GROSSMAN YANAK & FORD LLP

BUSINESS VALUATION & LITIGATION SUPPORT SERVICES GROUP

2021
3rd 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 September 8, 2021. In the publication, it was noted that:[1]

- Economic growth downshifted slightly to a moderate pace in early July through August 2021.
- The stronger sectors of the economy of late included manufacturing, transportation, nonfinancial services, and residential real estate.
- The deceleration in economic activity was largely attributable to a pullback in dining out, travel, and tourism in most Districts, reflecting safety concerns due to the rise of the Delta variant, and, in a few cases, international travel restrictions.
- Other sectors of the economy where growth slowed or activity declined were those constrained by supply disruptions and labor shortages, as opposed to softening demand. In particular, weakness in auto sales was widely ascribed to low inventories amidst the ongoing microchip shortage, and restrained home sales activity was attributed to low supply.
- Growth in non-auto retail sales slowed a bit in some Districts, rising at a modest pace, on balance, across the nation.
- Residential construction was up slightly overall and nonresidential construction picked up modestly.
- Trends in loan volumes varied widely across Districts, ranging from down modestly to up strongly.
- Reports on the agriculture and energy sectors were mixed across Districts but were generally positive.
- Looking ahead, businesses in most Districts remained optimistic about near-term prospects, however, widespread concern about ongoing supply disruptions and resource shortages remains.

Employment and Wages

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

*"*All Districts continued to report rising employment overall, though the characterization of the pace of job creation ranged from slight to strong. Demand for workers continued to strengthen, but all Districts noted extensive labor shortages that were constraining employment and, in many cases, impeding business activity. Contributing to these shortages were increased turnover, early retirements (especially in health care), childcare needs, challenges in negotiating job offers, and enhanced unemployment benefits. Some Districts noted that return-to-work schedules were pushed back due to the increase in the Delta variant. With persistent and extensive labor shortages, a number of Districts reported an acceleration in wages, and most characterized wage growth as strong – including all of the midwestern and western regions. Several Districts noted particularly brisk wage gains among lower-wage workers. Employers were reported to be using more frequent raises, bonuses, training, and flexible work arrangements to attract and retain workers."[2]

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[1] *Beige Book* – September 8, 2021
[2] Ibid.

Federal Open Market Committee – Monetary Policy Commentary

The Federal Open Market Committee ("FOMC" or the "Committee") acts as the monetary policymaking body of the Federal Reserve System. The FOMC 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 contained in the statement issued on September 22, 2021, indicates that:[4]

- With progress on vaccinations and strong policy support, indicators of economic activity and employment have continued to strengthen.
- The sectors most adversely affected by the pandemic have improved in recent months, but the rise in COVID-19 cases has slowed their recovery.
- Inflation is elevated, largely reflecting transitory factors.
- 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 continues to depend on the course of the virus.
- Progress on vaccinations will likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remain.

The FOMC reported that it seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run.

"With inflation having run persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. 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 1/4 percent 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 percent and is on track to moderately exceed 2 percent for some time. Last December, the Committee indicated that it would continue to 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 its maximum employment and price stability goals. Since then, the economy has made progress toward these goals. If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses."[5]

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[3] Structure of the Federal Reserve System, Federal Open Market Committee.
[4] Federal Reserve issues FOMC statement. September 22, 2021
[5] Ibid.

The Committee further noted,

"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."[6]

Coronavirus Impact

The novel coronavirus (COVID-19) continues to have an effect on the U.S. economy since the first case was reported in the United States in January 2020.

On September 22, 2021, the United States Food and Drug Administration "amended the emergency use authorization (EUA) for the Pfizer-BioNTech COVID-19 Vaccine to allow for use of a single booster dose, to be administered at least six months after completion of the primary series in:

- individuals 65 years of age and older;
- individuals 18 through 64 years of age at high risk of severe COVID-19; and
- individuals 18 through 64 years of age whose frequent institutional or occupational exposure to SARS-CoV-2 puts them at high risk of serious complications of COVID-19 including severe COVID-19."[7]

As of September 30, 2021, 215 million Americans (65.3% of the eligible population) have received at least one dose of a COVID-19 Vaccine, while 186 million Americans (56.3% of the eligible population are fully vaccinated.[8]

