Jefferies & Company, Inc.

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U.S. Economy, Inflation & Policy

Sustainable economic expansion, low but rising inflation, unique monetary policy challenges & profligate fiscal policy

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Jefferies

U.S. Economy, Inflation & Policy: Sustainable economic expansion, low but rising inflation, unique monetary policy challenges & profligate fiscal policy

Key Themes & Risks

1. The U.S. economic fundamentals and growth prospects continue to improve. Growth is sustainable.

2. State and local finances, possible consequences of the catastrophe in Japan, lingering mortgage and housing imbalances, as well as rising food and energy prices are speed bumps that will limit the upside growth potential but not derail the U.S. economy.

3. 2011 growth will be driven by increased investment spending and a moderate increase in consumer spending.

4. Manufacturing activity is whirring and will continue to do so.

5. With income growth remaining moderate, consumers will continue to spend, but the increase in food and energy prices will cause reductions in discretionary spending.

6. Inflation is low but will gradually head higher. Because of the composition of the U.S. economy, the effect of rising commodity prices will be more limited than is the case in commodity-based economies.

7. Improved growth prospects and rising inflation will continue to increase friction on the FOMC as policymakers debate the timing of the eventual exit strategy.

8. The size and composition of the Fed's balance sheet will be the primary battle ground for policy debate ,especially over the second half of the year.

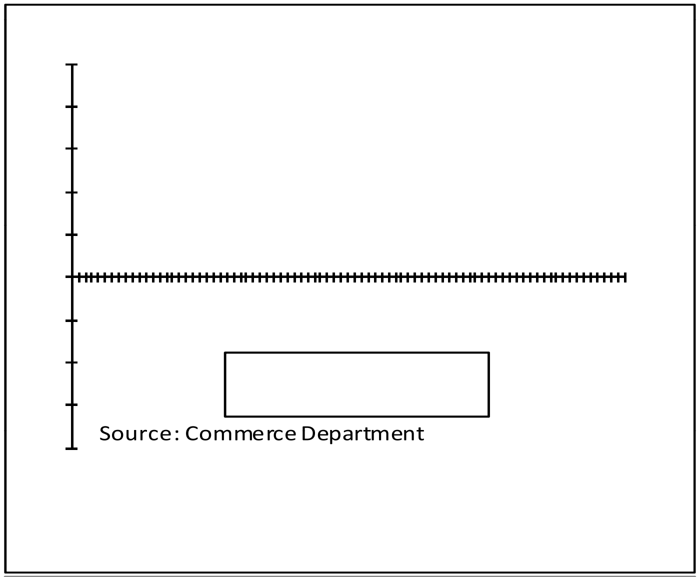
9. The Fed's ongoing efforts to prevent deflation, including QE2, is reviving inflation and bringing an end to a 30-year secular disinflationary trend.

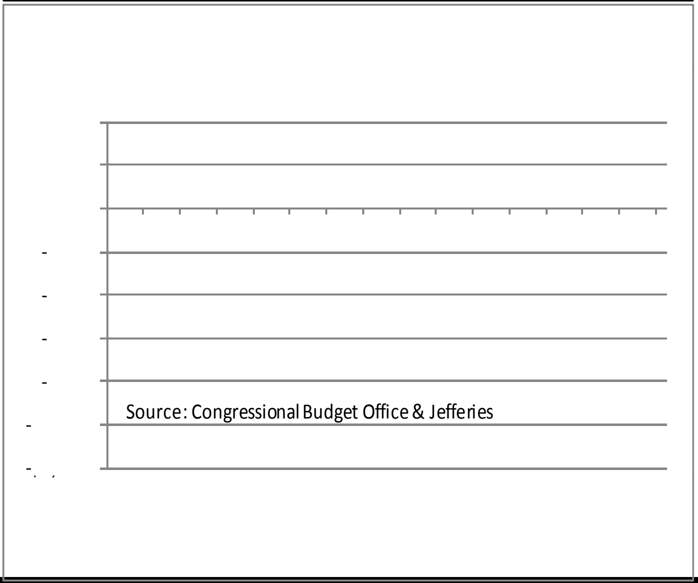
10. The Treasury MBS wind down will reduce the need to increase auction sizes over the second half of the year, but the debt ceiling will still need to be increased by late-Q2.

11. Congress must bring an end to the age of entitlement to reduce the U.S. budget deficit or the U.S. will lose the AAA credit rating.

Economic Expansion: Sustainable, GDP remains below potential

- U.S. economy entered the expansion phase of the cycle in Q4 2010
- U.S. economic growth will accelerate from the 2.3% quarterly average of the final three quarters of 2010
- Jefferies projects 2011 GDP growth between 3% and 3.5%
- Nonetheless, GDP will remain well below potential for several more quarters because of the severity of the output gap from the recession





Economic Expansion: The composition of the economy, implications for growth

- GDP growth in the current recovery has been similar to the prior two “jobless” recoveries and less robust than recoveries prior to 1990
- U.S. activity & employment has become increasingly concentrated in the service sector of the economy, which helps to explain why growth has become less robust
- This trend is also unsustainable if the U.S. economy is to maintain a preeminent role in the global economy

There are speed bumps, but none of them will derail the U.S. economy:

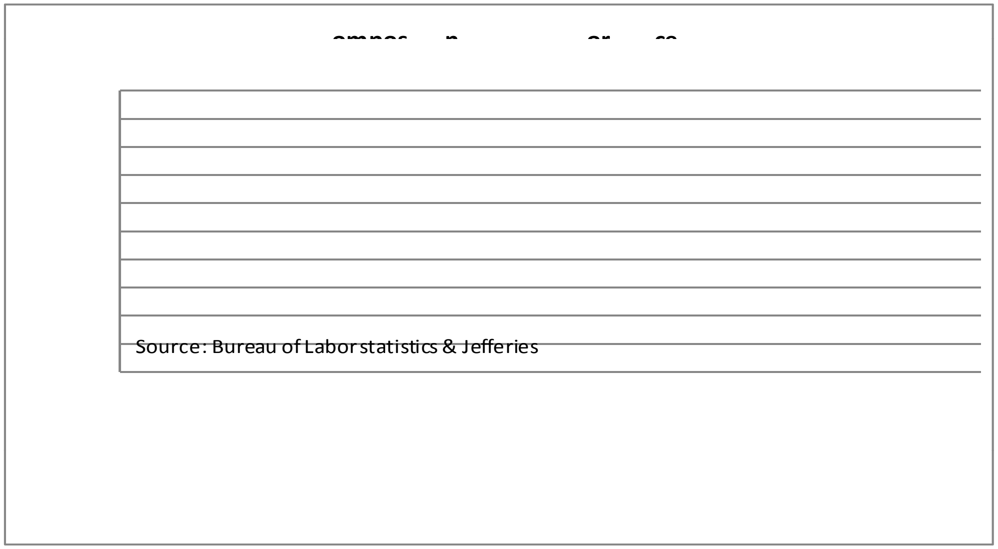
- The rise in oil prices and ongoing distress in state and local finances pose headwinds that will limit the upside to growth
- Events in Japan create near-term downside risks and longer-term upside risks to the U.S. economy

Recessions & Recoveries, 1973 - 2010

	Length Of Recession	Decline In Real GDP	---------Quarterly GDP Growth Following the Recession--------- Trough +1	Trough +2	Trough +3	Trough +4	Trough +5	Trough +6	Average
1973/1974	16 months	-2.8%	3.1%	6.9%	5.3%	9.4%	3.0%	2.0%	5.0%
1980	6 months	-2.2%	7.6%	8.6%	-3.2%	4.9%	-4.9%	-6.4%	1.1%
1981/1982	16 months	-2.7%	5.1%	9.3%	8.1%	8.5%	8.0%	7.1%	7.7%
Average	13 months	-2.6%	5.3%	8.3%	3.4%	7.6%	2.0%	0.9%	4.6%

	Length Of Recession	Decline In Real GDP	---------Quarterly GDP Growth Following the Recession--------- Trough +1	Trough +2	Trough +3	Trough +4	Trough +5	Trough +6	Average
1990/1991	8 months	0.0%	2.7%	1.7%	1.6%	4.5%	4.3%	4.2%	3.2%
2001	8 months	0.0%	2.6%	-1.1%	1.4%	3.5%	2.1%	2.0%	1.8%
2007/2009	16 months	-3.7%	1.6%	5.0%	3.7%	1.7%	2.6%	3.1%	3.0%
Average	11 months	-1.2%	2.3%	1.9%	2.2%	3.2%	3.0%	3.1%	2.6%

Source: Commerce Dept



State & Local Finances: Time to pay the piper with job losses

- State & local government payrolls have declined by 479k since August, 2008

- Local government payrolls have declined by 397k

- State government employment has fallen by a more moderate 82k, but more significant job losses are likely as state governments grapple with fiscal imbalances

- The ripple effect will reach federal government employment between 2012 and 2015

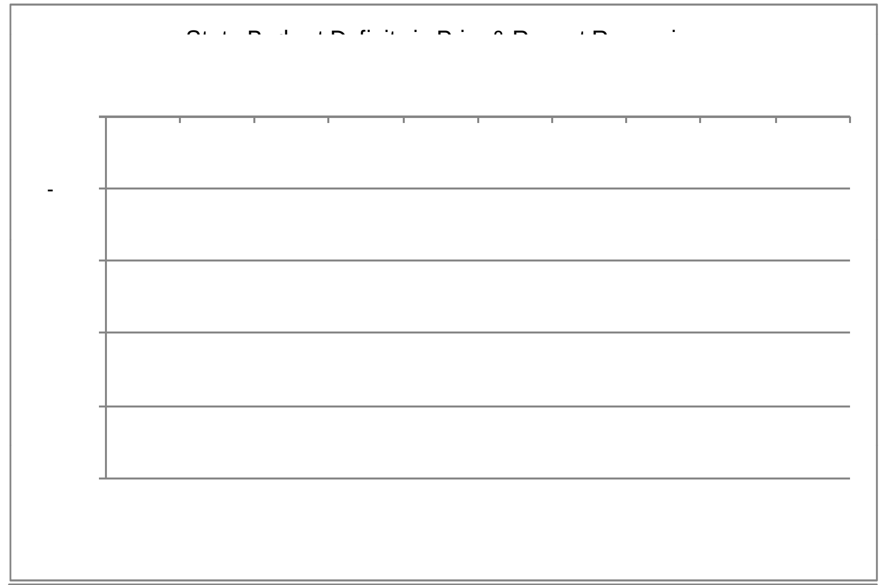
- **California Snapshot:**

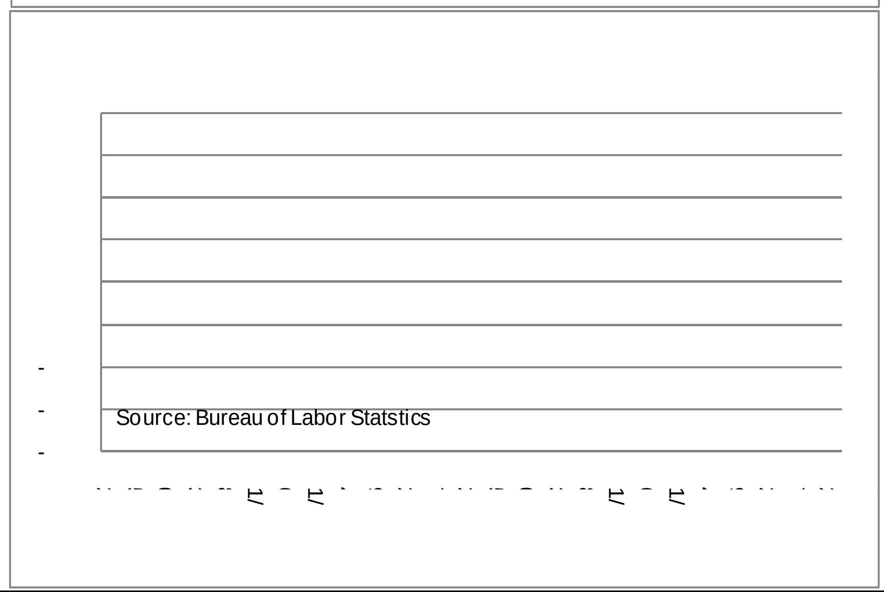
California's February unemployment rate of 12.2% is the second highest in the nation and well above the 8.9% national unemployment rate

