2013 Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye On The Future

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 Study

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 include "Key Signposts," which are leading indicators for the direction of growth in equipment investment. The outlook report also includes 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 2013 Annual Outlook, and quarterly updates will be provided in March, June, and September of 2013.

Annual 2013 Equipment Leasing & Finance U.S. Economic Outlook Dec 2012

SUMMARY

Overall, the U.S. economy continues to exhibit sub-par growth, with expensive oil and policy uncertainty flowing from the fiscal cliff political standoff taking their toll. Although the U.S. economy showed some improvement in the third quarter, the slight acceleration of growth was largely due to special factors. Personal consumption remained lackluster, and equipment and software investment fell 2.7% (annualized rate) after a 4.8% increase in the second quarter. The data suggest that businesses have essentially "hit the pause button" on investment until there is a resolution to the "fiscal cliff". Our 2013 outlook for equipment & software investment calls for 2.9% growth. Relatively weak growth in the first half of the year will be held back by soft demand and fiscal uncertainty – both giving businesses little reason to invest despite generally improving credit conditions. By the second half of 2013, however, we expect investment activity to regain momentum thanks to an improving housing sector and relief from policy uncertainty that will have an unlocking effect on business investment.

Sector-level trends will remain subdued for the beginning of 2013 *(note: growth rates are expressed on a year-year basis)*:

- *Agriculture equipment* investment is likely to contract in Q4 2012 and Q1 2013.
- *Computers & Software equipment* investment is projected to stagnate for the next 3 to 6 months.
- *Construction equipment* investment is projected to average strong growth (about 15%) as the housing market continues to improve.
- *Industrial equipment* investment will grow but at a slower rate than recent quarters. Depending on the outcome of the fiscal cliff debate, manufacturing could drive stronger growth in the second half of 2013.
- *Medical equipment* investment growth is likely to range between -2% and 2% in the next 3 to 6 months.
- Growth in *Transportation equipment* investment is likely to moderate, averaging about 10% over the next 3 to 6 months.

Financial stress indicators remain subdued as both household and corporate debt levels have held steady, and debt obligation ratios continue to decline. Mortgage rates are at historic lows, spurring housing market activity. Interest rates are likely to remain near historical lows through the first half of 2013, with the potential for moderate upward pressure later in the year. Credit supply and demand will largely stay in balance, and credit markets should continue to slowly thaw over the coming year.

The U.S. economy accelerated in the third quarter of 2012 to an annualized growth rate of 2.7%, up from 1.3% in Q2 2012. However, much of this growth can be attributed to business inventory increases and extensive federal defense spending – two factors likely to dissipate in the fourth quarter. Exports and investment spending were particularly weak in the third quarter, as the global slowdown has softened demand for U.S.-produced goods, and policy uncertainty has weighed heavily on business confidence. The drought in the Midwest continues to plague the agricultural economy, and Hurricane Sandy is projected to have had an acute negative short-term effect on the Northeast.

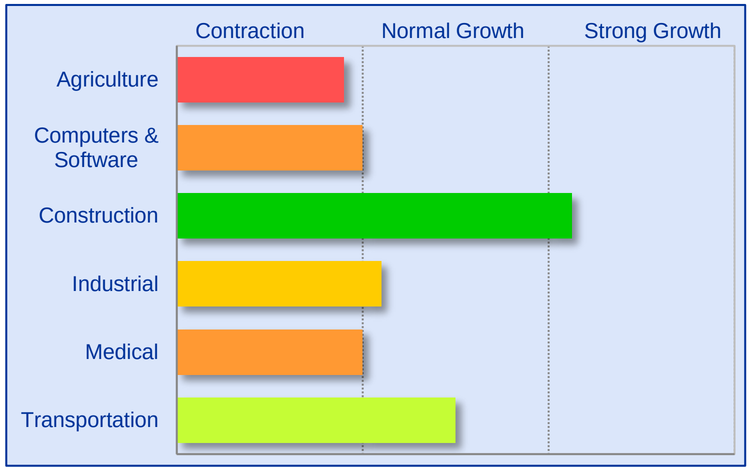
Overall, our macro outlook for 2013 is slightly more optimistic than consensus estimates. We expect 2.4% real GDP growth, and for 2.3% inflation. There is still the possibility that a consensus will not be reached in Washington and that the full effects of the "fiscal cliff" will be realized. While we believe that scenario is unlikely, we do expect some fiscal tightening through some spending cuts and the expiration of the payroll tax holiday (together shaving about 1% off of growth for the year). Despite these potential setbacks, there remains optimism from strength in the housing market, the natural gas industry, and the auto sector

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

Summary

Equipment and software investment contracted at an annualized rate of 2.7% in the 3rd quarter of 2012. The slowdown was felt broadly across subsectors as agriculture, computers and software, medical, and transportation equipment investment all declined from Q2 to Q3. Industrial equipment investment grew but at a slower pace, and investment in construction equipment was the only subsector to accelerate in Q3. Overall, 2013 will be relatively weak, but it is shaping up to be a tale of two halves – a slow first half is likely to be followed by improving conditions due to a strengthening housing sector and a reduction in policy uncertainty.

Key Signposts "Heat Map" Growth Chart



Agriculture Equipment: In Q3, investment contracted sharply by 40% year-over-year. One of the worst droughts on record has depressed crop production, and with it, demand for new equipment. Plans to reauthorize the Farm Bill are likely to remain on hold until Congress reaches deal on the fiscal cliff – this could involve savings through cuts to crop subsidies or conservation programs. Looking forward, a key leading indicator for this sector, the Texas Index of Leading Indicators, has improved only slightly in the past quarter. Taken together with drought conditions and fiscal pressures, agriculture equipment investment is likely to remain soft over the next 3 to 6 months.

Computers & Software: Year-over-year growth fell from 5.3% in Q2 to just 0.5% in Q3 as businesses hit the pause button on IT-related investments. The two signposts – the ISM Nonmanufacturing Index and the BRT CEO Economic Outlook Survey – provide somewhat mixed signals, suggesting relatively weak growth.

Construction Equipment: Investment grew in Q3 by 52% year-over-year, up from 37% in Q2. This rapid growth has been driven by improving household market conditions – sales of new single family homes and housing building permits are up 112% and 30% year-over-year, respectively. Housing market improvements will be regional – and the northeastern market should benefit from rebuilding efforts after Hurricane Sandy. Overall, these positive trends are expected to continue and translate into continued growth over the next 3 to 6 months.

