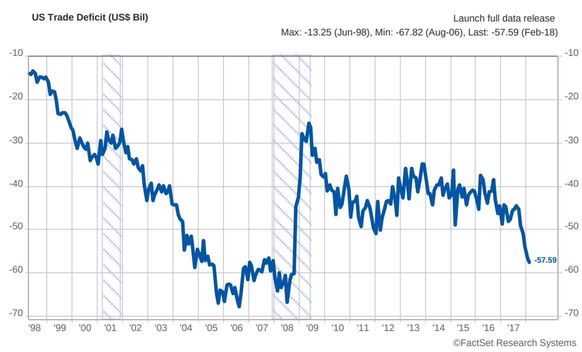
SECOND QUARTER 2018 MARKET OUTLOOK

Our Outlook

	2015	2016	2017	2018 Est	2019 Est	Long Term
GDP Growth (1)	1.9%	2.0%	2.5%	2.8%	2.2%	2.0%
Change in Consumer Prices(2)	0.7%	2.1%	2.1%	2.1%	2.0%	2.0%
Fed Funds Target Rate (3)	0.50%	0.75%	1.50%	2.25%	2.75%	3.00%
10-Year Treasury Yield (3)	2.28%	2.43%	2.41%	3.05%	3.60%	4.50%
S&P 500 EPS	$116	$118	$133	$156	$165	

(1) 4th Quarter y/y change
(2) December year/ year change
(3) Year end

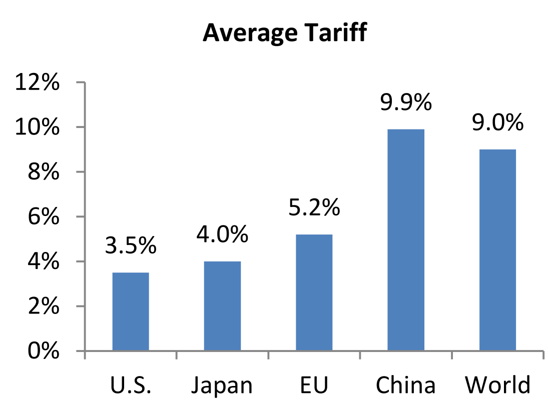
Security National Bank's Wealth Management Department maintains an economic forecast that provides our Investment Committee and the Bank's Funds Management Committee background assumptions for use in investment decisions.



Trade

In early March, the Trump Administration initiated a round of trade skirmishes by imposing tariffs on steel and aluminum in the name of national security. The U.S. then temporarily exempted Mexico and Canada pending progress on NAFTA renegotiations. Europe, Korea and other allies were also shortly thereafter exempted. It appears the Trump administration is making headway in its goal to renegotiate NAFTA. An agreement in principal on NAFTA could be announced shortly at the Summit of Americas in Peru.

Later in March, the U.S. proposed limited tariffs on approximately $50 billion of Chinese goods, aimed at pushing China to protect intellectual property and further open their markets to U.S. goods. Mr. Trump is invoking Section 301 of the 1974 Trade Act, which allows the U.S. to counteract any trade practice that unreasonably burdens U.S. commerce.



The World Trade Organization (WTO) estimates the United States collects on average 3.5% tariffs on $2.2 trillion of imports. This is among the lowest rate for WTO members, which on average impose a 9% tariff on imports. The U.S. Chamber of Commerce estimates

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that China has stolen at least $250 billion worth of intellectual property. President Trump campaigned on addressing these imbalances and fixing the trade deficit. It appears Mr. Trump has brought his unconventional rough and tumble Art of the Deal negotiating style to trade negotiations. Mr. Trump is bypassing the WTO by using unconventional and more aggressive methods to address important grievances against Chinese trade practices.

Forbes annually ranks the world's top 2,000 companies. Companies from the US and China comprise 40% of the list. US companies account for 565 Global 2000 companies, including 12 of the top 20. China accounts for 263 Global 2000 companies, including 5 of the top 20. Most of these are state controlled. The State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) controls more than half of China's Fortune 500 list. SASAC controls hiring and firing of management, deploying and transferring resources across all of these companies, and generating synergies and subsidies among them. SOEs both controlled by the central government and local government, account for 30% to 40% of total GDP and 20% of total employment. State control has meant production well beyond demand in many key areas. The WTO is poorly equipped to address many important issues given the heavy state involvement in the Chinese economy. WTO shortcomings and a distain for multilateral institutions led Mr. Trump to Section 301. He apparently believes it is the best way to address Chinese industrial policy such as China 2025.

