1st Quarter 2023
ECONOMIC
OUTLOOK
WEBINAR

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

FULL TRANSCRIPTION

Opening Commentary from Dr. Bill Conerly

“I’m going to say something that I know with great confidence, and then I’m going to go into a discussion of things that I think I know, but maybe, maybe not. I’ll review where we have been, I’ll talk about the normal path of a business cycle, and that I know with great confidence; and then I will look at what’s different about this cycle and what the forecast is.

“You may know in terms of things that have happened recently that we had a pandemic. We got a stimulus. The federal government sent checks to people. They pushed money out to the state and local government. They expanded social welfare programs. And the Federal Reserve threw a ton of monetary stimulus into the economy, bringing interest rates to near zero. Then we got inflation, advertised as transitory, but not as transitory as we were hoping. The Federal Reserve started raising interest rates 51 weeks ago. Now we’re in this higher interest rate environment, waiting for inflation to come down, wondering if we’re going to get a recession. The usual pattern for a business cycle is that the Federal Reserve tightens, pushing interest rates up. The first casualties are the interest-sensitive sectors of the economy. And the number one interest-sensitive sector of the economy is home sales. So, the drop in sales in the early stages of the business cycle causes home construction to go down. Some people lose their work.

“There are other interest-sensitive sectors that move quickly -- primarily consumer spending on big ticket items: cars, RVs, and boats -- and there are other interest-sensitive sectors that move a little more gradually. Multi-family construction, non-residential construction, business capital spending, and people lose jobs in these sectors. Then as we get job losses, income losses, people spend less on their discretionary purchases. They keep the staples up, but spend less on discretionary purchases, and that causes more layoffs. Ripple effects snowball for a little while, we go into a recession, but in the recession, something happens that helps trigger the rebound.

“Two things happen actually in a recession, even a bad recession. There are many people with secure jobs. I looked at the 2008, 2009 recession. We peaked at about 10 percent unemployment. And I rubbed my chin and I said, ’10 percent unemployment. What does that mean for the percentage of the workforce that actually is employed?’ It turns out that 10 percent unemployment translates to 90 percent employment. Now, some of those 90 percent are worried about losing their job, so they’re cautious in their spending. But for 85 or 90 percent of the people, they’re saying this is a buying opportunity. Products go on discount, ranging from cars, big screen TVs, Hawaii vacations. People start spending, but before that happens, the demand for loans has gone down and the banks start cutting interest rates to push some cash out the door. Sometime around this point in the business cycle, the Federal Reserve says, ‘oh, holy cow, we need to do something,’ and they cut interest rates. Then the interest sensitive sectors of the economy rebound. You folks are sort of at ‘ground zero,’ the most interest-sensitive part of the industrial sectors. So, you are the first to go down. You’ll be the first to recover. That’s the normal progress of a business cycle, but every cycle’s a little different.

Let me tell you some of the key differences this time that are affecting my forecast. First of all, car sales were [impacted] by production problems, supply-chain problems. I think we have pent-up demand

for car sales. So, we won't see that decline right away. Most business capital spending is replacing old machinery, equipment, and computers, plus a little bit of planning for increased productive capacity. But, in this cycle, companies have been spending money because they can't find humans. They wanted a human, but they had to put up with a robot. And that is leading business capital spending to be a little stronger. So, that's two parts of the spending equation that will last a little longer.

"And then, when layoffs are happening, some people are getting rehired. They walk across the street from the company they just got laid off from and go to work somewhere else because we have so many job openings. And this morning's news is that the number of jobs, of open positions, ticked down just a little bit, but it's still abnormally high. That doesn't work for highly specialized technical people, But for the lower skilled people, that's why we're seeing very little increase in unemployment at this point. And then, in addition to the layoffs being a little bit delayed, or the job losses being delayed, people accumulated a lot of savings. When those stimulus checks went out, most of that money was saved. People's balances and banks are high. Now they are spending a little bit more than I would expect given their income. So they're rolling down that accumulated excess savings, but there's enough extra money in people's bank accounts to help support spending for a year or so.
"So that is going to cushion it. With those factors in mind, I look at sort of the usual pattern. I look at what's different this time, and I have a forecast. I believe the Federal Reserve will keep pushing interest rates up. I think another percentage point on short-term interest rates, so we're in the the neighborhood on the interest rate that they actually manipulate the Fed funds rate about four and a half. I think that's going up another percentage point. Jerome Powell kind of telegraphed they're thinking about a half a percentage point, and I could be a little bit low on that. Maybe it's a little bit more than one percentage point.

