GROSSMAN YANAK & FORD LLP

BUSINESS VALUATION & LITIGATION SUPPORT SERVICES GROUP

2021
FIRST QUARTER
ECONOMIC OUTLOOK

United States Economy :
Current Economic Conditions and Recent Developments

Federal Reserve – Current Economic Conditions Commentary

The Federal Reserve publishes a report (known as the *Beige Book*) eight times per year that summarizes current economic conditions throughout the 12 Federal Reserve Districts in the United States. The most recent *Beige Book* publication was released on March 3, 2021. In the publication, it was noted that:[1]

- Economic activity expanded modestly from January to mid-February 2021 for most Federal Reserve Districts.
- Most businesses remain optimistic regarding the next 6-12 months as COVID-19 vaccines become more widely distributed.
- Reports on consumer spending and auto sales were mixed. Although a few Districts reported slight improvements in travel and tourism activity, overall conditions in the leisure and hospitality sector continued to be restrained by ongoing COVID-19 restrictions.
- Despite challenges from supply chain disruptions, overall manufacturing activity for most Districts increased moderately from the previous report.
- Among Districts reporting on nonfinancial services, activity was mixed, though most reported modest growth over the reporting period.
- Some Districts noted that financial institutions experienced declines in loan volumes, but most cited lower delinquency rates and elevated deposit levels.
- Historically low mortgage interest rates continued to spur robust demand for both new and existing homes in most Districts, and home prices continued to rise in many areas of the United States.
- On balance, commercial real estate conditions in the hotel, retail, and office sectors deteriorated somewhat, while activity in the multifamily sector remained steady and the industrial segment continued to strengthen.
- Districts reporting on energy observed a slight uptick in activity related to oil and gas production and energy consumption.
- Overall, reports on agricultural conditions were somewhat improved since the previous report. Transportation activity grew modestly for many Districts.

Employment and Wages

In terms of Employment and Wages, the most recent Beige Book reported an increase in hiring:

"Most Districts reported that employment levels rose over the reporting period, albeit slowly. Labor demand varied considerably by industry and by skill level, and many contacts noted continued difficulties attracting and retaining qualified workers. Labor supply shortages were noted by contacts as most acute among low-skill occupations and skilled trade positions. Constraints on labor supply

[1] Beige Book – March 3, 2021

included those related to COVID-19, childcare, and unemployment benefits. Overall, contacts expect modest improvements in employment levels in the near term. Several Districts reported modest wage increases for high-demand positions with many also noting upward pressure on wages to attract and retain employees. On balance, wage increases for many Districts are expected to persist or to pick up somewhat over the next several months."[2]

Federal Open Market Committee – Monetary Policy Commentary

The Federal Open Market Committee ("FOMC" or the "Committee") acts as the monetary policy-making body of the Federal Reserve System and makes all decisions regarding open market operations, which affect the federal funds rate (rate at which depository institutions lend to each other), the size of the Federal Reserve's asset holdings, and public communication regarding the likely course of future monetary policy.[3] Information received by the FOMC since they last met in 2021 indicated that:[4]

- The COVID-19 pandemic continues to cause tremendous human and economic hardship across the United States and around the world.
- Following a moderation in the pace of the recovery, indicators of economic activity and employment have turned up recently, although the sectors most adversely affected by the pandemic remain weak.
- Inflation continues to run below 2%.
- Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.
- The path of the economy will depend significantly on the course of the virus, including progress on vaccinations.
- The ongoing public health crisis continues to weigh on economic activity, employment, and inflation, and poses considerable risks to the economic outlook.

The FOMC further noted,

"The Committee seeks to achieve maximum employment and inflation at the rate of 2% over the longer run. With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2% for some time so that inflation averages 2% over time and longer-term inflation expectations remain well anchored at 2%. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0% to ¼% and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time. In addition, the Federal Reserve will continue to

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[2] Ibid.

[3] Structure of the Federal Reserve System, Federal Open Market Committee.

[4] Federal Reserve issues FOMC statement. March 17, 2021.

increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments."[5]

Coronavirus Impact

On January 21, 2020, the United States reported its first case of the novel coronavirus (COVID-19) in Washington State.[6] Since the beginning of the outbreak, the virus has brought the steady growth of the U.S. economy to a screeching halt. COVID-19 has caused the temporary (and, in some cases, permanent) closure of non-life sustaining businesses across the country.

