



Briefing: Monday, 4 April 2011

The following estimate provides detail on the macro perspective and rationale that drives our Severity Impact Index (page 5). Events are collected, assessed, and analyzed for their impact on conditions that drive National Economic Security. This estimate is fluid and ever-changing - it will change over time with events as they transpire - and we will provide updated estimates monthly.

Current National Economic Security Estimate (ME: March)

Summary:

If we were to envision a pyramid of economic factors, at the top of the pyramid for those that currently carry the most impact on the US (at a macro level) could be either the current Japan Crisis or global Food Shortages, followed closely by oil prices. Page 5 of this March estimate shows these three elements in the proprietary scoring model Armada has developed. These impacts can be both positive and negative - and in most economic conditions there are winners and losers. Therefore, we call them simply "impacts" on purpose. Many of the conditions throughout the economy can be tied back to one of these macro events for the month of March - and looking ahead into April, the same factors (plus a few secondary factors) are expected to be important to watch.

March Review:

US economic conditions were generally positive for the United States. Manufacturing and retail volumes were stronger and business inventory building activity spurred growth in all transportation sectors (rail, trucking, air cargo, maritime container volumes). The business sales to inventory ratio index remained at some of its lowest levels in more than five years - driven in part by business conservatism and unwillingness to rebuild inventories too quickly into an uncertain demand environment. Housing was still historically at some of its weakest levels, but recent activity on the existing home sales front shows some new kindled movement despite housing prices continuing to fall. Consumers are generally a bit downbeat about the economy of late - largely because of higher oil and food prices and pessimism that job growth can become strong. However, consumer spending still seems to be keeping pace with expectations (less environmental impacts from severe weather in the northeast helping March volumes). Lastly, business spending remains strong and analysts still see more than \$1.9 trillion tied up in safe haven investments in US corporations (which could be interpreted as pent-up demand waiting on something worthy to invest in; i.e. some of the large M&A activity and equipment purchases we currently see happening).

On the headlines front: Japan's crisis which started of course with the worst earthquake in 140 years on March 11th and was followed closely by a massive tsunami, has led to a concurrent nuclear power plant situation which continues to spiral out of control today - creating hour-by-hour news of interest for businesspeople as you all know. Placing the toll on human life aside for this particular assessment, business managers around the world are grappling with the sheer magnitude of the disaster on both their global supply chains and the stability of their supplier bases. Since the ripple effect from the third largest economy in the world being disrupted is still filtering through the global economic landscape, March impacts from the disaster are just now really being felt. This will continue through April and well into the rest of 2011. Japanese authorities believe that the rolling blackouts will continue through the summer - at least.

Inflationary pressure from spiking global commodity prices (specifically in food, energy, and raw material inputs) is still accelerating. Eighty-two percent of the world's GDP is



held in just 25% of the global population - and 75% of the global population will struggle under severe inflationary conditions with basic life-sustaining commodities. The Food and Agriculture Organization of the United Nations (FAO) estimates that more than 925 million people (1.2 billion at the height of the 2009 food crisis) are at risk of starvation or undernourishment this year (because of high food prices) and aid programs that would provide a critical gap-filling service are short on funds/resources. With every weather-related event that impacts access to food or oil supply, inflationary pressures increase and the stability of LDC's and Developing Nation's declines.

Lastly, the Middle East is still capturing much in the headlines. With general demonstrations happening in Syria, Libya, Egypt, Jordan, Bahrain, Saudi Arabia, Yemen, China, Greece, and even London, 2011 has started out as the year of the protest. Food shortages, unemployment, austerity measures and general displeasure with current ruling authorities in those countries have impacted those governments. But, US businesses are most seeing impacts from those protests that take place in an oil exporting nation. Those are the ones to keep our eyes on as we move forward into April.

Outlook for the Month Ahead:

National Economic Security Outlook - Primary Drivers (in red on Impact Matrix).

