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Special **Report**

The Milken Institute Global Conference 2016 The Global Economy and The Future of Investing

By Jim Altenbach, CFA

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The Global Economy and The Future of Investing

GLOBAL OVERVIEW: THE MILKEN INSTITUTE GLOBAL CONFERENCE 2016

By Jim Altenbach, CFA

In May of this year, over 3,500 attendees and 700 thought-provoking panelists from around the world gathered in Los Angeles, California, USA, for the 19th annual Milken Institute Global Conference. Speakers included Nobel Prize winners, top industry leaders, scientists and heads of state, including Treasury Secretary of the United States Jacob J. Lew, Tony Blair, Eric Schmidt, General Wesley Clark, Nobel Laureates Myron Scholes and Elizabeth Blackburn. Over 170 panel sessions offered a global overview of pressing questions facing investors and decision-makers. This year's conference theme was "The Future of Humankind." There were numerous panels on technologies that are fundamentally changing not just society, but business and investing. As such, we present topics of interest to those with an eye toward growth, progress, and innovation, including an expanded section previewing the future to come.



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Panel: U.S. Overview: Will Recovery Prevail?

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The U.S. economy has continued to show key signs of strength, including job growth, healthy car sales and construction spending, thus this year began with optimism that the U.S. economy could pull the rest of the world up. But challenges remain.

Monty Bennett, Founder, Ashford Group of Companies – which operates 140 U.S. hotels - observed “The consumer is in good shape. The real trouble is that total debt is huge. It is North of \$60 trillion and growing (See Figure 1).”

“A 1% increase in the average interest rate is approximately \$620 billion pulled out of the hands of consumers / spenders / borrowers to savers / banks / pension funds that save and don’t spend - a huge de-stimulus.”

Regarding U.S. GDP potential growth rate, Bluford Putnam, Chief Economist, Strategic Intelligence and Analytics, CME Group replied: “Labor productivity and total factor productivity growth have been exceptionally weak in recent years. We are slowing down as a country

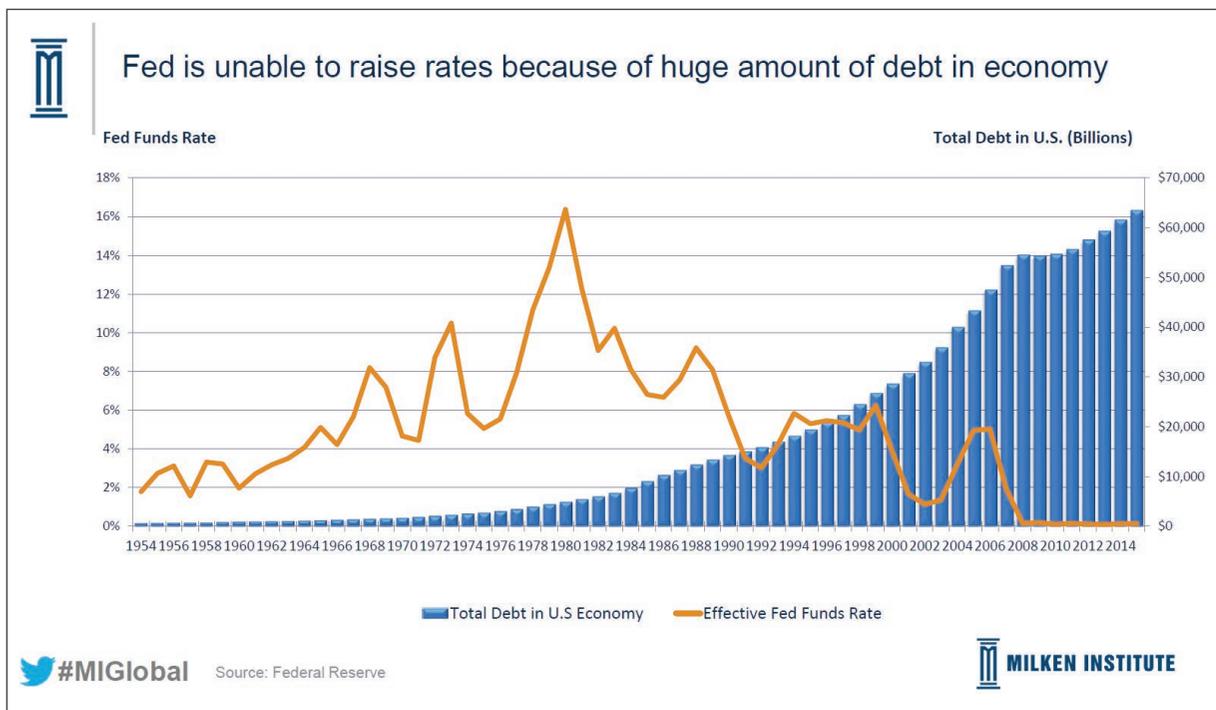
because we don’t have labor force growth anymore. It’s maybe ½ % on some trend basis. Over time, we get 1 to 1.5% out of labor productivity in a decade. So that means we’re a 1 to 2% growth economy (See Figure 2).”

“It’s because we don’t have much population growth, much labor force growth, and we’re aging.”

On emerging markets pulling the U.S., Fred Hochberg, Chairman, Export-Import Bank of the U.S. commented “With changes in commodity prices, countries are retooling and reforming and finding new ways to run their economies. In Saudi Arabia, Indonesia, Egypt, India, where fuel subsidies are being reduced or eliminated, bankruptcy laws, property transfer laws, rules pertaining to formation and lending of/to small businesses, countries are competing on the basis of being the best place to start a business. Those economies are building up and starting to go in the right direction. This will cause infrastructure investment which will make the world [including the U.S.] more productive as well (See Figure 5 below).”

