ENDOWMENT
WEALTH MANAGEMENT

Quarterly Economic & Market Update

2nd Quarter 2015

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Our mission is to provide professional wealth management services that will sustain Multi-Generational Family Wealth, Unity and Legacy.

Disclaimer/Important Information

Performance quoted is past performance and cannot guarantee comparable future results; current performance may be higher or lower.

Results shown assume the reinvestment of dividends.

An investment cannot be made directly in an index.

Investments with higher return potential carry greater risk for loss.

Investing in small companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

Foreign securities have additional risks, including exchange rate changes, political and economic upheaval, the relative lack of information about these companies, relatively low market liquidity and the potential lack of strict financial and accounting controls and standards.

Investing in emerging markets involves greater risk than investing in more established markets such as risks relating to the relatively smaller size and lesser liquidity of these markets, high inflation rates, adverse political developments and lack of timely information.

Fluctuations in the price of gold and precious metals often dramatically affect the profitability of the companies in the gold and precious metals sector. Changes in political or economic climate for the two largest gold producers, South Africa and the former Soviet Union, may have a direct effect on the price of gold worldwide.

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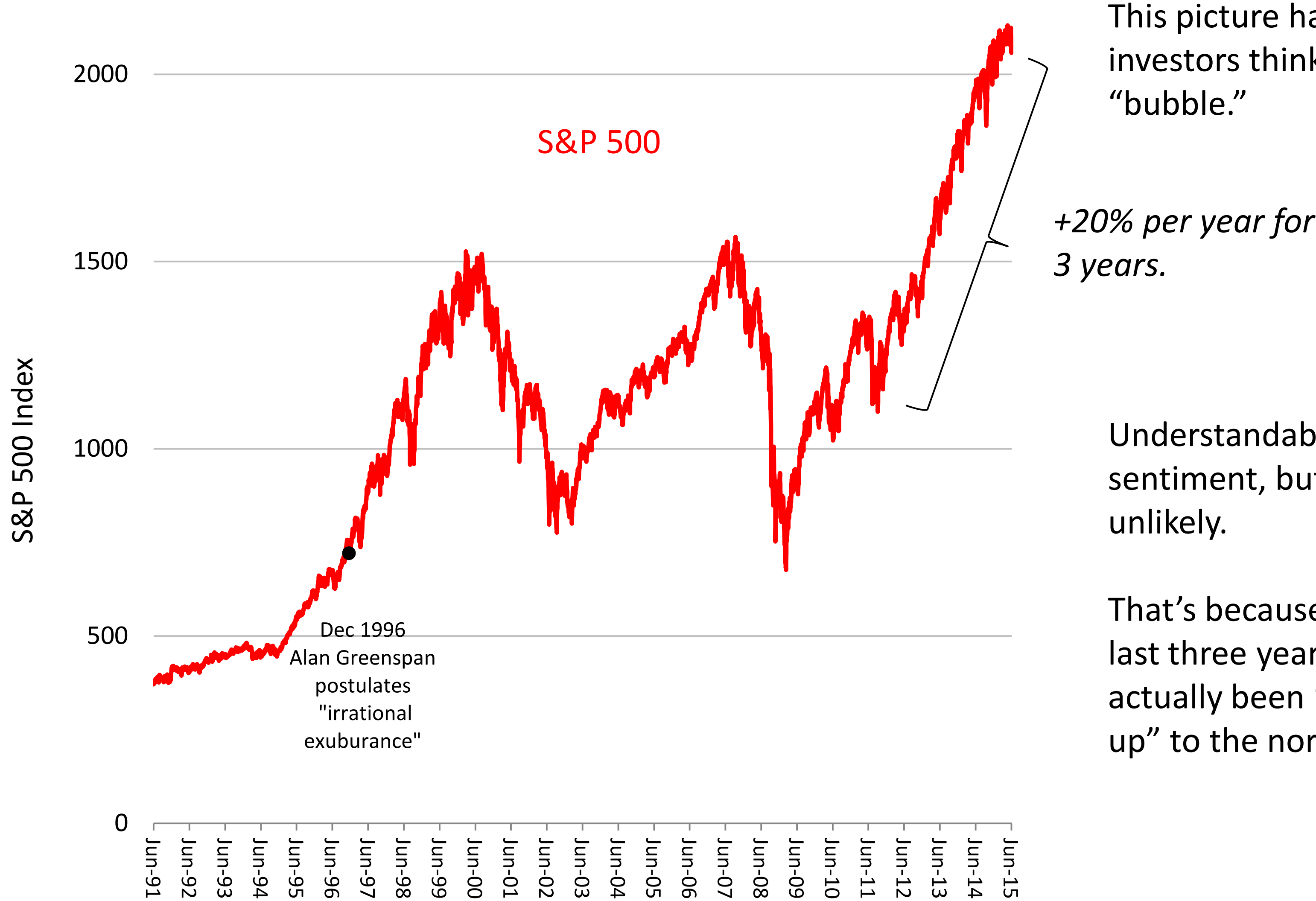
Stock Market

- Bubble or reversion to the mean?
- Earnings drive stock prices
- Margins peaking but can remain high
- New era of lower stock returns?
- Normal valuations
- Lack of irrational exuberance
- Chinese Stock Markets
- Fed Liftoff & Stocks
- Yield Curve & Stocks
- US Dollar & Stocks

Stock market bubble?

Bubble baloney



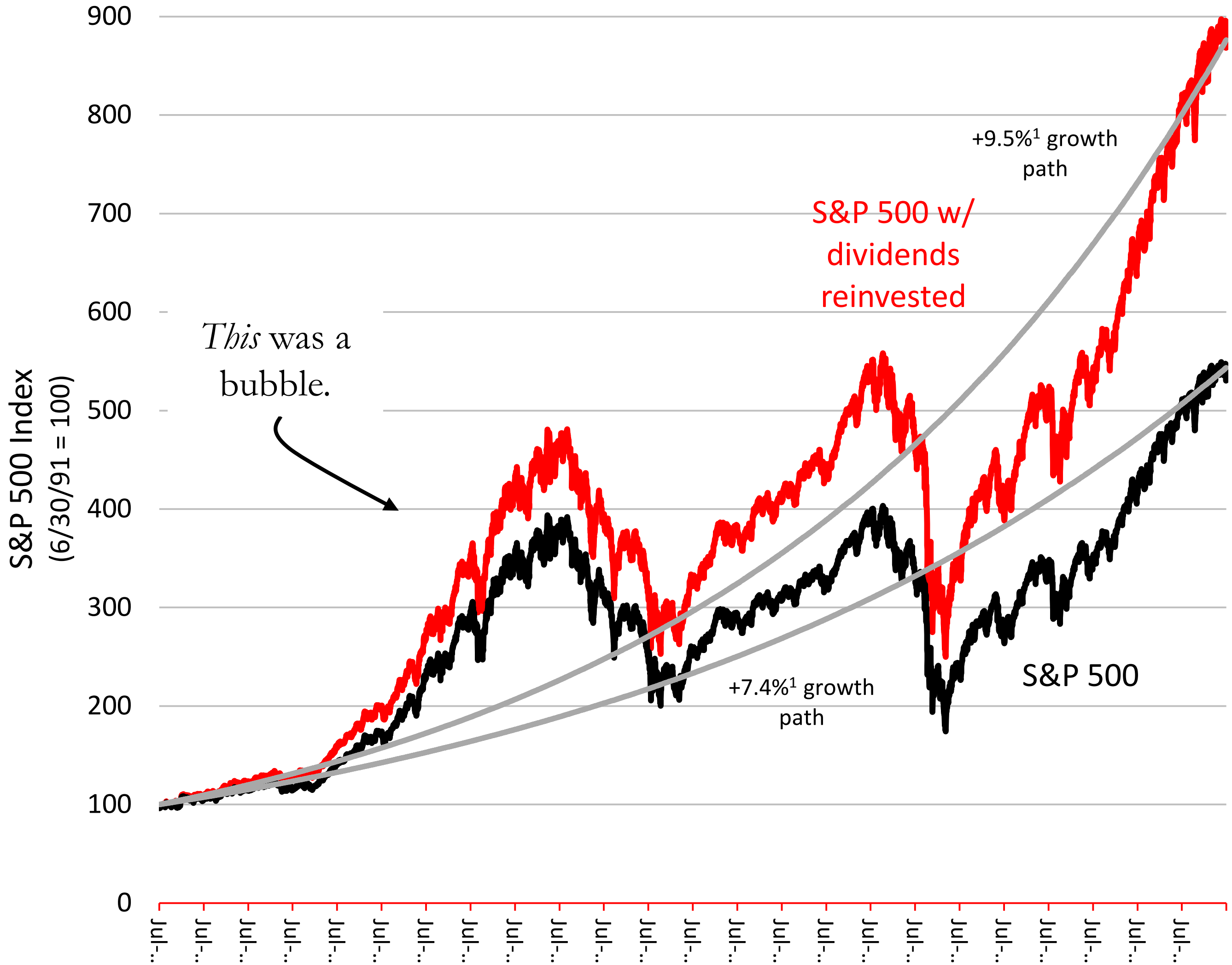
Source: Standard & Poor's. Data through July 2, 2015.

This picture has some investors thinking "bubble."

Understandable sentiment, but unlikely.

That's because the last three years have actually been "catch-up" to the norm.

Total return = 7.4% earnings-driven price + 2.1% dividends reinvested



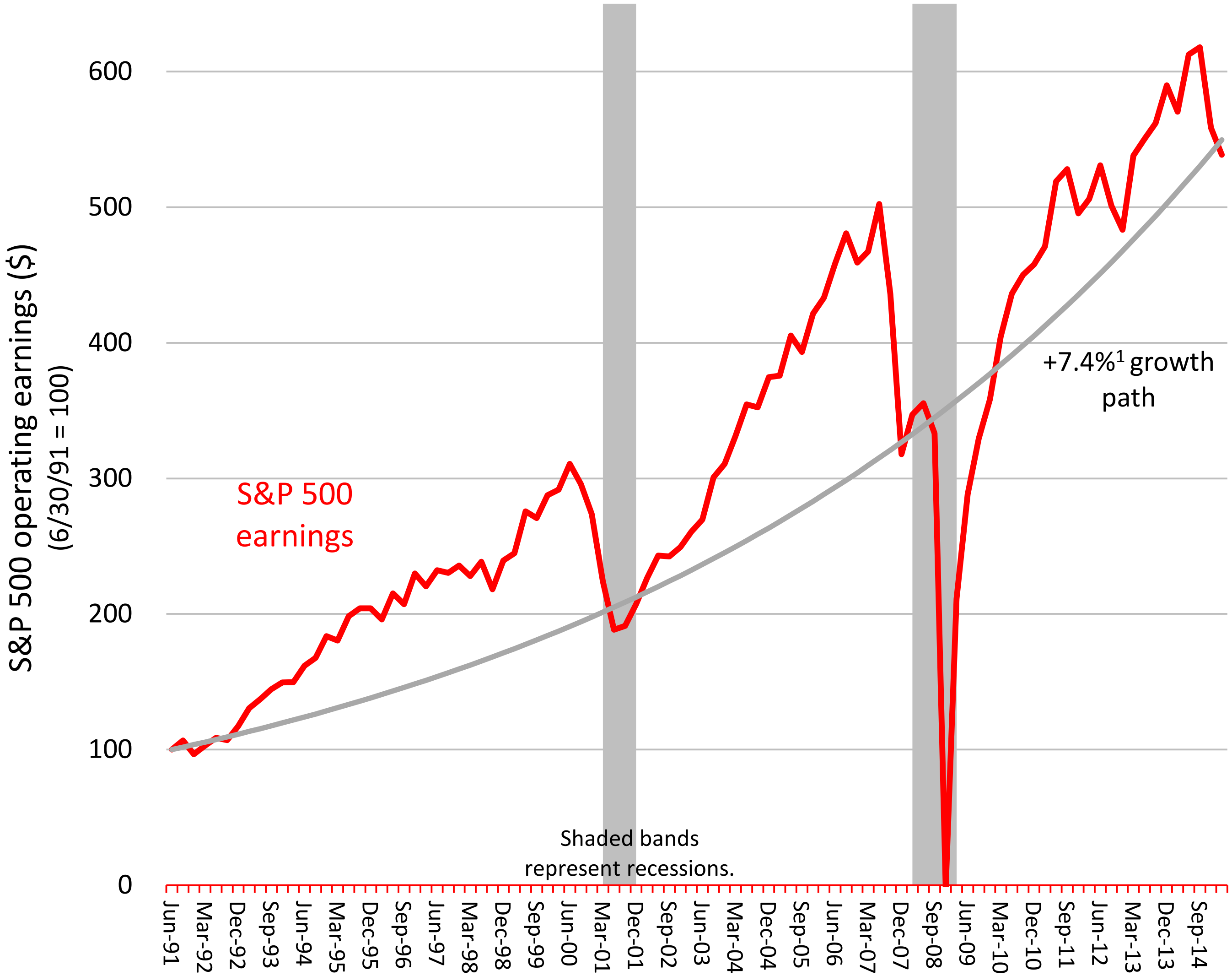
Neither of these indexes presently look like bubble territory. They are right in line with their long-term trend rates of appreciation.

<u>+9.5% per year S&P 500 total return over the last 25 years is right in line with the stock market's *long-term* returns going back to 1926, or back even further to 1871.</u>[3]

Source: Standard and Poor's. Data through June 2015.[1] Compound annual growth rate. [2] S&P 500 total return index.
[3] per Professor Jeremy Siegel's seminal *Stocks for the Long Run*, first published in 1994.

Stock market arithmetic

S&P 500 earnings drive stock prices



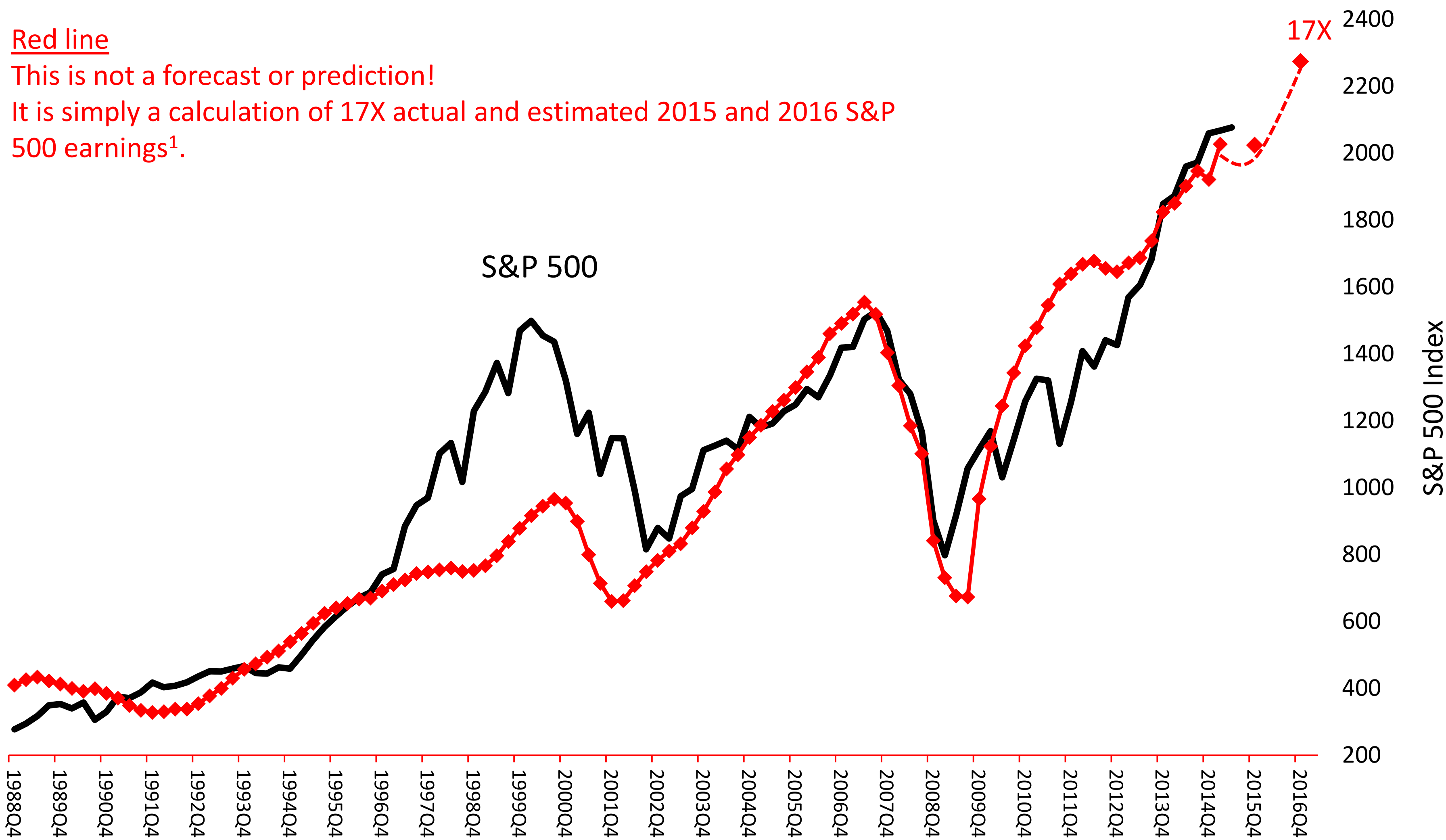
Source: Standard and Poor's. Data through March 2015. [1] Compound annual growth rate.

S&P 500 earnings have trended higher at approximately +7.4% CAGR[1] for the last 25 years.

It is not unreasonable to expect that economists' roughly +3% GDP growth forecast could result in a continuation of +7% S&P 500 earnings growth.

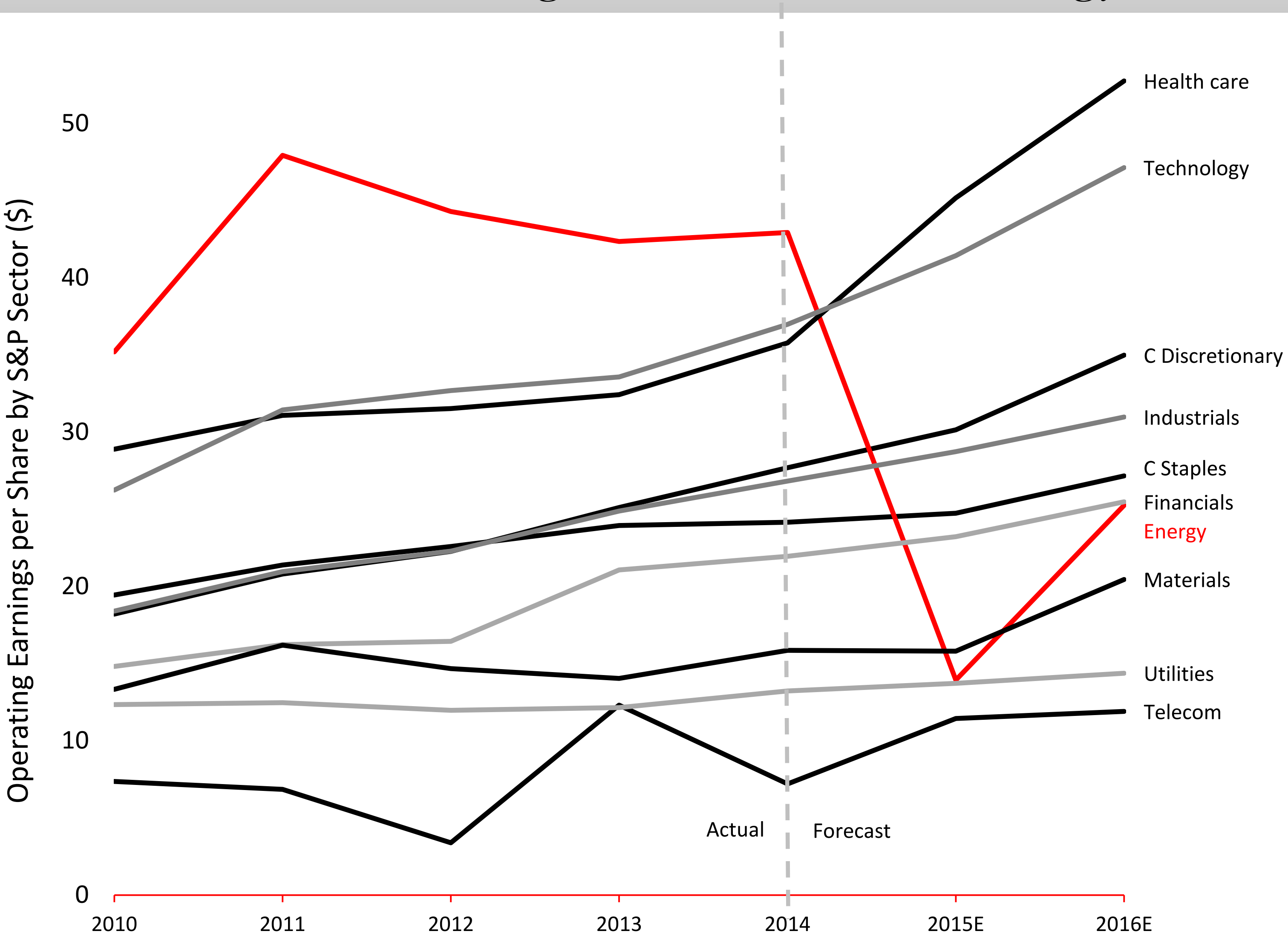
S&P 500 vs. 17X actual and estimated earnings

Red line
This is not a forecast or prediction!
It is simply a calculation of 17X actual and estimated 2015 and 2016 S&P 500 earnings[1].



[1] Estimated 2015 and 2016 bottom-up S&P 500 earnings per share as of June 25, 2015: for 2015, $119.06; for 2016, $133.74. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S survey of consensus estimates. Standard and Poor's for index price data through July 2, 2015; and actual earnings data through 2014.

S&P 500 sector earnings forecasts – all but energy headed higher



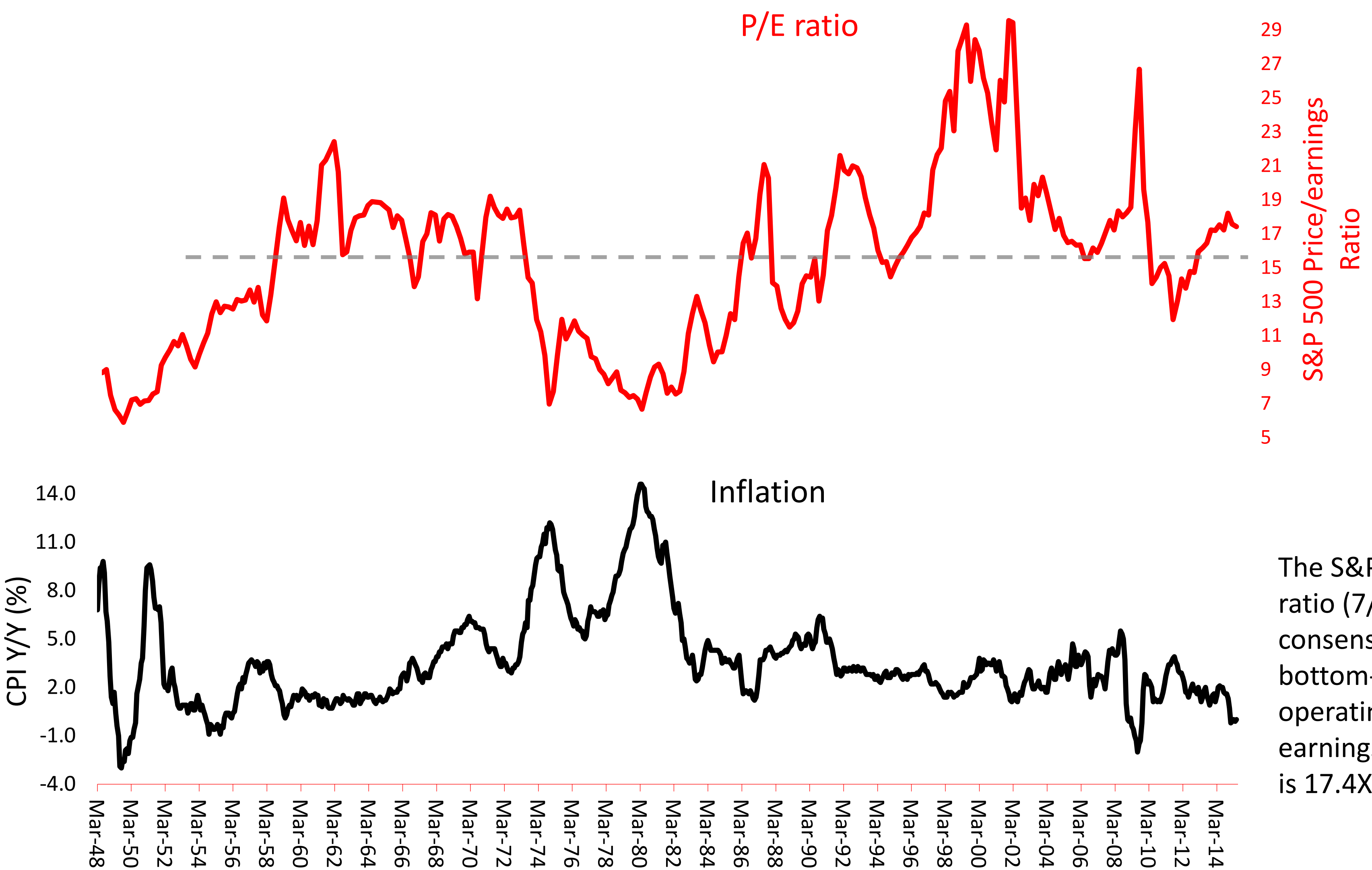
Accelerating earnings growth is forecast in almost every sector but energy.

