PA HealthCare Credit Union

2014
Economic and Financial Forecast

The PA HealthCare Credit Union is making your financial health better.

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Agenda

Welcome & Introduction

- The PA HealthCare Credit Union is proud to sponsor this event to better educate members and non-members on the 2014 economic and financial environment which impact these indicators.

- Paul Fero is the CEO of the PA HealthCare Credit Union and is also part of the Adjunct Faculty of Robert Morris University, La Roche College and the University of Phoenix teaching in areas of Economics and Finance.

- Follow Paul on Twitter @PaulFero for periodic updates.

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What we said was going to happen…

- “Economic growth as measured by Real GDP will continue to be somewhat “anemic” by conventional standards but just end up below the long term average between 2% to 2.5%. Just mediocre and muddling through.”

  Sometimes mediocre is not a bad thing.

- “Look for more confrontations from Congress about deficits with zero headway.”

  Fiscal cliffs and government shutdowns with a bitterly divisive Congress. Not a surprise there. There’s no safety in being in the middle of the road. “Those yellow lines get run over all the time.” (Unnamed political operative comment from 2002. Still fits.)

What we said was going to happen…

- "Look for new monthly job gains of about 150,000 a month on average".

  For 2013, job growth has increased 182,000 a month versus 183,000 for 2012. Again, just a mediocre monthly increase. We did say this was going to be a slow and long process of recovery.

- Unemployment rate will slowly decline as the participation rate declines as baby boomers leave the workforce.

  The civilian workforce year over year has shrunk by 548,000 reducing the participate rate from 63.6% to 62.8%. Certainly not a good sign for the labor market.

  Overall, unemployment rate forecast just slightly higher by the number but the effect of lower participation rate taking a greater toll on the number. Here a lower number isn't really a positive sign of a better economy.

Recap of 2013 Forecast

Interest Rate Forecast – Got one, missed one

1. "Short term interest rates, as controlled by the Fed, will continue to stay at the designated 0% to 0.25%."

   The Fed announced that it will continue with the policy of maintaining short term rates to 2015.

2. "Mid-term and long term yields will move plus or minus 50 basis points throughout the year... and will swing yields around current levels. The Fed is inclined to let the economy slowly mend itself by keeping the US 10 year Treasury under 2%."

   Federal Reserve Chairman Ben Bernanke comments that Quantitative Easing will need to eventually wind down and the bond yields rise over 120 basis points within 45 days to 3%. Instead of Ben Buzz Lightyear, it's more like Ben Buzz Saw.

Recap of 2013 Forecast

Stock Market Forecast – Ouch…missed that one.

- The stock has continued it's uptrend. Remember, the trend is your friend.

- Overall, the year will likely trade range-bound within the 1350 and 1475 range all year ending relatively unchanged.

Ouch…taken behind the woodshed again by that call. The S&P 500 gained over 25% for the year without any meaningful correction. Should have remembered the trend is your friend.

The economy overcame some pretty significant headwinds and the market responded in exaggerated fashion to the fundamentals. The fundamentals have improved but only slightly. The market seems to have gotten ahead of itself. Unless fundamentals don't matter….(more on that later).

Federal Reserve’s QE3 to the Big Taper

- The Federal Reserve has come to the conclusion that tapering it’s Quantitative Easing will be the transition period for 2014 to a “normalized” monetary policy.

- As a result, the $85 billion a month the Fed has used in 2013, will slowly come to an end. The reduction is likely by $10 billion for each meeting the Fed has during 2014, whereby ending the year without any additional stimulus.

- This will make 2014 the year of transition and the Fed will be closely watching its’ impact to the greater economy of as a whole.

- Cutting to the chase, the result won’t look much different than with the stimulus. Economic growth will slow slightly but not by any meaningful amount that would have any cause-effect relationship. Greater impacts will be felt in the housing market as borrowing costs will rise slightly and will impact purchases of new and existing homes.

Economic Forecast - Overview

- Economic growth as measured by Real GDP will continue to be somewhat "anemic" by conventional standards but just end up below the long term average between 2% to 2.5%. Just mediocre and muddling through, again.
- Unemployment rate will continue a slow decline with the participation rate declining as well with more leaving the workforce.
- Inflation levels will remain within reasonable and tolerable levels at 2%.
- Globally speaking, no major economic crisis expected. However, temporary regional economic flair ups could likely occur in China, Latin America (i.e. Brazil), and Europe (i.e. France and the U.K.).

