FALL 2023 OUTLOOK

SECURITY NATIONAL BANK
PRIVATE CLIENT SERVICES

Current Forecast

	2021	2022	2023 Est	2024 Est
GDP Growth	5.7%	0.9%	1.4%	-0.9%
Change in Consumer Prices	7.1%	6.4%	3.0%	1.7%
Fed Funds Target Rate	0.25%	4.50%	5.50%	3.50%
5-Year Treasury Yield	1.26%	4.00%	3.75%	3.75%
10-Year Treasury Yield	1.51%	3.87%	4.00%	4.00%
S&P 500 EPS	$206	$217	$219	$222

Security National Bank Private Client Services forecasts that the U.S. will enter a mild recession early next year. We expect inflation will fall below 2% during the recession before returning to a long-term average of 3%. We expect the Federal Funds Target Rate (FFR) to stay at 5.50% through the second quarter of next year before a series of rate cuts return it to the neutral level of 3.5%. The yield curve will likely remain inverted until rate cuts are nearly finished. We expect earnings for the S&P 500 to stagnate for several years.

Last Month's Rates and Total Returns

August 31, 2023	Value	One Month	Year to Date	1 Year
Fed Funds Target (Upper)	5.50%	--	+ 100 bp	+300 bp
3-Month Treasury Yield	5.46%	+4 bp	+105 bp	+260 bp
2-Year Treasury Yield	4.84%	-2 bp	+42 bp	+140 bp
5-Year Treasury Yield	4.23%	+4 bp	+23 bp	+95 bp
10-Year Treasury Yield	4.09%	+14 bp	+21 bp	+96 bp
Mortgage News 30-Year	7.07%	+2 bp	+53 bp	+108 bp
S&P SuperComposite 1500	1,025	-1.73%	17.93%	15.39%
S&P 500 Index	4,508	-1.59%	18.73%	15.94%
S&P 500 Equal Weight Index	6,074	-3.16%	7.24%	8.67%
S&P Midcap 400	2,645	-2.89%	10.06%	10.71%
S&P SmallCap 600	1,227	-4.14%	7.24%	5.53%
S&P 500 Growth	2,905	-0.62%	24.16%	13.38%
S&P 500 Value	1,596	-2.74%	12.80%	17.28%
World ex-US, net *	273	-4.52%	8.78%	11.89%
Wilshire Liquid Alts	179	-0.29%	3.15%	2.31%
BB U.S. Aggregate	89	-0.64%	1.37%	-1.19%
Crude Oil – WTI Near Term	$83.63	2.24%	4.20%	-6.61%
Commodity Index	106	-0.77%	-2.77%	-8.67%
FT Wilshire Bitcoin	$27,169	-7.26%	64.14%	35.15%
Gold – Near Term	$1,938	-1.64%	6.51%	13.16%
U.S. Dollar Index	104	1.73%	0.09%	-4.67%

**= MSCI ACWI ex the U.S. in USD*

Prepared by Damian Howard September 4, 2023

Security National Bank's Investment Services team in the Private Client Services division authors a monthly economic forecast that provides our Investment Committee and the Bank's Funds Management Committee with background assumptions for use in investment decisions. We are pleased to share our economic outlook with you. Please be advised that our crystal ball is just as clouded as other prognosticators and that all forecasters have poor track records. Our projections are based on what we think monetary and fiscal policymakers *will* do, not what they *should* do. Commonly used abbreviations and terms are listed at the end of the report.

Stock Market

Equities fell during the first part of the month. At mid-month, the S&P1500 was down almost 5%. Stocks rallied over 3% to finish down just 1.7%. Losses were greater down the capitalization scale. YTD stocks have returned 17.9%.

After two straight months of small and mid-capitalization stocks outperforming, mega-cap stocks led. Midcap stocks returned a negative 2.9%, while small-capitalization stocks returned a negative 4.1%. The equal-weighted S&P 500 index underperformed the capitalization-weighted index by 1.43%. This indicates that stocks of larger companies outperformed.

Of the S&P 500's 18.7% YTD return, only 4.0% came from higher earnings, and 1.0% came from dividends. The remaining 13.7% came from a higher multiple. The forward P/E rose from 16.8X to 19.0X.

For the month, the top-performing sector was energy (up 1.8%), as the oil price was up 2.2%. The worst-performing sector was utilities (down 6.2%), as higher rates provide yield competition. Year to date, the top-performing sector was communication services (up 45.2%), while the worst-performing sector was utilities (down 9.3%).

Over the last twenty years, the U.S. experienced a global financial crisis, a pandemic, bouts of inflation, and multiple bear markets. Stock market returns have shown consistency over the longer term. Each month, we list the longer-term returns for the broad stock market. This chart reminds us to focus on the long term.

Annualized Total Return							
	One Year	Three Years	Five Years	Seven Years	Ten Years	Fifteen Years	Twenty Years
Stocks	15.4%	10.7%	10.7%	12.7%	12.5%	10.9%	10.0%
Bonds	-1.2%	-4.4%	0.5%	1.9%	1.5%	2.6%	3.1%

The chart also illustrates stocks' return advantage for those who can tolerate the volatility. From 1950 to 2020, one-year stock returns have ranged from up 47% to down 39%, a 86% range. This volatility has caused many investors to be underweight stocks or sell during market downturns. Over more extended periods, volatility is more subdued. When taking a rolling twenty-year view, stock returns have ranged from 17% on the high side to 6% on the low end, only an 11% range. Over the last 100 years, stocks have returned 10.5%. Adjusted for inflation, the 100-year average real stock market return is 7.4%

Interest Rates

On July 26, the FRB decided to raise the target range for the FFR by 0.25% to 5.25% to 5.50%. The FRB signaled that it might raise rates one additional time this year. However, most observers and the futures market believe further rate hikes are off the table, leading to an extended pause. Interest rates rose through most of the month, peaking on August 21, when the 10-Year Treasury closed at 4.34%, a level not seen since the Financial Crisis. Interest rates moderated over the subsequent ten days, finishing the month slightly higher than where they began. Inflation-friendly consumer confidence and JOLT reports reassured investors that the economy is slowing at an orderly pace. Fixed-income securities posted a slight loss for the month globally as higher interest rates translate into lower bond prices.

