Weekly Relative Value

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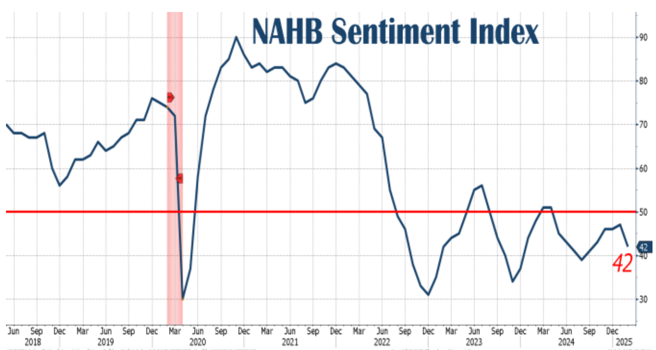
Market Strategist

WEEK OF FEBRUARY 24, 2025

Burning Down the House

Hold tight,
Wait 'til the party's over.
Hold tight,
We're in for nasty weather.
There has got to be a way,
Burning down the house.
- Talking Heads

The U.S. housing market received another blow with the release of the February National Association of Homebuilders' (NAHB) sentiment index, which sagged badly to a five-month low of 42 from 47 in January. The consensus was at 46, so a big miss to the downside. This also was the steepest setback since last May.

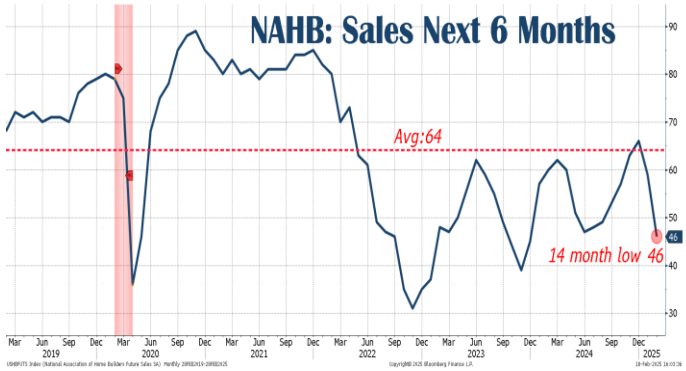


The decline in the headline was broadly based regionally, but the West was super weak, with the NAHB slumping to 35 from 42 and down to 48 from 65 in the Northeast. This was the third largest decline on record and the lowest reading since August of last year.

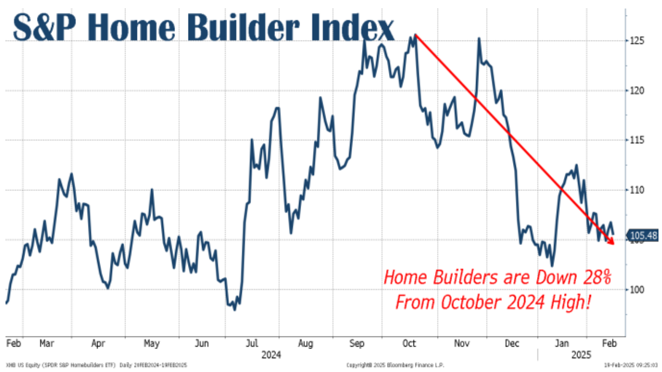
More troublesome, forthcoming buyer traffic is dismal. While the current sales subindex and the measure of prospective buyer traffic were both lower this month, it was the six-month sales outlook segment that really took it on the chin — plunging to a 14-month low of 46 from 59 in January and 66 in December. This was the sharpest two-month slide since April-May 2020.

THIS WEEK

- HOUSING STARTS STOP!
- LOWER THE PRICE AND THEY WILL COME
- HOME PRICES BEGIN TO DEFLATE
- DEBT HANGOVER
- ATTENTION WALMART SHOPPERS (AND INVESTORS!)
- AUTO DELINQUINCIES REACH A 15-YEAR HIGH
- DON'T CONFUSE FACTS WITH A TWEET
- SOLVING THE DEBT CRISIS
- THE STRONGEST ECONOMY IN 35 YEARS!
- MARKET OUTLOOK AND PORTFOLIO STRATEGY



If you're wondering why the S&P 500 Homebuilding Index has been walloped -28% from the nearby October highs, the NAHB survey tells you why.

