

# FOURTH QUARTER 2021 MARKET OUTLOOK



## Our Outlook

	2019	2020	2021 Est	2022 Est	2023 Est
GDP Growth <sup>(1)</sup>	2.6%	-2.3%	5.4%	3.2%	2.0%
Change in Consumer Prices <sup>(2)</sup>	2.3%	1.3%	5.7%	2.9%	2.9%
Fed Funds Target Rate <sup>(3)</sup>	1.75%	0.25%	0.25%	0.50%	1.00%
5-Year Treasury Yield <sup>(3)</sup>	1.69%	0.36%	1.05%	1.28%	1.71%
10-Year Treasury Yield <sup>(3)</sup>	1.92%	0.92%	1.80%	2.15%	2.50%
S&P 500 EPS	\$162	\$138	\$201	\$212	\$228

## Last Month's Rates and Returns

September 30, 2021	Value	One Month Change	YTD	1 Year Change
Fed Funds Target (Upper)	0.25%	--	--	--
2-Year Treasury Yield	0.29%	+9 bp	+17 bp	+16 bp
5-Year Treasury Yield	0.99%	+22 bp	+63 bp	+71 bp
10-Year Treasury Yield	1.53%	+23 bp	+61 bp	+85 bp
SNL 30Yr Fixed – U.S. Avg.	3.03%	+3 bp	+2 bp	-12bp
S&P 500 Index*	4,308	-4.65%	15.92%	30.00%
S&P Midcap 400*	2,641	-3.97%	15.52%	43.68%
S&P Small Cap 600*	1,332	-2.43%	20.05%	43.68%
S&P SuperComposite 1500*	985	-4.56%	16.02%	31.38%
S&P 500 Growth*	2,984	-5.79%	16.44%	28.86%
S&P 500 Value*	1,438	-3.29%	15.31%	32.02%
World ex U.S., net **	294	-3.20%	5.90%	23.92%
Liquid Alternatives ***	183	-0.92%	4.06%	8.62%
BB U.S. Aggregate *	106	-0.87%	-1.55%	-0.93%
Crude Oil – WTI Near Term	\$75	9.53%	79.11%	93.78%
Gold – Near Term	\$1,755	-3.29%	-7.28%	-8.02%

\* = Total return \*\* = MSCI ACWI ex U.S. \*\*\*\* = 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 that our crystal ball is just as clouded as other prognosticators and that all forecasters have poor track records.

Prepared by Damian Howard

October 11, 2021

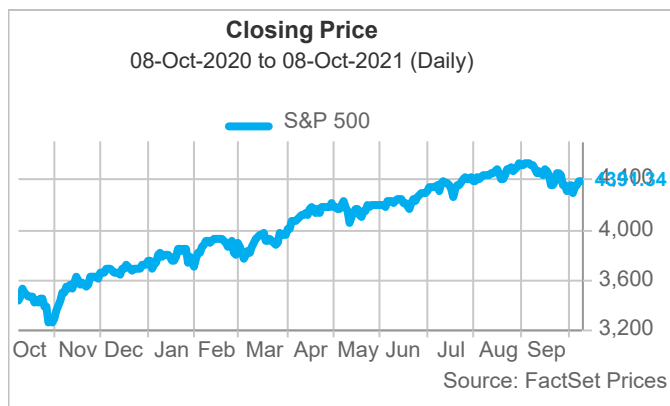
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## Much Awaited Correction

From September 2 to September 30, the S&P 500 fell 4.97% including dividends. Value stocks outperformed, falling only 3.74% including dividends. Growth stocks fell 6.00% including dividends.

With the recent correction, the S&P 500 now trades at a more reasonable 20 times forward earnings versus 23 times forward earnings last year. The market's P/E has fallen by about 13%.

