Greece, the Euro-Zone and America’s Future

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July 17, 2012
Strategic Inflection Points Are Scary

“"A strategic inflection point is a time in the life of a business [or a country] when its fundamentals are about to change. That change can mean an opportunity to rise to new heights. But it may just as likely signal the beginning of the end."

Andy Grove, Only the Paranoid Survive
We Are In The Eye of a S.I.P.
Athens, Greece
Can Greece Survive?

The Relative Level Of Deposits In Various Countries' Banking Systems Since The Beginning Of 2011

Index

France

Germany

Portugal

Italy

Ireland

Spain

Greece

Source: Sky News / Ed Conway (05/17/12)
Greece vs. 1929 Crash

Athex Composite and DJIA Performance After Peak

Source: Bloomberg (05/14/12)
PIIGS GET SLAUGHTERED

With unemployment at 20 percent, Spain has an economy among the weakest in Europe.

Nearly one-third of Portugal’s debt is held by Spain, and both countries’ credit ratings have been dropping.
Contagion from 2008

Unemployment rate

<table>
<thead>
<tr>
<th>Country</th>
<th>Youth December 2007</th>
<th>Other Latest</th>
<th>GDP, latest, % change from pre-crisis peak</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>5</td>
<td>20</td>
<td>-3.0</td>
</tr>
<tr>
<td>Greece</td>
<td>5</td>
<td>20</td>
<td>-17.1</td>
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<td>Portugal</td>
<td>5</td>
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<td>Ireland</td>
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<td>Latvia</td>
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<td>-15.0</td>
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<tr>
<td>Hungary</td>
<td>5</td>
<td>20</td>
<td>-4.6</td>
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<td>Euro area</td>
<td>5</td>
<td>20</td>
<td>-2.1</td>
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<tr>
<td>Poland</td>
<td>10</td>
<td>20</td>
<td>10.7</td>
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<td>France</td>
<td>15</td>
<td>Latest</td>
<td>-0.3</td>
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<tr>
<td>Italy</td>
<td>10</td>
<td>Latest</td>
<td>-5.3</td>
</tr>
<tr>
<td>United States</td>
<td>10</td>
<td>Latest</td>
<td>0.8</td>
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<tr>
<td>Britain</td>
<td>10</td>
<td>Latest</td>
<td>-4.3</td>
</tr>
<tr>
<td>Sweden</td>
<td>10</td>
<td>Latest</td>
<td>2.1</td>
</tr>
<tr>
<td>Iceland</td>
<td>5</td>
<td>20</td>
<td>-7.9</td>
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<tr>
<td>Czech Republic</td>
<td>10</td>
<td>Latest</td>
<td>-1.2</td>
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<td>Germany</td>
<td>5</td>
<td>Latest</td>
<td>0.5</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5</td>
<td>Latest</td>
<td>-1.9</td>
</tr>
</tbody>
</table>

Sources: Eurostat; The Economist
Who Will Save the Children?

MoneyGame  Chart of the Day

European Youth Unemployment
Unemployment Rate Under 25 Year Olds %

Source: Thomson Reuters Datastream, Eurostat Reuters graphic/Scott Barber 5/2/2012
Two Months Ago

Major International Indices Decline From 2012 Peaks

- China: -2.8%
- USA: -4.6%
- UK: -7.6%
- Canada: -8.4%
- Germany: -9.9%
- India: -11.0%
- Japan: -11.7%
- Brazil: -13.0%
- France: -13.3%
- Russia: -15.5%
- Italy: -19.7%
- Spain: -24.0%

Source: Bespoke Investment Group
European Purchasing Managers Indices

“One of the biggest concerns surrounding Europe’s future is the impact another recession would have on its debt crisis. To gauge the direction of Europe’s economy I created this chart overlaying key PMIs and euro area GDP growth. Right now it is telling us Europe may be headed for a deeper recession than many analysts may be anticipating, which could wreak havoc on countries deficit and debt reduction plans leading to an even deeper crisis.”

—Michael McDonough, Bloomberg Brief Economist
French 5-Year Credit Default Swaps (CDS)

This is the price of insuring against a French default. French banks would be massacred by defaults in Spain and Italy, so this is an indirect indicator of the strength of the euro area as a whole.

