

The U.S. Economic Outlook

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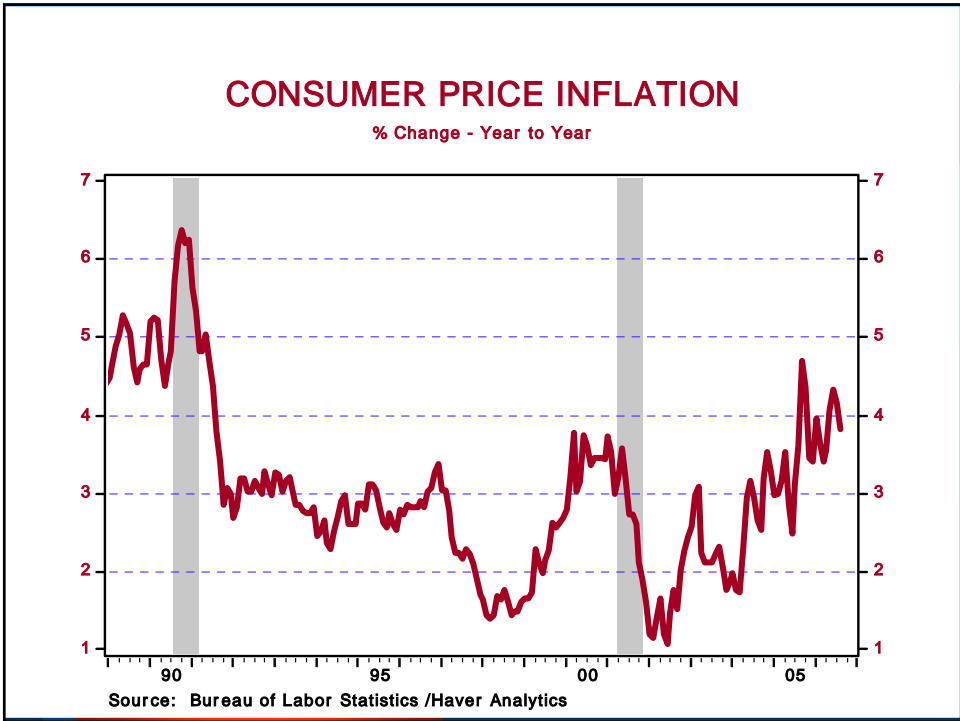
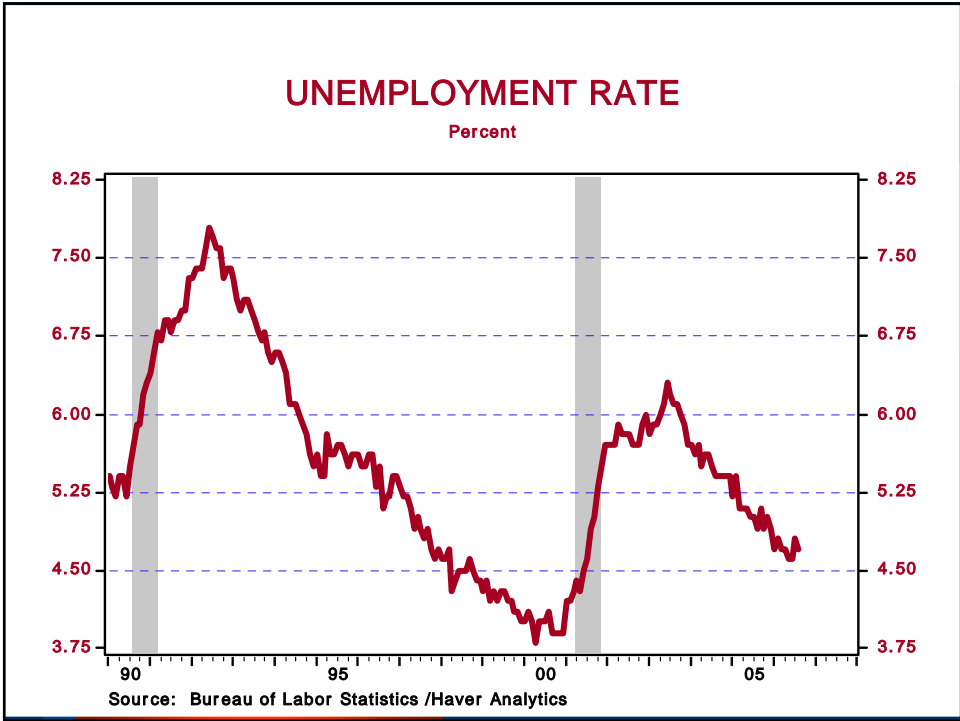
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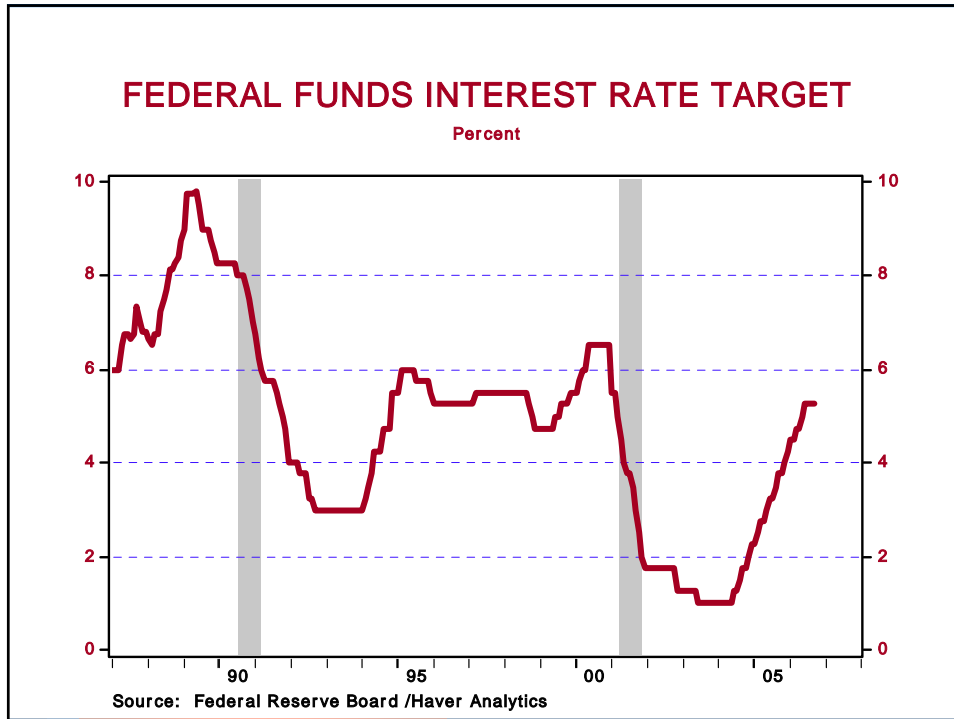
Today's Economy

