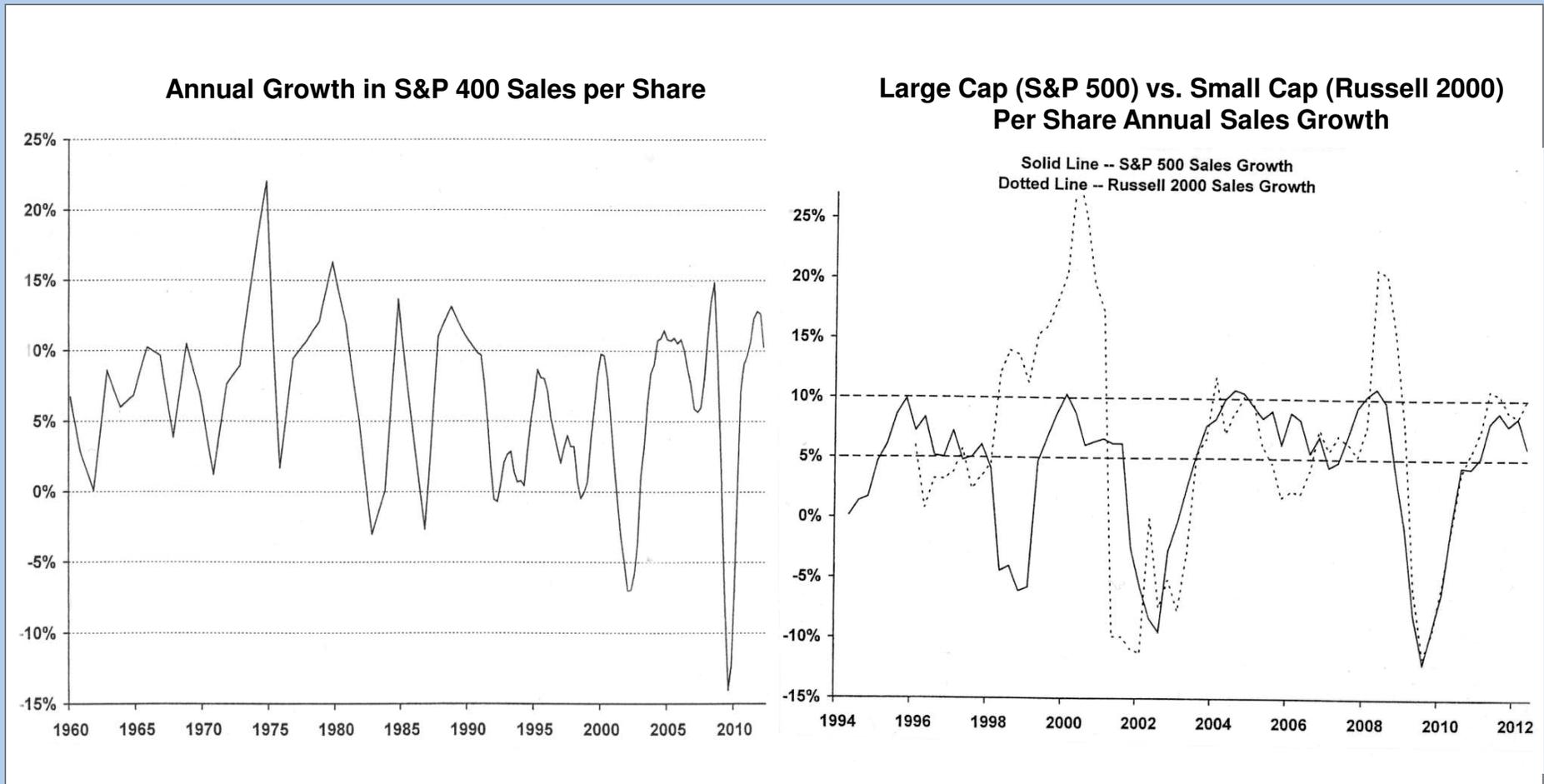
**S&P 400 Real Sales Per Share\*\* vs. U.S. Real GDP Annualized Growth by Decade\***

\*\* S&P 400 Sales Per Share Adjusted by GDP Price Deflator Index

\* The 2000s decade is actually from 1999Q4 to 2012Q2



# Earnings Story Is Not Just Margins!?



# What About Europe???

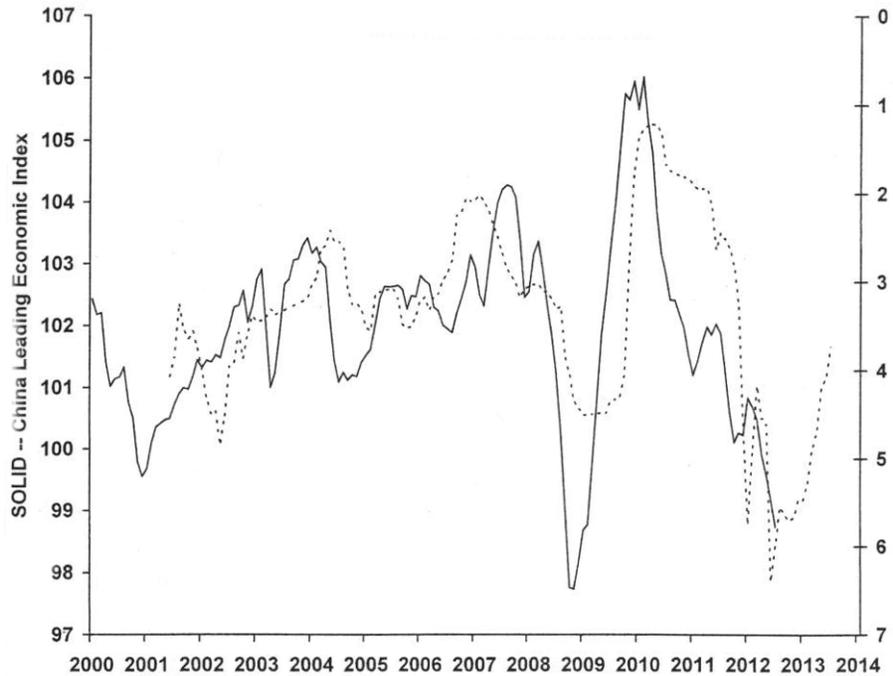
- **Solution is Growth ... Not Austerity**
- **Finally, an “Economic Union”**
- **Moving Euro zone from “Imminent Calamity” to “Chronic Problem”**
- **Fallout is Slower/No Growth from Euro zone**
- **“Financial” Contagion Unlikely**
- **In 1990, Global Recovery Proceeded Without Japan**
- **Investor Sensitivity is Decaying**



# What About CHINA???

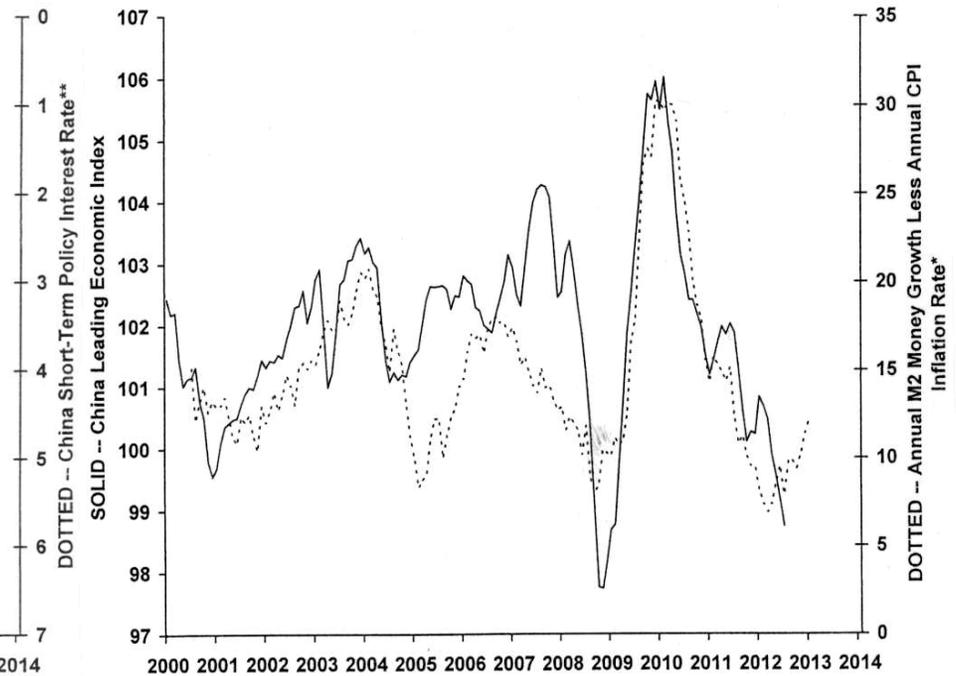
## China Leading Economic Index vs. Short-Term Policy Interest Rate\*\*

\*\* China CHIBOR 3 month interest rate (six month moving average) Until 7/2002 and China SHIBOR 3 month interest rate thereafter.  
NOTE: Interest Rate LEADS by One Year



