November 2023 – What Happened to Higher-for-Longer?

November was another whirlwind month with markets up and interest rates down across the board. The S&P 500 was up 8.9% and the VIX hit pre-COVID lows. The ten-year treasury fell to 4.33% from its October peak above 5%.

Market Benchmarks

	YE-2022	Oct-23	Nov-23	1-Month Change Δ	1-Month Change % Δ
Fed Funds	4.50%	5.50%	5.50%	0.00%	0.00%
1-Month SOFR	4.06%	5.32%	5.33%	0.01%	0.19%
10-Yr Treasury	3.88%	4.79%	4.33%	-0.46%	-9.54%
S&P 500	3,839.50	4,193.80	4,567.78	373.98	8.92%
REIT Index[1]	27.41	24.25	27.16	2.91	12.00%
VIX	21.67	18.14	12.92	-5.22	-28.78%

1. Vangaurd Real Estate Index Fund tracks the MSCI U.S. REIT Index

Last month, we discussed the potential for an extended period of high rates. Though long-term macro trends still support this narrative, near-term sentiment has moved in the opposite direction. The narrative of cooling inflation has strengthened and there are growing expectations that the Fed will begin cutting rates during the first half of the year.

Bill Ackman announced that his firm, Pershing Square Capital Management, currently has a macro bet that the Fed will cut by the first quarter. He believes that there is a real risk of a hard landing if the Fed doesn't begin cutting soon. Furthermore, Fed Governor Christopher Waller, usually quite a hawk, even admitted in a speech that if we continue our current path: "[…] you could then start lowering the policy rate just because inflation's lower."

At Caisson Capital Partners, we anticipate continued disinflation, driven in large part by the continued drop in shelter costs' contribution to both CPI and PCE. Additionally, cracks in American consumer balance sheets will likely pose challenges to consumer spending and further cooling.

What about Real Estate?

The prospect for monetary policy easing in Q1 2024 offers optimism for real estate markets. However, our industry faces challenges. One of the most jarring headlines of the month was: "An ugly scorecard: Nearly 50% of real estate equity was likely wiped out over the last year." Though extreme, when we look at the numbers, this statement bears some consideration.

Estimates are that total U.S. CRE peaked in value in 2021 at $11.2 trillion with a subsequent decline of 22% or $2.5 trillion. Given the highly levered nature of the asset class, if 100% of that value loss is attributed to equity vs. debt, it equates to a 49% decline in CRE equity value.

The key thing to note about real estate is that it is illiquid, and most assets have long hold periods with fixed-rate mortgages. As such, most losses will remain unrealized.

Zooming into the multifamily world, this analysis gets even more interesting. There are approximately $256 billion of multifamily mortgages maturing in 2024 and 2025 potentially leading to a realized loss of as much as $114 billion over the next two years. This is likely a worst-case scenario as some of this debt will be restructured and lose value in addition to the equity, but this gives us a general sense of what the current picture looks like. For context, the market capitalization of the S&P500 is approximately $36 trillion so the multifamily loss is roughly equal to a 30-basis point move in the S&P500.

Estimated CRE Sector Values & Losses

($ in Billions)	Peak Value	Value Decline %	Current Value	Value Decline $
Multifamily	$4,027	-29%	$2,859	$1,168
Retail	2,745	-15%	2,333	412
Industrial	2,000	-16%	1,680	320
Office	1,785	-31%	1,232	553
Hotels	675	-5%	641	34
Total	**$11,232**	**-22%**	**$8,745**	**$2,487**

Implied Equity Losses

($ in Billions)	Peak Value	Current Value	Value Decline %
Value	$11,232	$8,745	-22%
Debt	6,178	6,178	0%
Equity	5,054	2,568	-49%

Source: CRE Analyst; Green Street Research

MF Realized Loss Projections (Based on 2024 - 2025 Debt Maturities)

($ in Billions)	At Issuance	Current Value	Value Decline %	Value Decline $
Value	$394	$280	-29%	$114
Debt	256	256	0%	0
Equity	**$138**	**$24**	**-83%**	**$114**

Consumers vs. Investors – Black Friday, Credit Cards, and Money Market Accounts

Black Friday/Cyber Monday spending was strong. However, rising credit card balances and delinquencies are growing precipitously. Simultaneously, money market account balances hit record highs (+$700 billion since 2022). Market participants are debating whether this money has found a permanent home or whether it is waiting for opportunities to redeploy into other more risk-on opportunities. The reality is likely a mixture of both.

Caisson Capital has had several conversations with wealth advisors on this topic and the general feedback has been that clients remain ready to put their capital to work into real estate deals that make sense either from a yield or total return perspective. The primary challenge – it is consistent with the way that we've been underwriting deals – is that everything is viewed relative to that magic 5% return number that is achievable in many money market accounts.

Charlie Munger – "I have nothing to add."

Finally, we would be remiss to not give a nod to the passing of one of the greatest investors of all time. Charlie Munger, Vice-Chairman of Berkshire Hathaway, usually gave the limelight to his partner Warren Buffet, often following his partner's comments at the annual meeting with a crowd pleasing, "I have nothing to add." He did offer us some incredible advice over the years, and some of my personal favorite's quotes of his are below:

- We all are learning, modifying, or destroying ideas all the time. Rapid destruction of your ideas when the time is right is one of the most valuable qualities you can acquire. You must force yourself to consider arguments on the other side.
- The big money is not in the buying and selling, but in the waiting.
- You have to love what you do. My whole life I've never been good at anything that I wasn't interested in. Architecture is a terrible way to make a living, but a friend of mine who is an architect says he loves it so much that he never has to work. That's a great way to live. Everyone should try it.