

Economic Outlook: *Turning the Corner to 2015*

Lindsey M. Piegza
Chief Economist

February 2015

Table of Contents

Agenda

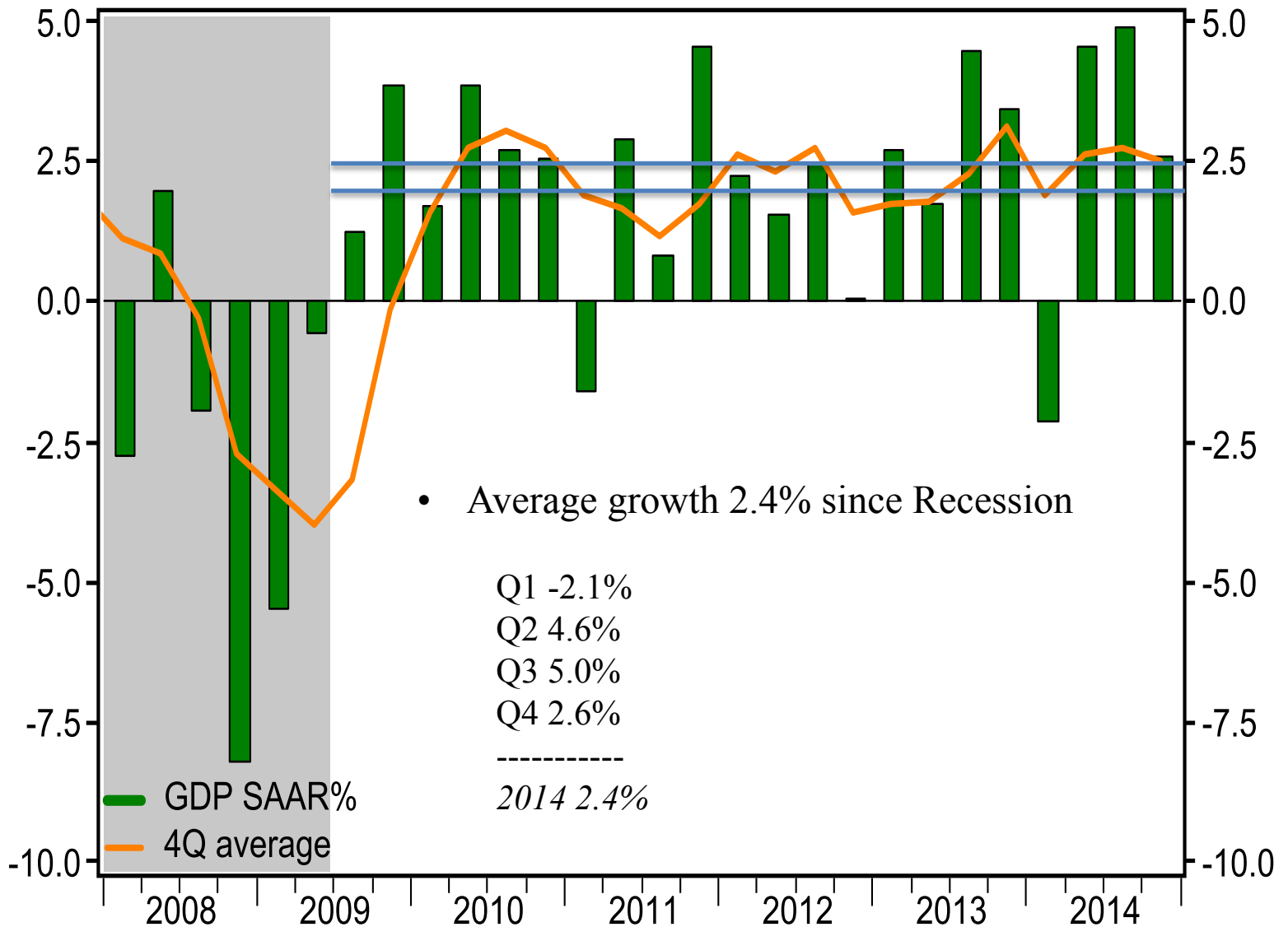
1. Growth
2. Energy, Inflation and the International Economy
3. Labor Market
4. Consumers and Investment
5. Housing
6. The Fed
7. Summary and Outlook
8. Forecast Grid



Growth

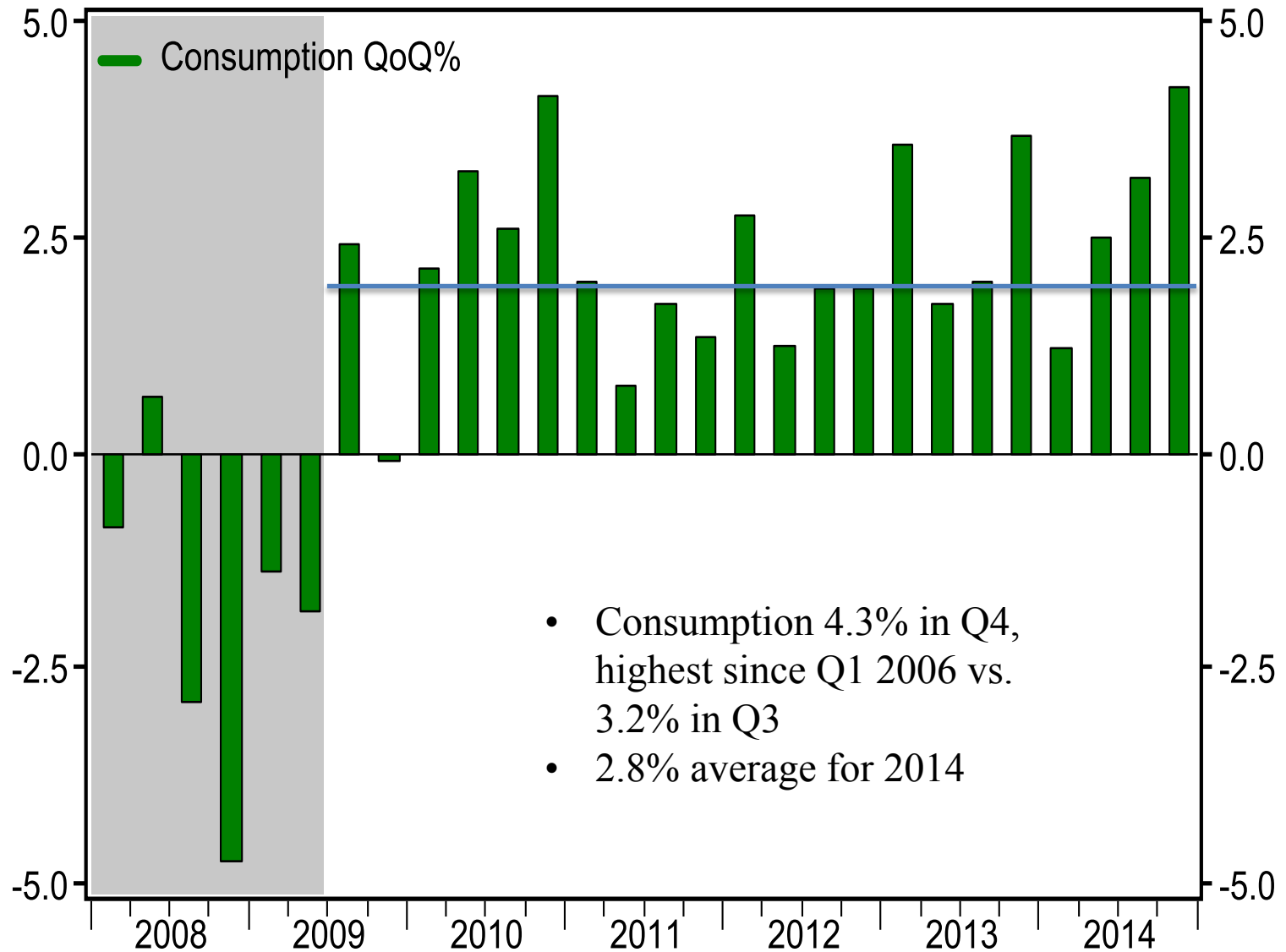


Growth Momentum Slows



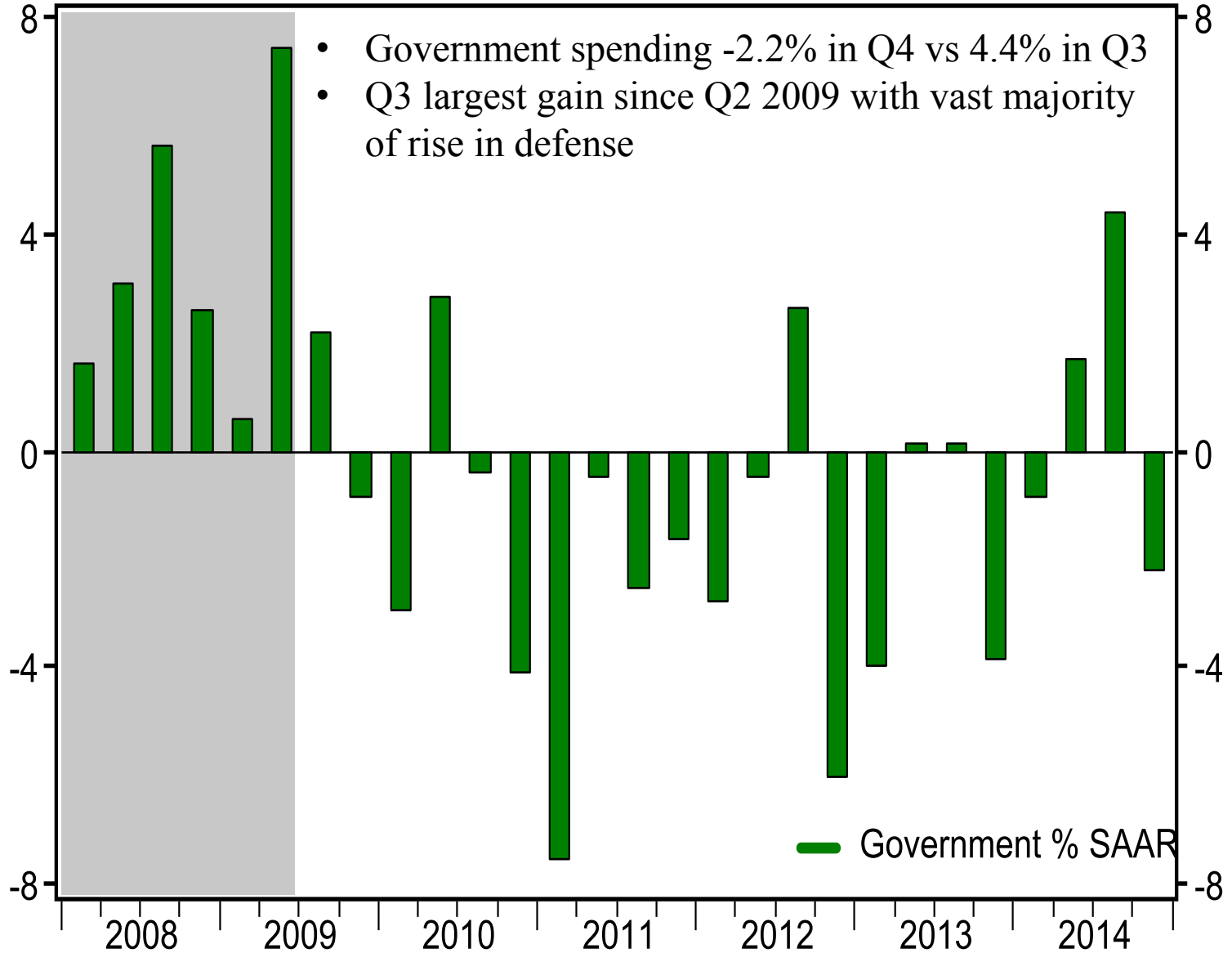
Source: Bureau of Economic Analysis /Haver Analytics

Above Trend Consumption Growth



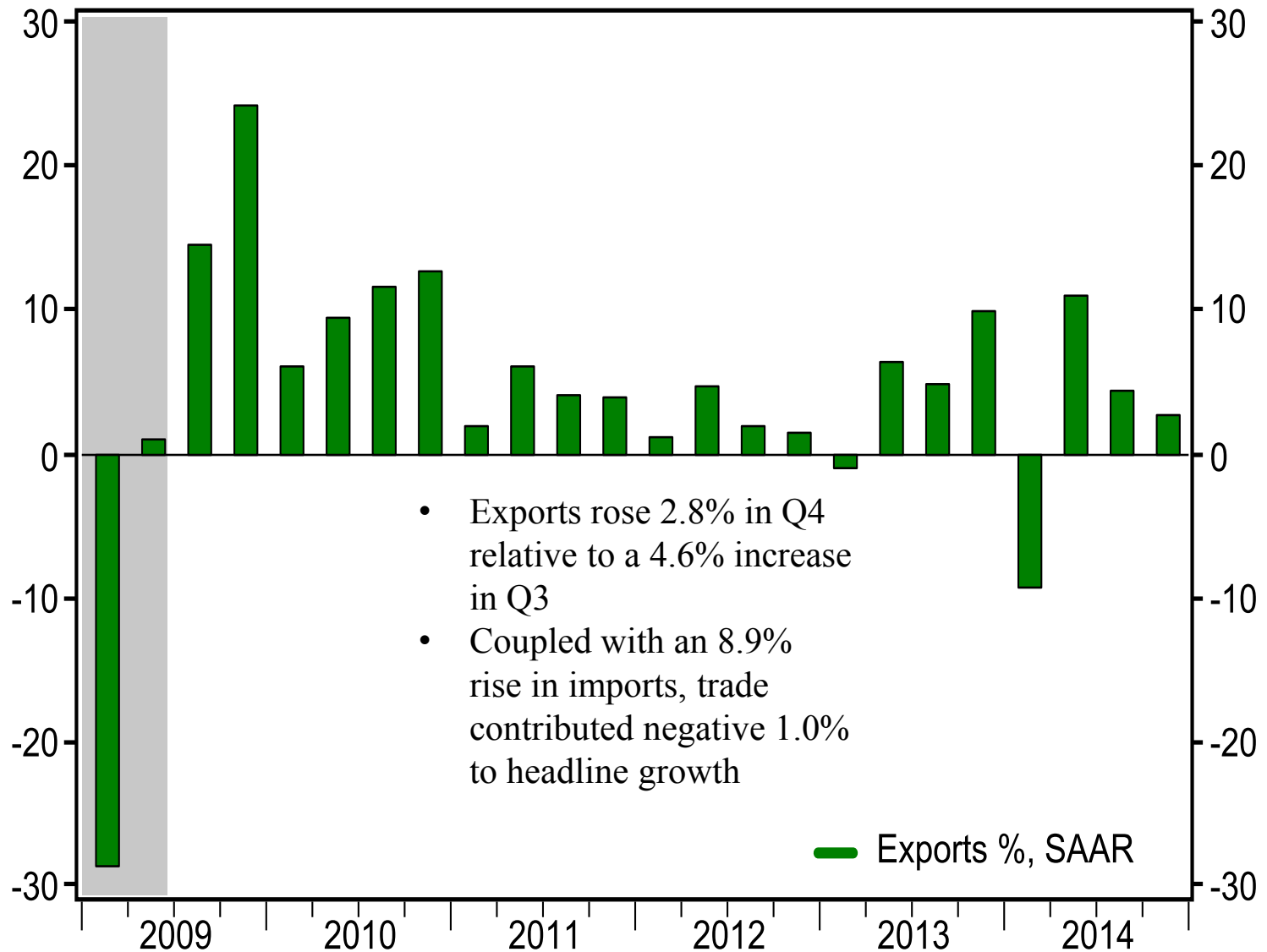
Source: Bureau of Economic Analysis /Haver Analytics

Government Spending Declines



Source: Bureau of Economic Analysis /Haver Analytics

Export Growth Weakened by Stronger Dollar

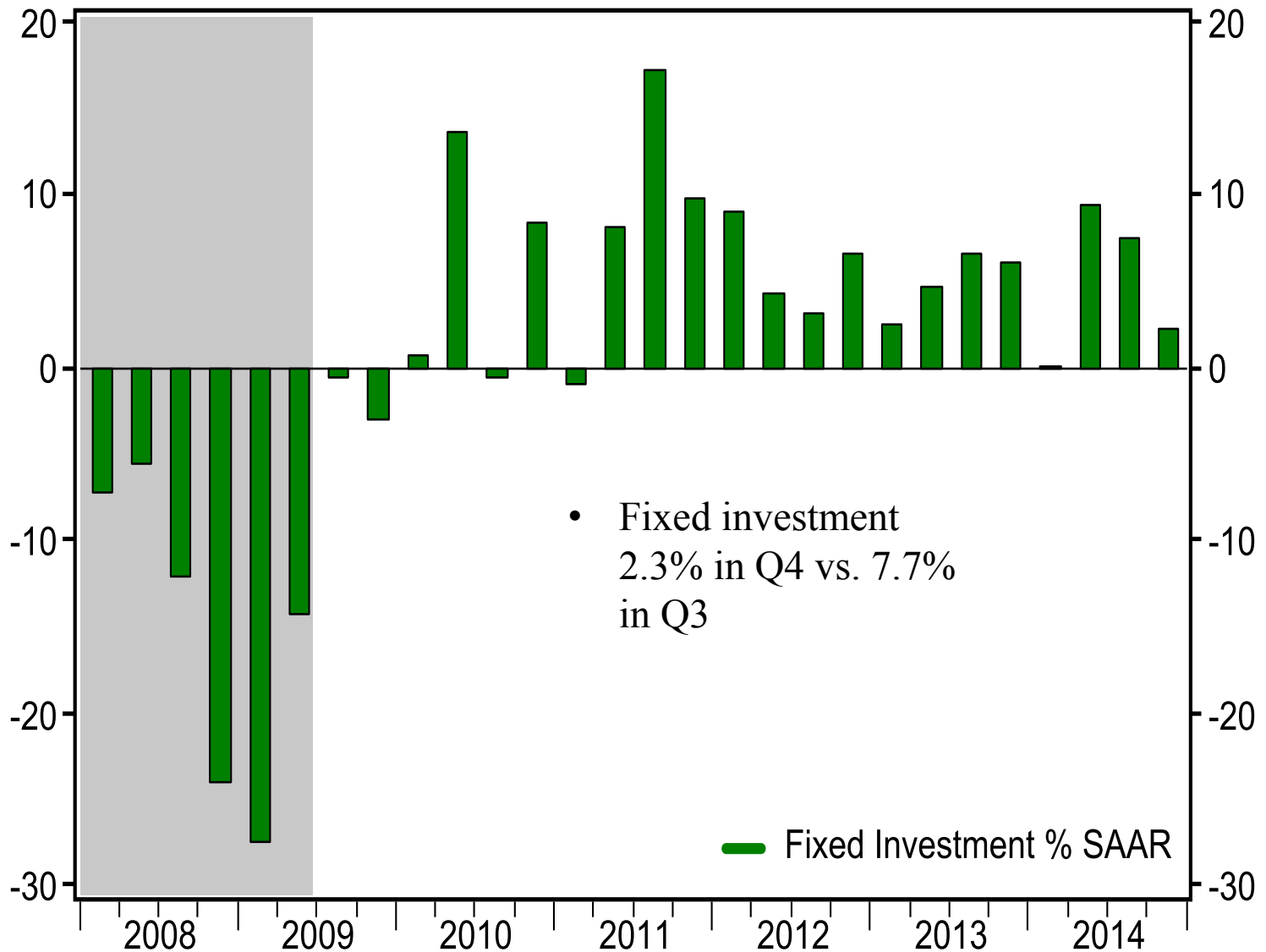


- Exports rose 2.8% in Q4 relative to a 4.6% increase in Q3
- Coupled with an 8.9% rise in imports, trade contributed negative 1.0% to headline growth

