Risk Management Association General Membership Meeting

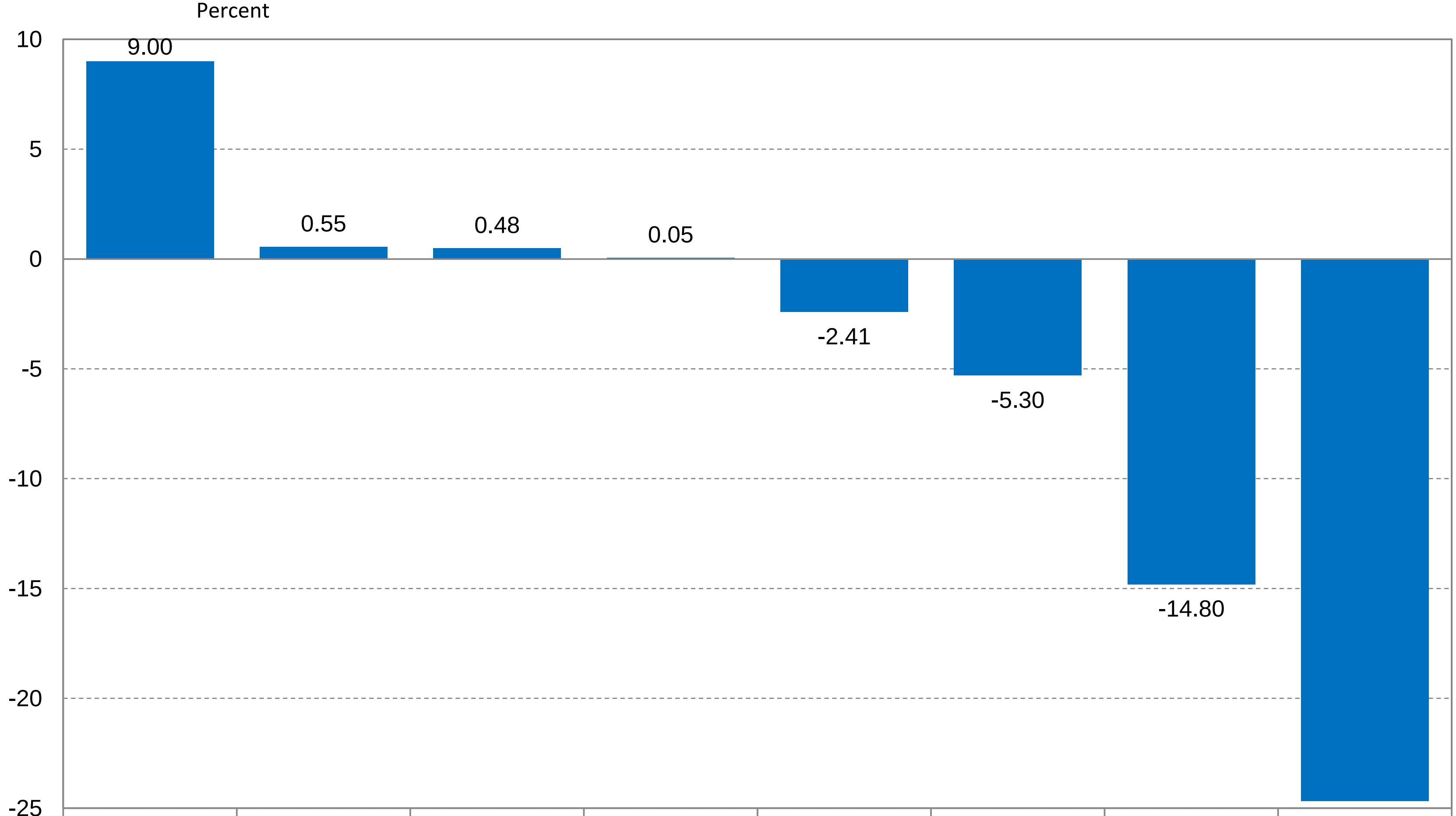
January 29, 2016

Chuck Webb CFA, Chief Investment Officer

Weaver C. Barksdale & Associates, Inc.

BARKSDALE & ASSOCIATES INVESTMENT MANAGEMENT

2015 Returns by Asset Class

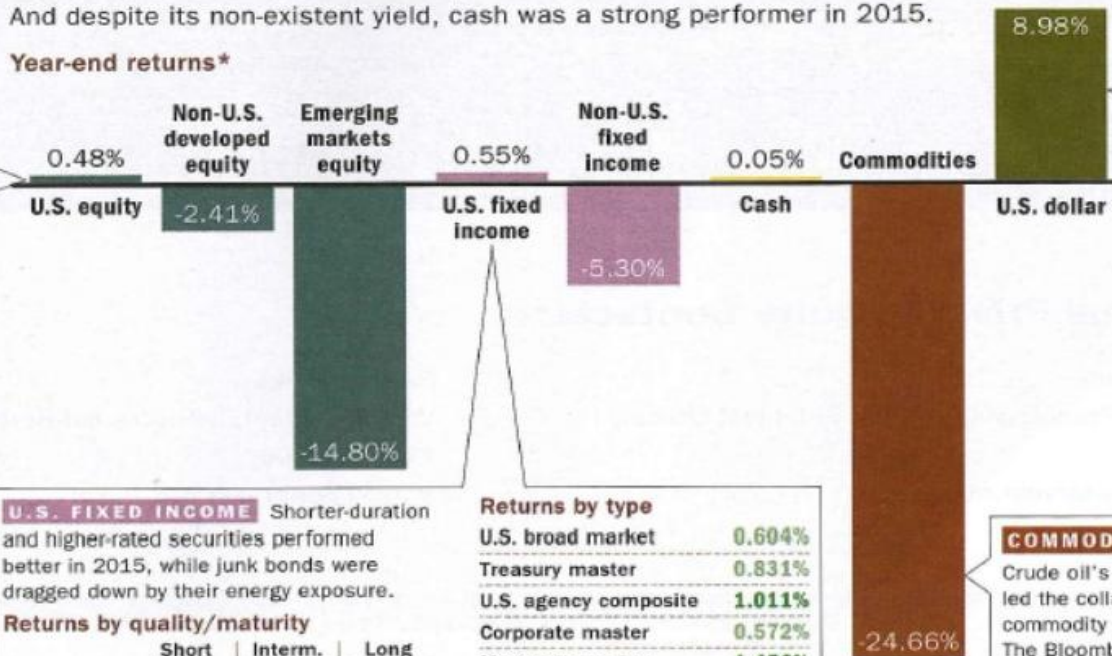


	U.S. Dollar	U.S. Fixed	U.S. Equity	Cash	Non - U.S. Dev. Equity	Non - U.S. Fixed	Emerging Mkts Equity	Commodities
2015 Return	9.00	0.55	0.48	0.05	-2.41	-5.30	-14.80	-24.66

Source: Barclays, Bloomberg, SunGard

A tough year: The global commodity rout had a significant impact across asset classes that are influenced by energy prices. The anticipation of a Fed interest rate increase, and subsequent reaction, caused the dollar to strengthen across the board. And despite its non-existent yield, cash was a strong performer in 2015.

Year-end returns*



U.S. EQUITIES Large-cap growth stocks led the way, with the Nasdaq composite topping its tech-bubble high. The collapse in crude oil and natural gas caused significant underperformance in energy stocks.

U.S. equity returns

	Value	Core	Growth
Large cap	-3.13%	1.38%	5.52%
Midcap	-6.65%	-2.18%	2.02%
Small cap	-6.70%	-2.00%	2.74%

Returns by sector

Energy	-21.71%
Materials	-7.54%
Industrial	-1.98%
Consumer discretionary	8.98%
Consumer staples	6.02%
Health care	7.10%
Financials	-0.71%
Information technology	5.27%
Telecom	3.51%
Utilities	-5.82%

U.S. FIXED INCOME Shorter-duration and higher-rated securities performed better in 2015, while junk bonds were dragged down by their energy exposure.

Returns by quality/maturity

	Short duration	Interm. duration	Long duration
High quality	0.54%	0.83%	-0.97%
Med. quality	1.01%	-0.63%	-4.87%
Low quality	-1.35%	-4.64%	-3.67%

Returns by type

U.S. broad market	0.604%
Treasury master	0.831%
U.S. agency composite	1.011%
Corporate master	0.572%
Mortgage master	1.456%
CMBS	1.134%
U.S. Treasury Infl. Linked	-1.714%
High yield master II	-4.643%

CURRENCIES The U.S. dollar was stronger against all G-10 currencies in 2015. Emerging markets and commodity-influenced currencies dropped sharply.

Best/worst currencies vs. the dollar

Israeli shekel	0.18%
Hong Kong dollar	0.06%
Japanese yen	-0.37%
Swiss franc	-0.78%
Taiwanese dollar	-3.82%
Russian ruble	-20.30%
Colombian peso	-25.15%
South African rand	-25.20%
Brazilian real	-32.94%
Argentine peso	-34.54%

COMMODITIES Crude oil's drop led the collapse of commodity prices. The Bloomberg Commodity index hit a decade-plus low.

Returns by sector

Energy	-38.87%
Precious metals	-11.45%
Industrial metals	-26.88%
Livestock	-18.83%
Grains	-19.42%
Softs	-9.85%

Source: Pensions & Investments 1/11/16

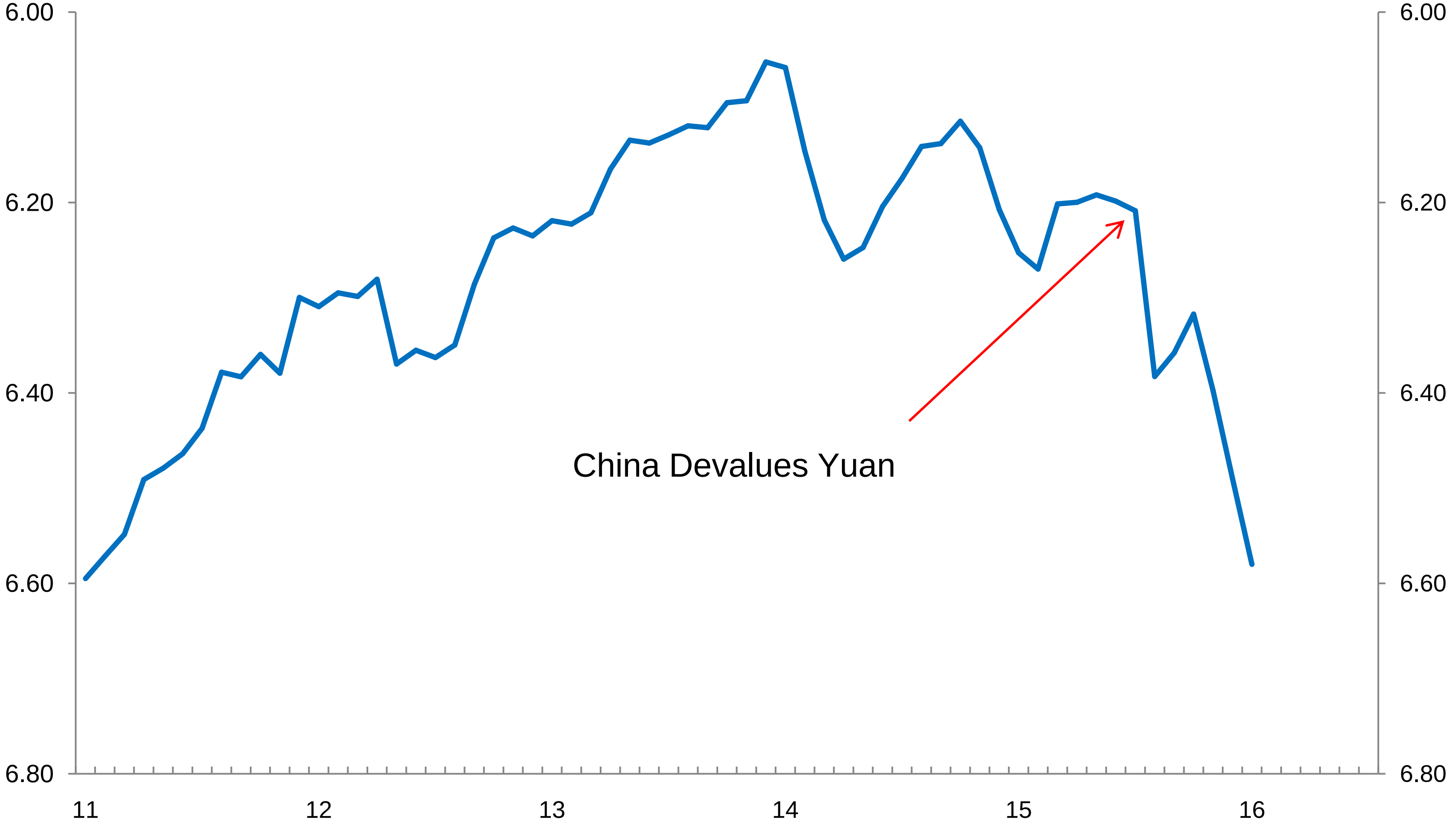
Equity Market

S&P 500 Price Performance

WCB

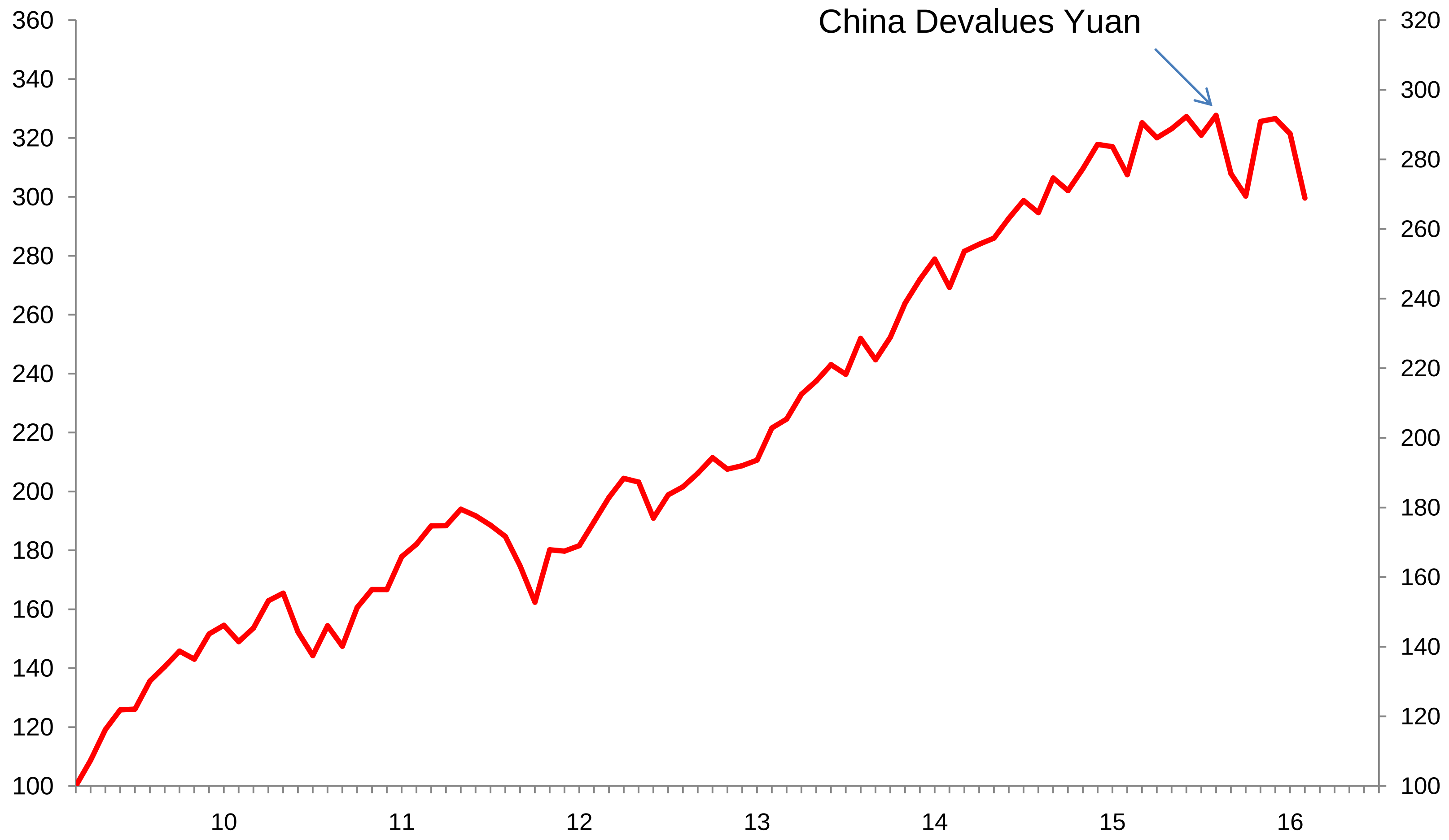
Chinese Yuan vs U.S. Dollar

WCB

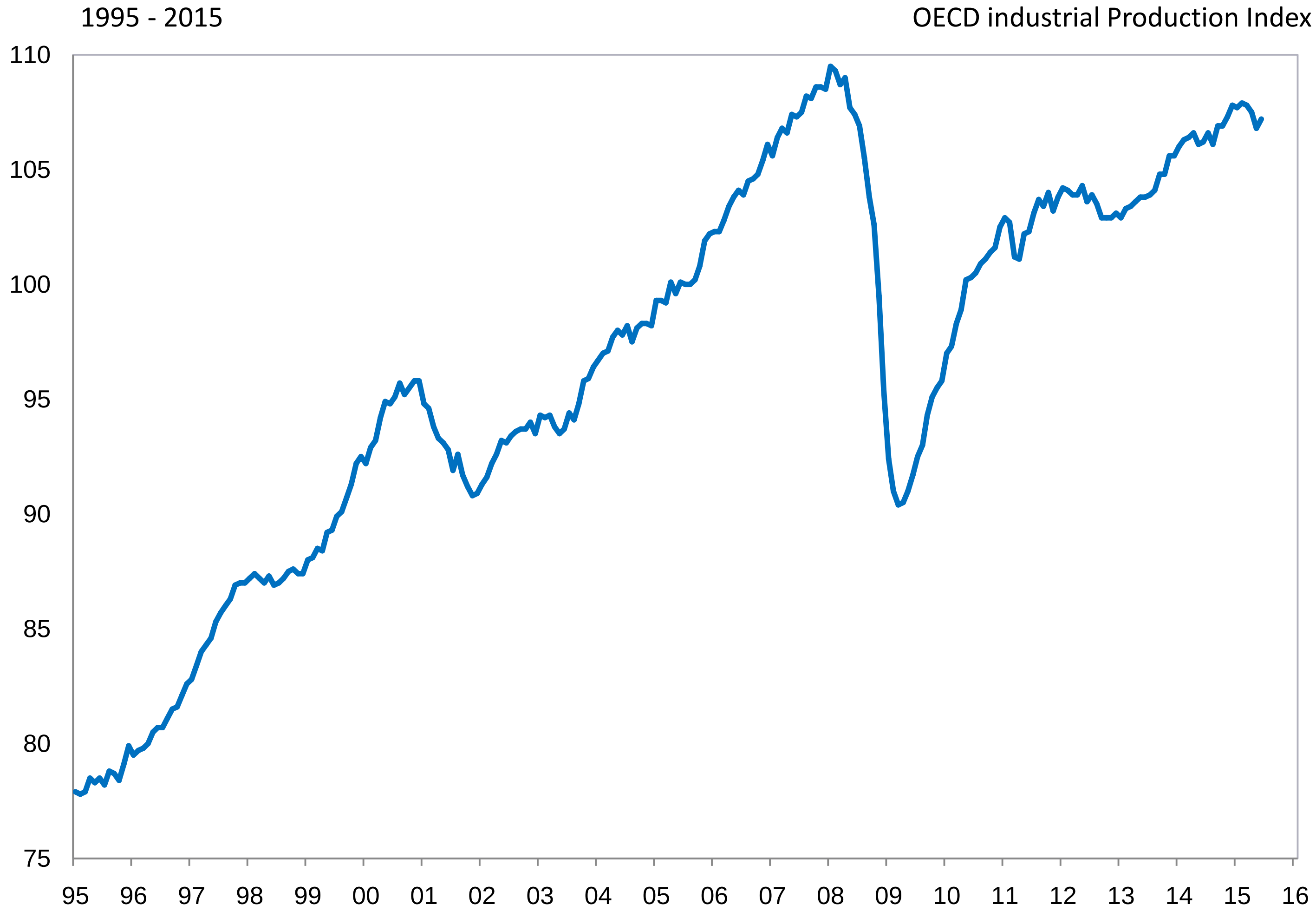


Source: Bloomberg,

Since Stock Market Bottom March 2009
Value of $100 Invested 3-31-09 thru 1-27-16



Source: Bloomberg,



Source: Bloomberg

Developed Economies (OECD) GDP Estimate

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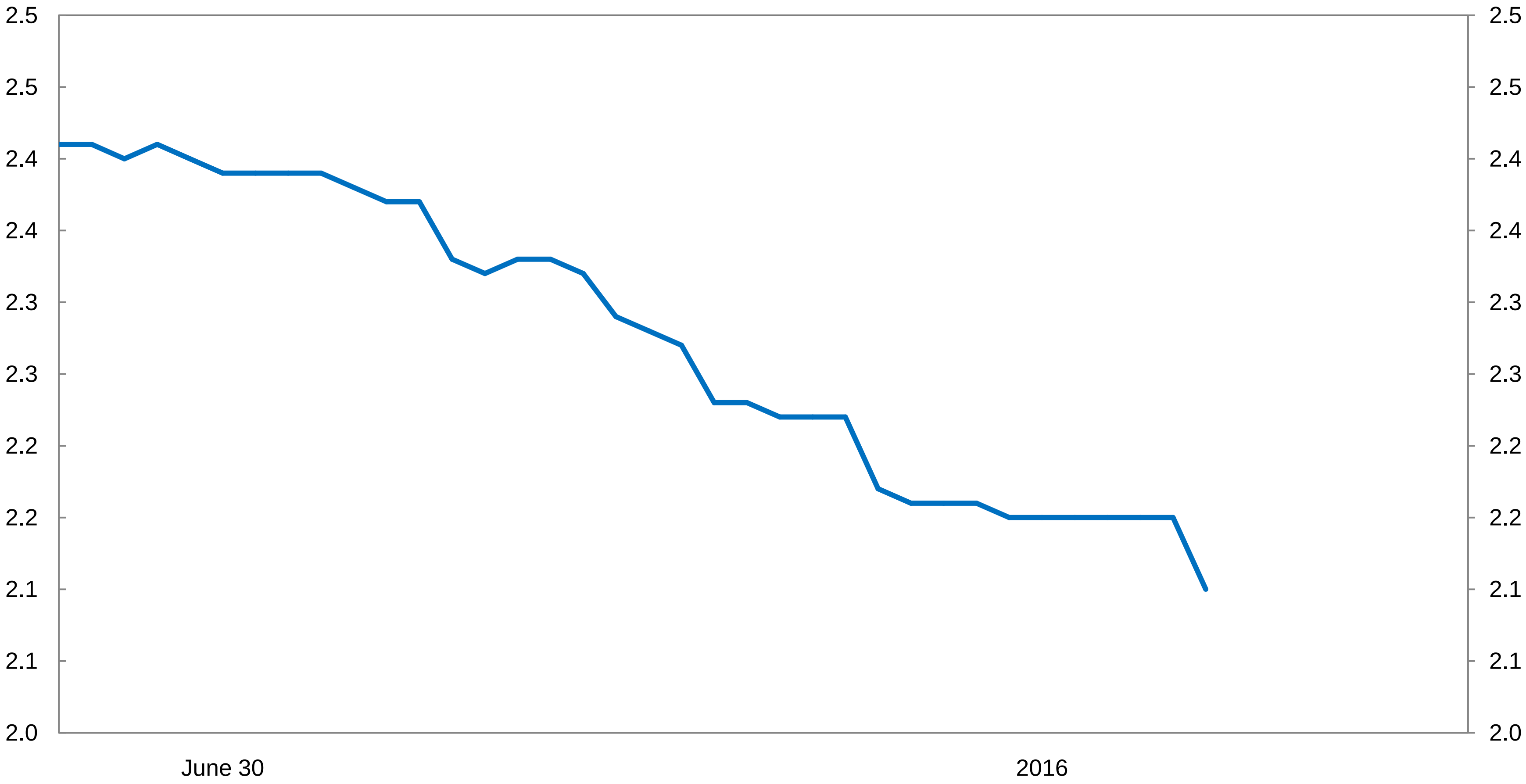
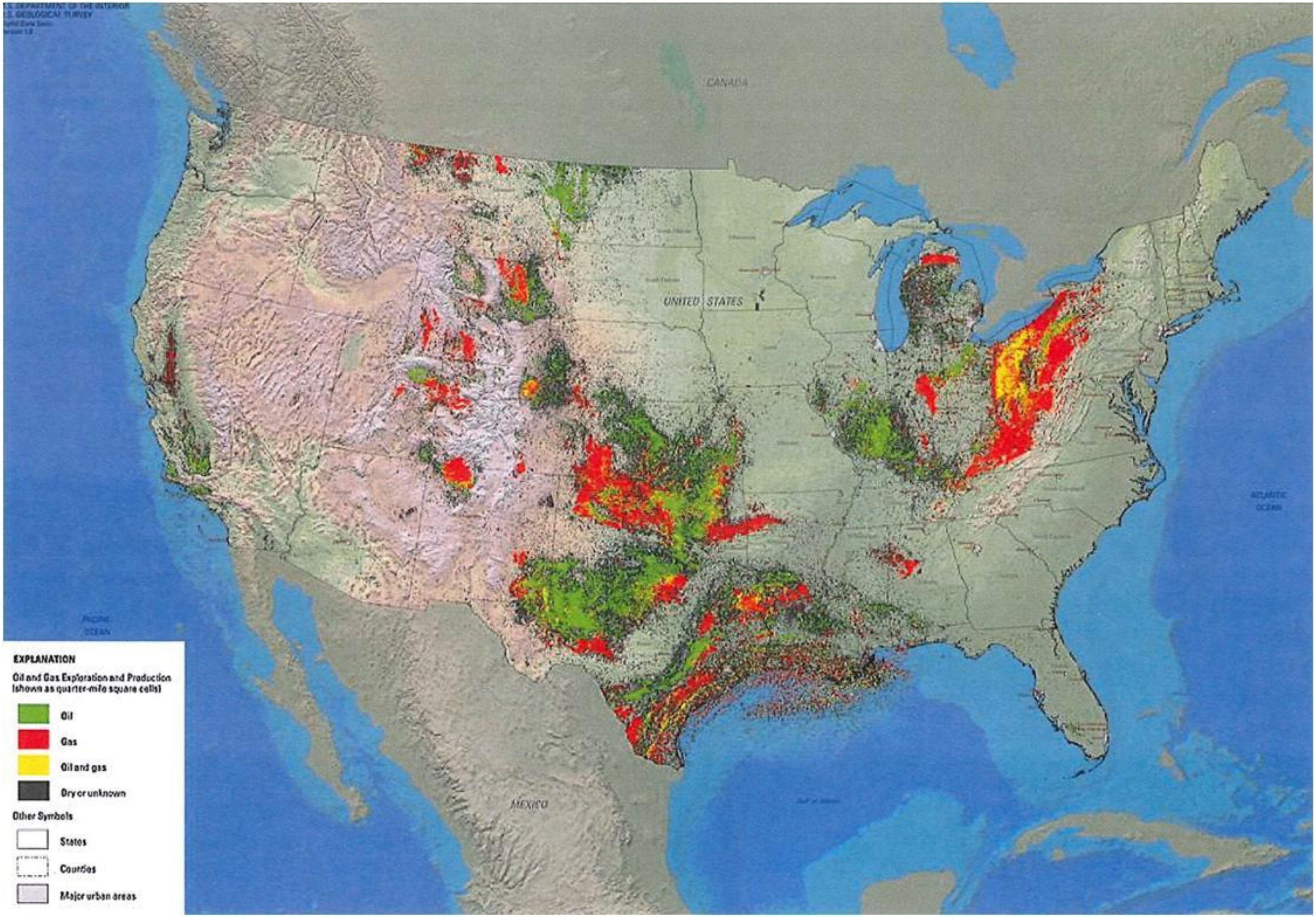
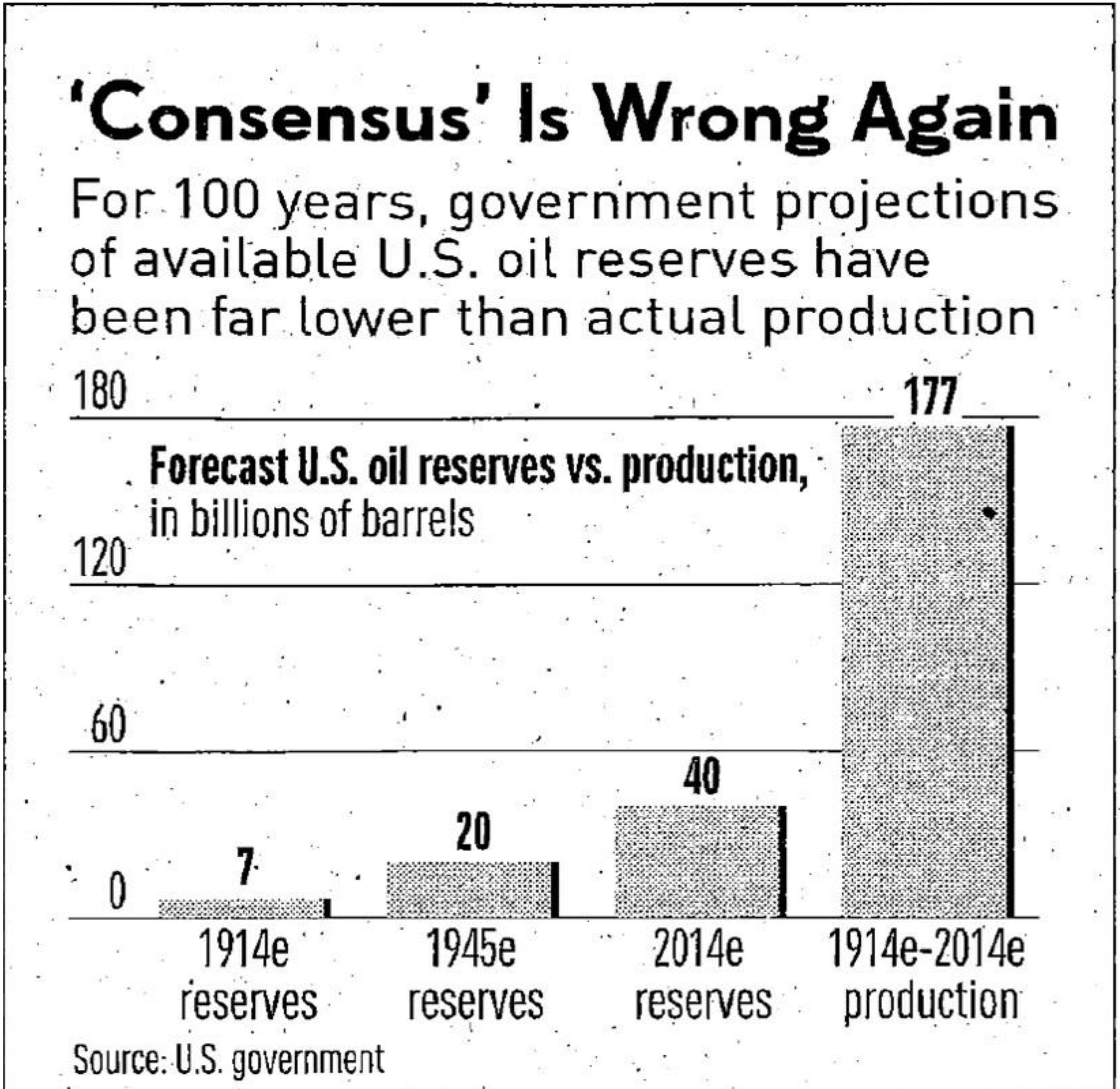
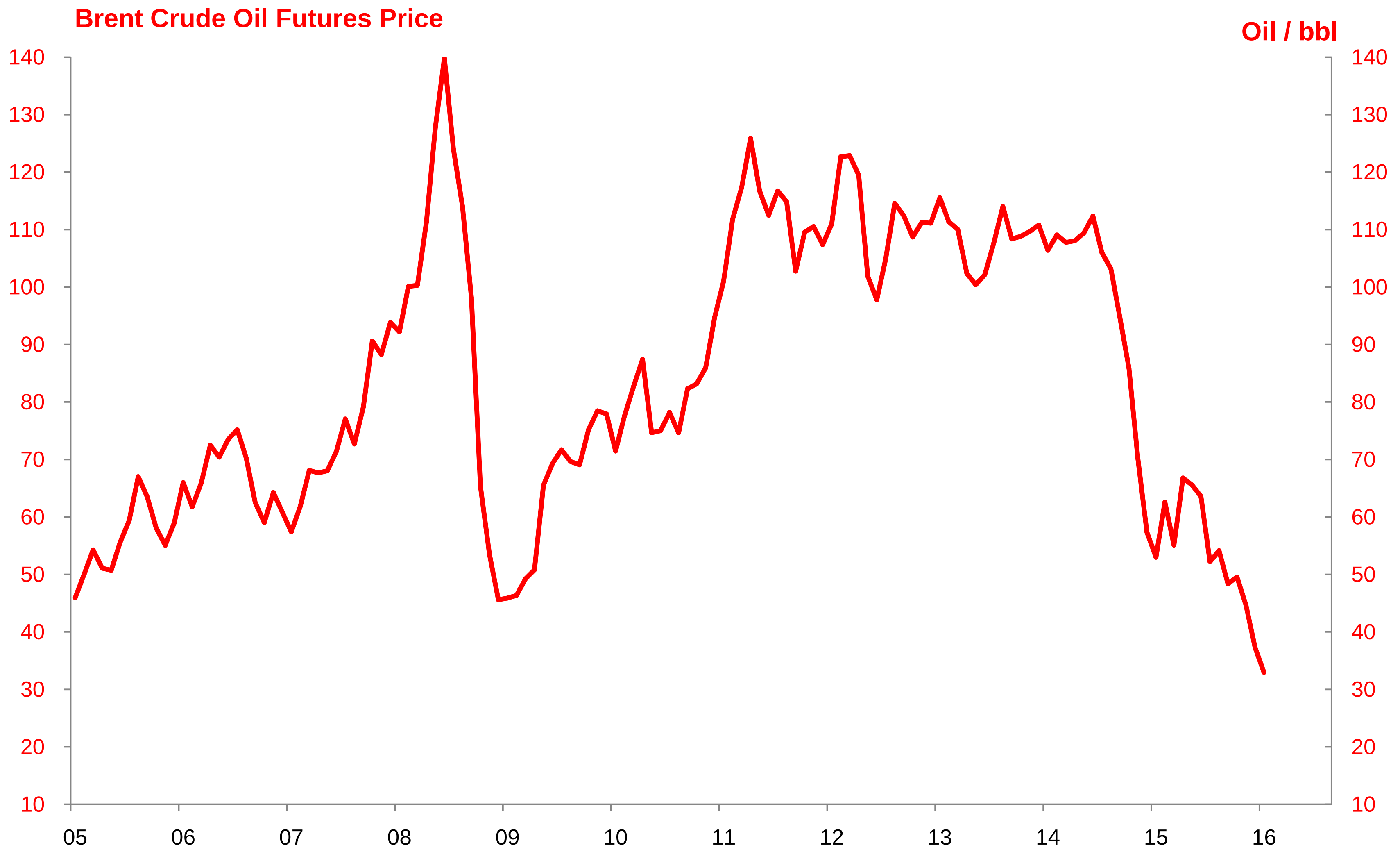




