SUMMER 2024 OUTLOOK

SECURITY NATIONAL BANK
PRIVATE CLIENT SERVICES

Current Forecast	2023	2024 Est	2025 Est	2026 Est
GDP Growth	3.1%	1.5%	1.4%	1.7%
Change in Consumer Prices	3.3%	3.3%	2.7%	2.8%
Fed Funds Target Rate	5.50%	5.00%	4.00%	3.50%
5-Year Treasury Yield	3.85%	4.50%	4.25%	4.50%
10-Year Treasury Yield	3.84%	4.50%	4.75%	5.00%
S&P 500 EPS	$218	$237	$250	$263

Inflation may progress toward the Federal Reserve Board's (FRB) 2.0% goal but not sustainably remain below 2.0%. The consumer price index (CPI) will likely hover around 3.0%, and personal consumer expenditures price index (PCE) inflation will average 2.5%. We expect the FFR to stay at 5.5% through the third quarter before a series of rate cuts return it to the neutral level of 3.5% in 2026. We expect the 10-year treasury to end the year at 4.5%. Fiscal pressures will eventually lead to higher long-term rates. We expect earnings for the S&P 500 to post modest growth for several years.

Last Month's Rates and Total Returns				
May 31, 2024	Value	One Month	Year to Date	1 Year
Fed Funds Target (Upper)	5.50%	--	--	+25 bp
3-Month Treasury Yield	5.38%	--	+3 bp	-3 bp
2-Year Treasury Yield	4.87%	-16 bp	+62 bp	+48 bp
5-Year Treasury Yield	4.49%	-22 bp	+64 bp	+74 bp
10-Year Treasury Yield	4.49%	-19 bp	+61 bp	+85 bp
Mortgage News 30-Year	7.17%	-34 bp	+50 bp	+29 bp
S&P SuperComposite 1500	1,195	4.93%	10.85%	27.86%
S&P 500 Index	5,278	4.96%	11.30%	28.19%
S&P 500 Equal Weight Index	6,707	2.82%	5.55%	20.96%
S&P Midcap 400	2,982	4.39%	7.87%	25.97%
S&P SmallCap 600	1,330	4.96%	1.59%	20.34%
S&P 500 Growth	3,490	6.60%	15.50%	31.77%
S&P 500 Value	1,812	2.97%	6.48%	24.03%
World ex-US, net *	307	2.90%	5.79%	16.74%
Wilshire Liquid Alts	191	0.94%	4.85%	8.15%
BB U.S. Aggregate	89	1.70%	-1.64%	1.31%
Crude Oil – WTI Near Term	$77	-6.03%	7.45%	13.07%
Commodity Index	102	1.30%	4.41%	5.13%
FT Wilshire Bitcoin	$67,416	10.13%	59.44%	149.32%
Gold – Near Term	$2,323	1.37%	12.63%	18.28%
U.S. Dollar Index	105	-1.46%	3.29%	0.33%

**= MSCI ACWI ex the US in USD*

Prepared by Damian Howard June 10, 2024

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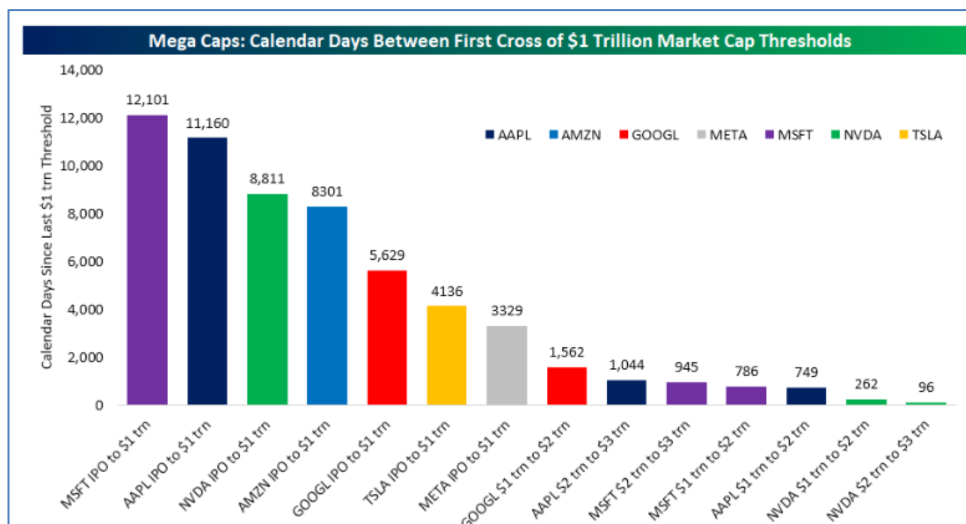
Security National Bank's Private Client Services Department authors a monthly economic forecast that provides our investment committee and the bank's funds management committee with background assumptions for use in investment decisions. We are pleased to share our economic outlook with you. Please be 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.

Rate Cut Timing

We have moved our forecast of the FRB's first rate cut back one meeting from July to September. We expect one cut at every other meeting, meaning the second cut will come in December. Recent speeches by FRB governors indicate that a July cut would require significantly softer economic data. The timing of the first cut is optional. The economy continues to grow at its long-term growth potential and is strong enough to allow the FRB to wait until next year if it chooses to. However, the longer the FRB waits, the more likely an unpredictable event will happen. The FRB must weigh the chances of reigniting inflation versus buying insurance against the unexpected.

Stock Market

Stocks rebounded in May, with the S&P 500 returning 5.0% and the broader S&P 1500 returning 4.9%. This brought the year-to-date (YTD) returns to 11.3% and 10.9%. NVIDIA accounted for 60% of the S&P 500's YTD return. NVIDIA was up 26.9% during the month and 121.4% YTD. Recently, NVIDIA saw its market capitalization surpass $3 trillion and now has the second largest weighting in the S&P 500 Index, second only to Microsoft and ahead of Apple. Bespoke Research noted that it took NVIDIA just 96 days to add $1 trillion in market capitalization. This represented a much faster pace of market capitalization appreciation than other well-known technology stocks such as Apple (1,044 days to climb from $2 trillion to $3 trillion market capitalization) and Microsoft (945 days). Over the last 10 years, NVIDIA has had a compound average return of 73.1% versus 12.7% for the S&P 500. The stock has been a once-in-a-generation investment. Your performance likely significantly trailed the market if your portfolio did not hold NVIDIA.



