Demming
Financial Services Corp.

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2ND QUARTER 2021

Special Notes:

We have launched our new and improved website! Please visit demmingfinancial.com to check it out.

The Demming Financial team proudly sponsored and participated in the annual "Putts for Pets" golf event to support the Summit County Humane Society.

Reminder: Please be sure to send in your 2020 Taxes!

Booming Home Sales

Arguably the wildest consequence of the recent pandemic is the remarkable price boom in the U.S. housing market—which, some might remember, went spectacularly bust in the 2008-9 Great Recession collapse. Today, half of all houses put on the market are purchased in less than a week, often for more than the asking price. One recent poll found that most buyers admitted to bidding on homes they had never seen in person. Home prices are at record highs; inventories are at record lows. More than half of homes on the market have been selling above the asking price—which is so far above the previous record that the statistic is simply offered in isolation. The average home price, as measured by the S&P CoreLogic Case-Shiller 20-city index, rose 13.3% in a single month, following a 12% jump the previous month.

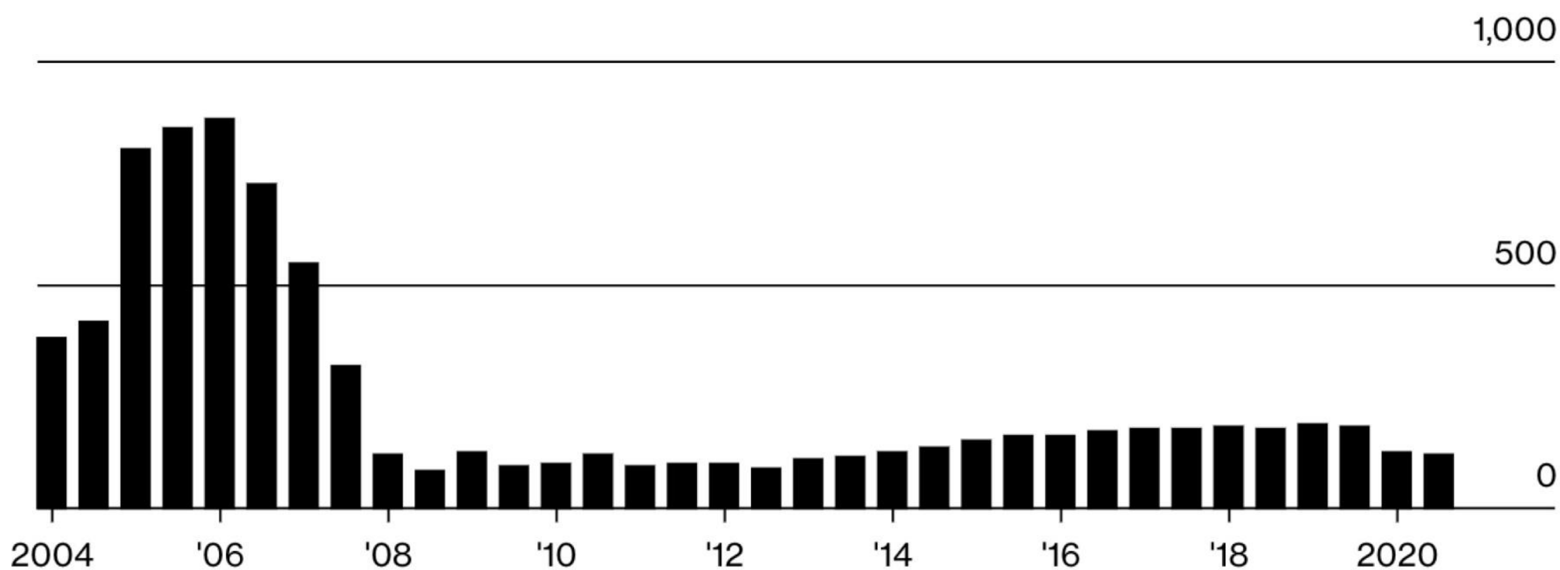
By: Harley Schwadron

One driving factor is historically low mortgage rates, around and sometimes below 3% currently. Investors have also stepped in; they bought 17% of all homes in April, and some might relabel them speculators who believe (as many did in the runup to 2008) that prices have nowhere to go but up—forever. But beyond that, prices have been driven up by simple economics and the laws of supply and demand. The number of homes for sale fell 21% recently, near a record low that dates back to 1982. New home construction has been slow due to a severe lumber shortage, and we are still feeling

the effects from 12 years ago, when the Great Recession knocked the construction industry back on its heels. At the same time, millennials—many of them too financially-constrained to have bought houses at normal interest rates—are storming into the housing market, ending forever the trope of boomerang kids living in their parents' basement.

