SECOND QUARTER 2020 MARKET OUTLOOK

Our Outlook

	2017	2018	2019	2020 Est	2021 Est
GDP Growth (1)	2.8%	2.5%	2.3%	-3.7%	4.7%
Change in Consumer Prices(2)	2.1%	1.9%	2.3%	0.90%	1.7%
Fed Funds Target Rate (3)	1.50%	2.50%	1.75%	0.25%	0.25%
5-Year Treasury Yield (3)	2.20%	2.51%	1.69%	0.50%	0.76%
10-Year Treasury Yield (3)	2.41%	2.69%	1.92%	0.85%	1.35%
S&P 500 EPS	$131	$160	$162	$125	$166

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

On March 27th, President Trump signed the Coronavirus Aid, Relief and Economic Security Act (CARES Act). At $2.2 trillion, it is the largest ever fiscal stimulus package. It provides direct support to individuals, small businesses, state and local governments, and select industries. The ink on the President's signature was barely dry before talk of a $2 trillion phase 4 infrastructure package started. Washington is clearly willing to spend an unlimited amount of money to rescue the economy from restrictions placed on it by Washington. The Federal Reserve Board (FRB) has reduced interest rates to zero and has embarked on unlimited bond-buying and is backstopping numerous sectors including commercial paper, money markets, commercial mortgages and municipal securities. It has also provided liquidity swap lines with other central banks, becoming the world's lender of last resorts.

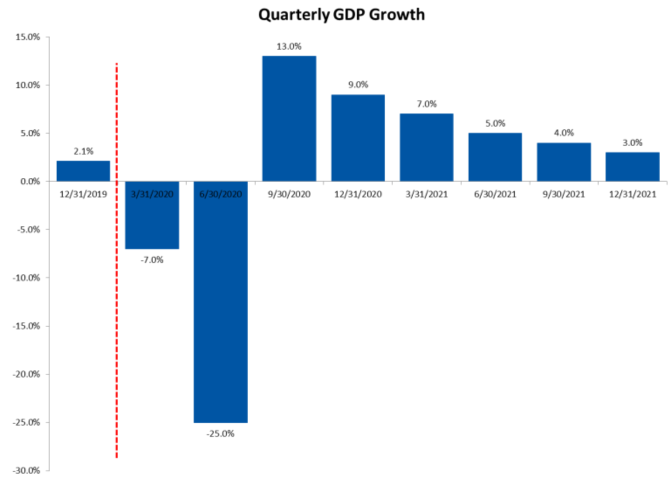
Prior to the crisis, the federal budget deficit for this fiscal year was projected to run about $1.1 trillion. The federal deficit is now likely to run $2.4 trillion in fiscal year 2020 and $1.7 trillion in fiscal year 2021. The fiscal year 2020 deficit will be the largest deficit as a share of the economy (11.2%) since World War II. This also vastly exceeds the deficit following the Great Financial Crisis (GFC) in 2009 at a more modest 9.8% of the GDP. The FRB is likely to absorb the vast majority of the newly issued debt. On April 2nd, The FRB reported its balance sheet has reached $5.8 trillion, up 54% from the $3.8 trillion reported on September 4th.

The government is caught in a tough situation. The longer and stricter the social distancing and quarantining are, the better the medical community is able to fight and ultimately defeat the pandemic. However, the longer and stricter the social distancing and quarantining protocols remain in place, the more permeant damage is done to the economy. The government can make up some of the lost income. But, once a company goes bankrupt, it cannot be unbankrupted. Vast amounts of financial and entrepreneurial capital will be destroyed. Most of it will be replaced but not all, and not right away. The Trump administration must find the right balance between risking a second wave of the pandemic against risking economic ruin.

Security National Bank's Outlook at a Glance

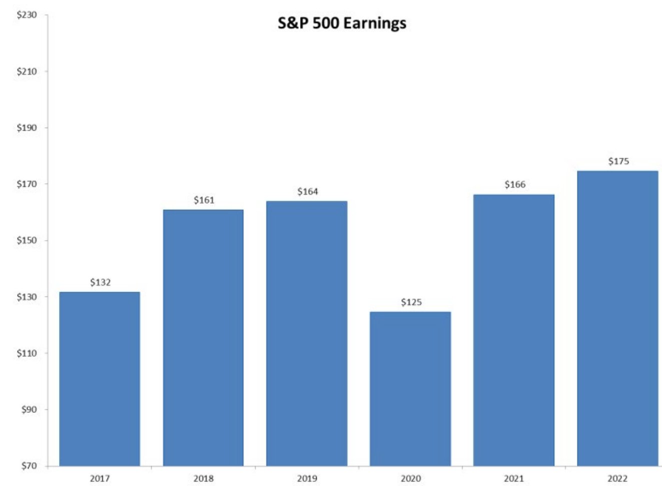
The US economy will likely have shrunk at a 7% annual pace in the first quarter. It will likely shrink at a 25% annual rate in the second quarter before growing at a 13% and 9% pace in the third and fourth quarters. For the full year, the economy is likely to shrink at a 4% rate. As a frame of reference, the economy shrank 2.5% in 2009.