These macro items will continue to drive undercurrents of the global economy in the next thirty days:

1. **Oil** - On a supply basis, the world is truly adequately supplied with oil. The run up in oil prices for both West Texas Intermediate and Brent North Sea Crude are largely a result of speculation driven out of Middle East unrest. Even the temporary softening of oil prices immediately after the Japan earthquake were recovered on news that Libyan unrest would spill over to include a UN operation to enforce a no-fly zone. Looking ahead, oil prices are likely to soften further as Libyan rebels continue to gain UN military support and the overthrow of Colonel Gaddafi seems imminent. Further Middle East tension would only work to keep a small underpinning of support for oil prices. At the pump, conditions are likely to be somewhat different. April will be an interesting month to watch for fuel prices. Barring any extreme global event, April should be headlined by being the "lull before the peak storm" (so to speak). Business demand for diesel and gasoline will be slightly softer than March because of inventory rebuilding trends. And, April is just too early for summer travel or business inventory building into the peak summer months for corporations. Still, our Severity Index shows that the impact on the rest of the globe is just slightly greater than the US and is currently at one of the highest levels of any indexed item. And, given the impact of oil prices on everything from plastic production to the movement of goods and people, energy production, and a host of other uses - current high prices has a strong impact on the overall global economy. Airlines will especially continue to be hit hard with the impact of high jet fuel prices - enough so that several global lines may not survive the effect.
2. **Food Supplies** - Global supplies of basic food stuffs indicate that there is generally enough supply to meet global demand - but not at prices that most citizens can afford on a global basis. We continuously brief you on the challenges with food supply worldwide and although there are many reasons for global unrest - one of the primary factors is the socio-economic standing of citizens in those countries having difficulties. Analysts believe that a high unemployment rate coupled with spiking food prices in Egypt pushed groups of citizens there to begin protests that eventually got out of hand - thus indirectly resulting in the overthrow of the Egyptian Government. Looking ahead, increased ethanol production does have an impact on food production despite reports to the contrary. Many farmers will be tempted to shift production to crops in higher demand - especially oilseed crops, forcing much of the human consumption crops to switch over to ethanol producing oilseed plantings. It's less risky for farmers because the quality of the harvest can vary to a greater degree -



whereas there is a narrower band for high-quality consumable wheat (for instance). Historically, as the year progresses, the supply of food will decrease from early spring projected levels as weather impacts production and yield rates. Currently, analysts still see supply barely meeting demand (or slightly lower given current crop conditions) for the rest of the year barring any substantial weather-related disasters. We see this as a sign that food prices will remain high on basic supply/demand relationships. Adding to the equation the impact of higher transportation and harvesting costs (impact of oil) and the higher price for food would seem to be further supported. Even if commodity investments slow, global access to affordable food will tax governments and aid agencies throughout this year - possibly worsening into 2012. The World Health Organization has increased its count of those worldwide starving or malnourished to 950 million (down from 1.2 billion in 2008 at the height of the oil and food crisis), but up from the ten year average and likely to get worse.

- Japan Crisis** - written about extensively by us and many media outlets, simply put: the Japan crisis and the ripple effects from it will last throughout the year if not longer - and the situation for Japan is getting worse by the day in many aspects. This is both a good news/bad news story for the broader market. Simply put: Japanese production will be slow to come back to full capacity and the ripple effects for any item with an electronic component will be somewhat significant. Spot shortages of many products will result (we see and hear reports of Chinese manufacturers closing plants because of parts shortages just starting to hit that market) and the shifting of sourcing to alternative markets (at least in the interim) will force many distribution pattern changes (implications on shipping capacity, trade lane balances, and increased supply chain costs). Consider also the impact of some of our most recent reports. For instance: China and several other countries have recently "turned back" ships from Japan that tested positive for higher levels of radiation. Although a US military source said that the type of contamination being reported was easily cleaned with soap and water, the impact will still be significant either for the maritime providers offering the transportation service to shippers or for shippers that are stuck with stock delays because a shipment was delayed (as much as two to four weeks if an entire shipment is "turned back" to its origination port. This has implications for everything from air cargo service (increasing demand and adding product cost in the process) to contingency planning activities for global corporations. We will have an extensive discussion of the Japan situation and its real impact on global business in our quarterly Black Owl Report being released next week.

National Economic Security Outlook - Secondary Drivers (in black on Impact Matrix).

