Current Forecast

	2021	2022 Est	2023 Est	2024 Est
GDP Growth (1)	5.7%	0.3%	-0.8%	1.6%
Change in Consumer Prices (2)	7.1%	7.1%	3.2%	3.0%
Fed Funds Target Rate (3)	0.25%	4.50%	4.75%	3.75%
5-Year Treasury Yield (3)	1.26%	4.13%	3.75%	3.75%
10-Year Treasury Yield (3)	1.51%	3.75%	3.75%	3.75%
S&P 500 EPS	$206	$217	$210	$231

(1) 4th quarter/4th quarter (2) December / December (3) Yearend rates

Security National Bank Private Client Services expects 4Q/4Q GDP growth will slow to 0.3% in 2022 and fall 0.8% in 2023 as the U.S. enters a recession in spring 2023. We expect the FOMC will raise rates by 0.50% in December and 0.25% in February 2023 and March. The FFR will likely stay at 5.00% for most of 2023. We expect inflation will fall to 4.6% in 4Q2022 and 2.4% by 4Q2023 as supply chains normalize and aggregate demand falls.

Last Month's Rates and Total Returns

November 30, 2022	Value	One Month	Year to Date	1 Year
Fed Funds Target (Upper)	4.00%	+75 bp	+375 bp	+375 bp
2-Year Treasury Yield	4.38%	-11 bp	+365 bp	+386 bp
5-Year Treasury Yield	3.83%	-41 bp	+257 bp	+268 bp
10-Year Treasury Yield	3.70%	-37 bp	+219 bp	+226 bp
S&P 30Yr Fixed – U.S. Avg.	6.72%	+13 bp	+356 bp	+359 bp
S&P SuperComposite 1500	934	5.58%	-12.74%	-8.80%
S&P 500 Index	4,080	5.59%	-13.10%	-9.20%
S&P Midcap 400	2,578	6.12%	-7.96%	-3.29%
S&P SmallCap 600	1,243	4.17%	-10.06%	-5.99%
S&P 500 Growth	2,558	5.10%	-23.58%	-21.69%
S&P 500 Value	1,496	6.02%	-1.36%	5.59%
World ex-US, net *	253	11.81%	-15.37%	-11.87%
Wilshire Liquid Alts	176	1.77%	-4.41%	-3.69%
BB U.S. Aggregate	89	3.68%	-12.62%	-12.84%
Crude Oil – WTI Near Term	$81	-6.91%	7.10%	21.71%
Commodity Index	116	2.74%	19.01%	23.20%
FT Wilshire Bitcoin	16,877	-17.27%	-64.80%	-70.0%
Gold – Near Term	$1,746	6.73%	-4.46%	-1.56%

**= MSCI ACWI ex the US*

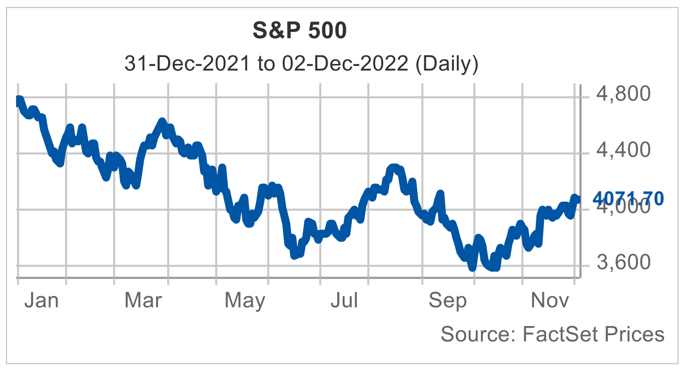
Security National Bank's Wealth Management Department authors a monthly economic forecast that provides our Investment Committee and the Bank's Funds Management Committee with background assumptions for use in investment decisions. We are pleased to share our economic outlook with you. Please be advised that our crystal ball is just as clouded as other prognosticators and that all forecasters have poor track records. This report will use FRB for Federal Reserve Bank and FOMC for Federal Open Market Committee. 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 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), and real values enable comparisons that are not distorted by inflation. GDP numbers are usually reported as real growth.

Our projections are based on what we think monetary and fiscal policymakers *will* do, not what they *should* do.

Stock Market

The S&P 500 Index rallied for a second month. The benchmark index was up 5.6% in November, up 14.4% from its October lows but down 13.7% from its all-time closing high on January 3, 2022. Mid-Cap and Small-Cap stocks were up 6.1% and 4.2% during the month.



The top-performing sector was materials (up 11.8%), while the worst showing came from consumer discretionary (up just 1.1%). Year-to-date, only two of the 11 major sectors, energy and staples, were positive on a total return basis. The index's top performer was energy (up 70.7%), while the worst showing came from communication services (down 34.8%).

International stocks rallied strongly and were up 11.8% for the month and are down 15.4% YTD. Stocks in the Asia Pacific were up 15.0% for the month and were down 17.0% YTD. European stocks were up 11.4% for the month and were down 17.1%YTD.

Potential catalysts for the global market rally were many but likely included:

- Better-than-expected inflation data in the U.S. and Europe,
- A potential slowing to the pace of interest rate hikes,
- Potential reopening in China, and
- Moderating but still strong labor market.

While the stock market incorporates some risk of a recession, we do not believe it fully includes a mild recession, much less a deep one. There remains substantial downside risk if a downturn does occur. The recent rally off the lows appears to be a bear market rally or a bear trap.

We can only be sure that a recession will be avoided once the FRB stops raising interest rates. It is unlikely to stop raising interest rates until the path of inflation is lower, and the labor market has softened. As outlined as follows, a recession is our base case. The recent stock market rally may be a bear market trap.

On the other hand, avoiding a recession would ultimately lead to higher equity returns and the start of a bull market.

Bond Market

A better-than-feared inflation report on November 10 spurred a 0.45% decrease in the 10-year Treasury yield and a 3.7% gain on the Bloomberg Aggregate Bond Index through month end. For the month, the benchmark 10-year Treasury Note yield fell by 0.37% to 3.70%. The yield on the 2-year Treasury Note fell by 0.11% to 4.38%, but the 1-year Treasury interest rate rose by 0.10% to 4.78%. Moderating interest rates translate to gains for bondholders. The Bloomberg Aggregate Bond Index posted a total return of 3.7% for the month but remained down 12.6% YTD. Global bonds posted a positive return of 4.7% for the month but remained down 16.7% YTD.

Comments from several FRB officials pushed up near-term (the 1-year Treasury rate rose 0.10%). The same commentary raised the concern that the FRB will raise rates high enough to cause a recession in 2023, and that concern was the catalyst for lower longer-term rates. Bond investors are betting that a downturn will cause inflation to fall swiftly, allowing the FRB to lower rates.

Our Outlook in a Nutshell

Inflation remains too high. While goods inflation is moderating, services inflation is at a 7.8% pace. Labor costs are a significant component of service costs. To reduce services inflation, wage growth must slow.

The labor market remains too strong. Wage growth needs to slow from 5.8% to 3.5%. This will likely require a recession and higher unemployment. We expect unemployment will rise to at least 5.5% next year, implying an additional 3 million or more unemployed persons.

Interest Rate Policy

By March 2023, the FRB will have raised rates by 4.75%. It takes twelve to eighteen months for FRB policy to impact the broad economy and inflation statistics. Outside of a few sectors, such as housing and investment portfolios, the impact of higher rates has only started to show. Much of the effects of rising rates are yet to come. During the press conference on November 2, Chairman Powell clarified that the FRB would rather err on raising rates too high than let inflation become entrenched. Both employment and inflation are lagging indicators, forcing the FRB to set policy by looking into the rearview mirror or using secondary indicators such as inflation expectations.