## China Leading Economic Index vs. Real Annual M2 Money Growth\*

NOTE: Annual Real Money Growth (dotted line) LEADING by Six Months



# Inflation Story??

## Unstoppable Forces Meet Immovable Objects!?!

### Inflation Forces

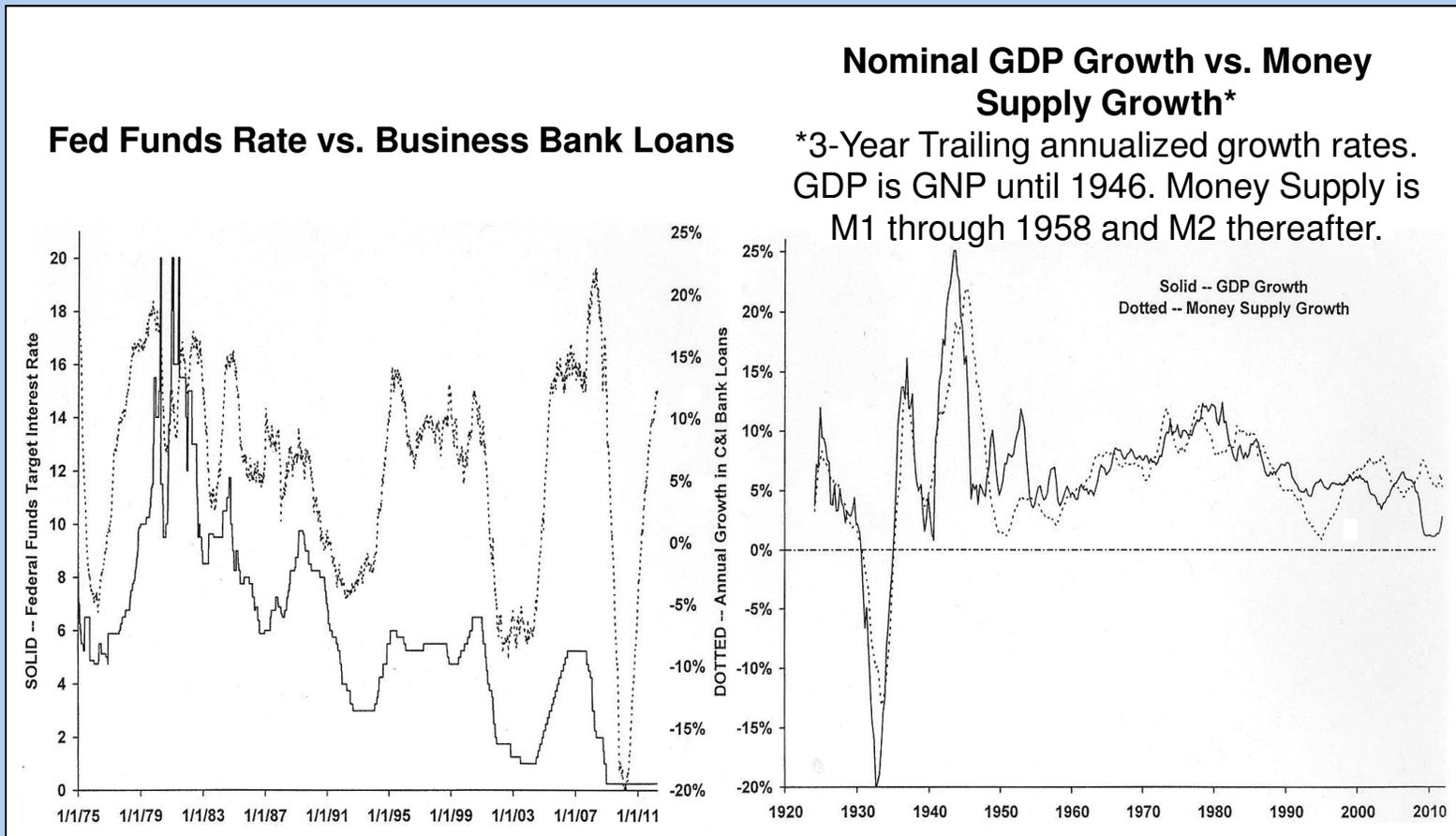
- Massive Newly-Developing Demand Force
- Excess Liquidity Everywhere
- Monetary /Fiscal Overkill
- Pent-Up Demands
- Improving Balance Sheets
- Government Solutions

### Deflation Forces

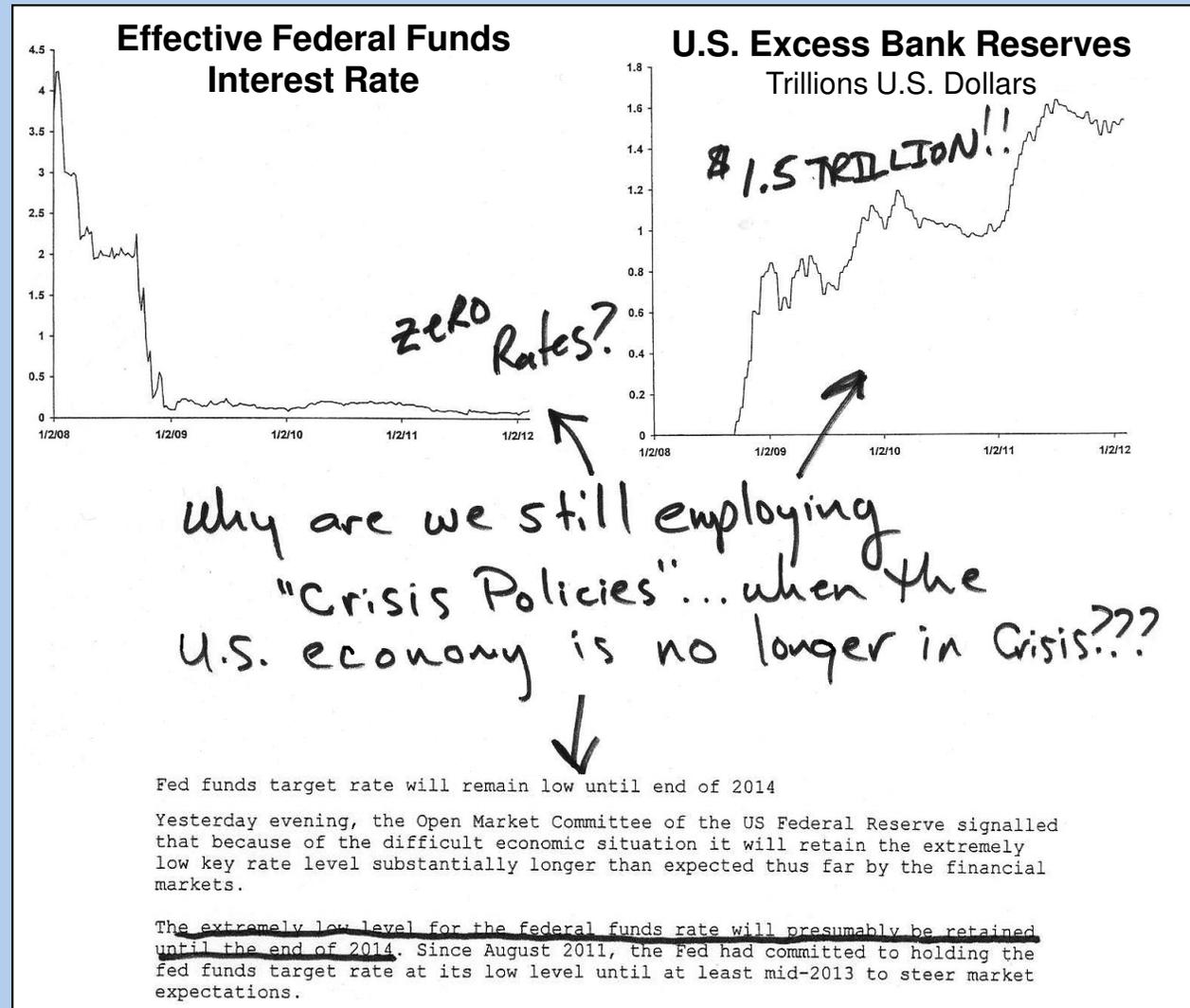
- 30-Year Disinflationary Culture
- Tech-Induced Productivity Surge
- New-found Global Competition
- Impaired Balance Sheets
- Resource/Potential GDP Slack



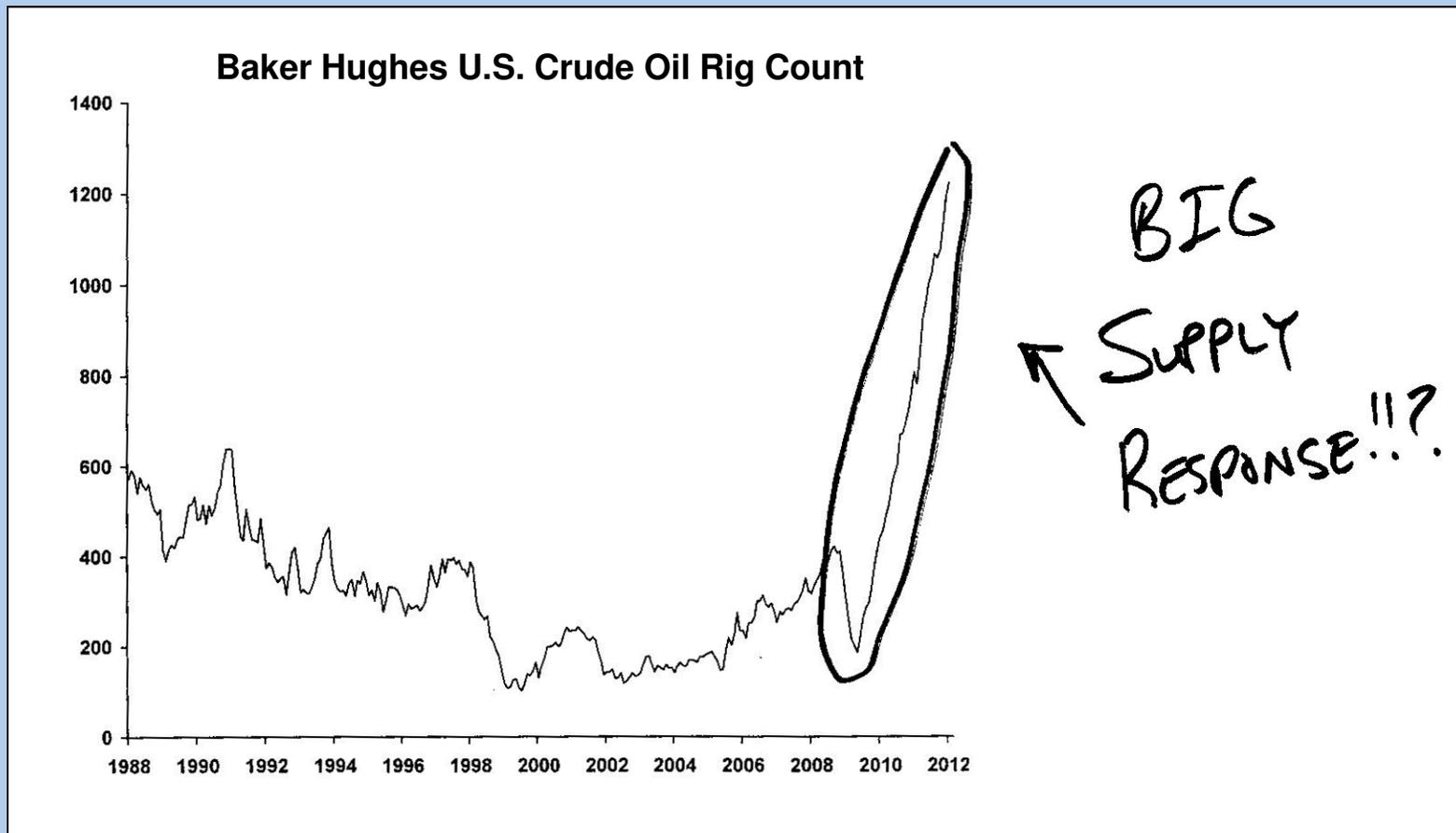
# Time to Start Normalizing Monetary Policy!!?!



