$80/YEAR

DeWolf Associates Forecast Letter

Looking at Leading Indicators

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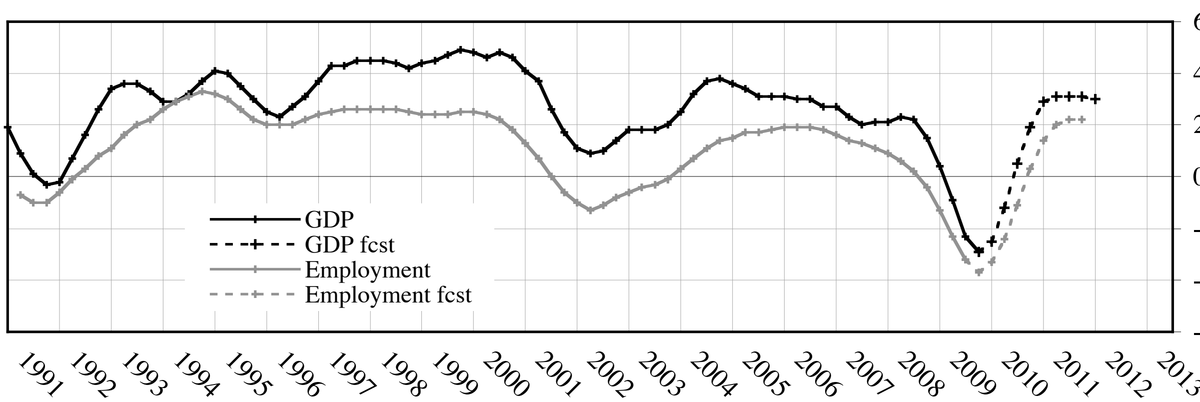
Summary for non-technicians –The economy continues to gradually pull out of the severe recession that officially started in December 2007. Growth curves for the economy should reach their lows by the end of 2009. The estimated timing for the next high is in the first or second quarter of 2011.

Outlook for the economy

As we approach the end of 2009 it is clear that the economy is starting to improve. Yr/yr growth curves have either started to turn up or will by the end of the year. There is still a long way to go to recover from this deep recession, and 2010 will only be a beginning. It continues to appear that the next high will occur in either the first or second quarter of 2011. While the amplitude of the high will look impressive, most industries will not recover to their pre-recession sales by this point. After the high, the growth rate will start to slow to what should be a mild low, quite possibly not even into negative growth. A close look at the most likely timing for this low has it in the first quarter of 2013.

Employment continues to be a problem for the recovery, but a surprisingly strong jobs report has helped to convince some skeptics that there really is an upturn on the horizon.

GDP & Employment (CES) minus 1 Quarter Yy/Yr Growth



Leading Indicators

State & Local Bond Interest, Corporate Bond Aaa Interest and **Mortgage Interest Rates** – Long-term interest rates continue to remain at very low levels. Mortgage interest rates were 4.88% in November with yr/yr growth (inverse) of +16.8. There is some hope that 10-year treasury bonds may be returning to a role as a long-term leading indicator. T-bond interest rates have not had the extreme drops of some other interest rates. T-bond yr/yr growth (inverse) offset 7 quarters suggests a high in early 2011.

T-Bills and Prime Rate – T-bill interest rates fell even further to 0.5% in November. Ridiculous. The prime rate has been held at 3.25% since January. With the current economic uncertainty it is unlikely that rates will be encouraged to rise over the next few months.

CEWI-M - The Cahners Early Warning Indicator is a combination of housing starts, the mortgage interest reciprocal, and the Dow Jones monthly median. It leads the economy by about one year. The CEWI-M reached bottom in the first quarter of 2009. This puts low for the overall economy in early 2010. The curve continues to rise decisively. CEWI-M numbers: April -27.8, May -26.1, June -24.1, July -20.4, August -16.8, September -12.5, October -8.5, November -1.9, December positive?.

PMI - The Purchasing Managers Index is one of the best short-term indicators for industry, leading by two quarters. The PMI slowed to 53.6 in November after 55.7 in October. Even assuming a modest 52.5 in December the growth curve will just move into positive territory at the end of this year and then climb to a high in the third quarter of 2010. This would put the economic high in early 2011.

Durable Goods Orders/Inventory – Forecasting orders and inventory separately and combining them into a ratio gives a series that leads the economy by one to two quarters. The ratio is forecast to reach its high at the end of 2010, agreeing with the forecast model.

