



# Impact of the Current Financial Crisis and 2009 Market Outlook

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December 8, 2008

*ask  
listen  
solve*

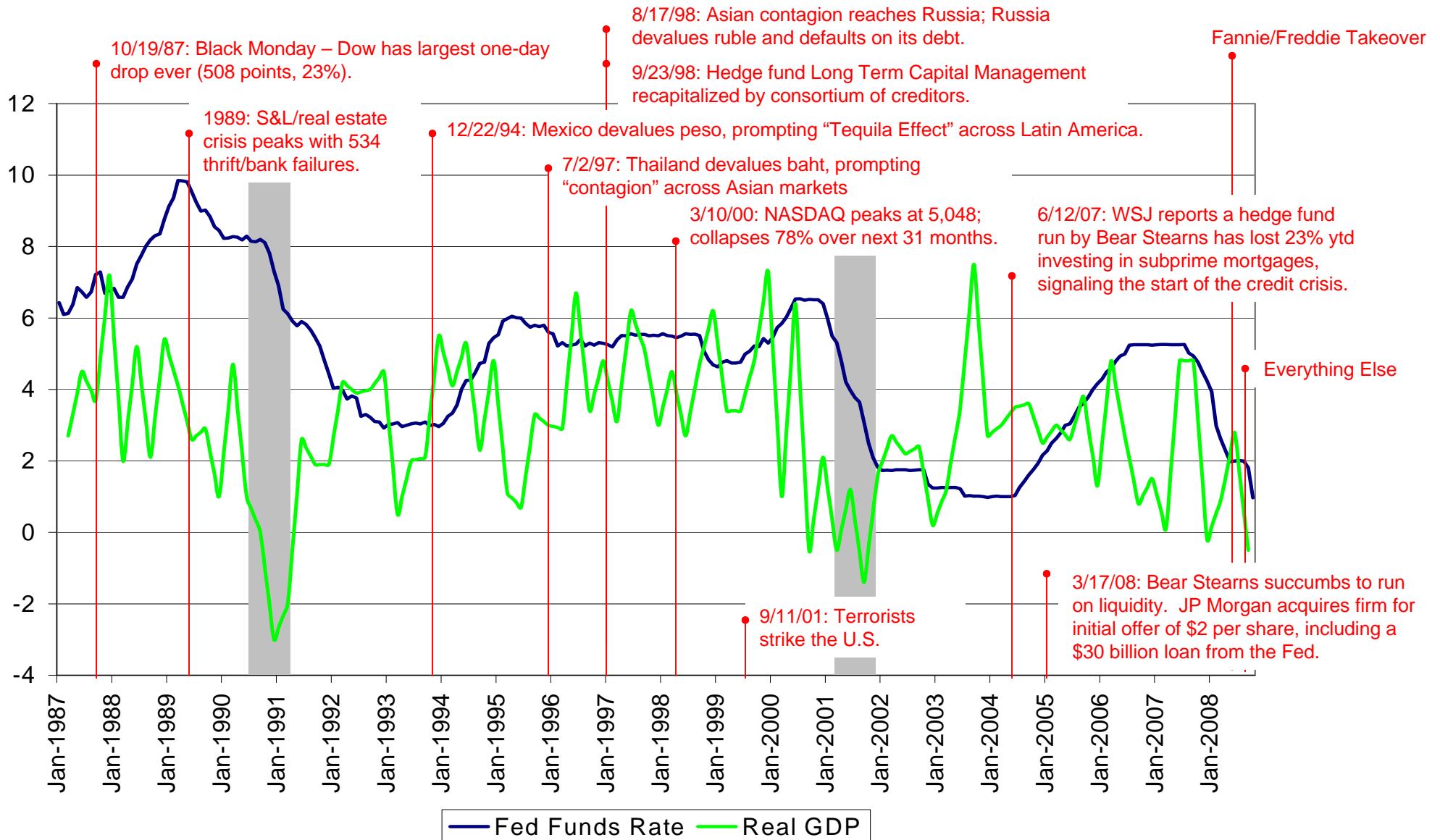


**The Commerce Trust Company**  
*A division of Commerce Bank, N.A.*

## Economic Outlook

- Substantial to severe recession by historical standards
- Four quarters of negative growth, an unemployment rate around 8% and a modest recover by late 2009
- Key drivers are the substantial decline in credit conditions, accelerated unemployment, falling home prices, and the recent decline in equities.
- Offsets are lower global short term interest rates, massive policy response, declining inflation (oil) and a second round of financial stimulus.
- Key wildcards – slowing global growth, firmed up dollar, compelling financial asset valuations and avoiding outright deflation

# Domestic Financial Market Crises – “20+ Year View”



## Bailout Size So Far!

	\$ (billions)	
	Max	Current
<b>Federal Reserve</b> CP, TAF, TSLF, MB, DW, etc.	<b>\$5,065</b>	<b>\$1,839</b>
<b>FDIC</b> Liquidity and GE	<b>\$1,539</b>	<b>139</b>
<b>TSY</b> TARP, FNMA, Stimulus, Citigroup, TALF, etc.	<b>\$1,803</b>	<b>597</b>
<b>FHA</b> Hope for Homeowners	<b>300</b>	<b>300</b>
<b>Total</b>	<b>\$8,707</b>	<b>\$2,875</b>

## Today's Financial Crisis – Fundamental Drivers

### — Three Drivers

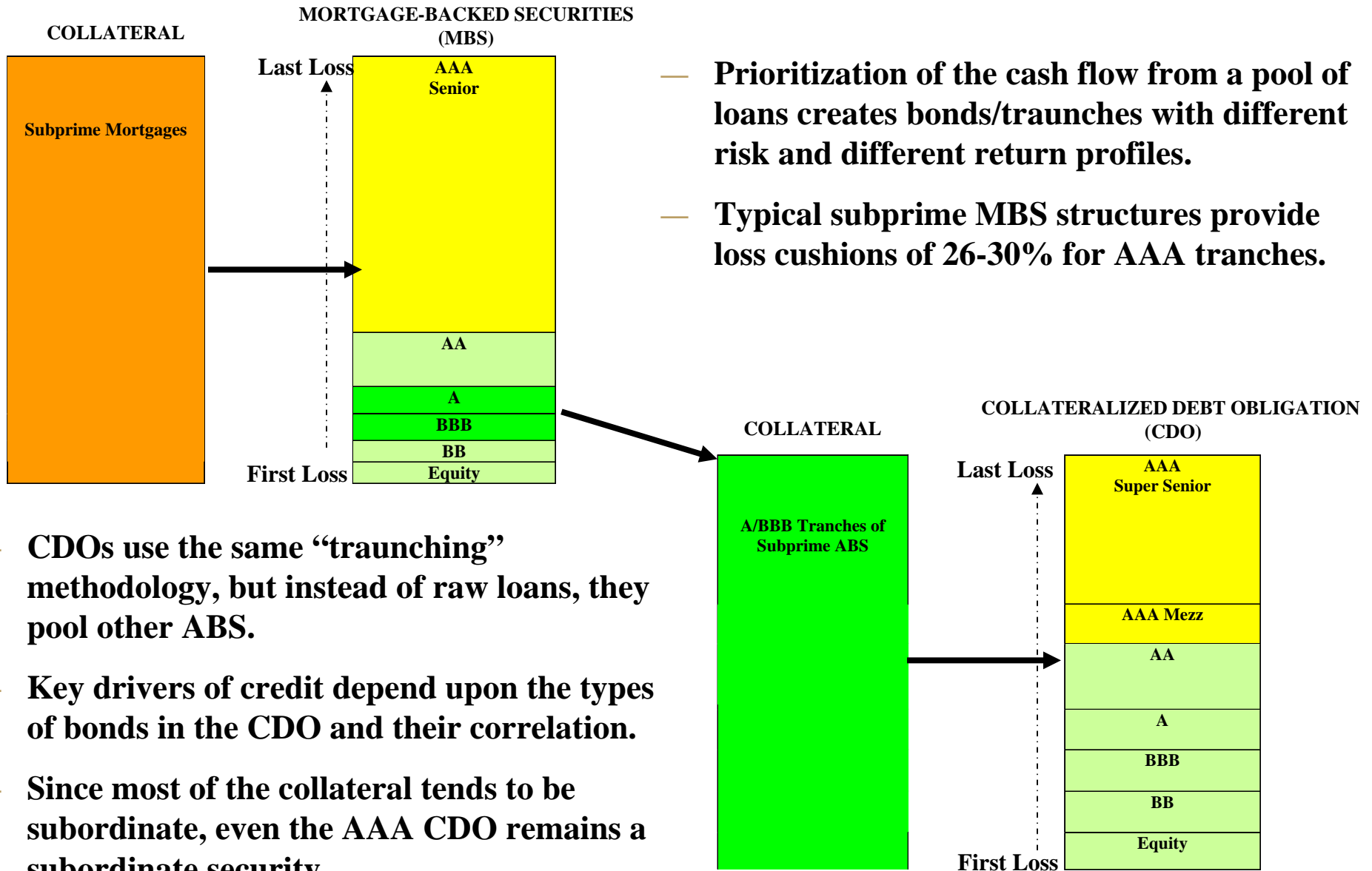
- Excess Credit – Primarily in housing and secondarily in LBO's, commercial mortgage and consumer credit
- Leverage – Primarily in securitization, hedge funds, and off balance sheet financing
- Maturity Mismatch – Shadow banking system of SIV's, ABCP, ARC's, VDRN's and repos

### — Result

- Massive capital leverage in banking system, credit constraints and global recession.



