SECURITY NATIONAL BANK
PRIVATE CLIENT SERVICES

Current Forecast

	2021	2022	2023 Est	2024 Est
GDP Growth	5.7%	0.9%	0.6%	0.4%
Change in Consumer Prices	7.1%	6.4%	3.0%	1.6%
Fed Funds Target Rate	0.25%	4.50%	5.25%	3.50%
5-Year Treasury Yield	1.26%	4.00%	3.75%	3.75%
10-Year Treasury Yield	1.51%	3.87%	3.75%	4.00%
S&P 500 EPS	$206	$217	$213	$218

Security National Bank Private Client Services forecasts that U.S. economic growth will be modest in 2023 as the U.S. enters a mild recession toward the end of the year. We expect inflation to fall to 2.5% by 4Q2023 as aggregate demand and labor markets soften. We expect the Federal Open Marketing Committee (FOMC) will stay at 5.25% for the rest of the year. The contraction of credit availability will negate the need for additional rate hikes. The yield curve is likely to remain inverted for an extended period. We expect earnings for the S&P 500 to stagnate for several years.

Last Month's Rates and Total Returns

May 31, 2023	Value	One Month	Year to Date	1 Year
Fed Funds Target (Upper)	5.25%	+25 bp	+ 75 bp	+425 bp
2-Year Treasury Yield	4.39%	+33 bp	-3 bp	+185 bp
5-Year Treasury Yield	3.75%	+21 bp	-25 bp	+94 bp
10-Year Treasury Yield	3.62%	+17 bp	-26 bp	+78 bp
Mortgage News 30-Year	6.88%	+29 bp	+34 bp	+141 bp
S&P SuperComposite 1500	949	0.18%	8.77%	2.35%
S&P 500 Index	4,180	0.43%	9.65%	2.92%
S&P Midcap 400	2,407	-3.19%	-0.29%	-2.63%
S&P SmallCap 600	1,126	-1.75%	-2.03%	-7.26%
S&P 500 Growth	2,675	2.50%	13.98%	1.96%
S&P 500 Value	1,492	-1.91%	4.94%	3.02%
World ex-US, net *	263	-3.64%	4.77%	-1.41%
Wilshire Liquid Alts	176	-0.64%	1.23%	-1.54%
BB U.S. Aggregate	90	-1.09%	2.46%	-2.14%
Crude Oil – WTI Near Term	$68	-11.32%	-15.16%	-40.62%
Commodity Index	98	-5.64%	-11.37%	-22.48%
FT Wilshire Bitcoin	$27,040	-7.08%	63.37%	-14.62%
Gold – Near Term	$1,964	-1.32%	7.92%	6.58%
U.S. Dollar Index	104	2.62%	0.78%	2.53%

**= MSCI ACWI ex the US*

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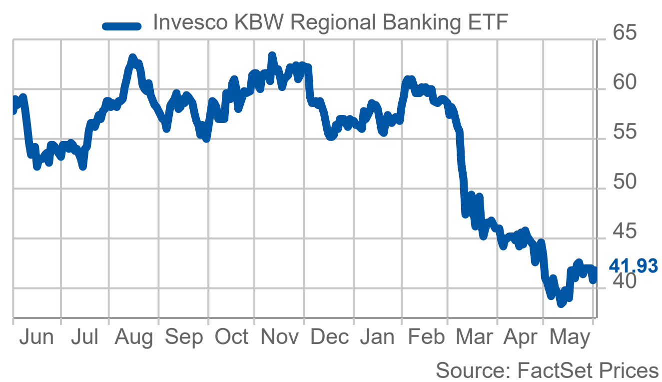
Security National Bank's Wealth Management Department authors a monthly economic forecast that provides our Investment Committee and the Bank's Funds Management Committee with background assumptions for use in investment decisions. We are pleased to share our economic outlook with you. Please be advised 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.

Stock Market

May brought high school and college graduations to Nebraska along with the periodic debt ceiling drama in Washington. Despite all the distractions, financial markets were calm. The S&P 1500, which tracks large, mid-, and small capitalization stocks, returns 0.2%. YTD, the broad market is up 8.8%. Gains were led by mega-cap companies such as Nvidia, Amazon, and Microsoft. The Nasdaq 100 index was up 7.9% in May.

On May 1, First Republic failed and was acquired by J.P. Morgan. This set off another round of regional bank weakness. The regional bank index ended the month down 8.6%. Mid- and small-capitalization stocks indices posted losses. Regional banks have a significant weighting in these indices. Smaller companies are more reliant on regional banks for their funding needs. A pullback in bank lending translates into slower growth. Turmoil in regional banking has pushed investors to large technology companies with stable and predictable cash flows. This can be seen in the equal-weighted S&P 500. In May, the equal-weighted S&P 500 Index was down 3.8% and 1.6% YTD. Whenever the equal-weighted S&P 500 Index dramatically underperforms, returns are concentrated in the largest companies. Most asset managers' portfolios skew toward the equal-weighted S&P 500 Index.



Energy prices tumbled in May, with oil and natural gas down 11.3% and 12.5%. Lower energy prices will eventually translate into lower inflation and lower stock prices for energy companies.

For the month, the top-performing sector was Information Technology (up 9.5%), while the worst showing came from Energy (down 10.0%). Year to date, the top-performing sector was Information Technology (up 34.0%), while the worst-performing sector was Energy (down 11.4%).