Now, long-term rates such as mortgage rates are different. They are affected by Fed policy, but also the global demand for credit, global supply of savings, and I think that mortgage rates are only going to go up a little bit. It wouldn't surprise me if they kiss 7 percent, but I do not expect them to go much above that. And then, as we roll through 2024, the Federal Reserve at some point will say we've done enough on pushing short-term interest rates up, our next move will be down. But they'll think about it before they actually pull interest rates down. And the long-term bond markets are pretty good at anticipating the Fed's next move. And sometime in 2024, the Bondos will say, the Fed's next move is down. We will pull long-term interest rates down in anticipation of that. So I think that the peak on mortgage rates will be early in 2024, and they'll start coming down even before the Fed starts cutting the short-term interest rates. But don't expect them to come back down to the 3 percent level. I think that is something that you'll tell your grandchildren about. It will not be repeated.

"Inflation will come down. The usual time lag between cause and effect, monetary policy to employment is about a year. The long-term lag between monetary policy and inflation is about two years. That's kind of a rough ballpark. Every sector is a little different. But the Fed started raising interest rates last year on March 17th, 51 weeks ago. It hasn't even been a year, and they started gradually. Just a quarter-point move, and then they waited a while, and then they started doing bigger moves in the summer and fall.

"So, I think that we will have a recession, but it will start late in 2023 or early in 2024. And remember, most families survive a recession. A lot of people are like doom and gloom, 'ah, recession, the world is over.' We survive recessions. Most families do okay in a recession, and businesses, in most cases, lose some profits, but most of them survive. Now, there will be more bankruptcies, but most businesses will survive with good management because the underlying need for the goods and services that businesses provide is still there. And I think that people in your industry will be able to survive the upcoming probable recession.

"And one last thought, the 2008, 2009 recession was about twice as bad as average. So, when I talk to a generic company, I say look at your 2008, 2009 experience. Lop that pain in half and that's an

average recession. But 2008, 2009 was particularly bad for the housing sector, so that's even too pessimistic to say it'll be half as bad as 2008, 2009. I think it'll be even milder than half bad. So that's where I see things going."

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WFG Chairman and Founder Pat Stone's Introductory Commentary

"Thank you, Bill. I agree with most of what you said. From a real estate perspective, I really think we're suffering a little bit here from the degree of uncertainty and then also lack of context. And, what I'm talking about here, the uncertainty, obviously the inflation issue, and where mortgage rates go is top of mind. And you're right, they started slow, but this has been the fastest increase in Fed fund rates in history. And mortgage rates skyrocketed from an extremely low level induced by the quantitative easing that occurred after the Great Recession and went on for a long, long time driving mortgage rates way down. I think you're 100 percent accurate. We will not see 3 percent mortgage rates again in our lifetime. And who knows if ever.

"The overlay of all this, of course, is geopolitical uncertainty, the Ukraine war, Chinese relations. But, if I could be really honest with everybody, my biggest concern right now is the Federal debt limit. That's going to come up and really raise its ugly head this summer, and if we get a lot of political fighting going on and we don't raise that Federal debt limit, that could have a catastrophic effect. A default would cause a rating down downgrade, and then also higher interest rates. Just for everybody's education, when I think about my grandkids, I worry about the Federal debt. In the 1980s, it went from one to three trillion. In the 1990s, it went up to 6 trillion, in the 2000s, it went up to 12 trillion. In 2011, it got up to 16.4 trillion. The debt limit right now, which was set in December of 2021, is 31.8 trillion, and we've hit that. We are at that, right? So, we'll see what happens on the Federal debt rate. But I do think that we've got so much uncertainty out there that we're all very, very on edge.

"And one of the problems we have in terms of statistics around real estate is context. Everything is what happened last year, or 2021. We had an abnormally hot market for a couple of years. I would really love to see the media use 2019 as a base for context, but that's not happening. So keep that in mind when you see numbers going up and down, contextually we've lost our basis. We should be comparing things to 2019.

"One of the things that concerns me also is that consumer financial confidence has plummeted. The share of respondents to the Bloomberg Survey who expect their personal finance situation to improve in the next 12 months is now at 31 percent. That's an all-time low. It was at 58 percent at the start of the pandemic. And to give you a little bit more context here, it was at 35 percent in 2011, which was at the bottom of the impact of the Great Recession. So we're at 31 percent right now, which is extremely low and really concerning, and I think that has a lot to do with the media.

