CIO Total Fund Performance & Risk Report
STATE OF THE ECONOMY

Period Ending December 31, 2013

ECONOMIC SUMMARY

Broadening US expansion and reduced global tail risk

- US real GDP growth accelerated to 3.75% in the second half of 2013 after 1.75% in the first half.
- A combination of more robust household spending, inventory rebuilding by businesses, a strong growth contribution by petroleum and auto production, along with the (tentative) reemergence of spending by state and local authorities have been significant contributors to this turnaround.
- Jobs growth averaged around 180K per month during 2013, little changed from 2011 and 2012. However various qualitative measures such as labor mobility, job seeking and full time work have improved.
- Housing affordability has cooled off and so have sales. However toward the end of the year there was a strong second wind for housing starts and plans to buy a home.Builders are likely to be busy during 2014.
- Inflation remains well behaved in the low to mid-1s. Soft wages growth and cheap energy should keep inflation contained during 2014. There is some risk of higher healthcare and housing inflation.
- While it would be unwise to ignore the risk to emerging markets from weak financial conditions, purchasing managers globally finished the year strongly as regards new business and hiring intentions.

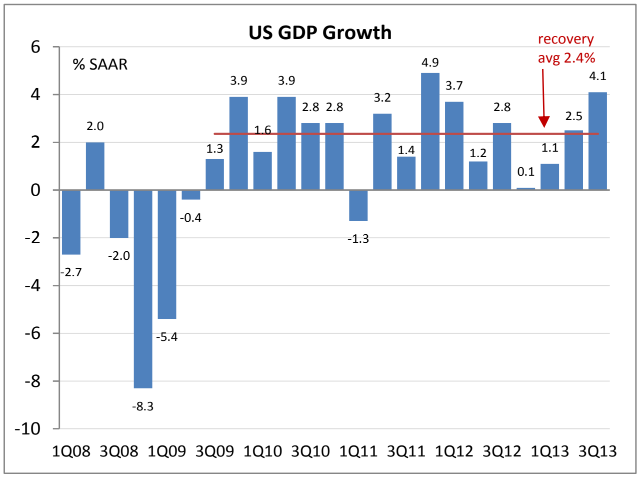
WHAT IS TRENDING

Positive	Same Trend	Negative
- Economic growth Real GDP growth may have reached 3.75% in 2H 2013, double the first half rate. **- Labor market quality** New high in temp jobs, more full time work, greater mobility, fewer discouraged workers. **- Consumer sentiment and spending** Confidence rebound after budget deal shows up in better chain store and retail sales. **- Manufacturing and trade** 2H IP strength led by IT, autos and oil/gas. Sharp narrowing of petroleum trade gap. **- Construction** Improvement in apartments, office and commercial building into year end. **- Household balance sheets** Net worth +$19bn in 4 years. Households have largely saved rather than spent it. **- Buiness profits and capex** 8% yearly profit growth for nonfinancial corporates, improving capex orders. **- Government sector** Federal deficit $560bn in 2013 vs $1060bn in 2012. Municipal spending improves.	**- Inflation** Headline and core inflation rates still in the low to mid 1s. **- Car sales** Auto sales have leveled out at a 15.5 mn unit rate and imports' share is recovering.	**- Cold weather** First casualty was a low rate of jobs growth in December, likely to bleed into January. **- Unemployment Rate** At 6.68% it is very near Fed's 6.5% threshold for considering less easy money. **- Mortgage applications** As mortgage rates rise, applications for purchase and refinancing slump. **Housing affordability** Decision between purchase and renting has become more even again. **- Home resales** Peaked in August at 5.4mn rate, now down to 4.9mn. But plans to buy jumped in Dec. **- Expiry of extended jobless benefits** This will impact 1.3mn workers at the start of 2014, with a small GDP impact. **- Inventories … too much?** Inventory rebuild has been aggressive although not out of whack with sales.

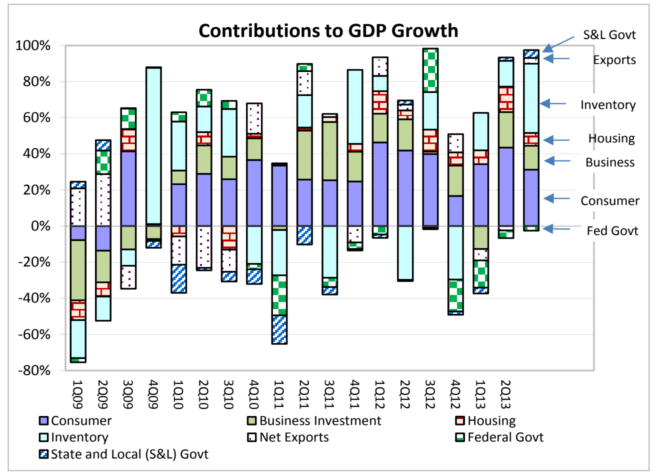
THE US ECONOMY IN AGGREGATE

SUMMARY

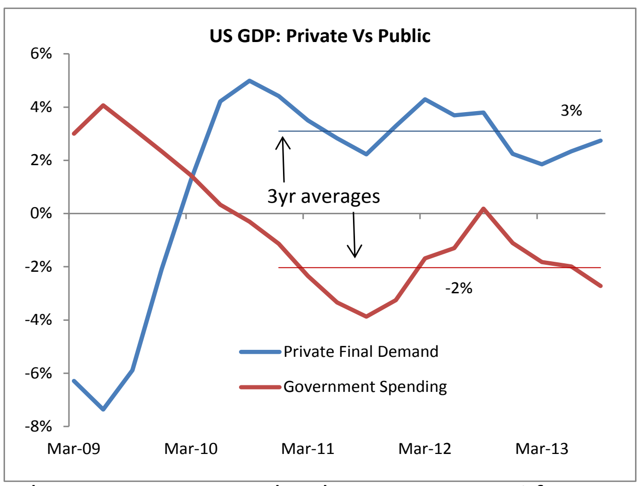
- The US economic expansion, now in its fifth year, appears to be broadening.
- US real GDP growth accelerated to 3.75% in 2H 2013 after 1.75% in 1H 2013



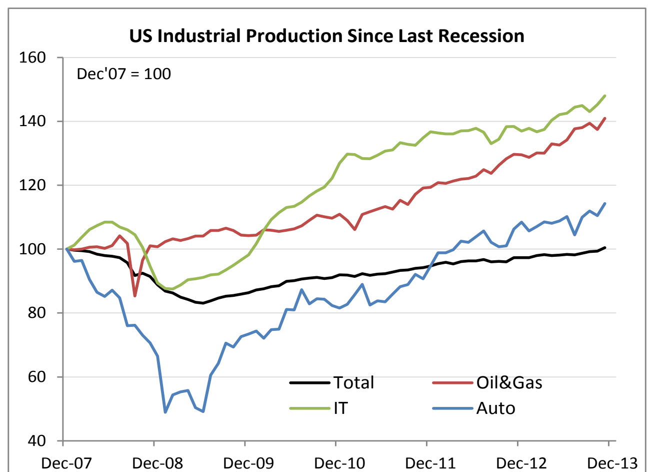
- US GDP growth improved as 2013 progressed, reaching 4.1% in 3Q and likely to beat 3% in 4Q.



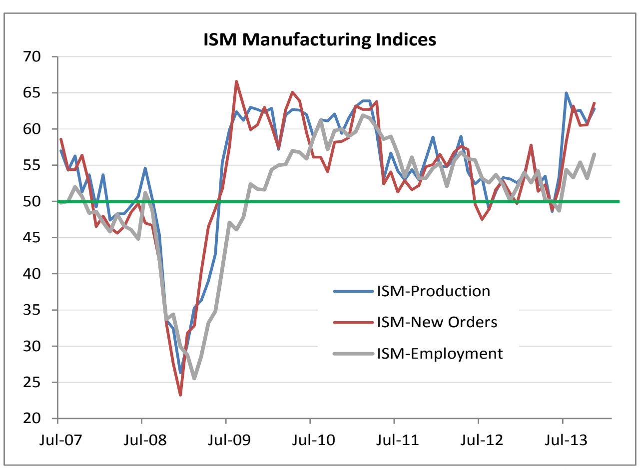
- Recent contributions include business inventory rebuilding and state and local government.



