2024 Q1

BELL WEALTH

—BY GREG SWEENEY
CFA, SVP/Chief Investment Officer

What Does 2024 Have in Store?

There is no shortage of events in 2024 with the potential to influence market volatility — a presidential election, the possibility of continued geopolitical crises, fed fund rate decisions and inflationary developments, just to name a few. Let's take a look at what the year may bring. >>>

Bell Bank Wealth Management

We have mentioned in the past that fixed income bond yields represent some of the best value we have seen in the last 20 years. Bonds are starting to get investors' attention, and more money is moving that direction.

—Greg Sweeney

As of the time of this writing in December, bond and stock markets were up more than normal on hopes that interest rate hikes are over. One thing to note about interest rates is that the Federal Reserve sets short-term rates through their fed fund mechanism while the market sets rates on longer maturities. The market looks to price in variables like the stickiness of inflation, levels of debt issuance due to federal deficit spending, quantitative tightening in the form of Federal Reserve balance sheet reductions and chances for changes in economic conditions, to name a few. It seems a bit early to attach a reasonable level of confidence to many of these variables.

It stands to reason that housing would be noticeably affected by rising interest rates, and a quick look at the data shows that existing home sales are down. At the same time, new home sales are up. How is that possible? There is a suggestion that one of the forces keeping existing home sales down is that current home owners don't want to lose their 3% mortgages and are not putting their houses up for sale. Bell Bank Mortgage President Tony Weick takes a closer look at mortgage and home trends for the year ahead later in this newsletter.

The 2024 consensus is for equity markets to move higher, with many forecasting the S&P 500 to finish around 5,000, or about 10% higher than where it was at the time of this writing in early December. We see these types of projections even more marginalized than usual if for no other reason than this year's 18.5% return has been so lopsided. The seven largest stocks in the S&P 500 have driven the majority of the return, with the remaining 493 stocks up by just a few percentage points as of early December. Energy, consumer staples, healthcare and utilities have attractive valuations but don't get much attention in the market.

We have mentioned in the past that fixed income bond yields represent some of the best value we have seen in the last 20 years. Bonds are starting to get investors' attention, and more money is moving that direction. The challenge is balancing available yield with the proper spot along the maturity curve. Investors had been favoring short-term bonds offering the highest yield, but we see that shifting in an effort to spread out maturity roll rather than having so much concentrated in a narrow time frame.

Election years tend to avoid damaging recessions if for no other reason than because of the spending that occurs around election campaigns. While we don't rule out a slowdown this year in the wake of higher interest rates and slowing consumer demand, our best estimate is for slow growth.

These outlooks are a collection of data points that come together with varying levels of influence, which is why nobody ever knows what the future will bring. It is important to remember that whatever happens, it is just one stepping stone along the way to long-term goals.

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—Greg Sweeney

—Tony Weick President, Bell Bank Mortgage

MORTGAGE UPDATE:

OPPORTUNITIES ON THE HORIZON AFTER A YEAR OF HEADWINDS

As we enter 2024, it's important to look into the past to understand where the industry is today and consider the trends expected in the future. Looking back at 2023, we saw hopes that the tightening cycle was coming to an end replaced by even tighter conditions, with rates rising to higher levels than most thought conceivable. In the mortgage industry, instead of headwinds beginning to subside, challenges only became more severe as the year continued.

Let's take a closer look at where we were, where we are currently and where we think we are headed during these ongoing times of uncertainty.

TIMES OF ONGOING UNCERTAINTY

Throughout 2023, even amidst ongoing tightening measures, the overall economy remained resilient – too resilient in the eyes of many, which led to continued measures to slow inflation to the Federal Open Market Committee's (FOMC's) stated target of 2%. After an extended period of low rates, we saw continual rate hikes over the last 16 months, reaching 5.50% in July 2023. While the fed funds rate does not directly impact mortgage rates, they do typically trend in a similar direction.

As the mortgage and real estate industries see positive opportunities on the horizon for 2024, we at Bell Bank Mortgage also expect great things for our business partners and clients. — Tony Weick

Additionally, the treasury bond market – which mortgage rates are closely tied to – also saw significant increases over the course of the last few years, eventually reaching 5% in late October 2023. This spike in treasury yields also led to mortgage interest rates rising above 8% in November, the highest level in over 23 years.

