SECURITY NATIONAL BANK
PRIVATE CLIENT SERVICES

Current Forecast	2023	2024 Est	2025 Est
GDP Growth	3.1%	1.2%	1.6%
Change in Consumer Prices	3.3%	2.5%	2.8%
Fed Funds Target Rate	5.50%	4.50%	3.50%
5-Year Treasury Yield	3.85%	4.50%	4.25%
10-Year Treasury Yield	3.84%	4.50%	4.75%
S&P 500 EPS	$218	$229	$244

The United States (U.S.) will avoid a recession this year; inflation will briefly touch 2.0% before returning to a long-term average of 2.8%. We expect the Federal Funds Target Rate (FFR) to stay at 5.5% through mid-year before a series of rate cuts return it to the neutral level of 3.5% in 2025. The yield curve will remain inverted until the FRB begins easing. We expect the 10-year Treasury to hover around 4.2% for most of the year before ending at 4.5%. We expect earnings for the Standard and Poor (S&P) 500 to post modest growth for several years.

Last Month's Rates and Total Returns				
February 29, 2024	Value	One Month	Year to Date	1 Year
Fed Funds Target (Upper)	5.50%	--	--	+75 bp
3-Month Treasury Yield	5.40%	+4 bp	+5 bp	+59 bp
2-Year Treasury Yield	4.63%	+41 bp	+38 bp	-17 bp
5-Year Treasury Yield	4.24%	+38 bp	+39 bp	+7 bp
10-Year Treasury Yield	4.24%	+29 bp	+36 bp	+32 bp
Mortgage News 30-Year	7.10%	+35 bp	+43 bp	+16 bp
S&P SuperComposite 1500	1,155	5.32%	6.73%	28.75%
S&P 500 Index	5,096	5.34%	7.11%	30.43%
S&P 500 Equal Weight Index	6,594	4.16%	3.31%	13.28%
S&P Midcap 400	2,891	5.94%	4.13%	13.05%
S&P SmallCap 600	1,305	3.32%	-0.75%	6.50%
S&P 500 Growth	3,342	7.30%	10.40%	38.60%
S&P 500 Value	1,769	3.05%	3.35%	21.68%
World ex-US, net *	295	2.53%	1.51%	12.51%
Wilshire Liquid Alts	188	0.99%	1.66%	6.79%
BB U.S. Aggregate	90	-1.41%	-1.68%	3.33%
Crude Oil – WTI Near Term	$78	3.18%	9.23%	1.57%
Commodity Index	97	-1.47%	-1.08%	-3.94%
FT Wilshire Bitcoin	$62,803	44.85%	48.53%	166.98%
Gold – Near Term	$2,046	-0.13%	-0.81%	11.85%
U.S. Dollar Index	104	0.85%	2.79%	-0.68%

**= MSCI ACWI ex the US in USD*

Prepared by Damian Howard March 12, 2024

Security National Bank's Private Client Services team 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

Investor optimism regarding artificial intelligence (AI) has continued to fuel the stock rally. NVIDIA Corp (NVDA) posted a total return of 28.6% during the month. It returned 59.8% and 240.9% YTD over the past year. NVDA has accounted for about half of the market's YTD total return.

Stocks and bonds posted mixed results in February. U.S. large capitalization stocks posted solid gains of 5.34%. Mid-cap stocks returned 5.94%, while small-cap stocks returned 3.32%. U.S. fixed income fell an additional 1.41% as interest rates drifted higher.

Source of Returns	
Earnings Growth	1.9%
Dividend	0.2%
Multiple Expansion	4.9%
Total Return	7.1%

Of the Standard and Poor (S&P) 500's 7.1% YTD return, 1.9% came from higher forward earnings, and 0.02% came from dividends. The remaining 4.9% came from an expansion of the price-earnings ratio (P/E) multiple. Returns derived from higher multiples are not sustainable. The 12-month forward P/E rose from 19.6X to 20.8X. Over the last 20 years, the forward P/E has averaged 15.8X. The stock market is expensive by almost all measures—primarily the Magnificent Seven, the stocks like Facebook, Amazon, Netflix, Google and other high-profile stocks. The S&P 500 Equal Weighted Index has a forward P/E of 16.7X versus its 15-year average of 15.5.

For the month, the top-performing sector was consumer discretionary up 8.7%. The worst-performing sector was utilities up, 1.1%. YTD, the top-performing sector, was communication services, up 11.0%. The worst-performing sector was real estate, up 2.3%.

Over the last 20 years, the U.S. experienced a global financial crisis, a pandemic, bouts of inflation and multiple bear markets. Stock market returns (as measured by the S&P 1500) have shown consistency over the longer term. Each month, we list the longer-term returns for the broad stock market. This table 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	28.8%	11.3%	14.3%	13.2%	12.4%	16.0%	9.9%
Bonds	3.33%	-3.1%	0.6%	0.9%	1.4%	2.6%	4.0%

Volatility of Returns			
	One Year	Ten Years	Twenty Years
Stocks			
Best	47%	19%	17%
Worst	-39%	-1%	6%
Bonds			
Best	43%	16%	12%
Worst	-13%	1%	1%

The table also illustrates the return advantages of stocks for those who can tolerate volatility—no 20-year period produced negative returns. Most investors have more than a 20-year time horizon. The longer time horizon should allow for a higher equity allocation and the potential for higher long-term returns. The table also illustrates that bonds can also be volatile. Over the last 20 years, fixed income (bonds) has delivered lackluster results with substantial volatility. There is hope that fixed income will provide better returns over the next decade. Interest rates have risen to the point where returns over the next few years should be slightly more rewarding. The yield on the U.S. Aggregate Index is now 4.8%. The duration is 6.3 years. A reasonable expectation is a 4.0% to 5.0% return over the next five years. We believe interest rates will be more volatile in the next decade than in the previous decade. Our reasoning is outlined below.

