

**A DOUBLE
ISSUE REPORT**

Raymond F. Saleeby, Jr
President

Saleeby & Associates, Inc.

Where Trust And Confidence Are Paramount™

Economic Update

The U.S. stock market had its worst year since 2008 and the global markets were bad as well. “Global stocks and bonds lost more than \$30tn in 2022 as inflation, interest rates and war in Ukraine triggered the heaviest losses in asset markets since the global financial crisis.”¹ “The broad MSCI All-World index of developed and emerging market equities ended the trading year down nearly a fifth in value, the biggest decline since 2008, with bourses from Wall Street to Shanghai and Frankfurt all notching up significant falls.”¹ I believe the main cause stems from the rapid increase in inflation. At one point during 2022 the inflation rate was 9.1% annual rate which is the highest level in 40 years. In late 2021, the Federal Reserve had to recognize that inflation was not just transitory but might be sustained unless they reacted quickly. Because they were late to react, they had to rapidly increase interest rates. In February 2022, Russia invaded Ukraine which accelerated inflation and compounded their problem.



I believe the housing sector was hit hardest when mortgage rates went from approximately 3% to 7% throughout the year. “One of the most rate-sensitive sectors -housing- is stumbling amid high mortgage rates. Residential investment declined throughout last year, while existing-home sales fell almost 18% in 2022 from the previous year.”² This put a damper on housing affordability. Plus, many people who were fortunate to lock in a 3% mortgage will think twice before financing a new home at 7%. In my opinion, housing has never fully recovered from the 2008-2009 housing crisis. What is different now is that private equity, hedge funds and corporate America dramatically increased their ownership in housing. We need at least 5 million homes built, but there is a shortage of labor, inventory, capital, and confidence in constructing these homes. In addition, interest rates hikes have certainly postponed many initial builds and purchases of new houses.



However, unaffordable housing has significantly increased rentals over the last couple of years which has added to the 2022 inflation problem. “Perhaps the most striking shift is the age of new homebuyers. The median age of someone purchasing their first home in 1981 was 29. Over the next 30 years that figure barely crept up, rising to just 30 in 2010. But in the past decade, the median age has ticked up even higher, reaching a record of 36 last year.”³ “Rental costs in the US are soaring at the fastest pace in more than three decades, surpassing a median of \$2,000 a month for the first time ever and pushing rents above pre-pandemic levels in most major

cities. Increases are particularly steep in metropolitan areas that saw large influxes of new residents during the pandemic, but the rental market is sparing almost nowhere and no one.”⁴ While communities want to increase apartment inventory to fulfill this demand, rates are stifling development.

Economic Update (Continued)



Higher interest rates have also affected the commercial property sector. “Before the pandemic, 95% of offices were occupied. Today that number is closer to 47%. Employees' not returning to downtown offices has had a domino effect: Less foot traffic, less public-transit use, and more shuttered businesses have caused many downtowns to feel more like ghost towns. Even 2 1/2 years later, most city downtowns aren't back to where they were prepandemic.”⁵ Activity in the commercial sector has decreased, particularly in office buildings. Right now, many people in bigger cities like New York or Los Angeles are hesitant to return to work in these office buildings. “And while city planners are reimagining downtowns, the impact on cities'

bottom lines has been devastating; in New York, for instance, the value of commercial real estate declined by 45% in 2020, and research suggests it will remain 39% below prepandemic levels.”⁵

I believe office buildings that have done the best are newer with more amenities. Thus far, many of those are achieving record high rents. However, many older commercial buildings (B&C Properties) are having major problems. In some areas 40%-50% or more are empty with low rental income. These buildings are in dire need of improvements (technology, windows, plumbing, amenities, and other upgrades) to attract people to return. But in many cases, developers are postponing or eliminating plans for development due to interest rates. So we are seeing two different sides of the commercial office building market. I believe once the economy is stronger, and rates are lower, many of these B&C commercial properties will be converted into residential housing to fulfill demand. “Not unlike how deindustrialization led to abandoned factories and warehouses, the pandemic has led downtowns into a new period of transition. In the 1920s factories were replaced by gleaming commercial high-rises occupied by white-collar workers, but it's not clear yet what today's empty skyscrapers will become. What is clear is that an office-centric downtown is soon to be a thing of the past. With demand for housing in cities skyrocketing, the most obvious next step would be to turn empty offices into apartments and condos. But the push to convert underutilized office space into housing has been sluggish.”⁵



Affordable housing for middle to low-income areas is also needed due to high inflation and lower wages. The Fed, state and local governments must intervene by subsidizing rent and/or providing other subsidies to help middle to low-income workers live close to their jobs rather than in the suburbs. Even though there are some bright spots in real estate (apartments, cell towers, some warehouses, and data centers) there is major trouble in many commercial real estate assets.

