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Global, US and China Issues

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Donald H. Straszheim

Donald H. Straszheim is principal of Straszheim Global Advisors, Inc.; Vice Chairman of Roth Capital Partners in Los Angeles; former global Chief Economist at Merrill Lynch and Co. in New York; Visiting Scholar at the UCLA Anderson School of Management; an advisor to Main Management and to Hathaway-Nguyen Asset Management; a contributing columnist to *Forbes.com* and Shanghai's *21st Century Business Herald*, and a long-time US and global economist as well as a China specialist.

Following a long career as a US and global macro economist and strategist, Straszheim turned his attention in the mid 1990s to China and Asia. A regular visitor to China since 1985, he has focused most of his attention since 1997 on understanding China's economic development and its effects on financial markets, companies, industries, sectors and policy in America and elsewhere. He speaks and writes regularly on China, Asia and the US -- economy, markets and policy.

In 1981, he joined Wharton Econometrics, the analysis firm at the University of Pennsylvania's Wharton School of Finance, rising to the position of Chief Economist under Nobel Laureate Professor Lawrence R. Klein.

From 1985 to 1997, Straszheim served as global Chief Economist for Merrill Lynch and Co. in New York where he was voted ten consecutive years to *Institutional Investor's* 'All-Star Team,' Wall Street's most prestigious award. As Merrill's chief economic spokesperson, he represented the firm globally and led its worldwide economic research effort, splitting his time between the institutional businesses, private wealth management, investment banking and the senior management group.

From 1997 to 2001, he was President of the Milken Institute, a not-for-profit economic and public policy think tank in Santa Monica, CA, continuing as Vice Chairman to 2004. He originated the well-known Milken Institute Global Conference series as well as other programs and research initiatives.

In 2001, Straszheim founded and to this date remains the principal of Los Angeles based Straszheim Global Advisors, Inc. an economic and financial markets consultancy. From 2002 to 2004, the firm also had offices in Beijing.

In 2006, Straszheim was appointed Vice Chairman of boutique broker/dealer Roth Capital Partners to spearhead the firm's new China initiative. In under three years, China has become a significant portion of the firm's business with offices in Shanghai as well as in the U.S.

Currently Straszheim also serves on various public- and private-sector boards and is a past President of the Los Angeles Society of Financial Analysts. He is an active member of the Advisory Board of the Asia Society in Southern California.

He earned B.S., M.S. and Ph.D. degrees from Purdue University, and is a regular public speaker as well as media commentator on CNBC, Fox, Bloomberg, NPR and other outlets.

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Credit Crisis - 2008

Events keep moving and all is not yet decided. London and Europe have forced Washington's hand toward bank nationalization and public injection of funds to unfreeze the credit markets. More blow-ups are likely, but the issue is being resolved. Both presidential candidates continue to flounder on this, without a clue – just like Congress. Wall Street and the US banking system are being utterly transformed. Fundamental financial sector reform is urgently needed in 2009. Sadly, a zillion bad decisions have us on the verge of a nationalized banking system. Ugh understates it.

- Washington became obsessed in the later Clinton years with trying to drive ever higher homeownership rates. Many unqualified were given mortgages. They failed. Now we are all painfully trying to restore equilibrium. House prices, wealth and incomes have to be brought back into alignment. It will still take years.
- Culpable? Lax regulation, politically-correct Washington, greedy mortgage brokers and Wall Street, inadequately skeptical investors, unrealistic home buyers.
- Core of crisis is now commercial banking. No lending or inter-bank lending. Frozen globally. First time in modern era. Partial nationalization of commercial banking in every important country. Rules? Very undesirable. Inefficient. But we have been driven there. Big risks. How well thought out? Unintended consequences. Need for global coordination of financial rules, regulations. Highly contentious. A tangle.
- Bear Stearns failure in March 2008 was a total game changer -- with the Fed extending 'lender of last resort' protection to a securities firm for the first time.
- Gvmt reforms coming with individual firms' behavior regulated so they are unable to create systemic risks. This means the 'securities firm' model of 2000-08 is dead.
- Valuable services still with good long-term prospects – raising capital, M & A, advisory, private wealth management, and institutional sales and trading.
- The 30x leverage of recent years which dominated the bulge-bracket firms is over. Washington DC, post 1-20-09, is going to focus heavily on more regulation.
- Bear, LEH was next. MER captured by BAC. GS and MS were in line, but now are 'banks.' The new GS won't look like the old GS. What other evolutions occur?
- Fannie, Freddie had mixed objectives – profit making or public service. Hope we learned our lesson. Foreigners had agency paper right – it was 'money good.'
- Implications of the unprecedented global financial rescue still unclear. More or less comfort or trust? We have passed the point of no return. Hard to over-emphasize the significance of a nationalized US banking system. How damaging? Invites far more DC interventions. Hopefully our other entrepreneurial instincts will sustain us.

US – Economic Outlook 2008-10

As the global credit crisis gradually gets resolved, the US economy has fallen into its most serious postwar recession. Features – 100% revamped financial-sector rules, new leadership in DC, and a ‘back to the past’ era of much less leverage. US real GDP potential is probably at least one percentage point less than before – a big deal.

- My view – we have been in recession since January 2008. For most of us, if we have a job we are OK. If not, we are not OK. Jobs are down since January 2008.
- Job losses in the 100-200k per month well into 2009 coming. We need 125k per month new jobs to keep up with labor force growth. I see 8-9% unemployment rate.
- Holiday selling season to be the worst in 25 years. Job security down. Wealth losses in housing and equities. Scared. Save, don't spend. This is good -- not bad. Real consumer spending down in 2008Q3 and 2008Q4, probably much of 2009.
- Housing prices not bottomed yet. Another 10-20% dip to come. First victims are toast. Next victims are those being caught in evolving cyclical downturn. Must get prices, wealth and income back into alignment. Home equity loans? – forget it.
- Commercial real estate also overextended. Consolidation here for years as well. Too much capacity; too expensive; inadequate leverage to continue on old path.
- Capital spending also retrenching. Technology and new products; not much else.
- Watch ISM data, for both manufacturing and non-manufacturing. Sensitive, timely, best early indication on present/upcoming business activity, jobs, orders, pricing.
- Fed likely to keep lowering Fed Funds rate, probably to 1% at next meeting. Doing all they can to reflate, rescue economy. Money velocity will be far less in lower leverage environment, so inflation a distant fear. Oil and commodity prices down.
- Earnings estimates far too high for very weak 2008 and 2009 in many/most sectors.
- Equities bottomed with US/global policy consensus on credit crisis response. Now the issues are recession, and who leads in new slow-growth era. Long-term, equities still do best. ‘Death of equities’ exaggerated in 1974, and in 2008 as well.
- Pension-return assumptions throughout the US are too high for slower-growth, less leveraged economy. Troubling, will again encourage ‘reaching for returns.’ Danger.
- Washington looks like it is going to prop up autos with public \$s. Big mistake. Autos don't play an across-the-board role in the US like the financial sector does.
- US budget mess. Overcommitted. Partisanship rules. State/local is even worse.
- Risk. DC turns much more protectionist. Lots of talk about punishing China. If we act, China can be counted on to counter-attack. They don't want our lectures.