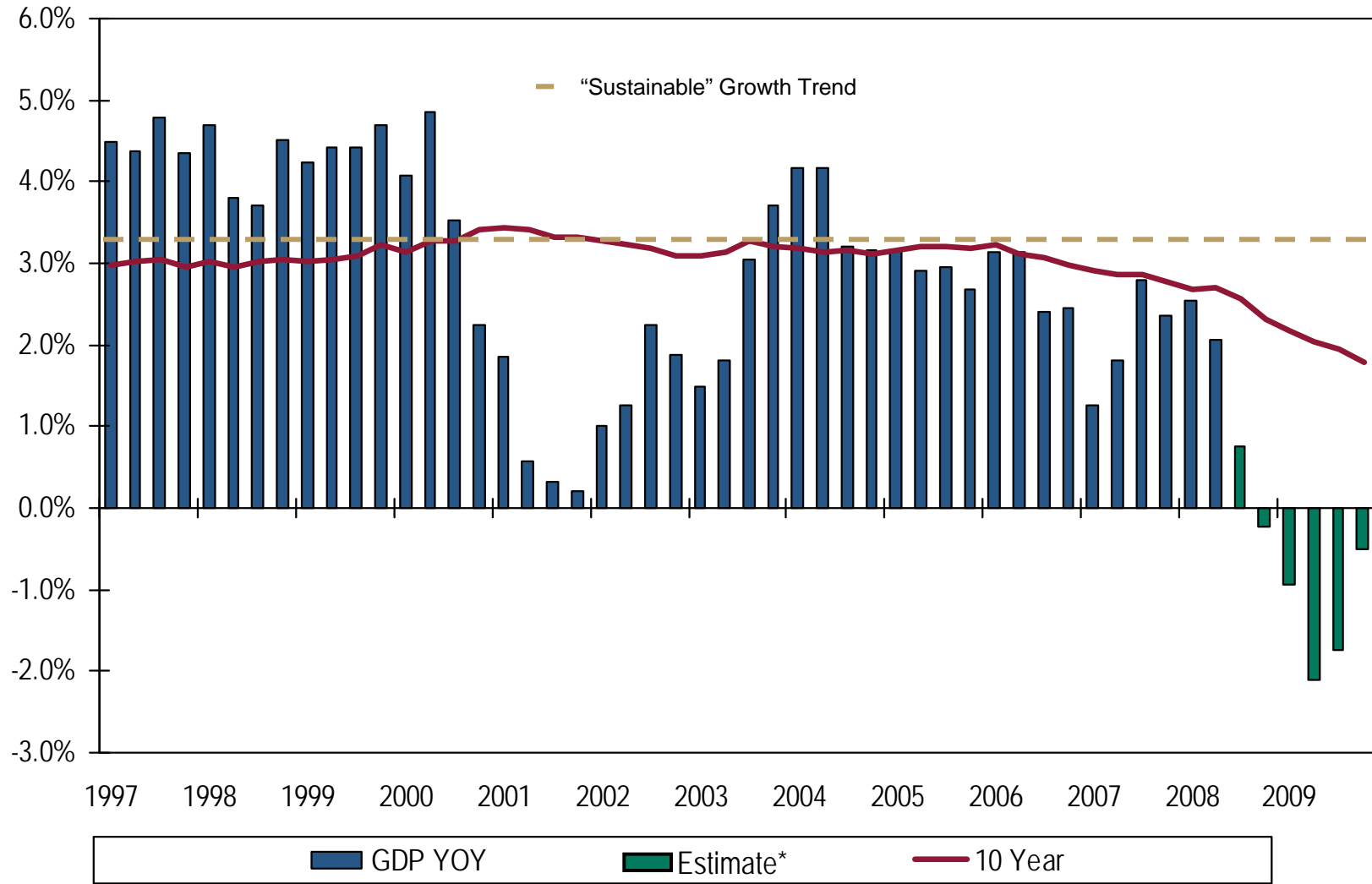
# Securitization Alchemy – What Got Us Into This Mess In The First Place?



- Prioritization of the cash flow from a pool of loans creates bonds/tranches with different risk and different return profiles.
- Typical subprime MBS structures provide loss cushions of 26-30% for AAA tranches.

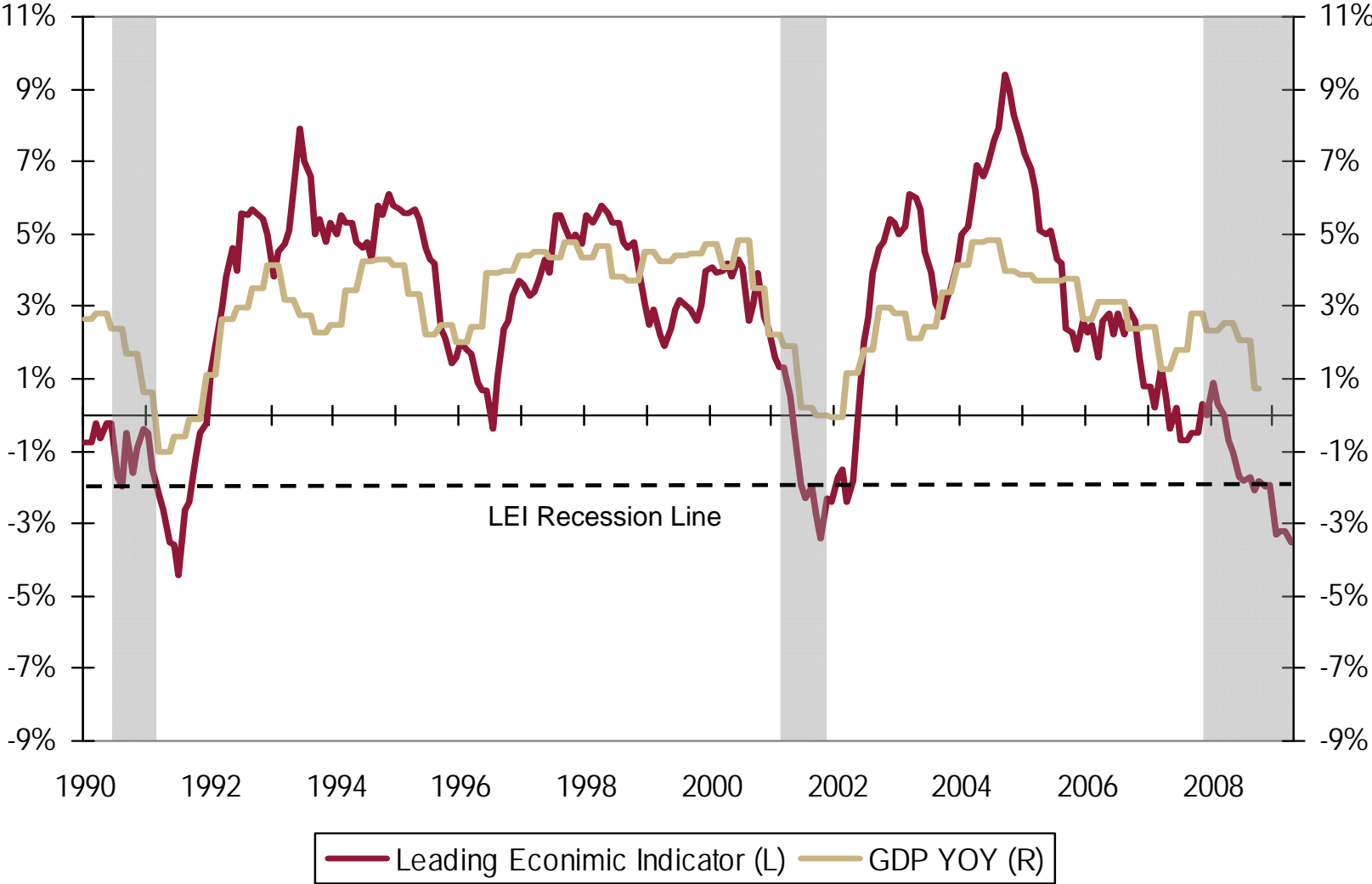
- CDOs use the same “traunching” methodology, but instead of raw loans, they pool other ABS.
- Key drivers of credit depend upon the types of bonds in the CDO and their correlation.
- Since most of the collateral tends to be subordinate, even the AAA CDO remains a subordinate security.

# Real Gross Domestic Product

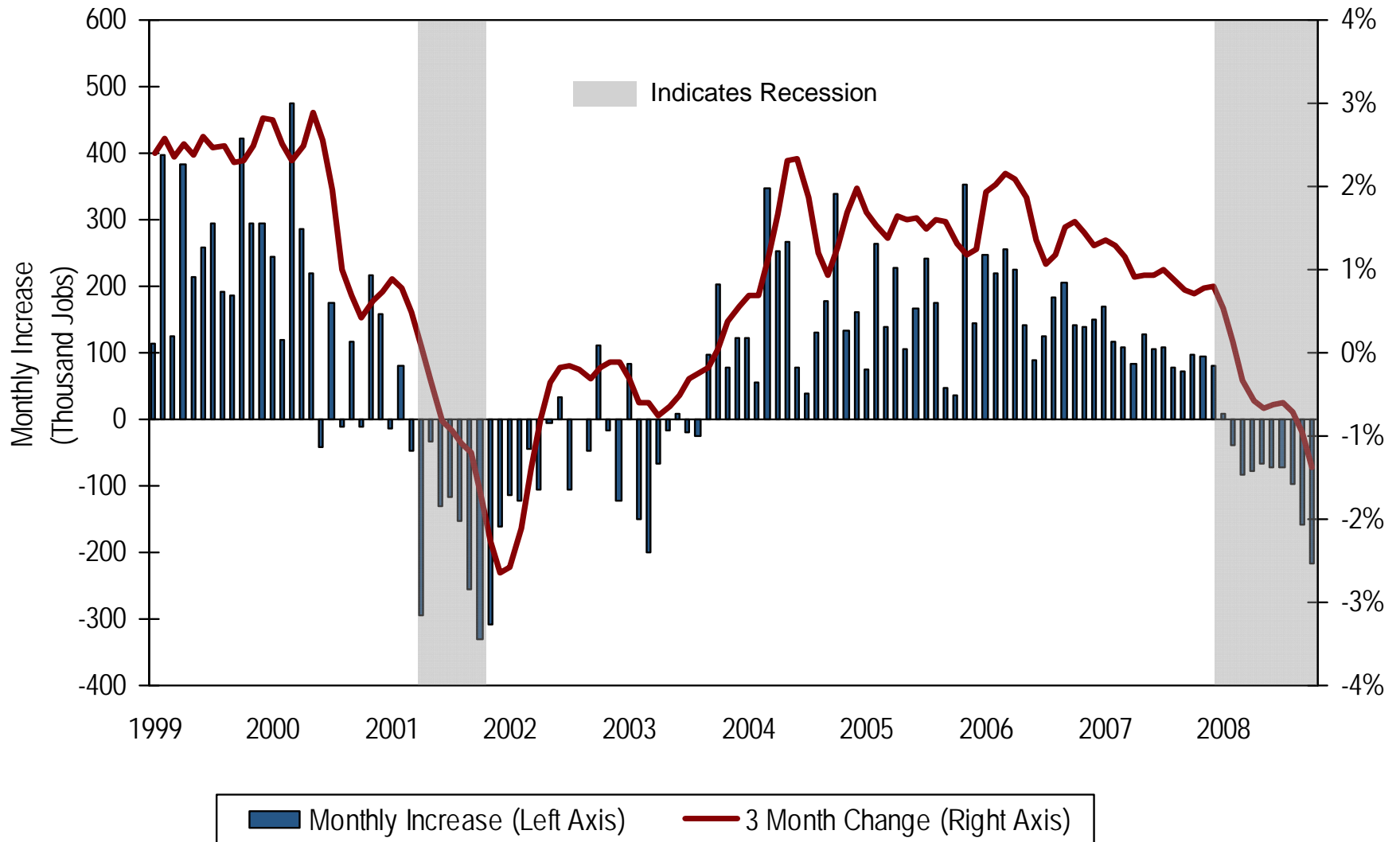


\*Commerce Estimate: -0.5% 3rd Quarter 2008, -4.0% 4th Quarter 2008, -2.0% 1st Half 2009, 1.0% 2nd Half 2009

