Talk CNY- Transcript for S1Q2

Andrew Fish 0:06
Welcome to Market Insights, a special series of CenterState CEO's podcast, Talk CNY presented by NBT Bank. In this quarterly series, we'll be talking to Ken Entenmann, Chief Investment Officer and Chief Economist for NBT Bank. Today, Ken and I will discuss the second quarter of 2023 and what's ahead in regards to inflation, stock market, and the disruption potential of artificial intelligence on things like labor and productivity. Ken, thank you so much for joining us, again, for a second installment of our Market Insights, really excited to be having our conversation today.

Ken Entenmann 0:42
It's great to be back. It's great to be here.

Andrew Fish 0:44
Yeah, we won't go through all the last stuff. But if you haven't listened to go back and take a listen, you were spot on on so much as it related to what was going to happen and how things played out. So let's dive right in. You know, we're looking at the second quarter and what we have ahead. You know, a lot of people are talking about the imminent recession, right? It's coming. It's imminent. We're just waiting for it. Like we were having that conversation three months ago. And we were talking where is it?

Ken Entenmann 1:05
Oh, that's a good question. We've been looking for it really, for about two years, the Federal Reserve started raising interest rates, it was March 16, of 2022. And the fear was rising interest rates, were going to cause a recession. So really, it's we're going on, you know, pushing a year and a half of of the imminent recession. Even today, the forecast for a recession in the second half of 2023 is still relatively high. But it's kind of interesting, the consumer has held in there really well. They have changed their spending patterns. They're not buying microwave ovens and refrigerators and painting their house anymore. We did that all in COVID. But they are spending money like crazy doing trips and vacations and things like that. So the consumer has demonstrated remarkable resilience. And on the corporate side, we're just about done with the second quarter earnings season. And corporations have proved to be incredibly resilient. And so all that money that was pumped into the economy due to COVID is to to a large extent stills sloshing around the economy and providing stimulus and so we have been delaying that imminent recession, it seems every quarter, we talk about the next quarter, and it may happen. But for the time being the economy, while it is slowing is still growing. And the recession isn't here yet.

Andrew Fish 2:26

Knowing us when the minute we're like, well, it's not going to happen. That's when it'll actually kick in and happen.

Ken Entenmann 2:30
Well, the reality is the National Bureau of Economic Research is the arbiter of recession. And they typically announce recession. Well, after it's started. It's already started job the statistics are always laid out. Yeah.

Andrew Fish 2:44
But it makes them always right. Yeah, exactly. You know, it's interesting, we're talking about this, as you said, it's been over a year and a half, almost two years, since the Feds really started aggressively raising rates, they're still talking tough on inflation, you call it quarter percent raise. That's what we saw, you know, what does that mean for rates going forward, though, with that talks still have tough on inflation, we're seeing a slowing of that inflation. But still there. Where do we think this is headed?

Ken Entenmann 3:07
So I think there's two aspects to inflation that are giving the Fed continue to give the Fed pause. One is employment. Employment has been remarkable. And I think it's particularly true here in Central New York, where small businesses and let's face it, we're not a Fortune 500 economy, we don't have all these massive corporations in town. So it's really small business that drives our economy, and drives the business here at CenterState. And quite frankly, I see help wanted signs everywhere. And so the employment market is still rather robust. And the employment numbers reflect that. The second piece is is inflation itself. And this morning, we got the latest data point, which was the Consumer Price Index. There's good news and bad news. And that number this morning, the good news is inflation came in at 4%, the headline number which is down from 4.9%, just a month ago, it's the 11th consecutive month that the headline inflation numbers declined. So that's really good news. In addition to that, as we roll forward, last June was the peak in the CPI number at 9.1 or 9.2%. And just the way the math works, if you're running a 12 month average, well, if I dropped 9.2, from last June, and even if inflation remains flat at 4%, that's going to mark a pretty big drop in the average. So the trend is our friend right now. inflation is coming down. The bad part of today's numbers, the core inflation, which backs out volatile food and energy is 5.2. So the good news is inflation is trending lower. The bad news is it's a little bit stickier than than I think the Fed hopes so I think the general result the combination of very strong employment gives them a little bit of pause. And the stickiness of the of the core inflation number also gives the Fed pause. So, after this morning's number, the market forecast 91% of economists are forecasting that the Fed which is will announce its latest interest rate tomorrow at two o'clock, is going to announce his first pause and interest rates will remain flat. And we expect the language to say yes, there has been some

