

“The era of optimism dies in the crisis, but in dying it gives birth to an era of pessimism. This new era is born not an infant, but a giant.” –Arthur C. Pigou

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The Bear Case

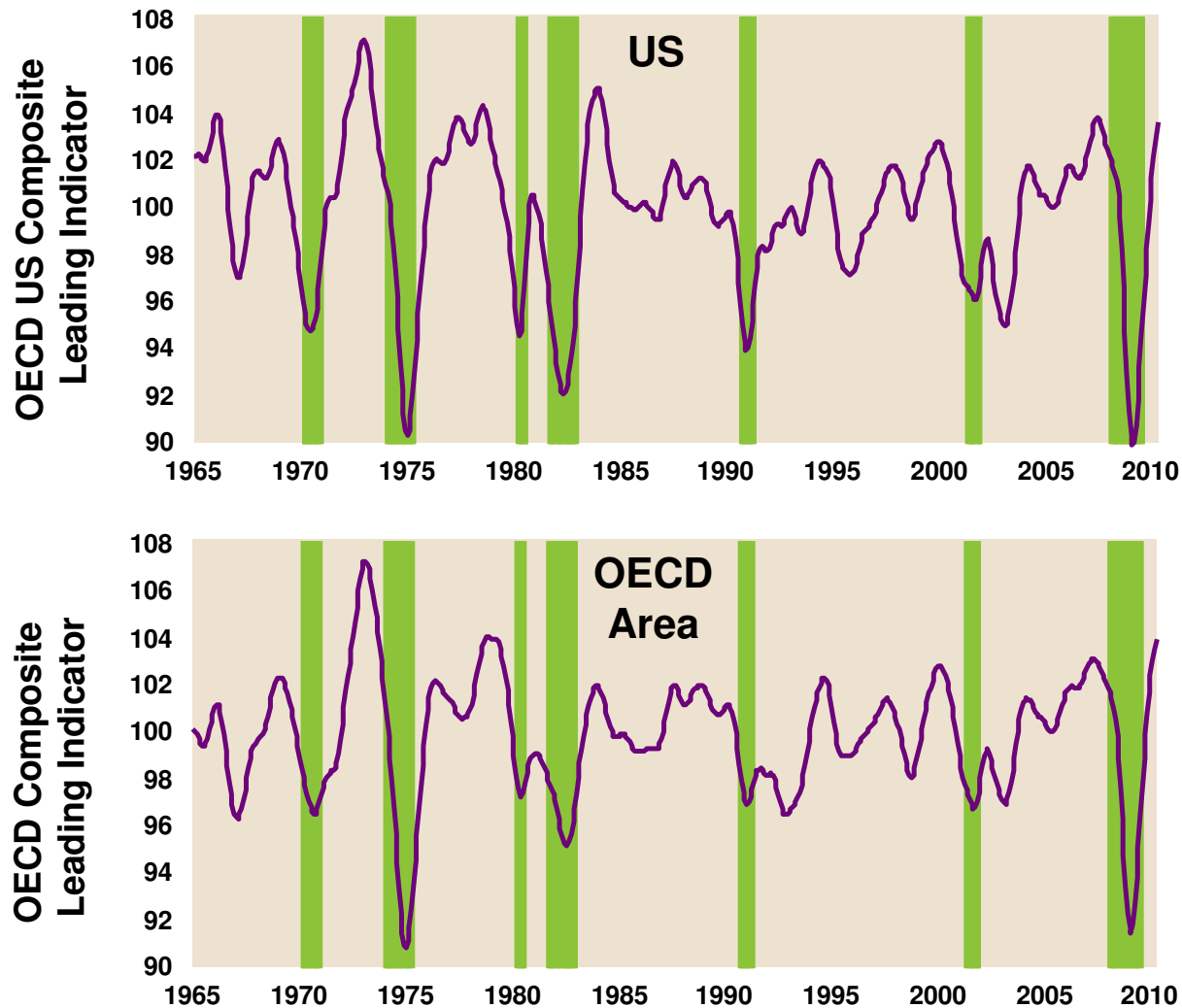
- Debt bubble has shifted from private to public sector globally
- Greece/contagion in Europe
- Heightened volatility/high-frequency trading/“flash crash”
- Latest jobs report a dud
- Deflation concerns re-emerging
- Fledgling real estate recovery
- US leading indicators recently peaked
- China’s leading indicators peaked last fall
- Government intervention (rising taxes, protectionism & regulation)
- Earnings estimates being pared back
- Anti-Wall Street sentiment

The Bull Case

- Unprecedented global stimulus (1-2 year lag typically)
- Coiled springs for inventories, production, consumption & employment
- Pent-up demand (consumer & business)
- Wall of worry is back
- Credit markets back to pre-Lehman levels
- Steep yield curve
- Booming corporate profits and productivity
- Record positive spread between corporate cash & capital spending
- Reasonable valuation
- Tame inflation
- Oversold stock market

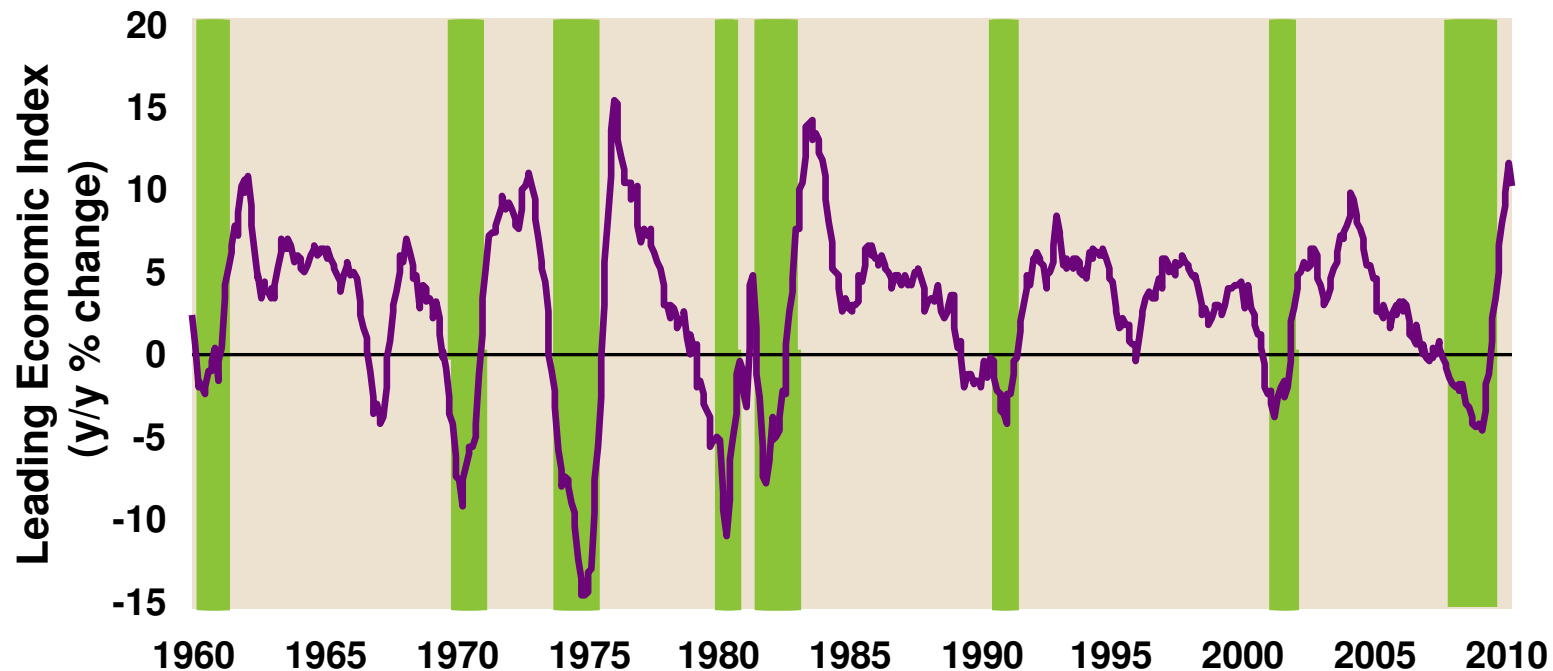
Global Economy in V-Shaped Recovery

But Where Do We Go From Here?



US Leading Indicators Rolling Over?

Contributing to Heightened Market Volatility



Improving

- new orders-capital goods
- interest rate spread

Stable

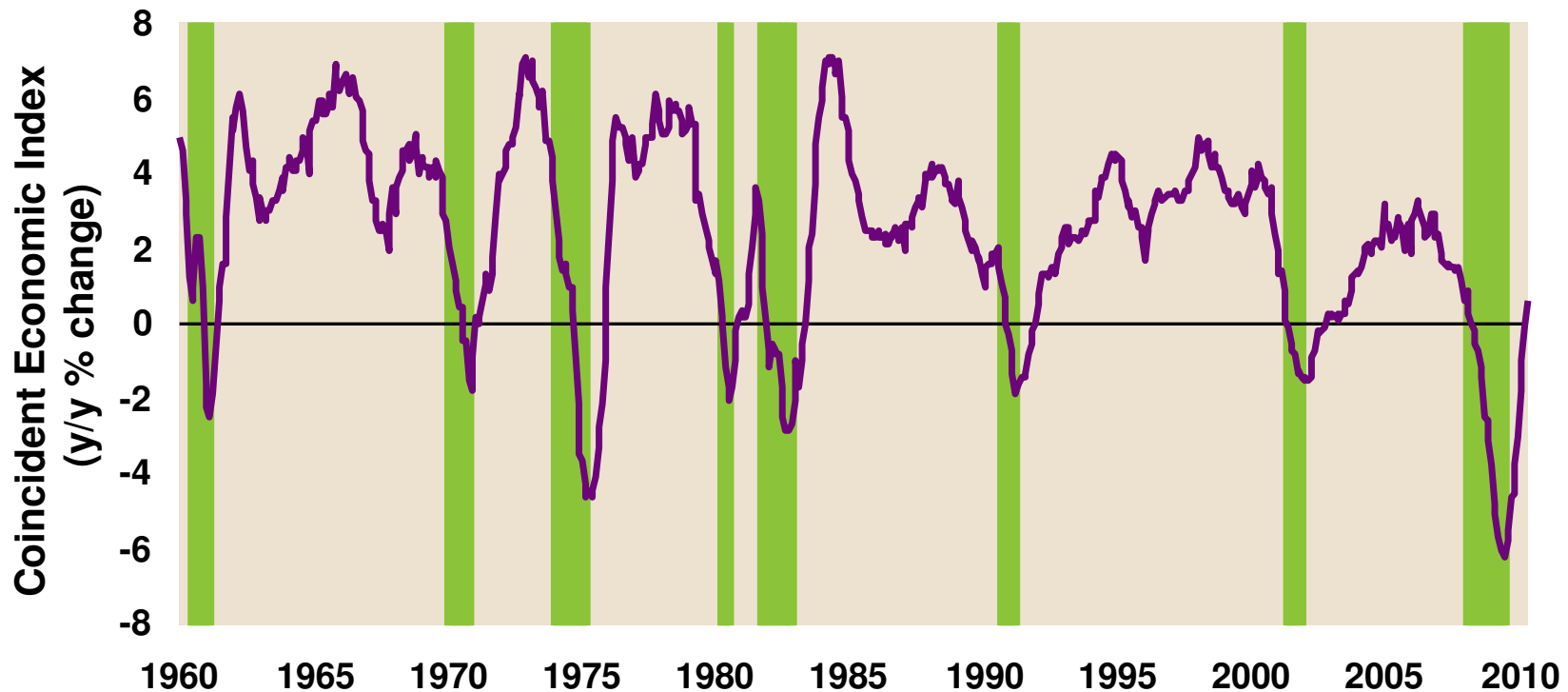
- average workweek
- money supply
- consumer expectations