CANADA
UNITED STATES
MEXICO
EXPLANATION
Oil and Gas Exploration and Production (shown as quarter-mile square cells)
Oil
Gas
Oil and gas
Dry or unknown
Other Symbols
States
Counties
Major urban areas



Source: IBD 1-6-16



Source: Yardini Research, JP Morgan, Bloomberg

U.S. Dollar vs Crude Oil Price

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Source: Yardini Research, JP Morgan, Bloomberg

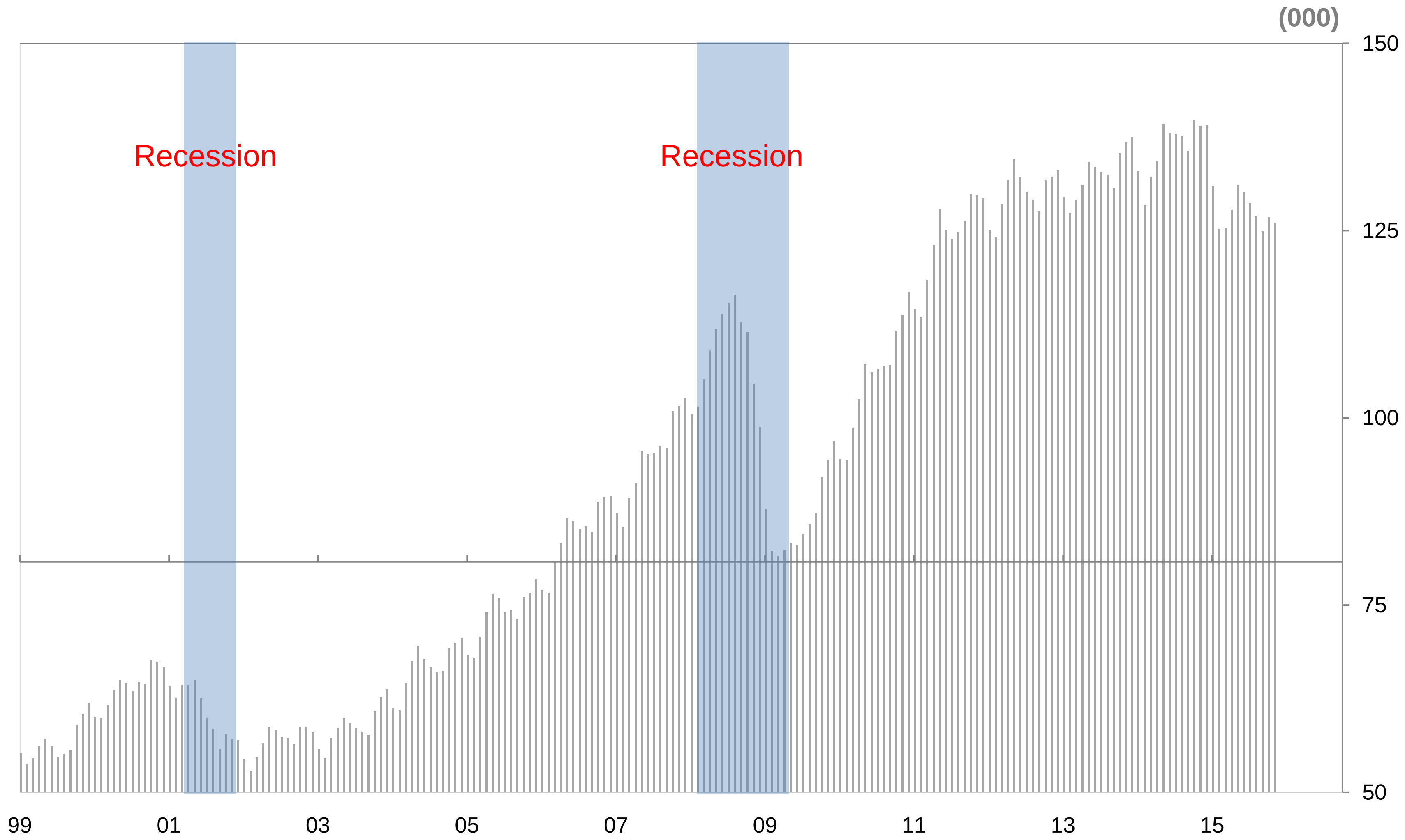
U.S Dollar Index

WCB

Source: Bloomberg

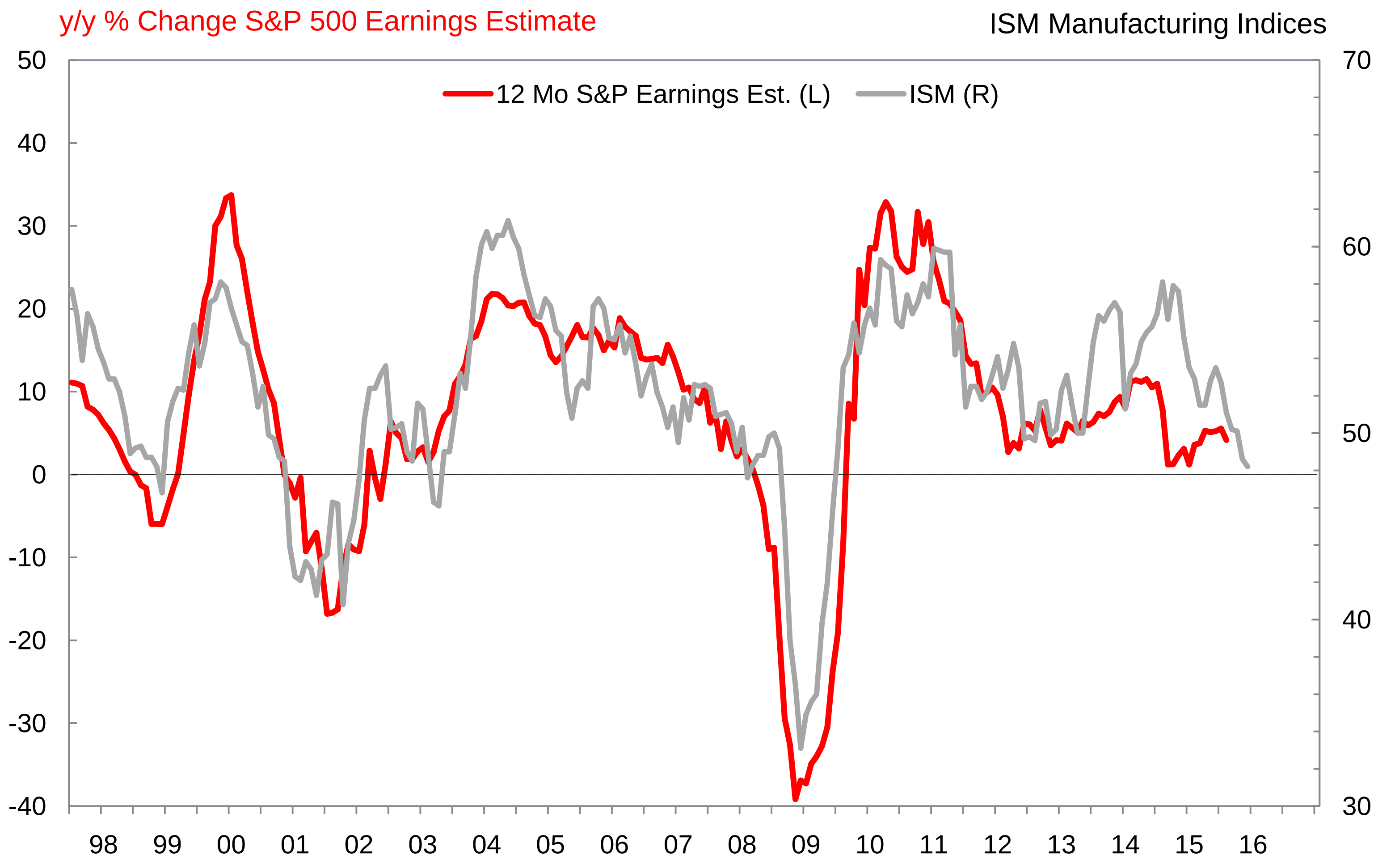
Total U.S. Exports
3 Month Average

WCB



Source: Bloomberg, Bureau of Labor Statistics,

Corporate Earnings vs Manufacturing

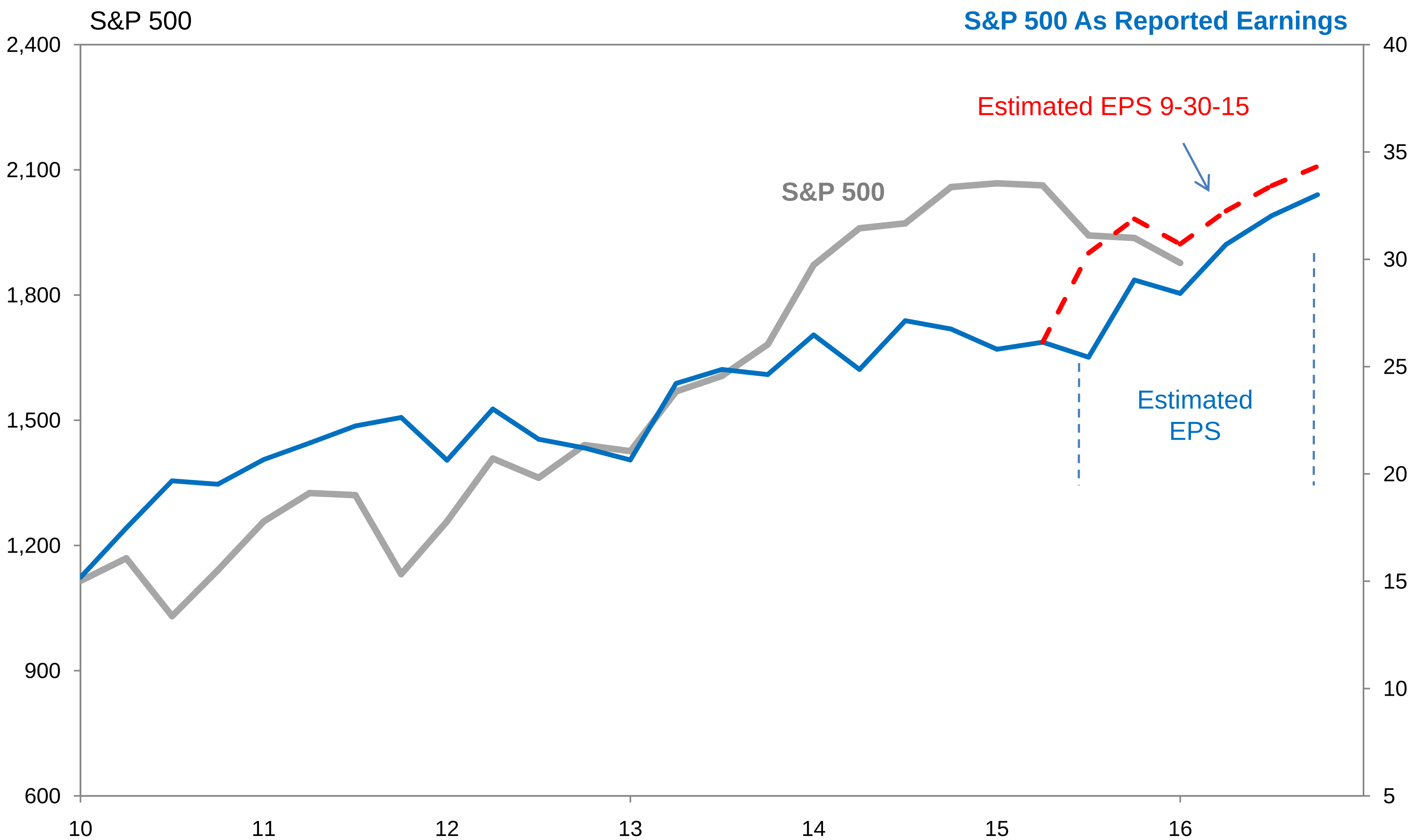


Source: Bloomberg

S&P 500 Earnings vs Stocks

WCB

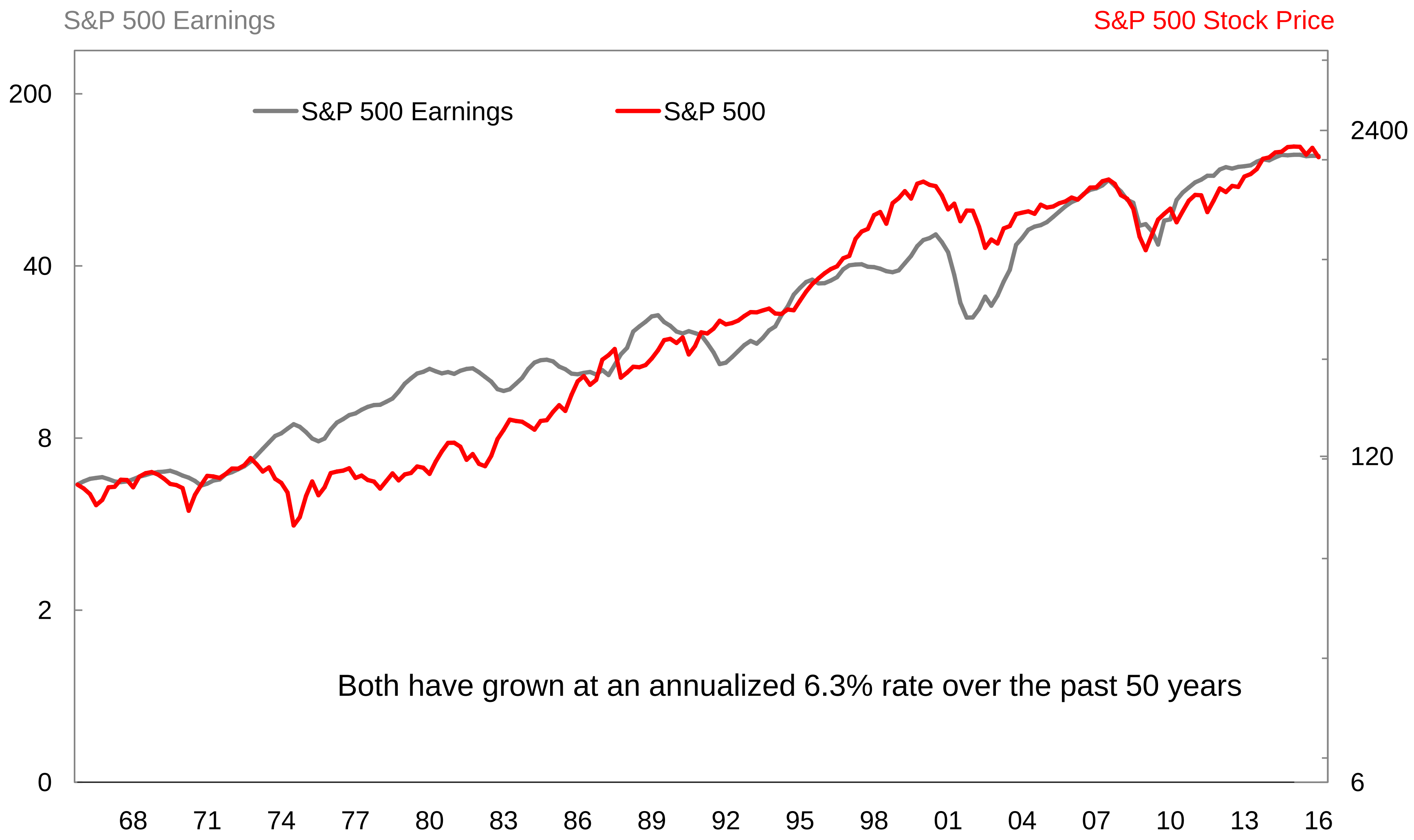
THE STOCK MARKET IS BEING DRIVEN BY EARNINGS



Source: Gerring Wealth Management, Standard and Poors

S&P 500 Earnings vs Price

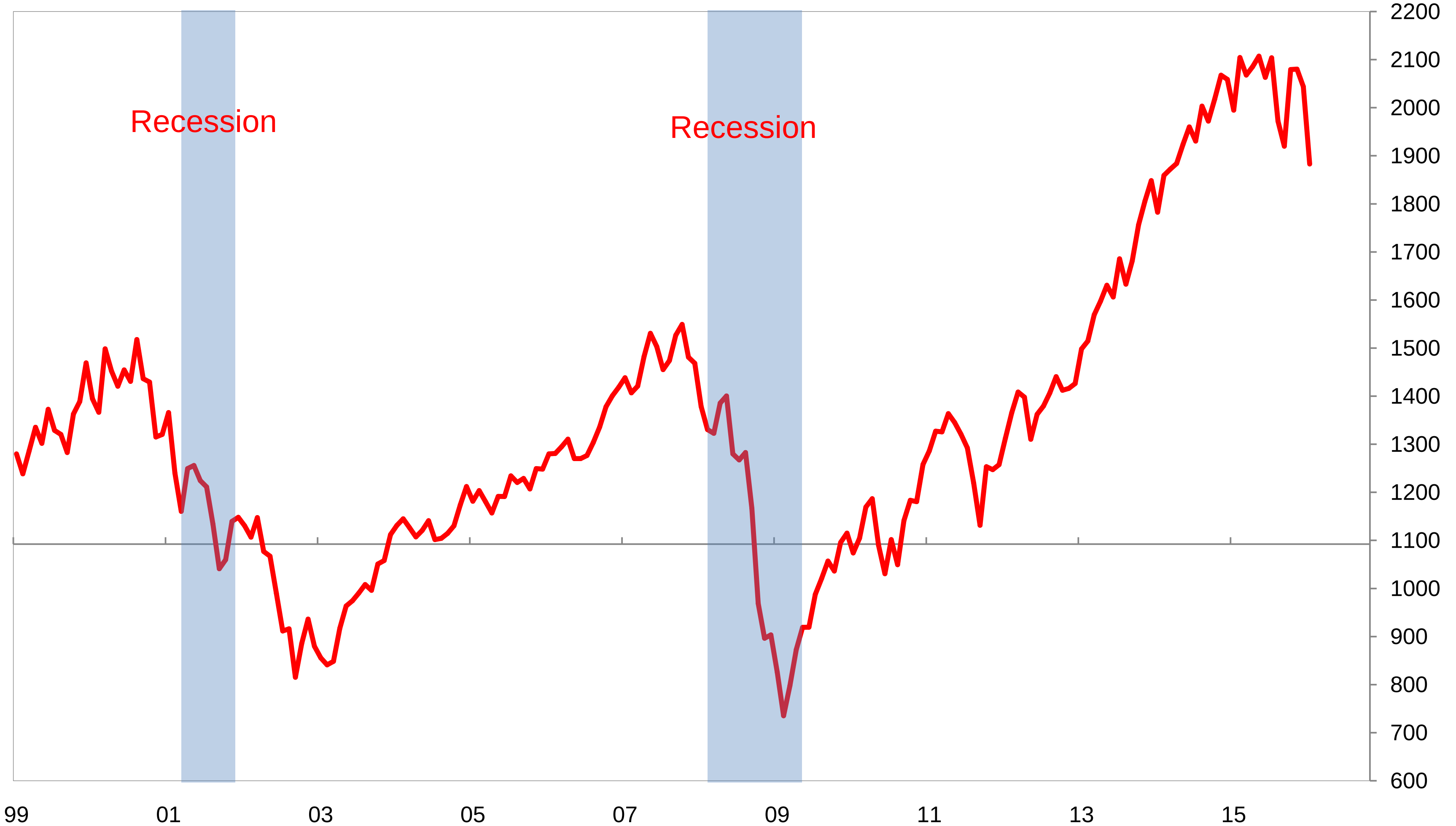
WCB



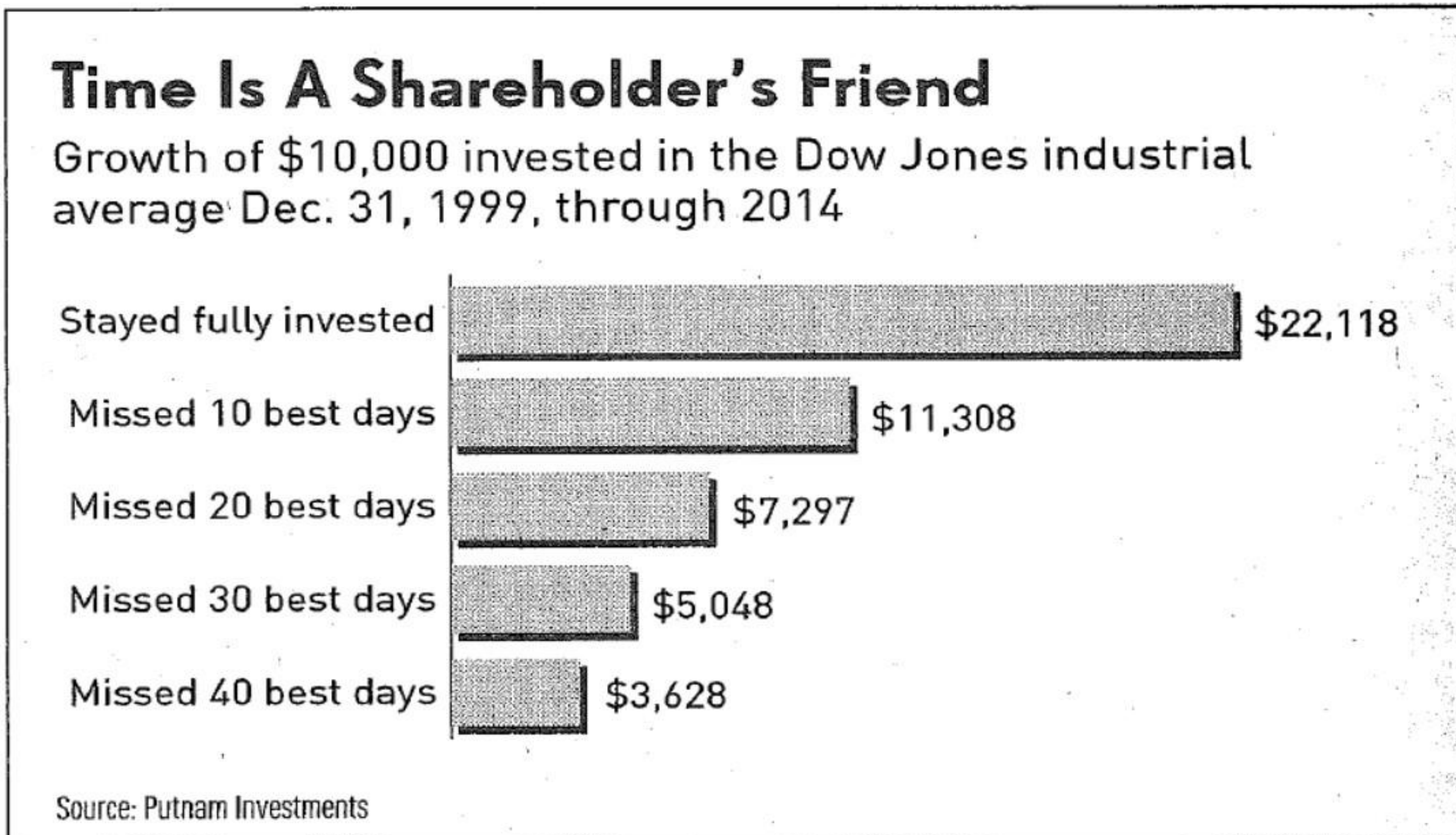
Source: Bloomberg, WCB Computations

S&P 500
Monthly Close

WCB



Source: Bloomberg, Bureau of Labor Statistics,


Time Is A Shareholder's Friend
Growth of $10,000 invested in the Dow Jones industrial average Dec. 31, 1999, through 2014
Stayed fully invested
$22,118
Missed 10 best days
$11,308
Missed 20 best days
$7,297
Missed 30 best days
$5,048
Missed 40 best days
$3,628
Source: Putnam Investments

IBD 9-4-15

U.S. Real GDP Growth

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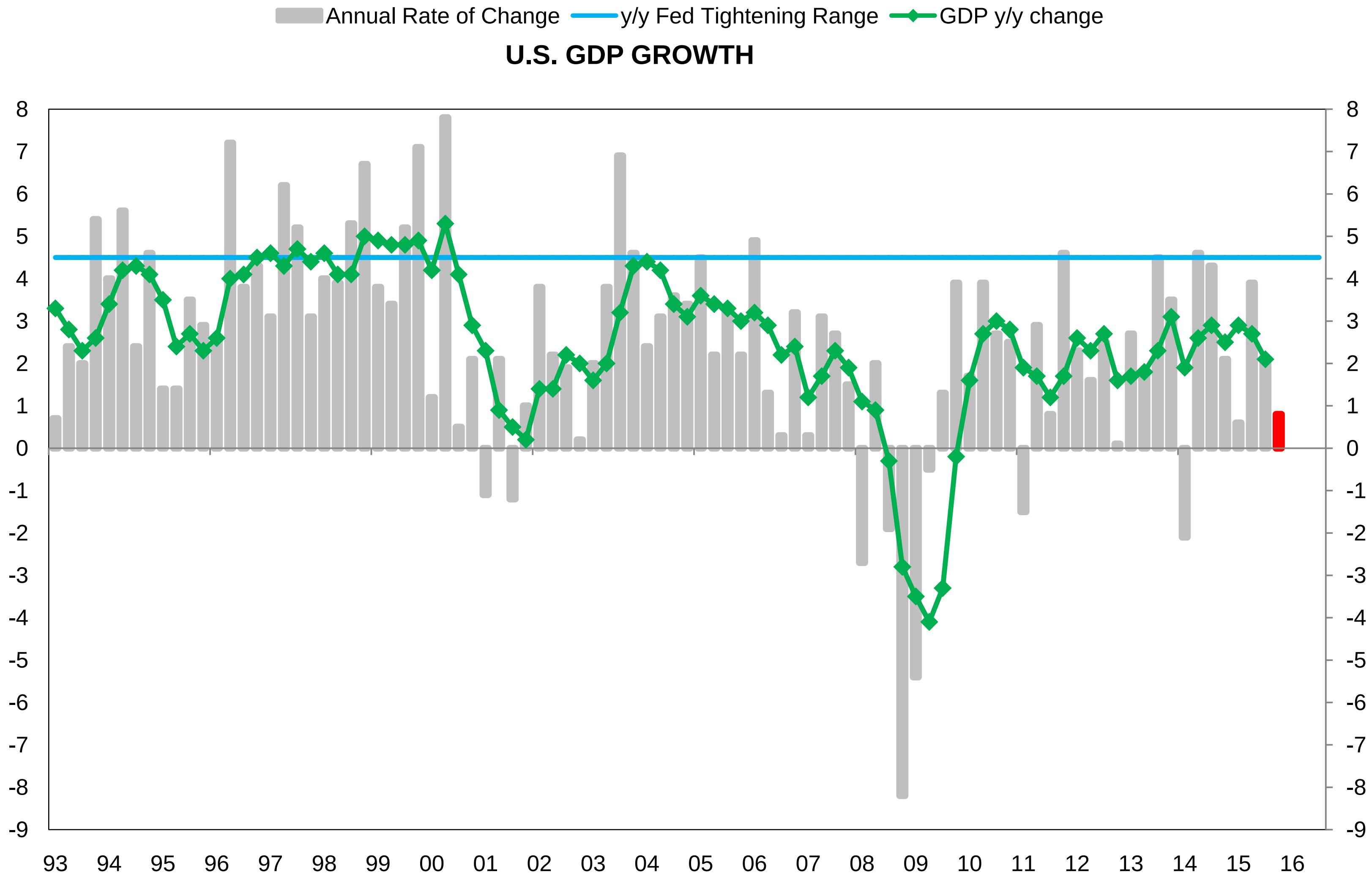
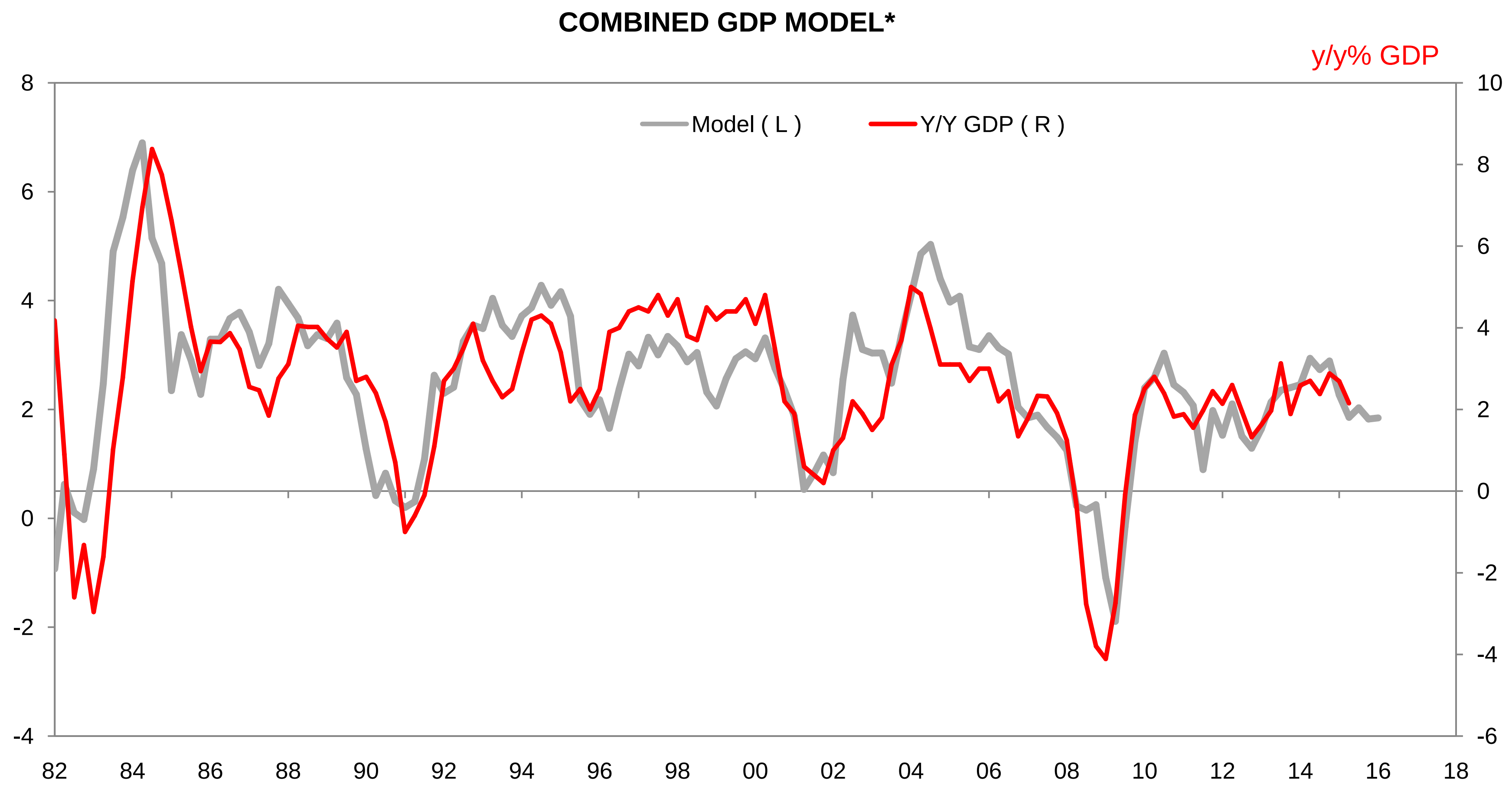


Source: Bloomberg

* Housing Starts, Yield Curve, ISM Mfg, Sales Expectations, Real M2, LEI, Philly Fed Business Outlook



