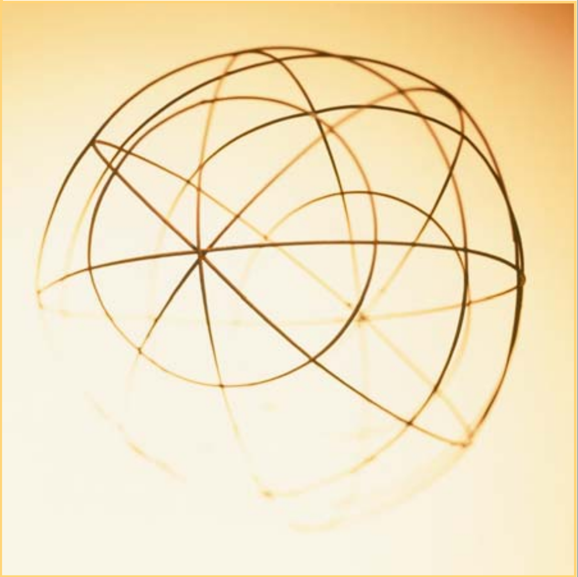
Macroeconomic Outlook

November 19, 2010

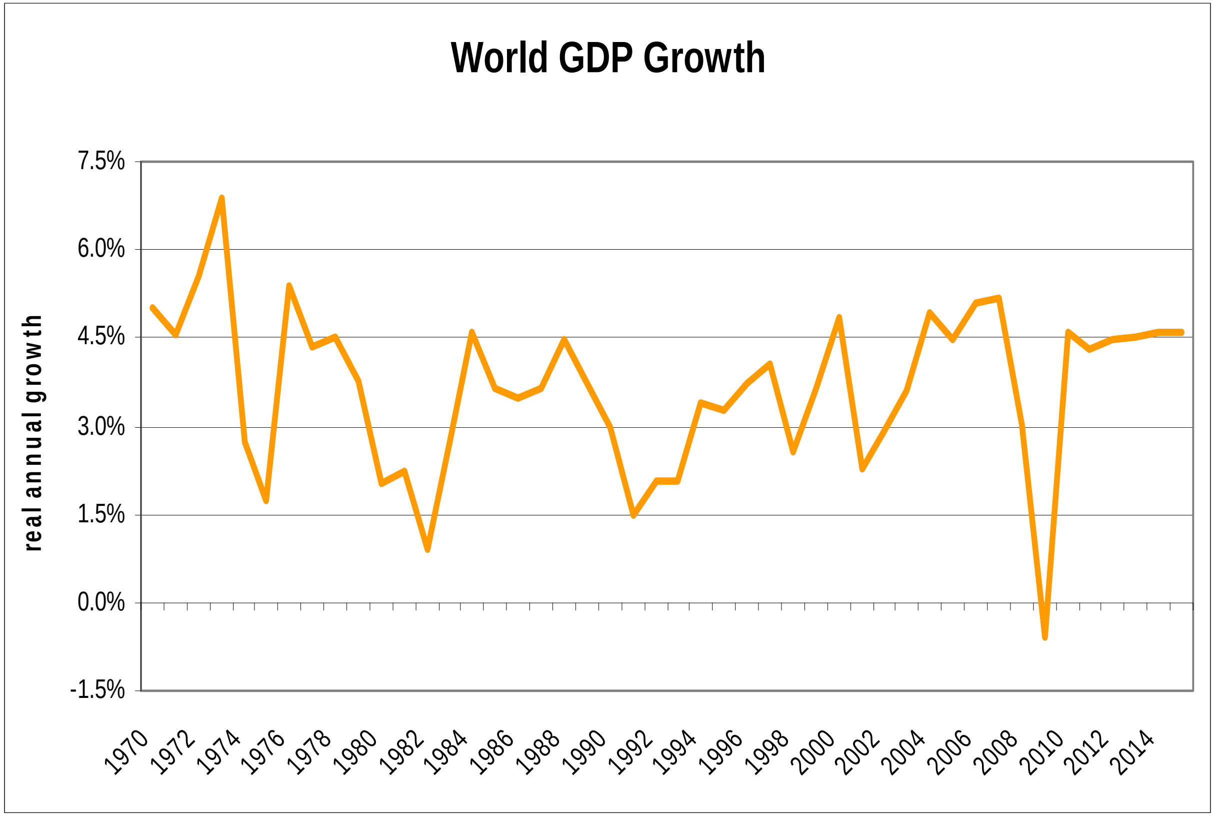


U.S. Economic Outlook

- Recovery more balanced, but losing momentum
  - Still weak housing market
  - High unemployment rates
  - Limited credit access for small business
- Corporate balance sheets very strong, but businesses not yet inclined toward major expansion initiatives
- Government policy error represents primary downside risk
- Projected U.S. real GDP growth of 2.5 – 3%* in 2010 and 2011
  - Market attention turns to deflation
  - Fed likely on hold until at least second half of 2011
  - Potential for improved job growth in 2011 as productivity slips
  - Extended period of highly accommodative monetary policy
- The prospects of a double-dip recession

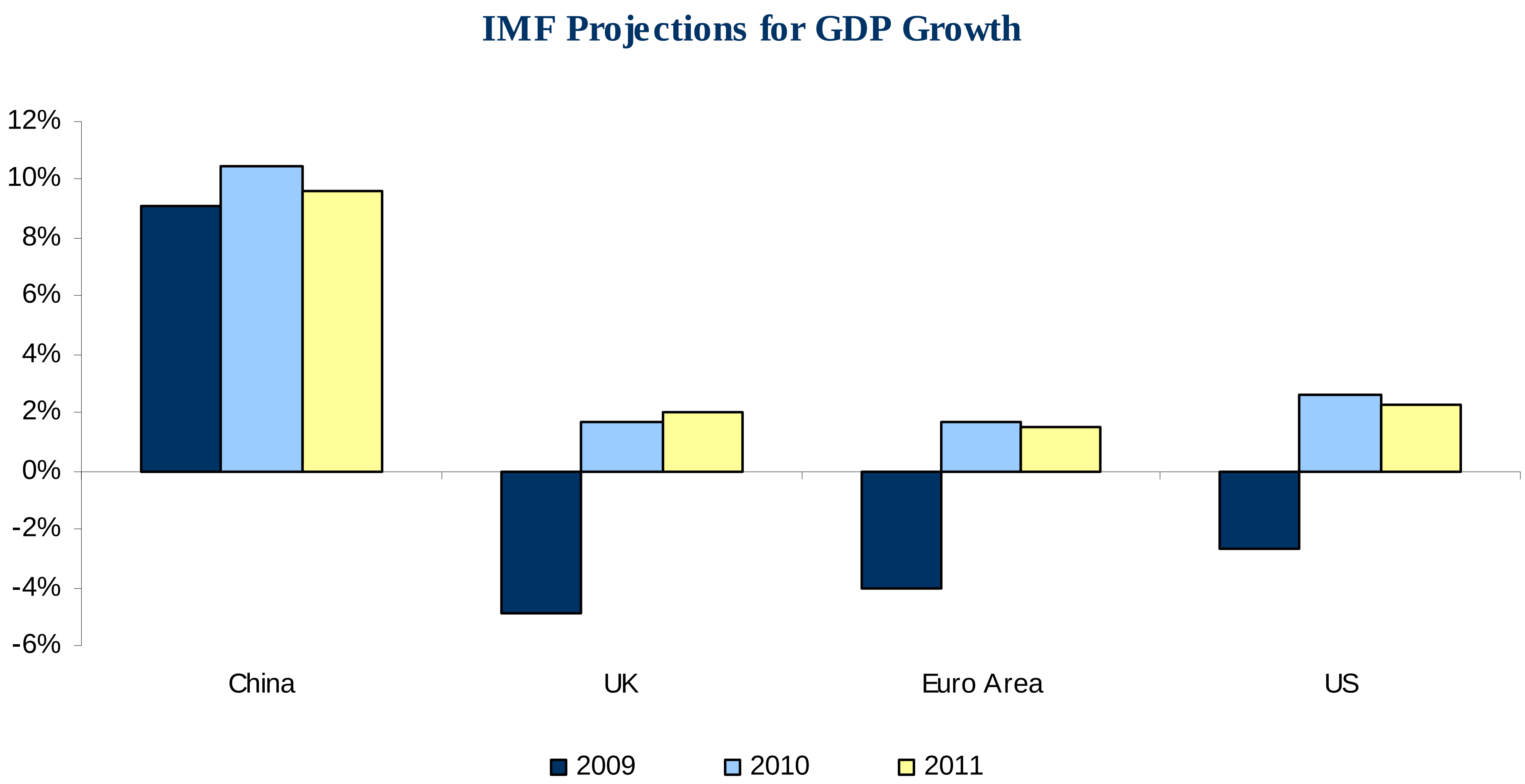
Global Economic Recovery

- Strength of global economic recovery coming into question, especially developed nations
  - Emerging markets leading recovery despite concerns about China growth trajectory
  - Many developed nations struggling with budget deficits and job creation
  - Austerity vs. continued government spending

