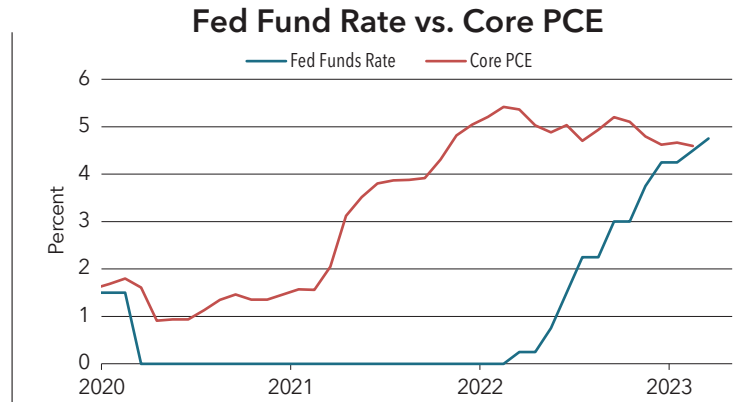


Inflation and Labor Guide the Fed

Markets rebounded in the first quarter as investors digested the impact of inflation, interest rates, a banking scare and the outlook for economic growth. The economy is split with some areas looking strong while others are sending warnings of weakness. Labor remains a bright spot with the unemployment rate still near record lows and almost 10 million jobs open across the country. This has kept wages up and helped consumers keep pace with inflation. Consumer spending has been aided by excess pandemic-related savings and credit usage, which may not be sustainable for the rest of the year. However, after two years of negative real disposable income, wages are rising as inflation comes down and may act as a spending boost.

As illustrated in the chart, inflation (Core PCE) has decelerated since the Fed started increasing rates and has now crossed below the Fed funds rate. This is a key metric we have been waiting for before we believe the Fed rate hikes may pause. The rapid rise in interest rates is hurting parts of the economy. The manufacturing and service sectors have been slowing for several months and are signaling a potential recession. Housing is struggling with record low affordability due to high prices and mortgage rates. This has raised the question: Will we have a recession? As of early April, the markets are saying no. Our base forecast is still a mild recession, however, the prospect of avoiding a recession has grown.



Source: Board of Governors of the Federal Reserve System

Market Returns

Source: Morningstar Direct data as of March 31, 2023

Asset Class	Index	Total Return 3 Month (%)	Total Return YTD (%)	Total Return 1 Year (%)	Annualized 3 Year (%)	Annualized 5 Year (%)
Global Equities:	Diversified Equity Benchmark*	6.89	6.89	-8.28	16.80	8.57
Domestic Equities:	S&P 500 (Large Cap)	7.50	7.50	-7.73	18.60	11.19
	Russell 2000 (Small Cap)	2.74	2.74	-11.61	17.51	4.71
International Equities:	MSCI EAFE (Developed)	8.47	8.47	-1.38	12.99	3.52
	MSCI Emerging Market	3.96	3.96	-10.70	7.83	-0.91
Fixed income:	Barclays Intermediate U.S. Gov't/Credit	2.33	2.33	-1.66	-1.28	1.40
	Barclays Muni Short-Interm 1-10 Years	1.84	1.84	1.81	0.71	1.79
	Barclays Global Intermediate	2.29	2.29	-5.88	-3.09	-1.69

Recession in 2023 or Not?

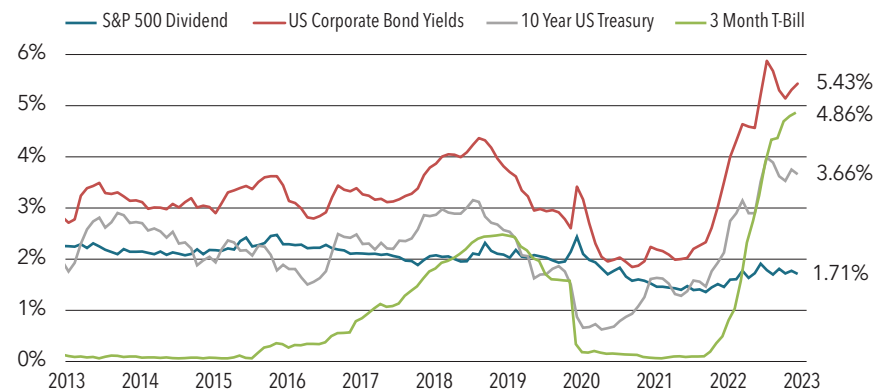
Silicon Valley Bank and Signature Bank of New York both collapsed within days of each other in early March. Is this the start of another banking crisis like 2008? We think not as the situations with these banks were more risk management issues than credit and economic problems. While we can't rule out other banks failing at this time, we believe the Fed's actions are sufficient to curtail the systemic risk of loss from bank bond portfolios. Most of the sector is in good shape from a capital perspective and will likely improve if we see interest rates trend lower.

Portfolios Rebound After Brutal 2022

Investors in mixed asset portfolios of stocks and bonds had a difficult year in 2022 with the average 60/40 portfolio declining more than 13%¹. As written in the FNBO 2023 Investment Outlook², the poor year provided better long-term opportunities, and we are off to a positive start so far in 2023.

