Overview of the Economy

Gross Domestic Product (GDP) in the second quarter advanced at a 4% annual rate following a revised 2.1% first quarter decline. Inventory changes accounted for almost half of this swing, adding 1.7% to second quarter growth after subtracting 1.2% during the first quarter. Personal consumption expenditures (PCE) added 1.7%, rebounding from surprisingly low first quarter growth. Total growth will likely moderate to 2% to 2.5% for the year. Payrolls increased in July by over 200,000 for the sixth straight month. The unemployment rate increased by 0.1%, but the increase was due to a higher labor force participation rate, as previously discouraged workers rejoined the labor force. Inflation continues to trend near the Federal Reserve’s (Fed) 2% target, as the second quarter personal consumption deflator rose at a 2.3% annual rate. Expectations for the beginning of rate normalization should be the first half of 2015.
Consumer Expenditures

Total consumer spending in the second quarter increased at a 2.5% annual rate, sharply rebounding from slower than expected first quarter growth. Spending on durable goods increased at a 14% rate, led by strong growth in motor vehicles and parts. Second quarter auto sales averaged nearly a 17 million annualized rate, but will likely level off going forward. Consumer spending for services slowed to a 0.3% annual rate in the second quarter from 1.4% in the first quarter. This was due to lower housing and utilities spending, which was unusually high in the first quarter due to the harsh winter. Spending on health care grew at only a 0.7% rate in the second quarter after declining in the first quarter. Consumer confidence continued to increase, but remains at a lower level than the 2004-2007 average. The continued rise in household net worth was driven by strong financial market performance and the home price recovery.
Housing

Housing construction has been one of the economy’s weaker areas, with June housing starts and permits declining to the lowest levels of the year. Demand for mortgages remains low, as the mortgage applications purchase index is well below pre-crisis levels and has recently trended down since mortgage rates began rising in the first half of 2013. Home price appreciation is still strong with a 9.3% annual growth rate in May, but price increases are decelerating. This price appreciation has reduced affordability and led to a declining homeownership rate, even as mortgage rates have trended moderately downward since the beginning of the year. Home price gains will likely slow further going forward as price gains realign with the pace of income growth. Lower vacancies, population growth and historically attractive affordability should support gradual improvement in housing demand.
Production and Investment

Fixed investment increased at a 5.9% annual rate in the second quarter and contributed 0.9% to GDP growth, with companies increasing investments in information processing and industrial equipment. In addition, residential investment advanced at a strong rate after declining the prior two quarters. The July ISM Manufacturing Index increased to the highest level since 2011, consistent with production gains continuing into the third quarter. Business inventories relative to sales stabilized over the last few months after declining from recent highs. Durable goods orders increased at a higher than expected 1.7% rate in June, with computers, electronics, and aircraft notable areas of strength for the month. Moderate production growth is likely to continue throughout the second half of the year, in line with the moderate expected trend in final sales.
The trade deficit continued to widen in the second quarter, with rebounding growth in exports offset by a double digit annual growth rate in imports. Net exports reduced second quarter GDP growth by 0.6% after taking away 1.7% in the first quarter. Second quarter growth in exports was driven by capital goods and autos, while food and industrial supplies lagged. Second quarter import growth was high in most categories, with the notable exception of oil imports, which were lower than the previous quarter. Export growth in the second half of the year is likely to be moderate, with trade headwinds that include slowing Euro-zone growth, geopolitical tensions and the related economic sanctions in Russia and structurally lower growth in China going forward. Net exports’ contribution to growth in the second half of the year should stabilize.
Nonfarm payrolls increased by 209,000 in July, roughly in line with prior months this year. Manufacturing industries added 28,000 jobs, the highest amount this year as production activity continues to grow. Growth in service industry payrolls slowed from prior months, but was still positive in all major categories. The unemployment rate increased to 6.2% from the cyclical low of 6.1% last month, but the increase was due to the labor force participation rate increasing. Overall labor market conditions have continued to improve. The pace of payroll increases should continue to put downward pressure on the unemployment rate, with the year-end rate likely ending at 6.0%. Average hourly earnings increased again last month, indicating moderate upward pressure on wages. Wage growth will likely grow moderately throughout the rest of the year, consistent with inflation trending towards the Fed’s objective.
Inflation and Monetary Policy

