



About Bill Sullivan

William V. Sullivan, Jr. serves as Chief Economist at JVB Financial Group, working closely with the firm's trading desk, providing analysis and commentary on the U.S. economy and the financial markets. Among his duties are authoring a report on credit market trends and maintaining a regular schedule of economic broadcasts that focus on interest rate developments. He appears frequently on Bloomberg TV and is often quoted in Barron's.

Mr. Sullivan is the familiar voice that JVB features on our weekly Economic Broadcast, where he discusses the economy and the events that affect the marketplace.

He was previously associated with Morgan Stanley in New York City for more than twenty years, where he was an Executive Director and a Senior Economist in the firm's Retail Fixed Income Division. Bill published a widely quoted weekly letter on the financial markets and was a frequent guest commentator on several business networks, including Bloomberg TV, CNBC, and Fox News.

Prior to joining Morgan Stanley, he was affiliated with The Bank of New York, where he was a Senior Vice President in the Treasurer's Division.

Mr. Sullivan holds a Bachelor of Arts Degree in Economics from Fairfield University and an MBA in Investments from New York University.

JVB FINANCIAL

Economic Commentary by Bill Sullivan, JVB Chief Economist

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Back to the drawing board for the second half?

Approaching mid-year, it is becoming apparent that the growth prospects for the U.S. economy have shifted as compared to the environment that was in place as 2009 came to a close. Indeed, a variety of headwinds have surfaced over the last few months that were not operative late last year. These forces appear significant enough to suggest that overall business activity could lose some momentum during the second half of 2010, a development that could have a huge impact on financial asset valuations over the period ahead.

Clearly, the sovereign debt crisis in Europe will have major consequences for the domestic economic outlook. Perhaps the most obvious fallout from the events on the Continent is the altered exchange relationship that has occurred. In particular, the dollar has strengthened dramatically versus the Euro, raising the potential for reduced competitiveness for U.S. products on the global marketplace. To provide perspective, the dollar was trading at approximately 1.32 to one versus the Euro last May, but finished the year in the 1.50 vicinity. The persistent erosion in the greenback as 2009 progressed undoubtedly gave a lift to export business that in turn bolstered the manufacturing sector of the economy. Since then, the dollar has reversed course and has appreciated by at least 15% against the Euro, trading in the 1.22-1.23 range of late. The higher value for the dollar will eventually translate to some loss of business with European clients that points towards export activity providing less support for the recovery process later this year and beyond.

The stronger dollar will, of course, have an adverse impact on the earnings of those companies that have meaningful exposure to Europe. Needless to say, for most of 2009 these firms benefited from the dollar's decline as offshore profits were more valuable against the backdrop of a weaker U.S. unit. The dollar's rapid ascent against the Euro points towards a curbing impact on foreign earnings that could lead to somewhat slower profit growth for those firms with large international operations. As a result, income estimates for many firms may need to be scaled downward for the third and fourth quarters of the year as the firmer dollar takes its toll on earnings power. The potential for slimmer margins could prompt many investors to reconsider the current pricing mechanism of the equity arena, thus reversing some of the bull market gains of the last year or so.

Another important change that could impede economic momentum is the run-up in selected borrowing costs, but especially the key London Inter-Bank Offered Rate (LIBOR). Three month LIBOR, for instance, finished 2009 at 25 basis points but has since risen to 46 basis points as of Monday morning. The near doubling of the ninety day rate reflects increasing anxiety about counter-party risks among European banks, many of which hold a substantial amount of sovereign debt that has lost value during the crisis. The upturn in LIBOR rates, if sustained, will elevate credit costs for many borrowers with that added debt expense possibly acting as a drag on some investment expenditures. For sure, the rise

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in borrowing costs is representative of another round of tightening in general credit conditions that probably wasn't factored into many economic projections as 2010 got underway.

Growth prospects both here and abroad must also now allow for the various austerity measures at different levels of government that are just being implemented. Quite obviously, the potential for a double dip recession in Europe is real as various countries are forced to prune spending and raise taxes in order to achieve a sounder fiscal position. Often overlooked, however, is the huge retrenchment that is currently taking place at state and local governments in the U.S. Balanced budgets for these entities are a legal necessity and in order to achieve the desired results massive cutbacks are taking place in the biggest states and in the biggest cities throughout the nation. These reductions are apt to have their largest adverse impact on the economy over the second half of the year. The size of the drag forthcoming from this sector is certainly open to debate, but these measures will be transpiring just as some Federal Government stimulus programs are ending. As an example, housing could once again retreat later this year as the first time home buyer tax credit has expired, thereby removing an important prop for this area of the economy.

If a slower pattern of activity does surface, the Federal Reserve will maintain its accommodative stance keeping the funds rate at its historically low range for at least several more quarters. A loss of economic momentum could place further downward pressure on commodity prices and the stock market could be vulnerable to a major correction. Treasury securities would

certainly benefit, setting the stage for even lower yields on intermediate and long term maturities as compared to current postings. Most likely, any slowdown would result in a further uptick in the nationwide unemployment rate that would produce readings above ten percent later in the year. Double digit joblessness would receive a great deal of attention in the media and could be a major factor in determining the outcome of the November elections. ■

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