

Weekly guidebook for the global investor



Macro viewpoint: The roof caves in again on housing and Fed tightening calls

The Fed is clearly juggling a lot of balls, and heightened inflation pressure from food and fuels certainly is among them. But make no mistake, as long as Bernanke sees “downside” risks to the growth outlook, there is very little chance that interest rate hikes will be forthcoming despite high and rising headline inflation rates, in our opinion. It is also interesting to see that for all the talk of oil prices causing a further outbreak of inflation expectations, the Fed Chairman still sees it as a double-edged sword – a de facto deflationary tax on incomes, profits and spending.

The week ahead: A busy week, with the Fed on Wednesday

There will be a large number of economic releases next week, though market focus will likely fall on the two-day FOMC meeting that ends Wednesday. We will get housing sales, consumer confidence, durable goods orders, personal income and spending, core PCE deflator, as well as the final read of GDP.

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Builder sentiment hooks back down to its all-time low
National Association of Home Builders: Housing market index



Source: National Association of Home Builders, Merrill Lynch

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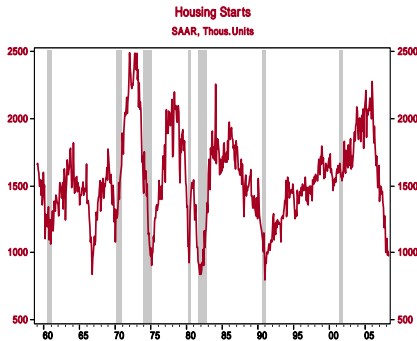
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Macro viewpoint

The roof caves in again ... on housing and the Fed tightening calls

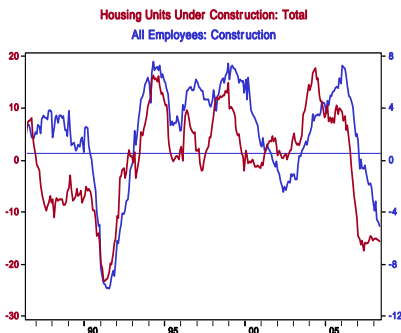
“...until the housing market, and particularly house prices, shows clearer signs of stabilization, growth risks will remain to the downside. Recent increases in oil prices pose additional downside risks to growth.”
 Fed Chairman Ben Bernanke, “Remarks on the Economic Outlook”, 3 June 2008.

Chart 1: Housing starts fast approaching historic lows



Source: Census Bureau, Haver Analytics, Merrill Lynch

Chart 2: Units under construction sag, employment will too (year-over-year % change)



Source: Census Bureau, Haver Analytics, Merrill Lynch

Little chance rate hikes are coming despite rising inflation

The Fed is clearly juggling a lot of balls, and heightened inflation pressure from food and fuels certainly is among them. But make no mistake, as long as Bernanke sees “downside” risks to the growth outlook, there is very little chance that interest rate hikes will be forthcoming despite high and rising headline inflation rates, in our opinion. It is also interesting to see that for all the talk of oil prices causing a further outbreak of inflation expectations, the Fed Chairman still sees it as a double-edged sword – a de facto deflationary tax on incomes, profits and spending.

Housing starts data show that downside risks remain

As Mr. Bernanke indicated earlier this month, the downside risks to the economy will remain intact in the absence of a visible recovery in the residential real estate market. This week’s housing starts data for May reinforced those downside risks – down 3.5% to 975,000 units (annual rate), which sets not just a new low for the cycle but the lowest level since March 1991 (and the Fed didn’t start tightening back then for another three years!).

Housing downturn has not fully run its course

What really caught our eye was the 4% plunge in single-family building permits to 623,000 units, which is nearly 8% below the prevailing level of starts, not to mention down a whopping 41.4% year-on-year. In other words, look for further declines in residential construction in coming months and likely quarters too. The dip in the NAHB in June to a new record low (tied actually) of 18 from 19 in May, coupled with this bond-induced spike in mortgage rates to their highest level in eight months, also strongly suggests that the housing downturn has yet to fully run its course.

Accelerated job losses in the construction sector

Housing completions are starting to peel off as the prior downturn in housing starts feeds through the construction pipeline – down 1.9% month to month and 15.6% from year-ago levels. This points to accelerated job losses in this sector. Construction jobs are declining at a pace of more than 40,000 a month so far this year, more than double the average slippage posted in 2007. If the experience of the early 1990s is any indication, at the peak of the job retrenchment, we could well expect to see monthly declines in this space approach 70,000-80,000.

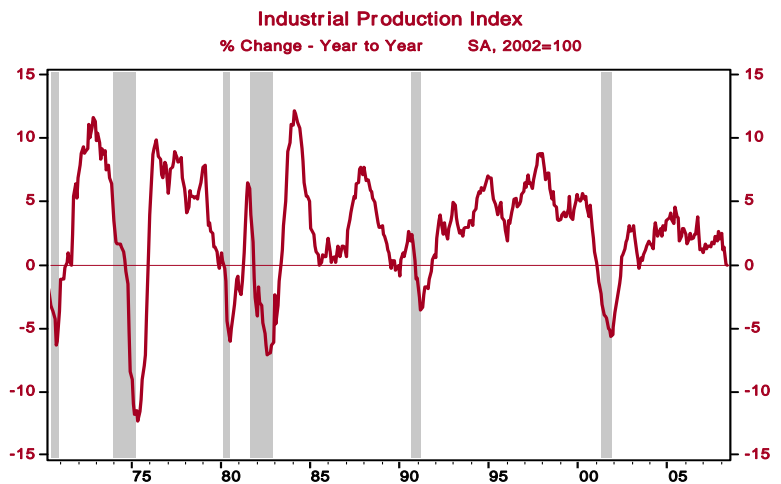
Very disappointing industrial production data

The industrial production data for May were also very disappointing in light of the returned strike-affected auto workers during the month. Output was down 0.2% instead of rising 0.1% as was widely expected. And, while the generally volatile utilities sector was one culprit (-1.8%), even outside of that, manufacturing production was flat on the month after a huge 0.9% slide in April. Declines were very broadly based in consumer goods (-0.2% – down four months in a row); defense/aerospace (-0.5%), construction supplies (-0.1%), business supplies (-0.3%) and even basic materials (-0.2% and down two months in a row).

