THIRD QUARTER 2021 MARKET OUTLOOK

SECURITY NATIONAL BANK
WEALTH MANAGEMENT

Our Outlook

	2019	2020	2021 Est	2022 Est	2023 Est
GDP Growth (1)	2.3%	-2.4%	7.3%	2.9%	1.8%
Change in Consumer Prices (2)	2.3%	1.3%	4.1%	2.5%	2.4%
Fed Funds Target Rate (3)	1.75%	0.25%	0.25%	0.25%	0.75%
5-Year Treasury Yield (3)	1.69%	0.36%	0.98%	1.08%	1.58%
10-Year Treasury Yield (3)	1.92%	0.92%	1.80%	2.00%	2.50%
S&P 500 EPS	$162	$138	$191	$206	$219

Last Month's Rates and Returns

June 30, 2021	Value	One Month Change	YTD	1 Year Change
Fed Funds Target (Upper)	0.25%	--	--	--
2-Year Treasury Yield	0.25%	+11 bp	+13 bp	+10 bp
5-Year Treasury Yield	0.88%	+9 bp	+52 bp	+60 bp
10-Year Treasury Yield	1.45%	-14 bp	+53 bp	+80 bp
SNL 30Yr Fixed – U.S. Avg.	3.10%	--	+ 9 bp	- 30 bp
S&P 500 Index*	4,298	2.33%	15.25%	40.79%
S&P Midcap 400*	2,696	-1.02%	17.59%	53.24%
S&P Small Cap 600*	1,375	0.33%	23.56%	67.40%
S&P SuperComposite 1500*	985	2.08%	15.61%	42.12%
S&P 500 Growth*	2,934	5.68%	14.31%	41.36%
S&P 500 Value*	1,458	-1.17%	16.30%	41.36%
World ex US, net **	7,598	-1.02%	9.92%	33.60%
Liquid Alternatives ***	184	-0.13%	4.44%	11.56%
BB U.S. Aggregate *	106	0.70%	-1.6%	-0.30%
Crude Oil – WTI Near Term	$73	10.78%	51.42%	84.51%
Gold – Near Term	$1,771	-6.92%	-6.46%	-0.14%

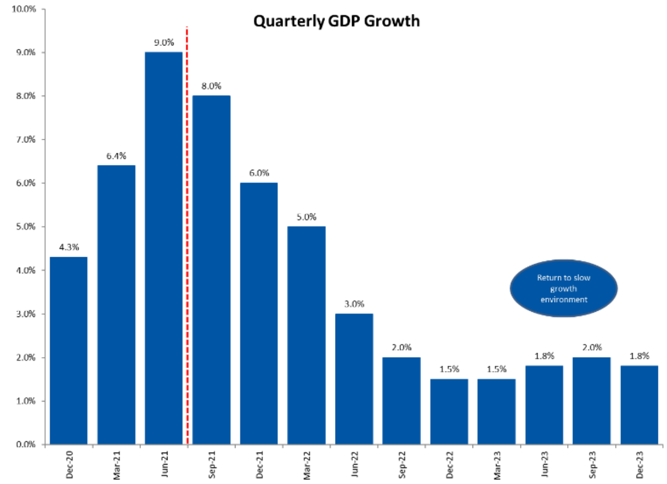
** = Total return **= MSCI ACWI ex US **** = Wilshire Liquid Alternative Index*

Security National Bank's Wealth Management Department authors a monthly economic forecast that provides our Investment Committee and the Bank's Funds Management Committee background assumptions for use in investment decisions. We are pleased to share our economic outlook with you. Please be advised our crystal ball is just as clouded as other prognosticators and that all forecasters have poor track records.

Prepared by Damian Howard June 7, 2021

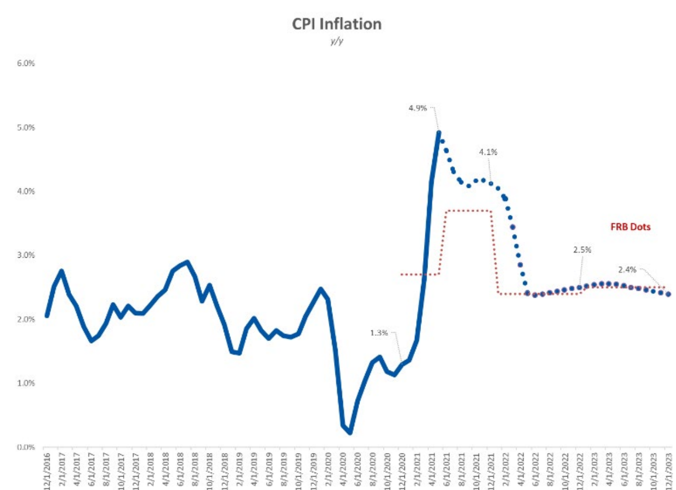
2021 economic growth at 7.3% will be the highest since 1951. Growth rates will ease next year.