The risks of a global trade war are well documented. According to Warwick McKibbon of the Brookings Institute, a minor trade war (tariffs rise 10%) would reduce U.S. GDP by 1.3% and other countries including China by as much as 4.5%. A 40% increase would cause a deep global recession.

On April 3rd, the U.S. announced its initial list of proposed tariffs on $50 billion worth of Chinese goods under Section 301. The goods targeted for 25% levies focuses on those that benefit from Chinese industrial practices. China immediately said it would levy 25% tariffs on imports of 106 U.S. products worth approximately $50 billion including soybeans, automobiles, chemicals, and aircraft. Both countries designed their tariffs to maximize political benefits without disrupting the global economy. A decision to actually impose these tariffs won't come for up to eight months. In the meantime, Washington and Beijing are conducting negotiations to settle trade differences according to media reports. However, on April 5th, a White House statement said that President Trump has instructed the U.S. Trade Representative (USTR) to consider additional tariffs on an additional $100 Billion of Chinese products. These additional tariffs and the likely Chinese response would raise the likelihood of a recession substantially if implemented.

Chinese Premier Li Keqiang reiterated pledges to ease access for American businesses. Li told global chief executives China would treat foreign and domestic firms equally, would not force foreign firms to transfer technology, and strengthen intellectual property rights. There remain several sticking points, mainly the requirement that foreign firms form JVs with domestic partners and rules for foreign automakers.

The fear of a trade war is in part responsible for the losses in March and early April. Trade negotiations will continue to be a source of market volatility for the foreseeable future. The situation remains fluid. The U.S. is rethinking its stand on Chinese participation in the global economy, especially in high-tech areas. Our base case is that trade tensions will remain headwind to the stock market and economy.

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However, it will not escalate into an all-out trade war and global recession. This issue is likely to remain contentious for the remainder of the Trump administration and likely beyond.

The Quarter in Review

Since February 2nd, the market has faced a series of negative narratives (e.g. wage inflation, rising yields, hawkish Fed, rising deficits, trade wars, Facebook privacy violations). The complacency that built up last year appears to have abated. The U.S. stock market, as measured by the S&P 1500 SuperComposite, was down 0.72% during the first quarter of 2018 and was up 13.73% in the last twelve months. This was the first quarterly loss since the third quarter of 2015. Small capitalization stocks outperformed large capitalization stocks 1.33% this year. Small cap stocks are seen as least likely to be harmed by trade frictions. Despite recent troubles in the FAANG stocks, growth stocks also bested value stocks by 5.50% this quarter.

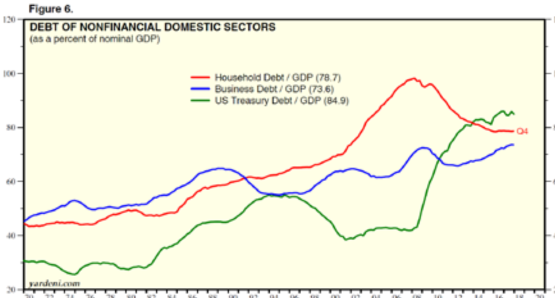
The bellwether 10-year Treasury ended the quarter at 2.74%. Our forecast is for the 10-year Treasury to end the year at 3.05%. High yield credit spreads widen by 9 basis points during the first quarter. After reaching a cyclical low on January 29th high yield spreads widened 42 basis points.

Investment grade credit spreads also widened during the quarter. They ended the quarter 16 basis points wider and 24 basis points wider than their cyclical low on February 2nd. We look for credit spreads to continue to widen as they remain very tight versus their twenty year averages.

The Next Recession

Corporate debt as a percent of GDP is currently at a record high, along with U.S. Treasury debt. It is highly likely that we will enter the next recession with record debt loads for the government and corporate sectors. During the last recession, consumption by the households collapsed in part due to the stress of consumer debt. Household have not repeated this mistake. Household debt coverage ratios remain strong.

Figure 6.



Source: Federal Reserve Board, Flow of Funds Accounts and Yardeni Research, Inc.