"If I can rant just for a second here, our media is in competition with each other to get our attention. It's no longer about news or information. It's about scaring you. And they do a darn good job of it. They scare us daily and they try harder to get our attention. So contextually, we've lost our basis here.
"So, talking about real estate, the sharp rise in rates obviously caused a sharp drop in sales. Probably the sharpest drop in sales in memory. I mean, it just fell off a cliff. Home sales were down 17.8 percent in Q3 of 2022 compared to Q3 of 2021. Candidly, I expect a similar decline this year, Q3 of 2023 to compare to Q3 of 2022 because we are starting so slowly. The biggest issue for everybody is affordability, and the current mortgage rates based on median income, 21 percent of homes listed for sale in 2022 were affordable. According to the MBA, only 49 percent of US households can afford a $250,000 home. So, because of high interest rates, we've really eliminated a great percentage of

the population from being able to buy a home. Current mortgage rates based on median income, 21 percent of the homes listed for sale in 2022 were affordable. So it's going to be tough.
"Demand supply remains in balance despite of all of this. People keep saying, 'well, aren't you worried that home prices are going to drop?' No, I'm not. People tend to look at home prices like they look at the stock market. Like it's an investment, like it's going to go up and down based on emotional issues. Yes, emotional issues impact it, but it really is a supply-demand relationship. Yes, demand went down because of affordability, but supply has gone down almost as dramatically. So there has been a slight erosion of prices in some markets, but I really don't see and I am not worried about a big drop in prices because supply is down almost as much as demand.

"We looked at the inventory of homes for sale, 418,000 versus 1.2 million seven months ago. So we've dropped the amount of homes available for sale in half. Demand has gone down because of interest rates, but supply has gone down. So why is supply down? There's a lot of theories about it. Obviously, the lock-in effect has had a big impact. The lock-in effect is essentially this, 40 percent of all US mortgages were originated 2021 at a very low rates. Two-thirds of all homeowners have a mortgage rate two and a half percent below what they would qualify for today. So, in other words, they're not going to move because they would have to pay an extraordinarily high amount more in mortgage payments than they're paying now because they've got a very, very good rate. 99 percent of all mortgages are at a rate below 6.5 percent, and there's 60 percent below 4 percent. So, we are really in a very good situation in terms of what the mortgage rates are that people are carrying, and consequently, they are staying in their home.

"It's a little bit more than that though because, if you look at the luxury market, which is really probably not as impacted by mortgage rates, you see that from May of 2022 through January of this year, the median selling price dropped from $6 million to $4.1 million. So, 25 percent sold below listing price, and luxury homes are on the market now for 61 days versus 38 days in May of last year. So, it's even hit the luxury market, which again, is not as impacted by mortgage rates as the average median wage earner; but, the lack of confidence and confusion and concern has impacted the market at multiple levels.

"Should we see a sharp drop in prices or a wave of foreclosures? No, no, no. We will not! New listings in January versus January 2022 were down 2.5 percent in price. Despite all the things that have gone on, the Case-Shiller index is down 4 percent from June of last year through January of this year. January-to-January 2022 to 2023, the Case-Shiller Index was up 1.3 percent. Four markets get most of the conversation around potential price drops -- San Francisco, Seattle, Austin, and Phoenix -- all because of run-ups in prices and also drops in the amount of tech employees, and other issues, but I don't see anything dramatic happening in those markets either. Maybe a 1 to 4 percent drop in prices at the worst case. Overall, I do think real estate prices will go up in 2023, even with all the uncertainty and the issues.

"Foreclosures? No, we're not going to have a wave of foreclosures. Two-thirds of all mortgages issued in the last three years have had a FICO score over 760. I mean, these are very, very solid situations. No junk loans, no stated income loans, or a lot of subprime loans. We're not at all in the same situation we were during the financial crisis, and we're just not going to have the same thing.

"I kind of agree with Bill. It was good to hear that he was somewhat optimistic in his outlook, and I am also. I do think it's going to be interesting to see what the Consumer Price Index does this month. It will come out next Tuesday on March 14th. One thing I would point out, I keep expecting the CPI to start dropping a little bit more significantly, and now it went up in February because that's January's numbers, and they reflected the year-end or the first of the year price increases a lot of companies do automatically. With the March numbers that come out next Tuesday that'll be based on February inflation, I think you're going to start seeing the impact of a decline in owners' equivalent rent and rent overall, about 42 percent of the CPI is based on rent or owner's equivalent rent. So, I think that's

going to drop. If it drops a lot, I think you'll see mortgage rates come back down closer to 6 percent like they were a month ago or so. And I think that will be very, very good for the economy. So we'll see what happens there.