Industrial production goes into the recession call

Remember that industrial production is one of the four inputs that the National Bureau of Economic Research uses in making the ultimate recession call – and it peaked in January and is down at a 4.2% annual rate since that time. One recession indicator in the production report was the 0.1% dip on a year-on-year basis. We have not seen a “minus” sign on the 12-month trend since June, 2003 when activity stalled amid the Iraq war, and outside of that, such a move below the zero-line only occurred in recessions going back over the past 40 years.

Chart 3: Industrial production down 0.1% year-over-year



Source: Federal Reserve Board, Haver Analytics, Merrill Lynch

We will keep a keen eye on the core intermediate PPI because it is showing a visible breakout.

Narrow group of manufacturers able to pass on some costs

No doubt we have a narrowly confined group of manufacturers now able to pass on some costs, as we saw in the PPI data for May, but the closer to the factory gate level, the tougher it is to raise prices. Hence, the core PPI was up only 0.2% in May and 3% year-on-year. We will keep a very keen eye on the core intermediate PPI because this is showing a visible breakout (+2% MoM; +18.5% at an annual rate over the past three months; +7.4% year-over-year). But again, this surge is narrowly confined to metals and chemicals.

Not enough broad-based pricing power to cause concern

Most other components of the core intermediate PPI are not flashing an inflationary pulse at all. In fact, outside of chemicals and metals, the core intermediate PPI is only running at a 3% year-on-year rate. Be that as it may, the entire core PPI intermediate index can sometimes be a useful guide for the future outlook for the core goods CPI (which is running flat right now). So, we will be vigilant in monitoring the situation, but, at this stage, there is just not enough broad-based pricing power to cause us undue concern.

The Fed is very clearly caught in the proverbial box

The Fed cannot tighten policy in advance of an improvement in housing, credit or labor markets, and nothing in the leading indicators suggests any significant parting of the clouds on the horizon. The NAHB is pointing to sustained weakness in sales and starts. The Manpower survey is flashing more job losses in the next three months. And, banks continue to post large-scale losses and take on more writedowns. The only source of support right now is from the tax rebates, but the impact of this on consumer spending will start to fade before the summer ends.

By the time Labor Day rolls around, we could be dealing with a headline inflation rate of close to 6% for the first time since December 1990.

Yet, by the time Labor Day rolls around, we could be dealing with a headline inflation rate of close to 6% for the first time since December 1990 – not just due to energy but also food, with the floods in the Midwest triggering record highs in corn and cattle futures, and this will show through in a surge in meat and poultry prices in the months ahead. Also keep in mind that the CPI data will be calculated off of a low year-ago base in coming months, skewing the YoY inflation rates even further.

We are looking for a deceleration in core inflation

We are not looking for any acceleration in the core rate of inflation going forward and actually look for a mild deceleration from 2.3% to 2% into the fall (despite the latest pickup in the core intermediate PPI). This includes our assumptions of some pass-through to air fares, but this barely accounts for over 1% of the core CPI. Automotive commands a 10% share, and excess supply will drive more deflation in this sector. And of course, about 40% of the index is the rental and owners' equivalent components. These have now embarked on a significant downtrend, and both will provide a very strong antidote to any prospective surge in air fares. We should mention that just as the surge in gas prices has actually played a role in deflating auto prices, the runup in fuel prices is doing the same thing to the hotel/leisure sector.

Core inflation has an 86% correlation with 10-year yields

We went back over the last two decades and found that the core inflation rate – despite the fact that it has become so maligned by some pundits who claim the index is only followed by economists who don't eat or drive – has an 86% historic correlation to the 10-year T-note yield. This is in contrast to the 53% correlation with headline inflation. Be that as it may, headline inflation is not, on its own, insignificant, and we will hazard to guess that as it tests the 6% mark later this summer, there will be no shortage of bearish strategists telling us that the last time the inflation rate was this high, the yield on the 10-year note was sitting just north of 8%. And that would in fact be true. It is also true, however, that the core inflation rate back then was nearly 4-1/2%, not 2.3% as is the case today.

Fed can't bite with the market backdrop this fragile

In our view, the Fed is barking now because deep down inside, it knows it can't bite with such a fragile macro and market backdrop. We are barely three months removed from the failure of a major investment bank and the full repercussions of the end of the parabolic secular credit expansion have not yet been fully felt – not by a long shot. This is where many of the bond bears and policy hawks have not got the right story in our view.

Fed knows jump in inflation is likely to be temporary

The Fed must talk about quashing inflation expectations now because it knows that they can become really unhinged if inflation does break 5% and test 6% this summer. So, make hay while the sun shines – this does not mean the central bank is going to actually pull the trigger. The Fed, like us, knows that the jump in inflation is likely to be temporary and sees the food and fuel induced surge as a move in relative prices – the Fed simply does not want businesses to see this coming move as permanent.

Despite dissenters, Bernanke still gets what he wants

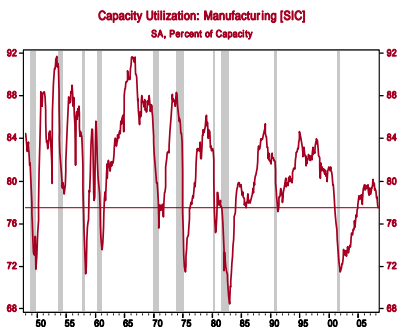
The problem as we see it is that the hawkish Fed bank presidents do a ton of interviews, a lot of speeches, and they get a ton of press – but only two hawkish presidents currently have a vote – Messrs Plosser and Fisher. These two dissented at the last meeting; they are probably going to dissent next week. But Bernanke has faced no fewer than eight dissenters since he started to cut rates last September, and he has basically done what he wanted. There are eight others who have a vote on the FOMC, and we cannot find any that seem willing to vote against the Chairman. Bullard from St. Louis and Lacker from Richmond will undoubtedly be heard, but these hawks do not have a vote.