If not caused by a trade war, the next recession is likely to emanate from the corporate sector. There is likely to be a sharp decline in profitability followed by an uptick in corporate defaults and significant widening of corporate spreads. The high U.S. government debt level will limit its ability to respond with counter-cyclical measures and may require pro-cyclical measures such as raising taxes during a recession. It is likely the budget deficit will balloon out to well above 10% of GDP during the next recession. The recent budget deal greatly increased the risk of this happening. The next downturn is likely to be much deeper than it would have been absent our current failed fiscal policy.

We avoid investing in companies that have high debt levels. We currently define this as net debt to EBITDA greater than three times. Companies that take on high debt levels in good times will be hard hit during the next downturn. We also plan on liquidating our high yield debt exposure prior to when the real

Fed Funds (Fed Funds rate less the inflation rate) reaches 1.0%. At that level debt service obligations will begin to pinch corporate cash flow and the risk of recession rises.

We do not expect a recession within the next year or so. In the last 8 business cycles, the U.S. has never entered a slowdown with negative policy rates. Currently the real policy rate is a negative 0.15% (1.75% Fed Funds rate less 1.9% core CPI). Real policy rates were at least at 1.8%, or higher in the 6 months prior to previous downturns. We currently do not expect the real Fed Funds rate to be in the danger territory during our forecast period. We always invest with the next recession in mind.

Improved Earnings Prospect

Projected earnings from the S&P 500 have risen significantly since the passage of tax reform. In mid-November, prior to talk of significant tax reform, consensus 2018 earnings were $145.38. A strengthening economy and tax reform have led to significant earnings revision. Consensus earnings are now $157.01. This is up 8.0% since mid-November and would result in an 18.76% year over year growth.

In response to the strengthening economy and tax reform, we have raised our 2018 S&P 500 earnings estimate from $145 (prior to tax reform) to $156 and 2019 estimate from $146 to $165. We remain slightly more conservative than consensus.

At our 4th Annual Investment Outlook Luncheon, we gave a year end forecast for the S&P 500 Index of 2,763. Today the S&P 500 is trading at 2,663, just 3.8% below our forecast. The market is trading at just 16.5 times next twelve months earnings. This is about average for the last several decades. Corporate earnings are strong. The consumer is in great shape. Barring a trade war, we believe the stock market has several more years of positive returns. We remain cautious (chicken) bulls.

Value Investing Dinner

Security National Bank will be hosting a table as the CFA Nebraska Society's Value Investing Dinner on May 3rd. The dinner is held annually just prior to the Berkshire Hathaway Annual Meeting. This year's keynote speaker is David Rolfe, partner and architect of Wedgewood Partners' investment strategy. Wedgewood has been a long time investor in Berkshire and brings a different perspective to the company. The cocktail reception starts at 5:30 with dinner at 7:00. It will be held at the Omaha Marriott in Regency. If you would like to join us please email me at dhoward@snbomaha.com or call me at 402.221.0178.

If you have friends or family that may benefit from the Market Outlook, feel free to have them send me their email address, and we will add them to our mailing list.

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

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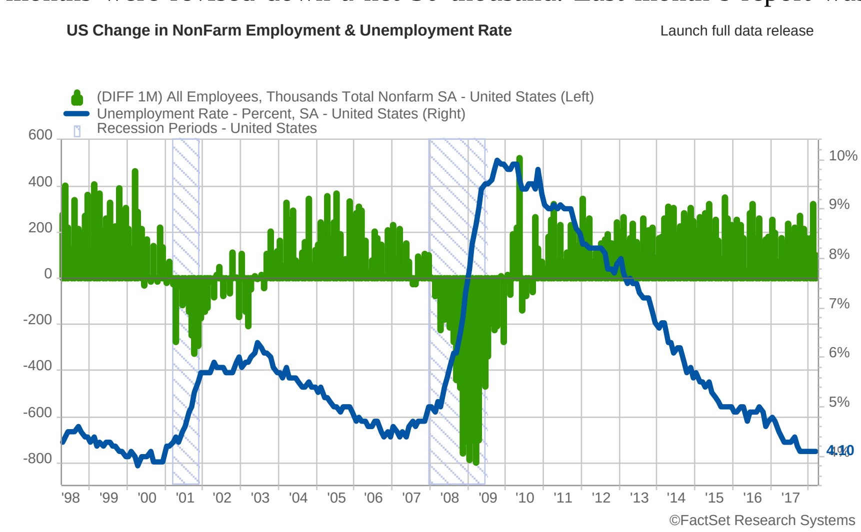
Recent Economic Reports