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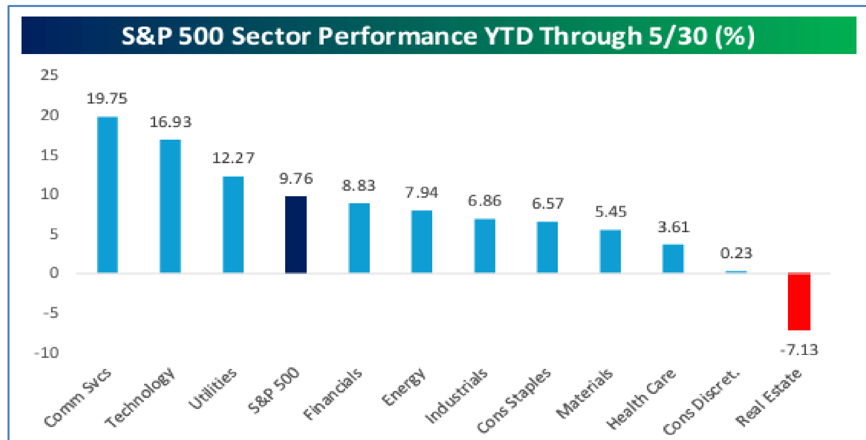
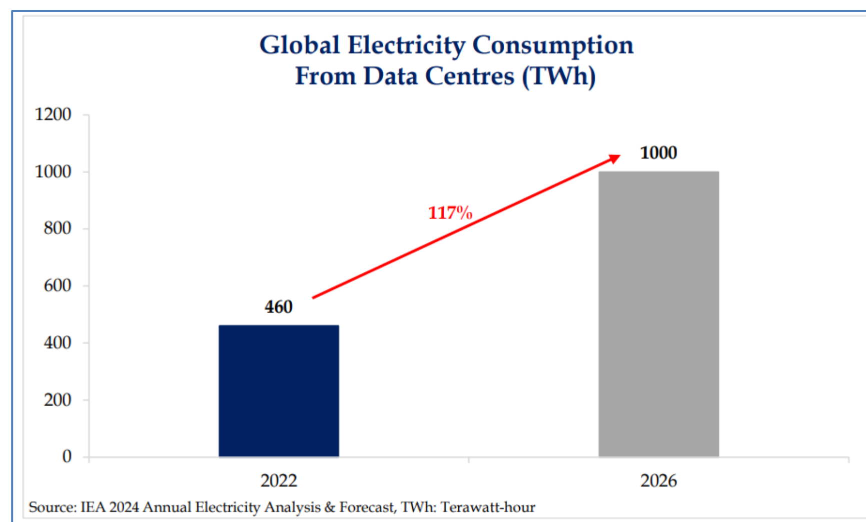


The overall market environment remains highly concentrated relative to historical patterns. Through the end of May, just three sectors have posted returns that have surpassed those of the overall market, including communication services, technology, and utilities, while eight sectors have trailed the overall market on a year to date (YTD) basis. While the technology and communication services sectors have posted solid returns for quite some time, the utilities sector represents a more recent source of market leadership. The outperformance of the utility sector originates from the belief that the growing adoption of artificial intelligence could meaningfully contribute to power demand within the United States (U.S.) and abroad during the coming years. While this thesis makes sense conceptually, several uncertainties still exist around this thesis, ranging from the potential for future advancements in power consumption in AI-related chips/training models to the potential resistance from consumers regarding higher utility bills.



Meanwhile, small-cap stocks returned 5.0%, matching their larger brethren's performance. However, they still trail by a large margin on a YTD basis. Mid-cap stocks returned 4.4% for the month and are up 7.9% YTD. U.S. fixed income returned 1.7% for the month but is down 1.6% YTD.

International Stock Returns

Last month, international stocks rose 1.9% in local currencies and 2.9% when translated into U.S. dollars. international stocks rose 9.9% in local currencies YTD, but only 5.8% when translated into U.S. dollars. The 4.1% difference is due to changes in the dollar's value. Last month, the U.S. dollar index fell 1.5% but was up 3.3% YTD. A rising or falling dollar hurts or helps dollar-denominated returns for international stocks.

Over the short term, the direction of the U.S. dollar is influenced by U.S. interest rates compared to global rates and relative economic growth. The dollar was on a weakening trend. However, a divergence in monetary policy is keeping the dollar strong. The European Central Bank (ECB) and Canada's central bank have begun their easing cycle. Higher U.S. interest rates are attracting more foreign investment into the U.S., keeping the dollar strong. This pattern will likely hold until the FRB cuts rates. A strong dollar will be a headwind for international stocks and bond performance.

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Fixed Income Returns
Interest rates fell across the curve last month. The U.S. Aggregate Index rose 2.5%, and the Global Aggregate Fixed-Income rose 1.3%. YTD. The U.S. fixed income is down 1.6%, while the Global Aggregate Fixed-Income is down 3.3%.

Over the last 30 years, the U.S. experienced a terrorist attack, 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. We list the longer-term returns for the broad stock and bond markets each month. This table reminds us to focus on the long term.

Annualized Total Return					
	One Year	Five Years	Ten Years	Twenty Years	Thirty Years
Stocks	27.9%	15.4%	12.4%	10.2%	10.8%
Bonds	1.3%	-0.2%	1.3%	3.1%	4.5%

The table also illustrates the return advantages of stocks for those who can tolerate volatility. Fixed income has been disappointing over the last 10 years. We hope the era of financial repression (zero interest rates) is finally over. With the 10-year treasury at 4.5%, fixed-income investors should expect a 4.0% to 6.0% total return from a diversified fixed-income portfolio. The current yield of 5.0% on investment-grade corporate bonds should offset any principal degradation from volatile rates.

Interest Rate Policy
At the May 1 press conference, Chairman Jerome H. Powell stressed that the FRB is not considering raising rates and is not likely to cut rates soon. Inflation remains stubbornly high, and the Federal Open Market Committee (FOMC) is not seeing enough progress toward its 2.0% inflation goal. The next FOMC rate decision will be made on June 12. The FOMC will undoubtedly vote to maintain the FFR at its current level. There is less than a 1.0% chance the FOMC will cut interest rates on June 12. They may provide additional insight into when the initial rate cut will occur.

Meeting Date	Futures Market 06/07/2024	SNB Forecast
June 12	5.50%	5.50%
July 31	5.50%	5.50%
September 18	5.25%	5.25%
November 7	5.25%	5.25%
December 18	5.00%	5.00%
January 29	5.00%	5.00%
March 12	4.75%	4.75%
April 30	4.75%	4.75%

As stated earlier, we moved our forecast of the FRB's first rate cut back one meeting from July to September. The futures market puts the odds of a September rate cut at 59%. We expect one cut at every other meeting, meaning the second cut will come in December. The table above shows that our FFR forecast is the current consensus. While it makes us nervous to have a consensus outlook, it is probably the most likely scenario.

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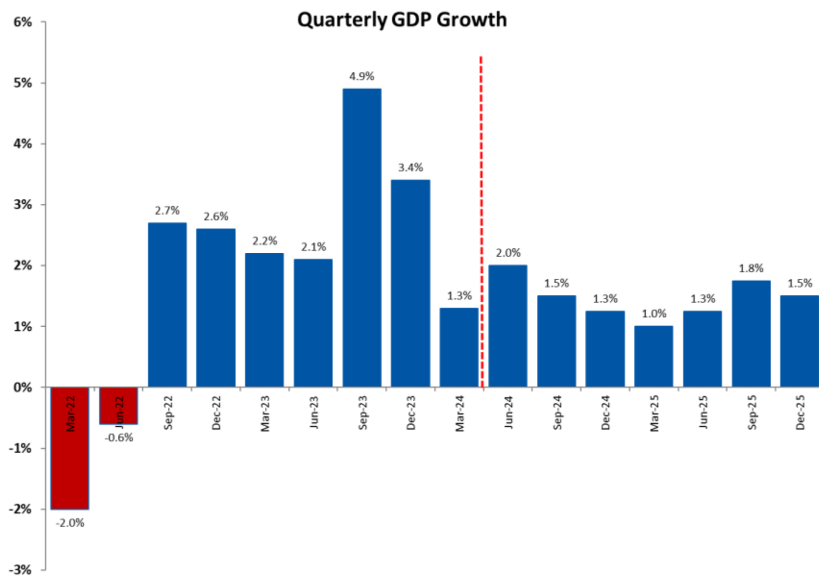
Recent Economic Reports

The chart at the right shows that economic reports have been disappointing and below expectations. The Citi Economic Surprise Index compares economic reports with expectations. When the line falls, actual results are less favorable than expectations. The graph summarizes many economic reports into an easily understood graph. In general, growth is slower than expected. For now, softer economic growth is good for stocks and bonds. The growth implies that the FRB is slowly succeeding in the economy enough to tame inflation. At some point, slower economic growth may raise the concern of a recession, but we are not there yet.