California payrolls rose 218k over the past year

California industries with the fastest payrolls growth have been professional & business services (100k) , trade 8 transportation (38k) and education & health services (49k)

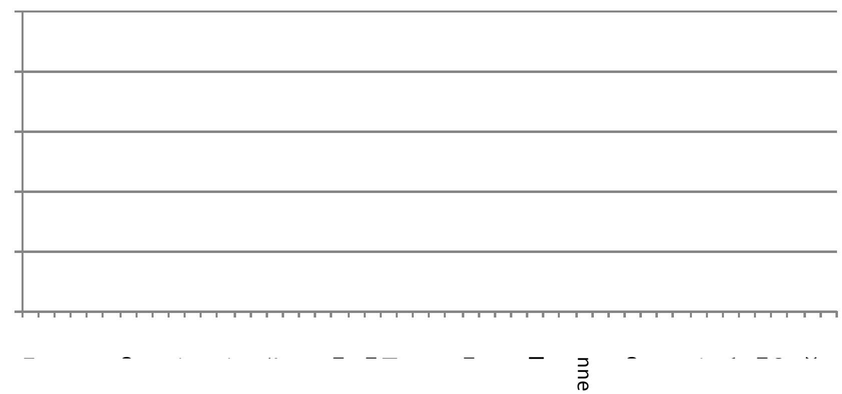
Government payrolls have declined by 62k

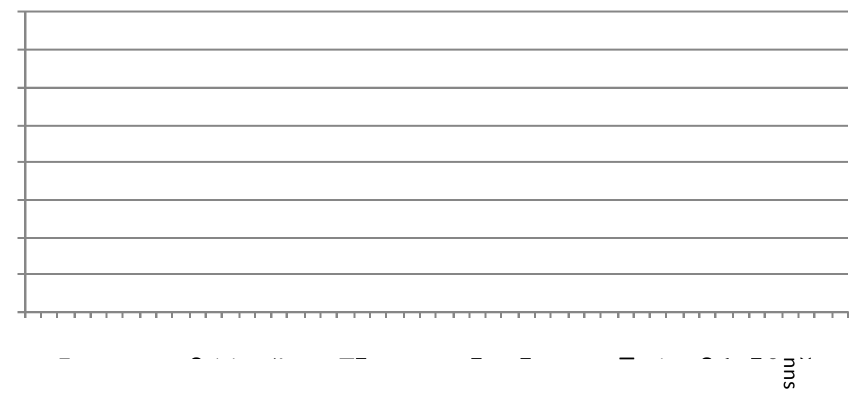


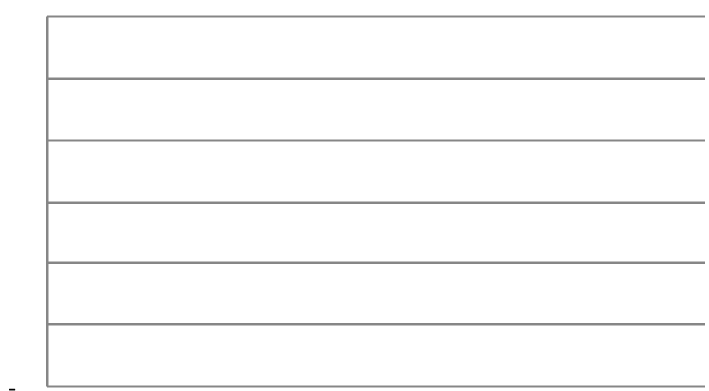


Source: Bureau of Labor Statstics

State & Local Finances: California Snapshot







Anatomy of the economy: Consumer & investment are vital

- Consumer spending & inventory accumulation have been the backbone of growth to-date
- The boost to growth from inventory accumulation is dissipating
- A continued rise in consumer spending and increased investment outlays will carry the economy going forward
- The combination of high corporate cash positions and investment tax stimulus will boost investment spending in 2011, but borrow from 2012
- Real estate activity and construction will not play a significant role in the growth trajectory in 2011
- Trade is the direct link between Japan and the U.S. economy
- The indirect link with the financial markets and confidence has greater potential to adversely affect the U.S. in the short-term, but the markets are weathering the storm
- Reconstruction will boost U.S. exports to Japan & activity once it is underway

Anatomy of the Recovery & Incipient Expansion
Contributions to GDP Growth by Sector

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Average
Real GDP	1.6%	5.0%	3.7%	1.7%	2.6%	3.1%	3.0%
PCE	1.4%	0.7%	1.3%	1.5%	1.7%	2.8%	1.6%
Durable goods	1.4%	-0.1%	0.6%	0.5%	0.5%	1.5%	0.7%
Nondurable goods	0.3%	0.5%	0.7%	0.3%	0.4%	0.7%	0.5%
Services	-0.2%	0.3%	0.0%	0.7%	0.8%	0.7%	0.4%
Fixed Investment	0.1%	-0.1%	0.4%	2.1%	0.2%	0.8%	0.6%
Nonresidential	-0.1%	-0.1%	0.7%	1.5%	0.9%	0.7%	0.6%
Structures	-0.4%	-1.0%	-0.5%	0.0%	-0.1%	0.2%	-0.3%
Equip & Soft	0.3%	0.9%	1.2%	1.5%	1.0%	0.5%	0.9%
Residential	0.3%	0.0%	-0.3%	0.6%	-0.8%	0.1%	0.0%
Chg Inventories	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Net Exports	-1.4%	1.9%	-0.3%	-3.5%	-1.7%	3.3%	-0.3%
+Exports	1.3%	2.6%	1.3%	1.1%	0.8%	1.1%	1.4%
-Imports	-2.7%	-0.7%	-1.6%	-4.6%	-2.5%	2.2%	-1.6%
Government	0.3%	-0.3%	-0.3%	0.8%	0.8%	-0.3%	0.2%
Federal	0.5%	0.0%	0.2%	0.7%	0.7%	0.0%	0.3%
State and local	-0.1%	-0.3%	-0.5%	0.1%	0.1%	-0.3%	-0.2%

Source: Commerce Dept

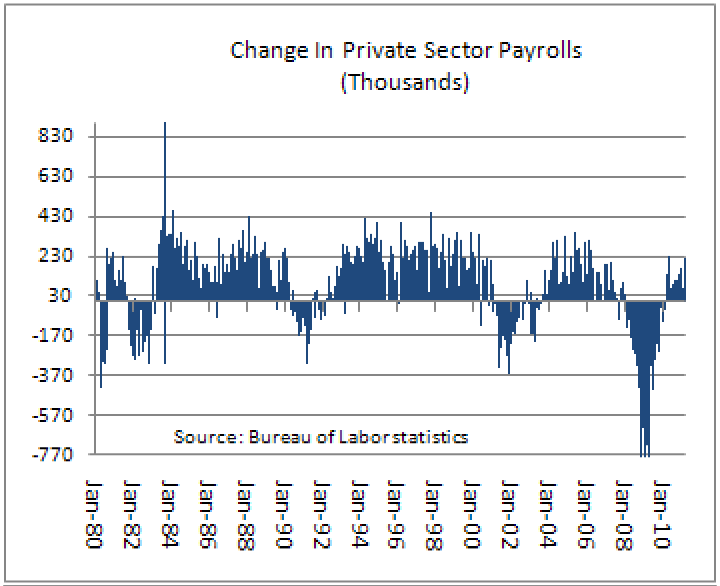
Labor Market: Private sector payrolls up, unemployment down

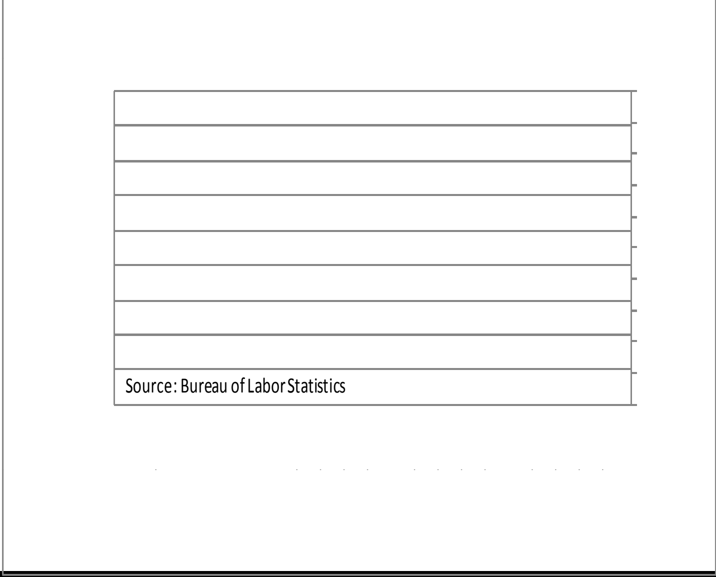
- The labor market continues to pull itself out of a very deep hole
- Private sector payrolls increased by almost 1.3 million in 2010
- Jefferies projects that private sector payrolls will rise by roughly 2 million in 2011

- Recent unemployment claims are the lowest since July of 2008 and reflect improved market conditions

- Extended benefits caused the unemployment rate to remain stubbornly high and also contributed to large declines in the December and January unemployment rate

- The unemployment rate will dribble lower in the months and years ahead





Labor Market: This is not a jobless recovery

- The recovery in the labor market has been slower since 1990 than was the case in the 1970s and 1980s
- The good news is that private sector job growth has materialized earlier and been stronger in the current cycle than in either of the prior “jobless” recoveries
- Conditions for faster private sector job growth are in place to offset losses in government payrolls
- State and local government employment has declined by a combined 459k, more losses are on the way as states grapple with bloated budget deficits
- There is a long way to go before the labor market is back to normal, but the market is headed in the right direction
- 8.8 million private sector jobs were lost during the recession and the first two quarters of the recovery, and this reservoir of unemployed will limit wage increases