Exports %, SAAR

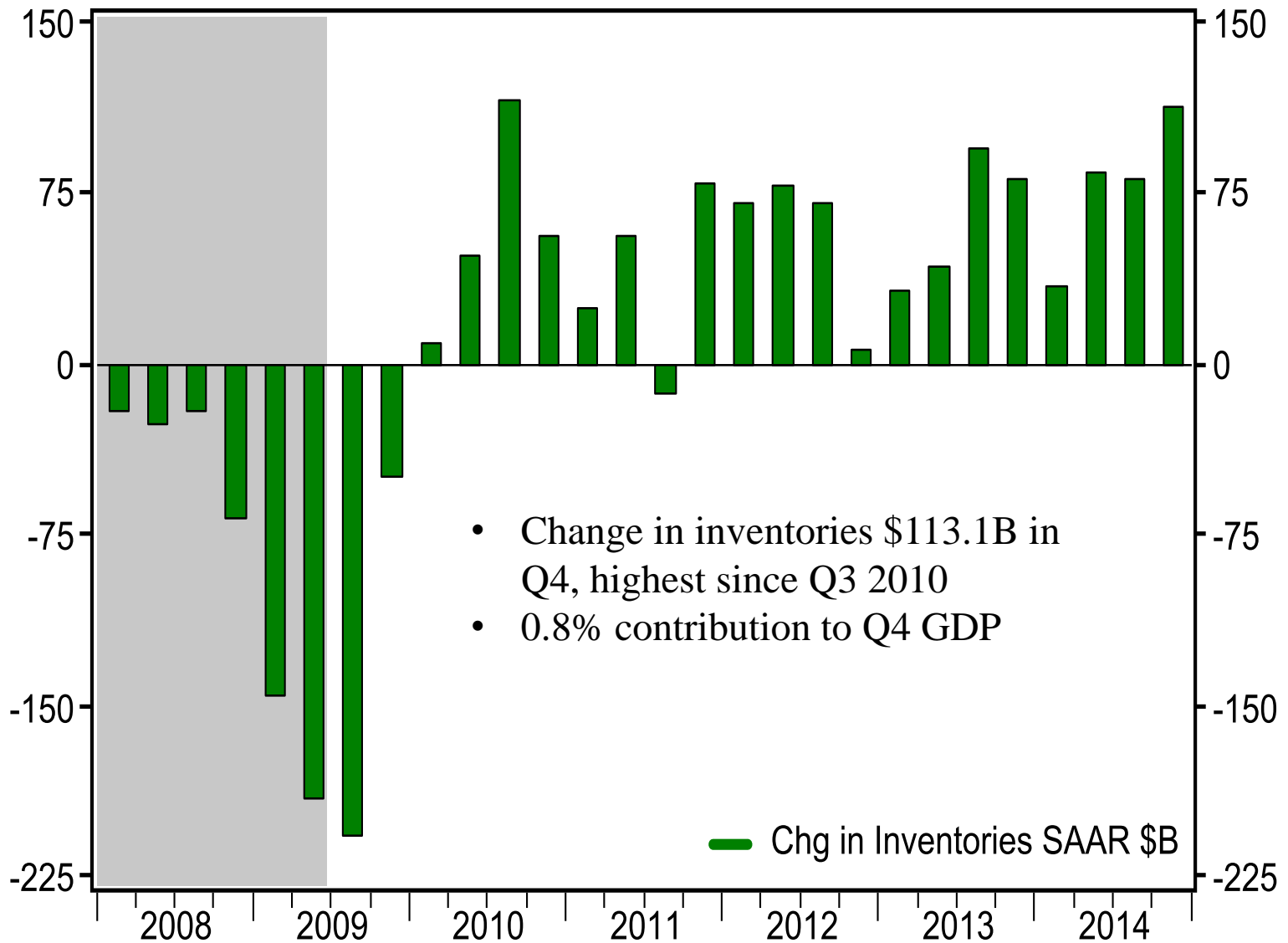
Source: Bureau of Economic Analysis /Haver Analytics

Waning Investment Momentum



Source: Bureau of Economic Analysis /Haver Analytics

Inventory Growth

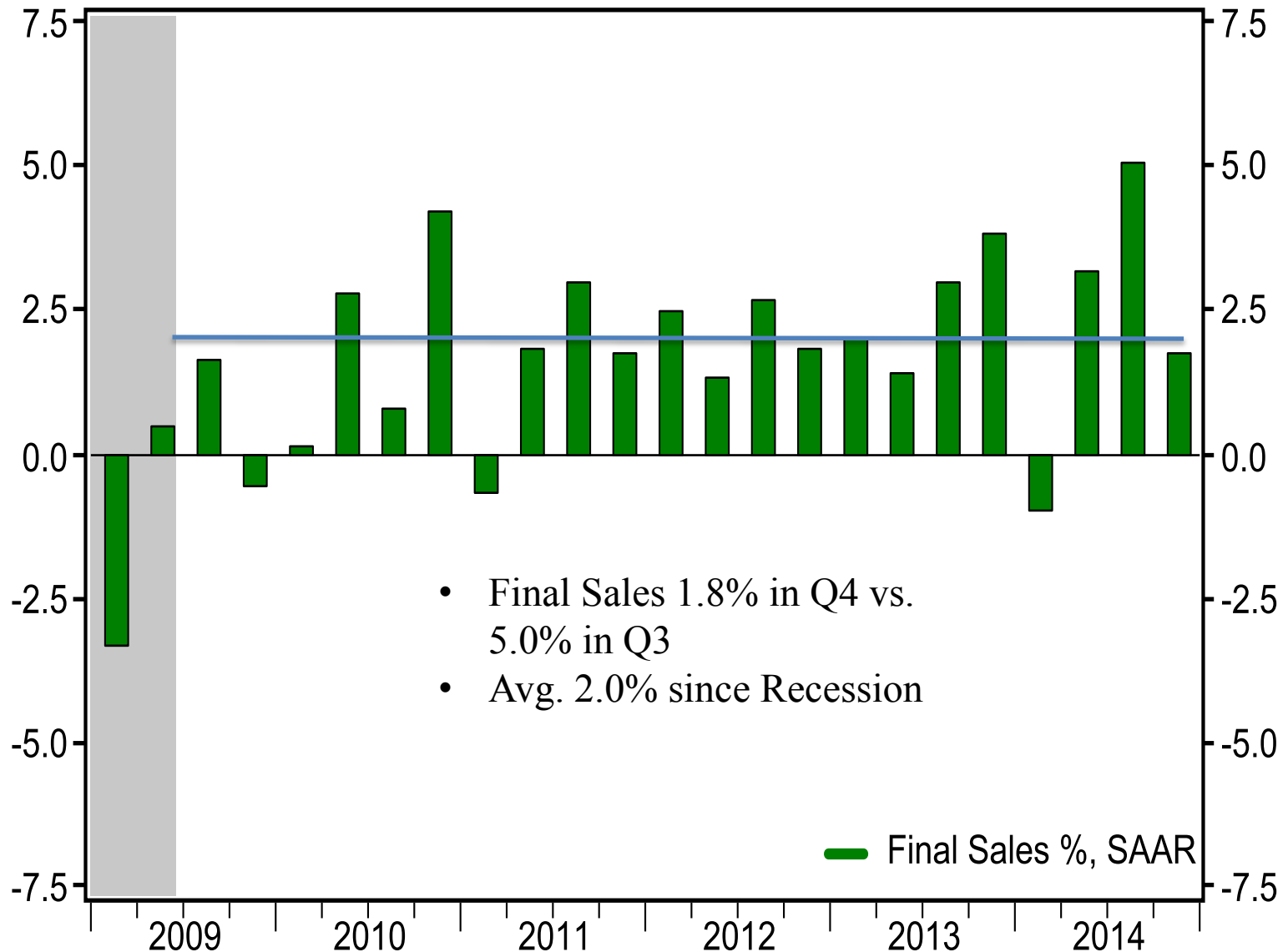


- Change in inventories \$113.1B in Q4, highest since Q3 2010
- 0.8% contribution to Q4 GDP

— Chg in Inventories SAAR \$B

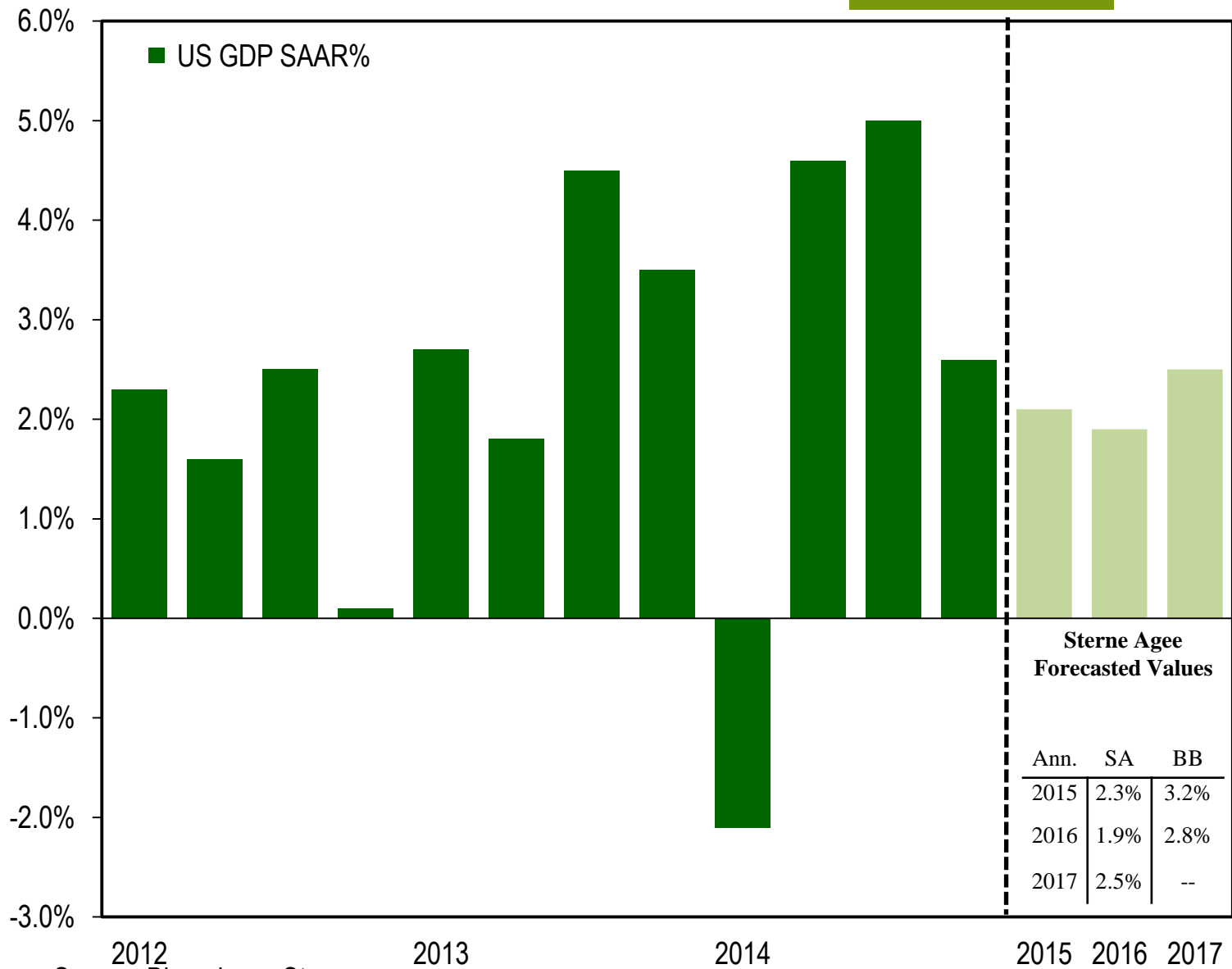
Source: Bureau of Economic Analysis /Haver Analytics

Final Sales Below Trend



Source: Bureau of Economic Analysis /Haver Analytics

Forecasted GDP Growth



**Sterne Agee
Forecasted Values**

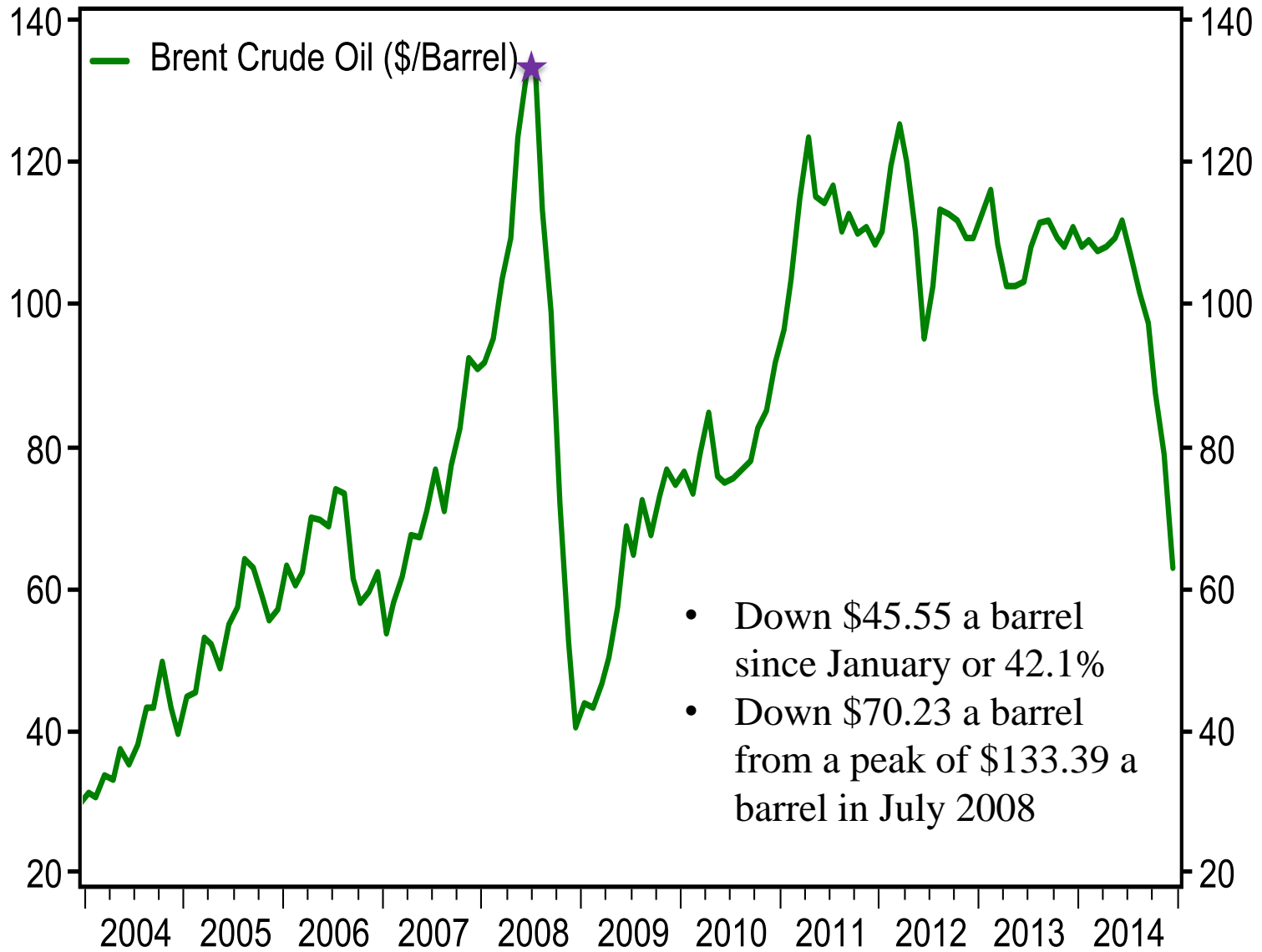
Ann.	SA	BB
2015	2.3%	3.2%
2016	1.9%	2.8%
2017	2.5%	--

Source: Bloomberg, Sterne



Energy, Inflation, and the International Economy

Crude Oil Prices Declining



Source: Financial Times /Haver Analytics

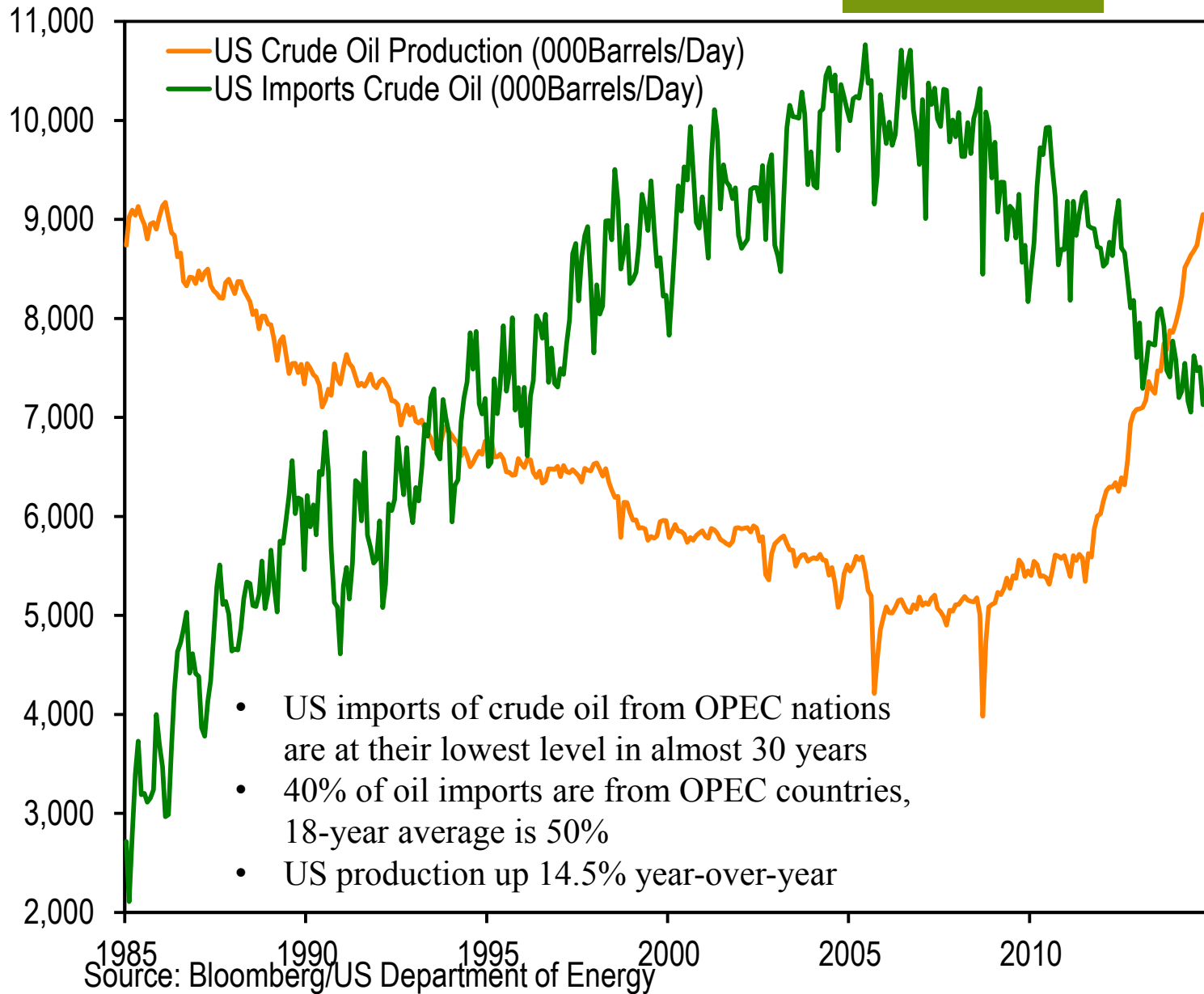
Imports of Crude Oil

	YTD 2014* Imports (K Barrels)	YTD 2014 Exports (K Barrels)	
Crude Oil	2,454,417	112,458	Net Importer
Crude Oil Products	620,069	1,261,097	Net Exporter
Petroleum	3,074,486	1,373,556	Net Importer