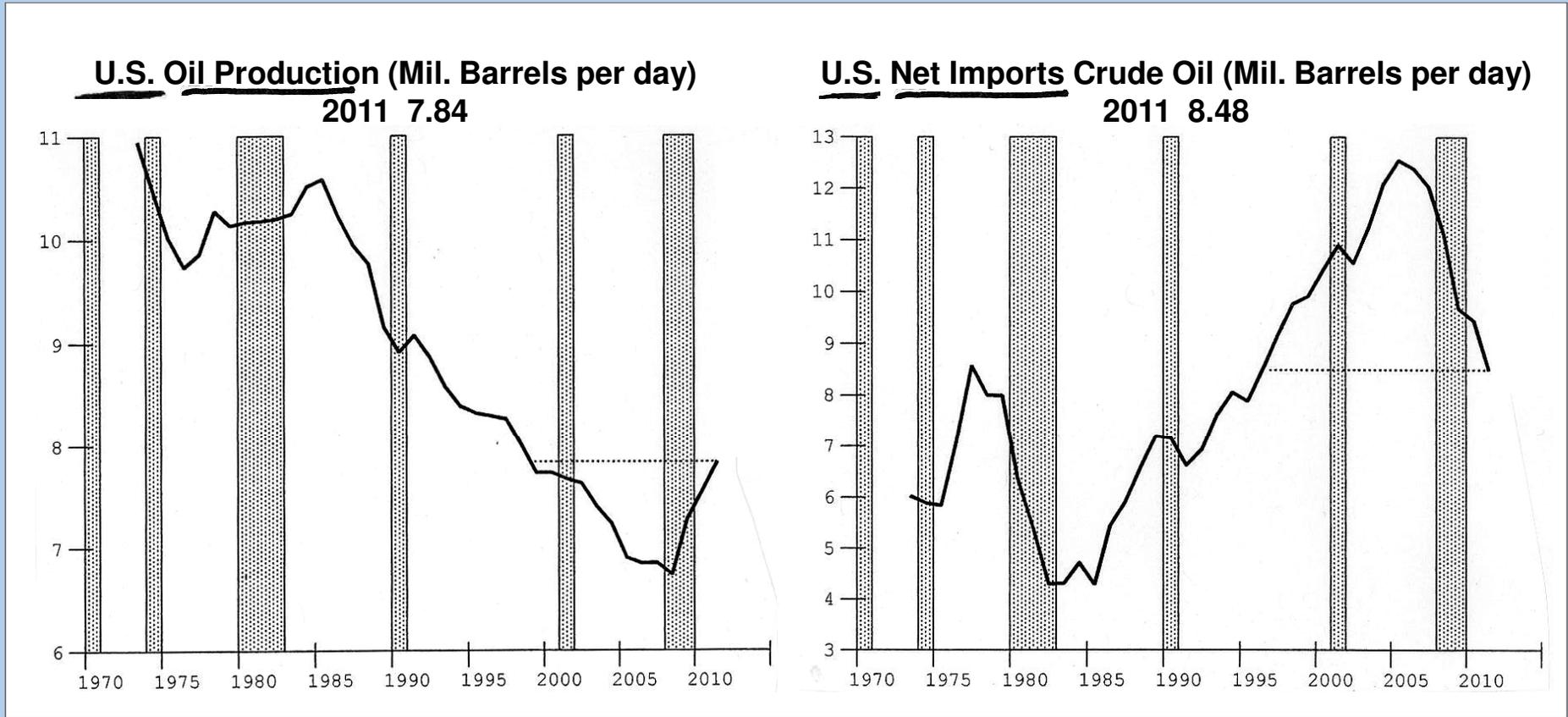
# Fed Needs to Get Beyond its Crisis Mindset???



# Oil? Supply Catching Demand???



# What Oil Crisis???

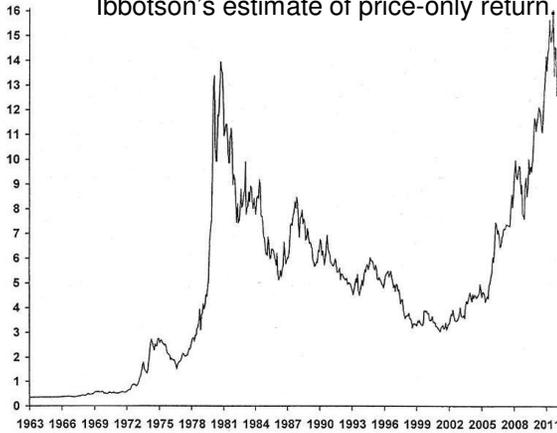


# So ... You Like Gold, Huh??!?

**Price of S&P 500 Stock Index in Ounces of Gold\***  
 \*Relative Price of S&P 500 divided by Price of Gold. Number of Ounces of gold it takes to purchase the S&P 500 Stock Price Index.



**Price of Gold Relative to U.S. Treasury Bond\***  
 \*Price of gold divided by Long-term U.S. Treasury Bond Prices. Bond Price set at \$100 in December 1962 and then rose or fell each month based on Ibbotson's estimate of price-only return.



**Price of Gold Relative to U.S. House Price\***  
 \*Price of gold divided by U.S. House Price Index. House Price Index is based on the Median New Home Sales Price Index until March 1987 and the Case-Shiller National U.S. House Price Index thereafter.



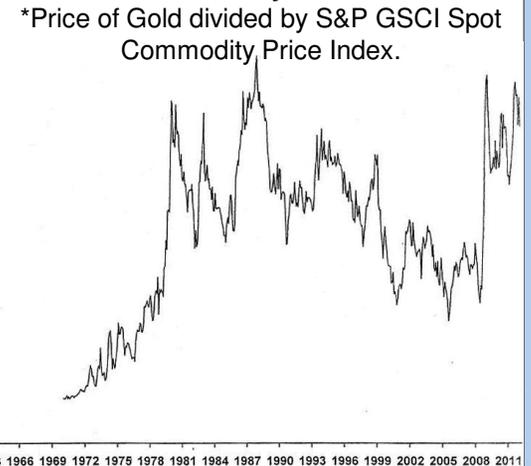
**Number of Hours of Work Required to Purchase an Ounce of Gold\***  
 \*Price of Gold Price divided by the Average Hourly Earnings Index.



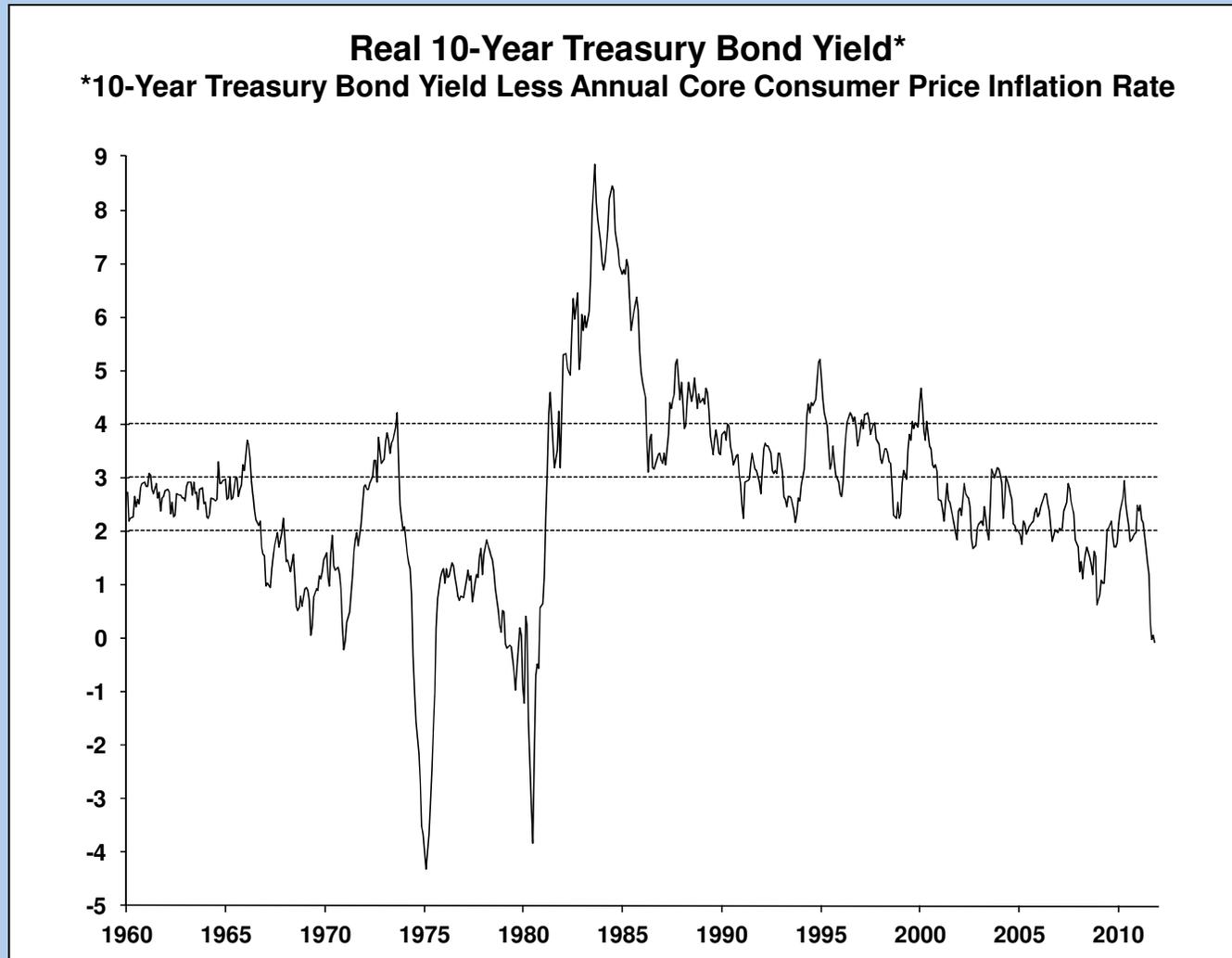
**Price of Gold Relative to Consumer Price Index Basket of Consumer Goods and Services**