Global Economic Outlook 2008-10

Economic activity in recent years has become truly global, with international trade, multinational companies dominating many (most) sectors, cross-border capital flows and foreign direct investment, raw material commodities sourced everywhere, and technology and talent increasingly mobile. The US credit crisis, infecting all financial markets worldwide, and involving every country's financial officials, proves the point.

- World real GDP rose the fastest in recorded history in 2003-07, average 4.7%. A billion people out of poverty with investment, real jobs and a rising standard of living.
- World growth in 2008, 3.5% (our estimate), much slower. US, Europe and Japan all in recession. Developed and developing are all weaker than last year. Credit freeze-up has hurt all economies, large and small, developed and not, and market troubles have caught all in the web. No one left out. Recovery will take time.
- 2009 also weak globally, at about 2%. Our estimates are well below those of IMF.
- 2010 better, at about 3%. With less leverage, we see 2011-15 growth 3.5%, still under the 2003-07 record. Consider this in jobs, incomes, earnings, investment.
- Eurozone unable to react rapidly in unified way because of no comprehensive governmental authority – 1 currency, but 15 countries. Aging, a slow-growth future.
- China's economy is slowing, 9.5% in 2008, 7.0% in 2009, versus 10-11% in 2003-07. Still, fastest in world. China increasingly confident of her 'go her own way' path.
- India growth slowing, to 7.0% in 2008 and 5.0% in 2009. Lack of commitment to infrastructure and pro-market reforms and to long-term planning evident in China.
- Russia may lose out as a "BRIC" country with issues rising on Russia's resolve for market rules. An extractive economy, investors are understandably afraid.
- Brazil remains the standout opportunity in Latin America.
- Africa is still making great strides, but from nowhere. China is colonizing the place. Still, lots of problems – domestic and geopolitical. Instability is hard to deal with.
- WTO still plays a limited role as arbiter on trade rules. More important is for the global financial system to become more integrated with consistent rules.
- Commodities – manufacturing fuel -- are a rising concern as they help to lift the developing world's living standard. Energy security is a key specific example.
- Global trade is more unbalanced than at any time in postwar era. Troubling. Note that largest imbalance is with China – that will not let its currency be market priced.
- Sovereign wealth funds are a new powerful force in global economics. China by far the biggest, most powerful. Worrisome that they might have non-market intentions.

China — Near Term Outlook

China's economy is slowing considerably in 2008, to the weakest rate since 2002 in response to the slowdown, troubles in the US, Europe and Japan. But growth should still be the world's fastest. Inflation, still high, is secondary concern.

- Credit crisis in US, spreading globally, hurting China. Has policy makers' attention. Banks, PBOC own US agency paper. New, unwelcome drag on their economy.
- Beijing view -- We run our economy our way; no need to listen to American ideas.
- Concern starting 2008 was economy too hot, inflation too high, funds too many. But worsening global credit squeeze and near-recession in US, Japan and Europe has yielded slower China exports, growth slowdown and 180 degree policy reversal.
- Real GDP, 2007 = 11.9 %. We expect real GDP to be, 2008 = 9.0%, slowest since 2002 reflecting weak US, Japan, Europe, elsewhere. But industrial production, fixed investment suggesting considerably weaker. We are watching this – data credibility?
- China has poor economic management tools; increasingly dangerous as China still heavily state-driven economy but they more tied to global economic ups and downs.
- Olympics lesson was 'control works.' Re-emphasizing retaining "absolute control" in many industries, giant SOEs dominant. Carefully limit foreign M&A where desire.
- Inflation +8.5% year ago, peaked, still above 4.8% 2008 official target. Food, energy, other commodity prices plus wage pressures. Non-food and food CPI improving. Beijing relied much on price controls during recent inflation. Discouraging.
- Equities in Shanghai ugly. From 6,124 peak, 10-16-06 to under 2000 recently. Up, down much like Nasdaq 1999-2000. Foreign conditions directly hurt China. No lasting upturn until external (and internal) econ/market conditions stabilize, improve.
- Retail/consumer sector up 8-9% real. About half of economy, smallest share in world. Few good savings vehicles. Rising incomes creating Chinese shoppers.
- Real capital formation (China's investment account) up 13-15% again in 2008. Driven by SOEs and state-owned banks. FDI inflows slowing – don't need capital.
- Forex reserves, \$1970 billion July 2008, to \$2300 billion by end-2009. Global trade tension up. Over 50/50, Washington DC sharp anti-trade turn January 2009? Ugh.
- Currency? Made in Beijing. 95% managed; 5% floating. CNY6.83/\$ now. We see CNY6.80-6.90/\$ end-2008; CNY6.50/\$ end-2009. Trade still is #1 growth driver in China. They have the jobs, tech, new skills; we get the goods.
- China economic ties with Taiwan stronger with Taiwan election. China pushing more global trade deals – Africa, Latin America, Middle East, etc. Positive; not negative.

China — Long-term Fundamentals

China's best-in-the-world economic growth record to continue, albeit slowing, in coming years. Has evolved an economic development strategy different from those in developed countries – and with great success. Greater global role means China more market sensitive, but state-controlled entities to remain dominant.

- China is the dominant global agent of change. G-2 is China, US. China has become a global player — but not ready to give up power to the invisible hand of markets.
- Beijing wants state-owned enterprises to be their economic “mainstay.” Many big sectors remain largely closed to major foreign competition. Goal is to re-invent SOEs so they can compete outside China. We expect few to be successful overseas.
- Beijing wants to use foreign technology, talent and capital, while still restricting the role of many foreign firms inside China. This will be increasingly contentious.
- Official Beijing is talking more of other economic issues besides GDP growth -- environment, energy and commodity security, healthcare, income inequality, migration, inland development and moving the economy up the value chain.
- Rising income remains all-important to China's leaders as it is all-important to the people. Beijing will be held to account if the standard of living increases stall.
- Investment still growing 15% per year real. Driven by state-owned sector and public decisions. Sadly, much inefficient asset allocation remains. Consumer sector is half of economy, lowest in world. Consumer, 8% gains, a falling share of total economy.
- Foreign direct investment inflows still big – bringing in capital, technology, talent.
- Currency? Made in Beijing, still. 95% managed; 5% floating. To continue. China's “weak currency strategy” is at heart of their growth, development plans. High domestic inflation will continue to force gradual currency appreciation.
- Trade? China has jobs; investment; takes in \$s. US buys, gets cheap goods. Until either/both sides say no, current circumstance will continue. Trade is key. Many countries are getting angry with China's export stance. A trade collision is coming.
- Japan-China ever closer economic ties (trade, capital); relations are improving. Economy #1 to both. Taiwan-China economic ties tighter. Positive news here.
- China working hard at building long-term global economic relations — Africa, South America, middle East. Every new global-China economic link is a big plus.
- Migration, rural to urban (17 million annual next decade) driving industrialization. Faster growth urban over rural, and inland cities. Rural areas depopulating is OK.
- Demographics aging fastest in the world. Births below replacement rate. And an unprecedented (in world history) gender imbalance developing. Consequences?

