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Emerging Trends in Sacramento's Economy



Your Best Guide to Sacramento's Economy

2014 Mid-Year Update



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Message from the *Chief Economist*

Dear Friends,

I am pleased to share the 12th edition of the *Sacramento Business Review* – the most comprehensive, precise, and intellectually sophisticated analysis of the regional economy. For more than six years, our team has accurately forecasted the economic and business climate and has provided thoughtful predictions. With 14 of Sacramento's very best financial analysts and researchers combining their skills and talent, the Sacramento Business Review (SBR) has become the most credible source of independent thinking, insights, and research not found elsewhere in the region.



I am delighted by your overwhelmingly positive response, as you have embraced the publication and have used it as your regional guide. Last year, we made countless presentations of our work to the community, and I received hundreds of emails and phone calls complimenting the great work. I want you to know that none of the analysts who produce the SBR forecast receive any monetary benefit or compensation; they do this work entirely as a public service to the region.

Earlier in the year, our forecast for 2014 was very optimistic. We predicted that real estate markets would see continued recovery with declining vacancy rates and improved asking rents, unemployment would decrease further to a mid to high single digit, local banks would experience meaningful loan growth and see some M&A activity, the local government sector would stabilize and may expand somewhat, and equities would remain the favored asset class with lower systematic risk. **We were absolutely right.**

However, the region continues to face headwinds with some sectors lagging in job growth, and noticeable cooling in the housing market. Our **Small Business Confidence Index** shows continued high optimism for the next year in spite of a softening in the small business sales market. The median sale price per square foot for single family homes in the Sacramento region remained relatively flat with a 5.8% increase and showed no change during the first half of 2014 relative to 2013. New home sales activity declined 11% year over year as compared to an increase of 40% during the same period a year ago. Our **SBR Index** has shown sustained stability and predicts continued improving conditions for the region. While jobs growth remains weak, the unemployment rate for the region has dropped sharply and the government jobs have shown recovery.

We are committed to delivering the very best economic and financial research to the region. I invite your feedback. Please do not hesitate to let me know how we may improve future issues or if you wish to be a supporting sponsor. To download your free copy, please visit www.sacbusinessreview.com.

Warm regards,

Sanjay Varshney, PhD, CFA,
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- Some areas have demonstrated significant improvement while others have lagged.
- The overall upward trend remains intact.
- The pace of the increase in health care jobs has been consistent.
- The recent recovery in government jobs is important for the health of the region's economy.
- The weakening pace of the housing recovery may create a headwind for the regaining of construction jobs.

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- All commercial real estate sectors enjoyed positive net absorption in the first half of 2014, which led to lower vacancy rates and higher or stable lease rates.
- The median sale price per square foot for single family residences in the Sacramento region remained relatively flat with a 5.8% increase and showed no change during the first half of 2014 relative to 2013.
- New home sales activity declined 11% year over year as compared with an increase of 40% during the same period a year ago.

Banking Industry 16

- Led by commercial real estate, including strong construction loan growth, loans for the Sacramento Region Banks increased at a 7.4% annualized pace through the first six months of 2014.
- Greater loan balances have translated into higher net interest income for the local banks, enabling them to improve their pre-tax income by 5.4% (annualized) through the first half of the year.
- The SBR banking team's long-time prediction of merger-and-acquisition activity finally started to materialize in January, when Tri Counties Bank announced the purchase of North Valley Bank.

Small Business 18

- SBA lending in the region shows robust growth, easing worries regarding access to credit for small businesses.
- The Small Business Confidence Index sustains record levels of optimism indicating a manufacturing rebound in the region may be underway.
- The small business sales market softens in tandem with the housing sector with declines in sales and median closing price.

Capital Markets 22

- The Fed continues with its tapering process and maintains that the time for raising interest rates is near.
- China continues to slow its economy as anticipated.
- Relatively speaking, America looks to have the strongest economic tailwinds, and we expect that trend to continue.
- The SBR Financial Conditions Index indicates the region is maintaining its recovery.

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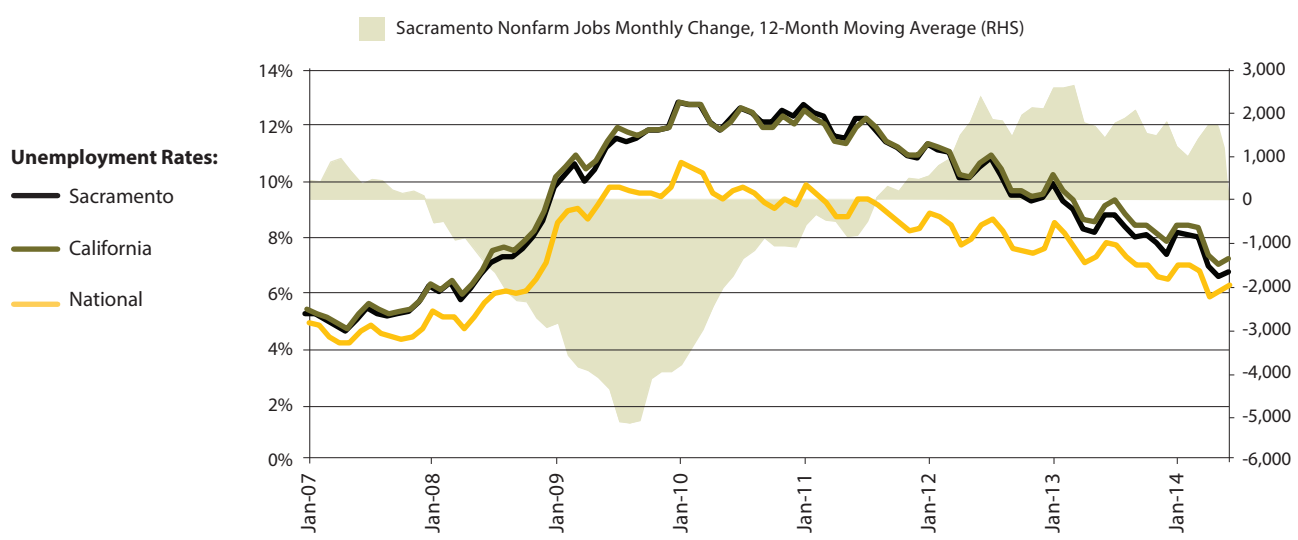
Sacramento's Labor Market & Regional Economy: *Mid-Year Update*



In our January 2014 report, we asked the question: "Are we there yet?" This referred to the slow pace of the labor market recovery in the Sacramento region, which resembles a long, tired car ride. Although 2014 started off slowly on the national level, the local economy continues to gain momentum, and we are steadily making our way toward our final destination of a full recovery.

In general, the Sacramento region's economic and labor market recovery may be best described as uneven. Some geographic areas and labor categories have demonstrated significant improvement in the past several years while others have lagged. However, the overall upward trend remains in-tact.

Figure 1
Unemployment Rates and Local Jobs



Whereas the national unemployment rate has declined to 6.3% in June, many of the local geographic areas are still approximately 0.5% to 1.5% percent above the national level. However, the pace of the improvement in the local data has outpaced that of the national data in recent years. Therefore, with continued improvement, the local unemployment rate will likely converge with the national number, perhaps returning to the pre-2007 relationship where the Sacramento region tracked the national data much closer.

