PIMCO

Your Global Investment Authority

PIMCO's Economic Outlook

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July 2012

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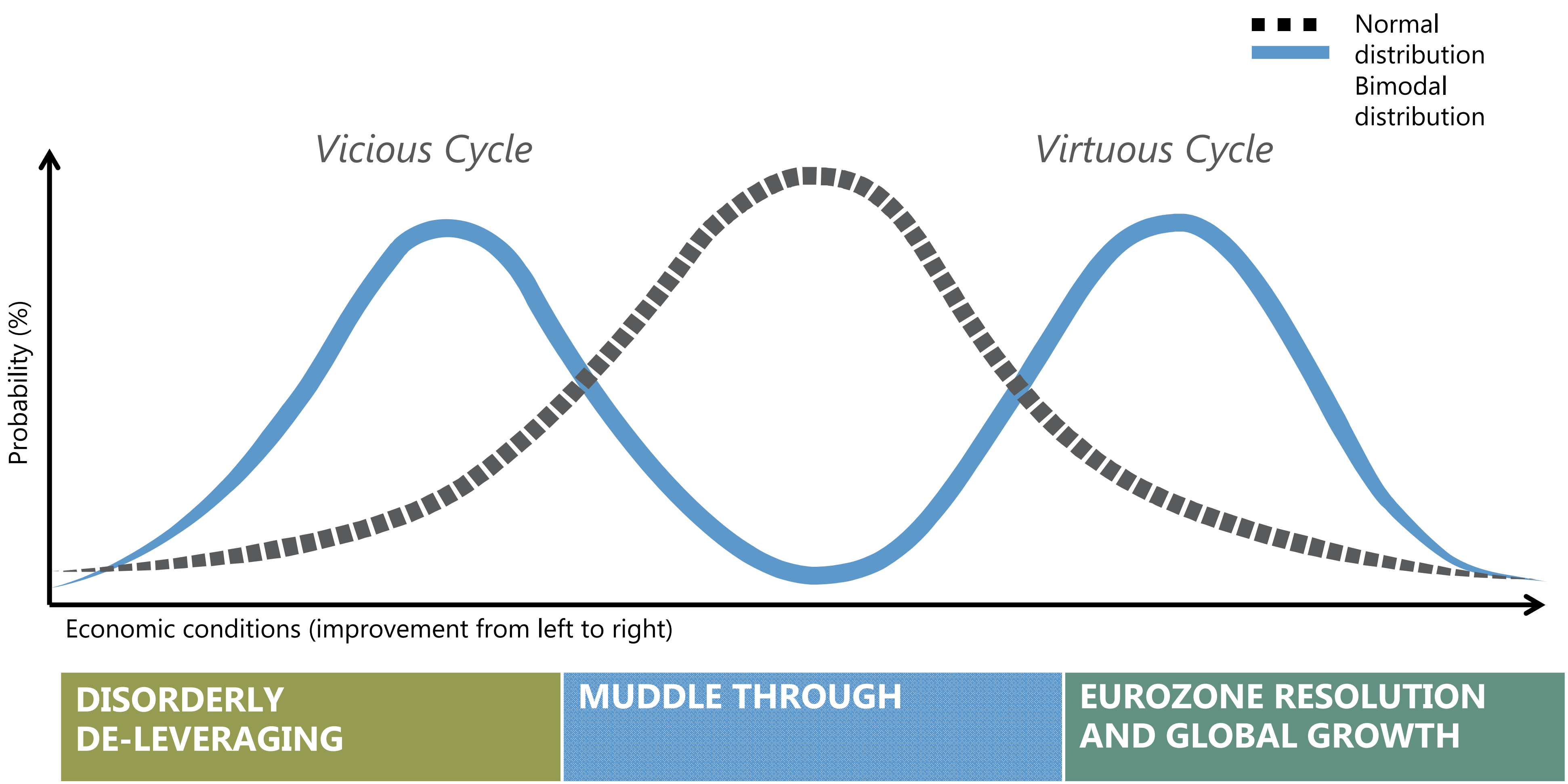
Agenda

1. PIMCO's Global Outlook
2. PIMCO's U.S. Outlook
3. Headwinds to growth
4. PIMCO's European Outlook
5. Investment Implications

1. PIMCO's global outlook

The New Normal:
Moving from a normal to a bimodal distribution

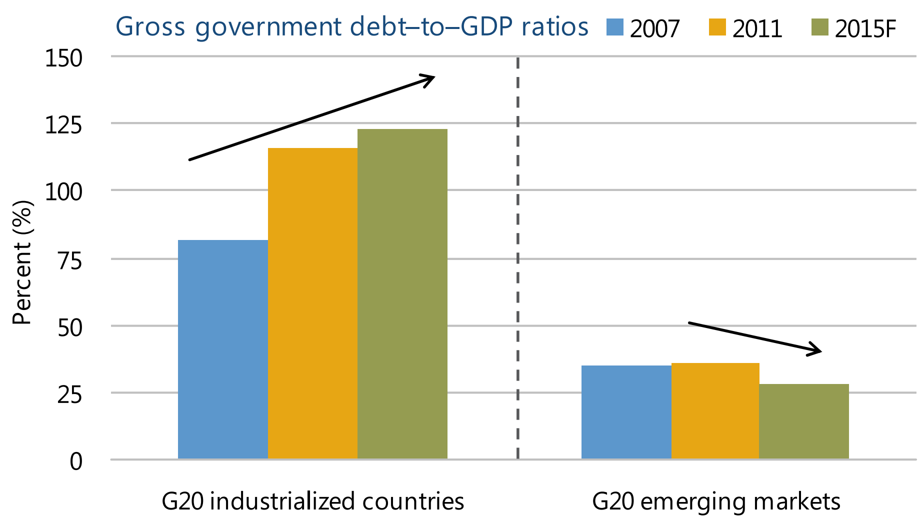


As of 31 March 2012
Refer to Appendix for additional investment strategy, outlook and risk information.

Structure of global economy and debt dynamics are changing rapidly

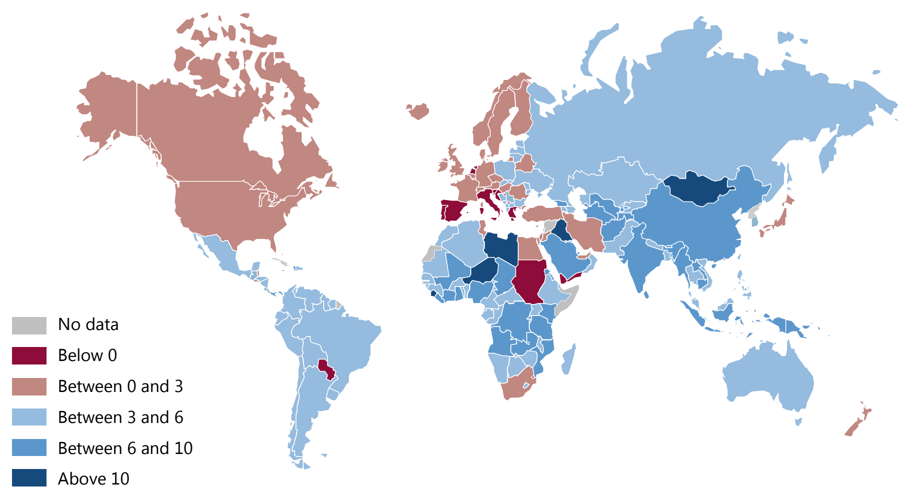
- Advanced Economy indebtedness is increasing sharply and has reached unprecedented levels
- At the same time Emerging Markets (EM) share of global activity is increasing with high savings and lower leverage supportive of positive debt dynamics

Traditional patterns of global indebtedness are being turned around



Emerging markets now the main drivers of global growth

Average real GDP growth forecasted for 2012 (percent)



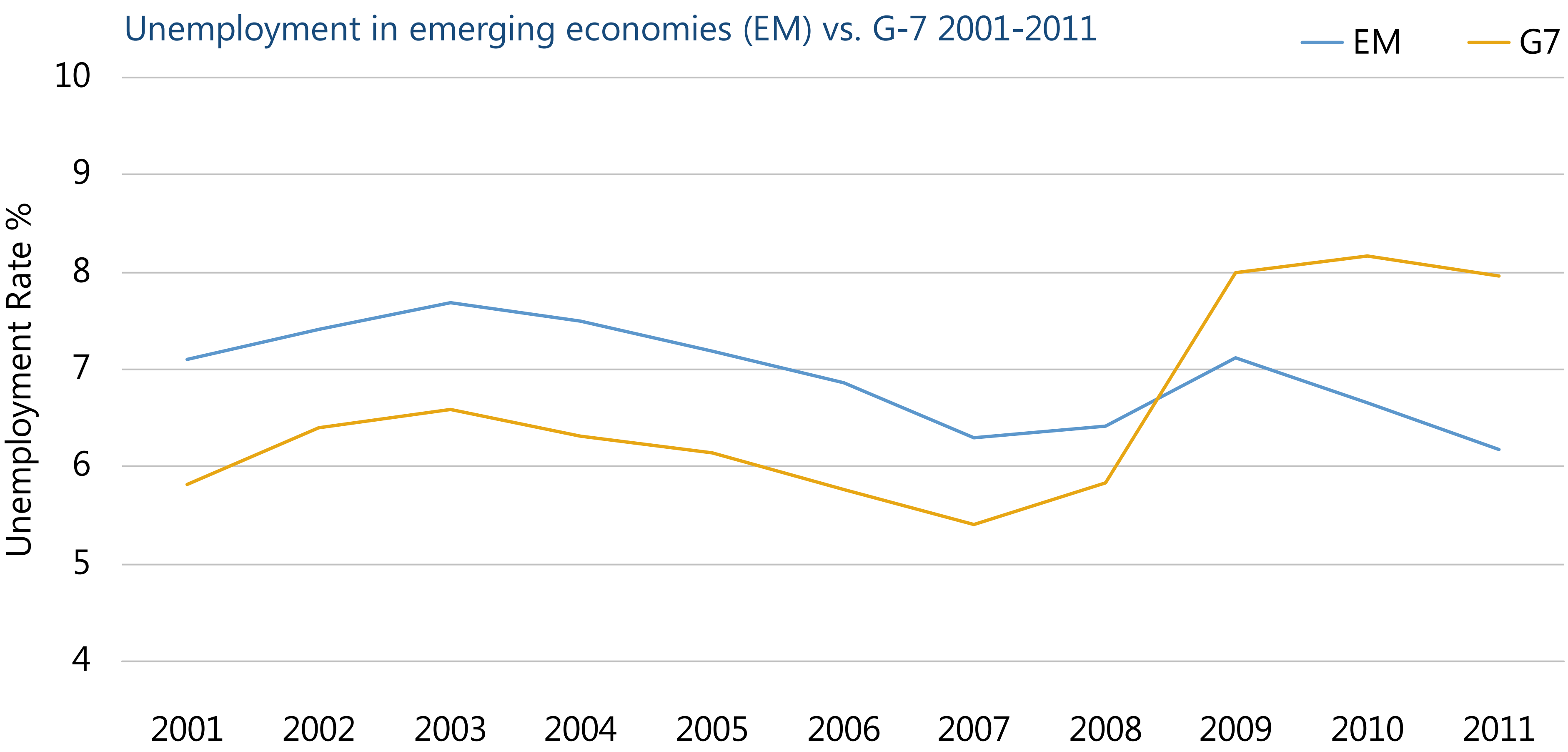
SOURCE: International Monetary Fund (IMF), World Economic Outlook (WEO) April 2012
Refer to Appendix for additional outlook information.

