Weekly Relative Value

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WEEK OF JULY 28, 2025

The Affordability Crisis

*"Our economy is so strong now, we're blowing through everything, we're setting records....**People aren't able to buy a house because this guy is a numbskull, he keeps the rates too high and probably is doing it for political reasons."***
— President Donald Trump

After a small bounce in May, expectations were for existing home sales to fall once again in June as mortgage rates ticked up. The analysts were right as sales dropped 2.7% month over month (versus -0.7% month over month expected), leaving existing home sales unchanged year over year. It really does say something that sales are now below the levels that defined the past three recessions.

Except for the West, where sales were little changed, all other regions were down for the month (Northeast -8.0%; Midwest -4.0%; South -2.2%).

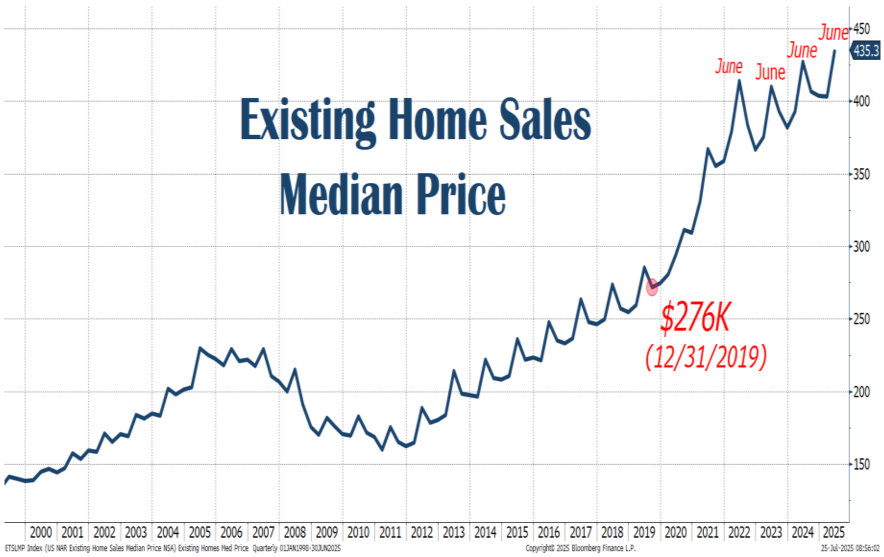
When sales began plunging in 2022, the narrative from realtors was that sales were plunging because there was nothing to sell. But sales continued to plunge even as inventories soared, and now it's a buyer's market with plenty of supply, but few buyers.

THIS WEEK

- NEW HOME SALES
- CUT THE PRICE AND THEY WILL COME
- THE PRESIDENT WANTS LOWER RATES
- STILL NOT OUT OF THE WOODS
- A CHICAGO BEAR
- NOTHING DURABLE HERE
- BEST DEAL OF ALL TIME
- NO INFLATION FROM WAGES
- MARKET OUTLOOK AND PORTFOLIO STRATEGY

The median sales price increased to a record high of $435,300. That said, home price appreciation is cooling off, with growth in median sale prices slowing from over +4.0% year over year a year ago to slightly below +2.0% currently.

I should note that it's typical to see high home prices this time of year because families want to move before the school year begins. In the spring, nationally, a larger number of higher-end homes come on the market and sell, which changes the mix of what sold and shifts the national median price higher. It does the reverse in the fall and winter. June is generally the seasonal high point of the median price (as indicated in the graph below), which then declines through January or February. The exception was 2020.



This measure of the national median price had exploded by 50% in the three years between June 2019 and June 2022, on top of the large price gains in the prior 10 years, driven by the Fed's interest-rate repression and fear of missing out (FOMO) . The national median price is deceiving because regional housing markets do not move in lockstep.

In fact, lots of regional markets have already turned down. In 10 bigger cities, prices of single-family homes have declined by 9% to 23% from their peaks. And these are not median prices that are skewed by shifts in what sells. These are prices of mid-tier single family homes.

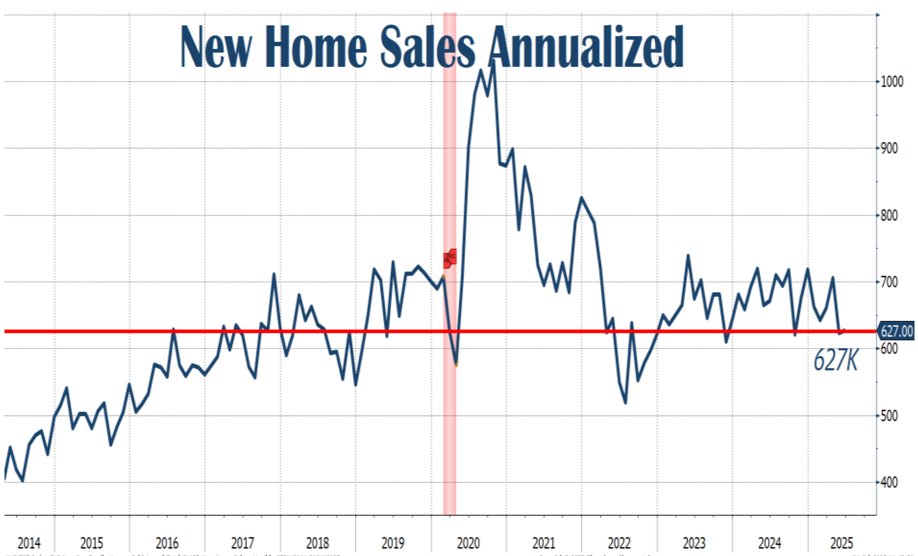
Below I list the 10 bigger cities that have seen the largest declines in prices from their respective peak levels.

