



Pierpont Securities LLC
www.pierpontsecurities.com

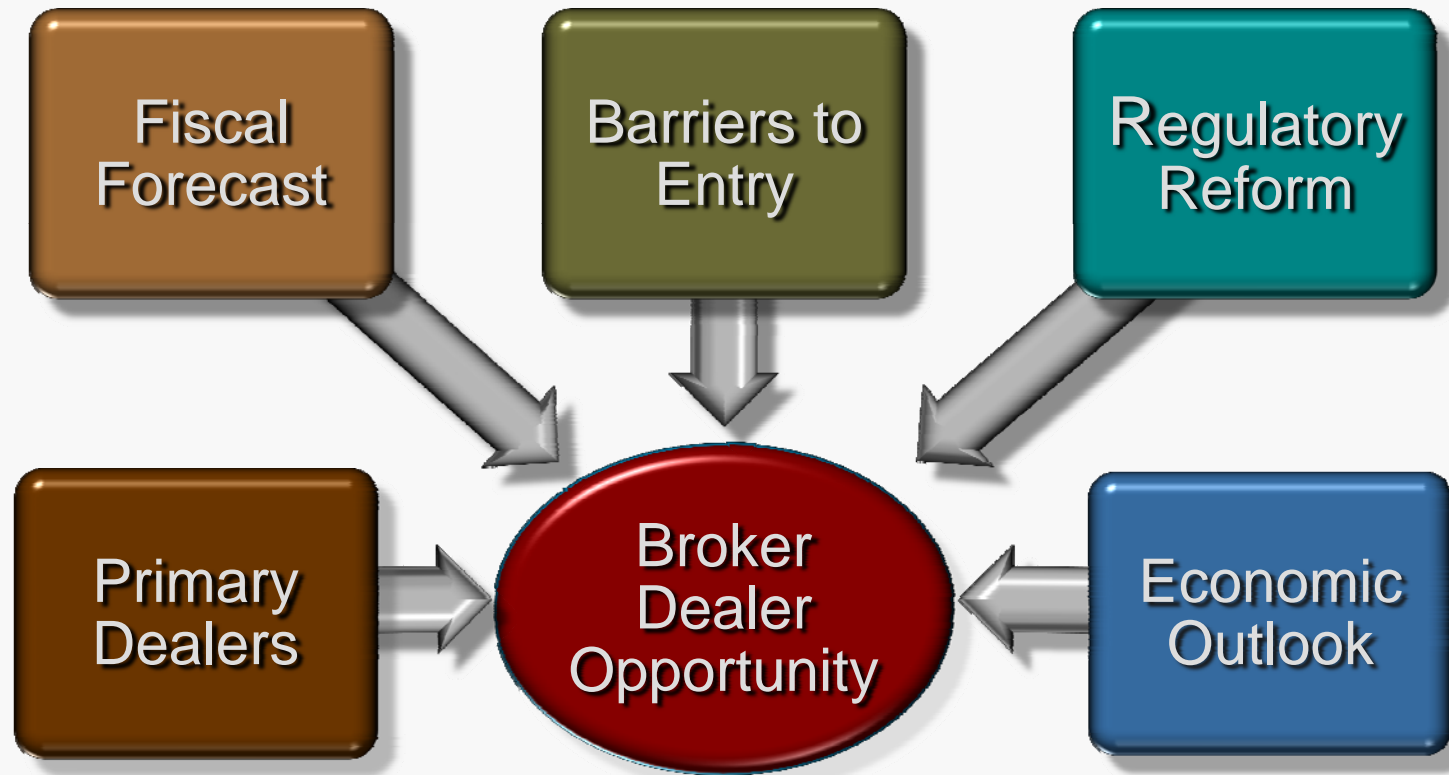
October 19, 2010

THE CASE FOR BUILDING A GOVERNMENT SECURITIES DEALER

Grant's Fall Conference 2010



The Business Case





▶ Section 1

Primary Dealers



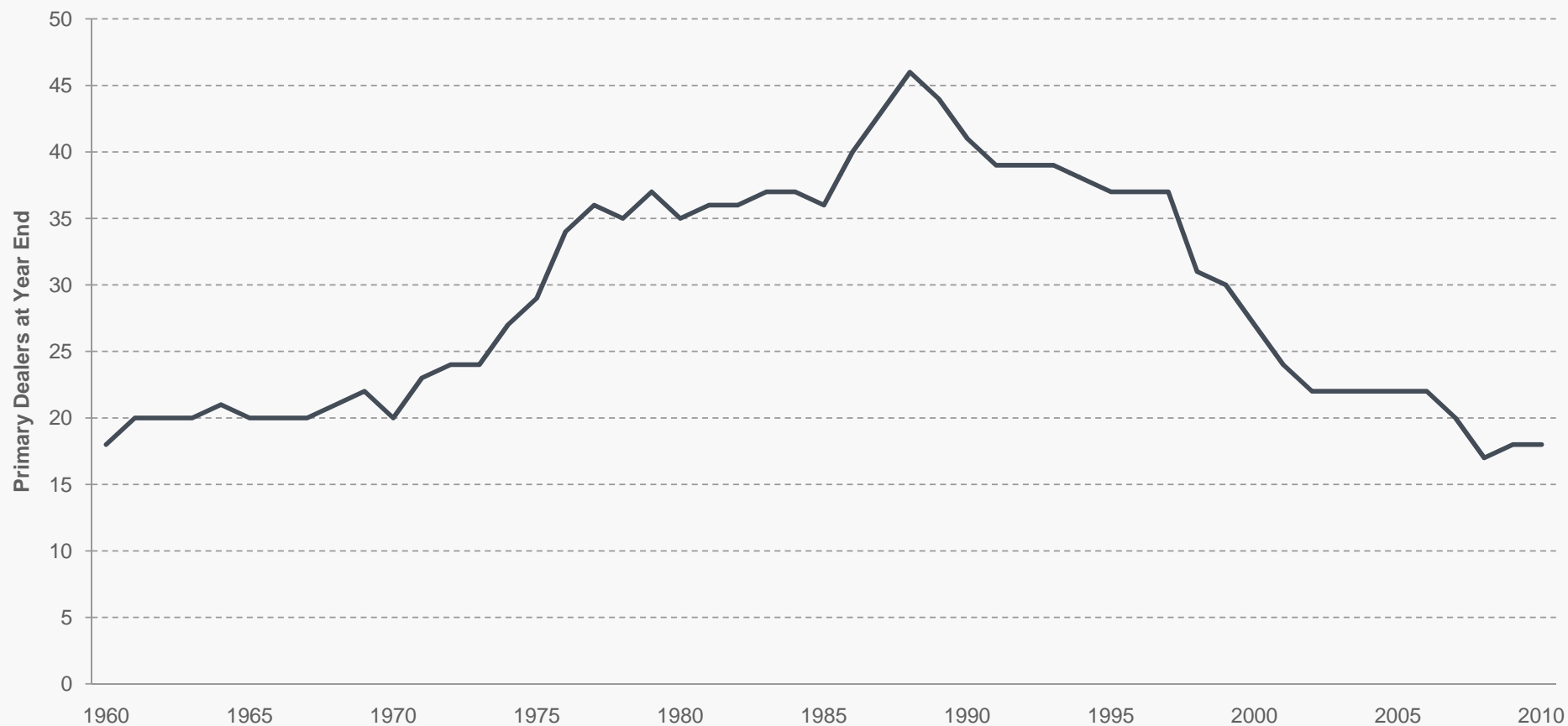
Primary Dealers: Definition

A Primary dealer is a bank or securities broker-dealer that may trade directly with the Federal Reserve System of the United States. Such firms are required to make bids or offers when the Federal Reserve conducts open market operations, provide information to the Federal Reserve's open market trading desk, and to participate actively in the U.S. Treasury securities auctions. They consult with both the U.S. Treasury and the Federal Reserve about funding the budget deficit and implementing monetary policy.

Source: The Federal Reserve Bank of New York

Primary Dealers

The number of Primary Dealers has come full circle over the last 50 years to 18 from a peak of 46 in 1988



Source: The Federal Reserve Bank of New York

Primary Dealers

September 1988 (46)

Aubrey G. Lanston & Co., Inc.	Dean Witter Reynolds Inc.	Kidder, Peabody & Co., Inc.	Salomon Brothers Inc.
Bank of America NT & SA	Dillon, Read & Co. Inc.	Kleinworth Benson Government Securities, Inc.	Sanwa-BGK Securities Co., L.P.
Bankers Trust Company	Discount Corporation of New York	Lloyds Government Securities Corporation	Security Pacific National Bank
Bear, Stearns & Co., Inc.	Donaldson, Lufkin & Jenrette Securities Corporation	L.F. Rothschild & Co.	Shearson Lehman Government Securities, Inc.
Carroll McEntee & McGinley Incorporated	Drexel Burnham Lambert Government Securities Inc.	Manufacturers Hanover Securities Corporation	Smith Barney, Harris Upham & Co., Inc.
Chase Manhattan Capital Markets Corporation	The First Boston Corporation	Merrill Lynch Government Securities Inc.	S.G. Warburg & Co., Inc.
Chemical Bank	First National Bank of Chicago	Midland Montagu Securities Inc.	Thomson McKinnon Securities Inc.
Citibank, N.A.	Goldman, Sachs & Co.	Morgan Stanley & Co. Incorporated	Wertheim Schroder & Co. Incorporated
Continental Illinois National Bank and Trust Company of Chicago	Greenwich Capital Markets Inc.	The Nikko Securities Co. International, Inc.	Westpac Pollock Government Securities, Inc.
