FOURTH QUARTER 2019 MARKET OUTLOOK

Our Outlook

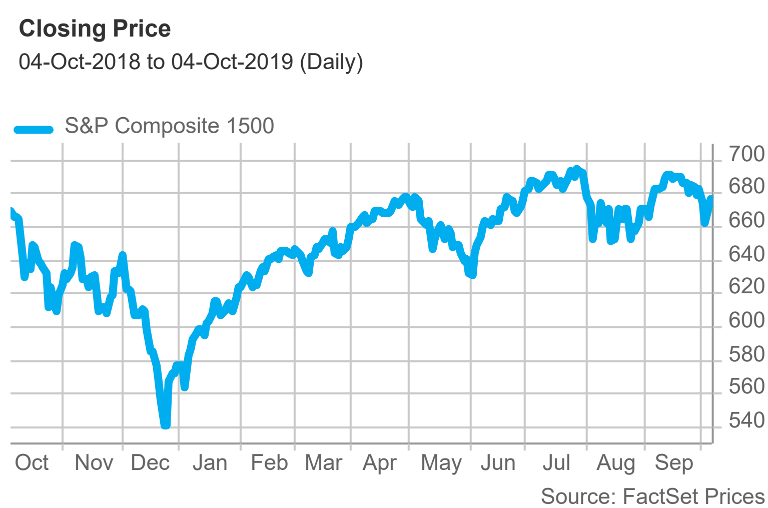
	2017	2018	2019 Est	2020 Est
GDP Growth (1)	2.8%	2.5%	2.1%	1.6%
Change in Consumer Prices(2)	2.1%	1.9%	2.0%	2.0%
Fed Funds Target Rate (3)	1.50%	2.50%	1.75%	1.75%
5-Year Treasury Yield (3)	2.20%	2.51%	1.80%	1.83%%
10-Year Treasury Yield (3)	2.41%	2.69%	1.85%	1.90%%
S&P 500 EPS	$133	$161	$165	$172

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

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. 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 a poor track record.

Markets in Review

The U.S. stock market, as measured by the S&P 1500 SuperComposite, rose 1.98% in September and 1.53% in the third quarter bringing its year to date total return to 20.18%. Including last year's sell-off, the stock market is up 3.39% over the last twelve months.



Real estate was the best performing sector during the third quarter. It posted a 7.71% total return as investors reacted to lower interest rates and economic slowdown concerns. Real estate is seen as a safe haven sector that benefits from lower interest rates. Year-to-date, the sector is up 29.71%. We remain equal to over-weight our real estate weighting.

The worst performing sector during the second quarter was energy. The slowing global economy has reduced global demand. The U.S. Energy Information Administration (EIA) has lowered forecasted global demand each month. Oil prices failed to sustain a rally despite an unprecedented attack on Saudi oil facilities. Year-to-date the sector is up only 6.00%. We remain underweight energy.

Growth stocks significantly underperformed value stocks during the quarter, 0.72% versus 2.83%. Year-to-date, value stocks have closed the performance gap, returning 20.01% versus 21.06% for growth stocks.

Prepared by Damian Howard October 7, 2019

For the quarter, U.S. stocks outperformed non-U.S. developed markets and emerging markets. Year-to-date, domestic stocks outperformed non-U.S. developed stocks by 7.38% and emerging markets by 14.29%. While muted, U.S. companies still lead their foreign brethren in earnings growth, liquidity, and innovation. We continue to favor domestic stocks overdeveloped and emerging market stocks.

Security National Bank's Outlook at a Glance

The global economy is probably in or near recessionary levels. Economists generally consider a global economic growth of 2.5% to be a recession. Global economic growth will likely trough at that level in the current quarter. In 2020, growth should improve slightly as global monetary and fiscal easing kicks in and trade issues start to anniversary.

The US manufacturing sector is contracting. Manufacturing is the sector most exposed to slower global economic growth, trade frictions, and a pause in capital spending. The PMI index is in contraction territory and at its lowest level since 2009. This sector is likely to be a drag on growth for a couple of quarters.