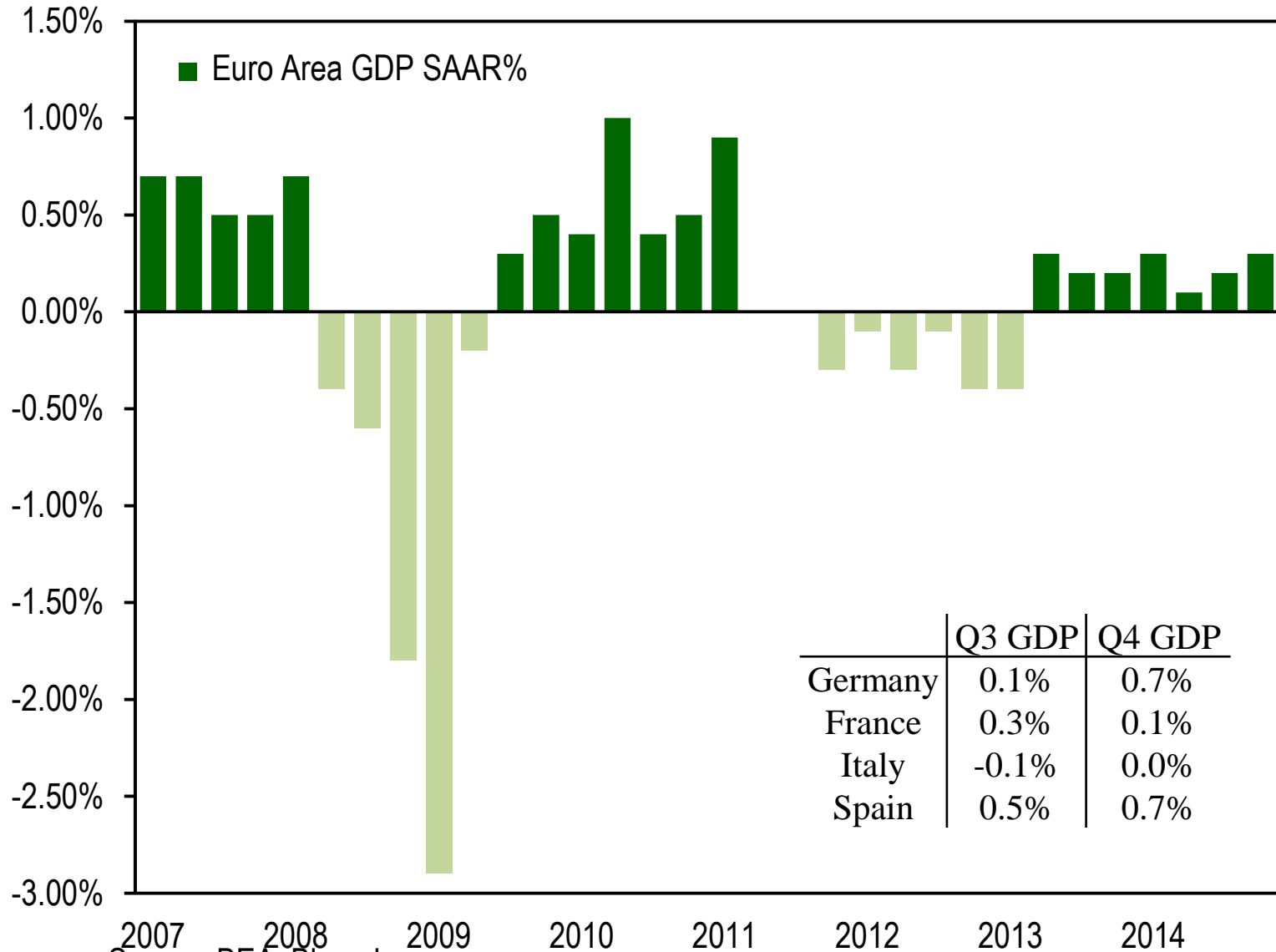
*Through Nov 2014

Source: DOE

Oil Imports



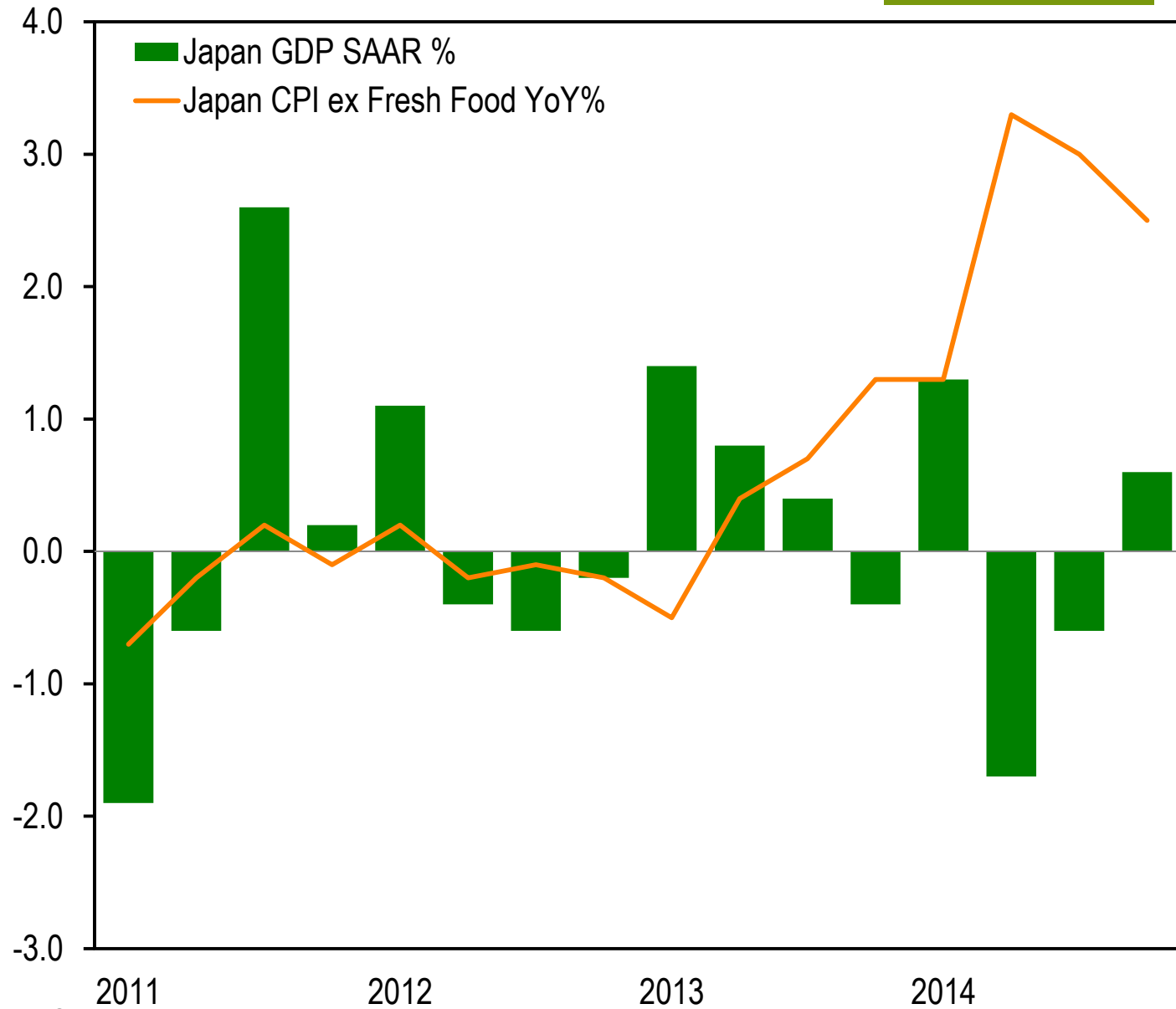
Eurozone Growth Remains Tepid



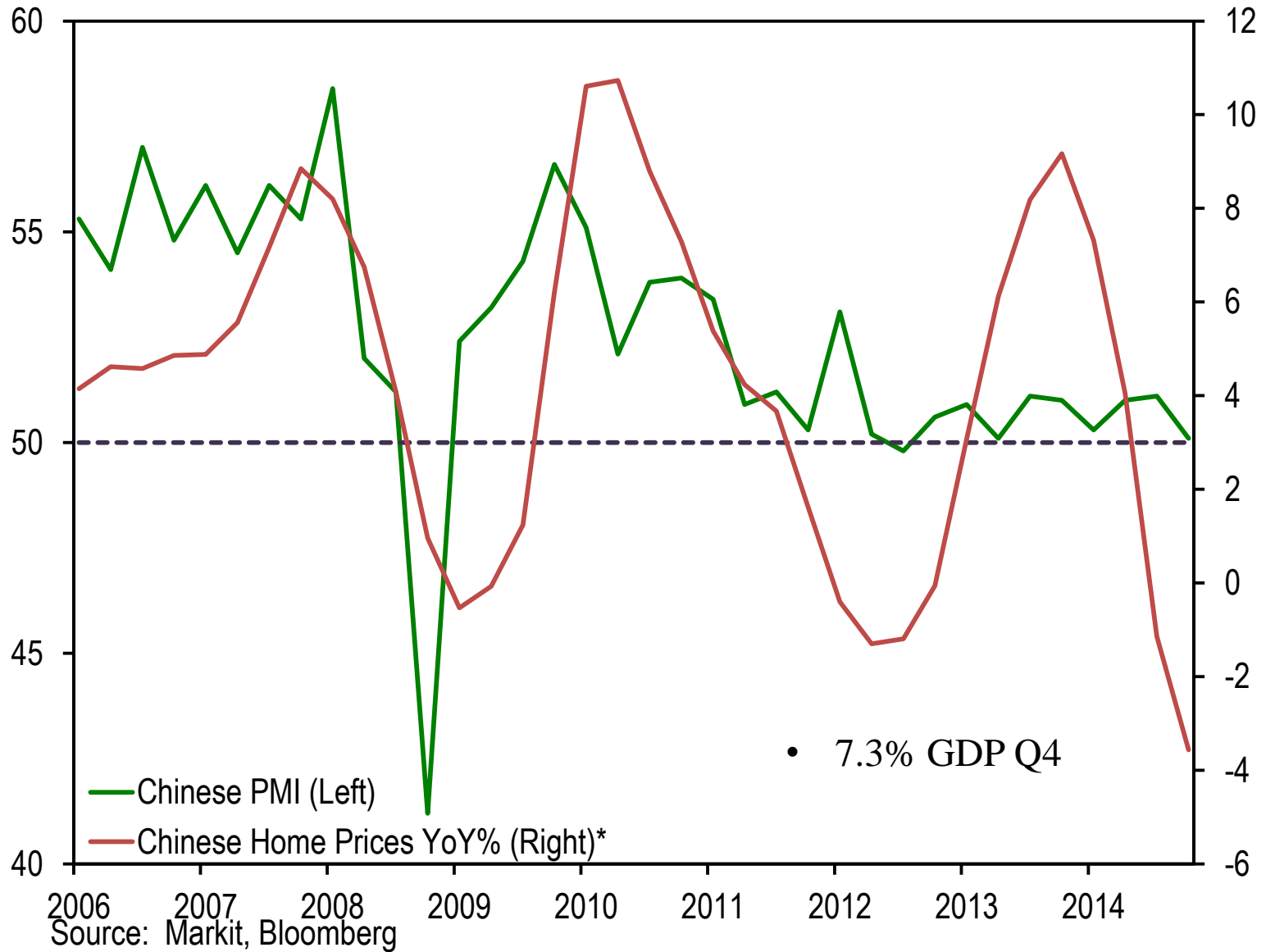
Source: BEA, Bloomberg

*The IMF lowered their world growth forecast for 2015 from 3.8% to 3.5%

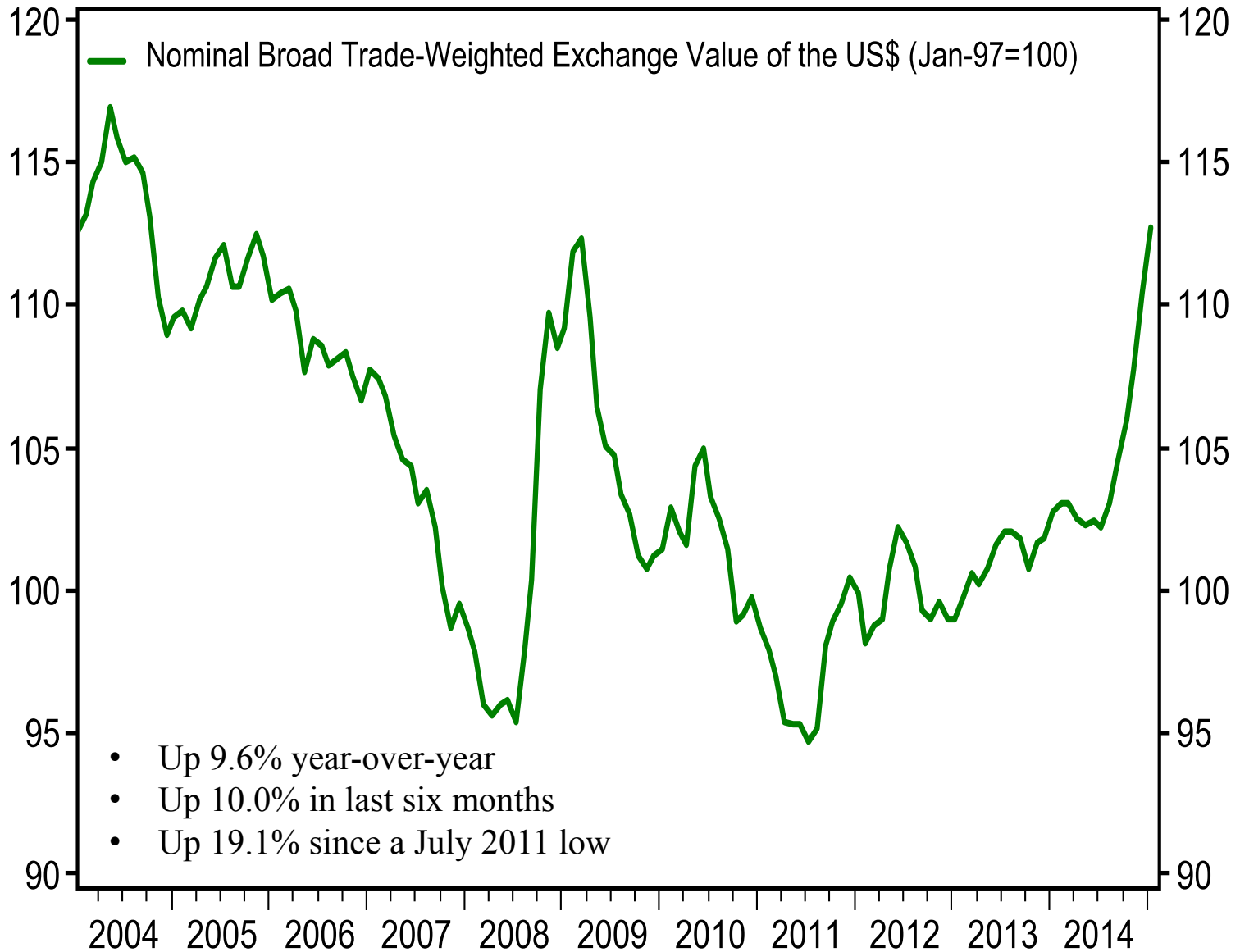
Slow Growth in Japan



Chinese Production Cooling Amid Uneven Export Demand

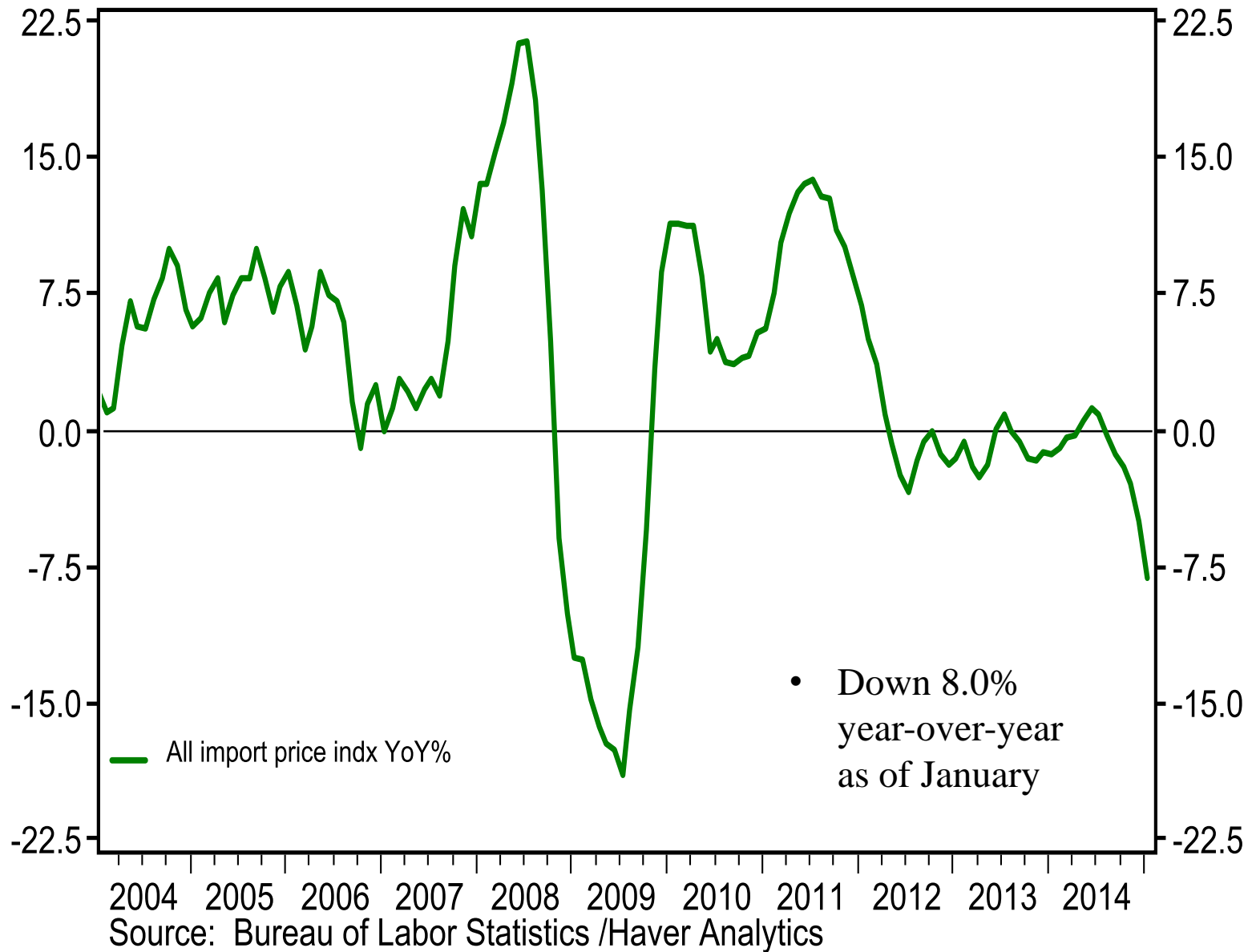


US Dollar Strengthening, Limits Import Prices

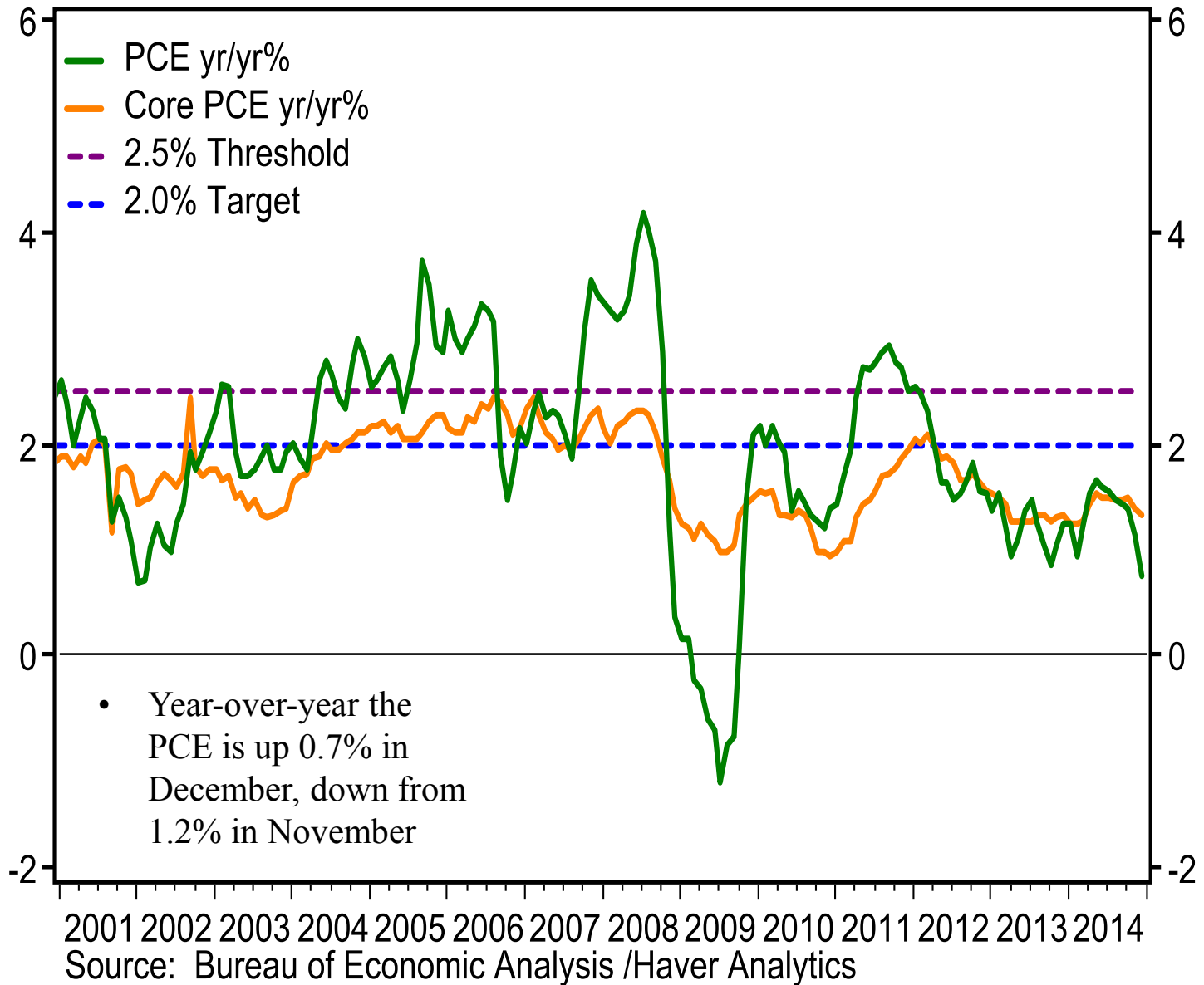


Source: Federal Reserve Board /Haver Analytics

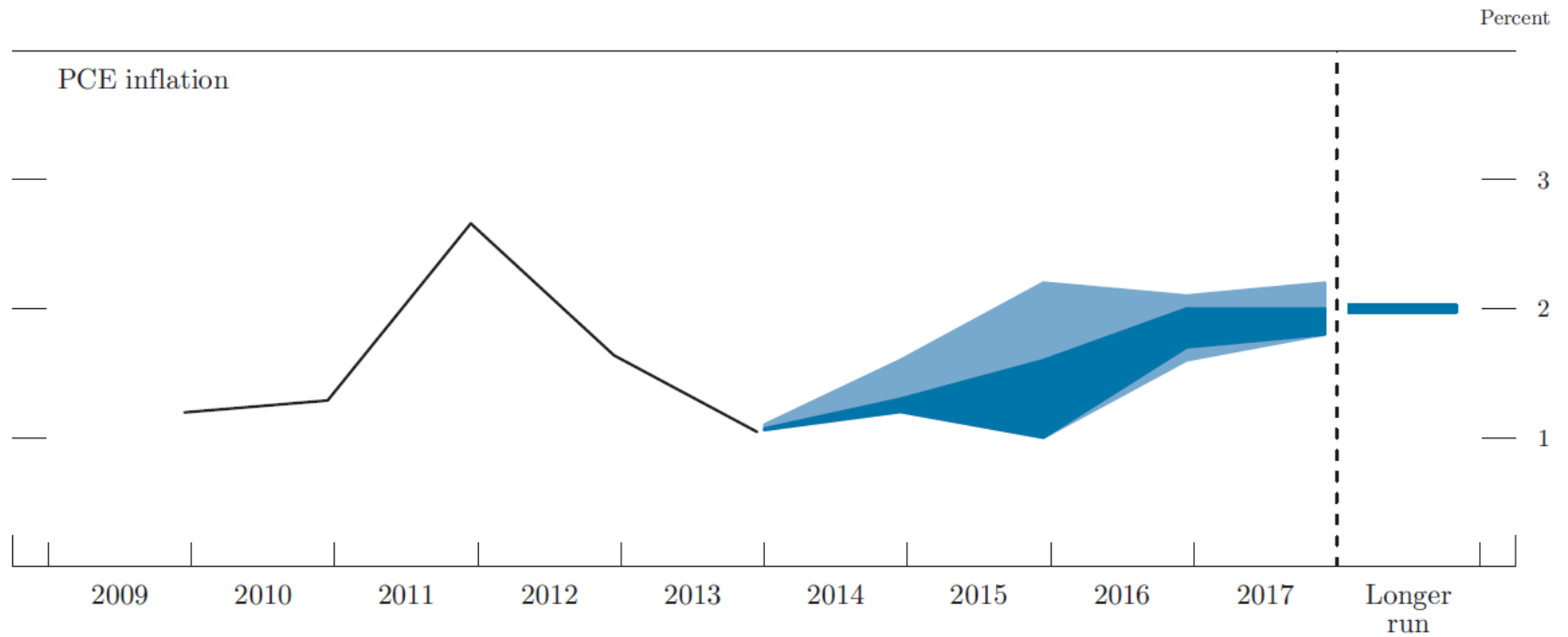
Import Prices Declining



Benign Inflation



Benign Inflation Forecast



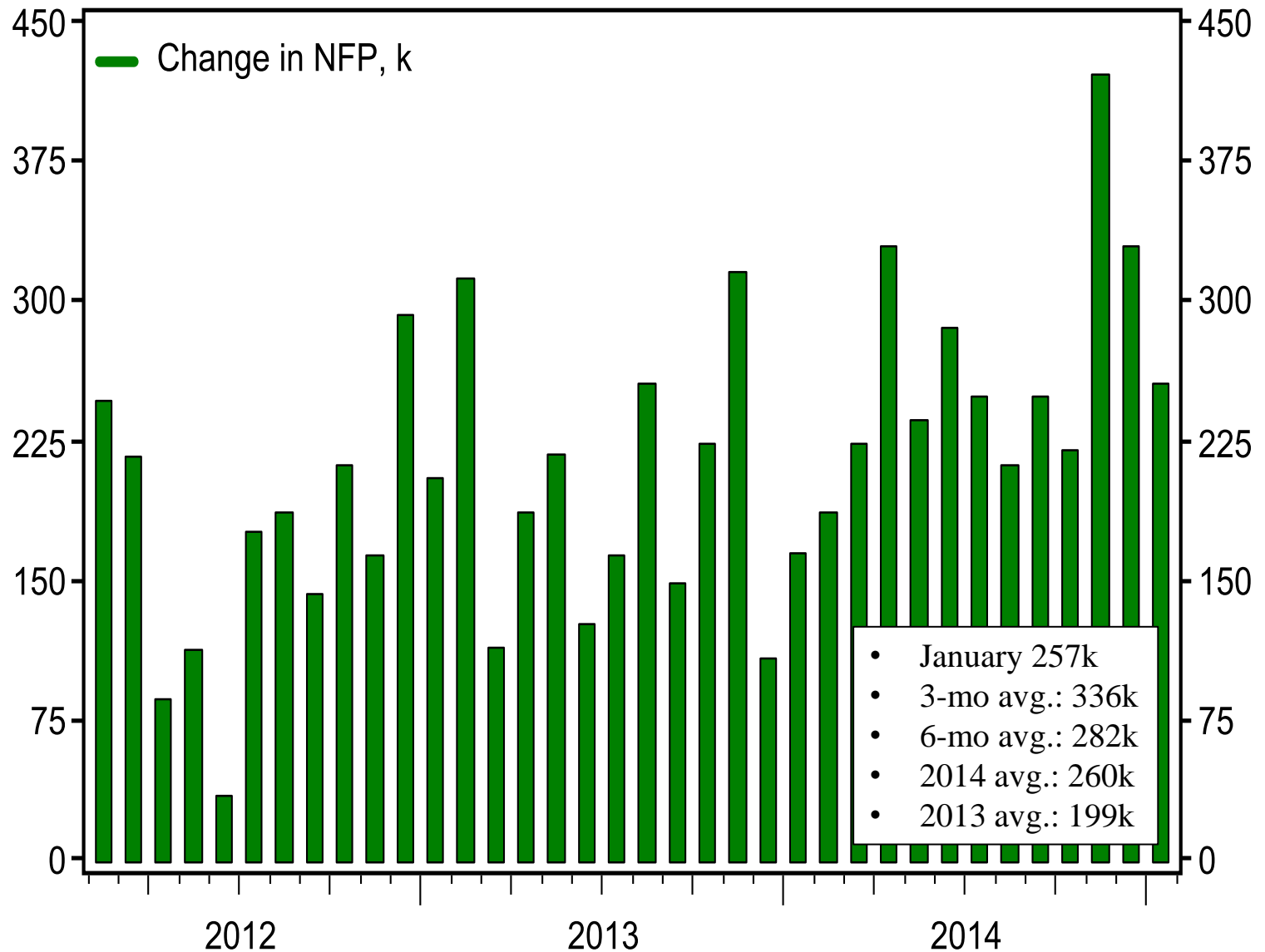