Meeting Date	Fed Funds Futures	SNB Forecast
Current	4.00%	
December 14	4.50%	4.50%
February 1	4.75%	4.75%
March 22	5.00%	5.00%
May 3	5.00%	5.00%
June 14	5.00%	5.00%
July 26	5.00%	5.00%
September 20	5.00%	5.00%
November 1	4.75%	5.00%
December 13	4.75%	4.75%
Data as of 12/03/22		
The upper end of the range		

Like most investors, we expect the FRB to raise rates by 0.50% on December 14, down from the 0.75% hike at its November meeting. The FRB will benefit from one more CPI report on December 13 before the next meeting on December 14. A better-than-expected or a worse-than-expected inflation report may render our outlook mute.

The FRB will likely raise rates by a more traditional 0.25% at its first two meetings in 2023. By that time, core inflation should be below the FFR, traditionally the point where it stops raising rates. If the economy avoids a recession and inflation persist, the FRB may need to increase interest rates by an additional 0.25% hike at subsequent meetings. The economy will likely slip into a recession by the May meeting.

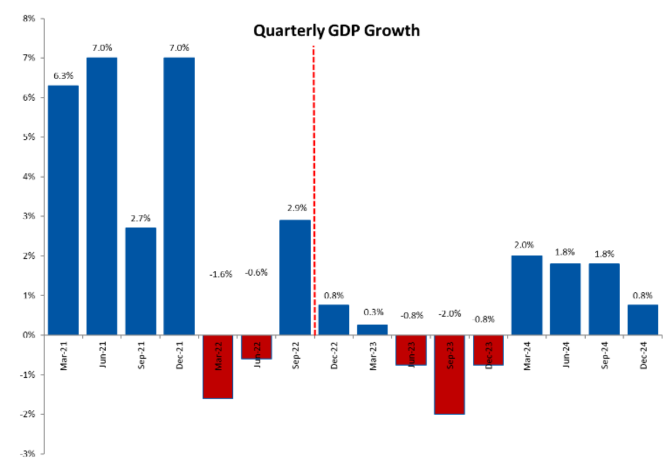
We have included our Fed Funds Rate (F.R.) forecast and market-based expectations for comparison. The FRB rarely keeps interest rates at their peak for very long, and the FRB has historically remained on hold at its peak rate for an average of 5.5 months. We expect the FRB keep rates high for a bit longer than average, lowering rates in December 2023. By then, the U.S. will have been in a recession for several quarters, unemployment will have risen, and inflation will have moderated.

The 2-Year Treasury security has been an excellent guide to the path for the FFR. The 2-Year Treasury tends to peak slightly above and slightly before the FFR peak rate. The 2-Year Treasury peaked at 4.73% on November 7, just before the most recent CPI report. Currently, the 2-Year Treasury yields 4.29%. We now have a 5.0% FFR peak. The 2-Year Treasury rate supports our peak FFR.

Economic Forecast

Contribution to GDP Growth Trends												
	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22
PCE - durable goods	0.5	(0.8)	0.1	6.2	0.1	3.2	0.9	(2.2)	0.4	0.6	(0.2)	(0.0)
PCE - nondurable goods	0.0	0.8	(2.2)	4.6	0.0	2.1	1.7	0.3	0.1	(0.7)	(0.4)	(0.0)
PCE - services	1.0	(4.2)	(21.0)	15.5	2.5	1.7	5.2	3.9	1.6	0.9	2.0	1.2
Business Investment - Structures	(0.2)	(0.1)	(1.6)	(0.3)	0.0	0.0	(0.1)	(0.2)	(0.4)	(0.1)	(0.3)	(0.2)
Business Investment - Equipment	(0.5)	(1.4)	(2.1)	2.7	1.0	0.4	0.7	(0.1)	0.1	0.6	(0.1)	0.5
Business Investment - IP	0.4	0.4	(0.5)	0.5	0.4	0.8	0.6	0.4	0.4	0.5	0.5	0.3
Homes	-	0.6	(1.2)	2.2	1.3	0.5	(0.2)	(0.3)	(0.1)	(0.2)	(0.9)	(1.4)
Core GDP	**1.3**	**(4.8)**	**(28.4)**	**31.5**	**5.3**	**8.7**	**8.9**	**1.8**	**2.3**	**1.7**	**0.5**	**0.4**
Gross Domestic Product	**1.8**	**(4.6)**	**(29.9)**	**35.3**	**3.9**	**6.3**	**7.0**	**2.7**	**7.0**	**(1.6)**	**(0.6)**	**2.9**

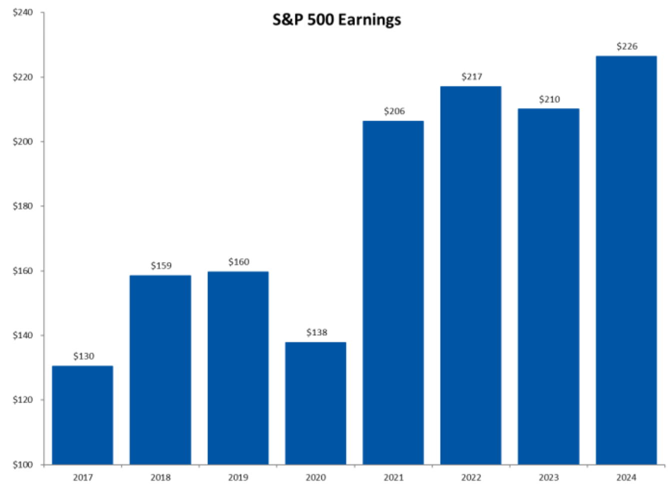
On November 30, the U.S. Bureau of Economic Analysis released the second estimate of 3Q2022 economic growth. Headline numbers proclaimed that the economy grew at a robust 2.9% annual growth rate after two consecutive quarters of negative growth. We favor a "core GDP" approach. This number strips out the highly volatile sectors of inventories, net exports, and direct government purchases. The core GDP figure points to a slowing economy. Core economic growth was a paltry 0.4% during the quarter. Growth was held back by the plummeting housing sector, business investment in structures, and the switch from goods purchases to service purchases. The service sector remained strong, along with business investment in intellectual property and equipment



Based on our reading of the core GDP, the economy was not in a recession during the first half of the year, nor is it in one now. That does not mean the U.S. will avoid a recession. The FFR will have increased by 4.75% in a year by March 2023. In addition, the money supply has not grown and may have fallen year over year (y/y) by then. We expect a recession will start during the second quarter, as early as April. The equivalent of 19 rate hikes and no money supply growth will be too much to power through.

Corporate Earnings

Estimates for 2023 S&P 500 earnings have decreased slightly over the last month from $232 to 231, a decrease of less than 1%. We currently forecast $210 for 2023 S&P 500 EPS, 9% below consensus. Stock analysts usually are very optimistic, and they typically start next year's earnings projections high and cut them as the year progresses. It is usual for next year's earnings to be cut by 5% over the preceding year. Since January 2022, projected 2023 earnings have only been cut by 6%. This cut is slightly less than usual, leading us to conclude that analysts have not factored a recession into their 2023 earnings estimates. Assuming our forecast of a mild recession is correct, 2023 earnings have another 10% to fall. The big adjustment will likely come in the second half of January as CFOs update their guidance during earnings calls. The stock market is susceptible to a correction at that point.



