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Financial Advisors

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MFA Economic Outlook 2022 – 3rd Quarter

Time is flying by. It is hard to believe that we are in the third year of a pandemic. We are halfway through 2022 and we find ourselves comparing 2022 to 1980. This is not just a normal year. Some of the mid-year headlines are:

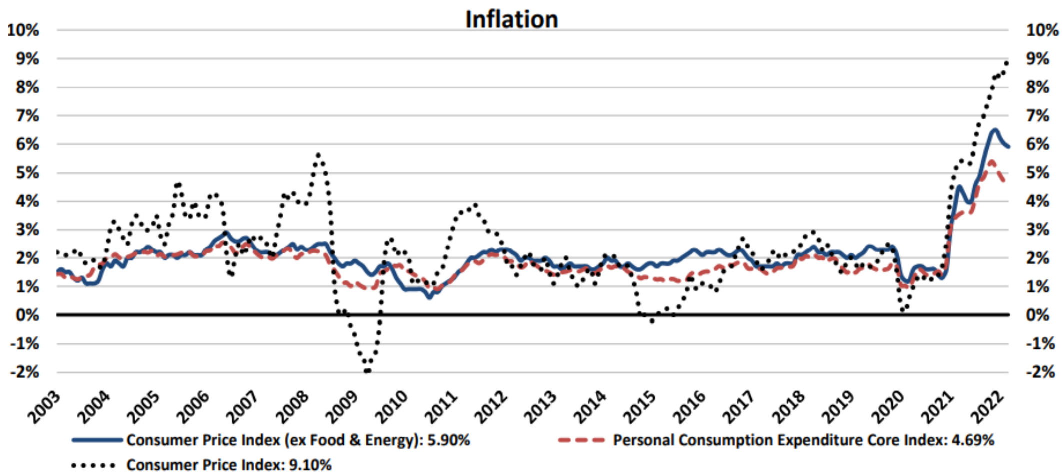
- War
- Supply chain meltdowns
- Highest Inflation since 1980
- Rising interest rates
- The FOMC increased rates by 0.75% at the last two meetings and there is speculation of another 0.50% to 0.75% at the next meeting.

Prices are rising quickly with inflation reaching 9.10% This is the highest rate of inflation since 1982.

The FOMC is battling the perception and potential reality that they are behind the curve with their dual mandate of full employment and price stability. The bond market is signaling that the FOMC is behind the curve on raising rates.

McQueen Financial Advisors Q3 2022 Economic Update

Inflation – The Focus Of Today:



"Inflation has reached rates not seen since 1982."

Inflation is rising in all areas of the economy. Inflation has reached rates we have not seen since 1982. The consumer price index has reached a blistering 9.10%. The largest components in this staggering increase include:

- Meat, Poultry, Fish & Eggs: 12.3%
- Transportation: 19.4%
- Electricity: 24.1%
- Used Automobiles: 37.3%
- Gasoline: 50.8%

Waged-based inflation is both productive and challenging for individuals. As wages rise, so will the cost of labor-intensive products, such as housing and food. As prices go up, they become permanent. As the price of the goods goes up, they become less affordable, at times even with higher wages. So far, consumers have a reduced buying power of 4.40% after factoring in inflation and wage growth.

The FOMC has two tools at its disposal to reduce inflation.

