Q4 Update October 2012

2012 Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE FOUNDATION
Your Eye On The Future

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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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KEYBRIDGE RESEARCH

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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 includes the third update of the 2012 Annual Outlook and a revised preliminary outlook for 2013. This report will be followed by the 2013 Equipment Leasing & Finance U.S. Economic Outlook Annual Report in December, 2012.

Q4 2012 Equipment Leasing & Finance U.S. Economic Outlook October 2012

SUMMARY

The U.S. economy continues to grow at an anemic pace, evidenced by weaker-than-expected job creation in the past three months. Although growth in equipment and software investment slowed to an annualized rate of 4.8% in the second quarter from 5.4% in Q1, it continues to be a driver of growth in an otherwise subdued economy. Overall, we revised our 2012 outlook for equipment & software investment upward, from 6.4% to 6.7% due to a mix of better–than-expected growth in the first half of the year and a recent slowdown in shipments of non-defense capital goods. Our revised projection for 2013 growth in equipment and software investment is 4.5%.

Sector-level trends are consistent with our July outlook *(note: growth rates are expressed on a year-year basis)*:

- *Agriculture equipment* investment is likely to decline by 5%-10% in the next three to six months.
- *Computers & Software equipment* investment is projected to grow at a relatively slow pace of 1%-3%.
- *Construction equipment* investment is projected to continue to grow at a strong pace (15%+) as the housing market rebounds.
- *Industrial equipment* investment should grow at a moderate clip of 5%-9% in Q4.
- *Medical equipment* is likely to grow but at a slow pace of 1%-2%.
- Growth in *Transportation equipment* investment is likely to moderate, but should stay above 15%+ over the next 3 to 6 months.

- Credit market conditions remain in flux and highly reactive to Federal Reserve policy and the latest events in Europe. On balance, financial stress indicators have fallen as U.S. Treasury rates remain near historical lows, corporate spreads have narrowed, and banks continue to marginally loosen lending standards on business loans while also reporting increased demand for capital. Our baseline assumption is that Europe will continue to muddle through its economic crisis, causing global demand for U.S. Treasuries to moderate over the next 12 months. As a result, we expect that tensions in global credit markets will ease somewhat, and U.S. interest rates should marginally increase in 2013 as the “flight to quality” trend slowly unwinds.

- The U.S. economy slowed in the second quarter of 2012 to an annualized growth rate of 1.3%, down from 2.0% in Q1 2012. Policy uncertainty increasingly appears to be a factor in the slowdown in hiring as businesses are holding off on expanding until there is greater clarity over future tax and budget policies. The drought in the Midwest—the worst in more than 50 years—was also a drag on second quarter growth. The European crisis and the slowdown in emerging markets remain significant headwinds for 2012—and combined, are likely shaving a few tenths of a percent off of GDP growth.

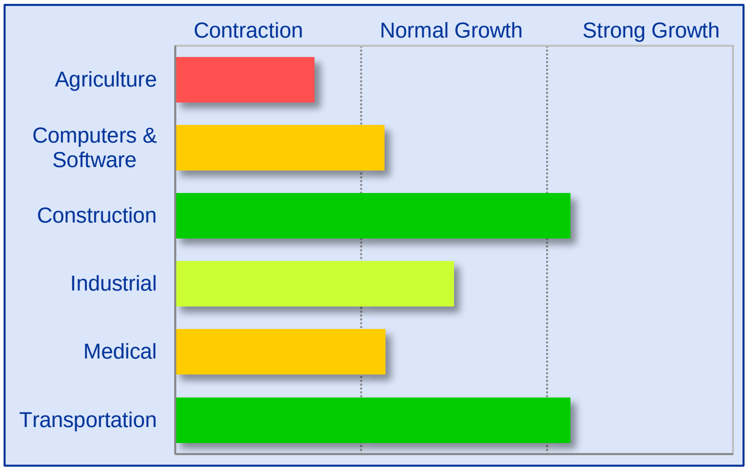
- Overall, our macro outlook for 2012 has not changed materially from June. We are holding steady at 2.2% real GDP growth for 2012, and dropping our inflation expectations to an average rate of 2.1% from 2.3%. The emergence of the “fiscal cliff” as a major risk has weighed heavily on confidence and could potentially push the U.S. economy into recession in 2013. We believe that scenario is unlikely, but do expect some fiscal tightening if the payroll tax cut is rolled back as scheduled. As a result, although we expect cyclical forces (namely, housing) to continue to gain traction, we forecast 2.1% GDP growth for 2013.

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

Summary

Normal revisions to the national accounts showed equipment investment growth slowing in Q2 2012 to an annualized rate of 4.8%, down from 5.4% in Q1. The recent slowdown in durable goods shipments indicates that equipment investment continued to lose momentum in Q3, but should remain positive on a year-year and quarter-quarter basis. At the sector-level, construction and transportation equipment should continue to grow at a healthy clip, but agriculture, computers and software, industrial, and medical equipment show varying degrees of weakness.

Key Signposts "Heat Map" Growth Chart



Agriculture Equipment: Revised figures for Q1 came in closer to expectations, as agriculture equipment investment posted a 10% year-year gain. In Q2, however, the subsector dropped by 8.1% year-year, as the worst drought in 56 years in the Midwest battered farm equipment sales. Looking forward, the sole leading indicator for this sector points to continued weakness over the next 6 months. We expect a short-term reauthorization of the existing Farm Bill to be passed by the end of the year, which will postpone tough decisions on federal support for crop subsidies, crop insurance, conservation programs, and food stamps until 2013. Overall, we project that the annual growth rate in agriculture equipment investment will remain in negative territory over the next 6 months.