Contributed by Michael Block, Chief Equities Strategist at Phoenix Partners Group

Simone Foxman for Business Insider/Bloomberg Data
Germany = European Growth
Is German Growth Slowing?

Sources: Markit, EcoWin.
“Germany’s private sector economy slipped deeper into contraction territory at the midway point of the year, with output falling at the fastest pace since June 2009.

German manufacturers were at the forefront of the downturn, as a worsening global economic backdrop and the ongoing euro crisis weighed heavily on export demand.

... There is a deepening consensus among German businesses that the euro area turbulence has already damaged their growth prospects for the latter half of 2012.”
THE RAIN IN SPAIN
TWO BIG TO FAIL OR BAIL

Clusterstock Chart of the Day

Bank Holdings Of PIIGS’ Sovereign Debt

In Millions

Source: stress test results, via Peterson Institute

Italian
Spanish
Greek
Portuguese
Irish

Other
BNP-PARIBAS
ING Bank
Hypo Real Estate
Banco Popolare
WestLB
SocGen
CAIXA
BPCE
RBS
HSBC
Monte Dei Paschi
Santander
BBVA
Credit Agricole
Deutsche Bank
Intesa SanPaolo

McCOMBS SCHOOL OF BUSINESS
Asset performance in April 2012

U.S. dollar based performance since 31st March 2012 - percent*

- US 10 year Treasury: 2.8%
- JPM EMBI emerging debt: 1.7%
- German 10y Bund: 1.5%
- ML Global corporate bonds: 0.9%
- Copper: 0.7%
- ML Global high yield bonds: 0.6%
- MSCI Asia ex Japan: 0.0%
- Gold: -0.2%
- Dollar index: -0.2%
- CRB commodities index: -0.8%
- MSCI developed equities: -1.0%
- MSCI emerging equities: -1.1%
- MSCI Europe: -2.1%
- Japan Nikkei 225: -2.6%
- Brent crude oil: -2.7%
- Yen per $: -2.9%
- Spanish 10yr gov. bonds: -3.0%
- Italy 10yr gov. bonds: -3.2%
- GSCI soft commodities: -6.7%
- Spanish equities - IBEX 35: -11.1%

*Total return in U.S. dollars except currencies, Gold and copper which are spot returns

Source: Thomson Reuters Datastream

Reuters graphic/Scott Barber - to last close 30th April 2012
May, 2012

Data published by Spain’s central bank in May showed €97bn had been pulled out in the first quarter – around a 10th of the country’s GDP – as concerns mounted over Madrid’s ability to contain its twin economic and financial crises, which have forced government borrowing costs to euro-era highs.

http://www.ft.com/intl/cms/s/0/25c39204-ab01-11e1-b875-00144feabdc0.html#axzz1wTRrUbnI
Spanish 10-year bonds hit 7.18%
Highs And Lows For Spanish And German 10-Year Bonds

“I look to this chart as a gauge for the half-life of periods of ‘panic’ and ‘contentment’ in Europe. Unfortunately, the number of new highs for the Spanish 10Y spread and the number of news lows for Germany’s 10Y bonds are increasing and becoming more frequent.”

—Michael McDonough, Bloomberg Brief Economist
Bailout = €1.6 Trillion

<table>
<thead>
<tr>
<th></th>
<th>2012 H2</th>
<th>2013</th>
<th>2014</th>
<th>Total (Euro bn)</th>
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<tr>
<td><strong>Spain</strong></td>
<td></td>
<td></td>
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<tr>
<td>Budget Deficit</td>
<td>6.0</td>
<td>5.7</td>
<td>5.2</td>
<td>151.3</td>
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<tr>
<td>Maturing Debt</td>
<td>14.8</td>
<td>15.8</td>
<td>14.7</td>
<td>412.7</td>
</tr>
<tr>
<td>Total</td>
<td>20.8</td>
<td>21.5</td>
<td>20.0</td>
<td>564.0</td>
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<tr>
<td><strong>Italy</strong></td>
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<td></td>
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<tr>
<td>Budget Deficit</td>
<td>2.4</td>
<td>1.5</td>
<td>1.6</td>
<td>68.5</td>
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<tr>
<td>Maturing Debt</td>
<td>26.4</td>
<td>22.4</td>
<td>22.6</td>
<td>928.1</td>
</tr>
<tr>
<td>Total</td>
<td>28.8</td>
<td>23.9</td>
<td>24.2</td>
<td>996.6</td>
</tr>
</tbody>
</table>

**Grand Total**

|                  |         |      |      | 1560.6          |

Source: IMF and Fulcrum Asset Management
10-Year Yields Beyond The PIGs

"10-year borrowing costs demonstrate where the angst is focused in the global economy. Even excluding the bailed out countries of Greece, Ireland, and Portugal, European yields remain elevated in comparison to those of the rest of the world."