softening in the softening in the economy. But unemployment, the labor markets remain robust. And inflation is a little stickier than we like. But we're going to pause because interest rates Milton Friedman, world famous economists once said ,"monetary policy works with long and variable lags". Well, as long as a year, and we're right at a year from the first hike and variable, it's we're kind of where we would expect the real bite of the rising interest rate environment that we've been in for the last year really take effect. So the expectations are the Fed to call a bit of a timeout say we're gonna pause, see how the data comes out between now and July. But it doesn't mean they're done. But they're going to pause and it will give them another two months to figure out whether inflation is really trending low or if if they need to raise rates again. So I wouldn't rule out further rate hikes. But for the time being, I think they're going to pause, which is good news.

Andrew Fish 6:21
Great. Just for folks that are listening later. We're talking about numbers that are released today and and things tomorrow. We're recording today on June 13. And so that's the relative numbers that we're talking about. You mentioned how things are really strong in the labor market here in Central New York. And you know, that is absolutely true. We just recently had a meeting of our investor level members, and what we were talking about is talent attraction, right. And it is on everyone's mind, everyone, you know, almost every member that I've talked to almost every business in this region said, you know, if I could hire 10% more employees today, I would do it right. And that's been consistent for almost two years now that we've been hearing that conversation with folks even longer than that even pre COVID. We were hearing that. So I think we've got some unique opportunities here. And you know, we talked a little bit last quarter about how what we're experiencing here, yes, obviously is impacted by the global factors and the national economy. But we're also seeing some some local factors, you know, the Micron announcement, other growth that we're experiencing driving some of that. Interest rates are important, why? Because the cost of money and the cost of money is important for our businesses in terms of their growth. But it's also important when you think about things like housing. One of the things that came up when we were talking about talent attraction is we're bringing people here, where are they going to live? Let's talk a little bit about the housing market. What are we seeing what's happening not just nationally, but here in the region, any interesting stats and interesting things that you've picked up on and that you want to share with our listeners.

Ken Entenmann 7:45
So certainly, the housing market is the most interest rate sensitive of all the economic sectors and a year ago mortgage 30 year fixed rate mortgages were below 3%. And Andrew, you just bought a house a year and I was telling probably painfully aware that you're right now, the rates did 30 year fixed rates did bump over 7%, they've come down a little bit, they're somewhere in the neighborhood of six and a half percent. And certainly that has an