International Stock Returns

Higher-for-longer U.S. interest rates and more robust U.S. growth prospects increased the attractiveness of U.S. dollar-denominated assets. Last month, the U.S. dollar index rose 0.9%, bringing the YTD increase to 2.8%. This hindered the relative performance of international stocks. International stocks rose 3.5% in local currencies but only 2.5% when translated into U.S. dollars in February. Over the short term, the direction of the U.S. dollar is influenced by U.S. interest rates compared to international rates and relative economic growth. For now, it appears the dollar is on a strengthening trend.

Fixed Income Returns

Interest rates rose last month across the curve. The U.S. Aggregate Index fell 1.4% last month as income of 0.2% was insufficient to offset the 1.6% drop in value. The global fixed income aggregate posted similar returns, falling 1.3% as income did not offset the 1.0% drop in value and the impact of currency.

Interest Rate Policy

Federal Reserve Chairman Jerome H. Powell told lawmakers on March 7 that the FRB was "not far" from cutting rates. Current rates are restrictive and above the levels required for an economy with moderate inflation and growth. He added that the FRB still seeks confirmation that inflation was returning to the 2.0% target. "When we do get that confidence, and we're not far from it, it will be appropriate to dial back," said Chairman Powell. Chairman Powell took a March rate cut off the table at the last Federal Open Market Committee (FOMC) meeting. He reiterated that stance during his testimony before Congress. Rate cuts at subsequent meetings are still up for debate.

Meeting Date	Futures Market 03/08/2024	SNB Forecast
March 20	5.50%	5.50%
May 1	5.50%	5.50%
June 12	5.25%	5.50%
July 31	5.00%	5.25%
September 18	4.75%	5.00%
November 7	4.75%	4.75%
December 18	4.50%	4.50%
January 29	4.25%	4.50%
March 12	4.25%	4.25%

We expect the first rate cut at the September meeting, followed by 0.25% rate cuts at each subsequent meeting until January. We forecast rate cuts at every other meeting until the FFR reaches 3.50%. We view 3.5% as a neutral FFR when underlying inflation runs at 2.8%.

Artificial Intelligence Hope and Hype

Wage growth has been high and is accelerating. Businesses can afford to pay higher wages by increasing productivity or raising prices. Over the last couple of years, businesses have been able to raise prices, translating into inflation. With a lower overall inflation environment, businesses have less room to raise prices and must now turn to productivity to protect profit margins.

Some simple formulas tying productivity to wages and economic growth:

1.5% productivity + 2.0% inflation = 3.5% wage growth

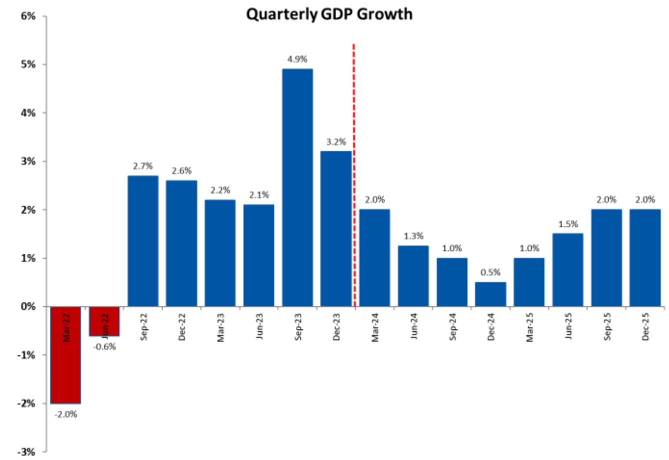
1.5% productivity + 0.3% labor force growth = 1.8% GDP growth

Productivity has averaged 1.9% this century, and the labor force has grown 0.5% yearly. These rubrics slightly lower the numbers out of caution and adjust for recent trends. The FRB's inflation target is 2.0%, translating to a 3.5% wage growth target and 1.8% GDP growth. Productivity has picked up and has averaged 3.7% over the last three quarters. AI promises a leap forward in productivity. A recent study by Massachusetts Institute of Technology (MIT) suggested that AI can improve a worker's performance by 40% compared to workers who do not use AI if the worker uses AI within the boundaries of its capabilities. Microsoft claims their Copilot AI product saves knowledge workers 10 hours per week (Microsoft Morgan Stanley TMT Conference). If AI achieves just a fraction of this productivity improvement, wage growth may not translate into higher prices and the economy will be able to achieve faster growth. There will likely be a higher number of losers than winners in the AI race, with valuations possibly becoming inflated for certain companies. One of our investment focuses lies in AI-driven productivity enhancers.

Economic Forecast

While we no longer expect a recession in 2024, we believe growth will slow. Congress will likely pass a bipartisan tax bill that expands the Child Tax Credit, restores full expensing of R&D, the 100% bonus depreciation and allows higher interest deductions. The bill will likely provide an additional stimulus of

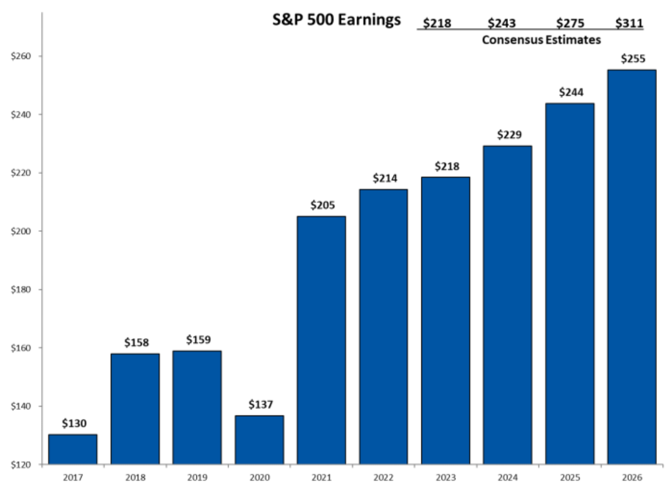
$136 billion (0.5% of the GDP) this year. The IRS will also likely process an extra $150 billion (0.5% of the GDP) in Employee Retention Tax Credit payments, further adding stimulus this year. The additional 1.0% fiscal stimulus may hit the economy this summer and fall. Our forecast will be adjusted more if this happens.



