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What It's Worth

Economic Outlook Update

MONTHLY

Review of and outlook for the U.S. economy. December 2010

Contents

An extremely important section of a well-prepared business valuation is a thorough and relevant economic section. First, Revenue Ruling 59-60 requires consideration of "the economic outlook in general and the condition and outlook of the specific industry in particular." Secondly, an understanding of the economic outlook is fundamental to developing reasonable expectations about the subject company's future prospects. In any business valuation, the general economic outlook as of the appraisal date should be considered, since the national economic outlook is often the basis of how investors perceive alternative investment opportunities at any given time.

In this analysis, we have examined the general economic climate that existed at the end of December 2010. This summary provides an overview of some selected economic factors that prevailed in December 2010, as well as a discussion of the factors that are crucial over an extended period of time. Topics addressed include general economic conditions, gross domestic product, consumer prices and inflation rates, energy prices, interest rates, unemployment, consumer spending, the stock and bond markets, construction, manufacturing, real estate markets, and the future economic outlook.

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GENERAL

The third-quarter GDP was revised upward in December to an annual rate of 2.6% (from an originally reported annual rate of 2.0%). The S&P 500 ended December at 1,257.64, for a monthly return of about 6.5% and a yearly return of about 12.8%. The 10-year U.S. Treasury fell 12 basis points the last week of December to 3.30%. The 10-year U.S. Treasury decreased a total of 55 basis points for the year. Inflation remained subdued this month as the Federal Reserve maintained its plan to purchase Treasury securities. President Obama signed a broad tax package that included extending the tax cuts enacted during the Bush administration. The Federal Open Market Committee kept their target for the federal funds rate unchanged at a range of 0% to 0.25%. Unemployment remained high, as the U.S. Labor Department reported on December 3 that the rate was at 9.8%. Consumer confidence declined during the month of December as many remained concerned about the future of the job market.

CONSTRUCTION SPENDING

The U.S. Census Bureau reported that construction spending rose 0.4% in November, to a seasonally adjusted annual rate of $810.2 billion. The November figure is 6.0% below the November 2009 figure of $861.5 billion. During the first 11 months of 2010, construction spending amounted to $753.9 billion, 10.6% below the $843.1 billion for the same period in 2009.

Spending on private construction grew 0.3% in November to a seasonally adjusted annual rate of $491.8 billion. Residential construction was at a seasonally adjusted annual rate of $235.7 billion in November, 0.7% above the revised October figure of $234.1 billion. Nonresidential construction was at a seasonally adjusted annual rate of $256.1 billion in November, 0.1% below the revised October figure of $256.3 billion.

The seasonally adjusted annual rate of public construction spending was $318.5 billion in November, up 0.7% from October. Educational construction was at a seasonally adjusted annual rate of $73.4 billion, up 1.0% from October. Highway construction was down 1.0% from October at a seasonally adjusted annual rate of $86.8 billion.

MANUFACTURING AND SERVICES

The Institute for Supply Management (ISM) reported that their manufacturing index expanded for the 17th consecutive month in December to a reading of 57.0%. The head of the survey committee for the ISM commented:

> The manufacturing sector continued its growth trend as indicated by this month's report. We saw significant recovery for much of the U.S. manufacturing sector in 2010. The recovery centered on strength in autos, metals, food, machinery, computers and electronics, while those industries tied primarily to housing continue to struggle. Additionally, manufacturers that export have benefitted from both global demand and the weaker dollar. December's strong readings in new orders and production, combined with positive comments from the panel, should create momentum as we go into the first quarter of 2011.

The ISM reported that their non-manufacturing index reached a reading of 57.1% in December, marking the 12th consecutive month of growth. The ISM's nonmanufacturing index measures the strength of the services sector. The chair of the ISM commented:

> The NMI (Non-Manufacturing Index) registered 57.1 percent in December, 2.1 percentage points higher than the 55 percent registered in November, and indicating continued growth in the non-manufacturing sector. The Non-Manufacturing Business Activity Index increased 6.5 percentage points to 63.5 percent, reflecting growth for the 13th consecutive month at a faster rate than in November.