The following are briefs on several sectors worth watching over the next month:

- Manufacturing** - the manufacturing sector in the United States has done well over the past 11 months - steadily growing into this mild economic recovery that we are experiencing. The unknowns from Japan can have a sizeable impact on the sector. First, on a positive note, many US companies will become contingency sources for products disrupted by the Japan crisis. This could add a short term boost to production rates that were already strong. Purchasing managers have a difficult dilemma on their hands. They have to keep inventory levels moderate because demand on the business and consumer fronts is still uncertain. In this environment, it would be easy to get caught up in trying to build inventory (stockpiling to prevent shortages later) only to have the current global uncertainty lead to a double-dip of sorts. The higher volume of inventory would then appear to mimic the situation in January of 2009 when the inventory to sales ratio spiked and many corporations were at risk of insolvency because they had too much cash tied up in inventory. DSO figures went way off of central positions. This is likely to keep the "on demand" rapid manufacturing activities in high gear - producing smaller quantities with quick reorders on those quantities. Second, the flip side of the positive news is that oil prices continue to remain high and there are potentially going to be a number of unexpected layoffs



coming if the situation in Japan leads to more assembly line shutdowns. That ultimately seeps into consumer spending and creates a soft economic environment - leading to a slowdown. We believe that the broader macro-market global environment is strong enough to push through these negative forces - leading to a more robust manufacturing environment for the rest of the year.

