WINTER 2023 OUTLOOK

SECURITY NATIONAL BANK
PRIVATE CLIENT SERVICES

Current Forecast				
	2022	2023 Est	2024 Est	2025 Est
GDP Growth	0.7%	2.6%	-0.3%	1.7%
Change in Consumer Prices	6.4%	3.1%	1.9%	2.7%
Fed Funds Target Rate	4.50%	5.50%	4.50%	3.50%
5-Year Treasury Yield	4.00%	4.75%	4.50%	4.25%
10-Year Treasury Yield	3.87%	4.25%	4.50%	4.75%
S&P 500 EPS	$216	$219	$229	$243

Security National Bank's private client services team continues to forecast the United States (U.S.) will enter a mild recession early next year; inflation will fall below 2% during the recession 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 Federal Reserve Board (FRB) begins easing. We expect earnings for the S&P 500 to post modest growth for several years.

Last Month's Rates and Total Returns				
November 30, 2023	Value	One Month	Year to Date	1 Year
Fed Funds Target (Upper)	5.50%	--	+ 100 bp	+150 bp
3-Month Treasury Yield	5.39%	-9 bp	+98 bp	+101 bp
2-Year Treasury Yield	4.71%	-35 bp	+29 bp	+33 bp
5-Year Treasury Yield	4.28%	-54 bp	+28 bp	+45 bp
10-Year Treasury Yield	4.36%	-54 bp	+48 bp	+66 bp
Mortgage News 30-Year	7.13%	-75 bp	+59 bp	+50 bp
S&P SuperComposite 1500	1,034	9.08%	19.52%	12.62%
S&P 500 Index	4,566	9.13%	20.80%	13.84%
S&P 500 Equal Weight Index	6,003	9.14%	6.56%	1.55%
S&P Midcap 400	2,564	8.51%	7.10%	1.17%
S&P SmallCap 600	1,171	8.27%	2.89%	-4.02%
S&P 500 Growth	2,924	8.77%	25.37%	15.82%
S&P 500 Value	1,631	9.57%	15.82%	11.29%
World ex-US, net *	276	9.00%	10.09%	9.26%
Wilshire Liquid Alts	181	2.30%	4.00%	2.69%
BB U.S. Aggregate	88	4.53%	1.64%	1.18%
Crude Oil – WTI Near Term	$76	-6.86%	-5.14%	-5.52%
Commodity Index	102	-2.25%	-5.37%	-7.68%
FT Wilshire Bitcoin	$37,613	9.70%	127.87%	122.87%
Gold – Near Term	$2,038	2.66%	12.00%	16.73%
U.S. Dollar Index	104	-2.97%	-0.02%	-2.32%

**= MSCI ACWI ex the US in USD*

Prepared by Damian Howard — December 8, 2023

SECURITY NATIONAL BANK
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We author 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

Last month, the stock market rallied with a 9.1% gain – its best month since July 2022 and the best November since 2020. November also snapped a three-month losing streak. The month was characterized by two bullish narratives: a likely soft landing, inflation falling toward the FRB's two percent target without a sharp rise in unemployment, and a year-end Santa Claus rally.

The broad-based S&P1500 closed at 1034.3, up 9.1% for the month. This was 5.4% below its all-time high of 1093.3 on January 3, 2022, and only 1.0% from the recent peak of 1,044.7, established on July 31, 2023.

Small-capitalization (small-cap) and mid-capitalization (mid-cap) stocks trailed their larger brethren. Mid-cap stocks returned 8.5%, while small-cap stocks returned 8.23%. The equal-weighted S&P 500 index returned 9.1%, equaling the capitalization-weighted index. In a welcome development, market participation broadened during November as gains were more widely disbursed than in the top 10 largest stocks. At the end of November, the 10 largest stocks in the S&P 500 accounted for approximately 80% of the year-to-date (YTD) return of the overall market, compared to greater than 90% of the YTD return seen just a few months ago.

Focus on the Long Term

Of the S&P 500's 20.8% YTD return, 6.3% came from higher forward earnings, and 1.4% came from dividends. The remaining 13.1% came from expanding the price-earnings ratio (P/E) multiple. Returns derived from higher multiples are not sustainable. The 12-month forward P/E rose from 16.8X to 19.0X. Over the last 20 years, the forward P/E has averaged 15.8X. By almost all measures, the stock market is expensive.

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 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.

The table also illustrates stocks' return advantage for those who can tolerate the volatility. From 1950 to 2022, one-year stock returns have ranged from up 47% to down 39%, an 86% range. This volatility has caused many investors to be underweight on stocks or sell during market downturns. Over more extended periods, volatility is more subdued. When taking a rolling 20-year view, stock returns have ranged from 17% on the high side to 6% on the low end, only an 11% range.

Annualized Total Return							
	One Year	Three Years	Five Years	Seven Years	Ten Years	Fifteen Years	Twenty Years
Stocks	12.6%	9.5%	12.1%	12.6%	11.5%	13.7%	9.7%
Bonds	1.2%	-4.7%	0.7%	0.8%	1.4%	2.7%	3.0%

Prepared by Damian Howard December 8, 2023

Over the last seven years, fixed income (bonds) have delivered disappointing results. Interest rates have risen to the point where returns over the next few years should be more rewarding.