Despite inflationary pressures, clogged supply chains, and a lack of available labor, the economy is booming. We estimate the U.S. economy grew at a 9% annual rate in the second quarter. The economy is likely to grow at a similar rate in the third quarter. Economic growth should be robust through mid-year 2022. The massive tidal wave of fiscal and monetary expansion will make its mark on the economy for quite a while. Growth will remain above trend for the next year or so. Beyond that, economic growth will likely return to the plow-horse economy we experienced during President Obama's Second Term. Increased regulation and income distribution policies will be additional impediments to growth and keep inflation higher than pre-pandemic levels.



Inflation is high. It should ease but will remain elevated.

We have raised our 2021 inflation outlook from 2.5% to 4.1%. Inflation is running at a 5.9% pace over the last six months. This is a faster increase than we had forecast three months ago. This would mark the highest inflation since 1991. The Federal Reserve (FRB) believes the inflationary surge is transitory. We partially subscribe to this notion. Some of the increased inflation is due to temporary supply chain problems. This will ease as the supply chain normalizes. We also believe inflation will exit this surge and plateau at a higher than normal level. The risk to our forecast is most likely to the upside, higher than anticipated inflation rather than lower inflation. By this time next year, we may be worrying about stagflation (rising without economic growth).



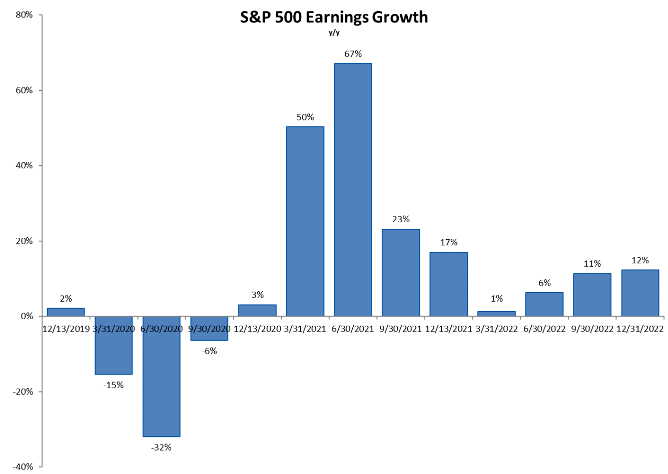
Short-term rates will remain low for an extended period.

While inflation is high and will likely remain above the FRB's target, labor markets have not fully healed. The economy is still short 8 million jobs. It may take another year before it fully recovers. The FRB will want to see substantial actual progress before raising rates and is content to be behind the curve on raising rates. The FRB will likely reduce their bond-buying program around year-end and begin raising interest rates mid-2023.

We currently think the 10-Year Treasury will end the year at 1.80%. Currently, the 10-Year is at 1.35%, down 0.39% from recent highs. The next leg up in longer-term rates is likely to cause a mild correction. The stock market is traditionally weak during mid-August to mid-October. We are not making a stock market call, but we would not be surprised to see a rise in interest rates accompanied by a mild stock market correction around the start of the football season. We also think the market will rally back into the end of the year to around its current level. We are more often wrong than right when making such calls. We do not try to time the market, neither should anyone. We have found it to be more profitable to take a longer-term approach. Time in the market has proven to be better than timing the market.

Stock prices are up strongly, so are corporate earnings.

The stock market, as measured by the S&P 500 index, posted a 15.3% total return for the first six months of 2021. Most of the gain can be traced to better-than-expected earnings. We increased our forecast of 2021 S&P 500 earnings. In January, we expected the S&P 500 to earn $173 per share. We now predict $191, an increase of 12%. Normally earnings expectations fall as the year progresses. Second-quarter earnings are likely to grow 67% y/y and be 12% higher than pre-pandemic levels. Over time, stock prices follow earnings. For the next couple of quarters, earnings growth should be strong. This could offset some of the stings from rising interest rates.



Our earnings estimates for next year and 2023 are a bit lower than published consensus estimates. We incorporated increased corporate taxes and regulations into our forecast. We also believe street strategists are a bit too optimistic.

The West is at herd immunity

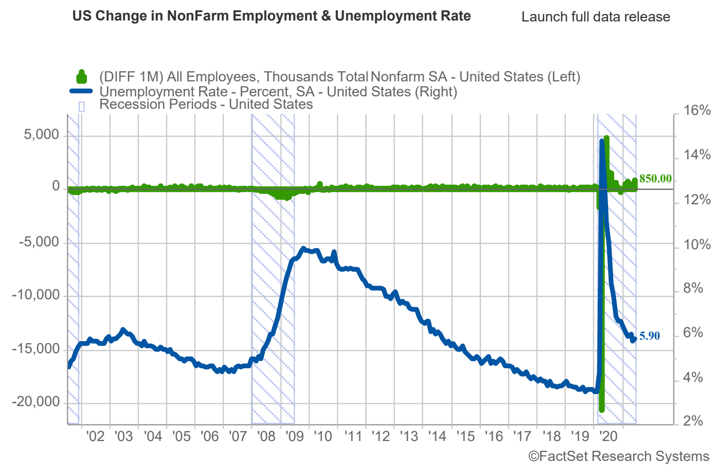
Including those who have contracted COVID-19 and those who have received a dose of the COVID-19 vaccine, an estimated 72% of the U. S. population has immunity. This immunity rate compares to 67% of the U.K.'s population, 53% of Germany's, 64% for Italy's, and 53% of France's population. After a slow start, Europe has ramped up its vaccination program. As their programs ramped, so did their economies. We expect the EU to lead the world in growth for the second half of 2021.

