Sunwest Bank Economic Outlook

December 5, 2024

Last Year's Economic Predictions

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- **U.S. Economy:** The consumer will run out of gas and the U.S. will enter a recession that could turn into a hard landing; however, GDP will be lumpy with one potential positive quarter in 2024.
  - Outcome: Due to government spending and consumer spending remaining resilient the economy did not go into recession with positive GDP growth through each quarter.

- **Unemployment Rate:** Corporations will start to downsize in early 2024, and the unemployment rate will slowly lift through the year but remain slightly below 5%.
  - Outcome: Employment clearly softened, and the unemployment rate rose to 4.4% before a recent correction down to 4.1%. However, employment data has been erratic.

- **Interest Rates:** The Fed at most will have one more 25 basis point increase and will be forced to cut rates at some point in mid to late-2024, but do not expect rate cuts of more than 75 basis points in 2024 unless a global crisis ensues.
  - Outcome: The Fed did not have another 25 basis point increase, and they have cut rates 75 basis points so far in September and October of 2024.

- **Fed Balance Sheet:** Fed will continue with Quantitative Tightening (QT) through the remainder of 2023 and will be forced to stop again in the first half of 2024.
  - Outcome: The Fed continued Quantitative Tightening throughout 2023 and reduced the pace of runoff from $90 to $60 billion in June.

Last Year's Asset Value Predictions

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- **U.S. Equities:** The equity market will have a selloff by 15% in the next 6 months as investors realize that the country will be entering a recession. Once the Fed indicates that it will pivot, the equity markets will have a moderate rally.
  - Outcome: Equities saw no selloff as a recession never materialized and the market had one of its all-time best years fueled by liquidity and the Fed reducing rates.

- **Fixed Income:** The bond markets, after having three consecutive down years, will reverse course and have a positive year in 2024.
  - Outcome: Bond markets have had a strong year in 2024.

- **Residential Real Estate:** Housing values will continue to decline by up to 10% but will again remain more resilient because of limited supply.
  - Outcome: Housing values increased largely driven by limited supply, but certain high growth markets like Austin, Las Vegas, and many markets in Florida have seen 10% declines.

- **Commercial Real Estate:** CRE values will continue to decline through 2024 as foreclosures and distress sales will become a significant part of transaction volumes. Multi-family will surprise to the downside given its outperformance over the past decade.
  - Outcome: Commercial real estate values largely declined. Distressed sales occurred primarily in office. Multi-Family saw a spike in delinquencies and defaults. Retail and industrial saw the least stress.

Last Year's Political and Global Predictions

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- **Presidential:** Joe Biden will not be President after the next election. **It is my only strong conviction.**
  - Outcome: Joe Biden was pushed out of the race in July and Donald Trump was elected President.

- **Senate:** Republicans will re-take the Senate with West Virginia, Montana, and Ohio flipping back into Republican hands, garnering them a one seat majority. The Republicans have a decent chance of winning up to three additional seats.
  - Outcome: West Virginia, Montana, and Ohio all elected Republican senators and Republicans picked up one additional seat in Pennsylvania. Unfortunately, not Wisconsin.

- **House of Representatives:** There will be losses and gains by incumbents of both parties, but the Republicans will retain a modest majority.
  - Outcome: Republicans retained a modest majority as they have 220 seats versus 214 for the Democrats.

- **Global:** There is over a 50% chance that China blockades Taiwan.
  - Outcome: China has yet to blockade Taiwan but continues to add pressure and engage in military activities around Taiwan. Further, China has become very aggressive in other parts of the South China Sea.

Politicians Kept the Party Going

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Government Deficit Spending Kept the Economy Afloat

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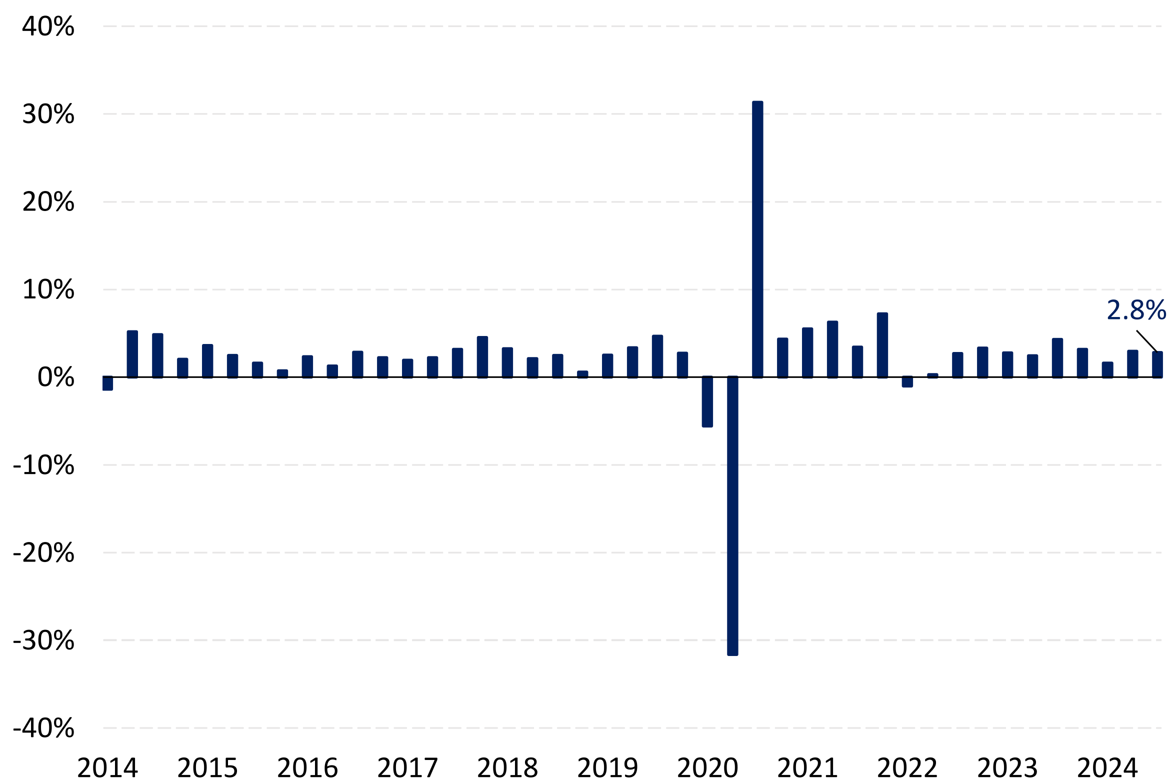
- Real GDP remained resilient in 2024, growing at an average annualized rate of 2.5% through three quarters (+1.6% in Q1, +3.0% in Q2, and +2.8% in Q3).
- Government spending has largely kept the economy afloat as federal outlays totaled $6.7 trillion in FY 2024, a 10% increase from FY 2023 and $71 billion short of being the most expensive fiscal year on record (FY 2021).
- Consumer spending has also remained resilient as personal consumption expenditures (PCE) have grown at an average rate of 2.5% in 2024.

U.S. Real Gross Domestic Product QoQ Change (%)



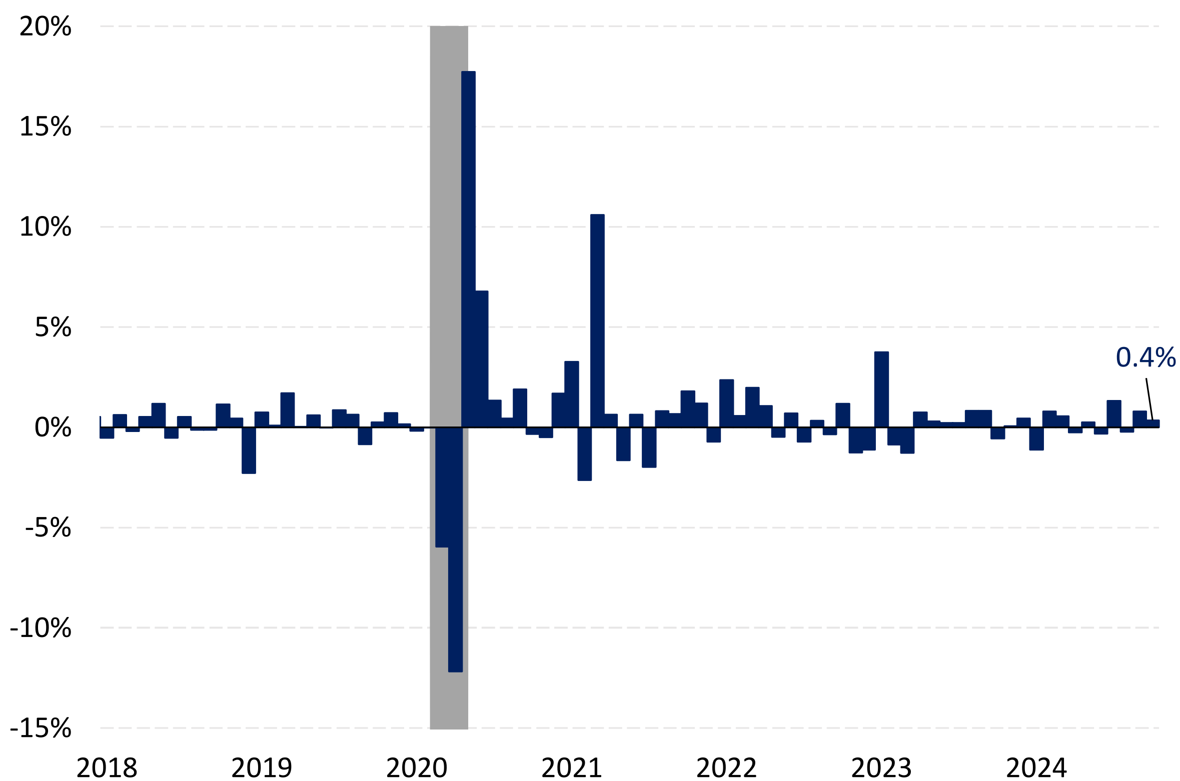
Source: Bureau of Economic Analysis

Consumer Spending Tempered but Steady

- Total consumer spending has increased 2.1% YTD through October. This represents the lowest YTD increase through October since 2015.

Kind of Business	Adjusted YoY (%)
Non-Store Retailers	7.0%
Food Services Places	4.3%
Motor Vehicle and Parts Dealers	3.4%
Retail and Food Services	2.8%
Food & Beverage Stores	2.7%
Health & Personal Care Stores	1.6%
Furniture Stores	1.5%
Electronics & Appliance Stores	-2.3%
Gas Stations	-7.0%

U.S. Retail Sales MoM Change (%)



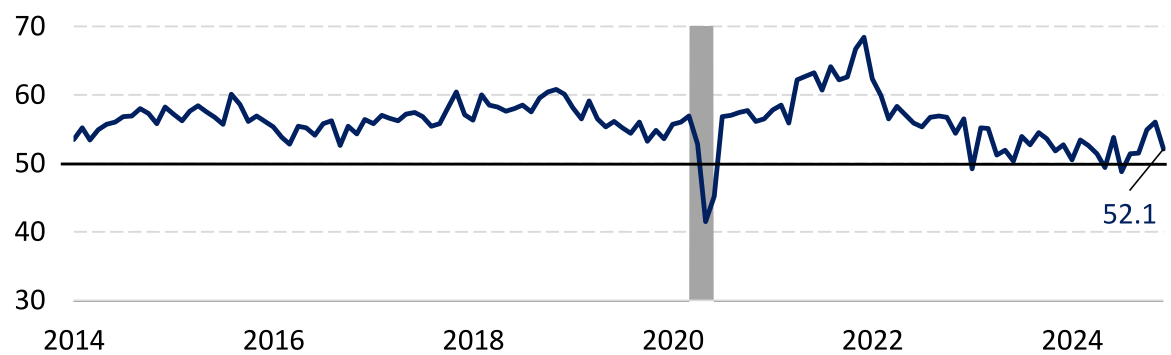
Grey Bars Indicate Recession

Source: U.S. Census Bureau

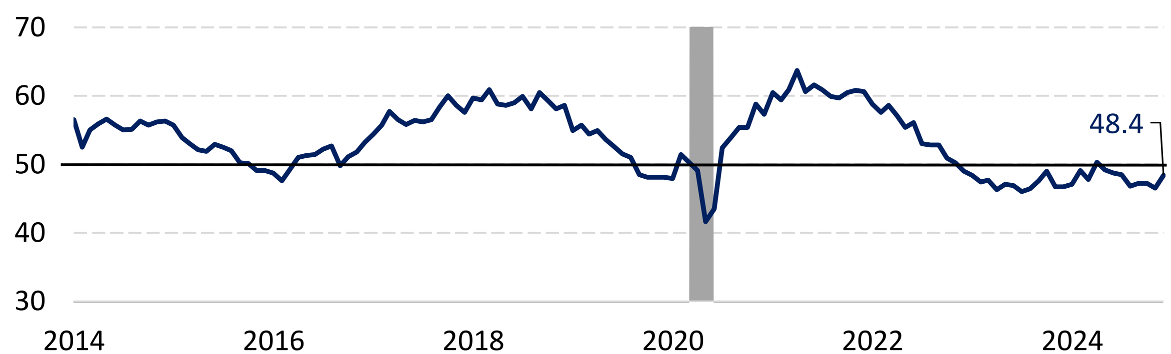
Services and Manufacturing Stayed Bifurcated

- The service sector has been in expansion while the manufacturing sector has largely been in recession over the past two years.
- Services continues to remain resilient as it has expanded in all but three months over the past four years. The current measurement is at 52.1.
- Manufacturing continues to contract as only one month over the previous two years has shown expansion. Currently, manufacturing has a measurement of 48.4.

U.S. ISM Services PMI



U.S. ISM Manufacturing PMI



Grey Bars Indicate Recession

Source: Institute for Supply Management

Four Main Reasons the Economy Remained Resilient

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Federal Spending

Consumer Debt Binge

Illegal Immigration

Equity Market Boom

Federal Government Outlays Continued to Break Records

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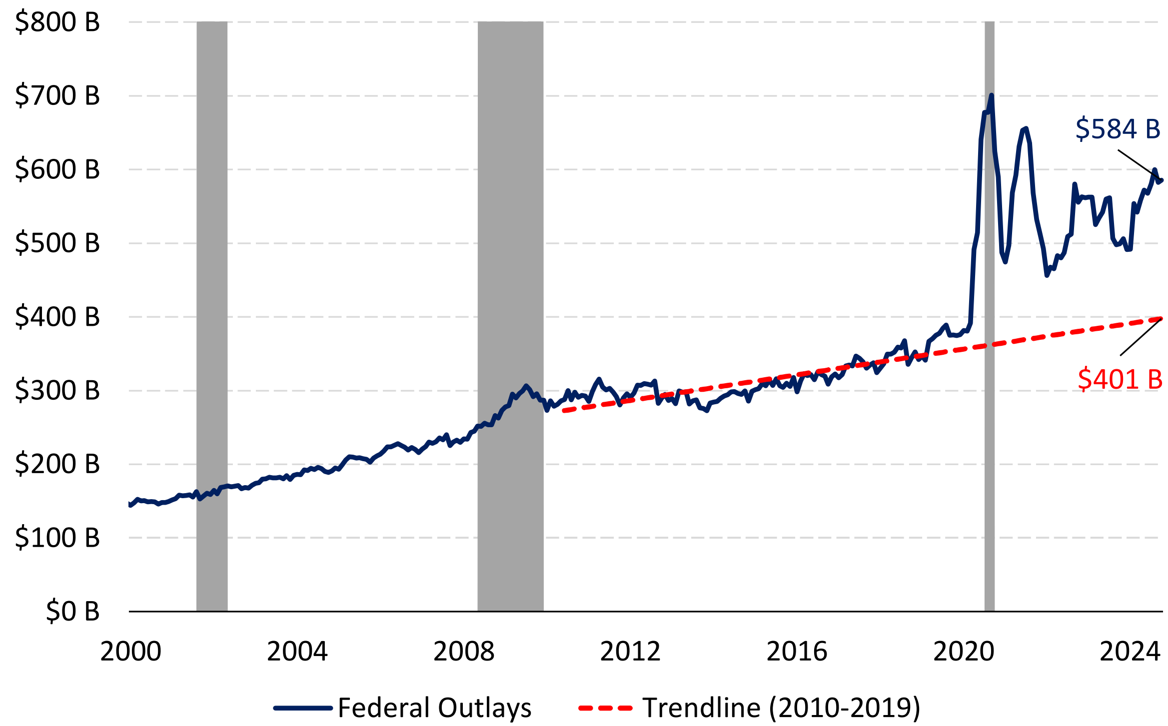
- In FY 2024 the federal deficit was $1.8 trillion. This accounted for **6.2%** of Real GDP output.
- In October 2024, the first month of the 2025 Fiscal Year, total federal outlays were $584 billion. This represents the highest start to a fiscal year in our country's history.
- The last 12 months have seen federal outlays of **$6.9 trillion** compared to receipts of just $4.8 trillion.
- Based on the trendline from 2010 through 2019, the United States has overspent on federal outlays in total by approximately **$10 trillion** since 2020.

Total Federal Outlays 6-Month Moving Average (in $ billions)



Grey Bars Indicate Recession

Source: Department of the Treasury

Biden Admin Timed the Spend of COVID Money

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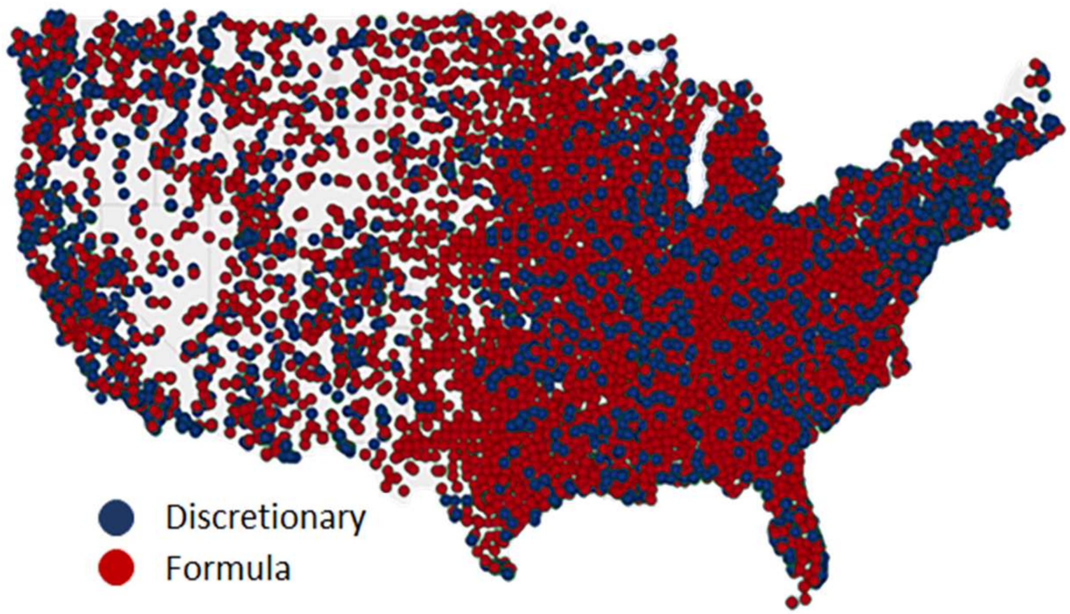
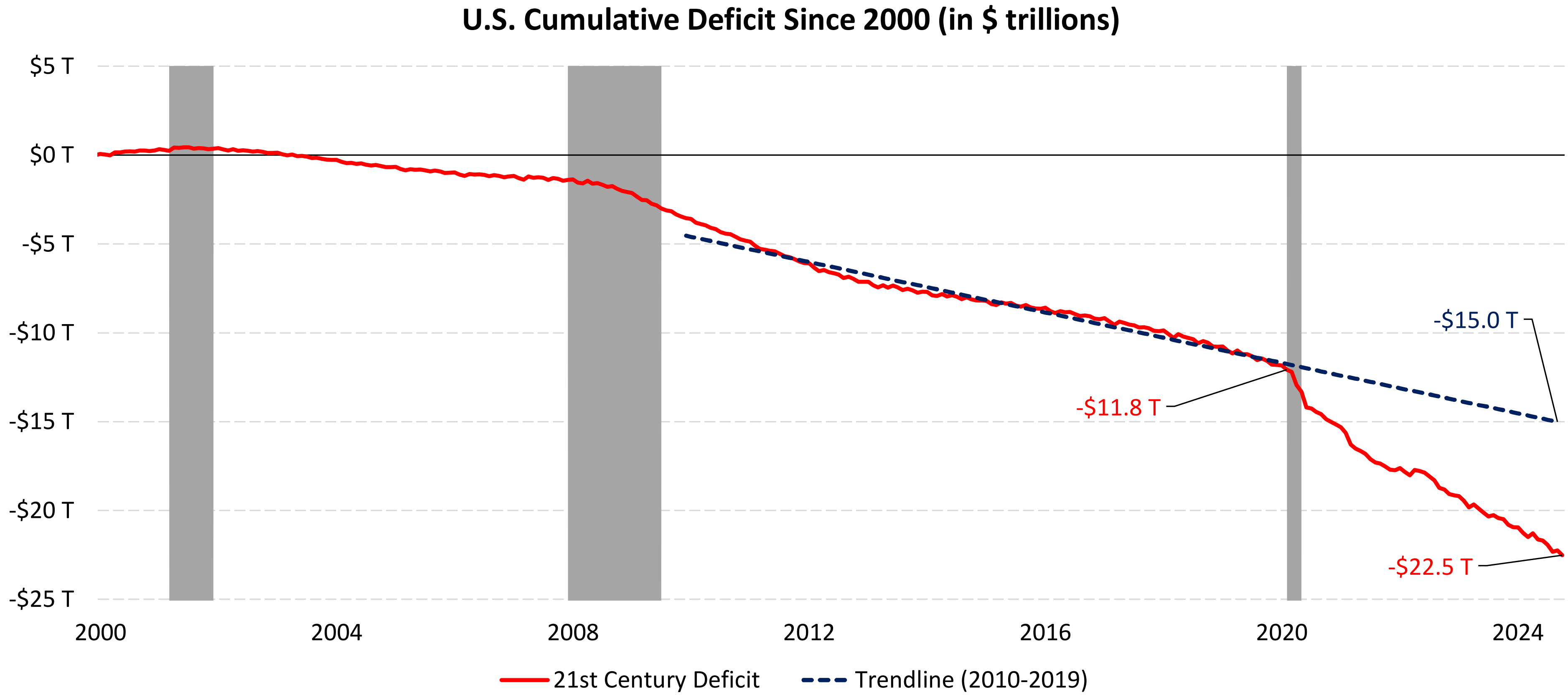
CARES Act March 2020	$2.2 TRILLION
Consolidated Appropriations Act December 2020	$900 BILLION
Other Related 2020 Spending	$400 BILLION
American Rescue Plan Act March 2021	$1.9 TRILLION
Infrastructure Investment and Jobs Act November 2021	$1.2 TRILLION
The CHIPS and Science Act August 2022	$280 BILLION
Inflation Reduction Act August 2022	$437 BILLION
Total as of December 2024	**$7.32 TRILLION**