Computers & Software: The ISM-Manufacturing Index has shown a slight but positive shift in momentum in the past two months. The Business Roundtable CEO Economic Outlook Survey fell sharply in Q3, but still points to a slow expansion. Taken together, these signposts suggest that growth in computer and software investment is likely to slow over the next 3 to 6 months. Whereas the sector grew 5.3% year-year in Q2, growth is expected to be in the 3%-5% range in Q3 and fall to 1%-3% by Q4.

Construction Equipment: Sales of new single-family homes and housing building permits continue to grow rapidly, but the rate of acceleration is showing signs of moderating. This pattern suggests that the housing recovery will drive construction equipment investment, but the year-year growth rate will decelerate relative to an average growth rate of 33% over the past 2 years. Overall, investment in construction equipment should continue to grow at 15%+ year-year during the next six months.

Industrial Equipment: Even with solid, steady growth over the past 8 quarters, industrial equipment investment is still about 2 years away from pre-recession highs. While growth should remain in the high single digits during Q3 and Q4, the key signposts for this sector suggest a slowing trend. New orders for industrial machinery jumped 3.5% in July but likely reversed those gains in August. Meanwhile, industrial production and capacity utilization have also eased. Overall, these indicators suggest that demand is not strong enough to pick up the remaining slack in manufacturing capacity, and there is a limited need for businesses to make large investments.

Medical Equipment: As expected, medical equipment investment contracted on a year-year basis in Q2, but the key signposts suggest slightly positive growth over the next 3 to 6 months. Although hospital in-patient days continue to decline, the slight rebound in prices for medical and diagnostic labs and revenue for nursing and residential care facilities are indicating stronger demand for medical equipment.

Transportation Equipment: The Philadelphia Fed Business Outlook Survey jumped sharply in September, but real personal consumption expenditures for motor vehicles and parts slowed in Q2. Taken together, this sector should continue to grow at 15%+ year-year over the next three to six months, but the growth rate is likely to decelerate from current levels.

Key Signposts for Equipment Investment

*(Estimated growth rate ranges are on a **year-year** basis)*

Leading Indicator	Most Recent Data Point	Recent Trend	3-6 Month Signal & Annualized Growth Rate Range
Agriculture Equipment			***Negative Growth (-5% to -10%)***
Texas Index of Leading Indicators (SA)	122.2 Jul-12	Down 0.9% over the past 3 months, but up 1.2% year-year	Negative growth
Computers & Software			***Below Average Growth (1% to 3%)***
ISM Nonmanufacturing Composite Index (SA)	53.7 Aug-12	Down 6.3% over the past 6 months, but still above 50 signaling an overall expansion	Normal growth
Business Roundtable CEO Economic Outlook Survey	66.0 Q2-12	3rd largest drop on record; Reached a 3-year low	No growth
Construction Equipment			***Above Average Growth (15% or higher)***
HMI: Sales of New Single-Family Detached Homes Index (SA), Next Six Months	51 Sep-12	Up 200% in the past year, and 55% in the past 3 months	Above average growth
New Private Housing Building Permits (SAAR, Thousand Units)	801 Aug-12	Up 25% year-on-year, and up 2.4% over the last three months	Above average growth
Industrial Equipment			***Slowing Growth (5% to 9%)***
Capacity Utilization (SA)	78.2% Aug-12	Up 1.4% from last year, but down 1.3% from last month	Slowing growth
Manufacturers' New Orders (SA, $Mil)	3,242 Jul-12	Up 19% year-year and 3.5% in July	Normal growth
Industrial Production Index (SA)	96.8 Aug-12	Up 2.8% year-year, but down 0.5% in past 3 months	Slowing growth
Medical Equipment			***Slow Growth (0% to 2%)***
Hospital In-patient Days (Thousands)	55,499 Q2-12	Down 1.9% year-year, and down 3.7% in Q2	Slow to no growth
PPI: Medical & Diagnostic Labs	108.5 Aug-12	Up 0.1% in August, but down 0.5% year-year	Slow to no growth
Nursing & Residential Care Facilities Total Revenue ($Mil)	50,323 Q2-12	Up 0.5% in Q2 and 0.9% from last year	Slow growth
Transportation Equipment			***Above Normal Growth (15% or higher)***
Philadelphia Fed Business Outlook Survey, Future Activity	41.2 Sep-12	Up 64% year-year and surged in September	Above average growth
Real PCE: Motor Vehicles & Parts (SAAR, Bil.Chn.2005$)	361.8 Q2-12	Up 7.6% year-year, but down 2.5% in Q2	Declining momentum

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

The U.S. economy continued to slow in the second quarter of 2012 to an annualized growth rate of 1.3%, down from 2.0% in the first quarter of 2012. Overall, our macro outlook for 2012 remains steady at 2.2% growth for the year. Inflation should average 2.1%.

The U.S. economy slowed in Q2 2012 to an annualized growth rate of 1.3%, down from 2.0% in Q1 2012. Policy uncertainty, the unresolved Eurozone debt crisis, and the slowdown in emerging markets remain significant headwinds to U.S. growth. Hiring has stalled in the second and third quarters, and business investment has slowed noticeably. 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 after the November elections and resolution of the "fiscal cliff."

Macroeconomic data for the U.S. economy remains somewhat mixed. The housing sector continues to show signs of life, and retail sales grew 0.6% in July and 0.9% in August. However, hiring has stalled and industrial production is down 0.5% over the past three months. Policy intervention continues to play a large role in shaping U.S. and global macroeconomic conditions. The Federal Reserve announced an unprecedented and open-ended commitment to large-scale asset purchases ("QE3"), Europe has made some positive steps to backstop the weak peripheral countries, and China and other developing countries announced new rounds of stimulus spending to boost flagging growth. However, the U.S. "fiscal cliff" (i.e., the potential rollback of the Bush tax cuts at the end of 2012 and $1.2 trillion in automatic budget cuts that will occur over a 9-year period) and policy uncertainty in general appear to be weighing down hiring and business investment in the U.S.

