First Quarter 2021 Market Outlook

SECURITY NATIONAL BANK
WEALTH MANAGEMENT

Our Outlook

	2018	2019	2020 Est	2021 Est	2022 Est
GDP Growth (1)	2.5%	2.3%	-2.7%	5.8%	2.3%
Change in Consumer Prices (2)	1.9%	2.3%	1.1%	1.9%	2.2%
Fed Funds Target Rate (3)	2.50%	1.75%	0.25%	0.25%	0.25%
5-Year Treasury Yield (3)	2.51%	1.69%	0.36%	0.81%	0.96%
10-Year Treasury Yield (3)	2.69%	1.92%	0.92%	1.45%	1.75%
S&P 500 EPS	$160	$162	$138	$173	$193

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

Last Month's Rates and Returns

December 31, 2020	Value	One Month Change	YTD	1 Year Change
Fed Funds Target (Upper)	0.25%	--	-150 bp	-150 bp
2-Year Treasury Yield	0.12%	- 2 bp	-145 bp	-145 bp
5-Year Treasury Yield	0.36%	-- bp	-133 bp	-133 bp
10-Year Treasury Yield	0.92%	+ 8 bp	-100 bp	-100 bp
SNL 30Yr Fixed – U.S. Avg.	3.01%	-2 bp	-88 bp	-88 bp
S&P 500 Index*	3,756	3.84%	18.40%	18.40%
S&P Midcap 400*	2,307	6.52%	13.66%	13.66%
S&P Small Cap 600*	1,119	8.32%	11.29%	11.29%
S&P SuperComposite 1500*	858	4.11%	17.92%	17.92%
S&P 500 Growth*	2,577	4.08%	33.47%	33.47%
S&P 500 Value*	1,267	3.50%	1.36%	1.36%
Developed Ex U.S., net **	6,619	4.65%	7.82%	7.82%
Emerging Markets, net **	624	7.35%	18.31%	18.31%
Liquid Alternatives ***	176	1.66%	3.18%	3.18%
BB U.S. Aggregate *	110	0.14%	7.51%	7.51%
Crude Oil – WTI Near Term	$49	7.01%	-20.54%	-20.54%
Gold – Near Term	$1,893	6.61%	24.59%	24.59%

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

Prepared by Damian Howard

January 8, 2021

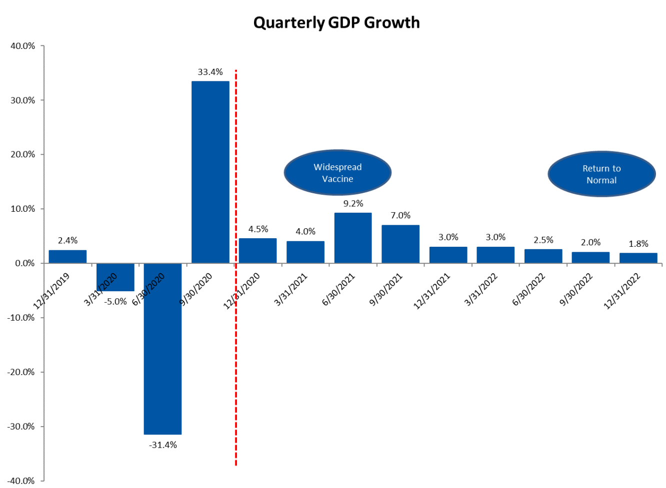
FIRST QUARTER 2021 MARKET OUTLOOK

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 poor track records.

I recently came across this quote by President Eisenhower: "Plans are worthless, but planning is everything." 2020 showed us that while events will make our forecast obsolete, the process we go through each month helps us quickly adjust to a rapidly changing environment. Each month we develop a forecast and an asset allocation framework. We are under no illusion that our forecast covers all possible outcomes. We did not foresee 2020's first quarter 34% decline in stock prices, nor a pandemic, nor the massive fiscal and monetary response. Nonetheless, our forecast helped us make sense of the rapidly changing environment. We were able to navigate the annus horribilis with stellar results. Below are our latest thoughts on the coming year.

On Sunday, December 27, President Trump approved the most recent COVID relief package worth roughly $900 billion or 4% of GDP. The package includes $600 per person payments, a second round of Paycheck Protection Program (PPP) loans to small businesses, tax-deductibility for PPP expenses, an additional $300 per week in unemployment benefits through March, and extended duration of other federal benefits, among other provisions. The most recent relief package should be enough to make it most of the way through the winter virus resurgence. Just as the relief package begins to fade, the vaccination should begin to lessen the strain on the health care system. By summer, the economy should be close to fully reopened.

It now appears that the Democrats have gained control of the legislative branch with the slimmest of majorities. The policy difference between the most liberal and conservative Senate Democrat is large. This makes the prospect of a sweeping progressive agenda remote. What is likely to emerge is an additional stimulus (as much as $1 trillion) and higher infrastructure and healthcare spending. To fund part of the additional spending, a scaled-back tax increase should be expected. Higher fiscal deficits should also be expected. These measures should lead to higher longer-term rates, higher short-term economic growth, and lower long-term economic growth. Finally, inflation is likely to be higher than it otherwise would be in the next couple of years, but lower over the next decade.