China — Equities

For the first time, in 2007-08, China's domestic equity markets are being affected by economic and financial events outside China as well as inside. Those same events are moving equities of both Chinese and non-Chinese companies traded outside China. This is the new reality of China growing and maturing into global significance.

- Shanghai Composite down from all-time bubble high 6124 on 10-16-07. Broke below 2000 last week (down 69%). Beijing now working to lift equities.
- 2005-07 mania – free money. Investors taking funds from banks. Like other global manias. Local investors' naïve. Gambling, hoping, not investing is descriptive term.
- October 2007 market top, factors; US/global credit crisis, fears of global/China slowdown, China interest rates up, rising China inflation, oil/commodity prices.
- September 2008 bottom(?) factors; US credit rescue plan works(?), China monetary policy eased, inflation peaked, currency appreciation ended, stamp tax cut, gvmt taking other steps (slow the share unlocking, Beijing direct stock purchaser, etc.)
- We see China GDP slowing to 9.5%, but still OK. At these valuations, hard to imagine a global/growth investor without major China exposure.
- SHA EPS, 2006 = +27%; 2007 = +45y%. 2008 = +12%. 2007 big upside from bull market and cross-holding equity shares. In 2008, we see minus 13% from cross holdings, +25% from operations. Note big equity market leverage in equity EPS.
- SHA P/E peak 2007 = 47, reflective of the mania. Recent P/E 20. Reasonable with global situation, China prospects. If P/E flat at 20, SHA +10% by end 2008.
- SHA a 'policy market' – gvmt intervenes to make stocks rise. SHA still 90%+ state-owned enterprises (SOEs). Beijing wants upward bias to push out SOE IPOs.
- Investing in Chinese SOEs? Caution on massive distortions from gvmt intervention (oil now). Gvmt can and does protect SOEs against competition – very valuable.
- China companies, with no state ownership, listed in US remain best insulated. US accounting, standards, market rules, governance. Way to enjoy China best-in-world economic growth with global protections. Also US/foreign firms operating there.
- HK a real market, great way for foreigners to play China. 28 of 43 companies in Hang Seng Index are China companies; remaining firms are heavily China centric.
- Qualified Domestic (and Foreign) Institutional Investor systems (QDII and QFII) still small but gradually enlarging, letting Chinese investors out, foreign investors in.
- CSRC slowly pushing market reforms. Rumors of allowing margin trading. No shorting still. Stamp tax reduced from 0.3% (world's highest) April 2008 to 0.1%.

China — Financial Sector (ex Equities)

Compared to investment, manufacturing and trade, China's financial sector remains its weakest link. Made great progress – but still so far to go. Strengthening finance, an ongoing process, with more talent, technology and market practices, is paying off.

- Biggest shortcoming – China doesn't yet have the experience, talent or technology required in modern financial markets. Within China's still-dominant state sector, it will take decades to develop. Beijing still nervous of global-market involvement.
- Massive, near fatal credit crisis in US means China will be highly reluctant to listen to US suggestions. American filings so fundamental – Beijing is shocked.
- China's big-4 state-owned banks are less 'banks' than they are commercial/lending arms of the government. Consolidation in China banking continuing. Progress on credit cards, checking, debt markets, on and on.
- PBOC multiple hikes in interest rates and reserve requirements in 2007-08 before reversing in September 2008. Real monetary lever in China is PBOC loan quotas.
- Lift to growth if capital went to expected highest returns. China has a monetary 'result' more than a 'policy.' PBOC does not operate independently. Nothing does.
- Various restrictions remain on foreign bank operations despite China WTO entry and associated pledge to open up on December 2004. Openness has its limits.
- China Development Bank (a 'policy' bank) and Postal Service taking on more bank-like features. Agricultural Bank of China (rural) just too far behind to ever catch up.
- China Investment Corp (CIC), their sovereign wealth fund (SWF), to invest forex reserves overseas. Forex inflows still \$300+ billion – FDI, trade. CIC absent as buyer in latest US credit crisis, burnt on Blackstone stake, petrified of US current credit crisis. China holds \$200+ billion in Fannie, Freddie. Many foreign governments will resist majority positions by CIC. Most are concerned about CIC's lack of transparency, possible non-financial investment objectives.
- How SWFs use their reserves is the top global economic/financial sector story of the next decade. CIC opening offices in London and NYC. Expect CIC to take passive positions mostly. Also more in PE funds, and to give \$s to overseas fund managers.
- SAFE (State Administration of Foreign Exchange) becoming more active as a global investor, like CIC. 'Hot money' flows, outside trade and FDI rising, very troubling.
- Chinese citizens now allowed to buy up to US\$50k in foreign currency every year, up from US\$20k earlier. More liberalization coming; a major positive.
- Weak accounting standards, oversight, talent shortage a constraint. Needed even more – get on board with global rules, practices. Big long-term gain; no cost.

China — Industries and Sectors

Remember, industries seen as 'strategically vital' are protected (to varying degrees) against foreign competition. This concept is dynamic. Regulations, rules that help/hurt are made by municipalities, provinces and Beijing. Most sectors growing slower in US than in China. China still needs technology, talent. JVs and M&A coming in. Chinese private-sector companies the most dynamic, need financing \$s and expertise.

- **Environment.** Protection/remediation the best growth sector for foreseeable future. Most polluted in world; China knows must clean up. Key; no old legacy companies to protect from international competition. Sector is quite open to overseas firms.
- **Commercial banking.** Banks still largely 'lending arms' of government. Beijing focused on modernizing, learning. All of finance remains China's weakest link.
- **Infrastructure.** Essential for growth; a priority. Highway/rail grids, air/sea ports, subways, sewer, water, electric power and grid, flood). Need steel, cement, E&C.
- **Commercial real estate.** Driven by SOE bank lending, big overhand now. Second-tier cities (1-5 mil) the best prospects, inland cities. Big cities overbuilt.
- **Oil, other energy.** World #2 oil consumer. Modernization driving demand. Big imports. Looking for oil overseas. Best opportunities in new energy tech – clean coal, nuclear, hydro, some gas. Big interest in alternatives – wind, solar, etc.
- **Steel, other commodities.** SOEs dominate. Demand still big via mfging for trade, infrastructure, construction; but supply (govmt decisions) even bigger. Risks here.
- **Transportation, logistics, travel.** Key with growing trade, industrial and inland development, procurement. Multi-national firms need these capabilities in China. Chinese firms need these to serve global markets as well as local.
- **Health care.** Public system largely broken down in reforms of last 3-5 years. Growing demand from wealthier consumers; opportunity from public system failure.
- **Macau.** Gaming bigger than Vegas. Best opportunity; all that goes with gaming.
- **Telecomm.** Government is in charge. Wire, wireless merging. Internet. Not just individuals, but businesses rapidly adopting telecomm, processing, new practices.
- **Retail.** 'Middle class' 2008 = 250 million; 2015 = 650 million. As incomes rise, Chinese want to consume. More durables, services. Sector is relatively open.
- **Agribusiness.** Herbicides, pesticides, hybrids, fertilizer, equipment. Richer population means diets change, upgrade. Grain demand for fuel a big, new factor.
- **Automobiles.** China world #1 auto producer by 2012. Exporting to the US by then. All world car companies will have a JV of some sort with a Chinese auto maker.