Looking ahead to 2013, natural cyclical forces—particularly housing—should gain more traction and drive growth. However, we expect some fiscal tightening to counter-balance these positive trends. Our baseline forecast assumes that the payroll tax cut will be rolled back, which will dampen consumer spending and could shave between 0.5% and 1.0% off of GDP. We also expect that Congress will "kick the can" on the fiscal cliff either to the end of March (and link it with the debt ceiling debate) or sometime later in the year. This outcome is far from certain, and there is potential for upside or downside surprises—a "grand bargain" on taxing and spending could bolster confidence, but a continued political stalemate would stunt businesses' hiring and investment.

Review of Key Economic Indicators

Key Points:

- *Consumer spending picked up in Q3 compared to a slow second quarter.*
- *Investment spending has slowed in recent months.*
- *Government spending appears to be near a bottom.*
- *Exports continue to be weak due to the global slowdown.*
- *Job growth stalled in the past three months.*
- *Inflation remains contained.*

- **Consumer spending** slowed in the second quarter to an annualized rate of 1.5%, following a 2.4% increase in the first quarter. In the third quarter, real consumer spending is off to a slightly better start, growing 0.4% in July and 0.1% in August. Compared to a year ago, real consumer spending is up 2.0%. Consumer confidence jumped in September, but is still a historically low level as employment has softened, and the European sovereign debt crisis and the slowdown in emerging markets have weighed heavily on global equity markets.
- **Investment spending** has begun to slow with fears of the fiscal cliff seemingly hurting investors' confidence. Investment spending for equipment and software, the main capital spending category, increased at a 4.8% annual pace in the second quarter, following a 5.4% gain in the first quarter of 2012. Investment in nonresidential structures (including office buildings, plans, and retail space) increased at a 0.6% annual rate in the second quarter compared with a 12.9% increase in the first quarter. Residential investment (new home building and additions) increased 8.5% in the second quarter, following an increase of 20.5% in the first quarter.
- **Government spending** has been a consistent source of weakness for the past two years. However, while federal, state and local government spending has continued to decrease from the latest quarter, it is now declining at slower rates than in 2011. Real federal government expenditures and gross investment decreased at an annual rate of 0.2% in the second quarter after declining 4.2% in the first quarter. State and local government expenditures and gross investment decreased at an annual rate of 1.0% in the second quarter, following a decline of 2.2% in the first quarter.

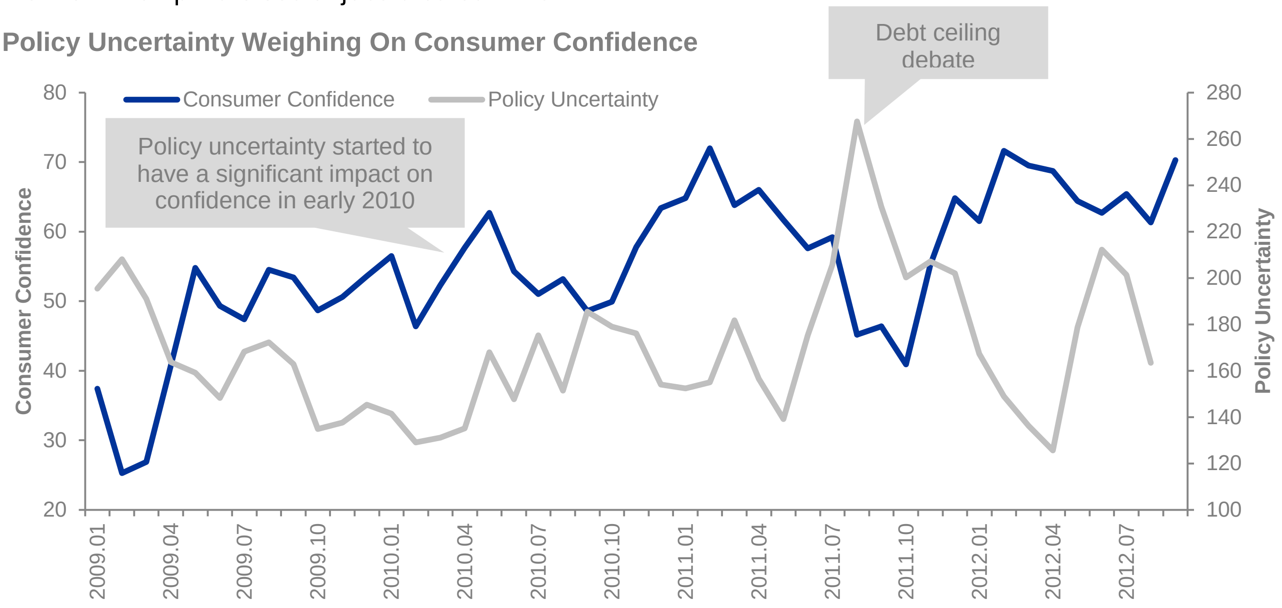
- **Exports** (after adjusting for inflation) increased at an annual rate of 5.3% in the second quarter, compared with an increase of 4.4% in the first quarter.
- **Employment** continues to be slow in the third quarter of 2012. The U.S. added 237,000 net new jobs in the past three months (96,000 in August, 141,000 in July, and 45,000 in June), after adding just 200,000 jobs in the second quarter. Government payrolls decreased by 46,000 from June to August, led by losses at the federal and local levels. Private-sector payrolls increased by a net of 282,000 from June to August. The unemployment rate has been generally flat in the past 6 months but ticked down to 8.1% in August. Although the unemployment rate dropped slightly, the labor force participation rate is at its lowest level, 63.5%, in three decades.
- **Inflation** remains fairly well contained so far in 2012, but price pressures may begin to push inflation higher as oil prices have recently hovered around $100 per barrel. Headline Consumer Price Index (CPI) prices increased 0.6% in August but were flat in July and June and declined 0.3% in May. In the past 12 months, consumer prices have increased by only 1.7%. Core inflation (which excludes food and energy costs) has decelerated in recent months; over the last year, core inflation has been 1.9%, which is down from its four-year high in the previous quarter.

