2014 Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE
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The Foundation is the only research organization dedicated solely to the equipment finance industry.

The Foundation accomplishes its mission through development of future-focused studies and reports identifying critical issues that could impact the industry.

The Foundation research is independent, predictive and peer-reviewed by industry experts. The Foundation is funded solely through contributions. Contributions to the Foundation are tax deductible.

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ABOUT THIS OUTLOOK

The Equipment Leasing & Finance Foundation (the Foundation) recognized that with the wide variety and increasing complexity of economic data available to the public, the best way to utilize key equipment investment data is to have it all in one place, where business leaders can access it easily and quickly, thus assisting them in making the best business decisions. This report highlights key trends in equipment investment and places them in the context of the broader U.S. economic climate.

Industry-specific data within the report are complemented by "Key Signposts" and Keybridge's Equipment and Software Momentum Monitor, leading indicators for the direction of growth in equipment investment. The outlook report also includes a review of regional trends and an analysis of capital spending in the United States, as well as an evaluation of how capital spending is affected by various related and exogenous factors in play, both currently and in the foreseeable future.

Partnering with Keybridge Research LLC, the Foundation was able to produce this economic outlook report specific to our industry. This report is the full 2014 Annual Outlook, and quarterly updates will be provided in April, July, and October of 2014.

Annual 2014 Equipment Leasing & Finance U.S. Economic Outlook Dec 2013

EXECUTIVE SUMMARY

In the 3rd quarter, GDP grew at an annualized rate of 3.6%, which was well above our forecast of 1.9%. However, subtracting out a 1.7% bump from a temporary inventory build-up, growth matched our forecast and is consistent with an economy still struggling in a "2 percent world." On top of the fiscal drag from the government shutdown in October, the jump in Q3 inventories will likely result in slower momentum in the fourth quarter. Accordingly, we expect GDP growth to end the year at just 1.6%.

Looking ahead to 2014, the balance of positive cyclical forces and persistent headwinds should shift moderately in a pro-growth direction. Assuming there is a tidy solution to the current budget discussions, economic growth is set to accelerate in 2014, driven by a number of positive factors. Specifically, a sustainable housing market recovery, low natural gas prices, robust auto sales, record high household wealth, steadily improving credit availability, and improving employment gains all point to 3 percent or stronger growth next year. However, these positive trends are counter-balanced by high oil prices, slow international growth, moderating fiscal consolidation and the continued threat of political uncertainty.

Overall, we expect the U.S. economy to grow 3.0% in 2014, the fastest pace since the 2008-09 recession.

Equipment and Software investment slowed from 1.0% annualized growth in Q2 2013 to 0.4% in Q3. Looking ahead, we expect modest growth in equipment and software investment for the coming year, with an overall forecast of 3.1% growth in 2014.

- Agriculture equipment investment is expected to remain weak on a quarter-to-quarter basis, and is projected to decline by 4% in 2014.
- Computers & Software investment is expected to continue growing at the current below average rate. Annual growth should be in the 2% to 4% range during Q4 of 2013.
- As expected, construction equipment investment declined in the 3rd quarter, falling 2.8% year-over-year. After reaching record-levels of investment in 2013, this vertical will likely decline by 5% to 10% in 2014.
- Industrial equipment investment accelerated to 5.0% annual growth in Q3, and is expected to maintain a steady growth trend going forward. Employment, new orders, and earnings data point to a positive 2014.
- Medical equipment investment grew in the third quarter but the sectors' leading indicators suggest little to no growth going forward.
- Transportation equipment investment saw modest growth in the third quarter, and improving indicators point stronger momentum over the next 6 to 12 months.

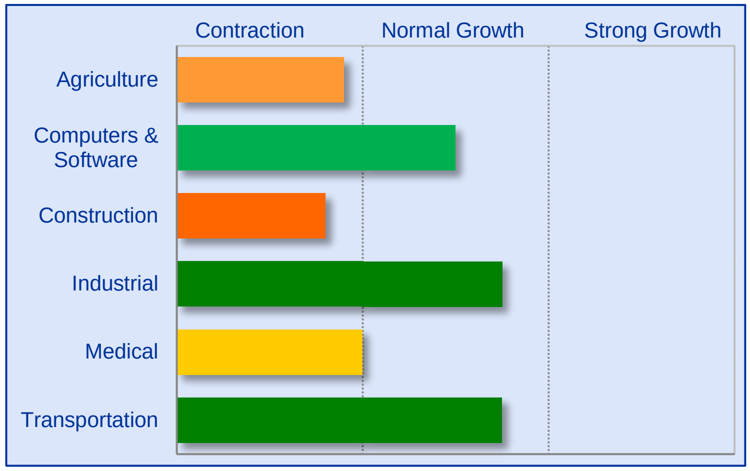
Credit market conditions remain highly accommodative, with many indicators continuing to recover to levels not seen since the onset of the recession. The Federal Reserve will continue to implement a two-pronged policy agenda in 2014. First, the Fed has pledged a firm commitment to holding short-term interest rates near zero until 2015. Secondly, the Fed is continuously re-evaluating its long-term asset purchase program ("QE"). The latest guidance is for QE tapering in the "coming months," which the market has interpreted as March 2014. This remains a fluid situation and one of the most important elements for anticipating interest rate movements. The market has partially factored in a near-term taper, but long-term interest rates are likely to rise in 2014. Because interest rates will remain low by historical standards, rising rates may have only a marginal impact on the lease-versus-buy decision. However, the changing rate environment could impact the equipment leasing industry in other ways, for example, through net interest margin compression.

KEY SIGNPOSTS FOR EQUIPMENT INVESTMENT: THREE- TO SIX-MONTH OUTLOOK

Summary

Equipment and software investment grew at an annualized rate of just 0.4% in Q3 2013, following similarly weak growth of 1.0% in Q2. Among verticals, agriculture and construction equipment contracted, computers & software and transportation equipment experienced moderate positive growth, and industrial and medical equipment grew at the fastest pace in over two years. Overall, we expect equipment and software investment to grow 3.1% in 2014 as economic conditions solidify and business confidence continues to recover.