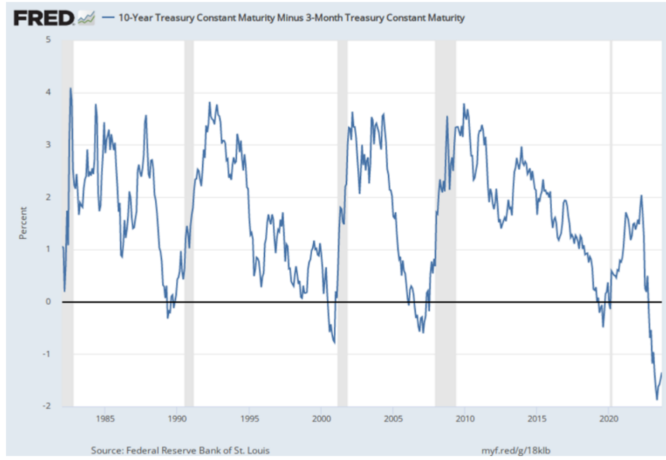
Fitch Downgrades the United States' Long-Term Rating

On August 1, Fitch Rating downgraded the U.S. government's credit rating from AAA to AA+ with a stable outlook. Fitch's action was based on "the expected fiscal deterioration over the next three years, a high and growing general government debt burden, and the erosion of governance relative to 'AA' and 'AAA' rated peers over the last two decades that has manifested in repeated debt limit standoffs and last-minute resolutions." Only Moody's continues giving the U.S. government its highest rating. It is difficult to argue against Fitch's rationale. Federal net debt is 98% of GDP. During an economic expansion and low unemployment, the federal government still runs a budget deficit of 5.5% of the GDP. This does not bode well for any pending recession.

While the downgrade may not have a lasting impact on the $27.2 trillion federal government debt, it is a symptom of the dismal government finances when 23% of every dollar spent is borrowed. Upcoming budget negotiations may be very contentious.

International Stock Returns

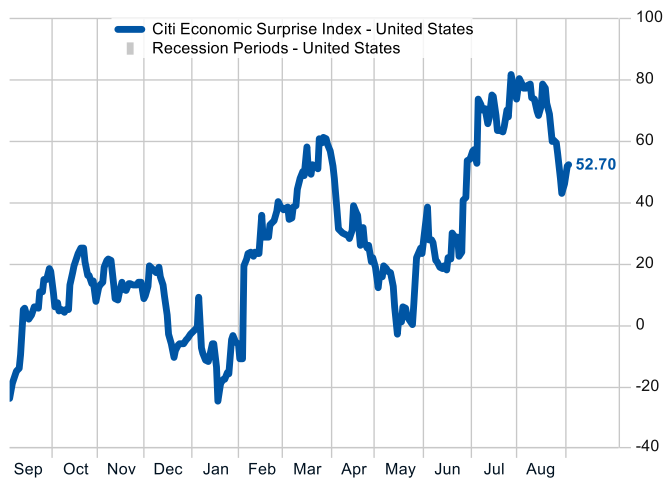
The U.S. dollar rose last month. This hindered the relative performance of international stocks. International stocks fell 2.07% in local currencies and 2.79% when translated into U.S. dollars. Over the short term, the U.S. dollar's direction is influenced by U.S. interest rates compared to international rates and relative economic growth. For now, it appears the dollar is in a tight trading range.



Our Outlook in a Nutshell

Slowing inflation, modest economic growth, strong stock market returns, and rising forward corporate earnings all point to a soft landing for the economy. One indicator, the yield curve, continues to flash yellow, keeping us from embracing the soft-landing thesis.

In October 2022, the 10-year Treasury minus the 3-Month Treasury (10Y/3M) curve first inverted. Other yield curves inverted a couple of months earlier. The 10Y/3M yield curve has an unparalleled track record when forecasting a U.S. recession. Academic studies have shown that the longer the yield curve is inverted, the longer the recession lasts. Interestingly, the depth of the inversion is not correlated with the depth of the subsequent recession. We are suspicious of strategists who claim, "This time is different," when calling for a soft landing (no recession). They may well be right. It is hard to argue against the 10Y/3M yield curve.

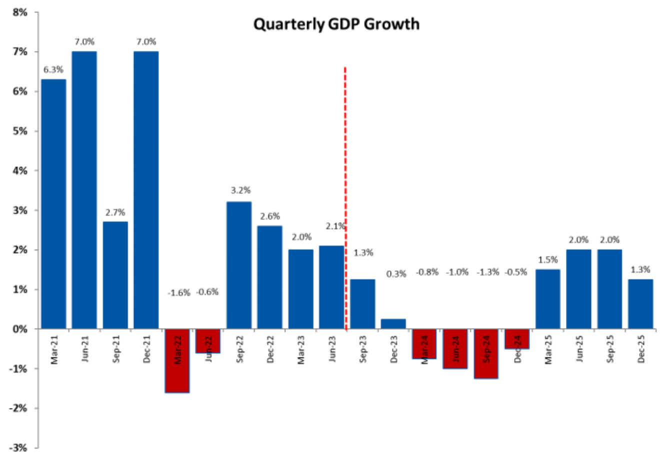


While the manufacturing sector continues to reset to pre-pandemic activity levels, the service sector remains in expansion mode. The Citigroup Economic Surprise Index (Surprise Index) tracks economic data compared to expectations. When the index rises, economic conditions are generally better than expected. When the index falls, economic conditions are usually worse than expected. The index represents the sum of the difference between results and forecasts. As the chart at the right shows, economic statistics generally disappointed in the second half of August. Stocks and bonds rallied during this period as the net results were "Goldilocks," Not hot enough to force the FRB to raise rates and not cold enough to signal an imminent recession. This has contributed to many market participants' renewed faith in a soft landing.