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Economic Forecast - Indicators

	2014				
	Q1	Q2	Q3	Q4	Average or
	Forecast	Forecast	Forecast	Forecast	Annualized
Oil per barrel *	$95.00	$105.00	$105.00	$100.00	$100.00
CPI - Urban - Annual	2.0%	2.0%	2.0%	2.0%	2.0%
Unemployment Rate (U-3)	6.8%	6.6%	6.4%	6.2%	6.5%
Unemployment Rate (U-6)	13.2%	13.0%	12.8%	12.6%	12.9%
GDP (annualized rate)	1.5%	2.0%	2.5%	2.0%	2.25%
Fed Funds Rate	0%-0.25%	0%-0.25%	0%-0.25%	0%-0.25%	0%-0.25%
10 Year US Treasury Yield	3.00%	3.20%	3.40%	3.50%	3.25%
S&P 500 Index	1,700	1,850	1,900	1,850	1,800

* West Texas Intermediate / Light Sweet Crude

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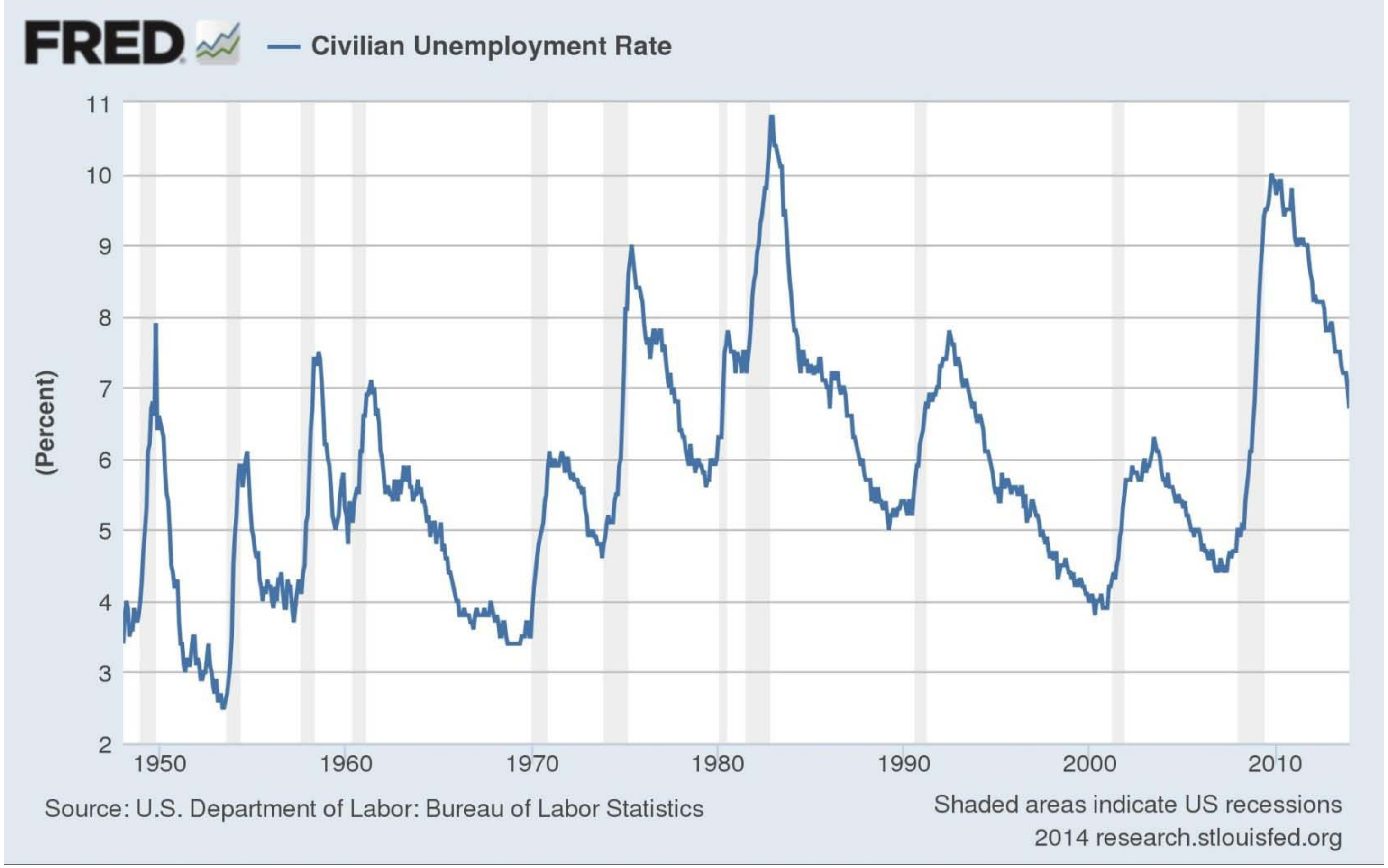
U.S. Unemployment Rate