Economic Growth

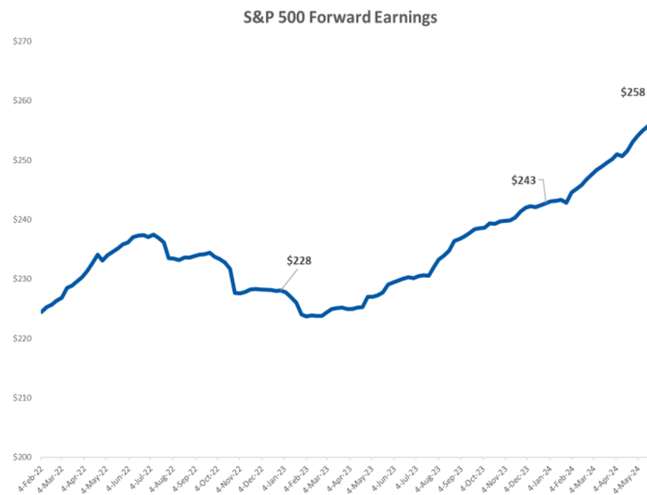
While reported first-quarter growth was a bit muted at 1.3%, core economic growth was more robust at 2.4%. Core economic growth strips out the impact of inventory flows, net exports, and government purchases, which we view as a more accurate picture of underlying growth momentum. More recent data implies slower economic growth. We expect the second quarter's growth to print at 2.0%. Growth is likely to slow in the fall and winter months.



There is ample evidence that consumers have slowed their consumption. Pandemic-related savings are gone, and credit card debt is close to its upper limit. In addition, job growth is expected to slow. The economy grew 3.1% during the fourth quarter of last year. We forecast the economy will grow 1.5% this year, compared to the 1.7% FactSet consensus growth forecast.

Stock Earnings Forecast

Among S&P 500 constituents, 98% have reported first-quarter earnings results. First-quarter earnings were up 6.0% over last year's first quarter, slightly better than the 5.3% expected at the start of the quarter. Revenue was up 4.3% year over year (Y/Y) compared to the expected 4.4%. Over the year's first five months, the expected 2024 earnings per share (EPS) has held relatively steady. Usually, earnings expectations fade as the year progresses.

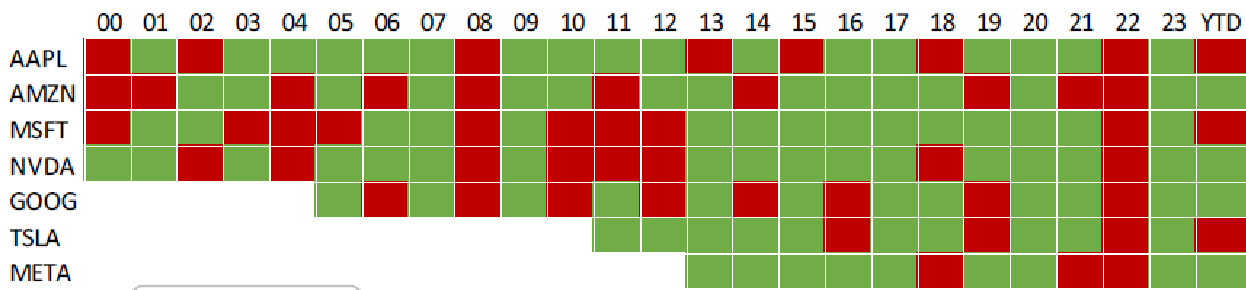


The chart on the right shows consensus forward earnings for the S&P 500. Forward earnings are up 6.1% YTD. Stock prices generally follow forward earnings. When earning expectations rise, stock prices typically rise. This year's strong market returns are supported by solid earnings growth.

We raised our earnings estimates to incorporate better-than-expected corporate earnings and economic growth. We now expect the S&P 500 to earn $237 this year and $250 next year. The S&P 500 currently trades at 20.5 times forward earnings (P/E). As shown in the chart at the right, the current multiple aligns with recent multiples but is significantly ahead of longer-term market multiples. It is unlikely that the market's multiple will expand from here. This implies that earnings growth and dividends will drive stock market returns. A 7% annual total return over the next several years seems reasonable.

Market P/E	
Current	20.6X
1-year	19.5X
5-Year	19.4X
10-Year	17.6X
20-Year	15.5X

Outperformance Is Not Guaranteed …
Even For The Most Successful Companies In The World



Despite Consistently Strong Fundamentals, Sometimes These Stocks Underperform Because The Macro Backdrop Favors Other Types Of Stocks

Finally, we would like to point out a chart that Piper Sandler's Portfolio Strategy team recently published. Even the best companies will have extended periods of underperformance. Microsoft's and NVIDIA's stocks underperformed for three straight years, and all the great company stocks underperformed in 2008

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and 2022. We strive to invest in great companies and hold on to them for the long term. We may trim the positions to maintain diversification but rarely sell them. These companies are great compounders but do run into occasional rough patches.

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

Clinton Rushing, CFA
VP, Senior Investment Officer

Lauren Mozur
Investment Officer

Please see the obligatory disclosures at the bottom of each page and 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," (Steelman, 2011). For this reason, we always start our economic review with employment followed by inflation.

Employment

Please remember that the labor market is a lagging indicator. Job losses typically occur after the economy enters a recession. The May employment report was more substantial than expected. The private sector added 229,000 jobs, significantly more than the 12-month moving average of 178,300 and the three-month moving average of 206,300. Job growth above 90,000 is considered strong. Layoffs and new unemployment insurance claims remain muted. Wage growth reaccelerated to 0.4%. The April's Turnaround Management Association of 4.1% for wage growth is above the FRB's target of 3.5%. The report marginally reduces the chances of a rate cut in September. There is still plenty of data to digest between now and then.

We begin our employment review by examining the Job Openings and Labor Turnover (JOLTS) report published by the Bureau of Labor (BLS). The report 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	Long-Run
Open Positions	8,059	8355	9,904	
Open/Unemployed	1.2X	1.3X	1.7X	0.9X
Open Rate *	5.0%	5.2%	6.3%	4.4%
Hire Rate *	3.9%	3.9%	4.2%	4.1%
Lay-Off Rate *	1.1%	1.1%	1.2%	1.4%
Quit Rate *	2.4%	2.4%	2.6%	2.4%

* Private Sector

The April JOLTS was weaker than expected. The consensus was for 8,360 job openings. The ratio of openings to unemployed individuals fell to 1.2X. This ratio aligns with the 1.2X ratio that prevailed before the pandemic but above the long-term average of 0.9X. The hire rate held steady at 3.9% and was below the long-term average. The layoff rate remained below the long-run average. This rate indicates that employers are retaining their talent, creating a low layoff rate, but are unable to or unwilling to expand payrolls. This is consistent with Institute for Supply Management (ISM) and other survey data. It also contradicts the headline narrative of increased layoffs.

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 of nine months. The lower quit rate should lead to lower wage growth in the second half of this year. Based on the JOLTS report, the labor market is weakening but remains healthy. Wage growth should continue to moderate, eventually reducing the services inflation.