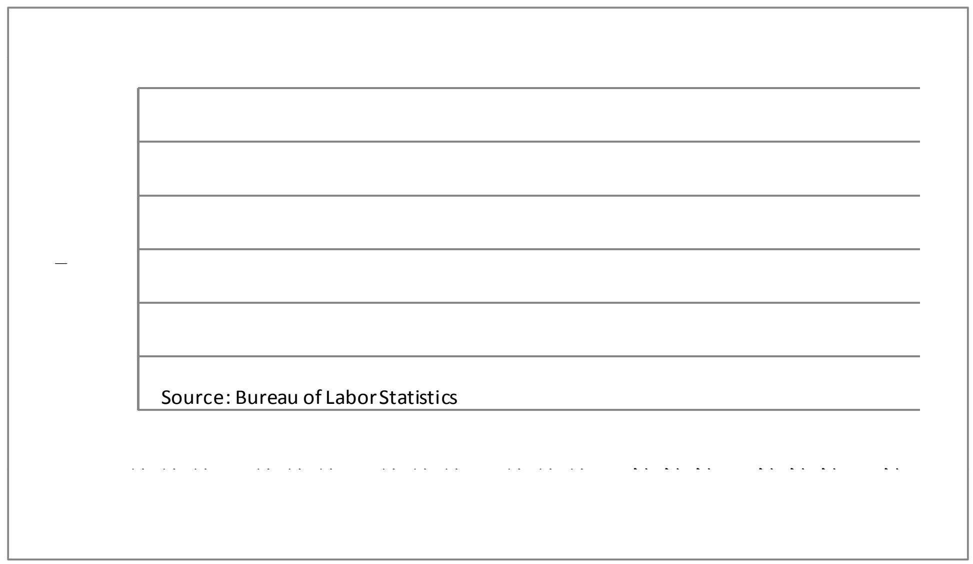
The Labor Market In Recessions & I

1973 2011

-----Quarterly Change in Private Sector Nonfarm Payrolls

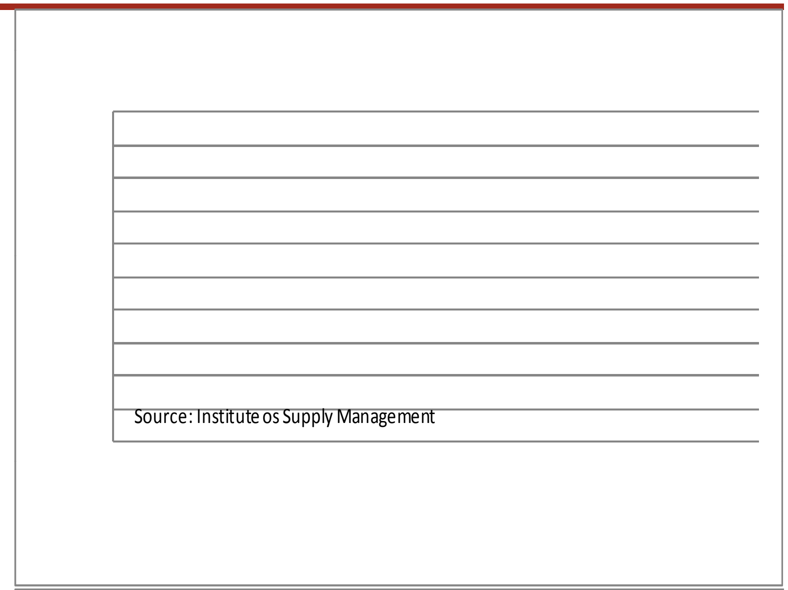
	Peak to Trough Decline in Payrolls	Trough +1	Trough +2	Trough +3	Trough +4	Trough +5	Trough +6	Trough +7	Average
1973/1975	-956,000	-160,000	673,000	663,000	991,000	351,000	508,000	452,000	496,857
1980	-837,000	688,000	347,000	413,000	117,000	1981/1982		Recession	391,250
1981/1982	-2,710,000	296,000	916,000	1,202,000	1,013,000	1,179,000	953,000	736,000	899,286
Average	-1,501,000	274,667	645,333	759,333	707,000	765,000	730,500	594,000	639,405
		Trough +1	Trough +2	Trough +3	Trough +4	Trough +5	Trough +6	Trough +7	Average
1990/1991	-1,280,000	-325,000	21,000	-121,000	-41,000	297,000	180,000	479,000	70,000
2001	-1,630,000	-379,000	-165,000	-165,000	-64,000	-309,000	-53,000	188,000	-135,286
2007/2009	-7,311,060	-715,000	-386,000	81,000	342,000	312,000	438,000	564,000	90,857
Average	-3,407,020	-473,000	-176,667	-68,333	79,000	100,000	188,333	410,333	-58,444

Source: Jefferies & Bureau of Labor Statistics

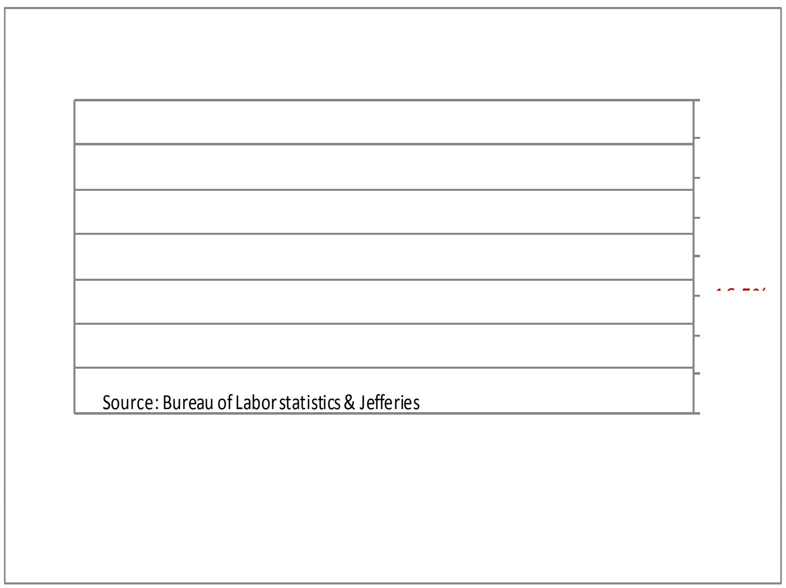


Labor Market: Tea leaves point to improvement & compositional change

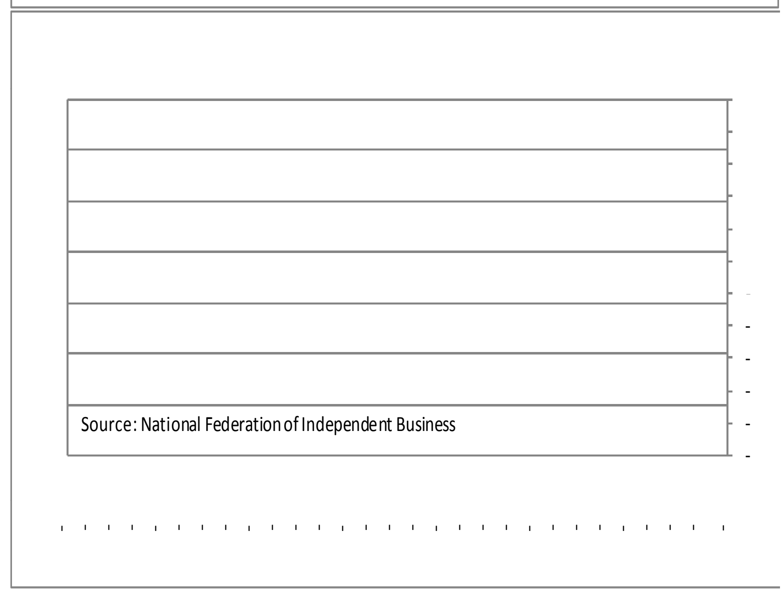
- Indications from both the service and manufacturing ISM surveys point to continued hiring going forward
- There has also been an encouraging improvement in small business optimism and hiring intentions
- Small and medium-sized firms need to be the driving force job creation at this stage of the cycle
- The combination of private sector payroll growth and state & local government job losses have caused the government share of employment to decline



Source: Institute os Supply Management



Source: Bureau of Labor statistics & Jefferies



Source: National Federation of Independent Business

Labor Market: Invisible hand at work, small & medium sized firms kick into gear

- Job creation at small and medium-sized firms is critical to job growth
- Hiring at small and medium-sized firms is off to an encouraging start in 2011
- The service sector continues to drive job growth, but manufacturing employment has been on the rise
- Large firms continue to lag in job creation
- Construction remains mired in recession

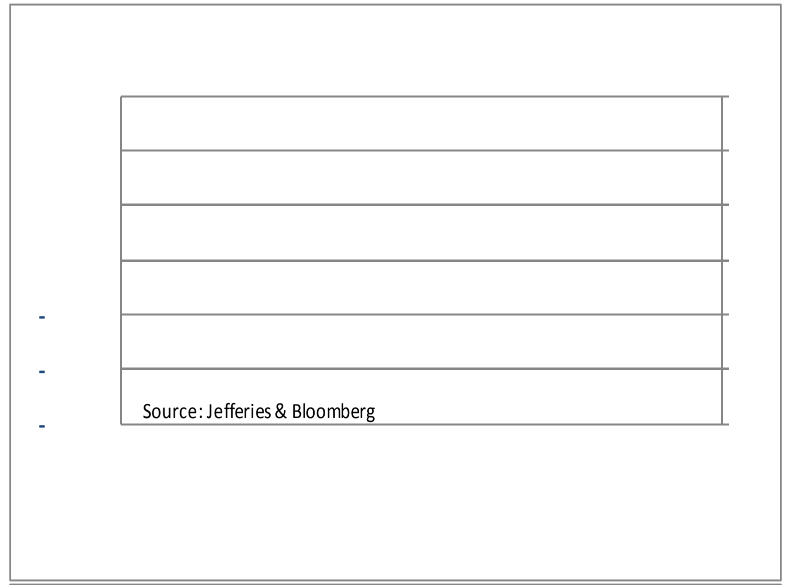
Composition of AD Employment Data								
	Level			Changes				
Industry/ Size	January	February	March	January	February	March	YTD	2010
Total private nonfarm	190	208	201	190	208	201	599	781
Small (1 - 49)	102	96	102	102	96	102	300	381
Medium (50-499)	82	101	82	82	101	82	265	441
Large (>499)	6	11	17	6	11	17	34	(41)
Goods-producing	30	21	37	30	21	37	88	(121)
Small (1 - 49)	10	5	13	10	5	13	28	(115)
Medium (50-499)	17	19	21	17	19	21	57	41
Large (>499)	3	(3)	3	3	(3)	3	3	(47)
Service-providing	160	187	164	160	187	164	511	902
Small (1 - 49)	92	91	89	92	91	89	272	496
Medium (50-499)	65	82	61	65	82	61	208	400
Large (>499)	3	14	14	3	14	14	31	6
Addendum:								
Manufacturing	26	20	37	26	20	37	83	78

	October	November	December	January	February	March	YTD	2010
Total private nonfarm	79	122	246	190	208	201	599	781
Goods-producing	(11)	21	26	30	21	37	88	(121)
Service-providing	90	101	220	160	187	164	511	902
Manufacturing	2	19	29	26	20	37	83	78
Construction & Mining	(13)	2	(3)	4	1	0	5	(199)