Inflation Challenges



In 2022, many experts and investors were surprised that full employment was sustained in the United States. This was despite the economic slowdown and considerably higher interest rates. Many experts thought 2022 would be the year of recession and increased layoffs. This was partially true with some layoffs in the tech industry but there was no recession. Now many experts are predicting a recession in 2023 but who knows whether they will be right or wrong. It is very difficult to gauge but rarely does one see a recession with full employment. We have seen many people shift their wants and needs from goods to services now that Covid is becoming less of an issue.

This has caused higher inflation rates for the service industry. Once again, people are traveling, eating out at restaurants, looking for experiences... but there is a shortages of workers in many of these areas due to the Covid crisis. In many cases these jobs do not pay a lot and/or are unwanted jobs. To compensate for this short-fall, employers must increase wages which in turn increases inflation. Overall, when one tries to predict the economy on a short-term basis it is very much like trying to predict the stock market... I have never seen it done consistently and never will.

In the fourth quarter of 2022, we began to see a reduction in the inflation rate thanks to the Federal Reserve restricting credit. However, I believe the Federal Reserve will raise rates a couple more times because they want to have inflation viewed as a past problem rather than a future problem. Sometimes this inflation mindset is hard to break so they want to make sure they raise rates enough to break it. However, they risk the economy going into a moderate to severe recession. Many believe the Federal Reserve will not be able to engineer a soft landing or a mild recession. Part of the problem stems from the fact that the Federal Reserve is targeting 2% inflation. This target, I believe, is unrealistic for many reasons. We have had around 2% inflation for 25+ years however we are living in different times. I do not believe they will be able to achieve this 2% rate in the short-term without a severe recession. I think there is a good chance in 2023 that we will have interest rates remain stable and relatively high. But most investors believe otherwise and if rates go down due to their prediction, we might have a recession.

There are many factors in which I believe inflation is partially engrained in our system and the 2% long-term inflation rate is unachievable.

1. Deglobalization — Bringing more factories along with skilled and unskilled labor back into our country is inflationary. Over the next several years, I believe 3-4% inflation rate would be more likely because of deglobalization and other factors which are happening throughout the world.
2. Demographics and Poor Immigration Policy — Many people, especially ages 55-65, have decided to retire rather than experience Covid at work. Odds are they will not return to the workforce. Our population is getting older, and we need the youth, immigration reform, and productive older people to support our economy.

Inflation Challenges (Continued)

3. China's Low-Cost Labor Ending — Over the past 25 years there has been approximately 400 million Chinese that have gone from poverty to middle class. They are no longer willing to work for cheap wages and there are no other countries as well suited to fill the void. India might be the only possibility but due to the horrible infrastructure and politics, I do not believe it is possible. Instead, one of the biggest opportunities may lie with Mexico, east Asia and Vietnam. "The Mexican government says more than 400 companies currently have shown interest in moving production from Asia to Mexico."⁶
4. Covid Policy Changes in China — Recently we have seen some of China's Covid policies come under fire. Unfortunately, they did not want to use western vaccines. I believe they have tried to reverse engineer them with limited success. "Chinese officials estimate about 250mn people, or 18 per cent of the population were infected with Covid-19 in the first 20 days of December, as Beijing dismantled restrictions that contains the disease for almost three years."⁷ China's policy to lock down Covid patients hurt their economy and its citizens are rebelling. Consequently, they have changed their policy to become more open, which I believe has led their stock market to rally due to the potential increased economic activity both there and abroad.
5. Higher Commodity Prices — When China recovers, I believe it will put more emphasis on commodities, in particular oil. China is not particularly rich in natural reserves so they must import more oil and natural gas. This may lead to increased commodity prices since the U.S. is competing for these scarce resources. I believe that it will drive prices higher over time thereby causing inflation.
6. Domestic Wage Pressure — When the U.S. economy has full employment and people feel shortchanged by inflation, they are more likely to ask for wage increases. This could lead to a spiraling effect. Layoffs may be the only answer to squash wage inflation.
7. Generation Work Ethic — Recently Bernie Marcus, Home Depot's cofounder, admitted "he does not want the 'woke generation' leading business because of their 'laziness'".⁸ "Marcus said that the reason that people didn't want to work is that "they're entitled, they're given everything," adding that government unemployment benefits were pushing people to stay at home."⁸ "So you get this laziness ... and it's basically a socialistic society," he said. Marcus also said that people wanted to work "three days a week," possibly referring to the growth in demand for flexible working during the pandemic, as well as the recent push for a four-day workweek."⁸
8. Supply Change Repositioning — We are still experiencing supply chain issues in many industries which leads to reformulating logistics, manufacturing, mining... These are gradually getting better but result in higher manufacturing and consumption costs which leads to increased inflation. In addition, there are a lot of international conflicts escalating supply chain issues. International peace is very important for companies and countries to control costs through stable, long-term supply chains. We cannot count on another technology revolution (like in 1995-2005) for great productive enhancements to keep prices lower. If it happens, great, but its yet to be realized. But some promising techs developments that could make a difference are AI, gene development, robotics, etc.