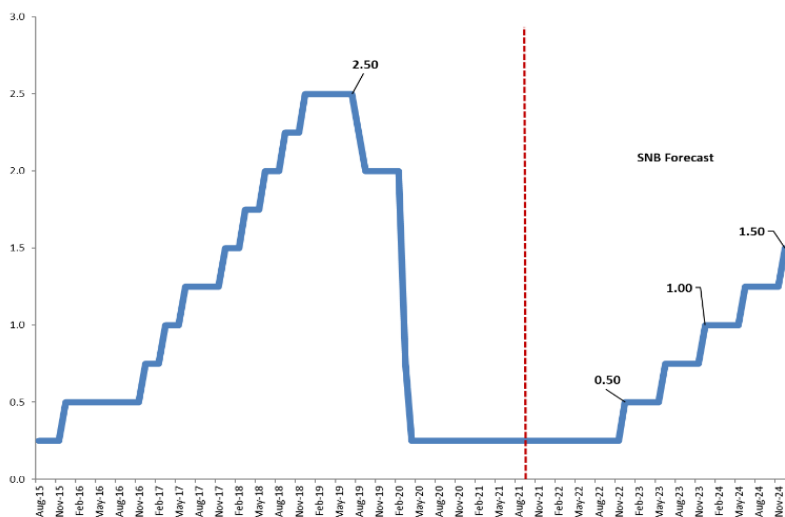
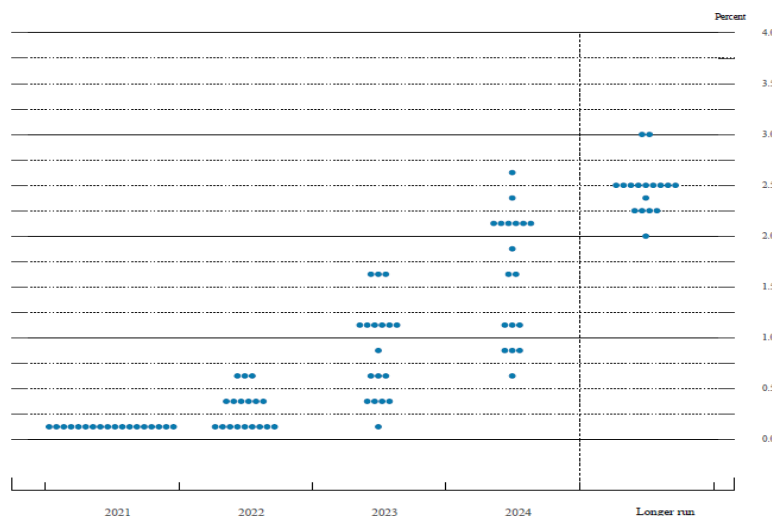


## The Federal Open Market Committee (FOMC)

The FOMC has moved past “talking about talking about” to “talking about” tapering asset purchases. The FOMC signaled that it would likely begin to reduce the pace of asset purchases after the next meeting (November 3, 2021) or December 6, 2021, at the latest. It expects the taper process to be rather quick, ending about mid-year 2022.

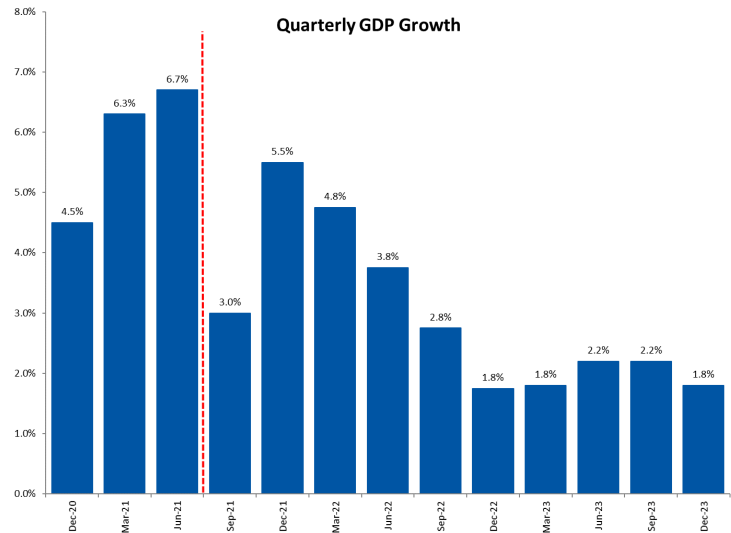
Policymakers also indicated that they might begin to raise the target range for the Fed Funds rate sooner rather than previously expected. Nine of the 18 committee members believe it would be appropriate to raise rates by the end of 2022. The FOMC continues to believe that 2.50% is the neutral Fed Funds rate. At that level, monetary policy is no longer accommodative.

We have pulled forward our expected rate hike by six months to December 2022 from June 2023. We continue to model a gradual series of rate hikes, a 0.25% hike every six months. At such a gradual pace, it will take 4 ½ years for rates to reach neutral, June 2026. As we get closer to the eventual rate hike, short-term rates should rise.



## Slower Growth

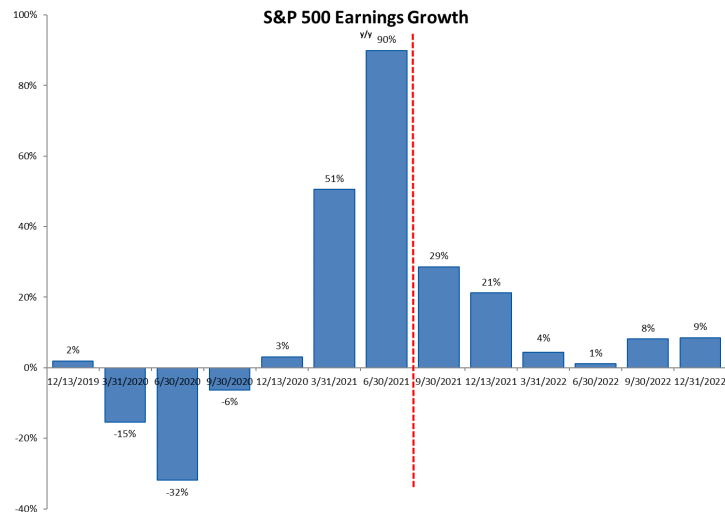
Supply chain havoc, especially for goods originating from China or Southeast Asia, continues to suppress economic growth. In recognition of continued supply chain issues, we lowered third-quarter growth expectations from 5.0% to 3.0%. Not all the lost growth was destroyed; some was just delayed. We raised our 2022 quarterly growth rates by 0.25% each to recapture the lost growth as the supply chain normalizes next year.