The global economy will likely shrink by 2% this year. This will make 2020 weaker than 2009, the year after GFC.



Initial jobless claims rose to 6.6 million on April 2nd doubling the prior week's 3.3 million print. Both numbers far outpaced the previous record for new claims. Unemployment is expected to spike above 15% by the end of the second quarter. It will remain elevated for the next two years.

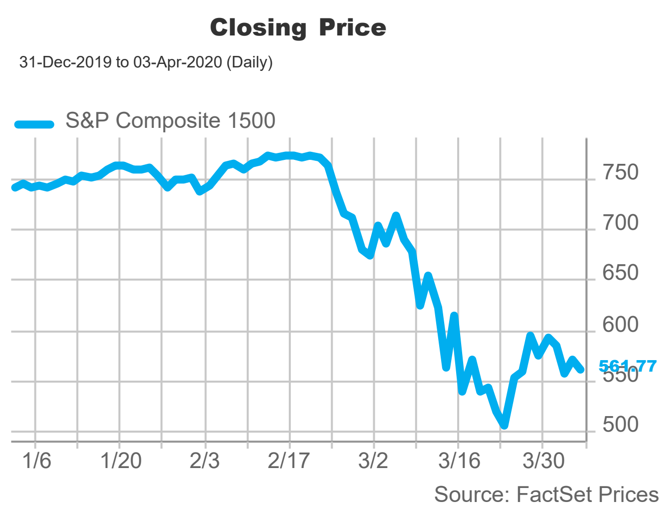
Interest rates are likely to stay low for the foreseeable future. It is unlikely the FRB will raise the Fed Funds Rate prior to 2022. The FRB will try everything imaginable to avoid negative interest rates. Its balance sheet will balloon in absolute dollars and as a percent of the economy. It may eventually purchase equity securities.



Bond market downgrades and credit losses have only just begun. Lower rated, but still investment-grade credits are weaker than they should be. That said, overall credit spreads should tighten as the FRB provides liquidity and a backstop for credit markets. They will not revisit recent lows for several years.

Earnings on the S&P 500 Index is likely to fall by 24% this year and rebound by 33% next year.

From its high on February 19th to its recent low on March 23rd, the S&P 500 lost 33.8% of its value. From March 23rd to April 1st, the index rose 10.5%. The index will need to rise an additional 37% to reach its all-time high. It may reach that level mid-2021.



Themes
Here are some themes we consider when investing:

- The economic outlook is changing rapidly. Most of the revisions are trending toward a deeper drop in economic activity followed by a steep rebound. Expecting every area of the economy to return to normal after the pandemic passes is unrealistic. The best bet is to monitor the economic and medical data and adjust our outlook and investments as events unfold.

- After the shocks of trade wars and pandemic, global supply chains will shift from China to North America. This might not be the cheapest sourcing but it will be the safest. Global companies will resort to local sourcing and production.
- The decarbonization of the economy will continue and may accelerate. The auto industry is facing reduced resources available for R&D. It will focus its available resources on electric vehicles. Improvements to the internal combustion engine will not be made. Look for additional stimulus packages coming out of Europe and the House of Representatives to include more Green New Deal elements.
- The national debt will balloon in a nominal amount and as a percent of the economy. Potential growth will likely be lower for a generation. The degrees of freedom for government policy will be narrower.
- Expect companies to cut their dividend. Companies that borrow stimulus money from the federal government may not repurchase stock, pay a dividend, or make any other capital distributions until 12 months after the loan is repaid in full. The optics of maintaining, much less increasing, a dividend while a company furloughs employees is poor. In addition, there is a substantial minority calling for banks to suspend their dividend, regardless of their current capital strength. Banks provide 8% of the S&P 500's dividend. Already twelve of the S&P500 companies have announced dividend cuts. The dividends on the S&P 500 index may be cut by up to 30%, from a projected $62 to $45 this year. Instead of trading at a 2.5% dividend yield, the market is trading at a 1.8% dividend yield.
- Along with dividend cuts, companies with high levels of debt will be forced to reduce their debt load. Companies will either slow their growth or shareholders will see their economic interest diluted by forced issuance of equity at low prices. This will add to shareholder losses and limit the potential to recoup losses as the economy improves.