Markets are now acknowledging this shift in sovereign credit risk

Difference in sovereign spreads between emerging and advanced economies

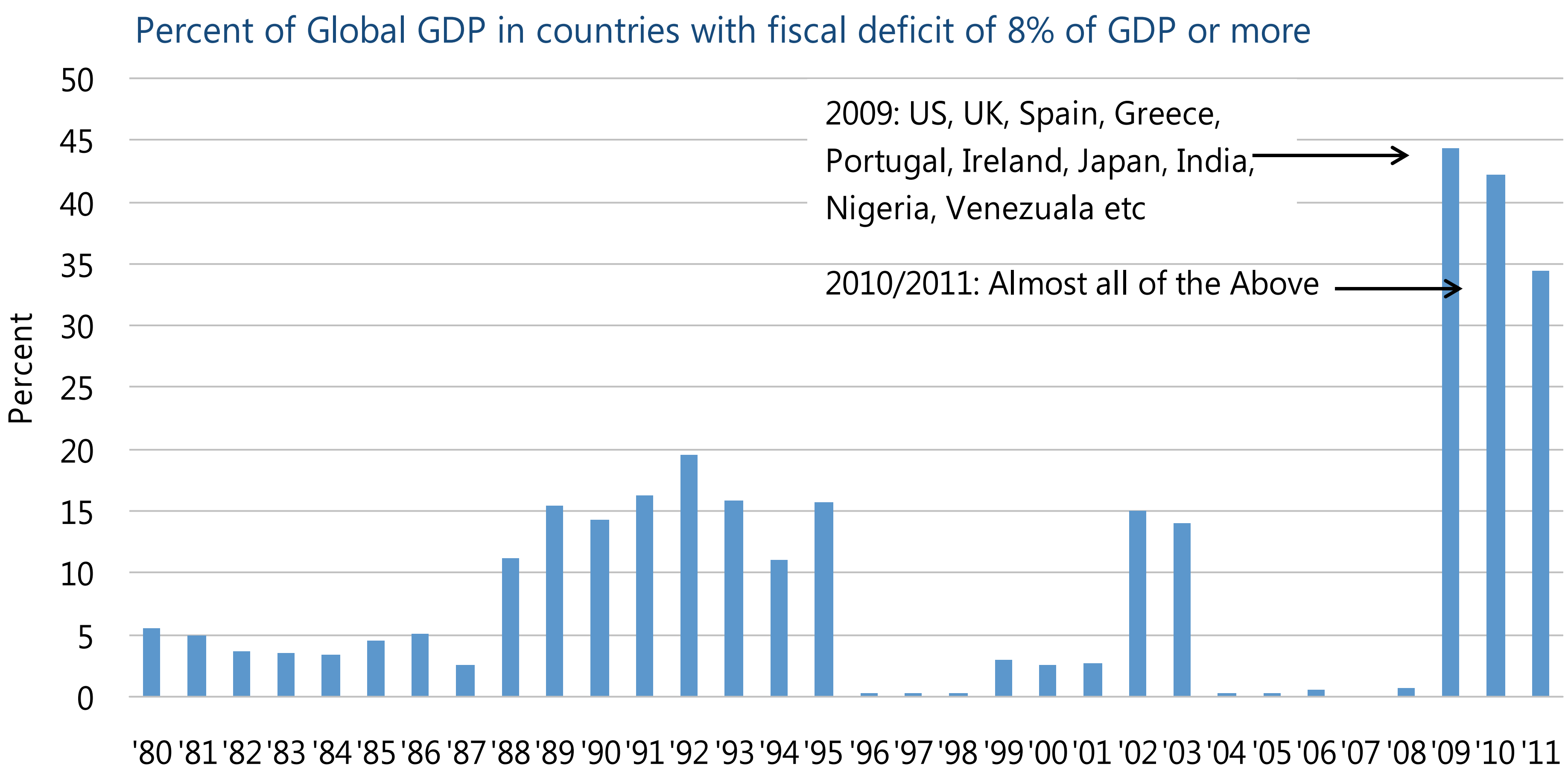
As of 31 March 2012
SOURCE: Bloomberg, PIMCO
Note: Chart shows CDS spreads for Markit iTraxx SOVX Western European Index and Markit CDX Emerging Markets Index
A positive number implies that EM spreads are greater than DM spreads. A negative number implies that EM spreads are less than DM spreads, therefore implying that market is pricing lower credit risk for specified baskets of EM countries than for DM countries.
Refer to the Appendix for additional index information.

Grand bargain #1: Can EM re-orient towards domestic growth allowing the developed markets (DM) to de-leverage?



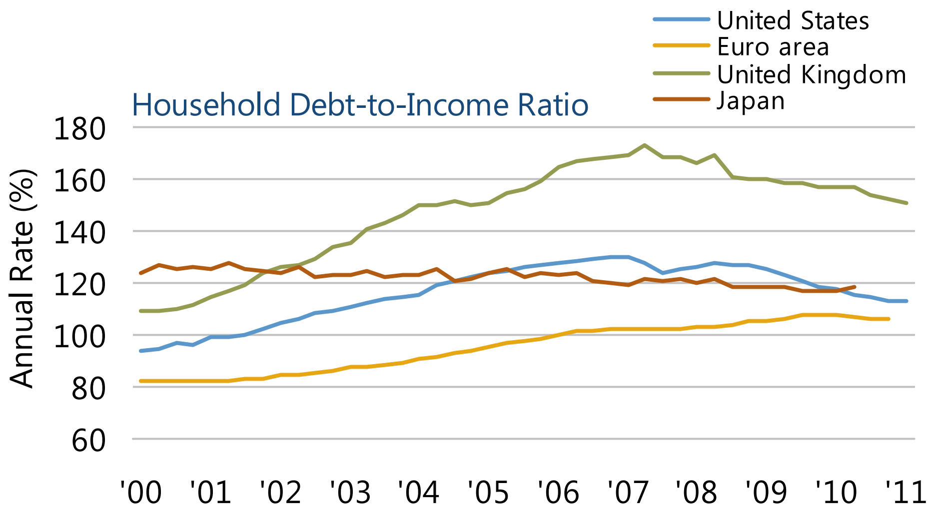
As of 31 December 2011
SOURCE: Haver Analytics

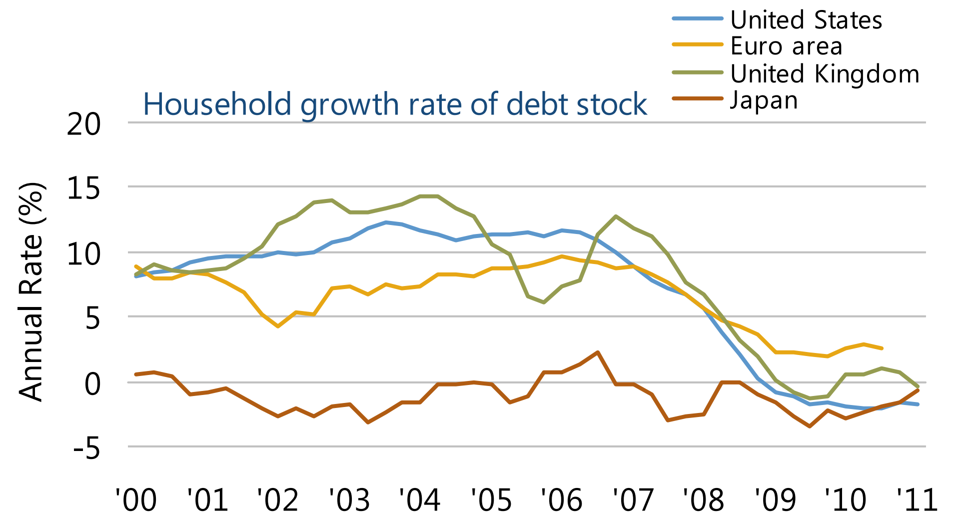
DM public sector de-leveraging is a multi-year headwind to global growth

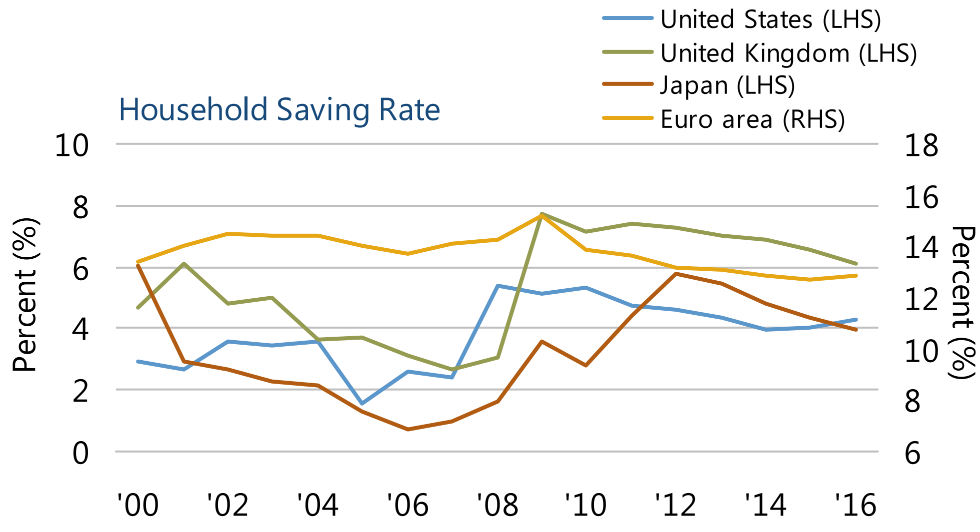


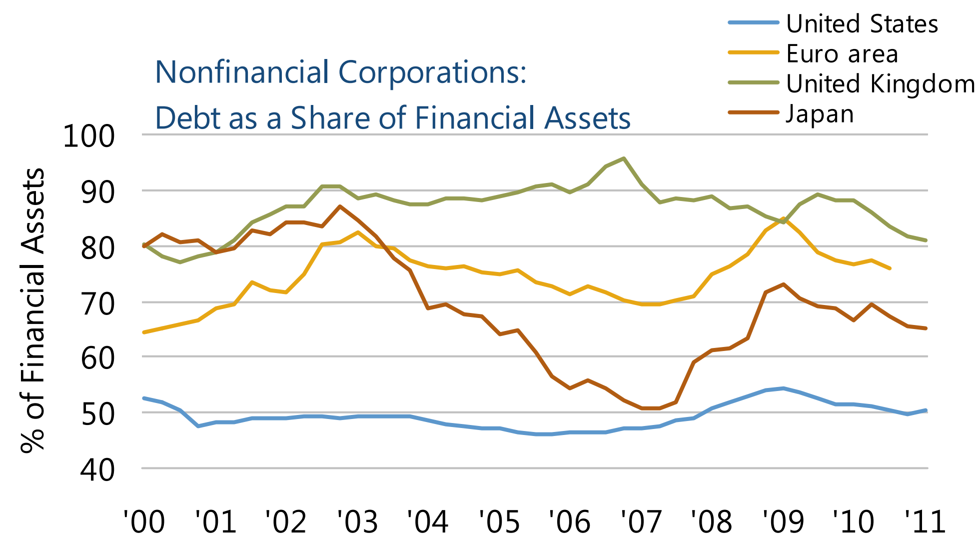
As of 30 September 2011
SOURCE: PIMCO, Citi, IMF, Bloomberg Financial Markets