Earnings Forecast

Fourth-quarter results are in the books. Earnings for S&P 500 companies were up 4.1% Y/Y, while sales were up the same amount.

Earnings finished the year at $218. On January 1, the consensus estimate was $251. The consensus estimate was only 3.5% too high, roughly half the typical overestimate. We had forecasted that 2023 earnings would be $203. We underestimated by 7.0%, as our predictions factored in an economic slowdown but failed to anticipate the impact of the larger-than-expected federal deficit.



We are forecasting earnings of $229 this year compared to the consensus estimate of $243. We also forecast $244 for 2025 versus $275 for the consensus estimate.

The S&P 500 is currently trading at 22.5X our 2024 estimate and 21.2X the consensus estimate, which are rich multiples. We estimate the "fair value" to be 18.7X earnings. The S&P 500 valuation has been elevated by the high P/E of some substantial, fast-growing and profitable companies. The average stock is trading at 16.1X 2024 earnings. This is only slightly more than the long-term multiple of 15.8.

Europe and Japan will likely spend the year in a recession. China has significant issues that will probably cause it to miss growth targets. This leaves the U.S. as the only major economy that will grow this year.

The U.S. faces multiple challenges. The greatest immediate challenge is commercial real estate, especially the central business district (CBO) office. Projects financed before the pandemic now face a different world. Occupancy and demand are substantially lower. Rents will need to be reset lower. Interest rates are significantly higher. The economics of these projects no longer make sense. Significant losses are expected, and the extent and breadth of these losses are still under evaluation. While they are not anticipated to reach levels that would trigger a recession, their magnitude remains uncertain. As a measure of caution, we have limited our exposure to regional banks.

The ballooning federal deficit is a concern but unlikely to cause significant short-term financial disruption. Interest rates will be slightly higher due to the crowding-out effect. Neither presidential candidate has shown a history of fiscal restraint, and the voting public has not punished many politicians for their prolific spending. Both candidates favor industrial policy to one extent or another. The economy will be less efficient because governments are poor allocators of capital. The result is slower growth, higher interest rates, and volatile inflation. The next generation will be substantially poorer as a result. As with most things in finance, bad financial decisions can compound over time.

We will continue to search for companies that can grow in a slow-growth environment. These companies have low debt burdens and high returns on capital. They will continue to innovate despite governments' follies. We agree with Chairman Powell that forecasters have much to be humble about, and we will adjust our forecast as the year unfolds.

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

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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 Reserve's "dual mandate." For this reason, we always start our economic review with employment followed by inflation.

Employment

Please remember the labor market is a lagging indicator. Job losses do not typically occur until after the economy enters a recession. The January and February employment reports are subject to errors in seasonal adjustments. Statisticians continue to struggle with changing pandemic-induced changes. Payrolls for the previous two reports were revised down 167,000. The March report may contain additional revisions. This is evident in the differences between the household and establishment surveys.

Despite the revision, the employment report was strong. Job growth was widespread. The private sector added 223,000 jobs in February, substantially more significant than the 12-month moving average of 176,600 and modestly more outstanding than the three-month moving average of 204,700. Job growth above 90,000 is considered strong. These numbers are solid. Layoffs and new unemployment insurance claims remain muted. February also saw a significant deceleration in wage growth. The TMA of 4.0% is very close to the FRB's target of 3.5%. We shall see if wage growth moderation continues.

We begin our employment review by examining the Jobs Openings and Labor Turnover Survey (JOLTS) report 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.

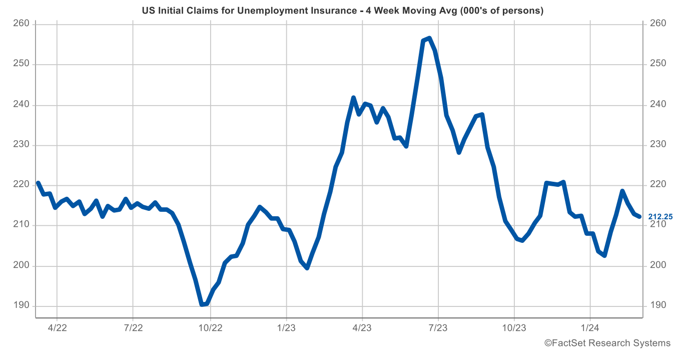
JOLTS Report				
	Most Recent	Previous Month	Previous Year	Prior to Pandemic
Open Positions	8,863	8,889	10,425	
Open/Unemployed	1.5X	1.4X	1.8X	0.9X
Open Rate *	5.6%	5.5%	6.6%	4.4%
Hire Rate *	4.0%	4.0%	4.5%	4.1%
Lay-Off Rate *	1.1%	1.1%	1.3%	1.4%
Quit Rate *	2.4%	2.4%	2.8%	2.4%

* Private Sector

The January JOLTS was roughly in line with expectations. The ratio of openings to unemployed persons increased slightly to 1.5X. This is close to the 1.2X ratio that prevailed before the pandemic but above the long-term average of 0.9X. The hire rate has returned to the long-term average, and the layoffs remain subdued. This indicates that employers retain their talent (low layoff rate) but are not looking to expand payrolls. This also squares with the reduction in hours worked.

The quit ratio is back to pre-pandemic levels. A high quit rate is associated with higher wage growth, as employees usually switch jobs for higher pay. The ratio tends to lead to compensation costs by six months. The lower quit rate should lead to lower wage growth around mid-year. Based on the JOLTS report, the labor market remains healthy, which may help the FRB achieve its soft landing.

