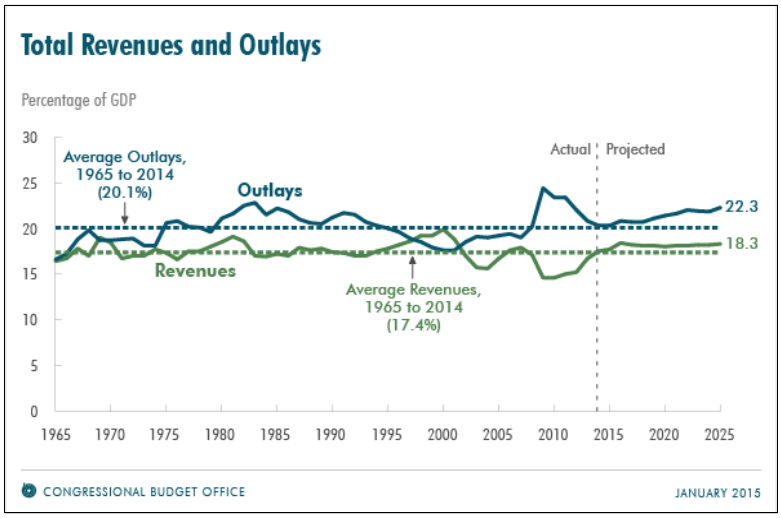
PRIVATE ASSET MANAGEMENT, INC.
WEALTH STRATEGY ADVISORS
PARADIGM

February 13, 2015

The Congressional Budget Office (CBO) recently updated its ten-year budget and economic outlook for the United States. The data plus its investment implications are worth reviewing.

All of the data in this newsletter is from the CBO's report titled The Budget and Economic Outlook: 2015 to 2025, which can be found at www.cbo.gov.

Near term, annual deficits are projected to fall below the 50-year average of 2.7% of GDP. They should remain at or below the long-term average through 2018. These figures are much better than those envisioned even a few years ago.



For all of the rhetoric that comes from Washington D.C., the government has been able to piece together something that is workable. Outlays were down in both 2013 and 2014 plus 2015's outlays will be roughly the same as 2009's outlays.

Long term, the deficit outlook has not changed much. Deficits over the next ten years are projected to be marginally lower than were forecast a year ago, but not materially lower.

The period post-2018 remains troubling. As the graph shows, revenues remain fairly constant as a percentage of GDP while outlays begin to grow faster than GDP. This causes the deficit to reach 4% of GDP, versus the long-term average of 2.7%. Outlays will rise faster because of our aging population, expanded healthcare coverage, and rising interest rates.

Inflation is projected to rise to 2%, but not go much higher. The CBO believes, though, that this increase will result in ten-year Treasury rates of 4.6% by the end of 2017 versus 2% currently.

Annual real GDP growth is estimated to average 2.5% from 2014 through 2019 and only 2.2% from 2020 through 2025. This is much lower than the nearly 3.5% annual rate for the 1980 through 2000 period. The slower future growth of the labor force relative to the past is the main reason for the reduced growth.

We want to highlight several **investment implications** that arise from this report and the resulting analysis from us and other investment firms:

1. Subdued GDP growth will affect corporate earnings growth, which will affect stock market returns. Past Paradigm newsletters have discussed the need for investors to have realistic expectations about future returns.

2. Over the next several years, we will need to monitor the projections for future deficits. Given that we have limited ability to grow our way out of the deficit, projections made in 2019 could give rise to a credible forecast of much higher future inflation.

3. An investment strategy too dependent on a specific forecast could prove unwise. For example, the report concludes that inflation will remain at 2% through 2025. We would not advise a portfolio structured around 2% inflation as a strategic centerpiece.

The near-term deficit situation is in line with historical averages. However, the long-term picture is fuzzier than ever with potentially less flexibility to address issues. Our job is to help you navigate this ever-changing landscape so you can achieve your financial goals.

Tel. 425-213-1600 Fax. 425-213-1610 3740 Carillon Point Kirkland, WA 98033 www.privateasset.com