Some other series

Gross Domestic Product – The preliminary number for the third quarter GDP was +2.8%, slightly slower than the advance +3.5. The forecast assumes a similar rate of growth in the fourth quarter based on continued solid auto sales (although not at the rate of "cash for clunkers"). This puts 2009 down -2.5% compared to 2008. Growth will return to +2.9% in 2010 and 3.0% in 2011.

Industrial Production – The Industrial Production index number continued its slow but steady rise in November after leveling off in October. The low was passed in October at -10.4 and the year is on track to end down -9.8%. This should be followed by 5.0% growth in 2010 and additional gains of close to 5% at the end of 2011.

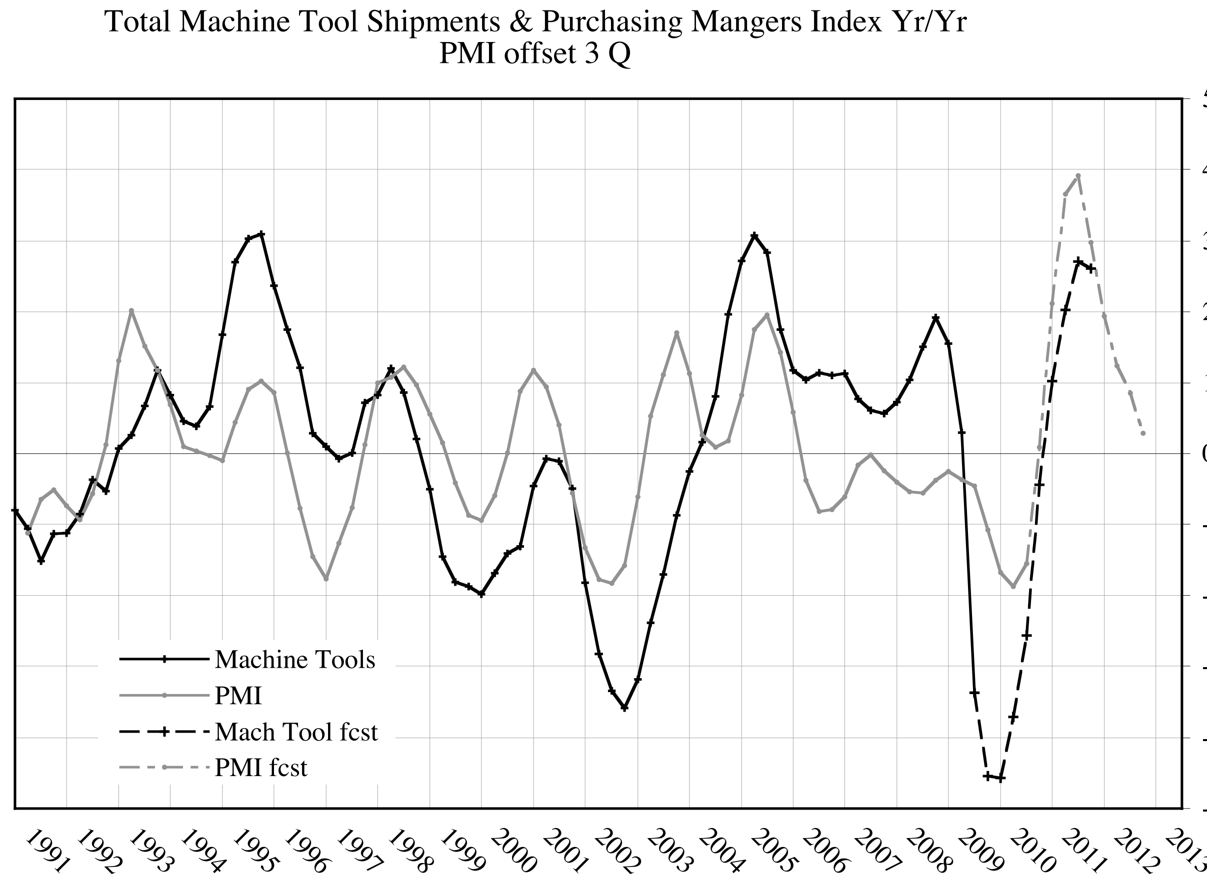
Housing Starts – Housing starts were a meager 42.2 thousand in November. However, given normal seasonal slowing this is actually encouraging. Qtr/qtr growth was -26.3 in November compared to the qtr/qtr low of -50.6 in March. Yr/yr growth has started to rise and is at -40.7. The forecast has housing starts down 38.5% in 2009 and then gaining 27% in 2010 and 46% in 2011. In actual numbers, this becomes 559 thousand starts in 2009, 712 thousand in 2010, and 1,020 thousand in 2011. By comparison, there were 2,068 thousand starts in 2005. Data from the National Association of Realtors indicates that existing home sales will be slightly better in 2009 than in 2008.

