



TOM SEAY, SENIOR MANAGING DIRECTOR, RESEARCH, CLEARSTEAD

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Administration and Private Client teams with Mitch Herringshaw, Bob Lavin, Kelsey Alletto, and Nico Cefaratti, respectively.

Mitch Herringshaw has joined Clearstead as Managing Director – Systems & Operations Integration. In this new role for the firm, Mitch will be responsible for acquisition due diligence, integration planning and execution, and related key initiatives. Mitch has a BA from John Carroll University and an MBA from Lake Erie College. Mitch comes to us from MAI Capital Management where he most recently worked as Director, Investment Operations Team Manager, and was focused on acquisition integration.

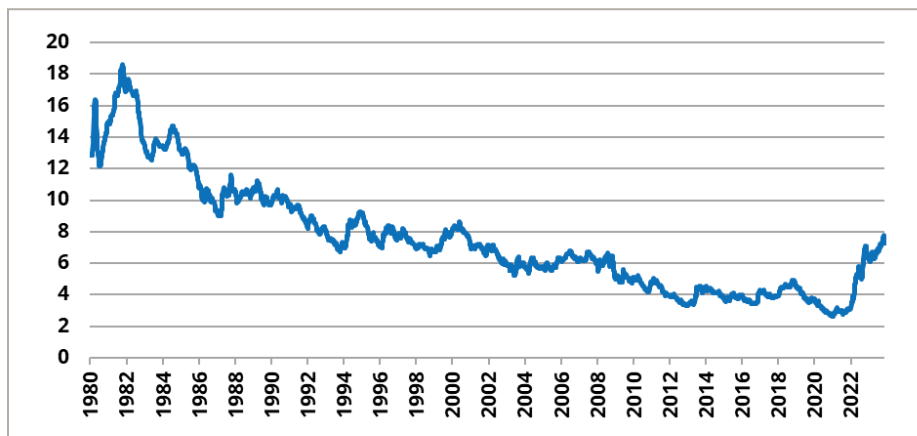
Bob Lavin has joined Clearstead as a Senior Compliance Associate. In this new role, Bob will work on our compliance processes and efficiencies for our growing firm. Bob has a BS from Bowling Green State University and an MBA from Cleveland State University. Bob has experience with increasing levels of responsibility in compliance with several Cleveland companies. He comes to us from MAI Capital Management where he worked as Director, Team Lead, Corporate Accounting, Client Treasury.

THE ROAD TO NORMAL THE RIDE COULD BE BUMPY

BY TOM SEAY, SENIOR MANAGING DIRECTOR, RESEARCH, CLEARSTEAD

Merriam-Webster states, “Something that is normal is usual and ordinary, and what people expect.” I believe what people “expect” is colored by one’s perspective. For example, today it is often stated that “high” interest rates are an obstruction for first time home buyers; but, as the following chart shows in the ‘80s and early-’90s getting a 7½%, 30-year, fixed rate mortgage would have been a bargain.

AVERAGE 30-YEAR FIXED MORTGAGE RATE



Source: fred.stlouisfed.org, as of 11/22/2023.

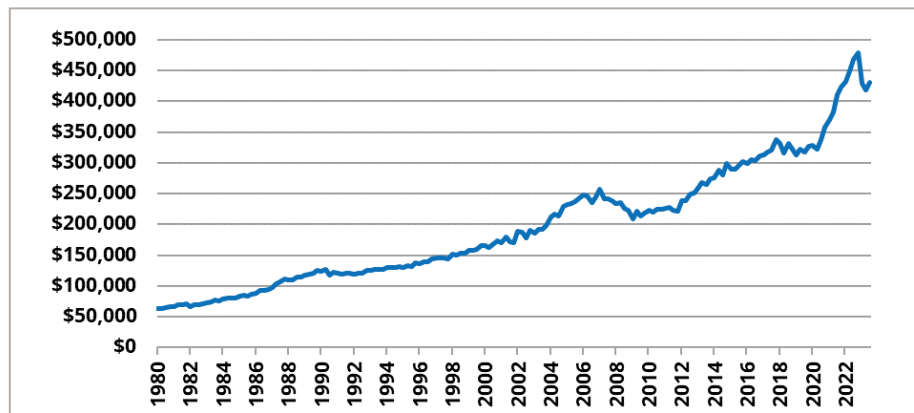
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What is high is not the cost of money, but the cost of a home. In 1990 the median sales price for new houses sold in the United States was ≈\$120,000 and today the median sales price is ≈\$431,000 (see the following chart).