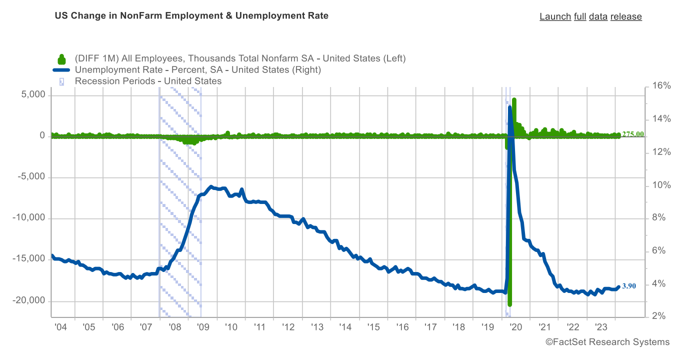
Initial jobless claims March 1, 2024, were 217,000, bringing the four-week average to 212,250. Continuing claims rose slightly to 1,906,000. Initial claims would need to rise above 300,000 before unemployment would increase dramatically. This indicates a robust labor market.



The BLS reported that the number of jobs fell by 184,000 or increased by 275,000 in February. The Establishment Survey puts the job gains at 275,000 versus the consensus estimate of 200,000 jobs added. The volatile Household Survey indicates that the economy shed 184,000 jobs. The Household Survey puts the 12-month gain in employed individuals at 0.7 million. The Establishment Survey estimates the economy added 2.7 million positions over the last 12 months. There is a substantial difference between the two surveys.

Establishment Survey payrolls for the previous two months were revised lower by 167,000. The unemployment rate rose by 0.2% to 3.9% as the number of unemployed persons increased by 334,000, and the labor force grew by 150,000. The participation rate held steady at 62.5%. Hourly earnings rose by just 0.14%, significantly less than the consensus estimate of 0.3%.

The economy added 275,00 jobs, 223,000 of which were in the private sector. The consensus was for 200,000 and 175,000 new private sector jobs. Last month saw notable gains in healthcare, with 67,000 jobs added; government, 52,000 jobs added; and food service, 42,000 jobs added.



The manufacturing sector shed 4,000 jobs, while manufacturing, computers, electronics, chemicals, food manufacturing and transportation sectors lost around 2,000 jobs.

Job losses in the service sector were concentrated in warehousing and temporary help services. Warehousing lost 6,800 jobs, bringing the 12-month total to 90,800 jobs. Temporary help services lost 15,400 jobs, bringing the 12-month total to 207,100. Employment in temporary help services has fallen for 23 consecutive months.

The unemployment rate rose to 3.9%, and the number of officially unemployed persons increased by 334,000 to 6,458,000. The broader U-6 unemployment rate rose by 0.1% to 7.3%.

The participation rate held steady at 62.5%. The participation rate was 63.3% in February 2020. The employment-to-population ratio fell by 0.1% to 60.1%. This number was 61.1% in February 2020.

Last month's average hourly earnings (wages) rose by $0.05 per hour to $34.57, up 0.14%, significantly lower than the consensus estimate of 0.3%. Average hourly earnings are up $1.42 per hour or 4.28% Y/Y. Over the last three months, average hourly earnings grew at a 4.0% pace, down from a revised 5.0% the previous month. Wage growth is decelerating again. The FRB wants wage growth to decelerate and stay below 3.5% for an extended period. If this trend is confirmed, the FRB may be able to cut rates sooner than our forecasted July.

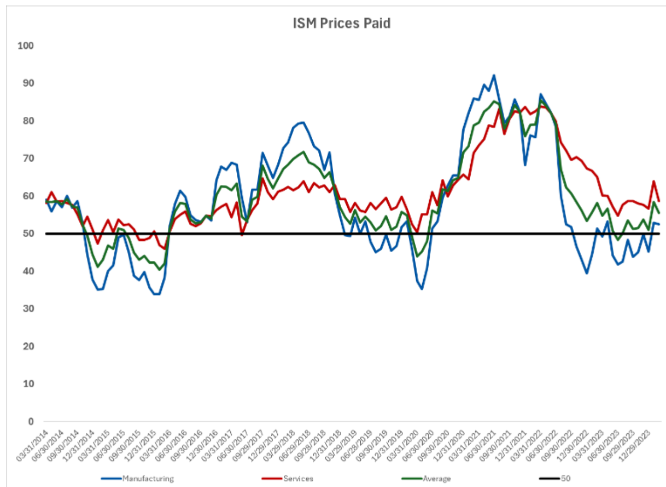
The average workweek rose by 0.1 hours to 34.3 hours, but it is down 0.6% (0.2 hours) Y/Y. A longer workweek combined with slightly higher wages resulted in average weekly earnings rising by $5.17, or 0.44%, from the previous month. They are up $42.07 (3.68%) Y/Y.

The monthly Employment Report suggests the labor market remains strong. Average hourly earnings decelerated. If the trend is confirmed by subsequent labor reports and is coupled with moderate Consumer Price Index (CPI) reports, the FRB may be able to cut rates at its June meeting. We continue to forecast a July rate cut.

Inflation

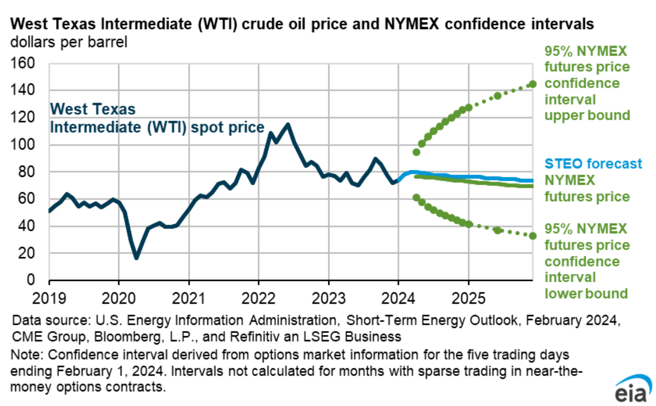
The following Consumer Price Reports will be released on March 12. The FOMC will benefit from one more report before its next rate decision on March 20. We expect prices to moderate but remain above target, reinforcing the higher-for-longer narrative.