US economic growth is slowing. Economic growth is likely to average 1.5% to 2.0% over the next twelve months before increasing in the latter half of 2020. Job growth will slow to about 100 thousand per month. The housing sector is improving, thanks to lower rates. The consumer remains strong with solid income growth and a stable balance sheet. This should provide enough support for the US to avoid a recession. We believe the odds of a recession in the next year are less than 50%.

The Federal Reserve will deliver one more interest rate cut in October. The current Fed funds policy rate is 2.0%. An additional cut will bring the rate down to 1.75%. The policy rate is likely to remain under 2.0% through the election season. Interest rates will remain low. We do not foresee negative rates in the US.

The Trump Administration will likely raise existing tariffs as planned in October and December. However, further escalation is unlikely. The marginal benefit to further escalation is minuscule. It is also unlikely that any meaningful agreement will be struck prior to the election. Political tensions make the passage of USMCA a toss-up. US importers will continue to alter supply chains to deal with this new reality, a bi-polar global economy.

Next year's earnings estimates are too high. The consensus S&P500 estimate for 2020 is currently $181, an increase of 10.4% over 2019. We believe estimates will come down another 5% as companies provide 2020 guidance over the next four months. The stock market is likely to experience higher volatility until earnings expectations are reset. We currently peg 2020 earnings at $172.50 for the S&P500. Street estimates assume profits margins will improve next year. With increasing wage pressures and a slow global economy, this seems a bit aggressive. Profit margins will likely be flat at best. Lower interest rates, lower commodity costs, and a strong dollar should help offset wage pressures.

The stock market is trading at 17.2 times our next twelve months' earnings (16.1 times consensus). This is one point above the long term average of 16.1. The low rate environment and a possible bottoming of global growth support the slightly high premium. We should not expect P/E expansion from here. Investors should expect returns to mirror earnings growth (5%) plus dividend (2%) for a total return of 7% over the next twelve months. This is in line with the 6.7% total return investors have enjoyed over the last twenty years.

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

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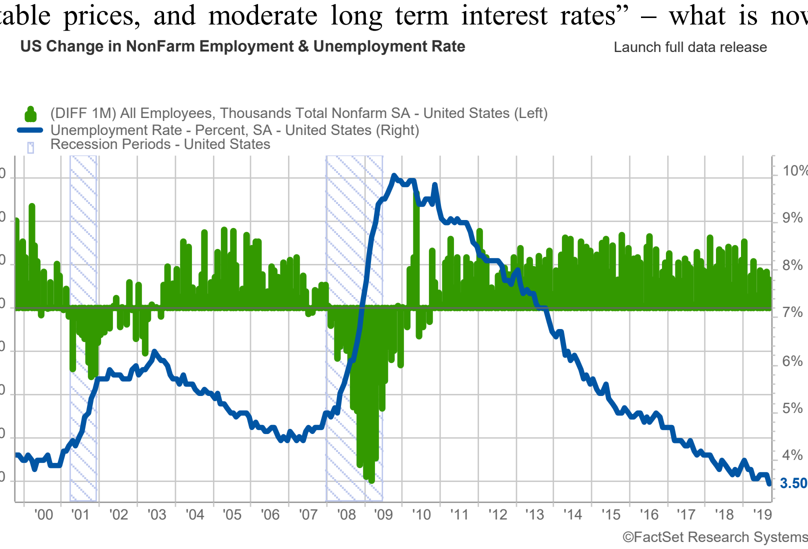
SECURITY NATIONAL BANK
Wealth Management

