

Numbers That Count

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U.S. Economy: Jobs And Oil Are The Primary Drivers

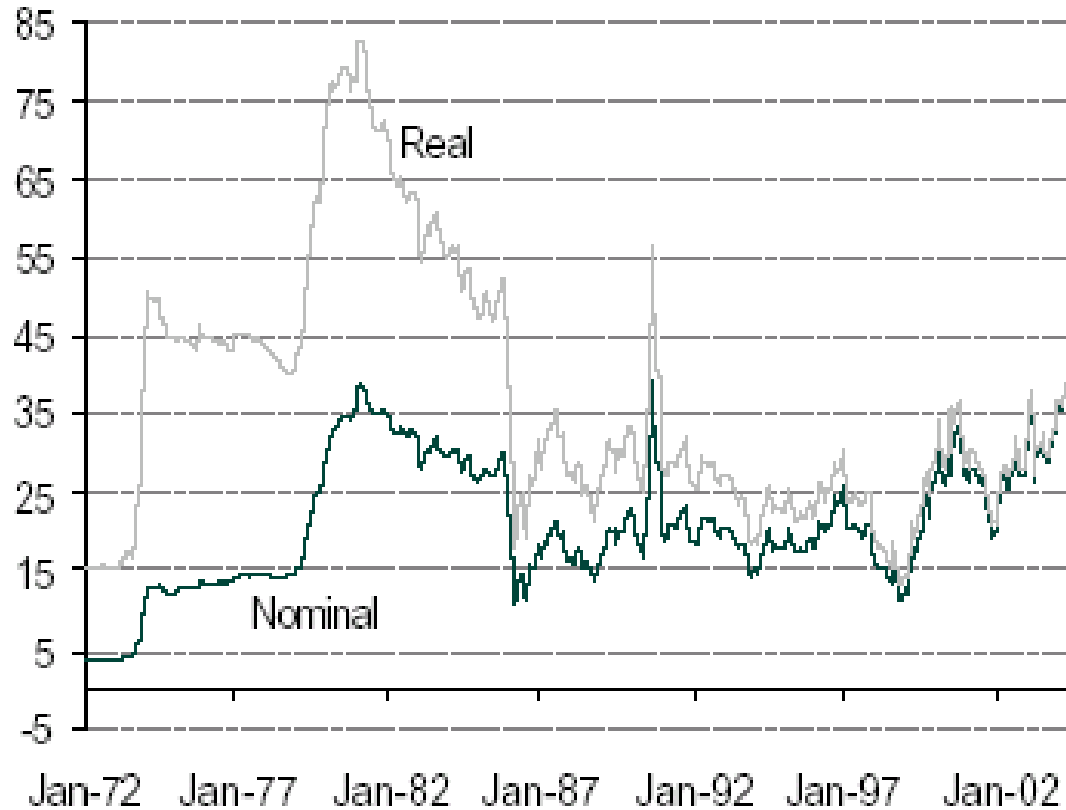
- ▶ The main jobs issue – employment growth very slow to develop in this cycle
 - Non-farm payrolls peaked at 132,507,000 in March 2001
 - U.S. recession trough occurred in November, 2001
 - Non-farm payrolls finally reached a low of 129,789,000 in August, 2003
 - The employment trough occurred 22 months after the recession trough – 1990/1991 only 10 months
 - Non-farm payrolls have now gained 1.7 MM from last August, but are still 1.0 MM below the March, 2001 peak – extremely unusual
 - Bottom line – still too much slack in the labor force!

Crude Oil – Disruption Or Shock?

- ▶ Crude oil prices reached an all time high of \$49.40 per barrel on August 20th from \$25.47 a year ago
- ▶ Retail gasoline prices reached a national average of \$2.10 per gallon in May
- ▶ Crude oil prices averaged \$10.41 in 1974 relative to \$2.83 in 1973 – a 267.8% increase. We might agree this was a “shock”
- ▶ Crude oil increased from \$14.55 per barrel in 1978 to \$37.96 in 1980 – an increase of 160.9% and the equivalent of \$86.93 in today’s dollars. Here again the word “shock” might apply