We acknowledge there is a substantial risk that supply chain issues will continue into next year. Some of the lost growth will not be recaptured. The risk for our forecast is to the downside. Indications are that supply chain issues are not getting worse. In fact, they are better, but only marginally better.

## Earnings Season

Public companies will start reporting earnings shortly. Consensus quarterly earnings for the S&P 500 are expected to be \$48.40, up 27.7% y/y. We are a bit more optimistic. Expectations have held steady since the end of July with limited preannounced warnings. Last quarter, most companies beat expectations by a wide margin. We expect more modest earnings beats this quarter. Analysts have likely caught their models up to reality. The key theme for this quarter will be supply chain issues, input cost inflation, and the ability to pass the higher cost along to customers.



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 the goals of maximum employment, stable prices, and moderate long-term interest rates effectively” – 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

September jobs report again disappointed, marking two consecutive months of disappointing results. In September, the economy added 194,000 jobs versus the consensus estimate of 479,000 new jobs added. The U.S. Bureau of Labor Statistics (BLS) revised the prior two months’ jobs number up by 169,000. The unemployment rate fell to 4.8%. The participation rate fell slightly while the employment-to-population ratio rose.

The education (state, local, private) sector shed 179,700 jobs. Hiring in the education sector typically occurs in September. The pandemic has distorted the normal seasonal hiring and lay-off patterns, resulting in less reliable seasonal adjustments. The job loss was a result of the seasonal adjustment. Despite some questions regarding seasonal adjustments, it is clear is that employment in the education sector has yet to recover. Total employment in education is down 676,000 since February 2020. This is about 14% of the estimated total job losses over the same period.

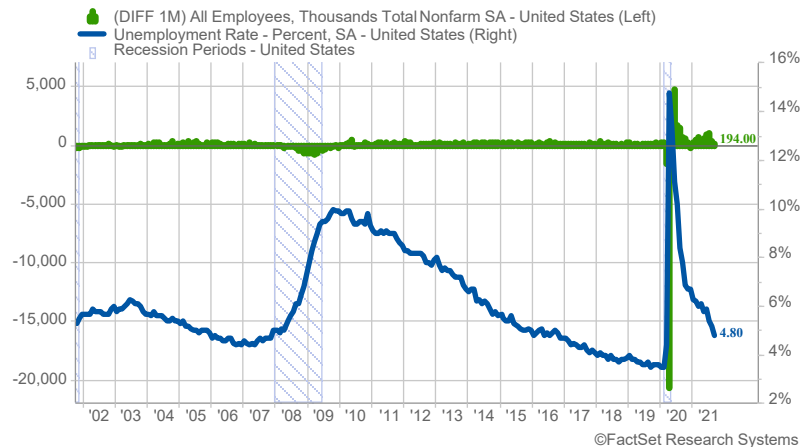
Restaurants added 29,000 jobs. Entertainment venues added 43,000 jobs. Construction added 22,000, primarily in the trades. Architectural and engineering services added 15,100 jobs, indicating an improved outlook for non-residential construction. Manufacturing added 26,000 jobs, however, auto manufacturing lost 6,100 jobs. The chip shortage continued to impact auto production. Retail trade added 56,100 jobs. Warehouses and delivery services added 28,100 jobs. Both brick and mortar and eCommerce grew last month.

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 gain of 526,000 jobs while the establishment puts the change in employment at 194,000. The household survey put the cumulative job losses since February 2020 at 5.1 million or 3.2% of then-existing jobs. The establishment survey puts the cumulative losses at 5.0 million.

The unemployment rate decreased 0.4% to 4.8%. The number of officially unemployed persons fell by 710,000 to 7.7 million. This is down from the 23.1 million reported in April 2020, but up 2.0 million from the number reported in February 2020. The broader U-6 unemployment rate fell to 8.5% from 8.8% the previous month, down considerably from the 22.8% reported in April 2020. The U-6 rate was 7.0% in February 2020.