Unfortunately, DM private sector deleveraging is also a significant headwind





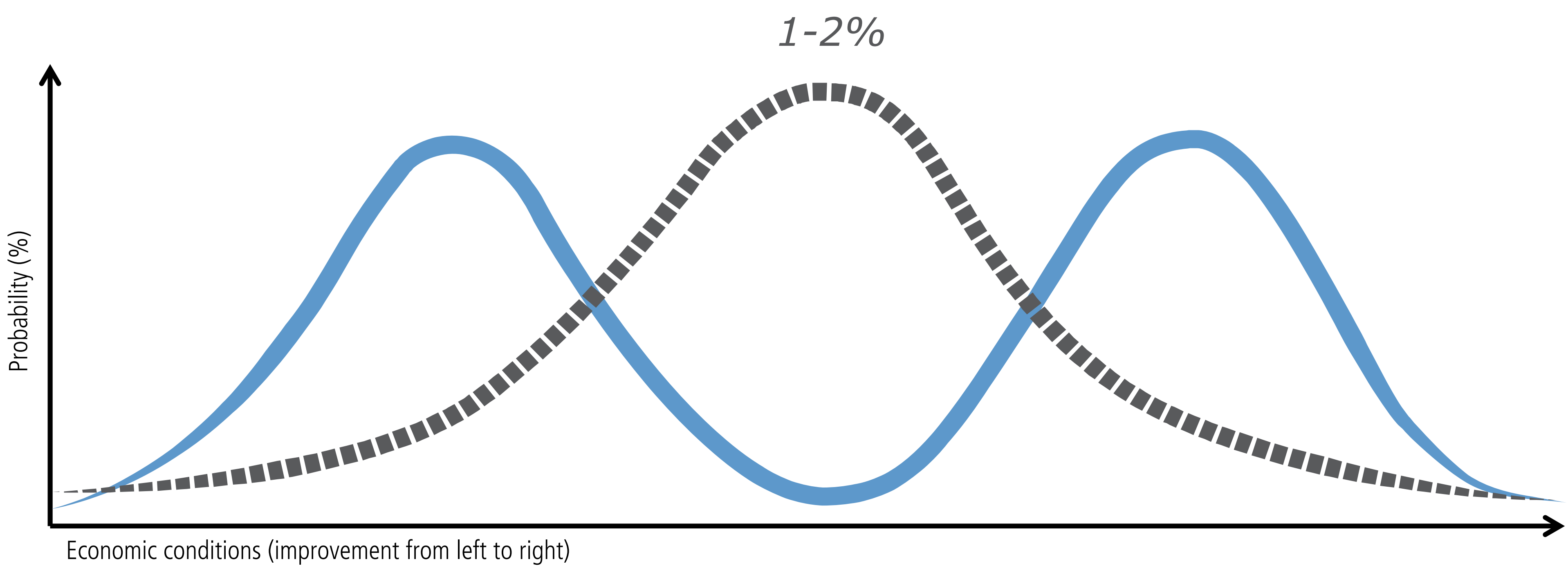




As of 30 September 2011
SOURCE: Haver Analytics, IMF

2. PIMCO's U.S. outlook

Baseline: US real growth of 1-2%
There are fat tails to this forecast



As of 31 March 2012
SOURCE: PIMCO
Refer to Appendix for additional outlook and risk information.

Support for U.S. economic growth

- Top factors that we believe are likely to contribute positively to U.S. economic growth in 2012:

1. A reduction in negativity from Washington relative to 2011
2. Fracking and factories
3. Credit and cars
4. Multi-family housing
5. Hiring

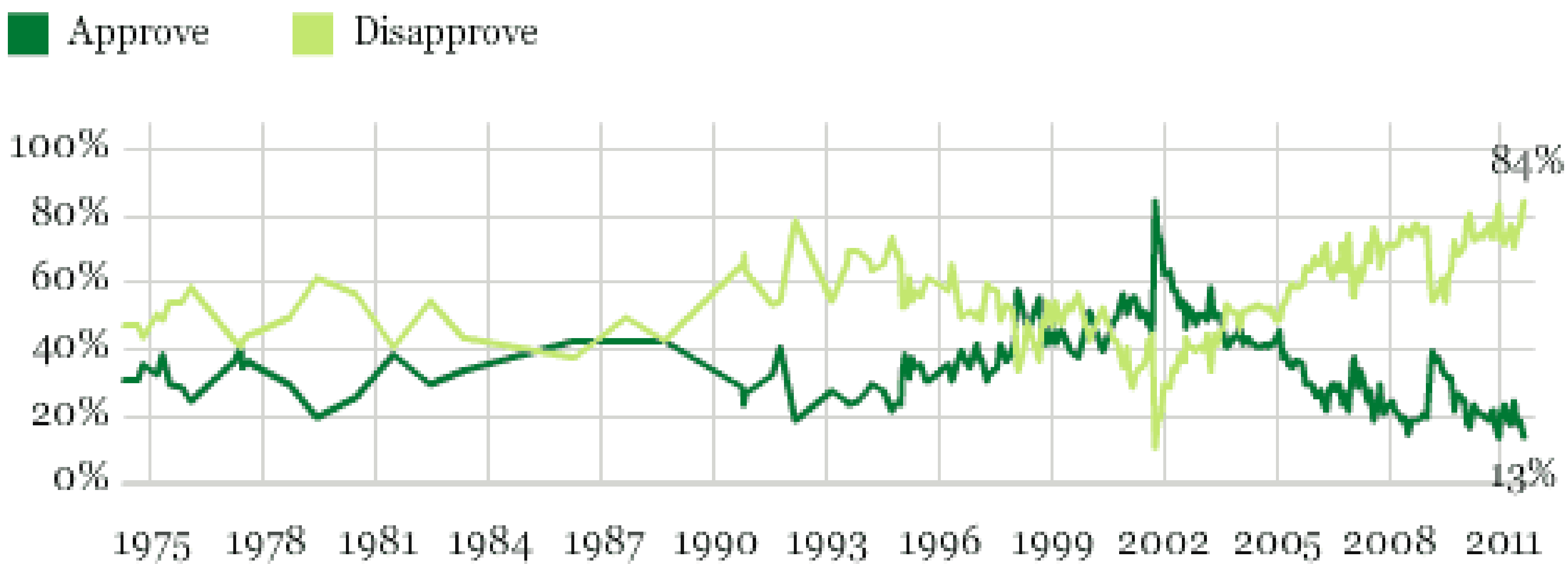
As of 31 December 2011
SOURCE: PIMCO
Refer to Appendix for additional outlook information.

Good riddance, Washington

- Elections bring empowerment: Washington's abrogation of the electorate's right to steer the direction of the nation will give way yet again to hope for "change"

Do you approve or disapprove of the way Congress is handling its job?