Our Executive Vice President, Mr. Doug Oldaker, is fond of saying "So what?" By that, he means 'It's one thing to have a theme or an idea, it is another to do something about it. What are you going to do about it?' If you would like to know how we incorporate these themes into our investment process or your personal portfolio, please give us a call or email us.

Please email us about what you are seeing in the economy and your businesses. We are always eager to receive additional input. Our economic outlook is a mosaic; the picture becomes clearer with more pieces.

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

Recent Economic Reports

March 31, 2020	Value	One Month Change	YTD	1 Year Change
Fed Funds Target (Upper)	0.25%	-150 bp	-150 bp	-225 bp
2-Year Treasury Yield	0.23%	-63 bp	-135 bp	-204 bp
5-Year Treasury Yield	0.37%	-52 bp	-132 bp	- 191 bp
10-Year Treasury Yield	0.70%	- 43 bp	- 122 bp	- 171 bp
SNL 30Yr Fixed – U.S. Avg.	3.67%	+ 5 bp	- 21 bp	- 87 bp
S&P 500 Index*	2,585	-12.35%	-19.60%	-6.98%
S&P Midcap 400*	1,443	-20.25%	-29.70%	-22.51%
S&P Small Cap 600*	685	-22.40%	-32.64%	-25.89%
S&P SuperComposite 1500*	585	-13.08%	-20.57%	-8.51%
S&P 500 Growth*	1,664	-9.96%	-14.50%	-2.47%
S&P 500 Value*	953	-15.25%	-25.34%	-12.20%
Developed Ex U.S., net **	4,951	-13.35%	-22.83%	-14.38%
Emerging Markets, net **	403	-15.40%	-23.60%	-17.69%
Liquid Alternatives ***	170	-2.01%	-2.32%	1.56%
BB U.S. Aggregate *	108	-0.59%	3.15%	8.93%
Crude Oil – WTI Near Term	$20	-54.24%	-66.46%	-65.95%
Gold – Near Term	$1,583	1.23%	4.21%	22.46%

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

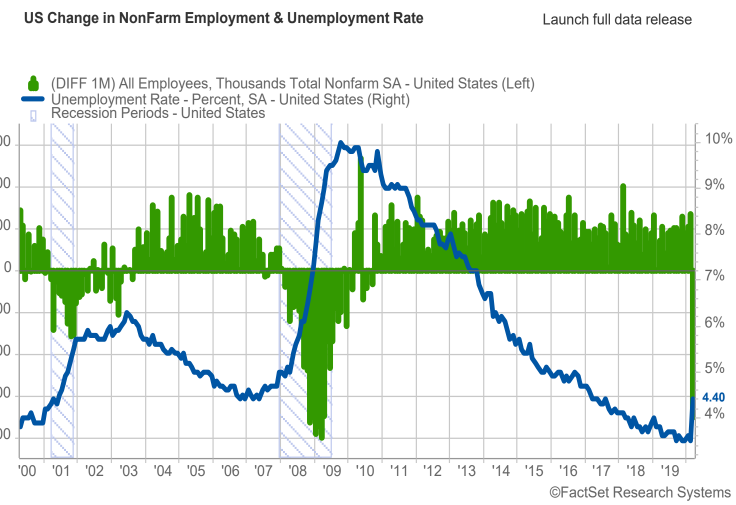
Since 1977, the Federal Reserve has operated under a mandate from Congress to "promote effectively the goals of maximum employment, stable prices, and moderate long term interest rates" – what is now commonly referred to as the Fed's "dual mandate." For this reason, we always start our economic review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

Data, this past month, only hints at how large the impact on our economy will be from the various coronavirus-related hits. Efforts to contain the virus will likely result in fifteen to twenty-five million American's losing their job. It is only a matter of weeks until the full impact shows up in economic statistics. Economic data, by its nature, is backward-looking. The data presented below currently has limited relevance to the current state of our economy and its immediate future.