Light Vehicle Sales – The "cash for clunkers" program was very successful and boosted light vehicle – especially automotive – sales in July and August. While the pace of vehicle sales has slowed, they have continued to show surprising strength. Both October and November sales exceeded same-month sales for the previous year. This is the first time in more than two years that monthly sales have exceeded the year-ago month. Yr/yr growth is forecast to end this year down 23.2% and then recover 21.0% in 2010. There should be additional 20% growth in 2011.

Retail Sales – Retail sales reached their yr/yr low in September, down 9.4%, and should now improve quickly. This year is expected to end down 6.8% before 6.0% growth in 2010 and 5% gains in 2011.

Machine Tool shipments – Cutting machine tools, as reported by the government, tend to lag the economy by a quarter while forming machine tools are currently matching the business cycle. Total machine tools are expected to drop by 45% this year and then lose a slight 4% in 2010 before solid gains of 26% in 2011.

Estimated turning point timing for the overall economy based on leading indicators:
Recession level low 4th Q 2009 – High 2nd Q 2011 – Low (mild downturn) 3rd Q 2013


Total Machine Tool Shipments & Purchasing Mangers Index Yr/Yr
PMI offset 3 Q
50
40
30
20
10
0
-10
-20
-30
-40
-50
Machine Tools
PMI
Mach Tool fcst
PMI fcst
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1992
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2010
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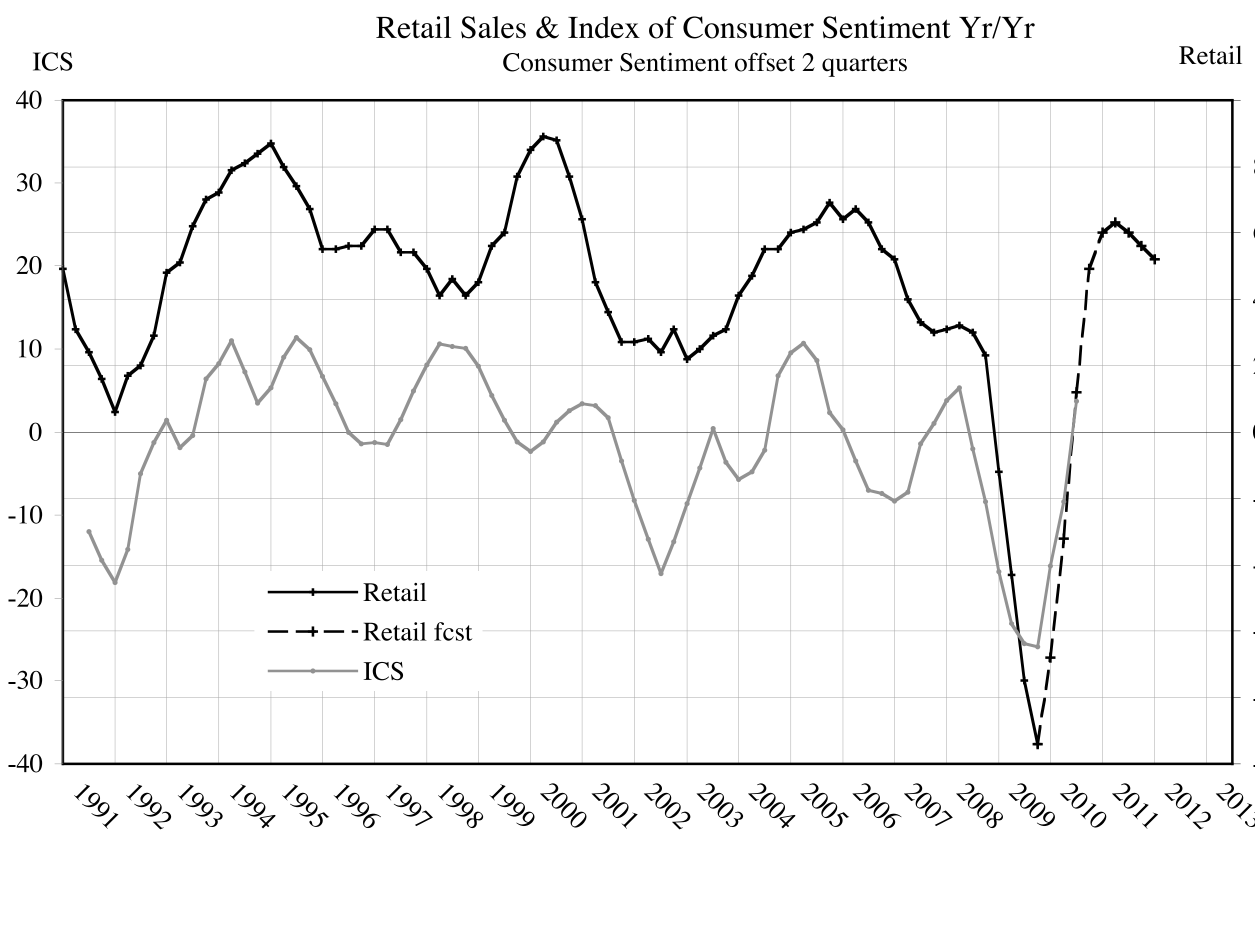
2012
2013