County NatWest Government Securities, Inc.	Harris Government Securities	Nomura Securities International, Inc.	Yamaichio International (America), Inc.
CRT Government Securities, Ltd.	Irving Securities, Inc.	Paine Webber Incorporated	
Daiwa Securities America Inc.	J.P. Morgan Securities, Inc.	Prudential-Bache Securities, Inc.	

Source: The Federal Reserve Bank of New York website

Conclusion: US Treasury Needs More Counterparties

August 2010 (18)				
Aubrey G. Lanston & Co., Inc.	Dean Witter Reynolds Inc.	Kidder, Peabody & Co., Inc.	Salomon Brothers Inc.	Cantor Fitzgerald & Co.
Bank of America NT & SA	Dillon, Read & Co. Inc.	Kleinworth Benson Government Securities, Inc.	Sanwa-BGK Securities Co., L.P.	Credit Suisse USA LLC
Bankers Trust Company	Discount Corporation of New York	Lloyds Government Securities Corporation	Security Pacific National Bank	Deutsche Bank Securities Inc.
Bear, Stearns & Co., Inc.	Donaldson, Lufkin & Jenrette Securities Corporation	L.F. Rothschild & Co.	Shearson Lehman Government Securities, Inc.	HSBC Securities USA Inc.
Carroll McEntee & McGinley Incorporated	Drexel Burnham Lambert Government Securities Inc.	Manufacturers Hanover Securities Corporation	Smith Barney, Harris Upham & Co., Inc.	Jefferies & Company inc.
Chase Manhattan Capital Markets Corporation	The First Boston Corporation	Merrill Lynch Government Securities Inc.	S.G. Warburg & Co., Inc.	Mizuho Securities USA Inc.
Chemical Bank	First National Bank of Chicago	Midland Montagu Securities Inc.	Thomson McKinnon Securities Inc.	RBC Capital Markets Corp.
Citibank, N.A. (Citigroup Global Markets Inc.)	Goldman, Sachs & Co.	Morgan Stanley & Co. Incorporated	Wertheim Schroder & Co. Incorporated	RBS Securities Inc.
Continental Illinois National Bank and Trust Company of Chicago	Greenwich Capital Markets Inc.	The Nikko Securities Co. International, Inc.	Westpac Pollock Government Securities, Inc.	UBS Securities LLC
County NatWest Government Securities, Inc.	Harris Government Securities	Nomura Securities International, Inc.	Yamaichio International (America), Inc.	
CRT Government Securities, Ltd.	Irving Securities, Inc.	Paine Webber Incorporated	BNP Paribas Securities Corp.	
Daiwa Securities America Inc.	J.P. Morgan Securities, Inc.	Prudential-Bache Securities, Inc.	Barclays Capital Inc.	