1. Austin, TX: -23%
2. Oakland, CA: -22%
3. New Orleans, LA: -18%
4. San Francisco, CA: -16%
5. Birmingham, AL: -15%
6. Washington, DC: -12%
7. Fort Myers, FL: -10%
8. Denver, CO: -10%
9. Portland, OR: -9%
10. Phoenix, AZ: -9%

At the same time, supply is exploding. The number of homes in the existing resale market with a "for sale" sign in front of them has ballooned by +20% in just the past twelve months to a five-year high of 1.54 million units. This backlog of unsold units has risen from 3.2 months' supply in February to 4.7 months as of June. This is the largest shift away from the sellers' market to a buyers' market since the summer of 2016. While there are geographical regional differences, supply spiking like this destroys the real-estate industry hype, deployed to drive up prices, about there being a "housing shortage."

NEW HOME SALES

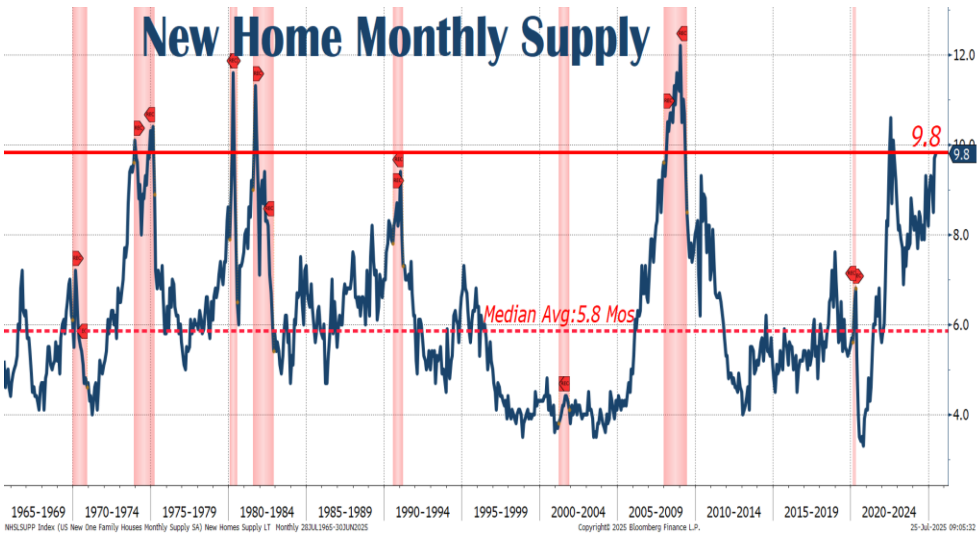
Following the disappointing existing home sales print, new home sales confirmed the disappointment with a mere 0.6% month-over-month rise (well below the 4.3% month-over-month rebound expected after tumbling 11.6% month over month the month prior). The year-over-year pace has throttled back from +22.8% two years ago, to virtually flat a year ago, to -6.6% currently.



Home builders now have 9.8 months of supply on their lots. Such a high backload of inventory has only happened six other times in U.S. history. The long-term median months of supply is around 5.8 months, meaning today's home building market is 70% more oversupplied than normal.

As shown below, there are only five times there has been more builders supply relative to demand in U.S. history:

- Dec 1973: 10.1 months (recession)
- Aug 1980: 11.6 months (recession)
- Sep 1981: 11.3 months (recession)
- Jan 2009: 12.0 months (recession)
- July 2022: 10.6 months (mortgage rate shock)



In the South, dominated by Texas and Florida, inventories of new houses for sale spiked to a record of 312,000 in June, up by 6.5% from the peak level a year ago, and up by 78% from June 2019. This region accounted for 61% of total U.S. new-home inventory, and for 61% of total U.S. new-home sales.

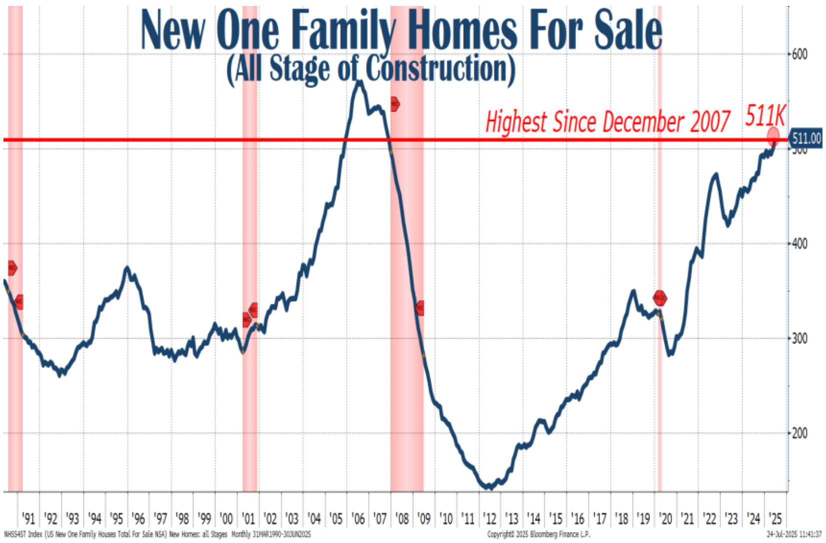
In the West**,** dominated by California, inventories of new homes for sale jumped by 6.5% year over year to 115,000, up by 35% from June 2019. In the Midwest, inventories of new homes for sale spiked by 26.8% year over year and by 41% from June 2019 to 52,000 new homes, the highest since February 2009. **In the Northeast,** inventory jumped by 24% year over year and by 11% from June 2019 to 31,000 new homes.