"The Fed likes the personal consumption expenditures that comes out at the end of the month, but the media jumps on CPI because that comes out first and that has a real psychological impact. I think real estate will experience impact for rates, but volume based on demand, desire and affordability, and I will tell you that demand is high and it will continue to be high because the millennials are the second-largest population bubble behind baby boomers, and they're in the thirties now. Now, the average age of a first-time buyer is up at the high thirties, which is probably the highest it's been, and that's because of the pandemic and all the things we've been talking about.

"But I do think that the demand is still there. The demand to having a place to live and the creation of households has gone up because of the millennials coming of age, and the desire for home ownership -- and I base this a little bit on the statistics you see around the amount of people looking for homes on the internet – it is still extraordinarily high. The pandemic made people realize they want to control the environment they live in, and I think the demand and desire are there and will continue to be there, so the big issue is affordability. Affordability is very, very closely attuned to mortgage rates. Yeah, I think we've had a run-up in prices. They'll come down a little bit, maybe overall they'll stay the same or go up, but affordability will really be dependent on mortgage rates going forward.

"I'm going to be a little adventurous here and step out and tell you that I think that mortgage rates will be down to 6.5 percent or lower by mid-year this year. Down to 5.5 percent by December and down close to 5 percent a year from July. So July, 2024, 5 percent. Totally agree, Bill. We'll never see them down below 3 percent like they were. In fact, I doubt that we'll see them below 4 percent again. So, I think anything around 5 percent will be very, very good, and the economy in real estate will really go very strong.

"New construction will accelerate this fall. I think the builders see people coming back in the market rates come down a little bit, they'll get more aggressive. And I do think, as Bill said, that basically the US economy is good and will continue to be good. So, I'm pretty optimistic. We'll see what happens."

Question and Answer Segment

What are the potential long-term effects of the current economic downturn on industries, job markets and the overall global economy?

Dr. Bill Conerly's response:

A number of things are going on here, and one of the things that has struck me in terms of an impact for some years has been the tight labor market. I've talked about this before. The boomers are retiring. The working-age population is not growing in this decade. And, I think that the rethinking what's important in our life that a number of people did in terms of retirement or just not working, I think it's going to be a tight labor market for a long time.

Another impact that we've had, we had supply chain problems because, when the pandemic hit, we switched our spending from services to goods and we couldn't get all the goods in. Plus, you had the lockdowns in China, the Ukraine-Russia war. I think companies are going to say, 'gee, let's shorten up our supply chains.' That's impossible to do overnight, but I think gradually that will be one of the changes. And of course, the remote work -- the whole Zoom thing -- I don't know how that is settled out, but that's going to be a long-term impact from the impacts we've seen. And that maybe a whole

other question in and of itself that we can talk about, but I think it's unsettled how we're going to end up there, but it's not going to be exactly like it was in 2018.

Is this cycle going to be a repeat of 2008 and 2009?

Patrick Stone's response:

Not at all. We are in a completely different situation, both from product risk and credit risk. The lenders, the FHA and the GSEs all maintained a fairly conservative posture since the great recession. We do not have the product risk. Do you remember stated-income loans? 'Hey, I made $500,000 last year, give me a mortgage. Okay.' You may be an unemployed, but you could say it and get away with it. And then the amount of subprime loans prior to the Great Recession, and Wall Street securitized mortgage loans and packed those securitizations with subprime loans to get the rate return up, and that's what caused the bubble to burst, if you will. We don't have the same situation at all. Again, as I said, FICO scores are high, and then we have a new movement today where we're going to see the availability for people that are having a problem with their loan, the availability to go out further on their mortgage and run it out 40 years. So they can actually modify their mortgage from a 30-year loan to a 40 year-loan if they're having problems right now. So you're just not going to see the same situation. You're not going to see foreclosures go up dramatically, and we're not going to see a lot of people displaced. So I'm not too worried about that at all.

How likely is the US government debt default?

Dr. Bill Conerly's response:

I have learned over the course of many years since I was a young economist with a lot of dark hair that the best forecast is often muddled through. We're going to muddle through, and I think that we'll go to the precipice, it'll be a crisis, but at the last minute, Congress will increase the debt limit. I understand the fiscal hawks saying the government's spending too much, being irresponsible, increased debt, as you discussed; but, at some point they need to either increase the debt limit or cut spending, and they're refusing to do either. But, I don't think we'll actually have a default. There may be a technical default for a day or two, and then the US resumes payments. So, I don't worry about this as much as you do, but I do think it would be significant, and don't forget that US government debt used to be AAA and then it got downgraded a while back, and, you know, people are still buying it. So I'm not too worried about that.

