February 17, 2012

"In short, the Fedâ??s actions, rather than helping, are having the perverse effect of destroying the confidence of businesses and individuals and the willingness of banks to loan to anyone but those whose credit is so strong they donâ??t need loans."

- CHARLES SCHWAB

POINTS TO PONDER

1. The Fedâ??s massive monetary expansion has been necessary due to the collapse in US money velocity from the normal 17.7 times a dollar circulates per year to a mere 5.7 times today. Should velocity recover to its typical rate, the overall price level could nearly triple unless the Fed were to rapidly shrink its bloated balance sheet, a liquidity withdrawal that might pose some serious problems in the future.

1

- 2. In a scathing Wall Street Journal op-ed piece last week, Charles Schwab, founder of the discount brokerage firm bearing his name, lashed out at the Fedâ??s seemingly perpetual policy of near-zero interest rates. Accordingly, he is joining the King of Bonds, Pimcoâ??s Bill Gross, in asserting that the Fed is actually retarding economic growth.
- 3. While miniscule interest rates and trillions of dollars of printed money are not doing much for the real economy, they are driving stocks higher, at least for now. There are growing signs the recent advance is becoming increasingly frothy, including short interest on stocks hitting a four-year low. Numerous other sentiment readings are also indicating pervasive optimism and an extremely overbought market.
- 4. Based on the continuation of trillion-dollar deficits, itâ??s hard to realize that federal spending has actually been plunging at a rapid clip, albeit from outrageously elevated levels. Next year, the combination of potential tax increases and spending cuts could create the most serious "fiscal drag" seen in more than 30 years.

2

- 5. One of the most distressing aspects of President Obamaâ??s latest budget is that three years into an economic recovery, and despite the aforementioned spending drop, the federal deficit is still projected to exceed \$1 trillion.
- 6. The budget news is much more encouraging at the state level, with the once chronically red ink-drenched state of New Jersey now running surpluses. Even more remarkable is that the poster child for economic devastation over the last decade, the state of Michigan, posted nearly half a billion dollar surplus for 2011.
- 7. Although it is this authorâ??s belief, as well as Fed Chairman Bernankeâ??s, that the labor market is not mending as fast as the official unemployment statistics indicate, there is clearly a steady improvement underway.

- 8. Senior management compensation has increased at an unjustifiable rate at American companies in general, but the banking industry stands out as particularly abusive. In 1989, the average CEO pay at the seven largest banks was \$2.8 million, nearly 100 times median household income. By 2007, on the eve of the global financial crisis, it had exploded to \$26 million, a staggering 500 times what the typical household earned.
- 9. Corroborating those who believe that the average investor lost money in 2011, Wells Fargo has stated that its retail brokerage assets fell 3%. Given that Wellsâ?? wealth division custodies \$1.1 trillion in assets, this is likely a very representative sample set.
- 10. The perception seems to be spreading that Europe has its crisis under control and that Greece will agree to further austerity measures. This view may be overly optimistic, however, given that Greek unemployment is now nearly 21% and almost certain to head higher as its beleaguered economy continues to contract. Consequently, the odds of a sudden and disorderly exit from the European Union by that country remain appreciable.

4

- 11. One of the most pernicious aspects of Europeâ??s financial crisis is the contraction in lending that is occurring. On a rolling three-month basis, credit is shrinking at a faster rate relative to GDP than it did after the collapse of Lehman. This, among other factors, has caused S&P to raise its estimate of eurozone corporate defaults to 8.4%.
- 12. The situation in Greece has devolved to the point that a growing number of senior eurocrats are discussing its exit from the EU. When and if that happens, it will become essential to further buttress the bond markets in Italy and Spain. This will be no easy task as each country needs to raise and/or refinance a sum exceeding 20% of GDP in 2012, equivalent to the US government needing to sell or roll over \$3 trillion in debt.
- 13. The creative efforts of Mario Draghi, the new head of the European Central Bank (ECB), deserve accolades for bringing interest rates down for the weaker eurozone countries from cataclysmically high levels. However, the issue of extremely weak, or even negative, growth continues to plague the Continent, with more of the same likely for the foreseeable future. (Please reference chart below)

5

14. Chinaâ??s economic advance over the last 30 years provides one of those rare instances when the word "miraculous" is not hyperbolic. Yet despiteâ??or perhaps because ofâ??its parabolic growth, income inequality has been extreme, essentially on a par with some of the most unequal African nations. The good news is that even though the highest income segment in China saw its earnings double from 2002 to 2007, the poorest saw a 40% gain.

6

15. Japanâ??s deepening government debt hole has become truly shocking. It is now issuing more in bond debt annually than it collects in total revenue, although this is partially due to the cost of rebuilding after the Fukushima earthquake. Sadly, there does not seem to be a plan in place to reverse this unsustainable situation.

David_Hay_Signature

IMPORTANT DISCLOSURES

This report is for informational purposes only and does not constitute a solicitation or an offer to buy or sell any securities mentioned herein. This material has been prepared or is distributed solely for informational purposes only and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. All of the recommendations and assumptions included in this presentation are based upon current market conditions as of the date of this presentation and are subject to change. Past performance is no guarantee of future results. All investments involve risk including the loss of principal. All material presented is compiled from sources believed to be reliable, but accuracy cannot be guaranteed. Information contained in this report has been obtained from sources believed to be reliable, Evergreen Capital Management LLC makes no representation as to its accuracy or completeness, except with respect to the Disclosure Section of the report. Any opinions expressed herein reflect our judgment as of the date of the materials and are subject to change without notice. The securities discussed in this report may not be suitable for all investors and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients. Investors must make their own investment decisions based on their financial situations and investment objectives.