2nd Quarter 2023 ECONOMIC OUTLOOK WEBINAR

with WFG's Patrick Stone and economist Dr. Bill Conerly

FULL TRANSCRIPTION

Welcome

"Good morning, everybody. My name is Pat Stone. I'm chairman and founder of WFG National Title, and thank you for joining us today for our Q2 economic overview. With me today is an old friend, Bill Conerly. I've known Bill, as I've said before, a little over 40 years. We don't agree on everything, but we like each other. And I will tell you one thing I respect about Bill. He is the most practical, down-to-earth and realistic economist I've ever met, and does a lot of great advising to business people all over the country. So listen to what he has to say. He usually has some very, very good insights. And with that, I'll turn it over to you, Bill."

Opening Commentary from Dr. Bill Conerly

"Thanks, Pat. And the plan here is I'll speak for a few minutes on the economic outlook. Then Pat will do a few minutes on what's happening specifically in real estate. And then we'll do questions back and forth based on the questions that you submitted."

"So, when are we going into recession?"

"That's a question I get from a lot of business people. For this audience though, most of you are already in recession because the single-family home transactions market is sick. It's in recession without a doubt. Keep that in mind because it's actually kind of good news. I mean, it's not good news that you're in recession. I don't take any pleasure from your pain, but the fact that you are already in a downturn means that you'll come out of it sooner. First in, first out. So that's positive."

"I'm going to begin by reviewing a few facts that you already know just to get them out on the table. Then talk about the usual course of a business cycle, and then what's going on in this particular business cycle that's maybe a little bit similar, a little bit different."

"So, you may have heard we had a pandemic. We had stimulus from the federal government to keep people spending money, both stimulus checks, extra unemployment insurance, and a whole let's say boatload, that's not the word I was about to use, but a whole boatload of other federal spending going to state and local governments and federal programs as well. In addition to this fiscal policy stimulus, the Federal Reserve printed a lot of money, brought interest rates down, and people ended up with more money than they had before the pandemic, but could not spend it. Restaurants were closed, travel was limited, so we tried to buy stuff, things, physical goods, and that clogged up the ports, the trucking lines and prices went up."

"The inflation, you know, the classic definition is too many dollars chasing too few goods. We have a lot of dollars in the economy, limited ability to produce and move the stuff we wanted to buy. Inflation went up and the Federal Reserve said, 'oh, this is transitory.' And there was some truth, maybe 50% truth to the statement that the inflation was transitory. There were some temporary elements and

inflation has come down from its peak. But then the Fed realized, ‘Oh, holy cow. We have caused a good bit of disinflation with excessive stimulus.’ And then they raised interest rates. Short-term interest rates, the policy rates that the Federal Reserve influences, are up five percentage points in 14 months. And that is affecting mortgage rates. I think of mortgage rates as, you know, they’re determined in the bond market, actually by the institutional investors who are buying long-term bonds and mortgage backed securities.”

“And I think of mortgage rates as a mixture of short-term interest rates and expectations for future short-term interest rates. And we’ve seen the mortgage rates fluctuate up and down. They’re not directly controlled by the Fed, now around 7%. So that’s pretty high, and that’s why you folks are in a whole batch of trouble right now.”

“So what usually happens in a business cycle? Interest rates go up. Most recessions are caused by the Federal Reserve tightening too much. In this case, they started too late, and then they had to tighten too much. The interest rate-sensitive sectors of the economy, single-family home sales and construction, first of all, but car sales, business capital spending, those are both interest rate-sensitive. Multi-family construction, non-residential construction, interest rate-sensitive. The interest rate-sensitive sectors weaken in the early stages of Federal Reserve tightening, and that causes some job loss. And the people who have lost their jobs, the people who are worried about losing their jobs, cut back on their discretionary consumer spending -- things like clothes furniture, vacations -- and that causes another round of layoffs. Businesses trim their overhead, another round of layoffs, but this does not snowball to a zero economy because there are portions of the economy that are stable, insensitive to these economic fluctuations. And if you’re wondering, what are these stable sectors, the next time you have to renew your driver’s license go to the motor vehicle’s office in your state and ask the clerk who’s helping you renew your driver’s license if the clerk is worried about a job loss because of recession. Healthcare is also fairly impervious to recession. And there are retirees whose income does not depend on having a current job. So there’s a sector of the economy that will keep going.”