Worsening

- unemployment claims
- new orders– consumer
- vendor performance
- building permits
- stocks

Coincident Indicators Up 10 Consecutive Months

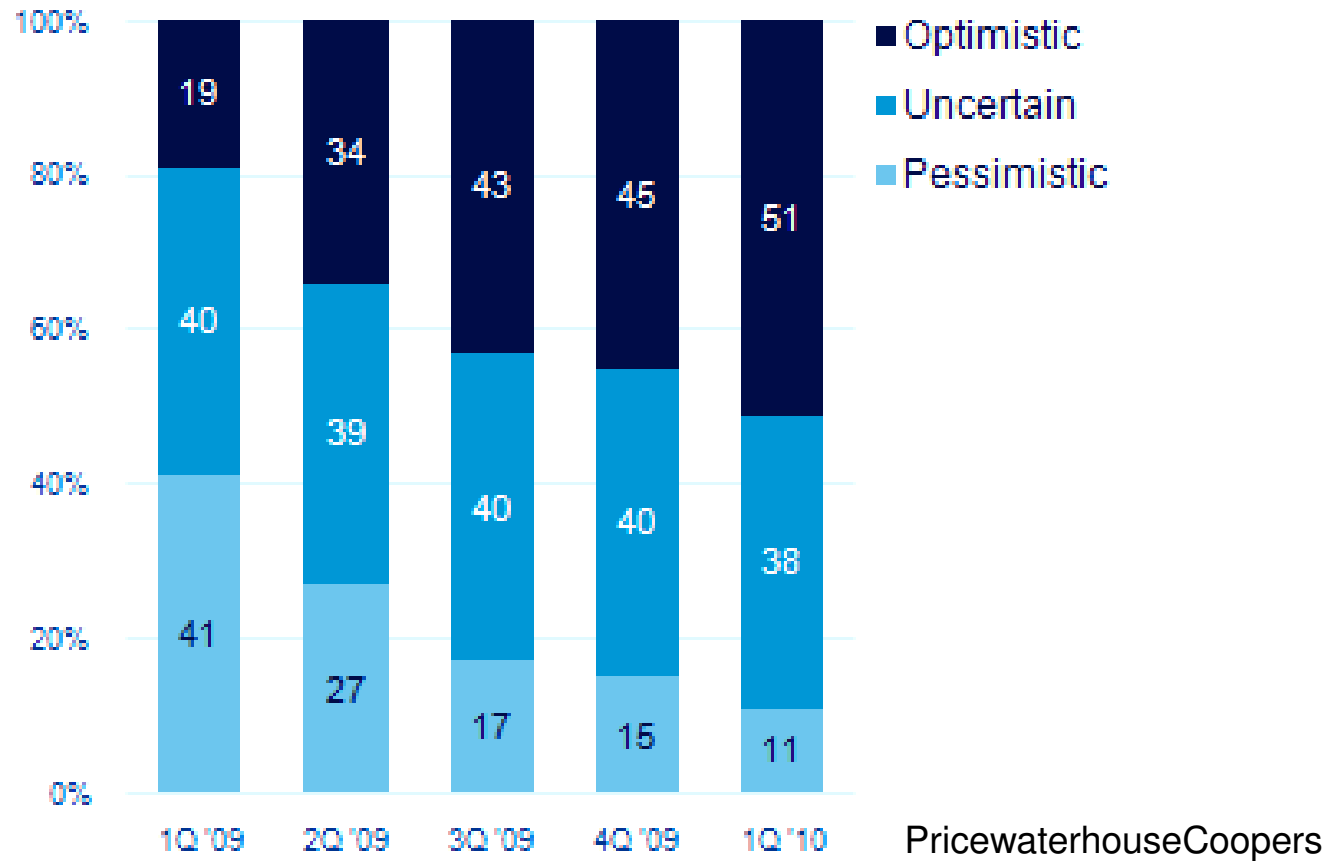
Now in Positive Territory



- 1) real manufacturing & trade sales: fair but improving
- 2) industrial production: strong & improving
- 3) personal income less transfer payments: weak but improving
- 4) payrolls: fair but improving

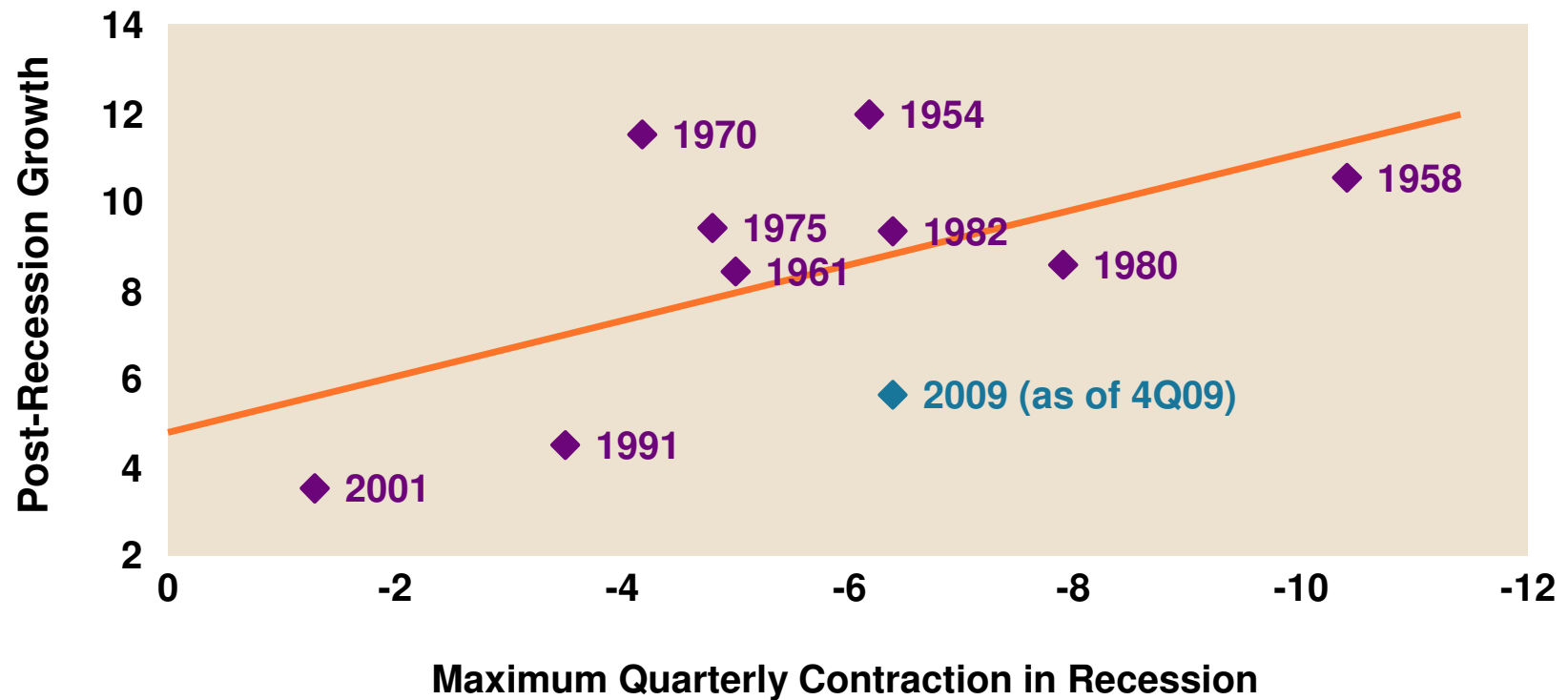
Optimism Surges But Uncertainty Persists

Looking ahead at the next 12 months, how do you feel about the prospects for the US economy?