The Summer Olympics begin at the end of the month. Only 19% of the Japanese population has immunity to the virus. It will be interesting to see how Japan manages to host the games during a pandemic. Much of Asia remains in the mid-teens. We expect Asian economies to boom as their vaccination programs ramp up. This should happen as the leaves turn in the U.S. Emerging Africa and South America will follow next year. This is likely to result in a rolling recovery with China recovering last year, the U.S. in the first half of 2021, followed by Europe, Asia ex-China, and the rest of the world.

There is always a risk a new variant will emerge and set us back. A substantial percentage of our population will refuse to be vaccinated. For those who are vaccinated, no vaccine is 100% effective. There will continue to be a low level of deaths associated with the coronavirus. Isolated spikes of COVID-19 will occur, especially in unvaccinated populations. The pandemic's impact on the economy may have passed, but the virus is not going away. We are now dealing with the after-effects: supply disruptions, slack labor markets, and demand imbalances. The longest-lasting impact will be the massive fiscal and monetary stimulus. We will be dealing with the huge increase in debt for generations. Unfortunately, the government did not use the excess borrowing to improve the economy's long-term growth potential. For now, the federal debt burden is manageable. In this case, the old saying "It doesn't matter until it does" applies. On the bright side, consumers have cut their debt burden and businesses are flush with cash.

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

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



Employment

In June, the economy added 850,000 jobs versus the consensus estimate of 700,000 new jobs added. This marked the fastest job growth since August of last year. The U.S. Bureau of Labor Statistics (BLS) revised the prior two months' jobs number up by a modest 15,000. The unemployment rate rose to 5.9%. The participation rate and the employment-to-population ratio held steady.

There were notable job gains in leisure and hospitality, which added 343,000 jobs, and education (private, state, and local), which added 268,000 jobs. Manufacturing added 15,000 jobs primarily in the furniture sector. Auto manufacturers shed 12,300 jobs as the ongoing semiconductor chip shortage wreaks havoc with production schedules.

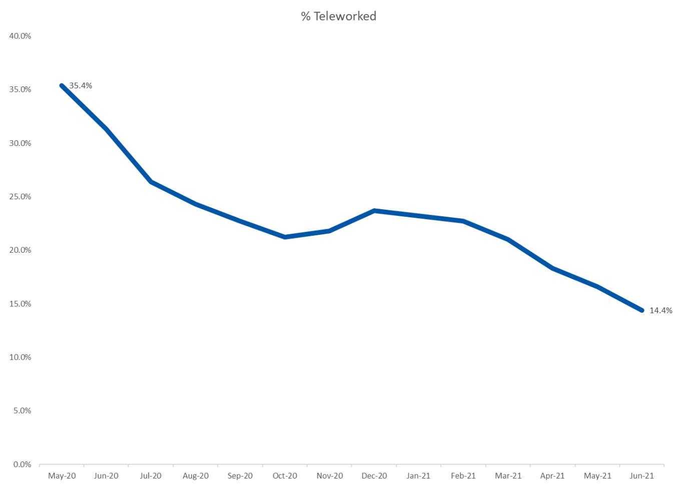
The lack of daycare services is an ongoing impediment to many workers returning to the labor force. Prior to the pandemic, 1 million people worked in child daycare services. By April 2020, this number fell to 673,000 a drop of 36%. The most recent employment report showed that 25,000 workers returned to daycare services. In total, 932,000 people worked in childcare. While up substantially, it is still down 11% from pre-pandemic levels. Additional child daycare must become available before the labor force fully heals. At the current pace, childcare services should be back to full strength when school reopens in the fall.

The BLS reports statistics from two monthly surveys. The household survey measures labor force status, including unemployment, by demographic characteristics. The establishment survey measures non-farm employment, hours, and earnings by industry. There can be some differences in the numbers. The household survey puts the change in employment at a loss of 18,000 jobs while the establishment puts the change in employment at 850,000. The household survey put the cumulative job losses since February 2020 at 7.1 million or 4.5% of then-existing jobs. The establishment survey puts the cumulative losses at 6.7 million.

The unemployment rate increased 0.1% to 5.9%. The number of officially unemployed persons rose by 168,000 to 9.5 million. This is down from the 23.1 million reported in April 2020, but up 4.1 million from the number reported in February 2020. The broader U-6 unemployment rate fell to 9.8% from 10.2% the previous month, down considerably from the 22.8% reported in April 2020. The U-6 rate was 7.0% in February 2020.