Retail Sales & Index of Consumer Sentiment Yr/Yr
Consumer Sentiment offset 2 quarters
ICS
Retail
40
30
20
10
0
-10
-20
-30
-40
10
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4
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-2
-4
-6
-8
-10
Retail
Retail fcst
ICS
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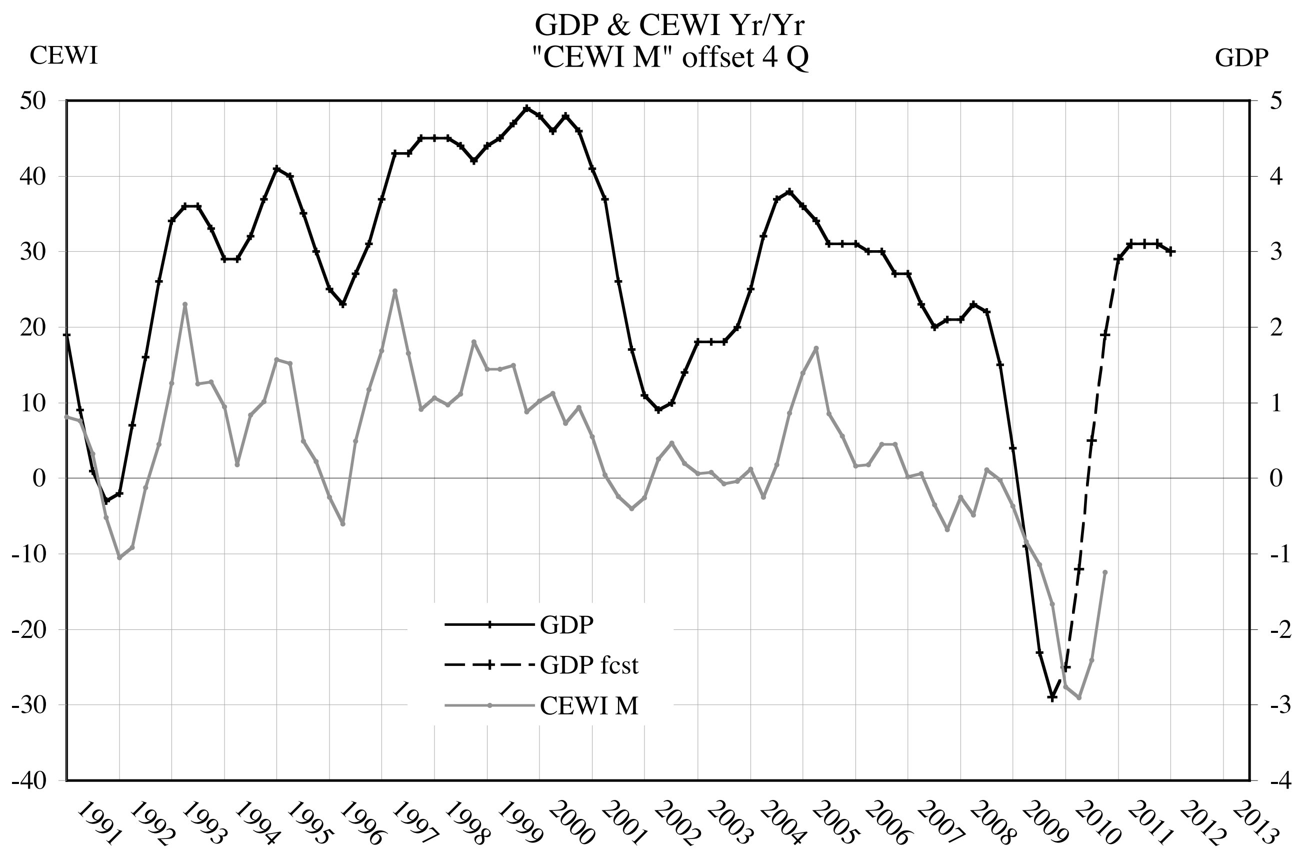
GDP & CEWI Yr/Yr
"CEWI M" offset 4 Q
CEWI
GDP
50
40
30
20
10
0
-10
-20
-30
-40
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3
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1
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-1