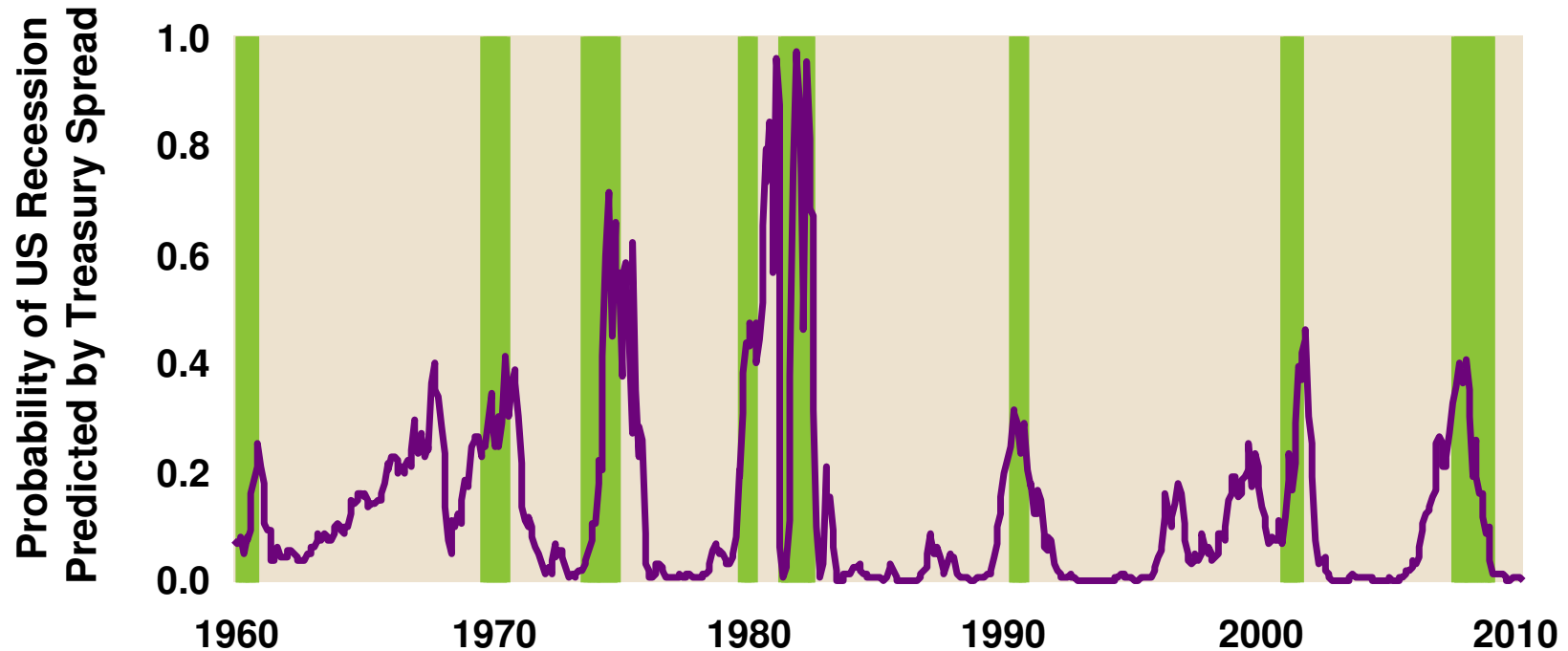
Sub-Par Recovery So Far

Sharp Recoveries After Sharp Recessions...Until Latest 3 Periods



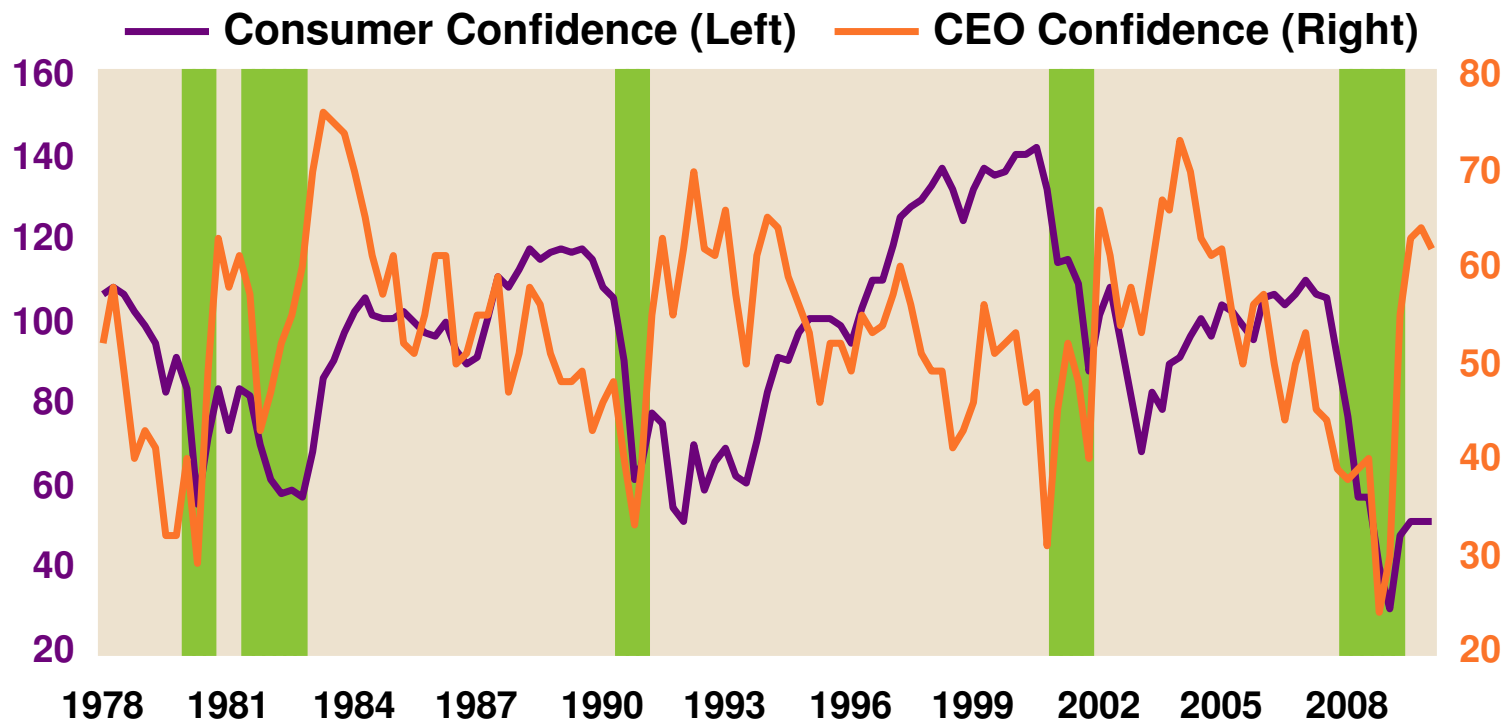
Positive Yield Spread Predicts No Double-Dip

Fed Rate Hikes Likely Pushed to 2011



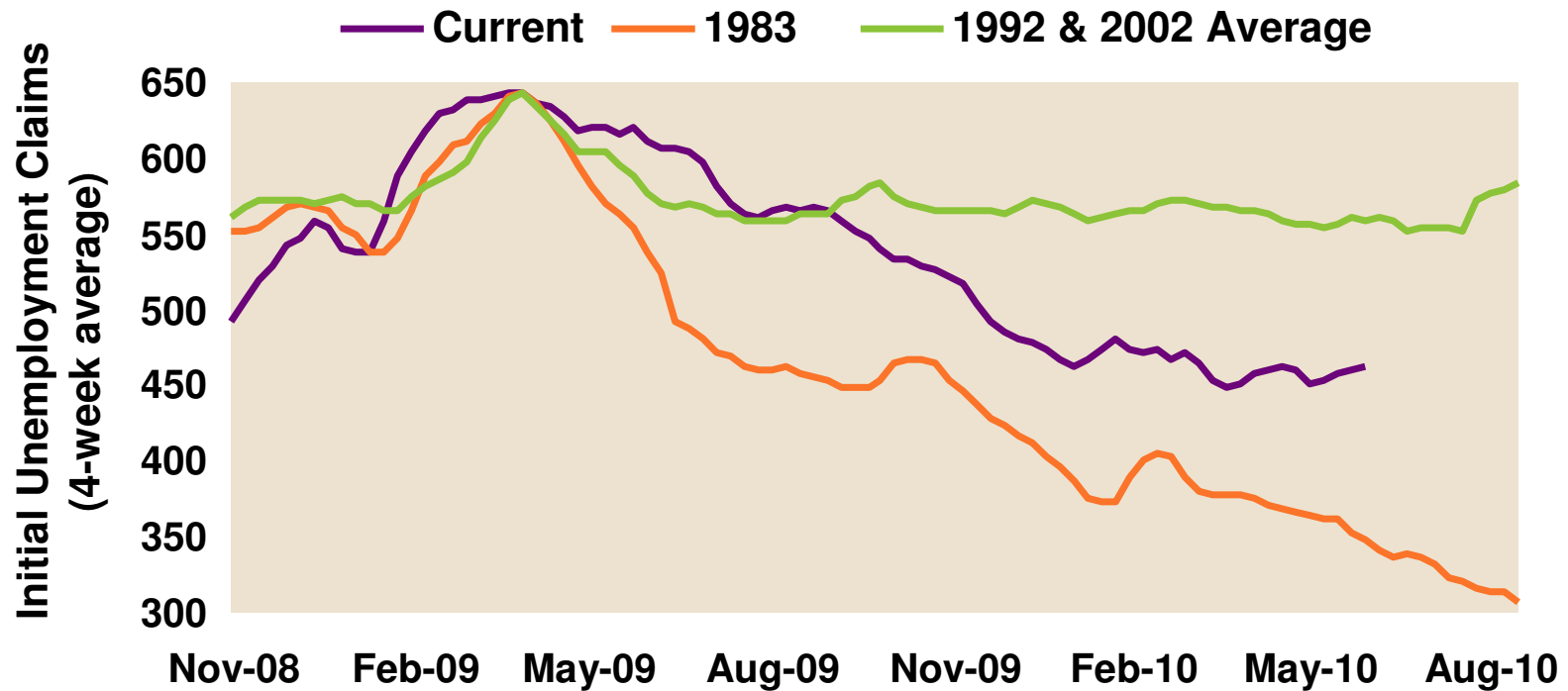
Consumer & Business Confidence Mirror Images

Consumer Confidence Typically Grows With Recovery; Business Leads



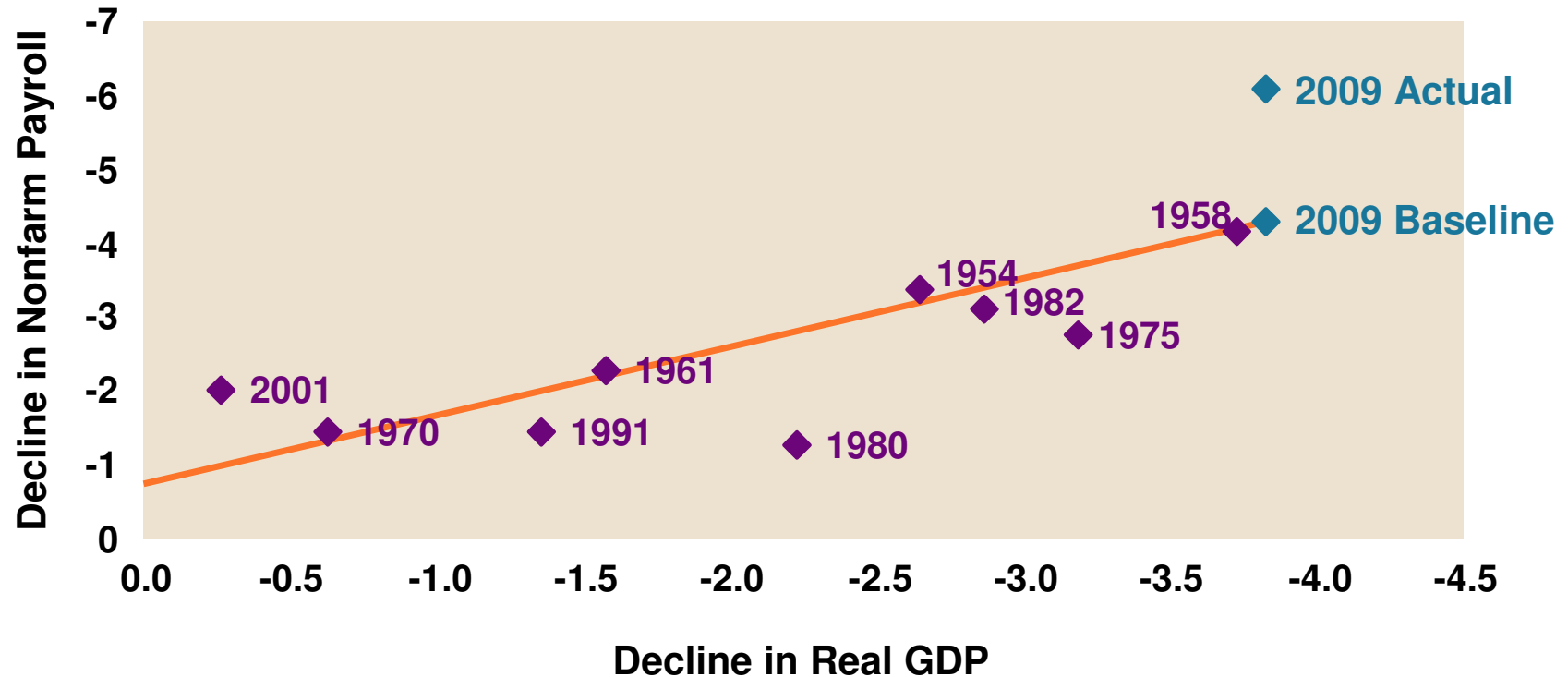
Claims' Drop Has Lost Some Momentum

But Still Better Than Two Prior "Jobless" Recoveries



Coiled Spring for Employment?

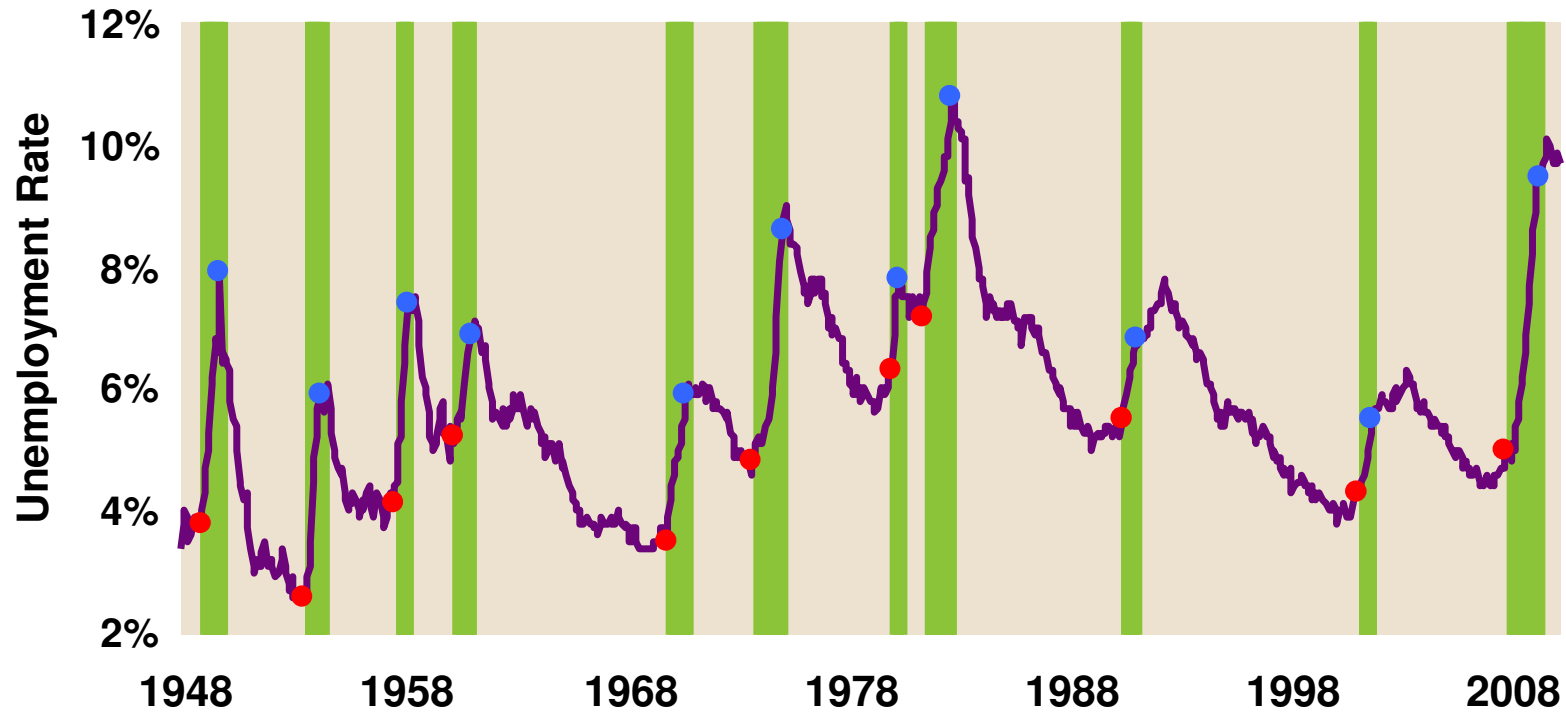
Reflected Armageddon Possibility, Not Deep Recession Reality