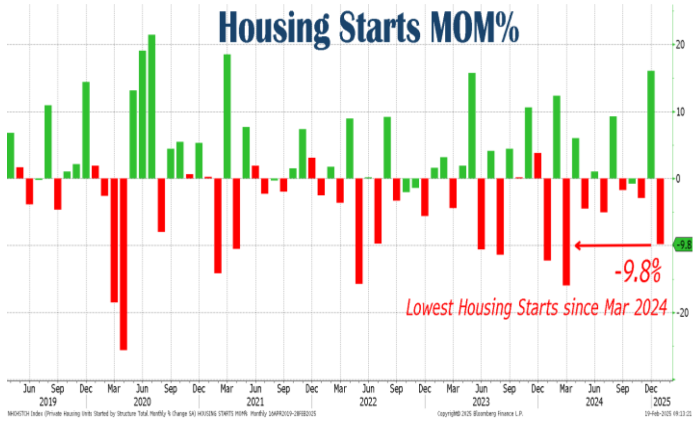


Another reason the homebuilder sector is taking it on the chin starts with the letter "T." President Trump is talking about as much as a 25% tariff on lumber. Remember that 30% of America's timber is imported (mostly from Canada). The assumption that Canadian lumberjacks will bear all the cost has no basis in theory or practice. At the end of the day, this policy will only serve to exacerbate the affordability crisis that confronts the U.S. housing market.

Bottom line: It's no secret what the problem is. Homebuilders and housing will remain in the doldrums until mortgage rates or home prices are significantly lower. And that does not appear to be any time soon.

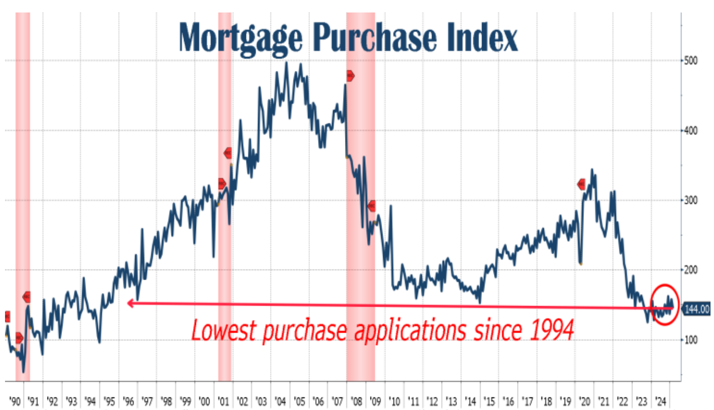
HOUSING STARTS STOP!

Moving on. After December's unexpected huge upside surprise (+15.8% month over month), analysts expected housing starts to tumble back to earth in January as the lagged impact of higher rates unsettles homebuilders' "goldilocks" reality dream. Sure enough, housing starts plunged 9.8% month over month (worse than the 7.3% decline expected). That was the biggest drop in monthly starts since March 2024. Forward-looking permits rose a skimpy 0.1% month over month.



Under the hood, the decline was broad-based across both the key single-family sector (-8.4% to a three-month low of 993,000 annualized units) and the multi-family space as the developers have responded forcefully to the oversupplied rental backdrop (-13.5% month over month to 373,000 units at an annual rate).

While the starts and permits data is always lagged, the mortgage applications plunged 6.6% week-over-week, tumbling back to the multi-decade lows after a quick surge to start the year. Not a good sign for the American housing market.

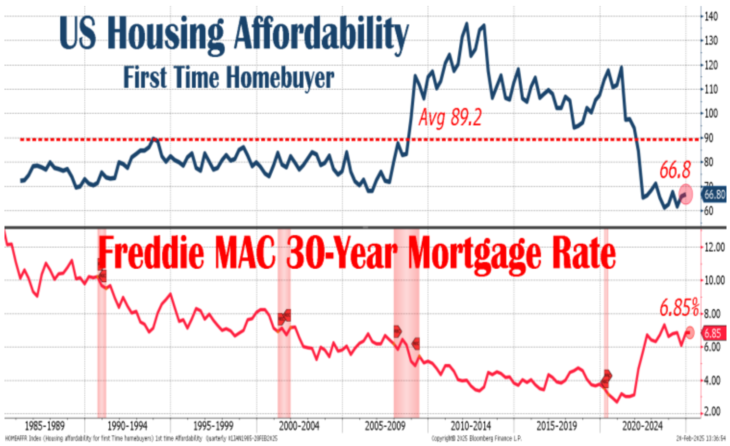


Bottom line: A rollover in housing starts has historically been a pretty reliable recession predictor. This is no country for realtors! Housing is in a world of hurt!