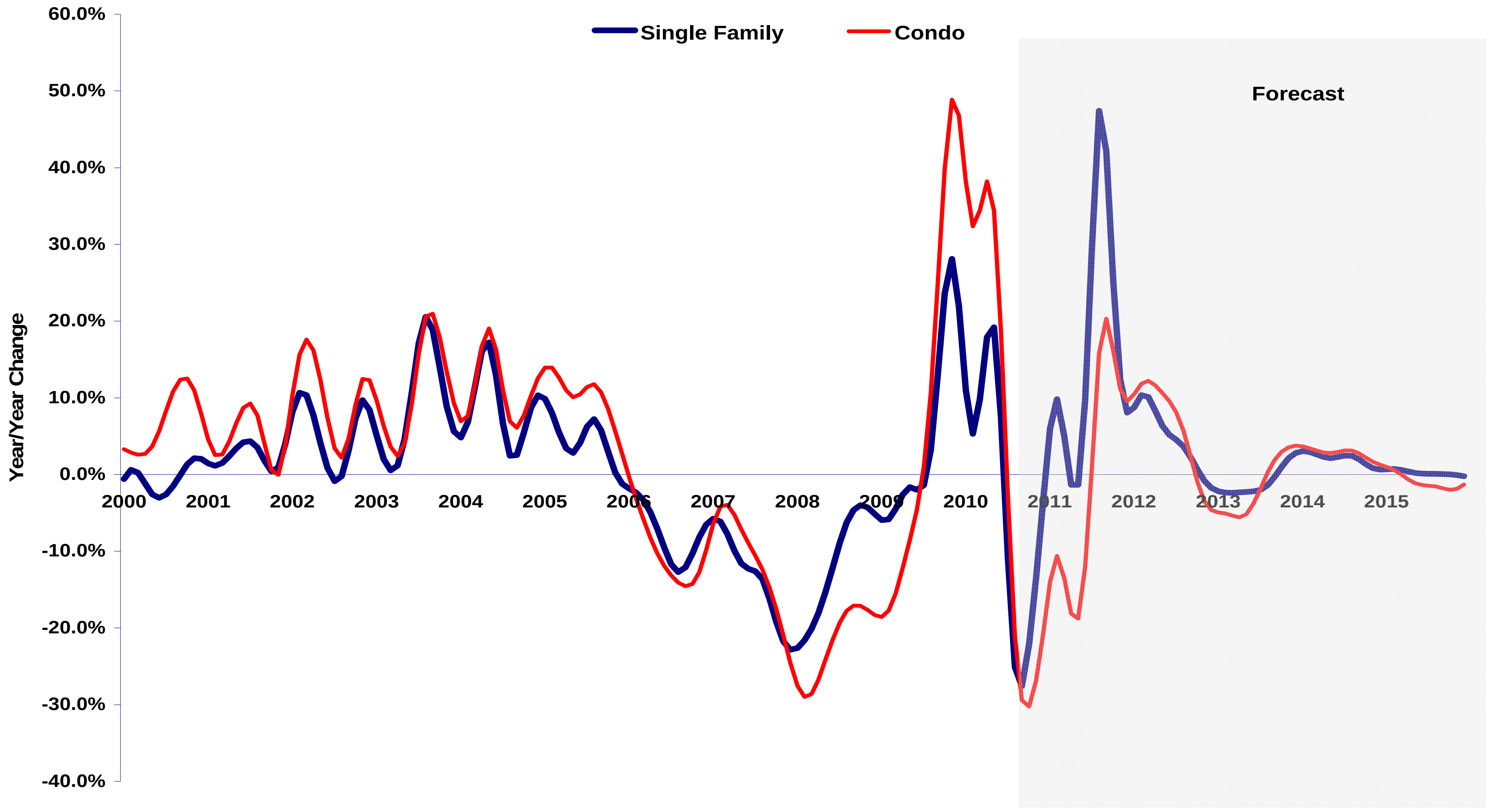


Source: International Monetary Fund, July 2010

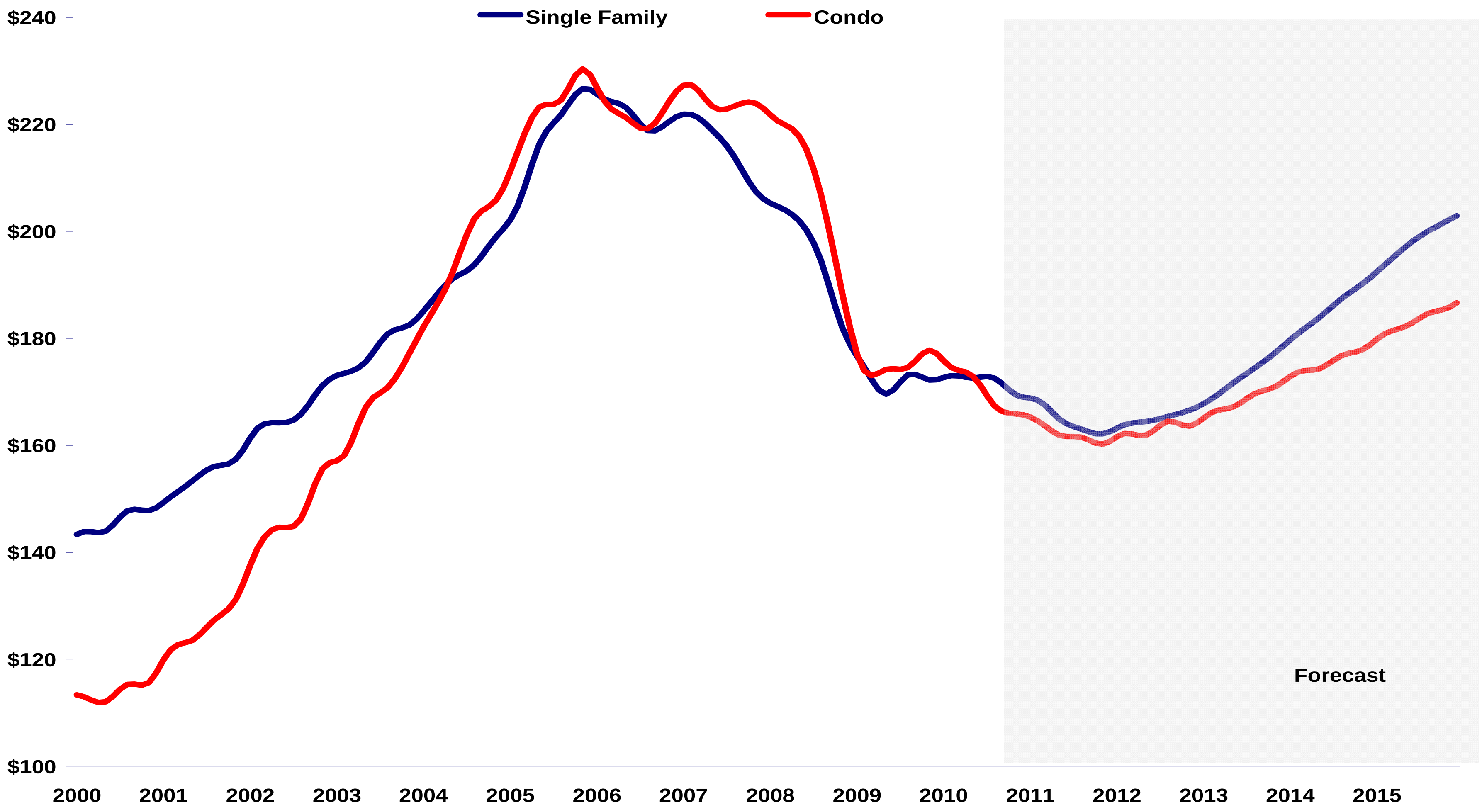
Economic Decoupling



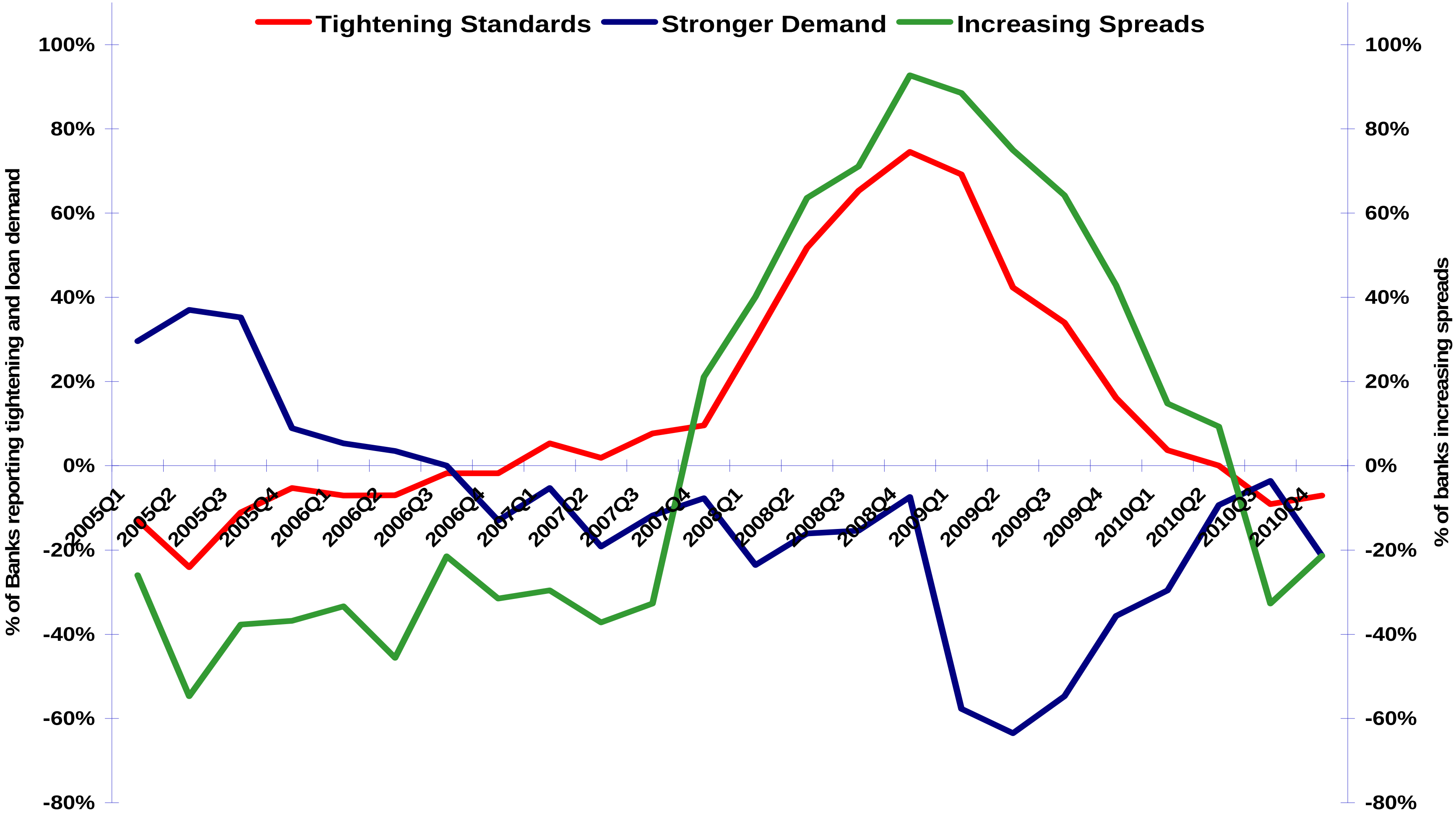
Housing Sales Remain Down



