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Market Facts

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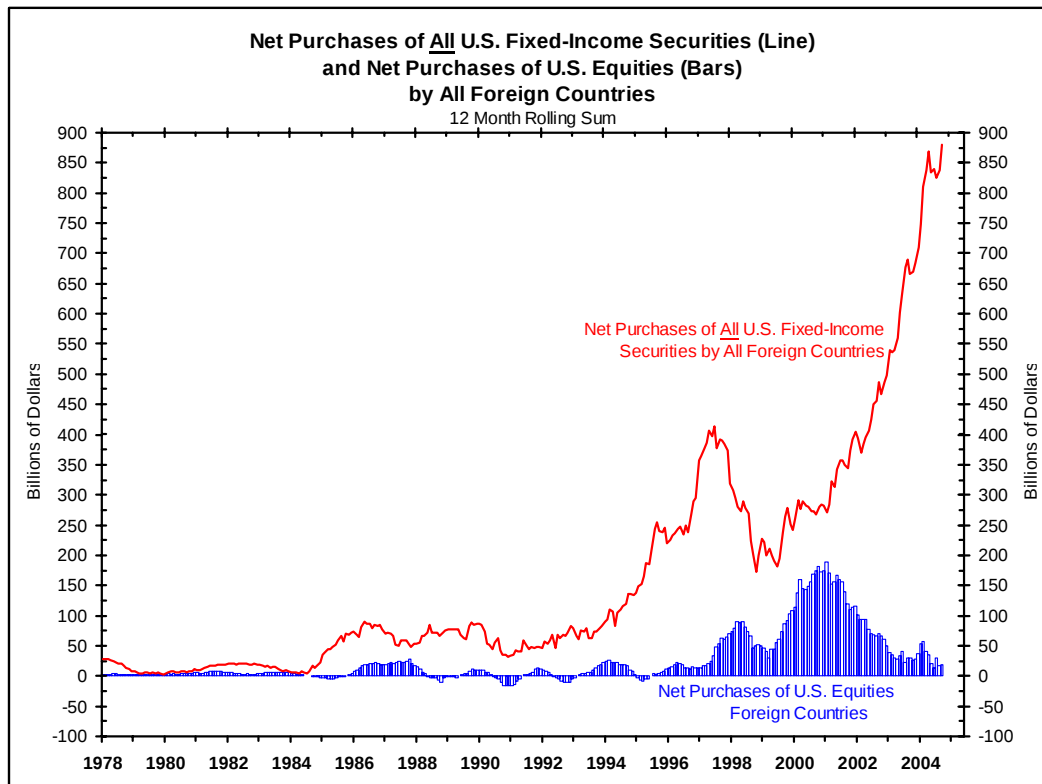
December 14, 2004

A Perspective on the TIC Data

The U.S. Treasury's monthly release of the International Capital Statistics (TIC) report is garnering increasing attention in the financial media. This is understandable given the widening current account deficit and the declining dollar.

The connections between the monthly data and financial markets are not as direct as some would like them to be. Accordingly, we have compiled a list of charts worth noting after the December 15th release of TIC data through October 2004.