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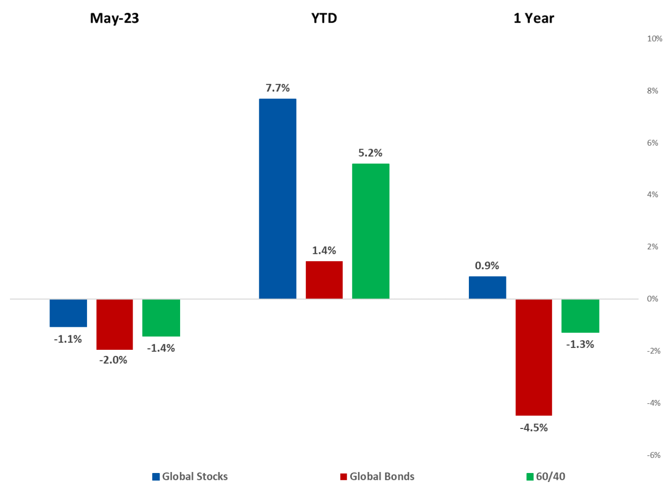
Over the last twenty years, the U.S. experienced a global financial crisis, pandemic, and multiple bear markets. Stock market returns have shown consistency over the longer term. Each month, we list the longer-term returns for the stock market to think long-term.

S&P 1500 Annualized Total Return						
One Year	Three Years	Five Years	Seven Years	Ten Years	Fifteen Years	Twenty Years
2.4%	12.9%	10.5%	12.1%	11.7%	9.7%	9.8%

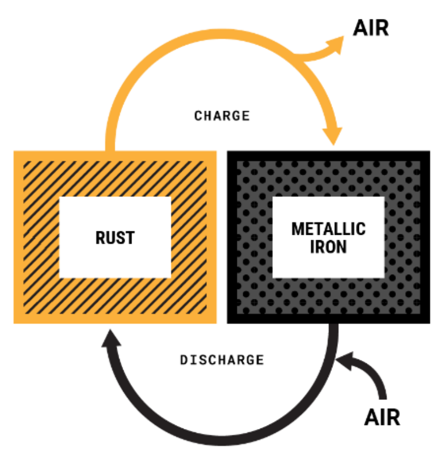
International Stock Returns
The U.S. dollar rallied in May. This hurt the relative performance of international stocks. International stocks fell 1.7% in local currency and 3.6% when translated into U.S. dollars. The U.S. dollar is widely viewed as overvalued. An overvalued dollar does not rule out occasional dollar rallies. A weakening dollar will boost international fixed income and equity returns. Since peaking on September 27, 2022, the U.S. dollar index is down 12.5%.

Interest Rates
Interest rates rose across the board. On May 3, The FOMC increased the FFR by 0.25%. They signaled that they might be done raising rates for a while. They then spent the month informing everyone that they were unlikely to lower rates soon. The jawboning had the effect of shifting the yield curve up by 0.25%. Rates rose across the board. Higher interest rates translate into losses on bonds. The U.S. Aggregate, which measures the investment grade bond market, had a 1.1% loss for May.



Global Index
Globally, stocks lost 1.1% in U.S. dollar terms. Bonds lost 2.0%. A 40%/60% balanced index would have lost 1.4%. Year-to-date, the balanced index is up 5.2%.

Interesting Developments
One of the concerns about the transition to clean energy is the dependence on lithium batteries. Lithium-ion batteries tend to overheat and catch fire and can be damaged at high voltages. The mining of lithium is not an ecologically friendly process. There are multiple dozens of companies working on new energy storage technologies. We want to highlight Form Energy. Form Energy is developing and commercializing a pioneering iron-air battery capable of storing electricity for 100 hours at a fraction of the cost of lithium batteries. The basic principle of operation is reversing rusting. Extended storage technology makes renewable energy available during multiple days of extreme weather or periods of low renewable generation. Once proven, technology such as iron-air energy batteries could allow for high renewable penetration at a cost below gas-fired power plants. Check out Form Energy's website.



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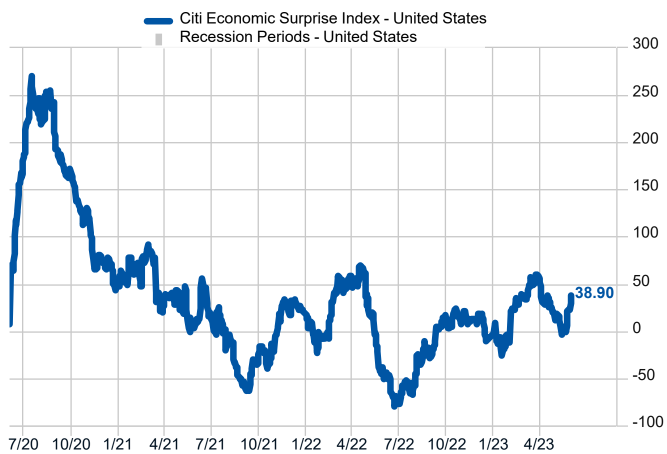
We highlight Iron-Air storage as an example of the tremendous innovation happening today. Significant resources have been applied to pressing problems, and those efforts are now paying dividends. We continue to watch developments in clean energy. There are some significant technological advances about to happen. We strive to invest in those companies benefiting from new technology but currently make a solid profit. We leave venture investing to others. Artificial Intelligence (AI) has been in the news recently. AI promises advances in efficiency. AI is not new. The earliest successful AI programs were written in the early 1950s. The most recent leap in AI results from advances in semiconductor technology. We are a long-time investor in the leading AI chip company. It was much smaller but very profitable at the time of our first investment. It is much easier to be patient when investing in money-making companies.

Our Outlook in a Nutshell

Economic indicators have been better than expected. When the index rises, economic conditions are generally better than expected. When the index falls, economic conditions are usually worse than expected. The Citigroup Economic Surprise Index represents the sum of the difference between results and forecasts.