The CPI rose 0.2% in January and 2.8% on a Trailing Three-Month Annualized (TMA). Core prices rose 0.4% and were up 4.0% TMA. The acceleration in prices was generally attributed to annual price increases that took effect in January for labor-reliant categories such as medical services (+0.7%), car insurance (+1.4%), car repair (0.8%), and daycare (0.7%). Many of these increases reflect the lagged effect of solid wage growth in 2023 and may slow in 2024 if wage growth slows. If wage growth remains robust, inflation will remain a concern.



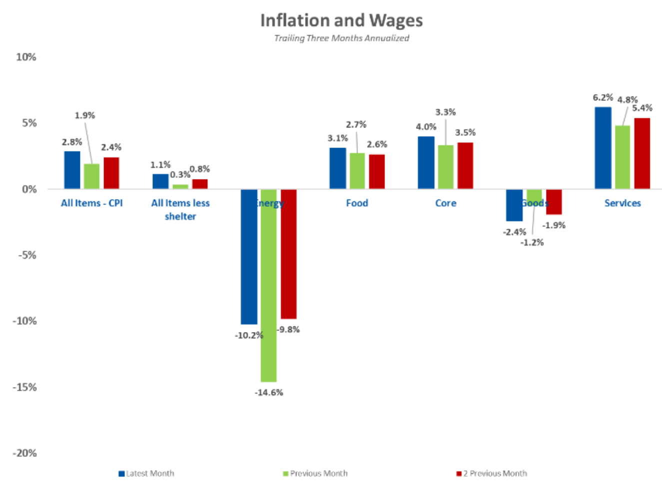
There is reason to believe that the subsequent 1.0% decrease in inflation may be significantly more challenging to achieve than the last 6.0%. The ISM prices paid indices are a good indicator of near-term inflation changes. Both indices eased slightly (lower cost pressure) in February but remained in expansion territory. Companies have limited room to hold the line or lower prices without sacrificing margins.

Energy prices fell 0.9% and are down 10.2% TMA. While geopolitical events can always roil energy markets, prices usually come down to supply and demand. The U.S. Energy Information Administration (EIA) forecasts that U.S. oil will remain stable for the next few years. U.S. production reached an all-time high of 13.3 million barrels per day (Mb/d) in December 2023. The EIA forecast U.S. production will average 13.1 Mb/d in 2024 and 13.5 Mb/d in 2025, which will be record



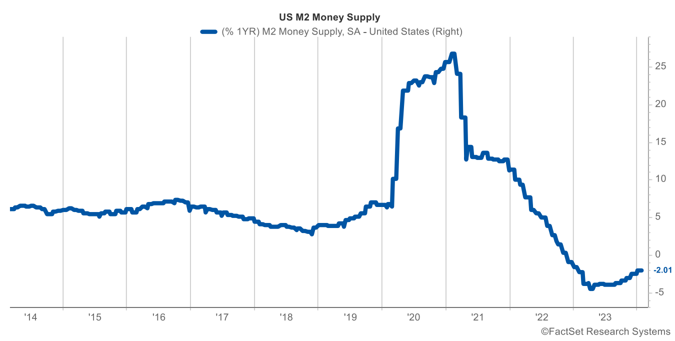
levels. Increased U.S. production will keep global energy markets balanced, which means stable prices.

Food inflation is reaccelerating. Food prices rose 0.4% and are up 3.1% TMA. Goods prices fell 0.3% in January and are down 2.4% TMA. New vehicle prices were up 0.3%, and used vehicles fell slightly. Used vehicle CPI fell by 3.4% and will likely continue moderating. The Manheim Used Vehicle-Price Index fell 1.0% in February and is down 15% from its March 2023 peak. New and used car prices should moderate through 2024.



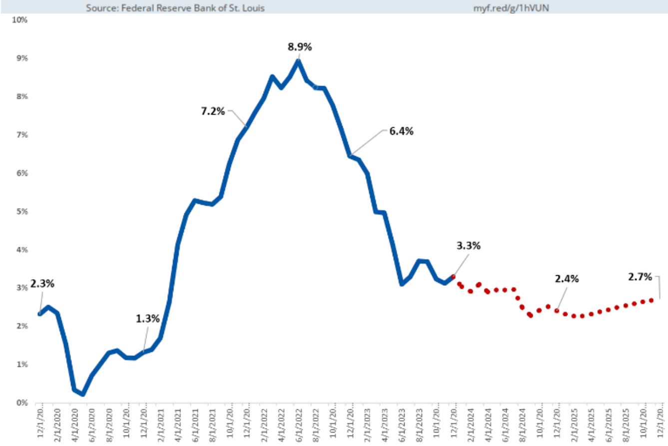
Service inflation was 0.7% and 6.2% TMA. Owners Equivalent Rent (OER) was up 0.6% and 6.0% TMA. OER has remained stickier than anticipated. We expect this part of service inflation to be moderate as statistics catch up with current market conditions. Wage-related inflation will likely remain sticky as wage growth has risen to the upside recently.

Milton Friedman, a nobel prize American economist and statistician 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" (Friedman, Causes and Consequences. First Lecture). Much of 2022's and 2023's inflation was caused by the rapid growth of the monetary supply in 2020 and early 2021. At its peak growth, the money supply grew at over 27% Y/Y. The money supply increased faster than output for three years, leading to inflation. The FRB slammed on the brakes in 2022. From March 2022 to March 2023, the money supply contracted 3.7%, or $0.8 trillion. Since March 2023, the money supply has remained relatively flat. A reasonably flat money supply is better than rapid shrinkage but insufficient for a growing economy. Based on the money supply, inflation and economic growth should 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 five-year break-even inflation rate peaked at 3.60% in March 2022. Inflation expectations have fallen to the current 2.4%. Inflation expectations continue to run above pre-pandemic levels and are slightly above the FRB's long-term target of 2.0%. This supports a higher-for-longer FFR and our view that long-term inflation will likely be closer to 2.8% than 1.8%.