Recent Economic Reports

September 30, 2019	Value	1 Month Change	YTD Change	1 Year Change
Fed Funds Target (Upper)	2.00%	-25 bp	-50 bp	-50 bp
2-Year Treasury Yield	1.63%	+13 bp	-85 bp	-118 bp
5-Year Treasury Yield	1.55%	+16 bp	-96 bp	-139 bp
10-Year Treasury Yield	1.68%	+18 bp	-109 bp	-137 bp
SNL 30Yr Fixed – U.S. Avg.	4.00%	-2 bp	-82 bp	-72 bp
S&P 500 Index*	2,977	1.87%	20.55%	4.25%
S&P Midcap 400*	1,935	3.06%	17.87%	-2.49%
S&P Small Cap 600*	948	3.06%	17.87%	-9.34%
S&P SuperComposite 1500*	683	1.98%	20.18%	3.39%
S&P 500 Growth*	1,809	0.29%	21.06%	3.25%
S&P 500 Value*	1,177	3.74%	20.01%	5.56%
Developed Ex U.S., net **	5,931	2.87%	12.80%	-1.34%
Emerging Markets, net **	472	1.91%	5.89%	-2.02%
Liquid Alternatives ***	168	0.14%	5.04%	1.13%
BB U.S. Aggregate *	107	-0.53%	8.52%	10.30%
Crude Oil – WTI Near Term	$54	-1.87%	19.07%	-26.18%
Gold – Near Term	$1,466	-3.52%	14.66%	23.01%

** = Total return **= MSCI EAFA and EM **** = Wilshire Liquid Alternative Index*

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

The September Jobs Report was on balance as expected. The headline number missed expectations. However, revisions to previous month's numbers more than made up the shortfall. The unemployment rate fell to a level not seen since December 1969. The average hourly earnings growth rate slipped under 3%. Manufacturing (trade and slow global growth) and retail (Amazon) shed jobs. Overall the report paints a picture of an economy slowing as expected. We continue to look for an additional rate cut on October 30th.

Prepared by Damian Howard | October 7, 2019

FOURTH QUARTER 2019 MARKET OUTLOOK

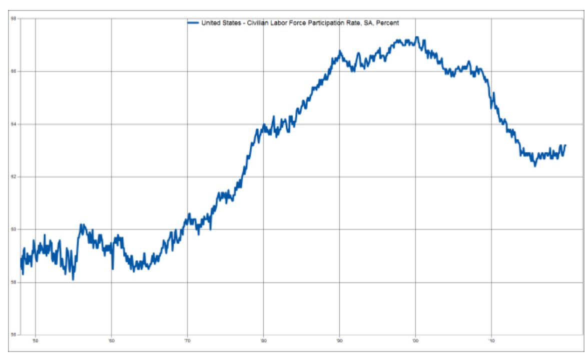
The Labor Department released its latest Employment Situation (Jobs) Report on October 4th. The labor market added 136 thousand jobs in September compared to expectations of 145 thousand new jobs. Wages grew 2.9% y/y. The unemployment rate fell to 3.5%. The broader U-6 rate fell to 6.9% and the participation held at 63.2%.

The U.S. economy added 136 thousand jobs last month. The previous two months total was revised up by 45 thousand jobs for a net 181 thousand jobs added. The household survey showed a gain of 391 thousand jobs. In total, 158.3 million people are working versus 156.1 million last year at this time. The working-age population is 259.6 million. There remain 5.8 million people unemployed versus 7.2 million job openings.

To smooth out some of the revisions, we also look at the trailing three-month averages. The trailing three-month average job growth was 156,700 versus a revised 170,700 last month and 189,300 last year. The labor market is clearly slowing down. Over the next couple of years, job growth will slow to the pace of that of the working-age population: 1.0 million per year (+ or - 0.2 million) or 65,000 to 100,000 monthly jobs added. We are not concerned about slowing job growth. Job growth should slow to about 100 thousand per month. We are currently running about 50% faster than that.

The broader U-6 measure fell to 6.9% from 7.2% last month. 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).

Both the establishment and the household survey estimated that the economy added about 2.1 to 2.2 million jobs over the last twelve months. The number of employed individuals has increased by 1.4% over last year. At the same time, the working-age population has grown by 1.3 million or 0.5%. Job growth in excess of population growth can only happen if more working-age people join the labor force. This continues to happen. The participation rate (percent of working-age people in the labor market) has increased from 62.7% to 63.2% in the last year. Over the last ten years, the participation rate has averaged 63.3% with a high of 65.2% and a low of 62.4%. There remain 95.6 million working-age adults not in the labor force. As the baby boomers turn the labor market over to Millennials and Gen Z, the participation rate should rise. The last of the baby boomers reach retirement age toward the end of the next decade. Job growth above that of the population can continue if the participation rate increases.