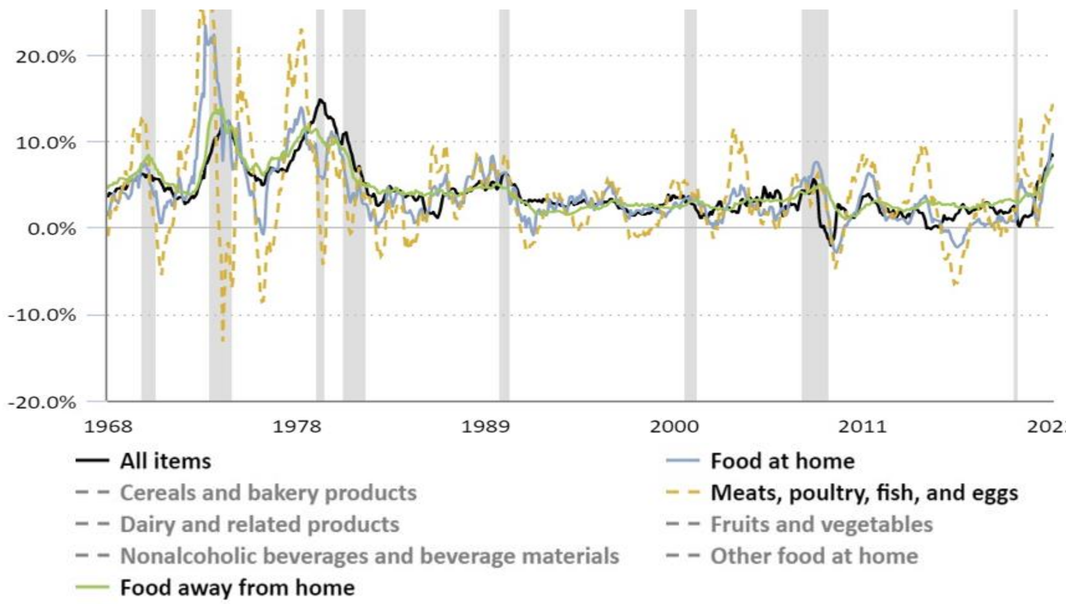
1. Federal Funds Rate
   The FOMC can raise the Federal Funds rate to increase the cost of borrowings which results in slowing the economy.
2. Asset sales
   The FOMC can sell longer-term assets that it owns. These sales will reduce cash in the market and results in higher long-term yields. Lower cash and higher yields will result in a slower economy.

One of the areas with large inflation is food prices:

Food prices are rising quickly due to several issues. The cost of transportation and employment are major components of the price increase. Additionally, we are struggling with fertilizer supply as a significant amount of product came from Russia and Ukraine.

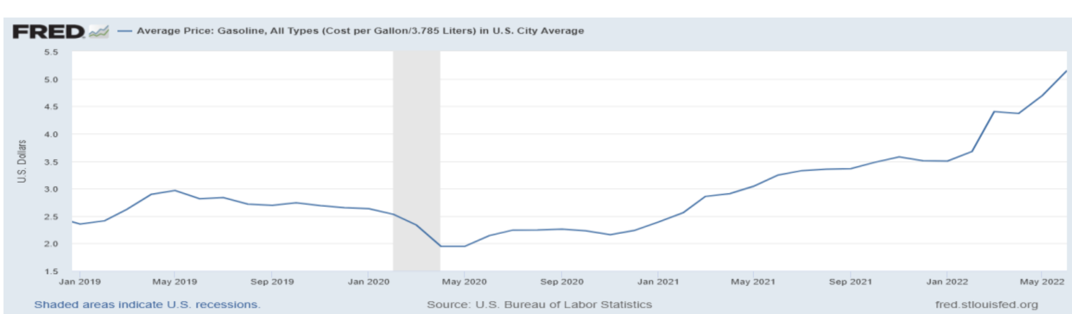
Overall, the cost of food at home increased 10.8% from April 2021 to April 2022, according to the U.S. Bureau of Labor and Statistics. This is the most since 1980.

"Oil is a good indicator of the strength of the economy."



Gas:

Gas prices have risen very quickly due to US Government policy, inflation, and Russia's invasion of Ukraine. Supply chains are struggling, and Europe is in great need of gasoline and natural gas from other sources besides Russia. The average cost of a gallon of gas reached an average of nearly $5.00 and now stands at $4.50 a gallon in the U.S.A.



What is Going on with Home Values?

Home values are still rising in some markets and have flatlined in others. Affordability is causing a pause in pricing in many markets in our great country. Further, the cost of building houses and the limited supply of homes due to labor and material shortages should keep prices elevated for the foreseeable future.

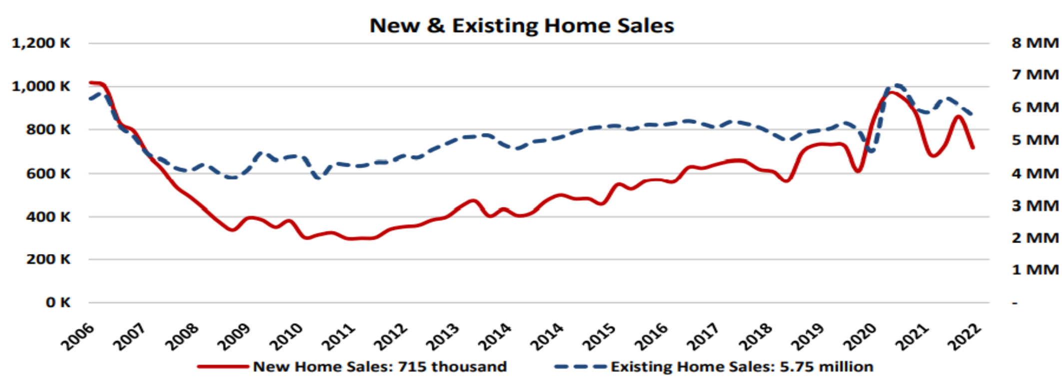
Given the effects of COVID-19, consumers want a house where they can work remotely, vacation, and have enough room for the kids to attend remote school if needed. Millennials are entering prime home-buying ages and rent has risen significantly. This combined has resulted in significant growth in housing demand and prices.

