



Bumpy Journey to a New Normal

Ft. Myers Presentation

Presented by:

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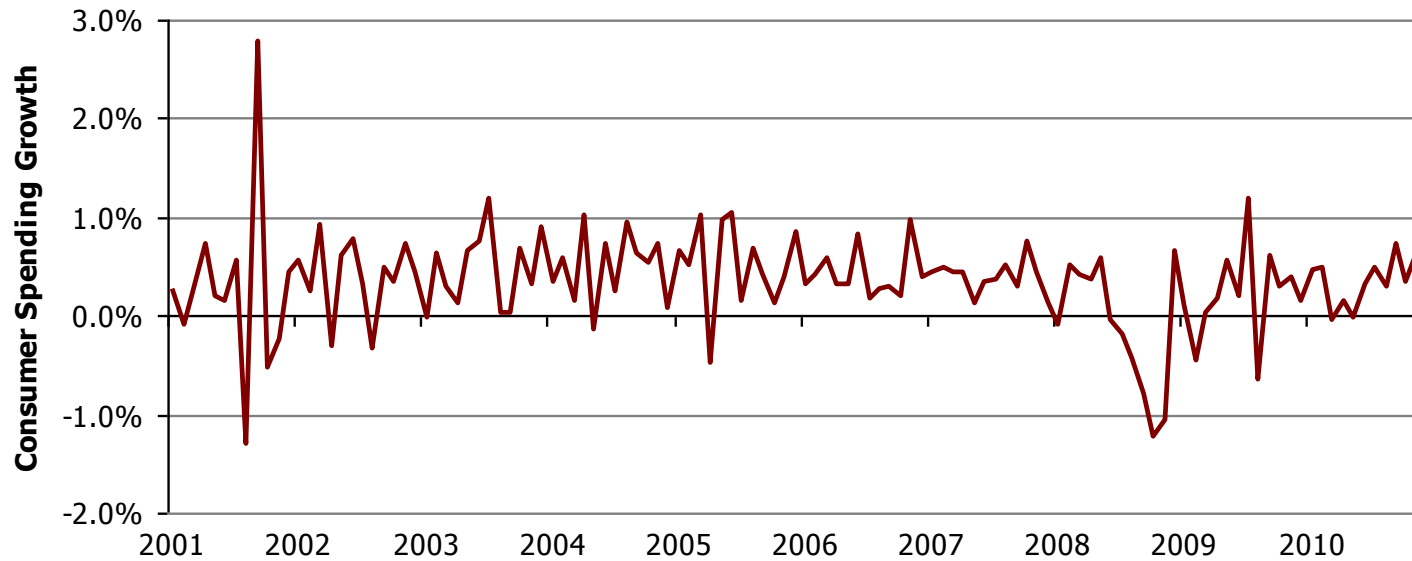
“Never make predictions, especially about the future.”

- Casey Stengel

Positive Sign: Consumer Spending

- 2010 saw positive growth in U.S. consumer spending

U.S. Consumer Spending Growth



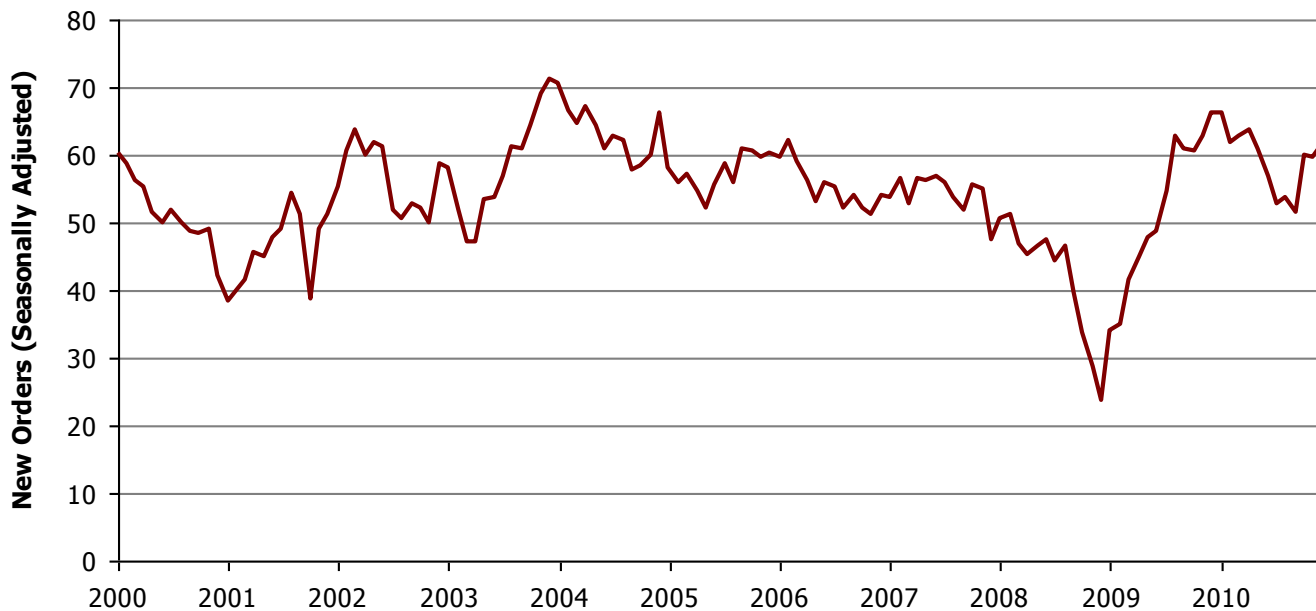
Source: FactSet, data as of December 31, 2010