Analysts have a tendency to be too optimistic and these estimates will probably be shaved over time.

<u>But, we think, investors understand that the weak +2% 2015 S&P 500 earnings growth forecast is due to the collapse of energy sector earnings… and the rest look good.</u>

Source: Standard & Poor's. Earnings estimates are based on the Capital IQ consensus forecast. Data as of June 29, 2015.

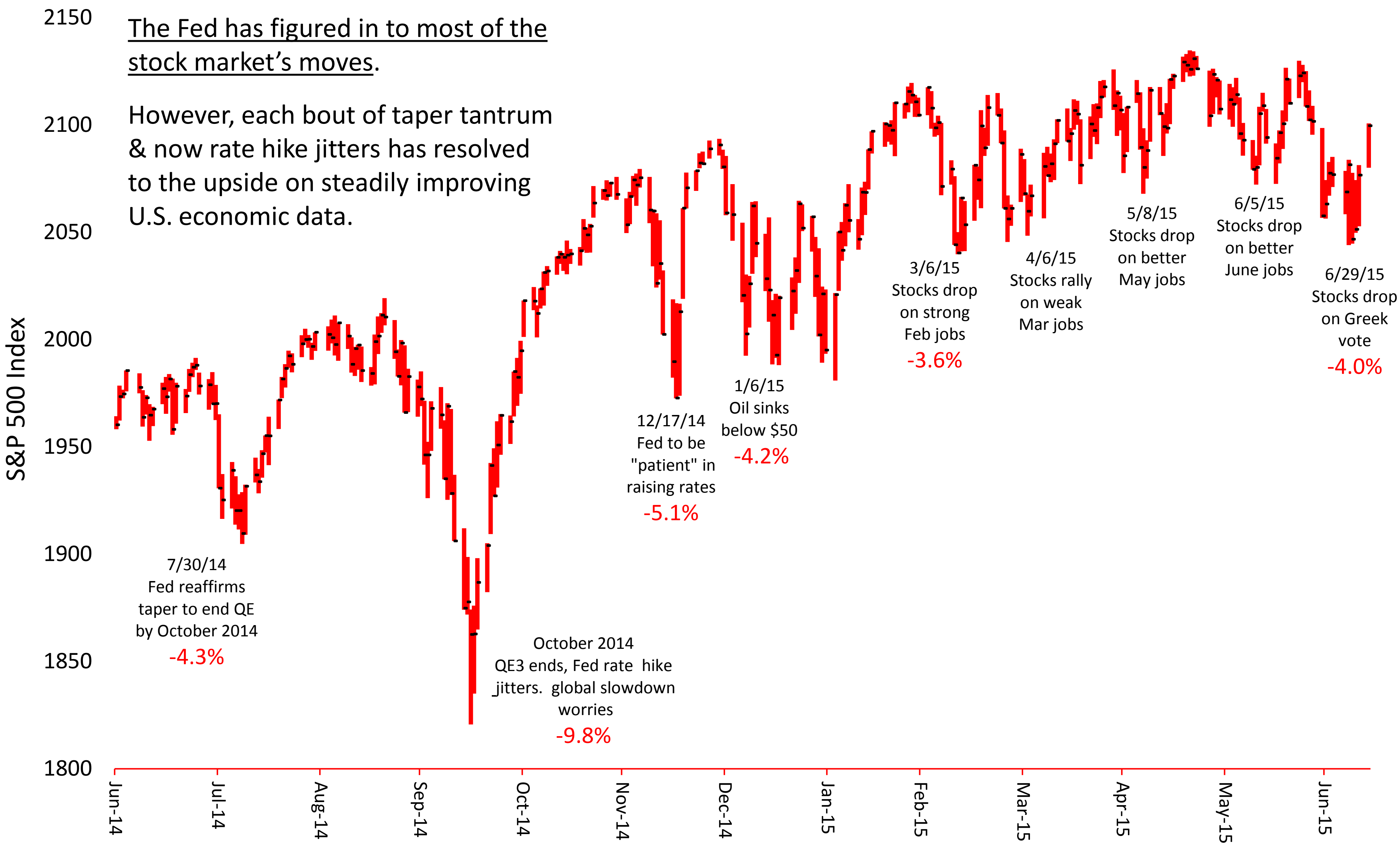
Valuation – S&P 500 P/E ratio



The S&P 500's P/E ratio (7/2/15) on consensus 2015 bottom-up operating earnings estimate is 17.4X[1].

Sources: Standard & Poor's Corporation, Capital IQ and Thomson Reuters I/B/E/S earnings estimates, BLS. Stock price data through July 2, 2015; inflation data through April 2015. Top panel, latest data point: 2077 ÷ trailing earnings of $119.25(e) through 3/31/15 = 17.4X. [1]S&P 500 at 2077 ÷ 2015 EPS(e) $119.06.

S&P 500 – economic fundamentals are in the drivers seat



Source: Standard and Poor's, data through July 13, 2015.

China

Shanghai composite index

June 9, 2015: MSCI decided not to include mainland-listed shares in its Emerging Markets Index.

"Individuals account for 80% of all transaction in Chinese stock markets. … China's stock market is a small factor in the overall economy. Relatively few individuals own stocks, and most companies get funding through bank loans rather than selling shares."[1]

* … and, local investors interpreted the move as a vote of world-wide confidence in the outlook for Chinese stocks … and started piling in.

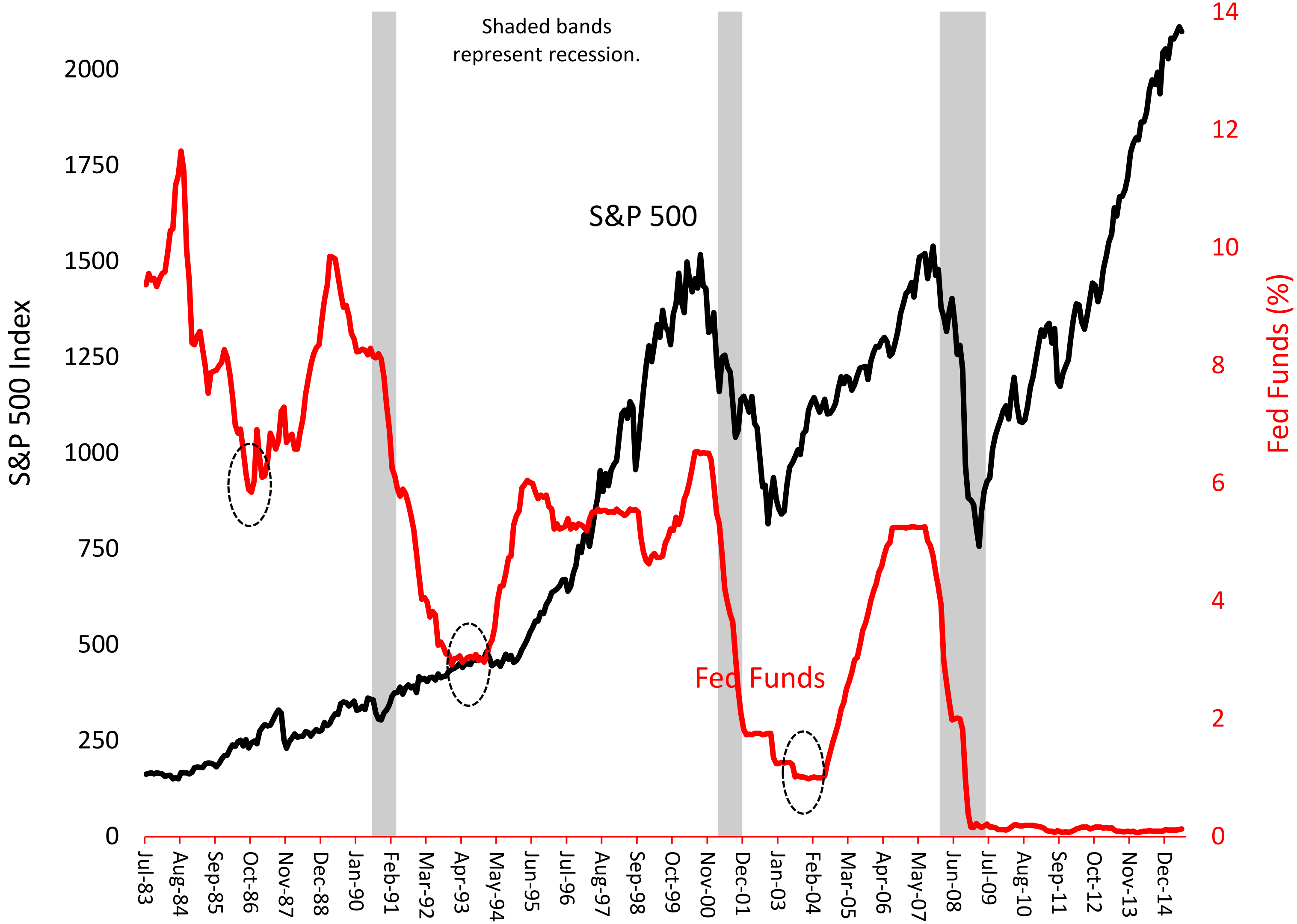
Source: Bloomberg.com. Data through July 8, 2015.
[1] The Wall Street Journal, July 9, 2015.

Hong Kong Hang Seng composite index

The Hong Kong index is composed of China's biggest public companies and shares are predominately held by global institutional investors.

Source: Bloomberg.com. Data through July 8, 2015.

Initial fed funds rate hikes and the S&P 500

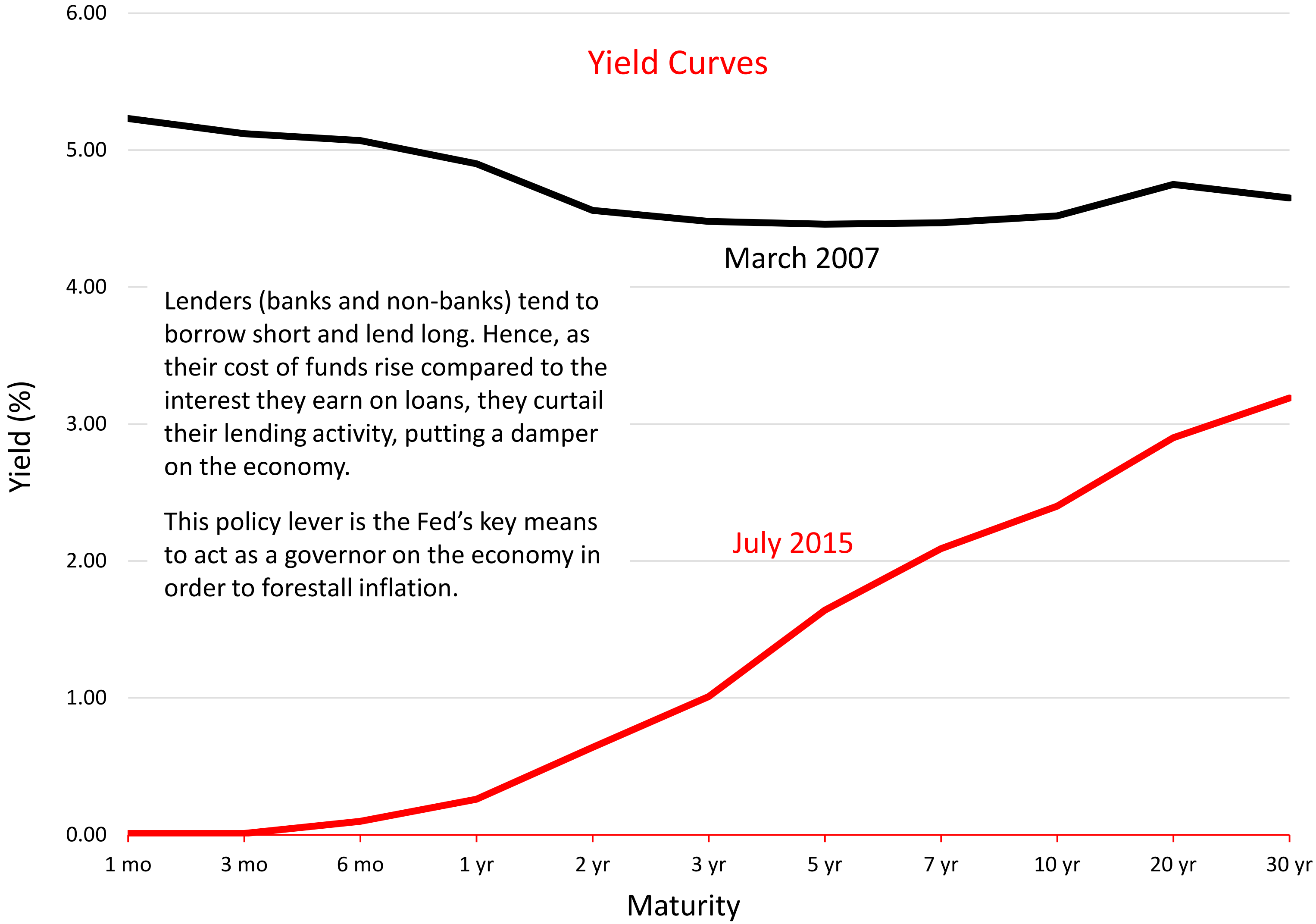


Yes, initial fed funds rate hikes have caused the stock market to stutter.

<u>But, following the initial stutter stocks have continued higher even as the Fed has repeatedly hiked rates</u> ... until fed funds have approximated bond yields.

Sources: NBER, Federal Reserve and Standard & Poor's. Data through June 2015.

Fed's key policy lever is the yield curve

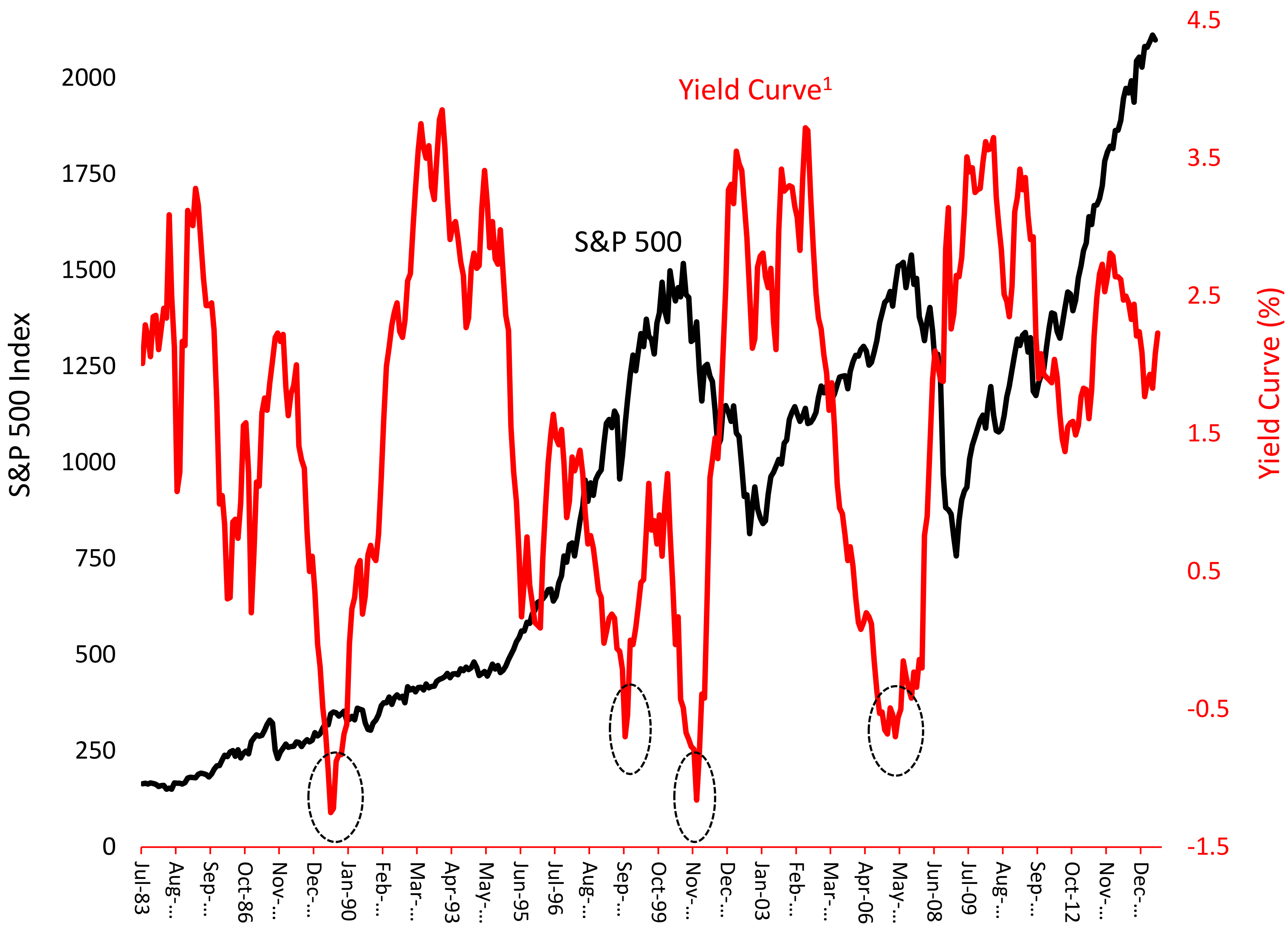


Source: U.S. Department of the Treasury.

<u>This is an inverted (negative) yield curve</u> resulting from the Fed's raising the Fed Funds target rate (1 mo. maturity) to 5.23%.

<u>Today's is a steeply positive yield curve</u> resulting from the Fed's pushing the Fed Funds target rate (1 mo. maturity) to zero.

Yield curve has been key to the stock market



Sources: Federal Reserve, Standard and Poor's. Data through June 2015. [1]The differential between the interest rate on Fed Funds (short term) and the 10-year Treasury bond (long term).

Steep yield curves – high bond yields compared to Fed Funds rates – are consistent with strong GDP growth.

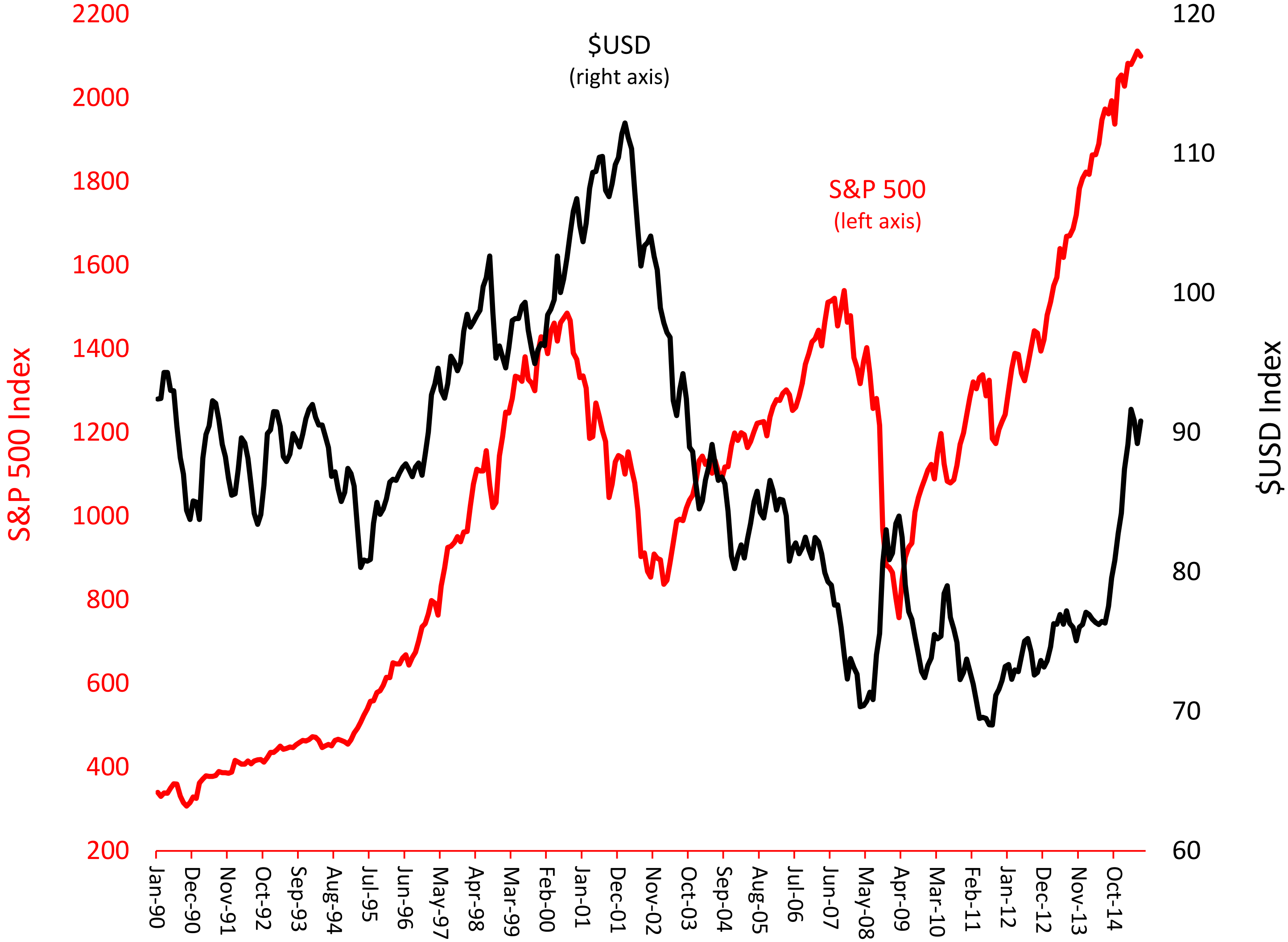
Flat or negative yield curves have preceded recessions.

<u>Flat or negative yield curves have signaled bear markets in stocks</u>.

Conversely, we haven't had a sharp correction *without* a sharp downward move in the yield curve.

Strong dollar bad for stocks?

S&P 500 vs. $USD



Source: Standard and Poor's, Federal Reserve. Monthly data through June 2015.

Strong dollar bad for stocks?

The argument is often made that a stronger dollar makes it tougher for exporters and foreign currency translation, hurting earnings and, thus, stock prices.

