FIRST NEBRASKA Trust COMPANY

Fourth Quarter 2019

Quarterly Letter to Clients

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January 20, 2020

Tempus Fugit! Many of us have heard this Latin phrase, translated as 'Time Flies', which seems to appropriately describe this past year. It's hard to believe all the events that occur in a year, let alone a decade, that mix together to mold our perceptions of the world around us. How busy or bored we are may impact our perception of how quickly time passes. Yet, time is a constant and therefore it doesn't speed up or slow down. It is one of our most valuable resources, but one that many times we take for granted. It gets measured in many ways, but for most of us, it is marked by the milestones that we experience. The births of children, the birthdays and anniversaries we have, the time until the kids go to (or get out of) college, our retirement date, the time passed since the last recession, or the length of an expansion, to name a few.

If anything, it is worthwhile to take a few moments to ponder the extraordinary path we've experienced over the past decade. The uncertainties of ten years ago were focused on the Great Recession and the pain many folks were experiencing due to loss of employment, or even the loss of their home, as record home foreclosures and unemployment combined to push the misery index to highs not seen in years. Fears were abundant and the stock market was coming off of a 50% decline, as confidence in the future and jobs were both in scarce supply. Governments around the globe were taking extraordinary measures to try to improve confidence and stimulate economic activity.

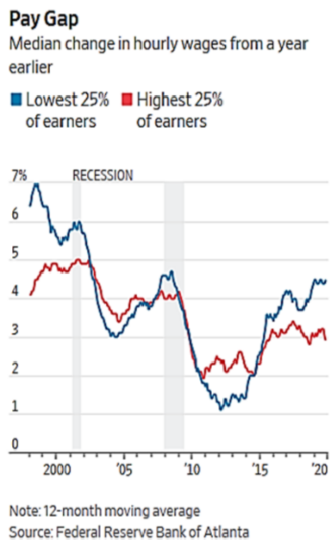
Fast forward to December 2019. The worries of a decade ago have been replaced with new worries. We have reached a point in time since the Great Recession in which the recovery of economic activity holds the record for being the longest, albeit slowest, recovery in modern history. Prosperity has spread throughout the nation is a similar pattern to the overall economy. Unemployment declined from its peak of 10% in October 2009 to 3.5% in December 2019. Wage growth is finally improving, with the last few years seeing wages growing at a faster pace than reported inflation. Home and auto sales improved markedly over the last ten years, both being benefactors of the improving job market and low interest rates. Historically low interest rates throughout the decade have conditioned investors to reach for higher yields in the fixed income markets, while being a boon for borrowers and a burr in the saddle for investors.

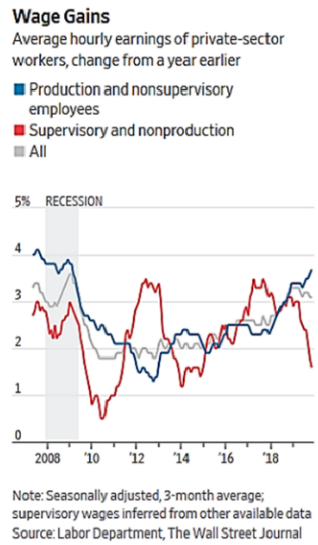
During the 4th quarter of 2019, the focus on the economy and the capital markets spilt time between the actions of the Federal Reserve and whether or not some of the uncertainty around trade and tariffs would be resolved. Manufacturing data have reflected the slowing global economy due to softer demand. This may be the result of companies placing larger orders in early quarters of the year to avoid the impacts of threatened tariffs. Industrial Production growth turned negative during the quarter, mimicking the downward trends seen in both Durable Goods and Capital Goods orders, posting its lowest reading on business activity since 2009. Similarly, the Institute of Supply Management (ISM) Purchasing Managers Index posted its 5th consecutive monthly decline in December.

However, the consumer remains resilient. As the primary driver of domestic GDP growth, the US consumer is key to sustaining the economic expansion, now in its 126th month. Consumer confidence remained elevated, as massive gains in financial assets and an improved housing market combined to push household net worth to new all-time record-highs. Consumer spending remains healthy at the aggregate level, mainly due to the continued progress in the labor market. Unemployment remains low, at 3.5%, with labor participation levels rising slightly to 63.2%, even though job growth slowed somewhat in the final month of the year.