		1 Month Change	YTD Change	1 Year Change
Fed Funds Target	1.50% to 1.75%	+0.25%	0.25%	+75 bp
2-Year Treasury Yield	2.27%	+2 bp	+38 bp	+100 bp
10-Year Treasury Yield	2.74%	-7 bp	+34 bp	+34 bp
SNL 30Yr Fixed – U.S. Avg	4.45%	+9 bp	+37 bp	+23 bp
S&P 500 Index*	2,641	-2.54%	-0.76%	13.99%
S&P Midcap 400*	1,879	0.93%	-.077%	10.97%
S&P Small Cap 600*	938	2.04%	0.57%	12.68%
S&P SuperComposite 1500*	612	-2.17%	-0.72%	13.73%
S&P 500 Growth*	1,558	-2.98%	1.93%	19.69%
S&P 500 Value*	1,080	-2.04%	-3.57%	7.69%
Crude Oil – WTI Spot	$64.91	5.66%	7.36%	28.43%
Gold – New York Spot	$1,325	0.55%	1.73%	6.07%

*Data as of March 31, 2018. * = Total return*

Employment

The Labor Department reported in its April 6th Employment Situation (Jobs) Report that the economy added only 103 thousand jobs last month. This was well off of the 185 thousand consensus expectation. The totals for the previous two months were revised down a net 50 thousand. Last month's report was revised from 313 thousand to 326 thousand. The January number was revised to 176 thousand from 239 thousand (63 thousand lower) and 228 thousand originally.



We caution against over reacting to any single economic report. As seen in the January jobs number and the initial February wage growth number, these reports can be significantly revised. The trailing three month average job growth was 201,700 versus 225,700 last month and 177,300 last year. On the other hand, the weak job growth could be a sign that the economy is finally running out of employable individuals. The U-6 rate points to that possibility.

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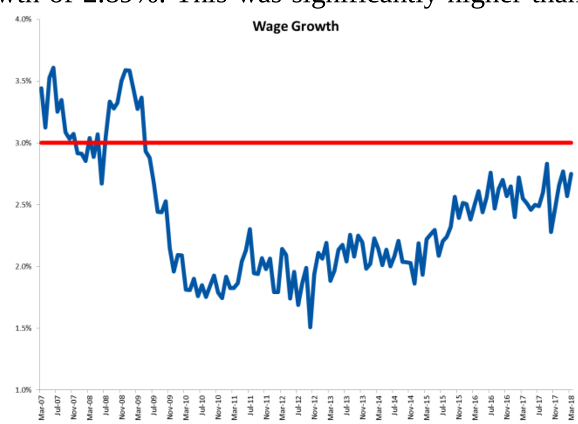
The unemployment rate held steady at 4.1% for the sixth straight month and tied a 17 year low. This is down from 4.5% last year. The broader U-6 measure fell to 8.0% from 8.2% and is down from 8.8% last year. This measure includes part-time workers who would prefer a full-time position and people who want a job but are not actively looking for one (so-called discouraged workers). The Labor Department started tracking U-6 in January 1994. This month's reading of 8.0% is tied for the lowest ever recorded.

Over the last twelve months the U.S. economy added a net 2.3 million jobs. The number of employed individuals has increased 1.38% over last year. During the same time, the labor force has grown by 1.5 million or 0.95%. The labor participation rate fell slightly to 62.9% from 63.0% versus last month and 63.0% last year.

Last month's average hourly earnings (wages) grew at a 2.72% y/y rate, up from a revised 2.57% last month and 2.55% wage growth reported last year. The average work week held steady at 34.5 but rose from 34.3 last year. Average weekly earnings are up 3.32% from last year to $925.29. Wage growth has not exceeded 3.0% since April 2009.

