

CONSTRUCTION WEBINAR

CAN THE FED THREAD THE NEEDLE?

How Fed Interest Rate Hikes Could Impact Commercial Construction

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Speakers



WELCOME

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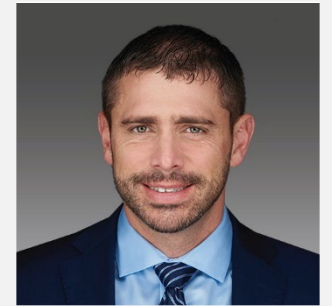
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Economic Recovery from the Pandemic Continues, but Facing Headwinds

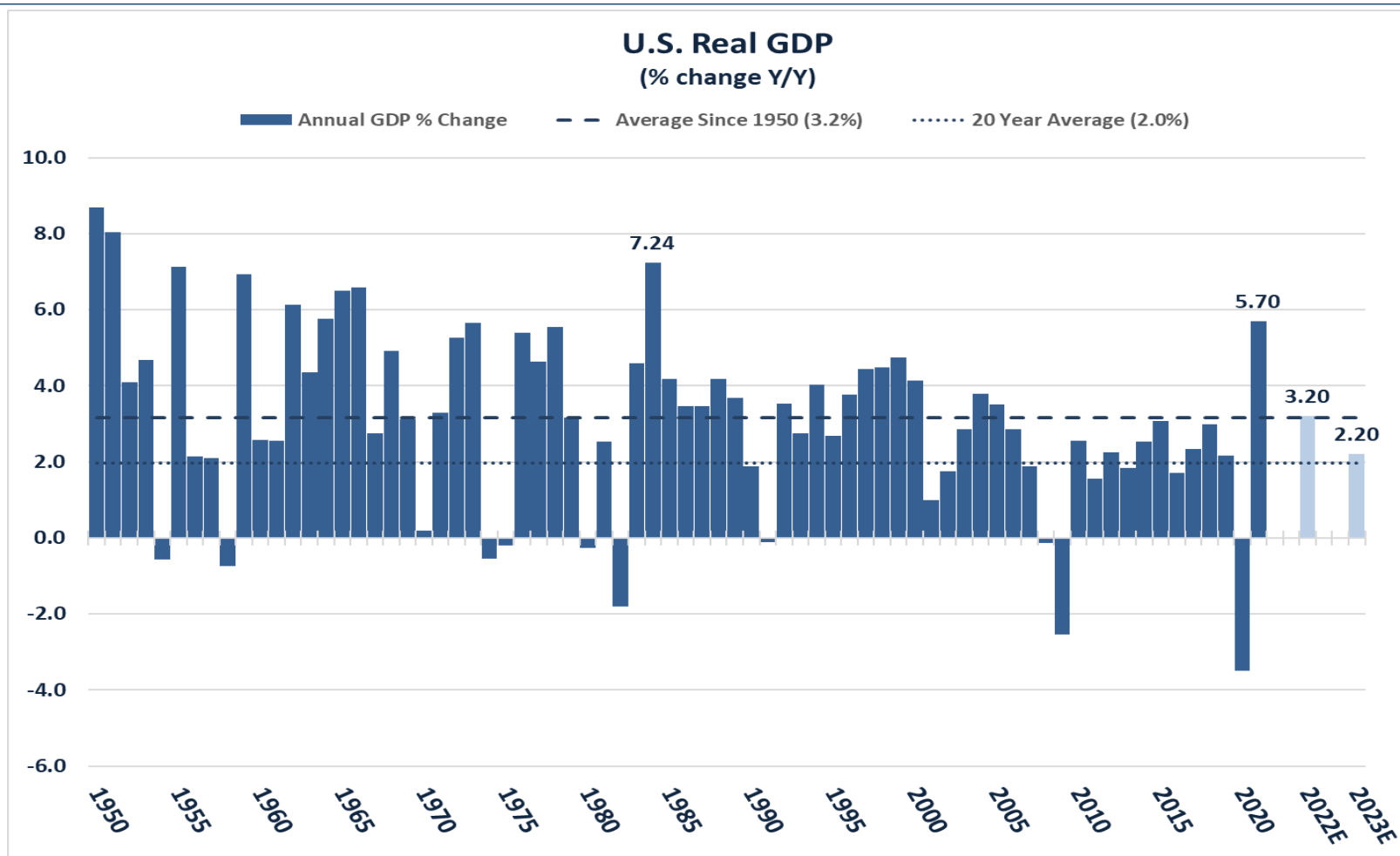
May 26, 2022

Peter R. Phillips, CFA, CAIA

Senior Vice President and Chief Investment Officer
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The U.S. Economy Continues to Recover from the COVID Induced Slowdown

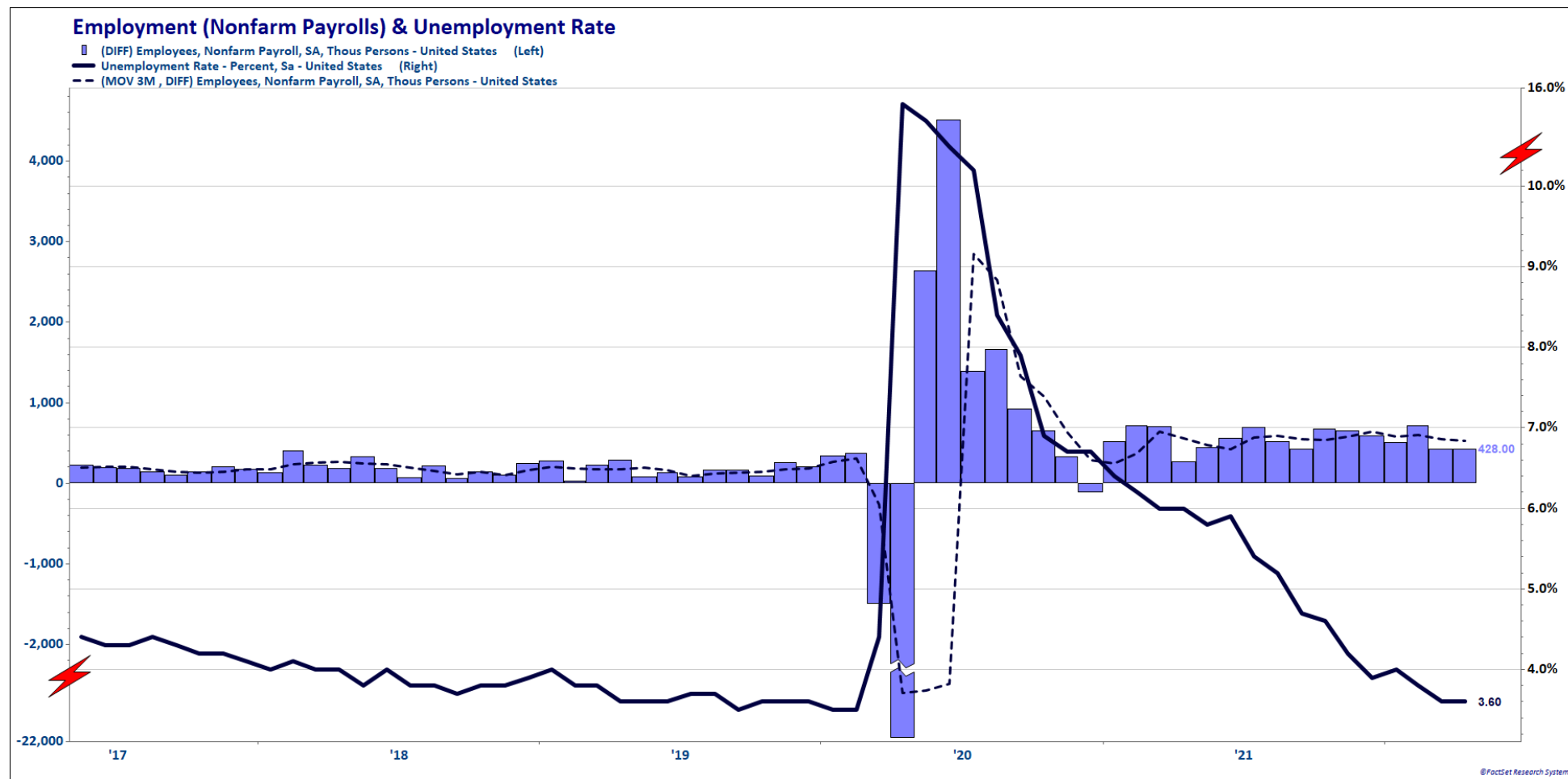
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Source: FactSet, BEA Note: Consensus estimates for 2022 and 2023 from Factset