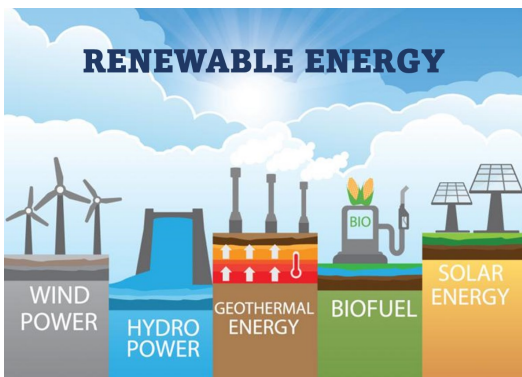
Energy Sector

The top performing sector in the stock market in 2022 was energy. I believe this sector got a big boost when Russia invaded Ukraine. However, sadly we are still playing catch up to act on these supply and demand imbalances. We now realize how fragile the energy market is when the smallest imbalance between supply and demand can cause great volatility, political fighting, disruptions, wars... I feel our country must wean itself from this energy exposure along with the rest of the world. Russia's aggressiveness adds another reason for our energy independence. I believe one of President Biden's greatest successes is the Inflation Reduction Act (IRA). I believe it is the wrong title with the right message. It is a bill to increase usage of clean energy and fuel. In addition, it will be good for high paying jobs, the environment, less reliance on foreign energy... However, I do not agree with his position against fossil fuels.



The 2022 Inflation Reduction Act

Green Energy Benefits!



I believe that the trillions of dollars spent on renewable energy over the last decade has only dropped overall usage of fossil fuel by a couple percent. While the Inflation Reduction Act is a step in the right direction, we must realize that electric cars, solar, and wind are only part of the solution. These renewable energies rely heavily upon hostile entities like China to source and process materials necessary to use these energies and we do not have the best relationship with them. In fact, most solar panels are made in China and other Asian countries along with processing rare earth metals which are vital for electricity. "Chinese companies have been setting up plants in Southeast Asia, which accounts for roughly 80% of U.S. solar-panel imports."⁹

I believe the real long-term solution lies with hydrogen which will be decades out to have a meaningful impact. "When hydrogen burns, the combustion product is simply water. When a fossil fuel burns, by contrast, the combustion products are water and carbon dioxide. Thus, hydrogen enables the use of energy without the addition of more carbon dioxide to the atmosphere"¹⁰ "However, it matters how the hydrogen is produced. You may have heard of grey, blue, or green hydrogen. That just refers to the process of producing the hydrogen. If hydrogen is produced from fossil fuels, carbon dioxide is still a byproduct, even though the hydrogen is burned cleanly. But there are ways to produce hydrogen without meaningful carbon byproducts. That is so-called "green hydrogen", and that is what the utilities are interested in using".¹⁰ Blue hydrogen which is made from natural gas will be a viable option as the costs go down and becomes more efficient.



Many people do not understand that it may take decades for renewable products to help our energy transition. Nor do they understand the cost and ramifications to our standard of living and wealth of the country. In other words, we need to encourage clean energy research and subsidize it accordingly. At the same time, we need to stop bashing the existing fossil fuel and infrastructure companies and realize we are in a transitory situation that will take decades to wean ourselves off of. So, there is certainly room for improvement in both areas. And these are vital for our great wealth and sovereignty and our country's bright future.