Source: Bloomberg, WCB Computations

S&P 500 Earnings Peak

% Above Prior Post WWII Non-Disinflation Cycle Peak

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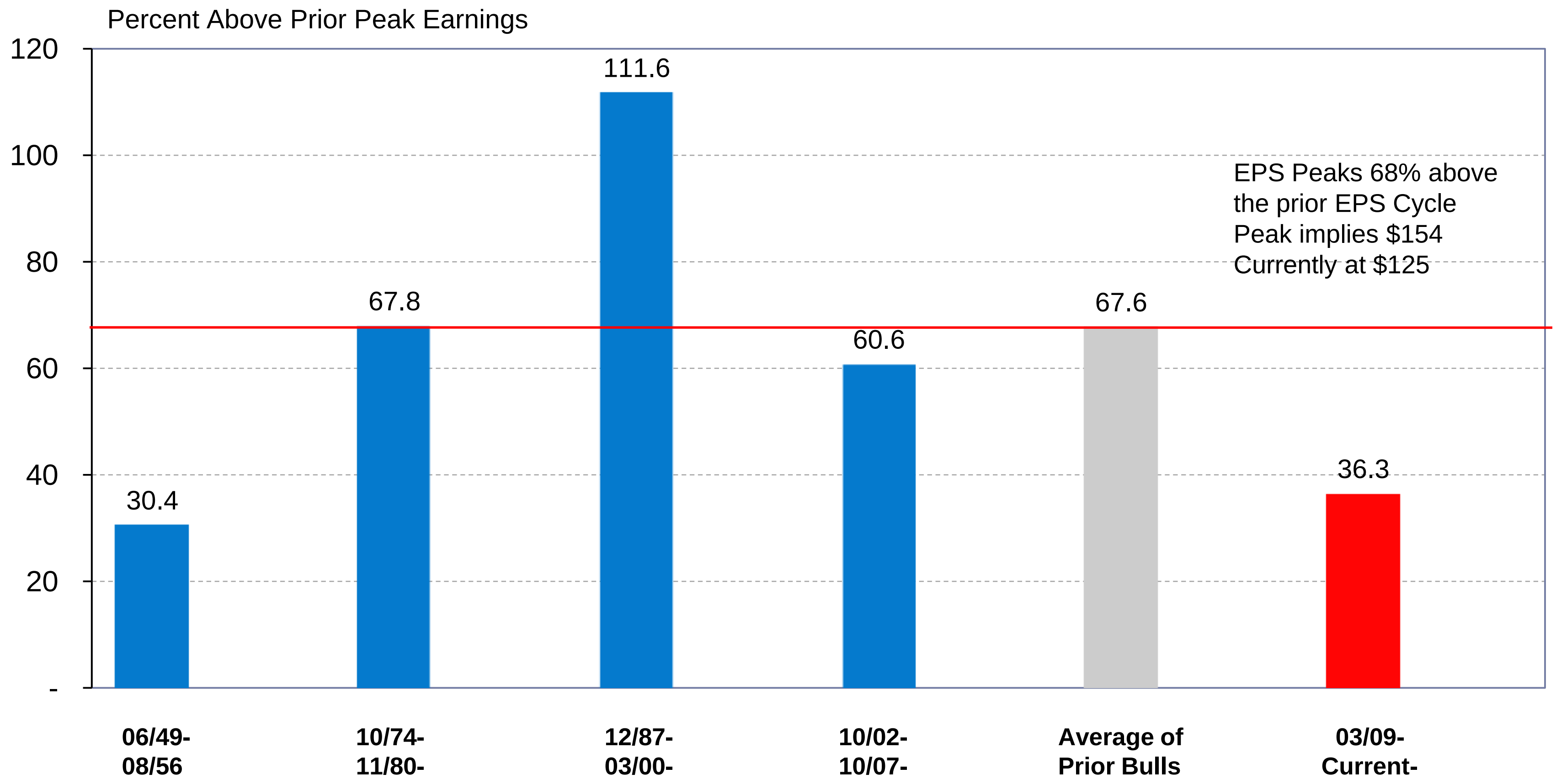
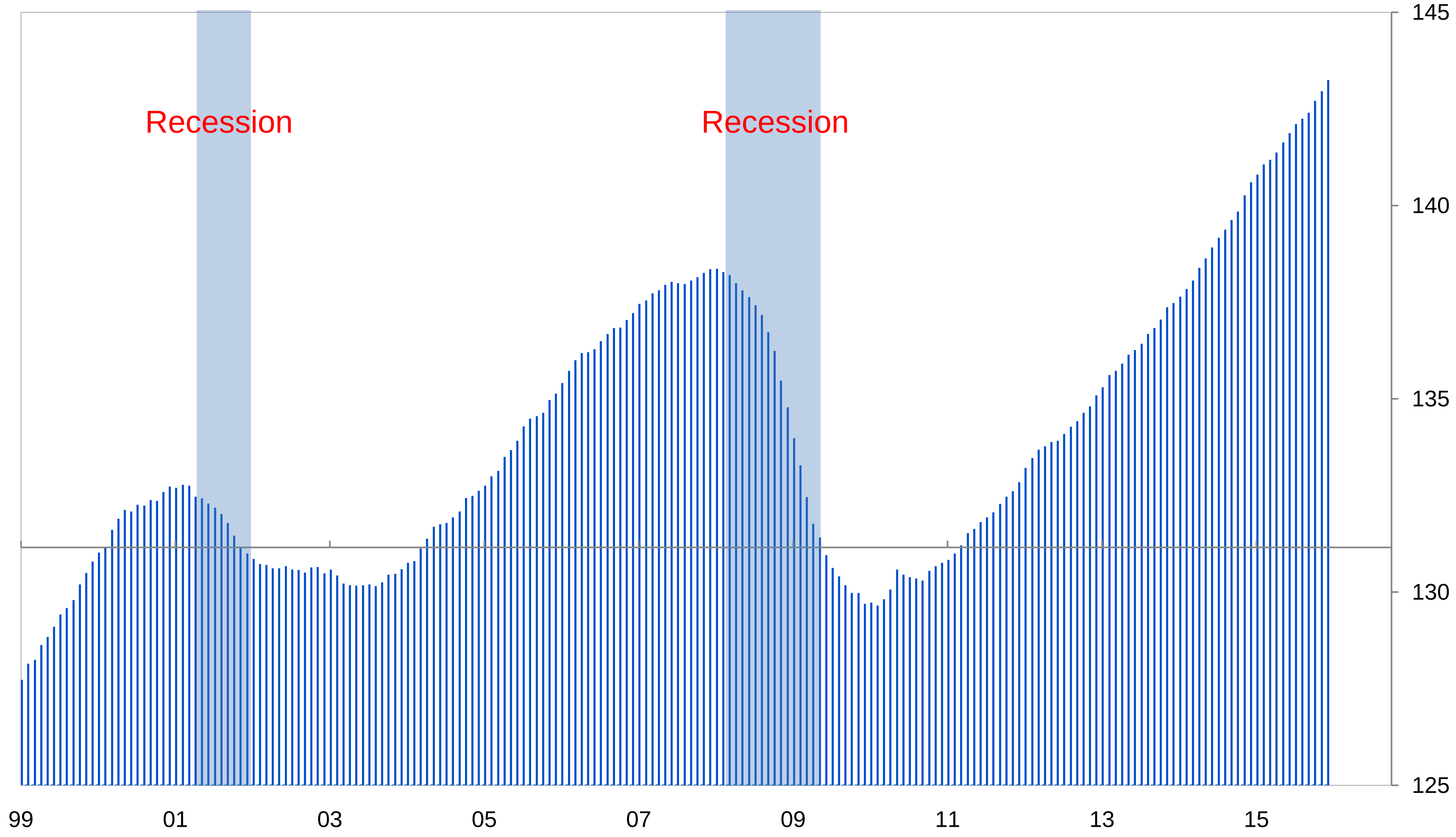


Source: Fundstrat Global Advisors per Bloomberg, Factset

Total U.S. Employees

WCB

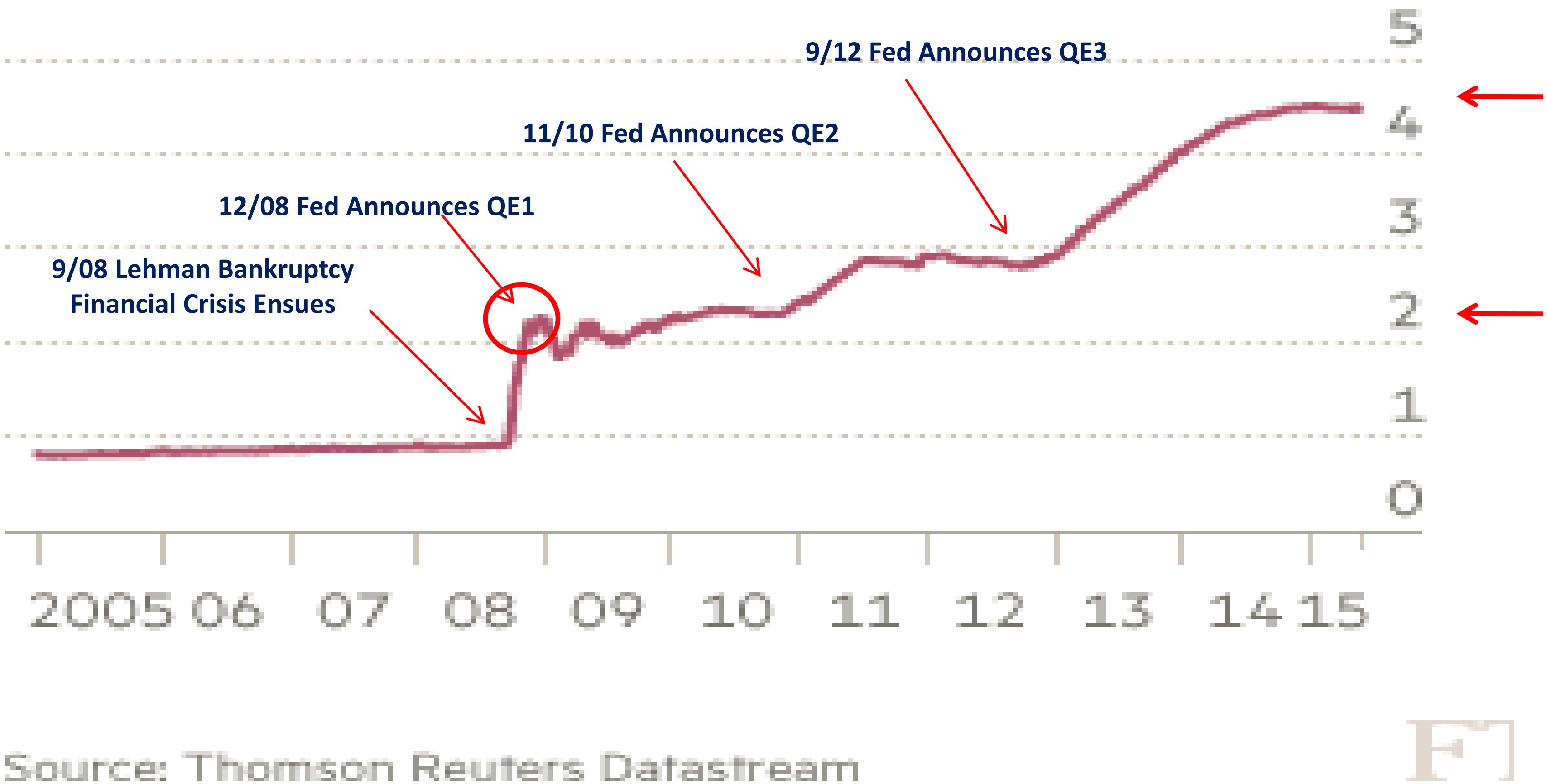
Nonfarm Payrolls



Source: Bloomberg, Bureau of Labor Statistics,

Fed's Balance Sheet is Bloated by Crisis-Fighting

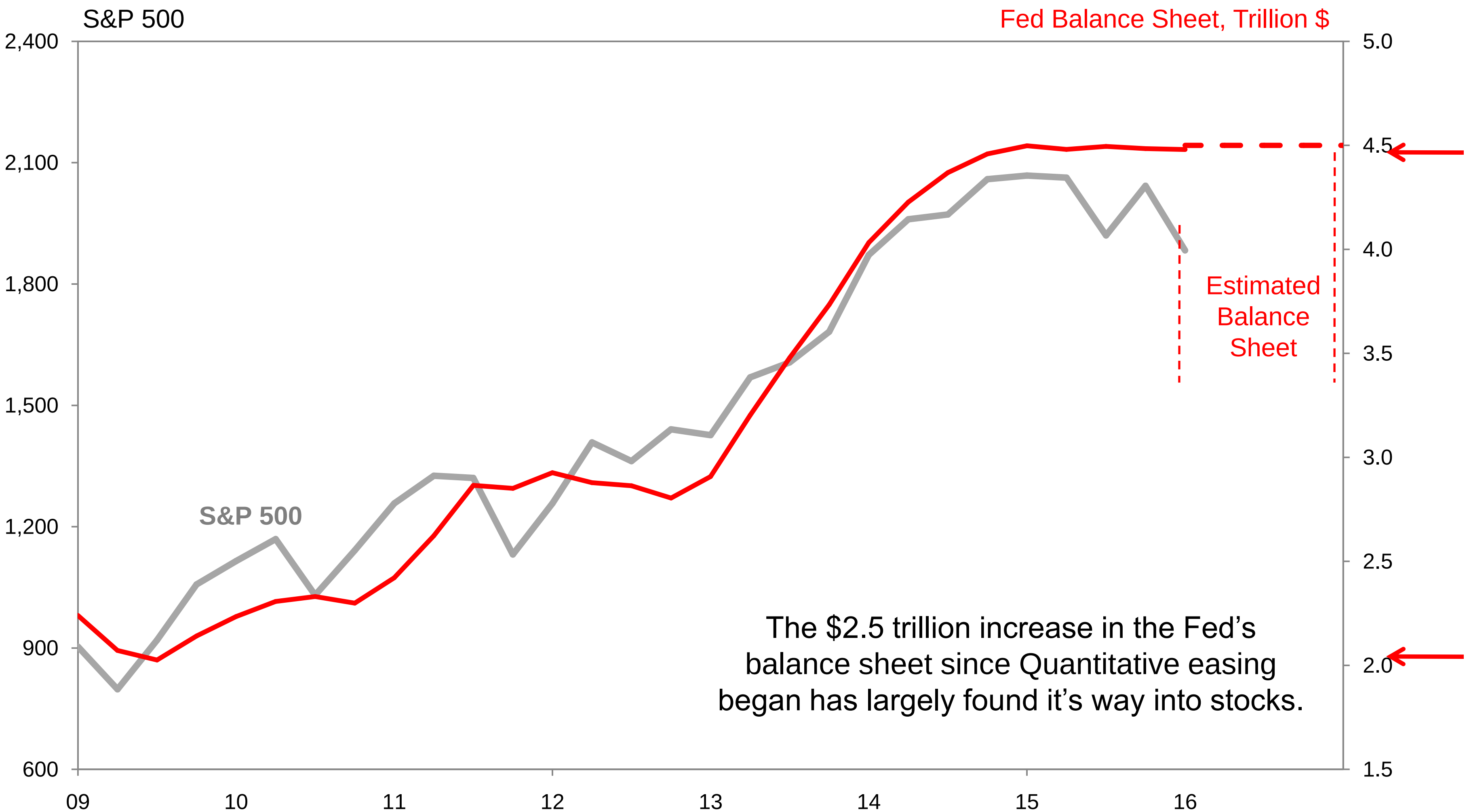
Federal Reserve Total Assets ($Tn)



Fed Balance Sheet Assets vs Stocks

WCB

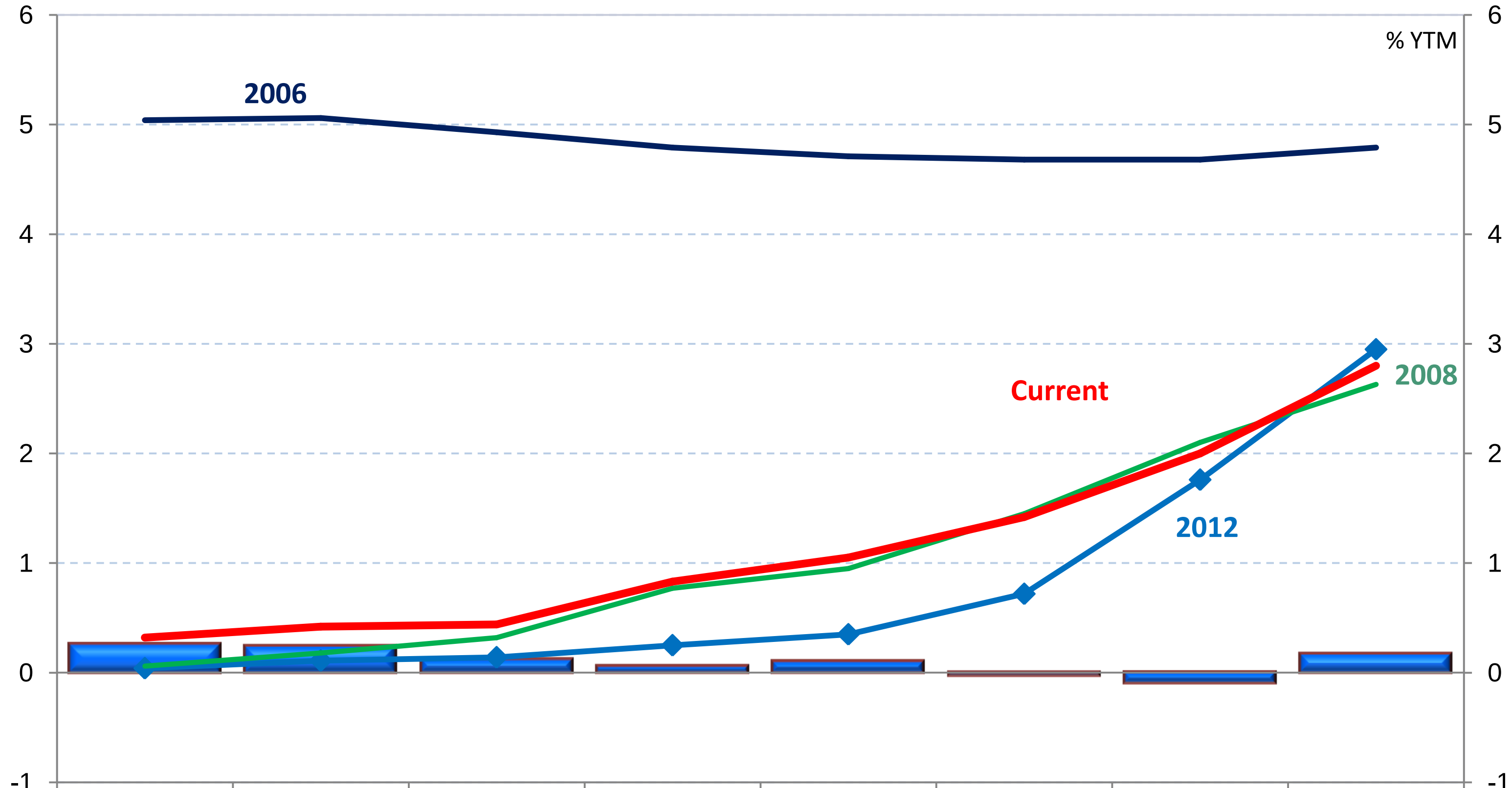
THE STOCK MARKET IS BEING DRIVEN BY THE FED BALANCE SHEET EXPANSION



Source: Gerring Wealth Management, Federal Reserve Bank of Cleveland 09/2014

Treasury Yield Curves

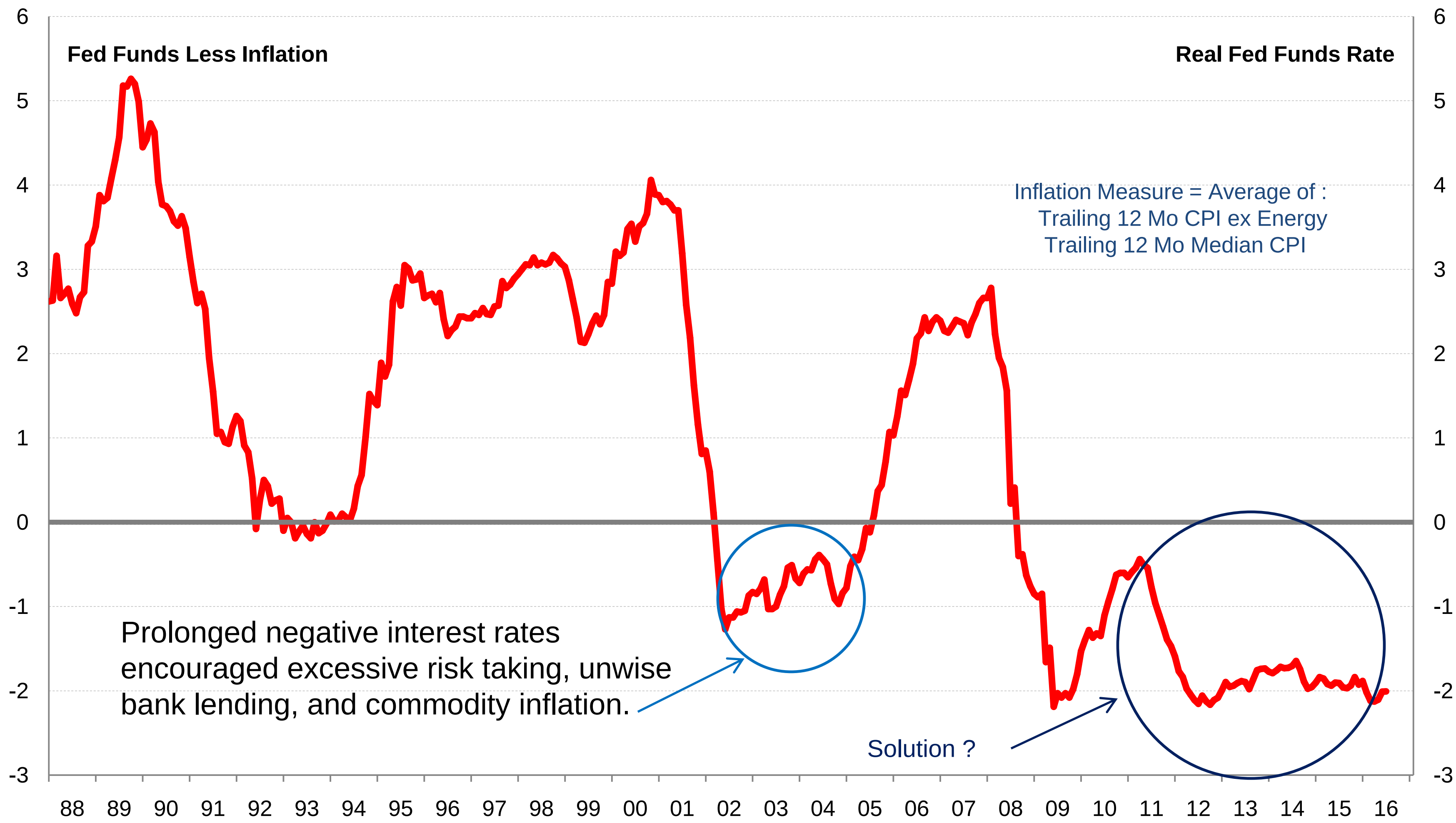
Treasury Yield Curves - At Various Year Ends and Current



	3 mo	6 mo	1yr	2 yr	3 yr	5 yr	10 yr	30 yr
7 year Change	0.26	0.24	0.12	0.06	0.1	-0.03	-0.1	0.17
12/31/2012	0.04	0.11	0.14	0.25	0.35	0.72	1.76	2.95
12/31/2006	5.04	5.06	4.93	4.79	4.71	4.68	4.68	4.79
12/31/2008	0.06	0.18	0.32	0.77	0.95	1.45	2.1	2.63
Current	0.32	0.42	0.44	0.83	1.05	1.42	2	2.8

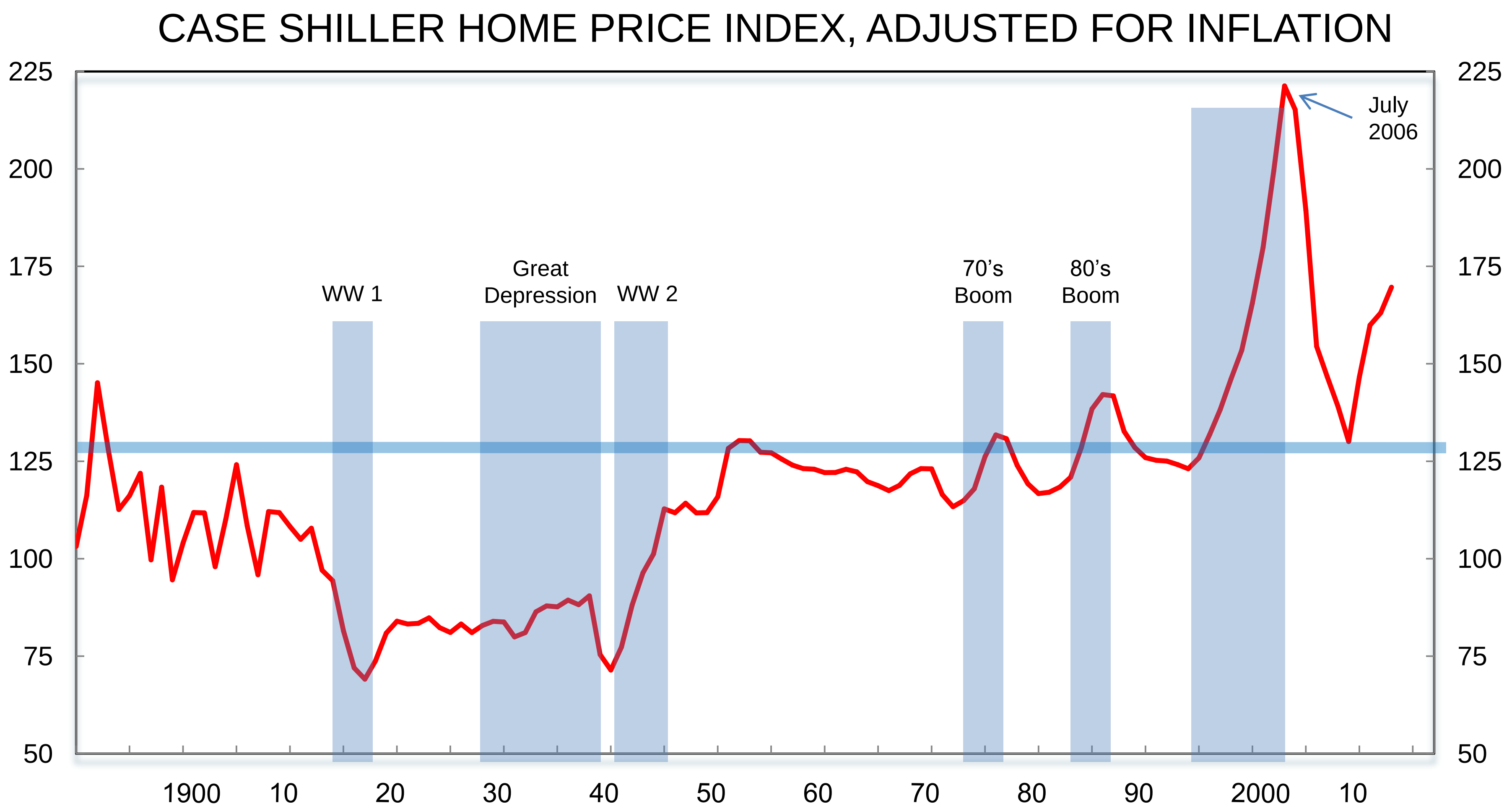
Source: Bloomberg

Historical Fed Monetary Policy

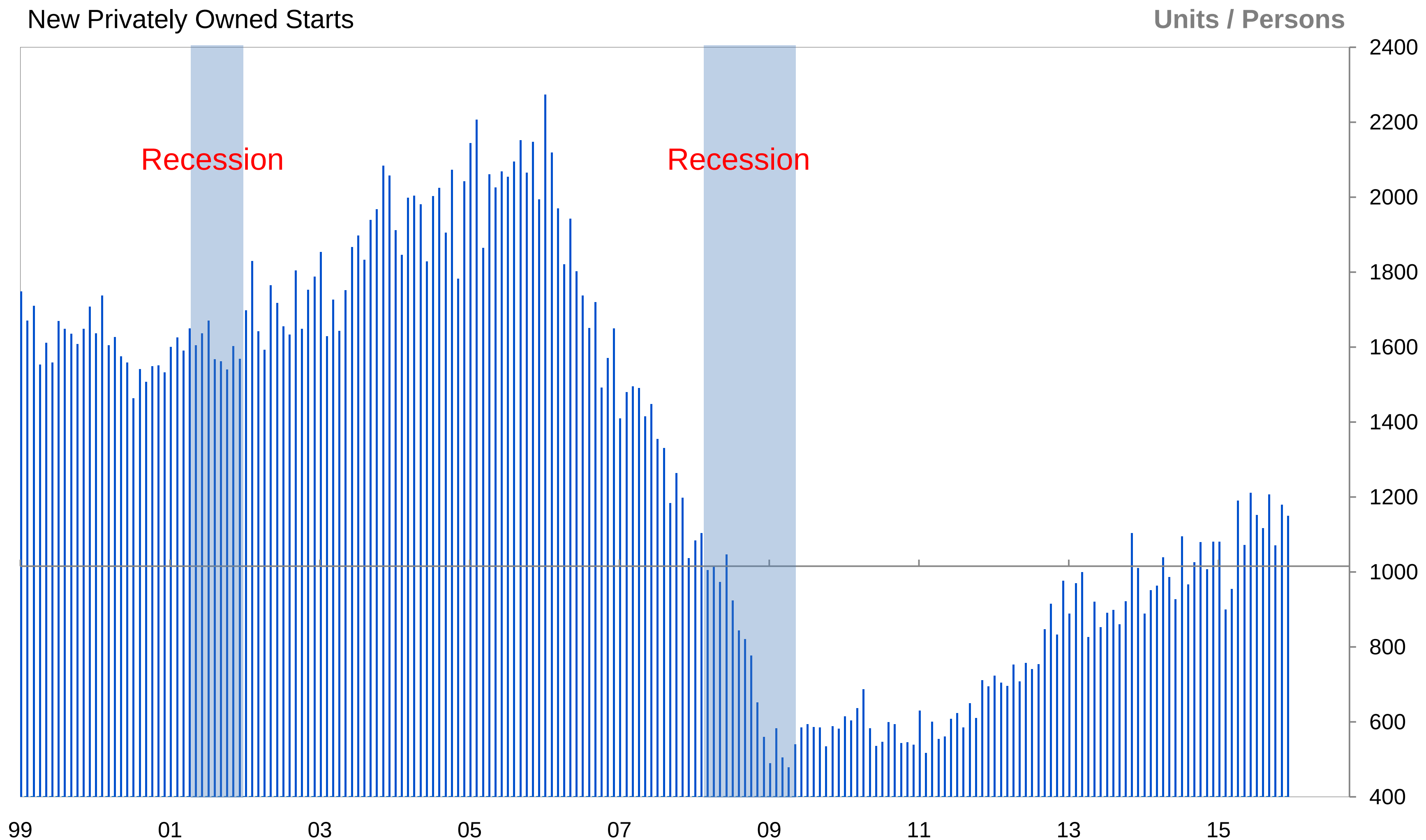


Ironically, now the Fed is encouraging risk taking and inflation through repressing interest rates.