The optimism is a bit premature. It has only been 18 months since the initial rate hike. The bulk of the hikes occurred in the fall of 2022. More time is needed for the rate hikes to have their maximum impact. Much of the effect will be felt toward yearend.

Economic Forecast

While we forecast a shallow recession, we continue pushing back the start of the contraction. In June, we predicted the recession would start in the fourth quarter. Since then, we raised 3Q growth to 1.25% from 0.5% and 4Q growth from -0.2% to 0.25%. Our 3Q forecast may be too conservative. Many credible economists put 3Q growth over 2%. The Atlanta FRB's GDPNow model estate for 3Q is 5.6%. The economy is proving to be more resilient than we expected.

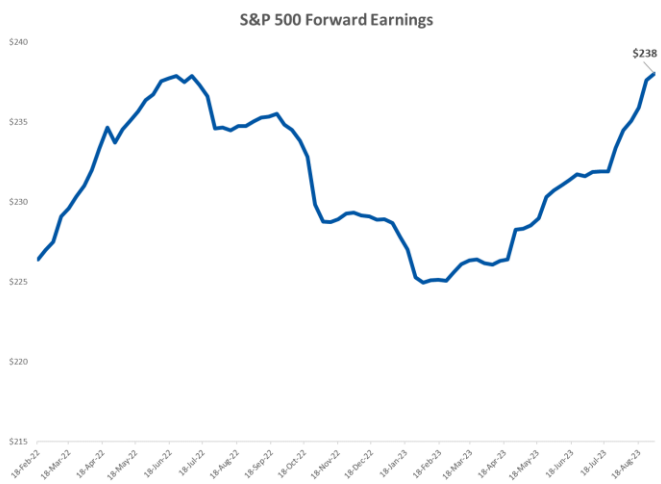


We are not yet in the soft landing camp. We fully acknowledge that the arguments for a soft landing become more persuasive each month. We are not ready to say, "This time is different." Stocks tend to peak six months before the onset of a recession. The most recent high was July 31. This fits an early 2024 recession scenario.

Corporate Earnings

Stock analysts are clearly in the soft-landing camp. After swooning late last year in response to aggressive interest rate increases, forward earnings estimates bottomed in February. They are now at historical highs.

2Q S&P 500 earnings were down 4.1% y/y. Energy sector earnings were down 52% y/y, reflecting the 40% y/y decline in oil prices. Merck (MRK) also recorded a $10.3 billion charge related to the closing of an acquisition. Excluding the energy sector and MRK's charge, S&P 500 earnings would have been up 4.6% y/y.

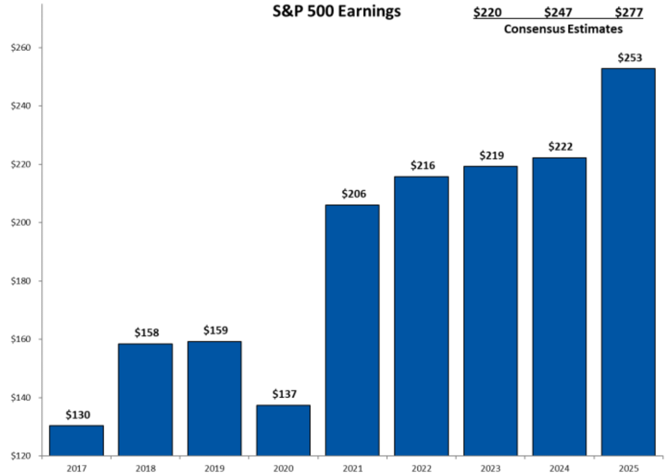


Our 2023 earnings forecast is in line with consensus. We are considerably below consensus regarding 2024 earnings. We forecast only modest earnings growth as the U.S. contends with a modest recession. If the FRB can engineer a soft landing, earnings will likely be closer to the consensus estimate of $247. Since our Summer Outlook, we have increased our 2023 earnings forecast from $213 to $219.

The S&P 500 Index is trading at 20.3X our 2024 earnings estimate and 18.3X consensus estimates. We calculate a "fair value" P/E of 17.0X based on current interest rates and credit spread. Based on our simplistic model, the stock market is currently expensive. We would need to increase our earnings outlook substantially or see lower interest rates to be more enthusiastic about stock market value. We remain cautious in our approach.

Flat earnings do not always lead to a flat stock market. The three years from 2015 to 2017, the S&P 500 earnings were stuck at $117. Despite flat earnings, stocks posted returns in line with their long-term averages.

The U.S. bond index has an average maturity of eight years and yields 5%. A buy-and-hold bond investor would earn around 5% over the next decade. Stocks have returned 10.5% over the last 100 years. Markets should compensate investors with similar returns over the next decade. The burden of proof is on those who claim otherwise.



Don't hesitate to contact our Security National Bank Private Client Services team with questions or comments about our Outlook.

Damian Howard, CFA
SVP, Director of Investment Services

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Investment Officer

Please see the obligatory disclosures at the bottom of each page and at the end of this report.

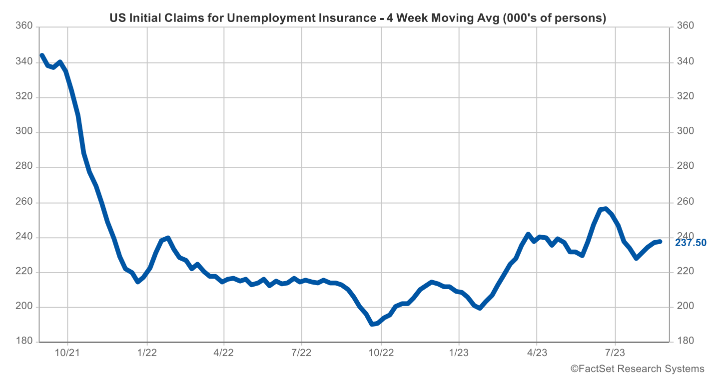
Since 1977, the Federal Reserve has operated under a mandate from Congress to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" –commonly called the Federal's "dual mandate." For this reason, we always start our economic review with employment followed by inflation.