2012-2013 U.S. Economic Outlook

The latest poll from *The Economist* magazine shows that the consensus GDP growth forecast for 2012 held steady at 2.1%, and inflation expectations remained unchanged at 2.0%. The consensus outlook for 2013 calls for 2.0% growth. Our expectations for 2012 have been marked down slightly as the economy grew slower than anticipated in the second quarter, and July-August data have been mixed. We expect 2.2% GDP growth in 2012, and for inflation to average 2.1%. Our second look at 2013 suggests that growth will slow slightly to 2.0% as the housing market continues to improve, but fiscal tightening will subtract up to a full percentage point off of GDP.

Uncertainty surrounding tax and budget policy has been and will likely continue to be a major drag on consumer confidence, business investment, and hiring for the remainder of 2012 and potentially 2013. A recent study by the Federal Reserve Bank of San Francisco suggests that policy uncertainty has caused the unemployment rate to be about 1 percentage point higher than it would be otherwise—this translates to nearly 1.6 million jobs, compared to the 1.8 million private sector jobs created in 2011.

Policy Uncertainty Weighing On Consumer Confidence

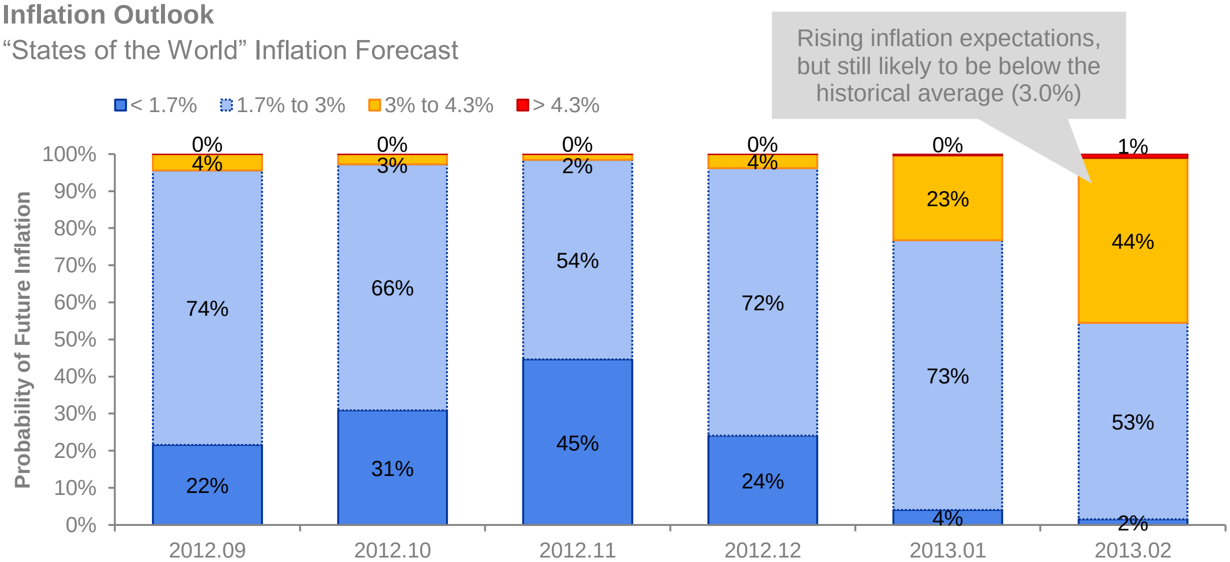


The Federal Reserve pulled out all the stops to stimulate growth—recently announcing an indefinite commitment to its near-zero interest rate policy and a third round of quantitative easing. Chairman Bernanke is clearly worried about weak job growth and is attempting to bring down long-term interest rates in order to stimulate the housing market and business investment. We are skeptical that QE3 will have a significant impact on interest rates, and regardless, even a relatively large cut in interest rates would not materially impact the overall macroeconomy. A recent survey of business CFOs by the Duke Fuqua School of Business suggests that even a 1%-2% drop in interest rates (which would be a very large and highly unlikely rate reduction) would not induce higher investment. Also, recent reports suggest that mortgage lenders have a back-log of several months on mortgage loans, and therefore have not felt pressure to pass on lower rates to consumers. Consequently, so-called hawks on the FOMC are increasingly worried about the medium- to long-term inflation risks posed by QE3, evidenced by a surge in the Treasury breakeven rate (i.e., the gap between yields on Treasury 10-year notes and inflation-linked securities) to a 5-month high. We consider this potential in our forecast, and our inflation outlook suggests that upside inflation risks may begin to take hold in early 2013 but will remain well-within normal levels over the near-term. As shown in the chart below, our inflation "states of the world" model predicts a 45% chance that headline inflation will move above the long-term average of 3%. A more likely scenario, depending on oil prices, is for inflation to drift upwards to 2.5%–2.9% by early 2013.

Coming off of weak growth in the first half of the year, consumer spending should rebound somewhat in Q3 and Q4, driving GDP growth in the second half. Investment looks like it is slowing considerably, and along with net exports, is not expected to contribute meaningfully to overall growth. Government spending should be relatively neutral as well, as evidenced by the slowdown in net layoffs in the public sector.