Shaded bar areas highlight recession periods.

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U.S. Unemployment Rates

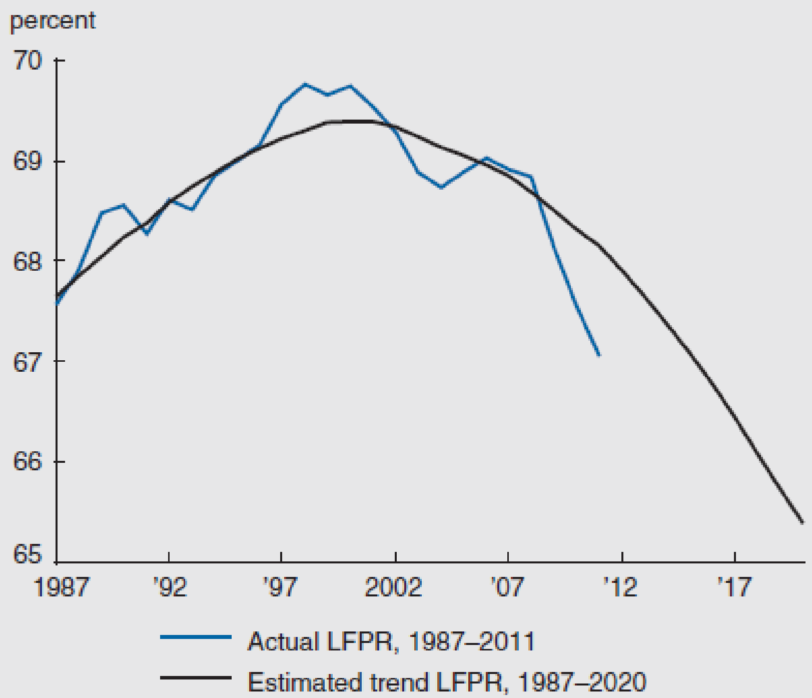
U-6 Rate

U-3 Rate

Shaded bar areas highlight recession periods.

Labor Market – Jobs, Jobs, Jobs (Repeated from last year's forecast)

3. Actual vs. trend LFPR, 16–79 year olds



NOTES: Trend labor force participation rate (LFPR) is the LFPR consistent with the contemporaneous composition of the work force and an economy growing at its potential. For details on the U.S. Census Bureau sources, see note 8.

SOURCES: Authors' calculations based on U.S. Bureau of Labor Statistics, *Current Population Survey*; and U.S. Census Bureau, population data and projections.

The graph to the left illustrates the labor participation rate and how it will worsen for the remainder of the decade. More workers are leaving the workforce than by those new entrants to the workforce or through expansion. The workers leaving the workplace generally tend to be baby boomers that either voluntarily left the workforce, or were forced to leave the workforce through early retirement incentives.

Source: Aaronson, Davis, et al, "Explaining the decline in the U.S. labor force participation rate", Chicago Fed Letter, The Federal Reserve Bank of Chicago, Number 296, March 2012.

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U.S. Participation Rate

Shaded bar areas highlight recession periods.

U.S. Total Non-Farm Payrolls

Shaded bar areas highlight recession periods.