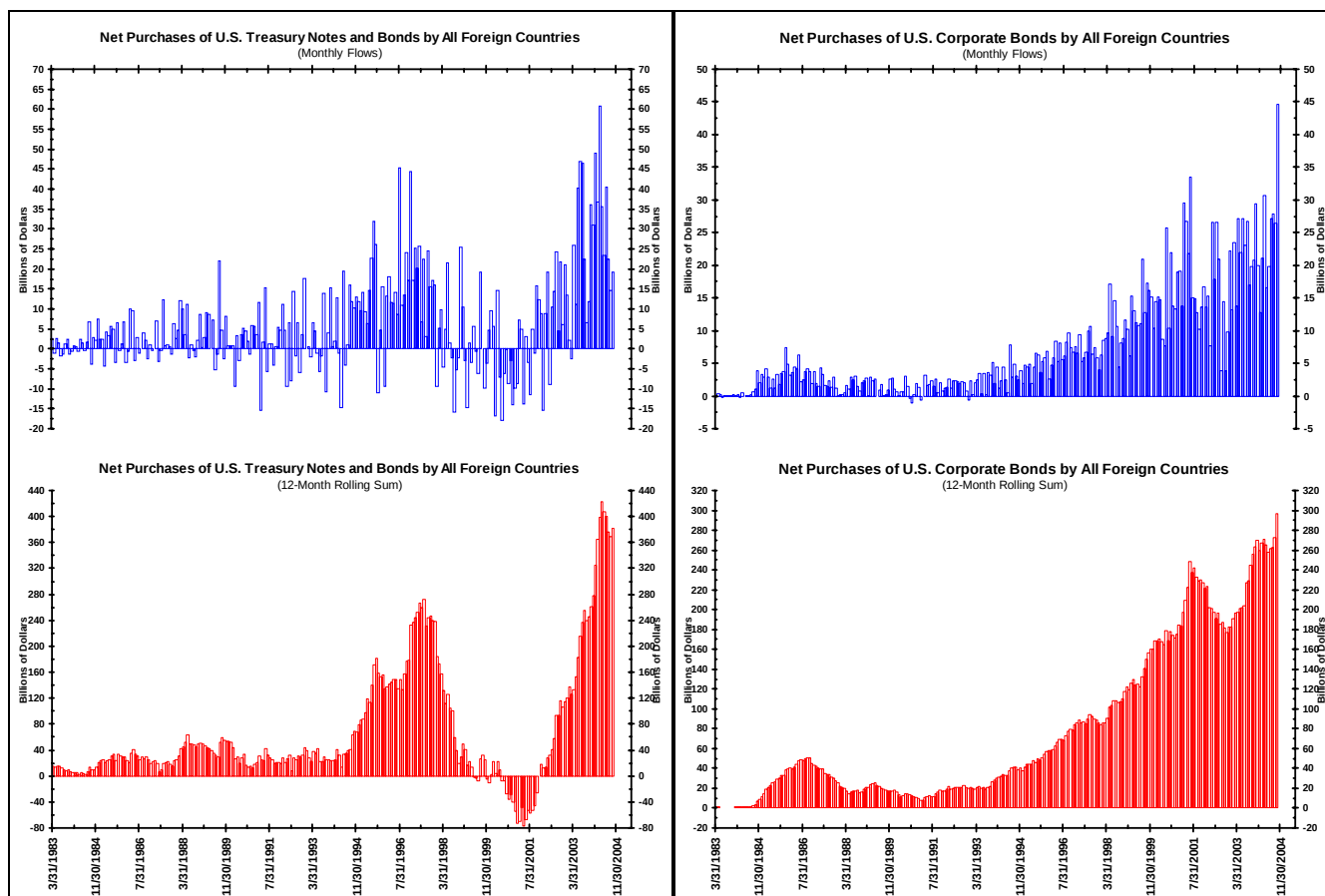
The focus is likely to remain whether foreign investors will continue to finance the U.S. current account deficit. The trend depicted in the chart below for fixed-income securities (red line) is most encouraging. The trend for equities (blue bars) is less striking, but still is at a net inflow. **We believe these trends will continue, and in large part because of and not despite the weaker dollar.** Both data streams represent 12-month rolling sums.



What Are Foreigners Buying?

Foreign net purchases of U.S. Fixed Income securities, including Treasuries, Corporates and Agencies, dwarf those of U.S. Equities. For the year ending September 30, 2004, equities only accounted

