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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, about what's happening in the markets and how it impacts you. Today, Ken and I will discuss the fourth quarter of 2023, the volatility of this year, recent economic numbers, and get an early look as to what to expect in 2024. Ken, welcome. Thanks so much for joining us again for another Market Insights.

Ken Entenmann 0:36
Great to be here.

Andrew Fish 0:37
Absolutely. So wanted to jump right in. Here we are. We're wrapping up the fourth quarter of 2023. And we've got some some new numbers that have come out. We've got some interesting stuff happening with the market. What are we seeing right now?

Ken Entenmann 0:49
Well, we're seeing some volatile data that we go back to our last podcast, the data for the third quarter came in incredibly strong GDP up 5.3% in its last revision, which is very strong, and retail sales continue to be really good. And then ever since then, the numbers have been somewhat weak. And that has been interpreted as maybe the Fed has done raising interest rates. And the stock market has been on a bit of a tear up almost 10%, in the last couple of weeks made up a lot of that ground from up almost 20% year to date. So pretty strong market based on weak data. And then on Friday, we got relatively strong employment data with non farm payrolls coming in at 199,000. And the unemployment rate ticking down from three nine to three, seven. So that's given the market a little bit of a pause. And interest rates have ticked back just a little bit. But so really, a quite a volatile last couple of months to say the least.

Andrew Fish 1:51
Yeah, absolutely. And of course, you and I have talked before about kind of what's happening more broadly, right? You've got the the numbers around the weather, the feds are gonna raise it, you got the unemployment, the what's happening with the GDP in the market. But then we've also seen some really crazy stuff with Treasury this year, haven't we, in terms of the rates?

Ken Entenmann 2:11
Yeah, so I think it's something that's bothered me for a long time. But I've been somewhat of the "boy who cries wolf", and we're talking about just the general debt level and interest expense for the US government. And that certainly was muddied up by the COVID crisis, because there was just a massive amount of money that was spent by the government to deal with the COVID crisis, but that a massive amount of money kind of led to inflation. And what that did was it raised the interest expense for the US government and the Treasury in it. And it's really starting to be, you know, in the past, I would say, was not a clear and present danger to the economy.

But now the level of interest expense is becoming problematic, it's kind of beginning to suck some of the economic oxygen out of the room for the private sector. So if we think about in 2007, prior to the financial crisis, debt was about 9 trillion. Today, it's about 33 trillion. And as I said, the last 10 years starting with the financial crisis, and oh, wait and then exacerbated by the COVID crisis, we've effectively been in a 0% interest rate environment for the last 10 years. And the onset of inflation has changed that dramatically. We've talked in previous podcasts that the Fed raised rates, 525 basis points, or five and a quarter percent in about 18 months, which is a world record increase in terms of speed. And now that's just beginning to have an impact. But we're really has an impact is on interest expense. So this week, the United States Treasury will be auctioning off over three to $300 billion worth of treasury bills and notes. And as as interest rates go up, it's having a dramatic impact on the budget. So that interest expense last year was estimated to be about 8% of the total budget this year, it's estimated to be about 14%. And it's up almost $700 billion from last year, just interest expense, just interest expense. $700 billion. That's really remarkable. And my concern, longer term, even though interest rates if you use the 10 year note as a proxy, began the year around 328. It they got up to just shy of 5%. And in the last month or so have have come back down down to the 410s. And as of this morning, we're at 428. But still 328 to 428 is a very big number, especially when you're anticipating issuing over $20 trillion in debt this year. That's a lot of money. And if you're paying a full percentage, if not more in interest rates, that can be problematic.

Andrew Fish 4:51
You're talking about 200 billion plus.

Ken Entenmann 4:53
Yeah, yeah, that's a lot.