However, the growing vaccination rate may have instilled a false sense of security, and it is likely that COVID will continue to have a negative impact for the rest of 2021. As the spread of the Delta variant has also brought with it a feeling of panic for Americans, the country has yet to realize the full impact of the virus. In fact, "the University of Washington's Institute for Health Metrics and Evaluation projects that between September 1 and December 1 there will be 100,000 COVID deaths, more than in the same period last year, when a wave of winter infections took hold and vaccines were not yet available."[9]

Current Employment Conditions

The Bureau of Labor Statistics (BLS) reported that the unemployment rate fell by 0.4% to 4.8% in September 2021.[10] Total nonfarm payroll employment rose by 194,000 in September 2021. Notable job gains occurred in leisure and hospitality, professional and business services, retail trade, and transportation and warehousing.[11]

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[6] Ibid.
[7] FDA Authorizes Booster Dose of Pfizer-BioNTech COVID-19 Vaccine for Certain Populations.
[8] Coronavirus (COVID-19) Vaccinations.
[9] U.S. economy's hot vax summer ends in cool COVID fall as Delta rises.
[10] The Employment Situation – September 2021 – Bureau of Labor Statistics.
[11] Ibid.

In September 2021, the unemployment rate and the number of unemployed persons, at 4.8% and 7.7 million, respectively, both dropped from the previous month. The number of unemployed persons who were on temporary layoff changed little from the previous month, totaling 1.1 million in September 2021. The number of unemployed persons who were jobless less than 5 weeks also changed little from the previous month, holding steady at 2.2 million in September 2021. The number of persons who reported that they had been unable to work because their employers 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 Covid) fell to 5.0 million, down from 5.6 million in the previous month.[12]

The BLS also noted:[13]

- Employment in leisure and hospitality increased by 74,000 in September 2021 from the previous month, with continued job growth in arts, entertainment, and recreation (+43,000). Employment in food services and drinking places changed little for the second consecutive month, compared with an average monthly gain of 197,000 from January through July 2021. Employment in leisure and hospitality is down by 1.6 million, or 9.4 percent, since February 2020.
- Professional and business services added 60,000 jobs in September 2021. Employment continued to increase in architectural and engineering services (+15,000), management and technical consulting services (+15,000), and computer systems design and related services (+9,000). Employment in professional and business services is 385,000 below its level in February 2020.
- In September 2021, employment in retail trade rose by 56,000 over the previous month's total, following two months of little change. Over the month, employment gains occurred in clothing and clothing accessories stores (+27,000), general merchandise stores (+16,000), and building material and garden supply stores (+16,000). These gains were partially offset by a loss in food and beverage stores (-12,000). Retail trade employment is 202,000 lower than its level in February 2020.
- Employment in transportation and warehousing increased by 47,000 in September 2021 from the previous month, in line with gains in the prior two months. Job gains also continued in September 2021 in warehousing and storage (+16,000), couriers and messengers (+13,000), and air transportation (+10,000). Employment in transportation and warehousing employment is 72,000 above its pre-pandemic level in February 2020.
- Employment in manufacturing increased by 26,000 in September 2021, compared to August, with gains in fabricated metal products (+8,000), machinery (+6,000), and printing and related support activities (+4,000). These gains were partially offset by a decline of 6,000 in motor vehicles and parts. Manufacturing employment is down by 353,000 since February 2020.
- In September 2021, construction employment rose by 22,000 from the previous month, but has shown little net change thus far this year. Employment in construction is 201,000 below its February 2020 level.
- Employment in health care changed little from August 2021 to September 2021 (-18,000). Job losses occurred in nursing and residential care facilities (-38,000) and hospitals (-8,000), while ambulatory health care services added jobs (+28,000). Employment in health care is down by 524,000 since February 2020, with nursing and residential care facilities accounting for about four-fifths of the loss.

[12] Ibid.
[13] Ibid.

The following table contains historical U.S. unemployment rates. The unemployment rate from March 2018 to February 2020 was between 3.5% and 4.0%, indicating the economy was 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%	6.1%	5.8%	5.9%	5.4%	5.2%	4.8%			
Source: YCharts.com												

Economic Forecast – Major Indicators

Gross Domestic Product (GDP) and Inflation

In conjunction with the Federal Open Market Committee (FOMC) meeting held on September 21-22, 2021, meeting participants submitted their projections of the most likely outcomes for real gross domestic product (GDP) growth, the unemployment rate, and inflation for each year from 2021 to 2024 and over the longer run. Each participant's projections were based on information available at the time of the meeting, together with her or his assessment of appropriate monetary policy – including a path for the federal funds rate and its longer-run value – and assumptions about other factors likely to affect economic outcomes.