Housing is in a world of hurt!

LOWER THE PRICE AND THEY WILL COME

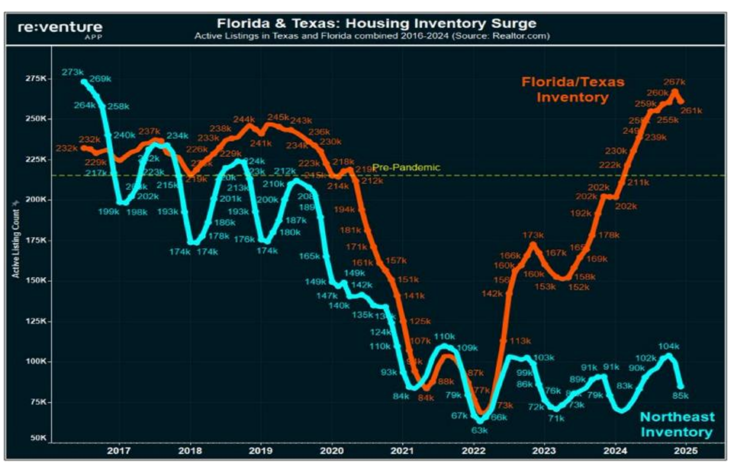
The monthly mortgage payment needed to buy the median priced home for sale in the U.S. has nearly doubled over the last five years. This remains the most unaffordable housing market in history.



Prices need to drop to bring buyers back in. Very simple. However, for prices to drop, inventory levels need to go up enough to force sellers into meaningful price reductions. In the South and Texas/Florida more specifically, that's happening. In Northeast, it's not.

The following chart by *re:venture* (one of my favorite real estate graphs) highlights the bifurcated nature of this housing market. In Texas and Florida, there are 261,000 active listings on the market. This is ~ 200% higher than the level in Northeast, which covers nine states. Prior to the pandemic, these regions were the same.

The downturn in prices is already happening in Texas and Florida, but there is still a historic inventory shortage in the Northeast. Too few homes for sale means high competition and even bidding wars, still.



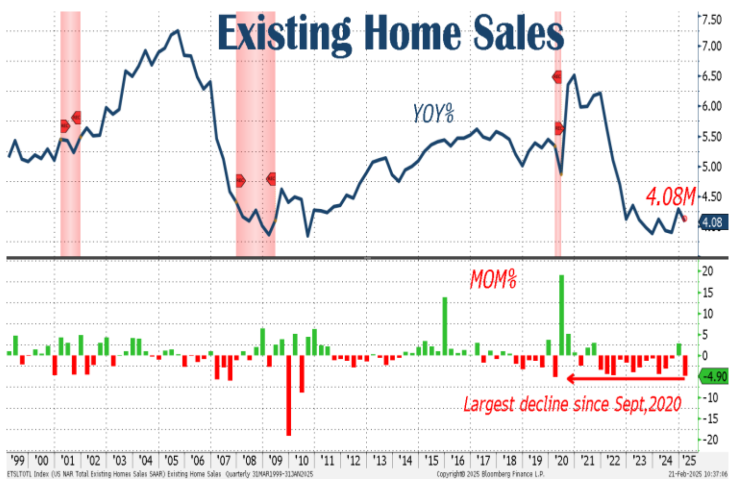
Bottom line: With inventory rising in the South and Southwest and employment weakening, the all-important spring housing season should be quite interesting. Buckle up.

