

# 2014 GFOAA Summer Conference

## *Economic and Investment Update*

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# Executive Summary

## U.S. Economic Outlook

- After a Dismal Start, Expect Stronger 2H
- Housing Recovery Continues, Albeit Slowly
- Domestic Energy Production is a Secular Positive
- Budget Deficit Shows Cyclical Improvement

## Fixed Income

- Expect Yields to Rise
- Underweight to Asset Class is Recommended
- Consider Munis for Tax-Exempt Income

## Stocks

- A correction is Overdue
- Valuations Suggest a Neutral Weight is Appropriate

## After a Red Hot 2013, Financial Market Returns Have Moderated

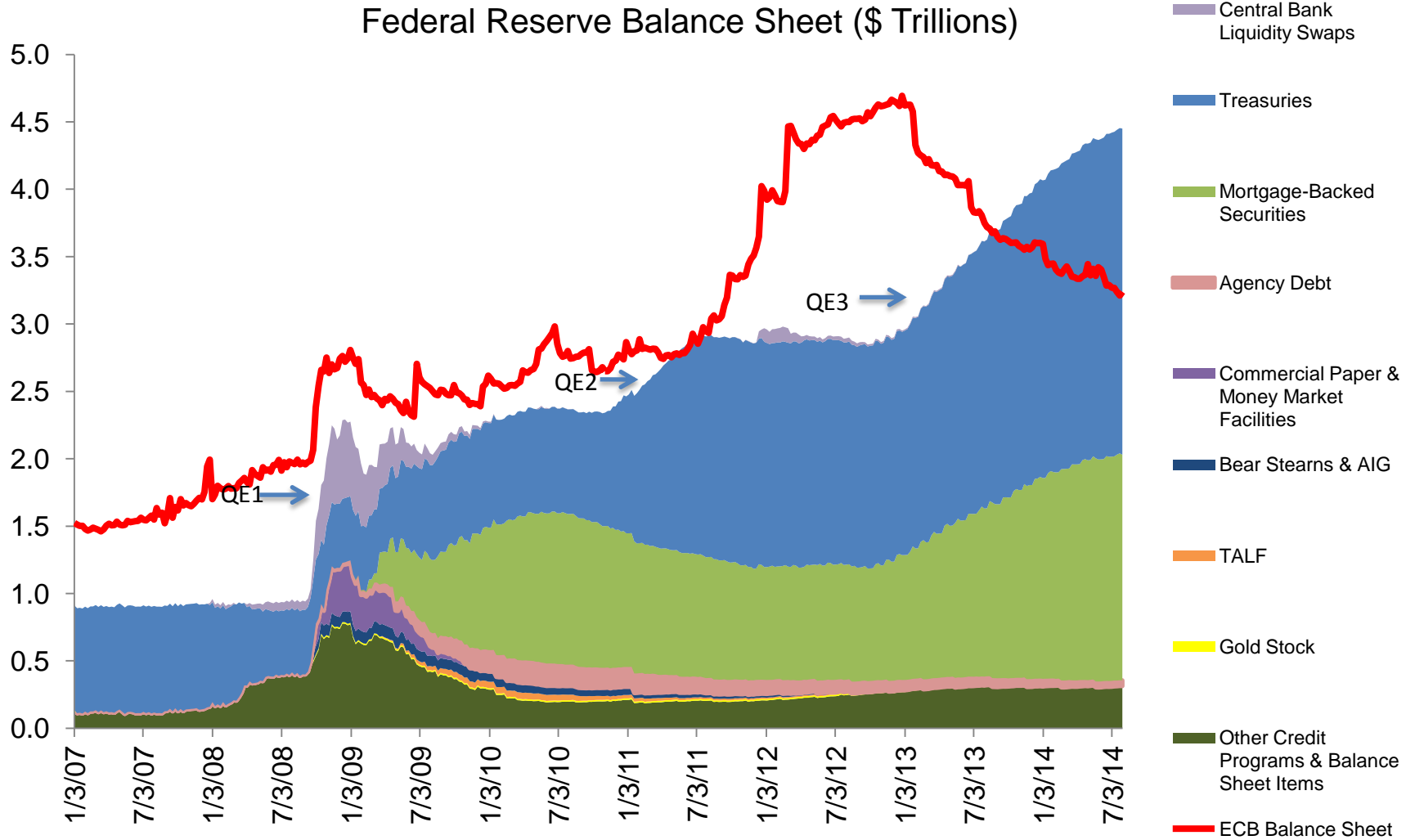
	YTD 7/31/14	2013	2012
S&P 500 Index (Domestic Large Cap Stocks)	5.66%	32.38%	16.00%
KBW Bank Index ( Domestic Bank Stocks)	2.37%	37.76%	33.03%
EAFE Index (Developed Country Foreign Stocks)	3.23%	23.57%	17.87%
MSCI Emerging Index (Emerging Market Foreign Stocks)	8.26%	-2.30%	18.66%
STOXX 600 Banks Index (European Bank Stocks)	2.29%	23.29%	26.37%
NIKKEI 225 Index (Japanese Stocks)	-3.24%	59.32%	25.64%
GOLD (ETF)	6.26%	-28.33%	6.60%
U.S. Aggregate Bonds (Barclays Index)	3.66%	-2.02%	4.22%

U.S. Economy hit Weather-Related  
“Pothole” in Q1  
Expect Faster Growth in 2H

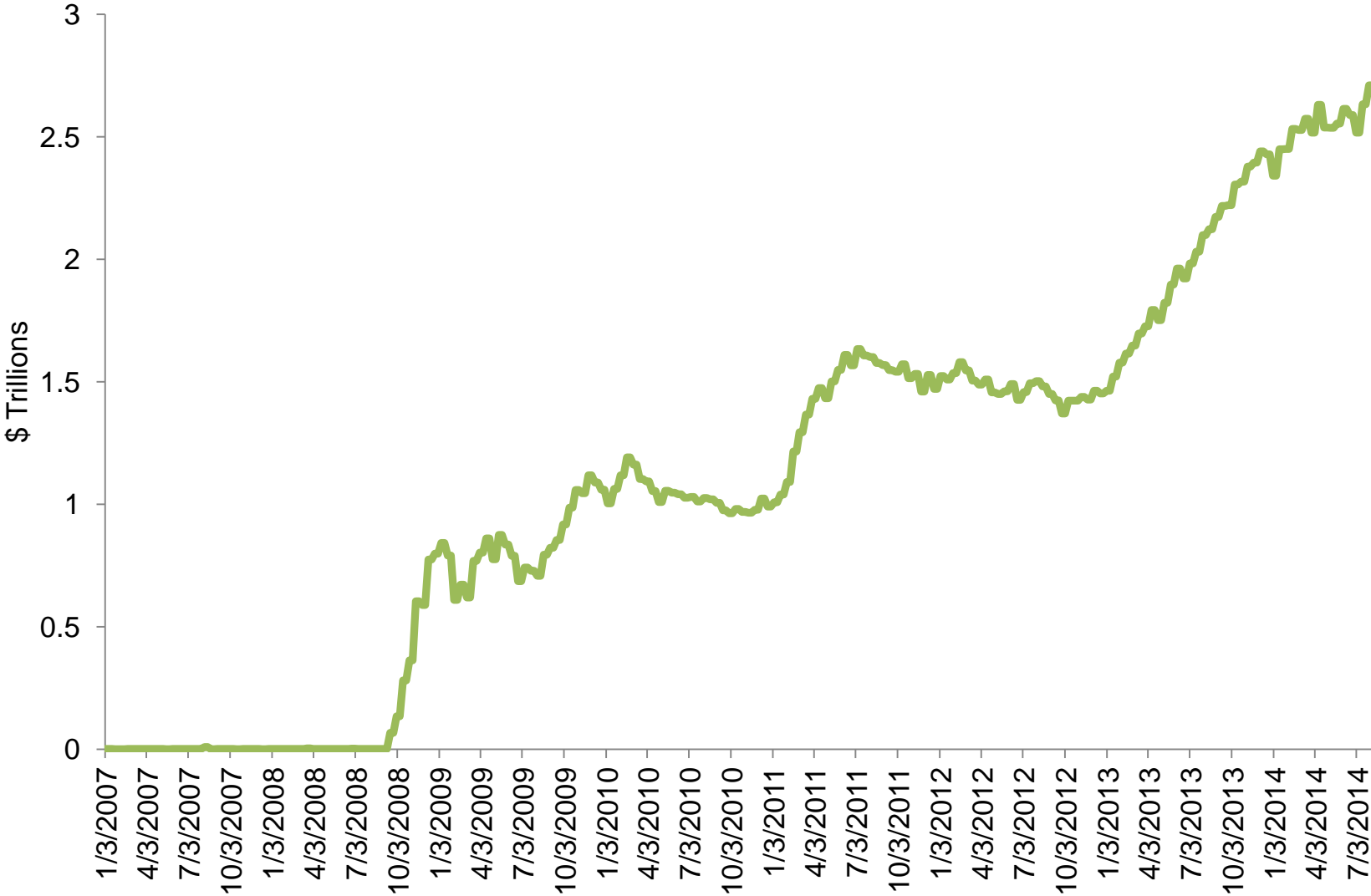
## GDP: Eurozone, U.S. and Major Trading Partners + Brazil

	Annual GDP (Bln USD)	GDP YoY % Chg March 2014	GDP Q1 2014 % Chg Annualized	GDP Estimate Calendar Yr 2014
United States	16,245	1.50%	-2.90%	1.70%
Eurozone	12,213	0.90%	0.20%	1.10%
China	8,227	7.40%	7.40%	7.40%
Japan	5,961	3.00%	1.40%	1.50%
Brazil	2,253	1.91%	0.17%	1.35%
Canada	1,780	2.10%	1.20%	2.20%
Mexico	1,178	1.80%	0.28%	2.80%
<b>Weighted Average</b>		<b>2.60%</b>	<b>0.57%</b>	<b>2.53%</b>