International Stock Returns

Lower U.S. interest rates diminished the attractiveness of U.S. dollar-denominated assets. Last month, the U.S. dollar index fell 3.0% and has changed little YTD. This boosted the relative performance of international stocks, which rose 5.9% in local currencies and 9.0% when translated into U.S. dollars. 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 weakening trend.

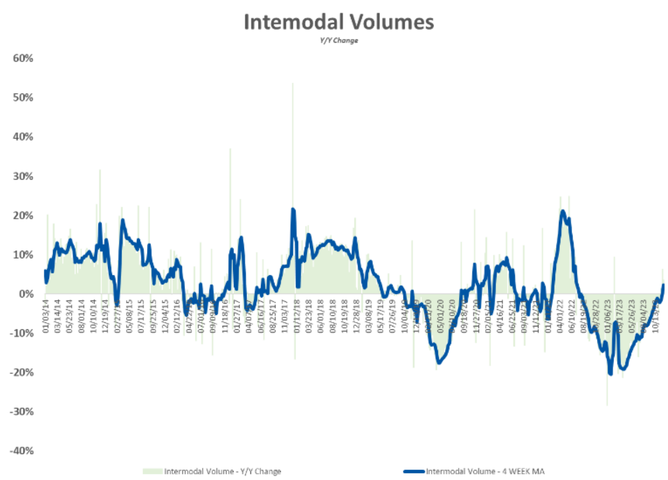
Fixed Income Returns

Equities had a stellar November. Fixed income did even better, posting the highest monthly return since July 1984. The U.S. Aggregate Index rose 4.53% in November as interest rates fell, bringing the year-to-date number to 1.64%. YTD returns for all major bond categories are now positive. The global fixed income aggregate rose 5.0%, bringing YTD returns to 1.5%.

Our Outlook Summary

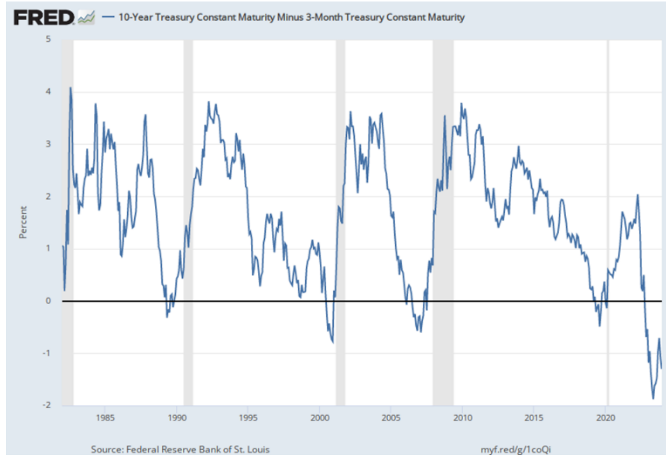
Possible End of Destocking

The chart at the right shows the year-over-year (Y/Y) change in intermodal containers, in which most goods are shipped on rail lines. Intermodal trends are a leading indicator of retailer inventory. Intermodal shipments fell during the pandemic as supply chain issues prevented the normal movement of goods. Shipments soared as supply chains normalized, leaving retailers with too much inventory. Shipments fell again last year as retailers cut back on purchases to clear bloated stockpiles. As retailers now seem more comfortable about inventory levels, the volume of container shipments is no longer falling. We outline a bit later that new orders, while still contracting, are contracting at a slower pace.



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.

It may seem like a broken record, but we continue to forecast a recession next year (2024). Last year, we also predicted a recession next year (2023). Our recession call has been delayed, not denied. Because of the strength of the labor market, we have halved the depth of the recession, from 0.8% contraction to just 0.3%.



Interest Rate Policy

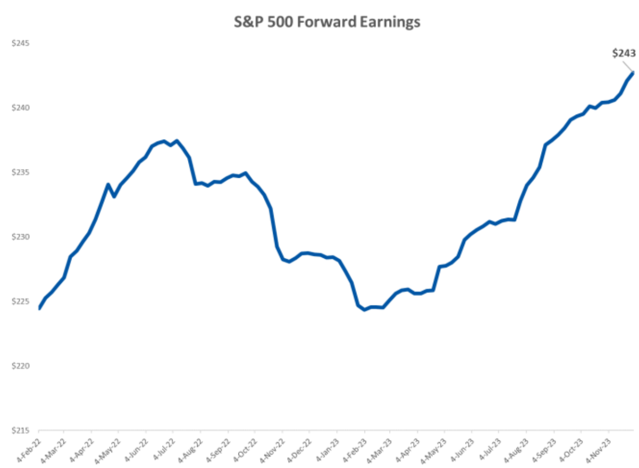
The next interest rate-setting meeting will be held on December 13. We expect the FRB will keep interest rate policy steady at 5.25% to 5.50%. The Federal Funds (FF) futures market is only pricing in a 2% chance that the FRB will raise rates at its upcoming meeting. It also indicates that the FRB will likely remain on hold until March 2024 before beginning an easing campaign. The futures market suggests at least five rate cuts in 2024, with the FFR ending at 4.25%.