HOME PRICES BEGIN TO DEFLATE

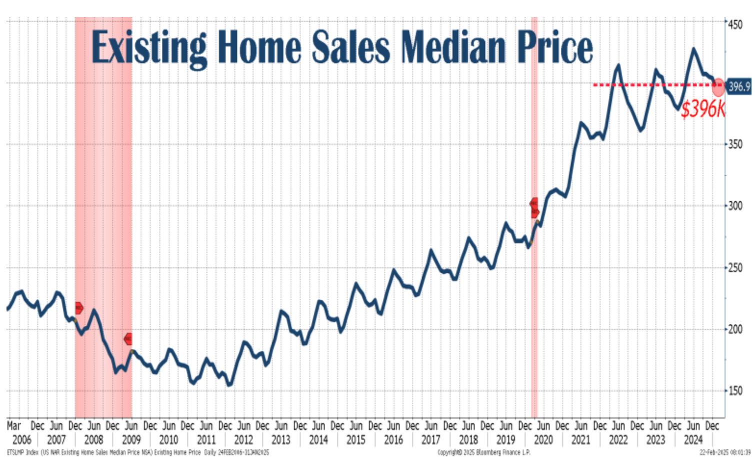
"Mortgage rates have refused to budge for several months despite multiple rounds of short-term interest rate cuts by the Federal Reserve…*When combined with elevated home prices, housing affordability remains a major challenge."*
- Lawrence Yun, Chief Economist & Senior Vice President of Research, The National Association of Realtors (NAR)

As noted above, the U.S. housing market is clearly feeling a whole lot of pain. The level of home sale transactions today is comically low and almost hard to fathom. In 2024, it had 4.06 million existing sales, the worst performance of anywhere since 1995. Adjusted by the number of houses in America, this was the worst year for demand in 42 years.

And as shown below, it's not getting any better. The lagged impact of a resurgence in mortgage rates came back to bite existing home sales in January, as they fell 4.9% month over month (worse than the 2.6% decline expected) and to a three-month low of a 4.08-million-unit rate (annualized) in January. This was about the same number we had on our hands in October 2008, the month after Lehman collapsed.



And it wasn't just because of the horrible fires in L.A. (even as sales in the West tumbled -7.4%) because sales also fell hard in the Northeast (-5.7%) and the South (-6.2%), and the Midwest was flat for the second month in a row.



And believe it or not, "deflation" is setting in. Yes, I said DEFLATION. Median prices dropped -1.7% month over month and have been down or flat now in each of the past seven months and now are basically unchanged from where they were in April 2022.

The inventory backdrop appears to be thawing because the number of homes listed for sale is running at a +17% year-over-year rate compared to just +2.0% for the total volume of sales. Also worth noting: Properties stayed on the market for 41 days on average in January, the highest in five years.

One more point: Yun said the NAR is concerned about the Trump administration's interest in privatizing mortgage giants Fannie Mae and Freddie Mac**.** Releasing them from the government could lead to even higher mortgage rates.

Bottom line: If the housing market and equity market begin to show signs of price erosion, the subsequent depressing impact on consumer spending will be immense because at no time in the past has the household sector been as sensitive to asset inflation — the fabled "wealth effect" — as is the case today.

DEBT HANGOVER

The retail sales report for January (-0.9% month over month, and 70% of the subsectors were negative) was the worst in at least two years in terms of both the magnitude and breadth of the decline.

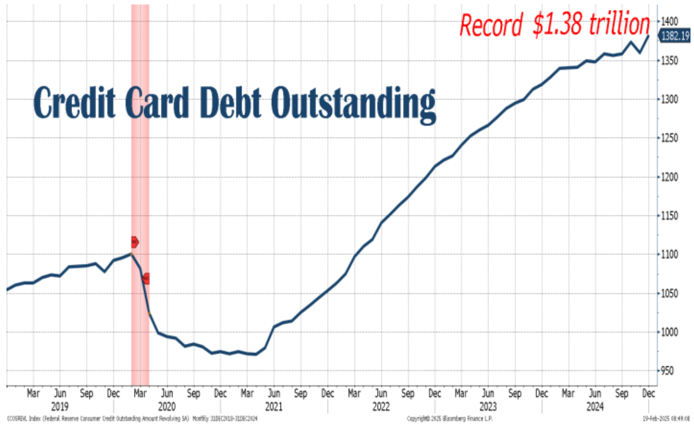
There were some minor upward revisions to all the December numbers but not nearly enough to offset the downbeat message on the American consumer to kick off the year. Admittedly, it remains to be seen just how much of this intense weakness reflected distortions from the L.A. fires.