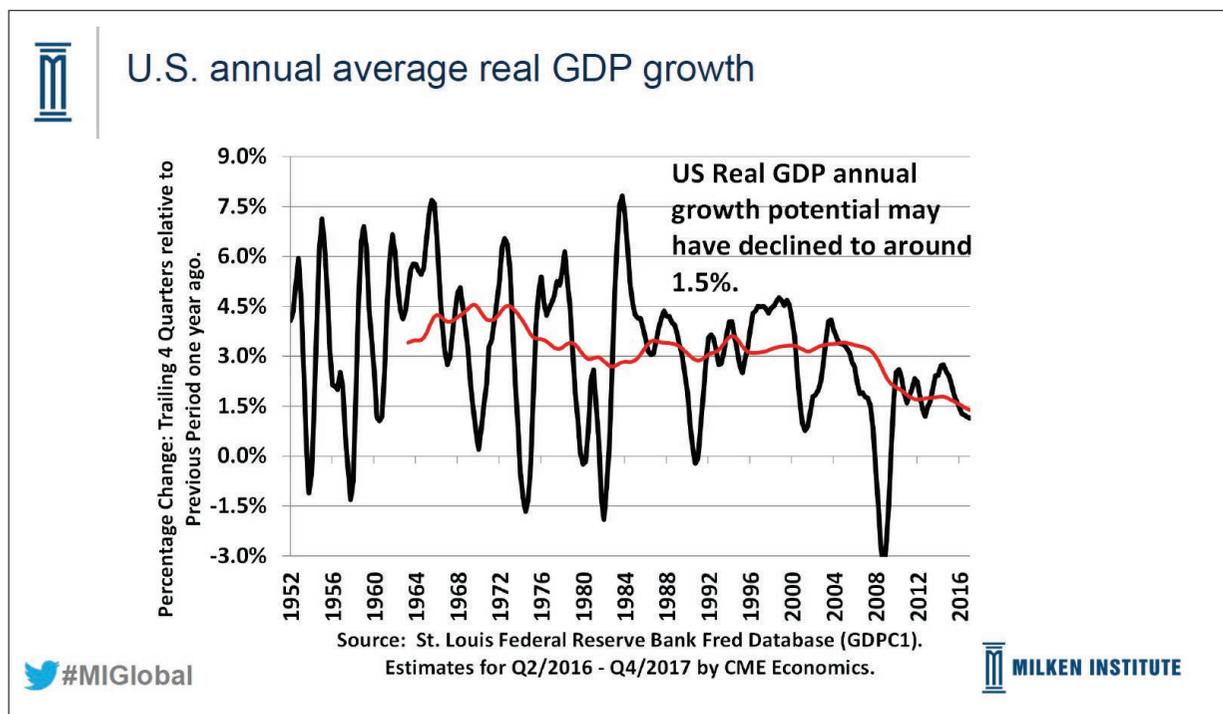


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"(Figure 1) Courtesy: Milken Institute"

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"(Figure 2) Courtesy: Milken Institute"

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Panel: Global Overview: Will Economic Growth Be Sustained?

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Does the turmoil in global markets signal widening fault lines in the world economy, or are markets out of sync with reality? The list of concerns includes China jitters and plunging oil and commodity prices, etc. Advanced economies are troubled as well (See Figure 3).

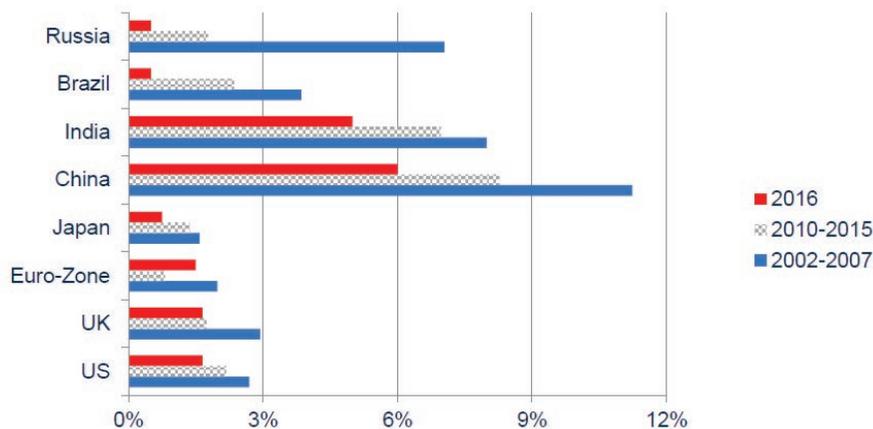
Regarding technology's effect on industry, Kevin Turner, Chief Operating Officer, Microsoft observed "We're entering the fourth industrial revolution. From steam, to electricity, to connected electronics, to now this digital era. A lot of innovative companies came in and disrupted very traditional industries." E.g., Uber in

transportation and Bitcoin in finance. They are all digital companies."

Mark Weinberger, Global Chairman, EY explained "I've never seen an environment that is more uncertain. There is incredible divergence of policy around the world along with fragile growth affecting multinational businesses. Will the U.K. pull out of Europe, if Venezuela institutes currency controls, or how monetary policy will affect our clients. Incredible external uncertainty is affecting overall growth and productivity." Cap-Ex spending is weak.



Global growth deceleration



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Source: World Bank via Bloomberg Professional.



"(Figure 3) Courtesy: Milken Institute"

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Panel: Global Capital Markets: Deflation or Stabilization?

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Global capital markets opened 2016 facing more uncertainty than perhaps at any time since the 2008 crash. But the panelists added that higher volatility presents attractive opportunities for those who can handle the risks. Developing markets – though slowing down – have a secular growth trend exceeding the advanced world (See Figures 3, 4, and 5).

