AUGUST 17, 2022

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ARRA
Airport Restaurant & Retail Association

Airport, Travel and Market Update

Firm Disclaimer is Provided at the End of the Presentation

The Airport Sector Outlook

- S&P's baseline activity estimate predicts air travel to return to nearly pre-pandemic levels by the end of the year with those serving warm-weather and leisure domestic destinations to experience strong recoveries (i.e. Florida Airports). Those serving international markets will rebound slower (i.e. LAX).
  - TSA checkpoint data estimates show that passenger traffic has exceeded the pre-pandemic average, but remains lower than the record pace set in 2019.
- Credit ratings have been resilient given the faster than expected return in enplanements.
  - Reflected by recent upgrades by S&P for Cleveland Hopkins International Airport, Minneapolis St. Paul International Airport, Indianapolis Airport Authority, and Palm Springs International Airport in just August alone.
- Majority of Airports increased their cash on hand by an average of 23% to 681 days cash on hand because of unspent federal stimulus. Four major airports saw a drop in days cash on hand, but still had more than a year of cash on hand.
- The outlook for US airports is positive at S&P, Moody's, and CreditSights because of improving industry conditions, increasing domestic passengers, stabilizing of credit conditions, and restricted supply continues to drive higher fares. The higher fares will increase revenues and help cover inflation adjusted costs.

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MARKET UPDATE

Inflation, Rising Rates & Recession Fears Cause Volatility

Market Starts to Pick-Up as Volatility Shifts Downwards

- Equities ended prior week with sharp gains as investors weighed easing inflation and improved consumer sentiment. This marked the fourth straight week of gains for the S&P 500 & Nasdaq - their longest streak since November 2021.
- In other news Covid-19 continues its sporadic resurgence in parts around the globe amid a ongoing conflict in Ukraine. A conflict that has recently grown with North Korea offering 100k troops to support Russia's ongoing operations throughout the country.
- In the Municipal sector, the Triple-A scale saw yields increasing by (2 bps.) on the long-end of the curve week over week. U.S. Treasuries saw additional increases on the long-end of the curve with yields rising (6 bps.) respectively.
  - 10 yr. UST on August 5th was 2.83%. On August 12th, the 10 yr. was 2.84%.
  - 10-year average for the 10 yr. UST = 2.07%; 20 yr. average = 2.95%.

Muni/UST Ratios Continue to Cheapen in 2022

While value for Muni Bonds exist even with Munis & U.S. Treasury yields facing uncertainty, yield levels continue to fluctuate

- 10-year Muni/UST ratio - 78%.
- 30-year Muni/UST ratio - 93%.

Market Remains Choppy Amid Various Unknowns

- Fluctuating volatility in market conditions expected to continue
  - Focus on economic news, Central Bank actions, and Geo-political issues.
- August muni bond redemptions will total $41bn, which will be $1bn less than the amount paid out in July, August redemptions will see the heaviest month of activity in 2022 from issuers in California, Massachusetts & Maryland.
- While taxable munis have outperformed the Treasury market so far during the week prior, the tax-exempt and taxable muni indices are underperforming the corporate bond indices.
- Municipal bond mutual funds for August started the month in positive territory gaining $1.5bn for the week ending August 5, 2022.
- This week's Municipal New Issue Supply stands at $11.2 bn, with Tax-Exempt issuance of $7.2 bn, while Taxable issuance totals $4.0 bn.

Key Market Drivers

- Federal Reserve action (September & November meetings)
- Continued Inflation Concerns
- Recession Concerns Grow despite employment strength
- In Municipals, fluctuating bond fund inflows/outflows and daily resets of Muni/UST ratios are impacting investor demand
- AMT Spreads have widened significantly during 2022

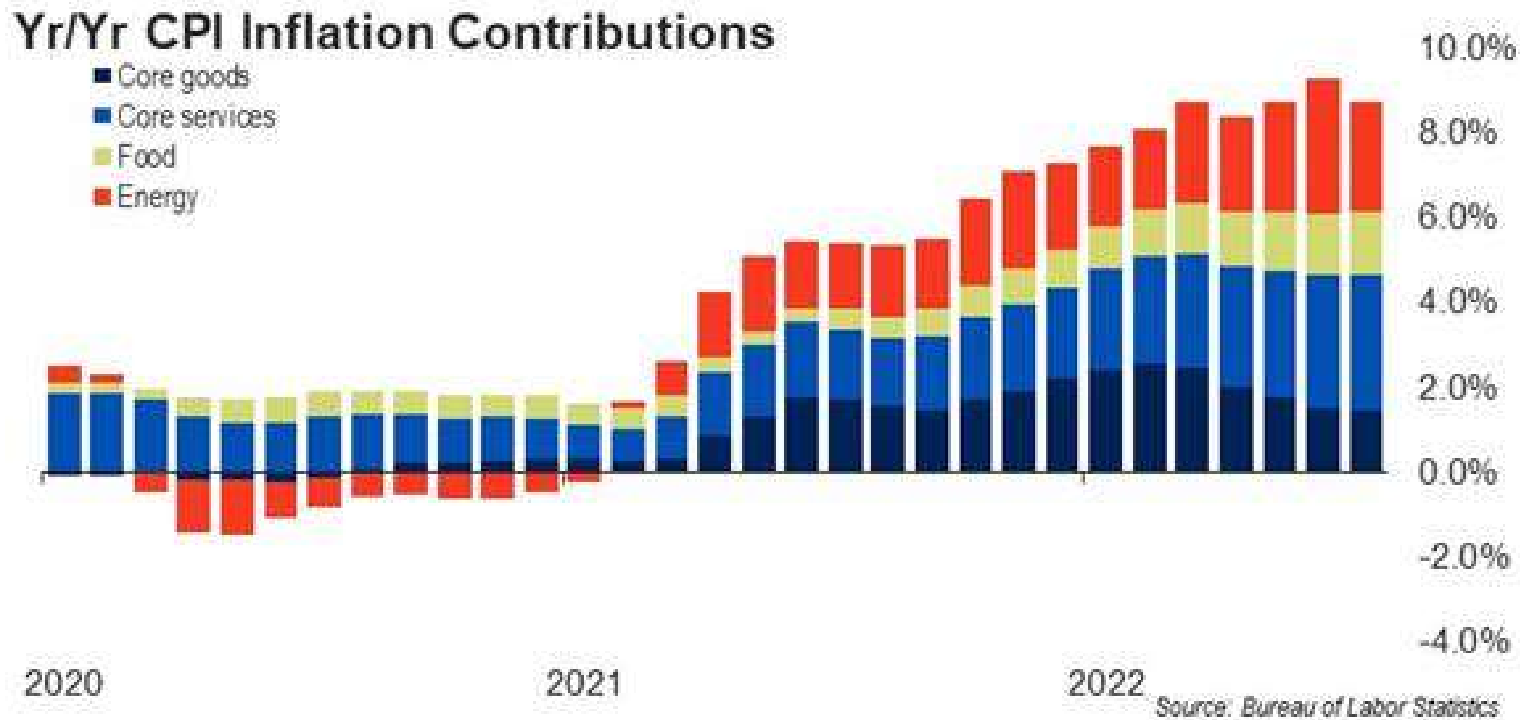
Source: ICI, Credit Sights ,FHNCM & Bloomberg as of 8/15/2022

FED WILL STOP INFLATION!

- **FOMC: "Far from done yet"**
- **Pace? 50-75 bps. in September, then maybe slower**
- **Fed not going to let weak economy stop them**

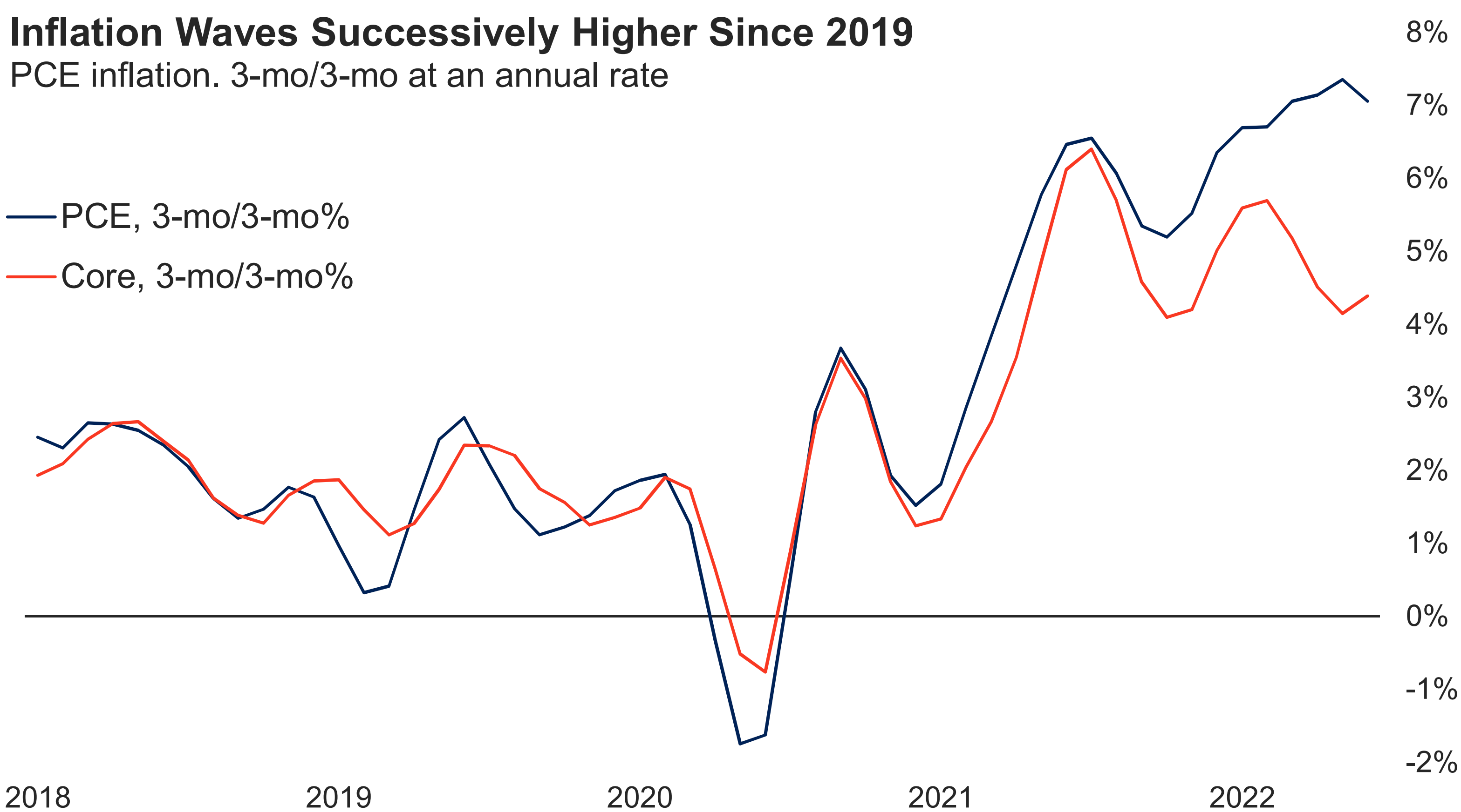
<u>Bottom Line</u>: FOMC still sees risk of doing too little — much worse than risk of doing too much

Inflation High, Broad-Based



- For the first time since April, the CPI report brought unexpected good news on inflation. In July, the CPI was unchanged for the first time since May 2021 thanks to a 7.6% drop in gasoline prices and a smaller-than-expected 0.3% rise in the core
- The Fed has seen inflation pressures wax and wane in three waves since the spring of 2020, and at 8.5% it is still much too high to think about ending rate increases. Still, there are widespread downside surprises in this report, which will help tame expectations and tilts the balance — for now — from a 75bp rate hike in September to 50bp. The ultimate deciding factor will be August's inflation reports in early September.