“And in the recession, they see that there’s a lot of stuff for sale. Companies cutting prices in order to move their merchandise. In addition, you have some lenders cutting interest rates. Even before the Fed relents and cuts interest rates, there are some banks and other lenders cutting interest rates to try to get some loan volume. And then the Fed eventually cuts interest rates. And this sets in stage the recovery. So those interest rate sectors that were the first to go down in the recession will be the first to rebound. In fact, sometimes things like home sales and new home construction starts moving up even while the economy is still, the overall economy, is still in recession. So I think that’s our future. This time around there’s a slightly different pattern. Some of the interest rate-sensitive sectors are slow to contract. New car sales are actually good right now, despite their higher interest rates, because of pent-up demand from when we had supply chain problems. Business capital spending is holding up better than normal because companies are trying to buy computers, equipment, machinery to make up for the humans that they’re unable to find. And this tight labor market also means that when a person is laid off, that person has probably on the daily commute, driven past three or four other companies with help wanted signs in front. So the person who’s laid off oftentimes is getting a job within a week or two. So we’ve had layoff announcements, you’ve seen the news reports, but the total employment continues to grow. And then when people are laid off and cannot find a job, those stimulus payments they received in 2020, and in 2021, they were not spent right away, they went into savings. And about half of that excess savings is still in bank accounts. So people will not have to cut back quite as sharply as in the typical cycle.”

“So that is a reason why this current business cycle of the effect of monetary policy on the overall economy is delayed. Delayed because of strong car sales, strong capital spending, people finding other jobs because of the tight labor market and people having money pent up. But the overall economy will eventually slow down. I expect a recession in late 2023 or early 2024. I’m kind of leaning towards late 2024, but it’s hard to pinpoint this. And the critical issue for the overall economy and for

you folks, is what is the Federal Reserve going to do? It's worth keeping in mind, there have been a lot of reports of 'the Fed is going to start cutting rates.' 'The Fed is done raising rates.' And I think the Fed is going to keep rates high for a while."

"They're pursuing a risk management perspective, and it's something that you and I do in our lives at various times. The Fed would like to make a perfect decision right down the middle of the fairway, so to speak, but they're also aware that they could be making a mistake. So they've said, 'What if we are keeping interest rates too tight for too long? What's the cost? And what if we don't tighten enough? We don't push interest rates high enough and hold them high enough, long enough? What's the cost?' And this too tight, too long results in either a recession that we did not have to have or a recession that's a little bit worse than we would otherwise have had, but it is a short run, short-term pain. But, if they keep interest rates not high enough, not long enough. If they're too loose with monetary policy, then inflation gets embedded in the psychology of workers, consumers, businesses, and that affects wage setting, price setting. And that inflation becomes much, much harder to bring down. So the Fed says if they're too tight, it's a short temporary problem. If they're too loose, it's a long-term problem that will take a very severe recession to calm down. So they're saying if they have to make a mistake, they'd rather be too tight this year for too long."

"So my forecast for short-term interest rates, Federal Reserve policy, is I think we have another half a point of short-term interest rate increases, and then the Fed, I think, is going to keep short-term interest rates up for at least a year before they start cutting. But that's not exactly the same as mortgage rates. I think mortgage rates are staying in the neighborhood of 7% for quite a while, but sometime in 2024 the bond markets will say, 'okay, the Fed has kept interest rates high for a while, their next move will be down.' And when the bond markets say the Fed's next move is definitely down, then mortgage rates will start coming down on their own in anticipation. But I think we're going to see high mortgage rates for over a year from now. And even then, they're not going to come down nearly as low as they have been. Pat may have a different opinion, and I'd of course be welcome to argue with him on, as we've argued on many other things. But I think the good news for most of you folks is that because you were the first to go into a downturn, you're going to be the first to recover. And eventually all recessions end and recovery always comes. Pat, what are your thoughts on real estate?"

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Opening Commentary from WFG Chairman and Founder Patrick Stone

"Thanks, Bill, and I agree with most of what you said. I'll kind of give a little different perspective on what I think is going to happen with rates or how long it'll take. Let's put it that way. You know, I would start out by saying I can't remember a period of time where we've had such a high degree of uncertainty, and I think it really is being manifested right now, or exacerbated, if you will, by the debt ceiling debate. And candidly the damage that that's doing is very noticeable and very unfortunate, and I wish our politicians would figure that out. Give you just an example. Mortgage applications were up 6.3% the first week of May, and then down 5.7% the second week of May. And I attribute that directly to this ongoing debate and the apparent disagreements and the tough stance being taken by both parties. So as long as that goes on, it's going create a lot of background noise. It's unfortunate. I do think there are some good things happening. One, we're seeing builder confidence pick back up. And I think you're going to start seeing more starts. Permits and starts right now are actually higher than they were prior to the pandemic. But we're still way short on single-family construction. Probably in my estimate, at least a million and a half homes short of where we should be, maybe even more than that. But you see builder confidence picking back up. We are seeing signs that inflation is declining. I'd really like to point out, you know, the supply chain was a big problem. Obviously it got a

lot of notoriety, got a lot of conversation. It's kind of fun to look at some of the numbers here."