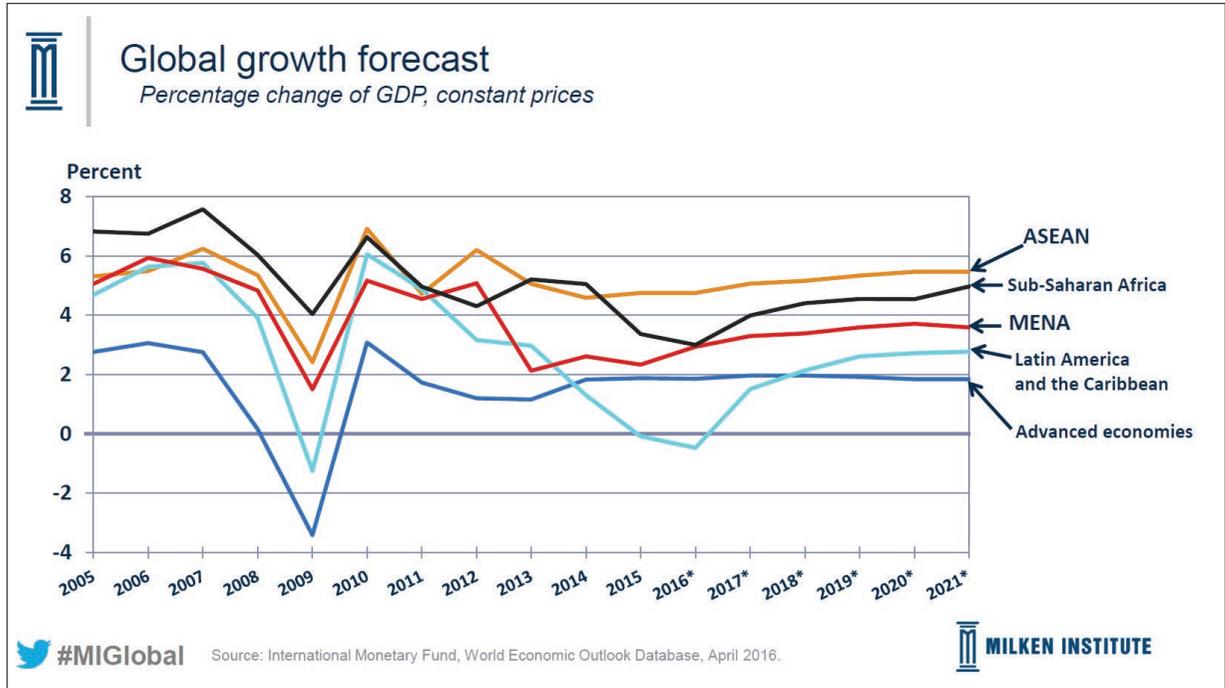
Mohamed El-Erian, chief economic advisor at global financial titan Allianz, said central banks "are having greater and greater difficulty" stimulating their economies. The result is that "growth will become more uneven and more unstable." On top of that, "the growth model of the advanced world is getting exhausted, and the emerging world's (commodity and manufactured goods) is getting contaminated."

"The fate of the global economy depends on the ability of the emerging world to grow quickly enough to provide

us with demand to support growth there and in developed countries" El-Erian argued. "The most important emerging market, China, is making the transition from export dependent to one that is driven by domestic consumer spending...a transition made by a handful of countries in the history of capitalism."

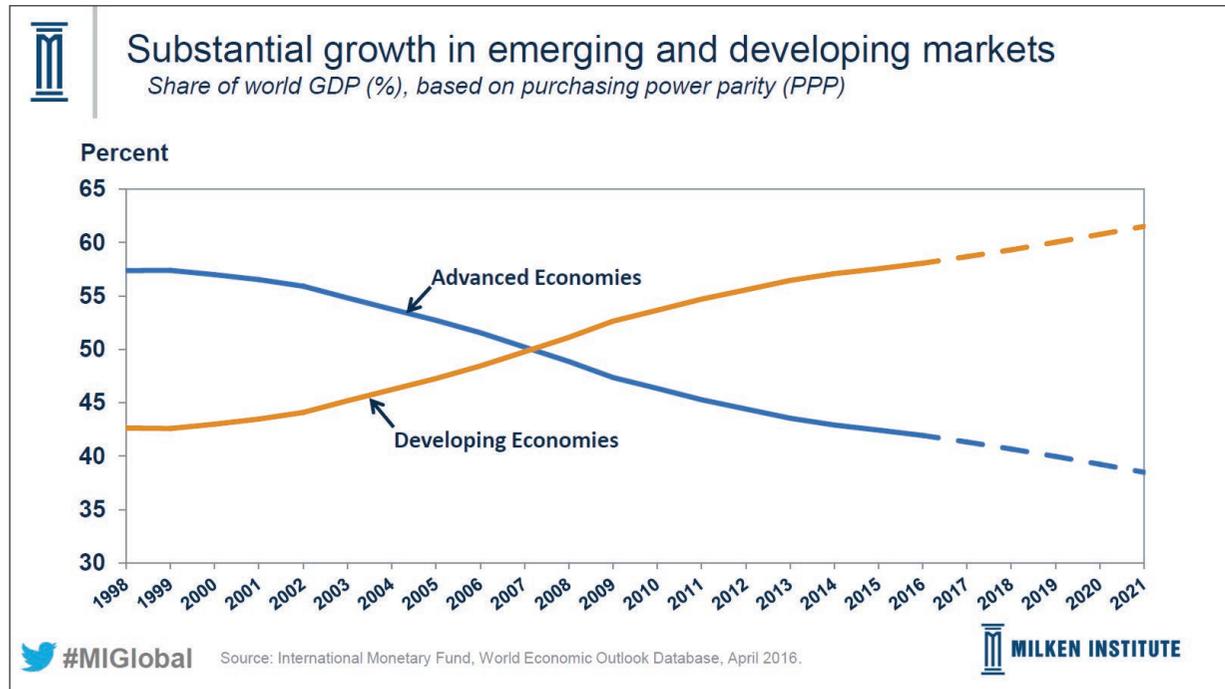
Where is the value? El-Erian commented he likes cash, but stressed "whoever can combine platform and content, like Facebook or Google, have a very long runway. How are existing platforms and new platforms and content – old and new - going to mix in this world? The most likely disruption will be not from above [inflation or deflation] but from below. It took the Hilton Corporation 100 years to deliver 700,000 rooms. AirBnb took 6 years to deliver 1 million rooms." Economists may eventually realize that the economy today is performing better than we thought.