As seen in the chart at the right, economic statistics have been generally better than expected since mid-May. The same can be said for corporate earnings. First quarter earnings were much better than feared. 2023 S&P 500 earnings and revenue estimates have risen since March. This helps explain the recent better-than-expected stock market returns.

The recession can be delayed, not denied. The Federal Reserve Board (FRB) began its rate hiking cycle in March 2022. Most of the impact is yet to be felt. “A large body of research tells us it can take 18 months to two years or more for tighter monetary policy to materially affect inflation,” Raphael Bostic, President and CEO of the Atlanta Federal Reserve Bank.

Multiple indicators point to a pending recession.

- Inverted yield curve
- Weak PMI new orders
- Weak housing market
- Leading indicators
- Money supply contraction
- Depressed consumer expectations
- Pull back in bank lending.

Offsetting recession indicators is the resilient labor market and real income growth. We continue to believe the yield curve is correct in signaling a recession. On the other hand, the housing market may have bottomed out, and corporate profits have been resilient. Head fakes and false signals usually precede economic turns. The multiple rate hikes since March 2022 will cause a mild recession.

The FRB is most likely in a pause and monitor mode. We believe they will keep interest rates the same at their June 14th meeting. Federal Funds futures have the odds of a hold at 75%. We agree. In general, our forecast aligns with the futures market. If the FOMC raises rates one more time in July, that is immaterial

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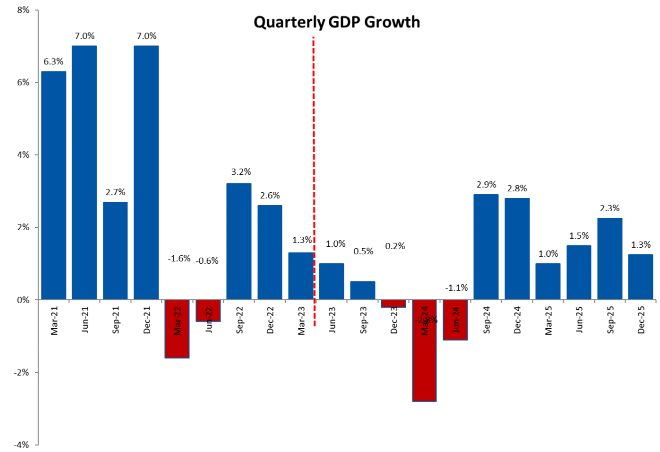
compared to the 5.00% rate hike over the last fifteen months. We continue to forecast no rate changes this year.

Economic Forecast

First quarter gross domestic product (GDP) growth was 1.3%, slightly better than our 0.9% forecast. Core GDP growth rose from 0.0% in 4Q to 2.5%. This was much stronger than anticipated. The surge in motor vehicle purchases in January lifted durable goods consumption for the whole quarter. Durable goods consumption contributed 1.3% to GDP growth, up from detracting 0.1% in 4Q22. A stabilizing housing market subtracted just 0.2% from economic growth, significantly better than the 1.2% drag in 4Q2022. The increased availability of new cars and a bottoming in the housing market accounted for 1Q23's economic growth.



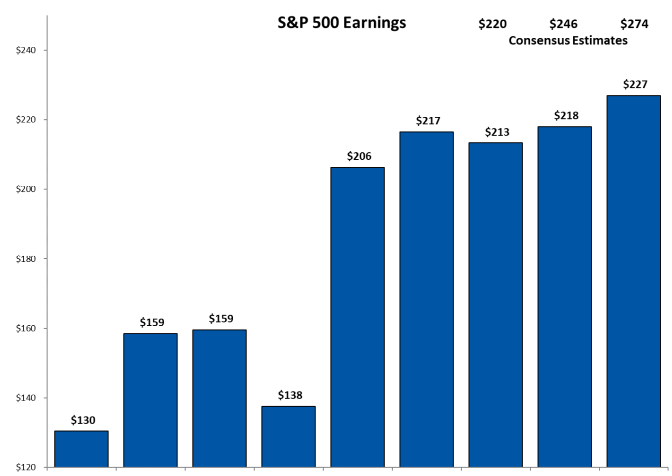
We have increased our outlook for 2Q23 and 3Q23 economic growth to account for the continued strong labor market and real income growth. While slightly higher, growth will likely remain below potential. Eventually, the cumulative impact of five hundred basis points of rate hikes will tip the economy into a recession.

We are not in the soft landing camp. We fully acknowledge that there is a strong possibility that the U.S. will avoid a recession.

Corporate Earnings

First quarter 2023 results were better than we expected. It now appears earnings for the S&P 500 Index will be $53, versus our expectation of $49 and the consensus estimate of $50.

Consensus estimates for 2023 S&P 500 earnings have held steady over the two months at $220. Revenue estimates have climbed from $1,814 to $1,821. We have increased our 2023 estimate to $213 for 2023 S&P 500 earnings per share (EPS), 3% below consensus.



We lowered our 2024 EPS forecast from $222 to $218 to incorporate a delayed recession. The net result is three years of flat earnings, much like 2014 through 2017.

The chart shows our current forecast and current consensus expectations. We are more cautious than consensus. Our forecast calls for modest growth over the next couple of years.

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Outlook Luncheon and Webcast
We will be hosting the Mid-Year Economic Outlook on Wednesday, July 19. Lauren Mozur will be up in Omaha from Dallas, and I promised her no snow. The event will be in-person at our Omaha headquarters' Three Pacific Place Conference Center, so please let us know if you would like to attend in person. If you wish to attend via Zoom, visit SNBconnect.com/events to register.