- **Cash:** Goldman Sachs Financial Square Government Fund money market fund ended the quarter returning the highest yield on cash since 2007**
- **Bonds:** The Fed raised interest rates at the fastest pace in the past 40 years. So far in 2023, the hikes continued but at a significantly reduced pace, signaling we are close to the end of the cycle. Bank failures in mid-March spooked markets and sent rates downward, which contributed to fixed income boasting a positive return north of 2%. As seen in the chart, bonds now offer attractive yields relative to other assets and recent history.
- **Stocks:** Most of last year's decline was due to multiple contraction. This year, stocks found some stability in valuations as the end of the Fed's rate hiking cycle draws closer. The Diversified Equity Benchmark is up just under 7% this year, being led by developed international returns. As we maneuver through the rest of the year, our focus will be on evaluating the sustainability of company earnings during this high inflation environment.
- **Alternatives:** We continue to utilize alternatives to hedge risks we see building in the marketplace. Our alternative allocation benefitted clients by reducing risk.

Bond Yields vs. Dividend Yields



Source: Ice Data Indices, Federal Reserve Bank of St. Louis, S&P DJ Indices (FactSet) as of March 31, 2023

¹Vanguard calculations, based on data from Standard & Poor's, MSCI, and Bloomberg. Returns in 2022 were -16.1% for the U.S.-only 60/40 portfolio and -15.7% for the globally diversified 60/40 portfolio. For the U.S. portfolio, we used the S&P 500 Index as a proxy for stocks and the Bloomberg U.S. Aggregate Bond Index as a proxy for bonds. For the globally diversified 60/40 portfolio, we used the following proxies: for U.S. stocks, a 36% weighting in the MSCI US Broad Market Index; for non-U.S. stocks, a 24% weighting in the MSCI All Country World ex USA Index; for U.S. bonds, a 28% weighting in the Bloomberg U.S. Aggregate Bond Index; and for non-U.S. bonds, a 12% weighting in the Bloomberg Global Aggregate ex-USD Index.

²2023 FNBO Investment Outlook

*Benchmark consists of Russell 3000 (76%), MSCI ACWI ex US (20%) and FTSE EPRA/NAREIT Global (4%)

**Board of Governors of the Federal Reserve System (US)

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Sources:

Morningstar

Index Definitions:

Indexes shown are market indicators and are for comparative purposes only. They are not meant to represent any actual investment. Indexes are unmanaged and cannot be invested in directly. Securities indexes assume reinvestment of all dividends and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index.

Barclays Global Intermediate: This index measures global investment grade debt from 24 local currency markets, including treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

Barclays Intermediate US Government/Credit Index: The index is a broad-based flagship benchmark that includes investment grade, US dollar-denominated, fixed-rate Treasuries, government-related and corporate securities, within a 2-10 year maturity range.

Barclays Municipal Short-Intermediate 1-10 Years: Index that measures the performance of US municipal bonds with time to maturity of between one and ten years.

MSCI EAFE - Developed International: This index reflects the performance of small- to large-cap stocks across the developed regions of Europe, Australasia, and the Far East (EAFE). The index was developed by Morgan Stanley Capital International (MSCI) in 1969 and lists 926 stocks from 21 countries in the EAFE.

MSCI Emerging Market: An index used to measure equity market performance in global emerging markets, consisting of 23 economies including Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

Russell Indices: The Russell 3000 is a market-capitalization-weighted equity index maintained by the FTSE Russell that provides exposure to the entire U.S. stock market. The index tracks the performance of the 3,000 largest U.S. traded stocks which represent about 98% of all U.S. incorporated equity securities. The Russell 2000 index measures the performance of approximately 2,000 of the smallest companies in the Russell 3000 index.

S&P Indices: The S&P 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies by market value. Other popular indices include the S&P MidCap 400, which represents the mid-cap range of companies and the S&P SmallCap 600, which represents small-cap companies. The S&P 1000 is a combination of the S&P 400 and 600, representing the small and mid-cap market. The S&P 500, S&P MidCap 400 and S&P SmallCap 600 combine to create a U.S. all-capitalization index known as the S&P Composite 1500.

The Personal Consumption Expenditures Price Index is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. For example, if car prices rise, car sales may decline while bicycle sales increase.

The PCE Price Index Excluding Food and Energy, also known as the core PCE price index, is released as part of the monthly Personal Income and Outlays report. The core index makes it easier to see the underlying inflation trend by excluding two categories - food and energy - where prices tend to swing up and down more dramatically and more often than other prices. The core PCE price index is closely watched by the Federal Reserve as it conducts monetary policy.

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Sectors: Strategies that invest primarily in securities of companies in one industry or sector are subject to greater price fluctuations and volatility than strategies that invest in a more broadly diversified strategies. The Strategy may have over-weighted sector and issuer positions and may result in greater volatility and risk. Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. The prices of small company stocks may be subject to more volatility than those of large company stocks.

Equity securities may fluctuate in response to news on companies, industries, market conditions, and the general economic environment. Small-cap and mid-cap stocks may not be appropriate for all investors. Bonds and fixed income securities are subject to interest rate, inflation, reinvestment, and credit risk. There are special risks associated with investments in high yield bonds. Low rated bonds carry heightened credit and investment risk. Credit ratings are subject to change. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall, and when interest rates fall, fixed income prices rise. If bonds are sold prior to maturity, investors may receive more or less than their initial cost.

U.S. government bonds and Treasury bills are guaranteed by the federal government and, if held to maturity, offer fixed rates of return and guaranteed principal. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the U.S. government.

Alternative investments can result in higher loss potential and are sensitive to changes in economic conditions or other circumstances. International investing involves special risks, such as currency fluctuations, different financial accounting and reporting standards, and potential political or economic volatility. Investing in emerging markets can be riskier than investing in well-established foreign markets.

Asset Allocation or Diversification: Asset Allocation/Diversification of your overall investment portfolio does not assure a profit or protect against a loss in declining markets.

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