Higher Highs and Higher Lows



- Momentum in inflation; moving increasingly higher as it oscillates
- People are beginning to change behavior as a result of inflation (gap between PCE & CPI is wide)

Source: Bureau of Economic Analysis

Highlights from July's FOMC Meeting Reaffirm Fed's Commitment to Tame Inflation

Our overarching focus is using our tools to bring demand into better balance with supply in order to bring inflation back down to our 2 percent goal and to keep longer-term inflation expectations well anchored.

Nothing works in the economy without price stability. We can't have a strong labor market without price stability for an extended period of time.

Federal Reserve Chair, Jay Powell, July 27, 2022

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Interest Rate Environment is Now Driven by Anticipation and Size of Future Federal Reserve Rate Hikes

Implied Probability of a Rate Hike

The table on the **(Top-Right)** represents the implied probability of the number of rate hikes that may take place at each Fed meeting. Starting in September, there appears to be 100% chance of at least two interest rate hikes with the probability of a third hike at 48%. Fears have stayed constant amongst investors that the Federal Reserve will continue an aggressive tone towards rate hikes as core inflation remained stable in July, though down .6% overall.

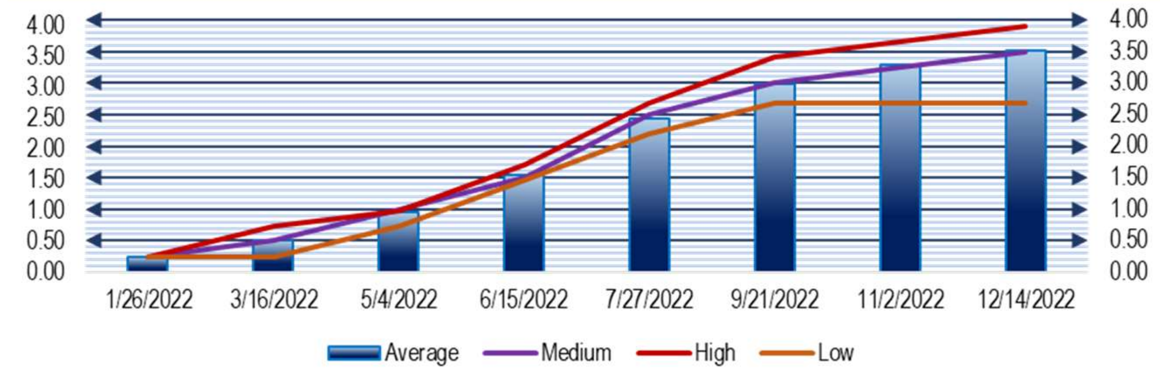
Federal Funds Target Rate

The chart on the **(Bottom-Right)** illustrates the upper target estimates for fiscal year 2022. The upper-bound for the low estimate of the Federal Funds Rate for September's FOMC meeting stands at a hike of (50bps). The Fed indicated that it expects additional interest rate increases will be necessary to drive down inflation. The policy change shifted the Fed Funds Rate range up to 2.25-2.50% and 3.50% by year end.

Implied Probability of a Rate Hike (Fed Funds)

Date	September FOMC	November FOMC	December FOMC	February FOMC	March FOMC	May FOMC	June FOMC
Rate Hikes	2	3	4	5	5	5	5
Add'l Hikes	**48%**	**96%**	**76%**	**14%**	**31%**	**27%**	**.02%**

Federal Funds Target Rate-Upper Bound



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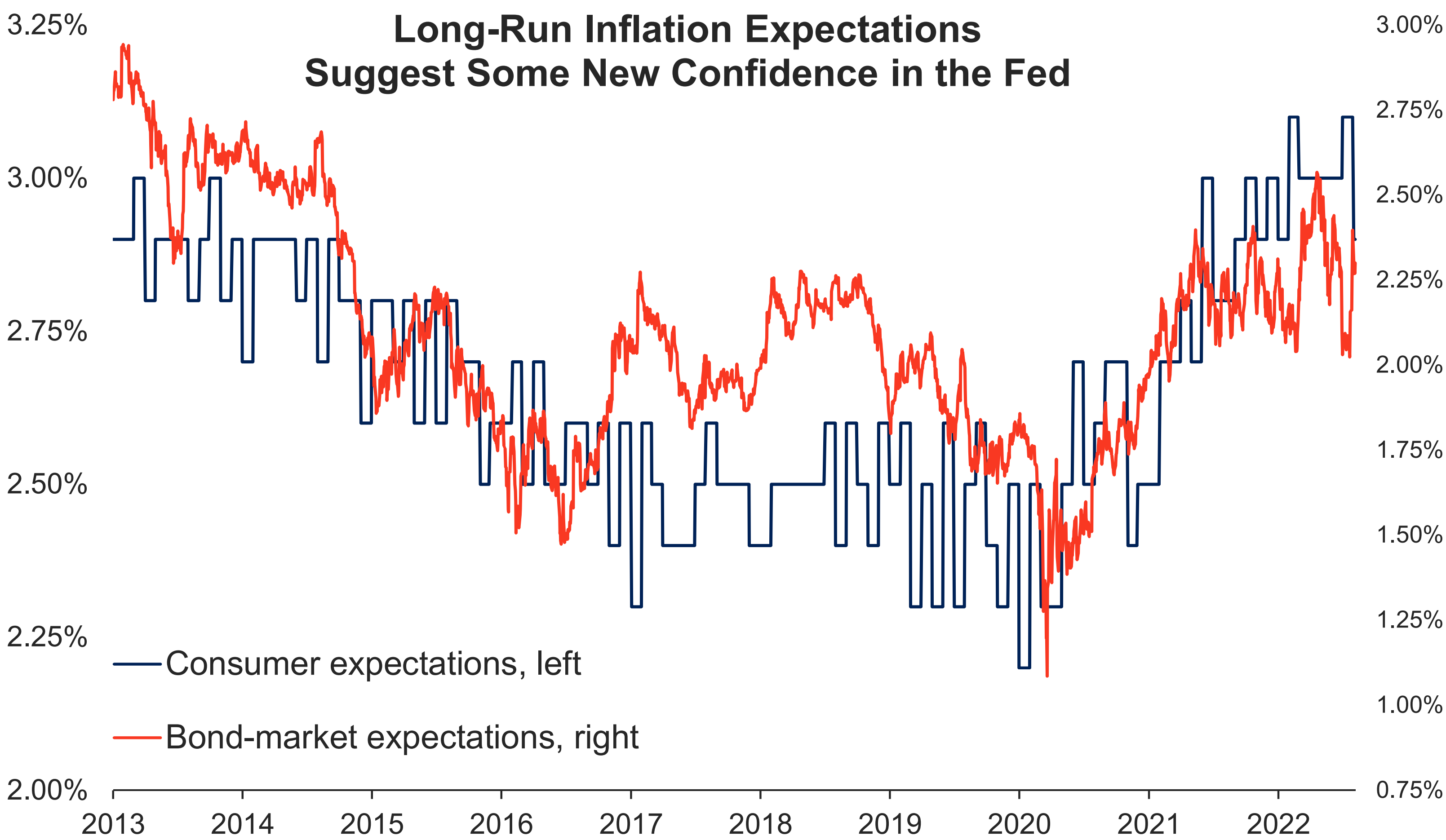
Source: Bloomberg & FHN Financial as of 8/15/2022

Are Inflation Expectations Cooling?



- Last several weeks saw market inflation expectations heating up with easing financial conditions and commentary from Chair Powell

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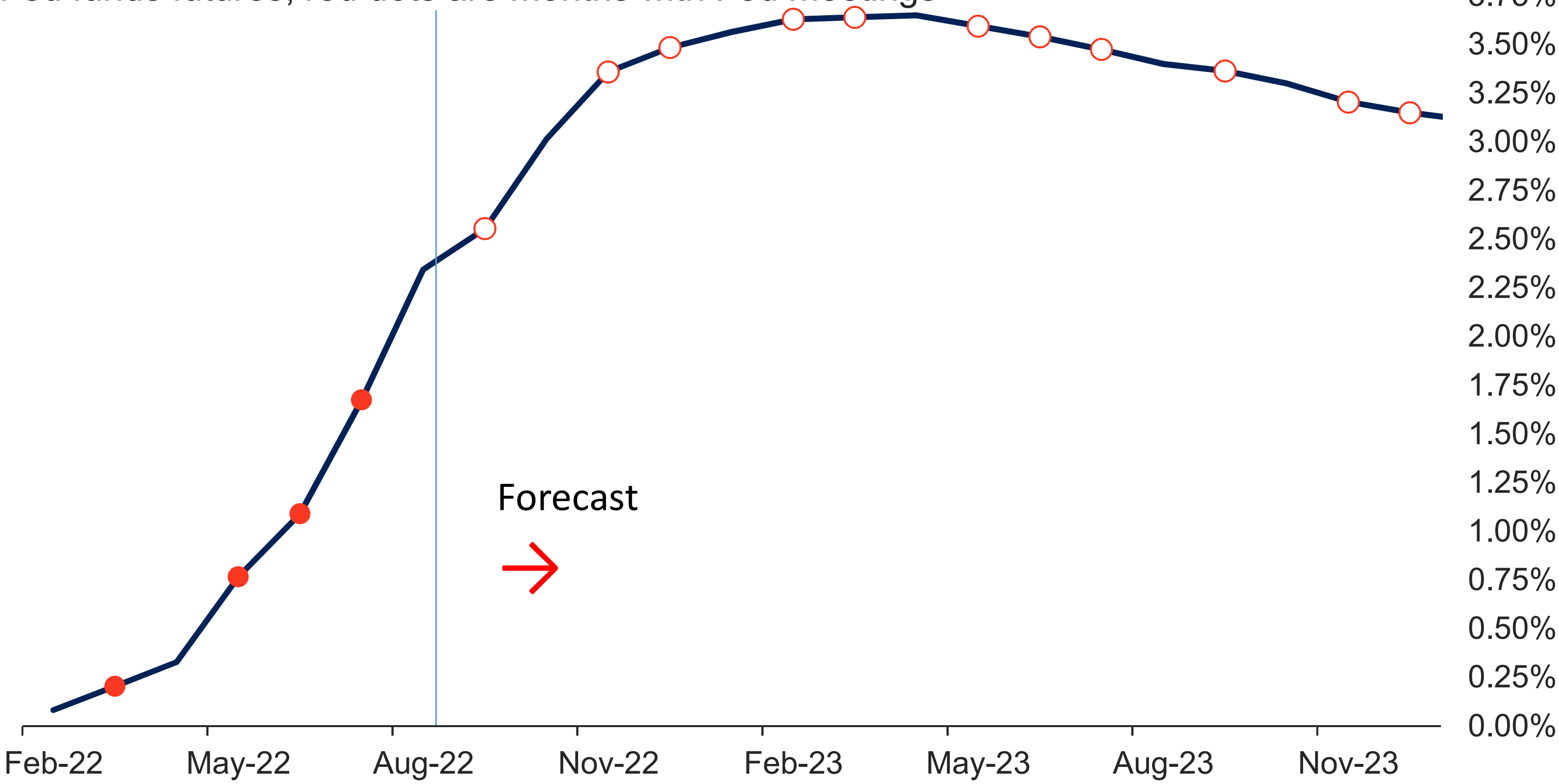
Source: University of Michigan, Federal Reserve, Bloomberg

