



2010 Economic Forecast Breakfast

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This Morning's Agenda

- Our “Report Card” for 2009
- A crisis of historic proportion
- Current economic metrics
- Outlook for 2010
- What could change our course?
- Q & A

An Economic View

First, let's turn back the clock a year ...

January 2010

An Economic View

First, let's turn back the clock a year ...

January 2010

An Economic View

First, let's turn back the clock a year ...

January 2009

An Economic View

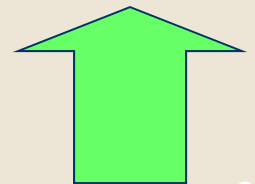
Follow-up to January 2009

We Said:

“Actions by the U.S. Treasury, Federal Reserve, FDIC and global Central Banks will stabilize the lending markets ”

Result:

By December 2009 the LIBOR spread to US Treasuries was LOWER than before the crisis. Corporate debt rates returned to normal levels.



An Economic View

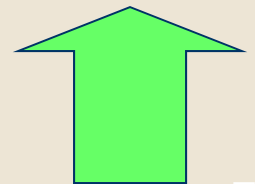
Follow-up to January 2009

We Said:

**“Interest rates will remain low
throughout 2009”**

Result:

The Federal Reserve maintained the Fed Funds target interest rate at 0.25% throughout the year



An Economic View

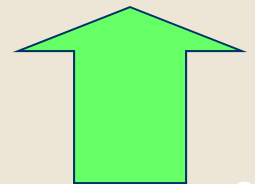
Follow-up to January 2009

We Said:

**“The U.S. & Global economies will
improve after lending markets stabilize:
we target late 2009”**

Result:

Lending markets stabilized in Spring and Summer 2009;
3rd QTR GDP Growth turned positive
on a quarterly basis in September 2009.



An Economic View

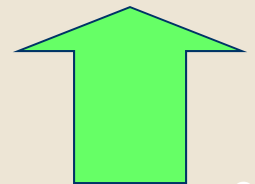
Follow-up to January 2009

We Said:

**“Buy and hold QUALITY STOCKS - -
stock prices have fallen sharply and are
inexpensive by historical standards”**

Result:

The S&P 500 Index rose 25.46% from January 8, 2009 through the end of 2009. Lower quality stocks actually rebounded even further.



An Economic View

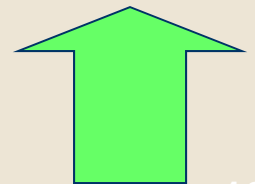
Follow-up to January 2009

We Said:

**“Markets typically rebound 6 – 9 months
before economic recovery is evident”**

Result:

Evidence of economic recovery appeared in the form of positive GDP growth in September 2009; the market low point was 6 months earlier on March 9, 2009



An Economic View

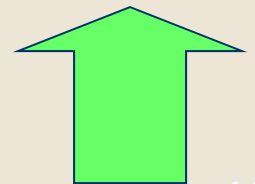
Follow-up to January 2009

We Said:

“We believe most US Treasuries are over-valued and will decline when the economy recovers”

Result:

It's too soon to fully evaluate, though we note that US Treasuries declined -2.61% in December 2009 and -3.57% for the full year.



An Economic View

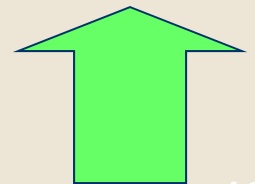
Follow-up to January 2009

We Said:

**“Many Corporate Bonds are attractive - -
watch credit quality ”**

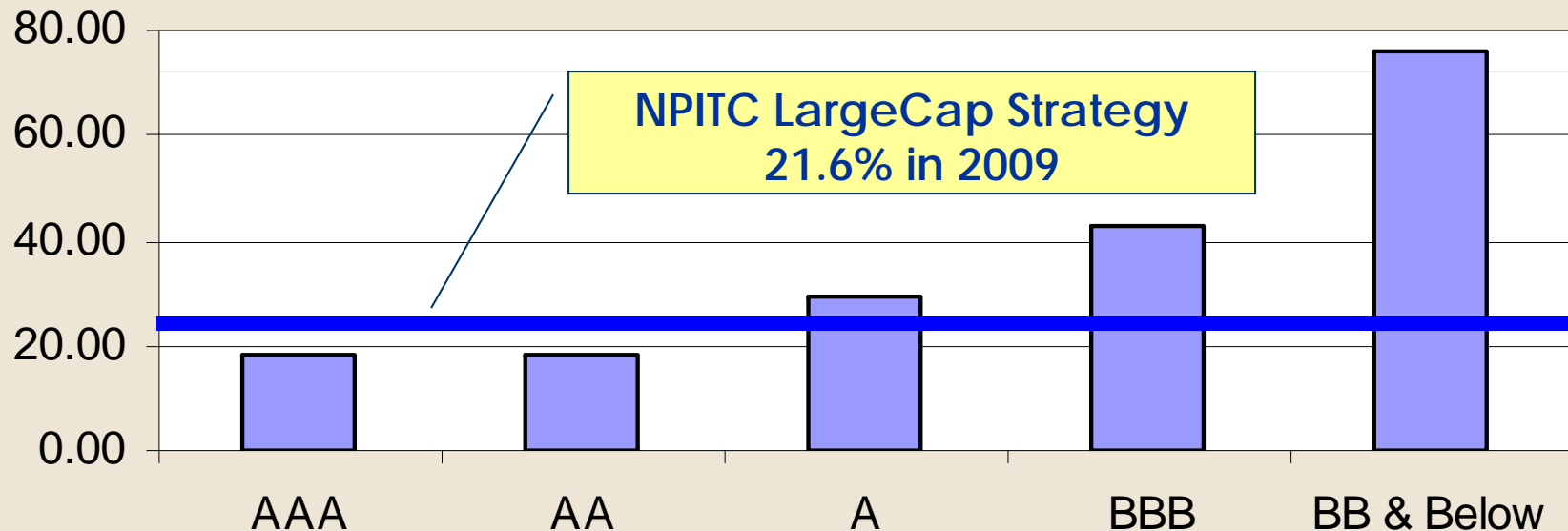
Result:

US corporate bonds returned an average of 18.68% in
2009



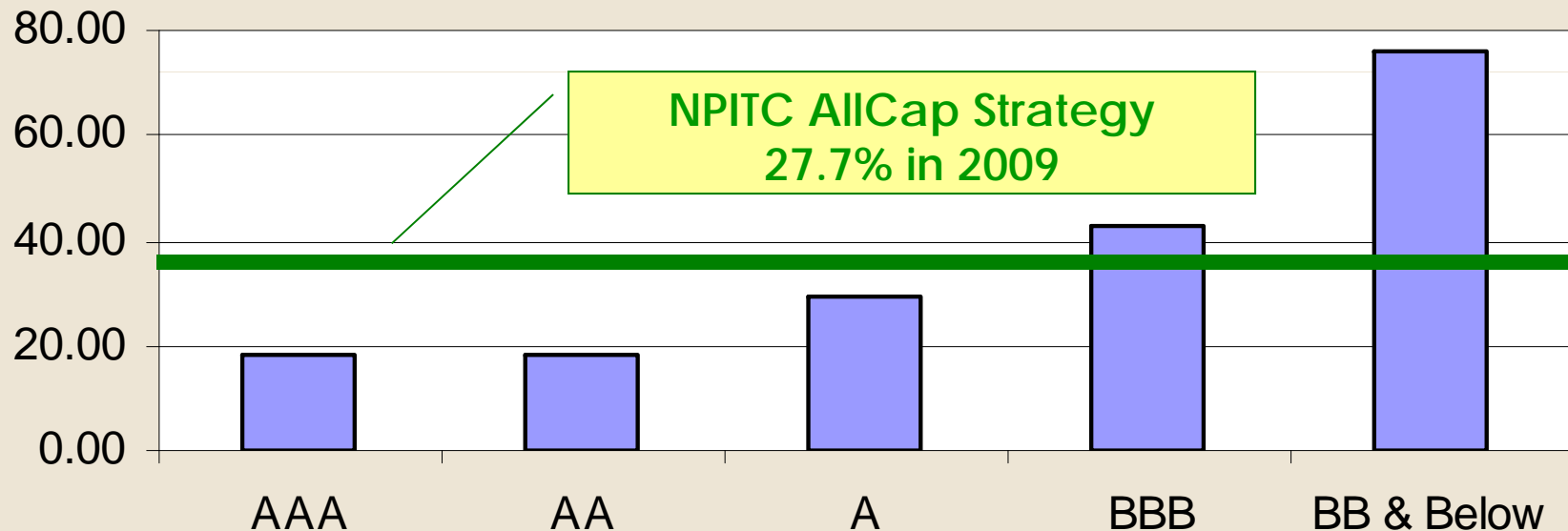


2009 Equity Market Returns by Quality Rating



Results above report the excess return of selected NPITC individual security strategies over appropriate benchmark indices over multiple trailing time periods. Results are annualized and are calculated by measuring the performance of NPITC decisions for model investment portfolios. Returns are net of estimated transaction costs but are exclusive of account level fees. Strategic decisions are consistently applied to NPITC client portfolios but individual results may vary, and are not guaranteed or insured.

2009 Equity Market Returns by Quality Rating



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Background

- Low interest rates and “easy” loan terms leads to excessive home prices and innovative mortgage related vehicles
- Consumers relied too heavily on equity built on real estate and stock market increases
- Appetite for return led to increased assumption of risk by both individuals and institutions
- Later rising interest rates leads to increase in mortgage loan delinquencies then an increase in security impairments

Financial Crisis Timeline

**TROUBLE
BREWING**

February – September 2007:

- FHLMC ceased purchase of riskiest sub-prime mortgages
- New Century Financial, a sub-prime lender files Chapter 11
- S&P and Moody's downgrade 100+ sub-prime backed bonds; S&P puts 612 sub-prime mortgage-backed bonds on Watch
- Countrywide Financial warns of "difficult conditions", American Home Mortgage files for Chapter 11
- France's largest bank halts redemptions on 3 investment funds
- The FOMC notes that the "downside risks to growth have increased appreciably."
- The Fed Funds Target Rate is changed for the first time since June 2006 by decreasing Fed Funds 50 Basis Points to 4.75%

Financial Crisis Timeline

**TROUBLE
BREWING**



**October
2007**

- ❑ S&P 500 Stock Index peaked at 1565.15
- ❑ EAFE International Stock Index peaked at 2388.737

Financial Crisis Timeline

FINANCIAL CRISIS

October 2007 – October 2008:

- Bank of England lends help to U.K.'s 5th largest mortgage lender
- US Treasury's "Hope Now" initiative launched
- Financial pressures intensify – diminished interbank liquidity
- Federal Reserve creates "Term Auction Facility" to provide \$100 Billion in liquidity to depository institutions
- Bank of America buys Countrywide Financial
- AMBAC rating dropped by S&P; on "Watch" by Moody's
- The Fed drops rates by 1.25% in one month to 3.00%
- The Economic Stimulus Act of 2008 is signed into law
- The Term Securities Lending Facility lends up to \$200 Billion of treasuries to provide liquidity

Financial Crisis Timeline

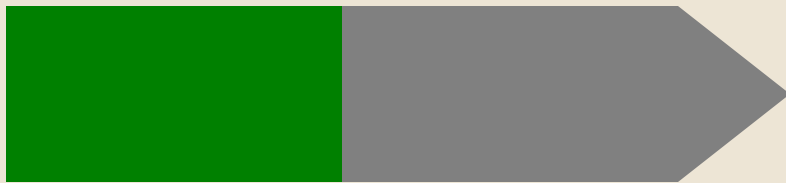
FINANCIAL CRISIS

October 2007 – October 2008:

- The Fed finances JP Morgan Chase's purchase of Bear Stearns
- Bond insurer's AMBAC and MBIA ratings drop
- FNMA and FHLMC placed in government conservatorship and provided with added liquidity
- Bank of America buys Merrill Lynch and Co.; Lehman Brothers files Chapter 11; \$85 Billion lent to AIG
- Short-selling restrictions imposed on financial institution stocks
- The Reserve Primary Money Fund falls below \$1; certain money fund balances guaranteed
- The FDIC facilitates JP Morgan Chase acquisition of Washington Mutual; Wells Fargo acquires Wachovia.