What has become the longest hiring expansion in 80 years has translated into lower-income workers seeing much better wage growth than those at managerial or higher levels. According to the Wall Street Journal, “Pay for the bottom 25% of wage earners rose 4.5% in November from a year earlier, according to the Federal Reserve Bank of Atlanta. Wages for the top 25% of earners rose 2.9%. Similarly, the Atlanta Fed found wages for low-skilled workers have accelerated since early 2018, and last month matched the pace of high-skill workers for the first time since 2010.” [1] Production and nonsupervisory employees saw their average hourly earnings increase approach 4%, while supervisory and nonproduction workers saw increases of less than 2%.

[1] *Rank and File Worker’s Get Bigger Raises*, By Eric Morath and Jeffrey Sparshott Wall Street Journal, December 27, 2019.





In most cases, wage growth outpaced inflation, providing workers additional real spending power.

However, while the consumer appears to be in better shape than a decade ago, there are some clouds on the horizon. Student, auto, and credit debt have all climbed to levels surpassing their 2008 peaks. Delinquencies in all three categories are rising, providing an early warning indicator of financial stress. Auto loan delinquencies have been rising for the past 4 years, while credit card balances that are seriously past due have seen similar increases. Both may indicate that consumers will have less ability to make purchases with credit in the near term.

Of course, the cost of credit can be influenced by the changes that the US Federal Reserve makes in interest rates. Looking back over the last year, the capital market's focus on the Fed's actions is apparent from looking at a price chart of the major indices. Earlier this year, in an almost Pavlovian response, stocks quickly rebounded at the news that the Fed was reversing its policy towards easing. This was followed by three "insurance rate cuts" conducted throughout the year, with the last occurring at the beginning of the 4th Quarter targeting a federal funds rate of between 1.5 and 1.75%. Fed Chair Powell then announced that the Federal Open Market Committee (FOMC) would pause rate cuts for the time being, barring a deterioration in economic activity.

During the past quarter, the bond markets responded positively to the improving economic and inflation reports that provided hopeful signs that the economic recovery may be sustained just a little bit longer. The yield curve steepened somewhat, alleviating the concerns of many that the inverted yield curve was forecasting a recession. The short maturities of the curve saw yields decline between 15 and 30 basis points, while the long end of the curve saw similar increases. The 10-year US Treasury Bond ended the quarter at 1.92%, up 24 basis points from the prior quarter's level of 1.68%. Lower quality bonds, including non-investment grade and high-yield bonds (aka junk bonds) outperformed the quality part of the credit spectrum.

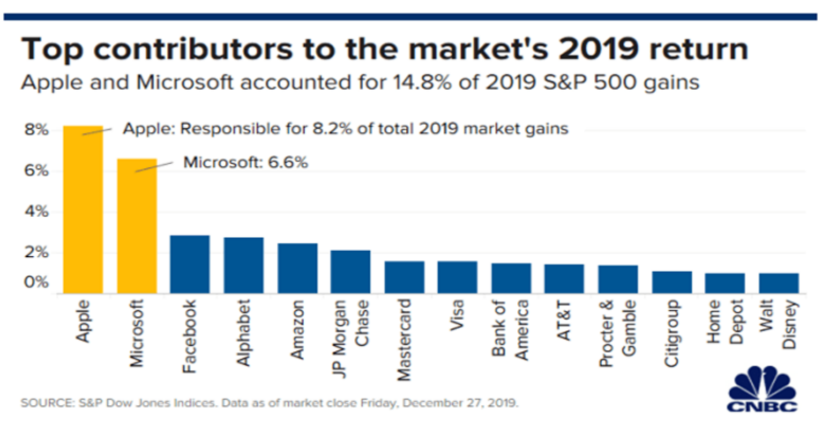
Time-Weighted Rate of Return Summary *As of 12/31/2019*

Bond Indexes	Quarter	1-Year	3-Year	5-Year
US Treasury Bills	0.5	2.5	1.8	1.2
Barclays US Gov 1-3 Year	0.6	3.9	2.0	1.5
Barclays Intermed Gov/Corp	0.4	6.8	3.2	2.6
Salomon Treas Agency TTL Rtn	(0.8)	6.7	3.3	2.3
Barclays Muni Bond 5 Year	1.0	5.5	3.4	2.4