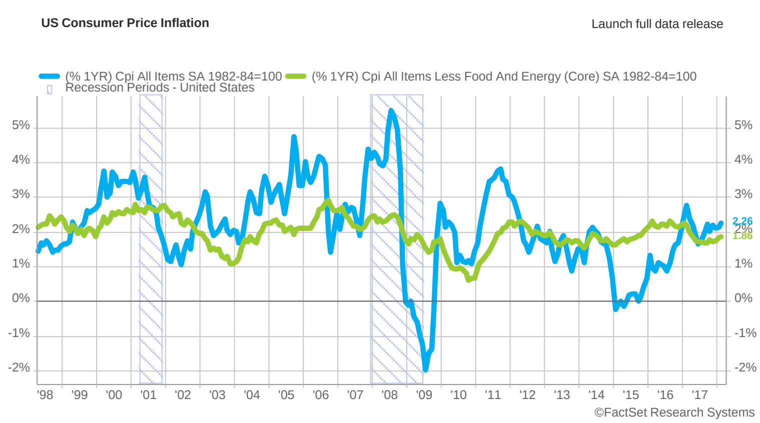
The February Job's report originally reported wage growth of 2.89%. This was significantly higher than expected. The unwelcome surprise sent inflation fears throughout the economy. We viewed that report as highly suspect and likely impacted by weather and the strong flu season. We chose not to jump on the inflation band wagon. It now appears that such caution was warranted. Wages remain under control and well below levels that typically induce inflation.



Sustained wage inflation has not yet reached the 3.0% level. We believe wage growth can surpass 3% for an extended period of time before wage induced inflation starts to become a concern. Until then, monetary policy will remain accommodative. The FRB can maintain its pace of gradual interest rate hikes.

Inflation

The consumer price index was up 0.2% m/m in February and up 2.3% y/y.



Gasoline prices fell 0.9% last month and are up 12.6% y/y. Energy prices are up 8.0% y/y. Medical costs are up 1.8% y/y and Owners' Equivalent Rent is up 3.1% y/y. All other categories remain under control. Consumer prices, excluding energy, are up a more modest 1.8% y/y.

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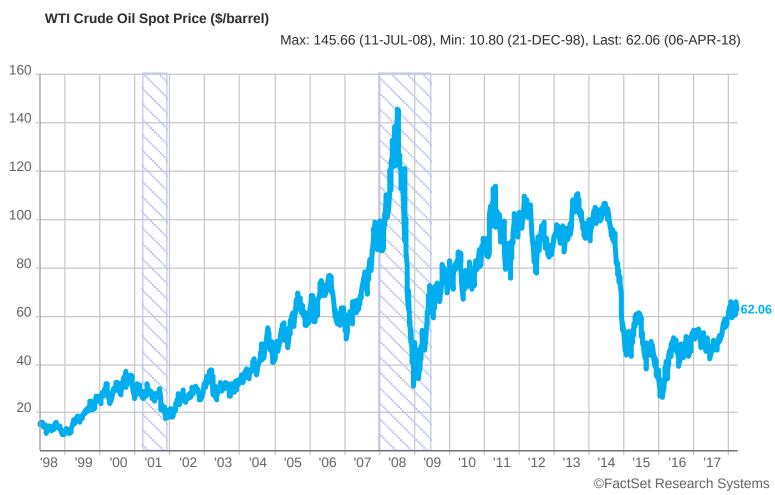
The FRB prefers the Personal Consumption Expenditure (PCE) as its measure of inflation. Due primarily to differences in how health care costs are allocated between employers and consumers, the PCE tends to run 0.25% to 0.50% below the CPI. The PCE was up 0.2% in February and is up 1.8% y/y. The core PCE was up 1.6% y/y.

Inflation remains under control and close to the FRB's stated goal of two percent. This should allow the FRB to increase the Fed Funds rate at a steady pace in 2018 and 2019. We believe they will raise rates at least two more times in 2018 and at least two times next year. The FRB will keep monetary policy accommodative until wage growth runs in excess of 3.0% for an extended period of time. One possible source of inflation remains energy prices, in particular the price of oil.

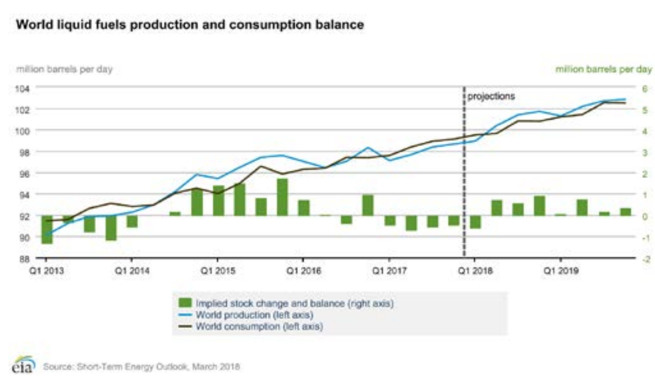
Oil

Oil prices peaked at $66.27 on January 26th and have since fallen to slightly above our $50.00 to $60.00 long term per barrel range.



