Week in Review

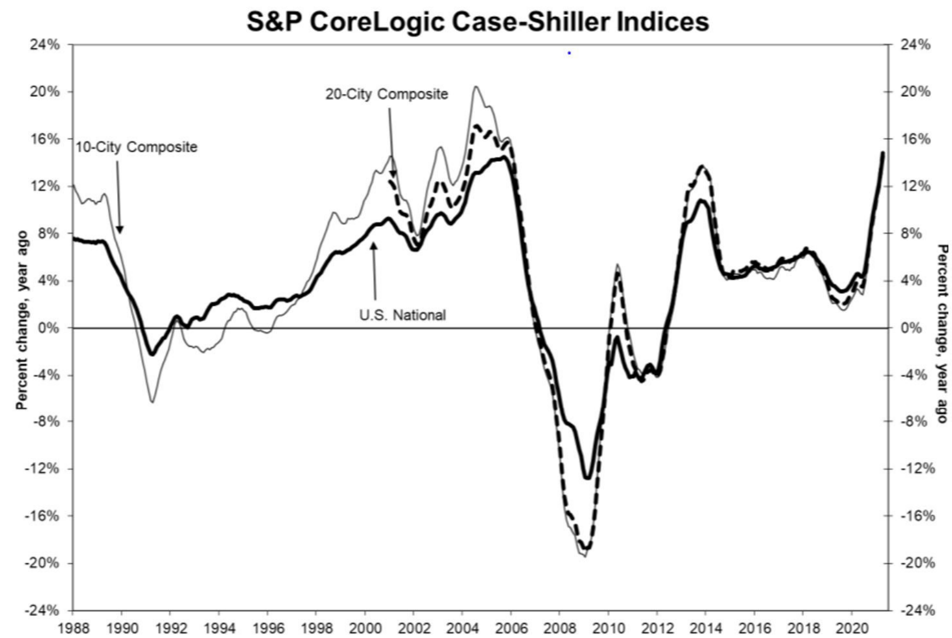
Friday, July 2nd 2021

1. Housing Prices Have Hit a New High with the Fastest Rate of Increase Seen Since 2005

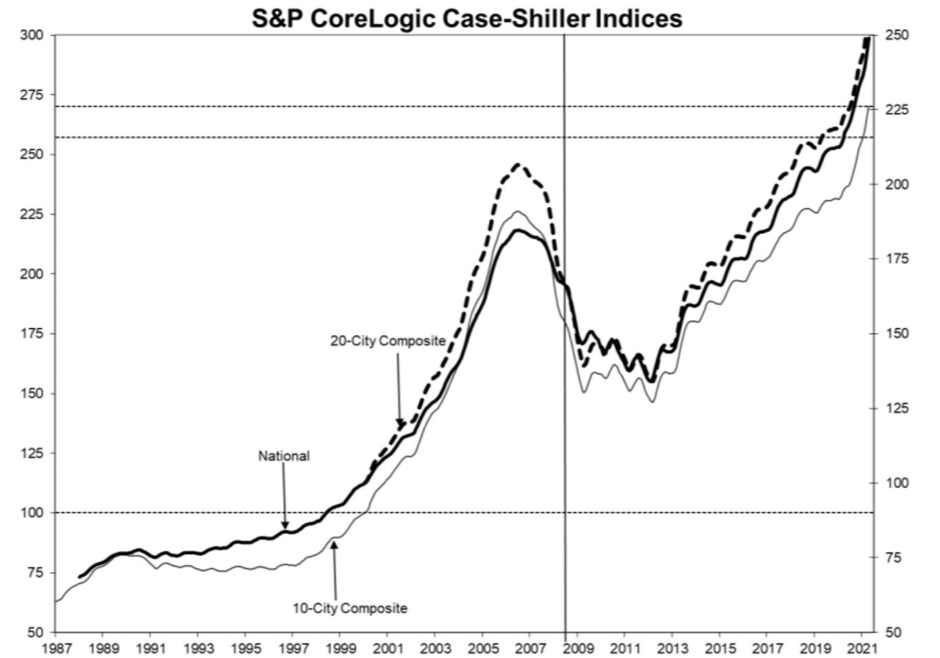
As with most sectors of the U.S. economy, housing prices have risen significantly with the S&P Case-Shiller house price index up 14.9% on a year-on-year basis. Low mortgage rates, a new way of working at home, and supply constraints have driven the increase.