Baseline = -4.3% but actual = -6.1% in anticipation of Armageddon

Unemployment Rate Lags Big Time

Low When Recessions Begin ... High/Usually Rising When They End



6-month average lag between recession end and unemployment rate peak

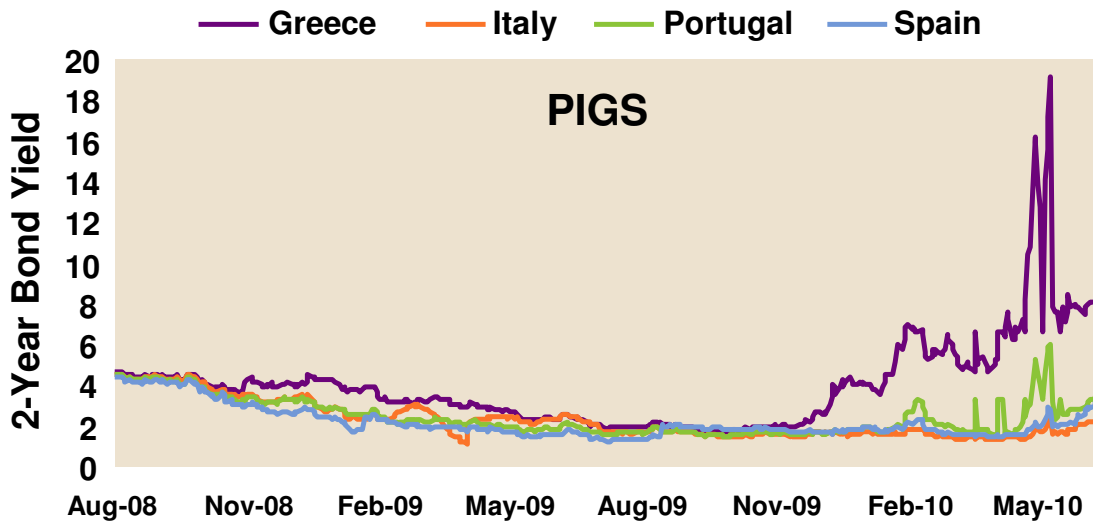
Greece Debt Crisis Rocks Europe

But US Less Exposed

Estimated European Bank Foreign Exposure to Public Debt (\$, billions)						
	Greece	Italy	Portugal	Spain	Total	Total as % of GDP
Bank Nationality:						
France	35	208	11	31	285	40.3
Germany	20	78	12	35	145	16.1
Spain	1	19	21	-	41	10.6
Switzerland	2	8	1	3	14	10.7
UK	7	31	6	16	60	10.4
Other Europe	22	74	8	37	141	
Total European Banks	87	418	59	122	686	
US	7	22	1	9	39	0.3

Spreads in Greece Skyrocket

While TED Spread Remains Subdued



Debt as % of GDP

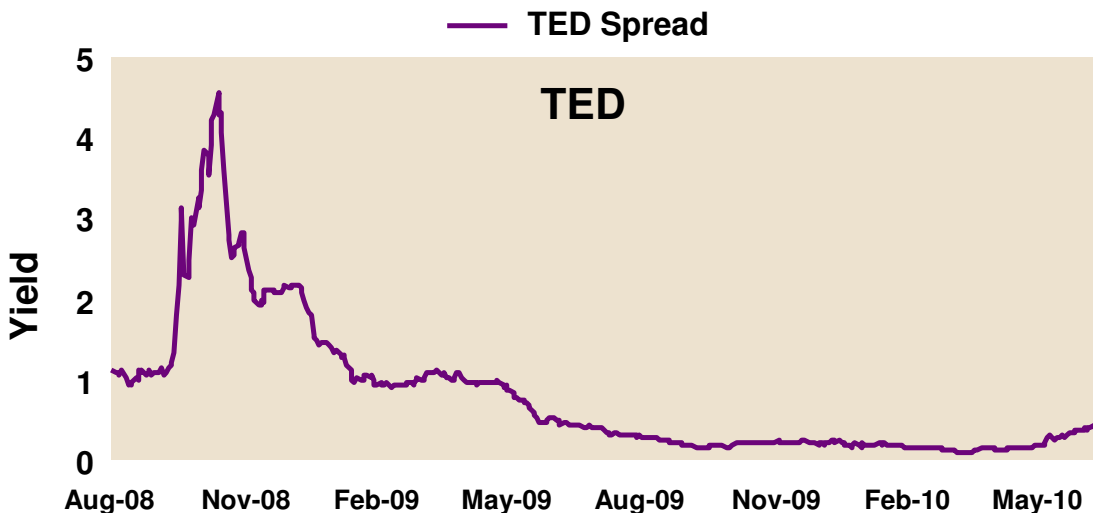
Greece: 124%

Italy: 119%

Portugal: 86%

Spain: 67%

US: 93%



TED spread: difference between 3-month T-bill yield and 3-month LIBOR ... indicator of perceived credit risk in the general economy

Debt's Growth as GDP-Driver

Over \$5 of Debt to Produce \$1 of GDP...Not Sustainable!

Diminishing Returns from Debt-Financing by Decade			
Date Range	Decade Change in Debt (\$, billions)	Decade Change in GDP (\$, billions)	Debt/GDP
12/31/49-12/31/59	337.6	248.0	1.36
12/31/59-12/31/69	752.1	491.3	1.53
12/31/69-12/31/79	2,785.2	1,654.9	1.68
12/31/79-12/31/89	8,562.8	2,922.3	2.93
12/31/89-12/31/99	12,550.0	4,026.0	3.12
12/31/99-12/31/09	26,939.2	4,846.1	5.56

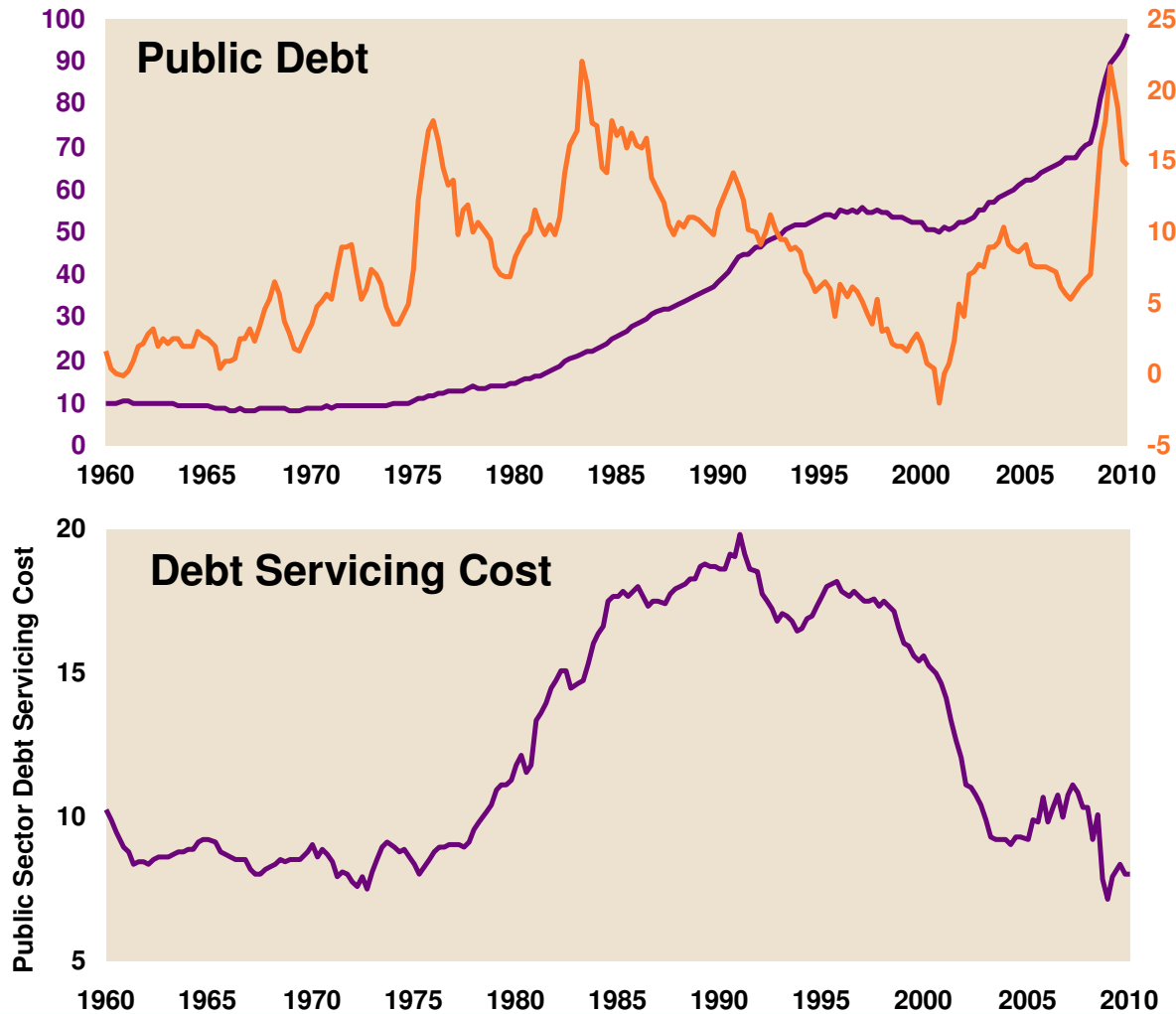
90% Debt/GDP = Threshold Above Which GDP Suffers

US Federal Debt Presently 93%

Real GDP Growth as Level of Government Debt Varies				
Select Advanced Economies (1790-2009)				
	Central (Federal) Government Debt/GDP			
	Below 30%	30% - 60%	60% - 90%	90% and Above
Average	3.7	3.0	3.4	1.7
Median	3.9	3.1	2.8	1.9
# of Observations	866	654	445	352
Select Emerging Market Economies (1900-2009)				
	Central (Federal) Government Debt/GDP			
	Below 30%	30% - 60%	60% - 90%	90% and Above
Average	4.3	4.1	4.2	1.0
Median	4.5	4.4	4.5	2.9
# of Observations	686	450	148	113