Positive Sign: Manufacturing



- Business momentum recovered after summer softness

ISM Manufacturing New Orders Index

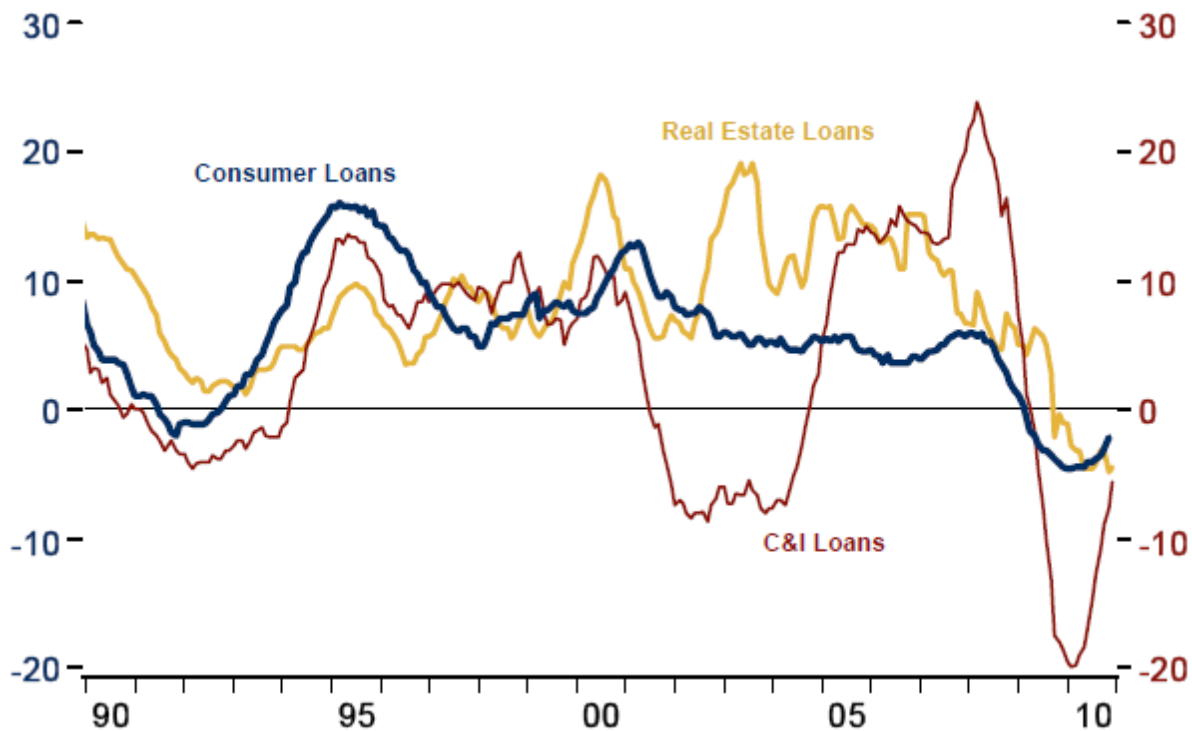


Source: ISM, BBTCM Research

Positive Sign: Bank Lending

- Loan growth appears to be turning the corner

Loans Outstanding (YOY%)

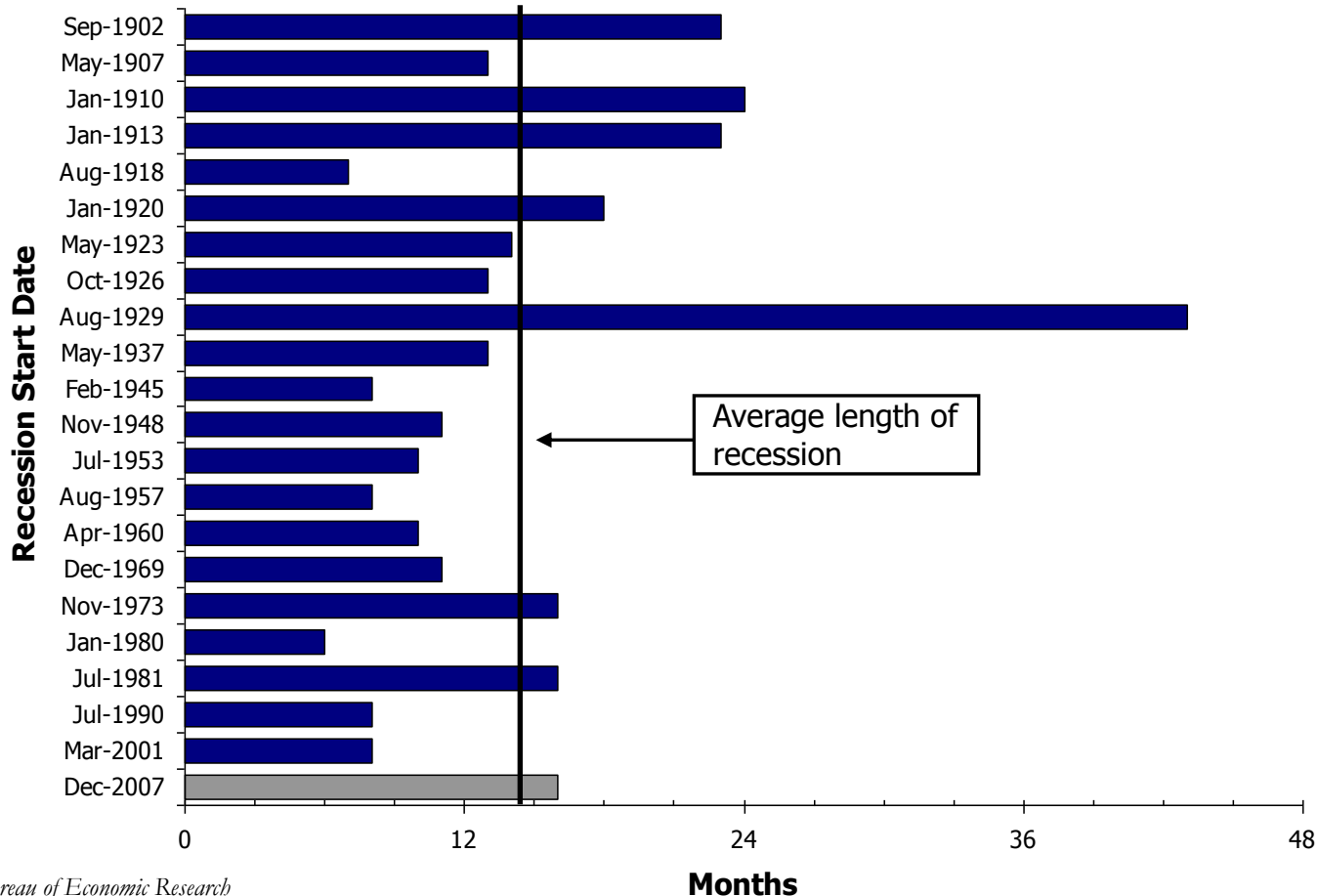


Source: FRB, RidgeWorth Investments

Technically, The Recession Is Behind Us

- Although the most recent recession was particularly severe, it was only slightly above average in terms of duration

Length of U.S. Recessions (1900-Present)



