GODSEY & GIBB
WEALTH MANAGEMENT

OCTOBER 4, 2023 STATE OF THE ECONOMY CALL – Q&A RESPONSE

Thank you again to everyone that participated in our call on October 4, 2023, and to those who have watched the recording on our website. We received several questions during the call that we did not have time to address. Below are the questions and responses. If you have any additional questions, please reach out to your Wealth Management Advisor and we will address them individually.

State of the Economy Call Questions:

1. **What is reinvestment risk and how does it relate to the fixed income allocation?**

   To start with, there was a typo in our original slides and presentation that may have caused confusion. This has been fixed in the video recording and newly updated slides. The sixth bullet point on Slide 2 had read as: "The fixed income market should provide solid returns and our focus is on non-reinvestment risk." This should have instead read as: "The fixed income market should provide solid returns and our focus is on reinvestment risk."

   Reinvestment risk is a concern when interest rates are near a peak. This occurs when interest rates fall over time and investors must put the proceeds of a bond's maturity in a new lower-yielding bond. Reinvestment risk is also higher when the time horizon to maturity is shorter. Today, with the yield curve inverted (short-maturity bonds provide higher yields than longer maturity bonds), investors may be tempted to buy short-term bonds and maximize the yield. However, it is possible that when the bond matures, prevailing yields will be lower than today, and therefore income and potential return will be lower.

   Currently, you can purchase a 12-month Treasury bond with a yield of 5.4% and a 5-year Treasury note with a yield of 4.6%. Even though we believe that the Federal Reserve (Fed) will keep rates higher for longer, market interest rates tend to move ahead of actual Fed changes, and it is likely that market interest rates will be lower next year. Therefore, we are focused on locking in the higher rates for a longer time. This had led to extending maturity range on our bond ladder to include bonds maturing through 2028.

   As a side note, we are buying high quality corporate bonds in the fixed income allocation, and they provide additional yield above those used in the example above.

2. **Are the high money market interest rates causing people to rely less on the stock market for investing?**

   For the first time since before the Great Financial Crisis, investors are earning attractive yields on cash and other fixed income securities. This has caused investors to reduce equity holdings in favor of cash and/or bonds. This shift may be appropriate for investors that need access to funds over the near-term and do not want to leave it in the market. However, cash is not a good long-term investment strategy, as both longer-maturity bonds and equities provide better return prospects over longer time periods.

Given the improved outlook for fixed income returns, it is a good time for investors to review their long-term investing goals to be sure that your portfolio is aligned with these goals as well as your risk tolerance.

3. **What do you think the impact of student loan repayments resuming will have on the economy?**

There has been significant discussion on the potential impact of the resumption of student loan payments, but it is a little too early to fully understand how it might affect consumer spending. Each borrower's situation is different both in terms of size of the debt payment, level of income, and willingness to make payments. We do know that some borrowers began to make student loan payments over the summer ahead of the official start date, which may suggest that at least a portion of them are able to manage the payments.

There are approximately 27 million student loan borrowers that are affected by the return to payments. For about half of those borrowers, the monthly payment will be below $200 a month, but 25% of borrowers will see a monthly payment of more than $500. The borrowers with the largest debt payments tend to be older, with 60% coming from the Silent or Baby Boomer generation, and only 25% coming from Millennial or Gen Z generations.*

The real question is what these borrowers have done during this moratorium, to improve or add to their overall debt. Many student loan borrowers added to credit card debt, auto loans, or moved into more expensive rental properties or homes. Those additional obligations may make it harder for them to service the student loan debt and maintain current spending levels on goods and services.

Borrowers who do not make payments will not be considered delinquent or be reported to credit agencies through September 2024. They will be subject to interest accruals. The Biden Administration has also raised the income threshold on monthly payments to reduce the burden on lower income borrowers. These two factors could significantly offset the potential drag on spending as the payments begin.

*The data on student loans comes from the TransUnion US consumer credit database.