As a sign of how tough it is for the builders, it is taking them a median of 2.8 months to land a sale upon completion, up from 2.1 a month ago, and is the highest figure for this time of year since 2022, amidst the Fed's interest rate shock at the time.

While the builders have acted to curb their production, there is more to go. There are now 511,000 newly constructed homes that have yet to sell — the highest since October 2007 (which foretold the housing bust of that cycle). The inventory backlog expanded by +8% in the past year and by nearly +20% over the past two years.

"Multiple years of undersupply are driving the record high home price. Home construction continues to lag population growth." — Lawrence Yun, Chief Economist, National Association of Realtors (NAR)

The fictitious real estate-hype meme that there is a "housing shortage," bandied about endlessly in the media to pump up prices, needs to be flushed down the toilet, where it belongs.



There are two stories at play. One is good; one is bad.

The good story is that this excess builder inventory is finally giving opportunities to homebuyers. More inventory from builders is resulting in price reductions and aggressive mortgage rate buydowns, and it is enticing more buyers to come back into the market. All good things.

Because of the supply demand dynamics, the building community has had to sharply discount their product. To wit: The median new home price sagged by -4.9% month over month in the steepest discounting of the year thus far to a seven-month low of $401,800. Year-over-year prices have deflated by -3.0%.

It's important to stress that builder incentives are not included in the median sales price. The Census Bureau tracks sales prices of new houses by the prices in purchase contracts that buyers signed, which do not include the costs of mortgage-rate buydowns and some other incentives (free pool, cabinet upgrades, etc.) and thereby overstate the effective sales prices and understate effective price cuts.

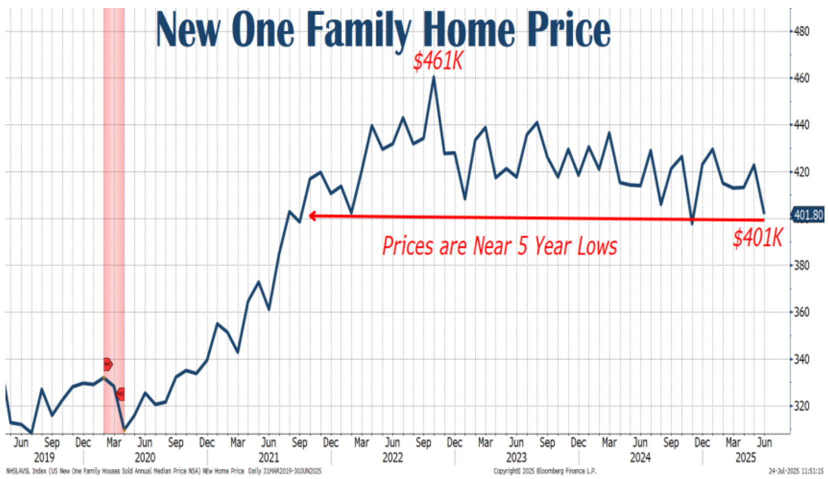
I should add that even with the price cuts, D.R. Horton (the largest homebuilder in America) still made over $1 billion in net income in the past quarter, so there's plenty of room left to give more discounts. They don't plunge 50% overnight (usually). Effective price drops are far bigger. For example: Lennar's average price is down by nearly 20%; D.R. Horton's is down by 11%, including incentives.

This is what D.R. Horton reported in its quarterly filing:

> *"We expect to maintain an elevated level of incentives to support demand and may increase them further…"*

The ongoing aggressive pricing from homebuilders represents significant competition for anyone trying to see their existing home.

Moreover, while lower prices are definitely a positive development for prospective buyers, the bad story is that such overcapacity in home building could be a signal of labor markets and economic weakness, as well as a potential harbinger of layoffs.



Bottom line: The FOMO of the 2021-2024 housing buying panic is gone, and an expectation of price drops is beginning to arise, largely due to prices dropping in many markets. If the stock market drops for many months or recession hits and unemployment spikes, the real estate price decline would likely accelerate.

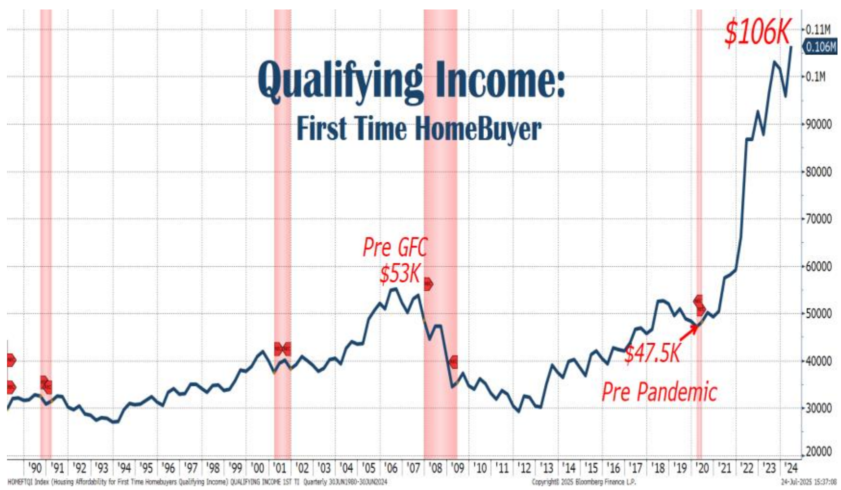
CUT THE PRICE AND THEY WILL COME

We're staring down the barrel of one of the most severe housing affordability crises ever recorded. This is due to the combination of punishingly high interest rates and home prices that have deviated from their underlying fundamentals.