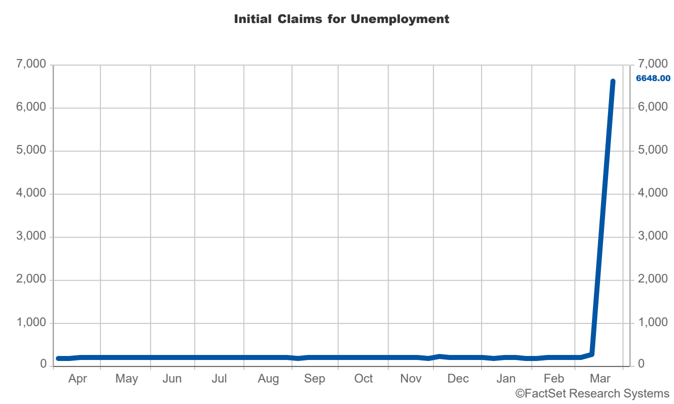
We still believe the U.S. economy will start to recover in the third quarter. The next three weeks will tell if the U.S. has been able to flatten the curve. By next month, we will have a better handle on how this recession will play out. The economic data will also provide more insight.

Employment

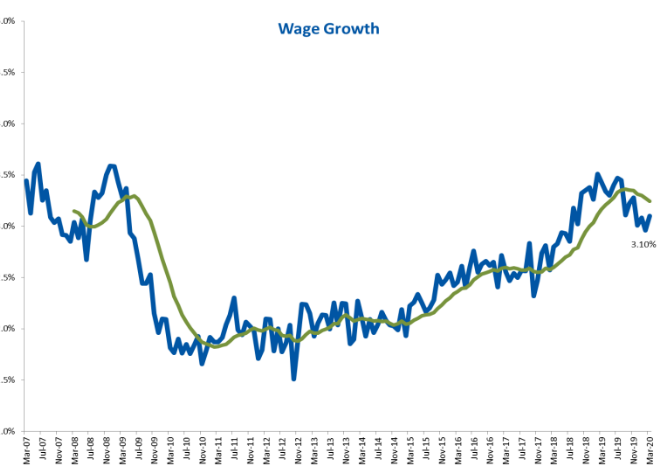
Unemployment is expected to spike above 15% by the end of the second quarter. The April jobs report released on April 3rd is just the beginning of a succession of bad labor market reports. The Labor Department in its Employment Situation (Jobs) Report estimates the U.S. economy shed 701 thousand jobs. It was the first decline since September 2010. The unemployment rate rose to 4.4%. The Bureau of Labor statistics uses the week ending March 12th for a reference point. The massive job losses that occurred in the latter half of March will not show up in statistics until next month's report.



The weekly new claims report has become an important labor market indicator. It provides the most up to date view of the economy's health. Initial jobless claims rose to 6.6 million on April 2nd doubling last week's 3.3 million print. Both numbers far outpaced the previous record for new claims. The May jobs report may show the economy lost a staggering 10 to 15 million jobs. Total non-farm payroll was 152.5 million prior to the downturn. A 15 million downturn in jobs would mean 10% of working Americans lost their job in one month.



The private sector lost 713,000 jobs. Job losses were concentrated in accommodations and food service which lost a staggering 446.3 thousand jobs. An estimated 14.4 million people worked in the sector prior to this downturn. Last month's job losses were only 3.1% of those working in the sector. A significant percentage of those remaining will likely lose their job. Retail lost 46 thousand jobs. Construction lost 29 thousand jobs. Temporary help services lost 49.5 thousand jobs.

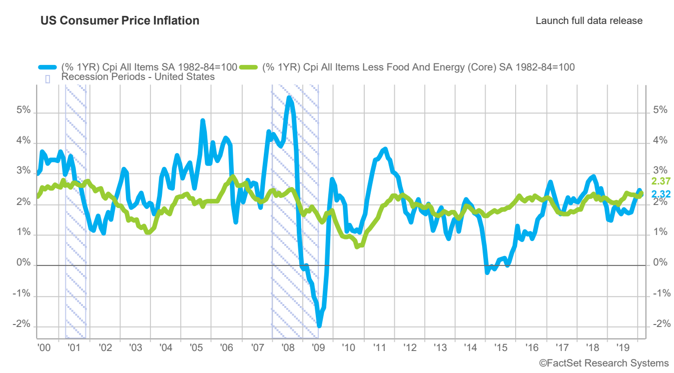


Last month, average hourly earnings (wages) grew at a 3.1% y/y. The average work-week fell to 34.2 hours. Average weekly earnings are up 2.2% from last year to $978.8 ($50,898 annualized). Average wage growth appears a bit stronger than it actually is due to the fact that many of those losing their jobs are in lower-wage industries. As lower-paid workers leave the workforce the average rises.

The labor market is in a free fall. The forced social distancing is wreaking havoc on the leisure industry. The enhanced unemployment benefits and small business loan initiatives will help soften the blow. The longer the virus countermeasures remain in place, the greater the job losses will be. We look for the unemployment rate to exceed 15% by the end of the second quarter. How quickly the job market fully recovers is unknown.