Inflation Outlook

"States of the World" Inflation Forecast



The major risk for 2013 continues to be the so-called "fiscal cliff" in which the scheduled fiscal consolidation and rollback of tax cuts would have a major impact on the U.S. economy and likely result in another recession. The Congressional Budget Office estimated that the current fiscal path would result in fiscal consolidation of about 4% of GDP in 2013. However, we think that is an unlikely scenario, and that the lame-duck session will produce a bargain to "kick the can down the road" on taxes and budget cuts. The two most likely scenarios, depending on the outcome of the November elections, are either to hold off on budget decisions until the next debt ceiling debate in late March, or to punt until sometime later in the year. The handling of the situation has both upside and downside potential. Expectations appear to be factoring in a difficult debate, and therefore a "grand bargain" on tax and budget policy could be a welcomed surprise that could restore confidence. We do expect the payroll tax cut to expire, which will act as a strong headwind to consumer spending, knocking as much as 1% off of GDP.

Other key considerations affecting our forecast are:

- **Housing & Construction:** There is continued evidence that the housing sector may be beginning to rebound. New private housing permits have increased by 29% over the past 12 months, and for the past three months, the S&P/Case-Shiller Housing Price Index has increased, after being at a decade-low level in March.

Moreover, the "shadow" in the housing market is beginning to disappear. Freddie Mac's August Economic & Housing Market Outlook showed that there has been a substantial decline in overall vacancies in U.S. homes that are either for sale or for rent. Oversupply of vacant houses – whether for rent or for purchase – is at its lowest level in almost a decade. On the construction side, the Housing Market Index (HMI), a strong indicator of builder confidence, recently reached 40. After five consecutive months of improvement, it now stands at its highest level since June 2006. Similarly, Housing Starts rose 2.3% in August on a month to month basis. A sustained housing rebound would help to increase construction activity, housing-related employment and consumer confidence.

- **"Energy Renaissance":** High oil prices and the advent of new technology have paved way for a robust "energy renaissance" to occur in the United States, particularly within the regards to the mining of natural gas. This has led to an increased demand for the purchasing and the leasing of drilling and drilling-related equipment. Additionally, truck transportation employment has seen positive growth over the past five months, and U.S. truck production is up 7.0% year over year.

- **European Crisis:** The continued unresolved status of the Eurozone debt crisis is weighing on the global financial sector and U.S. corporate earnings. Approximately 20% of U.S. exports go to Europe and exports account for about 14% of U.S. GDP. A 10% decrease in European imports could shave about 0.3 percentage points off U.S. GDP. Although the future of the Eurozone is uncertain, Europe averted a major obstacle as Germany's Constitutional Court gave the green light to ratify the European Stability Mechanism, which could help pave the way for providing further assistance to the weaker periphery countries. Previously, the European Central Bank had also stepped up its support, announcing a program to purchase unlimited amounts of debt issued by at-risk nations. The likelihood of a Eurozone collapse has declined, but the threat is still tangible. In addition, fiscal austerity across the Euro Zone is likely to dim growth prospects over the short-term.

- **China's Slowdown:** The "soft landing" of China continues to have a negative impact on demand for U.S. exports and expectations for global growth in general. Signs of overbuilding and excess debt in China's real estate and industrial sectors threaten a sharper slowdown, which would shave several tenths of a percent off of U.S. economic growth in 2012. Recent data from the Chinese economy confirms the overall slowdown. In August, China's Manufacturing PMI index dipped below 50 for the first time in 10 months and New Orders contracted for the 4th month straight. On the financial side, there have been three straight months of capital outflows from China, which is likely a response from muted economic growth outlooks and declining Chinese corporate profits. Chinese officials have recently responded with additional stimulus spending on public infrastructure, but it may take several months or more for the impacts to be felt

Summary of 2012-2013 U.S. Economic Outlook

2012 has been marked by continued domestic and foreign headwinds that have stalled growth. The negative effects of a potential "fiscal cliff" have dented consumer confidence and caused businesses to hold-off on hiring and investment. Internationally, the Eurozone crisis and the slowdown in emerging markets have also had a marginal downward impact on growth, decreasing demand for U.S. exports abroad. Conversely, the housing sector rebound, and the "energy renaissance" are reasons for cautious optimism. We continue to expect to the United States' economy to experience "sideways movement" during the rest of 2012 and in first half of 2013. Overall, our revised 2012 outlook is for 2.2% growth, which is in line with the consensus view. In 2013 we expect growth to remain in a similar range of 2.0%-2.3%.

- As more workers re-enter the workforce, unemployment will likely remain above 8.0% through 2012.
- We expect inflation to move up slightly by the end of the year, and average 2.1% for the year.
- The biggest risks for 2012 are a surge in oil prices resulting from rising tensions in the Middle East, a disorderly default on Greek debt, and a "hard landing" scenario in China.
- The top risk for 2013 is a "fiscal cliff" scenario.