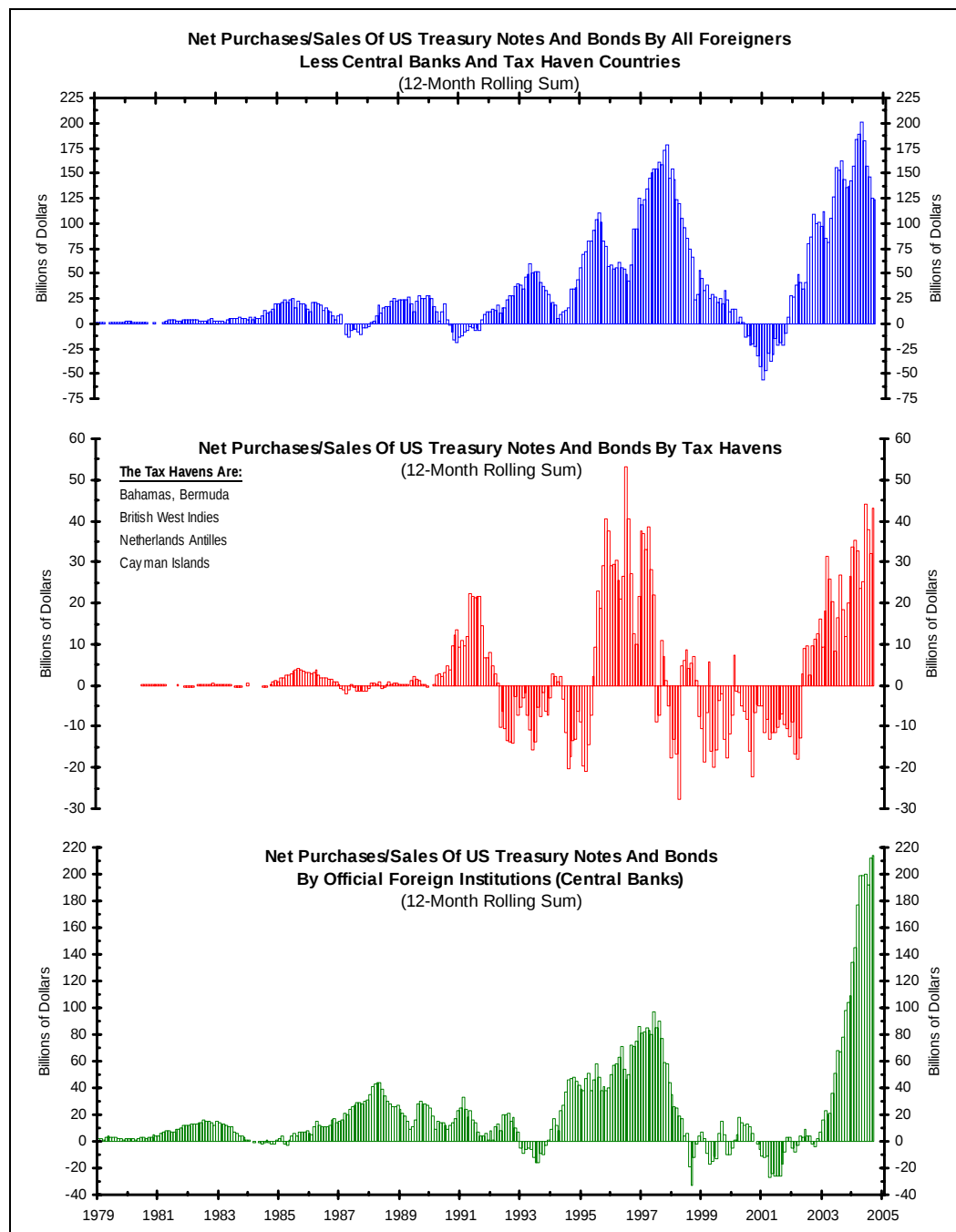
for 2.09% of the foreign net purchases of all securities in the U.S. During the same period, Treasury Notes and Bonds accounted for 42.39% of all foreign net purchases. This discrepancy explains the common focus on foreign net purchases of U.S. Treasury Notes and Bonds each month.



The majority of this fixed income buying is U.S. Treasury Notes and Bonds. The chart of All Foreign net purchases of Treasuries is shown above left. While foreigners have been buying huge amounts of U.S. Treasuries over the past year (bottom panel red bars), many will often focus too much on the monthly net purchases (top panel blue bars). While the monthly flows should not be ignored, this series usually proves to be too erratic to view the larger overall trend.

Other than U.S. Treasuries, Corporate Bonds constitute the next largest total of net purchases by All Foreigners over the past year. In fact, All Foreigners' net purchases of Corporates over the past year set an all-time record at \$297.16 billion (bottom panel red bars). This is due in part to the record net purchases in September 2004, totaling \$44.60 billion (top panel blue bars).

If the TIC data through October 2004 reveal a drop-off in the net purchases of U.S. Corporate Bonds, please understand this is probably due to comparisons with September's huge number. The overall trend will remain decisively higher, and that, more than any one month's data, is important.



Who Is Buying?

The fact that foreigners purchase more U.S. fixed income than U.S. equities should not come as a huge surprise. As the chart above shows, Official Foreign Institutions account for the majority of the Treasury buying. In the year ending September 30, 2004, they bought \$213.88 billion of U.S. Treasury Notes and Bonds (bottom panel green bars). For the most part, this group of buyers can be labeled as the foreign central banks.