—Steven Englander, Head of G10 Strategy, Citi FX Team (chart also noted by Michael McDonough, Bloomberg Brief Economist)

Source: Reuters EcoWin
Courtesy of Citi FX Strategy
For the (financial) record...

Ministers deny contagion in the Eurozone.

"Spain is not Greece" - Elena Salgado, Spanish Finance Minister, Feb 2010.

"Portugal is not Greece" - The Economist, April 2010.

"Greece is not Ireland" - George Papaconstantinou, Greek Finance Minister, Nov 2010.

"Spain is neither Ireland nor Portugal" - Elena Salgado, Spanish Finance Minister, Nov 2010.

"Ireland is not in 'Greek Territory'" - Irish Finance Minister Brian Lenihan, Nov 2010.

"Neither Spain nor Portugal is Ireland" - Angel Gurria, Secretary-general OECD, Nov 2010.

"Italy is not Spain" - Ed Parker, Fitch MD, June 2012.

"Spain is not Uganda" - Spanish PM Mariano Rajoy, June 2012.

"Uganda does not want to be Spain" - Ugandan Foreign Minister, June 2012.

Heard through Alex Banbury of Hamilton Capital who sent this to IFRAsia.

NOW IT'S ALL ABOUT THE US
Why Does America Scare Everyone?

- **August 1st FOMC Meeting**
  - More Quantitative Easing = Printing Money?
  - Fed already owns over 50% of outstanding float of some securities

- **The Fiscal Cliff**
  - End of Bush era tax cuts & Automatic Cuts Poor Employment Data

- **Declining Retail Sales**
  - 70% of Retailers missed their June targets

- **Declining GDP Growth Estimates**

- **The Election**
Moving in the Wrong Direction

- In the US, real median incomes have not grown since 2007. Those on the lower rungs of the income ladder have fallen backwards.

- Net household wealth remains some 37% below its peak. All gains since 1992 have been wiped out.

- For the first time ever, a new generation of Americans faces a bleaker economic future than their parents.
Euro Plunges As Bernanke Speaks
Bernanke Speaks to Senate Banking

- Bernanke Makes Dismal Economic Forecast, Unconvincing Promises That The Fed Can Do More
  - Business Insider – 7/17/12

- The Key Question is will the Fed replace “Operation Twist” with more Quantitative Easing (Printing Money)?
  - “Operation Twist” = the Fed selling short-dated securities and purchase long-dated securities, in order to push down the cost of long-term lending

- We will have to wait until the end of the month for the FOMC Meeting
Fed owns 50%+ float of some securities

Unchanged expectations, but lower risk premium

The extension of MEP calls for 29% of the $267bn purchase amount to be allocated to the 20- to 30-year part of the curve. In some securities, the Fed already owns more than half of the outstanding float. Not only will it become harder for the Fed to increase holding amounts, prices will also become more dislocated.

Source: SG Cross Asset Research, Bloomberg
The Federal Reserve Balance Sheet

The Federal Reserve—along with other central banks around the world—have engaged in unprecedented monetary expansion. While such behavior has succeeded in pushing investors to riskier assets, the long-term effects of this policy remain unknown, and thus worrisome. Further, such policy amid continued economic sluggishness suggests that growth has not been sustainable.

Contributed by David Rosenberg, Chief Economist and Strategist at Gluskin Sheff + Associates

**CHART 2: UNPRECEDENTED MONETARY EXPANSION**

**United States**

<table>
<thead>
<tr>
<th>Fed Funds Rate (percent)</th>
<th>Fed Balance Sheet – Total Assets ($ trillion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.5</td>
<td>3.0</td>
</tr>
<tr>
<td>5.0</td>
<td></td>
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<td>4.5</td>
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<td>0.5</td>
<td></td>
</tr>
<tr>
<td>0.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Haver Analytics, Gluskin Sheff
Is It The Economy, Stupid?