impact. But it shouldn't be the end all be all. I think another big factor going into housing is just the lack of supply. And I think the Micron deal here specifically to the CenterState footprint is only going to exacerbate that. But there's there's other factors going on in the in the housing market. So one of them is if you bought the house bought a house in the last two or three years, and you have that 3% mortgage. Think about somebody who say a young couple, and they just started a family and they're moving out of that apartment. And they want to go into that first entry level house. And they they were successful, say two years ago, and they have a 3% mortgage, and maybe they're having their second or third child, and they're looking to go from that one or two bedroom house to that three or four bedroom house. Well, there's a problem, that three or four bedroom house is probably going to be one or $200,000 more. So your principal is going to go up by 200,000. And then your rate on the mortgage is going to go from three to six. The combination of those things is almost $1,000 a month in payments. So you have what I would call a lock in effect where a lot of people who may or may have been moving up the housing food chain are kind of locked in and they're hoping that rates are going to come down the second factor that's going into the supply of that entry level house that's kind of clogging the system is we have this huge bulge of baby boomers retiring and they are selling the big house and moving into that entry level house so they're selling the four or five bedroom house, but they are now very attracted to that one, two or three bedroom house. And guess what they're they're retired or approaching retirement. They are flushed with cash and when they sell that big house, they are coming in paying cash for that smaller house. So it's really kind of disrupted the normal flow of move from the apartment into the smaller house, into the intermediate house into the big house. You do that over the span of a normal household life expectancy. It's kind of clogged the system. So we have a supply problem here, not only here in Central New York, but it's truly a nationwide problem. What I would also say is, while the national statistics show housing prices coming down, here in Central New York, we never experienced the boom in housing prices. So when you look at nationally the Case Shiller Price Index, and you can say, well, year over year, housing prices are down 20%, that is being driven by the what I would call the hot market, San Francisco, Austin, Texas, Charlotte, some of those boom towns, and they are experienced a pretty big drop in prices. But when you look at the cities are crossed across the New York State through by Buffalo, Rochester, Syracuse, Utica prices have come down a little bit, but not much. They're kind of stable. And I suspect, especially here in Syracuse, with the Micron dynamic, taking into consideration, I don't think prices are going to collapse. And I've had this discussion with my son and he said, you know, who's in Buffalo, actively searching for a house and he will asked out to cash bids by baby boomers or by retiring baby boomers, you know, the notion that people are going to sit around and wait for rates to come down? I would ask, certainly, if with the lack of supply, if you find that house, don't don't wait, because you think rates are going to go from six and a half to five or four, what I would suggest to people is the 3%

mortgage is the abnormal experience when you're looking at mortgage rates over a 20-30 year period, a six and a half percent rate is a pretty darn good rate.

Andrew Fish 11:52
Just because we had it from you know, 10 to 20. Doesn't mean that that's what's we're going to continue to have.

Ken Entenmann 11:57
Exactly and so I think the housing and and one of the drivers of lower inflation has been housing prices coming down. I'm not sure especially in a marketplace like Central New York, I if I if I were to advise a young couple as I am my son in Buffalo. If you find that right house, get after it. And if you get a six and a half percent mortgage, and it turns out a year or two from now it's four and a half or five refinance, refinance, but don't give up on that house. Because the rates six and a half because the rate could change but that house house maybe there won't be there week. So it's very challenging environment for for younger people looking to enter their way into housing.

Andrew Fish 12:37
So both of our main episodes on Talk CNY this month are focused on housing. Our first episode, we spoke with Ryan Benz from ReDEV the development company and Oh My Darling and then second episode was David Mankiewicz, who is our resident, you know, urban planner expert talking about housing. You know, one of the things that's really drives home, that point of the supply issue is that just with the Micron project alone, we know that we need to be adding 2500 housing units a year just to meet that demand doesn't encompass all the rest of the demand that we have. In 2021 in the Central New York region, we only permitted 780 units. So there's a there's a, you know, almost five, four times growth that we need to experience in that in that space in order to to really meet that demand. So cost of money also impacts the number of new construction and the ability to finance a new construction project. But you know, we need it all over the board. It's not just the $400,000-$500,000, single family, three or four bedrooms, it's multi units, it's affordable, it's workforce housing. We need a lot of that, because that lifecycle, as you said, has really been disrupted.

Ken Entenmann 13:40
Right. And I would, the economic data shows that any development, whether it's high end, low income, affordable housing, our multiple family versus any development helps, because it just frees up the overall supply chain. So even if we get a big development of million dollar houses, well, there are going to be people selling their $500,000 house to move into the million dollar house. And suddenly that that opens up the food chain, as I call it. And so I've been amazed at the development of multifamily houses in downtown Syracuse, you

know, a lot of it around the Syracuse campus, but also here and kind of, you know, the center of the city, it's been remarkable, but it needs to be accelerated. And so so that means, you know, bank lending programs got to be part of it, developers got to be part of it. And frankly, the government's got to be part of it too. Because one of the biggest obstacles is just all the red tape that that goes on, in terms of getting it and then frankly, as a society, we have become so environmentally conscious that the answer is no all the time. And when you're looking at the the the projections for housing needs, you can't afford to wait four years to go through lawsuits to get permits and do all that. That doesn't mean I want to just sell say The hell with it.