Source: The Federal Reserve Bank of New York website



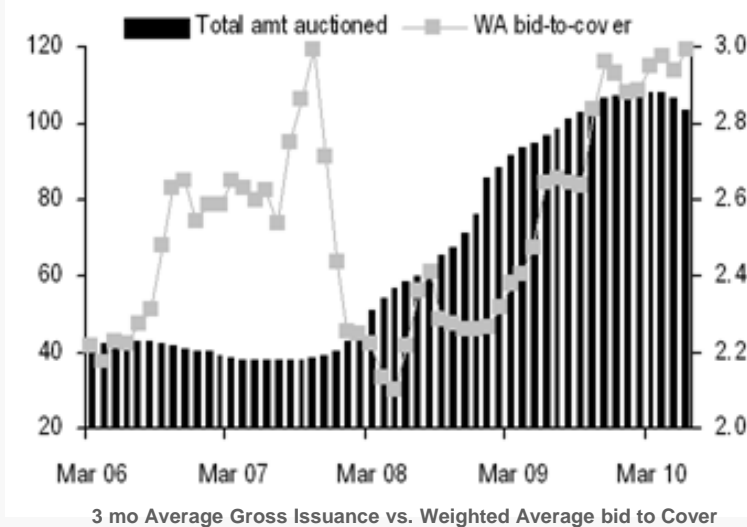
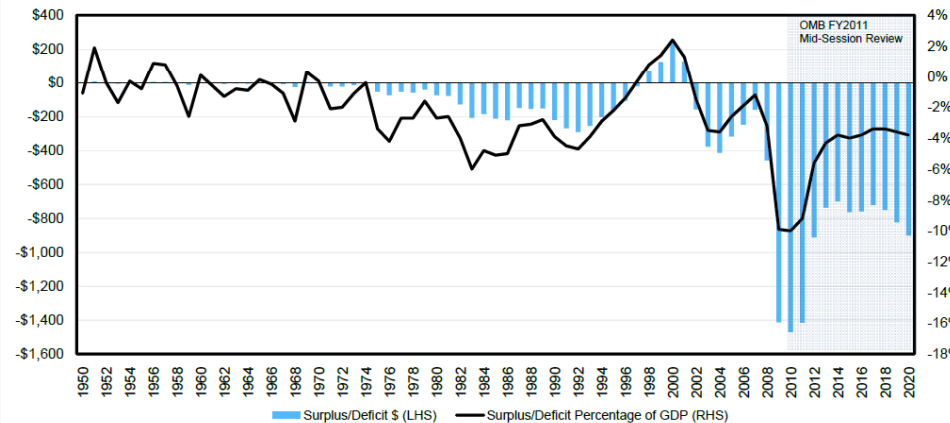
▶ Section 2