Unemployment Rate Projections (Vs. Actual)


Dec '08 Apr '09 Aug '09 Dec '09 Apr '10 Aug '10 Dec '10 Apr '11 Aug '11 Dec '11 Apr '12 Aug '12 Dec '12 Apr '13 Aug '13 Dec '13
New Orders Collapsed Like 9/11

ISM Manufacturing: New Orders Index (NAPMNOI)
Source: Institute for Supply Management

2012 research.stlouisfed.org
America is a Deficit Addict

Deficits forever

The federal government has spent more than it has raised every year since 1970, except for a four-year period at the end of the Clinton administration. Projections show this year’s record gap will narrow as the economy improves, but it won’t be closed.

Sources: White House Office of Management and Budget; Congressional Budget Office

By Julie Snider, USA TODAY
Runaway Spending, Not Inadequate Tax Revenue, Is Responsible for Future Deficits

The main driver behind long-term deficits is government spending—not low revenues. While revenue will surpass its historical average of 18.0 percent of GDP by 2021, spending will shoot past its historical average of 20.3 percent, reaching 26.4 percent in the same year.
Average Tax Levels vs. Spending

Entitlements Will Consume All Tax Revenues by 2049

If the average historical level of tax revenue is extended, spending on Medicare, Medicaid and the Obamacare subsidy program, and Social Security will consume all revenues by 2049. Because entitlement spending is funded on autopilot, no revenue will be left to pay for other government spending, including constitutional functions such as defense.

**PERCENTAGE OF GDP**

- **Tax Revenue**: 30-Year Average Tax Revenue: 18.0%
- **Entitlements**: 2049: Entitlements 18.2% of GDP
- **Social Security**: 24.2%
- **Medicaid, Obamacare Subsidy Program**:
- **Medicare**:

Data: 1970 to 2080.
<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Medicare and Medicaid</td>
<td>$1.18 Trillion</td>
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<td>Social Security</td>
<td>$885 Billion</td>
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<tr>
<td>Defense</td>
<td>$620 Billion</td>
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<tr>
<td><strong>Interest on Public Debt</strong></td>
<td><strong>$472 Billion</strong></td>
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<tr>
<td>Agriculture</td>
<td>$155 Billion</td>
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<tr>
<td>Veterans Affairs</td>
<td>$137 Billion</td>
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<td>Education</td>
<td>$56 Billion</td>
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<tr>
<td>Homeland Security</td>
<td>$45 Billion</td>
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<tr>
<td>Justice</td>
<td>$30 Billion</td>
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</table>
US Interest Payments/Revenue

“If we keep on accruing $1+ trillion in debt annually and interest rates go from 2.16% to 3%, the cost of servicing the U.S. debt will rise from 7% of tax revenues to over 20% by 2020 crowding out Social Security, healthcare and defense expenditures.”

—Byron Wien, Vice Chairman at Blackstone Group

A Challenging Environment for the Federal Government

Interest Payments / Revenue

Source: Gluskin Sheff & Associates
No Jobs To Be Found  (8.2% Unemployment)
US Full-Time Employment

“This is US Full-Time Employment, population-adjusted and set in today’s population (over to the right.) So, adjusted for the growth of our nation, full-time employment is back to the late, late-seventies and early-eighties.”

—Tom Keene, Host of Bloomberg Surveillance on Bloomberg TV
US Deficit Is At Civil War Levels

MoneyGame Chart of the Day

Surplus/Deficit As A Percentage Of GNP/GDP

Source: ritholtz.com

1791 to 1928 = GNP
1929 to 2010 - GDP

Civil War

WW1

WW2
This Dog Don’t Hunt, America!

- 2000 = $5.67 Trillion
- 2004 = $7.54 Trillion
- 2008 = $10.57 Trillion
- Today = $15.81 Trillion
- 2016 = $22.01 Trillion (Current Spend)

Source: Usdebtclock.org
Daily Oil Production In North Dakota

“Few people realize North Dakota is now the second most important OIL producing state in union after Texas. We are on the way to much less dependence on Middle East oil with enormous economic and geopolitical implications.”

—Byron Wien, Vice Chairman at Blackstone Group
How Do We Pay Down The Debt?