The economic impact of the novel coronavirus has been rapid and has created significant uncertainty relating to the future health of the domestic economy. As such, in early March 2021, President Biden signed off on a $1.9 trillion COVID-relief bill, which included direct payments of $1,400 to most Americans. The bill also put almost $20 billion into COVID-19 vaccinations, $25 billion into rental and utility assistance, and $350 billion into state, local, and tribal relief.[7]

More relief is also on the way, as three separate vaccines are currently being administered to Americans all across the country. Pfizer and BioNTech had a vaccine approved for emergency use by the Food & Drug Administration on December 11, 2020.[8] Moderna received approval for their vaccine from the FDA on December 18, 2020.[9] Finally, Johnson & Johnson got the green light on their single-dose vaccine from the FDA on February 27, 2021.[10] With three different vaccines being administered, the number of vaccinated people in the United States continues to climb, getting us closer to overcoming the Coronavirus pandemic.

As of March 31, 2021, nearly 30% of the U.S. population has received at least one dose of a vaccine, while 16% of the population is fully vaccinated.[11] Dr. Anthony Fauci, Director of the National Institute of Allergy and Infectious Diseases, projects 70% to 85% of the population must be vaccinated in order to begin to turn the page on the COVID-19 pandemic and return to a sense of normalcy.[12]

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[5] Ibid.

[6] Timeline: How coronavirus got started.

[7] Biden signs $1.9 trillion Covid relief bill, clearing way for stimulus checks, vaccine aid.

[8] FDA approves Pfizer's Covid vaccine for emergency use as U.S. reaches pivotal moment in the pandemic.

[9] FDA approves Moderna's COVID-19 vaccine.

[10] FDA approves Johnson & Johnson's single-shot Covid vaccine for emergency use.

[11] U.S. Covid cases are on the rise as vaccinations pick up amid expanded eligibility guidelines.

[12] US could reach herd immunity by summer through vaccinations alone, CNN analysis finds.

Current Employment Conditions

The Bureau of Labor Statistics (BLS) reported that the unemployment rate decreased to 6.0% in March 2021.[13] Total nonfarm payroll employment rose by 916,000 in March 2021. These improvements in the labor market reflect the continued resumption of economic activity that had been curtailed due to the coronavirus pandemic.[14]

In March 2021, the unemployment rate and the number of unemployed persons both decreased to 6.0% and 9.7 million, respectively. The number of unemployed persons who were on temporary layoff decreased by 203,000 to 2.0 million, and the number of unemployed persons who were jobless less than 5 weeks was unchanged at 2.2 million in March 2021. Also in March 2021, 11.4 million persons reported that they had been unable to work because their employer closed or lost business due to the pandemic. That is, they did not work at all or worked fewer hours at some point in the last 4 weeks due to the pandemic. This measure is down from 13.3 million in the previous month.[15]

The BLS also noted:[16]

- In March 2021, employment in leisure and hospitality increased from the previous month by 280,000, as pandemic-related restrictions eased in many parts of the country. Nearly two-thirds of the increase was in food services and drinking places (+176,000). Job gains also occurred in arts, entertainment, and recreation (+64,000) and in accommodation (+40,000). Employment in leisure and hospitality is down by 3.1 million, or 18.5%, since February 2020.
- In March 2021, employment increased from the previous month in both public and private education, reflecting the continued resumption of in-person learning and other school-related activities in many parts of the country. Employment rose by 76,000 in local government education, by 50,000 in state government education, and by 64,000 in private education. Employment fell from February 2020 in local government education (-594,000), state government education (-270,000), and private education (-310,000).
- Construction added 110,000 jobs in March 2021, following job losses in the previous month (-56,000) that were likely weather-related. Employment growth in the industry was widespread in March 2021, with gains of 65,000 in specialty trade contractors, 27,000 in heavy and civil engineering construction, and 18,000 in construction of buildings. Employment in construction is 182,000 below its February 2020 level.
- Employment in professional and business services rose by 66,000 over the month but is down by 685,000 since February 2020. In March 2021, employment in administrative and support services continued to trend up (+37,000), although employment in its temporary help services component was essentially unchanged. Employment also continued on an upward trend in management and technical consulting services (+8,000) and in computer systems design and related services (+6,000).

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[13] The Employment Situation – March 2021.
[14] Ibid.
[15] Ibid.
[16] Ibid.