# U.S. Fed is Winding Down Asset Purchases, ECB is Considering QE



# Excess Reserves US Depository Institutions

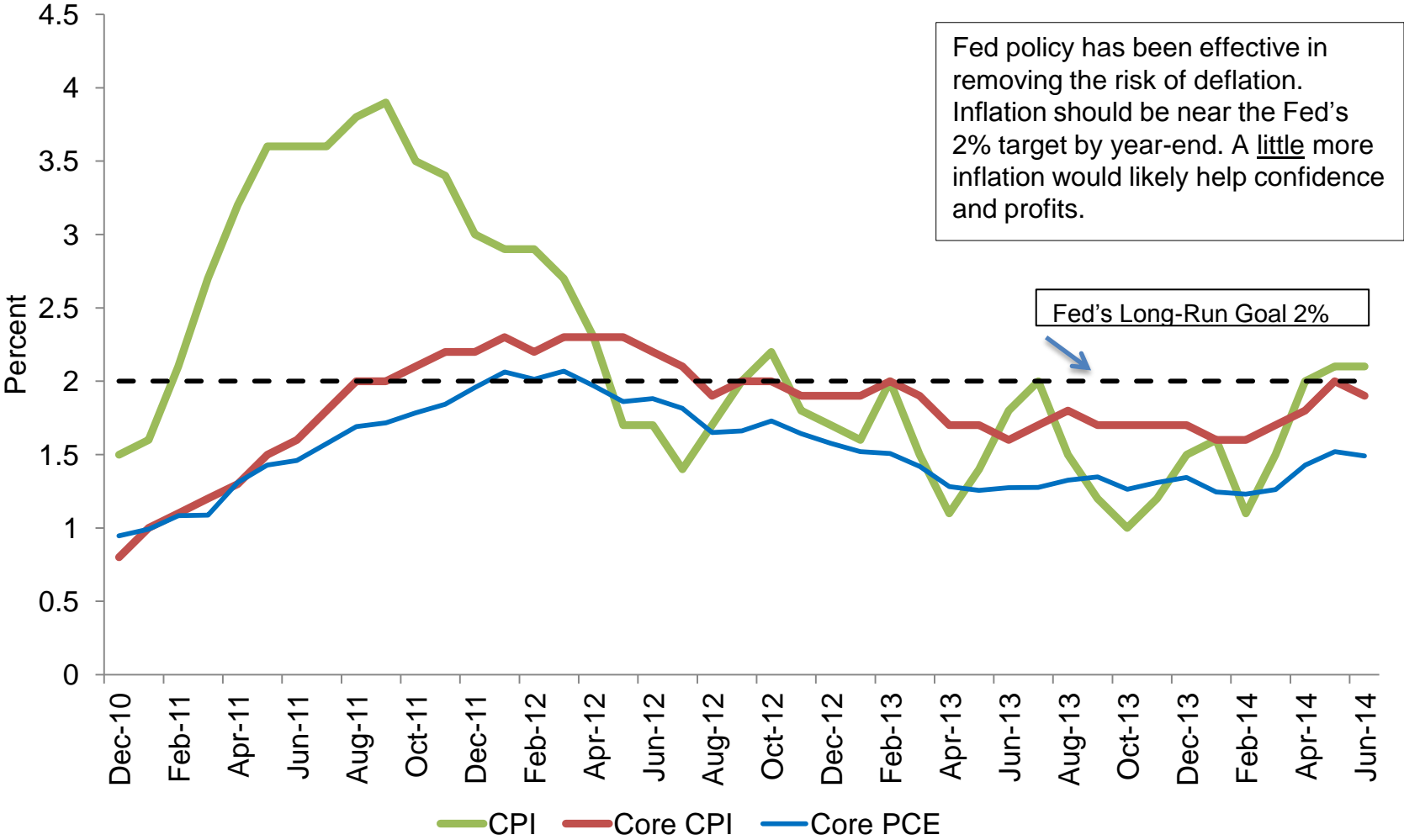


Source: Bloomberg and Federal Reserve



# Inflation has Bottomed in the U.S.

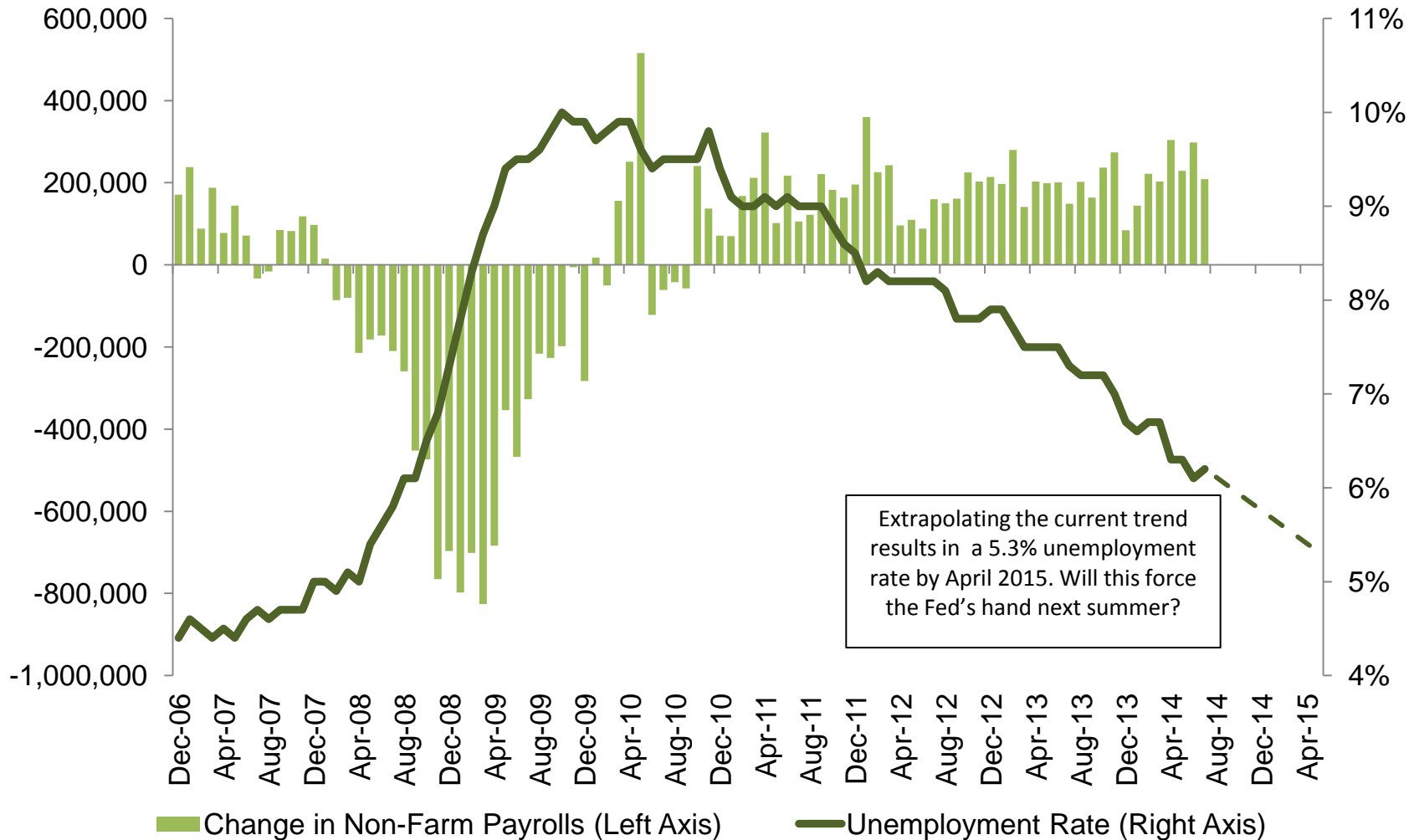
December 2010 – June 2014



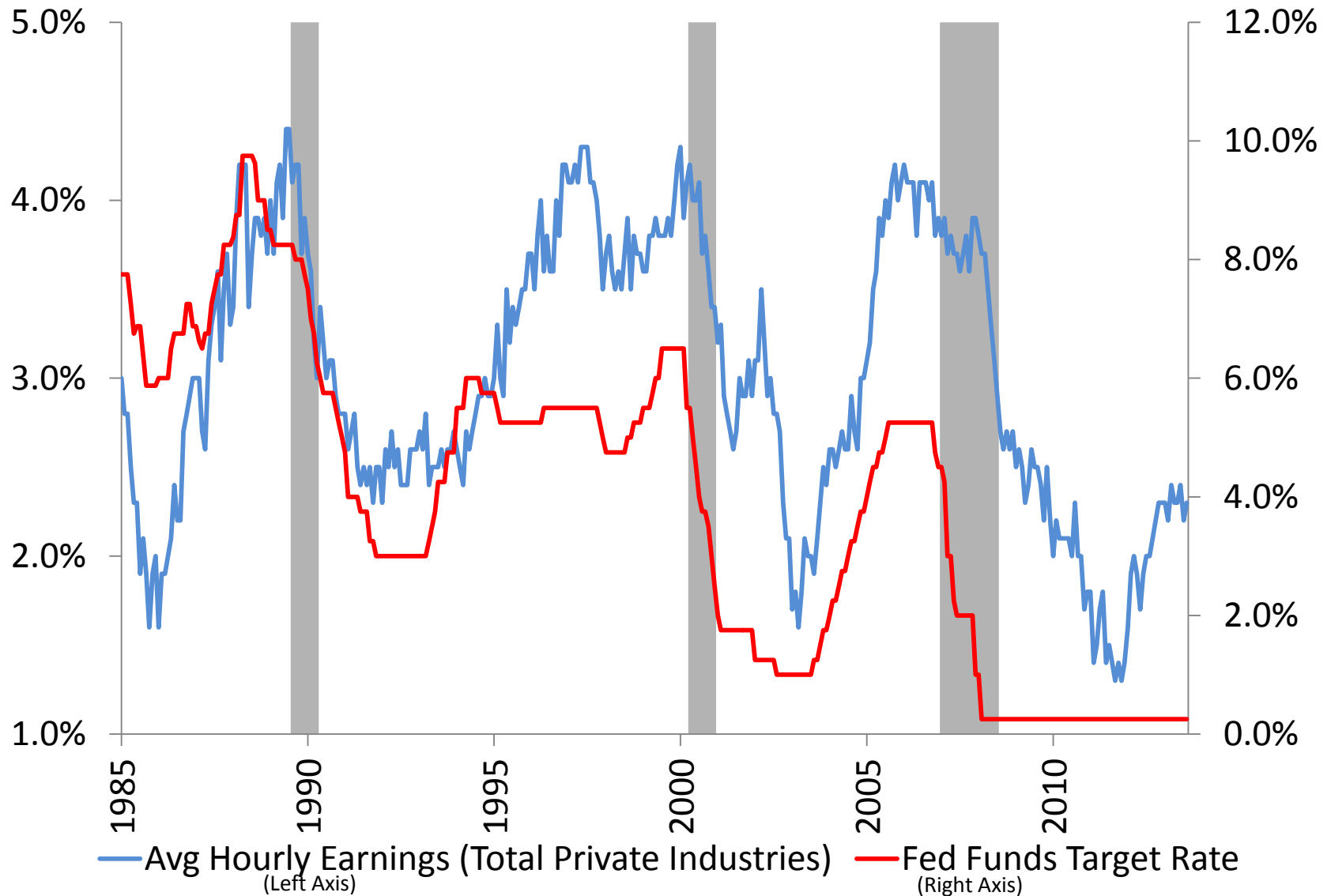
Source: Bloomberg

