WFG National Title

4th Quarter 2023

ECONOMIC OUTLOOK WEBINAR

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

TALKING POINTS

Opening Commentary from Dr. Bill Conerly

- Dr. Bill Conerly anticipates a national recession in 2024, albeit milder than average and far from the severity of 2008-2009.

- His prediction of a 2023 recession did not materialize, and he suggests that a 2024 recession is not inevitable, with a 40% chance of it being averted.

- He perceives the real estate sector as already having experienced a recession-like scenario and believes it's unlikely to be further affected by the anticipated national recession.

- The third quarter was strong for the US economy, with a solid fourth quarter, but he foresees some economic weakness in 2024 as a result of the Fed's decision to raise interest rates.

- He discusses multiple factors that have delayed or mitigated the downward effect of monetary tightening, such as pent-up demand for new cars, businesses investing in equipment due to labor shortages, the rapid re-employment of laid-off workers due to numerous job openings, and sustained consumer spending fueled by pandemic stimulus savings.

- Dr. Conerly believes the Federal Reserve will keep interest rates high to curb inflation, likely until mid-2024, after which it may start to ease.

- He anticipates that mortgage rates may begin to decline in spring 2024 but warns not to expect a sharp fall in those interest rates.

- His overall message is to be prepared for the possibility of inaccurate forecasts and to focus on improving personal well-being.

Opening Commentary from WFG Chairman and Founder Patrick Stone

- Patrick Stone, along with Dr. Bill Conerly, has found preparation for this presentation challenging due to the high degree of uncertainty and numerous hard-to-define issues.

- He highlights political dysfunction, global political issues, ongoing wars, and questions about our ability to fund our government as major challenges.

- Despite these hurdles, Stone sees signs of a turn in the real estate market, albeit subtle.

- There has been a significant change in attitude towards buying homes, with fewer people waiting for home prices or mortgage rates to drop.
- The Home Purchase Sentiment Index has shown a rise, indicating a more positive sentiment towards buying homes.
- Sales of newly constructed homes have increased and November saw the first annual growth in newly listed homes in 17 months.
- Still, Stone acknowledges, there is a long way to go.
- There has been a shift in real estate purchase demographics, with single women buying more homes than single men.
- Stone posits that home prices will not decrease due to the strong demand and limited supply.
- He anticipates an increase in sales next year and a decline in mortgage rates.
- He acknowledges a shift in societal norms with people becoming more settled and moving less frequently.
- The real estate market may see a boost from the large population of Millennials and Gen Z, who express strong desires to own a home.
- Stone is optimistic about mortgage rates dropping in 2024 and beyond and maintains a positive outlook for the real estate market.
- Despite his overall optimism, he does express concern over the amount of commercial real estate debt held by small banks.
- The commercial real estate sector has a lower delinquency rate than residential loans, but he acknowledges concerns over the office space market due to the pandemic.
- He sees no issues with the multi-family sector, though construction has slowed down.
- Stone expresses concern about the level of US government debt and the upcoming challenges with servicing this debt.

Question and Answer Segment

Most often when experts agree the economy or interest rates are heading a certain way, they end up saying, "we could not have predicted the things that happened that made our predictions wrong." What is being missed or overlooked right now that would cause mortgage interest rates to stay where they are or increase over the coming one to three years?

Dr. Bill Conerly's response:

- The Federal Reserve holds the key to potential changes in mortgage rates, despite not directly manipulating them.
- If the Federal Reserve raises short-term interest rates, bond and mortgage rates could increase.
- The transition from cutting rates to raising them would likely be triggered by inflation.
- Current economic models for inflation have not been consistently accurate, leading to potential mispredictions.
- While there is high confidence that mortgage rates will not rise in 2024 and 2025, unexpected inflation could prompt an increase.

What's driving your interest rate predictions? Is it the US economy, Chinese debt, wars? What other things are you looking at that we should be looking out for?

Patrick Stone's response:

- Patrick Stone notes that the abatement of inflation has a positive impact on interest rates.
- He emphasizes that we are already part of a global economy, with the US being the key player.
- Globalization and an overall slowing down of the global economy could cause a decrease in demand, including in the US.
- Stone predicts a minor recession in the next year, triggered by negative economy trends in both Europe and China.
- This recession, while not overly painful, is expected to cause a decrease in rates, including mortgage rates.

How do you expect the political turmoil in the US and overseas will affect Q4 and 2024? Also the affect on cryptocurrency?

Dr. Bill Conerly's response:

- Political turmoil, especially overseas, can have a significant impact on economic forecasts. International conflicts, such as those in Israel, the Ukraine-Russia war, China's actions towards Taiwan, and attacks on shipping in the Red Sea, all pose potential geopolitical problems.

- While there is often a lot of speculation about potential issues that could arise, many of these situations do not come to pass. However, the possibility of a major international issue cannot be discounted.

- The Ukraine-Russia war has placed Europe in a difficult position regarding higher energy prices.