The fact is this was the worst retail sales report in at least two years in terms of both magnitude and breadth of the decline. To add to this, 70% of the subsectors were *negative*. Notably, online activity is the one area that generally does exceptionally well during bad weather and natural disasters.

Thus, from my perch, this was not a weather story, since online retail sales plunged -1.9% month over month (the worst drubbing since July 2021).

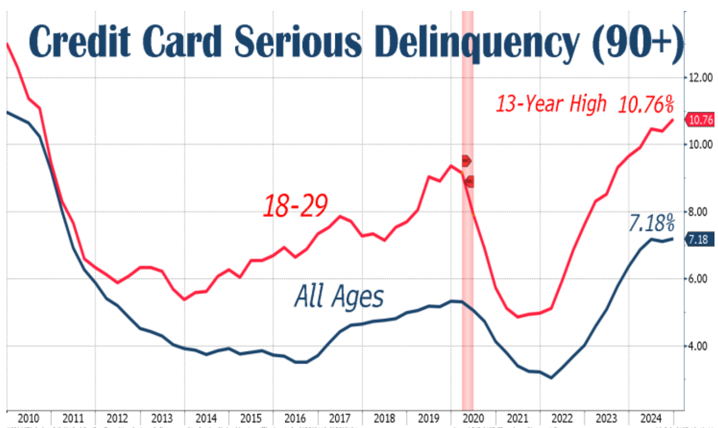
More likely we are seeing a debt hangover after consumers took on $53 billion of credit card debt in Q4 to support their holiday shopping habits (compared to a $32 billion debt increase in the Q4 of 2023).

Outstanding balances just crossed above $1.3 trillion for the first time on record and are up ~7 % from a year ago. The number of Americans with a credit card now stands at 617 million, up from 595 million a year ago, 508 million five years ago, and 413 million a decade back. There are only 132 million households, which means that, on average, each American household has five pieces of plastic in its wallet. Per capita credit card debt came to nearly $4,000, which is without precedent.



And now it's payback time. The bill is coming in at a time when the 90-day delinquency rate on credit card loans has risen to ~7%. The youngest generations have been hit the hardest, as serious delinquencies surged to 10.8%.

It's been 13 years since consumers have fallen this far behind on their payments. At that time, the unemployment rate was more than double today's 4.0% level. This tells you a thing or two right there, not all is resilient when it comes to the American consumer. A widening swath of consumers are facing escalating financial difficulties.



Bottom line: The debt-financed cheerful spending spree in the holiday shopping season has been followed by a pretty wicked hangover now that the bills are coming in. The surge in credit card delinquencies is a red flag for both household financial health and the broader economy.

ATTENTION WALMART SHOPPERS (AND INVESTORS)!

"Wallets are still stretched." - John Rainey, Chief Financial Officer and Executive Vice President, Walmart

Morning Consult shows 89% of households earning at least $100,000 are now frequenting Walmart stores — up from 77% five years earlier (and this has not happened at the expense of low- and middle-income consumers whose trips to Walmart have also accelerated over this period). Thus, Walmart provides us all with "facts on the ground" insights into the true health of U.S. consumers.

In the wake of the horrible retail sales report, Walmart revealed just how much all the economic uncertainty, the run-up in food and energy prices, and the cooling jobs market are affecting discretionary spending of consumers from all income strata. The company offered squishy-soft guidance and lowered profit growth for 2025 to between $2.50-$2.60 per share, which was well short of consensus expectations. Walmart fell 6.5% — one of its worst days since 2023**.**

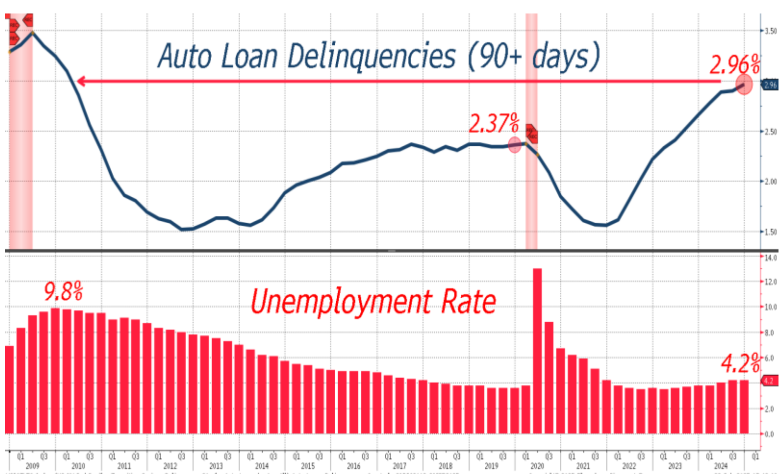
Rainey added that the current guidance doesn't include the potential impact of tariffs given the unpredictability around the levies. Walmart imports food from Mexico and general-merchandise products like microwaves from China.

