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Weekly Relative Value

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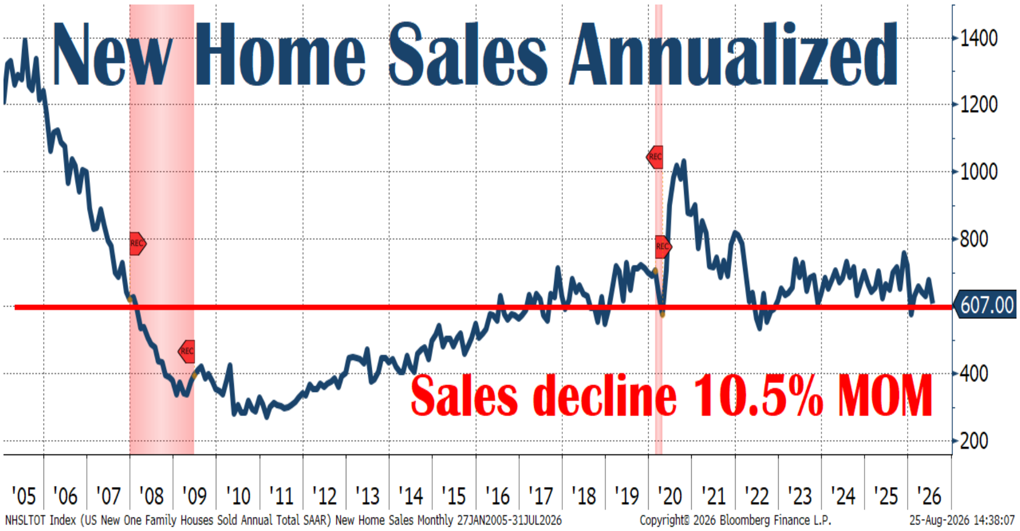
Market Strategist

WEEK OF AUGUST 31, 2026

Housing in Deep Trouble

"The housing market is absolutely frozen. Americans have no anticipation that their incomes are going to keep up with latent inflation and the persistence of high prices vis-à-vis what they were before the pandemic hit."
— Danielle DiMartino, Chief Executive Officer, QI Research

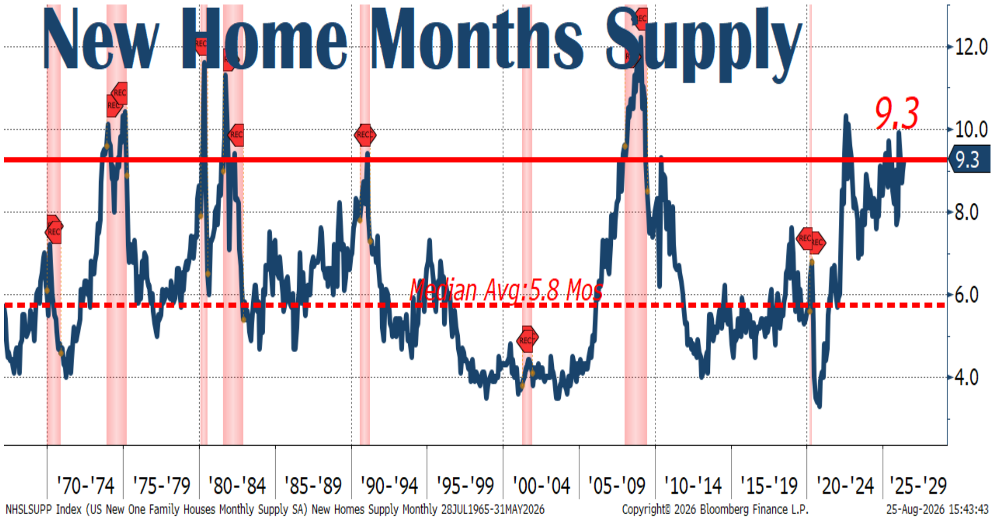
The U.S. homebuilder recession got even worse in July. Sales of new single-family houses in July 2026 were at a seasonally adjusted annual rate of 607,000. This is 10.5% below the June 2026 rate of 678,000 and is 6.3% below the July 2025 rate of 648,000. It says something that new home sales today are lower than they were in December 2007 (691,000), the month that the steep housing-led downturn began.