Rates began to fall shortly after, but questions remain whether we've seen the peak. The overriding consensus is rates will begin to decrease, but nobody knows when that will begin, or how fast or how far the decline ultimately will be. In terms of general forecasts, most prognosticators expect rates to decrease gradually starting early this year and continuing over the next few years.

What will rates look like in the future? There are no crystal balls, but if we are indeed near the high point of the cycle, economists expect inflation to continue to cool and for mortgage rates to begin to cool as well. With rates ending 2023 roughly in the mid-7% range, expectations are to see rates approaching the mid- or even low-6% range by the end of 2024.

However, it is important to remember interest rate movement is rarely a straight line, and as we have experienced over the past few years, many believe we will continue to see significant volatility as the trend line changes directions as well.

HOUSING INVENTORY AND VALUES

As it relates to available homes for potential buyers, we continue to see a severe shortage of what the industry would consider healthy. This has been a common theme for the past couple years, and there are a number of reasons why. Over the past decade, new construction activity has lagged behind where many believe it should run. Also during this timeframe, many single-family housing units have been acquired by large institutions, or even hedge funds, and turned into rental properties.

The third major factor has been labeled the "handcuff" factor, as the majority of current homeowners with financing have rates in the 3-4% range, far below current levels. That's keeping many from considering selling. When homeowners consider their current rates doubling (or more), and the higher payments associated with new rates, that becomes too large a hurdle for many people to accept. As rates begin to retreat, this will become less of an issue.

Over the past few years, home appreciation has been very significant, and in some geographies even extreme. Since 2020, markets on the lower end of the scale have seen the value of homes increase more than 20%, and on the upper end some locations have seen prices increase 60-70% or more during the same timeframe.

While the pace of appreciation definitely slowed in 2023 to around 4-5%, when looking over the past four years, home prices have increased roughly 35% on average across the entire country. One of the benefits of homeownership over time is the ability to put your home equity to work for you through an equity (cash out) refinance. In 2023, even during a time of increasingly high interest rates, refinances made up more than 20% of all loans being done, with the vast majority seeing homeowners pull equity out for various reasons.

For all of the reasons mentioned above, affordability has become a bigger challenge than ever for many Americans. In the past, people focused on the size of their potential payments when considering whether they could afford a home, but as the cost of entry has increased, the initial down payment has become an equally important challenge.

Many still wrongly believe it takes 20% down to buy a home, but there's been an increased industry commitment to making sure potential homeowners understand all available options. From lenders to secondary market investors to local governments, many around the industry continue to develop more programs to help overcome the affordability challenges for qualified applicants.

MOVING FORWARD

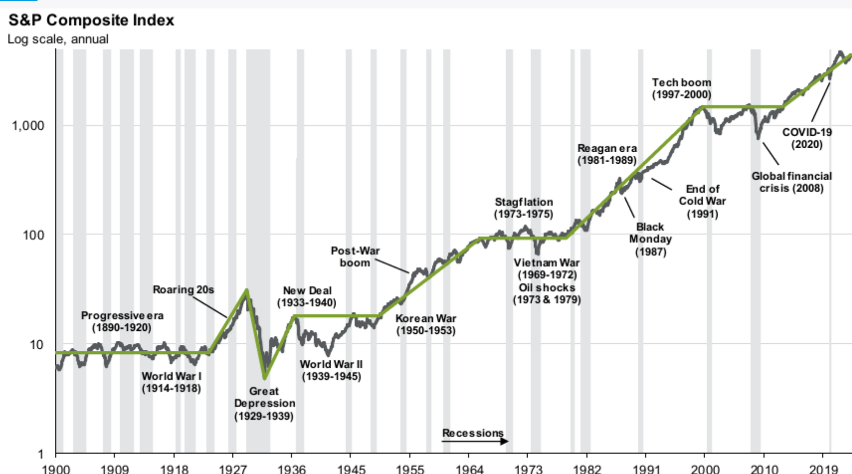
As the mortgage and real estate industries see positive opportunities on the horizon for 2024, we at Bell Bank Mortgage also expect great things for our business partners and clients. If you're thinking about building or buying a new home, or considering refinancing alternatives, we'd love the opportunity to help you determine what's in your best interests. As always, we welcome your business and referrals and would be honored to serve you.