"(Figure 4) Courtesy: Milken Institute"

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"(Figure 5) Courtesy: Milken Institute"

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A Conversation with Jacob J. Lew, Secretary, U.S. Department of the Treasury

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The preceding day saw the U.S. territory of Puerto Rico miss a principal repayment of about \$400 million to bondholders. The island's fiscal situation, worsening by the day, appeared to be top of mind for Lew.

"The next step in the crisis will be shutting down not only hospitals but also the police and firefighters," Lew said. "They're having trouble getting the fuel to put into police cars."

What are the remedies available to Congress and the Treasury Department? "We have a history of restructuring authorities. Why? Because the alternative is chaos" observed Lew.

With a \$2 billion payment due at the beginning of July, the pressure for congressional action is likely to grow.

Taxes and Housing

Regarding the deterring of "corporate inversions" (reincorporating abroad for tax advantage), Lew maintained that "Congress should deal with the trend by undertaking business tax reform, weakening companies' incentives to even consider the strategy."

Tax reform, he said, presents the "possibility that we can move forward in a bipartisan way." Loopholes need to be closed, and rates should come down.

Regarding housing finance, Lew suggested comprehensive legislation: "there needs to be an alternative way to structure risk across parties, so it isn't just the government standing behind the risk. Providing affordable housing while opening the system to greater securitization can be achieved," Lew said.



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The Economy, Europe, etc

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On Tuesday, Tony Blair, former Prime Minister of Great Britain, spoke with CNBC's Brian Sullivan, and commented "I'm confident Britain will stay in the EU. This is the biggest commercial market and political alliance in the world. We sell half our goods into it."

If the vote was approved, Blair commented "a long period of uncertainty would affect the global economy. We would then have to painstakingly renegotiate trade deals with each individual item with each country."

Importantly, El-Erian (again) said earlier: "If you run capitalist economies at low speeds for a long time, things start to break - economically, financially, and politically. The growth of the [nationalist] anti-establishment movements in advanced countries on both sides of the Atlantic is a reaction to low growth."

However, during a session on Europe, panelists warned Brexit is less important than migration, the failure of most European countries to improve their own defenses, and most importantly the destabilizing and

pernicious effect of Putin's policies, particularly in Ukraine.

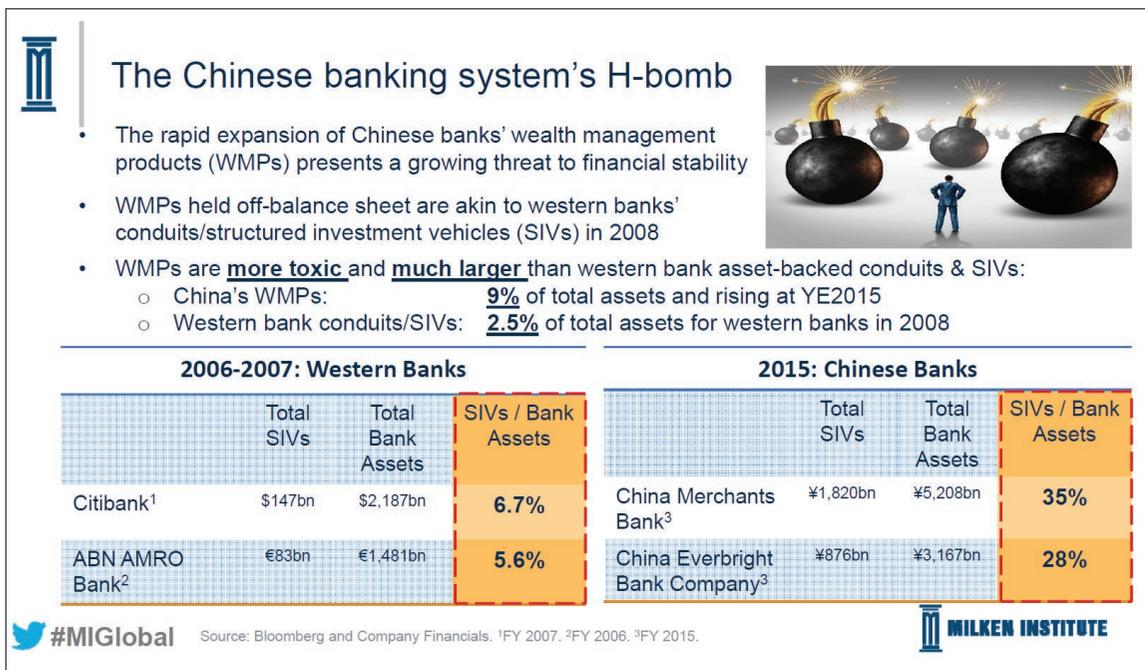
On Tuesday, Nouriel Roubini, Professor of Economics, New York University, commented: "In the global economy, there is plenty of savings – sometimes called a "global savings glut". But we don't have enough demand, especially in capital spending. It's a paradox – most firms are flush with cash, flush with profit, and they are under pressure from shareholders to pay dividends or buyback shares. More than a global savings glut, we have a global investment slump. Investment as a share of GDP – globally – fell during and after the financial crisis and has not recovered. That is why we have weak economic growth, globally. Over spenders and over savers had to spend less and save more (respectively). They haven't. Investment is so low because unless there is a pick up in Cap-Ex and investment, we're not going to see the cross-border flows we've seen before. The two are related to each other."