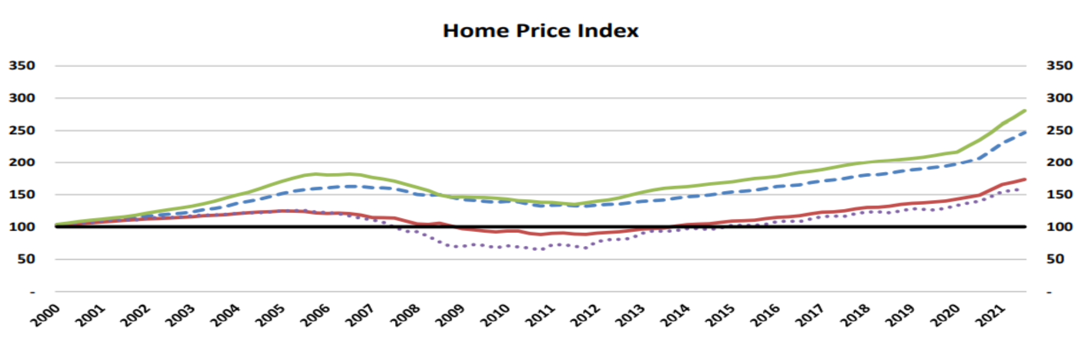
"We expect the housing market to cool."

We expect the housing market to cool to some degree. Why do we see this?

One – Mortgage rates continue to increase. The 30-year mortgage rate increased to roughly 5.50%. This results in a 30% reduction in the amount one can borrow for the same payment when compared to a 3.00% rate.

Two – Inflation is causing the cost of necessary items to reduce borrowers' free cash flow. We are seeing anecdotal evidence that food and gas prices have effectively doubled. This will reduce borrowers' capacity for debt payments.





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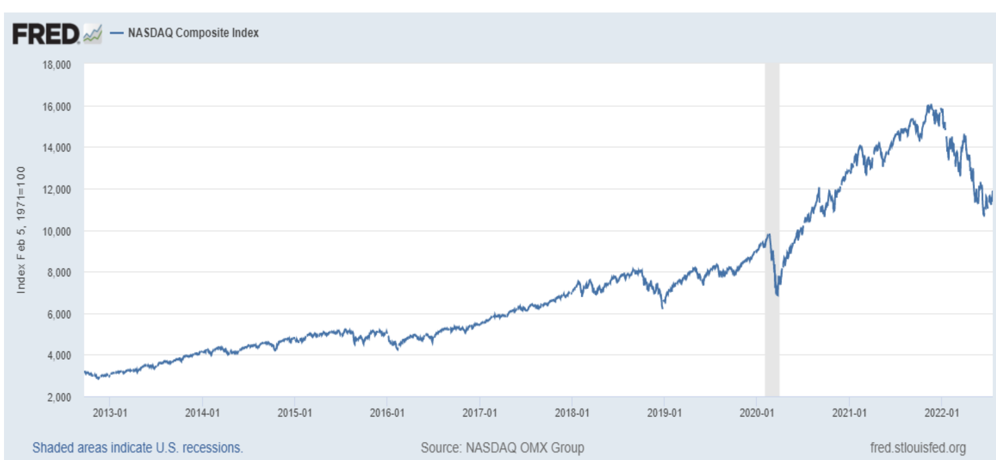
Stock Market:

The S&P 500 and the NASDAQ have fallen enough in value to have entered a technical correction. The markets are nervous about the inflation data and are trying to digest the changes. Further, the rise and fall of technology stocks have created a significant swing in personal investment portfolio values.