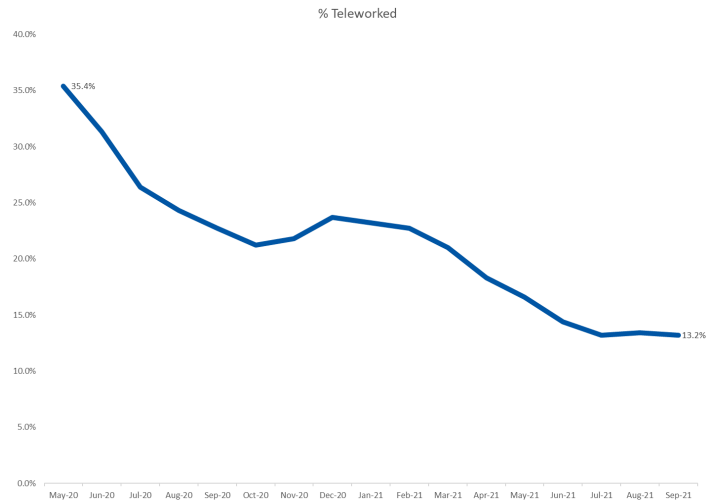
US Change in NonFarm Employment & Unemployment Rate

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The participation rate fell modestly to 61.6% from 61.7% the previous month. The participation rate was 62.7% in February 2020. The employment to population ratio rose by 0.1% to 58.7%. This number was 61.1% in February 2020. If the employment to population ratio were to return to the February 2020 level, an additional 6.3 million jobs would be added for a 4.1% increase.

The percentage of employed persons who teleworked due to COVID decreased last month to 13.2% from 13.4% the previous month. This number includes individuals who 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. The recent spike in the Delta variant has slowed the back-to-work trend.



In August, 5.0 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 the 5.6 million reported last month. 15.5% of those individuals received at least some pay from their employers for hours not worked. This 5.0 million is roughly the same number of jobs lost during the pandemic.

Last month’s average hourly earnings (wages) grew by \$0.19 per hour to \$30.85. This is up \$2.34 per hour, or 8.21%, from February 2020 (pre-pandemic). The Consumer Price Index has been up 5.49% since then. Real hourly wages are up 2.72% since the pandemic started.

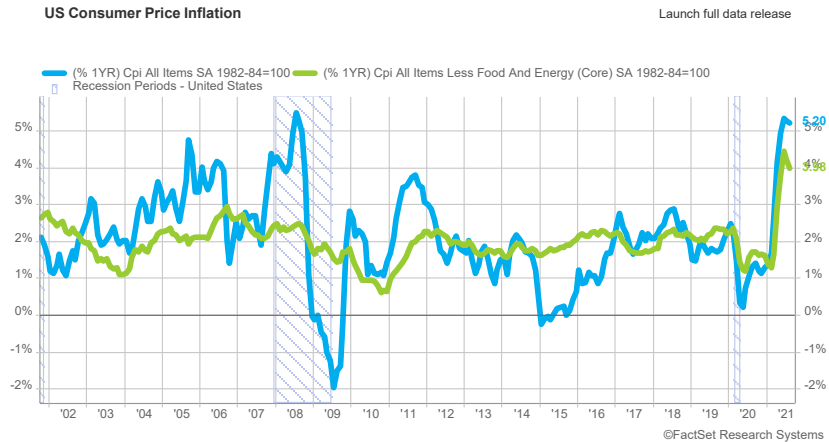
The average workweek expanded by 0.2 hours to 34.8 hours. Average weekly earnings are up 1.2% from the previous month, 4.58% from last year, and 9.47% from February 2020. Average weekly earnings were \$1,074 (\$55,826 annualized) versus \$1,027 (\$53,383 annualized) last year and \$981 (\$50,998 annualized) in February 2020.

Labor markets have significantly healed since April 2020, but there remains more work to be done. The economy is still about 5 to 6 million jobs short of where it should be. Based on the average gains of the last three months (550,000 jobs per month added), it will take ten months for the labor markets to heal fully. At this pace, the labor market will have fully regained its footing by the Summer of 2022.

We still think the FRB will announce a slowing of bond purchases at their November 3rd meeting. They will most likely complete the taper around mid-year 2022. At that point, labor markets will have likely met the FRB’s goal of full employment. The FRB is likely to wait a couple of quarters before raising interest rates. We have penciled in the first interest rate hike for yearend 2022, followed by a rate hike every six months. The normalization pace will be slow, well telegraphed, and predictable.

## Inflation

In August, consumer prices increased at their slowest pace since January, increasing 0.3%. Consumer prices are up 5.2% y/y and an annualized rate of 7.6% over the last six months. August's report was slightly better than expected. The better-than-feared inflation report eased some runaway inflation concerns.



Used car prices fell 1.5%. The sharp increase in used car prices has been well documented and a source of unusual inflation. In June 2021, the y/y increase in used car prices peaked at 45.2%. The Manheim Used Vehicle Index, which measures wholesale prices, peaked in May with a 48.2% y/y increase. From May to August, the index fell 4.2%, signaling further easing in retail prices. We should expect a couple of months' reprieve in the CPI report. However, wholesale prices rose 3.6% in September as the automotive chip shortage dragged along. Higher used car prices are likely to again fuel inflation in the October report.

Other prices that saw a reopening surge also eased somewhat: airfares fell 9.1%, car rental prices fell 8.5%, lodging away from home fell 2.9%, and motor vehicle insurance fell 2.8%.

Five-Year Breakeven Inflation Rates remain remarkably steady at 2.53%. This measure of inflation expectations has remained anchored on the 2.50% line since June 2020. We will be closely watching this rate for any signs that market participants are raising their inflation expectations.



