An analysis by McQueen Financial Advisors, Inc.

McQueen Financial Advisors

October 2017

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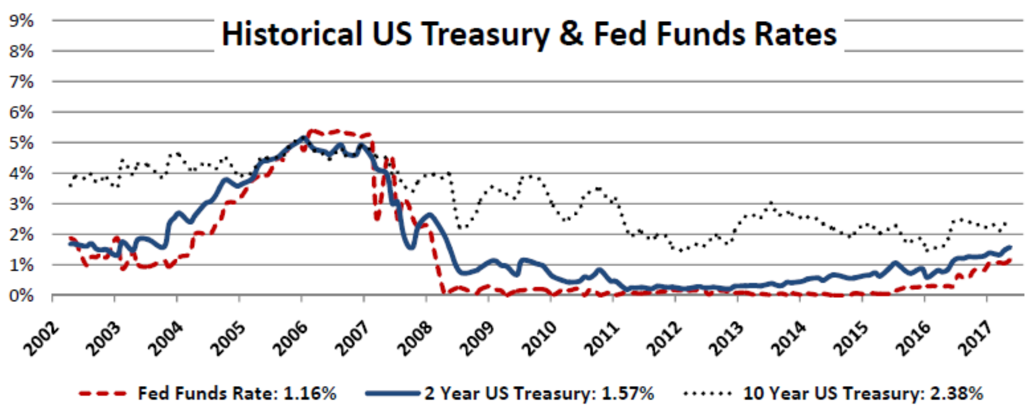
MFA Economic Outlook

October 2017

HIGHLIGHTS



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McQueen
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" We are roaring to just over 23,000 on the DOW. New all - time highs."

ABSTRACT

This paper describes our current view of the economic environment.

COMMENTARY

Happy Fall! As we come towards the close of 2017, we present our view point on the economy, our industry, and our interest rate projections. If I were to compare the current environment to a specialty cocktail, I would sound like a hip bartender repeating an order after I butchered the name. "Let me get this right; you would like a sustainable recovery with a twist of uncertainty and a few drops of political environment?" Drink up.

" As of today, the forward yield curve is projecting a 0.25% increase in the Fed Funds rate in December and another increase possibly in June."

What is going on with the hip Federal Open Market Committee (FOMC)?

The FOMC is going to start shrinking the quantitative easing (QE) portfolio; the portfolio currently holds $4.5 trillion in assets. This is a considerably large portfolio as the USA has a total of $20 trillion in debt. And, it is even larger if you look back and see that over the past 10 years our national debt has increased from $10 trillion to $20 trillion. The FOMC will start reducing their mortgages and US Treasury holdings in the 4th quarter of 2017 (now). The portfolio currently has between $20 billion and $50 billion maturing a month. The schedule below allows the portfolio to slowly contract as maturities happen, which means the FOMC will not be selling bonds. The contraction will be as follows per month:

- Q4 – 2017 - $10 billion a month
- Q1 – 2018 - $20 billion a month
- Q2 – 2018 - $30 billion a month
- Q3 – 2018 - $40 billion a month
- Q4 – 2018 - $50 billion a month
- Going forward - $50 billion a month. At this pace, it will take approximately 8 years for the portfolio to get to pre-QE size.

Along with the modification to the QE portfolio, the FOMC is planning on increasing the Federal Funds rate (Fed Funds). The Fed Funds rate is projected to go up 0.25% in December, 2017 to 1.50%, based on the Fed Funds futures, or betting in the bond market. The bond market is expecting an increase in June 2018 which will result in a 1.75% Fed Funds rate. This ending rate is lower than what the FOMC has publicly stated. At a recent FOMC meeting, they provided guidance that they expect to increase the Fed Funds rate three times in 2018. This would result in a 2.25% Fed Funds rate. On a side note, the FOMC has consistently been wrong on their written projections.

Is there inflation and is there ever going to be inflation?

The easy answer to this two-part question is no. Inflation is still very low. Inflation, as measured in several different ways, is still below the FOMC target of 2.00%. The FOMC has a dual mandate, price stability and full employment. It appears that we have price stability, and by definition, we are at full employment.

I believe the FOMC should be weary of employment numbers, as the continued improvement of automation and technology will keep pressure on wages and employment. I need to ask, "Will my taco be assembled by a robot?" (hip word for a mechanical arm).

What is going to happen with long-term US Treasury yields?

As we examine the outlook on long-term US Treasuries, we expect the 10-year US Treasury yield will remain low for the foreseeable future. A rate between 2.50% and 3.50% appears reasonable, given the low inflation and low economic growth.

What is the one thing that is keeping me up at night?

Actually, there are two things:

1. The wild fires in Napa California. It is a terrible situation for all; land owners, tourists, wine enthusiasts.
2. Deposit Generation

As we move forward to 2018, we expect deposit generation is going to be difficult. Certificates of Deposit as a percent of deposits is nearly 15% on average. This is down from an industry average of nearly 30% just a few years back. As consumers continue to spend and potentially chase the stock market, deposits will become more difficult to generate. Today is a good day to start a deposit campaign that does not focus on interest rates.

The unknown is at times something we worry about.

Black Swan events, or unpredicted events, can cause interest rates to move substantially. There are a plethora of national and worldwide issues that keep jumping up into the spotlight. The unknown can cause significant market changes, which have historically resulted in lower stock prices and lower bond yields.