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 Wealth Management

Lauren Mozur
Wealth Advisor I

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

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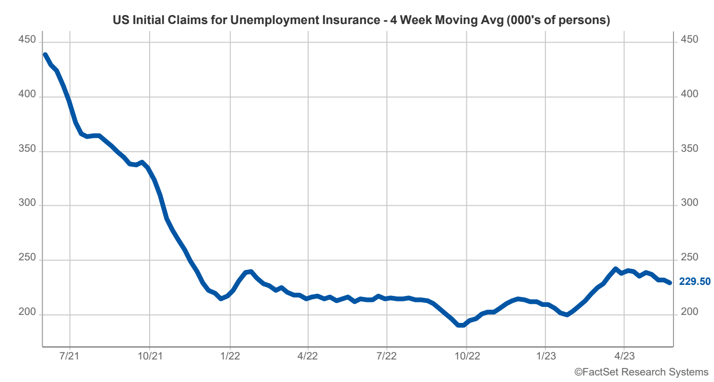
Since 1977, the Federal Reserve has operated under a mandate from Congress to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" –commonly called the Federal's "dual mandate." For this reason, we always start our economic review with employment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

Employment

The labor market continues to show exceptional resiliency. The three-month moving average private sector job growth has rose from 201,000 last month to 231,000. Job growth must slow to 90,000to match the labor force's long-term growth rate. The FRB would like wages to grow below a 3.5% pace. The current pace of wage growth (4.0%) is slightly above the FRB's preferred range. We expect the labor market to weaken along with the economy. We expect unemployment will rise to at least 5.5%. This implies an additional 3 to 4 million or more unemployed people.

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. The April JOLTs report indicated that open positions rose by 358 thousand to 10.1 million month over month (MOM) and fell by 1.7 million year over year (YOY). 6.4% of private sector jobs remained unfilled versus 6.2% the previous month and 7.6% last year. Available positions increased primarily in retail, transportation, warehousing, and health care. The private sector quit rate held steady at 2.7% from the previous month and was down from 3.3% last year. The private sector layoffs and discharges rate fell to 1.1% from 1.3% the previous month, up slightly from 1.0% last year. JOLTs report points to a continued healthy labor market.



For the week ending May 26, initial jobless claims were 232,000 bringing the four-week average to 230,000. Continuing claims fell slightly to 1,795 persons versus 1,801 four weeks ago. The claims data points to a softening but still robust labor market. Initial claims will need to rise above 300,000 before job growth stalls.

The BLS reported that the economy either lost 310,000 jobs or added 339,000 jobs in May. The Establishment survey puts the job gains at 339,000 versus the consensus estimate of 187,000 jobs added. The Household survey puts the job losses at 310,000 . The previous two months' Establishment survey payrolls were revised higher by 93,000 . The unemployment rate rose to 3.7% as the number of unemployed persons increased by 440,000 , and the labor force grew by 130,000 persons. The participation rate held firm at 62.6%. Hourly earnings rose 0.33%, in line with the consensus estimate of 0.3%. A very weak Household survey offset the stronger-than-expected Establishment survey. A low response rate to this month's Establishment survey injects caution regarding the robust numbers reported.

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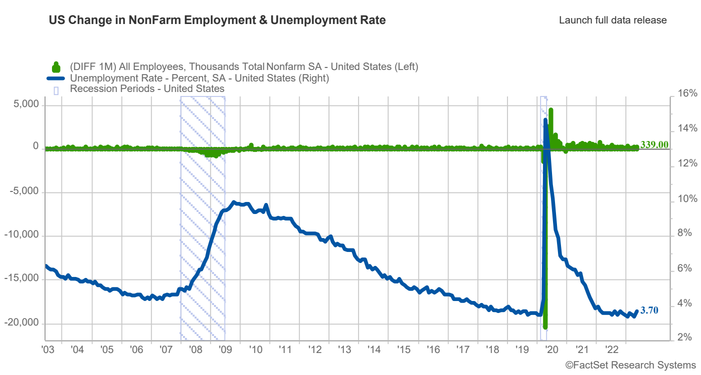
The private sector added 283,000 jobs versus the consensus estimate of 178,000 private-sector jobs. The three-month average gain rose from 201,000 to 231,000 . May saw notable gains in professional and business services (64,000 jobs added), healthcare (52,000 jobs added), and leisure and hospitality (48,000 jobs added. The month also saw some notable job losses in information (9,000).

State and local governments added 49 ,000 jobs. State and local governments have had a tough time attracting talent. Rising employment is a sign of increasing labor availability.



The unemployment rate rose to 3.7% from 3.4% last month. The number of officially unemployed persons increased by 440,000 to 5.1 million. The broader U-6 unemployment rate increased to 6.7% from 6.6% the previous month. There are 1.7 job openings for every unemployed person, even with the previous month. The unemployment rate is calculated from the Household survey. Occasionally the surveys conflict with each other, and happened in this survey.

The participation rate held steady at 62.6%. The participation rate was 63.3% in February 2020. The employment-to-population ratio fell by 0.1% to 60.3%. This number was 61.1% in February 2020.

While above the FRB's preferred 3.5% range, wage growth is cooling. Last month's average hourly earnings (wages) rose by $0.11 per hour to $33.44, up 0.3%, even with the consensus estimate of 0.3%. Average hourly earnings are up $1.38 per hour or 4.3% YOY. Over the last three months, average hourly earnings grew at a 4.0% pace versus 3.8% last month (revised lower from 4.2%) and 3.4% the month before. The previous month's hourly earnings were revised lower, from 0.5% to 0.4%.