# An Improving Labor Market Should Produce More Wage Inflation

## Change in US Non-Farm Payrolls and Unemployment Rate

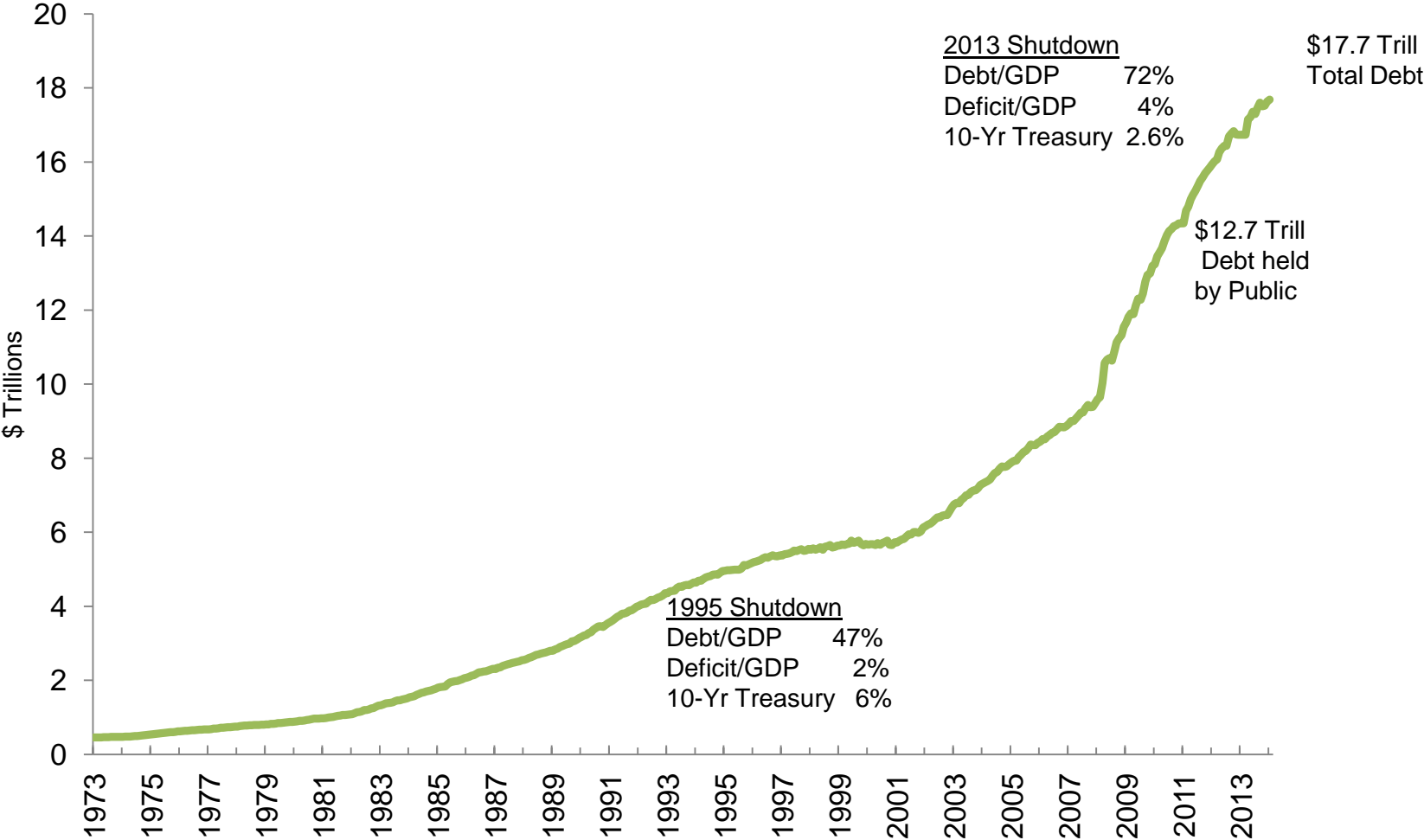


## Historically the Fed has hiked rates when wages started rising...



# Federal Government Debt

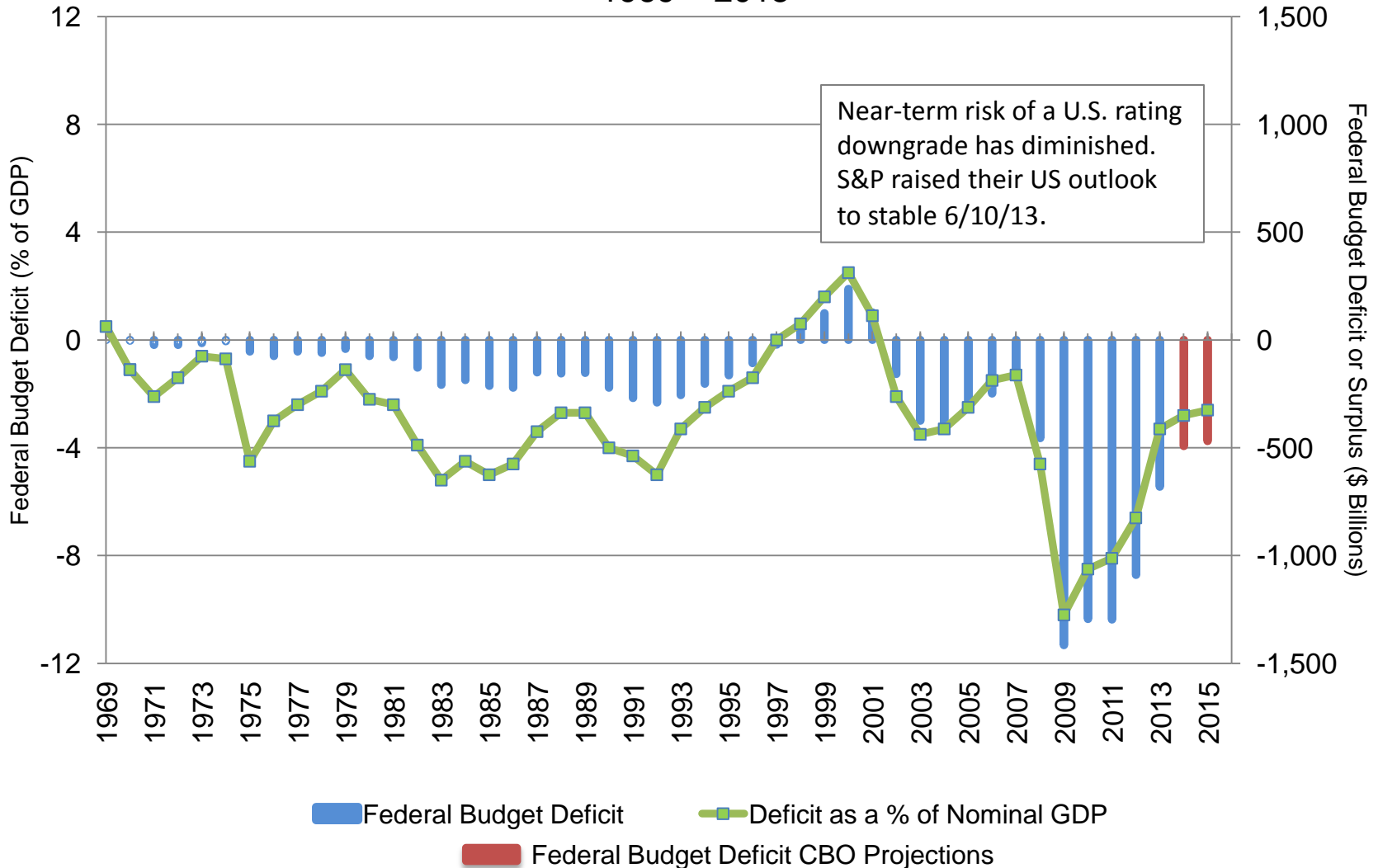
## Total Public US Debt Outstanding



Source: Bloomberg