While Prices Continue To Decline

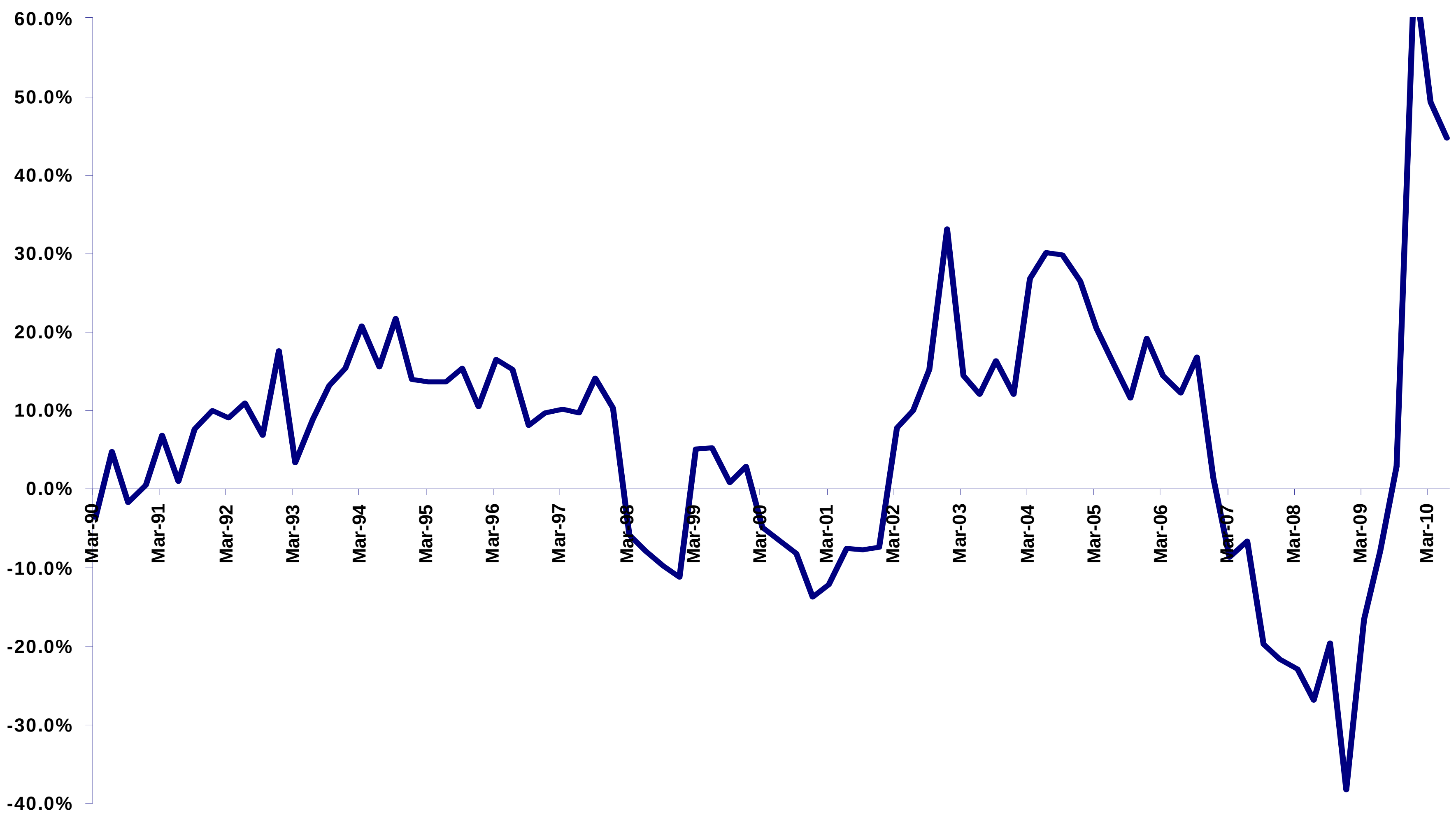


Access To Credit Still Difficult For Small Business



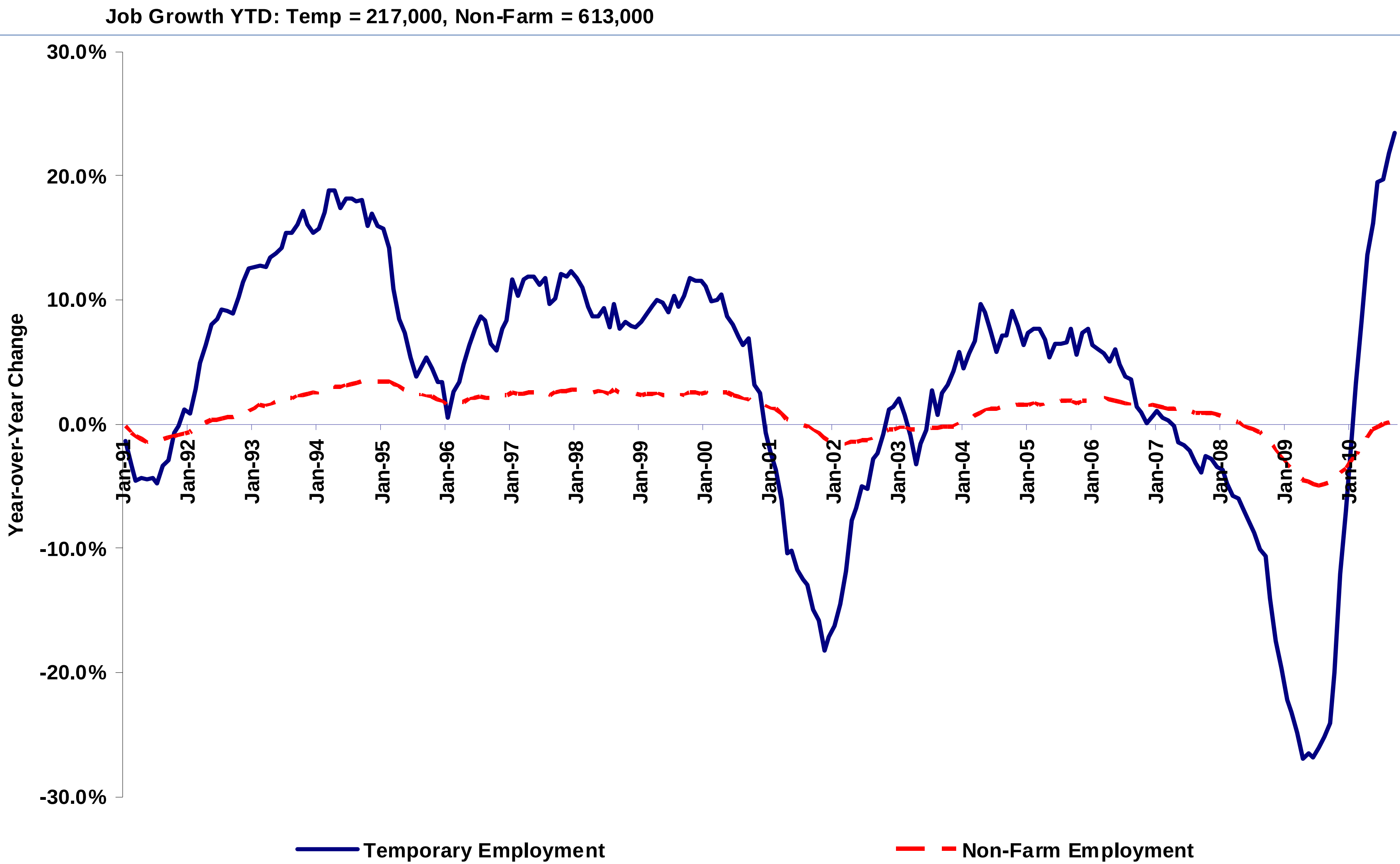
Source: Federal Reserve Senior Loan Officer Survey