Meeting Date	Futures Market	SNB Forecast
December 13	5.50%	5.50%
January 31	5.50%	5.50%
March 20	5.25%	5.50%
May 1	5.25%	5.50%
June 12	5.00%	5.50%
July 31	4.75%	5.25%
September 18	4.50%	5.00%
November 7	4.50%	4.75%
December 18	4.25%	4.50%

We are less aggressive than consensus on the timing of the first rate cut. We currently forecast that the FRB will remain on hold until its July meeting. The FRB has presently a better late-than-early mentality regarding lowering rates. No FRB chairperson wants to cut rates only to have to raise them as inflation increases. There is less damage done from being late than from being early.

Corporate Earnings

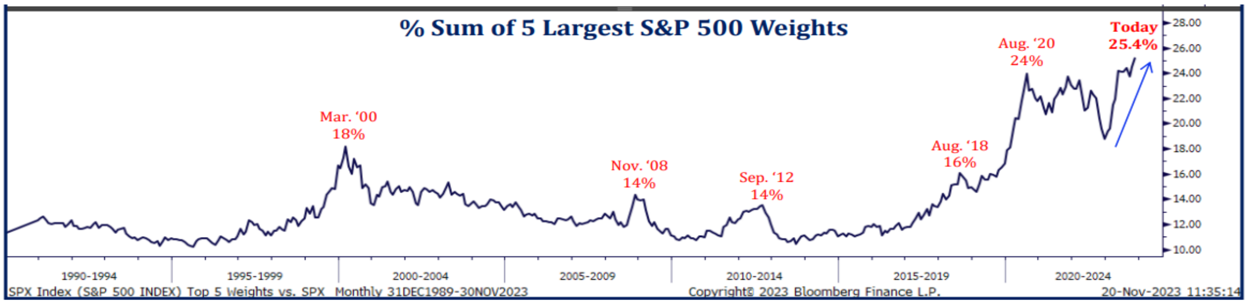
Forward earnings for the S&P 500 continue to climb and are now at a record high. Based on stock analyst projections, corporate America will avoid a recession.



We expect a mild recession in 2024, with two consecutive quarters of economic contraction. Slower economic growth will lead to slower earnings growth. Our 2024 and 2025 forecasted S&P 500 earnings growth trails consensus by 6% to 7%.

Market Concentration

While the U.S. equity market has recently shown signs of broadening to other market sectors, the overall market picture remains concentrated.

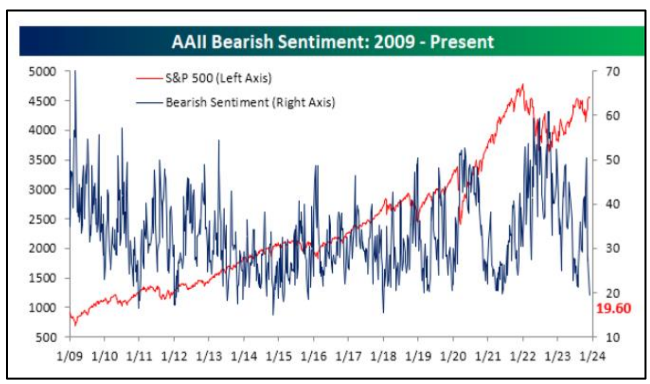


Historically, investors looking to achieve a reasonable level of diversification could look to the S&P 500 Index to provide a relatively balanced level of exposure across the various sectors of the economy and market. This same logic is being questioned today as the largest companies exert tremendous influence upon the overall market landscape. The five largest companies within the S&P 500 now account for just over 25% of the entire index, marking the highest level of market concentration we have seen in recent history, exceeding the levels witnessed in the final stages of the late 1990s technology boom. A critical difference between today's market darlings and those of the late 1990s is that the largest companies within the S&P 500 Index today tend to have desirable levels of profitability and cash flows.

Strategas Research Partners recently highlighted that the seven largest companies in the S&P 500 (The Magnificient 7) feature a profit margin of 17%. This compares to a profit margin of just over 10% for all of the firms within the S&P 500. A higher valuation for these companies is likely justified, but the question remains as to what that extra premium should be over time.

Bears in Retreat

During the past several weeks, investors have become increasingly optimistic and less bearish on additional signs of moderating inflation and a corresponding drop in interest rates. As we pointed out earlier in this note, investors have also moved their anticipated date for the first interest rate cut from the FRB to the first quarter of 2024.



Combined, these factors have driven a notable drop in bearish sentiment amongst investors. The percentage of investors identifying as 'bearish' recently stood at just 19.6%, marking the lowest level of bearish sentiment seen since 2018. Sentiment indicators like these tend to exhibit notable volatility (as seen in the chart to the right). Still, the bearish sentiment decline tends to line up quite well with the historically strong December seasonals.

We agree with Federal Reserve Chairman Jerome Powell that forecasters have much to be humble about. Time will tell if the U.S. achieves a soft landing, fiscal responsibility, and energy transition. We are rooting for the home team but are still determining if they can pull off the trifecta. 2023 has surprised us to the upside. We will be fine if 2024 turns out better than we expect.

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 moderate but remains strong. The private sector added 150,000 jobs in November, slightly below the 12-month moving average of 179,000 and above the three-month moving average of 144,700. Job growth above 90,000 is considered strong.