We doubt the Fed will be tightening this year

So to reiterate, we would say that barring convincing signs that the housing recession is over, that credit conditions are back to normal or that employment is no longer declining, the Fed may bark about inflation expectations, but we doubt it will be tightening this year. If there is a hurdle in the near term, it may be more for the back end of the yield curve, if inflation expectations continue to rise with a 6% CPI rate looming. As we said, there is little the Fed is going to be able to do to prevent this acceleration from happening, and with 2-3 months to go at that point before the election, we would have to think the Fed is going to want to be out of the picture.

It may be time to start thinking about a bear steepener through the summer as a main strategy.

Chart 4: CAPU rates down to recession levels

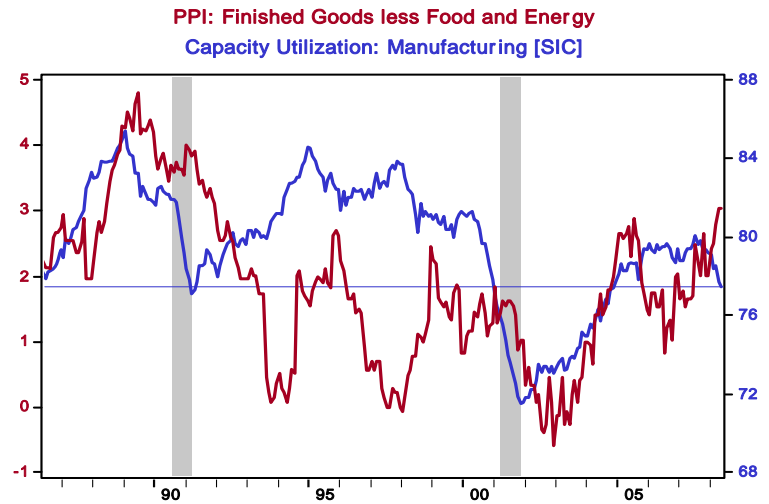


Source: Federal Reserve Board, Haver Analytics, Merrill Lynch

We think that if the Fed does raise rates it will be because the economy is showing signs of vigor, not because of a temporary spike in the inflation rate. Remember that just as the inflation rate is testing 6%, the fiscal stimulus is going to fade (though there is talk of another package coming to the fore by July), and the unemployment may well be reaching 6%. So you may want to start to think about a bear steepener through the summer as a main strategy.

But in our view, an interim selloff at the longer end of the bond curve this summer will likely prove to be an excellent buying opportunity into the fourth quarter as real GDP growth falters and inflation pressures subside in response to widening excess capacity in both the product and labor markets. From our lens, it is tough to square a sustained increase in producer inflation with manufacturing capacity utilization rates declining as they did in May to a four-year low of 77.5%, now well off the peak of 80.1% posted last July.

Chart 5: CAPU rates (%) flashing a peaking out in core PPI
(year-over-year % change)



Source: Federal Reserve Board, Haver Analytics, Merrill Lynch

Core inflation, funds available to household spending, and asset deflation all suggest that our call for lower Treasury yields is the right call,

Premature to back off our call for lower Treasury yields

The other factors that we believe will cap this selloff in Treasuries, even in the face of what is soon to be a surprising set of consumer inflation data, will be the sharp dampening effect this will have on profit margins, equity valuation and employment. This in turn suggests some really serious pressure on overall GDP growth is going to persist for as long as this commodity explosion remains in place – a deflationary tax on incomes and profits. For that reason, we think it is premature to back off our call for lower Treasury yields over the next 12-18 months because when we add up the pluses and minuses, the only minus is headline inflation. Core inflation, funds available to household spending, and asset deflation all suggest that our call for lower Treasury yields is the right call, notwithstanding intermittent bumps along the way.

We are not alone in our inflation view

Let's just say that we are not alone in our inflation view – the Bank of England believes the jump in inflation is going to reverse course as well. In his letter to the Chancellor this week, BoE Governor Mervyn King did not mince any words:

“There are good reasons to expect the period of above-target inflation we are experiencing now to be temporary. We are seeing a change in commodity, energy, and import prices relative to the prices of other goods and services. Although this clearly raises the price level, it is not the same as continuing inflation. There is not a generalized rise in prices and wages caused by rapid growth in the amount of money spent in the economy. In contrast to past episodes of rising inflation, money spending is increasing at a normal rate. In the year to 2008 Q1, it rose by 5.5%, in line with the average rate of increase since 1997 – a period in which inflation has been low and stable. Moreover, in recent months the growth rate of the broad money supply has eased and credit conditions have tightened. This will restrain the growth of money spending in the future.”

The same holds true in the United States, even if Bernanke doesn't have to write letters to Paulson.

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Key market movers

The week ahead

There will be a large number of economic releases next week, though market focus will likely fall on the two-day FOMC meeting that ends Wednesday. We will get housing sales, consumer confidence, durable goods orders, personal income and spending, core PCE deflator, as well as the final read of GDP.

No improvement yet from home sales data

The home sales reports are expected to be soft. New and existing home sales are expected to fall in May, with months' supply likely to remain elevated. We have seen a rise in mortgage rates in the past month, providing additional restraint to sales.

Fragile households, despite boost in spending

Monthly personal spending should post gains in the month, with spending looking strong in nominal terms, but barely rising once price increases are taken into account. In line with the retail sales report, spending is expected to rise 0.6% m/m, as households appeared to be spending a good deal of the stimulus checks. The core PCE price index – the Fed's favorite inflation gauge – is expected to climb from 2.1% YoY to 2.2%.