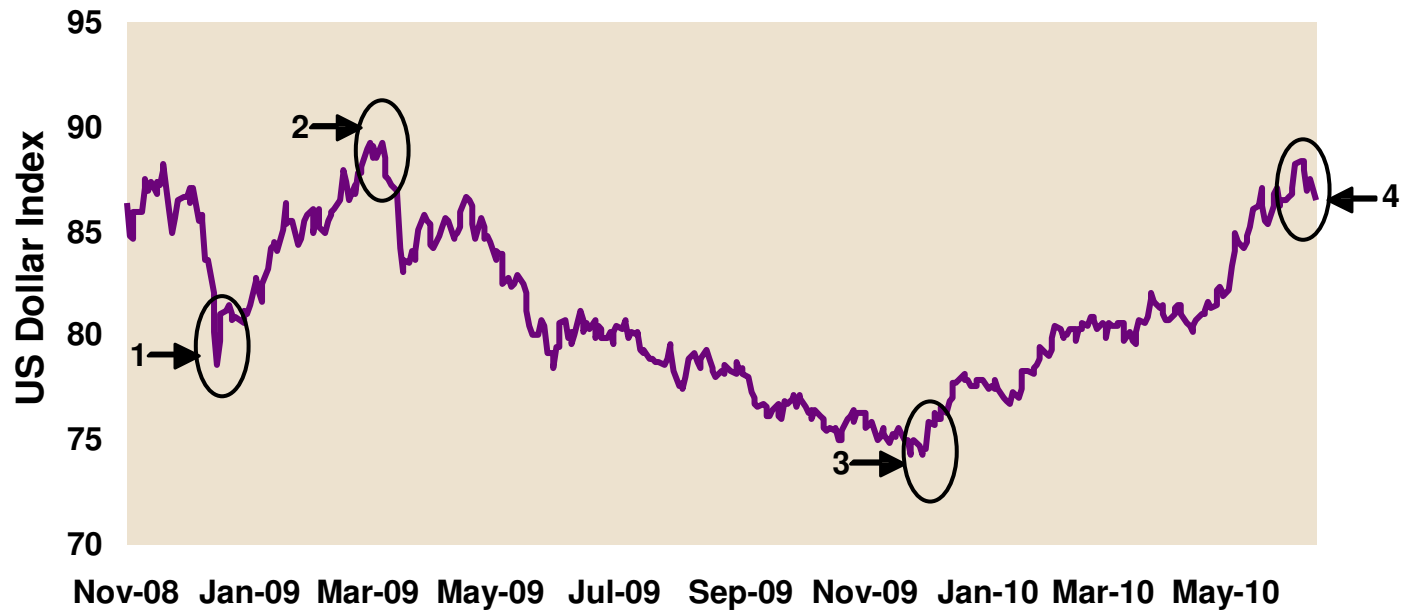
Public Debt's Surged, Though Growth Rate Waning But For Now, Costs of Debt Servicing Remain Low

— Public Debt as % of Real GDP (Left) — Public Debt, annual growth rate (Right)



Dollar & Risk Assets Inversely Correlated During Crisis

Risk Assets' Performance More Mixed During Latest Dollar Rally

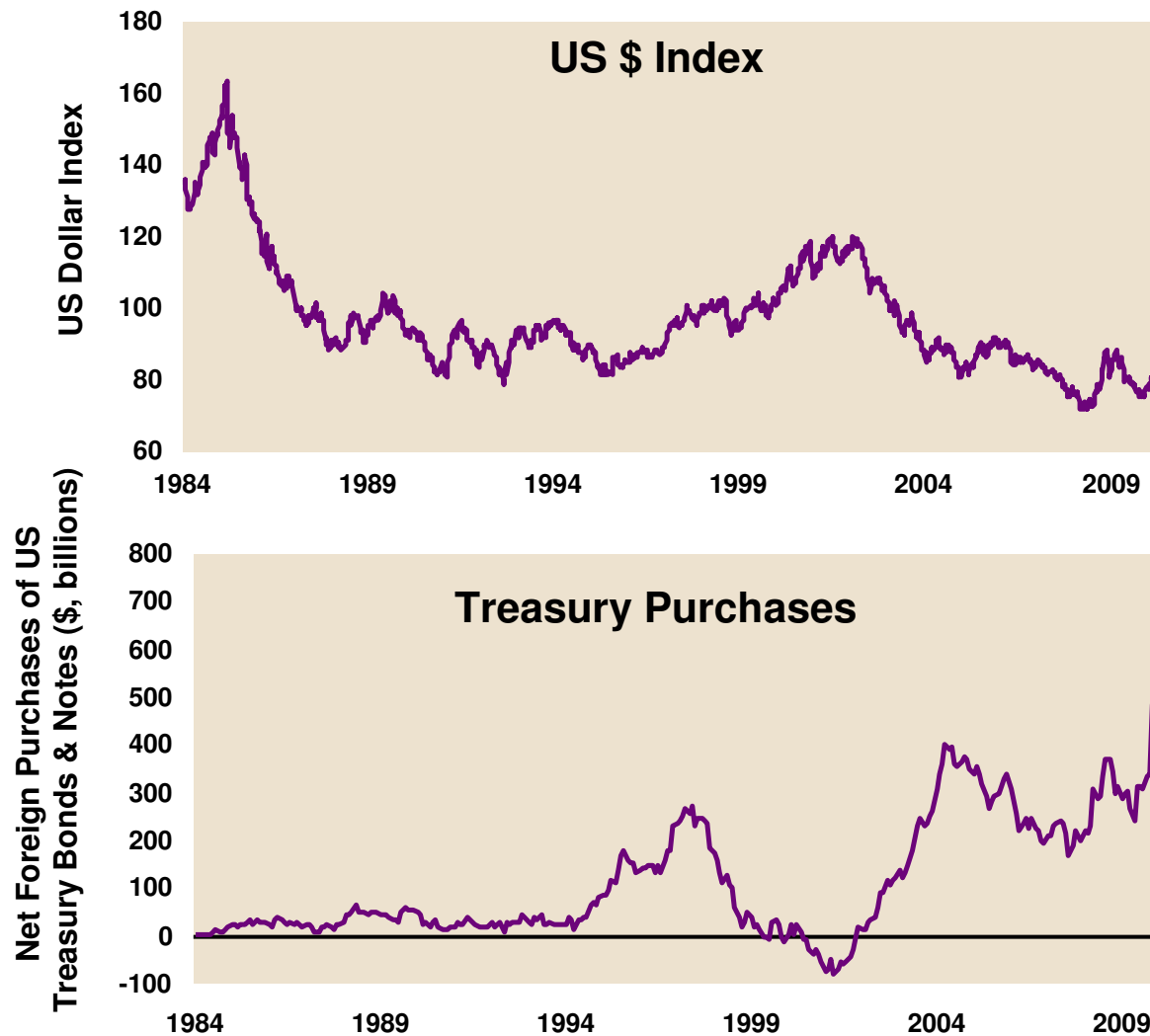


	1-2: Trough-to-Peak	2-3: Peak-to-Trough	3-4: Trough-to-Present
Gold	6.2%	27.7%	3.7%
Emerging Markets	-17.2%	101.7%	-4.9%
CRB	-7.9%	33.6%	-6.6%
S&P 500	-25.2%	64.2%	-1.9%
NASDAQ	-19.7%	71.5%	3.1%
Junk Bonds	5.2%	45.9%	1.3%

1-2=12/17/08-3/9/09 performance. 2-3=3/9/09-11/25/09 performance. 3-4=11/25/09-6/14/10 performance. Emerging markets based on Morgan Stanley Capital International Emerging Markets Index. CRB (Commodity Research Bureau) based on Reuters/Jefferies-CRB Index. Junk bonds based on Barclays Capital U.S. Corporate High Yield index. Source: Barclays Capital, FactSet, New York Board of Trade (NYBOT).