The pending cut in earnings expectations leads us to believe the recent stock rally is a bear trap. Improvements in inflation trends led to the current stock market rally. The recent rally is not sustainable because investors still need to incorporate the earnings hit from the pending recession fully. We remain cautious and suggest you do, too.

Please do not take our outlook as a suggestion to time the markets. History has proven that the penalty for being early into a downturn is usually only a couple of months of losses. However, the penalty for being late can last a lifetime. Seven of the ten best days in the stock market occur within two weeks of the ten worst days.

- Six of the seven best days occurred after the worst days
- The second-worst day of 2020, March 12, was immediately followed by the second-best day of the year.
- Missing the ten best days results in your stock market returns being cut by 45%. The same caution that kept our ancestors from being eaten on the savanna makes it difficult to reenter the stock market after a large one of the worst days. Six of the seven best days occurred after the worst days
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You can use the recent rally to trim some of your weaker positions in anticipation of better buying opportunities in a couple of months. We suggest doing this with a small fraction of your portfolio. We could be wrong, and the recent rally could start a historic bull market.

If you have any questions or comments, please feel free to reach out to our Security National Bank Private Client Services team.

Damian Howard, CFA
Senior Vice President, Director of Wealth Management

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

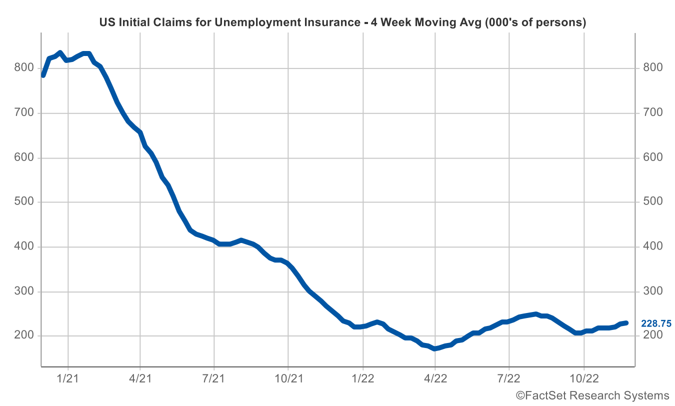
Since 1977, the Federal Reserve has operated under a mandate from Congress to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" –commonly referred to as the Fed’s "dual mandate." For this reason, we always start our economic review with employment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

Employment

Employment is a lagging indicator, meaning that employment usually softens after a recession begins. It takes a lot of money and effort to attract and retain employees, especially in this environment. Employers wait to let staff go until falling revenue forces them to cut costs. Declining revenues are usually only evident once the recession has run for a couple of months.

The labor market remains too strong for the FRB’s liking. The FRB would like to see wages grow at a 3.5% pace. Currently, wages are increasing at a 5.8% pace. Slower wage growth will require a recession and higher unemployment. We expect unemployment will rise to at least 5.5% next year, and this implies an additional 3 million or more unemployed persons.

We begin our employment review by looking at the Jobs Openings and Labor Turnover Report. (JOLTs) published by the Bureau of Labor Statistics (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 October JOLTs report indicated that open positions fell by 353,000 to 10.3 million, in line with consensus expectations. 6.7% of private sector jobs remain unfilled versus 6.9% the previous month. The available positions decreased in manufacturing (89,000) and healthcare (86,000). The private sector quit rate held steady at 2.9%. This number will decrease as the U.S. enters a recession and employees become more concerned about finding a new position. The private sector layoffs and discharges rate also held steady at 1.0%. We look for this number to rise before a recession. The FOMC has stated its desire to see the number of job openings fall. This month’s report indicates that the labor market has softened but continues to be resilient. Wage pressure and the risk of a wage/price inflation spiral remain.



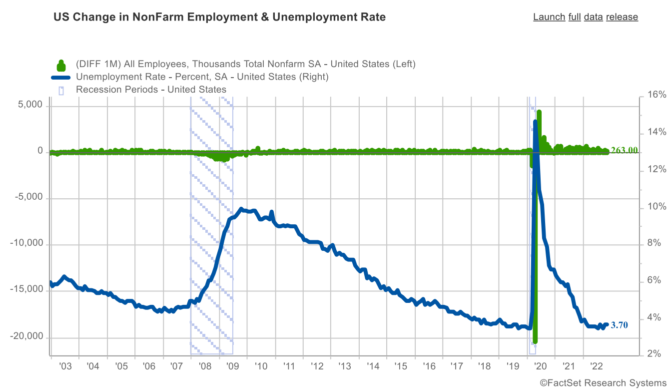
We also watch the initial weekly claims figure for early warning of a weakening jobs market and a potential recession. Unemployment insurance claims remain remarkably low. For the week ending November 25, initial jobless claims were 225,000, below the consensus forecast of 240,000, bringing the four-week average to 229,000. Weekly jobless claims signal that the labor market remains strong. Workers who lose their job have been able to find work quickly. Continuing claims have increased slightly to 1,608,000 persons from 1,487,000 four weeks ago. Several large, well-known technology companies have announced significant layoffs. Many old economy companies remain eager to hire the newly available talent. These coddled former tech employees may need to do without free meals, laundry, and lavish perks provided by their former employer.

The BLS reported that the economy either added 263,000 of jobs or lost 138,000 jobs in November. The Establishment survey puts the job gains at 263,000 versus the consensus estimate of 200,000 jobs added. The Household survey puts the job losses at 138,000. The previous two months’ establishment payrolls were revised lower by 23,000. The unemployment rate held steady at 3.7% as the number of unemployed persons decreased by 48,000, and the labor force fell by 186,000 persons. The participation rate fell by

0.1% to 62.1%. Hourly earnings rose 0.55%, higher (worse) than the consensus estimate of a 0.30% increase.

The private sector added 221,000 jobs versus the consensus estimate of 200,000 private-sector jobs, with notable gains in leisure and hospitality (88,000 jobs added) and healthcare (45,000 jobs added). The government sector added 42,000 of jobs, evenly split between local education and other local government services.

The BLS reports statistics from two monthly surveys, and there can be some differences in numbers. The household survey measures labor force status, including unemployment, by demographic characteristics. The establishment survey measures non-farm employment, hours, and earnings by industry. The household survey puts the change in employment at a loss of 138,000 jobs, while the establishment puts the change in employment at a gain of 263,000. This marks two consecutive months of Household survey job losses and Establishment survey gains. Monthly numbers can be volatile and are often revised but tend to converge over the long term. The Household survey is seen as a more volatile and less reliable indicator of labor market strength.



The unemployment rate held steady at 3.7%. The number of officially unemployed persons fell by 48,000 to 6.0 million. The broader U-6 unemployment rate fell 6.7% from 6.8% the previous month. There are 1.7 job openings for every unemployed person, slightly below last month's 1.8. The FRB suggests a 1.4 number or below, signifying a more balanced labor market.

The participation rate fell by 0.1% to 62.1%. The participation rate was 62.7% in February 2020. The employment-to-population ratio fell by 0.1% to 59.9%. This number was 61.2% in February 2020.

Last month's average hourly earnings (wages) rose by $0.18 per hour to $32.82, up 0.55%, above the consensus estimate of 0.30%. Average hourly earnings are up $1.59 per hour, or 5.1% y/y, significantly higher than the consensus estimate of 4.6%. Average hourly earnings for the previous two months were also revised higher. With these revisions, wage growth is no longer decelerating and remains significantly above the 3.5% rate favored by the FRB. Over the last three months, average hourly earnings have grown at a 5.8% pace versus 4.7% last month and 4.8% the month before. Wage growth is accelerating rather than decelerating.

