fnbo 2021 OUTLOOK

2021

2021 Outlook: Staying Disciplined in a Diversified Portfolio

In last year's Outlook, we reviewed our Investment Principles and articulated the Investment Process we utilize to help maximize return and mitigate risk. Our long-term investment approach and emphasis on staying invested during market cycles is intended to work in every economic environment. This tactic provided benefits in 2020 during the COVID-19 market downturn and subsequent recovery.

This year's Outlook begins with a review of **behavioral finance**, emphasizing how we help clients make sound investment decisions. We highlight behavioral mistakes that may lead to losses and stress the importance of diversification. We then turn to our **economic, fixed income and equity outlook**, concentrating on the opportunities and risks in the current macro-environment. Lastly, we review our investment process focusing on the current **portfolio strategy** being implemented for clients.

For each topic, we share FNBO's Perspective.

Primary Content

FNBO PERSPECTIVE

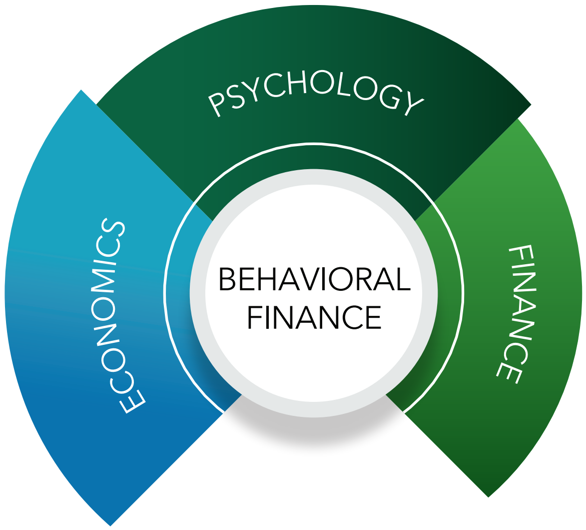
We believe markets are not entirely efficient, creating opportunities for a sound investment approach to add value.

Behavioral finance is a field of research that outlines theories based on economics, finance and psychology in order to explain stock market trends. It focuses on the fact that investors don't always make rational investment decisions and are influenced by their own biases.

Traditional finance theory is based on the assumption that markets are efficient and asset prices perfectly reflect all information. We combine behavioral and traditional finance theory to take advantage of market opportunities and build stronger portfolios. Through awareness and application of this research, we help clients stay objective and make prudent portfolio changes.

There are many types of behavioral biases that can be detrimental to the investment experience. The first step in overcoming these biases is to acknowledge that personal beliefs and prior experiences may influence decision making.

Of the common behavioral biases, loss aversion, herd mentality and familiarity are common mistakes we see investors make.



Examples of Common Biases in Behavioral Finance

FNBO PERSPECTIVE

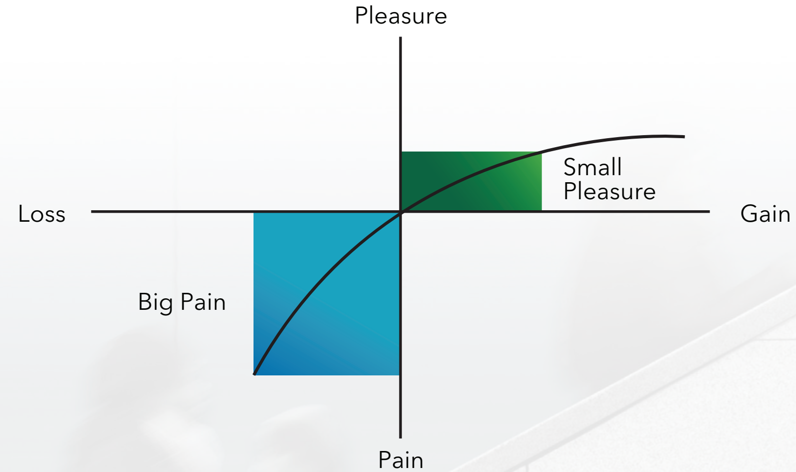
Our role is to maximize chances of success by helping clients stay objective and avoid behavioral biases.

Loss Aversion

Most individuals would prefer to realize a gain rather than incur a loss. As displayed in the Loss Aversion chart, human nature takes it a step further as we typically react more strongly to losses than gains. A landmark study found that investors feel twice as bad about a loss as they feel good about a gain.[1]

Loss aversion can drive investment mistakes, such as underinvesting and trading based on whether the investment is profitable. Underinvesting occurs when individuals are afraid to invest and hold too much in cash or ultra conservative investments. We seek to counteract this bias through financial planning and tailoring portfolios with an emphasis on the long-term.