Year-over-year inflation in June was stable after moving incrementally higher over the last few months. The increase in recorded inflation has been driven by higher gasoline, food and housing costs. These three components comprise over 50% of the weight of the Consumer Price Index (CPI). Beef, bacon, shrimp and milk prices have all moved notably higher as droughts and disease have had larger than normal impacts. Gasoline will likely have a more moderate impact on inflation going forward, with price increases starting to reverse in July. Home prices and rents have continued to increase and will likely have an upward impact on inflation in the second half of the year. The Fed’s preferred inflation measure, the personal consumption expenditure deflator (PCE), increased at a 2.3% annual rate in the second quarter, above the 2% target rate. This is consistent with the Fed continuing to taper quantitative easing, with the program concluding in October. We believe the PCE deflator will continue to run near the Fed’s target in 2014 and 2015.

Source: Bureau of Labor Statistics

Source: Federal Reserve Board

Source: Bureau of Labor Statistics

Source: Reuters
After rising steadily through most of the first half of the year, U.S. equity markets reversed some gains in July and the beginning of August. Positive economic data has been outweighed by the bank failure in Portugal and escalating geopolitical tensions in Russia and Ukraine. Volatility has increased significantly over the last few weeks after trending down over the first half of the year. We believe second half volatility will run at higher average levels than the first half of the year. Large cap outperformance over small caps accelerated in July, and we remain overweight large caps relative to small caps. Technology, health care and utilities have been the strongest performing U.S. sectors this year on a total return basis, with biotechnology a notable outperforming sub-sector. We continue to underweight consumer discretionary, which has been the worst performing sector year to date.
International Markets

International equity markets have lagged domestic stocks over the last couple of months after trading mostly in line the first five months of the year. Europe has underperformed recently, with worse than expected economic data, the bank failure of Banco Espirito in Portugal and tensions in Russia and Ukraine weighing down stocks. The losses in Europe have been partially offset by sharp outperformance over the last few weeks in China, as better recent economic data and stimulative government actions have pushed equities higher. Asian markets, (excluding Japan) have generally outperformed this year. Emerging markets equities have strongly outperformed developed markets stocks over the last month as China, India and Mexico have all outperformed.
Fixed Income Market

Longer-term U.S. Treasury yields drifted lower over the last several months even as second quarter growth rebounded and inflation readings have increased. The decline in U.S. yields has been consistent with declining yields globally. The yield spread between 10-year U.S. Treasuries and German Bunds is currently 133 basis points, a 25-year high. This makes U.S. Treasuries attractive on a relative basis. Low yields internationally will work to hold down U.S. yields, although we still anticipate 10-year Treasury yields to move towards 3% by the end of the year. High yield corporate bonds underperformed notably in July with significant fund and ETF outflows, as investors were concerned with valuations and potential interest rate increases. High yield municipal bonds suffered losses in the early part of July on fears of losses in Puerto Rico, but losses were mostly reversed by the end of the month. We continue to overweight high yield municipal bonds and believe prospective returns remain attractive.