When we look into a Crystal glass with clear ice cubes, what do we see?

We see that we are in a slowly improving economy. The pace of the recovery is painfully slow, but the metrics keep pointing in a good direction. Unemployment is really low, and the underemployment rate is slowly improving. Inflation is low, and technology is lowering some costs every day. GDP growth is modest, but improving.

There are some headwinds that may keep the pace of growth slow, or even derail the positive growth. The explosion of student loans is a significant concern as this is damaging the financial position of young adults when they graduate. We are concerned about the affordability of housing and the fading of the American dream to own a home. Finally, we are excited and anxiety-ridden about automation, artificial intelligence, and the employment rate. Manufacturing continues to automate, resulting in less manufacturing jobs. Is the next frontier fast food jobs?

Where do we go from here?

We expect a continued slow increase in the Federal Funds rate. We surmise this is being done to "normalize" rates and allow for the FOMC to lower rates if we get into a problem. We expect the 10-year Treasury to increase in yield a bit as the FOMC unwinds the QE portfolio. We expect continued slow growth, especially with the dysfunction in Washington.

Interest Rate projection for 2018:

	9/17	**12/17**	**3/18**	**6/18**	**9/18**	**12/18**
Fed Funds	1.25	1.50	1.50	1.75	1.75	2.25
2-year US Treasury	1.52	1.75	1.75	2.00	2.10	2.25
5-year US Treasury	1.95	2.00	2.00	2.25	2.30	2.50
10-year US Treasury	2.30	2.50	2.50	2.60	2.65	2.75
GDP	2.60	2.60	2.65	2.65	2.70	2.70
CPI-X-YOY	2.00	2.00	2.25	2.25	2.25	2.50

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McQueen Financial Advisors, Inc. (MFA) is a leading nationwide provider of financial advisory services that has been serving financial institutions since 1999. An SEC-registered investment advisory firm, MFA works only for financial institutions. We provide our services to institutions throughout the United States, with assets ranging from $20 million to over $5 billion.

Products and Services

McQueen Financial Advisors provides the following services to financial institutions throughout the country:

Investment Portfolio Management: As a fixed income investment advisor, we will bring professional, in-house fixed income investment portfolio management to your financial institution at substantial savings. Our process is designed to develop a desired portfolio structure while focusing on your current income and total return with safety of principal.

Municipal and Corporate Credit Review: On a quarterly basis, we provide you with a detailed credit review on all municipal and corporate credits. Having and reporting our strong credit culture is a paramount philosophy and daily practice at McQueen Financial Advisors. We focus on credit to ensure that we are able to harness the benefit of credit spread products and take advantage of the additional yield, without taking unnecessary risk.

Asset Liability Management: McQueen Financial Asset Liability Management reports will provide you with recommendations and strategies that are designed to fit your unique needs and provide you with the information you need to make the most informed decisions and add income to your bottom line.

Core Deposit Studies: This report will be an integral part of your Asset Liability Management report. The Core Deposit Study is comprised of two sections. The first is a historical comparison of your deposit rates to market interest rates. The second section is the determination of the duration of your core deposits.

Prepayment Speed Analysis: McQueen Financial has developed a process to determine your actual prepayment speeds. Our analysis provides a report that shows your actual prepayment speeds, the national or state speeds and our recommended prepayment speeds for your ALM report.

Liquidity Analysis: The liquidity stress testing report covers 30-day, 60-day and 90-day liquidity in current, moderately stressed and severely stressed scenarios. The report is designed to be easy to understand and provide significant detail to allow for a comprehensive view of your liquidity position.

Assumption Stress Testing: McQueen Financial provides a detailed list of the assumptions in your Asset Liability Management report. We have developed a model that stress tests your assumptions and provides you with a detailed analysis of the results. The goal is to understand if an unanticipated change in assumptions would significantly hurt your projected financial performance or risk profile.

ALM Backtesting: The objective of the back testing report is to determine the net interest income projection in your ALM report was reasonable. Our analysis focuses on volume as well as booked interest rates of each interest-sensitive component of the balance sheet. The backtesting analysis is a useful management tool that provides you with a cross-check of ALM inputs and assumptions.

ALM Validation: The objective of the ALM validation report is to provide you with an independent review of your ALM model, your ALM policy, and procedures used to measure interest rate risk. The validation process involves a detailed study of your financial statements, ALM reports, ALM policy and inputs to your model.

Mortgage Servicing Rights Valuations: The Mortgage Servicing Rights Valuation (MSR) process is an integral step in determining the overall financial success of a financial institution's mortgage operations. By outsourcing your MSR Valuation to McQueen Financial, you will receive an independent third party market valuation.

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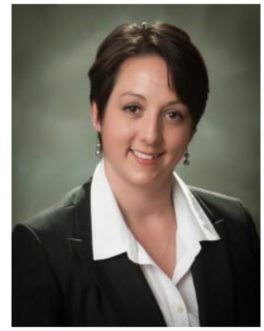

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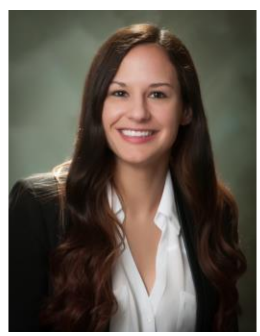

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