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TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hello there and thank you so much for making the time to join us for *Market Sense* today. I'm Heather Hegedus with Fidelity. Stocks generally held their ground in the last week as investors processed some inflation and some jobs—jobless claims data. And by the beginning of this week, the S&P had hit another all-time high to kickoff third quarter earnings season. So investors, of course, are watching all of these data points very carefully for clues as to the pace of the Fed's rate cuts and the strength of the economy. And to talk about w hat it might mean for investors, we are joined today, as we often are, by Jurrien Timmer, Fidelity's director of global macro.

Also, mortgage rates have been dropping over the last year in anticipation of Fed rate cuts after peaking back in October of 2023. And rates may fall even further if the Fed keeps cutting interest rates like they did in September, creating opportunities for everybody, from homeowners to also investors. And that's why we asked Mike Mariani to come on the show today. He's a vice president of lending solutions here at Fidelity, and he's worked at banks and mortgage companies setting rates in his former lifetime before joining us here at Fidelity. Thank you both for being here today. And, Mike, welcome. I'm really excited to hear what you have to say about this housing market and mortgage rates. It's certainly something that is important to a lot of our viewers and listeners, as we know. So welcome, Mike.

MIKE MARIANI: Thanks for having me on. Great to be with you both.

JURRIEN TIMMER: Nice to see you both. Welcome, Mike, to the show. Thank you.

HEATHER: Well, today is Tuesday, October 15. Jurrien, there is a lot to talk about and a lot going on in the world right now, frankly. But, you know what, the markets have been surprisingly calm lately, it feels like—first of all, our hearts continue to go out to the people in Florida affected by

Milton as that cleanup continues. There's also geopolitical concerns. Do you find it surprising that the market has not been reacting to these news headlines more or the election cycle, for that matter—we've got a presidential election, we can't forget about that, in less than a month from now? What's going on under the surface, do you think here? What do you think the market is really focused on right now, Jurrien, if it's not distracted by those headlines.

JURRIEN: It's a great question and it's one that I get often from our customers. And the markets are brutally efficient, if you will. They are somewhat cold-hearted. And I don't mean that in the worst way, but markets are very rational. They look at the facts, at the fundamentals of earnings, interest rates, monetary policy, economic growth, things like that. And, obviously, the headlines we see are often very disturbing or heartbreaking—the hurricanes, the news out of the Middle East, and out of Russia and Ukraine, the election cycle, many other things that give people a lot of pause and reasons to either cheer or worry, depending on which side of the political spectrum you're on. But the markets are rightfully laser-focused on the numbers. And that's a good thing because, otherwise, the markets would be all over the place reacting to every headline. I mean, imagine how stressful that would be.

And it's worth remembering the economy—the US economy is $30 trillion large. The global economy is $105 trillion. The US stock market alone has a valuation of $50 trillion and it is the deepest, most liquid, most efficient market—or one of them around the world. So the markets, with thousands, if not millions, of people with computer screens looking at the data will cut through the headlines very quickly and ask the question, OK, what does it actually mean for the market.

So a hurricane, for instance, or an earthquake would, obviously, stop GDP in its tracks for a certain amount of time, but then it gets rebuilt and the economy comes back. COVID was kind of a microcosm of that as well. And the markets will often look through that.

And, right now, this is about the economy, about whether the Fed can land the plane without crashing it, if you will, and where interest rates go. And, ultimately, the market is worth what the present value is of future earnings or cash flows. So its earnings and interest rates that will determine the value of the market.

And, obviously, there are things that will affect economic growth—policy decisions resulting from the election, for instance—but the market is very efficient at cutting through that. And it's a good thing because we worry about enough things as people. It's nice to have the market be anchored and rooted in the fundamentals.

HEATHER: In the fundamentals. It's cutting through the noise. Well, some of the fundamentals include jobs data. That's one of the Fed's part of the Fed's dual mandate. And we did get some hotter than expected jobs data earlier this month, Jurrien. So how do you think that jobs data might affect what the Fed decides to do next month in November?

JURRIEN: So the Fed is poised to cut rates further, maybe not as much as what the market was expecting until a few weeks ago when we had the employment number that you just referenced. But the Fed was at a rate of 5 and 3/8, while the inflation rate was heading lower—the rate of inflation, not the price level. It was heading lower towards 2 and 1/2, 3—where we are today—and that's not quite at the Fed's target, but it's heading in the right direction.

And so for—so regardless of what happens to the jobs market, whether it's strong or weak, there really is not the justification to have rates be that far above the inflation rate if that inflation rate is starting to come down. And that's really the reason for the Fed to cut rates. It's now at 4 and 7/8. The expectation is that in November it will cut rates by another quarter and maybe even another quarter in December.