The longer-run projections represent each participant's assessment of the value to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her individual interpretation of the statutory mandate to promote maximum employment and price stability.[14] The following table contains the median forecasts of the participating individuals.

FEDERAL RESERVE ECONOMIC PROJECTIONS (MEDIAN)					
	2021	**2022**	**2023**	**2024**	**Longer Run**
Change in Real GDP	5.9%	3.8%	2.5%	2.0%	1.8%
Unemployment Rate	4.8%	3.8%	3.5%	3.5%	4.0%
PCE Inflation	4.2%	2.2%	2.2%	2.1%	2.0%
Federal Funds	0.1%	0.3%	1.0%	1.8%	2.5%
Source: Federal Open Market Committee, September 21-22, 2021					

[14] Summary of Economic Projections. Federal Open Market Committee. September 22, 2021.

Real GDP growth is expected to slow starting in 2022. PCE inflation is expected to decline from 2021 to 2024, while the unemployment rate is expected to decline year-over-year to 2023, and the federal funds rate is expected to increase year-over-year, starting in 2022. 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.

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. 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.[15] The PMI increased 1.2 points to 61.1 in September 2021, compared to August 2021.[16] This figure indicates expansion in the overall economy for the 16th month in a row after a contraction in April 2020, which ended a period of 131 consecutive months of growth.[17]

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

"Business Survey Committee panelists reported that their companies and suppliers continue to deal with an unprecedented number of hurdles to meet increasing demand. All segments of the manufacturing economy are impacted by record-long raw materials lead times, continued shortages of critical materials, rising commodities prices and difficulties in transporting products. Global pandemic-related issues – worker absenteeism, short-term shutdowns due to parts shortages, difficulties in filling open positions and overseas supply chain problems – continue to limit manufacturing growth potential. However, optimistic panel sentiment remains strong, with three positive growth comments for every cautious comment. Panelists are fully focused on supply chain issues in order to respond to the ongoing high levels of demand."[18]

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 October 2021 Preliminary Data *Surveys of Consumers* reported the following: [19]

UNIVERSITY OF MICHIGAN SURVEYS OF CONSUMERS					
	Oct-21	**Sep-21**	**Oct-20**	**M-M Change**	**Y-Y Change**
Index of Consumer Sentiment	71.4	72.8	81.8	-1.9%	-12.7%
Current Economic Conditions Index	77.9	80.1	85.9	-2.7%	-9.3%
Index of Consumer Expectations	67.2	68.1	79.2	-1.3%	-15.2%
Source: University of Michigan, Surveys of Consumers, Final Results for October 2021					

[15] September 2021 Manufacturing ISM Report on Business.
[16] Ibid.
[17] Ibid.
[18] Ibid.
[19] Surveys of Consumers. University of Michigan. October 2021.

Survey of Consumers chief economist, Richard Curtin, opined: "Consumer sentiment remained virtually unchanged from its mid-month reading, gaining just 0.3 Index points, and just 0.1 Index points above the average in the past two months, and only 0.1 Index points below the April 2020 low. The positive impact of higher income expectations and the receding coronavirus has been offset by higher rates of inflation and falling confidence in government economic policies."[20]

Housing and Construction

The Momentum Index, issued by Dodge Data & Analytics ("Dodge") is a monthly measure of the initial report for nonresidential building projects in planning, which have been shown to lead construction spending for nonresidential buildings by a full year. The September report showed that the Dodge Momentum Index gained 11% in September 2021 to 164.9 (2000=100) from the revised August 2021 reading of 148.0. The commercial planning component increased by 13% in September 2021, while the institutional component rose 8%.[21]

A total of 17 projects with a value of $100 million or more entered planning during September 2021. The leading commercial projects were a $500 million office building in Los Angeles, CA, and a $250 million office project in Cambridge, MA. The leading institutional projects were the first and third phases of a lab facility in Boston, MA, valued at $450 million and $225 million respectively.[22]

The gain in the Momentum Index and its components in September 2021 is certainly good news and a sign that owners and developers are looking past the current concerns over pricing, Delta, and politics, and are moving forward with projects to meet demand. However, this optimism does not mean there are no problems ahead for the sector. Month-to-month volatility in the data is likely to remain for some time.[23]

Interest Rates

As of September 30, 2021, the prime interest rate remained at 3.25%.[24] 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. 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.[25]

Although, the Federal Reserve Board promised to keep interest rates low until 2023, recent forecasts indicate that the end to this accommodative monetary policy could come sooner than the Fed originally pledged in September 2020.