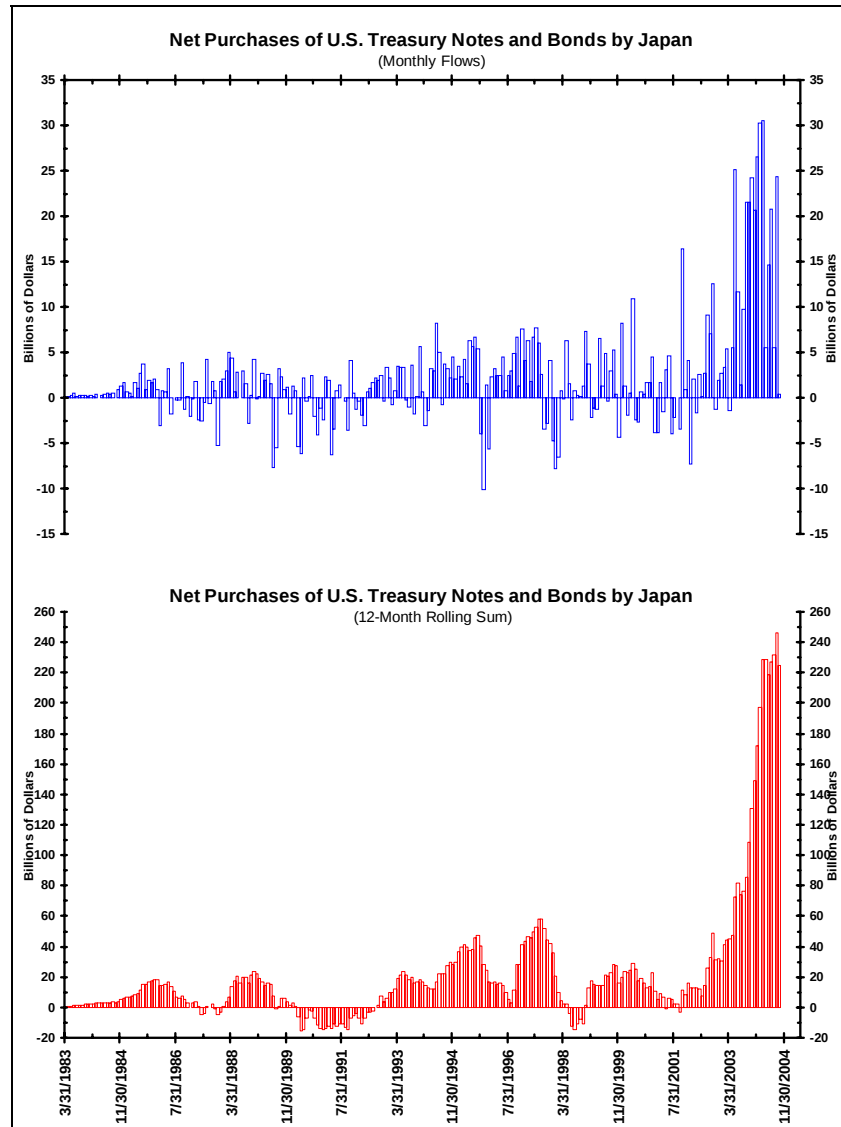
Another large group of foreign buyers of U.S. Treasuries is shown in the middle panel (red bars). In the year ending September 30, 2004, the Tax Haven Countries accounted for \$43.21 billion in net purchases. This group is largely believed to be dominated by offshore hedge funds and banking operations.

On a country-by-country basis, the largest net purchaser of U.S. Treasuries is Japan. In the year ending September 2004, Japan's net purchases of U.S. Treasury Notes and Bonds totaled \$225.04 billion (bottom panel red bars). Just to give an idea of how huge a sum this is, the next largest buyer of U.S. Treasuries in the year ending September 2004 is the United Kingdom with \$63.95 billion in net purchases.

The monthly net purchases by Japan are also included in the top panel of this chart (blue bars). Any drop in the monthly net purchases of U.S. Treasuries, especially by Japan, will likely be

misconstrued in the financial press. It happens almost every month. The stories will state that Japan will no longer support the U.S. consumer and its current account deficit or that concerns over the dollar are causing Japan to shy away from U.S. securities.

Events such as this would not happen overnight. For this reason, the 12-month rolling sum of net purchases is a much better indicator of the appetite for U.S. Treasuries. **Until this measure, which is still very close to all-time highs, begins to fall, there is no reason to believe that Japan no longer has a need for U.S. Treasuries.**



Conclusion

Understanding some of these simple statistics should help place perspective on the current state of foreign demand for U.S. securities. Knowing who is

buying what securities and to what degree they are buying these securities should prove useful at this time tomorrow when the media is flooding the tape with headlines about foreign purchases of U.S. securities.

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