Employment

The labor market continues to show exceptional resiliency. The three-month moving average private sector job growth fell from 165,300 last month to 140,300. Last month's figure was revised down from 185,000. During the previous twelve months, monthly private sector job growth has slowed from a 394,000 pace to the current 140,000 pace. A balanced labor market is thought to grow at a 100,000 monthly pace. The current level is not that far from that level.

While wages grew at a modest 0.24% in August, the three-month trailing average remains high at 4.5%. This is down from the previous month's 4.9% pace. The FRB wants wages to grow below a 3.5% Y/Y or 0.28% M/M pace. One month does not make a trend. Wage growth slowed in February and March, only to spike in April and remain elevated through July. Wage growth needs to remain at the current level for an extended period. We expect the labor market to weaken along with the economy.

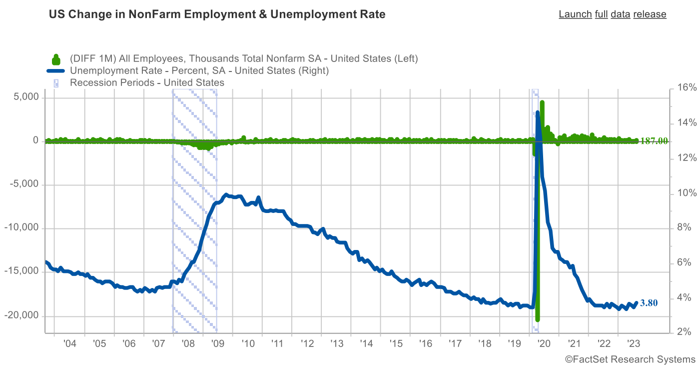
We begin our employment review by looking at the Jobs Openings and Labor Turnover Report. (JOLT) published by the Bureau of Labor (BLS). This gives us an idea of how big a cushion the economy has before employment is impacted. Companies will first cut open positions before actual employees. The July JOLT report indicated that open positions fell by 182,000 M/M to 7.9 million and fell by 2.5 million Y/Y. 5.6% of private sector jobs remained unfilled versus 5.7% the previous month and 7.3% last year. Available positions decreased primarily in professional and business services and health care. Job openings grew in IT. The private sector quit rate fell to 2.5% from 2.7% the previous month and was down from 2.9% last year. The private sector layoffs and discharges rate held steady at 1.1% compared to the previous month and last year. JOLT report points to a slowing but continued healthy labor market. Open positions have fallen to the 7 to 8 million range, which many economists consider healthy.



Initial jobless claims for the week ending August 25 were 228,000, bringing the four-week average to 236,750. Continuing claims rose slightly to 1,725,000 persons versus 1,692,000 four weeks ago. The trend in unemployment claims is up from recent lows but still below the 300,000 that prevailed before the pandemic.

The BLS reported that the economy added between 187,000 and 222,000 jobs in August. The Establishment survey puts the job gains at 187,000 versus the consensus estimate of 170,000 jobs added. The Household survey puts the job gains at 222,000. The previous two months' Establishment survey payrolls were revised lower by 110,000. The unemployment rate rose to 3.8% as the number of unemployed persons increased by 514,000, and the labor force grew by 736,000 persons. The participation rate rose to 62.8%. Hourly earnings rose 0.24%, slightly less than the consensus estimate of 0.3%. The employment report was strong enough to dispel imminent recessionary concerns. At the same time, it was not so strong as to force the FRB to raise rates.

The private sector added 179,000 jobs versus the consensus estimate of 155,000 private sector jobs. August saw notable gains in healthcare (71,000 jobs added), leisure and hospitality (40,000 jobs added), and construction (22,000 jobs added). The month also saw job losses in transportation and warehousing (34,000 jobs lost) and temporary services (18,900 jobs lost). The loss of temporary help is a sign of a softening labor market. These are typically the easiest and first positions cut when the labor market softens. This sector has shed employment over the last seven months and is down 6.6% from its recent peak in November 2022. Transportation and warehousing job losses reflect Yellow's bankruptcy.



The unemployment rate rose to 3.8% from 3.5% last month. The number of officially unemployed persons increased by 514,000 to 6.4 million. The broader U-6 unemployment rate rose to 7.1% from 6.7% the previous month. There are 1.4 job openings for every unemployed person, down from 1.6 last month and 1.9 last year. FRB Chairman Powell has previously cited this ratio as a sign of an overheated jobs market. It has improved dramatically in recent months.

The participation rate rose to 62.8% from 62.6%. The participation rate was 63.3% in February 2020. The employment-to-population ratio held steady at 60.4%. This number was 61.1% in February 2020.

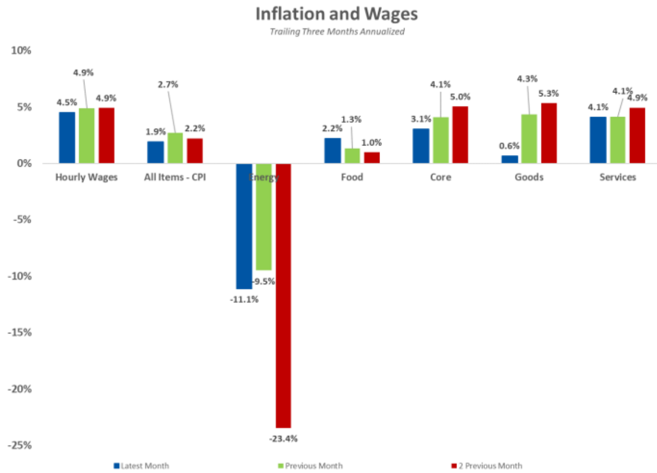
Last month's average hourly earnings (wages) rose by $0.08 per hour to $33.82, up 0.24%, slightly lower than the consensus estimate of 0.3%. Average hourly earnings are up $1.39 per hour or 4.3% Y/Y. Over the last three months, average hourly earnings grew at a 4.5% pace, down from 4.9% calculated the previous month. Wage growth is moderating.