Economic growth may have stalled in December 2020 and January 2021. The increase in hospitalizations and resulting economic restrictions has once again put pressure on pandemic sensitive sectors. We expect economic growth will accelerate once the recent stimulus money starts to flow and immunization levels increase. We are increasing our first and second-quarter GDP estimates to incorporate the additional stimulus. We now forecast the first-quarter 2021 growth to be 4.0% and the second quarter to be as high as 9.2%. In addition, the final quarter of 2020 looks to have grown a bit faster than originally thought. We have raised the fourth-quarter 2020 GDP growth from 3.2% to 4.5%.

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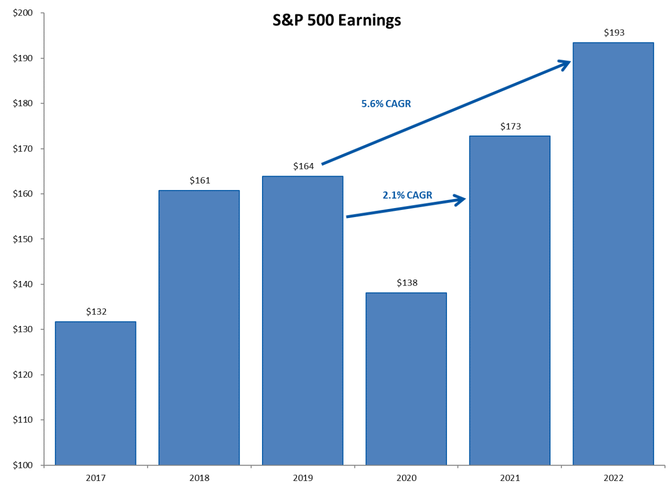
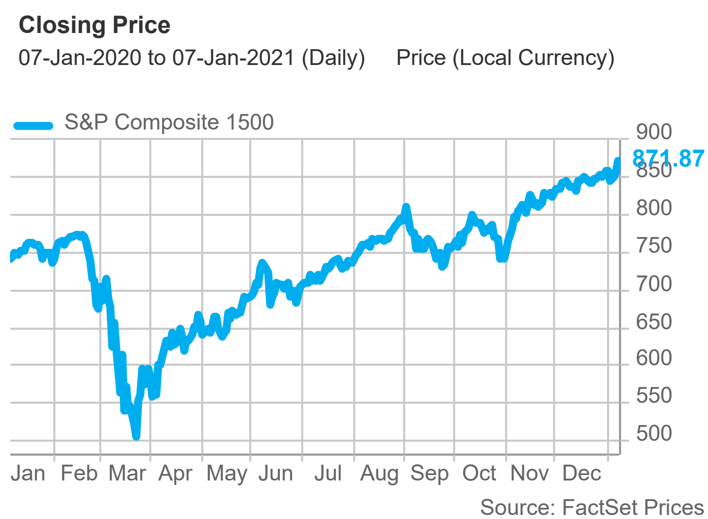
Fourth-quarter 2020 economic growth was likely down 2.4% y/y. We now forecast fourth-quarter 2021 economic growth to be 5.8% above last quarter's results while consensus estimates call for 3.7% y/y growth. We are forecasting substantially higher economic growth than consensus. We are considerably more optimistic than many published forecasts. Our above-consensus growth forecast positively impacts earnings estimates.



Inflation may briefly spike as the economy fully reopens before settling back down to a gently rising trend. Inflation is unlikely to consistently exceed the Federal Reserve Board's (FRB) 2% average until the end of our forecast period, at the earliest. We do not expect the FRB to raise short term rates during our forecast period. This should result in a steeper yield curve. Toward the end of our forecast period, the FRB will likely face increased pressure to begin the normalization process.

Higher economic growth and increased share repurchases translate into higher earnings growth. We now forecast 2021 S&P 500 EPS to be $173. This would be a y/y gain of 25%. Prior to the pandemic, we had forecast earnings of $181 per share. During the depth of the pandemic, our forecast for 2021 EPS fell to $160 per share. Our current forecast recovers slightly more than half of the decline. The current consensus calls for $165 per share for next year's S&P500 earnings. We seldomly forecast higher than consensus earnings growth. Our higher than consensus growth forecast is a result of our above consensus economic growth forecast. We suspect consensus earnings will rise after companies report final 2020 results. For 2022, we forecast the S&P 500 earnings to be $193. Any increased corporate taxes should be offset by higher economic growth and possibly lower tariffs on international trade. While high compared to 2020's depressed earnings, our 2022 forecast is just a 5.6% compound growth rate from the pre-pandemic levels. This is in-line with long-term earnings growth rates.



The stock rally continued in December:
U.S. equities continued their advance last quarter. The broad market advanced another 13.24% bringing the full-year return to 17.92%. The market has rallied an astounding 71.80% from its March 23 lows. The continuing gains were largely chalked up to vaccine optimism and an additional round of stimulus.

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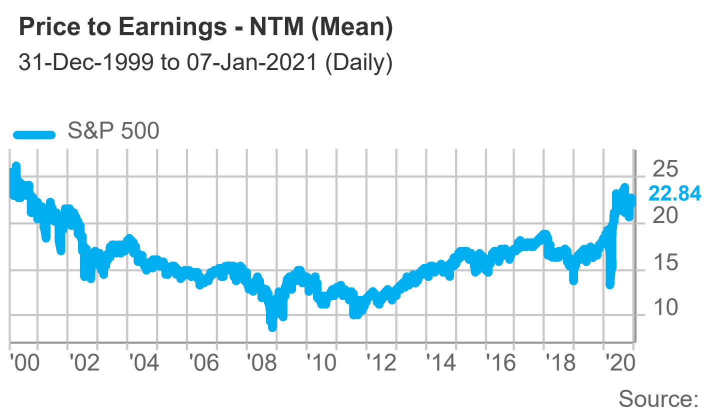
Information technology was the best performing sector for 2020, returning 43.89%. The worst performing sector, energy lost 33.68% last year.