Bottom line: Walmart may be the proverbial canary in the coal mine telling us that the consumer has finally hit the wall.

AUTO DELINQUENCIES REACH A 15-YEAR HIGH

Much like what is happening in the credit card space, auto loans transitioning into 90+ days past due are up 60 basis points from 2019. While still not the record high seen during the peak of the Great Financial Crisis, this is your economy with a 4% unemployment rate. In 2009, the economy had a near double-digit unemployment rate.

The next time someone says, *"The consumer is strong,"* ask them what auto loan delinquencies will be if the unemployment rate moves up the TEENSIEST bit.



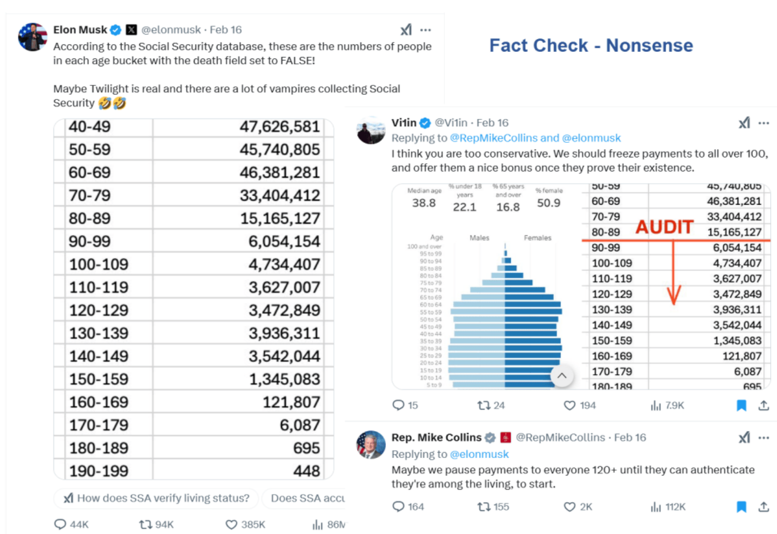
Bottom line: Consumers are buckling under the weight of economic pressures (and probably high pandemic-era monthly payments in some cases).

DON'T CONFUSE FACTS WITH A TWEET

Elon Musk has repeatedly claimed that his so-called Department of Government Efficiency (DOGE) project uncovered massive government fraud when it alleged that 150-year-olds were claiming Social Security benefits.

"Cursory examination of Social Security, and we got people in there that are 150 years old. Now, do you know anyone that's 150? I don't know. They should be in the Guinness Book of World Records … So that's a case where I think they're probably dead." - Elon Musk, Senior Advisor to the President of the U.S.

Musk claimed the payments to 150-year-olds was part of the billions, maybe even tens of billions, in corruption and waste that his DOGE effort had already uncovered. His tweet was received by millions of his followers and reposted as if gospel truth.



Meanwhile, the experts quickly pointed out that this is very likely just a quirk of the decades-old coding language that underpins the government payment systems. (See "No, 150-Year-Olds Aren't Collecting Social Security Benefits" in *Wired*.)

In fact, a 2023 audit of Social Security revealed that 18.9 million people in the Social Security database were listed as 100 years or older. This is compared to Census Bureau data, which found only 86,000 people in the U.S. were living past the age of 100.

However, the vast majority of those listed in the database were not receiving monthly checks, with 18.4 million who had not earned benefits for 50 years and likely deemed dead. The Social Security Administration's (SSA) inspector general found that 98% of those aged 100 or older in the Social Security databases are not in receipt of any benefits.

Musk also could have simply looked up the SSA's own website, which explains that since September 2015, the agency has automatically stopped benefit payments when anyone reaches the age of 115.