Source: WhiteHouse.gov

U.S. Deficits Exploded



Grey Bars Indicate Recession

Source: Department of the Treasury

Consumer Debt Kept Setting New Highs

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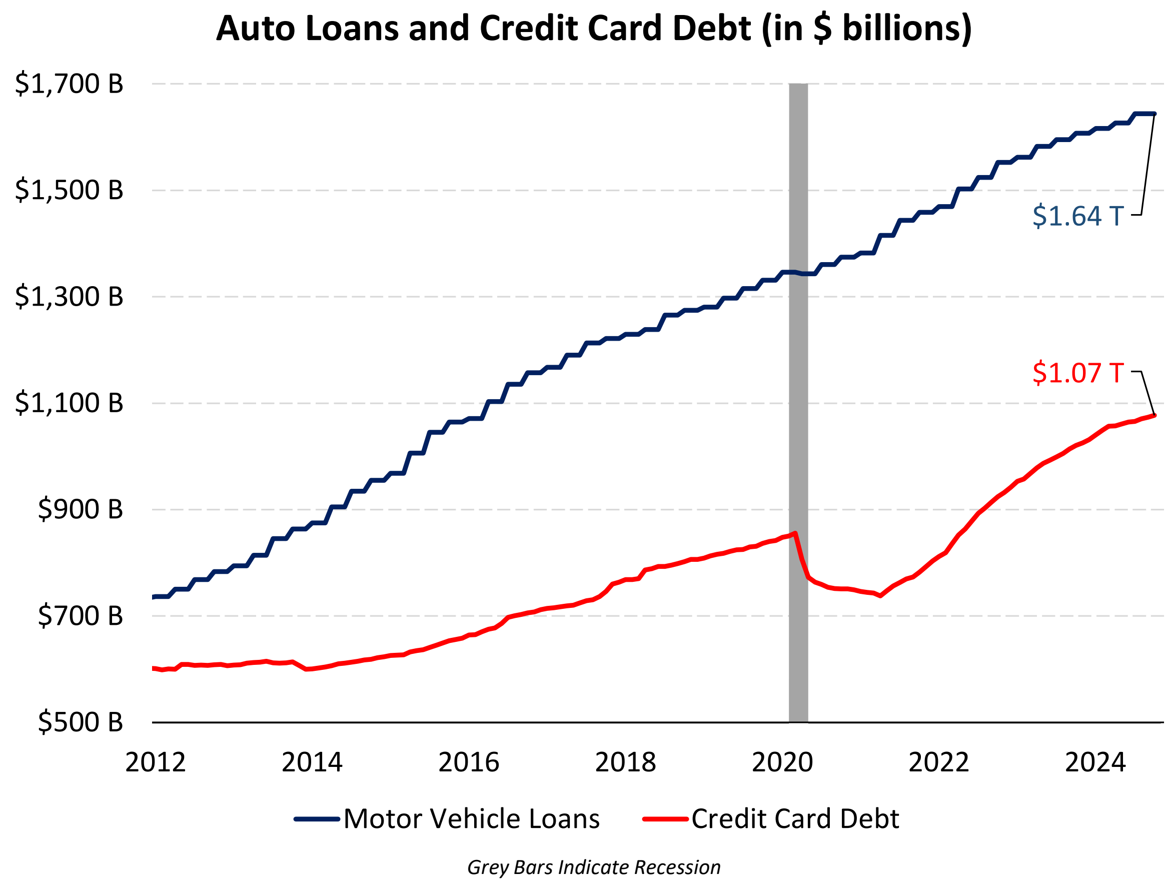
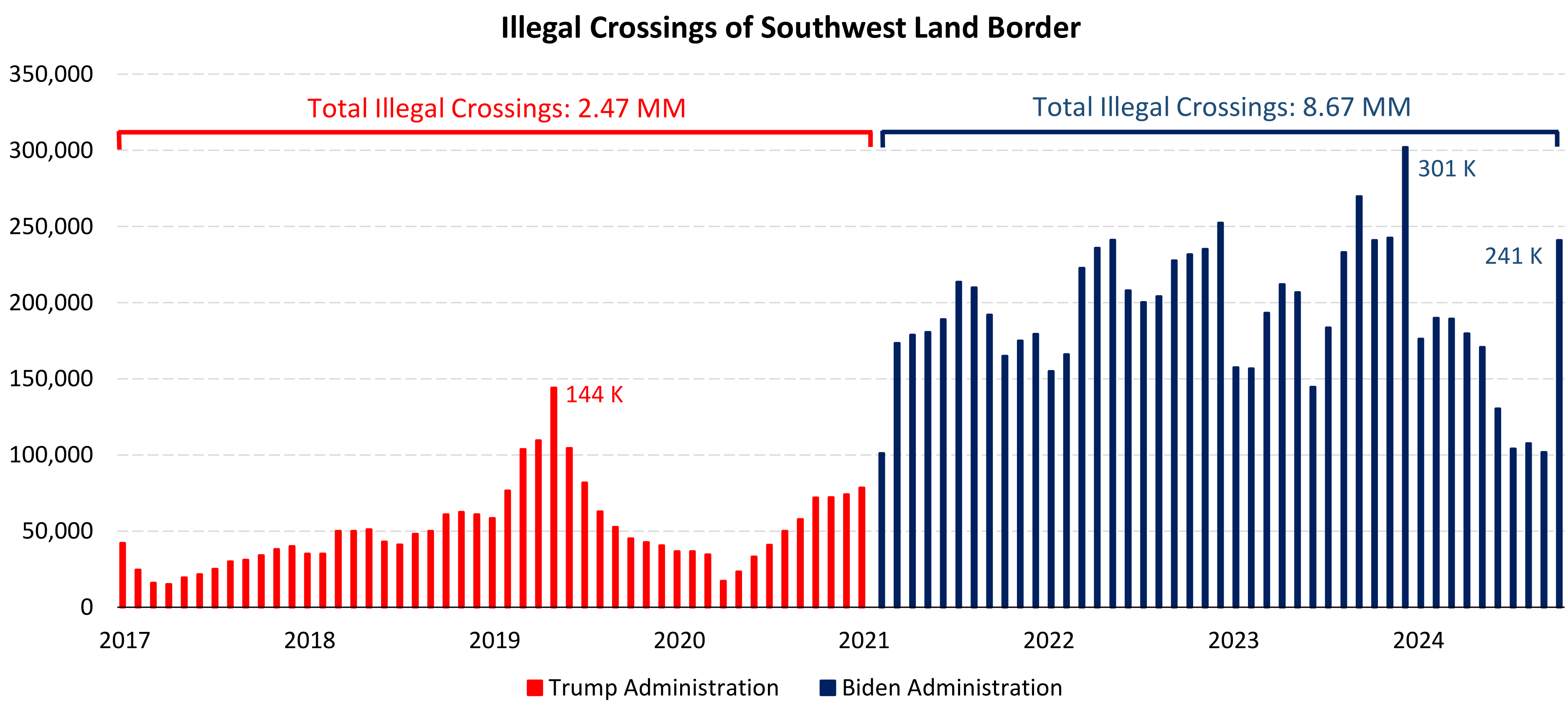
- Americans continue to spend at an unsustainable pace as consumer credit card debt has exploded to $1.07 trillion. Consumer credit card debt has increased for 43 consecutive months, and a new record high has been reached in each of the last 30 months.
- In addition to credit card debt, total auto loans have increased 17 consecutive quarters and are now at a record high of $1.64 trillion.
- The percentage of Americans who used a Buy Now Pay Later program grew to 13.6% in 2023.



Source: St. Louis Federal Reserve, New York Fed Consumer Credit Panel/Equifax

Illegal Immigration Brought Major Problems but Supported GDP Growth



Source: U.S. Customs and Border Protection

Equity Markets Partied Like It's 1999

Equities Rallied in 2024 Driving High End Consumer Spend

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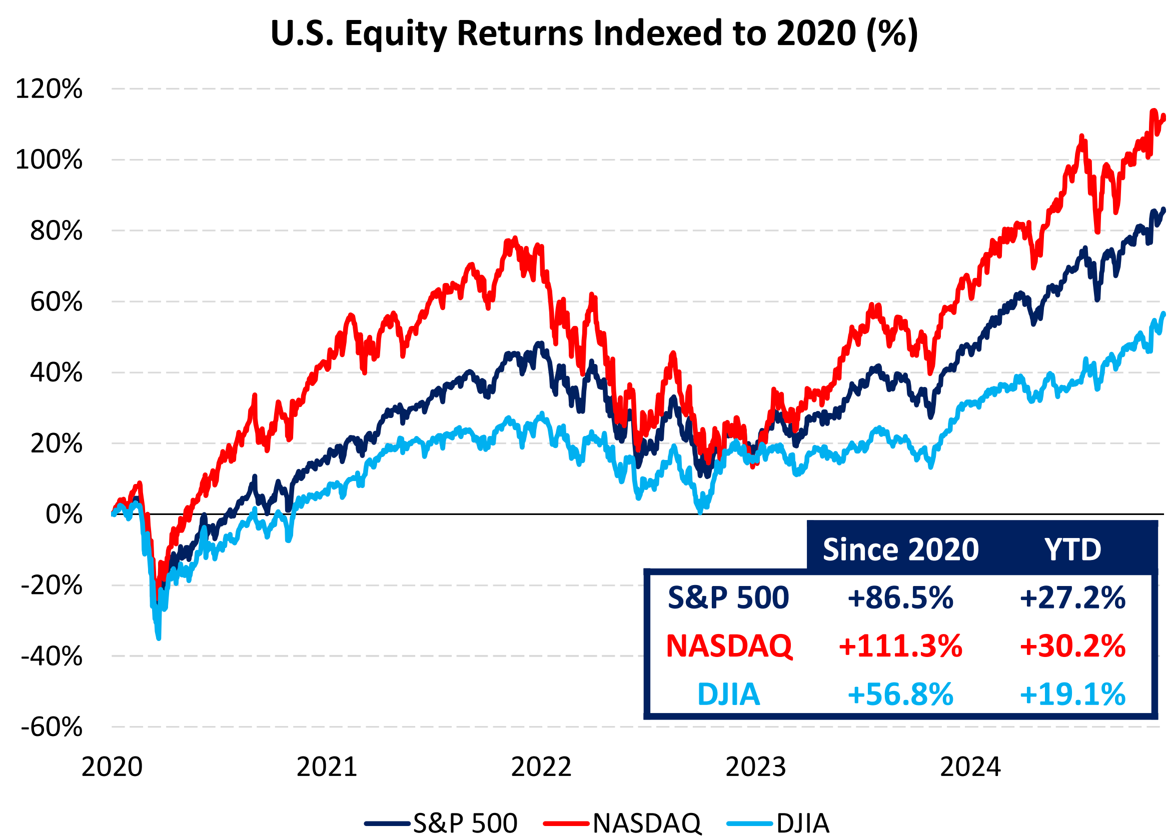
S&P 500 Sector Performance YTD	
Financials	+36.02%
Communication Services	+34.21%
Information Technology	+34.19%
Utilities	+30.07%
Consumer Discretionary	+26.19%
Industrials	+25.84%
Consumer Staples	+18.18%
Energy	+13.13%
Real Estate	+11.97%
Materials	+10.19%
Health Care	+7.76%



	Since 2020	YTD
S&P 500	+86.5%	+27.2%
NASDAQ	+111.3%	+30.2%
DJIA	+56.8%	+19.1%

Source: Yahoo Finance, Fidelity

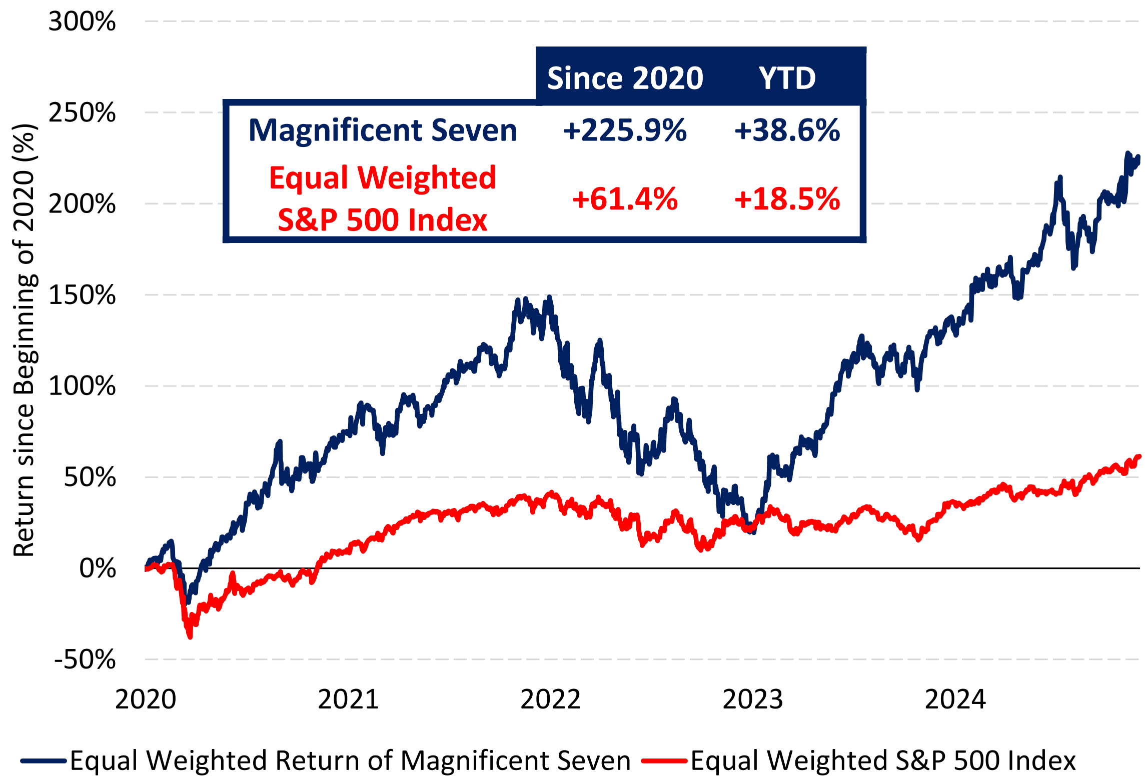
The Mag-7 Is Still Driving Overall Equity Returns

Company	Market Cap	P/E LTM
Apple	$3.66 T	39.8x
Nvidia	$3.53 T	56.9x
Microsoft	$3.24 T	36.0x
Amazon	$2.29 T	46.6x
Alphabet	$2.14 T	23.1x
Meta	$1.54 T	28.8x
Tesla	$1.13 T	96.4x

- In the first half of 2024, the Magnificent Seven generated roughly 60% of the S&P 500's overall return
- The Magnificent Seven accounted for more than half of the S&P 500's gain in 2023.

Return from Magnificent Seven Stocks vs. S&P 500 (%)

	Since 2020	YTD
Magnificent Seven	+225.9%	+38.6%
Equal Weighted S&P 500 Index	+61.4%	+18.5%



Source: Yahoo Finance, S&P Capital IQ

Equities Entered Another Bubble

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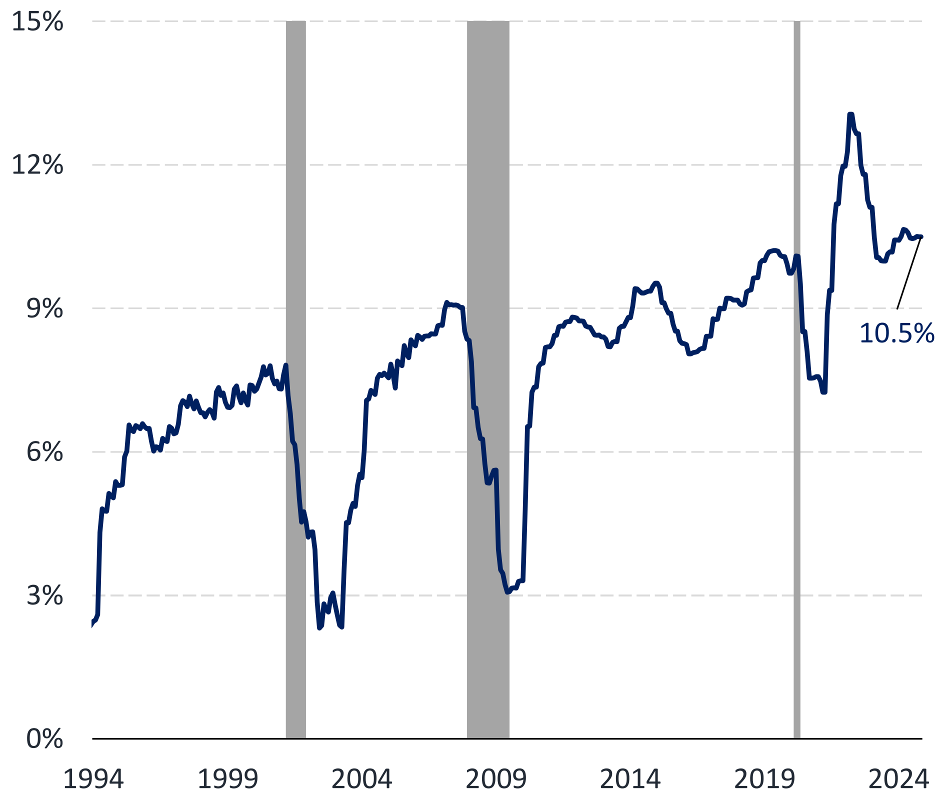
S&P 500 Forward P/E Ratio (x)

S&P 500 Profit Margins (%)



Grey Bars Indicate Recession

Source: Bloomberg

The Buffett Indicator Shows Equities Grossly Overvalued

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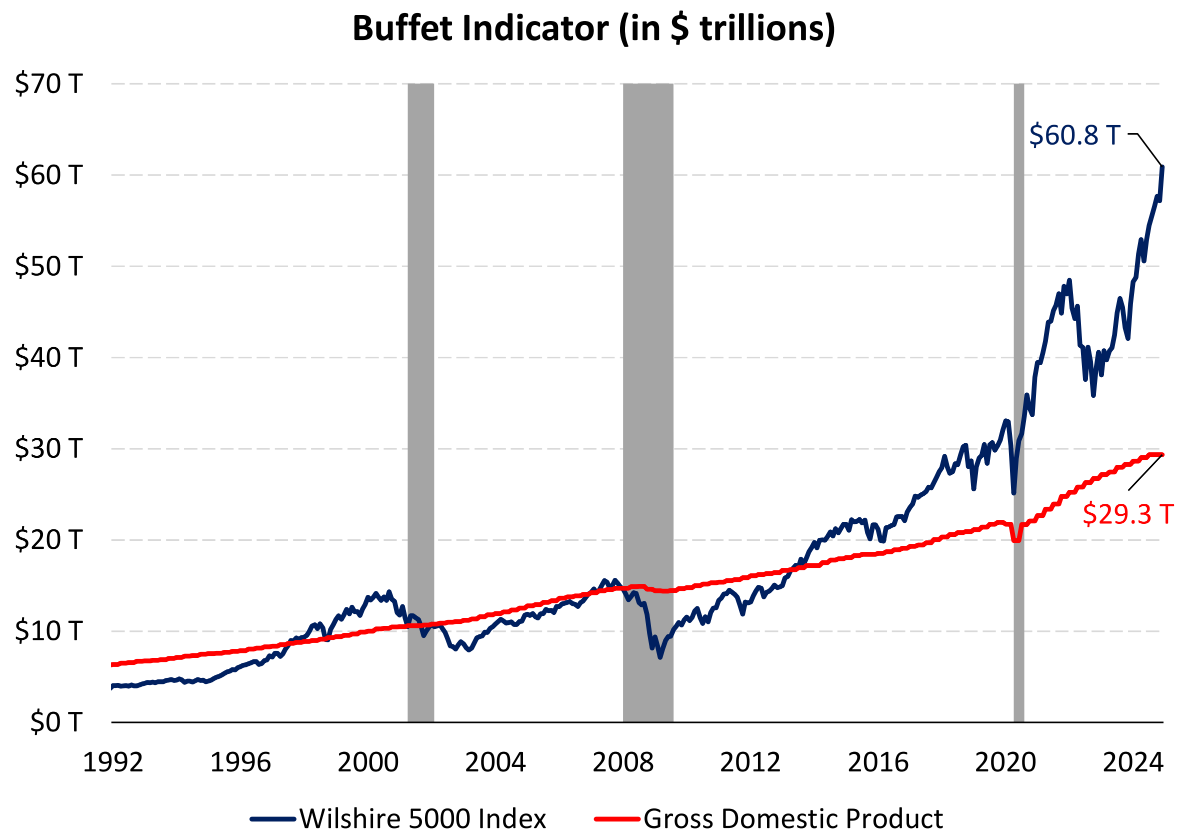
- The Buffett Indicator is a stock market valuation metric that compares the total market capitalization of a country's publicly traded stocks to its GDP. A ratio above 100% suggests the stock market is overvalued while a ratio below 100% suggests that the stock market is undervalued.