Crude Oil Prices

\$/barrel



Source: Global Financial Data, BLS, and Lehman Brothers

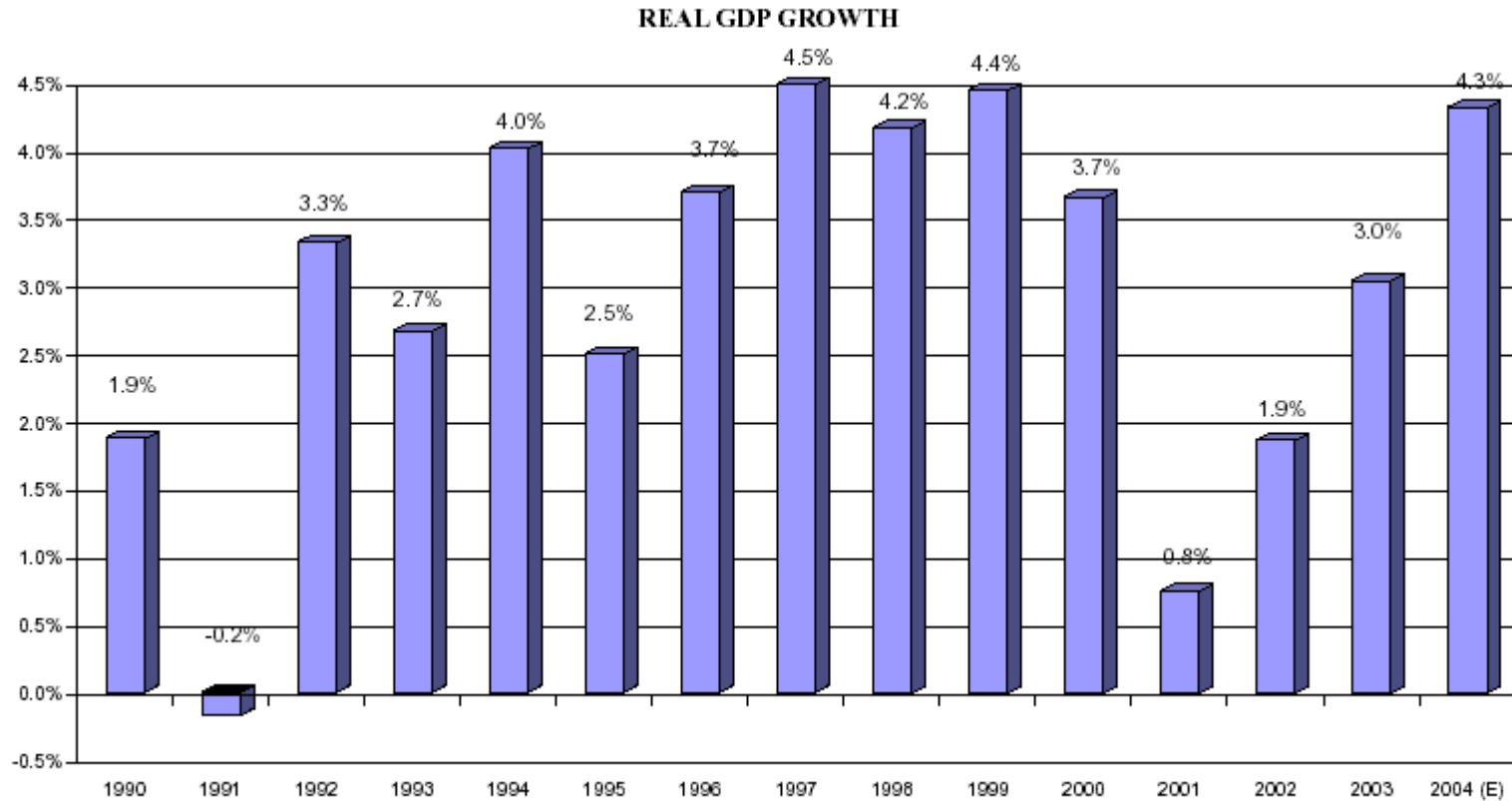
“Disruption” Not “Shock”

- We have “disruption” not “shock”
 - No threat of supply disruption
 - U.S. energy consumption a small part of GDP
 - Can’t associate oil price shock with recession

- At most the impact on economy was a “soft patch” not an impairment of the cyclical expansion

U.S. Real GDP Growth 1990-2005

- ▀ Economic growth over the last 4 quarters has been good



Source: Historical Statistics - U.S. Dept. of Commerce, Bureau of Economic Analysis (<http://www.bea.gov/bea/dn1.htm>),
Projections - Internal Estimates.