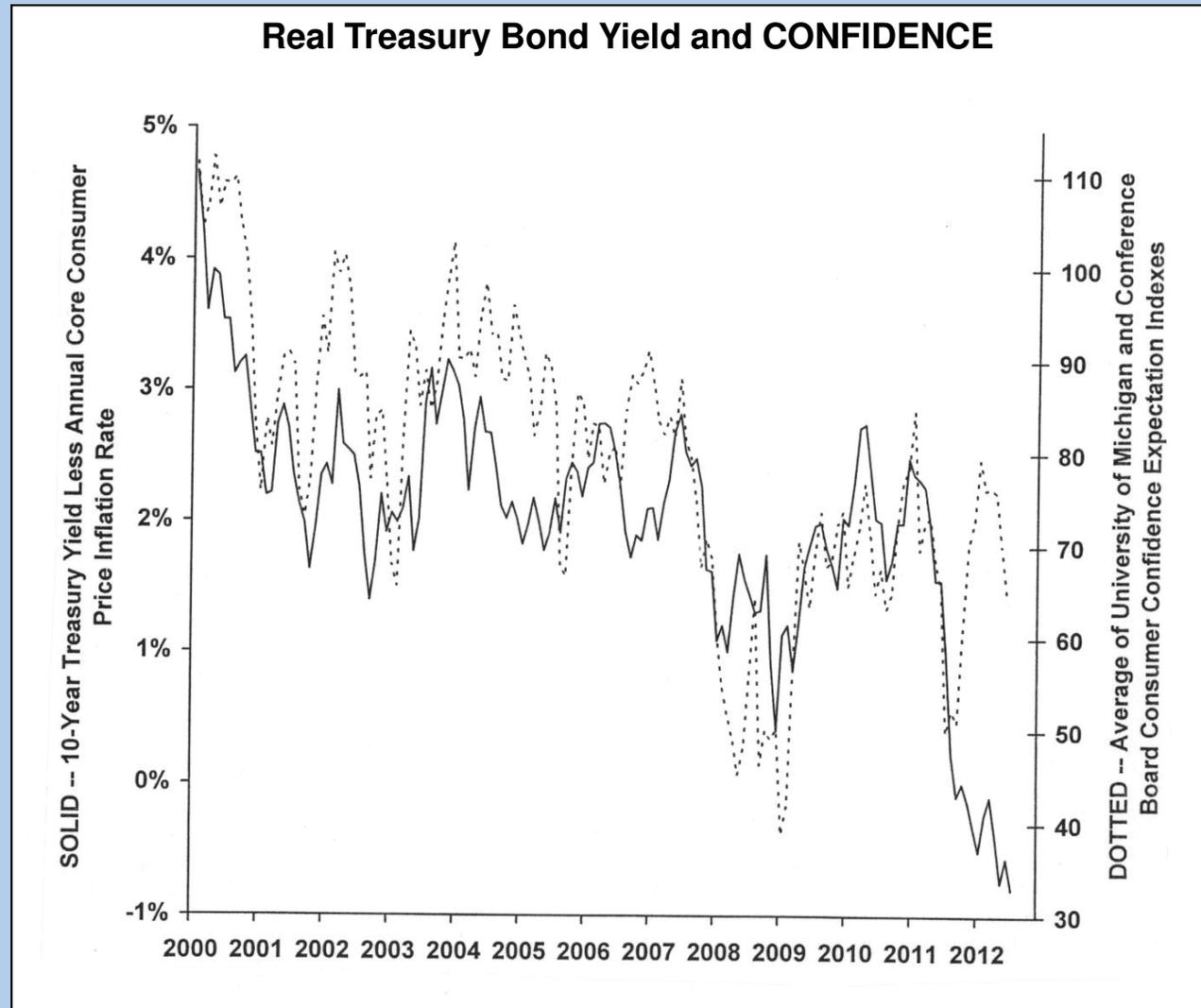
**Price of Gold Relative to Overall Commodity Prices\***



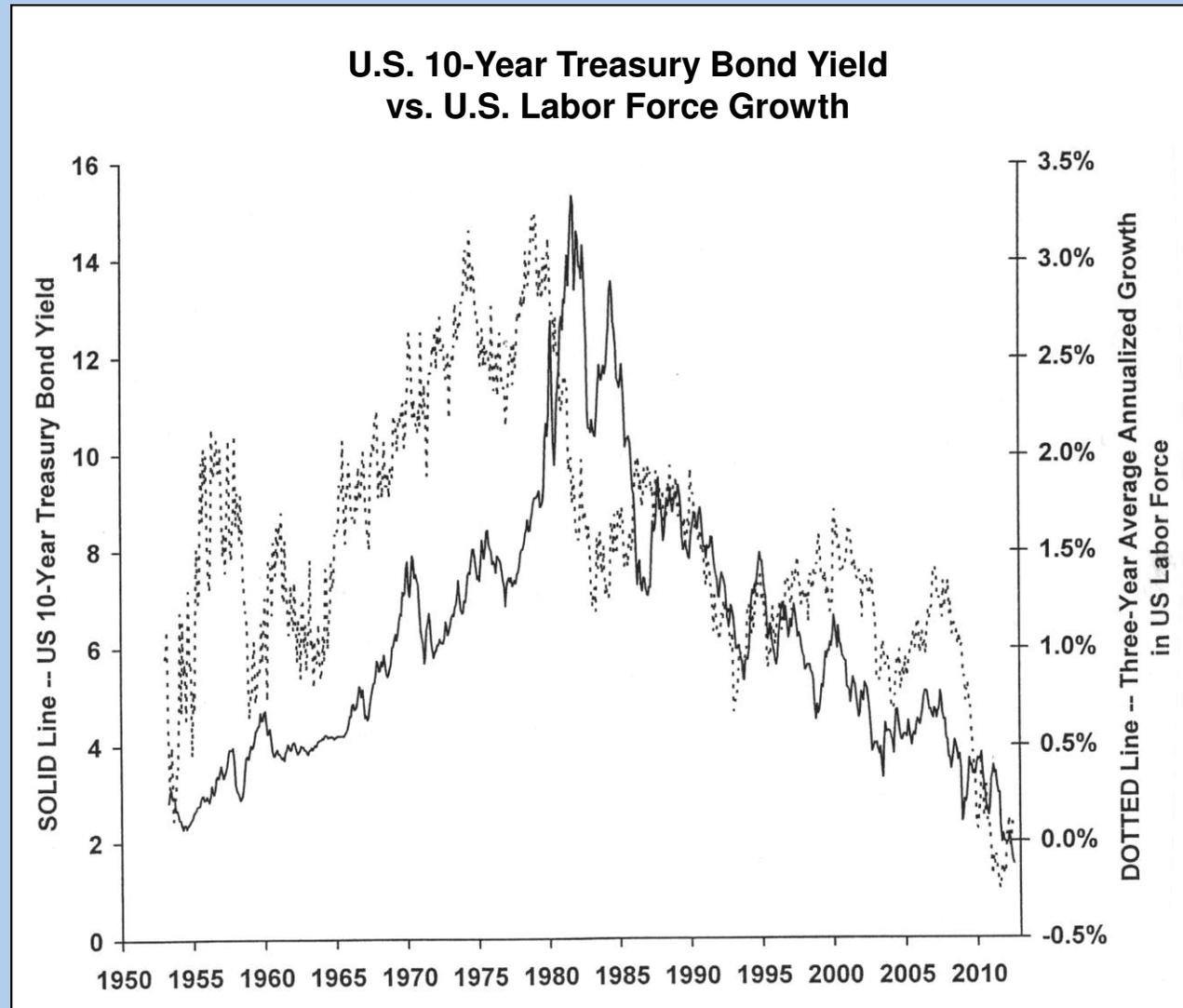
# Will Bonds Be Bloodied???



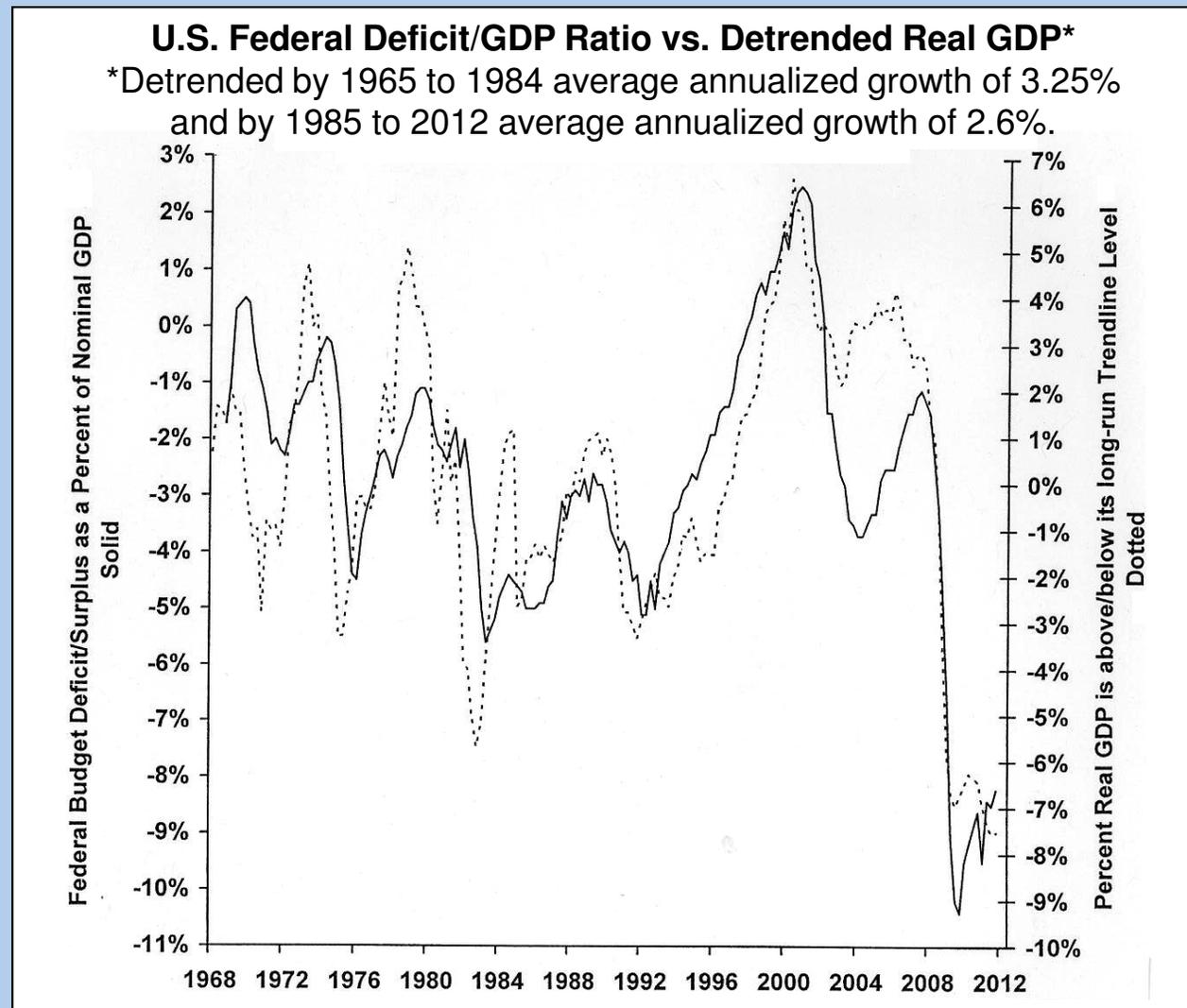
# FEAR Has Been Bond Market's Best Friend!!?