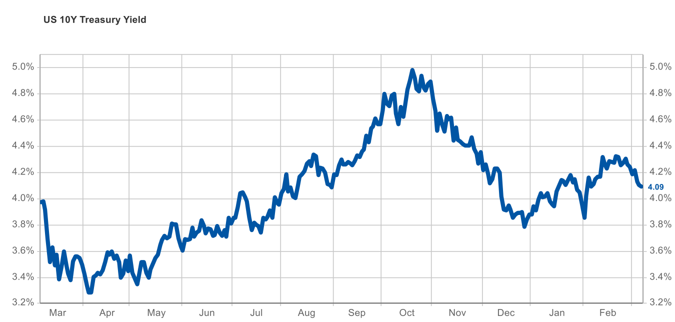
The graph on the right shows our most recent inflation forecast. We project that Y/Y headline inflation will bottom out just north of 2.0% in the third quarter, with core prices hitting a low of 1.8%. We expect inflation to rise from there slowly.



We believe the central tendency for inflation will be higher than in the pre-pandemic period, with higher lows. Under-investment in the commodity sector, deglobalization, hot wars (Ukraine and Israel), cold wars (China and Russia), and the shift to zero-carbon will cause inflation to be higher than in the pre-pandemic period. Higher and more volatile inflation will likely result in a higher interest rate environment.

Interest Rates and Credit Markets

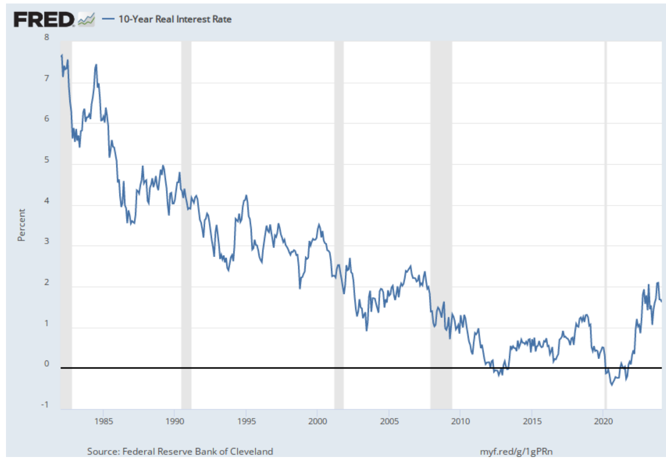
Yields move modestly higher across the curve in February. The two-year Treasury ended the month at 4.63%, up 41 basis points, while the 10-year ended the month at 4.24%, up 29 basis points.



Most of the increase occurred in the first half of the month in response to more robust economic data, especially the January jobs report. The FRB repeatedly warned investors that they are not likely to cut rates or stop shrinking its balance sheet at their next meeting.

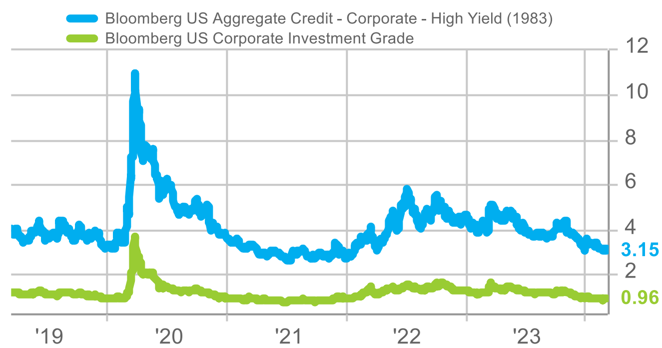
Congress will likely pass a bipartisan tax bill that expands the Child Tax Credit, restores full expensing of R&D, the 100% bonus depreciation, and allows higher interest deductions. The bill will likely require an extra $136 billion (0.5% of the Gross Domestic Product, GDP) financing in 2024. The IRS will also likely process an additional $150 billion (0.5% of the GDP) in Employee Retention Tax Credit payments, further adding to the deficit. An additional 1.0% fiscal stimulus will hit the economy this spring and summer. The extra stimulus may be enough to keep the FRB from cutting rates as growth reaccelerates.

The Congressional Budget Office (CBO) 2024 budget deficit will equate to 6.4% of the GDP, up from 5.3% in 2023. The U.S. Treasury increased its borrowing by $1.8 trillion over the past 12 months and $532 billion over the last four months alone. The Treasury is relying on a substantial increase in capital gains taxes, projected from a 25% return on the S&P1500 in the previous year, during this tax season to maintain the deficit below $2 trillion. Disappointing April tax receipts and the two stimulus measures outlined above will likely drive additional borrowings above $2 trillion, leading to higher rates in the second half of this year.



Real rates (nominal yields minus inflation) have returned to levels that prevailed before the financial crisis, 2%. After the financial crisis, real rates rarely rose above 1.0% and were often negative. The chart at the right illustrates the change in real rates. Real rates recently fell from 2.0% to 1.6%. We view real rates of 2.0% plus or minus 0.25% as sustainable. This implies that nominal rates can ease as inflation eases. We base our long-term ten-year rate (4.75%) on 2.0% real rates plus 2.8% inflation.

While risk-free rates have returned to adequate levels, credit spreads could be more attractive. During periods of financial stress, investment grade spreads often widen beyond 2.0%. During periods of exuberance, they fall below 0.8%. Investment grade spreads ended the month at 1.0%, even with the previous month. Investment grade spreads are discounting a soft landing. They are not signaling a recession or credit stress in large corporate America.

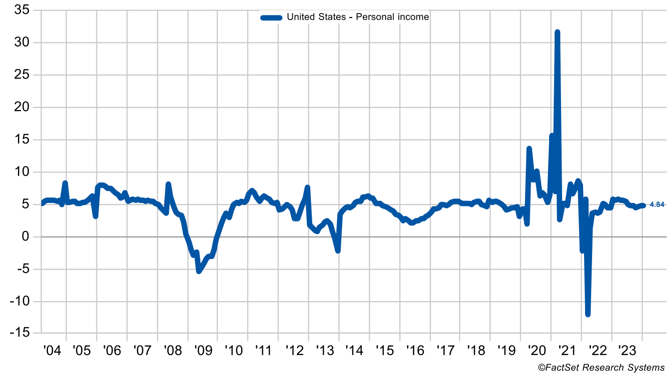


High-yield spreads tightened by 0.3% to 3.1%. During periods of economic stress, high-yield spreads often widen to above 8.0%. During periods of exuberance, they fall below 3.5%. Contrary to expectations, credit spreads have narrowed to "Goldie Locks" levels or levels that are perfect in moderation.