Despite the better data on spending, households remain in fragile state. This is expected to be seen in both the Conference Board's consumer confidence index, which is expected to hit a new cycle low of 57.0 in June, and the University of Michigan index, which is expected to see no significant upward revision in its final read. A myriad of headwinds continue to face households, including rising gasoline prices, falling equity markets and weakening labor markets.

Fed expected to keep rates unchanged Wednesday

The FOMC is widely expected to keep rates unchanged at 2.0% (consistent with all 96 economists polled on Bloomberg though current pricing is discounting a 10% probability of a hike in futures markets). The press statement is likely to suggest the Fed remains on hold for now, and balance the Committee's concerns between the upside risks from inflation and downside risks from economic growth. There is likely to be an upgrade to concerns over inflation. The Fed is likely in wait-and-see mode, gauging the incoming data from the housing market, the impact of high energy prices on households and the evolution of inflation expectations.

Tuesday, 24 June

The April Case Shiller home price index will extend the unbroken string of declines to 21 consecutive months

Case-Shiller Home Price Index (Composite 20), April—9:00am

	Exp	Cons	Range	History
Case-Shiller 20	-1.0%	--	--	Mar = -2.2% vs. Feb = -2.6%

Source: Merrill Lynch, Bloomberg

We expect the Case Shiller home price index to decline by 1.0% MoM in April, extending the unbroken string of declines to 21 consecutive months. On our forecast, the year-on-year rate will decline to -15% from 14.4% in March. The median price of existing home sales held relatively steady in April, suggesting that the monthly pace of decline in the Case Shiller will ease up in April. This is also corroborated by the month-to-date numbers in the RPX index from Radar Logic. Residential real estate remains 15-20 percent over valued in spite of the 17% decline in home values we have seen since 2006, in our view. With foreclosures yet to crest and inventories still close to 23 year highs we expect a continued grind lower in home prices over the balance of 2008 and 2009.

Consumers continue to face headwinds, and we expect confidence to hit a new cycle low of 57.0 in June.

Conference Board Consumer Confidence, June—10:00am

	Exp	Cons	Range	History
Consumer confidence	57.0	56.3	51.0 to 59.0	May = 57.2 vs. Apr = 62.8

Source: Merrill Lynch, Bloomberg

We expect consumer confidence hit will a new cycle low of 57.0 in June down from 57.2 in May, in line with the consensus outlook, with myriad factors still weighing on sentiment. Consumers continue to get buffeted by many headwinds; few of which seem to be abating. Gasoline prices continue to climb, moving firmly above \$4 per gallon nationally in early June. Food prices also remain on the rise and the flooding in the Midwest and reports of serious crop damage will only drive prices higher. There is no sign of recovery yet in the housing market and the latest back up in rates will only retard the process. The stock markets remain under downward ward pressure amid the sluggish US economic outlook and struggling financial sector. Meanwhile, labor markets are still very weak, with jobless claims now suggesting that the pace of job losses is mounting. Still, the weekly ABC/Money Magazine poll shows sentiment at about the same level as in mid-May, which suggests that the federal stimulus checks are providing the consumer with some support for now.

Wednesday, 25 June

We expect capex orders to pull back in May after the outsized 4.0% increase seen in April

Durable Goods Orders, May—8:30am

	Exp	Cons	Range	History
Durable Goods	0.2%	0.0	-2.2% to 1.0%	Apr = -0.6% vs. Mar = -0.2%
Durable Goods ex Trans	-0.3%	-1.0	-0.3% to 0.2%	Apr = 2.4% vs. Mar = 1.8%

Source: Merrill Lynch, Bloomberg

Durable goods orders will probably post a tepid 0.2% MoM gain in May after a 0.6% decline in April. The transportation sector will probably provide some support. Vehicle orders could turn higher since the strike at the GM parts manufacturer ended in May. Boeing received 67 civilian aircraft orders, up from 58 in April, though in value terms they rose just 6.2%. Machinery orders will likely pull back in May after two consecutive months of substantial gains – though we expect that the strong demand in resource based sectors has not changed materially at this point. Electrical equipment orders will probably decline after the

unusual 28% jump in April. Providing some offset will be tech orders, which could see a rebound after a 2.3% pullback in April. In all though, we expect that nondefense capital goods orders excluding aircraft – the proxy for capex spending – will drop by 2.3% MoM in May after the unusual 4.5% jump in April.

New home sales will probably slip to 512k units in May, marking a 63% decline in the annualized pace of sales from the 2005 peak.

New Home Sales, May—10:00am

	Exp	Cons	Range	History
New Home Sales	512k	514k	495k to 570k	Apr = 526k vs. Mar = 509k

Source: Merrill Lynch, Bloomberg

New home sales will probably slip to 512k units in May a 2.7% decline from April, marking a 63% decline in the annualized pace of sales from the peak back in 2005. Our weak outlook is supported by the National Association of Home Builders survey, which returned to the historic low of 18 in May that it originally attained last December. Both conforming and nonconforming mortgage rates have risen sharply in May as inflation fears have gripped the Treasury market.

Month's supply is likely to remain elevated at very close to 27-year highs. Home completions have generally been declining so we expect the number of homes for sale to drop to about 450k units from 456k in April. However, this will merely take the months supply down to 10.5 months from 10.6 months, which is still a daunting surplus that will no doubt continue to put downward pressure on home prices – as will the ongoing flood of foreclosed homes coming onto the resale market.

Thursday, 26 June

Initial jobless claims are expected to rise 4K to 390k in the week ending June 21.

Weekly Initial Jobless Claims, week ending 6/21/08—8:30am

	Exp	Cons	Range	History
Initial Claims	385k	377k	370-386	June 14 ^h = 381k

Source: Merrill Lynch, Bloomberg

Initial jobless claims are expected to rise to 385k in the week ending June 21, taking the 4-week moving average moves up to 378k, which would be the highest level since the October 2005 hurricanes. The floods in the Midwest are expected to disrupt business and transportation routes, leading to additional displaced workers. We see a net upside impact here of about 5k to 10k, with the potential for the floods to affect payrolls in June as well (report due out July 3). Seasonal influences this week are minor. Continuing claims have remained above 3mn, suggesting that those who have lost their jobs are having a difficult time finding work again.