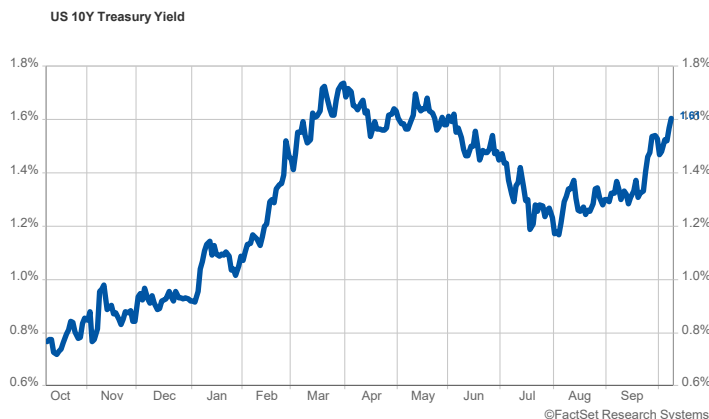
The FRB prefers the Personal Consumption Expenditure (PCE) as its measure of inflation. Due primarily to differences in how health care costs are allocated between employers and consumers, the PCE tends to run 0.30% below the CPI.

Recently, FRB Chairman Powell admitted that the current spike in inflation is not quite as transitory as he initially expected. In the September 2021 Summary of Economic Projections, the FRB increased Fourth Quarter 2021 y/y PCE inflation by 0.8% from its June projection to 4.2%. 2022 and 2023 inflation expectations were roughly the same at 2.2%. We think inflation will continue to run a bit hotter and remain a bit higher than the FRB. We believe inflation averages 5.7% for full-year 2022 and 2.9% inflation for 2023.

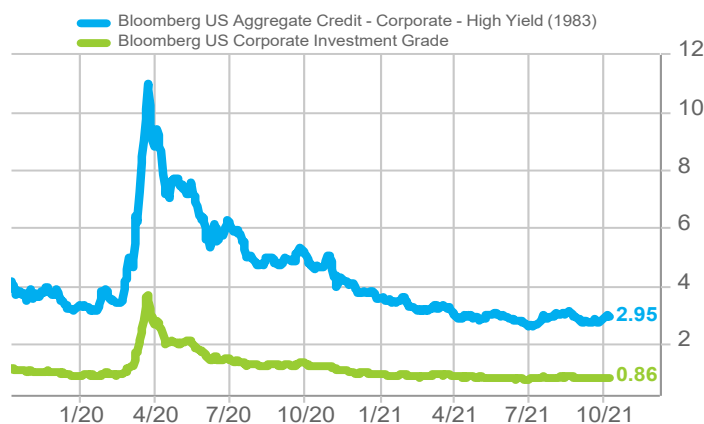
Since February 2020, which includes price declines during the shutdown and price spikes during the reopening, consumer prices are up at a 3.6% annual rate. Core prices are up at a 3.1% annual rate. This is well above the FRB’s 2.0% target. Much of this higher inflation can be attributed to the rapid growth in money supply. M2 growth spiked above 25% earlier this year. It has since eased to 13% y/y growth. The pending taper should bring monetary growth back to historical levels of about 5% plus or minus a couple of percent. Until supply chains normalize, there will continue to be too much money chasing too few goods. This has and will lead to higher than desired inflation.

## Credit Markets

Peaking COVID-19 cases coupled with the FRB’s talk about tapering bond purchases helped push rates higher. During September, the 10-year Treasury rate rose from 1.30% to 1.53%, increasing 0.23%. The Bloomberg Barclays Aggregate had a total return of negative 0.87% during the month, with a negative 1.14% return due to price and 0.27% income.



Credit markets fell sharply in September. The Bloomberg Barclays (B.B.) U.S. Corporate Investment Grade index had a total return of negative 1.05%, with a negative 1.47% price return and 0.42% from income. Credit spreads narrowed 0.03% to 0.84%. The index has an 8.7-year effective duration.



The B.B. High Yield index had a total return of negative 0.01%, with a negative 0.55% price return and 0.54% from income. Credit spreads widened by 0.01% to 2.89%. The index has a 4.0-year effective duration.

We believe that spreads for both investment grade and high yield bonds are too low. The risk does not justify the return. The world is awash in cash, looking for income. 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 appetite. We will continue to invest our risk bucket in stocks. We believe stocks offer a greater risk/reward trade-off. We also look for alternative sources of income, such as market-neutral funds and real assets.

## The Consumer Sector

Personal income rose 0.2% in August after rising 1.1% the previous month. Government transfer payments rose 0.52% during the month, as Child Tax Credit payments offset a 3.7% drop in unemployment benefits. Personal income excluding government transfer payments was up 0.1% m/m, up 7.7% y/y, and up 3.7% from February 2020.

Private sector wages and salaries were up 0.5% m/m, up 11.0% y/y, and up 7.3% from February 2020. Proprietors' income was down 1.5% m/m, up 1.2% y/y, and up 3.8% from February 2020. This line does contain the impact of PPP. Interest and dividend income were up 0.1% m/m, up 3.5% y/y, and down 1.2% from February 2021.