Industrial Equipment: Year-over-year growth in industrial equipment investment slowed from 13.1% in Q2 to 4.5% in Q3. This was foreshadowed by weaker industrial production, stagnating capacity utilization, and only slight gains in manufacturing new orders. Opposing tensions are creating different short- and long-term dynamics in industrial equipment. In the near-term, capacity overhang from the recession and heightened policy uncertainty are stunting investment. In the longer-term, the "reshoring" of U.S. manufacturing will drive demand. Overall, the key signposts suggest average growth during the next 3 to 6 months.

Medical Equipment: The contraction in medical equipment investment worsened in Q3. The signposts remain soft, suggesting stagnant growth in investment over the next quarter. The ultimate effects of "Obamacare" are still unknown and politically controversial, but it could be a net positive for the industry. In particular, the negative effects of the 2.3% excise tax on domestic and imported medical equipment will likely be overshadowed by the addition of some 30 million people to the health insurance rolls.

Transportation Equipment: Investment increased 11.1% year-over-year in Q3, down from 27% in Q1 and Q2. At the surface, the key signposts tell opposite stories – the Philadelphia Fed Business Outlook Survey declined rapidly, but real personal consumption expenditures for motor vehicles and parts continues to demonstrate strength. We slightly discount the Philadelphia Fed survey due to the effects of Hurricane Sandy, and believe this sector should continue to grow, but at a slower rate than the past 18 months.

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			***Below Average Growth (0% to -10%)***
Texas Index of Leading Indicators (SA)	122.9 Sep-12	Up 1.0% over the past 3 months and 3.9% year-year	Below average growth
Computers & Software			***Below Average Growth (1% to 3%)***
ISM Nonmanufacturing Composite Index (SA)	54.7 Nov-12	Up 0.9% this month and up 4.0% year-year; above 50 signals an overall expansion	Above average growth
Business Roundtable CEO Economic Outlook Survey	65.6 Q4-12	Relatively unchanged from last quarter	Slow growth
Construction Equipment			***Above Average Growth (15% or higher)***
HMI: Sales of New Single-Family Detached Homes Index (SA), Next Six Months	53 Nov-12	Up 112% on the year, but only 23% in the past three months	Above average growth
New Private Housing Building Permits (SAAR, Thousand Units)	868 Oct-12	Up 30% year-on-year and up 7.0% over the last three months	Above average growth
Industrial Equipment			***Average Growth (3% to 6%)***
Capacity Utilization (SA)	78.4% Nov-12	Up 0.9% from last month, but down slightly from 3 months ago	Average growth
Manufacturers' New Orders (SA, $Mil)	3,177 Oct-12	Up 20% year-year and up 0.6% on the month	Average growth
Industrial Production Index (SA)	97.5 Nov-12	Up 2.5% year-year, but only 0.2% in past 3 months	Average growth
Medical Equipment			***Slow to No Growth (-2% to 2%)***
Hospital In-patient Days (Thousands)	55,520 Q3-12	Effectively flat this quarter but down 0.6% year-year	Slow growth
PPI: Medical & Diagnostic Labs	108.4 Nov-12	Down 0.1% in November, and down 0.6% year-year	Slow to no growth
Nursing & Residential Care Facilities Total Revenue ($Mil)	49,464 Q3-12	Down 1.7% in Q3 and 0.7% from last year	No growth
Transportation Equipment			***Average Growth (8-12%)***
Philadelphia Fed Business Outlook Survey, Future Activity	20.0 Nov-12	Down 47% year-year and 7.4% in November	Slowing growth
Real PCE: Motor Vehicles & Parts (SAAR, Bil.Chn.2005$)	370.7 Q3-12	Up 2.5% in Q3 and up 9.6% year-year	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.

U.S. Macro Outlook

Overview

Overall, the U.S. economy continues to exhibit sub-par growth, with expensive oil and policy uncertainty flowing from the fiscal cliff political standoff taking their toll. The U.S. economy grew in the third quarter of 2012 at an annualized rate of 2.7%, up from 1.3% in Q2. Although the headline figure for Q3 looks encouraging, much of the upwardly revised growth can be attributed to increases in business inventories and military spending – two elements that will likely dissipate over the next quarter or two. Meanwhile, consumer spending growth slowed to an annualized rate of just 1.4%, nonresidential investment declined, and exports were soft.

The U.S. economy grew in Q3 2012 at an annualized rate of 2.7%, up from 1.3% in Q2 2012. Fiscal policy uncertainty, the unresolved Eurozone debt crisis, and the slowdown in emerging markets remain significant headwinds to U.S. growth. Hiring decreases have begun to slow, but business investment has sharply declined. The public sector has become less of a drain on economic growth, but the private sector appears to be "hitting the pause button" on hiring and investment decisions until a resolution of the "fiscal cliff".

The conventional view is that the U.S. economy is stuck in first gear, with continuing negative effects from expensive oil, the mortgage debt overhang, confidence-sapping policy uncertainty, and negative headwinds from overseas. While the housing market has seen improvement, progress is being suppressed by the "shadow inventory problem" – the stock of foreclosed homes that have been held off the market while owners (often banks) wait for a stronger price recovery – and high unemployment. CEOs of large corporations and small business owners alike, have been expressing deep concern over the lack of progress on fiscal policy issues. Uncertainty over the election (and the subsequent fate of "Obamacare," environmental policy, and financial reform), and Congress's inability to tackle fiscal issues has cast a pall over business investment. Additionally, the protracted European financial crisis, and a clear slowdown in China have noticeably hurt U.S. exports. In this context, roughly 2.2% growth in 2012 is not bad, but it is still not good enough to induce businesses to boost investment and hire substantially more workers.

Looking ahead to 2013, economists' consensus forecast is for about 2.0% growth, net of a full percentage point or more in "fiscal drag." Our macro outlook is somewhat more optimistic. We expect growth 2.4%, with even more upside potential depending on the size and scope of fiscal consolidation and the market credibility of a fiscal reform package. One of our key baseline assumptions is that the Obama Administration and Congress will reach a relatively tidy fix to the fiscal cliff, which will help unlock pent up demand. Given the Federal Reserve's latest comments, we expect inflation to remain tame in the 2.2% to 2.5% range, for long-term interest rates to remain near historical lows. Job growth should accelerate in the second half of the year, and the unemployment could fall to the low 7s or even the high 6s.