MEDIAN HOME SALES PRICE



Source: fred.stlouis.org, as of 7/01/2023.

Today's first-time buyer in Ohio (assuming a 20% down payment of \$86,200) would have a monthly mortgage payment of ≈\$3,000 (including taxes & fees). In 1990, that same buyer, at the same 7½% mortgage rate, for their \$120,000 house would require a down payment of \$24,000 and would be saddled with only a \$831 monthly mortgage payment. The cost of money is not the impediment, it is the rising cost of a house (i.e., the inflationary impact) that is the obstruction for first time home buyers.

To focus on inflation is not just a theoretical exercise, but as Norman Lamont, former United Kingdom Chancellor of the Exchequer stated, "Inflation is a profound evil. It cheats savers, undermines living standards, promotes instability, labour unrest and undermines confidence. Inflation is the most important immediate problem we face. This is not to downplay growth, but we cannot have sustained growth without first getting on top of inflation."¹ As such, the Federal Reserve's monetary policy that has driven interest rates higher since the Spring of 2022, is not an attack on financial markets, but a desire to squelch the evils of inflation and allow the economy to grow at a sustained pace. The question financial markets are struggling with is what is the appropriate level of interest rates that not only slow the growth of inflation but also allow for sustained economic development. That is, what is the normal level of interest rates that balance inflationary pressures and economic growth?

INFLATION

The Federal Open Market Committee (FOMC) judges that inflation of 2 percent over the longer run, as measured by the annual change in the price index for personal consumption expenditures, is most consistent with the Federal Reserve's mandate for maximum employment and price stability. When households and businesses can reasonably expect inflation to remain low and stable, they are able to make sound decisions regarding saving, borrowing, and investment, which contributes to a well-functioning economy.²

Kelsey Alletto has joined Clearstead as a Senior FP&A Analyst. Kelsey has a BS from Ohio University, majoring in Finance and Entrepreneurship. She brings experience with several Cleveland companies where she has held roles of increasing responsibility in finance including financial planning and analysis, billing, and systems/data.

Nico Cefaratti has joined Clearstead as a Client Planning Associate. Nico has a BS in Finance with a focus on Accounting from John Carroll University. He was recently employed as a Tax Preparer at Anthony Rinaldi & Co.

These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

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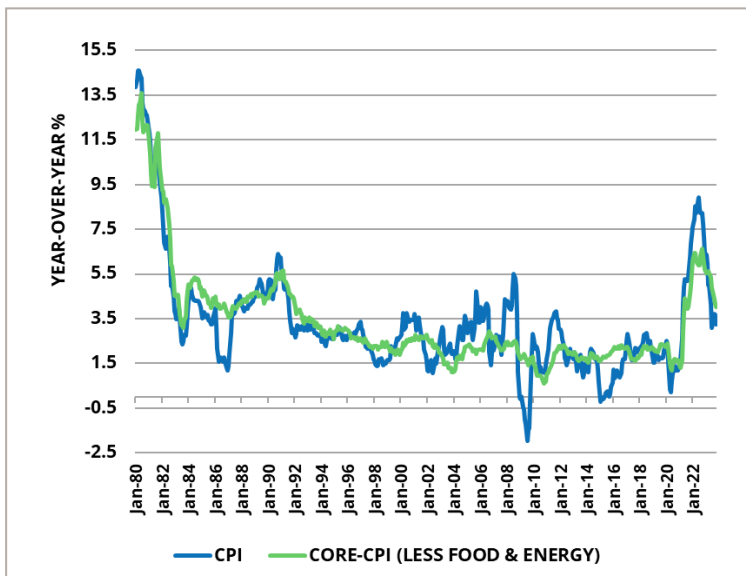
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The Fed has made it abundantly clear and repeated it often that 2% inflation is their goal. Prior to the COVID pandemic, inflation had remained low and stable for over a decade. But the implementation of aggressive monetary and fiscal policies to protect the economy from descending into a deep recession, or possibly a depression—alongside snarled supply chains—laid the foundation for the rapid inflation that followed. Although inflation has receded from the lofty levels following the end of the COVID pandemic and is trending lower, current inflation levels remain above the Fed’s 2% objective.