In response to higher prices, drillers once again increased the number of rigs drilling for oil. The most recent Baker Hughes survey puts the U.S. land rig count at 785. With oil prices firmly above $60 per barrel, more rigs continue to be deployed. Drillers have returned to growth mode. This should help boost U.S. production in 2018 and 2019.

The U.S. Energy Information Administration, EIA, estimates that U.S. Crude production averaged 9.3 million barrels per day in 2017, up 0.5 million (5.7%) b/d from 2016. In 2018, the EIA expects total U.S. crude oil production to average 10.7 million b/d (up 15% y/y). In 2019, the EIA expects crude oil production to continue to increase, reaching an average 11.3 million b/d (up an additional 5.6% y/y). The 2018 annual production will mark the highest in U.S. history, surpassing the previous record of 9.6 mb/d set in 1970.

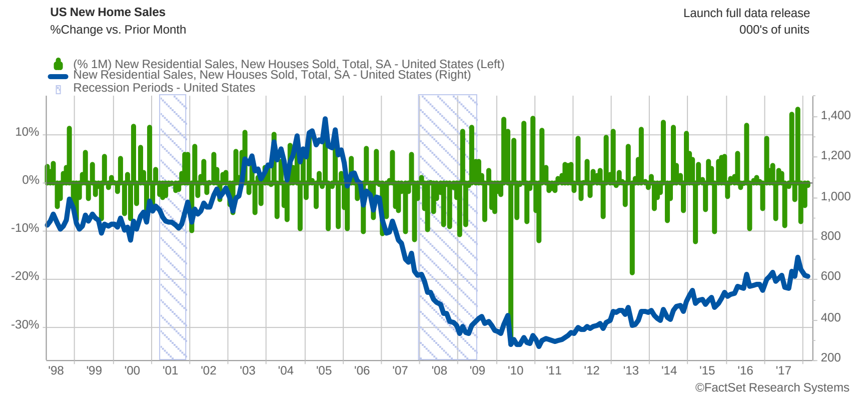


Last year's rise in energy prices put upward pressure on inflation and interest rates. As seen by the chart on the right, the EIA expects global oil markets to be in balance or in a slight surplus for the next several quarters. Thanks to U.S. shale, the probability of a major oil price spike and its economic impact has greatly diminished. The higher rig count will likely boost U.S. industrial production, capital goods investment and earnings for the S&P 500 Index.

Housing

In February, new single-family home sales were 618,000, down from a revised 622,000 pace the month before. Monthly data tends to be volatile and is often revised significantly. To even out the volatility, we use a rolling three month average. February's trailing three month trend was up 7.4% y/y. The gains were led by a 20.9% growth in the West.

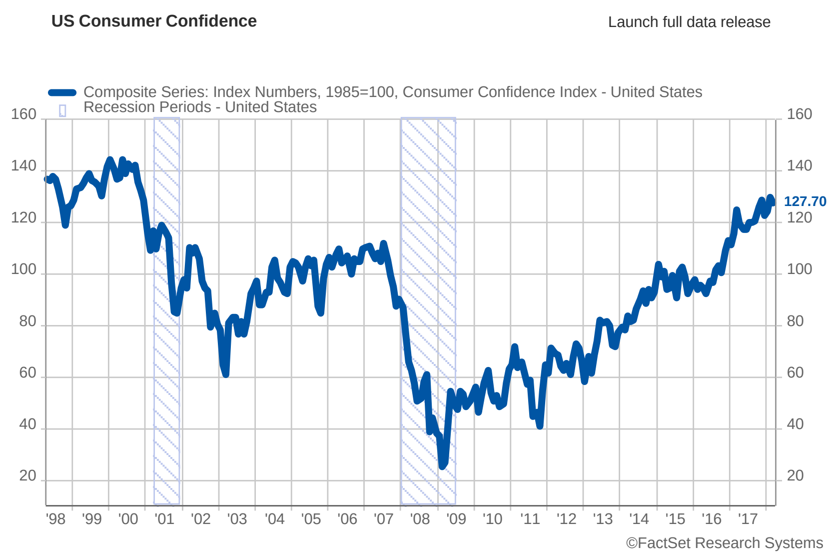
The trailing 3 month average median sales price is up 5.5% y/y to $331 thousand. For the last year, new home prices have risen faster than disposable personal income per capita (3.2%). Existing home prices as measured by the Case-Shiller 20-City Index are up 6.4%. If home prices rise too much above incomes, potential purchasers will be shut out of the market and new home sales growth will falter. The current pace of price increases should not materially retard new home construction.