Source: Salomon Smith Barney, Bloomberg, Federal Reserve, Institute for Supply Management, Bureau of Labor Statistics, WCB computations



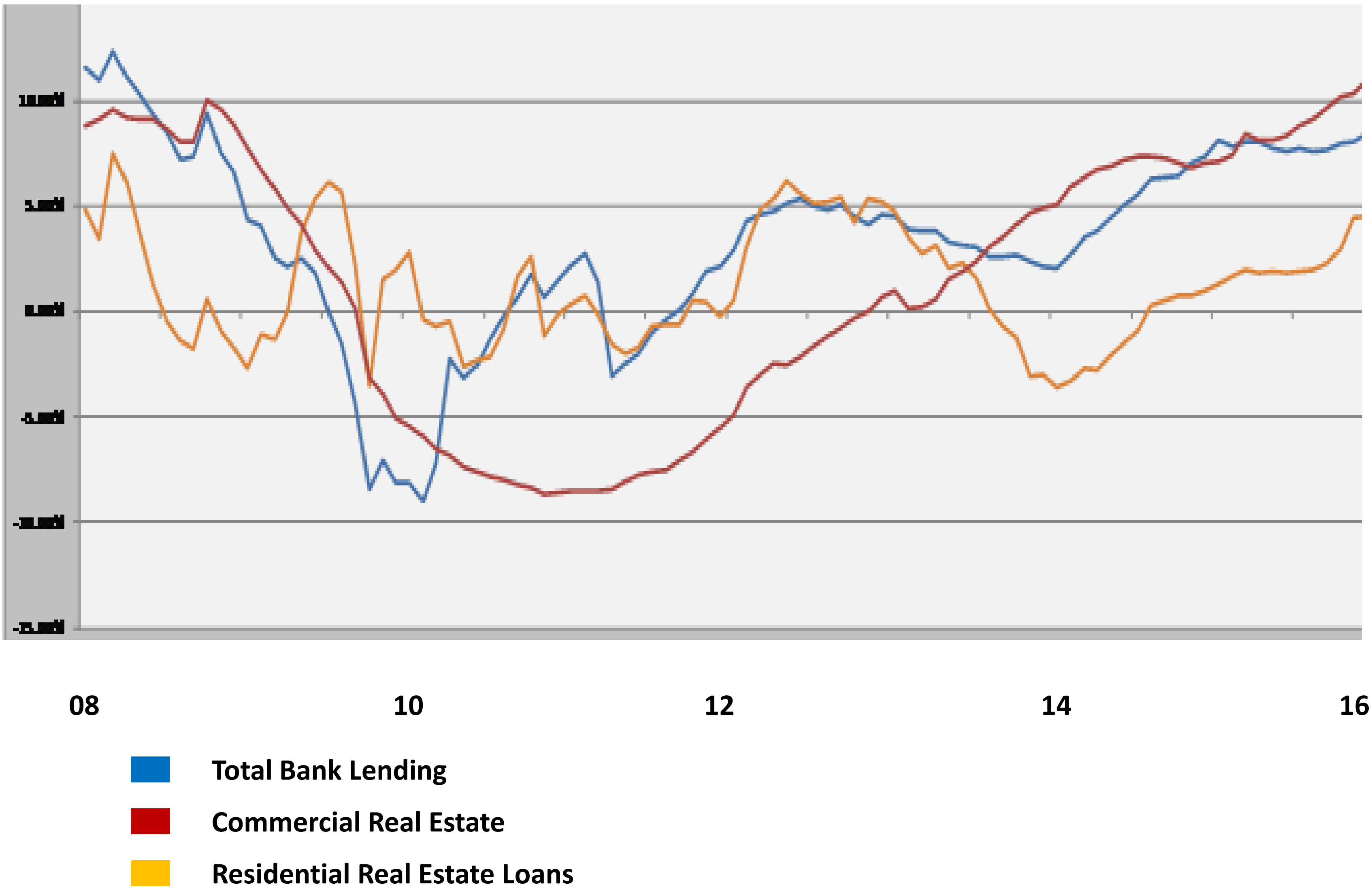
Source: 2006 Irrational Exuberance by Robert Shiller, multpl.com/sitemap; in October 2015 dollars



Source: Bloomberg, Bureau of Labor Statistics,

Bank Lending by Type
Year over Year Jan 2008 to Dec 2015

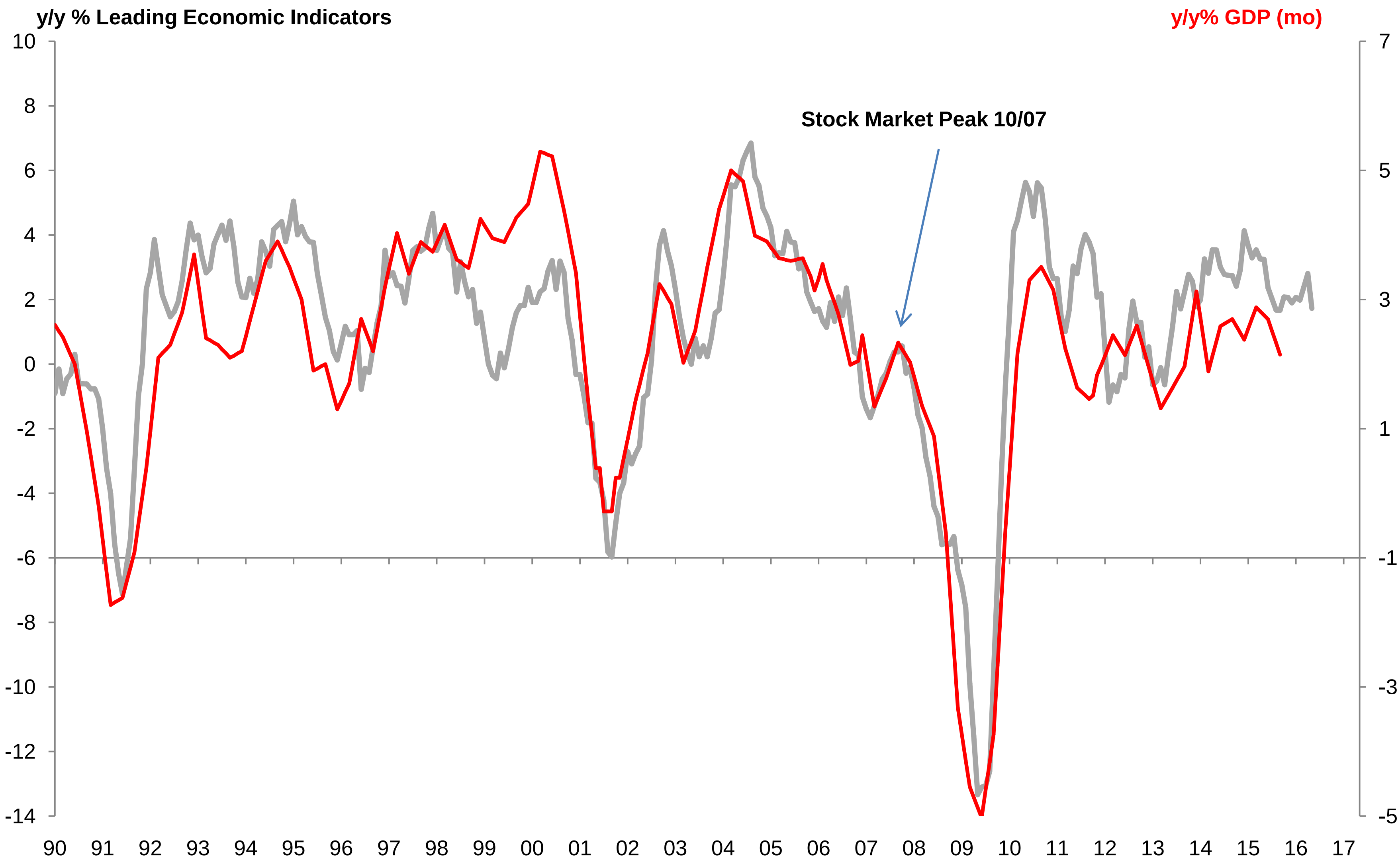
WCB



Source: Federal Reserve, SISR,

Leading Economic Indicators vs GDP

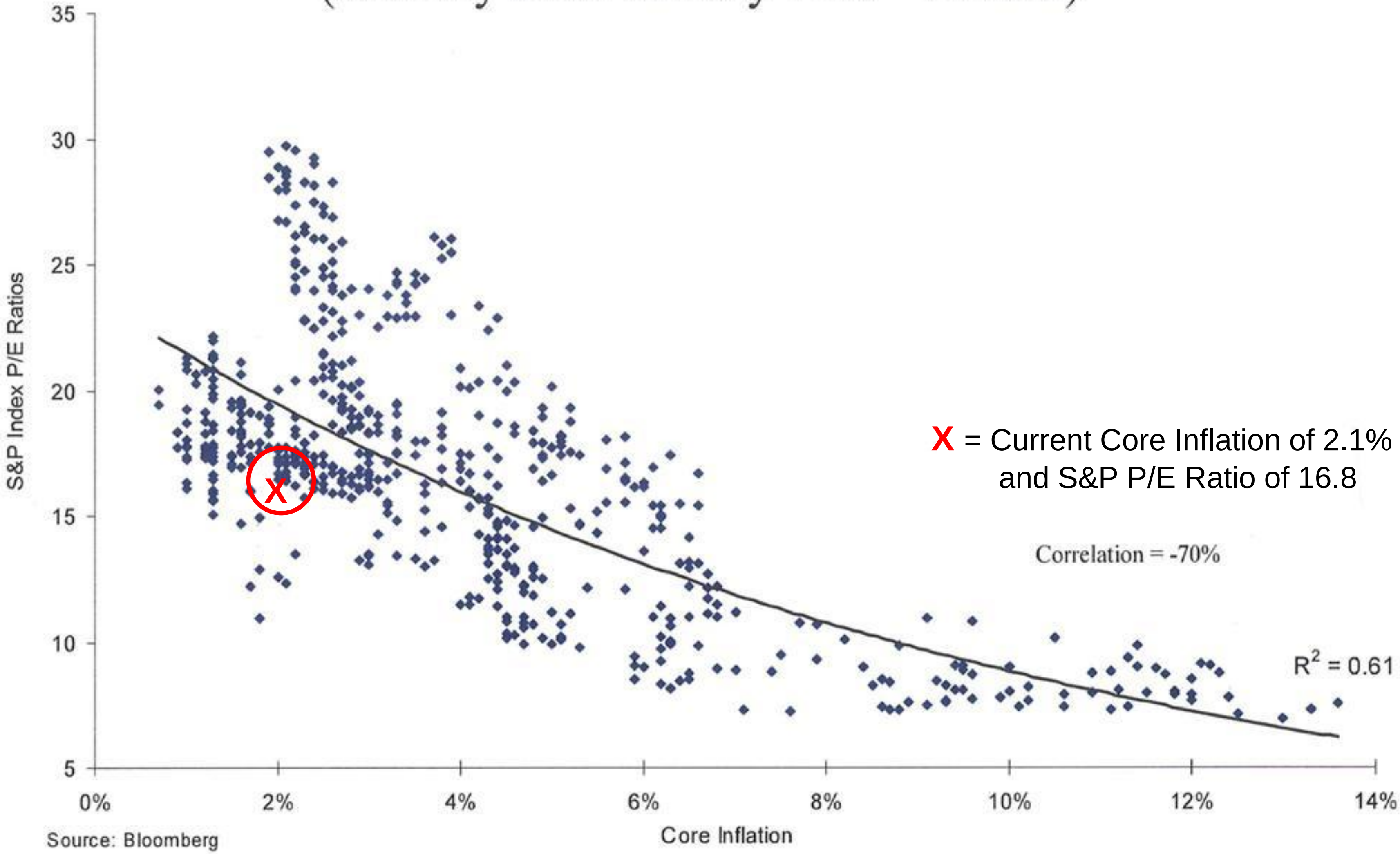
WCB



Source: Bloomberg, WCB Computations

S&P Index P/E Ratios and Core Inflation

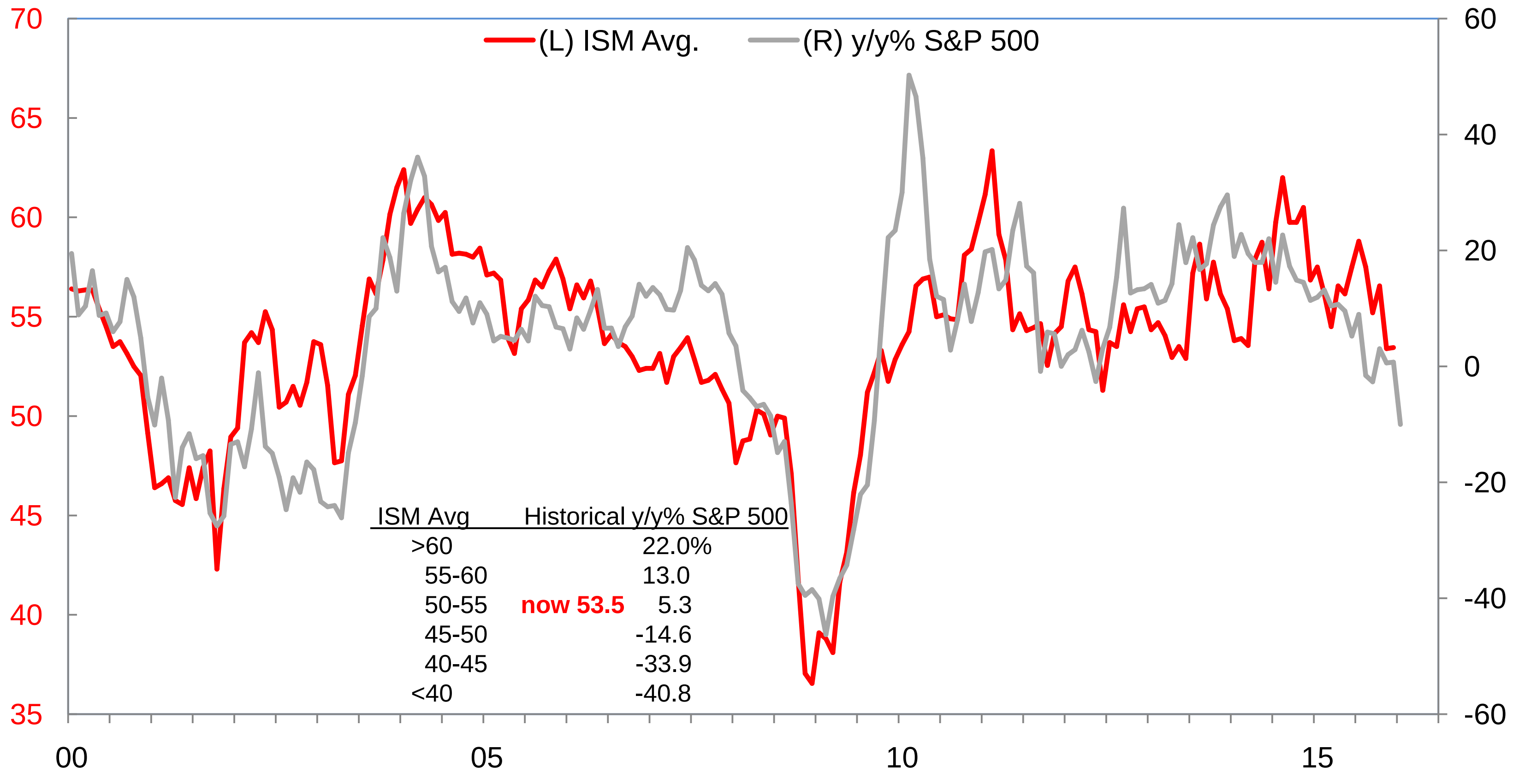
(Monthly Data: January 1960 – Present)



There is a negative correlation between core inflation and P/E ratios. Higher discount rates translate into lower prices, all other things being equal.

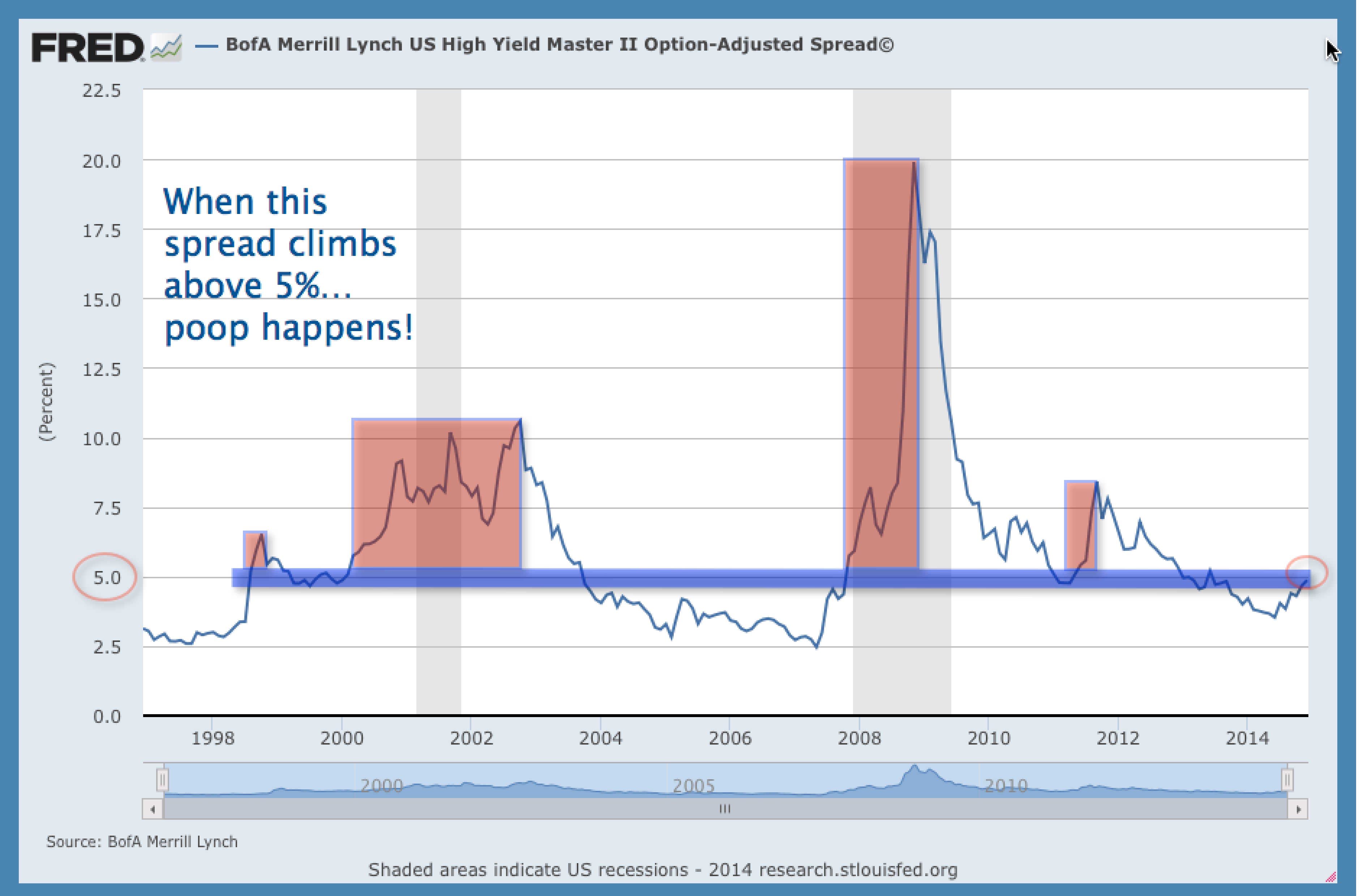
Equity Market Valuation
Based on Manufacturing Data

WCB



ISM Avg		Historical y/y% S&P 500
>60		22.0%
55-60		13.0
50-55	**now 53.5**	5.3
45-50		-14.6
40-45		-33.9
<40		-40.8

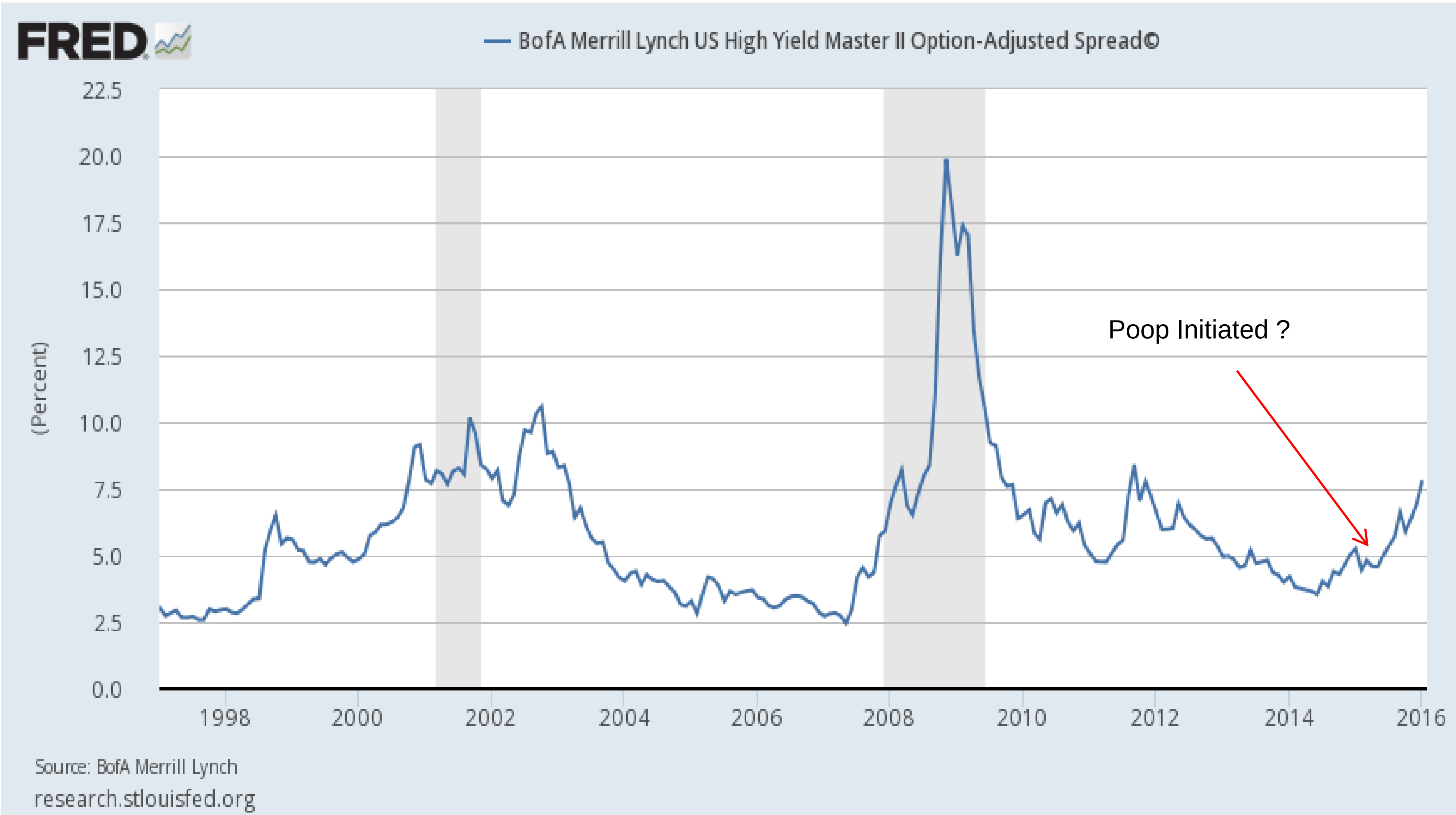
Source: ISM, Bloomberg, WCB Computations



(Dallas President not yet named)

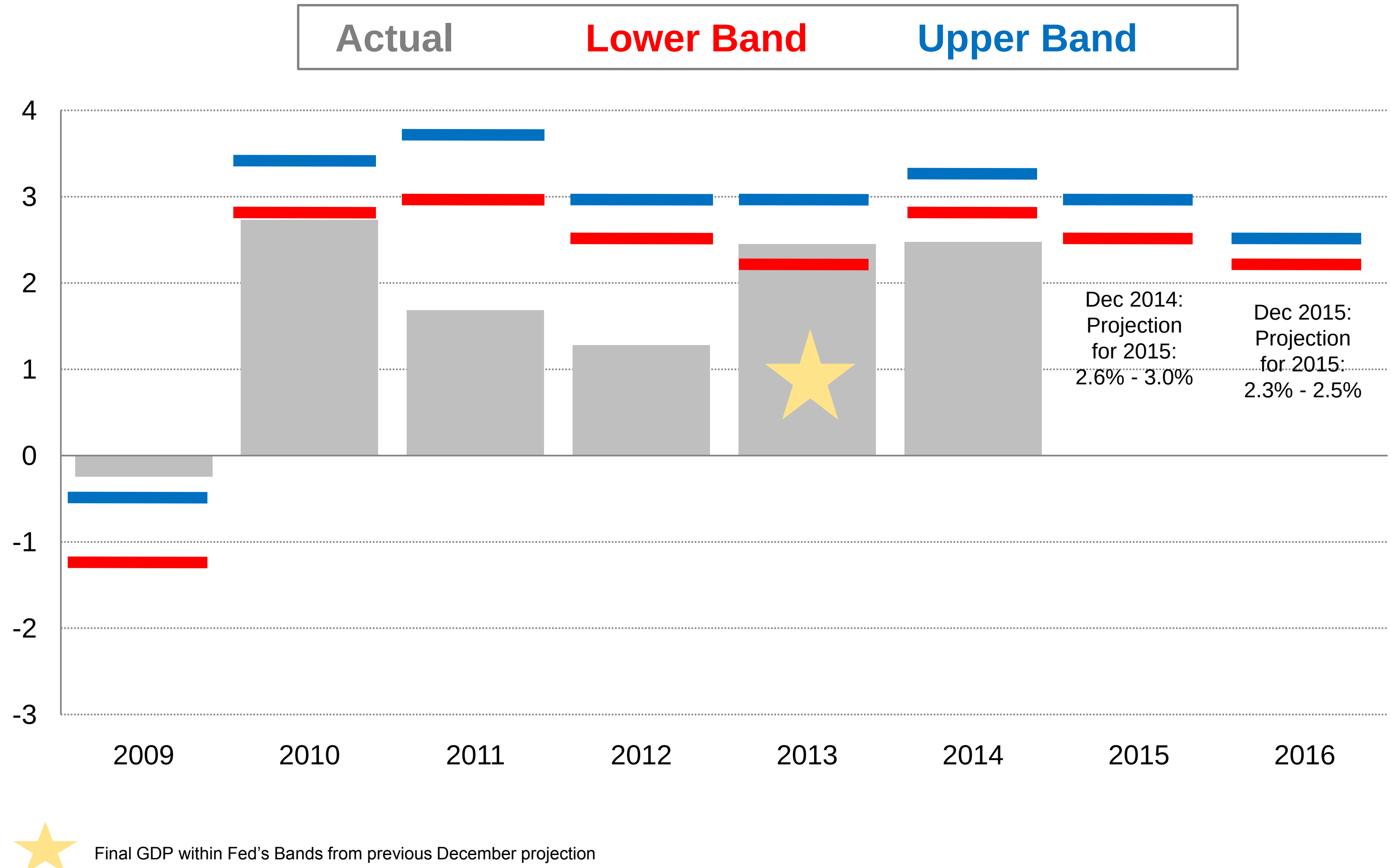
Average

NOTE: Two permanent seats are yet to be filled. *Has announced his retirement by Feb. 2016
Source: Federal Reserve; Reuters reporting

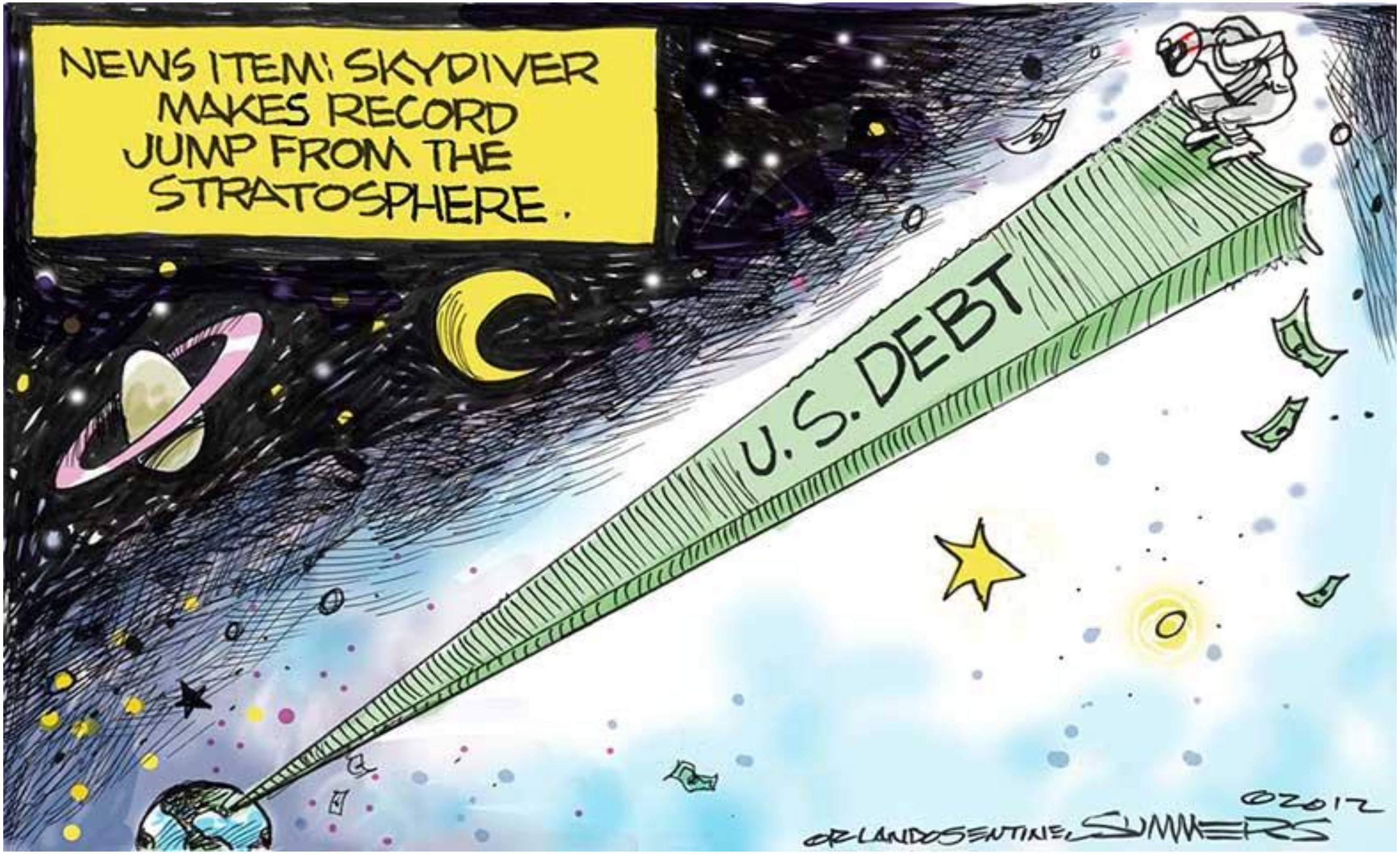

FRED
BofA Merrill Lynch US High Yield Master II Option-Adjusted Spread©
22.5
20.0
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
(Percent)
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
Poop Initiated ?
Source: BofA Merrill Lynch
research.stlouisfed.org

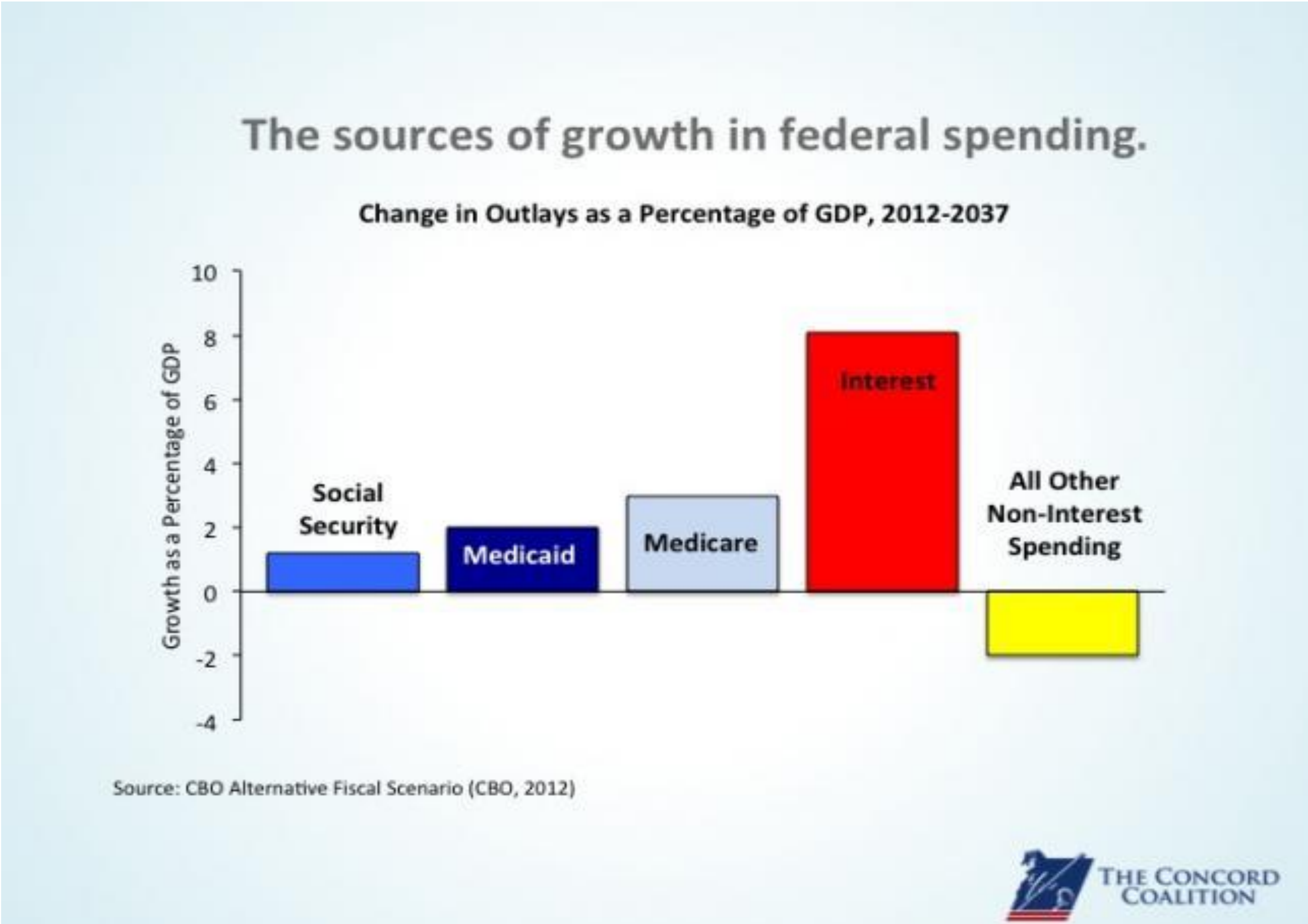
Annual GDP Forecasts by FOMC
In December of the Prior Year

Actual 4Q-to-4Q GDP percent growth vs Fed's central tendency forecast at the start of each year



Source: Federal Reserve, Commerce Department


NEWS ITEM: SKYDIVER MAKES RECORD JUMP FROM THE STRATOSPHERE.
U.S. DEBT
©2012
ORLANDOSENTINEL SUMMERS


The sources of growth in federal spending.
Change in Outlays as a Percentage of GDP, 2012-2037
Growth as a Percentage of GDP
10
8
6
4
2
0
-2
-4
Social Security
Medicaid
Medicare
Interest
All Other Non-Interest Spending
Source: CBO Alternative Fiscal Scenario (CBO, 2012)
THE CONCORD COALITION

Fixed Income

Accuracy of Economist Predictions

- Historical Record of the Predictions of the Economists Surveyed by the Wall Street Journal

Have Correctly Predicted The *Direction* of Long-term Interest Rates < 50% of the Time