# AGING Demographics & the Bond Market?!?

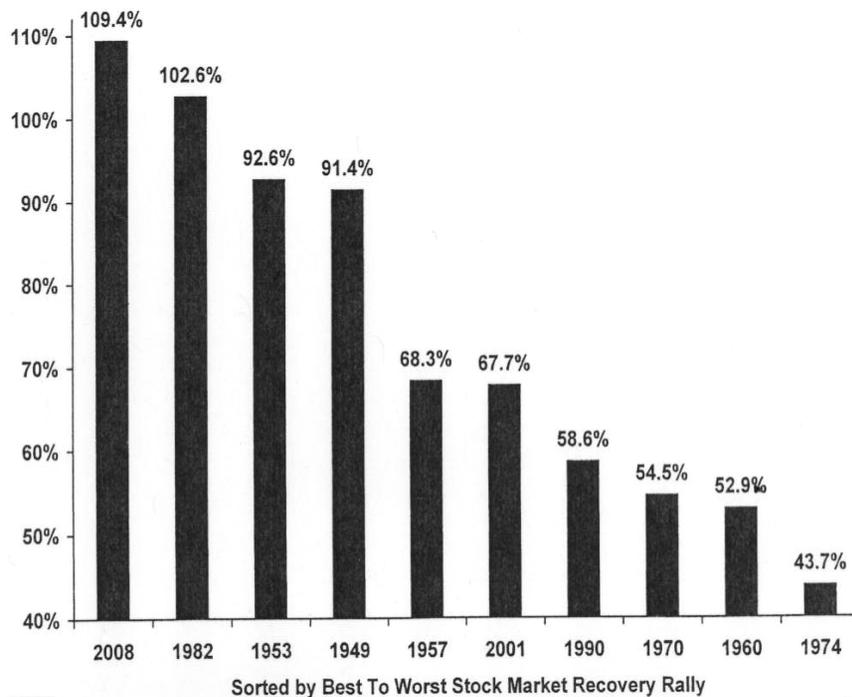


# U.S. Deficit... More Cyclical Than Structural?!?!



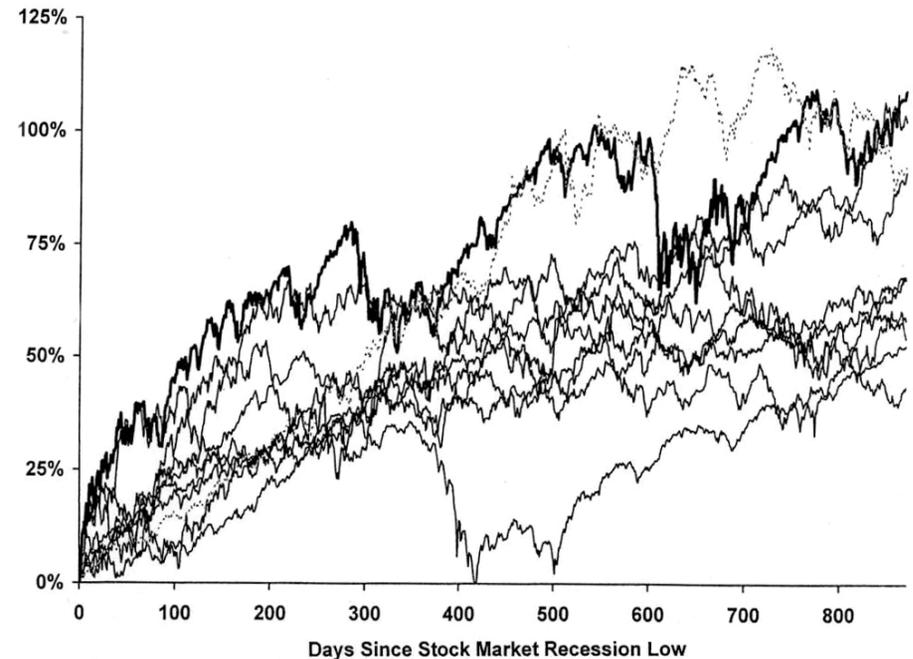
# Huh.... Best Post-Recession Stock Market Rally Ever???

**Post-War Stock Market Rallies  
Cumulative Price-Only Percent Returns  
From Recession  
Low During First 870 Days**



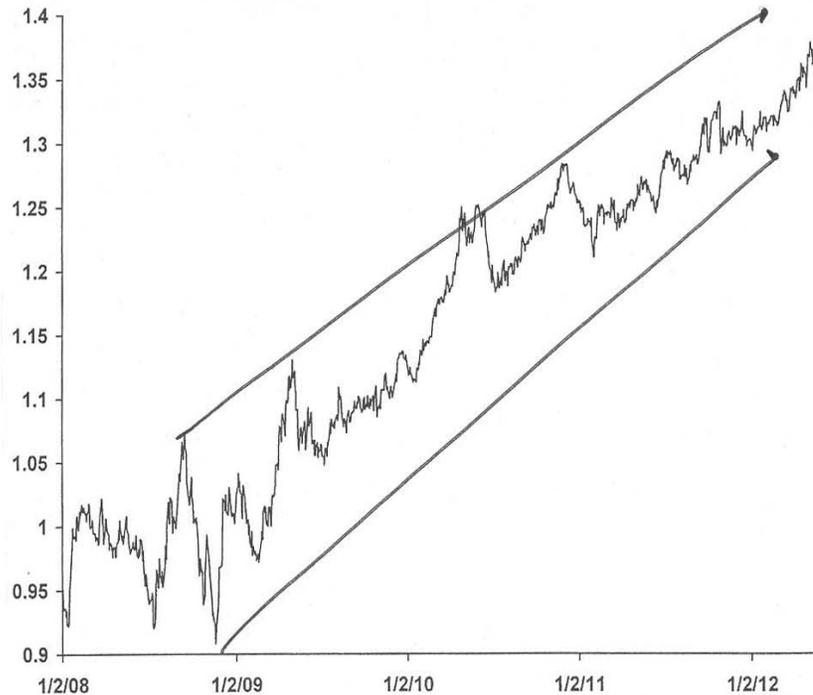
**Post-War Stock Market Rallies  
Cumulative Percent Price Only Return  
from Recession Low**

NOTE: BOLD Line is the Current Recovery Stock Market Rally



# “DOA” Sectors LEAD Stock MARKET!?!

**S&P 500 Consumer Discretionary Stock Index  
RELATIVE Total Return Performance**



**Ranked Returns: Index Groups**

Index: SPXL1		S&P 500 ECO SECT	Base Currency USD
All Group Performances		1) S&P 500 CONS DISCRET IDX	172.59
		2) S&P 500 INDUSTRIALS IDX	128.19
		3) S&P 500 FINANCIALS INDEX	126.06
		4) S&P 500 INFO TECH INDEX	124.71
		5) S&P 500 MATERIALS INDEX	96.88
		6) S&P 500 CONS STAPLES IDX	75.04
		7) S&P 500 HEALTH CARE IDX	66.38
		8) S&P 500 UTILITIES INDEX	58.83
		9) S&P 500 ENERGY INDEX	57.56
		10) S&P 500 TELECOM SERV IDX	57.26

10 Groups	
Start Date	End Date
3/ 9/09 -	5/25/12
676.53 -	1320.59
Return: 95.20%	

Index: SPXL1		S&P 500 ECO SECT	Base Currency USD
All Group Performances		1) S&P 500 CONS DISCRET IDX	45.77
		2) S&P 500 CONS STAPLES IDX	27.49
		3) S&P 500 INDUSTRIALS IDX	24.72
		4) S&P 500 INFO TECH INDEX	21.00
		5) S&P 500 TELECOM SERV IDX	20.86
		6) S&P 500 HEALTH CARE IDX	16.34
		7) S&P 500 UTILITIES INDEX	14.41
		8) S&P 500 ENERGY INDEX	13.96
		9) S&P 500 MATERIALS INDEX	7.24
		10) S&P 500 FINANCIALS INDEX	-2.27

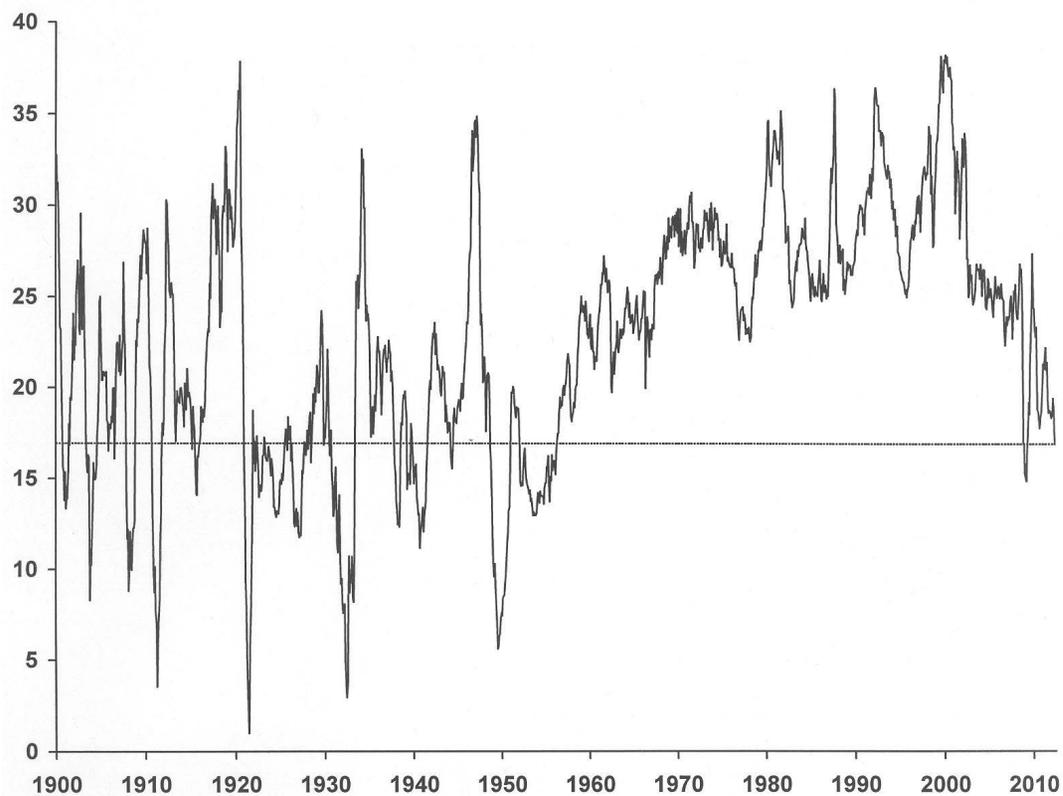
10 Groups	
Start Date	End Date
12/31/09 -	5/25/12
1115.10 -	1320.54
Return: 18.42%	