Loss Aversion



Source: FunRetrospectives Pleasure and Gain

Herd Mentality

Source: www.Investing.com; Equities Could Go (A Lot) Lower

Herd Mentality

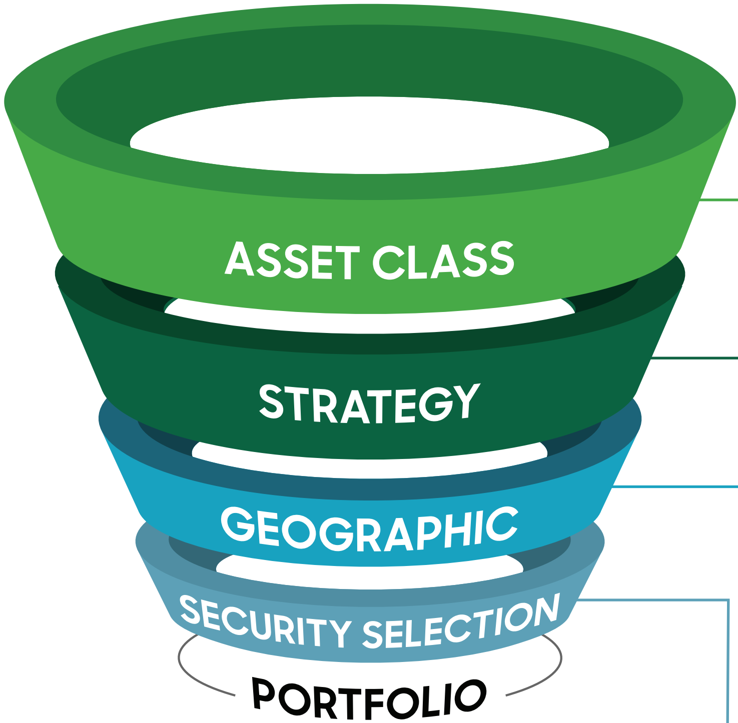
Individuals who "follow the herd" tend to buy into the stock market after it goes up and sell when the market corrects. In extreme cases, this can lead to stock market anomalies, such as bubbles and crashes. As the Herd Mentality graph indicates, the point of maximum investment opportunity is to buy when others are capitulating. We seek to counteract this bias by educating clients on the pitfalls of market timing and the benefits of staying invested through market cycles.

Familiarity

When people are offered two investment options, they generally prefer the one they recognize. In investing, that can lead to a higher allocation to well-known U.S. large-cap companies, and lower exposure to small- and mid-cap companies. This may also result in a low allocation to international equities. What individuals may not realize is that emphasizing one area of the market may lead to greater risk. We seek to counteract this bias by staying disciplined and investing in various asset classes.

FNBO PERSPECTIVE

We believe portfolio diversification is the key to meeting financial goals with the least amount of risk.



Building a diversified portfolio is an investment principle we incorporate to help mitigate behavioral biases. This is how we diversify portfolios:

ASSET CLASS diversification is the inclusion of various investments, such as cash, bonds, equities, real estate and alternatives. Each asset class provides unique return and risk characteristics and will likely perform differently in various market environments. For example, during an economic recovery, stocks will likely perform well, whereas in a downturn, bonds may provide protection. The alternative allocation, when paired with traditional investments, is intended to provide a diverse return stream.

STRATEGY diversification refers to the importance of exposure to different investments within each asset class. In stocks, we diversify portfolios by size (large, mid, small cap) and style (value, core, growth). In fixed income, we complement high-quality, investment-grade securities with high yield and other opportunistic credit strategies.

GEOGRAPHIC diversification refers to the amount of equity securities held in the U.S. versus other countries. Owning international stocks provides diversification in the companies owned, as well as exposure to the U.S. dollar. We believe a long-term international equity allocation of 20% is optimal.

SECURITY SELECTION is the type of investment used to gain asset class exposure. Depending on the strategy employed and client preference, we may use individual securities as part of an allocation. We utilize mutual funds and exchange-traded funds (ETFs) to provide further diversification.

The diversified portfolio is also a function of our ongoing assessment of global economic and market conditions.

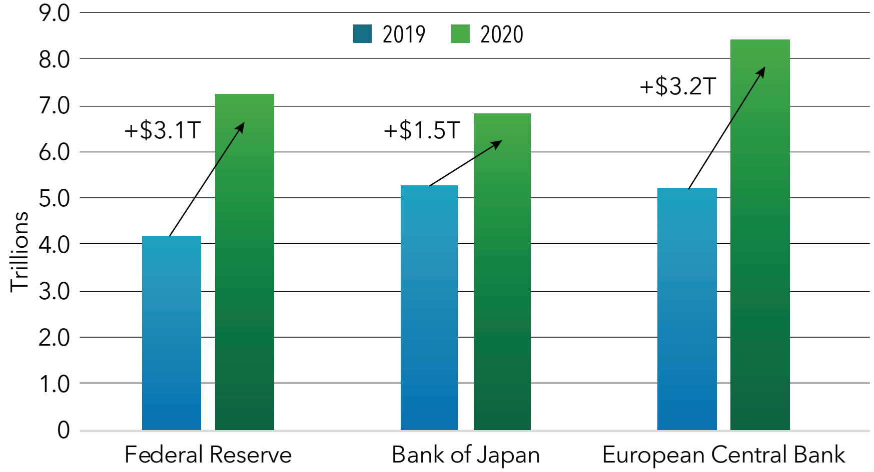
FNBO PERSPECTIVE

1 In 2021, the global economy should rebound due to increased confidence as COVID-19 restrictions fade.

As the U.S. economy is closely connected to the world economy, it is important to understand international growth expectations. Overall, the decline in economic activity from the global pandemic was significantly larger than the 2008 recession. Countries that had success containing the virus, primarily in Asia, fared better economically as compared to the U.S. and Europe.