Supply of new homes for sale has generally been rising. Actual sales have generally been falling. New homes **at all stages of construction** jumped to 495,000, the fourth month in a row of month-to-month increases. Months of supply is now north of 9.0 — comparable to the levels in 2008 right before the Great Financial Crisis. Compared to July 2019, inventory for sale has soared by 71%.

THIS WEEK

- MORE ON HOUSING
- MORE TROUBLE AHEAD
- ECONOMY SHIFTS TO LOW GEAR
- NOT SO GREAT EXPECTATIONS
- STILL ABOVE TARGET
- A FED HIKE WOULD BE OVERKILL
- MARKET OUTLOOK AND PORTFOLIO STRATEGY



There have only been four other times in U.S. history where builders have had this much inventory:

- 1973-74 recession
- 1981-82 recession
- 1991 Gulf War Recession
- 2008-09 Financial Crisis

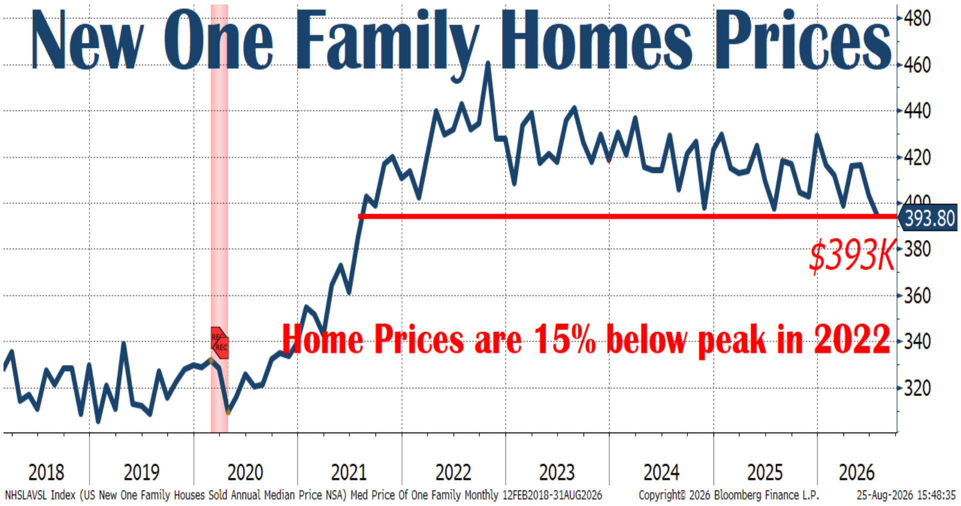
Builder inventory is closely tied to the economic cycle because homebuilders are highly sensitive to shifts in demand. When affordability deteriorates, mortgage rates rise and consumers grow less confident about their financial future, home sales slow. Meanwhile, builders are often left with elevated inventories from the construction boom earlier in the cycle. The result is a deflationary, recession-like environment marked by excess supply, discounting and margin pressure. If builders are feeling that strain, other sectors are likely to feel it as well.

Yet the broader U.S. economy has avoided recession over the past four years, even as builder inventories have continued to climb. The likely explanation is the rise in the stock market and the AI-driven capital-spending boom, which have helped offset weakness elsewhere. But that does not make the builders' warning any less important. Housing has historically been an early-cycle signal, and rising inventories, falling prices and shrinking margins should not be ignored.