In the last couple of years, the Sacramento metropolitan area has been consistently adding 1,000-2,000 nonfarm jobs per month that show a slow but steady economic recovery from the last recession. We expect the number of local jobs to reach the pre-recession level by the end of 2016 or early 2017.

Data Source: EDD & BLS

“While there is a relatively larger hole to climb out of, Sacramento has outpaced the national economy in recovery.”

Macro Trends Affecting the Sacramento Region

In January we listed the strong pace of national economic growth reported in the fourth quarter as a potential tailwind for the national labor market recovery, and we predicted that continued economic growth could contribute to a further decline in the national unemployment rate. However, we also noted that the Federal Reserve’s decision to reduce the pace of bond purchases could represent a headwind to the local economy as it could put upward pressure on interest rates, hurting interest rate sensitive industries. Instead, interest rates have declined in the first six months of 2014, possibly due to the 2.9% decline (annualized rate) in national GDP in the first quarter, which has largely been blamed on the harsh weather conditions in the Northeast, and because of numerous geopolitical conflicts that cause investors to seek safety in U.S. Treasury securities. The sharp rebound in GDP for the second quarter will likely cause the Fed to stay the course in reducing asset purchases and eventually raising rates toward the latter part of 2015.

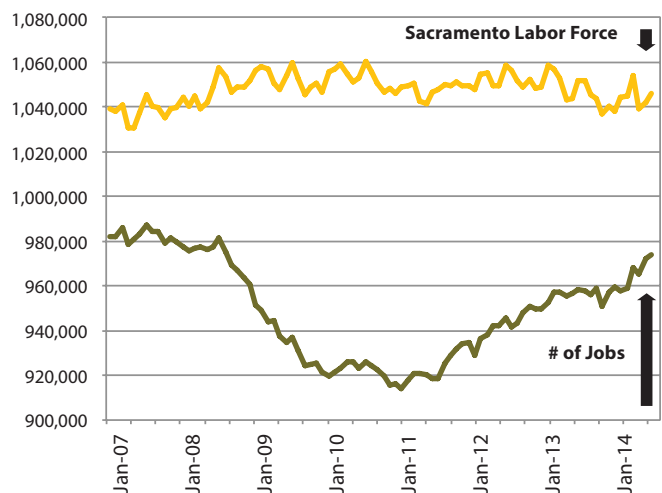
The national unemployment rate has continued to decline, although economists continue to debate the quality of the data, as many of the jobs added have been either part-time jobs or in industries that typically pay low wages. The unemployment rate in the Sacramento region has followed suit, although the pace of the recovery of the different geographic areas have varied.

Local Labor Market Trends

When our last report was released, the latest local labor market data (November 2013) reported year-over-year job growth of nearly 2.5%, which contributed to a decline in the local unemployment rate to 8% from 9.8% the previous year. Our prediction for 2014 was that the local unemployment rate would fluctuate between 7% and 8.5%, and as of the July data release, the unemployment rate was well within that range at 7.4%. May and June data showed that the local unemployment rate dipped below 7%, exceeding our

“Our prediction for 2014 was that the local unemployment rate would fluctuate between 7% and 8.5%.”

Figure 2
Sacramento Labor Force Trend



Data Source: EDD

expectations for the year. One of the reasons for the better than expected results is that we predicted that the local labor force would increase as greater job availability caused discouraged workers to re-enter the labor force, causing the improvement in the unemployment rate to slow; however, this has not been the case. Instead, the local labor force has continued to decline, albeit slowly. Since the beginning of the year, the size of the local labor force has declined 0.4%, essentially further reducing the unemployment rate by an equal amount. As we have mentioned in the past, this decline may be due to demographic trends as members of the Baby Boomer generation exit the labor force.

Sacramento's Labor Market & Regional Economy: *Mid-Year Update*

Government Sector Shows Improvement

In January we predicted that continued improvement in state government finances would help to support the region's economic and labor force recovery. At that time the estimated state government surplus was \$1.1 billion for the June 30 fiscal year. In fact, the pace of the improvement in state finances accelerated leading to a \$1.9 billion surplus. This has likely helped to fuel the positive trend in government sector jobs since the beginning of 2013, with

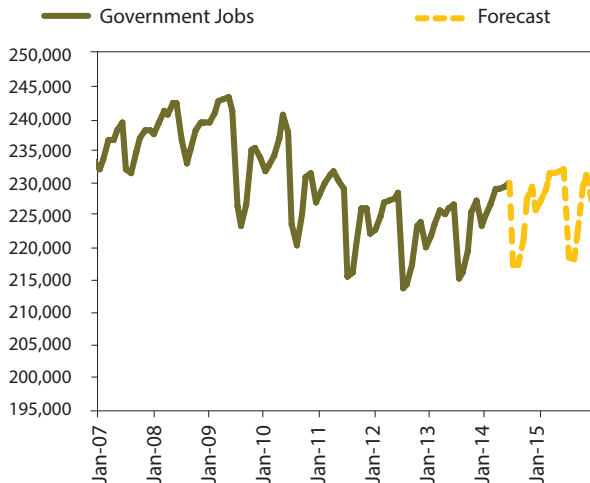
the pace of government job creation accelerating slightly in the first six months of 2014. Given that government jobs represent the largest labor category in the Sacramento region, accounting for approximately 25% of total employment, this recovery in government jobs is an important contributor to the overall health of the region's economy.

Construction Sector Appears Mixed

While the construction sector only represents less than 5% of the Sacramento region's labor market, there is a strong correlation between the number of construction jobs and the region's economic growth. In our 2013 report, we predicted that a housing recovery would help to support the region's economic recovery. Indeed, the number of construction jobs in the region has increased over 25% from the post-recession low in 2011; however, this still represents a decline of over a third of the total construction jobs since the peak in 2005.

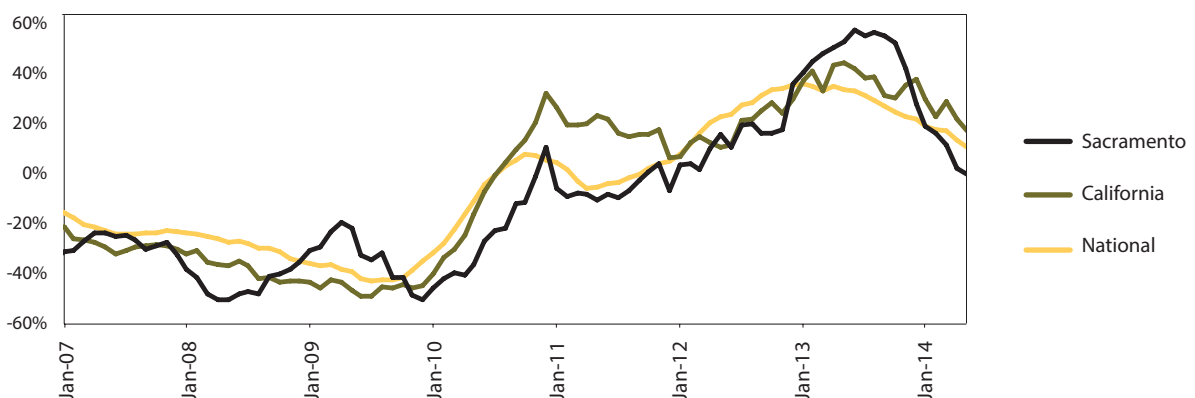
Going forward, the weakening pace of the housing recovery may create a headwind that could reduce the rate of growth in construction-related jobs. Recent data shows that year-over-year increases in building permits, a leading indicator for construction activity, has declined significantly over the past 12 months. Whereas the Sacramento region was outpacing the state and the nation in building permits issued, the region has also experienced a much larger correction in recent months. Currently, the year-over-year change in building permits