Domestic political risk is the major concern currently on the radar for 2013. For various reasons discussed below, our forecast assumes that the fiscal cliff and debt ceiling issues will be addressed by policymakers. However, without a smooth solution to our fiscal challenges, growth will almost certainly fall significantly below 2%, and, as the Congressional Budget Office points out, almost certainly would trigger an outright recession if all 2001/03 tax cuts expire and if all sequestration spending cuts materialize.

Review of Key Economic Indicators

Key Points:

- *Consumer spending slowed in Q3 compared to the second quarter.*
- *Nonresidential Investment spending has stalled out.*
- *Government spending has bottomed out.*
- *Exports continue to be weak due to the global slowdown.*
- *Job growth continues to grow slowly.*
- *Inflation remains contained.*

- **Consumer spending** slowed in the third quarter to an annualized rate of 1.4%, following a 1.5% increase in the second quarter. In the fourth quarter, real consumer spending is off to a weak start with a 0.3% decrease in October, and is up only 1.3% from one year ago. The University of Michigan Index of Consumer Sentiment dropped sharply in December, a sign that consumers are worried about future economic conditions.
- **Investment spending** – apart from residential investment – has

slowed significantly as business confidence has weakened amidst the gridlocked negotiations over a resolution to the "fiscal cliff". Investment spending for equipment and software, the main capital spending category, decreased at a 2.7% annual pace in the third quarter, following a 4.8% gain in the second quarter of 2012. Investment in nonresidential structures (including office buildings, plans, and retail space) decreased at a 1.1% annual rate in the third quarter compared with a 0.6% increase in 2012Q2. Residential investment (new home building and additions) increased 14.2% in the third quarter following an increase of 8.5% in the second quarter of 2012.

- **Government spending** has been a consistent source of weakness for the past two years, although federal spending increased in the third quarter at an annualized rate of 9.5%. This was mostly due to defense-related expenditures, which grew at an annualized rate of nearly 12.9%. State and local government spending has continued to decrease at slower rates than in 2011 and early 2012, which may be a sign that state and local finances are beginning to firm up. State and local government spending decreased at an annualized rate of 0.4% in the third quarter, following a decline of 1.0% in the second quarter of 2012.
- **Exports** (after adjusting for inflation) increased at an annual rate of 1.1% in the third quarter, compared with an increase of 5.3% in the second quarter as weak growth in Europe, Japan, and Latin America took its toll.
- **Employment** continues to be modest over the past few months. Payrolls increased by 147,000 in November, 138,000 in October, and 132,000 in September 2012. Private-sector payrolls have increased by a net of 458,000 during the past three months, while government payrolls have decreased by 42,000 in the past three months, mostly led by a 51,000 decline in October. The unemployment rate reached a four-year low of 7.7% in November. However, the November decrease in labor force participation may be a signal that more discouraged workers are leaving the workforce.
- **Inflation** remains well contained in 2012. Consumer Price Index (CPI) prices decreased 0.3% in November, rose 0.1% in October, and rose 0.6% in both September and August. In the past 12 months, headline inflation is only 1.8%, while "core inflation" (excluding food and energy costs) is 1.9%. Much of the recent weakness in the inflation data is due to falling prices for energy, apparel, and used cars and trucks.

Review of Regional Trends

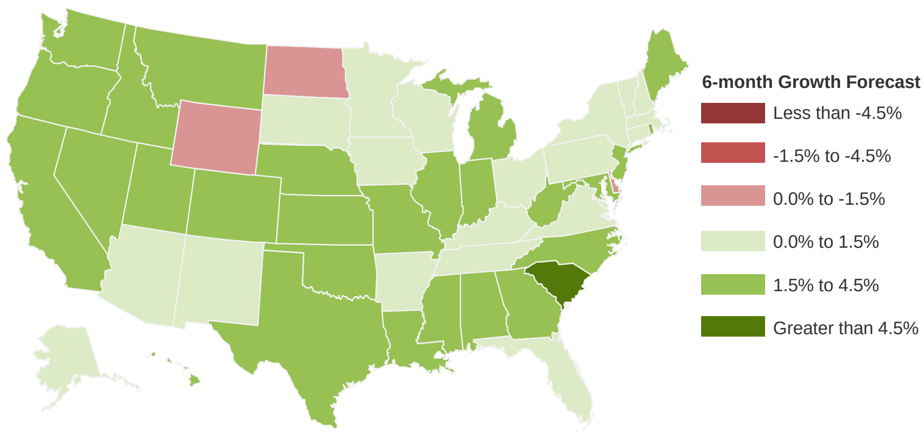
Over the past year, U.S. state economies have been shaped largely by disparities in local housing markets, shifting industry dynamics (particularly the auto and energy sectors), and natural disasters. These same factors are likely to shape 2013, as growth rates between regional housing markets diverge, manufacturing continues to rebound, the Northeast rebuilds from Hurricane Sandy, and the drought either ends or continues to batter the Midwest. The near-term regional outlooks are generally consistent with the overall U.S. outlook – slow but steady growth. Leading indicators are somewhat mixed, and reflect inter-regional dynamics:

- **Northeast**: The New York region, directly affected by Hurricane Sandy, showed a decline in current economic activity, but is poised for a rebound. In particular, the Empire State Manufacturing Survey reflects a slowdown in current business conditions, but the improvement in the sub-indices for new orders and shipments point to a stronger Q1 2013.
- **Southeast:** The latest Fifth District Manufacturing Survey from the Federal Reserve Bank of Richmond showed positive growth for shipments and new orders. However, employment remained below zero, indicating continued weak labor markets. The Texas Manufacturing Outlook Survey showed a modest increase in production levels, which is the most precise measure of the state's manufacturing conditions.
- **Midwest:** The Kansas City Federal Reserve Manufacturing Survey showed a decline in new orders and shipments due to decreased demand on the east coast from the impact of Hurricane Sandy. This should rebound, however, during the rebuilding phase. In the north, Minnesota, Montana, South Dakota, and Wisconsin are all expected to see gains in business activity and personal income. On the other hand, North Dakota's growth may have reached a plateau after experiencing an energy sector boom in 2010-2012.