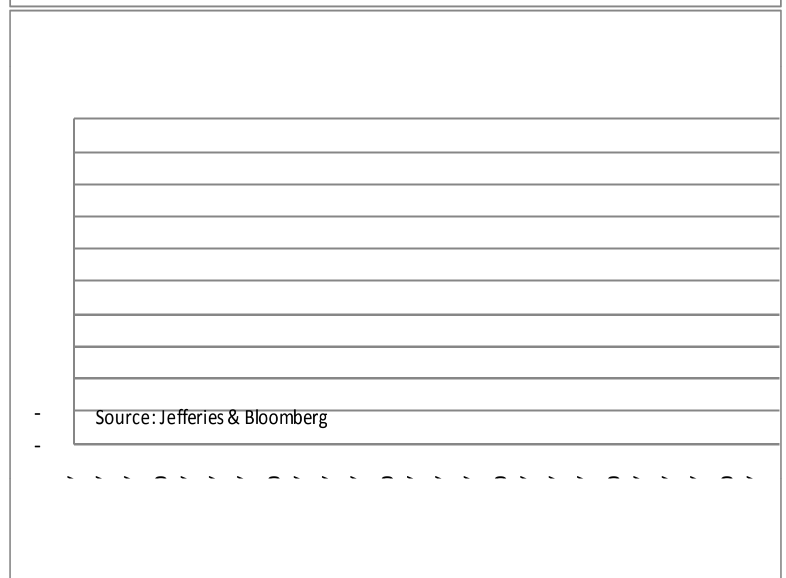
Source: ADP

Consumers: Making ends meet, setting an example for government

- Consumers have restructured balance sheets by reducing debt and increasing savings
- The reduction in the payroll tax will expedite this restructuring process and also support spending
- Job growth and the consequential increase in income will support somewhat faster spending going forward
- If sustained, the rise in gasoline prices will cause some reductions in discretionary spending
- The ongoing struggles in the housing market will limit the ability of consumers to increase leverage to accelerate spending



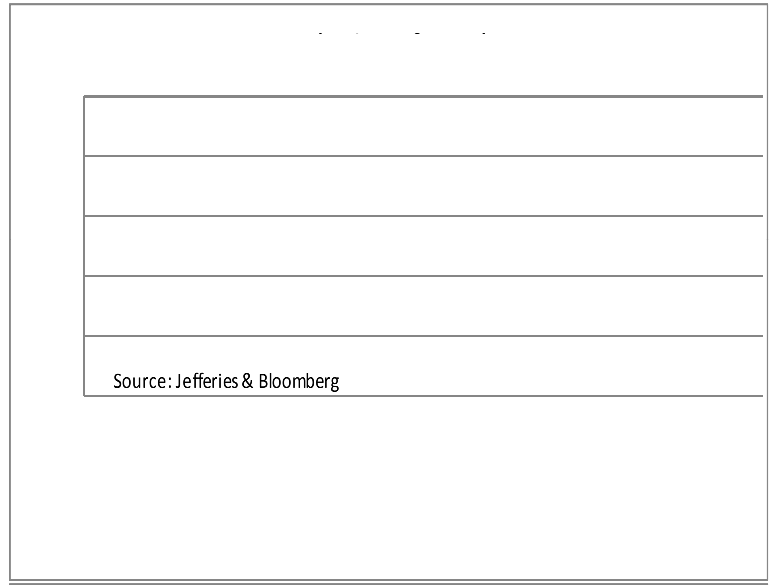
Source: Jefferies & Bloomberg



Source: Jefferies & Bloomberg

Housing: Bouncing along the bottom, regional imbalances

- The 21.8% unemployment rate in the construction industry is the highest of any sector of the economy, and there is no significant relief in sight
- The good news in the housing sector is that the worst days are over, however
- Housing starts, building permits and new home sales are all hovering near historical low levels with no evidence of upward momentum
- The housing sector will continue to bounce along the bottom in 2011, into 2012, and quite possibly beyond, but the housing data also reflects regional imbalances
- Home prices appear to have bottomed, although the evidence is not yet totally compelling because of the high percentage of distressed sales
- Nevada, Arizona, Florida, Michigan and parts of California continue to have severely distressed housing & mortgage markets, high Loan-to-Value ratios
- These five states account for a disproportionate share of problem mortgages and have housing markets that lag other parts of the country



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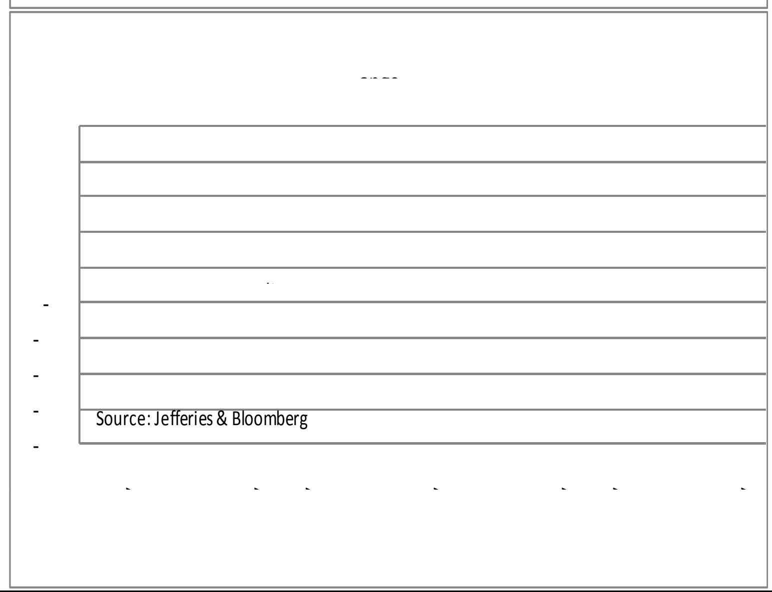
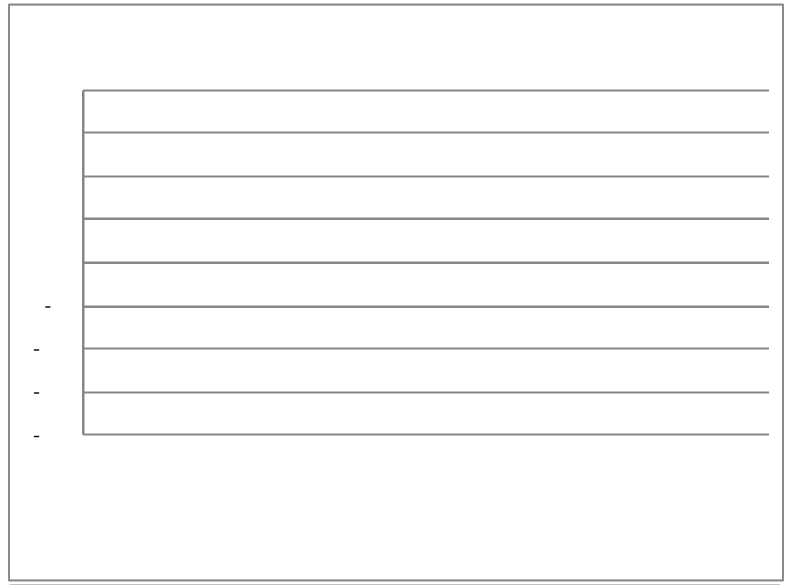
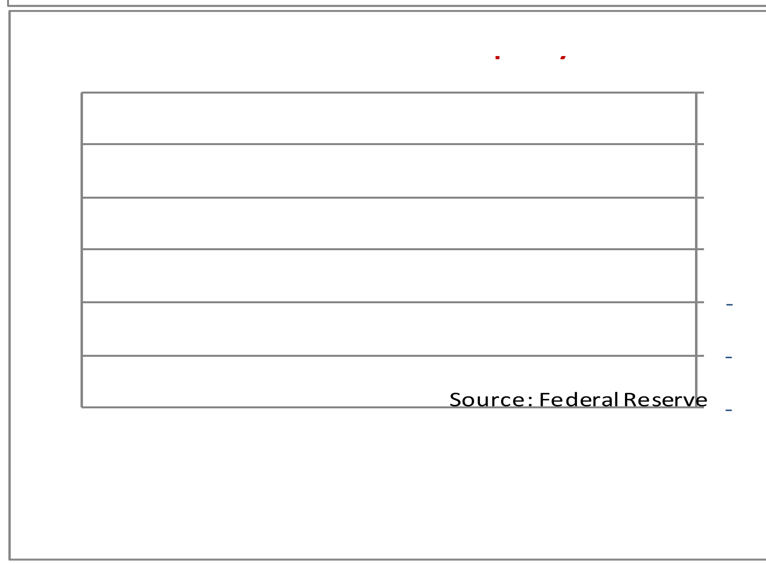


Source: Jefferies & Bloomberg

Manufacturing: Whirring, whittling away at excess capacity

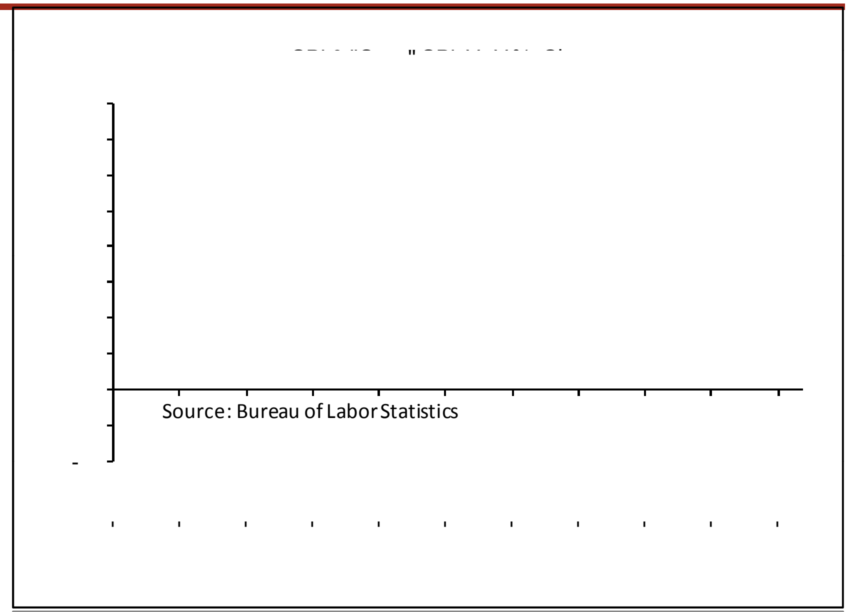
- Inventory rebuilding and manufacturing activity have played a decisive leadership role in the recovery and the incipient expansion
- The recovery has reached the stage where inventories are likely to provide less of a lift, although the drag on Q4, 2010, GDP is not likely to be repeated
- Investment tax incentives should help to boost investment spending, new orders and manufacturing activity in 2011
- However, some of the increased investment spending in 2011 will come at the expense of investment spending in 2012
- Despite the recovery in manufacturing activity, utilization rates are low and unemployment is high
- The unemployment rate in the manufacturing sector is 9.9%
- The capacity utilization rate of 76.3% compares with a 30-year average of 79.9%, peak of 85.2% and trough of 68.2%