S&P 500:

NASDAQ:

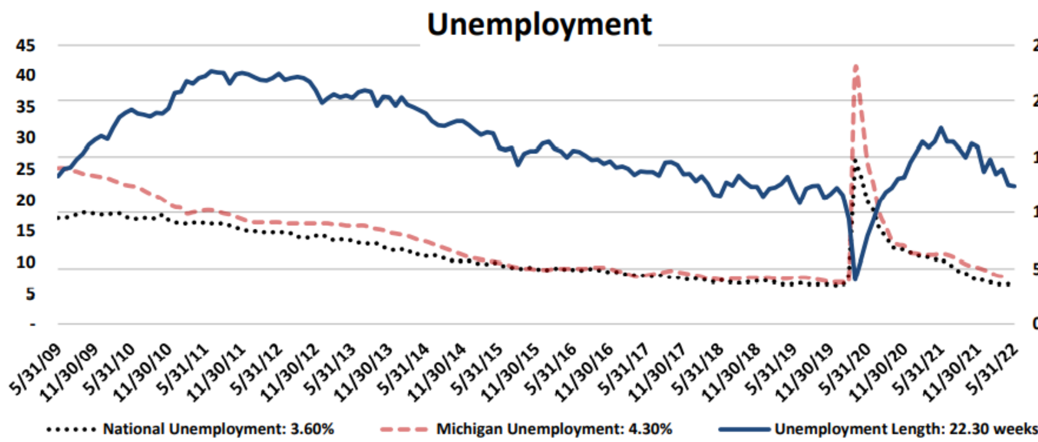


"The markets have entered recession levels."

“Unemployment is projected to drop to 3.4% in 2022.”

Unemployment:

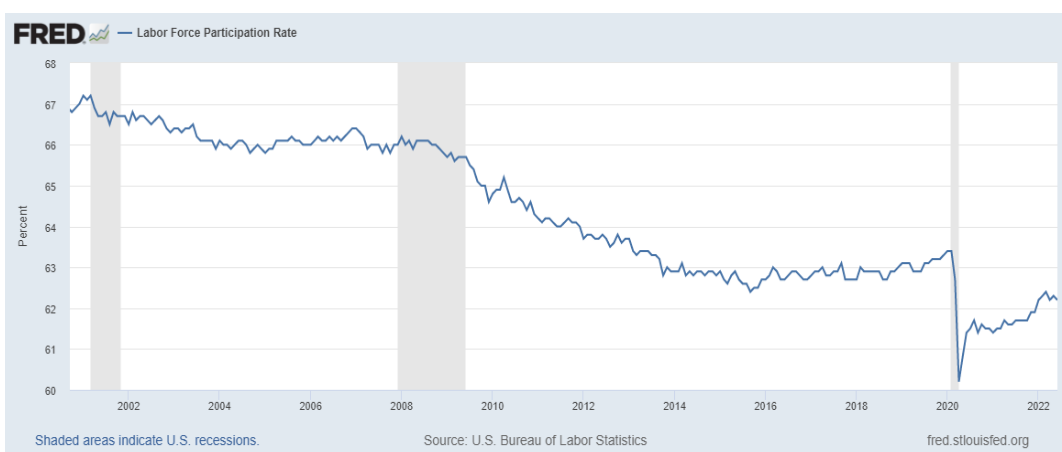
If you want a job, you can have a job. There are more than 11.4 million open jobs. According to PBS, there are more than two jobs available per unemployed person.



Participation Rate:

The participation rate has stayed very low. We see this as the result of:

1. Retirement of baby boomers
2. Remote work allowing families to move to lower-cost areas
3. One parent working
4. Continued fear of COVID-19

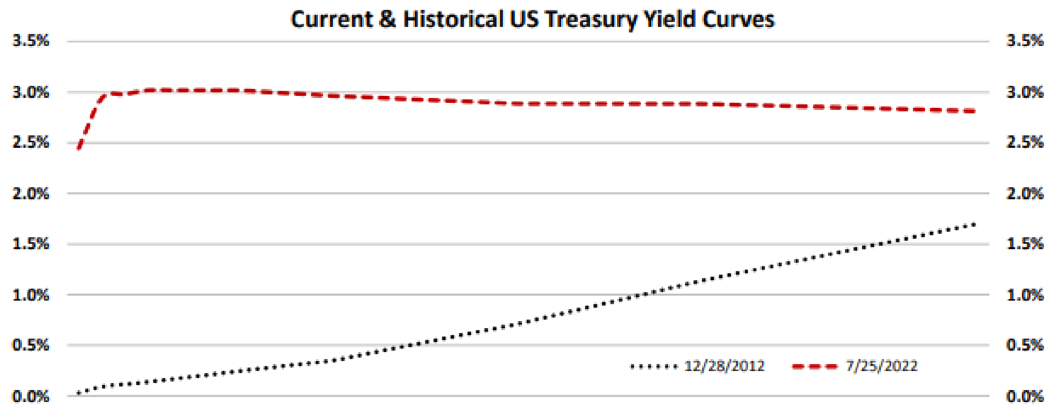


"The Fed Funds Rate is projected to reach 3.40%."

