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- I. The Economy
- II. The Fed & Monetary Policy
- III. Interest Rate Environment
- IV. The Issue
- V. Strategies and Takeaways

I. The Economy

- ❏ U.S. economic data remains mixed, but has improved over recent months... much work remains
- ❏ Uncertainty is ubiquitous
 - Fiscal
 - Regulatory
 - Economic
- ❏ Double dip, **new normal** or sustained recovery

1. Employment Situation Report
2. Consumer Prices
3. ISM Report—Manufacturing
4. Producer Prices
5. Weekly Claims for Unemployment Insurance
6. Retail Sales
7. Housing Starts
8. Personal Income and Spending
9. ADP National Employment Report
10. GDP

Economic Indicators Most Sensitive to Bonds



		2009	2010	2011	2012	Jan-12	Feb-12	Mar-12	Apr-12	May-13	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12
1	US Unemployment Rate	9.30	9.60	8.90	8.10	8.30	8.30	8.20	8.10	8.20	8.20	8.20	8.10	7.80	7.90	7.80	7.80
1	US U-6 Unemployment Rate	17.10	16.60	15.20	14.40	15.10	15.00	14.50	14.50	14.80	14.80	14.90	14.70	14.70	14.50	14.40	14.40
1	Change in Total Nonfarm Payrolls	(220)	95	230	196	311	271	205	112	125	87	153	165	138	160	247	196
1	Change in Private Payrolls	(167)	114	249	202	323	265	208	120	152	78	177	131	118	217	256	202
1	Avg. Hourly Earnings	1.80	1.70	2.00	2.10	1.70	1.90	2.10	2.00	1.70	2.00	1.80	1.90	2.00	1.60	1.90	2.10
2	US Consumer Price Index (CPI)	2.70	1.50	3.00	1.70	2.90	2.90	2.70	2.30	1.70	1.70	1.40	1.70	2.00	2.20	1.80	1.70
3	ISM Manufacturing	55.30	57.30	52.90	50.20	53.70	51.90	53.30	54.10	52.50	50.20	50.50	50.70	51.60	51.70	49.90	50.20
4	US Producer Price Index (PPI)	4.30	3.80	4.70	1.30	4.10	3.40	2.80	1.80	0.60	0.70	0.50	1.90	2.10	2.30	1.50	1.30
5	Initial Jobless Claims	467	419	383	367	381	373	362	368	389	376	368	367	369	363	371	367
6	Change in Retail Sales	0.40	0.70	(0.10)	0.50	0.90	1.00	0.40	(0.50)	(0.10)	(0.70)	0.70	1.00	1.20	(0.20)	0.40	1
7	Housing Starts	581	539	697	954	720	718	706	747	706	754	728	750	843	889	851	954
8	Personal Income	(4.80)	3.80	5.10	2.60	0.90	0.70	0.50	-	0.10	0.30	0.10	0.10	0.40	0.10	1.00	2.60
8	Personal Spending	0.60	0.40	0.10	0.20	0.50	0.80	0.30	0.20	(0.20)	-	0.40	0.30	0.80	(0.10)	0.40	0.20
9	ADP Employment Change	(106)	239	294	185	219	226	90	130	81	116	145	82	124	159	173	185
10	Gross Domestic Product (GDP)	(3.10)	2.40	1.80	2.20			2.00			1.30			3.10			(0.10)