- **West:** Housing and employment appear to finally have turned around in California. The state added 45 thousand jobs in November, and there was a 25% jump in home sales in Southern California. Additionally, the latest Cal State Fullerton Southern California Leading Economic Indicator suggests that growth in Southern California will accelerate over the next 3 to 6 months. State finances are also improving (the most recent deficit projected at $1.9 billion).

The Federal Reserve Bank of Philadelphia's state-level leading indices project slow to moderate growth in forty seven states, and negative growth in only three states – North Dakota, Wyoming, and Delaware. The strongest growth is expected in South Carolina, due to a growing manufacturing sector and a strengthening housing market.

State Leading Indexes: 6-Month Forecast
October 2012



Source: Federal Reserve Bank of Philadelphia

2013 Economic Outlook

We expect growth of 2.4% in 2013, with an acceleration in the second half of the year. This outlook is based on a number of key factors, the most important of which is the "fiscal cliff" debates. Depending on the outcome of this debate, growth could swing by several percentage points. Europe will remain a source of weakness, as the continued recession will lessen demand for exports. However, other factors – including upside potential in China, an improving U.S. housing sector, and the abundance of cheap natural gas – should all work to drive growth higher.

- **Fiscal Cliff and Post-Election Policy Uncertainty:** The "fiscal cliff" continues to be the largest drag on business and consumer confidence. President Obama and Congressional Democrats and Republicans are digesting the election results and are trying to gauge their support from their key constituents. In an act of political theater, both the President and Speaker Boehner put forth their respective plans which appear worlds apart. However, behind the scenes, the stage is potentially being set for a compromise. In particular, the Republican leadership has taken a less hardline stance on new tax revenue (some Congressional Republicans have even defected from the Grover Norquist "no tax" pledge), and the Republican leadership removed several dissidents who routinely failed to compromise from the House Financial Services Committee and the Budget Committee.

  A framework agreement between the two sides in late December that would undo between two thirds and three quarters of the $600 billion fiscal cliff in 2013, and also put the country on a 10-year, roughly $4 trillion deficit reduction path would be a positive development. This path would include higher taxes on the wealthy and substantial cuts in entitlement programs, including Medicare and Medicaid. In fact, if politicians reach such an agreement in December, it would almost certainly cause a financial market rally. However, it cannot be ruled out completely that talks between the two sides will break down and that the country will actually go over the fiscal cliff, which is likely to bring a very poor market reaction in addition to the 3% to 4% hit to 2013 GDP.

- **European Recession:** Although the general consensus now is that the Eurozone will remain intact, many economists predict that 2013 will be worse for Europe. The OECD recently revised its 2013 forecast for Europe downward to negative 0.1% growth on the year, and European Central Bank President Mario Draghi believes the recovery in Europe will not begin substantially until the second half of 2013. A recent debt deal relieved Greece of $44 billion in debt payments, which gave European markets some much-need optimism. However, the overall European Union unemployment rate reached a record-high in November, reminding observers that the crisis is far from over.
- **Hurricane Sandy:** Sandy destroyed countless homes, vehicles and commercial properties, causing about $71 billion in damages in New York and New Jersey alone and will likely subtract 0.35 to 0.5% off Q4 2012 GDP growth. The impact of Sandy closed many retail stores temporarily and for good. The most recent BLS Employment Situation report indicated that Hurricane Sandy did not have a substantial effect on job creation, although some private forecasters, in particular Moody's Analytics and ADP, estimated that Hurricane Sandy was responsible for reducing private payrolls by about 86,000 in November. The consensus is, however, that despite the Hurricane depressing short term economic activity, it will end up supporting economic activity in 2013 through rebuilding activity.
- **A Weak China:** The slow momentum of the Chinese economy continues to have a negative impact on demand for U.S. exports and expectations for global growth in general. The government stimulus has been effective, as there have been rebounds in growth of industrial production and retail sales in the past several months. Additionally, the Manufacturing PMI for China was at a 7-month high of 50.6 in November, signaling mildly positive economic momentum into the last quarter. The recent appointment of a new Premier raises the probability of additional stimulus spending. Overall, there appears to be upside risk in China that could help boost global growth in 2013.
- **Housing:** All U.S. housing indicators are flashing green now, with prices up, mortgage rates at record lows, excellent affordability, a lot of pent up demand, and an extremely lean inventory of new homes for sale. Historically residential investment has accounted for nearly 5% of GDP, but lately it is only running at a little more than 2% of GDP. Given the recent upswing in momentum, housing could easily add one percentage point to U.S. GDP growth each year for the next three years, and could more than offset the fiscal drag from a budget deal. Such an increase in residential investment would likely lead to 20,000 to 30,000 new construction workers being hired each month.
- **Auto Sales:** Automotive sales have continued to increase over the past year and are very strong at the end of 2012. November auto sales reached an annualized rate of 15.8 million units, which is the highest rate since March of 2008. Such sales levels are now closing in on the 16-17 million unit peak sales rates in the early- to mid-2000s.
- **Natural Gas:** The "energy renaissance" has continued to help the current economic conditions and shape the U.S economic future. Fractured gas now accounts for more than one third of U.S. domestic production, and with prices in the range of $3-4 per million BTUs, energy using industries are starting to have confidence that gas prices will remain cheap. On the household side, electricity costs for many Americans have declined and will continue to decline, which should boost disposable income.

Summary of 2013 U.S. Economic Outlook

The fourth quarter of 2012 is likely to decelerate relative to Q3, bringing average annual growth for the year to around 2.3%. 2013 is shaping up to be a tale of two halves. The first half of the year could be much like 2012 – slow growth largely due to a series of domestic and foreign headwinds. Although we expect the full "fiscal cliff" to be averted, there will be some fiscal consolidation at a rate of about 1.0% to 1.25% of GDP. This will in turn dampen consumer spending and business investment. On the other hand, the second half of the year could see an acceleration of growth, driven by the housing and auto sectors, continued "reshoring" of manufacturing in the U.S., and a resurgence of business confidence. Europe will likely remain in recession through the first half of the year, shaving several tenths of a percent off of U.S. GDP growth, but this could be at least partially offset by an upside surprise in China.