Conclusion

In conclusion, the U.S. economy grew at a 2.9% rate in the fourth quarter which is down slightly from the 3.2% in the third quarter. It was a slow quarter, but I believe it was much stronger than most investors and forecasters thought. I believe most corporate profit margins last year were at an all-time high however inflation will certainly impact those high margins going forward. In fact, I believe that in the 1950-1960s the profit margin of corporate America was about half of what it is now. But they are likely to go down along with earnings. How much? Nobody knows. In addition, corporations will have to deal with a higher interest rate environment thereby affecting capital spending, expansions, takeovers, restructuring, stock buybacks... One can see there are many headwinds when inflation gets out of control and forces the Federal Reserve to raise interest rates. We don't know the repercussions yet, nor the impact on our economy or the stock market.

Thus far, the stock market and bond market are off to a good start in January 2023. I do not believe it is a typical rebound from tax loss sells and new monies coming in from retirement accounts like what typically happens in January. There are signs that the Federal Reserve may be topping out the interest rate increases due to the recent relatively good inflation and economic statistics showing the economy is slowing down. Due to this, I believe many people feel that there is a good chance we could have a soft landing orchestrated by the Feds. Consequently, investors are showing their enthusiasm toward that change of opinion. Today, I believe the current economy is harder to predict than it has been in recent memory. There are so many intangibles and variables that could cause it to go in either direction. I believe that is the main reason you have seen extreme volatility in the stock market. Expect more volatility until there is further evidence or a clear picture as to when inflation will be at an acceptable level. I believe inflation will be higher for longer. Therefore, interest rates will also be higher for longer. This makes fixed income a more attractive alternative. Something we have not seen for a long time. One hopes that we do not see pockets of excess jubilation rather than fundamental improvements in the stock markets to climb its "wall of worry". Right now, we are seeing signs of both. It is impossible to predict the stock market so one must always have a long-term horizon to pick the best companies and have the best chance for above average returns. As always, we will continue to do our best as we strive to be the best steward of your hard-earned capital. Thank you.

Optimistically Yours,



Raymond F. Saleeby
President

Footnotes

1. Stubbington, Tommy and Adam Samson. (31 Dec 2022). “Markets lose more than \$30tn in worst year since financial crisis”. Financial Times. Retrieved from <https://ft.pressreader.com/v99e/20221231/281479280494775> 31 Jan 2023
2. Cambon, Sarah Chaney. (26 Jan 2023). “U.S. GDP rose 2.9% in the fourth quarter after a year of high inflation”. The Wall Street Journal. Retrieved from <https://www.wsj.com/articles/us-gdp-economic-growth-fourth-quarter-2022-11674683034> 31 Jan 2023
3. Rodriguez, James. (22 Jan 2023). “Bad news for millennials: Things have never looked bleaker for first-time homebuyers”. Business Insider India. Retrieved from <https://www.businessinsider.nl/bad-news-for-millennials-things-have-never-looked-bleaker-for-first-time-homebuyers/> 31 Jan 2023
4. Bloomberg News. (11 Aug 2022). “The snowballing U.S. rental crisis is sparing nowhere and no one”. Financial Advisor. Retrieved from <https://www.fa-mag.com/news/the-snowballing-u-s--rental-crisis-is-sparing-nowhere-and-no-one-69188.html> 31 Jan 2023
5. Skandul, Emil. (6 Dec 2022). “Get ready for a big downturn – America’s ‘office apocalypse’ is even worse than expected”. Business Insider Nederland. Retrieved from <https://www.businessinsider.nl/get-ready-for-a-big-downturn-americas-office-apocalypse-is-even-worse-than-expected/> 31 Jan 2023
6. Harrup, Anthony and Montes, Juan. (1 Feb 2023). “Mexico’s Industrial Hub Grow as Part of Trade Shift Toward Nearshoring”. Wall Street Journal. Retrieved from <https://www.wsj.com/articles/mexicos-industrial-hubs-grow-as-part-of-trade-shift-toward-nearshoring-11675257070> 3 Feb 2023
7. Liu, Qianer and Cheng Leng. (24 Dec 2022). “China battles 250mn covid cases”. Financial Times. Retrieved from <https://ft.pressreader.com/v99e/20221224/281479280482717> 31 Jan 2023
8. Dean, Grace. (20 Jan 2023). “Home Depot’s cofounder – who retired in 2002 – says he doesn’t want the ‘woke generation’ leading business because of their ‘laziness’”. Business Insider. Retrieved from <https://www.businessinsider.com/home-depot-bernie-marcus-woke-generation-climate-labor-jobs-work-2023-1> 30 Jan 2023
9. Hua, Sha and Phred Dvorak. (31 Jan 2023). “New China rule threatens to disrupt U.S. solar ambitions”. The Wall Street Journal. Retrieved from https://www.wsj.com/articles/new-china-rule-threatens-to-disrupt-u-s-solar-ambitions-11675173199?mod=world_major_pos1 31 Jan 2023
10. Rapier, Robert (Feb 2023). “Outlook 2023: Navigating an Uncertain Year”. Utility Forecaster. Retrieved from <https://www.investingdaily.com/utility-forecaster/> 30 Jan 2023

Did You Know

The new SECURE Act 2.0 and what it means

<https://www.wealthmanagement.com/retirement-planning/new-secure-act-20-and-what-it-means>

Warren Buffett just beat the S&P 500 by the widest margin since 2007. Can he do it again in 2023?