Corporate Profits Point to Potential Growth



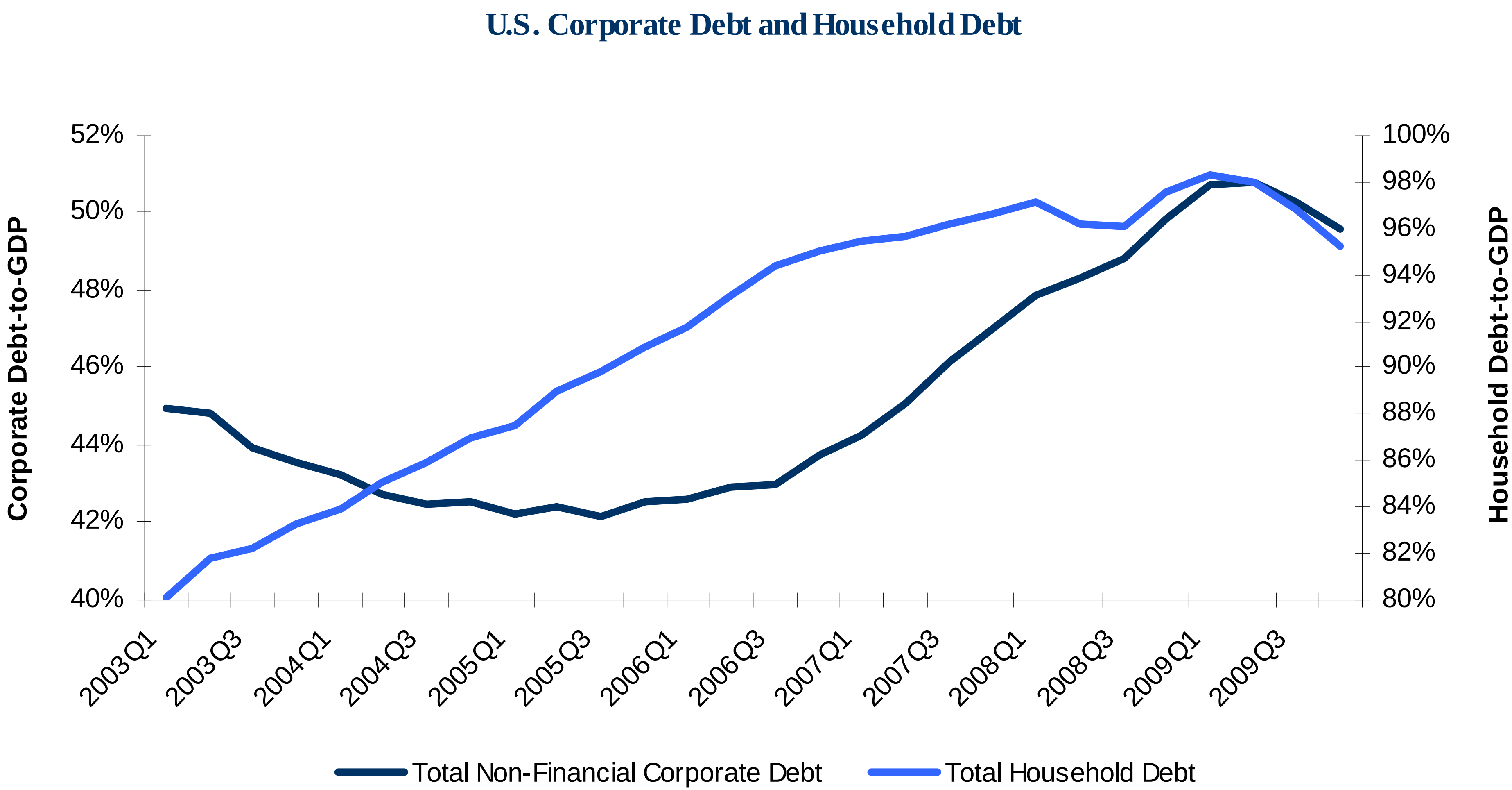
Source: Bureau of Economic Analysis

Companies Hesitant To Add Permanent Jobs

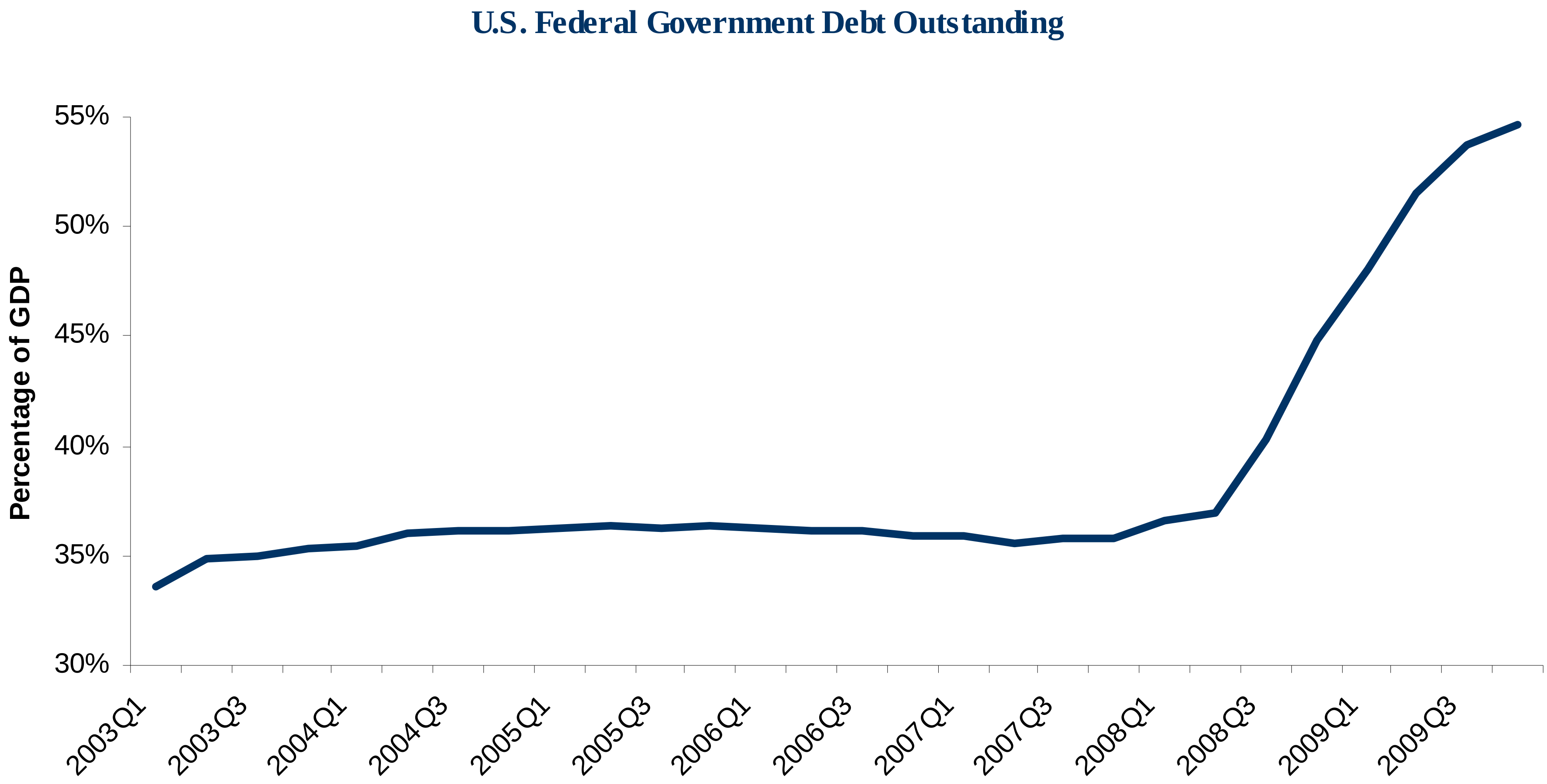


Source: BLS

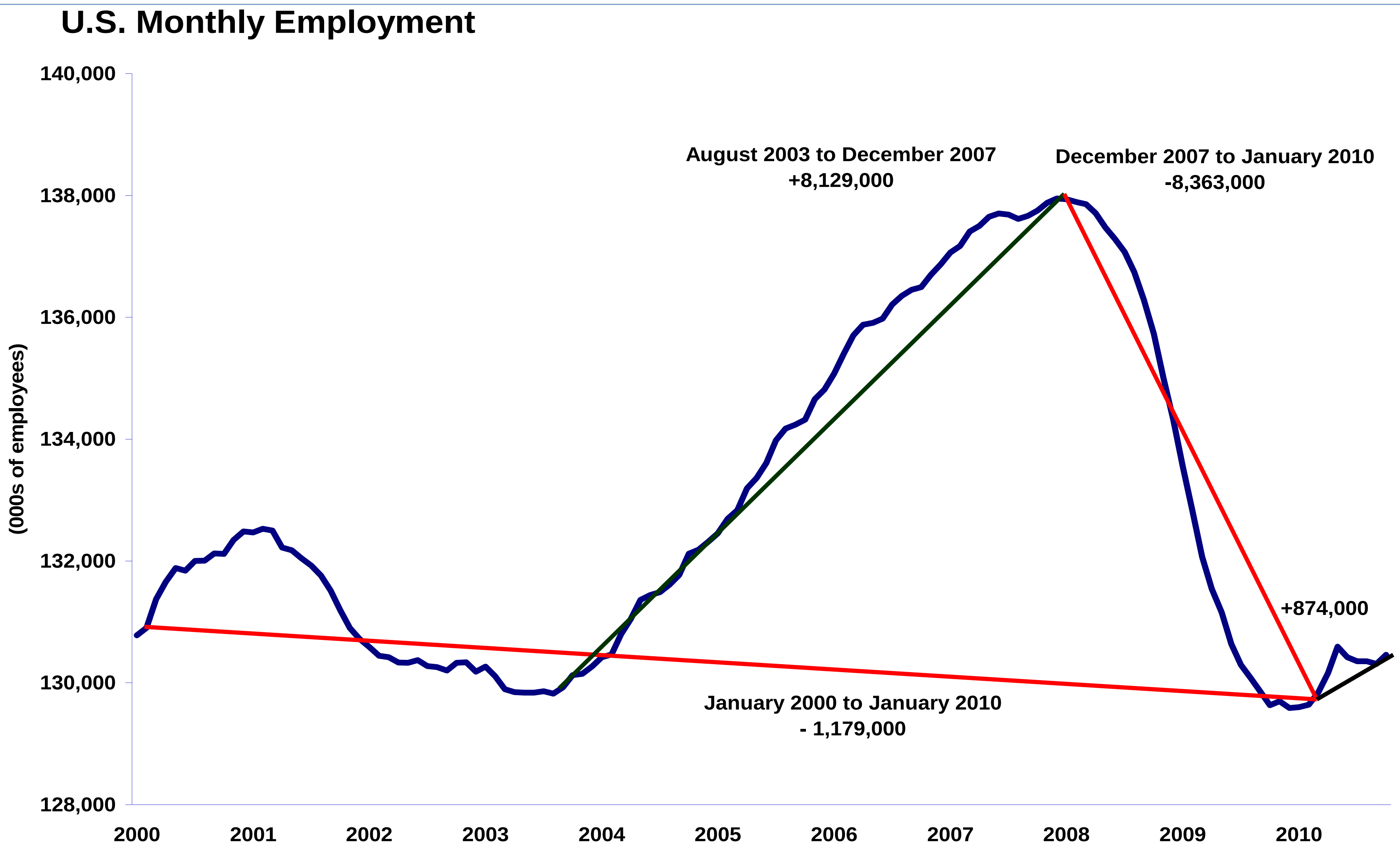