U.S. Housing Starts



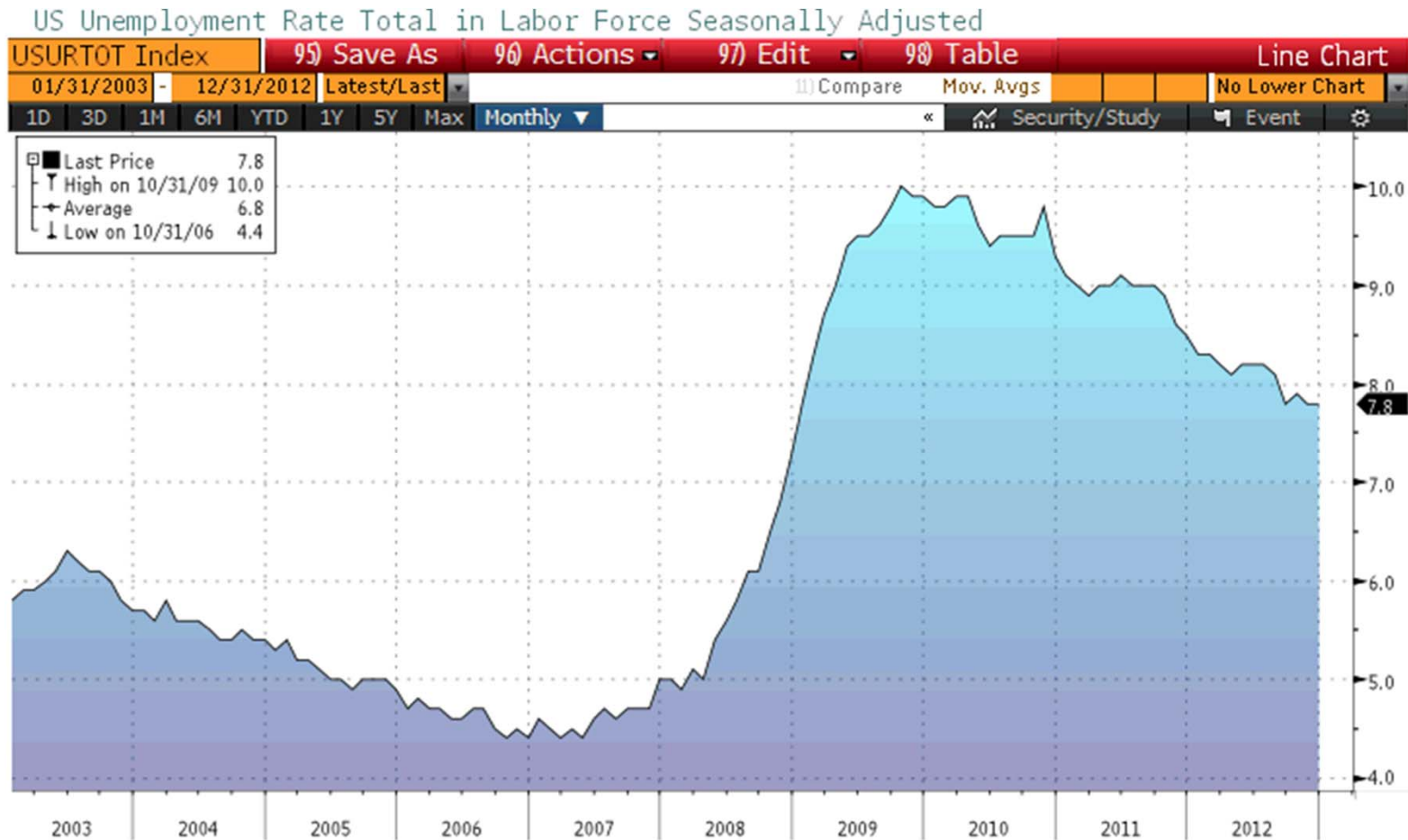
Source: Bloomberg

U.S. Housing Starts



Source: Bloomberg

U.S. Unemployment Rate



Source: Bloomberg

Labor Force Participation Rate



Source: Bloomberg

The world has gotten smaller due to globalization



-  European Issues
-  China slow down & economic manipulation
-  Currency Wars
-  Massive amounts of global debt
-  Natural disasters and weather events
-  Geopolitical risk
-  U.S. Political Environment

II. The Fed & Monetary Policy


The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long-run growth of the monetary and credit aggregates commensurate with the economy's long-run potential to increase production, so as to promote effectively the goals of **maximum employment and stable prices.**

Current Monetary Policy



1. Interest Rate Policy

 Maintain the overnight rate at 0.00%-0.25%

 “This exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6.50%, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee’s 2% longer-run goal, and longer-term inflation expectations continue to be well anchored.”

2. Quantitative Easing Policy

 Currently in fourth round (QE4)