With the recent rise in housing prices, home values have now meaningfully eclipsed the average level realized during the peak of the housing boom in July 2006. At a national level, housing prices now stand nearly 35% above July 2006.

Supply constraints have been an important factor that is boosting prices. The stock of inventory for sale is close to record low levels for existing homes, and while new construction has risen from its pandemic lows, the combined inventory remains very low relative to the past 20 years. New construction inventory is not expected to rise significantly in the near-term as shortage of labor and elevated commodity prices such as lumber have delayed construction timelines and profitability. This lack of inventory suggests that prices may be more sustainable now than they were in 2006. However, high prices and rising interest rates may prove an impediment to affordability and dampen demand for housing, curbing any further rise in prices.



Sources: S&P Dow Jones Indices & CoreLogic



Sources: S&P Dow Jones Indices & CoreLogic

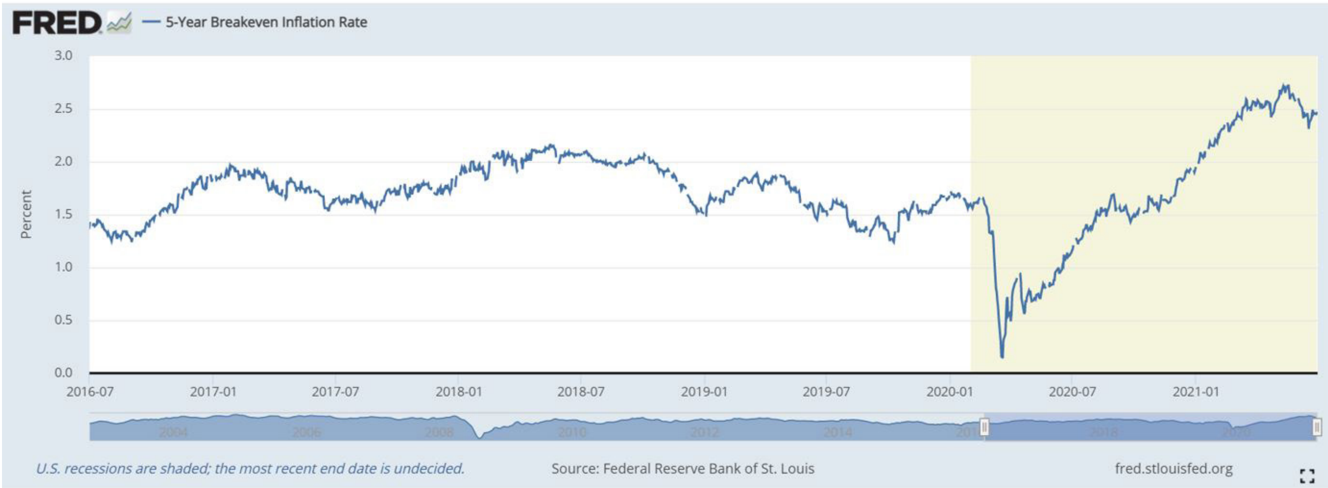
Higher housing prices have historically been an indicator of broader inflation. Rents and implied rents for owners are an important part of the Consumer Price Index (CPI) basket and movements in these components tend to lag 12-18 months behind the house price data. This suggests headline inflation may be further pressured upward later into the year and into the next. This could add more momentum for moving the timetable for the interest rate hikes by the Federal Reserve forward.

