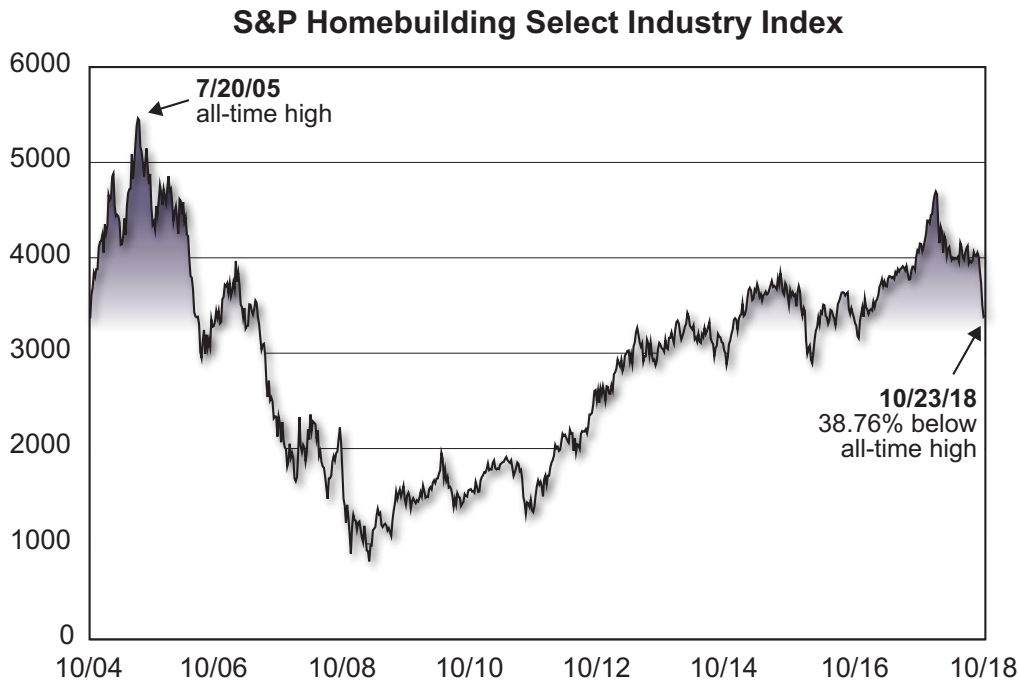


Homebuilder-Related Stocks Hit Hard By A Confluence Of Events



Source: Bloomberg. Weekly data points from 10/22/04-10/23/18. Past performance is no guarantee of future results.

View from the Observation Deck

1. Year-to-date through 10/23/18, the S&P Homebuilding Select Industry Index posted a total return of -23.06%, compared to a gain of 4.09% for the S&P 500 Index, according to Bloomberg.
2. In 2017, the S&P Homebuilding Select Industry Index posted a total return of 32.16%, well above the 21.83% total return on the S&P 500 Index, according to Bloomberg. What changed from 2017 to 2018? Apparently, enough for investors to take profits and then some.
3. While the strong job market and overall housing shortage in the U.S. – MarketWatch reported that Freddie Mac estimates that the U.S. is shy about 4.6 million housing units – are likely tailwinds for homebuilders and related businesses, the list of current headwinds has grown formidable, in our opinion.
4. Here are some factors that could be contributing to the selling pressure in 2018: changes in the tax law last December capping mortgage interest and local property tax deductions; the strong recovery in home prices; rising mortgage rates; the rise in the cost of raw materials due in part to the implementation of tariffs; hurricane damage in the South; and a shortage of construction workers.
5. We believe that some of these factors can be mitigated over time, such as higher mortgage rates eventually being offset by lower home prices, which are already beginning to fall in Manhattan, according to StreetEasy.
6. The sell-off in homebuilder-related stocks has pushed valuations considerably lower. Bloomberg's 2018 and 2019 estimated year-end price-to-earnings (P/E) ratios on the S&P Homebuilding Select Industry Index were 10.95 and 9.88, respectively, as of 10/24/18. Both are well below the index's three-year average P/E of 16.05.
7. For comparative purposes, Bloomberg's 2018 and 2019 estimated year-end P/E ratios on the S&P 500 Index were 16.31 and 14.81, respectively, as of 10/24/18. Its three-year average P/E was 20.57.
8. The 2018 and 2019 earnings-per-share estimates for the S&P Homebuilding Select Industry Index were \$310.10 and \$343.44, respectively, as of 10/24/18, according to Bloomberg. That is up from \$255.41 per share in 2017.
9. As indicated in the chart, the index stood 38.76% below its all-time high on 10/23/18.

This chart is for illustrative purposes only and not indicative of any actual investment. There can be no assurance that any of the projections cited will occur. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The S&P Homebuilding Select Industry Index provides investors with an equity benchmark for U.S. traded Homebuilding-related securities. The S&P 500 is a capitalization-weighted index comprised of 500 stocks (currently 505) used to measure large-cap U.S. stock market performance.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA and the Internal Revenue Code. First Trust has no knowledge of and has not been provided any information regarding any investor. Financial advisors must determine whether particular investments are appropriate for their clients. First Trust believes the financial advisor is a fiduciary, is capable of evaluating investment risks independently and is responsible for exercising independent judgment with respect to its retirement plan clients.