During the fourth quarter, value stocks outperformed growth stocks 14.49% to 10.66%. Rallies in value stocks tend to last about three months before long term trends reassert themselves. Our portfolios have a growth bend to them. Despite that, we held our own during the quarter. With the promise of additional stimulus, value stocks may have their run during the first quarter of 2021.

Interest rates and bond prices held steady along during the quarter. For the year, the Bloomberg Barclays U.S. Aggregate Index returned 7.51% with half the gain coming from income and the other half coming from price improvement (lower interest rate environment). The index is currently yielding a miserly 1.17%. The low yields are fueling a global search for income and make continued gains difficult. Total returns on the 10-year Treasury are likely to be close to 0% over the next five years. Investors in core bond funds are likely to suffer negative real yields over the next five years as inflation outpaces the yield offered by bonds.

Fixed income markets are also looking toward a post-vaccine world. Inflation expectations are rising, and the yield curve is steeping (longer-term rates rise more than short-term rates). The 10-year treasury is now above the 1% threshold, a level not seen since March. Inflation expectations are also now at 52-week highs.

The S&P 500 is trading at 21.7 times our 2021 forecasted earnings. This is significantly above the long-term average of 16.1 times. By almost any measure stocks are expensive. Valuations are in the top decile of historical P/Es. Stocks are likely to provide mid-single digit returns over the next five years. We expect the P/E multiple will slowly decline as earnings grow into today's lofty valuation.



Even with this low projected return, stocks are likely to outperform fixed-income investments. The odds remain on the side of equities. During periods of economic expansion, stocks have a positive return 87% of the time. The odds of a decline of at least 10% are less than 4%. As stated, the market has rallied an astounding 71.80% from its March 23 lows. The median post-WWII gain off a recession bottom is 138% and the median of the last four gains is 403%. If history is a guide, this rally has room to run.

Once the economy gets past the vaccine and stimulus-fueled high growth phase, economic growth will likely return to the plow-horse economy we experienced during President Obama's Second Term. Increased regulation and income distribution schemes will add additional impediments to growth. Slow growth with pockets of rapid technological innovation will again be the norm. We strive to invest in those pockets. The long-term trends of decarbonization, artificial intelligence (AI), and a bifurcated global economy (One-part China-centric another part U.S. centric)) will reassert themselves. Innovators will continue to capture the laurels.

Prepared by Damian Howard January 8, 2021

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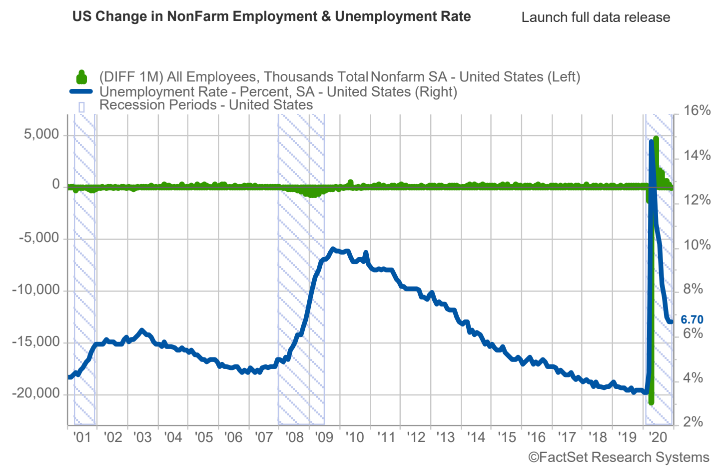
There are significant risks to our economic and market outlook. There are political and medical factors that could render our forecast moot. Any bump in the road back to normalcy may result in swift and severe stock and bond selloffs.

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. I hope this review provides a framework for the next quarter. We will update our outlook monthly to incorporate developments. I look forward to sharing our next forecast with you next April. The only thing that brings clarity is time. If you have comments or questions, we would love to hear from you.

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

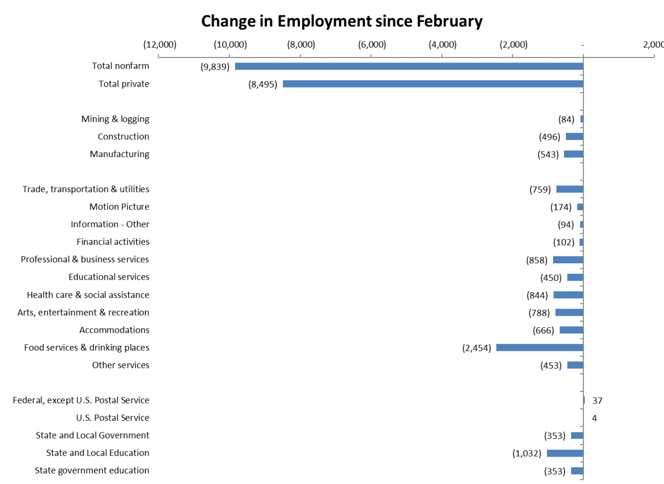
FIRST QUARTER 2021 MARKET OUTLOOK

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

For the month of December, the U.S. economy **lost** 140 thousand jobs, well below the consensus estimates of a **gain** of 100 thousand new jobs. The decline in employment reflects the recent increase in economic restrictions and other efforts to contain COVID-19. Job losses were concentrated in leisure and hospitality and in private education. The U.S. Bureau of Labor Statistics (BLS) revised the prior two months' job gains up a surprisingly large 135 thousand. The unemployment rate held steady at 6.7%. The participation rate also held steady.