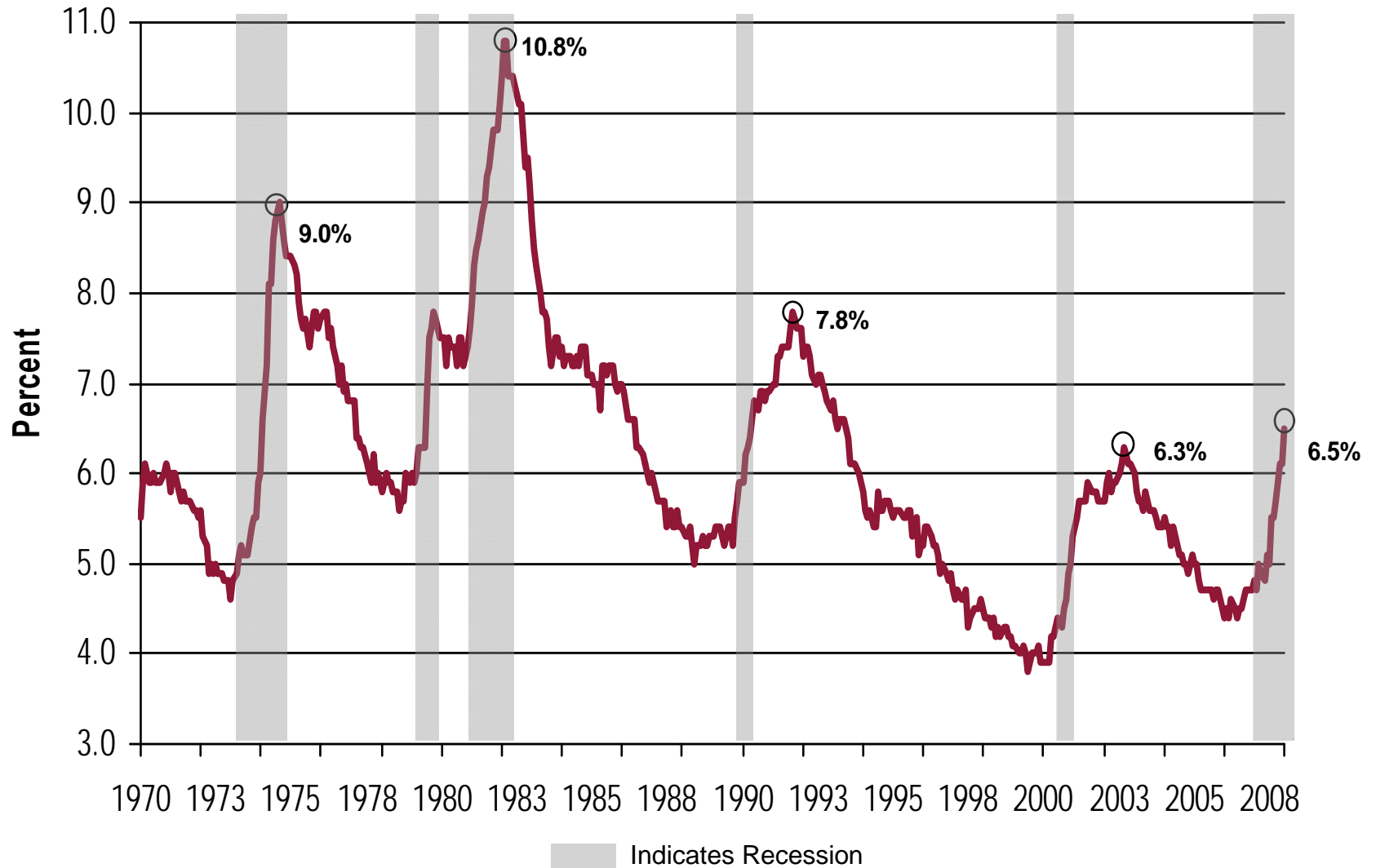
# Leading Economic Indicator



# Employment

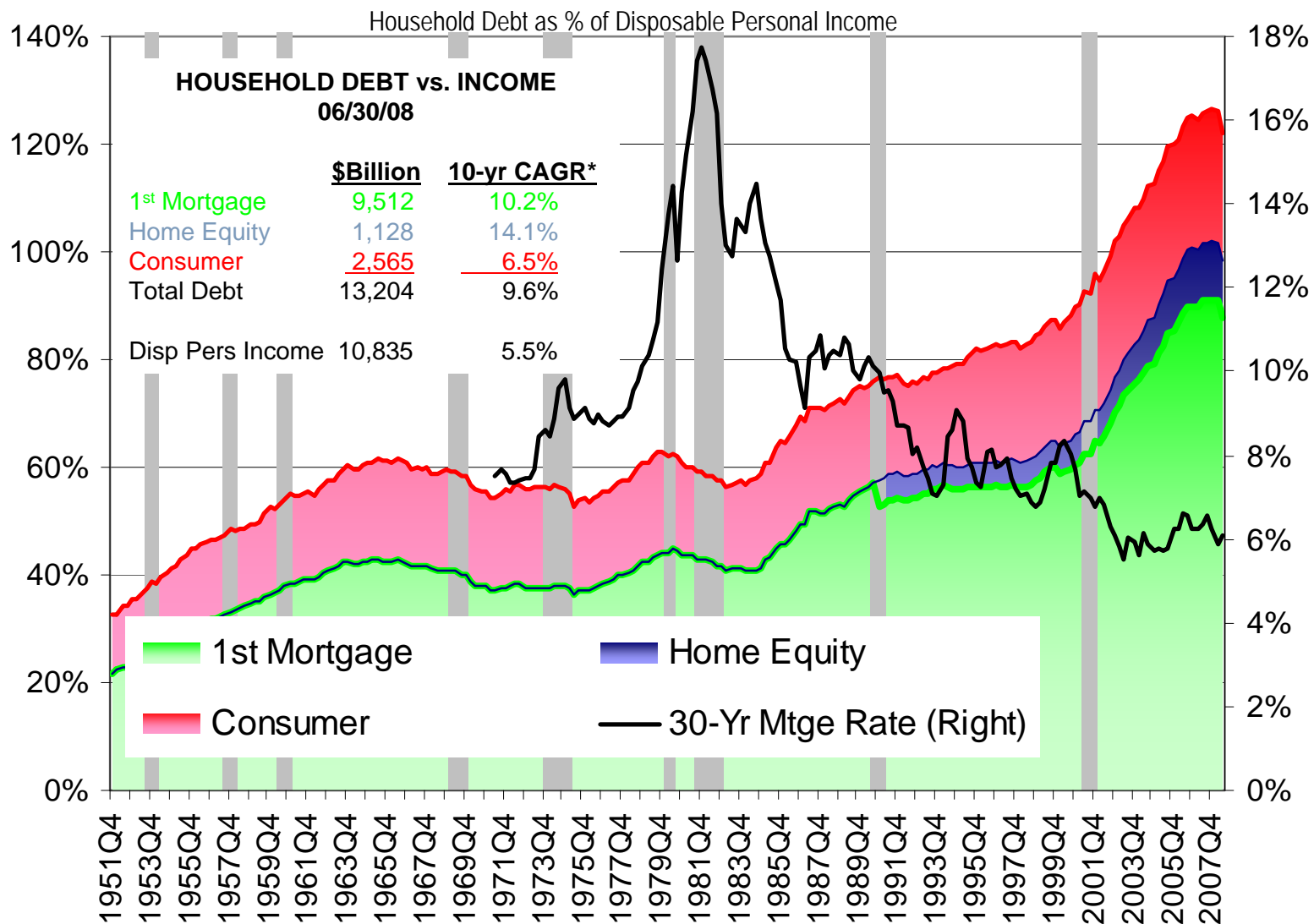


# US Unemployment Rate

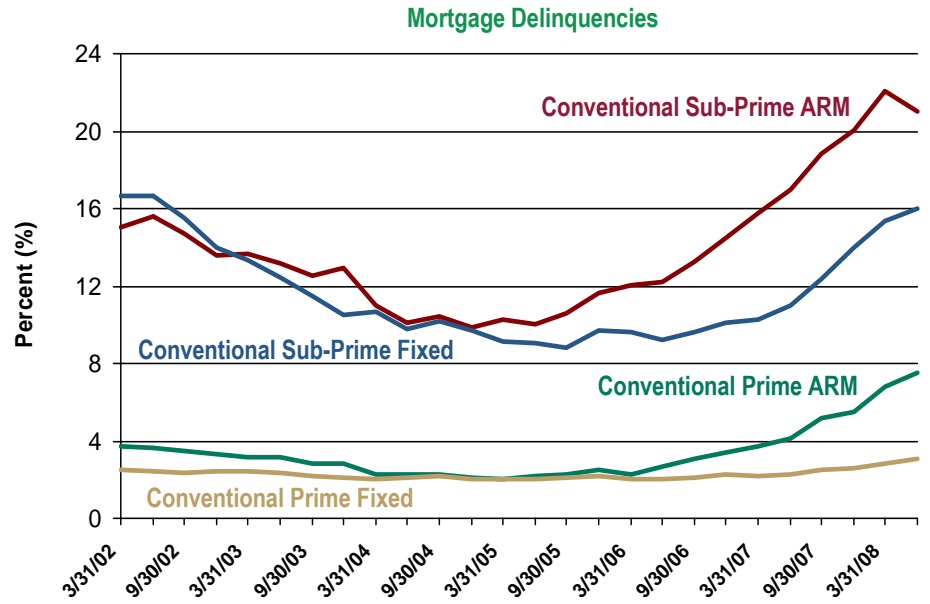
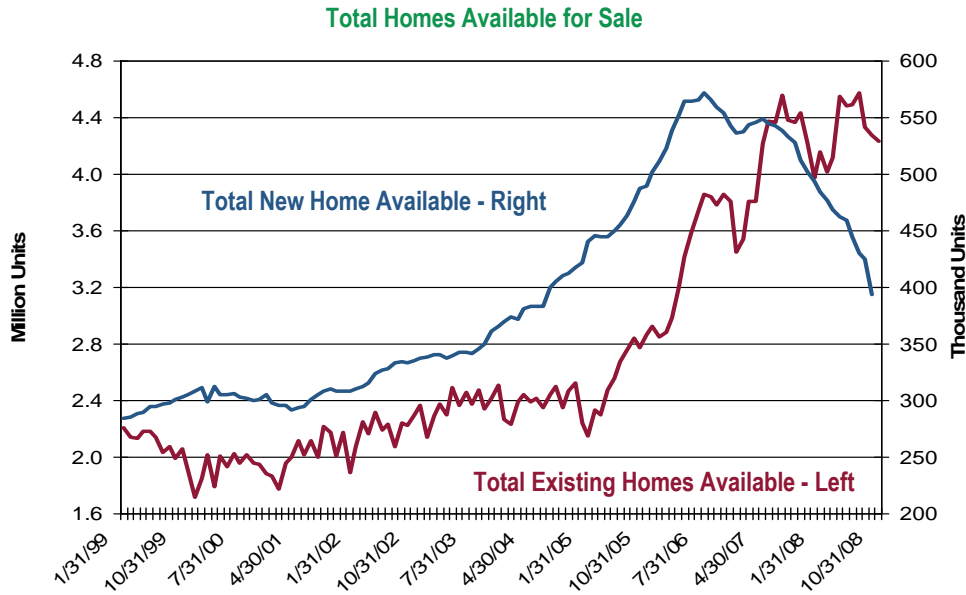
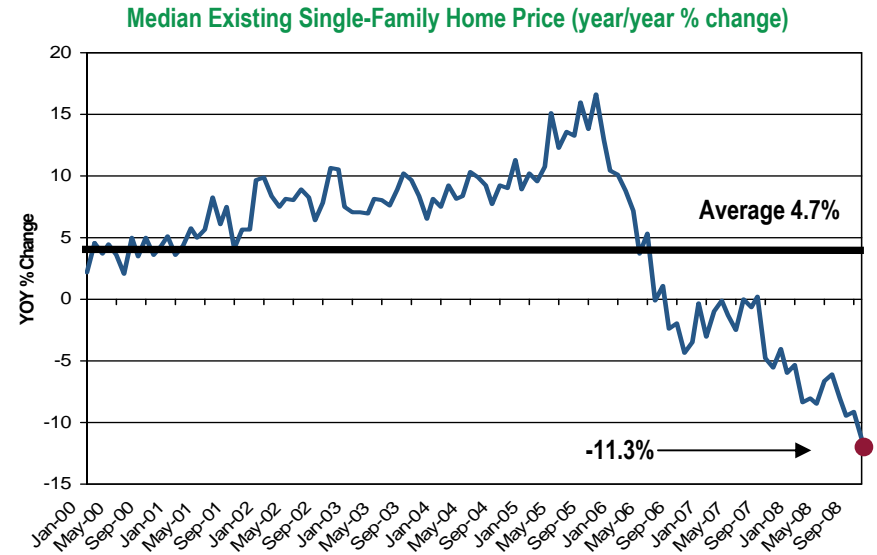
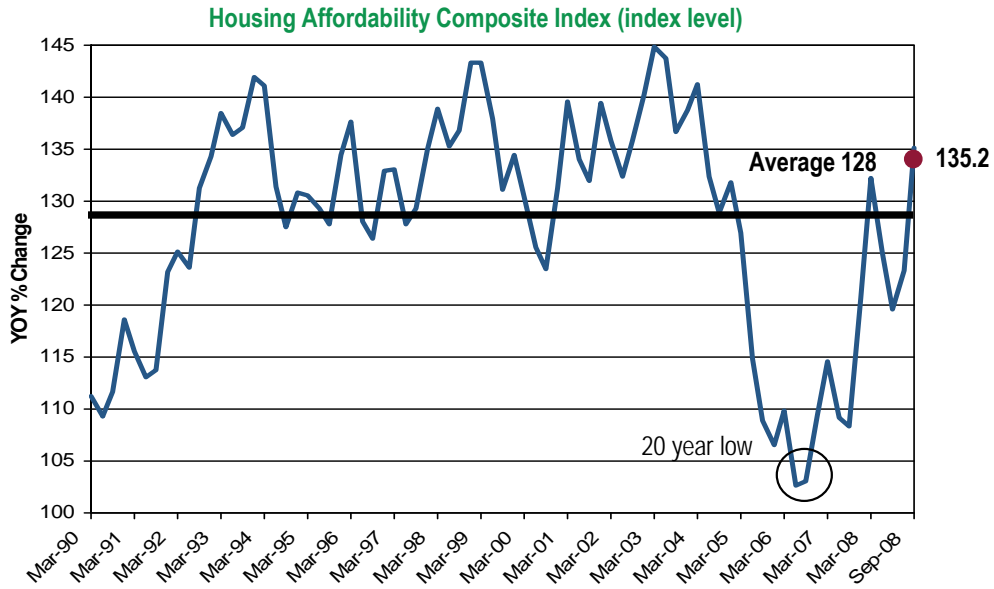


# Household Debt Burdens

(shaded columns represent recessions)