Can you compare resales versus new construction in 2023? Where's the activity going to be?

Patrick Stone's response:

Well, the new construction really, really dropped. The irony here was a year ago, going into 2022, I was really pretty optimistic about new construction. Builders were gearing up. They had lots accumulated. They had this situation where they had growing certainty about the cost and time of constructing a home. That dissipated dramatically with rising rates, so builders got very conservative and it's really totally understandable why they got conservative. If a builder's building a spec home, it's a gamble if you don't know how much it's going to cost or how long it's going to take to sell, and, if you're a builder, why would you take that gamble? So, new construction really abated. I see new construction coming back when rates come down a little bit, and we have a little less uncertainty in the market. I think we're not going to see a lot of new construction until later this year. Will new construction get back to the point where it was prior to the great recession? It's got a long ways to go, and we have

underbuilt in this country to an alarming degree for the last 13 years. So, if you look around, multifamily was built quite extensively in the last couple years, but single family homes are really undersupplied. And when I said earlier that I thought the average price of a home was going to go up this year despite all the nonsense going on, that's in part because there's not a lot of homes out there. I've seen estimates from 1.8 to 5 million underbuilt on single family construction, so it's going to be interesting to watch.

Can you discuss the global threats of China, Russia, and the weakening status of the US?

Dr. Bill Conerly's response:

Yes, I can. The weakening status of the US does not bother me. That kind of thinking says, 'Hey, it's like a race. There's only one winner, and if you're not number one, you know, it doesn't matter.' Actually, our position, our economy, the standard of living of our people improves when other countries are doing well. As a good example, we would be better off if Mexico were a richer country. We'd be selling more, we'd be trading more with them. We would be worse off if Canada were a poorer country. And those are two of our biggest trade partners. So, other countries doing well is good, but we now have this geopolitical problem with China and Russia. Russia is going to have a weak economy for years to come. It's not showing up in their statistics. The head of their statistics agency was appointed to that position by a guy named Vladimir Putin, and, you know, I don't trust those numbers at all. I do know there's a lot of western technology throughout the Russian economy. Farmers, manufacturers, wholesalers are using western computers and equipment and can they get the software upgrades? Can they get the replacement parts with the sanctions? I think Russia is going to be a disaster over the next five years. That's not good for the US, but it's particularly bad for them. China, I worry about them partially because they are adding more to their military and the risk of a conflict over Taiwan is growing. But, also, president Xi is exerting more dictatorial control over business, and that's not going to be good for business. He's throttling their entrepreneurs. So, I think that our relative status is going to look better, but I think that the world is going to be worse off because of these geopolitical problems.

Will home prices go back up, making it a seller's market again, with multiple offers on a home and offers above listing price? Are we going to see those days again?

Patrick Stone's response:

Well, eventually. I don't think anytime soon though. I think basically you have to have a full recovery of the economy before we get back to that level. And by that, I mean you're going to have to have the affordability issue go away, you're going to have to have people fully engaged, fully employed and confident about their jobs and the demand will be there, but I think you have two things to overcome in the interim, and that is getting rates down and confidence back up. And then you'll start seeing multiple offers on homes. So I do think it will happen, but I do think it's contingent on having a better environment than we're in right now. I don't see it happening as long as we have high rates and uncertainty to the level that it's in effect right now.

One man's opinion, for what it's worth, I think the real estate market is going be very, very good from 2024 to 2029 because demand and desire are there. You get mortgage rates back down to five and a half percent or lower, and people are going to jump. Again, historically seven percent mortgage rates are probably about average for where they've been in my career. Contextually it's a little difficult to really get your head around what's going on, but I think get rates down to five and a half or lower, then the affordability issue becomes less of a factor, and I think you'll see multiple offers reemerge. So, one man's opinion, we're going to have about five really good years of real estate market if there's no

major economic disruptions. And then that's based on demand and desire and affordability coming back into line.

Are there states that will fare better than others in 2023?

