

---

## QUARTERLY ECONOMIC AND MARKET UPDATE

January 2010

---

Presented By  
SWIS Advisory Service Group

**Brian Turner**  
Director, Advisory Services

**Jeremy Blair**  
Institutional Advisor

---

## ECONOMIC SNAPSHOT

---

### **NATIONALLY - SIGNS OF ECONOMIC IMPROVEMENT**

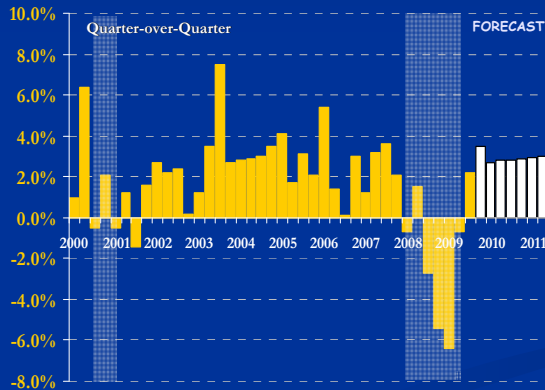
- Pockets of Improvements but Weakness “Scattered” Across Country
- Overall Labor Market Improving but still Considered “Tenuous”
- Impact on Consumer Net Wealth Still Impacting Spending Behavior

### **SOME SIGNS OF OPTIMISM**

- Encouraging Employment Reports Imply Some Stabilization
- Although Spending Remains Muted, Debt Burdens Declining
- Overall Weakness Has Helped to Keep Prices Down, Home Affordability Up
- Steep Yield Curve Helps to Support Net Interest Margins

# ECONOMIC GROWTH, JOBS AND SPENDING

## ECONOMY BEGINNING TO TURN ... POSITIVE OUTLOOK?



Source: Commerce Department, Bloomberg

### CURRENTLY....

- Initial Signs of Recovery
- Improved Spending?

### OUTLOOK....

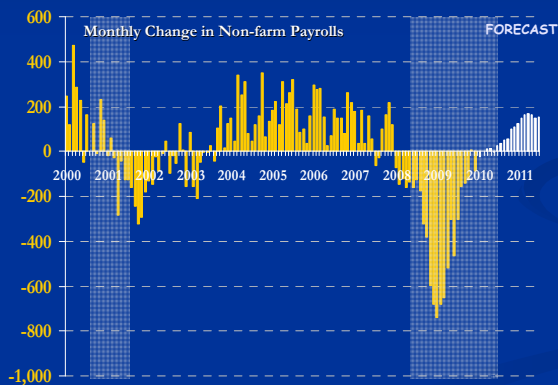
- Survey of 66 Economists
- Reflexes Expansion or Recovery?
- 2009 = -2.6% 2010 = 2.70%

### MAKING THE DIFFERENCE? .....

- Consumer Spending
- Labor Markets

# ECONOMIC GROWTH, JOBS AND SPENDING

## JOB LOSS HAS DECLINED ... WEAK PRIVATE SECTOR

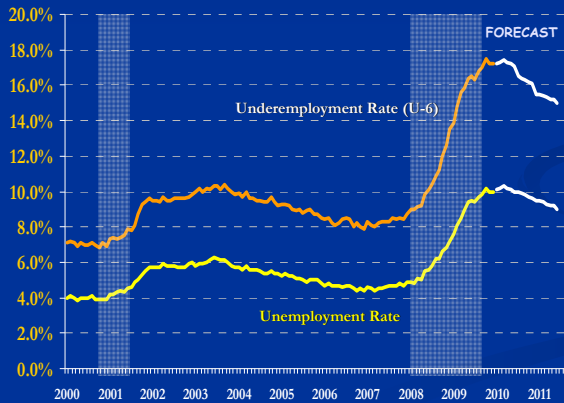


Source: Bureau of Labor Statistics

- Degree of Job Loss has been Deep
- Includes "Real" Jobs Created Between 2005 and 2007
- Includes both Manufacturing and Service Sector
- Pattern Has been Improving Although Unemployment Rate Still Increasing (Lagging Economic Indicator)
- Outlook not enough to fully recover total loss

