Capital Markets Group

Points to Ponder

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The First Tee...

The New Abnormal…the extended tenure of low interest rates has derailed theories about money and changed a generation of investors, savers, traders and policymakers:

- Cheap money has boosted economic growth and borrowing but has decimated savers:
  - As interest rates decline, the value of bonds rise and typically stocks as well…but as rates remain close to zero, or negative, there is less room for price appreciation **(leading investors to add more risk in search for yield)**
    - The risk-for-yield exercise can get inflated to the point that asset bubbles form, destabilizing the financial system.
- Low interest rates have created an environment where it is becoming increasingly difficult for middle and lower income class Americans to have future financial stability:
  - Many households are living paycheck to paycheck with little hope of paying-off large debt amounts:
    - The opportunity to obtain financial stability and a secure retirement from low risk investing has been minimalized:
      - The low level of short and long term bond rates are indicating investors see little chance of levels (and the economic conditions they represent) changing anytime soon…pension funds have been reducing return expectations (lengthening the time to retirement!):
        - The national average interest rate on savings accounts (the past 4 years) has been .1%, down from .3% in 2009…was 1.73% average rate in 2000
        - A majority of the yield-curve is trading around a 1.5% rate…inflation adjusted real returns make bond and savings rates negative.
  - Middle to lower class wages are still at the same level as 18 years ago when inflation is considered.

Tariff Transparency…quantifying the cost of duties on consumer goods to Americans:

- The cost of higher gasoline prices is viewed as a good alternative indicator when calculating the impact of tariffs on household budgets (hikes in gasoline prices have been compared to a tax on consumers)
  - The $30 billion tariff bill resulting from a 10% duty on $300 billion of Chinese goods equates to about a 20 cent per gallon price increase on gasoline…*not a household budget disaster but will take a toll over time*:
    - The price of regular gasoline in the U.S. went from about an average price of $1.50 per gallon at the end of 2003 to as high as $4.00 in mid-2008…over this period an additional 2% of household budgets went to energy consumption:
      - The percentage of household budgets spent on energy is currently near a record low…one reason consumer confidence remains high.
    - The percentage of household budgets spent to pay for tariffs will rise in lock-step as duties on goods increase.

Dialing for Dollars…as economic growth slows, falling currency values are in the cards:

- It appears it is a race to the bottom for currency levels as most countries are cutting rates and creating money as they try to protect (or enhance) their exporting capabilities:
  - With synchronized monetary easing, it becomes increasingly difficult for large market currencies (like the dollar) to be engineered to lower levels…simultaneous moves by other countries to weaken currency values cancel each other out:
    - Despite the Federal Reserve's increasingly dovish policy strategy the dollar is among the most overvalued of the Group of Ten trading partners (according to a Bank for International Settlements model on real effective exchange rates):
      - The strong dollar is not surprising given the current state of the European Union countries (Germany on the verge of recession, Britain close to exiting the EU and the break-up of the Italian government) and Japan at perpetual zero percent interest rates.
  - Competitive currency devaluations typically create political tensions, while extended periods of low interest rates increase the probability of asset bubbles and financial repression *(the new normal?)*:
    - Growth is the driver for value of the dollar…an easing of monetary policy by the Federal Reserve is not going to reduce the value of the dollar versus the euro if economic growth in the European Union is weak.
- The Federal Reserve is considered the central bank to the world…further rate reductions by the Federal Open Market Committee will open the door for further policy easing by other countries.

At the turn…

The Back Nine…

House Hunters…first-time home buyers are being froze-out of market by high prices:

- Strong demand and tight supply of entry level homes has pushed prices for the bottom third of properties up by 9% versus a year ago, while the top third has only risen 1.1%:
  - After a slow start, the large millennial population has now entered the home buying market:
    - There were almost 6 million Americans who lost their homes during the Great Recession…many of these displaced individuals needed time to rebuild their credit and have also re-entered the market for starter homes *(a seller's market!)*.
  - The supply of used-homes available on the market has been below 5 months for several years:
    - The National Association of Realtors classifies a less than 5-month supply of homes for sale as a tight market:
      - Many of the single-family homes that were foreclosed on (10 years ago) were purchased by investors and are now rental units.
  - The pace of sales for lower-priced homes plunged almost 20% during the past twelve months.
      - Builders have focused new-home construction on more expensive structures with higher profit margins (creating a glut in the sector).
- The U.S. homeownership rate fell to 64.1% during the 2nd quarter (the lowest in two years):
  - Number of new homeowners created last quarter was the lowest since 2006 (spring home sales were slowest in 5 yrs):
    - Black homeownership fell to 40.6% (the lowest since the 1960's)…white home ownership is at 73.5% (the largest gap on record).
  - Homeownership rates hit an all-time high in 2004 at 69.2%...the record low rate was in 1965 at 62.9%.
- The government is enhancing condo opportunities as a home ownership alternative:
  - The Federal Housing Administration (FHA) has lowered the down-payment requirement for first-time home buyers to 3.5% for condominiums…while also allowing a lower credit score than conventional loans:
    - The FHA insures loans made by banks and private lenders…the agency is expecting to insure as much as an additional 60k condominium loans each year (above the 16k condo loans it backed in 2018)…6.5% of the 150k condo projects are FHA certified:
      - The median price for a used condominium is currently $254,300…$30k less than the average price for used single-family homes.

East Bound and Down…trucker shortage expected to double in the next ten years:

- An American Trucking Association study showed driver shortages in the U.S. increased by 10k in 2018 over the previous year to 60,800…driver deficiency is the worst for long-haul drivers:
  - The ATA estimates 160k driver positions will go unfilled in the next decade (average age of long-haul drivers is 47):
    - Firms are increasing pay and recruiting women to help build their driver populations (women make-up less than 7% of drivers):
      - ATA is hoping to have the age for commercial drivers who can cross state-lines reduced from 21 to 18 years old…this would allow drivers to be recruited straight out of high school, helping increase the size of the labor pool *(robotic drivers to fill void?)*

19th Hole...

The most terrifying words in the English language are: I'm from the government and I'm here to help. Ronald Reagan

Ross Elford, First Vice President

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