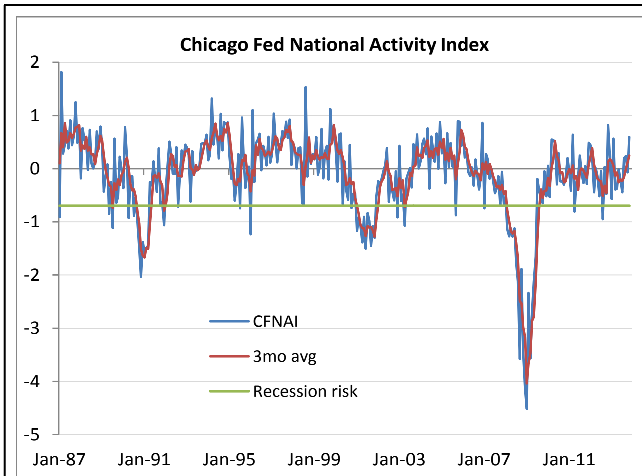
- The private economy has been growing 3% for 3 years but government has been -2%.



- Industrial production rebound has been led by IT, oil and gas, and autos.



- The Institute of Supply Management survey of manufacturers has shown recent strength.

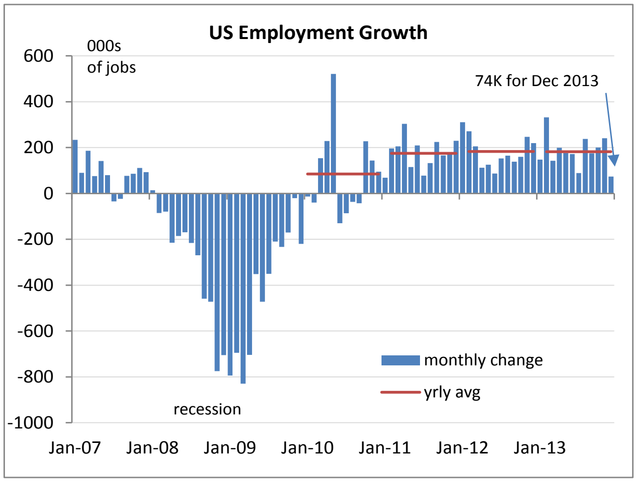


- The Chicago Fed's broad gauge of the economy has improved in recent months.

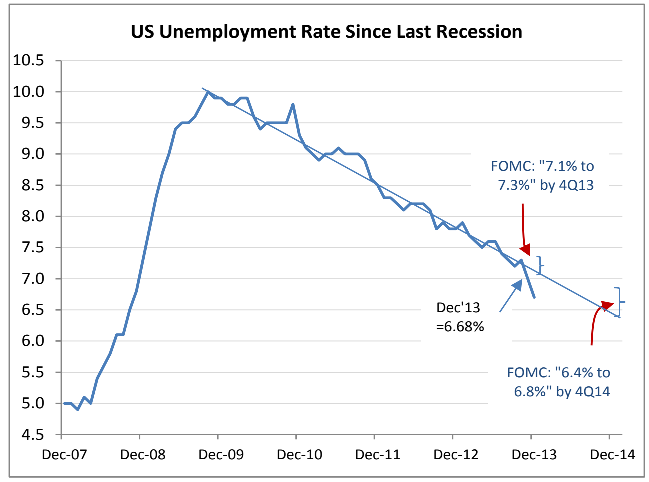
THE LABOR MARKET

SUMMARY

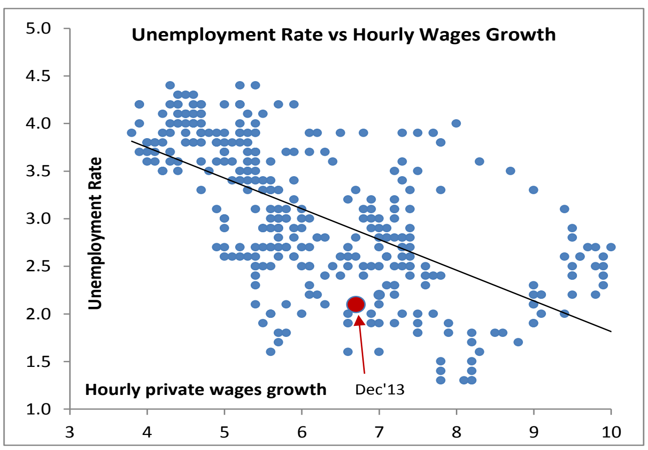
- US employment growth has been steady for three years at about 180K per month Wage growth remains low.
- However some qualitative aspects have improved such as labor mobility, full timework andless discouragement.



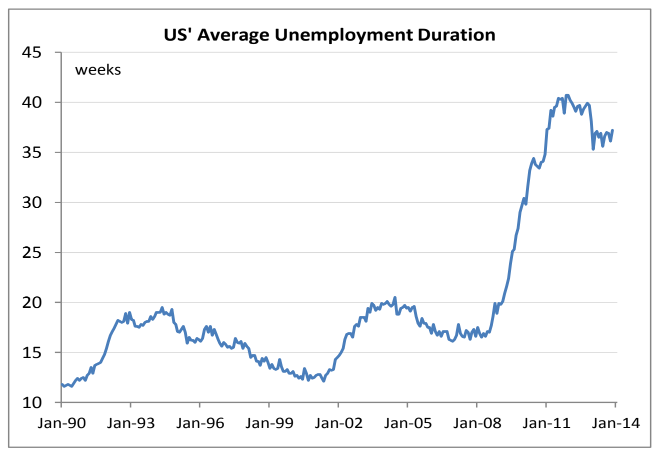
- Jobs growth averaged 182K per month in 2013,, almost identical to 2011 (175K) and 2012(183K).



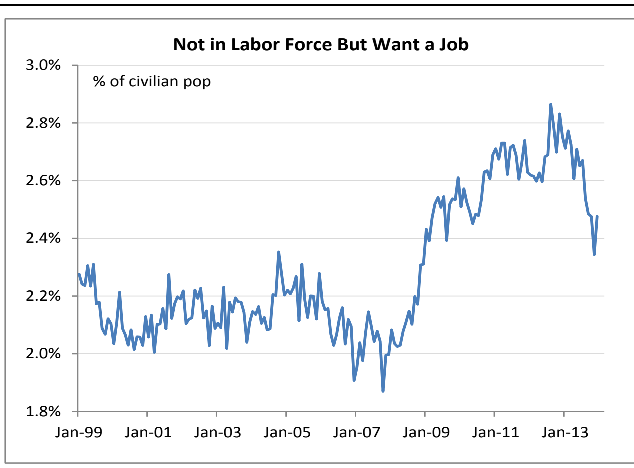
- The US unemployment rate has come down more sharply than the Federal Reserve expected.



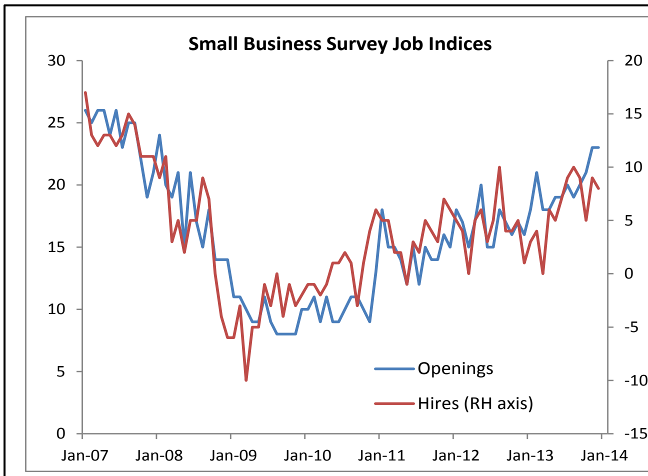
- US wage growth remains low when measured against the unemployment rate.