And the idea is not to for the Fed to panic because the economy is weak. It's not doing any of that. But the idea is that a more neutral policy is probably more warranted than a very restrictive policy when the clear and present danger of accelerating inflation seems to be behind us. And that's juxtaposed against a jobs market that remains pretty solid.

The economy—so far, like I said, the Fed has is landing the plane. We'll see if that continues because the pendulum does tend to swing all the way from one extreme to another. But right now, the Fed is in a sweet spot. It has a license to cut rates a few more times to maybe 3 and 1/2%, 4%. And that, of course, has implications for the economy and for the housing market as we're about to discuss with Mike here.

HEATHER: Perfect segue there, Jurrien. Exactly. Interest rates impact mortgage rates, among other things. Before we dive into this next topic, I need to note that, of course, Fidelity is not a bank. Fidelity is also not a mortgage lender. *Market Sense* is an investing show. And part of this show is addressing your whole financial picture. And for most of us, our home is our biggest asset. So that's one reason we wanted to take up this topic today.

Mike—so I'm so excited, welcome to the show. I'm so excited to hear from you today. First of all, can you talk a little bit about what you're seeing for rates these days and how rates right now compare to where they had been?

MIKE: Sure, Heather. So the good news here is that mortgage rates have decreased since they approached almost 8% in the second half of last year. Right now, 30-year fixed mortgage rates are averaging a little above 6%. For someone that's considering buying a home with a $400,000 mortgage amount, the savings from where we were at that peak to where we are roughly today would translate to $400 per month. Or, thought differently, if they were comfortable with that payment when rates were higher, it would actually give them an additional $75,000 of mortgage buying power while keeping the payment the same.

So Jurrien just talked a little bit about the Fed and how they're lowering rates. And last month we saw that half a percentage point cut. One of the most common questions I heard leading up to that meeting and then since that time is whether or not this reduction lowered mortgage rates by the same amount and then how do those two things work together, the Fed funds rate and mortgage rates?

The short answer is no. Mortgage rates actually stayed the same immediately following the meeting and then since have moved slightly higher. The Fed's rate changes directly effect short-term rates and some loans that have a variable rate feature that's tied to the Fed funds rate or prime rate. So think of home equity lines of credit, a securities-based line of credit, or even credit cards. In most cases, they move down that half a percentage point with the rate reduction.

But longer term rates, and I would include mortgages in that group, are really influenced by broader economic factors and are particularly sensitive to inflation. When inflation rises, investors demand higher interest rates in bonds to compensate for the loss of purchasing power. So interest rates tend to rise when inflation—or inflation expectations rise and then fall when inflation—or inflation expectations fall.

As we look back at mortgage rates over the past four years here, inflation was already moving higher in 2021 and 2022 before the Fed began to raise rates in March of that year. Because of that, investors had already started demanding those higher yields to compensate them for the higher inflation. So we saw mortgage rates move up by over—or just about a percentage point and a half before the Fed started their actions.

And then in the same way, with inflation decreasing, they had actually happened before the Fed lowered rates last month. So we'd actually seen the decline in mortgage rates by over one percentage point in the past six months by the time the Fed had moved in September. So by the time they've taken—

HEATHER: --the market had anticipated it. So the market anticipated it and mortgage rates were going down before the Fed made its first cut in September.

MIKE: Exactly.

HEATHER: There's broad market anticipation that the Fed's going to keep cutting rates a few more times over the next year or so. Do you think it's fair to say that mortgage rates, though, will keep dropping, even though you're saying right now that the market had already priced it in and, in fact, mortgage rates have actually risen a little bit since September. In other words, for somebody trying to decide whether it makes sense to refinance right now or wait, what kind of factors need to be weighed into making that kind of calculation, Mike?

MIKE: So for many people with an existing lower rate mortgage and looking at a recent realtor stat, about 75% of people have a mortgage rate below 5%. At today's rates in the low six percentage range, it may not make sense to refinance into a new mortgage. But even though rates are still relatively high compared to recent years, for someone who has bought a house in the past 18 months, when we saw that spike in rates, they'd likely have a 30-year fixed mortgage between 7% or 8%. So for a lot of these people, it may make sense to consider a refinance to where rates are today.

But my view with any mortgage scenario is it's really important to review your options and compare rates and fees across multiple lenders. This can really increase your chances of finding the best and lowest rate and fee options available for your specific needs.

So for some people, it may make sense to wait, but you're really balancing it out with the uncertainty aspect. We don't know for sure what will happen with rates. The mortgage industry is anticipating a slight improvement in rates for 2025, with projections from Fannie Mae and the Mortgage Bankers Associating—Association suggesting an average in the upper 5% range, which is really close to the long-term 30-year average we've seen.