The Labor Market is Remarkably Strong

6



Source: FactSet, BLS

Construction Industry Employment at Pre-Pandemic Levels

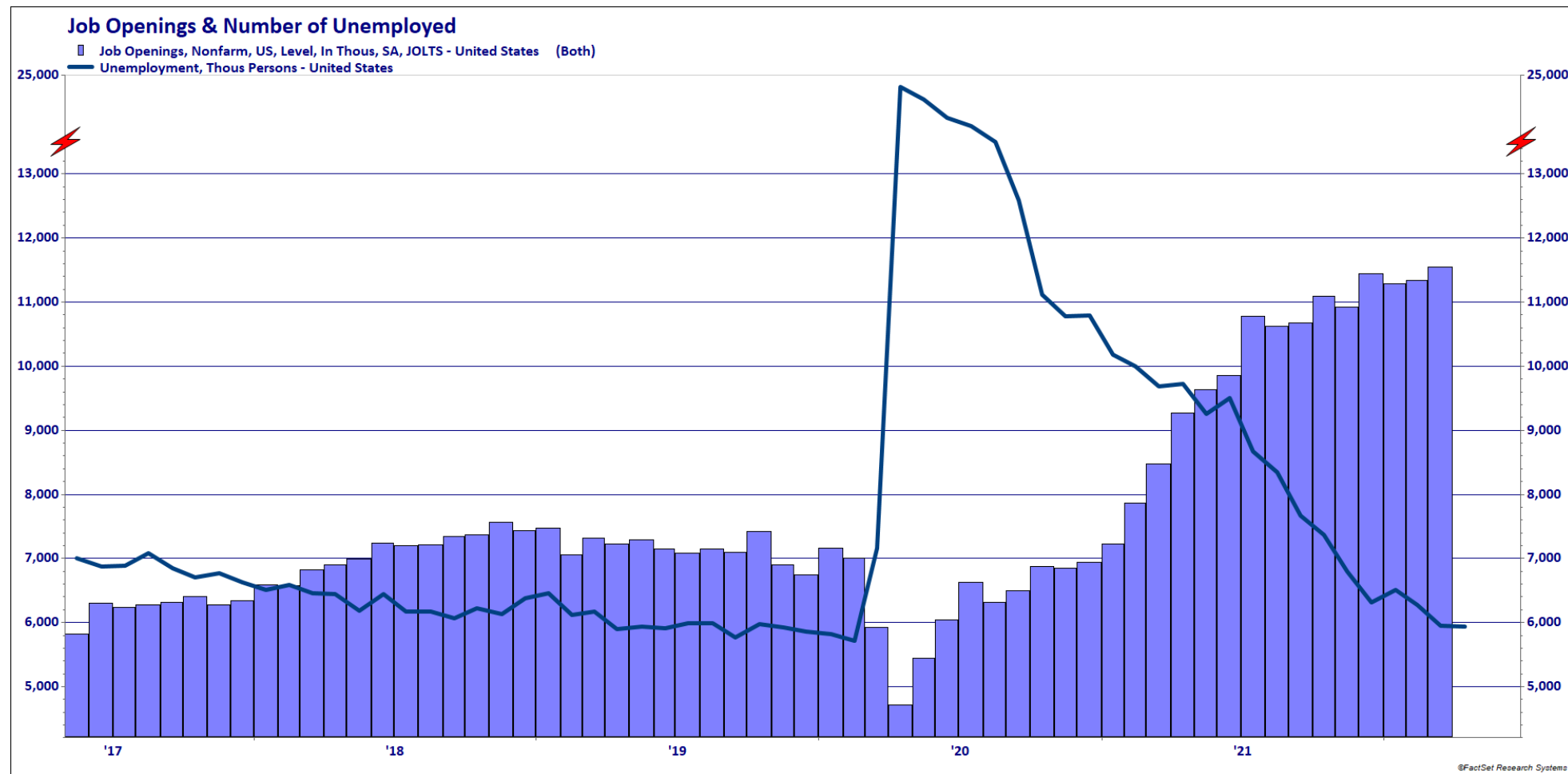
7

	Jobs gained/lost since February 2020 ('000s)	% Change in Jobs since February 2020	% Change in Jobs YTD
Total nonfarm	-1,190.0	-0.8%	1.4%
Total private	-500.0	-0.4%	1.6%
Construction (total)	4.0	0.1%	1.1%
Residential building	57.5	6.9%	1.9%
Nonresidential building	-42.6	-5.0%	1.6%
Heavy & civil engineering construction	-30.9	-2.8%	0.8%
Residential specialty trade contractors	107.6	5.0%	1.2%
Nonresidential specialty trade contractor	-87.6	-3.3%	0.7%

Source: FactSet, U.S. Department of Labor

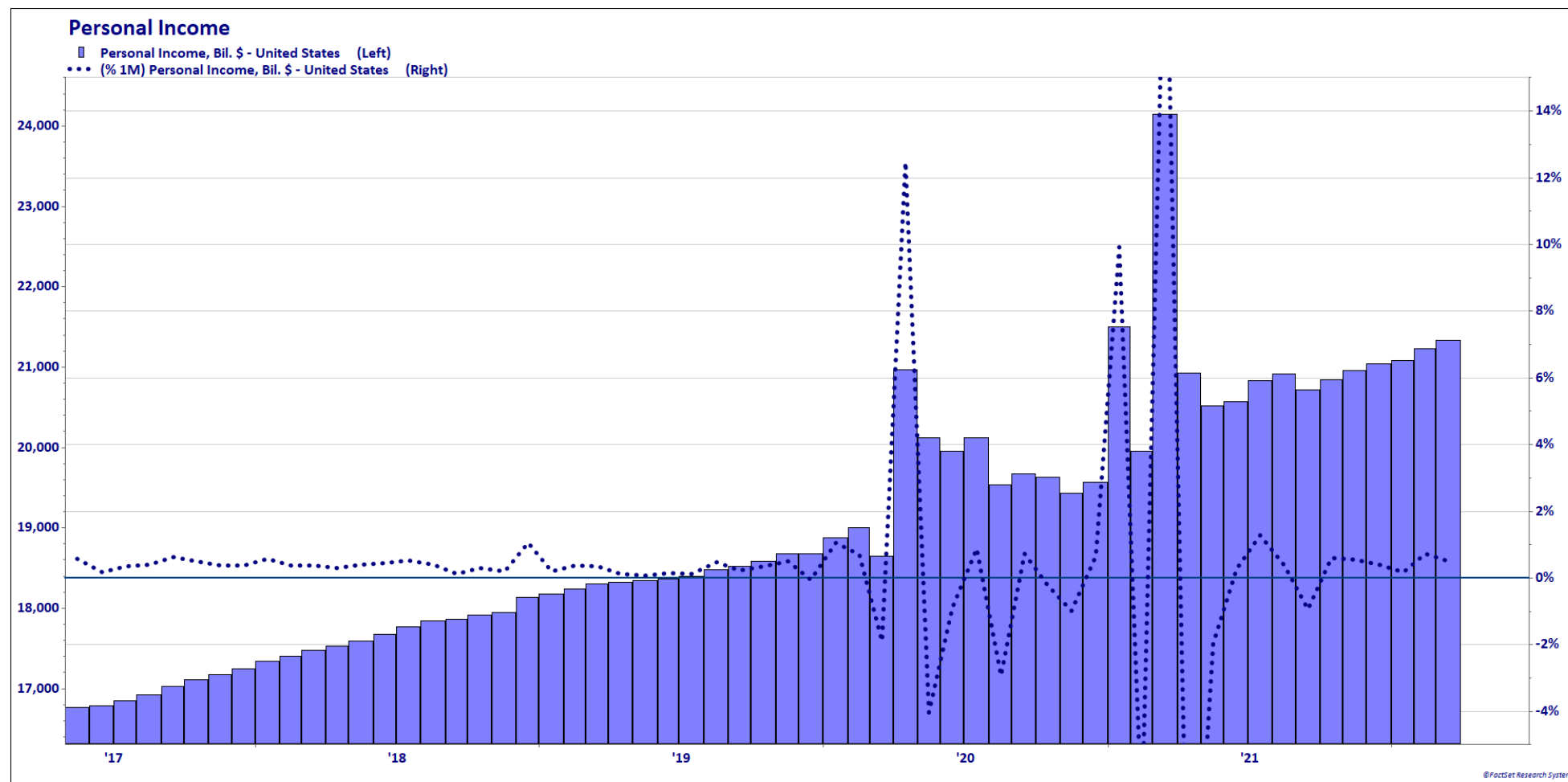
There is Room for Additional Job Creation and Growth

8



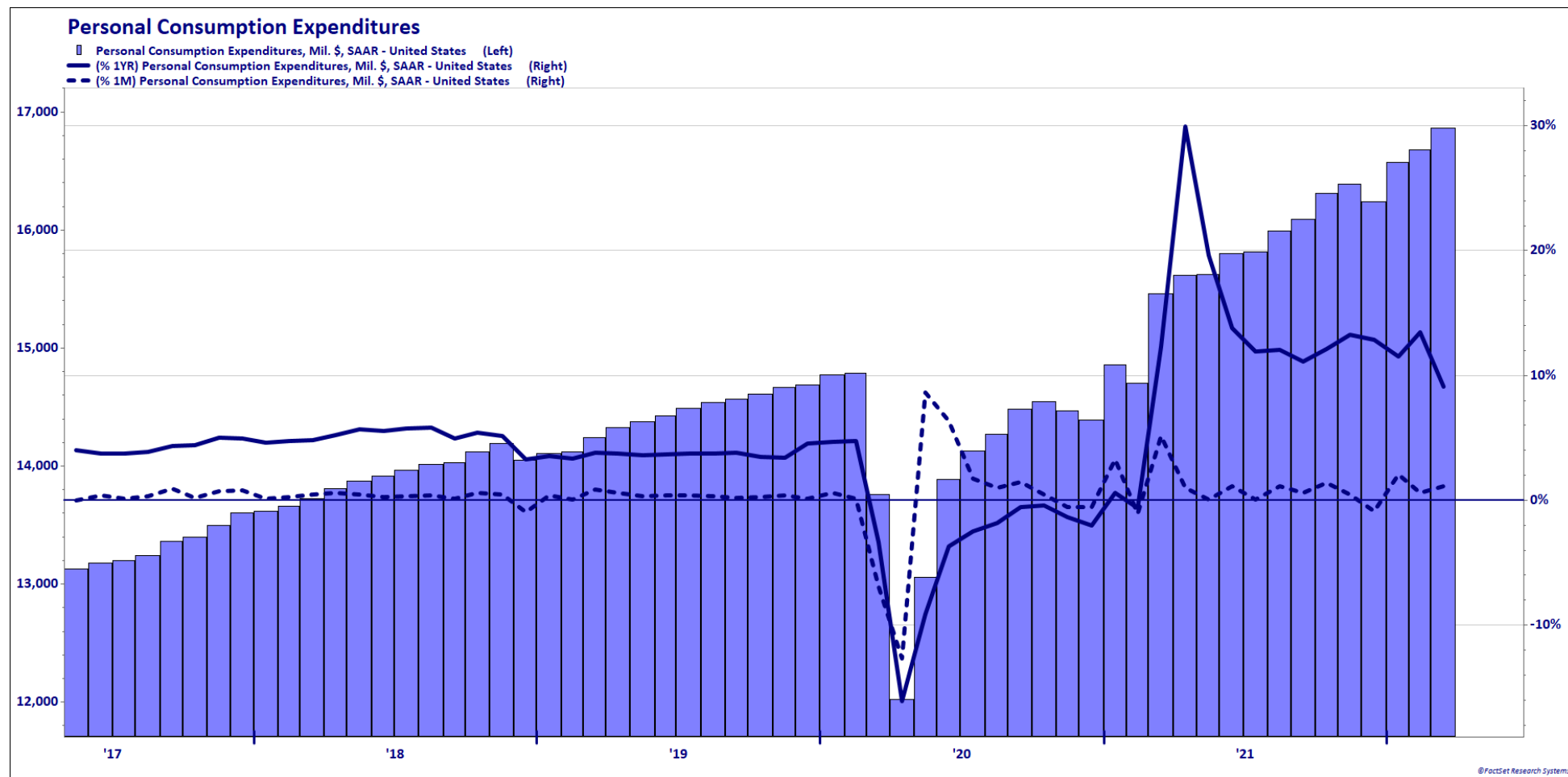
A Robust Job Market is Translating into Solid Income Gains ...