China — Energy

The energy sector in China is regarded as 'strategically vital,' protected (to varying degrees) against foreign competition. Beijing decides everything. All energy decisions start with three issues – jobs, environmental impacts, and geopolitical energy security.

- China's incremental energy demand greater than any other country in the world over the last decade. Oil would not be \$100+/barrel without China's big demand.
- Coal, dirty, is 70% of China's primary energy, highest in world. Coal's world average is 28%, hence China's interest in clean coal tech. Massive effort to get share down to 60% in 20 years. Exports, imports in balance now, but far larger future imports.
- China welcomes foreign technologies in clean coal and all other environmental issues related to energy. They have the problem, but don't have the technology.
- Oil is 21% of China's primary energy, below world average of 36%. China oil production 4.0 mb/d; few see any real rise. Consumption 8.0 mb/d, and rising 0.5 mb/d annually. Rapidly rising import bill – China's top international concern.
- PTR, SNP and CEO (all traded NYSE, n/r), SOEs, dominate the oil industry. Foreign firms; OK to bring in new technologies or capabilities, but big multinationals that might represent a threat to the top SOEs – '...if we need you we will call you.'
- Huge recent market distortions from retail price controls (to keep inflation down, mistake) but crude prices are set worldwide. Gvmt cost; \$30-40 billion in 2008.
- L/T plan, to use oil for only two things by 2015 – transportation, and petrochemical feedstocks. Should largely make this goal. Building above-ground SPR; ½ done.
- Nuclear, 1% now. China launched, 2004, world's largest ever nuclear power program. First nuke online in 1991; 11 operating now. Plan is 40 by 2015-20.
- Hydro is 5% of China's primary energy. Biggest untapped hydro says more construction coming. 3 Gorges Dam built for electricity, flood control and irrigation. Electric power grid and railroads for coal transport are big electricity shortcomings.
- Natural gas, 3% of energy versus 24% worldwide -- another obvious dirty-air clue. Building pipelines and LNG port facilities. LNG is not China's energy future.
- Various renewables have China's attention, but are too small to matter at present as is case in every poor economy. China wants to lead world in wind and solar. Beijing pushing R & D hard here in future. Big untapped geothermal reserves.
- Economic growth is yielding better energy efficiency in the usual historical pattern. If China's annual growth is 9% for next 5 years, energy growth about 6%.
- Not a member of International Energy Agency (IEA), 24 countries. So, weak data.

*What I learned from Economists was:
“October....is one of the peculiarly
dangerous months to speculate on
stocks in...*

Mark Twain

*The others are July, January,
September, April, November, May,
March, June, December, August and
February.”*

Mark Twain

Credit Crisis 2008

Global – Potentially More Serious than 1930s

- **Housing Excesses. Plenty of Blame. Politically Correct DC. Homeownership. Years to Equilibrate**
- **Leverage Killed Securities Firm Model. GS? MS? Must Protect Public from Recent Systemic Risk**
- **Problems Spread Widely. More Pitfalls Coming**
- **Europe, UK Forced US Hand – Near Nationalization of Banking. Inefficiency. Rules? Execution? End?**
- **2009+ Redo US Financial Regs. DC Intrudes More**
- **Equity Bottom Made. Quality Firms L/T Winners**
- **Fortunes Are Made at Bottoms, Not at Tops**

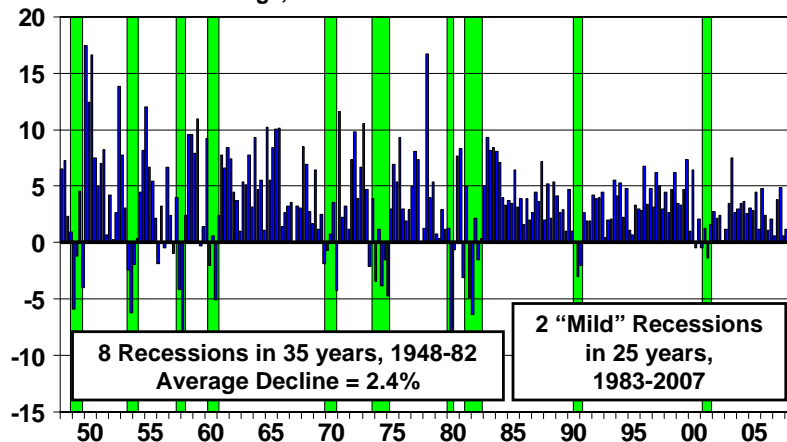
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U.S. Economy Is Less Cyclical

Real GDP Percent Change, SAAR



Source: Department of Commerce

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Postwar U.S. Recessions and Recoveries

Dates and GDP Change, Peak to Trough

<i>Recession Start Date to End Date</i>	<i>Recession Duration (Months)</i>	<i>Real GDP Decline % Change</i>	<i>Subsequent Recovery Duration (Months)</i>
11/48 to 10/49	11	-1.6%	45
7/53 to 5/54	10	-2.7	39
8/57 to 4/58	8	-3.7	25
4/60 to 2/61	10	-1.6	105
12/69 to 11/70	11	-0.6	37
11/73 to 3/75	16	-3.4	59
1/80 to 7/80	6	-2.1	12
7/81 to 11/82	16	-2.9	92
7/90 to 3/91	8	-1.5	120
Average	10	-2.2	59
3/01 to 1/02	10	-0.6	61

Source: NBER

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The U.S. Situation – Autumn 2008

Big Shortfall, Output vs. Potential. A Long Weak Spot

- 1-08 'Recession' Began. Jobs. Consumer Weak. Housing Struggles. Commercial Real Estate Down
- L/T Leverage Contraction. Future Growth 1% Less. Wall Street, Banks, Finance Never the Same Again
- Profits Way Down. Fed to Do More. No Inflation
- Exports Up. Dollar Lift Temporary. Protectionism
- US Budget, Partisanship. DC After 1-2009. Global Standing. State/local. Entitlements. Time Horizon
- Ongoing Strengths – Technology, Entrepreneurial, Labor Mobility, Institutional Capital