Key Signposts "Heat Map" Growth Chart



Agriculture Equipment: As expected, investment contracted from Q2 to Q3, but increased year-over-year due to a low-base year effect. We expect a similar trend in Q4 as the continued delay of a Farm Bill and low crop prices will likely hold back investment in new agriculture equipment. The Texas Index of Leading Indicators continued to grow, but not by enough to outweigh other macroeconomic factors. Taken together, agriculture equipment investment is expected to grow at a below average rate (0% to -2%) over the next 3 to 6 months.

Computers & Software: Year-over-year growth increased from 1.9% in Q2 to 4.0% in Q3 as growing demand for cloud and mobile technology overcame an overall slow investment climate. The ISM Non-Manufacturing Index fell to a five-month low while the BRT CEO Economic Outlook Survey reached a six-quarter high. Overall, these signs suggest growth of 2% to 4% over the next several quarters.

Construction Equipment: As expected, investment in construction equipment contracted 2.8% year-over-year in Q3, after growing 38.1% in Q2. The decline was due to two major drivers. First, the market for construction equipment is slowing after a strong replacement cycle and build-up of rental equipment drove unsustainably rapid growth during 2012 and early 2013. Secondly, the housing market recovery, although still strong, has sputtered recently. Two leading indicators – Sales of New Single Family Homes and Building Permits – declined 12% and gained 9% respectively over the past three months. Overall, we expect a continued contraction of investment over the next 3 to 6 months.

Industrial Equipment: Year-over-year growth in industrial equipment investment accelerated from 1.4% in Q2 to 5.0% in Q3, hitting the upper end of our forecasted range. Three leading indicators for the vertical – Capacity Utilization, New Orders of Industrial Machinery, and Industrial Production – all hit a 5-year highs within the past few months. The sector has been driven by both a broad U.S. economic recovery and specifically by the resurgence of U.S. manufacturing, two factors that should continue to drive demand for industrial equipment in 2014. Overall, the key signposts suggest above average growth (2% to 5%) over the next 12 months.

Medical Equipment: Investment in medical equipment surprised on the upside, growing 7.3% year-over-year in Q3. Despite the above average pace seen in Q3, the signposts suggest little to no growth over the next 6 months. In particular, Hospital In-Patient Days have fallen to their lowest reading on record, while Producer Prices for Medical and Diagnostic Labs and Nursing & Residential Care Facility Revenues have effectively flat-lined.

Transportation Equipment: Investment grew 0.4% year-over-year in Q3, an improvement from the 4.6% contraction experienced in the second quarter. The signposts point to average growth (4% to 6%) for investment in transportation equipment. In particular, the Philadelphia Fed Business Outlook Survey surged in the Fall and Personal Consumption Expenditures for Motor Vehicles and Parts has continued to steadily grow.

Key Signposts for Equipment Investment

(Estimated growth rate ranges are on a __year-over-year__ basis)

Leading Indicator	Most Recent Data Point	Recent Trend	3-6 Month Signal & Annualized Growth Rate Range
Agriculture Equipment			***No Growth (0% to -2%)***
Texas Index of Leading Indicators (SA)	126.9 Sep-13	Up 0.6% in the past month, and up 3.2% over the past year	No Growth
Computers & Software			***Slow to Average Growth (2% to 4%)***
ISM Non-Manufacturing Composite Index (SA)	53.9 Nov-13	Down 2.7% this month and down 1.6% on the year	Slow to average growth
Business Roundtable CEO Economic Outlook Survey	84.5 Q4-13	Up 6.8% this quarter and up 29% year-year	Above average growth
Construction Equipment			***Contraction (-5% to -10%)***
HMI: Sales of New Single-Family Detached Homes Index (SA), Next Six Months	60 Nov-13	Down 12% over the past three months but still up 15% over the past year	Contraction
New Private Housing Building Permits (SAAR, Thousand Units)	1,039 Oct-13	Up 8.9% in three months and up 14% year-over-year	Average Growth
Industrial Equipment			***Above Average Growth (2% to 5%)***
Capacity Utilization (SA)	78.1% Oct-13	Down just 0.3% after September's 5-year high	Average growth
Manufacturers' New Orders (SA, $Mil)	4,060 Oct-13	Up 11% in six months and right below last month's 6-year high	Above average growth
Industrial Production Index (SA)	100.0 Oct-13	Down just 0.1% after September's 5-year high; Up 3.3% year-year	Average growth
Medical Equipment			***Little to No Growth (0% to 2%)***
Hospital In-patient Days (Thousands)	55,876 Q2-13	Down 2.2% year-over-year, and the lowest reading on record	Contraction
PPI: Medical & Diagnostic Labs	107.2 Oct-13	Up 0.4% this month, but still down 1.2% year-over-year	Little to no growth
Nursing & Residential Care Facilities Total Revenue ($Mil)	52,235 Q2-13	Up 2.6% year-over-year, but up just 0.1% over the past two quarters	Slow to average growth
Transportation Equipment			***Average Growth (4% to 6%)***
Philadelphia Fed Business Outlook Survey, Future Activity	45.8 Nov-13	November was weak but past 3 months are up over 100% from same period in 2012	Average growth
Real PCE: Motor Vehicles & Parts (SAAR, Bil.Chn.2005$)	384.8 Q3-13	Up 1.3% quarter-to-quarter and at a five-year high	Above average growth

How to Use the Key Signposts

Key Signposts are leading indicators for turning points in the equipment investment cycle, and also the direction of growth in equipment investment. "Turning Points" are defined as any point where the annualized growth rate is at a two-year high or low. The signposts are designed to analyze the 6 largest subsectors of equipment investment, as defined by the U.S. Department of Commerce's National Income & Product Accounts. These indicators have been chosen based on their ability to consistently and accurately identify future trends in equipment investment with a lead-time of 3 to 6 months. For each investment subsector, the signposts should be interpreted together—providing either reinforcing or counter-balancing signals. There are three components of the signpost analysis that can be used to identify the direction of growth in major sectors of the equipment financing industry:

(1) The summary provides a narrative for each investment sector.
(2) The "heat map chart" shows which investment sectors are poised to contract, or grow at a normal or strong pace.
(3) The data table lists the most recent sign post data, recent trends, and the investment growth signal provided by each indicator.