-2
-3
-4
GDP
GDP fcst
CEWI M
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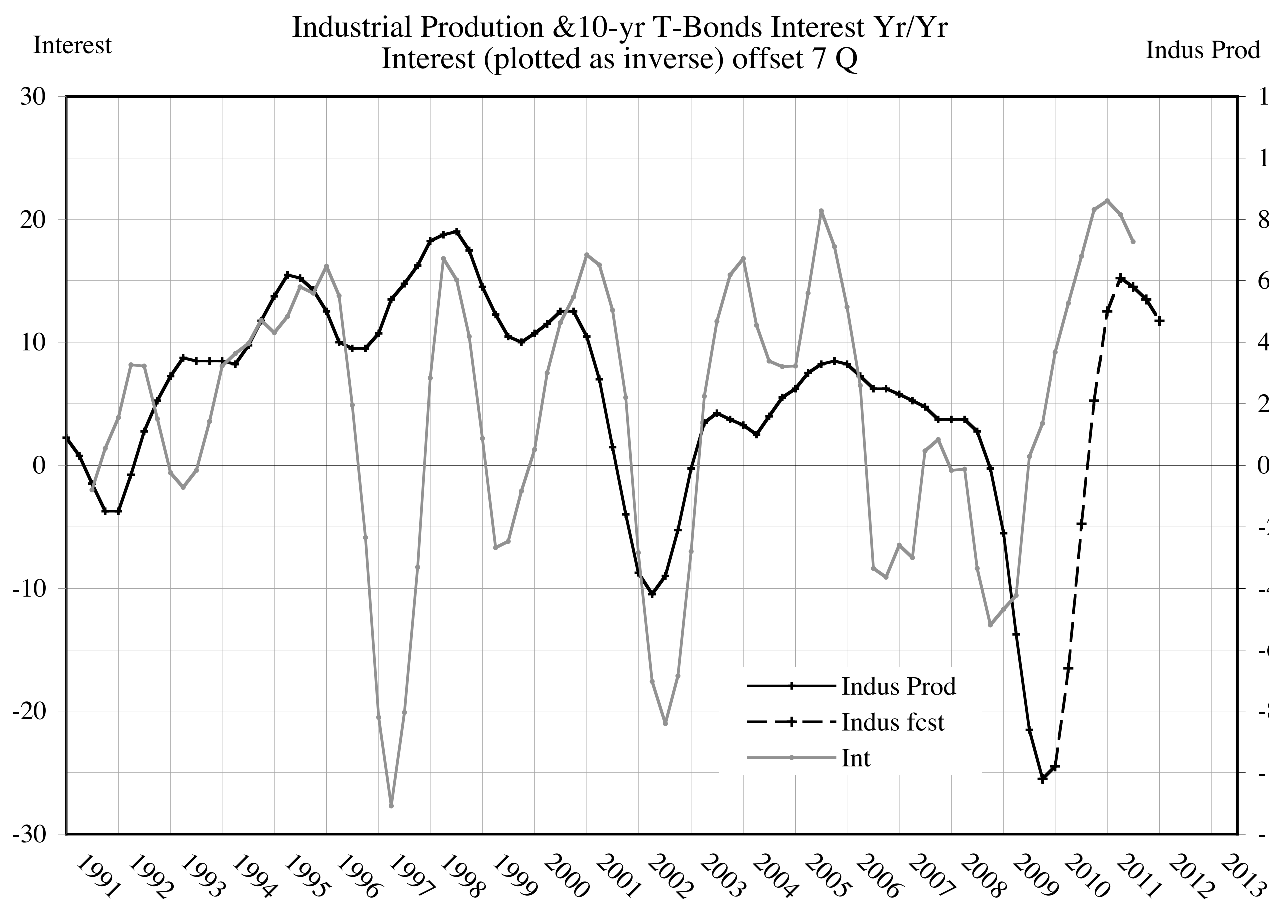
2013


Industrial Prodution &10-yr T-Bonds Interest Yr/Yr
Interest (plotted as inverse) offset 7 Q
Interest
Indus Prod
30
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-20
-30
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0
-2
-4
-6
-8
-10
-12
Indus Prod
Indus fcst
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2001
2002
2003
2004
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2006
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2008
2009
2010
2011
2012
2013