FACTORY ORDERS

The U.S. Department of Commerce reported that factory orders rose 0.7% in November after a slight decline in October. Nondurable goods demand fueled the increase, indicating the ongoing economic recovery is bumpy. New orders for durable goods—items meant to last three or more years, such as computers, cars and machinery—dropped by 0.3% to 195.7 billion dollars in November. Demand for transportation equipment, which accounts for more than a quarter of total durable goods demand, plummeted 11.1% to $46 billion in November. New orders for nondurable goods, including food, paper products, petroleum and coal products, rose by 1.7% to $228.2 billion for the month.

INDUSTRIAL PRODUCTION

The Federal Reserve Board published that industrial production rose 0.4% from October to November, with manufacturing production rising 0.3%. Industrial production is the total output of factories and mines in the U.S. Excluding motor vehicles, the manufacturing increase was 0.7%, the highest reading since May. Industrial capacity utilization increased to 75.2% from 74.9%, reaching its highest level in two years. Capacity utilization is the percentage of production capacity manufacturers actually use.

TRADE DEFICIT

The U.S. Department of Commerce reported that the trade deficit narrowed to $38.7 billion in October as U.S. exports jumped to their highest level in two years. The U.S. Department of Commerce went on to report that the deficit with China shrank 8.3%, to $25.5 billion. The deficit with China is an important figure for U.S. trading activity. Exports to China surged nearly 30%, to a record high of $9.3 billion.

The report indicated that the inflation-adjusted deficit, used by economists to determine the impact of trade on GDP, dropped to $45.2 billion from $50.3 billion in September. Experts suggested the surge in exports could alter forecasts for fourth-quarter GDP, though the deficit with other trading partners—from Canada to Japan and the European Union—continued its upward trend.

CONSUMER CONFIDENCE

The Conference Board's Consumer Confidence Index®, which had improved in November, decreased slightly in December.

The Index now stands at 52.5, down from 54.3 in November. Many economists had expected an increase in confidence for December because of Congress' vote to extend the Bush-era tax cuts.

Lynn Franco, Director of the Consumer Research Center at The Conference Board, commented:

> Despite this month's modest decline, consumer confidence is no worse off today than it was a year ago. Consumers' assessment of the current state of the economy and labor market remains tepid, and their outlook remains cautious. Thus, all signs continue to suggest that the economic expansion will continue well into 2011, but that the pace of growth will remain moderate.

RETAIL SALES

The U.S. Department of Commerce reported that consumer spending continued to increase. Retails sales were up for the fifth month in November, rising 0.8%. Also, the October gain was upwardly revised to 1.7% (excluding automobiles, the increase was 1.2%). For the last 12 months, retails sales were up 7.7%, the third straight month of year-over-year growth at or near 8%. Retail sales grew at a 13.7% annualized pace over the past four months, bringing retail sales near the same level as their November 2007 peak.

CONSUMER PRICES

Inflation, as measured by the Consumer Price Index (CPI), continues to inch along, as reported by the U.S. Department of Labor on December 14. Consumer prices crept up 0.1% in November and rose only 1.1% for the 12-month period. The CPI is a measure of the change over time in the prices paid by urban consumers for a representative basket of goods and services. Energy costs, which had surged 2.6% in October, rose only 0.2% in November. Excluding the more-volatile food and energy categories, the core price index logged the same 0.1% rise for the month after remaining at 0% for three consecutive months. For the past 12 months, the core CPI has risen only 0.8%, showing that sellers of goods and services, while experiencing modest inflation as measured by the Producer Price Index, are not passing along increased costs to consumers.

WHOLESALE ENERGY AND FOOD PRICES

Although consumer prices are hardly moving, the U.S. Department of labor reported that wholesale prices rose a bit in November. The Producer Price Index (PPI) increased 0.8% for finished goods. The PPI measures how much manufacturers and wholesalers pay for goods and materials. A big part of the increase stemmed from energy costs—particularly gasoline and other fuels—which rose 2.1% for the month. A 1.0% increase in consumer foods also contributed to the advance. Meanwhile, the core PPI—excluding food and energy prices—was up a more modest 0.3%, after dropping 0.6% in October. The rebound was attributed to passenger cars, which dropped 3.0% in October but rose 1.7% in November. For the last 12 months, the core PPI has been tame, rising only 1.2%.