OVERVIEW OF MACROECONOMY IN 2014

In the 3rd quarter, GDP grew at an annualized rate of 3.6%, which was well above our forecast of 1.9%. However, subtracting out a 1.7% bump from a temporary inventory build-up, growth matched our forecast and is consistent with an economy still struggling in a "2 percent world." On top of the fiscal drag from the government shutdown in October, the jump in Q3 inventories will likely result in slower momentum in the fourth quarter. Accordingly, we expect GDP growth to end the year at just 1.6%.

Looking ahead to 2014, the balance of positive cyclical forces and persistent headwinds should shift moderately in a pro-growth direction. Assuming there is a tidy solution to the current budget discussions, economic growth is set to accelerate in 2014, driven by a number of positive factors. Specifically, a sustainable housing market recovery, low natural gas prices, robust auto sales, record high household wealth, steadily improving credit availability, and improving employment gains all point to 3 percent or stronger growth next year. However, downside risks from high oil prices, slow international growth, moderating fiscal consolidation, and the continued threat of political uncertainty could stunt growth in the year ahead.

Indicator	Recent Activity
Consumption	Consumer spending grew in Q3 2013, but at its slowest rate since Q4 2009.
Equipment & Software Investment	Equipment & Software Investment increased at a 0.4% annualized rate in Q3. This marks the slowest rate in four quarters.
Residential Investment	Residential Investment continued to post strong growth in Q3, further evidence of the sustained housing recovery.
Government Expenditures	Government spending increased a mere 0.4% in Q3, led by a rebound in state and local government spending. Federal spending remained weak.
Net Exports	Exports grew in Q3, albeit at a slower pace than in the previous quarter.
Inflation	Inflation has averaged only 1.5% from January through October.

The December average of the *Economist* Poll of Forecasters for 2014 GDP growth is unchanged from 2.7% in September, while the Federal Reserve's most recent "central tendency" forecast for growth is in the range of 2.9% to 3.1% – a slight decline from the Fed's September forecast. According to minutes from the latest FOMC meeting, this forecast assumes that the "fiscal drag", which was a major detractor from growth in 2013, will subside in 2014, as taxes are not set to increase and automatic budget cuts will be less severe.

Positive cyclical momentum should outweigh the negative forces and provide for the strongest growth since the recession of 2008-09. Domestically, momentum is observed in crucial sectors, such as housing, oil & gas production, financial markets and employment. And abroad, Europe is emerging out of recession while growth is stabilizing in Japan and China.

Overall, Keybridge's macro outlook is slightly above consensus forecasts – we expect growth of 3.0% in 2014.

Headline CPI inflation will likely remain subdued – slightly below 2% – in 2014. Given the geo-political environment, oil price shocks are a concern, but rising domestic energy production will otherwise continue to temper prices and help tame inflationary pressures. Additionally, limited real wage growth, and flat food prices are likely to continue for much of 2014. On the upside, the run-up in housing prices will begin to work into the CPI inflation, but will likely only add 0.1% to 0.3% to headline inflation

Two central themes affecting our outlook for the remainder of 2013 and 2014 are fiscal and monetary policies.

The October government shutdown will unfortunately clip Q4 2013 GDP growth by between 0.3 and 0.6 percentage points. However, these negative effects will be temporary, and most of the foregone output will be added back into the economy in early 2014. For example, furloughed government workers or contracted employees, who are now back to work, are likely to quickly return to their normal rates of economic activity. As a part of the deal that re-opened the federal government and raised the debt ceiling in mid-October, Congress required a joint conference committee to propose a 2014 budget deal by December 13th. Notwithstanding a messy fiscal policy resolution to the budget negotiations, "fiscal drag" should become less of a factor in 2014. As of December 9, it appeared that Congressional budget negotiations are moving in a constructive direction. In addition to the American public and the corporate sector, Republican and Democratic leaders are eager to avoid another showdown, or potential government shutdown, over the budget. Indications are that a budget deal will partially repeal the sequester and raise agency spending to roughly $1.015 trillion in 2014 and 2015. With factions on both sides of the aisle resistant to compromise, it remains unclear whether such a budget deal would have enough votes to pass. If a deal cannot be reached, House Republicans will likely try to push through a short-term continuing resolution to avoid another financial crisis after the New Year. If the budget deal does pass, government spending could provide a slight positive bump to GDP in 2014 in the range of 0.25%.

The future of monetary policy will be the other central theme of 2014. With a new incoming Federal Reserve chairman, a shuffling of FOMC members, and improving labor market conditions, the likelihood of tapering continues to increase. The detailed minutes from the FOMC meeting on October 29-30th show the Fed's clear commitment to short-term zero interest-rate policy well into 2014. However, a reduction in the pace of quantitative easing remains on the table now that fiscal headwinds appear to have subsided and job market gains are showing positive momentum. Additionally, the Fed is looking for ways to reinforce that short-term interest rates will remain low long after any type of "tapering" begins, which would ease any potential shock to interest rates once the Fed does in fact announce a taper. Janet Yellen is set to take over as Fed chairman in early 2014, and it is largely expected that her views will be a continuation of current policies. At her confirmation hearing, she noted the effectiveness of the large-scale asset purchases in helping to support a robust economic recovery, a clear signal of her commitment to continuing current monetary policy to support the Fed's dual mandate of price stability and full employment. Overall, we expect a moderate steepening of the yield curve in 2014, as short-term rates remain low and long-term rates rise in response to the Fed's expected tapering actions.