Andrew Fish 4:54
So you know, I think it's interesting. Sometimes we hear those numbers and it's hard to kind of internalize those but I think But from my own personal spending in my own household, right, and so the difference for me would be okay, if I can, if I can even just the difference between what we were getting in mortgages previously to what we're getting today, right? That spending power is significantly impacted by that percentage point, right? What you can buy for 4% versus what you can buy for 5%. And governments are experiencing that same thing. Now, not all of us can go out and just issue more money. But that creates a whole lot more problems. But it really is significant. When you think about to take that or even think about putting something on a credit card with those high interest rates versus getting a bank loan with something that's more locked and set in the impact to your bottom line to your budget is pretty significant. It gets to a point where you're not making any progress towards that principle, you're literally just paying out interest. And that's where you start getting upside down when you're spending. Yeah, seems like the government might be there.

Ken Entenmann 5:49
Yeah, and I and one of the reasons why I'm so worried about this is the government has taken to issuing a lot of short term debt. And so it rolls over quite a bit about 60% of the total debt rolls

over every four years. So they've effectively been funding the government it with effectively a floating rate note, and but then when rates go up, it's really painful. So one of the reasons why this concerns me so much is when you look at overall government spending roughly 60% of its in entitlements, and they're kind of set on autopilot. We don't vote to increase Social Security or Medicare, though that that spending is is kind of baked in where they have cost of living adjustments. So really challenging, particularly politically and both sides of the aisle. Donald Trump says he's not touching Social Security, President Biden says he's not touching Social Security, it's a problem. And Medicaid and Medicare are even more so because the population is aging so much. But when you have 60%, of your budget, on autopilot, entitlements, another 15% is interest expense, and roughly another 15% is defense. And we're living in a pretty scary world right now. When you add them up, that's close to 80 85% of the overall budget, it's really hard to see where you're going to cut spending to kind of fix this debt problem. And that's why it's a long term concern. And it's a little Cavalier to say, well, that's just the government. So you know, interest expense is going up. But it's going to have an impact on the average consumer. So you mentioned that, when you think about buying a home where home prices, we've talked about this, really overall, our podcasts, home prices, we were hoping we're gonna go down post COVID, but they just don't, they aren't because there's a shortage of supply. And we all know mortgage rates should stay actually higher than where they were. So for many homeownership is kind of out of reach right now. And even something as buying a car, where those rising rates and even purchase kind of an average startup car, what we are seeing is that the payments are close to $700 a month for a car where not too long ago, you thought-

Andrew Fish 8:01
$400?

Ken Entenmann 8:02
Yeah $300-400 So that has a material impact. And that has an impact in the sense that if I have to, if I was paying for and now I'm paying $700 For my car, well, that's $300 Less I can spend on fun stuff or other stuff. And so it's not some esoteric government theory that government spending and the debt and the interest expense really filter into the economy. And it's it's a long term concern.

Andrew Fish 8:28
And they factor into the Fed's decision making when it comes to rates and what they're going to do. I mean, certainly the, the overall economy is much more of a driving factor. But they they look at those things, and they think about it.

Ken Entenmann 8:38
And the scary thing is that we just just read an article this week where the spending in the first two months of the government has an October year end. So October and November, spending in the new fiscal year was over 200 billion more than budget. So not only was there a projected deficit, but that deficit is already growing mightily. And I would like to think at some point, our politicians will get a little bit serious about this. But I hate to tell you, I'm not terribly confident.

Andrew Fish 9:08
Especially going into an election year, but-

Ken Entenmann 9:10
Especially going into an electio year.

Andrew Fish 9:11
When we think about that we have an opportunity before us for them to do that. Right. Everything's operating on the continuing resolutions right now. And we have until the end of January for new spending bills without getting into too much of the politics of it, obviously. But you know, what can people expect when they think about whether those turn into more continuing resolutions? Because certainly I don't think we're going to see a government shutdown in an election year. But is there a reality and possibly not even getting to into an actual spending bill or defense spending bill? Do we end up just kicking the can and saying okay, all things hold as they are now till we get after the election in 2024? What do you think about the end? What are kind of the impacts potentially on the economy for those two paths?