- Domestically, theories abound about the impact of upcoming elections on the economy. However, historical analysis of post-World War II elections shows no clear effect on the economy.

- Political discord within the US may have a minor negative effect on the economy. However, overall, consumer and business decisions are likely driven more by facts than politics.

- As for cryptocurrency, it has valuable use cases like international asset transfers and smart contracts. Its role as an investment may be less appealing now, but it's not completely gone. Regardless, the overall impact of cryptocurrency on the economy is not expected to be significant.

Will home price affordability come back into a better range anytime soon?

Patrick Stone's response:

- The return to home price affordability will not happen quickly.

- Historical comparison: In 1985, the median home price in the US was $86,800, approximately three times the median income. Interest rates were around 12%.

- Current situation: Today, the median home price is about $400,000, which is six times the median income. Despite lower interest rates, the cost of homes compared to the median income precludes many from buying.

- The issue: Home prices need to return to a more steady appreciation rate of 1-3% annually. Furthermore, there should be an increase in income and savings over time to improve affordability.

- Current trend: The cost of homes compared to the annual income or savings is still prohibitive for many potential homebuyers. Some need assistance, while others need increased income before they can afford to buy a home.

- Prediction: It may take three to five years to see significant progress towards improved home affordability.

Please speak to the consequences of continued unchecked growth and government spending in the deficit.

Dr. Bill Conerly's response:

- Dr. Conerly is concerned about the continued unchecked growth and government spending in the deficit, but unsure as to when the repercussions will be felt.
- He criticizes the government's decision to continue short-term borrowing when interest rates were low, instead of opting for a 30-year debt at 2%.
- He notes the lack of concern in Congress and the White House about total government spending or the deficit.
- A potential consequence could be investor hesitation to buy treasury securities due to fear of a default or inflation diminishing the value of the currency.
- This could lead to an increase in interest rates on government securities.
- While he acknowledges that these effects usually take time to occur and are hard to predict, he warns that the repercussions often suddenly hit countries in crisis.
- Dr. Conerly believes the issue needs to be addressed, but does not believe it should influence decision-making for the next year, except when electing government officials.

We are seeing consequences of 12 years of artificially low rates in housing. So what do you think it will do to stocks?

Patrick Stone's response:

- Most US corporations did not take undue advantage of the low rates.
- US corporations are well-financed and well-capitalized, placing them in a strong position.
- Low rates have boosted the ability of US companies to function and compete internationally.
- Reactions to global events differ between large US corporations and mid-size corporations and investors. Large corporations operating in the global marketplace tend to be more negative due to the slowing global market.
- On the other hand, mid-size companies and investors have a positive outlook.

- The low rates have been beneficial overall for businesses, without resulting in excessive or risky corporate debt.
- Overall, the low rates have proven to be beneficial for corporate America.

How will personal debt and the US' ability to lower tax debt while their debt credit ratings drop affect US citizens?

Dr. Bill Conerly's response:

- Dr. Conerly suggests that the total indebtedness of U.S households has increased by approximately 4%, a figure that aligns with general economic and income trends, indicating that consumers are, on average, managing their debt responsibly.
- He acknowledges that while there are some individuals who mishandle their personal finances, this is not representative of the larger population, and should not pose a significant problem.
- Dr. Conerly brings up the often-overlooked fact of intergenerational wealth transfers, where older generations assist younger ones in building assets. This practice, he suggests, can offset high levels of debt among younger individuals.
- Overall, Dr. Conerly does not perceive excessive consumer debt to be a widespread issue, based on the data he has reviewed.

How do you see the upcoming 2024 elections possibly affecting the housing market?

Patrick Stone's response:

- Patrick Stone doesn't foresee major impacts on the housing market in the 2024 elections unless there is a sweeping majority.
- With balanced representation in the House and Senate, Stone expects little change in the housing market.
- If Democrats gain significant control over Congress, Stone anticipates more liberalized laws or initiatives to make mortgages more accessible.
- He recalls the excesses prior to the Great Recession, such as stated income loans, and hopes the market won't return to such practices.
- Stone supports changes to the mortgage market and a variation in product types, but not extreme liberalization.
- At this time, Stone doesn't expect either party to seize a significant majority and strongly influence policy. Consequently, he predicts minimal election impact on the housing market.

Why is the Fed so focused on a goal of 2% inflation?

Dr. Bill Conerly's response:

- The Federal Reserve (Fed) is primarily focused on 2% inflation due to a belief in low, stable inflation fostering the best long-term economic outcomes.

- This belief arose from a historical exploration of the assumed fixed trade-off between inflation and unemployment, which proved unreliable, leading to periods of high inflation and high unemployment, known as stagflation.

- Economists Milton Friedman and Ned Phelps argued that this fixed trade-off only functions if individuals do not expect rising inflation, otherwise they will demand higher wages and accept higher prices, disrupting the trade-off.