- Manufacturing employment rose by 53,000 in March 2021, with job gains occurring in both durable goods (+30,000) and nondurable goods (+23,000). Employment in manufacturing is down by 515,000 since February 2020.
- Transportation and warehousing added 48,000 jobs in March 2021. Employment increased over the past month in couriers and messengers (+17,000), transit and ground passenger transportation (+13,000), support activities for transportation (+6,000), and air transportation (+6,000). Since February 2020, employment in couriers and messengers is up by 206,000 (or 23.3%), while employment is down by 112,000 (or 22.8%) in transit and ground passenger transportation and by 104,000 (or 20.1%) in air transportation.
- Employment in the other services industry increased by 42,000 over the month, reflecting job gains in personal and laundry services (+19,000) and in repair and maintenance (+18,000). Employment in other services is down by 396,000 since February 2020.

The table below shows historical U.S. unemployment rates. The unemployment rate from March 2018 to February 2020 was between 3.5% and 4.0%, indicating the economy is at or near full employment. The rising unemployment rate starting in March 2020 is due to the coronavirus and its effects.

UNITED STATES UNEMPLOYMENT RATE												
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2017	4.8%	4.7%	4.5%	4.4%	4.3%	4.3%	4.3%	4.4%	4.2%	4.1%	4.1%	4.1%
2018	4.1%	4.1%	4.0%	3.9%	3.8%	4.0%	3.9%	3.8%	3.7%	3.8%	3.7%	3.9%
2019	4.0%	3.8%	3.8%	3.6%	3.6%	3.7%	3.7%	3.7%	3.5%	3.6%	3.5%	3.5%
2020	3.6%	3.5%	4.4%	14.7%	13.3%	11.1%	10.2%	8.4%	7.8%	6.9%	6.7%	6.7%
2021	6.3%	6.2%	6.0%									
Source: YCharts.com												

Current Interest Rates and Market Implied Inflation Compensation

The yields below were reported by the Federal Reserve[17] for constant maturity treasuries (nominal and inflation-indexed) as of March 31, 2021. Taking the difference between nominal yield and inflation-indexed yields gives a market-based estimate for inflation compensation over each maturity period.

MARKET IMPLIED INFLATION					
	5 Year	**7 Year**	**10 Year**	**20 Year**	**30 Year**
Nominal Treasuries	0.92%	1.40%	1.74%	2.31%	2.41%
Treasury Inflation Protected Securities	-1.62%	-1.08%	-0.63%	-0.13%	0.11%
Market Implied Inflation	**2.54%**	**2.48%**	**2.37%**	**2.44%**	**2.30%**
Source: Board of Governors of the Federal Reserve System, Data as of 03/31/2021					

[17] Federal Reserve. Selected Interest Rates (Daily) – H.15

Economic Forecast – Major Indicators

Gross Domestic Product (GDP) and Inflation

On March 17, 2021, the Federal Reserve released its economic projections for real GDP growth, the unemployment rate, personal consumption expenditures inflation, and the federal funds rate. The projections reflect the individual projections of the Federal Reserve Board members and Federal Reserve Bank presidents under what each individual considered appropriate monetary policy to be moving forward.[18] The table below contains the median forecasts of the participating individuals.

FEDERAL RESERVE ECONOMIC PROJECTIONS (MEDIAN)				
	2021	**2022**	**2023**	**Longer-Run**
Change in Real GDP	6.5%	3.3%	2.2%	1.8%
Unemployment Rate	4.5%	3.9%	3.5%	4.0%
PCE Inflation	2.4%	2.0%	2.1%	2.0%
Federal Funds	0.1%	0.1%	0.1%	2.5%
Source: Federal Open Market Committee, March 17, 2021				

Real GDP growth is expected to slow starting in 2021. PCE inflation is expected to decline from 2021 to 2023, while the unemployment rate is expected to decline year over year to 2023, and the federal funds rate is expected to remain constant until 2023. These forecasts suggest that in the long term, the economy will experience a slowing of growth and a decrease in inflation.

Long-term real GDP growth for the next 10 years is expected to average 1.8%, representing moderate expected real growth. The median projections of Federal Reserve data suggest longer-run PCE inflation is expected to be approximately 2.0%, consistent with the FOMC's inflation target.

The Bureau of Economic Analysis ("BEA"), an agency of the Department of commerce, produces economic account statistics that enable government and business decision-makers, researchers, and the American public to follow and understand the performance of the nation's economy.[19] In the most recent release, The BEA notes real GDP increased at an annual rate of 6.4% in the first quarter of 2021, compared to an increase of 4.3% in the fourth quarter of 2020.[20] The upward revision primarily reflected the continued economic recovery, reopening of establishments, and continued government response related to the COVID-19 pandemic. In the first quarter, government assistance payments, such as direct economic impact payments, expanded unemployment benefits, and Paycheck Protection Program loans, were distributed to households and businesses through the Coronavirus Response and Relief Supplemental Appropriations Act and the American Rescue Plan Act.[21]

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[18] Summary of Economic Projections. Federal Open Market Committee. March 17, 2021.