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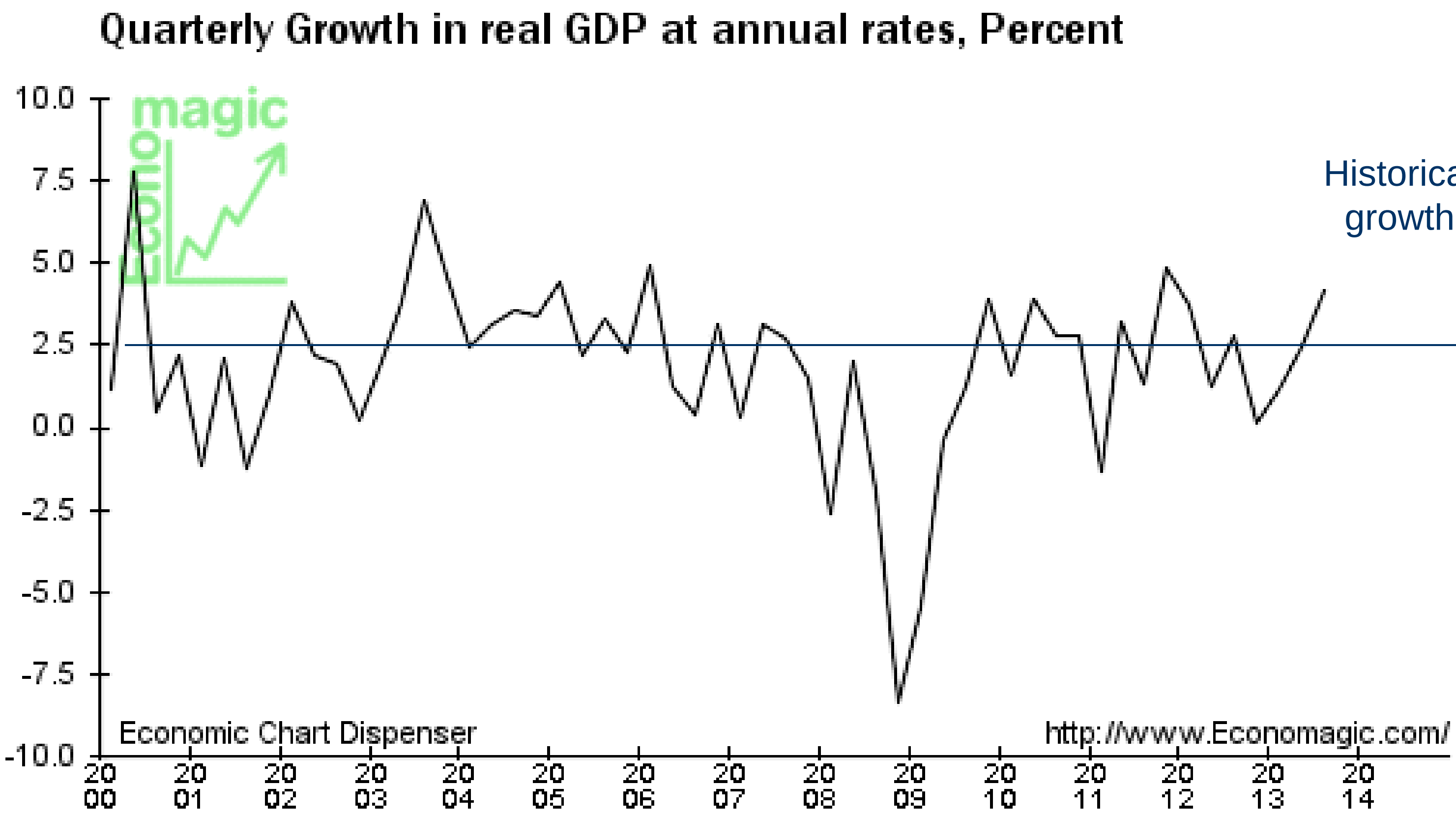
Gross Domestic Product - GDP