Market Sees Fewer Hikes Than the Fed is Projecting

Expected Fed Funds Tightening This Year

Fed funds futures; red dots are months with Fed meetings



- Fed expected to continue hiking interest rates through the end of the year in order to tamp down inflation
- Inflation too high for Fed to back away

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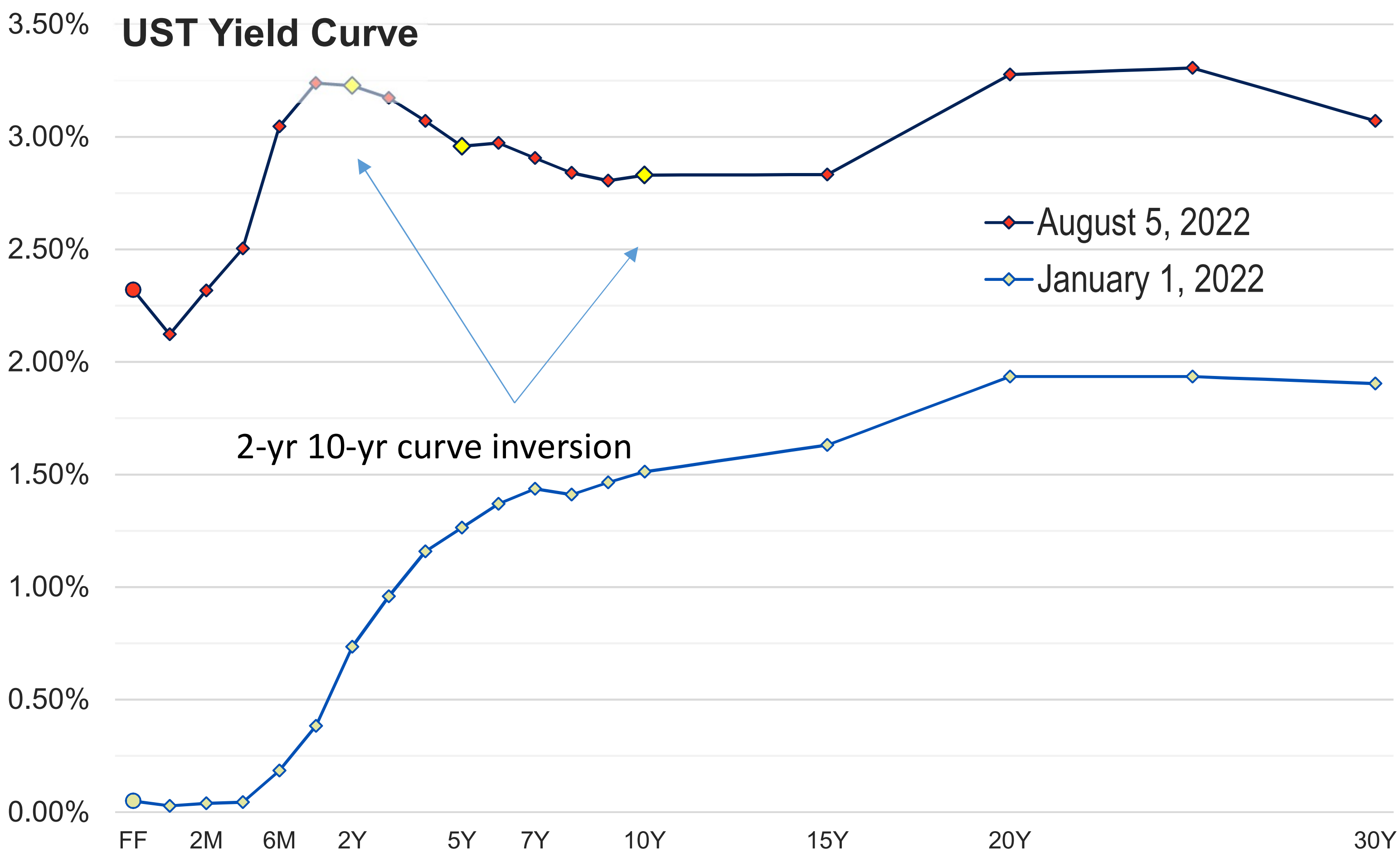
Source: Bloomberg, FHN Financial

Bond Market Reacting to Fed's Plans



- US Treasury Curve has shifted dramatically as participants grapple with inflation expectations
- Bond market sees weakness in future growth – indicative of the Fed tightening in an environment with a bleaker outlook (not in a recession yet but will be soon enough)

Source: Bloomberg

Inflation Previews Recession Worry

- How will inflation end?
  - Fed can restrict demand
  - Or Fed can destroy demand
  - Volatile expectations increases destructive route
- How high will rates rise? Fed says at least 4%. Bullard says 4% this year, more next year. Market thinks 3.5% in February.
- Market overestimating Fed recession sensitivity.
- Stocks priced for mild recession ending soon.
- **When Fed tightens in a mild recession, it becomes severe.**

Takeaway*: For first time since Volcker, recession alone is no reason to stop tightening.

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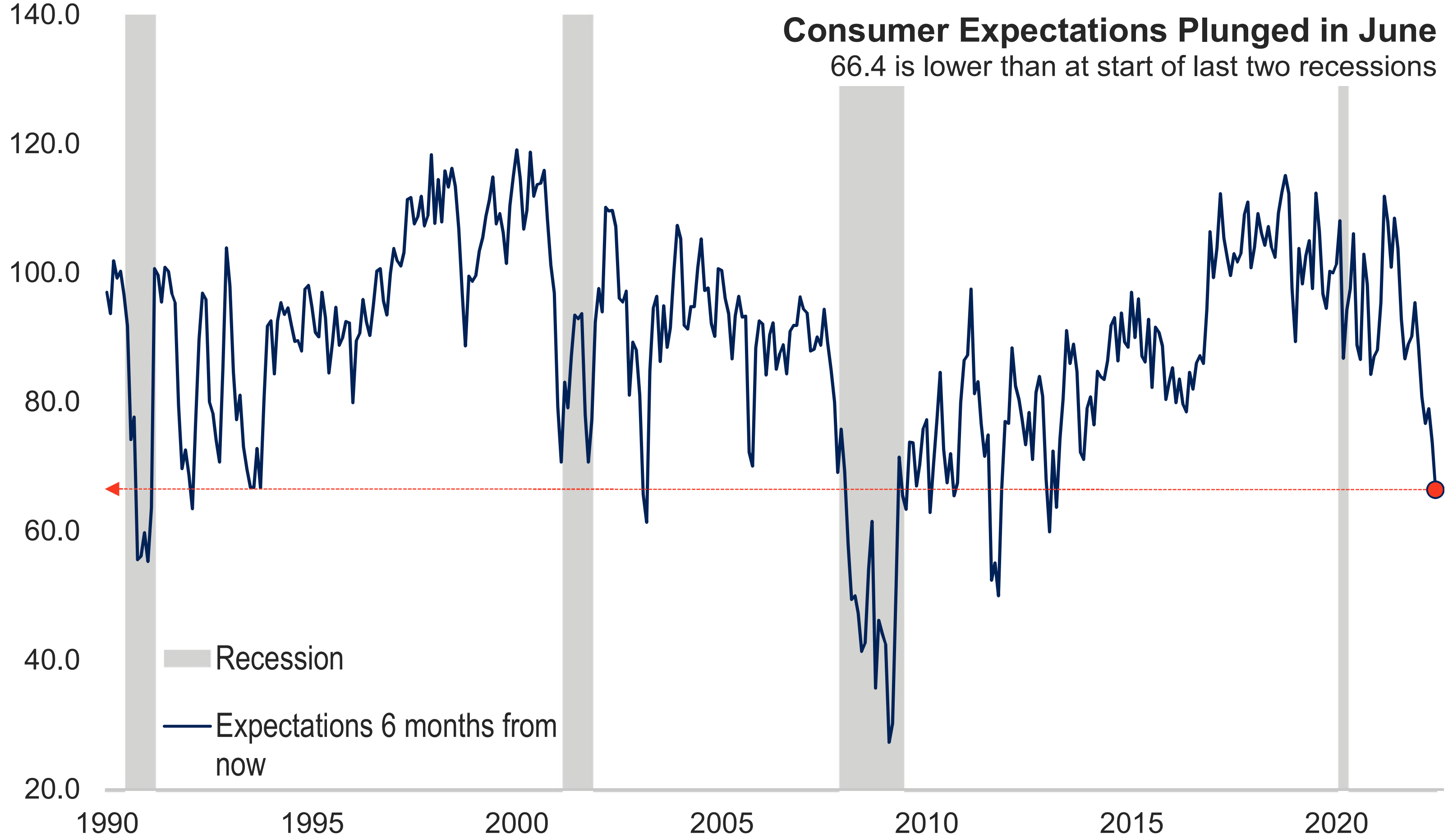
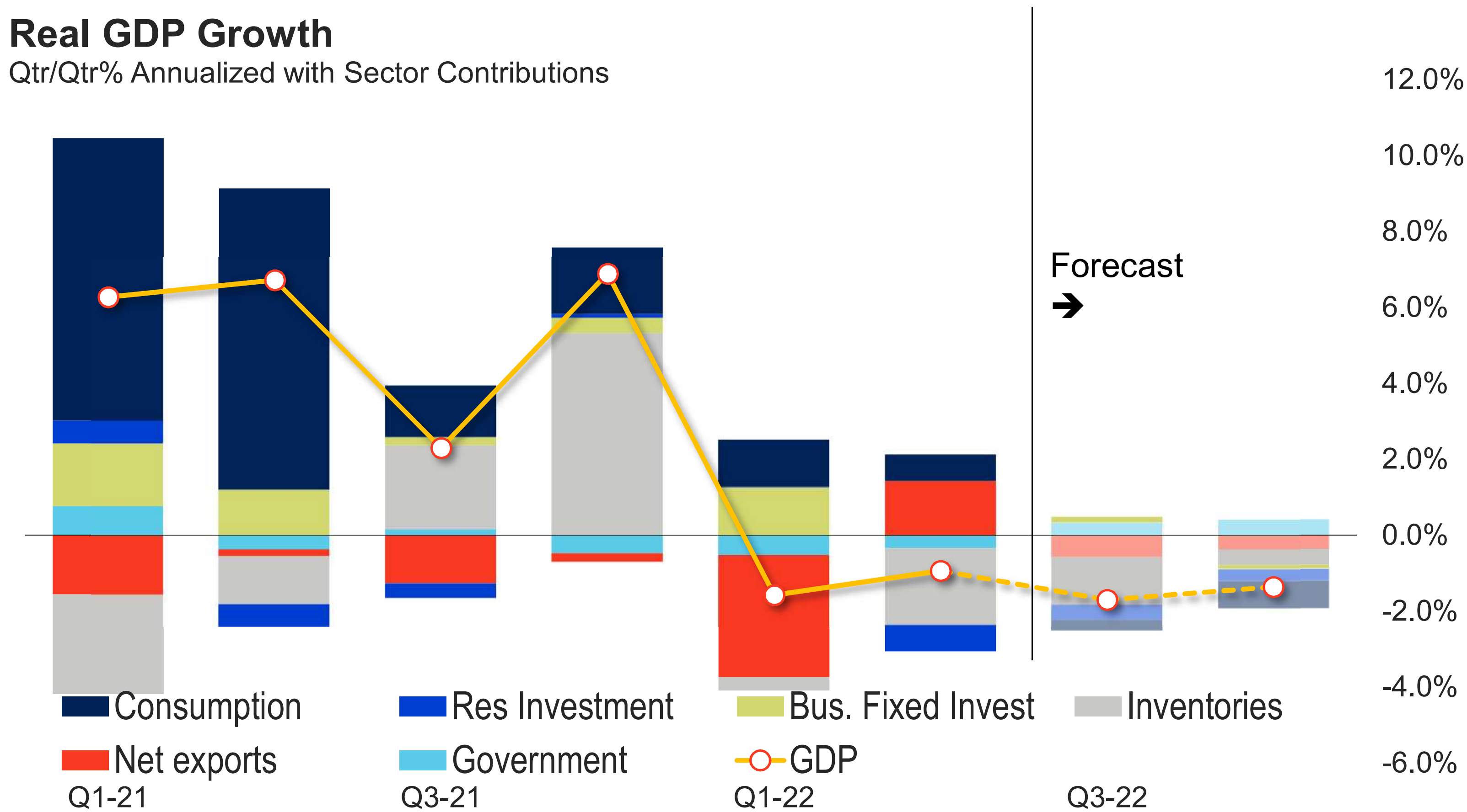
Sentiment Lower Than at Start of Last Three Recessions