Private Sector Deleveraging



…But Not the Public Sector



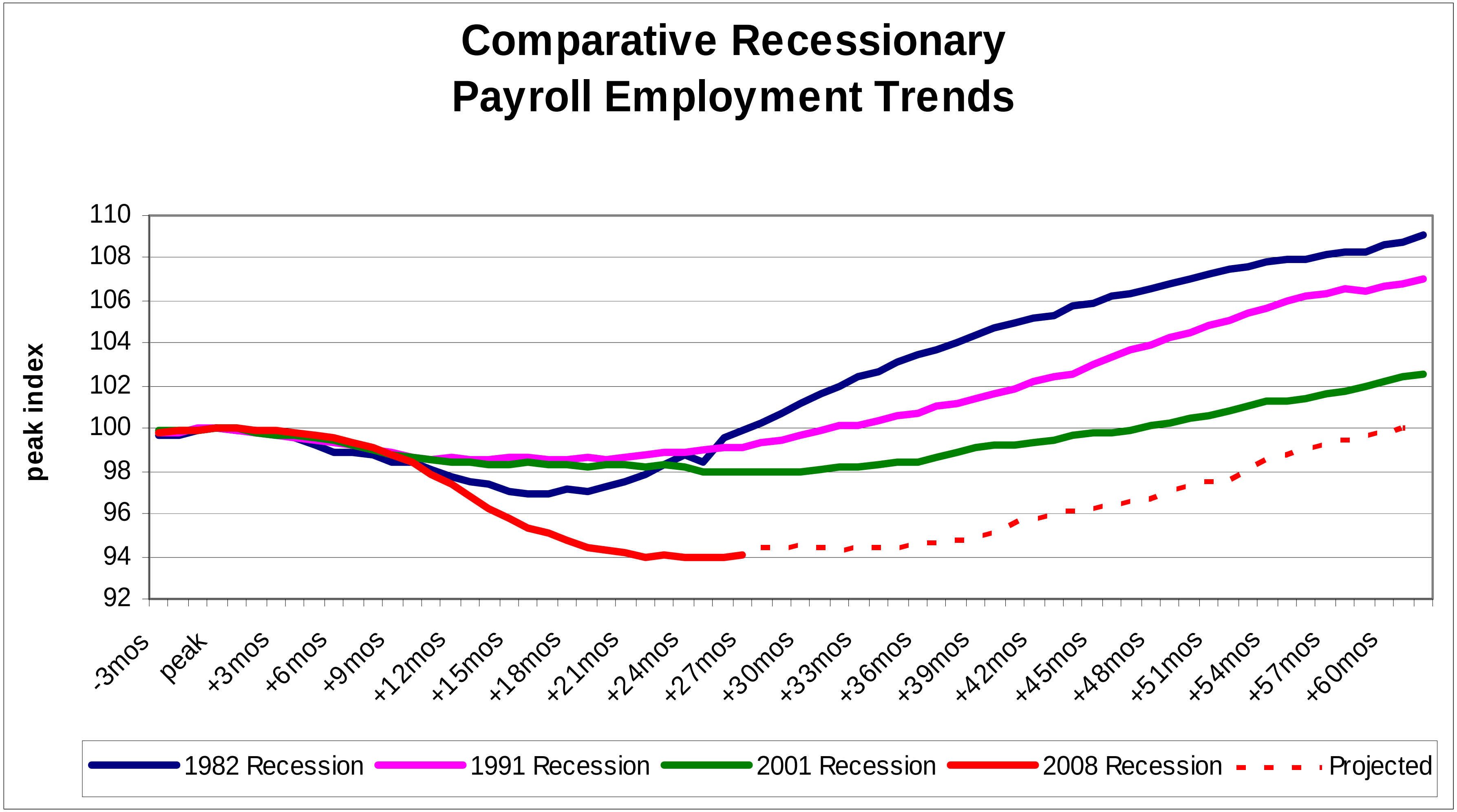
Payroll employment growth remains weak



Through October 2010

Source: BLS

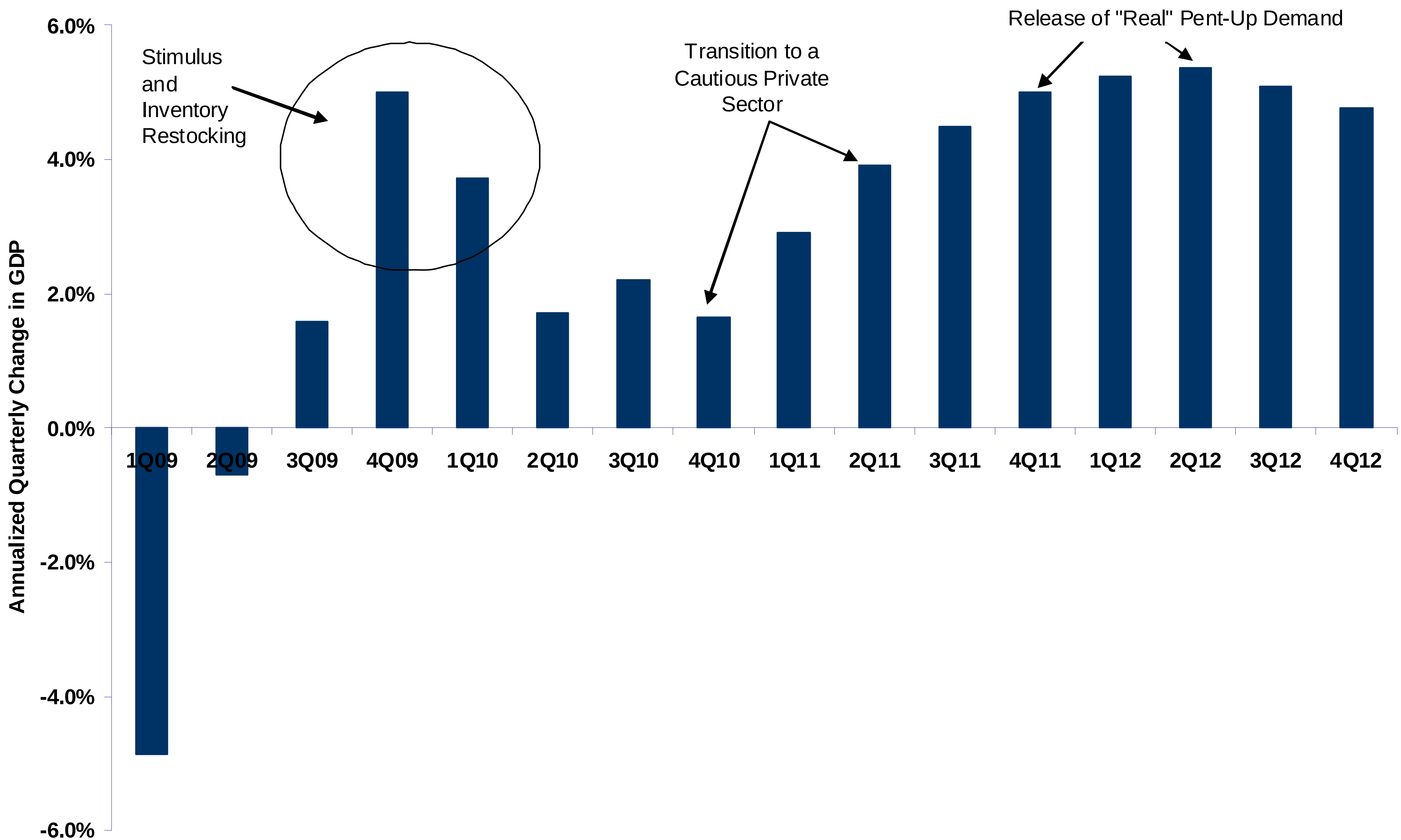
An Extended Job Recovery Likely In Store