During the 1970’s, inflation surged to almost 15% prior to the Federal Reserve’s aggressive monetary policies that saw the Fed Funds rate peak at 20% in the early ‘80s and steadily decline for over thirty years to bottom at almost 0% in 2010. The average Fed Funds rate in the 1980s was 9.87%, 5.12% in the 90s, 2.98% in the 00s, and 1.00% post GFC (since 2008). So, what is the “normal” level of Fed Funds?³

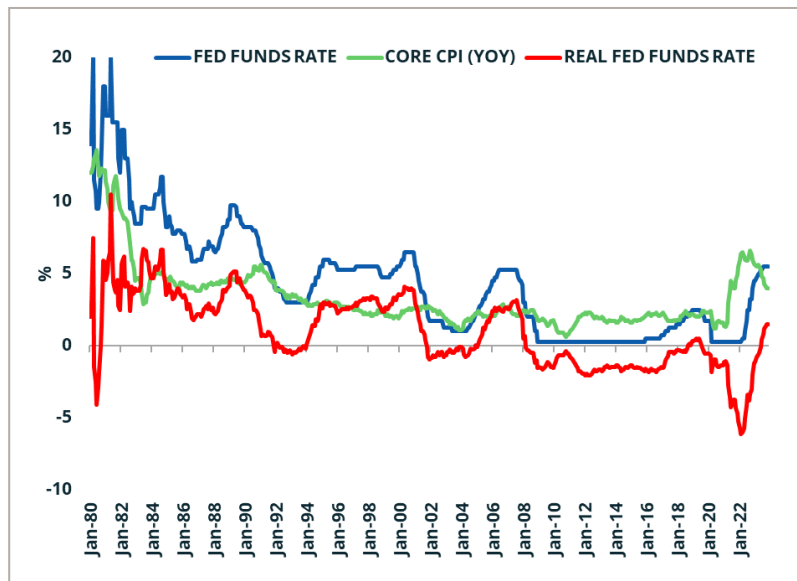
To try and determine normal, it might be instructive to see what the difference between the Fed Funds rate and inflation was during the period since 1980. First, instead of using the CPI index let us use Core CPI. "If we remove food and energy (the most volatile components in the price index), we get a smoother measure of inflation, often called core inflation. Focusing on core inflation gives us a better idea of the effects of monetary policy in the medium and long runs."⁴

U.S. INFLATION RATE



Source: fred.stlouis.org, as of 10/01/2023.

REAL FED FUNDS RATE



Source: Bloomberg LP, as of 10/31/2023.

Again, trying to determine normal is challenging. Nonetheless, from the mid-80s through the GFC, the real Fed Funds rate stayed in a range between zero and 5%. But the period following the GFC was abnormal and greatly influenced by central banks adopting policies like quantitative easing, with several central banks having a dalliance with negative interest rates. The central banks knew such policies were not sustainable and to extricate themselves from such activities would be difficult. But the Fed’s appears resolute to return to a positive real Fed Funds rate environment.

INTEREST RATES

Not surprisingly, the path of 10-year U.S. Treasury bond yields looks remarkably similar to that of inflation; that is, as inflation declined from 1981, so did 10-year bond yields.