Dr. Bill Conerly's response:

Yes, some states will, and what I think of it is that we have a business cycle that goes up and down, but that is superimposed on a trend. Texas and Florida, upward trend. Connecticut and California, downward trend. And the demographics of people moving are fairly slow to change. So, if you look at last year's population change, that's a good approximation of this year's and next year's population change. People are moving into the biggest states, Florida and Texas, but also the Carolinas. Moving from California and the northeast. So I think that the states that have continued in-migration are going to do better. They've got more people coming in with money. The retirees come with pension checks and social securities, but the other people come with a demand for stores, houses, services. So, I think that the states that are the recipient of this migration will benefit, which means that in the cycle, they just maybe will flatten out somewhat for the overall economy. The states that are on the downward trend, California and the middle Atlantic states, I think they'll have it particularly harsh. And just to elaborate on that, where people are moving, when people move, every decision to move from one place to another is based on multiple factors, but the things that I see statistically influencing it is job opportunities, home prices, taxes and climate. Crime may be in there, but I haven't seen good enough statistical analysis to be sure. But, jobs are important and we have lower unemployment rates in those recipient states than we have in other places. And, of course, home prices are much less in Texas and Florida than they are in the upper East Coast and California.

Personal income taxes, of course, there are none in Texas and Florida. So I think there'll be a continuation of that. But, let me add a little bit of caution there. Let's say a metropolitan area is going to get 20,000 new families moving in. The developers there are going to say, 'oh, 20,000 new families, that's a great business opportunity.' And all the developers start developing and they create room for 40,000, whether it's stores or homes, and people can go overboard. So, it's a little bit risky, but I think that the overall economy of those recipient states is going to be better.

What's the expected impact on the housing market of the Baby Boomers aging?

Patrick Stone's response:

Historically in our country, we have seen a lot of older people sell their home, move to a smaller home somewhere or to a retirement community of some kind. I think that will continue, but it slowed down because of the pandemic and the impact on mortgage rates and everything else. Plus, the pandemic, again, it really heightened one's awareness of controlling your environment. I can tell you that I'm in my mid-seventies, but I'm not moving out of my home anytime in the foreseeable future. So, I think there has been some impact from it. I do think that we won't see as much relocation because of retirement as we've seen in the past. And then if you look at numbers, historically people moving has dropped in half from 1980 up until 2019, right before the pandemic. People used to relocate. We used to have about 18 to 20 percent of the population relocating annually. That went down to about nine to 10 percent right before the pandemic. So, I think things have changed psychologically. Yes, people will retire. Yes, people will move, but not with the level they used to. So, the Baby Boomers are coming into that age where they make that consideration. I think the amount of Baby Boomers moving and relocating out of their home will go way down compared to what the numbers have been in the past.

What are the three economic leading indicators that you watch for a change in our economy?

Dr. Bill Conerly's response:

The question should have been, 'what are the 123 indicators I watch?' I look at everything, but that's my job. But for leading indicators, and a leading indicator is the measure that moves before the economy moves. It's not like the leading lady, the most famous, or the best, but it's the one that moves before the economy. And the three good ones to watch are, first of all, initial claims for unemployment insurance. It comes out every Thursday. You can access that data from the US Government Department of Labor, or the FRED database. If you just Google FRED Database, you would get a lot of the data. Initial claims for unemployment insurance. Another good one is the yield curve, which is the spread between long-term interest rates and short-term interest rates, and it's typically calculated as the 10-year Treasury Bond minus either the three-month Treasury Bill or the two-year note, or perhaps the Fed funds. But the difference between long-term interest rates and short-term interest rates is a good leading indicator. And the third one I watch, you may see references to the purchasing manager survey, and within that survey, there's a specific question about slow deliveries to factories. That's a good leading indicator, even though factories are not as big a part of the economy as it used to be. In general times when we're not running into unusual supply chain problems, the slow deliveries to factories means there's a lot of activity. It's a very positive sign. So, if you want three, that's what I would recommend.

Can you say something about the rental market? We have more questions about rental this quarter than we've seen in past episodes.

Patrick Stone's response:

I would agree with that, and thank you for bringing that up. The really interesting thing to me the amount of multi-family construction and multi-family units that came onto the market here in the last couple of years. I mentioned earlier that single-family construction has really been low and lagging for a long, long time; but multi-family accelerated dramatically. And, to pay a compliment to the Businomics newsletter you put out, you point out in your most recent edition that the amount of apartment demand went way up because stimulus provided a lot of excess capital and people could have their own apartments instead of sharing it with someone. That seems to be going down now, but we had a lot of demand for apartment units. Multi-family construction went way up. I do think that's declining. Rent increases are declining fairly dramatically, and owner's equivalent rent obviously is also declining fairly dramatically because house pricing appreciation has stopped or slowed way, way down. So again, now that those things will impact the CPI index when it comes out, hopefully in a very positive way. But, I see [multi-family construction] really coming down fairly significantly because, I think, as you pointed out, we've peaked in terms of demand for apartments, at least for the foreseeable future. So, we got a little readjustment we're going through right now.