Source: Bloomberg

Source: Barclays Capital. Based on the Barclays U.S. Aggregate Bond Index.
### Economic, Rates and Earnings Forecast

<table>
<thead>
<tr>
<th></th>
<th>2012 (A)</th>
<th>2013 (A)</th>
<th>2014 (F)</th>
<th>2014 Bloomberg Consensus*</th>
<th>2015 Bloomberg Consensus*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP (Q4/Q4)</strong></td>
<td>2.0%</td>
<td>2.6%</td>
<td>1.5% - 2.5%</td>
<td>1.70%</td>
<td>3.00%</td>
</tr>
<tr>
<td><strong>Personal Consumption Expenditures</strong></td>
<td>2.0%</td>
<td>2.3%</td>
<td>1.5% - 2.5%</td>
<td>1.70%</td>
<td>3.00%</td>
</tr>
<tr>
<td><strong>Investment</strong></td>
<td>3.1%</td>
<td>8.3%</td>
<td>4.0% - 6.0%</td>
<td>4.0% - 6.0%</td>
<td>4.0% - 6.0%</td>
</tr>
<tr>
<td><strong>Net Exports ($)</strong></td>
<td>-$412B</td>
<td>-$383B</td>
<td>-$420B</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Government Spending</strong></td>
<td>-1.1%</td>
<td>-2.4%</td>
<td>0.0% - 1.0%</td>
<td>0.0% - 1.0%</td>
<td>0.0% - 1.0%</td>
</tr>
<tr>
<td><strong>Unemployment Rate</strong>*</td>
<td>7.9%</td>
<td>6.7%</td>
<td>6.0%</td>
<td>6.20%</td>
<td>5.70%</td>
</tr>
<tr>
<td><strong>CPI</strong>*</td>
<td>1.7%</td>
<td>1.5%</td>
<td>1.5% - 2.5%</td>
<td>1.95%</td>
<td>2.20%</td>
</tr>
<tr>
<td><strong>CPI Excluding Food and Energy</strong></td>
<td>1.9%</td>
<td>1.7%</td>
<td>1.5% - 2.5%</td>
<td>1.95%</td>
<td>2.20%</td>
</tr>
<tr>
<td><strong>Fed Funds</strong>*</td>
<td>0.25%</td>
<td>0.25%</td>
<td>0.0% - 0.25%</td>
<td>0.25%</td>
<td>1.00%</td>
</tr>
<tr>
<td><strong>10 Year Treasury</strong>*</td>
<td>1.76%</td>
<td>3.03%</td>
<td>2.5% - 3.5%</td>
<td>3.11%</td>
<td>3.64%</td>
</tr>
<tr>
<td><strong>Corporate Earnings (S&amp;P Operating)</strong></td>
<td><strong>$96.82</strong></td>
<td><strong>$107.30</strong></td>
<td><strong>$113.50</strong></td>
<td>119.39**</td>
<td>$136.54**</td>
</tr>
<tr>
<td><strong>Trade Weighted Dollar</strong>*</td>
<td><strong>$79.80</strong></td>
<td><strong>$80</strong></td>
<td><strong>$80-$90</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Bloomberg - August 1, 2014  
** Standard and Poors - July 31, 2014  
*** End of Period Level
Index Definitions

The Barclays U.S. Aggregate Bond Index represents securities that are SEC-registered, taxable and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities.

The MSCI EAFE Index is an equity index which captures large and mid cap representation across Developed Markets countries around the world, excluding the US and Canada.

The MSCI Emerging Markets Index captures large and mid cap representation across 21 Emerging Markets (EM) countries.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.

The MSCI EM (Emerging Markets) Asia Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of emerging markets in Asia.

The MSCI North America Index is designed to measure the performance of the large and mid cap segments of the US and Canada markets.

The MSCI Pacific Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region.

The MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe.

The MSCI Europe & Middle East Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe and the Middle East.

The MSCI EM (Emerging Markets) Latin America Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of emerging markets in Latin America.

The Russell 1000® Growth Index is a market-capitalization-weighted index that measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000® Value Index is a large-cap value index measuring the performance of the largest 1,000 U.S. incorporated companies with lower price-to-book ratios and lower forecasted growth values.

The Russell Midcap Index is composed of the 2,000 smallest stocks in the Russell 3000® Index and is widely regarded in the industry as the premier measure of small-cap stock performance.

