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Economic Outlook 2010

Craig Infanger

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Economic Outlook 2010

Craig Infanger

October 2009



Dow at 10000 as Crisis Ebbs

A Rapid Recovery From Collapse, but Traders Voice Doubt About Bull's Staying Power

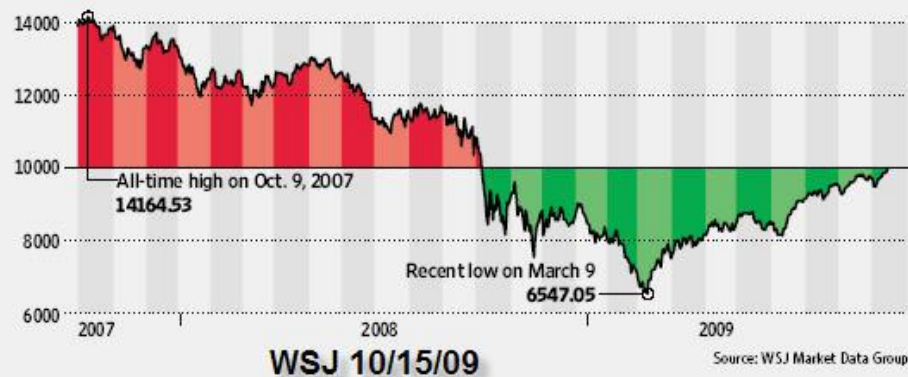
BY E.S. BROWNING

The Dow Jones Industrial Average surged to 10015.86, passing the symbolic 10000 level much faster than expected and racking up a 53% gain in just seven months.

Wednesday's trading marked the first time the Dow touched 10000 since October last year, when markets were unraveling after the collapse of Lehman Brothers Holdings. As recently as March 9, the Dow was at 6547.05.

Reaction this time was more muted than the first time the Dow closed above the 10000 mark, on March 29, 1999, when

The Market's Comeback | DJIA since October 2007



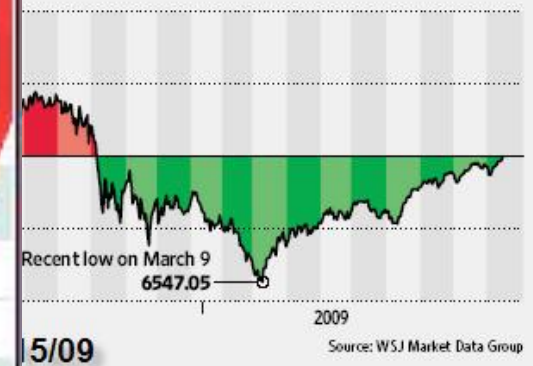


CREF Variable Annuity Accounts			
	Performance Data ¹ as of 10/16/2009		
	Unit Values ²	Net Change ³	YTD Return ³
World			
Global Equities	\$83.98	▼ -0.82	30.77%
U.S./International Equity			
Stock	\$204.14	▼ -1.94	29.43%
U.S. Equity			
Equity Index	\$77.43	▼ -0.67	24.28%
Growth	\$59.42	▼ -0.33	30.43%
Balanced			
Social Choice	\$120.91	▼ -0.59	20.05%
Fixed Income			
Bond Market	\$91.08	▲ +0.13	6.74%
Inflation-Linked Bond	\$54.91	▲ +0.21	8.42%

Crisis Ebbs

Doubt About Bull's Staying Power

since October 2007



One year after....

THE WALL STREET JOURNAL.

WEDNESDAY, SEPTEMBER 17, 2008 - VOL. CCLII NO. 66 ***** \$2.00
DOW JONES A NEWS CORPORATION COMPANY
DRA 11059.02 ▲141.51 1.3% NASDAQ 2207.90 ▲1.3% NIKKEI 11609.72 ▼5.0% DJ STOXX 50 2658.77 ▼3.1% 10-YR TREAS 7 3/32, yield 3.493% OIL \$91.15 ▼\$4.56 GOLD \$776.50 ▼\$6.60 EURO \$1.4143 YEN 105.92

U.S. to Take Over AIG in \$85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up

Emergency Loan Effectively Gives Government Control of Insurer; Historic Move Would Cap 10 Days That Reshaped U.S. Finance

The U.S. government seized control of American International Group Inc.—one of the world's biggest insurers—in an \$85-billion deal that signaled the intensity of its concerns about the danger a collapse could pose to the financial system.

By Matthew Karnitschnig, Deborah Solomon, Liam Pleven and Jon E. Hilsoncrank

The step marks a dramatic turnaround for the federal government, which had been strongly resisting overtures from AIG for an emergency loan or some intervention that would prevent the insurer from falling into bankruptcy. Just last weekend, the government essentially pulled the plug on Lehman Brothers Holdings Inc., allowing the big investment bank to go under instead of giving it financial support. This time, the government decided

sets, including its profitable insurance businesses, giving the Fed some protection even if markets continue to sink. And if AIG rebounds, taxpayers could reap a big profit through the government's equity stake.

"This loan will facilitate a process under which AIG will sell certain of its businesses in an orderly manner, with the least possible disruption to the overall economy," the Fed said in a statement.

It puts the government in control of a private insurer—a historic development, particularly considering that AIG isn't directly regulated by the federal government. The Fed took the highly unusual step using legal authority granted in the Federal Reserve Act, which allows it to lend to non-banks under "unusual and exigent" circumstances, something it invoked when Bear Stearns Cos. was rescued in March.

As part of the deal, Treasury Secretary Henry Paulson in-

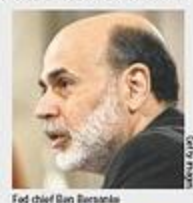
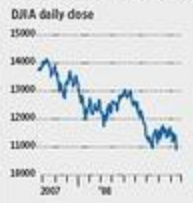
housing and insurance industries, while Wall Street has watched two of its last four big independent brokerage firms exit the scene.

The U.S. on Sept. 6 took over mortgage-lending giants Fannie Mae and Freddie Mac as they teetered near collapse. This Sunday, the U.S. refused to bail out Wall Street pillar Lehman Brothers, which filed for bankruptcy-court protection and is now being sold off in pieces. That same day, another struggling Wall Street titan, Merrill Lynch & Co., agreed to sell itself to Bank of America Corp.

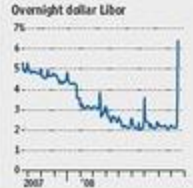
The AIG deal followed a day of high drama in Washington. The Treasury's Mr. Paulson and Federal Reserve Chairman Ben Bernanke convened in the early evening an unexpected meeting of top congressional leaders. Late in the trading day Tuesday, anticipation that the government might assist the insurer helped propel the Dow Jones Industrial Average to a 1.3% gain.

Urgent Mission

Plunging shares, soaring credit costs push the government to step in.



Fed chief Ben Bernanke



Treasury Secretary Hank Paulson

Lending Among Banks Freezes

BY CARRICK MOLLENKAMP, MARK WHITEHOUSE AND NEIL SHAH

Banks abruptly stopped lending to each other or charged exorbitantly high rates Tuesday, threatening to spread the troubles of American International Group Inc. and Lehman Brothers Holdings Inc. to a broad range of financial institutions and the global economy.

The breakdown came despite efforts by central bankers to keep money flowing. Central banks in the U.S., Europe and Japan pumped tens of billions of dollars each into the bank-

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- | SEP. 2008 | | OCT. 2008 | |
|-----------|-----------------------------------|-----------|----------------------------------|
| 1. | 9/7 Fannie & Freddie Takeover | 7. | 9/25 JPMorgan Chase Buys WaMu |
| 2. | 9/14-15 Lehman Bros. Bankruptcy | 8. | 9/29 House Rejects TARP |
| | BofA Buys Merrill Lynch | | Dow Loses 778 Points |
| 3. | 9/16 AIG Bailout | 9. | 10/3 House OKs TARP/Bush Signs |
| 4. | 9/17 Dow Loses 448 Points | 10. | 10/3 Wells Fargo Buys Wachovia |
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Source: CNBC.com



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Source: CNBC.com



Bailout + Credit Programs + Stimulus = \$10T!

Item	Issuer	Amount of Outlay
Commercial Paper Funding Facility	Federal Reserve	\$1,800 billion
Temporary Liquidity Guarantee Program	FDIC	\$1,400 billion
Term Asset-Backed Securities Loan Facility (TALF)	Federal Reserve	\$1,000 billion
Term Auction Facility (TAF)	Federal Reserve	\$900 billion
Fannie Mae (NYSE: FNM), Freddie Mac (NYSE: FRE), and Ginnie Mae	U.S. Treasury / Federal Reserve	\$800 billion
Obama Stimulus Plan	U.S. Treasury	\$787 billion
Treasury Asset Relief Program (TARP)	U.S. Treasury	\$700 billion
Total USD international currency swap lines	Federal Reserve	\$688 billion
Money Market Investor Funding Facility	Federal Reserve	\$540 billion
Citigroup (NYSE: C) Guarantee	U.S. Treasury / FDIC	\$306 billion
Hope for Homeowners Act of 2008	U.S. Treasury	\$304 billion
Term Securities Lending Facility (TSLF)	Federal Reserve	\$225 billion
Economic Stimulus Act of 2008	U.S. Treasury	\$168 billion
Other loans: Primary Dealer Credit, etc.*	Federal Reserve	\$142.9 billion
Paid to JPMorgan Chase (NYSE: JPM) to settle Lehman debt	Federal Reserve	\$138 billion
Bank of America (NYSE: BAC) Guarantee	U.S. Treasury / FDIC	\$118 billion
AIG (NYSE: AIG) Bailout	Federal Reserve	\$112.5 billion
Bear Stearns brokered s...		
I'm afraid to look ...		

Total:	\$10,155,300,000,000
---------------	-----------------------------



Bailout + Credit Programs + Stimulus = \$10T!