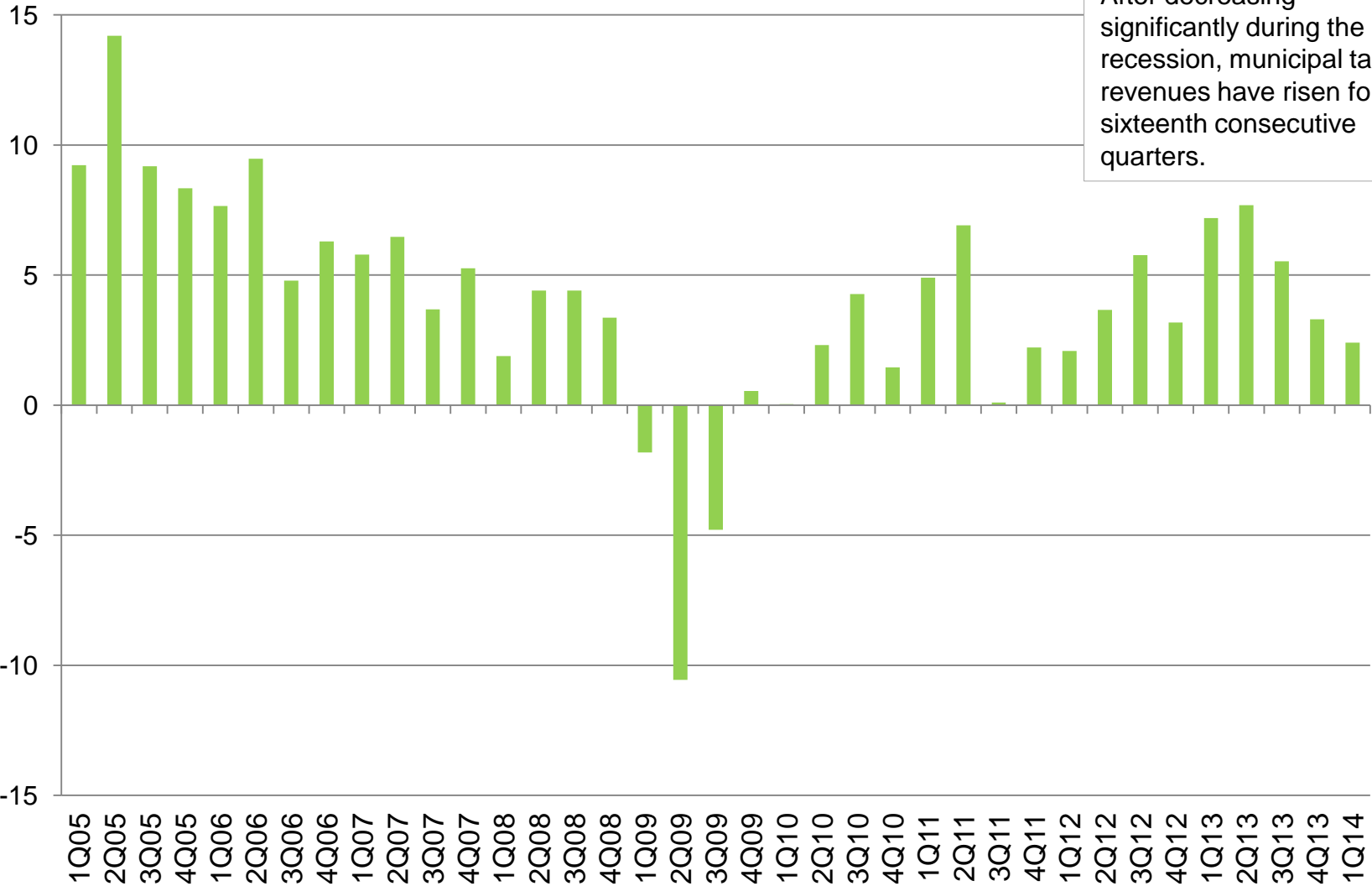
# Federal Budget Deficit

Fiscal Years  
1969 – 2015



# State and Local Tax Revenue

1Q 2005 – 1Q 2014

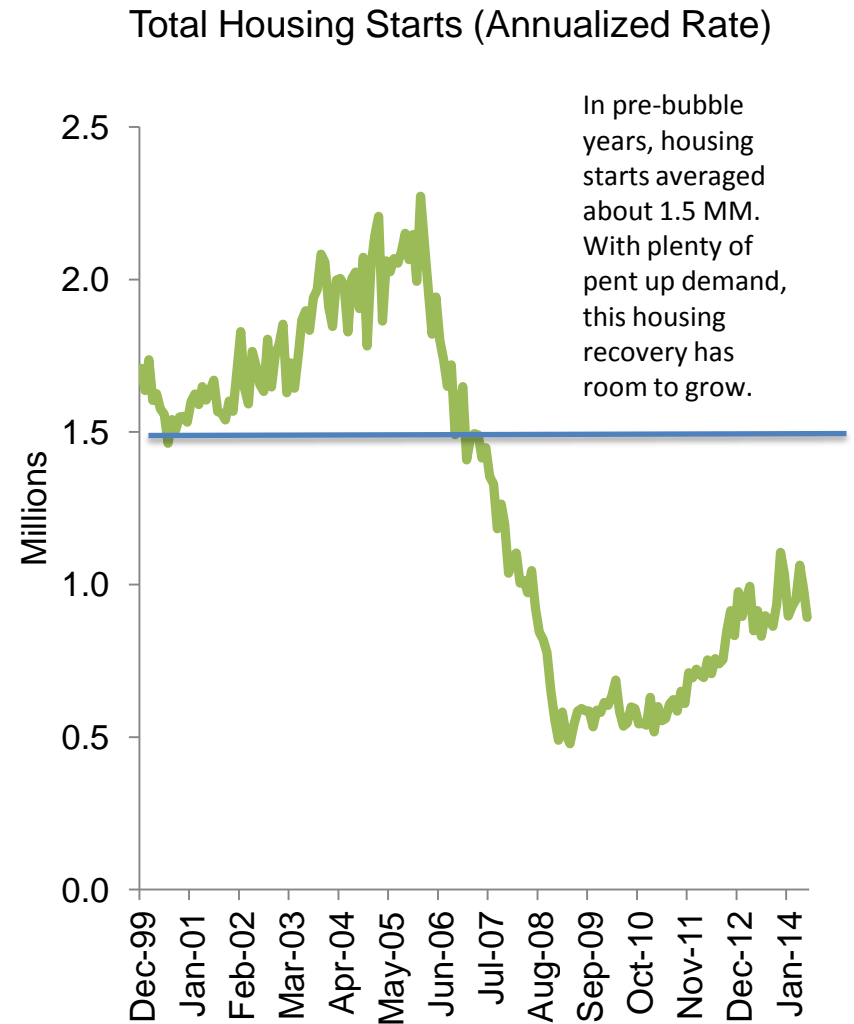
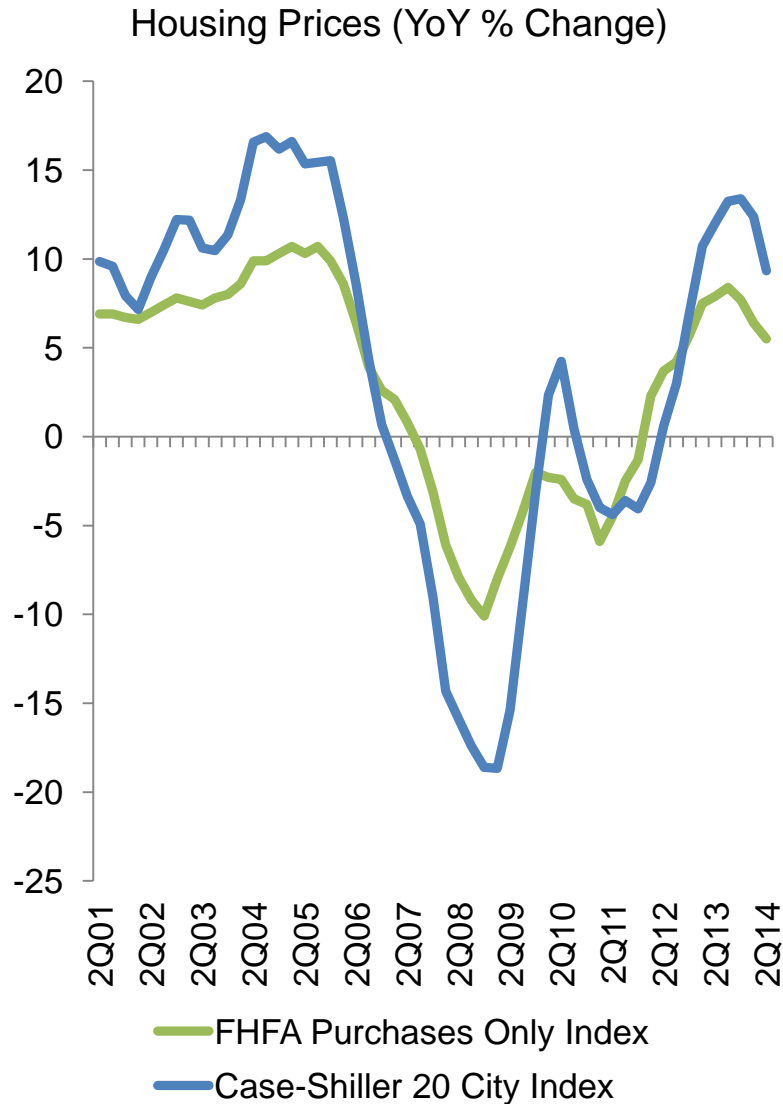


After decreasing significantly during the recession, municipal tax revenues have risen for sixteenth consecutive quarters.