Source: National Bureau of Economic Research

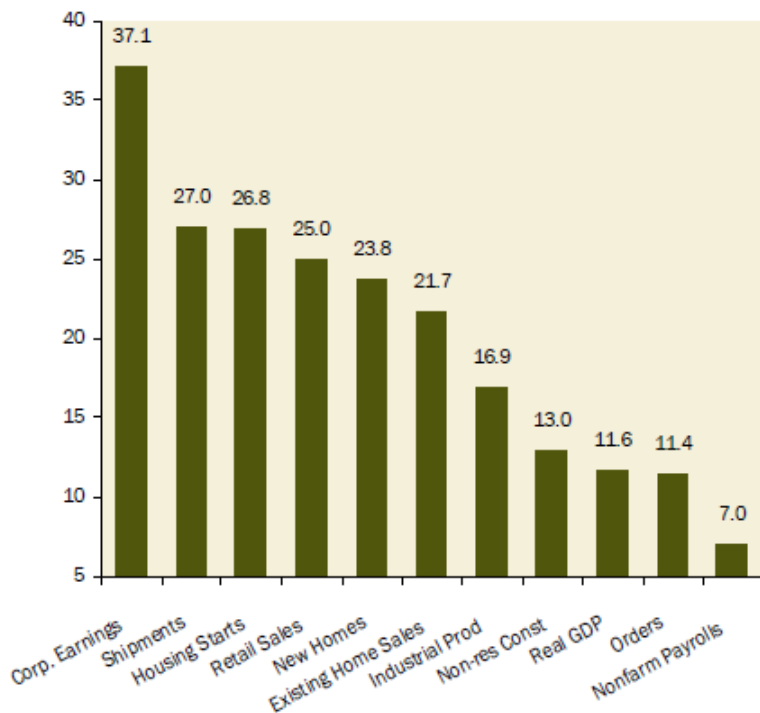
But The Effects Continue To Be Felt

- Due to the severity of the most recent recession, the recovery has been much slower and less pronounced than the recovery periods from past recessions

Percentage Change in Economic Indicators Following Recession

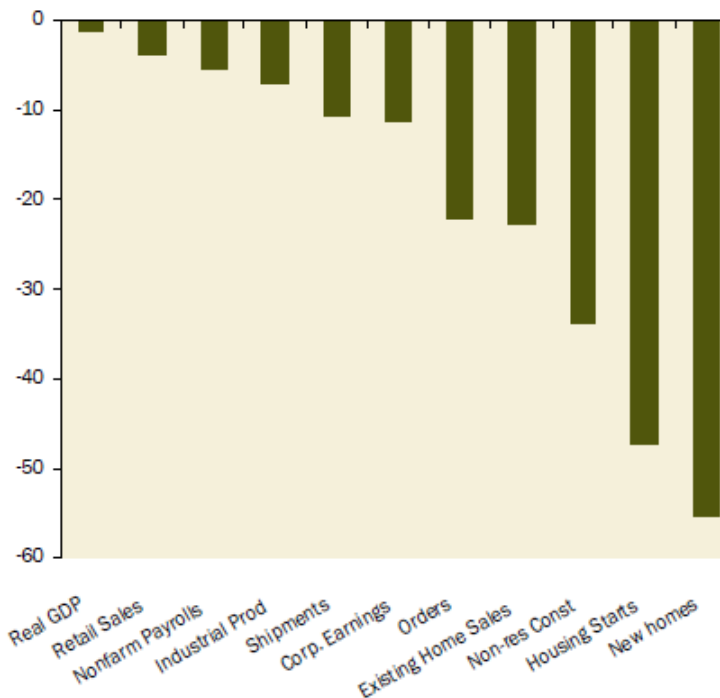
What is normal ...

Average, 33 Months After The Start of Recession*



... What is not

Current Cycle (from the end of 2007)