As we all are aware, home prices during the pandemic went up way faster than incomes, pricing out homebuyers and resulting in the highest overvaluation seen in decades. It's estimated that home values on a nationwide basis are overvalued by 16-20%, which is higher than at the heights of the 2006 bubble.

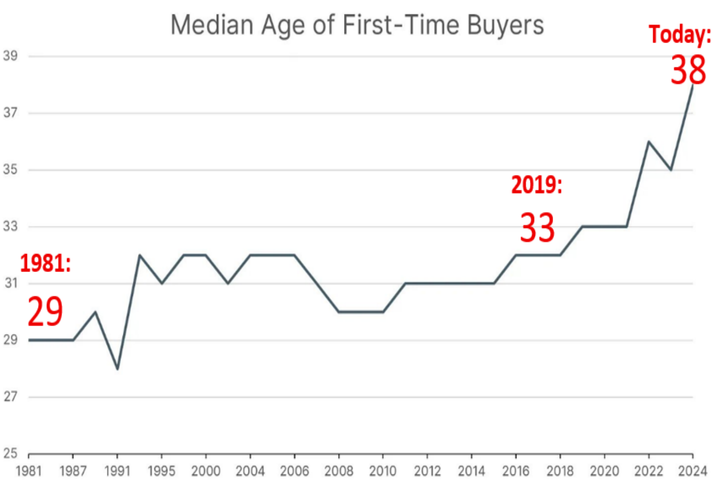
After that last bubble, prices became undervalued, and the period from 2008-2019 was a great time to buy a house. However, today the market has become too expensive, with home prices outpacing wage growth. The result is an overvalued and unaffordable market. This is the main reason why homebuyer demand is so low in 2025. Fix the overvaluation, fix the homebuyer demand problem.

The median American entry-level homebuyer now needs about $100,000 in qualifying income to buy a home. The problem is the median household in the U.S. earns around $83,000. The annual mortgage payment to buy a house is $33,000, which equates to payment/income ratio close to 40%. That's simply too expensive for first-time buyers. Rare has been the day that the typical first-time buyer has been pushed this far away from the American Dream, as is the case today.



As a result, it's hardly a shock that the homeownership rate for 30-34-year-olds is a pathetically low 46%, and 56.7% for those aged between 35 and 39 (both at multi-year lows). As shown below, the average age of the first-time homebuyer has sharply risen to 38 years. For comparison, in 1981 the average first-time home buyer was 29. Prior to the pandemic lockdown, the average age of the first-time homebuilder was 33.

The disconnect between incomes and the capacity to service high-cost mortgage debt is wider than the Grand Canyon. You can see why this is indeed a crisis. Prices have exploded beyond what the market can bear, and so demand has plunged because prices are way too high. Full stop.



The NAR and many industry professionals think lowering mortgage rates alone is the way to achieve affordability gains and incentivize buyers to get back into the market. But the math doesn't work. Today's payment is ~$2,800/month to buy, inclusive of taxes and insurance. If rates drop by 100 basis points, the payment goes to ~$2,570/month. Not enough to get anyone truly excited.

I think the "sweet spot" for mortgage payments on a national basis is around $2,100/month, which would drive the affordability ratio back in line with long-term norms (30% of income). To get there with lowering mortgage rates alone, the rate 30 years fixed would need to drop to 3.8% (not realistic).

But if you were to couple a mortgage rate of 5.7% with home prices dropping by 20% on a national basis, then the monthly mortgage payment would drop to ~$2,200/month, and then true affordability is unlocked. So, some level of price declines is needed to bring affordability and buyers back.

Bottom line: Housing is the bedrock of the household balance sheet ($48 trillion) and in the banking system. The rapid growth in the new supply against sluggish demand could well spark at least a -20% decline in average home prices nationwide.

If this were to happen, this loss of wealth would exert a far more powerful impact on the economy and on inflation than the Trump tariffs. Remember, housing values are more than double the level that preceded the bursting of the housing bubble in 2008 that prompted a consumer recession that nobody saw coming. Word to the wise.

Brace for a looming deflationary cycle in residential real estate. Eventually, incomes and the capacity to service mortgage debt will end up becoming connected via classic housing price deflation and by lower interest rates, which is a big reason why I remain bullish on bonds — the latter needing the Fed to wake up soon.