Historical average growth @ 2.5%

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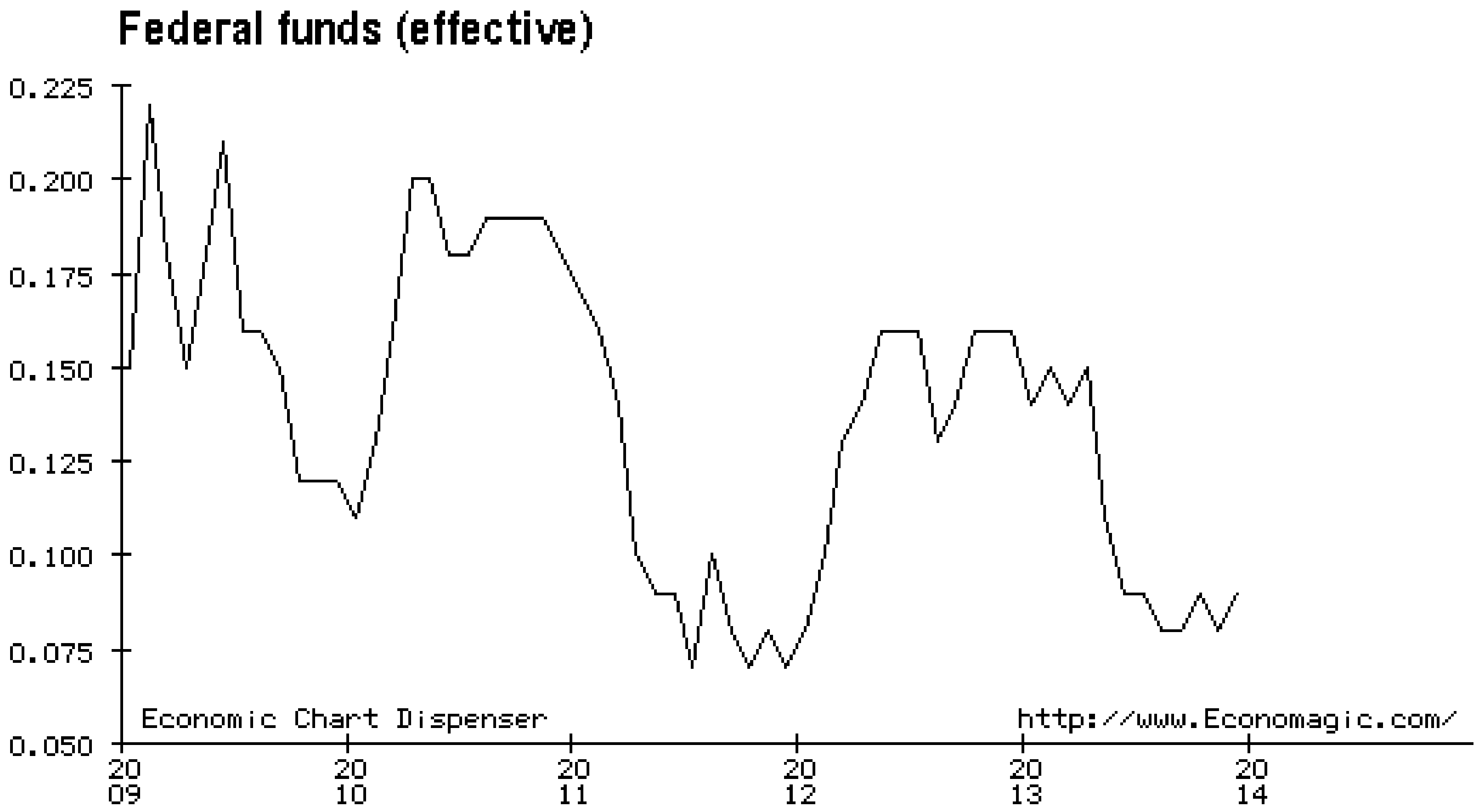
Interest Rate Forecast

- Short term interest rates, as controlled by the Fed, will continue to stay at the designated 0% to 0.25% until 2015. The big question is if and when in 2015 would they begin to raise? The Fed will not be too anxious to raise rates as the economy will still be anemic and will wait for later in 2015 rather than sooner.

- Mid-term and long term yields will move around 50 basis points plus or minus throughout the year. Therefore, look for the 10 year US Treasury to have a range of 2.75% on the downside to 3.50% for the upside.
- While not overly apparent given the current yields, the spread between the 10 year US Treasury and the effective Fed Funds Rate has already normalized (see chart on page 20). Therefore, expectations of additional widening of the yield curve doesn't seem warranted.