- Average duration of unemployment remains high.



- But the cohort of discouraged job seekers is coming down.

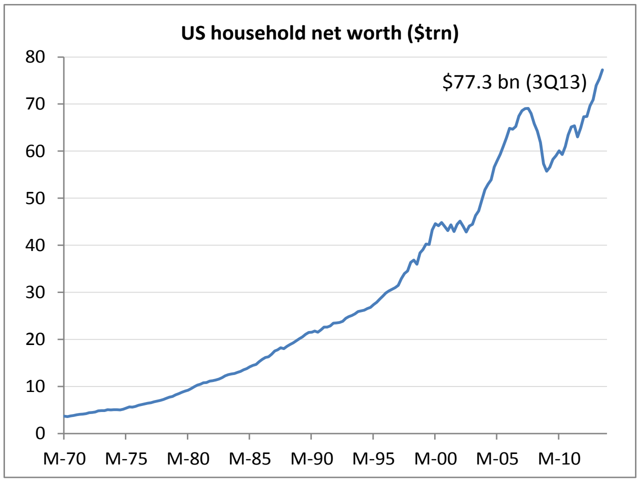


- Small business hiring and openings have recently accelerated.

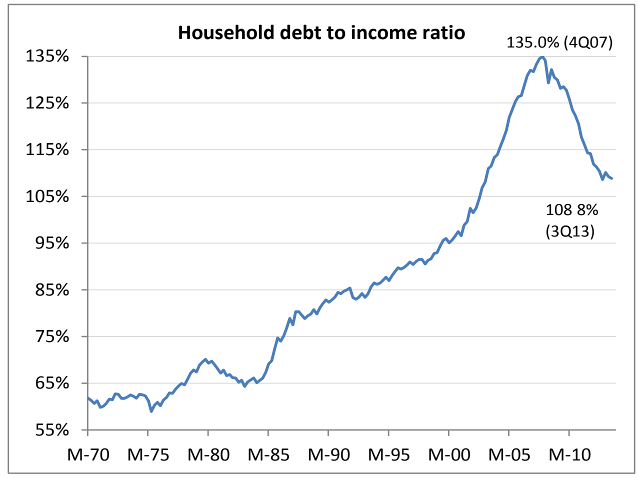
HOUSEHOLD SECTOR

SUMMARY

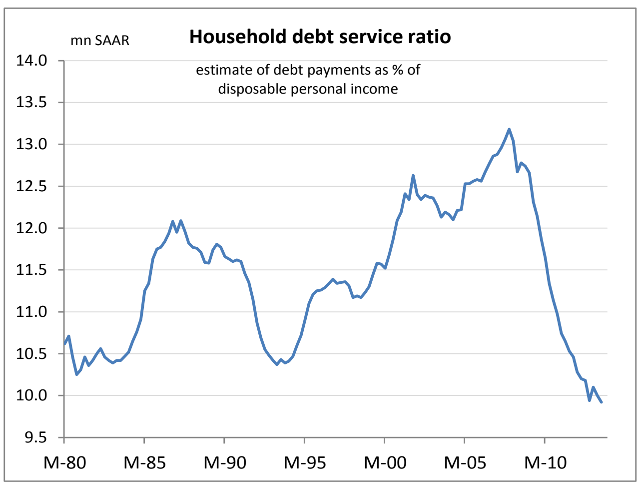
- US households in aggregate have seen a sharp rebound in their net worthand record low debt servicing costs.
- Housheolds are saving most of their wealth rebound, but there has been a modest rebound in spending too.



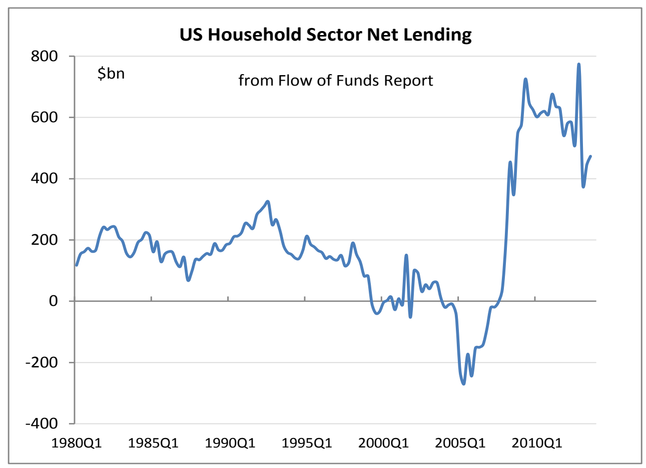
- US household net worth is back above the pre-recession peak.



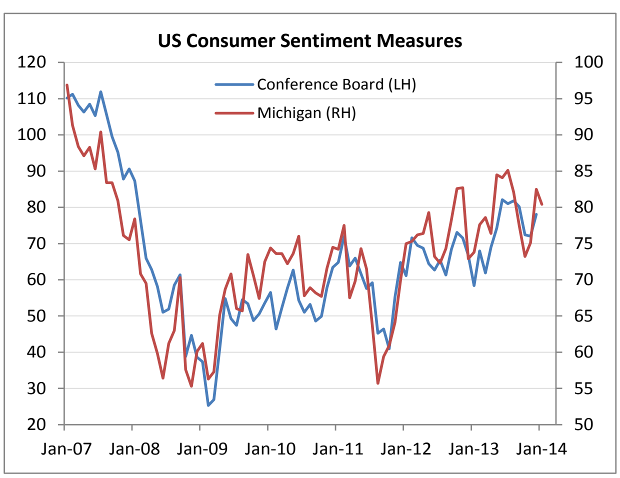
- Households have drawn down debt (especially mortgage and credit cards).



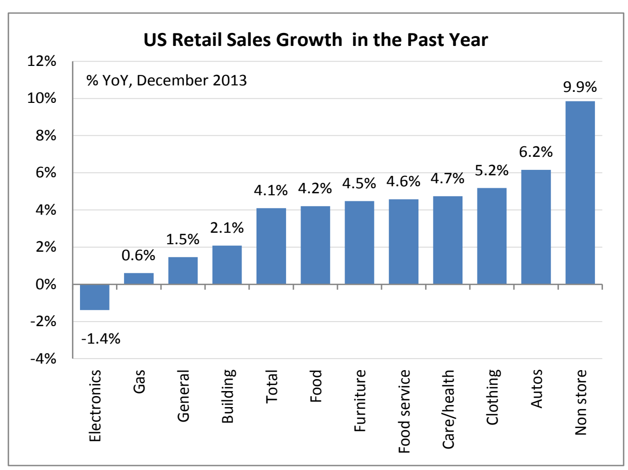
- Debt servicing burdens are very low.



- And so far households have largely been saving their improved worth, not spending it.



- Consumer sentiment has improved as Washington became less dysfunctional.