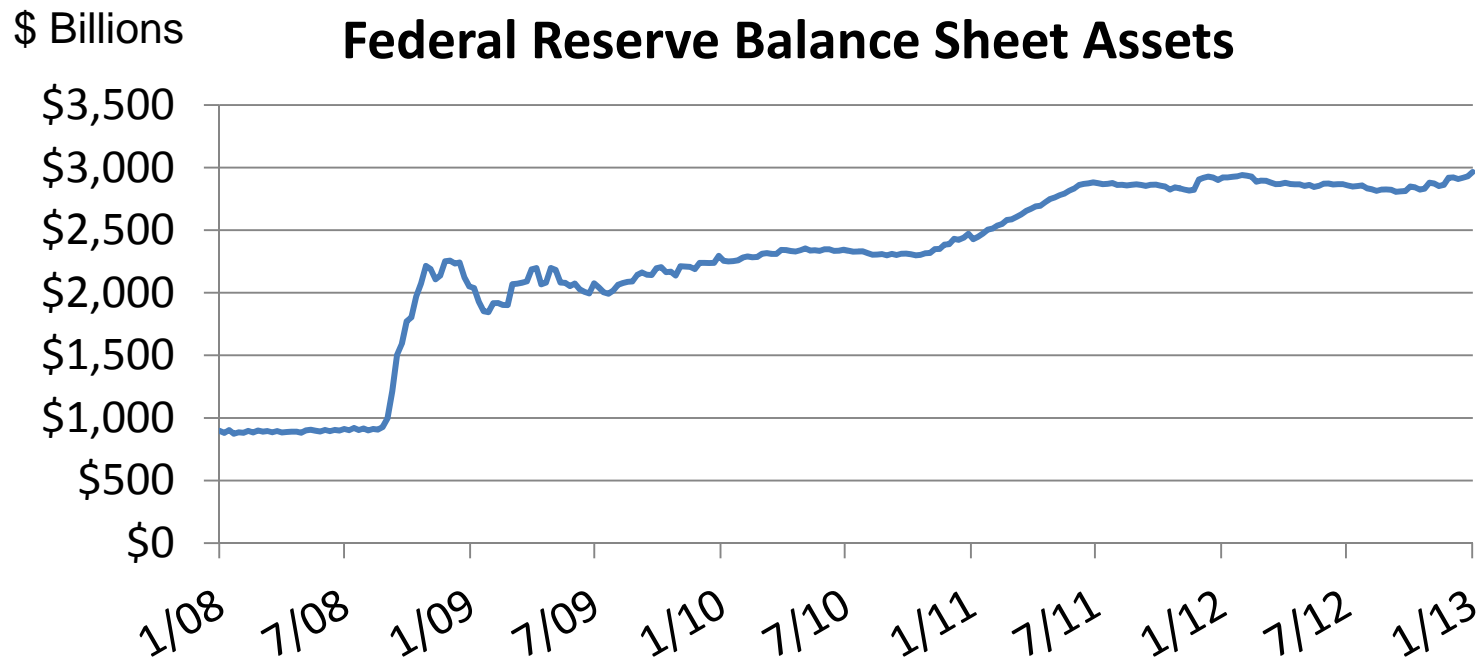
 \$45 Billion of Treasury Securities/month

 \$40 Billion of MBS/month

The Fed-Monetary Policy



\$ 4 Trillion



Is Fed Policy Working?



Market Metrics



Metric	3/1/2012	3/1/2013	% Change
DOW	12,980	14,089	8.54%
S&P	1,374	1,518	10.48%
NASDAQ	2,988	3,169	6.06%
VIX	17.26	15.36	
CDS Spreads	92.750	86.73	
5-yr A Rated Corp Spreads	143 bps	77 bps	
10-yr A Rated Corp Spreads	178 bps	110 bps	
Portuguese 10-yr	13.610%	6.298%	
Greek 10-yr	19.144%	10.922%	

