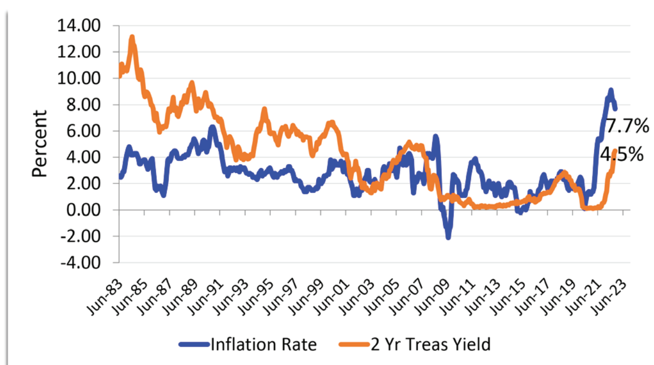
Bell Institutional

December 2022

Equity and Fixed Income Outlook

When What We Know Just Ain't So ...

Since the end of 2007, interest rates on the 2-year U.S. Treasury note have, most of the time, been lower than the annual rate of inflation. In economic vernacular, when interest rates are lower than the inflation rate, there is no real cost of money to borrowers (and no real return for savers). Following the financial crisis, the knock-on effect of this "free" money was excessive asset price growth in stocks, bonds and real estate – with the added benefit of cheap labor, cheap energy and cheap goods.



It appears that 15 years is enough time to lull us into believing things have always been this way – when in fact, they have not. For most of the time prior to 2007, interest rates were *higher* than the inflation rate. Borrowers experienced a real cost of money, and they had to think long and hard about incurring debt.

I don't know if patterns are returning to the days when there was an actual cost to borrow money, or if they will revert back to the more recent "free" money paradigm. What I do know is that the economy grew at about the same rate prior to the financial crisis, when there was a real (after inflation) cost to borrow money, as it has since the end of the crisis, when money became "free" in real terms.

Money is still essentially "free" in the sense that interest rates remain below the inflation rate. Even so, the absolute level of today's interest rates, compared to rates of the last 15 years, is discouraging borrowers.

It appears that 15 years is enough time to lull us into believing things have always been this way – when in fact, they have not.

Sales of houses and large-ticket items that often involve debt are slowing as consumers pull back on borrowing. Wherever interest rates may be headed, consumers eventually will acclimate and carry on in their ways.

We still believe there will be some form of recession in 2023. There has been a reluctance to declare the first two quarters of declining gross domestic product (GDP) this year a recession, even though GDP has been the primary determinant in the past. Our concern at this point is that the Federal Reserve has gone too far, too fast with its interest rate increases, with risks remaining too high for too long. More on this topic in January, when we will release our year in review and outlook for 2023.

In the meantime, inflation and elevated interest rates are a challenge for the economy and consumers along with stock, bond and real estate markets. We expect inflation to decline to about half its current level in the next 12 to 18 months. We also feel that inflation may settle in around the 3% range rather than the Fed's 2% target, suggesting that interest rates may not return to the unusually low levels of the recent past.

Greg Sweeney, CFA
SVP/Chief Investment Officer
Tenure: 09/1992
Years of Investment Experience: 37 years
Education: Greg holds a bachelor's degree in business from the University of North Dakota and is a CFA charter holder.

www.bell.bank Not FDIC insured | May lose value | Not financial institution guaranteed | Not a deposit | Not insured by any federal government agency 0-38290