## ECONOMIC GROWTH, JOBS AND SPENDING

### WILL TAKE TIME TO FULLY RECOVER.....



Source: Bureau of Labor Statistics

#### Unemployment is High and Deep....

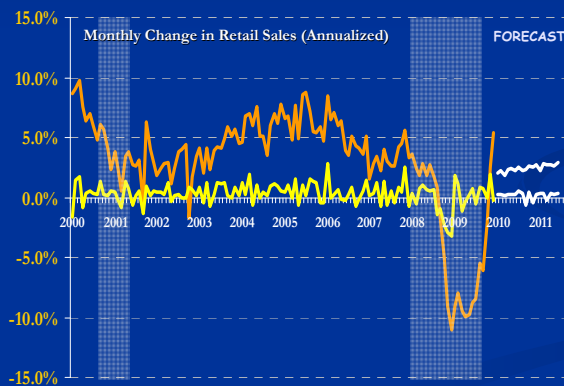
- The Unemployment Rate has Reached Levels Not Seen Since July 1983
- The Underemployment Rate is Even Higher

#### Moderate Improvement is Expected....

- Unemployment Rate will Remain Elevated thru 2010
- Estimates Show Employment Recovery may take Five Years

## ECONOMIC GROWTH, JOBS AND SPENDING

### SPENDING HAS FALLEN MORE THAN IN PREVIOUS RECESSIONS



Source: Commerce Department, Bloomberg

- Consumer Spending Accounts for 2/3rds of Nation's GDP

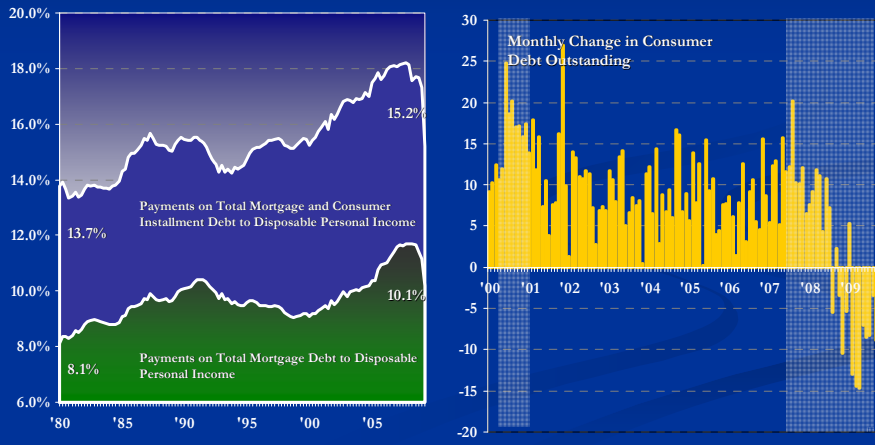
- Recent Reports May Point to an End of Protracted Decline

- Consumer Savings Ratio has Turned From Negative to Positive as Spending Cut Back

- But Labor Market Weakness Not Encouraging Consumer to Make Big Ticket Purchases or Pursue Added Services

# CONSUMER'S DEBT BURDEN AND LOAD

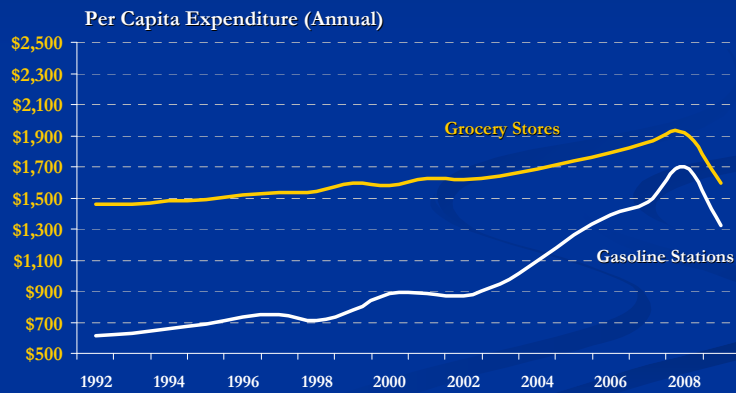
## CONSUMERS HAVE CHOSEN TO REDUCE DEBT BURDEN