—Chris Haarstick Senior Portfolio Manager

GEOPOLITICAL RISKS AND THE THREE BEARS

Equity Review

Stock Market Since 1900



Source: Factset, NBER, Robert Shiller, J.P. Morgan Asset Management
Guide to the Markets – U.S. Data are as of September 30, 2023

We all know bad news sells. That's why news programs are usually led by the latest crime or war stories. There is logic behind highlighting these types of stories, as they are closely connected to the fight-or-flight mechanism deeply ingrained in our DNA. In short, survival instincts kick in when bad news happens. For early humans hundreds of thousands of years ago, that would have been when we saw a lion walking toward our cave. Or, to use a more relevant and contemporary example, when we believe we see a recession lurking around the corner.

As professional investors, we know markets and bad news go hand-in-hand almost daily. That can be problematic, because bad news sells in our world too. It seems to us that society often props up the pessimist, and downright questions the sanity of any optimist. Therefore, it is necessary to dissect any news – both good and bad – in the world of investing. Perhaps equally important is that we understand how we can protect ourselves from our natural reaction to do something (such as make major changes to our portfolio) when

bad news is ever present (such as during market volatility). Here's the secret: we look at the evidence available to us, and we educate ourselves on the markets, history and current events.

Specifically, when it comes to bear markets – defined as a prolonged drop in stock prices of 20% or more – it's important to look at how they are tied to geopolitical risks, how often they occur and how severe they tend to be. In the U.S., we've had 12 bear markets over the last 66 years, which means we average a bear market once every five to seven years. However, in our opinion, it's important to distinguish between the type of bear market, and careful analysis suggests there are three different kinds: cyclical, structural and event-driven.

According to research from Goldman Sachs in 2022 that studied bear markets dating back to the 1800s, different types of bear markets produce different kinds of market downturns in terms of severity and duration. Here are some examples:

CYCLICAL BEAR MARKETS are associated with the normal fluctuation of the business cycle. If the economy gets too strong, the Federal Reserve will raise interest rates to keep prices in line, resulting in a lower outlook for growth. In this case, markets typically will sell off. These types of bear markets have average declines of 30% and will last an average of 25 months, with markets taking another 25 months to return to new highs, on average.

STRUCTURAL BEAR MARKETS are caused by a major bubble or significant imbalance in the economy. The 2008-09 bear market was the most recent example of this. Leading up to 2008, most of us remember that credit conditions were easy, and real estate was the home for excess dollars as borrowers and lenders gorged on residential real estate. These types of bear markets tend to see deeper selloffs as they correct a more systemic flaw in the markets. On average, structural bear markets see declines of 57% over a 42-month period. The frequency of these bears has been limited to just three instances since 1945, but the recovery from peak-to-trough is multiple years as a structural bear market takes longer to heal.

EVENT-DRIVEN BEAR MARKETS are idiosyncratic selloffs caused by a geopolitical event. These are semi-random quick shocks to our financial system, such as 9/11, the COVID-19 pandemic or Black Monday in 1987. Event-driven bear markets tend to unfold swiftly, and while the market falls 29% on average over eight months, it takes on average just 13 months from beginning to end to return to new highs.

We are evidence-based investors and know that most geopolitical events rarely create a material market selloff, and when they do, the markets recover quickly. We remain on guard against structural bear markets and manage risk closely to endure cyclical bear markets, but there is ample evidence that most headlines are here today and gone tomorrow, and the best course of action in the face of bad news is to stay the course with your long-term plan.

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By Matt Bushard
Senior Portfolio Manager, CFP®

New Year Financial Planning Tips

When it comes to financial planning, it can be useful to take some time to reflect on the prior year to celebrate your successes and critique any areas of struggle. With that information in hand, you can begin to evaluate and plan for the next 12 months. Here are some steps you can take to start the new year right.