[19] U.S. Bureau of Economic Analysis. Who We Are.

[20] U.S. Bureau of Economic Analysis. Gross Domestic Product, First Quarter 2021 (Advance Estimate).

[21] Ibid

Industrial Production and Manufacturing

The Institute for Supply Management's (ISM) Purchasing Managers Index (PMI) can be used as an indication as to whether or not the manufacturing sector of the economy is expanding or contracting.[22] A PMI above 50.0 indicates that the manufacturing economy is generally expanding, while a reading below 50.0 indicates that it is generally contracting.[23] The PMI increased by 3.9 points to 64.7 in March of 2021 compared to February 2021.[24] This figure indicates expansion in the overall economy for the tenth month in a row after a contraction in April 2020, which ended a period of 131 consecutive months of growth.[25]

Timothy R. Fiore, Chair of the Institute for Supply Management, stated:

"The manufacturing economy continued its recovery in March. However, Survey Committee Members reported that their companies and suppliers continue to struggle to meet increasing rates of demand due to coronavirus (COVID-19) impacts limiting availability of parts and materials. Extended lead times, wide-scale shortages of critical basic materials, rising commodities prices and difficulties in transporting products are affecting all segments of the manufacturing economy. Worker absenteeism, short-term shutdowns due to part shortages, and difficulties in filling open positions continue to be issues that limit manufacturing-growth potential."[26]

Consumer Confidence

The backbone of the U.S, economy is its consumer base. Consumers influence the economic outlook immensely through their spending and savings decisions. As such, measures of consumer confidence and sentiment may provide valuable information in discerning the expected outlook of the economy. The University of Michigan's March 2021 Surveys of Consumers reported the following results:

UNIVERSITY OF MICHIGAN SURVEYS OF CONSUMERS					
	Mar-21	**Feb-21**	**Mar-20**	**M-M Change**	**Y-Y Change**
Index of Consumer Sentiment	84.9	76.8	89.1	10.5%	-4.7%
Current Economic Conditions Index	93.0	86.2	103.7	7.9%	-10.3%
Index of Consumer Expectations	79.7	70.7	79.7	12.7%	0.0%
Source: University of Michigan, Surveys of Consumers, Final Results for March 2021					

The above metrics indicate an increase in consumer confidence when compared to February 2021 and a decrease in consumer confidence when compared to March 2020.

[22] March 2021 Manufacturing ISM Report on Business.
[23] Ibid.
[24] Ibid.
[25] Ibid.
[26] Ibid.

Surveys of Consumers Chief Economist, Richard Curtin, noted the following key points for the March 2021 results:[27]

- Consumer sentiment continued to rise in late March 2021, reaching its highest level in a year due to the third disbursement of relief checks and better than anticipated vaccination progress. As prospects for obtaining vaccination have grown, so too has people's impatience with isolation, as those concerns were voiced by nearly one-third of consumers in March 2021, the highest level in the past year. The majority of consumers reported hearing of recent gains in the national economy, mainly net job gains. The data clearly point toward robust increases in consumer spending. The ultimate strength and duration of the spending surge will depend on the rate of draw-downs in savings since consumers anticipate a slower pace of income growth. Despite the vast decline in precautionary motives sparked by the easing of pandemic fears, those precautionary motives will not completely disappear. Importantly, the two contrasting policy recommendations both find support in the data: the recovery is far from complete as only 45% of the fall in the Sentiment Index has been recovered, and the current and prospective stimulus and infrastructure spending has the potential to spark an inflationary psychology. The reestablishment of an inflationary psychology will not occur immediately. Buy-in advance psychology preceded actual inflation by about two years prior to 1980, with the lead time more variable and with no resurgence in the low inflation era. The key issues are not to underestimate the ultimate impact of policies on employment and inflation, and not to overestimate the ability of economic policies to bring any excesses to a painless soft-landing.
- Year-ahead inflation expectations remained elevated at 3.1%; below last month's 3.3%, but well ahead of last March's 2.2%. This is the second time in the past year that the annual expected inflation rates were in the 3.0% to 3.3% range. The first time was from May to August 2020, before falling back to 2.5% in December 2020, rising again to the 3.0% level from January to March 2021. Consumers continued to anticipate a lower long term inflation rate of 2.8% in March 2021. While this was just above the 2.7% set in the prior two months (and in five of the past 12 months), the small increase does not indicate any significant lessening of well-anchored inflation, even if the 2.8% was the highest long-term rate since the July 2015 survey.
- Consumers reported much more favorable assessments of the national economy in March 2021. Favorable economic developments were cited by 57% of mentions in March 2021, up from 38% last month. For the first time in the past year, more consumers expected good rather than bad times in the national economy during the year ahead (49% vs. 41%), a significant improvement from February 2021, when negative views were held by the majority (36% vs. 53%). Expected job gains were a critical component. Declines in the unemployment rate during the year ahead were anticipated by 45% in March 2021, up from last month's 36%.