Item	Issuer	Amount of Outlay
How much will "rescue" cost?		
Term Auction Facility	Federal Reserve	\$900 billion
Emergency Economic Stabilization Act of 2008	U.S. Treasury	\$700 billion
Total USD international currency swaps	Federal Reserve	\$620 billion
Other loans: Primary Dealer Credit, etc.	Federal Reserve	\$409.5 billion
Hope for Homeowners Act of 2008	U.S. Treasury	\$304 billion
Fannie Mae (NYSE: FNM) & Freddie Mac (NYSE: FRE)	U.S. Treasury	\$200 billion
Term Securities Lending Facility	Federal Reserve	\$200 billion
Economic Stimulus Act of 2008	U.S. Treasury	\$168 billion
Paid to JPMorgan Chase to settle Lehman	Reserve	\$29 billion
AIG (NYSE: AIG) Bailout		
Commercial Paper Funding Facility		
Bear Stearns Brokered Sale		
Total:		\$3,891,300,000,000
\$3.9 Trillion		
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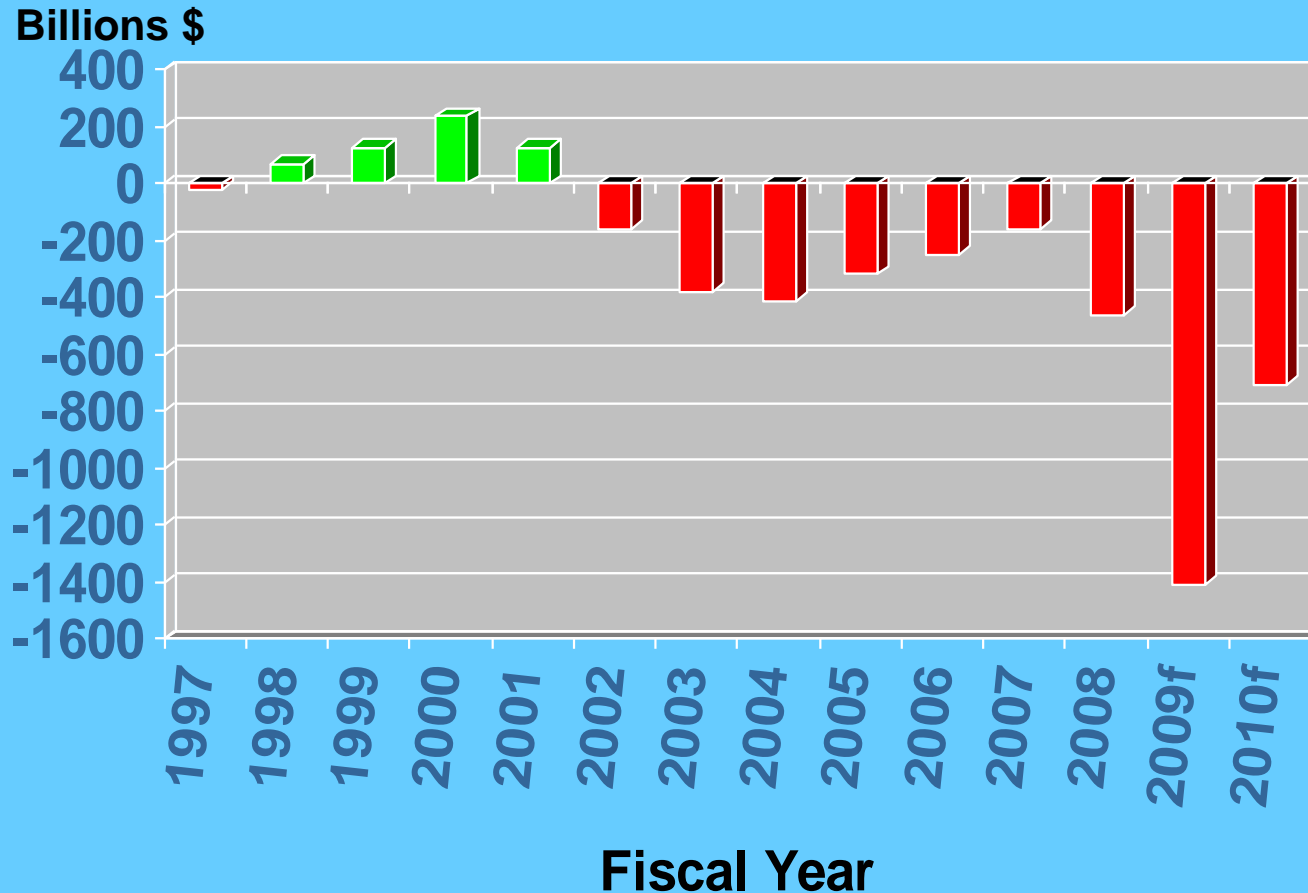
Reserve	\$29 billion
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Bear Stearns brokered s...		
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Total:	\$10,155,300,000,000
U.S. GDP \$14.1 Trillion	



Actual and Projected Federal Budget Surplus and Deficits, FY97-10



Source: CBO

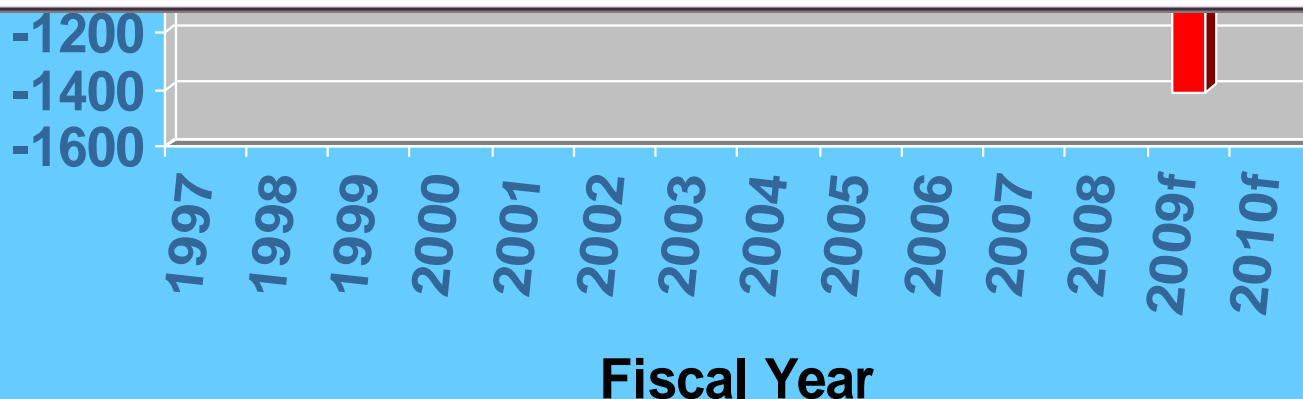


Actual and Projected Federal Budget Surplus and Deficits, FY97-10

BUDGET TOTALS THROUGH SEPTEMBER
(Billions of dollars)

	Actual FY2008	Preliminary FY2009	Estimated Change
Receipts	2,524	2,106	-419
Outlays	2,983	3,515	532
Deficit (-)	-459	-1,409	-950

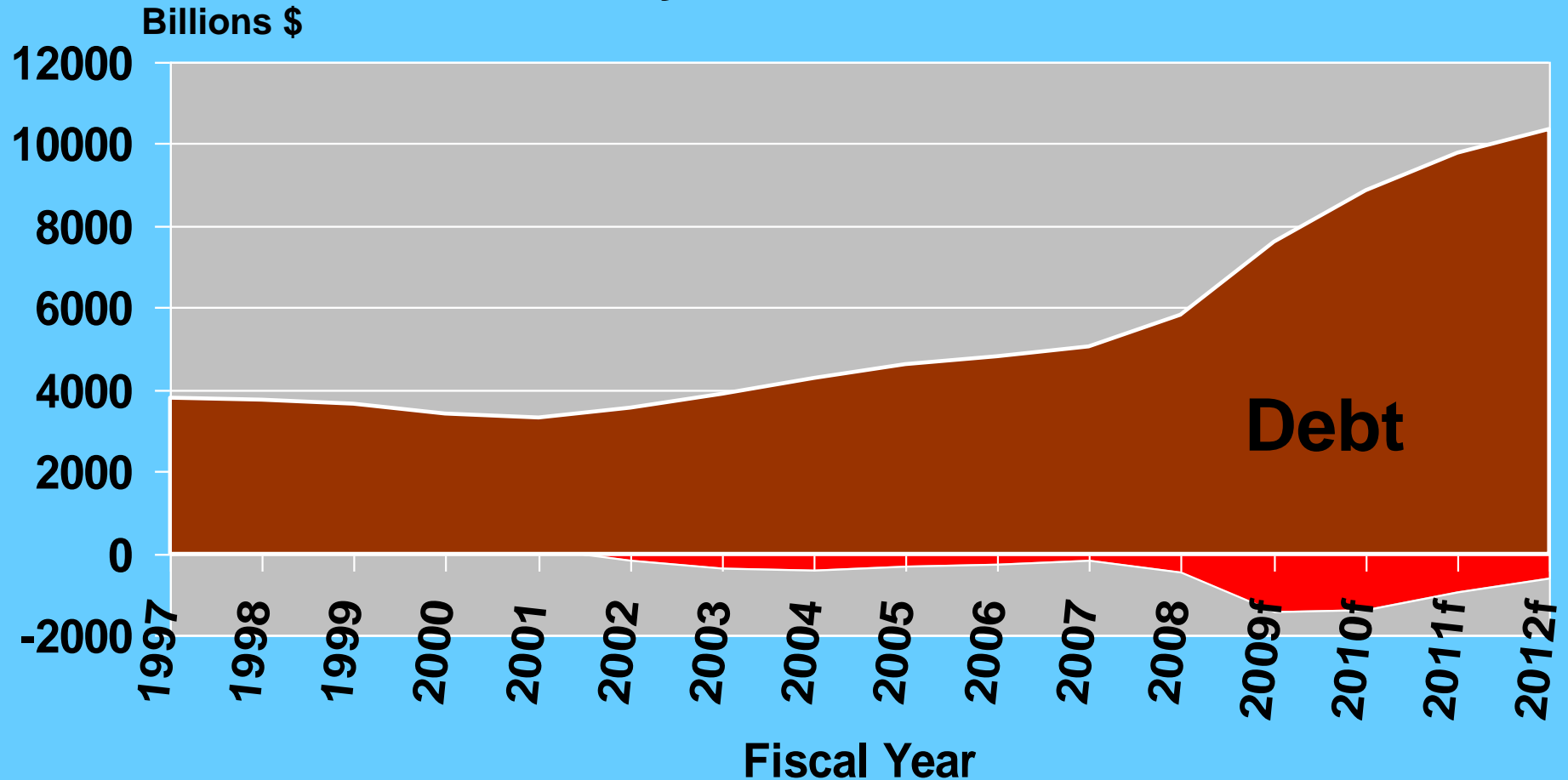
Sources: Department of the Treasury, OMB, and CBO.



Source: CBO



Actual and Projected Federal Budget Deficits and Debt Held by Public, FY97-12



Source: CBO



Has massive intervention worked?

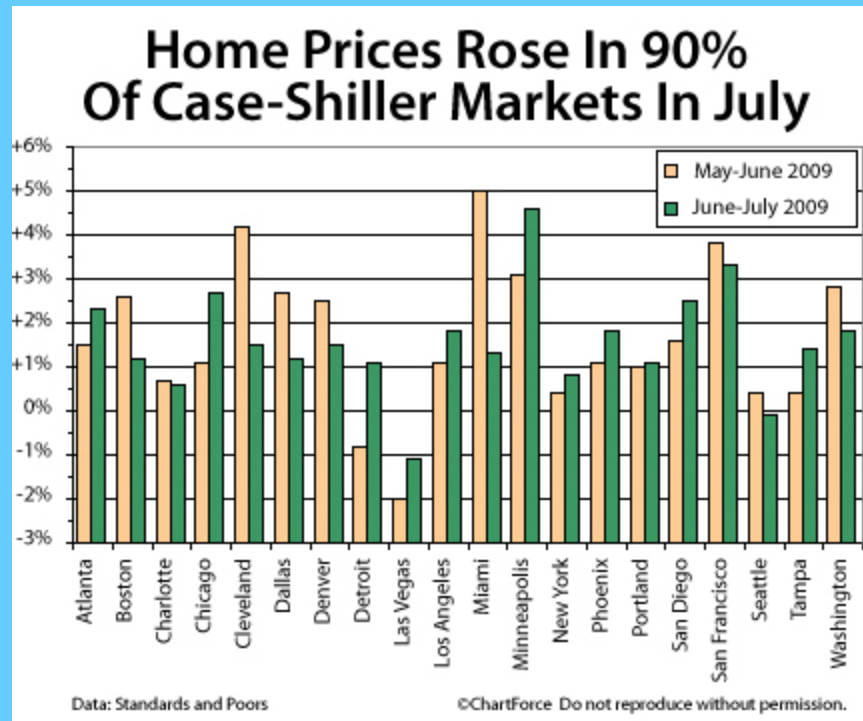


I don't think anyone fully understands yet how much damage was done to the U.S. economy by the events of September 2008.