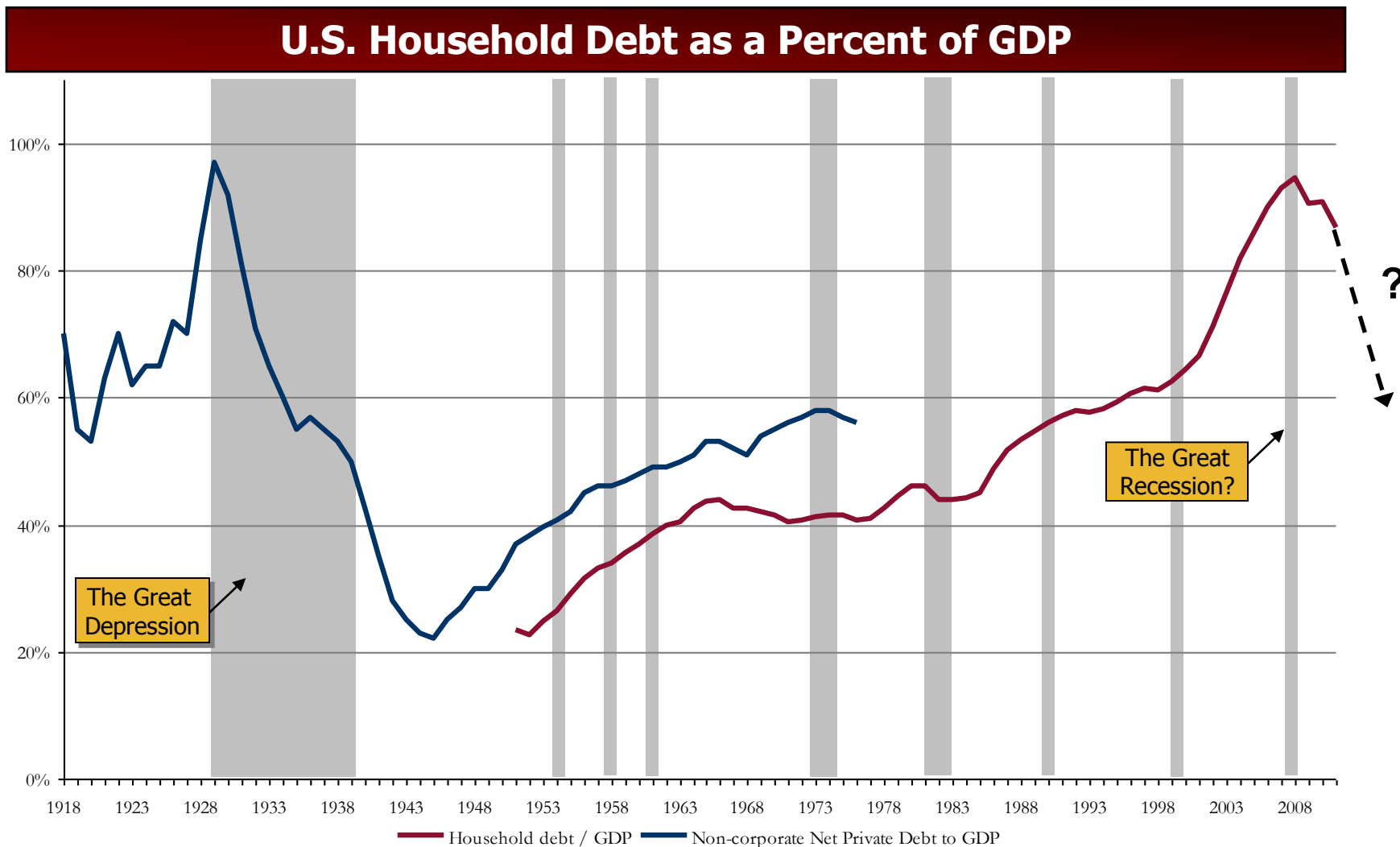


Note: Covers eight recession cycles going back to 1950 (does not include the truncated 1980 recession)

Source: Haver Analytics, Gluskin Sheff

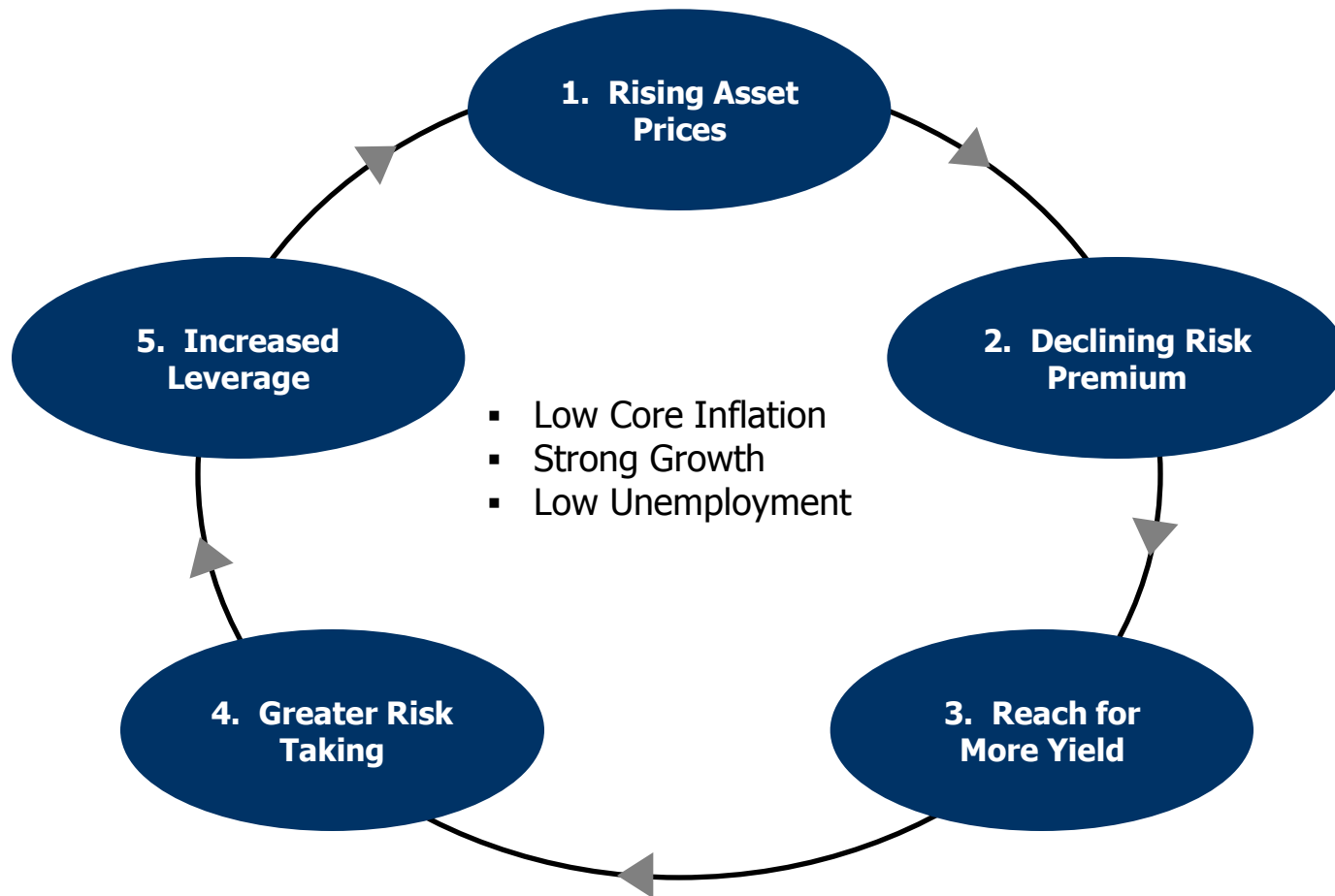
What Drove The Great Recession?