- **The economy has been expanding for almost five years.**
- **Unemployment has declined and inflation has increased.**
- **The Fed has raised short-term interest rates to the highest level since early 2001.**

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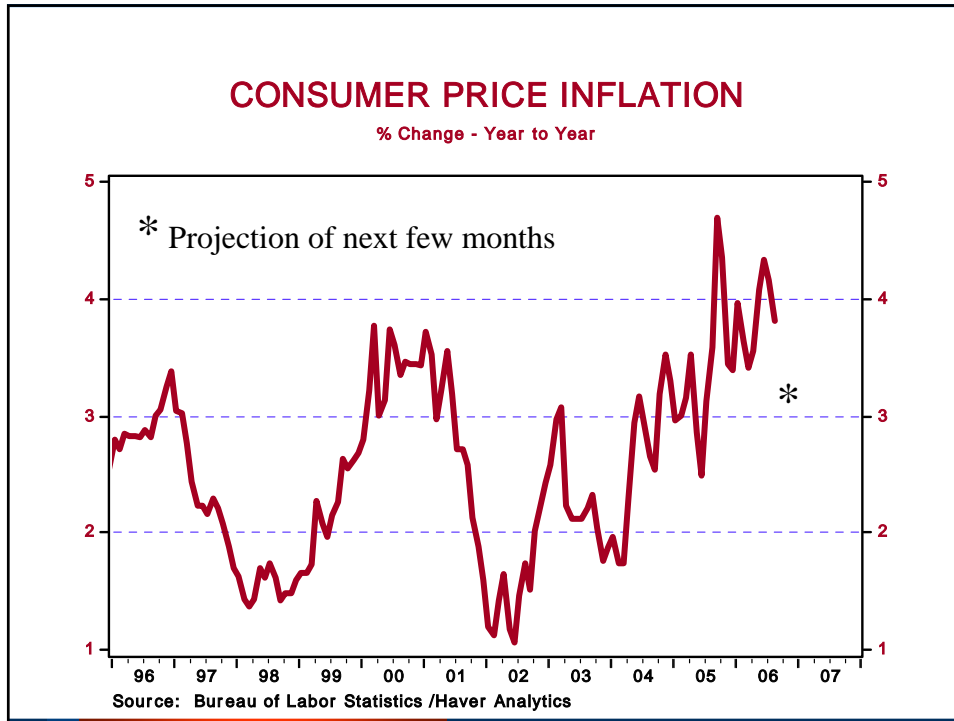


Changes underway

- The U.S. economy is cooling off.
- Housing is in recession, but the rest of the economy is not.
- As economic growth slows, inflation appears to be moderating.
- A soft landing is the most likely scenario.