- We must grow our way out of this crisis.
  - If the US economy grew by 6%, many of our problems would start to self heal.
  - If we grew at 9%, “Whoa Nelly!”
  - So, how do we turn America into North Dakota?

- As a “Last Resort”, we must sell “assets” owned by the federal government and apply to proceeds to reduce the federal debt.
We Have Assets We Can Sell

Percent of Federally Owned Acreage, by State

Please Give Back to McCombs!

Percentage of Alumni Giving

Dartmouth (Tuck)
Virginia (Darden)
Rice (Jones)
Notre Dame (Mendoza)
Harvard Business School
Northwestern (Kellogg)*
UCLA (Anderson)
Duke (Fuqua)
USC (Marshall)
MIT (Sloan)*
Chicago (Booth)*
Emory (Goizueta)
Berkeley (Haas)
UNC (Kenan-Flagler)
Texas A&M (Mays)
Michigan (Ross)
Indiana (Kelley)
SMU (Cox)
NYU (Stern)
Texas-Austin (McCombs)

Percentage of Alumni Who Give to Business School (FY2010)
Please Give Back to McCombs!

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Suggested fund: MBA or BBA Alumni Excellence Funds
Please use response code KTG

Online survey link: https://mccombs.qualtrics.com/SE/?SID=SV_3IswtACHUzNgOiN
Send me your feedback -- alumni@mccombs.utexas.edu
If We Had More Time

ADDITIONAL SLIDES
OVERALL DEBT
% of GDP, latest
- Over 400
- 300-399
- 200-299
- 0-199

Japan  Britain  Spain  France  Italy  South Korea  United States  Germany  Canada  China  Brazil  India  Russia
Is Italy Next?

Government debt
% of GDP, latest
- Over 150
- 100-150
- 50-100
- 0-50

Japan, Italy, France, Germany, Britain, United States, Spain, Canada, Brazil, India, South Korea, China, Russia
The Brits and the Canadians!
Financial debt
% of GDP*, latest

- Red: Over 150
- Pink: 100-150
- Orange: 50-100
- Green: 0-50

*Asset-backed securities removed because of double-counting
*Adjusted to remove foreign-owned financial debt
Productivity Gains with No New Jobs

Real U.S. GDP vs. Employment
2002 to 2011

Sources: BEA, BLS

mjperry.blogspot.com

McCOMBS SCHOOL OF BUSINESS
Is More Credit Card Debt Good?

Total Revolving Credit Owned And Securitized, Outstanding (REVOLSL)

Source: Board of Governors of the Federal Reserve System; research.stlouisfed.org (2012)
Is More Saving Good?

Household Balance Sheets Continue To Show Noticeable Improvement
Liquid Assets To Liabilities

Source: FRB, Haver Analytics & DB Global Markets Research (July 2012)
CONSUMER CAN CARRY A 2% RECOVERY, BUT THAT’S NOT ENOUGH

Contributions to GDP growth by sector

Potential tax increases will dampen consumption next year. Government retrenchment to deepen. We need exports and business investment to pick up the slack.

Source: Global Insight, SG Cross Asset Research/Economics

SOCIETE GENERALE
Cross Asset Research
Projected US Debt vs. Europe & Japan

PROJECTED U.S. PUBLICLY HELD DEBT AS PERCENTAGE OF GDP

Portugal: 71%
Italy: 98%
Greece: 109.6%
Japan: 178%
U.K.: 61.3%

America Is Sucking Debt

MoneyGame  Chart of the Day

Government Debt Outstanding

Source: Nomura, Haver
*Footnote: France could be on the verge of losing its high quality status by investors.
Flows of European Funds Into US Treasuries

Concerns about European sovereign debt and financial health have caused money to flow out of Europe to the safer haven of the US. Those flows have moderated recently, at least in some countries.

Contributed by George Goncalves, Head of US Rates Strategy for Fixed Income at Nomura
When Do We Say Enough Already?