China:

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On an investment panel, Kyle Bass, Chief Investment Officer of Hayman Capital Management, commented on the Chinese financial system. State-owned enterprises are among those who can't pay their debts. The numbers he has uncovered suggest a severe default wave ahead that will undermine Chinese savers' confidence in their banks' popular high-yield savings accounts. "If you think about how precarious that system is, if you took the time to look at it, you wouldn't be allocating money to China now," Bass said (See Figures 6 and 7).



"(Figure 6) Courtesy: Milken Institute"

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It's getting harder to find domestic suckers

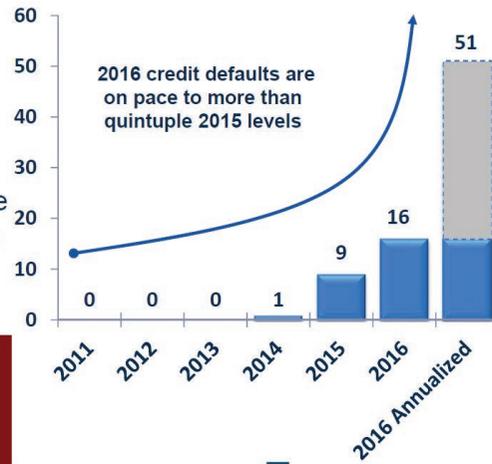
China corporate credit defaults accelerating

- The 16 defaults YTD (through April 21) have already exceeded defaults for all of 2015 and more telling, 8 of the 16 defaults are related to state-owned enterprises
- While local governments have historically helped support struggling enterprises, there is a limit to support that state sponsors can provide, especially to companies in structurally challenged industries

"It shows the government is taking away the implicit guarantee ... Now risk awareness is rising, so we will see which issuers are swimming naked."

- Quote from the Chief Economist at a Hong Kong Bank

Number of Corporate Credit Defaults in China



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Source: JP Morgan, Caixin, Quote taken from a Bloomberg News article (April 18, 2016) & company information



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"(Figure 7) Courtesy: Milken Institute"

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Nobel laureate Myron Scholes on Macro-Prudential regulation

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On a financial risk panel Nobel laureate Myron Scholes, professor of Finance, Stanford Graduate School of Business, commented on Macro-Prudential regulation: “Most of the Macro models that are used to look at crises don’t look at crises at all. They are all based on normal times. Normal times don’t mean anything.”

Scholes stressed what matters is “how the tail correlations are going to occur in the future or how shocks are going to permutate. Finance is dynamic. The distribution of returns and risk and correlations are not

constant over time. They are always changing. They [regulators] have to have forward-looking information; not rely on the past. Markets are the only dynamic answer to know what the future is going to be about risks and this is the most amazing thing to me is that the Fed and other central bankers do not believe markets are going to tell them anything about risk.” He added, “go back to 2008, the levered markets [deep out of the money options] of the world were screaming that risks were increasing. Regulators don’t use that information.”



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Global Risks, Energy, the Middle East, and Africa:

Panel: Global Risk: Challenges for the Next President

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Recent polls show that Americans are more concerned about the threat of ISIS and Iran than Russia, but according to Wesley Clark, U.S. Army General (Ret.) and Former Supreme Allied Commander, NATO, the most pressing issue facing the next President could be a return of a cold-war style nuclear arms race with Russia.

“I’m told Russia has moved ahead with research on fourth generation nuclear weapons—that is neutron bombs—with the idea of making a usable battlefield nuclear weapon.” He continued: “What we learned in the 1970s and 80s – when NATO last faced an existential

crisis confronting Russia’s nuclear build up - is that you have to be able to overmatch, for deterrent purposes, at every level of escalation. If the U.S. can’t match these battlefield nuclear weapons, do you still have deterrence? NATO is going to have to ask that question.”

Related to risk, on Tuesday, Hilda Ochoa - Brillembourg, Founder, Strategic Investment Group observed “a cyber attack on custodian banks is a low probability high impact crisis that could leave all but private equity funds unable to trade, due to lack of record of ownership. Risk might be mitigated by block-chain technology to create parallel tracks of ownership.”



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Panel: Defeating ISIS: A Battle for Hearts and Minds

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What will it take to defeat ISIS and global terrorism?

Brett McGurk, special presidential envoy for the State Department's Global Coalition to Counter ISIL, argued "We have to make it harder for fighters to get into Iraq and Syria and even harder to get out. Unfortunately, financially, ISIS coffers are fairly healthy, thanks to taxation, money laundering, donations, and Mafia style profit-making ventures that add up to \$1 million a day."

That's what makes the propaganda front so important. "Until you defeat the ideology, you will never

defeat the violence," said Tony Blair, former British Prime Minister. "The ideology behind these acts of violence has been incubating over a long period of time. The number of people prepared to act on those views is small. But the number of people who share those values is unfortunately large."

"In Northern Nigeria, there are millions of young kids educated to a view of the world that is poisonous," Blair said. "Around the Middle East, you see young people being taught a way of the world that is contrary to ours."



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Panel: The Changing Energy Landscape: What's the New Normal?

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"Look what American ingenuity did in the oil patch," said Michael Smith, Chairman of Freeport LNG, "If we didn't have shale oil ... we'd be short 3.5 million barrels a day."