NEW HOME CONSTRUCTION

New-home construction rose 3.9% in November to an annual rate of 555,000. The October number was revised upward to 534,000. Single-family construction showed some strength, rising 6.9%. However, multifamily starts declined 9.1%. Regardless of the recent growth, the housing market remains depressed compared to historical standards, with total housing starts down nearly 6.0% from last year's sluggish pace. Housing permits, an indicator of future construction starts, fell 4.0% in November and are down 14.7% from a year ago.

HOME SALES

The National Association of Realtors (NAR) reported that existing-home sales increased 5.6% in November, to an annualized 4.68 million units. Despite the increase, sales were 27.9% below the cyclical peak of 6.49 million in November 2009, which was the initial deadline for the first-time buyer tax credit.

Lawrence Yun, NAR chief economist, is hopeful for 2011. "Continuing gains in home sales are encouraging, and the positive impact of steady job creation will more than trump some negative impact from a modest rise in mortgage interest rates, which remain historically favorable," he said.

NAR went on to report that the median price of an existing home increased slightly from the year-ago median price of $170,000, to $170,600. However, a looming supply of potential bank repossessions and foreclosures could muffle prices again in the months ahead. Distressed properties accounted for about a third of November sales.

The U.S. Department of Commerce reported that new-home sales increased by 5.5%, to an annualized 290,000 units in November. New-home sales were down over the past year, with the sharpest plunge occurring in Midwest and the Northeast.

FORECAST

According to Consensus Economics, Inc., publisher of *Consensus Forecasts - USA*, real GDP is forecasted to increase at a seasonally adjusted annual rate of 2.5% in the first quarter of 2011, then at a rate of 2.8% in the second quarter. Every month, Consensus Economics surveys a panel of 28 prominent U.S. economic and financial forecasters for their predictions on a range of variables including future growth, inflation, current account and budget balances, and interest rates.

The forecasters in the survey believe real disposable personal income will increase at a seasonally adjusted annual rate of 1.3% in the first quarter of 2011, before increasing at rate of 2.2% in the second quarter. They project industrial production will increase at a rate of 3.5% in the first quarter of 2011 and 3.6% in the second quarter. They also believe consumer prices will rise at a rate of 1.6% and 1.2% in the first and second quarter, respectively. Producer prices are expected to increase at a rate of 2.0% in the first quarter and 1.2% in the second. They believe unemployment will drop to 9.2% by the end of 2011.