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Inflation Seeds

The Fed pushed interest rates down in 2001 in an effort to prevent deflation.

- **Those policies worked.**
- **Commodity prices stopped going down and trended upward for about five years.**
- **The Fed began to reverse the low interest rate policy in 2004 in order to contain inflation.**

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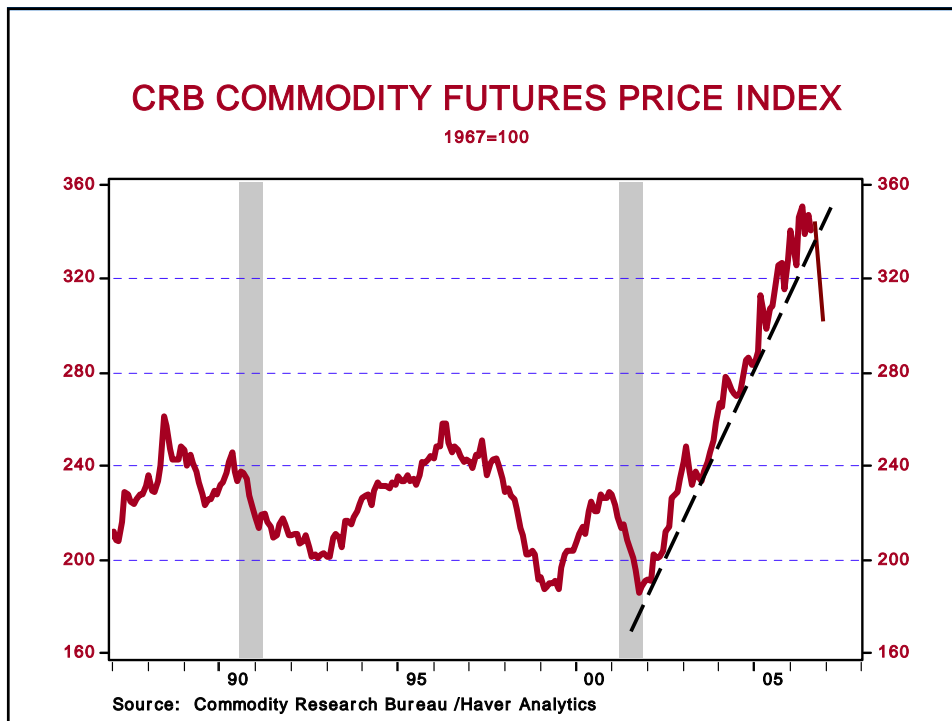
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Policy Successes

- The Fed's "reflation policy" worked.
- Inflation rebounded.
- The Fed's "anti-inflation" policy appears to be working now.
- Gold has lost its luster.
- Commodity prices have broken their five-year upward trend.

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Alternative Scenarios

- Strong economy with high inflation.
- Weak economy with low inflation.
- Weak economy with high inflation.
- Strong economy with low inflation.
- Last scenario is best.

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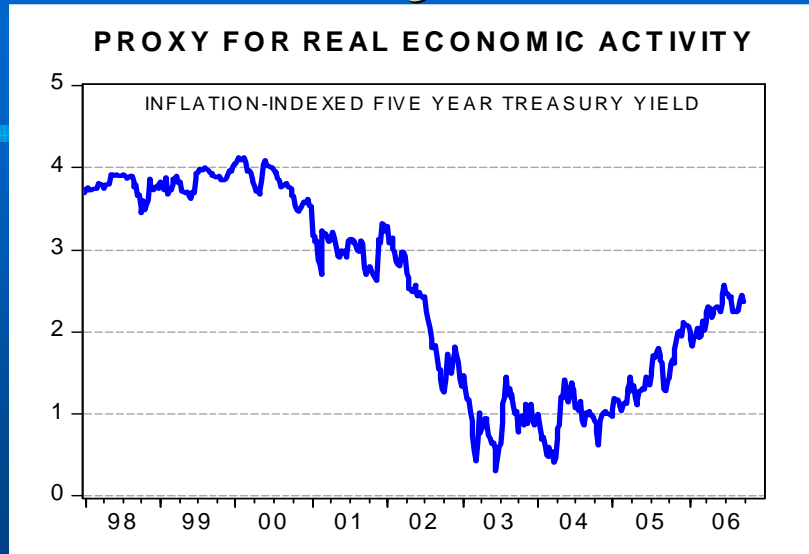
Where are we headed?