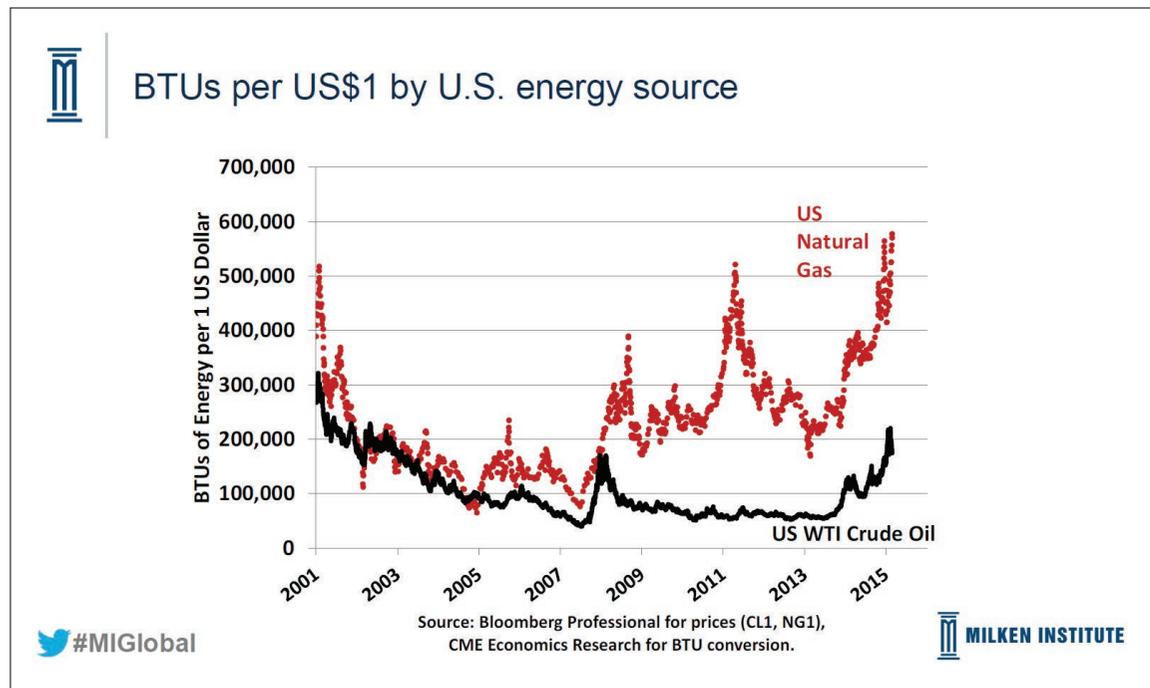
Even though U.S. crude prices have rebounded to \$44 a barrel from a low of \$26 early this year, the price was above \$80 for much of the period of shale-oil investment.

William Sonneborn, President of EIG Global Energy Partners, expects a mass extinction of U.S. energy businesses sooner rather than later. "Last time, there was a glut of telecom capacity that ended in an industry wipeout. Now, it's oil and gas."

Still Smith, emphasized energy prices will rise again. "Since the first oil well was drilled in the 1800s, prices have ridden a repeating cycle of booms and busts. It's basic economics: supply and demand," he says.

On Tuesday, Bluford Putnam, Chief Economist, Strategic Intelligence and Analytics, CME Group, commented "everything about extraction has gotten cheaper and flexible." He referred to Figure 8.

He observed "this tells you there will be further disruption in the energy industry. If you spend \$1 on natural gas, you'll get 500,000 BTUs from \$1. If you spend it on refined product or crude oil, you're going to get only 200,000 BTUs."



"(Figure 8) Courtesy: Milken Institute"



Nuclear Fusion: Has Its Time Finally Arrived?

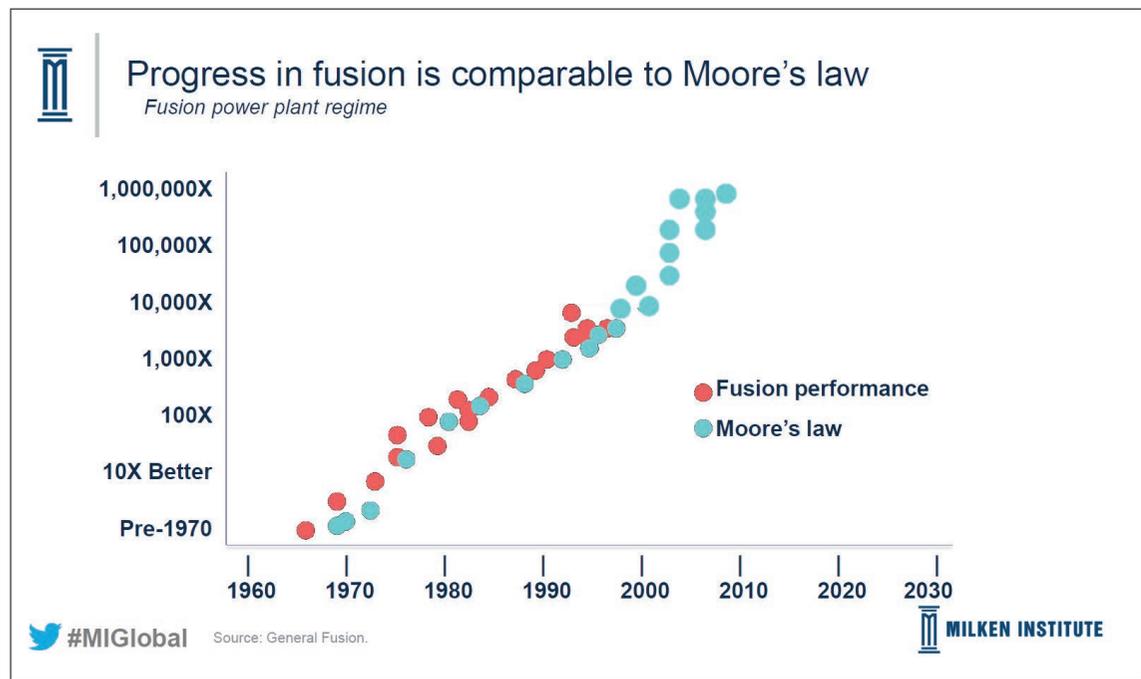
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Startups backed by the likes of Microsoft Co-founder Paul Allen et al are bringing the "move fast, fail fast" Silicon Valley mindset to making nuclear fusion a reality. Fusion startups are moving many times faster than publicly funded research ever could.