EXHIBIT 1: Historical Economic Data 2004-2009 and Forecasts 2010-2019

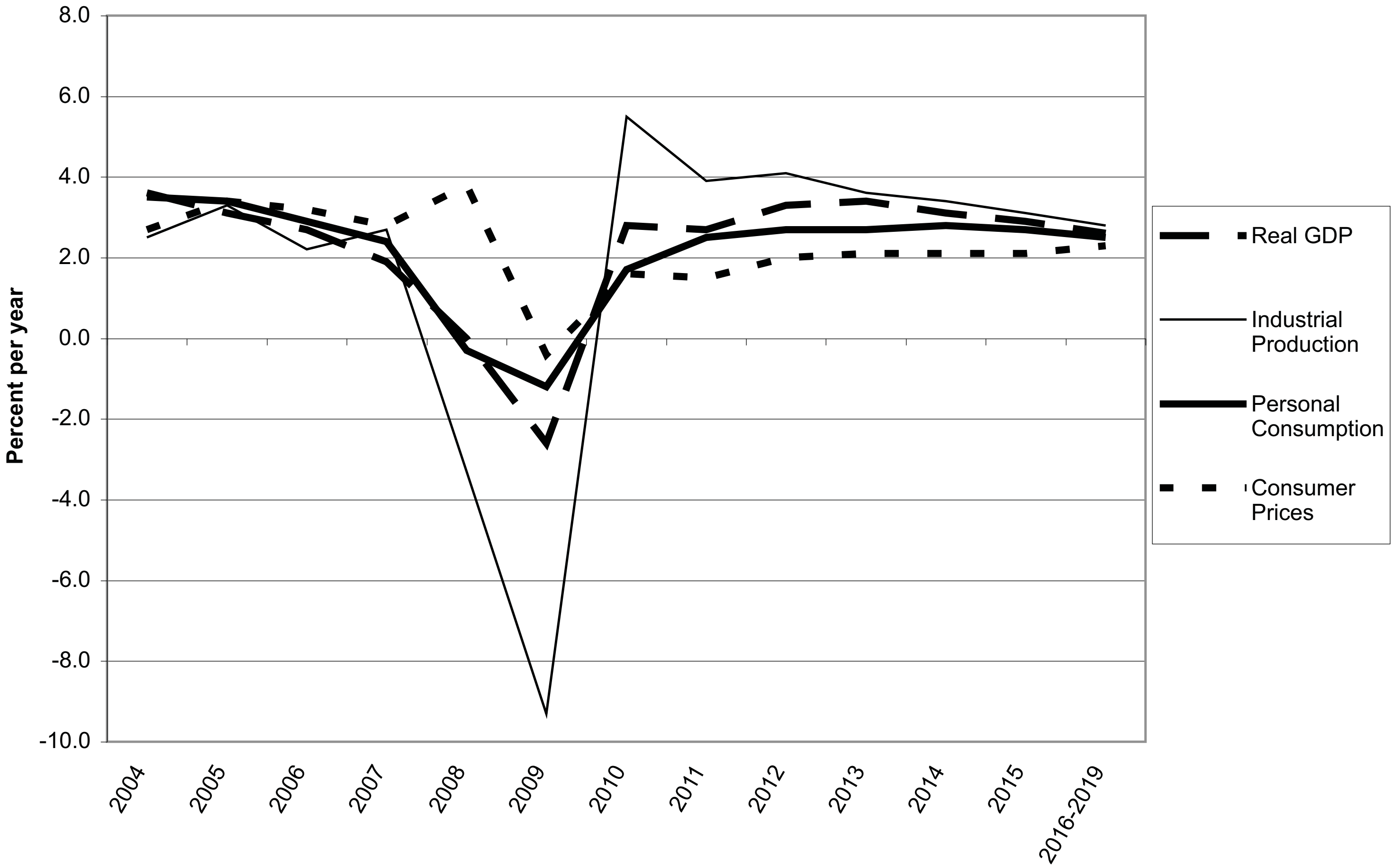
	HISTORICAL DATA						CONSENSUS FORECASTS**						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016-2019
Real GDP*	3.6	3.1	2.7	1.9	0.0	-2.6	2.8	2.7	3.3	3.4	3.1	2.9	2.6
Industrial Production*	2.5	3.3	2.2	2.7	-3.3	-9.3	5.5	3.9	4.1	3.6	3.4	3.1	2.8
Personal Consumption*	3.5	3.4	2.9	2.4	-0.3	-1.2	1.7	2.5	2.7	2.7	2.8	2.7	2.5
Real Business Investment*	6.0	6.7	7.9	6.7	0.3	-17.1	5.9	9.3	8.3	7.2	6.1	5.2	4.2
Nominal Pre-Tax Corp. Profits*	24.0	16.8	10.5	-6.1	-16.4	-0.4	29.5	6.7	7.5	6.7	6.4	5.4	4.9
Government Spending*	1.4	0.3	1.4	1.3	2.8	1.6	1.2	1.1	NA	NA	NA	NA	NA
Consumer Prices*	2.7	3.4	3.2	2.8	3.8	-0.4	1.6	1.5	2.0	2.1	2.1	2.1	2.3
Unemployment Rate	5.6	5.1	4.6	4.6	5.8	9.3	9.7	9.4	NA	NA	NA	NA	NA
Housing Starts (millions)	1.956	2.068	1.801	1.355	0.906	0.554	0.590	0.690	NA	NA	NA	NA	NA

Source of historical data: U.S. Department of Commerce, U.S. Department of Labor, U.S. Census Bureau and The Federal Reserve Board.
Source of forecasts: Consensus Forecasts - USA, October 11, 2010 and December 6, 2010.
Real Business Investment is also known as Nonresidential Fixed Investment.

Notes:
**Numbers are based on percent change from preceding period, seasonally adjusted rates.*
***Forecast numbers are based on average percent change on previous calendar year.*
Personal Consumption includes spending on services, durable, and nondurable goods.
Government Spending includes federal, state, and local government spending.