The Debt Boom
Federal debt held by the public as a share of GDP, 2000-2013*

*2012 and 2013 Estimates
Source: Office of Management and Budget
This Math Doesn’t Add Up

Our Frightening Fiscal Future
Government spending vs. government health care as a percentage of GDP

Health spending
Non-health spending

Historic and projected spending and revenue as a percentage of GDP

Spending
Revenue

Source: Congressional Budget Office, Long-Term Budget Outlook, June 2011
It’s 1981 Again
Change In Employment And GDP Post-Recession

“For the first time on record, we have gone 11 quarters into a recovery but not managed once to post a GDP quarter at 4% at an annual rate or better. That really tells you something about the lack of firepower in this recovery and how fragile the backdrop is, not to mention enduring two “double dip” scares in the first two years of this recovery phase. There is quite possibly a third on its way before long as concerns over a twin shock from Europe’s recession on trade and the ‘fiscal cliff’ impact on domestic spending both hit home at roughly the same time.”

—David Rosenberg, Chief Economist and Strategist at Gluskin Sheff + Associates

**CHART 1: A SUB-PAR U.S. ECONOMIC RECOVERY**

**United States**

**Real GDP 11 Quarters After A Recession Ends**  
(annualized percent change)

**Employment 11 Quarters After A Recession Ends**  
(annualized percent change)

*Source: Haver Analytics, Gluskin Sheff*
Monthly Housing Starts

“This shows the huge collapse following the housing bubble, and that total housing starts have been increasing lately after moving sideways for about two and a half years.”

—Bill McBride, Creator of the Calculated Risk Blog

http://www.calculatedriskblog.com/
Historical Relationships Between Mortgage Rates And Applications

“The charts below show the relationship between mortgage rates and mortgage purchase applications. As the first chart shows, historically this relationship has been negatively correlated which is proper (as rates fall, mortgage applications for purchase rise). In the second chart what you see is that recently this relationship has completely reversed and it’s positively correlated. In other words, potential homebuyers are not presently responsive historically low mortgage rates.”

—Tom Porcelli, Chief Economist at RBC Capital Markets
Net Flows Of Equity vs. Bond Mutual Funds

Net flows in equity and bond mutual funds serves as a good proxy for investor disposition towards different asset classes. Recently, this chart indicates growing interest in fixed income assets and a move away from equities.

Contributed by Jason Trennert, Chief Investment Strategist at Strategas
Demographics Of Capital

“The first of the baby boomers — the 78 million ‘pig in a python’ that own most of the wealth and have driven everything in the past six decades from politics to economics — have reached their mid-60s. The median age is 55 and going on 56. They are no longer in their capital appreciation/aggressive growth part of the life cycle as they were in the 1980s and 1990s. The aging but not yet aged 50+ crowd is still making up a greater share of the population pie, and as such will still pack a very powerful punch when it comes to driving fund flows across the various asset classes.”

—David Rosenberg, Chief Economist and Strategist at Gluskin Sheff + Associates

**CHART 5: DEALING WITH DEMOGRAPHICS**

**United States: Share of Total Population**

**Age 25-49**
(period percent)

**Age 50-74**
(period percent)

Dashed lines represent forecast
Source: Haver Analytics, Gluskin Sheff
Rich Pay Most Federal Income Taxes
China is Addicted to Saving

<table>
<thead>
<tr>
<th>Date</th>
<th>Value</th>
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<tbody>
<tr>
<td>January 1993</td>
<td>$20.138 billion</td>
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<td>November 1996</td>
<td>$102.306 billion</td>
</tr>
<tr>
<td>October 2006</td>
<td>$1.0096 trillion</td>
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<td>April 2009</td>
<td>$2.0089 trillion</td>
</tr>
<tr>
<td>March 2011</td>
<td>$3.0447 trillion</td>
</tr>
</tbody>
</table>

Source: State Administration of Foreign Exchange
Oh, To Be Korean

Government budget balance

1978-2011

Number of years in: deficit surplus

Italy 0 2 4 6 8 10 12 14 16 18 20 22 24 26 28 30 32 34 Average budget balance, % of GDP
France -7.0
Spain -3.3
United States -4.3
Britain -3.9
Japan -3.7
Canada -4.1
Sweden -3.5
South Korea -1.4

2015-2011

Number of years in: deficit surplus

Greece 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 Average budget balance, % of GDP
Japan -7.0
Poland -6.3
Portugal -4.7
Germany -4.6
United States -2.7
Britain -3.8
Spain -3.6
Sweden -2.9
Netherlands -1.9
Switzerland -0.4
Canada -0.8
Ireland -2.8
Sweden 0.1
Australia 0.2
South Korea 2.7

Source: OECD
Real GDP vs. Real Potential GDP

“The gap is 5.4% right now — that is equivalent to the whole state of Florida sitting idle, just for some perspective. On average, in the third year of recovery, the output gap is fully closed and the Fed is embarking on rate hikes, not contemplating a third round of Quantitative Easing as is now the case.”

