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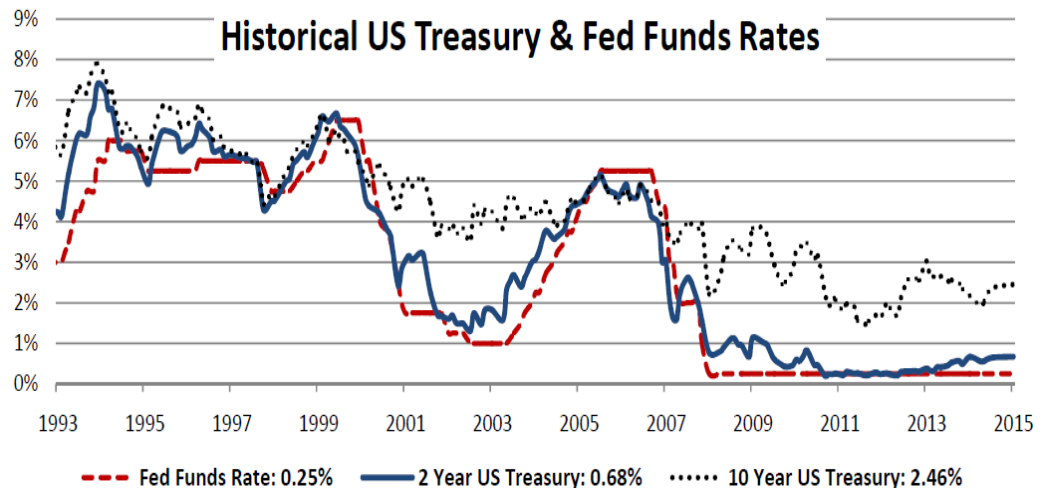
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MFA Economic Outlook

July 13, 2015

HIGHLIGHTS



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*“Sign, Signs,
Everywhere There’s
Signs”*

ABSTRACT

This paper describes our current view of the economic environment.

COMMENTARY

Signs, Signs, Everywhere There’s Signs

As a legendary song goes: “Signs, signs, everywhere there’s signs.” The artist was referring to signs to keep off the grass and, if you have long hair, there is no need to apply for a job.

The signs we see today are signs of an improving economy. Some examples include:

- The federal deficit has shrunk significantly in real and relative terms since 2009. While we still have a long way to go, the deficit represents 18% of expenditures for fiscal 2015, compared to 67% in 2009.
- The U.S. Census Bureau reported that May 2015, new housing permits totaled 20,589 units for the month. That is the first time since August 2007 that the monthly total exceeded 20,000 units. For reference, new housing permits (nationally) peaked in June 2005 at 32,303 units.
- Bank and credit union balance sheets are adding more loans. The F.D.I.C. reported that for the first quarter of 2015, insured bank loans grew at an annual rate of 5.4%, the highest growth rate since the 2008 "meltdown." Credit unions loans grew at the same rate for the first quarter.
- The June unemployment rate was 5.3%, continuing a downward trend from a recent high of 10% in October, 2009. The flip side of this is that many workers have simply stopped looking for work; others are working fewer hours.
- For our Michigan centered accounts, light new vehicle sales reached an annual rate of 17.6 million in June, having bottomed out at a 9.2 million rate in February 2009. Worldwide production has increased 50% since 2008, expecting to surpass 90 million units in 2015.

Other signs that do not look good include:

- The rebound for home values is over and many homeowners are still "underwater" with no relief in sight. This is especially true in cities and regions that have not had a significant rebound in employment. This is true all over the United States, including rural areas and major markets such as Atlanta.
- The Economic Policy Institute estimates that 3.3 million workers are missing from the labor force and the true unemployment rate is 7.3%. Required skills and education are simply not within the grasp of many individuals, for a variety of reasons. This will become more of an issue as student loans become more scarce and the cost of higher education skyrockets. Several public universities in Michigan recently announced tuition increases in excess of 8% for the fall of 2015. This cannot continue.
- Wayne County, Michigan, Chicago, the State of Illinois and Puerto Rico are all facing serious financial problems. This may be the tip of the proverbial iceberg. Take Chicago for example. Its annual budget is \$3.5 billion and its pension "gap" is \$20 billion. Chicago has a 9.25% sales tax; its latest proposal is to tax movie downloads, like Netflix, at 10%. Other state and local governments are sure to follow.
- By the time you read this, hopefully there will be an agreement to bailout the sovereign nation of Greece. Greek civil servants with 35 years of service and have reached the age of 58 retire with 80% of their pay and benefits. The retirement age is currently 61 and they want to change it to 63 or just two years longer. Greeks are rioting in the streets and, they have voted to reject this. By comparison, the retirement age in Germany is 67. Something has to change.