Last month's average hourly earnings (wages) grew at a 2.9% y/y rate down from 3.2% last month and 3.0% last year. The average work-week held steady at 34.4 hours but is down 0.1 hours from last year. Average weekly earnings are up 2.6% from last year to $966.30 ($50,248 annualized) versus $941.80 ($48,976 annualized) last year. Wage growth remains remarkably under control.

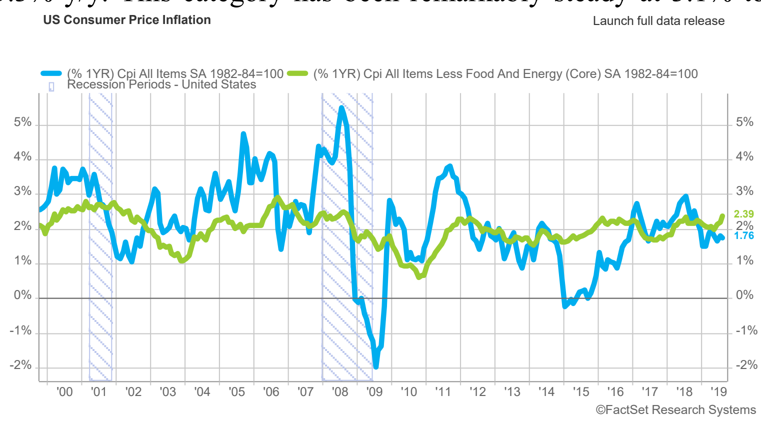
The labor market is in good shape. Wage growth is controlled in the 3.0% to 3.5% channel. Job growth will slowly slow to around 100 thousand jobs per month. We have always expected a slowing labor market. Math dictates that this will happen. Slowing jobs growth should not be a reason the FRB cuts rates. The labor markets should not be one of the FRB's current concerns.

Prepared by Damian Howard October 7, 2019

Inflation

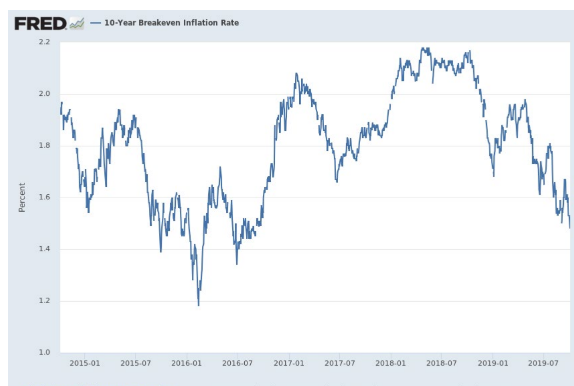
The consumer price index rose modestly in August. The price index rose 0.1% and is up 1.8% y/y. Inflation is running at or slightly below the FRB's 2.0% target on a headline basis but exceeding it on a core basis. On a year-over-year basis, food and beverage inflation is running 1.7%, Housing inflation is 2.8%, and medical care inflation is 3.5%. Core inflation is 2.4%. All items less energy inflation is 2.3%.

Owners' Equivalent Rent (OER) is up 3.3% y/y. This category has been remarkably steady at 3.1% to 3.5% for the last couple of years. Based on housing data, OER is likely to be the chief source of inflation for the foreseeable future. Changes in the supply and demand for housing occur at a glacial pace. Small changes in interest rates are not going to slow rent increases dramatically. In those markets hit by a housing shortage, changes in land use and zoning will make a bigger impact.



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 and the relative weighting of housing, the PCE tends to run 0.25% to 0.50% below the CPI. In August, the PCE was flat and is up 1.4% y/y. The core PCE was up 1.8% y/y. The PCE excluding energy was up 1.7% y/y.