9



...And, in Turn, Strong Consumer Demand and Spending

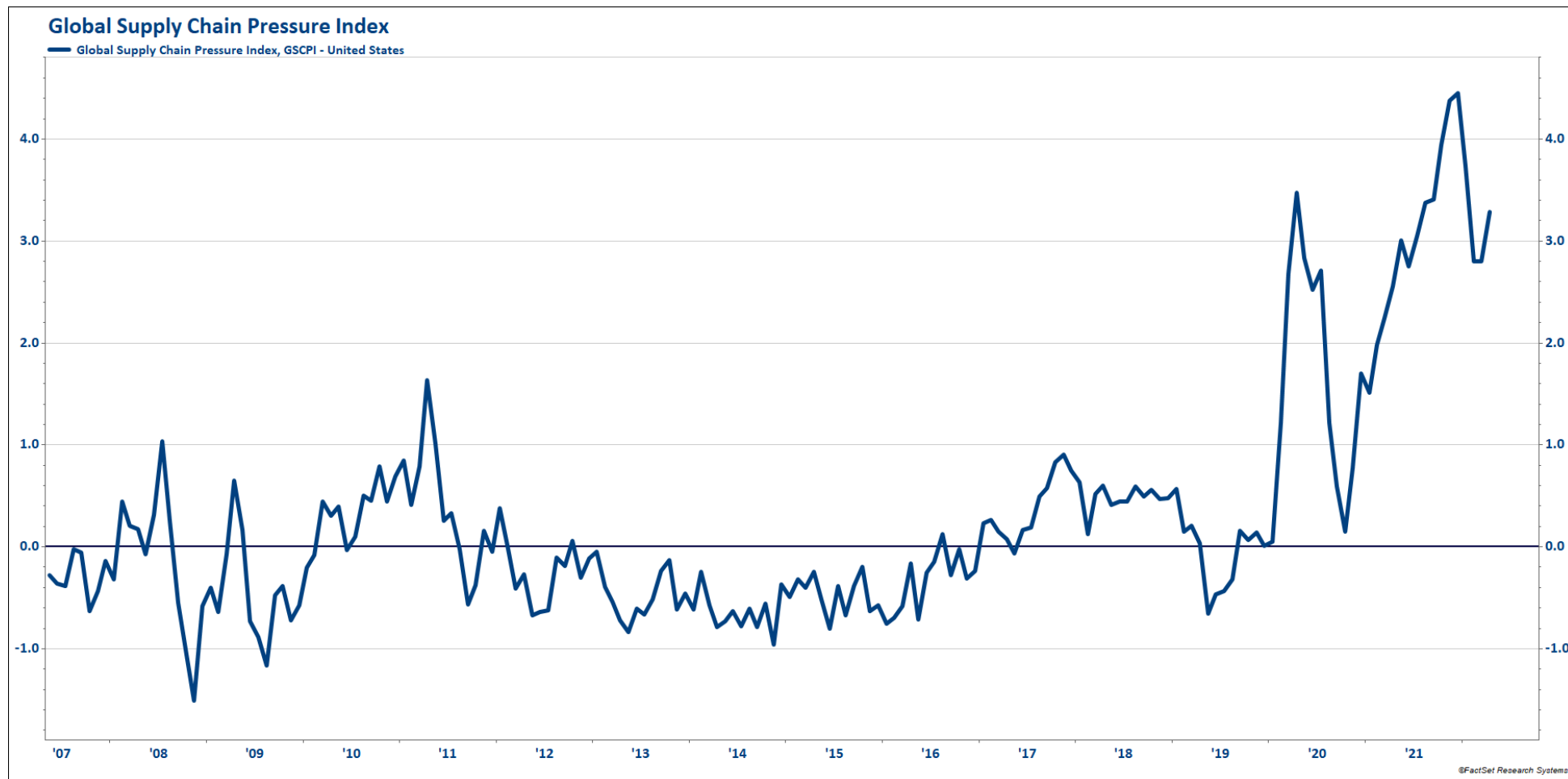
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Source: FactSet, BEA

Covid, Strong Demand and Labor Shortages Have Created Supply Chain Bottlenecks ...

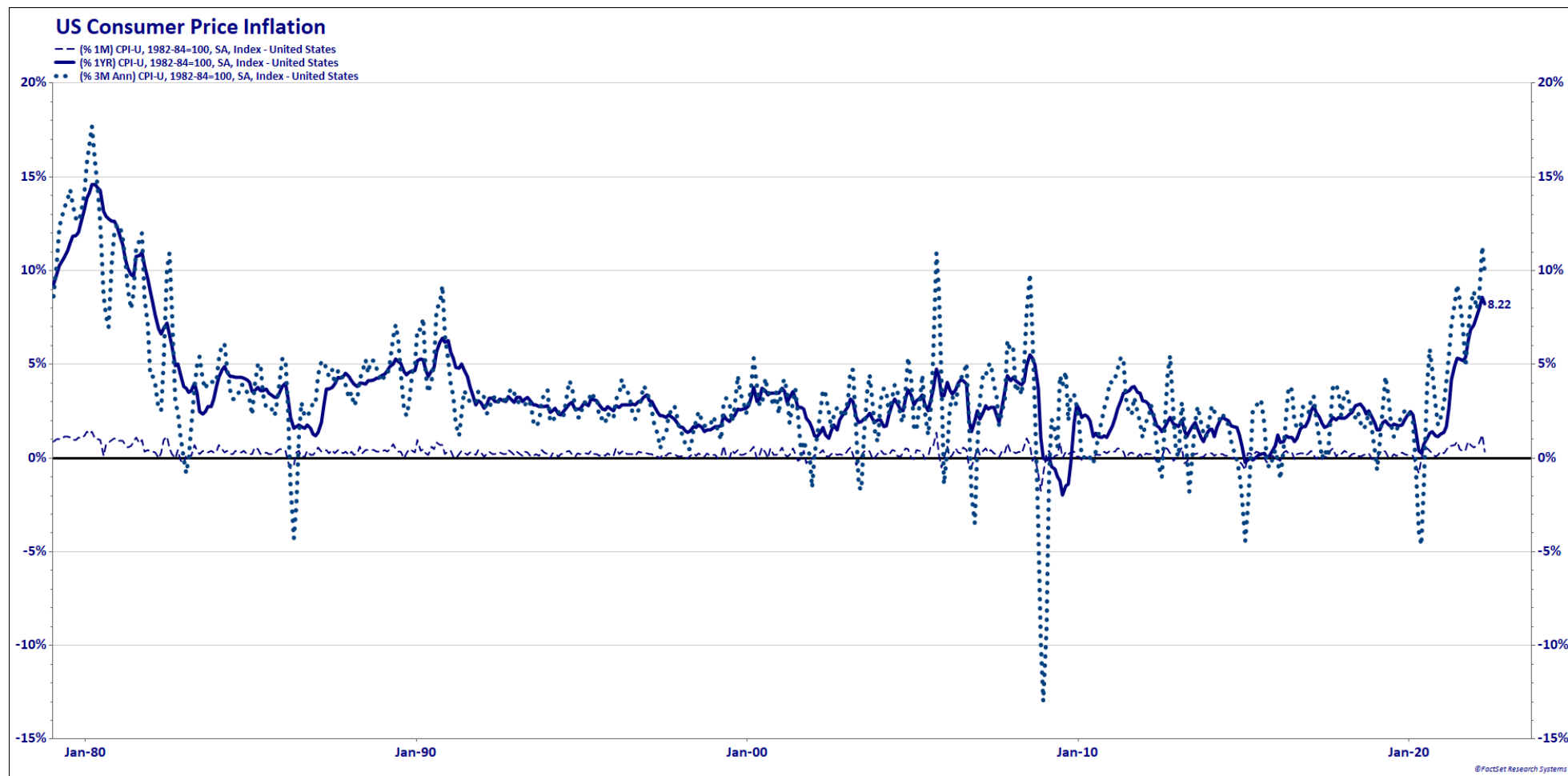
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Source: FactSet, Federal Reserve Bank of NY

... Contributing to a 40-Year High Inflation Rate

12



The U.S. Fed is Expected to Aggressively Raise the Federal Funds Rate ...

13

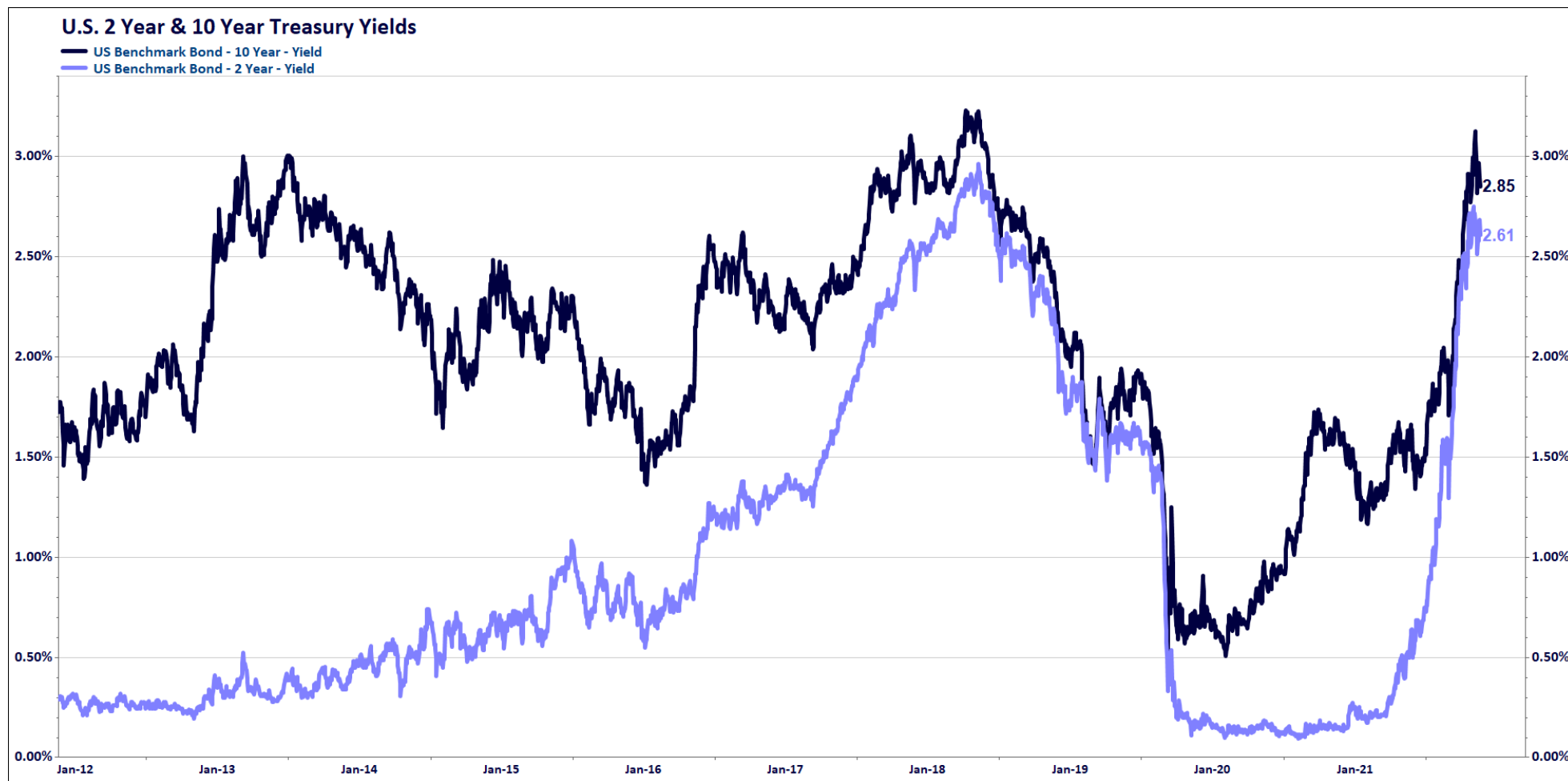
MEETING PROBABILITIES											
MEETING DATE	125-150	150-175	175-200	200-225	225-250	250-275	275-300	300-325	325-350	350-375	375-400
6/15/2022	97.4%	2.6%	0.0%	0.0%							
7/27/2022	0.0%	0.0%	90.1%	9.7%	0.2%	0.0%	0.0%	0.0%	0.0%		
9/21/2022	0.0%	0.0%	0.0%	39.7%	54.7%	5.5%	0.1%	0.0%	0.0%	0.0%	0.0%
11/2/2022	0.0%	0.0%	0.0%	0.0%	37.0%	53.7%	8.8%	0.5%	0.0%	0.0%	0.0%
12/14/2022	0.0%	0.0%	0.0%	0.0%	0.0%	34.3%	52.5%	12.1%	1.1%	0.0%	0.0%
2/1/2023	0.0%	0.0%	0.0%	0.0%	0.0%	1.6%	35.2%	50.6%	11.6%	1.0%	0.0%
3/15/2023	0.0%	0.0%	0.0%	0.0%	0.0%	1.5%	32.9%	49.6%	14.2%	1.7%	0.1%
5/3/2023	0.0%	0.0%	0.0%	0.0%	0.0%	1.2%	27.1%	46.5%	20.7%	4.0%	0.4%
6/14/2023	0.0%	0.0%	0.0%	0.0%	0.0%	1.1%	25.1%	45.0%	22.8%	5.4%	0.7%
7/26/2023	0.0%	0.0%	0.0%	0.0%	0.1%	2.9%	26.5%	43.3%	21.5%	5.0%	0.6%