Financial Crisis Timeline

**FINANCIAL
CRISIS**



October **October**
2007 **2008**

- ❑ S&P 500 Stock Index fell 35%
- ❑ EAFE International Stock Index fell 46%

Financial Crisis Timeline

CAPITULATION

October 2008 – March 2009:

- Emergency Economic Stabilization Act signed into law and establishes the \$700 billion Troubled Asset Relief Program TARP and begins to lend to financial institutions
- The Fed provides liquidity for Commercial Paper; FDIC insurance coverage increased to \$250,000
- PNC purchases National City Corporation
- Fed Funds Target rate dropped to 1.00%
- The Treasury decides not to purchase illiquid mortgage assets
- The FDIC, Federal Reserve and Treasury announces a \$306 billion guarantee on securities held by Citigroup
- The Federal Reserve announces intent to buy \$500 billion Mortgage-backed securities

Financial Crisis Timeline

CAPITULATION

October 2008 – March 2009:

- The Business Cycle Dating Committee of the National Bureau of Economic Research announces that a peak in U.S. economic activity occurred in December 2007 and that the economy has since been in a recession.
- The Fed Funds target rate set at 0% - 0.25%
- CIT Group and GMAC Bank approved as bank holding companies
- Federal Home Loan Bank's of Seattle and San Francisco suspend dividends due to MBS portfolio value declines
- \$138 billion in government financing provided to Bank of America
- Liquidity programs extended from April to October 2009
- Expansion announced of the Term Asset-Backed Securities Loan Facility (TALF) to as much as \$1 trillion

Financial Crisis Timeline

CAPITULATION

October 2008 – March 2009:

- Refinancing program announced for conforming home mortgages owned or guaranteed by Fannie Mae or Freddie Mac that currently exceed 80 percent of the value of the underlying home.
- Government agencies issue a joint statement that the U.S. government stands firmly behind the banking system
- FOMC increases the size of the Federal Reserve's balance sheet by bringing its purchases of agency mortgage-backed securities up to \$1.25 trillion, and agency debt this year to a total of \$200 billion, plus the purchase up to \$300 billion of longer-term Treasury securities

Financial Crisis Timeline

CAPITULATION



March
2008

October
2008

March
2009

- ❑ S&P 500 Stock Index fell another 29%
- ❑ EAFE International Stock Index fell 26% further

Financial Crisis Timeline

STABILIZATION

March 2009 – December 2009:

- Four bank holding companies repay TARP funds
- TALF program extended to certain high quality commercial mortgage securities
- The Federal Reserve modifies and extends multiple liquidity programs
- Fed Chairman Bernanke reports that extreme risk aversion has eased and investors are returning to private credit markets; Bernanke is nominated for a second term
- 9 of the 10 US bank holding companies identified as needing capital under the “Stress Test” now meet or exceed requirements
- Citigroup and Wells Fargo announce plans to repay TARP funds
- Treasury Secretary Geithner outlines TARP exit strategy

Financial Crisis Timeline

STABILIZATION



March
2008

October
2008

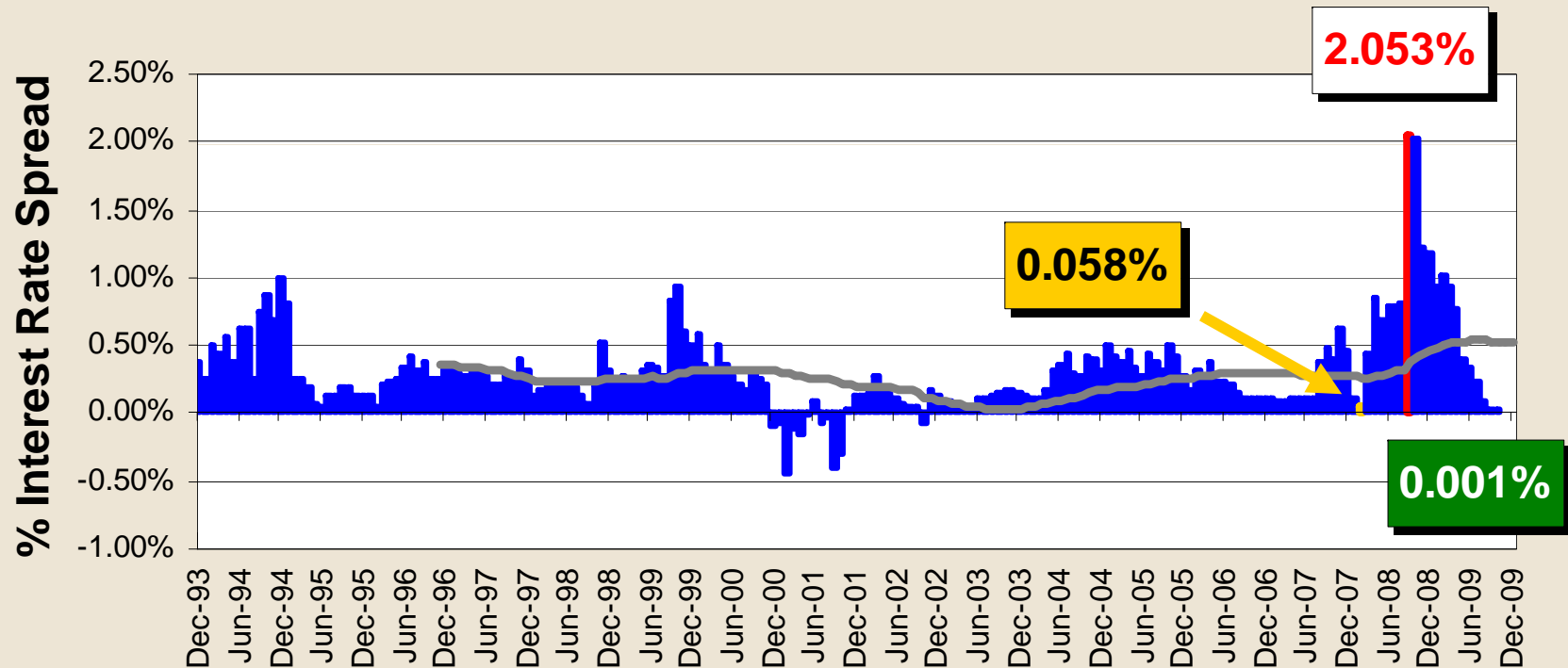
March
2009

December
2009

- ❑ S&P 500 Stock Index rebounded 68% from March 9
- ❑ EAFE International Stock Index rebounded 73%

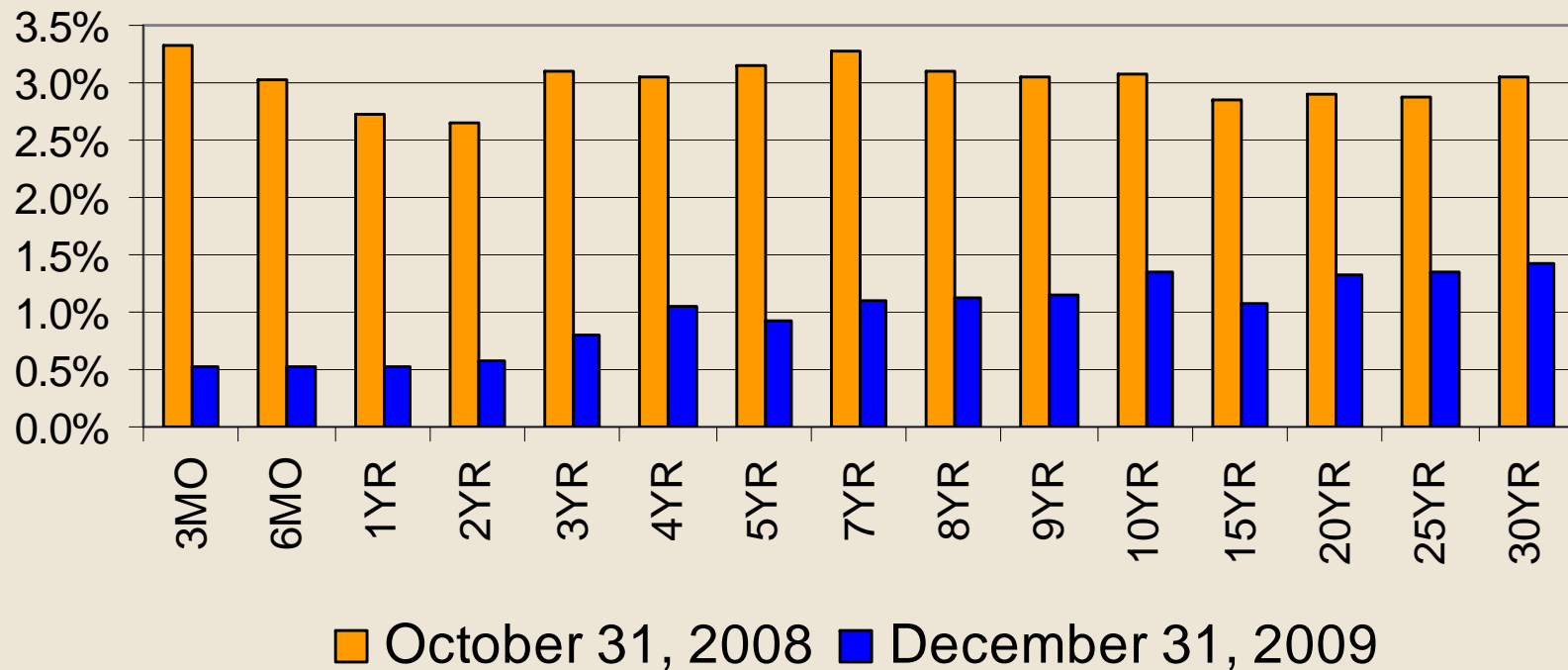
Where are we now?

3 Month LIBOR Spread Over Fed Funds Rate



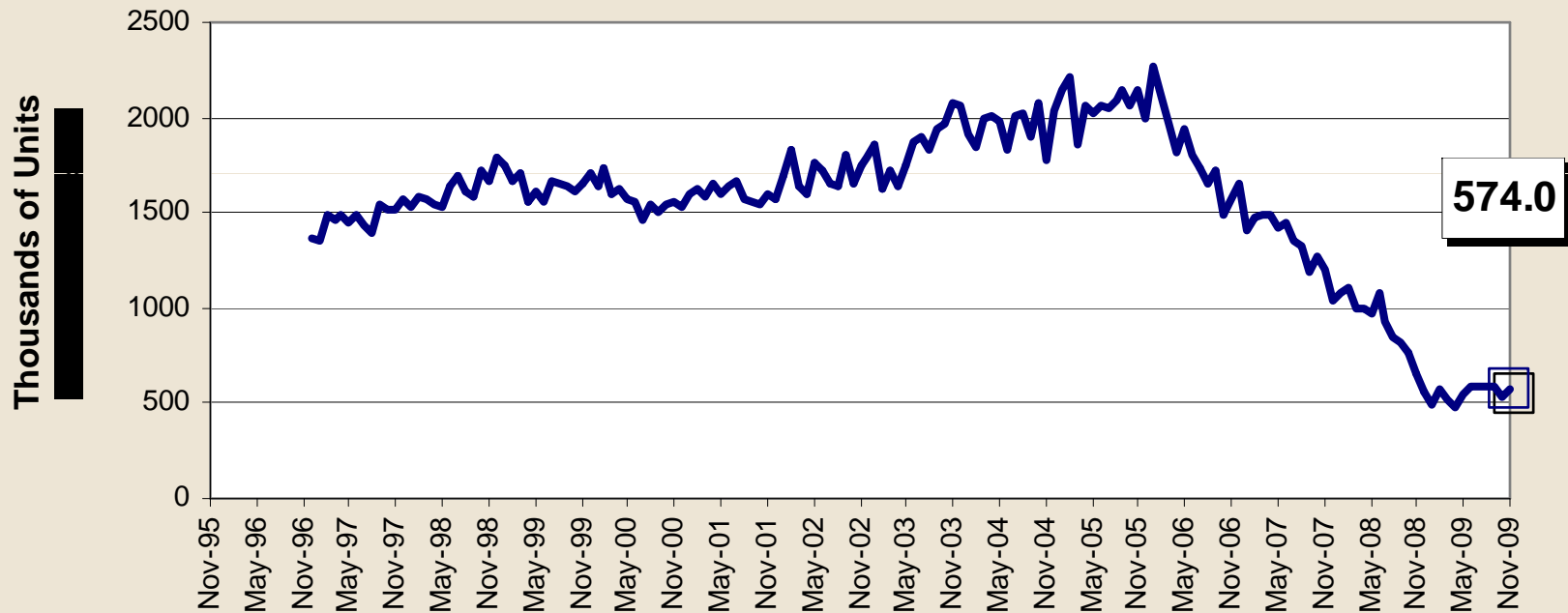
Fear, measured by LIBOR spread, has been wrung out of the market - - levels lower than before crisis