The participation rate held steady at 61.6%. The participation rate was 62.7% in February 2020. The employment to population ratio also held at 58.0%. This number was 61.1% in February 2020. If the employment to population ratio were to return to the February 2020 level, an additional 8.1 million jobs would be added for an increase of 5.3%.

14.4% of employed persons teleworked because of COVID-19. This number includes individuals that worked from home for pay at least sometime during the month because of the pandemic. The BLS first surveyed teleworkers in May 2020. At that time, a third of the labor force was working from home. Many articles were written about the demise of the office. Most of the work from homers (WFH) have returned to the office. It is too early to tell if the work from everywhere (WFE) movement gains traction.



6.2 million persons reported that they had been unable to work at all or worked fewer hours at some point during the month because their employer closed or lost business due to the pandemic. This measure is down from 7.9 million last month. 10.0% of those individuals received at least some pay from their employers for the hours not worked.

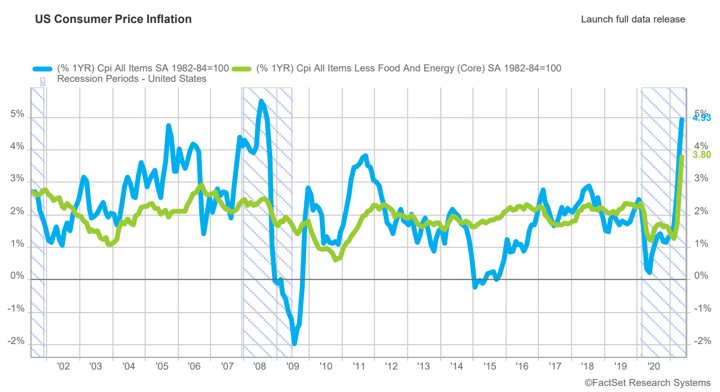
Last month's average hourly earnings (wages) grew by $0.10 per hour to $30.40. This is up to $1.89 per hour, or 6.63%, from February 2020 (pre-pandemic). Wages in the lower-paid leisure and hospitality sector rose by $0.37 per hour to $16.21 per hour (2.3%) during the month. Wages in this sector are up 11.2% y/y as employers are forced to compete against generous unemployment benefits.

The average workweek fell 0.1 hours to 34.7 hours. Average weekly earnings are up 3.9% from last year and 7.6% from February 2020. Average weekly earnings were $1,055 ($54,854 annualized) versus $1,016 ($52,807 annualized) last year and $981 ($50,998 annualized) in February 2020.

While the labor markets have significantly healed since April 2020, there remains significant progress yet to be made. The economy is still about 8 million jobs short of where it should be. Based on the average gains of the last three months (567,000 jobs per month added) it will take 14 months for the labor markets to fully heal. The FRB not only wants the labor market to return to pre-pandemic levels but also wants under-represented minorities to fully participate in labor market advances. The FRB will let labor markets run hot for a while before they raise interest rates. The FRB will want to see actual and substantial progress rather than forecasted progress before they act. We have penciled in the first interest rate hike for mid-year 2023, around 24 months from now.

Inflation

Consumer prices rose 0.6% in May, a bit slower than the 0.8% posted in April. Stripping out the impact of energy and food prices, core prices rose 0.7% m/m. On a year-over-year basis, headline inflation was 4.9% with core inflation of 3.8%. After a decade of low inflation, rising inflation has become an issue.



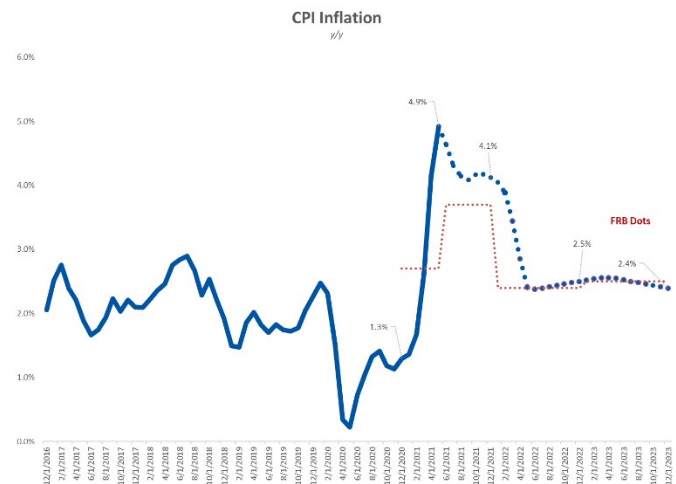
Food prices were up 2.2% y/y. Energy prices were up 27.8% y/y. The price of goods was up 6.5% y/y. Within goods (not services), new car prices were up 3.3% y/y, and used car prices were up 29.7% y/y. The price of services was up 2.9% lead by car rental, up 109.8% y/y, and airfares up 24% y/y. The cost of shelter was up 2.2% y/y with the cost of a hotel room up 8.9%. The all-important owners' equivalent rent (OER) was up 2.1% y/y. Market surveys and anecdotal evidence has apartment rent and OER rising significantly more than the 2.0%. This may fuel inflation numbers in the coming months.