- 80% of GDP is tied to consumer spending

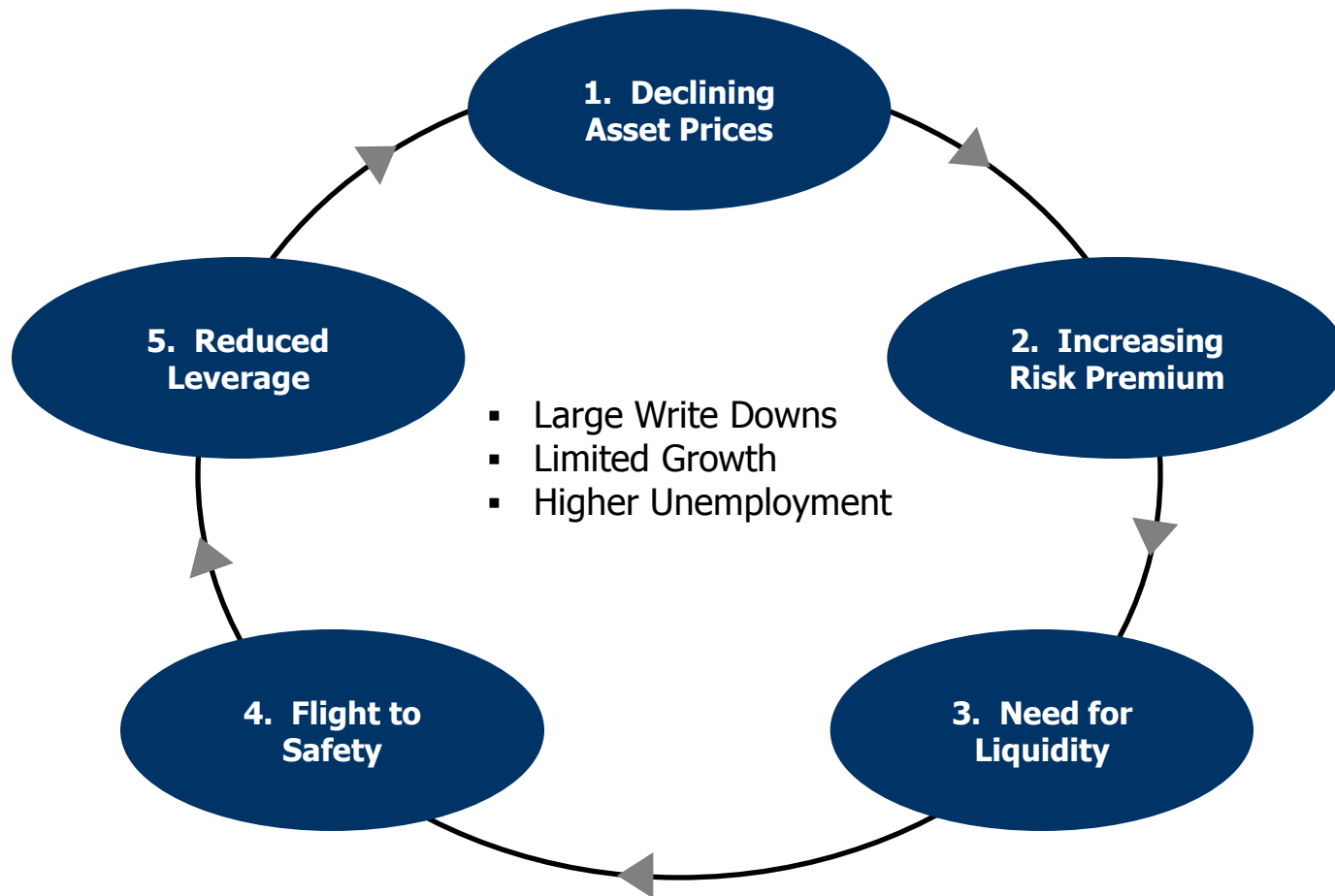


Source: U.S. Census, U.S. Federal Reserve Flow of Funds. Please note non-corporate net private debt is used as a proxy for household debt (going back to 1918) as the Federal Reserve did not begin tracking U.S. household debt until 1950

Leveraged Economy (1946 – 2007)



De-Leveraged Economy (2007 - ?)



- Muted economic growth
- Continuing private sector de-leveraging
- Continued asset re-pricing
- Large public sector deficits and debt
- Persistently high unemployment and growing underemployment
- Regulatory uncertainty
- Greater government role in the economy; increasingly political tone

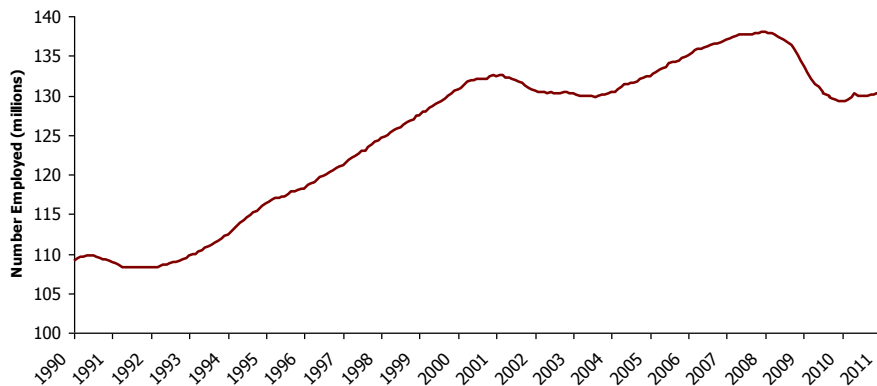
“This country had a huge, huge wound...It takes time for wounds to heal, regardless of how good the care is.”

-Warren Buffet

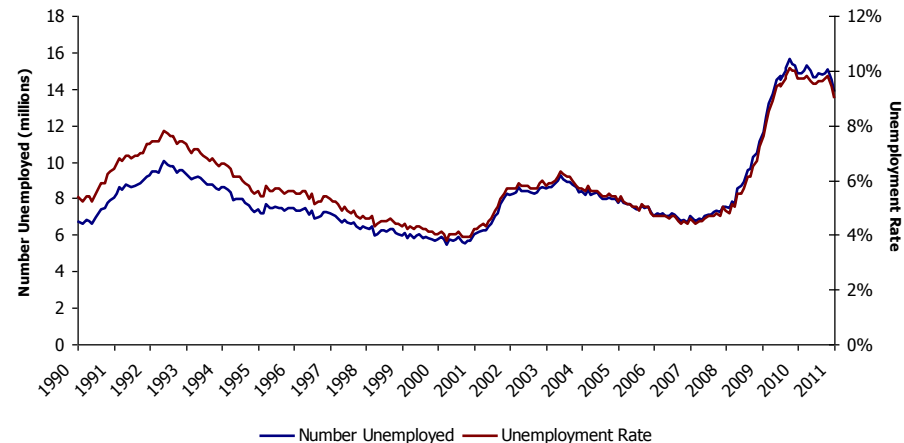
High Unemployment And Growing Underemployment

- The total number of unemployed is approximately **14.5** million and **6.4** million have been unemployed for six months or more (chronic unemployment)
- There are almost **27** million people unemployed, disillusioned, or underemployed.
- Companies are resisting policy measures aimed at pushing them to hire more people – will this lead to investment