Does all this signal another housing bubble? Are we now destined to live through another Great Recession when a housing bubble bursts? Fortunately, there are a few checks and balances on the current boom that were not in place back in 2006-7 when the seeds of the Great Recession were planted. For one thing, lenders are no longer handing out mortgage loans like candy, with zero documentation. Today's lending standards are higher even than the requirements of the Dodd-Frank act of 2010, which was passed in response to the financial crisis. Loans today are generally smaller in proportion to house values, and leverage is down on owners' balance sheets. You can see the difference in the accompanying table; today's mortgage credit availability looks nothing like it did during the previous residential housing boom years.

That doesn't mean that housing prices won't collapse at some point in the future. One possible trigger would be a sudden rise in mortgage rates, which would cool demand significantly. But even that wouldn't trigger defaults; according to the Mortgage Bankers Association, just 0.1% of mortgage loans issued this year are tied to adjustable rates. That's compared to about 60% during the bubble years of the mid-2000s.



Inflation and Social Security Benefits

Every year since 1975, the Social Security Administration has automatically adjusted its benefit payments upward to account for inflation; the goal is for the payments to keep pace with the cost of living that recipients are experiencing. For the past decade, these inflation adjustments have been pretty modest, as you can see in the chart. In 2009, 2010 and 2015, there was no increase, and many of the other raises were 2% or less.

That could change in the coming year, as a result of higher inflation. In June, the Consumer Price Index rose 5.4% from a year earlier—the largest gain since 2008. Extrapolating from the first six months of inflation data, the Senior Citizens League has estimated that the Social Security cost-of-living adjustment for 2022 would be at or about 6.1%—which would be the largest one-year increase since the bad old high-inflation days of 1983.

Social Security increases are tied to the CPI-W, the Consumer Price Index for Urban Wage Earners and Clerical Workers. Some economists believe that the CPI-W tends to undercount the cost-of-living increases that many people experience, and that is especially true for seniors, whose budget is more closely tied to housing and health care costs, and less to food, apparel, transportation and recreation.

Social Security Cost-Of-Living Adjustments

Year	COLA	Year	COLA	Year	COLA
1975	8.0	1995	2.6	2015	0.0
1976	6.4	1996	2.9	2016	0.3
1977	5.9	1997	2.1	2017	2.0
1978	6.5	1998	1.3	2018	2.8
1979	9.9	1999 [a]	2.5	2019	1.6
1980	14.3	2000	3.5	2020	1.3
1981	11.2	2001	2.6		
1982	7.4	2002	1.4		
1983	3.5	2003	2.1		
1984	3.5	2004	2.7		
1985	3.1	2005	4.1		
1986	1.3	2006	3.3		
1987	4.2	2007	2.3		
1988	4.0	2008	5.8		
1989	4.7	2009	0.0		
1990	5.4	2010	0.0		
1991	3.7	2011	3.6		
1992	3.0	2012	1.7		
1993	2.6	2013	1.5		
1994	2.8	2014	1.7		

A new bill in Congress, the Fair COLA for Seniors Act of 2021, proposes to change Social Security's measure of inflation from CPI-W to CPI-E, the Consumer Price Index for the Elderly, which the Bureau of Labor Statistics has been calculating since 1985. This shift, endorsed by the Biden Administration, would have resulted in a 1.4% upward adjustment last year (vs. the 1.3% figure used by the Social Security Administration), a 1.9% increase in 2020 (vs. 1.6%), 2.8% in 2019 (vs. 2.6%), 2.1% in 2018 (vs. 2.0%), and a much bigger increase in 2017, from 0.3% up to 1.5%. Comparing the two measures of inflation over time, economists estimate that over 25 years, the CPI-E cost adjustments would push benefits 5% higher than the existing CPI-W index increase calculation that we use today.

The Social Security Administration has published a lengthy analysis of the differences in the various inflation measures, and its analysis suggests that, even though healthcare costs are weighted more heavily in the elderly CPI statistics, the prices actually paid by the elderly for health care, medications and hospital costs may be different from the general population calculations of inflation that are embedded in CPI-E. Also, as the homes owned by the elderly increase in value, their out-of-pocket payments for property taxes and insurance premiums may be more volatile than they are for their younger peers. Beyond all that, every one of us is different, with different lifestyles, so our individual CPI—whatever index is used—is likely to be different from whatever number is published month to month, year to year.

2021 Second Quarter Report

The U.S. investment markets continued to defy gravity in the second quarter of the year, closing out the month of June—and the first half of 2021—at new record highs. This is the fifth consecutive quarter where the U.S. markets posted gains.