Source: Census Bureau

# Tepid Housing Recovery Continues

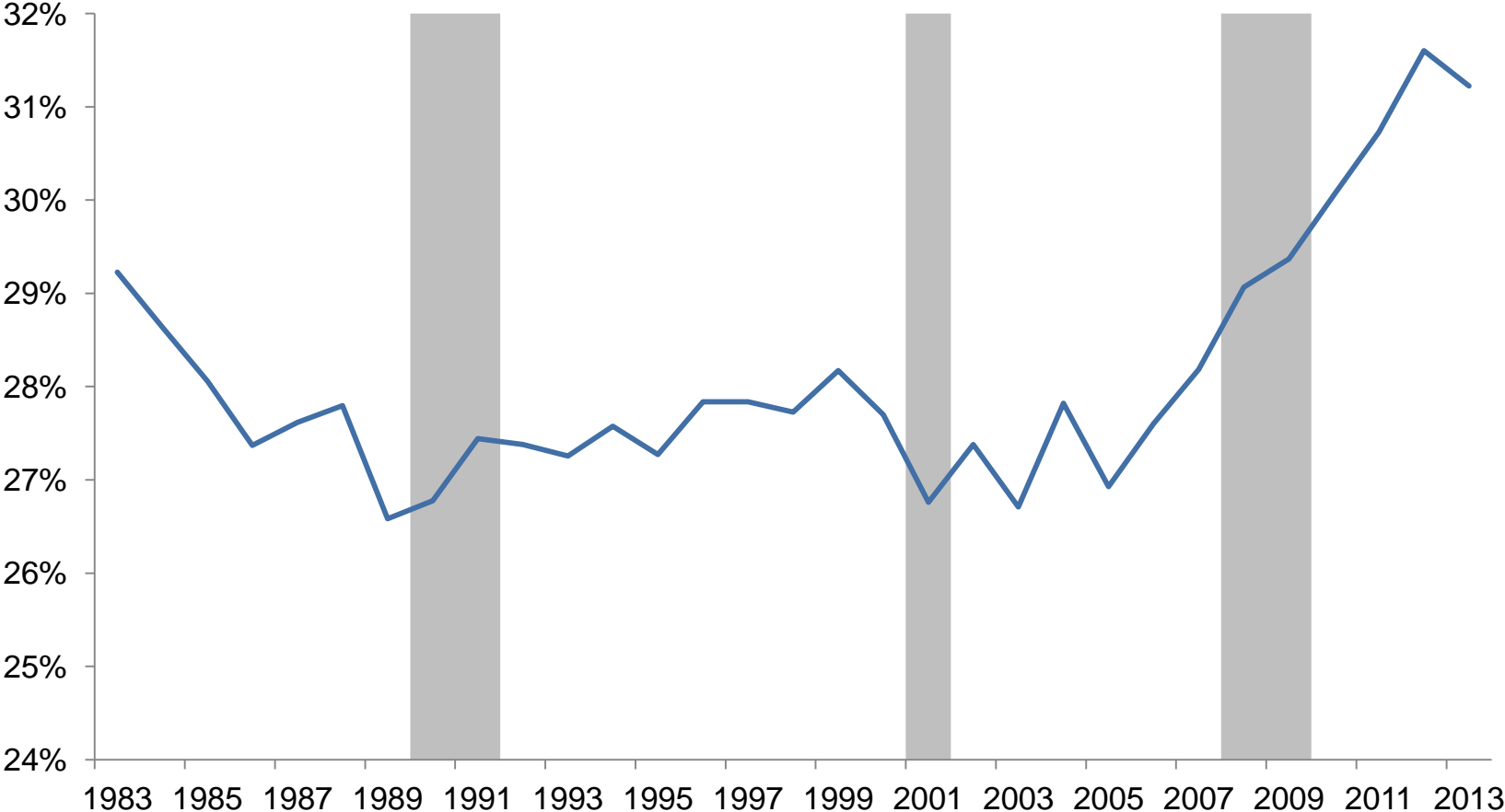
# US Home Values and New Home Construction Slowed Down in June