Source: Bloomberg

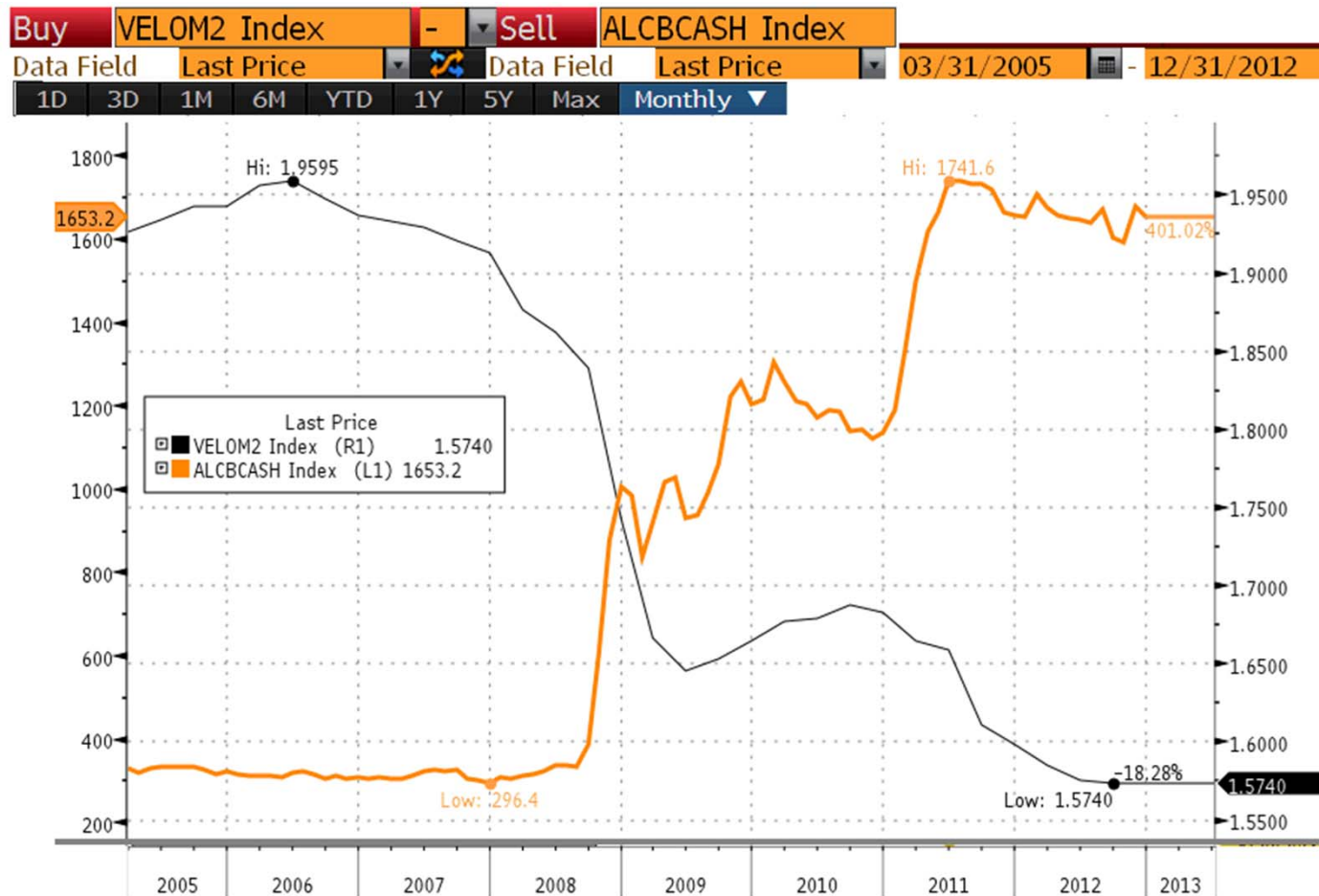
Economic Metrics- Global GDP Levels




Metric	2010	2011	2012
United States	2.40%	1.80%	2.20%
Japan	4.70%	-0.58%	2.00%
Euro Area	2.00%	1.40%	-0.40%
United Kingdom	1.80%	0.90%	0.00%
Germany	4.20%	3.00%	0.70%
BRICS	8.67%	7.05%	5.66%
Brazil	7.59%	2.76%	1.00%
Russia	4.50%	4.30%	3.40%
India	8.88%	7.50%	5.30%
China	10.40%	9.30%	7.80%
World Region	3.99%	2.90%	2.23%