"If you look at Q3 2021, it cost $20,000 a container to ship from Shanghai to Long Beach. Today, it costs $1,000 a container. $20,000 a container down to $1,000 a container. So the supply chain is clean, it is operating at a high degree of efficiency right now. It's no longer causing any pressure on prices. You know we keep track of inflation with the Consumer Price Index and Personal Consumption Expenditures. The Fed likes the later, the media likes the former because it comes out the first week of the month, and then the Personal Consumption Expenditures come out the last week of the month. But both have a large component based on rent and owner's equivalent rent. And obviously both those numbers were a strong contributor to inflation all the way up until about December. Now, they run about five to seven months at lag before it really starts showing up in the indexes, but we are starting to see it positively impact the indexes now. And so we are seeing some downward pressure on inflation, supply chain, owner's equivalent rent. Wage pressures are abating a little bit. They'll stay up a little bit higher, a little bit longer than almost anything else, but they are coming down. Biggest issue here, in my opinion, in terms of getting rid of inflation on a permanent basis is getting the Ukraine war over. The geopolitical uncertainty, but also couple that with a total disruption to grain and other supplies because of that and the tremendous impact on inflation in Europe has just been astronomical. So we do need to see the Ukraine war go away at some point in time to get back to a normal level."

"So getting back on real estate a little bit here. April we ran at about a 4.28 million annual level of sales. In 2022 we were at 5.96. In 2021 we were at 6.12. So a fairly significant drop in sales activity, as you all are painfully aware of. The median price, $388,000, that was down about 1.7% year over year. Prices have maintained fairly well, and that's because the supply-demand balance has been maintained. Yes, there's less demand, but there's a lot less supply on the market. If you look at MBA and NAR and what they project, they're both pretty optimistic. MBA indicates that they think this year will come in around about 4.9 million. They're saying next year we'll see about 5.4 million, up about 10%. And then 2025, they're predicting over 6 million, up another 10%. NAR has always been a little bit more optimistic than any other association. They're saying 5.2 million this year. I don't think that's going to happen. I think it's going to be in the fours. And they're saying 6 million next year. I don't think that'll happen either, but I think it will go up. So, I am cautiously optimistic you'll see some increases there."

"So, if you really break it down, what causes or what really impacts or drives home acquisition, home purchases, and I really break it down to demand, desire and affordability. And demand is really a function of people looking for a place to live. And obviously some of that is fulfilled with multifamily, but you have a tremendous amount of people in the young age group right now. If you look at millennials -- there's 72.2 million millennials, they're running ages 20 to 42 -- that's about 21.7% of the population. Gen Z, ages 11 to 26, there's 69.6 million or 20.9% of the population. So, you really have about 42% of the population in first-time home buyer age, or in a place where they'll start looking at buying a home. And interestingly enough, millennials, about 51% now own a home, and Gen Z, about 30% of 25-year olds own a home. Now, that's hard to believe, but 30% of 25-year-old people own a home in this country. That's the highest we've seen. That's higher than what we witnessed with the baby boomers, with Gen X. We are really seeing a strong level of desire for home ownership. In other words, people really think owning a home is a good idea."

"But 78% of all people still associate home ownership with the American Dream. About 65% see that home ownership is a means of building intergenerational wealth. And if you look at household wealth, people that own a home have 1469% higher net worth than people that don't own a home. So people have really continued to embrace the idea of home ownership being a way of starting your path towards economic independence. But I think the pandemic also reemphasized the desire to own a home because controlling your environment became of paramount importance during the pandemic. And people are really conscious of that now. So demand is strong. We got a lot of people in first-time homebuyer age. A lot of people are at a point in their life where they're looking to buy

a home to increase their financial wealth. Desire is there because of the financial benefits, but also because of the desire to control your environment. And then affordability is really the issue right now that is causing us to have a significant downturn. We got 30-year fixed this morning at 7.12%. That's up 38 BPS (Basis Points) in the last 30 days, and I attribute that principally to all the confusion and uncertainty surrounding the debt ceiling debate. The debt ceiling, if we don't raise that, it could be catastrophic. I mean, it is really hard to imagine. It's hard to imagine how people can play games with something that has such a profound impact on our economy. But that's probably a subject for another time when I can use a little bit stronger language. But we'll save that one."