Fiscal Forecast

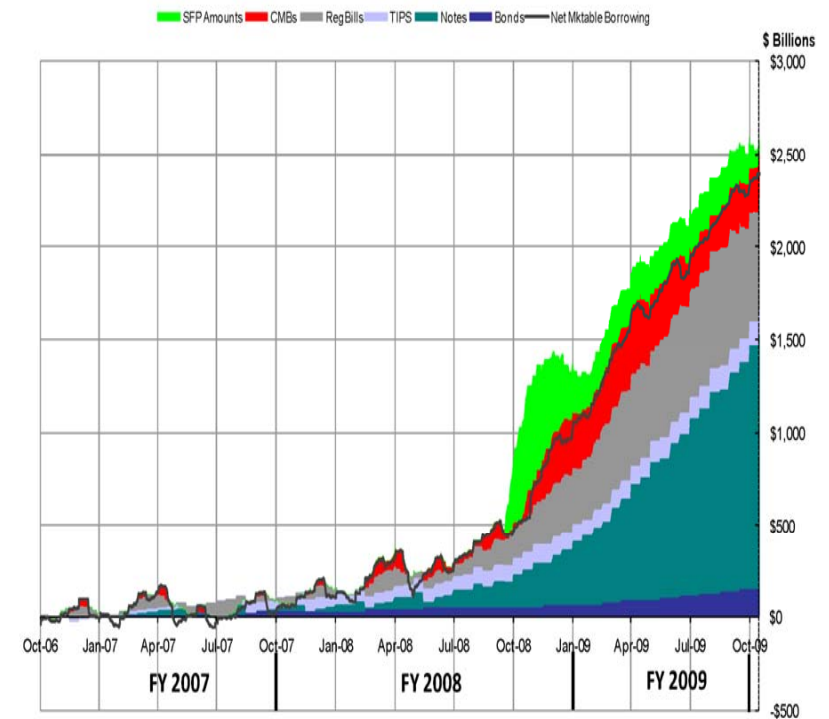


Cumulative Net Financing Flows Have Been Increasing Since FY 2007

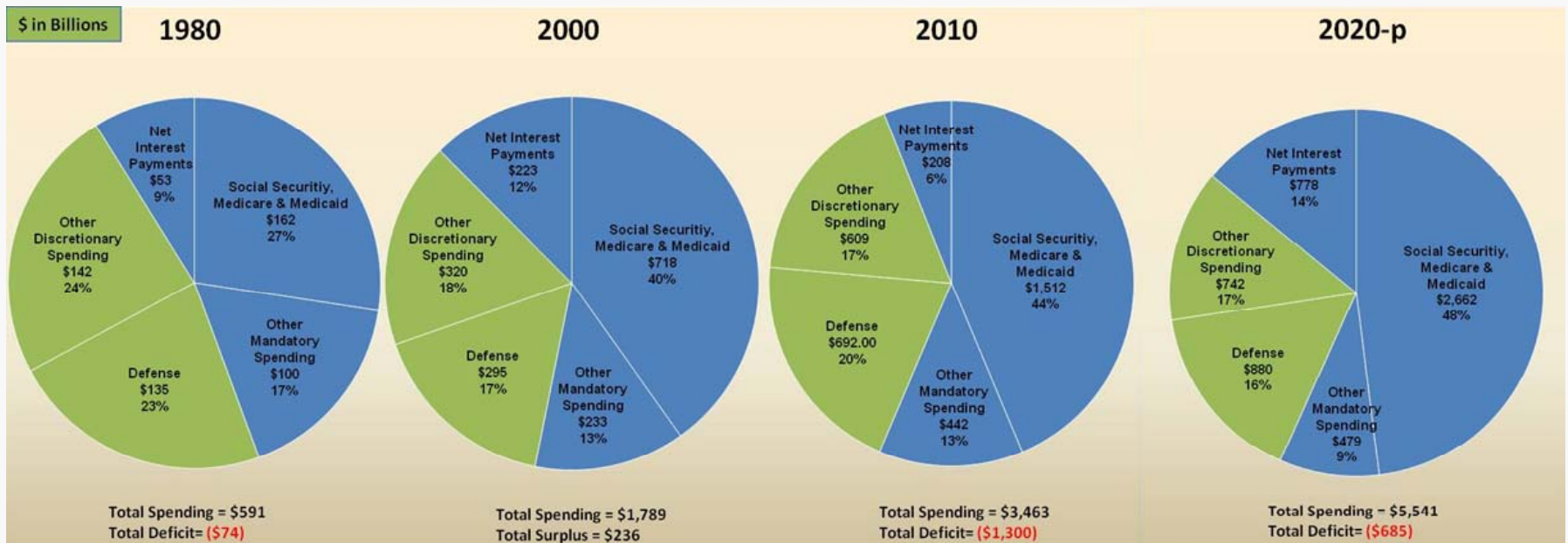
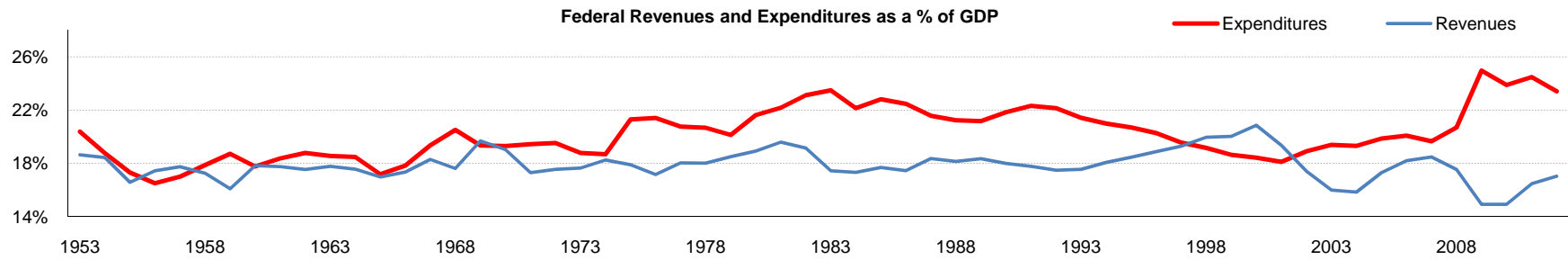
Budget Surplus/Deficit
In Billions \$, Percentage of GDP



Cumulative Net Financing Flows since FY2007



Spending Has Radically Increased and is Becoming More “Mandatory”



Source: Historical information from Treasury and CBO, 2010 is Pierpont estimate, 2020 projections from CBO.

Supply Drivers Are Not Expected to Change Any Time Soon

Entitlement Reform

Long-term budget outlook is dismal. Reform will ultimately happen, but is not on the immediate horizon. Budget headwinds (and thus heavy supply) will persist for years to come.

GSE Liabilities

There has been very little change enacted here. Will multi-trillion dollar liabilities be brought on to the balance sheet?

Foreign Central Banks

Central banks have accumulated massive amounts of dollar reserves, most of which have been invested in Treasury and Federal Agency paper. Will they diversify either across currencies or asset classes?