Forces Driving U.S. Growth Are Still Powerful

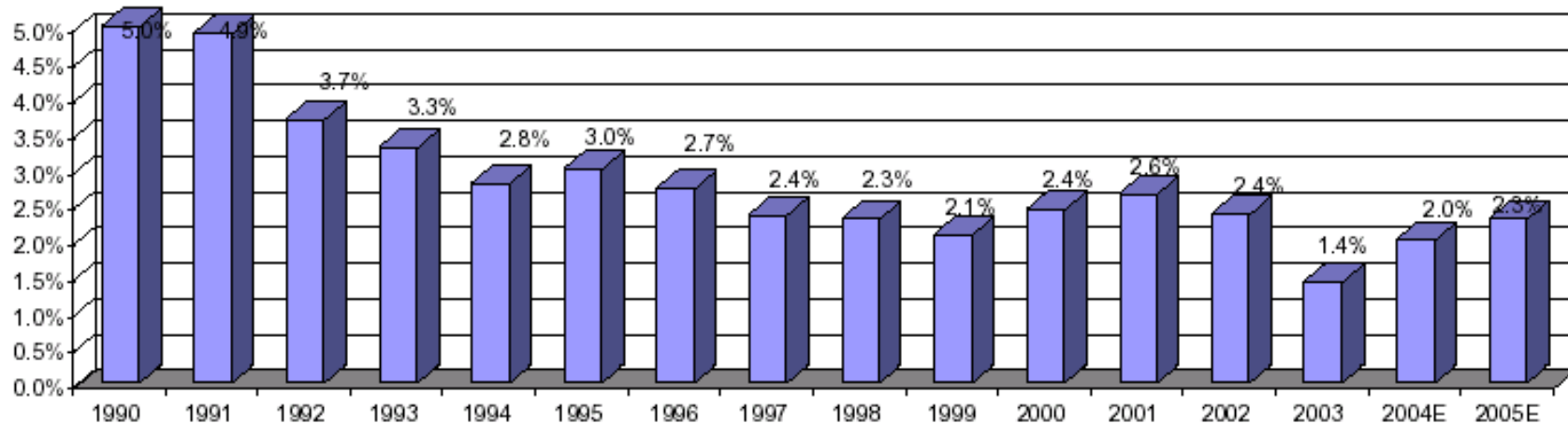
- The second quarter slowdown a challenge to our forecast of solid growth in the 2nd half of 2004, but usual signs of self growth not present
 - Trend in new claims for unemployment insurance down, not up
 - Manufacturing output and employment up sharply
 - Business investment spending increased at a tremendous pace in the 2nd quarter
 - Lower than expected interest rates are keeping housing activity at high levels
 - Personal income growth provides excellent support to consumption
 - Productivity gains are still driving business profits up

- Our growth forecasts
 - Real GDP up +4.3% in 2004 and +3.6% in 2005
 - Civilian unemployment rate average 5.4% in 2004 and 5.2% in 2005

The Inflation Story

- ▀ The secular decline still dominates over the cyclical upturn

CORE CPI: ALL ITEMS LESS FOOD AND ENERGY



- ▀ Headline inflation up +2.7% in 2004 and +2.8% in 2005
- ▀ Core inflation up +2.0% in 2004 and +2.3% in 2005

Source: Historical Statistics - U.S. Dept. of Labor, Bureau of Labor Statistics (<http://data.bls.gov/cgi-bin/surveymost?cu>);
Projections - Internal Forecasts.

Interest Rates Remain Low

	12/31/2003	3/17/2004 Low*	6/14/2004 High*	6/30/2004	9/24/2004
2-year	1.84%	1.47%	2.93%	2.69%	2.58%
10-year	4.26%	3.68%	4.87%	4.58%	4.03%
2-10-year spread	+242	+221	+194	+189	+147






*Based on the 10-year Treasury bond

The Outlook For Rates – Surprisingly Low

- The current low level of rates one of the surprises of 2004 but we still expect that they will move up
 - The Fed will continue to remove accommodation despite more moderate growth and reduced inflation expectations
 - There is no over heating or need to aggressively counteract inflationary tendencies so the reaction of rates to Fed action is muted