The Russell 2000® Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap is a subset of the Russell 1000® Index.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy.
Disclosure

Source: These views were prepared by Keith Hembre, Chief Economist for U.S. Bank. These views are subject to change at any time based upon market or other conditions and are current as of the date indicated on these materials. This information is not intended to be a forecast of future events or guarantee of future results. It is not intended to provide specific advice or be construed as an offering of securities or a recommendation to invest.

Not for use as a primary basis of investment decisions. Not to be construed to meet the needs of any particular investor. Not a representation or solicitation or an offer to sell/buy any security. Investors should consult with their investment professional for advice concerning their particular situation. U.S. Bank and its representatives do not provide tax or legal advice. Each tax and financial situation is unique. Consult a tax and/or legal advisor for advice and information concerning a particular situation.

Past performance does not guarantee future results. All performance data, while deemed obtained from reliable sources, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for investment. The S&P 500 Index is a capitalization weighted index of 500 widely traded stocks that are considered to represent the performance of the U.S. stock market in general. Russell 1000 Value measures the performance of those Russell 1000 Index securities with lower price-to-book ratios and lower forecasted growth values, and representative of U.S. securities exhibiting value characteristics. Russell Midcap measures the performance of those Russell 1000 Index securities with lower price-to-book ratios and lower forecasted growth values, and is representative of U.S. securities exhibiting value characteristics.

Russell 2000 measures the performance of the 2,000 smallest companies in the Russell 3000 Index and is representative of the U.S. small capitalization securities market. The NASDAQ Composite Index is market capitalization weighted average of roughly 5,000 stocks that are electronically traded in the NASDAQ market. MSCI EAFE Index is an unmanaged index that includes approximately 1,000 companies representing the stock markets of 21 countries in Europe, Australasia and the Far East (EAFE). MSCI Emerging Markets EMG Index is designed to measure equity market performance in global emerging markets. This index includes sub-indexes for various countries (such as China and Brazil). MSCI All Country World Index (excluding U.S.) tracks the performance of stocks representing developed and emerging markets around the world that collectively comprise most foreign stock markets. U.S. stocks are excluded from this index. MSCI World Index is an unmanaged index which tracks equity market performance of developed markets through individual country indices. MSCI Country Indices represent the market for a particular country.

Equity securities are subject to market fluctuations that occur in response to economic and business developments. Growth stocks are typically more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales. The value of large cap stocks will rise and fall in response to the activities of the company that issued them, general market conditions, and/or economic conditions. Stocks of small- and mid-cap companies pose special risks, including possible illiquidity and greater price volatility than stocks of larger, more established companies.

International investing involves risks not typically associated with domestic investing, including risks of adverse currency fluctuations, potential political and economic instability, different accounting standards, foreign government regulations, currency exchange rates, limited liquidity, and volatile prices. Investing in emerging markets may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investments in fixed income debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in real estate can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties, such as rental defaults. An inflation protected security is a special type of note or bond designed to offer protection from inflation. Interest payments vary with the rate of inflation. These securities offer a lower return compared to other similar investments. The principal value may increase or decrease with the rate of inflation. Investments in high-yield bonds offer the potential for high current income and attractive total return, but involve certain risks. These securities are typically more volatile than corporate bonds. Changes in economic conditions or other circumstances may adversely affect a bond issuer’s ability to make principal and interest payments. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes, and the impact of adverse political or financial factors. An investment in a hedge fund involves a substantially more complicated set of risk factors than traditional investments in stocks and bonds. Hedge funds are speculative and involve a high degree of risk. Investments in private equity are illiquid by nature and typically represent a long-term binding commitment. The investments made by private equity funds are not readily marketable and the valuation procedures for these positions are often subjective in nature.

NOT A DEPOSIT  NOT FDIC INSURED  MAY LOSE VALUE  NOT GUARANTEED BY THE BANK

NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY

MMWR-53236 0814

U.S. Bank Equipment Finance • August 2014