A+ Rated Industrial Bond Spreads to Treasuries



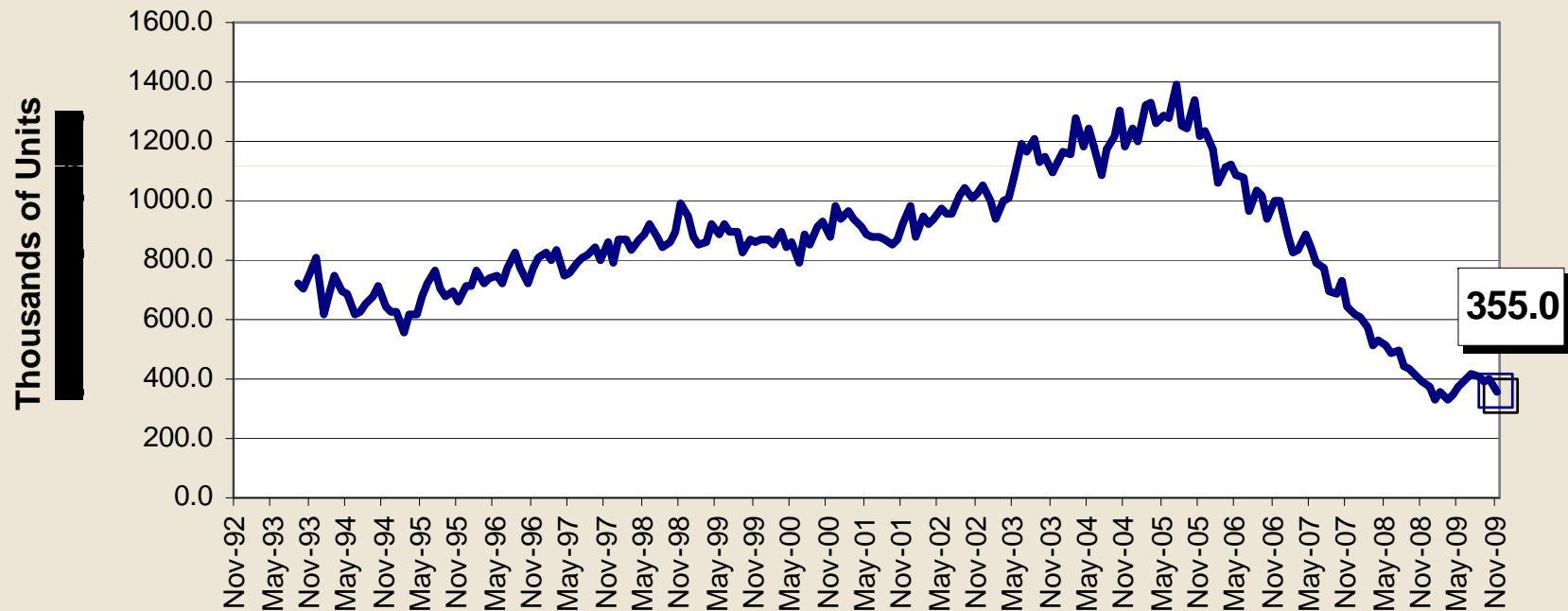
Restored confidence is exhibited in normalized funding costs for corporations

Monthly New Housing Starts



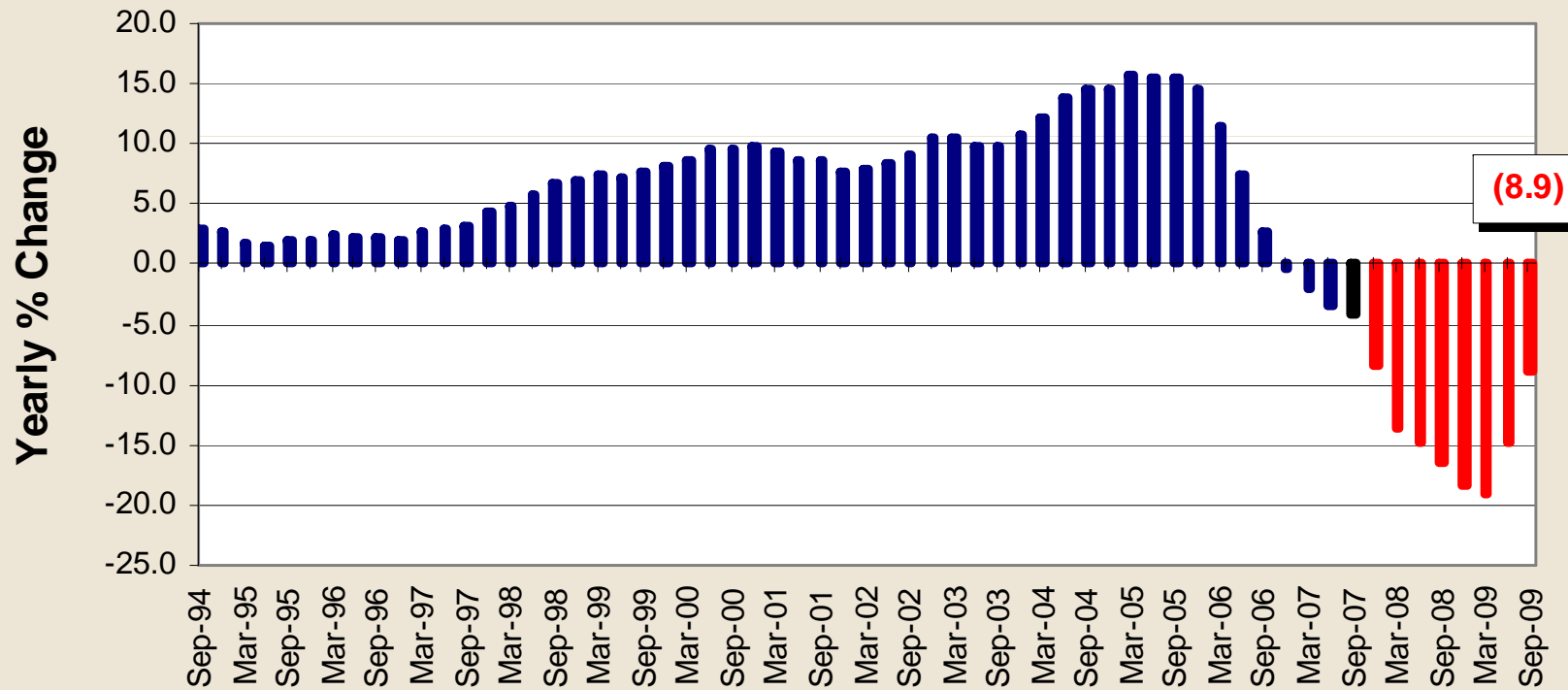
New housing activity has stabilized, but recovery is not likely soon

Monthly New Home Sales



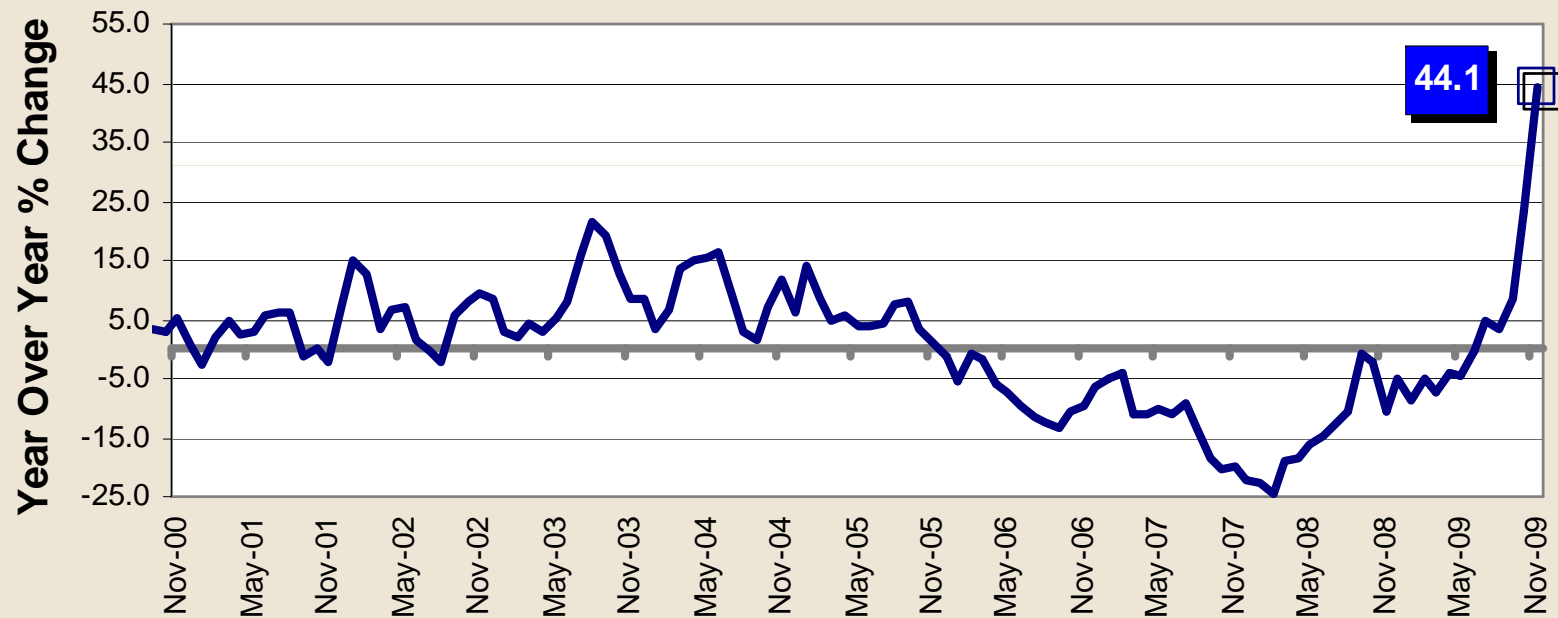
New housing activity has stabilized, but recovery is not likely soon