The final release of the 1Q National Income accounts will probably show a modest uptick in real GDP to 1.1% QoQ.

Real GDP, 1Q (F)—8:30am

	Exp	Cons	Range	History
Real GDP	1.1%	1.0%	0.9% to 1.2%	1Q (P) = 0.9% vs. 1Q (A) = 0.6%
Real GDP Price Index	2.6%	2.3%	2.6% to 2.6%	1Q (P) = 2.6%

Source: Merrill Lynch, Bloomberg

The final release of the 1Q National Income accounts will probably show a modest uptick in real GDP to 1.1% QoQ annualized from 0.9% in the preliminary figure. Consumer spending will probably be revised up to 1.1% from 1.0% previously and there will be modest upgrades to residential investment and inventories. We expect the trade deficit to hold about steady at \$480B, a \$23B improvement from 4Q, on a \$10B increase in both exports and imports.

The GDP price index likely will come in unchanged at 2.6% QoQ annualized, however, we do expect a modest upward revision to the core PCE chain price index. PPI medical services were revised higher in January which brought the quarterly annualized rate up by 0.4ppts for 1Q. Headline PCE prices will stay at 3.5% but core could be revised up to 2.2 from 2.1%.

Existing home sales will probably drop by 1.0% MoM in May to 4.84mn units.

Existing Home Sales, May—10:00am

	Exp	Cons	Range	History
Existing Home Sales	4.84mn	4.96mn	475mn to 515mn	Apr = 4.89mn vs. Mar = 4.94mn

Source: Merrill Lynch, Bloomberg

Existing home sales will probably drop by 1.0% MoM in May, to 4.84mn units as foreclosure sales continue to provide some support to overall resales. However, we have seen a rise in mortgage rates in both the conforming and nonconforming market in the past month and we believe this will put an additional restraint on the market. With foreclosed homes still coming onto the market and sales sluggish, we expect that months supply will remain elevated, at close to the 20-year highs.

The Help Wanted Index will probably stay at the historic low of 19 in May, where it has hovered since March.

Help Wanted Index, May—10:00am

	Exp	Cons	Range	History
Help Wanted Index	19	19	18 to 19	Apr = 19 vs. Mar = 19

Source: Merrill Lynch, Bloomberg

The Help Wanted Index will probably stay at the historic low of 19 in May, where it has hovered since March. This index has lost a good deal of predictive power for the labor market in recent years as employee search has shifted to on-line mediums. However, the recent decline in the index has been notable and is suggesting some cyclical forces are at work as well.

Friday, 27 June

We expect a weak outturn for personal spending once accounting for the rise in prices in the month, but see upside to personal income in the month.

Personal Income and Outlays, May—8:30am

	Exp	Cons	Range	History
Personal income	1.9%	0.4%	0.2% to 2.0%	Apr = 0.2% vs. Mar = 0.4%
Personal spending	0.6%	0.6%	0.1% to 0.9%	Apr = 0.2% vs. Mar = 0.4%
Core PCE (YoY)	2.2%	2.1%	2.1% to 2.2%	Apr = 2.1% vs. Mar = 2.1%

Source: Merrill Lynch, Bloomberg

We are expecting a very weak outturn for personal spending in May once accounting for the rise in prices in the month. Personal spending is looking to rise 0.6% m/m, a firm result in line with the retail sales report (which jumped 1.0%), as people spent the bulk of their stimulus checks. Spending is expected to be broad based, though much of it taken up by price increases in food and gasoline.

The current consensus forecast for personal income in May is for a monthly increase of 0.4% according to the latest read on Bloomberg. However, the print is likely to come in much higher than that. These payments usually flow to consumers in terms of reduced taxes so it only shows up as a boost to personal disposable income. That is likely how the consensus is currently accounting for the stimulus and thus the low personal income forecast. This time however, there is a portion of households who are eligible for the stimulus who did not receive any income in 2007. Therefore, the IRS actually cut them checks and this portion of the stimulus payments will show up on the income line. So we are now tracking a 1.9% m/m increase in personal income for May: 0.3% in base earnings and

\$15B in stimulus checks (which is then annualized by multiplying by 12). Another \$31B (\$373B annualized) is netted out of taxes to boost PDI up by 5.3% m/m.

Reweighting CPI components with PCE weights suggest that prices will increase by 0.5% MoM in May though the year-on-year rate will hold steady at 3.2%. The core measure, excluding food and energy, will see a 0.2% MoM increase that will push the yearly rate up to 2.2% from 2.1%. The main difference between the PCE deflator and CPI is that the medical services component carries more weight in the PCE report. In May, they rose about 0.15%, the third consecutive tame reading. Looking forward, core inflation measures are expected to ease back to below 2%, as we expect considerable slack to build up in the economy.

Confidence is expected to remain nearly unchanged from the preliminary read.

University of Michigan Index of Consumer Sentiment, June (F)—10:00am

	Exp	Cons	Range	History
Consumer Sentiment	56.8	56.8	55.9 to 58.0	Jun (P) = 56.7 vs. May = 59.8

Source: Merrill Lynch, Bloomberg

The final read of the University of Michigan confidence figure is expected to remain virtually unchanged from the preliminary reading of 56.7, which was the worst reading since the midst of the 1980 consumer recession. Since the preliminary estimate for the June confidence figure, equity markets have continued to slide, with the S&P declining 2.9%, while gasoline prices have risen to \$3.46/gallon (an increase of 1.5%). However, the weekly ABC News weekly confidence figures have come off their lows of -51 to remain nearly unchanged for the past three weeks, at around the -45 level.