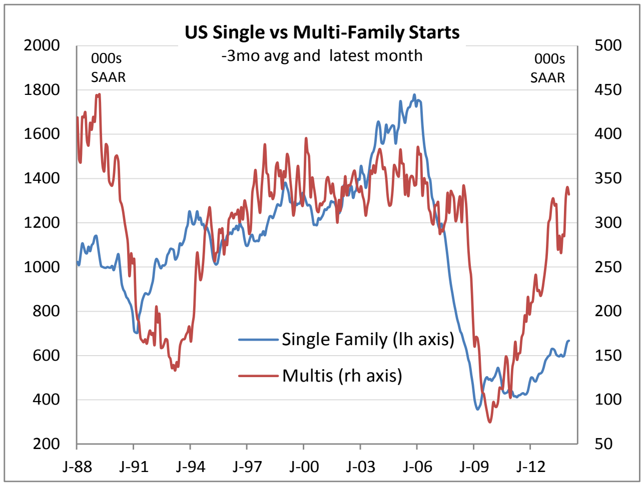


- Many categories of retail are growing strongly as household balance sheets improve.

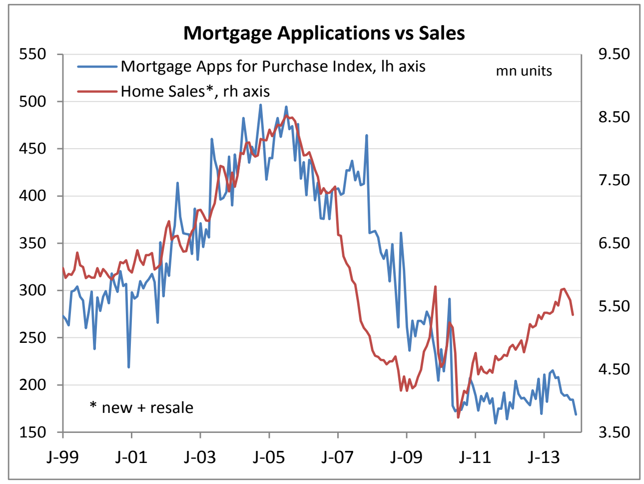
HOUSING

SUMMARY

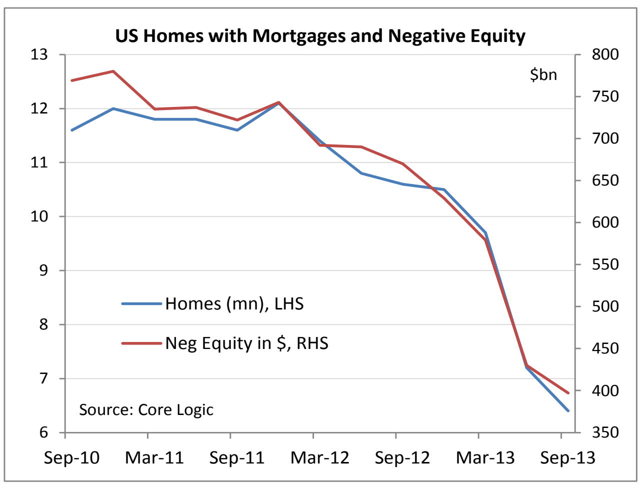
- After a lull in summer, starts for single family homes and apartments were very strong in the fourth quarter.
- Home resales have cooled off with lower affordability, but plans to buy a home in the next 6 months are robust.



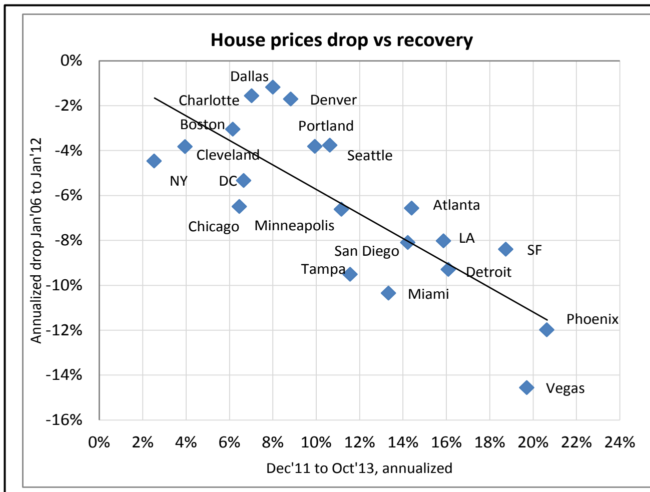
- Multi family housing starts remain strong while single family starts improved in fourth quarter.



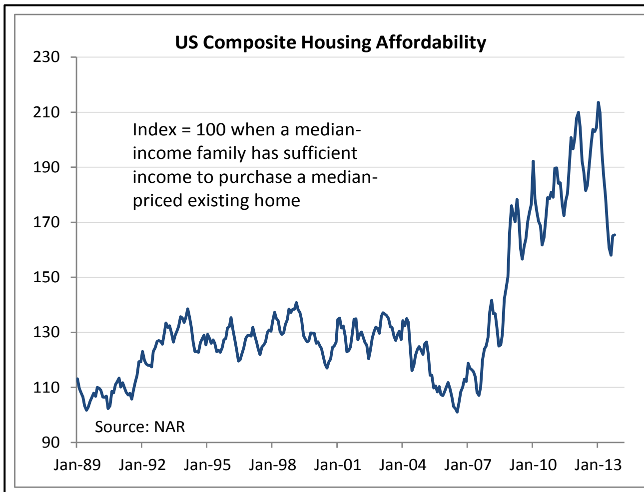
- Home sales have rebounded in spite of a stagnant mortgage market.



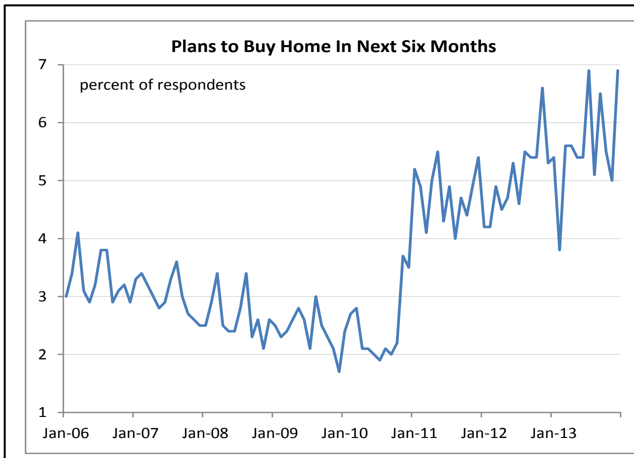
- The number of homes with negative equity, and its value, has halved since 2011.



- Housing markets which fell the most have largely led the price recovery.



- Housing affordability has cooled off.

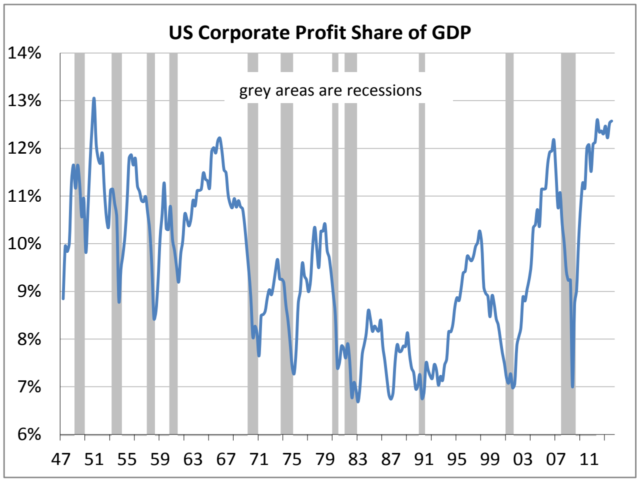


- However, based on improved buying intentions, sales should pick up again in 2014.