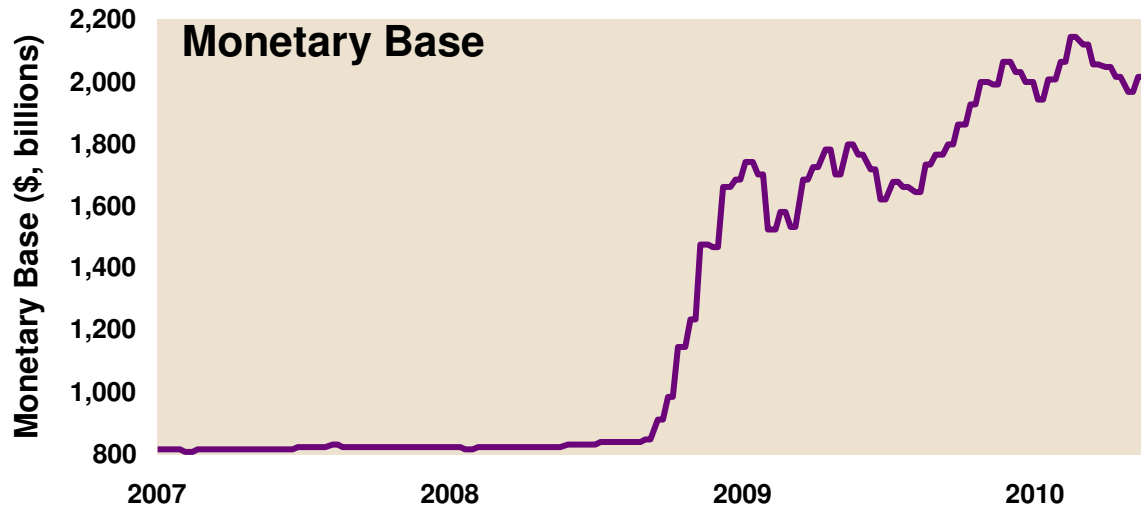
Foreigners Flocking to US Dollar Assets

Safe-Haven Status of US Treasuries Comes Roaring Back

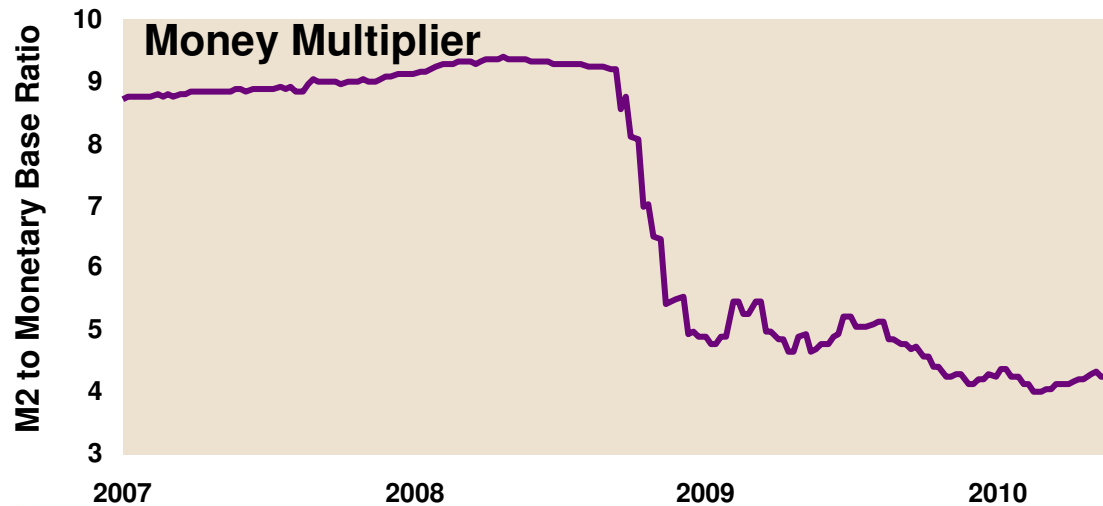


Inflation Not a Threat With No Velocity of Money

Until Then, Deflation's the Bigger Threat



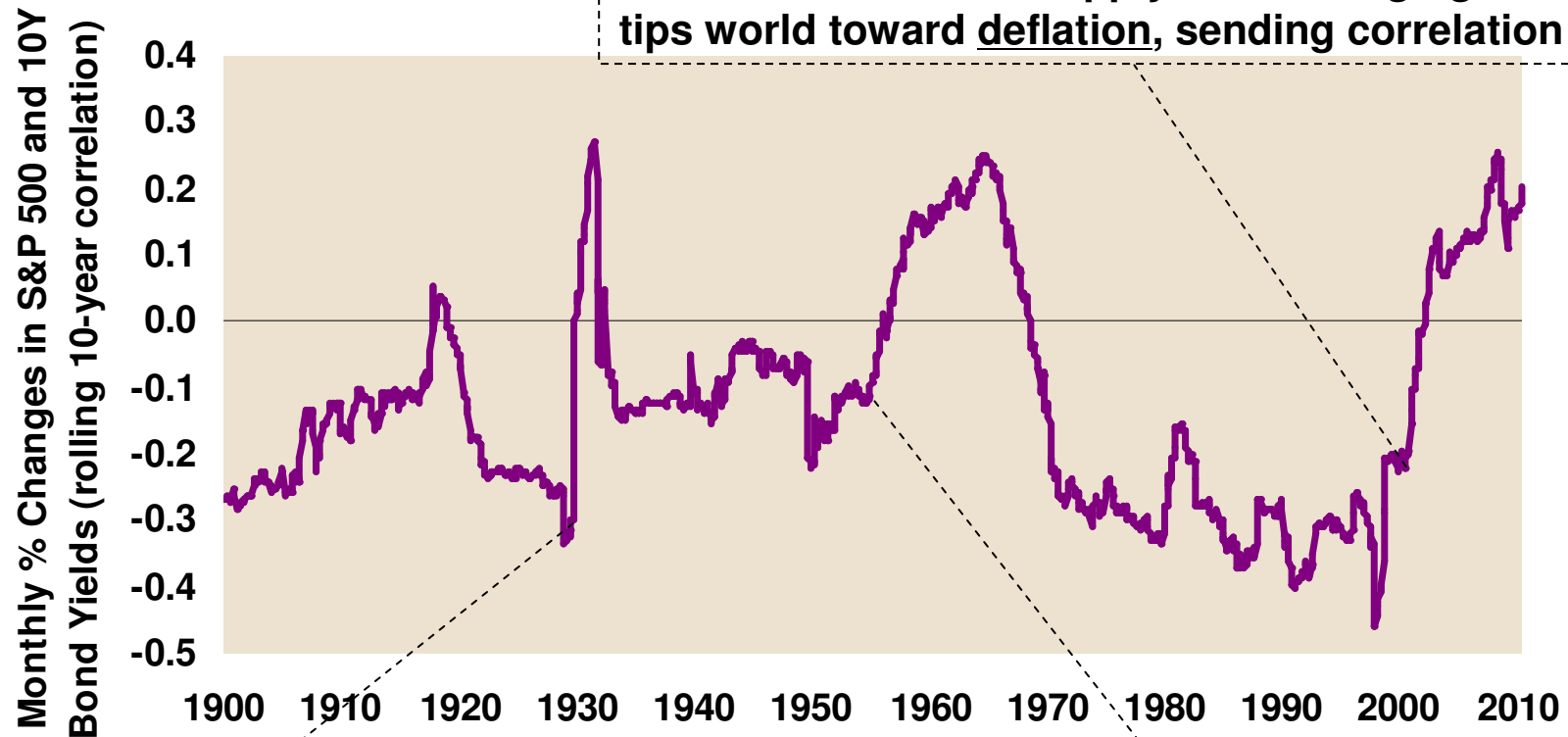
Fed flooded system



But “velocity” of money remains depressed

Bond Yields & Stock Prices Positively Correlated

Typical of Post-Deflation Eras



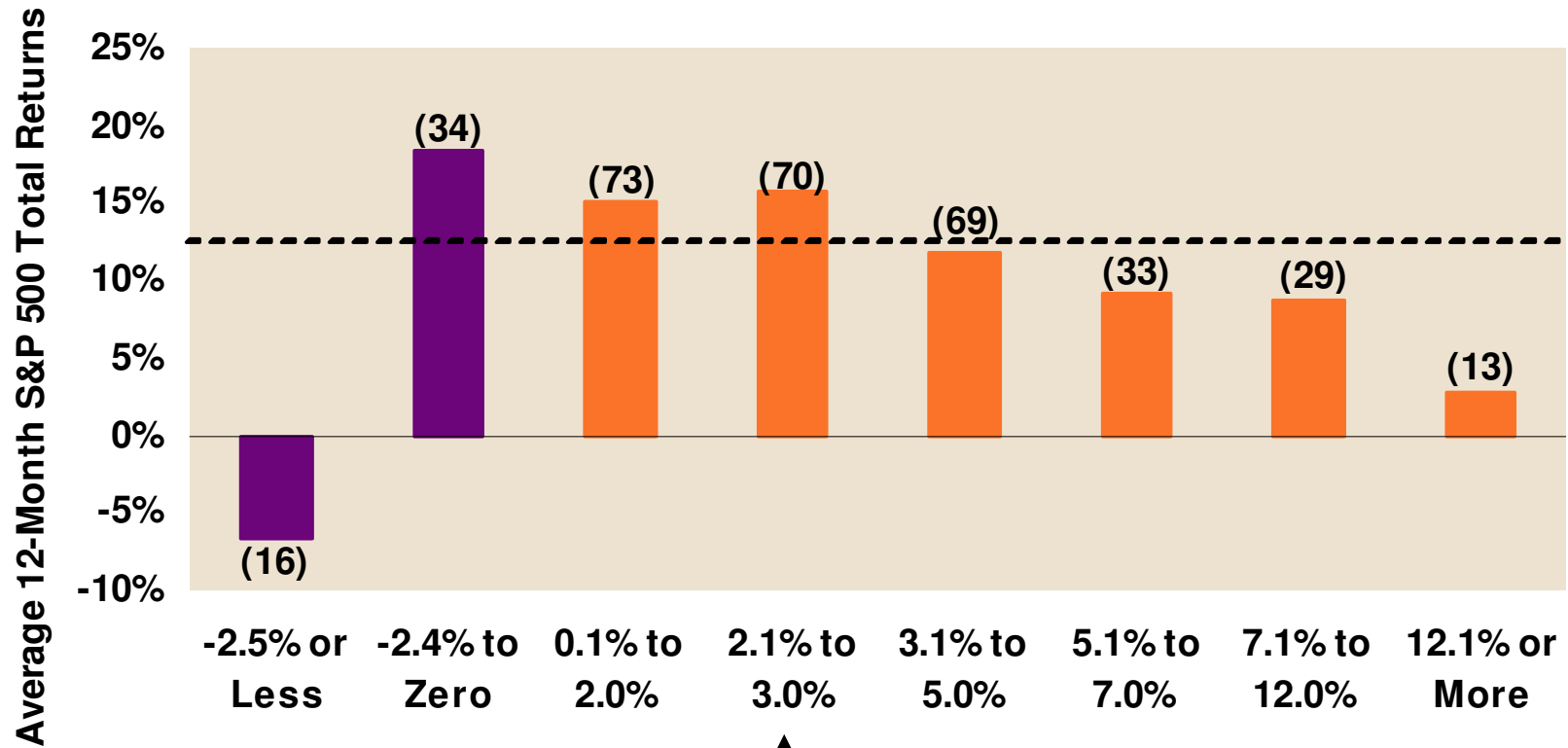
Since 1990s: excess supply from emerging markets tips world toward deflation, sending correlation up

Correlation surged at onset of deflationary 1930s

Correlation moved up in 1950s after post-WWII inflation finally broken

Stocks Dislike Both Severe Deflation and Hyper-Inflation...

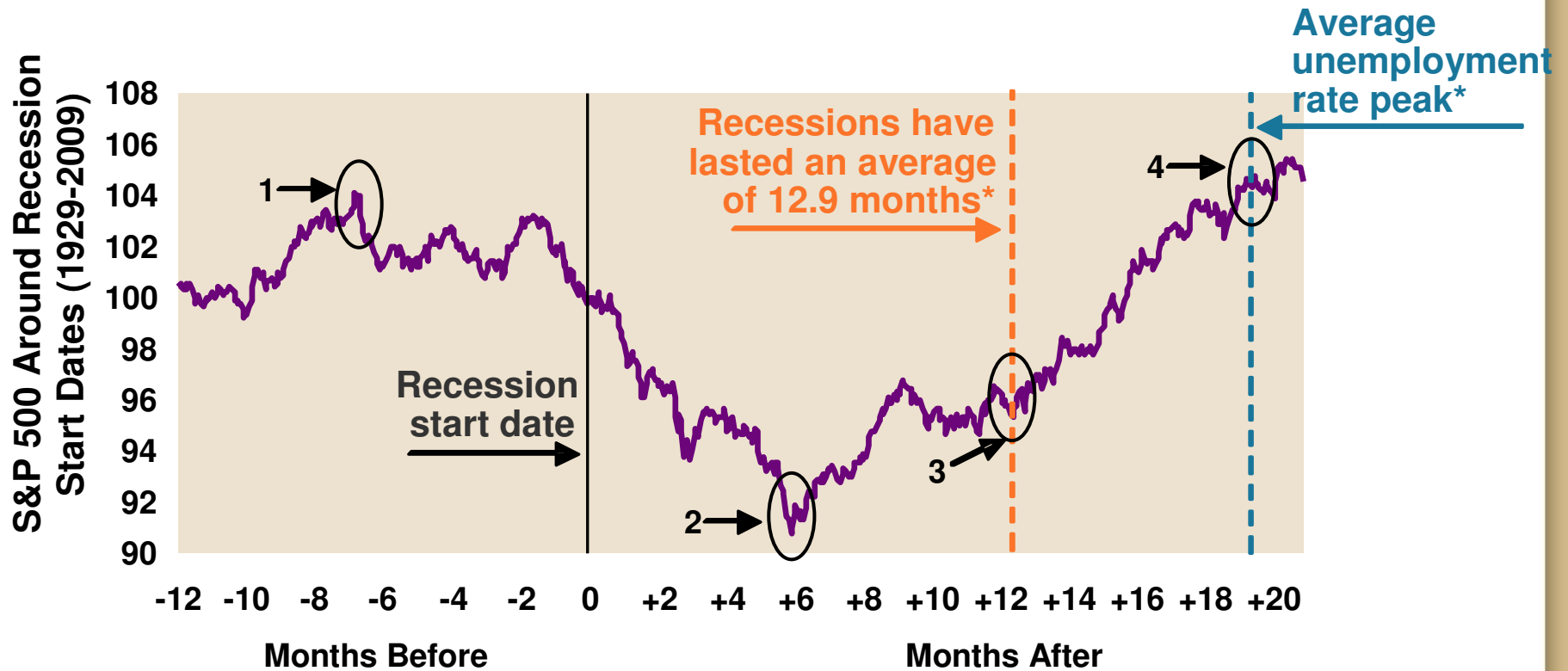
...But Love Mild Deflation



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Stocks Typically Lead Economy