Projections for Key Economic Indicators

Indicator	2011	2012e	2012-2013 Quarterly Estimates Q3e	Q4e	Q1e	Q2e	2013e
Real GDP (SAAR %)	1.8%	2.2%	1.9%	1.6%	2.0%	2.4%	2.1%
Real Investment in Equipment & Software (SAAR %)	11.0%	6.7%	1.2%	0.9%	5.9%	8.6%	4.5%
Inflation (annualized rate)	3.1%	2.1%	1.7%	1.9%	2.3%	2.5%	2.5%
Federal funds (effective, end of period)	0.07%	0.17%	0.15%	0.15%	0.15%	0.15%	0.15%
10-year Treasury Rate (end of period)	2.0%	1.8%	1.7%	1.8%	2.0%	2.1%	2.5%
Total Payrolls (in thousands)	+1,840	+1,600	+350	+375	+400	+500	+2,000

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

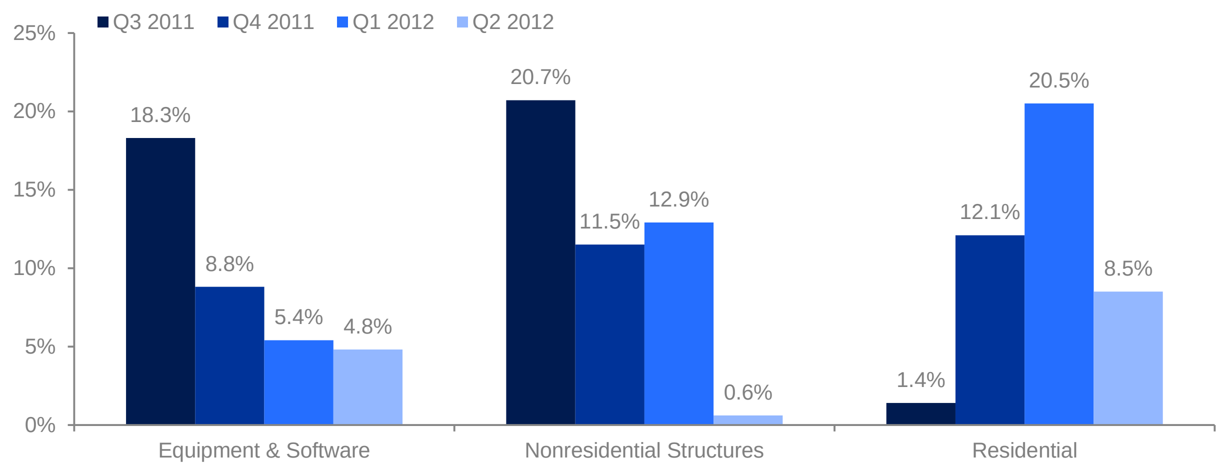
Investment activity grew but at a slower pace in the second quarter of 2012. The mix of investment continued to shift in the second quarter, as residential investment increased at an annual rate of 8.5%, equipment and software investment increased at a 4.8% annual rate, and investment in nonresidential structures increased by 0.6%.

Within the equipment and software category, investment in software and industrial equipment accelerated on a quarter-quarter basis; transportation investment grew, but at a slower pace; and investment in computers and peripheral equipment contracted.

The pace of equipment retooling is slowing down, and although the overhang of excess industrial capacity is tightening, it will still have a moderating effect on investment spending. At the sector-level, growth in investment should remain strong in the petrochemical industry, transportation, and construction. Credit conditions are generally improving, as demand for business loans has picked up slightly and lending terms are loosening. Financial stress has lessened slightly due to the Fed's latest policy actions and an easing of tensions in Europe.

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 is waning. As of August, the Equipment Leasing and Finance Association's Monthly Leasing and Financing Index (MLFI-25) showed that the three-month rolling average of new business volume was up only 15.0% from the same time last year (compared with 20%+ gains seen in 2011 and early 2012). Average losses as a percent of net receivables held steady at 0.4%. The credit approval ratio fell slightly in August to 77.0%, but remains above the long-term average of 75.0%. While these signals suggest that leasing activity is improving at a slower pace than in 2011, the Equipment Leasing and Finance Foundation's Monthly Confidence Index for the Equipment Finance Industry (MCI-EFI) increased slightly to 53.0 in September. Survey respondents remain concerned about domestic and international macroeconomic, regulatory, and political risks.

Credit market conditions remain in flux and highly reactive to Federal Reserve policy and the latest events in Europe. For example, the Fed's plan to engage in a third round of quantitative easing caused an upward movement in interest rates (investors shifted from bonds to stocks), but the trend was reversed over skepticism about U.S. growth and worry over the recent protests in Spain and Greece. On balance, financial stress indicators have fallen as U.S. Treasury rates remain near historical lows, corporate spreads have narrowed, and banks continue to marginally loosen lending standards on business loans while also reporting increased demand for capital. Our baseline assumption is that Europe will continue to muddle through its economic crisis, causing global demand for U.S. Treasuries to moderate over the next 12 months. As a result, we expect that tensions in global credit markets will ease somewhat, and U.S. interest rates should marginally increase in 2013. Overall, credit markets should continue to improve in 2012 and 2013 due to a loosening of supply constraints and modest growth in lending demand.

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	Moderate Improvement
Financial Stress	Slight Improvement

- **Credit Supply & Pricing:** Credit supply is generally improving, though small businesses continue to have a difficult time gaining access to capital. The latest Fed survey of banks' senior lending officers indicated that loosening of standards on commercial & industrial ("C&I") loans has resumed after a slight tightening in the first quarter. Interest rates remain near all-time lows, due to the Fed's loose monetary policy and the "flight to quality" caused by the Eurozone crisis. The Federal Reserve recently took an extremely aggressive stance by initiating a third round of quantitative easing, a further extension of the zero interest rate policy, and a continuation of the Operation Twist program. With bond spreads also leveling-off, the capital is likely to remain inexpensive for the foreseeable future.

- **Credit Demand:** C&I loans have increased 13% year-year, including a 3.4% jump in the past three months. For the third straight quarter, banks reported a strong increase in demand for capital after a drop in the fourth quarter of 2011. In August, the National Federation of Independent Business ("NFIB") reported that 30% of small businesses anticipated the need to borrow at least once per quarter, slightly below this year's average. The percentage of small businesses making capital investments edged up to 55%—more than double the percentage of small companies planning capital expenditures. The Thomson Reuters/PayNet Small Business Lending Index has given mixed signals over the last few months, but is up 15.3% year-year, indicating that demand for commercial loans is still growing.