Daniel Henninger

WSJ 9-10-09

Working our way past “crisis” mode



Focus shifts to local real estate markets and smaller banks

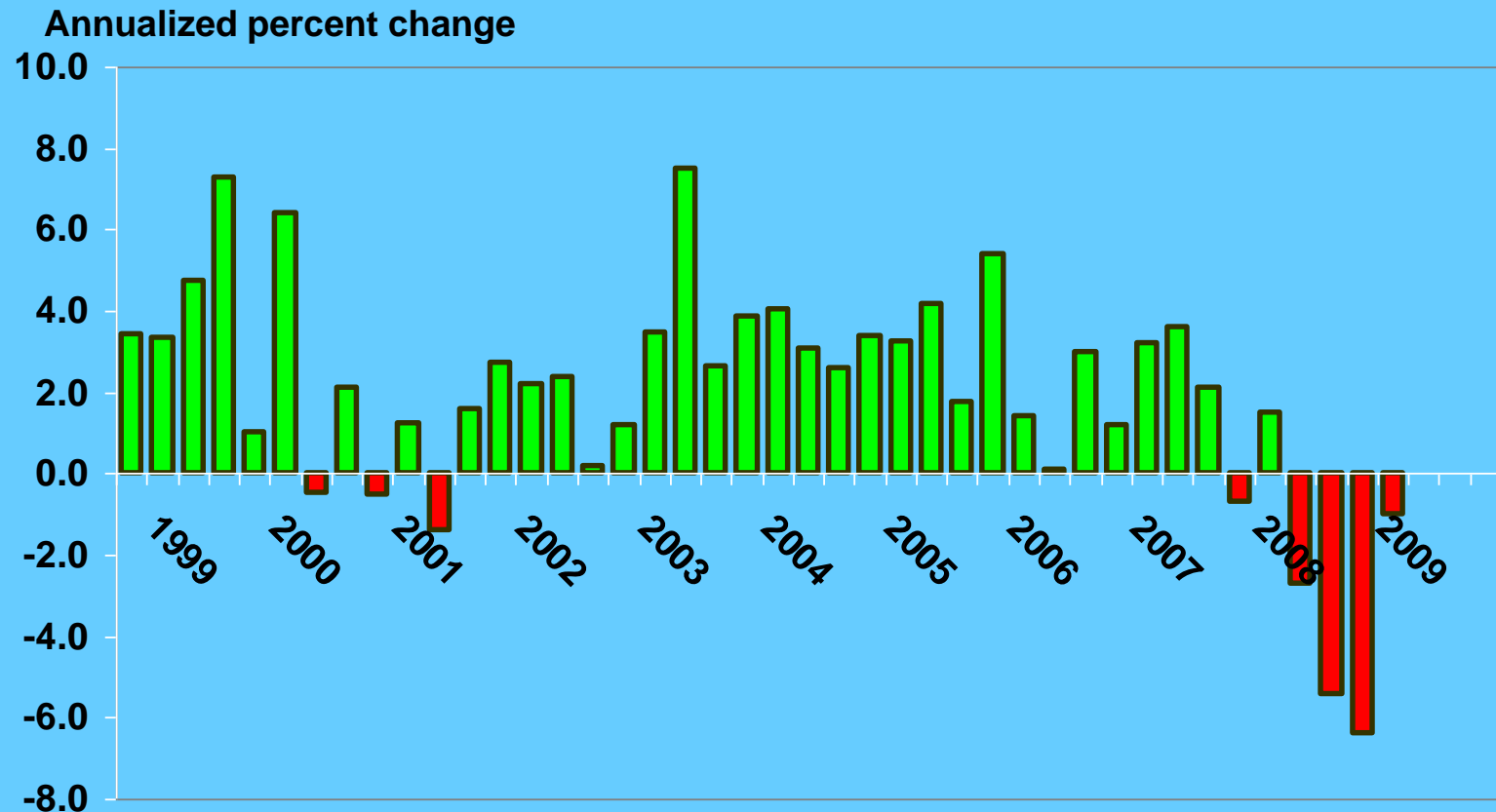


FEDERAL DEPOSIT INSURANCE CORPORATION

100

Worst recession since WWII

Quarterly U.S. Real Gross Domestic Product Growth



Source: Bureau of Economic Analysis



Worst recession since WWII

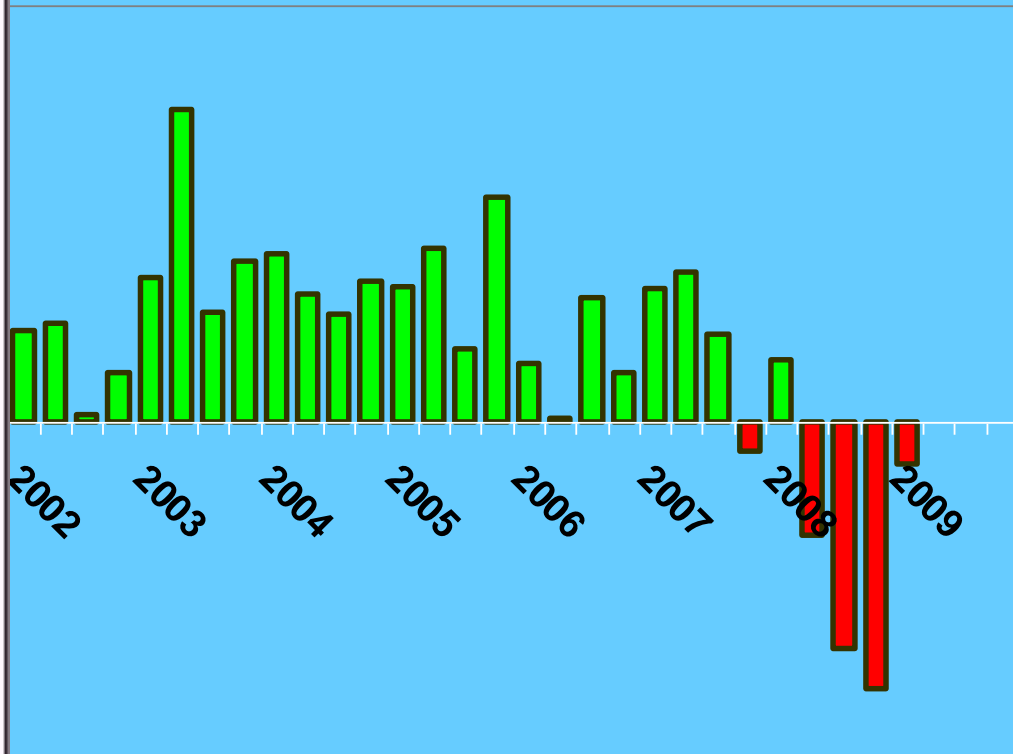
How long?

Post World War II recessions.

Start - End	Duration
Nov. 1948 - Oct. 1949	11 months
July 1953 - May 1954	10 months
Aug. 1957 - April 1958	8 months
April 1960 - Feb. 1961	10 months
Dec. 1969 - Nov. 1970	11 months
Nov. 1973 - March 1975	16 months
Jan. 1980 - July 1980	6 months
July 1981 - Nov. 1982	16 months
July 1990 - March 1991	8 months
March 2001 - Nov. 2001	8 months
Dec. 2007 - ?	TBD

SOURCE: NATIONAL BUREAU OF ECONOMIC RESEARCH

Real Gross Domestic Product Growth



Source: Bureau of Economic Analysis

Worst recession since WWII

Quarterly U.S. Real Gross Domestic Product Growth

GDP Forecasts		
	2009	2010
CBO	-2.2%	+1.5%
OMB	-1.2	+3.0
Blue Chip	-2.7	+3.0
NASBO	-2.4	+1.5-3.0

-6.0

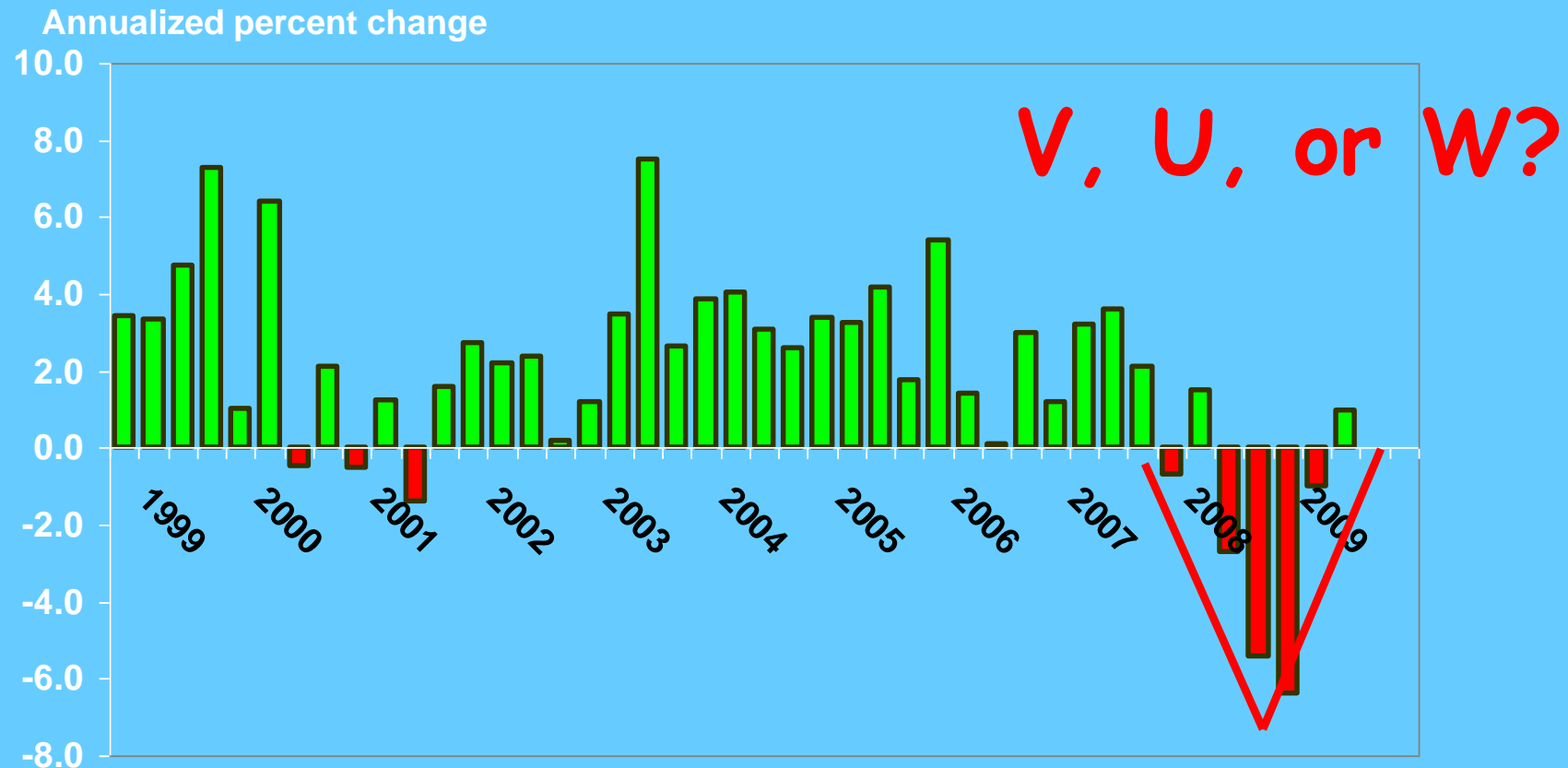
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Source: Bureau of Economic Analysis



What kind of recovery can we expect?