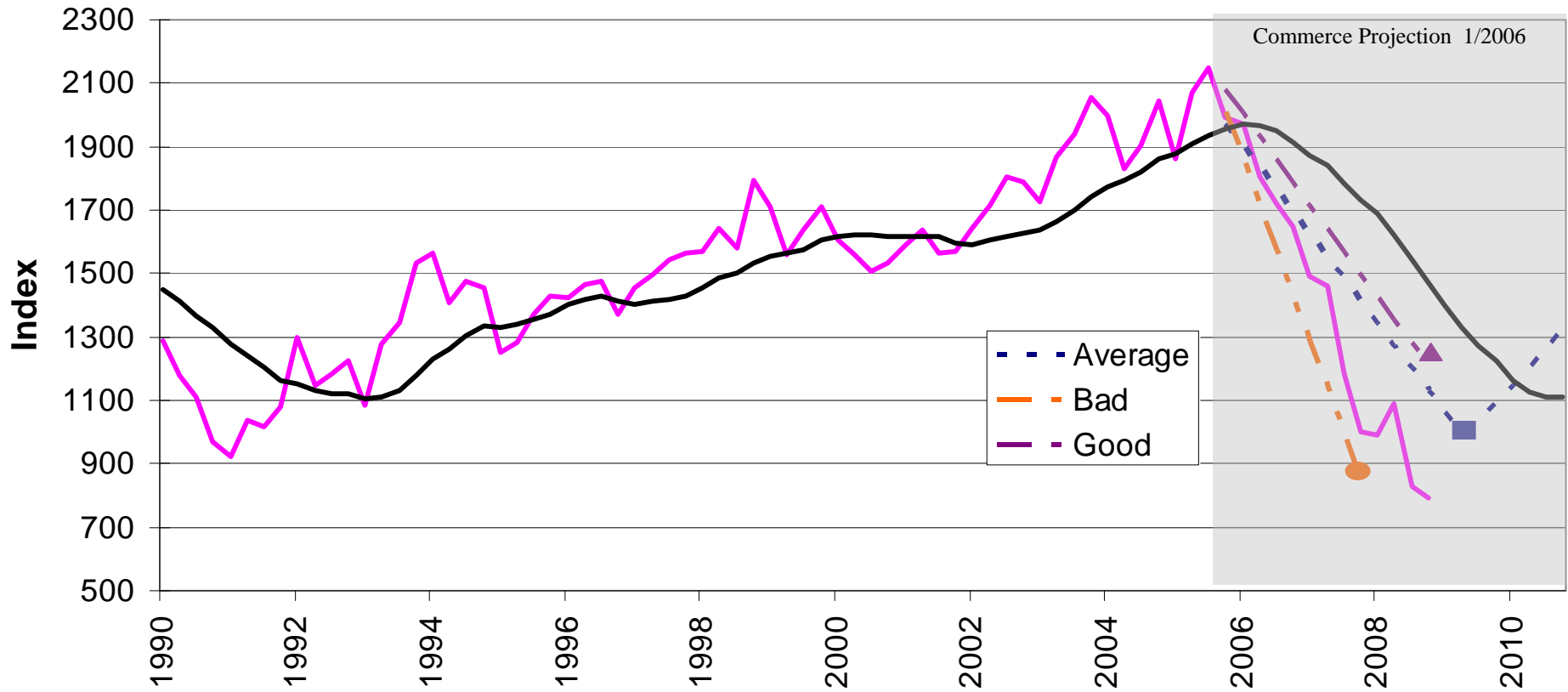
# Economy - Housing



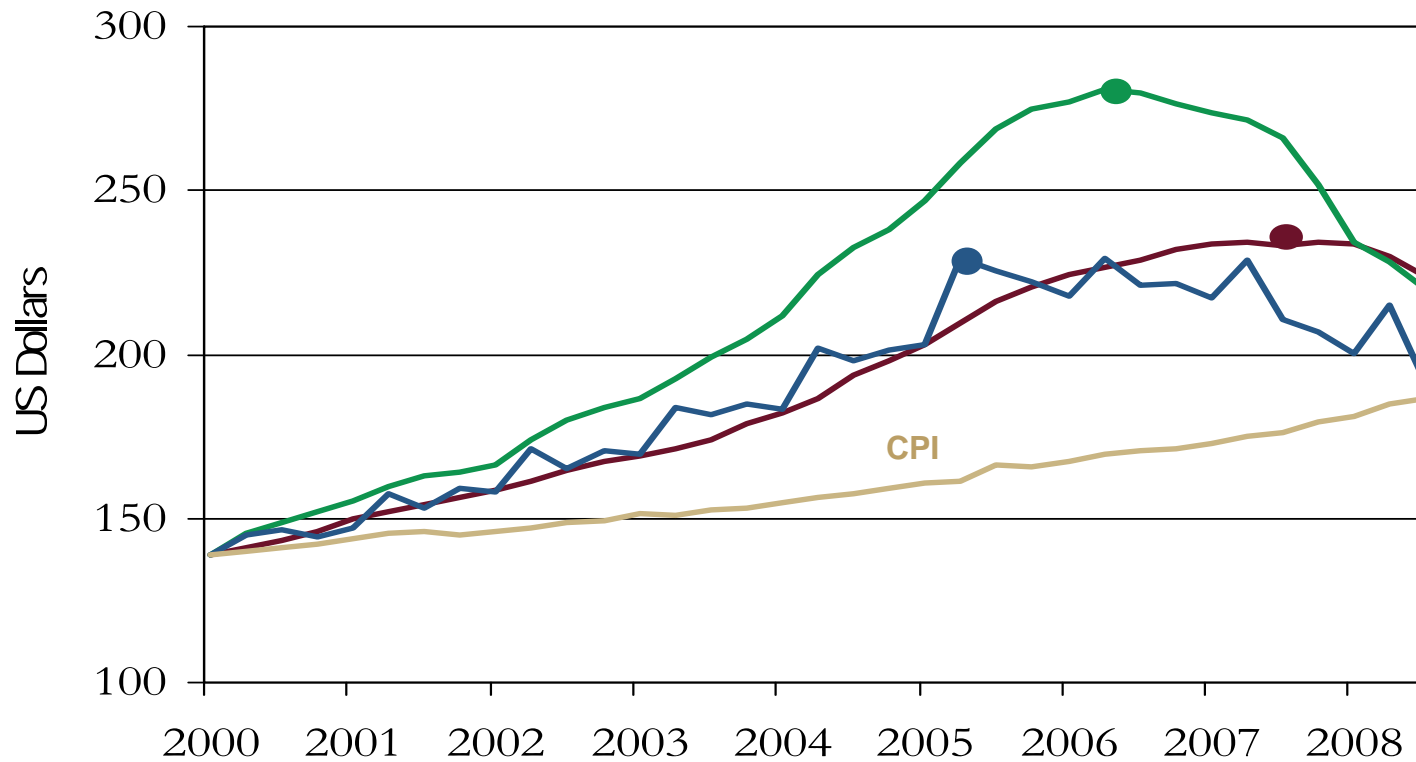
Source: Bloomberg/Commerce

# New Home Starts – Not Bottomed Yet, But Close

## Housing Start Index

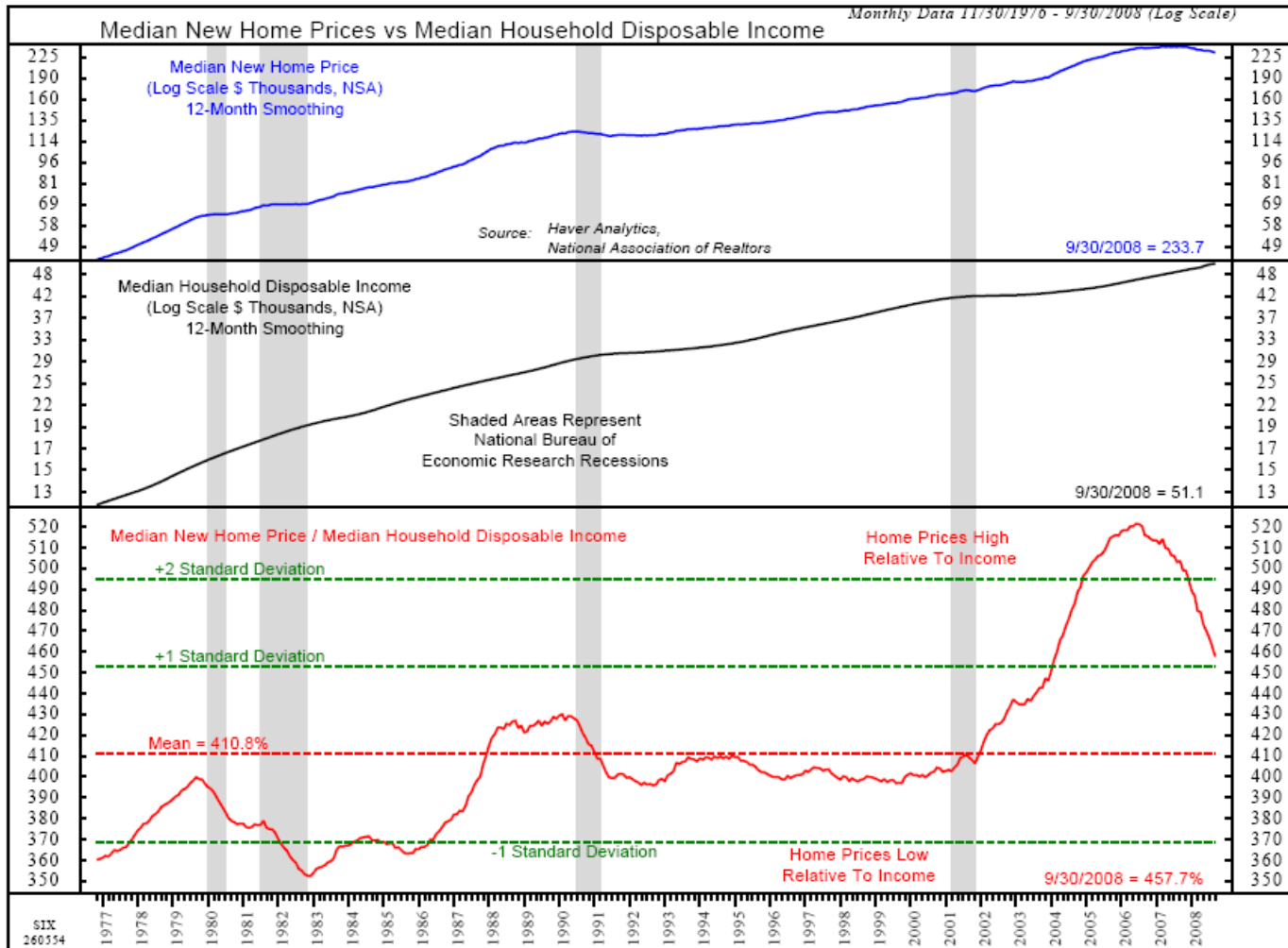


## Median Home Price Decline – Major Home Price Indices – 01/01/00 – 09/30/08



	Date of High	High	Current	% Decrease Since High
US Existing Home Sales Median Price (\$) - NAR	6/30/05	229.50	191.40	-16.60
