Alabama Municipal Electric Authority

Economic & Market Update
“A Cloudy Crystal Ball”

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President and Chief Investment Officer

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<table>
<thead>
<tr>
<th>Investment, Insurance and Annuity Products</th>
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<tbody>
<tr>
<td>Are Not FDIC-Insured</td>
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<tr>
<td>Are Not Deposits</td>
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After a Red Hot 2013, Financial Market Returns Moderated in 2014

<table>
<thead>
<tr>
<th>Index Description</th>
<th>YTD 4/3/15</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 Index (Domestic Large Cap Stocks)</td>
<td>0.92%</td>
<td>13.68%</td>
<td>32.38%</td>
</tr>
<tr>
<td>MSCI Emerging Index (Emerging Market Foreign Stocks)</td>
<td>4.31%</td>
<td>-2.11%</td>
<td>-2.30%</td>
</tr>
<tr>
<td>EAFE Index (Developed Country Foreign Stocks)</td>
<td>6.42%</td>
<td>-4.20%</td>
<td>23.58%</td>
</tr>
<tr>
<td>NIKKEI 225 Index (Japanese Stocks)</td>
<td>12.01%</td>
<td>8.91%</td>
<td>59.32%</td>
</tr>
<tr>
<td>GOLD (ETF)</td>
<td>1.50%</td>
<td>-2.19%</td>
<td>-28.33%</td>
</tr>
<tr>
<td>U.S. Aggregate Bonds (Barclays Index)</td>
<td>2.05%</td>
<td>5.97%</td>
<td>-2.02%</td>
</tr>
</tbody>
</table>

Source: RIM
### GDP: Eurozone, U.S. and Major Trading Partners + Brazil

<table>
<thead>
<tr>
<th></th>
<th>Annual GDP (Bln USD)</th>
<th>GDP YoY % Chg Dec. 2014</th>
<th>GDP Q4 2014 % Chg Annualized</th>
<th>GDP Estimate Calendar Yr 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>16,768</td>
<td>2.40%</td>
<td>2.20%</td>
<td>2.80%</td>
</tr>
<tr>
<td>Eurozone</td>
<td>13,148</td>
<td>0.90%</td>
<td>0.90%</td>
<td>1.50%</td>
</tr>
<tr>
<td>China</td>
<td>9,240</td>
<td>7.40%</td>
<td>7.30%</td>
<td>7.00%</td>
</tr>
<tr>
<td>Japan</td>
<td>4,920</td>
<td>-0.03%</td>
<td>1.50%</td>
<td>2.10%</td>
</tr>
<tr>
<td>Brazil</td>
<td>2,246</td>
<td>0.18%</td>
<td>-0.25%</td>
<td>-0.65%</td>
</tr>
<tr>
<td>Canada</td>
<td>1,827</td>
<td>2.53%</td>
<td>2.44%</td>
<td>2.10%</td>
</tr>
<tr>
<td>Mexico</td>
<td>1,261</td>
<td>2.10%</td>
<td>2.60%</td>
<td>3.00%</td>
</tr>
<tr>
<td><strong>Weighted Average</strong></td>
<td><strong>2.59%</strong></td>
<td><strong>2.65%</strong></td>
<td></td>
<td><strong>2.99%</strong></td>
</tr>
</tbody>
</table>

Source: Bloomberg
Central Bank Policy remains Accommodative

Global Central Bank Short Rates

Source: Bloomberg
U.S. Fed Has Finished Asset Purchases, ECB Instituted QE

Federal Reserve Balance Sheet ($ Trillions)

Source: Bloomberg
How Low Will Oil Push Inflation?

December 2010 – February 2015

Fed’s Long-Run Goal 2%

Source: Bloomberg
An Improving Labor Market Should Produce More Wage Inflation

Change in US Non-Farm Payrolls and Unemployment Rate

Extrapolating the current trend results in a 5.3% unemployment rate by May 2015. Will this force the Fed’s hand this summer?

Source: Bloomberg
Historically the Fed has hiked rates when wages started rising…

Source: Bloomberg
U.S. Housing Construction is Well Behind Normal Demand
US Home Price Growth is Slowing and New Home Construction Appears Stuck

In pre-bubble years, housing starts averaged about 1.5 MM. With plenty of pent up demand, this housing recovery has room to grow.

Source: Bloomberg
Pent-up Demand for Housing

% of all 18-34 year olds living with their parents

Source: Census Bureau
Consumers Have Repaired Balance Sheets

Household Debt to Personal Income
(Left Hand Scale)

% of Disposable Income Going to Debt Payments
(Right Hand Scale)

Consumer debt levels are the lowest in twelve years.