Source: Federal Reserve, December 2014

- Stable at 2% by 2018 (3 years from now)



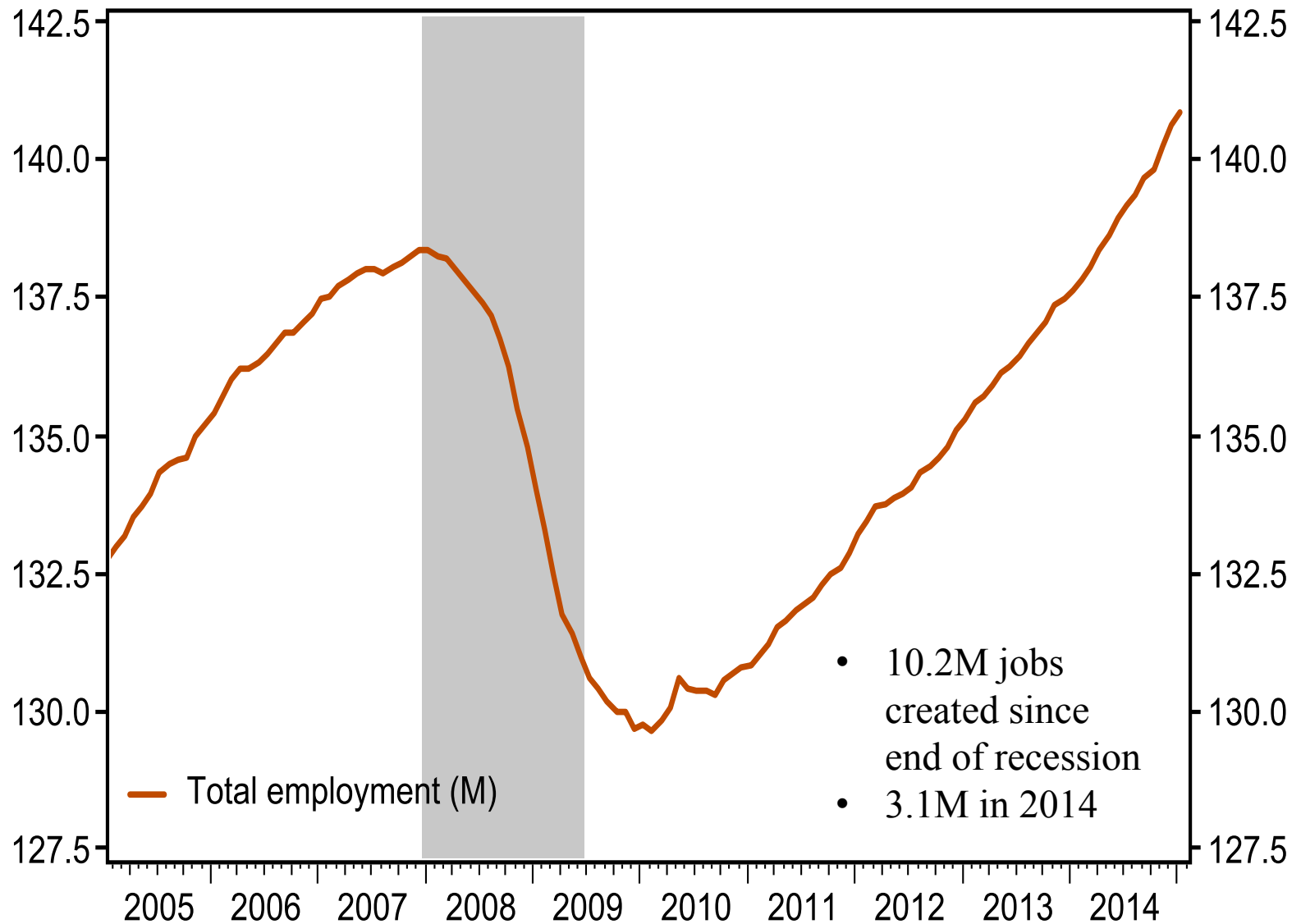
Labor Market

Nonfarm Payrolls Strong



Source: Bureau of Labor Statistics /Haver Analytics

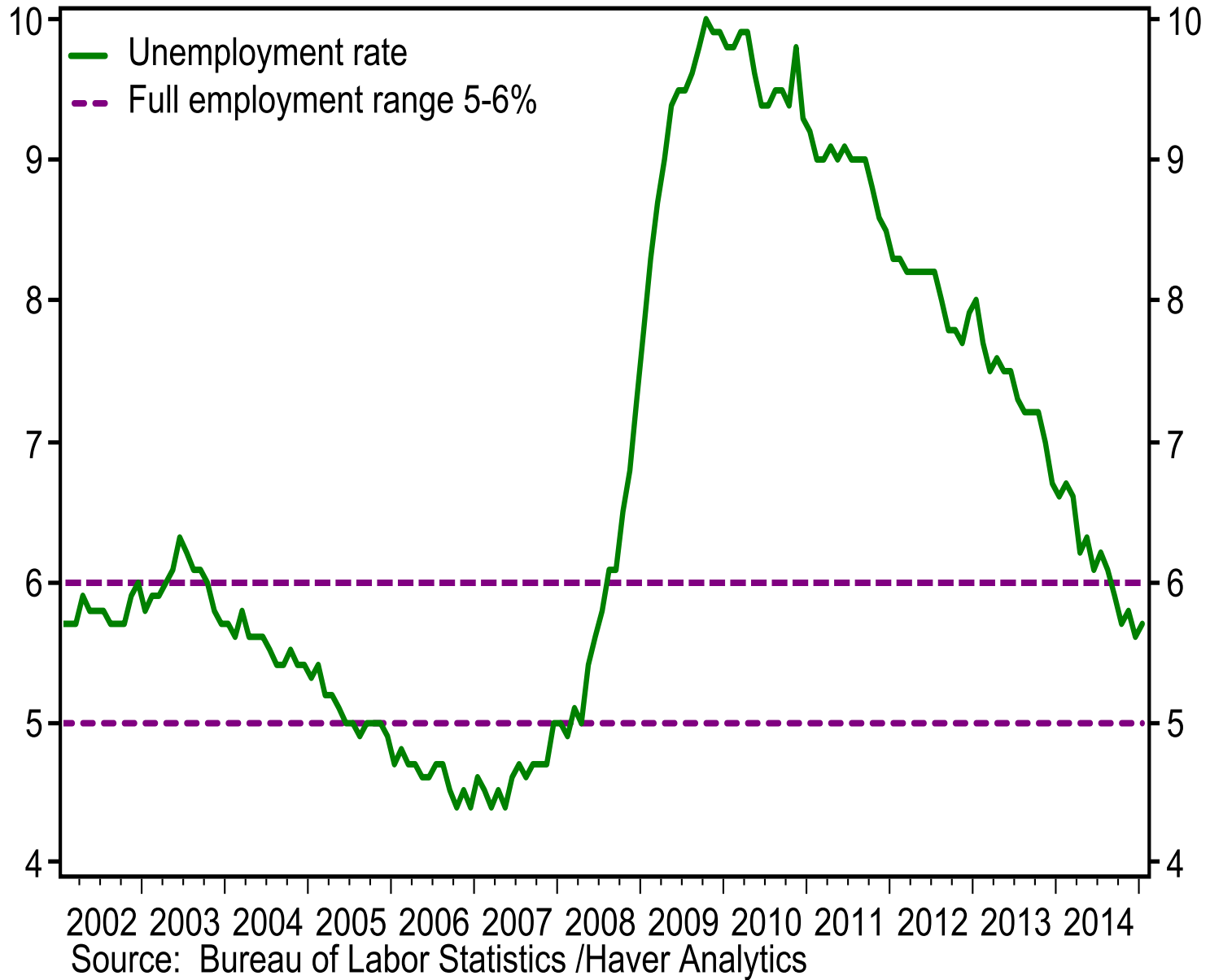
Employment Gains Recapture Pre-Recession Levels



- 10.2M jobs created since end of recession
- 3.1M in 2014

Source: Bureau of Labor Statistics /Haver Analytics

Unemployment Rate Down to 5.7%

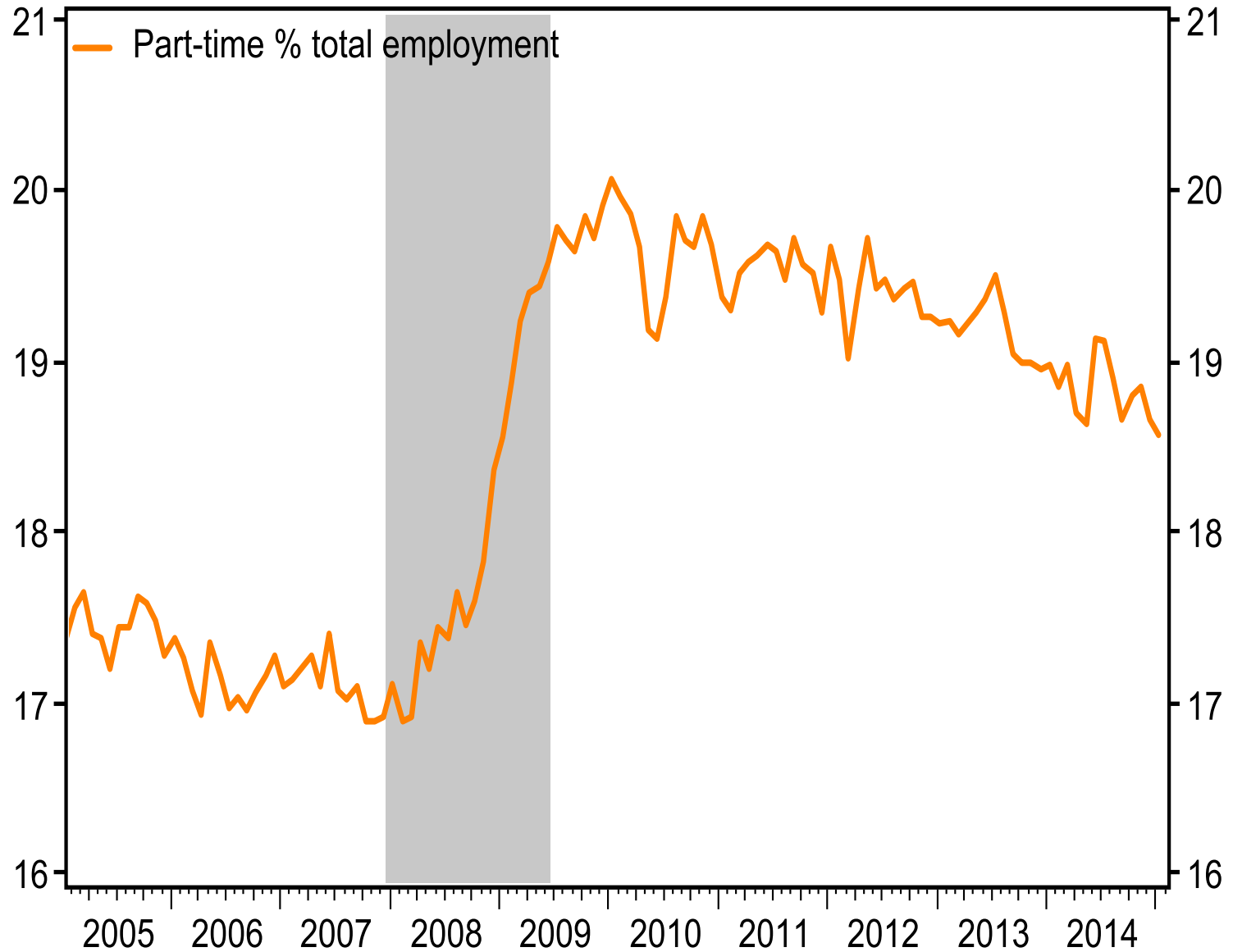


Labor Market Improvement

“Labor market conditions have improved further, with solid job gains and a lower unemployment rate. On balance, a range of labor market indicators suggests that underutilization of labor resources continues to diminish.”