- Currently, the United States has a Buffet Indicator ratio of **207%** and has not been under 100% since 2013.

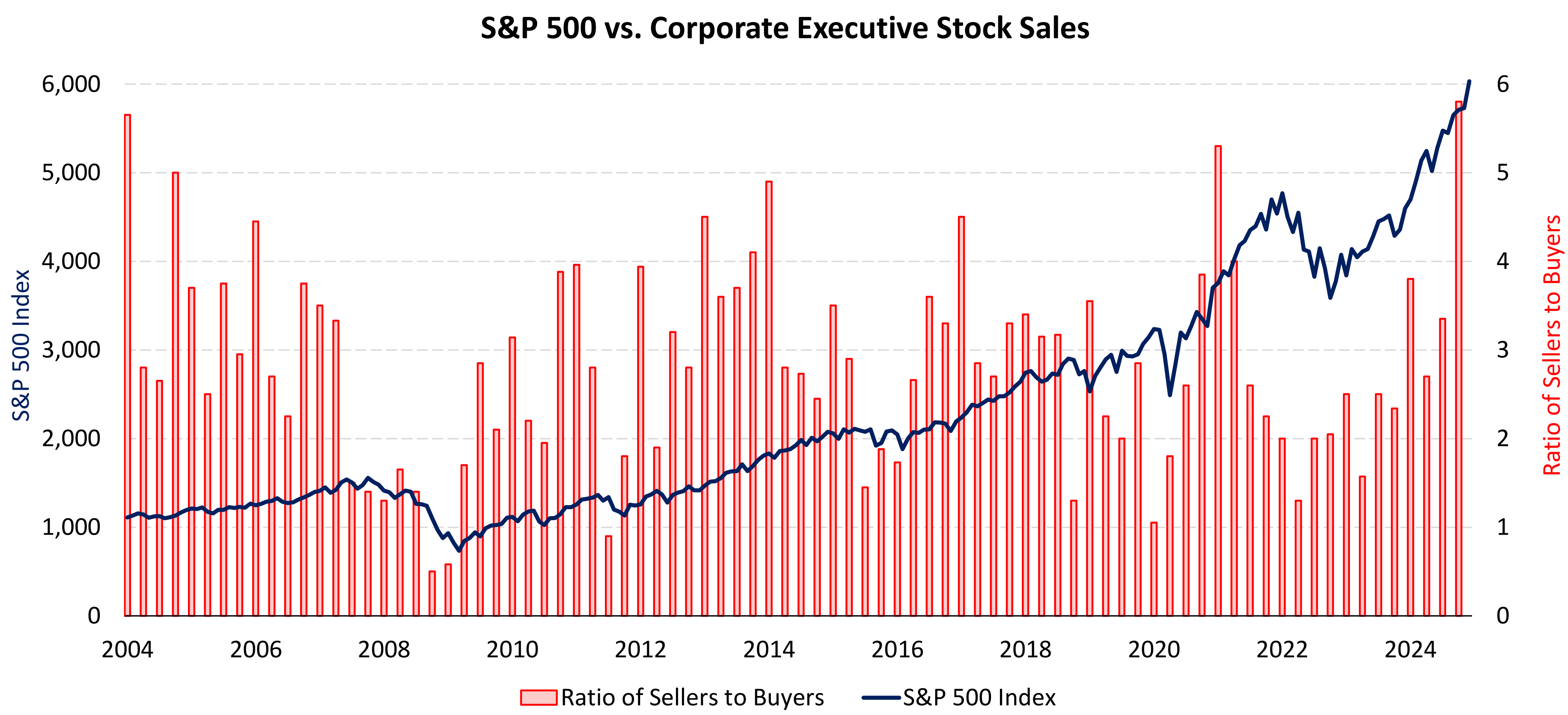
- Warren Buffett's Berkshire Hathaway has liquidated large shares of public equities and now holds over $325 billion in cash, representing 28.3% of equity.



Grey Bars Indicate Recession

Source: Yahoo Finance, Bureau of Economic Analysis

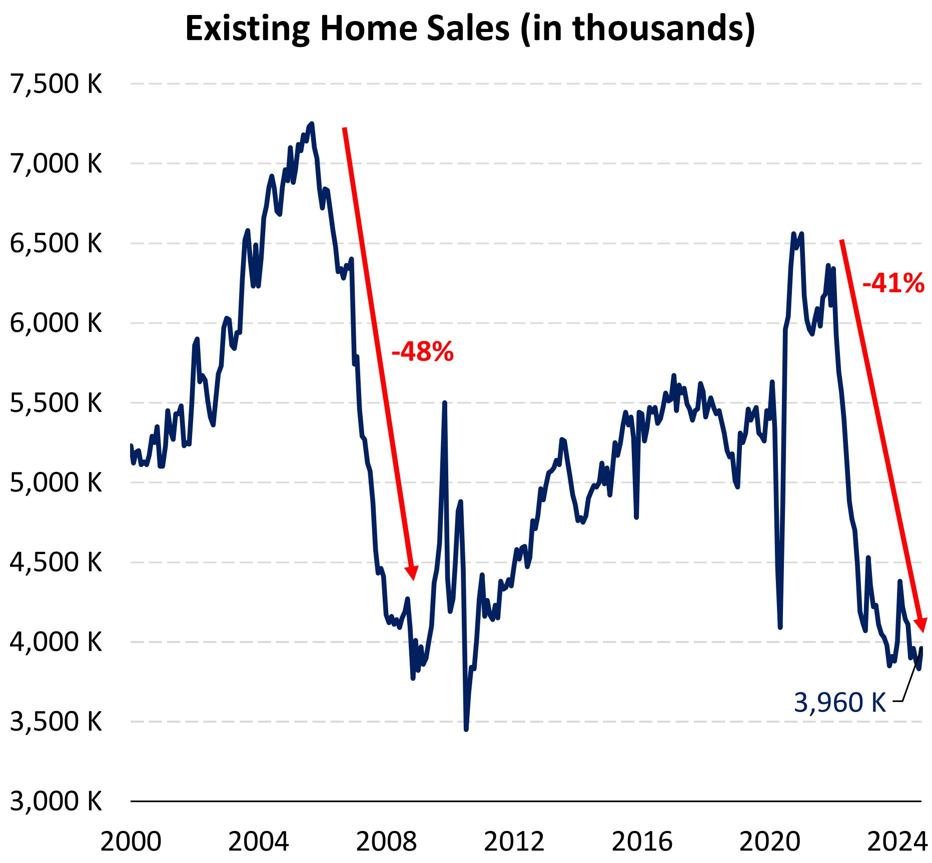
Corporate Insiders Sold Shares at Record Numbers

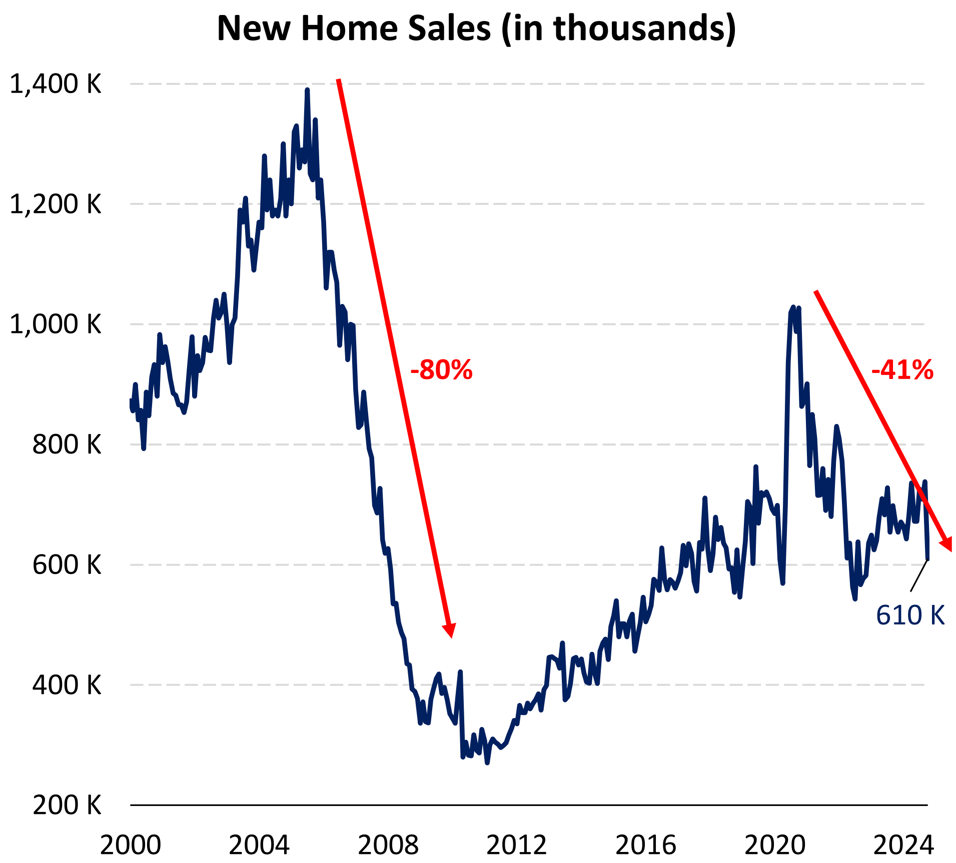


Source: Financial Times, Bloomberg

The Housing Market Is Frozen

Housing Sales Activity Collapsed but for New Homes

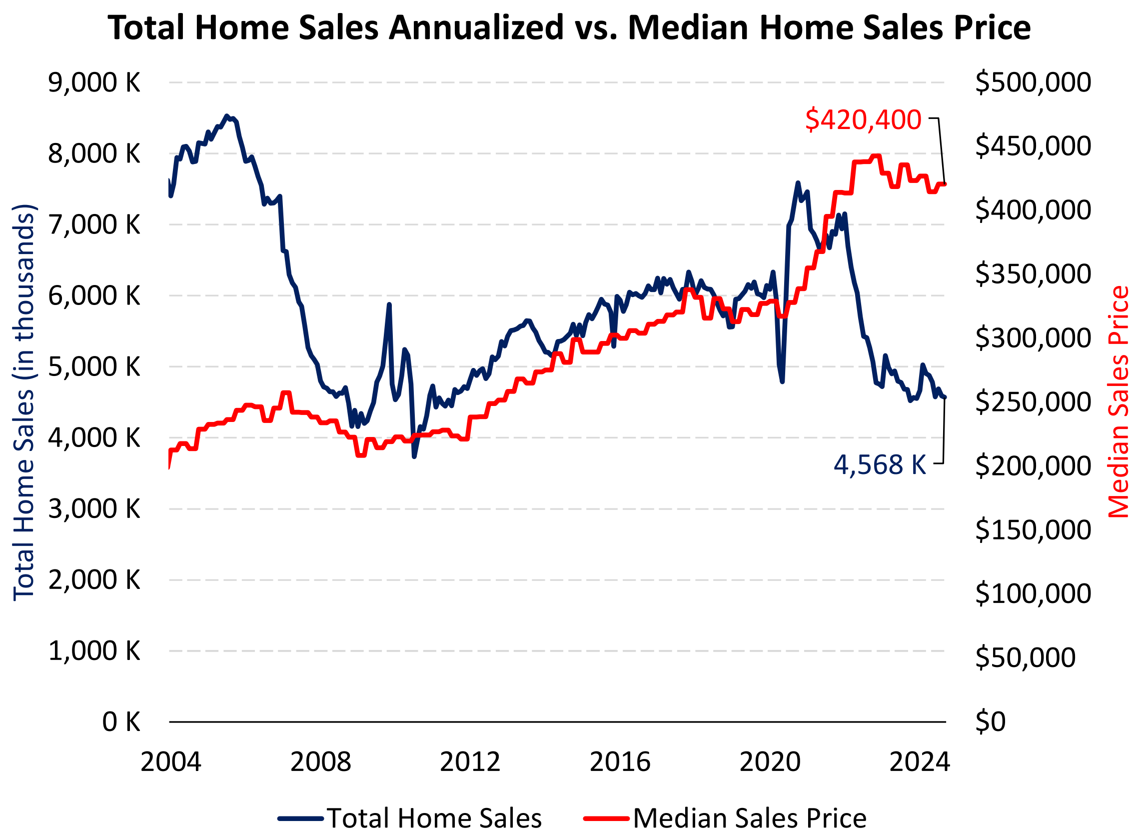




Source: National Association of Realtors

High Prices & Low Inventory Cratered Sales

- The housing market is experiencing a significant imbalance, as housing prices remain near record highs, even as sales volumes continue to plummet.
- Existing home sales have fallen to levels seen at the height of the housing crash.
- The collapse in sales in 2008 was caused by a flood of sellers with broken mortgages with very limited buyers. Today it is due to a lack of sellers with a younger generation desperately trying to own a home.



Source: National Association of Realtors, U.S. Census Bureau, U.S. Department of Housing and Urban Development

Locked-in Low Rates Suppress Inventory

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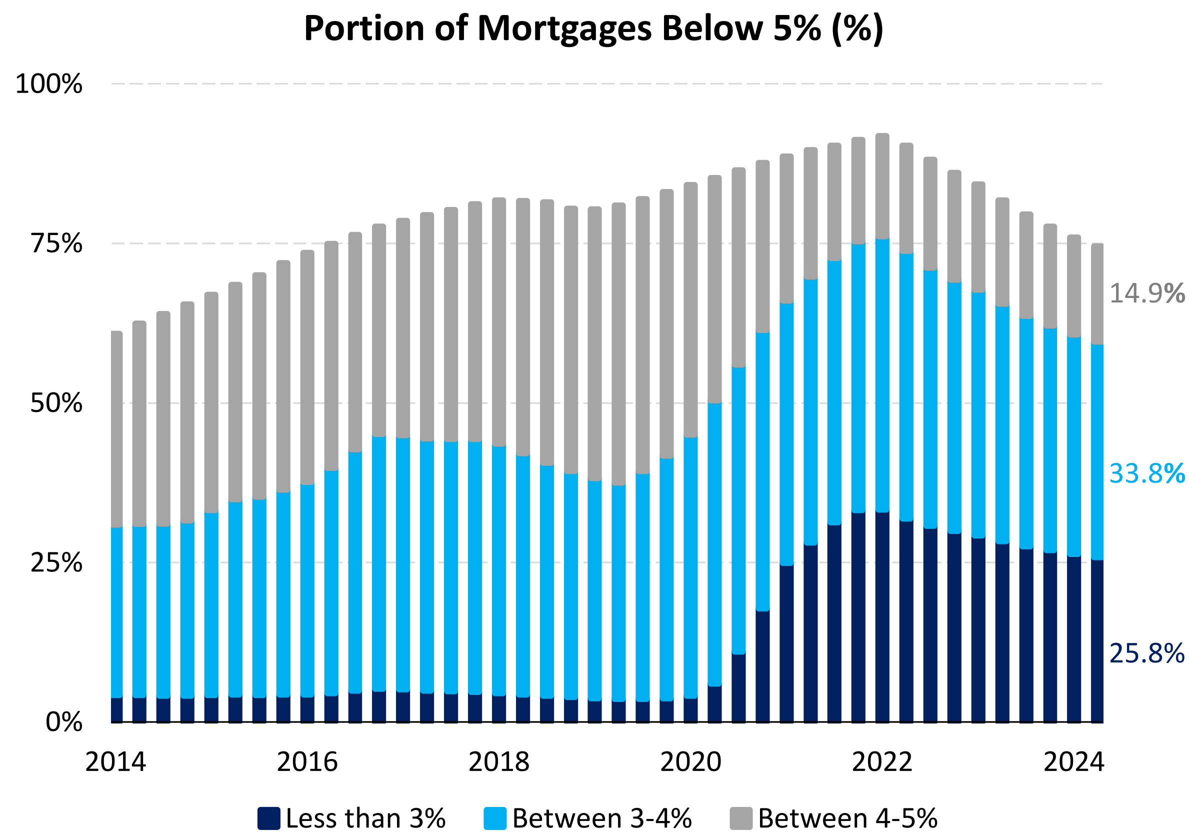
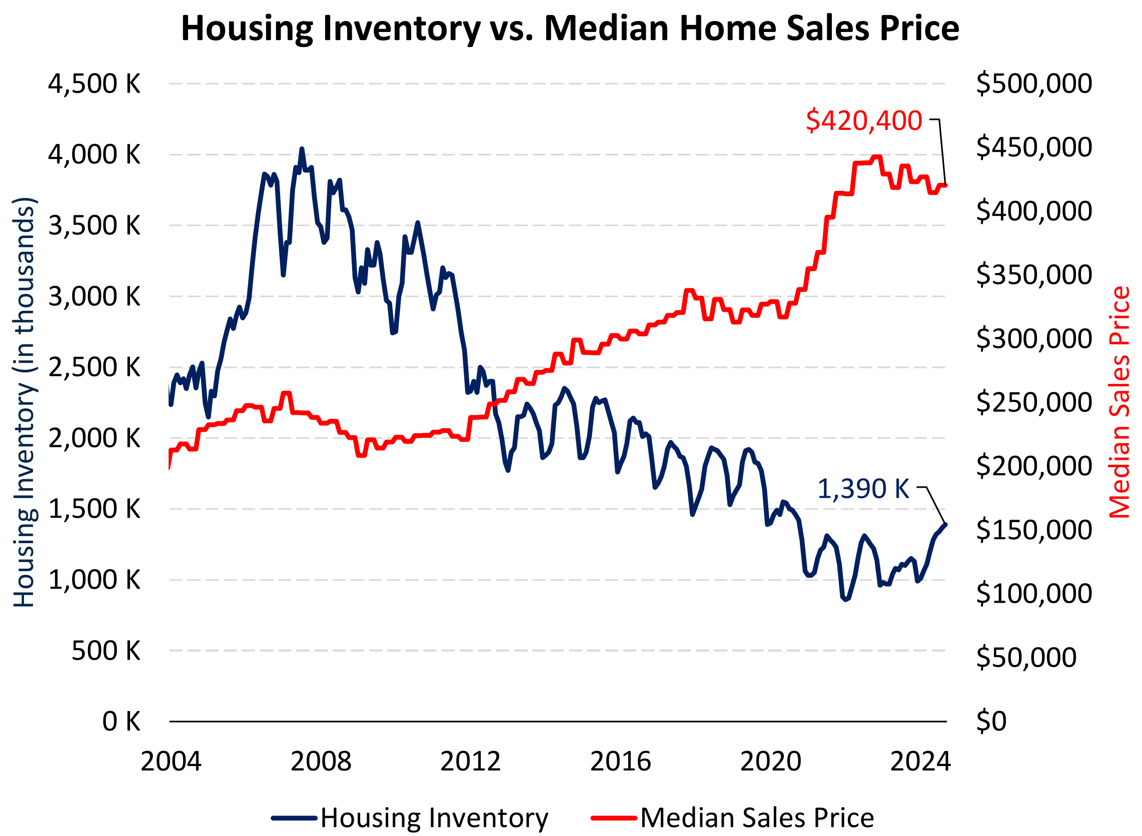
- Nearly 14 million mortgages were refinanced between Q2 2020 and Q4 2021. The average 30-Year Fixed Rate Mortgage was 2.97% during this time.
- As of Q2 2024, approximately 73% of all outstanding mortgages are less than 5% while 60% are less than 4%.
- The 30-Year Fixed Rate Mortgage has been above 5% since April 2022. Previously, it had remained below 5% for 581 consecutive weeks (11 years) leading up to April 2022.



Source: Federal Housing Finance Agency

Depressed Inventory Kept Prices Elevated

- Even with the increase in interest rates, the median home sales price remains near all-time highs due to near record low housing inventory.
- A shift may be starting with housing inventories having increased in the last few months, since its low in February 2022, housing inventory has increased 520,000. Increasing supply could cause housing prices to drop.
- Housing inventory will likely increase not only for the main reasons one would sell a home (death, divorce, job loss/change) but further a rapid rise in property taxes and homeowner insurance is starting to negatively impact many.