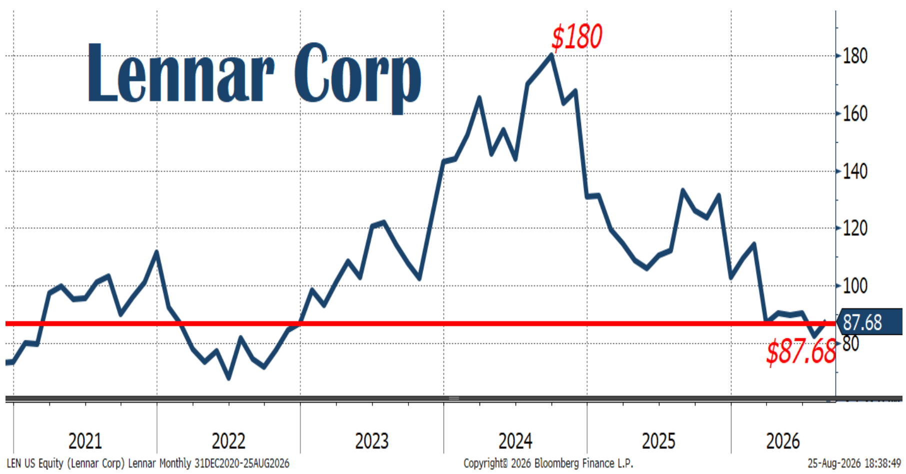
However, it's good news for prospective homebuyers.

Large homebuilders cannot simply wait out a weak market — they must keep building and selling to generate cash flow. For nearly four years, they have been adjusting prices to that reality. In July, the median price of a new single-family home fell to $393,800, down 1% from a year earlier, 8.2% from two years earlier, and 14% from its October 2022 peak. New home prices are at the lowest level since September 2021.

The decline is beginning to resemble the 2007-2010 housing downturn. During that cycle, the median builder price dropped from $262,000 in 2007 to $204,000 in 2010, a 22% peak-to-trough decline. Prices in the current cycle are already down roughly 15%, nearly two-thirds of the previous downturn's total decline. Even that comparison likely understates the adjustment because it captures only gross sale prices and excludes the substantial value of mortgage-rate buydowns that homebuilders use to prop up their sales.



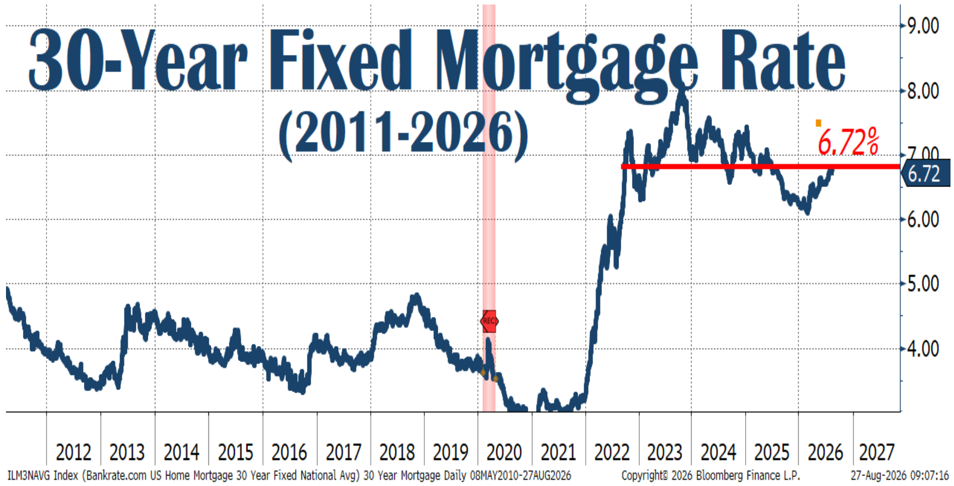
However, what's good for the homebuyer is not good for the homebuilder as homebuilders' lower margins have crushed their profits and share prices. Shares of the two biggest builders, DR Horton and Lennar, have plunged by 25% and 52% respectively since mid-September 2024.



Bottom line: New additions to the U.S. housing inventory are precisely what the housing market needs the most, and home builders are building it. They're sitting on 9.6 months of supply at the current rate of sales. Build them, and they will come — maybe, if the price is low enough and the incentives are high enough.