- The year end outlook for U.S. Treasury rates
 - Federal funds rate target of 2.00%
 - 10-year treasury at 4.75%
 - 2-year treasury at 3.00% – 3.25%
 - 2-10-year slope of +1.50% – +1.75%

Economic Statistics Of G-7 Countries

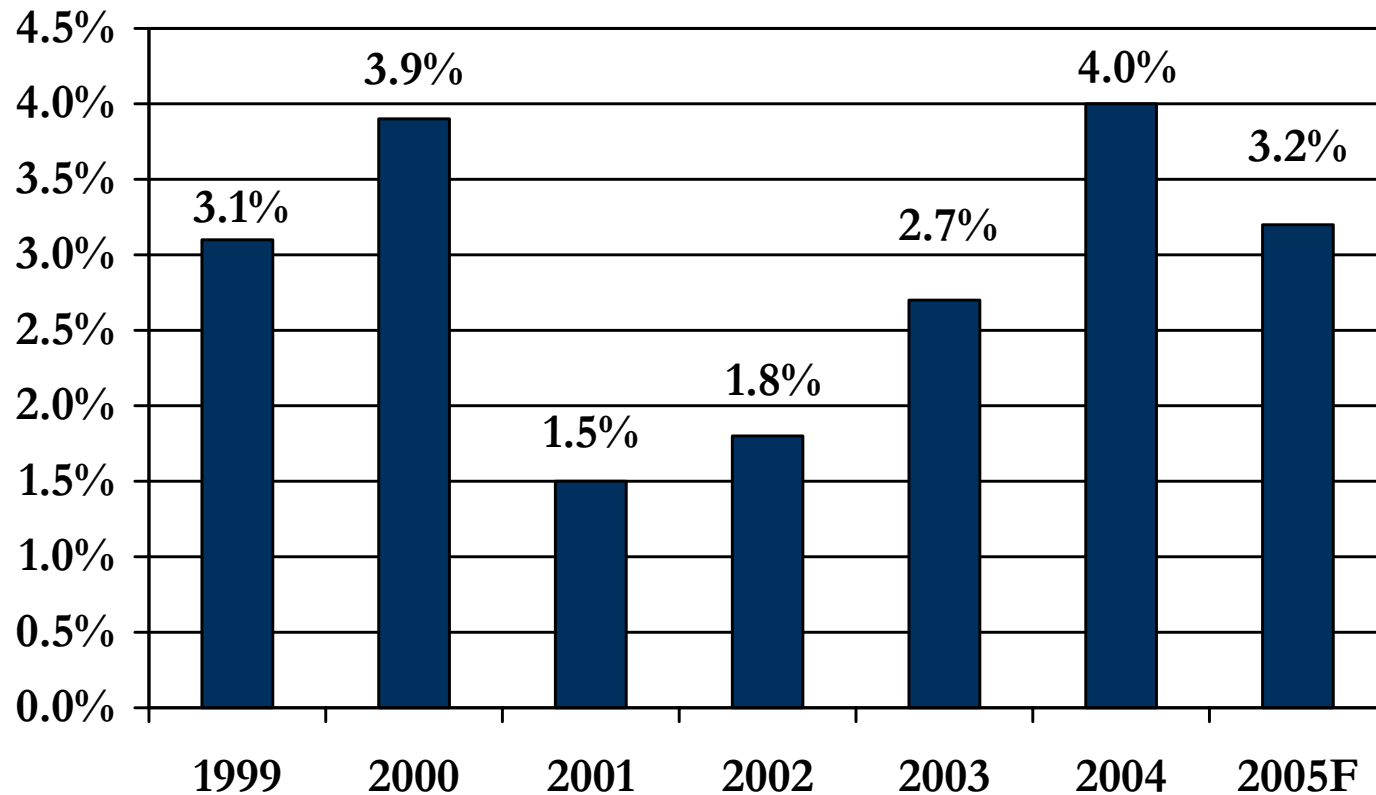
			<u>Real GDP</u>	<u>CPI</u>	<u>Benchmark Rate (EOP)</u>	<u>10 yr. Rate (EOP)</u>
	<u>US:</u>	2001	0.8%	2.8%	1.75%	5.05%
		2002	1.9%	1.6%	1.25%	3.81%
		2003	3.0%	2.3%	1.00%	4.26%
		2004F	4.3%	2.7%	2.00%	4.75%
		2005F	3.6%	2.8%	3.75%	5.00%
	<u>Euroland:</u>	2001	1.6%	2.3%	3.25%	5.00%
		2002	0.9%	2.2%	2.75%	4.20%
		2003E	0.5%	1.9%	2.00%	4.35%
		2004F	1.75%	1.9%	2.00%	4.75%
		2005F	2.0%	1.8%	2.50%	5.25%
	<u>UK:</u>	2001	2.1%	1.2%	4.00%	5.05%
		2002	1.7%	1.3%	4.00%	4.37%
		2003E	2.3%	1.4%	3.75%	4.80%
		2004F	3.3%	1.6%	5.00%	5.50%
		2005F	2.7%	2.0%	5.50%	5.75%
	<u>Japan:</u>	2001	0.4%	-0.7%	0.10%	1.37%
		2002	-0.4%	-0.7%	0.10%	0.91%
		2003	2.7%	-1.0%	0.10%	1.36%
		2004F	4.5%	-0.1%	0.10%	1.90%
		2005F	2.8%	0.3%	0.10%	1.85%
	<u>Canada:</u>	2001	1.9%	2.5%	2.25%	5.36%
		2002	3.3%	2.3%	2.75%	4.70%
		2003	1.7%	2.8%	2.75%	4.60%
		2004F	2.9%	1.9%	2.25%	5.10%
		2005F	3.4%	2.0%	3.25%	5.50%