← Fed Funds Target Range

Source: CME Group, [Countdown to FOMC: CME FedWatch Tool \(cmegroup.com\)](https://cmegroup.com/fomc-countdown/)

...Which Will Likely Keep Upward Pressure on Interest Rates

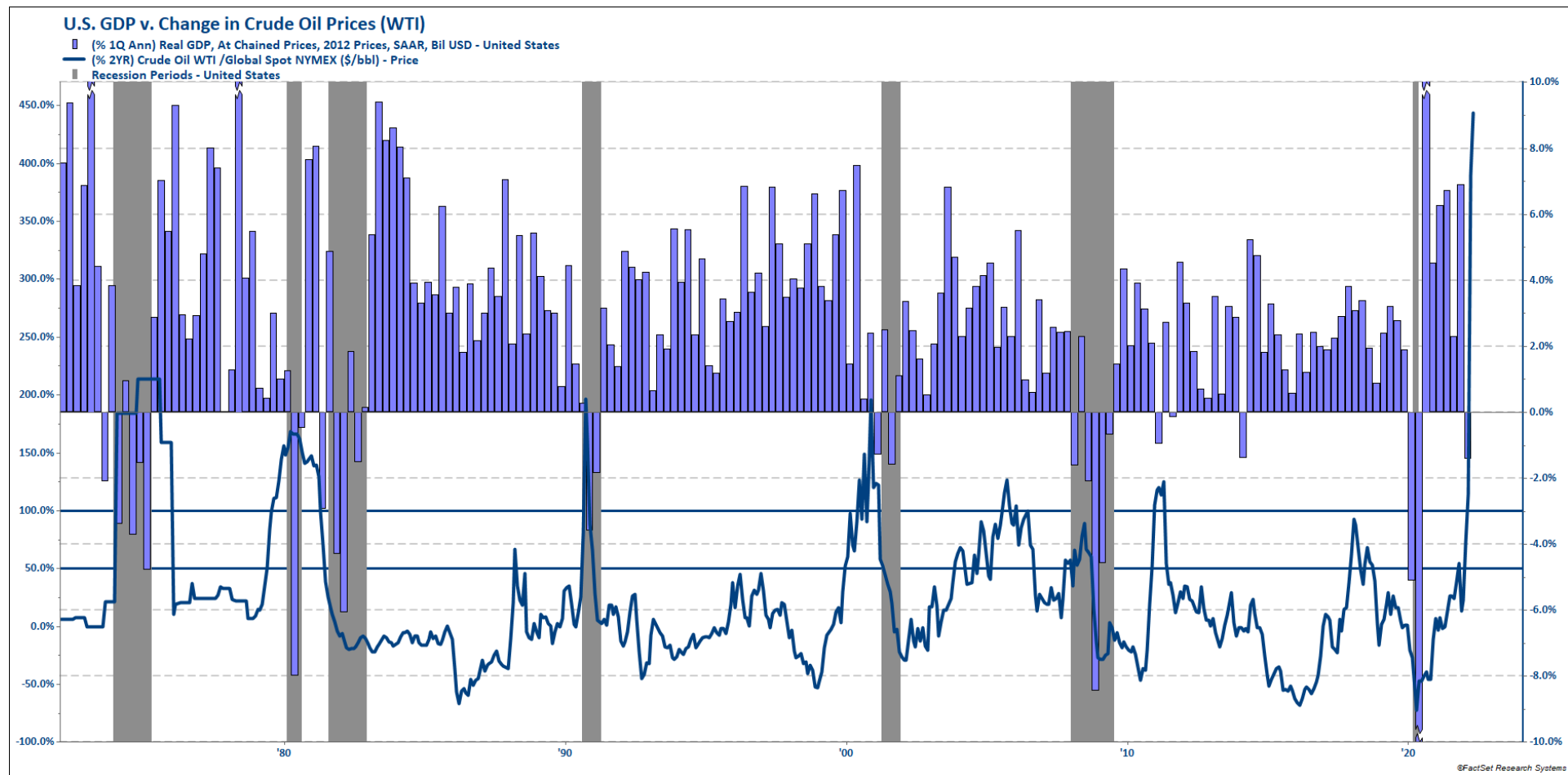
14



Source: FactSet

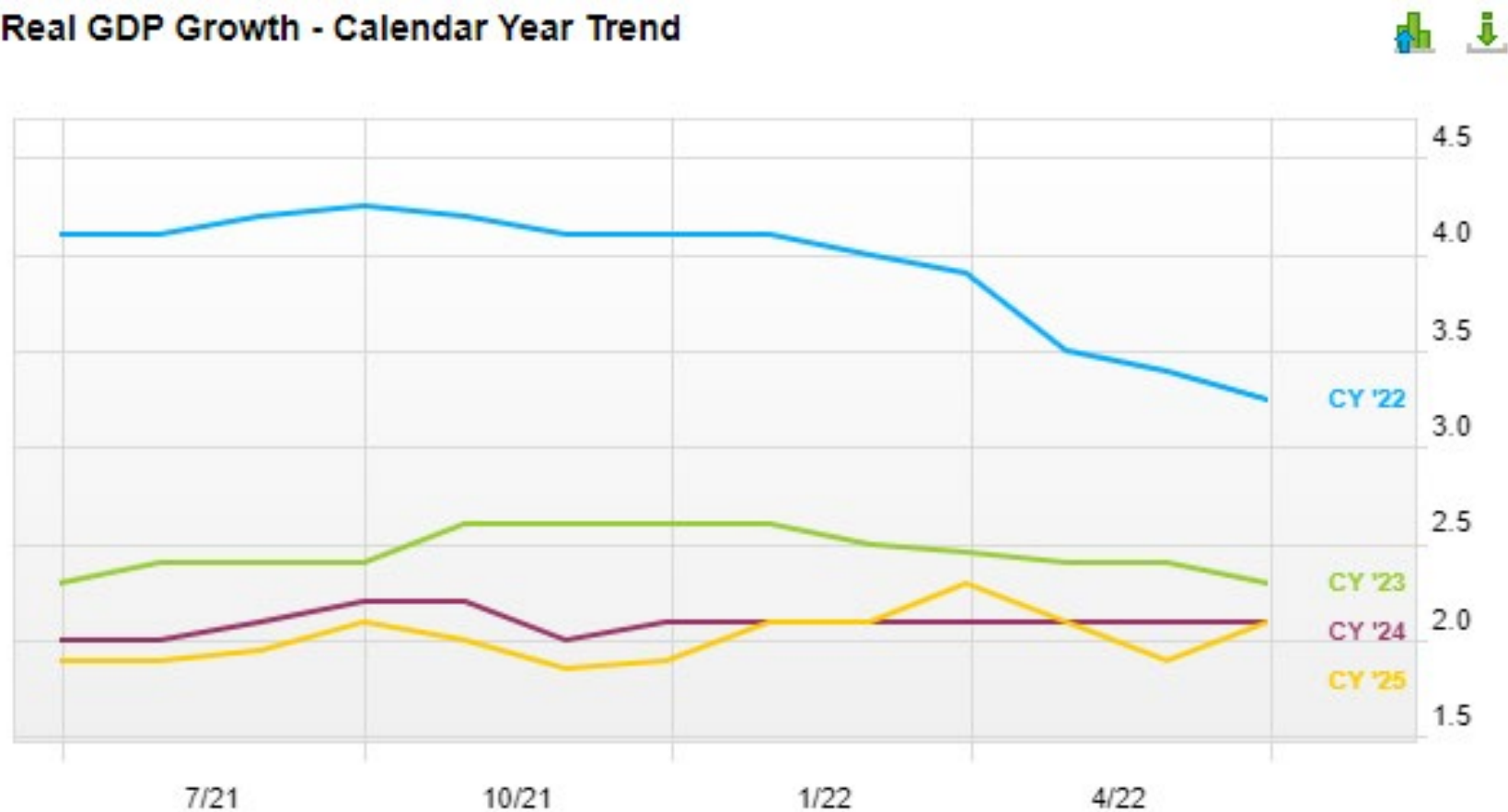
Sharp and Sustained Increases in Oil Prices Typically Slow GDP Growth