In an effort to stabilize their respective economies, central banks have aggressively reduced interest rates and expanded their balance sheets. The three largest banks added $7.8 trillion in assets, as illustrated in the Central Bank Assets graph. In our opinion, this has been a significant factor in the global rally in stock and bond prices.

Central Bank Assets



Source: Invesco Oppenheimer, as of December 7, 2020

Global Economic Growth

Region/Country	2020 Est.	2021 Est.	2022 Est.
World	-3.8%	5.2%	3.7%
International Developed	-5.2%	4.0%	3.2%
U.S.	-3.5%	3.9%	3.1%
Eurozone	-7.4%	4.6%	3.7%
International Emerging	-0.8%	5.0%	5.1%
China	2.0%	8.2%	5.5%

Source: Bloomberg Economic Forecasts; as of 12/15/2020

We believe that a global economic rebound is transpiring but see the growth outlook distinctly as pre-vaccine and post-vaccine. The current escalation of COVID-19 cases and hospitalizations may suppress economic activity in early 2021. Europe and Latin America have seen a larger increase of infections and may dip back into recession.

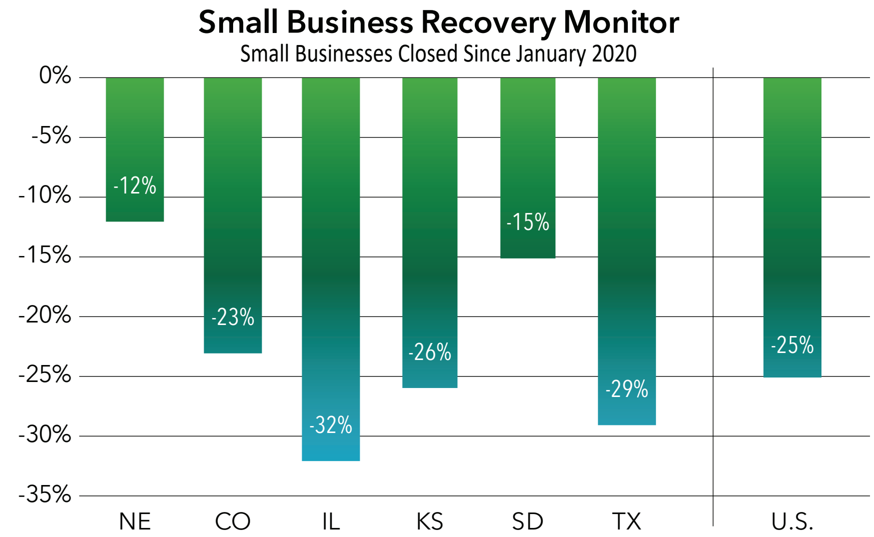
As 2021 progresses, global vaccination may lead to an easing of economic and health restrictions, resulting in increased confidence by individuals and businesses. As shown in the Global Economic Growth table, economists expect a worldwide recovery of 5.2% in 2021 and 3.7% in 2022. This outlook is somewhat dependent on continued fiscal support by governments through the pandemic.

FNBO PERSPECTIVE

Small businesses reopening will likely be the key to a sustainable economic rebound.

U.S. business activity has been a tale of the haves and have-nots. Large companies, especially in the technology sector, were well prepared for the pandemic shutdown. The resources and demand for their products likely helped them weather the recession.

Conversely, many small companies have been negatively impacted. There are 25% fewer small businesses open now than prior to the pandemic, as shown in the Small Business Recovery Monitor chart. In FNBO's footprint, several states have outperformed the U.S. average, with Nebraska reporting 12% fewer small businesses than in January 2020. As small businesses represent almost half of private sector employment, the impact on the labor market is significant.[2]

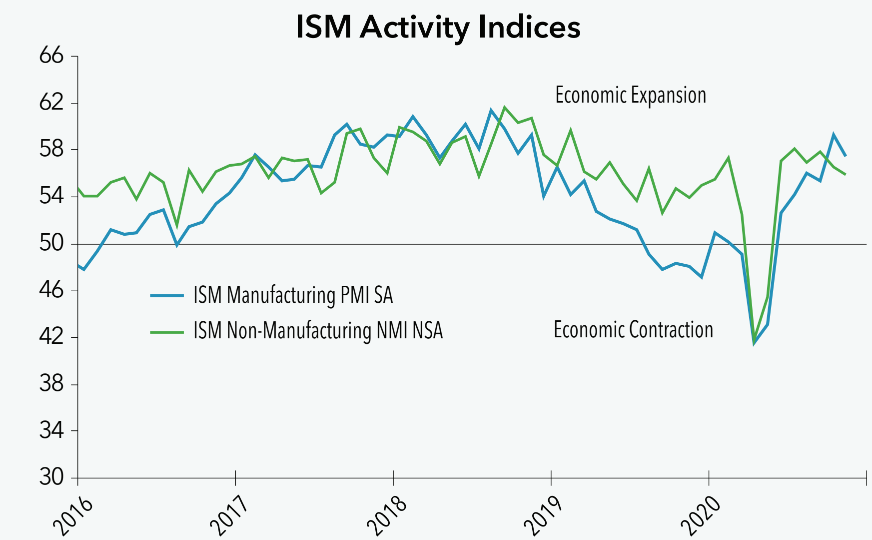


Source: Visa, Business and Economic Insights, December 2020

We expect an uneven recovery across industries in 2021. Manufacturing has bounced back aggressively since the shutdown, as goods have proved more resilient than services. As indicated in the ISM Activity Indices graph, manufacturing is expected to grow at around the 2018 level. Furthermore, inventories are low, which may lead to an investment boom as businesses replenish them.