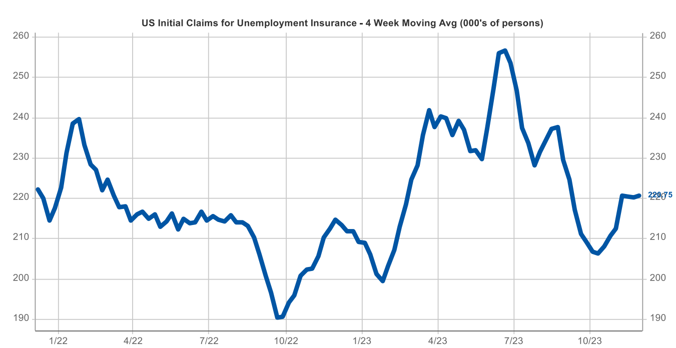
Wages grew at a modest 0.35% in November, bringing the three-month trailing average to 3.4%. The FRB wants wages to grow below a 3.5% Y/Y or 0.28% month-over-month (M/M) pace. Wage growth needs to remain at the current level for an extended period for the FRB to gain comfort that a wage-price spiral has been averted.

We begin our employment review by looking at the Jobs Openings and Labor Turnover Report (JOLTS) 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
Open Positions	8,733	9,350	10,471
Open/Unemployed	1.3X	1.5X	1.7X
Open Rate *	5.5%	5.9%	6.7%
Hire Rate *	4.1%	4.1%	4.4%
Lay-Off Rate *	1.2%	1.2%	1.1%
Quit Rate *	2.6%	2.6%	2.9%

* Private Sector

The October JOLTS suggests that the labor market is close to balance. The ratio of openings to unemployed persons is now 1.3X. This is very close to the 1.2X ratio that prevailed before the pandemic. The lay-off rate remains subdued. This indicates that employers are retaining talent. The quit ratio is back to pre-pandemic levels. A high quit rate is associated with higher wage growth as employees switch jobs for higher pay. Wage growth will moderate, leading to lower service inflation next year.

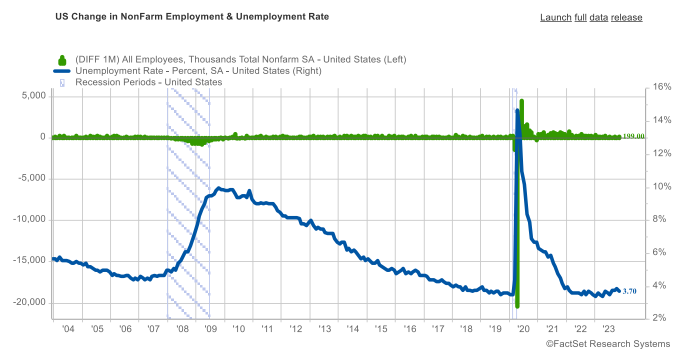


Initial jobless claims for the week ending December 1 were 220,000, bringing the four-week average to 220,750. Continuing claims have held steady at the 1,860,000 persons level for seven weeks. Initial claims would need to rise above 300,000 before unemployment would rise dramatically. This indicates a softening but continued robust labor market.

The BLS reported that the economy added between 199,000 to 747,000 jobs in November. The Establishment survey puts the job gains at 199,000 versus the consensus estimate of 172,500 jobs added. The Household survey indicates the economy added 747,000 jobs. The previous two months' establishment survey payrolls were revised lower by only 35,000. The unemployment rate edged down to 3.7% as the number of unemployed persons fell by 215,000, and the labor force grew by 532,000 persons. The participation rate rose by 0.1% to 62.8%. Hourly earnings rose 0.35%, slightly more than the consensus estimate of 0.3%.

The private sector added 150,000 jobs versus the consensus estimate of 130,000 private sector jobs. October saw notable gains in healthcare where 77,000 jobs were added.

Employment in manufacturing increased by 28,000, reflecting an increase of 30,000 in automobile manufacturing as workers returned from the United Auto Workers (UAW) strike. State and local governments added 49,000 positions, primarily in non-education areas. Retail trade shed 38,400 positions.



Employment services (temporary agencies) shed 24,600 positions. Employment services have shed 167,000 positions in the last eight months. Companies typically cut temporary positions before reducing the permanent workforce, a tactic seen as a leading indicator of a softening labor market.

The participation rate rose by 0.2% to 62.8%. The participation rate was 63.3% in February 2020. The employment-to-population ratio rose by 0.3% to 60.5%. This number was 61.1% in February 2020.

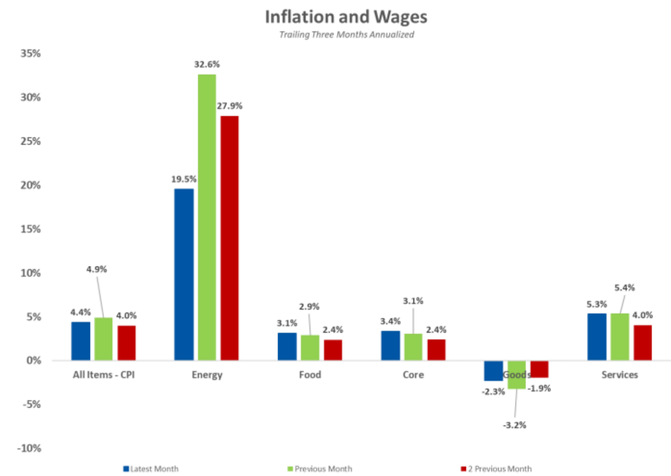
Last month's average hourly earnings (wages) rose by $0.12 per hour to $34.10, up 0.35%, slightly higher than the consensus estimate of 0.3%. Average hourly earnings are up $1.30 per hour or 4.0% Y/Y. Over the last three months, average hourly earnings grew at a 3.4% pace, up slightly from a revised 3.0% the previous month. Wage growth is moderating. The FRB would like to see wage growth stay below 3.5%.