Source: Bureau of Labor Statistics, Moody's Economy.com, July 2010

Economy Struggles with Transition

An Economy in Transition U.S. GDP Growth Past, Present and Future

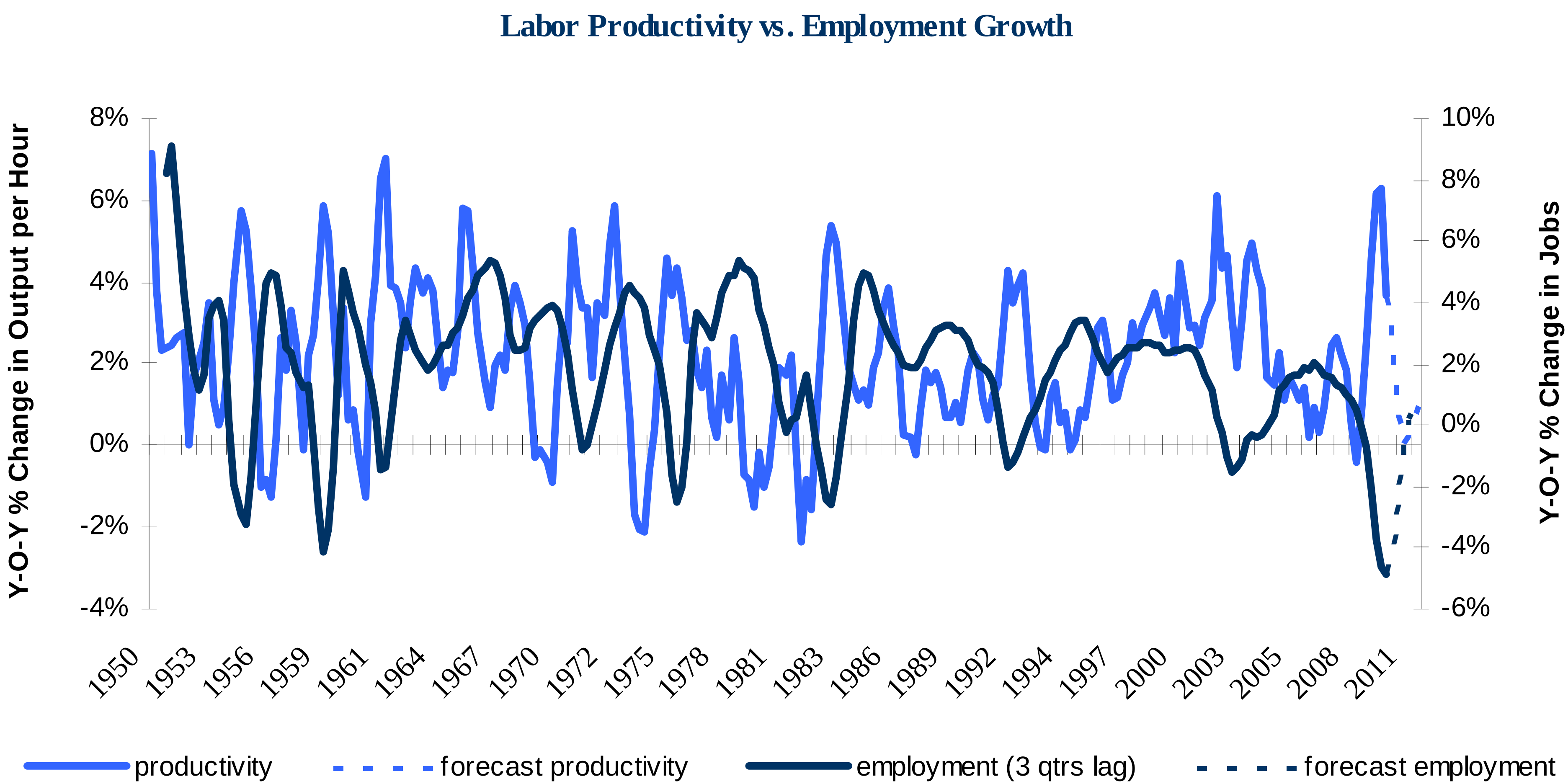


Source: BEA, Economy.com

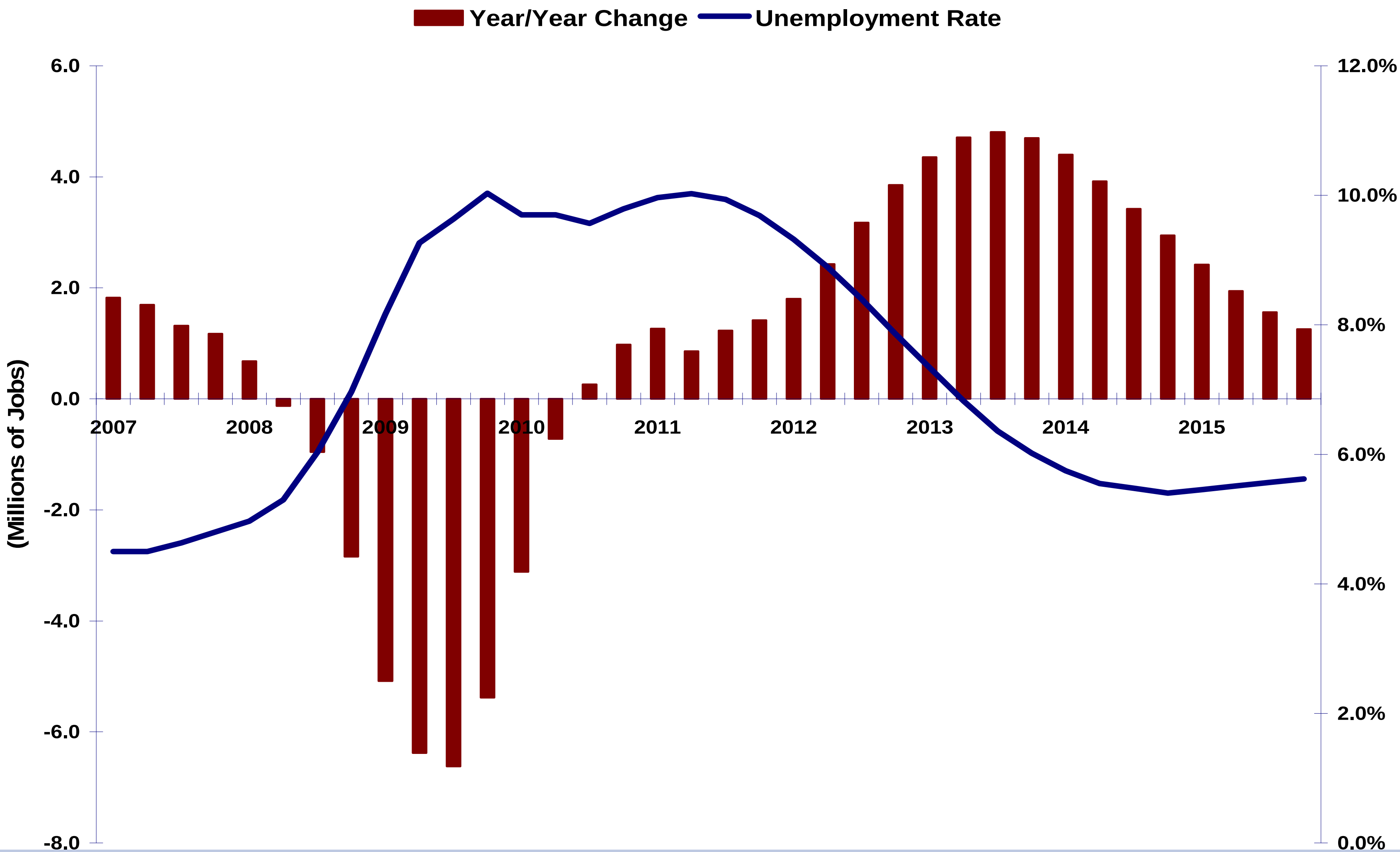
Reasons for Optimism in 2011

- Likely political gridlock → fewer unwelcome policy surprises
- Greater pro-business representation in Congress combined with continued strong business earnings → increased business confidence regarding expansion initiatives