Full trend

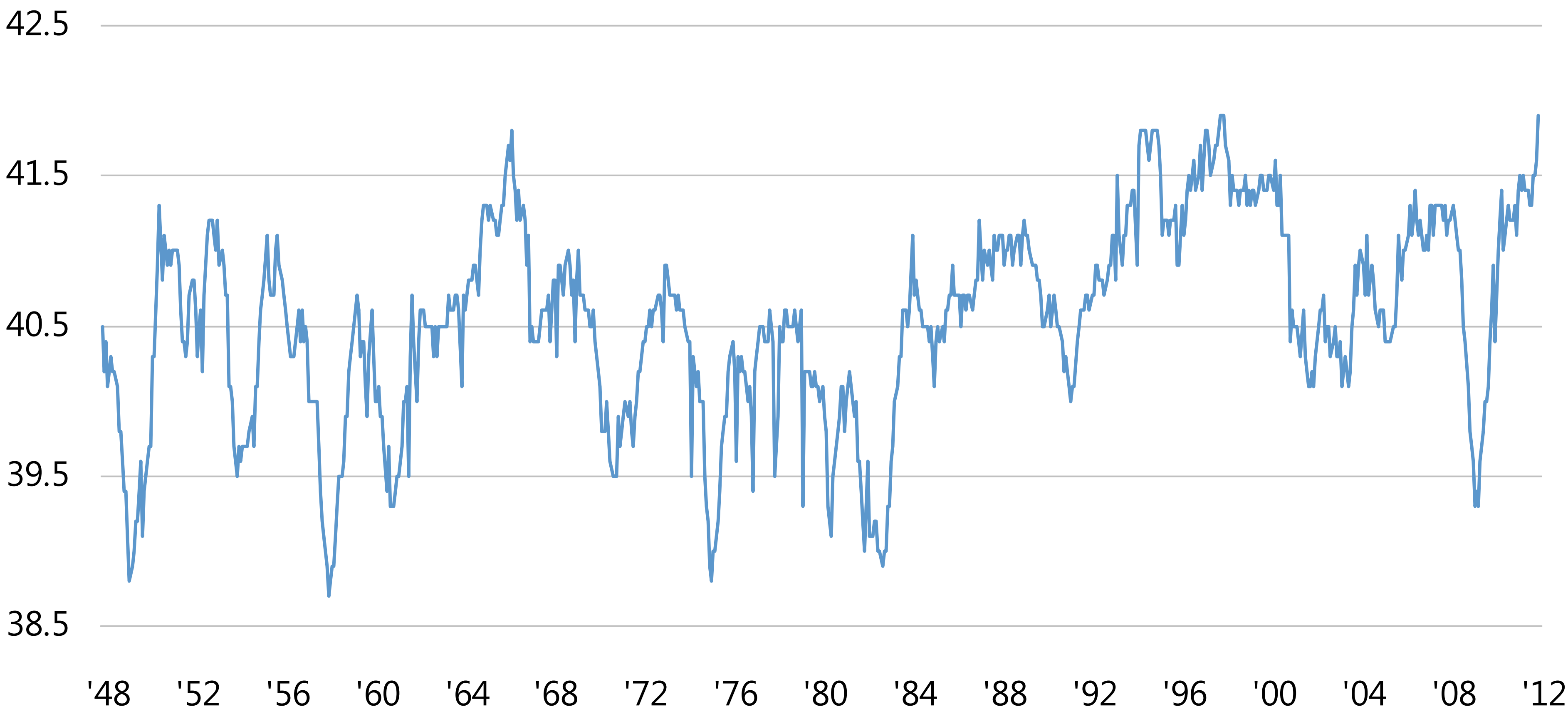


GALLUP

As of 16 August 2011

Fracking and factories

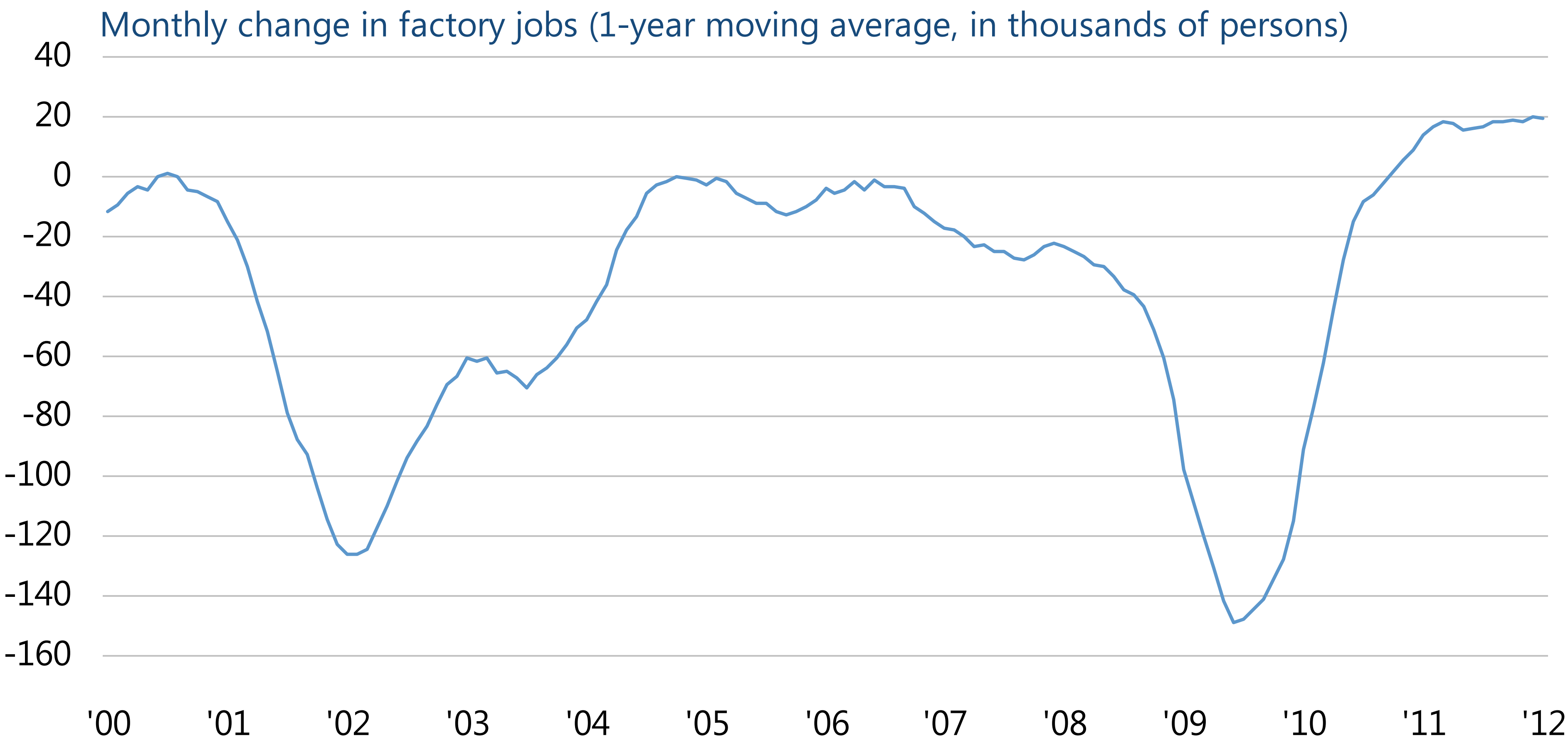
- The U.S. factory workweek is at its longest since 1945 (1945!)



As of: 31 January 2012
Source: Bureau of Labor Statistics

Fracking and factories

- Factory jobs are growing at their fastest pace in 15 years



As of 31 January 2012
Source: Bureau of Labor Statistics

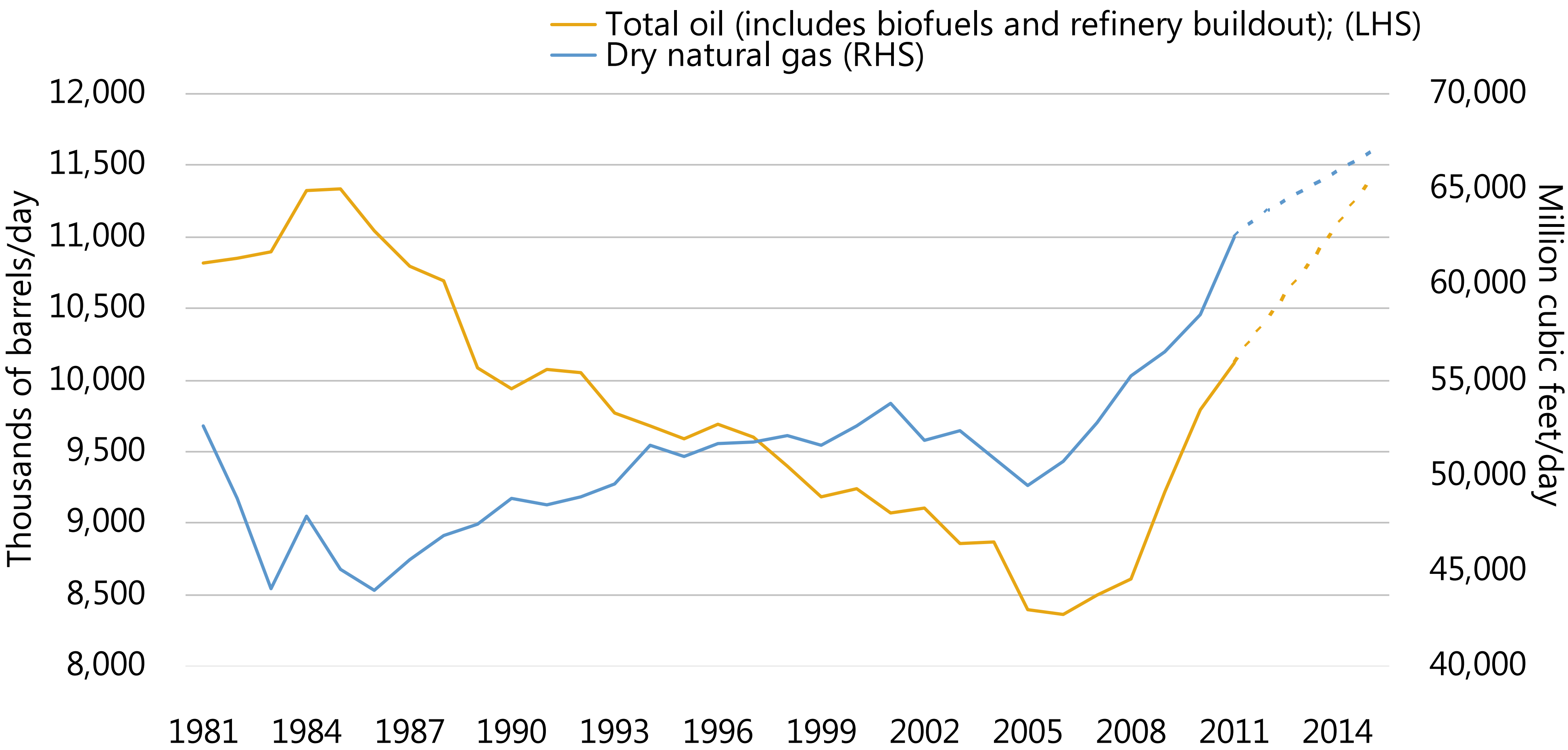
Fracking and factories

- Five top factors fueling the factory sector's revival:
  1. Persistent strength in the Japanese yen
  2. Supply-chain diversification
  3. Increased labor costs in China
  4. Increased U.S. competitiveness
  5. Decline in the price of natural gas

SOURCE: PIMCO
Refer to Appendix for additional outlook information.