—David Rosenberg, Chief Economist and Strategist at Gluskin Sheff + Associates

CHART 4: TREMENDOUS EXCESS CAPACITY IN THE U.S. ECONOMY

United States: Real GDP and Real Potential GDP
($ billion, 2005)
WHAT WERE THEY THINKING?
The BRIC Middle Class Is Exploding

- McKinsey says 48 million Chinese will join the middle class every year until 2020.
- Goldman says 30 million Indians, Brazilians and Russians will join the middle class every year until 2020.
- Only 312.5 million people live in the US.
- By 2020, the BRIC’s could have 1 billion middle class citizens.
- This is the greatest time to be an American farmer!
China is Our Future

- Wal-Mart plans to have more stores in China by 2025 than they have in the US.
  - There is a Wal-Mart store within 5 miles of 85% of all Americans today.

- IKEA has more stores in China than any other country besides Sweden.
  - They have more stores in Hong Kong (5) than they have in Texas (3)

- China is more profitable than the US for Yum Brands (KFC, Pizza Hut and Taco Bell) and General Motors
China’s Economy is a Job Machine
Chinese Banks and The World

Top 20 financial institutions by market capitalisation, $bn, 1999 - 2009

Mouseover chart for more information. Click on bank to highlight it and track its progress.

Citigroup
Annual % change in share price (as of March 17/18): -83.4%
Government bailout: $60bn
Employees: 322,800
Date founded: 1998

Citigroup has more than 200m customer accounts across more than 100 countries. The bank has suffered notably in the credit crisis. In 2008 Citigroup lost $27.7bn in part due to $32bn of revenue mark-to-market losses. It has received billions of dollars in capital injections from the government, which now holds a 36 per cent stake in the bank. Citigroup has outlined plans to shrink to its former core banking business, placing assets worth tens of billions of dollars in a non-core division.

Top three mergers and acquisitions since 1999:
- Travelers Property Casualty, US, 2003, $17.79bn
- Grupo Financiero Banamex Accival, Mexico, 2001, $12.66bn

Visit website
Inside Canada, China Asserts Itself (WSJ – 7/16/12)

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Source: Dealogic

0  $1  $2  $3  $4 billion
China Buys Up Spain's Assets

A debt-laden Spanish construction firm became the latest European company to unload assets onto eager Chinese buyers, as Europe's debt woes force firms to look to China for cash.

State Grid Corp., China's government controlled power-grid operator, said on May 29th it would buy high-voltage electricity transmission assets in Brazil from Spain's Actividades de Construccion y Servicios SA ACS.MC 0.00% for 1.86 billion reais ($938.2 million), including debt.

Wall Street Journal May 29, 2012
If You Have Cash . . .

- The deal is State Grid's second investment in Brazil and its fourth major investment overseas, and is the most recent in a string of deals in which a European company has looked to exit an investment amid financial troubles facing the region.

- Other southern European companies have also been selling their crown jewels abroad to raise cash. Portugal, for example, is attracting significant investments from China because of its presence in former colonies that are resurfacing as high-growth markets, rich in natural resources.
Cash is King

- In December, fellow state-controlled power giant China Three Gorges Corp. won a 21% stake in EDP-Energias de Portugal SA—which has significant Brazil operations—with a €2.69 billion bid.

- State Grid has also looked in recent years to resource-rich Latin America and other countries. In March, a joint venture that included State Grid won licenses to build transmission lines in Brazil. In February it said it would buy a 25% stake in Portugal's Redes Energeticas Nacionais SGPS SA, and it agreed in 2010 to buy seven Brazilian power transmission companies for nearly $1 billion.
Movies, Anyone?

- **Chinese Conglomerate Buys AMC Movie Chain in U.S.** *Wall Street Journal, May 21, 2012*

  - A Chinese conglomerate agreed to acquire U.S. movie theater chain AMC Entertainment Holdings in a deal that they valued at around $2.6 billion, in one of the biggest moves yet by a Chinese company to break into the U.S. industry.