In a recent release, the central bank noted, "… the economy has made progress toward these goals. If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted."[26]

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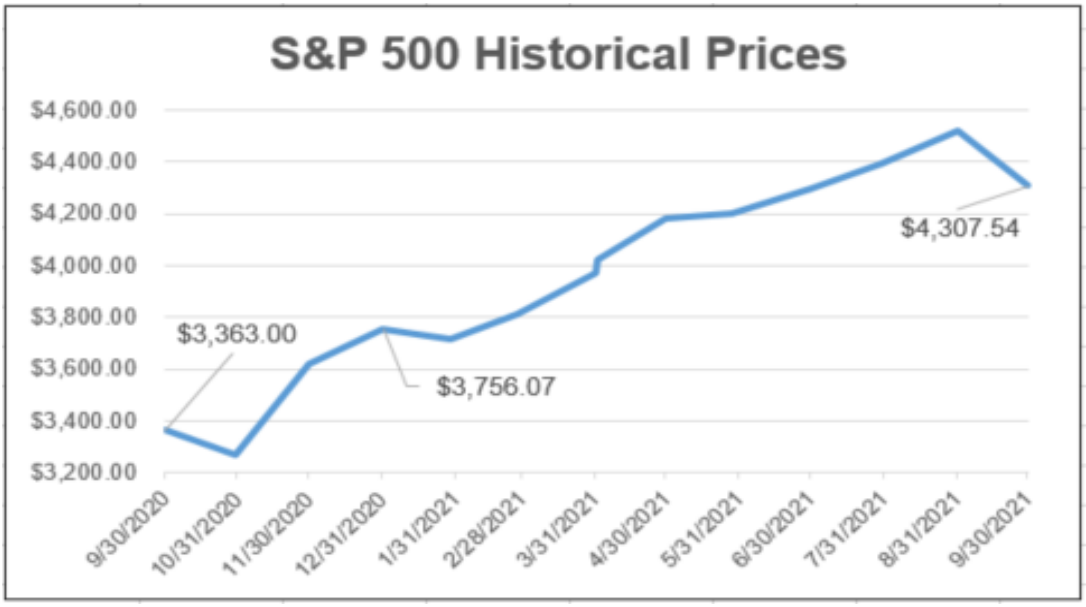
[20] Ibid.
[21] Dodge Momentum Index Recovers in September
[22] Ibid.
[23] Ibid.
[24] Board of Governors of the Federal Reserve System, Select Interest Rates, Bank Prime Loan.
[25] "What is the prime rate and does the Federal Reserve set the prime rate?"
[26] Fed Holds Steady on Interest Rates But Shaves 2021 Economic Forecast | Economy | US News

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 projections on the expected overall cost of capital and equity valuations cannot be readily discerned, as other variables necessary to 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.

As shown below, on September 30, 2021, the S&P 500 had increased 14.7% from December 31, 2020 levels, and was up 28.1% from September 30, 2020. As such, investor attitude should be optimistic.



The *GYF 3Q 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.[27]

Economic Outlook Conclusion

Economic conditions continued to improve this quarter, reflected in a strong performance by the S&P 500, which experienced a healthy increase through the first three quarters of the year. However, as we move into the fourth quarter, rising COVID infection rates could slow economic expansion. Consumer spending over the third quarter remained stagnant, as rising inflation rates worked to offset consumers with more disposable income looking to spend. Most sectors reported job increases in the third quarter, a positive sign for the economy. Manufacturers are reporting that supply chain issues are hindering their ability to meet high demand. Therefore, at the end of the third quarter of 2021, the current economic outlook is positive, but uncertainty looms moving towards the end of the year.

[27] Grossman Yanak & Ford LLP, 3Q 2021 Public Market Report, November 2021