Ken Entenmann 9:50
Yeah, I it's gonna be challenging. I mean, both the White House and in particular the house are obviously on opposite ends of the political spectrum and and they Are both talking very tough. We just recently had a continuing resolution. And I think the blame game of shutting down government is something neither party wants. But the likelihood that you go back to normal business where you actually pass a budget like a ordinary business or an ordinary household would do. I'm not overly optimistic cooperation across the aisle. Yeah. And so, you know, the good news is, they always take it to the bitter end. And, you know, there I find it amusing almost, that there's so much hype in the media about, oh, my god, the government is going to shut down and we, you know, it's kind of loosey pulling the football away from Charlie Brown, it happens over and over and over again, and they wind up passing a continuing resolution. So I think the markets kind of caught up with that. So you get a lot of heightened rhetoric, but in reality, I don't think it has a dramatic impact. But it we need to get serious about the fiscal psyche of the US government, it's, it's a long term problem. And the scary thing is we're in the strongest shape of most countries around the world. Where the cleanest shirt and a dirty closet, as they say, and that may give somebody some solace, but it's also kind of scary in its own right, too.

Andrew Fish 11:16
Yeah, for sure. So, you know, I think what's interesting is that we've talked a lot about this year, you know, we started the year thinking like, okay, is this going to be recession? Is it going to be a soft landing? Is it going to be, you know, kind of the the other term where we basically just continue with with marginal growth, and we've kind of seen a little of it all this year, right. I mean, there's been, there's been no point this year, where we've said, Well, it's clearly this or it's clearly that even as recently, as, you know, the most recent unemployment numbers where we had the softening of the of the market numbers, but you know, in terms of the GDP, but then, you know, turnaround in the unemployment takes down 2%. Right, so, or point 2%. So is this, I

don't want to say, is this a new normal? I do think that there is still a lot of, we've used the term whiplash, it feels like there's still a lot of whiplash in a post COVID environment, when you have a lot of, you know, geopolitical tensions across the world and classes across the globe, still kind of loosening up the supply chain. But are we going to see more of this in '24? Or where are we headed?

Ken Entenmann 12:17
Yeah, I think '24 is going to be a challenging year. You know, it's interesting. I've written a few articles where I talk about returning to normal and, and I joke that everybody's got a different definition of normal. But I do think we're grudgingly getting back to normal. And what do I mean by that? I mean, that the dramatic emergency spending that whether it was truly an emergency or not, that came under the guise of COVID relief, it stopped going up, there's still an enormous amount of money sloshing around the economy. So I still think it has a meaningful impact on the economy. But we're beginning to return to normal. Most importantly, what has and continues to surprise economists is that the consumer has remained as resilient as, as it has. And part of that is the employment market continues to be pretty strong. It's not there's no doubt that it's softening a little bit. But you know, I have a hard time arguing over whether three, nine or three, seven unemployment is, is a bigger, big difference or not. But, you know, I think, looking into '24, the thing that I would look to most is consumer spending, because there was an enormous amount of COVID Relief support, and particular going to individuals that I think those individuals saved up. And that money is no longer coming through. And they're beginning to be indications that particularly in the lower income categories, that the excess savings that was built up over COVID is beginning to get exhausted. And so when you look into 2024, when you look into that next year, a lot of it is going to depend on the consumer, because that's what's been carrying the day. And if that money, that savings, that COVID support, and the savings from that support begins to diminish, does the economy and consumer spending hit a wall? And that's really the concern that the market has, and it really is part of the debate as to whether the feds, in fact, is it time for them to start cutting rates. And this is a really interesting week because we have CPI, we have inflation data, we have a huge as we mentioned earlier government auction going on and we have the Fed meeting Tuesday and Wednesday. So fasten your seat belts this week, it'll be pretty interesting.