What is going on with interest rates and the Federal Open Market Committee (FOMC)?

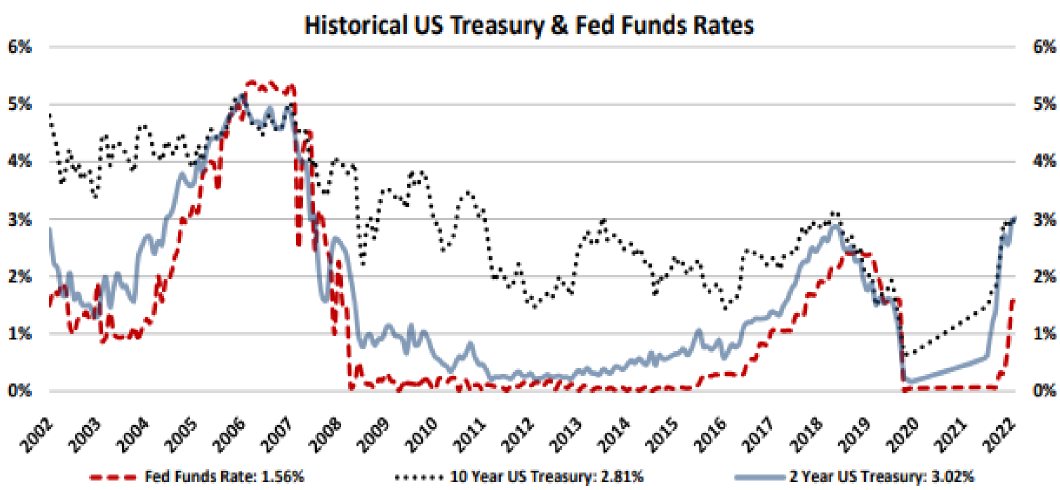
U.S. Treasury Interest Rates:

Interest rates have risen significantly in the last 90 days. Much faster than our initial projection at the start of the pandemic. The yield curve has risen and flattened quite a bit, resulting in the appearance that the FOMC will raise rates through year-end and reach nearly 3.40%



	3 Mo	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr
12/28/2012	0.03%	0.14%	0.25%	0.35%	0.71%	1.14%	1.70%
7/25/2022	2.44%	3.02%	3.02%	2.96%	2.89%	2.88%	2.81%
Change	2.41%	2.88%	2.77%	2.62%	2.18%	1.75%	1.11%

Looking at the yield curve over the long term allows us to understand the patterns.

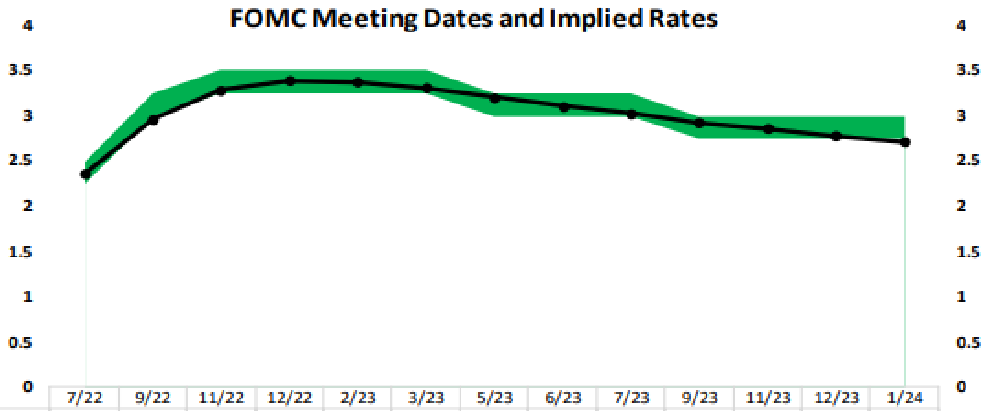


It is important to remember that the Federal Reserve bought an unprecedented amount of bonds during the pandemic (just over $6 trillion). As the FOMC starts to reduce its bond holdings it will potentially cause interest rates to rise more.