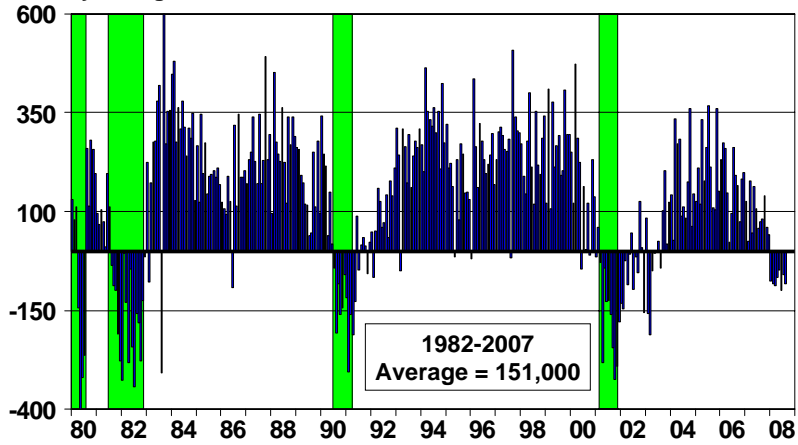
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'Headline' Payroll Employment

Monthly Change, Thousands



Source: BLS

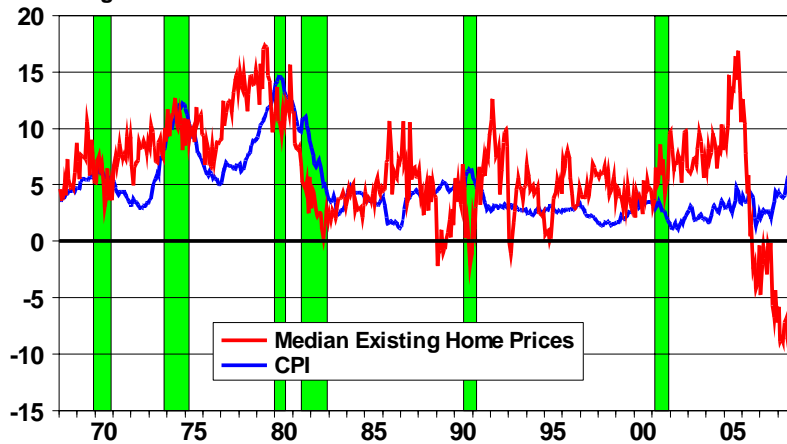
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Housing Inflation and CPI

% Year Ago



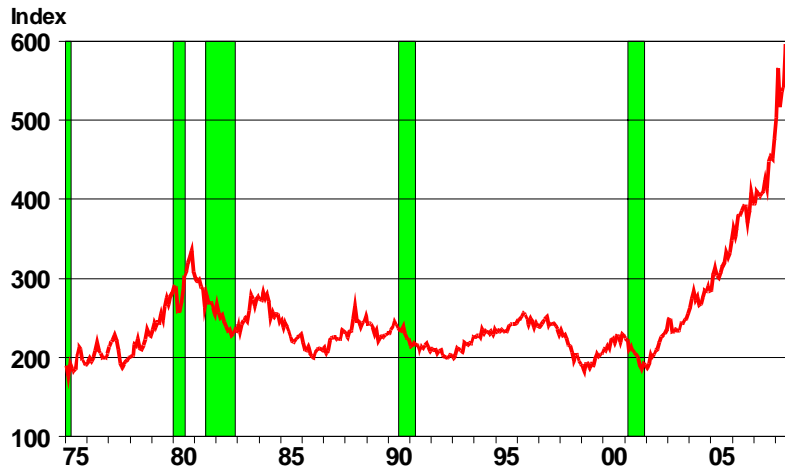
Source: NAR, BLS

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Commodity Prices– CRB Index



Source: CRB

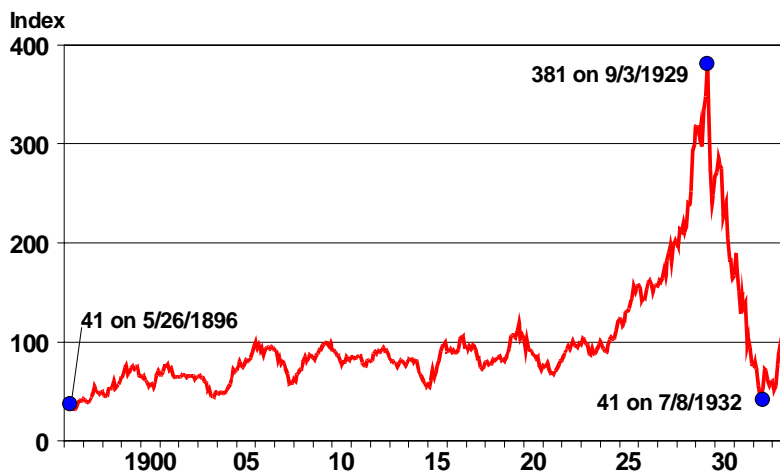
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ROTH CAPITAL PARTNERS

Flat for 36 Years

Dow Jones Industrial Average



Source: Bloomberg

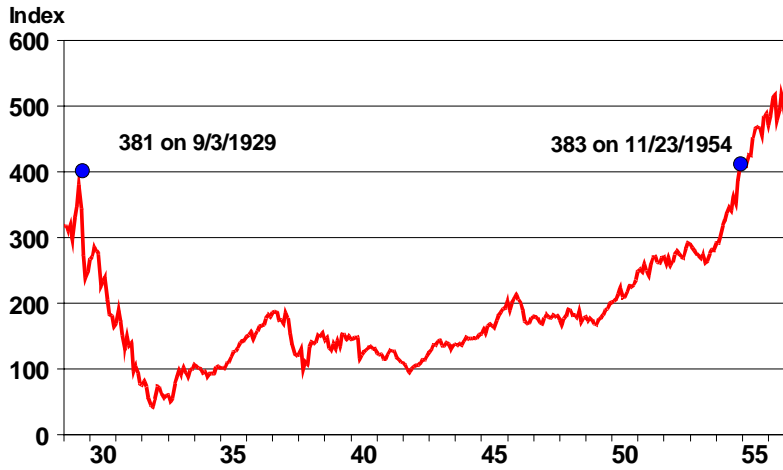
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ROTH CAPITAL PARTNERS

25 Years to Recover

Dow Jones Industrial Average



Source: Bloomberg

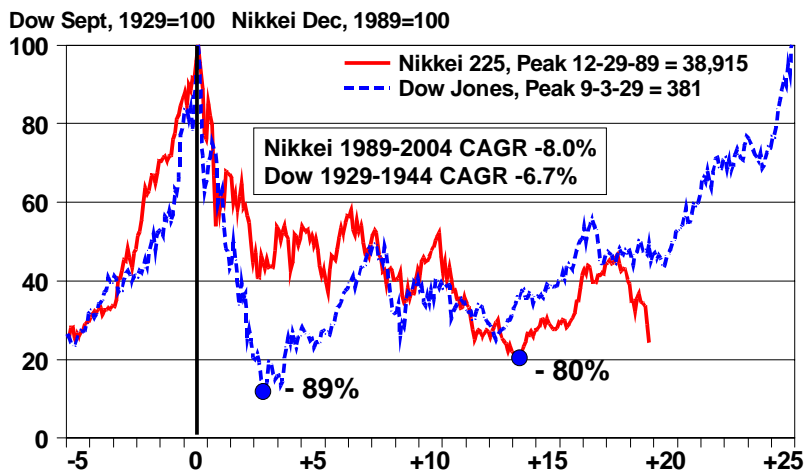
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ROTH CAPITAL PARTNERS