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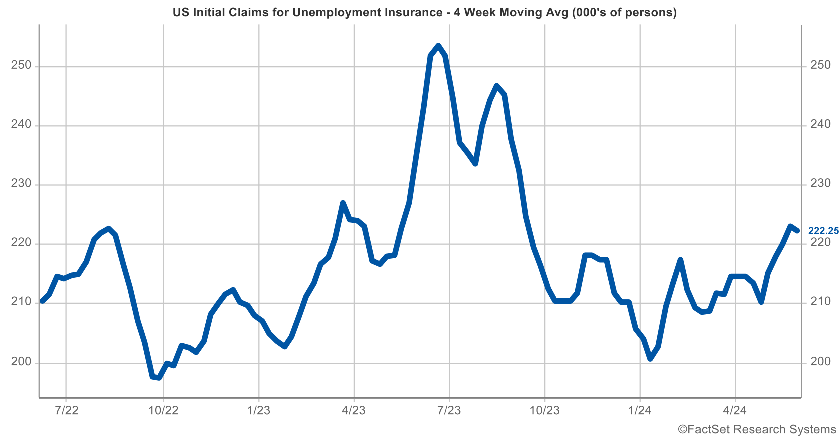
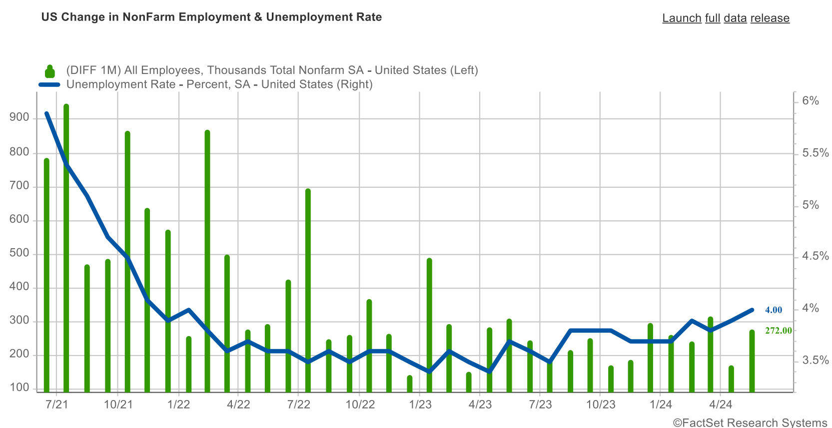
Initial jobless claims for May 31, 2024, were 229,000, bringing the four-week average to 222,250. Continuing claims rose slightly to 1,792,000. While up from their January lows, initial claims are significantly below last year's peak and would need to rise above 300,000 before unemployment would increase dramatically. The continued low level of jobless claims indicates a still robust labor market.



The Bureau of Labor Statistics (BLS) reported that the number of jobs either rose by 272,000 or fell by 408,000 in May. The Establishment Survey puts the job gains at 272,000 versus the consensus estimate of 180,000 jobs added. The volatile Household Survey indicates that the economy lost 408,000 jobs. The Household Survey puts the 12-month gain in employed individuals at only 376,000, while the Establishment Survey estimates the economy added 2.76 million positions over the last 12 months. The two surveys have a 2.4 million variance. There is a substantial difference between the two surveys. Most economists emphasize the Establishment Survey, but there is enough difference to provide evidence for both the bull and the bear case.

Establishment Survey payrolls for the previous two months were revised lower by only 15,000, a relatively modest revision. The unemployment rate rose by 0.1% to 4.0% as the number of unemployed persons increased by 157,000, and the labor force contracted by 250,000. May breaks a 27-month streak of sub 4.0% unemployment. The participation rate fell by 0.2% to 62.5%. Hourly earnings rose by 0.40%, substantially above the consensus estimate of 0.3%.

According to the Establishment Survey, the economy added 272,000 jobs, 229,000 of which were in the private sector. The consensus was for 180,000 and 165,000 new jobs in the private sector. Job growth was substantially above consensus.



Job gains were concentrated in the following sectors: healthcare, with 68,300 jobs added, local government, with 34,000 jobs added and food service, with 24,600 jobs added. Employment in temporary services contracted 14,100 jobs. Over the last two years, temporary services shed 372,000 employees.

The unemployment rate rose to 4.0% as officially unemployed persons increased by 157,000 to 6,649,000. Much of the increase came from the 16- to 19-year-old cohort, which saw the unemployment rate rise from 11.7% to 12.3%. This cohort is volatile and has complex seasonal adjustments. They tend to drift in and

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out of the labor market. The 25-year-old and older cohort's unemployment rate remained steady at 3.2%. The broader U-6 unemployment rate has been held at 7.4%. May marked the 31st month below 8.0%.

The participation rate dropped to 62.5%. The participation rate was 63.3% in February 2020. The employment-to-population ratio fell to 60.1% (down 0.1%). This number was 61.1% in February 2020.

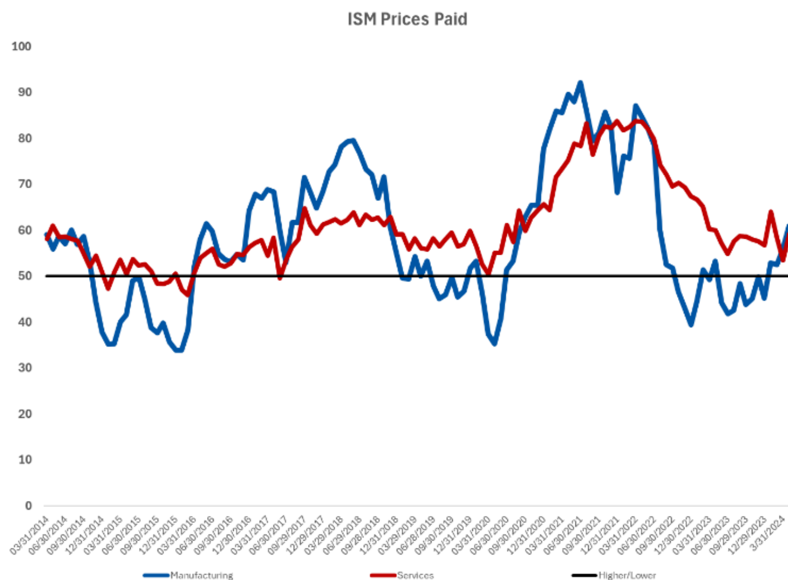
Last month's average hourly earnings (wages) rose by $0.14 per hour to $34.91, up 0.40%, above the consensus estimate of 0.3%. Average hourly earnings are up $1.37 per hour or 4.08% Y/Y. Over the last three months, average hourly earnings grew at a 4.1% pace, up significantly from 3.0% the previous month. The last two months' wage figures were also slightly revised, as TMA wage growth was initially reported at 2.8%. The FRB wants wage growth to stay below 3.5% for an extended period. Wage growth remains above the FRB's target, delaying any rate cut decision.

The average workweek held steady at 34.3 hours, down 0.1 hours Y/Y. Average weekly earnings rose by $4.80, or 0.40%, from the previous month and are up $43.63, a 3.78% increase Y/Y. Total payroll (number employed individuals times average hourly earnings times average weekly hours) was up 0.2% month over month (M/M) and 4.0% Y/Y.

The stronger-than-expected Employment Report was not strong enough to change the narrative materially. The report suggests the labor market remains strong but is not overheating. The initial rate cut is not expected until September. There will be multiple inflation and employment reports between now and then.

Inflation

The next FOMC interest rate decision and the following Consumer Price Reports will be announced on June 12. It is unlikely the upcoming report will factor into the FOMC's decision. We expect prices to moderate but remain above target, reinforcing the higher-for-longer narrative.



The ISM prices paid indices are also a good indicator of near-term inflation changes. It may lead to the Producer Price Index (PPI) by a month or so. Both the services and manufacturing indices fell in May. The percentage of respondents who saw lower prices rose slightly, and the percentage of respondents who saw higher prices decreased. The ISM reports hint at easing inflationary pressures. We will watch if the weaker ISM translates into lower PPI and eventually lower consumer inflation.