THE PRESIDENT WANTS LOWER RATES

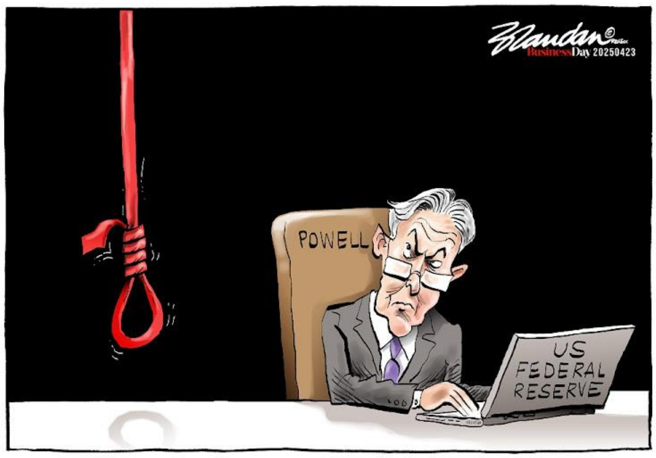
"I just want to see one thing happen, very simple: Interest rates have to come down."
— President Donald Trump, July 24, 2025

President Trump, as if in a state of cognitive dissonance, continues to pressure the Fed to cut rates even as he boasts that the U.S. has the greatest economy and stock market of all time. If things are so great, Mr. President, why the constant clamoring about the necessity of immediate rate relief?

It is also quite ironic that Donald Trump is so keen on firing Jay Powell or, at a minimum, pressuring the Fed Chairman to resign when it is the President's own policies that have created the conditions for the current environment of elevated interest rates, such as:

- Designing the Big Beautiful Bill to deliver its maximum fiscal juice to the economy in 2026.
- Immigration and Customs Enforcement (ICE) is now arresting up to 1,400 illegal entrants daily. This promotes immigration outflows, which in turn are causing the labor force participation rate to decline and prompting further tightening in the labor market. If anyone has noticed, the growth in the working-age population is in steady decline, and those aged 25-44 who are foreign-born saw their year-over-year population growth approach 0% in June.
- Policies aimed at reshoring production at home may be laudable, but the new facilities require workers — reinforcing the tightness in the labor market and causing anxiety over wage inflation. There are only 544,000 unemployed manufacturing workers in the U.S. (and the industry's jobless rate is nearly rock-bottom at 3.6%), about half the norm of the past quarter century. Where are the workers going to come from to facilitate the onshoring wave if immigration flows are moving in reverse?
- The tariff issue is already forcing many goods prices higher, and we are in the early stages of this development — thwarting the disinflationary momentum in the services sector. Powell has already stated that if it weren't for tariffs, the Fed would be cutting rates.

Meanwhile, Trump has it in for Jay Powell like it's nobody's business. It's not just President Trump and his truly ridiculous accusations of cost overruns regarding the renovations at the Fed headquarters, (which is hardly cause for dismissal, or even Powell's fault, to be frank), but the entire administration has the knives out for the chairman. Last week, all the president's men came out in unison to pressure and harangue the Fed to lower rates. Last week, Commerce Secretary Howard Lutnick suggested U.S. rates should be cut now and Federal Reserve Chair Powell should resign or be fired.



Likewise, Treasury Secretary Scott Bessent is now calling for a full-on investigation of the Federal Reserve. This is another attempt by the White House to pressure Powell to step down. (Mr. Bessent was certainly put in his place by daring to suggest that he was the one who convinced the president to back off his threats against the Fed Chairman.)

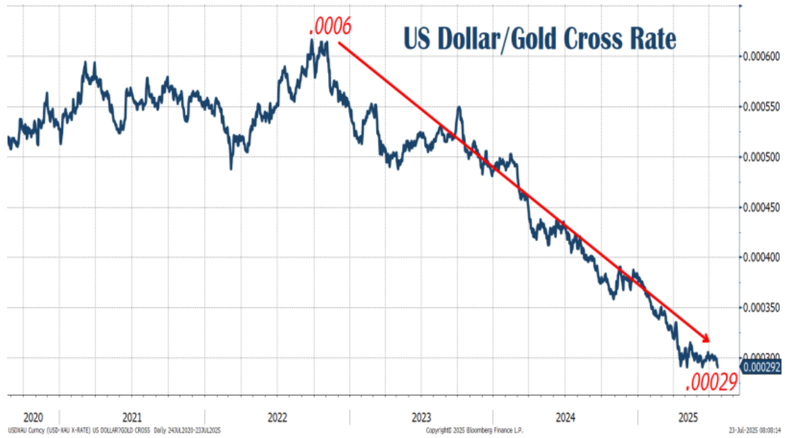
Also making the headlines, Kevin Warsh, who was once leader of the hawks while on the Federal Open Market Committee (FOMC) from 2006-2011, stated that if he were at the helm (by the way, he is interviewing for the job), he would be cutting rates at this week's FOMC meeting. He supported this view based on the beleaguered housing market, but the rant about strained affordability, as discussed above, is more due to super-inflated home prices. More importantly, the central bank has no control over mortgage rates in any event. One ruse followed by another.

With stocks at record highs, sky-high crypto prices, extremely tight credit spreads, and a weak dollar, only a fool would be choosing next week's meeting to restart the rate-cutting program. There is no case to be cutting rates now outside of the desperation to rein in runaway debt-service costs even though most of America's debt is priced at the longer end of the curve, which the Fed has no control over.

Finally, former St. Louis Federal Reserve Bank President Jim Bullard stated that any president has the right to choose the Fed Chairman he wants. Indeed, but it was Donald Trump himself who appointed Jay Powell to the seat eight years ago (though he blames Steve Mnuchin for making the recommendation). In any event, you can't make this stuff up.

Regardless of one's politics, the ongoing government meddling in monetary policy will not be good news for U.S. bonds, stocks or the greenback. The history books show that this pressure to undermine central banks does not end well for the markets.