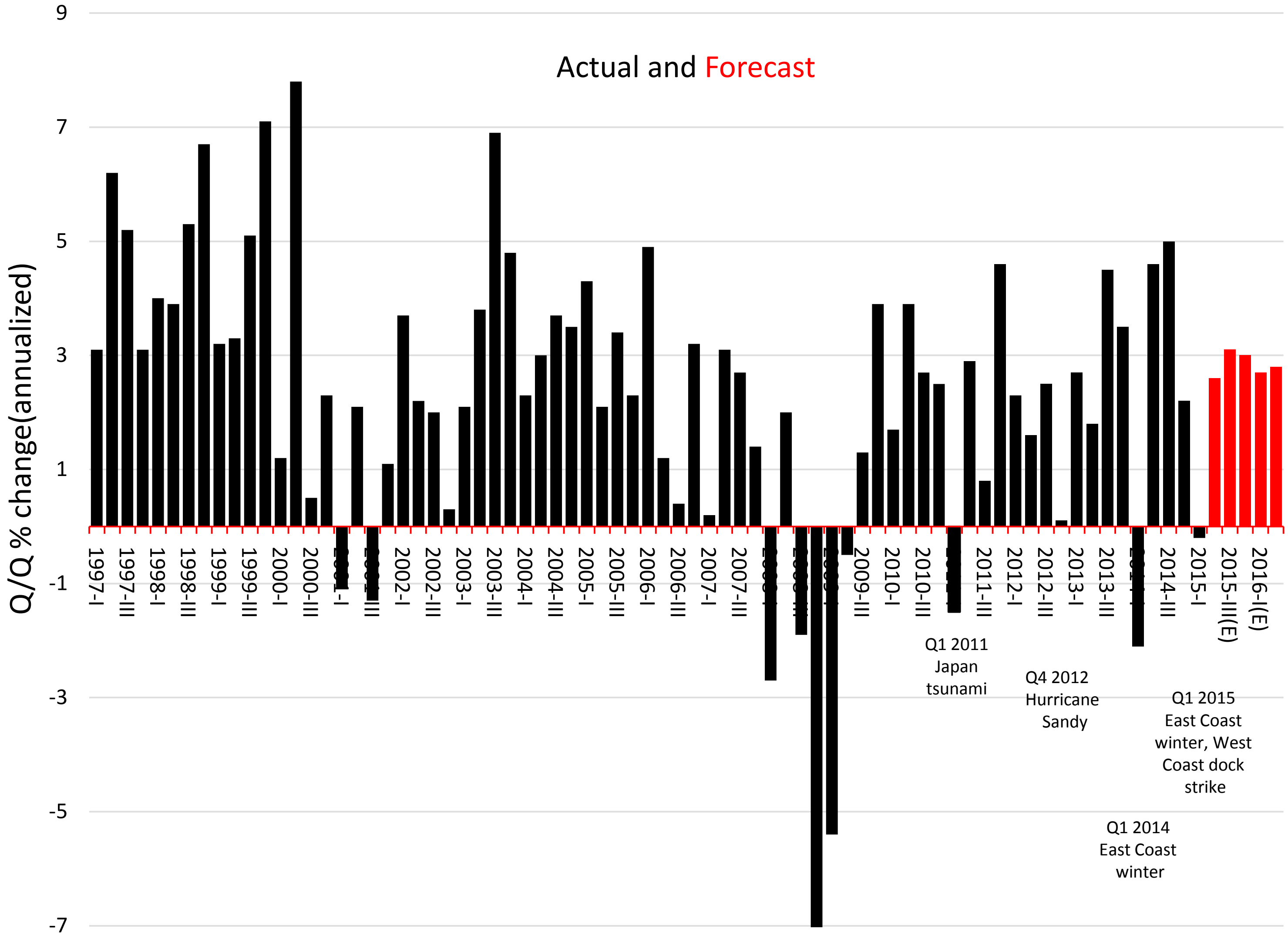
<u>The record illustrates bull markets in periods of both rising and falling $USD.</u>

Economy

- Forecast snap-back to ~3% GDP growth
- PMIs, LEI, new jobs, personal spending, job openings, car sales, housing starts, bank credit, household net worth – all supportive
- "Goldilocks" is a good description

Consensus U.S. economic forecast

Weak Q1 GDP to be followed by snap-back



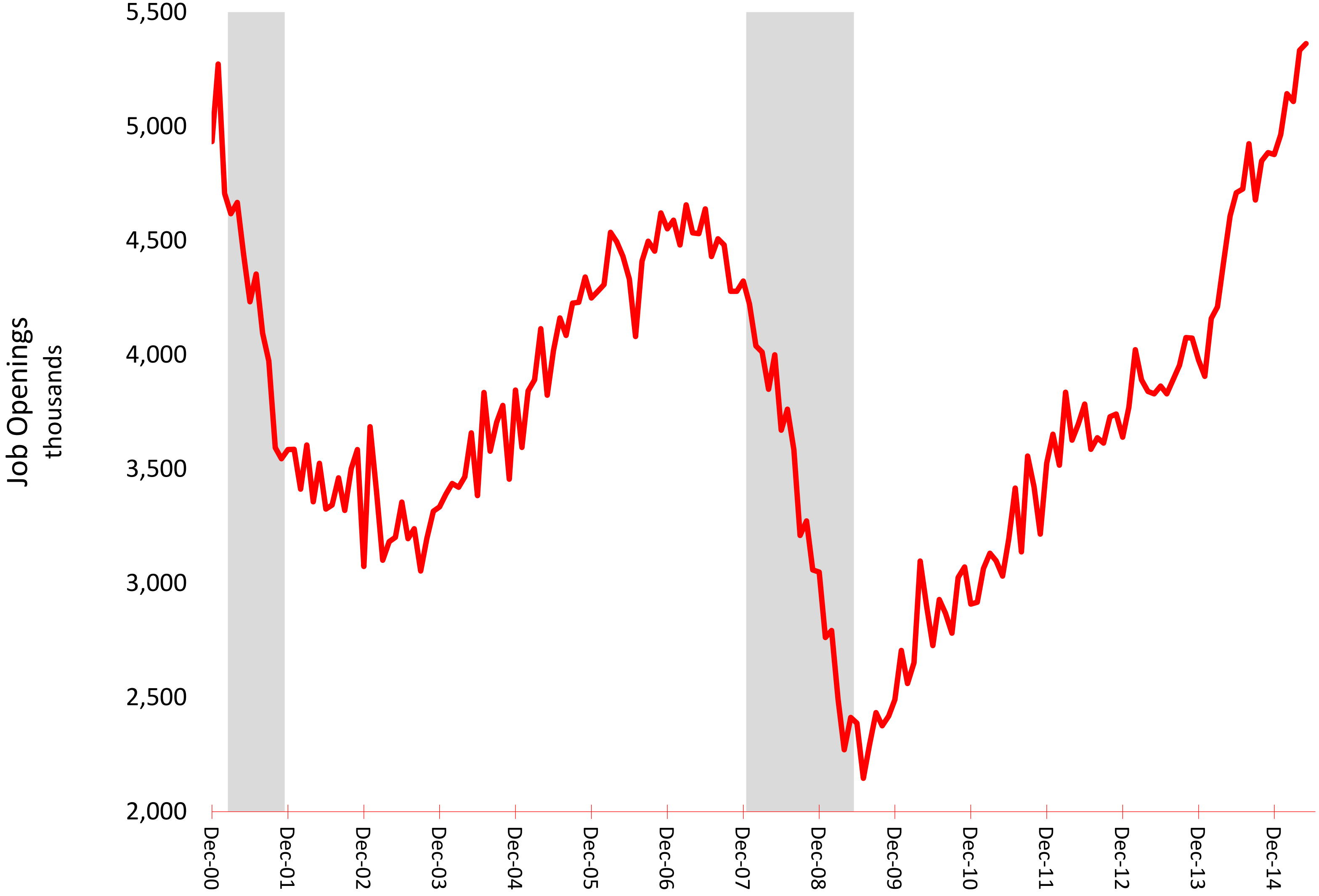
Weak Q1 but it's still a Goldilocks forecast … healthy economic growth with benign inflation.

The 70 economists surveyed by *The Wall Street Journal* in early June on average see strong snapback following Q1 contraction.

Sources: Bureau of Economic Analysis, actual data through March 2015; *The Wall Street Journal* survey taken June 2015.

Economic data - jobs

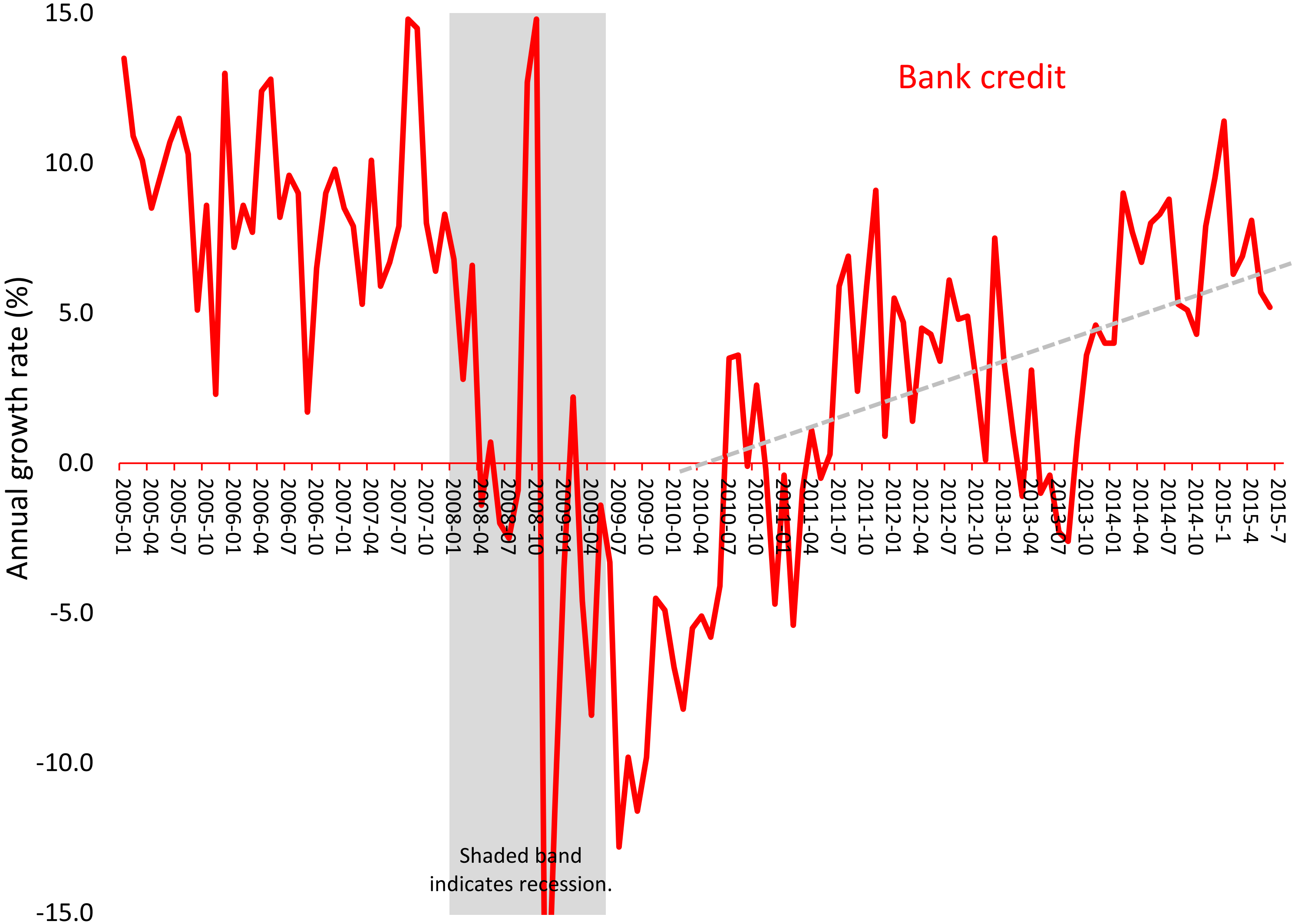
Job openings – record high



<u>Job openings at a record high</u>.

Source: U.S. Department of Labor, NBER. Data through May 2015.

Bank credit – recovery in a key economic driver



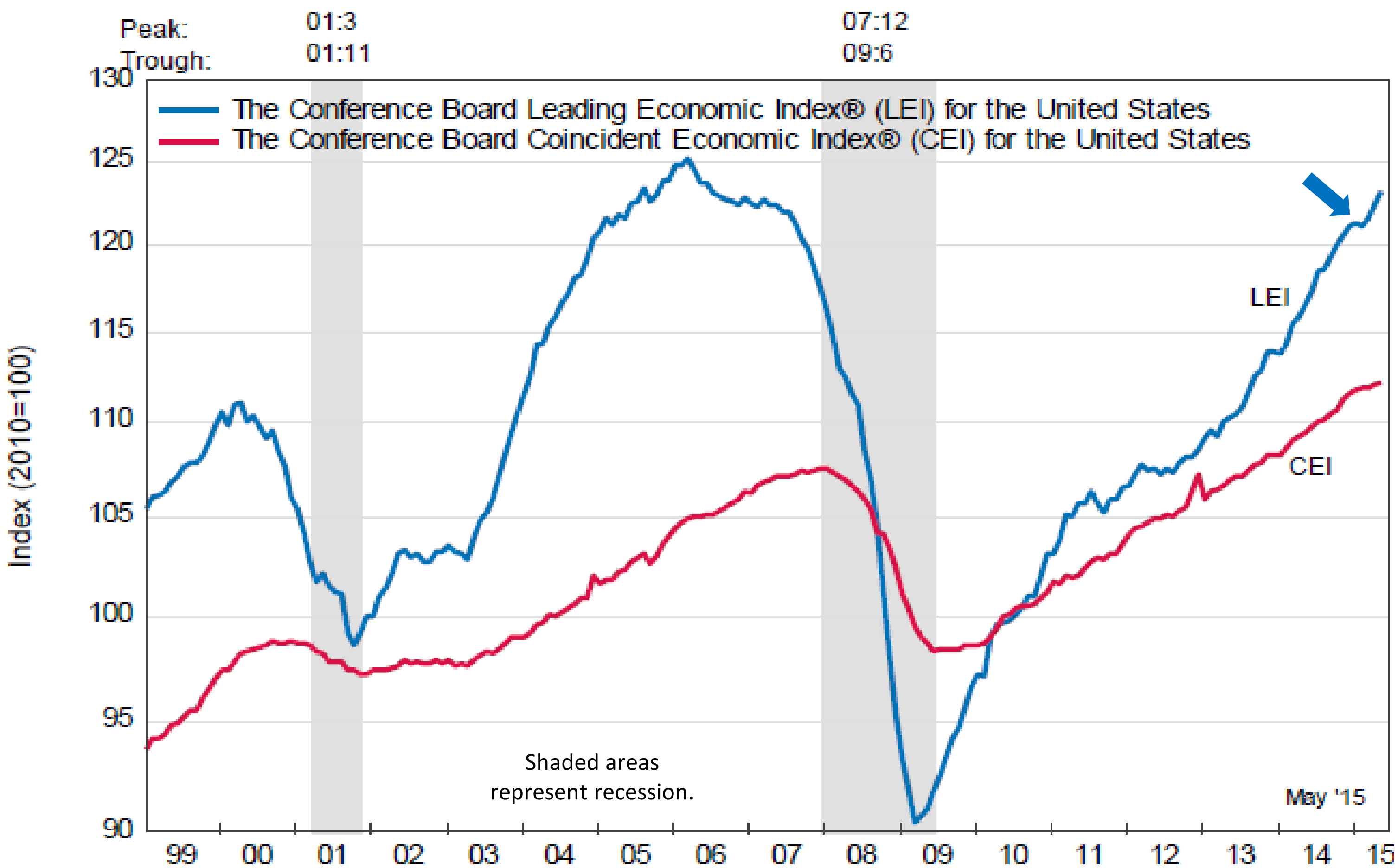
Source: Federal Reserve, schedule H8. Data through June 2015, released July 10, 2015.

Bank credit is the lifeblood of economic expansion.

Bank lending is finally kicking into full recovery mode.

ENDOWMENT WEALTH MANAGEMENT

U.S. Index of Leading Economic Indicators (monthly)



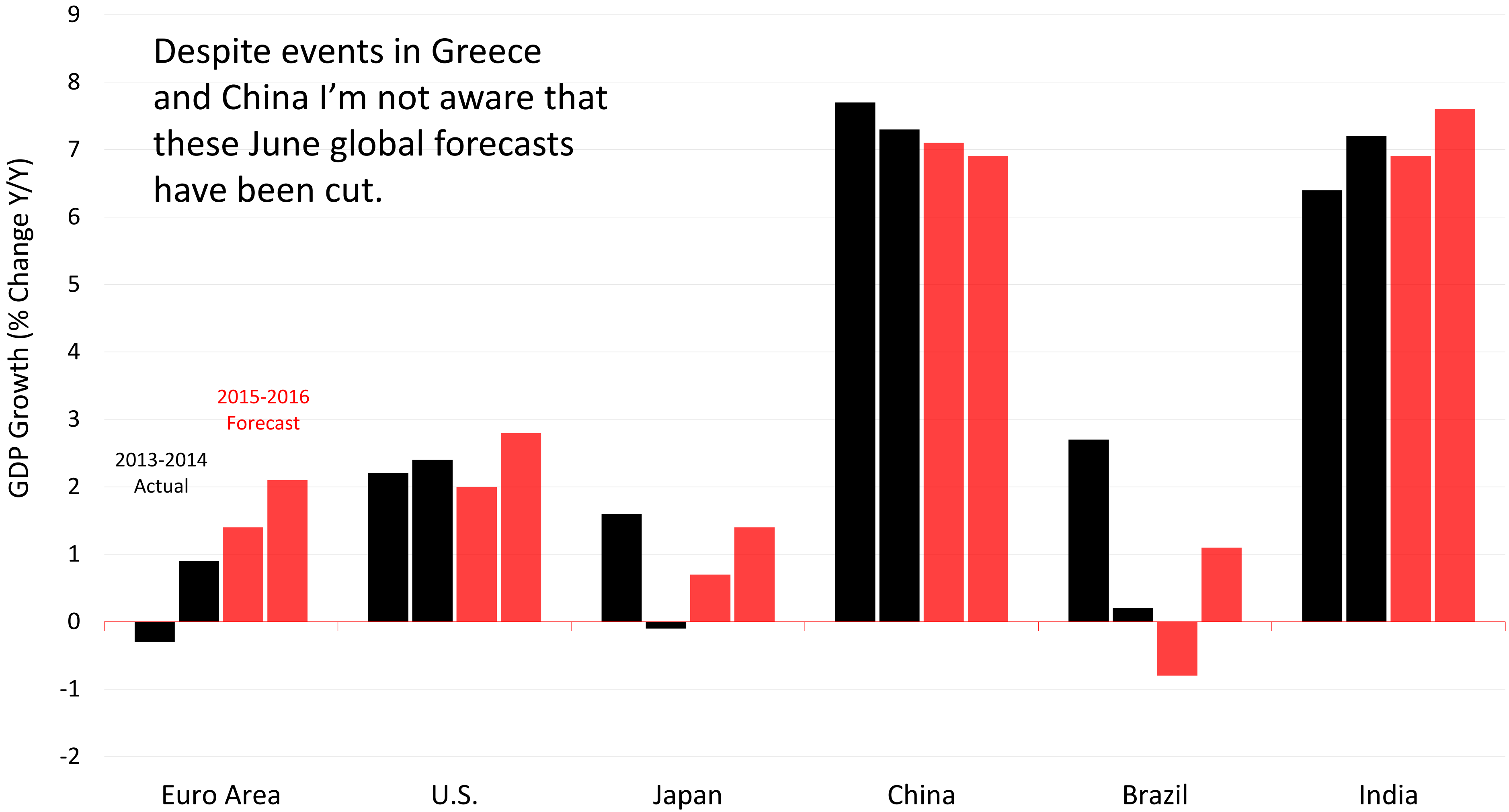
"The U.S. LEI increased sharply again in May, confirming the outlook for more economic expansion in the second half of the year …"

The Conference Board
June 18, 2015

The Conference Board Leading Economic Index® (LEI) components: 1) average weekly hours worked, manufacturing; 2) average weekly initial unemployment claims; 3) manufacturers' new orders – consumer goods and materials; 4) ISM index of new orders; 5) manufacturers' new orders, nondefense capital goods; 6) building permits – new private housing units; 7) stock prices, S&P 500; 8) Leading Credit Index™; 9) interest rate spread; 10-year Treasury less fed funds; 10) index of consumer expectations.

Source: ©The Conference Board. Data through May 2015, released June 18, 2015.

World GDP growth forecasts – improving growth expected

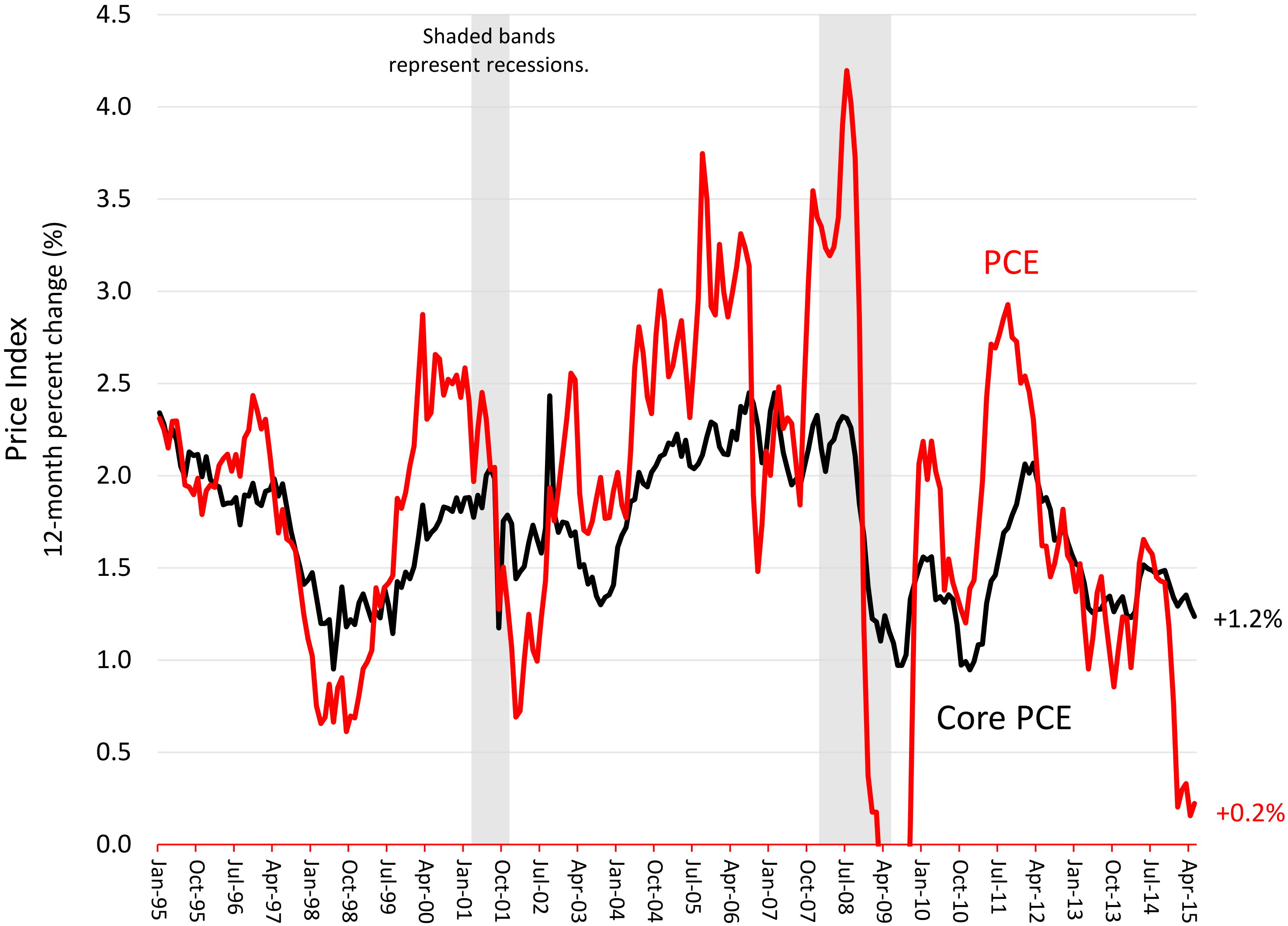


Source: OECD, *Economic Outlook*, June 2015.