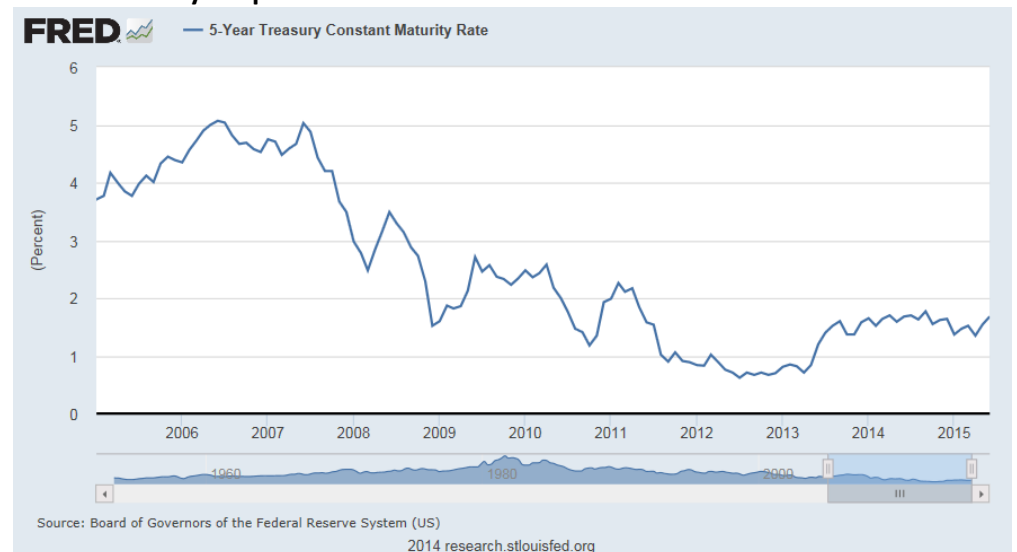
Other signs that are simply a fact of life: We are changing. Our population is changing. Look for a continuing shift in population to the south and west for the next several years. California's population will be boosted by 8 million immigrants from outside the United States by 2025. Our population is aging. By 2025, 18.5% of our population will be 65 years of age, or older. The demands upon federal, state and local governments for infrastructure and services will be "taxing," to say the least. If the Census Bureau's forecast is accurate, California will have 64 members of Congress in 2025, Michigan will have 12.

*"Yields on bonds
have risen a bit"*

Actively managing credit risk and interest rate risk is more important than ever. While the state of the economy is improving there are "signs" that cannot be ignored. There are also certain "facts of life" that have to be factored in when considering investment strategies and evaluating risk. As for the near term, what does the Federal Reserve do with the Federal Funds rate?

Yields on bonds have risen a bit. The 5 year Treasury has tripled from its low of 0.60% to nearly 1.80%. The yield is still low, but it has increased substantially.

5 Year Treasury Graph:



*"We need to focus
on two points"*

As the Fed ponders all of this data, we need to focus on two points:

1. The FOMC increases the Fed Funds rate to slow an overheating economy.
2. The FOMC may target a more neutral position of rates.

We do not see the economy overheating. We do not see much disagreement on this in the marketplace. What we do question, in our weekly investment meetings at McQueen Financial, is the possibility of a neutral rate for the Fed Funds rate. If there is one, what is it? Our internal view ranges from 0.75% to 1.25%

Our Forecast:

The FOMC will leave rates unchanged through the end of 2015. Somewhere near the end of 2015 and the first half of 2016, the FOMC will raise the Fed Funds rate from a range of 0.00% to 0.25% to just 0.25%. The next move will be to 0.50%.

	2015 Q3	2015 Q4	2016 Q1	2016 Q2
Fed Funds	0-0.25%	0-0.25%	0.25%	0.25%
2 Year Treasury	0.65%	0.70%	0.75%	0.85%
5 Year Treasury	1.70%	1.80%	1.90%	1.90%
10 Year Treasury	2.60%	2.70%	2.80%	2.80%
GDP (Annual)	2.00%	2.25%	2.50%	3.00%
US Unemployment	5.30%	5.00%	4.95%	4.90%

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Investment Portfolio Management: As a fixed income investment advisor, we will bring professional, in-house fixed income investment portfolio management to your financial institution at substantial savings. Our process is designed to develop a desired portfolio structure while focusing on your current income and total return with safety of principal.

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Asset Liability Management: McQueen Financial Asset Liability Management reports will provide you with recommendations and strategies that are designed to fit your unique needs and provide you with the information you need to make the most informed decisions and add income to your bottom line.

Core Deposit Studies: This report will be an integral part of your Asset Liability Management report. The Core Deposit Study is comprised of two sections. The first is a historical comparison of your deposit rates to market interest rates. The second section is the determination of the duration of your core deposits.

Prepayment Speed Analysis: McQueen Financial has developed a process to determine your actual prepayment speeds. Our Analysis provides a report that shows your actual prepayment speeds, the national or state speeds and our recommended prepayment speeds for your ALM report.

Liquidity Analysis: The liquidity stress testing report covers 30 day, 60 day and 90 day liquidity in current, moderately stressed and severely stressed scenarios. The report is designed to be easy to understand and provide significant detail to allow for a comprehensive view of your liquidity position.

Assumption Stress Testing: McQueen Financial provides a detailed list of the assumptions in your Asset Liability Management report. We have developed a model that stress tests your assumptions and provides you with a detailed analysis of the results. The goal is to understand if an unanticipated change in assumptions would significantly hurt your projected financial performance or risk profile.

Back Testing: The objective of the back testing report is to determine the net interest income projection in your ALM report was reasonable. Our analysis focuses on volume as well as booked interest rates of each interest-sensitive component of the balance sheet. The back-testing analysis is a useful management tool that provides you with a cross-check of ALM inputs and assumptions.

ALM Validation: The objective of the ALM validation report is to provide you with an independent review of your ALM model, your ALM policy, and procedures used to measure interest rate risk. The validation process involves a detailed study of your financial statements, ALM reports, ALM policy and inputs to your model.

Mortgage Servicing Rights Valuations: The Mortgage Servicing Rights Valuation (MSR Valuation) process is an integral step in determining the overall financial success of a financial institution's mortgage operations. By outsourcing your MSR Valuation to McQueen Financial, you will receive an independent third party market valuation.



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