# IF INFLATION STAYS LOW...LOTS OF VALUATION ROOM!?!

## U.S. Stock Market Environmental PE Valuation\*

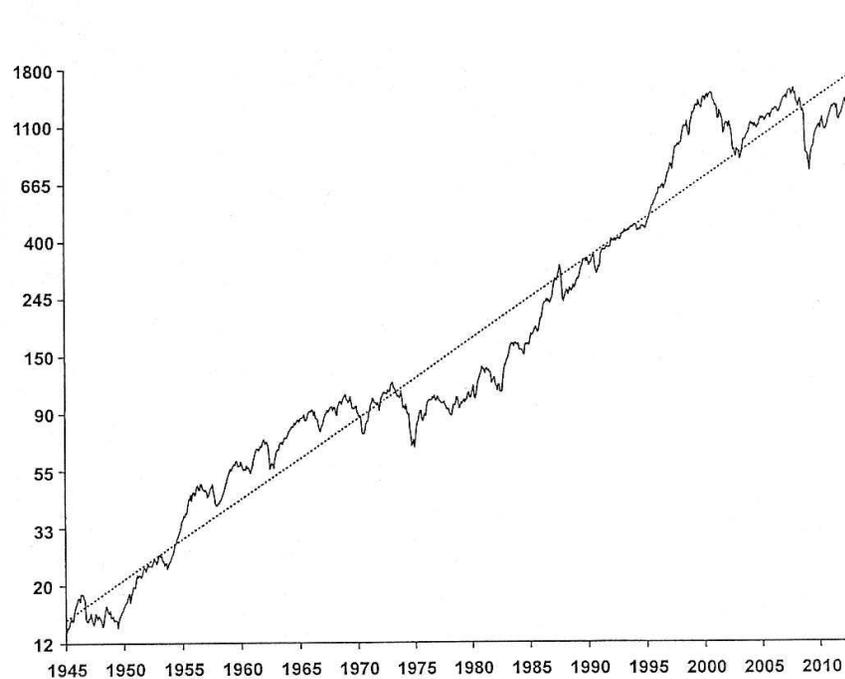
\*Sum of PE ratio (based on trailing 12-month eps),  
10-yr Treasury bond yield and Annual CPI Inflation Rate



# POST-WAR STOCK MARKET STORY!??!

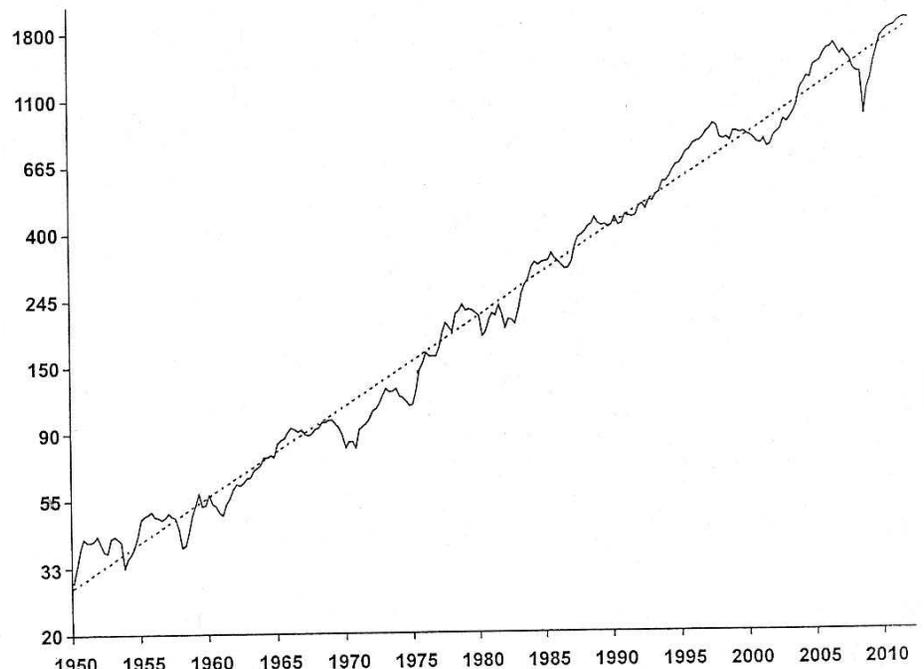
## U.S. Stock Market vs. Long-Term Trendline Level

S&P 500 Stock Price Index (Solid)  
Trendline Level (Dotted)

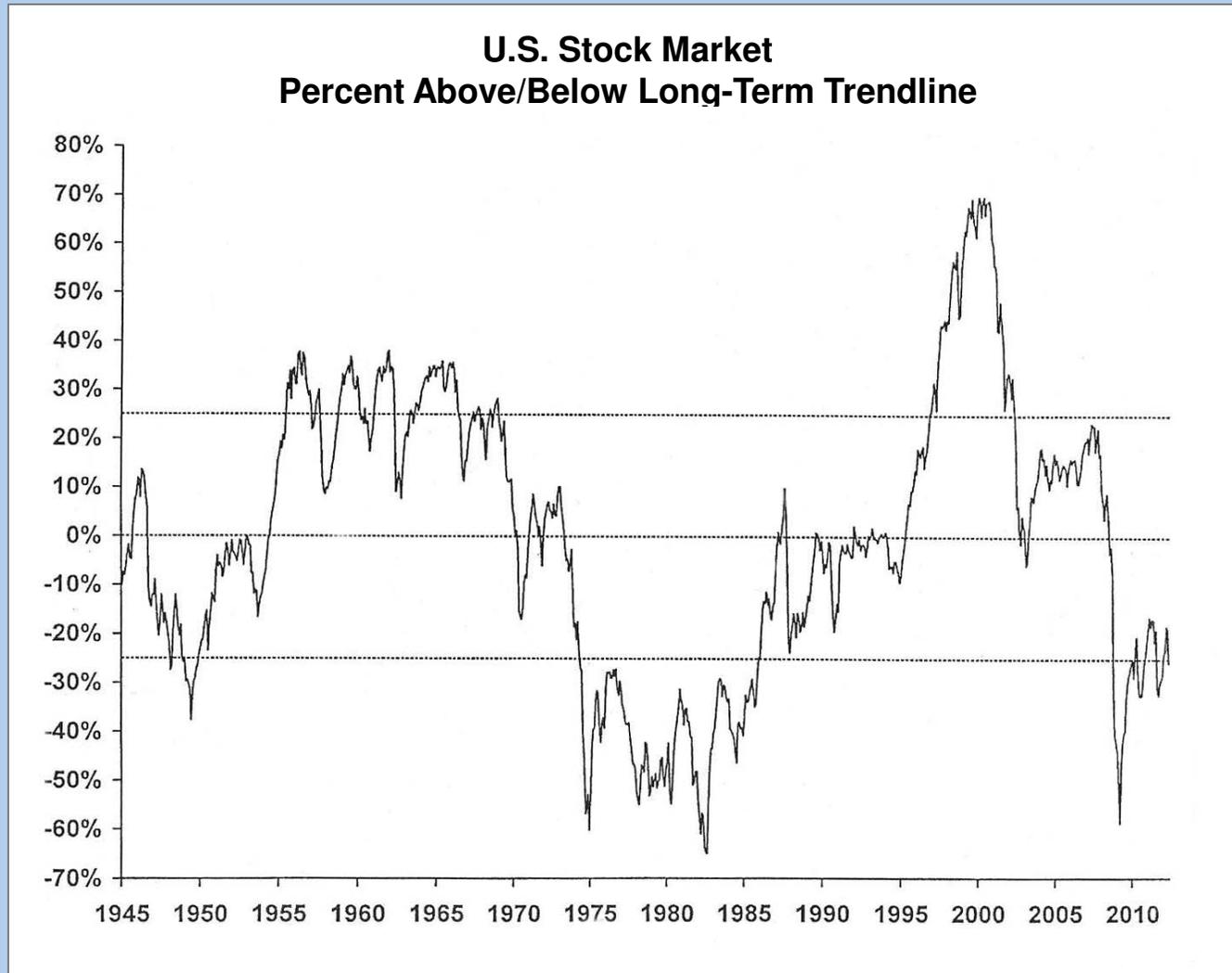


## Total U.S. Corporate Profits

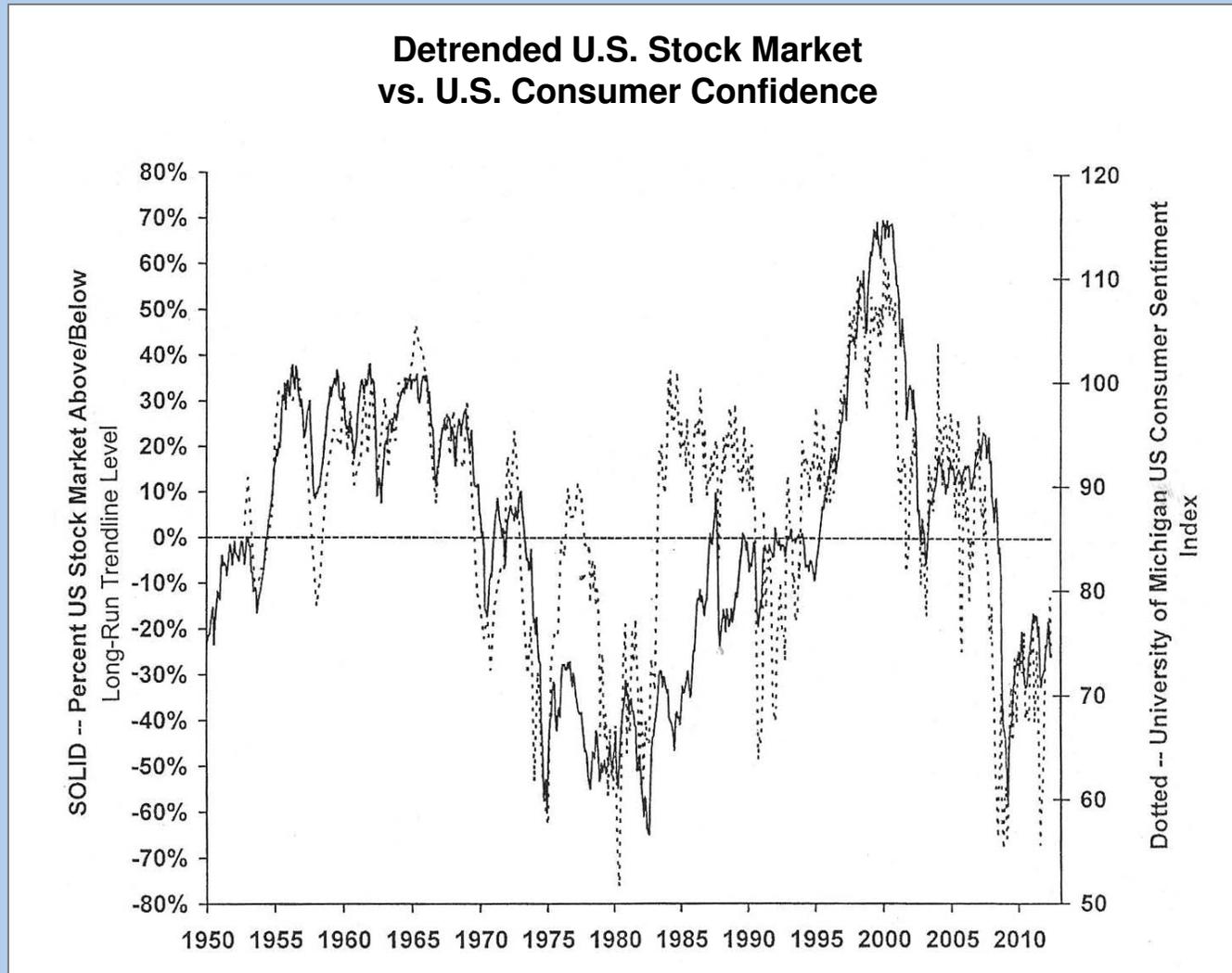
Actual Level (Solid) vs. Trendline (Dotted)