Source: National Association of Realtors, U.S. Census Bureau, U.S. Department of Housing and Urban Development

Homes Are Unaffordable and Require a Record Household Income

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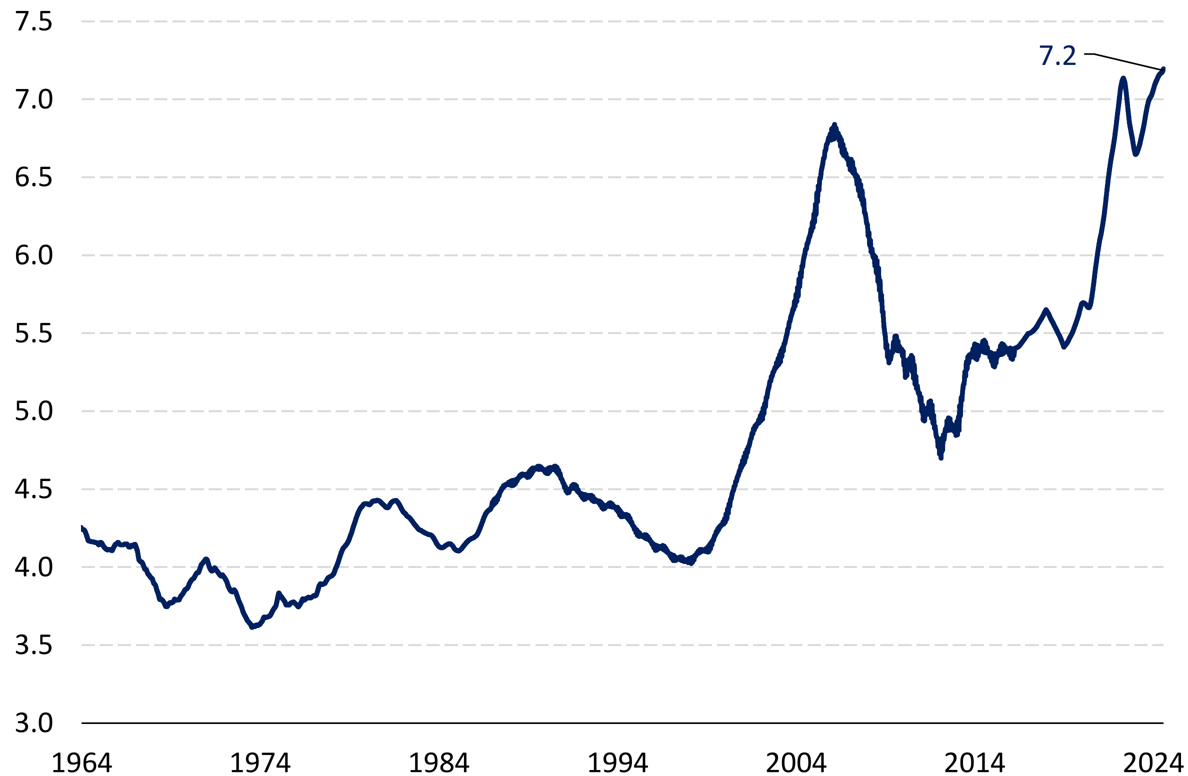
- Housing has become even less affordable than it was during the peak of the housing bubble in 2006. It reached 6.8 times yearly household income and today is at 7.2.

- The median sales price of a house sold in the U.S. has increased 34% since the beginning of 2019. Real median household income has decreased 1% over that same time period.

- From 1959 to 2002, the average cost of a house in the U.S. was less than 5 times the yearly household income.

Home Price to Median Household Income Ratio

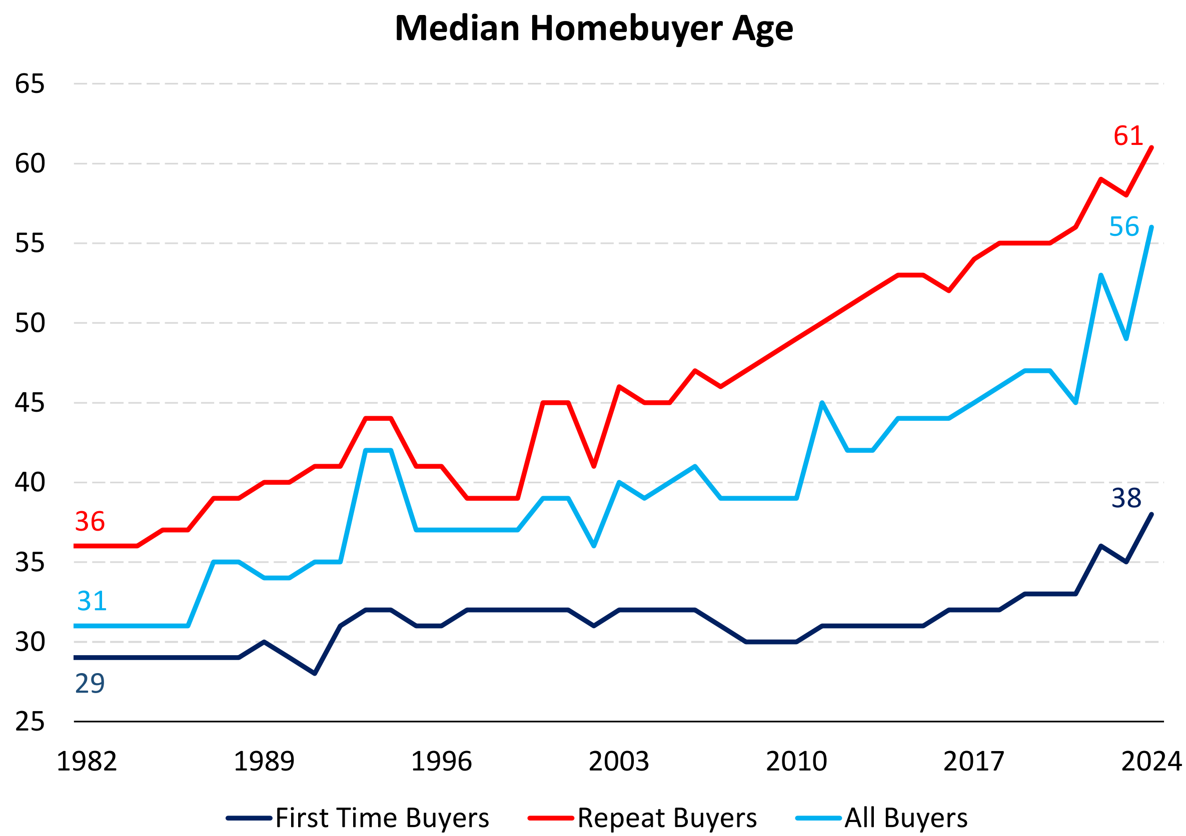


Source: St. Louis Federal Reserve, U.S. Census Bureau

Younger People Are Being Priced Out of the Market

- For the year ending July 2024, the median age of first-time home buyers rose from 35 to 38, while the share of first-timers dropped from 32% to 24% of all buyers.

- An 18% down payment, the median percentage buyers put down, on a $435,000 home comes to $78,300. For context, the U.S. median household income in 2023 was $80,610.



Source: National Association of Realtors

Commercial Real Estate Continues to Be Stressed

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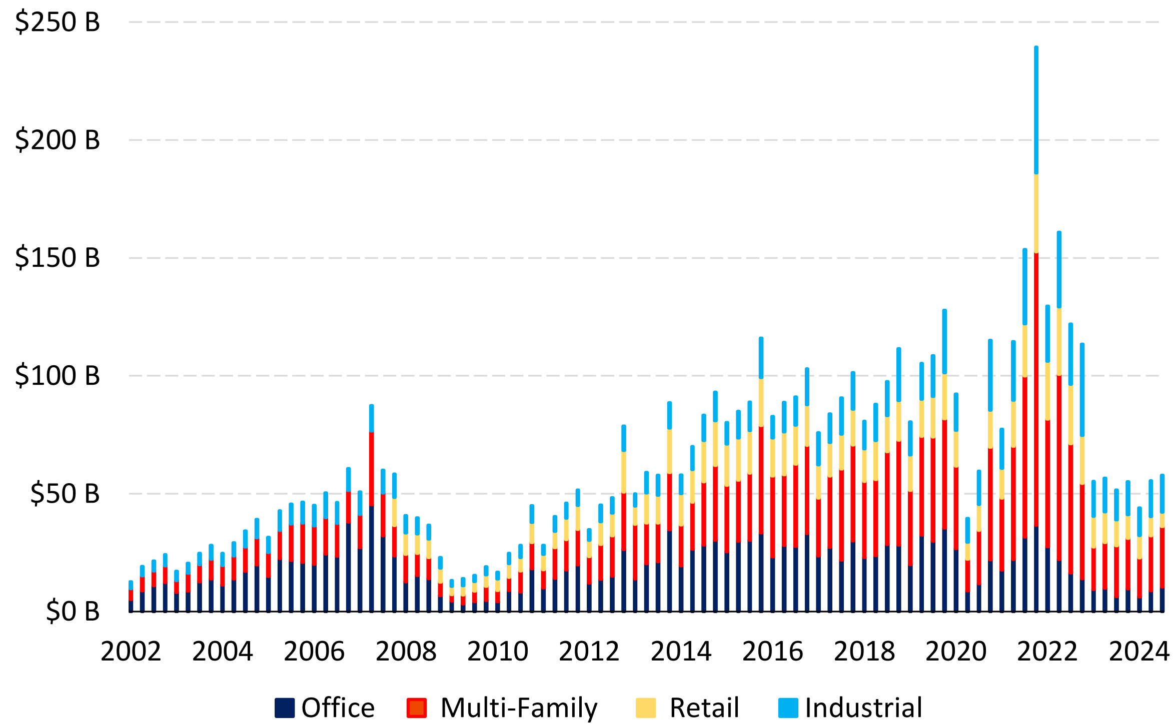
CRE Transaction Volumes Have Yet to Recover

- After peaking at $239 billion in Q4 2021, total commercial real estate transaction values have fallen to just $43 billion in Q1 2024.
- Transaction values of Office CRE totaled only $6 billion in Q1 2024, the lowest since the Great Financial Crisis, driven by collapsing CRE values in many urban hubs.
- As distress sales increase there is enormous amounts of investment capital that is ready to be deployed.

Total Commercial Real Estate Transaction Volumes (in $ billions)



Source: CoStar

CRE Cap Rates Found Some Equilibrium

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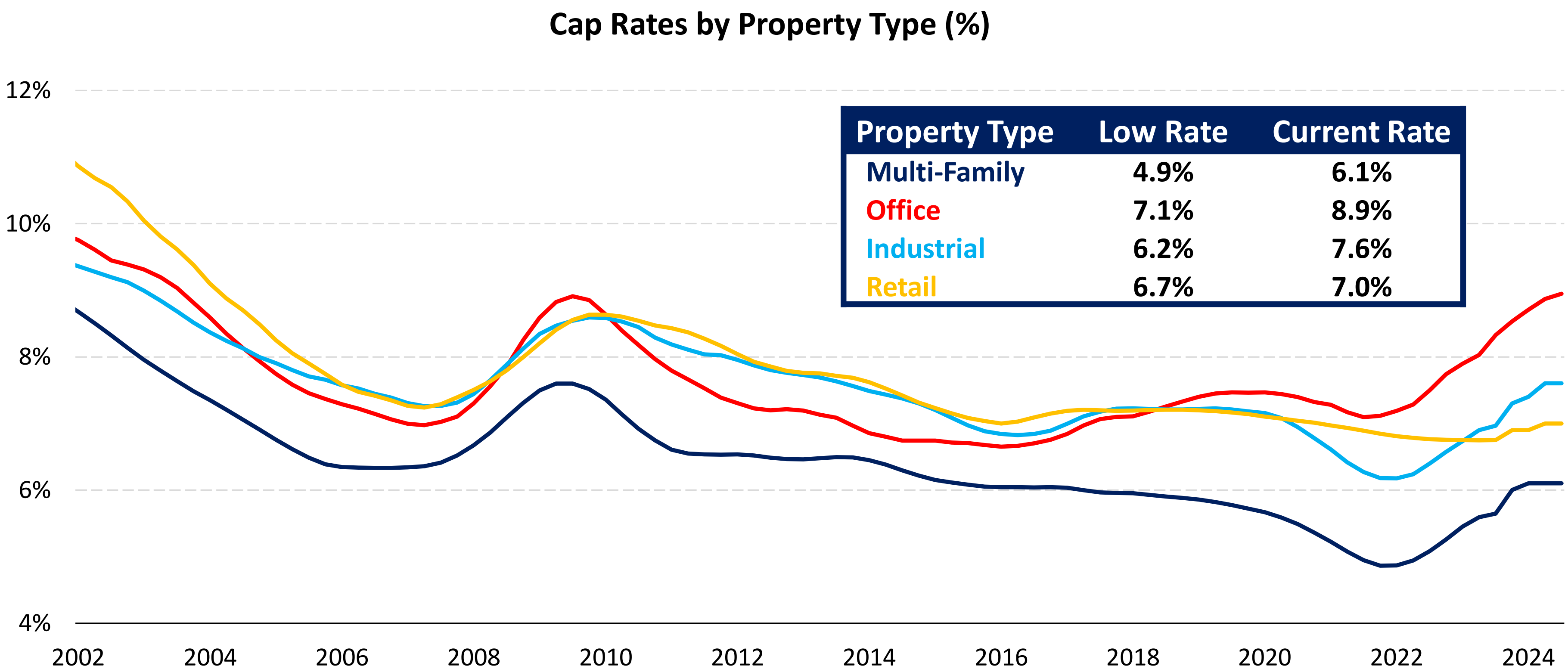
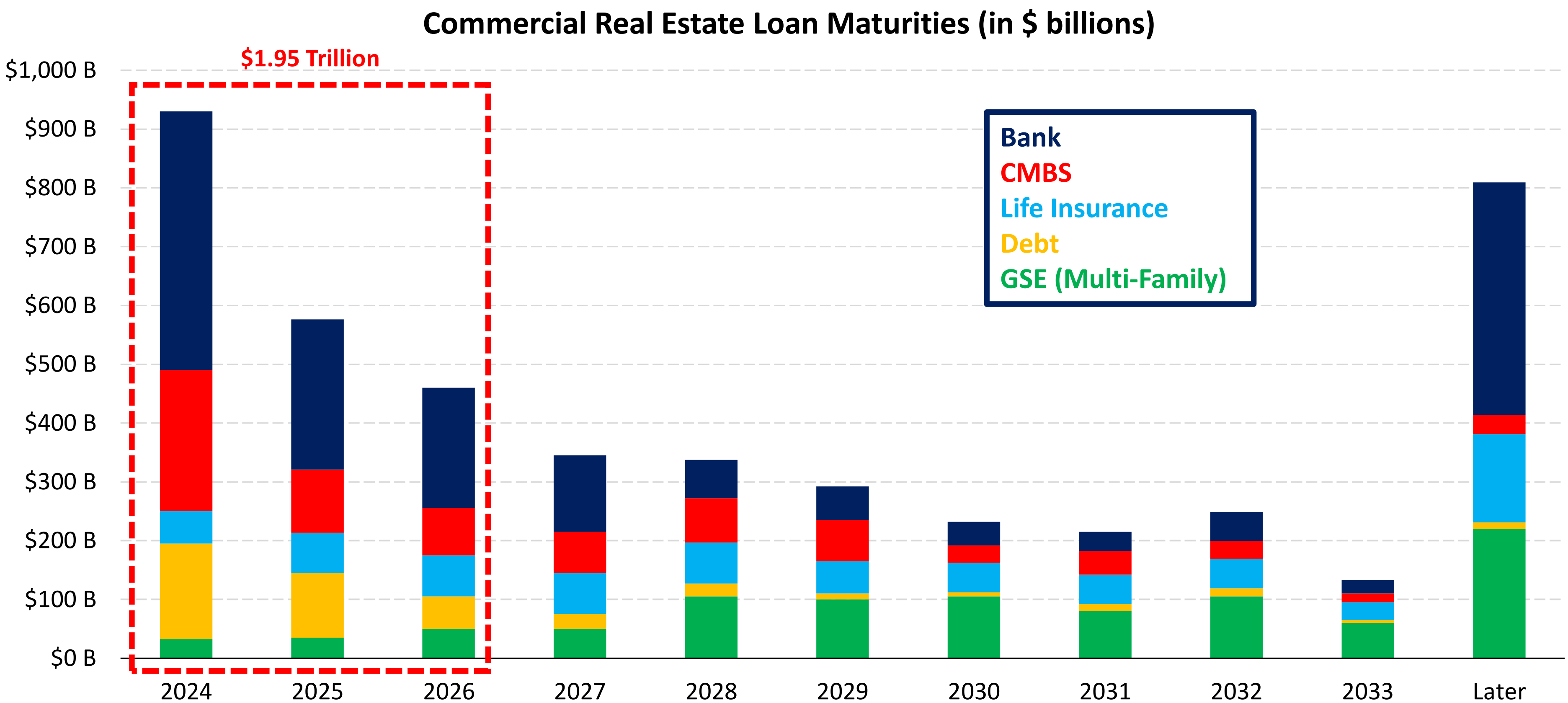


Property Type	Low Rate	Current Rate
Multi-Family	4.9%	6.1%
Office	7.1%	8.9%
Industrial	6.2%	7.6%
Retail	6.7%	7.0%

Source: CoStar

Coming Commercial Maturities Will Bring More Pain



Source: Mortgage Bankers Association

CRE Delinquencies Show Increasing Stress

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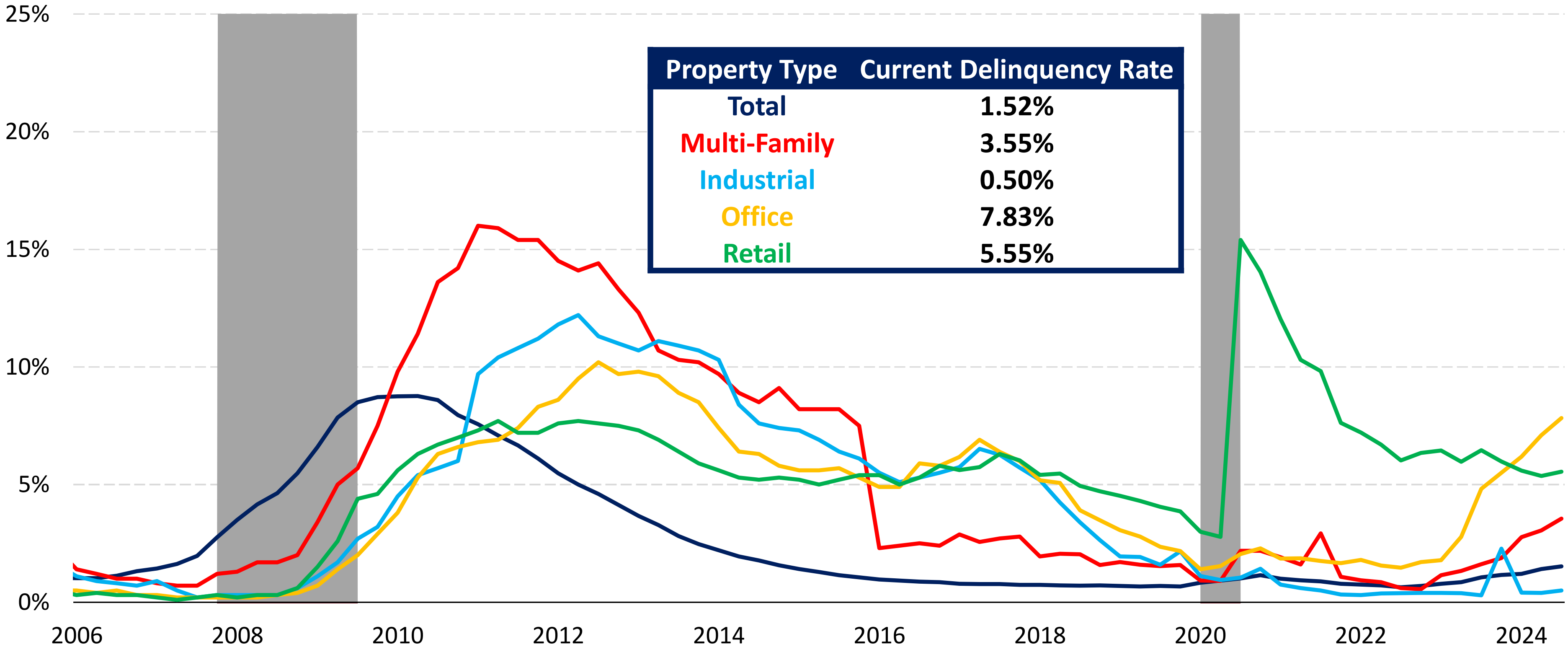

Property Type	Current Delinquency Rate
Total	1.52%
Multi-Family	3.55%
Industrial	0.50%
Office	7.83%
Retail	5.55%

Grey Bars Indicate Recession

Source: S&P Global

Is Employment as Robust as It's Made Out to Be?