Bottom line: Don't confuse a tweet with facts! If it looks too stupid to believe, then perhaps it is. But just like condom shipments to Gaza or payments to Politico, Musk's claims of Social Security fraud seems to be a gross misrepresentation of what's actually happening and why.

All Musk had to do was ask the head of Social Security if there was a simple explanation. Frankly, for the good of the country, it would behoove DOGE to ask a few questions regarding something that looks ridiculously wrong before tweeting it.

SOLVING THE DEBT CRISIS

"How does one leave Social Security and Medicare untouched, grow defense by more than $50 billion, slash taxes, launch a $1 trillion infrastructure program — and not explode the deficit and national debt?"
- Pat Buchanan, Political Commentator & Politician

DOGE is a nice vanity project for Musk and will undoubtedly find some cost savings. Given the current state of our fiscal position, all contributions are clearly welcome. That said, the savings from DOGE are likely to be immaterial to the actual spending problems that our country faces. And FYI, you don't need a team of computer scientists analyzing every line item to figure out how to fix this problem.

It's simple. To balance the budget, you either need to raise taxes or cut spending on entitlement programs and the military. Which will it be?

Anybody with internet access and a ninth grade level understanding of reading income statements and balance sheets could have told you that.

Everything else is a smoke screen.

Bottom line: Getting rid of as much waste and fraud as possible is the right thing to do. But we should not pretend that means we can address our fiscal challenges without addressing Social Security, Medicare, Medicaid and revenues.

THE STRONGEST ECONOMY IN 35 YEARS!

"This is among the best performing economies in my 35+ years as an economist."
- Mark Zandi, Chief Economist, Moody's Analytics

Thinking about this tweet again, it's even more insane than I first realized. The statement from Mark Zandi is so emblematic of the confusion and brainwashing that has infected mainstream economics and finance.

Using his own words, he is essentially making this statement:

Lower-income households are struggling financially, housing affordability has never been worse, and the federal government is running record deficits as a percentage of the gross domestic product (GDP) outside of a recession... but the economy has never been stronger!

Let's step back into reality:

- Lower-income households are struggling because their cost of living has risen far more than their wages or wealth in the past ~four years.
- Home price-to-median household income ratio (now > 7x) has never been higher since at least 1947.
- The U.S. federal government is deficit spending ~7% of GDP, which is larger than ever outside of a recession.

To acknowledge these realities AND STILL CLAIM that the economy is the strongest he's ever seen is contradictory, to put it politely.

Imagine telling one of those lower-income households:

"Hey, I know you are far worse off than you were four years ago... but the economy has never been stronger!"

Imagine telling a 22-year-old who just joined the workforce:

"Hey, it'll probably be a decade before you can afford a home, and you'll need to move to a different part of the country and it'll be smaller than the house you grew up in... but the economy has never been stronger!"

How about asking yourself what would aggregate economic statistics like GDP and unemployment look like if the federal government were NOT doing record levels of deficit spending?

Bottom line: Mark Zandi is a prime example of how lost mainstream economics is.

To be clear, I'm not calling for some imminent collapse or some sort of repeat of 2008 or anything like that. But to call this the strongest economy in 35 years is completely insane.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

"The top 10% of earners — households making about $250,000 a year or more — are splurging on everything from vacations to designer handbags, buoyed by big gains in stocks, real estate and other assets."

"Those consumers now account for 49.7% of all spending, a record in data going back to 1989, according to an analysis by Moody's Analytics. Three decades ago, they accounted for about 36%."

"All this means that economic growth is unusually reliant on rich Americans continuing to shell out. Mark Zandi, chief economist at Moody's Analytics, estimated that spending by the top 10% alone accounted for almost one-third of gross domestic product."

"A stock-market selloff or decline in home values that rattles the confidence of the top 10% and causes them to cut back would have a significant effect on the economy. Consumer sentiment is starting to slide overall, including for the wealthiest third of consumers, thanks in part to tariff threats." - Excerpted from "The U.S. Economy Depends More Than Ever on Rich People."

Federal Reserve Chairman Jerome Powell was busy telling Congress last week that the U.S. economy is in "solid" shape. If one is willing to ignore hiring activity, small business sentiment, consumer confidence, non-residential construction, retail sales, exports, the housing sector and manufacturing activity, I'm sure he must be right.