Interest Rate Forecast – Short Term Rates



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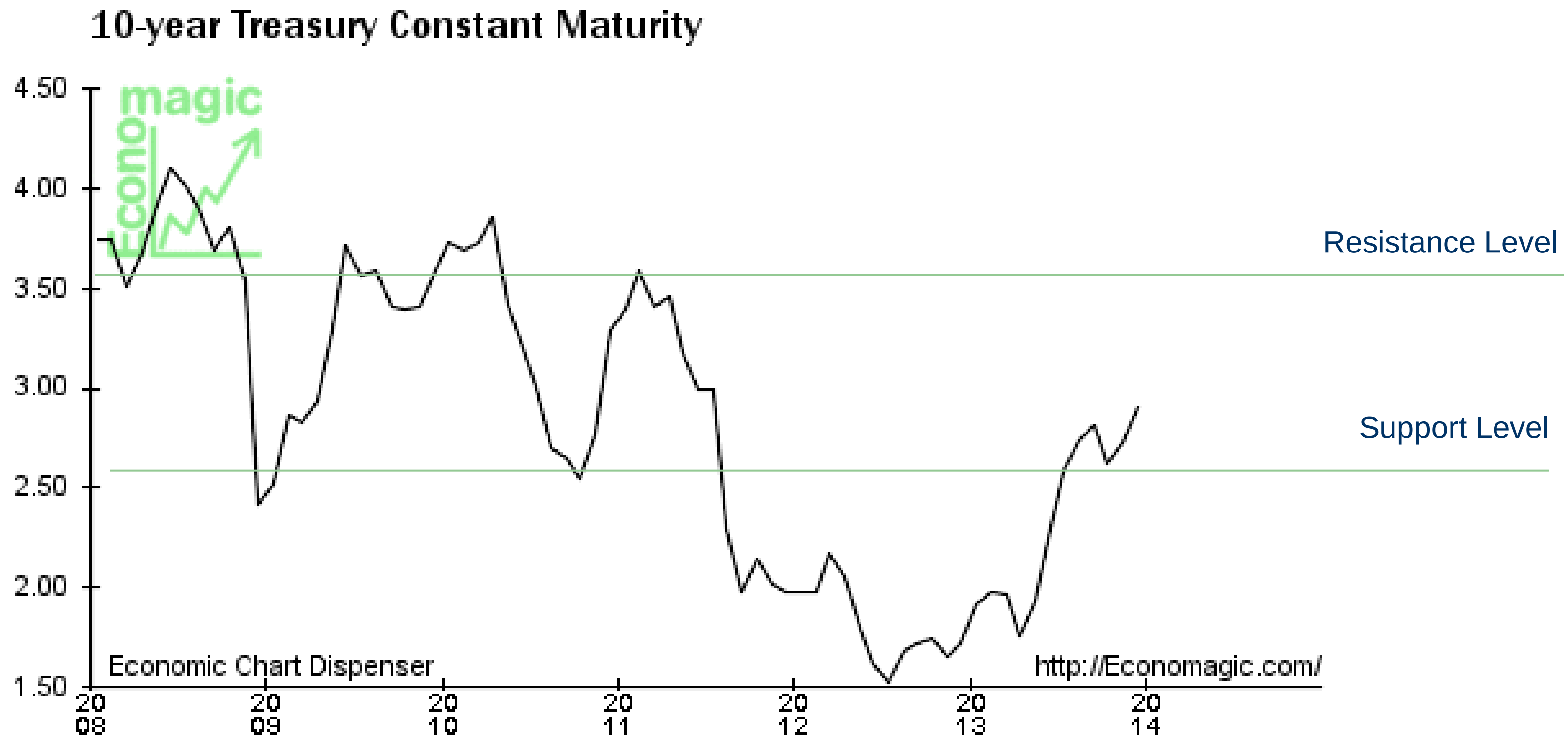
Interest Rate Forecast – Long Term Rates