- Overall, we expect real GDP growth to average 2.4% in 2013.
- Unemployment could be pushed to the low 7s or even the high 6s by the end of the year.
- We expect inflation to move up slightly by the end of the year, and average 2.3% for the year.
- The top risk for 2013 is a "fiscal cliff" scenario, followed by a breakup of the European Union, a hard-landing in China, and geo-political concerns in the Middle East.

Projections for Key Economic Indicators

Indicator	2012 Q4e	2012e	2013 Quarterly Estimates				2013e
			Q1e	Q2e	Q3e	Q4e	
Real GDP (SAAR %)	1.7%	2.3%	1.7%	2.8%	3.3%	3.5%	2.4%
Real Investment in Equipment & Software (SAAR %)	-1.0%	6.1%	2.7%	6.0%	7.3%	8.0%	2.9%
Inflation (annualized rate)	1.9%	2.1%	2.2%	2.3%	2.4%	2.5%	2.3%
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)	1.75%	1.75%	1.60%	1.70%	1.85%	2.00%	2.00%
Total Payrolls (in thousands)	+438	+1,820	+400	+500	+650	+750	+2,300

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

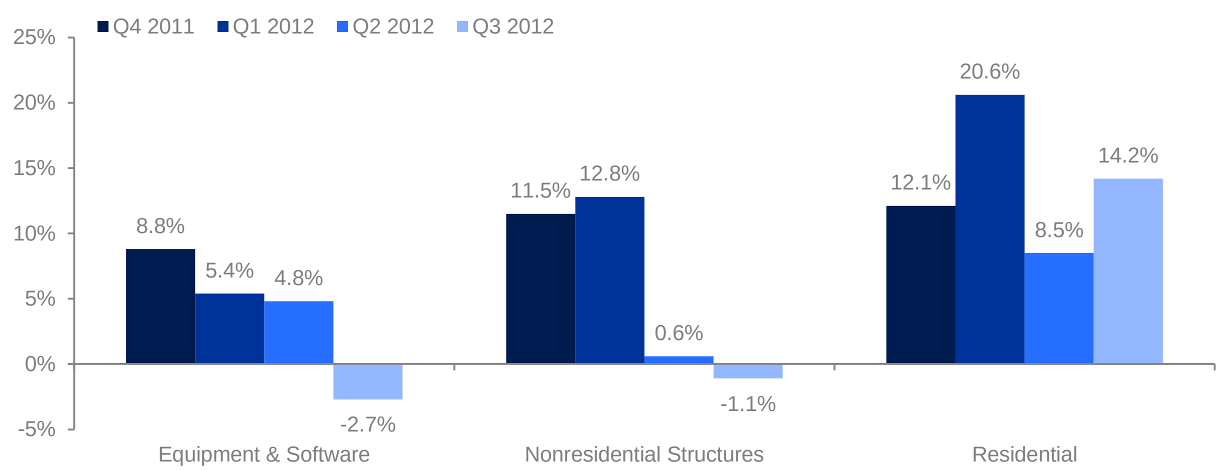
Investment activity declined in the third quarter amidst weaker business confidence. The mix of investment continued to shift in the third quarter, as residential investment was the only category to increase at an accelerating pace of 14.2% (quarter-to-quarter annualized rate). Real nonresidential fixed investment decreased 1.1%, and equipment and software investment decreased 2.7%.

The pace of equipment and software investment slowed sharply in the third quarter, but residential investment continued to show strong positive momentum. Equipment investment growth is expected to remain sluggish over the next 6 months across most sectors due to a stubborn industrial capacity overhang and fiscal policy uncertainty. Credit supply continues to improve, but demand has waned. Financial stress remains under control due to continued action by the Federal Reserve and central bankers in Europe.

Within equipment and software sub-sectors, Q3 investment in computers and peripheral equipment declined at an annualized rate of 31.9%, software increased by 2.6%, industrial equipment was relatively unchanged, transportation equipment declined 16.3%, medical equipment fell 11.6%, construction equipment jumped 142.5%, and agriculture equipment fell 59.4%.

Investment Growth Rates

Quarter-Quarter, Seasonally Adjusted Annualized Growth Rate



Conditions in the equipment leasing and finance industry are generally improving, though the rate of growth has slowed and confidence has waned. As of October, the Equipment Leasing and Finance Association's Monthly Leasing and Financing Index (MLFI-25) showed that the new business volume was slightly down from the previous month, but the three-month moving average is at a 10-month high. Average losses as a percent of net receivables held steady at 0.4%. The credit approval ratio was virtually unchanged in October at 79.5% from 79.6% in September, and it remains above the long-term average of 75.0%. The Equipment Leasing and Finance Foundation's Monthly Confidence Index for the Equipment Finance Industry (MCI-EFI) showed a slight decrease in optimism, as the Index fell from 53.3 in October to 49.9 in November. Notably, only 9.1% of survey respondents believe business conditions will improve over the next four months.

The Federal Reserve's quantitative easing program along with "flight to quality" demand from European investors has helped hold down U.S. Treasury rates. The FOMC's latest statement, for the first time, describes benchmarks the Fed will use to guide monetary policy decisions. Essentially, the Fed will continue to purchase $85 billion long-term securities as long as the unemployment rate stays above 6.5% and inflation remains near the 2.0% target. These are not harden-fast rules, just guideposts – but neither of these benchmarks would be triggered given our current outlook for 2013.

Domestic financial stress indicators remain subdued as both household and corporate debt levels have held steady, and debt obligation ratios continue to decline. Mortgage rates are at historic lows, spurring housing market activity – particularly through a large number of mortgage refinances, which soared in November. Low

U.S interest rates, lean corporate spreads, and marginally looser lending standards for business loans are likely to continue into 2013. These trends generally bode well for large corporations, but mortgage lending is still relatively tight and according to the Private Capital Access Index, small businesses' access to credit has stagnated in 2012.

Our credit outlook hinges to three primary factors that will result in only mild upward pressure on long-term interest rates in Q3 and Q4 of 2013. (1) Demand for risk assets will increase in the second half of 2013 as Europe emerges from recession and the U.S. economy picks up momentum. (2) The Federal Reserve will remain highly aggressive until it is clear that economic growth has gained solid traction. (3) Lenders will continue to loosen supply constraints.