Bull Markets Often Born in Recessions



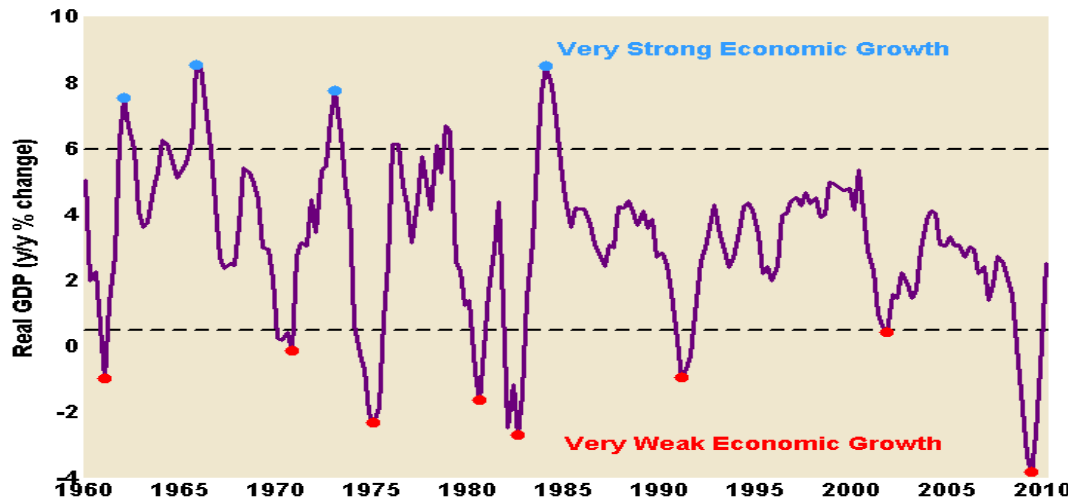
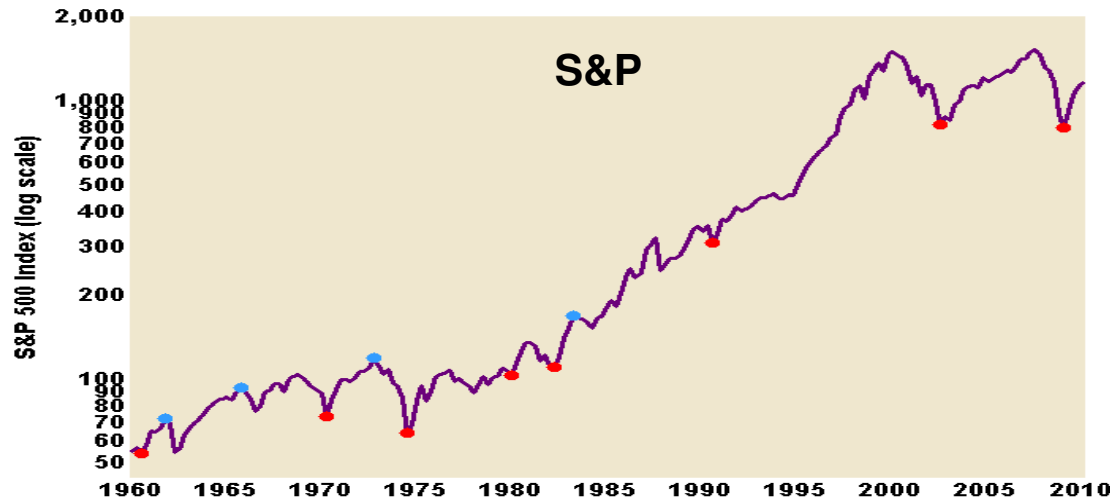
1-2: Peak-to-trough average decline = 32% (10/07-3/09 = 57%)

2-3: Trough-to-recession end average gain = 25% (3/09-6/09 = 36%)

3-4: Recession end to unemployment rate peak average gain = 16% (6/09-10/09 = 19%)

Stocks Typically Lead Economy

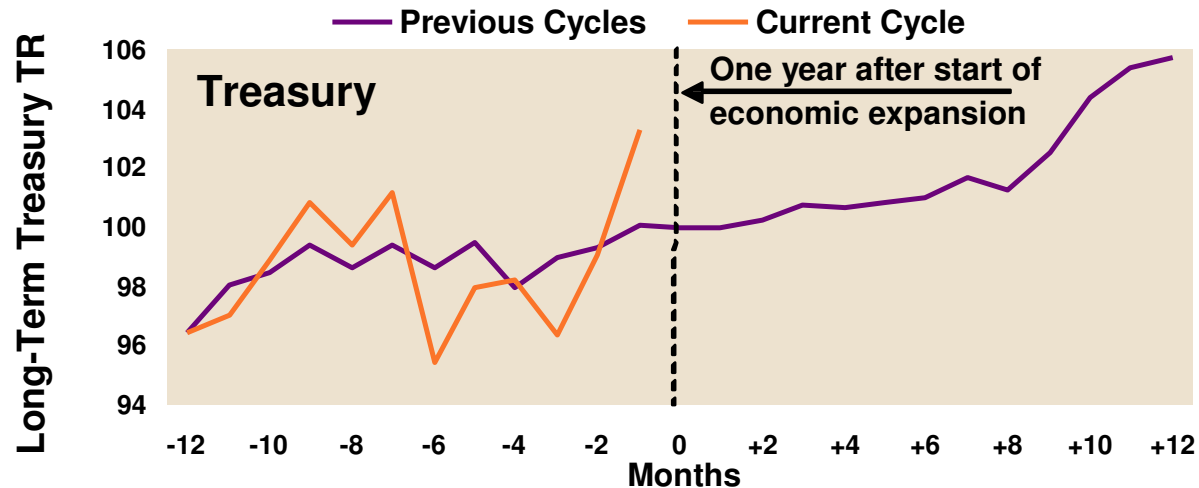
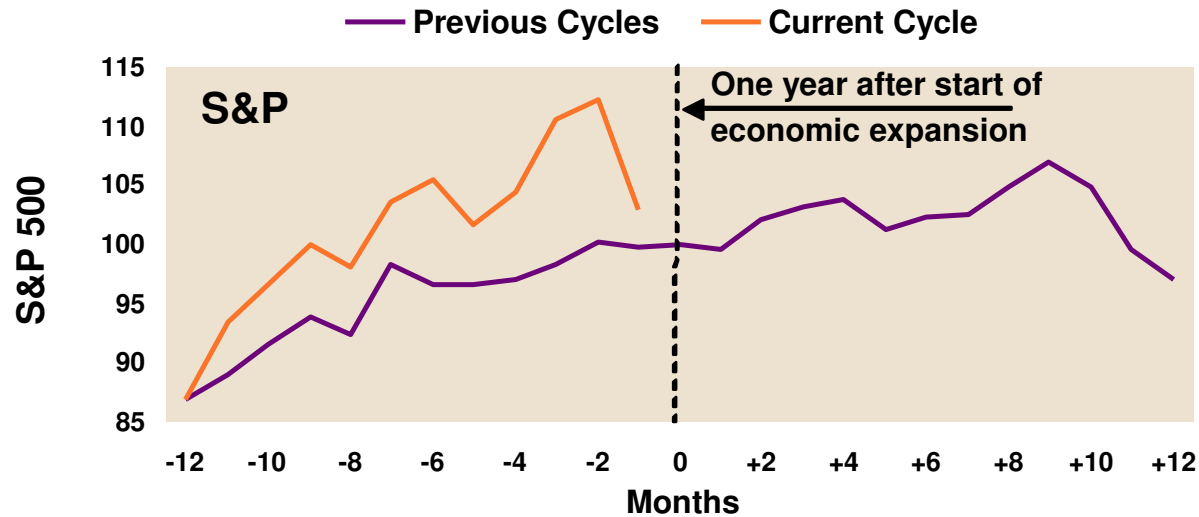
Market “Likes” Weak, Not Strong Growth



3/31/1960-3/31/2010	
Y/Y % Change of Real GDP	S&P 500 Annualized Gain
> 6.0	-4.6%
0.5-6.0	7.1%
< 0.5	10.5%

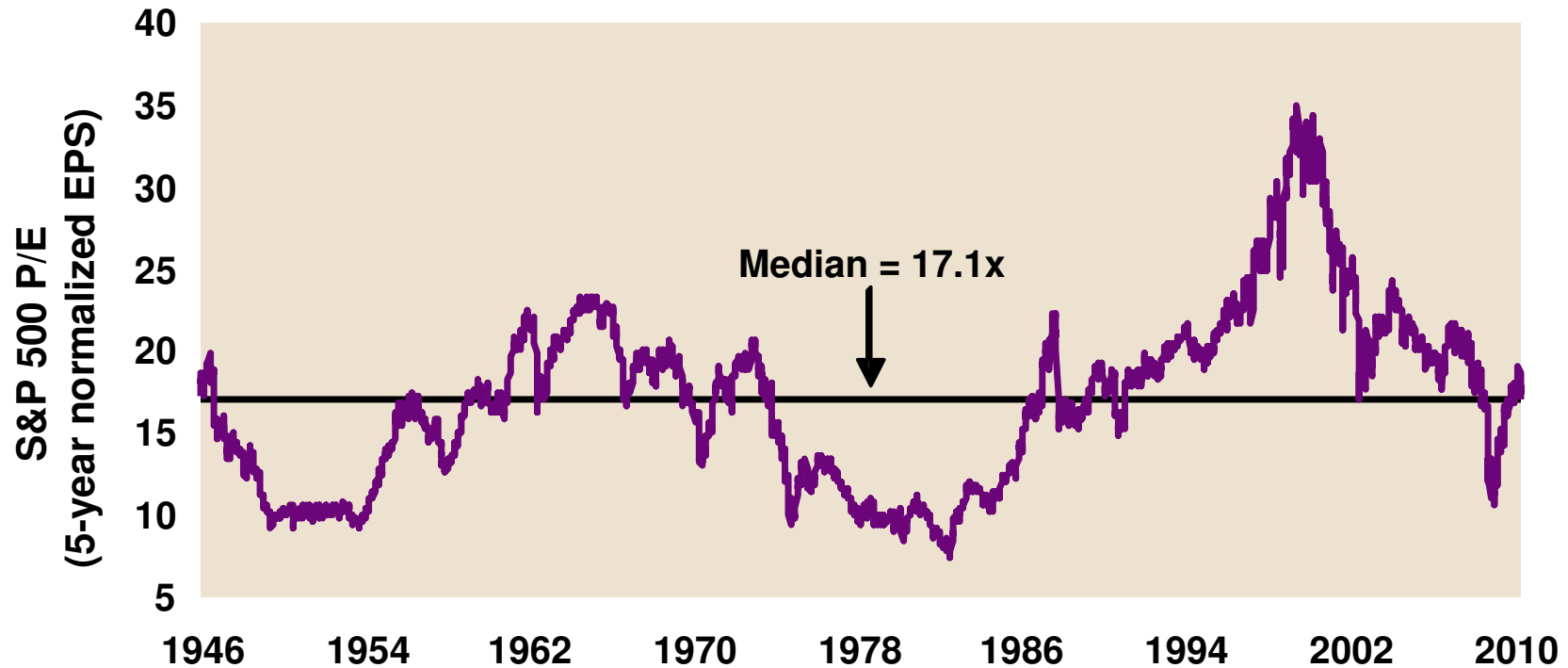
How Has Current Market Fared Relative to History?