"So, mortgage rates. To just give you some idea on mortgage rates, too, and it is good to have a little perspective here because, I will tell you, you get mortgage rates under 6 1/2, home purchases will go up. You get it under six, that will go up dramatically. All right? And if you look at mortgage rates historically, I started in this business in 1975 and the mortgage rates when I started were right around 9%. They peaked in 1982-1983 at 18 and a half percent. The first time in my career that I saw mortgage rates under 7% was the late nineties. I had been in the business over 20 years when mortgage rates finally got under 7%. They broke 5% in 2008-2009. So we've had high mortgage rates before, and we've managed to live with it. Of course the price of homes weren't as high then, too, so affordability wasn't as impacted by the mortgage rate as they are now."

"However, I will again say this, if you get mortgage rates under 6 ½%, home purchases will pick it up. If you get it under 6%, they'll pick up dramatically. You get down to 5% and then, Katie bar the door! I don't think we'll ever see mortgage rates under 4% again. The low mortgage rates that we saw right prior to the pandemic and then during the first part of the pandemic, this was quantitative easing over a long period of time with the Fed buying a tremendous amount of T-bills and mortgage backed securities. I don't think you'll see that again, knock on wood, but we'll see what happens here."

"So, I get asked a couple questions. I'll go over there real quickly and then we'll open it up to our back and forth."

"People ask a lot about low interest rates. Is that going to impact sales because people won't move? Yeah, a little bit, but not as much as you would think. I think 62% of the mortgage holders have a rate under 4%. 82% have a rate under 5%. 92 have a rate under 6%. If you get mortgage rates under 6% again, I don't think that will be a tremendous impediment to people moving if they have reasons to move, either job change or desire to go move up in quality or size, or whatever. So it will have an impact, but it won't be a debilitating or a major impact on home ownership."

"So a couple other questions real quick. So what will cause a change? Lower mortgage rates. Right now we've got demand and desire. We can check those boxes. We just need affordability to come back into play. That will require mortgage rates to come down. Will we have a surge in defaults? No, no, no. Two-thirds of all mortgages in the last five years have FICO scores over 760. We do not have a situation where we're going to have a significant amount of defaults or short sales."

"Will the single-family rental market have a major impact on the resale market? Not really. There's a lot of single family rentals out there, but I don't think it's going to have any kind of impact."

"State of the market on commercial. A lot of conversations about will the five-year calls on mortgage be a problem? Most mortgages in commercial really are five to 10 years, but amortized over 25 years. And there are some concerns out there right now in the commercial market. I'll be really brief about it. But if you look at office right now, it's got a lot of people really concerned. Nobody wants to raise money for acquisitions of an office. There's a lot of conversations that things will get better in the third and fourth quarter this year. We'll see what happens there. Class A office buildings, trophy buildings and major markets are not in trouble, but you see buildings in smaller markets. You know, it's really still a conversation piece whether or not people will come back to work. Candidly, one man's opinion,

in our industry, I don't know how we do OJT (on the job training) if people are not in the office. So it's going to be interesting how long we do this or how we maybe reach some sort of compromise where we're in the office three days a week or something like that."

"Multifamily. We had about 488,000 multifamily units going to be built this year. So the private equity people that I talk to are pretty nervous about that market being saturated now, so they're not putting any more money into that."

"Industrial has been very, very good. This is warehouses, but the prices are high there, so cap rates are becoming a concern with both multifamily and industrial property."

"The retail. You know, a lot of questions about retail. We saw a tremendous amount of online purchases because of the pandemic. E-Commerce became the major talking point, and people thought e-commerce would go up to 30 or 40% of all retail. It's stuck right at 15%. Right now we are still stuck at 15% e-commerce. People are going shopping now. So higher end malls in good neighborhoods will do well. Lower-end malls probably have to be repurposed, but retail will stay in existence for as long as we can see."

"I did do talk to some PE people and just to sum it up real, real bluntly, nobody is sure what's going to happen and people are being cautious right now on commercial, just like they're being cautious on residential, so we'll see what happens later this year, but there is plenty of money out there. Should we have a major run or a major problem with lower quality assets, borrowers not being able to renew or get a new loan on a lower quality asset, there's plenty of money out there to buy those assets. So I don't see a lot of property being dumped on the market that doesn't sell. There's a tremendous amount of dollars out there. So I think assets will be picked up fairly quickly and I don't see a real or horrific ongoing problem, if you will. So with that, I'm going to start asking Bill questions here. Bill, you ready?"