Source: University of Michigan and National Bureau of Economic Research

Recession Requirement #1: Falling Production



- Weakness in the second quarter, in contrast to the first quarter – was wide spread with declines in durable goods and non-durable goods consumption, business investment in equipment, business investment in structures, residential investment, and government spending

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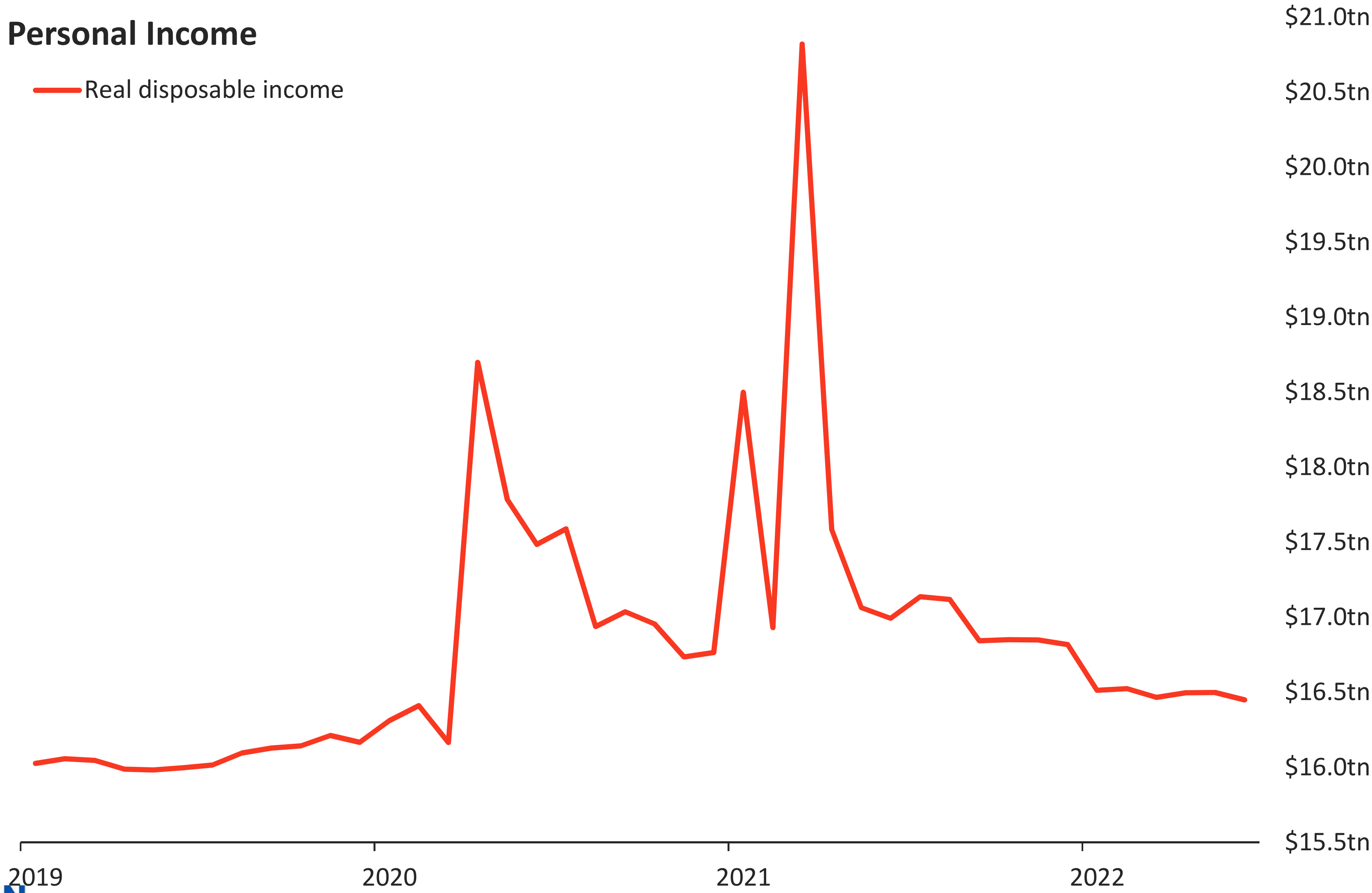
Source: Bureau of Economic Analysis and FHN Financial

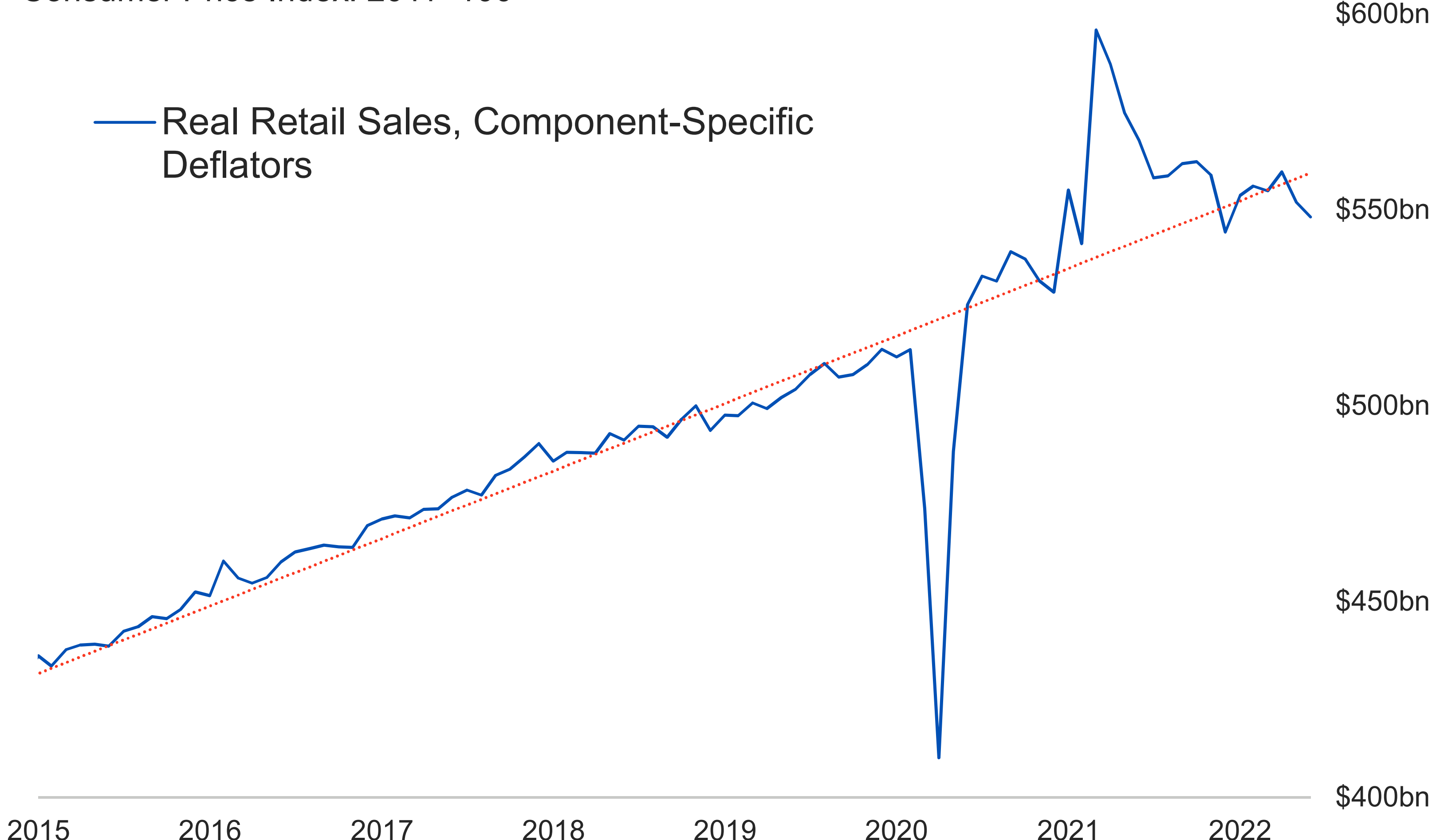
Recession Requirement #2: Real Income is Falling