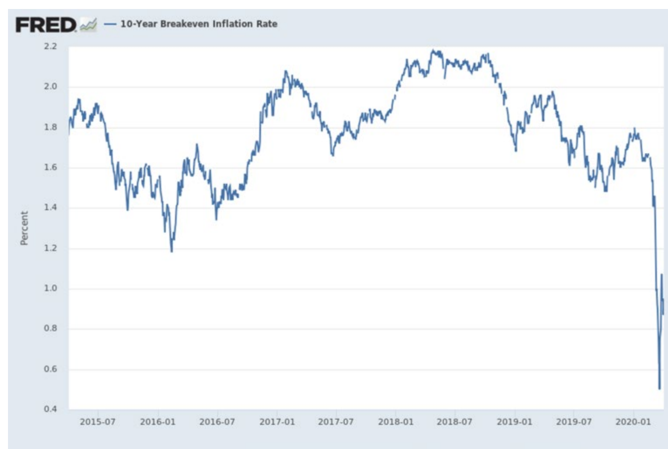
Inflation

The consumer price index was up 0.1% in February. The main drivers of inflation were Owners' Equivalent Rent and Medical. Energy prices fell 2.0% as the crash in energy prices are starting to show up in statistics. The price index is up 2.3% y/y and 2.2% on a trailing six-month basis. While above the FRB's 2.0% target, falling energy prices and possible rent should cause inflation to moderate in the next couple of months. Core inflation is 2.4%.



The FRB prefers the Personal Consumption Expenditure (PCE) as its measure of inflation. The PCE was up 0.1% and was up 1.8% y/y. The core PCE was up 1.8% y/y.

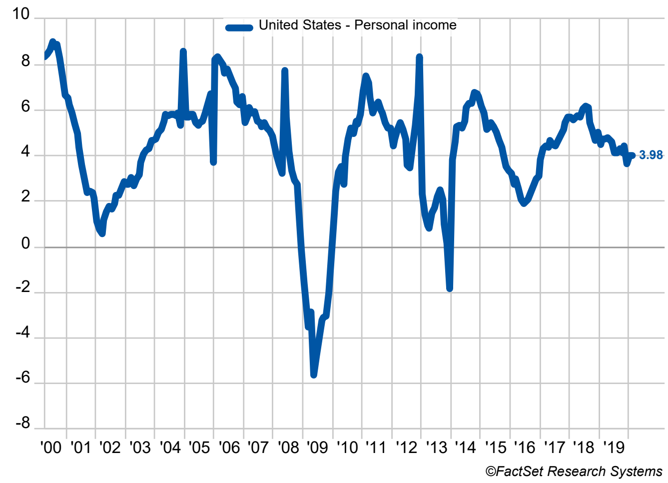
Consumers and investors base their financial decisions on what they expect inflation to be in the future. We can measure inflation expectations from the difference between a 10-year Treasury security and the ten year Treasury Inflation Protection security (TIPS). The difference implies what market participants expect inflation to average over the next ten years. In response to a slowing global economy and plunging energy prices, inflation expectations are rapidly declining. Currently, market participants expect inflation to average 0.87% over the next ten years.



Inflation does not matter during times of pandemic fear and economic collapse.

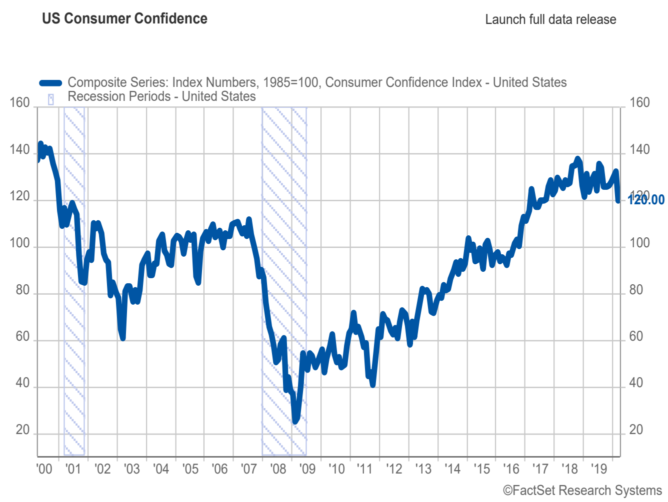
The Consumer Sector

Personal income grew by 0.6% in February and was up 4.0% over the past year. Private sector wages were up 0.5% and are up 3.2% from last year. Disposable personal income is up 4.0% y/y. Disposable personal income per capita is up 3.5% y/y. Real disposable income per capita is up 1.7% y/y. Growth at this level significantly enhances the overall standard of living. Consumers are entering the crisis from a position of strength.