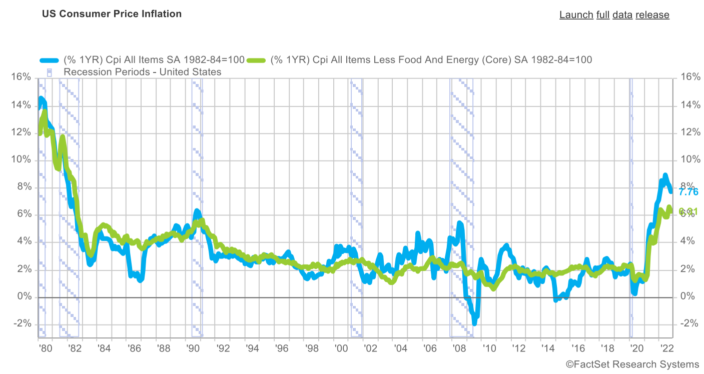
The average workweek fell by 0.1 hours to 34.4 hours. Average weekly earnings increased by $2.93 or 0.26% from the previous month. Average weekly earnings are up $42.21 (3.88%) y/y. Average weekly earnings were $1,129 ($58,709 annualized) versus $1,087 ($56,514 annualized) last year.

The establishment survey showed that the economy added jobs. However, the average workweek fell to its lowest since the pandemic at 34.4 hours. Slowing hours worked is a classic sign of a slowing labor market, and companies reduce hours worked before lowering employment. The labor market remains strong but is slowing. Nothing in the most recent labor reports will change the FRB's path. It stays on pace to increase the FFR by 0.50% on December 14.

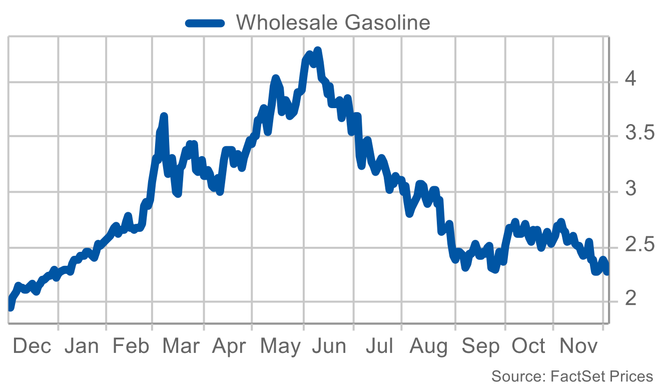
Further increases in the FFR will depend on how fast the labor market slows from here. We expect the FOMC to raise the FFR by 0.25% in February and March 2023, and we also expect a recession in 2023.

Inflation

The most recent data is from October, as The U.S. Bureau of Labor Statistics will release the November Consumer Price Report on December 13, only one day before the next rate decision. Falling energy and moderating goods prices helped ease inflation. Food inflation remains high but is moderating. Services inflation will remain sticky due to the lagging impact of rent.



The Consumer Price Index (CPI) rose 0.4% in October, and core prices rose 0.3%. Consensus expectations were for a 0.6% month over month (m/m) increase in headline inflation and a 0.5% increase in core inflation. Consumer prices are up 7.8% y/y, which is down from the 9.0% reported in June, the highest reported in four decades. Over the last three months, inflation has run at a 3.8% annual rate, with core inflation running at a 5.8% annualized rate.



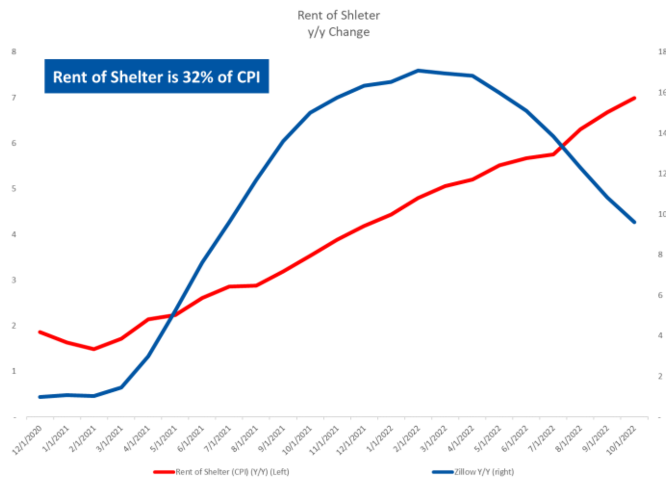
Energy prices rose 1.8% in October. And were down 20% on a trailing three-month annualized basis (TMA). Energy prices have remained relatively stable since October. Concerns about low inventories and lack of new supply have been offset by expected demand destruction from a possible global recession. Energy prices should be modestly disinflationary over the winter months. Energy prices may fall another 15% next year if the global economy falls into a recession. Longer term, energy prices a likely to be significantly higher. Increased carbon-free energy production may not be able to offset increased global demand. We forecast that energy prices will decrease by 1.4% in November.

Food prices rose 0.6% in October and are up 9.1% TMA. Commodity grain prices remain high because of the European war and poor global weather conditions. We forecast food prices will increase another 0.6% in October and end the year at a 0.6% m/m pace.

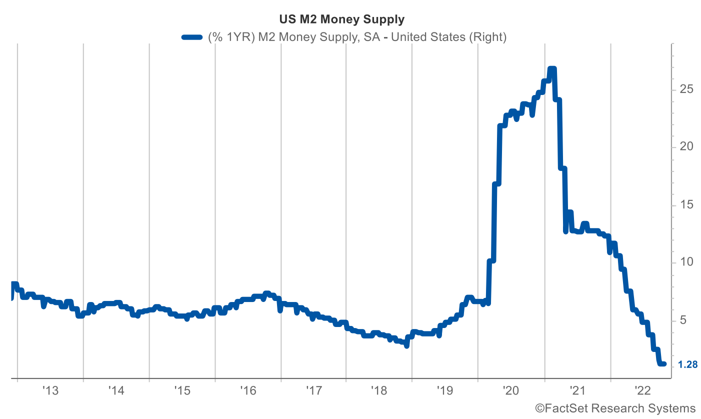
The core CPI rose 0.3% in October and is running at a 5.8% TMA. Core prices are likely to remain sticky due to sticky services inflation.

Goods prices fell 0.4% in October and are running up only 0.4% TMA. New and used car prices are a significant swing factor in goods inflation. Used car wholesale prices have eased by 9.9% since peaking in May 2022. It takes a while for wholesale prices to be reflected in CPI statistics. The prices of used cars fell 2.4% in October and are down 4% over the last four reports. We look for further drops in used car prices in future CPI reports. The cost of new vehicles rose 0.4% in October and is up 8.4% y/y. New vehicle sales rose to a 15.4 million pace in October, up from 14.0 million in September. The supply of new vehicles has been constrained for the last two years, leading to extraordinary pricing power for manufacturers, but that situation is about to change. Higher interest rates and lower trade-in values will pressure new car pricing. Consumers typically purchase cars based on monthly payments. To keep monthly payments flat compared to last year, new car prices would have to fall by 14%.