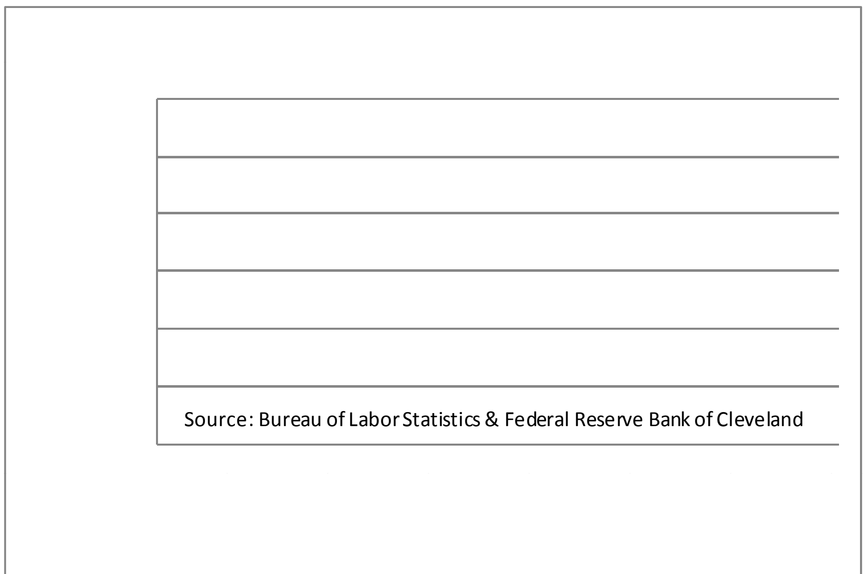


Inflation: Low, but headed higher gradually

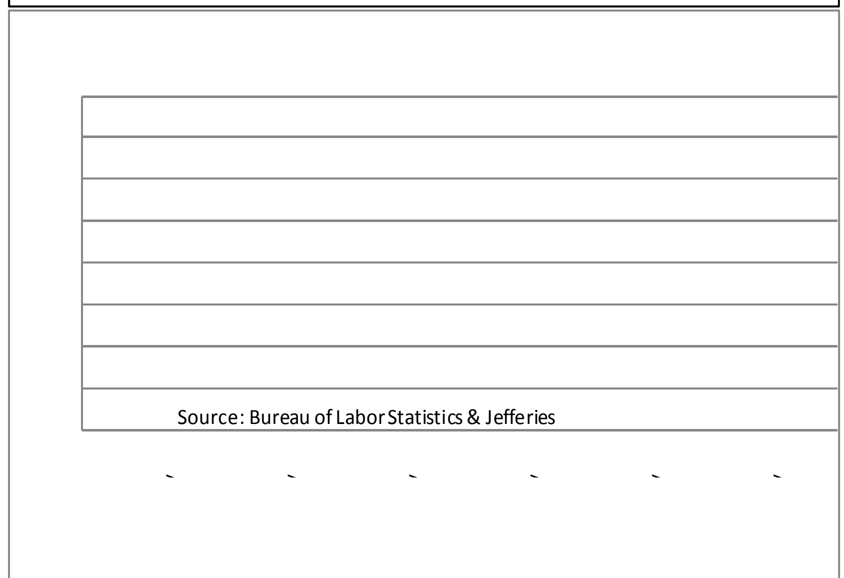
- Headline and core inflation remain low, but disinflation and the threat of deflation have abated
- Core prices have stabilized and will continue to creep higher as the year progresses
- The surge in commodity prices continues to cause a divergence between headline and core inflation readings



Source: Bureau of Labor Statistics



Source: Bureau of Labor Statistics & Federal Reserve Bank of Cleveland



Source: Bureau of Labor Statistics & Jefferies

Inflation: Commodity surge, know when to hold 'em

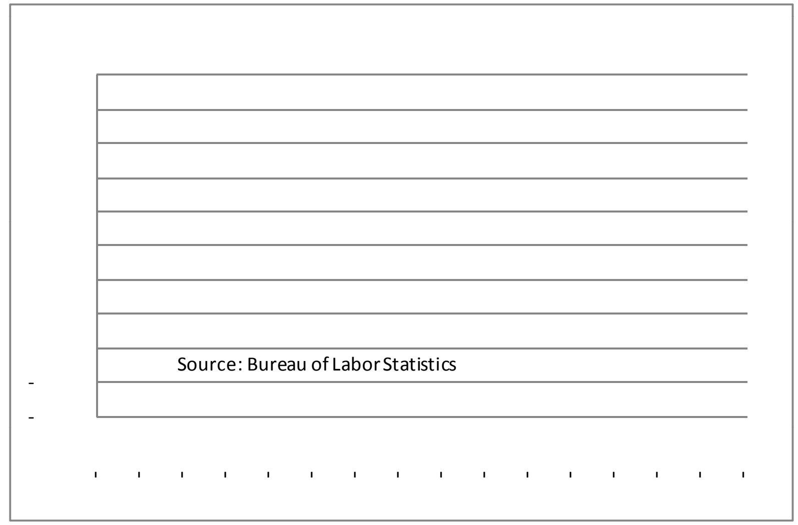
- Commodity prices tend to be far more volatile than more general inflation readings
- This is why the FOMC described the rise in inflation from the run-up in commodity prices, including food and energy, as being "transitory"
- The FOMC is effectively taking a gamble that the upward pressure on commodity prices abates in the months ahead
- Since the U.S. economy and inflation indices are dominated by the service sector, the rise in commodity prices has a more muted effect on the U.S. economy and inflation measures than countries that are more commodity-based
- Movement in commodity prices tends to be exacerbated by movement in the dollar
- A weaker dollar will support economic growth & boost both commodity inflation and import prices

Source: Bureau of Labor Statistics & Bloomberg

Source: Bloomberg

Inflation: Ripple effects of housing

- The disinflationary influence of the housing components of the CPI has abated
- The effect of the housing components on the CPI varies by region, but is no longer disinflationary
- The convergence of regional inflation rates is primarily due to the convergence of the housing components



CPI: Component & Regional Breakdown

	Northeast		Midwest		South		West		National	
	August	February	August	February	August	February	August	February	August	February
CPI	1.4%	2.0%	1.5%	2.2%	1.1%	2.2%	0.7%	1.9%	1.1%	2.1%
Core CPI	1.3%	1.1%	1.0%	1.1%	1.0%	1.1%	0.4%	1.0%	0.9%	1.1%
Food	1.6%	2.5%	1.2%	2.2%	0.9%	2.2%	0.9%	2.3%	1.0%	2.3%
Energy	2.8%	9.8%	3.9%	11.3%	2.4%	11.2%	2.1%	11.3%	2.8%	11.0%
Housing	0.1%	0.8%	0.1%	0.5%	-0.5%	1.0%	-1.1%	0.3%	-0.4%	0.7%
OER	0.5%	0.4%	0.2%	0.9%	-0.1%	1.2%	-1.4%	0.0%	-0.3%	0.6%
Rent	1.9%	1.9%	0.8%	1.1%	-0.8%	0.5%	-1.0%	1.1%	0.0%	1.1%
	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Commodities	2.2%	3.7%	1.6%	3.2%	1.5%	2.9%	1.6%	2.9%	1.7%	3.1%
Services	0.9%	1.1%	1.4%	1.5%	0.8%	1.8%	0.2%	1.3%	0.8%	1.4%

Source: Bureau of Labor Statistics & Jefferies

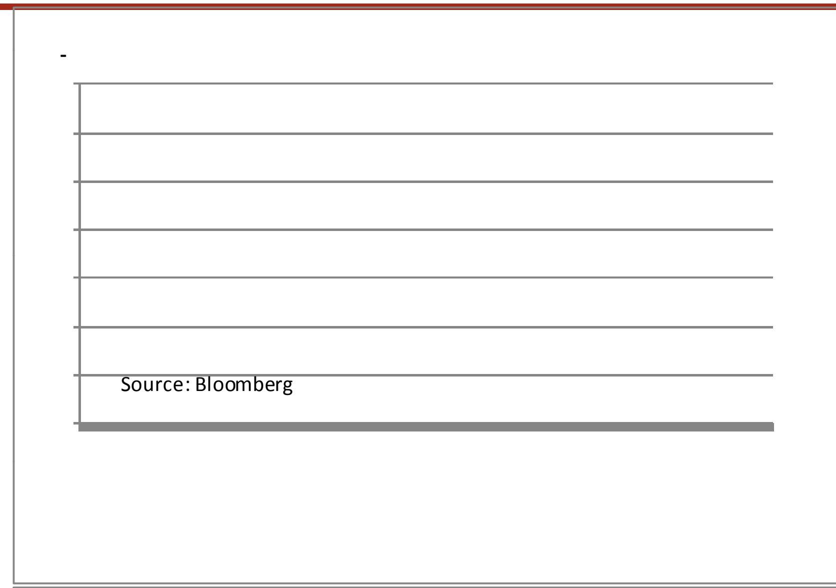
Change in CPI: August, 2010, to February, 2011 (YoY Percent Change)

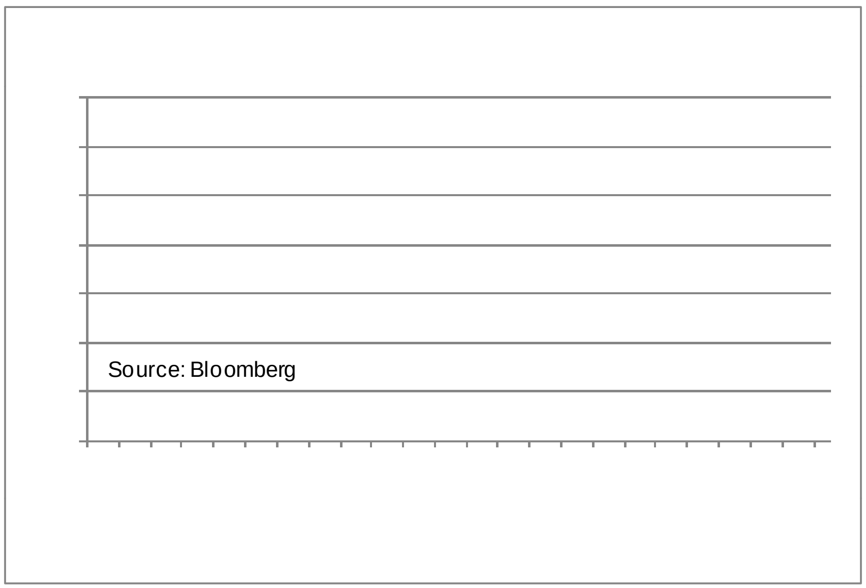
	Northeast	Midwest	South	West	National
CPI	0.6%	0.7%	1.1%	1.2%	1.0%
Core CPI	-0.2%	0.1%	0.1%	0.6%	0.2%
Food	0.9%	1.0%	1.3%	1.4%	1.3%
Energy	7.0%	7.4%	8.8%	9.2%	8.2%
Housing	0.7%	0.4%	1.5%	1.4%	1.1%
OER	-0.1%	0.7%	1.3%	1.4%	0.9%
Rent	0.0%	0.3%	1.3%	2.1%	1.1%
	0.0%	0.0%	0.0%	0.0%	0.0%
Commodities	1.5%	1.6%	1.4%	1.3%	1.4%
Services	0.2%	0.1%	1.0%	1.1%	0.6%