- => Less Accurate than Flipping a Coin

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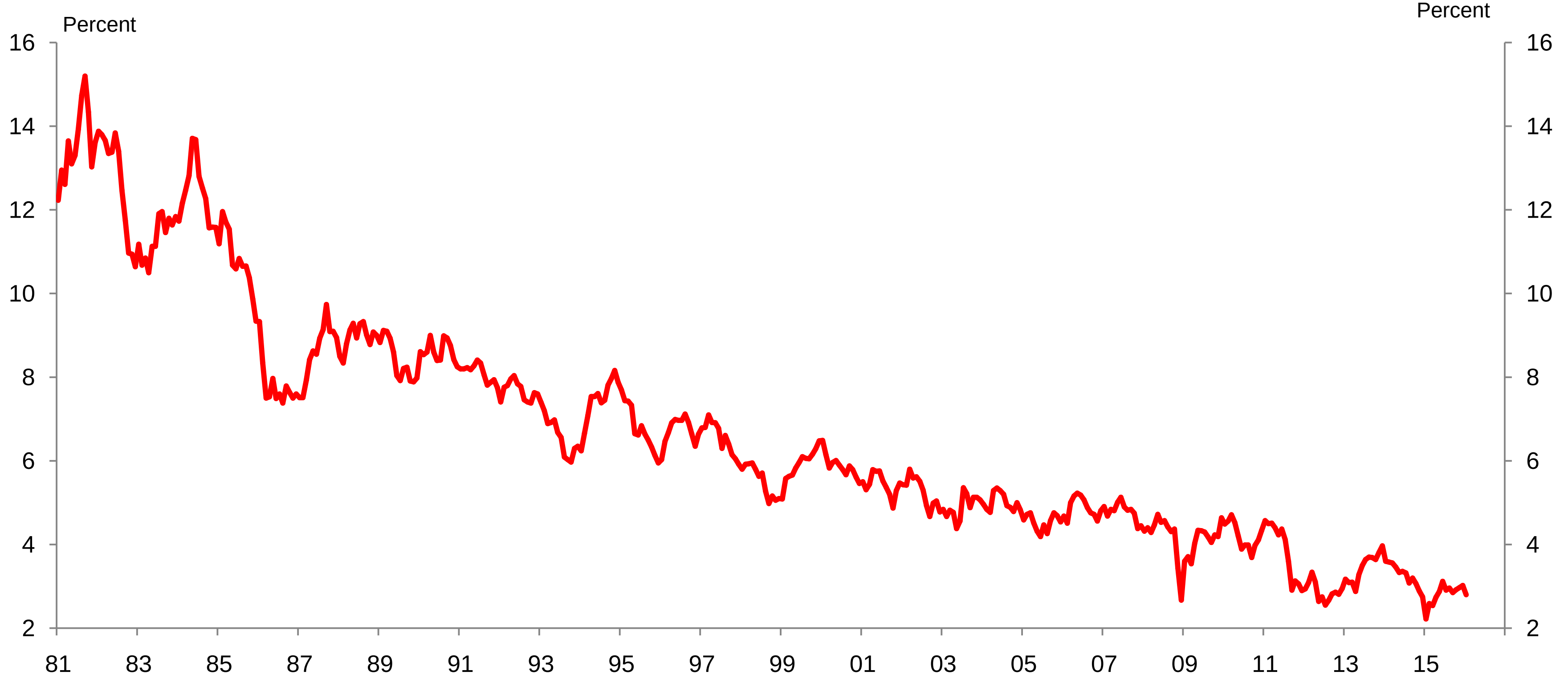
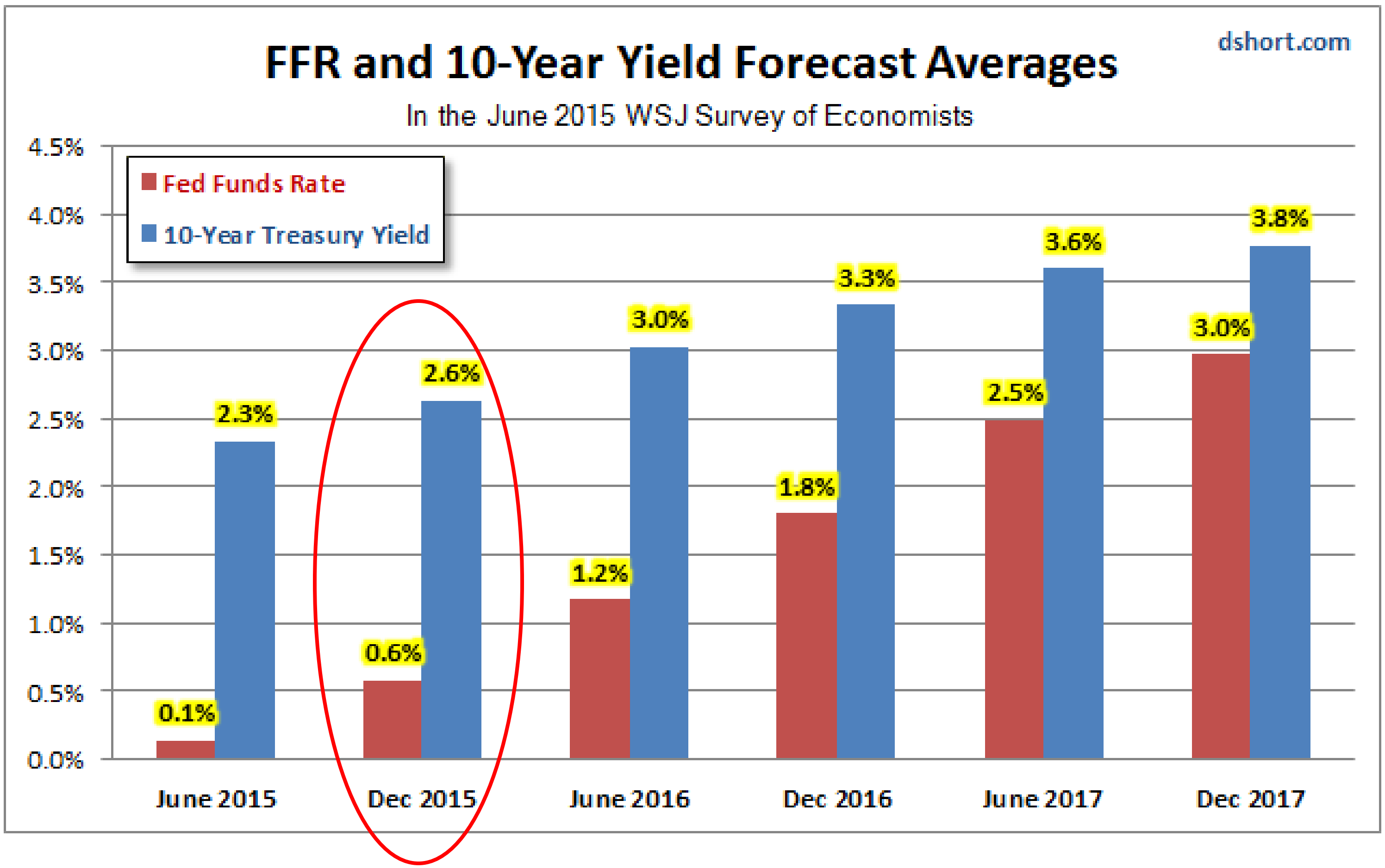
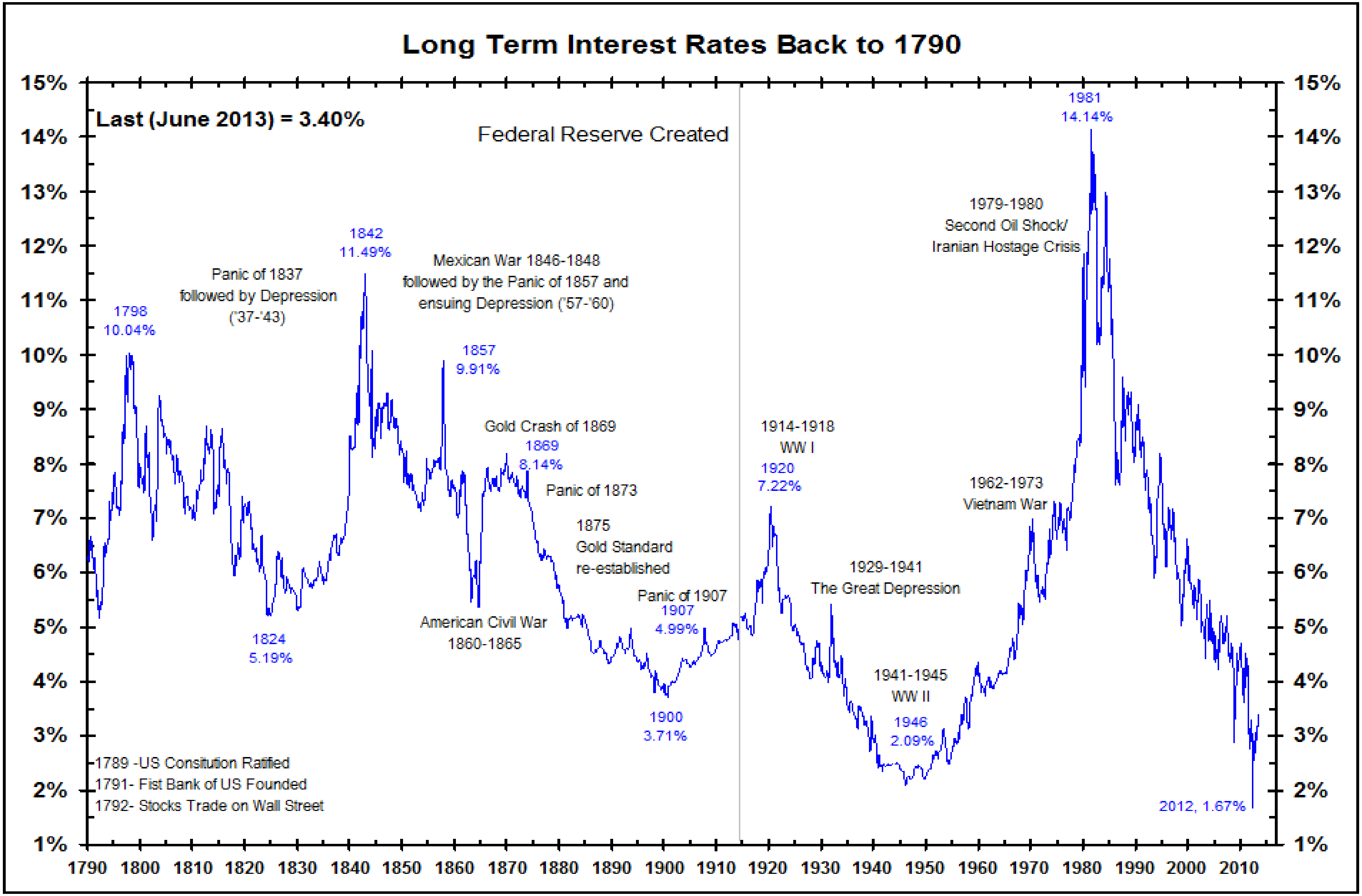


Source: Bloomberg, Bureau of Labor Statistics, WCB computations

WSJ Economists' June Forecasts for 10-Year Yields and the Fed Funds Rate June 17, 2015



Source: Federal Reserve

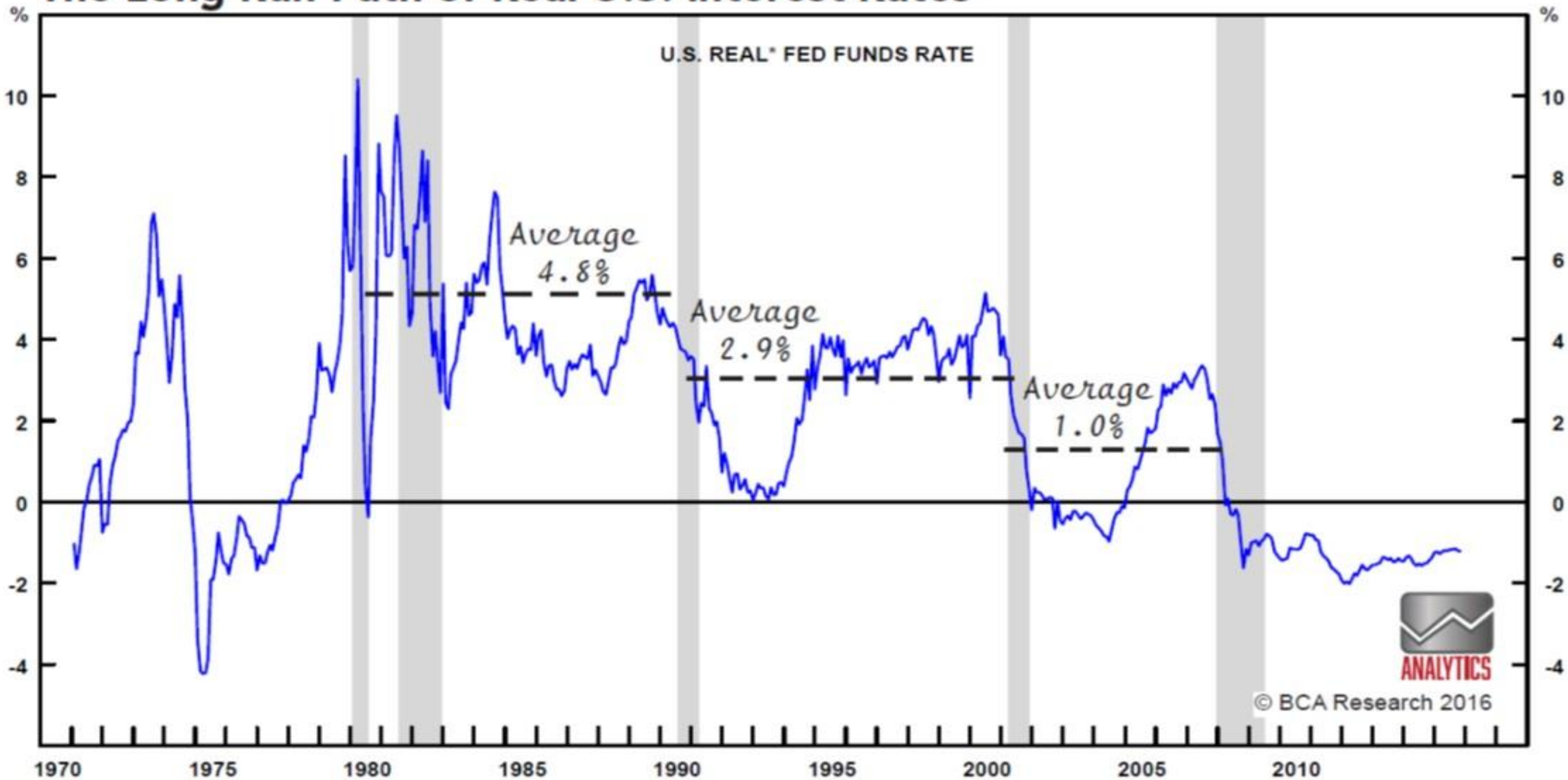


Long Term Interest Rates Back to 1790
Last (June 2013) = 3.40%
Federal Reserve Created
1798
10.04%
Panic of 1837
followed by Depression
('37-'43)
1842
11.49%
Mexican War 1846-1848
followed by the Panic of 1857 and
ensuing Depression ('57-'60)
1857
9.91%
Gold Crash of 1869
1869
8.14%
Panic of 1873
1875
Gold Standard
re-established
Panic of 1907
1907
4.99%
1824
5.19%
American Civil War
1860-1865
1900
3.71%
1914-1918
WW I
1920
7.22%
1929-1941
The Great Depression
1941-1945
WW II
1946
2.09%
1962-1973
Vietnam War
1979-1980
Second Oil Shock/
Iranian Hostage Crisis
1981
14.14%
2012, 1.67%
1789 -US Consitution Ratified
1791- Fist Bank of US Founded
1792- Stocks Trade on Wall Street
15%
14%
13%
12%
11%
10%
9%
8%
7%
6%
5%
4%
3%
2%
1%
1790
1800
1810
1820
1830
1840
1850
1860
1870
1880
1890
1900
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010

Thirty-five Years of Declining Interest Rates

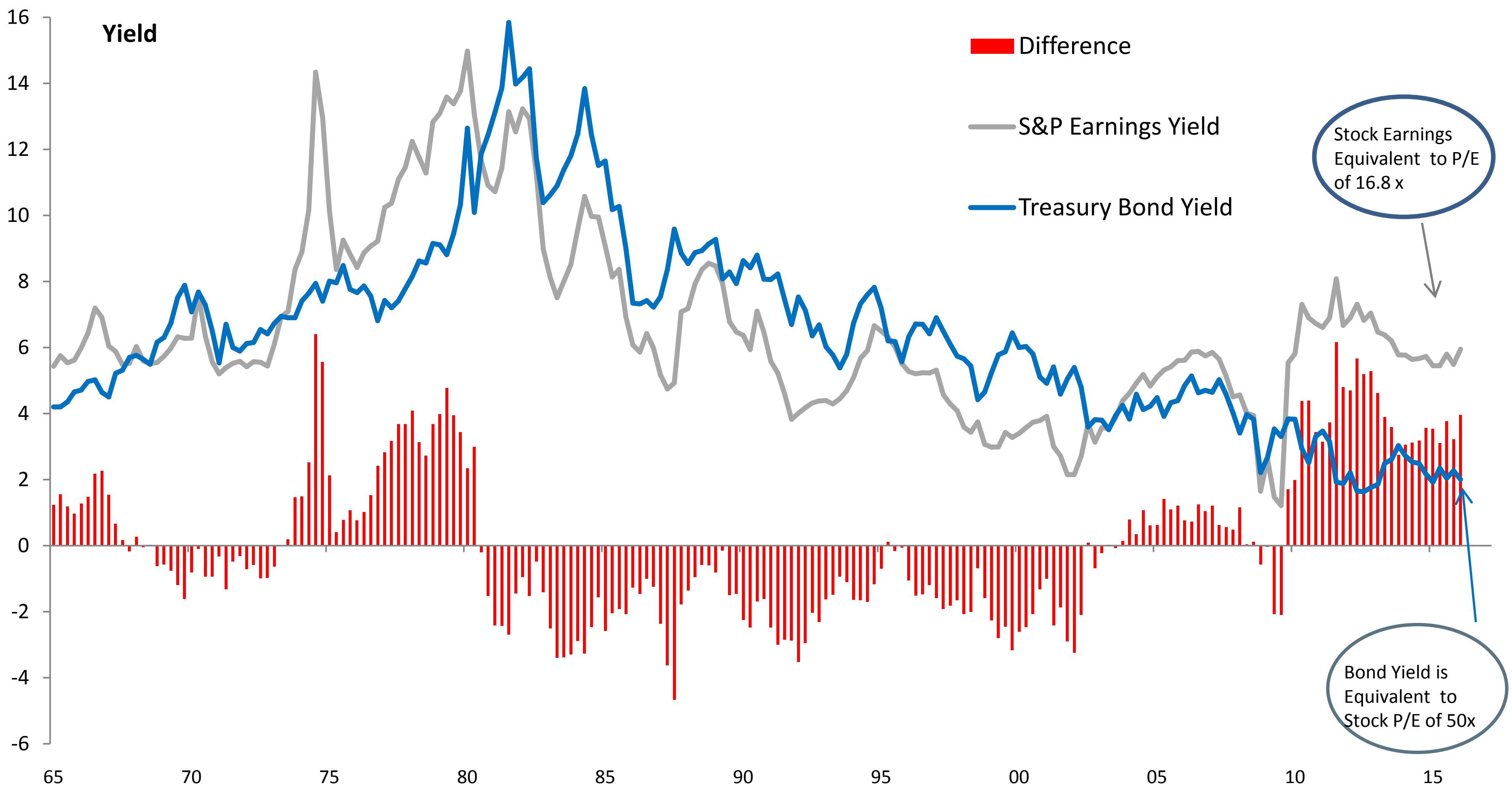
WCB

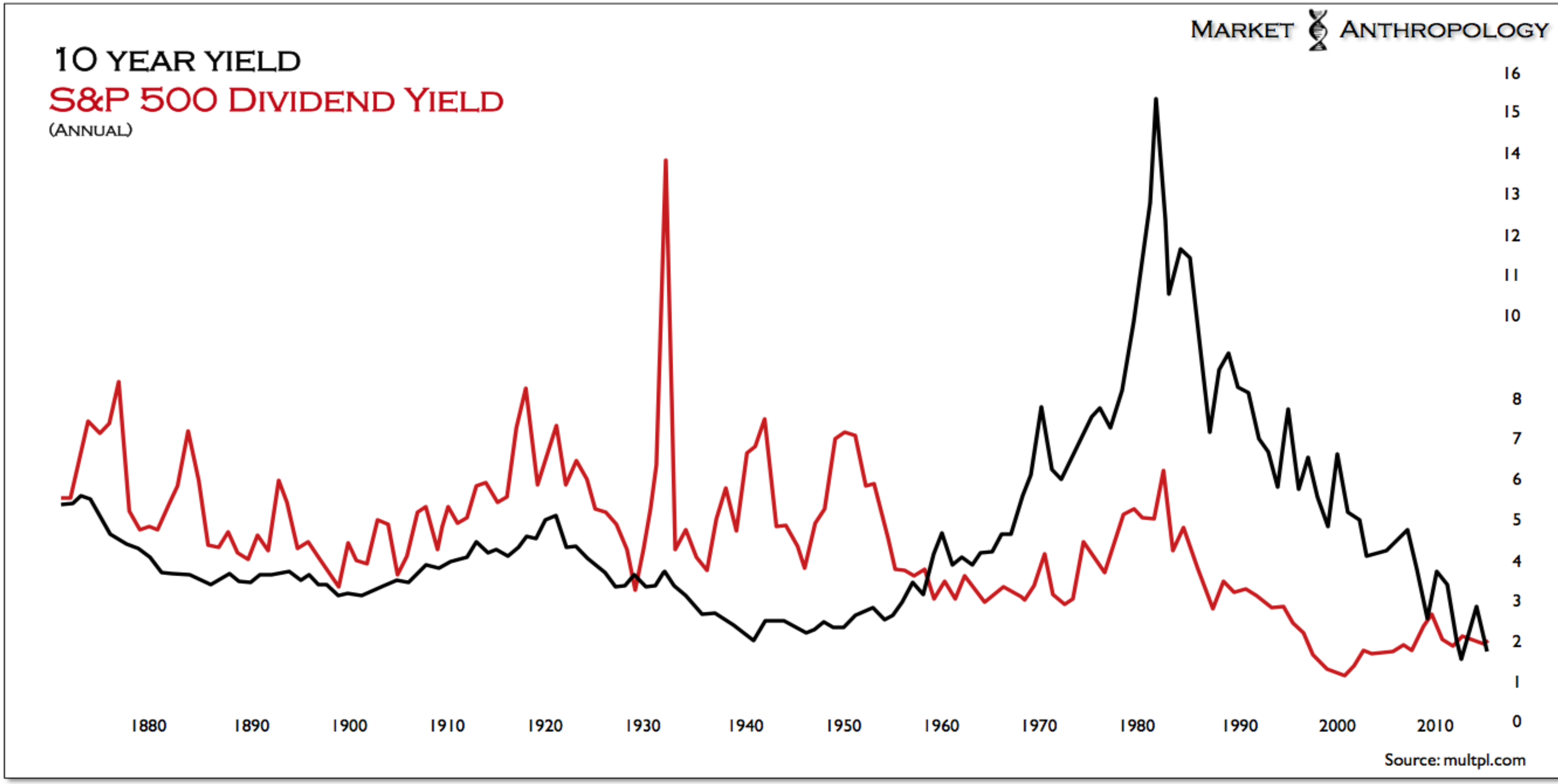
The Long-Run Path of Real U.S. Interest Rates



* DEFLATED BY CORE PERSONAL CONSUMPTION EXPENDITURE DEFLATOR.
NOTE: THE HORIZONTAL DASHED LINES REPRESENT PEAK-TO-PEAK AVERAGES OVER NBER-DESIGNATED BUSINESS CYCLES; THE 1980s RECESSIONS ARE TREATED AS ONE CYCLE. THE SHADED AREAS REPRESENT NBER-DESIGNATED RECESSIONS.

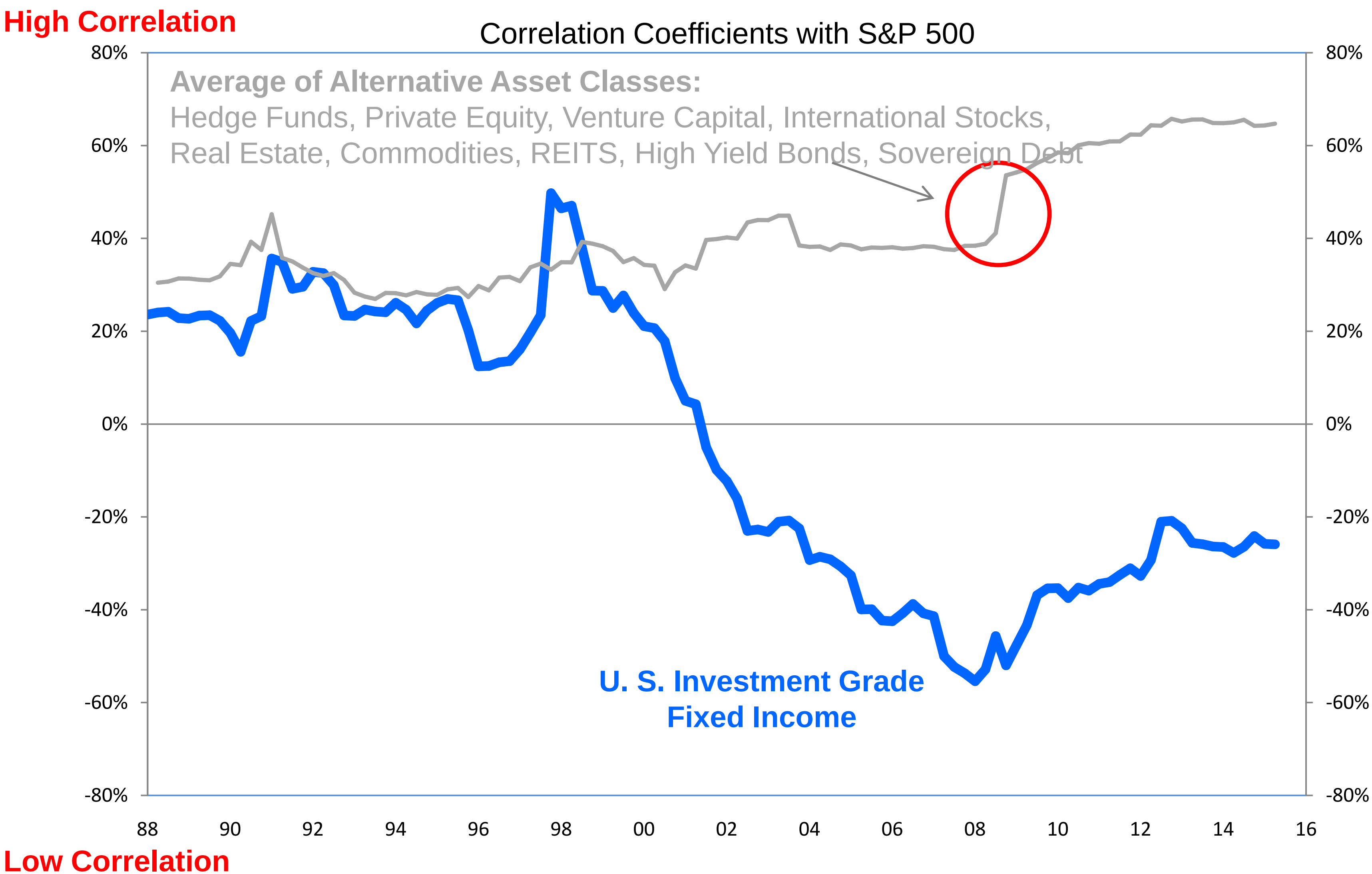
Stocks appear cheap to bonds based on the Fed model which compares the bond yield on Treasuries to the earnings yield (the inverse of the P/E ratio) on stocks.




MARKET ANTHROPOLOGY
10 YEAR YIELD
S&P 500 DIVIDEND YIELD
(ANNUAL)
16
15
14
13
12
11
10
8
7
6
5
4
3
2
1
0
1880
1890
1900
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010
Source: multpl.com

ROLLING 10 YEAR CORRELATIONS of U.S. EQUITIES (S&P 500) vs ALTERNATIVE ASSET CLASSES

The Case for Fixed Income – Lower Correlation with other asset classes



Source: Bloomberg WCB Computations

Historical Performance

Since Fixed Income Indices Inception 1972

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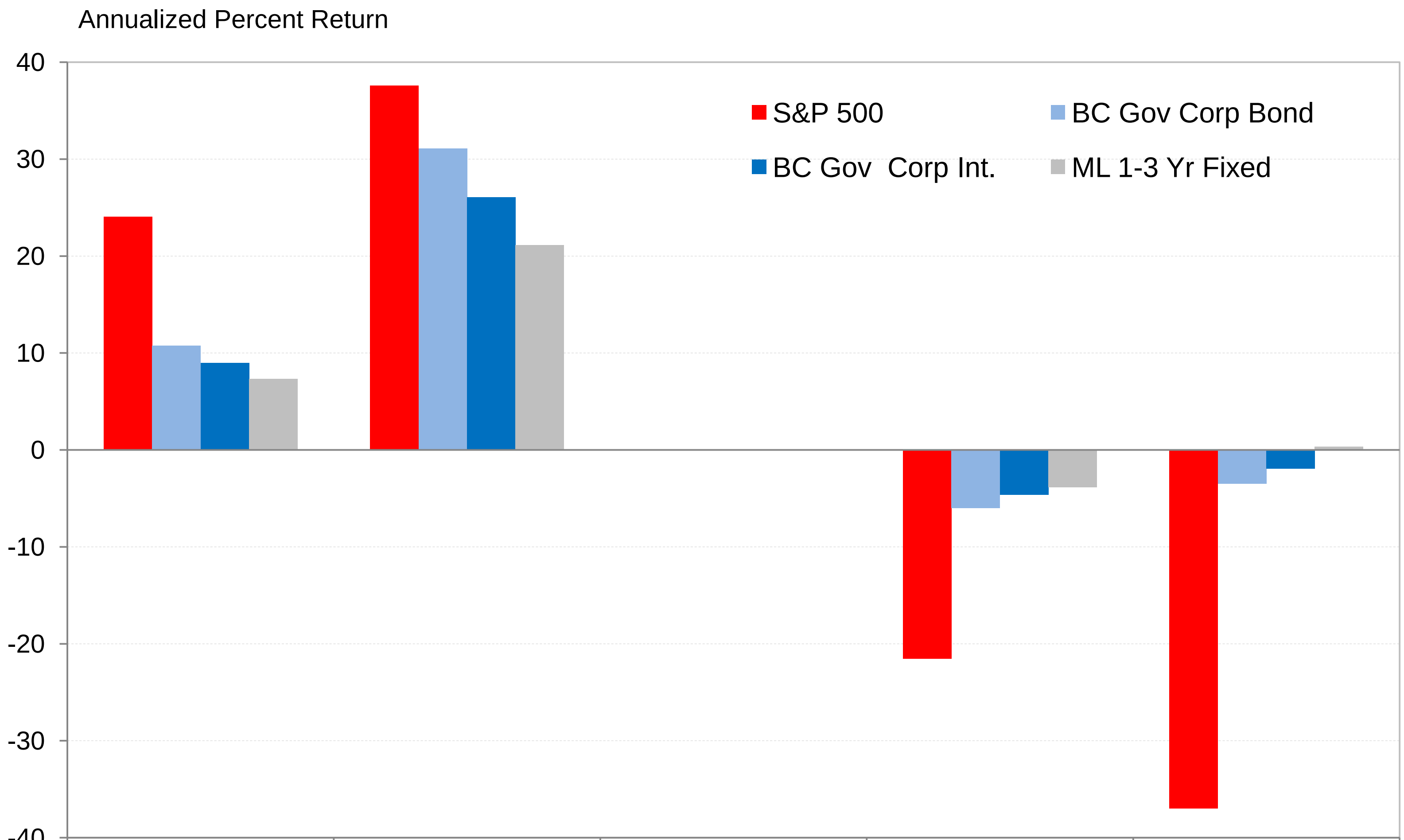


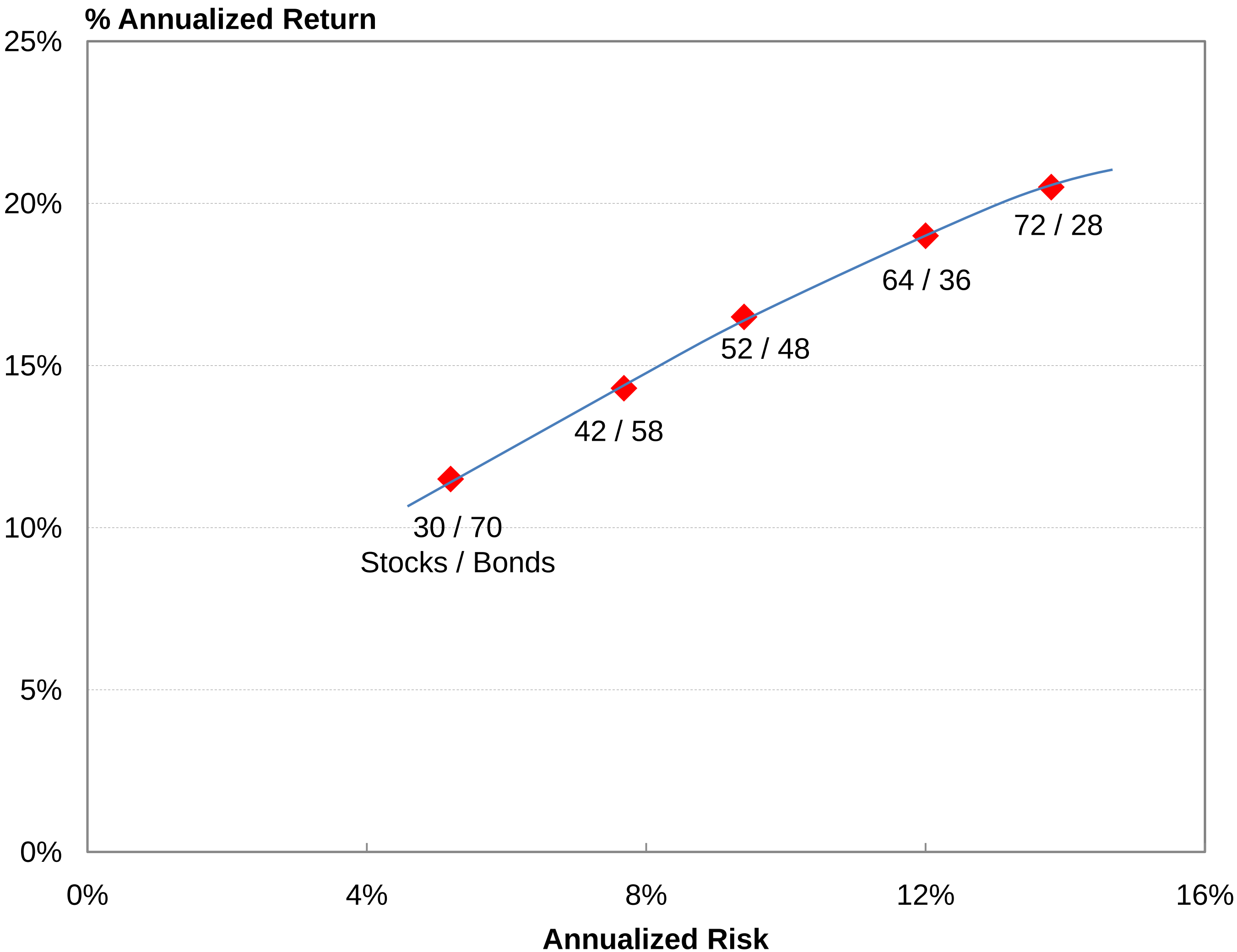
	best qtr	best year		worst qtr	worst year
S&P 500	24.06	37.58		-21.54	-37.00
BC Gov Corp Bond	10.76	31.1		-5.99	-3.51
BC Gov Corp Int.	8.98	26.1		-4.62	-1.93
ML 1-3 Yr Fixed	7.36	21.15		-3.85	0.36

The Historical Case For Bonds

Efficient Portfolios Still Contain Bonds in Bond Bear Markets

WCB

Efficient Frontier of Stocks & Bonds, 1951-81



The most previous major bear market in bonds occurred as the Fed unwound the last quantitative easing they undertook in order to deal with the debt buildup during World War II.