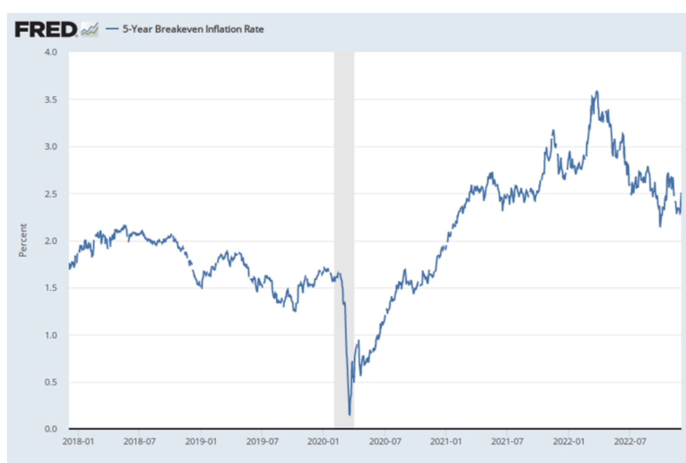
Rent of shelter increased by 0.7% in October and is up 7.0% y/y. According to Zillow Research, new lease apartment rents fell 0.1% m/m but were up 9.60 y/y in October. Rental inflation may have peaked in February at 17.1% y/y and is rapidly decelerating. High but rapidly decelerating inflation is also evident in the existing home prices. The S&P/Case-Shiller Home Price Index fell 1.2% in September (the third straight decline) but is up 10.5% y/y. Due to the nature of data collection, shelter CPI lags current condition by six to nine months. We expect shelter CPI to remain high for a couple of months before easing in 2023. Shelter rent is 32% of the overall CPI basket.



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 25%. The money supply has fallen by less than 0.4% YTD (flat) and is up only 1.3% y/y. We look for M2 to grow less than 4% over the next several years as the FRB shrinks its bloated balance sheet. The stagnant money supply heightens the risk of a liquidity crisis and will likely lead to higher volatility in short-term interest rates.

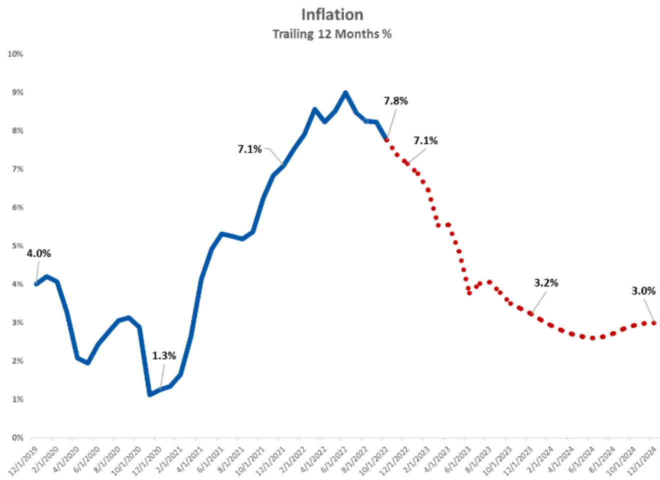


Because inflation statistics are a lagging indicator, the FRB uses forward-looking inflation expectations. The 5-Year Breakeven Inflation Rate peaked at 3.60% in March 2022. Since then, interest rates have risen significantly, leading to lower stock prices and tighter financial conditions. Inflation expectations have fallen dramatically to the current 2.51%. The Breakeven Inflation Rate implies what market participants expect inflation to be in the next five years, on average.



The 5-Year, 5-Year-Forward Inflation Expectations rate has remained steady, falling into a 2.2% to 2.4% band and is currently at 2.35%. This rate implies that market participants believe inflation will average 2.3% from 2027 thru 2032.

The graph on the right shows our most recent inflation forecast. We forecast a relatively rapid decline in inflation, primarily due to a pending global recession. Energy prices are likely to fall during a worldwide recession. Goods inflation will continue to moderate as consumers shift their purchase patterns and budgets become stretched. Higher unemployment will likely reduce wage pressures, allowing service inflation to moderate. We project that inflation will average 3.8% during the fourth quarter, down from 11.0% during the second quarter. By the fourth quarter of 2023, inflation will likely fall below its long-term run rate of 3.0%. The likely global recession should allow the FOMC to begin an easing cycle in late 2023.

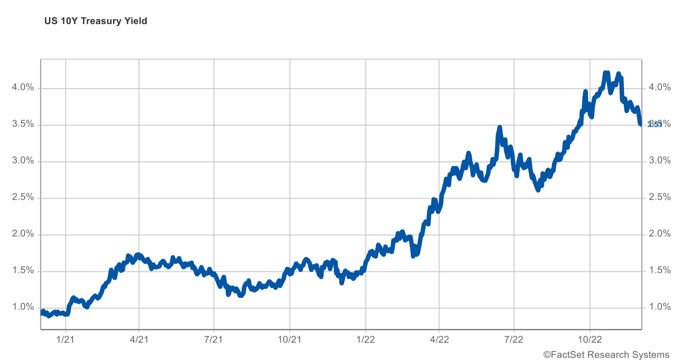


Our long-term inflation rate of 3.0% is above the 5-Year, 5-Year-Forward rate of 2.4% and the FRB's longer-run estimate of 2.3%. Previous Outlooks have outlined why we expect inflation to trend higher than FOMC projections. We also believe inflation and interest rates will be more volatile for the remainder of the decade as cycles will be shorter in duration and higher peak to trough. Investors will need to be more agile.

The FRB prefers the Personal Consumption Expenditure (PCE) measure of inflation. Due primarily to differences in how healthcare costs are allocated between employers and consumers, the PCE tends to run 0.30% below the CPI.

Interest Rates and Credit Markets

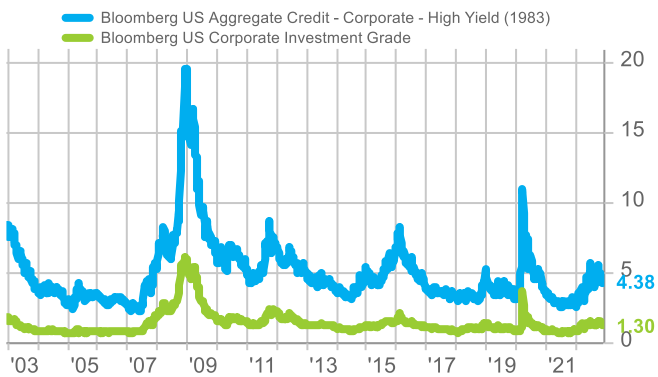
On November 10, the U.S. Bureau of Labor Statistics released a benign inflation report. The better-than-expected report triggered a massive bond rally. The U.S. 10-year Treasury rate fell by 0.27%. The bond rally continued through the end of the month.



The peak of the yield curve now sits at the twelve-month maturity. Market participants believe the FRB will begin cutting interest rates in about twelve months. It also implies that participants believe the FRB will raise rates high enough to cause a recession. They will then lower interest rates during the pending recession.

A recent study by Wells Fargo evaluated various yield curves for their ability to predict the depth of a recession. They found that the spread between the 10-year and 1-year Treasury yield was highly predictive in predicting a recession and the depth of the recession.

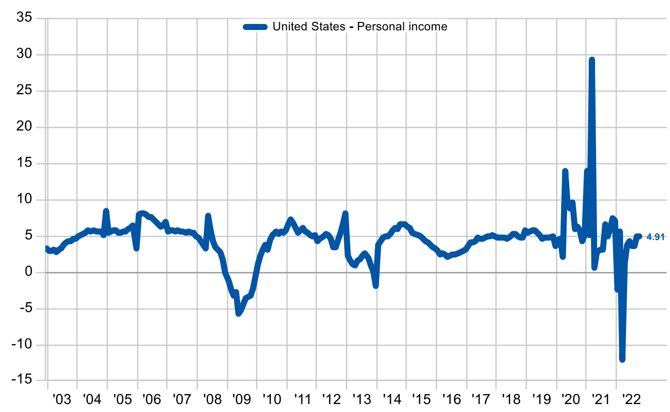
The 10-year/1-year spread turned negative in August and has remained negative, suggesting a near 100% chance of a recession in the next twelve months. When the 10-year/1-year spread remains negative for 12 consecutive months, there is an 80% chance the recession will be more profound than average. The Well Fargo study supports our current economic forecast of a recession next year.