  - The deal gives China's Dalian Wanda Group Corp. access to AMC's 346 multiplex theaters with more than 5,000 screens, mostly in the U.S. and Canada. Wanda plans to invest as much as an additional $500 million in AMC, which the U.S. chain can use to update its cinemas' technological innovations and reduce debt.
China is Buying

- Corn Takes Off as China Buys
  - *U.S. Futures Rise 9.4% in a Week; Exporters, Domestic Users Compete for Supplies*
    - *Wall Street Journal, May 20, 2012*

- China steps up Afghan role as Western pullout nears
  - China and Afghanistan will announce a plan in the coming days to deepen their ties, Afghan officials say, the strongest signal yet that Beijing wants a role beyond economic partnership as Western forces prepare to leave the country.
    - *Reuters, June 3, 2012*
Buy Low, Sell Never?

- Chinese Purchases Of U.S. Real Estate Poised To Rise

- Chinese land grab tests farming dynasties

- Brazil plans stricter land purchase rules as foreigners now own 10-30 million acres
  - www.af.reuters.com – 11/19/11

- Chinese Developer Wins Approval to Buy 16 New Zealand Farms
  - www.businessweek.com – 1/29/12
Chinese Hit New Space Heights

- China successfully achieved its first manned space docking, an important step in the country's quest to launch a space station by around 2020.
- The Shenzhou-9 mission reinforced China's long-term aspirations for a manned space presence just as the U.S. has significantly drawn down its own manned space program and retired its aging fleet of space shuttles.
### We Owe China, Inc. $1.47 Trillion!

#### May 2008 (Billion $)
- **Japan** = $575.3
- **China** = $506.8
- **UK** = $271.2
- **Oil Exporters** = $164.2
- **Brazil** = $151.4
- **Caribbean Banking Centers** = $104.5
- **Luxembourg** = $75.2
- **Russia** = $63.7
- **Hong Kong** = $61.4
- **Taiwan** = $38.9

#### April 2012 (Billion $)
- **China** = $1,145.5
- **Japan** = $1,066.1
- **Oil Exporters** = $252.4
- **Caribbean Banking Centers** = $247.0
- **Brazil** = $246.7
- **Taiwan** = $188.3
- **UK** = $154.2
- **Switzerland** = $151.1
- **Russia** = $146.8
- **Belgium** = $141.0
- **Hong Kong** = $139.4

The IMF Says . . .

China could pass the United States as the largest economy in the world by 2016.
CHINA COULD PASS THE USA BY 2012!

Source: The Conference Board Report issued on November 10, 2010 using Purchasing Power Parity (PPP)
The “Developed” World is Shrinking

Recent Results
Organic Sales Growth led by Developing Markets

Past 4 Quarters +12%

Developing

Developed

Source: Procter & Gamble Company (June 2012)
Can You Spell Irrelevant?

Clusterstock  Chart of the Day

Population Of The West As % Of The World Population

Source: United Nations (April 2011)
China Today Equals America In 1966

Clusterstock Chart of the Day

Putting China In Perspective: China/US (x, Current)

*X-axis measures the equivalent year of U.S. when the level of demand was equal to that of China. Y-axis measures the current level of demand in China compared to the U.S.


2009 China GDP per capita = 1966 U.S. GDP per capita

McCOMBS SCHOOL OF BUSINESS
N-11 countries (Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, Turkey, South Korea, and Vietnam)
Steel is Another Growth Indicator

Number Of Years Of Steel Production Above 500 kg/Capita

- US – 30 years
- Japan – 44 years (continuing)
- Germany – 45 years (continuing)
- Korea – 27 years (continuing)
- China – 0 years

Source: Rio Tinto
How Long Will They Wait?

THE GAP BETWEEN THE RICH AND POOR IS GROWING
2007 Shanghai Millionaires Ball
A Coal Baron Son’s Wedding
Job Fair for 150k College Graduates
How Long Will They Wait?
When Will She Wait?
How Long Will They Wait?
How Long Will They Wait?

One day the poor will have nothing left to eat but the rich.
Francois Hollande’s Opus

MoneyGame Chart of the Day

France Govt Oats Btan 2 Yr Btan (GFRN2)

Source: Bloomberg

05/11/2012