Source: Bloomberg

Cash Index vs. Velocity of Money



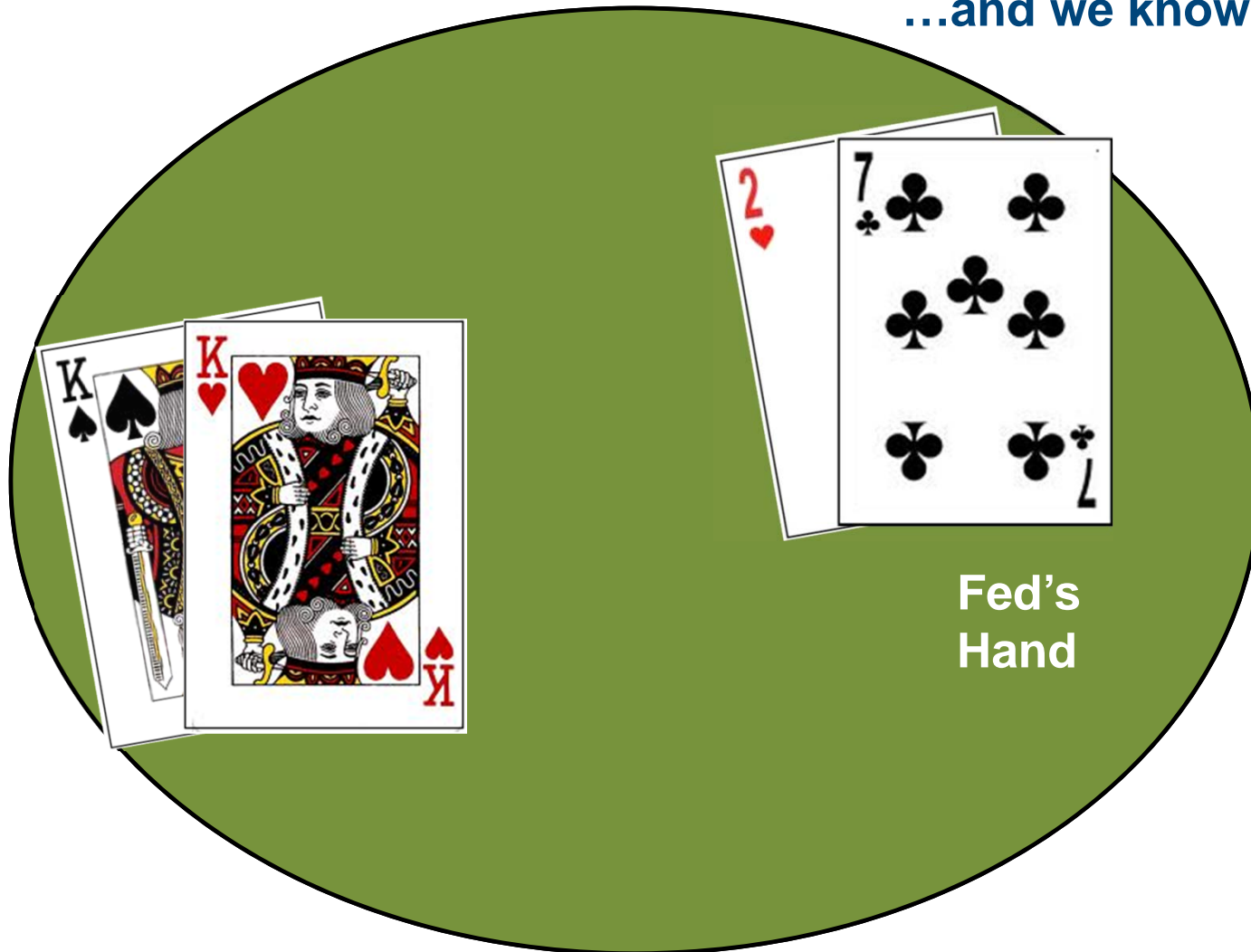
Source: Bloomberg

-  Symptoms of problem have been addressed
 - Market conditions have improved substantially
 - Bubble formation???

-  Problem hasn't been addressed
 - Economic conditions remain dubious
 - Inadequate economic growth

The Fed is "ALL IN"...

...and we know their hand!



III. Interest Rate Environment

Yield Curve Comparison



	3/1/12	3/1/13	Change
1 Year	.160%	.155%	-.005%
2 Year	.291%	.238%	-.053%
3 Year	.414%	.346%	-.068%
5 Year	.889%	.763%	-.126%
7 Year	1.437%	1.252%	-.185%
10 Year	2.027%	1.877%	-.150%
30 Year	3.148%	3.087%	-.061%

Source: Bloomberg



2012 Trading Range



	Low Yield	High Yield	Range
1 Year	.100%	.220%	.120%
2 Year	.204%	.393%	.189%
3 Year	.278%	.615%	.337%
5 Year	.543%	1.197%	.654%
7 Year	.882%	1.765%	.883%
10 Year	1.388%	2.378%	.990%
30 Year	2.454%	3.478%	1.024%

Source: Bloomberg

Last three years

-  Economic conditions improved Oct.-March only to deteriorate from April-Sept.
-  Treasury yields increase Oct.-March only to decline April-Sept.

Today's Yield Curve: Where are Rates Heading



	3/1/13 Rates	12/31/13 Rates
1 Year	.155%	?
2 Year	.238%	?
3 Year	.346%	?
5 Year	.763%	?
7 Year	1.252%	?
10 Year	1.877%	?
30 Year	3.087%	?