Despite a pending recession, credit spreads remain relatively tight and have narrowed during the quarter. The investment grade spread is currently 1.30%, down from 1.65% in mid-October. During periods of economic stress, investment grade spreads often widen to above 2.00%. The high-yield spread is currently 4.38%, down from 5.61% at the end of September. During periods of economic stress, high yield spreads often widen to above 8.00%. The credit markets remain remarkably calm with fixed-income investors pricing a very shallow recession at worst. We had expected credit spreads to widen by now and continue to monitor credit and duration risk.

The Consumer Sector

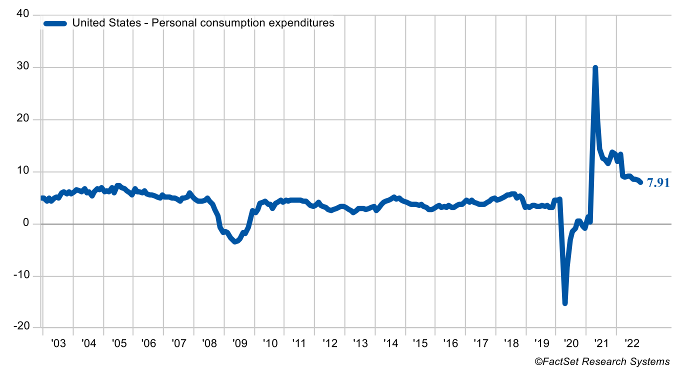
Consumers continue to dip into their savings and increase credit card borrowings to fund purchases, boosting current economic growth at the expense of next year's. When the growth rate for spending exceeds income, consumers' ability to weather a possible recession diminishes.



Personal income rose by 0.7% in October, smashing the consensus expectation of 0.4%. Personal consumption rose 0.8%, exceeding the consensus expected 0.7% rise. The PCE Price Index (PCE Inflation) rose 0.2%, lower (better) than the consensus expectation of a 0.3% increase.

Personal income rose 0.7% m/m and was up 4.9% y/y. Disposable personal income rose 0.7% m/m and was up 2.8% y/y. Government transfer payments rose 1.6% m/m and increased by 0.7% y/y, boosted by one-time prelection tax credits offered by several states. Personal income, excluding government transfer payments, rose 0.5% m/m and 5.9% y/y. Private sector wages and salaries were up 0.5% m/m and 7.1% y/y. Business owners' income was flat m/m and was up 3.9% y/y. Investment income was up 1.0% m/m and 5.1% y/y.

PCE Inflation rose 0.3% m/m and is up 6.0% y/y, slightly better than consensus estimates. Real income was up 0.4% during the month and is down 1.1% y/y. Real disposable personal income per capita was up 0.3% m/m and down 3.3% y/y. Consumers made a bit of progress in October but remain down y/y.



Personal Consumption Expenditures			
	Nominal	Inflation	Real
Durable Goods	2.1%	-0.6%	2.7%
- Motor Vehicles and Parts	5.2%	-0.6%	5.8%
Non-Durables	1.1%	0.8%	0.3%
- Gas and Energy	4.1%	4.9%	-0.8%
Services	0.5%	0.4%	0.2%
- Housing	0.7%	0.6%	0.1%
Total	**0.8%**	**0.3%**	**0.5%**
Data for September 2022 m/m			

Personal consumption expenditures (PCE) were up 0.8% for the month versus 0.6% the previous month. On a real basis, after subtracting out the impact of inflation, consumer expenditures were up 0.5% m/m compared to a decline of 0.3% the previous month.

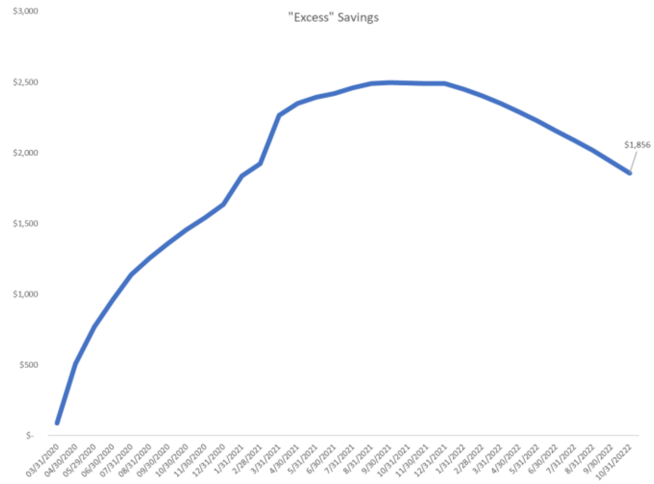
Purchases of durable goods rose by 2.1% m/m, led by a 5.2% recovery in motor vehicles and parts. The cost of new vehicles rose 0.4% in October and is up 8.4% y/y. New vehicle sales rose to a 15.4 million pace in October, up from 14.0 million in September and 13.7 million in August. Higher interest rates and lower trade-in values will pressure new car pricing. Consumers typically purchase cars based on monthly payments. To keep monthly payments flat compared to last year, new car prices would have to fall by 14%.

Purchases of non-durable goods rose by 1.1% m/m, led by a 4.1% increase in gas and energy purchases. On a real basis, spending rose by 0.3%, led by a 0.4% increase in grocery purchases.

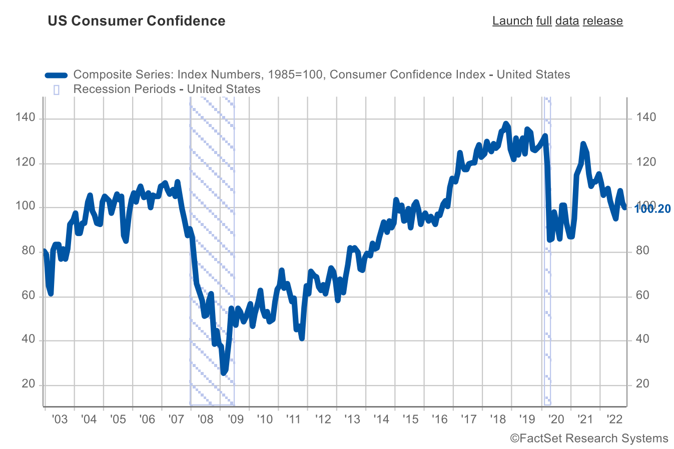
Spending continues to shift from goods to services. Purchases of services rose 0.5% m/m, led by housing. Housing costs continue to be very sticky. On a real basis, housing costs, excluding inflation, rose about 0.1% per month. As outlined above, we expect housing inflation to remain high for a while.

Except for new vehicles, we expect real goods spending to be subdued for an extended period as spending shifts from goods to services. This should alleviate pressure on stressed supply chains, allowing manufacturers to catch up with demand. During a recession, consumption of goods generally falls faster than services.

Consumers saved just 2.3% of disposable income during the month, significantly less than the 7.4% savings rate that prevailed before the pandemic. Consumers have dipped into their savings by $81 billion in October and $634 billion YTD. We estimate that consumers continue to have $1.8 trillion in excess savings or 10.4% of annual purchases of goods and services. We look for the savings rate to fall further as inflation continues to take a bite out of income and the economy weakens. We would not be surprised to see a negative savings rate.