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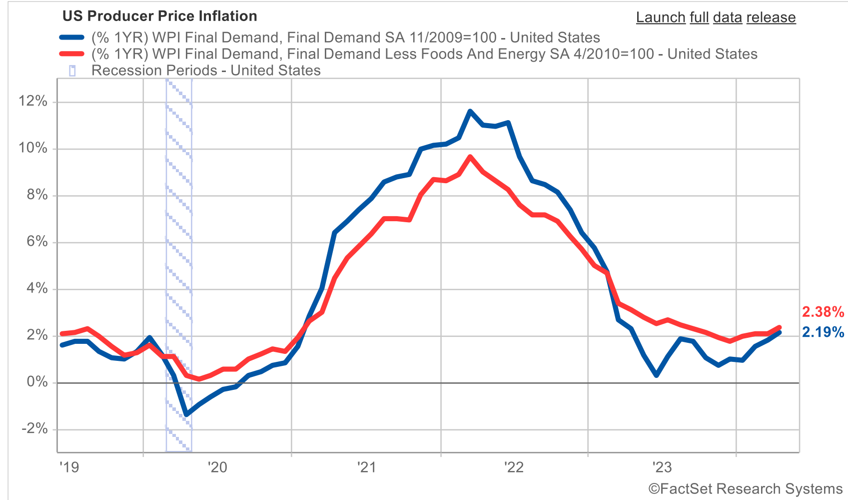
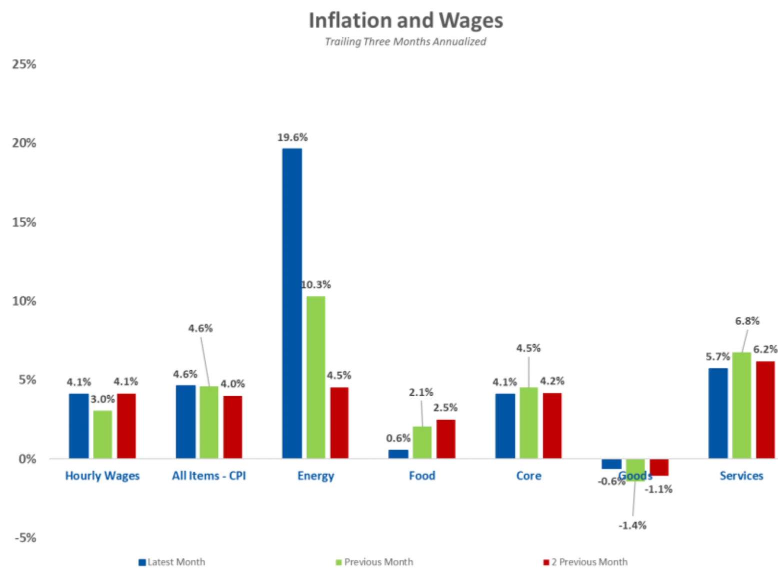


The PPI is a government economic report prepared by BLS that measures the change in prices domestic sellers receive for thousands of items and services. The PPI's primary use is to tell investors, businesses, policymakers and academics about the direction of inflation, and is considered a leading economic indicator. If the PPI indicates producers are raising prices, then inflation will likely appear at the retail level of the economy. The size of the change suggests the amount that inflation is increasing or decreasing. Producer prices rose 0.5% in April after declining 0.1% the previous month. The March PPI was revised down from 0.2% to -0.1%. Wholesale and intermediate goods inflation appears to be sticky. We shall see if the weaker PMI numbers flow through to the PPI.

The CPI rose 0.3% in April and 4.6% on a Trailing Three-Month Annualized (TMA). Core prices rose 0.3% and were up 4.1% TMA. All items less food, energy and shelter rose 0.2% M/M and 3.4% TMA. Cumulative inflation has been 21.1% since the end of 2019. During this same period, disposable per capita income has risen 23.1%. Cumulative core inflation has been 19.4% over the same period.

Food inflation decelerated. Food prices were up 0.02% M/M and 0.6% TMA. Cumulative food inflation has been 26.0% since the end of 2019.



Energy prices rose 1.1% M/M and 19.6% TMA. Cumulative energy inflation has been 31.4% since the end of 2019.

Goods prices fell 0.1% M/M and 0.6% TMA. Cumulative goods inflation has been 14.6% since the end of 2019.

New vehicle prices were down 0.5% M/M and 2.8% TMA, while used vehicle prices fell 1.4% M/M and 7.7% TMA. The Manheim Used Vehicle-Price Index rose 0.4% in May but is down 16.4% from its March 2023 peak. We expect both new and used car prices to moderate through 2024.

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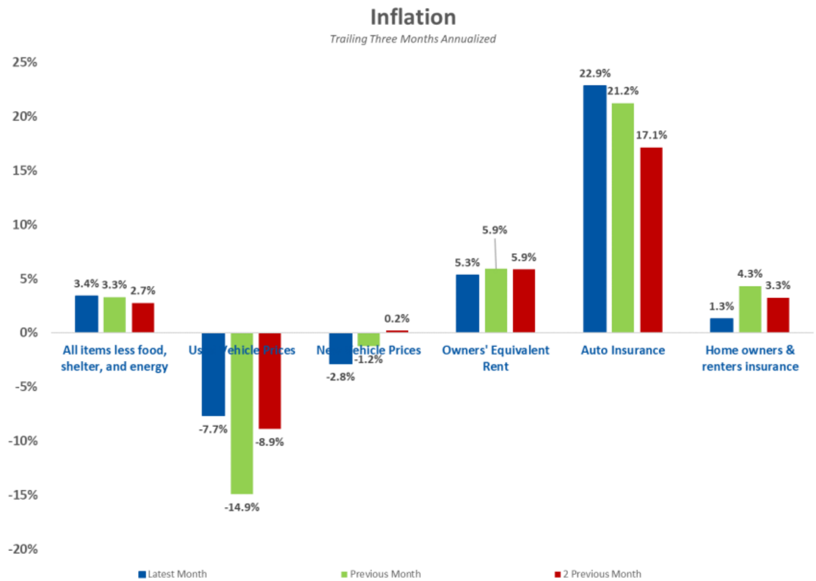
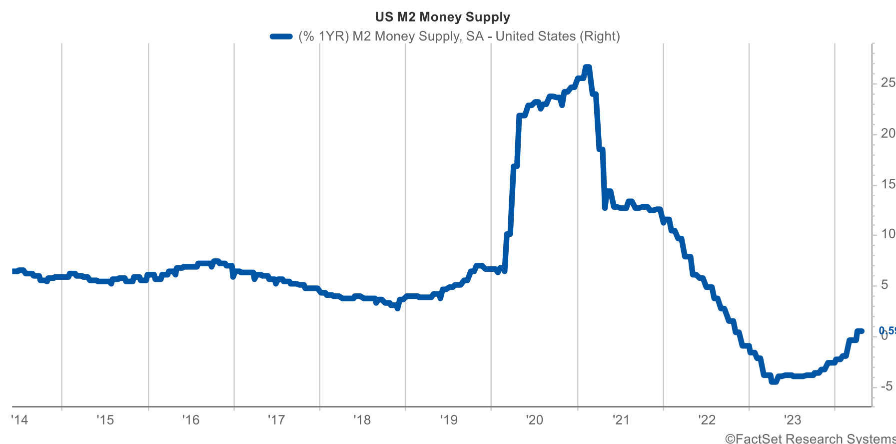
Service inflation was 0.4% M/M and 5.7% TMA. Cumulative goods inflation has been 21.2% since the end of 2019. Owners Equivalent Rent (OER) was up 0.4% M/M and 5.3% TMA. OER has remained stickier than anticipated. Cumulative OER inflation has been 35.5% since the end of 2019.