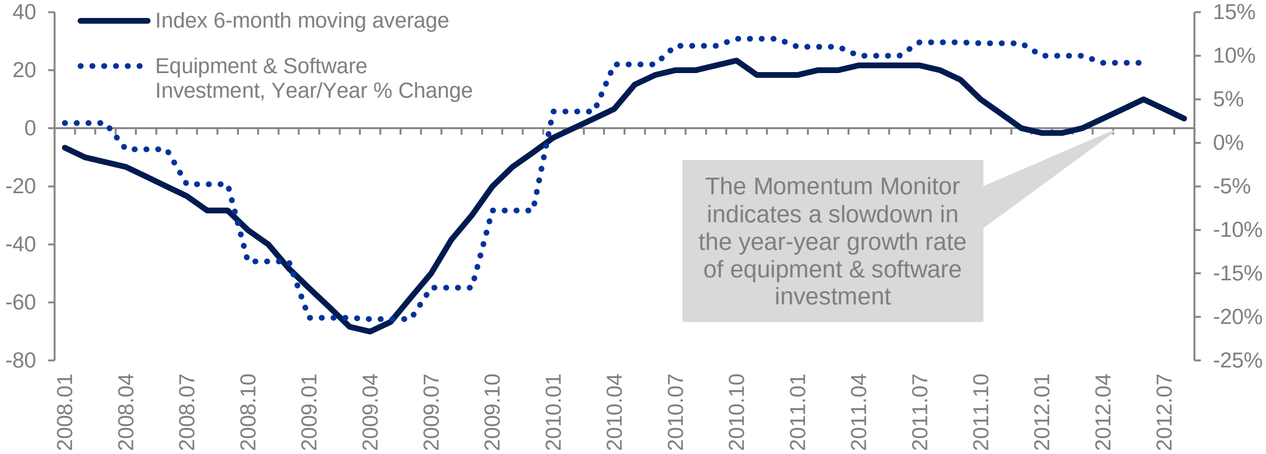
- **Financial Stress:** The Fed's latest actions, as well as European policymakers' efforts to curb fears of a Greek exit and financial contagion, have helped to ease financial stress. Low interest rates and calm markets better enable the public sector, businesses, and households to meet their debt service obligations and continue to deleverage their balance sheets. As of August, stress indicators have fallen relative to late 2011 when the Eurozone crisis spiked and the U.S. was reeling from debt ceiling debacle and subsequent downgrade of U.S. Treasury securities. As of Q2 2012, loan delinquencies were at an over three-year low of 5.1% (1.4% for C&I loans, and 0.8% for leases), but debt as a percentage of GDP for the nonfinancial corporate sector ticked up slightly. Spreads on corporate bonds increased slightly since early 2012, due largely to rising uncertainty of growth and corporate profits.

2012-2013 Investment Outlook

The *Keybridge Research Momentum Monitor for Equipment & Software Investment*—a leading indicator for equipment and software investment trends over the next 3 to 6 months—has drifted downward over the past several months. In particular, manufacturing has made negative contributions to the Index. Businesses have been reporting weaker earnings growth as revenue growth has slowed and there are fewer opportunities for cutting costs. In addition, uncertainty over future budget and tax policies suggests limited growth opportunities in investment spending over the next several quarters, though growth should remain positive overall.

Equipment & Software Investment Momentum Index

Leading Index for Investment Trends Over the Next 3-6 Months



The outlook for investment in 2012 is revised upwards due to better than expected growth in the first half of the year. Growth should remain relatively strong in the third quarter, but then begin to tail off by Q4. Capacity utilization dipped again recently, pointing to an excess level of industrial capacity in many sectors. Along with uncertainty over the "fiscal cliff", investment in new plants and equipment should begin to slow. The outlook for 2013 is more subdued, but there remains upside potential depending on tax policies aimed at stimulating investment. Growth within equipment categories will remain uneven:

- Transportation and construction look to grow at a healthy pace.
- Computers & software, industrial equipment, and medical equipment will continue to grow but at a slower rate.
- Agriculture equipment investment is likely to decline on a year-year basis over the next several quarters.

Credit market conditions will remain favorable for long-term financing versus leasing, though economic and policy conditions favor shorter-term commitments:

- Interest rates are near record lows, and are likely to remain low through 2013.
- Financial stress will remain sensitive to events in Europe and Congress's handling of the fiscal situation, but is currently in a manageable position.
- Demand remains tepid, and policy uncertainty appears to be a major obstacle for business investment.