Figure 3
Government Jobs



Data Source: EDD

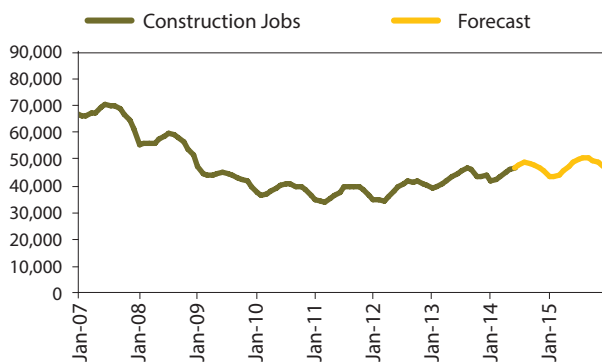
Figure 4
Building Permits



Data Source: economagic.com

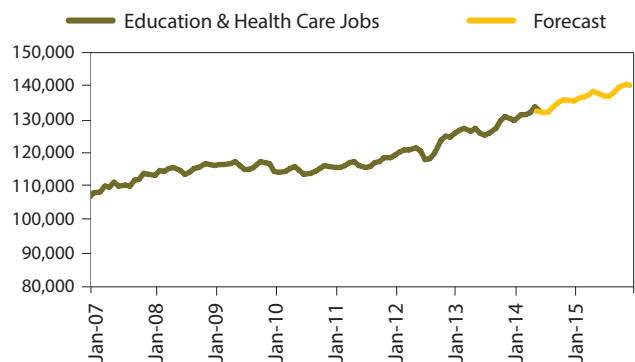
“Lately Sacramento has outpaced the national economy in recovery. But job losses in the last recession were deeper and lasted longer in Sacramento, and the local housing crash was larger.”

Figure 5
Construction Jobs



Data Source: EDD

Figure 6
Education & Health Care Jobs



Data Source: EDD

is essentially flat over the past 12 months. This trend could reduce the pace of recovery in construction jobs in future months. And unlike the national economic data, this change cannot be blamed on the weather. The start of construction on the new downtown arena is a welcome sign, and both the arena and revived development projects near the arena site should provide a steady stream of construction work for the next couple of years and potentially offset any reduction in jobs related to the housing sector.

Education and Health Care Increase in Importance

Fifteen years ago education and health care jobs represented less than 9% of the local job market. Today they represent over 13%, having increased in every year except 2010, and represent about half of the jobs created in the local region during that period. Health care, by far the largest segment of this category, has done most of the heavy lifting with the number of jobs increasing at a 3.7% average annual rate over the past decade. This has made health care an important contributor to the

local labor force, both in terms of the numbers of jobs and job growth in recent years. Given that the pace of the increase in health care jobs has been consistent over the long-term, we would argue that this data is likely due to demographic trends – as the population ages, the demand for health care services increases – as opposed to jobs created to fulfill the implementation of the Affordable Care Act.

Lately Sacramento has outpaced the national economy in recovery. But job losses in the last recession were deeper and lasted longer in Sacramento, and the local housing crash was larger. There is a relatively larger hole to climb out of. Overall, the Sacramento Metropolitan Statistical Area – which includes El Dorado, Placer, Sacramento, and Yolo counties—is definitely moving in the right direction and picking up steam along the way. Similar economic trends can also be seen in surrounding areas like Solano and San Joaquin counties. Looking forward, new downtown developments and talk of the downtown rail yard finally being ready for building continue to provide catalysts that should make 2015 an exciting year for the Sacramento region.

Real Estate Trends *in the* Sacramento Region



Commercial Leasing

- **Office Market** – Due to negative net absorption of 148,678 sq. ft., the vacancy rate in the Sacramento office market rose to 19.5% in the second quarter of 2014. However, this was mostly due to HP moving out of almost 200,000 sq. ft. of space in Roseville, and overall 2014 has been a positive year for the office market. Year-to-date net absorption was 145,419 sq. ft., reducing the vacancy rate that stood at 21% in the second quarter of 2013. Average office asking lease rates rose slightly by \$0.03 to \$1.69 per sq. ft. in the last quarter.
- **Retail Market** – The vacancy rate for retail properties declined to 10.9%, thanks to positive net absorption of 151,800 sq. ft. in the second quarter of 2014. The retail market enjoyed the second consecutive quarter of positive net absorption, as well as in 11 out of the last 12 quarters. Due to lower vacancy, the asking lease rates increased by \$0.04 to \$1.50. Rocklin, Highway 50/Rancho Cordova, and South Sacramento submarkets enjoyed the strongest leasing activity.
- **Industrial Market** – The industrial sector continues to be the strongest of the three major property sectors. Vacancy declined from 11.9% to 11.1% in the second quarter of 2014, thanks to a strong leasing activity that resulted in positive net absorption of 886,690. The year-to-date net absorption of over 1.7 million sq. ft. means the current vacancy rate is the lowest since the first quarter of 2011. Average asking

lease rates remained relatively flat at \$0.43 per sq. ft. The improving conditions in the industrial sector have ensured the continued feasibility of some speculative construction.

Investments

- President Barack Obama's signing of the Water Resources and Reform Development Act in June lifted the five-year building moratorium in Natomas. Construction of residential and commercial properties is expected to start in 2015.
- Investment activity remained strong across all property types in the second quarter of 2014. The largest transactions in the office market were the five-building University Office Park portfolio totaling 112,656 sq. ft. in the Campus Commons submarket, and a 51,337 sq. ft. class A property in Roseville.
- The largest sales transactions in the retail sector during the second quarter were the 182,500 sq. ft. The Ridge at Creekside shopping center in Roseville, and two 40,000+ sq. ft. properties in Carmichael and Elk Grove.
- The owner-sales continued their upward trend from previous quarters and dominated the transactions in the industrial sector in the second quarter of 2014. The largest transaction was E&E Trading's purchase of the 427,000 sq. ft. property at 1680 Tide Court (former HP facility) in Woodland. Additionally, Kodiak Roofing purchased a 114,000 sq. ft. property in Roseville.

Land

- The regional residential land market during the past year has continued to grow due to a lack of housing inventory, escalating home prices, accumulated demand for housing, and historically low interest rates. These factors have prompted the development community to acquire as much of the finished and tentative map lots as they could for home building. Each available developable lot or subdivision has had multiple offers. Home builders have been willing to pay double the price relative to what they would have offered for lots during 2013. This anxiety to lock in lot inventory for 2015 and 2016 has increased competition, thereby raising land prices.