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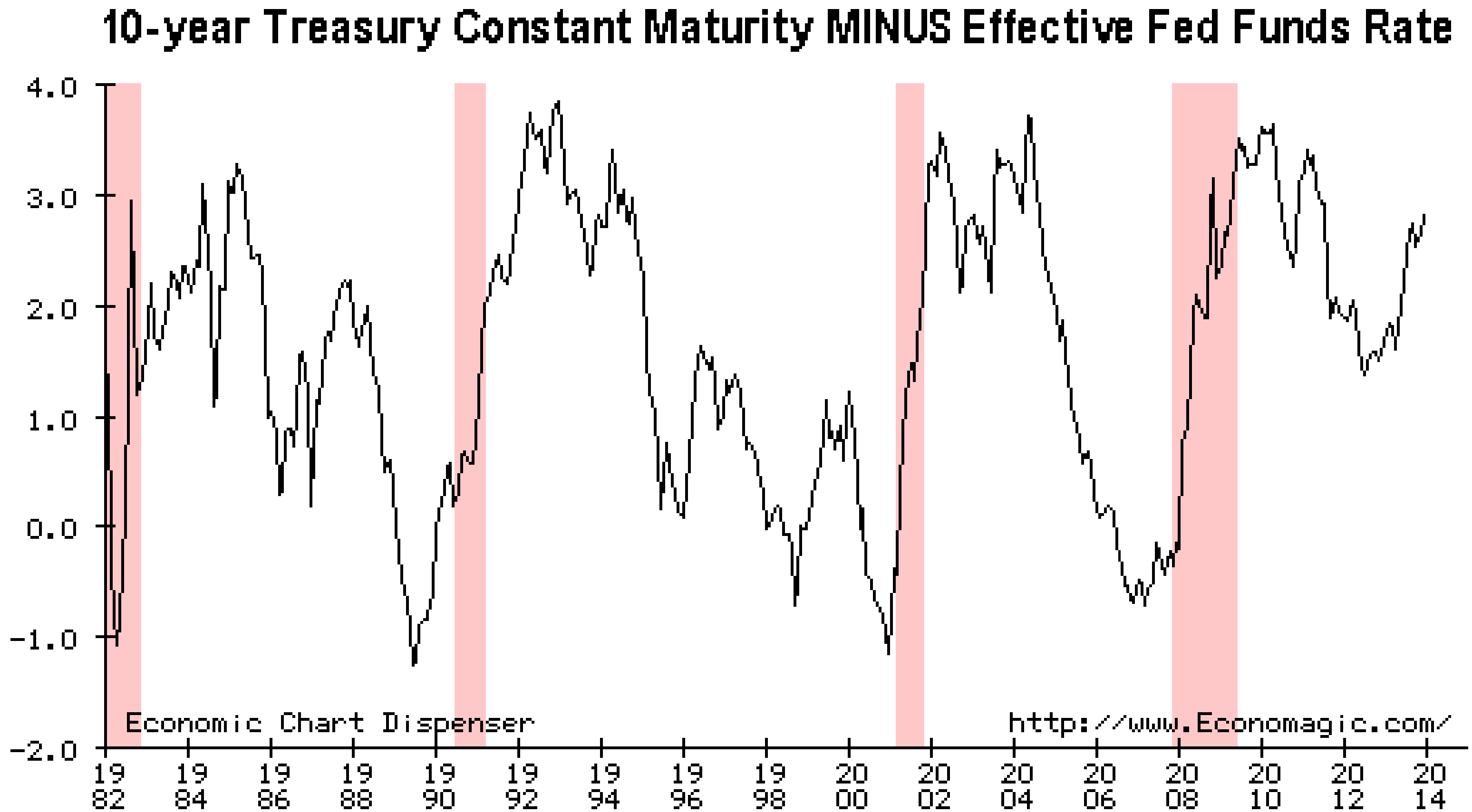
Interest Rate Forecast – Normalizing Yield Curve Spread



Shaded bar areas highlight recession periods.

Stock Market Forecast

- The stock market has continued its uptrend. Remember, the trend is your friend.
- Given the dramatic increase of the S&P 500 index for 2013, without a meaningful pullback, a correction of even a minor one would seem at least justified. (Remember, nothing goes up or down in a straight line.)
- With the VIX (Chicago Board of Options – CBOE Volatility Index) or "fear gauge" at well under 15, it almost begs for a market swing in a negative way. Remember, when the VIX is high, it's time to buy and when the VIX is low, it's time to go. (It's not an absolute, as it can stay high or low for extended periods without much volatility.)
- Trying to include fundamentals into a forecast seems like an exercise in futility – much like how high frequency trading dominates the market.
- Incorporating technical analysis utilizing 50 day moving average as a short term reversal and 200 day moving average as a mid to long term reversal seems to be the way to play.

Stock Market Forecast

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Long Term Forecast

- The overall economy will continue to “muddle” throughout 2014.
- Look for more of the same throughout the remainder of the decade.
- The good news is it’s halftime. The bad news is there is still another half to play in the aftermath of the Great Recession. Yep, economically muddling through to 2020.