Short-Term Federal Funds:

The FOMC needs to increase the Federal Funds rate to slow inflation. The futures market is estimating that the Fed Funds rate will be between 3.50% and 3.75% by the end of 2022. We are projecting that the Fed Funds rate to reach 3.00% by year-end and then decline in 2023.

"The FOMC will raise rates to close to 3.25% this year."



	7/22	9/22	11/22	12/22	2/23	3/23	5/23	6/23	7/23	9/23	11/23	12/23	1/24
Upper Bound	2.50	3.25	3.50	3.50	3.50	3.50	3.25	3.25	3.25	3.00	3.00	3.00	3.00
Lower Bound	2.25	3.00	3.25	3.25	3.25	3.25	3.00	3.00	3.00	2.75	2.75	2.75	2.75
Implied Rate	2.363	2.96	3.283	3.387	3.371	3.307	3.202	3.106	3.025	2.927	2.86	2.781	2.713

Where Do We Go From Here?

The economy has surged with demand-based growth funded by the multitude of government stimulus checks. This cash is starting to run low for many and the surging costs due to inflation are using up extra cash.

The potential for a slow down or recession is growing every day. We expect that as the FOMC raises interest rates the economy will slow significantly.

First quarter 2022 GDP growth was negative 1.60%, and the first read of second quarter GDP is showing a decline of 0.90%. Two quarters of negative GDP growth are the base indicators of a recession. Technically to be in a recession the National Bureau of Economic Research will determine if we are in a recession. So, we may be in a recession as I type this. Either way, the economy is slowing to some degree.

This slowdown we are entering is going to be limited, as the average consumer has savings (possibly lower now with gas and food prices) and everyone has a job.

A few positive and negative issues are keeping me up at night.

<u>**What excites me:**</u>

- Investment yields surging
- Net interest margins growing
- Low loan losses

<u>**What bothers me:**</u>

- Loss of non-interest income from mortgages and PPP
- Food and gas prices rising
- Inflation
- Commercial loans on office space are starting to see defaults rising

<u>A focus on profitability is key.</u>

Interest Rate Projection for 2022 and 2023:

	Actual	Projected			
	6/30/2022	Sept-2022	Dec-2022	Mar-2023	June-2023
Federal Funds Rate	1.75	3.00	3.25	3.25	3.00
SOFER	1.50	2.75	3.00	3.00	2.75
Prime Rate	4.75	6.00	6.25	6.25	6.00
2-Year Treasury	2.95	3.25	3.55	3.40	3.00
5-Year Treasury	3.04	3.15	3.35	3.15	2.70
10-Year Treasury	3.01	3.10	3.25	2.95	2.45
GDP - Annualized	(1.60)	(0.25)	(0.10)	-	0.50
CPI-X-YPY	5.90	5.80	5.25	4.00	3.00

About McQueen Financial Advisors

McQueen Financial Advisors (MFA) is a leading nationwide provider of financial advisory services, 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

MFA provides the following services to financial institutions throughout the country:

Investment Portfolio Management: As an SEC Registered Investment Advisor, we 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: Quarterly, 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 MFA. We focus on credit to ensure that we can harness the benefit of credit spread products and take advantage of the additional yield, without taking unnecessary risk.

Asset Liability Management: MFA Asset Liability Management (ALM) 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.

Merger Valuations: MFA's Merger Valuation services are designed to provide you with the expertise, experience, and data to help you fully understand a potential transaction. We ensure that you understand the risks and rewards inherent in each unique opportunity.

Transaction Advisory: MFA transaction advisory professionals work with strategic buyers and sellers across the full spectrum of merger and acquisition engagements. We are committed to delivering meaningful insights, recommendations, and analyses on potential transactions to our clients.

CECL: The Current Expected Credit Loss (CECL) standard is the new accounting model for the recognition of credit losses for both loans and investments. For clients who choose to calculate CECL internally, we provide Loan-Level Details, Loss Severity, and Environmental Factors. For clients who choose to outsource their CECL solution, we provide a turnkey CECL solution.

Core Deposit Study: This report will be an integral part of your Asset Liability Management (ALM) 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: MFA 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. This report is designed to be easily understood and provide significant detail to allow for a comprehensive view of your liquidity position.

Assumption Stress Testing: MFA 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 backtesting report is to determine if the net interest income projection in your ALM report was reasonable. Our analysis focuses on volume and 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.

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