S&P Case-Shiller US Home Price Index % Change



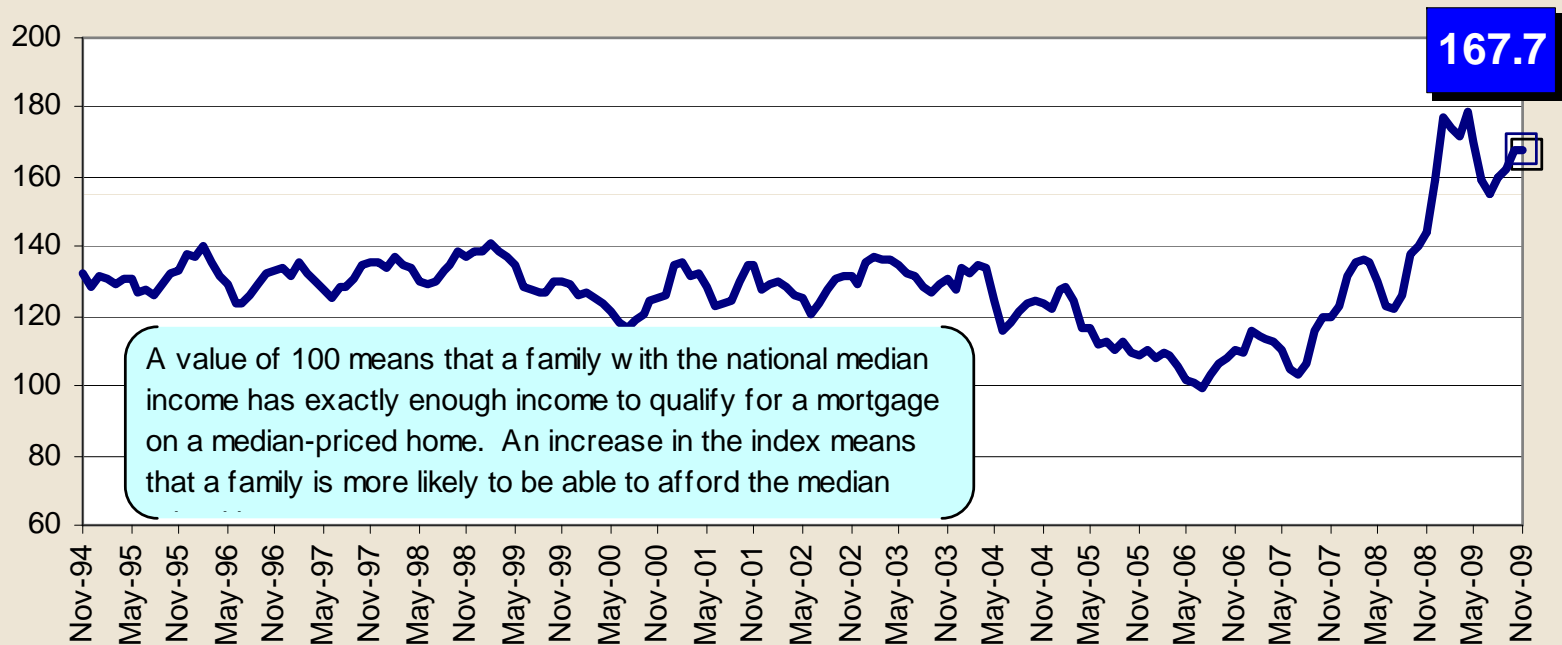
Home prices have declined 12 months in a row through September 2009

Existing US Home Sales YOY % Change



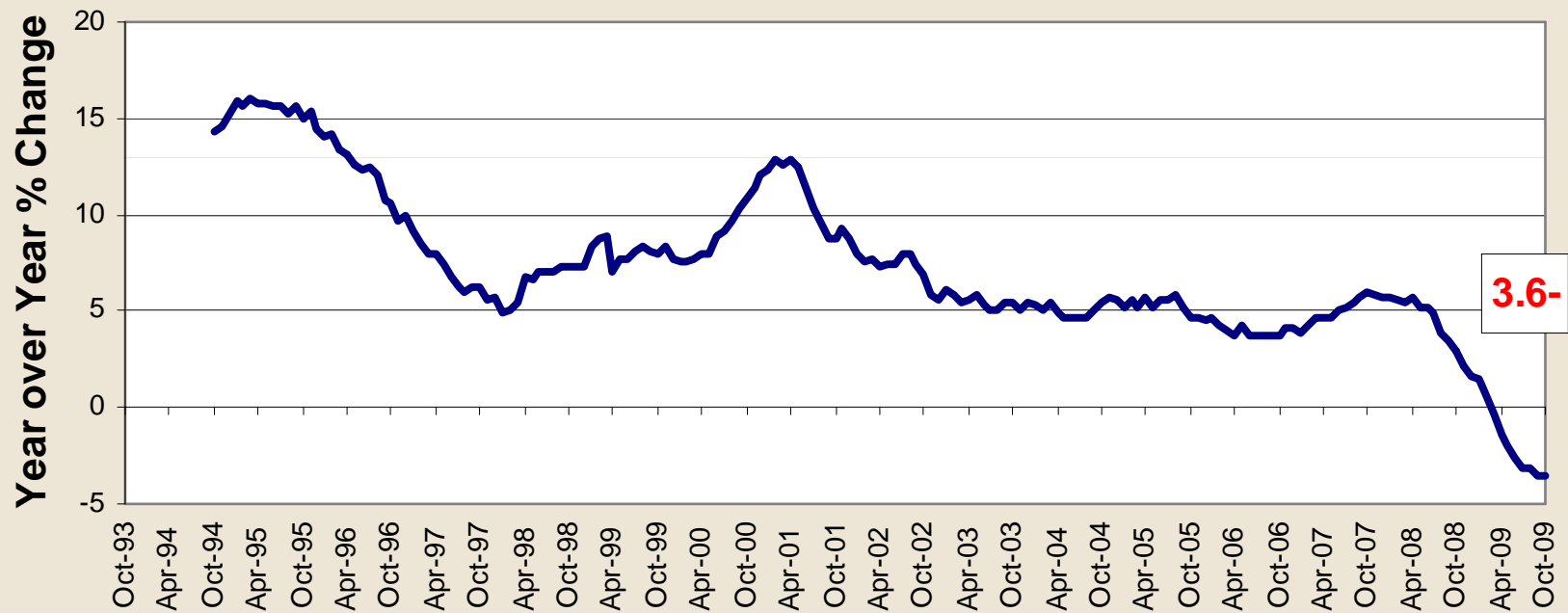
Existing home sales sharply higher due to low cost financing, bargain hunting, increased confidence

Homebuyer Affordability



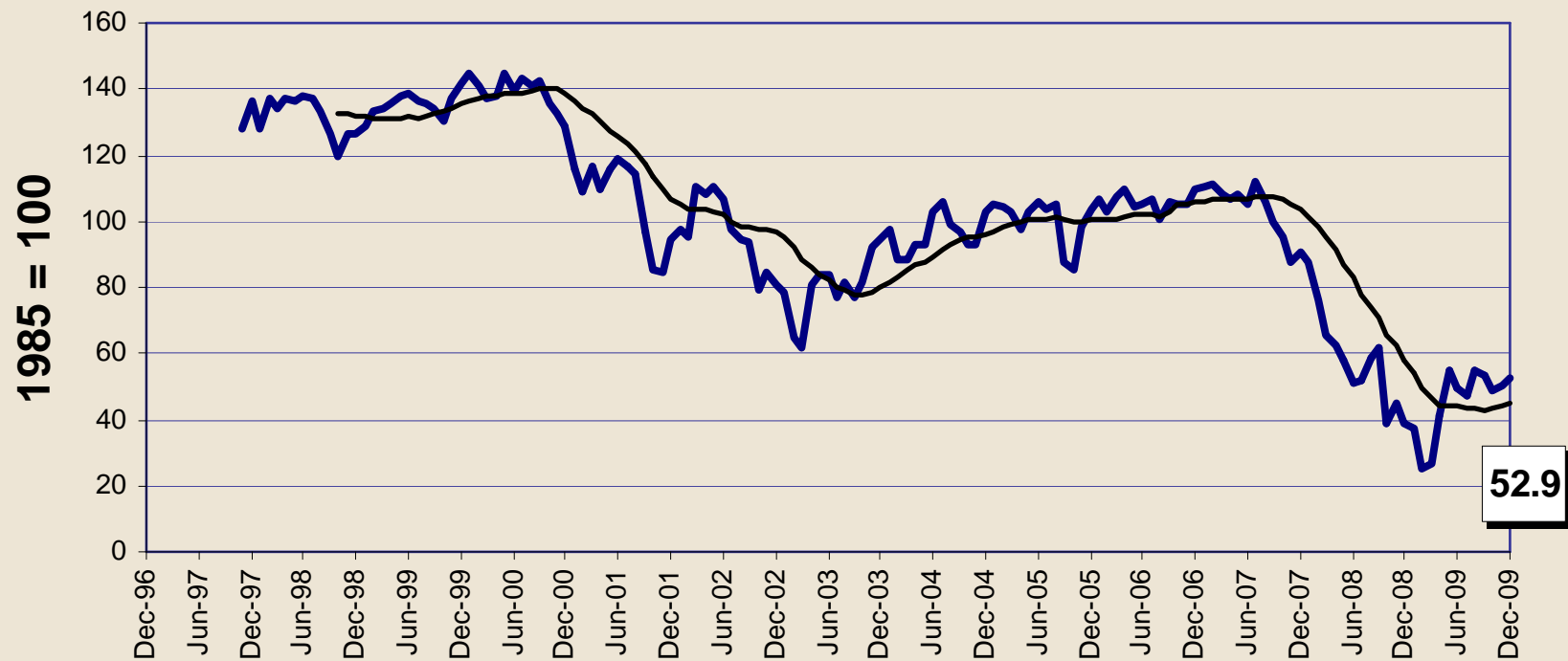
Sustained affordability bodes well for housing though significant oversupply is expected for several quarters

Consumer Credit Outstanding



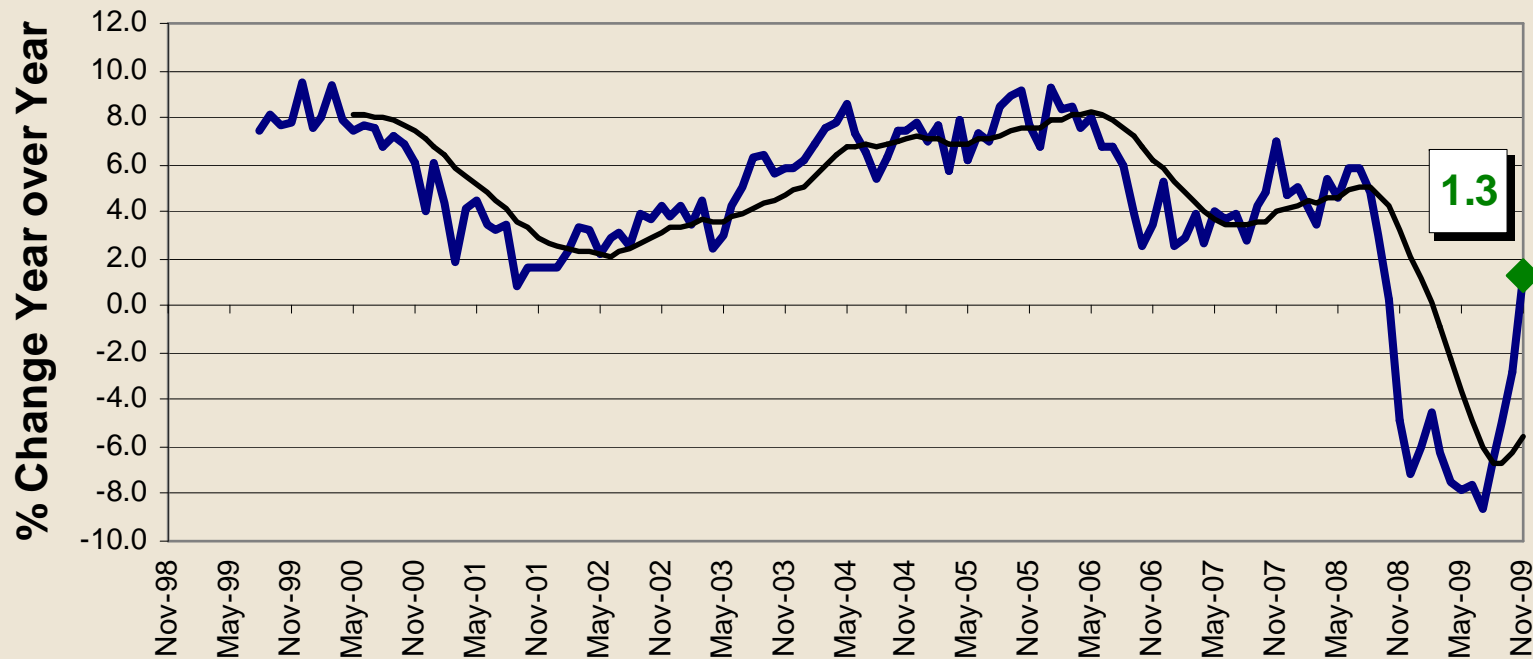
Reduced credit has resulted from consumer as well as lender caution and regulatory pressures

