INVESTMENT INSIGHTS

THIRD QUARTER 2023

Picture by Black Diamond President, Matt Goette
Park City, Utah

MARKET UPDATE

Strong Economy Pushes Fed Rate Estimates Higher

Market Concern Grows Over Higher Interest Rate Predictions

The Fed surprised financial markets by meaningfully increasing interest rate expectations during its September press conference. A solid economic outlook, continued low unemployment and sustained wage growth have made it difficult for the Fed to declare victory over inflation, the Fed's top priority.

Fed Chair Jerome Powell believes an extended period of below-average growth and a weakening job market is needed to control inflation. This means higher rates will likely last longer than previously expected. The Fed now predicts just two 0.25% cuts in 2024 versus four predicted prior to the September meeting. Additionally, the Fed signaled that another rate hike may be needed this year.

Financial markets recoiled as the Fed announced its plain to maintain heighted interest rates for an extended period. The S&P 500 declined 3.5% and intermediate-term bonds were down 1.4% (as interest rates rise, bond values fall) during the last ten days of the quarter. Short-term Treasuries continued to outperform this quarter by gaining 1.3% with minimal risk. The silver lining of higher interest rates is that fixed income investors can achieve meaningful returns given attractive current bond yields.

Fed rate predictions can change quickly depending on the latest economic data. The Fed will inevitably be successful in moderating inflation. The primary question most investors are asking is how much must economic growth slow for inflation to reach the Fed's 2% target? The market currently expects double-digit corporate earnings growth in 2024 and 2025. However, higher interest costs may dampen near-term earnings expectations and create a headwind for stock market appreciation. Despite this near-term headwind, stocks remain an attractive asset class to build long-term wealth in a tax efficient way.

Comparative Returns

			Annualized Performance			
	Q3 2023	YTD	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks[1]	(3.3%)	13.1%	21.6%	10.2%	9.9%	11.9%
Small Cap U.S. Stocks[2]	(5.1%)	2.5%	8.9%	7.2%	2.4%	6.7%
International Stocks[3]	(3.8%)	5.3%	20.4%	3.7%	2.6%	3.4%
Real Estate[4]	(7.3%)	(2.9%)	1.9%	4.5%	1.6%	4.7%
U.S. Bonds[5]	(3.2%)	(1.2%)	0.6%	(5.2%)	0.1%	1.1%

1 S&P 500 index. 2 Russell 2000. 3 MSCI ACWI ex-U.S. index. 4 MSCI U.S. REIT index. 5 Bloomberg Barclays Aggregate Bond index.

Fed Strives for Soft Landing

The Fed's goal in raising interest rates is to tame persistent inflation while maintaining positive economic growth and to orchestrate a "soft landing". The Fed's record of avoiding a recession in a rising rate environment is mixed. Since 1965, about half of the time when the Fed raised rates to tame inflation, a recession ensued.

The Fed's job is challenging. Its members admit that it is impossible to predict the time it takes for policy changes to be fully reflected in the economy. The full impact of rate changes can take 12 months or more. Historically, the Fed has raised rates at a moderate pace, but then dropped them quickly as economic conditions deteriorated. The Fed's current forecast calls for the most gradual rate decline in history, lasting through 2026. The path of rates will likely differ significantly from the Fed's forecast as the Fed reacts to new economic data.

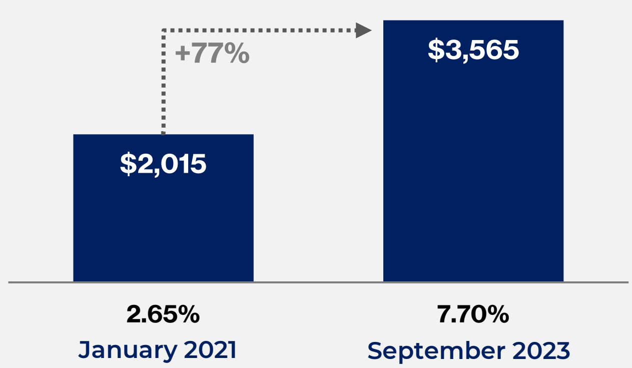
Federal Funds Target Rate Forecast Remains in Question

Source: FRED Economic Data (rates), Federal Reserve (forecast).

Rising Mortgage Rates Lower Home Sales

This quarter, 30-year mortgage rates hit a 23-year high of 7.7%. This is almost triple the 2.65% average mortgage rate in January 2021. This increase represents the most significant jump in mortgage rates since the late 1970s. Higher mortgage rates have caused monthly payments for 30-year mortgages to rise by 77%, which equates to over $310 more per month for every $100,000 borrowed. Higher mortgage payments have lowered buyer demand such that existing home sales are expected to be 4.1 million in 2023, an 18% decrease from 2022 and the lowest level since 2008, according to Zillow.

Monthly Mortgage Payments Jump by 77%



Note: Monthly payments shown for $500,000 borrowed with 30-year mortgage.
Source: Black Diamond Financial.

The housing market is also being negatively impacted by lower supply. Homeowners who locked-in low fixed mortgage rates are now fitted with "golden handcuffs" and are reluctant to sell. Homeowners are discouraged from selling their home and buying another because this would mean giving up a low mortgage rate and making larger monthly payments. This lack of supply has buoyed home prices and negated some of the Fed's ability to fight inflation with higher rates.

BlackDiamond Financial

ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment adviser with a unique and holistic focus on preserving and enhancing wealth. Our mission is to help you achieve your financial goals through the use of low cost, tax-efficient investment strategies. We create individualized investment portfolios for each client that are risk-appropriate, return optimized, and tax-efficient. Where appropriate, we incorporate institutional quality private investments to capture illiquidity premiums or yield opportunities. Furthermore, we believe cost is a critical factor in any successful investment strategy and therefore offer fully transparent pricing that is below industry standard. As an employee-owned firm focused on our fiduciary duty, we make our clients' interests our highest priority.

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