Inflation

- Headline near zero, more in the core
- Oil plunge's (transitory) effect on headline
- Goods vs. services inflation
- Employment costs heating up
- Key distinction between money supply and monetary base

PCE – headline and core



Source: NBER, BEA and Federal Reserve Bank of St. Louis. Data through May 2015.

Headline inflation (PCE) has plunged with the y/y plunge in gasoline, diesel and fuel oil prices.

Inflation ex-food and energy (core PCE) is higher than core but well below the Fed's 2% target.

Goods vs. services inflation

Consumers Pinched by Pricier Services Despite Low Inflation

Federal Reserve officials often note their concern about low U.S. inflation, which has been well below the central bank's target for three years. That lament might surprise consumers who are paying more every year for cable services, car insurance and dental checkups.

Chalk it up to a divide between goods and services.

THE OUTLOOK
KATHLEEN MADIGAN

The overall inflation rate, which has been well below 2% a year, according to several price measures, masks a split between the two main categories of consumer products. Prices of goods have been falling for most of the current economic expansion, while the cost of services has increased, sometimes sharply. Over the 12 months ended in May, goods prices fell 3.3%, or 0.3% when food and energy are excluded. Services prices were up 2%.

Much of the recent run-up in service inflation stems from the jump in rents. But service prices outside of rents also are increasing. The upward trend might signal the domestic economy has less excess capacity and labor-market slack than is commonly assumed. When the economy has a lot of unused capacity, businesses have less ability to raise their selling prices.

"Service inflation tells us the U.S. economy is in better shape" than total inflation does, said Aneta Markowska, chief U.S. economist at Société Générale. If so, Fed officials might be behind the curve when it comes to one of its policy mandates: price stability.

The inflation split is evident between goods and services that are somewhat connected. Buy a bottle of wine and uncork it at home and you are paying slightly less than you did five years ago, according to Labor Department data. If the same wine is served by a sommelier at a restaurant, you will shell out 12% more.

A new suit costs 3.7% less than it did five years ago for a man, and 3.5% less for a woman. Getting that suit dry-cleaned, however, will set you back 9.2% more.

Possibly the biggest gap is in entertainment. The price of a new television has tumbled nearly 58% over the past five years. The cable service that allows you to watch shows on the set costs 13.7% more.

Why do service providers have more pricing power than goods producers? Among the factors:

◆ **Lack of global competition.** Goods inflation began to slow in the 1980s as imported merchandise penetrated U.S. markets at a rapid clip. Lower wages and fewer regulations allow foreign companies to produce goods more cheaply than U.S. manufacturers can.

U.S. service providers need only focus on nearby competitors, not what is going on around the world. When asked about the inflation split, 83% of economists surveyed recently by The Wall Street Journal said the lack of global competition had a "large" or "modest" impact in allowing service inflation to run hotter than goods inflation.

◆ **Rising labor costs.** "Wage pressure will show up first in the service category," said Rajeev Dhawan, an economics professor at Georgia State University. Labor costs in services are determined more by domestic job markets, he said, and U.S. labor markets are tighter than those in other countries.

The yearly growth in hourly service pay has outpaced the raises at factories, narrowing the gap between the average hourly wage at private service companies and at manufacturers. That trend should continue in coming years because the push to increase the minimum wage will mostly lift service pay. Service companies, such as McDonald's and Wal-Mart, have recently announced pay raises.

◆ **Slower productivity.** To be sure, technological advances and reliance on computers have improved productivity in many service industries. According to Labor Department data, productivity in trucking, software publishing and accounting increased in 2014 at faster rates than the 2.4% yearly advance in manufacturing.

For other services, however, "you cannot substitute labor with capital," said Mr. Dhawan. Output per hour worked in service sectors like newspapers, engineering and air transportation declined or barely increased last year. If companies in these industries want to protect profit margins, they have to raise prices.

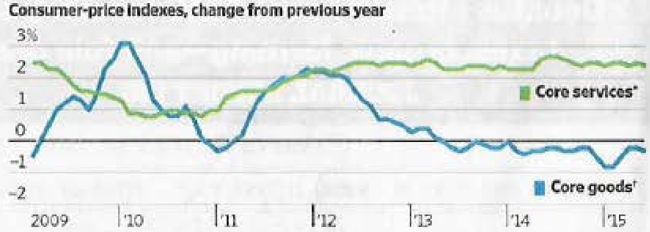
Because consumers pay service bills more often than they buy most goods other than food and gasoline, perceptions of inflation skew high. Among consumers in a June CNBC survey who thought prices would increase in the next year, the median inflation forecast called for prices to rise 2.8%. A large proportion, 15%, thought prices would be up 11% or more.

That's in contrast with the view at the Fed. According to the minutes of the Fed's June policy meeting, the central bank's staff projected that, because of slack in the resource and labor markets, inflation would continue to run below the Fed's target of 2% from now until the end of 2017.

Rising price pressures in the service sector—which accounts for two-thirds of the U.S. economy—suggest that the economy might have less unused domestic capacity than the Fed thinks. If so, policy makers may find themselves in an inflation bind within the next two years.

Split Decision

Although overall inflation is low, the rate masks a split between the prices of goods and services. Many services prices are rising at a steady clip while many goods are actually falling in price.



Cumulative change in related goods and services for the five years ended in May

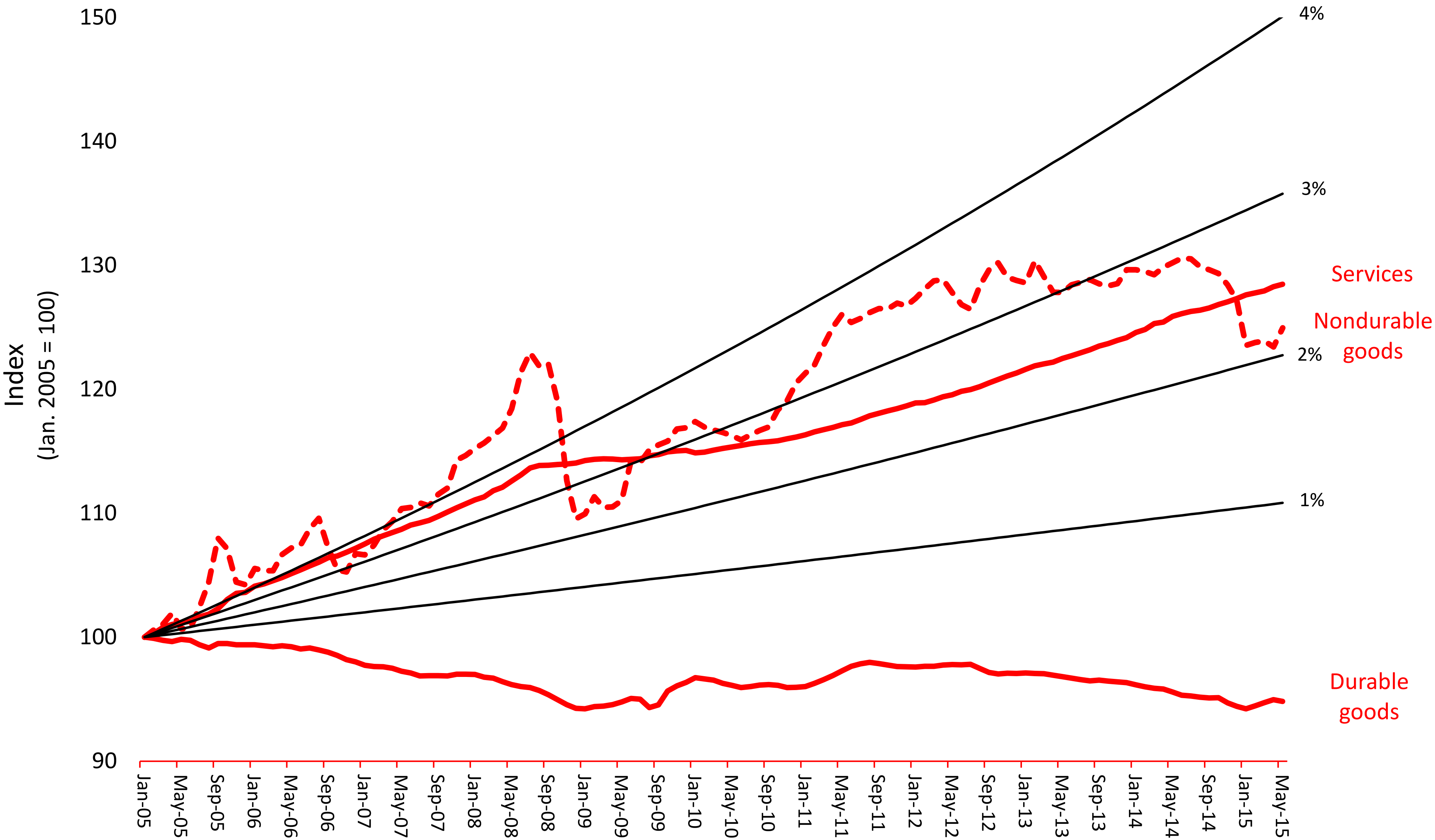
Goods	Change (goods)	Change (services)	Related services
Television set	-57.7%	13.7%	Cable/satellite service
Bottle of wine (for home)	-0.6%	12.0%	Bottle of wine (at restaurant)
Men's suits and coats	-3.7%	9.2%	Dry cleaning
Household cleaning products	0.3%	7.8%	Household domestic services
Stationery	-1.4%	19.2%	Postage for mail delivery
Sports equipment	-15.3%	17.3%	Tickets to sporting event

*Excludes energy †Excludes food and energy Source: Labor Department

THE WALL STREET JOURNAL.

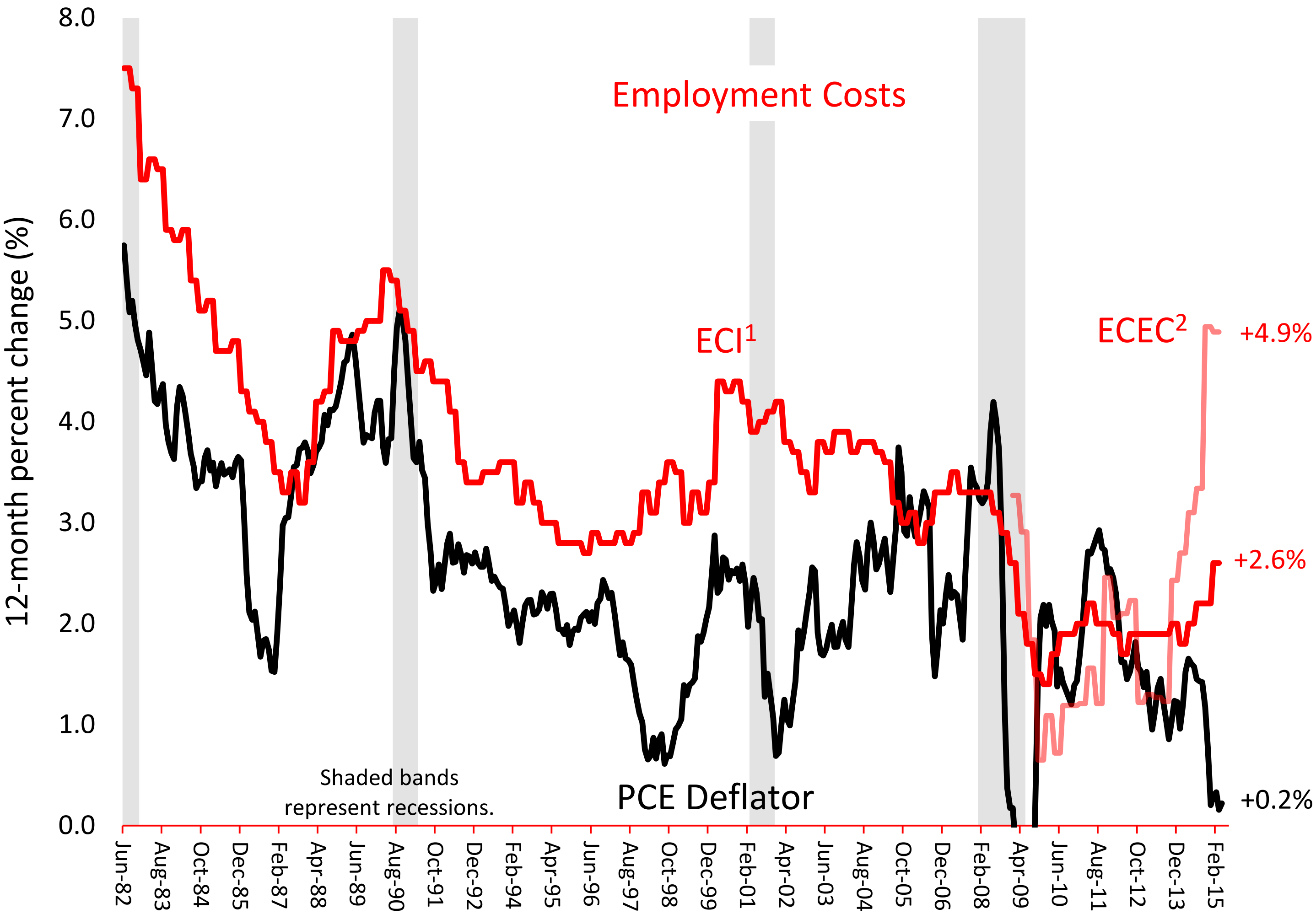
Source: *The Wall Street Journa*l, July 13, 2015.

Consumer inflation by expenditures category



Source: Bureau of Labor Statistics and BLS. Data through May 2015.

Employment cost index and inflation



<u>Wage and benefit pressure is picking up. The ECEC surged.</u>

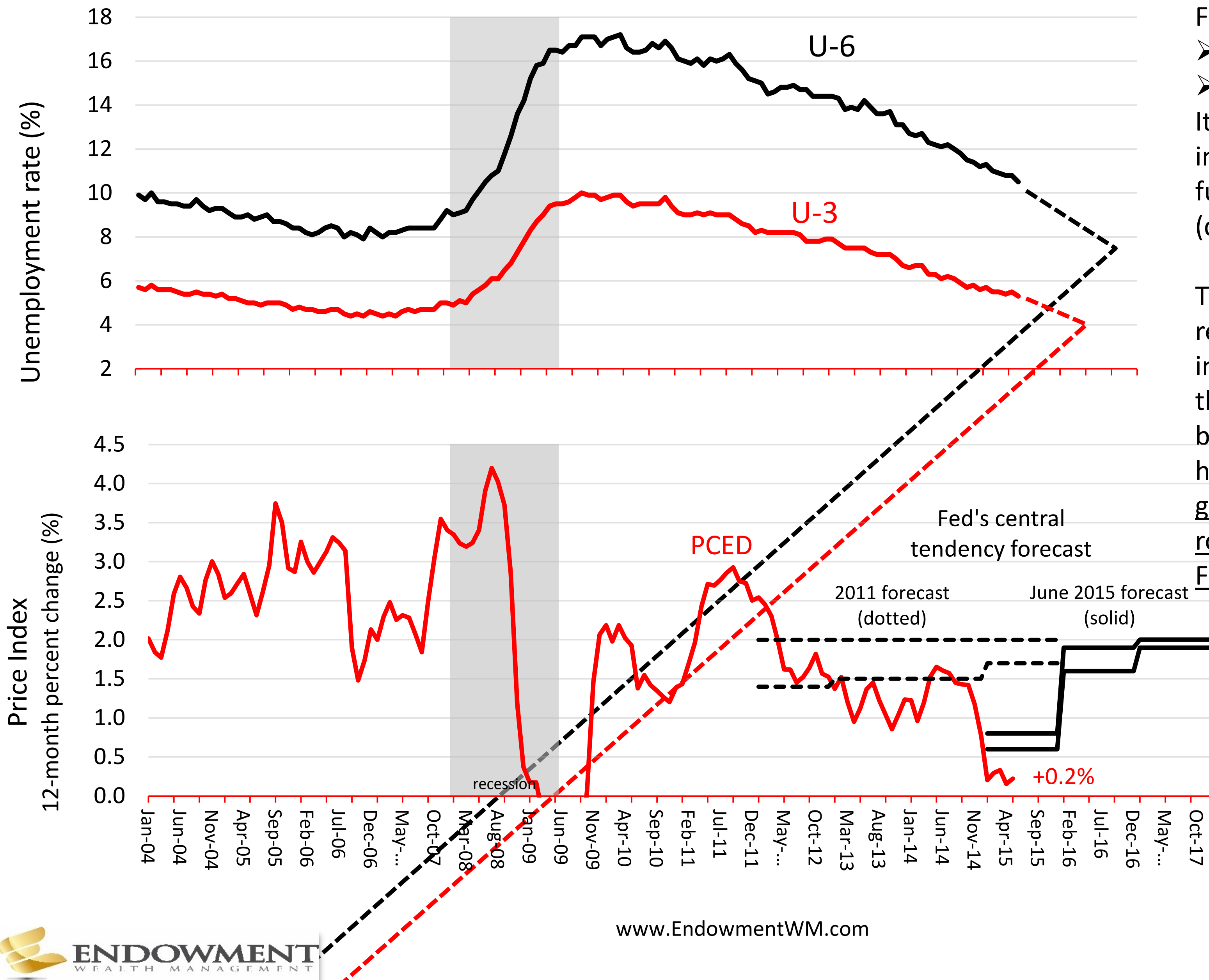
Because wages, salaries and benefits are companies' biggest single cost, they are also the biggest single inflation factor for the economy as a whole.

Inflation (PCE deflator) generally runs lower than measured ECI inflation because higher employment costs can be offset by productivity gains.

See next two charts.

Source: Bureau of Labor Statistics. Quarterly ECI and ECEC data through March 2015; monthly PCE data through May 2015.
[1] Employment Cost Index. [2] Employer Costs for Employee Compensation.
The BLS 's ECI is built with fixed weights for individual industries and occupations. The BLS's ECEC industry and occupation weights change with the changing structure of the workforce.

Dual mandate, dovish Fed



Fed's dual mandate:

- full employment
- 2% inflation

It may take until well into 2016 to regain full employment (dotted lines).

The Fed forecasts a return to 1½% to 2% inflation even though their forecasts have been consistently too high. Low inflation gives the Fed ample room not to raise the Fed Funds target rate.

Bond Yields

- Forecasts have grossly missed
- Forecast for steady rise to 3¾%
- Real yield back to normal
- Pressure on yields from declining federal deficit
- Pressure on yields from ECB's QE capping euro bond yields
- … but, eventually inflation will pick up

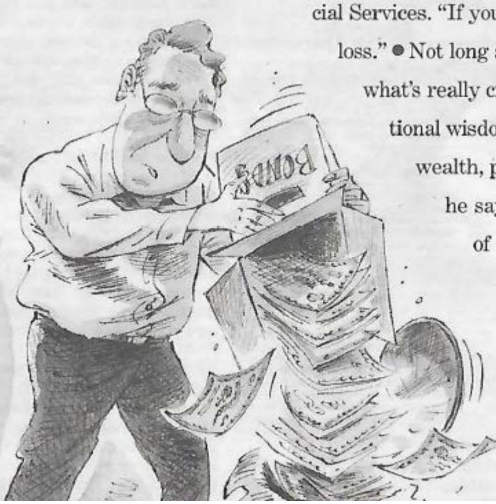
Higher yields ahead?

COVER STORY

Bond funds don't offer much in the way of income, and their stability is less certain than ever. Investors need a new approach to fixed income.

Bye-Bye Bond Funds

Bond funds tend to hold their value—unless rates are rising. Is it time to dump your bond fund?



by Sarah Max Robert Johnson has spent most of his career studying and teaching modern portfolio theory. So it may come as a surprise to some that Johnson, 57, has not a penny of his portfolio in bonds. ● "The absolute best-case scenario for bond investors is that rates remain low in the near future, which means your best hope is the status quo with no upside," says Johnson, president and CEO of the American College of Financial Services. "If you lock in bonds at these levels, you're locking in a purchasing-power loss." ● Not long ago, the notion of a no-bond portfolio would have seemed crazy. But what's really crazy, says Johnson and many of his peers, is clinging to the conventional wisdom. "What are bonds supposed to do? They're supposed to preserve wealth, provide periodic cash flow, and hopefully some price appreciation," he says. At the moment, however, they aren't offering much in the way of income, and there is a real possibility that investors could lose money. ● Although the bond market is anything but simple, the math is. The bull market for bonds began in September 1981, when the yield on the 10-year Treasury peaked at 15.84%. Over the past three decades, yields across the board have steadily fallen, with the bellwether 10-year dipping as low as 1.63% in May 2013. Recently it has hovered around 2.3%. As yields have fallen,

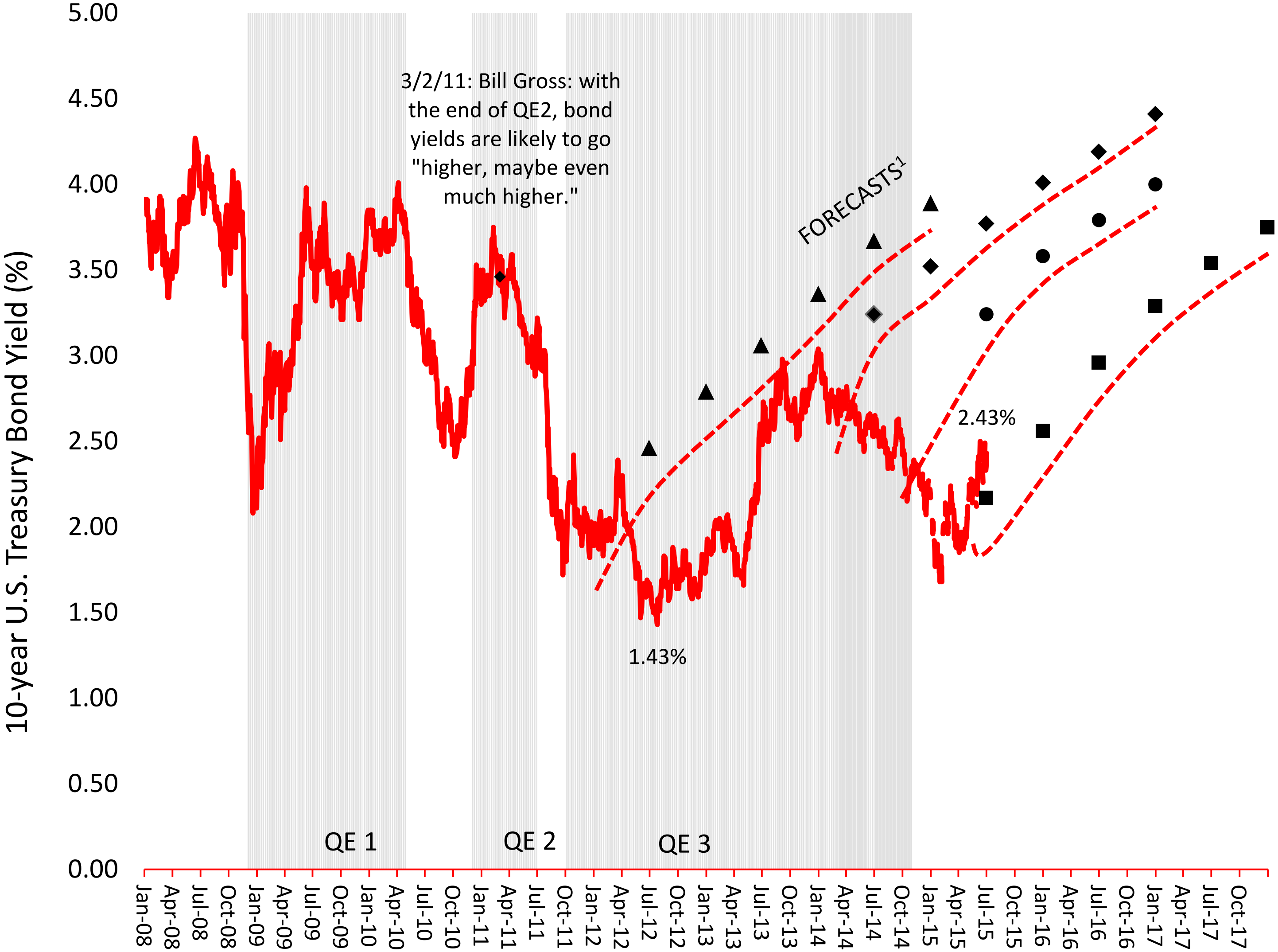
Source: *Barron's,* July 13, 2015.