The % of income needed to service debts is the lowest in over twenty years.

Source: Bloomberg
Domestic Energy Production is Rapidly Expanding

**US Natural Gas (Billion Cubic Feet per Day – 12 Month Average)**

**US Oil (Million Barrels per Day)**

Positive Benefits:
- More Jobs
- Lower Trade Deficit ($150B)
- Stronger Dollar
- Manufacturing Renaissance
- Price Declines

Source: Bloomberg
Our Process Begins with Business Cycle Analysis

GDP Expands  

GDP Contracts  

Source: *Investment Timing in the Business Cycle*  
by: Jon Gregory Taylor; published 1998 Wiley & Sons
Accommodative Global Central Bank Policies Have Kept Global Yields Low

10-Year Government Bond Yields

Source: Bloomberg
Faster US growth, higher inflation and a change in Fed policy will place upward pressure on US bond yields. We recommend an underweight to the fixed income asset class.
Equity Market Outlook:

As Stocks Rise, So Does Risk
## 2014 Was Another Great Year for Domestic Stocks

<table>
<thead>
<tr>
<th>Index</th>
<th>2014 Total Return</th>
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<tbody>
<tr>
<td>S&amp;P 500</td>
<td>13.68%</td>
</tr>
<tr>
<td>S&amp;P Citigroup Value</td>
<td>12.35%</td>
</tr>
<tr>
<td>S&amp;P Citigroup Growth</td>
<td>14.89%</td>
</tr>
<tr>
<td>Russell 2000</td>
<td>4.90%</td>
</tr>
<tr>
<td>Russell 1000 Value</td>
<td>13.45%</td>
</tr>
<tr>
<td>Russell 1000 Growth</td>
<td>13.05%</td>
</tr>
<tr>
<td>Russell 1000</td>
<td>13.24%</td>
</tr>
<tr>
<td>NASDAQ Composite</td>
<td>14.83%</td>
</tr>
<tr>
<td>Dow Jones Industrials</td>
<td>10.04%</td>
</tr>
<tr>
<td>International - EAFE</td>
<td>-4.20%</td>
</tr>
</tbody>
</table>

Source: Bloomberg
Stocks Are Up Over 200% Since the March 2009 Lows

Source: FactSet Research Systems
All Sectors Were Positive Except for Energy in 2014

Source: FactSet Research Systems
Our Crystal Ball is Getting Hazier

- Much hinges on the direction of energy prices and interest rates
- These are harder to forecast than earnings growth and corporate actions
- Many sectors could be impacted dramatically by movements in these two variables
What We Are Watching in 2015

- Drop in oil prices: a net negative or a net positive? When will oil rebound?
- Will consumer spending continue to show renewed signs of life?
- Will hiring translate into the wage growth this recovery has yet to see?
- Will rates increase and will this spur investment decisions on the part of corporate management?
- Implications of all of these on sector and stock selection
Drop in Oil – Good or Bad for Stock Prices?

Relative Performance of the Consumer Discretionary And Energy Sectors
During the Fourth Quarter of 2014

➢ Detrimental to 4Q S&P 500 EPS and to the shares of the Energy, Industrial and Materials sectors, but a boost to holiday spending and the shares of the retailers towards the end of the year.

Which sectors carry more weight?

Source: FactSet Research Systems
Wage Growth a Potential Catalyst to Spending but It Will Eventually Come with a Cost to Corporate Profitability

- Housing
- Trading up
- Corporate earnings have been protected from wage inflation even as the unemployment rate has fallen from 10% to under 6%
- Wage growth a double edged sword?
Fund Flows into Equities Have Slowed

Source: FactSet Research Systems, data as of January 30, 2015
Valuations Are Fair Overall but Extended Under the Surface in Many Areas

Source: RIM, FactSet Research Systems
Remaining Catalysts Are Getting Fewer

Catalysts – This list is getting “lighter”

Risks – The catalysts aren’t offsetting the risks anymore
Investment Thesis

- Positive earnings growth, a nice yield and an improving domestic economic outlook should help support stocks achieve mid-single digit returns in 2015 but we are expecting an uptick in volatility compared to what we have witnessed in the past few years.

- Valuations, volatility from global sources and energy-related dislocations pose risks for stocks this year. Should wage gains fail to materialize or if energy prices rebound sharply, recent gains in consumer spending and sentiment will dissipate.

- The longer this bull market lasts, the greater the risks as expectations rise.