As we move forward, there are five major downside risks to the U.S. outlook:

1. Government spending cutbacks
2. The squeeze on real incomes from tariffs
3. The impact of high uncertainty on business capital expenditure and household spending
4. A likely recession in the rest of the world if President Trump goes ahead with a tariff war
5. The Fed keeping policy more restrictive than it needs to be

From my perch**,** I believe the President is using America's clout as a negotiating tool. If companies move their production from their home country to the U.S., for example, no tariffs will be applied. This is all part of his protectionist industrial policy, an attempt to level the playing field on trade flows, as well as an opportunity to reduce the cost of his ambitious fiscal policies.

But what if he is serious about tariffs and goes through with 25% tariffs on a wide range of goods? Thus, we must be aware of the fact that based on what we know about the Trump tariffs, and depending on the degree of pass-through to the consumer, we could be looking at inflation accelerating to possibly +4.0% by late spring/early summer from +3.0% currently.

The reality is that no one knows what will actually happen but, in the meantime, uncertainty will affect economic growth. As shown below, economic uncertainty is back to pandemic levels. Economic uncertainty regarding trade, fiscal policy and immigration policy causes both consumers and firms to delay decisions, causing investment and purchases to fall. Precautionary savings and risk aversion will reduce economic growth as well.

Going forward, the key, as always, is the consumer, which will be negatively impacted from three channels:

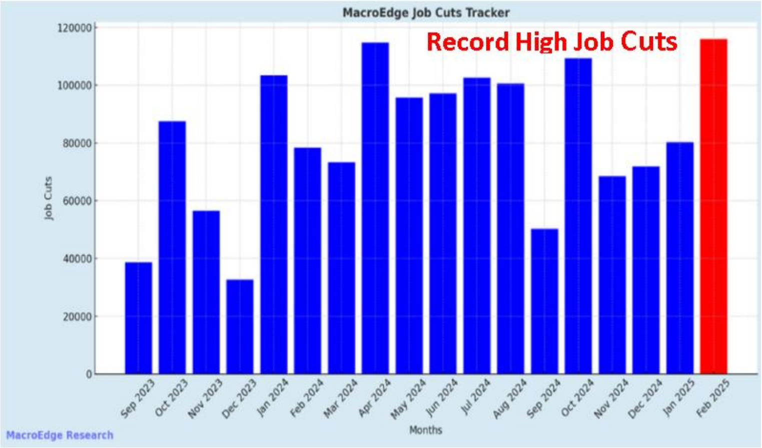
1. A lower savings rate (it was over 8% during the Trump 1.0 tariff war, twice today's level)
2. The effect of the tariff spike on inflation
3. The impact on real work-based incomes

Thus, the consumer is hit by a triple whammy!

Indeed, we received three critical data points on the U.S. consumer in recent weeks. First was the sharp -0.9% month-over-month drubbing in January retail sales, the worst drubbing since March 2023. Second was the deep -7.0-point dive in February consumer sentiment to its lowest level since November 2023. And the third was less a data point than a narrative that showed up on the front page of today's *Wall Street Journal* titled "The U.S. Economy Depends More Than Ever on Rich People."

Here are the major findings: The low and middle end of the income strata are already in a world of recession, joining the housing market, commercial construction, manufacturing activity, and exports on this file. Meanwhile, bloated fiscal deficits and the very high-end consumer are the glue that that has been keeping the U.S. economy afloat in the most lopsided expansion in recorded history.

And last but not least, let's not forget about the jobs market. According to MacroEdge, job cuts hit an all-time series high in February 2025, driven by thousands of retail store closures and Trump's layoffs of probationary employees. I expect the labor markets to show significant weakness in the weeks and months ahead.



Meanwhile, the Fed is sidelined. So for the here and now, the Fed is not going to be bailing anyone out.

So, the question is, what stops the economy from going into recession? Even if it doesn't, the overall result is a disinflationary output gap, which should be very beneficial for bond investors who extend duration during all this turmoil.

Big picture: Bond yields are attractive and technically oversold, but the uncertainty and effects of potential tariffs could end up taking people by surprise in the next few inflation readings. That is my concern. So, for now, and into the spring, it is best to play it safe.

In terms of portfolio strategy, credit unions should continue to maintain a risk-appropriate ladder strategy while buying the dips.

MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at tom.slefinger@alloyacorp.org or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.