Number of Workers Employed



U.S. Unemployment Rate and Number of Workers Unemployed

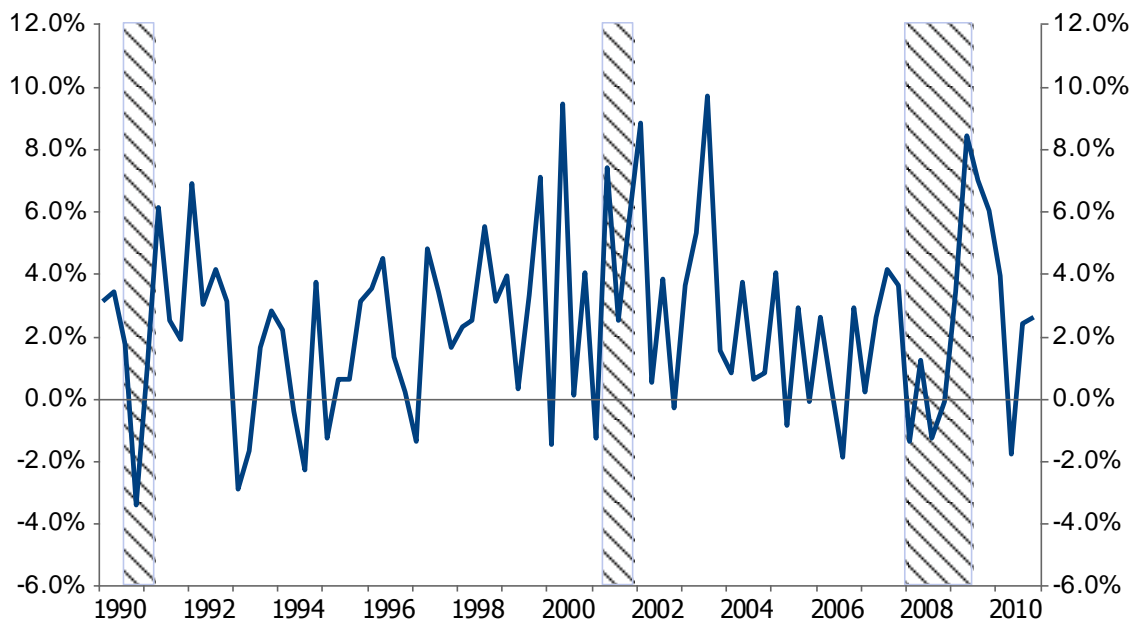


Source: U.S. Department of Labor; Bureau of Labor Statistics; FactSet, Associated Press

Companies Doing More With Fewer Employees

- Although the U.S. has lost nearly 8 million factory jobs since manufacturing employment peaked in mid-1979, U.S. manufacturers have placed near the top of the world rankings in productivity gains over the past three decades
- Productivity increased 2.6% in the nonfarm business sector in the fourth quarter of 2010
- The U.S. remains the No. 1 manufacturing country in the world, out-producing No. 2 China by a staggering 40%

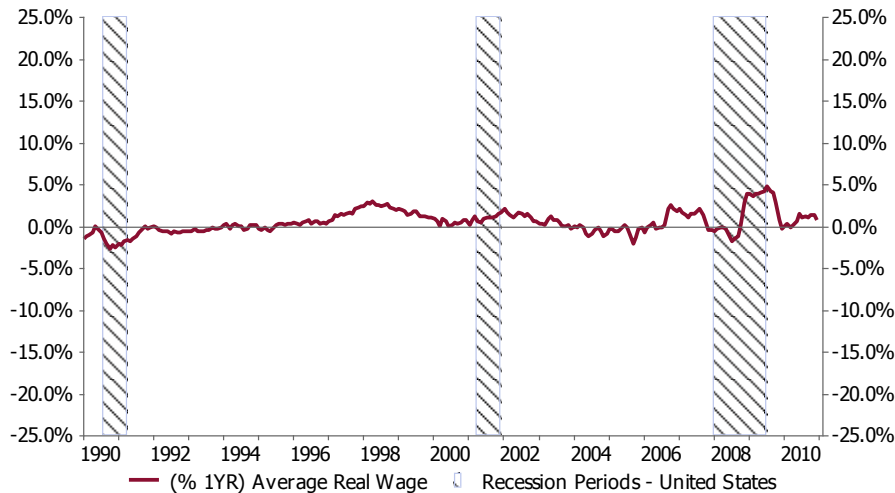
U.S. Labor Productivity



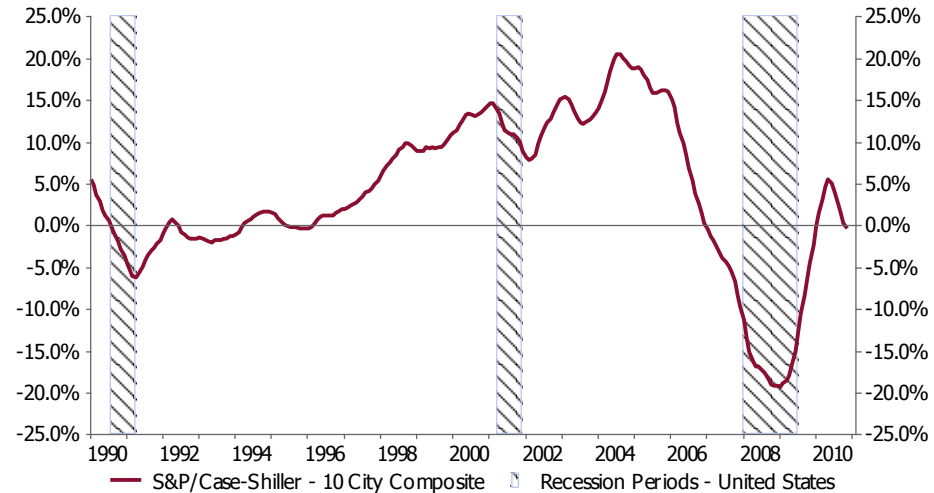
Source: U.S. Department of Labor; Bureau of Labor Statistics; FactSet, Associated Press

