

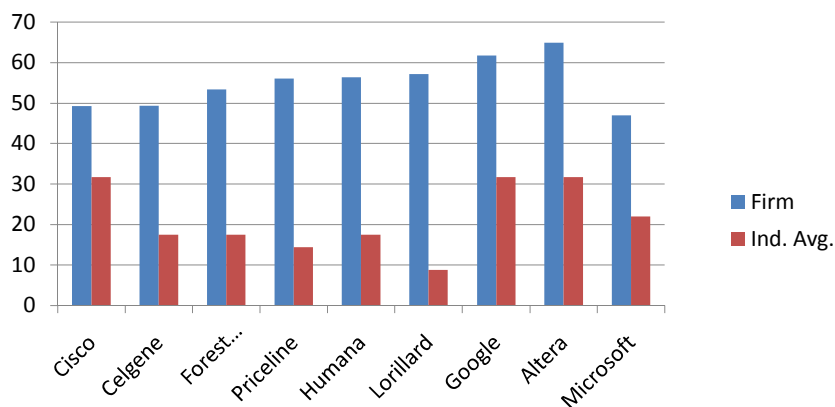


Many community banks are flush with short-term liquid assets as deposit inflows are high, strong borrowers pay down their debt and don't want replacement financing, and management doesn't want to invest in longer-term securities given the current low rate environment and likelihood that rates will rise in the near future. A critical issue is what to do with the funds to enhance overall profitability and not increase risk excessively.

Banks are not alone. The country's largest nonfinancial corporations now hold almost \$1.8 trillion in cash and equivalents (liquid assets) on their balance sheets as reported by the Federal Reserve. As a fraction of assets, these holdings are the highest since 1963. Consider the following chart, which indicates the proportion of assets held in short-term, liquid form at nine of the largest companies. Google and Altera Corp. have over 60% of total assets invested in cash and equivalents. Why are these firms not spending these funds? Think of alternatives; expanding plants or buying new equipment, acquisitions, paying dividends, buying back stock - - - or even, hiring new workers.

Clearly, these firms are being cautious. The likely reason is the considerable uncertainty surrounding government policies and future economic conditions. What taxes are coming? How much will health care obligations truly cost? What new regulations will bring higher compliance costs? The Business Roundtable, an association of large corporation CEOs, recently identified a long list of new and proposed rules and regulations that will diminish hiring and slow economic growth, which it presented to the Obama Administration.

Liquid Assets / Total Assets: March 2010



Before these firms will invest their cash, they must be confident that they know the rules and costs associated with regulations and be reasonably able to forecast applicable taxes.

Breaking News

- The federal deficit was \$68.4 billion in June bringing the total deficit to roughly \$1 trillion to date for 2010, below the \$1.1 trillion deficit over the comparable time last year. The estimated budget deficit is \$1.6 trillion for fiscal 2010.
- Asian Central Banks and other foreign investors have increased their holdings of Fannie and Freddie mortgage bonds by more than \$50 billion. The spread to the Treasuries on 30-year, fixed-rate agency mortgage securities has recently fallen to 0.65%, well below recent spreads.
- The Labor Department reported that in May there were 4.67 jobs advertised for each unemployed individual.
- BP installed a new cap on the leading oil well. It will test whether the cap stops the leak until it is permanently plugged, hopefully with cement.

Deal of the Day

The state of California is facing an estimated \$19 billion deficit for its fiscal year that started July 1st. Because the state legislators have not approved a budget, Governor Schwarzenegger lowered the pay of approximately 200,000 government workers to the minimum wage in an effort to cut spending and spur a budget response. Several California banks are stepping up to make ‘budget impasse’ loans designed to help individuals whose pay has been cut. The loans will presumably be repaid when the budget issues are resolved and the affected individuals again receive their pre-impasse compensation. With California’s history of financial difficulties, budget impasse loans have been offered before.

Economic News

The U.S. trade deficit continued to widen reaching \$42.3 billion in May. While exports increased, imports grew proportionately more. The deficits with China and Europe were \$22.2 billion and \$7.6 billion, respectively. The difference between exports and imports (a deficit indicates that imports exceed exports) is a key component of total spending and GDP growth. A rising trade deficit thus signals that GDP growth will slow, absent other factors.

Upcoming Events

- Alcoa, Chevron and Intel reported second quarter earnings that were above expectations. JPMorgan Chase is the first large banking organization to report earnings with many analysts expecting a strong report. During the second quarter of 2009, JPMorgan Chase reported \$0.28 in earnings per share. The consensus forecast appears to be \$0.71 per share for the quarter ending June 2010.
- Retail sales and manufacturing inventories are reported today. The FOMC also releases its minutes for the June meeting.