▶ Section 3

Lower Barriers to Entry



Barriers to Entry Have Decreased for Firms Like Pierpont Securities

A convergence of favorable tailwinds supports our venture

- Regulators (FRB NY) are acutely aware of the low number of underwriters
- Treasury supply is abundant going out several years
- Risk capital is available and being attracted to this space
- Technology and infrastructure costs have become commoditized
- Talent has become readily available post the financial crisis



▶ Section 4

Recent Regulatory Reform



Regulatory Reform

Regulatory reform is viewed as net positive for smaller more narrowly focused firms like Pierpont Securities

BASEL III

- Increased Bank capital levels will ultimately drive the cost for balance sheet and leverage higher

Dodd-Frank Bill

- Ultimately allows additional market participants to enter the swaps trading arena
- Regional derivatives dealers and broker-dealers will have an opportunity to compete with the large dealers that currently warehouse 93% of the outstanding US\$ derivative contracts.
- Encourages new trading arrangements and solutions e.g. International Derivatives Clearing Group (ICDG) to compete with the LCH and CME

*The Dodd-Frank Act remains a work in progress. It will require no fewer than 243 rulemakings and 67 studies or reports from 11 financial regulatory agencies

Regulatory Reform

"The Wall Street reform bill will - for the first time - bring comprehensive regulation to the swaps marketplace. Swap dealers will be subject to robust oversight. Standardized derivatives will be required to trade on open platforms and be submitted for clearing to central counterparties. The Commission looks forward to implementing the Dodd-Frank bill to lower risk promote transparency and protect the American public."

-CFTC Chairman Gary Gensler

"The top 5 derivative dealers hold 93% of total notionals. More than 86% of these dealer's holdings are interest rate contracts. Therefore, in terms of the derivatives risk matrix, a vast majority of commercial bank derivatives activities is in interest rate contracts at a few dealer banks."

-FDIC Allen C. Puwalski (analyst)



▶ Section 5

Economic Outlook

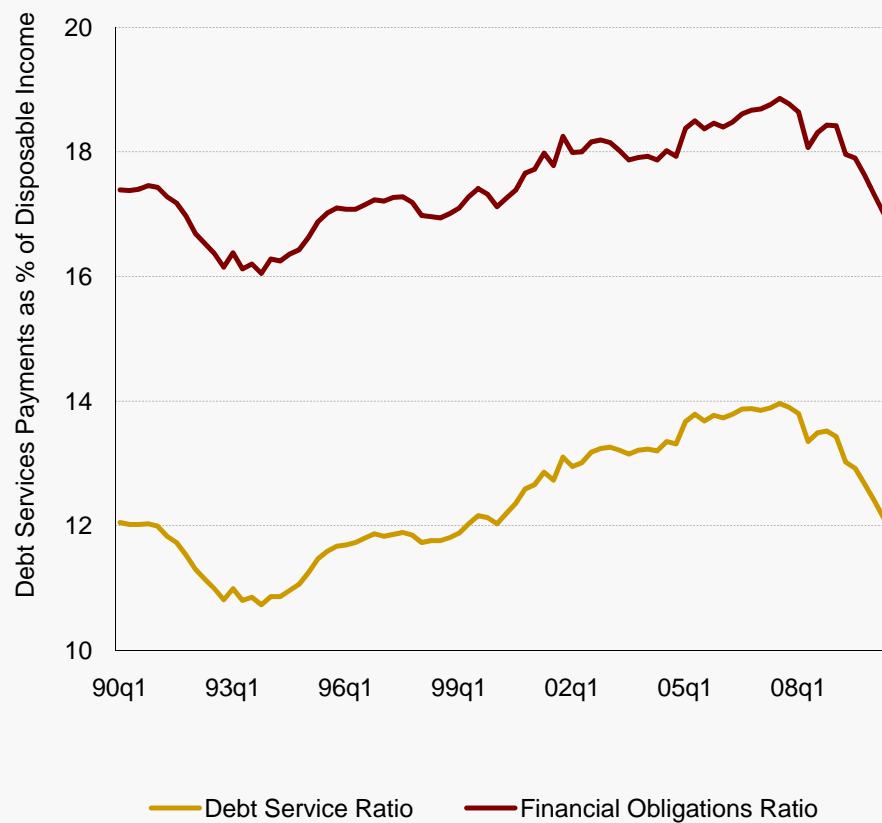


U.S. is not Headed for Japan Style Malaise

- Economic growth has proven sensitive to stimulus (2009) and restraint (2010)
- Inflation expectations are still significantly positive (gold, US\$, UST curve, TIPS)
- Activity should pick up in 2011 even if the soft patch continues for a while
- Thus, interest rates will be volatile, providing an active trading environment for a government securities dealer.

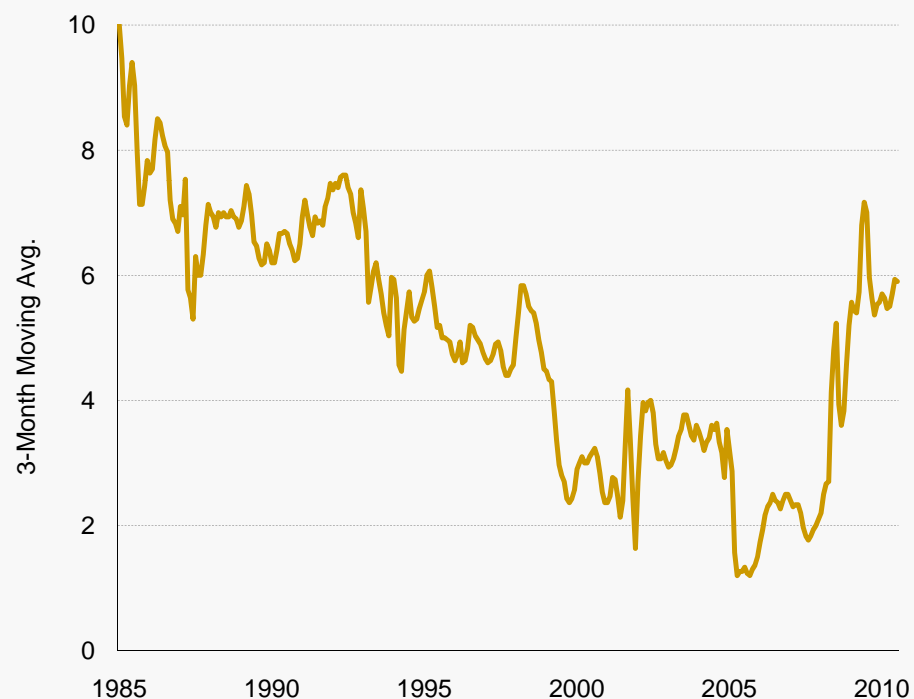
Households are Making Progress on Deleveraging and the Savings Rate has Soared