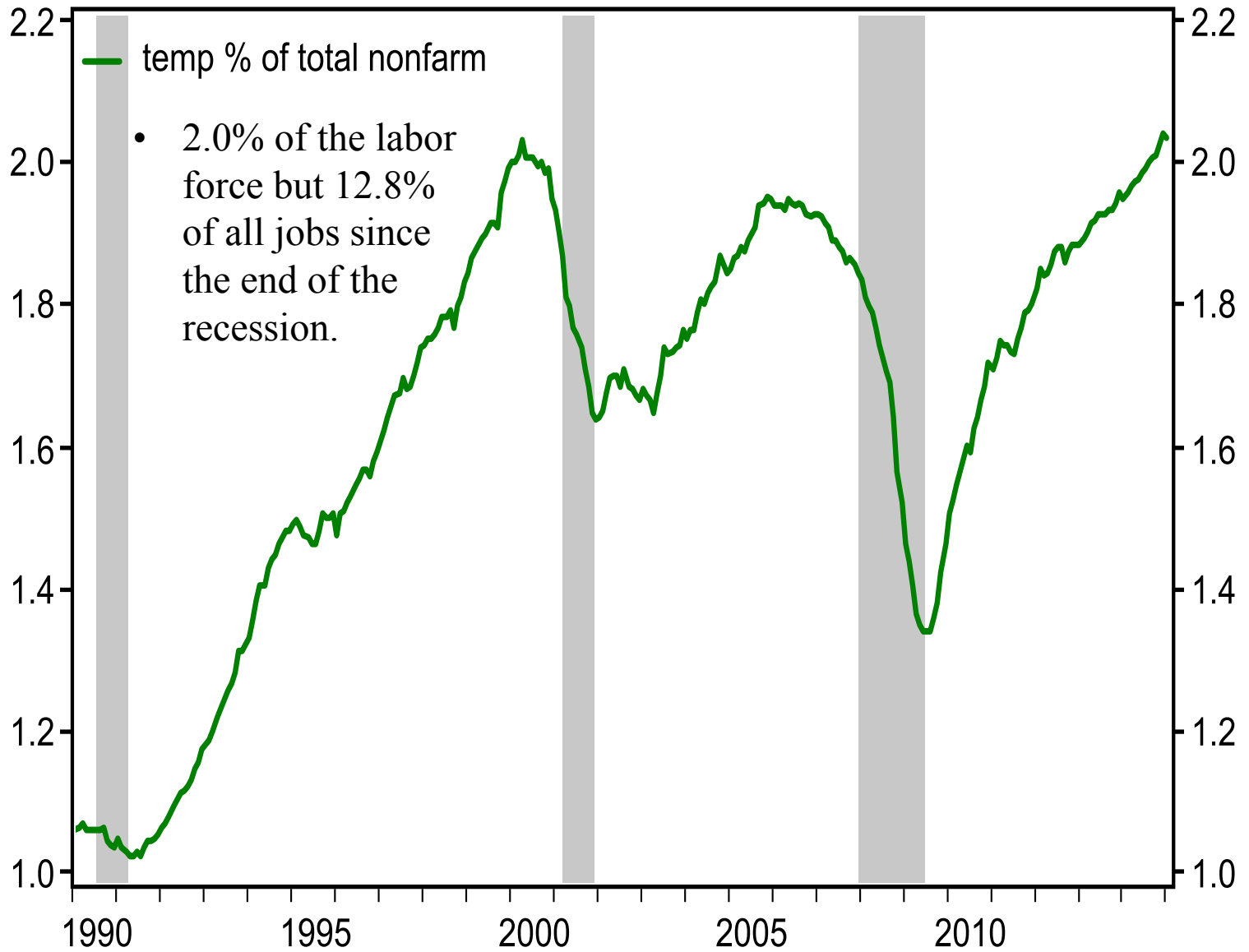
-January 28 FOMC Statement

Part-time Employment Recovery



Source: Sterne Agee / Haver Analytics / Haver Analytics

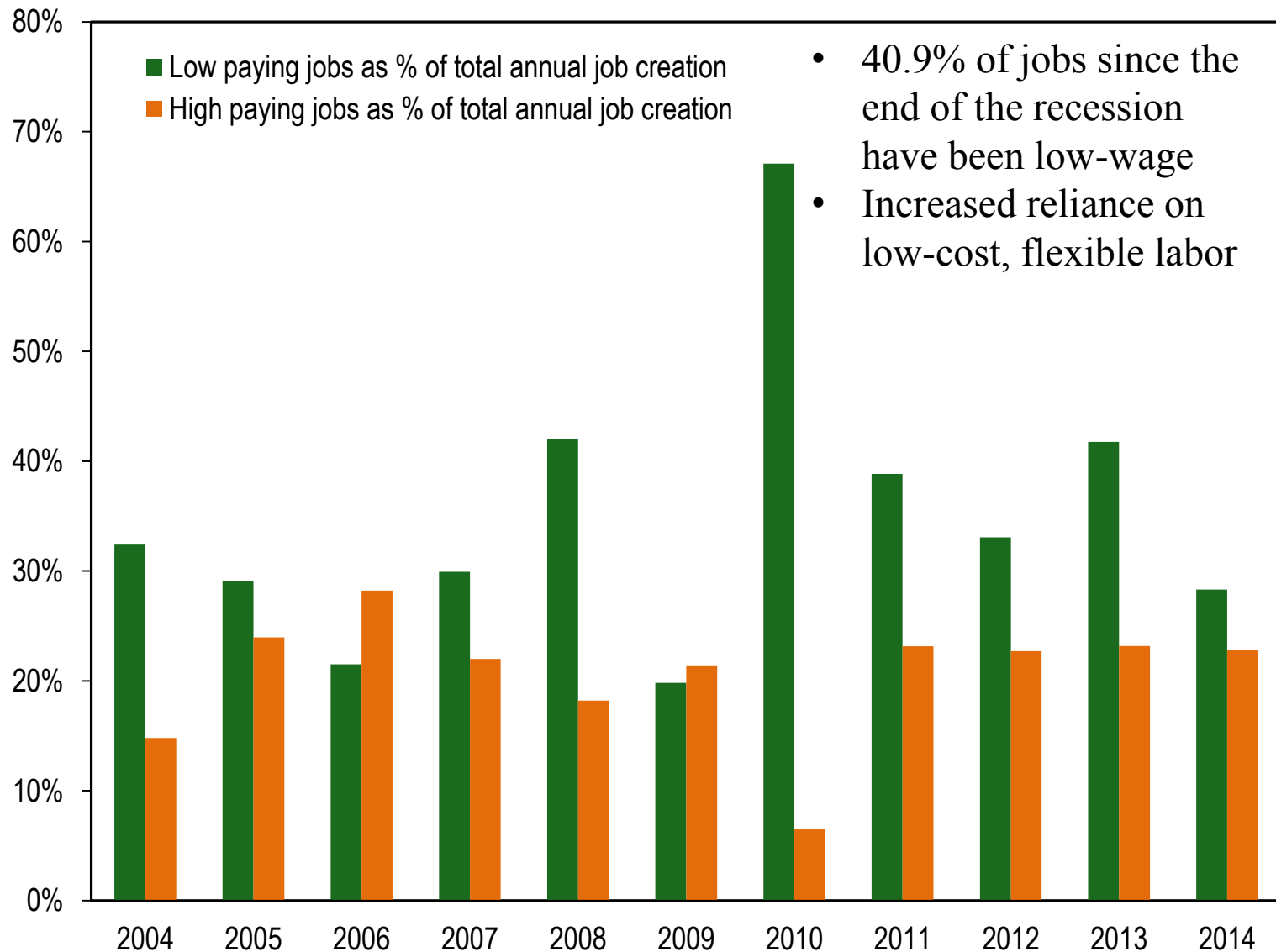
Temporary Hires



- 2.0% of the labor force but 12.8% of all jobs since the end of the recession.