Source: Bloomberg

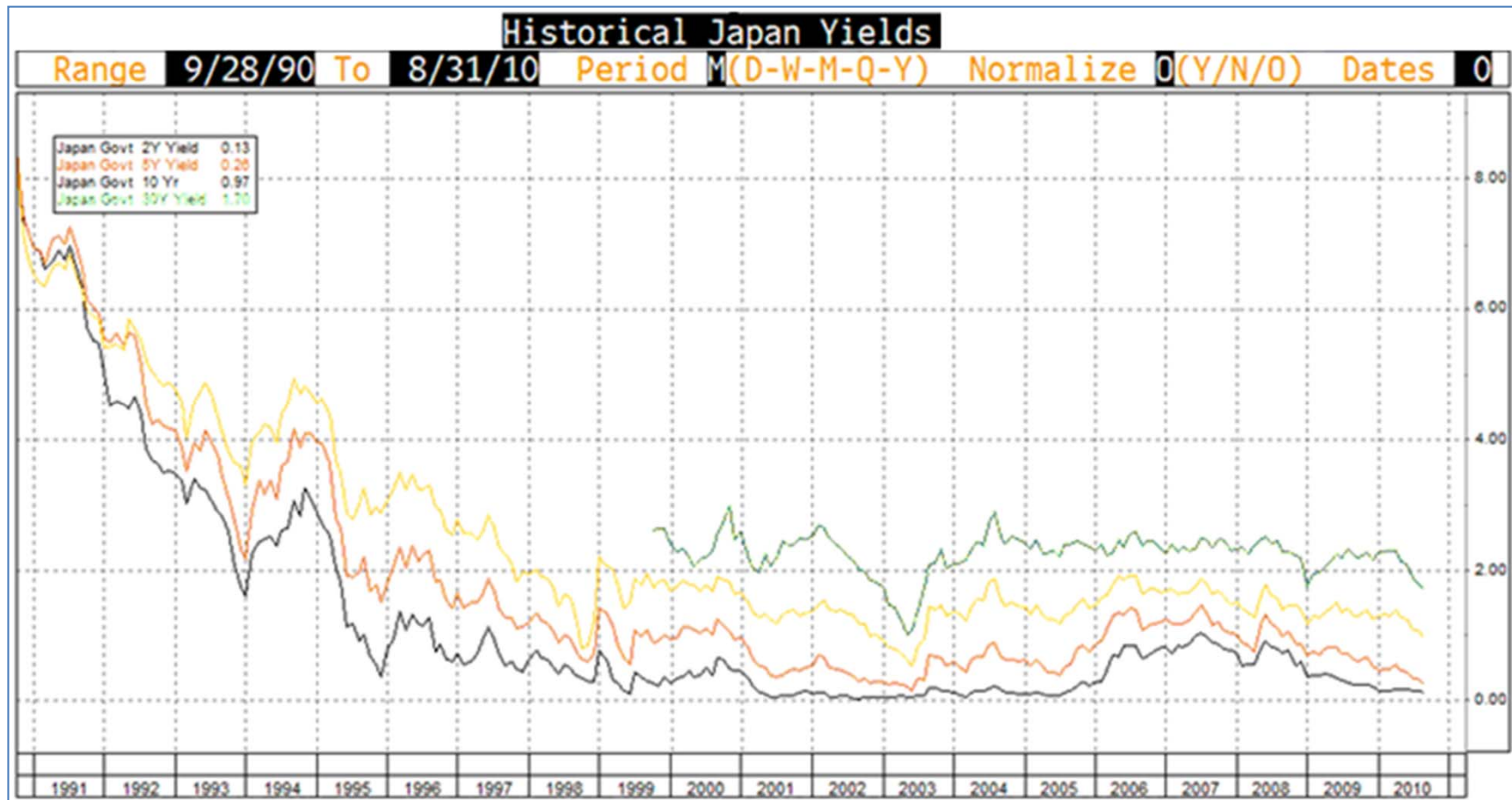
Global Sovereign Debt Yields




Maturity 10 Year		Trading Mode			Historical Data Range 3 Months						
Country	CMI	Security	Bid	Ask	Yield	Yld Chg	Yield	Low	Range	High	3M Chg
1) Americas											
10) United States		T 2 02/15/23	99-26	99-26+	2.019	-3.8		1.698		2.062	+32.1
11) Canada		CAN2 3/4 06/22	107.051	107.101	1.906	-3.3		1.753		2.035	+15.3
12) Brazil (USD)		BRAZIL8 7/8 24	153.585	154.450	3.048	-1.9		2.457		3.115	+54.9
13) Colombia (USD)		COLOM 8 1/8 24	144.425	145.365	3.253	-1.2		2.834		3.265	+38.0
14) Mexico (USD)		MEX8 09/24/22	142.750	144.250	2.700	-.1		2.483		2.839	+16.7
2) EMEA											
20) United Kingdom		UKT1 3/4 09/22	98.160	98.180	1.961	-5.2		1.804		2.205	+14.2
21) France		FRTR 2 1/4 22	101.255	101.310	2.097	-2.3		1.960		2.296	+13.6
22) Germany		DBR1 1/2 02/23	100.175	100.185	4.595	-3.5		1.307		1.710	+14.6
23) Italy		BTPS 5 1/2 22	107.285	107.380	4.707	-3.2		4.119		4.884	-3.3
24) Spain		SPGB5.4 01/23	105.215	105.360	4.707	-3.2		4.707		5.418	-62.1
25) Portugal		PGB4.95 10/23	92.430	93.400	5.796	-4.8		5.664		7.199	-140.4
26) Sweden		SGB3 1/2 06/22	112.795	112.984	1.946	-2.1		1.433		2.098	+51.3
27) Netherlands		NETHER2 1/4 22	104.460	104.510	1.722	-1.0		1.481		1.888	+18.3
28) Switzerland		SWISS 4 02/23	130.653	131.180	10.404	+2.0		.420		.756	+30.6
29) Greece		GGB2 02/24/23	54.100	55.050	10.404	+2.0		9.963		12.844	-244.0
3) Asia/Pacific											
30) Japan		JGB 0.6 03/23	99.605	99.699	3.613	-1.8		.606		.825	-5.9
31) Australia		ACGB 5 1/2 23	115.779	115.853	3.613	--		3.216		3.613	+31.3
32) New Zealand		NZGB 5 1/2 23	113.694	114.012	3.813	-1.7		3.470		3.888	+25.9