The average workweek rose 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 $7.53 or 0.65% from the previous month as a longer work week combined with higher wages for substantial gains. Average weekly earnings are up $41.44 (3.7%) Y/Y.

The monthly employment report suggests the labor market remains strong but is closer to balance. Decelerating employment and wage growth will further ease inflationary pressures. The labor market reports point to the Federal Open Market Committee's (FOMC) continued patience.

Inflation

The FRB will benefit from the December 12 consumer price reports before the next FOMC meeting on December 13. We expect prices to moderate, reinforcing the pause narrative.



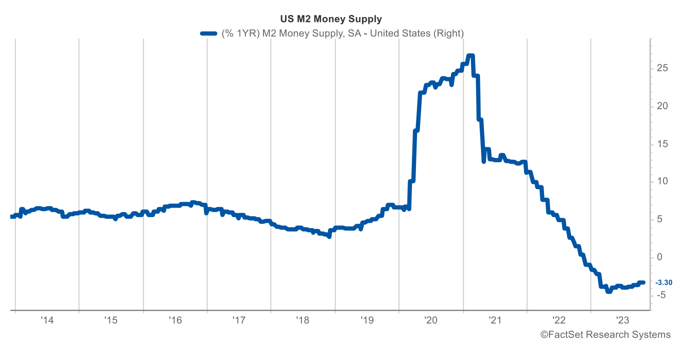
The Consumer Price Index (CPI) was flat (less than 0.1% change) in October and 4.4% on a Trailing Three-Month Annualized (TMA). Core prices rose 0.2% and were up 3.4% TMA.

Energy prices fell 2.5% and are up 19.5% TMA. Since peaking at $93.67 on September 27, the benchmark WTI has fallen by 23%. Energy will likely be a source of deflation for the next several quarters. Energy demand is slightly less than previously forecasted, while supply is slightly higher than predicted.

Food inflation is holding steady. Food prices rose 0.3% and are up 3.1% TMA. Abundant harvests and moderating inflation will lead to tame food prices. Corn prices are down 28% YTD, Soybeans are down 15% YTD, and wheat prices are down 20% YTD. Pork is down 21%, but beef is up 6%.

Goods prices fell 0.1% and are down 2.3% TMA. New vehicle prices were down 0.1% and used vehicle prices fell 0.8% in October. Used vehicle consumer price index (CPI) may be heading lower. The Manheim Used Vehicle-Price Index peaked in March and has fallen 13.4% since. New and used car prices should moderate into 2024.

Service inflation was 0.3% in October and 5.3% TMA. Rent of shelter inflation was 0.3% and is up 5.0% TMA. Shelter cost continues to be higher than market-derived measures. Market-based measures indicate that the rent of shelter is closer to 3% than 5%. Shelter costs should continue to moderate. Shelter rent is 34% of the overall CPI basket.

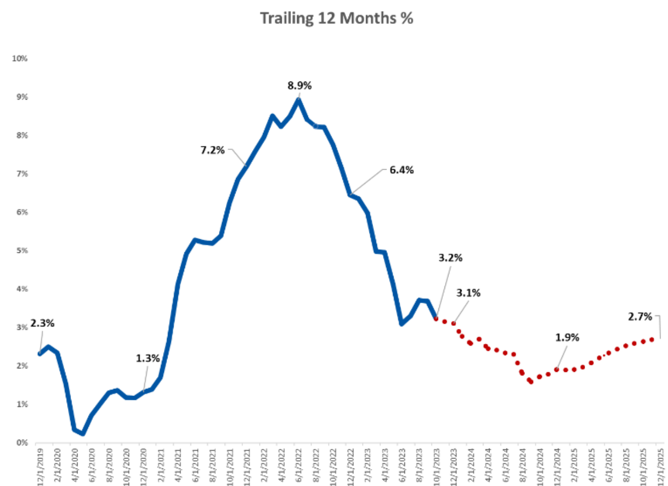


American economist and statistician Milton Friedman famously said, "Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." Much of today's inflation was caused by the rapid growth of 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. Since peaking in March 2022, the money supply has contracted by 4.5%, or $0.9 trillion. The money supply is no longer contracting and has held steady for eight months. 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.

Prepared by Damian Howard   December 8, 2023

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 2.1%. Inflation expectations have returned to the FRB's long-term target of 2%. Reduced inflation expectations support the FRB's rate pause.