E - Estimate; F - Forecast

Source: Economic Intelligence Unit, International Monetary Fund, OECD & Sovereign Group

World Growth 1999-2005F

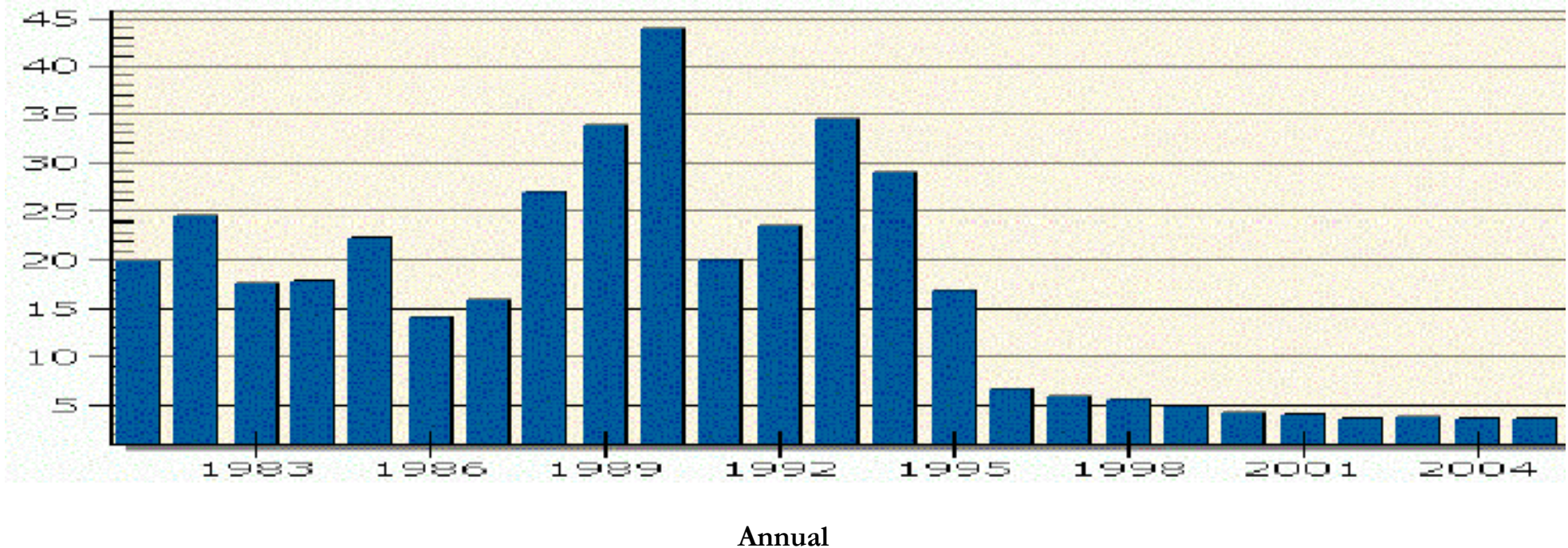