Michel Laberge, Founder and Chief Science Officer, General Fusion observed his company uses simpler more cost effective methods; like all of the other panelists' companies. "Progress in fusion is comparable to Moore's Law up to 2000 (See Figure 9)."

"After 2000, it became an international corroboration," and this slowed things down; it flattened. However, "from the mid 1960s to 2000, we had a 10,000X improvement." he says.

Dennis Whyte, Director, Plasma Science and Fusion Center, MIT observed the way to get back on track in progress "is not to build gargantuan devices, but small table top ones. This is the new accelerated pathway. That is the new science." The reason we stalled is "we put all our eggs in one basket." Now we have several private and public funded researchers searching for numerous simpler cheaper ways to achieve results. Tri Alpha Energy should have a proto-type in 5-10 years, says company Chief Technology Officer Michel Binderbauer. Panelists observed, ultimately we need public-private partnerships.



(Figure 9), Source: Milken Institute

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Panel: Africa: Understanding Its Unique Value Proposition

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African countries are among the highest growth countries in the world (See Figure 4 above).

Asked “why Africa?” Yvonne Ike, Head of Sub-Saharan Africa, Bank of America Merrill Lynch observed “Africa has a large population and market. The emerging middle class is changing the nature and rate of its rise.”

Ike added, “In 2010 Côte d'Ivoire was in trouble. Then political disruption happened. A leader came that acknowledged the need to “have a plan to develop infrastructure, employment, and attract foreign investment, and execute on the plan. Today it is well developing. Similar situation for Rwanda. Post genocide, Kagame did it his way.” Ethiopia, too.

Samit Gehlot, Managing Director, KG Group emphasized “leadership 10 years ago didn’t want to change. Today, with lot’s of global eyes watching, they’re more concerned about their bad behavior.”

Bassim Haidar, Co-Founder, GMT Group emphasized “The World Bank doesn’t understand Africa. They draw up policies and try to force them. The thought process needs to change at these organizations.”

Jay Ireland, CEO of GE Africa, observed “commodities cycles come and go. The demographics, the continued growth, and the need for infrastructure will be there. Did China drive that? No question. But Africa will soon drive some of that, too. It is 50 plus countries, not one monolithic government. When Kenya (and other countries) gets its roads, energy, and other infrastructure in order, that’s when we’ll see it take advantage of cheap labor.”

Haidar stressed “The biggest resource in Africa is its people who are resourceful. In the 1980s many families sent their kids abroad to be educated. Most came back. They’re very tech savvy. Now there’s lots of technology coming out of Africa.”



Panel: The Shifting Economic Power of Cities

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By 2025, 136 new cities are expected to enter the top 600, including 100 from China alone. As the geography of power shifts to urban centers, which cities will drive this change?

Fahd Al-Rasheed is group CEO of Emaar Economic City. He oversees the master planning and development of one of the largest projects on Earth - King Abdullah Economic City (KAEC), North of Jeddah in Saudi Arabia. With a \$100 billion budget, a consortium of investors are building a port city of 2 million people from scratch, the size of Washington D.C. The city is listed on the Saudi stock exchange.

Vision 2030 is the transformation of Saudi Arabia away from a petroleum-based economy. Al-Rasheed observed "oil revenue blinds governments around the world." Saudi Arabia asked, 'what is the potential of this country?' Two potentials he stressed.

"Geographic: Saudi Arabia straddles Africa, Asia, Europe, and the Red Sea – one of the most important trading routes in the world – 15% of global trade goes through it. The potential is massive for becoming a logistics zone. If you look at the 23 countries around the Red Sea - what we call the Red Sea market - is a 620 million person opportunity growing to 1.3 billion by 2050. This is a massive market - the next emerging market competing with China and India. We want KAEC to be a logistics hub for these countries."

The second potential is human capital. "We looked at all the industries we're trying to compete in and attract such as pharma, food, and logistics. We have attracted 110 companies, including companies like Pfizer, Mars (food), and Johnson Controls. Housing units for all income levels were built," he says. "How do we allow the population to empower themselves? We focus on education massively."



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Panel: The Future of Humankind

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Eric Schmidt, Executive Chairman of Alphabet (Google's parent company), shared his vision of cell phones that monitor your health and call your doctor in case of emergency, a 3-D printing system that can design and build a home or commercial structure in a fraction of the time required by traditional techniques, and the driver-less car, versions of which are currently being road-tested.

Guruduth Banavar, Chief Science Officer, Cognitive Computing, IBM, talked about achieving advances by marrying human skills ("self-directed goals, common sense and value judgments") with the capabilities of machines ("large-scale math, spatial discovery, statistical reasoning"). E.g., one company uses a so-called "cognitive assistant," like IBM's Watson, to assess an acquisition target, analyzing huge amounts of complex financial data in a matter of minutes.