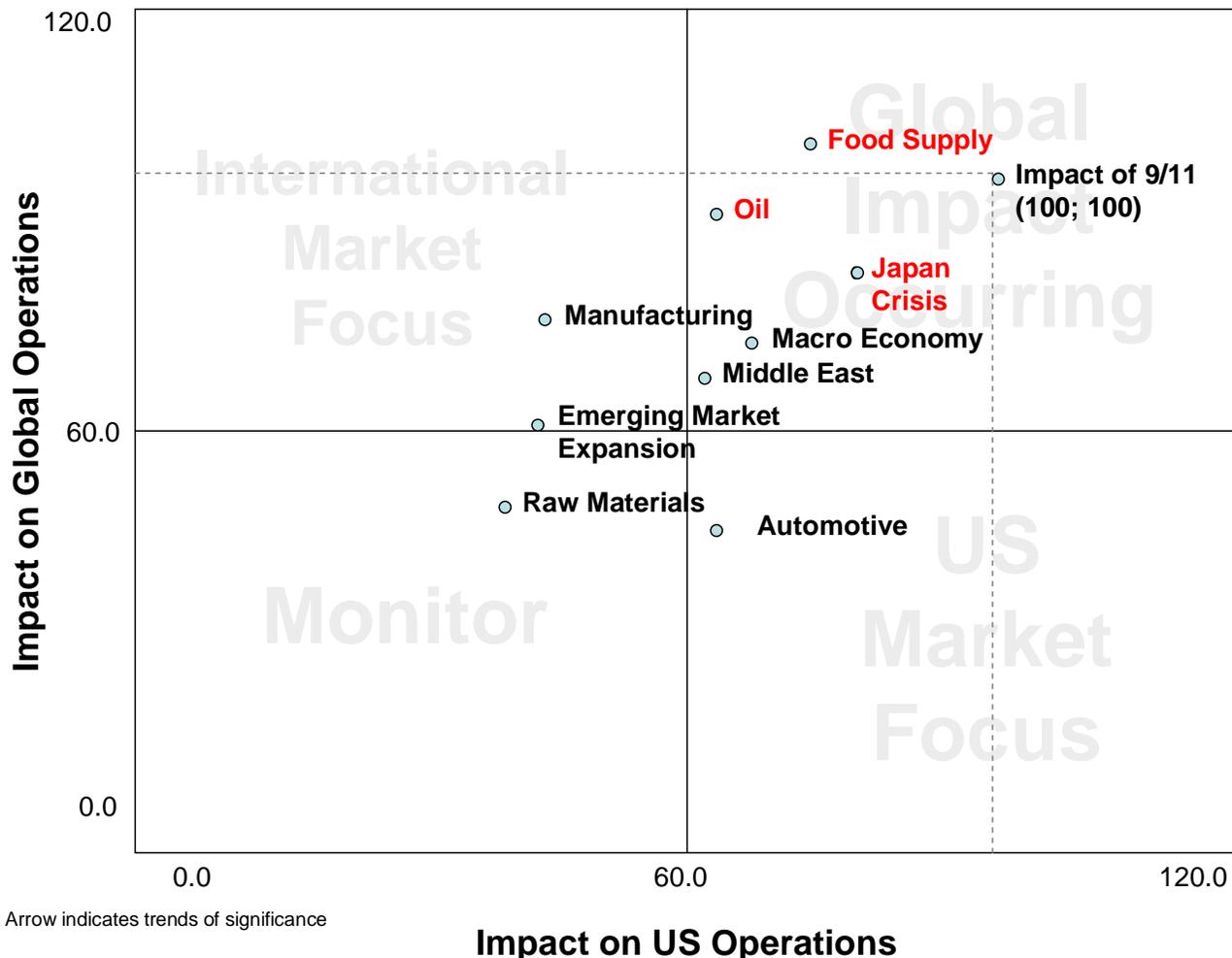
2. **Middle East** - Although some are getting weary of the episodes out of the Middle East, it is having a profound impact on businesses around the world. With Brent now clipping above \$120 a barrel (at least temporarily), there is a significant and profound impact from Middle Eastern events that have the potential to disrupt oil shipments. And in the spirit of Armada, let's be frank, oil is the single biggest impact to the business community from rising unrest in the region (social impacts aside). As we look into the next month, there is just as much of a chance that the unrest across the region subsides and moves off of the media front pages as there is that Saudi Arabia and others get fully involved. In the latter scenario, we would be discussing a completely different animal with regard to global oil prices and the impact on business.
3. **Emerging Market Expansion** - There have been numerous studies conducted on the impact of the emerging markets on world raw material supply. Ernst and Young estimated that there are roughly a billion new middle class consumers entering the global marketplace and the GDP of the BRICs (Brazil, Russia, India, and China) are expected to be 50% of global GDP by 2020 (worldwide emerging markets will overtake the developed nation's GDP by 2014). This is a net gain in consumption to the tune of 1 billion or more individuals looking for new products and a better standard of living. Everything from raw material demand to food stuffs will be impacted in ways we have never seen before - and the global infrastructure (including food production) really isn't ready for it. But, this will also provide significant growth markets for businesses around the world. No longer is the globe counting on the US for growth. Therefore, it is possible for US companies to grow right through another US downturn - bolstered by foreign demand for goods and services. It's a new dynamic that is difficult to fully grasp. But, each month, the role and impact of the emerging markets on global demand have to be figured into the global economic mix.
4. **Raw Materials** - As mentioned before, the global manufacturing growth and a series of natural disasters has led to basic raw material price increases over the past year. We expect much of these prices to hold steady or increase through the next month as demand increases and spot supply challenges remain. The Japan effect will also play a role if raw materials are shifted to alternative markets for some interim production. One caveat: we are still not seeing any movement in the Baltic Dry Index - a barometer of global key raw material prices for transportation. Overcapacity in the sector may be creating a soft-patch for the sector - an anomaly against what may be a really robust movement of raw materials ongoing. Transportation volumes currently moving around the world would suggest that demand is still strong.
5. **Automotive** - This is another sector that could really go either way - but the multiplier effect on dollars spent in the sector have a huge effect worldwide. Currently, demand is surprisingly still robust and supply is weaker until the Japan situation can stabilize. Production with global automakers is still challenged - the ripple effects have stretched to the US with closures of several plants and a series of layoffs ensuing as a result. Watch for changes here in April. Spot parts shortages will definitely continue through the month and well into the second quarter.

We continue to watch other developing events that could have a macro impact on the outlook. Those will be covered in future editions of the Executive Brief or a Falcon Report when events warrant.



Impact Matrix

Analysis May 16, 2008



** Arrow indicates trends of significance

The Impact Matrix is based on a proprietary index scoring system developed by Armada that compares current events to the global and US domestic impact from the attack on the United States on 9/11/2001 as a benchmark. 9/11 was chosen because it permanently changed the business environment, geopolitics, security policies, and directly impacted the personal lives of citizens around the globe.

Red Fonts: Indicate a trending event that has one dimension of its index over 90 and is of significant National Economic Security importance.

 : An arrow signifies movement of a trend and the direction of that movement.