The non-manufacturing sector has seen a wide variance in industry performance. Services such as retail, travel and leisure have struggled, as they are negatively tied to pandemic restrictions. As virus restrictions are lifted, the services sector is expected to further recover.

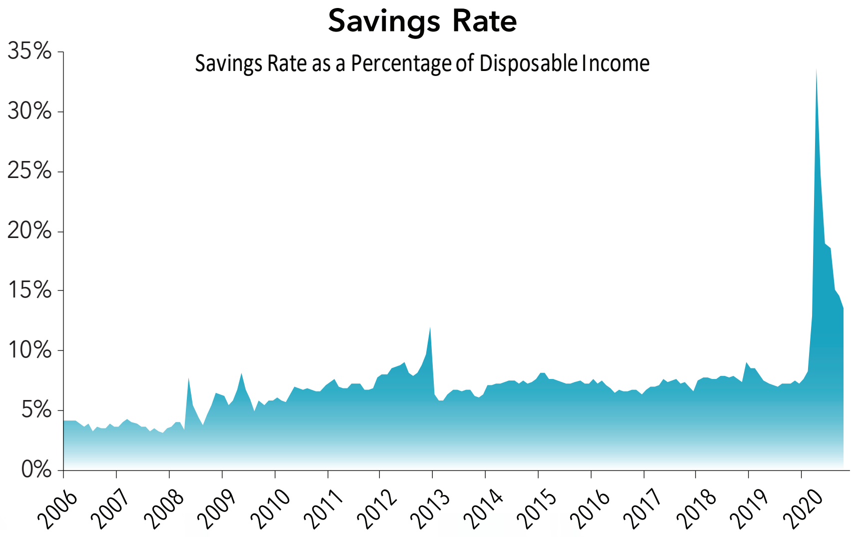
Housing is another area that may drive growth in 2021. This sector is benefiting from the lack of supply and low mortgage rates. Home prices have continued to rise, and the consumer is reaping the benefits. Spending on housing will likely continue as individuals spend on home improvement.



Source: Institute for Supply Management (Bloomberg) as of 11/30/2020

FNBO PERSPECTIVE

The consumer has the capacity to increase spending, which may occur if jobs are created and confidence increases.



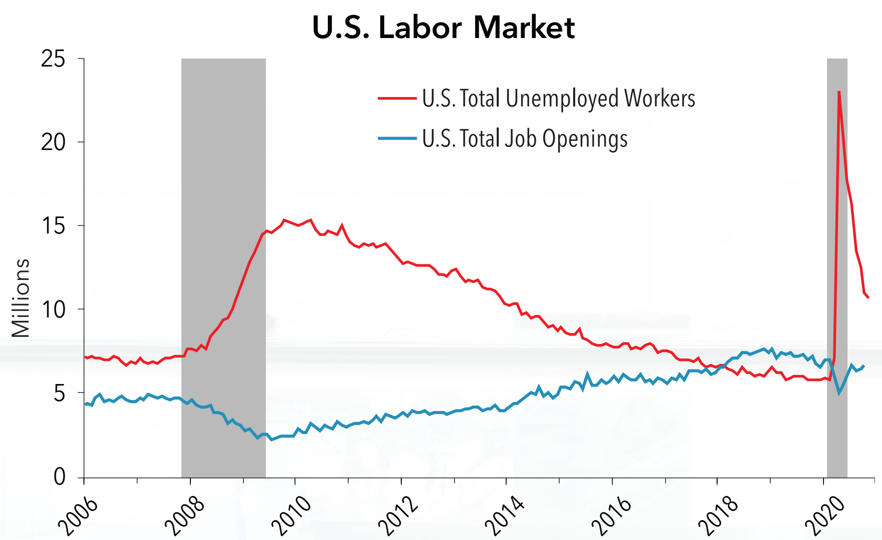
Source: Bureau of Economic Analysis (Bloomberg) as of 10/31/2020

Congress has passed multiple stimulus packages during 2020, supporting many families across the country. Unlike past economic downturns, individual income and savings actually increased.[3] The personal savings rate is the percentage of income people have after spending and paying taxes. The Savings Rate graph illustrates the spike in savings, which indicates capacity for spending once confidence returns. This is crucial as personal consumption expenditures drive around 68% of output.[4]

The economic downturn has also led to changing spending habits. Money previously spent on travel, leisure, and work-related expenses is now being saved or spent online for physical goods. The trend towards online spending, which has developed over the last 20 years, accelerated during the pandemic. This impacts commercial real estate, specifically the increased need for industrial space to ship goods, to the detriment of brick and mortar retail stores.

With a November 2020 unemployment rate of 6.7%, not all individuals are financially stable.[5] As seen in the U.S. Labor Market chart, the number of total unemployed workers exceeds job openings. The labor participation rate has also declined as individuals are dealing with altered schedules, new family dynamics and figuring out how to work from home. Unfortunately, most of the job losses have fallen on lower income earners.[6] An improvement in the labor market is critical for the consumer to keep spending.

