AlphaWealth Monthly Brief

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"Certainty is every investor's worst enemy. The only universal truth that the past offers about the markets is that they will surprise us in the future."

- Jason Zweig

In this month's edition of the Brief, we touch on upside risk to the inflation outlook and what this means for monetary policy. We also touch on a recent report by Moody's on the persistence of remote work and what this means for commercial property valuations.

Fed's Bowman Warns of Upside Risk to Inflation

In prepared remarks last week in London, Federal Reserve Governor Michelle Bowman emphasized the need to keep borrowing costs elevated due to several upside risks to the inflation outlook. She stated that it is not yet appropriate to lower the policy rate and expressed a cautious approach towards future policy changes. Echoing comments she made back in May, Bowman does not foresee any interest rate cuts this year, instead projecting them into future years. Several factors could put continued upward pressure on prices, including limited further supply-side improvements following pandemic-era disruptions, restrictive immigration policies affecting labor supply and rental costs, a tight labor market leading to elevated wage growth, geopolitical developments, fiscal stimulus, and loosening financial conditions.

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Bowman noted that differences between the US economy and other major economies in recent months could be attributed to the US's open immigration policy and significant fiscal support since the pandemic. “Reducing our policy rate too soon or too quickly could result in a rebound in inflation, requiring further future policy rate increases to return inflation to 2% over the longer run,” she said. Not only have officials pulled back their estimates for rate cuts in 2024, they now see their easing cycle bottoming out at a higher level than previously expected, underscoring the notion that higher rates are here to stay. As for now, interest rates continue to be held at their highest level in more than two decades as Fed officials work to return inflation to their 2% target.

Empty Offices Weigh on Commercial Property Values

It’s no secret that the demand for office space has significantly declined in recent years, but the exact extent of this downturn is still uncertain. Critical questions remain unanswered: How many employees will return to the office? On which days will they be present? Will employees share offices or utilize common spaces? Will firms require more collaborative areas and fewer individual desks? These answers are essential for accurately predicting the office sector's future performance. A new report released by Moody’s reviews a variety of studies and surveys on the persistence of remote work. Combining these insights with historical office performance data and future employment projections, Moody’s can make assumptions on the impact that work from home will have on the office sector.

According to the report, nearly 25% of U.S. office space will be vacant by 2026, leading to a potential $250 billion reduction in commercial property values. The shift to hybrid work models, adopted by 85% of North American organizations, and the preference for flexible co-working spaces have kept office occupancy in major U.S. cities at about 50% of pre-pandemic levels. This decreased demand, coupled with increased borrowing costs, has severely affected office property valuations, especially for older buildings, painting a bleak outlook for property owners and lenders. Let’s look at some of the highlights from the Moody’s report:

Increasing Vacancy Rates: Office vacancy rates are projected to rise to 24% from 19.8%, leading to reduced revenue for office landlords.

Impact on Property Values: The combination of higher vacancy rates, lower rents, and lease turnovers could result in a substantial decrease in property values, potentially amounting to $250 billion.

Shift in Lease Preferences: Companies are increasingly favoring shorter-term, flexible co-working arrangements over long-term leases.

Hybrid Work Adoption: A significant percentage of North American organizations have implemented hybrid work models, leading to decreased office occupancy.

Reduced Demand for Office Space: Demand for office space has decreased, and office workers now need about 14% less space than before the pandemic.

Long-Term Outlook: The market is expected to "right-size" over the next decade, with inefficient office spaces being repurposed for other uses such as residential properties or warehouses.

Fast Facts

Forty-nine companies have made the Fortune 500 list every year since its first edition in 1955. Exxon Mobile is the only Class of 1955 member still in the top 10 today. – Fortune

In 1790, Benjamin Franklin bequeathed 1,000 pounds sterling (roughly $4,000 at the time) to the cities of Boston and Philadelphia but requested that 25% not be touched until the 200th anniversary of his death. By 1994, these trust funds were worth some $6.5 million. – YahooFinance

In the United States last year, only 490 newborn babies were named ‘Alexa,’ plummeting from more than 6,000 in 2015. – Newser

About $38 billion in loans for U.S. office buildings are facing default or foreclosure, the highest number since 2012. Last year, only 35% of office building loans were repaid when they came due. – The Wall Street Journal

A Seattle Mariners baseball fan caught two consecutive foul balls at a recently played game. According to MLB Statcast, the probability of that happening is 0.0001%. – Yahoo Sports

Contact Us

As always, feel free to reach out to us if you have any questions regarding your investments or financial plan or would like to schedule a meeting with our advisors.