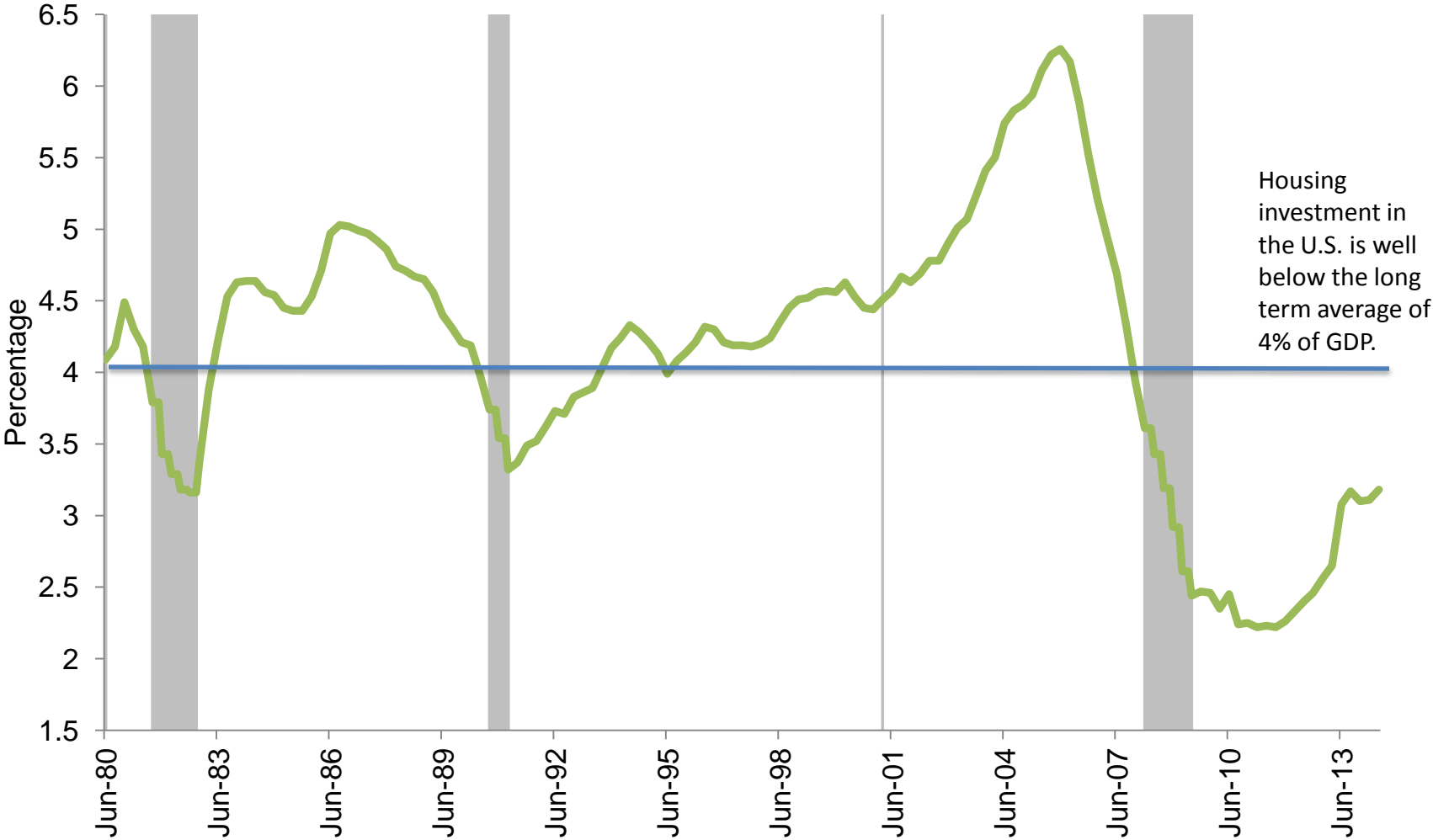
# Pent-up Demand for Housing

## % of all 18-34 year olds living with their parents



Source: Census Bureau

# Residential Investment as % of Nominal GDP

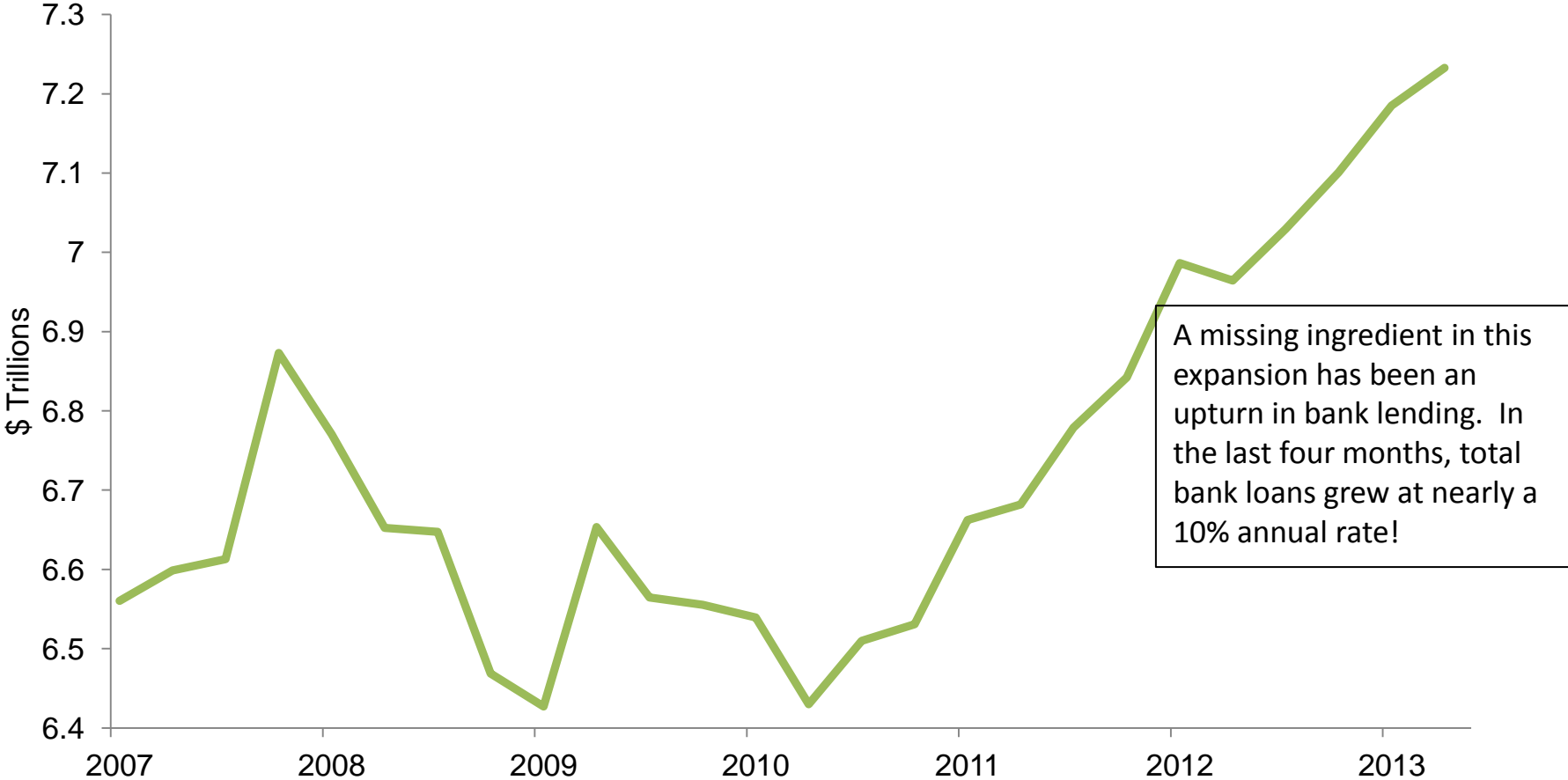


Source: Bloomberg

# Other Factors on our “Dashboard”

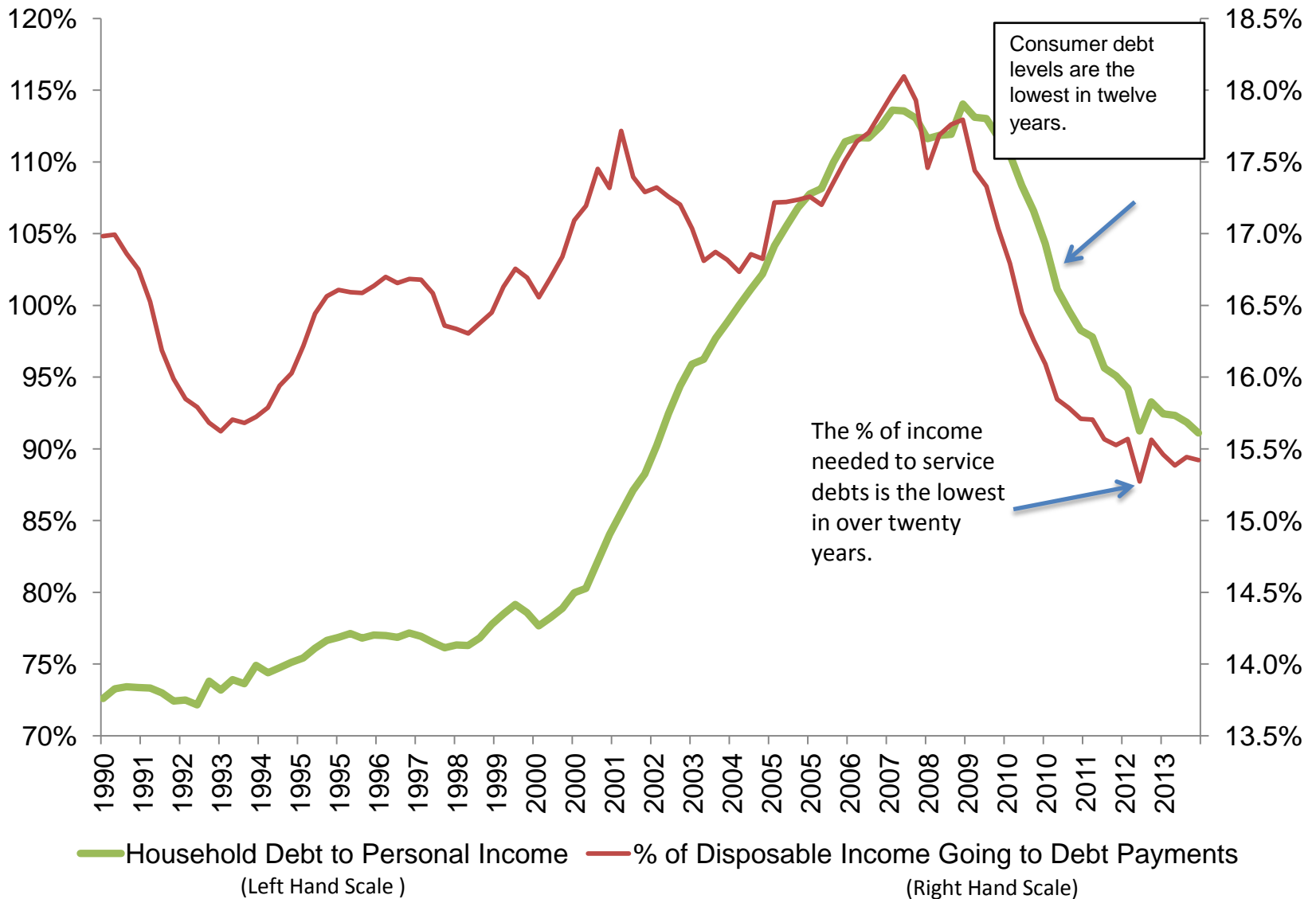
# Bank Loan Growth is Picking Up

## U.S. Total Bank Loans



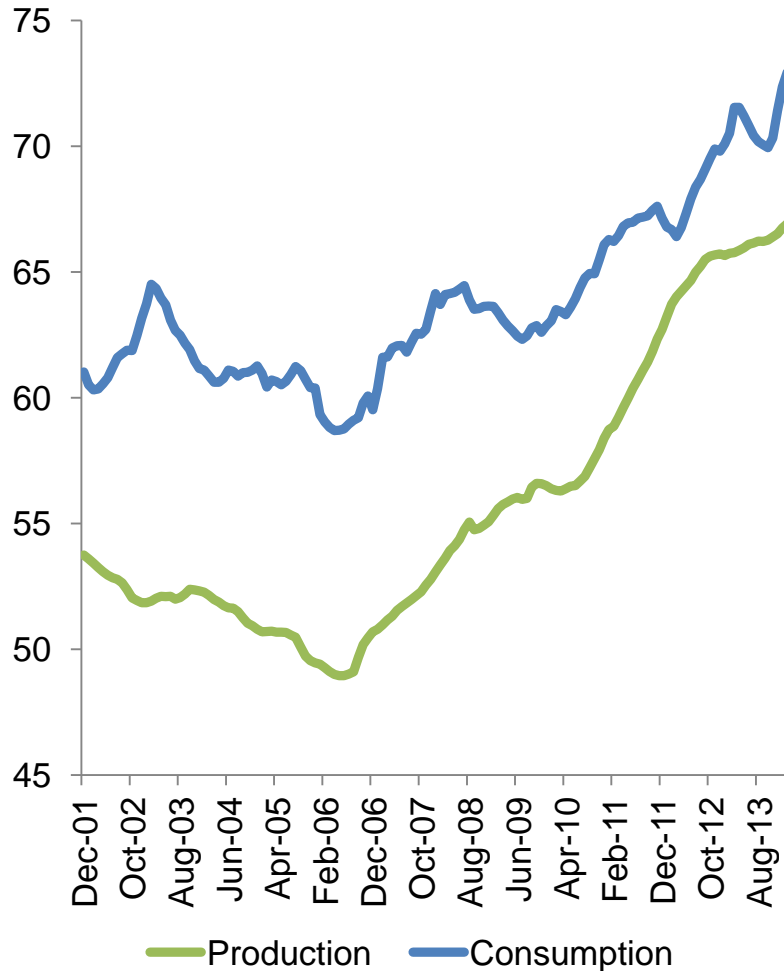
Source: Bloomberg