These forecasts assume that inflation will decrease toward the Fed's 2% target and that unemployment will gradually rise, which would really set the Fed up to consistently reduce rates. But this scenario is not guaranteed. If we do see employment actually grow more rapidly or potentially inflation remains high, rates could stay at their current levels or even potentially increase further.

HEATHER: Well, again, it's interesting, to hear that because there's no question that there is a housing crisis. We know that home prices have doubled in the last decade. Housing prices actually hit an all-time high back in July, just a few months ago. So could falling mortgage rates have an impact on home prices and home affordability? And how long could it take to see that impact?

MIKE: Sure. So lower rates are certainly welcome news for any potential home buyer. It's going to have an immediate effect on how much home they can afford and what that monthly payment would be. But rates are really one of the three main components I think about for housing affordability.

As a buyer, you also have to factor in where your income is and where it could potentially go and what's happening with home prices. If we have all three of these pieces working in your favor as a buyer—so maybe your income's increased, we're seeing interest rates decreasing and home prices are staying the same, or you could be in a market where you're actually seeing home prices decrease—then your relative affordability for housing is going to go up.

Overall, in the market—in the economy, we have seen income growth and real wages increasing with unemployment at a relatively low rate. But we have to offset that with the higher rates we've seen in the market and increasing home prices that you mentioned, Heather. So those have really combined to offset the gains and overall reduce housing affordability and create an environment that housing's relatively expensive compared to other times in the past.

I think one of the major factors that has really been keeping affordability down is that there's been a low supply of homes for sale relative to the amount of people looking to buy. So even with the historically slow housing market—and it is looking like 2024 will have the lowest number of homes sold in 30 years and that's despite a growing population over that time—we're still seeing home prices climb in many parts of the country, which can erase those gains that we're seeing from the lower mortgage rates.

One thing we could potentially see from this drop in rates is actually more buyers coming in off the sidelines. So, in the short-term, this could actually increase that demand and put more pressure on home prices to continue increasing.

JURRIEN: I would just add, as Jay Powell has said, the housing market has been frozen because when rates rise—unless you have to sell, you're not going to sell because a lot of people have locked in 2 and 1/2%, 3% mortgages back during the pandemic. So they're not going to sell unless they have to.

And then for buyers, there's sticker shock, of course—even if house prices are not rising, just the mortgage costs alone. And so with rates coming down, I think the hope is that this very large part of the economy gets unfrozen. And knowing that there's long lag times between a developer getting approvals to build an apartment complex or what have you or a series of homes, and actually funding that and constructing it, and then selling it—that [AUDIO OUT] a number of years.

But unfreezing the housing market, I think, would increase more mobility within the economy. People are able to move around and go to different places to get different jobs. And it could increase the—obviously, the supply of homes while making them, hopefully, more affordable. So it is a very important, potentially very positive thing because, again, the housing market is one of the largest parts of the economy and it really has been frozen, as Mike was just saying with the sales this year.

HEATHER: Yeah. And, Mike, do you see the rate cutting cycle improving affordability? Do you think that is the key to us finally getting out of this tight dynamic that you both described—the supply and demand issue in the housing market?

MIKE: Right. And I think I'm right along the lines as what Jurrien was saying, talking about unfreezing the housing market. So, ultimately, we need the housing supply to increase to help reset the market back to a more normal environment.

If mortgage rates do continue to move lower and, I think, approach more like a 5% level, it's going to increase the amount of people who are willing to trade in that lower, locked in 3% or 4% rate and buy a new home. So, ultimately, that will help push up the supply and potentially offset the demand side of the market.

A positive that we've seen recently here with rates coming down is that active listings are up 31% in September over the previous two years Septembers. But against a little bit of historical context, that's still 26% below the average we saw in 2018 and '19 in what was a more normal housing market.

HEATHER: All right, some helpful context there, Mike. Let's talk about what this might mean for investors as well, Jurrien, and where there may be some potential investing opportunities in the stock market. Historically, Jurrien, which sectors tend to be impacted by changes in mortgage rates? Who are the winners and losers of falling mortgage rates, in other words?

JURRIEN: I mean, specifically, it's the interest rate-sensitive sectors, as you might imagine—real estate, utilities, consumer staples, we call them bond proxies, if you will. But also financials, banks, because as rates fall, the yield curve steepens, which incentivizes the banks to lend more money. But I would just paint this with a broader brush and just say—we've been talking about the everything else trade, right, and the market leadership has been somewhat narrow until this year. Because during COVID, and the recovery, and then the rate hiking cycle, investors have been hiding in these mega-cap growth stocks that have tried and true earnings growth that are not really that sensitive to interest rates because they have so much cash on the balance sheet. They don't need to borrow money.