# CULTURAL “GLOOM TO GLEE” CYCLE!?!?



# Could A Return To “NORMAL CONFIDENCE” Double the Stock Market???



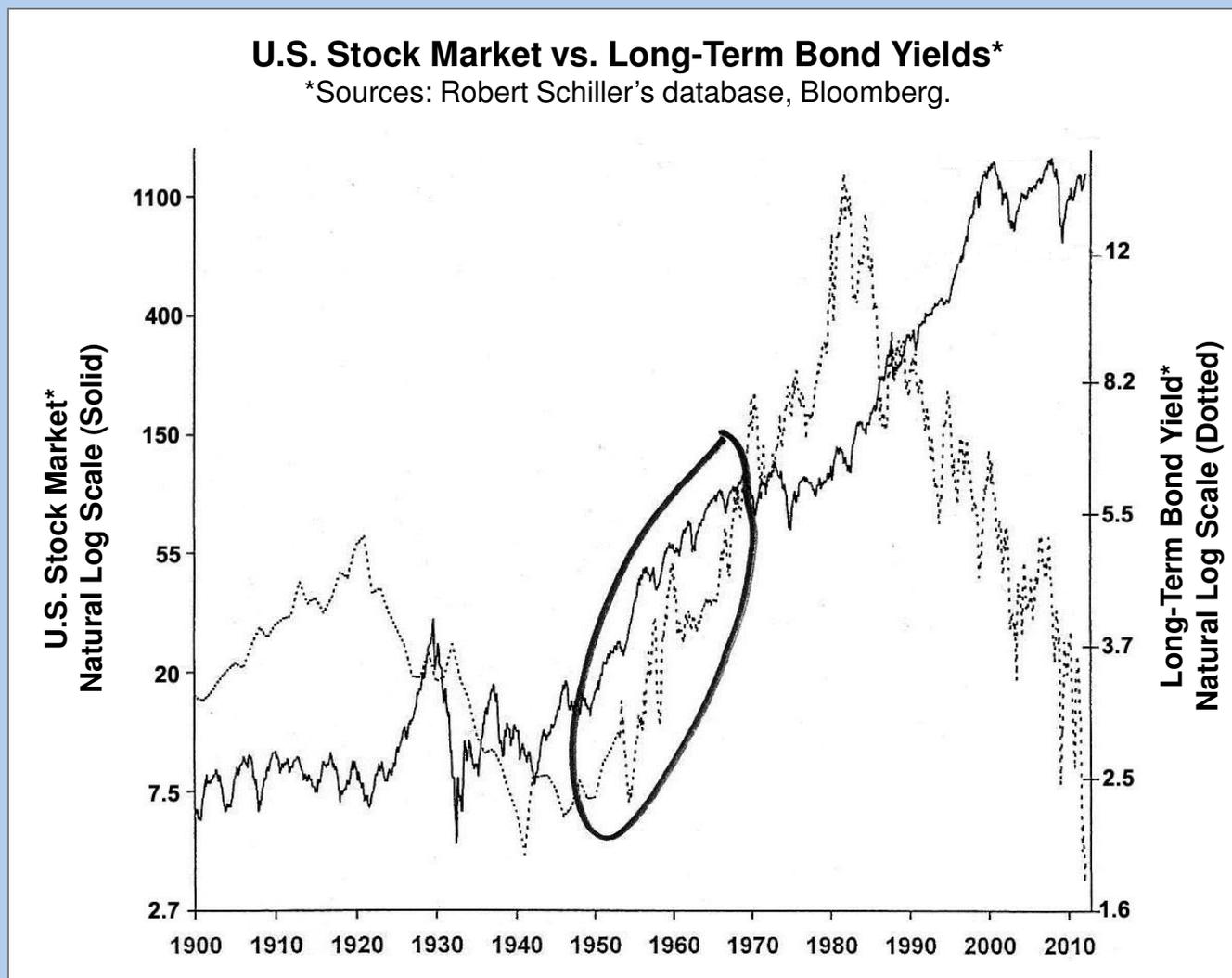
# Mania to Mania!!?