The average workweek increased by 0.1 hours to 34.4 hours. The average work week is down 0.3% (0.1 hours) y/y. Average weekly earnings rose by $6.13 or 0.5% from the previous month. Average weekly earnings are up $44.57 (3.98%) Y/Y.

The labor market is cooling but not in freefall. Job growth is only slightly above neutral (approximately 100,000 per month). We believe the U.S. will experience a mild recession in 2024 with rising unemployment. This should cool wage growth further.

Inflation

The BLS will release one more Consumer Price Report, scheduled for September 13, before the next FOMC meeting on September 20. This report will significantly influence the next policy decision. The consensus view and our base case is that the FRB pauses.



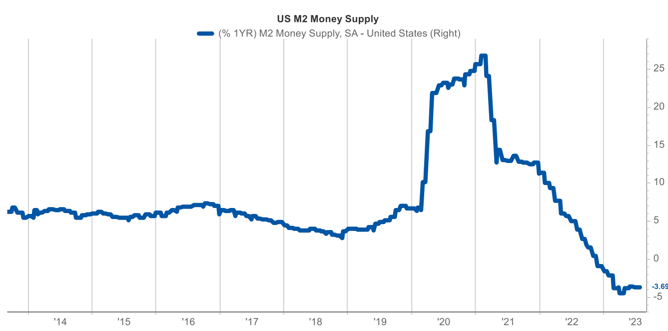
The Consumer Price Index (CPI) rose 0.2% in July and 1.9% on a Trailing Three-Month Annualized (TMA). Core prices rose 0.2% and were up 3.1% TMA.

Energy prices rose 0.1% in July but are down 11.1% TMA. Energy prices, especially crude oil, are up significantly since June (up more than 20%). Energy prices will likely add to inflation over the next few quarters.

Food inflation continues to moderate. Food prices rose 0.2% and are up 2.2% TMA. After several months of declining, meat and dairy prices rose in July. Restaurant inflation is finally showing signs of moderating.

Goods prices fell 0.3% and are up 0.6% TMA. New and used car prices comprise a third of the goods category and are a significant swing factor in goods inflation. New vehicle prices were down 0.1% in July. Used vehicle prices fell 1.3%. Used vehicle CPI may be heading lower. The Manheim Used Vehicle-Price Index peaked in March and has fallen 11% since. Major auto OEMs have recently announced price cuts (increased incentives). New and used car prices should moderate in the second half of 2023. A prolonged UAW strike may alter this trend.

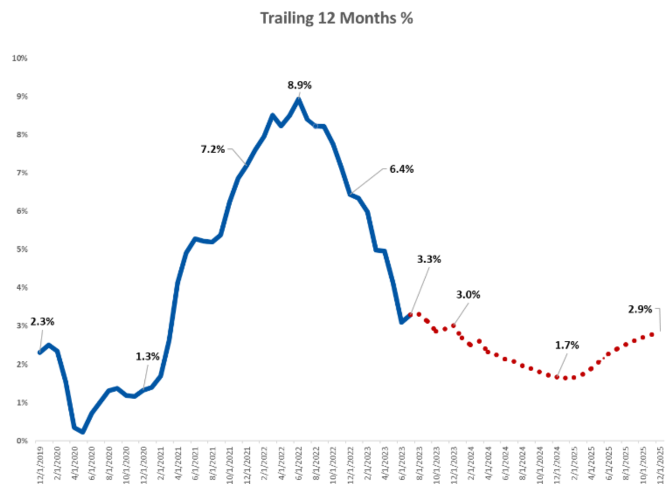
Rent of shelter increased by 0.4% and is up 5.5% TMA. Rent of shelter continues to be higher than market-derived measures but less than previously. The category should moderate only slightly from current levels. The y/y measure will continue to moderate to 2% to 4%. This is in line with long-term wage growth. Shelter rent is 34% of the overall CPI basket.



Milton Friedman, American economist and Nobel Laureate, famously said: "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." Much of today's inflation was caused by the rapid growth of the monetary supply in 2020 and early 2021, when growth peaked at over 27% year Y/Y. The money supply increased faster than output for three years, leading to inflation. The FRB slammed on the brakes in 2022. Since peaking in March 2022, the money supply has contracted by 3.7%, or $0.8 trillion. The money supply is no longer contracting and has grown for three consecutive months. Over the last three months, the money supply has grown at a 3.8% annual rate. This rate is insufficient but much better than shrinkage. Higher capital standards for regional banks will likely reduce credit availability and the velocity of money. Based on the money supply, inflation should continue to moderate.

Because inflation statistics are lagging indicators, economists use forward-looking inflation expectations. The Breakeven Inflation Rate implies what market participants expect inflation to be in the next five years, on average. The 5-year Breakeven Inflation Rate peaked at 3.60% in March 2022. Since then, financial conditions have tightened considerably. Slower growth has led to lower inflation expectations. Inflation expectations have fallen to the current 2.2%. Inflation expectations remain anchored near the FRB's long-term target of 2%. As previous reports outlined, we believe inflation will average closer to 3% over the next five years.

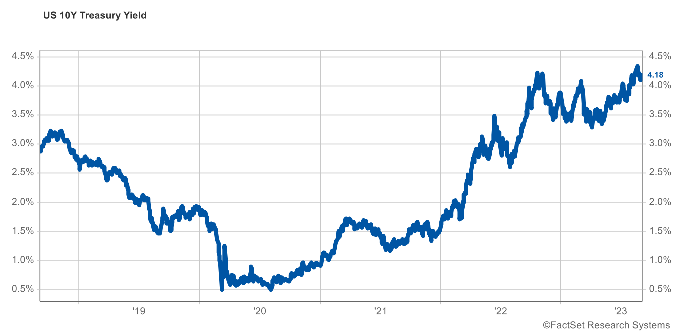
The graph on the right shows our most recent inflation forecast. We project that inflation will average 2.9% during 4Q23. This is up from 2.1% due to higher energy prices. We also project that inflation will average 2.0% in 4Q2024. This is unchanged from our previous forecast. We forecast inflation will return to 3% as the economy exits a recession.