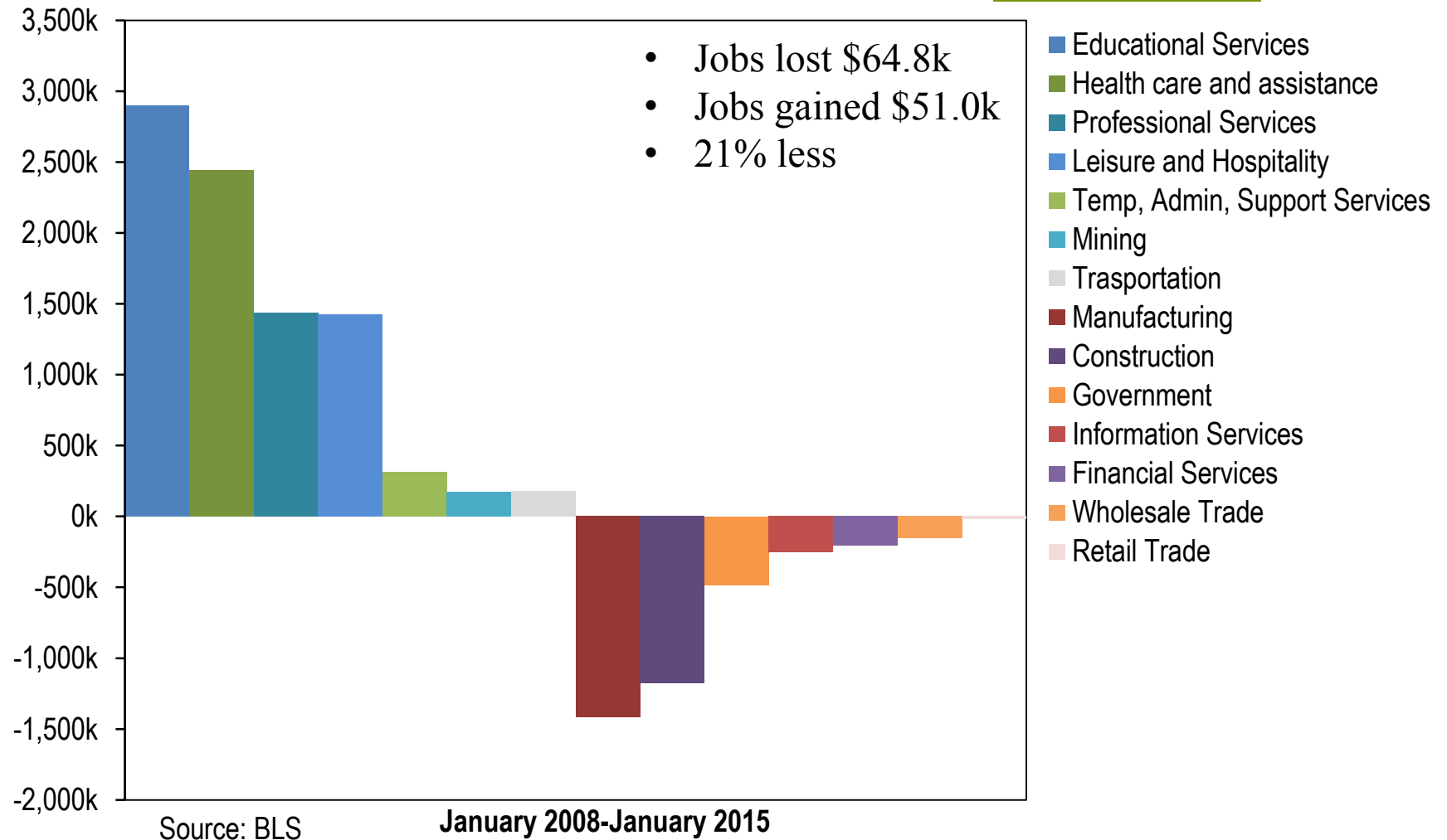
Source: Haver Analytics

Quality versus Quantity

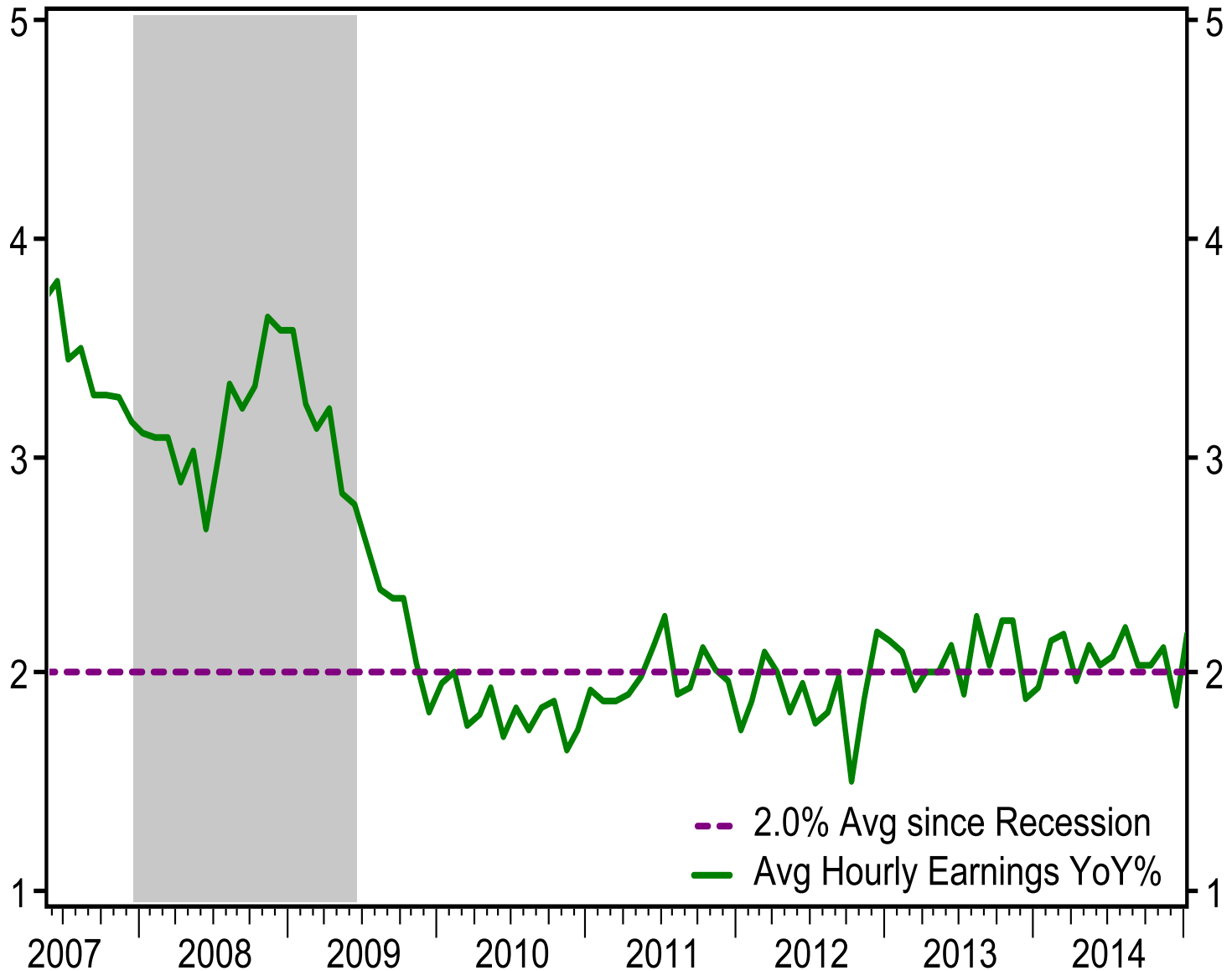


Source: BLS, Haver

Lower-Wage Jobs

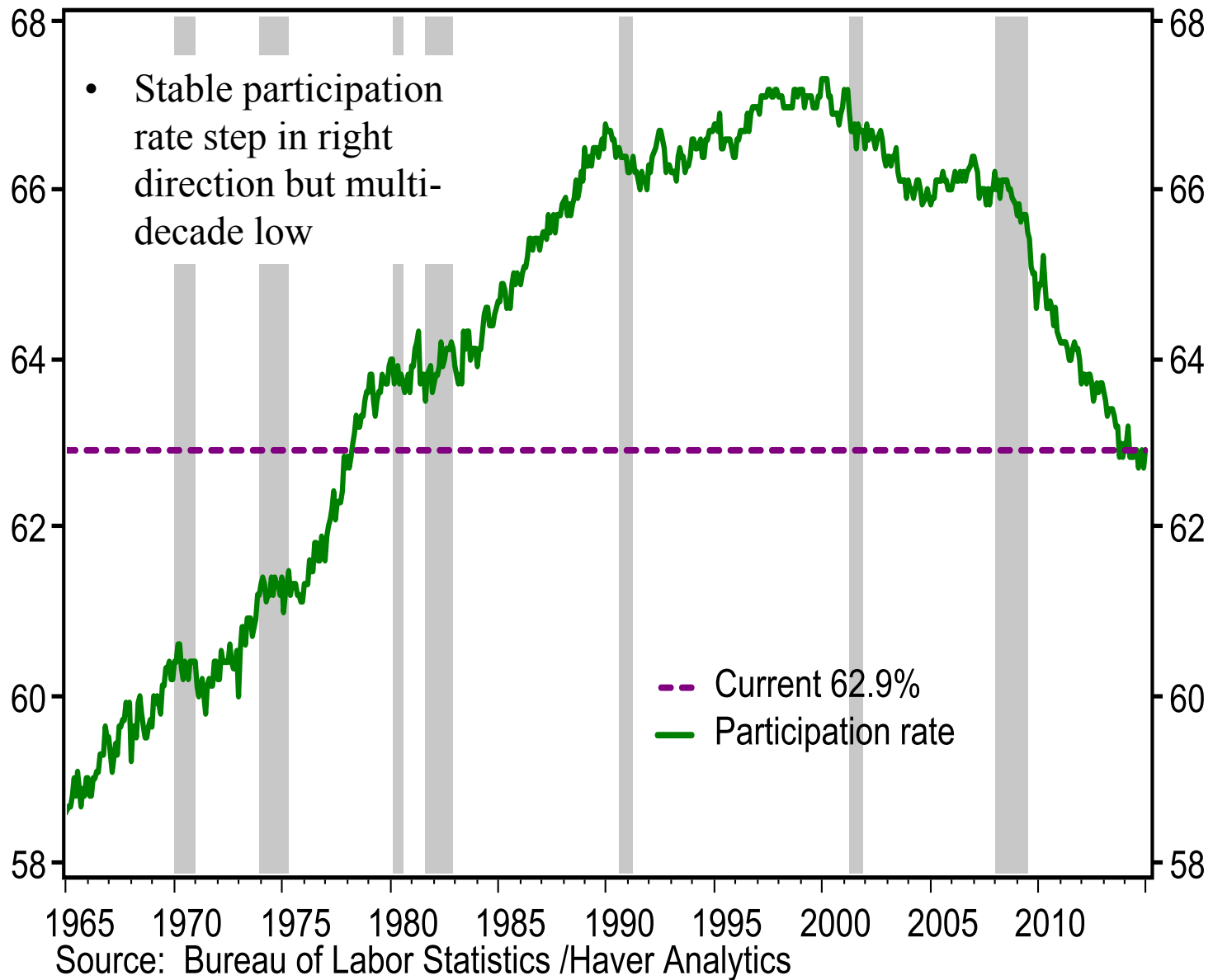


Average Hourly Earnings Stubbornly Low

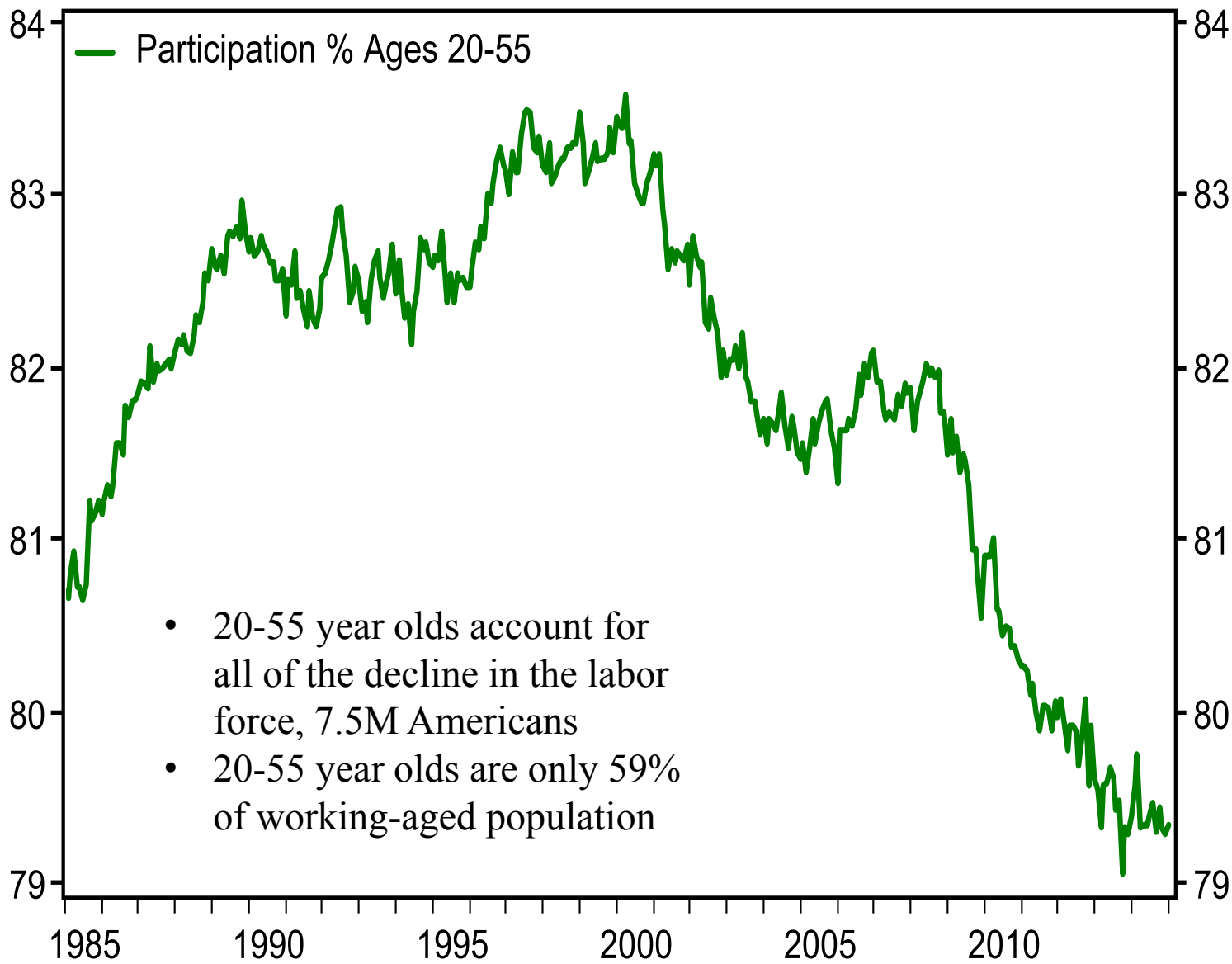


Source: Bureau of Labor Statistics /Haver Analytics

Participation Rate Still Declining



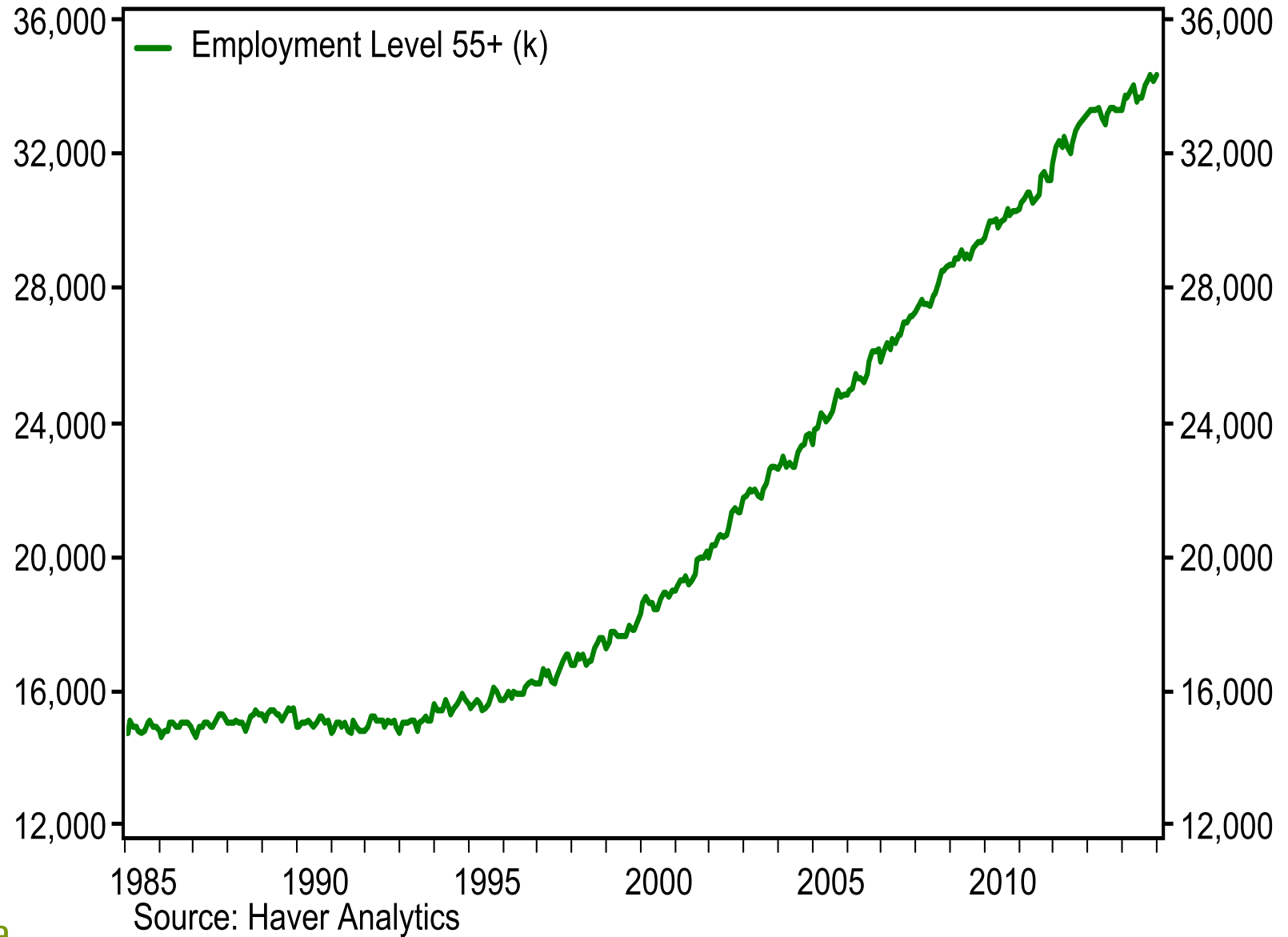
Participation Rate By Age Cohort



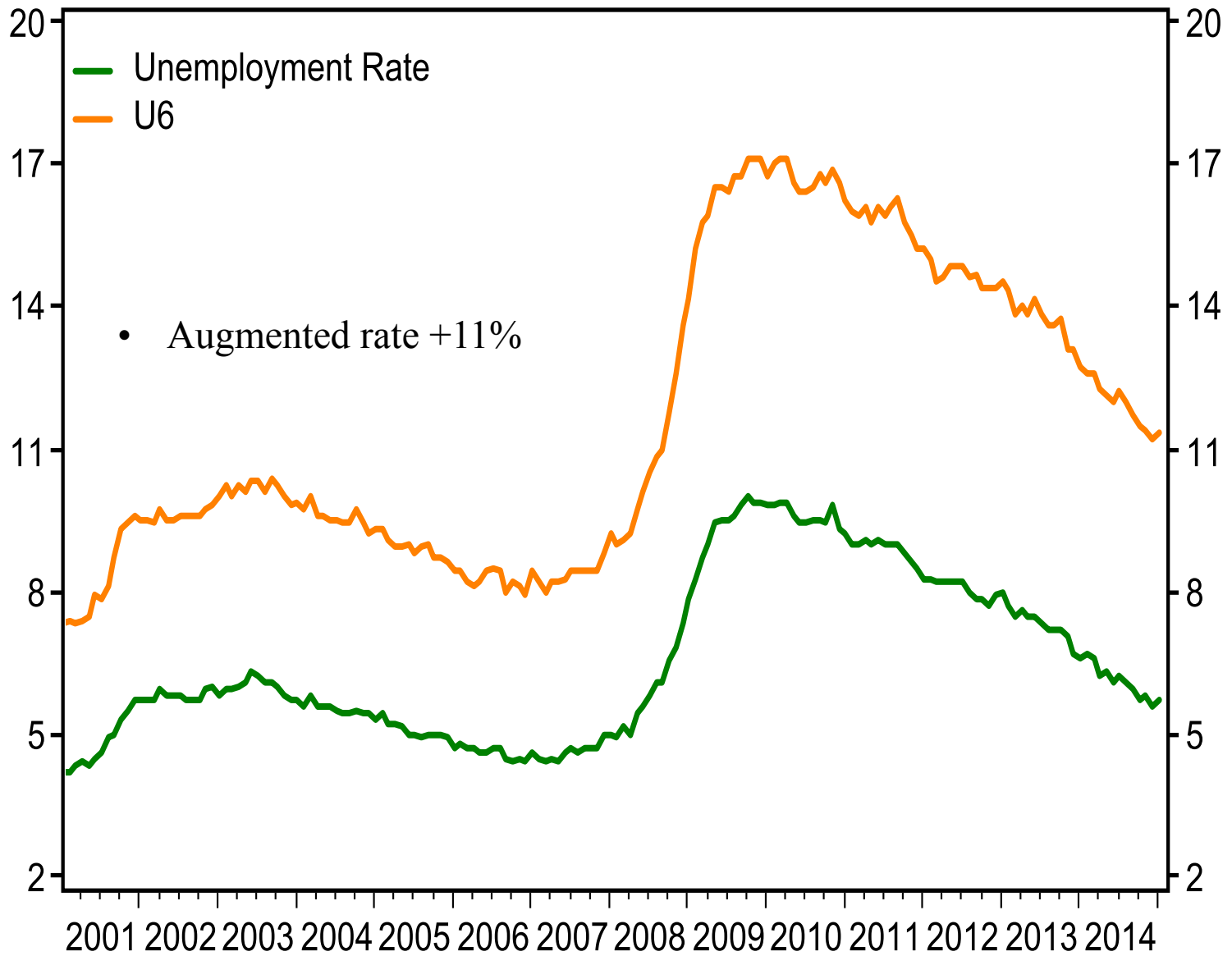
- 20-55 year olds account for all of the decline in the labor force, 7.5M Americans
- 20-55 year olds are only 59% of working-aged population

Source: Haver Analytics

Employment Age 55+



Full Unemployment

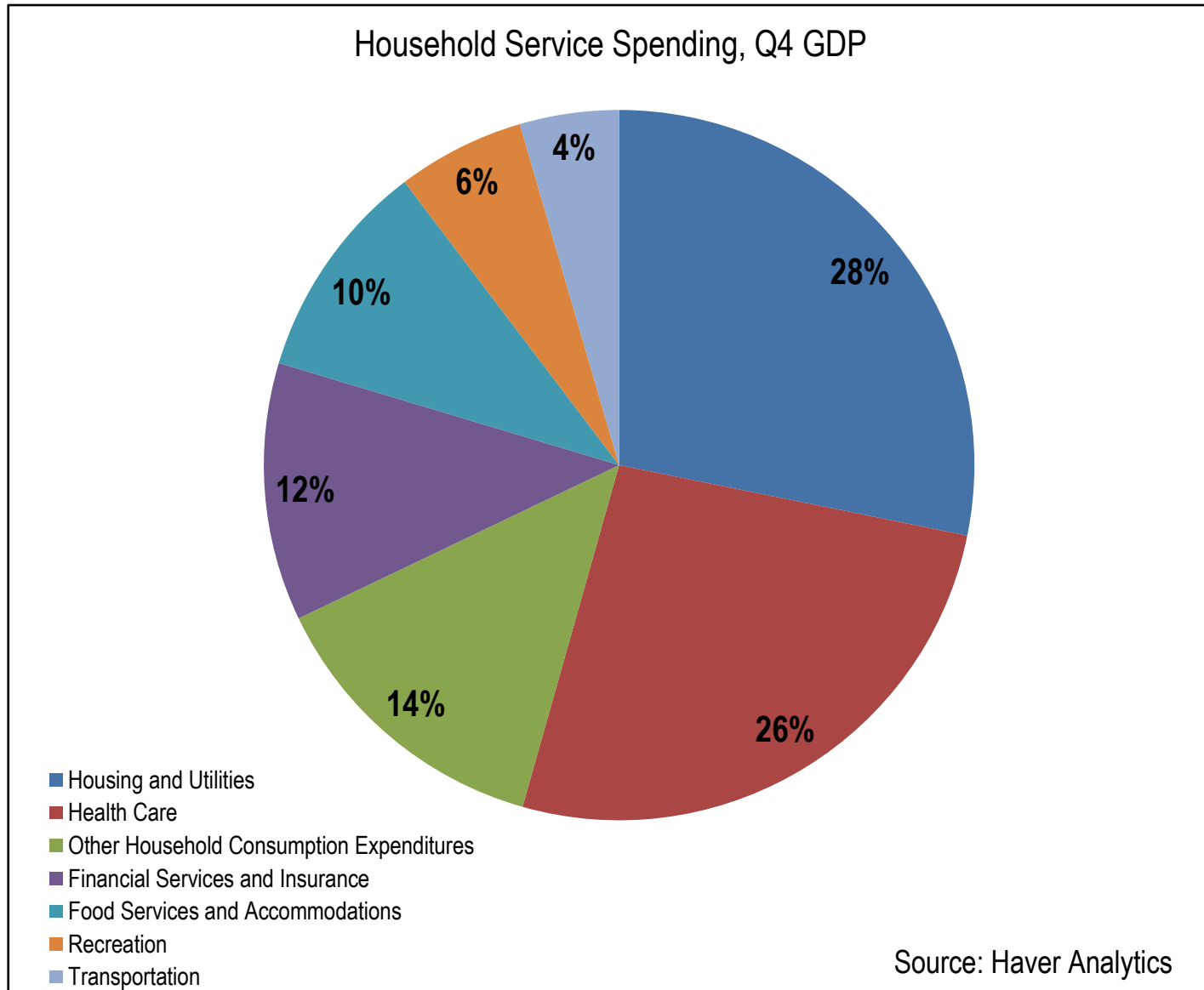


Source: Bureau of Labor Statistics /Haver Analytics



Consumers and Investment

Service Spending Dominated by Healthcare and Utilities



Rising Household Costs

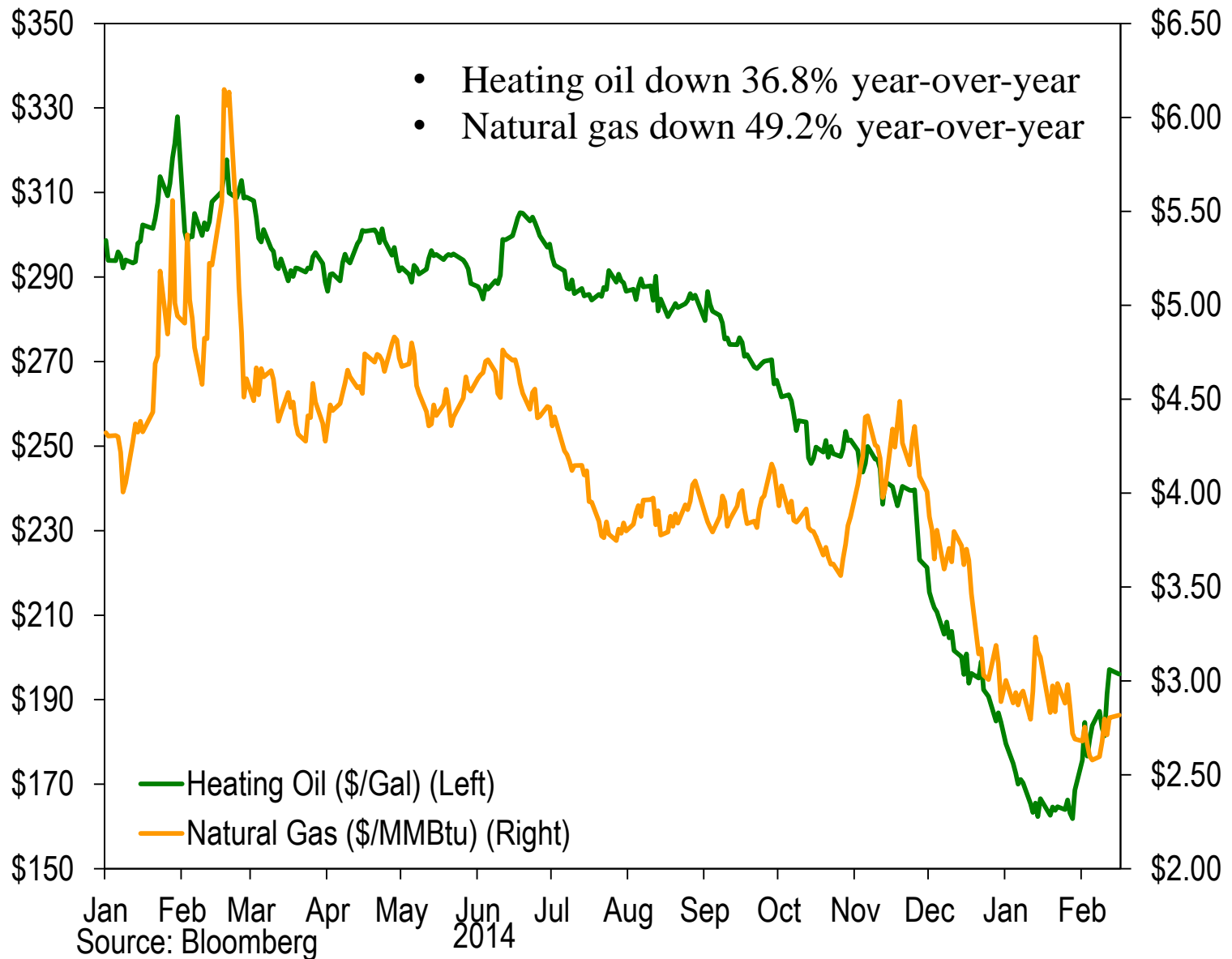
- Health insurance premiums have increased between 39-56% since early 2013 for an average family, that means paying \$663 a month, an increase of \$230 a month or nearly \$3,000 annually.

-National Online Private Health Insurance Exchange

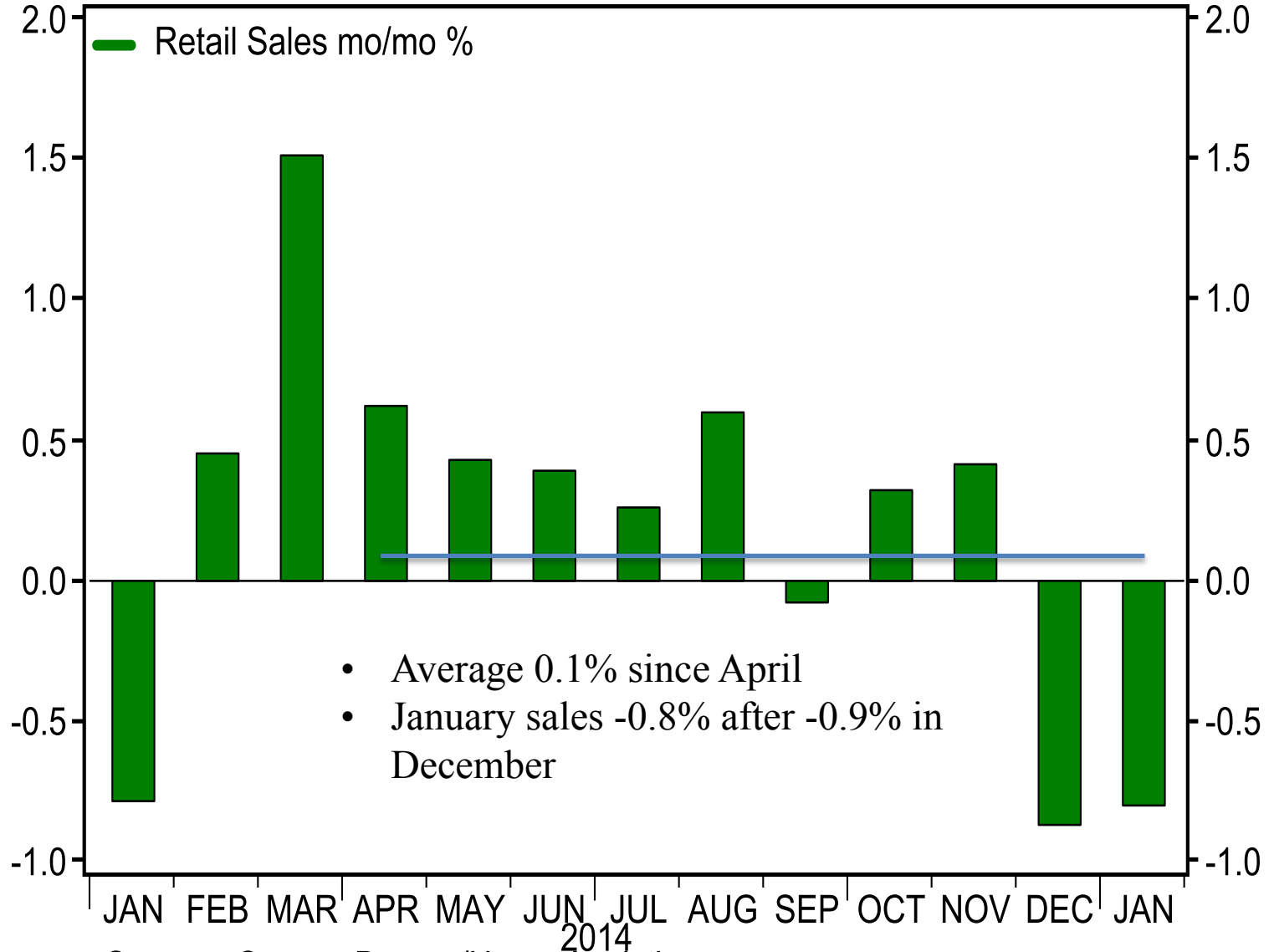
- In 2013/14, the average family shelled out an extra \$600 over the winter season to combat one of the coldest and snowiest winters in years.