Quarterly U.S. Real Gross Domestic Product Growth

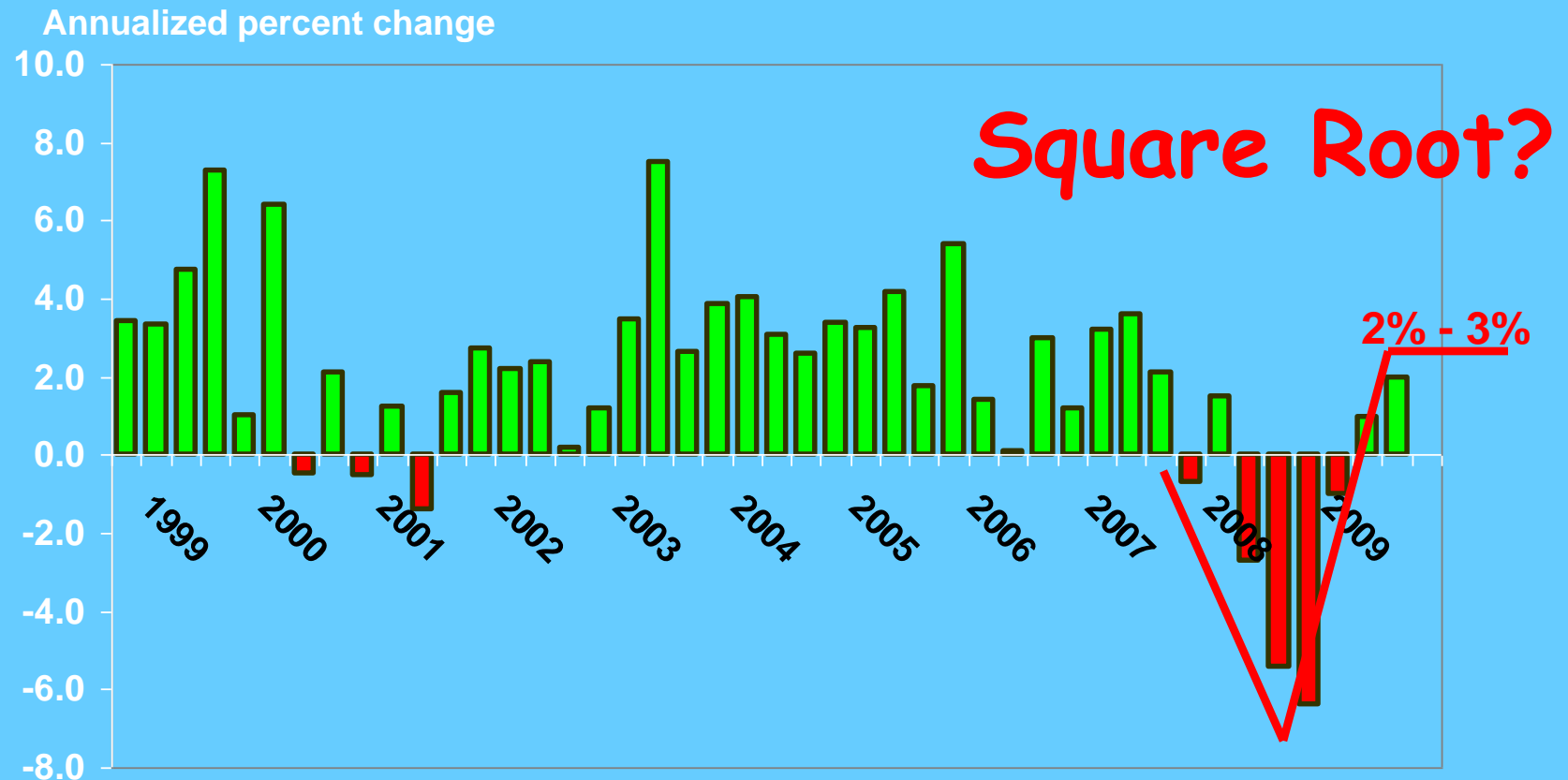


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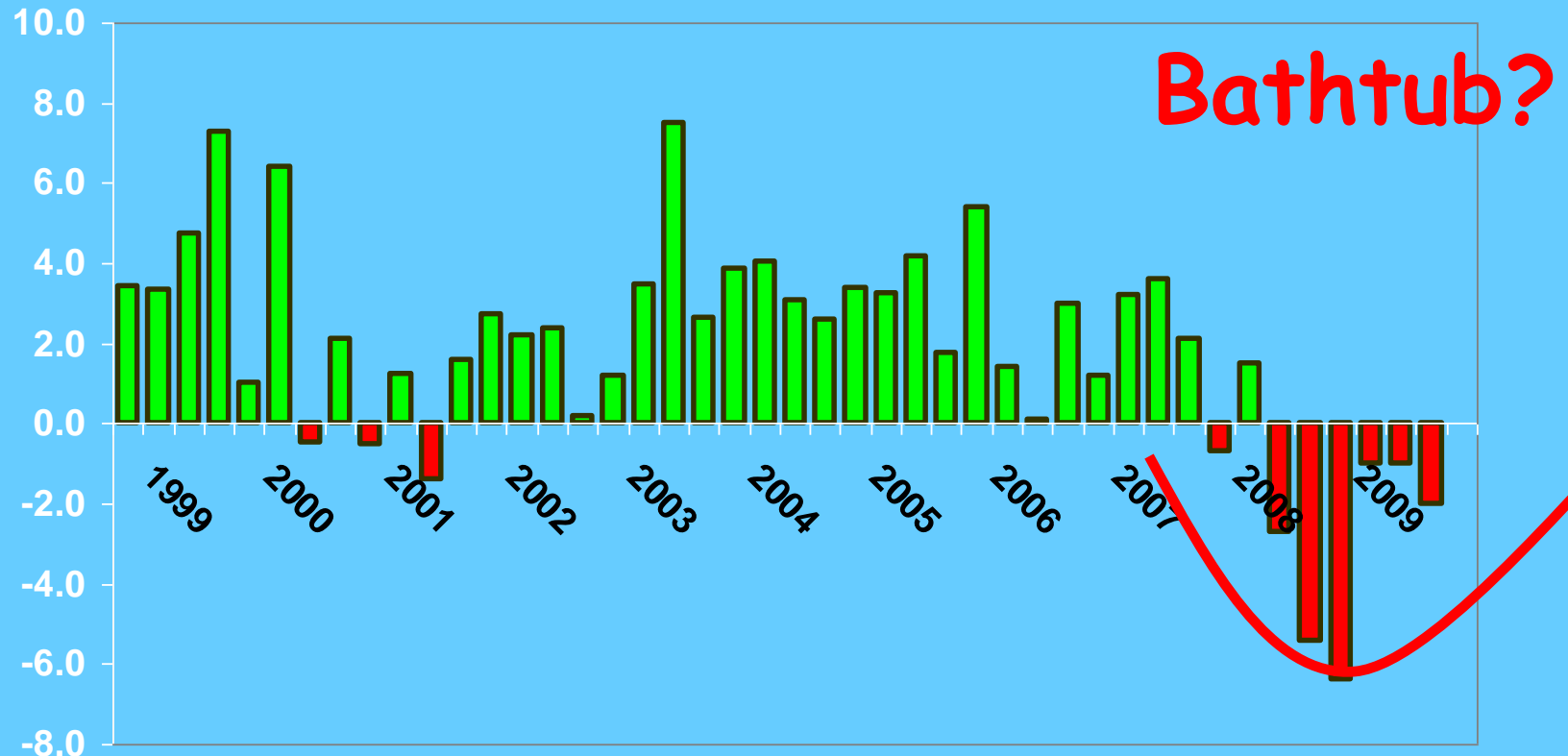
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What kind of recovery can we expect?

Quarterly U.S. Real Gross Domestic Product Growth

Annualized percent change

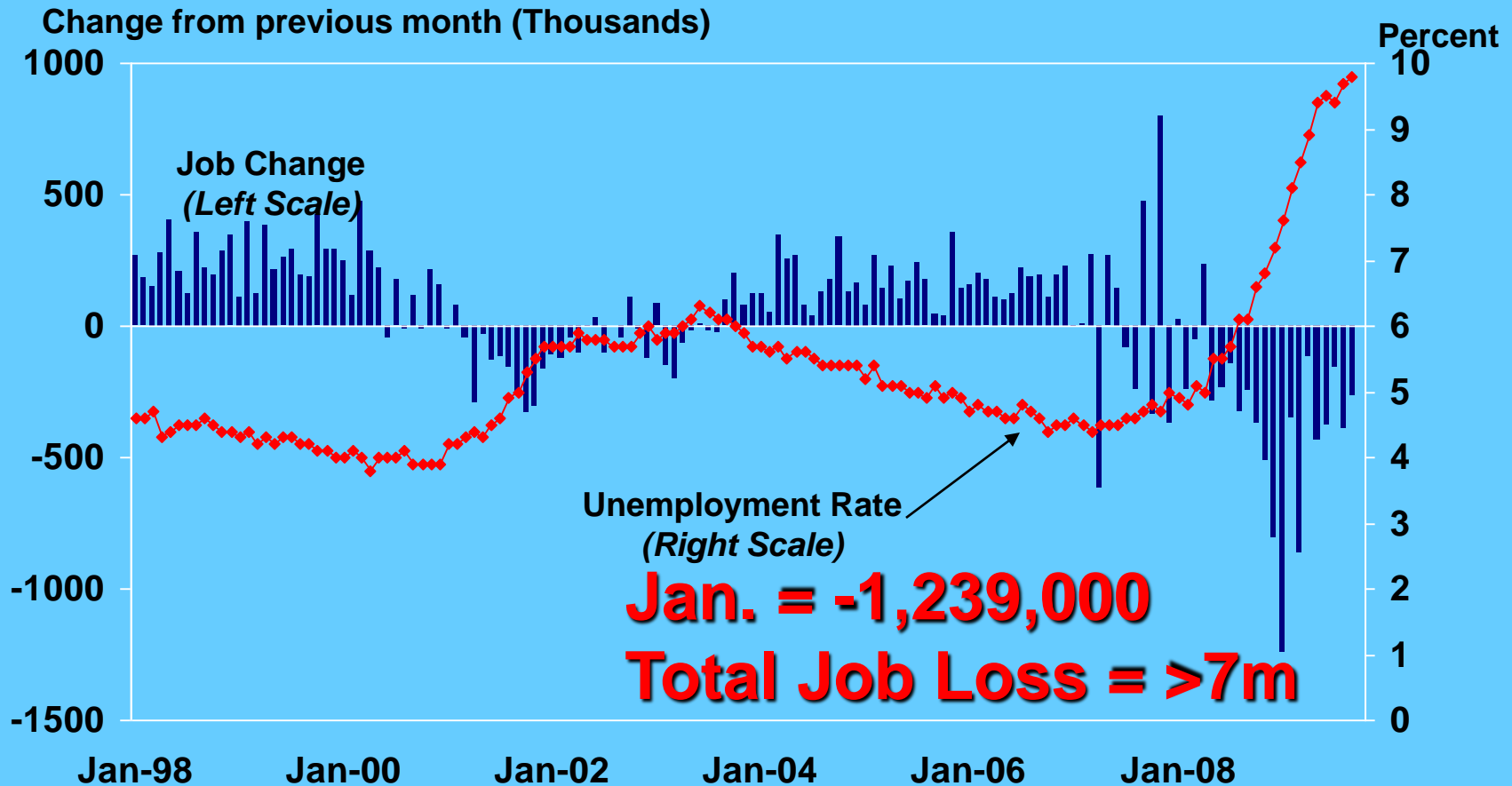


Source: Bureau of Economic Analysis



Unemployment: Jobless Recovery Again?