Equities In Japan and America

US 1929-54 and Japan 1979-04



Source: Bloomberg

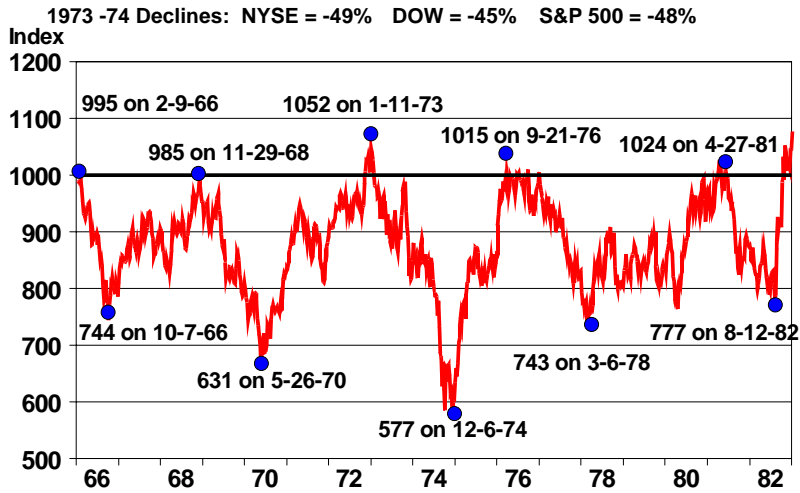
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ROTH CAPITAL PARTNERS

Hard to Break 1,000

Dow Jones Industrial Average



Source: Bloomberg

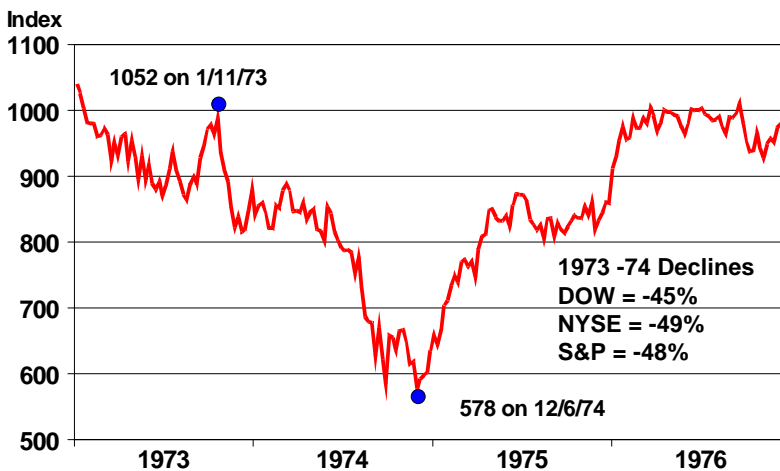
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ROTH CAPITAL PARTNERS

“I’ll Never Own a Stock Again”

Worst Bear Market Since 1929-1932



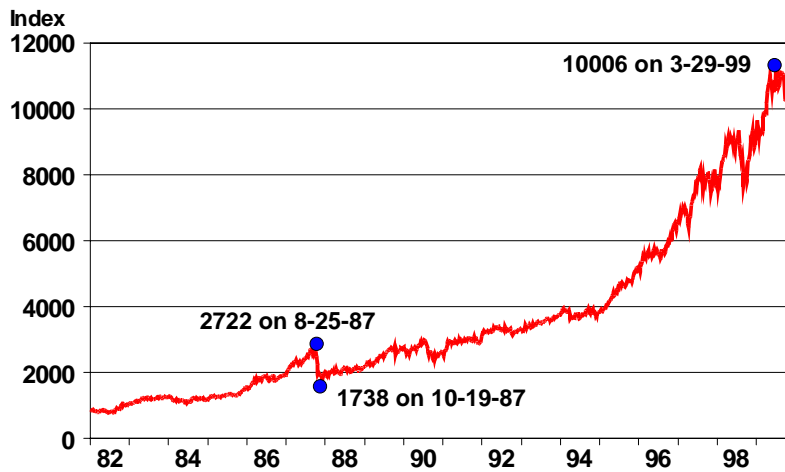
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ROTH CAPITAL PARTNERS

1982 - 99: Bull Market 18 Years

Dow Jones Industrial Average



Source: Bloomberg

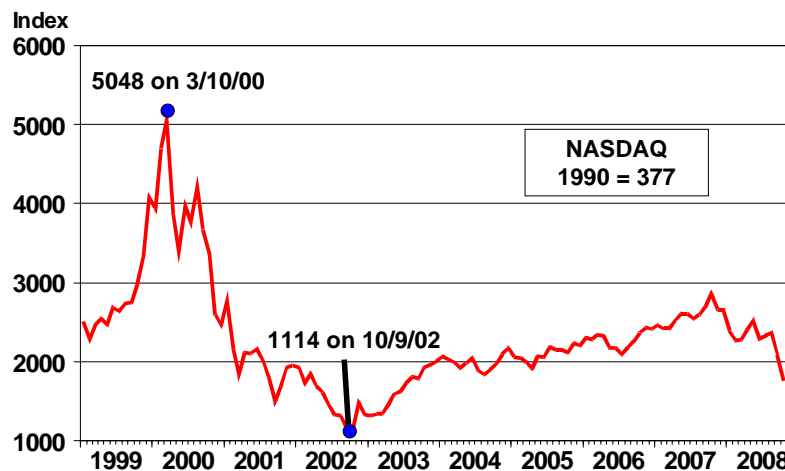
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ROTH CAPITAL PARTNERS

2000 - 2008: Tech Mania -- And Then

NASDAQ Composite Equity Index



Source: Bloomberg

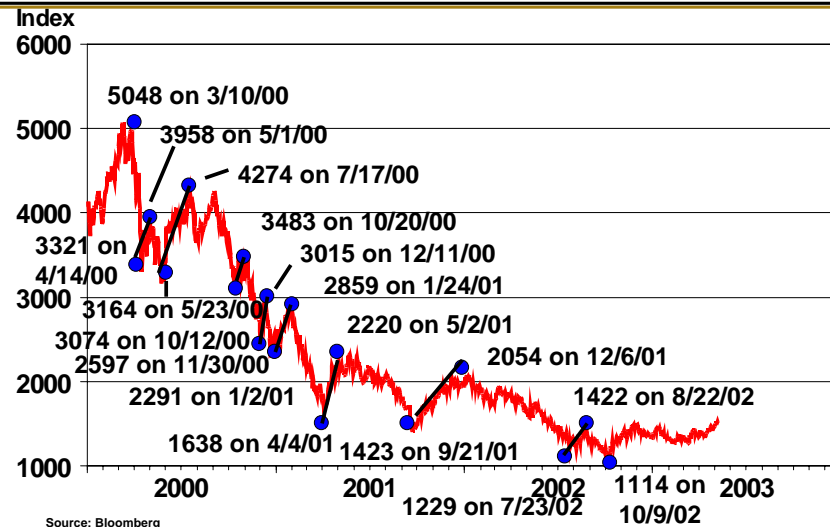
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Eight False Bottoms, 2000 to 2002