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Debt issuance

Treasury financing (billions of \$)

<u>Announcement date</u>	<u>Auction date</u>	<u>Settlement date</u>	<u>Issue</u>	<u>Size</u>	<u>New cash</u>
Jun-16	Jun-17	Jun-19	1-month	20.0	(12.0)
Jun-19	Jun-23	Jun-26	3- & 6-month	47.0	4.0
Jun-23	Jun-24	Jun-26	1-month	30.0*	3.0*

* Estimate. () = Paydown. (R) = Reopening. CMB = Cash Management Bill.
 Source: Bloomberg, U.S. Treasury, Merrill Lynch

Agency financing (billions of \$)

<u>Announcement date</u>	<u>Auction date</u>	<u>Settlement date</u>	<u>Issue</u>	<u>Size</u>
Jun-20	Jun-23	Jun-24	FRE 3-month	3.0
Jun-20	Jun-23	Jun-24	FRE 6-month	2.5
Jun-20	Jun-23	Jun-24	FRE 12-month	1.5
Jun-20	Jun-25	Jun-26	FRE 1-month	2.0
Jun-23	Jun-25	Jun-26	FNM 3-month	TBA
Jun-23	Jun-25	Jun-26	FNM 6-month	TBA
Jun-27	Jun-30	Jul-1	FRE 3-month	TBA
Jun-27	Jun-30	Jul-1	FRE 6-month	TBA
Jun-30	Jul-2	Jul-3	FNM 3-month	TBA
Jun-30	Jul-2	Jul-3	FNM 6-month	TBA

FRE = Freddie Mac, FNM = Fannie Mae, (R) = Reopening
 Source: Bloomberg, Freddie Mac, Fannie Mae.

Policy speakers

Key speaking engagements and news events*

Monday, June 23	<i>Nothing scheduled at this point</i>	
Tuesday, June 24	FOMC 2-day meeting begins	
	8:30 am	Former Fed Chairman Greenspan speaks in South Africa
Wednesday, June 25	2:15 pm	FOMC rate announcement and statement
Thursday, June 26	7:30 am	Fed Governor Kohn speaks at ECB conference
	9:00 am	St Louis Fed President Bullard (nonvoter) speaks at ECB conference
Friday, June 27	<i>Nothing scheduled at this point</i>	

*Time and date subject to change

Source: Bloomberg, Market News, Merrill Lynch

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Economic forecast summary

Real Economic Activity, % SAAR	4Q2007	1Q2008	2Q2008	3Q2008	4Q2008	1Q2009	2Q2009	3Q2009	4Q2009	2007	2008F	2009F
Real GDP	0.6	1.1	0.6	-0.1	-0.5	-0.2	1.5	2.5	2.6	2.2	1.3	0.6
% Change, Year Ago	2.5	2.6	1.8	0.5	0.3	-0.1	0.2	0.8	1.5			
Final Sales	2.4	1.0	1.1	-0.7	-0.5	-0.3	1.8	1.9	2.1	2.5	1.5	0.5
Domestic Demand	1.3	0.2	0.8	-1.1	-1.6	-1.6	0.9	1.7	2.0	1.8	0.6	-0.3
Consumer Spending	2.3	1.2	1.0	-0.4	-1.5	-0.7	1.5	2.0	2.4	2.9	1.2	0.2
Durables	2.0	-5.8	-4.9	-6.6	-10.0	-1.4	1.0	3.1	3.2	4.7	-2.9	-2.7
Nondurables	1.2	-0.1	1.9	0.3	-4.0	-4.7	1.0	2.0	2.5	2.4	0.6	-1.2
Services	2.8	3.1	1.7	0.5	1.2	1.3	1.7	1.8	2.1	2.8	2.2	1.4
Residential Investment	-25.2	-24.7	-17.5	-22.8	-22.7	-12.0	-2.5	1.0	1.5	-17.0	-21.8	-12.1
Nonresidential Investment	6.0	-0.9	5.2	-3.5	-1.0	-9.1	-3.2	0.3	1.6	4.7	3.1	-3.1
Structures	12.4	1.1	5.0	-6.5	-8.0	-10.0	-5.0	1.0	1.5	12.9	5.4	-5.3
Equipment and Software	3.1	-1.8	5.4	-2.0	2.5	-8.7	-2.3	0.0	1.6	1.3	2.0	-2.1
Government	1.9	2.0	1.2	1.4	1.7	1.3	1.7	1.4	1.1	2.0	2.1	1.5
Exports	6.5	5.6	10.4	4.5	4.5	4.5	4.3	3.9	3.2	8.1	8.2	4.7
Imports	-1.4	-0.6	6.4	0.5	-3.4	-4.5	-1.7	2.0	2.2	1.9	1.0	-1.3
Net Exports (Bil 00\$)	-503.2	-479.9	-473.5	-459.1	-424.9	-385.0	-360.0	-354.4	-352.4	-555.6	-459.4	-363.0
Inventory Accumulation (Bil \$)	-18.3	-12.4	-26.4	-6.6	-6.3	-4.1	-13.8	1.5	13.6	4.6	-12.9	-0.7
Nominal GDP (Bil \$)	14074	14201	14271	14347	14414	14470	14569	14693	14825	13841	14308	14639
% SAAR	3.0	3.6	2.0	2.2	1.9	1.6	2.8	3.5	3.7	4.9	3.4	2.3
% Change, Year Ago	5.1	4.8	3.6	2.7	2.4	1.9	2.1	2.4	2.8			
Key Indicators												
Industrial Production (% SAAR)	0.2	-0.1	-3.6	-1.1	-1.3	0.6	1.1	1.4	1.5	1.7	-0.2	0.0
Capacity Utilization (%)	81.0	80.6	79.5	78.9	78.4	78.2	78.1	78.0	78.0	81.0	79.3	78.0
Civilian Unemployment Rate (%)	4.8	4.9	5.4	5.7	6.1	6.3	6.3	6.3	6.4	4.6	5.5	6.3
Productivity (% SAAR)	1.8	2.6	1.1	2.5	1.0	0.5	2.5	3.2	3.0	1.8	2.5	1.7
% Change, Year Ago	2.9	3.3	2.9	2.0	1.8	1.3	1.6	1.8	2.3			
Real Disp. Personal Inc. (% SAAR)	0.9	1.8	12.8	-13.5	-1.1	2.2	2.7	2.9	2.7	3.1	1.5	0.3
% Change, Year Ago	2.4	1.5	4.8	0.1	-0.4	-0.3	-2.6	1.7	2.6			
Personal Savings Rate (%)	0.2	0.6	3.4	0.6	0.8	2.1	2.4	2.6	2.7	0.5	1.4	2.5
Light Vehicle Sales (Millions SAAR)	16.2	15.3	14.4	14.3	14.0	13.8	14.4	14.8	15.1	16.4	14.5	14.5
Housing Starts (Thous. SAAR)	1151	1042	930	790	680	720	780	815	845	1341	861	790
Current Account (Bil \$)	-172.9	-174.7	-167.1	-162.9	-146.0	-131.5	-121.5	-119.4	-119.4	-738.6	-650.8	-491.7
U.S. Budget Balance (Bil \$)										-163	-525	-425
Corporate Profits and Earnings												
Operating Corp. Profits After Tax (Bil \$)	1114.6	1156.6	990.5	955.6	865.4	945.5	957.4	985.4	1048.5	1128.6	992.0	984.2
% Change, Year Ago	3.3	5.6	-14.0	-17.1	-22.4	-18.3	-3.3	3.1	21.2	2.6	-12.1	-0.8
S&P 500 Reported EPS (\$)	7.8	15.5	18.0	13.0	13.3	17.3	18.2	13.5	14.0	66.2	59.8	63.0
% Change, Year Ago	-61.4	-27.2	-18.0	-14.5	70.3	11.2	1.5	4.2	5.3	-18.8	-9.7	5.4
S&P 500 Operating EPS (\$)	15.2	16.6	20.5	18.5	17.0	19.5	21.0	19.0	18.0	82.5	72.6	77.5
% Change, Year Ago	-30.8	-25.8	-14.8	-11.4	11.7	17.3	2.4	2.7	5.9	-5.9	-12.0	6.7
Inflation												
GDP Price Index (% SAAR)	2.4	2.6	1.4	2.2	2.4	1.8	1.3	1.0	1.1	2.7	2.1	1.7
% Change, Year Ago	2.6	2.2	1.9	2.2	2.1	1.9	1.9	1.6	1.3			
CPI, Consumer Prices (% SAAR)	5.0	4.3	5.0	8.7	3.2	1.7	-0.2	0.3	1.1	2.9	4.9	2.4
% Change, Year Ago	4.0	4.2	4.3	5.8	5.3	4.6	3.3	1.2	0.7			
CPI ex Food & Energy (% SAAR)	2.5	2.5	1.7	2.5	2.2	1.6	1.4	1.4	1.7	2.3	2.3	1.8
% Change, Year Ago	2.3	2.4	2.3	2.3	2.2	2.0	1.9	1.7	1.5			