In conclusion, we expect solid economic activity after a virus-related pause in activity early this year. The benefits from government stimulus will likely provide a tailwind until vaccine adoption increases confidence. The housing and automotive sectors should benefit from the low interest rate environment.



Source: Bloomberg Data as of 11/30/2020, Seasonally Adjusted

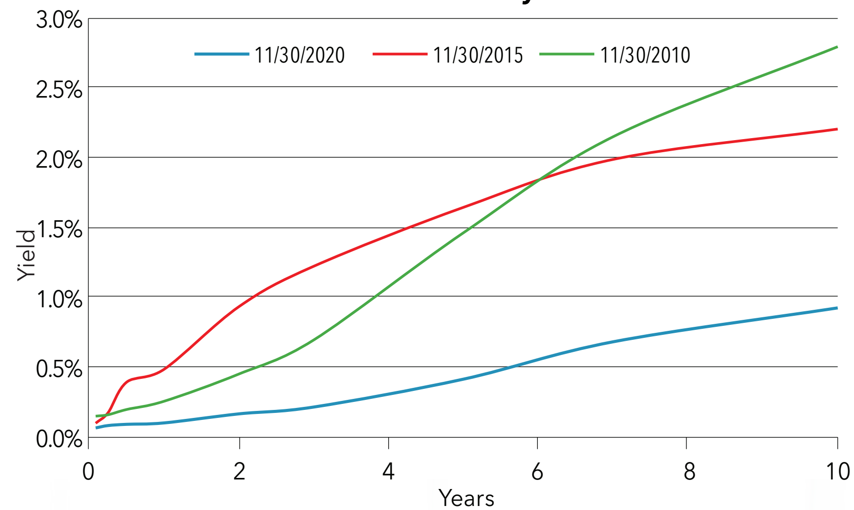
FNBO PERSPECTIVE

We expect interest rates to move modestly higher resulting in a difficult return environment for bonds.

The Federal Reserve lowered short-term interest rates to zero in an effort to stabilize the economy with yields declining to their lowest level in U.S. history. As indicated in the Historical Treasury Yields chart, interest rates are below 1% for all maturities less than ten years. In comparison to five and ten years ago, the 10-year Treasury is trading at lower levels.

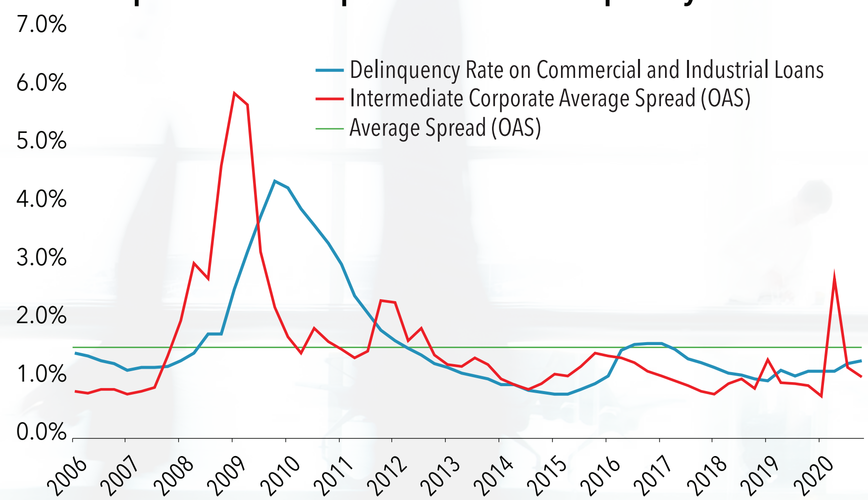
Federal Reserve Chairman Powell has stated, "we're not even thinking about raising rates,"[7] and has indicated the Federal Reserve is likely to keep short-term interest rates at or near zero for the next couple of years. In economic recoveries, long-term interest rates typically drift higher and the yield curve steepens. Based on our economic forecast, we expect long-term interest rates to adjust higher in 2021.

Historical Treasury Yields



Source: Bureau of Economic Analysis (Bloomberg) as of 10/31/2020

Corporate Bond Spreads and Delinquency Rates



Source: FRED Database & Bloomberg Data As of 11/30/2020

Investors in corporate bonds have experienced volatility in prices and returns and continue to evaluate delinquencies and defaults for signs of stress. The Corporate Bond Spreads and Delinquency Rates graph shows corporate spreads are trading at less than their 15-year historical average and well below the peak from the 2008 financial crisis. The spread or yield advantage over government bonds compensates investors for the additional default risk.

We are monitoring inflation as it remains a risk to the bond market. The economy is currently growing with trillions of stimulus dollars in circulation. If vaccines prove effective and the economy accelerates, inflation may increase faster than the fixed income market expects, which could lead to a spike in interest rates. Even if inflation remains contained, bond investors should expect low returns over the next three to five years.

FNBO PERSPECTIVE

We believe the stock market will trend higher if profit growth occurs in all sectors.

Earnings estimates bottomed last May with company profits showing incredible resilience. As portrayed in the Sector Earnings Growth table, five sectors have reported earnings growth over the last year. These industries have partially offset weak earnings in other sectors, keeping the U.S. market profit decline to -13.9%.