Supply chains are straining to catch up with rising demand. The ISM Manufacturing Price Index is at its highest level since 1979. 85% of respondents reported higher raw material costs. Less than 1% reported lower cost. On the used car front, the used vehicle index has decelerated rapidly. This indicates the spike in used car prices may be ending soon. The FRB believes the current rise in inflation is transitory. We believe inflation will moderate in the coming months. However, we are forecasting higher inflation post-pandemic, as compared to levels prior to 2020. This will put upward pressure on interest rates once the FRB allows them to rise.

We can tell what market participants think the long-term inflation rate will be, by measuring the difference between a 10-year Treasury security and the ten-year Treasury Inflation Protection security (TIPS). The difference implies what market participants expect inflation to average. This is called the 10-Year Breakeven Inflation Rate. Inflation expectations rose dramatically during the first five months of 2021 but have since eased as the FRB made its case that the surge in inflation was transitory. Currently, market participants believe inflation will average 2.35% over the next ten years.

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

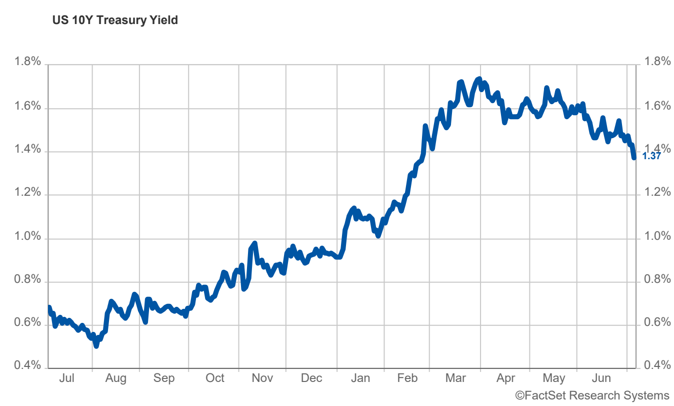
The members of the FRB have spent the last several months assuring the market the rise in inflation is transitory. They have been successful in calming the market's fears. Interest rates are moderating. 5-Year and 10-Year Breakeven Inflation Rates are no longer rising and have fallen slightly. The FRB has stated they will not raise interest rates until the PCE has averaged 2.0% over a twelve-month period and the economy is at maximum employment. For now, the FRB has earned the benefit of the doubt. Market participants believe the FRB can achieve its goals.



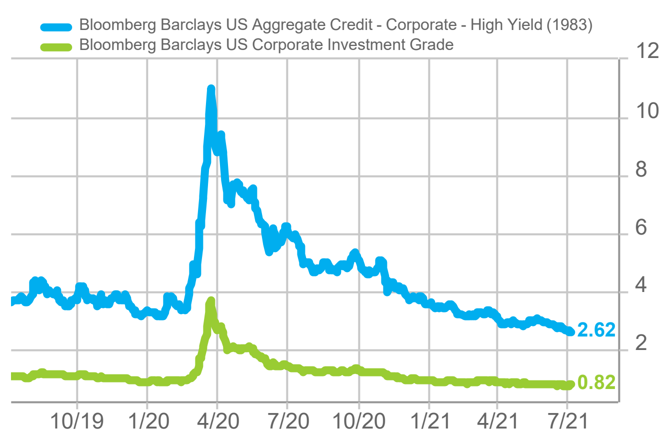
Growth in consumer prices will ease into the second half of 2021 but most likely not return to their pre-pandemic sub-2% level. We then expect the CPI to remain above 2% during our forecast period. Despite higher inflation, the FRB is unlikely to raise rates until Mid-2023. Many at the FRB believe they raised rates too fast and too far after the Great Financial Crisis (GFC).

Credit Markets

The yield on the 10-year Treasury fell to a record low of 0.50% on March 9, 2020, as the government shut down the economy to contain the spread of COVID-19. In February and March of this year, rates rose by 0.75% to 1.74% in response to better economic prospects and the specter of higher inflation. It has since eased a bit, in part due to the belief that the run-up in inflation may be transitory.