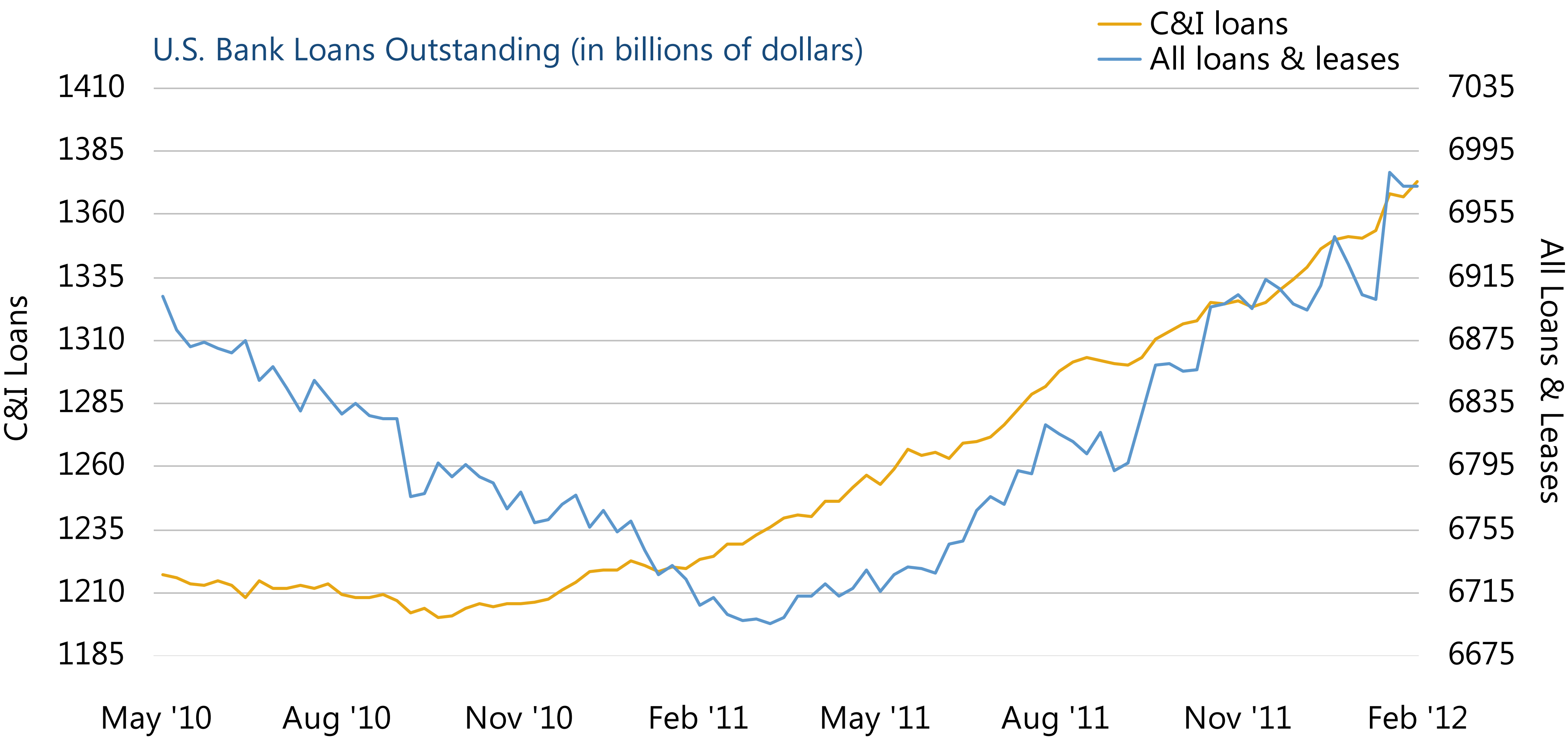
Fracking and factories

- U.S. energy production is rising sharply



As of 31 January 2012
SOURCE: EIA

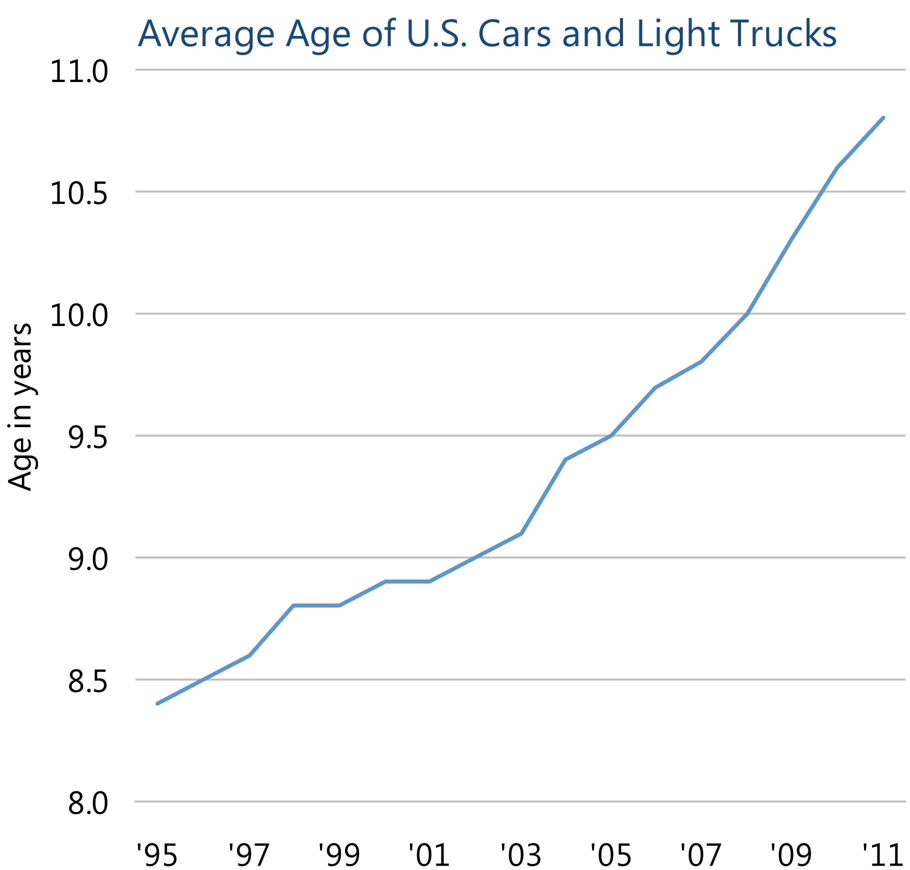
Credit and cars
Myth: Banks aren't lending



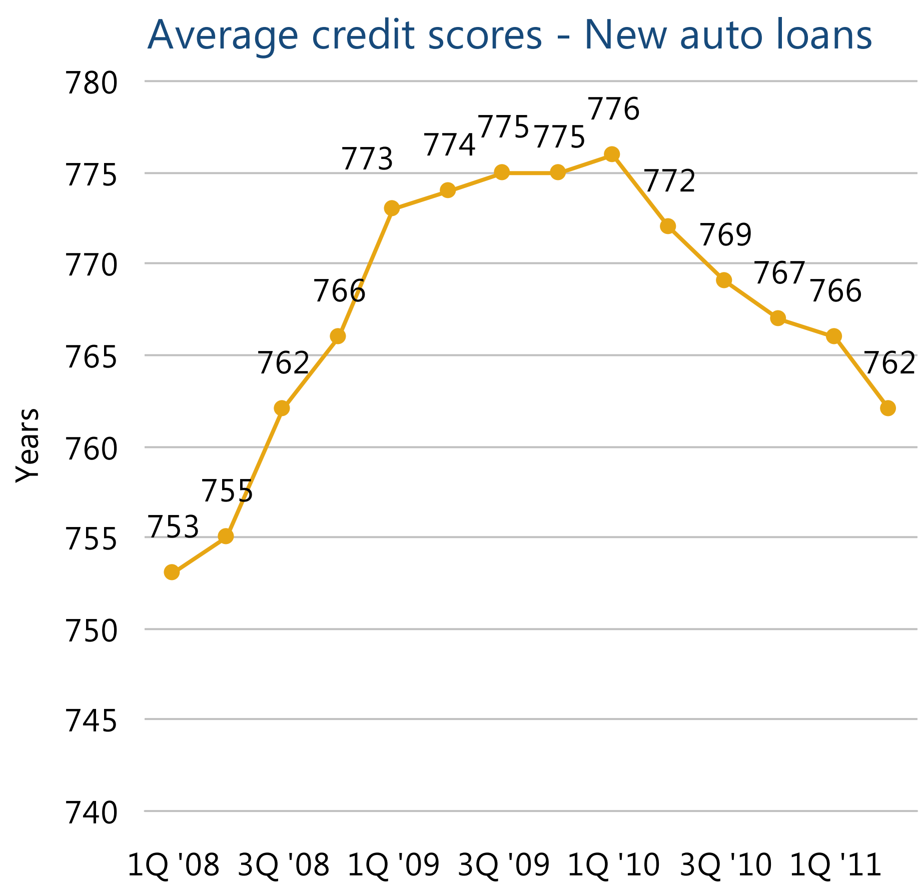
As of 15 February 2012
SOURCE: Federal Reserve

Time for a new car?

- Cars are older

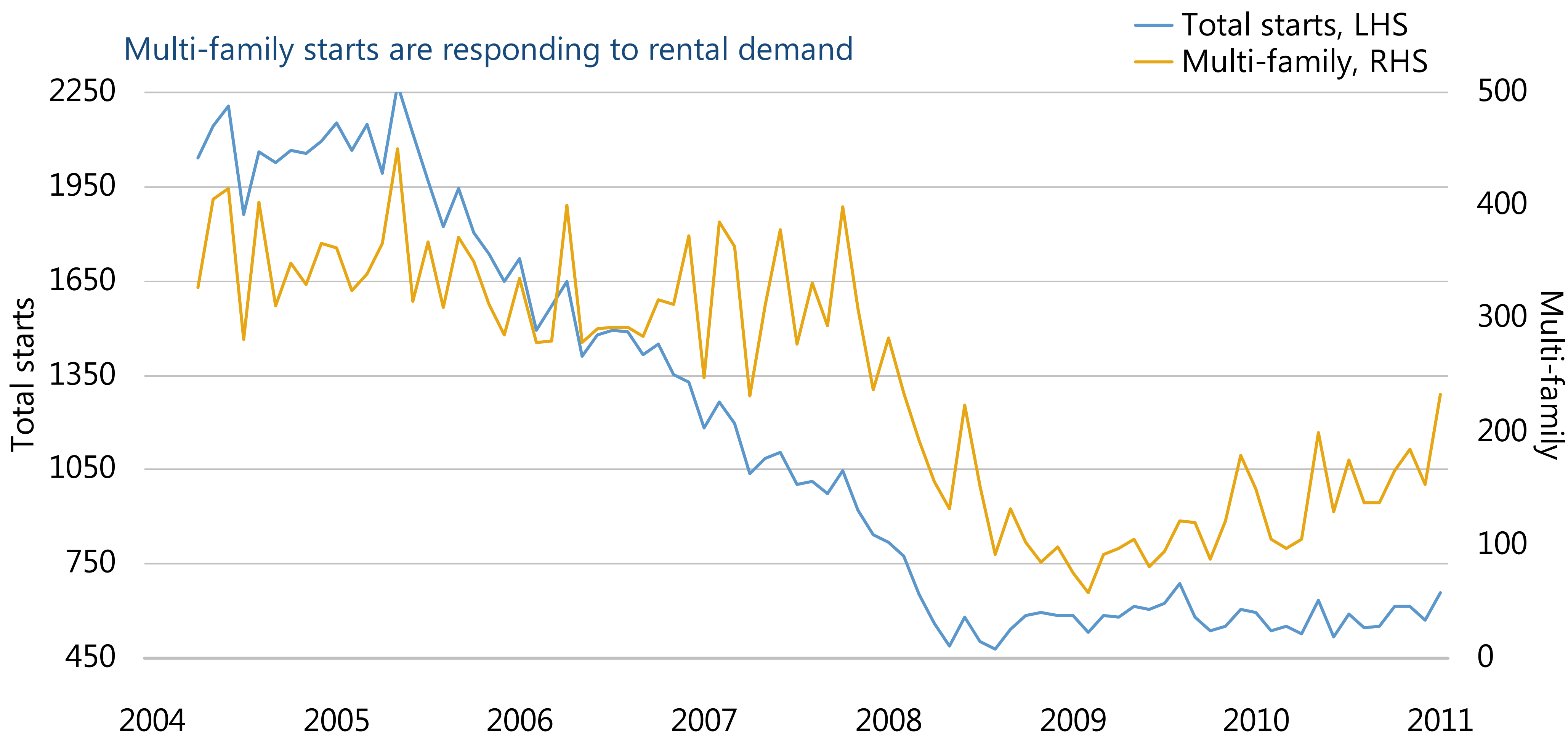


- Credit conditions have improved



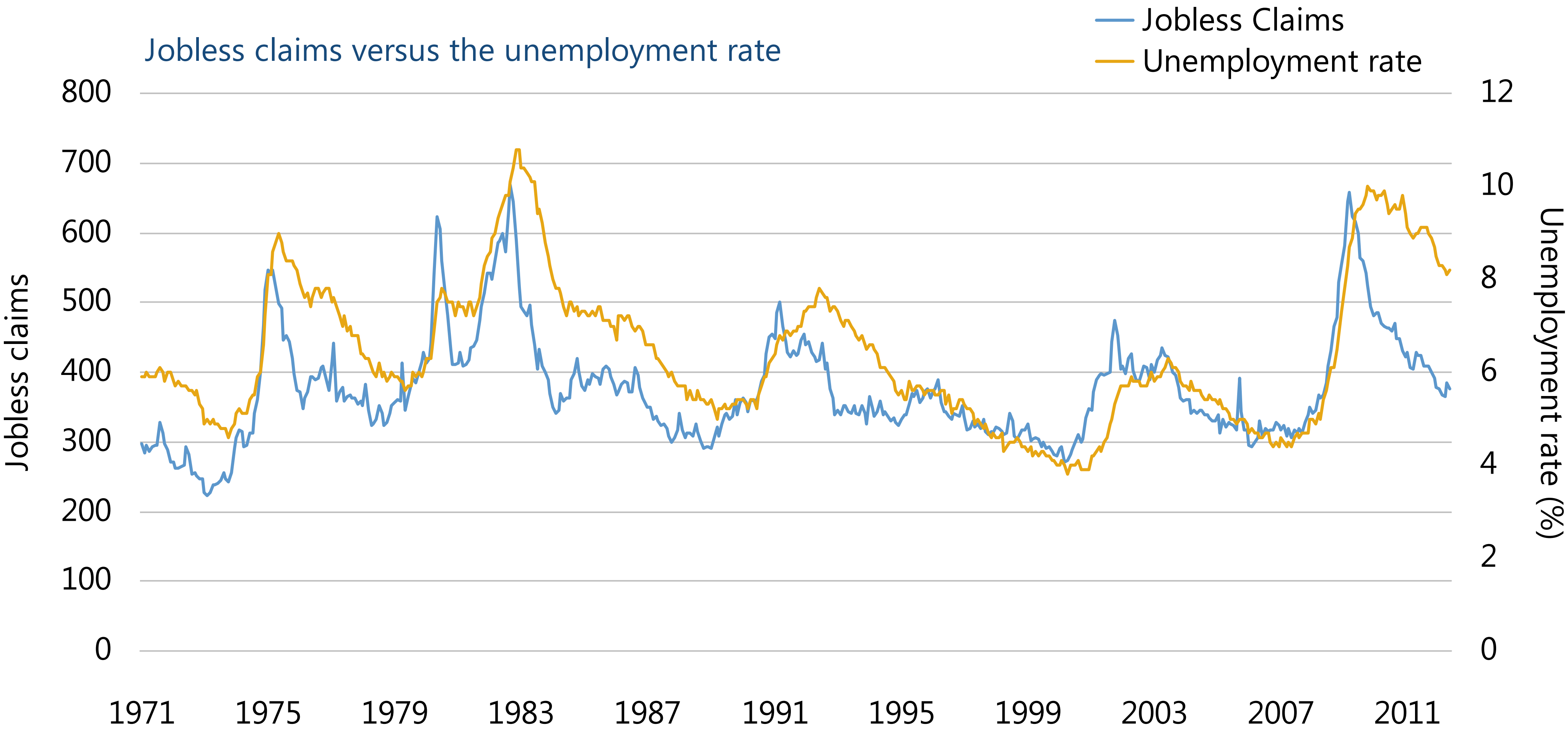
As of 30 September 2011
SOURCE: R.L. Polk, Experian Automotive © Edmunds.com, Inc.