Stocks Back Toward “Norm” While Bonds May Be Extended



Market Trading at Median Valuation

Earnings Growth Remains Healthy While Market Corrects



Current Normalized P/E @ 17.2

Moderate Inflation Supports Highest Valuation

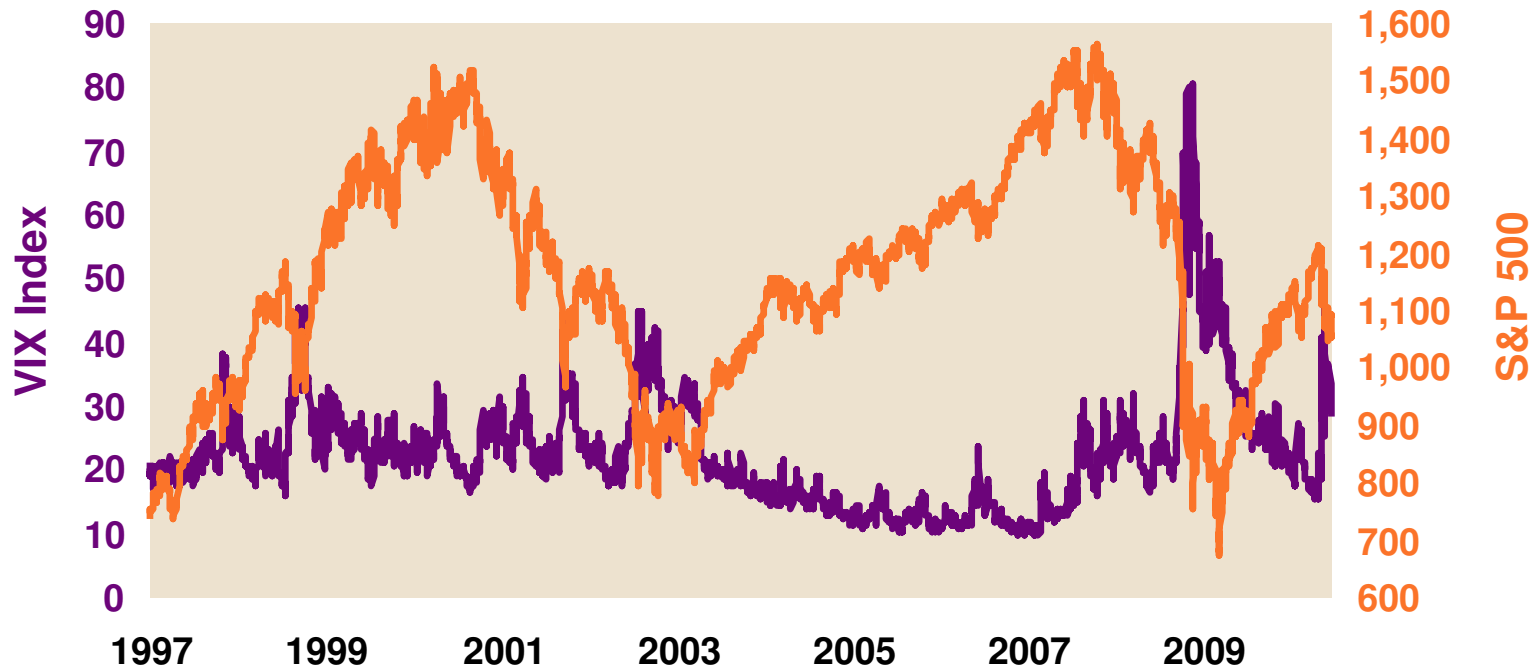
Market is Presently in Valuation Sweet Spot

1946-4/2010			
Inflation	Average P/E	Peak P/E	Trough P/E
< 0%	12.6	17.1	9.3
0 – 1%	14.5	22.5	9.2
1 – 2 %	19.8	32.6	9.2
You are here → 2 – 3%	20.6	35.1	9.7
3 – 4%	18.7	34.4	9.7
4 – 5%	16.8	22.4	9.6
5 – 6%	15.9	19.8	7.4
6 – 7%	12.2	18.1	7.7
>7%	11.9	19.1	7.9

Current Normalized P/E @ 17.2

Volatility as a Sentiment Indicator?

Spikes Historically Often Come at Short-Term Market Lows



12/31/1996-6/14/2010	
VIX Index	S&P 500 Annualized Gain
> 28.5	37.8%
21.5-28.5	-1.1%
< 21.5	-4.3%

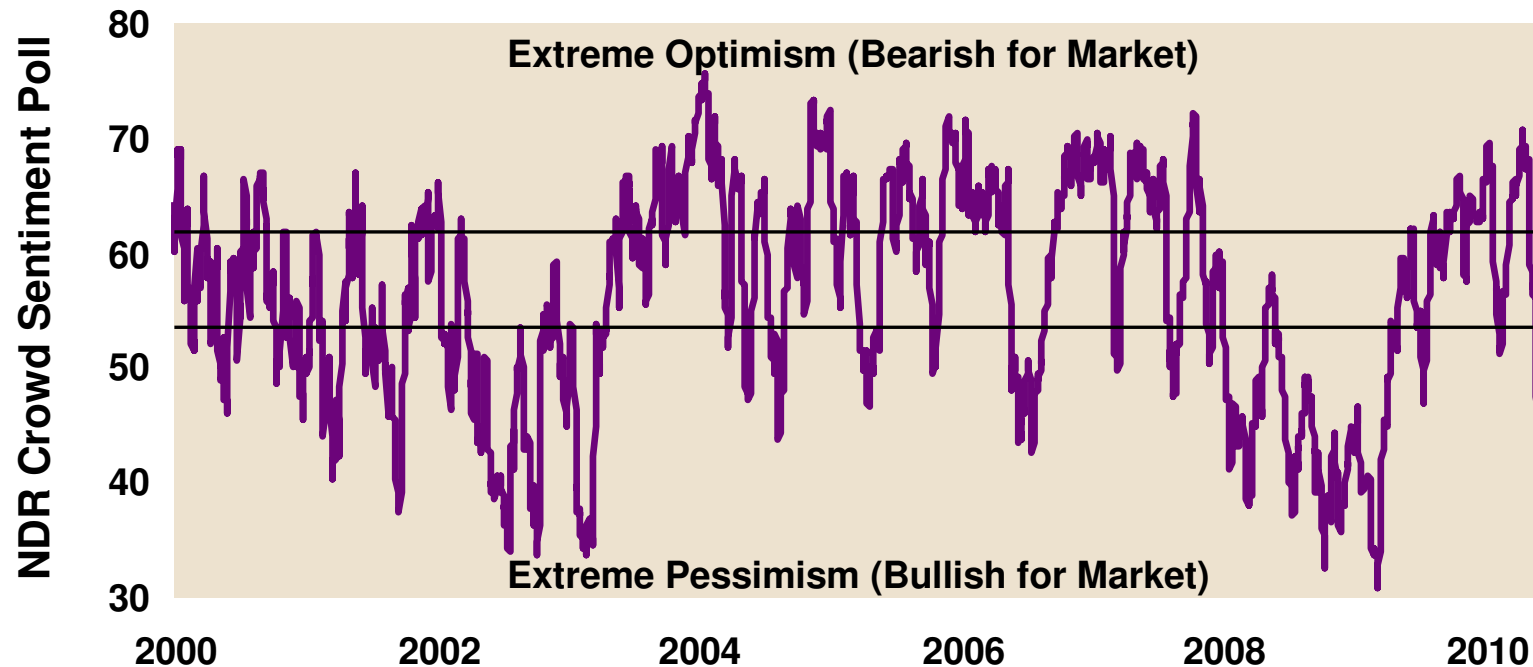
Uncertainty is Running Rampant

It's No Wonder So is Market Volatility!

ISI's Institutional Investors Consensus			
	Average	Low	High
S&P 500 (December 2011)	1,156	887	1,400
How many jobs will be created in the next 12 months?	1.3m	0m	6m
How much will home prices change in 2011?	3%	-12%	15%

Sentiment Moving Swiftly With Market

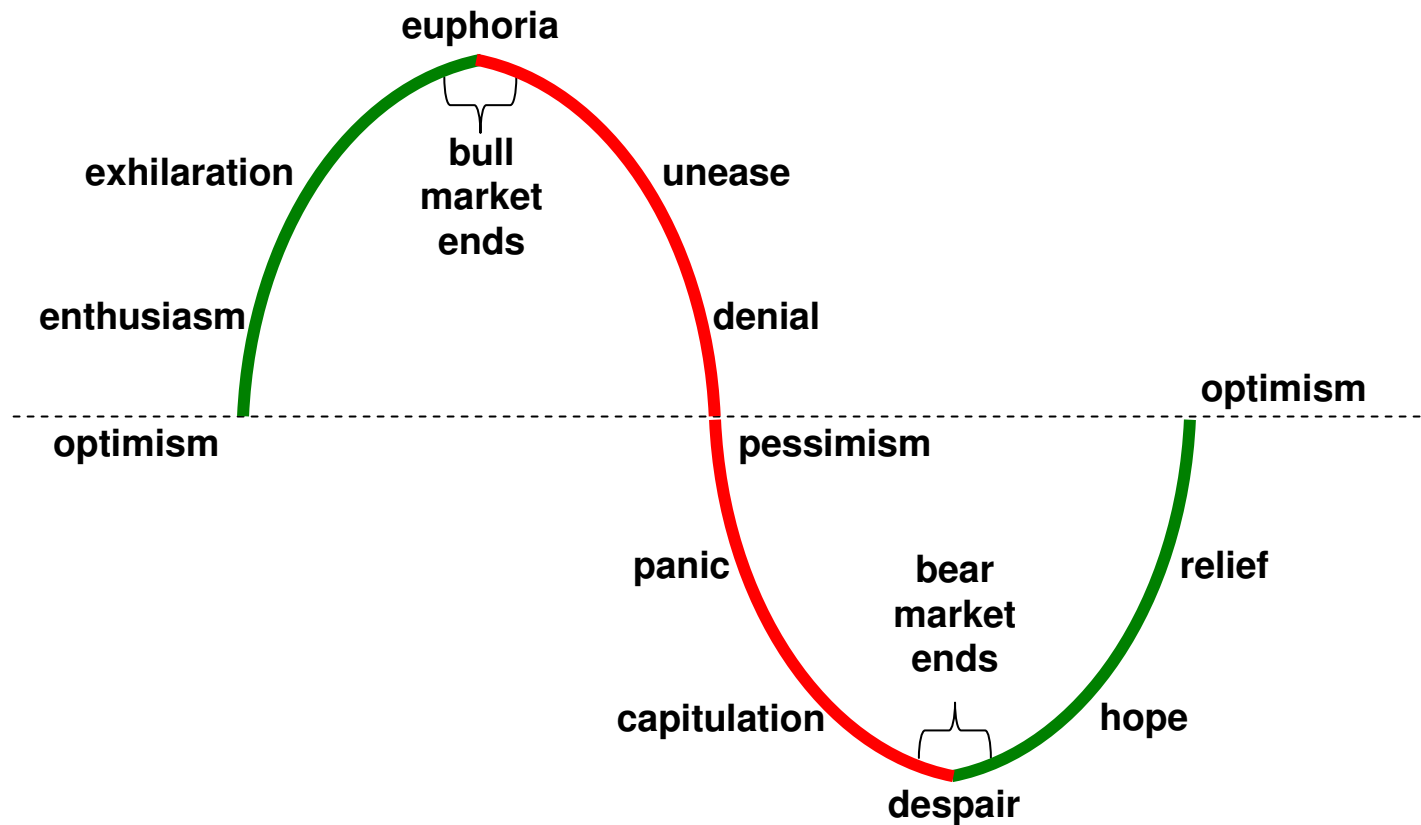
Optimism Came Quickly Off the Boil



12/1/1995-6/8/2010	
NDR Crowd Sentiment Poll	S&P 500 Annualized Gain
> 62	-2.2%
56-62	6.1%
< 56	8.3%

Market's Emotional Roller Coaster

Maintaining Discipline = Key to Long-Term Success



Disclosures

The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision.

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Examples provided are for illustrative purposes only and not intended to be reflective of results you should expect to attain.

Definitions

Indexes are unmanaged, do not incur management fees, costs and expenses (or "transaction fees or other related expenses"), and cannot be invested in directly.

The Dow Jones Industrial Average (DJIA, "The Dow") is a price-weighted average of 30 actively traded blue chip stocks, primarily industrials and is the oldest and most widely quoted of all the market indicators.

The S&P 500 Index is a capitalization-weighted index of 500 stocks from a broad range of industries. The component stocks are weighted according to the total market value of their outstanding shares.

Terms

Asset Allocation - The strategy of spreading your investment funds across categories of assets such as stocks, bonds and cash investments to help offset risks and rewards, based on your goals, time horizon and risk tolerance.

Ned Davis Research (NDR) Crowd Sentiment Poll - Shows perspective on a composite sentiment indicator designed to highlight short- to intermediate-term swings in investor psychology. It's based on seven different individual sentiment indicators in order to represent the psychology of a broad array of investors.

Recession - As per National Bureau of Economic Research (NBER), a recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.