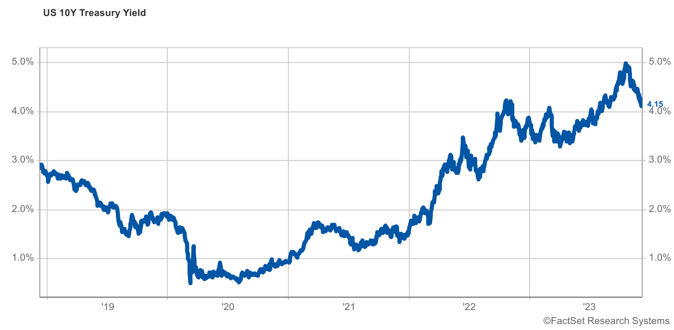
The graph on the right shows our most recent inflation forecast. We project that inflation will average 1.0% during 4Q23 as lower energy and auto prices work through the statistics. We also project that inflation will fall from 3.1% in 2023 to 1.9% in 2024 as the economy slows. We forecast that inflation will return to 2.8% by 2025.



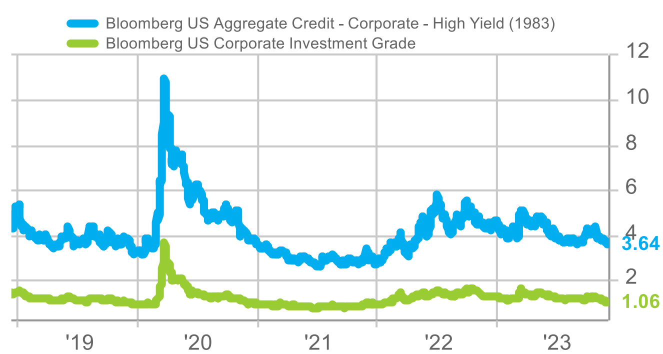
Under-investment in the commodity sector, deglobalization, hot wars (Ukraine and Israel), cold wars (China and Russia), and the shift to zero-carbon will cause inflation to be more volatile and at a higher level than in the pre-pandemic period. Higher and more volatile inflation will likely result in a higher and more volatile interest rate environment. Cyclical trends (an economic slowdown) will overpower the secular trends outlined above for the coming year.

Interest Rates and Credit Markets

After climbing for six consecutive months, the 10-year Treasury yield fell 0.54% in November, ending at 4.36%. Several factors contributed to the sharp rate drop. First, as expected, the FRB held its policy rate steady at 5.50% at the November FOMC meeting. Chairman Powell's comments were seen as more dovish than expected. He noted that the risks of over-versus under-tightening were now more balanced. Second, nonfarm payrolls rose just 150,00 versus expectations for a 180,000 increase and significant downward revisions of prior months' figures. Third, inflation cooled. Fourth, the U.S. Treasury Department altered the quarterly refunding allocation in a market-friendly way, trimming expected longer-term supply in favor of T-bills. Fifth, Congress passed a Continuing Resolution to avoid a shutdown, funding the government through January 19. Finally, investor anxiety over global events eased modestly last month following the meeting of Presidents Joe Biden and Xi Jinping.



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% and were often negative. The chart at the right illustrates the change in real rates. Real rates are most likely at a sustainable level. 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%. During periods of exuberance, investment grade spreads fall below 0.8%. Investment grade spreads ended the month at 1.04%, 0.25% tighter than the previous month.

High-yield spreads tightened by 0.67% to 3.70%. 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%. Contrary to expectations, credit spreads have narrowed and are at "Goldie Locks" levels. We do not find credit to be particularly attractive at this point.

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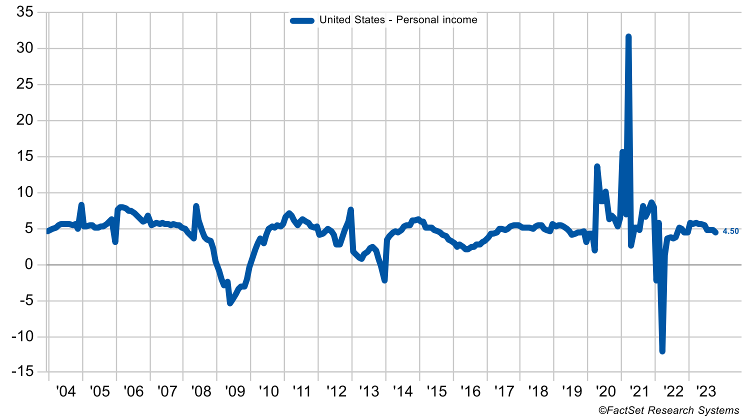
The Consumer Sector

Personal income rose by 0.3% in October. Personal consumption expenditures rose 0.7%. The PCE Price Index (PCE Inflation) rose 0.2%. The savings rate rose to 3.8% as consumers may run out of excess cash and borrowing power.



Personal income rose 0.3% M/M and was up 4.7% Y/Y. Private sector wages and salaries were up 0.1% M/M and 5.4% Y/Y. Disposable personal income was up 0.3% M/M and 7.0% Y/Y. Personal taxes are down 10.7% Y/Y as last year's market route reduced capital gains taxes. Lower individual taxes have increased the budget deficit.

Real disposable personal income per capita, or the income each person has left to spend after paying taxes, was up 0.2% M/M and 3.3% Y/Y. Real disposable income per capita rose for the first time in four months. Real income is moderating, and the savings rate is about as low as it gets. This implies that real consumption will grow at a snail's pace over the next several quarters.