NASDAQ



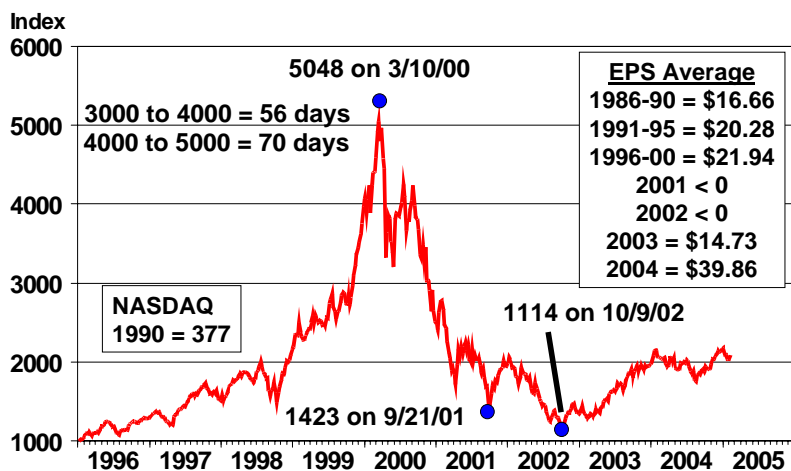
Source: Bloomberg
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Tech Mania – Fun While It Lasted

NASDAQ Composite Equity Index



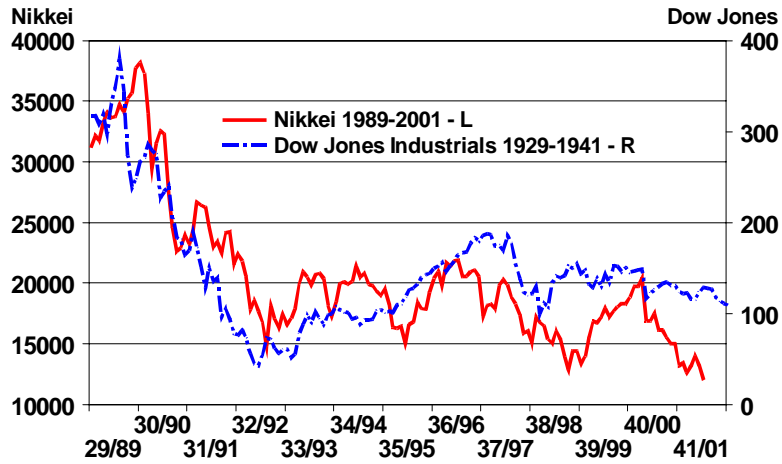
Source: Bloomberg
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Comparable Equity Market Cycles

US 1929-1941 and Japan 1989-2001



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S&P 500 Equities

Index, EPS, P/Es, Dividends

	Year End Index	Reported EPS, \$	Reported P/E	Dividend Yield (%)
1996	741	38.73	18.2	2.01
1997	970	39.72	22.1	1.60
1998	1229	37.71	27.8	1.32
1999	1469	48.17	28.4	1.14
2000	1320	50.00	23.5	1.23
2001	1148	24.69	29.6	1.37
2002	880	27.59	19.1	1.83
2003	1112	48.74	20.3	1.56
2004	1212	58.55	17.9	1.60
2005	1248	69.93	16.3	1.78
2006	1418	83.11	16.2	1.75
2007	1468	73.05	18.7	1.85

Source: S&P

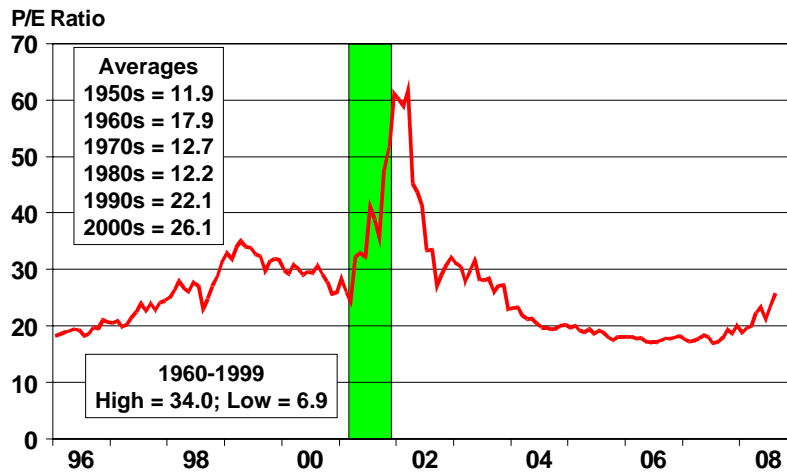
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ROTH CAPITAL PARTNERS

S&P 500 P/E Ratio

Price / (As Reported) EPS, 4Q Trailing Sum



Source: Bloomberg

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ROTH CAPITAL PARTNERS

World Real GDP Growth

	<u>1995-99</u>	<u>2000-04</u>	<u>2006</u>	<u>2007</u>	<u>2008*</u>	<u>2009*</u>
World	3.7	3.9	5.4	4.9	3.5	2.0
China	9.1	9.2	11.6	11.9	9.5	7.0
India	6.6	5.8	9.2	8.9	7.0	5.0
ASEAN	2.5	4.9	5.0	5.5	5.5	3.5
U.S.	3.9	2.5	3.3	2.2	0.0	-1.0
Euro Zone	2.3	1.8	2.6	2.6	0.0	-1.0
Japan	1.3	1.5	2.2	1.9	0.0	-1.0
Africa	3.5	4.0	5.5	6.0	5.5	4.5

Source: IMF, Roth Estimates

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* = Estimates

ROTH CAPITAL PARTNERS

The Global Situation – Autumn 2008

New Down Cycle Unfolding – US Credit Cycle Infected All

- 2003-07, Fastest Growth of Postwar Era. It's Over
- Billions Better Off (Poverty), New Global Order
- Rising Globalization, Nationalism , 'Control States'
- US, Japan, EU in Recession. Infected Everyone
- All Fighting Financial Problems, Slowdown. US No Longer the 'Model.' Finance Largely Nationalized
- Inflation Control Secondary. Trying to Coordinate
- Global Scramble for Access to Resources, SWFs
- US Global Leadership Sharply Diminished