MORE ON HOUSING

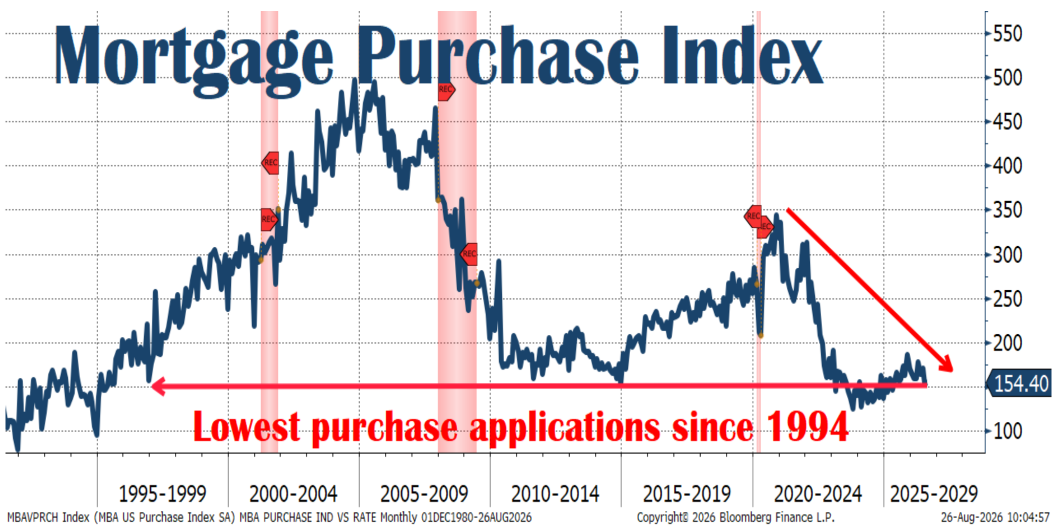
Housing is very sensitive to interest rates, so it is often one of the first parts of the economy to weaken when borrowing costs rise. Since February 27, the 30-year mortgage rate has climbed nearly 60 basis points to just under 6.7%, its highest range in more than a year. Mortgage rates tend to move with the 10-year Treasury yield.



The impact is already showing up. Since February, single-family housing starts have fallen 12%, the supply of homes for sale has risen to nearly five months — the highest since July 2016 — and affordability has dropped more than 10%.

Mortgage applications to purchase a home are down 38% from their January high. That was the steepest decline for this period since early 2023, when the Fed was raising rates aggressively.

The weakness will not stop with homebuilding. Spending on big-ticket items such as furniture, appliances and cars is likely to slow next. Consumers often use home equity or refinancing to pay for these purchases. Those options are now less attractive, while financing directly means higher monthly payments.



Bottom line: There are some who believe that Fed policy is too loose and that we need tightening immediately. Well, if monetary policy was too easy, the most interest-sensitive sector of the economy would be in a boom, not a bust.

Higher mortgage rates are weakening housing demand, construction and affordability. With mortgage applications down sharply and household savings nearly depleted, the slowdown is likely to spread to big-ticket purchases such as furniture, appliances and cars.

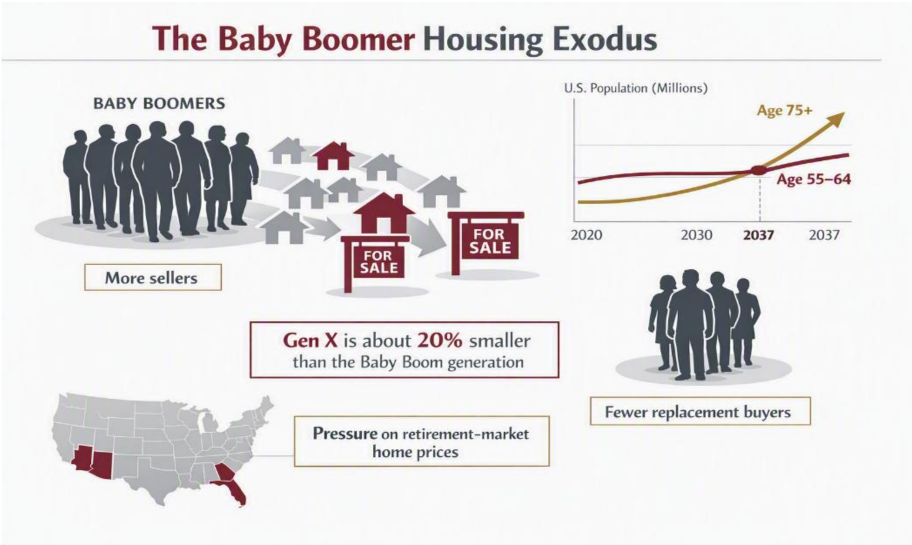
Housing is not weakening in isolation. It is an early warning that higher rates are beginning to slow the broader economy.