DEBT SERVICE BURDENS



Source: Federal Reserve

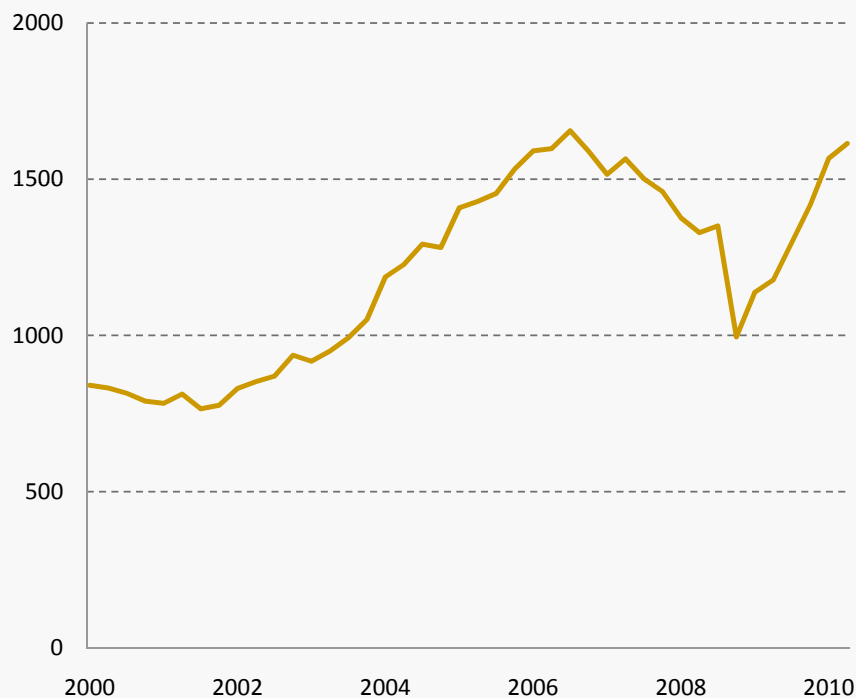
PERSONAL SAVINGS RATE



Source: BEA

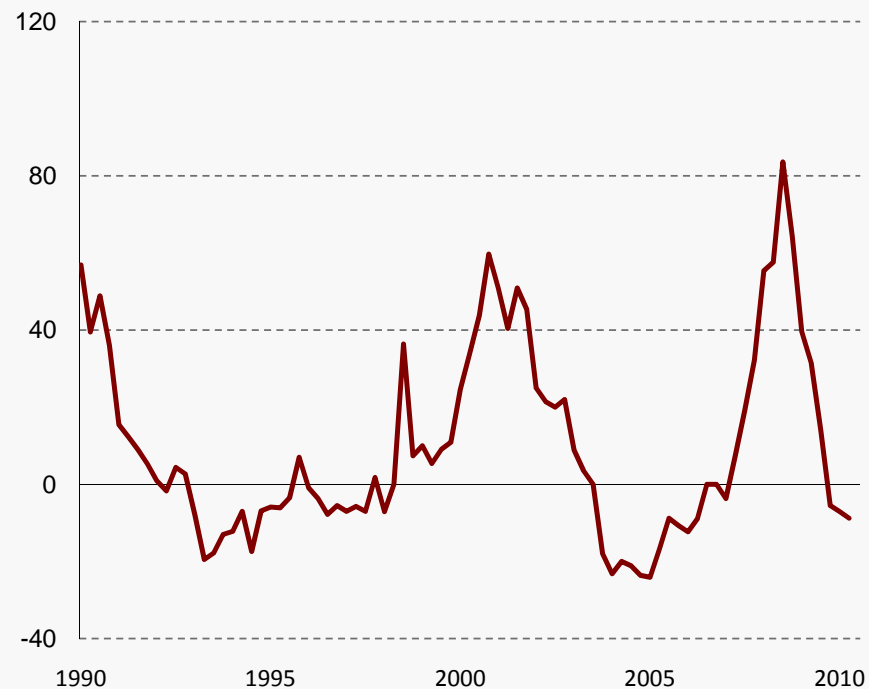
Corporate Profitability Means the Gun is Loaded and Credit While Tight, is Thawing

CORPORATE PROFITS (USD BN)