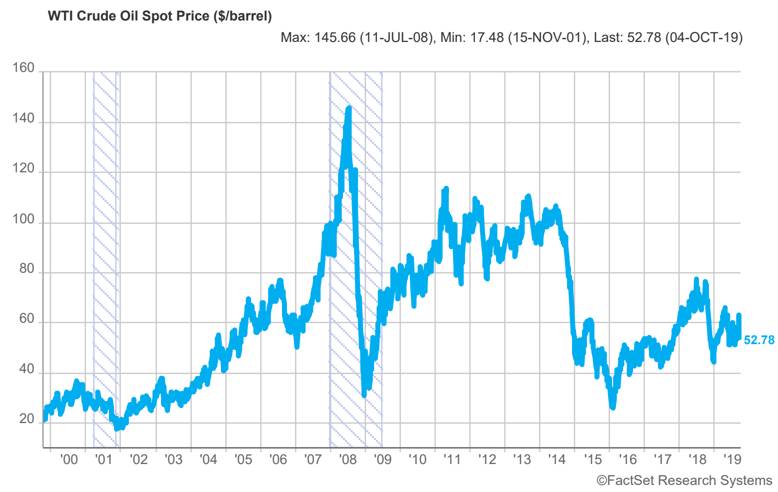
As with most things, consumers and investors base their decision on what they expect inflation to be in the future. We can measure inflation expectations from the difference between a 10-year Treasury security and the ten year Treasury Inflation Protection security (TIPS). The difference implies what market participants expect inflation to average over the next ten years. As evident in the chart at the right, inflation expectations have been falling since mid-October 2018. Currently, market participants expect inflation to average 1.48% over the next ten years.



Inflation is currently at or slightly under the FRB's inflation target. An inflation overshoot or deflationary spiral is not evident. The additional tariffs will increase inflation by 0.2% over the next year. It is doubtful the recent 0.50% interest rate cut or an additional 0.25% will have any measurable impact on inflation. The primary driver of inflation is housing cost. Lower interest rates may marginally apartments, but the constraining factors of labor availability and land use laws will not be lessened by slightly lower rates. We look for inflation to hover around 1.5% to 2.0% for a while.

Oil

Global economic growth is slowing. This is translating into slower oil demand growth. The U.S. Energy Information Administration (EIA) reduced its forecast for GROWTH in global oil consumption to 0.9 million barrels per day (mbpd). This marks the eighth consecutive month of lower global consumption growth forecast. While demand growth has fallen, we are not at a level that would signal a recession. During a recession, demand growth turns negative by a couple of hundred thousand barrels per day. Slow demand growth confirms our forecast of slow domestic and global growth.

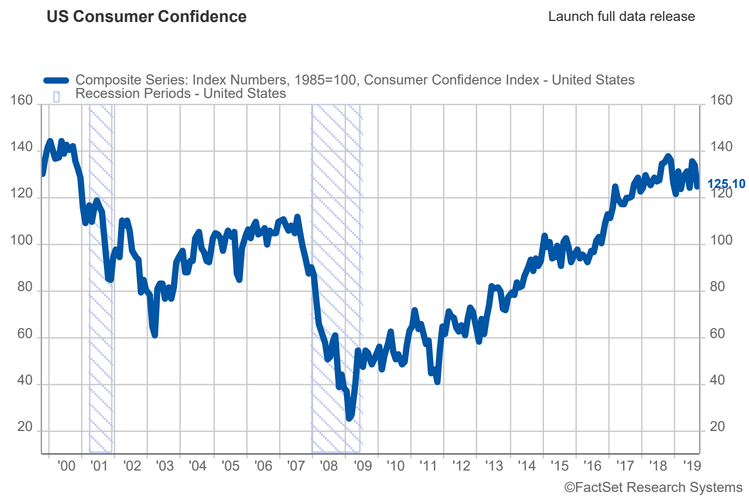


The EIA forecast U.S. crude production will average 12.2 mbpd in 2019, up by 1.2 mbpd from last year. U.S. increased production more than satisfied global demand growth of 0.9 mbpd. The EIA forecast U.S. production to increase a further 1.0 mbpd in 2020. This is also likely to meet or exceed global demand growth. Despite on-going OPEC supply curtailments and attacks on Saudi oil facilities, the global market remains well supplied. Global inventories are likely to build.