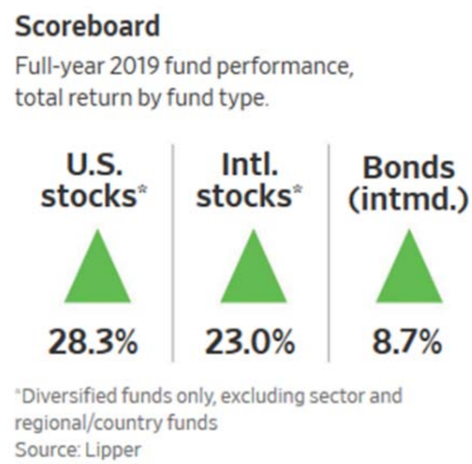
Stock Market Indexes	Quarter	1-Year	3-Year	5-Year
DJ Industrial Average	6.6	25.1	15.6	12.4
Dow Jones TTL Stock Mkt US	8.5	28.4	12.4	9.1
NASDAQ Composite	12.1	35.6	18.8	13.9
S&P 500	9.1	31.5	15.3	11.7
MSCI EAFE (NET DIV)	8.2	22.0	9.6	5.7

The stock market moved higher in the final months of the year on the heels of reduced trade tensions, possible tariff relief, and increase liquidity from the Federal Reserve. For the 4th Quarter, the S&P 500 increased 9.1%, while the Dow Jones Industrial Average (DJIA) climbed 6.6%, and the tech-heavy NASDAQ soared 12.1%. Investors regained their craving for riskier stocks, as smaller capitalization stocks outperformed their larger brethren. This reversed the trend seen on an annual basis, where the momentum of the larger capitalization stocks, heavily influenced by the technology sector, caused large and mega capitalization stocks to outperform.

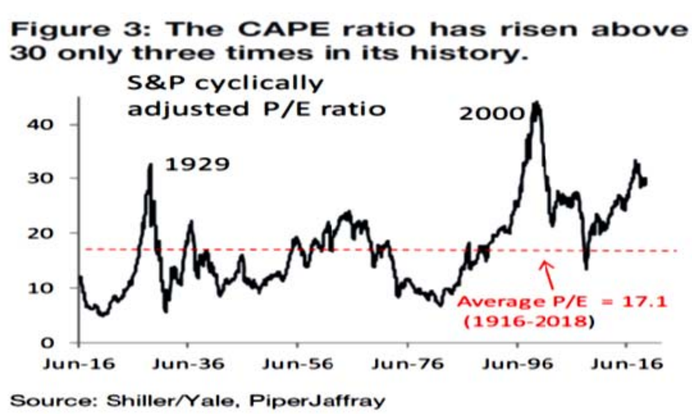
As the graphic below demonstrates, the largest technology related companies continued to dominate the indices. In fact, just two companies provided almost 1/6th of the market's annual total return, with another dozen companies providing 2 % or greater contributions to the market's 31.5% 2019 return.



As the Scoreboard graphic below shows, the average mutual fund saw an increase of 28.3% for the quarter, while international funds improved their relative returns posting a 23.0% over the same time period.[2]   In total, the stock market provided its best annual performance since 2013.



Finally, as the cyclical bull market enters its 12th year, valuations are again approaching record levels while earnings continue to underwhelm. Reported earnings are showing weakness that is partly masked by stock buybacks, which is boosting reported earnings per share. Fundamentals are showing signs of deterioration, as limited revenue growth and rising expenses are putting pressures on profit margins. In addition, consensus revenue and earnings growth estimates continue to be revised downward. All these factors combine to provide an investment atmosphere that has increased market risks and provides less room for errors. As the chart below shows, valuations rarely reach the level we're currently seeing. History repeatedly reminds us that periods where investments are made in high price/earnings (P/E) environments are followed by subpar long-term returns.



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[2] Source: https://www.wsj.com/articles/bond-funds-continue-to-attract-cash-11570414321

The current investment climate provides numerous challenges to those that are trying to put their capital to work. Nevertheless, our strategy for your account continues to focus on customizing your portfolio to meet the purpose of the funds invested. The fixed income portion of your account is structured to emphasize capital preservation and stable cash flow, while providing a probable source of funds for future cash needs. The equity portion is constructed to provide a combination of capital appreciation and dividend income to meet the long-term objective for your account. We will continue to be disciplined in our process, searching for those stocks that can be bought at prices that meet our investment standards, while providing a satisfactory margin-of-safety. Similarly, we will sell those stocks that exceed our estimate of fair value, irrespective of the vagaries in the general markets.