Source: Department of Commerce

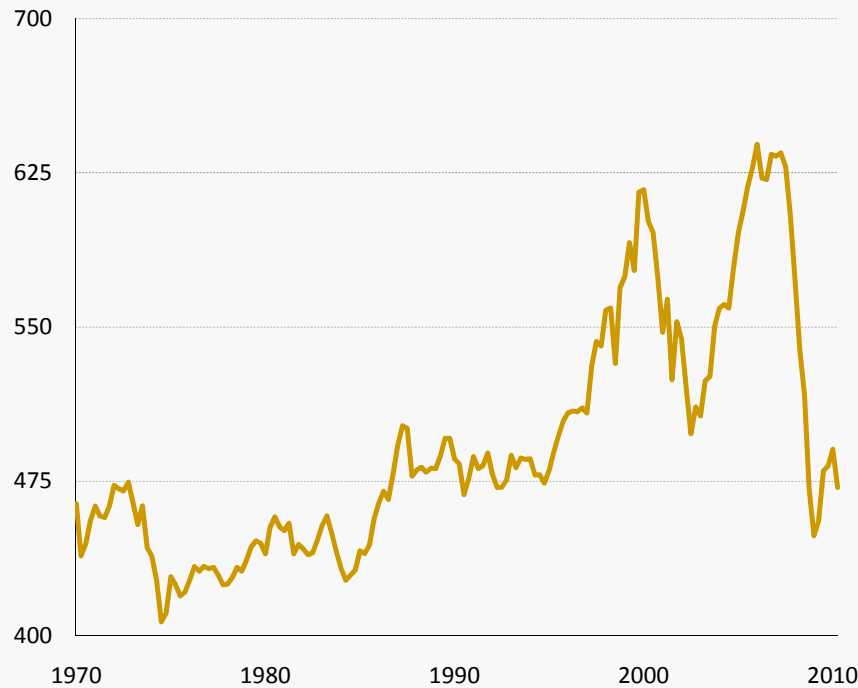
**FED SR. LOAN OFFICER SURVEY
NET % OF BANKS TIGHTENING C&I LOAN STANDARDS**



Source: Federal Reserve Board

But Household Balance Sheets Have Only Begun to Recover and Housing is Still a Mess

**HOUSEHOLD NET WORTH AS % OF DISPOSABLE
PERSONAL INCOME**



**COMBINED NEW AND EXISTING HOME SALES
ANNUALIZED THOUSANDS OF UNITS**



Source: Census Bureau, Natl. Association of Realtors.

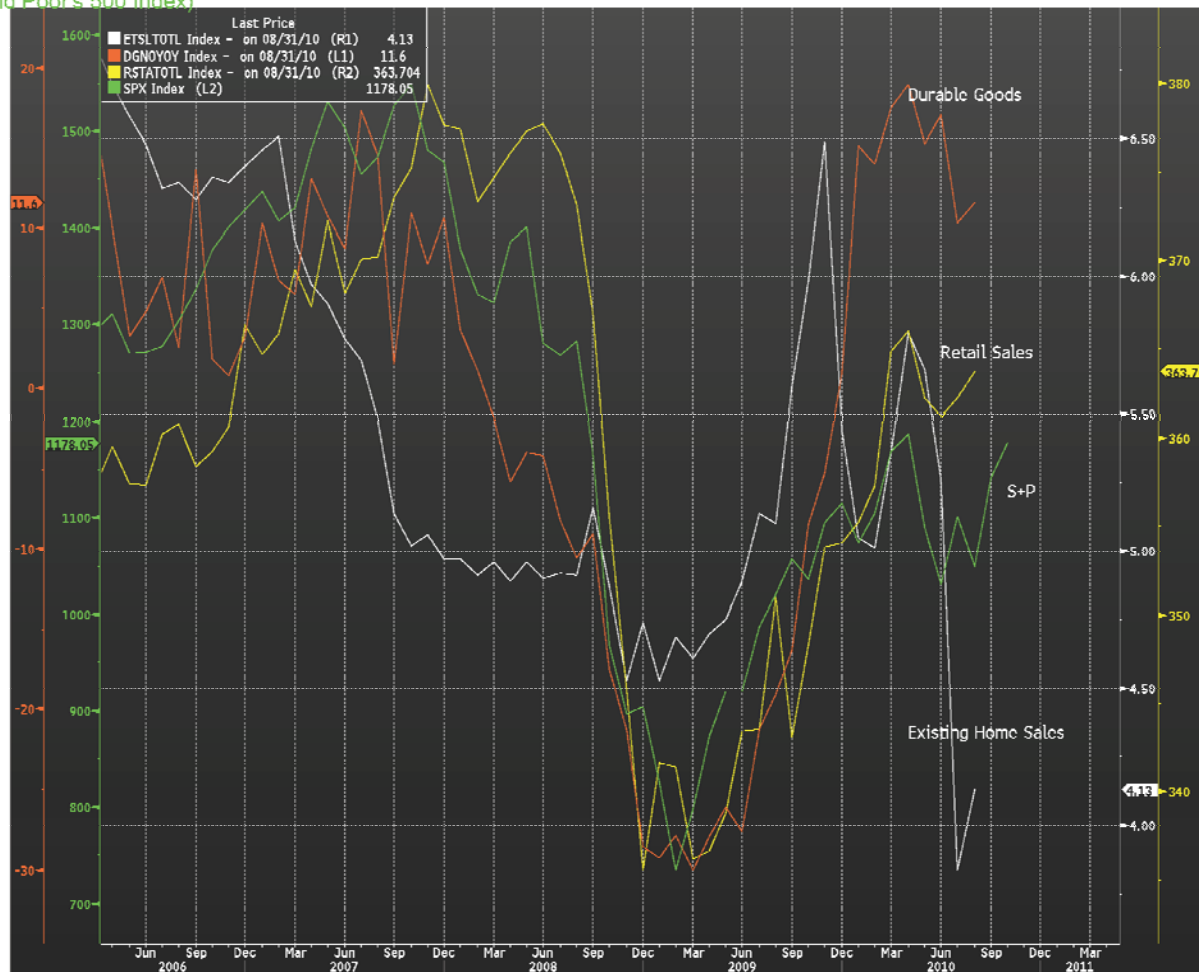
Housing Continues to Lag the Rest of the Economy

ETSLTOTL Index (US Existing Homes Sales SAAR)