Consumer Confidence Survey



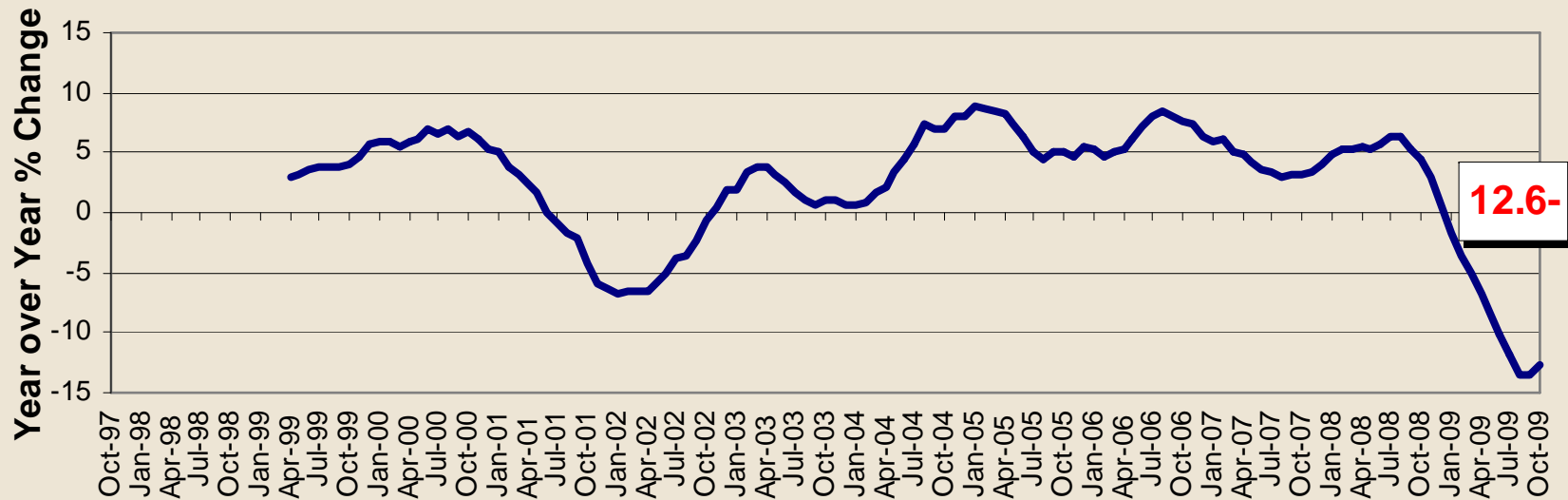
Stability in housing and the securities markets has stemmed continued decline in confidence ...

Retail Sales Excluding Autos



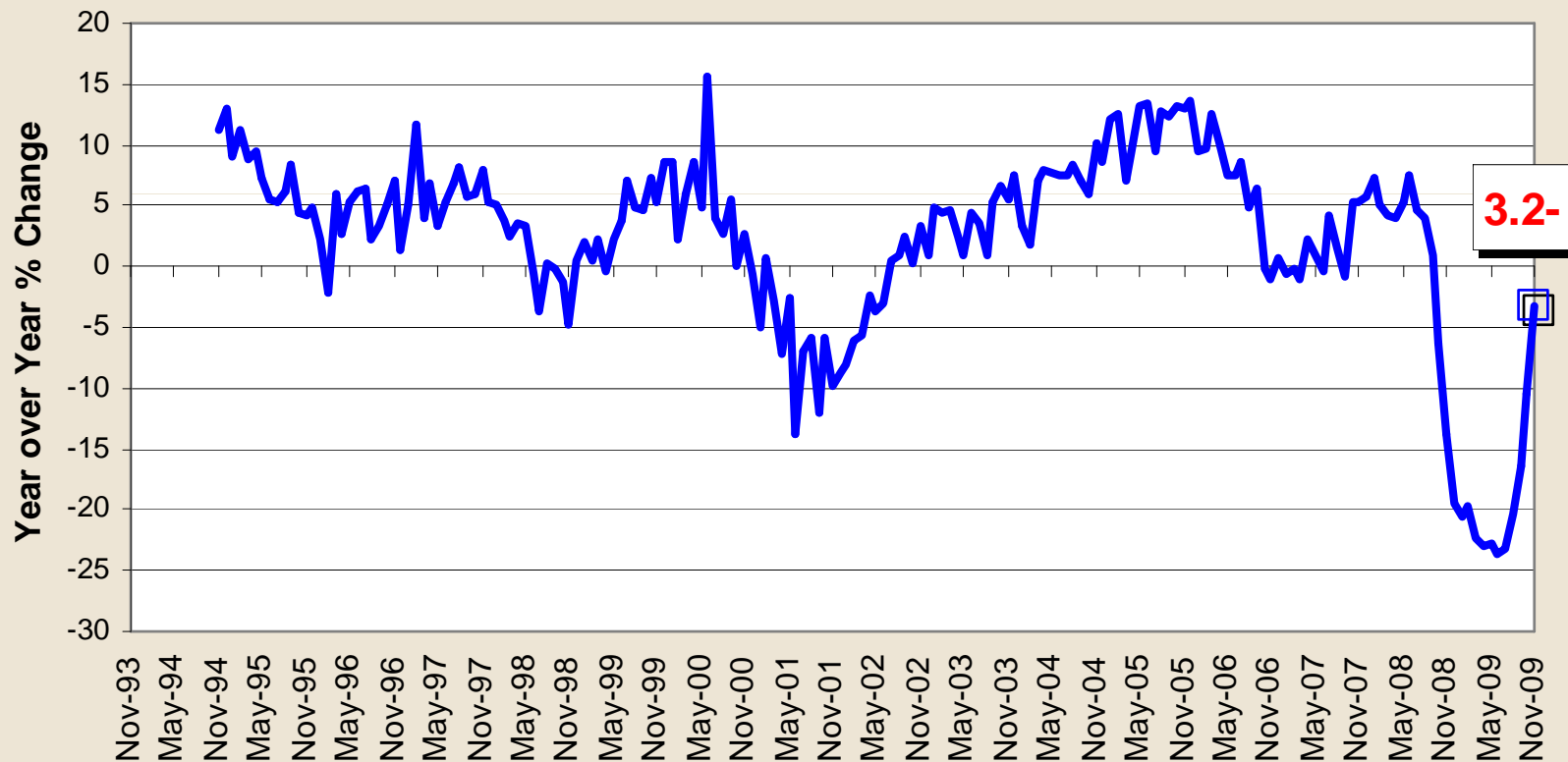
... and finally resulted in consumer spending increases, but comparisons to dismal prior periods is significant

Manufacturing and Trade Inventories



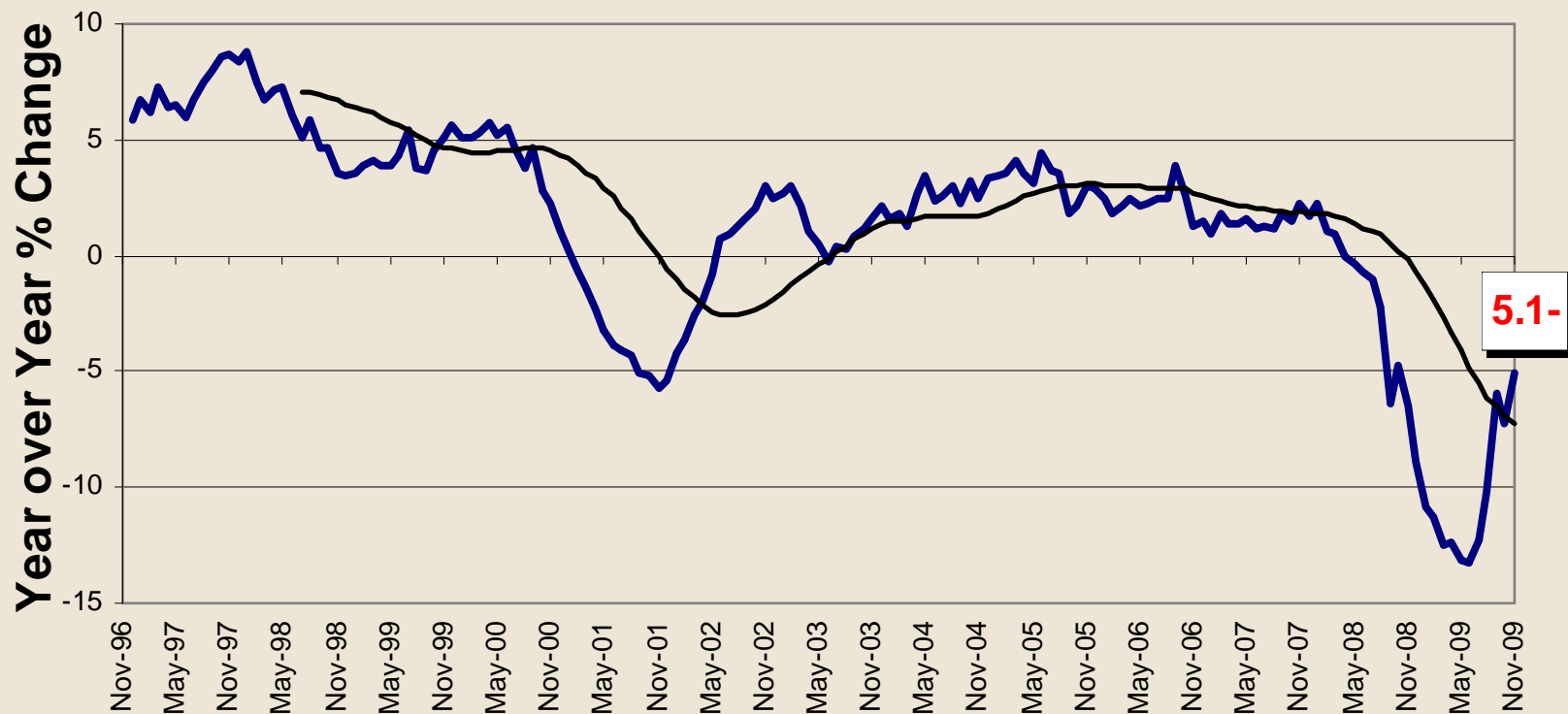
Tremendous decline in inventories suggests improved demand must be fed with increased production ...

Total Manufacturing New Orders



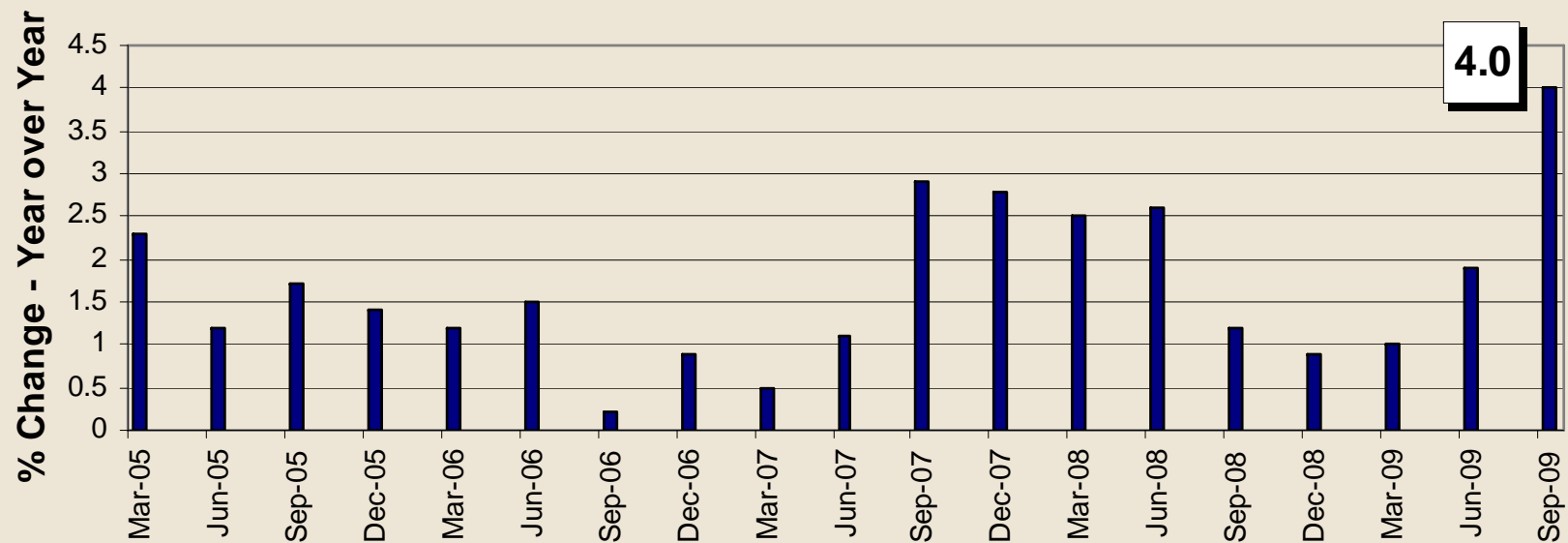
... and is supported by signs of rebounding new orders.