Andrew Fish 14:58
Of course not.

Ken Entenmann 14:59
But their needs to be a little bit more efficiency built into the system, because we're going to need it for sure.

Andrew Fish 15:03
And just think about if projects are taking 12 to 18 months to permit, think about projects that started 18 months ago, and what developers and you know, home builders are looking at in terms of the cost of that project, and what rates have done, right. So you have to have certainty or else people are just going to walk away from those opportunities for sure. So we talked about housing market, let's shift our conversation a little bit talk about the stock market, right? We've been doing very well, are we looking at another bull market? Where are we at?

Ken Entenmann 15:32
Well, I mean, technically, we're up 20%, from the lows, so that that's kind of a definition of a bull market. I'm a little suspicious of that number. And, and the main reason for it, is when you look at the S&P 500, which is our broadest gauge of large companies, so 500 companies, 100% of the 12% Roughly returned that we've had year to date, and the S&P 500 comes from seven stocks. And it's all the big tech stocks, driven largely by the great potential for AI. But if you back out those seven stocks, the index is flat. So I'm a little suspect that lack of breadth in the market makes me a little suspect of whether we're starting a bull market or not. But that being said, corporate earnings have been remarkably resilient. If we learn if corporations have learned anything in businesses in general, we've learned to manage our expenses. COVID forced us whether we liked it or not. It forced us to focus on our expenses and manage expenses. And that has resulted in really very resilient earnings. So that's great. And if the Fed is in fact done, whether they're done or not, I think they're mostly done, maybe there's another 25 or 50 basis points of rate hikes in

front of us. But we just went from zero to five, right? If we go to five and a quarter of five and a half, I don't think it's going to be the end of the world.

Ken Entenmann 16:33
Things from without difference.

Ken Entenmann 16:51
Correct and so but that being said, that that suggests there's a lid on the financing part of the of the economy and lower interest rates would be helpful for stock prices. So while the breadth of the market is lacking, right now, the market seems to be building some some momentum, and it is much more reasonably priced at roughly 17 times earnings. You know, in the peak of COVID, we got up to 21, 22, 23 times earnings. And that's expensive, historically, and so we're not overly expensive, earnings have held their own. Now, if we can resume growth of earnings, and combine that with lower interest rates, respectively, that's a pretty good recipe for a well performing stock market.

Andrew Fish 17:35
Okay, some kind of hearing like, the rate of growth is a little suspect, however, kind of maintaining that may not be possible, but still some steady growth is present.

Ken Entenmann 17:46
And I would, you know, one of the things that makes me pull out whatever little hair I have left is just the time horizon that people think about in terms of investing is so short, and it's driven by TV and buy, buy, buy, sell, sell, sell. And by that, you know, if you have a long term perspective, corporate earnings are resilient and starting to grow P multiples come down. So you have an opportunity for that to grow. And whether the Fed raises rates or not a couple of times this year, I don't know. But chances are rates are going to be lower in the first. So if you if you have the ability to think in more than in months and years, I think it's it's we're probably in a pretty good spot.

Andrew Fish 18:26
You'd mentioned the seven tech stocks that that have done very well. 12% of those earnings in the S&P 500. And you mentioned that it's largely driven by the potential with AI, artificial intelligence.

Ken Entenmann 18:39
Yes.

Andrew Fish 18:39
I want to talk to you a little bit about that. Right.

Ken Entenmann 18:41
Sure.

Andrew Fish 18:41
I mean, it seems like you can't, you know, go throughout a day now without hearing ChatGPT4 which was something that, you know, candidly, even six months to a year ago, most of the general public wasn't really sure about. Artificial intelligence has a tremendous opportunity to be disruptive, creates opportunities. What do you think that's going to do in terms of impact both on not just the equity market, but also maybe the labor market?