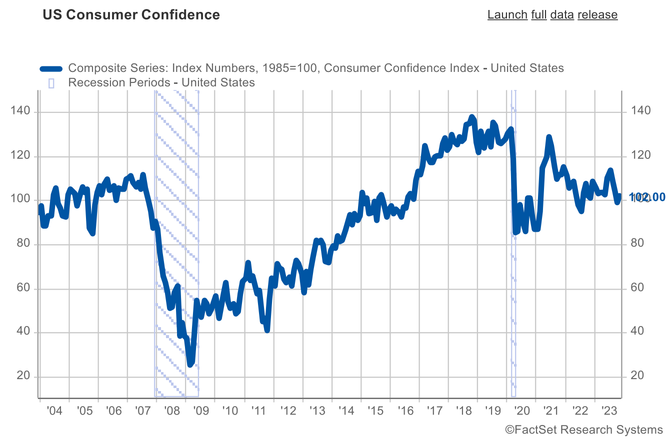
Personal Consumption Expenditures		
	Nominal	Real
Durable Goods	-0.2%	0.1%
- Motor Vehicles and Parts	-1.2%	-0.8%
Non-Durables	-0.0%	0.3%
- Gas and Other Energy	-1.8%	2.9%
Services	0.4%	0.2%
- Airline tickets	3.8%	1.1%
Total	**0.2%**	**0.2%**

Personal Consumption Expenditures (PCE) were up 0.2% for the month and were up 0.2% on a real basis after subtracting the impact of inflation.

Gas and other energy prices were down 4.6% in M/M and 6.5% Y/Y. Lower and middle-income consumers devote proportionately more of their income to buying gasoline. Indeed, according to the Consumer Expenditure Survey, in 2022, gasoline purchases absorbed 5.0% of the disposable income of the poorest 80% of households but only 2.3% of the income of the wealthiest 20%. Since less affluent households are much more likely to spend almost all their disposable income, lower energy prices allow consumers to shift purchases to other areas of consumer spending. This helps explain why energy prices have an outsized impact on consumption patterns and consumer confidence.

Consumers saved just 3.8% of disposable income during the month. This is significantly less than the 7.4% savings rate that prevailed before the pandemic. Consumers have drawn 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 4Q2023 and 2024 consumption as consumers are forced to save more.

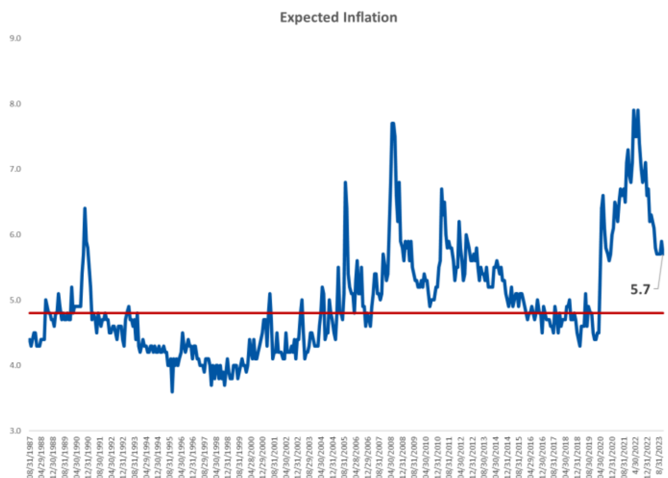
After three months of worsening consumer confidence, consumers' outlook brightened in November. The Consumer Confidence Index, compiled by the Conference Board, rose 2.9 points to 102.0. The cost of gasoline significantly impacts consumer confidence.



The present situation component fell by 0.4 points to 138.2. The forward-looking expectation component rose by 5.1 points to 77.8. Confidence in the economy is improving.

Mixed Employment Confidence

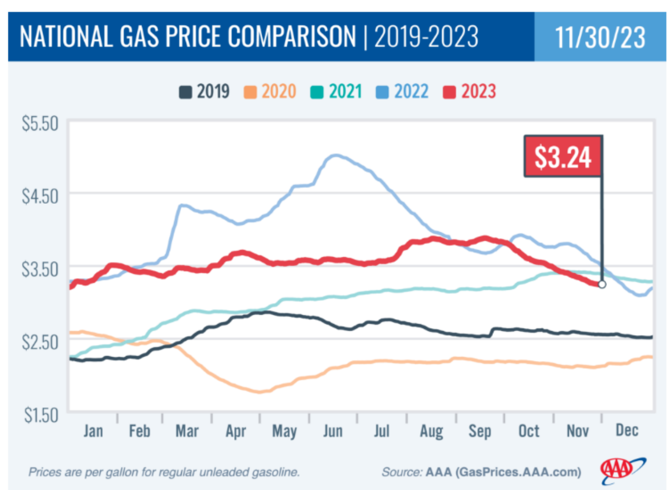
The current conditions net employment sub-index (plentiful - hard to get) rose slightly to 23.9 from 23.8 the previous month. Consumers' outlook for future employment also rose modestly as the net sub-index (more jobs – fewer jobs) fell to -3.5 from -4.4 the previous month.