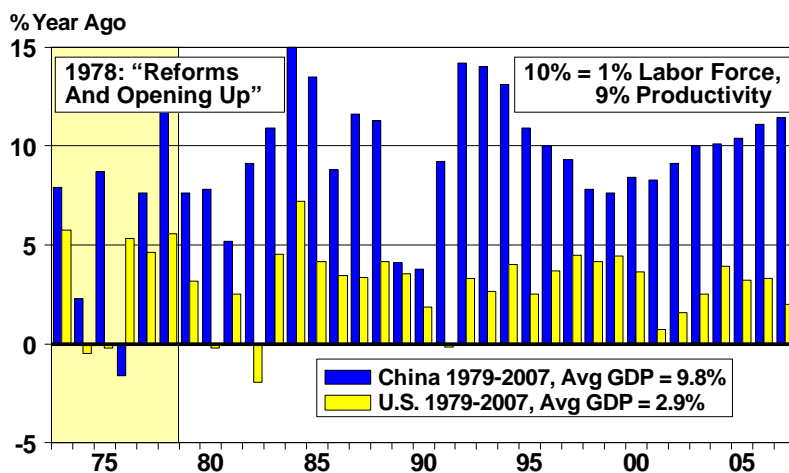
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Is China's Growth Real? Sustainable?

Real GDP Growth China vs. U.S.



Source: China NBS, US Dept of Commerce

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China Building a Different Economy

Capitalism Only Where China Wants It – Lots of Planning

- **How to; Bigger Global Player -- But Keep Control**
- **Great Sustained Growth Record. Confident in Own Path. Little Interest in Western Lectures**
- **Gvmt Economic Dominance to Rise, Not Fall**
- **Consolidate SOEs to 80-100 Globally Dominant 13 Sectors Strategically Vital (*Armaments, Power Generation/Dist, Telecom, PetroChem/Oil, Coal, Autos, Aviation, Shipping, Machinery, InfoTech, Non-ferrous Metals, Construction, Iron/Steel*)**
- **Global Acquisitions, JVs. New Colonial States**

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China Outlook – Post Olympics, L/T

July 2008, Biggest Economic Policy Shift in 5 Years

- **Olympics Lesson – Control Works, Listen Politely**
- **GDP Growth Too Slow – Stimulate Growth**
- **Export-Sector Weakness, Job Creation Concerns**
- **GDP 8 – 9%, 2008Q2 thru 2009, vs. 11.9% = 2007**
- **Inflation Priority Is Second. Rising Costs in PPI**
- **Monetary Easing, More Loans, Rate Hikes Ended**
- **Exchange Rate On Hold for Now, CNY6.80-6.90/\$**
- **Equities – Direct, Indirect Efforts to Stimulate It**
- **L/T, Still #1 World Real GDP (8-10% Sustainable)**

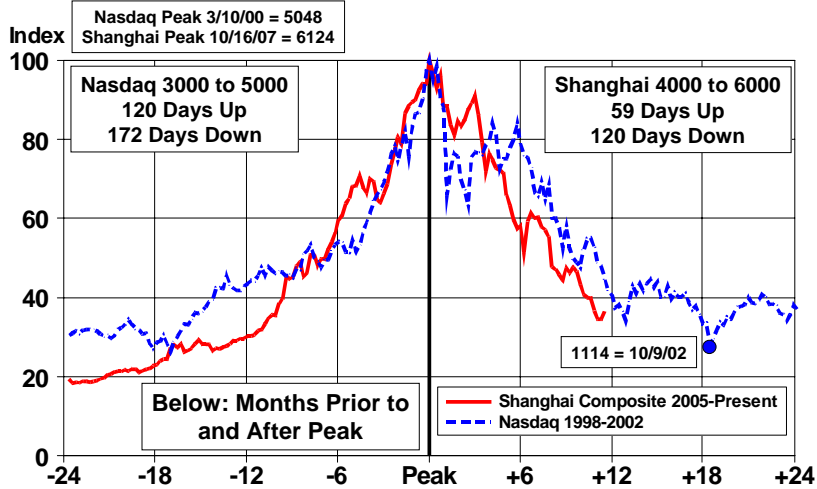
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Bubbles; Shanghai and Nasdaq

Both Indexed to 100 at Peak



Source: Bloomberg

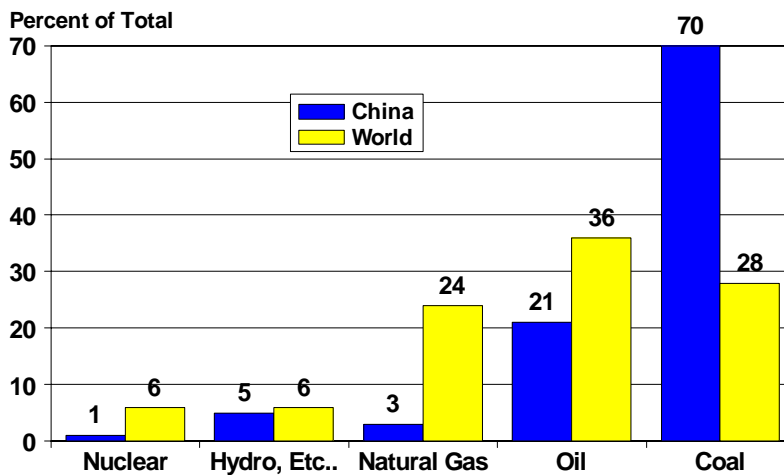
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China- World Energy Sources

Shares of Total Energy Supply, 2007



Source: British Petroleum, Roth Estimates

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Energy and Environmental Issues

Shares, Efficiency, Adjustments, the Environment

- **Global Consensus – Imprudent to Keep Ignoring**
- **Poor Are Energy Inefficient, Environmentally Dirty**
- **‘Self-sufficient’ Mentality; All Commodities; SOEs Dominate; New Colonialism Is Contentious**
- **Fuel Mix Varies Greatly Around the World – Key to New Energy and Environmental Decisions**
- **Reworking Global Energy Markets Worldwide**
- **E. & E. Focus Is Changing Inputs, Jobs, Locations, Strategies, Costs, Partners, Competitors**

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China Issues Below the Surface

But Remaining ‘Top of Mind’ in Beijing

- **Ongoing Growth Is Key to Stability, Control**
- **Democracy No. Better Government Yes**
- **Develop Better Economic Management Tools**
- **Upgrade their Weakest Link – Financial Sector**
- **State-sector Dominates. Capitalism ‘Lite’**
- **Global Relations and Influence -- Everywhere**
- **Seeking New Economic Drivers Beyond Trade**
- **Retain L/T Focus – Environment, Energy, Infra**
- **Aging Population. One Child Policy**

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*“Stocks have reached what
looks like a permanently high
plateau.”*

**Irving Fisher, Professor of
Economics, Yale University, 1929**