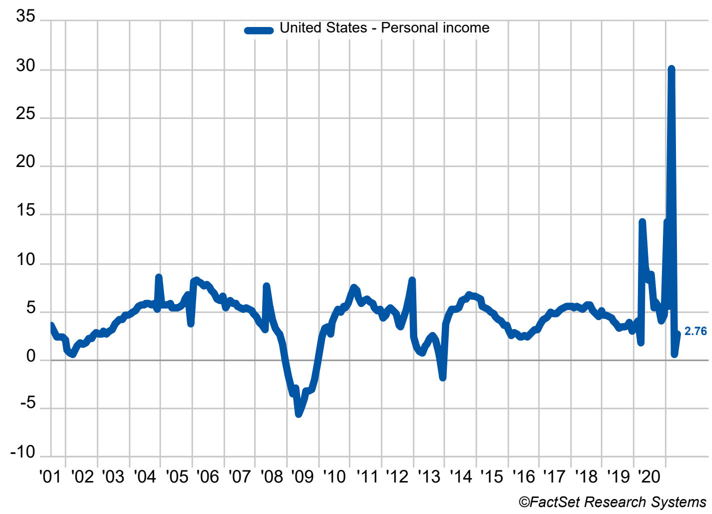
The credit markets had a respectable June. The Bloomberg Barclays (BB) US Corporate Investment Grade index had a total return of 1.63%, with a 1.27% price return and 0.36% from income. For the first six months of 2021, US corporate investment-grade bonds have returned -1.27%. Credit spreads tightened 0.04% to 0.81%. The index has an 8.6-year effective duration. Prior to the financial crisis, its effective duration was around 6.0 years. The longer duration increases the investment-grade corporate index's interest rate sensitivity. As an asset class, corporate bonds are 40% more sensitive to interest rates now than they have been in the past.



The BB High Yield index returned 1.34%, with a 0.84% price return and 0.50% from income. For the first six months of 2021, high-yield bonds have returned 3.62%. Credit spreads narrowed by 0.28% to 2.68% and are close to record lows. The index has a 3.8-year effective duration. The duration has shortened since the financial crisis, and the shorter duration reduces the high yield index's interest rate sensitivity.
Every month, we state that spreads are too low. The risk does not justify the return. We continue to concentrate our fixed income portfolios in higher-rated, short-duration bonds. While this penalizes our current income, it does reduce our sensitivity to rising interest rates or changes in credit. We will continue to invest our risk bucket in stocks. We believe stocks offer a greater risk/reward trade-off.

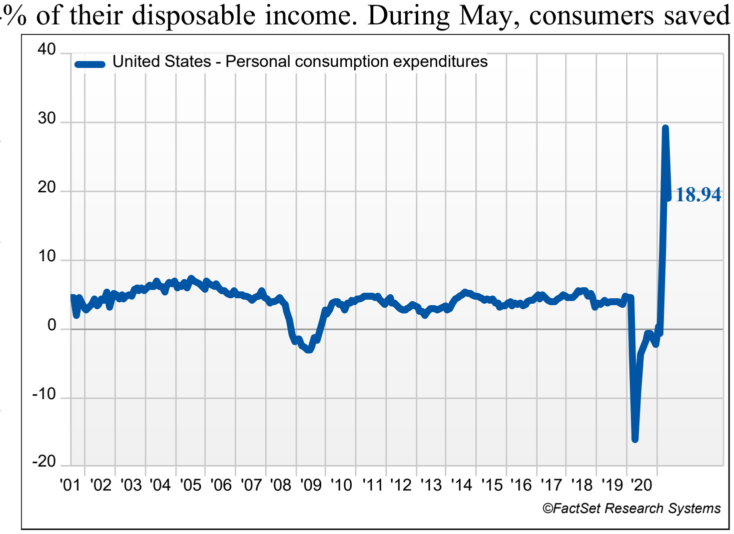
The Consumer Sector

Personal income declined 2.0% in May after falling 13.1% in April. The last of the payments from the American Rescue Plan (ARP) were disbursed in April. Government transfer payments fell 11.8% during the month, including a 7.3% drop in unemployment benefits. The drop in government transfer payments was partially offset by strong growth in the private sector. Personal income excluding government transfer payments was up 0.9% m/m, up 12.0% y/y, and up 4.1% from February 2020.



Private sector wages and salaries were up 0.85% m/m, up 15.7% y/y, and up 6.3% from February 2020. Proprietors' income was up 2.7% m/m, up 30.2% y/y, and up 10.3% from February 2020. Interest and dividend income were up 0.4% m/m, up 0.9% y/y, and down 1.6% from February 2021.

Prior to the pandemic, consumers saved 7.4% of their disposable income. During May, consumers saved 12.4% of disposable income. Since the pandemic began, consumers have saved an estimated $2.6 trillion more than normal. This extra savings equates to 16.8% of personal consumption expenditures ($15.56 trillion). A study by the Federal Reserve Bank of New York found that only 25% of the three "stimulus" checks were spent while 32% went to pay down debt, mainly credit cards - revolving debt is down $134 billion since February 2020. The remaining 43% was held in savings. A large chunk of these extra savings will be spent over the remainder of this year and into next year.



Consumer spending on goods and services was flat for the month. Purchases of durable goods fell 2.8% m/m, led by a 7.8% drop in new car sales. Purchases of non-durable goods fell 0.4% m/m led by a 0.5% drop at the grocery store. Purchases of services rose 0.7% m/m.

Within the services category, recreational service spending rose 3.5% m/m, spending at restaurants rose 1.6% m/m, spending at hotels rose 0.9% m/m and purchases of airfares were up 2% m/m. Spending in these categories should significantly increase over the summer months.

Consumer confidence rose in June. Both consumers' perception of the present situation and expectations for six months hence improved. The Consumer Confidence Index, compiled by the Conference Board, rose 7.3 points to 127.3. For reference, the average reading over the last twenty years has been 91.6. The present situation component rose to 157.7 from 148.7 the previous month. The forward-looking expectation component rose to 107.0 from 100.9 the previous month.