The average workweek fell by 0.1 hours to 34.3 hours. Slow hours worked is a classic sign of a slowing labor market. Companies typically reduce the hours worked before laying off staff. The average work week is down 0.9% (0.3 hours) y/y. Average weekly earnings rose by just $0.44 or 0.04% from the previous month. Average weekly earnings are up $37.71 (3.4%) YOY.

The Household survey partially offset the robust Establishment survey. Hours worked softened, and average hourly earnings moderated. The labor market is strong enough to dispel fears of an imminent recession but not hot enough to cause the FOMC to hike rates on June 14. We believe the FOMC will hold rates steady. The U.S. will also experience a recession, with unemployment rising to at least 5.5%. The resilient labor market may delay the onset of the recession.

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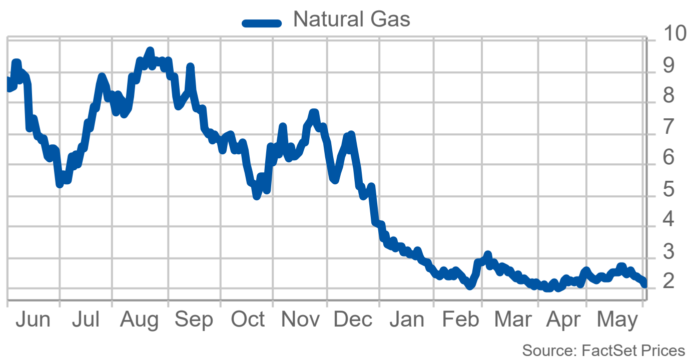
Inflation

The BLS will release the May Consumer Price Report on June 13.

The Consumer Price Index (CPI) rose 0.4% in April and 3.2% on a Trailing Three-Month Annualized (TMA). Core prices rose 0.4% and were up 5.1% TMA. Energy prices rose 0.4% as gas prices rose 3.0%, offsetting a 1.7% drop in utility bills. Utility bills have fallen for five of the last seven months.

Food prices continue to moderate. Food prices rose just 0.02% and are up 1.7% TMA. April saw widespread declines in grocery store prices. Restaurant inflation is moderating.

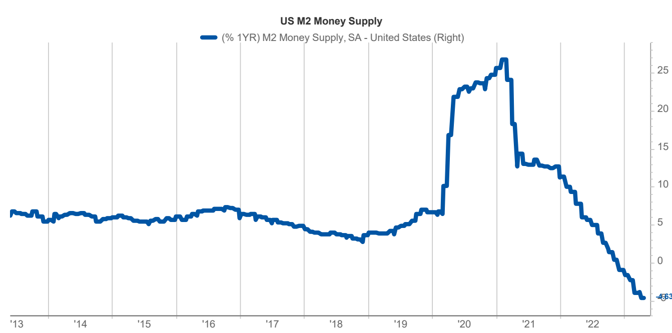


The core CPI rose 0.4% and runs at a 5.1% TMA.

Goods prices rose 0.6% and up 3.0% TMA. New and used car prices make up a third of the goods category. New and used car prices are a significant swing factor in goods inflation. New vehicle prices fell 0.2% in May, while used vehicle prices rose 4.4%. The Manheim Used Vehicle-Price Index peaked in March and has fallen 5.1% since. Used car prices may remain sticky on a lack of supply. The auto manufacturer factory shutdowns in 2020 and 2021 impacted used car availability.

CPI shelter increased by 0.4% and is up 7.2% TMA. We expect shelter inflation to slow through the end of the year as the statistics catch up with the slowing rental landscape. Shelter rent is 32% of the overall CPI basket.

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 when growth peaked at over 27% year over year (YOY). The money supply increased faster than output for three years, leading to inflation. The FRB slammed on the brakes in 2022, shrinking the money supply by 4.5% YOY. Since peaking in March 2022, the money supply has contracted by 4.7%, or $1 trillion. The money supply is primarily bank deposits. 5.6% of bank deposits have been withdrawn from the economy. This has led to the funding issues the sector is currently facing. Lower available funding will lead to fewer funds for banks to lend and higher loan spreads.



Because inflation statistics are a lagging indicator, economists use forward-looking inflation expectations. The Breakeven Inflation Rate implies what market participants expect inflation to be in the next five years,

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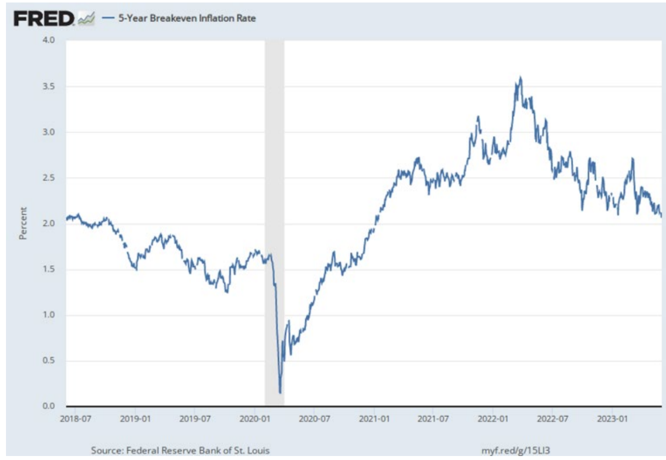
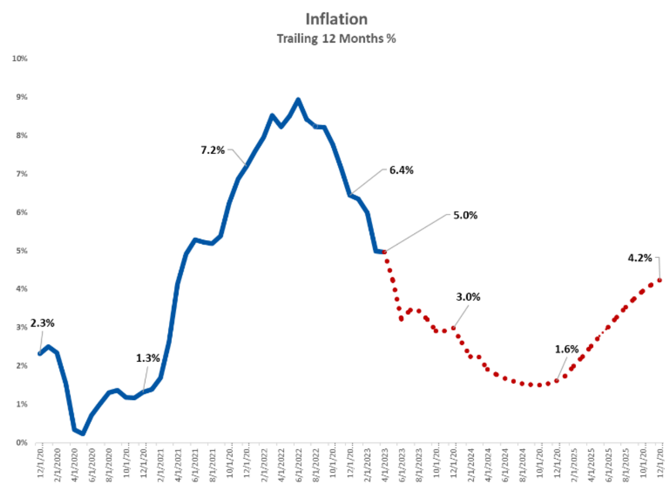
on average. The 5-Year Breakeven Inflation Rate peaked at 3.60% in March 2022. Since then, financial conditions have tightened considerably. Slower growth has led to lower inflation expectations. Inflation expectations have fallen dramatically to the current 2.1%.