Change in Payroll Employment and Unemployment Rate

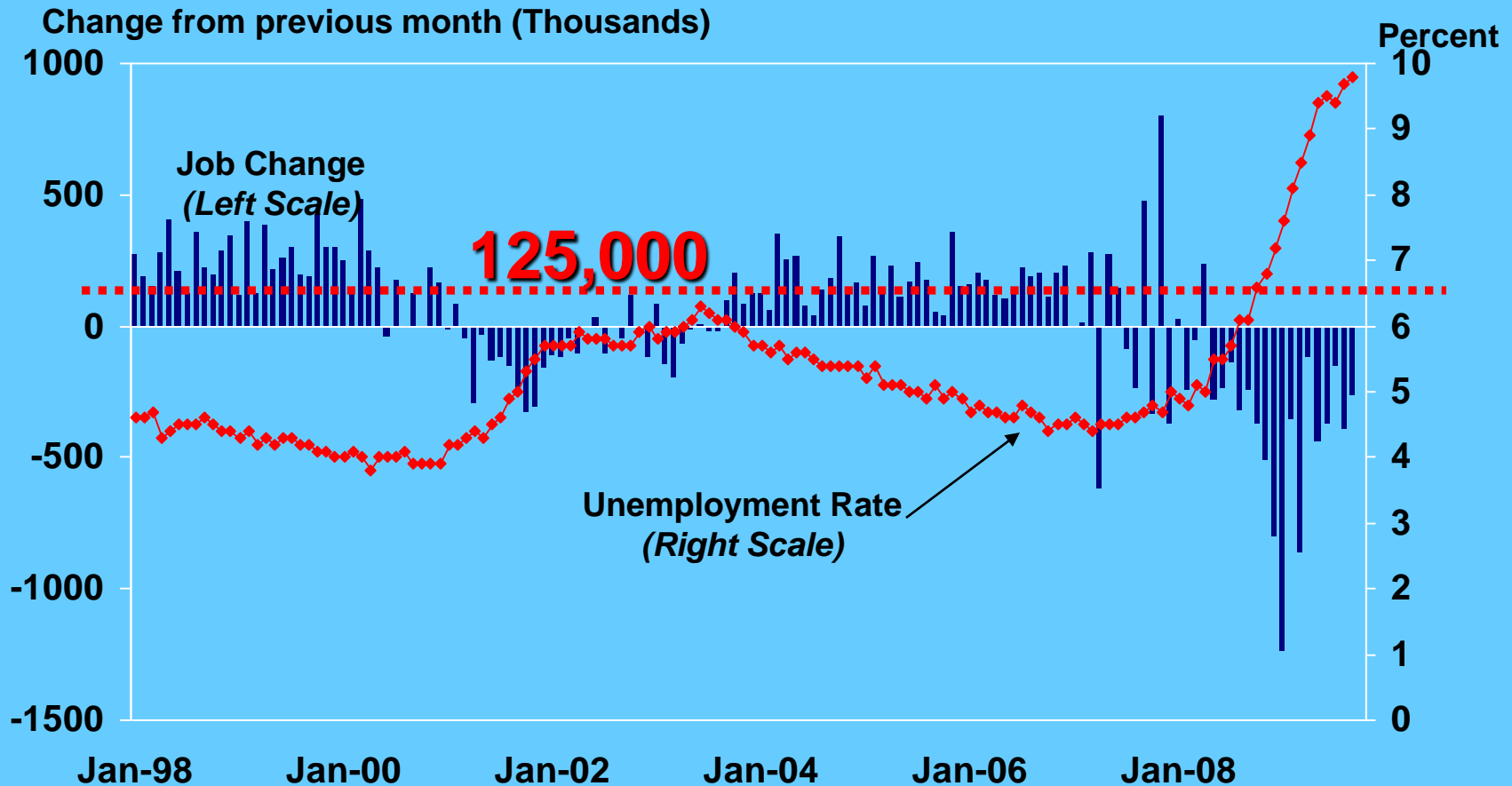


Source: Bureau of Labor Statistics



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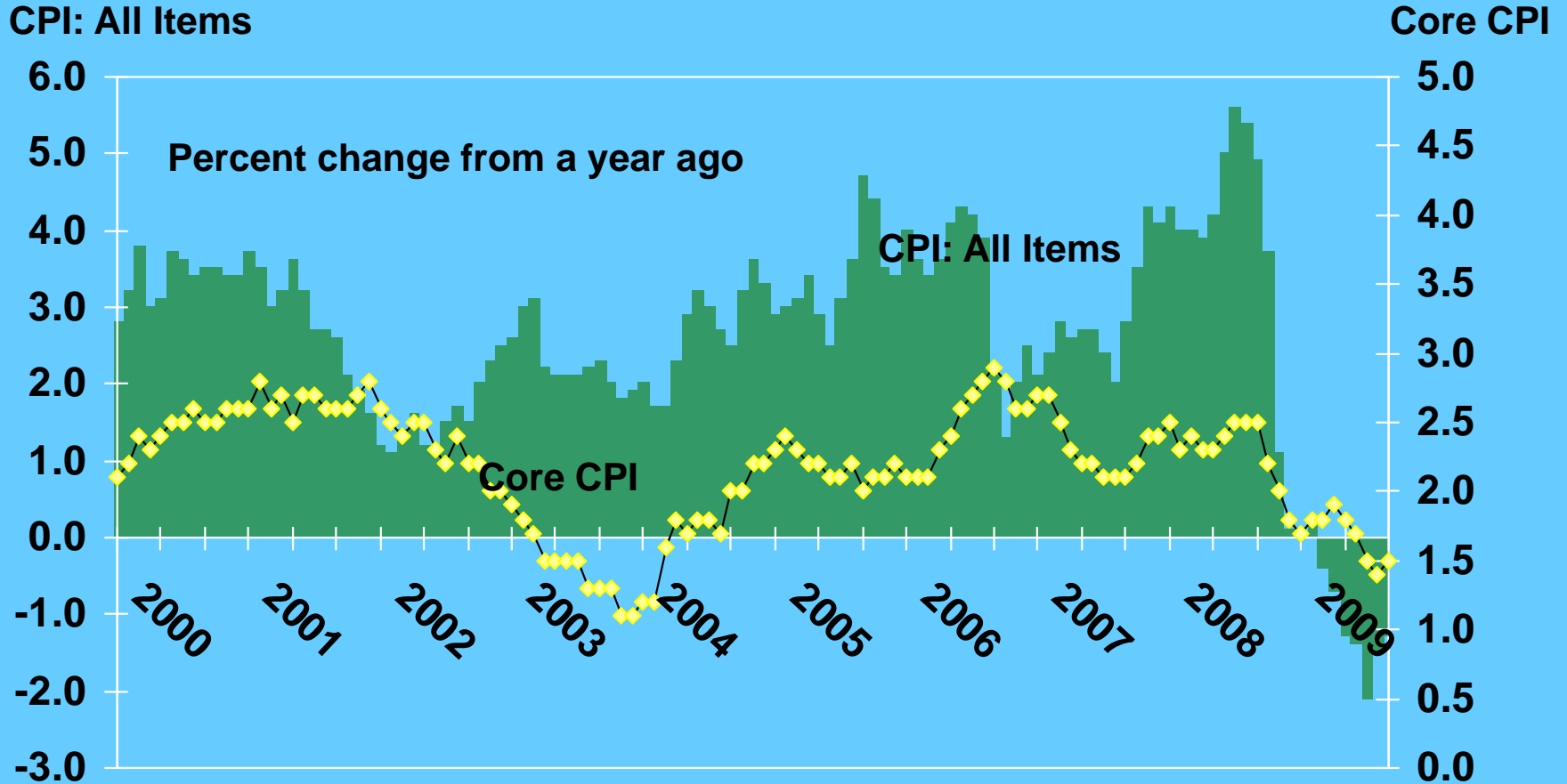


“Jobless recovery” is not good news for rural Kentucky

- Kentucky’s 85,000 farms are dependent on off-farm jobs.**
- >35,000 principal operators worked 200+ days off the farm.**
- Current KY unemployment rate = 11%.**
- About 3,000 - 6,000 “commercial farms” which account for 74% of all agricultural gross receipts.**

Inflation disappears as an economic issue

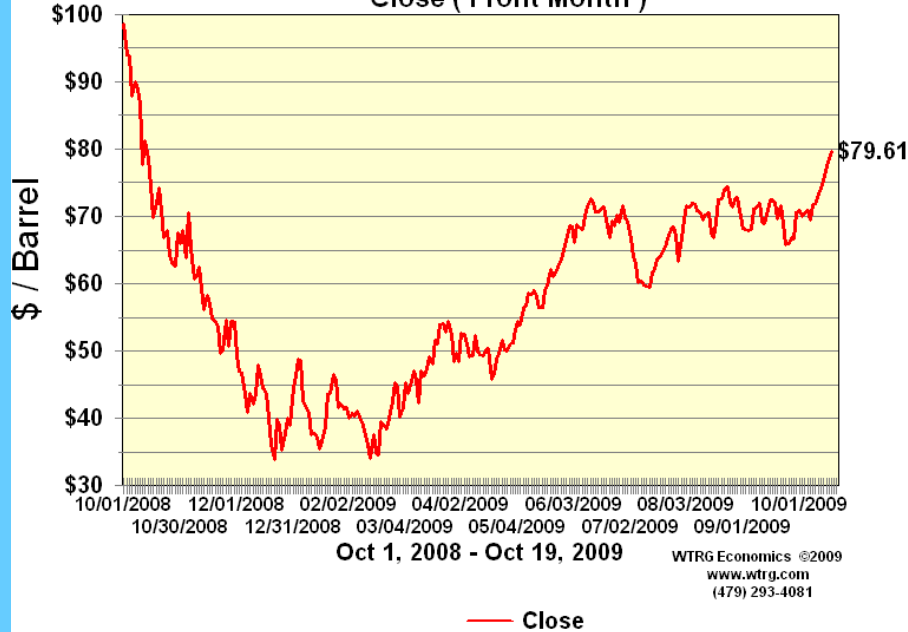
Consumer Price Index



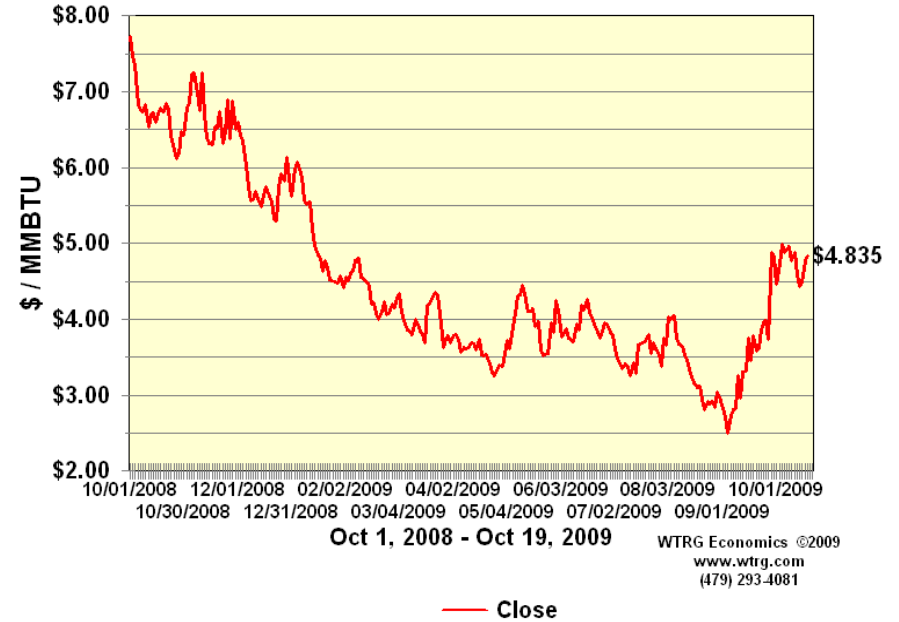
Source: Bureau of Labor Statistics

Two of the reasons inflation is low...