The U.S. profit cycle is expected to improve in the year ahead, assuming the economic recovery remains on track. Earnings are expected to reach their highest level ever for the U.S. market as profit margins return to peak levels. As of November 30th, earnings growth of 19.8% is expected over the next 12 months.[8] Corporate profit growth is expected to broaden to all 11 sectors with economically sensitive sectors like energy, industrials and consumer discretionary leading the way.

Sector Earnings Growth

Sectors	Last 12 Months	Next 12 Months
Healthcare	8.2%	11.0%
Information Technology	5.7%	14.0%
Consumer Staples	3.3%	6.4%
Utilities	3.0%	4.8%
Communication Services	0.4%	12.6%
Real Estate	-12.1%	5.4%
Basic Materials	-16.1%	27.0%
Financials	-25.0%	18.9%
Consumer Discretionary	-32.0%	51.1%
Industrials	-43.1%	53.1%
Energy	-101.1%	3328%
U.S. Broad Market	**-13.9%**	**19.8%**

Source: FactSet Research Systems as of 11/30/2020; S&P 1500 Index

Strong stock returns and the decline in earnings have increased global equity valuations. One measure we monitor for each equity asset class is the price-to-earnings (P/E) ratio. As depicted in the Stock Market Valuations table, U.S. and international markets are trading at premium valuations relative to history. On a relative basis, U.S. small- and mid-cap (SMID) stocks are trading at less of a premium. Internationally, companies in developed markets have experienced a greater deterioration in earnings, and trade at above average valuations.

For the majority of the last decade, U.S. equities have outperformed international equities, U.S. large-cap returns have exceeded SMID-cap, and growth-style returns have surpassed value. Late in 2020, a shift in market sentiment occurred as the lagging equity asset classes led the market to new highs. We believe some of these asset classes may continue to show leadership in 2021.

Stock Market Valuations

Equities	NTM P/E	15-Year Avg P/E	P/E Premium
U.S. Large-Cap	21.8x	14.9x	46.5%
U.S. Mid-Cap	18.9x	15.9x	19.2%
U.S. Small-Cap	18.9x	16.8x	12.4%
International Developed	17.8x	13.2x	34.7%
International Emerging	15.0x	11.7x	28.5%

Source: FactSet as of 11/30/2020 for Next Twelve Month & Average P/E

FNBO PERSPECTIVE

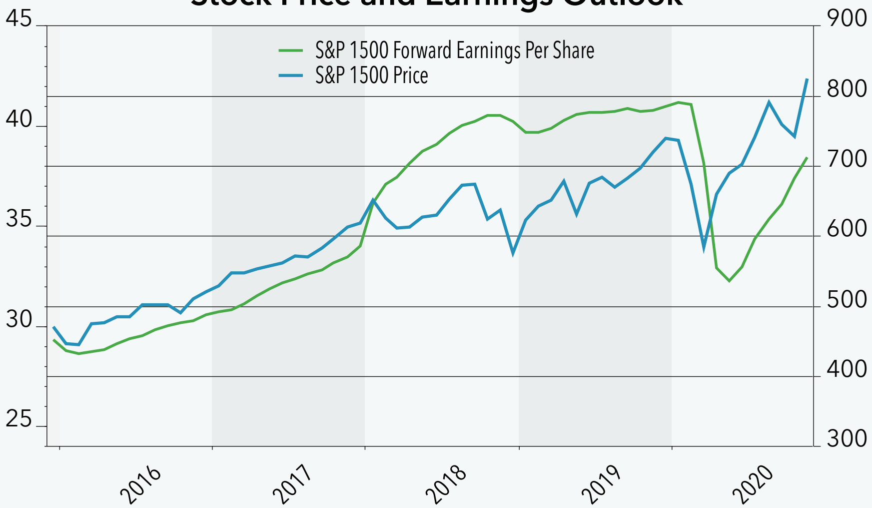
We favor equities over fixed income due to our expectation of economic growth and rising company profitability.

We tailor investment portfolios based on an understanding of each client's goals and risk tolerance. The portfolio could range from primarily fixed income to primarily equities, or a range between these asset classes.

In a world of uncertainty, we believe the best way to prevent emotions from influencing behaviors is to utilize a disciplined process for making decisions. Our approach, summarized in the Investment Process Table, begins with the asset class decision, specifically an evaluation of equities relative to fixed income.

Investment Process

Stock Price and Earnings Outlook



Source: FactSet, as of 11/30/2020

Process #1 / Asset Class Decision

The first step in the stock/bond allocation is an assessment of the global economy. As previously discussed, we expect a rebound in global economic activity. This positive outlook for growth favors a higher stock allocation, as equities typically perform well during periods of economic expansion.

Second, we believe earnings growth is another important determinant of stock returns. The close relationship between company fundamentals and the stock market is illustrated in the Stock Price and Earnings Outlook chart. After the sharp downturn in the market and profits early last year, we have seen a strong rebound. Our expectation of a continued rise in company profitability favors a higher stock allocation.