15



Source: FactSet, BEA

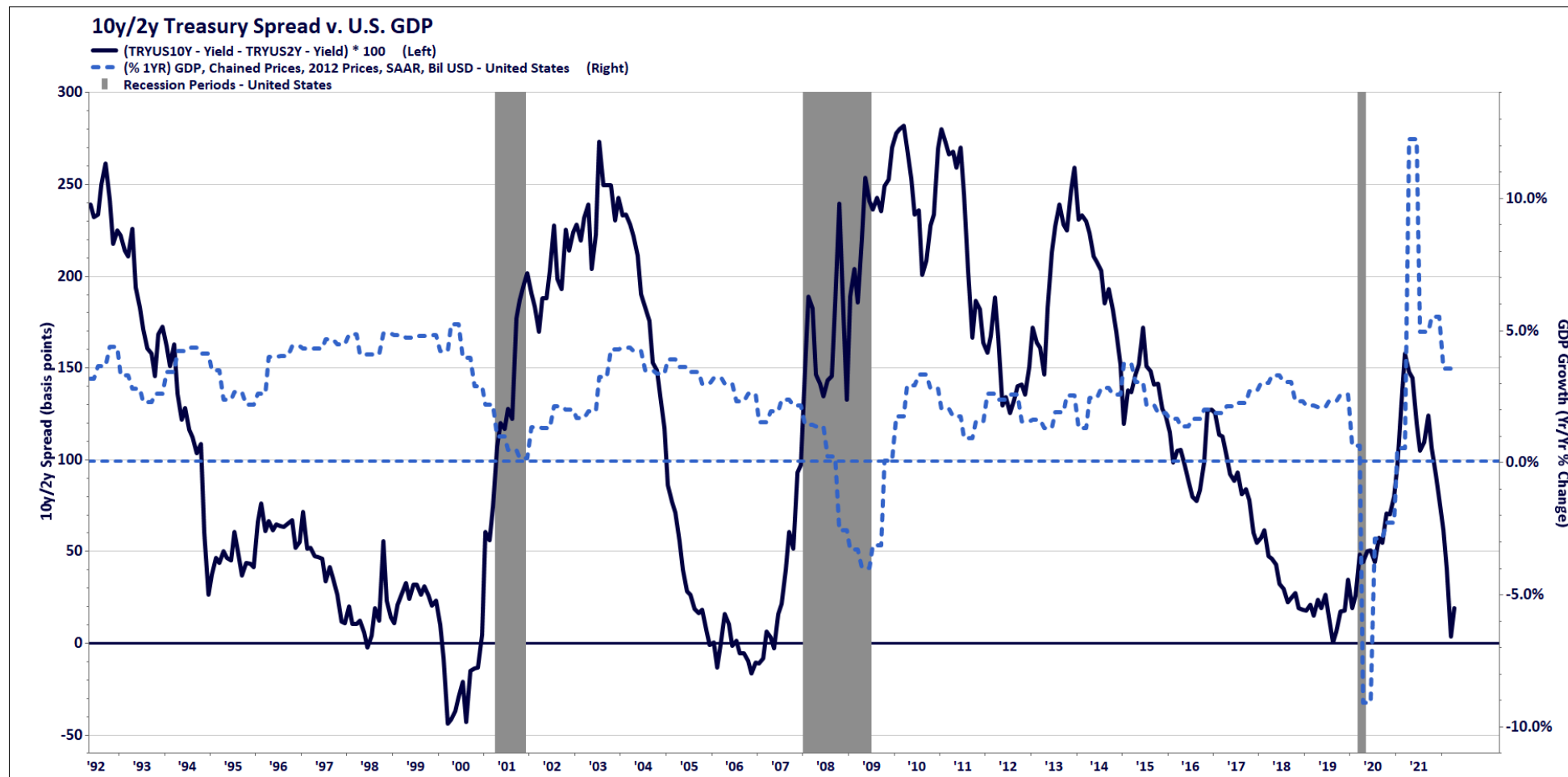
U.S. GDP Growth Estimates Are Falling Reflecting Growing Headwinds



Source: FactSet

Yield Curve as a Predictor of Recession

17



Source: FactSet

2s/10s U.S. Yield Curve Inverts About 12-Months Before Recession

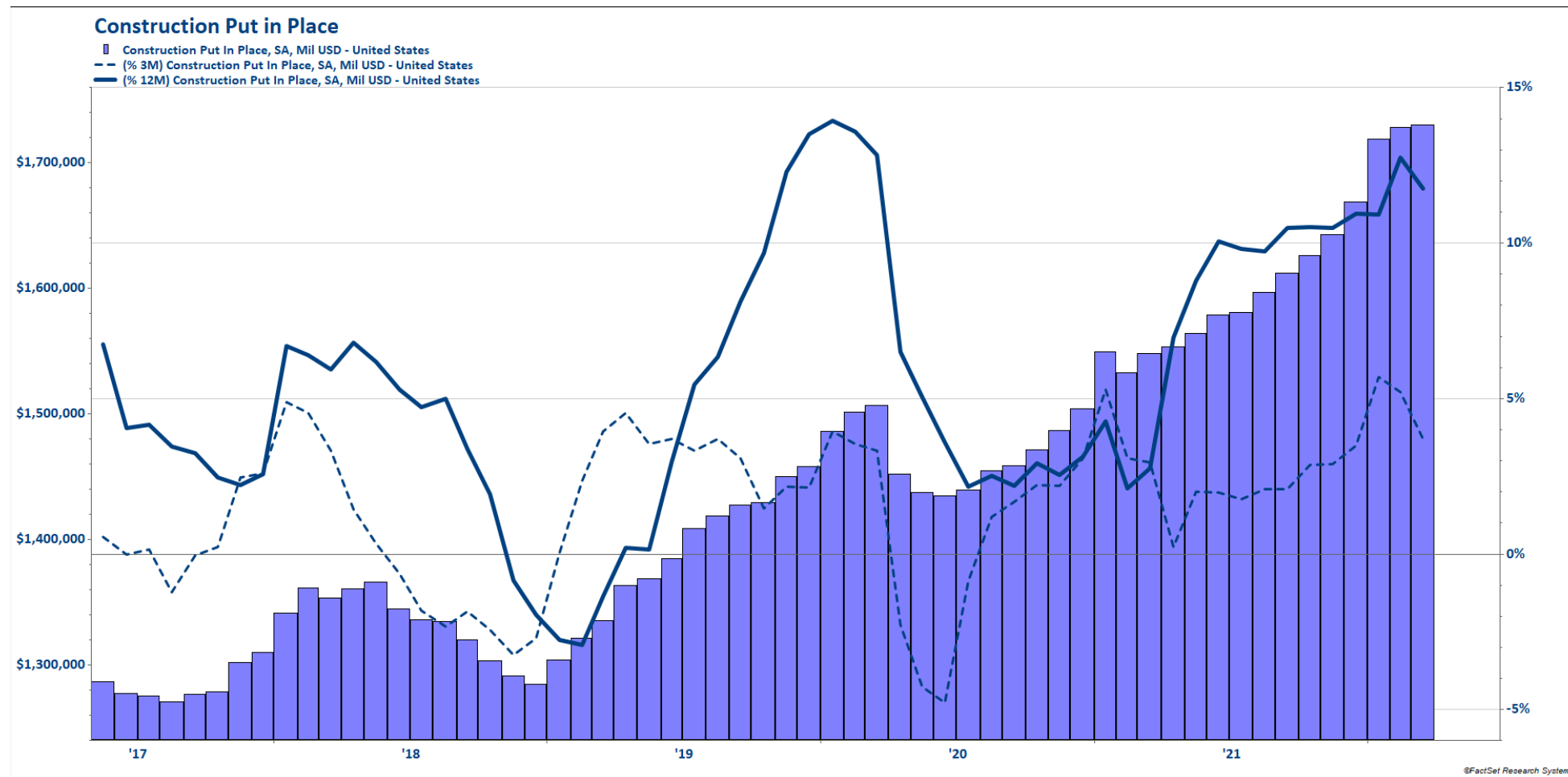
Since 1978, there have been six dated recessions by National Bureau of Economic Research and on average the yield curve inverted about 12 months before the recession occurred. Of course, some periods are shorter like the most recent recession while others are longer like prior to the financial crisis. There is one instance, 1998, where the curve inverted and the Fed was able prevent a recession by quickly cutting rates. Unfortunately, they do not have that luxury today.

2s/10s Inversion & Recession Dates (Source: Bloomberg)		
Yield Curve Inverts	Recession Begins	Months Between
Aug-78	Jan-80	17
Sep-80	Jul-81	10
Jan-89	Jul-90	6
Feb-00	Mar-01	13
Feb-06	Dec-07	22
Aug-19	Feb-20	6
Average		12.3