“The vacancy rate for retail properties declined to 10.9%, thanks to positive net absorption of 151,800 sq. ft. in the second quarter of 2014.”

Figure 1
Average Asking Lease Rate vs. Vacancy Rate for Office Properties.

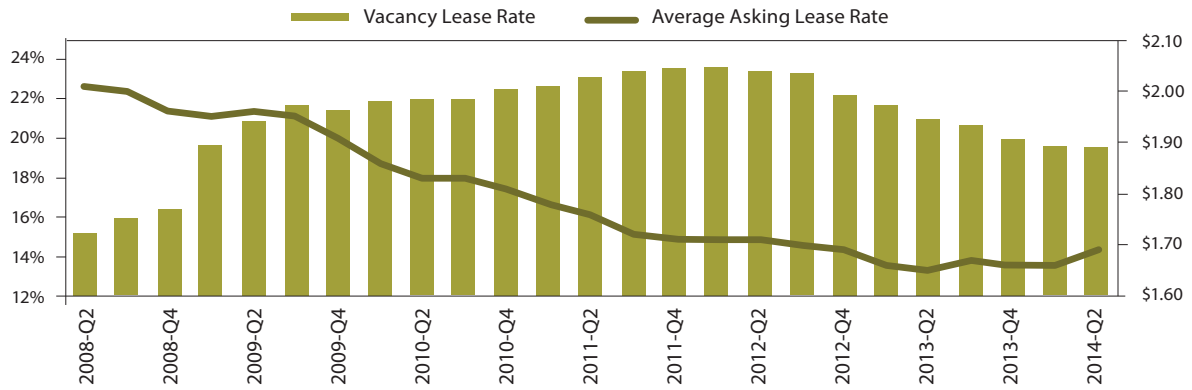


Figure 2
Average Asking Lease Rate vs. Vacancy Rate for Retail Properties.

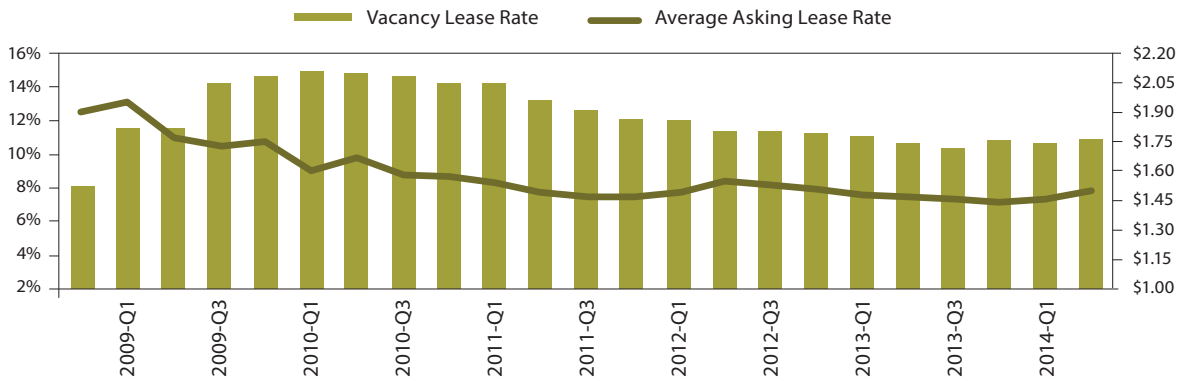
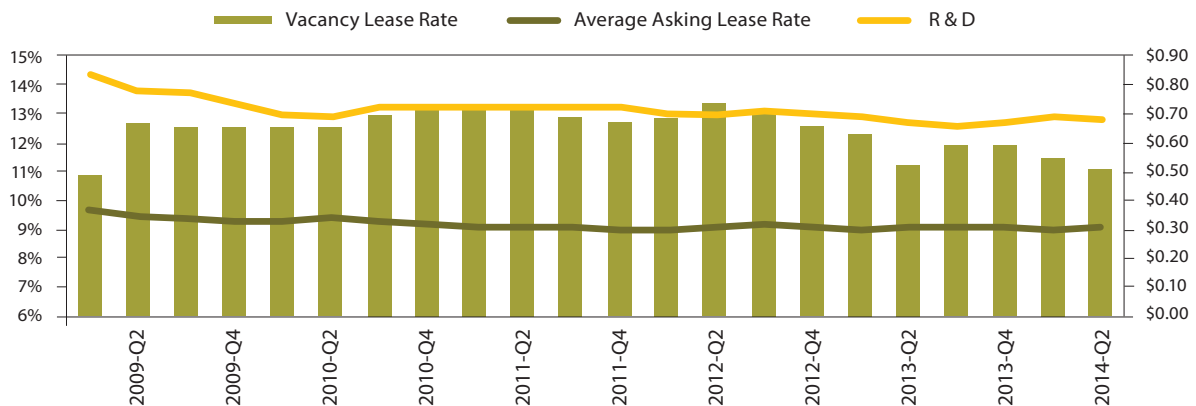


Figure 3
Average Asking Lease Rate vs. Vacancy Rate for Industrial Properties.



Data Source: CBRE Research

Real Estate Trends *in the* Sacramento Region

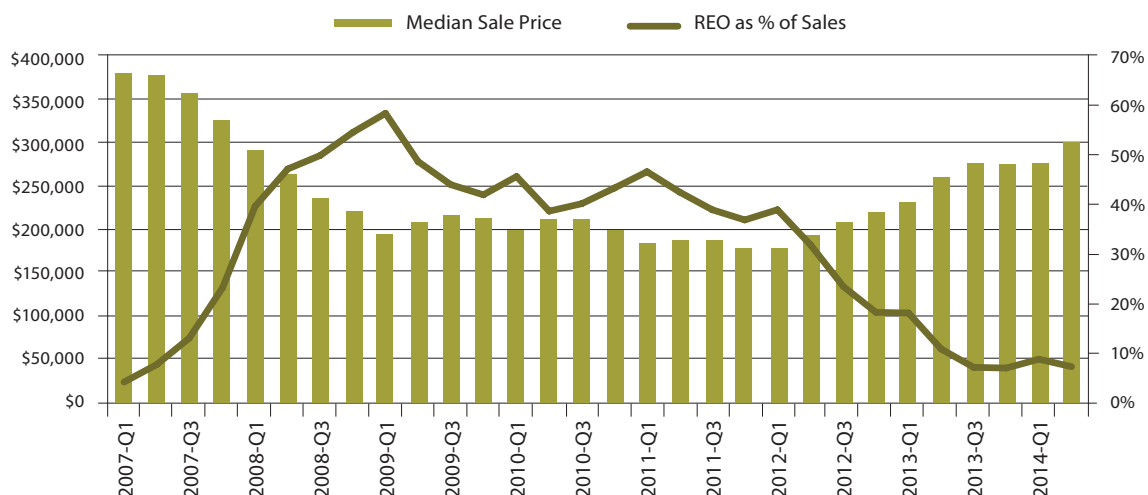
Residential

- The median sale price for the Sacramento region increased during the second quarter of 2014 relative to the fourth quarter of 2013. The median sale price during the middle of 2014 was \$298,000, which is a 9.3% increase from the fourth quarter of 2013 (\$272,000) and a 14.6% year-over-year increase (\$260,000 during the second quarter of 2013). It should be noted that the magnitude of increase was relatively small compared with the increase during 2013 over 2012. Also, the change during the second quarter of 2013 and fourth quarter of 2014 was similar relative to the periods 2002 and 2003, and there was a 28.7% drop from the peak during 2005 of the median sale price in the Sacramento region. The median sale price per square foot in the Sacramento region for single family residences remained relatively flat with a 5.8% increase and showed no change during the first half of 2014 relative to 2013. Further, with respect to year-over-year change in price per square foot, Yolo County showed a 19.12% increase, followed by Sacramento County (15.3%), El Dorado County (11.0%), Placer County (10.0 %) and for Sacramento MSA (14.0%).
- The overall selling activity of new homes year-over-year (Q2 2013-Q2 2014) showed an 11% decline