OFHEO US House Price Index – FNMA/FHLMC*	6/30/07	386.71	369.42	-4.47
S&P/Case-Shiller 20 City Home Price Index*	6/30/06	206.38	161.56	-21.72

# Home Prices vs. Income

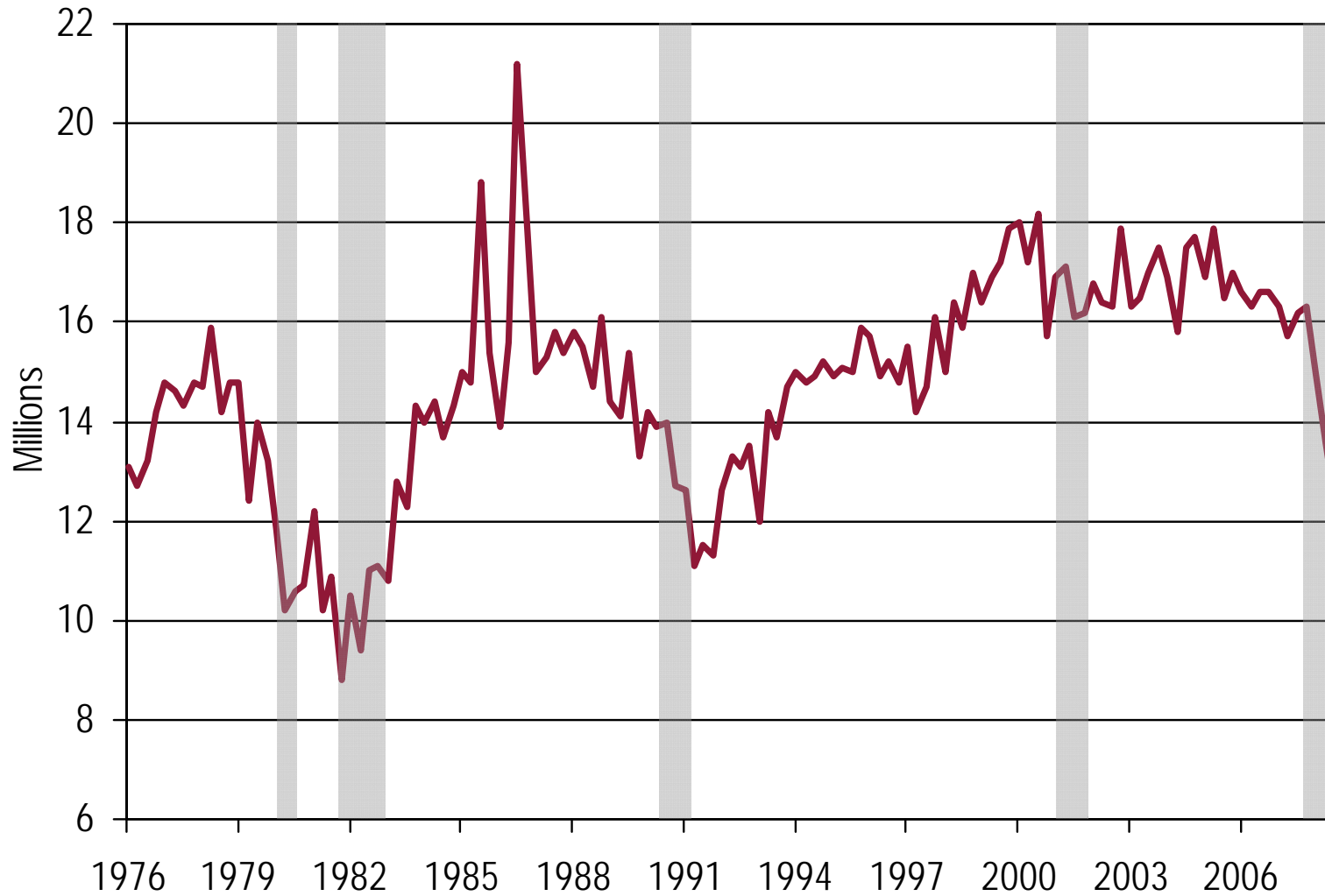


Home Price Appreciation needed to bring back valuation by Sept. 30, 2010

- +4.7%
- -5.0%
- -14.5%

Note: Assumes 6.0% Total Median Household Disposable Income growth over the next 24 month period.