The Consumer Confidence Index, compiled by the Conference Board, fell 2.0 points to 100.2. Consumers' perception of their present situation and expectations for future periods darkened. The present situation component fell 1.3 points to 137.4. The forward-looking expectation component fell by 2.5 points to 75.4. Consumers are tired of high inflation, rising interest rates, and the talk of a pending recession.

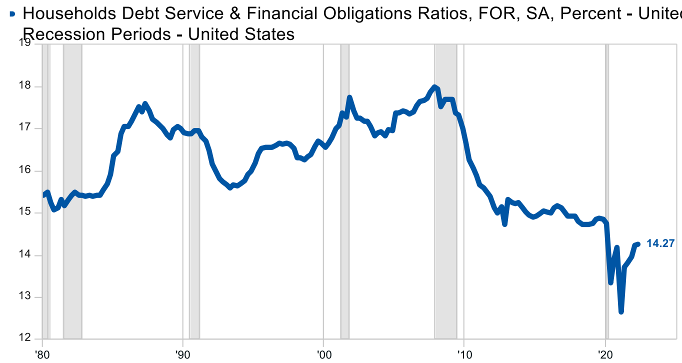


Consumers' perception of the labor market remains strong. The current conditions net employment sub-index (plentiful - hard to get) rose to 32.8 from 31.8 the previous month. Consumers' perception of employment conditions in six months improved as the net sub-index (more jobs – fewer jobs) fell to -2.8 from -1.3 the previous month. Consumers are beginning to brace for a recession and higher unemployment.

Respondent's perception of current business conditions worsened as the net sub-index (good-bad) fell to -8.5 from -6.3 the previous month. Consumers' perception of business conditions in six months improved as the net sub-index (better – worse) rose to -2.8 from -4.7 the previous month. Press reports of pending tech layoffs may be impacting consumer confidence. Consumers' perception of their household income in six months weakened. The net sub-index (an increase in income – a decrease in income) fell to 0.6 from 4.4 the previous month. Consumers are beginning to worry about their financial situation, not just the economy.

The Conference Board started asking consumers about inflation expectations in 1987. Consumers' expectations for inflation for the next twelve months remain stubbornly high. Consumers forecast inflation will be 7.2% in twelve months versus the 6.9% reported last month. Inflation expectations drove the FOMC to raise rates at an accelerated pace. Expectations remain higher than market-based measures. It may take a recession to reduce consumers' expectations.

Consumer balance sheets are in good shape. Please see the household debt service and financial obligations ratio (DSR) chart. DSR is the ratio of total required household debt payments, rent, auto lease payments, homeowners' insurance, and property tax payments to total disposable personal income. While the DSR is lower than before the pandemic, it is rising as consumer finances have deteriorated as they dip into their savings.



Consumer spending is slowing and shifting from goods to services. Inflation may have peaked, but consumers' inflation expectations remain elevated. Labor markets remain strong but may be turning. Household balance sheets remain strong, but consumers are eating into their savings. Household finances are in good shape. 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 activity in the manufacturing and non-manufacturing (service) sectors. The reports are sentiment-driven and can be influenced by current events. Nonetheless, they do provide real-time clues to what is happening

We expect the manufacturing sector to further weaken as changing consumer preferences, a strong dollar, and tighter financial conditions weigh on foreign and domestic consumer demand—the manufacturing index points to falling demand, prices, and supply chain normalization. The goods manufacturing sector has entered a mild recession. The service sector accelerated in November. Supply chains and input pricing improved modestly. The ISM surveys highlight shifting consumption patterns and modest progress in reducing inflationary pressures. The service sector is benefiting from the manufacturing sector's woes.

November's non-manufacturing index rose 2.1 points to 56.5, significantly better than the consensus expected 53.0. Activity in the services sector has grown for thirty months in a row. Growth narrowed as 13 industries reported growth versus 16 the previous month. The service sector is expanding at a slightly faster pace. The ISM summarized the report: "Supplier deliveries continued to slow, albeit at a slower rate in November. Based on comments from Business Survey Committee respondents, increased capacity and shorter lead times have resulted in a continued improvement in supply chain and logistics performance. A new fiscal period and the holiday season have contributed to stronger business activity and increased employment."

Non-Manufacturing Sector	Direction	Rate of Change
Business Activity / Production	Growing	Faster
New Orders	Growing	Slower
Backlog of Orders	Growing	Slower
Employment	Growing	From Contracting
Supplier Deliveries	Slowing	Slower
Customer Inventories		
Non-Manufacturing Sector	**Growing**	**Faster**
Industries Expanding	13	-3
Industries Contracting	3	+1

The business activities/production component rose 9 points to 64.7. thirteen industries reported an increase in business activity for the month. One industry reported a decrease in activity.

The new orders component fell 0.5 points to 56.0. Twelve industries reported an increase in orders. Four industries reported a decrease in orders. Corporate order books are clearing a bit as supply chains normalize. The backlog of orders component fell by 0.4 points to 51.8, with eight industries reporting an increase and five industries reporting a decrease.

The employment index rose by 2.4 points to 51.1, indicating that the pace of hiring has quickened. Comments from respondents indicate a slow improvement in labor availability.

The supplier deliveries component is an inverse indicator. A higher number indicates increasing lead times and difficulty obtaining supplies. A reading above 50 percent indicates slower deliveries, while a reading below 50 percent indicates faster deliveries. The supplier deliveries component fell by 2.4 points to 56.2. Nine industries reported slower deliveries. Six industries reported faster deliveries. The percentage of respondents reporting slower deliveries fell by 1.0% to 17.8%, while the percentage reporting faster deliveries rose to 10.3% from 6.4%. Supply chains are not getting much better, enabling companies to reduce their backlogs.

Prices paid for materials and services worsened at a slower pace. The price component fell by 0.7 points to 70.0. Sixteen out of 18 industries reported higher costs. 6.6% of respondents reported lower prices, even with 6.9% reporting the previous month. 42.7% reported higher costs, down from 47.5% the last month, indicating modest progress. The non-manufacturing sector has yet to make as much progress as the manufacturing sector. Labor is a more significant component of input cost versus materials, and wages continue to rise versus declining material costs.

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 fell 1.2 points to 49.0, slightly worse than the consensus estimate of 49.8. The manufacturing sector entered contraction territory after twenty-nine straight months of expansion. The two forward-looking measures (new orders and production) indicate a decelerating industrial sector. Supplier deliveries improved, and inflation fell. The manufacturing index corresponds to a 0.1% contraction in the GDP.

Manufacturing Sector	Direction	Rate of Change
Production	Growing	Slower
New Orders	Contracting	Faster
Backlog of Orders	Contracting	Faster
Employment	Contracting	From Unchanged
Prices Paid	Decreasing	Faster
Supplier Deliveries	Faster	Slower
Customer Inventories	Too Low	Slower
Manufacturing Sector	**Contracting**	**From Growing**
Industries Expanding	6	-2
Industries Contracting	12	+2

The production component decreased by 0.8 points to 51.5. Comments indicate that demand is softening, and activity will likely decline in the coming months. Backlogs of overdue orders are reduced, and material and labor availability are improving.