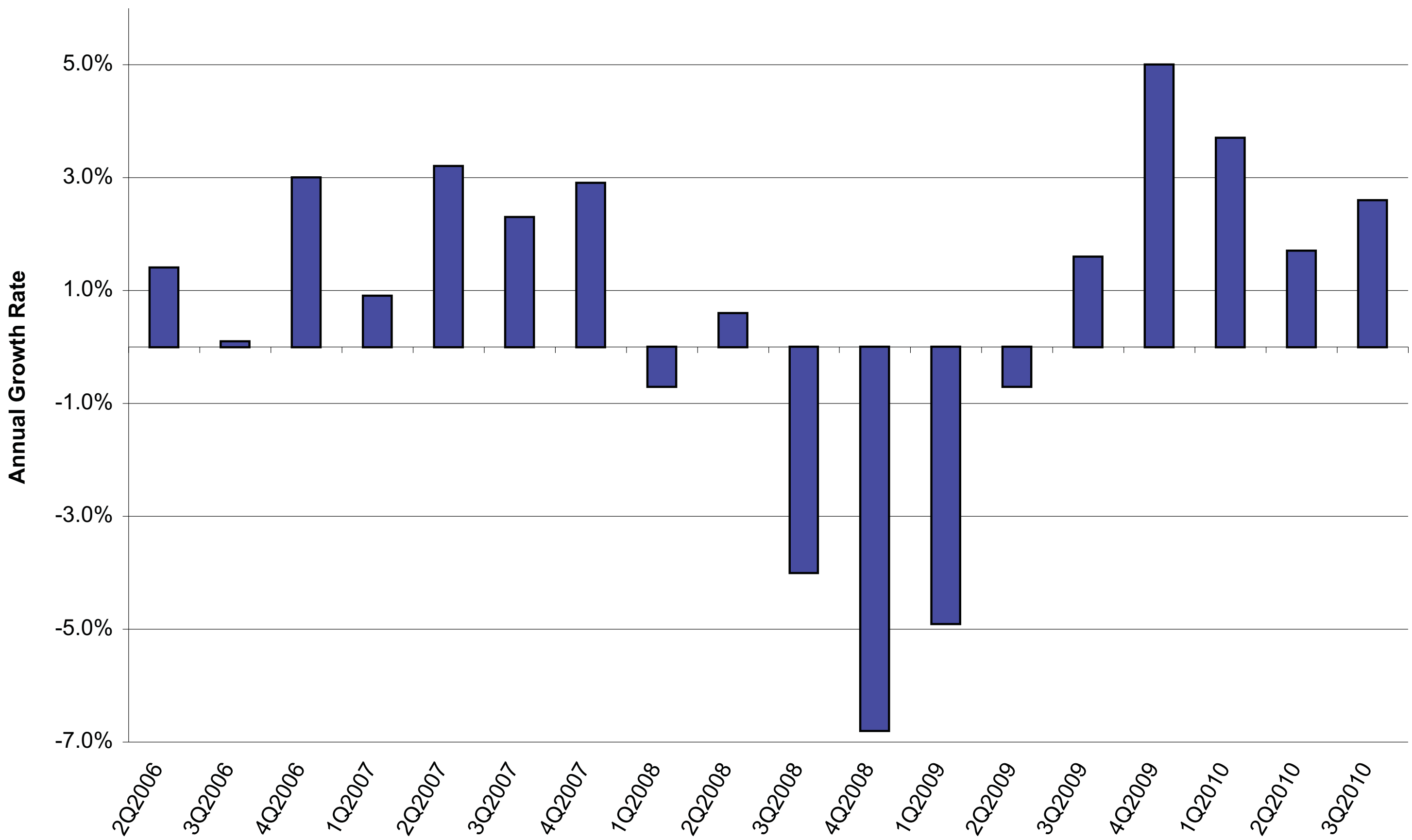
Every month, Consensus Economics surveys a panel of prominent United States economic and financial forecasters for their predictions on a range of variables including future growth, inflation, current account and budget balances, and interest rates.

EXHIBIT 2: Key Economic Variables Actual 2004-2009 and Forecast 2010-2019



Source of historical data: U.S. Department of Commerce, U.S. Department of Labor, U.S. Census Bureau and The Federal Reserve Board.
Source of forecasts: Consensus Forecasts - USA, October 11, 2010 and December 6, 2010.

EXHIBIT 3: Real Gross Domestic Product 2Q 2006 - 3Q 2010



Source of data: U.S. Department of Commerce.
Note: Figures are seasonally adjusted at annual rates. As the Government issues revised data, some historical reported figures may have changed.

Economic Outlook Update December 2010 Data Sources

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