Industrial Production



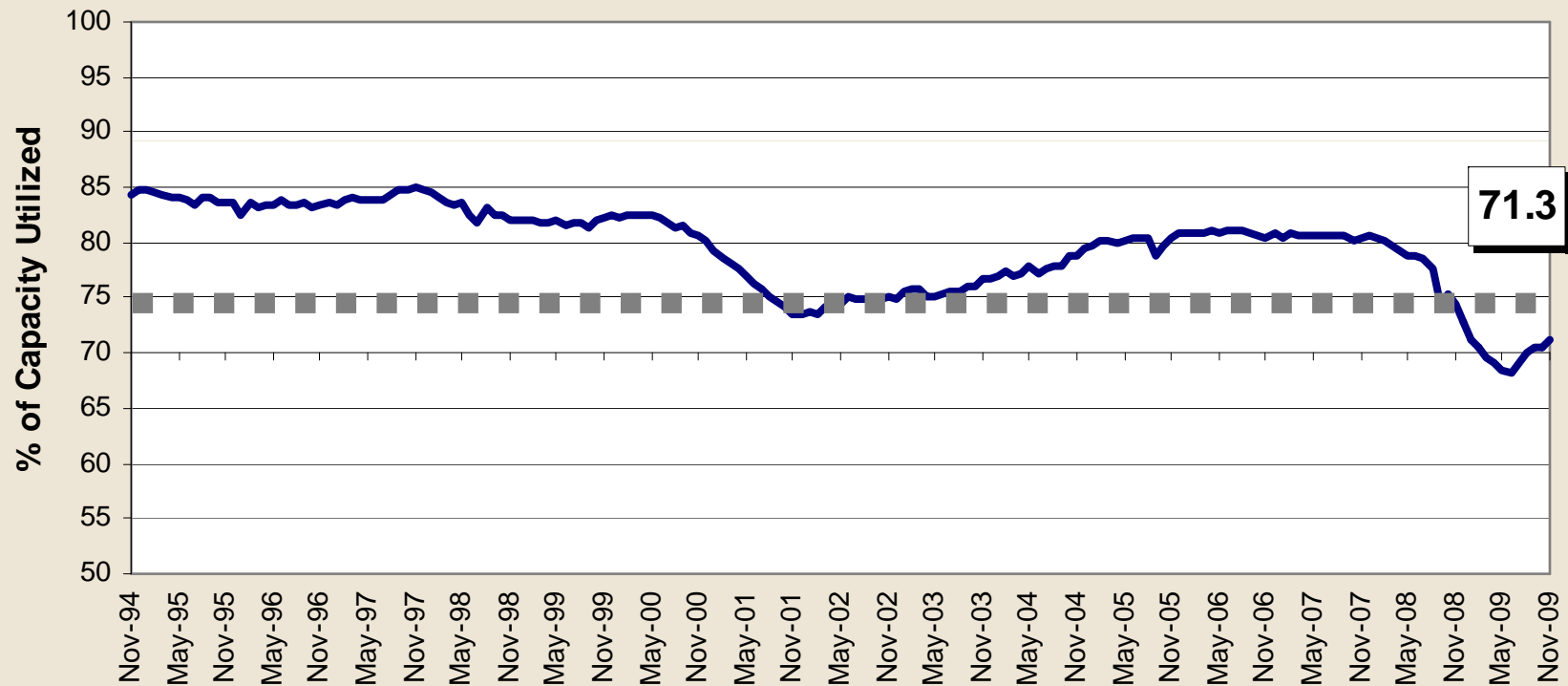
Industrial Production, while still negative, shows signs of improvement from new order flow.

Quarterly Non-farm Productivity



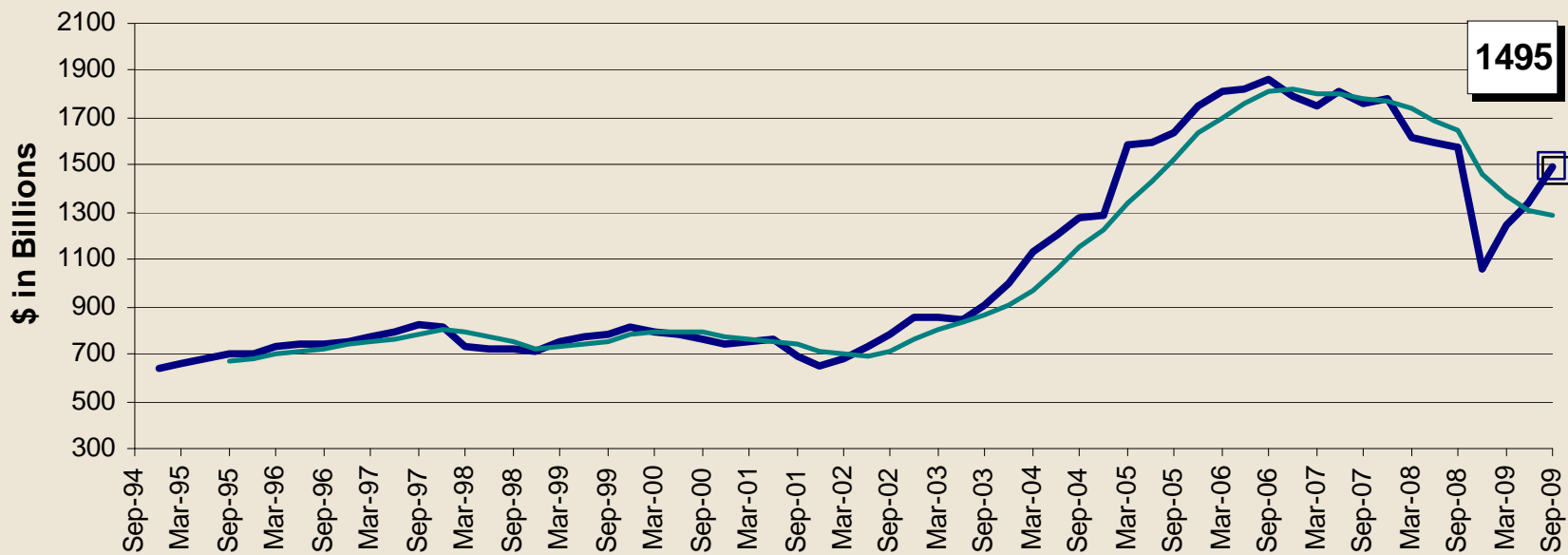
Reduced employment coupled with strengthening activity has improved worker productivity ...

Capacity Utilization



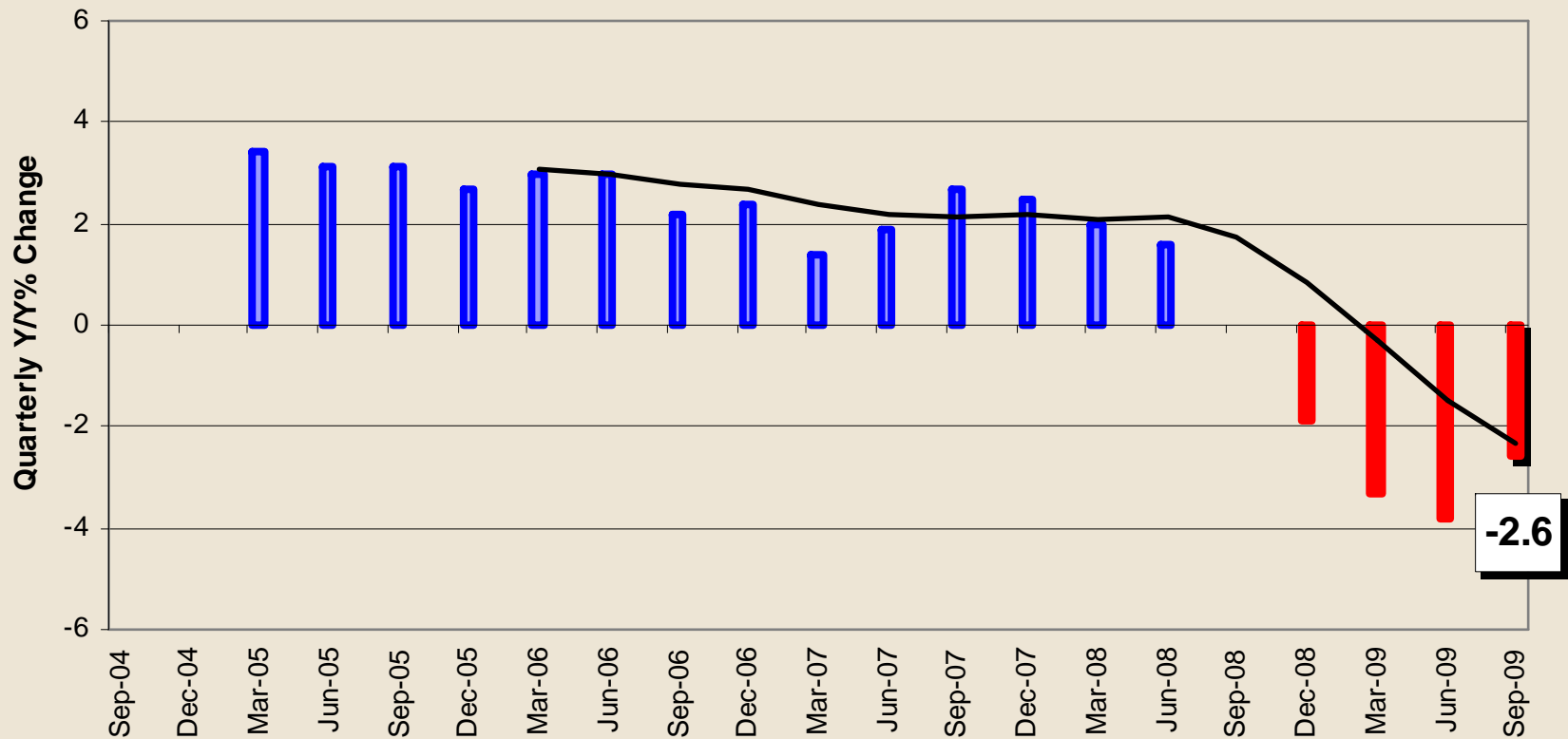
... while excess capacity postpones the need for heavy capital improvement ...