**NYMEX Crude Oil Futures
Close (Front Month)**



**NYMEX Natural Gas Futures
Close (Front Month)**



Two of the reasons inflation is low...

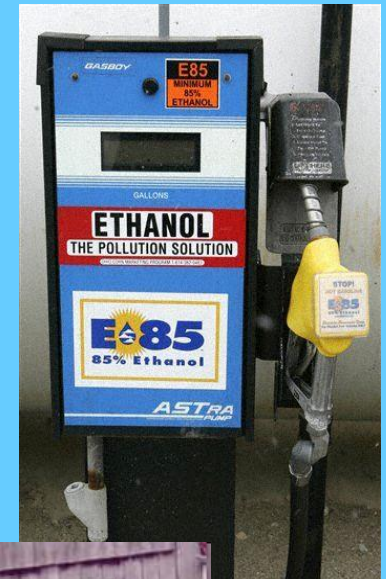


U.S. economic outlook for 2010

- ▶ Slow growth for U.S. & KY. Recession may be “over” but we face jobless recovery.
- ▶ Financial system appears stabilized and housing prices have begun recovery.
- ▶ Face serious debt service issues that will be drag on economic growth as interest rates rise.

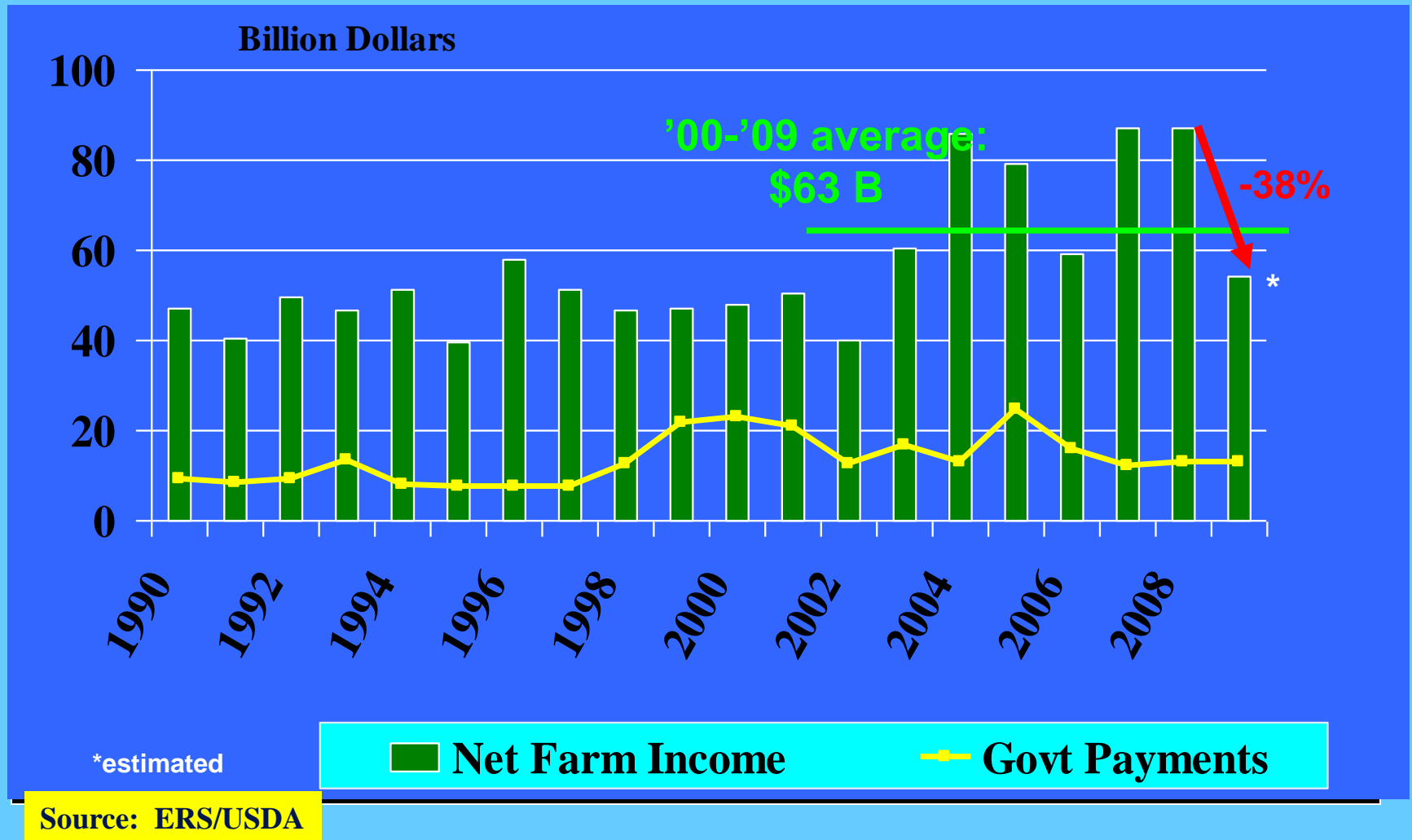
ECONOMIC FORECASTS	
GDP growth	Recovery to +1.5% to +3%
Interest rates	Trending up – Prime to 3.75% - 4% by summer 2010
Inflation	Low in near term; longer term risk of much higher inflation
Energy Prices	Crude oil in \$70 - \$80 range; natural gas price remains low
Unemployment	Unemployment rate slowly drop to 6-7%, jobless recovery
Housing	As prices stabilize, construction slowly recovers
Trade deficit	Recent improvement stops
Budget deficit	Down from \$1.4T record to \$700B in FY 2010