One painful reality is the cost of insurance. Since state regulators approve most insurance rates, there is usually a delay in premium inflation. We are currently in the catch-up phase for auto insurance. Today's skyrocketing rates reflect previous years' new and used car inflation. Cumulative automobile inflation has been 45.9%, and cumulative home insurance inflation has been 23.5% since the end of 2019. Auto insurance premiums were partly driven by the 48.8% cumulative inflation in auto repair costs.

Milton Friedman 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 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. The 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.



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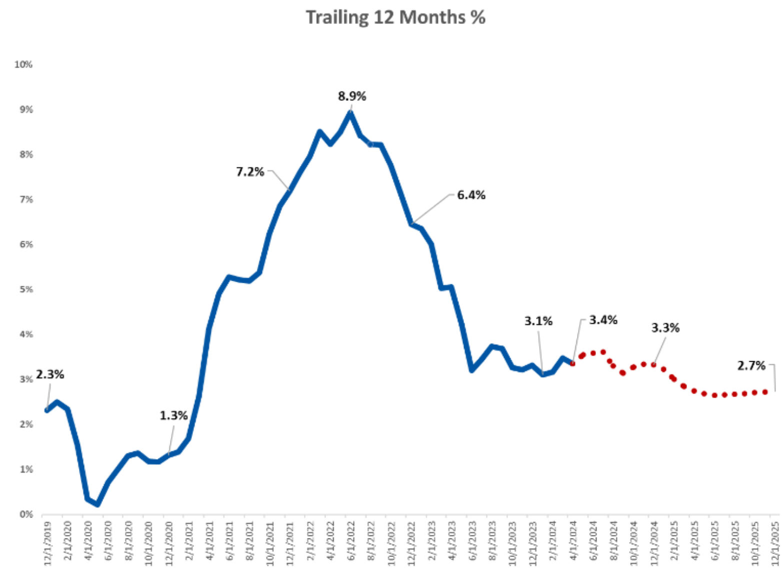
Because inflation statistics are lagging indicators, economists use forward-looking inflation expectations. The Breakeven Inflation Rate implies what market participants expect inflation to be in the next five years, on average. The five-year Breakeven Inflation Rate peaked at 3.6% in March 2022. Inflation expectations have fallen to the current 2.4%. The core PCE tends to run about 0.3% lower than the CPI used in this measure. Inflation expectations exceed pre-pandemic levels but are close to the FRB's long-term target of 2.0%. The FRB's higher-for-longer stance has anchored financial market participants' medium-term inflation view. We forecast long-term inflation to be closer to 2.8% than 2.0%.

The graph on the right shows our most recent CPI inflation forecast. May, June and July 2023 saw benign inflation prints of 0.1% and 0.2%. This creates some difficult comparisons as these prints roll off the 12-month average. This is called the base effect. This is also why Y/Y inflation will likely stall from 3.3% to 3.5% until the end of the year.
We project that Y/Y headline inflation will remain around 3.3% and fall to 2.7% next year.



We believe the central tendency for inflation will be higher than in the pre-pandemic period, with higher lows. Under-investment in the commodity and energy sectors, deglobalization, hot wars like Ukraine and Israel, cold wars like 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.

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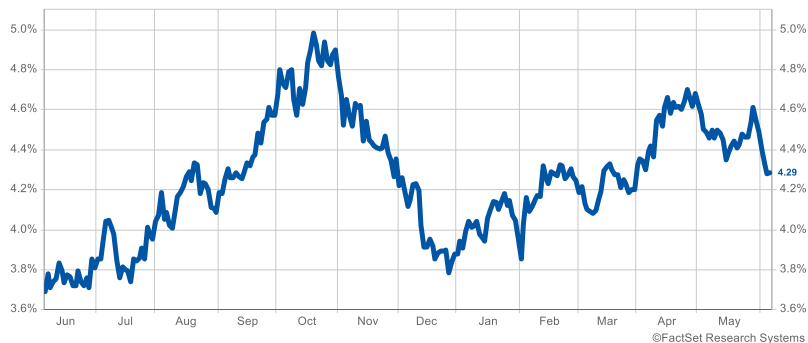
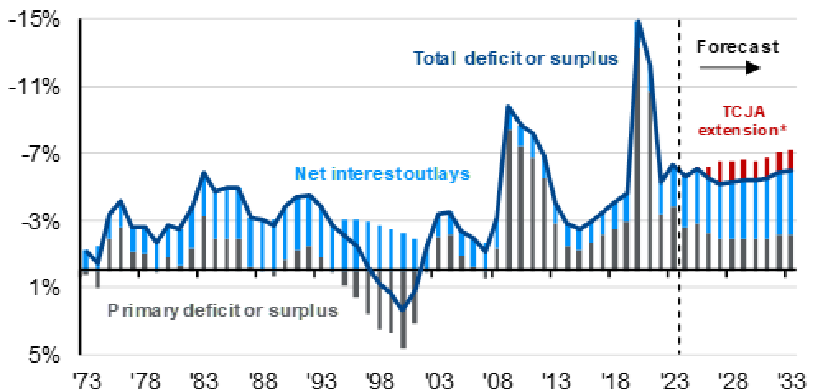
Interest Rates and Credit Markets

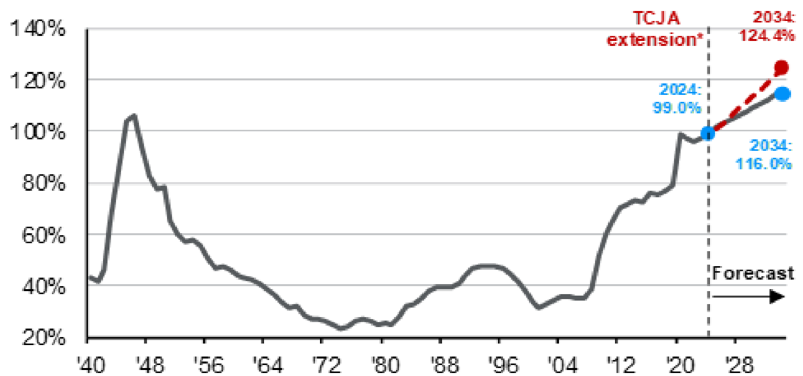
Yields moved lower across the curve in May. The three-month treasury remains anchored by the 5.5% FFR. The two-year treasury ended the month at 4.87%, down 16 basis points, while the 10-year ended at 4.49%, down 18 basis points.



Real rates (nominal yields minus inflation) have returned to 2.0%, a level that prevailed before the financial crisis. After the financial crisis, real rates rarely rose above 1.0% and were occasionally negative. The 10-year real rate is currently 2.10%. Negative real rates generally lead to a misallocation of capital and asset bubbles.



We view real rates of 2.0% plus or minus 0.25% as sustainable. This implies that nominal rates are likely near long-term averages as we forecast inflation to average 2.8%. We base our long-term 10-year rate (4.75%) on 2.0% real rates plus 2.8% CPI inflation.



We have added 0.25% to the long-term 10-year rate to incorporate the fiscal deficit and growing debt burden. Our 2026 10-year treasury rate projection is 5.0%. The rising debt burden is likely to cause treasury rates to drift up over time. The charts on the right, courtesy of J.P. Morgan Asset Management, illustrate the federal government's worsening financial condition.