Respondents' perception about current business conditions were improved as the net sub-index (good-bad) rose to 5.0 from -0.7 the previous month. Consumers have a substantially better outlook about business conditions in six months as the net sub-index (better - worse) rose to 22.7 from 16.6 the previous month.

Consumers' perception of the labor market was also mixed. The current conditions net employment sub-index (plentiful - hard to get) rose to 43.5 from 36.9 the prior month. Consumers' perception about employment conditions in six months held steady as the net sub-index (more jobs – fewer jobs) fell slightly to 9.7 from 10.2 the previous month.

Household net worth ended the first quarter of 2021 at a record $137 trillion, up to $25 trillion or 23% y/y. Since the depth of the GFC (2Q2009), household net worth is up to $76 trillion or 125%.

Since the pandemic began, consumers have saved an estimated $2.6 trillion more than normal. Households have the means to spend, but they may not have the desire. Much of the excess savings are held by high-income households. These households have a lower propensity to spend. In other words, they will likely invest or save the extra money. In addition, consumers may have satisfied much of their need for major durable goods purchases. As backlogs are fulfilled, new demand may be less than expected. Our forecast for next year's economic growth is a bit lower than consensus. We expect growth to slow a bit faster than most.

The Business Sector

Services comprise 66% of personal consumption expenditures (PCE). Activity in the manufacturing sector is easier to measure and track. Most of our growth and productivity measures were developed after WWII for the manufacturing sector. While it is easy to measure labor cost per widget produced, it is much harder to measure the productivity of a programmer or an app.

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

Non-Manufacturing Sector	Direction
Business Activity / Production	Growing
New Orders	Growing
Employment	Contracting
Supplier Deliveries	Slowing
Customer Inventories	N/A
Non-Manufacturing Sector	**Growing**
Industries Expanding	16
Industries Contracting	2

Globally manufacturers and non-manufacturing-orientated businesses report the same story. Growth is broad-based throughout the entire economy, but supply chains are stressed. Lengthening supplier delivery times are making it difficult to fulfill customer orders.

Prices paid for inputs are soaring. Rising input costs are being offset by higher efficiency. Some of the efficiency is forced due to worker shortages. The economy is producing the same amount of goods and services it was producing pre-pandemic. It is doing so with 5% fewer workers.

Margins are currently holding but are likely to fall as rising costs are not fully passed on to customers or offset through efficiency. Stressed businesses will eventually hire more workers or face attrition from burn-out. Businesses will also increase automation, both hardware, and software. Supply chain delays and labor issues will ease as the world is vaccinated. The U.S. and Europe are at herd immunity. Asia needs to ramp up vaccinations to catch up to the West.

The non-manufacturing index eased a bit in June. Activity in the services sector has grown for thirteen months in a row. The ISM's non-manufacturing index fell 3.9 points to 60.1. The two forward-looking components, business activity/production, and new orders fell indicating a rapidly growing economy, just not at the breakneck speed of May.

The business activities/production component fell 5.8 points to 60.4. The new orders component fell 1.8 points to 63.9. Both indices continue to indicate decelerating growth. The employment in the services sector fell 6.0 points to 49.3. Twelve industries reported an increase in employment. Two industries reported a reduction in employment. Comments from respondents include: "Increasingly difficult to find qualified candidates to fill open positions" and "Employees have been somewhat slow to return to work, and there has been turnover as some pursue new opportunities in a hot job market."

Supplier deliveries continued to worsen but at a slightly slower pace. The supplier deliveries component fell by 1.9 points to 68.5. A reading above 50 percent indicates slower deliveries, while a reading below 50 percent indicates faster deliveries. Seventeen industries reported slower deliveries. No industry reported faster deliveries. Prices paid for materials and services increased. The price component fell by 1.1 points to 79.5. Seventeen industries reported higher costs. Only one industry reported lower cost.

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 0.6 points to 60.6. The figure indicates the manufacturing sector has expanded for thirteen straight months. The production component rose 2.3 points to 60.8. The new orders component fell 1.0 points to 66.0. The employment component fell 1.0 points to 49.9, indicating a stalling of manufacturing employment. Ten industries reported employment growth. Five industries reported a decrease in employment.

Manufacturing Sector	Direction
Production	Growing
New Orders	Growing
Employment	Contracting
Supplier Deliveries	Slowing
Customer Inventories	Too Low
Manufacturing Sector	**Growing**
Industries Expanding	17
Industries Contracting	0

Supplier deliveries to manufacturers worsened at a slower pace as the sub-index rose 3.7 points to 75.1. Five of the top six manufacturing industries reported slowing deliveries. Supply chain difficulties are now expected to persist into the fourth quarter. The Prices Paid sub-index rose 41 points to 92.1, indicating raw material prices have increased for the 13th consecutive month. All eighteen industries reported increased prices for raw materials. Nearly every commodity was reported up in price and in short supply.