Job losses in leisure and hospitality jobs were considerable. 372 thousand jobs were lost in bars and restaurants during the month. An additional 24 thousand jobs were lost in the hotel industry. These two sectors have been the hardest hit by the reimposition of bans enacted to curb the spread of COVID-19. Private education lost 63 thousand jobs. In addition, public sector education lost 20 thousand jobs bringing the total education-related job losses to 83 thousand for December. Many schools and colleges extended their winter break, starting prior to Thanksgiving instead of the traditional mid-December. This may have impacted employment in this sector.

The federal government added 6 thousand workers. Job gains and losses associated with the census are no longer in the numbers. Another 31 thousand state and local non-education positions were eliminated. State and local governments are required to run balanced budgets. While there are numerous accounting tricks and funding slight of hands available; governments' ability to borrow their way out of shortfalls is limited. Since most of the governmental cost is personnel, layoffs are the primary tool to meet budget.

The BLS reports statistics from two monthly surveys. The household survey measures labor force status, including unemployment, by demographic characteristics. The establishment survey measures nonfarm employment, hours, and earnings by industry.

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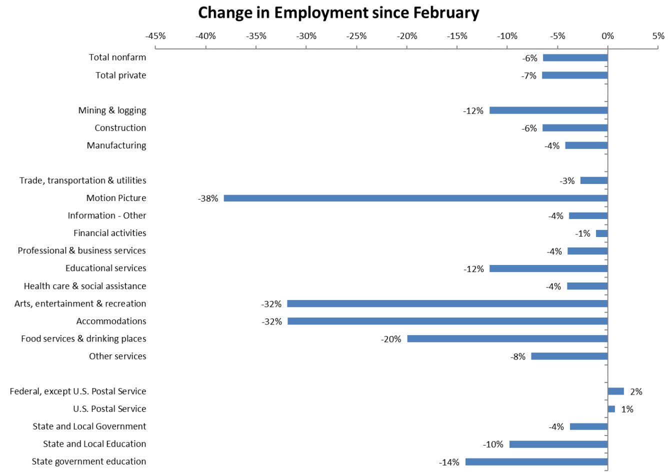
In November, the unemployment rate held steady at 6.7%. The rate is down by 8.0% from its recent high in April but 3.2% higher from its pre-pandemic level in February. The number of unemployed persons rose 8 thousand to 10.7 million. This is down from the 23.1 million reported in April, but up 4.9 million from the number reported in February. The broader U-6 unemployment rate improved to 11.7% from 12.0% the previous month and 22.8% reported in April. The U-6 rate was 7.0% in February.



Among the unemployed, the number of persons on temporary layoff increased by 277 thousand to 3.0 million. At its peak, the number of persons on temporary layoff hit 18.1 million. The number of long-term unemployed (those jobless for 27 weeks or more) increased modestly to 4.0 million and account for 37.1% of total unemployment.

The participation rate held steady at 61.5%. The participation rate was 62.7% in February. The employment to population ratio also held steady at 57.3%. This number was 61.1% in February.

23.7% of employed persons teleworked because of COVID-19 in October versus 21.8% the previous month. This number includes individuals that worked from home for pay at least sometime during the month because of the pandemic. The increase in work from home (WFH) is a result of the recent increase in new COVID-19 cases.

15.8 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 up 1.0 million from the 4.8 million the previous month. 12.8% of those individuals received at least some pay from their employers for the hours not worked.

About 4.6 million persons were without employment but not counted as unemployed because they were prevented from looking for work due to the pandemic. This is up from 3.9 million reported the previous month. To be counted as unemployed individuals must be either actively looking for work or on temporary layoff.

Last month's average hourly earnings (wages) grew at 5.1% y/y. The average workweek fell by 0.1 hours to 34.7 hours but up from 34.3 hours last year. Average weekly earnings are up 6.3% from last year to $1,034 ($53,789 annualized) versus $973 ($50,600 annualized) last year. The loss of relatively lower-paying leisure and hospitality jobs is still affecting the average wage and hours of work statistics. The average hourly and weekly earnings in leisure and hospitality is $17.04 which is 43% less than total, and the average weekly earnings are $429.41 which is 58% less than total. This has the effect of boosting current average hourly earnings.