This cover story could have run four years ago.

But … sooner or later it will *not* be a good idea to own bonds.

Stay short. Ladder maturities to capture rising yields.

Much lower than expected bond yields



Lower than expected bond yields have been the big surprise for the last four years.

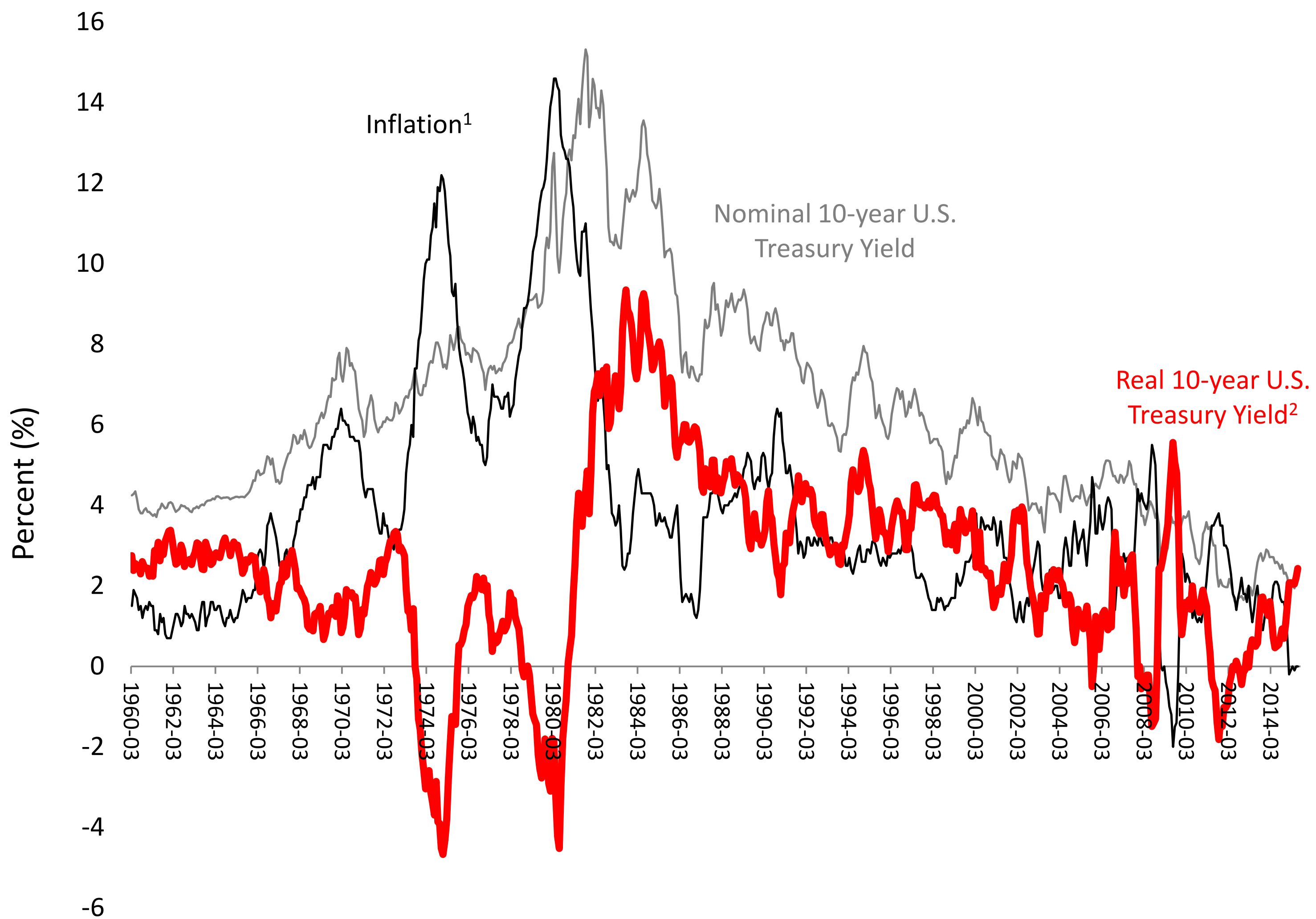
Where yields go from here depends on the inflation data and supply and demand for bonds.

Inflation is very low and apt to remain so. The rate of net new supply of U.S Treasury bonds will be close to flat.

Source: Federal Reserve. Data through July 1, 2015.

[1] Average of economists' forecasts from *The Wall Street Journal* 's monthly surveys taken November 2011, January 2014, September 2014 and April 2015.

Real yield = 10-year U.S. Treasury bond yield – inflation (CPI)



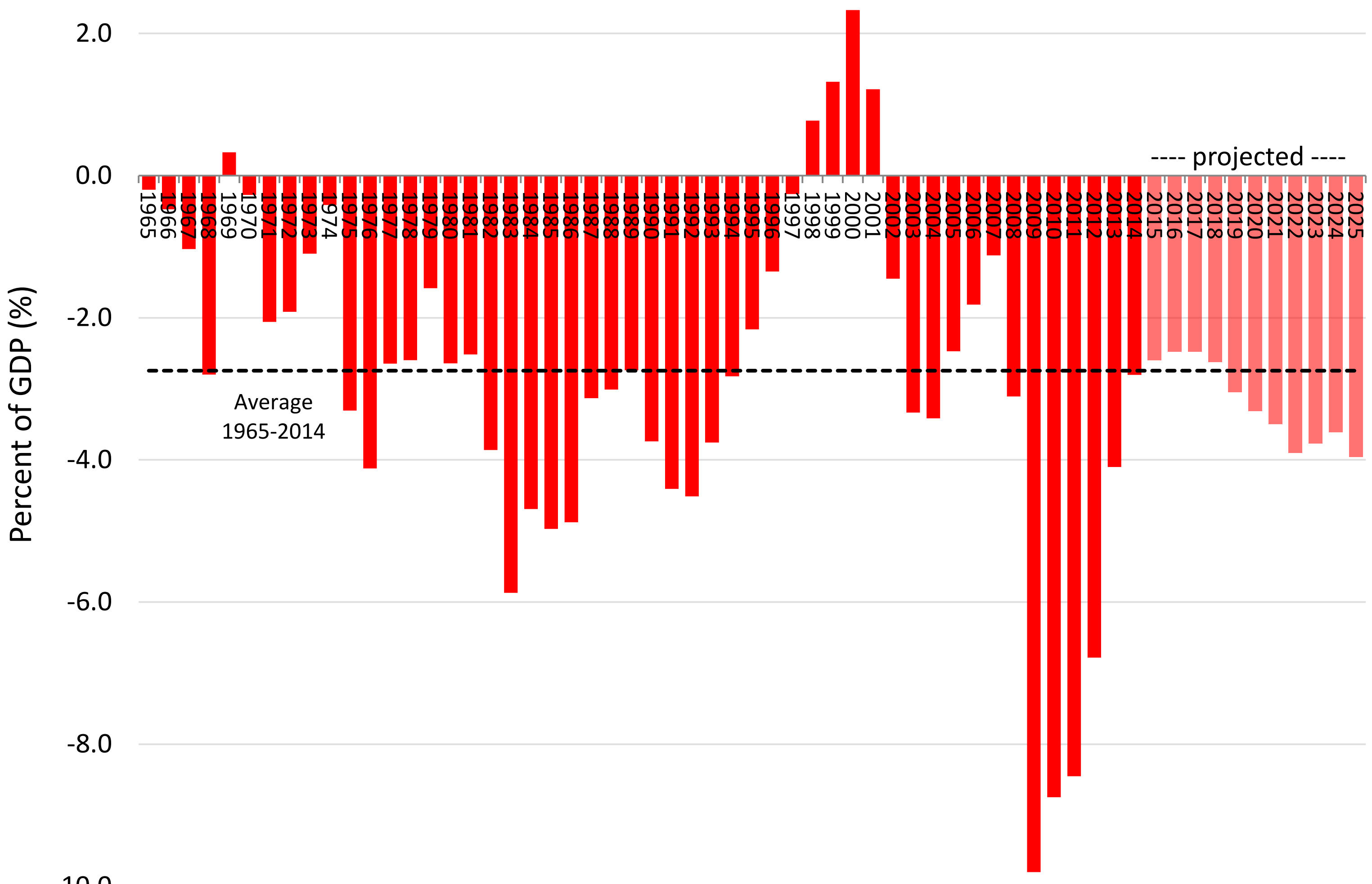
In theory, a lender (owner of a 10-year U.S. Treasury bond) should require a real rate of interest (for the use of his money over the term of the loan) plus compensation for the loss of purchasing power (an inflation premium).

With the latest CPI reading 0.0% year/year, the real yield has climbed to 2.43% – higher than the past decade's average.

2.43%	nominal
- 0.00%	CPI
2.43%	real

Sources: Federal Reserve, BLS. Bond yield data through June, 2015. [1] One-year percent change in the consumer price index (CPI), data through May 2015. [2] Real yield equals nominal 10-year U.S. Treasury bond yield (grey line) minus inflation (black line).

Federal deficits – declining



CBO is projecting diminishing growth in federal borrowing requirements through 2017.

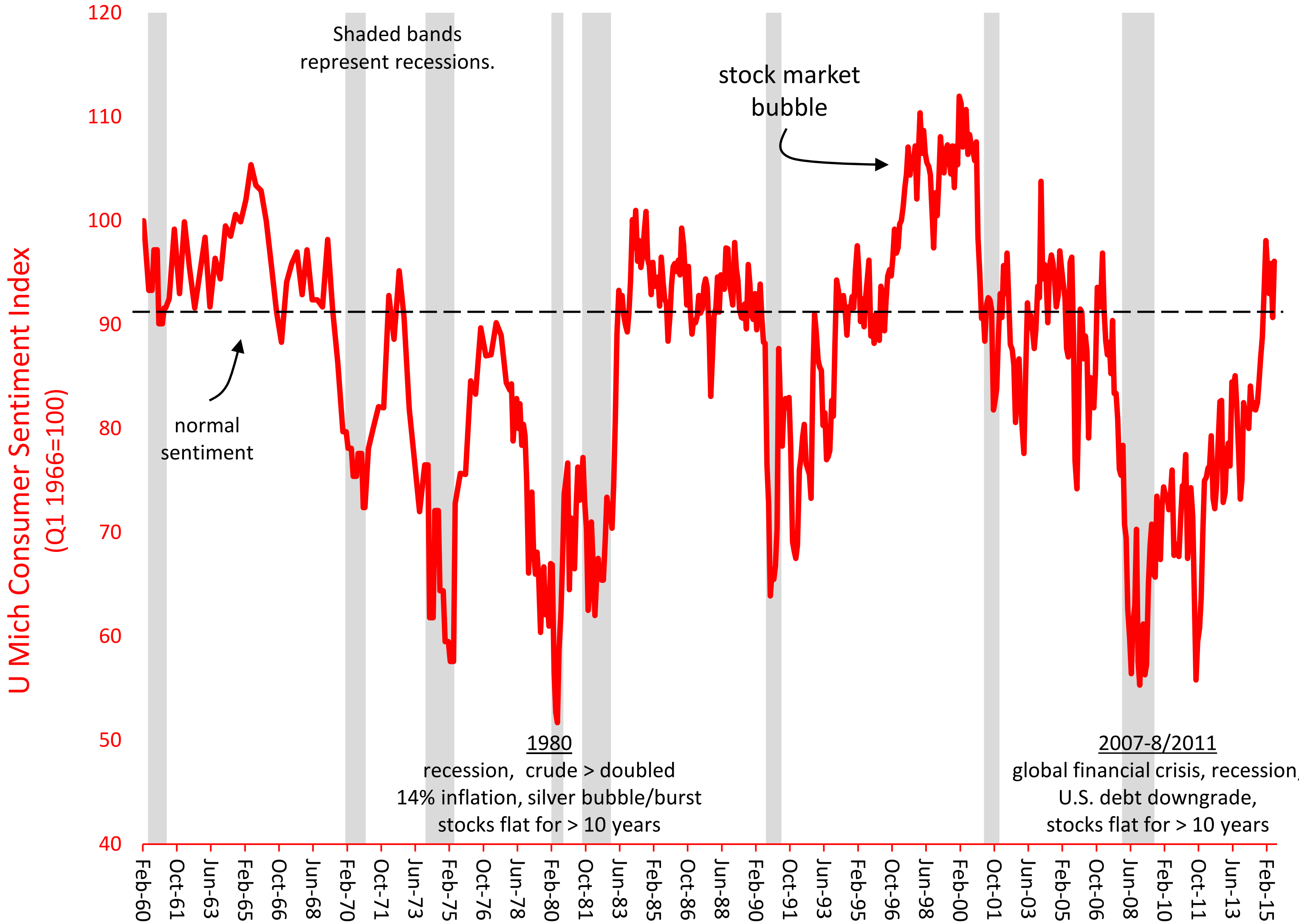
Source: Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2015 to 2025*, dated January 2015.

Household balance sheets

- Fully repaired
- Financial obligations ratio at record low
- Runaway growth and rising delinquencies in student loans

Irrational exuberance?

Good for consumer spending but not irrationally exuberant



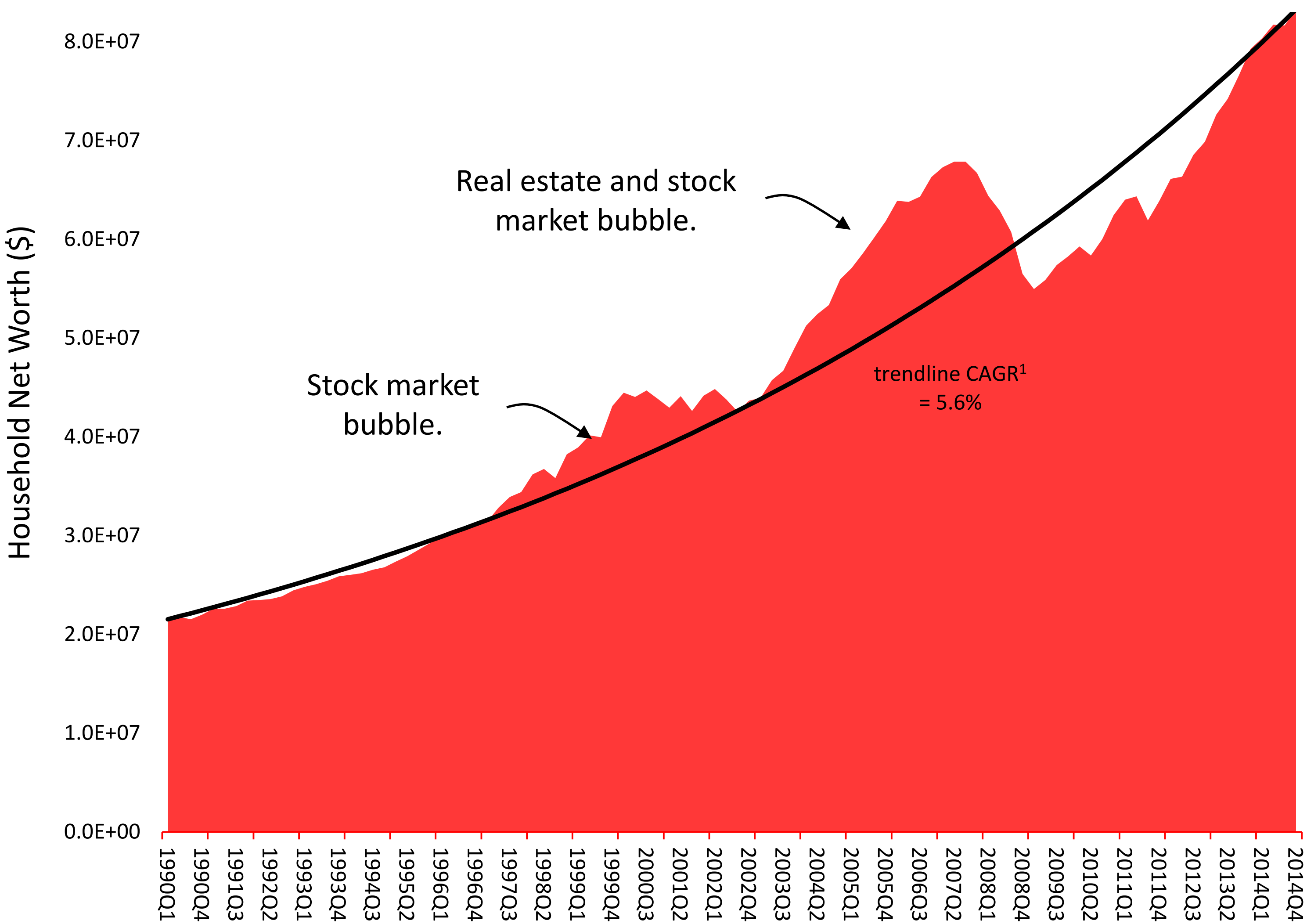
Source: The University of Michigan Survey Research Center, data through June 2015.

Consumer sentiment has finally normalized seven years following the collapse.

You have to go back a generation – more than 30 years – to find consumer sentiment as low as it got through the recent crisis.

June at 96.1 is a return to normal.

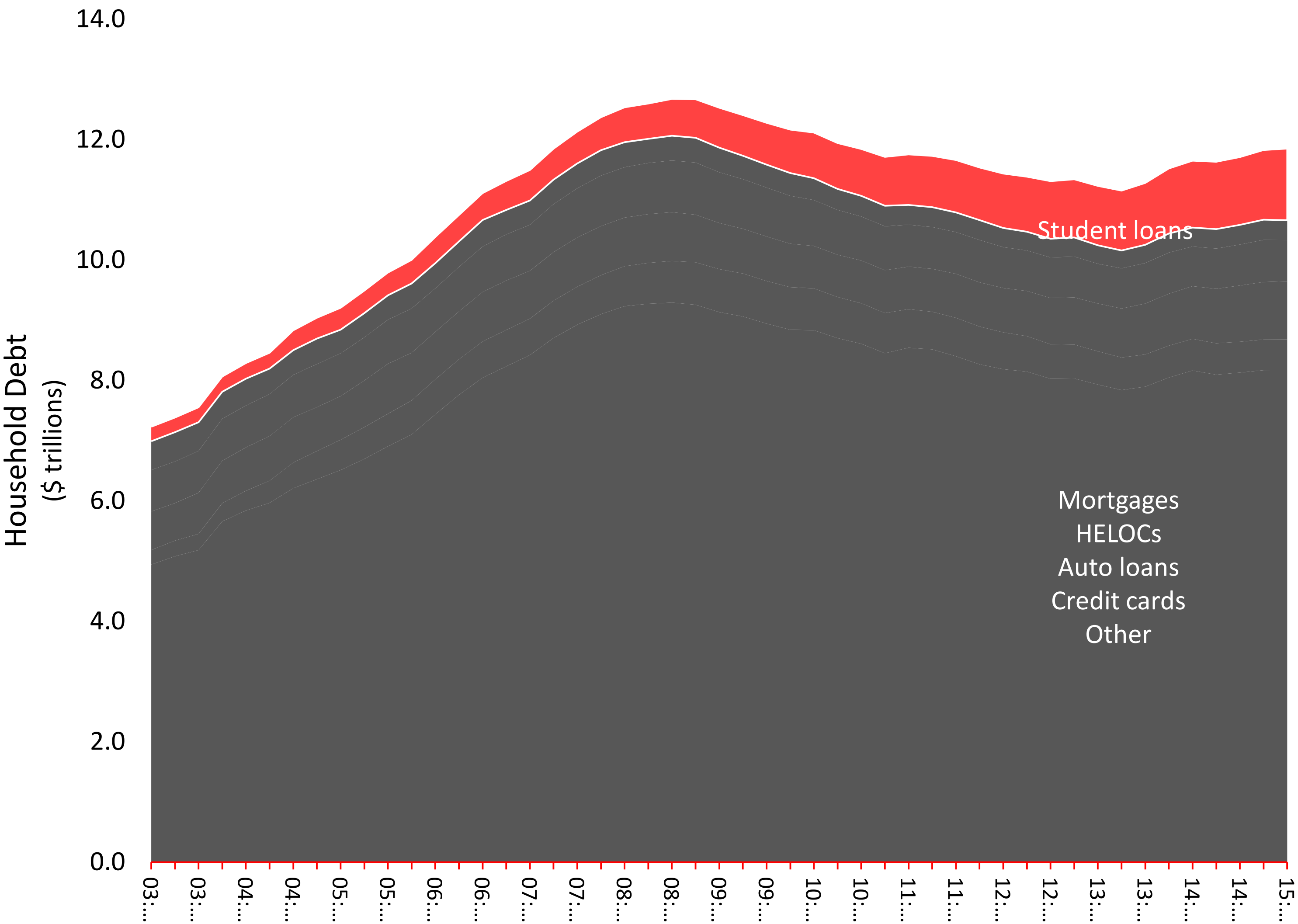
Household net worth



Household net worth has fully recovered.

Source: Federal Reserve. Data through March 2015, released June 11. [1]Compound annual growth rate.
$8.0E+07 = $80 trillion.

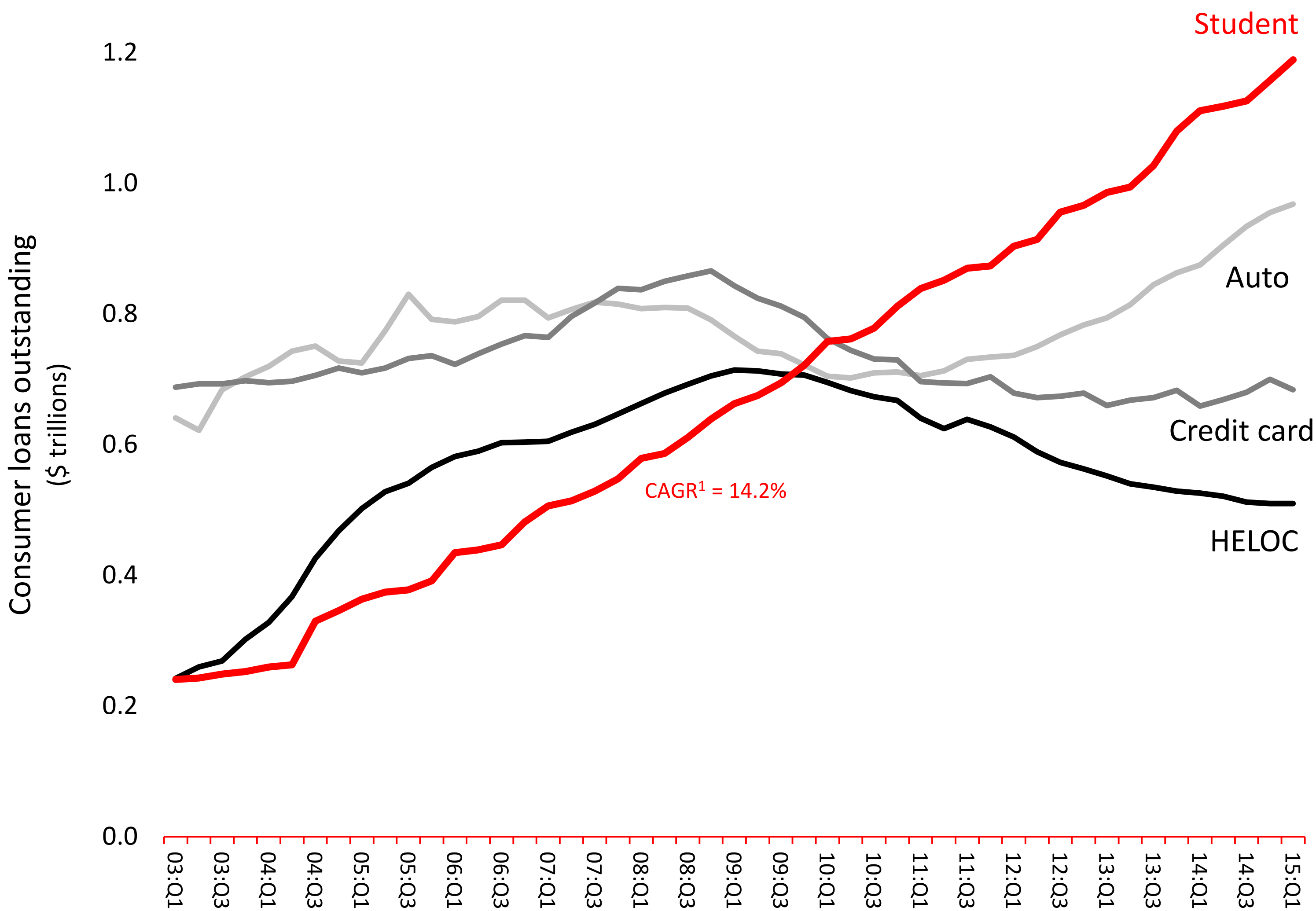
Household debt composition



Student loans comprise 10% of total household debt outstanding.