“The median sale price for the Sacramento region increased during the second quarter of 2014 relative to the fourth quarter of 2013.”

relative to an increase of 40% during the previous period (Q2 2012- Q2 2013). However, in terms of percentage change in sales, there was a miniscule increase in sales to 19.2% during first half of 2014 relative to 18% during first half of 2013. Further, sales of existing homes showed a decline of 11% during Q2 2013-Q2 2014 from an increase of 5.6% during Q2 2012- Q2 2013. However, sales during first half of 2014 increased by 37% relative to 30% during first half of 2013. The actual number of existing home sales dropped during the intervening period from 18,705 to 16,239, i.e., first half of 2013 to 2014. Geographically, El Dorado and Yolo counties showed relatively lower declines compared with Placer and Sacramento counties.

Figure 4
Median Sales Price (All Homes) vs. REO as a % of Sales: Sacramento MSA

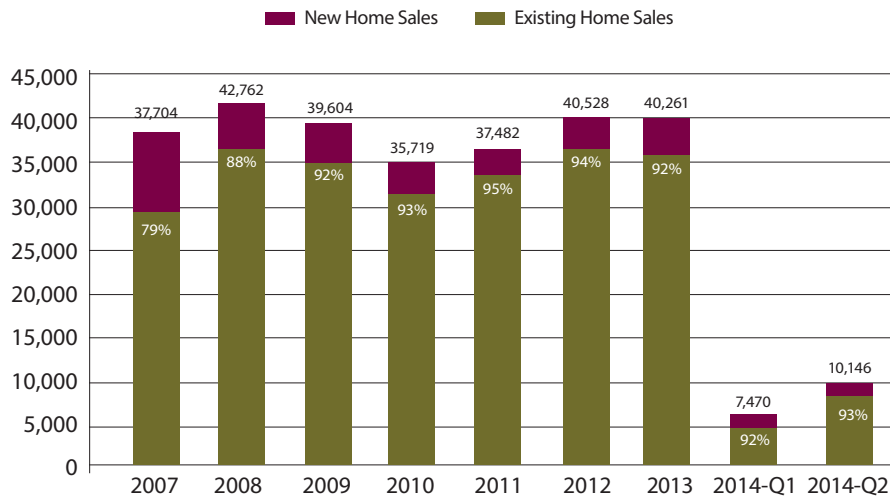


Data Source: Data Quick

■ The main reason why home prices have increased in the past few years is the decline in percentage of REO sales in the Sacramento region. The composition of such sales was almost 32% during second quarter 2012, and declined to 10.8% during second quarter of 2013 and further dropped to 7.3% during Q2 2014. This is not surprising since home sales for values less than

\$200,000 declined year-over-year by 11.1% (Q2 2013-Q2 2014) and increased for price ranges of \$400,000-600,000 by 12% and 9.4% respectively. These trends suggest that the regional residential housing market is poised for an upward trending during 2014 and 2015 as the overall health of the Sacramento economy continues to improve steadily.

Figure 5
New Home Sales vs. Existing Home Sales | Sacramento MSA



Data Source: Data Quick

2014 Sacramento Banking Industry

Mid-Year Update



In January 2014, the *Sacramento Business Review* (SBR) banking industry analysts questioned whether loan growth, which had been accelerating during the latter half of 2013, would continue at a healthy pace throughout the year. The team was concerned that the sizable increase in longer-term interest rates between May and December 2013 would create a headwind for borrowers, largely offsetting the benefit of higher real estate prices.

Through the first six months of 2014, the evidence appears to show that new loan volume remains solid. Led by commercial real estate, including strong construction loan growth, loans for the Sacramento Region Banks¹ increased at a 7.4% annualized pace (Table 1).

In their January forecast, the analysts noted that higher loan volumes would help local banks increase their net interest income, especially since the spread between longer-term interest rates (at which banks lend) and shorter-term rates (at which banks pay depositors) had widened materially since mid-2013. This top-line growth would be the key to improving bottom-line net income, especially since the boost from lower loan loss provisions was nearing an end.

Table 2 illustrates how the greater loan balances have translated into higher net interest income for the local banks this year. This top-line growth has enabled the Sacramento Region Banks to improve their pre-tax income by 5.4% (annualized) through the first half of 2014.

Table 1
Sacramento Region Banks • Loan Growth by Category
(through June 30, 2014)

% of Total	Category	% Change Since	
		6/30/13	12/31/13*
43.5%	Commercial Real Estate	7.7%	6.9%
25.4%	Residential	0.1%	-0.9%
11.1%	Commercial & Industrial	5.7%	15.5%
4.5%	Multifamily Residential	29.9%	3.0%
3.5%	Construction Loans	40.4%	40.3%
13.0%	Other	14.4%	11.6%
100.0%	Total	8.2%	7.4%

* Figures showing the 2014 year-to-date changes are annualized

Data Source: FDIC

Table 2
Sacramento Region Banks Aggregate Income Statement
(\$ in Millions)

	Last 12 Months		Annualized % Change
	12/31/2013	6/30/2014	
Interest Income	\$465.5	\$474.9	4.1%
Interest Expense	(25.6)	(24.5)	-8.6%
Net Interest Income	\$439.8	\$450.4	4.8%
Provisions for Loan Losses	(5.1)	(2.1)	-115.3%
Noninterest Income	101.0	94.0	-13.7%
Noninterest Expense	(356.9)	(358.7)	1.0%
Pretax Income	\$178.8	\$183.6	5.4%

Data Source: FDIC

“Those basing their trading strategies on the SBR bank stock ratings this year would have fared reasonably well.”

M&A Activity Finally Occurs

Since 2011, the SBR banking team has predicted that Sacramento would begin to see a pick-up in merger-and-acquisition (M&A) activity among local banks. The lack of transactions in recent years led the analysts to begin questioning their assumptions and had them wondering whether they would be “waiting for Godot” with respect to M&A. However, in January, the team’s prediction showed signs of materializing when Tri Counties Bank announced the purchase of North Valley Bank in a \$178 million all-stock transaction.

Year-to-Date Local Bank Stock Performance Review

Despite better financial performance this year, the major aggregate bank stock indices declined through the first eight months of 2014. The SBR Bank Index was no exception, as it fell 1.9% through August 31 (Table 3). This return exceeded that of the benchmark KBW Regional Bank Index, which declined 3.4% during the same time period.