Consumer spending on goods and services is up 4.9% from last year. Consumers saved 8.2% of disposable income. With the rapid rise in unemployment, unemployment insurance and other transfer payments will become the primary source of income growth.

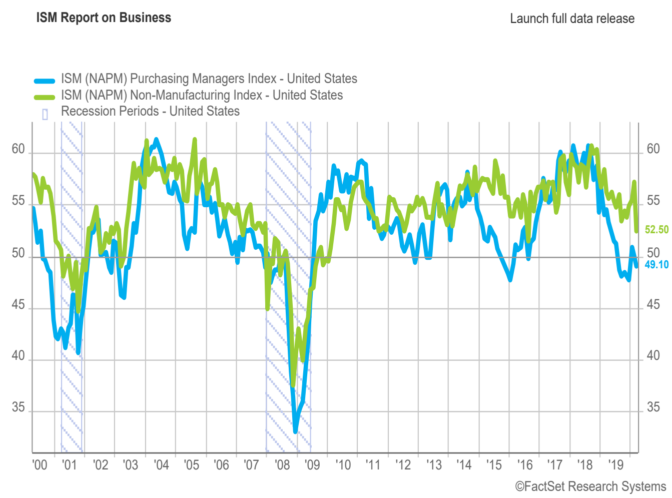
Consumer confidence as reported by the Conference Board fell sharply in March. The headline index fell to 120.0 from a revised 132.6 the previous month. For reference, the average reading over the last twenty years has been 93.



In general, consumers entered into the COVIS-19 crisis on a solid footing. The consumer is justifiably fearful, with sky rocking unemployment and active COVID-19 cases. There are too many unknowns at this time for the consumer to make an informed decision. Consumer confidence and income will take a substantial hit. When unemployment soars past 10%, income, spending and confidence will sharply decline. We look for the consumer sector to weaken substantially.

The Business Sector

The Institute for Supply Management's (ISM) non-manufacturing index fell 4.8 points to 52.5 and was better than expected (44.4). While the reading implied the U.S. economy continued its growth streak, the reading is misleading. Last month's index was impacted by the supplier deliveries component. The sub-index shot up to 62.1 from 52.4 the previous month. In a booming economy, capacity constraints will sometimes make the required supplies hard to get. Slower supplier deliveries are then a sign of a booming economy. In this case, slow deliveries are a sign of a COVID-19 stressed supply chain. Deliveries are delayed due to workforce quarantines and port closures. This makes the ISM reading a bit miss-leading.



The Business Activities/Production component fell 9.8 points and the New Orders component fell 10.2 points to 52.9 indicating orders are still growing. Five industries reported higher orders, but nine reported slower orders. The Employment component fell 8.6 points. The service industry is rapidly contracting. Comments from respondents indicate "The uncertainty has put all new business processes on hold" and "New orders are significantly lower due to COVID-19".

Non-Manufacturing Sector	Direction
Business Activity / Production	Contracting
New Orders	Growing
Employment	Growing
Supplier Deliveries	Slowing
Non-Manufacturing Sector	Growing

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.

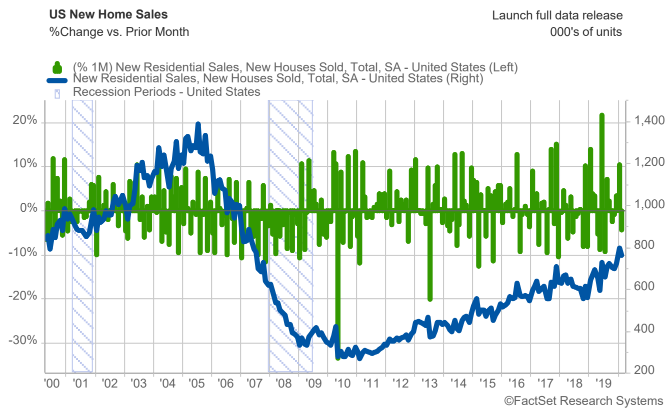
The Manufacturing Index has just started to register the effects of COVID-19. In March, it came in at 49.1 down from 50.1 the previous month. The index is at a level that ordinarily would suggest only a slight contraction. Like the non-manufacturing index, last month's index was impacted by the supplier deliveries component. The supplier deliveries component shot up to 65.0 from 57.3 the previous month.