Housing is estimated to be 3.8% of the economy. Residential construction directly employs 779 thousand persons. We look for new home sales and construction to continue to grow at a healthy mid to high single digits pace for the next couple of years. This sector will continue to provide support for economic growth.

The Consumer

The Conference Board reported that consumer confidence fell slightly to 127.7 from 130.0 the previous month. The prior month's reading topped the previous cyclical high of 128.6. Consumers' assessment of current conditions remains quite favorable. The Index suggests that the economy will continue expanding at a slightly slower pace. The average over the last twenty years has been 93.



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The present situation component fell to 159.9 from 161.2 the previous month. The expectations component fell to 106.2 from 109.2 the previous month. Both readings are significantly above their twenty-year averages of 102 and 87 respectively.

The sub-components of the present situations component continue to show broad based strength. The net appraisal of current employment opportunities being plentiful (plentiful less hard to get) rose to 25.0 from 24.0 the previous month. The strong employment environment has boosted consumers' confidence in the job market. Consumers' net perception of current business conditions (good less bad) fell slightly to 24.5 from 25.2 the previous month.

Personal income is estimated to be up 3.7% in the past year versus a 3.4% pace reported last year. The growth in personal income is accelerating. Private sector wages and salaries are up 4.8% from last year. Disposable personal income is up 3.9% y/y. Disposable personal income per capita is up 3.2% y/y.

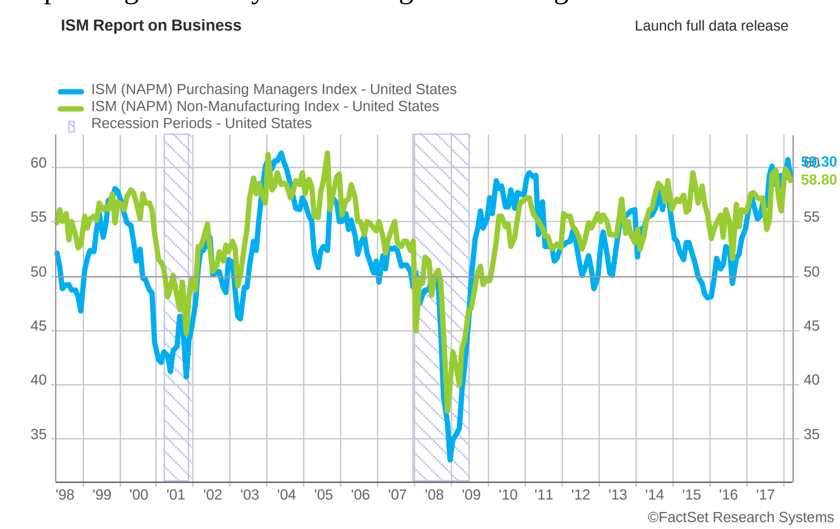
Consumer spending on goods and services is up 4.6% from last year. This is higher than income growth. To finance the buying, consumers are adding to their debt. Consumer credit outstanding is up 5.3% y/y. Revolving debt is growing slightly faster than non-revolving debt. The personal savings rate fell to 3.4% of disposable income. The savings rate was 4.1% this time last year.

Despite the lower savings rate, household balance sheets are still in reasonable shape. Household net worth is up 7.82% y/y. This is significantly faster than the growth in consumer spending or the growth in consumer debt. It may also account for consumers' willingness to reduce their savings rate. Their balance sheet can support more debt. The household debt service and financial obligations ratio remains at 15.86%, down significantly from the 18.14% registered at the end of 2007.

We expect consumer income and spending to continue to post nominal growth of about three to five percent for the next couple of years. Spending will likely mirror the growth in wages.

Business Activities Report

The Institute for Supply Management's (ISM) non-manufacturing index fell slightly last month to 58.8 from 59.5 the previous month. This reading marks the 98th consecutive month of economic growth in the service sector. Comments from the survey panel indicate business conditions are expanding at a slightly slower pace.



New orders, business activities / production, and export orders all continue to grow. Employment trends grew at a slightly slower pace while supplier deliveries slowed. Prices for purchased materials and services rose for the 25th consecutive month but at a slightly faster pace.