Source: Federal Reserve Board

# CONSUMER'S DEBT BURDEN AND LOAD

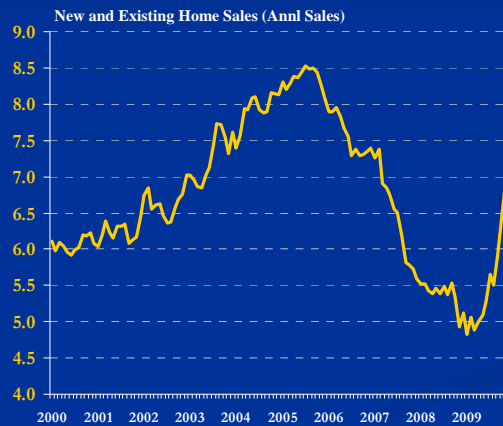
## AND INFLATION APPEARS TO BE IN CHECK.....



Source: Federal Reserve Board

# HOUSING ECONOMICS

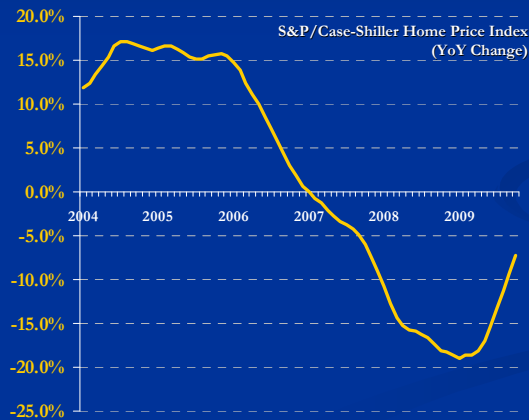
## HOUSING SECTOR IS IN TRANSITION.....



- Rising Foreclosures have Resulted in Lower Prices
- Pending Home Sales are Up 20% from Most Recent Low
- Existing Home Sales are Beginning to Stabilize
- Low Prices Means Improved Affordability (Depending on Region and Demographic)
- Impact on Home Equity and Net Wealth

# HOUSING ECONOMICS

## AS HOME PRICES APPEAR TO BE STABILIZING.....



### NATIONALLY.....

- Greatest Volatility Shown in West Coast, Upper Midwest and Deep South
- The Same Regions that:
  - Had the Highest Volume of Subprime, Adjustable Rate and ALT-A originations
  - Had the Lowest Affordability because of Past Acceleration in Home Prices (10-times the rate of Inflation)
  - Have the Highest Rate of Delinquency and Foreclosures.

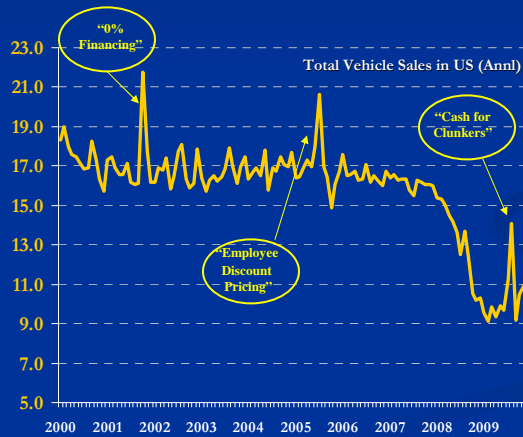
# HOUSING ECONOMICS

## ALTHOUGH IT VARIES BY REGION

S&P/Case-Shiller HPI		Oct/Sep Change	Sep/Aug Change	1-year Change
EAST	- Boston	- 0.6%	- 0.2%	- 2.8%
	- New York City	+ 0.0	- 0.3	- 7.7
SOUTH	- Atlanta	- 1.0%	+ 0.0%	- 8.1%
	- Miami	- 0.4	+ 0.5	- 14.0
	- Tampa	- 1.6	- 0.6	- 15.2
MIDWEST	- Dallas	- 0.6%	- 0.7%	- 0.6%
	- Minneapolis	- 0.5	+ 1.8	- 8.4
WEST	- Las Vegas	- 0.1%	- 0.9%	- 26.6%
	- Los Angeles	+ 0.3	+ 0.8	- 6.3
	- Phoenix	+ 1.3	+ 0.8	- 18.1
	- Seattle	+ 0.2	- 0.4	- 12.4
Composite - 20		+ 0.0%	+ 0.3%	- 7.3%