The 5-Year, 5-Year-Forward Inflation Expectations rate has remained in a narrow 2.2% to 2.4% band and is currently at 2.3%. This rate implies that market participants believe inflation will average 2.3% from 2028 thru 2032.

Despite higher current inflation, inflation expectations remain near the FRB's long-term target.

The graph on the right shows our most recent inflation forecast. Recent adjustments have modestly increased 2023 inflation. We project that inflation will average 2.5% during 4Q23 (up from 1.8%) and 2.9% in 4Q2024 (no change).



Commodity scarcity, deglobalization, a Cold War, and the shift to zero-carbon will cause inflation to be more volatile. Inflation pressures will likely return in late 2024 and 2025 as the economy recovers from the recession leading to another tightening cycle.

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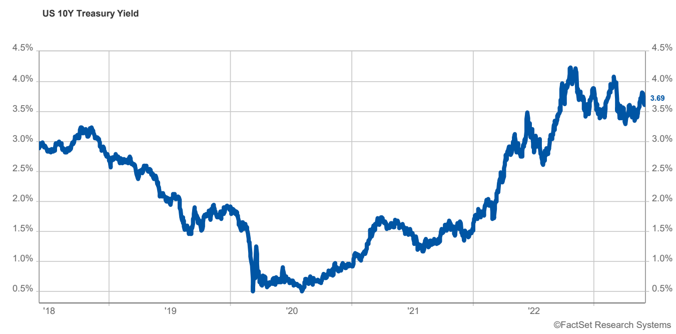
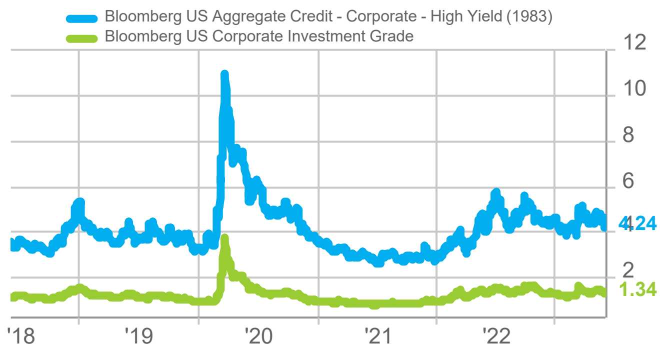
Interest Rates and Credit Markets

The Treasury yield curve rose across the yield curve in May. The curve became slightly more inverted as shorter rates rose marginally more than longer ones.



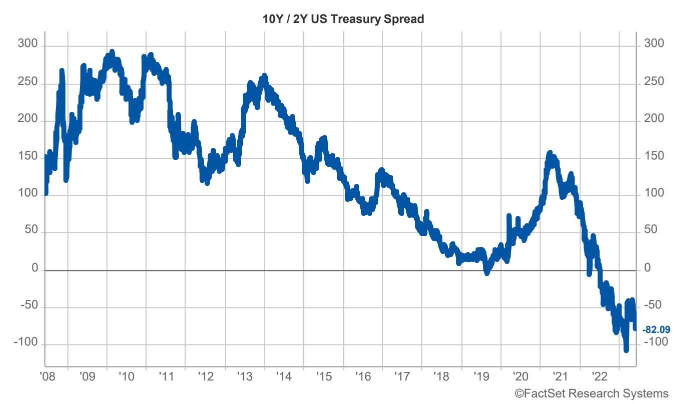
Credit spreads held steady during the month. During periods of economic stress, investment grade spreads often widen to above 2%. Investment grade spreads ended the month at 1.36%, unchanged.

High-yield spreads widened by seven basis points in May to 4.61%. During periods of economic stress, high yield spreads often widen to above 8.00%. The failure of three large regional banks and a debt ceiling fight have failed to widen credit spreads. Spreads remain comfortably far from recessionary levels.



The MOVE index measures interest rate volatility that tracks the movement in 2-year, 5-year, 10-year, and 30-year U.S. Treasury options. The index has retreated from recent highs and has returned to recent levels. Interest rate volatility should abate with the FRB signaling a pause in rate hikes and a resilient labor market.

We expect the current pause to last through the year. The FFR will likely end the year at 5.25%. The 10-year treasury will likely end the year at 3.75%. We also expect credit spreads to rise slightly from current levels as the economy enters a recession.