<https://www.fool.com/investing/2023/01/23/warren-buffett-berkshire-beat-stock-market-2023/>

Meet the most powerful man on Wall Street who is now a Ron DeSantis megadonor

<https://www.businessinsider.com/ken-griffin-citadel-florida-desantis-politics-hedge-fund-2022-12?ref=upstract.com>

Inside Ken Griffin's rise to one of Wall Street's most powerful people, and why politics could be next

<https://www.businessinsider.com/ken-griffin-citadel-florida-desantis-politics-hedge-fund-2022-12>

I'm a corporate fraud investigator. You wouldn't believe the hubris of the super-rich

<https://ritholtz.com/2023/01/sunday-reads-309/>

The forgotten lessons of 2008

<https://ritholtz.com/2023/02/10-wednesday-am-reads-320/>

Travelers with food allergies fight for early boarding.

<https://www.wsj.com/articles/allergies-travel-early-boarding-peanuts-tree-nuts-11673627555>

Amazon warns employees not to share confidential information with ChatGPT after seeing cases where its answer 'closely matches existing material' from inside the company

<https://www.businessinsider.com/amazon-chatgpt-openai-warns-employees-not-share-confidential-information-microsoft-2023-1>

A happy memory can help you fall asleep, if you know how to use it

<https://www.wsj.com/articles/a-happy-memory-can-help-you-fall-asleep-if-you-know-how-to-use-it-11674527348>

Are gas stoves dangerous to your health? Here's what science says

<https://www.wsj.com/articles/are-gas-stoves-dangerous-to-your-health-heres-what-science-says-11674650089>

How to be 18 years old again for only \$2 million a year

<https://www.bloomberg.com/news/features/2023-01-25/anti-aging-techniques-taken-to-extreme-by-bryan-johnson?sref=Ro2vIlyD>

4 expensive psychological tricks retailers use that I've learned to decode

<https://www.businessinsider.co.za/psychology-wasting-money-retail-spending-2023-1>

Long covid is keeping significant numbers of people out of work, study finds

<https://www.nytimes.com/2023/01/24/health/long-covid-work.html>

Almost 30% of professionals say they've tried ChatGPT at work

<https://www.bloomberg.com/news/articles/2023-01-20/who-uses-chatgpt-30-of-white-collar-professionals-tried-it-at-work?sref=Ro2vIlyD>

Tech that will change your life in 2023

<https://www.wsj.com/articles/tech-that-will-change-your-life-in-2023-11672405471>

Did You Know (Continued)

64% of Americans are living paycheck to paycheck – here’s how to keep your budget in check

<https://www.cnbc.com/2023/01/31/share-of-americans-living-paycheck-to-paycheck-jumped-in-2022.html>

America’s war against heart disease

<https://www.aarp.org/health/conditions-treatments/info-2023/fighting-heart-disease-in-america.html>

***Disclaimer:** Saleeby & Associates does not provide tax advice. Please consult with your tax advisor with regard to your personal situation. By clicking on these links, you will be redirected to a third party server. We have not independently verified the information available through these links. The link is provided to you as a matter of interest.*

Disclaimer

- Past performance is not a guarantee of future results.
- While the information has been obtained from sources we believe to be reliable, Saleeby & Associates, Inc./Raymond Saleeby and/or Cutter & Company does not guarantee its accuracy or completeness. Yields are annualized and also from sources we believe to be reliable.
- Securities and Investment Advisory Services offered through Cutter & Company, Inc.; 15415 Clayton Road, Ballwin, MO 63011 (636) 537-8770; member FINRA, and SIPC

Saleeby & Associates, Inc.

Achieving your goals is our passion

11301 Olive Blvd.
Creve Coeur, MO 63141
Phone: 314-997-7486
Fax: 314-997-1417
E-mail: rsaleeby@cutterco.com

**Check us out at
saleebyandassociates.com**