Housing Fueled Excessive Consumer Spending

U.S. Real Wage Growth



Home Price Indices



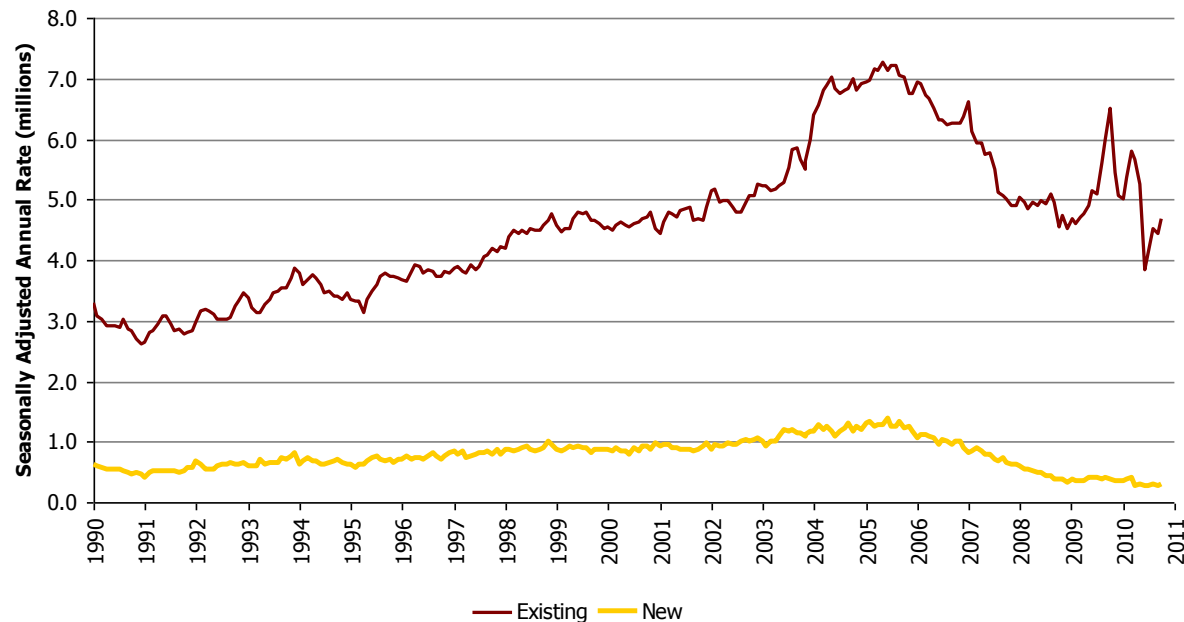
- 5.5 million U.S. Households are tied to mortgages 20% or more above value
 - 3.5 years to clear up the backlog of foreclosed properties
- Real estate experts now believe that home ownership will never again yield rewards like those enjoyed in the second half of the 20th century; it will take 20 years to recoup the \$6 trillion worth of housing value destruction seen in the last five years...after adjusting for inflation, values will never catch up
- GSE restructuring – any form will lead to higher interest rates / higher down payments – leading to lower home prices

Source: U.S. Census Bureau, National Association of Realtors, BBTCM Research, FactSet, Standard & Poor's, Financial Times, NY Times

Housing Continues To Be A Long-Term Drag

- New home sales are down 79.1% from their July 2005 peak; existing home sales are down 35.6% from their June 2005 peak.
- Home price declines are accelerating according to a WSJ report based on data from Q4. Inventory levels meanwhile are on the rise.
- **Housing affordability hits pre-recession levels** – the ratio of housing prices to annual household income has fallen from 2.3x during the peak of the bubble all the way back to 1.6x (well below the average of 1.9x). WSJ

U.S. New Home Sales



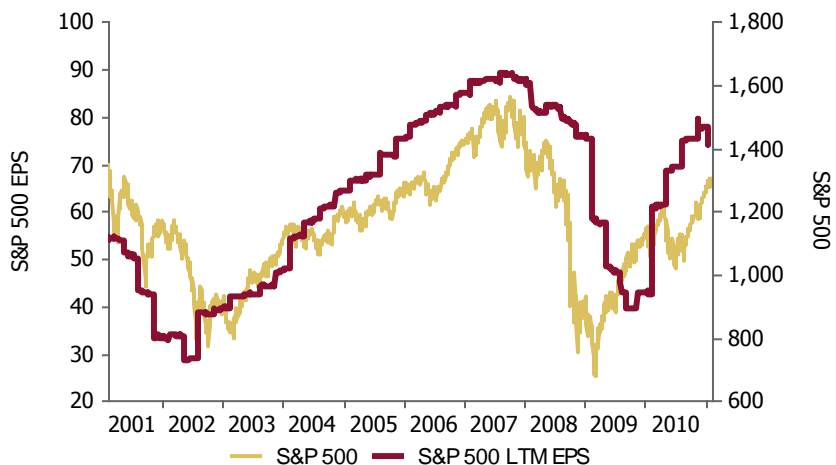
Source: U.S. Census Bureau, National Association of Realtors, BBTCM Research, FactSet, Wall Street Journal

Earnings Valued Less Than Before



- The S&P 500 has returned to a similar level to what it was in the beginning of the decade, yet the PE ratio is down about 40%