- Studies worldwide and from US economic history indicated that high inflation led to an unstable economy. In contrast, economies that had steady low inflation performed the best in the long run.

- The 2% is not a magical number and could be anywhere from 0% to 3%. However, the Fed deeply believes that a stable low inflation rate is best for everyone - the public, workers, and businesses.

- There's been ongoing debate on whether the inflation target should be raised to 3%. However, doing so without first achieving the 2% target can potentially erode the Fed's credibility.

- The ultimate goal is to have inflation so low that it becomes a non-factor in business decisions, as Friedman believed, thus promoting long-term growth.

Do we expect to see a lot of foreclosures next year?

Patrick Stone's response:

- Patrick Stone does not foresee a significant increase in foreclosures next year.

- There are currently no alarming factors or causes for concern.

- A significant recession and substantial job loss would be necessary to drastically increase the foreclosure rate, which Stone does not anticipate.

- Approximately 50% of homes possess 50% equity, suggesting a more stable housing market than before the great recession.

- The current mortgage landscape does not mirror that which led to the Great Recession, with fewer "junk loans" in circulation.

- Over the past five years, two-thirds of all mortgage recipients had a FICO score over 760, a score that is less likely to lead to a foreclosure.

- Stone does not anticipate any factors that could dramatically impact the foreclosure rate in a negative way.

Why does it appear that the unemployment numbers are always so far off?

Dr. Bill Conerly's response:

- New employment numbers are released each month, including revisions for the previous months.

- The initial numbers are subject to revision, as a trade-off exists between speed and accuracy.

- Employment numbers involve a complete survey of large employers and a sample survey of small and medium-sized employers.

- By the end of the year, these numbers are adjusted according to tax forms filed for unemployment insurance by every business, leading to significantly more accurate figures.

- Early estimates are based on samples and surveys, which are subject to revisions for accuracy.

- GDP numbers, which are also based on samples and surveys of various sectors of the economy, can be even less accurate.

- Government statisticians work with limited visibility and do their best to provide helpful and accurate numbers, although not every transaction in the economy is tracked.

- The economic statistics can be considered as "soft" due to these factors.

- The determination of a recession is made by a committee of academics who focus more on historical accuracy than up-to-date information, and therefore, this information should be taken with a grain of salt.

Do you project a refi boom and, if so, when?

Patrick Stone's response:

- Patrick Stone does not foresee a refi boom, attributing this to the slow decrease in rates.

- He predicts refinancing for many mortgages made in the last few years at higher rates.

- This process, according to Stone, will be progressive and gradual, not an instantaneous event.

- The reduction of mortgage payments will occur because people will leverage the lower rates.
- Despite the anticipated dip in rates, Stone doesn't expect them to drop quickly enough to trigger a significant one-time event.
- He believes this transition will take some time.

Let me ask you the $64,000 question. What would cause your view to change?

Dr. Bill Conerly response:

- Dr. Conerly identifies accelerating inflation as a potential factor that could change his short-term view.
- He is also conscious of the possibility of inflation being slow to decline, which could prolong certain economic conditions.
- International crises are also seen as potential change agents in his view.
- Dr. Conerly is closely monitoring the impact of artificial intelligence on the economy. He acknowledges its inevitable effect on most businesses, though the magnitude and timing remain uncertain.
- He stresses the importance of keeping an eye on how AI is changing not only specific businesses, but also the surrounding businesses, governments, and nonprofits.

Same question. What would make your opinion about the outlook change?

Patrick Stone's response:

- Patrick Stone believes international tension and ongoing wars are significant factors affecting the global economy and, by extension, the United States.
- He notes that the media often underplays the impact of the global economy on the US.
- Stone is optimistic about potential economic growth if geopolitical issues abate and wars come to an end.
- He looks forward to seeing positive changes in the economy in the coming year if these issues are resolved.

What will make 2024 a happy new year?

Dr. Bill Conerly's response:

- Dr. Conerly places family and friends above business concerns.
- Despite his professional focus on economic forecasting, he'd be happy if his prediction about a recession turned out to be incorrect.
- He looks forward to falling interest rates in 2024.
- He's optimistic about the increasing labor force participation rate, indicating a rise in the number of working-age people who are either employed or actively seeking work.
- He believes that work, aside from contributing to the economy, is beneficial for individuals' wellbeing.
- Technological innovation, particularly in healthcare, communications, manufacturing, and service production, is another element he anticipates will contribute to a happier 2024.

Patrick Stone's response:

- Patrick Stone anticipates a happy 2024, largely due to the installation of a pool at his home and the expectation of frequent visits from his seven grandchildren who live within proximity.
- Stone believes that the shared joy of his family, especially his wife's happiness, contributes to his own sense of well-being.
- From a business perspective, Stone indicates that a drop in mortgage rates to under 6% in 2024 would significantly enhance his happiness.
- Stone concludes by expressing his gratitude and wishing everyone a wonderful holiday season.

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/