Those basing their trading strategies on the SBR bank stock ratings this year would have fared reasonably well. For example, Sierra Vista Bank, one of the four banks rated as Outperform in January 2014, has been the best performing local bank stock this year, generating a 90% return.

The team would be remiss if it neglected to mention some of its erroneous calls, which included North Valley Bank (which got acquired and was up 11% as a member of the Underperform list) and Sutter Community Bank (down 13% while rated Outperform).

ENDNOTES

- 1 The Sacramento Region Banks include American River Bank, Bank of Sacramento, Community 1st Bank, Community Business Bank, El Dorado Savings Bank, Farmers & Merchants Bank, First Northern Bank, Five Star Bank, Folsom Lake Bank, Gold Country Bank, Merchants Bank of Sacramento, North Valley Bank, Redding Bank of Commerce, River City Bank, River Valley Community Bank, Sierra Vista Bank, Sutter Community Bank, and Tri Counties Bank.

Table 3
Year-to-Date Stock Performance
(through August 31, 2014)

Bank	2014 YTD Return	January 2014 Rating
Sierra Vista Bank	89.7%	Outperform
Folsom Lake Bank	20.4%	Market Perform
River City Bank	12.5%	Outperform
Bank of Sacramento	11.8%	Market Perform
North Valley Bancorp	11.1%	Underperform
Farmers & Merchants Bank	8.2%	Market Perform
First Northern Bank of Dixon	7.3%	Market Perform
Community Business Bank	0.6%	Outperform
American River Bank	-1.6%	Market Perform
Community 1st Bank	-10.0%	Market Perform
Sutter Community Bank	-13.0%	Outperform
River Valley Community Bank	-15.6%	Market Perform
Tri Counties Bank	-20.4%	Underperform
SBR Bank Index	-1.9%	
KBW Regional Bank Index	-3.4%	

The SBR Bank Index tracks the performance of all publicly traded Sacramento Region Banks on a capitalization-weighted basis (i.e., a weighted average of returns by market capitalization).

The Small Business Economy



SBA Lending Increases and Shows Robust Growth

The total dollar amount of SBA loans approved in the Sacramento MSA continued to increase for another year. While the overall loan amount increased 36% since 2012, Sacramento County (the largest county in the MSA) lending levels increased a robust 49% over the last two years. Increase in overall SBA lending is both promising and reassuring of the economic health of the small business sector that defines the economic backbone of the region. The Sacramento regional economy has now recovered substantially from the woes of the recession.

Small Business Confidence Index Sustains Record Optimism

The Small Business Confidence Index has remained at comparable levels from our January 2014 report. While overall credit conditions have improved in the region, credit accessibility is one area of concern that small businesses continue to share. The service sector anticipates a 13% decline in credit conditions, while the manufacturing sector and other sectors are much more optimistic and expect to see an 11% and 16% improvement respectively, for the credit conditions over the next six months.

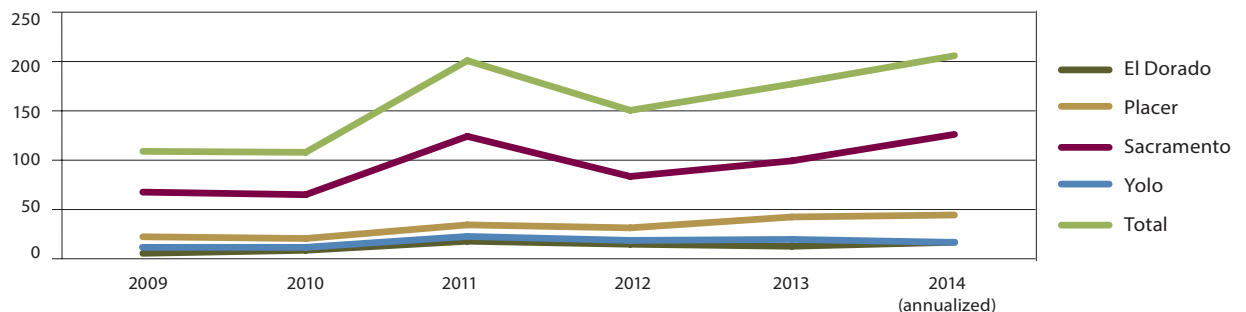
Manufacturing Sector Optimism Remains High

The manufacturing sector sustains its high level of optimism regarding the local business supportiveness. Higher optimism also fuels expectations regarding future revenues with a 17% increase in that index, and high sustained levels of optimism regarding the likelihood of new hires.

Small Business Listings and Sales Soften

The number of businesses listed for sale has been improving overall since 2010, but with slight softening in

Figure 1
Total Dollar Amount of SBA Loans Approved in Sacramento MSA (in Millions)



Data Source: U.S. Small Business Administration

“The manufacturing sector sustains its high level of optimism regarding the local business supportiveness.”

the recent two quarters. The actual number of successful sales, however, has declined steeply for the last two consecutive quarters: the 2014-Q2 sales figure is only 37% from its level in 2013-Q4. The medium closing sales price has also come down from its peaks levels in 2013-Q3, but remains steady has been the case over the last three or four years. Overall, the small business sales have softened in a cooled down market – a trend also seen in the housing sector.

“Overall, the small business sales have softened in a cooled down market – a trend also seen in the housing sector.”