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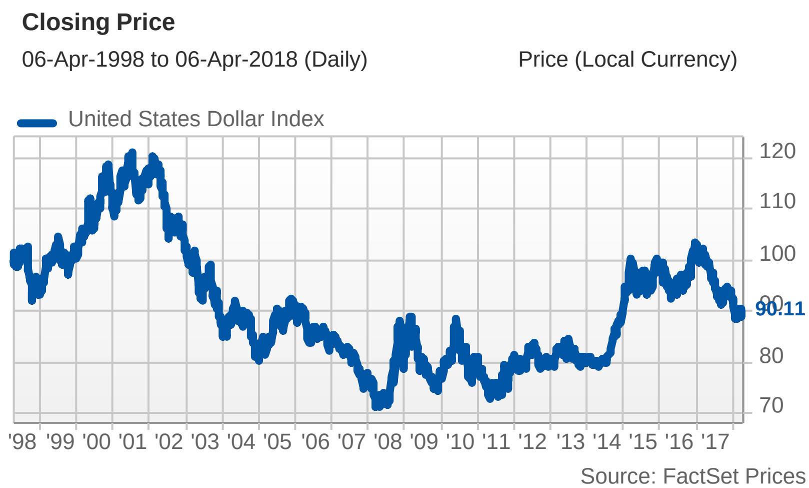
Fifteen industries indicated growth with two industries indicating contraction.

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 ISM Manufacturing Index fell to 59.3 from 60.8 the previous month, indicating growth in the manufacturing sector for the 19th consecutive month. Comments from the survey panel indicate "continued expanding business strength. Demand remains robust." "Labor and skills shortages are affecting production output." New orders continue to grow at a slightly slower pace. Order backlogs continued to expand with the highest reading since May 2004. Export and import orders continue to grow. Supplier deliveries continue to slow. Customer inventories are still too low. Manufactures reported widespread raw material price increases and that prices are increasing at a faster rate. Of the 18 manufacturing industries surveyed, 17 reported growth. Only one industry reported contraction during the period.

Both the manufacturing and non-manufacturing index came in a bit under expectations. They continue to indicate the economy is growing at a healthy pace. Both manufacturing and services also report rising prices for inputs.



Trade Weighted Dollar

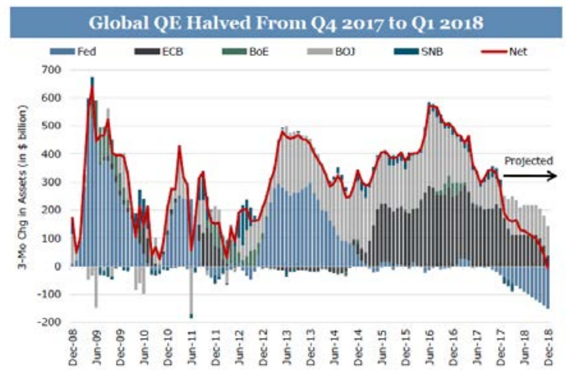
The U.S. dollar Index has fallen 2.1% in 2018 and is down 10.46% over the last year. The dollar is likely to be a tail wind for corporate earnings, and a slight boost to inflation and interest rates.

International Interest Rates

U.S. interest rates remain significantly above interest rates in other developed countries.

	1 Year	5 Year	10 Year
United States	2.07%	2.62%	2.80%
United Kingdom	0.79%	1.17%	1.41%
Europe	-0.67%	-0.08%	0.51%
Japan	-0.15%	-0.12%	0.04%

Interest rates in Europe and Japan have been depressed by their own central banks engaging in Quantitative Easing (QE). Under QE, central banks purchase long term government, mortgage, and sometimes corporate debt. It can also include the purchase of common stock. The goal of QE is to drive down long term interest rates. We believe global QE is in part responsible for the shallow yield curve. Until they ease the financial repression, low international interest rates will pressure U.S. long term rates and keep the yield curve shallower than it otherwise would be. As shown on the chart to the right, net global QE will reach zero by the end of this year. QE is likely to turn negative next year. QE turns negative when central banks let more bonds mature than they purchase. This adds to supply of long term bonds in the market and should drive long term interest rate higher on a global scale. International interest rates are then likely to join U.S. rates in the glacial pace of normalization.



We welcome your comments and suggestions. Please feel free to contact me at dhoward@snbomaha.com. Also, please see the obligatory disclosures at the end of this report.

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