Andrew Fish 14:37
Going to be a bumpy ride at the end of the year. I did want to throw a little curveball at you if you're willing. So you talked about the marginal difference between 3.9-3.7% unemployment. I know one of the things that happened as a result of COVID and what we are seeing at least in the labor market here regionally and we're seeing it elsewhere, too, is you know, kind of the the exodus from the late labor market in general. So labor force participation rate is a is a term that we use. Are you tracking anything around that? Is that still kind of has that recovered at all from kind of that mass exodus from COVID? I mean, we obviously saw it in healthcare and some of the other really stressful work. But you know, what are we seeing from the labor force participation rate? And is that tracking it all with the changes in the unemployment?

Ken Entenmann 15:21

Yeah so it's still ebbs and flows. But generally speaking, it's getting better. And it has been been growing. I do think there are two primary drivers to that. One is the money that was saved up to the extent that I was receiving government support and saved up a bunch of money that allowed me to stay out of the workforce, we're starting to see lower income people come back into the workforce, which is, which is a good thing. And it's a good thing on a second note, and that the wage increases on the lower tend to be lower. So if you think about, say, the UAW strike, and pretty robust wage increases, they got that generally isn't the case when you're dealing with lower income. So what it's doing is more lower income people coming in, and it's bringing down the overall wage growth, which is an important thing that the Fed watches for as the inflation piece. So the inflation piece correct. So it is encouraging that particularly entry level and lower income workers are coming back into the workforce. And then something we've talked about in previous podcasts is this retirement group, where many people who were eligible for retirement, particularly people, mostly government workers, that had full pensions, they took the opportunity to retire. And we expected them to kind of come back into the workforce and maybe have a second career. And I joke that retirement must be a pretty good gig because they haven't done that. And now we're starting to see some of the retired people coming back into the workforce. So it could be that maybe they have exhausted some of their savings that they they had when they were locked down. So there's beginning to be some optimism, optimism on both the retire the retirement category and the low income or entry level category, which is, which is a positive because we definitely still need workers, the jolts number of job openings, and labor turnover number is below 9 million. That's like eight and 8.4, something like that million job openings. So we still have almost twice as many job openings as we do workers, but That's down from 10 million just a few months ago. So we're beginning to see improvement on the labor front, the National Federation of Independent Businesses does a survey every month in small businesses. And in the last month's data, there seem to be some marked improvement in terms of the ability to find workers. So I do think there's optimism on that front.

Andrew Fish 17:41
Great, just to make sure our listeners understand when you see the unemployment number, you're seeing workers that are at or you're seeing individuals that are actually officially seeking work, they're on unemployment, they're going through that process. So anyone who's not working and is not part of that not seeking to find a job or are on unemployment benefits, they're actually not part of that rate. So you can have, you know, you can have your unemployment number go down and up. Also having your number of employed people go down depending upon what's happening with the labor force participation rate. So that's why I was getting to that. So we talked a little bit before we did the podcast about due to the volatility this year, you wanted to reinforce a point for the home investor home thinking about your portfolio, our listeners, you had a piece of advice for them, which I think is very salient as it relates to the craziness that we saw in '23.

Ken Entenmann 18:31
Yeah, so 2022, if I can go back-

Andrew Fish 18:34

Absolutely.