33) South Korea		NDFB 3 3/4 22	107.072	107.235	2.968	-4.3		2.940		3.229	-12.2


Source: Bloomberg


Japanese Historical Gov't Yields











Source: Bloomberg

-  Fed on-hold for years (we know their hand)
 - Anchors short-end of the yield curve

-  Fed remains “All In”
 - Anchors long-end of the yield curve

-  Global shocks
 - Precipitates the flight to quality




-  **Result: Rates will continue to stay low**
 - 2013 Mirrors 2012

-  Slow economic growth at best
-  Federal Reserve is determined to further reduce long term rates
-  Long Treasuries are attractive to pension funds and life insurers for A/L reasons
-  Treasuries remain the safe haven of choice
-  China's attempt to cool economy may precipitate hard landing
-  Global central banks and foreign governments continue to buy large quantities of treasuries
-  Treasuries have worked for 31 years and the 30 year bond has been one of the top performing assets

Source: Gary Shilling –famed economist

3 Catalysts for Rising Rates



-  Sustainable U.S. economic growth
-  A loss in confidence in the U.S. ability to pay debts
-  Hyperinflation

IV. The Issue

Source of Revenue



Area	Net Interest Income/ Revenue	Non-interest income/ Revenue
Key markets		
Washington	89	11
Philadelphia	89	11
Pittsburgh	89	11
Other markets		
North Jersey	92	8
South Jersey	91	9
Northeast PA	85	15
Central PA	83	17
Northern WV	84	16
Northeast Ohio	87	13
Troubled markets		
Baltimore	92	8
Eastern Shore	89	11

¹499 banks based in these market covered by this report with assets under \$20 billion. For the year ended December 31, 2012, or December 31, 2012.

Source: SNL.