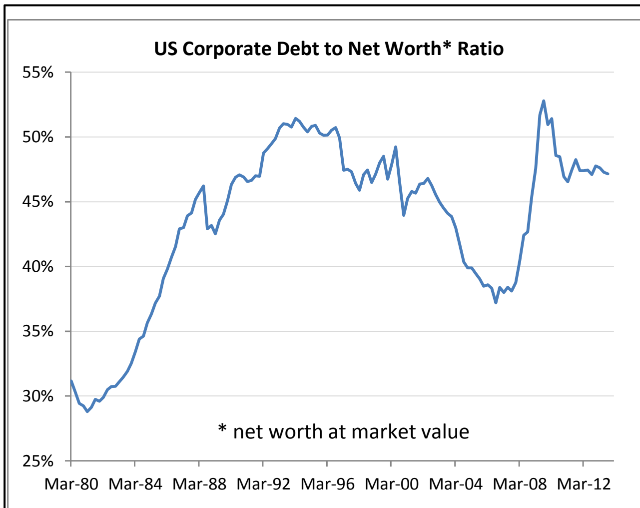
BUSINESS SECTOR

SUMMARY

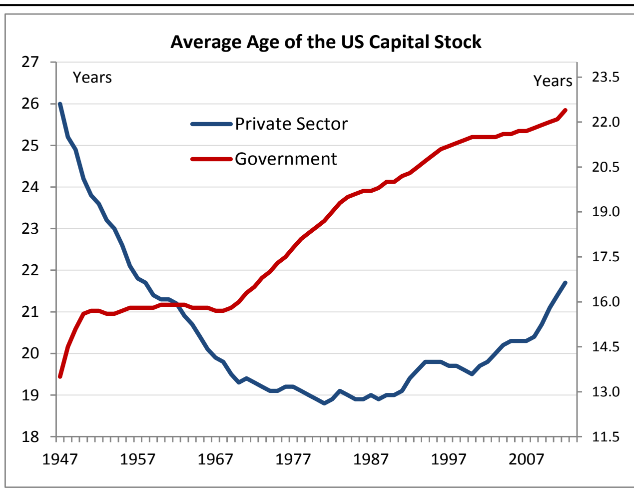
- Buoyed by strong profits, high cash reserves and improving sales, business investment has begun to stir.
- The ageing capital stock and less policy uncertainty from Washington are additional factors.



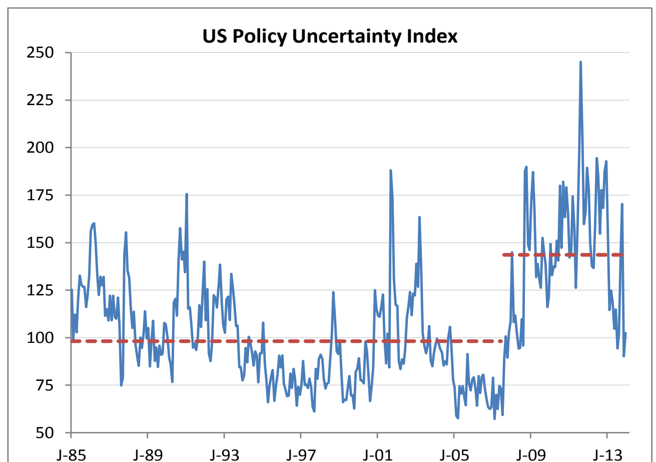
- The business profit share of the economy is historically high.



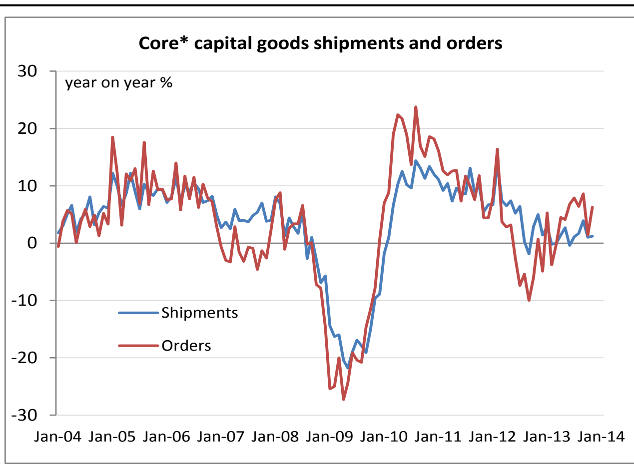
- Corporate debt is not extreme vs. net worth.



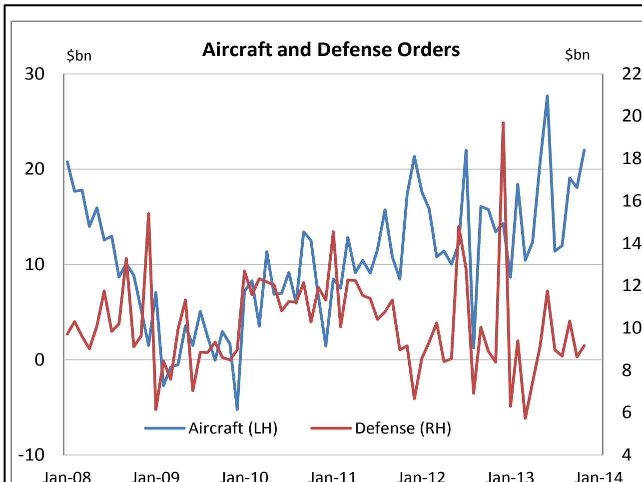
- Businesses may have to replace ageing capital stock.



- And can more confidently invest in a less uncertain economic policy environment.



- Core orders (i.e. ex defense and aircraft) for capital goods are on a rising trend.

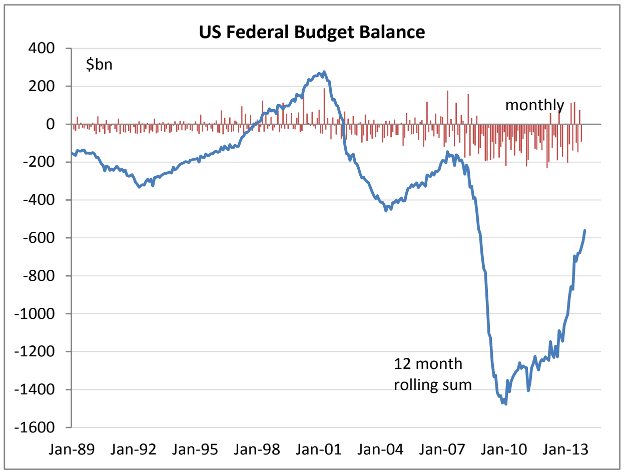


- Aircraft orders have also been particularly strong.

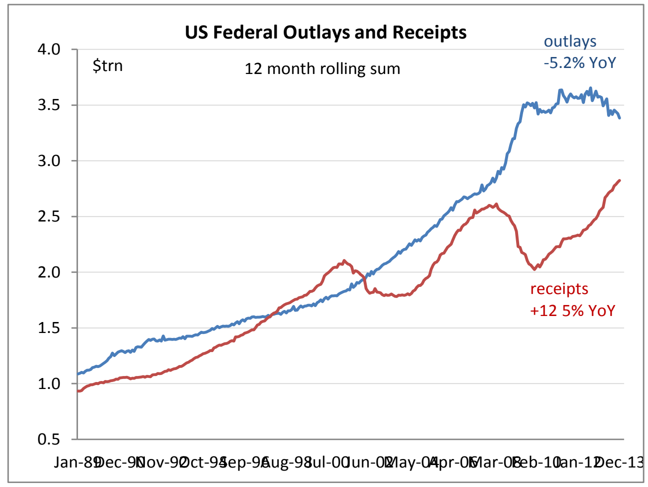
GOVERNMENT

SUMMARY

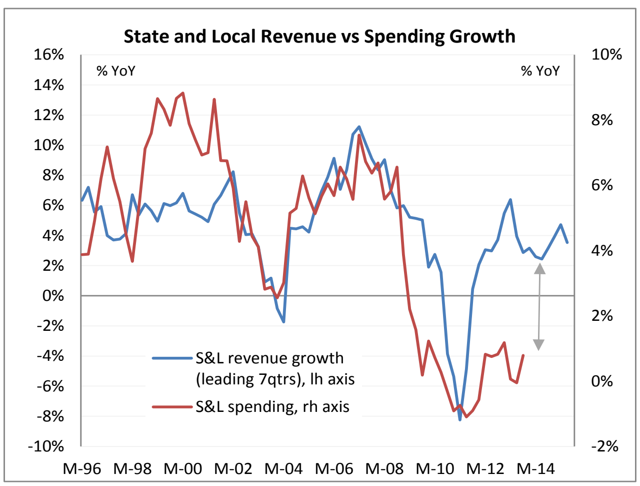
- The federal budget deficit has declined more sharply than the government or CBO expected.
- Government employment has leveled out and its spending has modestly improved at the municipal level.