Jennifer Doudna, Professor of Chemistry and of Molecular and Cell Biology, University of California, Berkeley, was part of the team that discovered CRISPR/Cas9, a technology for editing genes that could be used in a variety of ways, including the repair or replacement of mutations that cause genetic diseases that are currently incurable.



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Panel: Artificial Intelligence: Friend or Foe?

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To think that AI is only a reality within the tech industry and not a threat to your job would be a mistake. How vast is the reach of AI already? (See Figure 10 below).

The list - compiled by Bloomberg Beta – shows startups that have some sort of machine learning capacity that are impacting industries as diverse as education to agriculture and enterprises as distinct as sales and security grows everyday.

David Siegel, Co-Chairman of hedge fund Two Sigma, warned while the Industrial Revolution gave way

to millions of new jobs, it is unclear what jobs will be created when machines begin to takeover jobs in transportation, mining and agriculture. "Vast numbers of jobs that we humans are doing will be done by algorithms," he said. "One of the big causes for the stagnation of middle class wages is because of clever computer programs."

Michael Ferro, Founder, Merrick Ventures, cautioned "the AI-revolution will impact white collar jobs and the distribution of wealth in the country. AI will shift a thousand billionaires to a group of another thousand billionaires," he said.



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PLATFORMS

RESEARCH / AGI	FULL STACK	MACHINE LEARNING	INDUSTRIAL IOT	AUDIO	VISION	DATA ENRICHMENT

INDUSTRIES

ADTECH	AGRICULTURE	FOR GOOD	RETAIL FINANCE	LEGAL	MATERIALS & MFG	HEALTHCARE

INDUSTRIES (CONT'D)

EDUCATION	TRANSPORT & LOGISTICS	INVESTMENT FINANCE

TECH USER TOOLS

DATA SCIENCE	MACHINE LEARNING	OPEN SOURCE

SHIVONZILIS.COM/MACHINEINTELLIGENCE

Bloomberg BETA

(Figure 10), Courtesy: Milken Institute

Panel: This Changes Everything: How Technology Is Revolutionizing Medicine

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Panel moderator Michael Milken, Chairman, Milken Institute, opened the discussion by observing “Four million years of evolution increased average life expectancy by 11 years from 20 to 31. In the past 115 years, we’ve increased life expectancy by 41 years. It’s not just life expectancy, but the quality of life. Each life is priceless. But in economic terms, over the past two centuries, as much as 50% or more of all economic growth can be traced to advances in public health and medical research.”

Jack Gilbert, Director of the Microbiome Center at the University of Chicago, explained how a century of antibiotics and cleaning products has been “deforesting our own microbiomes,” the collection of good and bad bacteria that surrounds us all. That deforesting has led to increased incidence of allergies and diseases like asthma. His team is working on an innovation he calls Microbial GPS, which will allow people to pinpoint exactly what bacteria they need to eat.

Elizabeth Blackburn, Nobel Laureate, President, Salk Institute, is leading a team that hopes to prevent, pre-empt and intercept diseases. They’ve done a deep dive into telomeres, the cap ends of chromosomes, which wear down over time at a rate that can predict mortality. “If your telomere length is in the bottom 10

percentile, you’re twice as likely to die as those in the top 10 percent. We can have the option of making disease optional.”

Vadim Backman, Walter Dill Scott Professor of Biomedical Engineering, Northwestern University, said the key to curing cancer is not with better drugs, but with easy-to-administer tests that identify cancers earlier. Backman cited the Pap-smear, used to detect pre-cancerous cell changes, as a model for his research to create tests for other kinds of cancer that could be performed in a primary care setting.

Juan Enriquez, Managing Director, Excel Venture Management, described “Lifecode”, technology that allows reprogramming of DNA. The story of this innovation began with a question: “Can you program human cells in the same way you program computer chips?” A decade and \$40 million later, the answer is proving to be yes. It manifests itself in the form of a “green goo” that can be programmed to make all manners of substances. ExxonMobil uses it to make fuel and Novartis has used it to make a year’s worth of flu vaccines in a week. Enriquez proclaimed: “Nothing in the world is going to change humanity and all life on this planet more than the ability to read and write Lifecode.” (See Doudna-CRISPR/Cas9 above)



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Author's comments and Insights:

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This author will remind readers that markets themselves often have more predicting power than most economists – see Nobel laureate Scholes' comments above! David Ranson, Director of Research, HCWE, who uses market-based forecasts, observed on 5/25/16 "The outlook for US growth is weakening as the dollar has declined. The deceleration should be slight, however, given the narrowing of credit spreads."

Gold is the quintessential barometer of inflationary pressures. It had crashed in 2013. However, since January it has risen (i.e. the USD weakened) to 1215. Thus, if this trend continues, we are entering a new inflationary period. Priced in average gold price, crude should trade at about \$86 a few years out. This will pull crude and commodities higher – it's already happening – (contrast with Sonneborn above).

Lastly, Predictwise.com aggregates prediction markets and betting odds. On 5/31/16 the market-based odds of "Trump as President" is 28% vs. Clinton's 69% chance as president. Regarding "Brexit", there is a 65% chance the U.K. will stay in the EU.

Compare these market forecasts with panelists' comments above.



About the Author

James Altenbach, CFA is principal of Florentez Investment Management. Since the firm's inception, he serves as an advisor to the President on strategic matters including research and proprietary analysis and product development on ETFs. He writes published articles and reports on the global economy, financial markets, and investing. He possesses over 20 years of research, financial advisory, institutional relationship, and management experience, and has written several published reports and articles. Previously, he was an equity research analyst with RedChip Companies. He did his undergraduate work in business administration (Finance) at California State University, Los Angeles, with distinction, and holds the designation of Chartered Financial Analyst (CFA).



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