- What do the markets say?
- Collective wisdom is often the best (but not a perfect) indicator.
- Stock market
- Yield curve
- Credit spreads
- Inflation protected securities - TIPS

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Real Yields are Rising

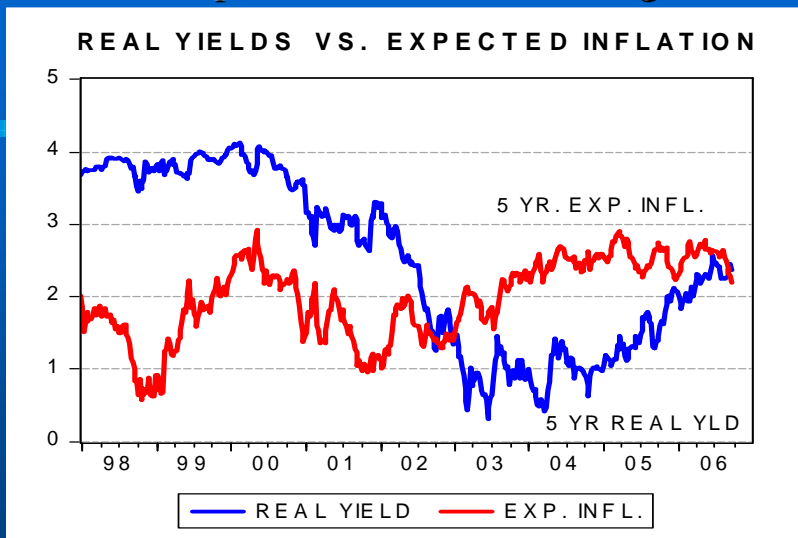


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Source: Bloomberg

Inflation Expectations are Moderating

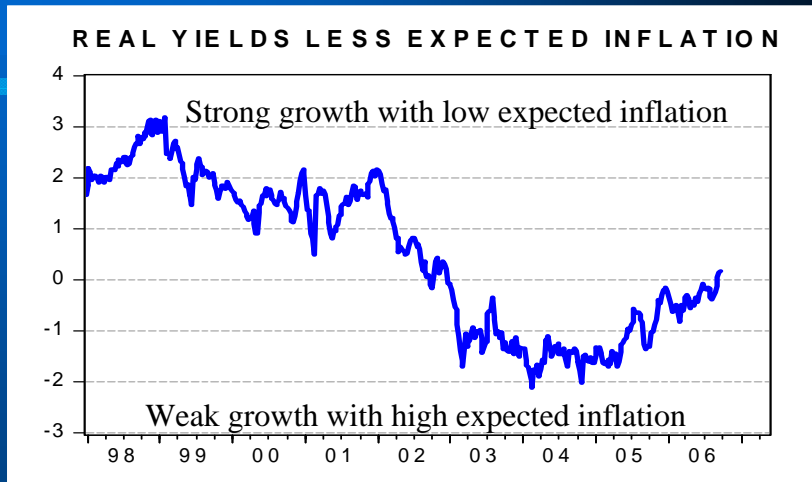


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Data source: Bloomberg

Economic Report Card



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Housing Remains a Risk



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Cushioning the Slowdown

- Mortgage rates have declined.
- Refinancing is rising.
- Energy prices have dropped.
- Consumer confidence appears to be rising.
- A hard landing would be more likely if mortgage rates were still rising and energy prices were going up instead of down.

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Who's In Control?

- Outside events create problems.
- The Fed tries to minimize the economic impact.
- High oil prices forced the Fed to raise rates to contain inflation.
- Lower oil prices would support growth and diffuse political problems.

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A.G. Edwards' Outlook

	December 2006	June 2007
GDP Growth, Six mo. Avg. annual rate.	2.75%	2.6%
12- mo. CPI	3.5%	2.6%
Fed funds rate	5.25%	4.75%
Ten-yr. Treas.	4.70%	4.50%

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