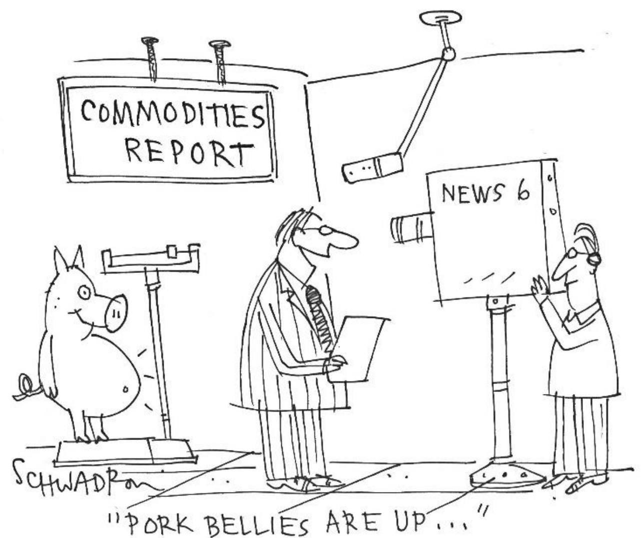
Everywhere you looked in a diversified portfolio, you saw gains in the second quarter. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—gained 6.49% since January 1. The comparable Russell 3000 index is up 15.11% for the first half of the year.

Looking at large cap stocks, the Wilshire U.S. Large Cap index has gained 8.42% in value in the recent quarter, and is now up 15.45% in the first six months of 2021. The Russell 1000 large-cap index finished the first half of the year with a similar 14.95% gain, while the widely quoted S&P 500 index of large company stocks rose 8.17% in the second quarter, to post a 14.41% return so far this year.

Meanwhile, the Russell Midcap Index gained 8.14% is up 16.25% so far in the year, posting a remarkable 62.03% gain since this time last year. The Wilshire Mid Cap index gained 7.40% in the quarter, for a 15.64% gain on the year.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies, experienced a 5.09% gain in the second quarter, which brings the total return up to 16.66% this year. The comparable Russell 2000 Small-Cap Index is up 17.54% in the year's first six months. The technology-heavy Nasdaq Composite Index gained 11.25% in the second quarter, and is sitting on a 12.73% gain so far this year.

International investors saw their stocks rise over the second quarter, but not with the same bullish intensity that we're experiencing in the U.S. The broad-based EAFE index of companies in developed foreign economies gained 4.37% in the second quarter, for a 7.33% return for the first half of the year. In aggregate, European stocks were up 6.37% for the quarter, gaining 10.11% for the first half of the year, while EAFE's Far East Index has returned just 1.47% so far in 2021. Emerging market stocks of less developed countries, as represented by the EAFE EM index, gained 4.42% in dollar terms in the second quarter, and finished the first half of the year with a 6.46% gain.



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Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted a 12.84% gain during the year's second quarter, and is up 22.78% since January 1. The S&P GSCI index, which measures commodities returns, gained 14.67% in the second quarter, and is now up a

remarkable 30.90% for the year. The energy and metals component of the index, which is influenced by the jump in oil prices, is up 37.62% so far in 2021.

In the bond markets, the rates on longer-term securities jumped from historically low rates to simply low rates. Coupon rates on 10-year Treasury bonds are yielding 1.465%, while 3-month, 6-month and 12-month bonds are still sporting barely positive yields. Five-year municipal bonds are yielding, on average, 0.51% a year, while 30-year munis are yielding 1.57% on average.

Five consecutive quarters of gains! All-time highs becoming a routine part of the news cycle! Have the markets banished volatility altogether?

Of course, the answer is no. This investment climate is not unprecedented (the late 1990s come to mind), but the current investing climate is clearly far from normal. Stock market investing always comes with a certain amount of risk, even if the risks are sometimes temporarily hidden from view.

Just a week ago, there were widespread concerns that the economy was about to experience higher inflation; a 5% single month increase in the Consumer Price Index was the highest jump in 13 years. Investors were startled, to the extent that the U.S. Federal Reserve Board felt compelled to put out a statement saying that it expected the gain in consumer prices to be merely 'transitory.' Apparently, investors took the Fed economists at their word; a quick drop in 10-year Treasury yields, when converted to the mathematics of bond market expectations, signals an expected inflation rate of 2% or less. Of course, the biggest investor in Treasuries at the moment (to the tune of $120 billion a month) is the Fed itself, so this may be an example of a government agency fulfilling its own prophecy.

But elsewhere, there doesn't seem to be any obvious cause for alarm. Hiring and consumer spending are rising, and small business owners' confidence has bounced back above its pandemic lows. Congress is about to pass some kind of a stimulative infrastructure bill, and interest rates remain low. Corporate earnings are projected to come in at record levels by the end of the year.

Of course, that doesn't mean we couldn't hit some rough patches in the second half of the year. Investor sentiment can be tricky, and bull markets have a tendency to end unexpectedly. The new variants of COVID-19 are an unknown factor, and eventually the government will have to stop juicing the economy with ever-greater amounts of money. We ought to be able to enjoy the gains we've experienced so far in the year without trying to project them out into the unknown future.

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Cartoons by: *Harley Schwadron*

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