MORE TROUBLE AHEAD

A major housing headwind is about to hit. And that's the Baby Boomer exodus from the U.S. Housing Market. In the next decade, the share of the U.S. population above 75 will skyrocket, meaning Baby Boomer owners who fueled the housing market over the last 20 years will turn into sellers.

And Gen X, the next generation in line to buy up those homes, won't be able to absorb it as they are 20% smaller in population than the Baby Boomers. The result is that by 2037, there will be more 75+ aged Americans than 55-64 aged Americans, which will be a first in modern U.S. History.

This will lead to lower homebuyer demand, more supply and lower prices in retirement destinations. Especially across Florida and Arizona.



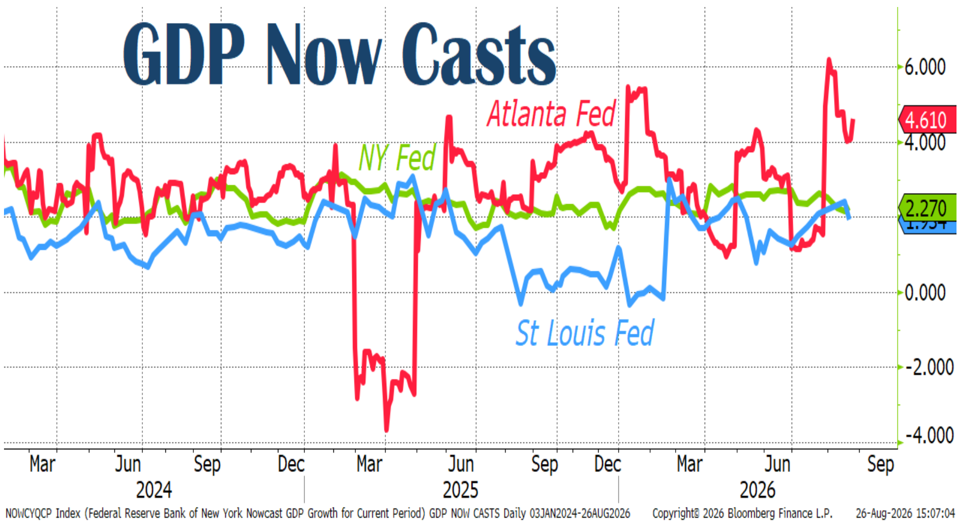
ECONOMY SHIFTS TO LOW GEAR

"The signals are accelerating in terms of a cooling of demand, mixed labor market signals that are increasingly worrying and then you look at the inflation cooling, it all suggests you'd see interest rates cuts this year despite the market looking at hiking." — Oliver Rust, Head of Data, Truflation

Most economists still describe the U.S. economy as "solid" or "resilient." I disagree — once again. Maybe that is what happens when you read Charles Mackay's classic, *Extraordinary Popular Delusions and the Madness of Crowds*.