Quarterly Corporate Profits (Pretax)



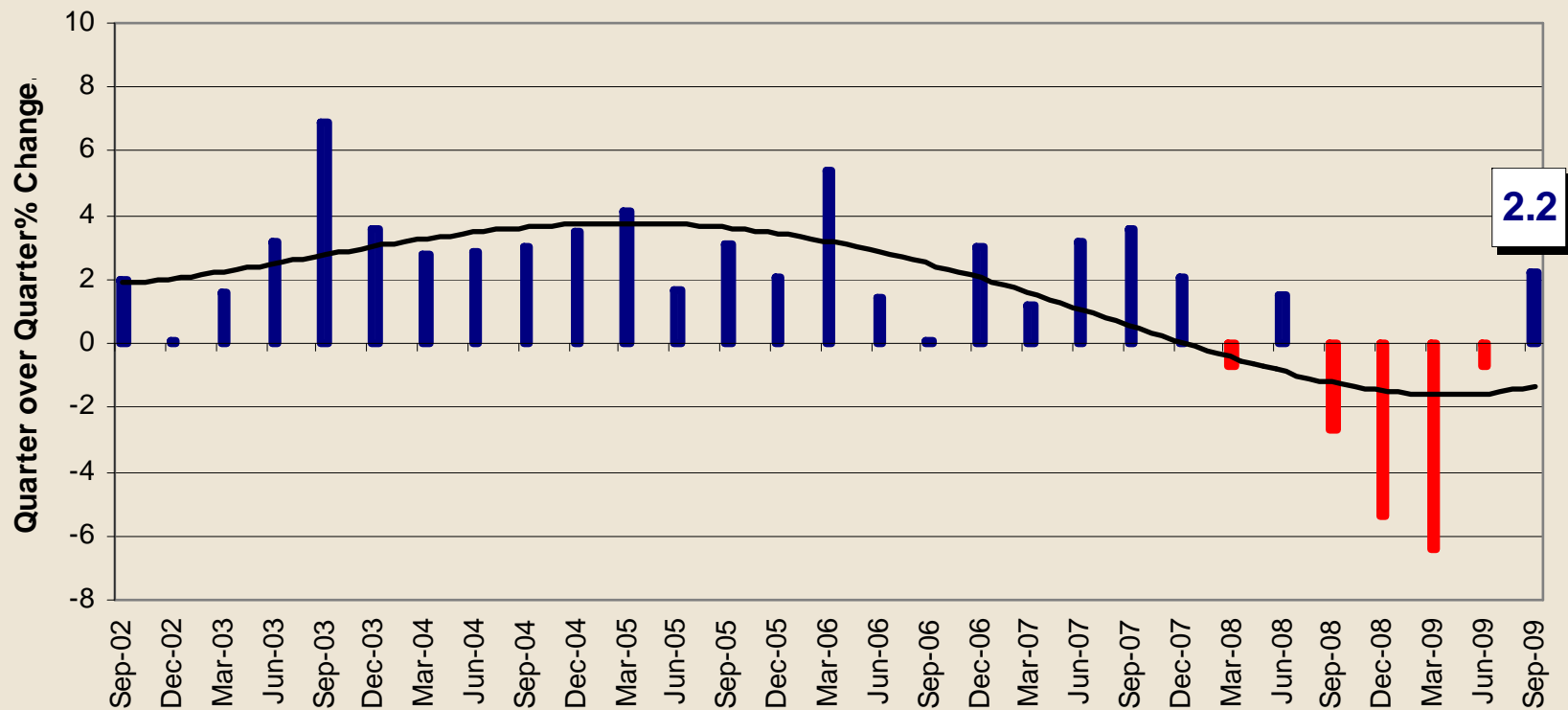
... setting the stage for continued recovery in corporate profits when satisfying increased demand.

Gross Domestic Product Year Over Year



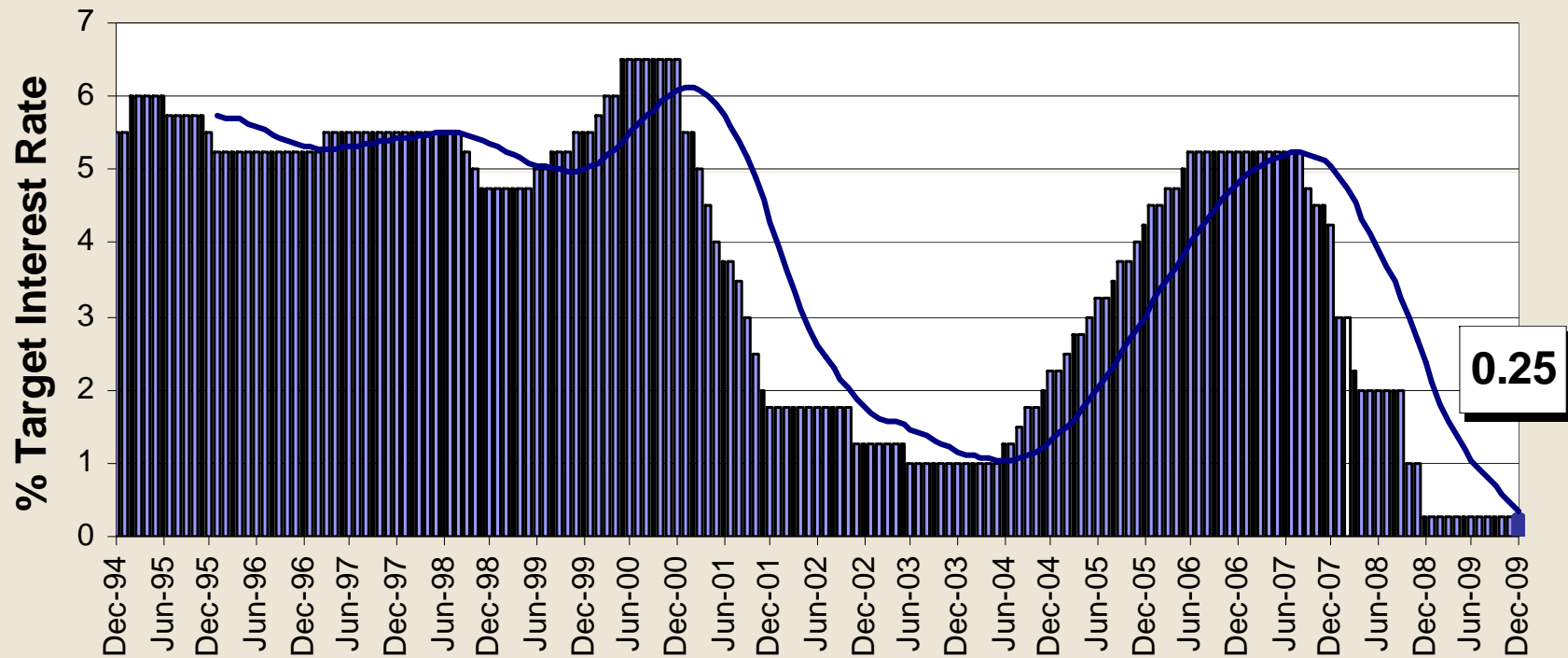
While GDP Growth has yet to turn positive on a Year-Over-Year basis ...

Gross Domestic Product Quarterly % Change



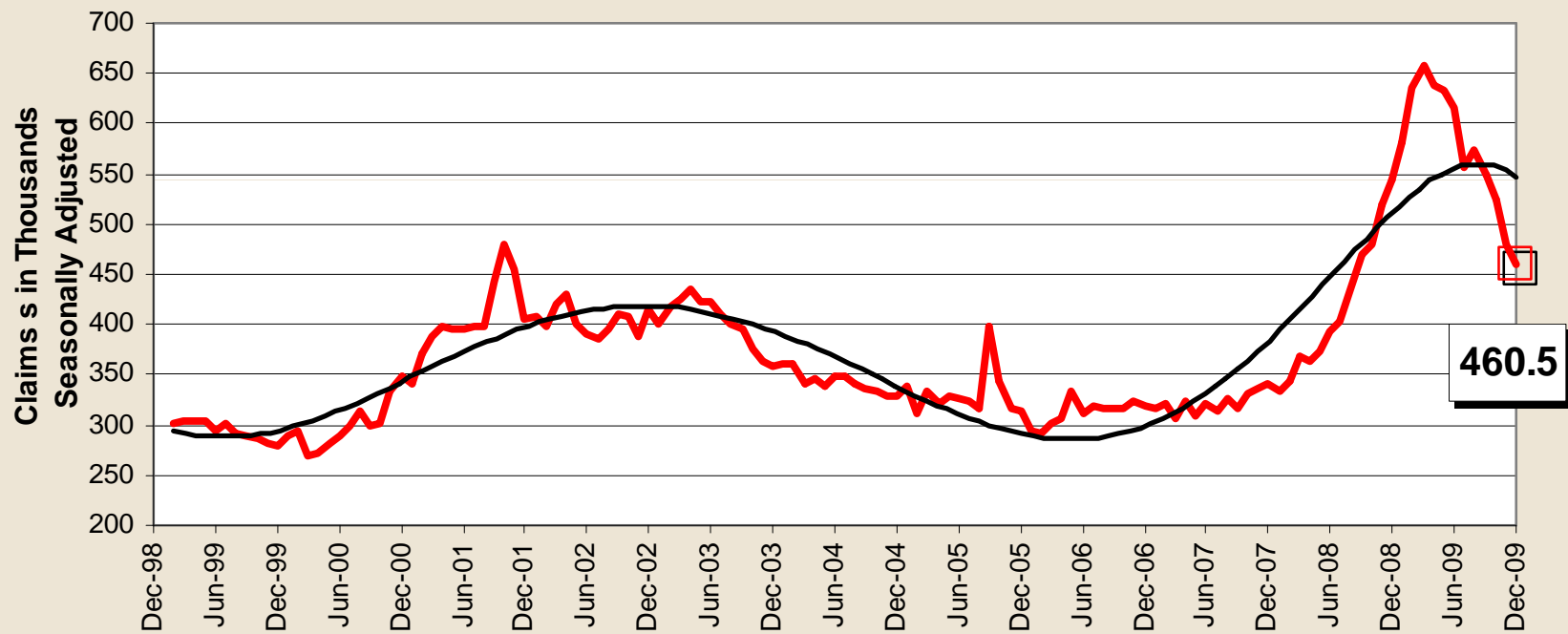
... 3rd Quarter GDP Growth turned positive, although significantly revised from an earlier estimate of 3.5%

Federal Funds Rate



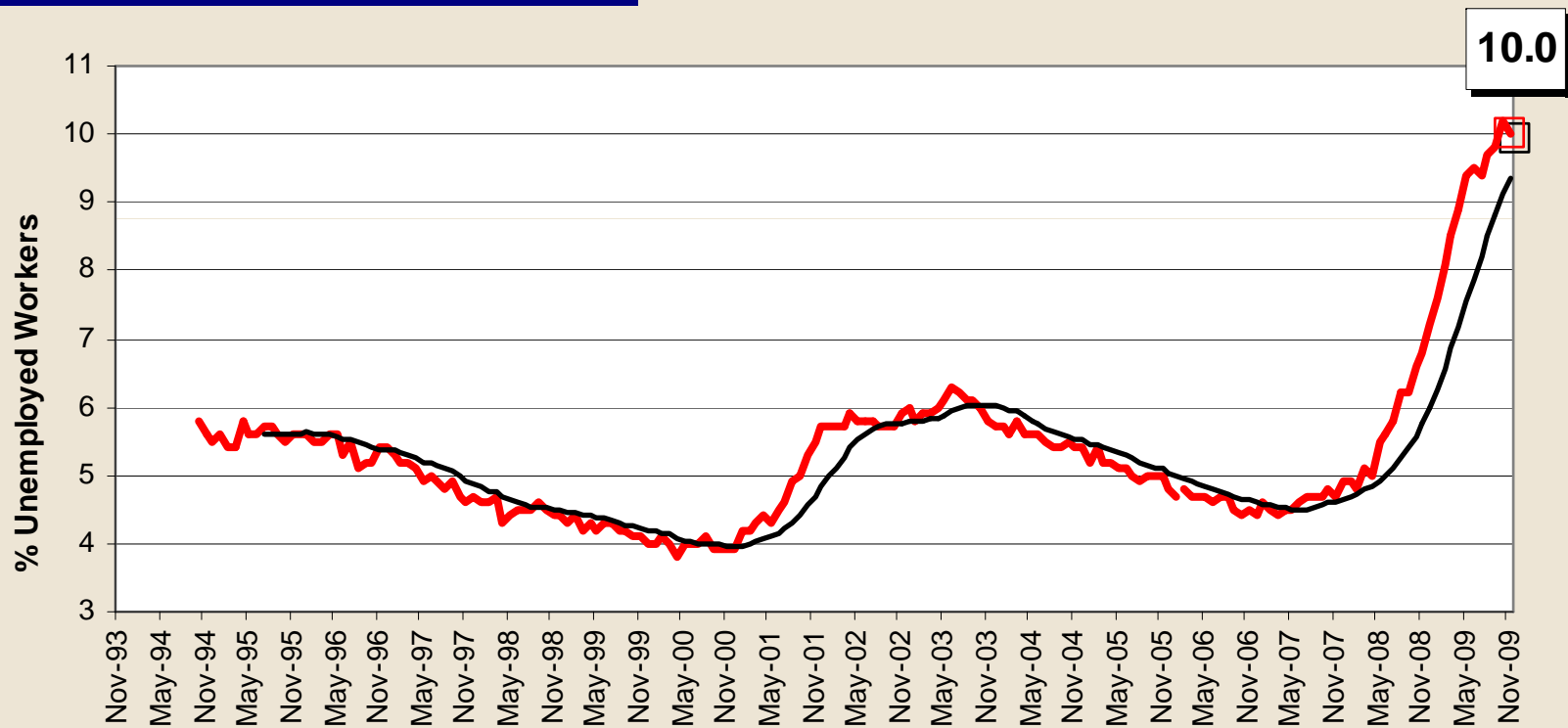
We believe the Fed will continue to err in favor of inflation rather than squashing recovery