Figure 2
Small Business Confidence Index Trends:
January 2013 – July 2014

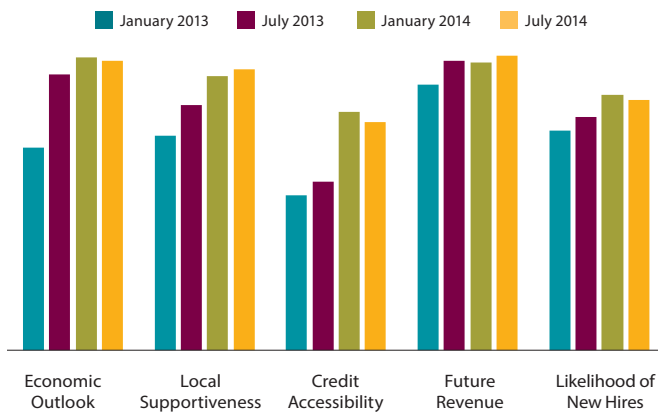


Figure 3
SBCI Trends in the Manufacturing Sector

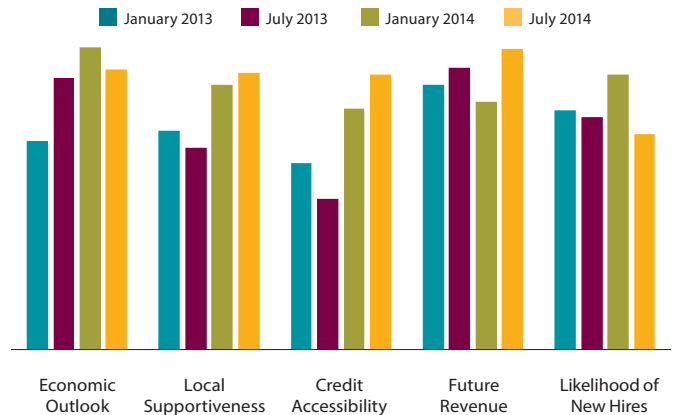


Figure 4
SBCI Trends in the Service Sector

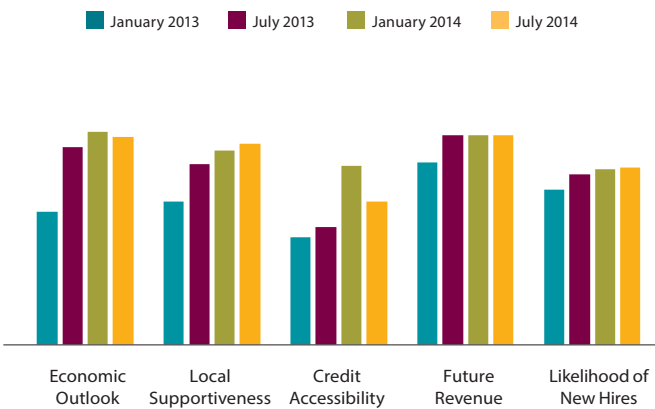


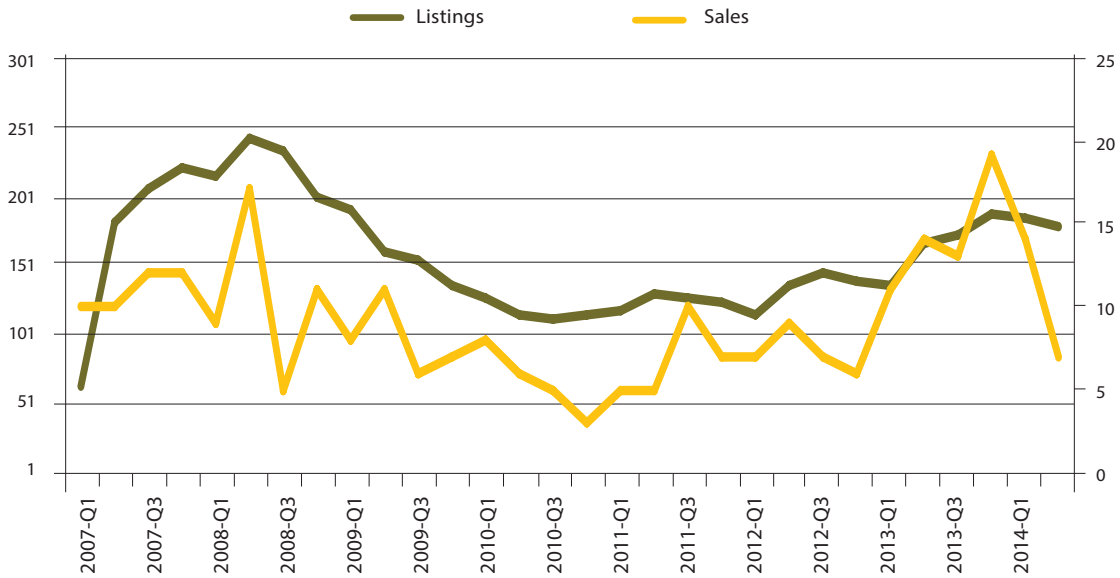
Figure 5
SBCI Trends in the Others Sector



Data Source: U.S. Small Business Administration

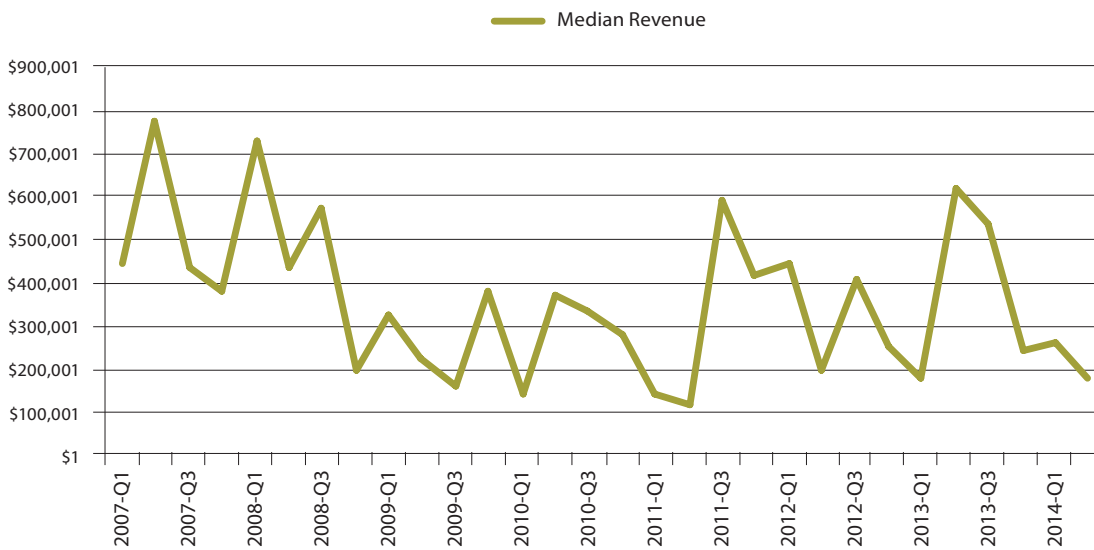
Small Business Sales

Figure 6
Numbers of Listings vs. Actual Sales (Quarterly)



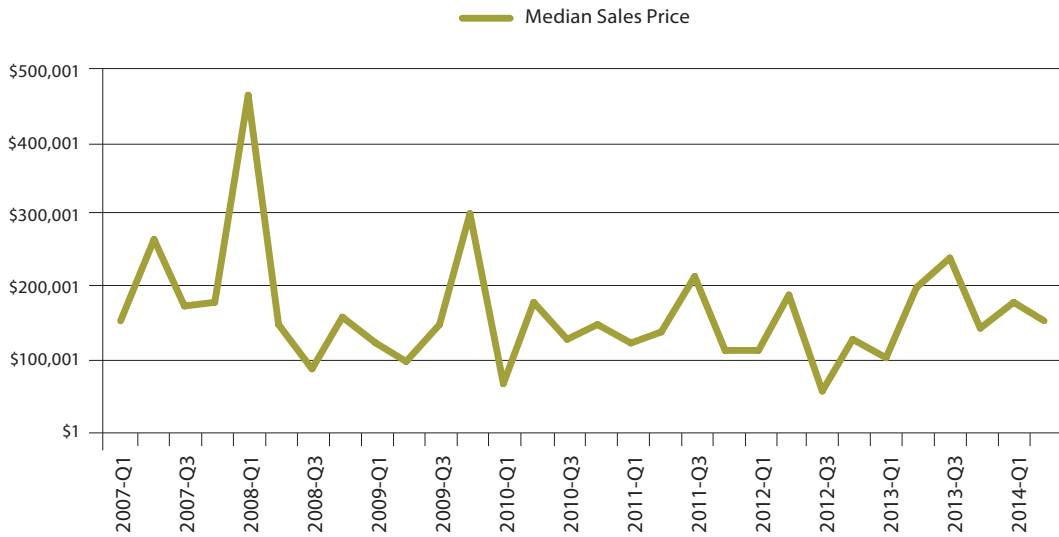
Data Source: BizBuySell

Figure 7
Median Revenue of Closed Sales (Quarterly)