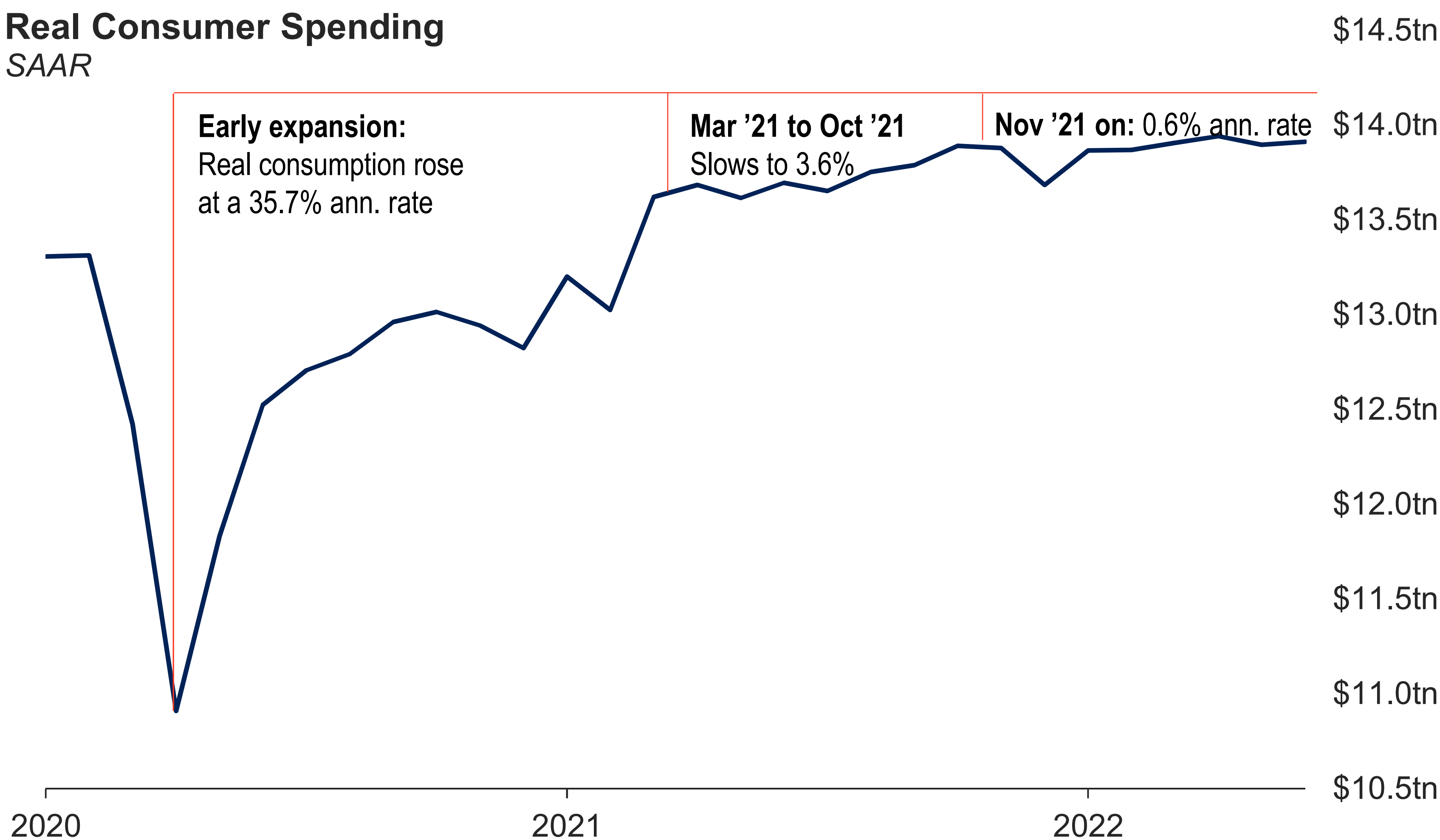
Source: Bureau of Economic Analysis, Jan. 2019 dollars