Ken Entenmann 19:04
Yeah. So I, I think it has great potential to be what I would call paradigm shifting. Well, what I would caution you is over the centuries, I mean, I'm going back to when Graag invented the wheel in the Stone Age, we've had these great inventions, but it takes time for it to really manifest itself. So right now, when we look at artificial intelligence, it has enormous potential and it has drawbacks, but every paradigm shifting new industrial new thing has has has done that. So if you think back to the industrial revolution in something like the steam engine, or a tractor well guess what it put a lot of farm labor out of business, right? It put blacksmiths out of business, right? But it grew our productive capabilities enormously. If you think about the automobile. Again, blacksmiths out of business, horse and buggy manufacturing out of business. So yes, people jobs will be lost. But I would caution people, if you look in the government does have a book of jobs, who lists all the jobs out there. Something like 40% of the jobs in the book didn't exist 20 years ago.

Andrew Fish 20:18
Sure.

Ken Entenmann 20:18
So this kind of constant evolution is always been the case. So you hear a lot of talk about AI, putting all kinds of people out of work. And I would suggest that's probably right over a long period of time. But I can't even begin to think of the new jobs that are going to be created because of that, you know, and I think it has enormous potential for things like health care. So if you think about diagnosing cancer, or running iterations of studies faster, so that cancer treatment may evolve, normally enormous potential. But, you know, so think back, you know, first of all, AI has been around for a while, it's just really starting to grow to the point where it has the potential to enhance productivity. And quite frankly, productivity growth in our economy, and really globally has been really lacking. And it is one of the big drivers. If you think back to the internet. Yeah, same argument, people are going to lose

their job, right and all of that. But it really took about 20 years for the Internet to really find its own out and generated enormous productivity. So I would-

Andrew Fish 21:27
Whole new industry.

Ken Entenmann 21:28
So I don't want to be callous to people who may lose their job because of AI but you think back over time you think of remember Ruth Buzzy on laughing with a one rinky dinky the old telephone. Well, those jobs don't exist anymore, right? I don't think as a society, we are worse off because because you don't have switchboard operators. Right. I you know, so there's a good example of a job that was eliminated. You know, the fact that we don't have a blacksmith on each corner is certainly a change. And it's certainly not good if you were a blacksmith or a switchboard operator. But what what history tells us is that switchboard operator has the potential to go to a much better job that's higher paying that has more career than just switching chords around. So enormous potential has its pros and cons. Do I think that you know, like Hal in the movie is going to take over the world? I don't think so today, and I think-

Andrew Fish 22:19
It has a fairly staring down the barrel of singularity just not yet.

Ken Entenmann 22:23
Not yet. I mean, as they're pretending. And certainly we need to think about that. Right. There's privacy concerns. And and really, in today's world of misinformation that we talk about all the time with our, with our news and media organizations, I think AI is fantastic for generating ideas. So it's different than search, right? Right, where a search, you just kind of said, give me directions or give me a recipe and up it pops, where AI is going to generate ideas on its own. So if you do something as simple as you know, a high school, we're doing a paper on George Washington, I wouldn't take it for face value, because it's not right all the time. But if I were to say to to an AI system, give me some talking points on George Washington, I'm going to get a list of 5-10 things of major. That's a pretty good outline to start my researche, as opposed to saying, "Well, I don't know where to start". But that very nature, that very event of fast forwards my research process. Well, the fast forwards research process for technology at fast food is a research process for economic forecasting, and fast forwards the forecast of the time horizon for medical research. So a lot of good, I think we'll manage, you know, the bad, but I think it has enormous potential to enhance the overall economic productivity, which is something that we desperately need. And when you look back over 100 years, things like the invention of the automobile, the expansion of commercial aviation coming out with a jet engine, but it took 25 years for

commercial aviation to be what it is today. Internet, it took 25 years. So I think we're in its infancy, and it has enormous potential, both good and bad, but we've managed it before. And I am hard pressed to go back and say when I look at some of those major paradigm shifts, that they were bad for society in the long run there they weren't, they typically proved to be pretty good. And lots of banter about all the evils of AI. And there's some legitimate concerns there. But I think society, you know, history tells us, we kind of work our way through it. And I hope that it will wind up being the great productivity boost that I think our economy really needs.