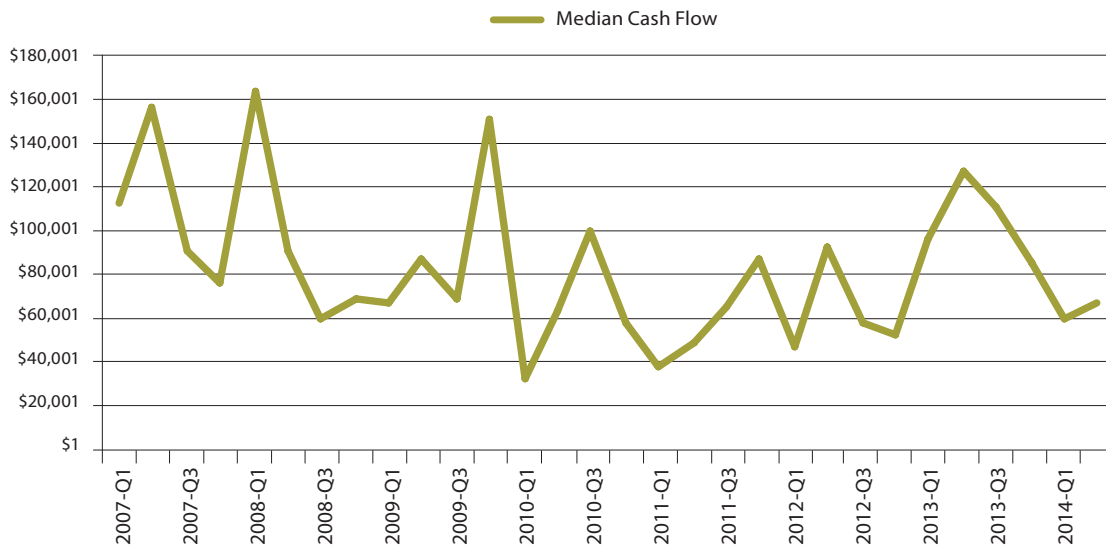
Data Source: BizBuySell

Figure 8
Median Closed Sales Price (Quarterly)



Data Source: BizBuySell

Figure 9
Median Cash Flow of Closed Sales (Quarterly)



Data Source: BizBuySell

2014 Capital Markets Outlook



Our midyear check-in finds our 2014 predictions with mixed results. The global recovery continues to unfold, equity markets are higher, and commodity markets are lower as we expected. Our proprietary SBR index shows that the Sacramento region continues to improve. However, we did not anticipate the effect of geopolitical issues in Russia/Ukraine and the Middle East, which has stifled the Eurozone recovery and has sent global bond prices higher. We have added updated comments to our January Outlook at right:

Macro Theme Updates

Fed Tightening – the Fed continues with its tapering process and maintains that the time for raising interest rates is near. The consensus view is that the first rate hikes will occur in June of 2015. As long as the markets do not materially over- or underestimate the timing and rate of change of those hikes, markets should remain relatively calm. We are not overly optimistic that this will be the case though – to us, it appears that the markets are a bit complacent about the expected path of interest rates, and

Market	January Prediction	Comment/Update
Economy	↗	Recovery on track, but divergent paths around the world
Global Growth	↗	U.S. + Emerging helping, Eurozone stuck in neutral
U.S. Growth	↗	Oil + housing + jobs + confidence = Good to be an American
Eurozone	↔	Russia/Ukraine turmoil further depressing weak growth
Emerging	↗	China is still slowing; we're not sold on the EM bounce
Global Inflation	↔	No change – inflation in check
Stocks	↗	Still our favorite asset class
Regions	U.S./U.K.	U.S./U.K. remain our favorite markets
Sectors	Consumer	Health Care and tech currently leading consumer sector
Bonds	↘	Stubbornly sticking to our call that rates end 2014 higher
Regions	Eurozone	German 10-year Bunds below 1%!!
Sectors	Corp/Floating Rate	Still better value than government debt
Commodities	↘	Headwinds picking up
Sectors	Oil	Gold currently leading, but we still favor oil

bond prices look a bit higher than they should be. We are confident in our view that Fed actions will allow the dollar to continue strengthening, which should keep U.S. inflation and global commodity prices well-contained.

China's Slowing Economy – China continues to slow its economy as anticipated. Surprisingly, the Chinese equity markets have rallied strongly this year as the government enacted various sets of mini-stimuli. We are not sold on the recent strength of Chinese equities – short-term lending

“Our latest reading of our proprietary SBR Financial Conditions Index indicates the region is maintaining its recovery.”

rates remain elevated, banks are still under pressure, concerns of a housing bubble lurk, and consumer confidence is at a two-year low and declining. Our view is that the government is slowly, but surely deflating its past credit and investment excesses and that this trend will be a multiple-year process.

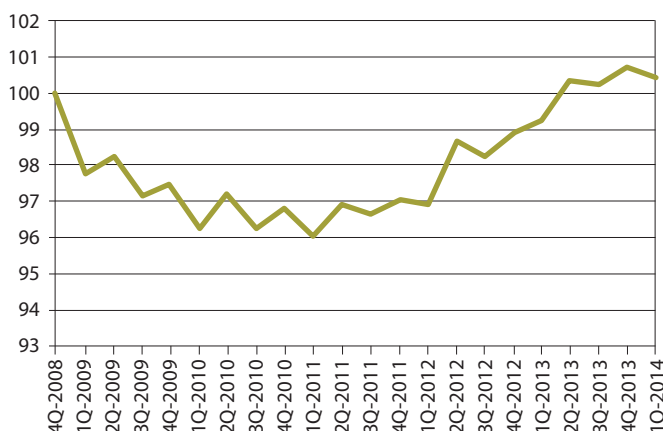
Saudi America? – U.S. crude oil production has surged 54% since January of 2010. Rising energy production has resulted in lower gasoline costs, lower inflation, increased

employment, increased housing, and higher consumer confidence. America is once again the beneficiary of its own ingenuity and vast natural resources, and U.S. equity markets are pricing in those attributes. We believe the recent decline of U.S. interest rates is due to anchoring by other global sovereign rates (e.g., German Bunds) and not reflective of concerns about future U.S. growth. By far, America looks to have the strongest economic tailwinds, and we expect that trend to continue for the next leg of the business cycle.

Sacramento Business Review Financial Conditions Index • July 2014

SBR Financial Conditions Index

Our latest reading of our proprietary SBR Financial Conditions Index indicates the region is maintaining its recovery. Our data show strong performance in capital markets, as well as increases in bank and small business lending. Housing is mixed as the rebound in house price is somewhat offset by the decline in home sales volume. We also see some improvements in local labor markets as both private and government sector employment have improved.



SOURCES:

Cornerstone Macro, Economic Research, August 27, 2014
 Wells Fargo Private Bank, Asset Allocation Strategy, August 2014
 Ned Davis Research, US Sector Strategy, August 5, 2014
 Ned Davis Research, Commodity Corner, August 16, 2014

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2015 ECONOMIC FORECAST



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