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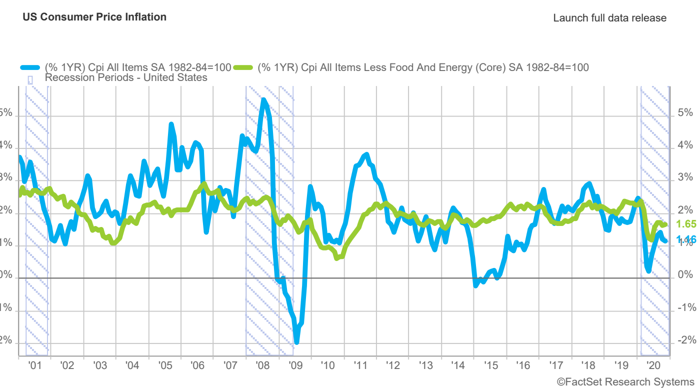
The labor market is currently highly volatile. This is evident in the large upward revision of the previous two months. This month's job losses may be revised away or may significantly increase. What is clear is that the labor market recovery has stalled. With the reimposition of focused bans, the job recovery has faltered. As with most things in the economy, the labor market needs progress on immunization to make it safe and profitable to work in restaurants, bars, and hotels, and to return to school. We believe it will take until the middle of 2022 for the economy to recover the remaining 8.9 million lost jobs plus the additional positions required to accommodate population growth of 1.1 million individuals per year.

Inflation

Consumer prices rose 0.2% in November. Strip out the impact of energy and food prices and core prices also rose 0.2%. Headline inflation was 1.2% y/y with core inflation of 1.7% y/y. Prices have mostly recovered from their pandemic induced volatility. The price of hotel rooms rose 4.5% in November as more people are traveling. Prices for hotel rooms are still down 12.7% y/y.



The prices for major appliances rose 3.4% in November with laundry equipment up 6.1%. The price of a new washer and dryer is up 13.6% y/y. One of the Trump Administration's first moves was to impose hefty duties on imported washing machines in 2018. Since most washers and dryers are sold as a pair, the price for dryers went up as well. Both Samsung and LG opened new factories in the U.S. adding about 1,600 jobs but costing consumers an estimated $1.5 billion in higher prices or about $820 thousand per new job created. With the pandemic induced remodeling boom, more washers and dryers are demanded. The high tariffs have allowed U.S. manufacturers to raise prices even further.

We look for y/y inflation to spike up in the first half of 2021 as we anniversary the price declines during the depth of the recession. Prices will quickly return to their sub-2% level in the second half of 2021. We then expect the CPI to gradually rise as the economy recovers and the impact of increased regulation takes effect.

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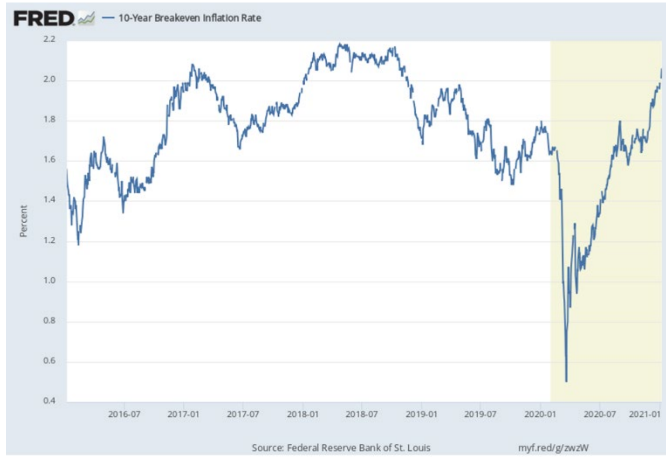
WEALTH MANAGEMENT

FIRST QUARTER 2021 MARKET OUTLOOK

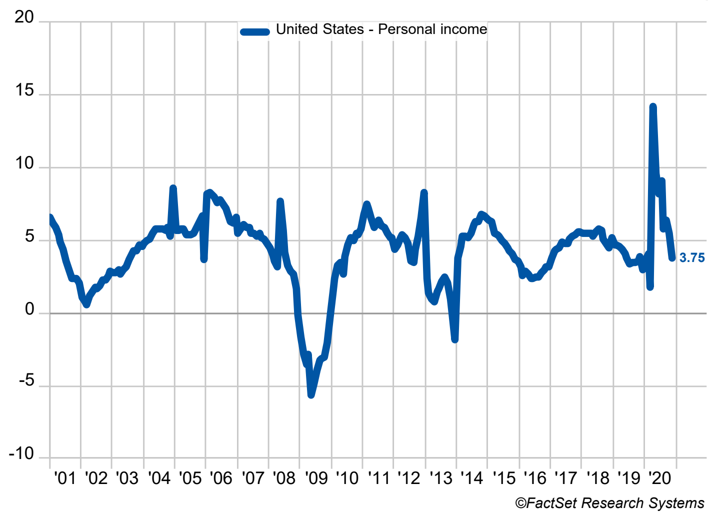
The most interesting development on the inflation front is inflation expectations. We can measure inflation expectations from the difference between a 10-year Treasury security and the ten-year Treasury Inflation Protection security (TIPS). The difference implies what market participants expect inflation to average over the next ten years. Inflation expectations have been steadily rising and are currently 2.06%.



Higher inflation expectations are putting upward pressure on long term interest rates. This will cause mark-to-market losses in buy-and-hold bond portfolios. We do not expect inflation expectations to rise too much further from here. Nor do we expect the FRB to move-off its Zero-Lower-Bound (ZLB) Fed Funds policy any time soon. We do not forecast them raising short-term rates prior to 2023. In the interim, higher inflation expectations will help steepen the yield curve but only so far. This will likely limit the total return on fixed-income investments for the foreseeable future.