ADDITIONAL FACTORS TO WATCH

Our sector-level analysis repeats many of the same themes of recent quarters, but the following trends continue to be a useful narrative for the U.S. outlook this year:

Healing of the Consumer: Household net worth has hit a record high, as house prices and financial assets continue to appreciate. Consumers are also benefiting from falling gasoline prices, which have driven real disposable income growth over the past few months. Going into the holiday season, lower gasoline prices will put more money into consumers' pockets and boost retail sales. However, the prospect of rising interest rates could have a temporary negative impact on the stock market and slow down the rise in home prices in early to mid-2014.

Housing Sector: Despite some slowing in recent months due to rising mortgage rates, the housing recovery continues to push forward. Home prices are up 13.3% year-over-year, and the increase in housing wealth has added an estimated additional $134 billion to consumer spending in 2013.

Energy Renaissance: A study from IHS estimated that unconventional oil and gas production supported 1.7 million jobs and contributed $238 billion to GDP in the U.S. in 2012. The International Energy Agency has also recently forecast that the United States will be the world's largest producer of oil by 2015, producing an estimated 11 million barrels per day. The wave of cheap domestic natural gas is also benefiting manufacturers of petrochemicals, plastics, and other downstream products.

Financial Sector Healing: Demand for Commercial & Industrial (C&I) loans has grown 8.0% year-over-year, while credit supply continues to heal after freezing up amidst the recession. Interest rates remain historically low and charge-off rates for all types of commercial loans and leases are at record lows.

Improving Global Economy: Global economic conditions continue to slowly improve. The ZEW Economic Sentiment Index is signaling stronger expectations in the Euro-Zone over the next six months, and the ECB's recent rate cut should help support rate-sensitive sectors. Elsewhere, Q3 GDP growth in China improved to 7.8% year-over-year, a sign that the world's second-largest economy may be exiting a soft patch.

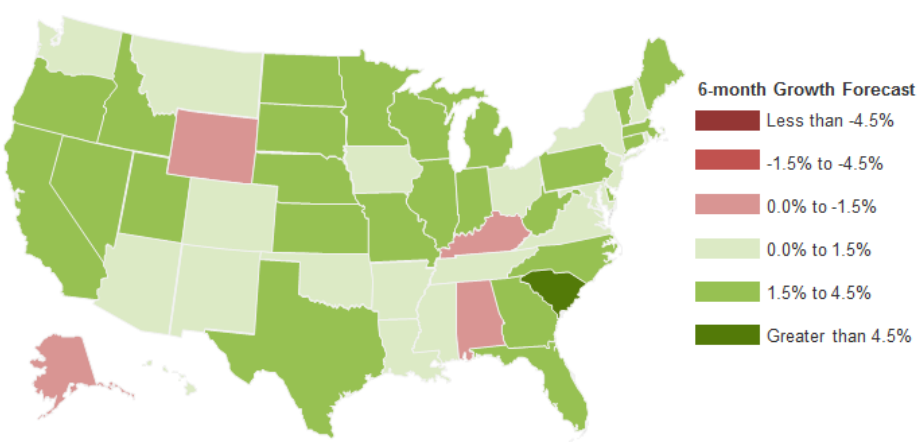
Review of Regional Trends

Although the country as a whole experienced subpar growth in 2013, there has been marked improvement in many state and local economies. The rebounding housing market, strengthening auto and energy sectors, rebuilding after Hurricane Sandy, and unconventional production of oil and gas continues to benefit regional employment and income growth in many regions. As a result of improving regional economic and fiscal situations, state and local government spending increased 1.7% at an annualized rate in Q3 2013, the fastest growth since Q2 2009. Overall, the near-term regional outlooks are pointing towards modest growth for many regions. Leading indicators are mixed, and reflect inter-regional dynamics:

- **Northeast**: After experiencing a difficult 2012 due to Hurricane Sandy, 2013 marked an improved year for the region. The unemployment in the Northeast has declined 0.6 percentage points from one year ago, and is now just slightly above the national average. Looking forward, the Empire State Manufacturing Survey for Future New Orders has increased steadily since mid-2013, indicating continued growth in the coming year.
- **Southeast:** Growth has been inconsistent across this large and economically diverse region. In particular, the latest Fifth District Manufacturing Survey from the Federal Reserve Bank of Richmond showed a massive drop off in shipments and new orders in October – likely due to deteriorated confidence amidst the government shutdown. However, the latest Texas Manufacturing Outlook Survey showed an uptick in the volume of shipments, a sign of gaining momentum.
- **Midwest:** The most recent regional data show a mixed picture. The latest Chicago Fed Midwest Manufacturing Index is up 5.7% year-over-year, but growth appears to be slowing elsewhere in the region. The Kansas Fed Survey of Tenth District Manufacturers shows mixed expectations about whether production will increase over the next six months, and a recent report from the St. Louis Fed shows that farmland values declined 6% in Q3 from Q2.
- **West:** Employment gains in California have rebounded strongly, resulting in a 1.4 percentage point decline in the unemployment rate over the past year. Much of the employment gains have been supported by the strengthening local housing recovery. The Q4 Orange County Business Expectations Survey showed a modest dip in local firms' expectations for increased economic activity, but the outlook for California remains optimistic overall.

The Federal Reserve Bank of Philadelphia's state-level leading indices from October project growth in forty-six states, and negative growth in only four states – Alaska, Wyoming, Alabama, and Kentucky. The strongest growth is expected in pockets where unconventional energy production and capital-intensive manufacturing have supported demand for equipment and employment.