Can you address the stock market predictions? If equity markets lose 20 percent value, will the fall and market valuations affect real estate companies that are publicly traded?

Dr. Bill Conerly's response:

Real estate companies do move with the overall stock market, but they also move with their industry, as every sector does. The things that I think are important, as an economist, to look at the stock market... Well, first of all, I don't look at my brokerage statement regularly except to make sure that

nobody has drained, through some fraudulent transaction, a lot of money. I try to catch that as soon as it happens. But, in terms of worrying, 'oh, it's up this month, it's down that month,' I push that out of my head. But, I'm very good at pushing worry out of my head. The dripping faucet doesn't scare me at all. The other things that are important, I think, is to keep in mind that the stock market is forward-looking. They're looking at the future, and sometimes we'll see good news and the stock market goes down. Well, that doesn't mean the stock market dislikes good news, but it's like they were thinking, what does this mean for the future? So think of it as a future-oriented indicator. And, to sort of return to that previous question about leading indicators, the stock market is a leading indicator of the economy. It's not perfect, but it does give us some idea. And the final point I want to make is that the direction of causation between the economy and the stock market is mostly the economy affecting the stock market. Occasionally the stock market affects the economy. A big collapse, October of 1987, big sharp correction, and yeah, that had an impact, but usually it's in the other direction. So, I would suggest that this should be of relatively minor importance to people except for their own long-term investment standpoint.

We've got a couple of questions relating to the commercial sector, like, how long will interest rates slow down commercial deals?

Patrick Stone's response:

The commercial market has remained relatively strong, except maybe office space and malls. The interest rates probably have less direct effect on commercial than they do on residential. In residential, the individual's affordability is directly impacted by that. In commercial, you have cap rates and you have issues and demand outside of necessarily the interest rate that the developer or purchaser would be charged to make the acquisition, so it doesn't have quite the same impact on commercial. I think the office market is the biggest question in the commercial sphere. I'll give you an example. Vacancy rates are somewhere around 12 to 14 percent, but occupancy rates are only about 48 or 49 percent on offices. By that, I mean there's a lot of space that is rented, but not being used. We had work from home become very prevalent during the pandemic. Candidly, I've been surprised at how slow we've been in a return to office movement. A lot of people I talk to still think it's going to happen, but it's going to take a few years before we really get back to the point where we have occupancy above 80, or close to 90 percent. I tend to agree. I think it's going to take quite a while just because we've come into a habit. Technology has allowed us to work remotely and I think people can live remotely in a lot of jobs and basically work online, if you will.

I do think malls are also questionable because so much retail moved to online purchases. So malls are having to reinvent themselves and have a little bit more uniqueness to attract people to come to a mall. High-end malls are doing very well. Average malls are having a pretty hard time. Storage has been maxed out. We've built a lot of storage. I don't see a lot of upside in the storage site. Industrial warehouse prices have gone up dramatically. They're starting to level off. There's still demand for warehouses, but everybody's kind of waiting to see where we go with e-commerce. You know, e-commerce got up to 14, 15 percent, and a lot of people thought it was going to keep going right up to 30 percent. It has kind of leveled off a little. We'll see where it happens there. And I think you point that out in your latest issue also, that the level of e-commerce has sort of leveled off. So we'll see what happens there. A lot of questions around commercial, but a lot of money still chasing commercial acquisitions, and not as impacted by mortgage rates as we are on the residential side, for sure.

When do you see the consumer confidence index bouncing back in a meaningful way?

Dr. Bill Conerly's response:

My view of consumer confidence is it's mostly a resultant. It results from unemployment, inflation and interest rates. And when all three of those are low, consumers feel good most of the time. There are a couple of exceptions, but usually when the economy is doing well, but not so well that we get inflation, and the economy's doing well, so unemployment is low, but not so well that interest rates are up, that's when consumers are at their happiest. So, I actually think that most of the time, consumer confidence is not a separate factor, it's just the result of where we are. But, I do watch it, especially around unusual times. So, after the 911 attacks, yeah, consumer confidence went way down. The first Gulf War. The US is in a fighting war, and consumer confidence went down. And consumer confidence went down with the Russian-Ukraine war. So, it's worth looking for unusual factors. But, in terms of if the geopolitical thing is stable, I think I get more value looking at the underlying fundamentals of do people have jobs? Can they afford the things they want to buy? Both in terms of price and interest rate.