Question and Answer Segment

What is your outlook on home improvement activity?

Dr. Bill Conerly's response:

I think that home improvement is going to be strong. There are many people who would like a larger or a nicer house or a house that someway is better than what they're in, but they've got a 3% or a 4% mortgage, and they don't want to walk away from that. So I think they'll do a remodel. They may add on or upgrade the kitchen and the bathroom. But when we talk about this sort of thing, we often get a mental image of one particular homeowner and say this is a typical person. And what I have learned is that we are not typical. Everybody is different. And there are going to be some people who say, 'yeah, I'm going to keep my low mortgage rate here and I'm going to add on. But other people are going to look at this and say, 'nah, I'll move. I can refi a couple of years later. I can get a 7% mortgage and it's not stupid if rates do come down in a couple of years.' So keep in mind there's a wide range of people out there, but I do think that the brightest part of residential construction in the next year will be remodeling and improvements.

Do you still think we are looking at five good years of real estate activity starting in 2024 and do you expect the title industry to pick up in 2024? What about title alternatives? Will they gain traction outside of the GSEs?

Patrick Stone's response:

You know I'm still pretty optimistic. Again, going back to both the demand and desire components of what I was talking about earlier. We have a large population, a large group of people in a fairly young age bracket and they are very aware of the desirability of home ownership. And, you know, a lot of people talk about affordability and 'Pat, aren't you worried about mortgage rates?' I'm telling you straight up, you get mortgage rates under 6%, they're not a problem anymore. And they say, 'How can that be with prices where they are?' Let's be honest here folks. If you don't buy a home, what do you do? You rent, right? So the difference in buying a home and renting a home is the difference between the rent and the purchase. Okay? So yes, you pay more with a mortgage, but it is worth it, and you probably can rationalize the desirability of paying more because you actually own an asset that appreciates. So I do think we're going to have a good market. I do have a little bit different view than you Bill. I do think we'll be down to 6% by year end and down in the fives next year, and I think that will make for a good market. We get in the low fives, it'll be a great market, and high fours will be a great market.

So with regard to Title Law alternatives, I'm not as worried about it as some people. I think the conversation probably got off track a little bit because some of the people involved didn't really understand the business or didn't understand what was happening or how it works. I think the basic desire was to try to figure out a way to lower the cost of home ownership for disadvantaged people or first time homebuyers. That could have been done a lot of different ways than trying to invent title alternatives or attorney opinion letters, both of which are fraught with risk. And I don't think you're going to see them get really a lot of traction because there's substantial evidence that it's a bad idea and that it will cost people a lot of money. So I don't see that happening. Maybe you'll see a little bit more cooperation among the different components of the industry to try to drive overall prices down, but that's a separate and probably a better conversation to have.

When will the spread between the 10-year treasury and the 30-year mortgage come back to the normal and what will cause it to narrow?

Dr. Bill Conerly's response:

A lot of people look at the 10-year US treasury bond and say, 'oh, mortgage rates ought to be that 10 year plus a margin.' And the margin has been a percent and a half, maybe up to 2%. It's a good bit higher these days. And here's what I think is going on. First of all, remember that most mortgages end up in Wall Street. They get packaged, securitized and sold to institutional investors, like a life insurance company that wants a long-term investment for the reserves that they have. And these institutional investors are saying 'maybe a 10-year treasury, maybe a mortgage backed security, a package of a thousand different mortgages.' Well, what they are saying today, I think, is that if they buy that mortgage-backed security with a bunch of mortgages with a 7% interest rate, that group of people will refinance when mortgage rates come down.

So let's say you borrow at 7%, what is your expectation about when would be a good time to refinance? One year, two years, three years out? So the Wall Street guys are saying, 'Hey, if we buy a mortgage-backed security, it may have a bunch of 30-year mortgages, but it's going to go away. Everybody's going to refinance in the next two or three years.' So they would like to lock in these high interest rates for a long term. So they're saying 'treasury bond is just a sure thing that it's going to last 10 years.' Debt crisis ignoring that. So I think that the spread is going to stay wide until we get

mortgage rates down to where Wall Street says, ‘yeah, this is a sustainable mortgage rate.’ Right now they agree with Pat that mortgage rates are unusually high and are going to come down quickly, and that’s why the spread is wide.

How bad is commercial real estate lending on from regional banks? We’re hearing a lot about commercial loans and default. Will this plus the difficulties in refinancing commercial properties damage the economy?