New-Era → Mania of OPTIMISM

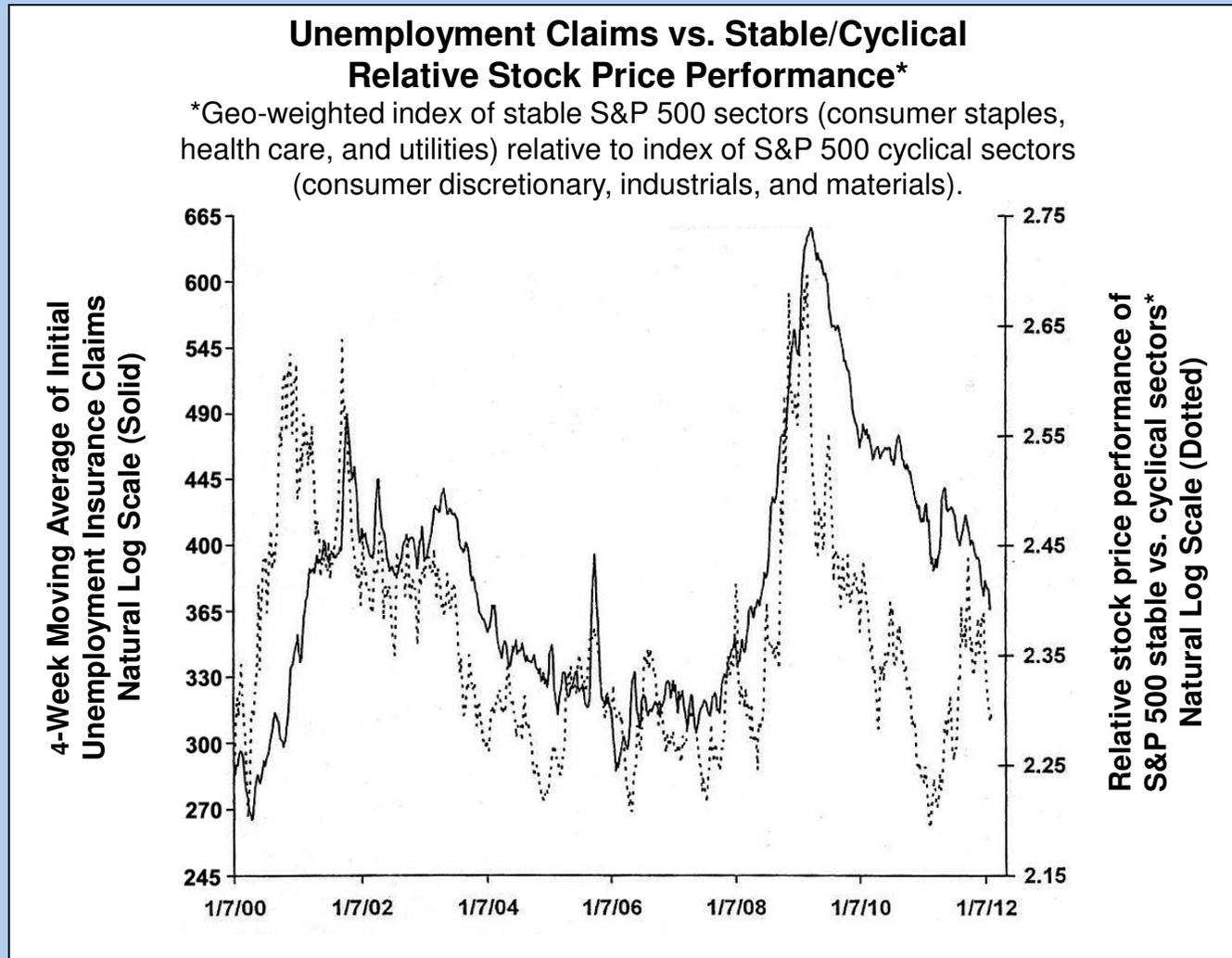
New-Normal → Mania of PESSIMISM



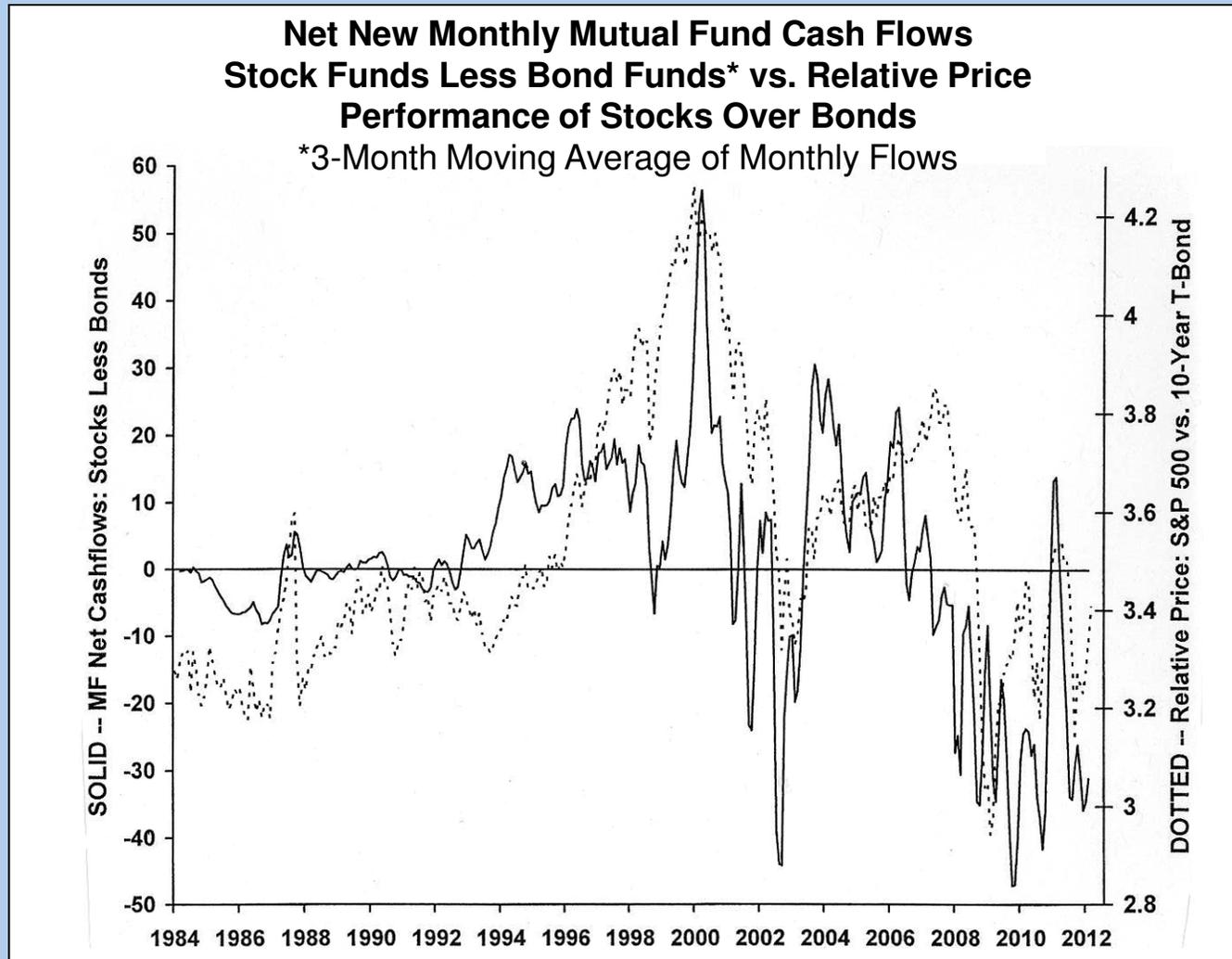
# A “Confidence-Driven” Secular Bull à la 1950s-60s!??!



# Stay With Cyclical Stocks?!?

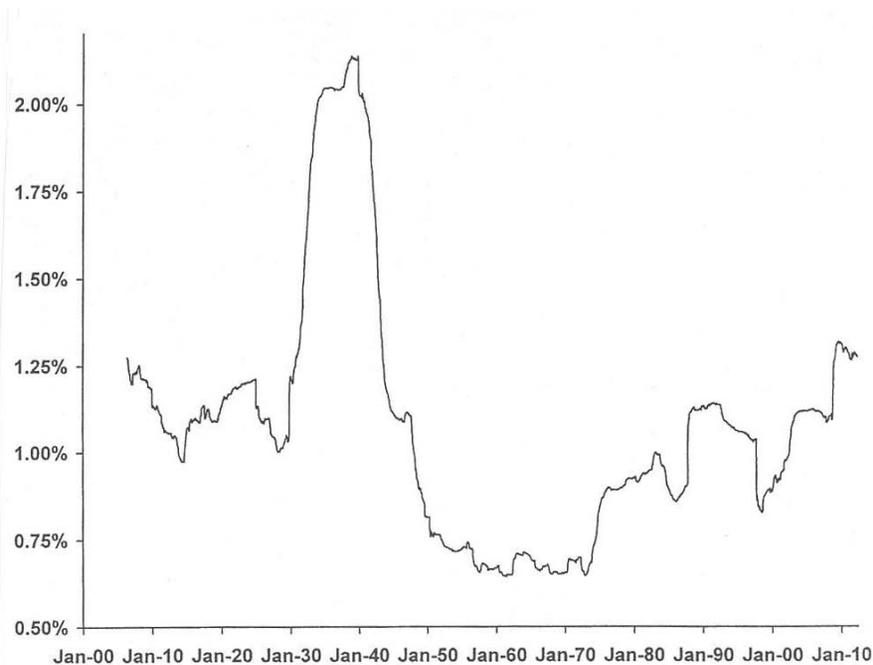


# Wait for the Flow!!!?



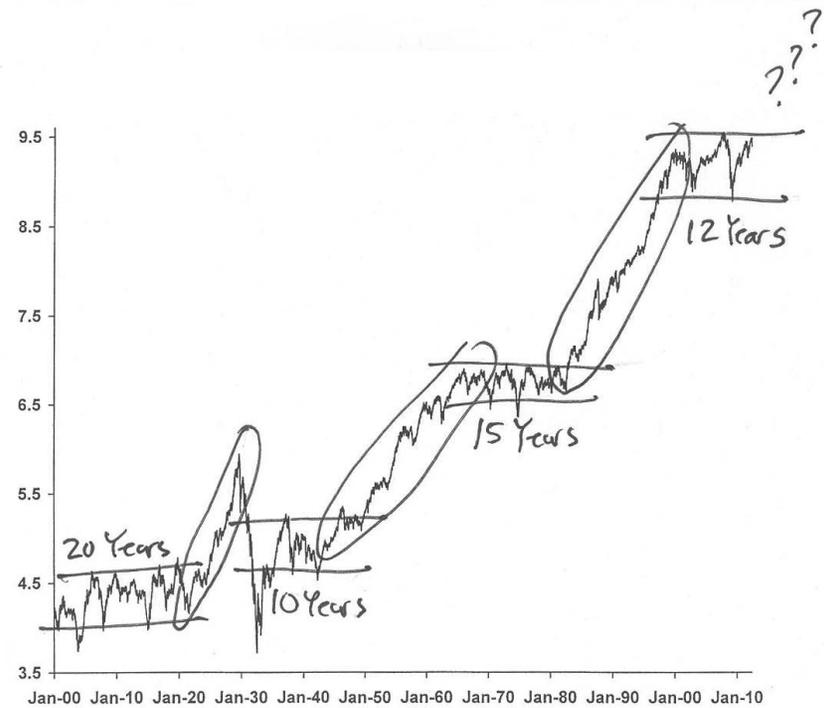
# BUY & "HOLD YOUR NOSE" !!??

### Rolling 10-Year Standard Deviations of Daily Percent Stock Market Changes



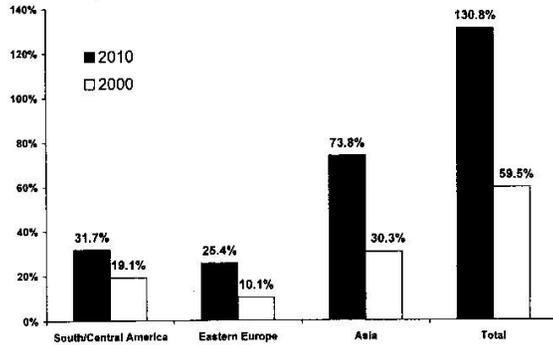
### Dow Jones Industrial Average – 1900 to 2012

Shown on a Natural Log Scale



# A Lost Decade?? Hardly!!!

**Emerging World Economies' Nominal U.S. Dollar GDP Percent of U.S. Nominal GDP 2000 vs. 2010**

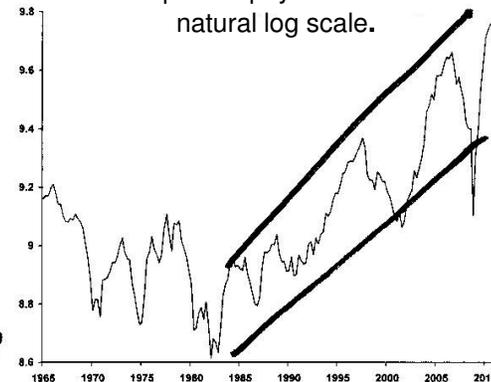


#1. CREATION OF EMERGING WORLD!!

#2. BIGGEST TECHNOLOGICAL LEAP in U.S. HISTORY!!

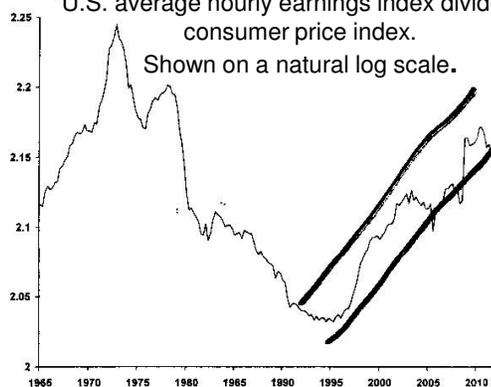
**Real Corporate Profit Per Job\***

\*Total U.S. corporate profits adjusted for GDP deflator inflation index and divided by nonfarm private payrolls. Shown on a natural log scale.

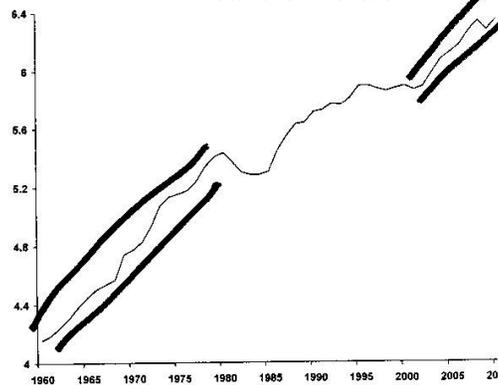


**Real U.S. Wage Rate\***

\*U.S. average hourly earnings index divided by consumer price index. Shown on a natural log scale.



**Inflation-Adjusted Total Global GDP Real U.S. Dollars**



#3. GLOBAL EMBRACEMENT OF CAPITALISM!!!



## 2012-2013 Possibilities???

- ▶ **U.S. Economy has a “GEAR YEAR”**
  - ▶ Real GDP Rises by 3%ish
  - ▶ U.R. Exhibits “Slow but Steady” Decline
  - ▶ H.H. & Biz Confidence Improve
  - ▶ Housing Market “Pops” a Little
  - ▶ Biz Spend Some of \$2 Trillion Cash Hoard
- ▶ **Euro Crisis Mutates from “Imminent Calamity” to “Chronic Problem”**
- ▶ **Emerging World Soft Landing... Accelerates in 2<sup>nd</sup> Half**
- ▶ **U.S. Politics Moves to a “Happier Middle”**
- ▶ **Talk of a “New All-Time” Stock Market High**
- ▶ **T-Bond Market Gets Drilled**



# Questions?

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# QUESTIONS?

OFFICE OF THE ARIZONA STATE TREASURER