State Leading Indexes: 6-Month Forecast
October 2013



Source: Federal Reserve Bank of Philadelphia

Projections for Key Economic Indicators

Indicator	2012	2013e	2014 Quarterly Estimates				2014e
			Q1e	Q2e	Q3e	Q4e	
Real GDP (SAAR %)	2.2%	1.6%	2.9%	2.8%	3.1%	3.0%	3.0%
Real Investment in Equipment & Software (SAAR %)	6.9%	2.9%	3.3%	3.6%	4.3%	4.0%	3.1%
Inflation (annualized rate)	2.1%	1.5%	1.5%	1.8%	2.0%	2.0%	1.9%
Federal funds (effective, end of period)	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%
10-year Treasury Rate (end of period)	1.72%	2.90%	3.00%	3.10%	3.20%	3.30%	3.30%
Total Payrolls (in thousands)	+2,193	+2,300	+600	+700	+750	+750	+2,800

Note: SAAR% refers to the annualized rate of change in seasonally adjusted data from one quarter to the next, which is the Bureau of Economic Analysis' standard method for reporting growth in the national accounts data.

U.S. Capital Investment and Credit Markets

Review of Recent Trends

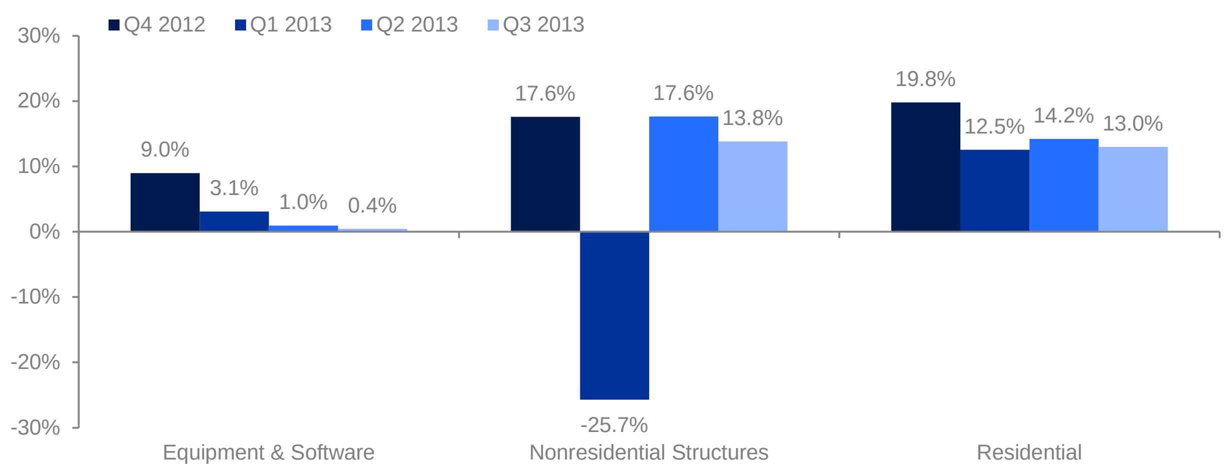
Equipment and Software investment grew at a 0.4% annualized rate in Q3, a slight slowdown from 1.0% growth in Q2 2013. Residential investment grew at a 13.0% annualized rate, a slight slowdown from 14.2% in the previous quarter. Investment in Nonresidential Structures increased at a 13.8% annualized rate, a slight slowdown from 17.6% in Q2.

Equipment and software investment grew but at the slowest quarterly pace in a year, while investment in structures continued to post strong gains. Equipment investment is expected to grow over the next 6 months as underlying economic fundamentals continue to improve. Credit supply remains highly accommodative, although credit demand has moderated slightly, especially among small businesses and downstream credits. Financial stress remains subdued.

Within the major equipment and software verticals, investment in Computers & Software increased at an annualized rate of 1.8%, Transportation equipment increased by 2.2%, Medical equipment increased by 11.3%, Construction equipment decreased by 38.8%, Agriculture equipment decreased by 40.5%, and Industrial equipment increased by 15.3%.

Investment Growth Rates

Quarter-Quarter, Seasonally Adjusted Annualized Growth Rate



Overall conditions in the equipment leasing and finance industry have stagnated in recent months. In October, the Equipment Leasing and Finance Association's Monthly Leasing and Finance Index (MFLI-25) reported new business volume of $7.6 billion, which is level with one year earlier and a slight decline from September. Losses as a percentage of net receivables held steady at 0.4%, while the credit approval ratio increased again from 77.3% in September to 77.6% in October.

Coming off of the October government shutdown, the latest Equipment Leasing and Finance Foundation's Monthly Confidence Index for the Equipment Finance Industry ("MCI-EFI") improved in November to 56.9 from 54.0 in October. When asked about their assessment of business conditions, 79.3% of respondents indicated that they expect business conditions to remain the same over the next four months, up from 74% in October. However, the percentage of respondents indicating that they expect to hire more employees over the next four months declined from the previous month.

Our credit outlook continues to hinge on three primary factors that continue to place upward pressure on long-term interest rates:

(1) "Risk-on" attitudes will spread from financial markets to the real economy as businesses gain confidence in the sustainability of stronger economic momentum.

(2) Lenders will continue to loosen supply constraints at a cautious pace.

(3) The Fed will remain accommodative in its unconventional monetary policy – short-term interest rates will remain near zero, and QE tapering will be carried out in a well-telegraphed and methodical manner. The expected rise in interest rates will likely not be rapid enough to affect business investment decisions in a material way. In fact, tapering may be a signal of stronger growth expectations and induce businesses to invest more.

Data suggests that the propensity to finance equipment may have declined slightly in 2013. In part, rental companies gained market share as they took advantage of heightened economic uncertainty. Looking into 2014, businesses will have to make financing decisions in a dynamic environment. On net, we believe several forces will help drive demand for equipment finance. In particular, more dependable economic growth will help to spur investment spending and market share gains for financing versus rentals. Additionally, a rising interest rate environment could induce companies to lock in lower rates. In this context, the first half of 2014 could be a positive story for the equipment finance industry.