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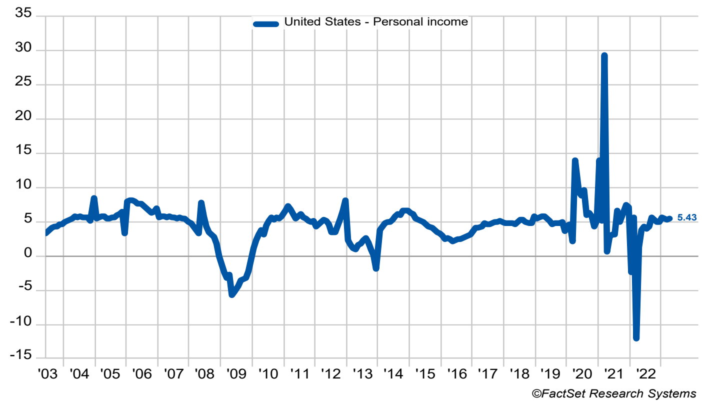
The Consumer Sector

Personal income rose by 0.4% in April. Consensus expectations were for a 0.4% increase. Personal consumption expenditures rose 0.8%. The PCE Price Index (PCE Inflation) rose 0.4%. The savings rate fell to 4.1%. Consumers dipped into their savings and tapped credit cards to support extra spending.



Personal income rose 0.4% m/m and was up 5.4% YOY. Disposable personal income rose 0.4% m/m and was up 7.9% YOY. The difference between disposable personal income and total personal income is due to an 8.8% YOY decline in personal taxes. Investors paid lower capital gains taxes after last year's horrible equity and fixed-income returns. Personal income, excluding government transfer payments, rose 0.5% m/m and 5.6% YOY. Private sector wages and salaries were up 0.5% m/m and 5.6% YOY.

Real disposable personal income per capita was flat m/m and 2.9% YOY. Real disposable personal income per capita has been growing (not falling) for 10 consecutive months. Consumers are benefiting from the strong labor market and moderating inflation. Rising real disposable income supports continued modest consumption and economic growth.

Personal Consumption Expenditures			
	Nominal	Inflation	Real
Durable Goods	1.6%	0.3%	1.4%
- Motor Vehicles and Parts	3.8%	1.5%	2.2%
Non-Durables	0.8%	0.4%	0.4%
- Restaurants	0.3%	0.0%	0.3%
Services	0.7%	0.4%	0.4%
- Tax Prep Services	9.0%	6.4%	2.5%
Total	**0.8%**	**0.4%**	**0.5%**
Data for April 2023 m/m			

Personal consumption expenditures (PCE) were up 0.8% for the month. On a real basis, after subtracting out the impact of inflation, consumer expenditures rose 0.5% m/m. Real personal consumption expenditures have tended to rise during the first month of a quarter and fall in the subsequent two months. We shall see if that pattern continues.

Purchases of durable goods rose by 1.6% m/m, led by a 3.8% increase in motor vehicles and parts. New car sales tend to jump in the first month of a quarter, only to fall in subsequent months. On a real basis, spending rose 1.4%, led by a 2.2% rise in motor vehicles and parts. Light vehicle sales rose to a 16.6 million adjusted annual rate (AAR) in April but fell to 15.6 million AAR in May. We expect lower durable goods consumption in the May report. Purchases of non-durable goods rose by 0.8% m/m, led by a 0.3% increase in dining out. On a real basis, spending rose by 0.4%, led by a 0.4% increase in the restaurant check. Services purchases rose by 0.7% in April. Spending to file our tax returns rose by 9.0%. On a fundamental basis, services consumption was up 0.4%. Tax prep fees increased 6.4% during the month and are up 13.3% YOY. Continued talent shortages are driving up the cost of accountants.

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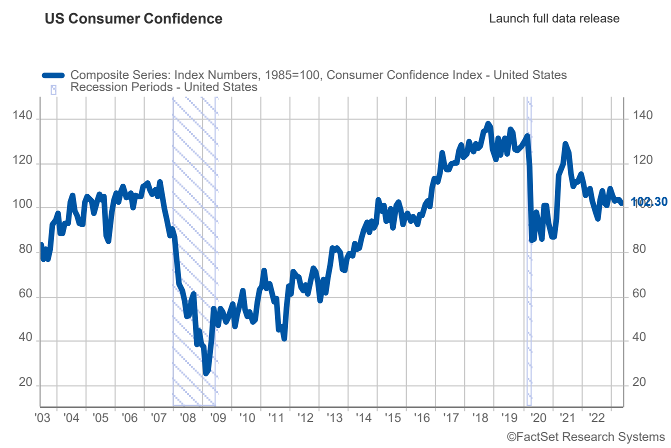
Consumption will likely slow as excess savings are exhausted. Consumers saved just 4.1% of disposable income during the month. This is up significantly from the 2.7% savings rate reported in June 2022 but less than the 7.4% savings rate that prevailed before the pandemic.

The Consumer Confidence Index, compiled by the Conference Board, fell 1.4 points to 102.3. The previous month's index was revised up by 2.4 points. The May index was higher than the initially reported April number. A rise became a drop with the revision.

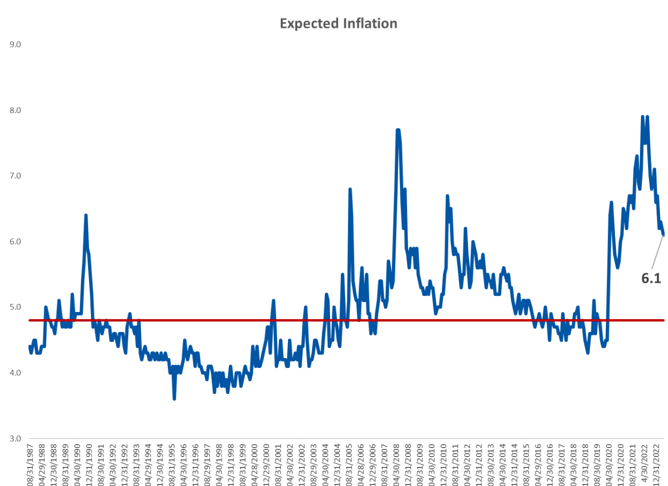


Consumers' perception of their present situation worsened. The present situation component fell by 3.2 points to 148.6. The forward-looking expectation component fell by 0.2 points to 71.5. Last month's expectations index was revised from 68.1 to 71.7. Consumers are starting to worry about the labor market.