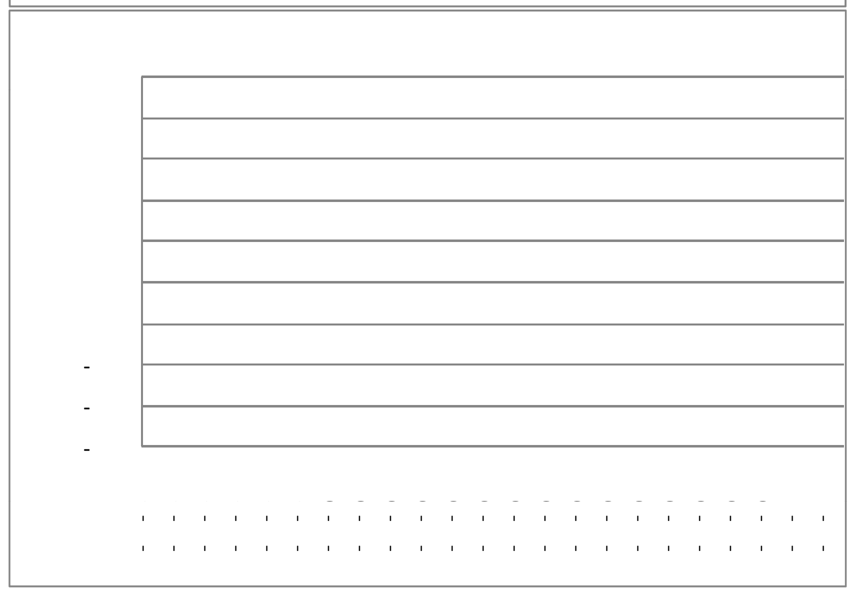
Source: Bureau of Labor Statistics & Jefferies

Inflation: Expectations, anchors and public relations

- The TIPS market suggests that perceptions of deflation risks have abated, while longer-term inflation expectations remain anchored …for now
- The rise in commodity prices –especially gasoline and food prices– has caused consumer expectations of inflation to spike well above actual inflation
- The rise in gasoline and food prices creates a significant public relations problem for the Fed which focuses on “core” price indices that exclude food and energy prices
- The rise in food and energy prices has also increased friction among policymakers at the Fed

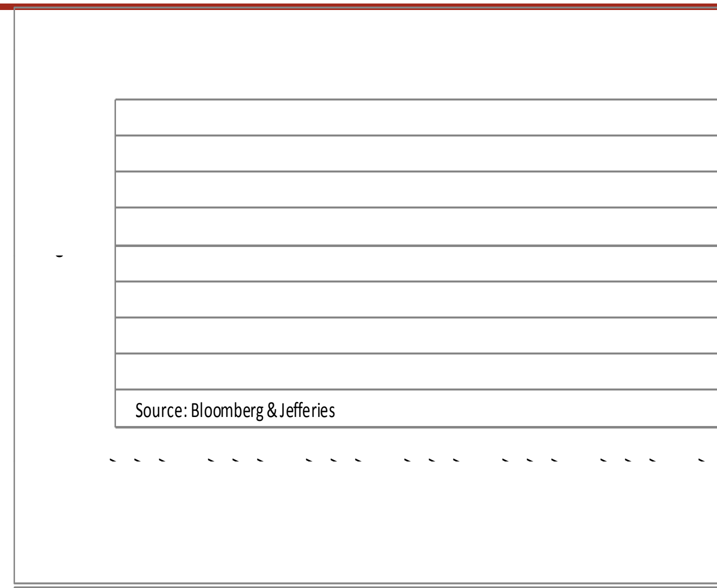


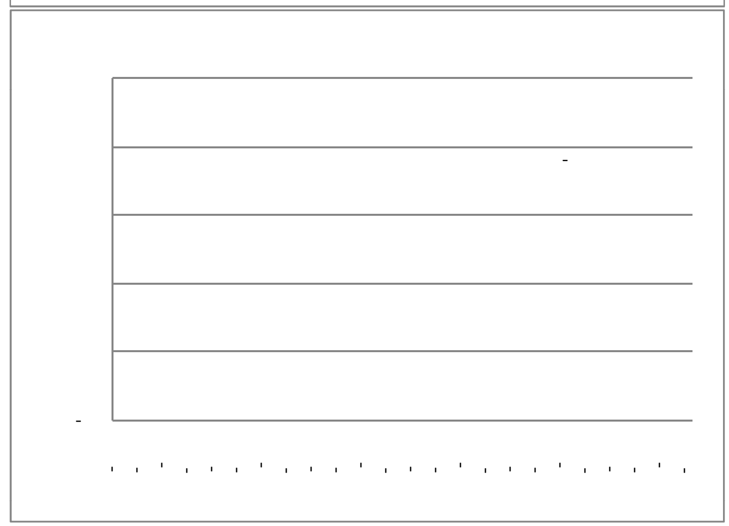




Monetary Policy: Volcker to Bernanke, ending a 30 year disinflationary trend

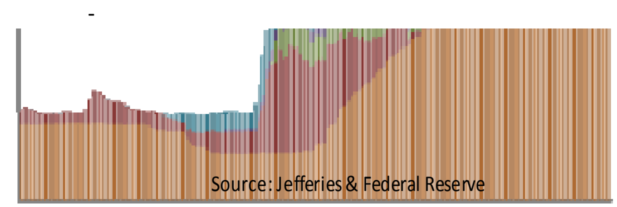
- The bond market appears to be at the end of a 30-year secular declining rate trend
- Extraordinarily tight monetary policy during Paul Volcker's regime caused two recessions in three years and also initiated a 30-year secular disinflationary trend that fostered lower rates
- This disinflationary trend had the potential to evolve into outright deflation if it persisted, which is why monetary policy has been and remains extraordinarily accommodative
- Ben Bernanke is attempting to resuscitate the economy and preempt deflation so it does not evolve into outright deflation
- Calibrating monetary policy to prevent deflation without generating inflation poses a unique policy challenge
- The FOMC focus on core inflation measures suggests that the Fed will move toward the exit strategy will be gradual

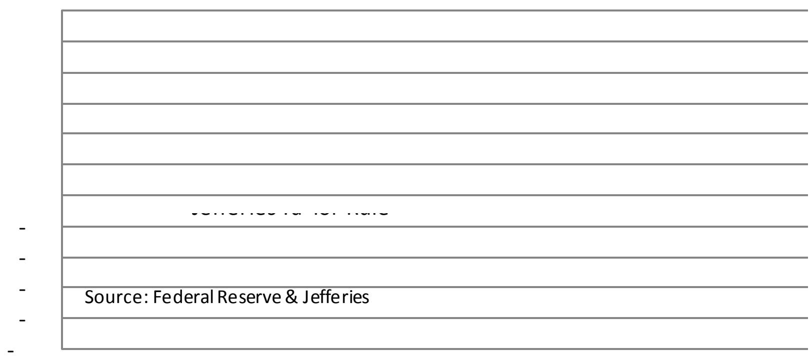


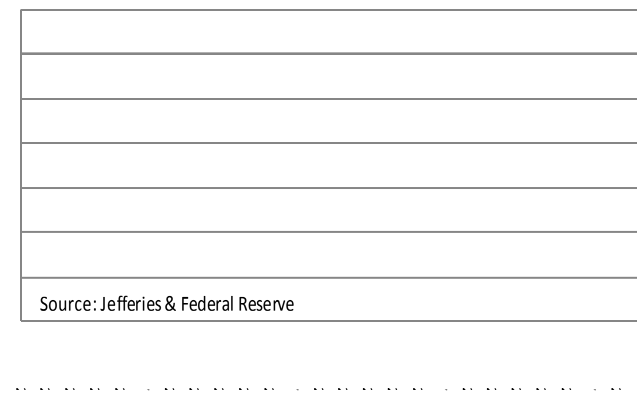


Monetary Policy: Taylor Made…balance sheet & fed funds rate

- The Fed balance sheet is again in the process of expanding and will exceed $2.75 trillion due to the ongoing $600 billion LSAP
- Once the ongoing $600 billion LSAP has been completed, bank excess reserves will exceed $1.5 trillion
- The fed funds rate target has been in a 0% to 25 bps range for more than two years as part of the Fed's anti-deflation defense
- The Fed will debate shrinking the balance sheet over the course of 2011
- The first steps will be to allow MBS and Treasury proceeds to roll-off
- 2012 will be when the Fed enters the exit in earnest

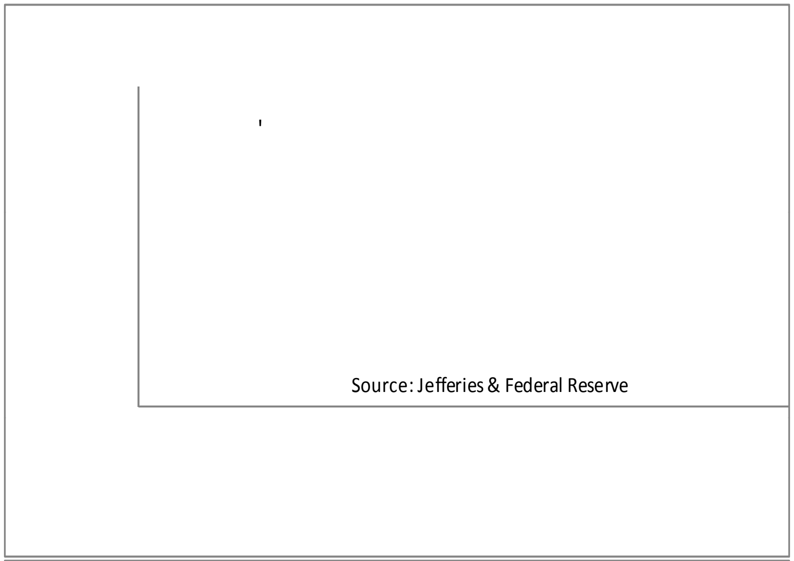


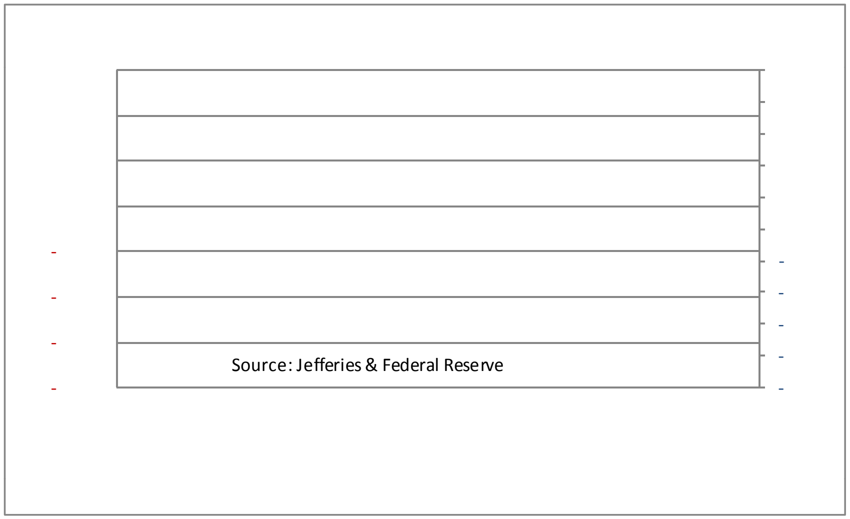


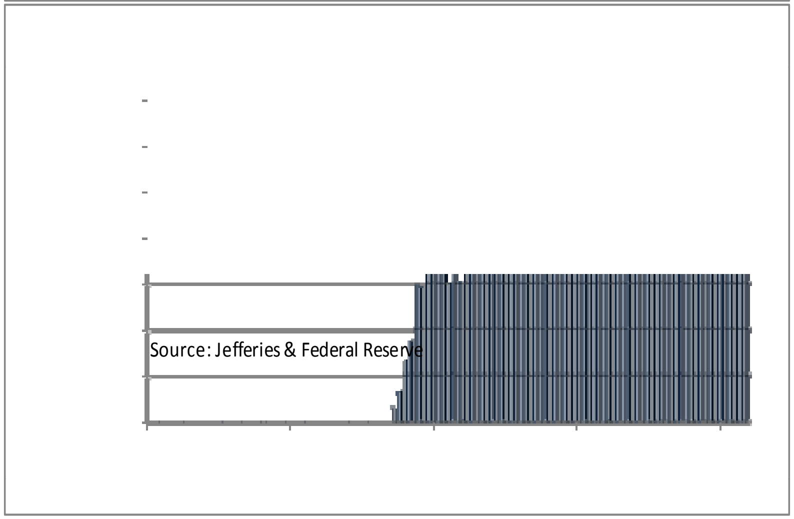


Monetary Policy: Bank loans, transmission breakdown or cyclical lag?