Recession Requirement #3: Real Sales Also Falling

Real Retail Sales
Consumer Price Index: 2011=100

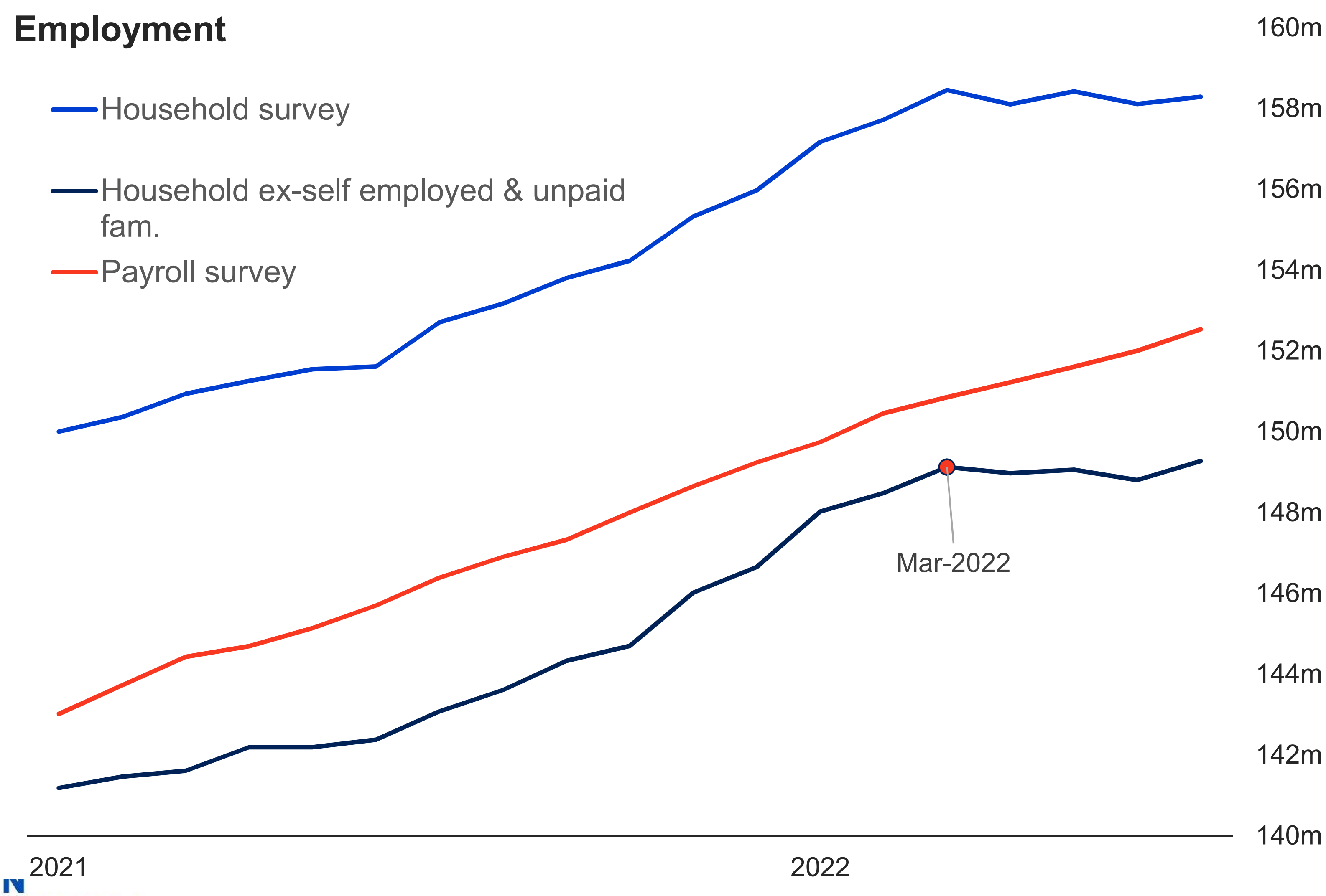


However, Consumption Remains Positive

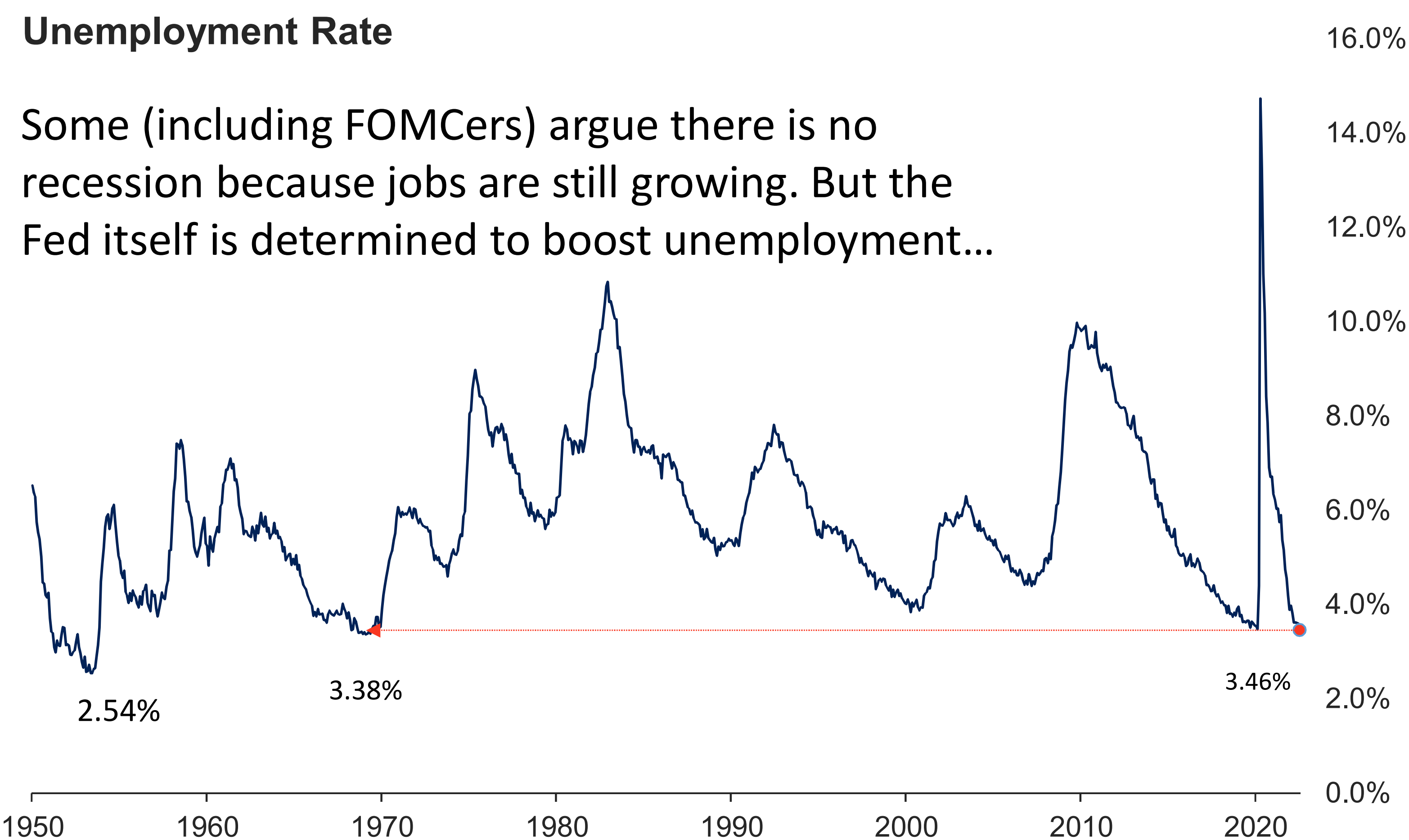


Source: Bureau of Economic Analysis

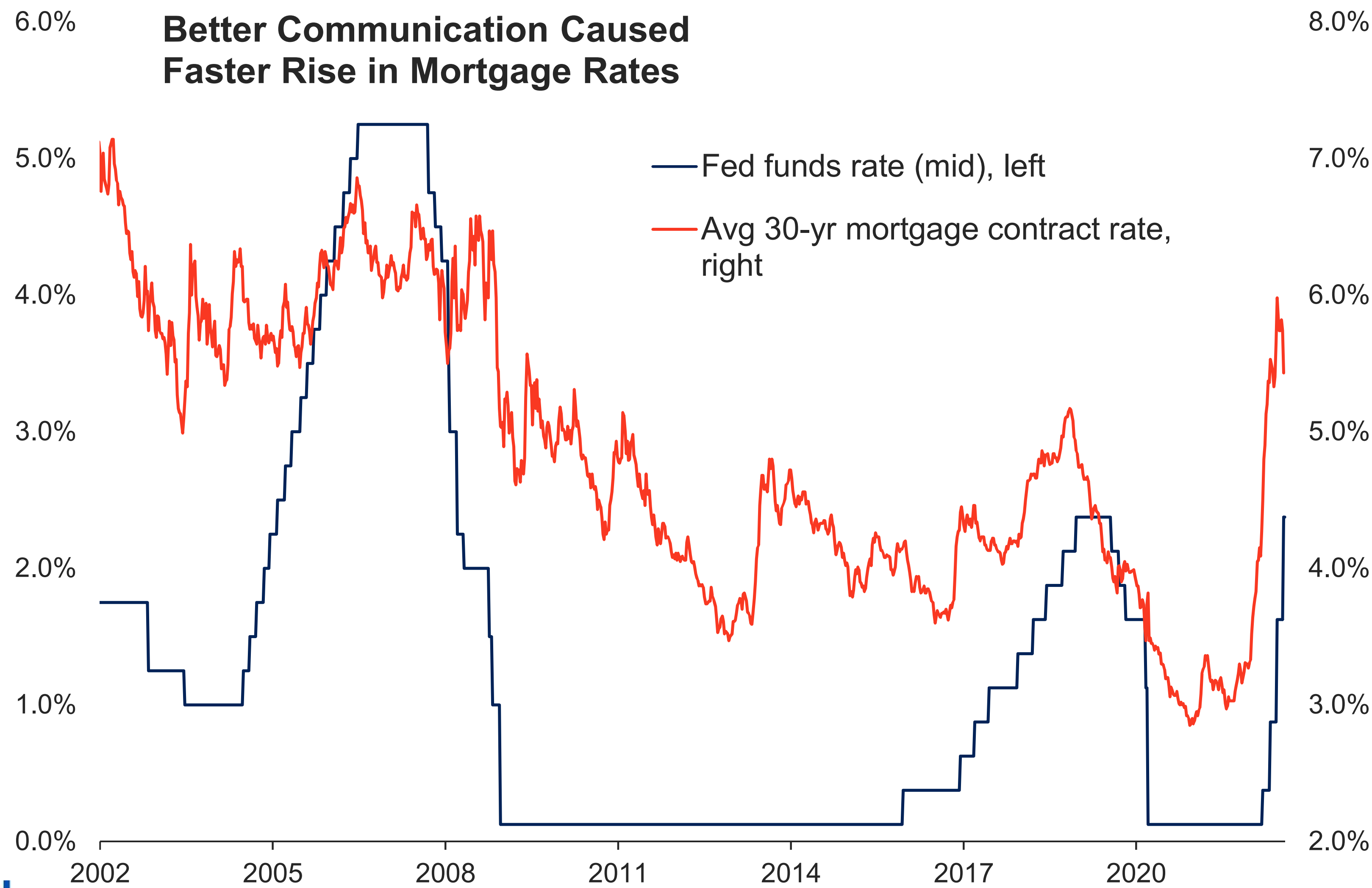
Recession Requirement #4: Falling Employment (Not Quite Yet)



Lowest Unemployment Since May 1969 at 3.5%

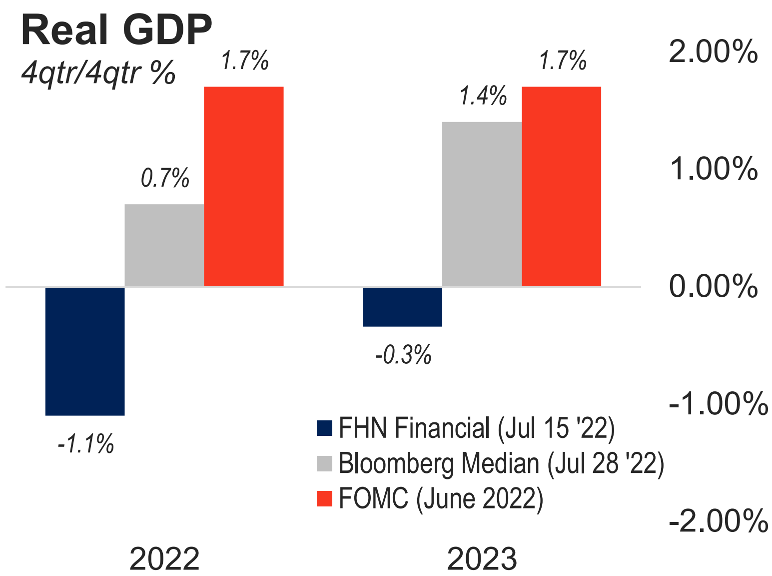


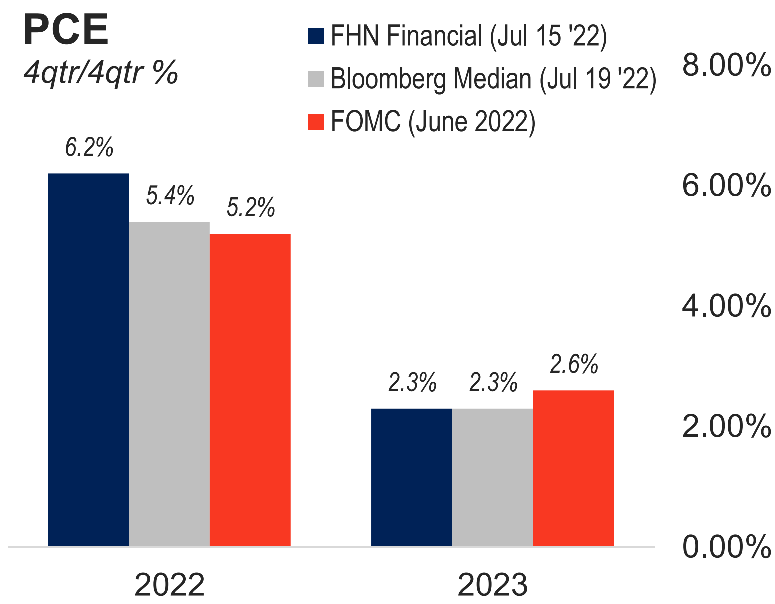
Mortgage Rates Have Peaked



Source: Bloomberg total return indices, Federal Reserve, Mortgage Bankers' Assoc., FHN Financial

Growth and Inflation Forecast Comparison





- Taking the GDP data at face value, the Fed needs growth of 4.7% in the second half to achieve its 1.7% forecast. Figures will be likely revised down in September

Source: FHN Financial, Bloomberg, Bureau of Economic Analysis, Federal Reserve

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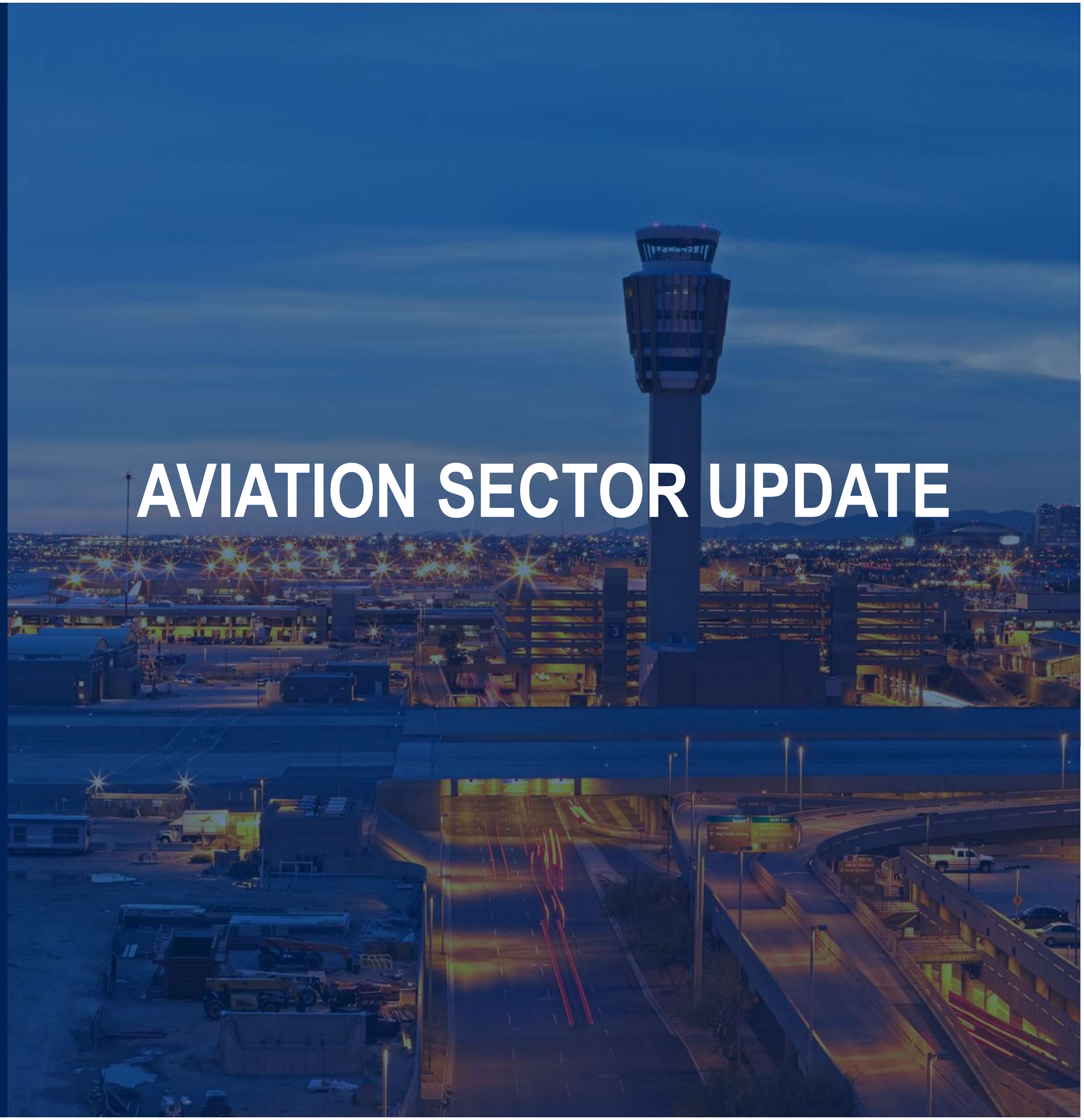
AVIATION SECTOR UPDATE