DGNOYOY Index (US Durable Goods New Orders Total YoY NSA)

RSTATOTL Index (Adjusted Retail & Food Services Sales Total SA)

SPX Index (Standard and Poor's 500 Index)



Source: Bloomberg

Forecast: Mediocre But No Malaise

		2010	2011	2012
Real GDP	Pierpont	2.8	3.3	4.4
	Bloomberg Survey	2.7	2.5	3.1
CPI Inflation	Pierpont	1.7	2.2	3.2
	Bloomberg Survey	1.6	1.5	2.0
10 yr Treasury Yields (Year End)	Pierpont	2.50	4.30	5.20
	Bloomberg Survey	2.56	3.48	N/A

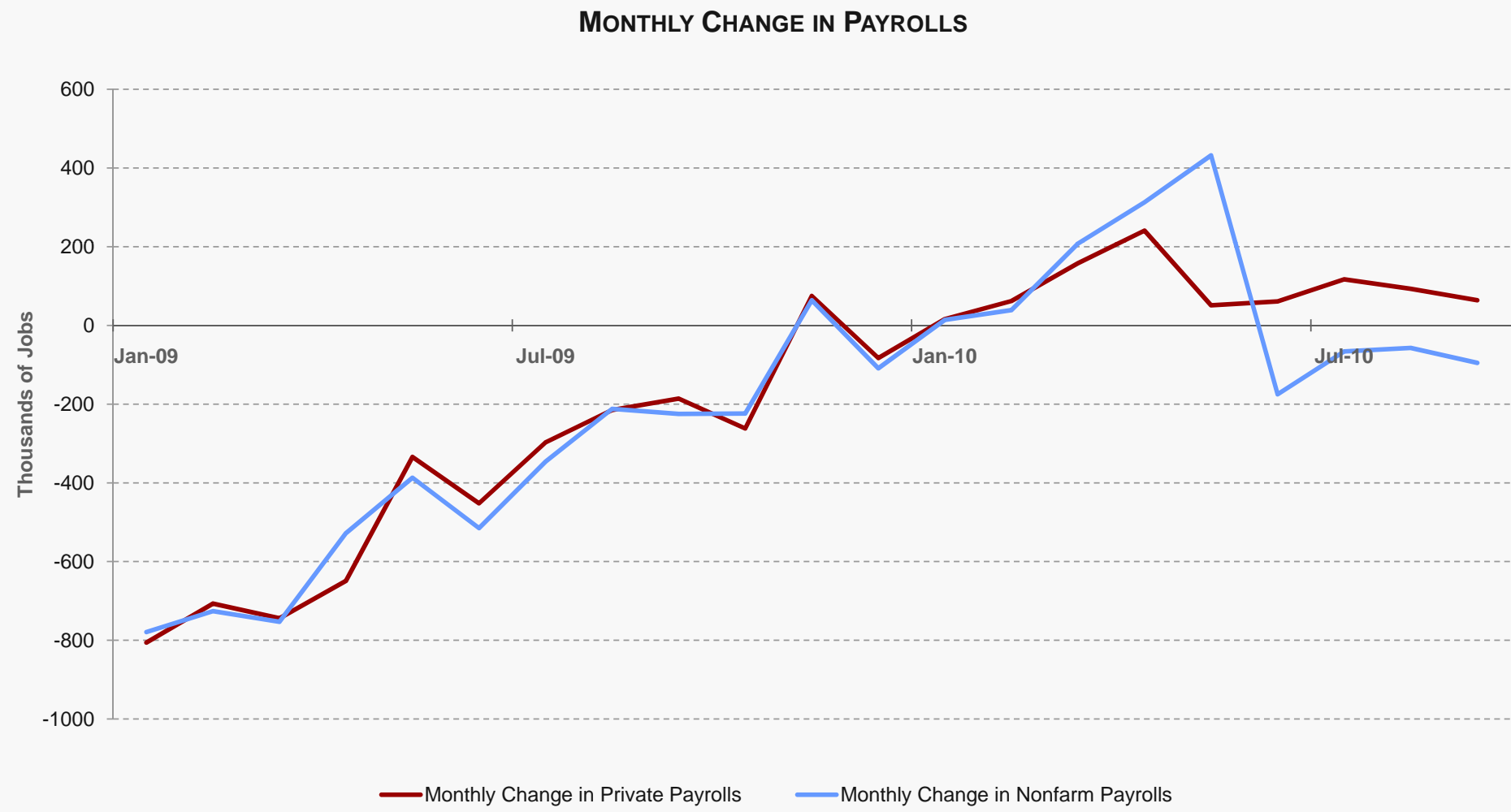
PROPRIETARY AND CONFIDENTIAL

How Will Policy Affect Treasury Financing and Interest Rates?

- Any further fiscal “stimulus” likely to be limited and would add to debt concerns
- Further monetary stimulus is on the way. QE2 will increase the amplitude of the rate cycle
- An aggressive FRB (zero interest rate policy?) means more rate volatility, not less

Economic Recovery Interrupted

PROPRIETARY AND CONFIDENTIAL



Economic Recovery Interrupted

Why has the economic recovery stalled?

Uncertainty has led businesses and households to temporarily flee to the sidelines. Government policies have people concerned.

- Obamacare. Tremendous uncertainty for businesses around labor costs, plus new taxes.
- FinReg Reform. Financial firms don't know the rules of the road yet.
- Energy. Cap and trade? Offshore drilling ban.
- Taxes. Where are taxes going to be in 2011?
- Fiscal policy. Still waiting for a plan to attack the deficit.
- Populism. President and Congress vilify industries that oppose their policies (health insurers, banks, oil companies, etc.). Who is next?



Pierpont

S E C U R I T I E S