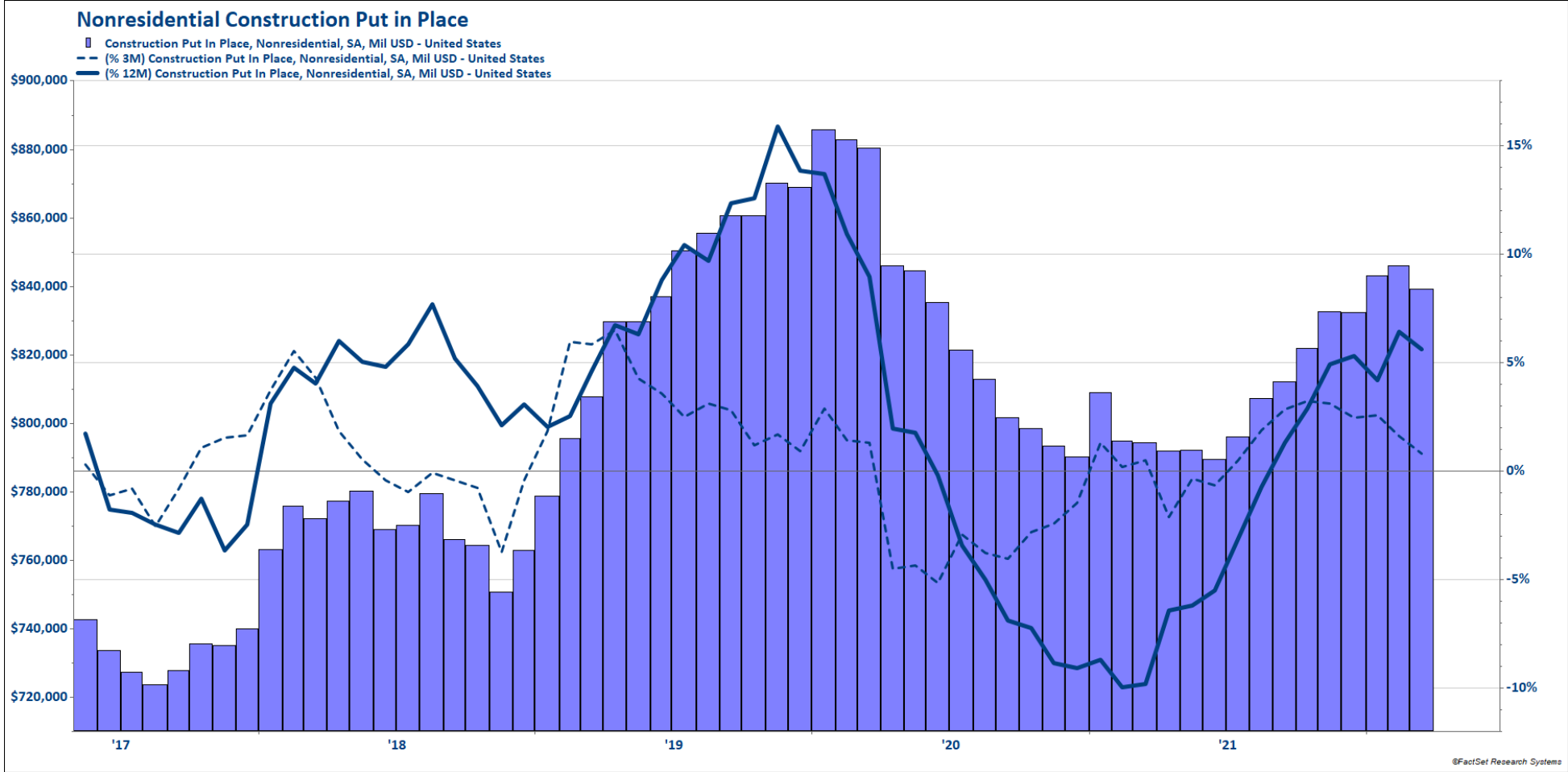
Source: Strategas

Total Construction Put in Place

19



Nonresidential Construction Put in Place



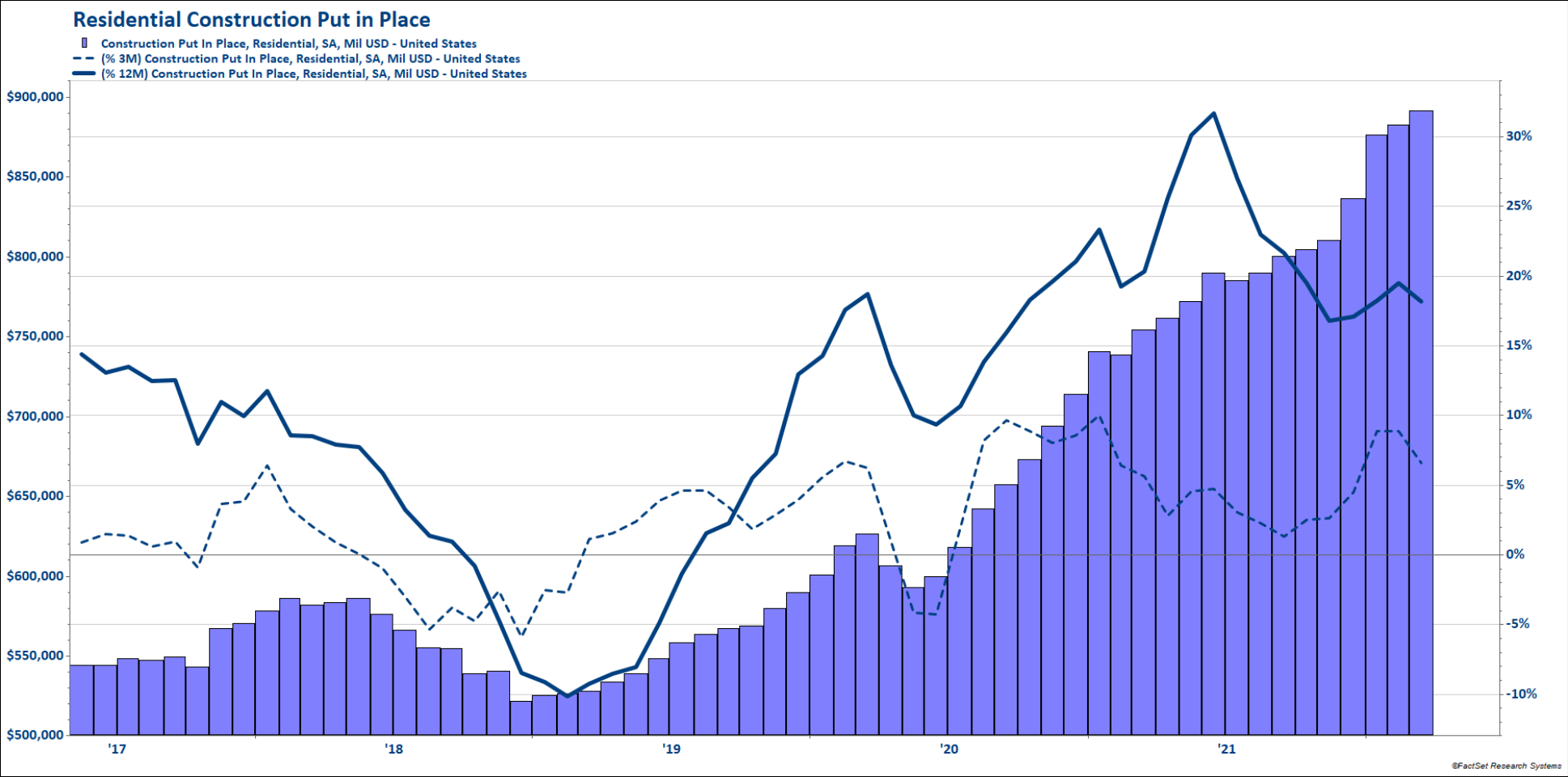
Nonresidential Construction – Manufacturing Strong

21

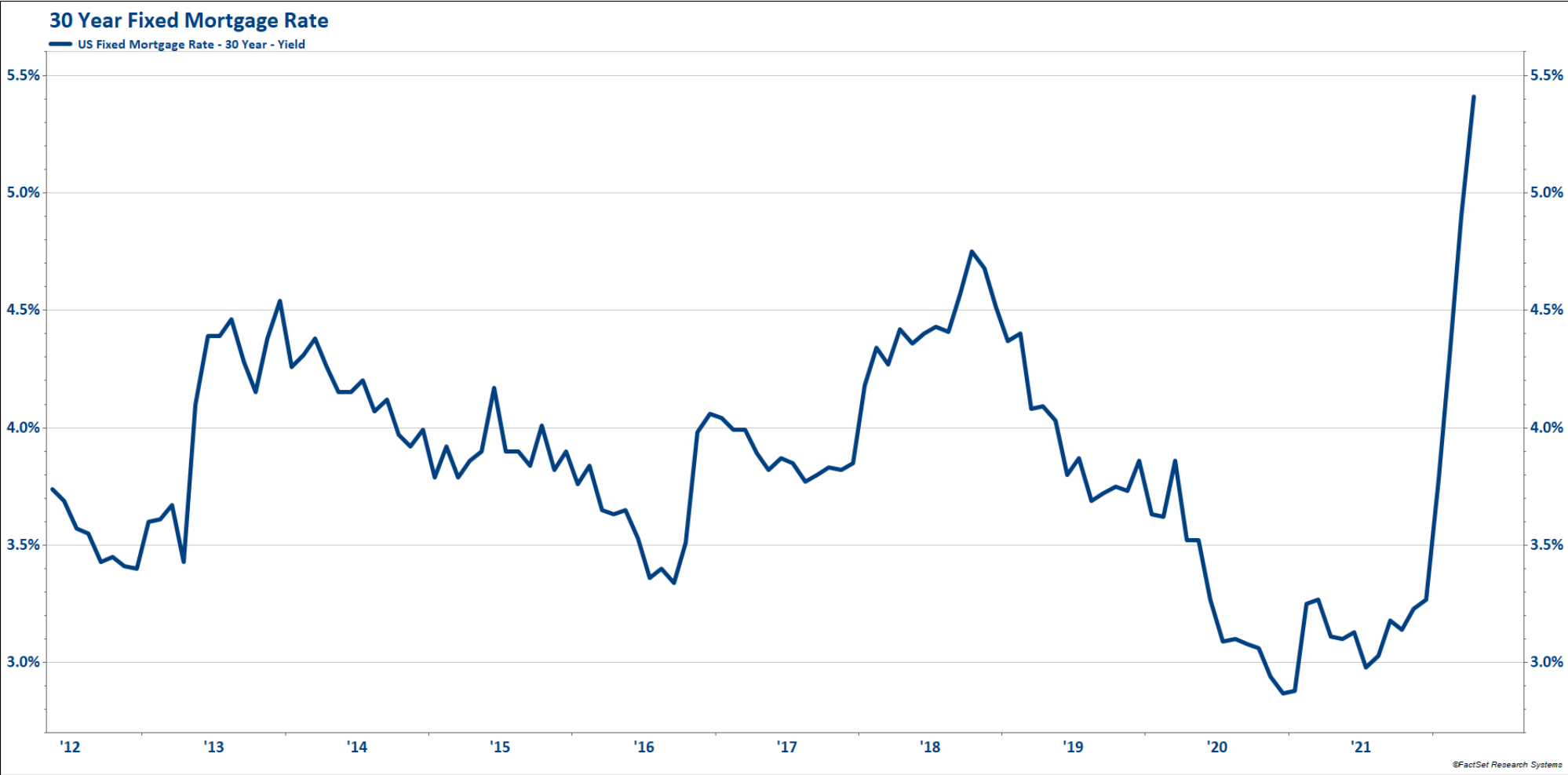
Type of Construction	% of Total Nonresidential Construction	YTD Growth	1-Year Growth	Growth since February, 2020 (sorted)
Manufacturing	11.3%	9.1%	31.9%	24%
Sewage & waste disposal	3.5%	-2.4%	10.4%	11%
Commercial	11.7%	-0.2%	14.7%	6%
Water supply	2.3%	5.2%	5.7%	5%
Health care	6.0%	-1.7%	7.8%	4%
Highway & street	12.4%	3.2%	7.9%	0%
Communication	2.6%	1.3%	-1.4%	-3%
Conservation & development	1.0%	2.6%	15.3%	-6%
Transportation	6.7%	-1.1%	-0.3%	-7%
Power	14.0%	-1.0%	1.3%	-10%
Office	10.1%	0.0%	4.8%	-10%
Educational	11.7%	-2.0%	-2.7%	-13%
Amusement & recreation	3.1%	6.6%	2.7%	-15%
Religious	0.3%	-0.6%	-10.0%	-27%
Public safety	1.3%	-8.0%	-23.4%	-41%
Lodging	2.0%	6.6%	-26.6%	-50%