## US Auto Sales (annualized) – 01-01-76 through 09-30-08

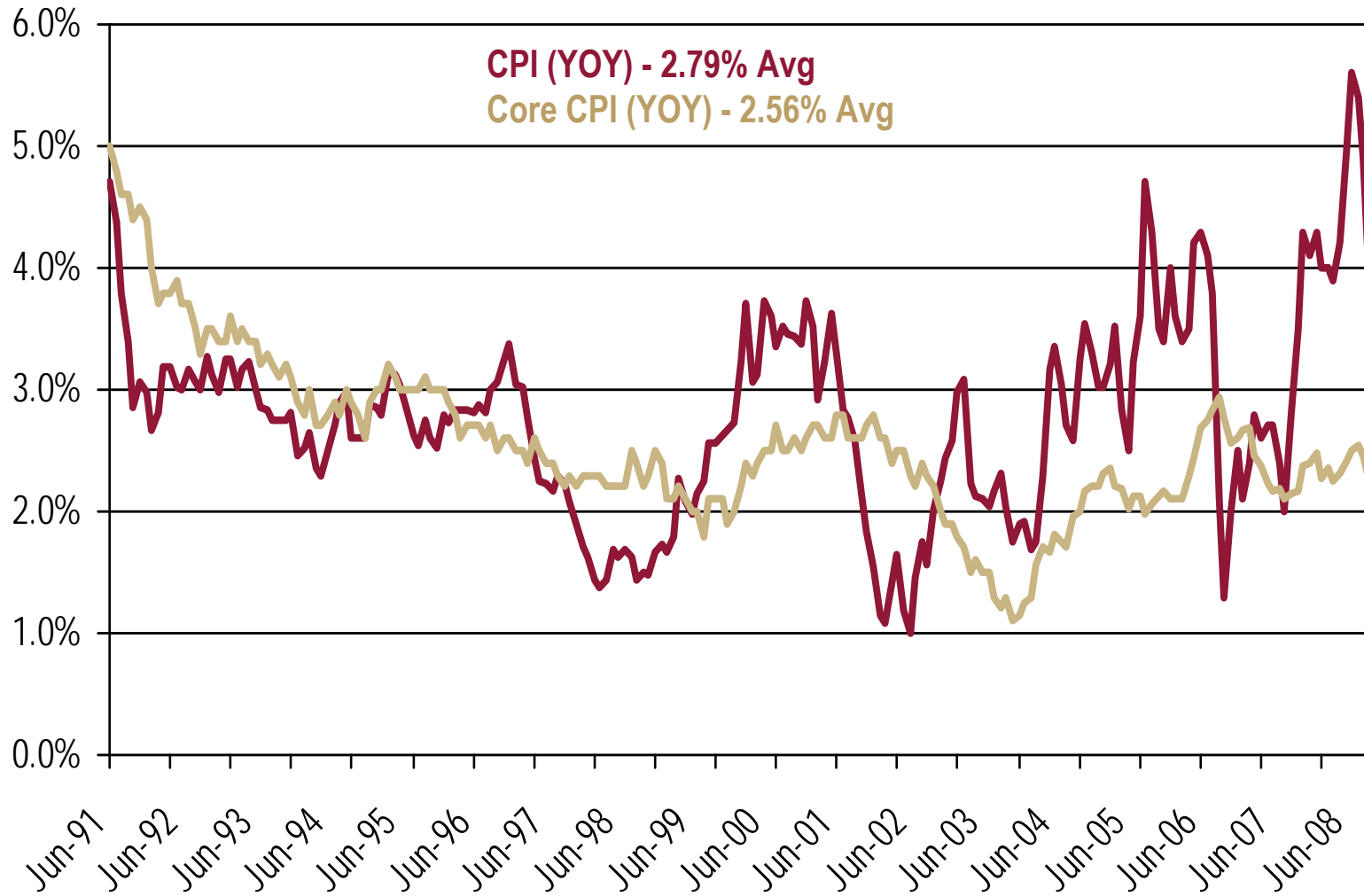


## CPI – Breakdown and Weightings

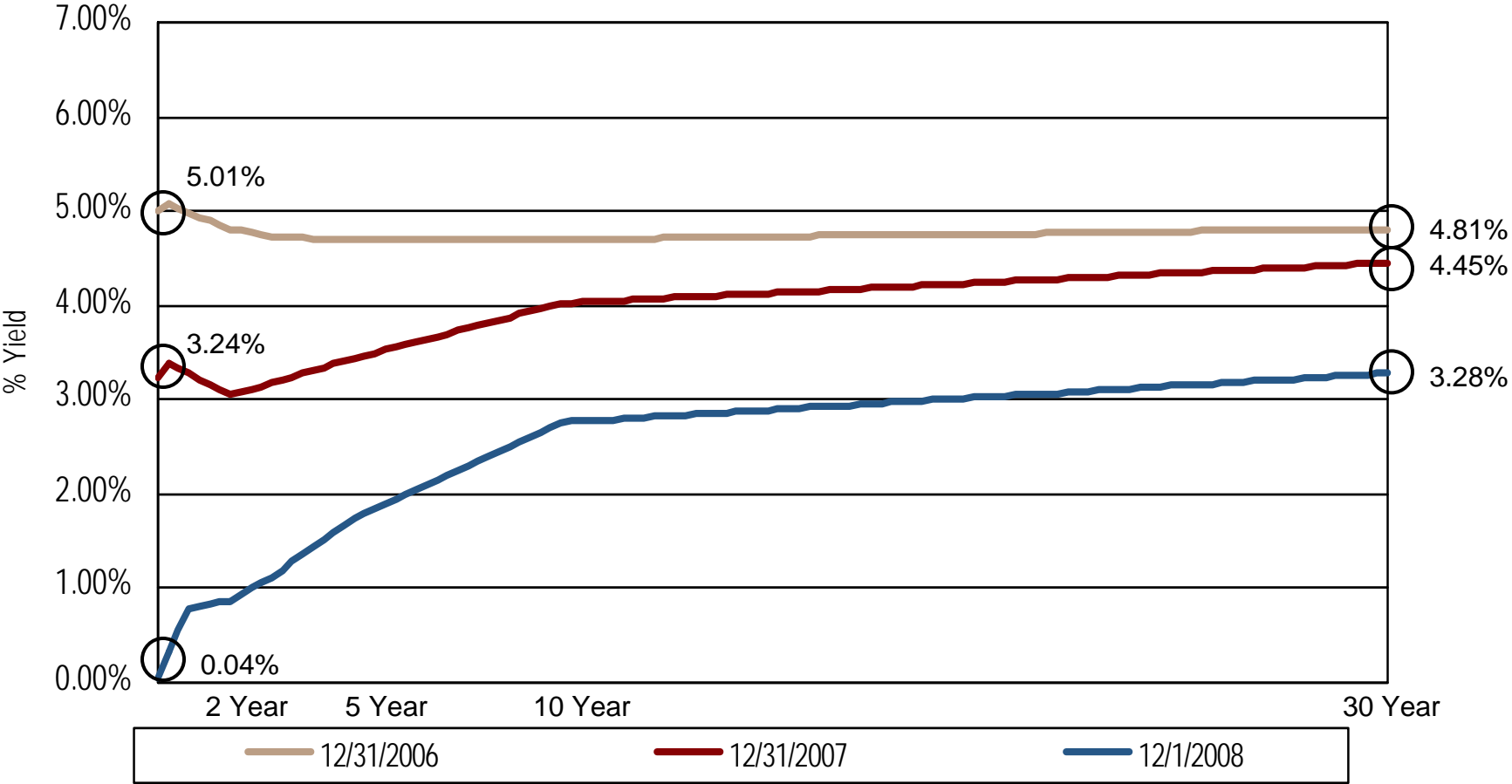
<b>Housing</b>	<b>42.4%</b>
Shelter (32.6%)	
Utility (5.1%)	
Furnishings (4.7%)	
<b>Transportation</b>	<b>17.7%</b>
Vehicles (7.2%)	
Fuel (5.5%)	
Maintenance/Other (5.0%)	
<b>Food &amp; Beverage</b>	<b>14.9%</b>
<b>Medical</b>	<b>6.2%</b>
<b>Education &amp; Communications</b>	<b>6.1%</b>
<b>Apparel/Recreation/Other</b>	<b>12.7%</b>
	<b>100.0%</b>

Note: Food (13.8%) and Energy ( 9.7%)