Consumers' perception of the labor market remains strong. The current conditions net employment sub-index (plentiful - hard to get) fell to 31.0 from 36.9 the previous month. Consumers' outlook for future employment stabilized as the net sub-index (more jobs – fewer jobs) rose to -6.6 from -7.0 the previous month.

Respondents' perception of current business conditions improved slightly as the net sub-index (good-bad) rose to 2.6 from 0.9 the previous month. Consumers' outlook for future business conditions modestly worsened as the net sub-index (better – worse) fell to -7.7 from -7.3 last month.

The Conference Board started asking consumers about inflation expectations in 1987. Consumers' expectation for inflation for the next 12 months continues to moderate. Consumers forecast inflation will be 6.1% in 12 months versus the 7.9% reported in June 2023 and the 4.8% long-term median. The FOMC is making modest progress in moderating inflation expectations. While lower than the recent peak, expectations are above the long-run average. Returning expectations to the long-run average may cause a recession.



Labor markets remain resilient. 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.

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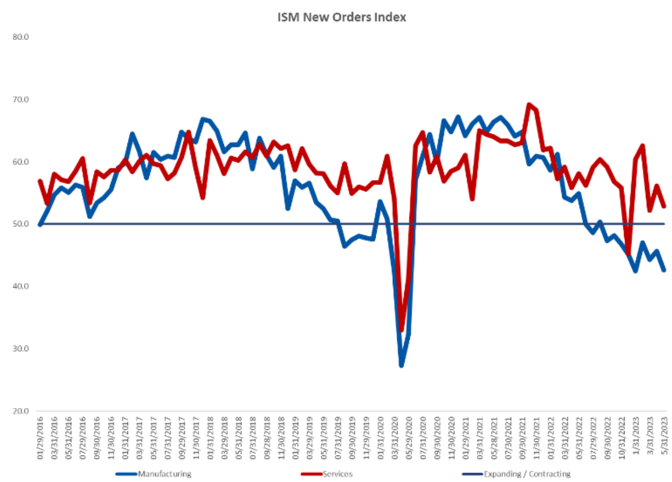
The Business Sector

The Institute for Supply Management (ISM) reports monthly on manufacturing and non-manufacturing (service) sector activity. The reports are sentiment-driven and can be influenced by current events. Nonetheless, they do provide real-time clues to what is happening.



The New Orders Index is a leading indicator for the ISM Activities Index and the economy. This chart supports a manufacturing recession. The manufacturing new orders index has been below 50 for nine of the last ten months. The pace of the decline is accelerating. New orders in the service sector, while expanding, are decelerating.

May's non-manufacturing index fell 1.6 points to 50.3, below the consensus expected 52.0. Growth narrowed as 11 industries reported growth versus 14 last month. The two forward-looking measures (new orders and production) showed slowing momentum. The report was overall weak and points to a slowing service sector.

Employment contracted slightly. The employment index fell by 1.6 points to 49.2, indicating that employment contracted in May. Nine industries reported increased employment. Seven industries reported a decrease in employment. Comments from respondents include: "We are trying to do more with the same staff because margins in the industry have compressed," and "Our company is currently on a hiring freeze until there's a better understanding of where the economy is headed."

Non-Manufacturing Sector	Direction	Rate of Change
Business Activity / Production	Growing	Slower
New Orders	Growing	Slower
Backlog of Orders	Contracting	Faster
Employment	Contracting	From Growing
Prices Paid	Increasing	Slower
Supplier Deliveries	Faster	Faster
Non-Manufacturing Sector	**Growing**	**Slower**
Industries Expanding	11	-3
Industries Contracting	7	+4

Prices paid for materials and services rose at a steady pace. The price component fell by 3.4 points to 56.2. 12 industries reported higher costs. Three industries reported lower costs. The non-manufacturing sector has only made slight progress in lowering input costs. Labor is a more significant component of input cost versus materials, and wages continue to rise versus declining material costs. This makes the FRB's task of taming service sector inflation much harder.

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.

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The manufacturing index fell 0.2 points to 46.9, slightly better than the consensus estimate of 47.0. May's report marks the seventh consecutive month in contraction territory. The two forward-looking measures (new orders and production) were mixed.

Supplier deliveries improved. Input inflation fell. Softness in the manufacturing sector is widespread as only four industries reported faster economic activity, while fourteen reported slower economic activity. Four of the ten components showed expansion.

Manufacturing Sector	Direction	Rate of Change
Production	Contracting	Slower
New Orders	Contracting	From Contracting
Backlog of Orders	Contracting	Faster
Employment	Growing	Faster
Prices Paid	Decreasing	From Increasing
Supplier Deliveries	Faster	Faster
Manufacturing Sector	**Contracting**	**Faster**
Industries Expanding	4	-1
Industries Contracting	14	+3

The manufacturing sector shed 2,000 jobs in May, despite adding 10,500 jobs in the transportation sector (autos and planes). It is safe to say that manufacturing is already in a recession.

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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 that meets eight times yearly to set monetary policy. The primary tool for monetary policy is the Federal Funds Rate (FFR). FFR is the rate set by the FOMC and is the rate 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
YOY = Year Over Year

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