Our outlook on the propensity to finance equipment investments is unchanged from last quarter. Given the current macroeconomic backdrop, companies may be more likely—on the margins—to use a combination of cash and long-term financing rather than leasing. In particular, corporate balance sheets are relatively healthy, companies are sitting on record levels of cash, and interest rates are near all-time lows. However, these conditions are counter-balanced with policy uncertainty and weak demand growth that favor shorter-term leasing arrangements.

Summary of Credit Market Conditions

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

- **Credit Supply & Pricing:** Credit supply is generally improving throughout the U.S. economy. The latest Federal Reserve survey of banks' senior lending officers continued to show loosening of standards on commercial & industrial ("C&I") loans from the previous quarter. Interest rates are at historically low levels due to the Fed's loose monetary policy and the "flight to quality" by battered European investors. The Federal Reserve has continued its accommodative monetary policy through continued quantitative easing (until full employment has reached) along with the near-zero interest rate policy that should go well into 2015. Capital is likely to remain inexpensive for the foreseeable future.
- **Credit Demand:** C&I loans have continued to increase, and are up nearly 2% in the past 3 months and almost 13% year-over-year. However, forward-looking indicators are somewhat mixed. On the positive side, the Thomson Reuters/PayNet Small Business Lending Index rose in October to 107.5, after a sharp drop in October to 96.4, and small banks are reporting a slight increase in loan demand. On the negative side, large and medium-sized banks are reporting a net decline in loan demand. The Q4 2012 Business Roundtable CEO Economic Survey indicates that large companies are, for the most part, holding off on capital spending. Also, the latest Wells Fargo/Gallup Small Business Index showed that 34% of small business owners expect to decrease their capital expenditures over the next 12 months.
- **Financial Stress:** Amidst accommodative monetary policy from both the Federal Reserve and European policy makers, financial stress has remained in check. Low interest rates and calm markets better enable the public sector, businesses, and households to meet their debt service obligations and continue to deleverage their balance sheets. Particularly noteworthy are the reduction in household debt and the continued decline in the household debt service ratio to early-2000 levels. As of October, stress indicators have remained subdued relative to late 2011 when the Eurozone crisis broke out and the U.S. was reeling from debt ceiling debacle and subsequent downgrade of U.S. Treasury securities. As of Q3 2012, loan delinquencies fell close to a 4-year low of 5.0% (1.24% for C&I loans, and 0.7% for leases). Nonfinancial sector debt as a percentage of GDP and corporate bond spreads have held relatively steady as of late.

2013 Investment Outlook

In terms of business investment, 2013 will be a tale of two halves. Growth in the first half of the year will be limited by relatively weak demand and fiscal policy uncertainty. By the second half of 2013, however, we expect investment activity to regain momentum thanks to an improving housing sector and relief from policy uncertainty that will have an unlocking effect on business investment.

The *Keybridge Momentum Monitor for Equipment & Software Investment* – a monthly leading indicator for equipment and software investment over the next 3 to 6 months – has held relatively steady the past two months.

Underlying data for the Index are somewhat mixed. New Orders and Industrial Production, in particular, have improved recently, while most other indicators are relatively neutral. At current levels, the Index suggests that year-over-year growth in equipment and software investment, which was 4.0% in Q3, will move in a sideways pattern over the next two quarters. In other words, growth is likely to remain below the historical average (about 5% over the past 15 years).

In addition to the quarterly key signposts presented on page 4, Keybridge's monthly Equipment & Software Investment Momentum Monitors provide a higher frequency view of trends in subsectors of business investment. The monthly Momentum Indices for December are consistent with the quarterly signposts:

- **Agriculture:** The drop in agriculture investment was signaled by the steady decline in the Momentum Index. Looking forward, investment is likely to remain sluggish over the next 3 to 6 months, and then level out by next spring.
- **Computers & Software:** The Momentum Index fell into negative territory, suggesting that growth will remain below average through Q1 of 2013.
- **Construction:** The drop in the Momentum Index suggests that the recent acceleration in construction equipment investment will dissipate, but not reverse field. Overall, the construction sector is expected to grow, but at a slower pace than recent quarters.
- **Industrial:** Momentum remains in positive territory, but appears to have stalled out. The Momentum Index suggests that growth will hold steady or trend down slightly.
- **Medical:** The year-over-year drop in Q3 was accurately picked up by the Momentum Index. With the Index still in negative territory, investment will likely remain sluggish over the next 3 to 6 months.
- **Transportation:** The recent downward drift in the Momentum Index suggests that the transportation sector will continue to lose its vigor over the next several quarters. Instead of 30% annual growth, 10% growth might be more realistic over the near term.

The outlook for investment in 2013 is largely contingent on the resolution of the "fiscal cliff," which could either continue to send negative shock waves through the economy or offer businesses encouragement. Capacity utilization edged up in November, but still points to an excess level of industrial capacity in many sectors. Along with policy uncertainty, investment in new plants and equipment will remain slow through the first half of 2013. However, there remains upside potential in the second half of the year.

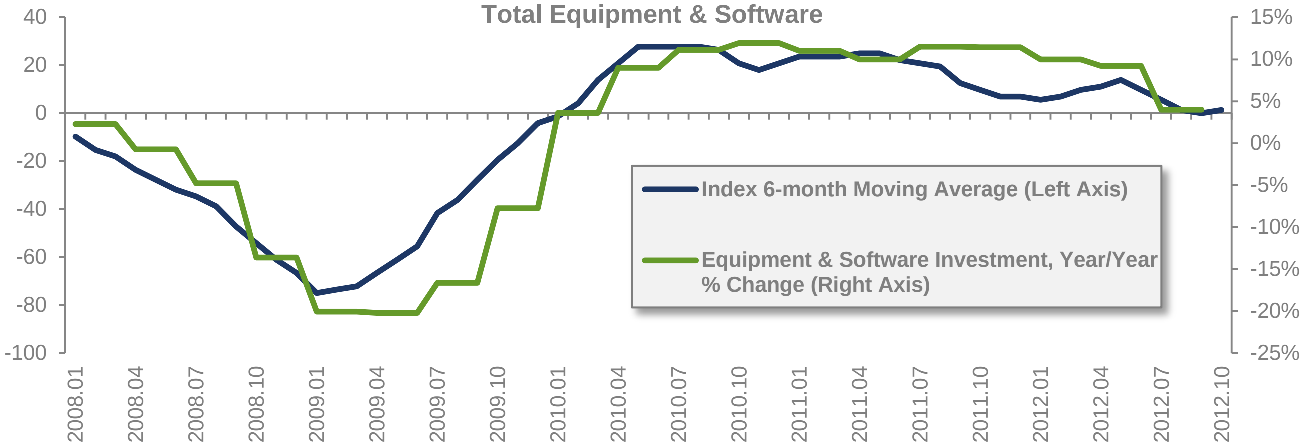
Growth within equipment categories will remain uneven:

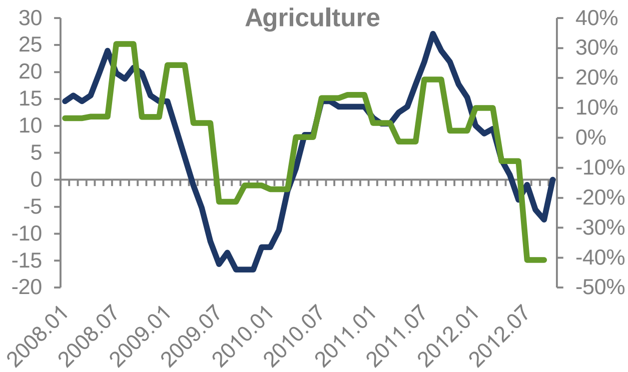
- Transportation and construction look to grow at a healthy pace;
- Industrial and medical equipment will continue to grow but at a slow rate; and
- Agriculture equipment and computers & software investment are likely to decline on a year-year basis in Q4 2012 and Q1 2013.

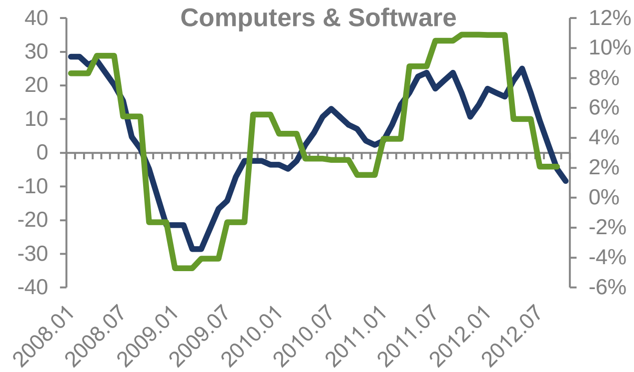
Similar to our Q4 2012 outlook, credit market conditions will remain favorable for long-term financing versus leasing, though economic and policy uncertainty favor short-term lease commitments:

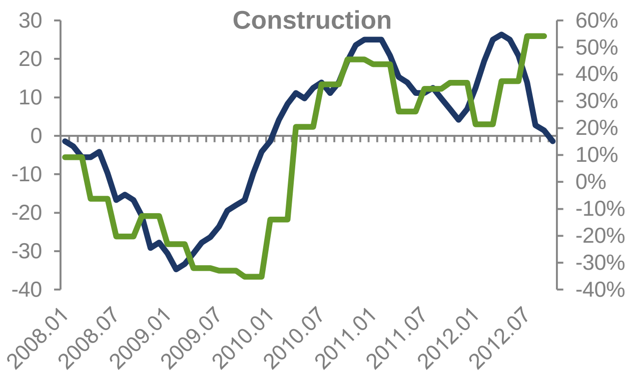
- Supply is growing slowly and interest rates will remain low for the foreseeable future;
- Financial stress will remain sensitive to events in Europe and Congress's handling of the fiscal situation, but it is currently in a manageable position; and
- Credit demand remains tepid, as policy uncertainty is a major obstacle to business investment.

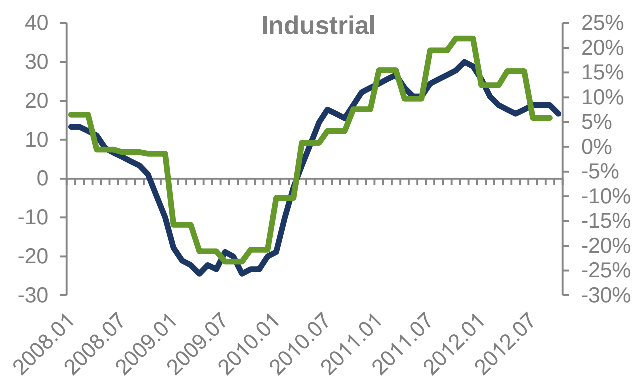
Keybridge Equipment & Software Investment Momentum Indices
Source: www.keybridgeresearch.com