-Energy Information Administration

Commodity Price Declines

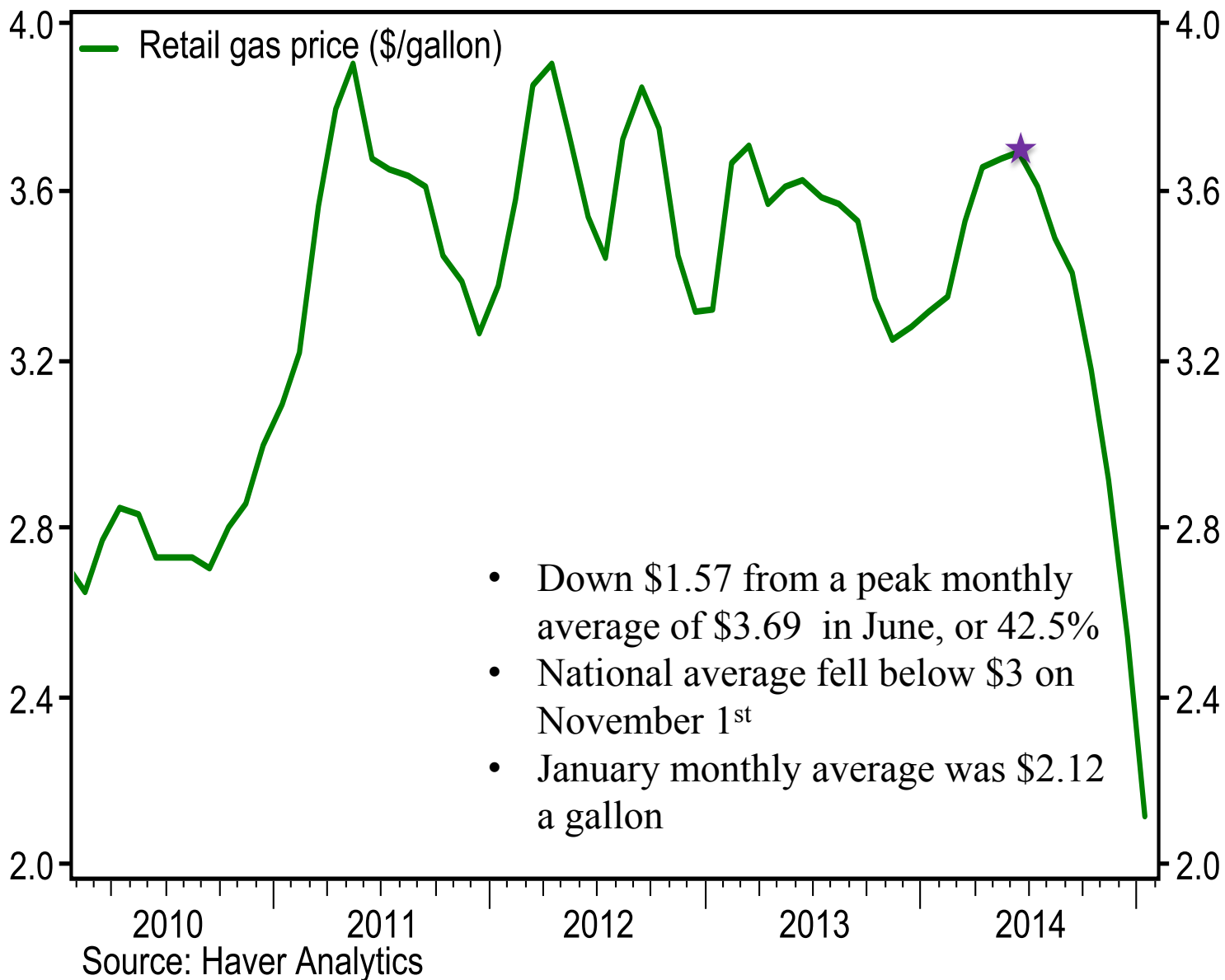


Retail Sales Losing Steam

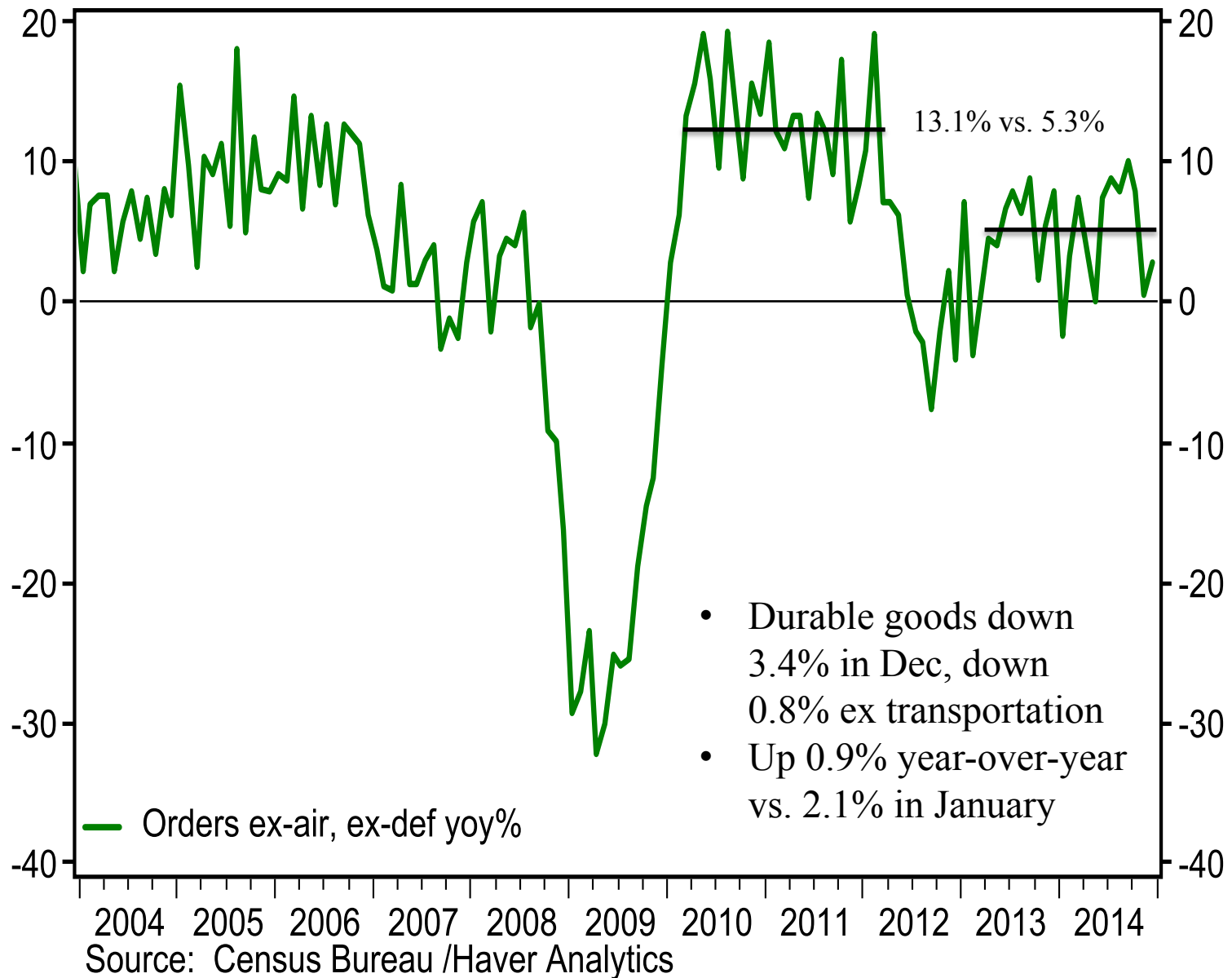


Source: Census Bureau/Haver Analytics

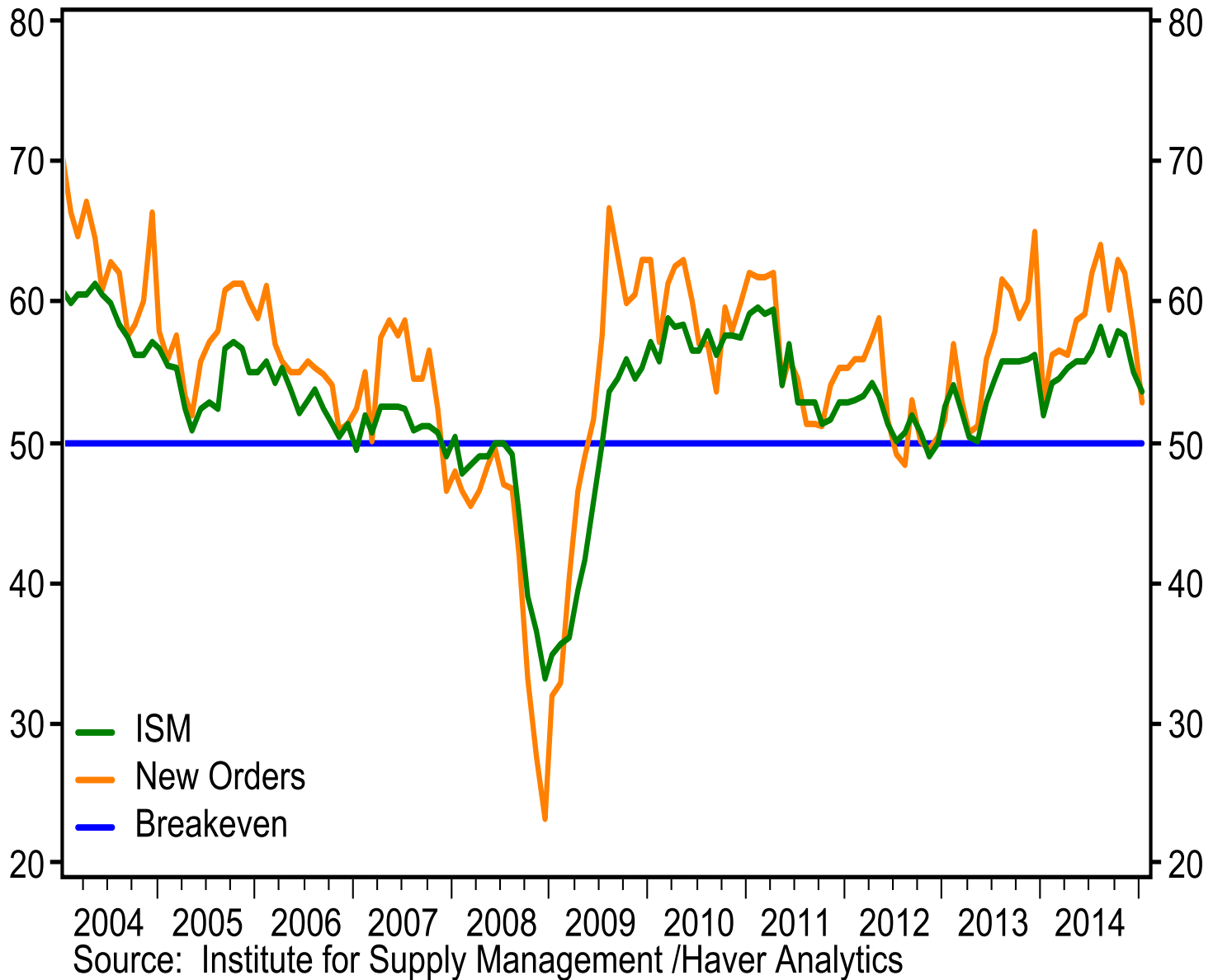
Gas Prices Give Muted Boost



Business Investment Uneven



Manufacturing Orders Overzealous





Housing

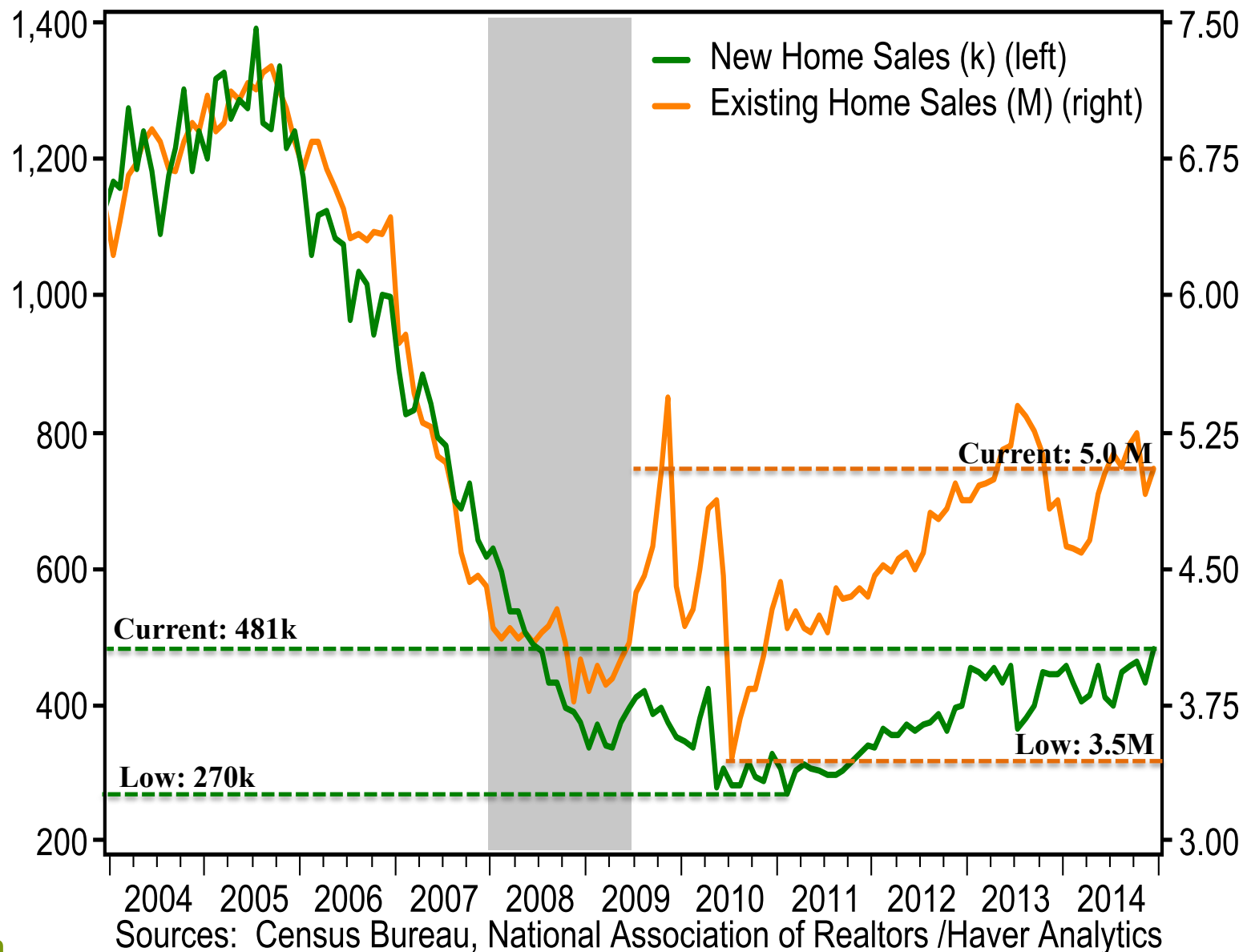


Housing Growth Slowing

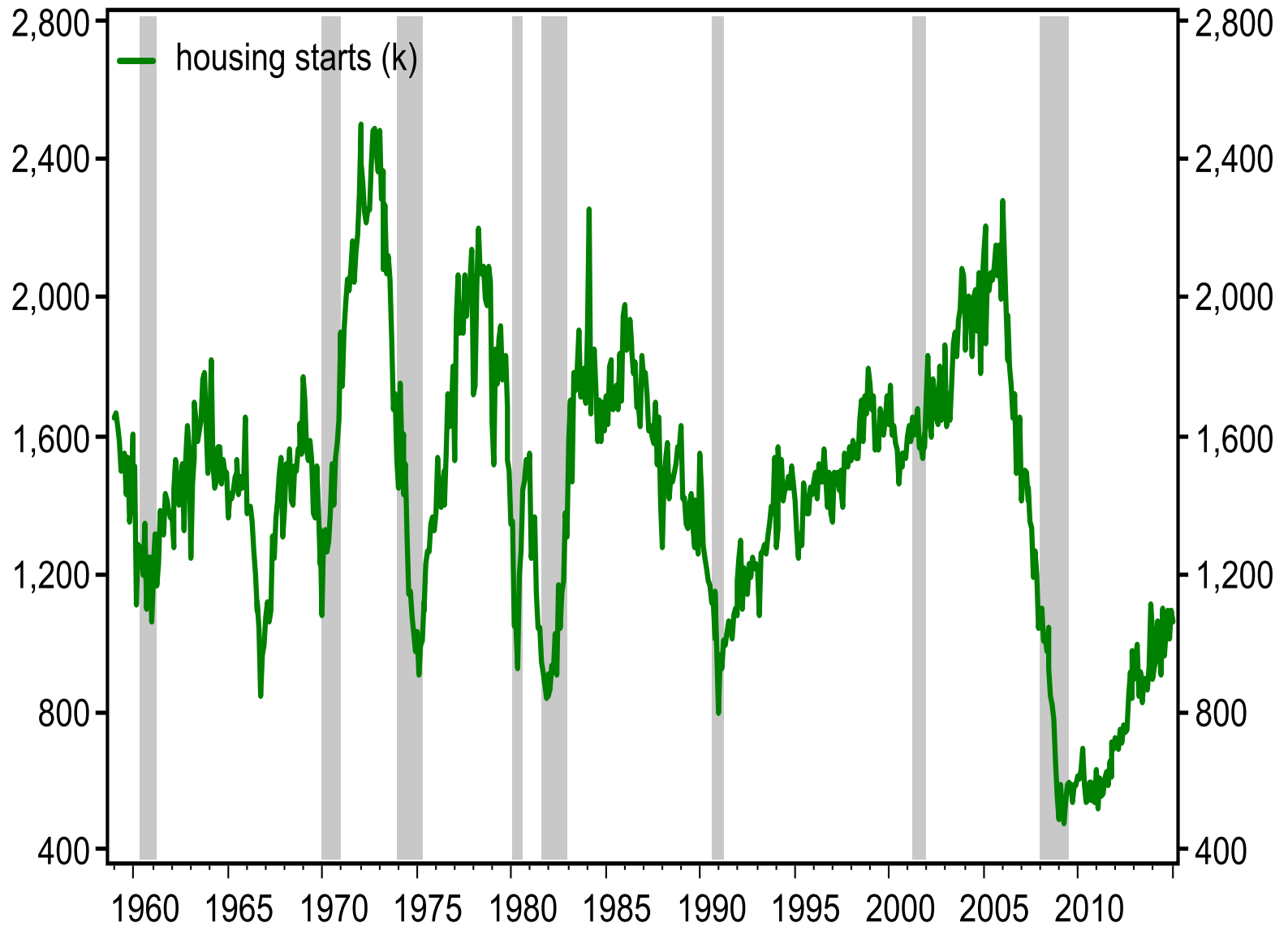
“...while the recovery in the housing sector remains slow.”