Research has shown that the most accurate forecast for oil prices is no change in prices. This forecast significantly outperforms the collective effort of professional oil forecasters. The average target price as tracked by FactSet is for WTI to end the year at $57.31 and end 2020 at $56.01. This is a bit higher than the current price of $53. We'll stick to a no-change forecast of $53.00 for year-end 2019 and 2020.

The Consumer

Consumer confidence has been shaken a bit by trade tensions and political wrangling. In general, consumers continue to feel pretty good about their current situation. They are growing a bit apprehensive when looking at the future.



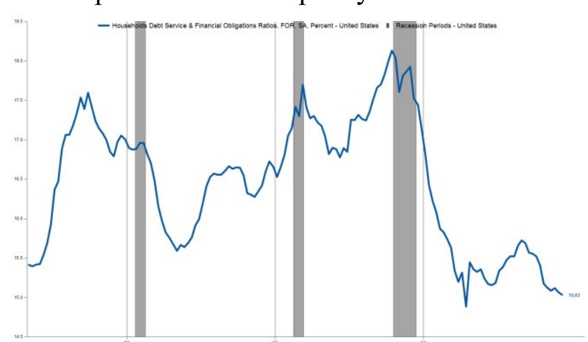
Consumer confidence as reported by the Conference Board fell in September. The headline index fell to 125.1 from 134.2 the previous month. While down, the recent readings remain some of the highest reading this century. The average reading over the last twenty years has been 93.

The present situation component, based on consumers' assessment of current business and labor market conditions, rose to fell to 169.0 from 176.0 the previous month. It remains significantly above its twenty-year average of 101.

The expectations component, based on consumers' short-term outlook for income, business and labor market conditions, fell to 95.8 from 106.4 the previous month. The reading is well above its twenty-year average of 87. The expectations component is most sensitive to market sell-offs, trade tweets, dower economic forecast, and political theater.

The sub-components of the present situations component fell modestly. The net appraisal of current employment opportunities being plentiful (plentiful less hard to get) fell to 33.2 from 38.3 the previous month. While down a bit, it is at July's level. Consumers' net perception of current business conditions (good less bad) fell to 24.6 from 31.0 the previous month.

Personal income rose 0.4% in August and is estimated to be up 4.6% over the past year. Private sector wages and salaries are up 5.8% from last year. Disposable personal income is up 4.5% y/y. Disposable personal income per capita is up 3.9% y/y. Real disposable income per capita is up 2.4% y/y. Personal income would have been higher (by 0.4%) in August if not for a 0.2% drop in interest income. Interest income is approximately 9.2% of total personal income. Look for this source to continue to come under pressure as interest rates fall. Real disposable personal income growth of 2.4% is stellar. It is doubtful that the economy will fall into a recession with such strong income growth.