Employment Is Weakening and the Data Is a Mess

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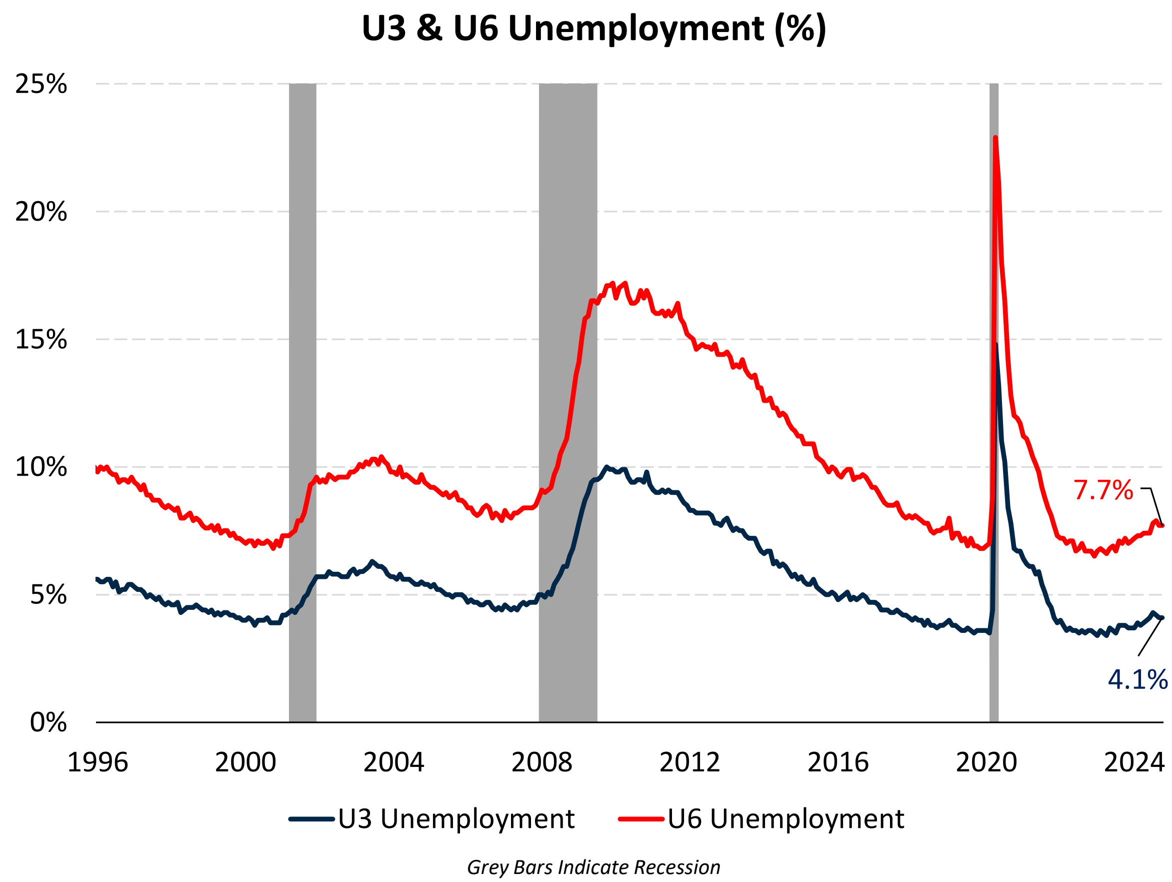
- The Establishment and Household Surveys have not correlated over the past couple of years. However, it is clear employment is weakening with U.S. Nonfarm Payrolls growing by just 12,000 in October, the weakest month since December 2020.

- Payroll data showed strong growth through most of the year but then had a negative revision of 818,000 in August. Conversely, the Household Survey showed the unemployment rate rose from a low of 3.4% to 4.4% but then saw a positive adjustment to 4.1% in October.

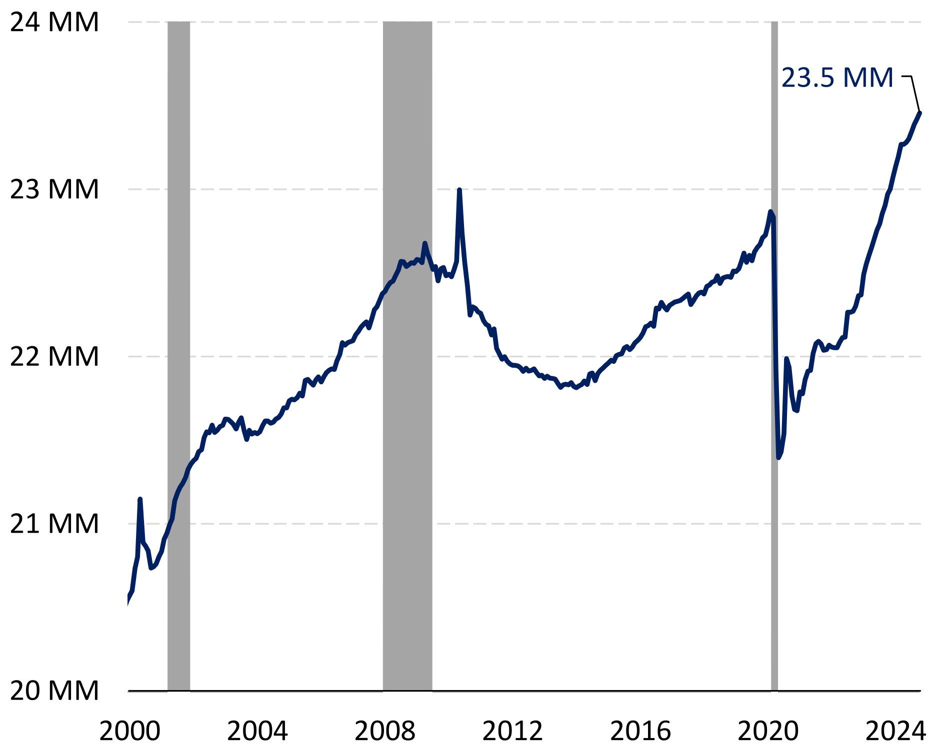
- Government and part-time jobs have been the biggest drivers of employment.



Source: Bureau of Labor Statistics

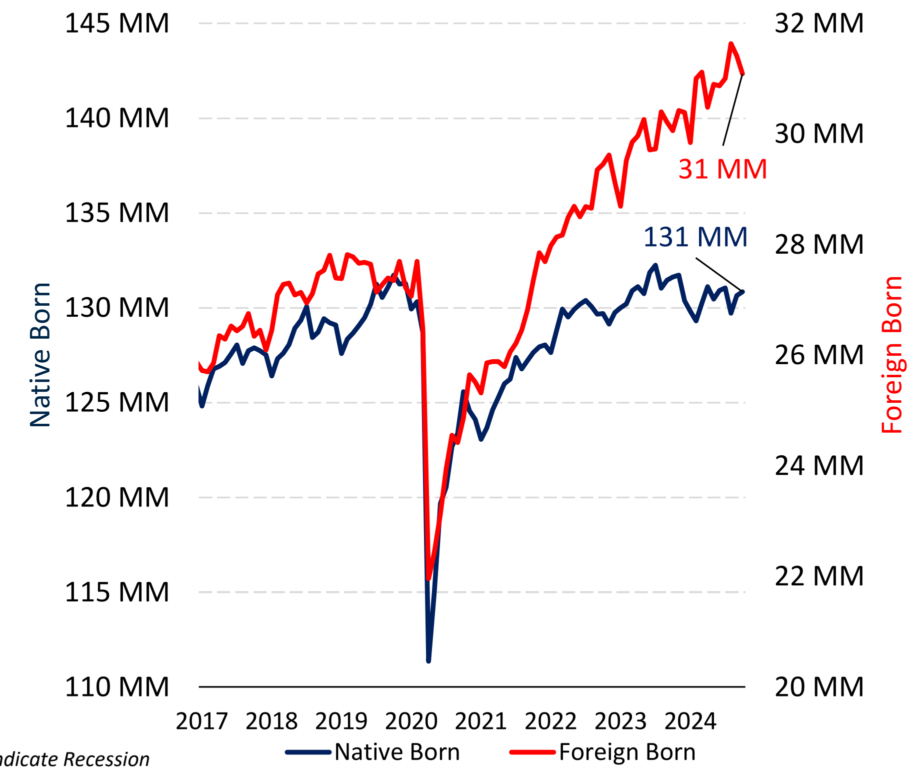
Two Factors Bolstering Employment… For Now

Total U.S. Government Employees (in millions)



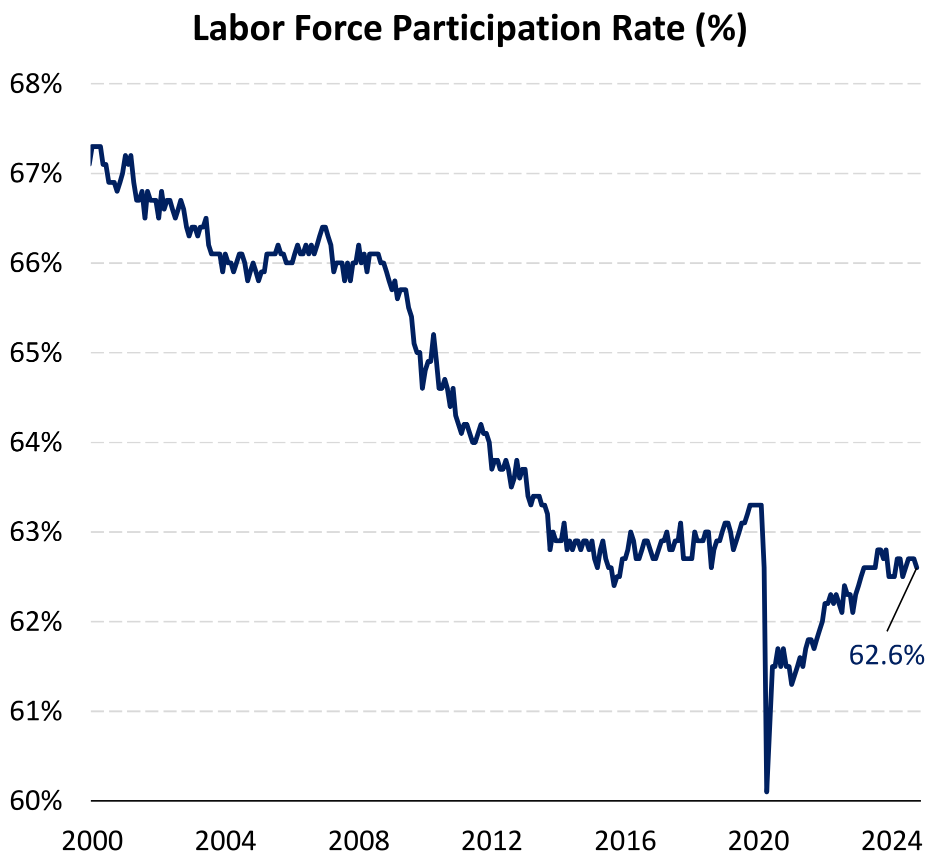
Grey Bars Indicate Recession

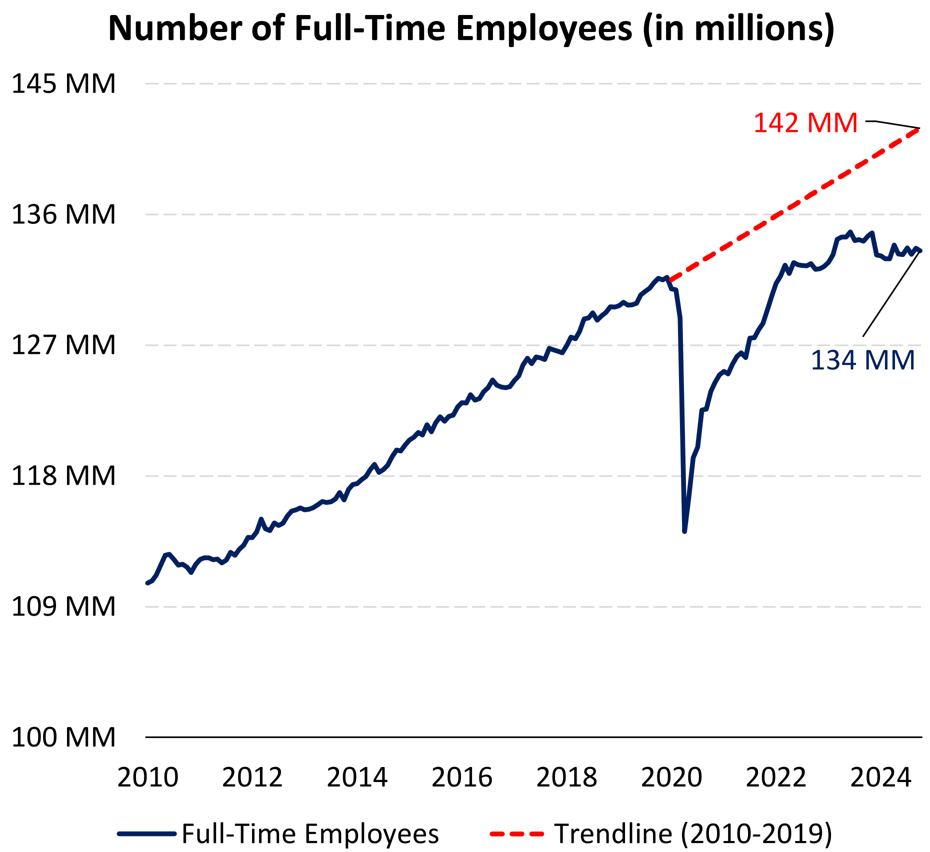
Native vs. Foreign Born Employment Level (in millions)



Source: Bureau of Labor Statistics

Employment Has Not Returned to Pre-Pandemic Levels





Source: Bureau of Labor Statistics

The United States Is a K-Shaped Economy

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The Top 20% Continue to Separate From the Bottom 80%

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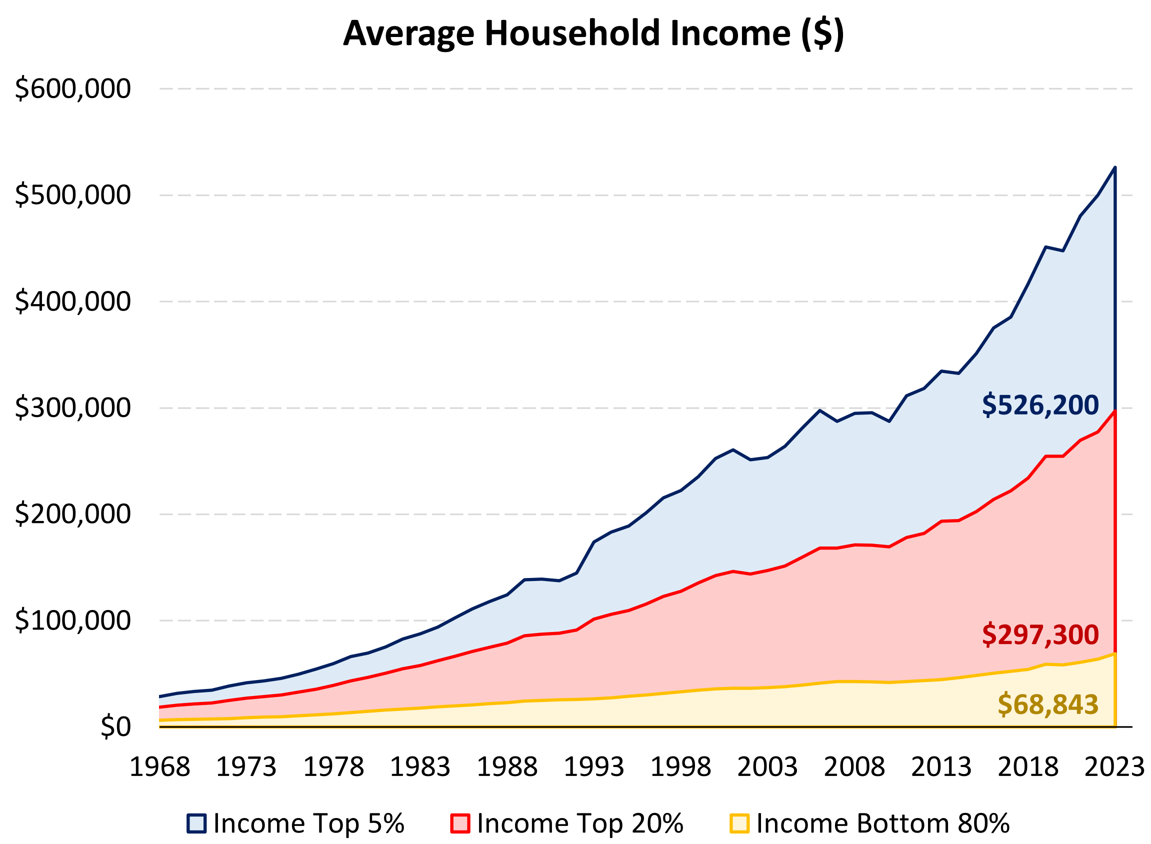
- Unsurprisingly, mean household income has continued to expand among the different wealth classes. In 2023, the mean household income for the top 5% of earners in the U.S. was $526,200 compared to $297,300 for the top 20% and just $68,843 for the bottom 80% of earners.

- A large part of this income disparity is due to the fact that the bottom 50% of earners in the United States own just 1% of all stocks and mutual funds.

- The top 10% of earners in the U.S. own roughly 67% of total wealth while the bottom 50% own just 2.5%.



Source: U.S. Census Bureau

Wealth Distribution in America Is Widening

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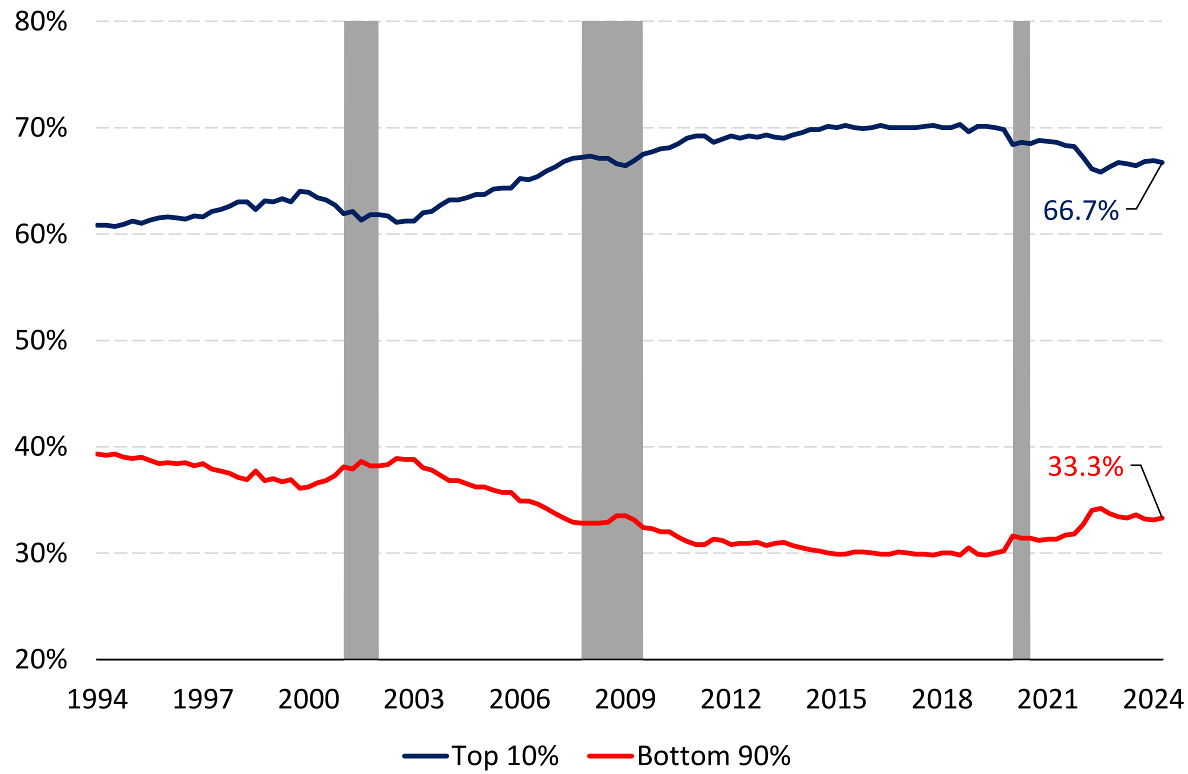
- Since 1994, the top 10% of earners have expanded their share of total net worth seeing it grow from 60.8% to 66.7%. Conversely, the bottom 90% has seen their share of total net worth decrease from 39.3% to 33.3%.
- 50% of Americans say that they are living paycheck to paycheck.