# VEHICLE SALES

## VEHICLE SALES HAVE HIT NEW LOWS

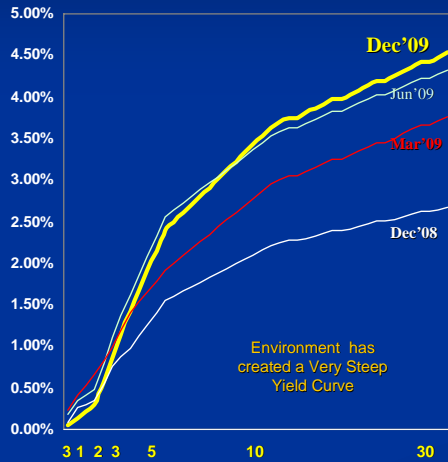


### NATIONALLY.....

- Weakness over past two years nearly unprecedented
- More than 1/3rd of CU Loans are still associated with Vehicle Loans
- "Cash for Clunkers" gave one-time, unsustainable boost to sales
- Outlook is very moderate although there is speculation of "pent-up" demand

Source: Bloomberg

## IMPACT ON INTEREST RATES



### SHIFTS IN THE YIELD CURVE

	Dec'08	Jun'09	Jan'10
Fed Funds Target	0.25%	0.25%	0.25%
2-yr UST Note	0.76	1.11	0.86
5-yr UST Note	1.55	2.55	2.39
10-yr UST Note	2.21	3.54	3.63
30-yr Fixed-rate FLM	5.14%	5.42%	5.06%
15-yr Fixed-rate FLM	4.91	4.87	4.45
60-mo Vehicle Loan	5.35	4.88	4.67

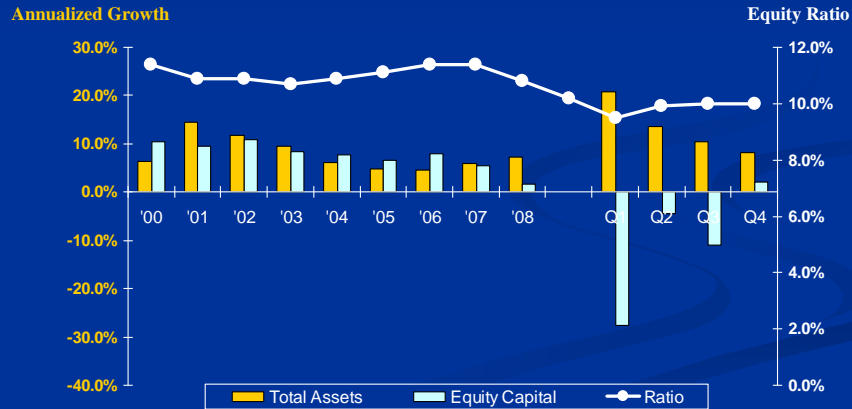
## IMPACT ON INTEREST RATES

### SHIFTS IN AVERAGE MARKET RATES

Avg National Rates	January, 2009		January, 2010	
	CU	Banks	CU	Banks
Classic Credit Card	11.73%	11.52%	11.66%	12.79%
Gold Credit Card	9.36	10.24	10.26	11.45
New Car – 60Mos	5.32	6.95	5.19%	6.33%
Used Car – 48Mos	5.19	7.10	5.33	6.83
15-yr FLM	5.03	5.00	4.73	4.69
30-Yr FLM	5.38	5.31	5.30	5.25
Regular Savings	0.55%	0.40%	0.40%	0.28%
Money Market – 10K	1.31	1.00	0.73	0.46
1Yr CD	2.44	2.12	1.39	1.09
2 Yr CD	2.70	2.21	1.81	1.53