Patrick Stone’s response:

Well, it’s good question. There’s a lot of concern out there and a lot of conversation around this. Banking sector disruption could be negative and, you know, it could be pretty meaningful. Banks have about, I think trophy assets about 27.5% share of the trophy assets. A lot less on class A, B, and C properties. B and C properties about 11% and about 3.2% of C properties. So it could be a problem. I don’t think it’ll be horrific because there’s a lot of dollars out there to pick up these assets and pick them up fairly quickly. So I don’t see a lot of issues where banks have to take properties back and then can’t get rid of that asset at a reasonable price fairly quickly. So is it an issue? Yes. Is it a concern? Yes. Do I think it’ll be a debilitating problem? No, I don’t. And knock on wood, I certainly hope it won’t be.

How will the recent bank failings affect commercial real estate, jobs and any predictions for the second half of 2023?

Dr. Bill Conerly’s response:

The collapse of Silicon Valley Bank and a couple of other banks have led to a lot of fears. I was a banker for a number of years. Sat on the Asset Liability Management committee, where we were very nervous about buying four-year bonds, much less 10-year bonds. There is a good deal of risk. But I do not think that there is widespread impact on the economy from those bank failures. If you look at past recessions, there are typically banks that fail in recession, though typically not as big a Silicon Valley Bank was. The Federal Reserve is trying to figure it out. Their first pass estimate was that the failures would cause nervousness on the part of other banks, and that would be roughly equivalent to a quarter point interest rate increase. And that was just a wild-ass guess, but it was the best guess. We don’t really have a good handle on that. It’s something that I’ve been monitoring, and the indicator that most of us economists are looking at the most, that you can look at, is the Senior Loan Officer Opinion Survey, SLOOS, by the Federal Reserve. And you can actually get the history of that quarterly survey. And the key question is, senior loan officers at banks are asked, ‘are you tightening your credit standards or easing your credit standards? Are you tightening your profit margins or easing your profit margins?’ And what they’re saying now is that a majority of banks are tightening their credit standards. And that sounds scary, but that is what happens whenever we expect a recession. Banks get nervous. So what I am seeing is that most likely banks are tightening their credit standards, but it’s consistent with what happens when the economy weakens, when interest rates rise, and when banks get nervous. So I think that it’s not going to be a significant event, but we do have to keep our fingers crossed for a while on that. But my best estimate is not a big deal.

How varied is real estate activity by region, and is this a function of cost, politics or business activity?

Patrick Stone's response:

First of all, you hear a lot of people talk about, 'Well, people are moving out of California because they're tired of the Democrats or the Socialists.' Candidly, I personally think that very few people move for political reasons. I don't think that that's a case at all. More people move for business reasons. But I tell you, the biggest driver is a tremendous disparity in the cost of home ownership. Just to give you an idea, looking at sales price of existing single family homes by region: the US median, average median US is $393,000. In the Northeast it's $428,000. In the Midwest it's $289,000, and in the south it's $364,000. And in the West it's $592,000. So, if you're a young person and you're looking at a median price home in the West it's $592,000 and in the Midwest it's $289,000. That's a fairly significant difference.

To give you a little bit more detail or a little bit more of a prime example, a lot of conversation lately about the Bay Area and how people are getting out of the Bay Area because it's going to hell in a hand basket. I don't think it is. Candidly, I've been down there a couple times and, like all major cities, there are some issues in San Francisco, but here's some median prices in the Bay Area. San Mateo $1,575,000, Marin County $1,467,000, Santa Clara County $1,459,000, San Francisco $1,458,000. But you see, with median sales prices at a $1,500,000, the average person starting out can't afford that. I mean, so it has caused a bit of a problem and it has had an impact on people moving.

How do you see some countries debating the US dollar as a global currency affecting the dollar's strength in US inflation and housing?

Dr. Bill Conerly's response:

That's a question that a lot of people have been asking for a number of years, and let me address two parts of it. One is that dollars are used outside of the United States for a lot of transactions and some of these are illegal drug transactions. But actually, if a Swede is buying something from a Nigerian they may very well settle the transaction with US dollars. It's something that they both trust. And that means that dollars are wanted either in currency or in bank accounts for people all over the world. What it does to us is it means that when the Federal Reserve creates more dollars, either by printing currency or enabling bank accounts to grow, that is not affecting the US economy when those dollars are held overseas and are facilitating foreign transactions.