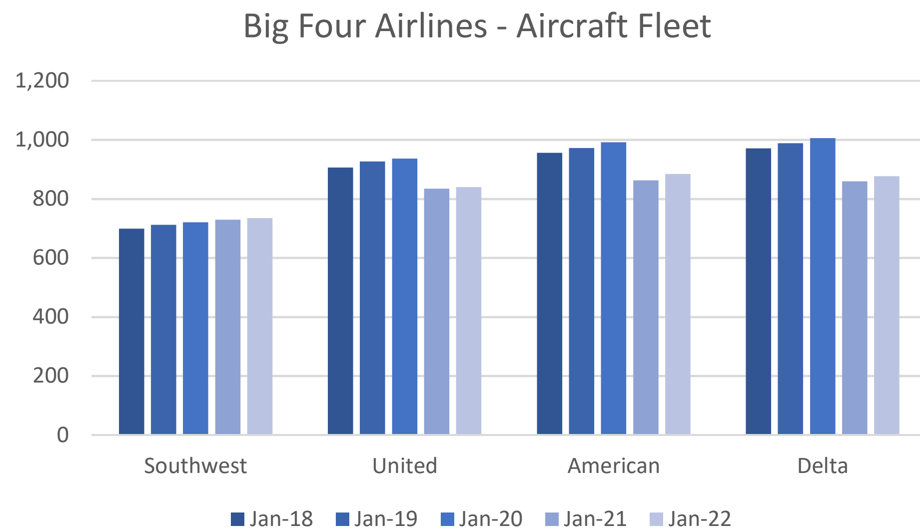


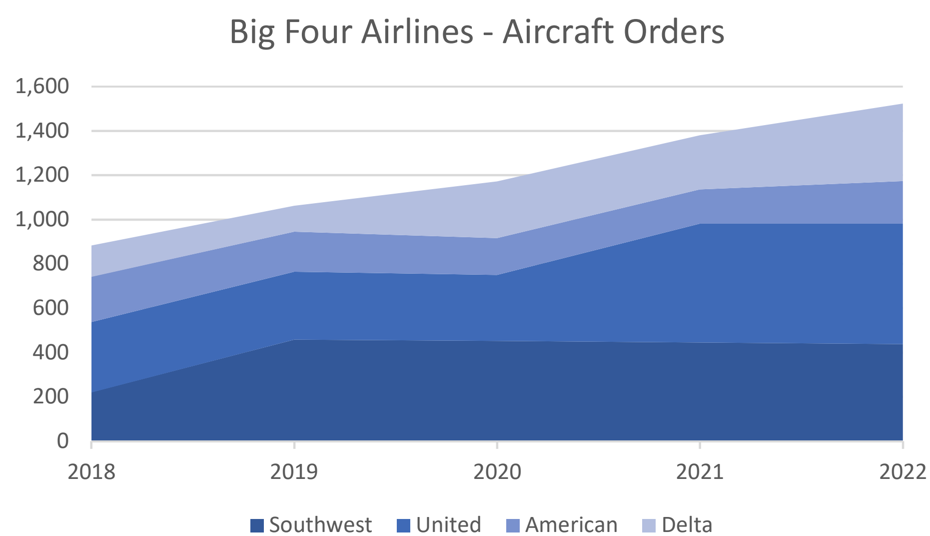
Travel Demand and 6-Month Outlook

- Airline resources (planes, staffing, etc.) are currently the limiting factor within the ability to transport additional passengers. Boeing and Airbus are expected to deliver approximately 16 planes per month to domestic carriers for the balance of 2022.
- July passenger enplanements decelerated due to a resurgence in Covid cases. July experienced 2.26 million average daily travelers, and a total of 70.3 million passengers and represented 88.5% of 2019's daily passenger levels.
- The August and September booking data shows a 4% decrease in the number of flights, and high passenger loads are expected through year end. FHN Financial projected 66 million passengers in August, a noticeable decrease as the summer domestic travel season slows. This equates to 2.13 million daily passengers, and would be about 88.5% of the historical peak (2019) for the month.
- The 3rd quarter is still expected to exceed 194 million passengers (2.15 million daily), however has been dialed back as airlines trimmed late summer flight schedules.
- The 4th quarter of 2022 expects to see 190 million passengers (2.06 million daily) as travel is expected to remain above 90% of 2019 passenger levels. Several airlines have already expressed confidence in their holiday schedules, and increased advanced bookings.

Airline Capacity and Fleet

- American, Delta, Southwest and United Airlines have a combined 317 fewer aircraft in their fleet as of July 2022 than they did in January 2020. This represents a 9% decrease in fleet size, and a 10% decrease in seats available.
- Southwest was the only major carrier to not permanently retire aircraft.
- Over the past five years, most of the major carriers have made capital orders with either Boeing or Airbus to replace aging aircraft.
- The total number of aircraft orders have risen by almost 650 since 2018.
- There have been orders for 442 aircraft since April 2020.





Source: Airline Filings, Boeing & Airbus; as of July 2022

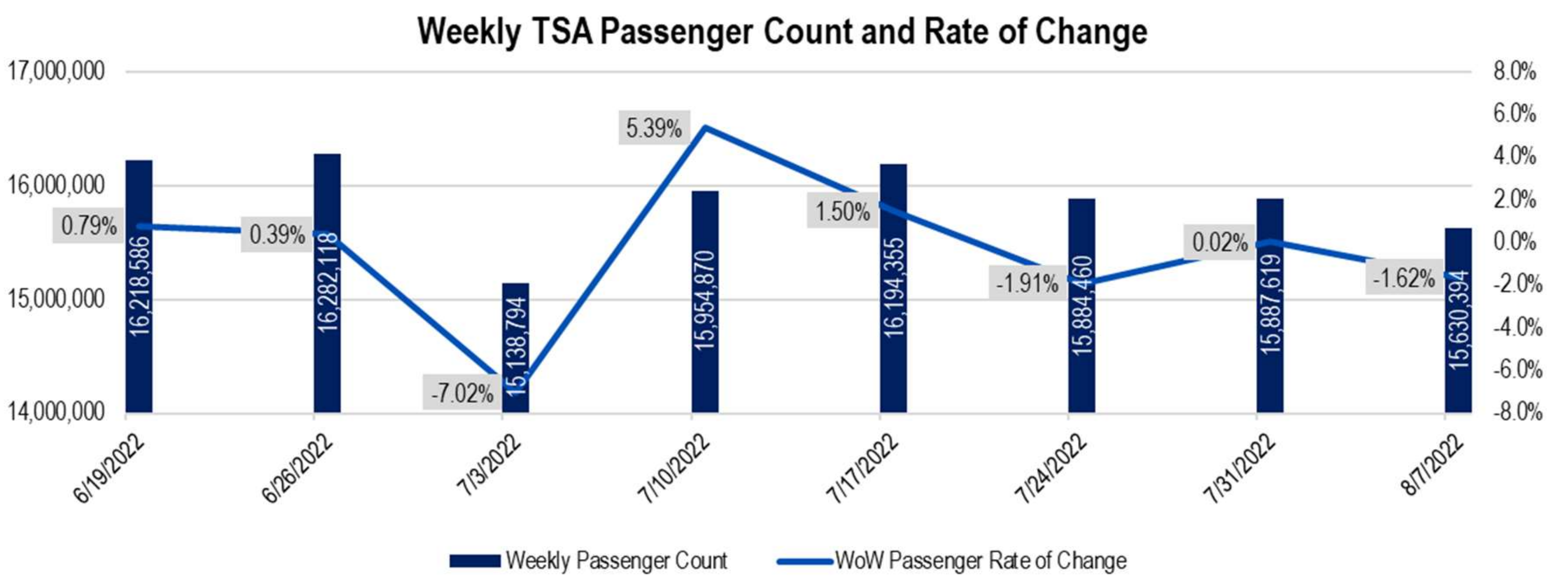
Domestic Business and International Leisure Travel

- Prior to 2020, business air travel accounted for ~10% of daily passenger volume, yet accounted for >70% of profits.
  - In 2021, approximately 19.2 million, or 3.3% of passengers traveled by air for business.
  - In 2022, business air travel is expected to account for roughly 7% of passengers volume, or approximately 50 million passengers.
  - Airlines have combated the decrease in business class revenue by increasing leisure travel rates, and repurposing business class seats.
- Domestic travel is expected to peak in 2024, and is likely to exceed 90% of daily passenger enplanements.
- European airports saw an uptick in foreign air travel demand, with Amsterdam and London airports expecting in excess of 87% of their 2019 passenger load in 2022.
- American, Delta and United Airlines expected international leisure travel to accelerate into the summer travel season, however cases of COVID have hampered some travelers plans.
- International leisure travel passenger volume has increased from 45% in July 2021, to almost 70% of pre-pandemic levels in July 2022, however Passenger Load Factors (PLF) for international (European routes) remain stagnant near 65%.
- Outbound International travel throughout Asia is expected to remain muted into 2023 resulting from precautionary COVID measures, and limitation on foreign tourism in some countries.

Source: Airline filings, FAA, TSA

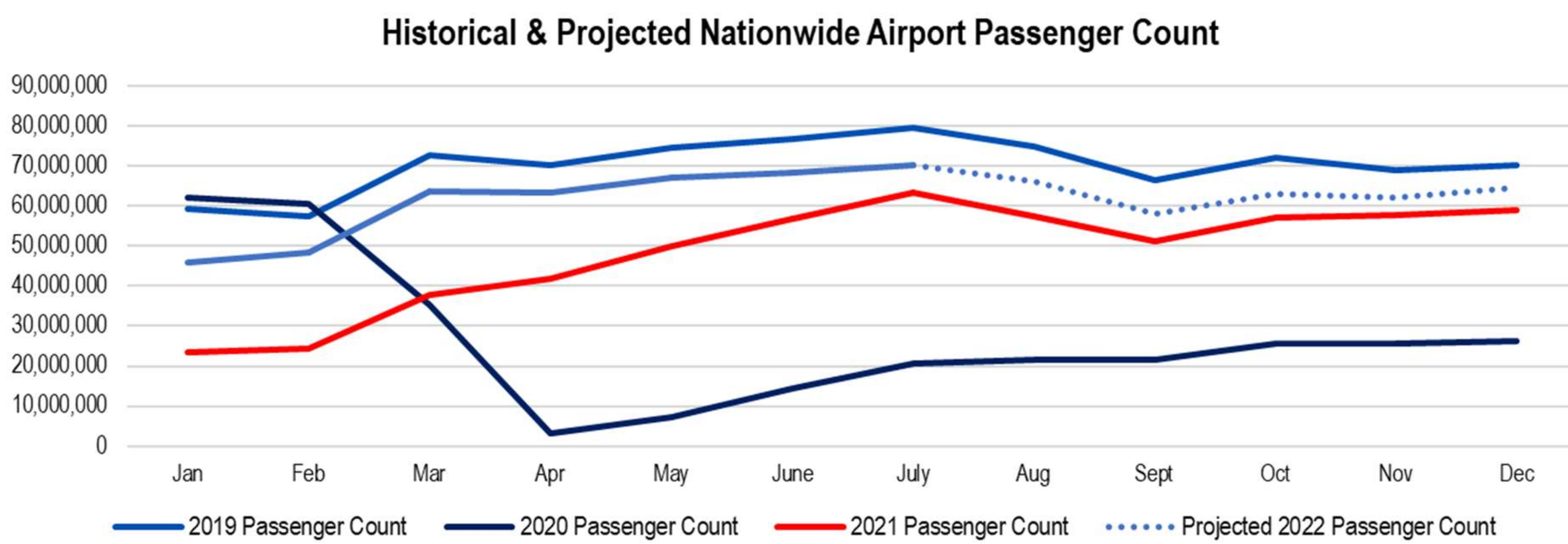
TSA Passenger Data Shows Steady Passenger Volume in July

- Since May, weekly TSA passenger count has been between 15.0 million and 16.2 million passengers, and is limited by a theoretical maximum capacity of 16.9 million passengers.
- The week ended 8/13/2022 saw a decrease of 257,225 TSA passengers over the previous week, totaling 15.63 million passengers.
- For the week ending 8/20/2022, FHN Financial expects TSA passenger volume of 15.31 million passengers, or a decrease 310,000 passengers.