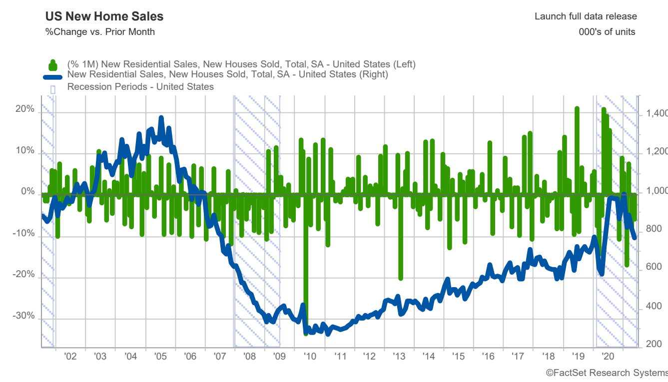
Europe started 2021 in a recession. A botched vaccination roll-out led to additional lockdowns. Europe now has caught up to the U.S. on the vaccination effort. Falling hospitalizations and rising vaccination levels are unleashing significant pent-up demand. Europe should lead global growth in the second half of this year. European PMI and sentiment numbers are looking significantly better. Asia should follow.

The J.P. Morgan all-industry PMI slowed modestly in June to 56.6 from 58.5 the previous month. While down slightly, the indices remain near a decade high. The index for future output rose 1.3 points to 68.6. Encouragingly, the index of output prices fell 0.9 points to 58.2, indicating an easing of inflation pressures.

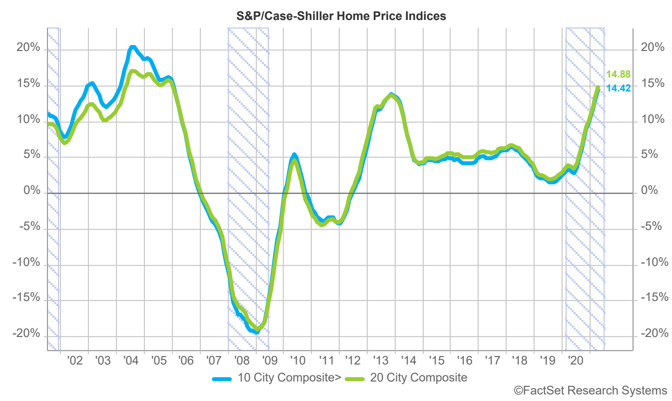
Production levels are rising, demand remains strong, but supply chains remain constrained. Supplier deliveries remain stressed. Input prices have risen to a 10-year high. Price pressures should fall as economies reopen. All the survey results point to a surge in economic activity. The gives us renewed confidence in our above-consensus growth outlook for this year. It also adds to the risk of higher than anticipated inflation.

The Housing Sector

New home sales add significantly more to economic growth than existing home sales. Like much of the economy, the housing sector is suffering from COVID-induced supply chain shortages. There are widespread shortages of new homes for sale, existing homes for sale, workers to build new homes, and lumber and materials to build them with. Lead times to build a new home have lengthened bthouy six weeks. Builders are selling new homes closer to completion to reduce inflation risk. Demand remains abundant. Supply has not yet caught up. This has pushed up prices dramatically. The cure for high prices is high prices.



New home sales fell in May to a 769,000 pace from a revised 817,000 pace the month before. New home sales are counted when the contract is signed, not at closing. Sales can be counted before construction begins. The median price of a new home is up 18% y/y.



The National Association of Home Builders reported that rising lumber costs alone have added $36,000 in cost to the average single-family home. Builders have become more cautious, preferring to list a home closer to completion instead of at groundbreaking. This minimizes risk. Builders are willing to carry the financing cost a bit longer in hopes of either falling lumber cost or rising finished home prices or both.

Existing home sales fell 0.9% in April to a 5.8 million annual rate. While down m/m, sales are up 8.8% from the level two years ago. 89% of existing homes sold were on the market for less than a month indicating continued strong demand. Strong demand has led to strong home price appreciation. Prices, as measured by the Case-Shiller 20-City Home Price Index, ticked up a strong 14.9% y/y. Many metro areas are seeing their largest-ever y/y price increases.

Despite soaring prices, demand remains strong. Millennials are now the largest living generation. They have just begun to enter the housing market. Millennials now account for over 50% of mortgage originations. Mortgage rates are up only 0.09% YTD and remain attractive. Higher purchase values result in higher monthly mortgage payments pushing marginal buyers out of the market. Even with today's higher monthly payments, demand still outstrips supply.

The housing market probably won't worsen dramatically from here. Realtor.com reported June's new listings increased 10.9% compared to May. Additional existing homes are coming to the market as COVID fears abate. Lumber prices are down 53% from their May peak. While down, lumber prices are still up substantially from pre-pandemic levels. Single-family housing starts have exceeded 1 million for the past ten months. We expect the worst to be behind us as a new supply hits the market. Prices are unlikely to fall, but they just won't rise as fast as they have been.

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