- Bank failures likely begin to ease in 2011
- Stabilizing commercial real estate values could finally unclog bank balance sheets and free up credit formation to small business
- Continued progress with household deleveraging and higher savings rates → a more stabilized consumer
- Asset reflation-friendly actions by the Federal Reserve (Fed) could help boost stock market
- Falling labor productivity correlated with improved job growth

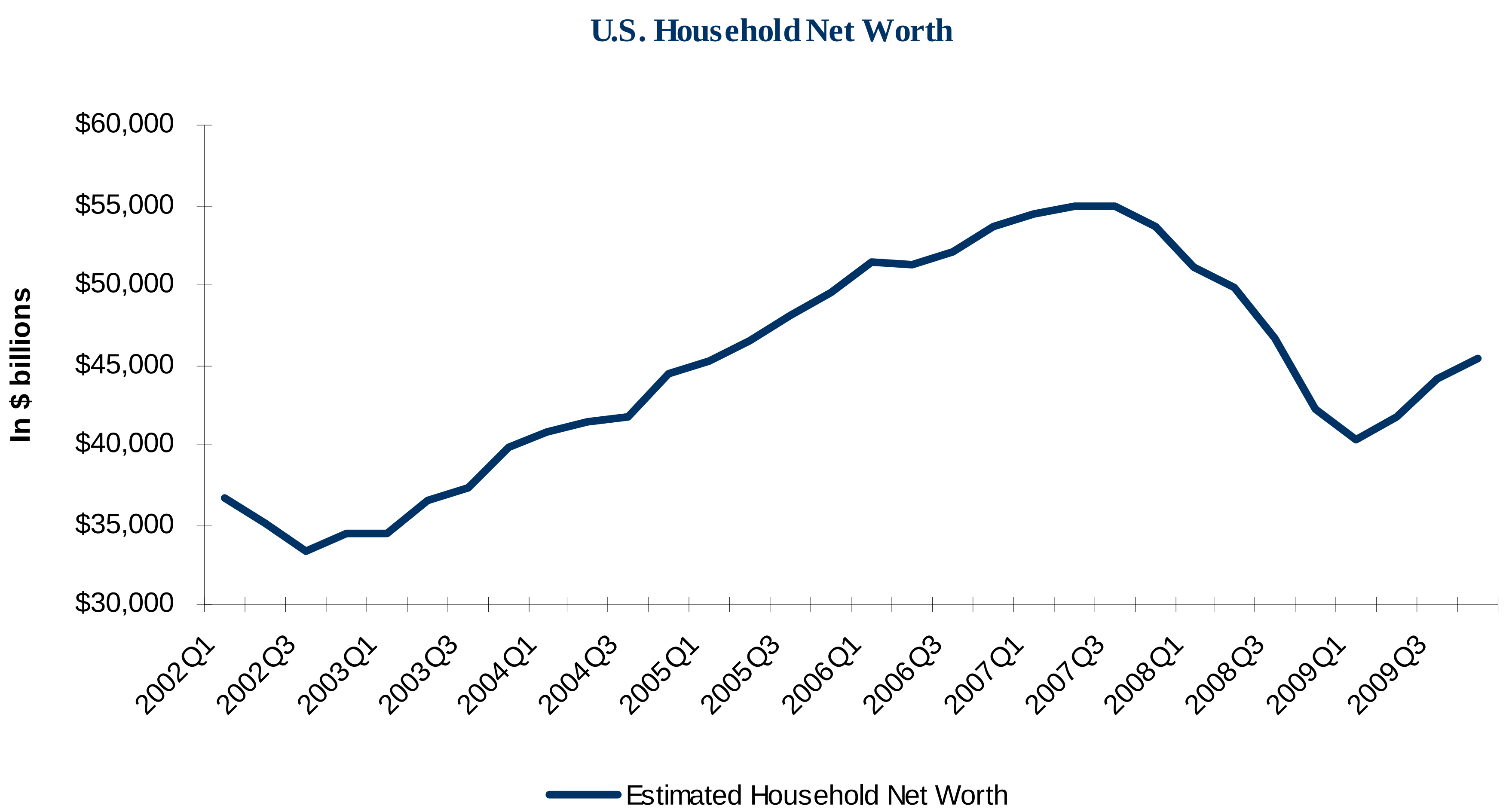
Slowing Productivity a Precursor to Job Growth?