## IMPACT ON CREDIT UNIONS

**2009: TOTAL ASSETS +8.1%    EQUITY CAPITAL +0.2%**



## IMPACT ON CREDIT UNIONS

### LOANS

<i>Annualized Growth Rates</i>		2008	2009
<b>TOTAL LOANS</b>		<b>+ 6.7%</b>	<b>+ 1.6%</b>
<u>Alloc</u>	<u>Alloc</u>		
10%	Unsecured	+ 5.7%	+ 1.6%
30%	Vehicle Loans	- 0.7%	- 0.5%
	New Vehicles ...    44%	- 6.3	- 6.1
	Used Vehicles ...    56%	+ 4.8	+ 4.3
53%	Total Real Estate	+ 11.5%	+ 1.6%
	First-Lien Mortgages ... 70%	+ 14.8	+ 4.6
	Second-lien Mortgages ... 15%	+ 0.5	- 14.2
	Home Equity ...    14%	+ 11.3	+ 7.8

} Reflects Economic Impact on Consumer Behavior

## IMPACT ON CREDIT UNIONS

### LOAN MISERY INDEX IMPACT IS ACROSS THE BOARD

Peer	(Total Assets)	Est	3-Year Average Loan Quality Rates*			
			Total	Unsecured	Consumer	FLM
Small	(\$0-\$50M)	2.30%	1.90%	3.57%	2.27%	0.80%
Moderate-size	(\$50-\$100M)	2.26	1.75	3.31	2.23	0.73
Mid-Size	(\$100-\$500M)	2.20	1.62	3.34	2.61	0.66
Large	(\$500M+)	2.14	1.48	3.47	2.19	0.40
All Credit Unions		2.22%	1.59%	3.45%	2.20%	0.65%

\*Combined Delinquency and Net Charge-off Ratios

## IMPACT ON CREDIT UNIONS

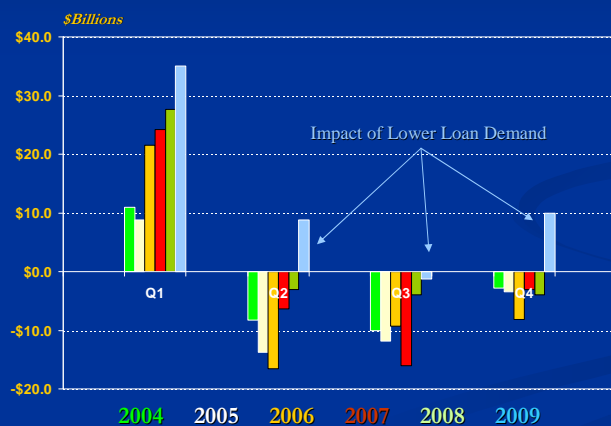
### SHARES

Annualized Growth Rates		2008	2009
<b>TOTAL SHARES</b>		<b>+ 6.9%</b>	<b>+ 10.8%</b>
<u>Alloc</u>	<u>Alloc</u>		
60%	Non-term Shares	+ 7.9%	+ 16.0%
	Share Drafts ...	+ 2.2	+ 13.0
	Regular Shares ...	+ 5.8	+ 12.1
	Money Market ...	+ 14.8	+ 23.4
40%	Certificates & IRAs	+ 5.7%	+ 4.0%
	Certificates ...	+ 3.8	+ 1.4
	IRAs ...	+ 12.9	+ 13.3

Reflects  
Disposable  
Income and  
Lower Consumer  
Spending

## IMPACT ON CREDIT UNIONS

### POSITIVE NET OPERATING CASH FLOW ... LIQUIDITY +31%



Traditional Quarterly Cash Flows Continue.....

- Net Inflows during Q1
- Loan ½ of the growth over next 3 quarters

Question Remains Whether Prolonged Recovery will Alter Tradition....

Causing Greater Reliance on Investment Revenues?

- \$3 for every \$1 in Principal?

## IMPACT ON CREDIT UNIONS

### EARNINGS AND NET RETURN

	2008	2009
Gross Asset Yield	6.51%	6.10%
Less: Provision	0.90	1.09
Net Asset Yield	5.61	5.01
Cost of Funds	2.44	1.81
Net Interest Margin	3.17%	3.20
Non-Interest Income	1.34	1.37
Non-Interest Expense	4.55	4.29
Net Operating Expense	3.21%	2.92%
Return on Assets	- 0.04%	0.28%
Return on Equity	- 0.04%	+2.7%