Source: Merrill Lynch

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Interest rate forecast summary

(% EOP)	4Q 07	1Q 08	2Q 08	3Q 08	4Q 08	1Q 09	2Q 09	3Q 09	4Q 09	2007	2008	2009
Fed Funds	4.25	2.25	2.00	1.75	1.25	1.00	1.00	1.00	1.00	4.25	1.25	1.00
3-Month T-Bill	3.36	1.38	1.85	1.50	1.10	1.00	1.05	1.05	1.10	3.36	1.10	1.10
3-Month LIBOR	4.85	2.95	2.75	2.30	1.80	1.55	1.50	1.50	1.50	4.85	1.80	1.50
2-Year T-Note	3.04	1.62	2.40	1.80	1.35	1.00	1.00	1.10	1.20	3.04	1.35	1.20
5-Year T-Note	3.45	2.46	3.10	2.75	2.40	1.85	1.60	1.65	1.70	3.45	2.40	1.70
10-Year T-Note	4.05	3.45	3.80	3.50	3.25	3.15	2.80	2.75	2.70	4.05	3.25	2.70
30-Year T-Bond	4.45	4.30	4.60	4.30	4.05	3.85	3.40	3.35	3.30	4.45	4.05	3.30

Shaded regions represent Merrill Lynch forecast.

Source: Merrill Lynch

Monthly CPI forecast update

	Total CPI					Core CPI			
	(nsa)			(sa)		(nsa)		(sa)	
	level	MoM	YoY	MoM	YoY	MoM	YoY	MoM	YoY
2008: Apr	214.823	0.61	3.9	0.21	3.9	0.09	2.3	0.10	2.3
2008: May	216.632	0.84	4.2	0.65	4.1	0.06	2.3	0.20	2.3
2008: Jun	218.555	0.89	4.9	1.05	4.9	0.08	2.3	0.22	2.3
2008: Jul	219.678	0.51	5.5	0.76	5.5	0.10	2.3	0.19	2.3
2008: Aug	220.255	0.26	5.9	0.47	5.9	0.21	2.3	0.21	2.3
2008: Sep	220.741	0.22	5.9	0.31	5.9	0.23	2.3	0.21	2.3
2008: Oct	220.932	0.09	5.7	0.13	5.7	0.33	2.3	0.18	2.3
2008: Nov	220.818	-0.05	5.1	0.25	5.1	-0.03	2.2	0.16	2.2
2008: Dec	220.712	-0.05	5.1	0.37	5.1	-0.11	2.1	0.15	2.1
2009: Jan	221.250	0.24	4.8	0.14	4.8	0.20	2.0	0.14	2.0
2009: Feb	221.911	0.30	4.8	0.03	4.8	0.41	2.0	0.11	2.0
2009: Mar	222.538	0.28	4.2	-0.24	4.2	0.44	2.0	0.12	2.0