Over the last 18 months, many market participants, including us, called for a recession. Contrary to expectations, credit spreads did not widen as anticipated, failing to signal a recession. The credit markets proved to be more reliable than our forecasts. Our current projections are now more closely aligned with the signals from the credit market.

The Consumer Sector
Personal income rose 1.0% in January, while personal consumption expenditures rose 0.2%. The savings rate fell to 3.8%.

Personal income rose 1.0% M/M and was up 4.8% Y/Y. Private sector wages and salaries were up 0.3% M/M and 5.4% Y/Y. Wages for government workers rose 0.6% and 7.8% Y/Y. Interest income is up 5.3% Y/Y. Dividend income is up 5.9% Y/Y. After two decades of financial repression, fixed-income investors may finally receive adequate compensation. Disposable personal income was up 0.3% M/M and 4.6% Y/Y.



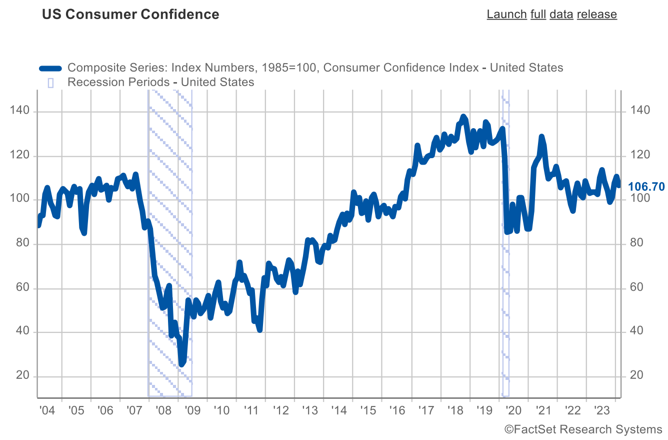
The savings rate was 3.8% in January, compared to 4.4% last year and the 7.0% level that prevailed before the pandemic. It is unlikely the savings rate will fall much further. This implies that real consumption will grow slightly slower than real disposable income over the next several quarters as consumers return to a more normal savings pattern.

Personal Consumption Expenditures				
	M/M		Y/Y	
	Nominal	Real	Nominal	Real
Durable Goods	-1.9%	-2.1%	-1.7%	0.7%
- Motor Vehicles and Parts	-4.6%	-3.7%	-6.5%	-6.1%
Non-Durables	-0.8%	-0.5%	2.5%	2.0%
- Gas and Other Energy	-4.6%	-1.4%	-2.2%	4.4%
Services	1.0%	0.4%	6.3%	2.3%
- Airline tickets	3.8%	3.8%	14.5%	12.0%
Total	**0.2%**	**-0.1%**	**4.5%**	**2.1%**

Personal Consumption Expenditures (PCE) were up 0.2% for the month but down 0.1% on a real basis after subtracting the impact of inflation. After several months of robust consumption, consumers finally took a break. Real expenditures rose a modest 2.1% Y/Y, led by a 12% increase in airline tickets. We expect personal consumption expenditures to grow this year at a 0.2% to 0.3% average monthly rate.

Demand for autos is down 6.0% Y/Y on a nominal and real basis. Most vehicles are purchased based on the ability to afford the monthly payment. Higher rates significantly raise the monthly payments, reducing consumers' ability and willingness to buy. We expect the auto sector to remain under stress until interest rates decrease.

Consumer confidence worsened in February. Dana Peterson, Chief Economist at The Conference Board, attributed the decline to "… persistent uncertainty about the U.S. economy," She also said, "The drop in confidence was broad-based, affecting all income groups except households earning less than $15,000 and those earning more than $125,000. Confidence deteriorated for consumers 35 and those 55 and over, whereas it improved slightly for those aged 35 to 54."



Peterson mentioned, "February's write-in responses revealed that while overall inflation remained the main preoccupation of consumers, they are now a bit less concerned about food and gas prices, which have eased in recent months. But they are more concerned about the labor market situation and the U.S. political environment."

The Consumer Confidence Index fell 4.2 points to 106.7. Confidence fell after three straight months of modest improvement. The present situation component fell by 7.7 points to 147.2, and the forward-looking expectation component fell by 1.7 points to 79.8.

Employment Confidence Slackened

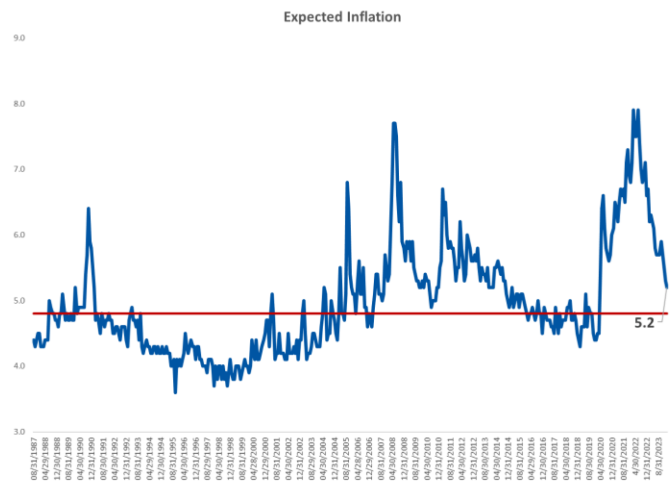
The current conditions net employment sub-index (plentiful minus hard to get) fell to 27.8 from 31.7 the previous month. Consumers' outlook for future employment also worsened as the net sub-index (more jobs minus fewer jobs) fell to -2.6 from 1.1 the previous month. Consumers' view of the labor market darkened last month.