And this year, especially since the summer, we've had a nice broadening into everything else. Because as rates come down and the cost of capital eases, it has the potential to unlock all these companies that were held back by these tighter financial conditions. So there are the rate-sensitive sectors, but I would say, just broader speaking, small caps, mid caps, the everything else side of the market really should be able to participate in what is now an exactly two-year-old bull market. We wished the bull a happy birthday last week, but—

HEATHER: Yes.

JURRIEN: —it was October 13, 2022 that the market bottomed and we've gained about 68% over 24 months. And now that market has broadened. So it's a good story, by and large.

HEATHER: A good story. We just celebrated that two-year anniversary of the bull market. And you still think there's some room for this bull market to run. Jurrien, we talked so much on the show about investing in stocks, and bonds, and other asset classes, but plenty of people also invest

in real estate, whether they're buying REITs, or becoming landlords, maybe flipping properties. I think one question that people may be wondering, because we don't talk about it as much, is, in your mind, what role, if any, should real estate play in a portfolio?

JURRIEN: Yeah, I think it plays a very large role. It's generally people's largest asset, right. I mean, you live in it. Even if it's not an investment property, you're living in it, you're generally paying a mortgage on it. So your cost of living is affected by your house and so I would view it as part of a more holistic portfolio approach and, maybe, it's half of your assets or your net worth. And I think it's important to look at that because real estate is a store of value. I mean, that's—they—prices tend to grow as the economy grows, as inflation goes up. So I would view it holistically as part of a broader portfolio.

And you don't want to look at your home listings every day, of course, you are living in it. But I would consider, say, if you have a lot of real estate and then you have stocks and bonds, you keep that in mind because real estate will go up—generally up. It doesn't go down very often. But, yes, I would keep that in mind as you look at your overall assets.

HEATHER: Your overall financial picture. All right, we are really out of time, Mike, but I wanted to just quickly squeeze this in, if you could just keep your answer to maybe one or two talking points. We talked about opportunities for investors, opportunities for homebuyers, how about folks who don't want to move, but they might be interested in tapping into home equity. Is this a time to do that?

MIKE: Yeah, I mean—so, right now, average home equity rates are right below 9%. Just like mortgage scenario, it's important to shop around. A lot of lenders, if you have a banking relationship, may give you a lower rate. There might also be introductory rates several percentage points below that level. So the way I think about it is people who want to move, but they locked in their rate at 3% and maybe they couldn't actually go out in the market today and buy the house they're in, you have this great asset in a house that you bought at a lower price with a lot of appreciation in equity in that house. So if you are looking potentially to improve that house or put on a renovation, now—if you use a home equity line of credit as an option, the actual cost of borrowing against that will continue to decrease as the Fed does lower rates.

HEATHER: Cost of borrowing is going down. And we are at the 20-minute mark, Jurrien, so what are you watching for the rest of the week?

JURRIEN: Two words, earnings season. It is underway and it will tell us whether the momentum from the second quarter is continuing.

HEATHER: All right, we've got to wrap it up. But I want to thank you and Mike for the great information and insights. Just a reminder before we go, we have an email address where you can reach out to our team. Tell us what's on your mind. Tell us what you want to hear about on a future episode. We really do read all of your emails and we use them to shape future shows. That address is marketsense@fidelity.com. As I said, we truly use your feedback, so please keep it coming.

On behalf of Jurrien Timmer and Mike Mariani, I'm Heather Hegedus. Thanks so much for your time. And we'll see you back here next Tuesday at our regular time of 2 o'clock Eastern.

[1]Freddiemac.com, October 2024: https://www.freddiemac.com/pmms

[2]Fidelity Viewpoints, June 2023: https://www.fidelity.com/learning-center/trading-investing/tips-and-inflation

[3]Realtor.com, October 2024: www.realtor.com/news/trends/majority-americans-still-feel-locked-in-by-mortgage-rates/?msockid=364ddc8b916764652c9fc85f90966517

[4]Newsweek, October 7, 2024: https://www.msn.com/en-us/money/other/time-to-treat-the-housing-crisis-like-a-crisis-opinion/ar-AA1rQW7n?ocid=BingNewsVerp

[5]Realtor.com, September 2024: https://www.realtor.com/news/real-estate-news/case-shiller-home-prices-july/

[6]Yahoo Finance, September 2024: https://finance.yahoo.com/news/existing-home-sales-fall-in-august-despite-lower-mortgage-rates-171246859.html?guccounter=1

[7]Bankrate, Best HELOC Rates In October 2024 | Bankrate

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