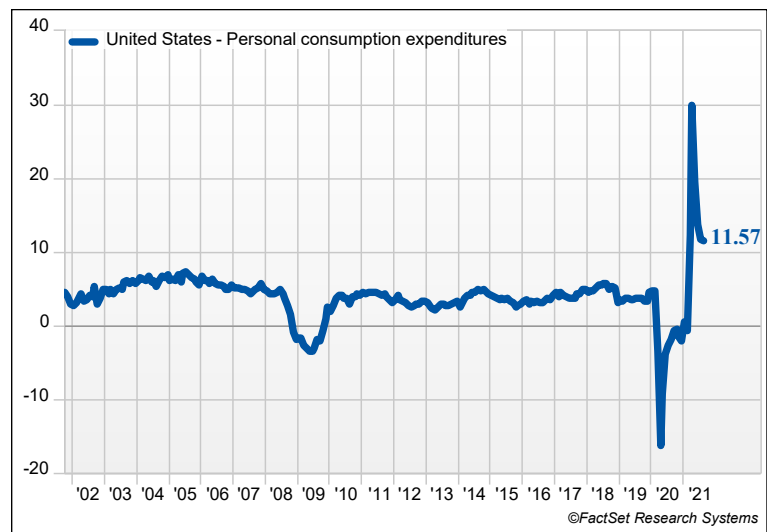
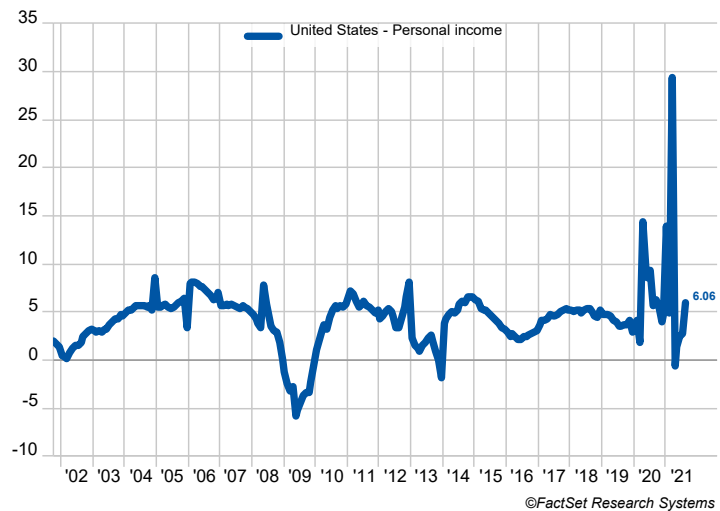
During July, consumers saved 9.4% of disposable income. Consumer spending on goods and services was up 0.8% for the month. Purchases of durable goods fell 0.4% m/m. A 6.3% decrease in motor vehicles led the drop in durable goods. Other durable goods categories rebounded for last month's drop with gains of 2.1% to 3.4%. Purchases of non-durable goods rose 2.1% m/m with grocery store purchases up 2.7%. Purchases of services rose 0.6% m/m led by a 6.6% increase in airline ticket sales. Most other service categories were up less than 1%.

Personal income and expenditure patterns are returning to normal, with the well-documented exception of autos.

The Consumer Confidence Index, compiled by the Conference Board, fell 5.9 points to 109.3, a much larger drop than expected.

Both consumers' perception of the present situation and expectations for six months hence fell. The current situation component fell to 143.4 from 148.9 the previous month. The forward-looking expectation component fell to 86.6 from 92.8 the previous month. The decline was substantial in the 35 to 54 age group.

Respondents' perception about current business conditions fell further into negative territory as the net sub-index (good-bad) fell to -6.1 from -3.9 the previous month. In six months, consumers' outlook about business conditions worsened as the net sub-index (better - worse) fell to 3.9 from 6.0 the previous month.





Consumers’ perception of the labor market only modestly worsened. The current conditions net employment sub-index (plentiful - hard to get) fell from 44.4 to 42.5. Consumers’ perception about employment conditions in six months fell slightly more as the net sub-index (more jobs – fewer jobs) fell to 1.2 from 5.1 the previous month.

### 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 calculate 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.