Housing supply near record lows - housing inventory on the market (equivalent months of sales)

Source: Macrobond, ING

2. Treasury Market Pricing in a Moderation in Inflation Expectations

Countering data suggesting higher inflation prospectively is the recent movement in the treasuries market. After rates moved up following the lows of the pandemic, they peaked in the second week of May and have subsequently retreated. This has led to a plateauing and even reversal of forward-looking inflation expectations. The threat of rising inflation and a shift towards tightening monetary policy from the Federal Reserve looms among the most significant risks confronting financial markets. Inflation pressures appear to be moderating at the moment, which will provide the Federal Reserve the flexibility to maintain its accommodative stance. This is supportive of risk assets including stocks, as we enter the second half of the year.

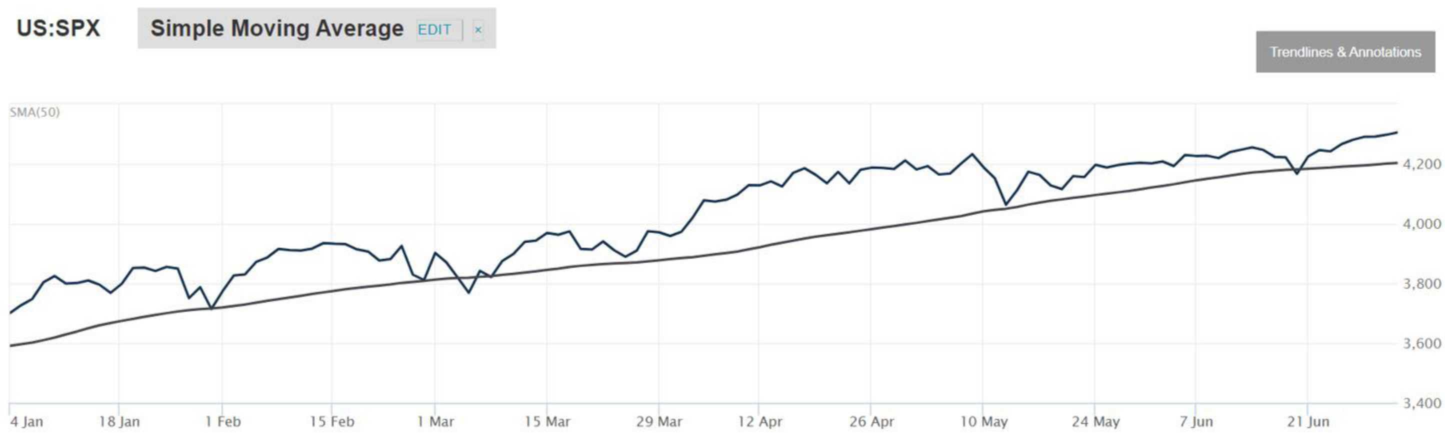


The breakeven inflation rate represents a measure of expected inflation derived from 5-Year Treasury Constant Maturity Securities (BC_5YEAR) and 5-Year Treasury Inflation-Indexed Constant Maturity Securities (TC_5YEAR). The latest value implies what market participants expect inflation to be in the next 5 years, on average.
Starting with the update on June 21, 2019, the Treasury bond data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department.

Source: fred.stlouisfed.org

3. S&P 500 Notches A Very Strong First Half of the Year

The S&P 500 set another record to finish the second quarter. The S&P 500 gained 8% for the second quarter and nearly 15% for the first six months of the year. The global economic recovery, the rollout of vaccines, and continued monetary and policy support by the Federal Reserve have continued to be very supportive of the financial markets.



Source: Barron's

Thinking Ahead

The first half of 2021 is complete and has been very positive for the appreciation of assets including real estate and public equities. Expectations remain upbeat for the second half of the year in terms of economic growth and supportive government policy. Pallas Capital Advisors will continue to monitor economic, political, and corporate data for implications to the markets.

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