Ken Entenmann 18:35
To what was kind of a historic year. So you know, investors typically talk about diversified portfolios, and in a very general way that that kind of plays out to be a 60% equity, 40% Fixed Income balanced portfolio. It varies amongst different people. But that's generally what the market means when they talk about a balanced portfolio. Well, in 2022, the s&p 500, benchmark for equities was down 18%, close to 20%. But importantly, the bond market as measured by the aggregate index was down 13. Think about that rapid raising interest rates. So it's really rare that the you know, so why do we use 6040 is because we expect when equities Zig the bond market will zag, but in 2022, they were both double digit negative. And that led to the conclusion that investors shouldn't diversify portfolios, and they should do more market timing things like that. And we have always had MBT have said no, stay the course. And I find it frustrating when I watch some of the particularly some of the television shows that the time horizon seems to be a nanosecond. When it's just not for investors. You're thinking about saving for college to buy a home or pay for college education or save for retirement, and they typically have very long time horizons. So whether the market goes up or down next week is really, truly not relevant relevant to your long term health. And so that horrible experience in 2022 led many to conclude that diversification didn't work. And this year, what I would point out is that the s&p 500 started the year off almost down 20%, rallied across the summer to being up almost 20%, then lost a whole bunch of you know, in September, October, the markets are quite negative and gave back around 80% of that. So we went from being up 22, down, up, maybe eight, so gave up more than 50% more than 10%, which technically is a bear market. And since then, we've rallied and made all of that back up in the last five weeks. And we're up the s&p 500 is up roughly 20% As we speak today, so anybody who thinks they could have timed the market in that whipsaw the year that we've just had, I think is kidding themselves. And then importantly, the bond market, even despite the rise in interest rates is up roughly three or 4%. So that that horrible balanced portfolio that everybody discarded a year ago is probably going to post a return to close to 10%, which is a pretty good number historically. And so I don't expect the volatility to diminish much, at least in the first half of of next year, or at least until you get a clearer picture of when the Fed is going to and central banks are going to start cutting interest rates. So my my message to do it yourself, home gamers, as they call it, is to don't give up on a balanced portfolio, stay diversified. And make sure you have the proper time horizon because the the newspapers and the media and the podcasts and the television shows all have to sell advertising today and their time horizon seems to be horrible mismatch for the majority of investors, true time horizon for sure.

Andrew Fish 21:58
You know, I remember coming out of college and thinking about my first 401k portfolio and investments. And thankfully, I had people in my life that gave me that very same advice. And I always like to remember it, of course, I'm not going to remember the product, but there was a very famous home shopping network television commercial, and it was set it and forget it. Yeah. And that was, you know, the mantra for that for that product. And that's how I've always treated that portfolio for me, you know.

Ken Entenmann 22:22
Yeah.

Andrew Fish 22:22
To an extent obviously.

Ken Entenmann 22:24
Got it your, you know, I set it and forget it has gone into negative connotation for people who want to sell products. But so I don't think it's necessarily set it and forget it, but it's it's set it to the appropriate time horizon, rebalance, or readjust as your needs change. So if you're a 20 year old, saving for a home that you plan to buy when you're 30, and you get to 28, the allocation you had when you were 18, or 19 is not the same as you're going to have, because that that that time horizons change. Or if you're saving, you know, I have a two year old grandson, and we contribute to his 529 plan. Well, he's got an 18 year time horizon, the allocation for that 529 account is very different from somebody who's going to be entering college next year, it's your time to spend the money, not invest it and grow it. So it's so critical to get the time horizon right, and to rebalance, or adjust the risk profile of the account as circumstances change. That's a little different from set it and forget it, right?

Andrew Fish 23:31
Absolutely.

Ken Entenmann 23:31
And that's an important caveat.

Andrew Fish 23:33
How I have in how I have actually put that into action is not that I haven't looked at my four years distribution since that time. But what I will say is that when I got my quarterly statement on September 30, I didn't care, right, that that significant loss that I experienced in those three months on my portfolio did not make me go I have to do something different because I knew that I was I had an investment plan that was staying the course.

Ken Entenmann 23:57
Yeah, absolutely. And so time, history tells us that being very, very investing in the tortoise and hare race, yes, everybody wants to be the hare and talk about the big hit that they had by buying this text on this fund. The tortoise wins the race if you do it right. And we're pretty happy being the tortoise.

Andrew Fish 24:19
Absolutely. My recommendation anybody who needs that as part of their life is do a 50/40 and then you can do something with that. 10%.

Andrew Fish 24:26

Absolutely. Well absolutely.

