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CLIENT BULLETIN

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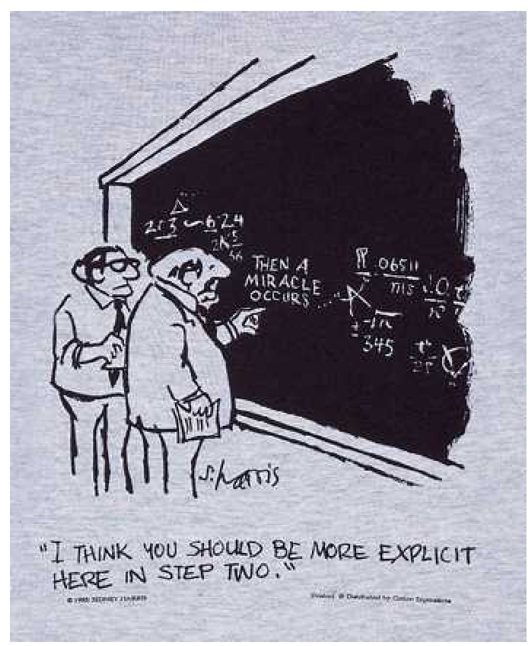
➢ *Dire Straits*

The dispute over Iran's nuclear program remains the biggest near-term threat hanging over the global economy. The key judgment is deciding when Iran has gone so far toward a nuclear weapon that it can no longer be stopped. Israeli Prime Minister Benjamin Netanyahu, who has a moral responsibility to protect his people from a second holocaust, will most likely have the shortest fuse in making this determination. Economically, the world could function without the 4.9% of the world's oil production that comes out of Iran, but an Iranian blockade of the straits of Hormuz, which carry 20% of the world's oil, could be more problematical. It doesn't even have to come to the point of exchanging fire between Iran, Israel and/or the U.S. Even if the U.S. Navy declares the straits safe, the companies that insure the oil tankers will not let the ships through. Either way it could get very messy for a while, although any disruption to global oil supplies would likely be temporary.

➢ *Social Security/Medicare Update*

Last week the Trustees of the Social Security and Medicare programs issued their required annual report on the current and projected financial status of the two programs. The report concluded that the trust funds for the social security and Medicare programs would run dry in the years 2033 and 2024 respectively. These figures do not even begin to tell the fiscal hardship of the two programs. The projections include two major assumptions that have virtually no chance of occurring. The first is that the Medicare program will save roughly $48 billion per year by lowering payments to physicians who see Medicare patients. This would lead to rationing of care to Medicare patients. This provision has been set to occur by law many times in the past but every time Congress kills it and will

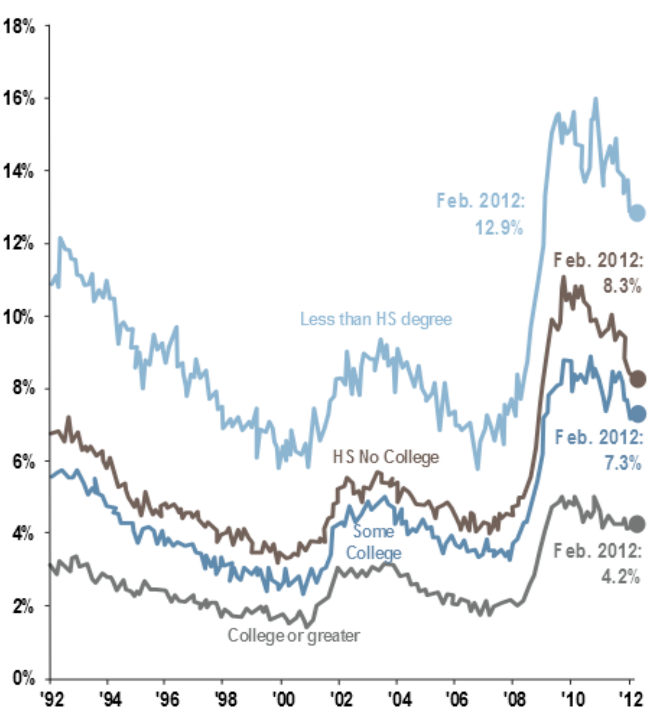


most likely do so again. Secondly, the projections assume that the "Affordable Care Act" (AKA Obama Care) will significantly lower government outlays for healthcare costs. Providing government funded healthcare coverage for **more** Americans while **reducing** the cost to government would be a neat trick. The cartoon above comes to mind.

➢ *Trust? Fund?*

More fundamentally, the reports consistently refer to the "trust funds" for the social security and Medicare programs. Conceptually this sounds good but in reality is a chimera. Both Social Security and Medicare are "pay-as-you-go" systems - any dollars that come into the system via payroll taxes paid by current workers immediately go out to retirees. More has come into these systems than has gone out in the past which is where the "trust fund" concept comes from - now that the social security system has rolled over and is in deficit every year we just start using the money that has built up in the trust fund from past surpluses to cover the shortfall – right? Wrong. While the social security and Medicare systems have been in surplus recently, the rest of the federal government has been running significant deficits and has "borrowed" all of the money from the social security and Medicare trust funds. As a result, there is no money in those trust funds, merely IOUs. Having one arm of the federal government (the Treasury) owe money to another arm of the federal government (social security and Medicare) does not help the government cover its' bills. In order to continue making social security and Medicare payments, the government has only three options: cut spending elsewhere; tax citizens more, or borrow more. These are the same options available if there was no "trust fund" so it doesn't really exist. It is beyond belief that these types of reports refer to "redeeming trust fund assets until they are exhausted". The trust funds are just a bookkeeping entry and have no financial relevance.

Unemployment Rate by Education Level



Source: BLS, FactSet, J.P. Morgan Asset

➢ *Drilling Down on Unemployment*

We are all familiar with the unemployment rate published by the Bureau of Labor Statistics. This rate currently stands at 8.3% after peaking at over 10% during the financial crisis. Breaking down unemployment rates relative to educational level provides an even more important lesson than the overall rate. The chart to the left shows the rate of unemployment by education level. The rates range from 12.9% unemployment for those with less than a high school degree down to 4.2% for those with a college degree or higher. A second critical point is that the main reason for people falling into the "Some College" category is that they run out of money before earning their degree. The messages in this data are unmistakable.

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