FNBO PERSPECTIVE

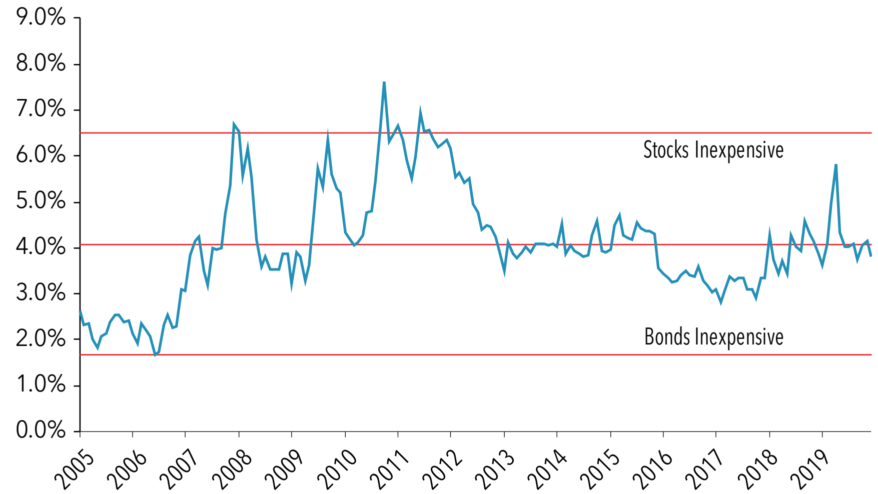
An expanded allocation to select alternative investments should improve portfolio diversification.

The last step in the stock/bond decision is evaluating the relative valuations of each asset class. The Equity Risk Premium graph compares the S&P 1500 valuation to 10-year Treasury yields. As illustrated, neither stocks nor bonds are inexpensive on a relative basis. This outcome favors a neutral stock allocation.

Based on our stock/bond allocation model, we are modestly tilting portfolios toward equities and away from fixed income.

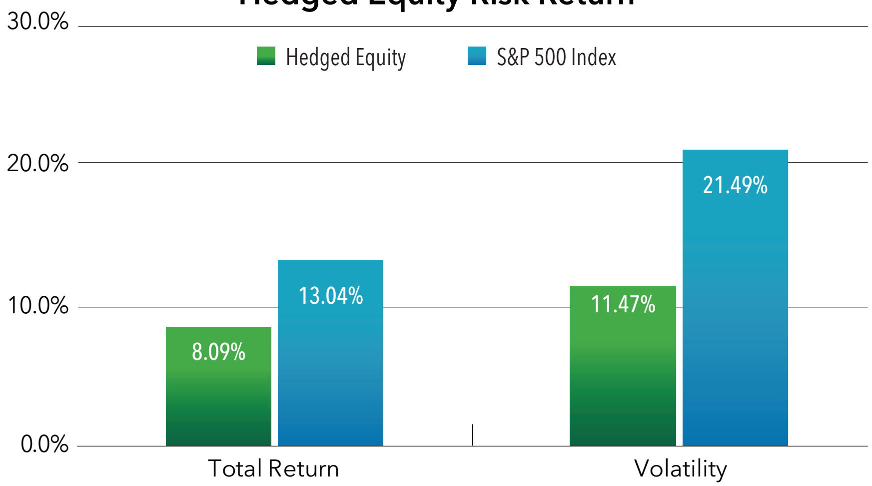
As we analyze opportunities in other asset classes, our focus is on portfolio construction and risk management. With money market funds yielding close to zero, holding a high allocation to cash is not attractive.

Equity Risk Premium



Source: FactSet as of 11/30/2020

Hedged Equity Risk Return



Source: JP Morgan, from 12/13/2013 to 11/30/2020

We believe alternative investments offer the best diversification strategy to tactically manage risk, while striving to meet client return goals. Currently, our primary holding is through a hedged equity mutual fund that provides exposure to U.S. equities while offering some downside protection through the use of options.

This fund exceeded expectations during the stock market downturn and recovery. As shown in the Hedged Equity Risk Return chart, the decline in volatility for Hedged Equity is greater than the decrease in total return. Therefore, risk-adjusted returns have been higher.

In late 2020, we added an allocation to a gold ETF, which we believe is a viable alternative to cash. It will likely act as a portfolio hedge against sovereign financial concerns and continued government budget deficits. Gold may also protect portfolios from an increase in inflation.

FNBO PERSPECTIVE

Within equities, we have increased exposure to U.S. SMID-cap, and emphasize core bonds in our fixed income allocation.

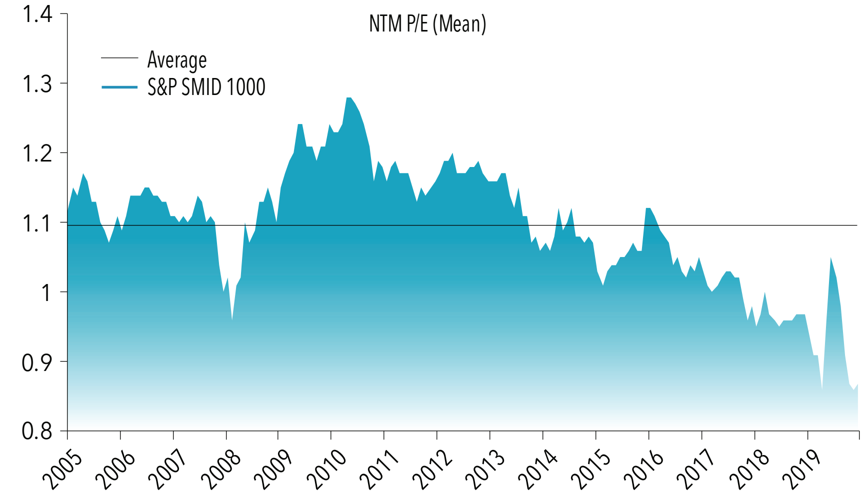
Process 2 / Identify Opportunities in Equities

We have been relatively well-positioned in the current market environment, consistently emphasizing U.S. large-cap equities. Based on our economic view and interest rate outlook, investors may be rewarded for increasing exposure to other equity asset classes.