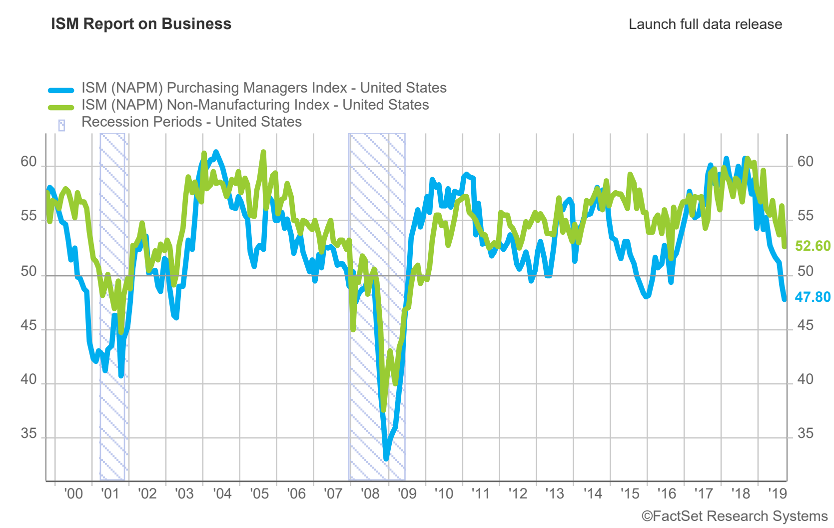


Consumer spending on goods and services is up 3.7% from last year. Consumers saved 8.1% of disposable income. Consumer credit is up 5.4% y/y. Consumer credit is growing slightly faster than nominal GDP (3.7%) and disposable income (4.5%). Despite the slight re-levering, the consumer's balance sheet remains strong. As seen in the chart above, the Financial Obligations ratio is at a generational low.

We look for consumption to mirror the growth of disposable income, about 3% to 4%. It does not appear that consumers have an appetite to significantly lever-up their balance sheets. Excesses are not building in the consumer sector. It is highly unlikely that the consumer will be the source of the next downturn. Look for consumer-related stocks to outperform stocks of companies that rely on corporate spending for growth.

Business Activities Report

The Institute for Supply Management's (ISM) non-manufacturing index fell 3.8 points to 52.6 from 56.4 the previous month. The reading was significantly worse than expectations of 55.1. The reading marks the 116th consecutive month of economic growth in the service sector. The Index indicates that the rate of growth for the service sector decelerated in September. The Institute for Supply Management stated "The non-manufacturing sector pulled back after reflecting strong growth in August. The respondents are mostly concerned about tariffs, labor resources and the direction of the economy."



Business activities/production, new orders employment, and inventories are growing at a slower rate. The Inventory Sentiment Index increased 2 points to 58.0. This indicates inventories are still too high and getting worse. Prices for purchased materials and services rose 1.8 points to 60.0 indicating input prices are rising at a faster pace. Thirteen of eighteen industries indicated growth in September. Four industries contracted.

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. A manufacturing PMI above 42.9 generally indicates an expansion of the overall economy.

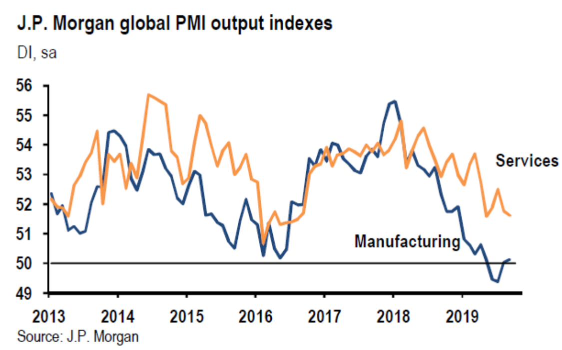
The Manufacturing Index fell 1.3 points to 47.8 and its lowest level since 2009. The index has now fallen deep into the contraction territory. The September PMI marks the second month of contraction in the manufacturing sector after 35 straight months of expansion. Slower global growth and trade tension have impacted this part of the economy. Manufacturing accounts for 11.5% of economic activity and 8.5% of employment. Manufacturing is weak, especially export-orientated manufacturing.

New Orders, production, employment, inventories, backlog of orders, new export orders and imports are all contracting. The prices component rose 3.7 points to 49.7, indicating raw materials prices continue to fall but at a slower rate. Only 3 of the 18 manufacturing industries reported growth. 15 industries reported contraction.

Comments from the survey panel reflect "Global trade remains the most significant issue, as demonstrated by the contraction in new export orders that began in July 2019. Overall, sentiment this month remains cautious regarding near-term growth." According to Institute for Supply Management (ISM) "The past relationship between the PMI and the overall economy indicates that the PMI for September (47.8 percent) corresponds to a 1.5-percent increase in real gross domestic product (GDP) on an annualized basis."

The NFIB Small Business Optimism Index bounced fell slightly in August to 103.1 from 104.7 the previous month. "Overall, August was a good month for small business. However, optimism slipped because fewer owners said they expect better business conditions and real sales volumes in the coming months. Job creation accelerated, positive earnings trends improved, and quarter-on-quarter sales gains remained strong." noted the NFIB. The NFIB also had a note of caution "(t)he pessimism we're seeing is contagious, even though the actual economy is thriving. Expectations can be infected and, as a result, could turn sour. All the talk about an impending recession can create a false reality, but it doesn't make it right. Main Street is continuing to produce and remains strong in spite of the headlines." The NFIB is worried that we might just talk our way into a recession.