Housing won't likely add much to growth; but it won't take away much either



As of 30 September 2011
SOURCE: U.S. Census Bureau. Shown in thousands of units
Refer to Appendix for additional outlook information.

Support for U.S. economic growth



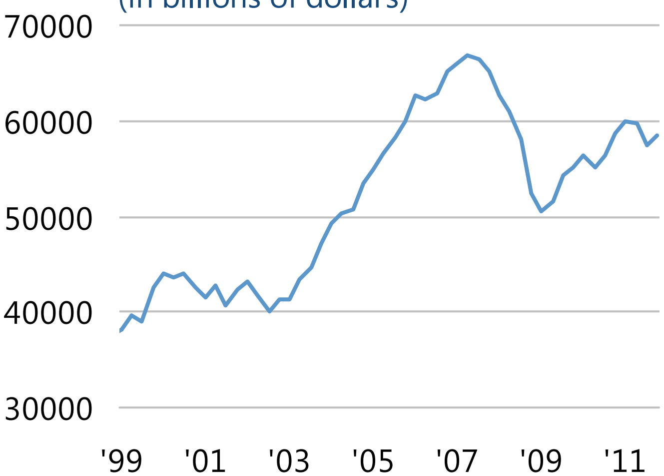
As of 31 May 2012
SOURCE: Haver

3. Headwinds to growth

Headwinds to growth

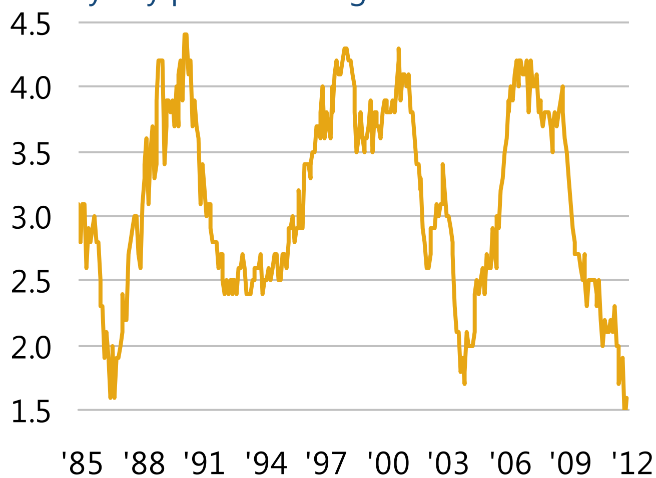
Wealth destruction

Household Net Worth
(in billions of dollars)



Income Growth

Average hourly earnings
y-o-y percent change



Mortgage credit availability

Real estate loans outstanding
(in billions of dollars)

As of 31 December 2011, 29 February 2012, and 31 December 2011 from left to right.
SOURCE: Haver

Headwinds to growth

A Massive Fiscal Cliff is Ahead for 2013

- $525 billion of tax increases and spending cuts are slated for January 1st
- Businesses and consumers could adjust their behavior beforehand
- Markets may also pull the date forward

2013 fiscal contraction could be extreme

	2013 Contraction ($B) Current law
Expiration of Bush-era tax cuts	(210)
AMT and Doc fix	(145)
Sequestration from super committee failure	(109)
Affordable Care Act	(25)
Payroll tax cut expiration	(110)
Unemployment insurance extension expiration	(35)
Total	$634 billion
Percent of GDP	**4.1%**

As of 30 June 2012
SOURCE: Nick Bloom, Stanford University, Bloomberg, Bank of America, CBO, Goldman Sachs, Center on Budget and Policy Priorities, Congressional Research Services, PIMCO
Refer to Appendix for additional outlook information.

4. PIMCO's European outlook

Grand bargain #.2: Can the core countries of Europe save its peripheral countries?

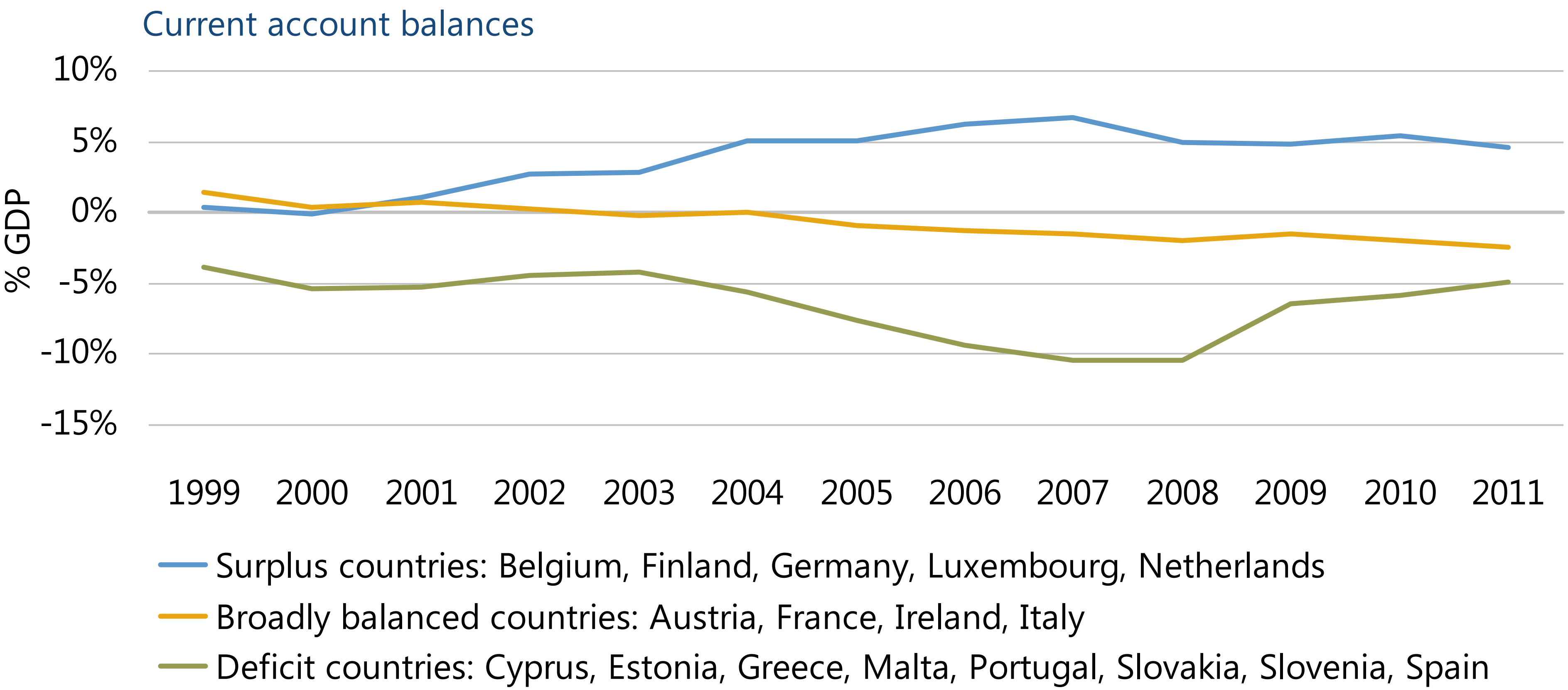
		Fiscal		Sovereign assuming banking sector obligations	Competitiveness
		Deficit	Stock		
Solvent and Investable	Italy		x		x
	Spain	x		x	
Potentially Insolvent	Portugal	x	x		x
	Ireland	x	x	x	
	Greece	x	x		x

- Greece, Ireland and Portugal are problematic, but likely not large enough to have global systemic implications
- Greece, Ireland and Portugal become systemically important when their spreads widening affects Spain and Italy access to the debt markets.

SOURCE: PIMCO
Sample for illustrative purposes only.
Refer to the Appendix for additional outlook information.

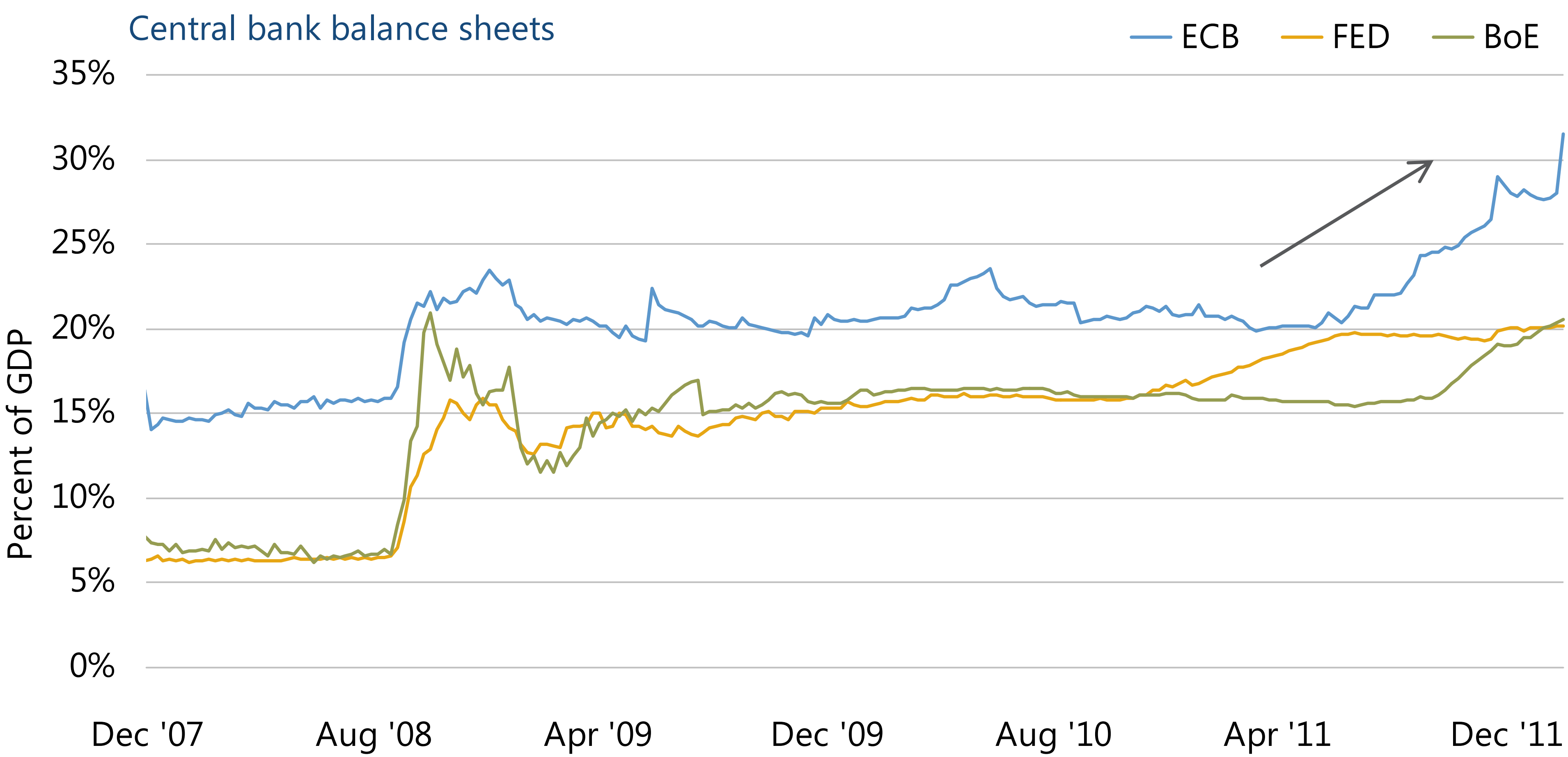
The main issue in Europe is a balance of payments problem