The new orders component fell to 42.2, indicating the fastest pace of contraction in new orders since 2009. Half of the industries reported growth, the other half contraction. It is not clear how bad things will get with many factories temporarily idling. Global PMIs tell much the same story, the manufacturing sector is under significant stress.

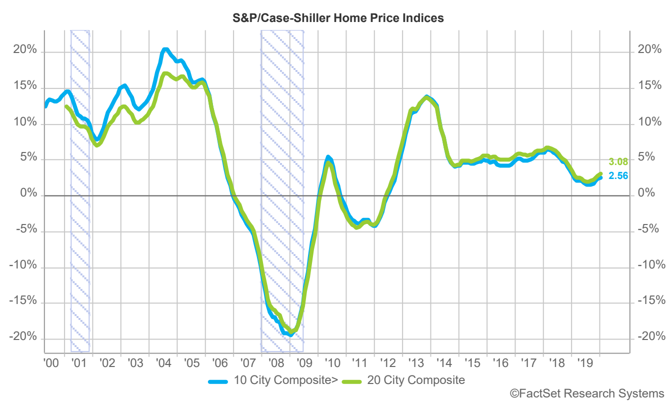
Manufacturing Sector	Direction
Production	Contracting
New Orders	Contracting
Employment	Contracting
Supplier Deliveries	Slowing
Manufacturing Sector	Contracting

The Housing Sector

Despite falling treasury yields, mortgage rates held steady last month. The mortgage industry is at capacity. Lower mortgage rates would only lead to more unwanted volume. The higher rates effectively limit demand to a manageable volume. While the industry has shifted to web-based applications, the shelter in place orders will reduce capacity. Demand will be reduced by the rise in unemployment. Those with a job will not be in a mood to make a major financial commitment like a new car or home. It is likely the housing market will stall until a vaccine is developed and widely available.



February's new single-family home sales came in at a 765 thousand annual rate which was up 14% from last year's pace. New home sales rose the fastest in the West, up 33%. New home sales fell by 2% in the Northeast. Single-family housing starts also improved to 1,072 thousand. The marked the third month in a row that single-family starts have topped 1 million units.

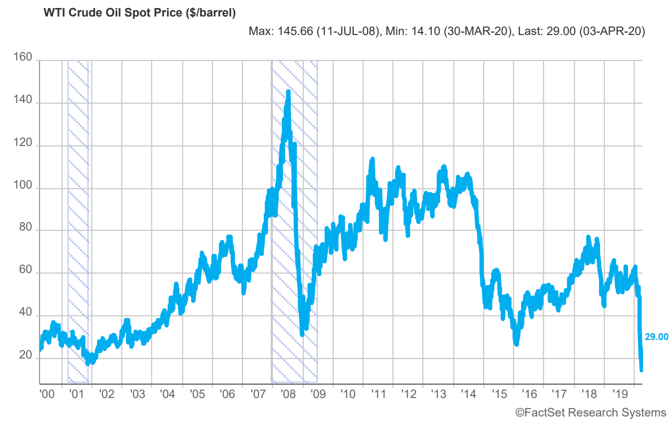


The median selling price for new homes rose 8% to $346 thousand with the trailing three-month average also up 4% y/y. The median price was impacted by a significant increase in the number of more expensive west coast homes. Existing home price appreciation picked up a bit to 3.1%.

The housing market is likely to take a pause from here. Much like the rest of the economy. For the last two quarters, residential housing had contributed 0.2% to the GDP or 10% of total growth. We expect GDP growth to turn negative in 2020. Housing growth is also likely to also turn negative.