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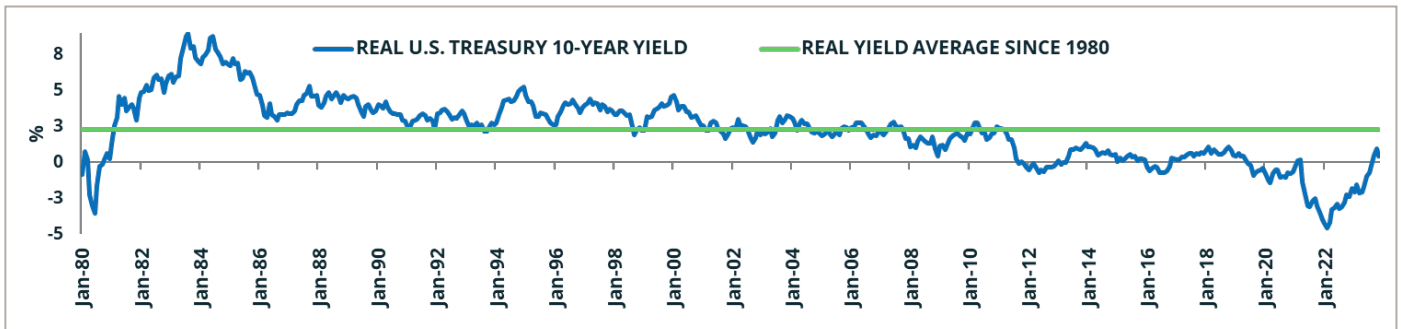
U.S. TREASURY 10-YEAR YIELD



Source: Bloomberg LP, as of 10/31/2023.

Let us repeat the process above and observe the difference between the 10-year U.S. Treasury yield and core inflation (i.e., real yield) during the period since 1980.

U.S. TREASURY REAL YIELD

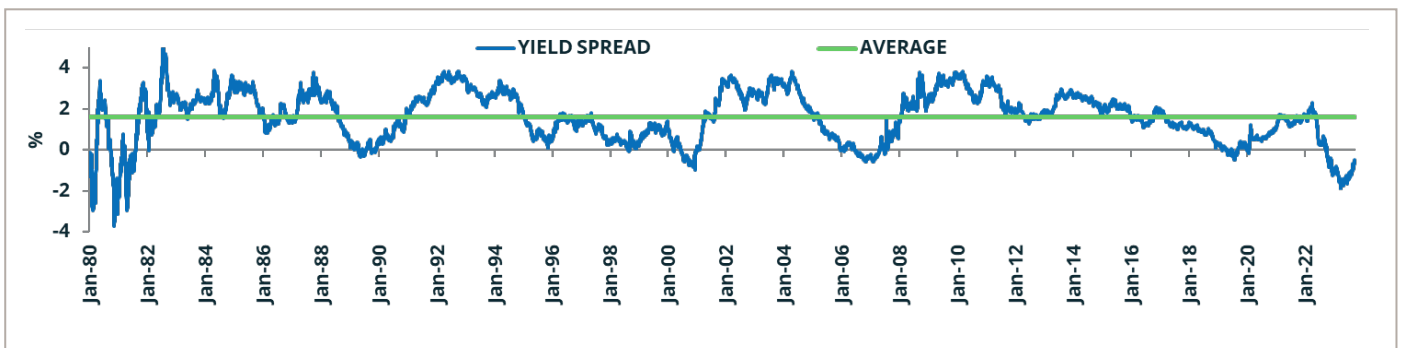


Source: Bloomberg LP, as of 10/31/2023.

At the risk of being repetitious, trying to determine normal is challenging, but we can again observe that the period since 2010 is again abnormal. In fact, in those periods when real bond yields were negative (i.e., below zero in the chart), even when factoring in the interest rate paid by the bond, a negative-yielding bond means the investor lost money at maturity.

Another anomaly we are currently facing is an inverted yield curve, where longer-term U.S. Treasury bonds have a lower yield than short-term U.S. Treasury securities. Typically, the yield curve slopes upward as maturities increase since investors require a higher yield as compensation for the risk of holding a bond for longer. But the yield on three-month U.S. Treasury Bills has been above that for ten-year notes since late October 2022.⁵

U.S.T. 10 YR - U.S.T. 3 MON T-BILL YIELD SPREAD



Source: Bloomberg LP, as of 10/31/2023.