Do investors want to live in a world where Fed independence is compromised and Lutnick influences policy? To judge from the dollar's reaction, the answer is "no." As shown below, since December 2022, the U.S. dollar has lost over 50% of its purchasing power versus gold.

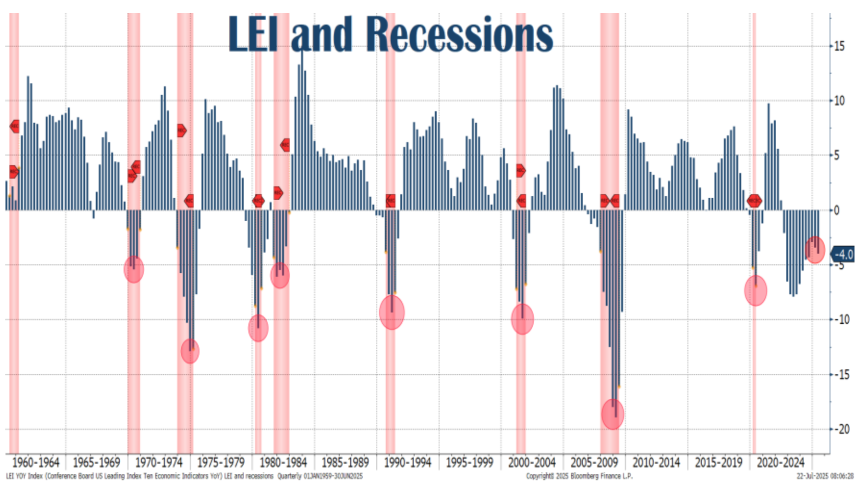


Bottom line: Whoever becomes the next Fed Chairman has one vote. Interest rates are set by the committee. The Fed is not one person; it is an institution. However, if a new Fed Chairman is willing to do Trump's bidding and cut interest rates by 300 basis points, we could be facing a mutiny. Would the president fire the entire FOMC?

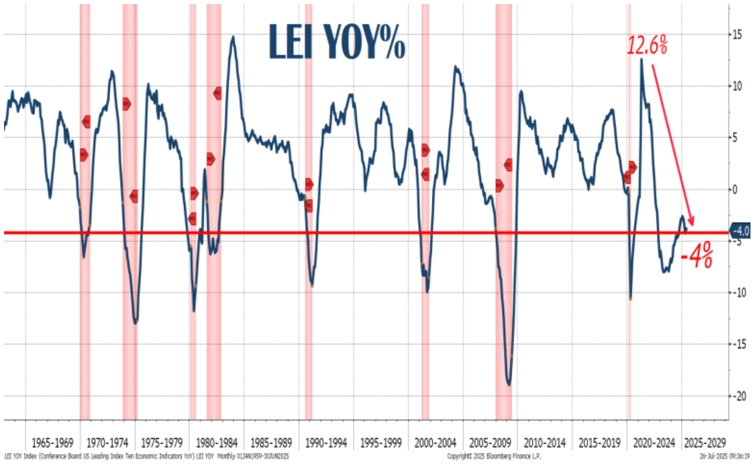
Gold will break out to new highs, stocks will boom on rate cuts and the yield curve will steepen, along with all the wonders to the bottom line that dollar depreciation generates.

STILL NOT OUT OF THE WOODS

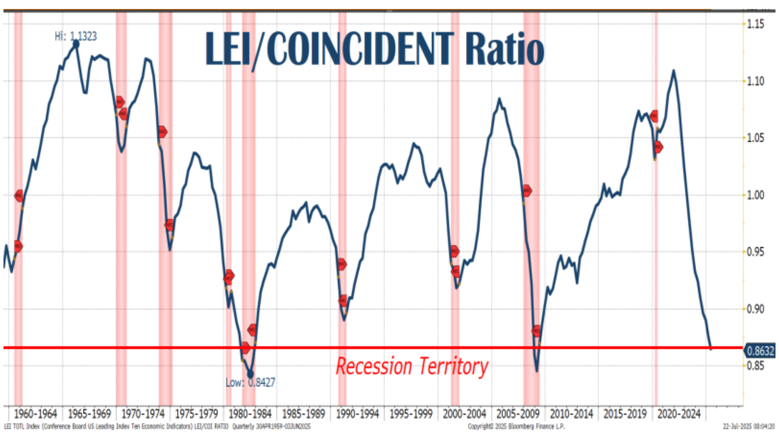
The Conference Board's index of leading economic indicators (LEI) continued to move opposite to the stock market (new orders, the labor market and consumer expectations were the big negatives). The index fell -0.3% month over month in June, marking a new 10-year low. The index has NOT posted a positive pulse since last November.



Year over year, the LEI is down -4%. The LEI peaked in December 2021 and is now down -17.8% since that time — mirroring the lengthy declines in the 1980s downturn and the Great Recession in 2008-2009.