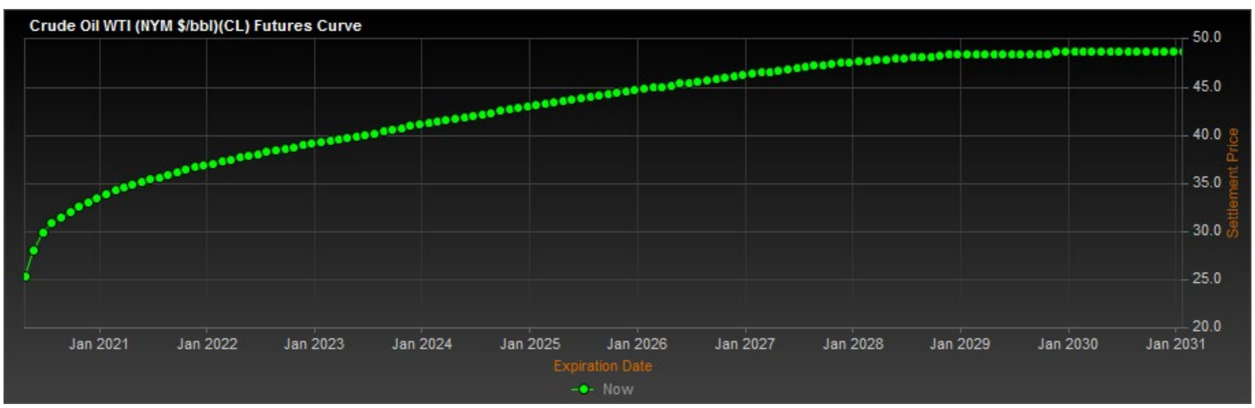
Oil

The oil market is currently in a state of turmoil. China accounts for 15% of global oil demand and 40% to 60% of demand growth. Global oil demand is in a free fall. OPEC and Russia continue to flood the global market. The world is about to run out of storage space. Recently President Trump has attempted to broker a truce between the two. If that attempt fails, the price of oil can fall below $20 per barrel.



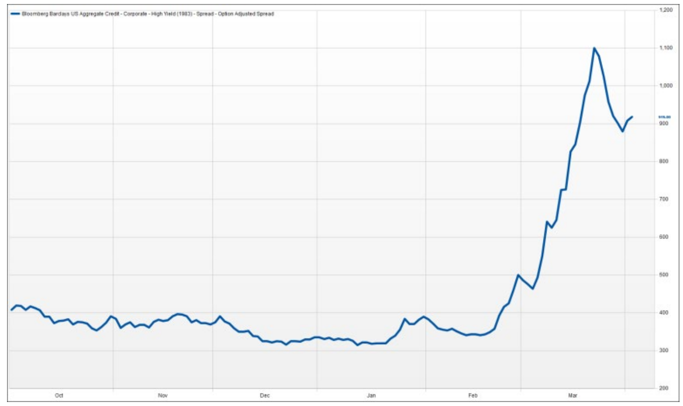
Oil prices are likely to remain depressed until the global economy recovers and Russia and Saudi Arabia agree to substantial production cuts. In addition, U.S. shell oil capacity has to be substantially and permanently destroyed. If production capacity is transferred through bankruptcy from weak hands to less weak hands, global oil markets are likely to be oversupplied for a long time. We do not have an optimistic outlook for oil markets.

The chart below shows the futures curve for WTI on April 3rd. According to the curve, prices won't break $35 per barrel until mid-2021.



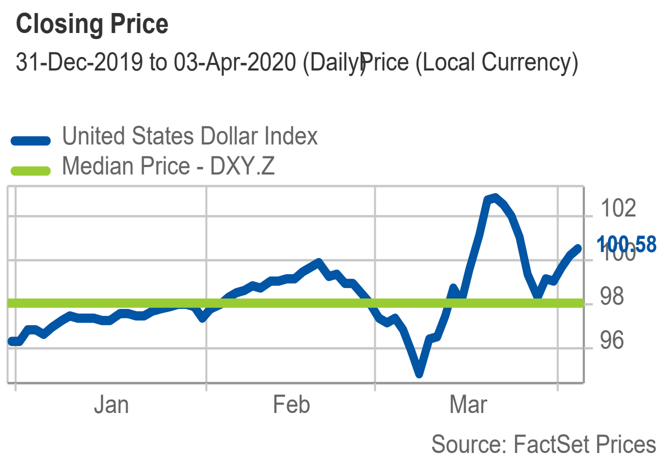
Credit Markets

COVID-19 has significantly impacted US credit markets. Fearing looming credit losses, investors rushed to the safety of cash. High yield ETFs were hit with a wave of redemptions. ETF managers were forced to sell into a collapsing market. Credit spreads widened sharply. From a low of 3.15% on January 13th, high yield spreads widened to 11.00% on March 23rd. The FRB has intervened and stabilized the credit markets. Things have stabilized but are still fragile. There will be significant losses in the oil sector and the hospitality and leisure industries.



Trade Weighted Dollar

Historically global investors buy the U.S. dollar in times of crisis. After initially declining due to falling interest rates and the unwind of the carry trade, the dollar has rallied. The carry trade is when an investor borrows in a slow-growth/low-interest-rate market like Europe and invest the funds in a higher growth/higher interest rate market like the U.S. The investor earns the difference. When rates fall in the U.S., foreign investors must unwind the trade by selling U.S. assets. They then sell the dollar and buy the Euro to repay the debt. Once the carry trade unwound, the dollar rallied as its status as a safe haven asset became the dominant factor. We look for the dollar to stay strong for the next several quarters.



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

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