# Consumers Have Repaired Balance Sheets

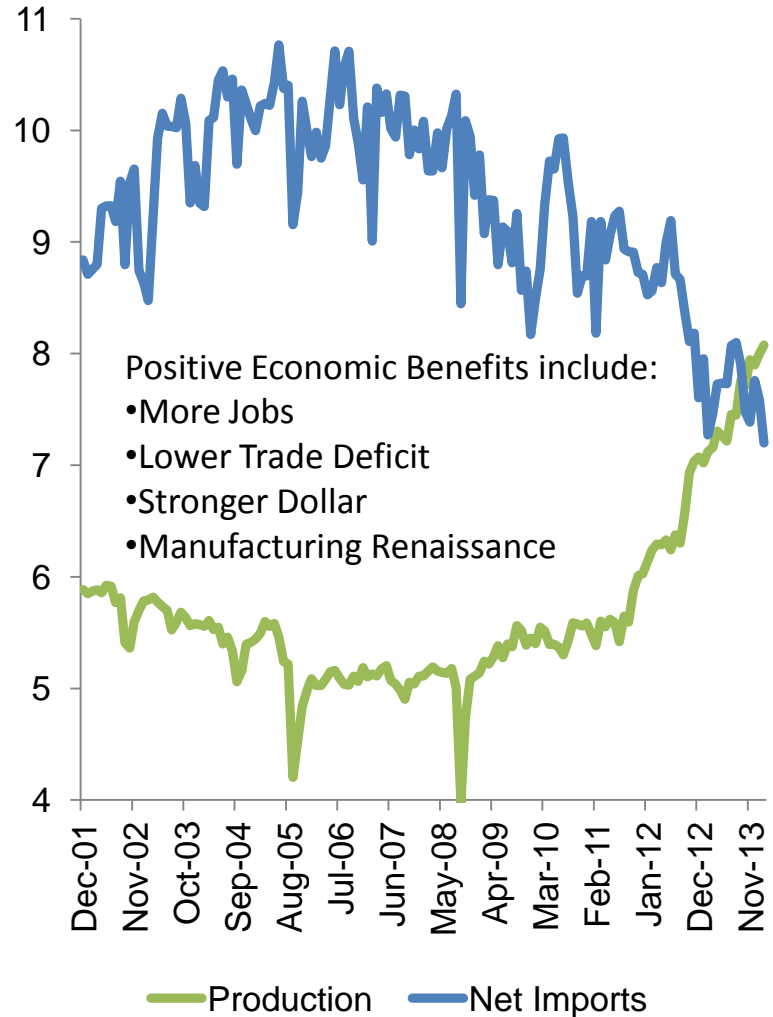


# Domestic Energy Production is Rapidly Expanding

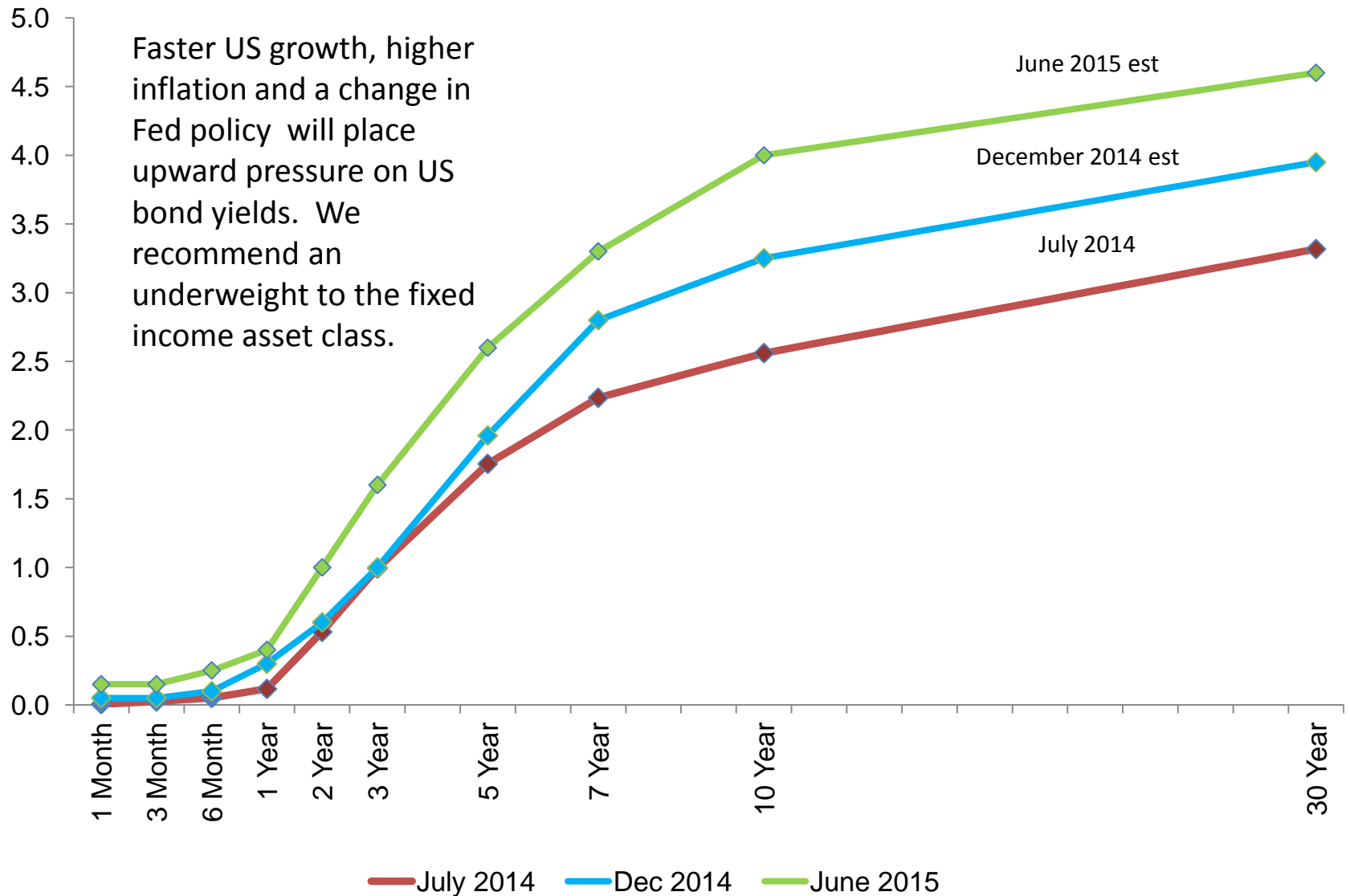
US Natural Gas (Billion Cubic Feet per Day – 12 Month Average)



US Oil (Million Barrels per Day)



## Current and Expected U.S. Treasury Yield Curves

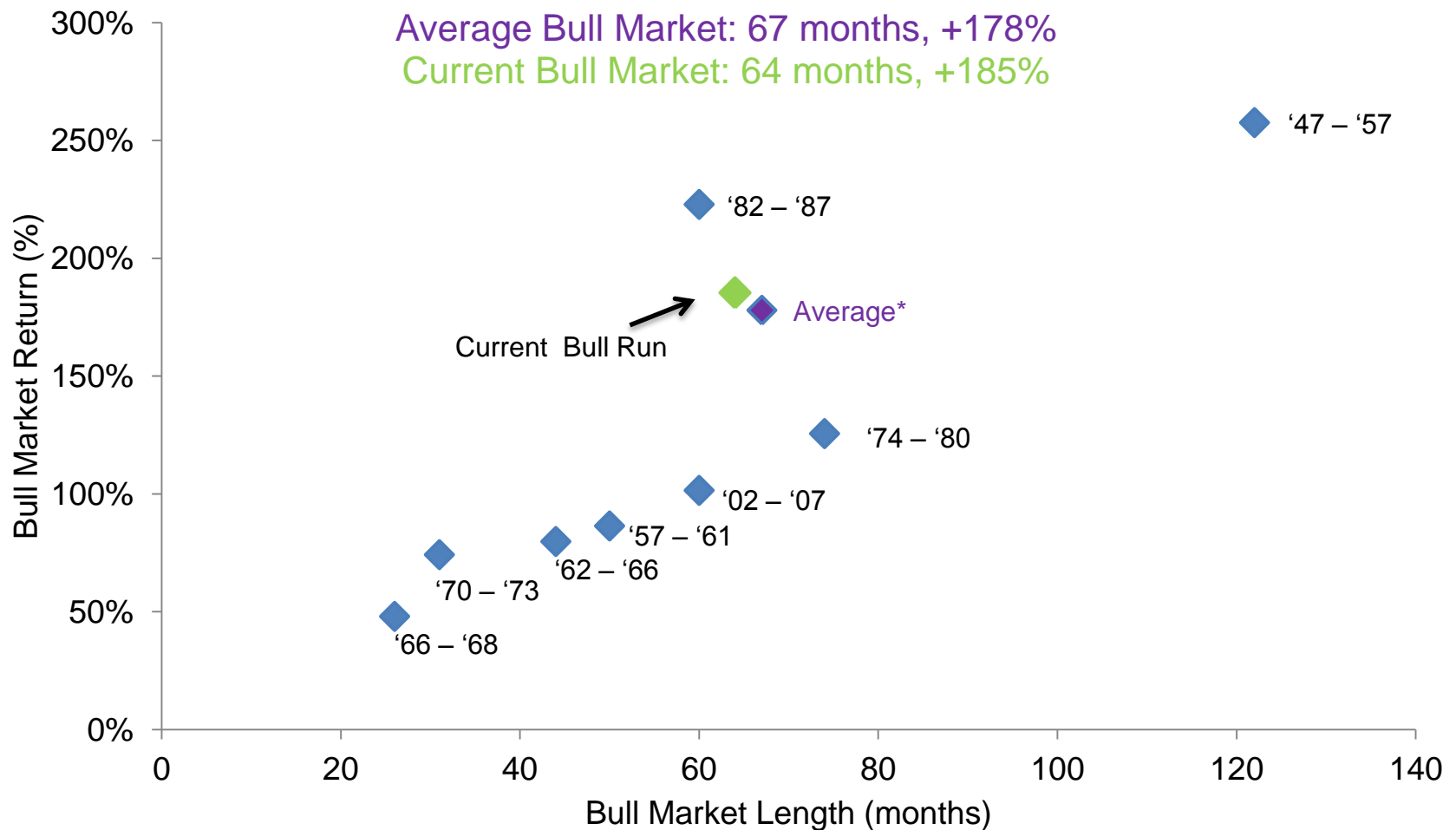


## Equity Market Outlook:

A correction is overdue. Valuations suggest a neutral weight to the asset class is appropriate.