Questions about Housing Prices:

- ***When will buyers who bought at the peak of home prices likely recuperate their equity?***
- ***Zillow recently announced that housing prices will recover and gain in 2024. Where do you see home prices going?***

Patrick Stone's response:

As I mentioned earlier, I do think net-net home prices will be up this year. Not dramatically, probably two to three percent. Historically home prices have gone up on average about 3.6 percent a year. I see them returning to that, maybe even going a little bit higher in 2024, because the demand and desire is so high. I think if you bought it at the peak, you'll be okay within a couple years. I just don't see any really dramatic downturn from here in prices, even in some of the markets that people are worried about. Again, supply and demand are still somewhat in balance, or pretty close to being in balance, and demand is going to be high for quite a while. So, I do see prices continuing to go up and recovering to where the peak was within a couple years. Again, it depends on the specific market, but overall, I'm pretty confident that we're not going to have a problem there.

Is there any data to indicate that there is a post-pandemic divorce boom? Is this something that has actually happened? Is it going to continue to happen?

Dr. Bill Conerly's response:

The data lag that, but let me tell you the old not very good joke about the man asking his wife, 'what do you want for your birthday?' And she says, 'I would like a divorce.' And the man stops and pauses and says, 'I wasn't planning on spending that much.' When some people want to get divorced, they're looking at their finances and, when they had stimulus payments, maybe they refinanced the house to a low mortgage rate, they could afford it. I haven't actually seen the latest divorce statistics, but that is usually a small part. The bigger factor on the housing market impact that is much bigger than divorce is adult children moving out of their parents' basements. You know, hallelujah. We love that! And also people with unrelated roommates saying, as we discussed earlier, I don't need a roommate anymore. I've got stimulus money, or I got a pay raise. So, I think that's the bigger effect.

What should people be thinking about as they roll into the middle of 2023? For the people in this audience connected to the real estate industry, what would you suggest they have a top of mind?

Patrick Stone's response:

Well, I think if you're running a real estate related business right now, you've got to be very, very, very conscious of your expense profile. AM Best downgraded the title industry today, and they did that saying that it's going to be a tough year for profitability in the title business because volumes have gone down so much. So I encourage everybody out there that is managing a business to make sure you have a metric that you follow, that you adjust to as the market goes up and down so that your staffing and your expense ratios are in line with where the market is. You can't afford to sit and say, I know this is going to change. I know this is going to return to a heightened level. We all hope it does, and I think both Bill and I are fairly optimistic compared to most people about where we're going, but you can't afford to bet on it. You can't afford to sit and wait. You can't afford to carry expenses you don't have to carry. And it is really unfortunate a lot of the expenses are personnel related, but the job market is still pretty good. So do yourself a favor. Make your adjustments on a timely manner. Make sure your expense ratios are in line with where the market is. Use a productivity standard that reflects that. Either your open files per employee, or whatever kind of metric you can find that aligns your business with where the market is. And be very diligent about remaining current with the current market. We can't afford to guess right now. There's too much uncertainty out there to guess about where things are going. We just don't know. And we won't find out until it happens. So be prudent. Be very, very careful on your expense ratios. Work very hard to get all the business you can get, but make sure you are in line with where your market is. Bill any concluding comments?

Dr. Bill Conerly's response:

Yeah, let me answer that question. Going into or continuing in a down cycle, I think my advice to businesses in any industry is survive and thrive. The survive part means you have to watch your cash flow very carefully and make sure that you are going to be able to pay your bills through this, but then thrive. In the rebound, there are always companies that end up better afterwards, and what they have done is they've said, 'okay, where can I expand?' It may be that in the rebound they provide better customer service than the competitors who cut too much or who are disappointed, discouraged, think you can't sell in a recession, so the salespeople don't try. There are going to be business opportunities. There are plenty of people our age who own real estate related businesses and in a downturn they're going to say, 'Hey, forget about it. I'm outta here. Let's sell the business.' So, if you're looking to buy, you might start thinking, who would I want to acquire? Or, if you're just thinking about building your company for the rebound, you might think, who would I like to have working for me who's not currently working for me, but I didn't want to pay a ridiculously high wage to last year, so I didn't recruit the person? But you may be able to find some great people available in the coming year or two. And, if you're thinking about expanding into another location, the recovery may be a great time to do that. So, even though recession sounds scary, there are always opportunities for growth in the recession. We're going to survive this and some businesses are going to come out better than ever before.

Patrick Stone's response:

Agreed. Be positive! Be positive! People want to relate to people that are positive. You're going to find your customers don't want to do business with somebody that's negative. They want to do business with somebody that is positive. So good advice, Bill! Thank you very much, folks. Take care. Stick to it. We'll get through this and I think we're in for a better time. So, thank you very much for your time today!

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/