Current Wealth Distribution (Share of Total Net Worth)	
Top 0.1%	13.5%
Top 1%	30.2%
90-99%	36.5%
50-90%	30.8%
Bottom 50%	2.5%

Share of Total Net Worth by Group (%)



Grey Bars Indicate Recession

Source: St. Louis Federal Reserve

Troubling Trends

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Consumer's COVID-19 Savings Have Now Run Dry

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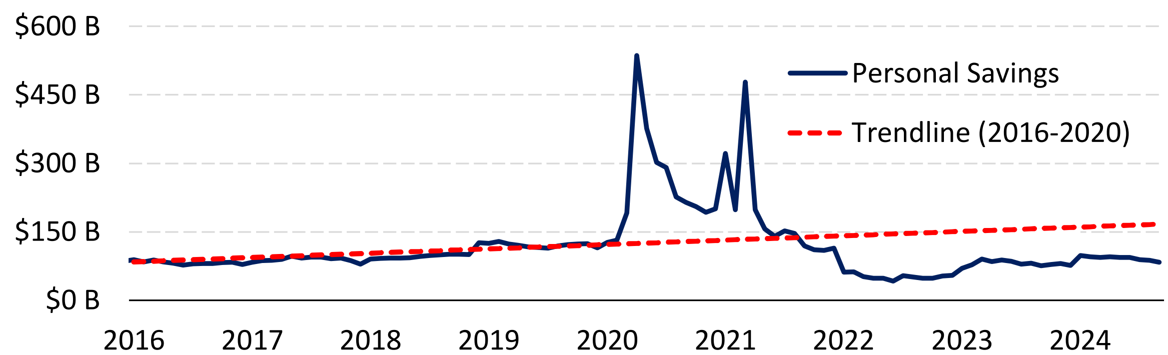
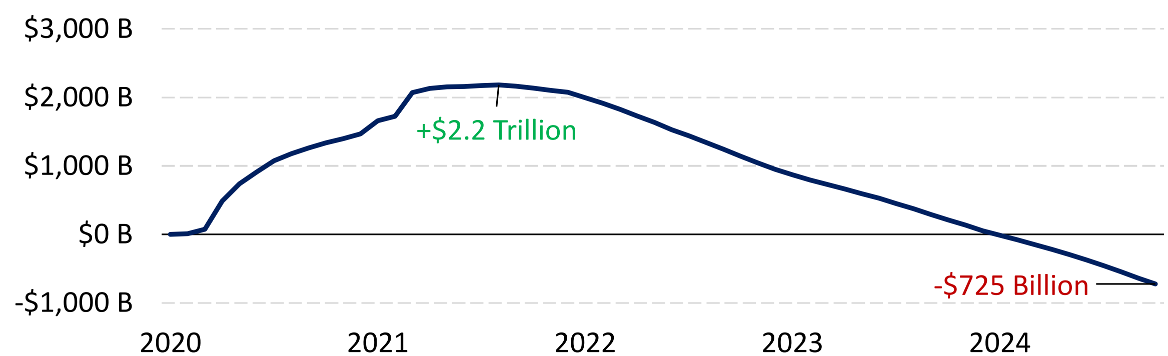
- Savings dramatically increased due to government transfer payments during COVID but consumers have now used their excess of savings and are in an even worse position than pre-COVID due to inflation.
- Currently the personal savings rate is at **4.4%**, up from a near all-time low of just 2.0% in June 2022. However, without government transfer payments the real savings rate is **-6.5%**.
- Excess Personal Savings that reached a surplus of $2.2 trillion is now gone for the American consumer and most are struggling with little to no savings.

Aggregate Personal Savings (in $ billions)



Aggregate Excess Personal Savings (in $ billions)

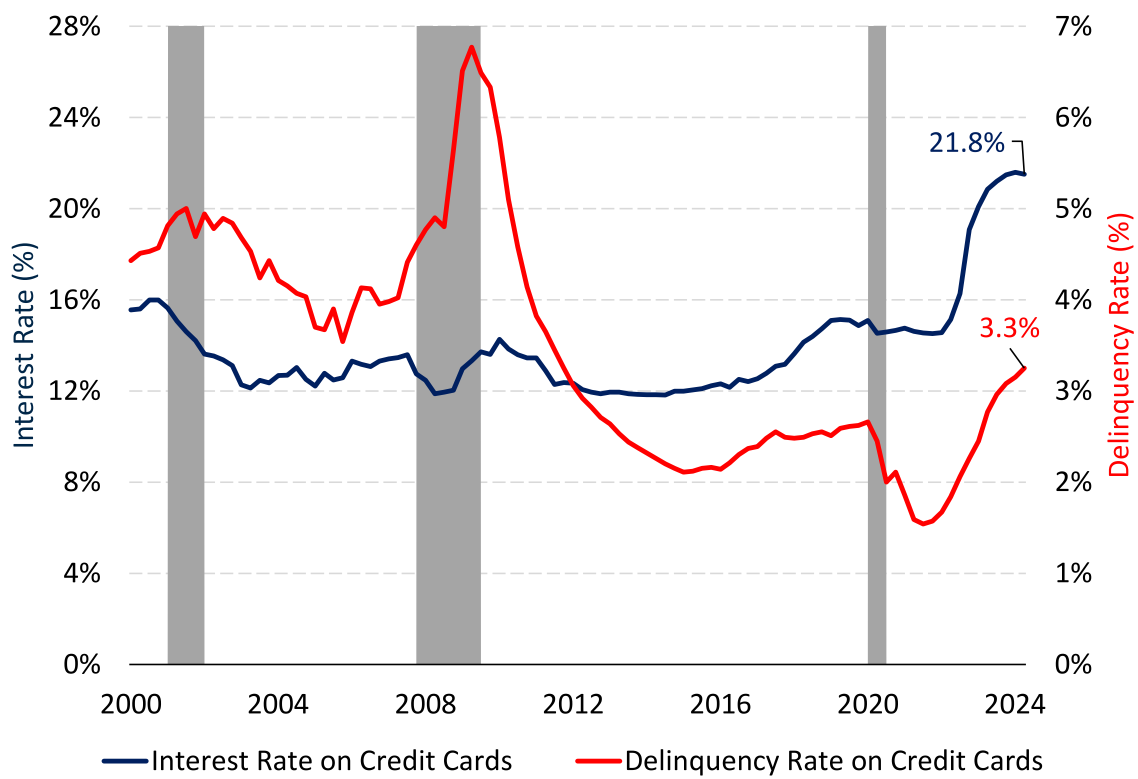


Source: Bureau of Economic Analysis

Rate Cuts Haven't Helped Struggling Consumers Yet

Sunwest Bank

- In Q3, the Federal Funds rate was cut by 50 basis points, but the average interest rate on credit cards still hit an all-time high of 21.8% in the quarter, up 0.3% QoQ and 0.6% YoY.
- While credit card interest rates have reached all-time highs, credit card delinquency rates are currently the highest they've been in 13 years.
- Since reaching a low of just 1.5% in Q3 2021, the delinquency rate on credit cards has increased every quarter for 12 consecutive quarters.



Grey Bars Indicate Recession

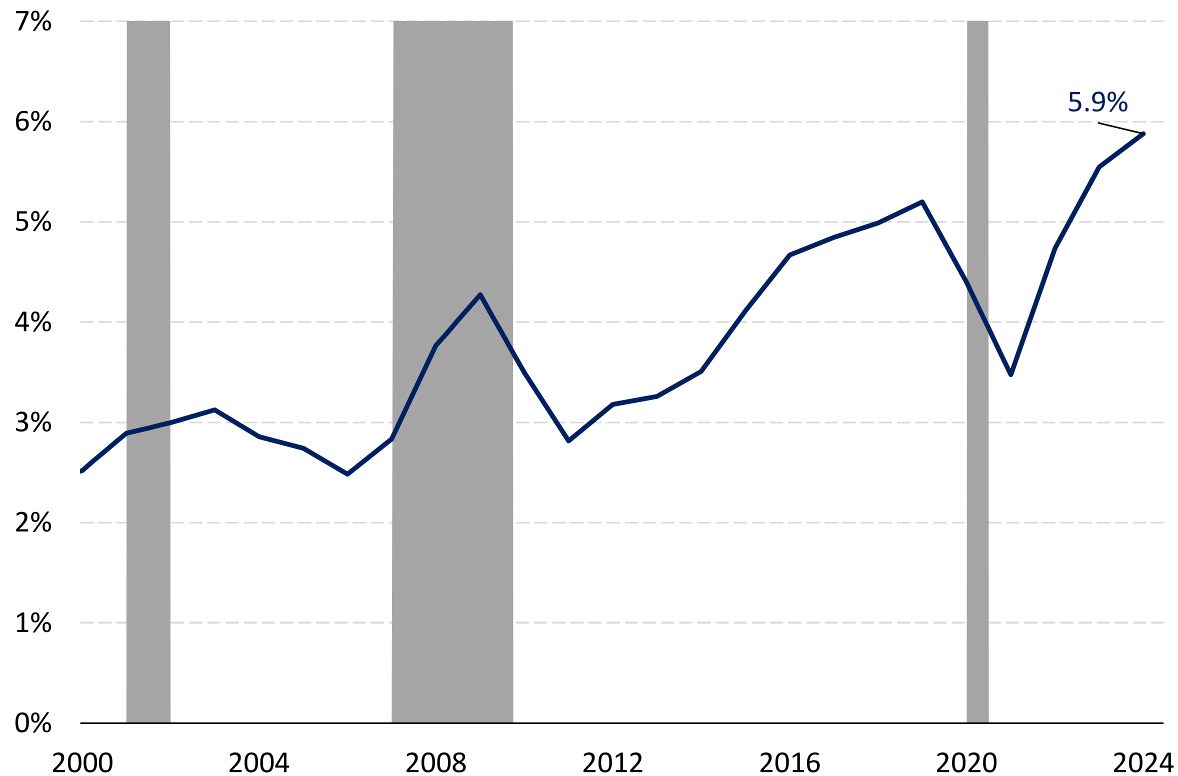
Source: St. Louis Federal Reserve

Cracks Among Weaker Consumers Are Worsening

Sunwest Bank

- Subprime Auto Delinquencies have reached an all-time high in 2024, reaching 5.9% YTD through October.
- During the Great Recession, average annual Subprime Auto Delinquencies peaked at 4.3% in 2009.

Subprime Auto Loan 60+ Delinquency Index (%)



Grey Bars Indicate Recession

Source: Fitch Ratings

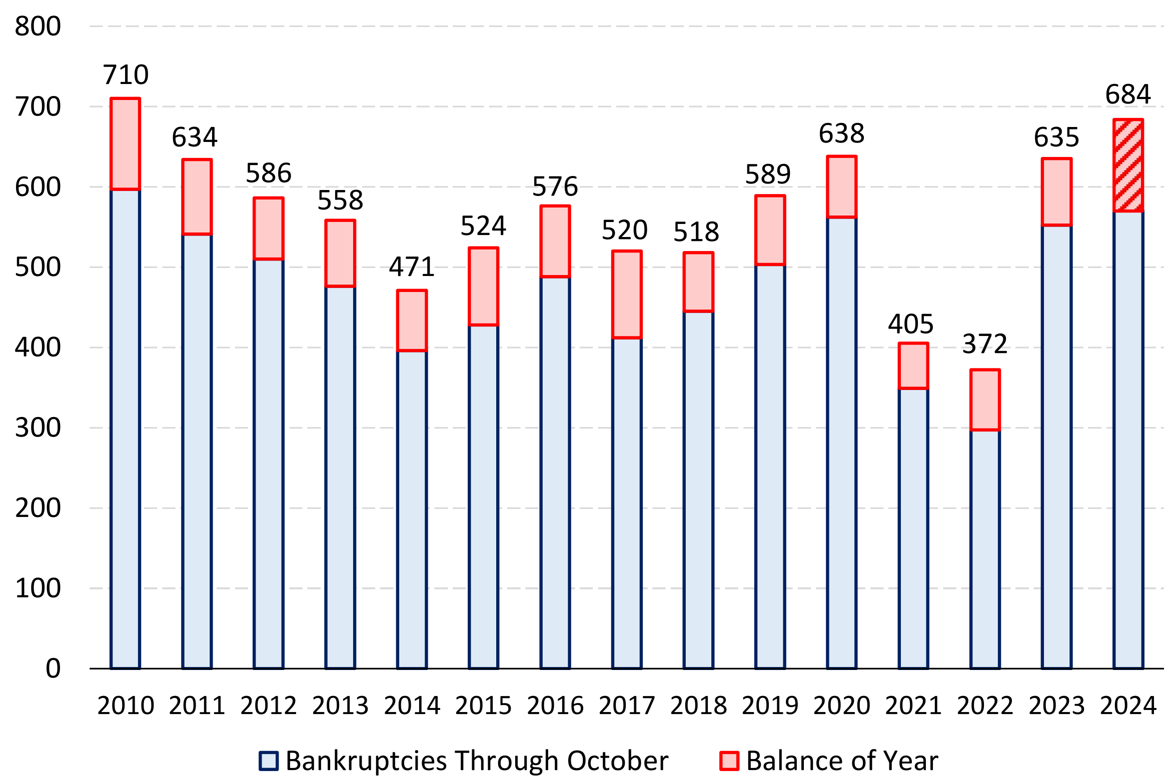
Corporations Across Industries Continue to Struggle

- U.S. bankruptcies in 2024 could reach the highest level since 2010 after filings in October continued to trend at an elevated monthly pace.

- Through October, **570** companies have filed for bankruptcy. Annualized, this amounts to 684 total bankruptcies.

- Notable bankruptcies in 2024 include:
  - Spirit Airlines
  - Red Lobster
  - Big Lots
  - Wheel Pros
  - Tupperware Brands
  - JOANN Inc.
  - American Tire Distributors
  - TGI Fridays

U.S. Bankruptcies by Year



Source: S&P Global

The Un-Inversion of the Yield Curve Signals Recession

Sunwest Bank

- While the inversion of the yield curve between the 10 and 2-Year Treasurys has been a consistent indicator of macro economic stress, it is the un-inversion of the yield curve that precedes a recession.

- The yield curve un-inversion typically follows a rate cut cycle because the Fed is reacting to slowing economic data. As economic data is revised, the Fed will cut rates more aggressively to offset deflationary pressures building in the economy.

- The yield curve un-inverted three months ago in September.

10-Year Treasury Rate Minus 2-Year Treasury Rate (%)

Grey Bars Indicate Recession

Source: St. Louis Federal Reserve

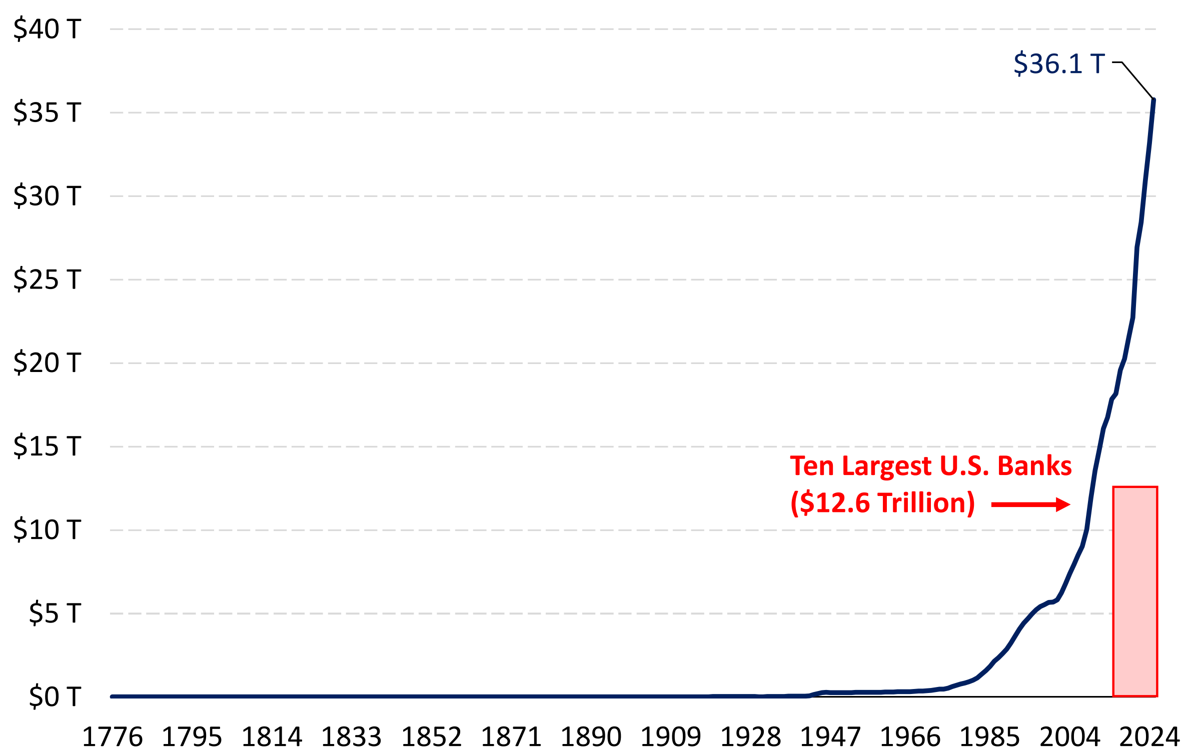
The Biggest Risk Is a Debt Bomb in Washington

Sunwest Bank

Government Debt Soared to a Colossal Level

- Since FY 2021, the start of the Biden Administration, the U.S. has added more than $13 trillion in debt. It previously took the country 234 years, until FY 2010, to reach $13 trillion in debt.
- The United States has increased the national debt more than **$30 trillion** since the start of the 21st century.
- On average, the United States has increased its debt by $1 trillion every **142 days** since the start of COVID-19.

U.S. Gross National Debt (in $ trillions)



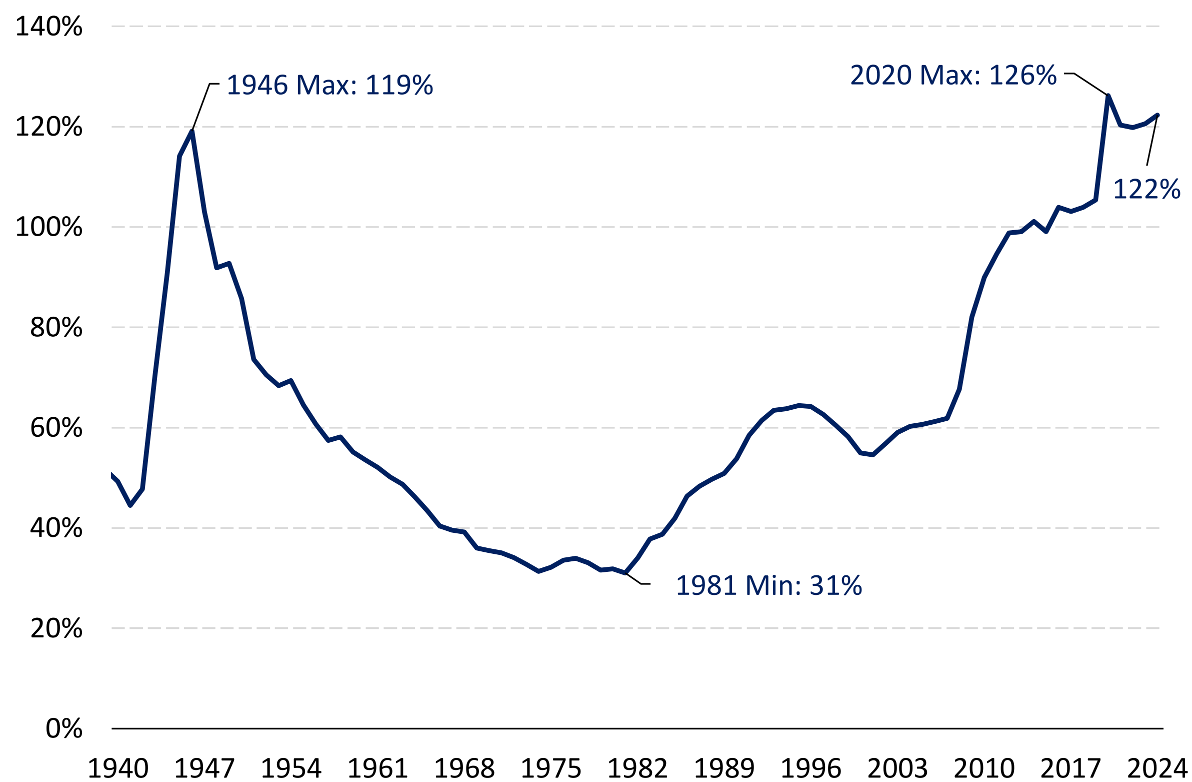
Source: U.S. Treasury Department

The United States Is in a Debt Trap

Sunwest Bank

- The U.S. Debt-to-GDP ratio is at 122%, near its all-time high of 126% in 2020.
- Previously, the U.S. Debt-to-GDP ratio peaked at 119% in 1946 as the government borrowed heavily to finance defense spending during World War II.
- Prior to the Great Financial Crisis in 2007, the U.S. Debt-to-GDP ratio was just 62%.

U.S. Annual Debt to Real GDP Ratio (%)



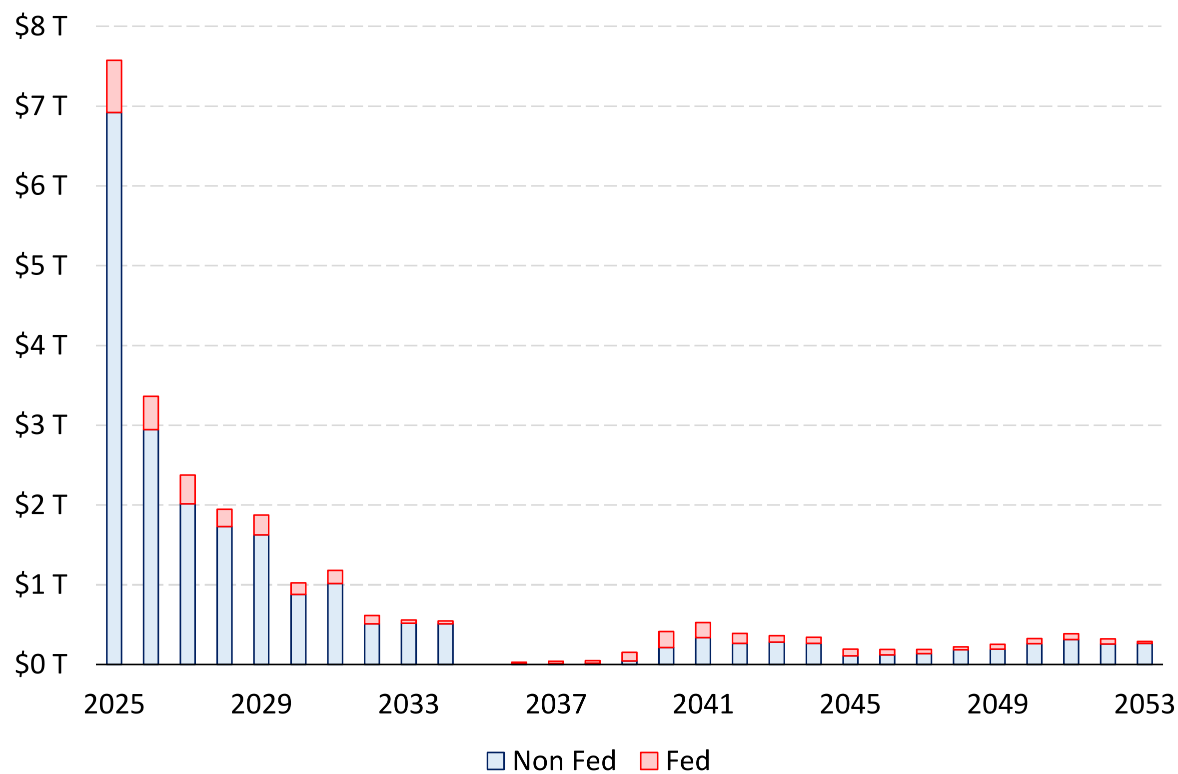
Source: U.S. Treasury Department, Bureau of Economic Analysis

U.S. Treasury Maturities Are Coming Fast

Sunwest Bank

- The U.S. Federal Government will have over **$7.5 trillion** in Treasurys come due in 2025 representing 21% of all outstanding U.S. Government debt.
- The average yield on Treasurys due in 2025 is 4.35%. Secretary Yellen made a colossal mistake by not funding with longer duration Treasurys when rates had collapsed.
- Maturities of this magnitude will put upward pressure on rates as the U.S. Government will have to issue new debt to cover those maturities.