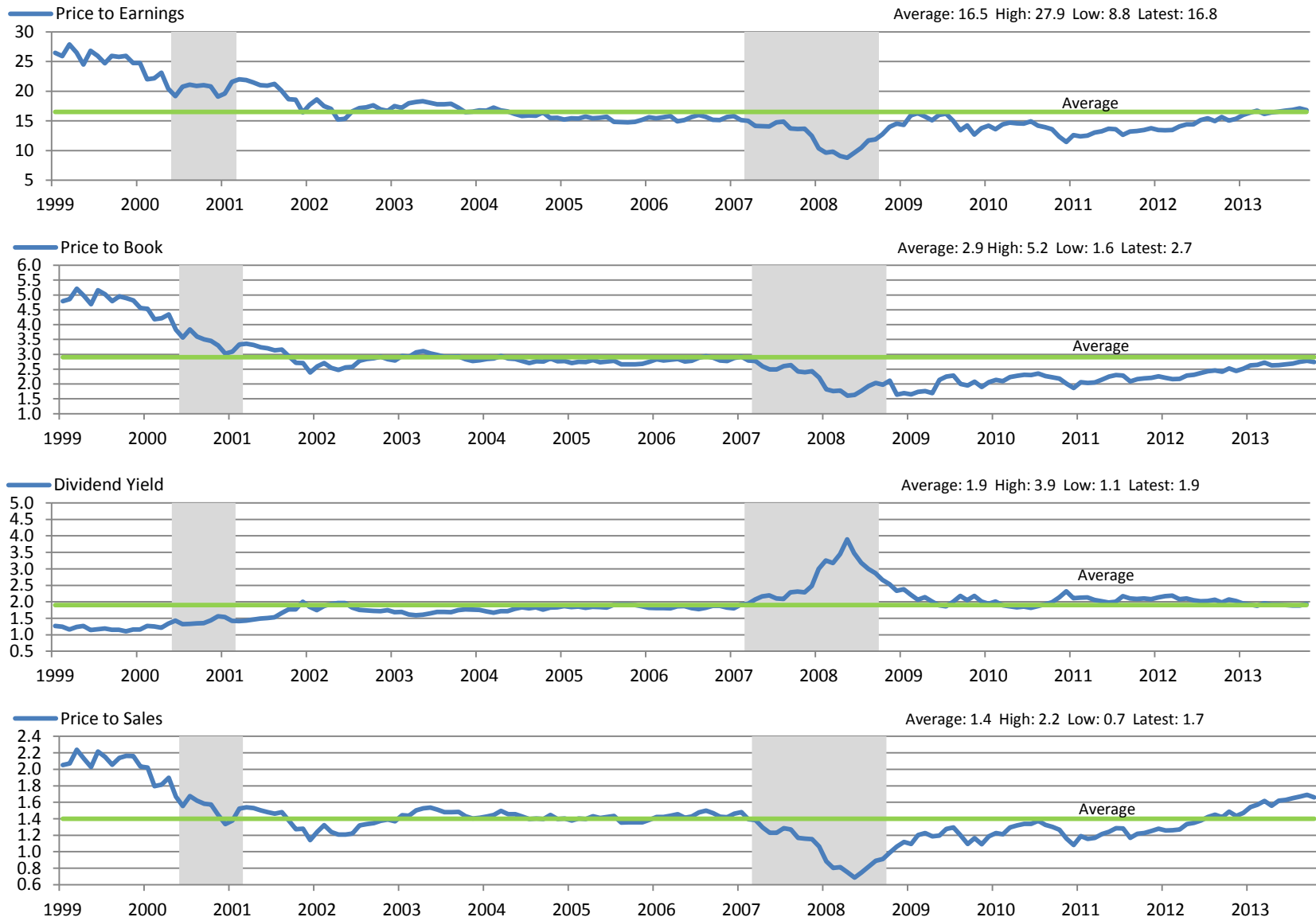


## Historical Bull Markets: Duration and Magnitude As of July 2014



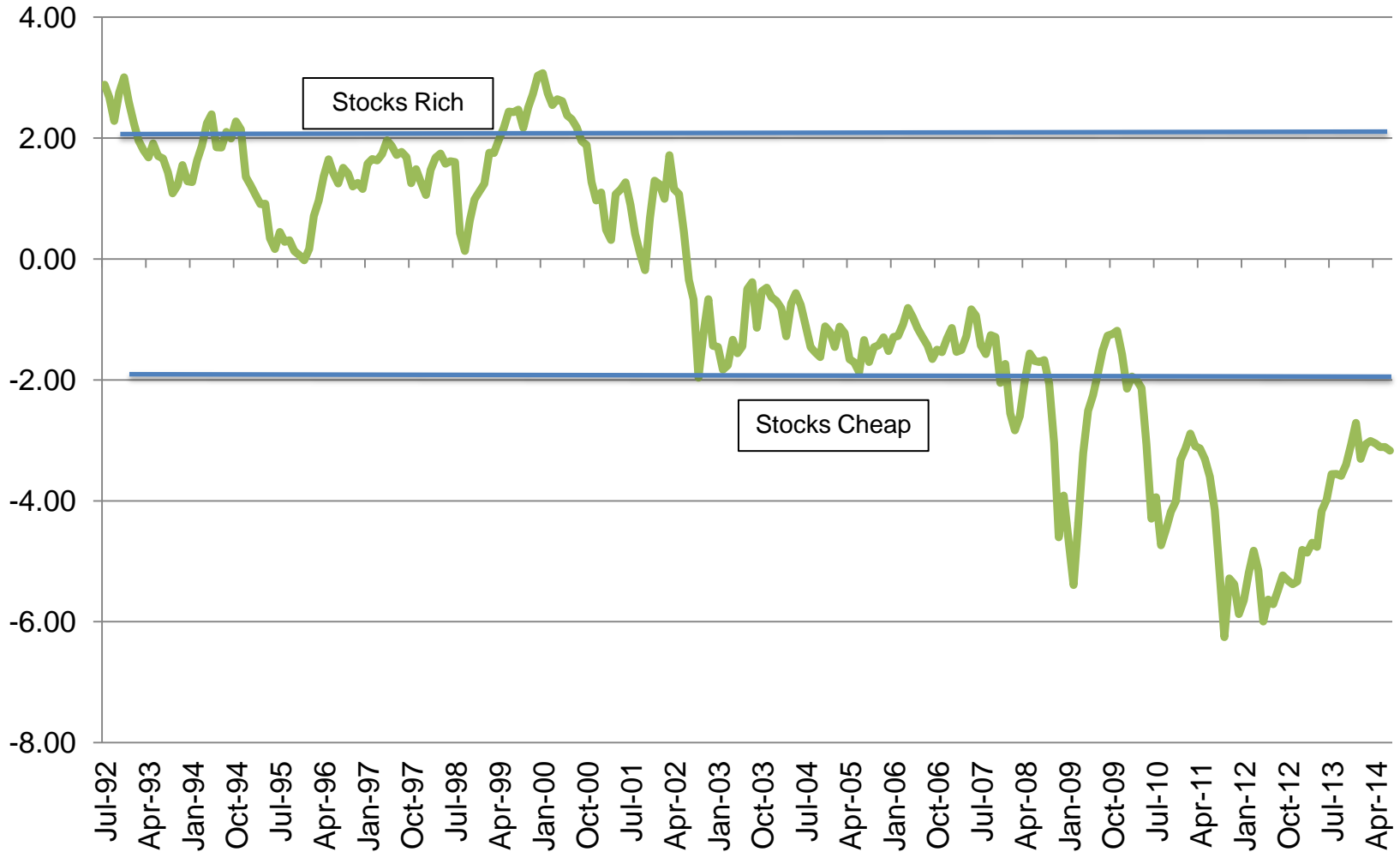
\* Please note, for graphical purposes, the above chart excludes the bull market period from 1987–2000 due to the exorbitant bull run return of 582%. However, this time period is included in the calculation of the average bull market return and duration.

# S&P 500 Valuations History



# U.S. Fed Model Valuation Indicator

## 10-Year Treasury Yield – S&P 500 Earnings Yield July 1992 – July 2014



## Conclusion

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- After a weather-related “soft patch”, economic growth in the U.S. should accelerate in the 2H. Plenty of pent up demand should support the housing recovery.
- As more and more “reluctant bulls” come into the fold, the “contrarian” case for stocks is no longer there. Many of our catalysts for the equity market have been achieved and finding additional catalysts is becoming difficult.
- Positive earnings growth, a nice yield, and an improving economic outlook worldwide should help support stocks. However, a correction is overdue and valuations suggest a neutral allocation is appropriate. Preserving the tremendous gains experienced since the market bottomed in March of 2009 is our main focus.

# Q & A