Under-investment in the commodity sector, deglobalization, hot wars (Ukraine), cold wars (China and Russia), and the shift to zero-carbon will cause inflation to be more volatile and at a higher level than in the pre-pandemic period. Higher and more volatile inflation will likely result in higher and more volatile interest rates. For the next eighteen months, cyclical trends (a recession will overpower the secular trends outlined above.

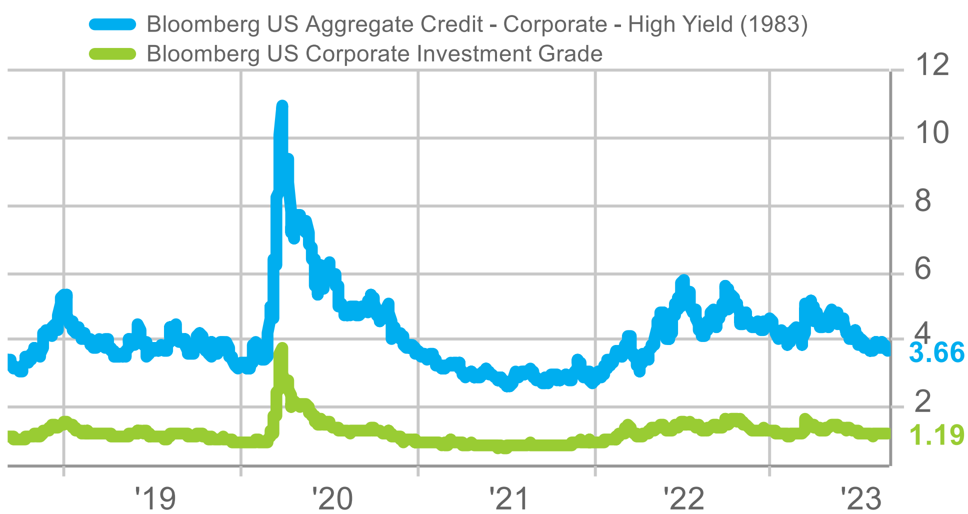
Interest Rates and Credit Markets

On August 21, the 10-year Treasury closed at 4.34%, a level not seen since the Financial Crisis. Longer-term interest rates have moderated a bit but remain above pre-pandemic levels. Like the U.S. 10-year Treasury, the Global Aggregate yield hit a post-Financial Crisis peak of 4.07% on August 21. The yield has since eased by 0.16%. Interest rates have risen globally and are likely near secular long-term levels. We have long believed the 10-year Treasury should yield 4.25% to 4.50%.



While risk-free rates have returned to adequate levels, credit spreads remain tight. During periods of financial stress, investment grade spreads often widen beyond 2%. During periods of exuberance, investment grade spreads fall below 0.8%. Investment grade spreads ended the month at 1.18%, 0.06% wider than the previous month.

High-yield spreads widened by just 0.05% to 3.72%. During periods of economic stress, high yield spreads often widen to above 8.00%. During periods of exuberance, high-yield spreads fall below 3.5%. Spreads remain near exuberance levels.

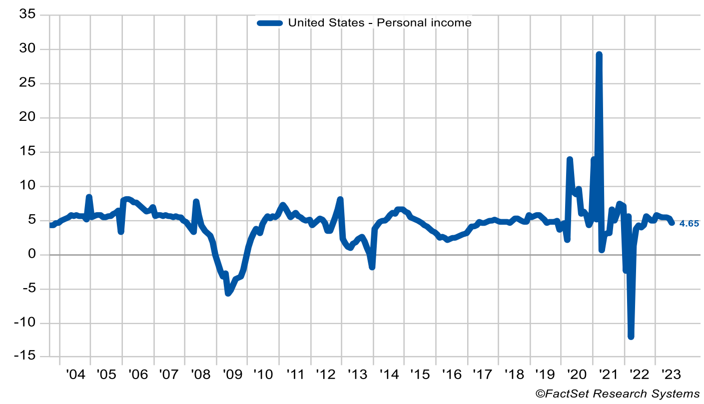


The MOVE index measures interest rate volatility that tracks the movement in 2-year, 5-year, 10-year, and 30-year U.S. Treasury options. The index is currently at the lower end of its recent range. Interest rate volatility is higher than in the last ten years but less than peak levels. Interest rate volatility leads to market value volatility in fixed-income portfolios.

Risk-free interest rates have finally returned to attractive levels. Credit spreads are narrow and do not indicate a pending recession. We continue to expect a mild recession and are cautious about credit risk. We recommend concentrating on highly rated bonds. We do not believe investors are adequately compensated for taking credit risk. This stance aligns with our long-held bias against assuming high levels of credit risk.

The Consumer Sector

Personal income rose by 0.2% in July. Personal consumption expenditures rose 0.8%. The PCE Price Index (PCE Inflation) rose 0.2%. The savings rate fell to 3.5% as consumers cut back their savings to fund purchases.



Personal income rose 0.2% M/M and was up 4.6% Y/Y. Private sector wages and salaries were up 0.4% M/M and 4.6% Y/Y. Disposable personal income was flat M/M and was up 7.2% Y/Y. Personal taxes are down 10.1% y/y as last year's market route reduced capital gains taxes.

Real disposable personal income per capita, or the income each person has left to spend after paying taxes, was down 0.2% M/M and 3.3% Y/Y. It has been growing for 12 of the last 13 months. Consumers have benefited from the strong labor market and moderating inflation. Rising real disposable income supports continued modest consumption and economic growth.