Globally, manufacturers and non-manufacturing-orientated businesses report the same story. The growth slowdown may have bottomed. Supply chains continue to be stressed but may be getting better incrementally. Long supplier delivery times are making it difficult to fulfill customer orders. Everyone could sell more products and services if only they had the goods

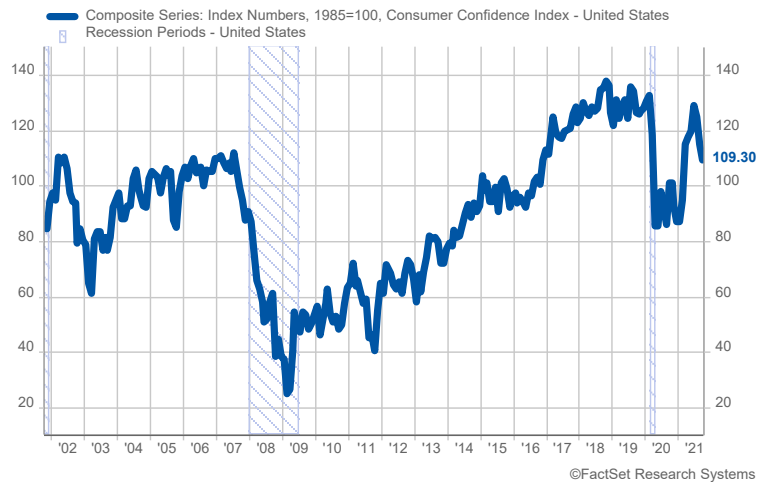
The non-manufacturing index rose in August to 61.9 from 61.7 the previous month. Activity in the services sector has grown for sixteen months in a row. The two forward-looking components, business activity/ production, and new orders fell indicating a growing economy, with increasing momentum.

The business activities/production component rose 2.2 points to 62.3. Seventeen industries reported an increase in business activity for the month of July. One industry reported a decrease in activity.

The new orders component rose 0.3 points to 63.5. 17 industries reported an increase in orders. One industry reported a decrease in orders.

US Consumer Confidence

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Non-Manufacturing Sector	Direction	Rate of Change
Business Activity / Production	Growing	Faster
New Orders	Growing	Faster
Employment	Growing	Slower
Supplier Deliveries	Slowing	Slower
Customer Inventories	N.A.	
<b>Non-Manufacturing Sector</b>	<b>Growing</b>	<b>Faster</b>
Industries Expanding	17	
Industries Contracting	1	

The employment in the services sector fell 0.7 points to 53.0. Fourteen industries reported an increase in employment. Three industries reported a reduction in employment. Respondents continue to report difficulty filling open positions with significant employee quit rates due to high pay elsewhere.

Manufacturing Sector	Direction	Rate of Change
Production	Growing	Slower
New Orders	Growing	Unchanged
Employment	Growing	Was Contracting
Supplier Deliveries	Slowing	Faster
Customer Inventories	Too Low	Slower
<b>Manufacturing Sector</b>	<b>Growing</b>	<b>Faster</b>
Industries Expanding	17	
Industries Contracting	1	

Supplier deliveries continued to worsen but at a slower pace. The supplier deliveries component fell 0.8 points to 68.8. 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 at a faster pace. The price component rose 2.1 points to 77.5. All eighteen industries reported higher costs.

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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 rose 1.2 points to 61.1 versus expectations for a slight decline. The figure indicates the manufacturing sector has expanded for sixteen straight months. The production component fell 0.6 points to 59.4. The new orders component held steady at 66.7. The employment component rose 1.2 points to 50.2, indicating expanding manufacturing employment. Six industries reported employment growth. Six industries reported a decrease in employment.

Supplier deliveries to manufacturers worsened at a faster pace as the sub-index rose 3.9 points to 73.4. All six of the top six manufacturing industries reported slowing deliveries.

J.P. Morgan global PMI summary

		May	Jun	Jul	Aug	Sep
Output	Total	58.5	56.6	55.8	52.5	<b>53.0</b>
	Manufacturing	55.6	54.4	54.4	51.8	<b>52.0</b>
	Services	59.5	57.4	56.3	52.8	<b>53.4</b>
New orders	Total	58.7	56.6	55.5	53.2	<b>53.3</b>
	Manufacturing	57.3	55.7	55.3	53.6	<b>53.9</b>
	Services	59.2	56.9	55.5	53.0	<b>53.1</b>
Future output	Total	67.3	68.6	65.2	65.8	<b>67.1</b>
	Manufacturing	65.1	66.1	64.2	64.1	<b>64.2</b>
	Services	68.1	69.5	65.6	66.5	<b>68.2</b>
Employment	Total	53.3	53.0	52.6	51.6	<b>51.5</b>
	Manufacturing	52.5	52.6	52.7	52.0	<b>51.4</b>
	Services	53.6	53.1	52.6	51.5	<b>51.6</b>
Output prices	Total	59.1	58.2	58.0	57.3	<b>58.0</b>
	Manufacturing	62.6	60.8	60.3	60.1	<b>60.9</b>
	Services	57.8	57.2	57.1	56.3	<b>56.9</b>

Source: J.P. Morgan, Markit

The Prices Paid sub-index rose 1.8 points to 81.2, indicating raw material prices have increased for the 16th consecutive month and at a faster pace. Seventeen industries reported increased prices for raw materials. One industry, Petroleum and Coal Products, reported lower prices.

Global PMI surveys indicate a quickening of global momentum. August may have marked the bottom. Both the services and manufacturing composites rose, indicating broad-based strength. Supply chain constraints have yet to abate. Inflation continues to be a factor, especially in manufacturing. The employment composite index indicates modest gains in hiring.