Review your current budget or spending habits: Use an app or online banking to help categorize and understand your money habits. Are you spending too much in a given area? Could you be saving more? If you had a budget for 2023, look at whether it's still applicable or whether you need to adjust it moving forward.

Pay yourself first: If you received a pay raise at work at the end of the year, one of the easiest and most effective ways to increase your savings is to simultaneously increase your retirement contributions when your raise takes effect.

Increasing your contributions to your retirement 401(k) plan, health savings account or other long-term savings vehicle can be a great way to add to your savings without changing your current lifestyle. Out of sight, out of mind.

Max out your IRA contributions: How much did you contribute to your Traditional or Roth IRA plans in 2023? If you haven't contributed the maximum amount yet ($6,500, or $7,500 if you're 50 or older), look at what you need to do prior to the tax deadline, if you're eligible. Perhaps you can repurpose a bonus or tax refund to complete these contributions, depending on your situation.

Review your insurance coverage: Because of the impact of high inflation, it's important to review the coverage and premiums of your auto, home, life, disability and long-term care insurance to see if your policies remain appropriate for your financial situation. If it has been several years since you last reviewed your insurance, it may be a good idea to shop around and see if you can save any money on your premiums without reducing your coverage level.

Plan ahead: In addition to planning for 2024, it might also be a good idea to begin planning even further out, as the current tax environment is scheduled to sunset at the end of 2025. At that point, current tax brackets will revert back to levels that likely will result in higher taxes for most individuals. Are there things you can do now to take advantage of today's lower tax rates?

Along with those steps, other ways you can prepare for the coming year include:

- Review your investment allocation to make sure it continues to meet your timeline for accomplishing your goals and still aligns with your risk tolerance.
- Obtain a free copy of your credit report to ensure its accuracy.
- Review your tax situation, including your current withholdings on your paycheck, annual giving to charitable organizations, etc.
- Review the beneficiaries listed on your accounts and life insurance, and review your estate planning documents to ensure they continue to be accurate and up to date with your wishes. These designations and documents should be reviewed on a regular basis.

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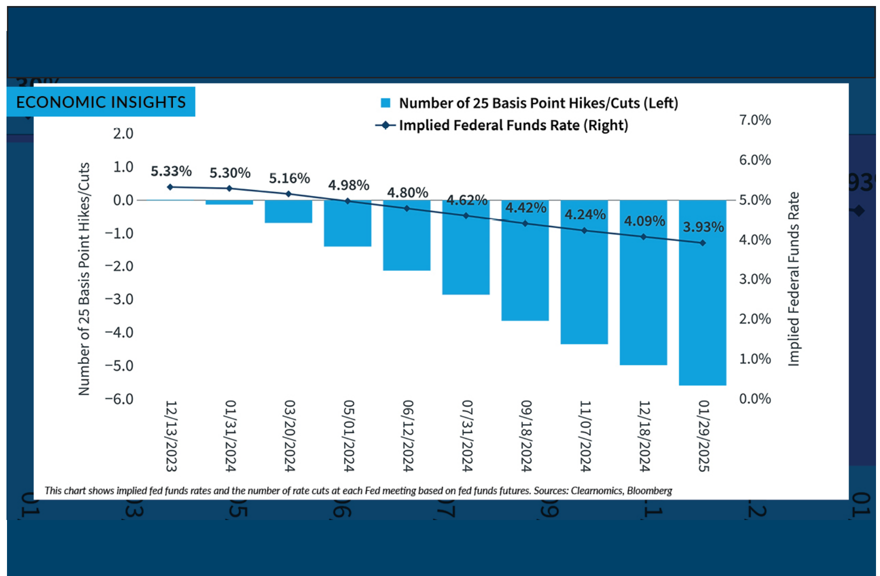
THE PROBABILITY OF FED RATE CUTS IS RISING

With improving inflation and signs of steady economic growth, the U.S. economy has made progress – but it's still too early to declare victory. While the Federal Reserve has held policy rates steady since its July meeting, rate cuts may be coming in 2024. Business owners and investors should look to the Fed's December and upcoming January meetings for clues to the future path of interest rates.



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