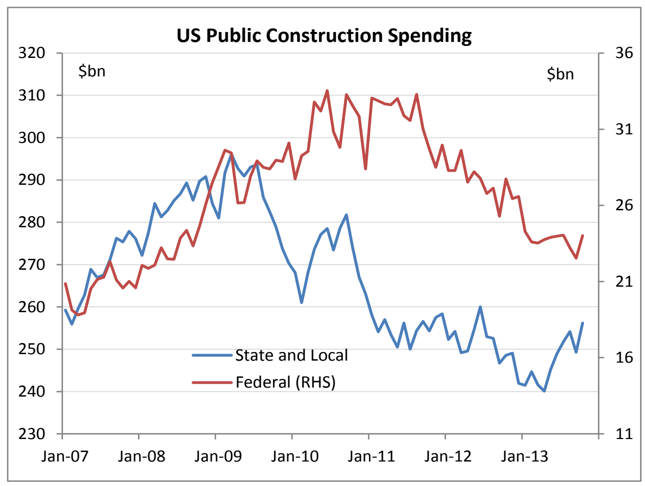
- The federal deficit was was only $560bn in 2013 after $1061 bn in 2012.



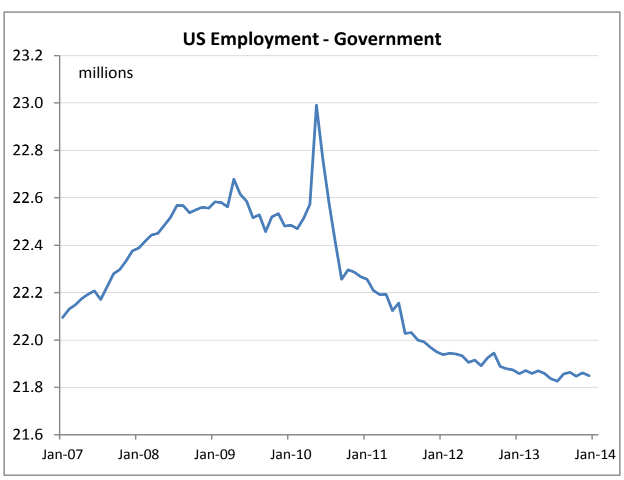
- A combination of higher tax receipts and reduced spending has gotten us here.



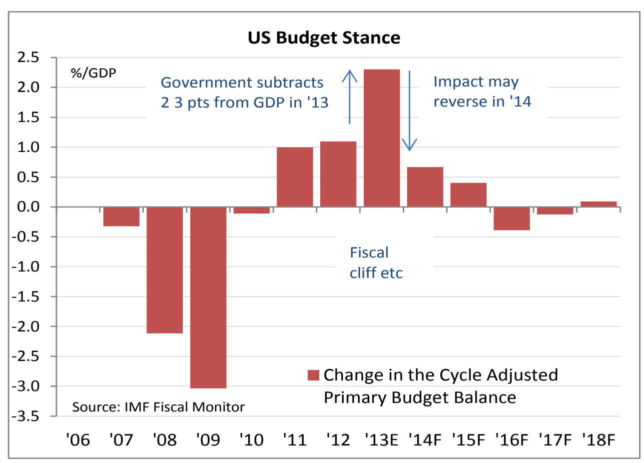
- State and local revenue has rebounded although authorities have been slow to spend it.



- Government construction spending has bounced from its lows.



- Government jobs have leveled out.

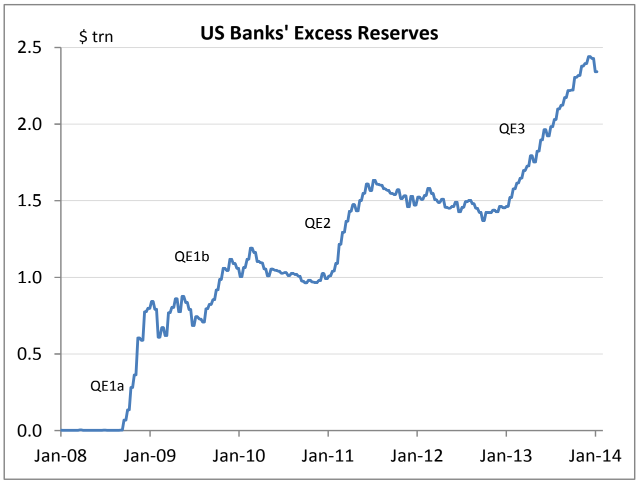


- In summary, the drag on the economy from frugal government is dissipating.

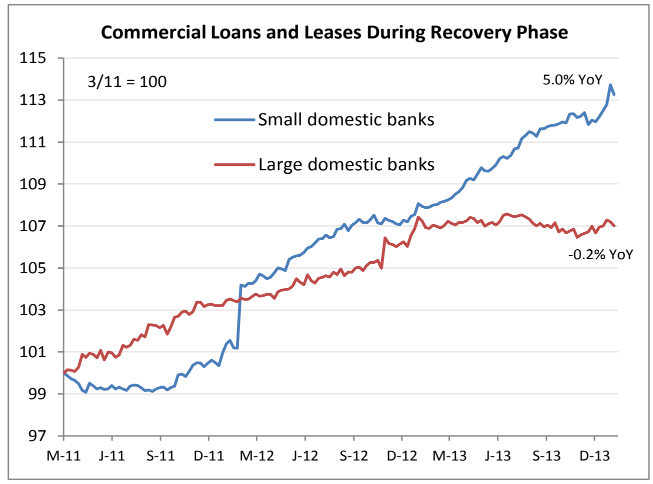
CREDIT AND INFLATION

SUMMARY

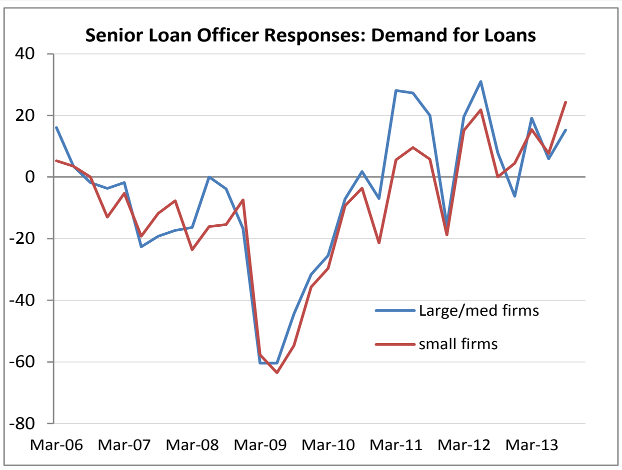
- There are some very early signs of improved lending, especially by smaller and regional banks.
- US inflation is well below the Fed's threshold of concern, assisted by cheap energy and contained healthcare.