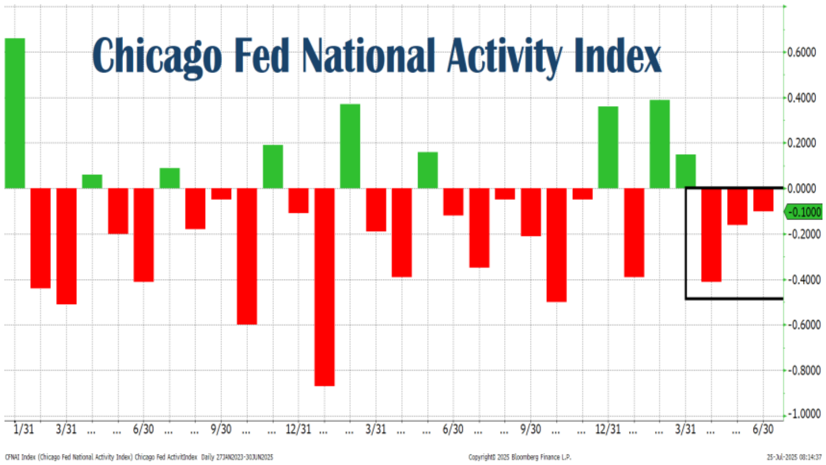
More importantly, the ratio of the leading index to the coincident economic indicator just hit the lowest level since May 2009 (which was at the tail end of the Great Financial Crisis); prior to that period, try September 1982.



Bottom line: The LEI Index has historically been prescient, signaling recessions. Based on the current reading, the recession may not yet have arrived, but this indicator stubbornly flashes downturn signals, nonetheless.

A CHICAGO BEAR

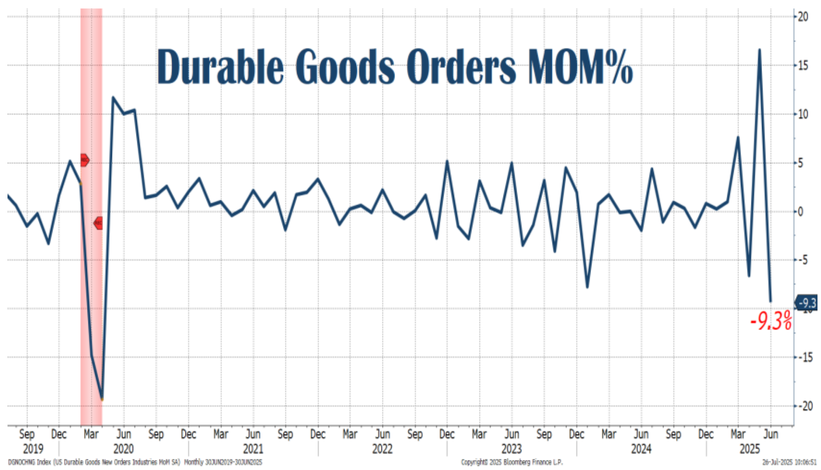
Arguably the most comprehensive monthly report card of real economic activity is the Chicago Fed National Activity Index. This index has been published since 1967 and is chock-full of 85 different macro variables. In June, the index had a contractionary -0.1 reading and has now been negative for three consecutive months. As a measure of how the economic weakness is spreading, all four corners of the report (Production and Income, Employment, Personal Consumption, and Sales and Inventories) were negative in June.



Bottom line: This index suggests that there is a broad weakness in the economy.

NOTHING DURABLE HERE

The durable goods orders and shipments data is notoriously volatile, but it provides a window into the U.S. capital spending backdrop and outlook. The headline declined -9.3% offset much of the sharp +16.5% month-over-month bounce in May. The volatility in the aircraft sector was once again behind the sharp up-and-down movement.



The most critical number is the "core capital expenditures (capex)" figure (which strips out defense capital goods and aircraft), and it sagged by -0.7% sequentially, which has now been down in two of the past three months. And the year-over-year trend was trimmed from +4.1% to +2.8%. Therefore, the widely anticipated capex boom coming from the Big Beautiful Bill looks like it will have to await another day.

Bottom line: Barring a significant improvement in net exports, a big inventory build, or a spurt in government spending, this report along with weaker-than-expected real retail sales (+0.5% in Q2), and housing starts (-19.4%) calls into question the veracity of the +2.4% gross domestic product (GDP) call as per the most recent Atlanta Fed Nowcast model.

BEST DEAL OF ALL TIME

“I just signed the largest trade deal in history; I think maybe the largest deal in history with Japan.”
— President Donald Trump

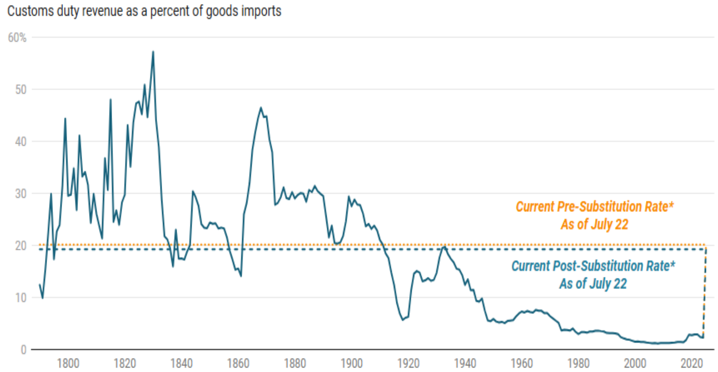
On the trade front, President Trump came out and said that the trade deal with Japan was the best of all time. Then again, he said the exact same thing eight years ago regarding the United States-Mexico-Canada Agreement that he then went on to annul. There are now signs that the EU is next in terms of coming cap in hand. The question is whether a deal with the EU will replace the one with Japan as the best deal ever. But even an agreement with Europe will take a back seat to a deal with China when that one comes.