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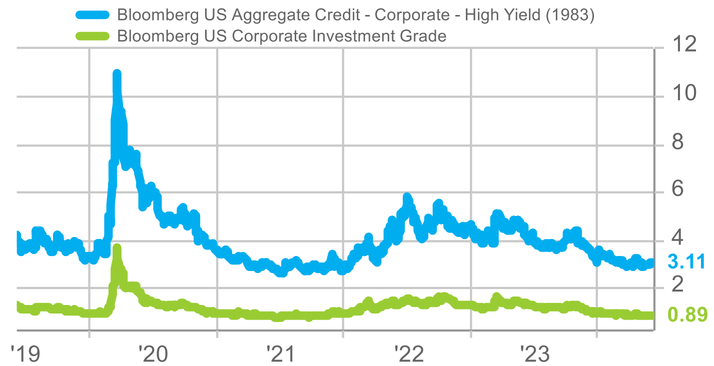
While risk-free rates have returned to adequate levels, credit spreads could be more attractive. During periods of financial stress, investment grade spreads often widen beyond 2.0%. During periods of exuberance, they fall below 0.8%. Investment grade spreads ended the month at 0.9%, down two basis points M/M. Investment grade spreads discount continued strong economic growth. They are not signaling a recession or credit stress in large corporate America.

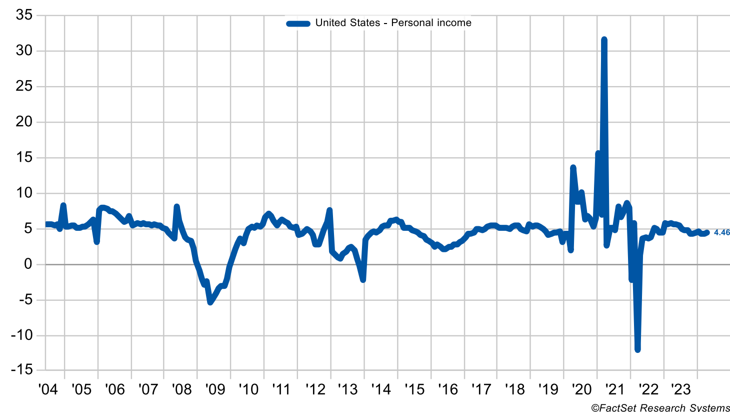


High-yield spreads widened by seven basis points to 3.1%. During periods of economic stress, high-yield spreads often widen to above 8.0%. During periods of exuberance, they fall below 3.5%. We currently classify high-yield spreads as highly exuberant. High-yield credit spreads forecast a "Goldie Locks" economy.

The Consumer Sector

Personal income rose by 0.3% in April, while personal consumption expenditures rose by 0.2%. The savings rate held steady at a revised 3.6%.

Personal income rose 0.3% M/M and 4.5% Y/Y. Private sector wages and salaries were up 0.2% M/M and 4.2% Y/Y. Wages for government workers rose 0.5% and 8.6% Y/Y. Interest income was up 0.4% M/M and 3.3% Y/Y. Dividend income was up 0.3% M/M and 0.9% Y/Y. Disposable personal income was up 0.5% M/M and 1.3% Y/Y. Wage growth is slowing to pre-pandemic levels.



The savings rate was 3.6%, compared to a revised 3.6% last month, 5.2% the previous year and the 7.0% level that prevailed before the pandemic. It is unlikely that the savings rate will fall much further. This implies that real consumption will grow slower than real disposable income over the next year as consumers return to a more normal savings pattern.

Disposable personal income (DPI) is a household's paycheck after income and social security taxes. It pays for everything else. DPI rose modestly on a nominal basis but fell when adjusted for inflation. Y/Y growth in DPI did not keep pace with purchases, necessitating reduced savings or increased debt usage. Over the long term, consumption cannot grow faster than DPI.

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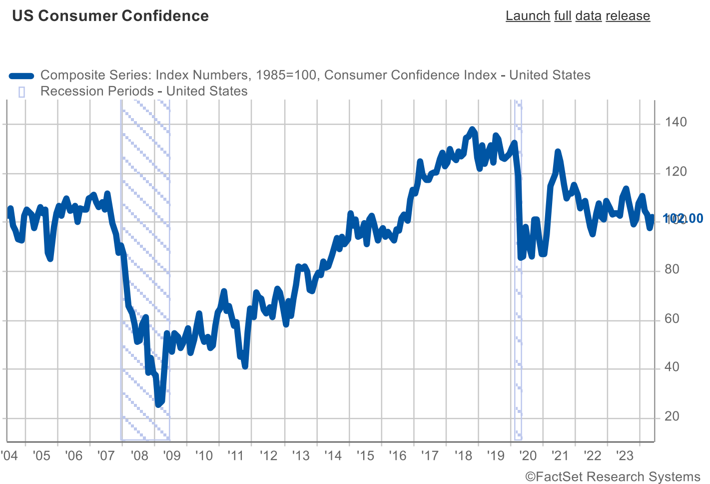
Personal Consumption Expenditures				
	M/M		Y/Y	
	Nominal	Real	Nominal	Real
Disposable Personal Income	0.2%	0.0%	3.7%	1.0%
Durable Goods	-0.3%	-0.1%	-0.1%	2.1%
- Motor Vehicles and Parts	0.8%	1.4%	-5.7%	-3.8%
Non-Durables	-0.1%	-0.5%	3.2%	1.8%
- Gas and Other Energy	-0.1%	-2.5%	0.6%	-1.9%
Services	0.4%	0.1%	7.0%	2.9%
- Restaurants	0.2%	-0.1%	6.2%	2.1%
Total	**0.2%**	**-0.1%**	**5.3%**	**2.6%**

PCE were up only 0.2% for the month and down 0.1% on a real basis (after subtracting the impact of inflation). Real consumption growth was negative for the month. Consumers have pulled back, especially in the goods sector. The slowdown in real gasoline consumption (-3.1% M/M and -2.1% Y/Y) indicates a weakening consumer. The cumulative impact of inflation has disproportionately hurt lower-income consumers. We expect PCE to grow at a 0.2% to 0.3% average monthly rate. Last month's report was in line with our expectations. The PCE is slightly less than our income growth expectations as consumers need to rebuild their savings rate.



The Consumer Confidence Index (CCI) rebounded in May to 102.0 from 97.5. Before last month's rebound, confidence had fallen for three straight months. The present situation component rose by 2.5 points to 143.1, and the forward-looking expectation component rose by 5.8 points to 74.6.

Employment Confidence Improved

The current conditions net employment sub-index (plentiful minus hard to get) rose to 24.0 from 22.9 the previous month. Consumers' outlook for future employment worsened as the net sub-index (more jobs minus fewer jobs) rose to -5.6 from -7.5 the last month. Consumers' views of the labor market improved after three months of deteriorating.

Business Confidence was Mixed

Consumers' perception of current business conditions weakened slightly as the net sub-index (good minus bad) fell 2.7 from 3.2 the previous month. Consumers' outlook for future business conditions fell as the net sub-index (better minus worse) rose to -3.5 from -5.7 last month.