U.S. Agriculture in a Chaotic Economy

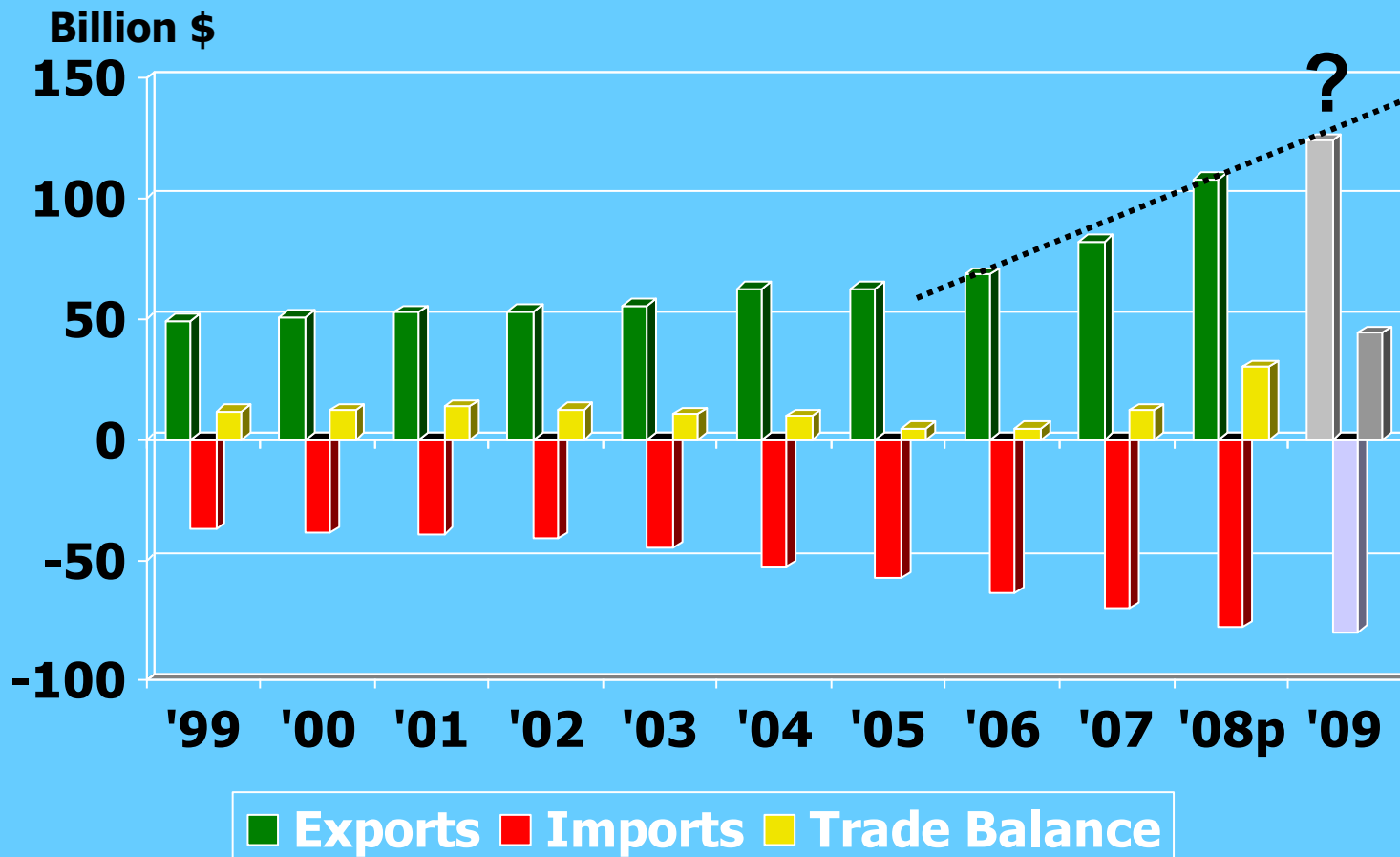


U.S. Net Farm Income

Major decline as prices & exports drop but costs rise

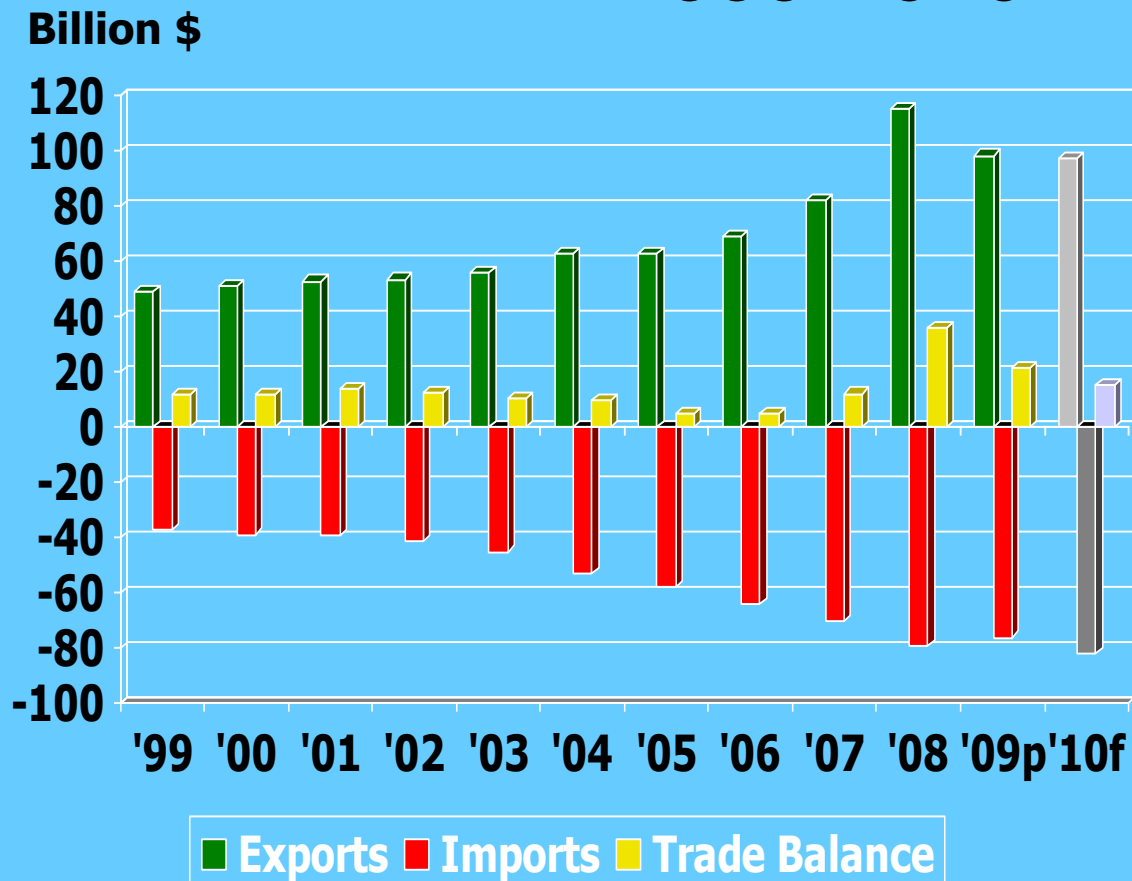


U.S. Agricultural Trade Situation as of Fall 2008...



Source: USDA, ERS; fiscal year ending 9/30; p = preliminary

U.S. Agricultural Trade 1999-2010



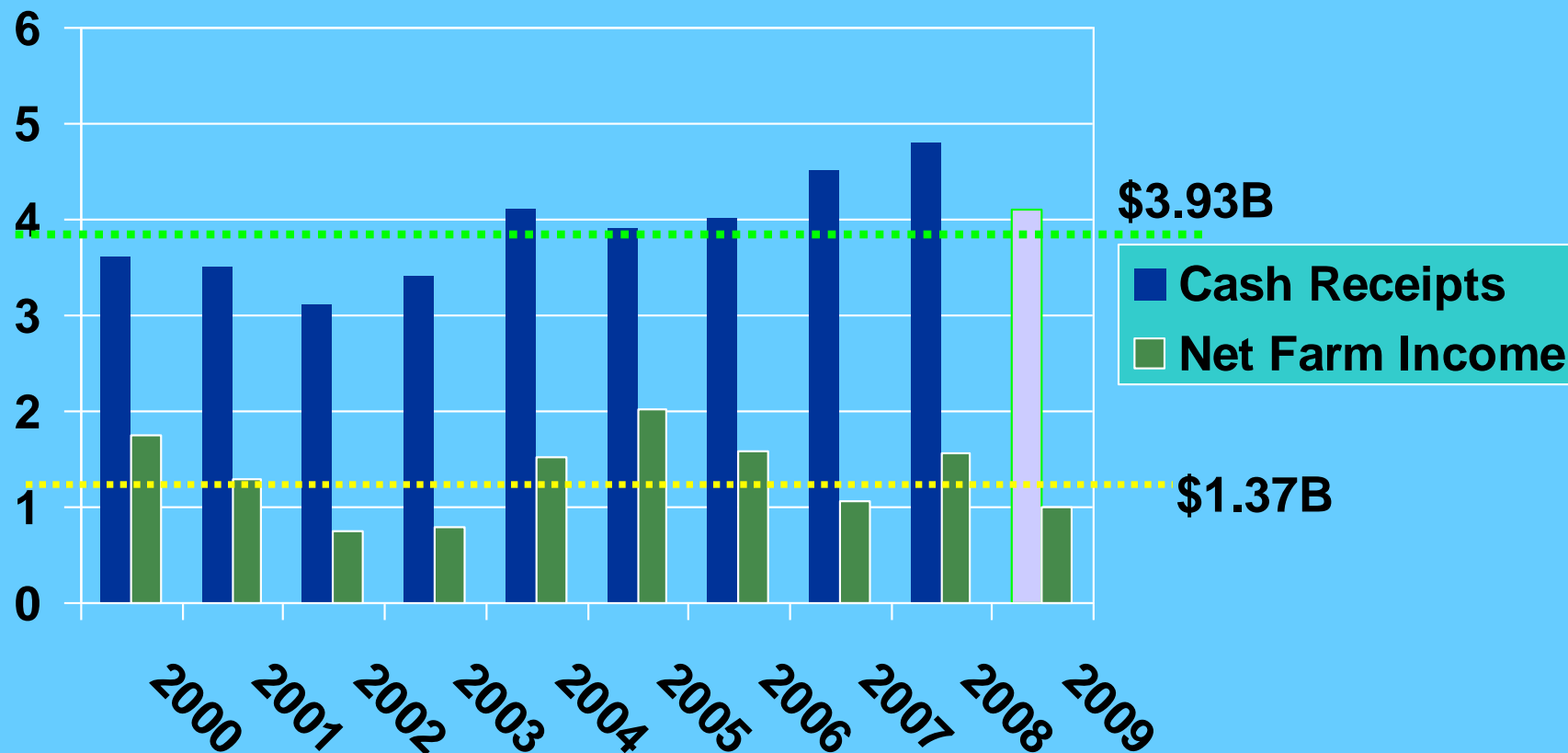
- Lower grain prices & volumes = 2/3 of drop in exports
- Exports stabilize in '10 as dollar weakens, global economy improves
- Food imports return to record-high as economy recovers
- Trade surplus only \$15B