- Fed balance sheet expansion and the consequential increase in bank excess reserves have yet to foster significant bank lending
- Bank C&I lending tends to lag the business cycle, so the slow recovery in lending is not atypical
- C& I lending has begun to creep higher, but consumer lending continues to contract
- Once banks feel more confident about taking on more credit risk, they will have an enormous reservoir of reserves to fuel increased lending

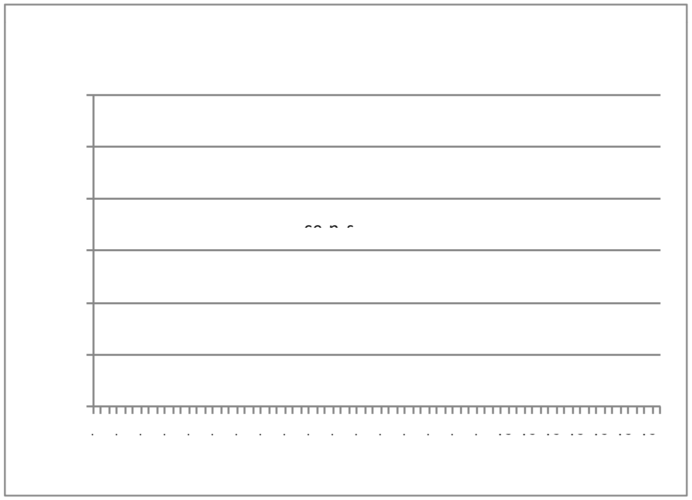


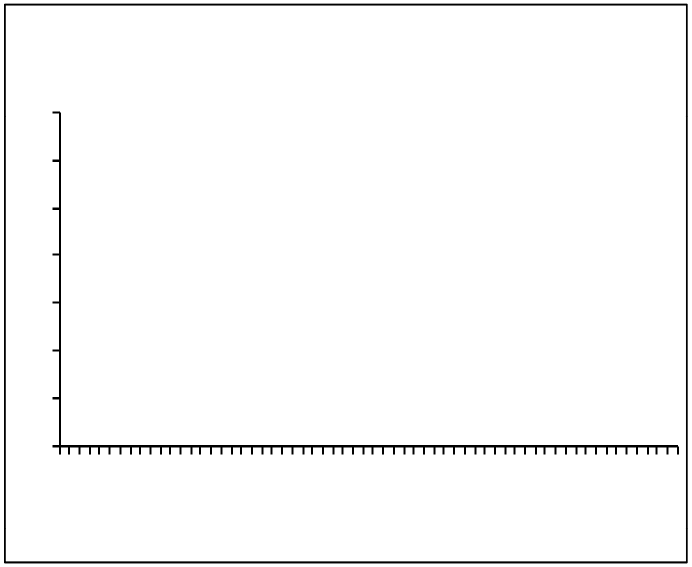




Fiscal Policy: Political irresponsibility in the age of entitlement

- The current schism in FY11 appropriations negotiations is over scraps from outlays of more than $3.4 trln
- The December 2010 decision to extend tax cuts & unemployment benefits, cut payroll and business investment taxes will increase the size of the FY11 budget deficit to roughly $1.45 trillion from $1.342 trillion in FY10
- Without significant remedial action, the budget deficit will remain massive and threaten long-term prosperity
- As a share of GDP, outlays remain well above the historical norm of about 21% of GDP
- As a share of GDP, revenues remain well below the historical norm of 18% of GDP. Congress has taken no steps to address these imbalances
- The U.S. risks losing its AAA credit rating as early as 2015 unless dramatic steps are taken to both increase revenue and cut spending
- The Bowles-Simpson Commission provides a good framework for deficit reduction negotiations over the next two years





Fiscal Policy: No BS, Bowles-Simpson Commission Recommendations

The Bowles-Simpson Commission provides a realistic and workable framework for deficit reduction negotiations.

It is a program of shared pain, but it is not clear if there is the political will adopt the B-S recommendations without the threat of losing the AAA credit rating.

Recommendations include:

- Capping both government expenditures and revenue at 21% of GDP, which would result in reduced spending and higher taxes to balance the budget
- Forcing Congress to undertake comprehensive tax reform by 2012 by raising taxes for each year Congress fails to act
- Simplifying the tax code by reducing the tax brackets to three personal brackets and one corporate rate, and eliminating all credits and deductions
- Increasing the Social Security contribution ceiling, indexing the retirement age to longevity and basing benefits on means testing
- Limiting tax collections to income earned within the United States
- Increasing Medicaid co-pays
- Capping for Medicaid/Medicare growth & forcing Congress and the President to increase premiums or co-pays and/or raise the Medicare eligibility age in the event of cost overruns
- Eliminating all earmarks
- Freezing federal worker wage increases through 2014, eliminating 200,000 federal jobs and 250,000 federal non-defense contractor jobs
- Reducing military forces in Europe and Asia by one-third

Treasury: MBS “wind down” reduces borrowing needs, debt ceiling hike still needed

- Treasury MBS sales will reduce borrowing needs by more than $140 bln over the next year
- This reduces the need to increase the size of auction sizes later this year
- Congress will need to raise the $14.294 trillion debt ceiling by mid-Q2
- Treasury may revert to “extraordinary measures” to avoid a debt ceiling violation if necessary
- These sales are independent of monetary policy and future Fed asset sales

Projected 2011 Treasury Coupon Cash Flows

Projected	2s	3s	5s	7s	10s	30s	TIPS5	TIPS10	TIPS30	Total	Maturing	Net	Coupon
Oct	$35.0	$32.0	$35.0	$29.0	$21.0	$13.0	$10.0			$175.0	$45.9	$129.1	$7.0
Nov	$35.0	$32.0	$35.0	$29.0	$24.0	$16.0		$10.0		$181.0	$48.4	$132.6	$25.0
Dec	$35.0	$32.0	$35.0	$29.0	$21.0	$13.0				$165.0	$47.9	$117.1	$5.0
Jan	$35.0	$32.0	$35.0	$29.0	$21.0	$13.0		$13.0		$178.0	$64.8	$113.2	$10.0
Feb	$35.0	$32.0	$35.0	$29.0	$24.0	$16.0			$10.0	$181.0	$75.5	$105.5	$32.0
Mar	$35.0	$32.0	$35.0	$29.0	$21.0	$13.0		$11.0		$176.0	$54.5	$121.5	$5.0
Apr	$35.0	$32.0	$35.0	$29.0	$21.0	$13.0	$12.0			$177.0	$71.6	$105.4	$6.0
May	$35.0	$32.0	$35.0	$29.0	$24.0	$16.0		$11.0		$182.0	$49.2	$132.8	$26.0
Jun	$35.0	$32.0	$35.0	$29.0	$21.0	$13.0			$9.0	$174.0	$55.2	$118.8	$6.0
July	$36.0	$33.0	$36.0	$29.0	$21.0	$13.0		$13.0		$181.0	$56.9	$124.1	$26.0
August	$36.0	$33.0	$36.0	$29.0	$24.0	$16.0	$11.0			$185.0	$81.8	$103.2	$6.0
September	$37.0	$34.0	$37.0	$29.0	$21.0	$13.0		$11.0		$182.0	$57.8	$124.2	$26.0
FY'11 Total	$424.0	$388.0	$424.0	$348.0	$264.0	$168.0	$33.0	$69.0	$19.0	$2,137.0	$709.5	$1,427.5	

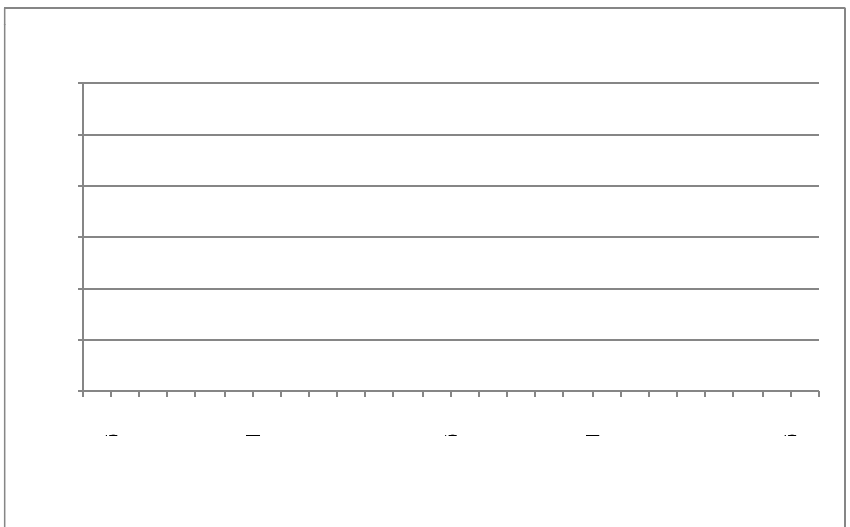
Source: Jefferies

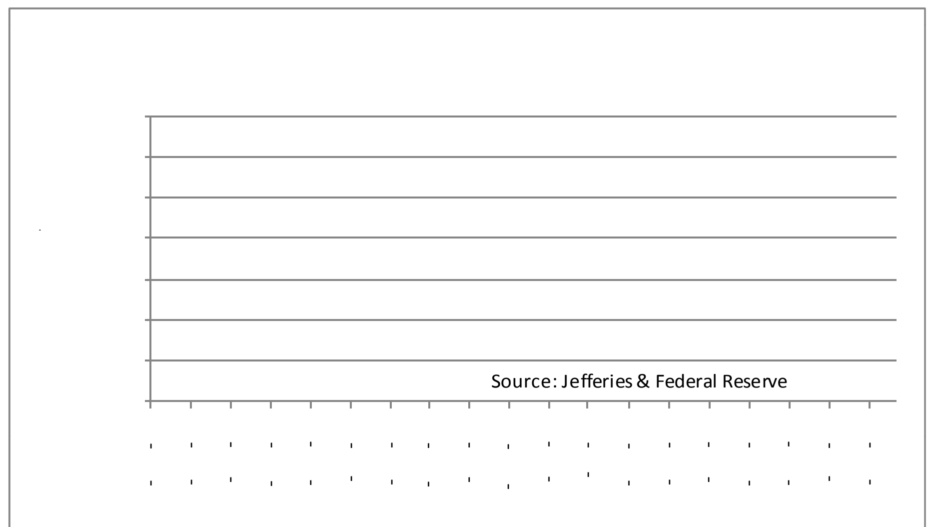
Treasury: Still reliant on overseas investors