## The Housing Sector

New home sales rose for the second month in a row in August to a 740,000 pace from a revised 729,000 pace the month before. July had marked the first increase in four months. While up from two months ago, new home sales are well below the 993,000 pace set in January.

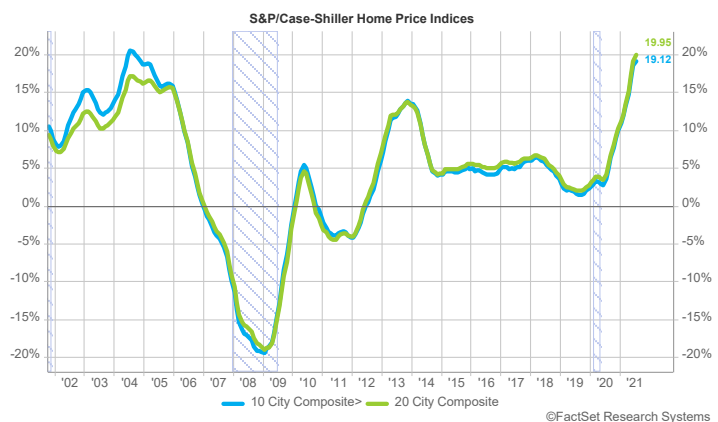
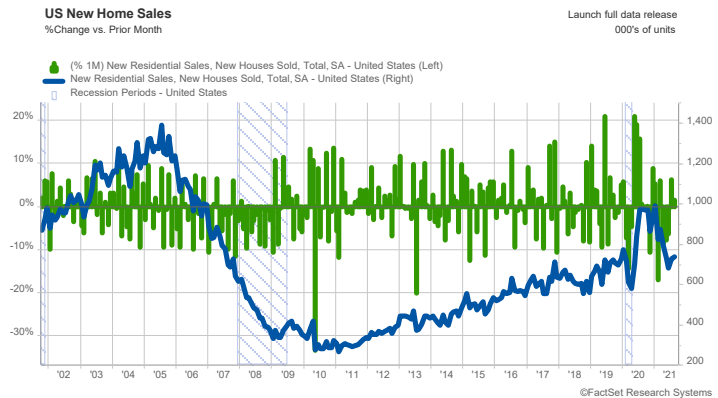
A shortage of material and labor continues to hold back the pace of new home sales. On October 6, 2021, Hovnanian Enterprises (HOV) stated “Given these supply chain uncertainties and delays, we are revising our guidance for Q4 and a full year.”

As a result of supply chain issues, HOV lowered their F4Q EBITDA by \$15 million or 15%. They further stated, “Even with these changes, we expect year-over-year improvements in pretax profitability for the full year to exceed 200%... As we look forward, we believe that today’s more rational, healthy contract pace, which has higher home prices and gross margins, along with an increase in community count, should lead to further growth in both total revenues and adjusted pretax income in FY22. We currently expect to begin FY22 with a strong Q1 compared to Q1 of FY21”. Once the supply chain normalizes, homebuilders should be able to further ramp up the supply of new homes. In the meantime, tight supply coupled with ample demand has led to higher prices. The median price of a new home is up 20% y/y to \$390,900.

There is reason to be optimistic. Homebuilders started construction on 1.1 million single-family homes last month. This marks the thirteenth month of greater than 1 million home starts. Homebuilders are working through their backlog of sold but unfinished homes. Total housing starts (single and multifamily) are up 18% from August 2019 (pre-pandemic). The total value of new single-family residential construction put in place in August was up 48% from August 2019.

Homebuilders were able to hire some (not all) of their needed workers. 18,400 individuals were hired in residential construction and related trades in August. Total employment in residential construction and related trades is up 5.0% from August 2019, while total economy-wide employment is down 2.6% over the same period. While job growth trails the amount of starts, indicating a need for additional workers, it does show that residential construction is addressing its labor shortage problem. The sector is outgaining the broader economy.

August’s existing-home sales fell 2.0% m/m and y/y to a 5.9 million annual rate. The supply of existing homes for sale held steady at 2.6 months, near a record low. Strong demand coupled with low supply has



led to strong home price appreciation. Prices, as measured by the Case-Shiller 20-City Home Price Index, increased by a strong 20.0% y/y. Many metro areas are seeing their largest-ever y/y price increases. Monthly home price appreciation peaked in March at 2.3%. While still quite high at 1.5%, price gains are decelerating.

There continues to be a housing shortage. The demand far exceeds the supply. After bottoming in August, lumber prices have risen and are up 7% y/y. Interest rates are likely to rise from here. The FRB will taper its MBS purchases, widening the spread. We do not believe mortgage rates will rise far enough to choke off supply. The market will remain supply-constrained for the next year at least.

We welcome your comments and suggestions. Please feel free to contact me. Also, please see the obligatory disclosures listed below.

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Investments offered by Security National Bank:

Are Not a Deposit

Are Not FDIC-insured

Are Not Guaranteed by the Bank

Are Not Insured by Any Federal Government Agency

May Go Down in Value