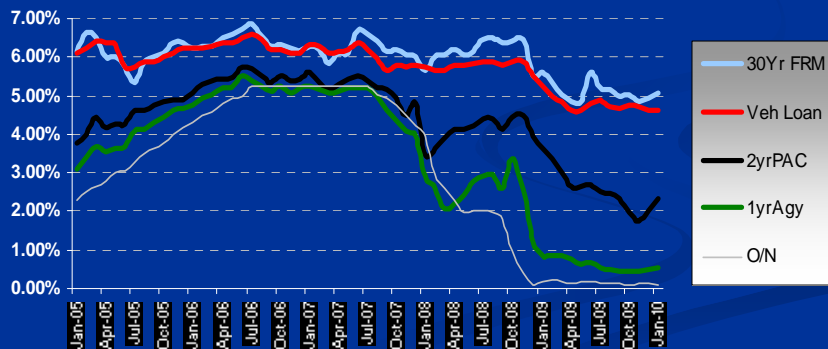
## RELATIVE VALUE OF MARGINAL ASSETS

### RELATIVE VALUE MATRIX

	6 Mos	1 Year	2 Years	3 Years	4 Years
U.S. Treasury	0.05%	0.30%	0.86%	1.43%	2.41%
Agency Bullets	0.10	0.42	1.02	1.70	2.25
Agency Callables	--	0.45	1.21	1.94	2.58
Corporate Certificates	0.28	0.44	1.09	1.74	2.25
SimpliCD	0.57	0.75	1.75	2.25	2.55
MBS – Agy PACs/SEQs	--	1.17	2.04	2.45	3.15
Vehicle Loans	--	--	--	4.65	--
15Yr FRM	--	--	--	--	4.45
30Yr FRM	--	--	--	--	5.09

## RELATIVE VALUE

### SHIFTS IN GROSS LOAN AND INVESTMENT RATES - Jan 2005 – Present -



## RELATIVE VALUE

---

### THINGS TO PONDER AND OPINE.....

- **WITH WEAK LOAN DEMAND, TO RETAIN CURRENT INCOME STREAMS .....**  
FOR EVERY \$1.00 OF LOAN PRINCIPAL RECEIVED, MUST INVEST \$2.45...
- **BY CHOOSING NOT TO HOLD 5.00% FIXED-RATE RESIDENTIAL MORTGAGES IN THIS ENVIRONMENT ...**  
OVER A 5-YEAR HOLDING PERIOD, THE CURRENT INVESTMENT RATE WOULD HAVE TO CLIMB AT LEAST 100 BPS per YEAR FOR 5-YEARS (+500bps) JUST TO BREAK-EVEN AGAINST THE 5.00% MORTGAGE LOAN (ASSUMING FIXED MARGINAL COSTS)
- **SHOULD WE EXTEND FUNDING DURATION IN THIS RATE ENVIRONMENT ...**  
HISTORICALLY, CREDIT UNIONS DO NOT RAISE THEIR NON-TERM SHARE RATES FOR THE FIRST +300 bps INCREASE IN THE FED FUNDS RATE. CURRENTLY, THERE IS A 176 bp DIFFERENCE BETWEEN THE AVG REGULAR SHARE AND 3-YEAR CERTIFICATE RATE.

## CURRENT OUTLOOK

---

### WHAT SHOULD WE EXPECT?

- Continued Rate Volatility as the Market Environment Shifts into a Growth Pattern. Steep yield curve should help to retain net interest margins.
- Little Movement in Short-term Interest Rates at least through the first half of 2010 as the Federal Reserve Continues to Struggle with Sustainable Economic Growth without Creating Upward Pressure on Prices.
- Credit Crunch to Continue Until Financial Institutions Can be Given a More Definitive Outlook on Federal Government's Fiscal Budget
- Pent up demand might bring short-term boom latter in 2010 especially if labor market improves
- Economic Growth to be Moderate in 2010 and early-2011 with Risk of "Double-Dip" Recession in latter-2011 if Consumer Spending Behavior Alters.

# QUESTIONS

---

## ADVISORY SERVICES GROUP

**Brian Turner**

Director, Advisory Services

[turnerb@swcorp.org](mailto:turnerb@swcorp.org)

**Jeremy Blair**

Institutional Advisor

[blairj@swcorp.org](mailto:blairj@swcorp.org)

**1-800-442-6427**