Historical Index Performance



S&P 500 Price To Earnings

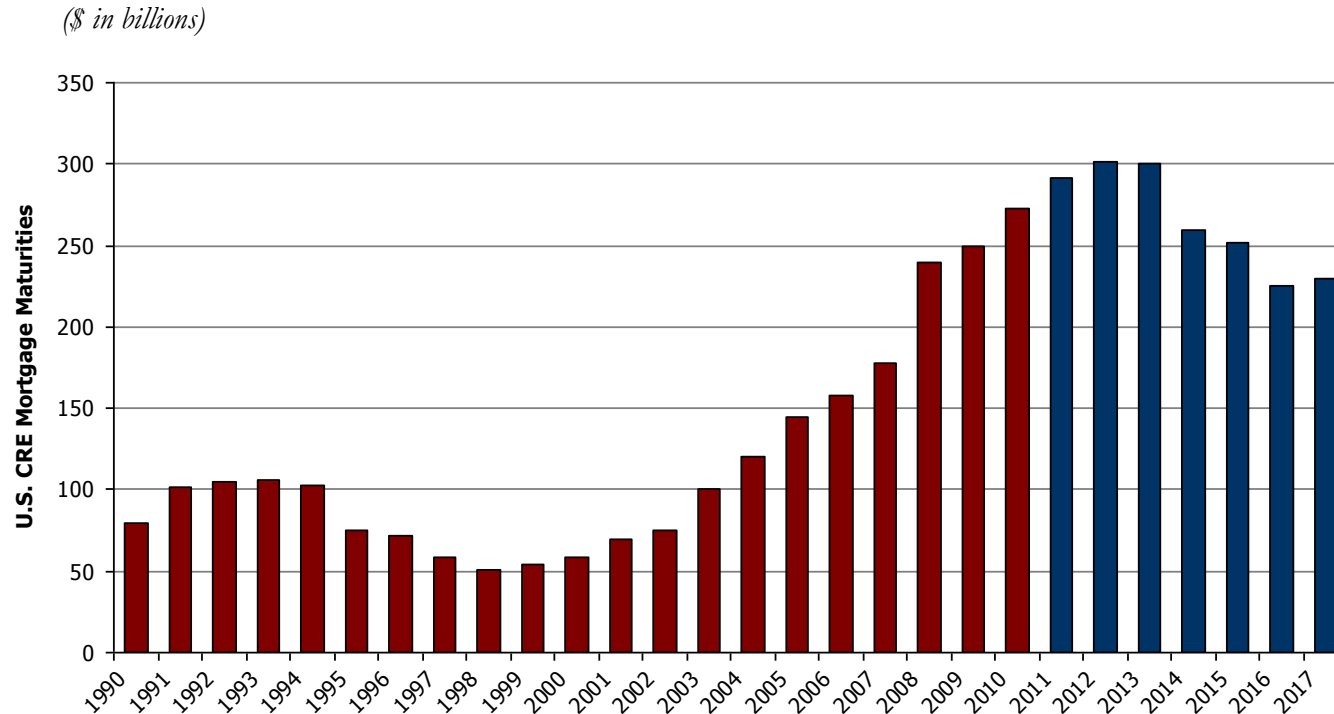


Source: FactSet, data as of February 4, 2011

Is CRE The Next Shoe To Drop?

- More than \$1.4 trillion worth of commercial real estate paper is coming due by 2016 and more than 50% is attached to properties that are currently underwater

U.S. CRE Mortgage Maturities



Source: Financial Sense

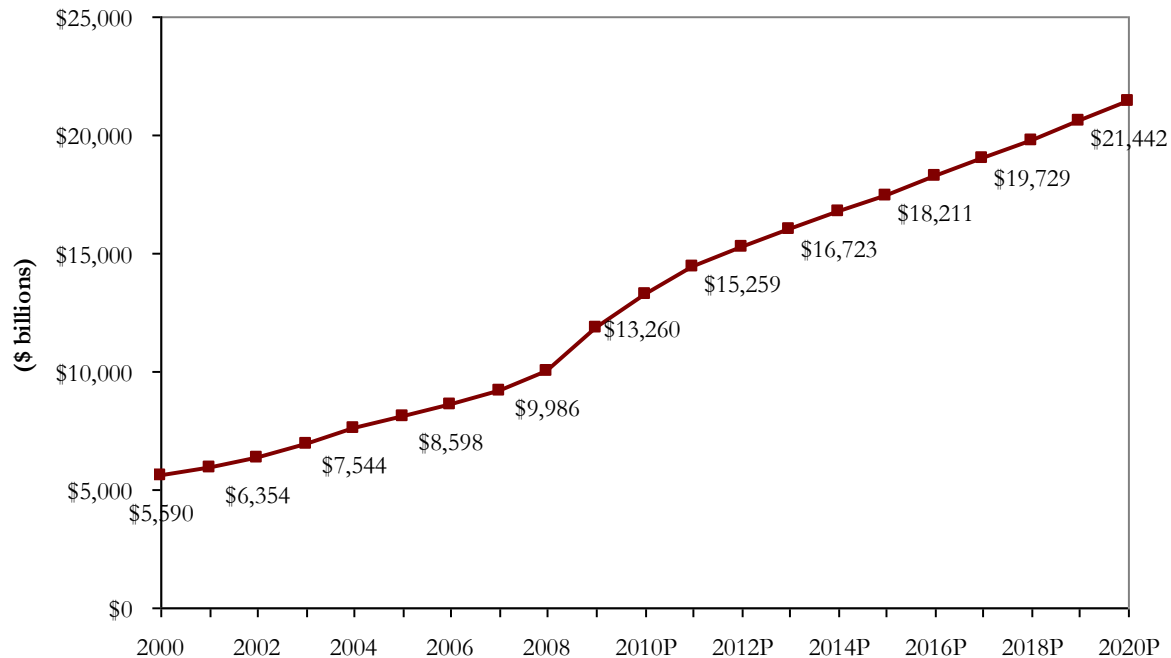
- BRIC (Brazil, Russia, India & China) countries
 - The fastest growing and largest emerging market economies in the world
 - China is the largest holder of U.S. debt (\$906.8 billion) and the second largest economy in the world
- European Union
 - Greece bailed out in May 2010
 - Ireland bailed out in November 2010
 - PIIGS (Portugal, Italy, Ireland, Greece & Spain) countries owe the “Big Three” of Europe (Germany, France, and Great Britain) more than \$2 trillion in debt
- Middle East Unrest
 - Harbinger of future turmoil?

Source: Forbes, Wall Street Journal, The Economist

Are there cards left to play?

- The 2010 Gross Federal Debt was \$13.2 trillion, a 43% increase since 2007 and \$44,000 per person
- In 2010 the \$1.3 trillion debt was equal to 9% of 2010 GDP / 2011 projected at \$1.65 trillion
- In 2011, the Gross Federal Debt is projected to exceed GDP (up \$1.6 trillion) – when interest rates rise, how will we amortize the debt?

U.S. Gross Federal Debt



Source: Congressional Budget Office; US Department of the Treasury.; These figures represent federal debt that is subject to limitations only

- Which is a bigger problem – deflation (asset bubbles and unemployment) or inflation (fiscal stimulus)?
- Are the current levels of unemployment structural
- Will housing be an “investment” in the future – or a place to live?
- Can we long-term de-lever the economy and do we want to de-lever the economy?
- Can we pay our bills – federal, state, municipal?
- How does the global economy affect our domestic policies (do we still have control)?

“The future ain’t what it used to be.”

-Yogi Berra

- This has happened before, and it will happen again – if the financial system is sound and the capitalist system is allowed to work we will continue to recover and grow (**economic growth = job creation!**)
- We have to avoid the inclination to over-regulate and to over-tax – very anti-growth. This is hard for the politicians who want to do something
- The message out of Washington is on point – invest in education and technology and infrastructure to spur growth – where will the money come from?
- In order to pay for the engine of growth (and to get back on track) two things have to happen:
 - Everyone will get less / Everyone will pay more (the devil being in the details)
- The companies who reacted rationally to the new circumstances are already the winners – rationalization is a major positive from the great recession
- Recovery will take time – it took 60 years to get here; it will take more time than we think / hope to get re-balanced

- Listen to the market – it is quieter when it is less crowded – unmet needs abound
- Invest in your customers – now they need you the most – loyalty hangs in the balance
- Offer more value to your customers
- Improve and increase communication
- Downturns provide an opportunity to widen the gap between you and your competitors
- Those who stay in the market and invest reap the rewards
- Time is more important to the market than money

Innovation is a good cost!

Source: The Andrew Razeghi Companies



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