Initial Jobless Claims - - 4 Week Moving Average



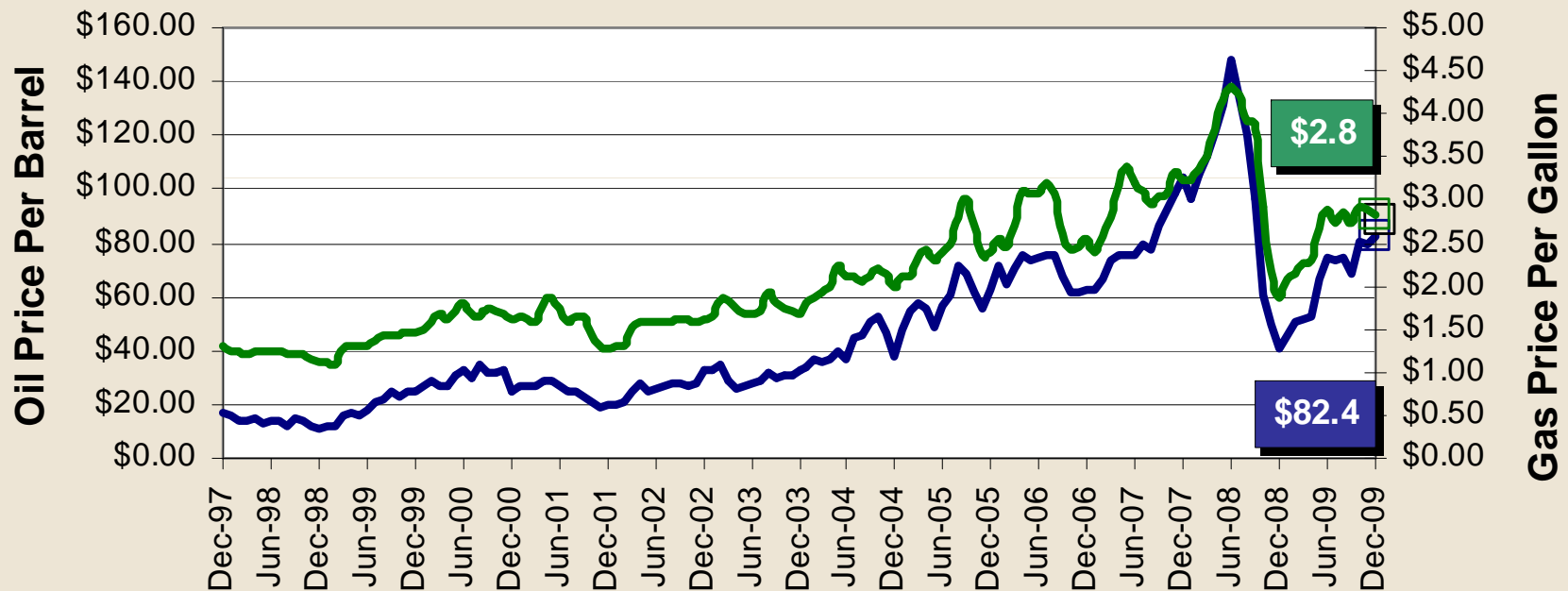
New jobless claims have declined sharply in recent weeks, yet ...

Total US Unemployment Rate



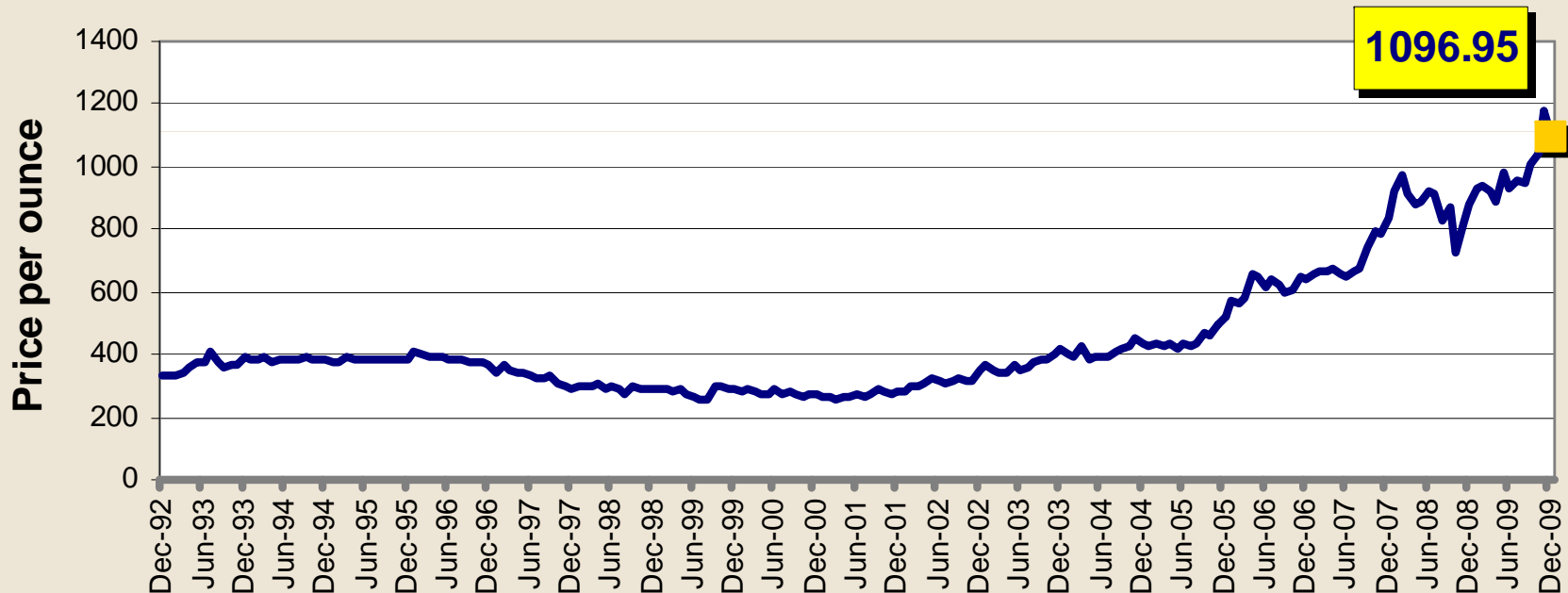
... unemployment remains quite high, and returning workers could prevent near-term improvement

Crude Oil and Gasoline Prices



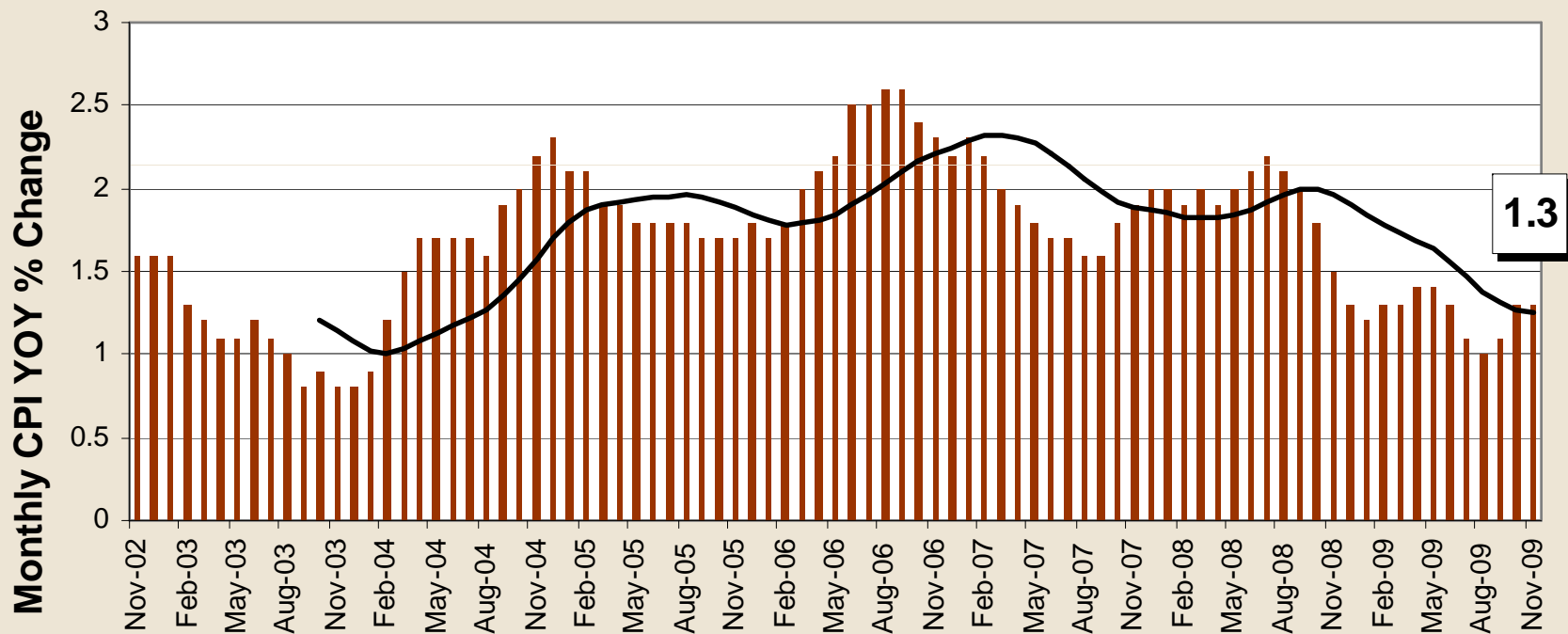
Relatively stable energy costs have not yet been an impediment to economic recovery

Gold Pricing



Yet gold price increases remind us to be wary of future inflation!

Inflation - - CPI Less Food and Energy - - YOY



Commodity price increases due to resumed global demand, coupled with a weak dollar are inflationary

NPITC 2010 Outlook:

- We expect continued economic recovery, albeit very slow with the possibility of needed added stimulus
- A sluggish housing market recovery is likely, led by existing rather than new home sales
- Consumer spending will increase, but current cautious trends will reverse slowly
- We believe the Fed will maintain the Fed Funds Target Rate at 0.25% through at least mid-year; increases will be modest until there is significant employment improvement

NPITC 2010 Concerns:

- A poorly implemented or too rapid withdrawal of government economic stimulus could thwart recovery
- Increased interest rates leading to higher borrowing costs for business, home buyers, and other consumers would damage recovery
- Another spike in foreclosures would depress housing and delay further recovery or even reverse positive trends
- Increased stress on banks: commercial real estate
- Increased inflation for the wrong reasons: lower dollar rather than increased demand

Summary:

- The economic recovery is real and sustainable but most likely will occur at a slow pace. Excess capacity, high unemployment, and reluctant consumers suggests robust growth will take several quarters to rebuild
- The massive recovery in equity prices in 2009 suggests price advances in 2010 will be far more modest and likely in line with the magnitude of recovery in the economy
- Stock prices don't only increase! A market correction would not be unusual and would not change our view
- Maintain caution in bond investing - - risks of inflation and higher rates outweigh likelihood of price appreciation

Questions and Answers?



Thank you for being
with us today!