- Too much debt and large productivity differences combined with currency account imbalances



As of 31 December 2011.
SOURCE: Eurostat

The ECB has bought time via the powerful LTROs, but this monetary policy is only a bridge …



As of 2 March 2012
SOURCE: Bloomberg Financial Markets
LTRO - Long Term Refinancing Operation

The Eurozone: A coordination problem with no easy answer

Eurozone sovereigns now have credit as well as interest-rate risk

- National Solvency Concerns:
  - High debt ratios with limited flexibility for fiscal adjustment
  - Fixed exchange rate constrains the use of fx depreciation to spur growth
  - Eurozone sovereigns do not have unilateral recourse to printing press
  - Contagion effects leading to a loss of confidence and reinforcing solvency concerns

- Policy Co-ordination Problems:
  - Absence of fiscal federalism drives moral hazard concerns
  - Limited agreement on form of policy solution to address underlying issues

Refer to Appendix for additional outlook information.

Incremental policy changes: Not enough to sustainably secure the Eurozone over the secular horizon

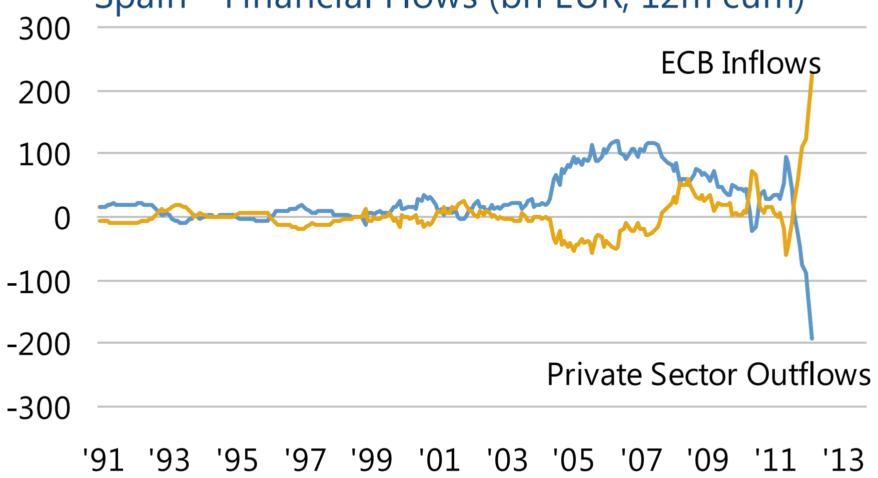
	Eurozone Fiscal Integration	Italy/Spain Debt Sustainability	Fragmentation of EMU financial markets	Financial Stability	Score
Immediate	Agree on plan for deeper fiscal union	ECB or Fiscal Lender of Last Resort for EMU Govts	Policy differentiation: Decide who is in and who is Not	Address bank capital shortfalls/deposit runs	**1 / 4**
Progress	**Just starting**	**Partial**	**NO**	**Partial**	
Intermediate	Lay groundwork for institutional/ constitutional changes	Have credible medium term fiscal austerity plans, but don't destroy growth	Prevent further inward shift in EMU Govt demand curve by lowering BTP/SPGB yield volatility	Contagion risks: Deal with Greece on sustainable basis with firebreak in place; get ready for Portugal?	**1/2 / 4**
Progress	**Just starting**	**Partial**	**NO**	**NO**	
Long-term	Introduce Common Bond	Implement structural reforms to raise growth	Adjust Current account imbalances	Common EMU bank regulator & FDIC	**1/ 4**
Progress	**No**	**Starts 2012**	**Progressing**	**Just starting**	

SOURCE: PIMCO
Refer to Appendix for additional outlook information.

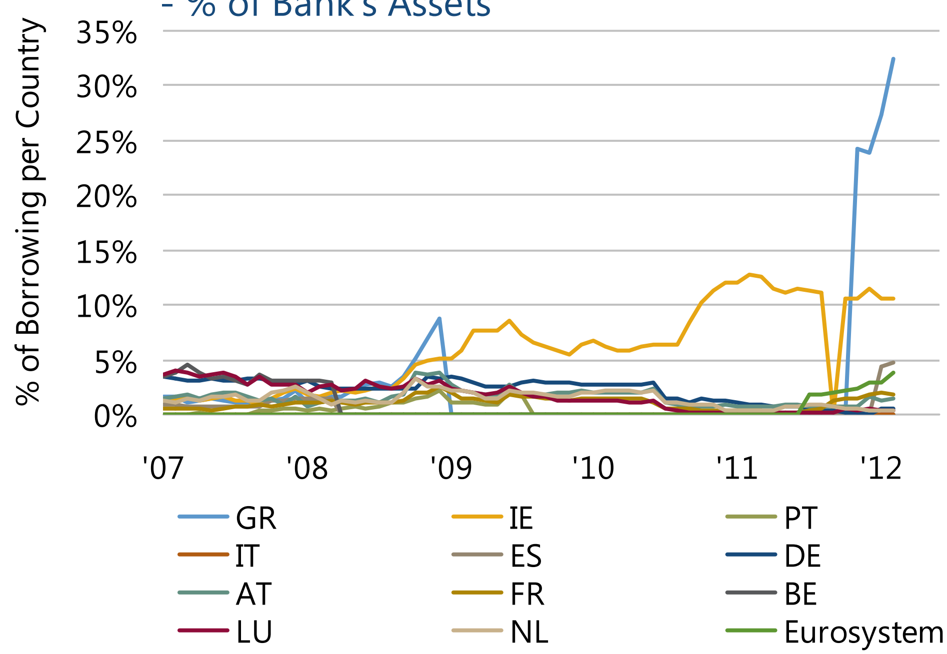
No credible policy response means private capital flight and increased dependence on ECB

- The Greek, Irish and Portuguese banking systems entirely reliant on ECB for over a year
- Usage by Spanish, Italian and French banks has picked up sharply since the summer
- ECB 3yr LTROs prevented disorderly de-leveraging but no sustainable policy for stabilizing sovereign market
- Expect continued private capital flight to result in greater financial tensions

Spain - Financial Flows (bn EUR, 12m cum)



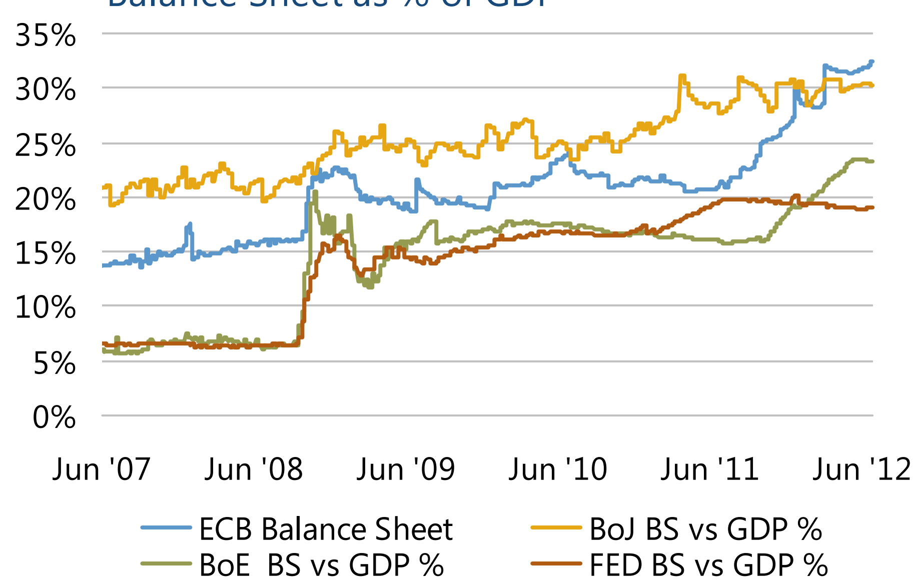
Borrowing from ECB (incl- ELA from NCB) - % of Bank's Assets



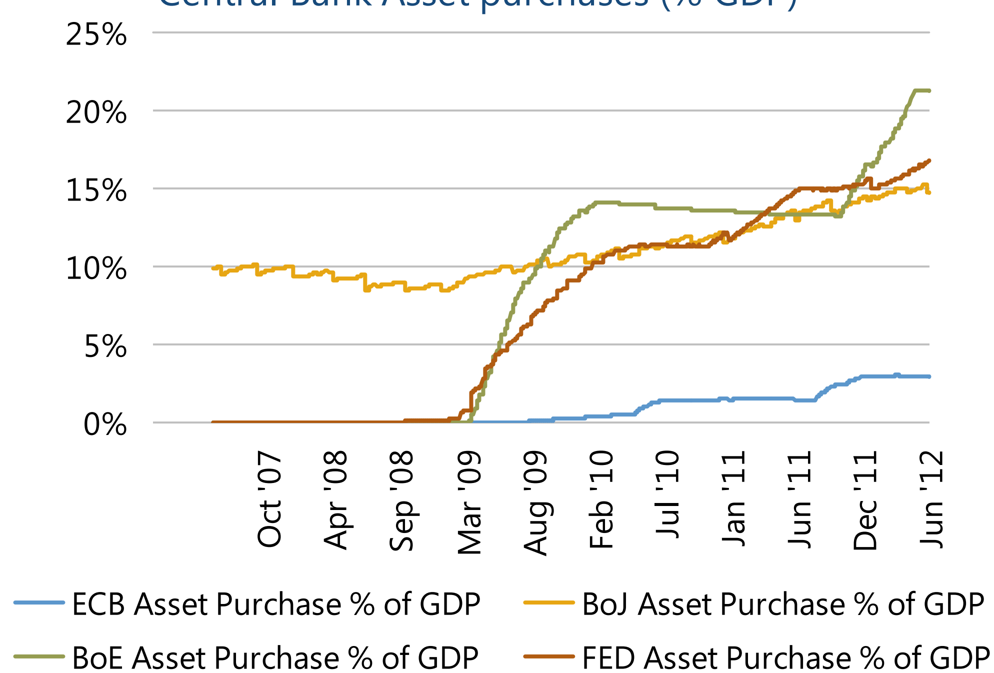
Left chart: As of 31 October 2011, SOURCE: PIMCO, ECB, National Central Banks
Right Chart: As of May 2012, SOURCE: PIMCO, ECB, National central banks
Refer to Appendix for additional outlook information.

The ECB's evolving mission

- ECB has provided ample liquidity support but purchased relatively few assets
- What next: expect slow mission creep not U-turn. ECB's institutional survival depends on Euro financial stabilization
- Success depends on ECB willingness to provide deep-pocket policy pre-commitments that create financial repression in Spain & Italy similar to what Fed & BoE have achieved.
- Fiscal & banking union, together with more growth focused agenda remain necessary to secure Eurozone over the longer-term.