At this point, per the non-partisan Yale Budget Lab, the average tariff is just under 20%. This is the strange world we live in today. Investors are giddy that the president has announced a tariff rate floor of 15% and a maximum level of 50% on countries deemed “uncooperative.” Averting disaster from what was being proposed back on April 2 is one thing, but the fact is that tariffs will end up having soared more than eight-fold on the $3.3 trillion of U.S. goods imports from the rest of the world. Other than helping in reducing the bloated fiscal deficit, this is not good economic news.

The equity markets have swung to a “new kind of normal,” where a tariff rate of ~20% is being treated as if it is 0%. Levels of tariffs that had investors freaking out in April are now being cheered. Sounds bizarre, but this is the nature of a sentiment- and headline-driven marketplace

Figure 1. U.S. Average Effective Tariff Rate Since 1790

Customs duty revenue as a percent of goods imports



* Incorporates US-Vietnam framework and July 7 announcements.

Chart: The Budget Lab • Source: Historical Statistics of the United States Ea424-434, Monthly Treasury Statement, Bureau of Economic Analysis, The Budget Lab analysis. • Created with Datawrapper

We have not seen an average tariff rate of ~20% in over a century. (Before the fun started, tariffs were 2.5%!) I would consider that a shock to the system that has yet to play out. Either U.S. companies absorb the tariffs or the American consumer does.

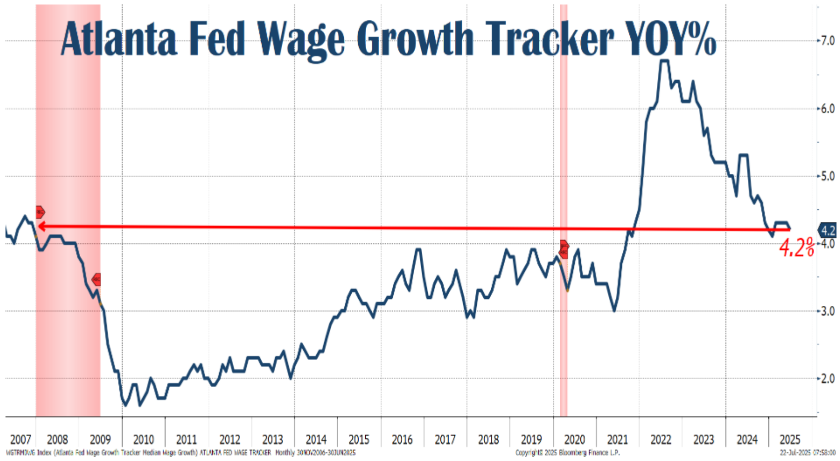
According to this *Wall Street Journal* article, “Trump’s Tariffs Are Being Picked Up by Corporate America.” With the effective tariff rate of ~17%, the duties paid by the private sector are estimated to be $300 billion annually. According to the article, many U.S. businesses “are absorbing much of the costs for now.” This should help with the inflation rate but will also be a dead-weight drag on corporate earnings.

While companies may be absorbing the bulk of the tariff, goods prices have already swung from deflation to inflation. We should hope and pray that we get some powerful disinflation coming out of the services sector (especially shelter costs) or everyone may be surprised at where the inflation rate lands by year-end. Check out what is happening now with steel prices.

As a result, Steel Dynamics and Cleveland Cliffs sharply boosted their prices in the second quarter and General Motors announced that the tariffs cost the automaking giant more than $1 billion in its bottom line. And let's not forget the consumer who is now facing higher prices. Bottom line: There is a cost to this degree of protectionist trade policies.

NO INFLATION FROM WAGES

While tariffs will lead to higher prices, there is no inflation pressure coming out of the labor market. Indeed, the Atlanta Fed's latest wage-tracker, which slowed to +4.2% year over year in June, from +4.3% in both April and May, is now tied for the softest pace in four years (not to mention it is lower now than it was in December 2007, the month that the Great Recession began, when the trend stood at +4.4%).



MARKET OUTLOOK AND PORTFOLIO STRATEGY

My long-term view is that rates will be lower over the next 12 months. Near term, the concerns over tariffs and Fed independence as well as incoming growth, employment and inflation data will dominate pricing.

This week's Fed meeting will be a key watchpoint for investors. The Fed is widely expected to keep rates on hold, but we could easily see at least one if not two dissents. Governor Chris Waller had argued that he sees tariffs hitting demand harder than prices and signaled he would dissent. Also the "dot plot" and Powell's presser may provide additional insight into the Fed's rate intentions in the second half of 2025.

The consensus forecast for the first estimate of Q2 GDP is 2.4% versus Q1 GDP -05%. Looking forward, the consensus is at barely more than +1% growth in both Q3 and Q4, which would be a performance that leaves average annual real GDP growth at around +1.0% in 2025, down from +2.8% in 2024. Excluding the pandemic, you must go back to 2009 to see the last time the economy sputtered so badly. Yet, the narrative is one of a strong economy. Perception and reality are at odds with each other.

In the inflation file, the Fed's preferred inflation metric (the core Personal Consumption Expenditures Index) is expected to show the effect of tariffs. The consensus forecast is for the core to increase by 0.3% versus 0.2%. The year-over-year reading is expected to remain at 2.7%.

Also, this week, we will get an update on the labor markets with the release of the ADP and non-farm payroll report for July. Will we see additional weakness in the jobs data? If so, pressure will continue to mount on the Fed to lower rates.

Despite the crosswinds form trade, politics and economics, credit unions should adhere to the discipline of maintaining a risk-appropriate laddered portfolio of high-quality securities. Unquestionably boring but effective. As always, sell-offs provide attractive entry points.

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.

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