Decreased Loan Demand

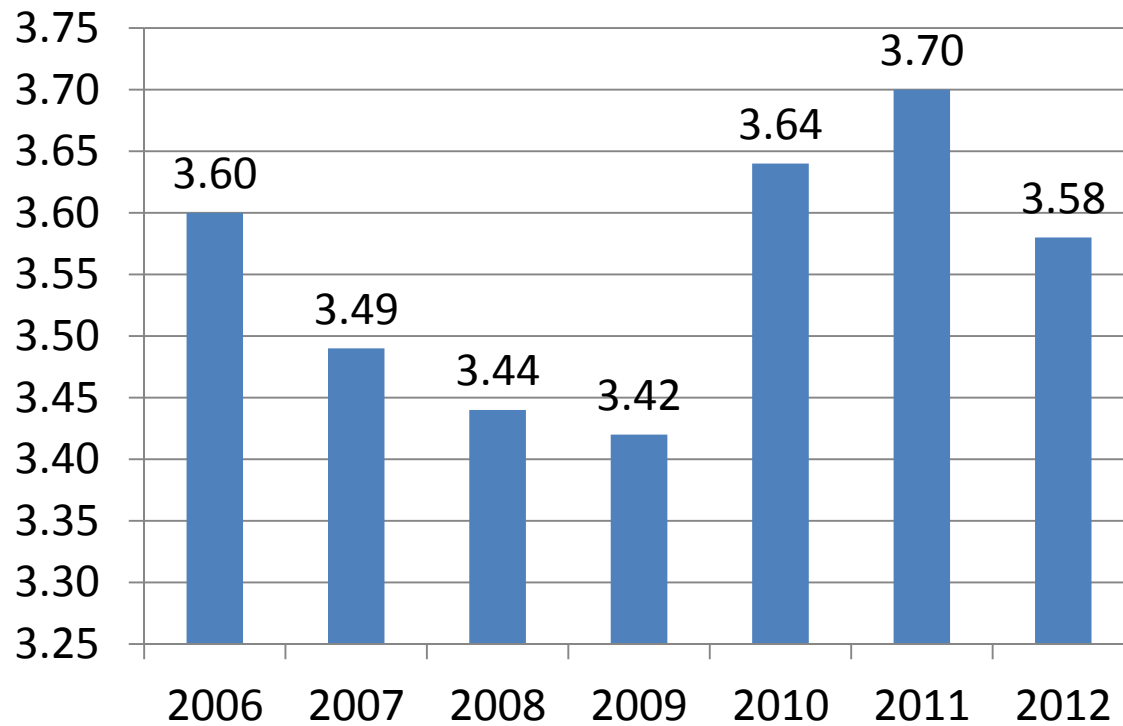


Key Markets	Loans to Assets (%)				
	2012	2011	2010	2009	2008
Washington	72	73	74	73	75
Philadelphia	65	66	68	70	72
Pittsburgh	61	61	63	63	66

¹499 banks based in these market covered by this report with assets under \$20 billion. For the year ended December 31, 2012, or December 31, 2012.

Source: SNL.

Net Interest Margin Trend







Group: Only banks and thrifts located in region covered.

Source: SNL.

V. Strategies & Takeaways





Assumption of risk

-  Interest rate risk
-  Credit risk
-  Liquidity risk
-  Earnings risk

BALANCE



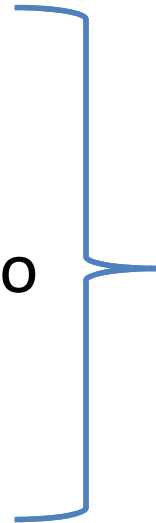
The Key is to manage these risks with a balance approached

-  Lack of robust loan demand on a macro level
-  Has created larger investment portfolios and excess liquidity
-  Yield on earning assets continues to decline with less offset from declining cost of liabilities
-  More attention to investment portfolio
 - View the portfolio as an opportunity rather than a necessary evil to drive value and hedge risks

Liquidity Portfolio

Intermediate Portfolio

Income Portfolio



Duration Based Approach







Investment Portfolio Mix and Cash vs. ROE








ROE (#)	US Gov't & Agency	State & Munis	MBS	CMOs	Private Label MBS & CMOs	Other	Total Sec.	Cash/ Assets
Over 15% (12)	28.3	38.5	22.7	0.0	0.3	10.2	100.0	6.7
10% to 15% (66)	17.3	27.9	42.1	0.5	4.5	7.7	100.0	5.2
5% to 10% (202)	16.5	18.3	55.5	1.3	1.7	6.7	100.0	6.5
Under 5% (161)	17.2	9.9	64.9	1.2	1.0	5.8	100.0	10.0
Negative (58)	19.1	6.7	68.5	1.0	0.4	4.3	100.0	11.5
All (499)	17.1	17.5	55.9	1.1	1.8	6.6	100.0	7.7

Banks with highest concentration in munis and corporates, and low cash balances have outperformed.

Group: Only banks and thrifts located in region covered.

-  Balance sheet restructuring
-  Actively manage the portfolio
-  Restructure MBS holding
 - Mitigate premium risk, cash flow risk, reinvestment risk and yield erosion risk
-  Ladder vs. barbell strategy
-  Munis & corporates (Loan surrogates-Income Portfolio)
-  Security selection process

-  Don't fight the Fed
-  Opportunistic and nimble
-  Utilize balanced approach
-  Add sources of non-interest income-diversify revenues
-  Growth through acquisitions

**“Face reality as it is,
not as it was,
or as you wish it to be”**

Jack Welch
Former CEO of General Electric