We believe an attractive post-recession opportunity exists in U.S. SMID-cap stocks. As depicted in the U.S. Relative Valuations graph, valuations are attractive relative to large-cap stocks. Increased exposure to this equity asset class will also diversify portfolios on a sector basis and add more exposure to value.

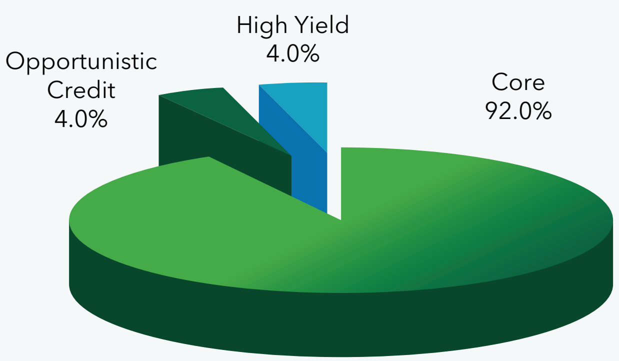
The primary return drivers for international equities are the strength of the global economy and changes to the U.S. dollar. Weakness in the U.S. dollar contributes to returns, whereas a strong dollar negatively impacts performance. We see the potential for U.S. dollar weakness given the budget and trade deficit and the Federal Reserve's stated interest rate policy. Within international equities, our preference is small- and mid-cap companies, as well as emerging markets.

U.S. Relative Valuations



Source: FactSet data as of 11/30/2020 relative to S&P 500

Fixed Income Allocation



Source: Internal Calculations as of 12/31/2020

Process 3 / Position Fixed Income

While we frequently tout the advantages of bonds in a portfolio (safety, income and diversification), they may not provide the same level of benefits due to the current low interest rate environment. Investors will generate less income from fixed income securities and may search elsewhere for cash flow. Bond holders could potentially experience price declines if interest rates rise.

In this environment, we are emphasizing high-quality, investment-grade (core) fixed income securities and hold a relatively low allocation to riskier bond investments. As depicted in the Fixed Income Allocation table, the core allocation constitutes 92% of the bond exposure.

FNBO PERSPECTIVE
Investment success is predicated on staying invested and rebalancing portfolios to target allocations.

Process 4 / Execute Our Strategy

This is how we implement our process:

Stay disciplined in a diversified portfolio: Accommodative central bank policies and deficit spending from governments around the world have contributed to global asset values rising. Equities offer the best long-term return potential, but are risky based on valuations and the potential for disappointing profit growth. Rebalancing to fixed income may not offer the same risk mitigation due to low interest rates and the potential for inflation. We have added to our alternative allocation to provide a return and risk profile that is different from bonds or equities.

Revisit asset allocation: We typically update our capital market assumptions at least annually. With recent price appreciation in equities and bonds, we have reduced our expected portfolio returns over the next ten years. Adjusting return goals or becoming more comfortable with taking additional risk to reach those objectives may be necessary.

Monitor and rebalance: We consistently apply our process every year, but in a post-COVID-19 world, it will be as important as ever to monitor portfolio allocations. Market adjustments are occurring more rapidly, shrinking the window to capitalize on investment opportunities.

We believe markets are not entirely efficient, creating opportunities for a sound investment approach to add value. Our role is to maximize chances of success by helping clients stay objective and avoid behavioral biases. We believe portfolio diversification is the key to meeting financial goals with the least amount of risk. In 2021, the global economy should rebound due to increased confidence as COVID-19 restrictions fade. Small businesses reopening will likely be the key to a sustainable economic rebound. The consumer has the capacity to increase spending, which may occur if jobs are created and confidence increases. We expect interest rates to move modestly higher resulting in a difficult return environment for bonds. We believe the stock market will trend higher if profit growth occurs in all sectors. We favor equities over fixed income due to our expectation of economic growth and rising company profitability. An expanded allocation to select alternative investments should improve portfolio diversification. Within equities, we have increased exposure to U.S. SMID-cap, and emphasize core bonds in our fixed income allocation. Investment success is predicated on staying invested and rebalancing portfolios to target allocations.

We hope you found this year's Outlook thought-provoking. Thank you for your interest and the trust you place in us.

fnbo

Kurt Spieler, CFA®

Chief Investment Officer

Contributors: Kurt Spieler, Scott Summers, Matt Veenker, Natalie Heckendorn, Jeff Burgher, Julie Driftmier, Christina Kahler, Krishelle McNeal

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For 2021 Outlook asset class definitions, key terms and model definitions, please visit www.fnbo.com/outlookdefinitions.

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