So that's the money issue. But the government debt issue is usually consisting of US treasury bills, treasury bonds, and that's part of international reserves. So let's say you're a small country and you watched the Asian debt crisis in the late 1990s, and your whole economy was under threat because of currency fluctuations. Those countries said, we want to hold a lot of dollar-denominated assets. We want them to be interest-earning assets like treasury bonds, but we want something that is liquid, that we could sell on short notice if we needed to, and we want something in dollars. And that means that if there is weakness in the Malaysian currency, for example, that country has a number of dollars that they could spend to prop up their currency and protect themselves from fluctuations. So you also have global investors looking for assets, and they're saying, what country's assets should we have? And when you think about what country's assets, a lot of us in America say, 'why would anybody want to buy us treasury securities? We've got a bunch of bozos in Congress, we've got…,' well, I'm not going to describe the president in pejorative terms, but some people do describe him in pejorative terms. There is and the current issue with the debt ceiling leads a lot of people to not have a lot of confidence in the short run, as well as some concerns from the long run. So we Americans are like, why would anybody say thumbs up on the US dollar when they could say thumbs down? But the global investors

and the countries looking to have reserves, international reserves, they're not saying dollar, yes or dollar, no. They're saying dollar or what else? If they don't put their international reserves in the dollar, should it be in the Japanese Yen, the Chinese Yuan, the Euro, the British pound? And when they look at the options, they want a big market for those securities so that they can readily sell them. They want something that they generally trust. And when we just look focus on the US and its problems, we're like, why would they buy the dollar? But when you look at the other countries, well the most insightful observation I heard is that the US dollar is like the best looking nag at the glue factory. So, you know, it's maybe not really great, but it looks better than most of the alternatives. Going forward, I expect countries to continue. They're trying to wean themselves off the dollar, not suddenly, not dramatically, but they're looking for alternatives. And what that will mean to the extent that they do invest their international reserves in other currencies is that the US Treasury will not be able to borrow at such low interest rates. But I think that's just pushing treasuries up five or 10 basis points and not going to be a big issue.

What is the probability of home prices decreasing if high interest rates persist?

Patrick Stone's response:

Well, I think it definitely has an impact, and the higher the interest rates and the longer it goes on, the more impact it will have. As you can see right now, it is having a small impact, but not very noticeable. Maybe one to 2%. And I think if the rates come down, that will abate fairly quickly. But again, if rates stay high and they stay high for a prolonged period of time, that will impact home prices because it makes less and less people qualified to buy. So you'll have more supply than demand, and that drives prices down. The one thing about residential real estate, we get a lot of conversation about emotions, politics, everything else involved in it, but there are probably very few things in our economy that are so directly supply-demand driven as single family residences. And if you have if you have demand exceed supply, prices go up fairly quickly, as we saw during the pandemic. And if you have supply exceed demand, they'll come down. They won't come down as quickly as they go up because people are reticent to reduce their profit, or walk away or take a loss. But if you have high interest rates long enough, it will impact the prices. So we'll see how this goes. Candidly, I don't think they'll stay that high to be that damaging for long, but we'll see.

How will AI impact the real estate industry and will WFG use AI for business research?

Dr. Bill Conerly's response:

I'll take the AI side and then maybe let you talk about WFG. I don't work for WFG and don't get to make your those decisions.

Artificial intelligence is big, it's going to be big. It's going to be very, very important for all parts of the economy and I suggest that everyone listening here spend a little time learning about it. One thing to do is jump on one of the things like Google Bard, ChatGPT, or Microsoft Bing, Microsoft Edge has AI capabilities. Play with it, learn about it. But AI is a tool. In the garage not far from where I am right now I've got a table saw. It's a tool and it can help me do little projects more quickly and more accurately, but it can also take a perfectly good piece of wood and mangle it. If I use the tool poorly, it could cut off a thumb. So far, I am good. All 10 digits still in place, but tools can be dangerous as well as useful, and AI can create some dangers. But the big improvement that we're going to see in productivity and accuracy of work will come from applications that connect to the AI and are specialized to a company. And I don't know yet what's going on in real estate, but let me tell you what's going on in some of the accounting functions at corporations. They get calls saying, 'Hey, can I get a copy of my last invoice? Or, I sent you some merchandise, when are you going to pay me?' And the AI has learned

how to answer those questions. They listened to a lot of customer service calls and they said, 'Oh, when somebody asks this, here is how we respond.' And that has enabled businesses to operate with less staffing and to provide more accurate answers. So it is coming, it's going to be big, and I think everybody needs to get familiar with it. Do you want to comment Pat on what WFG will be doing in this regard?