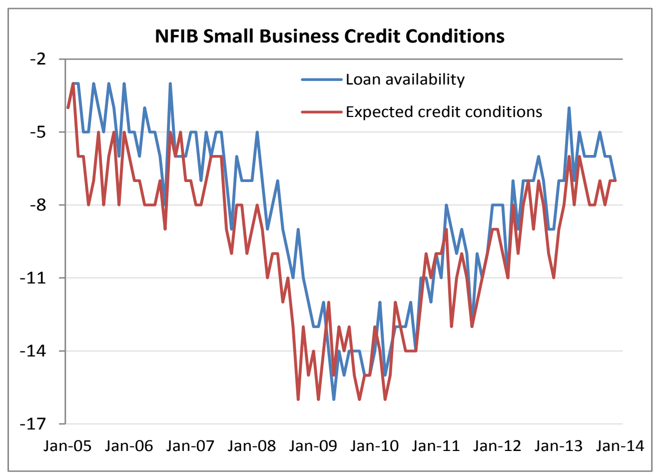
- Banks have locked away a good portion of the Fed's massive monetary expansion.



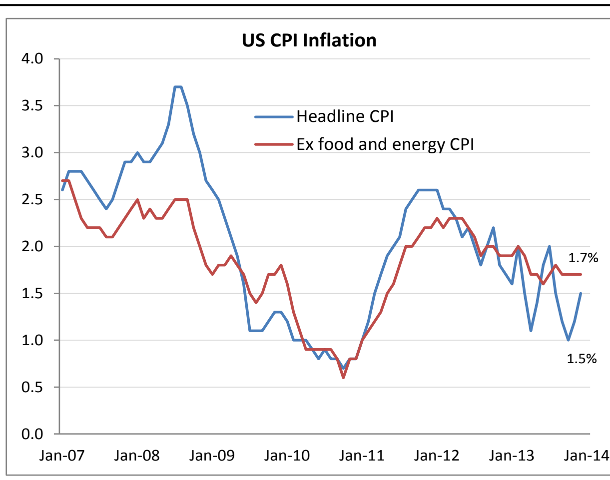
- Lending growth has largely been limited to smaller regional banks.



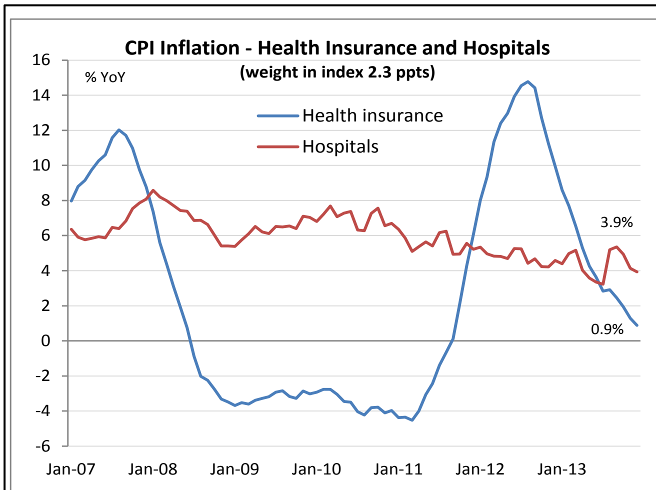
- However demand for loans has improved during 2013.



- As have borrowing conditions for small business.



- US CPI inflation remains well below the 2.5% rate that would concern the Fedreal Reserve.

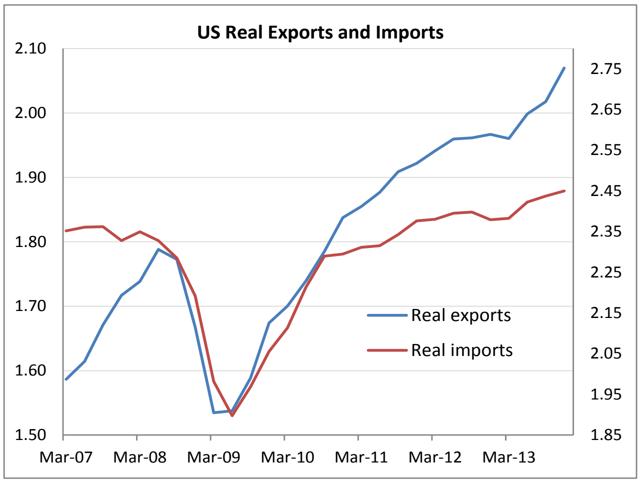


- Low medical inflation has been helpful.

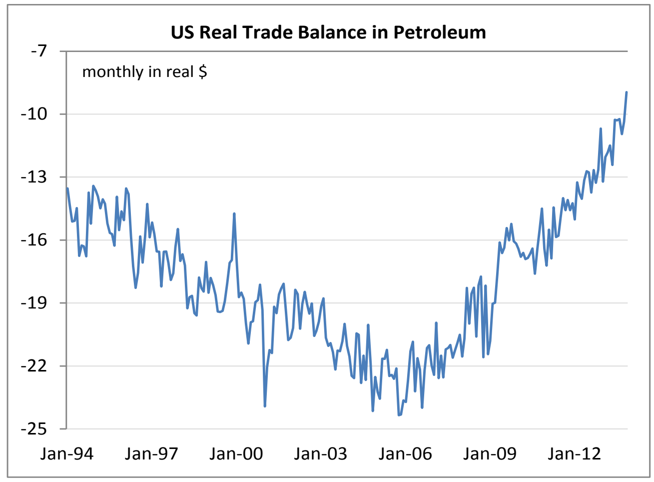
INTERNATIONAL

SUMMARY

- World trade and surveys of global purchasing managers such and improved world economy in 2H 2013.
- There has been a solid improvement in the US trade balance, led by petroleum.



- US export volumes are 16% above their prior peak, imports just 4%.



- The US production surge in petroleum has reduced import dependency and helped exports.

Global Manufacturing PMI™ Summary

50 = no change on prior month.

Index	Nov.	Dec.	+/–	Summary
Global PMI	53.1	53.3	+	Expanding, faster rate
Output	55.2	55.3	+	Expanding, faster rate
New Orders	54.8	54.7	–	Expanding, slower rate
Employment	50.8	51.6	+	Increasing, faster rate
Input Prices	55.6	56.5	+	Increasing, faster rate

Global Services PMI™ Summary

50 = no change on prior month.

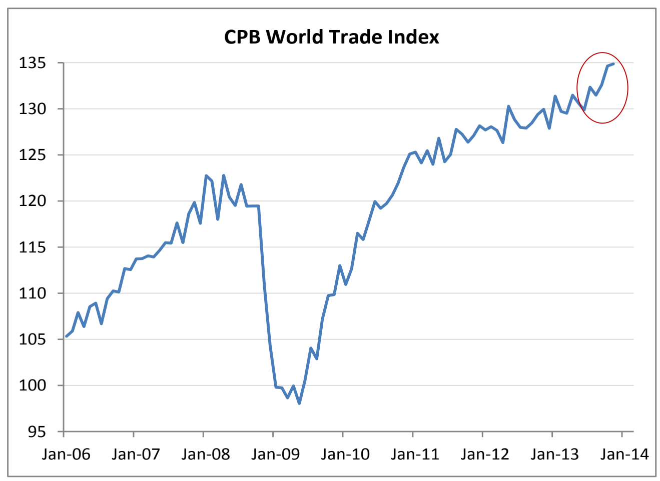
Index	Nov.	Dec.	+/–	Summary
Output/activity	53.8	53.6	–	Growth, slower rate
New business	54.6	54.8	+	Growth, faster rate
Backlogs of work	51.9	50.4	–	Growth, slower rate
Input prices	55.6	54.8	–	Rising, slower rate
Employment	51.4	52.7	+	Rising, faster rate

Global Manufacturing & Services PMI™ Summary:

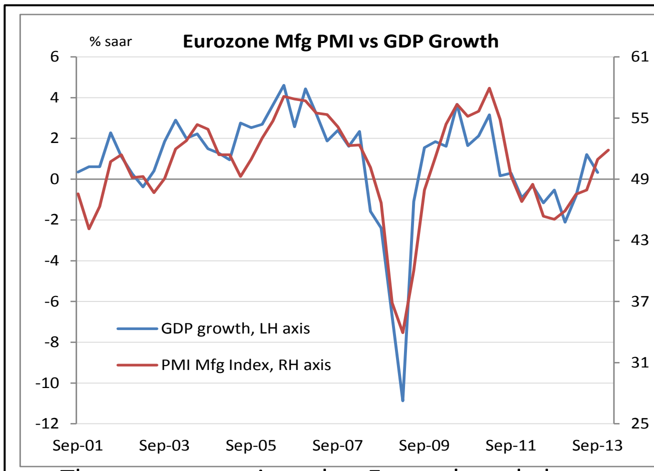
50 = no change on prior month.