Source: Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit*, May 2015.

Runaway growth in student loans

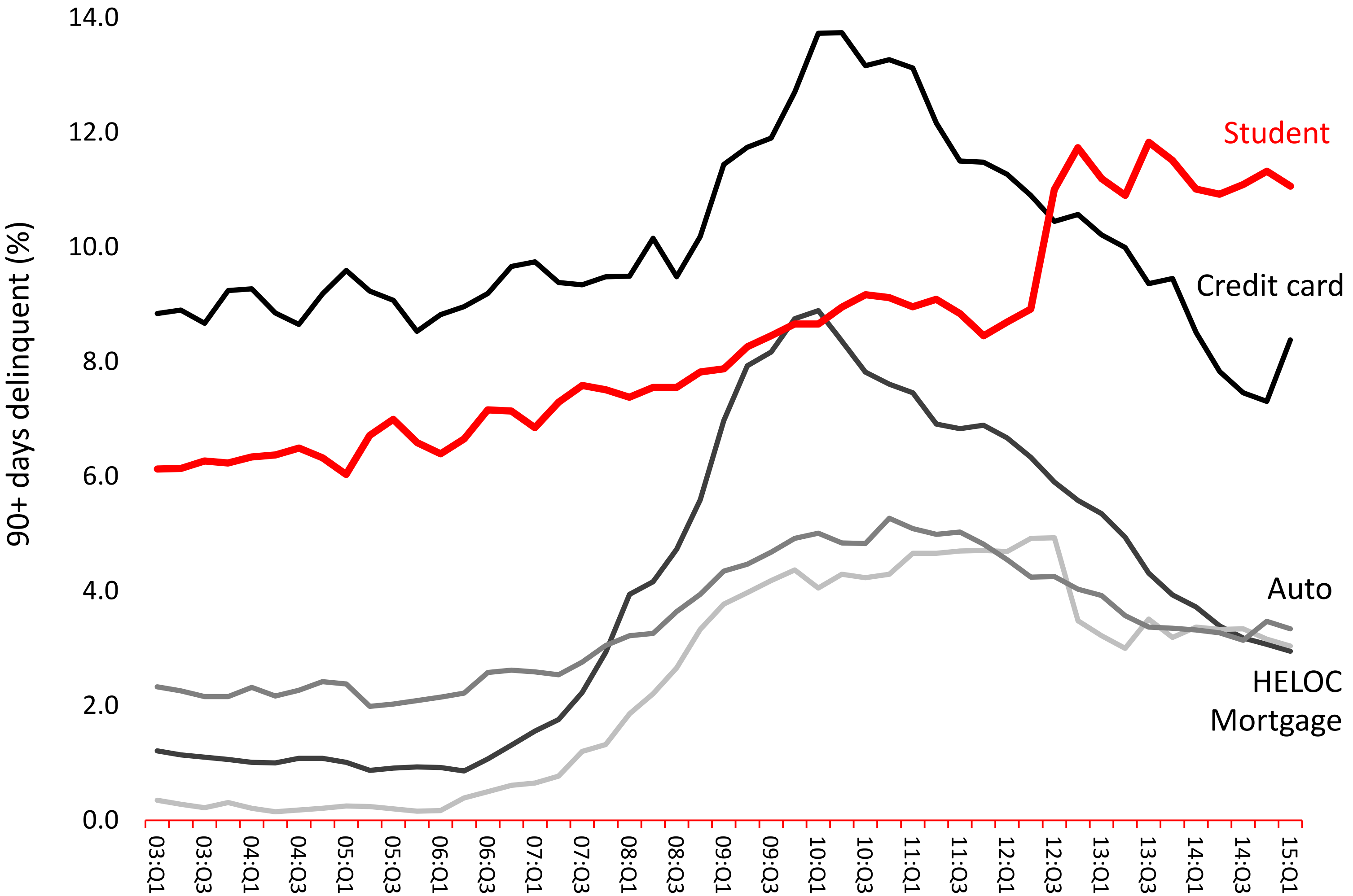


Student loans $1.2 trillion and growing 3X faster[2] than total household debt.

Source: Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit*, May 2015.

[1] CAGR = compound annual growth rate. [2] 14.2% CAGR compared to 4.2% CAGR for total household debt, including mortgages.

Household debt delinquency rates



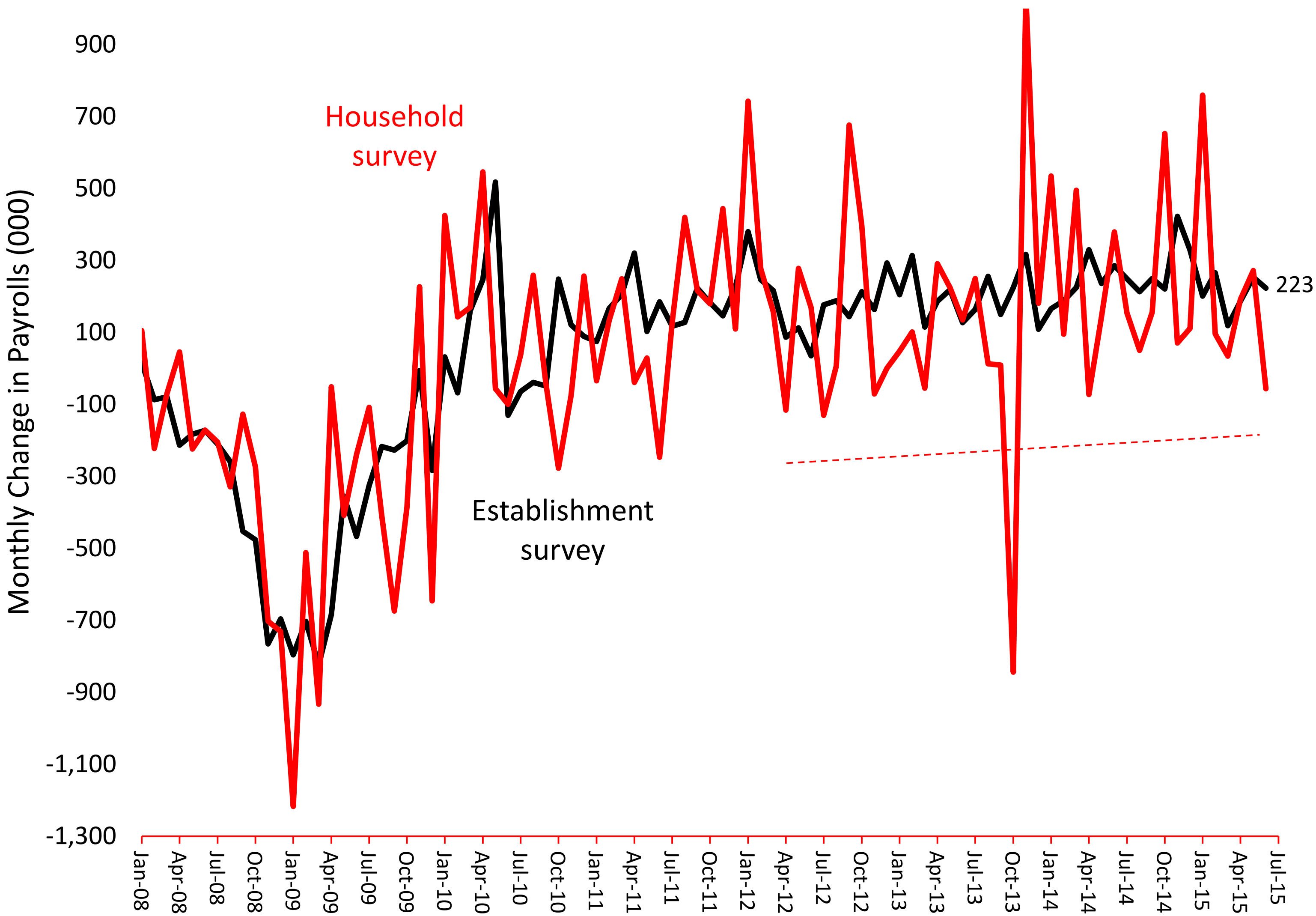
Student loan delinquency is high and rising.

Source: Federal Reserve Bank of New York, *Quarterly Report on Household Debt and Credit*, May 2015.

Jobs

- Better May/June new jobs
- Record job openings
- Strong private sector, public sector drag
- Strong relative U.S. job formation long-term
- Modest nominal, strong real wage growth
- Mean and median incomes bottomed
- Myth: "… but we're not creating good jobs"

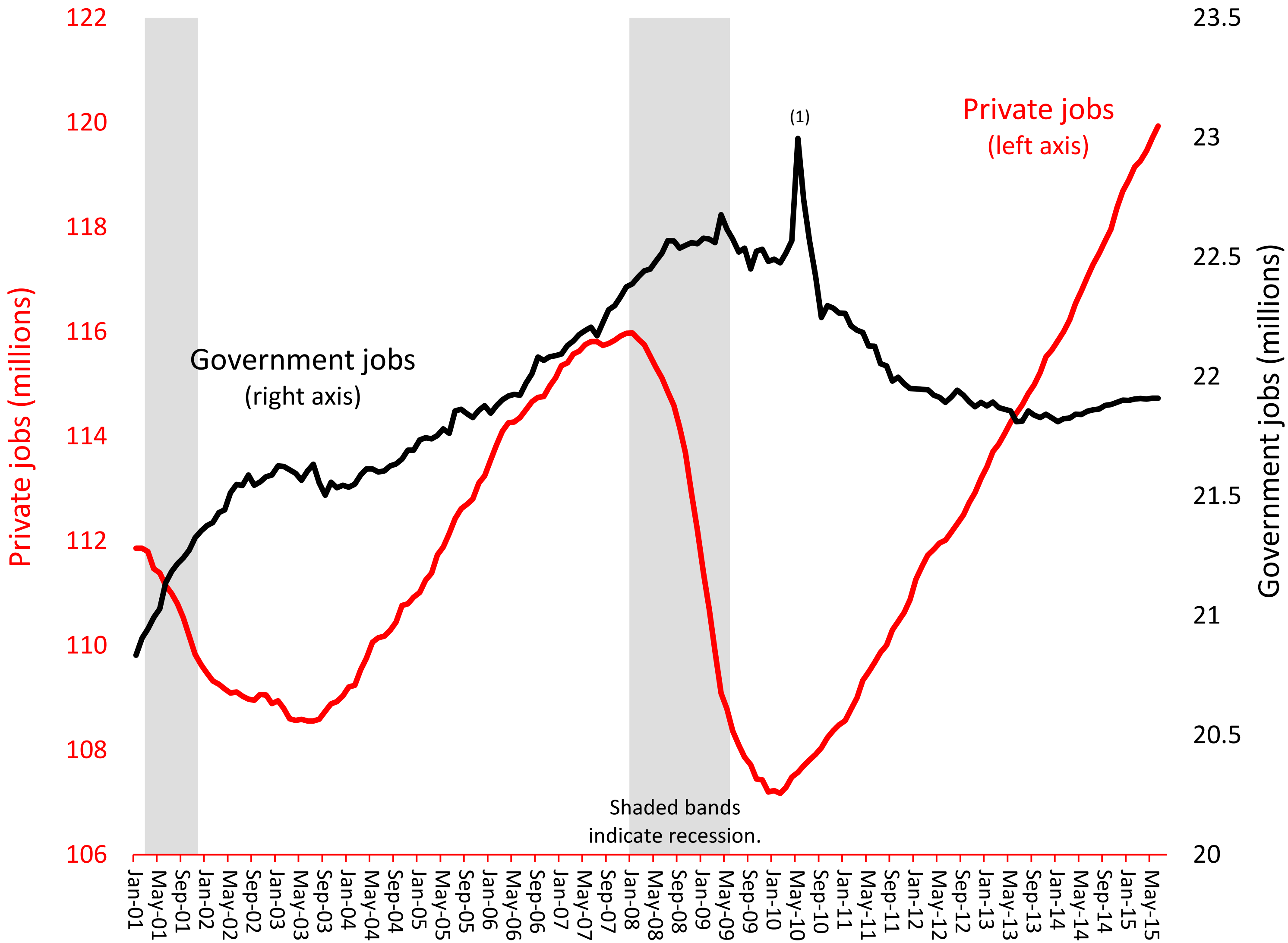
Employment



Both surveys have been trending gradually higher.

Source: Bureau of Labor Statistics. Data through June 2015.

Private jobs rising, government jobs finally turning higher

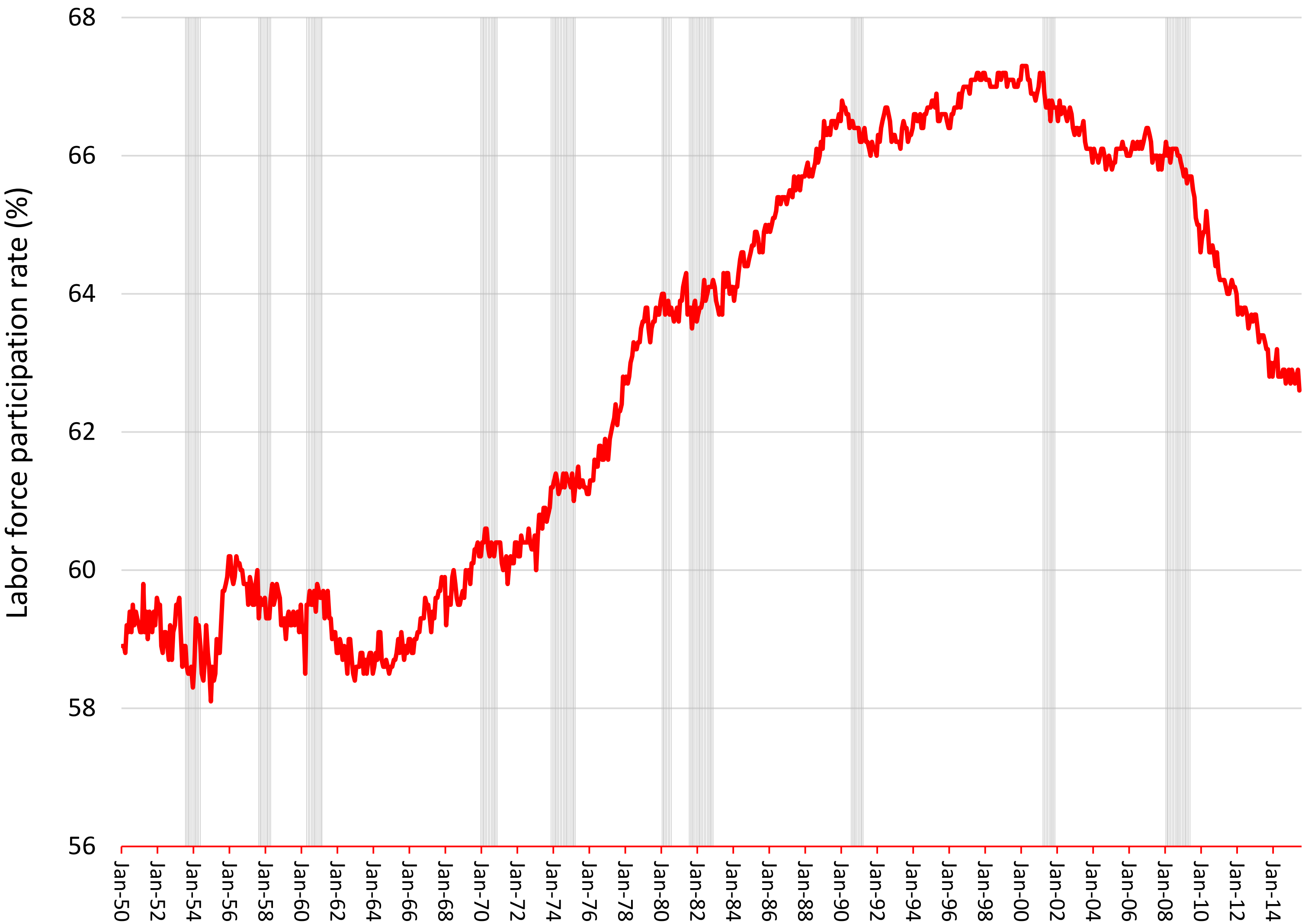


Private sector jobs recovery looking good.

Government jobs recovery is stalling.

Source: Bureau of Labor Statistics; data through June 2015.
[1] 2010 census hiring spike.

Labor force participation rate



Source: Bureau of Labor Statistics. Data through June 2015.

Participation rate is in a structural decline driven largely by demographics.

Recessions drive cyclical slides in the participation rate.

Labor force participation rate

Janet Yellen

structural

cyclical

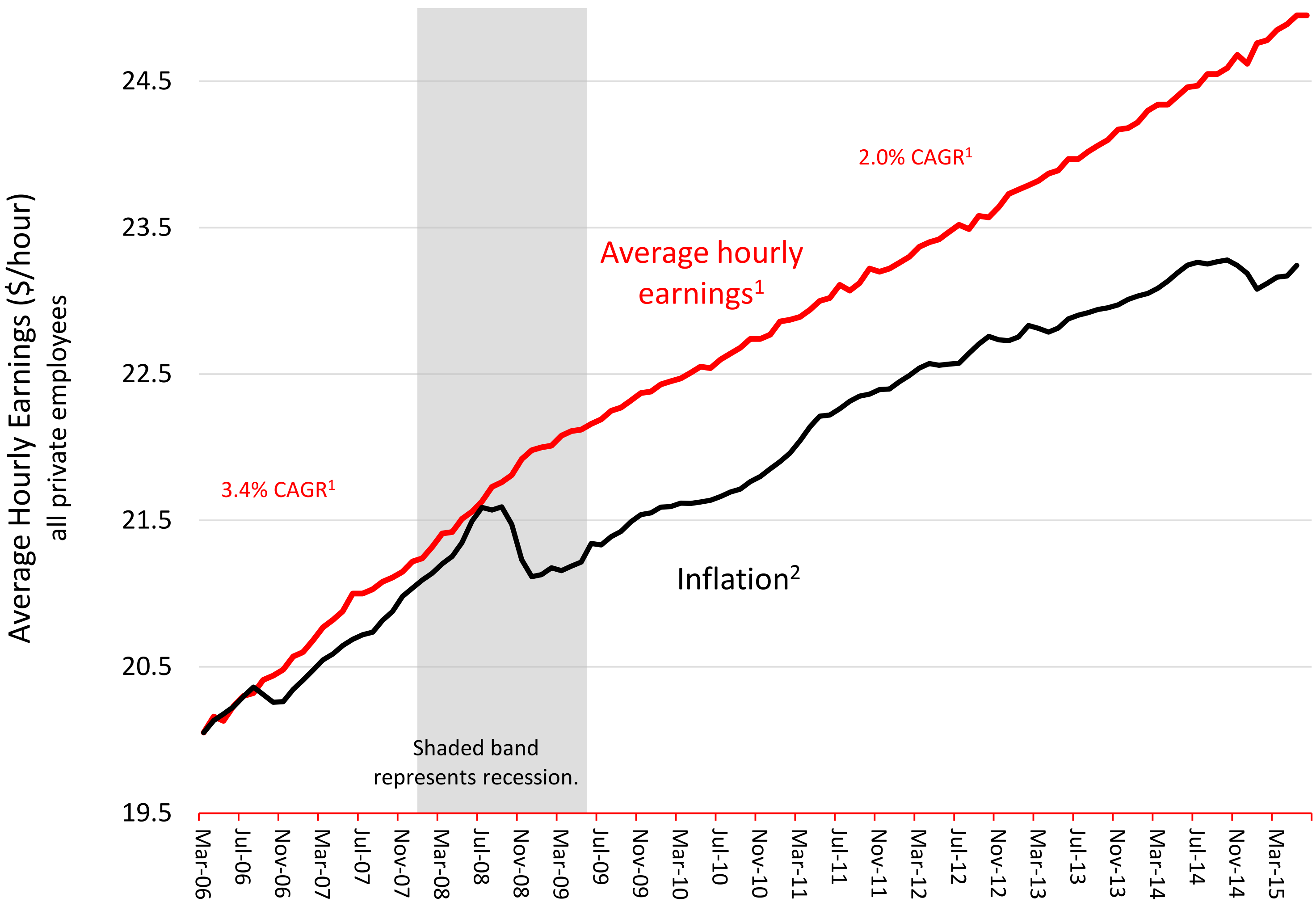
Let's first consider the labor force participation rate. It continued to decline substantially after the recession ended, with the pace of those declines slowing only over the past year or so even as the unemployment rate has continued to fall. Many working-age people who are not in the labor force have chosen that status voluntarily; examples would include retirees, teenagers and young adults in school, and people staying home to care for children and other dependent family members. Even in a stronger job market, it is likely that many of these individuals would prefer not to work. And, indeed, a noticeable portion of the decline in labor force participation seen over the past decade or so clearly relates to the aging of baby boomers and their ongoing retirements. However, the pace of decline in the participation rate accelerated during the recession, as some individuals who lost their jobs became discouraged and stopped looking for work. It appears that, despite a drop in the participation rate reported in June, the pace of this decline has slowed since early last year. Nevertheless I think a significant number of individuals still are not seeking work because they perceive a lack of good job opportunities, and that a stronger economy would draw some of them back into the labor force. [1]

Brookings Institute

ABSTRACT Since 2007, the labor force participation rate has fallen from about 66 percent to about 63 percent. The sources of this decline have been widely debated among academics and policymakers, with some arguing that the participation rate is depressed due to weak labor demand while others argue that the decline was inevitable due to structural forces such as the aging of the population. In this paper, we use a variety of approaches to assess reasons for the decline in participation. Although these approaches yield somewhat different estimates of the extent to which the recent decline in participation reflects cyclical weakness rather than structural factors, our overall assessment is that much of the decline is structural in nature. As a result, while we believe some of the participation rate's current low level is indicative of labor market slack, we do not expect the rate to substantially increase from current levels as labor market conditions continue to improve. [2]

[1] Janet Yellen speech July 10, 2014.
[2] Brookings Institute, *Labor Force Participation, Recent Developments and Future Prospects*, Fall 2014.

Average hourly earnings vs. inflation



The trend in AHE remains steady at +2.0% y/y growth – down from the pre-recession rate of +3.4%.

AHE growth has outstripped inflation.

