Market Commentary Blog

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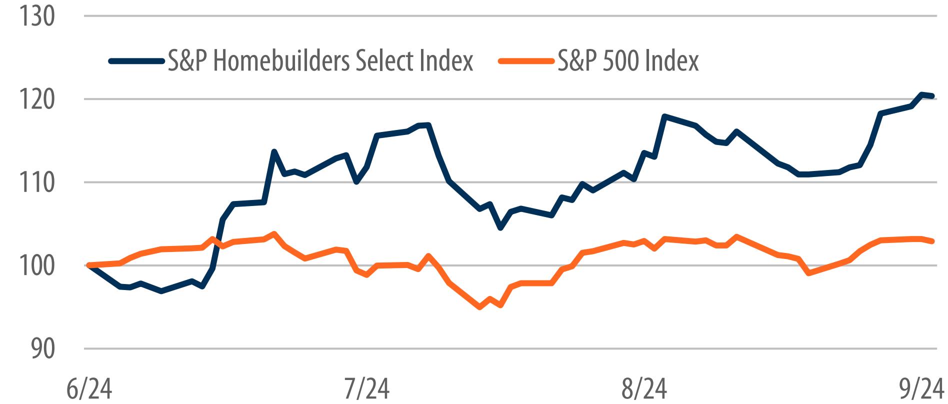
Homebuilder-Related Stocks

Price Returns 6/28/24 – 9/18/24



Source:Bloomberg. S&P Dow Jones Indices. Daily price returns, normalized to a factor of 100.
Past Performance is no guarantee of future results.

View from the Observation Deck

Given yesterday's announcement that the Federal Reserve ("Fed") would be reducing the federal funds target rate by 50 basis points (bps), we thought it would be constructive to revisit a sector of the market that we haven't touched on in some time: homebuilders. Data from the U.S. Census Bureau revealed that housing starts increased by 9.6% in August 2024, to an annual rate of 1.356 million, compared to the consensus expected annual rate of 1.318 million. New building permits increased as well, rising to an annual rate of 1.475 million (compared to estimates of 1.410 million). That said, the pace of housing starts remains below the levels seen in 2021-2023, according to Brian Wesbury, Chief Economist at First Trust Portfolios, LP.

The S&P Homebuilders Select Index (Homebuilders Index) increased by 20.36% on a total return basis since the start of the third quarter alone (thru 9/18).

The surge in the Homebuilders Index occurred despite the continued headwinds to housing starts and building permits we mentioned above. For comparison, the Homebuilders Index increased by 6.27% on a total return basis in the first half of 2024. From our perspective, one catalyst for the increase in valuations has been the increasing likelihood of multiple cuts to the federal funds target rate throughout the remainder of the year.

A lower federal funds rate translates to lower mortgage and construction financing rates, which could spur increased investment in housing.

As of 9/18/24, the national average for a 30-year fixed rate mortgage stood at 6.31% according to Bankrate. This is the lowest the national average has been since February of this year.

Housing inventory remains below historical averages.

According to data from the Federal Reserve Bank of St. Louis, there were only 829,000 vacant housing units for sale in the U.S. at the end of the second quarter. For comparison, there have been 1.395 million vacant homes for sale, on average, on a quarterly basis since the second quarter of 2000. Given current supply constraints as well as the potential for lower interest rates over the near term, we expect demand for the construction of new homes to rise even further.

Takeaway

The Homebuilders Index has enjoyed a remarkable start to the third quarter, increasing by 20.36% on a total return basis from 6/28 thru 9/18. From our perspective, the Fed's announcement that it was slashing the federal funds target rate by 50 bps, the continued drought in supply, and pent-up demand from potential buyers waiting for lower mortgage rates is likely to lead to further increases in the demand for new homes. In our view, homebuilders could benefit as tailwinds to homebuying continue to develop.

This table is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. The S&P Homebuilders Select Index comprises stocks from the S&P Total Market Index that are classified in the GICS Homebuilding sub-industry.

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