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Although the 10 Year - 3 Month relationship is in constant flux, what can be observed is that the long-term average spread of +160 basis points is significantly at odds from today's -53 basis points. Interestingly, the factors controlling each point on the curve are different, but each informs the other.

Short-term rates are significantly driven by the actions of the Federal Reserve. For example, since March 2022, the Fed has raised its federal funds benchmark rate from 0.25% to 5.50%. Over that same period, three-month T-Bill yields rose over 500 basis points while ten-yields rose 300+ basis points. Ten-year yields, on a day-to-day basis, are more influenced by financial market activities as bond speculators attempt to position their portfolios to benefit from changes in economic activity and what they believe will be the actions of the Fed. In that lending rates are based on the current level of market rates (e.g., 30-year mortgages rates are priced off 10-year U.S. Treasury yields) the Fed will attempt to influence longer-term rates in an effort to influence both consumer and corporate borrowing activity. This ongoing interplay between the Fed and the financial markets is complicated, but historical analysis can inform us of possible outcomes and how to best position investment portfolios.

I have thrown quite a bit of data out there, so let's see if we can link it all together to make some final observations.

	Current	Goal or Average	Distance from Goal or Average
Core CPI	4.00%	2.00%	2.00%
Real Fed Funds Rate	1.50%	1.00%	0.50%
Real U.S.T. 10-Year Yield	0.33%	2.27%	-1.84%
U.S.T. 10 Yr. - 3 Mon Spread	-1.06%	1.60%	-2.13%

Source: Bloomberg, Clearstead, as of 11/30/2023.

1. If the Fed's goal is to stabilize inflation at 2%, it still has work to be done.
2. Assuming inflation is trending down to 2%, in that the real Fed funds rate is above its long-term average, the Fed funds rate may have peaked at current levels.
3. With the U.S.T. 10-year yielding 4.33% as of November 30, 2023, at the current 4% core CPI, 10-year yield looks over valued.
4. If the Fed is successful in slowing inflation down to 2%, the 10-year yield has little room to decline. (Current 4.33% vs. future at 2% inflation plus long-term average of 2.27% = 4.27%.)
5. The short-end of the yield curve—two-to-five-year securities, not money market securities—could be a good place to invest. Short-term securities tend to march in lock step with the Fed, as current yields are higher than 10+ year yields and they are much less volatile than long-term bonds.

One often hears the term "higher-for-longer" these days, meaning that interest rates will stay at current levels for the near future. We are inclined to agree with the meaning of the phrase, but from my perspective (as an investment veteran) it is not "higher for longer" but "back to normal" regarding the investment environment we will travel in the future.

Sources:

- (1) Lord Lamont of Lerwick, <https://www.politicshome.com/thehouse/article/inflation-profound-evil-getting-control-vital#:~:text=Inflation%20is%20a%20profound%20evil,getting%20>
- (2) https://www.federalreserve.gov/faqs/economy_14400.htm
- (3) Bloomberg, Clearstead
- (4) <https://www.stlouisfed.org/on-the-economy/2014/may/why-inflation-matters-in-setting-monetary-policy#:~:text=If%20we%20remove%20food%20and,the%20medium%20and%20long%20runs>
- (5) Bloomberg LP

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Performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented.

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MARKET BENCHMARK RETURNS

November 30, 2023		1M	3M	12M	YTD
US Large Cap	S&P 500	9.1%	1.7%	13.8%	20.8%
US Small Cap	Russell 2000	9.1%	-4.4%	-2.6%	4.2%
Developed Intl	MSCI EAFE	9.3%	1.3%	12.4%	12.3%
Emerging Intl	MSCI Em Mkt	8.0%	1.1%	4.2%	5.7%
Real Estate	NAREIT	11.9%	0.5%	-2.8%	2.4%
Core Fixed	BarCap Agg	4.5%	0.3%	1.2%	1.6%
Short Fixed	BarCap 1-3Yr	1.2%	1.4%	3.6%	3.4%
Long Fixed	BarCap LT G/C	9.9%	-1.6%	-2.1%	-0.7%
Corp Debt	BarCap Corp	5.7%	1.1%	3.4%	3.8%

Source: Bloomberg

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