Source: FactSet, U.S. Census Bureau, WTWM

Residential Construction

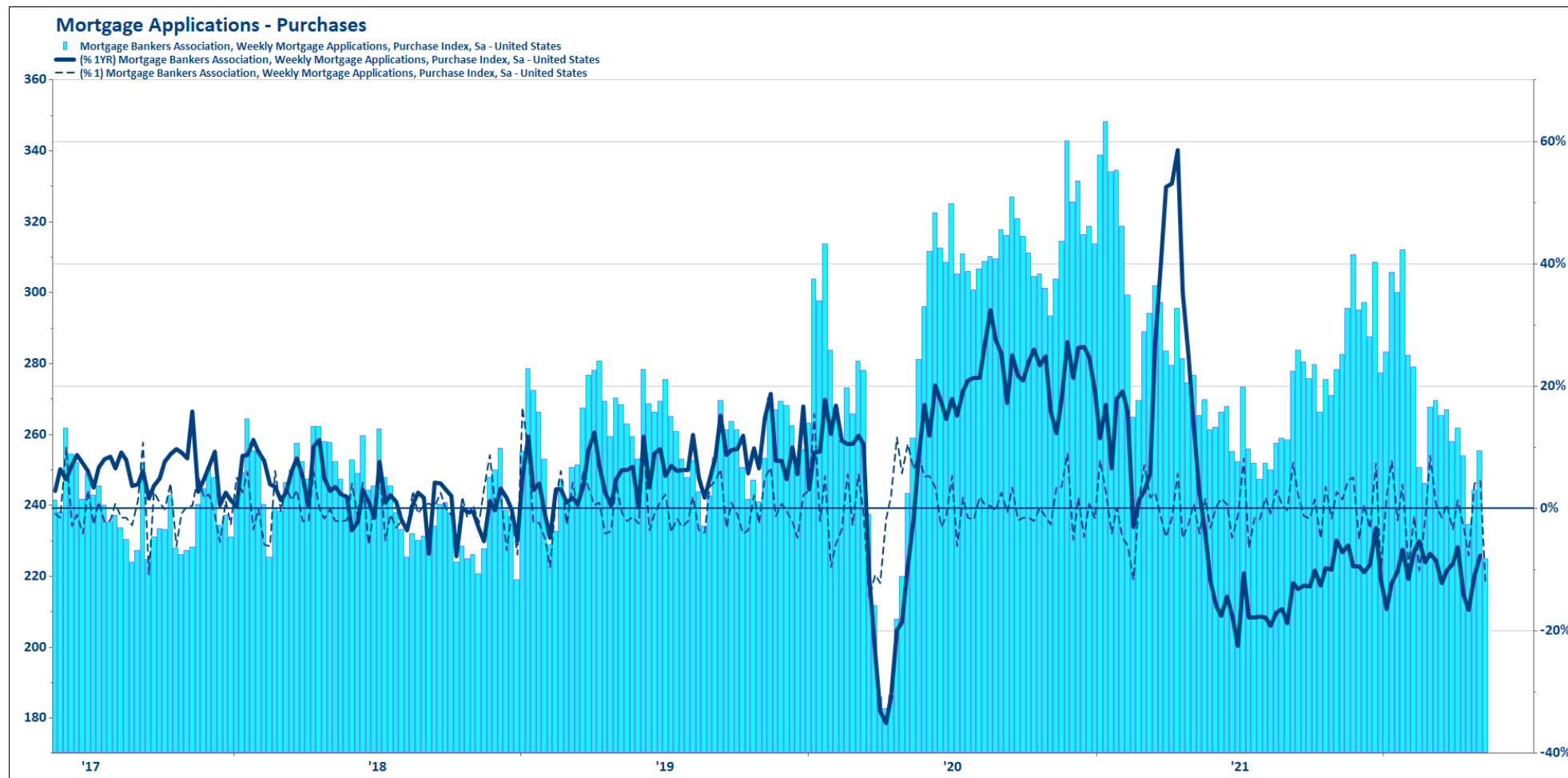


30 Year Fixed Mortgage Rates Are At Their Highest in Over a Decade



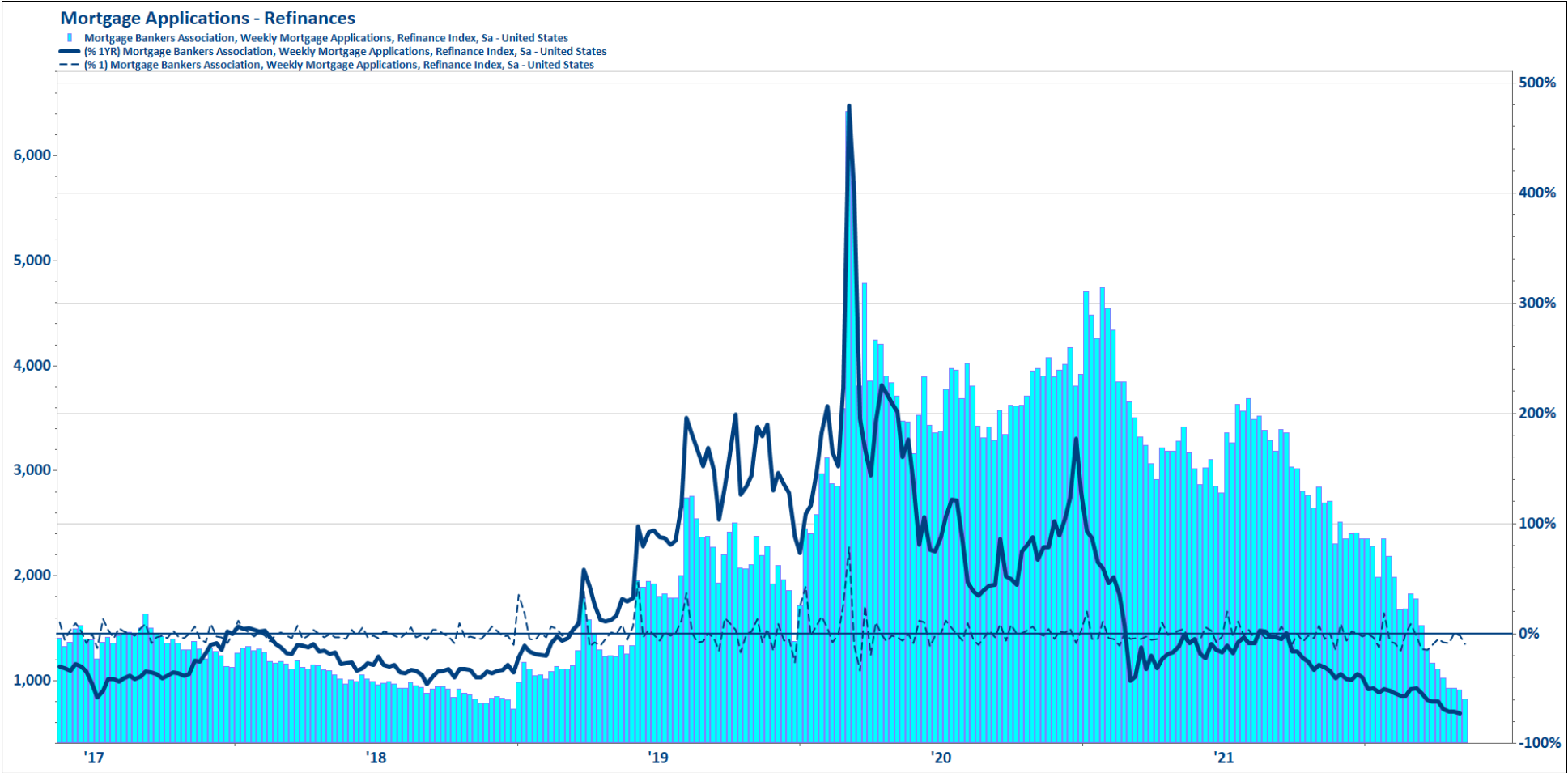
Mortgage Activity for Purchases is Slowing

24



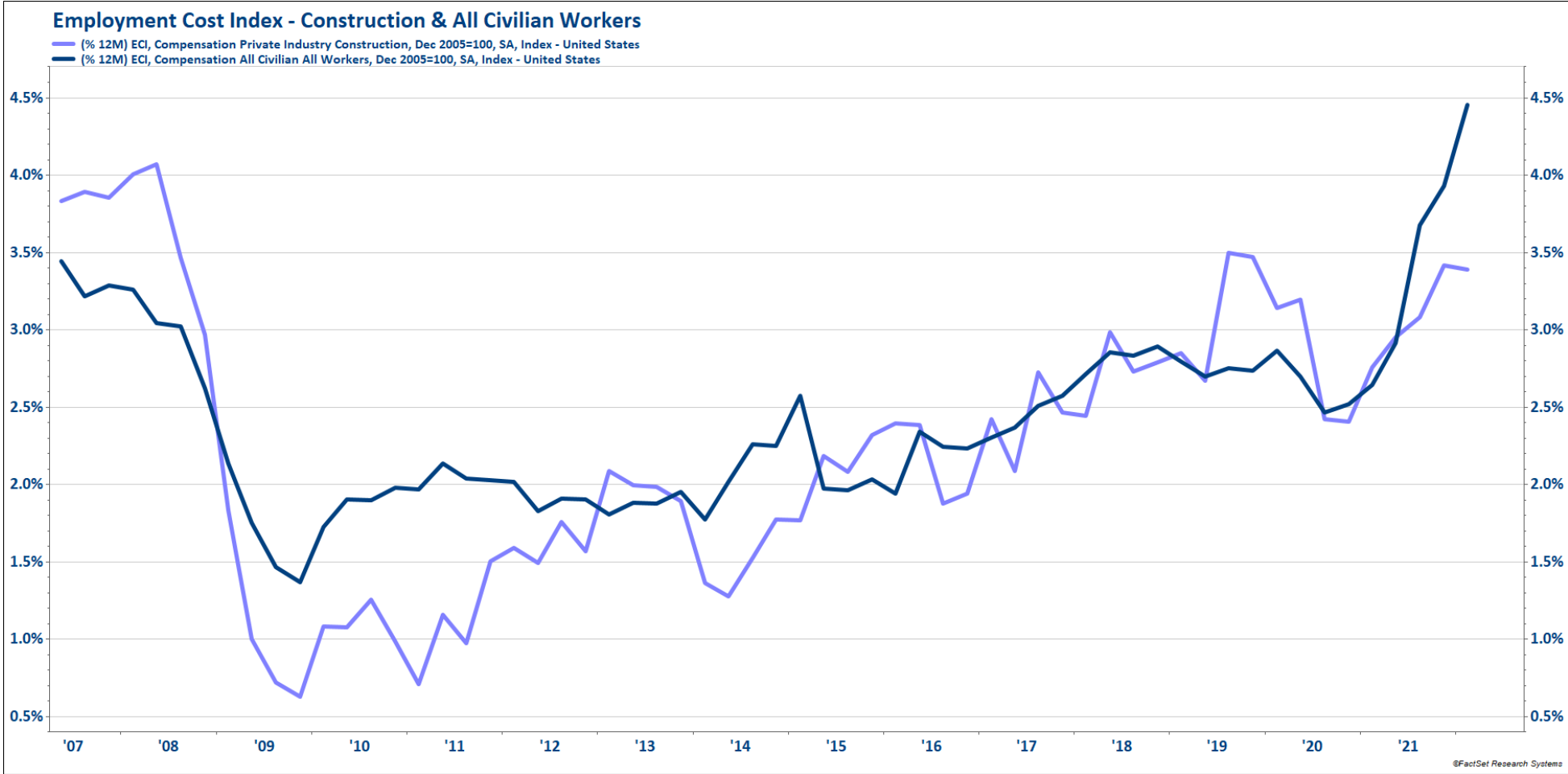
Source: FactSet, Mortgage Bankers Association