- The U.S. is still heavily reliant on overseas investors, especially central banks, to fund the budget deficits
- Overseas investors hold roughly 50% of U.S. Treasuries outstanding
- China is still the largest holder of Treasury debt, but has been shortening the maturity structure of holdings
- Estimates of China's holdings were revised higher by $351 bln as of June, 2010
- Global central banks tempered purchases of Treasury securities after QE2, but have been more active recently

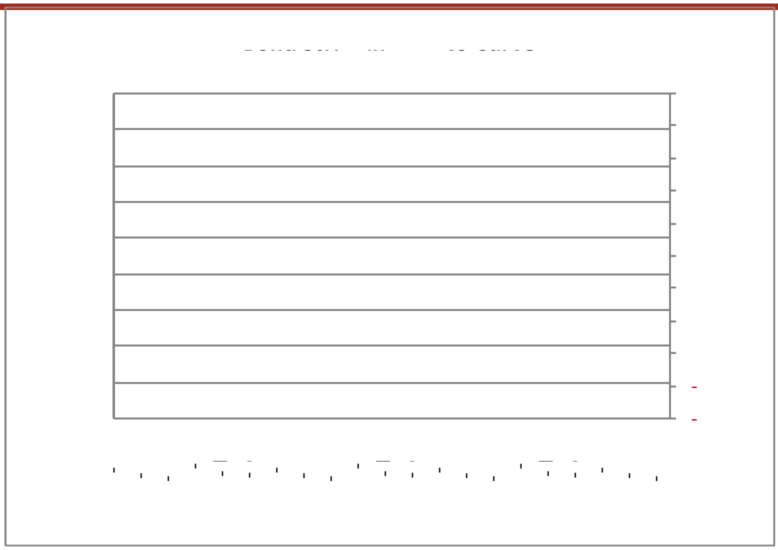
Major Foreign Holdings of Treasury Securities

Country	Jan 11	Dec-10	Nov 10	Oct-10	Sep 10	Aug-10
China, Mainland	$1,154.7	$1,160.1	$1,164.1	$1,175.3	$1,151.9	$1,136.8
Japan	$885.9	$882.3	$875.9	$873.6	$860.8	$832.5
United Kingdom	$278.4	$272.1	$242.5	$209.2	$190.5	$181.0
Oil Exporters	$215.5	$211.9	$204.3	$207.8	$215.4	$211.7
Brazil	$197.6	$186.1	$189.8	$183.0	$181.0	$170.5
Carib Bnkng Ctrs	$166.5	$168.1	$158.8	$146.3	$157.7	$172.6
Taiwain	$157.2	$155.1	$154.4	$154.5	$153.3	$153.4
Russia	$139.3	$151.0	$167.3	$176.3	$173.3	$173.7
Hong Kong	$128.1	$134.2	$134.9	$135.2	$131.9	$133.9
Switzerland	$107.6	$107.0	$107.0	$107.7	$110.0	$113.0
Canada	$86.6	$76.8	$76.9	$66.2	$56.5	$44.9
Other	$1,022.6	$1,010.4	$1,013.5	$1,004.2	$998.3	$992.7
Grand Total	$4,453.4	$4,438.3	$4,412.5	$4,373.1	$4,324.1	$4,271.8
Private	$1,303.7	$1,282.2	$1,231.4	$1,171.0	$1,156.9	$1,152.6
For. Official	$3,149.7	$3,156.1	$3,181.1	$3,202.1	$3,167.2	$3,119.2
Treasury Bills	$438.9	$462.3	$499.2	$531.3	$495.4	$486.9
T-Bonds & Notes	$2,710.8	$2,693.8	$2,681.9	$2,670.8	$2,671.8	$2,632.4

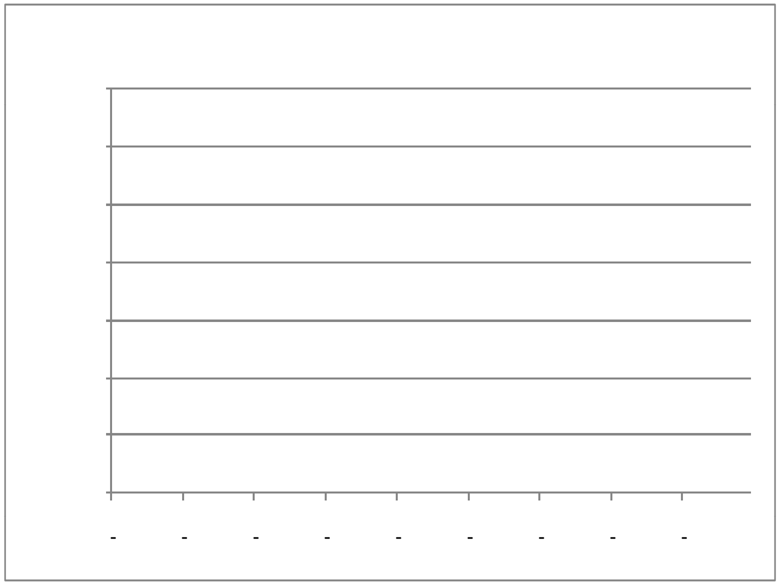




Treasury: Steep curve engenders stripping



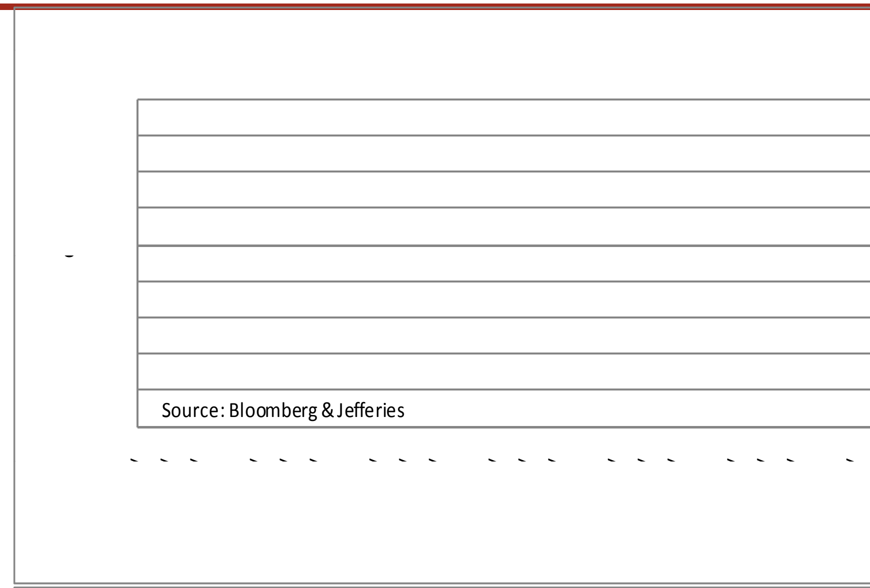
▪The steep slope of the curve has fostered record stripping activity

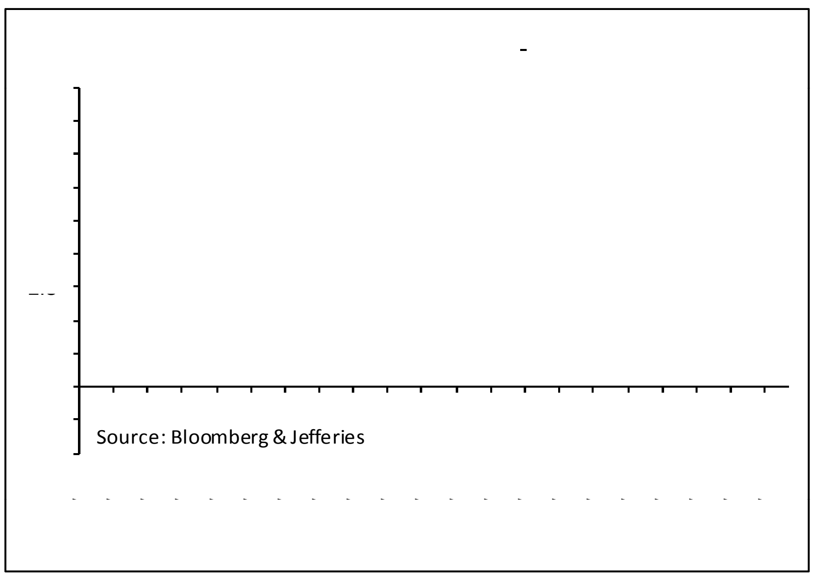


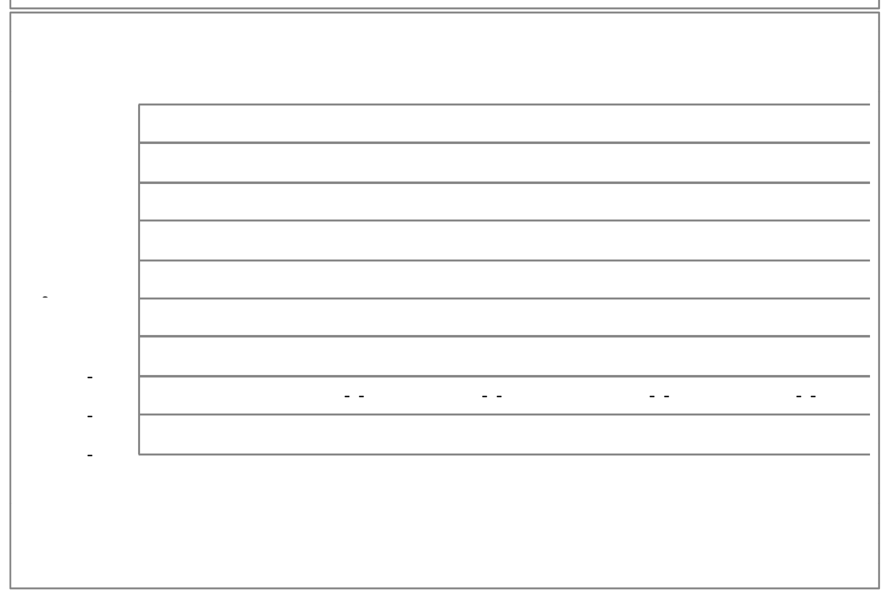
▪Pension funds and insurance companies, both domestic and overseas, have been actively purchasing long -term Treasury zero coupons to extend duration exposure

Appendix: Rates & Curve Perspective

- The Fed's QE2 is intended to reflate the economy and will cause both inflation and inflation expectations to rise
- QE2 marks the end of a 30-year secular disinflationary trend that was initiated during the Volcker years
- The slope of the curve will remain steep due to rising inflation, rising inflation expectations, the end of QE2, expectations of stronger growth, the threat to the U.S. AAA credit rating and the eventual need for the Fed to sell assets prior to raising the fed funds rate.







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