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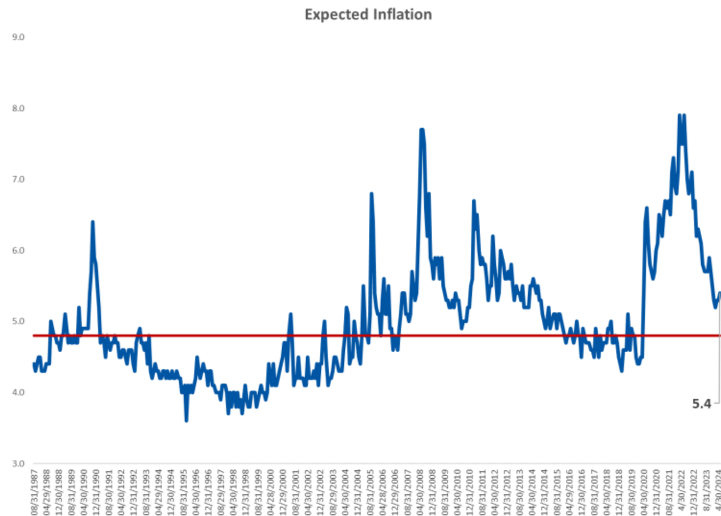
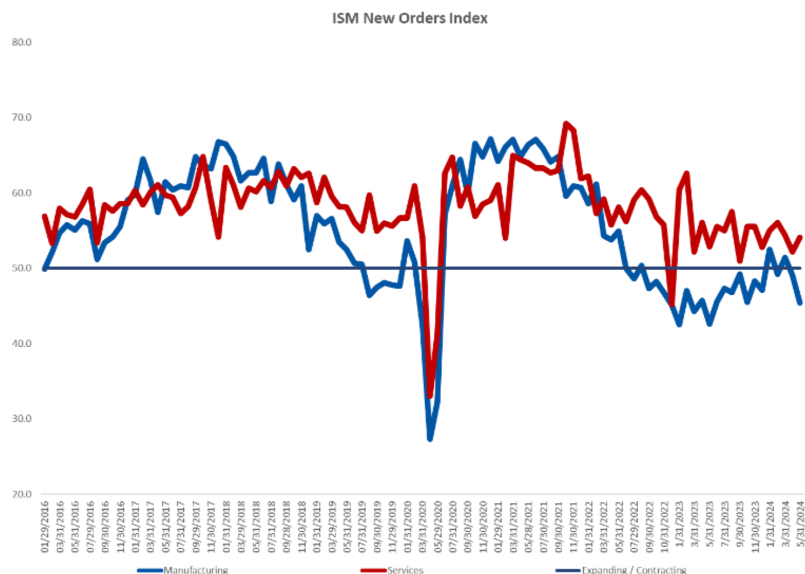
Inflation Expectations Moderated
The Conference Board started asking consumers about inflation expectations in 1987. Consumers' expectations for inflation for the next 12 months improved. Consumers forecast inflation will be 5.4% in 12 months versus the 5.3% reported the previous month and 7.9% reported in June 2023. While inflation expectations are down from last year's highs, they are no longer falling. These inflation expectations indicate efforts to reduce inflation expectations are stalling. Inflation expectations remain above the long-term average of 4.8%. These expectations also support our contention that achieving the FRB's 2.0% inflation goal may not be in the cards.



The Business Sector
The 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. After a few months of expansion, the manufacturing new orders index fell below 50. The most recent reading was 45.4, indicating a slowing momentum. The manufacturing sector's brief flirtation with growth may be over. New orders in the service sector accelerated in May, indicating continued growth in the much larger services sector.



As a frame of reference, a reading above 50 indicates expansion, and below 50 indicates contraction. Readings approximating 50 indicate the same level of activity. A Manufacturing PMI above 42.5% generally indicates an expansion of the overall economy.

Activity in the service sector contracted in May after a brief month in contraction territory. The Services Index rose 4.4 points to 53.8. The breadth of growth widened, as 13 industries reported growth compared to 12 last month, and one fewer industry contracted.

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The ISM report stated, "The increase in the composite index in May is a result of notably higher business activity, faster new orders growth, slower supplier deliveries and despite the continued contraction in employment. Survey respondents indicated that overall business is increasing, with growth rates varying by company and industry. Employment challenges remain, primarily attributed to difficulties in backfilling positions and controlling labor expenses. The majority of respondents indicate that inflation and the current interest rates are an impediment to improving business conditions."

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

Employment contracted for the fifth time in six months. The employment index rose by 1.2 points to 47.1. Eighteen percent of respondents reduced employment from 19.6% the previous month. 13.1% increased employment, compared to 12.8% the last month.

Prices paid for materials and services rose at a slower pace. Prices have been increased for 84 consecutive months. The price component rose by 1.1 points to 58.1. Fourteen industries reported higher costs. No industry reported lower costs. 25.9% of respondents reported higher prices than 26.9% the previous month. Only 5.5% of respondents reported lower prices than 2.5% in the last month. Inflationary pressures have eased a bit but remain a concern for the service sector.

Activity in the manufacturing sector contracted in May. The manufacturing index fell by 0.5 points to 48.7 points. Growth narrowed as seven industries reported growth compared to only nine last month. There was no change in the number of industries reporting contraction. The report stated, "Demand remains elusive as companies demonstrate an unwillingness to invest due to current monetary policy and other conditions. These investments include supplier order commitments, inventory building and capital expenditures. Production execution continued to expand but was essentially flat compared to the previous month. Suppliers continue to have capacity, with lead times improving and shortages not as severe."

Manufacturing Sector	Direction	Rate of Change
Production	Contracting	From Growing
New Orders	Contracting	Faster
Backlog of Orders	Contracting	Faster
Employment	Growing	From Contracting
Prices Paid	Increasing	Slower
Supplier Deliveries	Faster	Same
Manufacturing Sector	**Contracting**	**Faster**
Industries Expanding	7	-2
Industries Contracting	7	--

Employment expanded after seven straight months of contraction. Over time, an Employment Index above 50.3 percent is generally consistent with an increase in manufacturing employment. The employment index rose by 2.5 points to 51.1. 13.9% of respondents reduced employment compared to 15.8% the previous month and 17.1% increased employment compared to 16.3% the last month.

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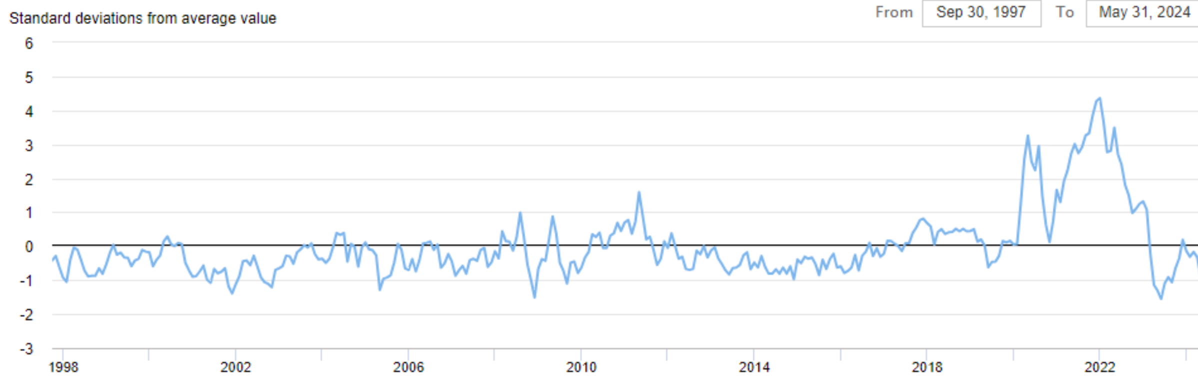
Prices paid for materials and services rose for the fifth month. The price component fell by 3.9 points to 57. Twelve industries reported higher costs, and three industries reported lower costs. 25.5% of respondents reported higher prices than 30.8% the previous month. 11.5% of respondents reported lower prices than 14.0% the last month.

The Federal Reserve Bank of New York tracks supply chain disruptions with its Global Supply Chain Pressure Index (GSCPI). Despite issues with the Suez and Panama Canals and the Key Bridge collapse, global supply chains continue functioning smoothly. Any supply chain issues remain modest and isolated.



The manufacturing sector has reentered a modest recession, while the more significant service sector continues to grow steadily. The forward-looking ISM indices point to continued modest economic growth.

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 regarding 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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