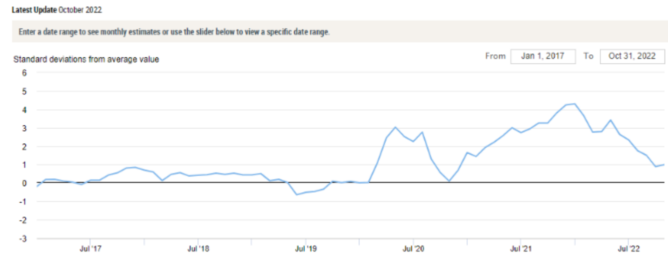
The new orders component fell by 2.0 points to 47.2, indicating that new orders are contracting faster, marking the third month of declining new orders. Only one industry reported growth in new orders, while fourteen industries reported lower orders. The order backlog subindex decreased by 5.3 points to 40.0. Only two industries reported an increase in order backlogs, while twelve industries reported lower backlogs. Both measures point to widespread weakness and significantly slower growth ahead.

The employment component decreased by 1.6 points to 48.4, indicating reduced manufacturing hiring. Seven industries reported employment growth. Five industries reported a decrease in employment.

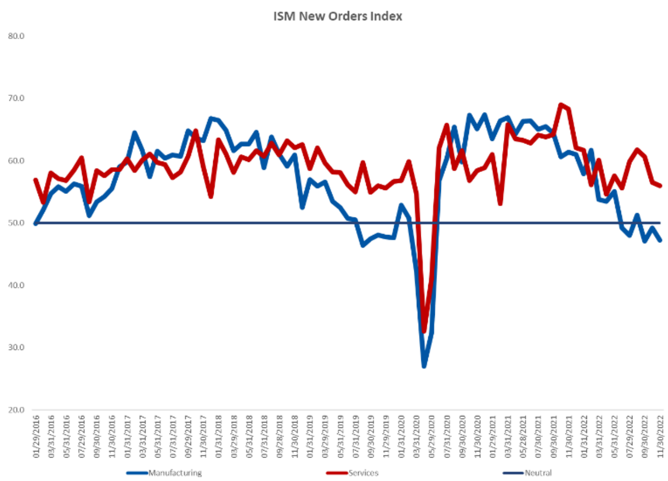
Supplier deliveries to manufacturers improved for the second straight month as the sub-index rose 0.4 points to 47.2. Six of eighteen manufacturing industries reported slower deliveries. Eleven industries reported faster supplier deliveries. Manufacturing supply chains are finally catching up to slowing demand.

The Prices Paid sub-index fell 3.6 points to 43.0, indicating raw material prices are decreasing for the second month. The report shows significant moderation of input inflation. 27.1% of respondents reported lower prices versus 8.3% five months ago. 13.1% of respondents reported higher prices versus 65.2% five months ago. Only one industry reported increased costs for raw materials. Ten industries reported lower prices for raw materials.

The Federal Reserve Bank of New York developed the Global Supply Chain Pressure Index (GSCPI) to measure supply change constraints for U.S. companies. The GSCPI integrates several commonly used metrics to comprehensively summarize potential supply chain disruptions. Supply chain pressures increased slightly in October after five consecutive months of easing. The GSCPI's YTD movement suggests that global supply chain pressures align with historical averages. The October setback was modest and did not break the trend toward thawing global supply chains.

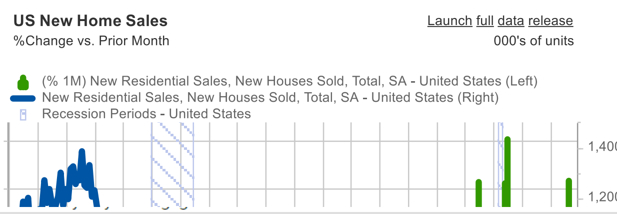


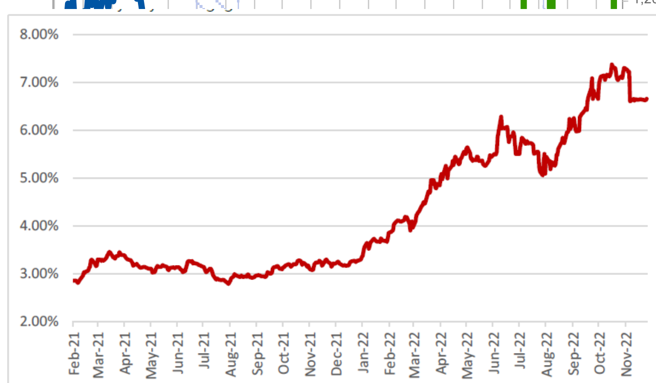
The ISM New Orders Index clearly shows a recession in the manufacturing sector. The service sector, while weaker, continues to grow. Supply chains are normalizing and will soon cease to be discussed, except for auto manufacturers. The ISM reports support our thesis that the manufacturing sector, especially consumer goods manufacturing, has entered a recession, while the non-manufacturing sector will experience a shallow showdown.



The Housing Sector

During his November 2 press conference, Chair of the Board of Governors of the Federal Reserve System Jerome Powell stated that "Housing is significantly affected by these higher rates, which are back where they were before the global financial crisis," "The housing market was very overheated for a couple of years after the pandemic, as demand increased and rates were low. The market needs to get back into a balance between supply and demand." Mortgage rates have more than doubled in the course of a year. The Cash-Shiller Home Price Index has fallen for three consecutive months. New home sales are down 5.8% y/y.

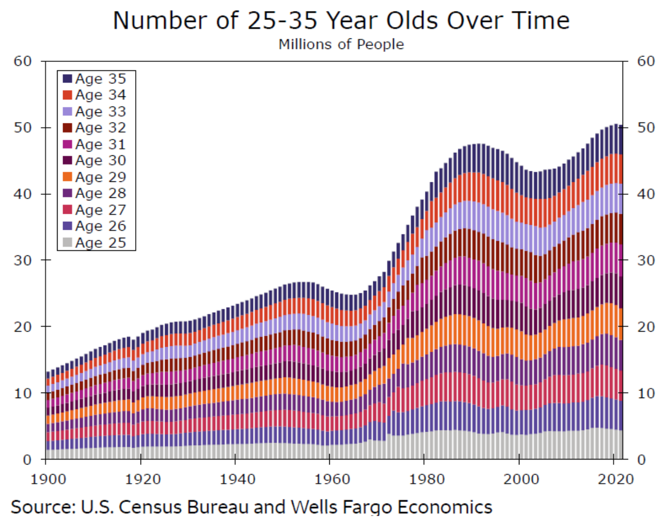




Source: Mortgage News Daily, Wells Fargo Securities, LLC

According to Mortgage News Daily, the 30-year mortgage rate was 6.65% on 11/29/2022. Mortgage rates followed the 10-year Treasury rate lower. While mortgage rates are down from the 7%+ rate last month, there are up substantially from last year. Mortgage rates fell enough to spark a mini spike in new home sales. We do not expect new and existing home sales to recover.

We expect the price of new homes to fall by $20,000 to $40,000 (6%) next year. This is primarily the result of lower construction costs. Lumber prices are down 56% y/y. Lower construction costs should cushion the margin hit for home builders. We also expect existing home prices to decline by 10% next year. Those markets that saw substantial home price appreciation, the Mountain West, will likely see more significant price declines.



Unlike the aftermath of the Great Financial Crisis, we do not expect a large inventory of new and existing homes for sale to build or a significant number of distressed sales. Underwriting has been significantly better this cycle, and the number of new homes built has yet to reach its previous peak. Any drop in mortgage rates is likely to be met with mini-refinance and purchase booms. The underlying demand remains strong. The cohort of first-time buyers is at a record high. Please see the chart on the next page. There will continue to be a demand generated from homeowners moving from high-cost coastal areas to more affordable areas. We welcome your comments and suggestions. Please feel free to contact any one of the investment teams.

Please see the obligatory disclosures listed below.

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