The Consumer Sector

Personal income fell 1.1% in November as various stimulus programs ended. Personal income is still up 3.8% y/y. Personal income excluding transfer payments are down 0.6% m/m as additional pandemic related shutdowns were imposed in November. Despite the pandemic and recession, personal income excluding transfer payments is up 0.9% y/y. Government transfer payments do not create wealth, they only transfer it from one group of people to another. In this case, it is from future generations to the current generation. Despite the pandemic, private sector wages are up 2.8% y/y.

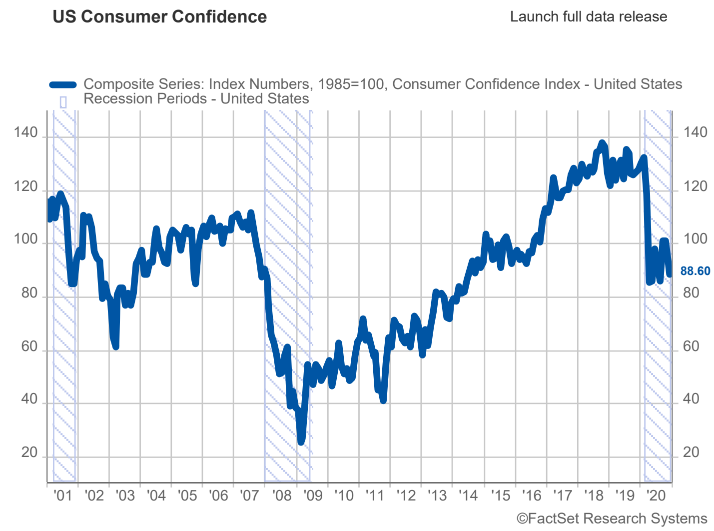


During the month, consumers saved 12.9% of disposable income. Earnings not spent on services is in part being saved. Most of these extra savings will be spent this year after a vaccine is widely available. This supports our above-trend GDP growth rate of 5.8%.

Disposable personal income is up 4.3% y/y. Disposable personal income per capita is up 3.8% y/y. Real disposable income per capita is up 2.6% y/y.

Consumer spending on goods and services fell 0.4% for the month and was down 1.3% y/y. Spending on services fell 0.2% m/m in part due to warmer weather. Utility bills were 9.5% lower m/m and 6.3% lower y/y. Spending at restaurants and bars fell 3.6% and spending at hotels fell 6.3%. State and local governments have reimposed targeted restrictions in response to an increase in new COVID-19 cases, further harming the already beleaguered sectors. Spending on cars fell 3.6% m/m as pent-up demand has likely been met. Spending should shift from durable goods to services next year as the pandemic lessens its grip.

Consumer confidence fell again in December. An increase in new COVID-19 cases and a sharp slowdown in new job growth led to a lower perception of current conditions. On the flip side, consumers' expectations for the future increased as the vaccine news brightened the outlook. The Consumer Confidence Index, compiled by the Conference Board, fell 4.3 points to 88.6. For reference, the average reading over the last twenty years has been 91.6. The present situation component fell to 88.6 from 105.9 the previous month. The forward-looking expectation component rose to 87.5 from 84.3 the previous month.



The net business conditions sub-index (good-bad) fell to -23.5 from -16.0 the previous month. The net employment sub-index (plentiful -hard to get) fell to -0.2 from 6.9 the prior month. We expect consumer confidence to be caught in a tug-of-war between vaccine developments and a rise in new cases. This situation should resolve itself during the first half of 2021. The consumer remains in good shape financially.

The Business Sector

Services comprise 66% of personal consumption expenditures (PCE). The activity in the manufacturing sector is easier to measure and track. Most of our growth and productivity measures were developed after WWII for the manufacturing sector. While it is easy to measure labor cost per widget produced, it is much harder to measure the productivity of a programmer or an app. The Institute for Supply Management (ISM) produces a monthly report on activity in each sector. The reports are sentiment-driven and can be influenced by current events. Nonetheless, they do provide real-time clues to what is happening.

Non-Manufacturing Sector	Direction
Business Activity / Production	Growing
New Orders	Growing
Employment	Contracting
Supplier Deliveries	Slowing
Customer Inventories	N/A
Non-Manufacturing Sector	**Growing**
Industries Expanding	14
Industries Contracting	4

The service sector continued to expand in December and at a faster rate. Activity in the services sector grew for the seventh month in a row. The ISM's non-manufacturing index rose 1.3 points to 572. The two forward-looking components, business activity/production, and new orders rose smartly, indicating an acceleration.

The business activities/production component rose 1.4 points to 59.4. The new orders component rose 1.3 points to 58.5. Both indices moved higher indicating building momentum. The employment in the services sector contracted in December as the component fell 3.3 points to 48.2. Only four industries reported an increase in employment. Ten industries reported a reduction in employment.

Supplier deliveries continue to worsen. The supplier deliveries component rose by 5.8 points to 62.8. Seventeen industries reported slower deliveries in December, none reported faster deliveries. One respondent commented, "Continued local and state shutdowns negatively impacting a variety of operations. Notably, shipping delays are beginning to affect operations as [parcel companies] all struggle under the strain of holiday-shipping demand."

The ISM indicated, "Respondents' comments are mixed about business conditions and the economy. Various local- and state-level COVID-19 shutdowns continue to negatively impact companies and industries. Applicable human resources, production capacity, and logistics have been more constrained than during the previous month. Most respondents are cautiously optimistic about business conditions with the recent approval and impending distribution of vaccines."