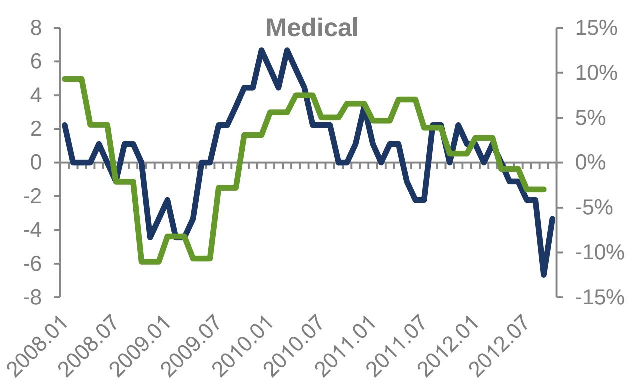


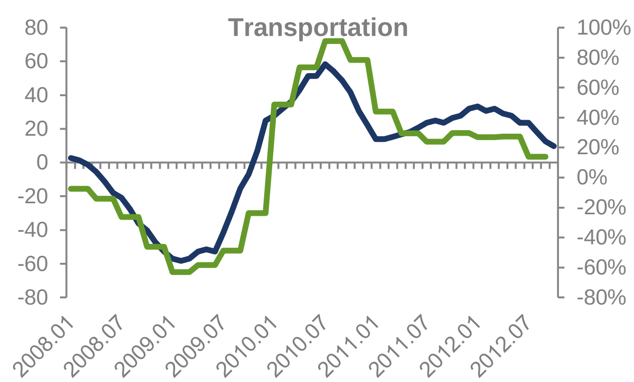












QUARTERLY DATA

Indicator	2010		2011				2012		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Real Gross Domestic Product (SAAR %)									
GDP	2.6%	2.4%	0.1%	2.5%	1.3%	4.1%	2.0%	1.3%	2.7%
Consumer Spending	2.5%	4.1%	3.1%	1.0%	1.7%	2.0%	2.4%	1.5%	1.4%
Gross Private Fixed Investment	16.4%	-5.9%	-5.3%	12.5%	5.9%	33.9%	6.1%	0.7%	6.7%
Inv: Equipment & Software	11.9%	9.2%	11.1%	7.8%	18.3%	8.8%	5.4%	4.8%	-2.7%
Inv: Computers & Peripheral Equipment	-7.3%	10.5%	2.4%	50.5%	11.5%	11.5%	14.7%	-19.6%	-31.9%
Inv: Software	7.1%	6.9%	7.8%	7.3%	7.8%	8.7%	2.0%	6.1%	2.6%
Inv: Industrial Equipment	-0.9%	10.1%	17.1%	0.6%	37.2%	21.5%	-13.6%	13.5%	0.2%
Inv: Transportation Equipment	73.1%	8.8%	30.8%	14.1%	45.0%	30.9%	20.0%	15.8%	-16.3%
Inv: Medical Equipment/Instruments	10.1%	7.6%	4.0%	6.4%	-2.1%	-3.9%	11.3%	-7.2%	-11.6%
Inv: Construction Machinery	25.7%	13.9%	62.7%	8.9%	62.9%	21.7%	0.7%	78.7%	142.5%
Inv: Agricultural Machinery	5.2%	-0.9%	-14.3%	6.6%	125.5%	-46.7%	14.2%	-47.3%	-59.4%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	77.0%	76.3%	76.5%	76.6%	76.6%	76.7%	76.7%	77.0%	76.8%
Loan Delinquency Rate	3.3%	3.0%	2.5%	2.1%	1.8%	1.6%	1.5%	1.4%	1.2%
Lease Delinquency Rate	1.8%	1.5%	1.2%	1.1%	1.0%	0.9%	0.8%	0.8%	0.7%
Net Tightening of C&I Loan Standards	-8.8%	-10.5%	-10.5%	-16.4%	-21.8%	-5.9%	5.4%	-6.9%	-9.5%

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	2011		2012										
	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov
Employment													
Change in Total Payrolls (thousands)	157	223	275	259	143	68	87	45	181	192	132	138	146
Change in Private Payrolls (thousands)	178	234	277	254	147	85	116	63	163	134	122	189	147
Unemployment Rate	8.7%	8.5%	8.3%	8.3%	8.2%	8.1%	8.2%	8.2%	8.3%	8.1%	7.8%	7.9%	7.7%
Business Activity													
Industrial Production	95.1	95.9	96.6	97.1	96.5	97.3	97.3	97.3	97.9	97.0	97.1	96.5	97.5
Capacity Utilization	77.7%	78.3%	78.7%	79.0%	78.4%	79.0%	78.9%	78.8%	79.2%	78.3%	78.3%	77.7%	78.4%
PMI Composite Index	52.2	53.1	54.1	52.4	53.4	54.8	53.5	49.7	49.8	49.6	51.5	51.7	49.5
NFIB Small Business Optimism Index	92	93.8	93.9	94.3	92.5	94.5	94.4	91.4	91.2	92.9	92.8	93.1	87.5
Consumer Activity													
Consumer Confidence	55	65	62	72	70	69	64	63	65	61	68	73	74
Real Personal Consumption (MM % Chg)	0.0%	0.0%	0.3%	0.4%	0.0%	0.2%	0.0%	-0.1%	0.3%	0.0%	0.4%	-0.3%	N/A
Retail Sales (M/M % Chg)	0.3%	0.1%	0.6%	1.0%	0.4%	-0.5%	-0.1%	-0.7%	0.7%	1.0%	1.2%	-0.3%	0.3%
Lending Activity													
C&I Loans (M/M % Chg)	0.7%	1.1%	1.3%	1.7%	0.7%	1.4%	0.5%	1.5%	1.2%	0.7%	0.1%	1.1%	N/A
MLFI-25 New Business Volume (Bil. $)	6.2	10.8	5.1	5.0	6.8	6.1	6.2	8.0	6.6	6.9	8.2	7.6	N/A
MLFI-25 Avg Losses as a % of Net Rec.	0.7	0.7	0.5	0.5	0.7	0.6	0.5	0.6	0.4	0.4	0.5	0.4	N/A
MLFI-25 Credit Approval Ratio	76.2	79.3	76.9	78.8	78.4	76.4	78.3	78.7	77.5	77.0	79.6	79.5	N/A
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	0.12	0.12	0.13	0.18	0.19	0.20	0.18	0.21	0.16	0.16	0.17	0.18	0.18
3-Year Treasury Rate	0.41	0.36	0.30	0.43	0.51	0.38	0.35	0.41	0.30	0.30	0.31	0.38	0.34
10-Year Treasury Rate	2.08	1.89	1.83	1.98	2.23	1.95	1.59	1.67	1.51	1.57	1.65	1.72	1.62
30-Year Treasury Rate	3.06	2.89	2.94	3.08	3.35	3.12	2.67	2.76	2.56	2.68	2.82	2.85	2.81
AAA Corporate Bond Yield	4.07	3.77	3.72	3.80	4.04	3.95	3.63	3.66	3.29	3.36	3.42	3.40	3.58
BAA Corporate Bond Yield	5.32	5.16	5.07	5.08	5.30	5.15	4.99	5.06	4.78	4.78	4.72	4.45	4.57
Prices													
Headline Inflation (Y/Y % Chg)	3.5%	3.0%	2.9%	2.9%	2.6%	2.3%	1.7%	1.7%	1.4%	1.7%	2.0%	2.2%	1.8%
Core Inflation (Y/Y % Chg)	2.2%	2.2%	2.3%	2.2%	2.3%	2.3%	2.3%	2.2%	2.1%	1.9%	2.0%	2.0%	1.9%
Oil Price (West Texas Intermediate, $/barrel)	97.21	98.57	100.24	102.25	106.19	103.33	94.70	82.41	87.93	94.16	94.72	89.57	86.66

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