Andrew Fish 24:40
That's great. So it's, you know, that typical evolution of the technology, right? It's this discovery, the technology, then it's the implementation with the application and then as the adoption and people actually using it, and that arc doesn't happen overnight. Certainly it happens a lot faster these days than maybe it did 100 years ago in terms of the automobile but we saw it with the internet and I think we're going to Yeah, like you said, again, with AI kind of feels like with this update, we're we're kind of taking a collective breath and have a deep breath. It's a bit of a pause seeing what the Feds are doing. khana me the markets doing really well, earnings are their job numbers are there. Who knows what could happen in third quarter? But right now it kind of looks like the train is on the track.

Ken Entenmann 25:19
Yeah. So I, you know, there's an old adage that Wall Street climbs a wall of worry, right. And that's always true. Sometimes there's more worries than other times. But what I would say is we have in the last year and a half to have knocked down or at least come to grips with some major worries. So COVID is not that far in the rearview mirror. It was a major event, major, major problems, major opportunities that came out of it. And hopefully, from a medical standpoint, it's behind us, it's still here, there are still people getting sick with it. But it's not the the crush that we experienced at its outset. So not to diminish people who might get cold. But it's largely behind us from a medical standpoint, and certainly from an economic standpoint, doesn't mean it can't rear its ugly head again. But I think the pandemics behind that's a pretty big brick in the wall that we can knock over the war in Russia within Russia and Ukraine was a big deal and had a very setting impact on the commodity markets. For better or for worse, we've kind of come to grips with that a lot of activity, building liquid natural gas facilities in Europe that we could export our abundant gas from here to Europe turns out that the sanctions on Russian gas, oil and gas has not been as strict as one might have hoped for the west so that there's more supply for oil, so oil prices have come down. And again, Russia, Ukraine, war is still going on. But it's not that existential threat that we thought it might be potentially, again, it can change more. But that risk seems to be contained. The budget situation and the debt ceiling was toxic. Yeah, I, you know, I wish I could attribute this I can't recall the person on TV who did it. But they

they likened the debt ceiling discussion to a kidney stone, that you get one occasionally, it's very painful while you're going through it, but you're going to it's going to pass sooner or later. And that's exactly what we experienced in you know, history tells us that it will come down on the wire, which it did, but you normally get a reasonable thing. So the the debt ceiling issue is behind us. And the biggest risk we had was that the Fed was going to raise rates to oblivion and crush the economy. Well, it appears we're pretty close to that. So you look at COVID, Russian Ukraine war, you look at fed interest rate, debt ceiling, those are some pretty big worries that for the most part are in our rear rear view mirror. And hopefully, if the Fed is done and inflation continues to come down, as as we already talked about is trending certainly in the right direction. Maybe we made the turn. And it's not it's pretty rare that you have this V shaped kind of okay. There's never I would love to have one as a Chief Investment Officer, Chief Economist, but nobody ever sounds the all clear signal. Yeah. Right. So you have this kind of period where, Wow, we had all these big negatives that were really weighing on on the economy in the market. And we just cited four of them, and they're largely behind us. So whether you call it a sigh of relief or a deep breath of pause, I do think that's kind of where we are doesn't mean that the next shock that can't come tomorrow.

Andrew Fish 28:36
The other shoe will drop.

Ken Entenmann 28:37
But I think we're in a position where we're far we have most of the big risks are either contained or understood. And that historically is a good, good place to be.

Andrew Fish 28:49
Great. That's a great place for us to in this update in this quarterly insight. And I look forward to reconvening Ken three months from now as we look at what happened during the third quarter and what's ahead for the rest of the year and really enjoyed these conversations and looking forward to the next one.

Ken Entenmann 29:04
Well, thanks for having me, all of us at NBT love our partnership with CenterState. And it's great to be here and I'm looking forward for for the three month window to go. It goes by fast. So looking forward to it. Thanks for having me.

Andrew Fish 29:15
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