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 sector has adapted to the pandemic better than the service sector. The change in consumer purchasing behavior has also benefited the manufacturing sector. However, slow supplier deliveries and repositioning manufacturing processes for social distancing have restrained the recovery.

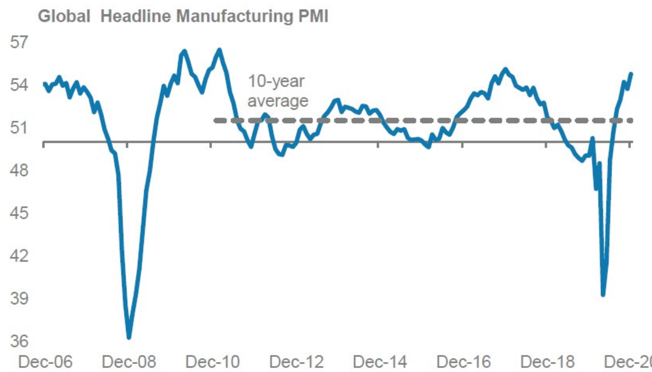
The manufacturing index rose 3.2 points to 60.7. The figure indicates the manufacturing sector has expanded for its seventh straight month after contracting sharply in April. The production component rose 4.0 points to 64.8. The new orders component rose 2.8 points to 67.9. The employment component surprisingly rose 3.1 points to 51.5, indicating increased manufacturing employment. Eight industries reported employment growth. Five industries reported contractions.

Supplier deliveries to manufacturers were slower in December as the sub-index rose 5.9 points to 67.6. Manufacturers continue to report stressed supply chains. "Suppliers continue to struggle to deliver, with deliveries slowing at a faster rate compared to November. Transportation challenges and challenges in supplier-labor markets are still constraining production growth — and to a greater extent compared to the previous month. The Supplier Deliveries Index reflects the difficulties suppliers continue to experience due to COVID-19 impacts. Supplier labor and transportation constraints are not expected to diminish in the near-to-moderate term due to COVID-19," reported the ISM.

Manufacturing Sector	Direction
Production	Growing
New Orders	Growing
Employment	Growing
Supplier Deliveries	Slowing
Customer Inventories	Too Low
Manufacturing Sector	**Growing**
Industries Expanding	16
Industries Contracting	2

"The manufacturing economy continued its recovery in December. Survey Committee members reported that their companies and suppliers continue to operate in reconfigured factories, but absenteeism, short-term shutdowns to sanitize facilities, and difficulties in returning and hiring workers are causing strains that are limiting manufacturing growth potential. However, panel sentiment remains optimistic" reported the ISM.

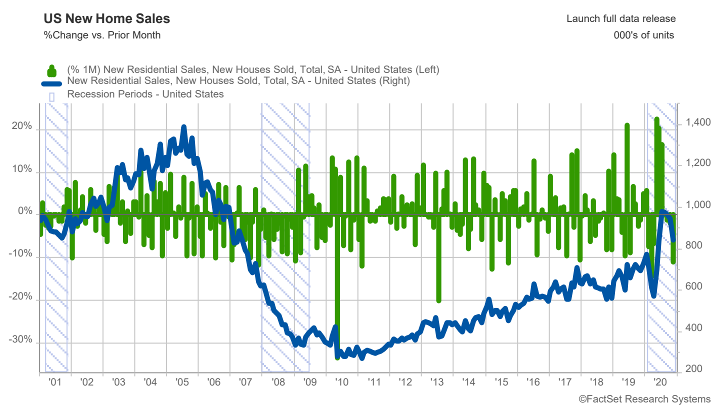
The Morgan Stanley Global Manufacturing PMI (GPMI) rose to 54.8 in December, a three-year high. 89% of global PMIs are in expansion territory with 68% of global PMIs rising in December. The GPMI suggests the global recovery in industrial activity and trade is both broad-based and gaining steam. New orders also rose with 68% of economies reporting improvement suggesting further improvement in the months ahead.



The service sector PMIs indicate the sector's recovery has slowed a bit. The targeted nature of recent restrictions has not had the same devastating effect as the broad closures in the spring. With restrictions likely to stay in place for a couple of months, service sector activity may be constrained over that period. We expect a sharp rebound once a vaccine is widely distributed and restrictions are lifted.

The Housing Sector

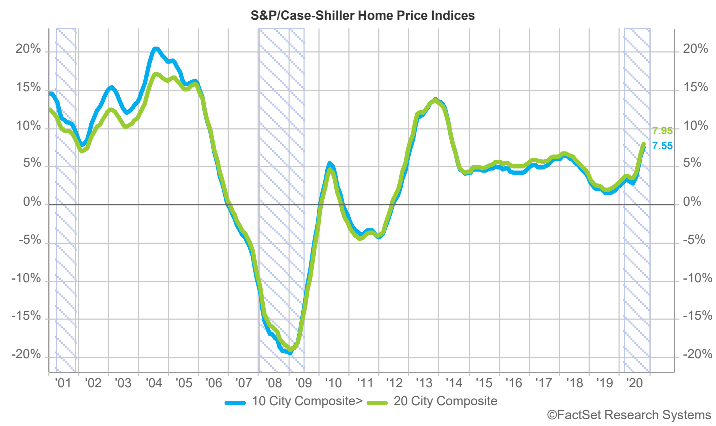
Despite record low-interest rates, the housing sector took a breather in November. A weak November report was coupled with large downward revisions of the prior month's sales data. The lack of finished new homes is putting the brakes on continued expansion. The inventory of new homes available for sale is down 11.2% y/y. Builders continue to face supply chain shortages and labor shortages. The requirement for social distancing on the job site has also slowed down the construction process. These impediments will ease in the spring. But in the meantime, constrained supply coupled with intense demand always leads to sharply rising prices.