## Inflation – CPI & Core CPI



# Historical Treasury Yield Curve

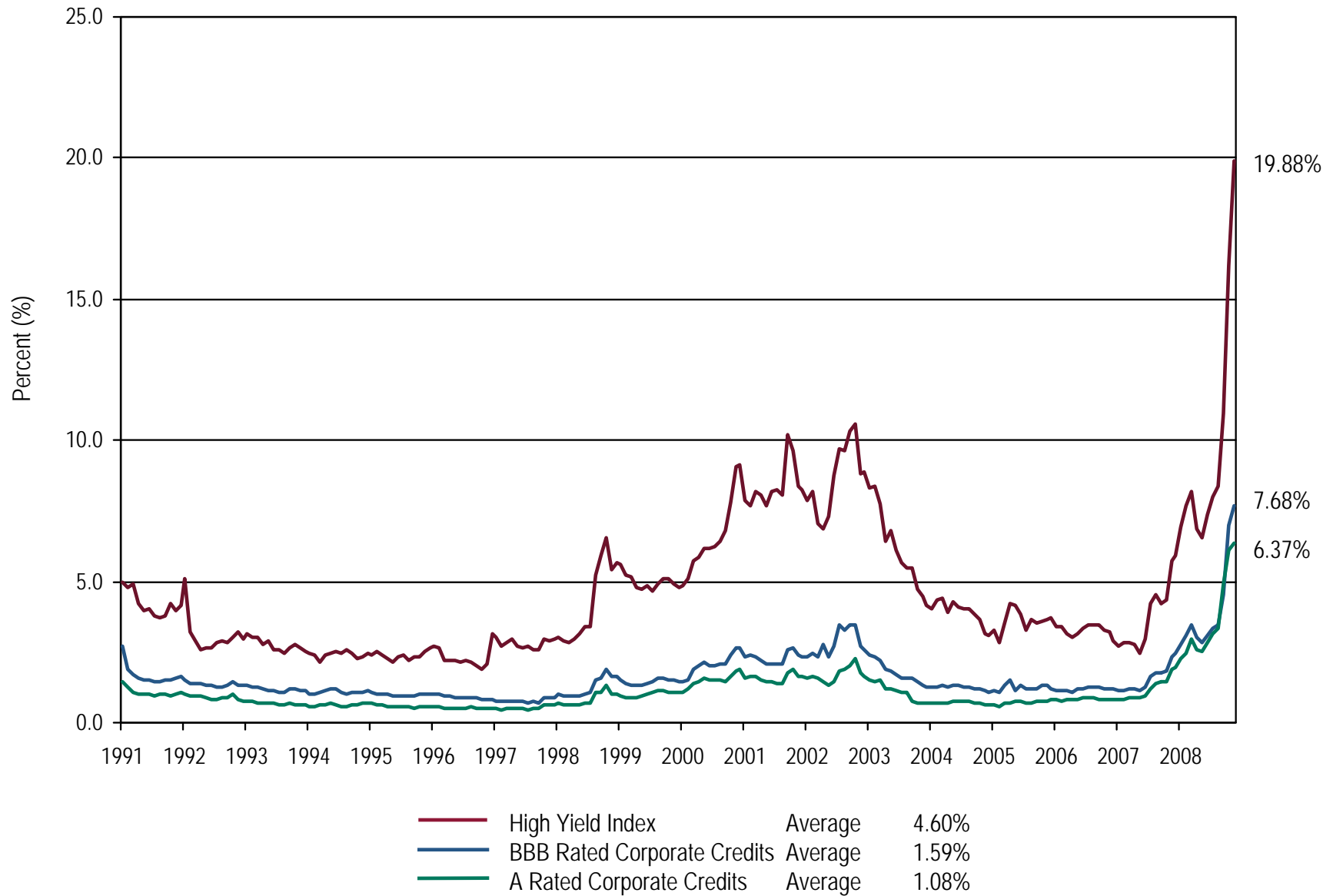


## Fed Funds Projections – as of December 1, 2008

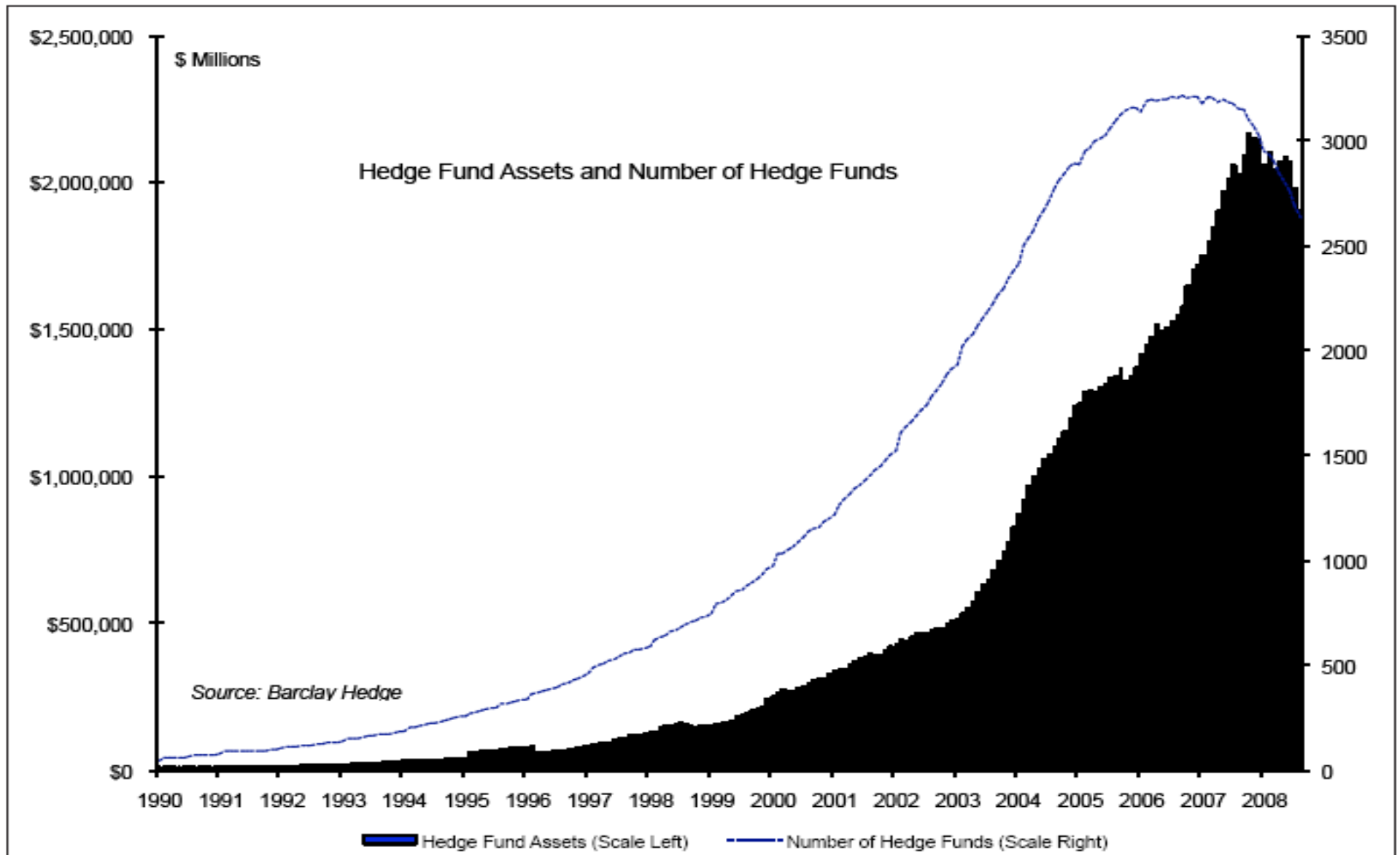
	Implied Probabilities					Expected Rate
	0.00%	0.25%	0.50%	0.75%	1.00%	
<b>Dec-08</b>		34%	66%			0.42%
<b>Jan-09</b>	6%	40%	54%			0.37%
<b>Mar-09</b>	5%	31%	50%	14%		0.44%
<b>Apr-09</b>	4%	26%	47%	21%	3%	0.48%



## Corporate Credit Spreads – 01-31-91 through 11-30-08

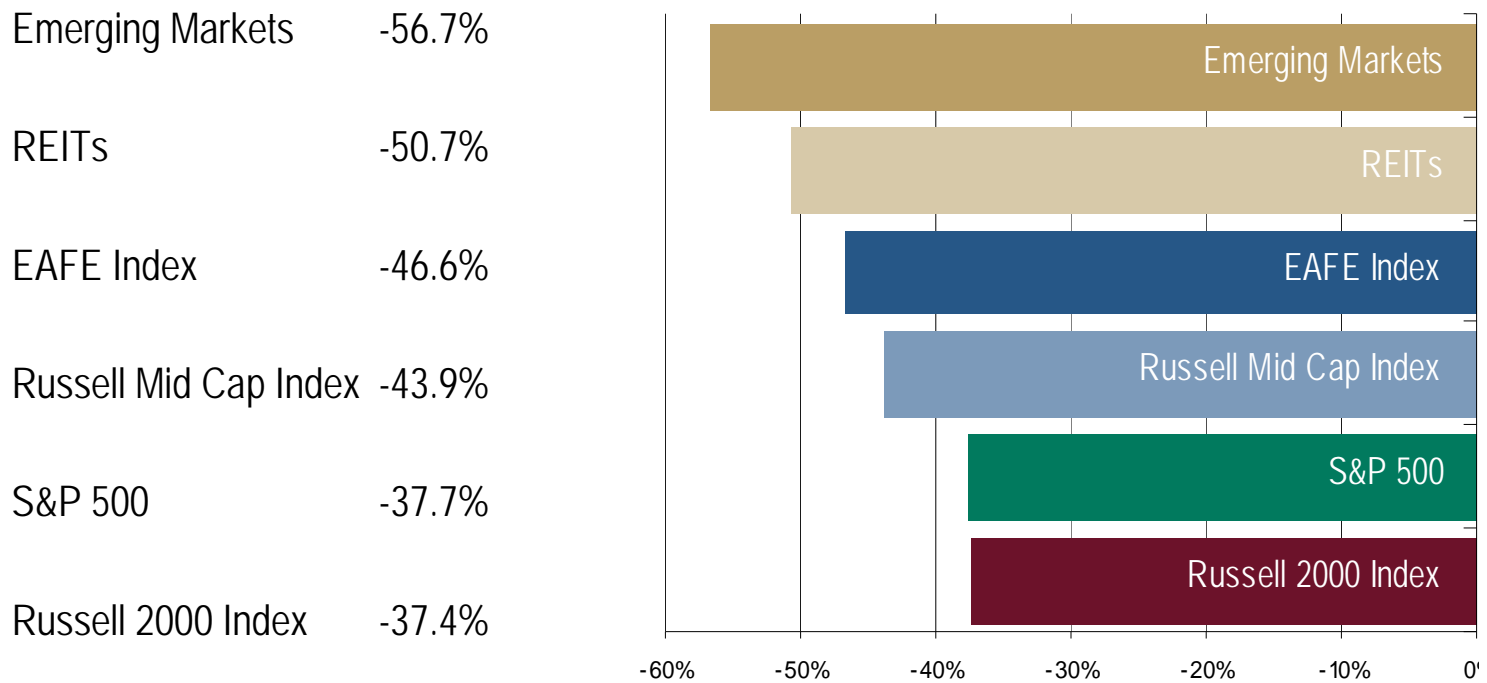


# Hedge Fund Assets



## Equities – YTD Returns through 11/28/08

### NO PLACE TO HIDE



## Tactical Asset Allocation Guidelines - November 12, 2008

Stocks/Bonds			
Stocks/Bonds	Overweight Bonds	Neutral	Overweight Stocks
Fixed Income			
Bond Duration	Shorter	➔ Neutral	Longer
Government/Corporate	Emphasize Government	Neutral	Emphasize Corporate
Domestic/International	Emphasize Domestic	Neutral	Emphasize International
Taxable Investment Grade/Taxable High Yield	Emphasize Investment Grade	Neutral	➔ Emphasize High Yield**
Municipal Investment Grade/Municipal High Yield	Emphasize Investment Grade	Neutral	Emphasize High Yield**
TIPS	Emphasize Conventional Bonds	➔ Neutral	Emphasize TIPS
Equities			
Growth/Value	Emphasize Value	Neutral	Emphasize Growth
Large Cap/Mid Cap	Emphasize Large Cap	Neutral	Emphasize Mid Cap
Mid Cap/Small Cap	Emphasize Mid Cap	Neutral	Emphasize Small Cap
Domestic/International	2x	Emphasize Domestic	Emphasize International
Emerging/Developed	Emphasize Developed	Neutral	Emphasize Emerging
Alternatives			
Commodities*	Emphasize Other Alternatives	Neutral	Emphasize Commodities
Hedge Funds*	Emphasize Other Alternatives	Neutral	Emphasize Hedge Funds
Private Equity*	Emphasize Other Alternatives	Neutral	Emphasize Private Equity
Real Estate*	Emphasize Other Alternatives	Neutral	Emphasize Real Estate