Summary of Credit Market Conditions

Factor	Conditions Compared With Last Quarter
Supply	Slight Decline
Demand	Slight Decline
Financial Stress	Moderate Improvement

- **Credit Supply & Pricing:** Credit supply remains mixed – large businesses and high-quality credits continue to have abundant access to capital markets, while capital remains tight for lower-quality credits and small businesses. The Q4 Federal Reserve survey of banks' senior lending officers showed a tightening of standards on C&I loans from the previous quarter, for both large & medium and small respondents. The benchmark 10-year Treasury rate has remained around 2.8% as of late, and given the improving position of the economy, upward pressure on rates will continue through 2014. However, as per the Fed's forward guidance, short-term rates will likely remain near-zero through 2014.

- **Credit Demand:** Recent key indicators mostly point to weaker demand for credit. Most importantly, C&I Loans continue to grow, but at a slower rate each month. Additionally, the latest Fed survey showed a sharp deceleration in the demand for C&I loans, and the NADCO Small Business Lending Report reported a continued decline in the size of loan pools for small businesses. However, the Thomson Reuters/PayNet Small Business Lending Index recently rebounded 10% in its preliminary monthly reading in October.

- **Financial Stress:** Macroeconomic conditions and the Fed's unconventional monetary policy continue to alleviate financial stress for businesses and households. The Kanas City Fed Financial Stress Index has ticked up slightly over the past few months, after being at a five-year low in August. The historically low level of the Index, nonetheless, remains a strongly positive signal for overall financial market conditions. Specifically for businesses, the lease delinquency rate declined in Q3 to 0.87%, and it remains well below its pre-crisis average. The charge-off rate for all leases has declined in each of the past two quarters and is at a nearly all-time low of 0.06%. Meanwhile, nonfinancial sector debt as a percentage of GDP continues to increase steadily and is indicative of businesses regaining their appetite for debt amidst improved balance sheets and economic conditions. Corporate bond yields continue to drift upward, but spreads have narrowed as a sign of lower risk.

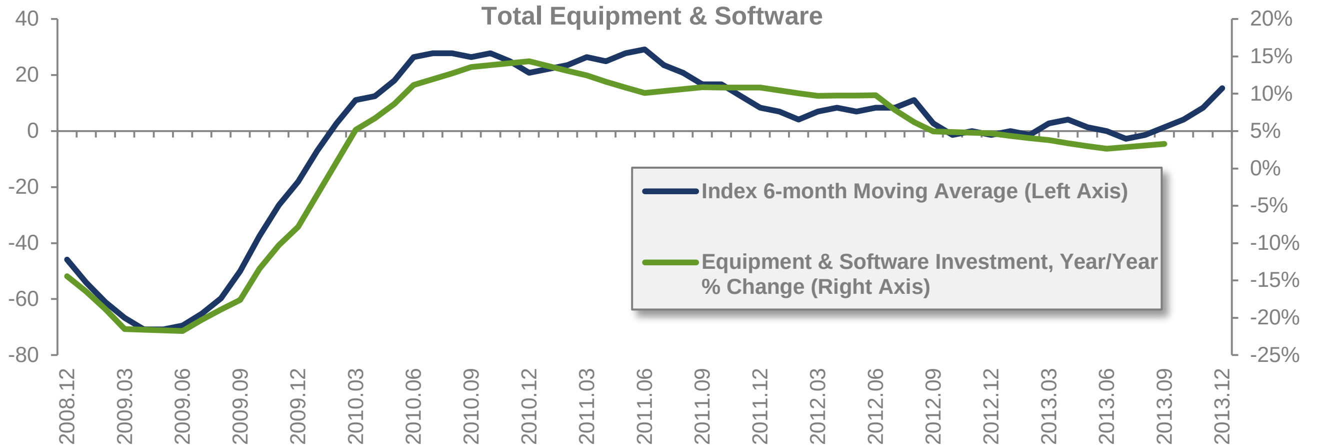
Keybridge Research Equipment & Software Momentum Monitor

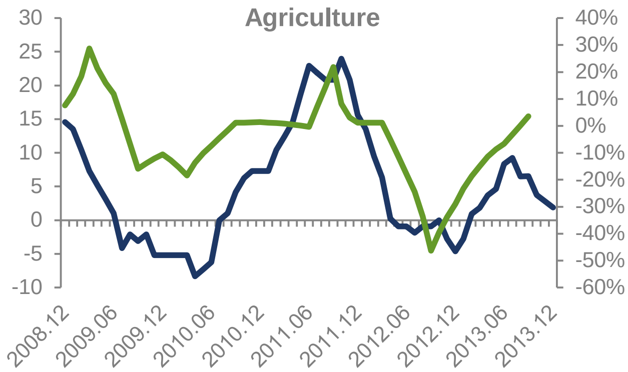
The *Keybridge Research Equipment & Software* Momentum Monitor – monthly leading Indices for equipment and software investment over the next 3 to 6 months – is predicting continued slow growth through the end of 2013, and an uptick beginning in 2014. Among specific verticals, growth will be mixed. In particular, leading indicators point towards weakness for agriculture, construction, and medical equipment; slow growth for computers and software investment; and moderate positive growth for industrial and transportation equipment. The latest monthly Momentum Indices indicate the following trends:

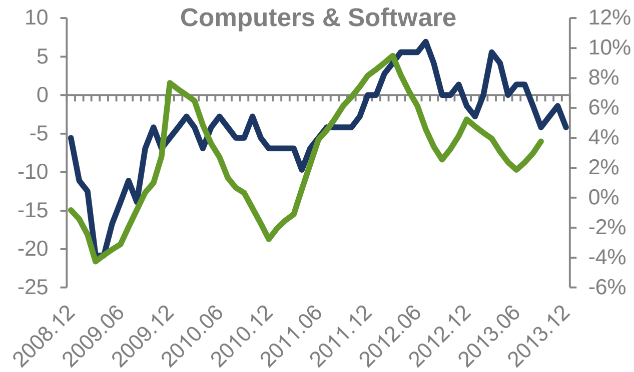
- **Agriculture:** The Momentum Index's 6-month moving average fell to a nine-month low, and is pointing towards continued stagnation for the sector. Shipments of Farm Machinery and Agriculture Equipment Sold and Leased have been especially weak over the past six months. Although investment increased year-over-year in Q3, it was due to a low-base year effect (Q3 2012 was particularly sluggish). In 2014, we expect investment levels to decline about 4% compared to 2013.
- **Computers & Software:** The Momentum Index's 6-month moving average declined further into negative territory, signaling below-average growth over the next three to six months. The Index itself fell below zero, thanks to a drop in Shipments of Computers (down 19% in a year). Overall, the Index suggests that growth will stabilize around its current rate of about 2% to 4%.
- **Construction:** The Momentum Index's 6-month moving average improved but remains below zero. On net, the Index was pulled down by declining Shipments of Construction Machinery over the past six months. Construction equipment investment contracted in Q3 after several years of rapid growth. The Index suggests that the slowdown is likely to continue into 2014, as investment returns to more normal levels. For the year, we expect investment levels to remain above average – in the $40 to $50 billion range – which would be about a 5% to 10% decline compared to 2013.
- **Industrial:** The Momentum Index's 6-month moving average remains strong, at a 17-month high. The Index was driven by positive momentum in the ISM Manufacturing Employment Index, the ISM Manufacturing New Orders Index, Average Hourly Earnings for Goods-Producing Industries, and Sales of Machinery. Data point to continued steady growth going forward.
- **Medical:** The Momentum Index is pointing towards a slowdown for investment in medical equipment. While the Index's mid-year strength accurately foreshadowed investment growth in Q3, the Index has since fallen and investment is expected to do the same. The Index and its 6-month moving average have been especially volatile, pointing towards high levels of uncertainty and tumult in the sector, not surprising given the political and regulatory climate surrounding healthcare.
- **Transportation:** The Momentum Index's 6-month moving average hit a four-month high and is now pointing towards a recovery after the recent contraction in investment. The Index has been boosted by strength in Sales from Motor Vehicle & Parts Dealers, Industrial Production of Aerospace & Miscellaneous Transportation Equipment, and the Bureau of Transportation Statistics' Passenger Index. Investment is expected to return to positive growth over the next few quarters.

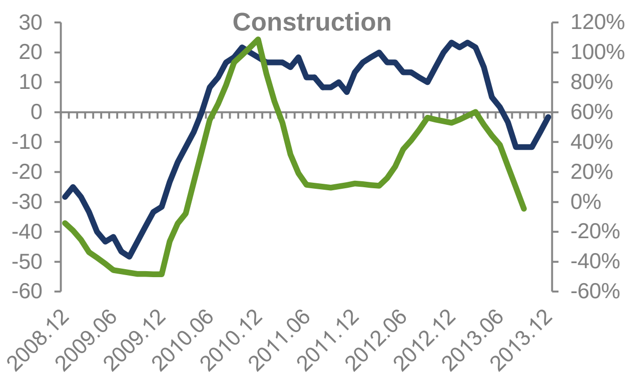
Keybridge Equipment & Software Investment Momentum Indices