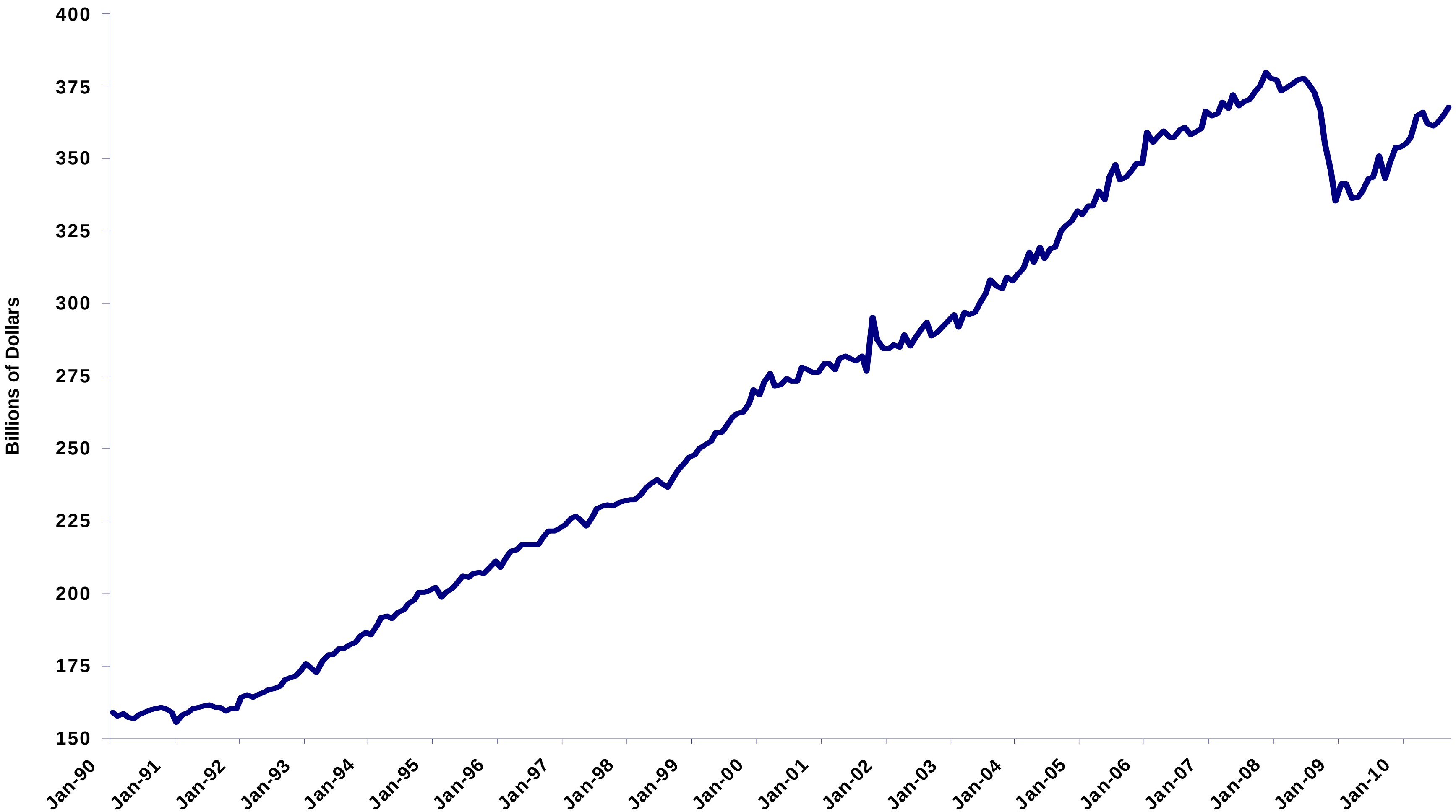
Job Growth Returns in 2011 and 2012



A Temporary Setback in Wealth Recovery

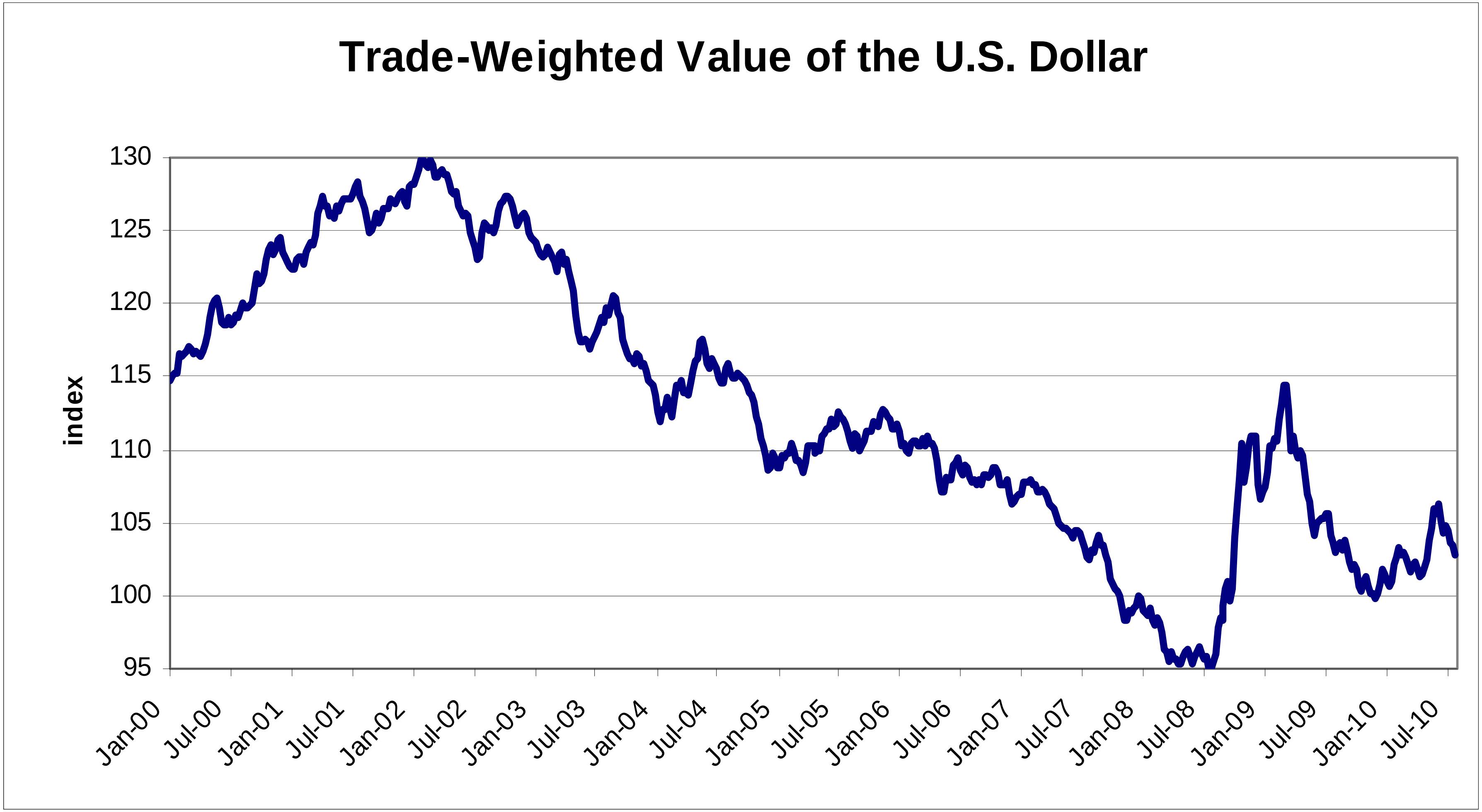


Retail Sales Have Resumed Growth



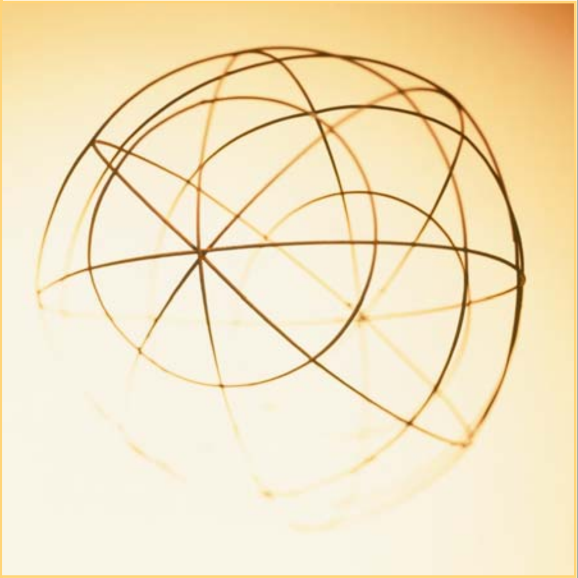
Source: U.S. Census Bureau

U.S. exports outlook strong, given weakened dollar



Source: Federal Reserve Bank, August 2010

Financial Reform



Dodd-Frank Wall Street Reform and Commercial Protection Act

Create a Sound Economic Foundation to Grow Jobs, Protect Consumers, Rein in Wall Street and Big Bonuses, End Bailouts and Too Big to Fail, Prevent Another Financial Crisis

- **Created a framework for multiple regulations**
- **Actual rulemaking will be handled by one of 11 different existing agencies**
- **Creates 13 new agencies and eliminates 1**
- **Will be phased in over next 1 to 5 years**

Summary Conclusions

- Final bill is sweeping in its scope and is especially tough on the Big Banks
- Most provisions will put downward pressure on profitability, upward pressure on capital and increase system stability
- Moves in the direction of ending Too-Big-to-Fail
- Insurance companies, credit rating agencies, and hedge funds relatively unscathed
- Regulations on derivatives market will likely make it more expensive to hedge macro-economic risk
- The complexity, ambiguity and timing of substantially higher capital requirements will have a negative impact on lending
- Once implementation is complete, credit markets should respond positively to the reduction in leverage, increased stability, and higher capital levels

A lot of work left to be done

Agency	All Rulemaking	One-Time Reports/Studies	New Periodic Reports
Bureau	24	4	5
CFTC	61	6	2
Council	56	8	4
FDIC	31	3	1
Federal Reserve	54	3	3
FTC	2	0	0
GAO	0	23	2
OCC	17	2	2
OFR	4	1	2
SEC	95	17	5
Treasury	9	1	1
Total	243	67	22

Rules That Could Impact Residential Real Estate

- Ability-to-Pay Requirements
- Prepayment Penalty Restrictions
- No Financing of Lump-sum Credit Insurance
- No Mandatory Arbitration
- Additional Disclosures – Charges, Compensation, Interest, Amortization, etc.
- No "Steering" Incentives
- Limits on Interaction with Appraisers
- High-Cost Mortgage Restrictions
- GSE reform is notably absent from the bill (although reform is still being studied)

Principal Global Investors

Rules That Could Impact CRE

- Risk Retention
- Increased ABS Disclosure
- Credit Rating Agency Reform
- Volker Rule
- FDIC "Safe Harbor" Proposed Rule
- SEC Regulation AB

Potential Unintended Consequences

- Decrease in bank lending
- Constrains recovery of securitization markets
- Scale back or divestiture of less attractive, less profitable consumer businesses
- Creates global regulatory arbitrage opportunities
- Drag on U.S. economic recovery
- More challenging for companies to hedge macro-economic uncertainty
- Less liquidity in selected financial markets (derivatives, FX, commodities?)
- Encourages the flow of risk and capital to less regulated jurisdictions, either outside the U.S. or in the “shadow banking system”