2x Designates double overweight

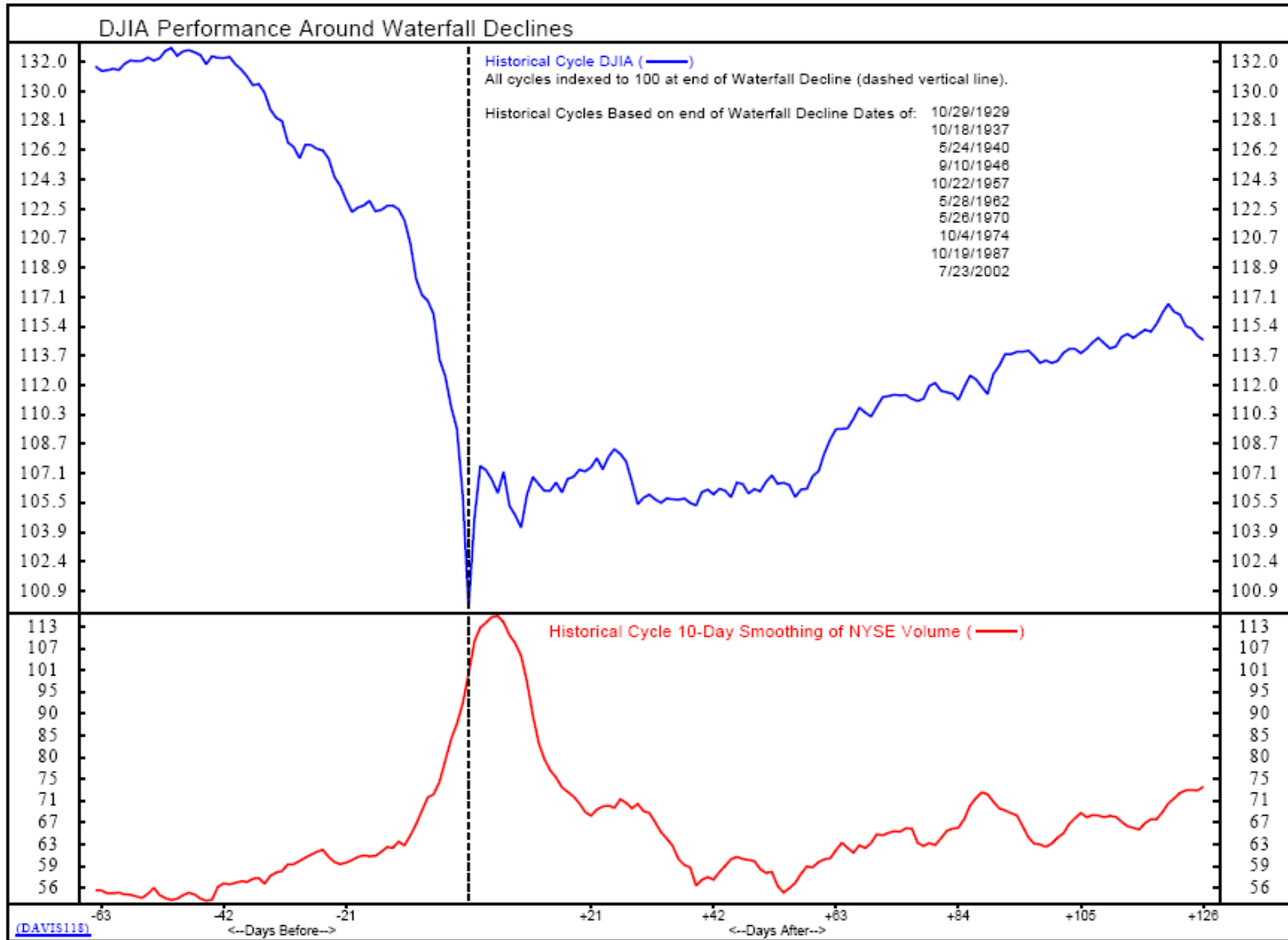
Designates current recommendation

↔ Designates developing trend

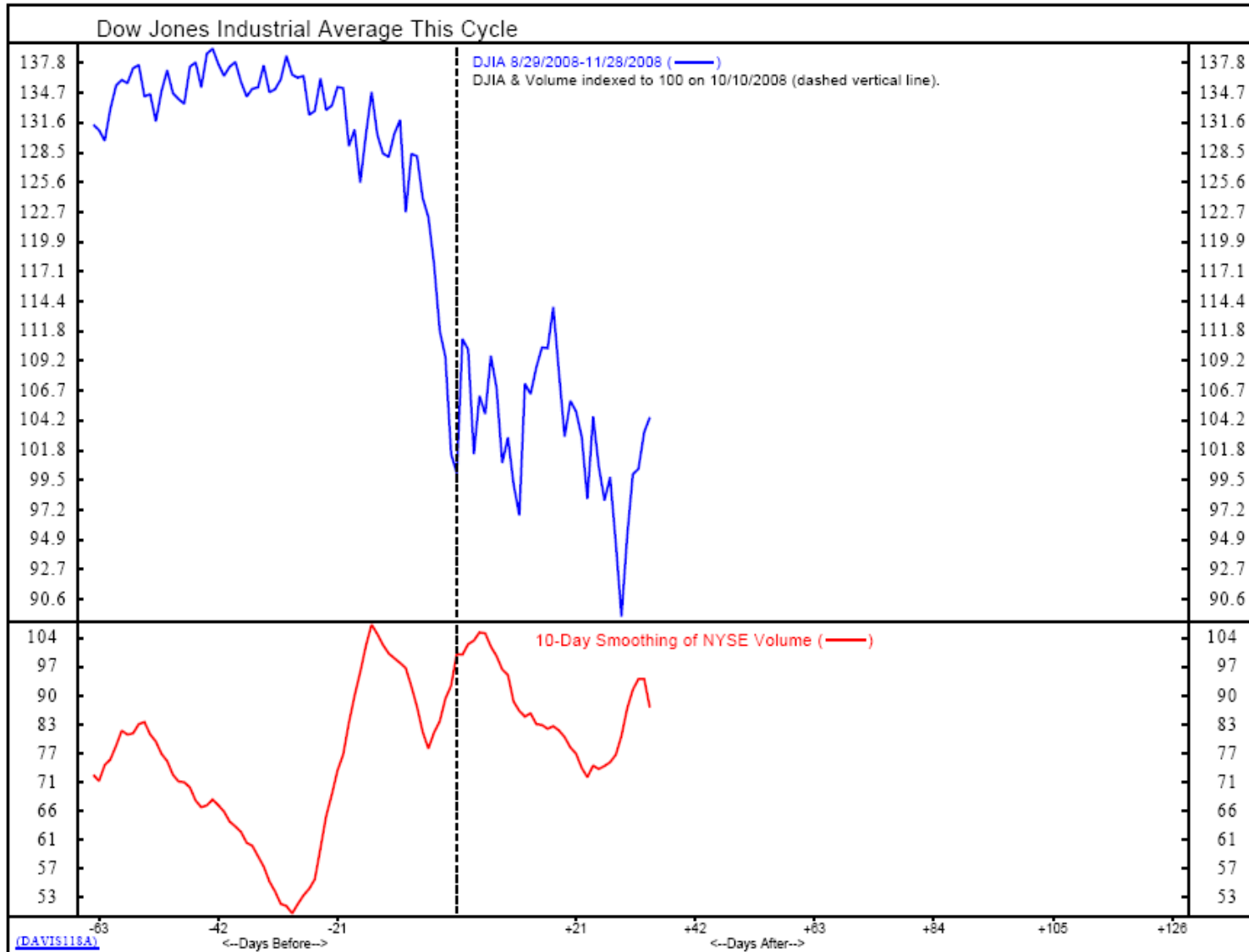
\* Neutral allocation indicates a 0% weighting.

\*\* Neutral allocation to this asset class is generally 0%.

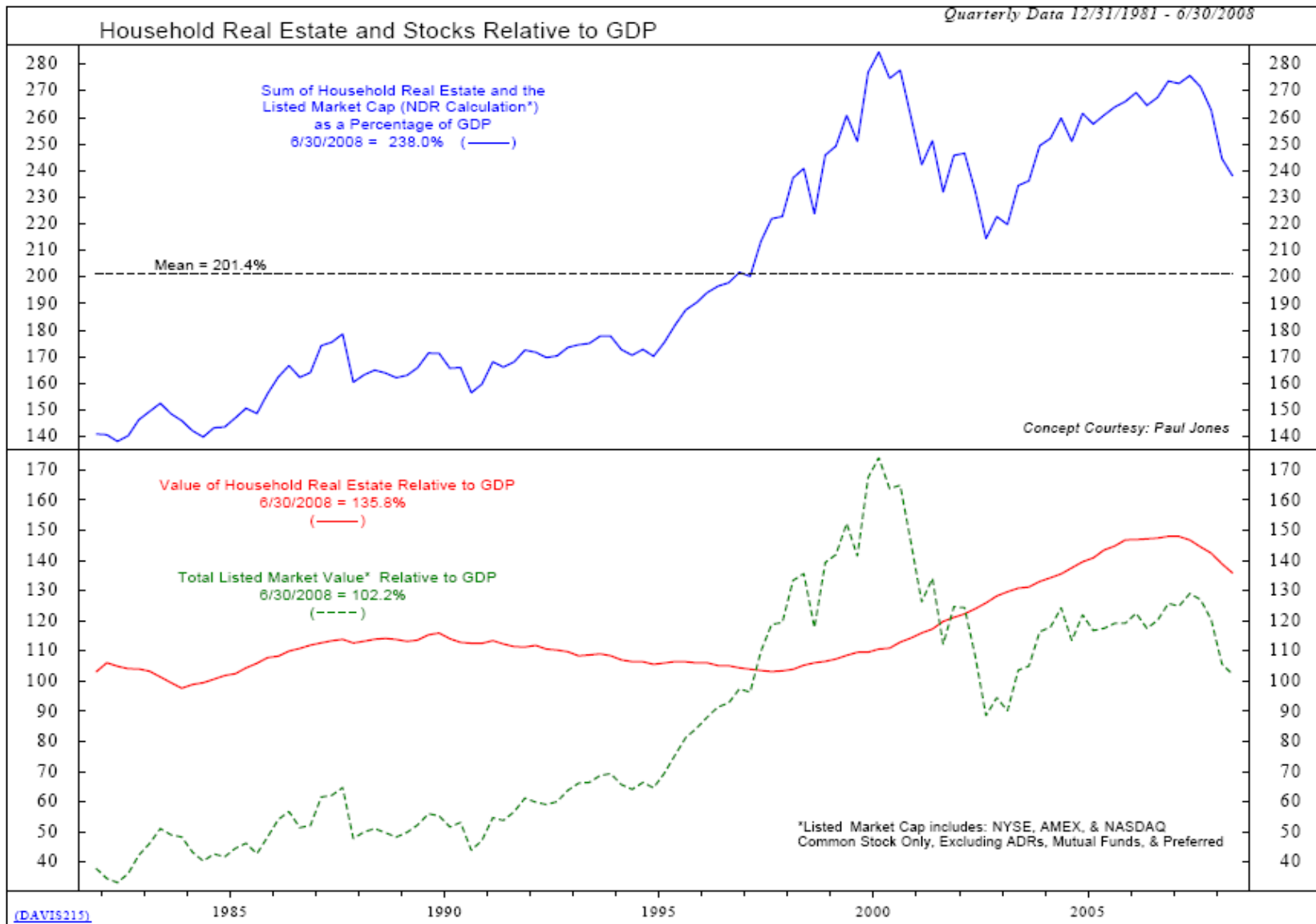
# Dow Jones Ind. Avg. Performance Around Waterfall Declines



# Dow Jones Ind. Avg. Decline in the Current Cycle as of 11/28/08



# Household Real Estate and Stocks Relative to GDP



## Top 10 Investment Ideas

High Quality Income	Equity	Alternative/ Diversifiers
<b>Investment Grade Municipal Bond</b> 7 yr avg life @ 4.25% → 6.53% TEY	<b>CVS</b>	<b>PCRIX</b>
<b>CFMOX 3.79% → 5.83% TEY</b>	<b>V</b>	<b>ASFIX</b>
<b>Investment Grade Corporate Bond</b> <b>CFBNX 5.01% 5.80%YTM</b>	<b>HPQ</b>	
<b>VFIDX 6.10% 7.76%YTM</b>	<b>GE</b>	