November reported new single-family home sales missed consensus by 149 thousand, coming in at an 841 thousand annual rate versus expectations of 990 thousand annual rate. Despite the substantial miss, new home sales are still up 21% y/y. The three-month moving average is up 29% y/y.

As stated above, there is a significant shortage of new homes available for sale. The recent increase in new single-family starts should help alleviate the shortage. Over the last three months, single-family home starts are running at a 1.15 million pace, up 26% y/y. At the same time, builders have curtailed new building of apartment units. Over the last three months, multifamily starts have fallen 15% y/y. Builders are adjusting their plans to meet the shift in housing preferences. With so many people working from home, going to school from home, or simply confined to their home, there appears to be a shift from higher-price rental housing toward homeownership.

The three-month moving average of the median selling price is up 4.9% y/y to $338 thousand. The shortage of supply is pushing the price of new homes up. Recent press reports have indicated some pushback against rising prices.

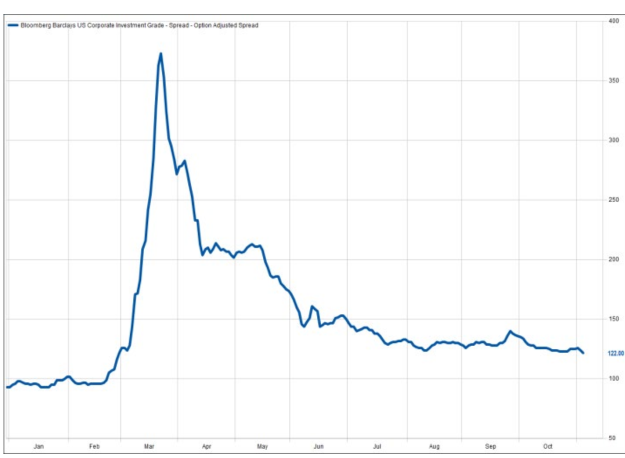


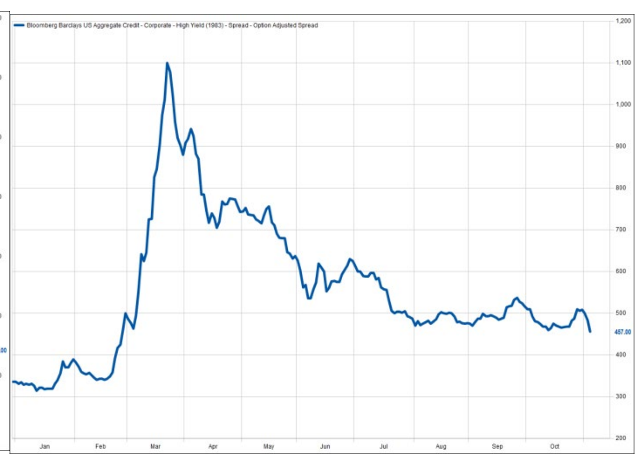
Existing home sales are also facing a shortage of inventory and rising prices. Inventory (homes available for sale) are at their lowest level since data was first collected in 1999. The number of existing homes for sale is down 22% y/y. The inventory shortage is most acute at the lower end of the price spectrum. Despite the lack of inventory, existing-home sales have averaged a 6.9 million annual rate over the last three months, up 26.6% y/y. Existing home price appreciation as measured by the Case-Shiller Home Price Index continues to climb as a result of the supply shortage. As with any market when there is an excess of demand, prices will rise.

It appears the housing sector is at a ceiling and unable to expand much further until the pandemic eases. Until new supply comes online and more homeowners are comfortable enough to allow strangers into their house for a showing, it is unlikely the record low-interest rates will cause this sector to overheat. The housing shortage has been a boon to the remodeling sector. Instead of moving, more homeowners have decided to renovate their existing homes. This has been a great benefit to Home Depot (HD), Lowes (LOW), and other stores that cater to remodeling.

Credit Markets

The credit markets modestly improved in December. Credit is correlated with equities and economic growth, especially high yield. As the economy improved and equity markets advanced, credit spreads narrowed. The BB US Corporate Investment Grade index returned 0.44% as spreads narrowed 0.08% to





0.96%. The BB High Yield index returned 3.96% as spreads narrowed 0.52% to 3.60%. Both investment grade and high yield credit spreads are now at post-pandemic lows. With low Treasury yields and tight spreads, the odds of outsized gains in either investment grade or high yield bonds over the next five years is low.

The yield on the 10-year Treasury fell to a record low of 0.50% on March 9 as the government shut down the economy to contain the spread of COVID-19. In December, rates rose to 0.92% as progress on the vaccine front and another round of stimulus was approved. Since the Democratic win in Georgia, Treasury yields have risen to 1.09%.

Since month end, the yield curve has steepened with the 10-year Treasury now yielding 1.10%. The FRB is anchoring short-term rates at the 0% to 0.25% level and will keep them there for years. The yield curve will likely steepen further as the economy improves and more stimulus is pumped into the economy.

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

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