nsa: not seasonally adjusted, sa: seasonally adjusted

Source: Merrill Lynch


FX rate forecast summary

(end of period)		Spot	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec 09
Euroland Euro	US\$/Euro	1.56	1.55	1.51	1.48	1.42	1.40	1.38	1.33
Japanese Yen	¥/US\$	107	103	103	102	100	98	98	98
	¥/Euro	167	160	156	151	142	137	135	130
British Pound	US\$/£	1.98	1.94	1.91	1.87	1.82	1.82	1.82	1.75
	£/Euro	0.79	0.80	0.79	0.79	0.78	0.77	0.76	0.76
Swiss Franc	SF/US\$	1.03	1.04	1.05	1.07	1.10	1.10	1.12	1.16
	SF/Euro	1.62	1.61	1.59	1.58	1.56	1.54	1.54	1.54
Canadian \$	C\$/US\$	1.02	1.02	1.04	1.06	1.08	1.11	1.12	1.12
Australian \$	US\$/A\$.95	0.93	0.91	0.84	0.80	0.74	0.72	0.70
Chinese Renminbi	RMB/US\$	6.80	6.90	6.75	6.70	6.60	6.60	6.50	6.50
Hong Kong \$	HK\$/US\$	7.80	7.75	7.75	7.75	7.75	7.75	7.75	7.75
Korean Won	KRW/US\$	1030	1030	1000	975	950	975	1000	1000
Singapore \$	SGD/US\$	1.36	1.35	1.33	1.32	1.32	1.32	1.32	1.33
Taiwan \$	TWD/US\$	30.44	30.50	30.25	30.00	30.25	30.50	30.75	31.00
Brazilian Real	BRL/US\$	1.61	1.60	1.65	1.70	1.75	1.75	1.80	1.80
Mexican Peso	MXN/US\$	10.28	10.60	10.90	10.80	10.90	11.00	11.20	11.00

Spot prices are as of Friday morning

Source: Merrill Lynch FX Strategy Team., Bloomberg

Rolling Calendar of Business Indicators

Monday	Tuesday	Wednesday	Thursday	Friday
23 June 	24 June ABC/Washington Post Consumer Comfort Survey —(week ending 6/22/08) LJR Redbook —(week ending 6/21/08) 9:00 am: Case-Shiller 20-City Composite Feb -2.6% Mar -2.2% Apr -1.0%* 10:00 am: Consumer Confidence Apr 62.8 May 57.2 Jun 57.0*	25 June MBA Mortgage Applications —(week ending 6/20/08) 8:30 am: Durable Goods Orders Mar -0.2% Apr -0.6% May 0.2%* 8:30 am: Durable Goods Orders ex Transportation Mar 1.8% Apr 2.4% May -0.3%* 10:00 am: New Home Sales Mar 509k Apr 526k May 512k* 2:15 pm: FOMC Rate Decision <i>Expected</i>	26 June 8:30 am: Initial Jobless Claims —(week ending 6/21/08) – 385k* 8:30 am: Real GDP – 1Q (F) 1Q (A) 0.6% 1Q (P) 0.9% 1Q (F) 1.1%* 8:30 am: GDP Price Index – 1Q (F) 1Q (P) 2.6% 1Q (F) 2.6%* 10:00 am: Existing Home Sales Mar 4.94mn Apr 4.89mn May 4.84mn* 10:00 am: Help Wanted Index Mar 19 Apr 19 May 19*	27 June 8:30 am: Personal Income Mar 0.4% Apr 0.2% May 1.9%* 8:30 am: Personal Spending Mar 0.4% Apr 0.2% May 0.6%* 8:30 am: Core PCE (YoY) Mar 2.1% Apr 2.1% May 2.2%* 10:00 am: University of Michigan Consumer Sentiment May 59.8 Jun (P) 56.7 Jun (F) 56.8*
30 June 9:45 am: Chicago PMI Apr 48.3 May 49.1 Jun 48.0*	1 July ABC/Washington Post Consumer Comfort Survey —(week ending 6/29/08) LJR Redbook —(week ending 6/28/08) 10:00 am: ISM Manufacturing Index Apr 48.6 May 49.6 Jun 48.7* 10:00 am: Construction Spending Mar -0.6% Apr -0.4% May -0.5%* All-day: Vehicle Sales Apr 14.5mn May 14.3mn Jun 13.7mn*	2 July MBA Mortgage Applications —(week ending 6/27/08) 8:15 am: ADP Employment Apr 13k May 40k Jun 58k* 10:00 am: Factory Orders Mar 1.5% Apr 1.1% May 1.4%*	3 July 8:30 am: Initial Jobless Claims —(week ending 6/28/08) 8:30 am: Nonfarm Payrolls Apr -28k May -49k Jun -110k* 8:30 am: Unemployment Rate Apr 5.0% May 5.5% Jun 5.5%* 8:30 am: Average Hourly Earnings Apr 0.1% May 0.3% Jun 0.3%* 8:30 am: Average Weekly Hours Apr 33.7 May 33.7 Jun 33.7* 10:00 am: ISM Non-manufacturing Index Apr 52.0 May 51.7 Jun 48.5*	4 July Independence Day (Holiday Observed) 
7 July	8 July ABC/Washington Post Consumer Comfort Survey —(week ending 7/6/08) LJR Redbook —(week ending 7/5/08) 10:00 am: Pending Home Sales – May Mar -1.0% Apr 6.3% 10:00 am: Wholesale Inventories – May Mar 0.1% Apr 1.3% 3:00 pm: Consumer Credit – May Mar \$13.1bn Apr \$8.9bn	9 July MBA Mortgage Applications —(week ending 7/4/08)	10 July 8:30 am: Initial Jobless Claims —(week ending 7/5/08)	11 July 8:30 am: Trade Balance – May Mar -\$56.5bn Apr -\$60.9bn 8:30 am: Import Prices – May Mar 2.4% Apr 2.3% 10:00 am: University of Michigan Consumer Sentiment – Jul (P) May 59.8 Jun (F) 56.8* 2:00 pm: Monthly Budget Statement – Jun 2008 Jun 2007 \$27.5bn
*Projections—subject to revision as additional data become available during the month. (R) denotes reopening.				

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