U.S. Treasury Maturity Schedule (in $ trillions)



Source: New York Federal Reserve

Foreign Investors Are Buying Less Volume of U.S. Debt

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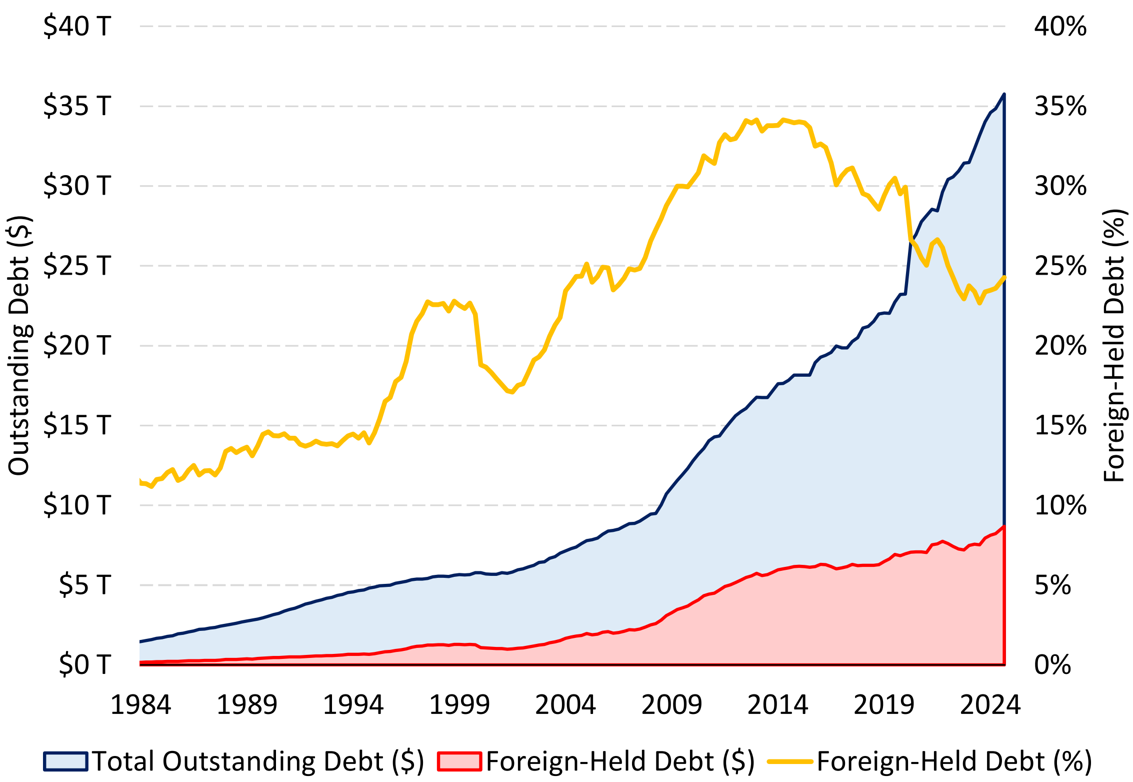
- While the amount of U.S. debt held by foreign investors increased to **$8.7 trillion** the percentage of total debt held by foreign investors has decreased to **24.3%**, down from a peak of 34.1% in 2014.
- Foreign buyers of U.S. Treasurys are becoming more reluctant to finance the United States' ever-increasing debt. China in particular has reduced its holdings by $466 billion over the past eight years.
- If foreigners become more reluctant to buy U.S. Treasurys it will force the Fed back into Quantitative Easing (QE) and help re-ignite inflation.

National Debt Held by Foreign Investors (in $ trillions)



Source: U.S. Treasury Department

“There are two ways to conquer and enslave a nation. One is by the sword. The other is by debt.”

- President John Adams

Necessary for the Long Run, Painful in the Short Run

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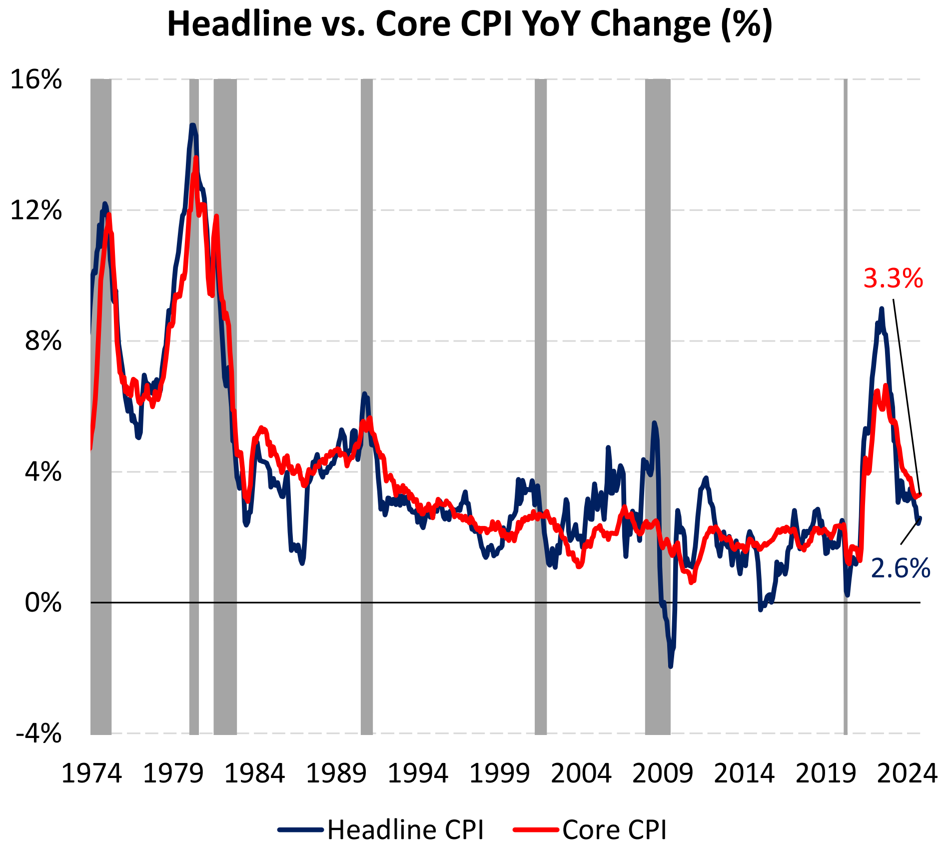
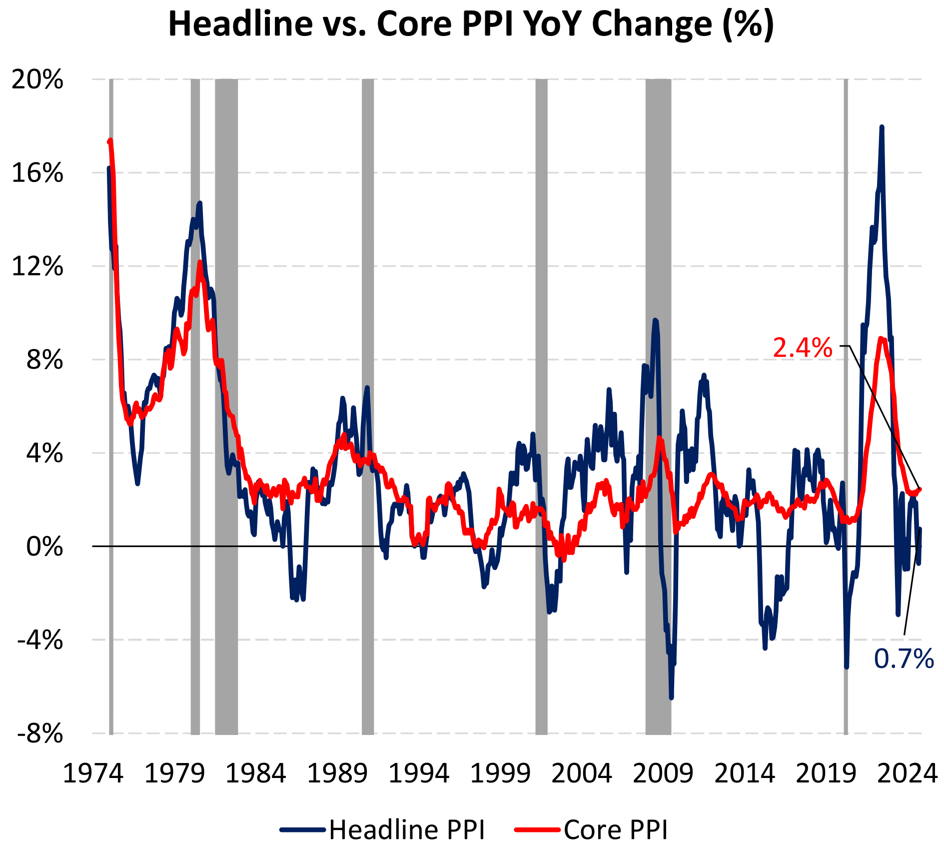
Uncle Sam Ran Up the Tab, Now You Have to Pay

Inflation is Still a Headache for Americans

Sunwest Bank





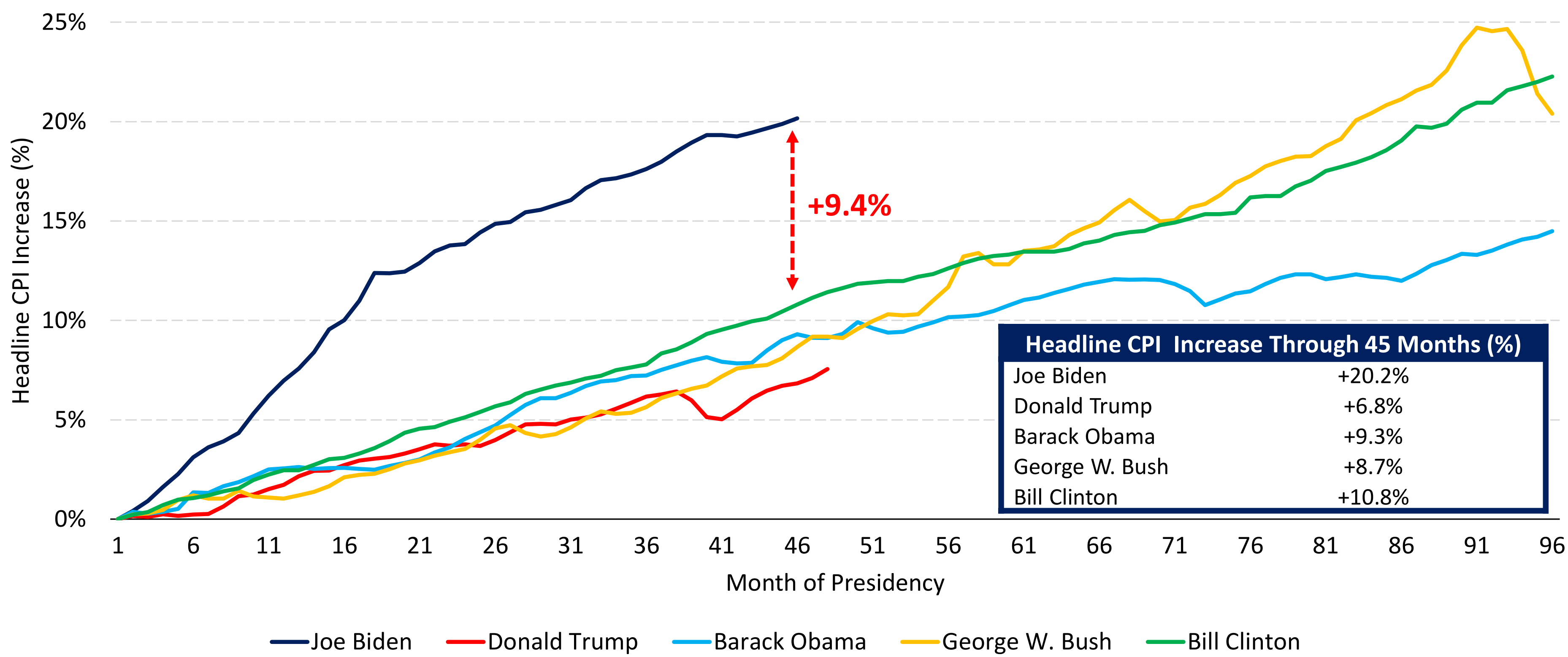
Grey Bars Indicate Recession

Source: Bureau of Labor Statistics

The Past Four Years Have Been Tough on Consumers

Sunwest Bank

Increase in Headline CPI by U.S. President (%)



Headline CPI Increase Through 45 Months (%)	
Joe Biden	+20.2%
Donald Trump	+6.8%
Barack Obama	+9.3%
George W. Bush	+8.7%
Bill Clinton	+10.8%

Source: Bureau of Labor Statistics

Crucial Items are More Expensive Than Ever

Sunwest Bank

McDonald's

Menu Item	End-of-2019 Price	Mid-2024 Price	% Increase
Big Mac	$1.79	$4.19	134%
Medium French Fries	$1.29	$3.89	202%
McChicken	$3.99	$7.49	88%
10 McNuggets	$4.49	$7.58	69%
Cheeseburger	$1.00	$3.15	215%

Average price increase across these five items: ***141%***

Chick-fil-A

Menu Item	End-of-2019 Price	Mid-2024 Price	% Increase
Deluxe Chicken Sandwich	$3.65	$6.55	79%
8 Chick-fil-A Nuggets	$3.05	$5.99	96%
4 Chick-n-Strips	$4.39	$7.85	79%
Medium Waffle Fries	$1.65	$2.99	81%
Large Milkshake	$3.15	$5.19	65%

Average price increase across these five items: ***80%***

Source: Bureau of Labor Statistics, McDonald’s App, In-N-Out Website, Chic-fil-A Website

What Does the Fed Do?

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The Fed Has Started a Rate Cut Cycle, but How Far Can It Go?

Sunwest Bank

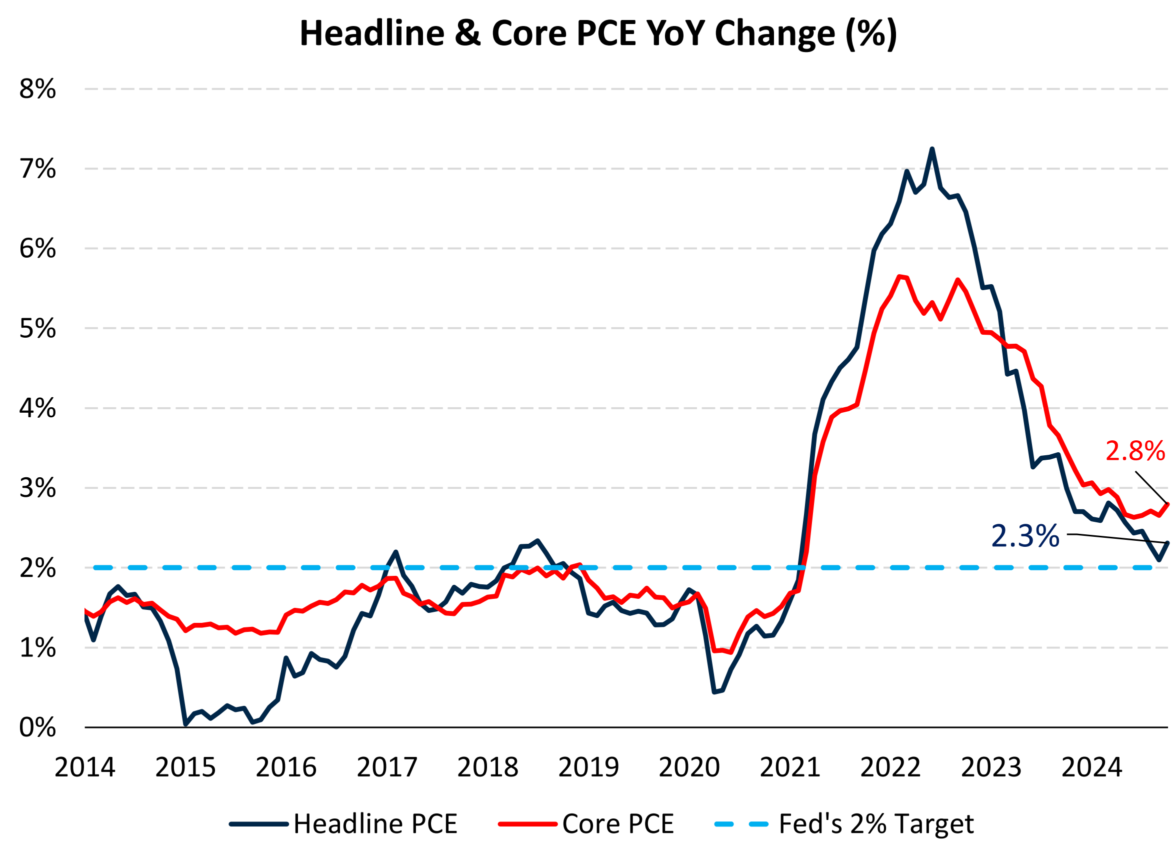
Duration	Rate as of Dec. 1, 2021		Rate as of Dec. 1, 2023		Rate as of Dec. 1, 2024
Federal Funds Rate	0.08%	+525bps	5.33%	-75bps	4.58%
2-Year Treasury	0.56%	+400bps	4.56%	-40bps	4.16%
5-Year Treasury	1.15%	+299bps	4.14%	-8bps	4.06%
7-Year Treasury	1.35%	+287bps	4.22%	-10bps	4.12%
10-Year Treasury	1.43%	+279bps	4.22%	-4bps	4.18%
30-Year Fixed Mortgage	3.10%	+412bps	7.22%	-41bps	6.81%

Source: Treasury Direct, St. Louis Federal Reserve

The Fed's Favorite Inflation Gauge is Reversing

Sunwest Bank

- Personal Consumption Expenditures (PCE) is the Fed's preferred inflation measure as it accounts for changes in consumer behavior, providing a more comprehensive and flexible measure of price changes.
- Core PCE has increased in three of the previous four months after reaching a low of 2.6% in June.
- Headline PCE is currently at 2.3%, up from 2.1% in the prior month.



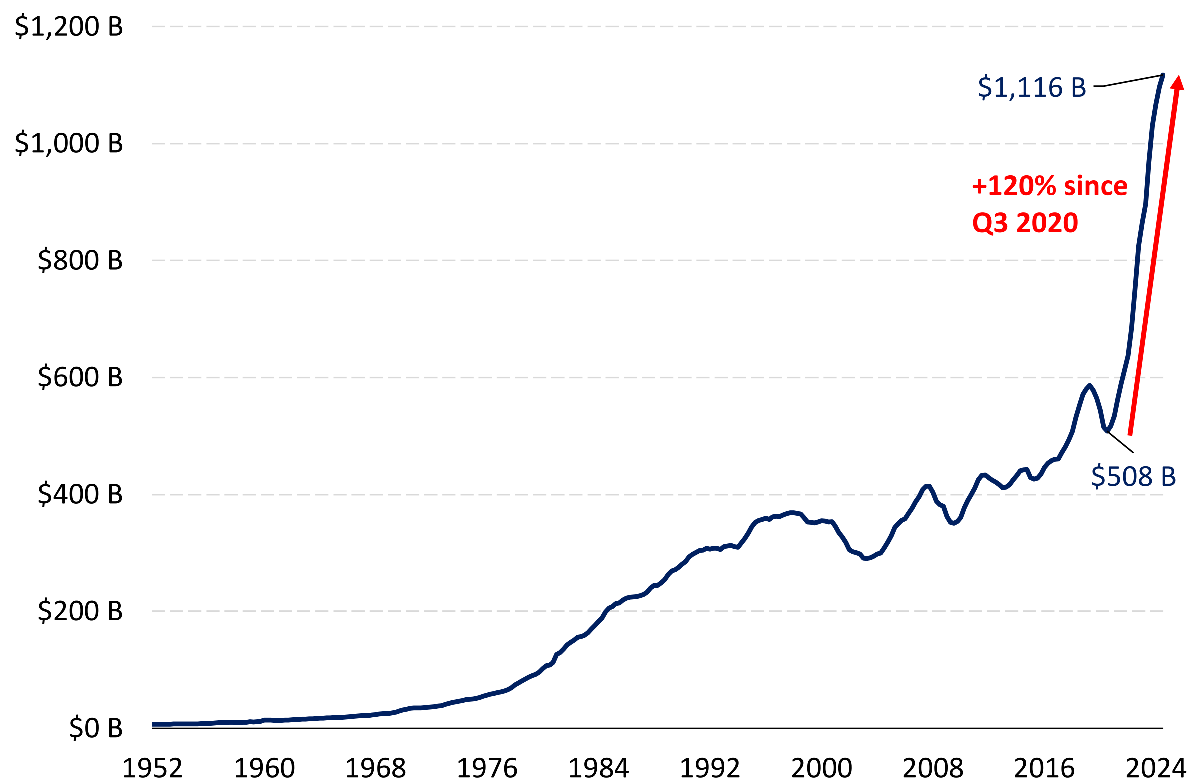
Source: Bureau of Economic Analysis

U.S. Interest Payments Leave the Fed Little Choice

- The Federal Government's annualized cost of interest payments for FY 2025 is estimated to be $1.1 trillion which is larger than any other expenditure by the Federal Government with the exception of Social Security.