-January 28 FOMC Statement

Homes Sales Showing Signs of Modest Improvement

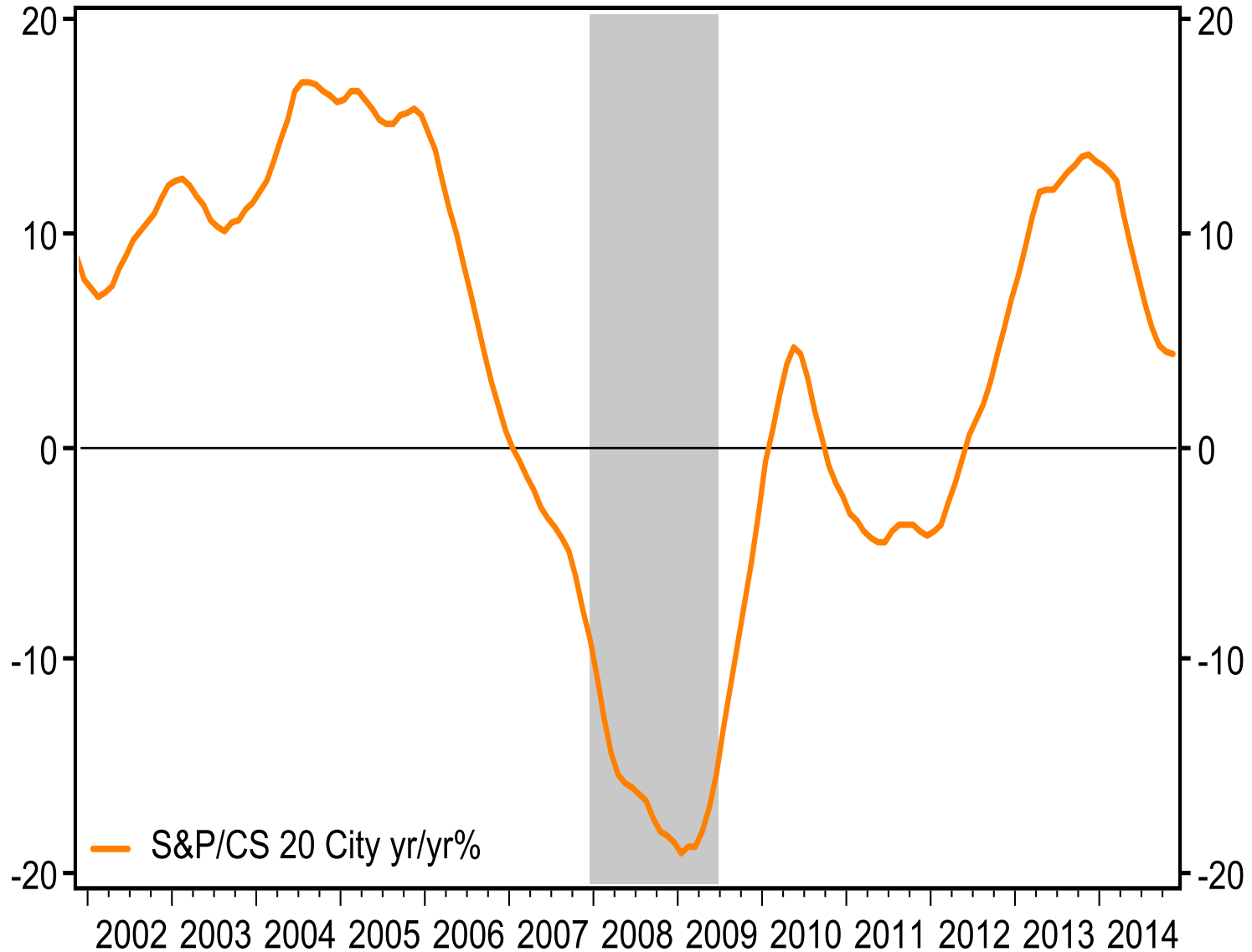


Housing Starts Still Recovering



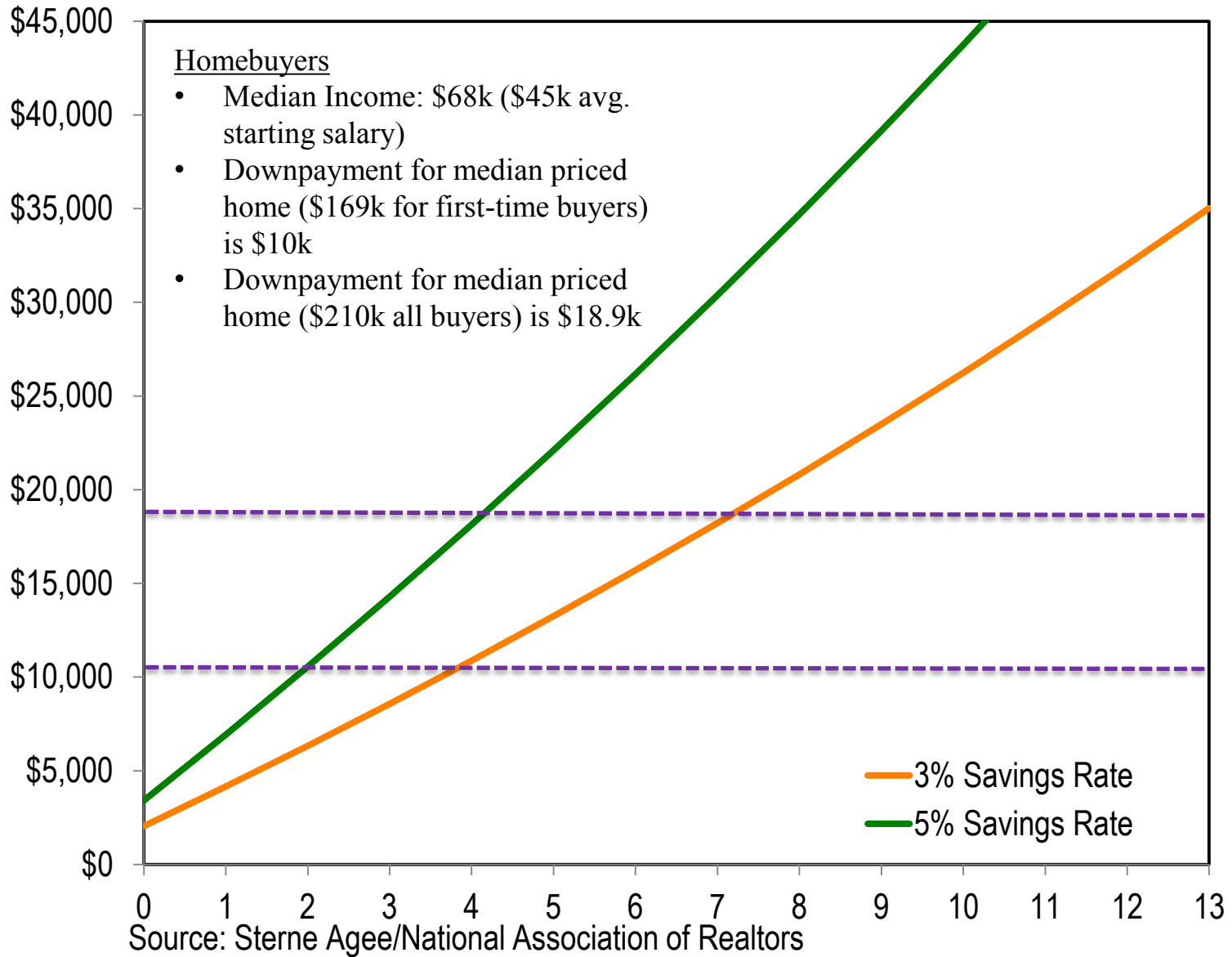
Source: Census Bureau /Haver Analytics

Rising Home Prices Squeeze Out New Entrants



Source: Standard & Poor's /Haver Analytics

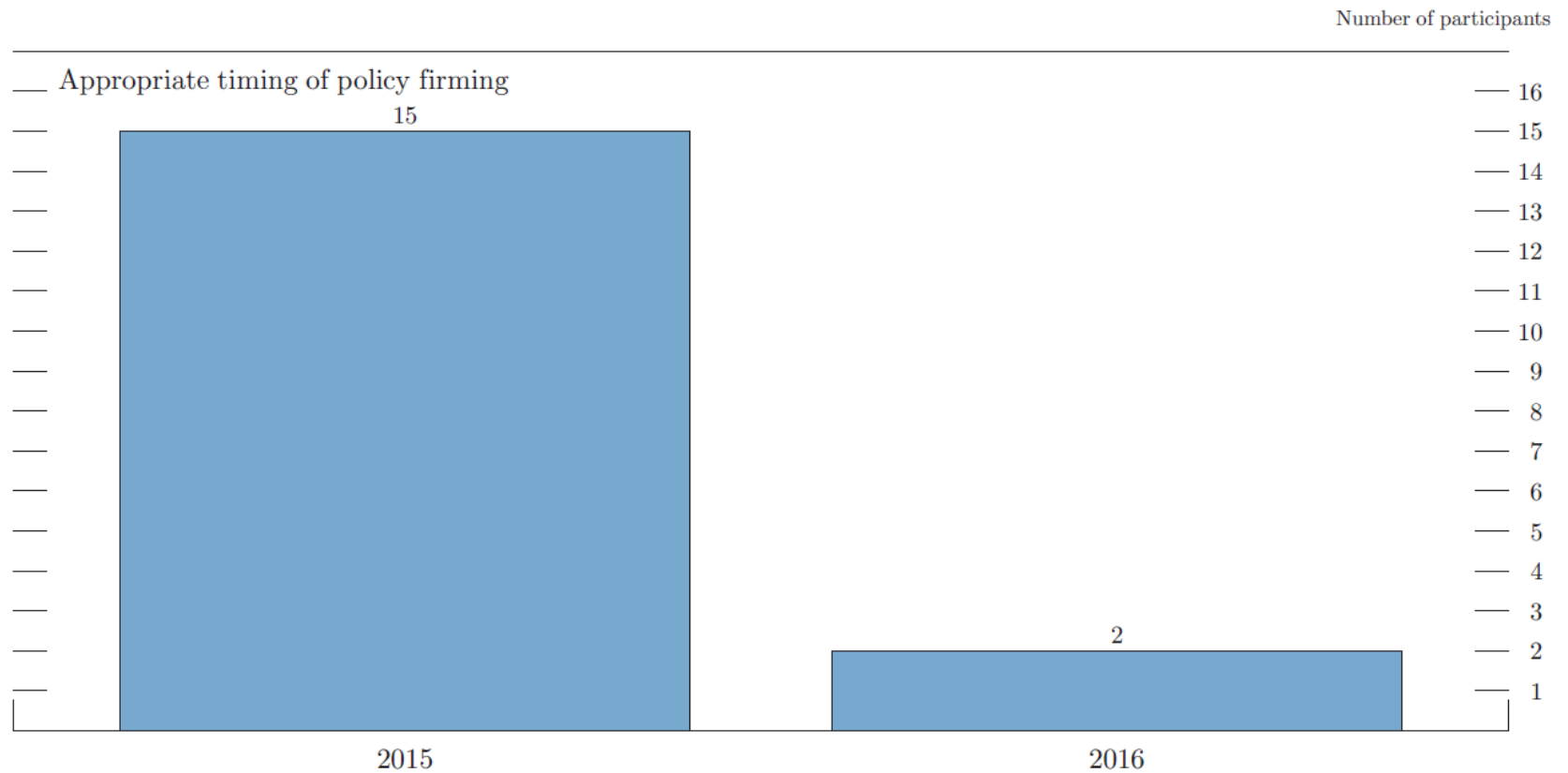
Years to Save for a Downpayment





The Fed

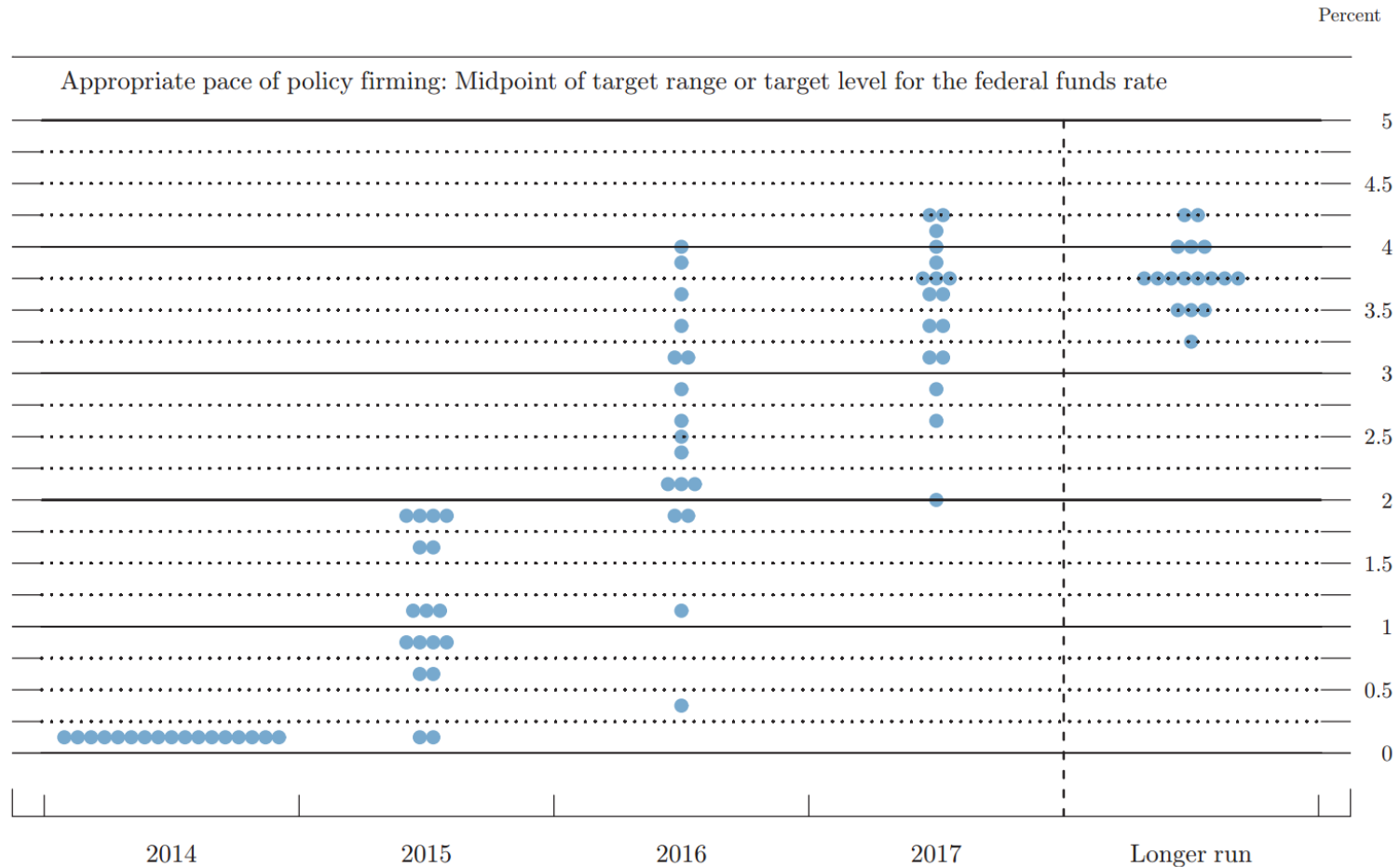
Majority of Committee Members See Rate Hike in 2015



Source: Federal Reserve, December 2014

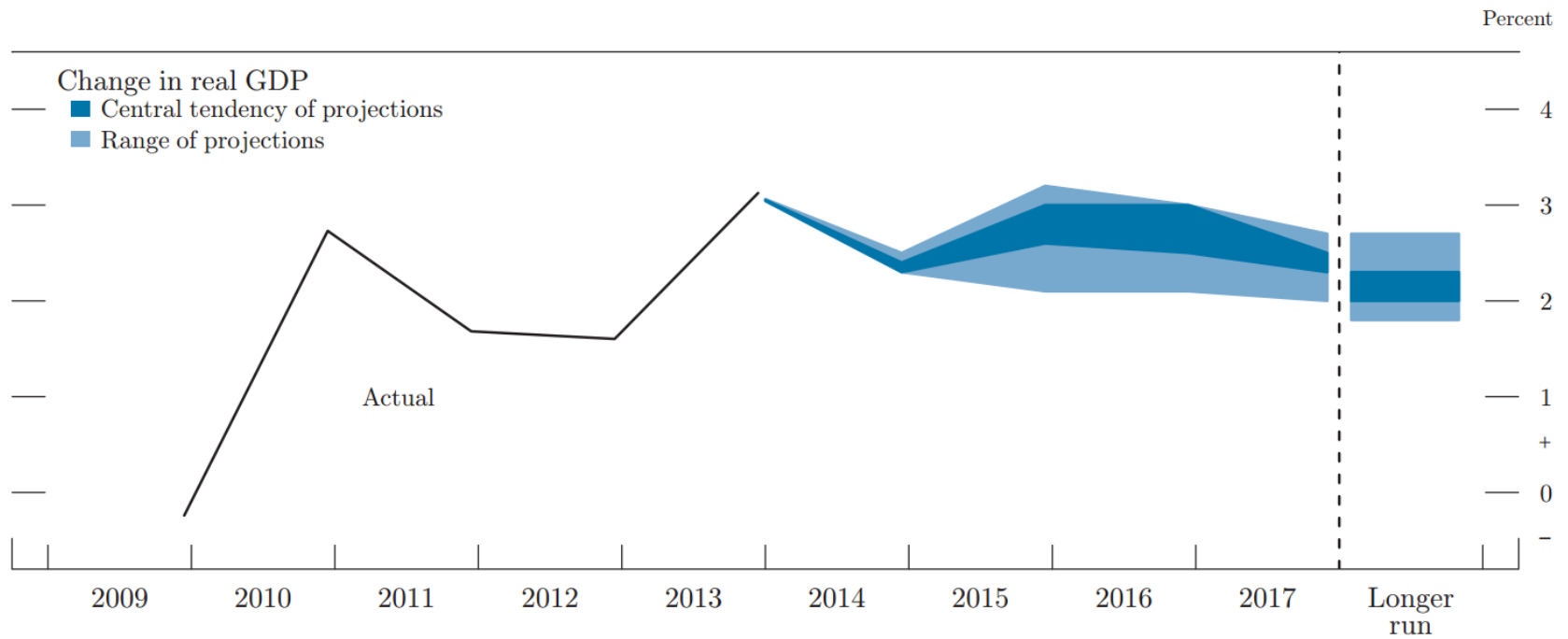
Famed Dot Plot Shows Lower Median Rate Forecast

2015 1.125% vs 1.375%
 2016 2.54%
 2017 3.50%



Source: Federal Reserve, December 2014

Fed's Outlook for Growth

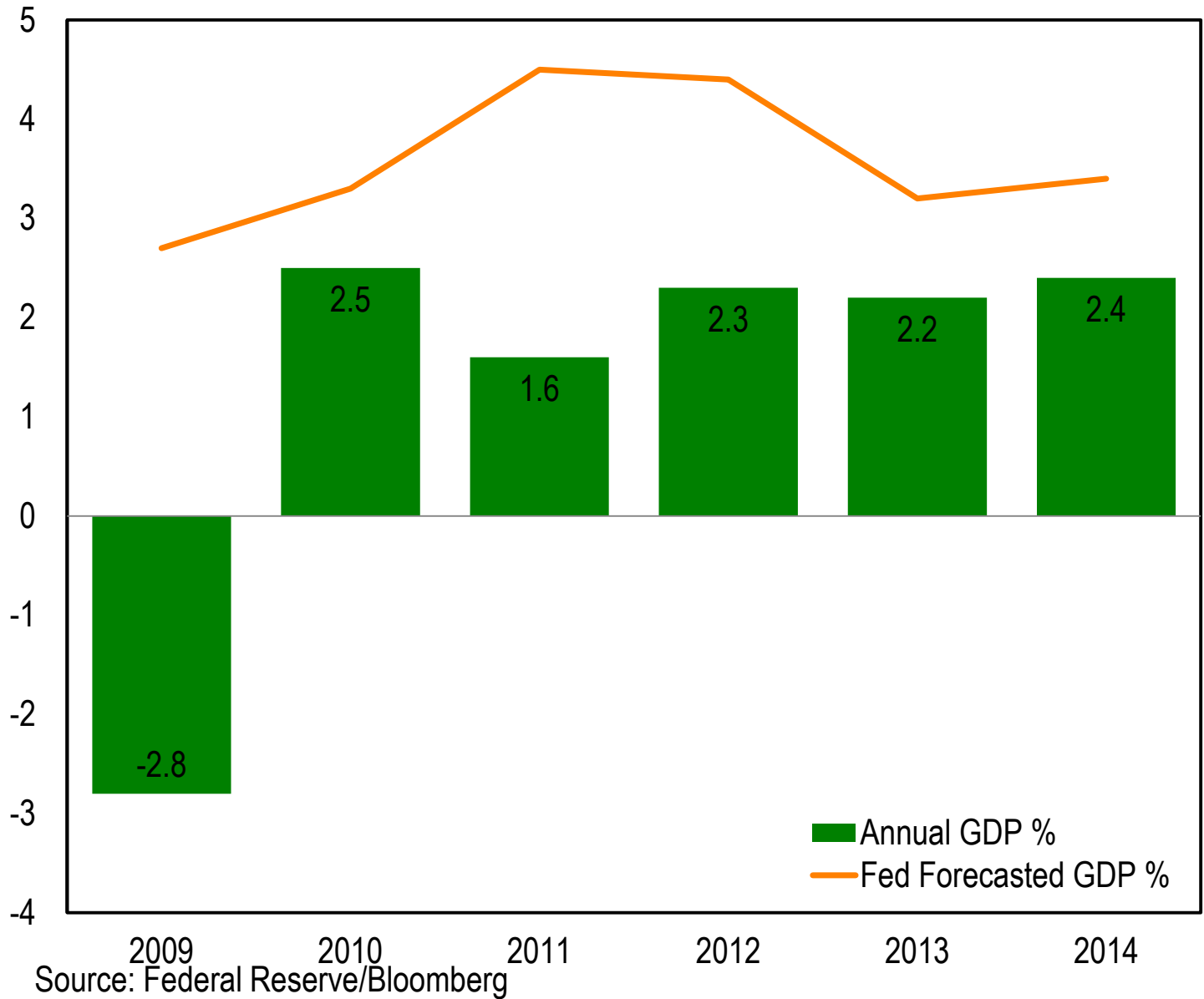


Source: Federal Reserve, December 2014

2015: 2.6-3.0%

2016: 2.5-3.0%

Fed Forecasted GDP vs. Reality



Fed Signals to Stay “Patient”

- Continues to maintain commitment to accommodation with “*patient*” stance - successfully weaning off “*considerable time*”
- Focus on labor market; “*underutilization*” of labor resources remains
- Extended considerations for policy firming to include “*international developments*”
- An end to QE3 because the economy was on relatively better footing and a more than \$4.5 trillion balance sheet posed unknown risks
- Threshold to raise rates will take more than relativity, the lackluster reality will likely keep the Fed on hold beyond 2015

Summary

- Signs of improvement
- Extraordinary accommodation has led to 2% GDP for the past five+ years
- Headline job creation not sufficient to spark wage pressures
- Consumer losing momentum without income growth
 - *Shift between goods and services*
- Manufacturing and investment remain directionless
 - *Regulation, healthcare, and tax uncertainty*
- Global economy tepid, international demand uneven
- Housing contribution is limited

Modest but positive growth.

We continue to look for positive but modest GDP growth through the year in the range of 2-2.5% keeping downward pressure on rates and keeping the Fed on hold beyond 2015.

Interest rate forecast grid

	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	2014	2015	2016	2017
<i>Growth indicators</i>													
GDP (QoQ)	4.6%	5.0%	2.6%	1.5%	2.3%	3.1%	2.1%	1.7%	1.5%	2.4%	2.3%	1.9%	2.5%
Fixed Investment	9.5%	7.7%	2.3%	-0.5%	-1.0%	3.0%	2.8%	1.5%	1.4%	4.9%	1.1%	2.0%	2.5%
Housing Starts	909k	1017k	1089k	995k	1,000k	995k	980k	975k	970k	991k	992k	980k	960k
Car Sales	16.92M	16.34M	16.80M	16.55M	16.60M	16.65M	16.70M	16.75M	16.60M	16.60M	16.63M	16.80M	16.85M
Unemployment Rate	6.1%	5.9%	5.6%	5.6%	5.5%	5.4%	5.5%	5.6%	5.6%	6.1%	5.5%	6.0%	5.9%
Participation Rate	62.8%	62.7%	62.7%	62.7%	62.5%	62.3%	62.5%	62.7%	62.7%	62.8%	62.5%	63.0%	64.0%
Savings Rate	5.4%	5.6%	4.9%	4.8%	5.0%	4.8%	4.4%	4.5%	4.6%	5.3%	4.8%	5.0%	5.2%
<i>Inflation indicators, yoy%</i>													
CPI	2.1%	1.7%	0.8%	0.5%	0.3%	0.2%	0.7%	0.9%	1.1%	1.4%	0.4%	1.2%	1.6%
PCE	1.6%	1.4%	0.7%	0.6%	0.4%	0.3%	0.6%	0.8%	0.9%	1.2%	0.5%	1.0%	1.2%
Core PCE	1.5%	1.5%	1.3%	1.2%	1.0%	0.8%	0.9%	1.1%	1.2%	1.4%	1.0%	1.2%	1.4%
<i>Interest rates</i>													
FF	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.75
3month UST bills	0.02	0.02	0.04	0.15	0.18	0.18	0.20	0.20	0.22	0.04	0.18	0.43	1.68
2yr UST notes	0.46	0.57	0.66	0.40	0.50	0.65	0.75	0.85	0.95	0.52	0.58	0.83	2.08
5yr UST notes	1.63	1.76	1.65	1.60	1.65	1.70	1.80	1.85	1.90	1.70	1.69	1.94	3.06
10yr UST notes	2.53	2.49	2.17	2.00	2.15	2.05	2.10	2.15	2.20	2.56	2.08	2.33	3.45
30yr UST bonds	3.36	3.20	2.75	2.60	2.75	2.65	2.70	2.75	2.80	3.32	2.68	2.93	4.05

Source: Sterne Agee/Bloomberg



IMPORTANT DISCLOSURES:

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST: Contact Robert Hoehn at 1-212-338-4731.

Other Disclosures:

Opinions expressed are our present opinions only. This material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Past performance is no guarantee of future results.

For UK Professional Clients

This research report is disseminated in the UK by Sterne Agee UK LLP which is authorized and regulated by the Financial Conduct Authority. This research report is intended for distribution in the UK only to, and should be relied upon only by, persons who or may be classified as eligible counterparties or professional clients pursuant to the FCA's rules or who are investment professionals as defined in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

Copyright © 2015 Sterne, Agee & Leach, Inc. All Rights Reserved.