Source: USDA, ERS; fiscal year ending 9/30; p = preliminary f = forecast

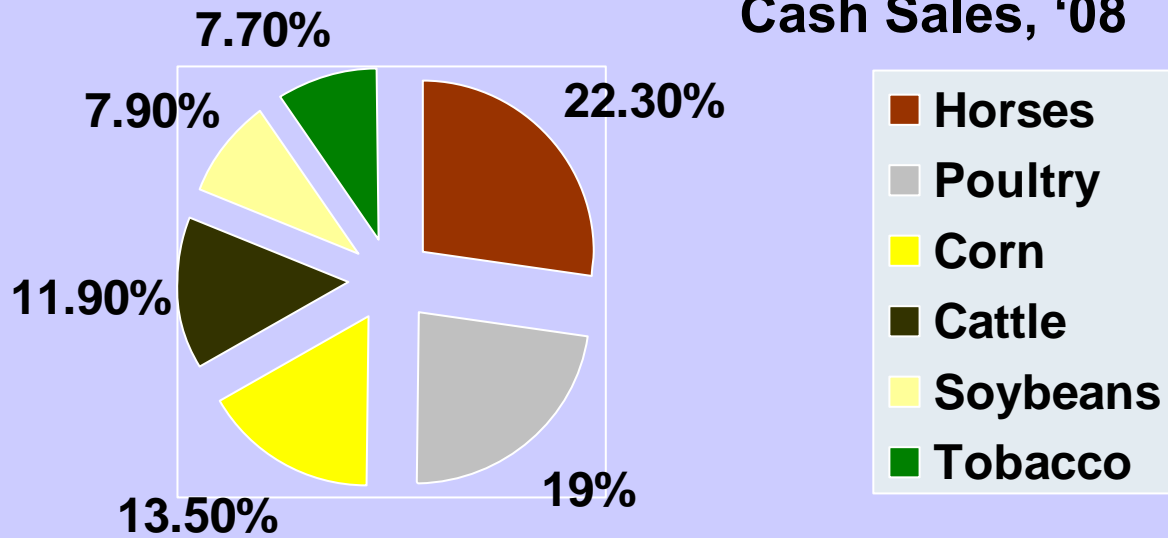
KY Cash Receipts and Net Income

Record high in 2008; sharp drop for 2009

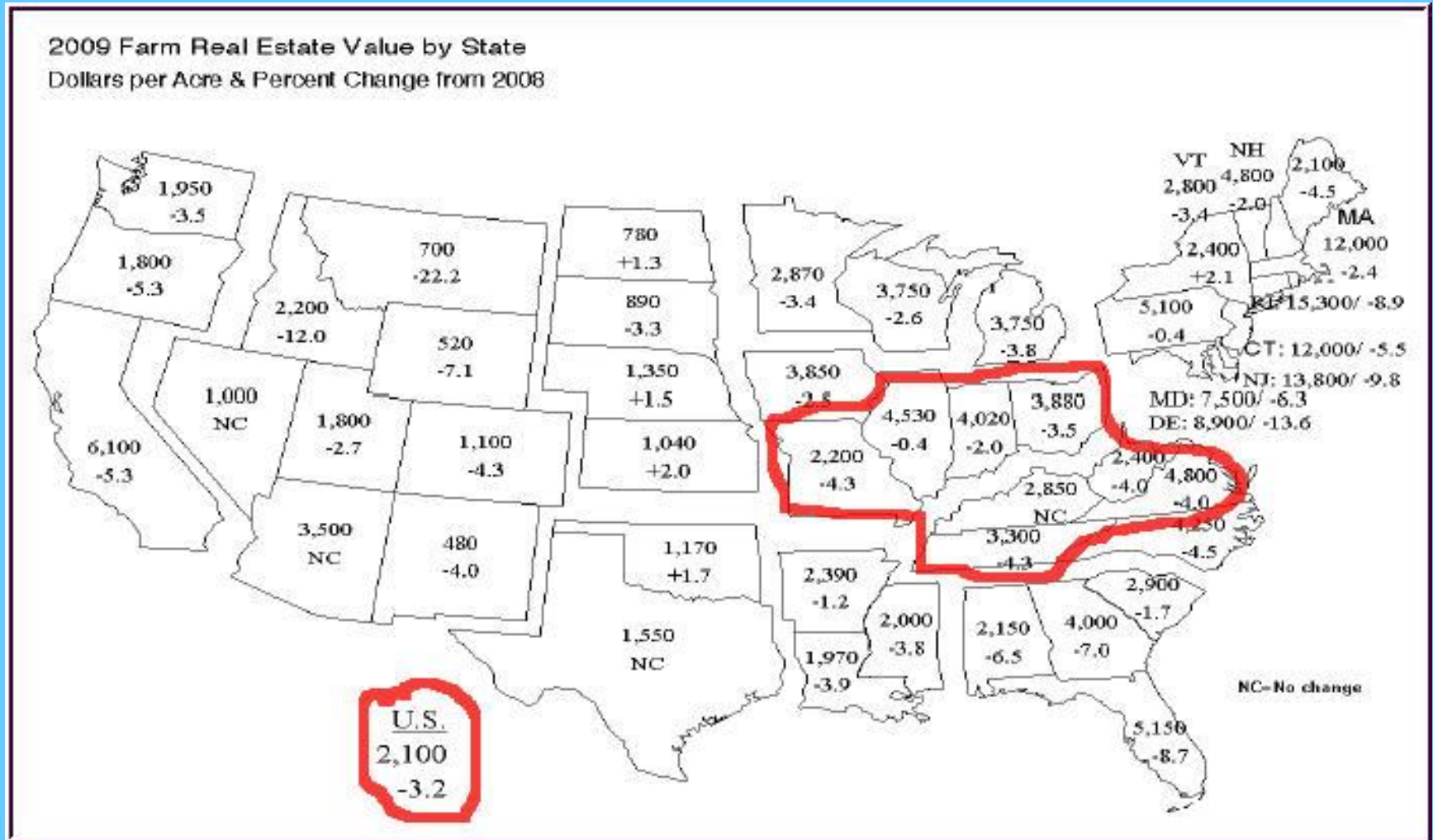
\$ billion



Big 6 = 82%
Cash Sales, '08



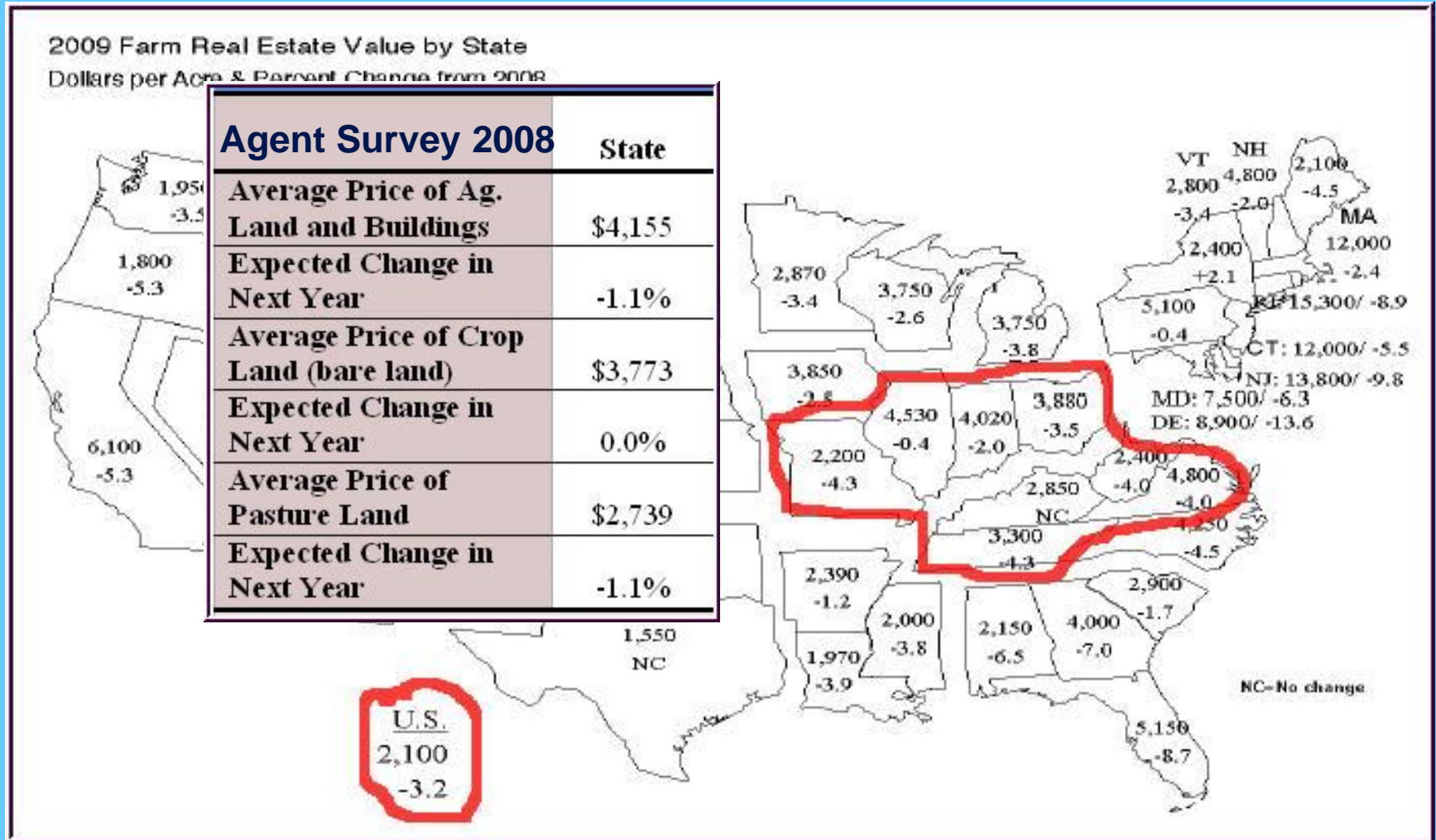
Lower farm income affects land prices



Source: USDA, NASS

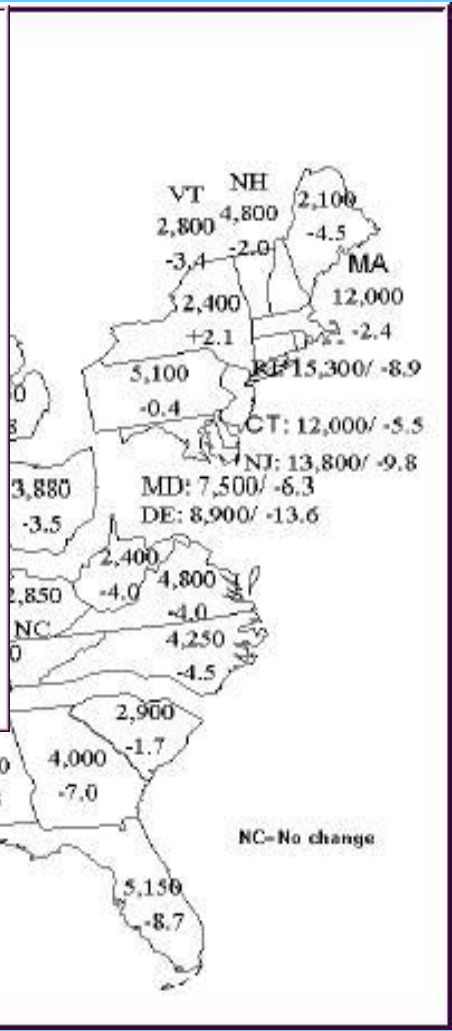
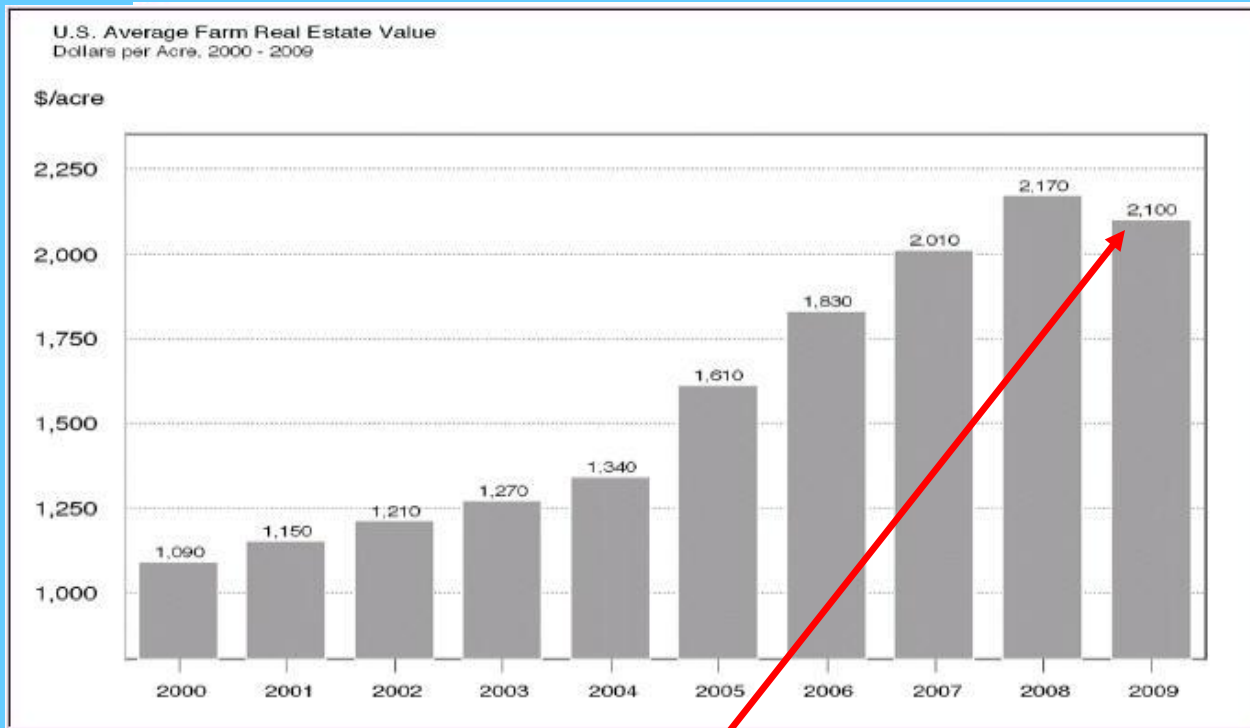


Lower farm income affects land prices



Source: USDA, NASS

Climb in land values stops (pauses?)



Source: USDA, NASS

Farm Balance Sheet Strong

Balance sheet of the U.S. farming sector, 2005- 2009F						
Financial measures	2005	2006	2007	2008	2009F	Change in 2009
08/27/09	\$ million					%
Farm assets	1,779,376	1,923,596	2,055,276	2,005,473	1,935,594	(3.5)
Real estate	1,486,960	1,625,835	1,751,386	1,692,727	1,626,711	(3.9)
Total farm debt 3/	196,377	203,581	214,063	240,022	234,074	(2.5)
Real estate	104,768	108,048	112,682	130,654	130,659	0.0
Farm equity	1,582,999	1,720,015	1,841,212	1,765,451	1,701,520	(3.6)
Selected ratios:						
Debt-to-equity	12.4	11.8	11.6	13.6	13.8	
Debt-to-asset	11.0	10.6	10.4	12.0	12.1	

Source: USDA, ERS

Recession Finally Hits Down On The Farm

WSJ 8/28/09

By SCOTT KILMAN
AND LAUREN ETTER

The American farm, which has weathered the global recession better than most U.S. industries, is starting to succumb to the downturn.

The Agriculture Department forecast Thursday that U.S. farm profits will fall 38% this year, indicating that the slump is taking hold in rural America. Much of the sector had escaped the harsher aspects of the crisis, such as the big drop in property values plaguing city dwellers and suburbanites.

"It is safe to say that the global recession has finally shown up on the doorstep of the agriculture economy," said Michael Swanson, an agricultural economist at banking giant Wells Fargo & Co.

The Agriculture Department said it expects net farm income—a widely followed mea-

- Impact of global recession on agriculture now clear – lower exports, prices & income.
- Global recovery holds promise for improved environment in 2010.
- KY agriculture will continue to feel the recession-like conditions into 2010.