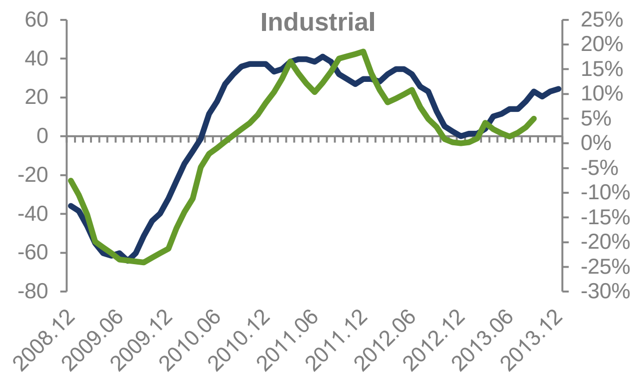
Source: www.keybridgeresearch.com

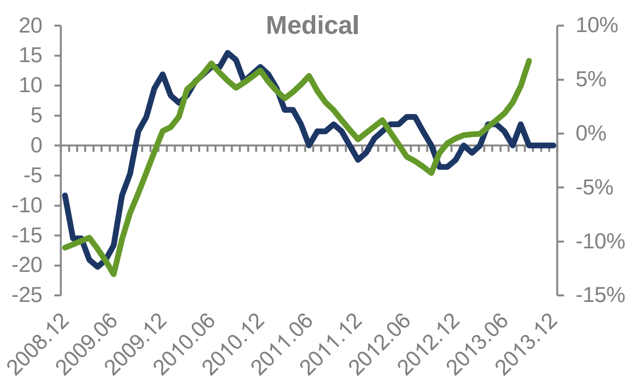


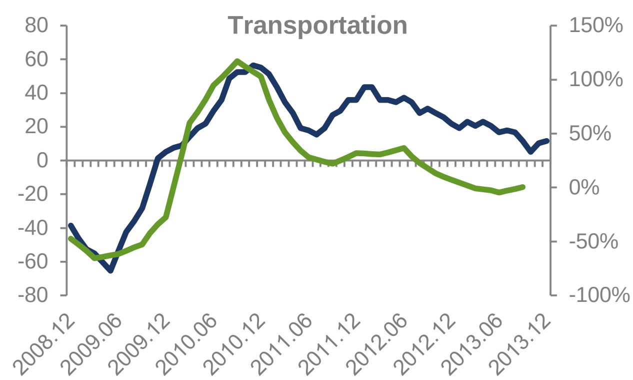












QUARTERLY DATA

Indicator	2011		2012				2013		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Real Gross Domestic Product (SAAR %)									
GDP	1.4%	4.9%	3.7%	1.2%	2.8%	0.1%	1.1%	2.5%	3.6%
Consumer Spending	2.1%	2.4%	2.9%	1.9%	1.7%	1.7%	2.3%	1.8%	1.4%
Gross Private Fixed Investment	2.5%	31.9%	10.5%	-1.6%	6.5%	-2.4%	4.7%	9.2%	16.7%
Inv: Equipment & Software	17.3%	10.1%	6.7%	5.5%	-2.1%	9.0%	3.1%	1.0%	0.4%
Inv: Agriculture Equipment	115.0%	-52.5%	-5.9%	-52.4%	-60.8%	45.2%	93.2%	-30.9%	-40.5%
Inv: Computers & Software	7.6%	10.5%	6.8%	-0.1%	-6.2%	22.6%	1.7%	-7.9%	1.8%
Inv: Construction Equipment	39.6%	17.9%	9.5%	85.6%	149.3%	7.6%	31.8%	2.8%	-38.8%
Inv: Industrial Equipment	32.6%	20.9%	-14.5%	10.1%	0.2%	6.2%	0.4%	-1.1%	15.3%
Inv: Medical Equipment/Instruments	-3.7%	-4.4%	8.9%	-8.5%	-9.6%	9.1%	10.7%	-1.4%	11.3%
Inv: Transportation Equipment	49.7%	48.0%	26.5%	24.2%	-16.8%	1.1%	-7.6%	6.5%	2.2%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	75.7%	75.6%	75.4%	75.7%	76.1%	77.5%	77.9%	78.7%	-
Loan Delinquency Rate	1.8%	1.6%	1.5%	1.4%	1.2%	1.2%	1.1%	1.0%	1.0%
Lease Delinquency Rate	1.0%	0.9%	0.9%	0.8%	0.7%	0.8%	0.8%	0.9%	0.9%
Net Tightening of C&I Loan Standards	-21.8%	-5.9%	5.4%	-6.9%	-9.5%	-7.6%	-7.4%	-19.1%	-18.1%

Note: SAAR% refers to the annualized rate of change in seasonally adjusted data from one quarter to the next, which is the Bureau of Economic Analysis' standard method for reporting growth in the national accounts data.

Monthly Data

Indicator	2012		2013										
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Employment													
Change in Total Payrolls (thousands)	247	219	148	332	142	199	176	172	89	238	175	200	203
Change in Private Payrolls (thousands)	256	224	164	319	154	188	187	194	100	207	168	214	196
Unemployment Rate	7.8%	7.8%	7.9%	7.7%	7.6%	7.5%	7.6%	7.6%	7.4%	7.3%	7.2%	7.3%	7.0%
Business Activity													
Industrial Production	98.1	98.2	98.2	98.8	99.1	98.8	99.0	99.2	99.0	99.5	100.1	100.0	-
Capacity Utilization	77.9%	77.8%	77.7%	78.1%	78.2%	77.9%	77.9%	77.9%	77.7%	77.9%	78.3%	78.1%	-
PMI Composite Index	50	50	53	54	51	51	49	51	55	56	56	56	57
NFIB Small Business Optimism Index	87.5	88.0	88.9	90.8	89.5	92.1	94.4	93.5	94.1	94.1	93.9	91.6	-
Consumer Activity													
Consumer Confidence	72	67	58	68	62	69	74	82	81	82	80	72	70
Real Personal Consumption (MM % Chg)	0.3%	0.1%	0.1%	0.3%	0.3%	0.0%	0.1%	0.2%	0.0%	0.2%	0.1%	0.3%	-
Retail Sales (M/M % Chg)	0.3%	0.3%	0.1%	1.1%	-0.3%	0.2%	0.5%	0.7%	0.4%	0.2%	0.0%	0.4%	-
Lending Activity													
C&I Loans (M/M % Chg)	0.3%	1.4%	1.0%	0.4%	0.7%	0.6%	0.1%	1.1%	0.9%	0.0%	0.3%	1.0%	-
MLFI-25 New Business Volume (Bil. $)	6.4	11.5	5.9	4.7	6.8	7.5	7.5	8.6	7.2	6.4	7.7	7.6	-
MLFI-25 Avg Losses as a % of Net Rec.	0.50	0.60	0.30	0.40	0.30	0.30	0.30	0.30	0.30	0.40	0.40	0.40	-
MLFI-25 Credit Approval Ratio	77.0	78.5	78.3	77.4	78.4	77.2	78.8	78.5	78.6	79.1	77.3	77.6	-
Interest Rates (% end of period)													
Fed Funds Target Rate	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250
1-Year Treasury Rate	0.18	0.16	0.15	0.17	0.14	0.11	0.14	0.15	0.11	0.13	0.10	0.10	0.13
3-Year Treasury Rate	0.34	0.36	0.42	0.36	0.36	0.32	0.52	0.66	0.61	0.79	0.63	0.57	0.56
10-Year Treasury Rate	1.62	1.78	2.02	1.89	1.87	1.70	2.16	2.52	2.60	2.78	2.64	2.57	2.75
30-Year Treasury Rate	2.81	2.95	3.17	3.10	3.10	2.88	3.30	3.52	3.64	3.70	3.69	3.63	3.82
AAA Corporate Bond Yield	3.58	3.67	3.90	3.84	3.90	3.70	4.09	4.32	4.38	4.49	4.56	4.48	4.62
BAA Corporate Bond Yield	4.57	4.63	4.84	4.78	4.83	4.53	4.95	5.35	5.28	5.34	5.39	5.22	5.36
Prices													
Headline Inflation (Y/Y % Chg)	1.8%	1.8%	1.6%	2.0%	1.5%	1.1%	1.4%	1.8%	2.0%	1.5%	1.2%	0.9%	-
Core Inflation (Y/Y % Chg)	1.9%	1.9%	1.9%	2.0%	1.9%	1.7%	1.7%	1.6%	1.7%	1.8%	1.7%	1.7%	-
Oil Price (West Texas Intermediate, $/barrel)	86.66	88.25	94.69	95.32	92.96	92.07	94.80	95.80	104.70	106.54	106.24	100.55	93.93

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