Andrew Fish 24:28
So you know, I think we we've covered a lot of ground. I'm curious, we we know that there's still going to be a lot of volatility around all the things we've been talking about in 24. But I know we kind of talked about these unemployment numbers. If they were not good and they were soft, then maybe we were heading towards a recession. Now they're a little bit stronger than anticipated. Are we still kind of in a, let's see what the first quarter of '24 looks like, when it's subject to when the Fed start cutting rates if they start cutting rates. What are you thinking about in terms of '24, where we're headed?

Ken Entenmann 25:03
Well, I'm pretty optimistic for '24. But I do think it's going to be a bumpy road in the beginning. And I'll talk about four things. And that's corporate earnings, inflation, the economy, and what does that force the Fed to do. And I think really the the Fed is going to be the driver. So, so first, when we look at the economic growth 5.3% in the third quarter was pretty robust. But already the Atlanta Fed GDP now, forecast for the fourth quarter is 1%. So we're having a slowdown, which isn't a bad thing. And with slowdown comes lower inflation. Hopefully, on the inflation front, clearly the trend is moving in the right direction. So that's very encouraging. And in theory, that should allow the Fed to cut interest rates. But in the meantime, the the employment market has been very strong and so strong, that right now the market is, is what I think is pricing imperfection, their pricing in a soft landing, so we're not going to have that recession that we've been calling for for two straight years. Now, we're going to avoid that and have the proverbial soft landing inflation is going to continue to trend lower, the consumer is going to slow down but not slow down enough to force a recession. That's kind of perfect, that's going to allow the Fed to start cutting interest rates. And in the last month, we've pulled the first rate cut, which was pushed out till September. Now we pulled it forward to march. And the market is forecasting 130 basis points of interest rate cuts in 2024. And that has driven up the stock market to where it's trading at 20 times earnings. Yeah, so 20 times earnings with a soft landing that's to achieve with inflation, collapsing to the Feds target, and the Fed cutting interest rates four times what possibly could go wrong with that scenario. And it's led to a really big rally both in stocks and bonds. Yeah, in the last month, I'm a little skeptical in a world that I don't think inflation is good. I do think it will continue to trend lower. But I think it will remain stickier. I think the optimism that the Fed is going to cut rates as soon as possible. Or early in March, we'll see what Chairman Powell has to say tomorrow afternoon. But I don't think they're giving up, you know, declaring victory yet. So I think that might be optimistic. 20 times earnings for the s&p 500 is on the high side. And, and so I'm a little concerned given, particularly given the recent rally, both in stocks and bonds, in the last month, that we're kind of priced for perfection. And perfection is a pretty rare occurrence here. And when you start to think about things like the physical deficit on the election here, the military conflicts going around the globe. It's a pretty scary place out there. And pricing and perfection gives me so I think we are going to have a very rocky road as we kind of work through what is the true economic growth number going to be is inflation going to go down to 2% to the Feds target as rapidly as people want? Is the consumer going to slow down but modestly and not cause it? All those things? We're going to have a lot more evidence

in the next couple of months and and therefore it will really determine whether the Fed is March or where is it September? And there's a big difference? Oh, yeah, it's a really big difference for the overall markets because interest rates price really are the underlying input for so much Asset Pricing around the world. So I am hopeful that that perfect scenario where the economy slows a little bit inflation drops, interest rates can come down, come down, the consumer still remains healthy. Nothing would please me more to see that happen. I'm a little worried that that's a little overly optimistic.

Andrew Fish 28:49
I think that's fair. Ken, I have appreciated these conversations so much. I am looking forward to continuing them and 2024 and I just am grateful for your wisdom and your information that you're sharing both with me and with our listeners. And I hope you have a wonderful new year.

Ken Entenmann 29:04
You do the same. Happy holidays to everybody. It's it's really fun doing these things. Great back and forth. I appreciate everything you do for us, too.

Andrew Fish 29:12
Absolutely. Thanks, Ken.

Ken Entenmann 29:12
Thank you.

Andrew Fish 29:13
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