Personal Consumption Expenditures		
	Nominal	Real
Durable Goods	0.7%	1.4%
- Motor Vehicles and Parts	0.0%	0.6%
Non-Durables	0.7%	0.7%
- Gas and Other Energy	-1.4%	-1.6%
Services	0.8%	0.4%
- Utilities	0.4%	2.6%
Total	**0.8%**	**0.6%**

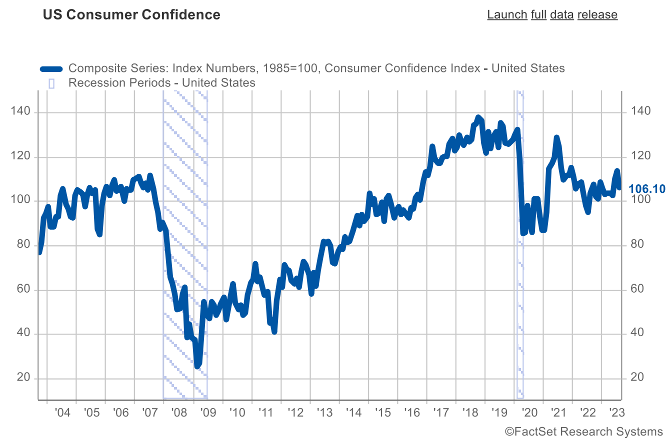
Personal Consumption Expenditures (PCE) were up 0.8% for the month and were up 0.6% on a real basis after subtracting out the impact of inflation.

Light vehicle sales rose to a 15.7 million adjusted annual rate (AAR) in July from a 15.6 million AAR the month before (up 0.5%). New and used vehicle prices have been moderating. August light vehicle sales fell to 15.0 million (AAR), down 4.5%. Goods consumption may be negative in the next report. The auto industry has finally recovered. A prolonged strike may upset the new-found stability.

On a real y/y basis, consumers purchased 5.4% more new and used cars and 5.9% more gasoline. While out and about, they spent 4.3% more in restaurants and hotels. They also spent 7.0% more on recreational goods and 4.3% more on recreational services. Much of the increased spending on the annual vacation was financed by borrowing on credit cards. The most recent figures show outstanding revolving credit rose $127 billion (11%) y/y. This is not sustainable. We look for consumption to slow down in the coming months.

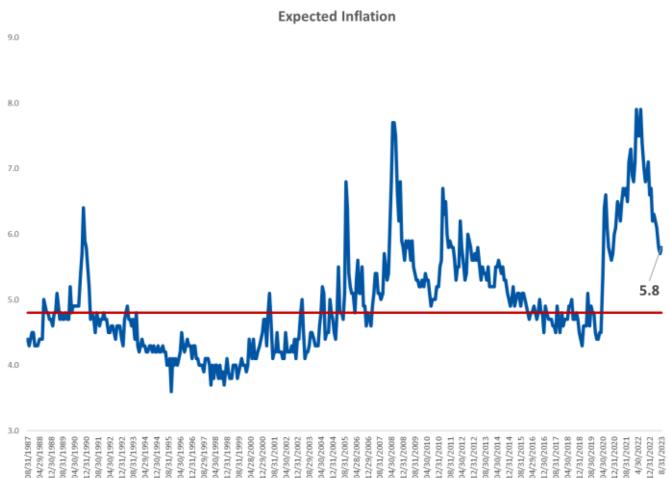
Consumers saved just 3.5% of disposable income during the month. This is significantly less than the 7.4% savings rate that prevailed before the pandemic. Consumers continue to draw down the excess savings built during the pandemic. A study by the San Francisco FRB concludes that the pandemic savings horde has been depleted. This will depress 2024 consumption as consumers are forced to save more.

The moderating labor market is gaining attention from consumers, who are beginning to show concern. The Consumer Confidence Index, compiled by the Conference Board, fell 7.9 points to 106.1.



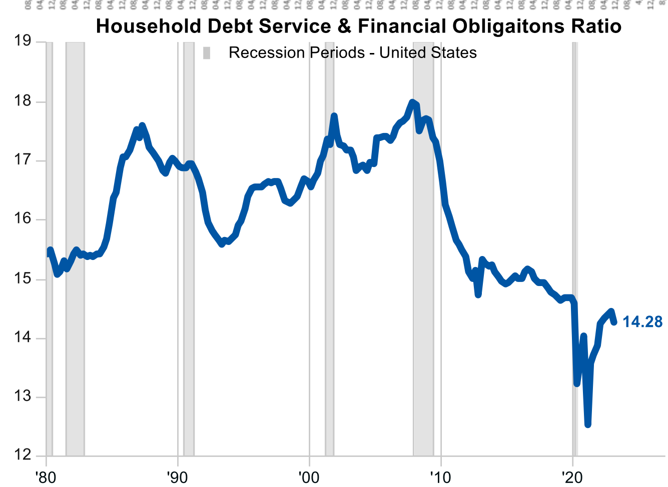
The present situation component fell by 8.2 points to 144.8. The forward-looking expectation component fell by 7.8 points to 80.2. Although the reading remains strong, confidence in the labor market is clearly waning.

The current conditions net employment sub-index (plentiful - hard to get) fell to 26.2 from 32.4 the previous month. Consumers' outlook for future employment stabilized as the net sub-index (more jobs – fewer jobs) fell to -1.3 from 1.0 the previous month.



Consumers' perception of current business conditions weakened as the net sub-index (good-bad) fell slightly to 3.5 from 4.5 the previous month. Consumers' outlook for future business conditions improved as the net sub-index (better – worse) fell to -0.6 from 2.7 last month. Perceptions of future business conditions mirror how often commentators talk about a soft landing or a recession.