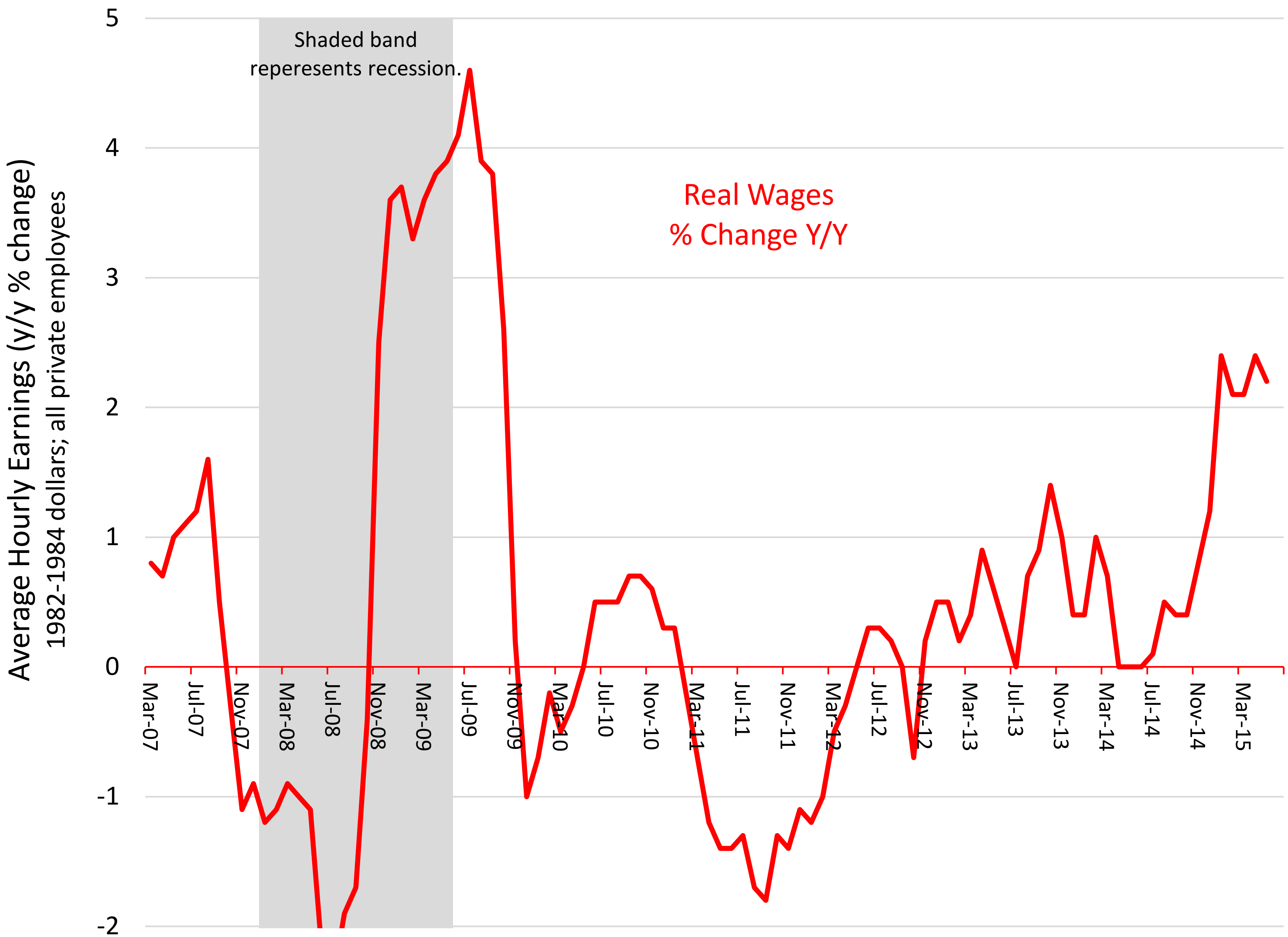
Real wages have grown … at a better clip than pre-recession because inflation has been declining.

Source: BLS, BEA. Wage data through June 2015. Inflation data through May 2015.

[1] Compound annual growth rate March 2006 through December 2008 = 3.4%; CAGR December 2008 through June 2015 = 2.0%.

[2] March 2006 average hourly earnings of $20.05 inflated by the personal consumption expenditures deflator (PCED).

Real wages surge lately



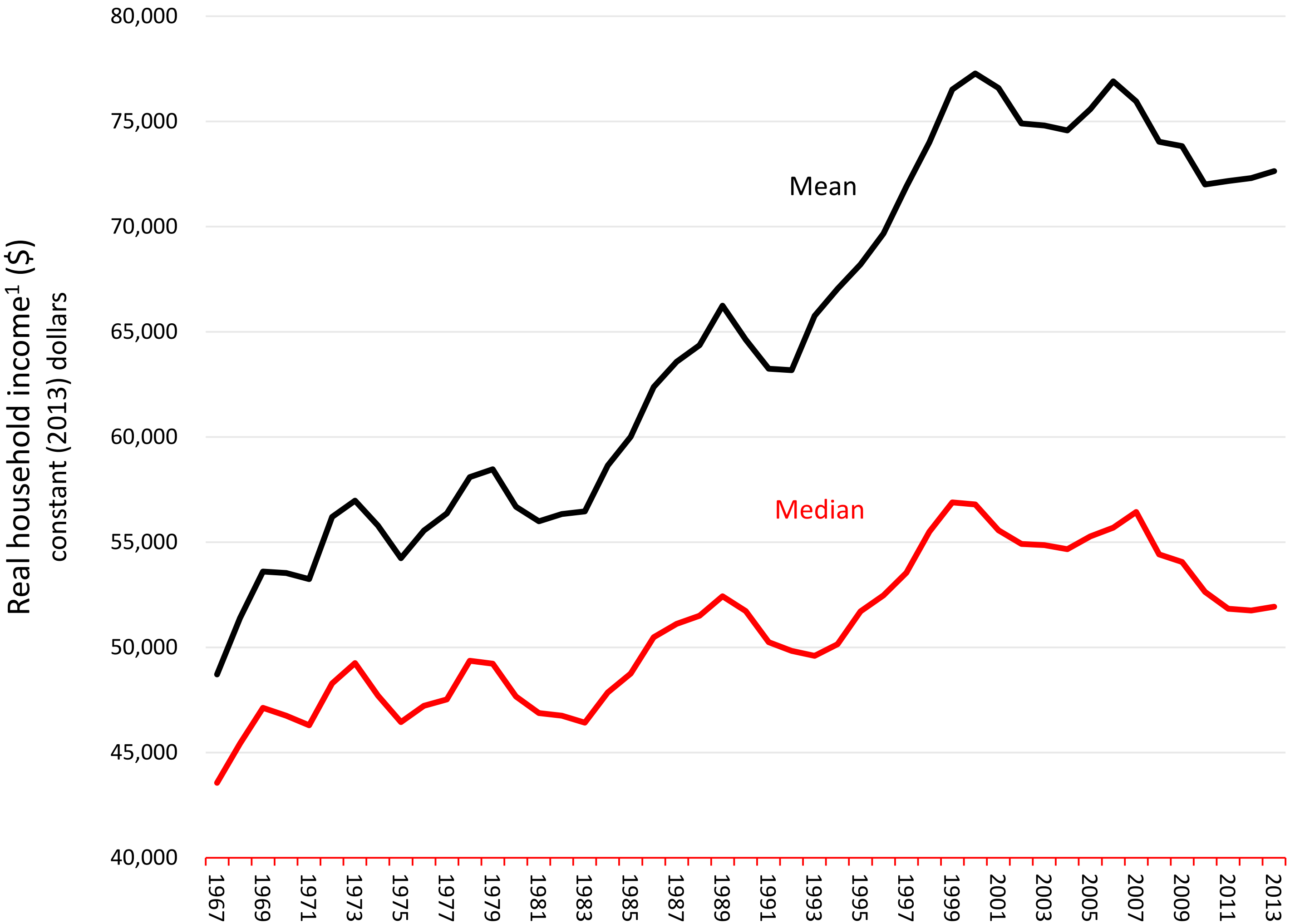
Source: BLS. Data through June 2015.

This is another look at the data presented in the previous chart.

Real wages are computed by subtracting inflation from nominal wages.

Over the past two years, with inflation having dropped so low, <u>real wage gains have surged.</u>

Median and mean household income



Real household income has been tracing a sluggish recovery post-recession.

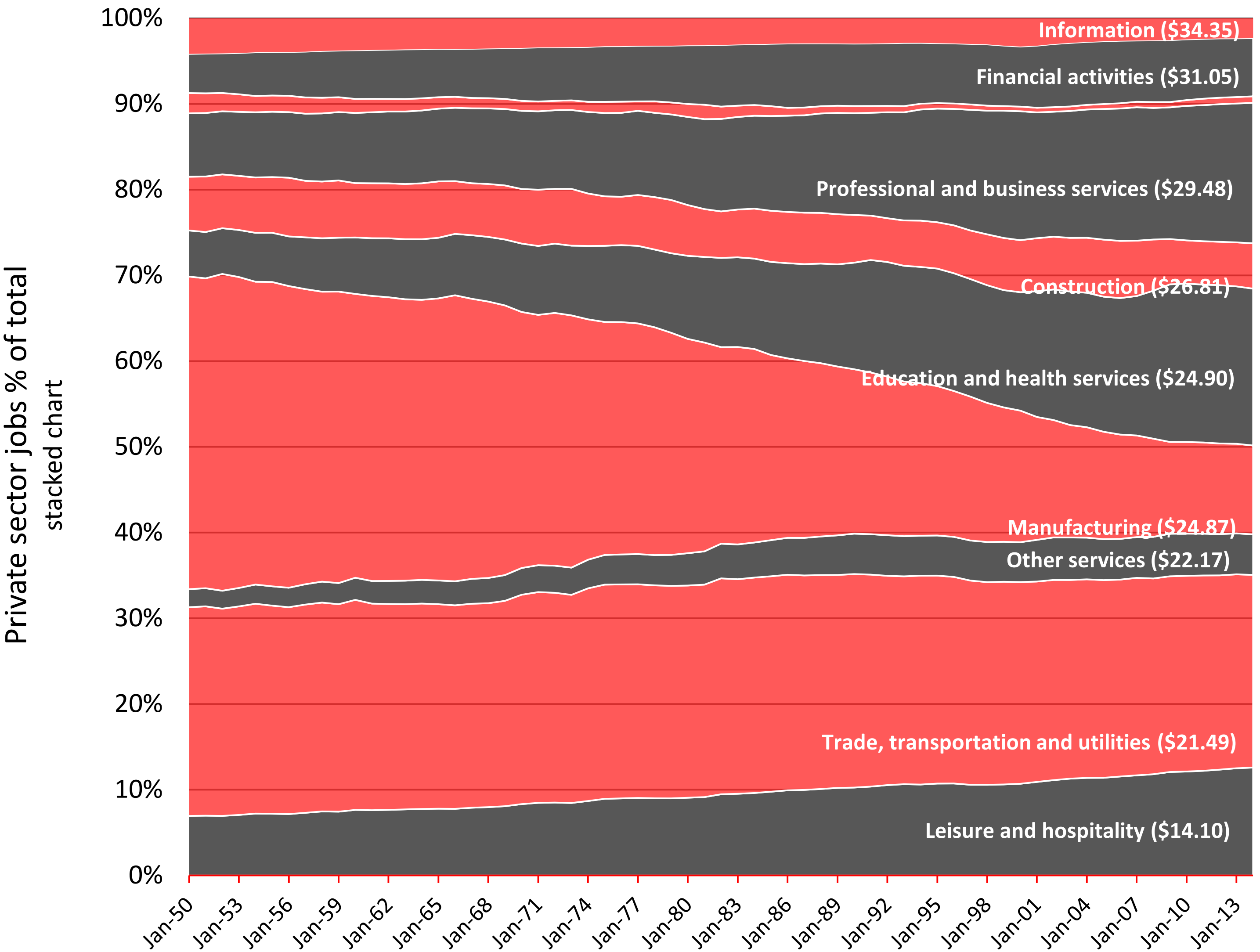
Good news is that both have bottomed.

Source: U.S. Census Bureau. Income and Poverty in the United States: 2013, issued September 2014.

[1] The Census Bureau's income estimates are based solely on money income before taxes and do not include the value of non-cash benefits such as food stamps, Medicare, Medicaid, public housing and employer-provided fringe benefits.

Jobs … "but the jobs we're creating aren't 'good' jobs."

All jobs by category (average hourly earnings in parentheses)



In 1950, manufacturing jobs were 37% of total jobs. Today that figure is 10%.

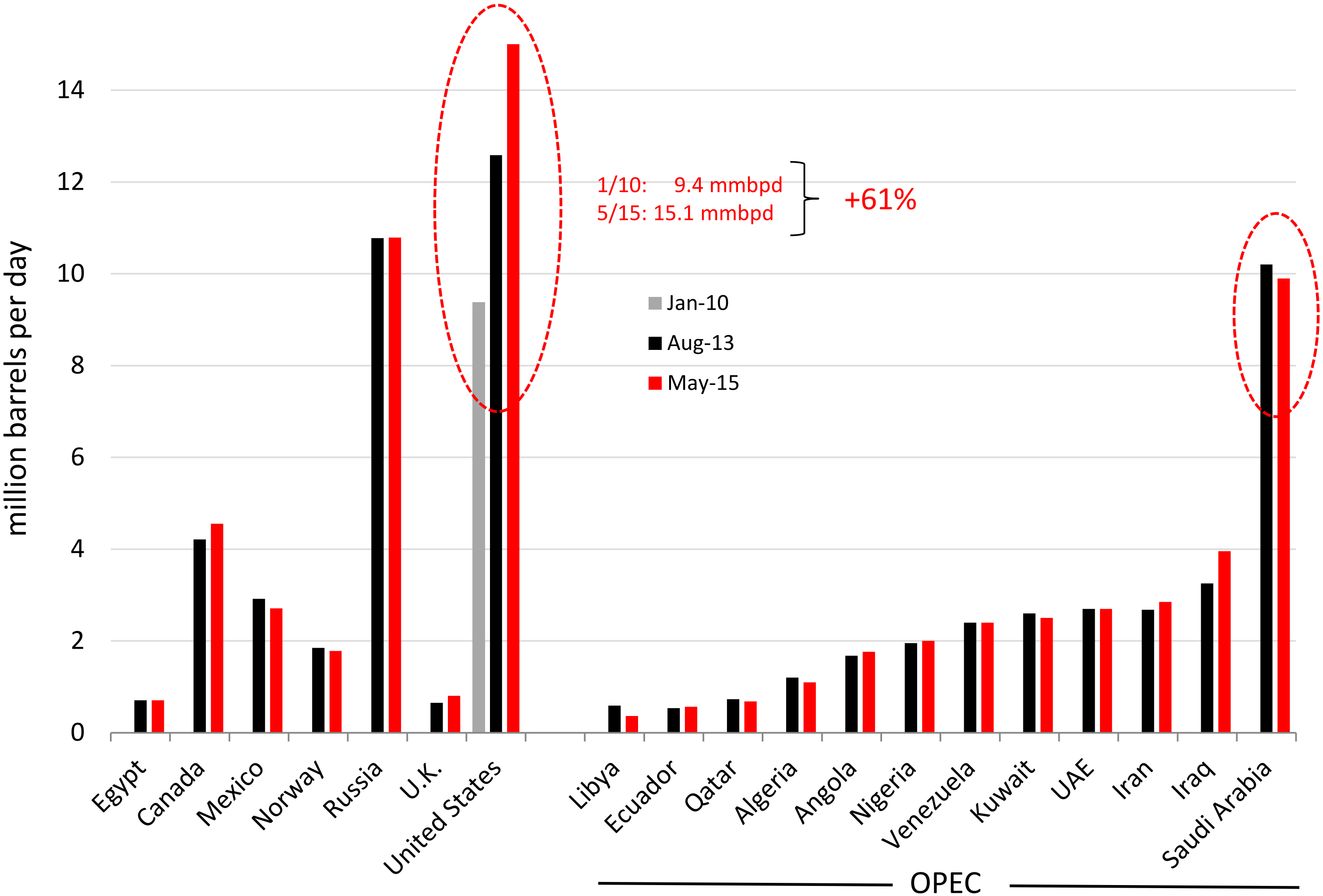
Some manufacturing jobs have been replaced by lower-paying jobs in leisure and hospitality; but many more have been replaced by higher-paying jobs in health services and professional and business services.

Source: Bureau of Labor Statistics; data through December 2014 Mining and logging ($30.70) is the small sliver between Financial activities and Professional and business services.

Crude oil

- No price recovery in sight
- 17 consecutive oversupply months
- *Record* 3 mmbpd supply/demand imbalance
- U.S. rig count down -60%, production up
- Oil is hitting inflation hard

World crude oil production – U.S. shale oil explosion



<u>U.S. shale production has upset the global supply/demand equilibrium</u>.

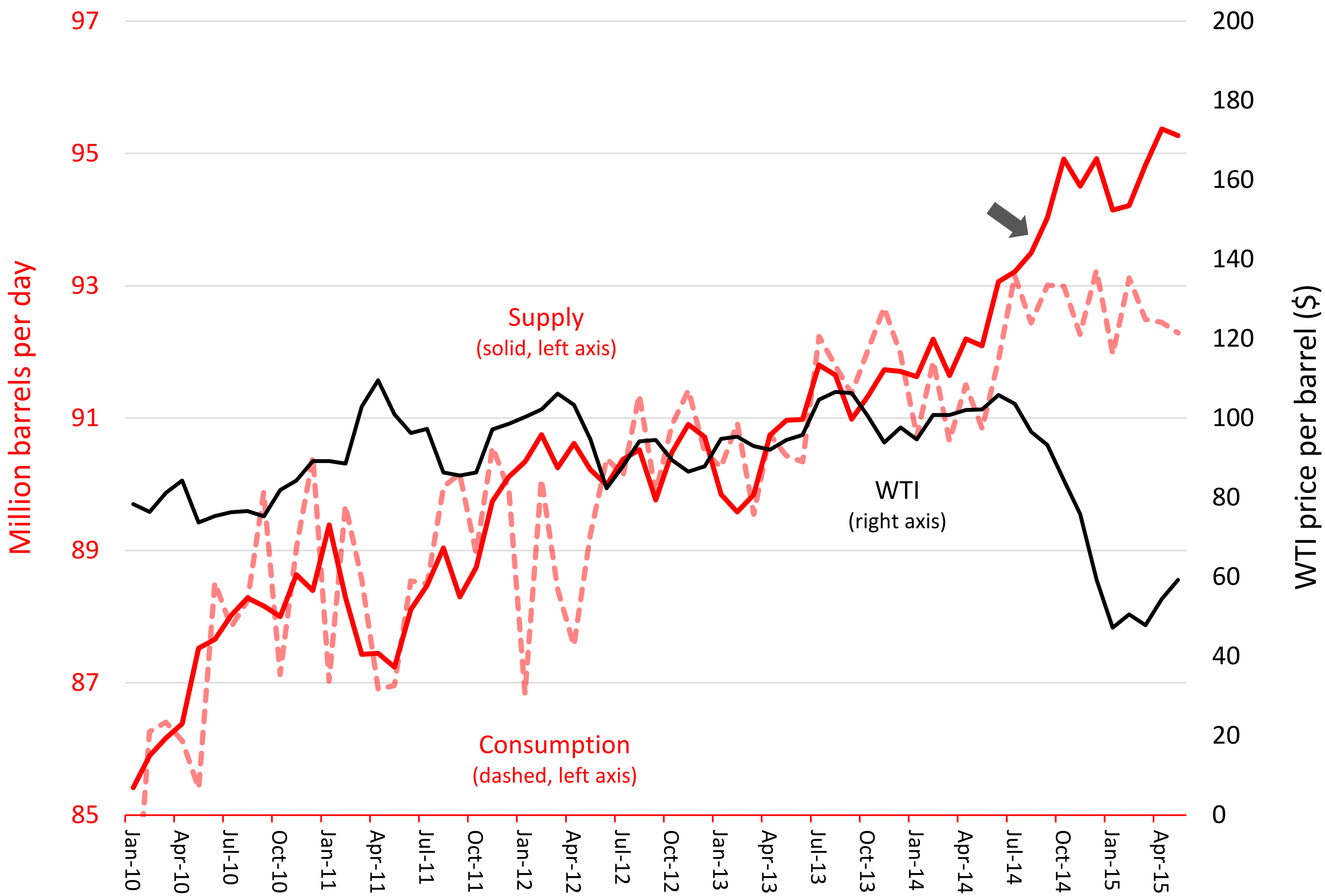
Saudi Arabia has borne the brunt of the production cuts while others in OPEC have increased.

Saudis decided not to take it any more!

Source: U.S. Energy Information Agency, *Short-Term Energy Outlook*, June 2015. For non-OPEC producers the figures include crude oil plus liquids production. For OPEC producers the figures include crude oil but exclude liquids.

Oil

World crude oil supply vs. consumption



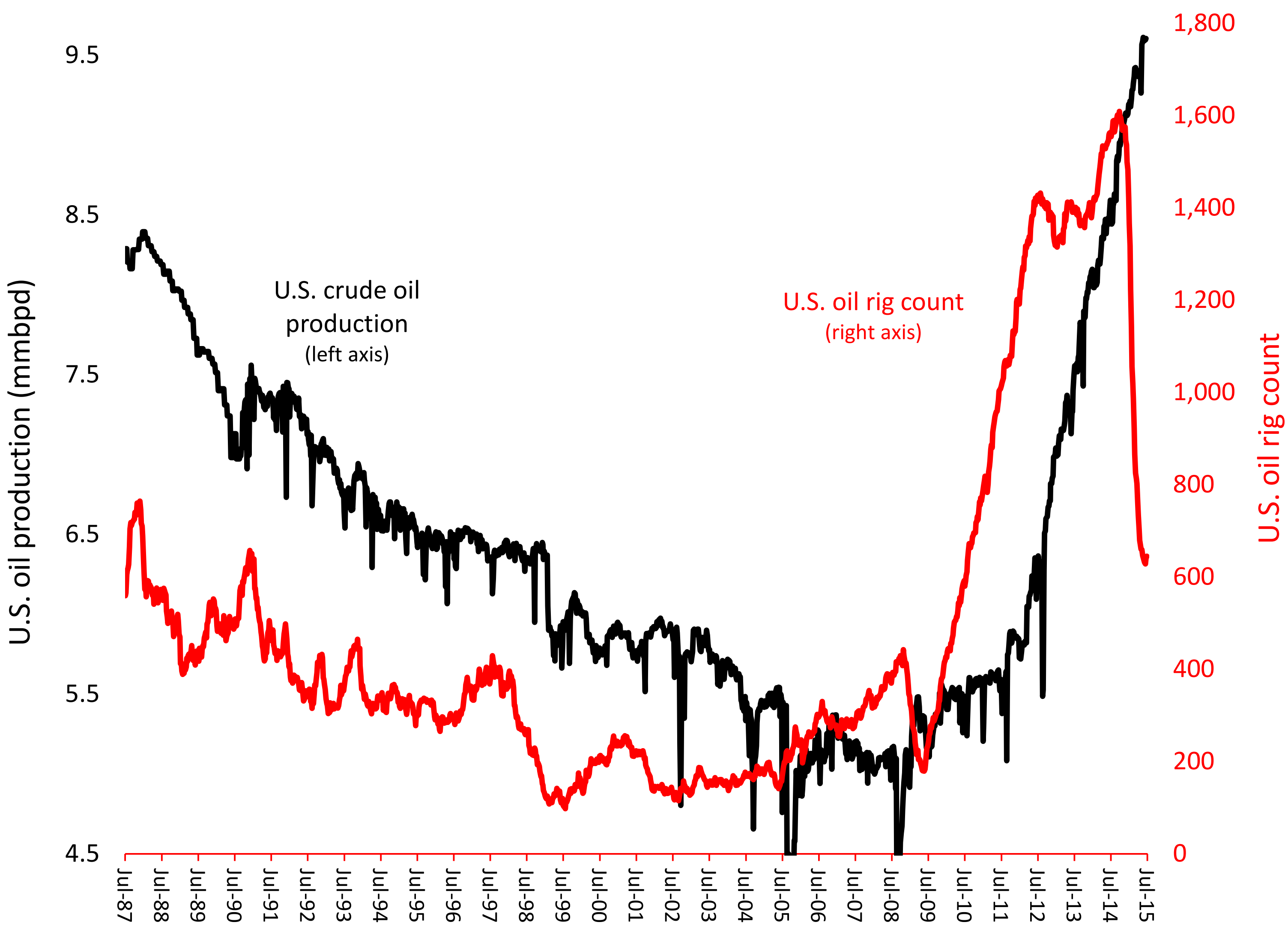
In 2014 and so far in 2015, global supply surged, outstripping demand growth, driving prices down.

Supply has now outstripped demand for 17 consecutive months.

<u>Record 3 mmbpd oversupply.</u>

Source: U.S. Energy Information Agency, *Short-Term Energy Outlook,* June 2015, data through May 2015. Includes condensate and natural gas liquids.

U.S. drilling plunge



U.S. oil rig count down -60%, production still rising.

How long before crude production follows suit?