Patrick Stone's response:

Well, I think almost all the underwriters have used AI, more specifically with refi transactions. A lot of different products out there that give basically instant title on refi. The accuracy and dependability of are enhanced where there's a 50-year automated title plant and I'm not too comfortable where there's an OCR, Optical Character Recognition built title plant. There's still a lot of questions around it. How far we can go with it, we'll see. So much of our losses are not directly dependent or not really discernible from an actuarial point of view. So I think it has limitations with regard to things like fraud and so forth. But, I do think it has applicability with refinances and those kind of products.

Will there be an increase in the number of home purchases with loan assumptions?

Patrick Stone's response:

Not really because there are very few loans that are assumable. I mean, if you're talking about GI loans and things like that that are assumable, but the probably 95% of all loans are not assumable, so I don't see that happening. You know, during the eighties when we had the big crash and the SNLs all went out of business, which was the way we financed homes back in the early eighties, we saw a lot of wraps. We saw inclusive trust deeds where people were wrapping trust deeds. And then you saw a lot of seller carry-back financing and a lot of assumable situations. The lending structure right now doesn't really facilitate a lot of assumable loans, so I don't think we'll see a lot of that happening. We'll see a little bit, but not a lot.

On a positive note, how can we take advantage of this downturn in the economy?

Dr. Bill Conerly's response:

Let me talk about a company I did some work for years ago just before a different recession. They went into recession, they were very sensitive to the downturn, and they let their sales staff go, or half of them go, and the sales staff had been doing a lot of outbound calls and they became order takers. There was so little business that they just sat in the office waiting for the phone to ring from those who were doing repeat business, because they knew you could not sell in the middle of a recession. But, two of their competitors hired some young people who were too stupid to know that you can't sell in a recession. And these young stupid people started working the phones. Making contacts, networking with people, letting them know they were there and they didn't get a lot of business right away, but what happened was, at the first signs of the recovery, those people who were too stupid to know you can't sell in a recession, they started getting business. And the folks who had become order takers, sit back, nothing's going to work, sort of like Eeyore from Winnie the pool. Those discouraged people ended up not selling anything, and that company that I had done some work for went out of business simply because their sales force was too discouraged to make outbound calls. There are other strategies that companies have used, but this is the time to think, 'What are the opportunities?' You probably have some competitors who are too discouraged to do the networking, to do the calls, and you can take market share from them if you can keep all of your people energized, optimistic,

optimistic despite my pessimistic view. Keep your people acting optimistic and tell them that there will be sales and they need to keep going on item. Pat, what do you think on that issue?

Patrick Stone's response:

I really like what you said because the reality is in this industry we all know who is selling and who is going to continue to sell homes. We all know the lenders that are successful are going to continue to be successful. And I strongly agree with you. Talk to those people! Make sure your sales reps are out talking to those people. Stay in contact with the people that do the business and you will get business. And you know, it's a funny industry. I always say you want to be a part of your client's process and you want to help your clients make more money because if they make more money, you make more money. So that is kind of a cumbersome way of saying what you're saying, Bill. And that is get out there and talk to people. Get out there and make sure they know you're here. Know you want their business. Know you want to help them. Know you're there. If they have a problem, make sure that you're a part of their conversation.

About Patrick Stone

Patrick Stone is Chairman and Founder of Williston Financial Group, the Portland, Oregon-based parent company of several national title insurance and settlement services providers, including WFG Lender Services and WFG National Title Insurance Company. Stone's lengthy career in real estate and related services includes C-level positions with three public companies and serving as a director on two Fortune 500 boards. His senior executive management positions include nine years as president and COO of the nation's largest title insurance company, chairman and co-CEO of a software company, and CEO of a real estate data and information company. Stone also served as vice-chairman of Metrocities Mortgage, a 2005 top-20 mortgage lender, and as chairman of The Stone Group, an Austin, Texas-based tenant-represented brokerage company. In 2013, Inman News named him one of the year's "100 Most Influential People in Real Estate." Stone received HousingWire's coveted Vanguard Award for lifetime career achievement in 2019 and again in 2021, was recognized in 2019 and 2020 as a Lending Luminary by Progress in Lending, and was the recipient of October Research's annual Leadership Award in 2020.

About Dr. Bill Conerly

Bill Conerly has a Ph.D. in economics from Duke University and more than 30 years of experience helping companies adapt to changing economic conditions. He was formerly Senior Vice President at a major bank and held positions in economics and corporate planning at two Fortune 500 corporations. He is also an online contributor to Forbes, chairman of the board of Cascade Policy Institute, and the author of The Flexible Stance: Thriving in a Boom/Bust Economy (2016) and Businomics (2007), a book about economics for business leaders. To subcribe to Conerly's monthly newsletter, visit: https://conerlyconsulting.com/newsletter/