Business Confidence Improve

Consumers' perception of current business conditions improved as the net sub-index (good-bad) rose to 0.3 from -0.5 the previous month. Consumers' outlook for future business conditions also improved as the net sub-index (better – worse) rose to -2.2 from -5.4 last month. Perceptions of future labor and business conditions indicate decreasing concern about a pending recession.

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 5.7% 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.



According to the American Automobile Association (AAA), the national average for a gallon of gasoline fell by $0.26 M/M and $0.26 Y/Y. In October, consumption rose by 3.1% M/M and 1.3% Y/Y on a real basis. Lower gasoline prices should translate into slightly higher consumer confidence in the coming months.

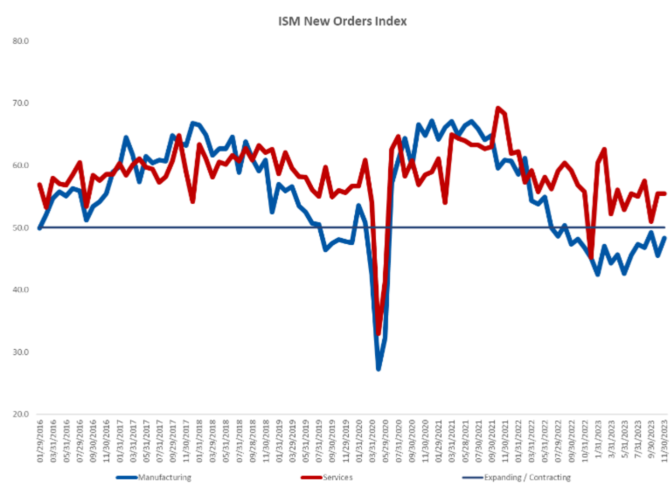
Labor markets are weakening but remain healthy. Despite rising debt and interest rates, the Financial Obligations Ratio remains below pre-pandemic levels. Consumers should be able to weather the coming recession without significant permanent damage, unlike the Great Financial Crisis, where significant 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.

After the Great Financial Crisis, the consumption of goods shifted downward. The subsequent trend was materially below pre-crisis levels, deemed to be the new normal.

Consumers took their stimulus payments and made up for lost purchases, temporarily boosted the demand for goods, resulting in a boom in the goods sector. The sector has returned to the pre-financial crisis trendline. The adjustment from a stimulus-fueled boom to trend growth has been painful. The manufacturing sector has been in a modest recession for over a year. The new orders index points to a modest contraction in the manufacturing sector.



New order data and container shipment data suggest that the manufacturing recession could end next year. This may be a source of additional economic growth not considered in our forecast. If the manufacturing sector stabilizes, we must increase our growth assumptions.

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Prepared by Damian Howard December 8, 2023

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 has been below 50 for 15 straight months. The pace of the decline has been modest, indicating a shallow recession. New orders in the service sector are moderately expanding, indicating slower future growth in services. October's services index rose 0.9 points to 52.7. The breadth of growth improved as 15 industries reported growth versus 12 last month. Overall comments leaned toward slower growth.

Employment expanded at a faster pace. The employment index rose by 0.5 points to 50.7. 13.8% of respondents reduced employment, down from 17.2% the previous month. 14.3% of respondents increased employment compared to 15.8% the previous month.

Manufacturing Sector	Direction	Rate of Change
Production	Contracting	From Growing
New Orders	Contracting	Slower
Backlog of Orders	Contracting	Faster
Employment	Contracting	Faster
Prices Paid	Decreasing	Slower
Supplier Deliveries	Faster	Faster
Manufacturing Sector	**Contracting**	**Same**
Industries Expanding	3	+1
Industries Contracting	14	+1

Prices paid for materials and services rose at a slower pace. The price component fell by 0.3 points to 58.3. Eleven industries reported higher costs. Three industries reported lower costs. 22.3% of respondents reported higher prices compared to 24.7% the previous month. 9.5% of respondents reported lower prices compared to 8.7% the previous month. Inflationary pressures persist but are easing in the service 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.

The manufacturing index held steady at 46.7 points. The report marks the thirteenth consecutive month in contraction territory. Weakness is widespread in manufacturing, as only three industries reported growth. 14 industries reported contraction versus 13 the previous month.

Non-Manufacturing Sector	Direction	Rate of Change
Business Activity / Production	Growing	Faster
New Orders	Growing	Same
Backlog of Orders	Contracting	From Growing
Employment	Growing	Faster
Prices Paid	Increasing	Slower
Supplier Deliveries	Faster	Slower
Service Sector	**Growing**	**Faster**
Industries Expanding	15	+3
Industries Contracting	3	-2

Employment contracted in the manufacturing sector. The employment index fell by 1.0 points to 45.8. 19.4% of respondents reduced employment, up from 17.4% the previous month. 9.3% of respondents increased employment compared to 11.7% the previous month.

Prices paid for materials and services fell at a slower pace. The price component rose by 4.8 points to 49.9. Seven industries reported higher costs. Six industries reported lower costs. 16.0% of respondents reported higher prices compared to 11.0% the previous month. 16.3% of respondents reported lower prices compared to 20.9% the previous month. Prices paid have decreased for the manufacturing sector for seven consecutive months. The recent decrease in energy prices should filter into lower prices over the next few months.

The manufacturing sector continues to experience a modest recession. The service sector has so far avoided a recession. This may change in the coming year.

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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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