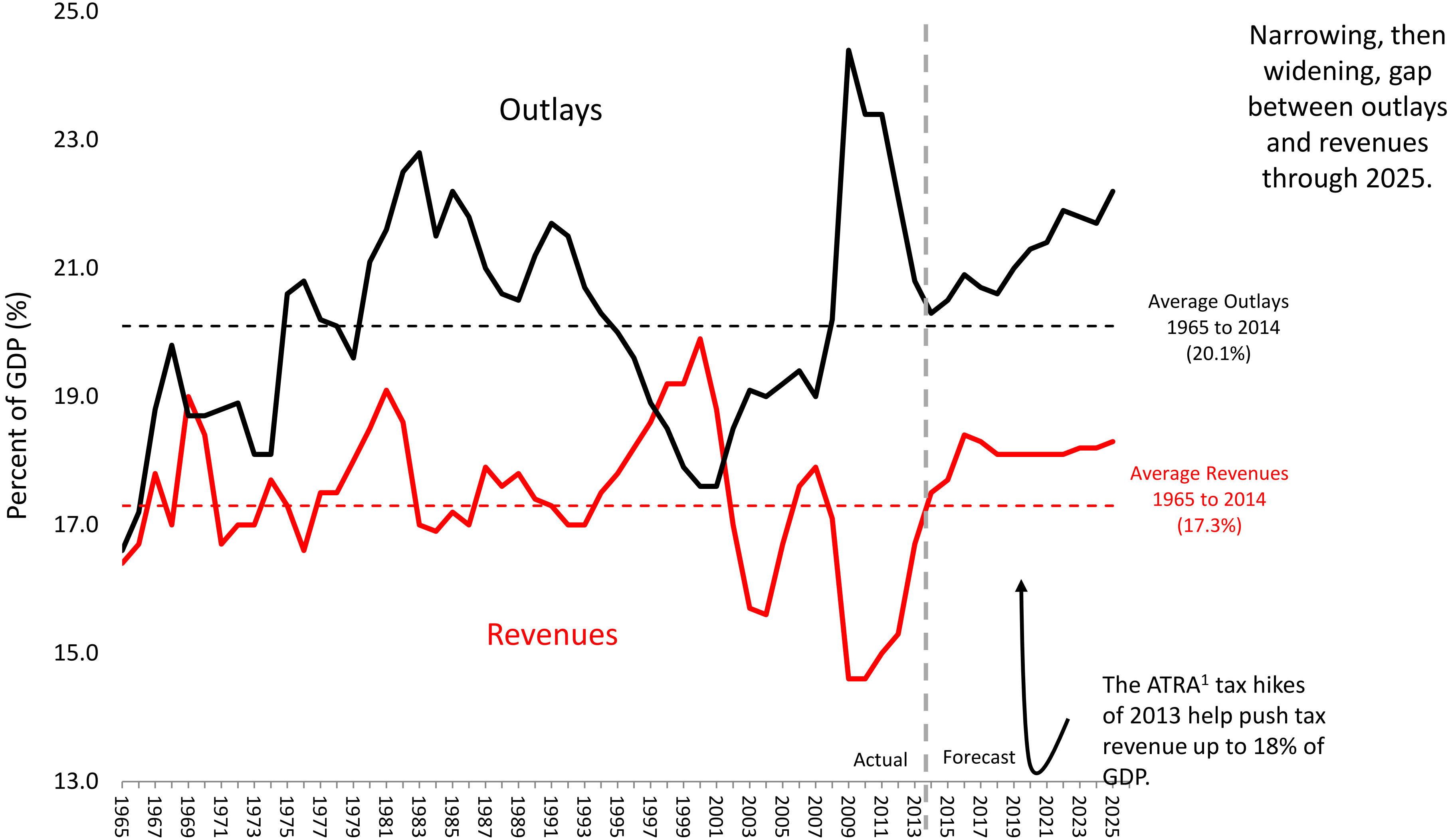
Source: U.S. Energy Information Agency, Baker Hughes. Rig count through July 10, 2015. Crude oil production through July 3, 2015.

Federal budget

- CBO's June 2015 forecast
- looks good for a few years …
- … but the entitlements problem hasn't gone away

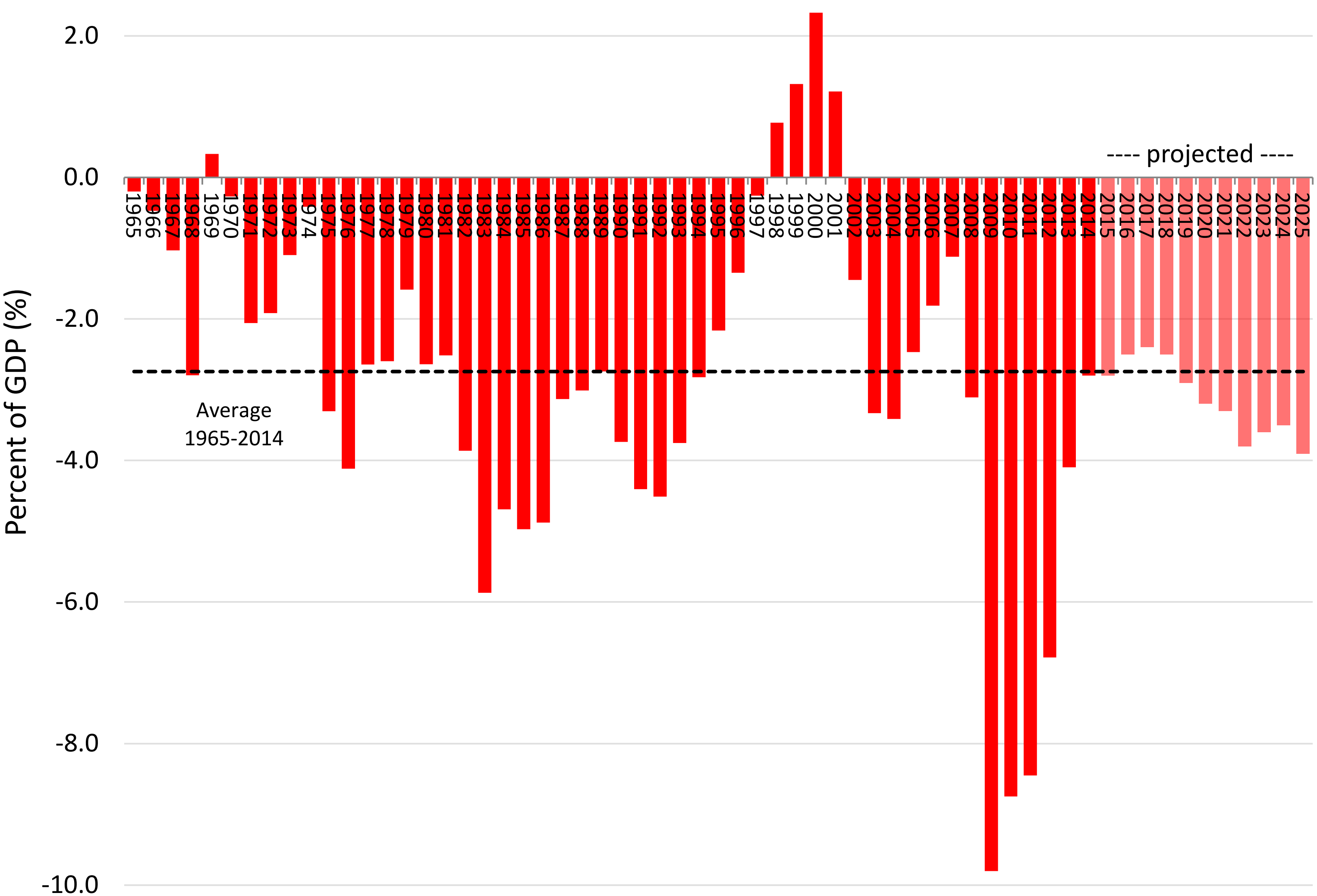
What happened to the debt crisis?

Federal revenues and outlays – a rising spending problem



Source: Congressional Budget Office, *The 2015 Long-Term Budget Outlook*, dated June 2015.
[1] American Taxpayer Relief Act.

Federal deficits – declining

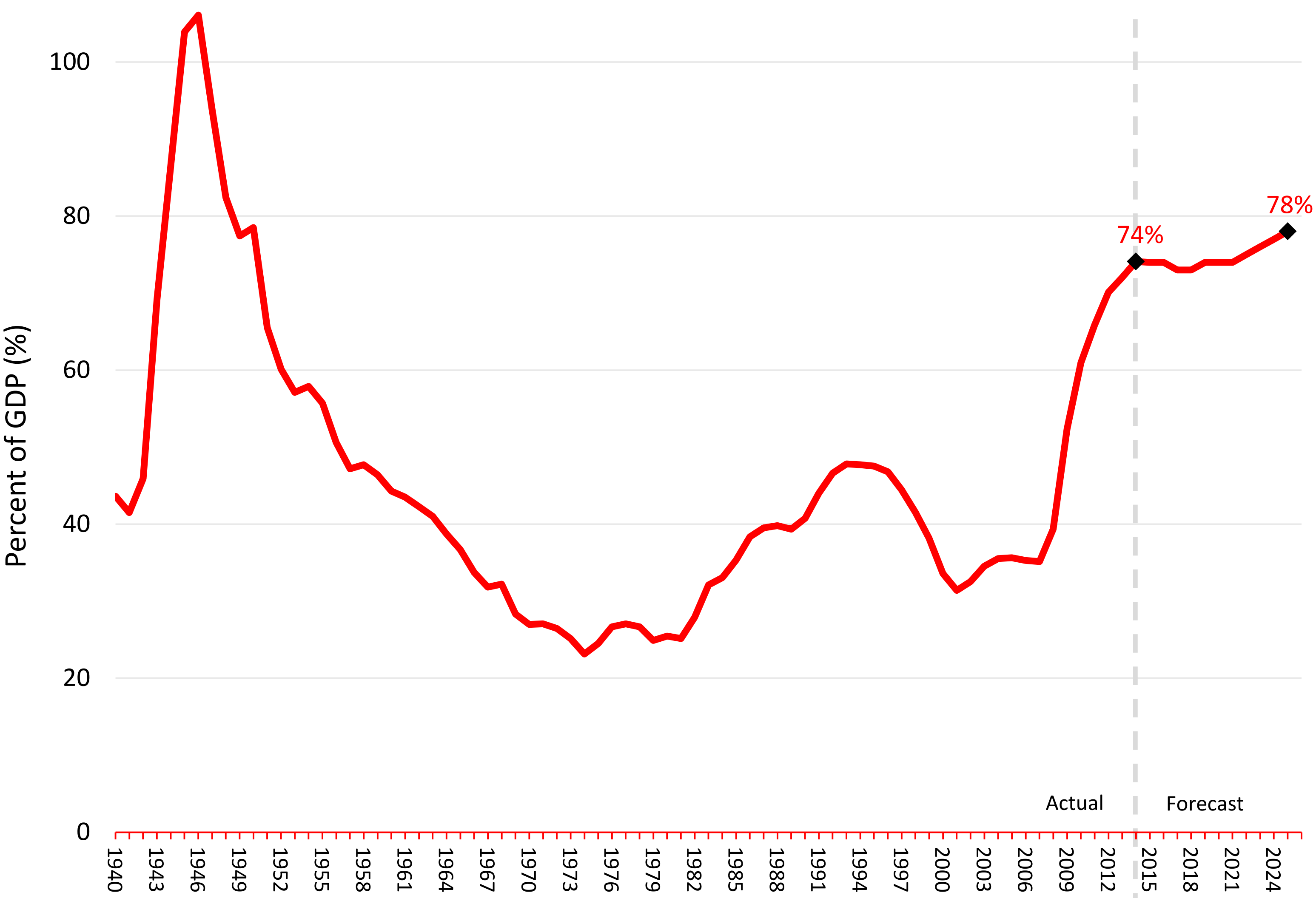


CBO is projecting diminished federal borrowing requirements through 2017.

Source: Congressional Budget Office, *The 2015 Long-Term Budget Outlook*, dated June 2015.

What happened to the debt crisis?

Federal debt % of GDP

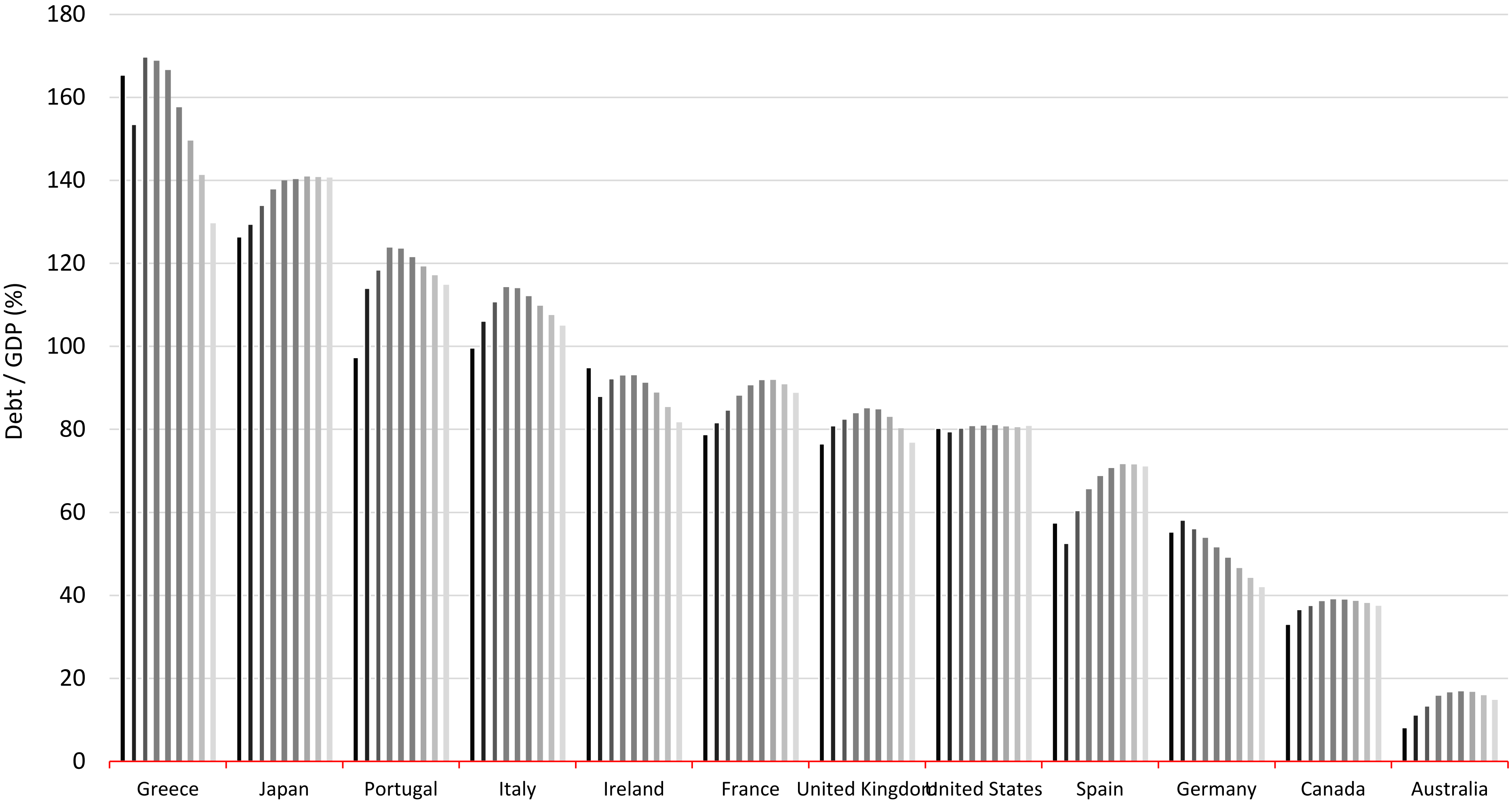


Debt % of GDP improves through 2018, then increases.

Source: Congressional Budget Office, *The 2015 Long-Term Budget Outlook*, dated June 2015.

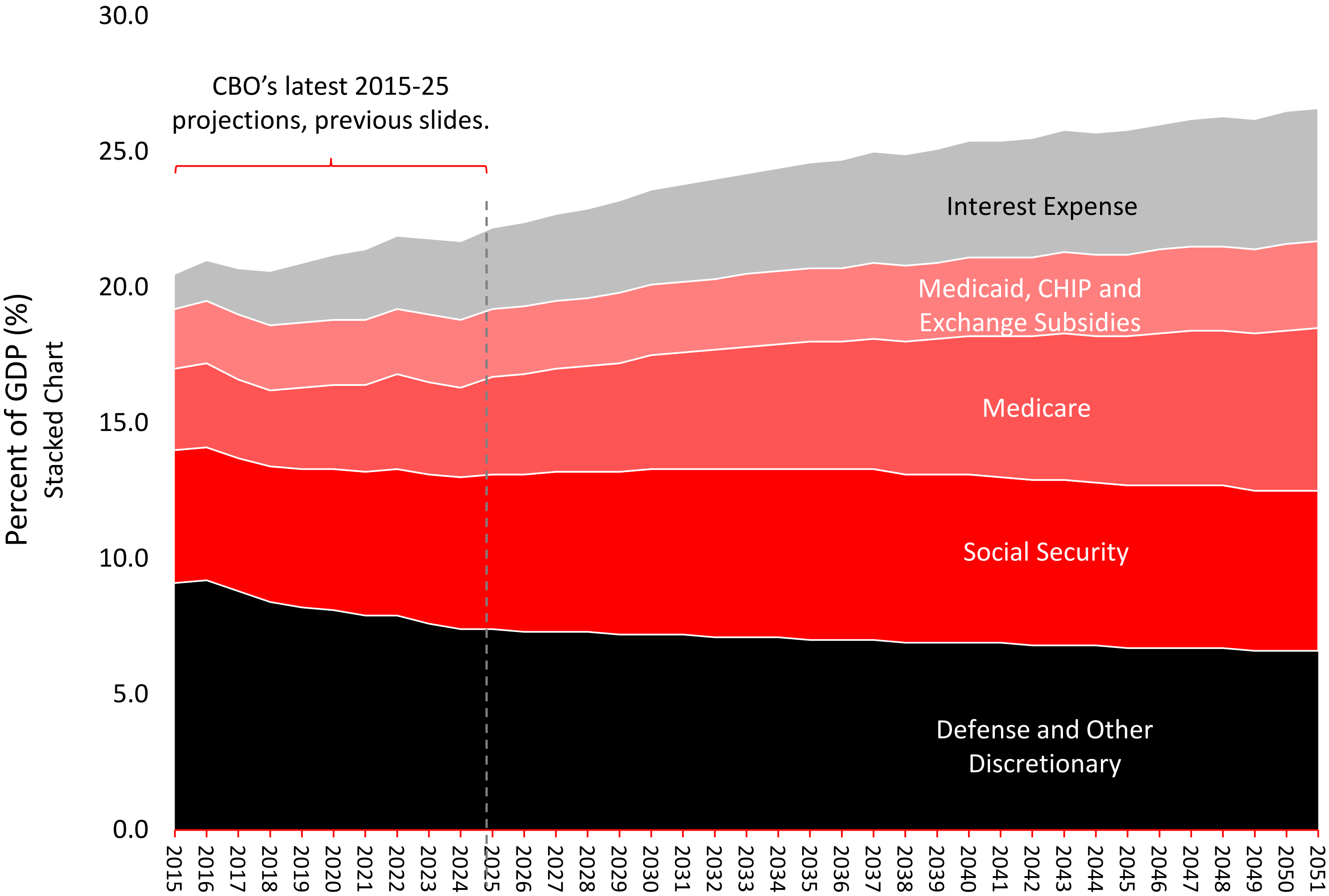
Deficit spending

Government debt-to-GDP ratios (2011-2019)



Source: IMF, World Economic Outlook Database, October 2014. Data for years (from left to right) 2011-2019. For all countries except the U.S.: actual data for 2011-2013, estimates for 2014-2019. For the U.S.: actual data for 2011-2012, estimates for 2013-2019

Projected federal spending[1]

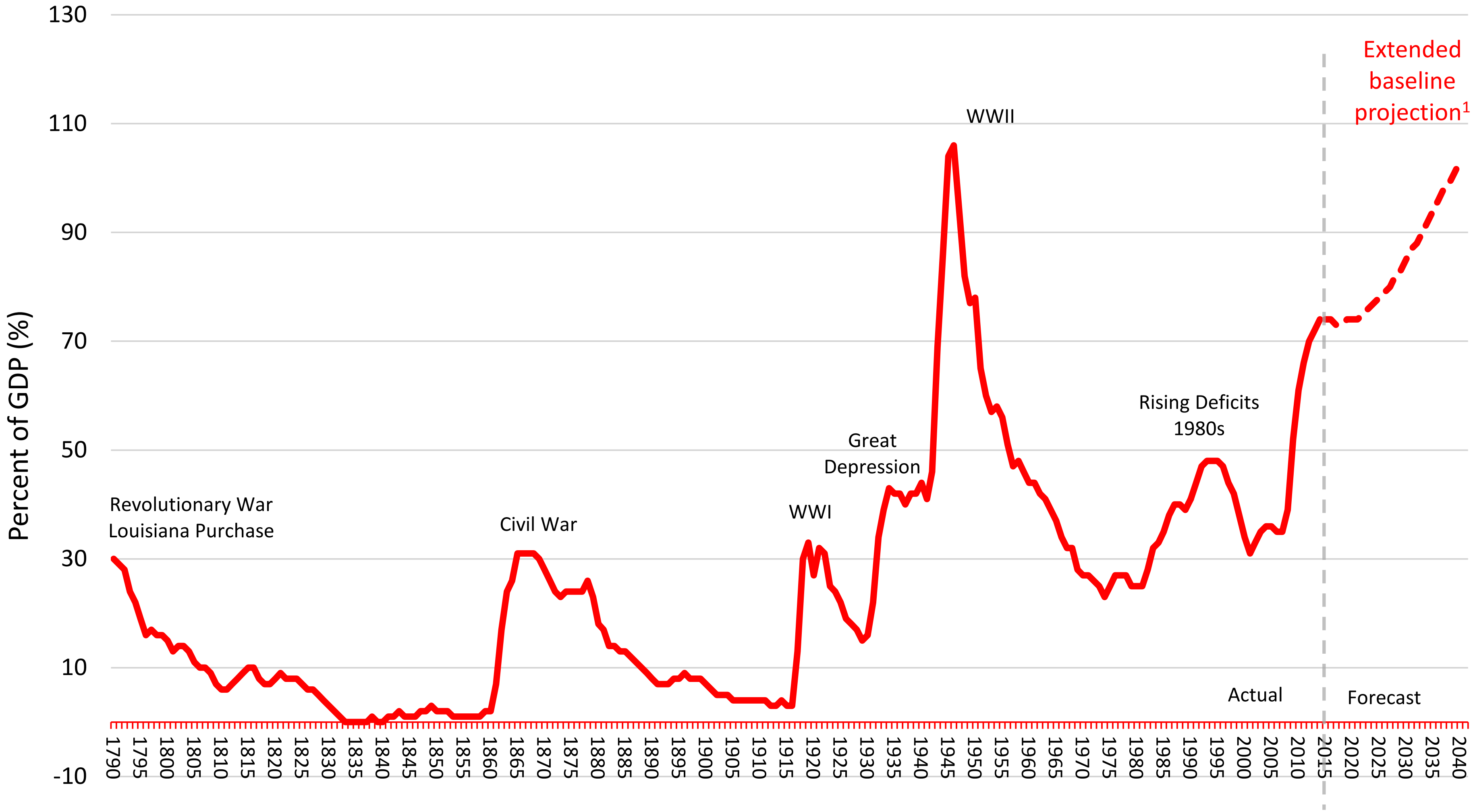


Entitlements are on autopilot and interest expense keeps growing as a share of total spending as the debt accumulates.

Source: Congressional Budget Office (CBO), *The 2015 Long-Term Budget Outlook*, June 2015. [1]CBO's 10-year and extended baselines are meant to serve as benchmarks for measuring the budgetary effects of proposed changes in federal revenues or spending. They are not meant to be predictions of future budgetary outcomes; rather, they represent CBO's best assessment of how the economy and other factors would affect revenues and spending if current law generally remained unchanged.

What happened to the debt crisis?

Federal debt % of GDP through 2040



Source: Congressional Budget Office (CBO), *The 2015 Long-Term Budget Outlook*, June 2015. [1]CBO's 10-year and extended baselines are meant to serve as benchmarks for measuring the budgetary effects of proposed changes in federal revenues or spending. They are not meant to be predictions of future budgetary outcomes; rather, they represent CBO's best assessment of how the economy and other factors would affect revenues and spending if current law generally remained unchanged.

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