Business Confidence Deteriorated

Consumers' perception of current business conditions deteriorated as the net sub-index (good minus bad) fell to 4.1 from 6.0 the previous month. Consumers' outlook for future business conditions fell slightly as the net sub-index (better minus worse) fell to -0.7 from 0.7 last month. Perceptions of future labor and business conditions indicate a slightly weaker economy.

Inflation Expectations Moderated.

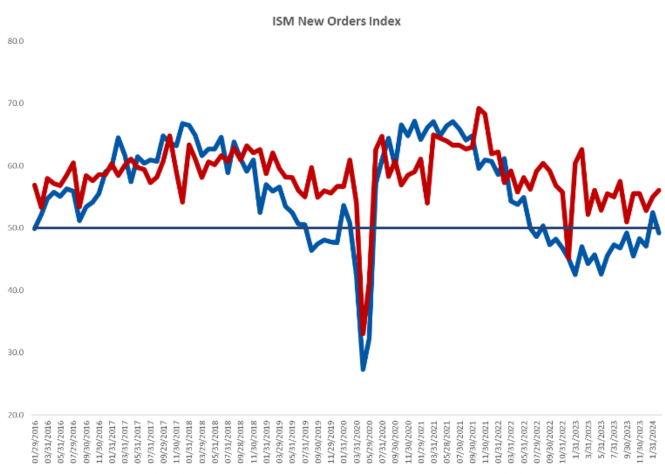
The Conference Board started asking consumers about inflation expectations in 1987. Consumers' expectations for inflation for the next 12 months improved. Consumers forecast inflation will be 5.2% in 12 months versus the 5.3% reported the previous month and 7.9% reported in June 2023. Inflation expectations are only slightly above the long-term median response of 4.8%. The FRB is making significant progress in moderating inflation expectations.



The Business Sector

The producer price index (PPI) is a government economic report prepared by the Bureau of Labor Statistics (BLS) that measures the change in prices domestic sellers receive for thousands of items and services. The PPI's primary use is to tell investors, businesses, policymakers and academics the direction of inflation. It is considered a leading economic indicator rather than a lagging one. If the PPI indicates producers are raising prices, then inflation will likely appear at the retail level of the economy. The magnitude of the shift indicates the rate at which inflation is either rising or falling. The Producer Price Index (PPI) gauges inflation from the seller's standpoint. In January, producer prices increased by 0.3% following a 0.1% decline in December. This January PPI reading suggests that inflation persists at a stable level.

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 New Orders Index is a leading indicator for the ISM Activities Index and the economy. This chart supports a continuing shallow manufacturing recession. The manufacturing new orders index dipped below 50 after a brief month in expansion territory. Previously, the index had been below 50 for 16 straight months. The manufacturing sector may be on the mend but is not booming. New orders in the service sector accelerated in January, indicating quickening growth in the much larger services sector.

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.

Activity in the service sector expanded in February but at a slightly slower pace. The Services Index fell 0.8 points to 52.6. The breadth of growth widened slightly as 14 industries reported growth versus 10 last month. Overall comments from the Institute of Supply Management report leaned toward sustained growth.

Employment contracted for the second time in three months. The employment index fell by 2.5 points to 48.0. 20.6% of respondents reduced employment, even with the previous month. 13.5% of respondents increased employment compared to 16.2% last month. Comments from respondents within the Institue of Supply Management report include: "We have lost employees due to normal attrition and are having issues backfilling these positions" and "Currently holding at post-peak employment levels; however, planning to bring in new associates as spring approaches."

Non-Manufacturing Sector	Direction	Rate of Change
Business Activity / Production	Growing	Faster
New Orders	Growing	Faster
Backlog of Orders	Growing	Slower
Employment	Contracting	From Growing
Prices Paid	Increasing	Slower
Supplier Deliveries	Faster	From Slower
Service Sector	**Growing**	**Slower**
Industries Expanding	14	+4
Industries Contracting	3	-4

Prices paid for materials and services rose at a slightly slower pace. Prices have risen for 81 consecutive months. The price component fell by 5.4 points to 58.6. Thirteen industries reported higher costs. Only three industries reported lower costs. 22.9% of respondents reported higher prices than 35.5% the previous month. 5.3% of respondents reported lower prices than 9.1% the previous month. The service sector continues to face inflationary pressures.

Activity in the manufacturing sector contracted for the 16th straight month. The manufacturing index fell by 1.3 points to 47.8 points. The sector continued to contract but showed signs of widening growth. Eight industries reported growth compared to only four last month, and seven reported contraction compared to 13 the previous month.

Employment contracted at an accelerating rate in the manufacturing sector. Over time, an Employment Index above 50.3% is generally consistent with an increase in manufacturing employment. The employment index fell by 1.2 points to 45.9. 18.6% of respondents reduced employment, up slightly from 18.4% the previous month. 10.9% of respondents increased employment compared to 11.0% the previous month.

Manufacturing Sector	Direction	Rate of Change
Production	Contracting	From Growing
New Orders	Contracting	From Growing
Backlog of Orders	Contracting	Slower
Employment	Contracting	Faster
Prices Paid	Increasing	Slower
Supplier Deliveries	Slowing	From Faster
Manufacturing Sector	**Contracting**	**Faster**
Industries Expanding	8	+4
Industries Contracting	7	-6

Prices paid for materials and services rose for the second month. The price component fell by 0.4 points to 52.5. Eleven industries reported higher costs. Four industries reported lower costs. 18.3% of respondents reported higher prices compared to 195% the previous month.

Prepared by Damian Howard March 12, 2024

13.4% of respondents reported lower prices compared to 13.8% the previous month. The recent increase in steel, ocean freight and energy prices are filtering into input prices. Freight costs are up in response to the drought in Panama and turmoil in the Red Sea. A sustained increase in input cost would pressure margins unless manufacturers raise prices due to inflation.

The manufacturing sector remains in a slight recessionary phase. While it's important to note that a single month doesn't establish a trend, signs suggest that the manufacturing recession might be approaching its conclusion. On the other hand, the service sector has thus far managed to steer clear of a recession.

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, which 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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