Federal Outlays FY 2024	
Social Security	$1.46 Trillion
Health Care	$912 Billion
Net Interest	$882 Billion
Medicare	$874 Billion
National Defense	$874 Billion
Income Security	$671 Billion
Veterans' Benefits	$325 Billion

Federal Government Interest Payments (in $ billions)



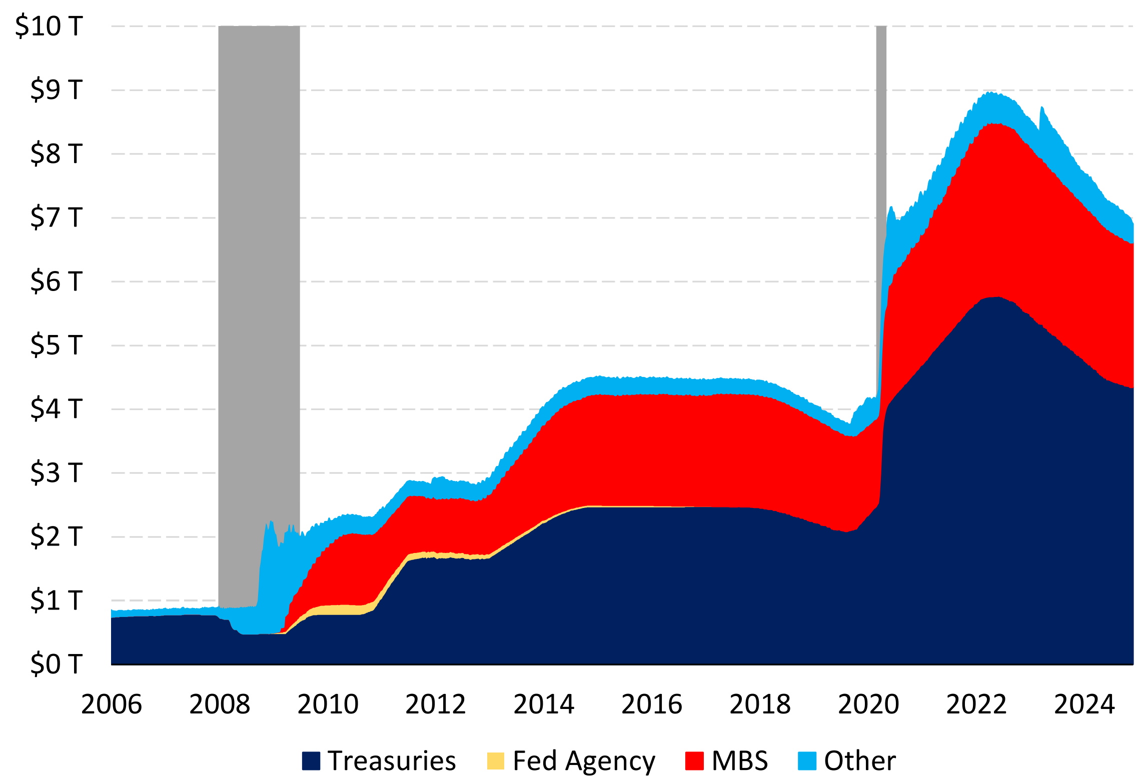
Source: Bureau of Economic Analysis

How Much Farther Can the Fed Decrease the Balance Sheet?

Sunwest Bank

- After peaking at $8.9 trillion in total assets in April 2022, the Fed began a cycle of Quantitative Tightening that has led to total assets decreasing to $6.9 trillion.
- Currently, the Fed holds $4.3 trillion in Treasury securities and $2.2 trillion in mortgage-backed securities.
- The Fed has slowed the velocity of Quantitative Tightening as the average weekly decrease in 2024 has been $16.8 billion compared to $22.3 billion in 2023 (excluding the March 2023 injection due to the Banking Crisis).

Federal Reserve Balance Sheet (in $ trillions)

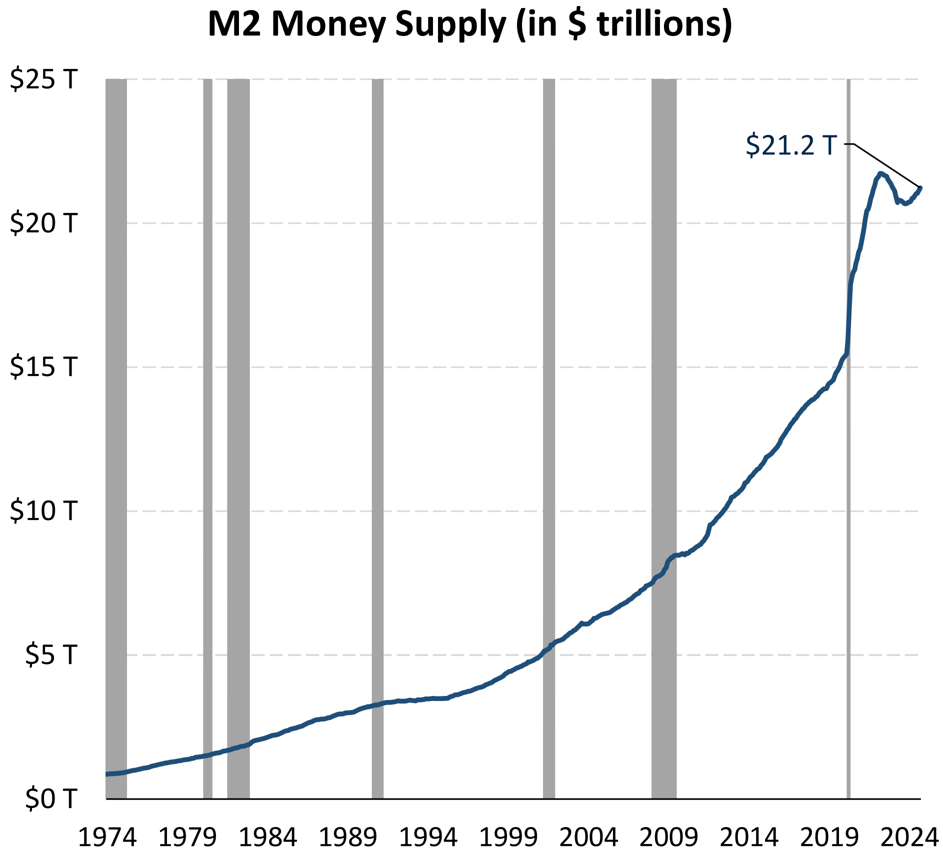


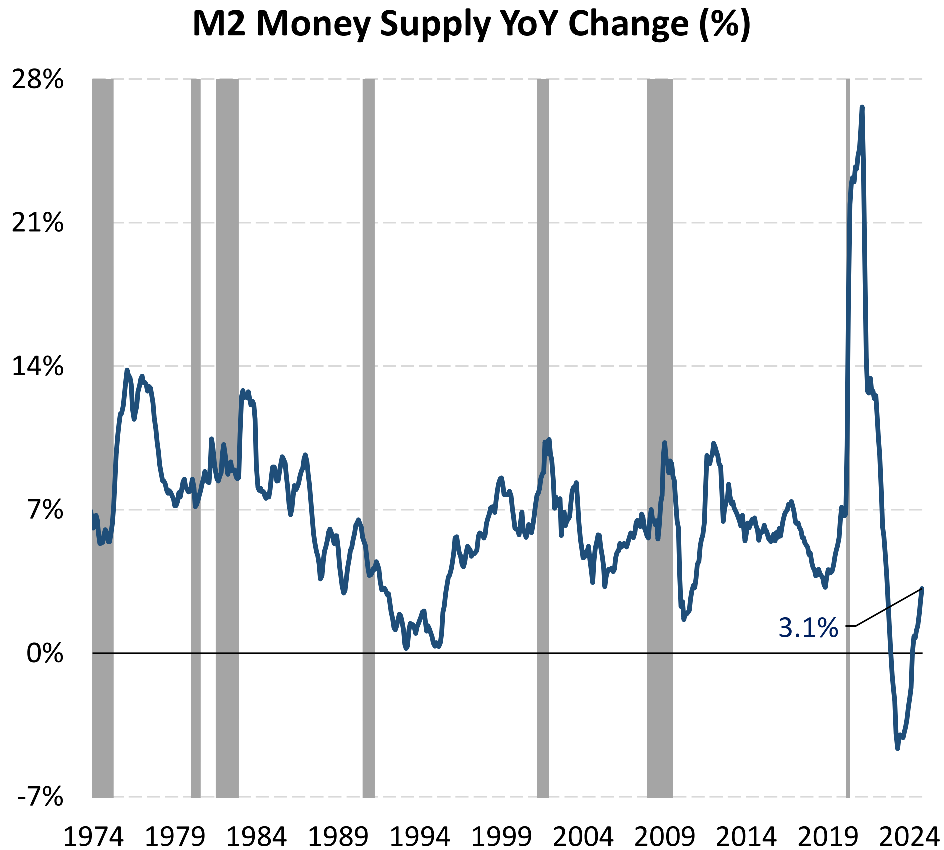
Grey Bars Indicate Recession

Source: St. Louis Federal Reserve

Money Supply Has Started to Grow Again

Sunwest Bank





Grey Bars Indicate Recession

Source: St. Louis Federal Reserve

The Trump Economy

Trump Known Knowns

- **Deportation of illegal immigrants** – will hurt overall GDP growth but will increase wages for U.S. workers and per capita GDP growth for U.S. citizens.

- **Trump Tax Cuts** will be extended for LLCs and subchapter S corporations with further potential cuts for tip and overtime income and social security benefits – beneficial from not hurting economic growth but may also contribute to increase deficits.

- **Tariffs will be used frequently** – if they can lower tariffs on U.S. goods and open up more free trade it will have an economic benefit to the globe if countries don't comply and we get in a global tariff war it may cause an increase in inflation and slower economic growth.

- **Deregulation** – will be a major benefit to economic growth and business activity regulations are estimated to cost the economy $3 trillion a year.

- **Government spending potentially being slashed** – will hurt economic growth in the short term but is critically needed and will help economic growth in the mid- to long-term.

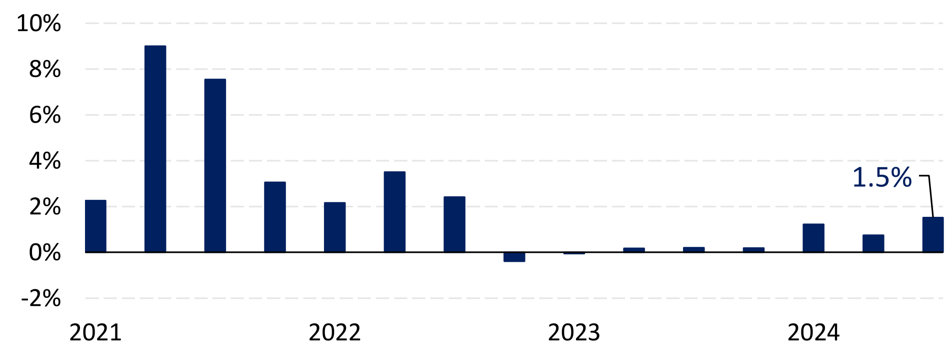
- **Drill, drill, drill** – increase domestic energy production to drive down energy costs to drive down inflationary pressures.

Global Economies and Markets

The Eurozone Countries Continued to Struggle

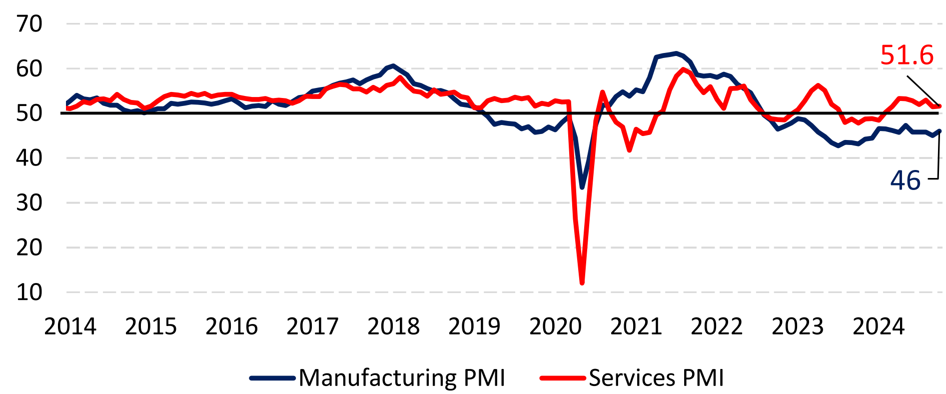
Country		GDP QoQ (%)	GDP YoY (%)
Germany		0.2%	-0.2%
France		0.4%	1.3%
Italy		0.0%	0.4%
Spain		0.8%	3.4%
Netherlands		0.8%	2.1%

Eurozone Gross Domestic Product QoQ Change (%)



Eurozone Inflation (%)

Eurozone PMI

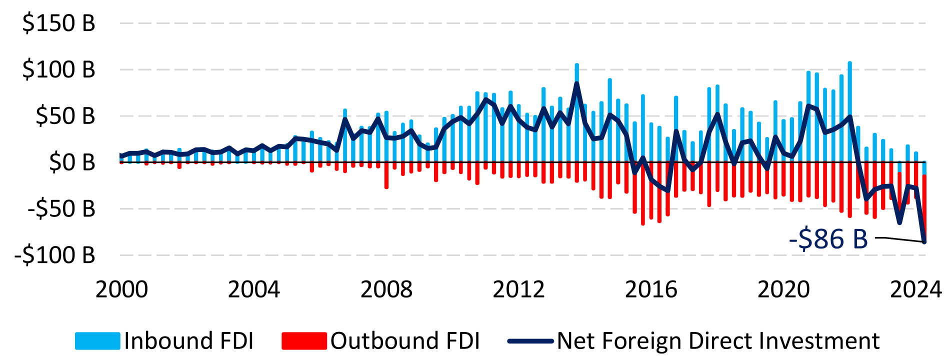


Source: Bloomberg

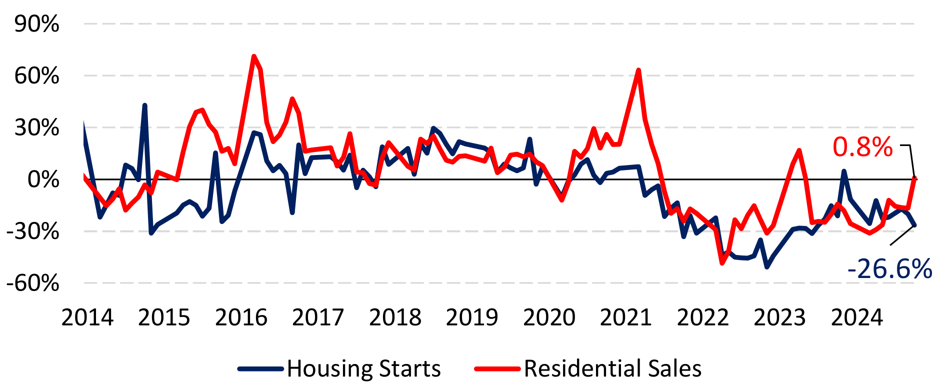
China Can No Longer Cover Up Their Issues

China Gross Domestic Product YoY Change (%)

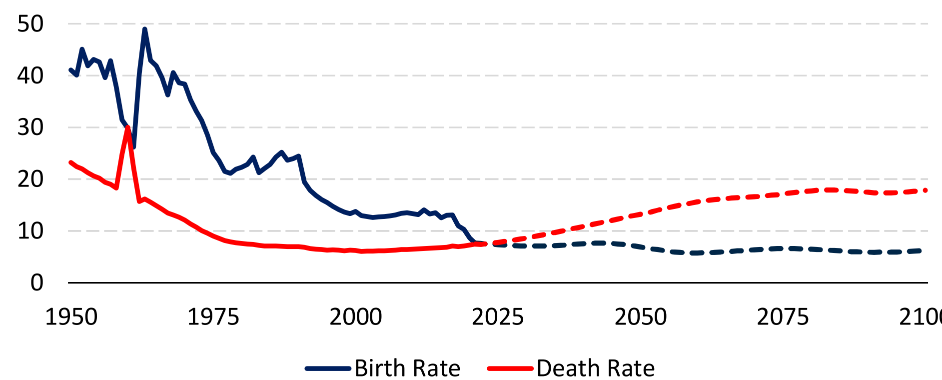
Foreign Direct Investment in China (in $ billions)



China Housing Starts and Sales YoY Change (%)



China Birth & Death Rates (per 1,000 people)



Source: National Bureau of Statistics of China, United Nations, Bloomberg

Drumroll…

I Have to Be Insane to Try to Predict 2025

Sunwest Bank

Predictions for the Economy 2025

- **U.S. Economy:** There are enormous cross-currents that will occur in 2025. Trump is inheriting a weakening economy with a severe debt problem. Conversely, the enthusiasm of a pro-business president with deregulation and retaining lower tax rates are big positives. My best estimate is that GDP will be lumpy with negative and positive prints throughout the year, but overall economic growth will come in at a muted 1.5%.

- **Unemployment Rate:** Employment will weaken as the economy softens, illegal immigrants are removed, and the significant increase in government jobs in 2024 will reverse as federal workers are forced to go back into the office and DOGE starts to rationalize the federal government workforce. Unemployment rate will lift to a range of 4.7-5.1% as Americans fill the void left by immigrant labor leaving.

- **Interest Rates:** The Fed will continue to cut rates throughout 2025, but it will not be in a linear progression as inflation will be stickier in the first part of the year. They may go a meeting or two without making a cut and then cut 25 or 50 basis points depending upon employment and inflation data. By the end of the year, they will cut overnight rates by 75-125 basis points.

- **Fed Balance Sheet:** They will continue their reduced quantitative tightening for the first part of the year but will eventually stop Quantitative Tightening and may be forced by the end of the year to start buying Treasurys again through Quantitative Easing.

Predictions for Asset Values in 2025

Sunwest Bank

- **U.S. Equities:** The rally in U.S. equities will continue through the end of the year and into the beginning of 2025 but then there will be a sharp reversal with a potential 15-20% correction. If or when the Fed resumes Quantitative Easing the markets will start to rally again. 2025 will be a choppy year for the markets.

- **Fixed Income:** Overnight rates will drop as the Fed continues cutting but mid and longer duration rates will be more stubborn without the corresponding drop in rates. The yield curve will be positively sloped through most of the year.

- **Residential Real Estate:** Housing values will fall by 7.5-12.5% nationwide as inventories continue to uptick across the country as homes are unaffordable for the majority of Americans today. The driving factor for increased inventories will be investors and second home buyers starting to put their homes on the market along with people that are being negatively impacted by the rising cost of homeowners insurance, property taxes, and employment issues where people have either lost their job or are needing to relocate.

- **Commercial Real Estate:** Performance will vary significantly due to asset class and location. Office properties will struggle due to a lack of financing availability and there will be an uptick in distress sales. Multi-family will see a modest uptick in vacancy rates and delinquency rates will rise as loans reprice due to maturities. Retail will find a more difficult year as more retail bankruptcies occur. The benefit for commercial real estate will be a drop in rates and transaction activity will increase as weak property holders have to sell to stronger buyers.

Global and Political Predictions for 2025

Sunwest Bank

- **United States:** 2025 in the United States will be unpredictably crazy. Legacy media will collapse, the economy could go through convulsions with a weakening labor market and yet sticky inflation, trade wars or real wars could expand.
- **China:** The Chinese economy will continue to worsen as Western companies further their divestment and the property markets continue to fall. Geopolitical tensions with America will increase.
- **Middle East:** President Trump and Israel will aggressively go after Iran, both with economic sanctions and military actions against all of their proxies in the Middle East.
- **Eurozone:** Europe will continue to slip into a deeper recession and political change will continue to sweep across Europe as their economies falter and the anti-immigration sentiment continues to build.
- **Super Bowl:** A desperate fan base will get their first Super Bowl... either the Detroit Lions or Buffalo Bills will win this year's Super Bowl.

Final Word

“Live boldly, because life is short.”

- Eric Hovde

Questions?

Sunwest Bank

For all feedback or questions, please email us at econupdate@sunwestbank.com

Thank You!