[27] Surveys of Consumers. University of Michigan. March 2021.

Housing and Construction

In March 2021, the Dodge Momentum Index rose 1.7% from the February reading of 148.8.[28] The Momentum Index, issued by Dodge Data & Analytics ("Dodge") is a monthly measure of the first (or initial) report for nonresidential building projects in planning, which have been shown to lead construction spending for nonresidential buildings by a full year.

Dodge Data & Analytics opined,

"Overall, the Momentum Index for March 2021 was up 11% in total versus March 2020. While healthcare and lab projects continue to dominate institutional planning, March 2021 saw a more broad-based selection of project types including education and recreation buildings. Institutional building construction rose 14.0% from February 2021, while year-over-year comparisons showed a 10% increase for the sector. Commercial construction, however, dipped 3.9% for the month due to a slight pullback in warehouse activity that other commercial projects could not make up for, though the sector showed a 12% increase from March 2020 in year-over-year comparisons."[29]

There were 16 projects with a value of $100 million or more that entered planning within March 2021. The leading commercial projects were a $400 million Facebook Data Center in Springfield, NE and a $350 million warehouse project in Shreveport, LA. The leading institutional projects were the $200 million Warhorse Casino in Lincoln, NE and the $163 million Inland Valley Medical Center in Wildomar, CA.[30]

Interest Rates

In September 2020, the Federal Reserve pledged to keep interest rates near zero until 2023. [31]

As of December 31, 2020, the prime interest rate is 3.25%.[32] The prime rate is posted by a majority of the top 25 (by assets in domestic offices) insured U.S. chartered commercial banks and is one of the several base rates used by banks to price short-term business loans.[33] While the Federal Reserve does not control the prime rate, many banks base their prime rates partly on the target level of the federal funds rate (the rate that banks charge each other for short-term loans) as established by the FOMC.[34]

In public markets, asset prices continually fluctuate with changes in future expectations. Thus, the impact on publicly traded equity valuations is focused not necessarily on the trend of lower future interest rates, but rather, whether or not the current expectations are higher or lower than previous estimates. The anticipated impact of interest rate expectations on the expected overall cost of capital and equity valuations cannot be readily discerned, as other variables necessary to

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[28] Dodge Momentum Index Posts Gain in March.
[29] Ibid.
[30] Ibid.
[31] Federal Reserve Says It Will Keep Interest Rates Near Zero Until 2023.
[32] Board of Governors of the Federal Reserve System, Select Interest Rates, Bank Prime Loan.
[33] Ibid.
[34] "What is the prime rate and does the Federal Reserve set the prime rate?"

make such a generalization are unknown. However, in analyzing changes in the expected level of the S&P 500 Index we are able to discern if economic conditions have evolved in a way that would generally suggest higher or lower equity values.

The S&P 500 closed the first quarter of 2021 up 5.8%, while the Dow Jones Industrial Average (DJIA) closed Q1 2021 up 7.8%. This marked the fourth straight quarter of positive growth for both indices. The Nasdaq followed suit, gaining 2.8% over the first quarter of 2021.[35]

The *GYF Q1 2021 Public Market Report* provides additional commentary on the continued signs of economic recovery as reflected in the public markets and M&A deal activity. The report includes detailed analysis of the various markets, funds and sectors.[36]

Economic Outlook Conclusion

The rollout of the coronavirus vaccines across the country has injected hope and optimism into the U.S. economy. As vaccinations increase and we inch closer to normalcy, more businesses will begin to open back up, causing unemployment to decline and the economy to expand. The vaccines have also provided a "shot in the arm" to the markets, with the S&P 500, DJIA, and Nasdaq all experiencing growth in Q1. Therefore, at the end of the first quarter of 2021, the current economic outlook is slightly positive due to the vaccine rollout.

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[35] S&P 500 rises lifted by tech shares, closes out best month since November.

[36] Grossman Yanak & Ford LLP, 1Q 2021 Public Market Report, May 2021