Global all-industry PMI numbers may be turning. The JPMorgan global all-industry PMI inched down 0.2 pts to 51.2 in September. The September service PMI moved down 0.2 points to 51.6. The manufacturing PMI held steady close to 50. The manufacturing PMI is consistent with global industrial production growth of 0.4%. The all-industry PMI is constant with a 2.4% global growth rate.



SECURITY NATIONAL BANK Wealth Management

The Yield Curve and International Interest Rates

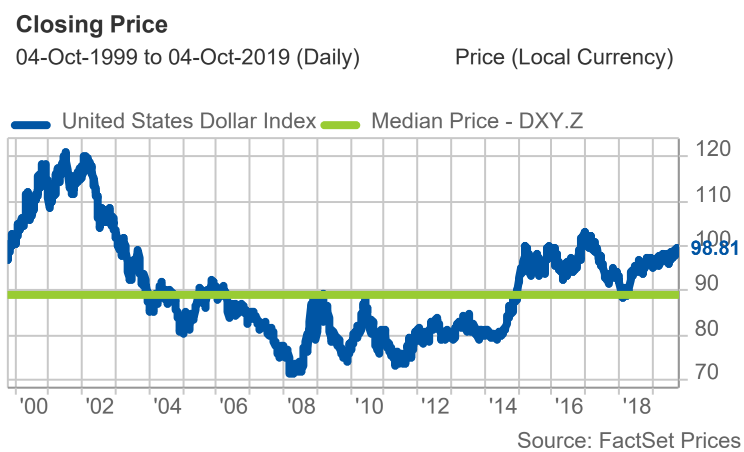
Fed Funds futures are pricing in a 94% chance that the FRB will lower rates by 0.25% on October 30th. The futures market implies a 58% chance the FRB will have cut one additional time by year-end for a total of 1.00% of rate cuts in 2019 bringing the Fed Funds rate to 1.50%. We are still in the three cut camp. We contend global growth will show enough signs of stabilization that a four cut will be deemed unnecessary.

The traditional measure for recession watching has been the 10-year minus the 2-year yield curve. After a brief flirtation with an inverted curve, the curve is slightly positive (13 basis points).

Some $15 trillion of global debt has a negative yield. We contend negative rates are unnatural. No rational economic participant would lend at a negative rate unless forced to by regulation or believed rates would go further negative (greater fool theory). We do not know when rates will normalize, but when they do, there will be substantial losses in accounts that thought they were in safe investments. In the interim, the bubble is likely to expand.

	GDP Growth	Inflation	Unemploy-ment	Interest Rate on Government Debt		
				1 Year	5 Year	10 Year
United States	2.3%	1.8%	3.5%	1.61%	1.34%	1.52%
United Kingdom	1.3%	1.7%	3.8%	0.45%	0.24%	0.43%
Germany	0.4%	1.2%	3.1%	-0.70%	-0.80%	-0.59%
Japan	0.8%	0.3%	2.2%	-0.32%	-0.37%	-0.22%
China	6.2%	2.8%	3.6%	2.63%	2.88%	3.16%

Trade Weighted Dollar



The dollar is caught between lower US interest rates and a weakening global economy. The index up 2.8% year to date and is up 3.3% over the last twelve months and up 14.1% over the last five years. The downward pressure on the dollar from lower US rates is being offset by the prospect of weaker global growth. The strong dollar will hurt US exports and lower earnings for large global companies. Every year, market prognosticators predict the dollar will fall next year. They use this justification for increased weighting in emerging markets and non-U.S. developed market stocks. We continue to believe the U.S. will lead the world in growth and innovation. We look for the dollar to remain strong and we continue to significantly overweight U.S. stocks.

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

Prepared by Damian Howard

October 7, 2019

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