Long-Term TSA Passenger Forecasts

- Domestic leisure rebounded in the spring of 2022, and despite the increased fuel and ticket costs, the industry's biggest issue remains the lack of equipment, pilots, and staff.
- Long-term projections assume between 87% and 91% of 2019's historical passengers for the balance of the year, with flights in November and December nearing capacity.
- Airlines have been trimming flight schedules in order to reduce delayed and flight cancellations.
- FHN Financial Projects 740 million passengers for the year, a 28% increase from 2021, or 88% of 2019's historical peak. A return to 2019 levels is not projected until 2024.



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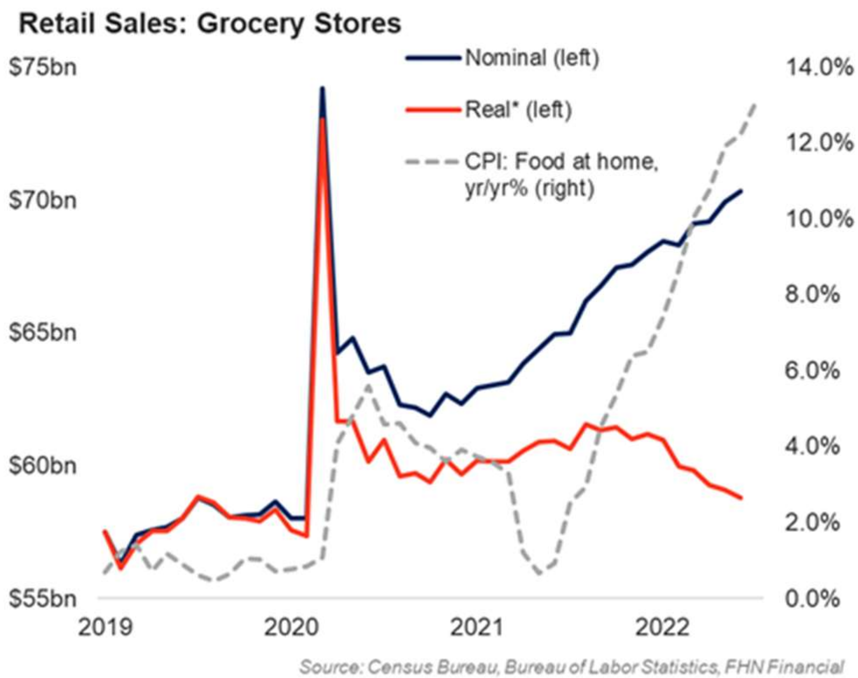
Retail Sales Shows Rising Food Costs to Consumers

- Retail Sales data shows a rise in costs for consumers in both grocery stores as well as bars and restaurants
- CPI for grocery stores - “food at home” - has risen more quickly than at restaurants and bars – “food away from home” - due to a combination of both a change in demand and supply issues.



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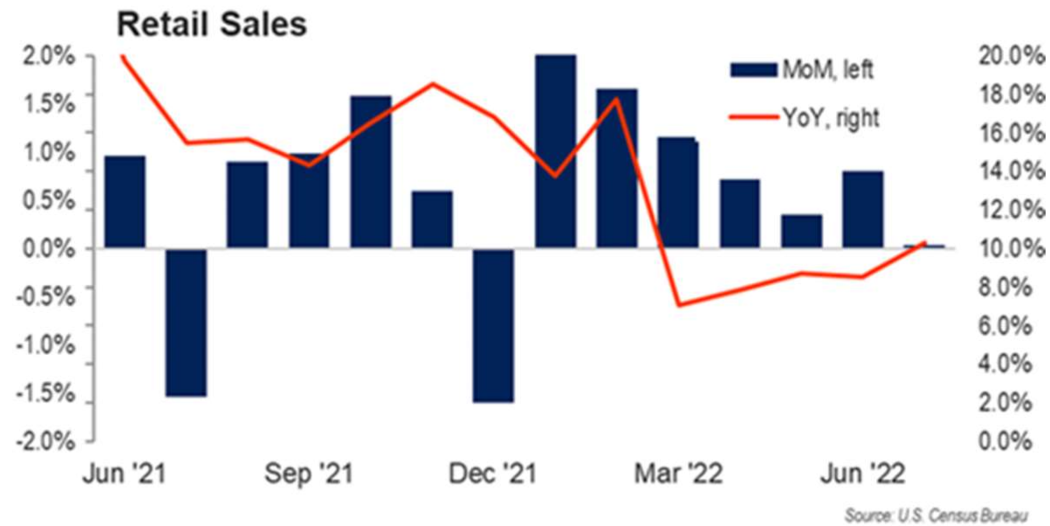
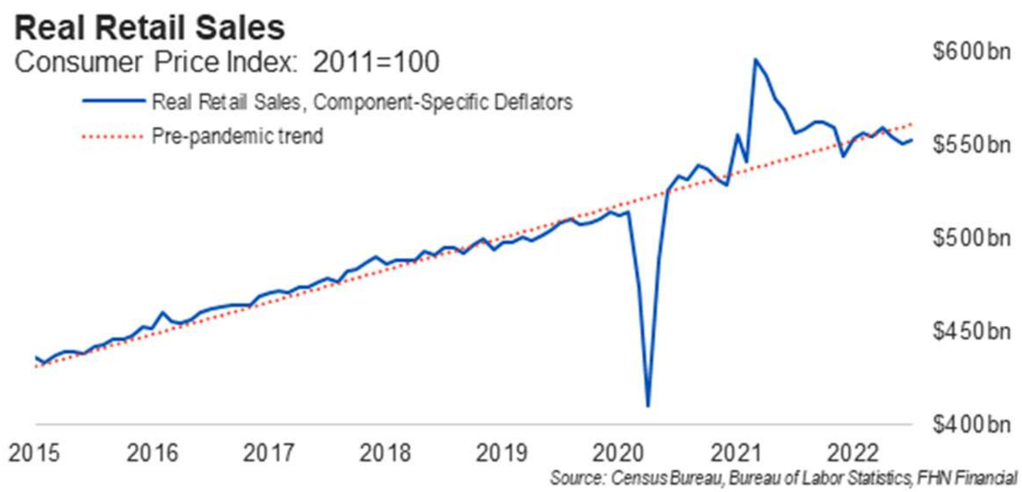
Source: Census Bureau, Bureau of Labor Statistics, FHN Financial

July Retail Sales Flat; Ex-Auto & Gas Beat Expectations

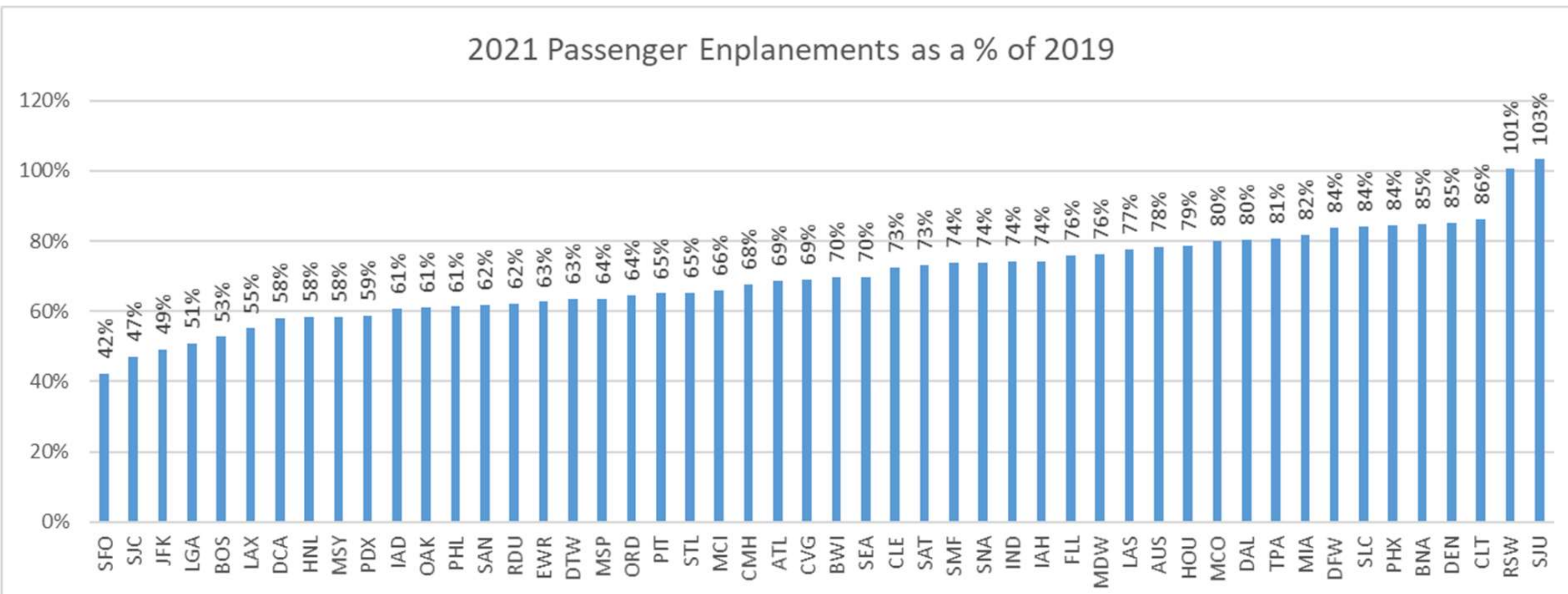
- Retail sales were unchanged in July, and were revised down two tenths from 1.0% to 0.8% in June,
  - net 0.3 miss from the consensus forecast of 0.1%.
  - Gasoline sales fell 1.8% and auto sales fell 1.6%, but sales ex-autos and gas were up 0.7%, beating expectations.
- In July:
  - Motor vehicle spending fell 1.6%
  - Gas station sales fell 1.8%
  - General merchandise fell 0.7%
  - Building material sales rose 1.5%
  - Misc. store sales rose 1.5%
  - non-store sales rose 2.7% (Prime Day?)
- The easiest way to understand retail sales, including the sudden drop off from 0.8% sales growth in June to no growth at all in July, is that people are spending what they must to keep up with inflation and no more. The trend in real sales — the quantity of goods sold — is sideways since last summer.





Airport Passenger Enplanements

- 2021 Passenger Enplanement Data (FAA) showed a continued rebound to 2019 historical levels, while San Juan (PR) and Southwest Florida exceed previous highs.
- Large and Medium Hubs that focus on Domestic Travel flourished, while Large Hubs that specialized in international travel floundered.
- Below is a graphical representation of the top-50 domestic airports by passenger enplanements for calendar year 2021 as a percentage of 2019 enplanements.



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