4. **In looking at the Job Openings and Labor Turnover (JOLTS) report, you highlighted the number of people leaving their jobs. Why are they leaving their jobs?**

When the labor market is strong and jobs are plentiful, workers may look to switch jobs for any number of reasons, including better working conditions, different hours, advancement opportunities and/or higher pay. Workers are less likely to make a change when the labor market is weak for fear of ending up in worse circumstances or unemployed.

We look at the level of job quits as a measure of worker confidence, and while it is down from the peaks, it still indicates that most people feel comfortable switching jobs or just leaving their current position.

Wages have been rising since early in 2021 across all categories, but wages for people switching jobs have risen faster. The most recent data in the Atlanta Federal Reserve Bank's Wage Growth Tracker shows that overall wages are up 6.0% year-over-year. Wages for job switchers are up 6.8%, while people staying in their current position have seen their wages rise 5.5% year-over-year. At the peak in March of this year, overall wages were up 6.4% while job switchers gained 7.7% and job stayers gained 5.7% year-over-year.

5. **How does the upcoming presidential election impact the market?**

   Historically, election cycles have had an impact on equity markets, especially when have a Presidential election. This impact comes from investor uncertainty about the direction of the country given the range of outcomes. In a mid-term election, the uncertainty is only related to the makeup of Congress. When you add the Presidential election, the control of the government could potentially shift, which can shift policy priorities. Typically, the market does not focus on the election until early summer of the election year. Equity markets tend to become more volatile, and it is not uncommon to see the market selloff in the months leading up to the election. The market impact can be different across market sectors based on the perceived benefit or the negative impact of future policy. As the outcome of the election becomes more certain or is decided, equity markets tend to rally, no matter the outcome. The fourth quarter of a Presidential election year typically provides an equity market rally.

   With the country evenly split, it is not likely that either party can gain enough of an advantage to significantly change policy in a manner that would alter this historical relationship.

6. **What are the impacts of the failures and store closings in the traditional retail sector?**

   Retail spending has been growing at mid-single digit levels for the last 12 years and makes up about 5.7% of U.S. GDP. That growth is expected to continue with total retail sales increasing by more than 12% over the next 3 years to $7.9 trillion. Despite this growth, the number of retail stores has declined, and some well-known retail chains have failed. The retail sector is in the midst of a significant transition driven by changing consumer preferences and after years of overbuilding. The Covid pandemic just sped up these changes.

Globally, per capital retail space averages 23.5 square feet per person, while in the U.S., we have 54.3 square feet per person (data as of 2018). That is down from 56.5 per capita in 2009. This highlights that in the U.S., there were not only more stores, but the stores tended to be larger. As consumer preferences for shopping changed, there was no longer a need for the same amount of retail space, which led to stores closings.

The growth of e-commerce spending also changed the need for a large brick and mortar presence. As of the end of 2022, e-commerce sales made up 13% of total retail sales, up from 5.5% in 2012. We expect that number to continue to grow over time. However, there will always be a place for traditional shopping and traditional retail. Expectations are that in-store sales will fall to around 72% of all sales over the next few years. Surveys show that consumers still enjoy a personalized in-store experience and 76% prefer to do holiday shopping in person. A sizable number of shoppers begin the process by researching on-line before going to a store.**

To be successful in this environment, retailers need to understand these consumer preferences and adjust their business models to better accommodate on-line search, on-line orders, and the ability to pick up in stores. This is in addition to resizing their physical store footprints to match today's dynamics. Most large retailers have closed stores across the county, and for the most part, the retailers that failed did not adapt to these changing consumer preferences. We expect that traditional retailers will continue to face headwinds even as retail sales increase.

This retail transition has also negatively impacted the commercial real estate market. The failure of large, big-box retailers has led to vacancies in strip malls that can be difficult to fill given the size of the space. Real estate developers and mall owners have had to look to non-traditional sources to lease space. Many traditional malls have added more experiences versus stores, and some are converting to mixed-use properties with commercial office space and residential housing.

The retail sector is transitioning to a new model, but the need for traditional retail outlets is not going away completely.

**All data on retail sales and stores comes from Statistica