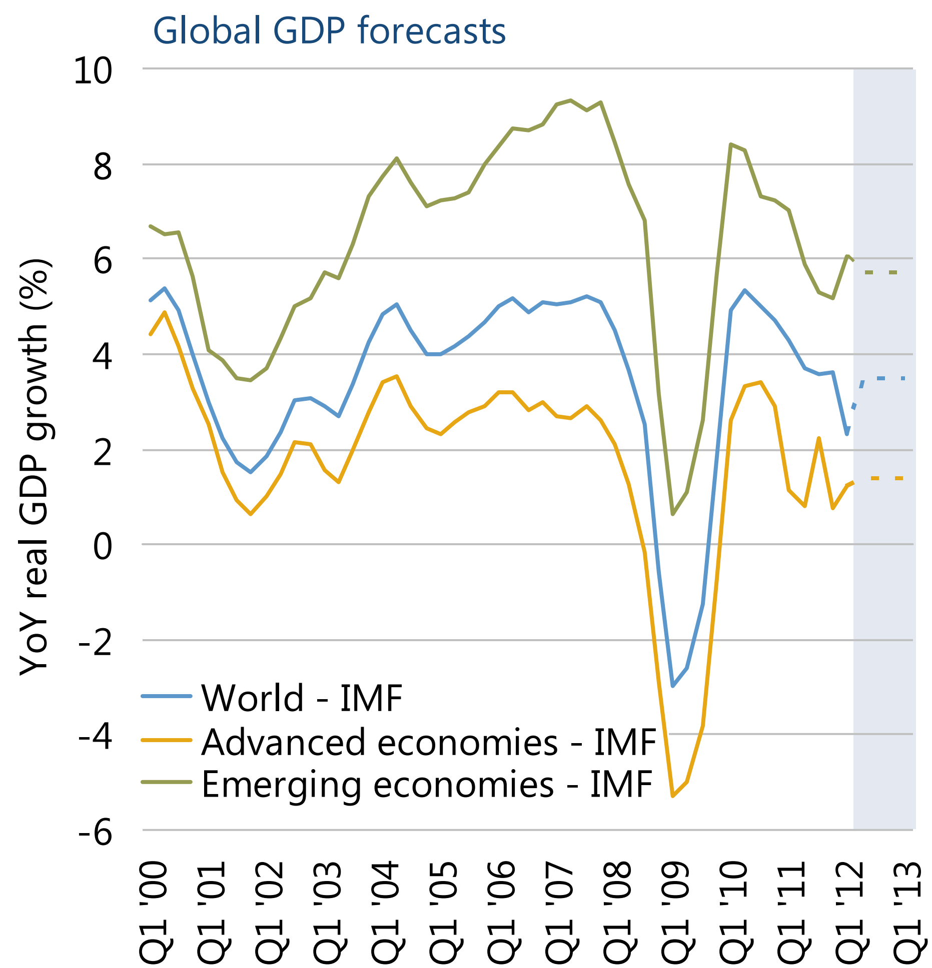


As of 25 June 2012
SOURCE: PIMCO, BoE, ECB, Fed, BoJ, Bloomberg
Refer to Appendix for additional outlook information.



The world needs growth and is currently undergoing a stall speed 'recovery' …

- Global economy on slowing, twin track recovery from recession
- Fiscal stimulus was necessary, but consolidation is on the way
- Sovereign default risk slamming confidence
- Deleveraging Continues
- No easy choices for the Central Banks or fiscal authorities
- Institutional Integrity on the Line



As of 30 September 2011
SOURCE: Haver Analytics, IMF World Economic Outlook, PIMCO
Refer to Appendix for additional forecast and outlook information.

PIMCO's cyclical framework for the global economic outlook

Deteriorating economic conditions

CYCLICAL OUTLOOK (6 – 12 MONTHS)	DESCRIPTION
A	▪ 4–6% nominal GDP growth rate ▪ Old Normal, V-shaped recovery
B	▪ 4–6% nominal GDP growth rate ▪ Old Normal, U-shaped recovery
C	▪ 1–3% nominal GDP growth rate
D	▪ Economy re-enters recession or worse

Overall, PIMCO sees below consensus global growth in 2012 of 2-3%

- Deleveraging continues in Europe but pauses in U.S.
- Inflationary pressures continue to build
- Policy deadlocks delay structural reforms

As of 31 March 2012
SOURCE: PIMCO
Refer to Appendix for additional forecast and outlook information.

PIMCO cyclical forum economic forecasts

	REAL GDP		HEADLINE INFLATION	
	CURRENT[1]	**PIMCO FORECAST Q1 '12 – Q1 '13**	**CURRENT[1]**	**PIMCO FORECAST Q1 '12 – Q1 '13**
Canada	1.8%	1.5% to 2.0%	2.1%[3]	1.75% to 2.25%
U.S.	1.8%	1.0% to 2.0%	3.3%	2.5% to 3.0%
Europe	0.7%	-1.5% to -0.5%	2.8%	1.5% to 2.0%
U.K.	0.7%	-0.5% to 0.0%	4.2%	2.5% to 3.0%
Japan	-1.0%	0.5% to 1.5%	-0.3%	-0.5% to 0.0%
China	8.7%	7.0% to 8.0%	4.1%	4.5% to 5.0%
BRIM[2]	3.8%	3.5% to 4.5%	6.0%	5.5% to 6.0%
World[3]	**2.3%**	**1.0% to 2.0%**	**2.9%**	**2.5% to 3.0%**

As of 31 March 2012
SOURCE: PIMCO, Bloomberg
1 Current data for real GDP growth and inflation is actual and represents four quarters ending Q1 2012
2 Brazil/Russia/India/Mexico
3 World is weighted average sum of PIMCO forecast countries
Refer to Appendix for additional forecast and outlook information.

5. Investment implications

Investment implications

Strategic considerations:

- Rethink traditional frameworks: EM-DM overlap means we can no longer classify sovereigns as distinctly as before
- Know what risk you are taking: Pay attention to sovereign credit as well as interest rate risk
- Re-examine your benchmark: Look for bespoke benchmarks with a higher weight of less-leveraged sovereign credits e.g. Investment-Grade Emerging Markets or GDP-weighted indices (e.g. PIMCO GLADI)
- Avoid passive investing: Emphasize bottom-up credit assessment for sovereigns as well as corporate credits.

Refer to Appendix for additional investment strategy, index and risk information.

Investment implications

Portfolio implications to consider:

- **Focus on Developed country interest rate risk in 5-7yr sector** which could benefit from expected carry and roll down as rates kept on hold.
- **Under-weight Eurozone peripheries** as crisis needs to get worse to elicit policy response, and left tail risk of policy failure can't be dismissed
- **Under-weight Bunds**: Own higher yielding German agencies instead
- **Diversify into local currency duration in high quality EM countries** where real interest rates are high and there is flexibility to withstand global and domestic shocks.
- **Focus on "safe spread*" investments** across assets taking into account loss- and volatility-adjusted total returns. Take liquidity rather than credit risk premiums.
- **Look to incorporate tail-risk hedges** to help manage high sovereign credit risk and the spillover effects.

* "Safe Spread" is defined as sectors that we believe are most likely to withstand the vicissitudes of a wide range of possible economic scenarios. All investments contain risk and may lose value.
Refer to Appendix for additional investment strategy and risk information.

Appendix

Past performance is not a guarantee or a reliable indicator of future results.

FORECAST

Forecasts, estimates, and certain information contained herein are based upon proprietary research and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. There is no guarantee that results will be achieved.

INVESTMENT STRATEGY

There is no guarantee that these investment strategies will work under all market conditions and each investor should evaluate their ability to invest for a long-term especially during periods of downturn in the market.

OUTLOOK

Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

RISK

Investing in the **bond market** is subject to certain risks including market, interest-rate, issuer, credit, and inflation risk. Investing in **foreign denominated and/or domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Sovereign securities** are generally backed by the issuing government, obligations of U.S. Government agencies and authorities are supported by varying degrees but are generally not backed by the full faith of the U.S. Government; portfolios that invest in such securities are not guaranteed and will fluctuate in value. **Derivatives** may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. Diversification does not ensure against loss.

Appendix

The PIMCO Canada Trusts offered by PIMCO Canada Corp. are only available in provinces or territories of Canada to investors who are accredited investors within the meaning of the relevant provincial or territorial legislation or rules and in certain provinces, only through dealers authorized for that purpose. PIMCO Canada will retain PIMCO LLC as a sub-advisor. PIMCO Canada will remain responsible for any loss that arises out of the failure of its sub-advisor.

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INDEX DESCRIPTIONS

The BofA Merrill Lynch Canada Corporate Index tracks the performance of CAD denominated investment grade corporate, securitized and collateralized debt publicly issued in the Canadian domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and DBRS), at least one year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of CAD 100 million.

The BofA Merrill Lynch Euro Broad Market Index tracks the performance of EUR denominated investment grade debt publicly issued in the eurobond or Euro member domestic markets, including euro-sovereign, quasi-government, corporate, securitized and collateralized securities. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch), at least one year remaining term to final maturity and a fixed coupon schedule.

BofA Merrill Lynch Global High Yield BB-B Rated 2% Constrained Index tracks the performance of below investment grade bonds of below investment grade bonds of corporate issuers domiciled in countries having an investment grade foreign currency long term debt rating (based on a composite of Moody's, S&P, and Fitch). The index includes bonds denominated in U.S. dollars, Canadian dollars, sterling, euro (or euro legacy currency), but excludes all multicurrency denominated bonds. Bonds must be rated below investment grade but at least B3 based on a composite of Moody's, S&P, and Fitch. Qualifying bonds are capitalization-weighted provided the total allocation to an individual issuer (defined by Bloomberg tickers) does not exceed 2%. Issuers that exceed the limit are reduced to 2% and the face value of each of their bonds is adjusted on a pro-rata basis. Similarly, the face value of bonds of all other issuers that fall below the 2% cap are increased on a pro-rata basis. The index is re-balanced on the last calendar day of the month. The inception date of the index is December 31, 1997.

The BofA Merrill Lynch US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch), at least one year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of $250 million.

The BofA Merrill Lynch US Financial Index is a subset of The BofA Merrill Lynch US Corporate Index including all securities of Financial issuers.

Appendix

The DEX Corporate Bond Index consists of a diversified selection of investment-grade corporate bonds issued domestically in Canada and denominated in Canadian dollars.

The DEX Universe Bond Index covers all marketable Canadian bonds with term to maturity of more than 1 year. History dates from December 1979. The Universe contains over 900 marketable Canadian bonds. The average term is 9 years and the average duration is 5.5 years. The purpose of this index is to reflect performance of the broad "Canadian bond market" in a manner similar to the way the TSE 300 represents the Canadian equity market. Prior to 22 October 2007, the index was known as Scotia Capital Universe Bond Index.

The DEX Long Term Bond index is an unmanaged index that covers bonds with term to maturity of greater than 10 years. The index includes historical dates from December 1947 and approximately 270 marketable Canadian bonds. The average term of the bond is 21 years and average duration is 10 years. Prior to 22 October 2007, the index was known as Scotia Capital Long Term Bond Index.

The JPMorgan Emerging Markets Bond Index Global is an unmanaged index which tracks the total return of U.S.-dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady Bonds, loans, Eurobonds, and local market instruments.

It is not possible to invest directly in an unmanaged index.