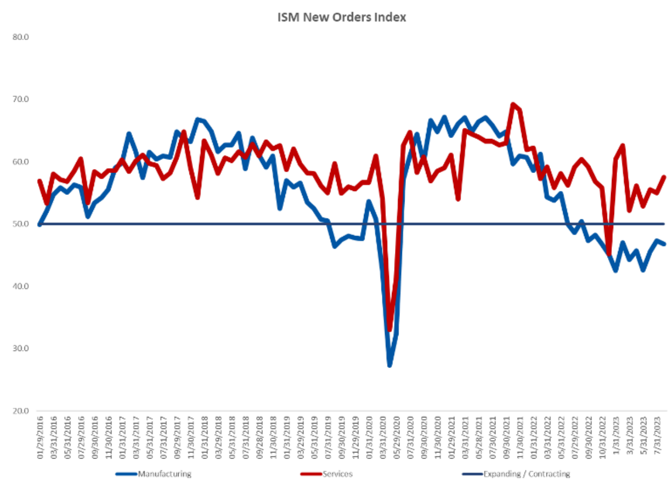
The Conference Board started asking consumers about inflation expectations in 1987. Consumers' expectation for inflation for the next 12 months continues to moderate. Consumers forecast inflation will be 5.8% in 12 months versus the 7.9% reported in June 2023 and the 4.8% long-term median. The FRB is making modest progress in moderating inflation expectations. Inflation is still viewed as too high. Inflation expectations are believed to impact wage growth. This is evident in the wage levels organized labor is seeking.



Labor markets are weakening but remain healthy. Despite rising debt and interest rates, the Financial Obligations Ratio remains below pre-pandemic levels. Consumers should be able to weather the coming recession without significant permanent damage, unlike the Great Financial Crisis, where significant permanent damage was done to household balance sheets. This should make the impending recession shallower and shorter than the one experienced during the Great Financial Crisis.

The Business Sector

The Institute for Supply Management (ISM) reports monthly on manufacturing and non-manufacturing (service) sector activity. The reports are sentiment-driven and can be influenced by current events. Nonetheless, they do provide real-time clues to what is happening. The shift from the goods economy to the service economy continues. This has pushed the manufacturing sector into a recession. The service economy continues to grow. Inflationary pressures are moderating.



The New Orders Index is a leading indicator for the ISM Activities Index and the economy. This chart supports a shallow manufacturing recession. The manufacturing new orders index has been below 50 for twelve straight months. The pace of the decline is decelerating in the manufacturing sector, indicating a shallow recession. New orders in the service sector are expanding at a steady pace, indicating continued strength in services. Consumer preferences continue to shift from the purchase of goods to services.

June's non-manufacturing index rose 1.8 points to 54.5. Growth narrowed as 13 industries reported growth versus 14 last month. Overall comments leaned toward steady, slower growth.

Employment expanded in August. The employment index rose by 4.0 points to 54.7. Only 10.9% of responents reduced employment. This is down from 18.7% in May. Comments from respondents include: "Open positions being filled with quality candidates" and "We have lost employees due to normal attrition and are having issues backfilling these positions." Also: "The labor market remains very competitive."

Non-Manufacturing Sector	Direction	Rate of Change
Business Activity / Production	Growing	Faster
New Orders	Growing	Faster
Backlog of Orders	Contracting	From Growing
Employment	Growing	Faster
Prices Paid	Increasing	Faster
Supplier Deliveries	Faster	Slower
Non-Manufacturing Sector	**Growing**	**Faster**
Industries Expanding	13	-1
Industries Contracting	5	+1

Prices paid for materials and services rose at a slightly faster pace. The price component rose by 2.1 points to 58.9. Twelve industries reported higher costs. Three industries reported lower costs. Commodities up in price include bacon, coper wire, fuel, and oriented strand board (OSB). Commodities down in price include caustic soda, steel products and pallets. Inflation pressures persist in the service sector.

The supply chain further improved as only 3.6% of respondents reported slower deliveries. 67% of respondents reported faster deliveries. Four industries reported slower deliveries while eight industries reported faster deliveries.

As a frame of reference, a reading above 50 indicates expansion; a reading below 50 indicates contraction. Readings approximating 50 indicate the same level of activity.

The manufacturing index rose 1.2 points to 47.6. August's report marks the tenth consecutive month in contraction territory. Every component (except production) was in contraction territory.

Manufacturing Sector	Direction	Rate of Change
Production	Contracting	Slower
New Orders	Contracting	Faster
Backlog of Orders	Contracting	Slower
Employment	Contracting	Slower
Prices Paid	Decreasing	Slower
Supplier Deliveries	Faster	Slower
Manufacturing Sector	**Contracting**	**Slower**
Industries Expanding	5	+3
Industries Contracting	13	-3

Prices paid for materials and services decreased at a slower pace. The price component rose by 5.8 points to 48.4. Five industries reported higher costs. Ten industries reported lower costs. Only 16.4% of respondents reported paying higher prices, while 19.7% reported paying lower prices. Higher energy prices are starting to impact input prices.

The manufacturing sector will continue contracting. Consumers are still purchasing goods at a rate above the prepandemic trend line. The normalization of the goods sector is not yet finished. Slowing consumption has allowed supply chains to normalize, reducing inflationary pressures. We expect the manufacturing sector to remain under pressure as consumers switch their consumption preferences from goods to services. The process may take a couple more quarters to complete. A recession will accelerate this process.

Abbreviations and Other Terms Used

This report will use FRB for the Federal Reserve Bank, FOMC for the Federal Open Market Committee, and BLS for the Bureau of Labor Statistics. The FOMC is part of the FRB that meets eight times yearly to set monetary policy. The primary tool for monetary policy is the Federal Funds Rate (FFR). FFR is the rate set by the FOMC and is the rate at which banks borrow and lend their excess reserves to each other overnight. It forms a floor for short-term interest rates.

We will use the following abbreviations for various governmental agencies.
BEA = U.S. Bureau of Economic Analysis
BLS = U.S. Bureau of Labor Statistics

We will use the terms nominal and real. Nominal values are measured in terms of money or things counted in the real world. Retail sales, personal income, expenditures, and corporate earnings are usually reported in nominal dollars. Real values are adjusted for inflation (nominal less inflation). Real values enable comparisons that are not distorted by inflation. GDP numbers are usually reported as real growth.

Other abbreviations are commonly used.
QTD = Quarter to date
YTD = Year to Date
M/M = Month Over Month
TMA = Trailing Three-Month Annualized
Y/Y = Year Over Year

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