Forecast closing date: August 24th 2004



Source: Economist Intelligence Unit

World Inflation Remains Subdued

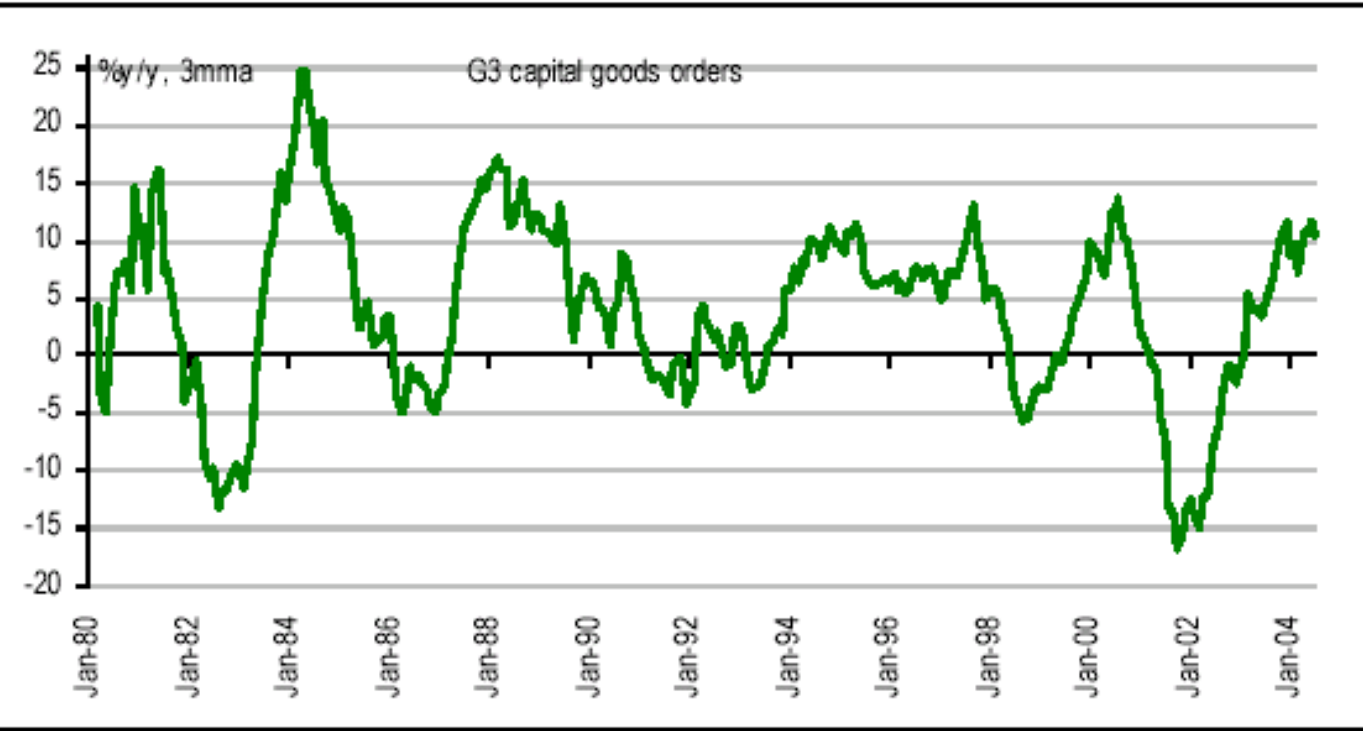
World – Consumer Prices (% change pa; av)