QUARTERLY DATA

Indicator	2010			2011				2012	
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Real Gross Domestic Product (SAAR %)									
GDP	2.2%	2.6%	2.4%	0.1%	2.5%	1.3%	4.1%	2.0%	1.3%
Consumer Spending	2.6%	2.5%	4.1%	3.1%	1.0%	1.7%	2.0%	2.4%	1.5%
Gross Private Fixed Investment	14.6%	16.4%	-5.9%	-5.3%	12.5%	5.9%	33.9%	6.1%	0.7%
Inv: Equipment & Software	12.0%	11.9%	9.2%	11.1%	7.8%	18.3%	8.8%	5.4%	4.8%
Inv: Computers & Peripheral Equipment	3.1%	-7.3%	10.5%	2.4%	50.5%	11.5%	11.5%	14.7%	-19.6%
Inv: Software	-2.2%	7.1%	6.9%	7.8%	7.3%	7.8%	8.7%	2.0%	6.1%
Inv: Industrial Equipment	25.9%	-0.9%	10.1%	17.1%	0.6%	37.2%	21.5%	-13.6%	13.5%
Inv: Transportation Equipment	74.2%	73.1%	8.8%	30.8%	14.1%	45.0%	30.9%	20.0%	15.8%
Inv: Medical Equipment/Instruments	-2.6%	10.1%	7.6%	4.0%	6.4%	-2.1%	-3.9%	11.3%	-6.4%
Inv: Construction Machinery	83.2%	25.7%	13.9%	62.7%	8.9%	62.9%	21.7%	0.7%	78.8%
Inv: Agricultural Machinery	35.8%	5.2%	-0.9%	-14.3%	6.6%	125.5%	-46.7%	14.2%	-47.9%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	78.5%	77.4%	77.1%	76.3%	76.6%	76.6%	76.6%	76.8%	76.6%
Loan Delinquency Rate	3.9%	3.7%	3.3%	3.0%	2.5%	2.1%	1.8%	1.6%	1.5%
Lease Delinquency Rate	2.2%	2.0%	1.8%	1.5%	1.2%	1.1%	1.0%	0.9%	0.8%
Net Tightening of C&I Loan Standards	-7.1%	-8.8%	-10.5%	-10.5%	-16.4%	-21.8%	-5.9%	5.4%	-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							
	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug
Employment													
Change in Total Payrolls (thousands)	85	202	112	157	223	275	259	143	68	87	45	141	96
Change in Private Payrolls (thousands)	52	216	139	178	234	277	254	147	85	116	63	162	103
Unemployment Rate	9.1%	9.0%	8.9%	8.7%	8.5%	8.3%	8.3%	8.2%	8.1%	8.2%	8.2%	8.3%	8.1%
Business Activity													
Industrial Production	94.2	94.4	94.9	95.1	95.9	96.6	97.1	96.5	97.3	97.3	97.4	98.0	96.8
Capacity Utilization	77.1%	77.2%	77.6%	77.7%	78.3%	78.7%	79.0%	78.4%	79.0%	78.9%	78.9%	79.2%	78.2%
PMI Composite Index	53	53	52	52	53	54	52	53	55	54	50	50	50
NFIB Small Business Optimism Index	88	89	90	92	94	94	94	93	95	94	91	91	93
Consumer Activity													
Consumer Confidence	45	46	41	55	65	62	72	70	69	64	63	65	61
Real Personal Consumption (MM % Chg)	-0.1%	0.4%	0.2%	0.0%	0.0%	0.3%	0.4%	0.0%	0.2%	0.0%	-0.1%	0.4%	0.1%
Retail Sales (M/M % Chg)	0.1%	1.0%	0.9%	0.5%	0.0%	0.6%	1.0%	0.4%	-0.5%	-0.1%	-0.7%	0.6%	0.9%
Lending Activity													
C&I Loans (M/M % Chg)	1.6%	0.5%	1.2%	0.7%	1.1%	1.3%	1.7%	0.7%	1.4%	0.5%	1.5%	1.2%	0.7%
MLFI-25 New Business Volume (Bil. $)	5.7	7.1	6.0	6.2	10.8	5.1	5.0	6.8	6.1	6.2	8.0	6.6	6.9
MLFI-25 Avg Losses as a % of Net Rec.	0.60%	0.90%	0.70%	0.70%	0.70%	0.50%	0.50%	0.70%	0.60%	0.50%	0.60%	0.40%	0.4%
MLFI-25 Credit Approval Ratio	77.6%	76.5%	76.3%	76.2%	79.3%	76.9%	78.8%	78.4%	76.4%	78.3%	78.7%	77.5%	77.0%
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	0.10	0.13	0.12	0.12	0.12	0.13	0.18	0.19	0.20	0.18	0.21	0.16	0.16
3-Year Treasury Rate	0.33	0.42	0.41	0.41	0.36	0.30	0.43	0.51	0.38	0.35	0.41	0.30	0.30
10-Year Treasury Rate	2.23	1.92	2.17	2.08	1.89	1.83	1.98	2.23	1.95	1.59	1.67	1.51	1.57
30-Year Treasury Rate	3.60	2.90	3.16	3.06	2.89	2.94	3.08	3.35	3.12	2.67	2.76	2.56	2.68
AAA Corporate Bond Yield	4.41	3.96	3.88	4.07	3.77	3.72	3.80	4.04	3.95	3.63	3.66	3.29	3.36
BAA Corporate Bond Yield	5.48	5.22	5.19	5.32	5.16	5.07	5.08	5.30	5.15	4.99	5.06	4.78	4.78
Prices													
Headline Inflation (Y/Y % Chg)	3.8%	3.9%	3.6%	3.5%	3.0%	2.9%	2.9%	2.6%	2.3%	1.7%	1.7%	1.4%	1.7%
Core Inflation (Y/Y % Chg)	1.9%	2.0%	2.1%	2.2%	2.2%	2.3%	2.2%	2.3%	2.3%	2.3%	2.2%	2.1%	1.9%
Oil Price (West Texas Intermediate, $/barrel)	86.33	85.61	86.41	97.21	98.57	100.24	102.25	106.19	103.33	94.70	82.41	87.93	94.16

ACKNOWLEDGEMENTS

This research endeavor was guided by a steering committee of dedicated industry volunteers who gave their time and expertise by providing comments and suggestions throughout the development of the report. Their participation is appreciated greatly. They are: Carl C. Chrappa, John C. Deane, Jeffry D. Elliott, Joseph C. Lane, Robert C. Neagle, James S. Schallheim and William G. Sutton, CAE. We extend special recognition to Robert J. Rinaldi, steering committee Chair, and Richard D. Gumbrecht, Chair of the Equipment Leasing & Finance Foundation's Research Committee for their leadership in bringing this project to life.

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