Beginning in 1951, over the next 30 years, interest rates rose from 2-3%, about where they are today, to over 15% in 1981.

In hindsight, the most efficient (highest return for the least risk) optimal stock / bond portfolios during those 30 years still contained a significant allocation to bonds.

During that time portfolios lost efficiency whenever the equity allocation exceeded 75%. And the worst performing 12 month period for bonds was less than half of what stocks lost during their worst performing periods.

Source: UBS CIO WMR, analysis performed 1951-1981; Financial Advisor Magazine Feb 2014

10-Year T-Note Fair Value vs Actual Nominal GDP

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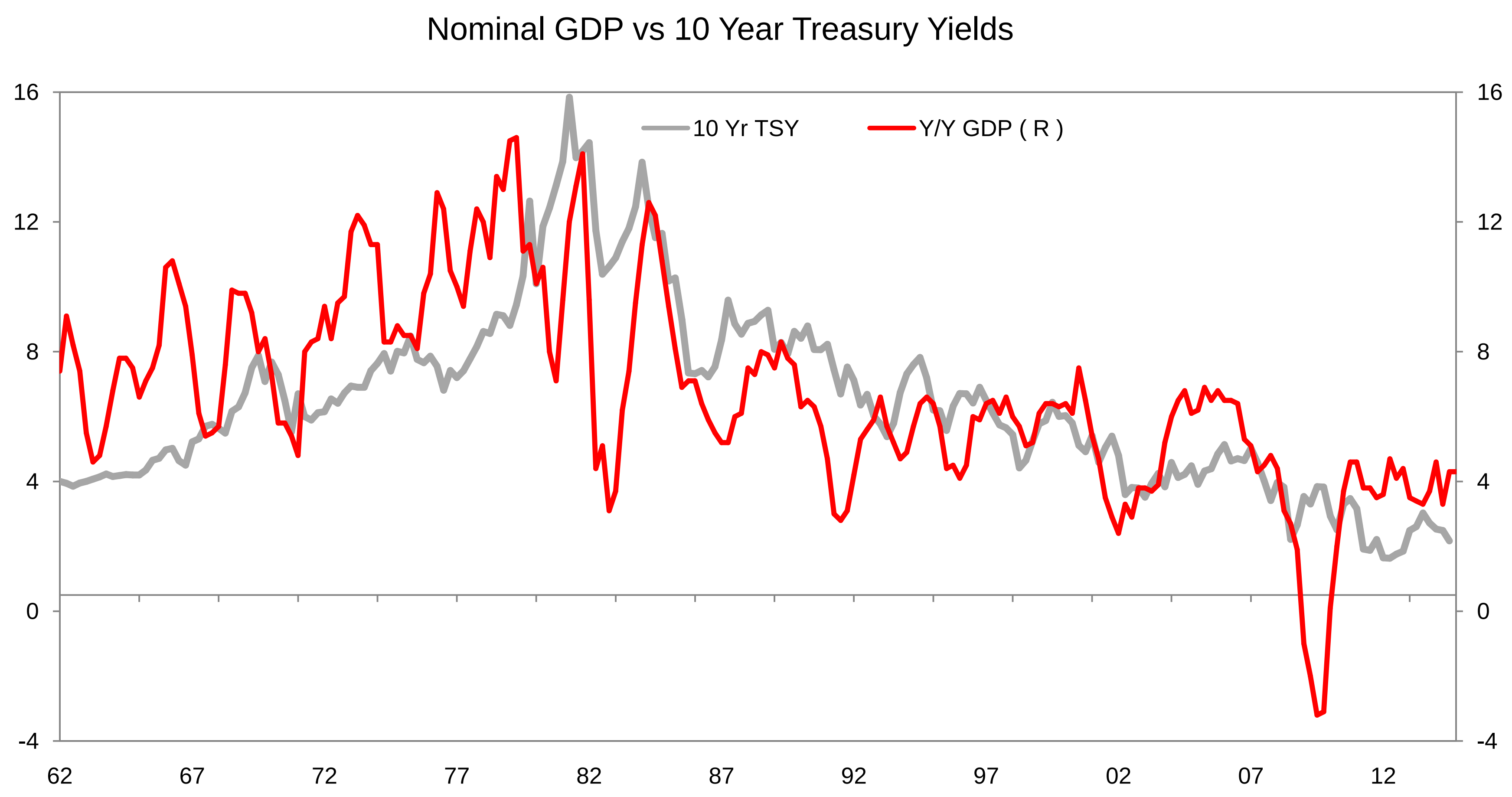
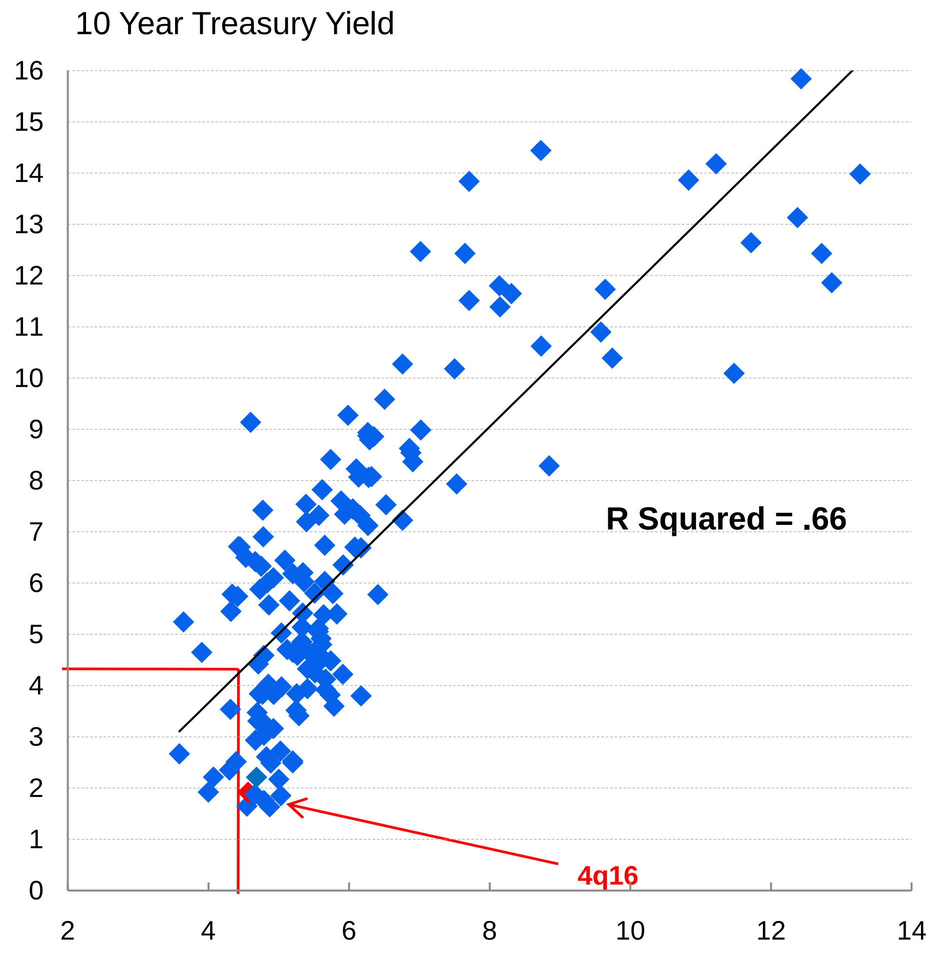


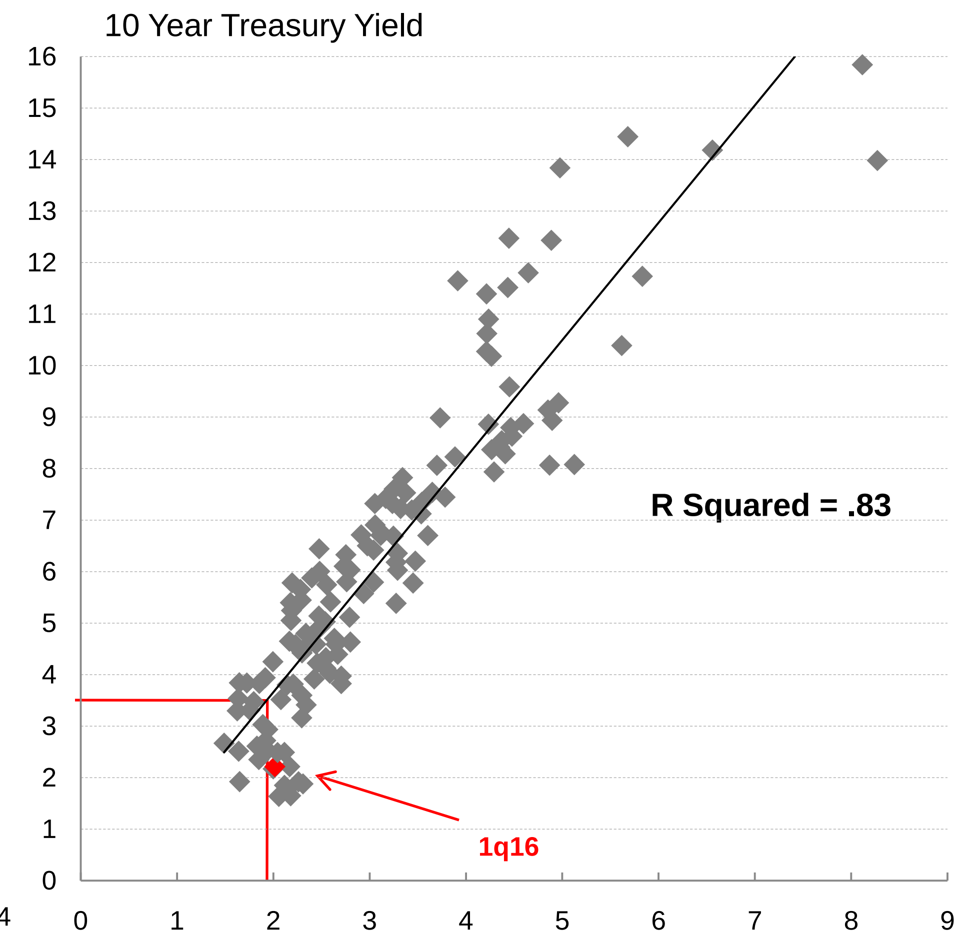
Source: Bloomberg

Treasury Yields vs Expected GDP Growth and Inflation
Quarters Since 1979

WCB



1 Year Forecast of Nominal GDP Growth*



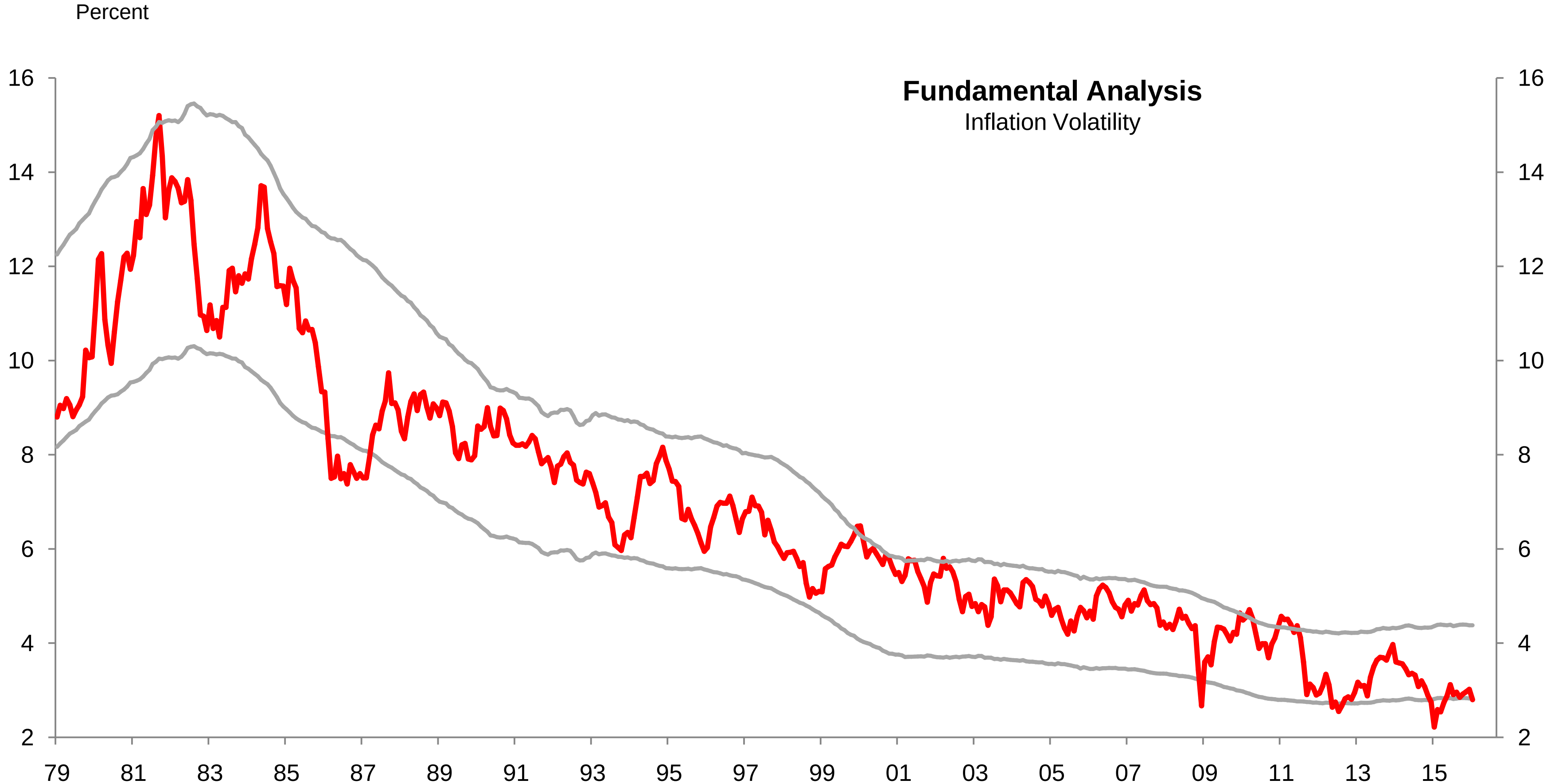
1 Year Forecast of CPI *

*Philadelphia Fed Survey of Professional Forecasters, 2q15

Treasury Bond Yield Valuations vs Inflation

WCB

In the very long run, Treasury bond yields follow the general direction of inflation. After factoring in the volatility of inflation our proprietary analysis creates fair valuation bands that Treasury bond yields generally fall between, but not now.



Source: Bloomberg, Bureau of Labor Statistics, WCB computations

Duration Scorecard – Weight of the Evidence Approach WCB

Below are fundamental, technical and quantitative indicators which independently have had a good correlation with changes in Treasury yields, along with some technical short-term timing indicators. We score each of these either positive, neutral or negative and sum the results, calibrated to our + or - 10% duration range around the benchmark, to arrive at our duration stance. Although each indicator alone will sometimes fail, in aggregate this weight-of-the-evidence approach usually is on the correct side of the interest rate trend.

1/21/2015	Last Update	Annualized Return at Current Reading	% of Time at Current Signal	Bull		Bear		
Fundamentals								
Nikkei 225 Correlation	20-Jan-15					-1		
Commodities	16-Jan-15	11.50%	17%	1				
Utilities	20-Jan-15	8.30%	39%	1				
Unemployment Claims	16-Jan-15	0.20%	63%		0		up	
Ted Spread	16-Jan-15	5.10%	46%	1			up	
Bond cash / Asset Ratio	31-Dec-14	1.70%	51%	1				
Fundamental Valuation	31-Dec-14	4.00%	"10 yr fair value at 2.23%"			-1	down	
Real Interest Rates	31-Dec-14	-1.40%	51%			-1		
Inflation Pressures	31-Dec-14	1.00%	46%	1				
LEI Diffusion Index	31-Dec-14	-1.00%	41%			-1		
								101.0
Technicals / Quantitative								
Overbought / Oversold	20-Jan-15	4.50%	67%	1				
Sentiment	20-Jan-15	-0.50%	23%			-1		
Bond Benchmark	16-Jan-15	2.80%	6%	1				
Bond Enhancement	20-Jan-15	19.80%	26%	1				
Signal Tot Ret.	16-Jan-15	16.40%	48%	1				
Trading Model Mode	20-Jan-15	7.80%	38%	1				
S&P 500 R.S.	20-Jan-15	8.70%	36%	1				
Corp Bond Oscillator	20-Jan-15	4.00%	41%	1				
Fear Index	31-Dec-14	2.70%	22%	1				
Seasonals	31-Dec-14					-1		
	avg	**5.31%**						**105.0**
Bond Market Focus	26-Aug-14	**f/ 95% to 100%**			0			**100.0**
S-T Technicals								
Rate Futures Momentum	20-Jan-15	4.10%	20%	1				
Oscillator Extreme	21-Jan-15					-1		
DMI				1				
Parabolic Systems				1				
On Balance Volume				1			up	
Trender Sig.				1				
Trender				1				
Enhancement Ossil.	20-Jan-15	5.70%	Buy	1			up	**107.5**
10 Yr M.A.	21-Jan-15		13 Day M.A.	1				
			39 Day M.A.	1				
			117 Day M.A.	1				**110.0**

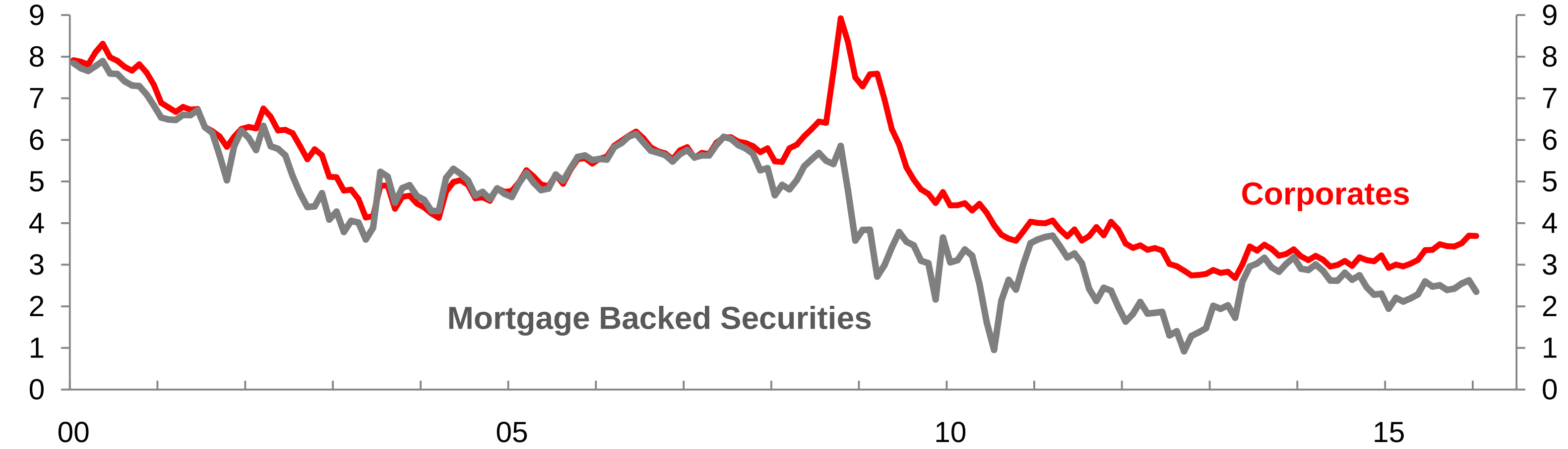
Duration Range +/-	10%	Last:	103.0%	**104.7%**
	25%	Last:	107.4%	**111.8%**

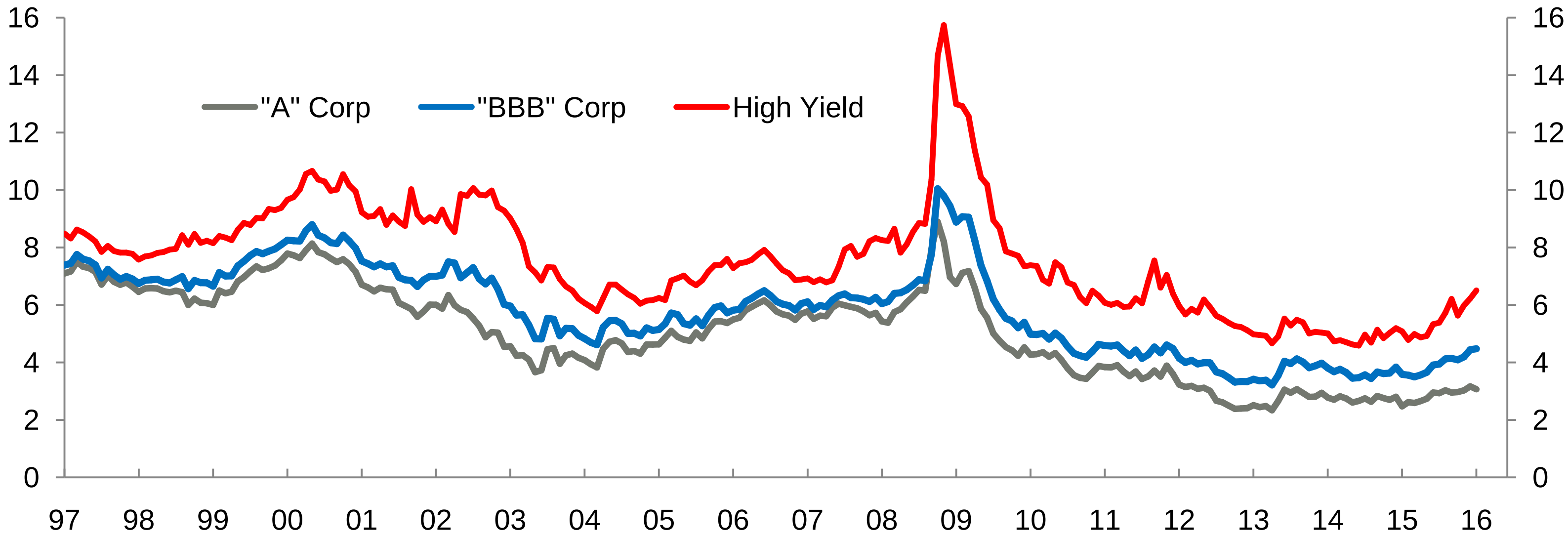
Source: WCB computations, Bloomberg, Ned Davis Research, Smith Barney, Merrill Lynch, Barclays, Bank Credit Analyst, R.W. Pressprich, Buckhead Technical Perspective

Fixed Income Sector Yield to Maturity

WCB

Fixed Income Sector Yields





Source: Bloomberg, Merrill Lynch

Federal Reserve Policy After Quantitative Easing

BARKSDALE
& ASSOCIATES
INVESTMENT
MANAGEMENT

Quantitative Easing by Fed - Pros

WCB

- Revived the economy from the brink – Ended the "Great Recession"
  - Cutting the Fed Funds rate by 500 basis points was inadequate to combat the recession
  - Continues to provide important support to the recovery.
  - Increases Aggregate Demand thereby reducing unemployment
- Reduces the risk of "deflation" (Japan)
- Fiscal policy is restraining growth via higher taxes and lower spending, so when it comes to supporting growth, the Fed is the only game in town
- Exiting the super-easy monetary policy (quantitative easing) won't be as difficult as feared:
  - Can shrink the balance sheet by letting assets mature as well as selling
  - Can pay banks more interest on their reserves (2/3 of Fed balance sheet), lessening the need to shrink
- Bond Purchases and "Forward Guidance" keep longer-term interest rates down & encourages borrowing
  - Reduced corporate borrowing rates = boosted earnings and balance sheet quality
  - Reduced consumer borrowing rates = housing and auto recovery
  - Dramatically reduces the interest costs to the U.S. government

Quantitative Easing by Fed - Cons

Low interest rates - incentivizes otherwise risk-averse to take on questionable investments in search of yield

- Increases the risk of long-term inflation expectations creating market imbalances;
- Already seeing emerging bubbles in bonds, agricultural land, gold, levered loans, high yield and stocks

➢ Easy Money Distorts Banking System

- Deposits at U.S. banks greatly exceed loans; much of surplus into U.S. Treasuries
- Makes it possible for banks to roll over rather than write off bad loans – locks up unproductive assets
- Places a ceiling on interest rates – produces little incentive for lenders to extend, esp. to consumers

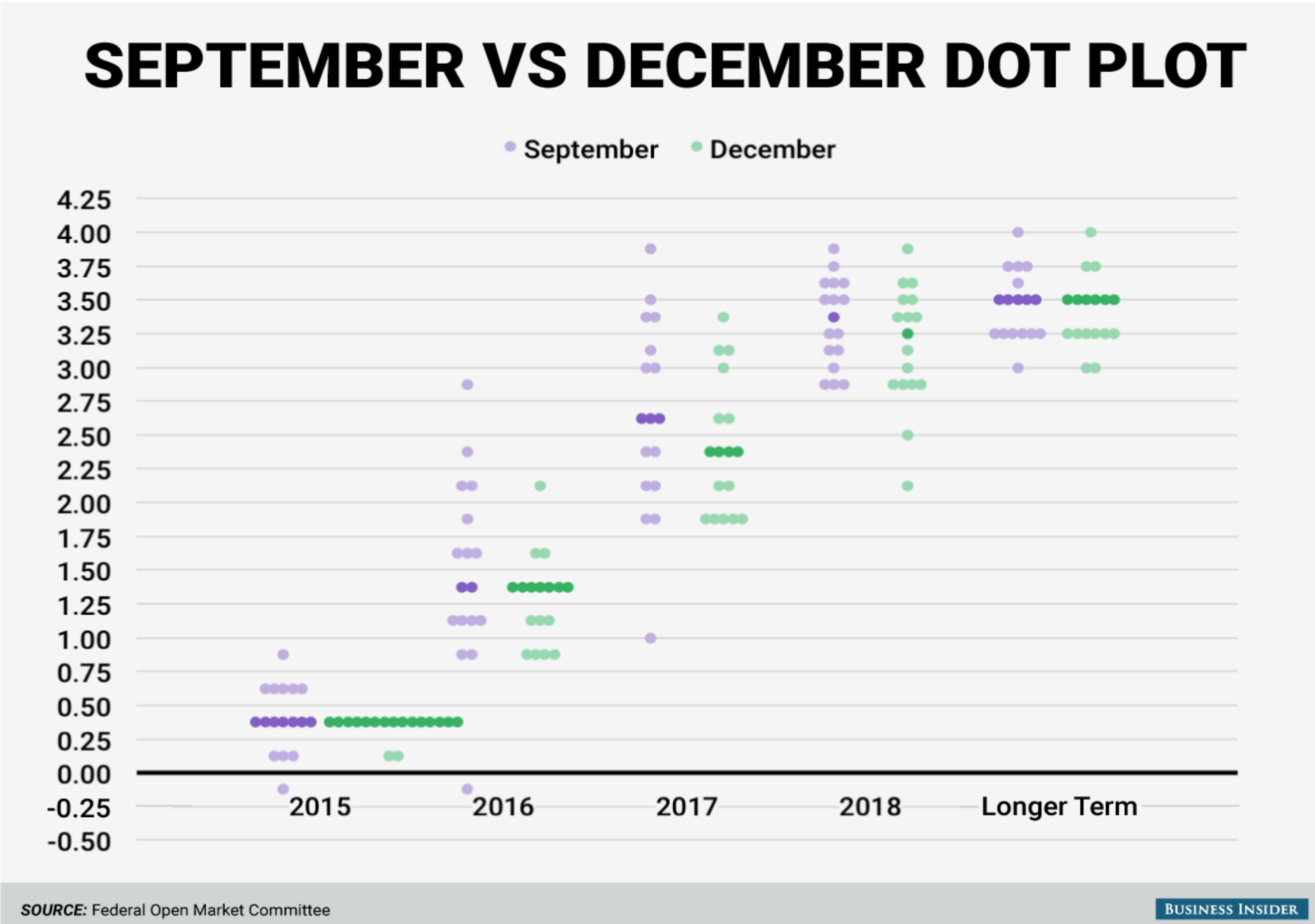
➢ Easy Money Distorts Government Decision Making

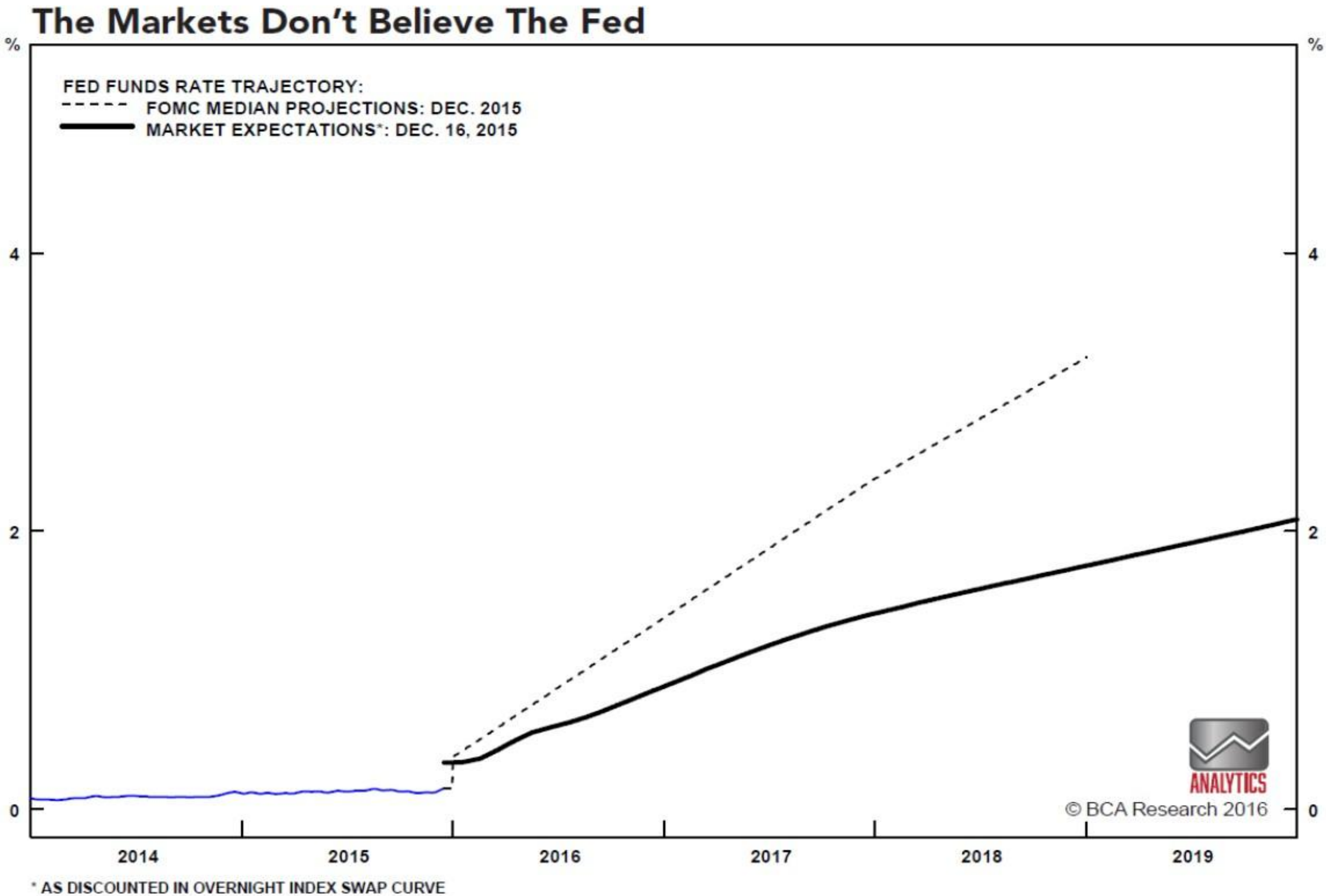
- Low rates support and feed the spending appetites of the government – increases deficits and debt
- Elected leaders have been able to avoid making the hard choices about cutting deficits.
- Raises questions about the Fed's independence and accountability – reduces public's confidence

➢ Leads other foreign central banks to follow to prevent their currencies from appreciating

➢ Fed's balance sheet is up to $4.5 billion (28% of GDP) - will make eventual exit more difficult.

- Hard to Unwind: Tighten too early and economy rolls over; Too late – inflation and new bubbles
- The more the Fed sells, and the more quickly, the more it will drive down bond prices.