Index	Nov.	Dec.	+/–	Summary
Output	54.2	54.0	–	Expanding, slower rate
New Orders	54.6	54.8	+	Expanding, faster rate
Input Prices	55.6	55.2	–	Rising, slower rate
Employment	51.3	52.4	+	Rising, faster rate
Backlogs	52.0	50.9	–	Rising, slower rate

- Global purchasing managers reports paint an increasingly positive picture.



- 4% improvement in world trade since June.

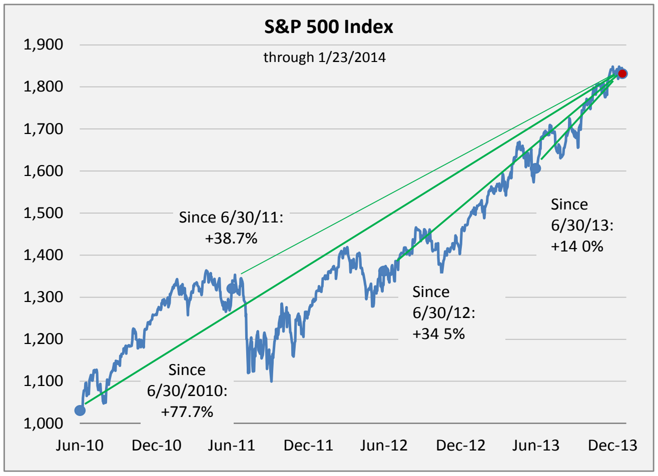


- There are even signs that Europe's cycle has bottomed.

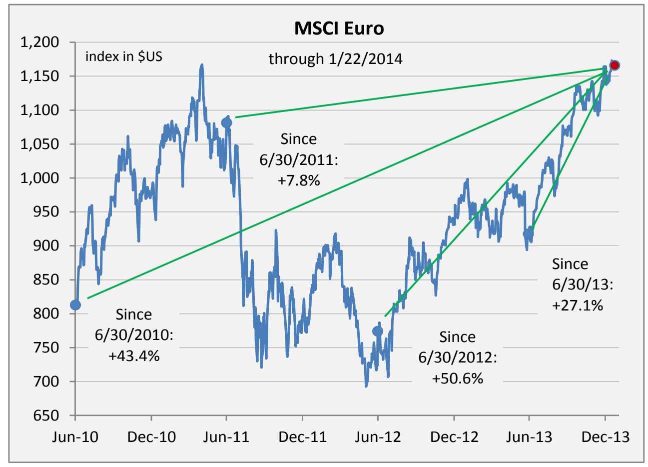
FINANCIAL MARKETS

SUMMARY

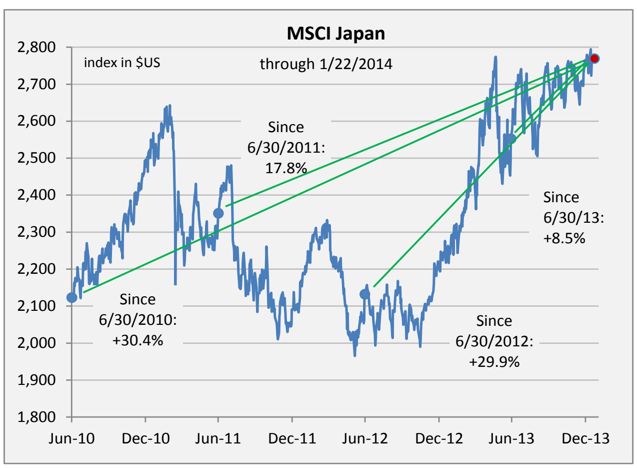
- European stocks remain the strongest region since June 2013, emerging markets the weakest.
- The US 10 year Treasury yield has increased as the economy improves but corporate bonds remain strong.



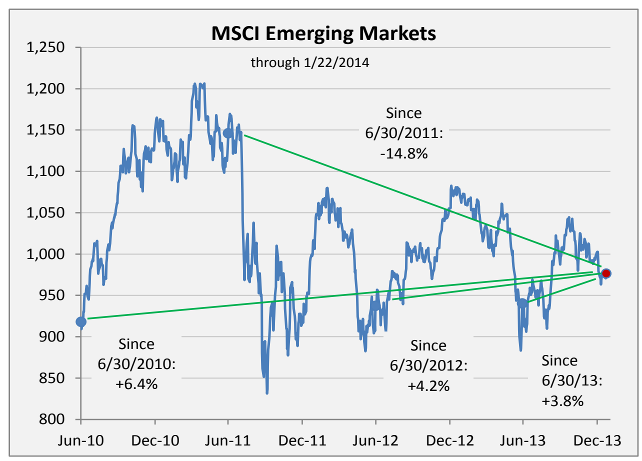
- The rise of US stocks has been very steady for two years.



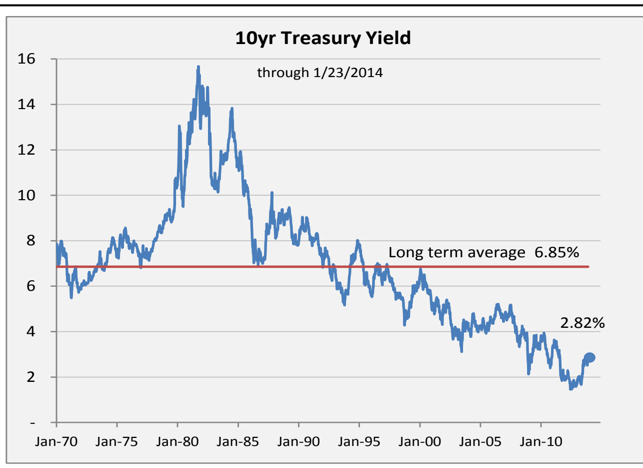
- European stocks are close to exceeding the last high in 2011 when measured in US dollars.



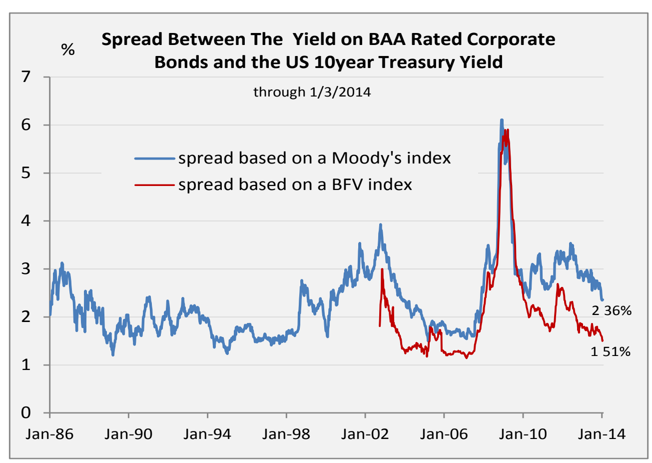
- The recovery in Japanese stocks has been held back somewhat by a lower yen.



- Emerging market stocks have not benefited from inflows for some time.



- The US 10 year bond yield rose from 1.75% to 3.00% during 2013 as the economy improved.



- The strong business contribution to the economic improvement meant corporate bonds did well.