Source: Economist Intelligence Unit

Business Investment Continues At A Moderate Rate

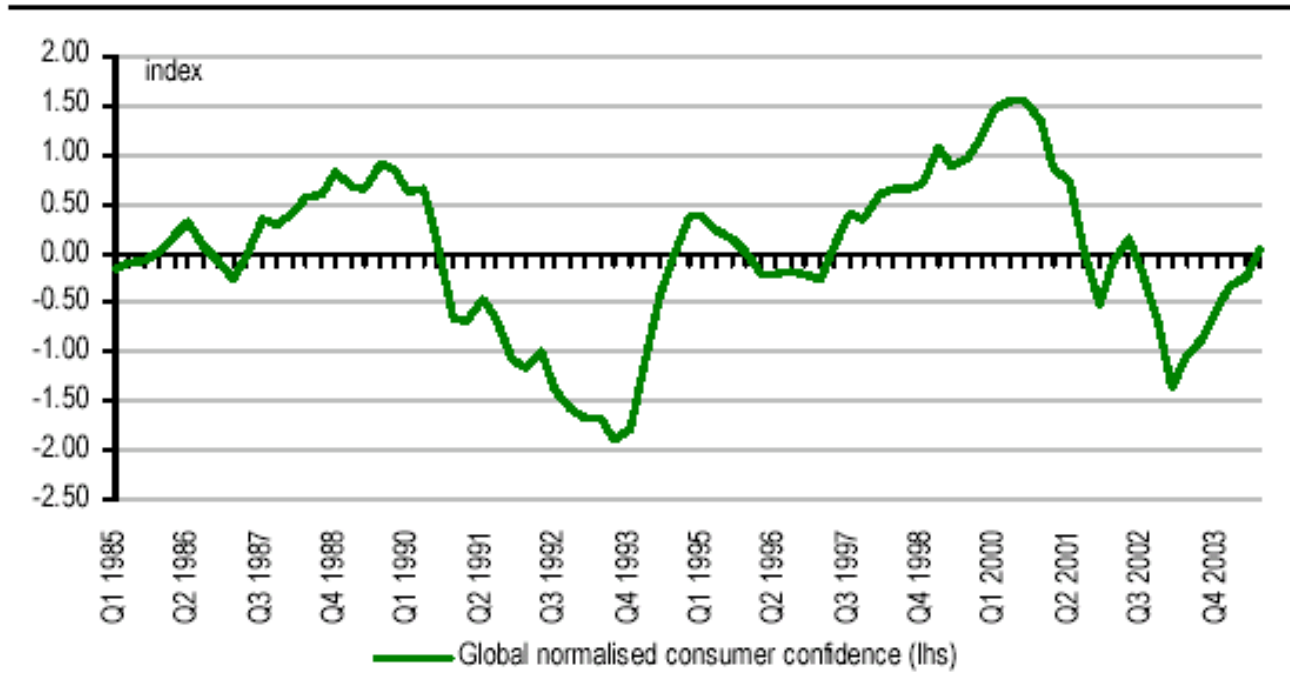
G3 capital good orders still suggest recovering capex momentum



Source: Thomson Financial Datastream/UBS

Household Optimism Remains High

Global consumer confidence



Source: Thomson Financial Datastream/UBS calculations. An aggregation of consumer confidence indices in the US, the eurozone and Japan. Q3 observation is based on average monthly outturns so far.

The "Election Effect" For U.S. Bond And Equity Returns 1945 To 2004

	Total Returns			10-year Treasury Yield
	Gov't	Corp	Equity	
1945-2003				
Democrats Overall	3.50%	4.62%	15.16%	4.46%
Year 1	5.50%	6.37%	19.95%	5.60%
Year 2	2.32%	2.96%	5.42%	4.11%
Year 3	2.49%	2.81%	22.58%	2.16%
Year 4	3.70%	6.36%	12.68%	5.97%
Republican Overall	8.75%	9.23%	10.95%	4.52%
Year 1	8.39%	9.04%	1.06%	4.25%
Year 2	14.23%	11.56%	9.47%	3.34%
Year 3	4.19%	6.50%	21.45%	4.57%
Year 4	8.13%	9.91%	11.97%	6.10%

Source: Lehman Brothers

Average Movements During Each Year Of A Presidency Since 1948

	1 st yr	2 nd yr	3 rd yr	4 th yr
S&P 500	12%	18%	4%	6%
Change in unemployment	-0.39%	-0.12%	0.28%	0.24%
Change in real per capita disposable income	3.01%	1.88%	2.15%	2.03%
GDP	3.70%	3.83%	2.76%	3.51%
CPI	4.08%	3.83%	3.99%	3.46%
Change in 10yr (bp)	10	33	-14	-17
Change in slope (bp)	-7	2	9	-6

Source: DB Global Markets Research

University Of Iowa Electronic Markets Future Contracts

As of September 24, 2004