SEPTEMBER VS DECEMBER DOT PLOT
September
December
4.25
4.00
3.75
3.50
3.25
3.00
2.75
2.50
2.25
2.00
1.75
1.50
1.25
1.00
0.75
0.50
0.25
0.00
-0.25
-0.50
2015
2016
2017
2018
Longer Term
SOURCE: Federal Open Market Committee
BUSINESS INSIDER



The Markets Don't Believe The Fed
%
FED FUNDS RATE TRAJECTORY:
FOMC MEDIAN PROJECTIONS: DEC. 2015
MARKET EXPECTATIONS*: DEC. 16, 2015
4
2
0
ANALYTICS
© BCA Research 2016
2014
2015
2016
2017
2018
2019
* AS DISCOUNTED IN OVERNIGHT INDEX SWAP CURVE

Reasons for the Fed to Continue Tightening in 2016

1) Headline Employment has beaten all forecasts and momentum is up

2) Wage growth is showing signs of increasing

3) Fed wants to maintain some credibility after repeated and continuing threats to tighten

4) More Hawkish FOMC profile in 2016

Reasons for the Fed to Continue Tightening
1) Headline Employment Improvement

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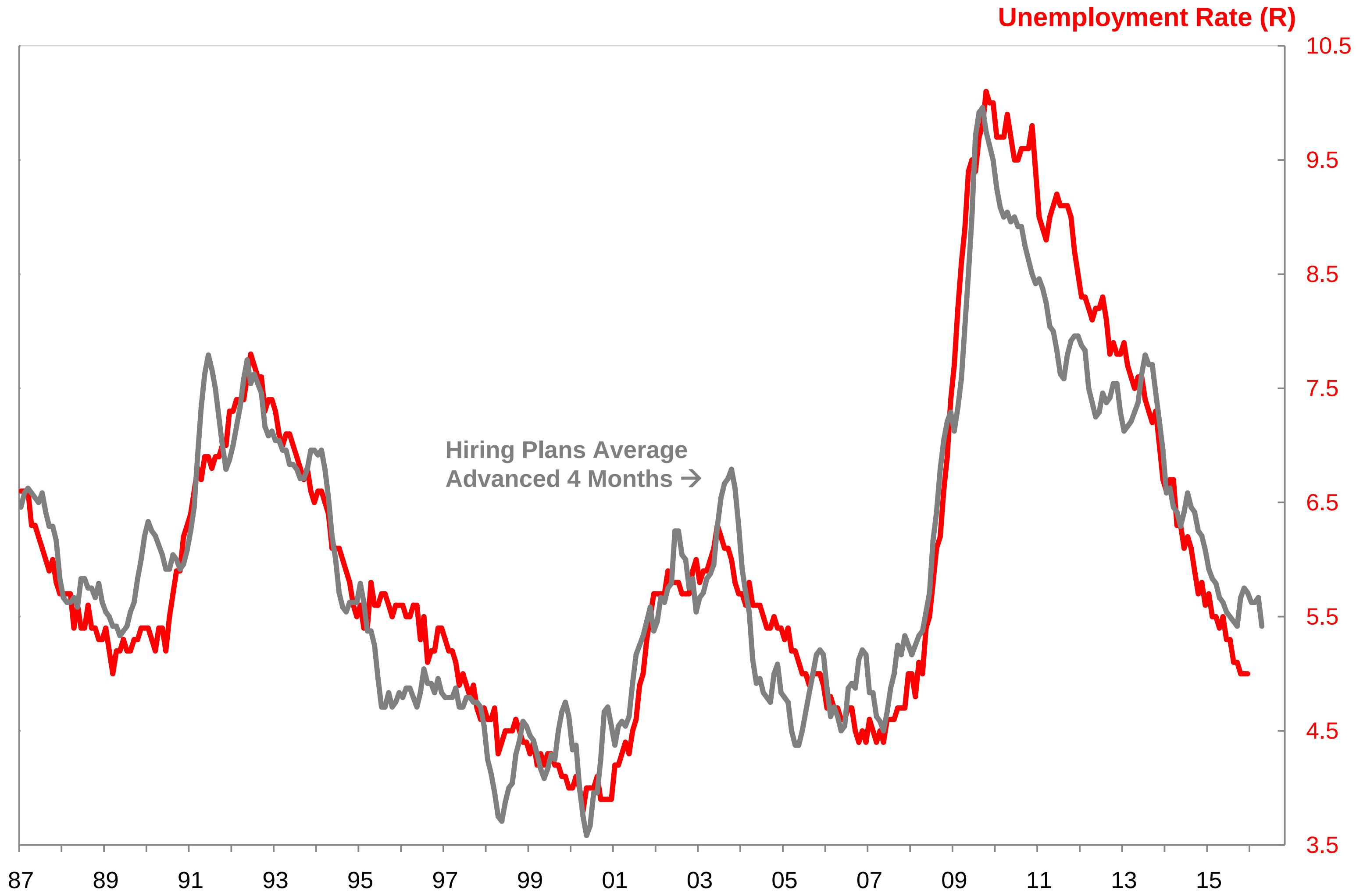

Source: Bloomberg, Ned Davis Research, NFIB

Reasons for the Fed to Continue Tightening

2) Wage growth is showing signs of increasing

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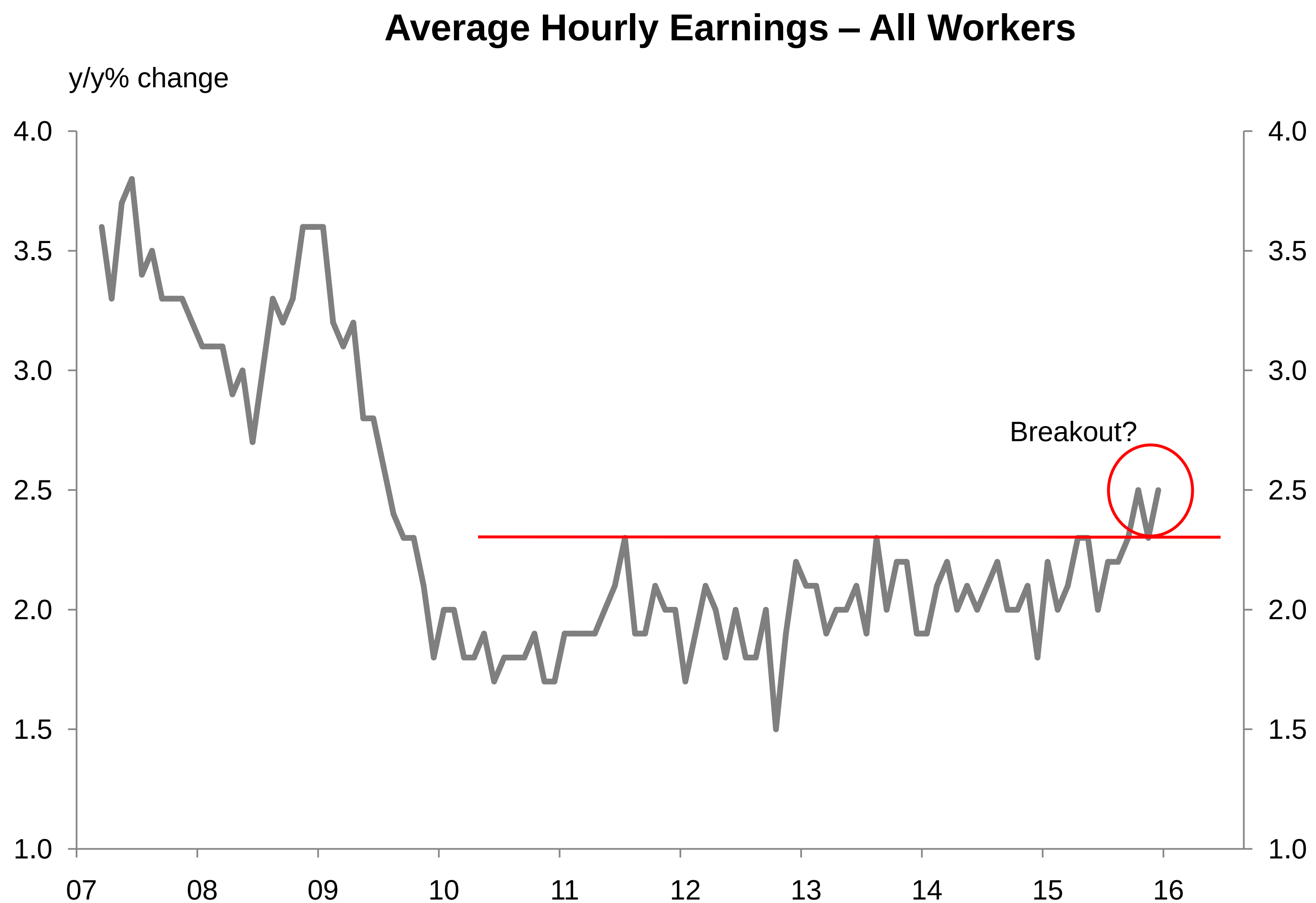
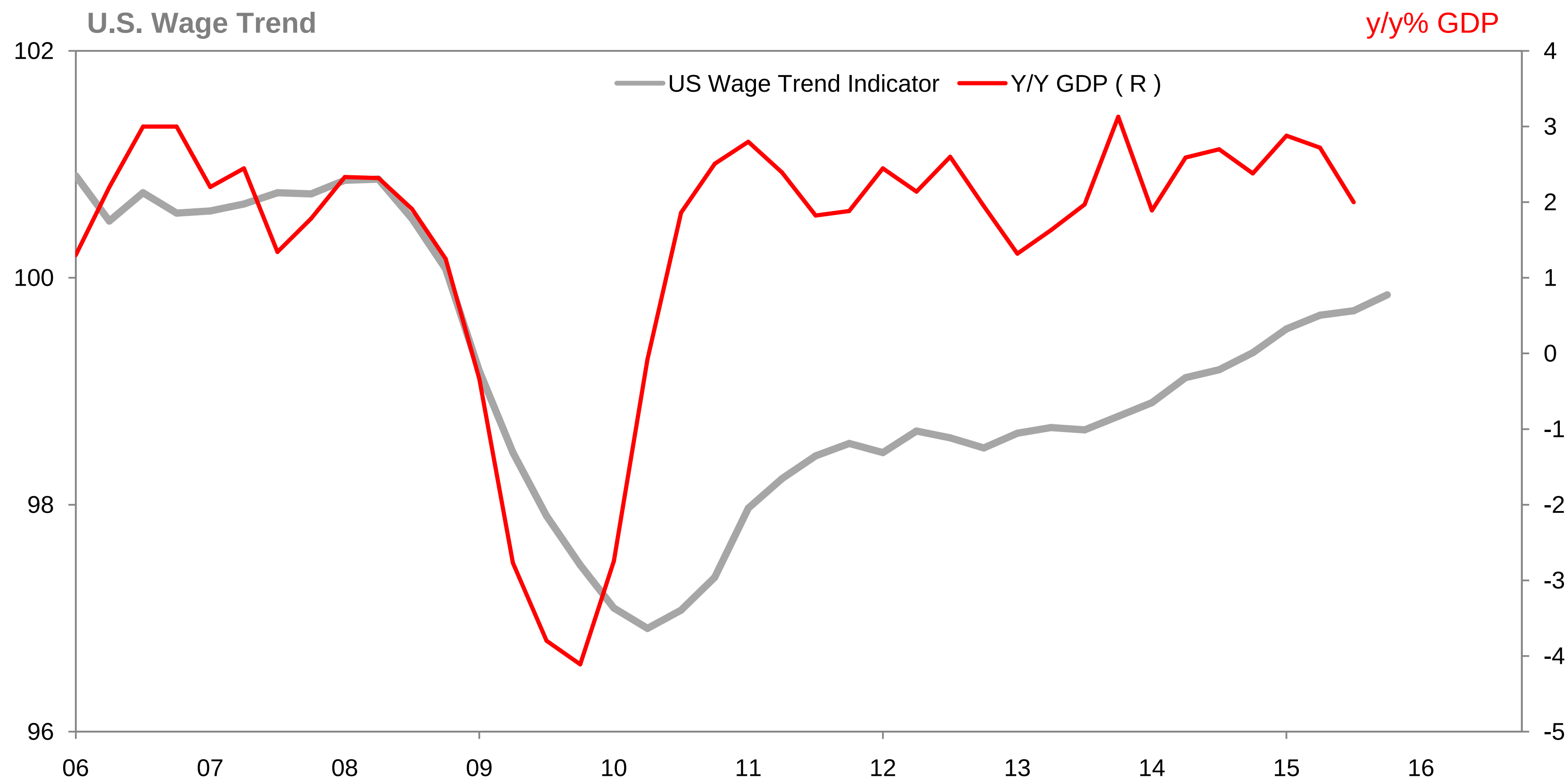
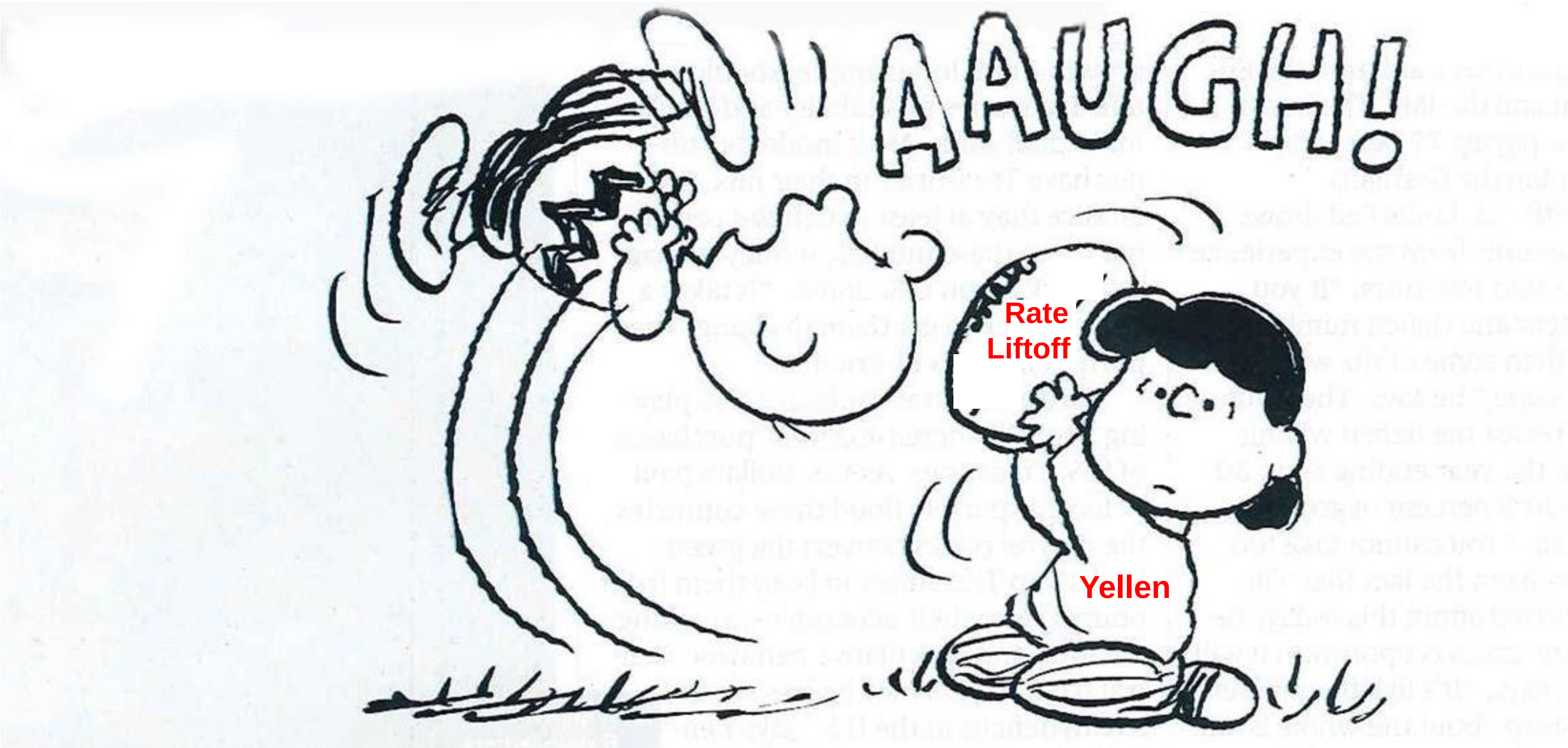


Source: Bloomberg,

Wage vs GDP Growth



Source: Bureau of National Affairs, Bloomberg



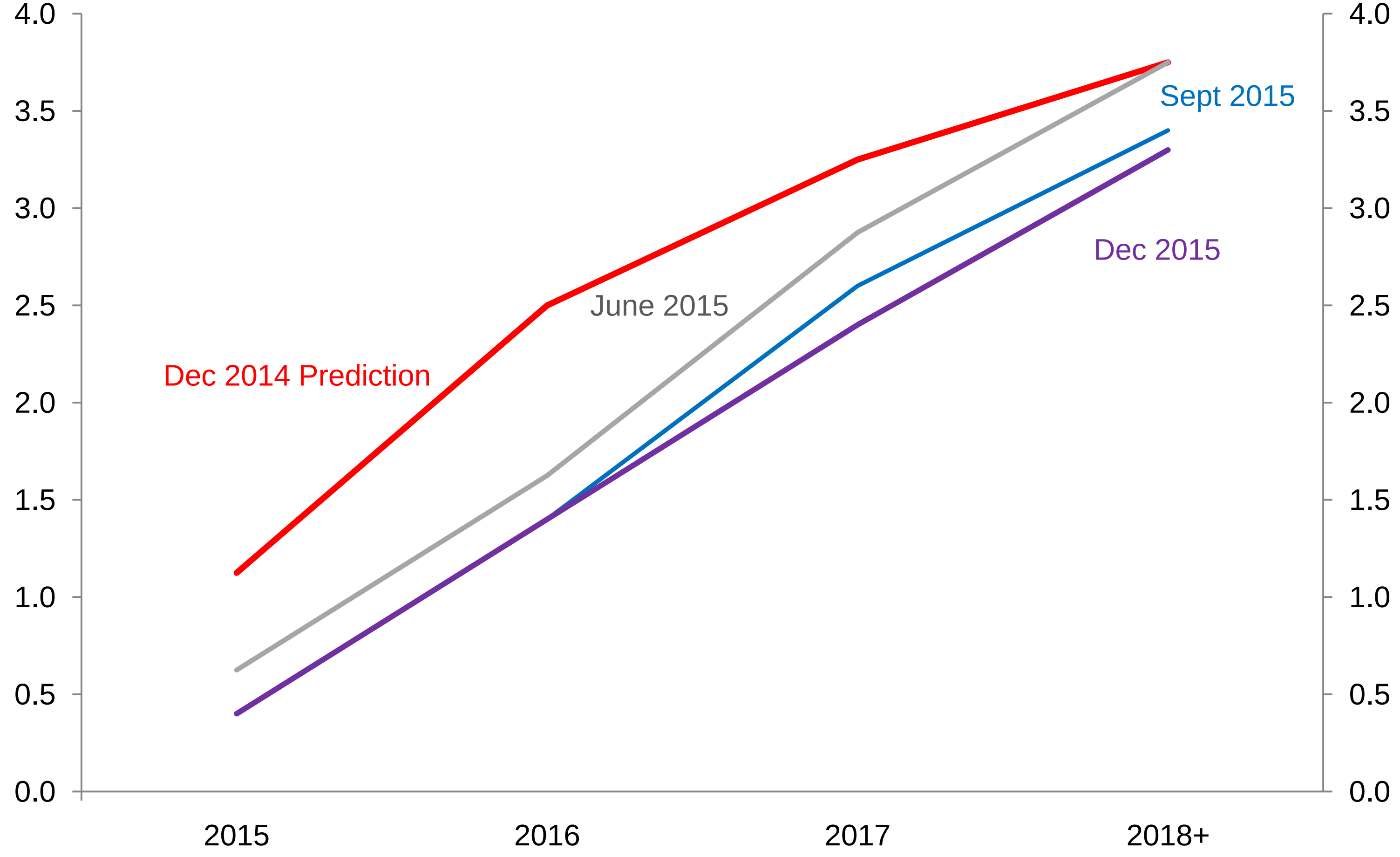
Rats! Financial Markets Fall for Same Old Fed Trick

One year ago, the consensus of the FOMC was they would tighten 4 – 5 times during 2015.

Bloomberg Businessweek

Fed's FOMC Prediction of Fed Funds Levels by Meeting

WCB



One year ago, the consensus of the FOMC was they would tighten 4 – 5 times during 2015.

Source: Federal Reserve Board

Reasons for the Fed to Continue Tightening

4) More Hawkish FOMC Profile in 2016

WCB

Dove = 1 Hawk = 5

2014 Federal Open Market Committee

2015 FOMC

- Remained on FOMC
- Rotated Off FOMC or Retired
- Rotated On FOMC

Janet Yellen	Chair		1
William Dudley	New York	1	
Lael Brainard	Board	2	
Stanley Fischer	Board	2	
Jerome Powell	Board	3	
Daniel Tarullo	Board	2	
Richard Fisher	Dallas	5	
Kocherlakota	Minneapolis		1
Loretta Mester	Cleveland	4	
Charles Plosser	Philadelphia		5

Charles Evans	Chicago	1
Jeffrey Lacker	Richmond	3
Dennis Lockhart	Atlanta	1
John Williams	San Francisco	2

Average Rating 2014 FOMC 2.6

Average Rating 2015 FOMC 1.8

Source: Federal Reserve Board & Joseph LaVorgna of Deutsche Bank 2015

The FOMC will become more likely to tighten in 2016 WCB

Dove = 1 Hawk = 5

2015 Federal Open Market Committee

Janet Yellen	Chair	
William Dudley	New York	1
Lael Brainard	Board	2
Stanley Fischer	Board	2 - > 3
Jerome Powell	Board	3
Daniel Tarullo	Board	2
Charles Evans	Chicago	1
Jeffrey Lacker	Richmond	3
Dennis Lockhart	Atlanta	1
John Williams	San Francisco	2

2016 FOMC

1 - > 2

Remaining on FOMC

Rotated Off FOMC or Retired

Rotated On FOMC

Loretta Mester	Cleveland	4
James Bullard	St. Louis	4
Eric Rosengren	Boston	1
Esther George	Kansas City	5

Average Rating 2015 FOMC 1.8

Average Rating 2016 FOMC 2.7

Source: Federal Reserve Board & Joseph LaVorgna of Deutsche Bank 2015

Taylor Rule Target

Fundamental Analysis of Short-Term Rates – Fed Funds Valuation*

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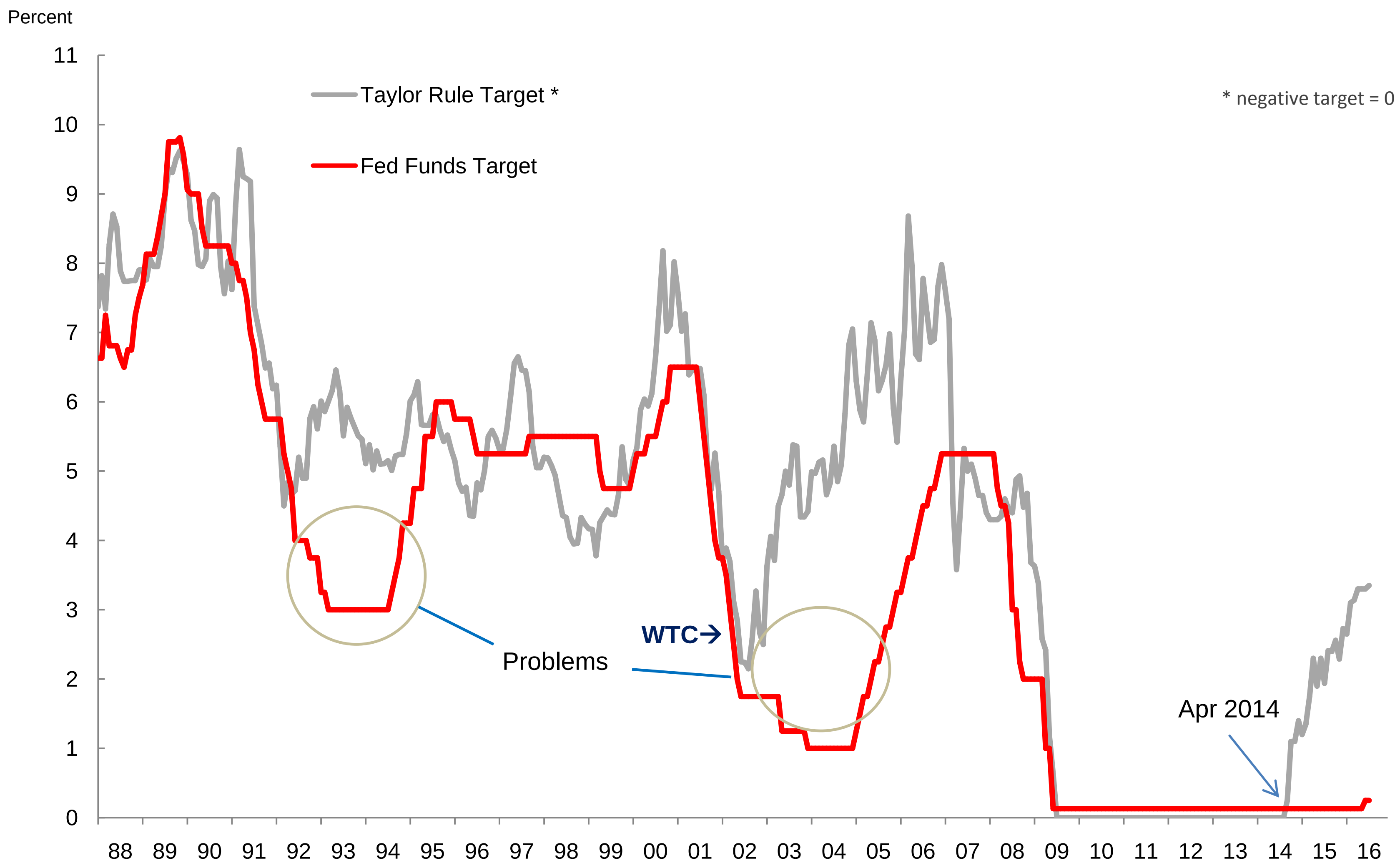

In the past, a negative real Funds rate has greatly stimulated the economy, just as a positive 2 -3% level has slowed the economy, like in 2007. This prolonged negative interest rate encouraged excessive risk taking, unwise bank lending, and commodity inflation.

Source: Salomon Smith Barney, Bloomberg, Federal Reserve, Institute for Supply Management, Bureau of Labor Statistics, WCB computations

Reasons for the Fed <u>NOT</u> to Continue Tightening

1) Inflation is Low – Below where the Fed wants

Target of 2% on PCE;
CPI has fallen short of 2% goal for last 4 years

2) Inflation Expectations Are Low

TIPS 5 year forward yield is weak

3) GDP Growth in Question

4) Labor Participation Rate – at 38 year low 62.6% rate

5) Economy Running at only 76.5% of capacity

6) Strong U.S. Dollar
Hurts Exports, Lowers Inflation, Slows U.S. economy
Hurts profits from multinational companies

7) Foreign Influences
China Devaluation – Impact World Equity Markets
Greece / EU Issues

8) Stock Market in Correction

Reasons for the Fed NOT to Continue Tightening

1) Inflation is Low – Below where the Fed wants

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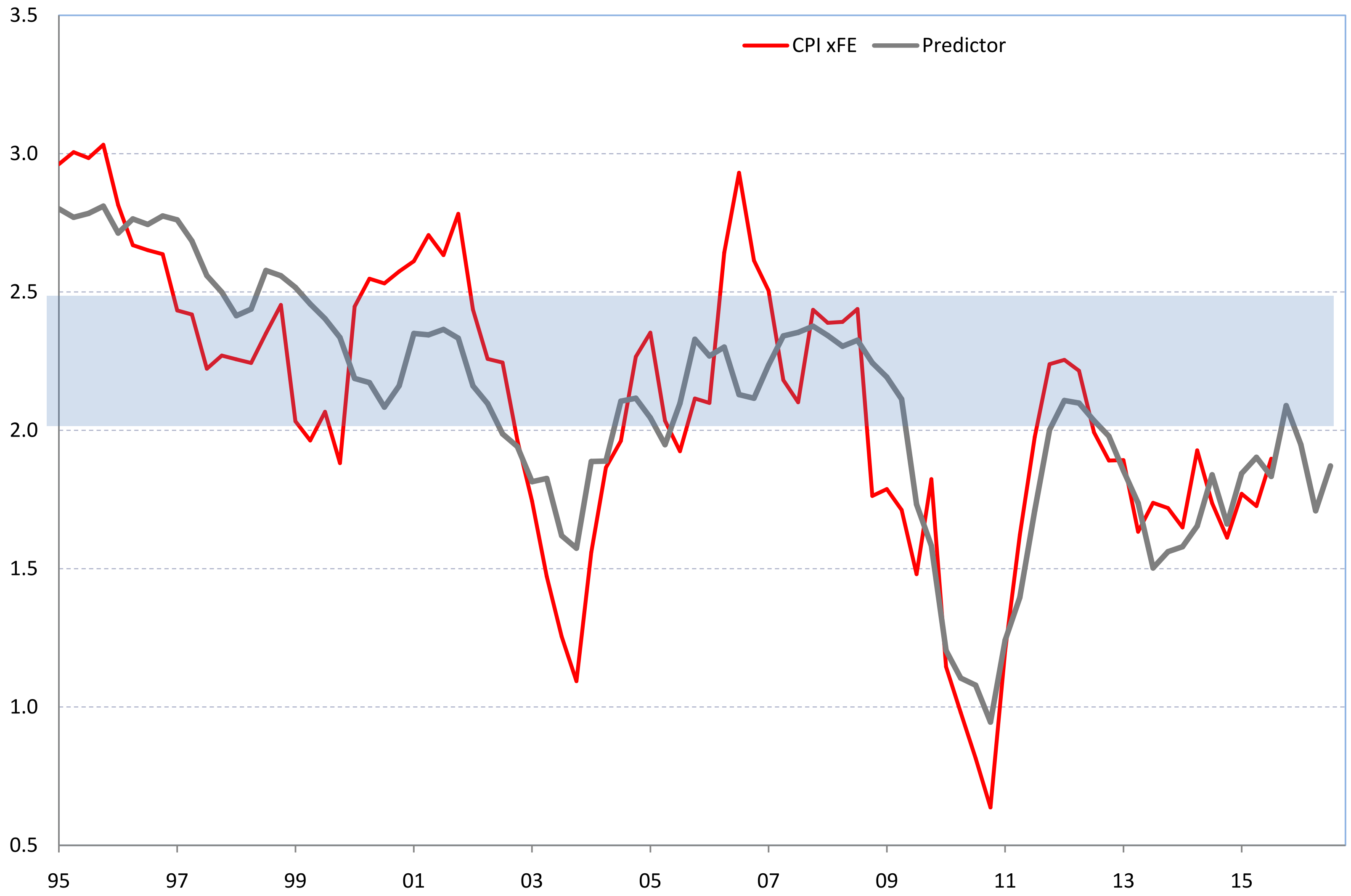
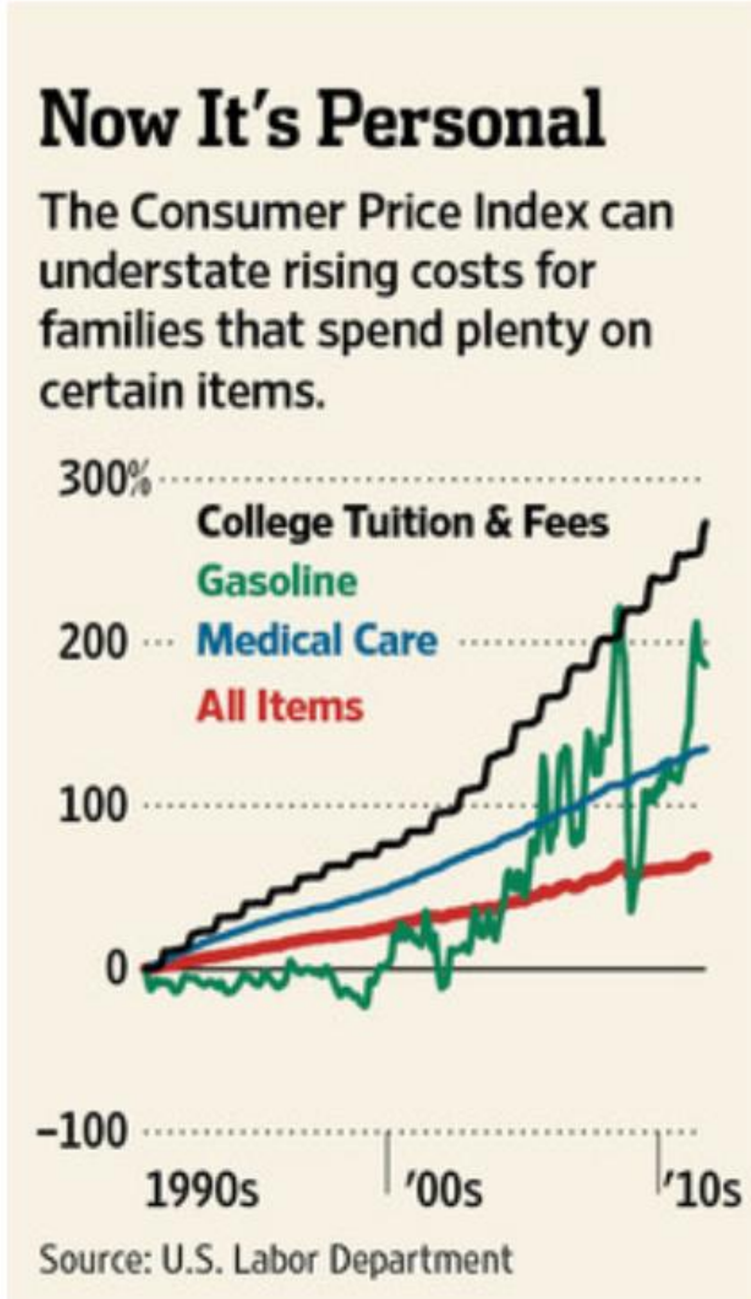
Near Term Inflation Model



Source: Merrill Lynch, Bloomberg, WCB computation
*Merrill Lynch Credit Card Master OAS

Inflation Other:



Source: WSJ 10-23-11

Single Biggest Problem Top 10 Ranking

PROBLEM	CURRENT	ONE YR AGO	SURVEY HIGH - LOW
Taxes	22	27	32 - 8
Gov't Regulation / Red Tape	20	22	27 - 4
Quality of Labor	15	11	24 - 3
Poor Sales	11	11	34 - 2
Cost / Availability of Insurance	9	8	29 - 4
Large Business Competition	7	8	14 - 4
Other	7	5	31 - 3
Cost of Labor	5	4	9 - 2
Finance and Interest Rates	2	1	37 - 1
Inflation	2	3	41 - 0

Becoming Less of a Relative Problem
Becoming More of a Relative Problem

Source: Small Business Economic Trends Survey, 1986 - 2015, December 2015

Reasons for the Fed NOT to Continue Tightening

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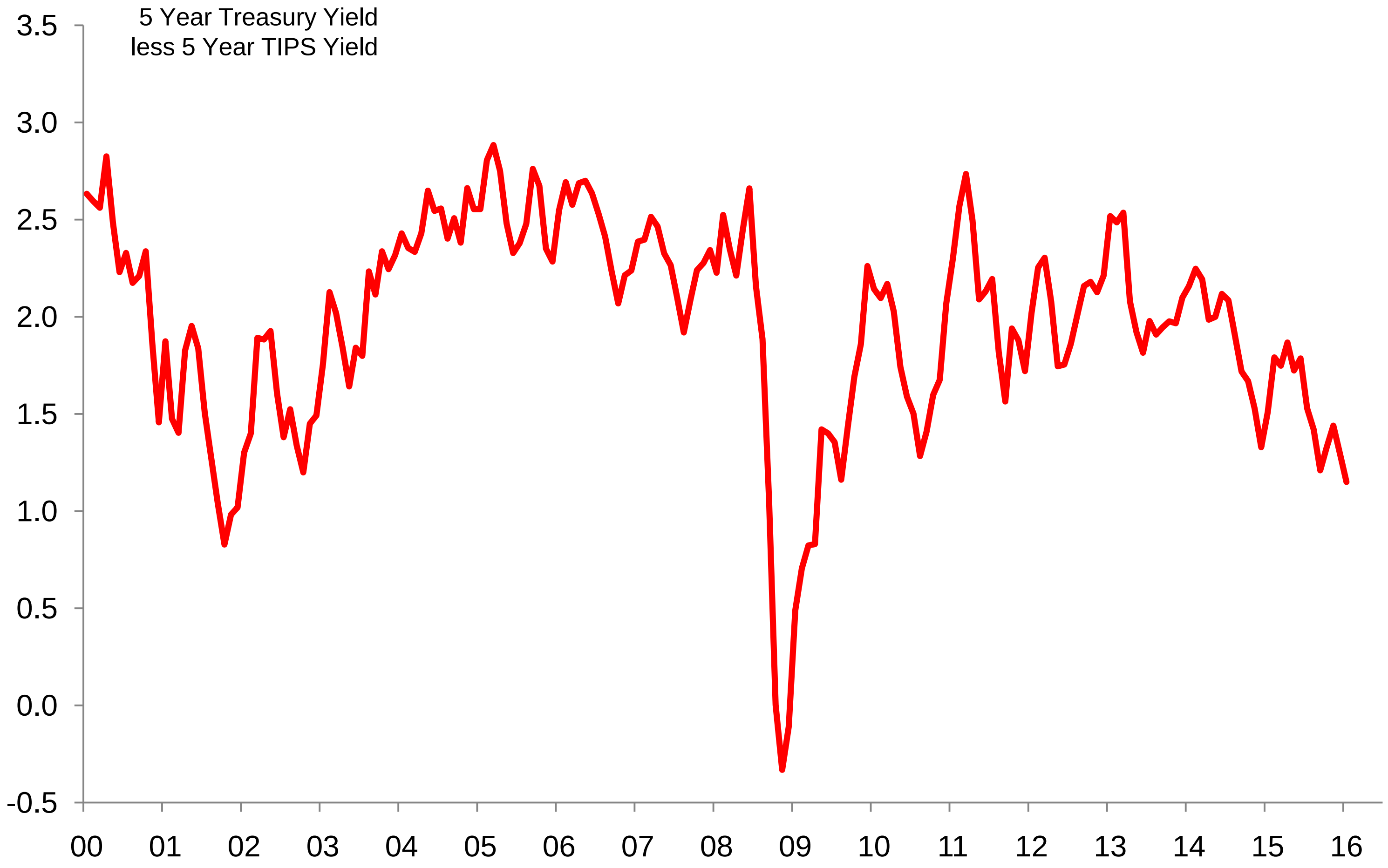
2) Inflation Expectations Are Low

5 YEAR EXPECTED INFLATION

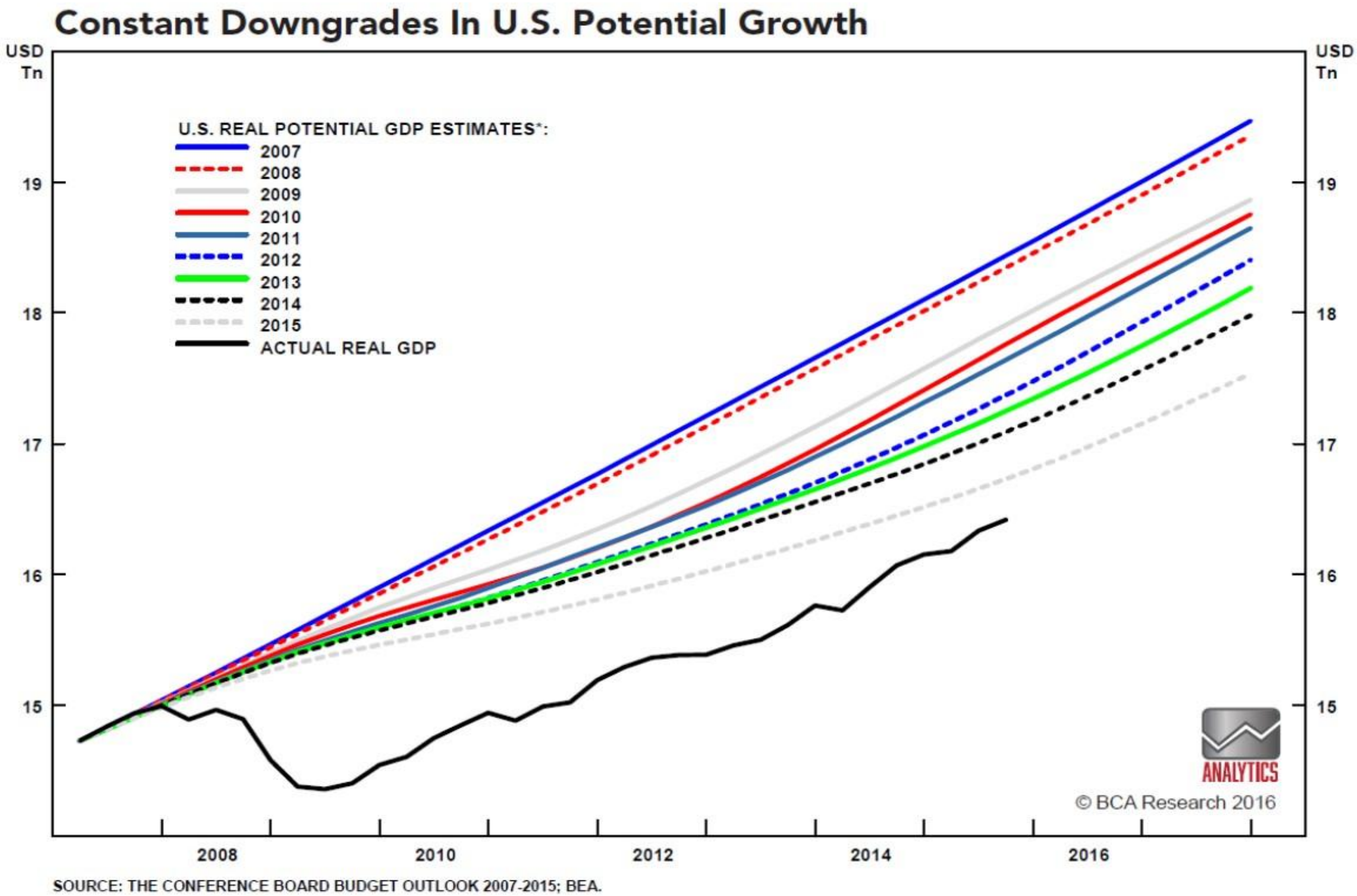


Source: Bloomberg,

Reasons for the Fed NOT to Continue Tightening

3) GDP Growth in Question

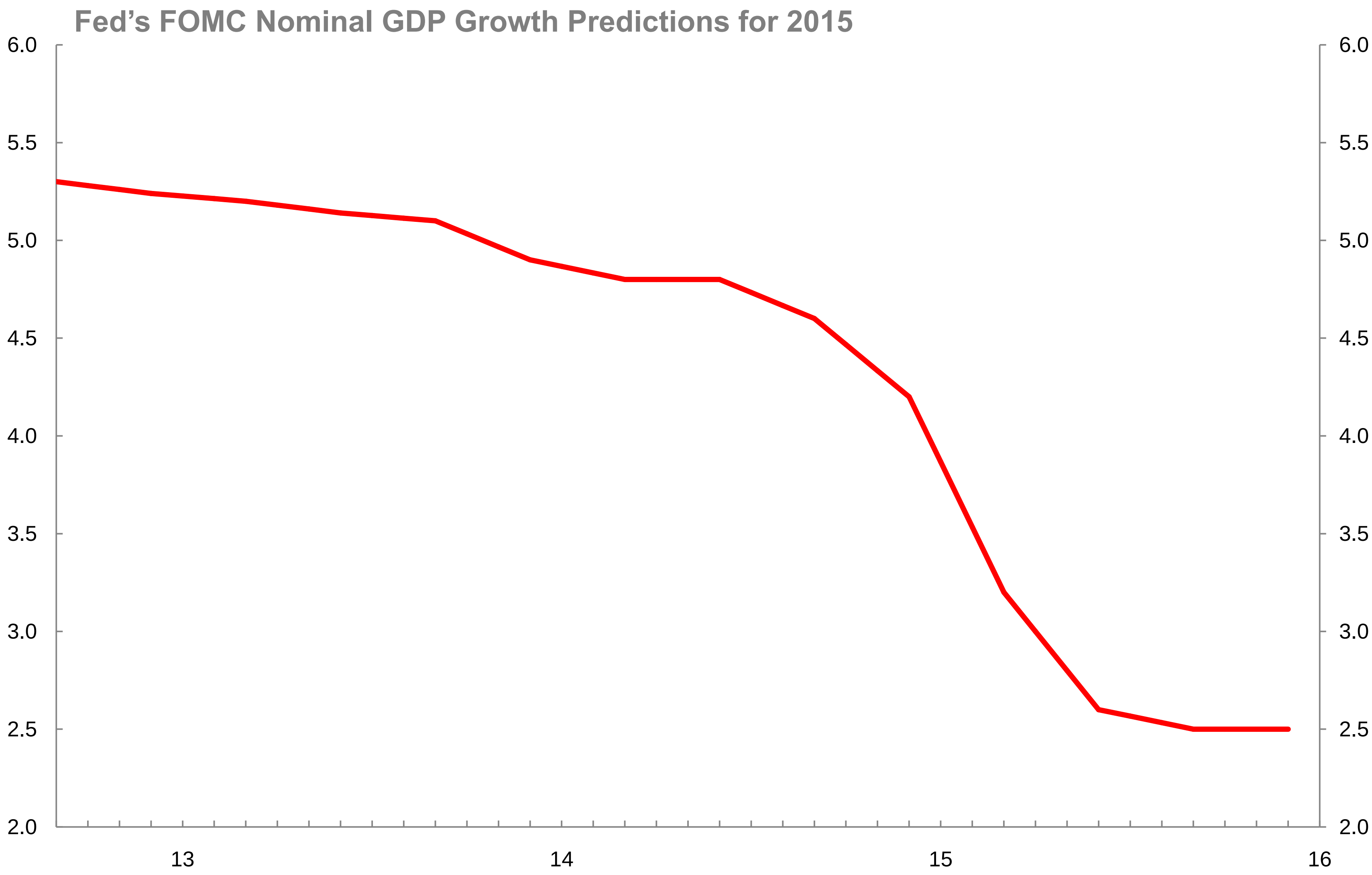
WCB



Source: Bloomberg, Ned Davis Research, NFIB

Reasons for the Fed NOT to Continue Tightening
3) GDP Growth In Question

WCB



Source: Federal Reserve

Reasons for the Fed NOT to Start Tightening

4) Labor Participation Rate is Low

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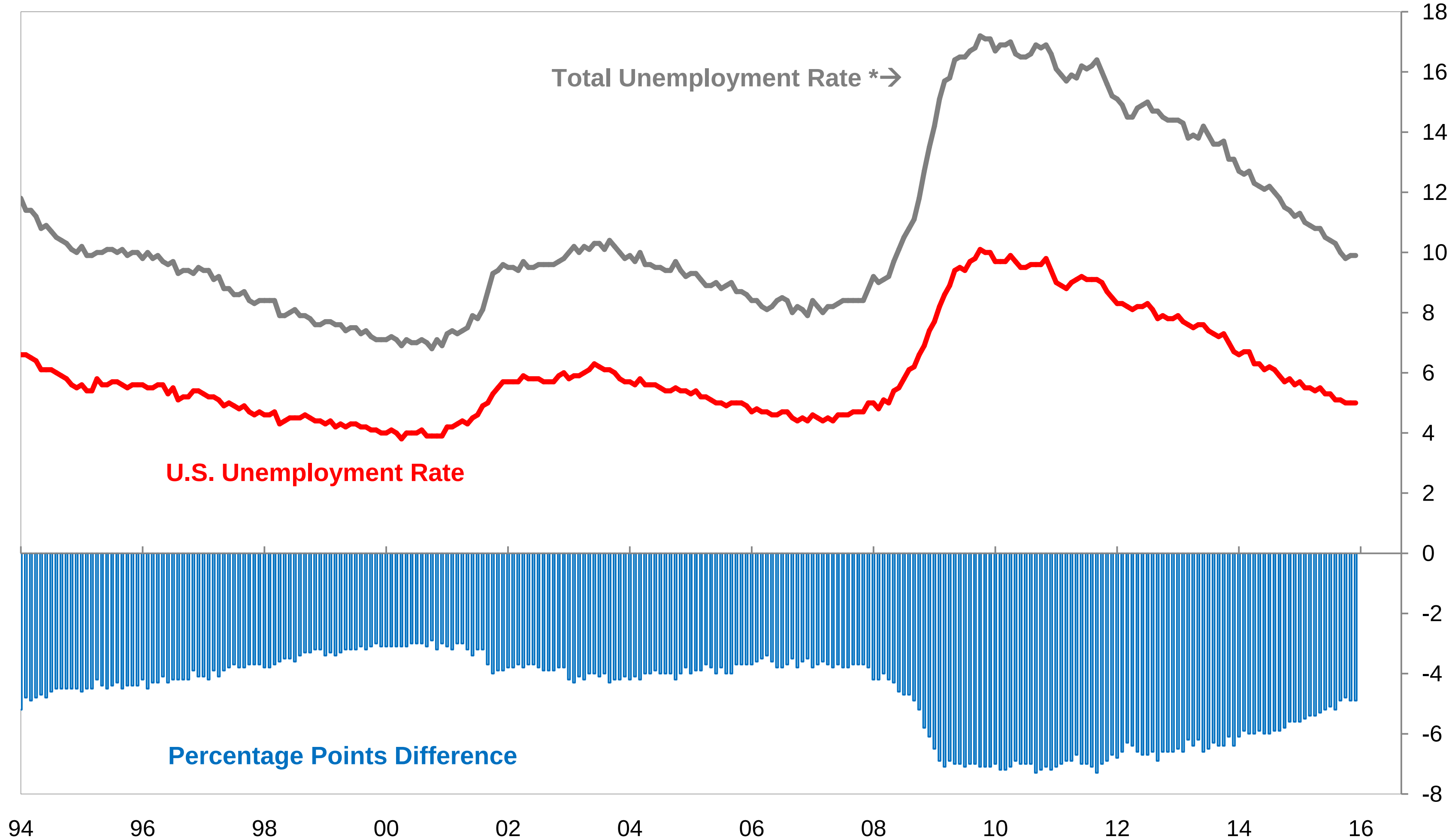
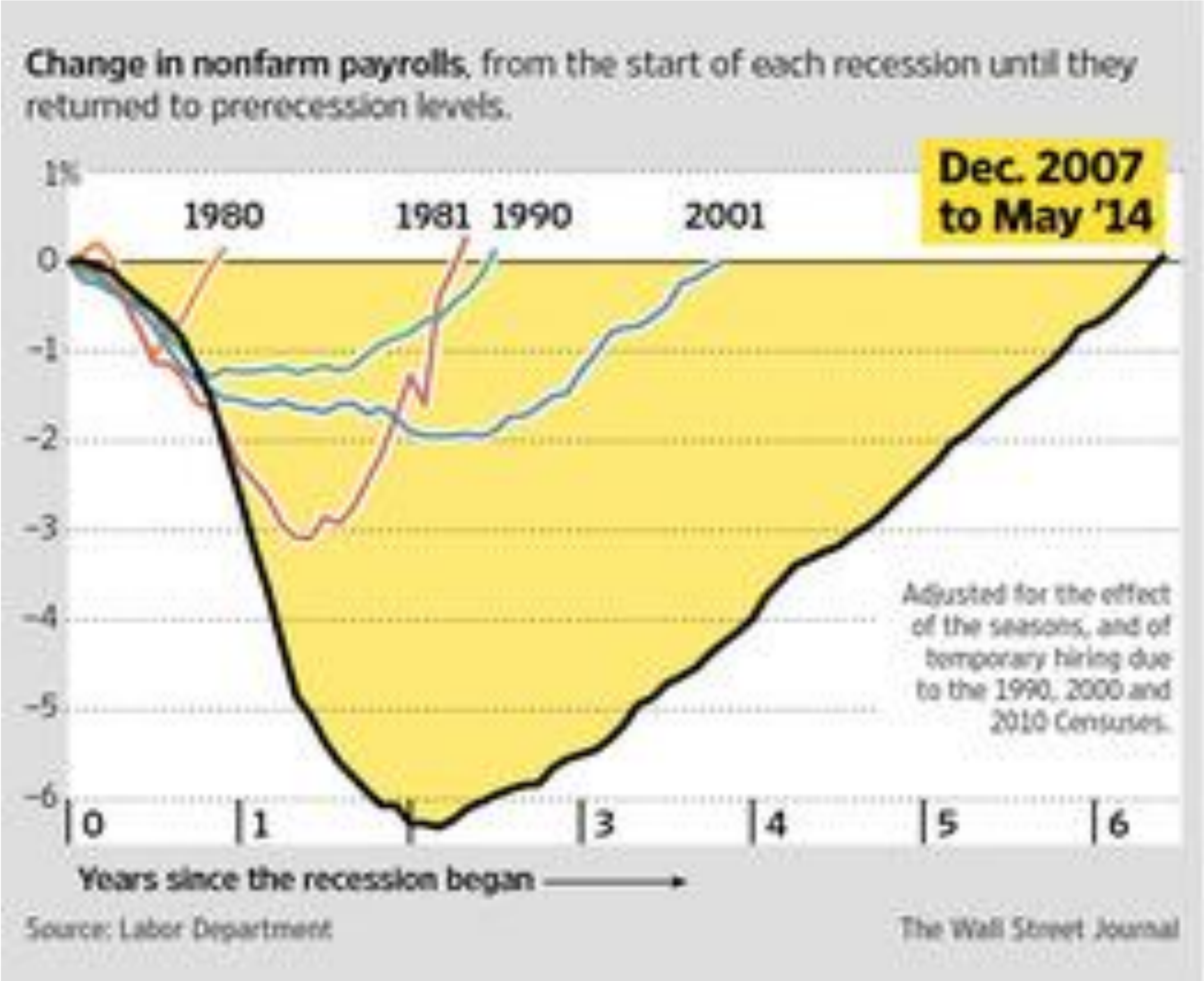


* U6 unemployment, which includes involuntarily part time and discouraged job seekers in addition to the jobless

Source: Bloomberg, Ned Davis Research, NFIB

THE DEEPEST JOB RECESSION OF OUR TIME

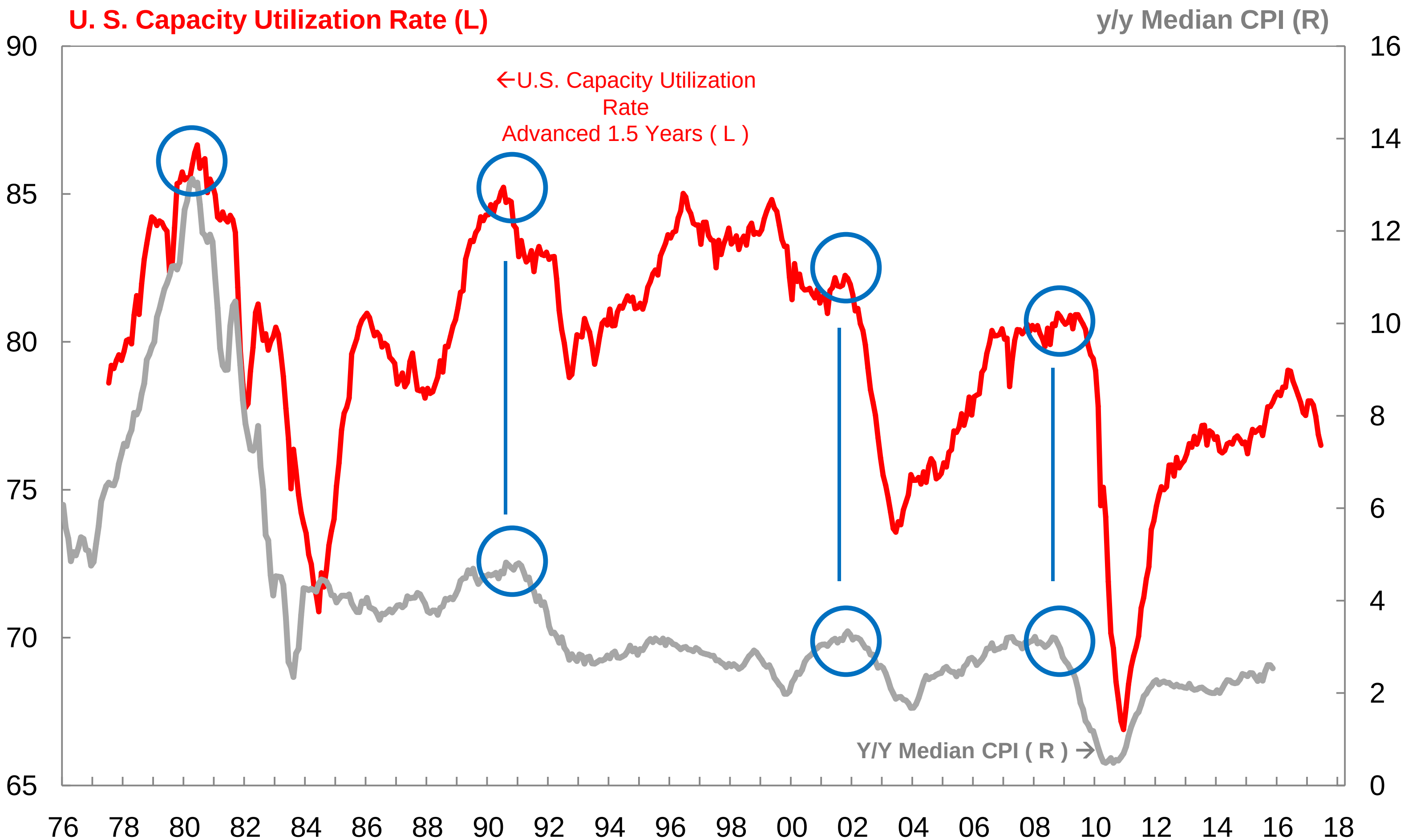


Source: Calculated RISK 9/2013

Reasons for the Fed NOT to Start Tightening

5) Economy Running at only 76.5% of capacity

WCB



Over the past 4 economic cycles, capacity utilization has led inflation by about a year and a half, with inflation not being a problem with the utilization rate under 80.

Conversely, inflation has bottomed about a year and a half after the capacity utilization rate peaks.

Source: Bloomberg, Federal Reserve Bank of Cleveland, WCB computations

Reasons for the Fed NOT to Start Tightening

6) Strong U.S. Dollar

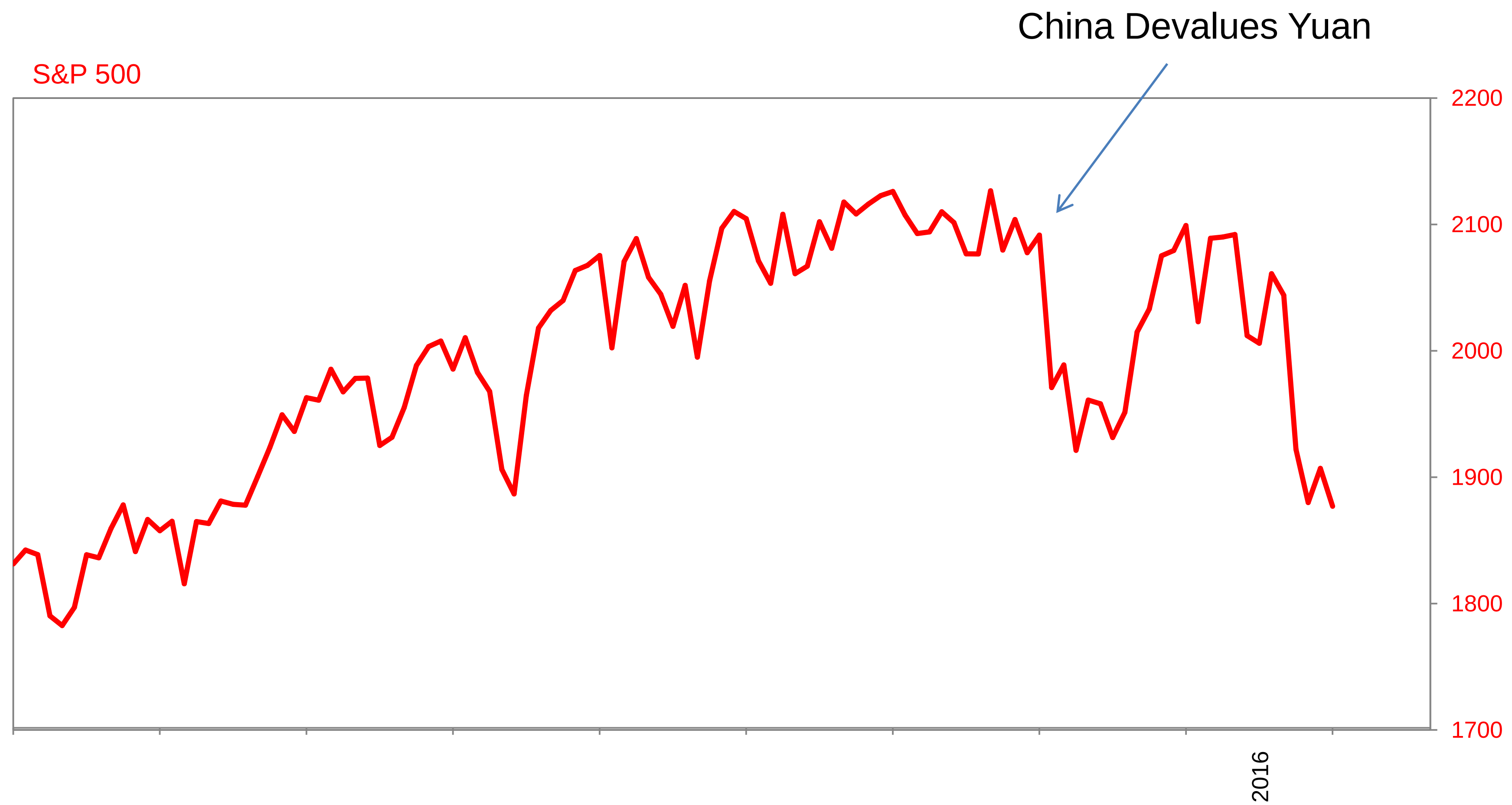
WCB

Source: Bloomberg

Reasons for the Fed NOT to Start Tightening

WCB

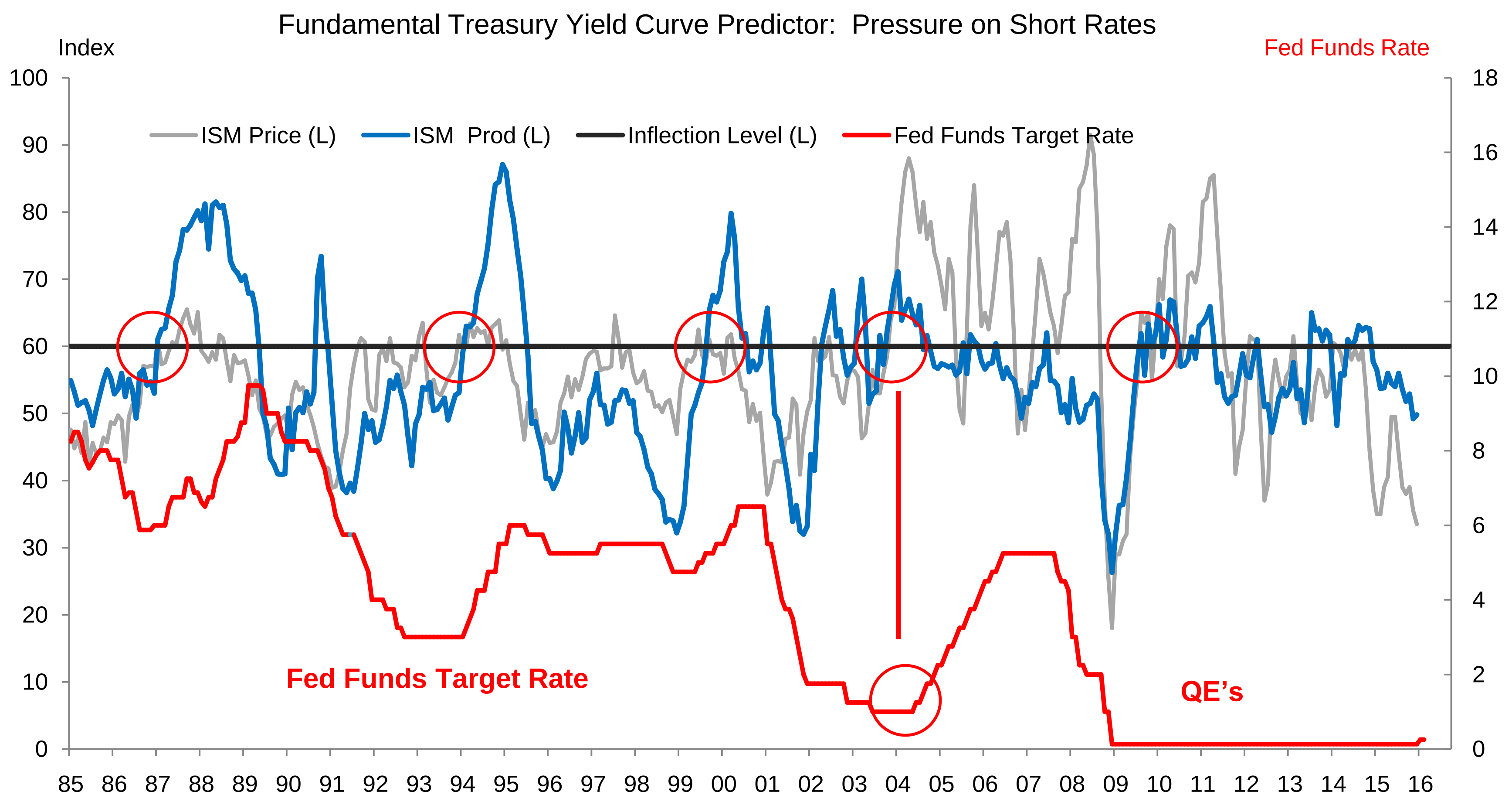
7) Foreign Influences: China Devaluation – Impact World Equity Markets



Source: Bloomberg

Reasons for the Fed NOT to Continue Tightening

WCB



In the past, the Fed raised the Fed Funds Target Rate when both the ISM Business Prices and Production Indices were above 60 and rising.

We are near that historical inflection point.

Source: Salomon Smith Barney, Bloomberg, Federal Reserve, Institute for Supply Management, Bureau of Labor Statistics, WCB computations

Pros and Cons for the Fed to Continuing Tightening Soon

WCB

Fed Will Raise Fed Funds Soon

1) Wage Growth Showing Signs of Increasing

   was < 2%; Should move with GDP growth

2) Headline Employment

   Has beaten all forecasts and Momentum is up

3) Fed Wants to Maintain Some Credibility

   After repeated and continuing threats to tighten

4) More Hawkish FOMC Profile in 2016

5) A return to a "normal" Fed Policy is desired

   After 7 years of mixed results from ZIRP

6) Imbalances in Asset Prices are Appearing

7) Fed Wants Some Ammo for the next Slowdown

Fed Will Wait to Tighten

1) Inflation is Low – Below where the Fed wants

   Target of 2% on PCE;
   CPI has fallen short of 2% goal for last 4 years

2) Inflation Expectations Are Low

   TIPS 5 year forward yield is weak

3) GDP Growth Coming into Question

4) Labor Participation Rate – at 38 year low 62.2% rate

5) Economy Running at only 77.6% of capacity

6) Strong U.S. Dollar
   Hurts Exports, Lowers Inflation, Slows U.S. economy
   Hurts profits from multinational companies

7) Foreign Influences
   China Devaluation – Impact World Equity Markets
   Greece / EU Issues

8) Stock Market in Correction

Source: Federal Reserve Board & Joseph LaVorgna of Deutsche Bank

Fannie rolls out 3% down payment option for homebuyers in 2015

New 97% LTV program expands buyer access to credit

What could possibly go wrong?

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