Mortgage Activity for Refinances has Collapsed



Source: FactSet, Mortgage Bankers Association

Employment Cost Index – Construction Industry

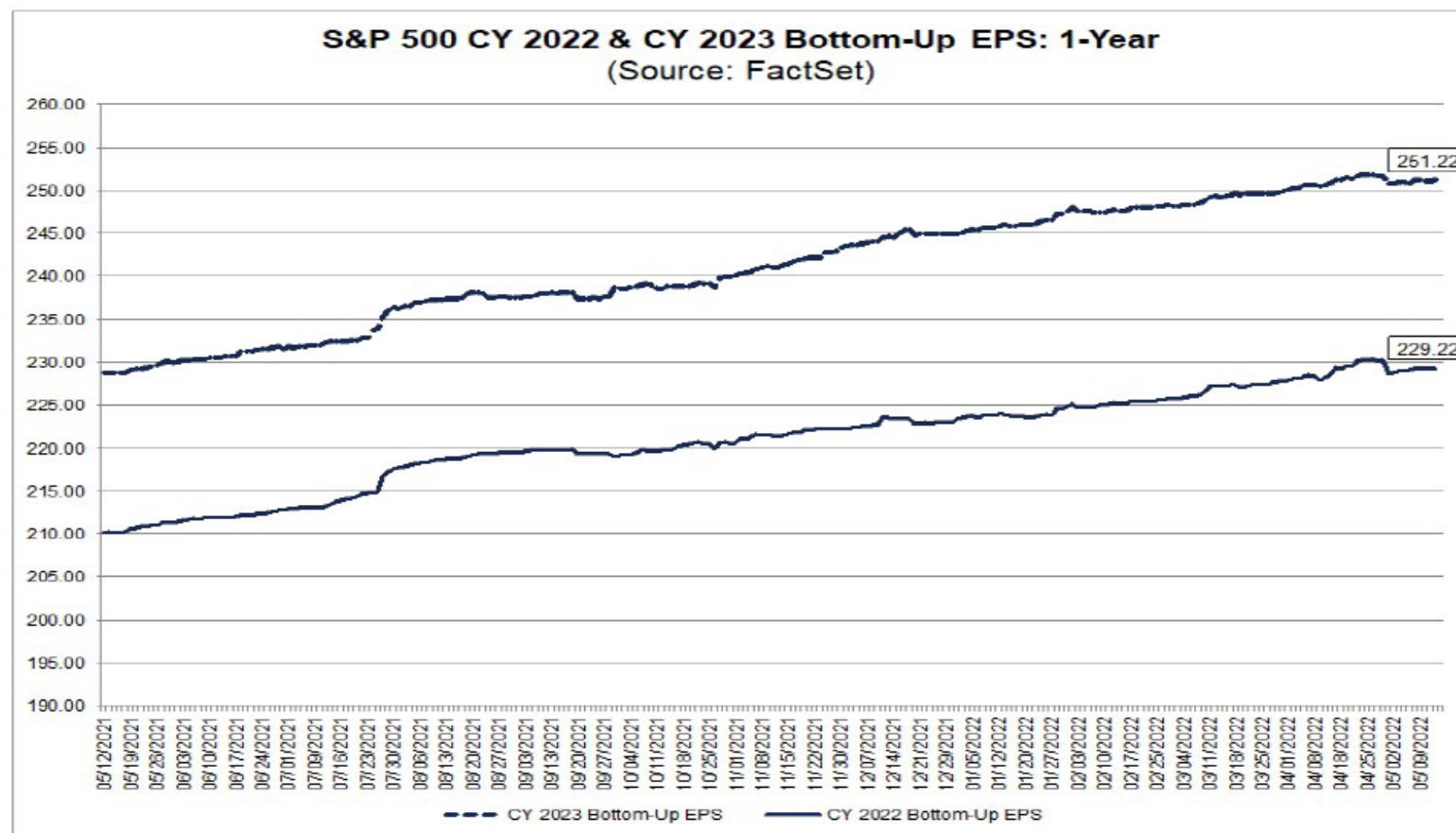


Source: FactSet, U.S. Department of Labor

S&P 500 2022/23 Earnings Estimate Remain Steady But at Risk

27

Bottom-up EPS Estimates: Revisions

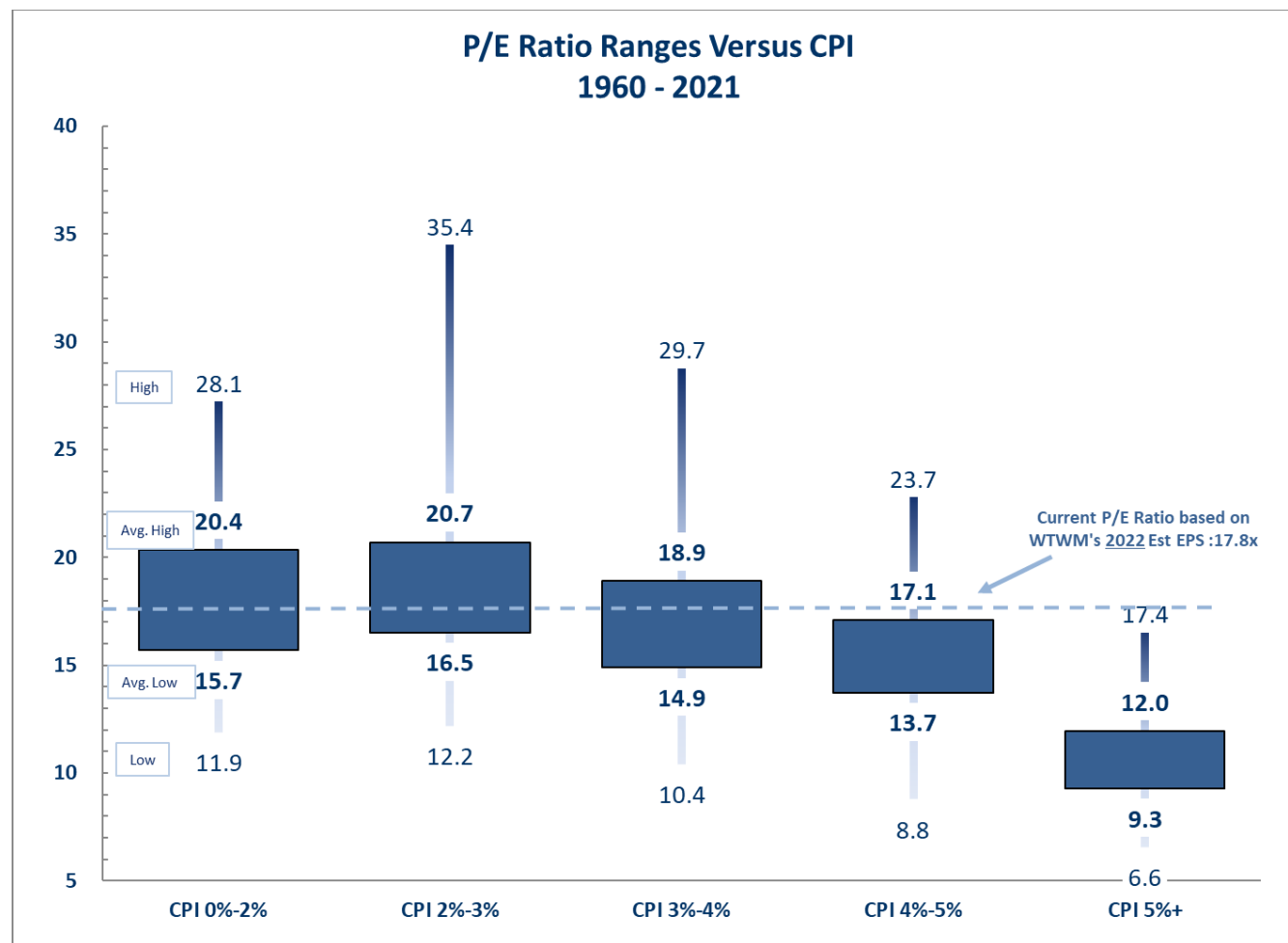


Source: FactSet

Note: Last data point May 13, 2022

S&P 500 Price/Earnings Ratio Relative to the Consumer Price Index (CPI)

28



Source: FactSet, BEA, Standard & Poor's, WTWM

- The U.S. economy continues to recover from the COVID induced slowdown
- The U.S. labor market is strong, driving good income gains and consumer spending
- Covid shutdowns, labor shortages and strong demand continue to pressure supply chains
- Inflation is at a 40-year high and starting to impact consumer spending and corporate profitability
- The U.S. Fed plans to aggressively fight inflation with higher interest rates and asset sales
- Interest rates are rising across the economy and will ultimately lead to slower economic growth
- A 'soft-landing' is the hope, but risks are high
- Construction spending has been a bright spot of the recovery, especially residential and manufacturing, but residential may be at risk due to higher interest rates
- Corporate earnings estimates remain solid; however, susceptible to downgrade
- We expect continued price volatility in the financial markets
- A moderation of inflation would be a positive for the economy and financial markets
- Wildcards: COVID, Ukraine escalation, U.S. mid-term elections



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QUESTIONS?

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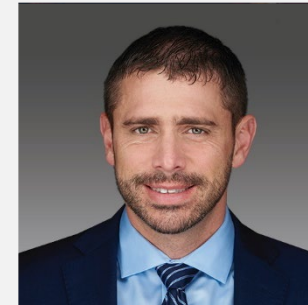
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