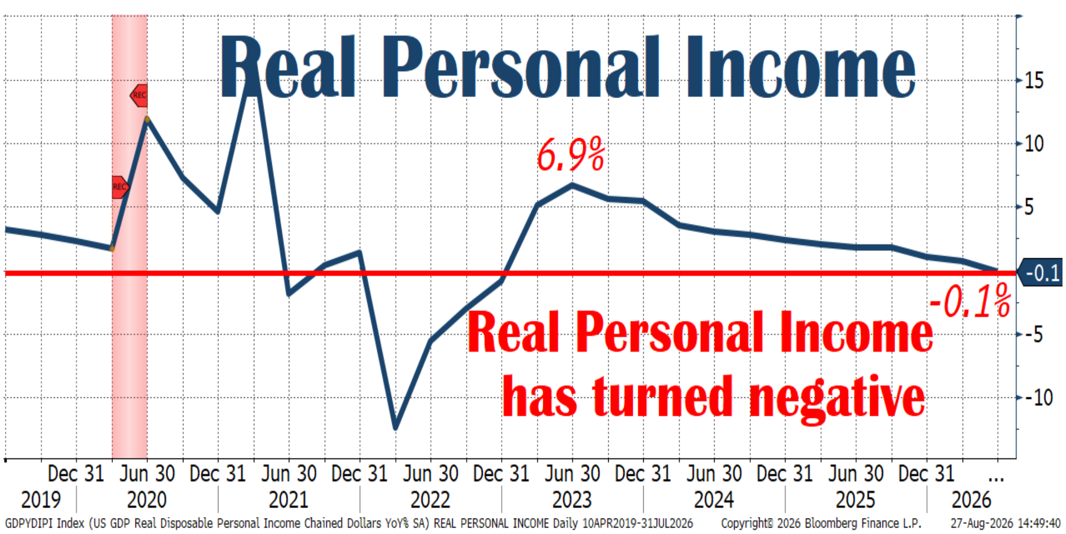
Behind the positive headlines, the economy appears to be growing at only about a 1.5% annual rate, which is below its normal potential. Roughly half of that growth is coming from AI investment, while much of the rest is being supported by gains in the stock market. Consumers have been spending faster than their incomes are growing.

The latest growth estimates are moving lower. The Atlanta Fed's GDPNow estimate reached 6.2% in early August but has since dropped to 4.6%. Excluding inventories, real domestic sales growth is closer to 2.3%. The New York Fed also estimates 2.3% growth, while the St. Louis Fed is lower at 1.9%, down from 2.1% at the start of the month.

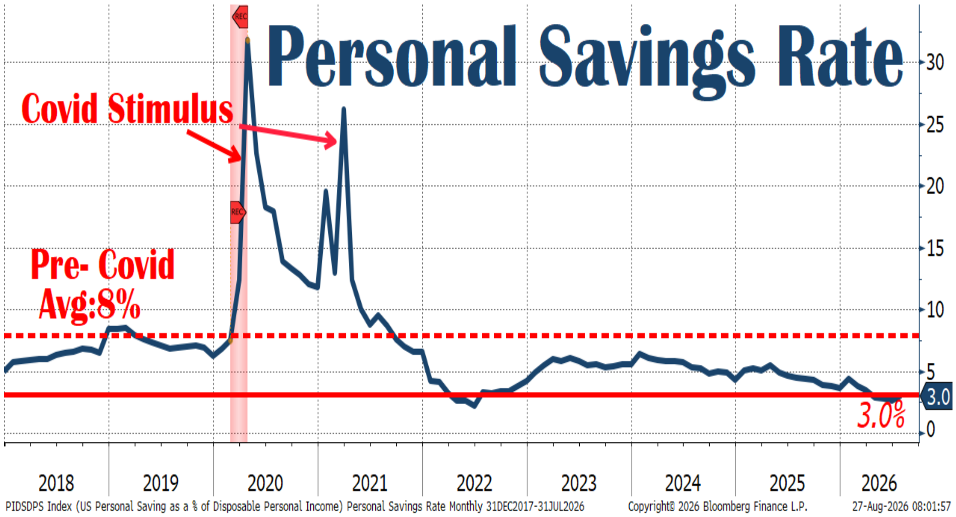


As for the American consumer, we saw first-hand what happens when the World Cup effect and the income tax refunds move into the rear-view mirror as real consumer spending — the largest part of gross domestic product (GDP) — is currently growing at about a 1.7% annual rate. That is below the Atlanta Fed's latest estimate of 2.5%.

Meanwhile, in a harbinger of things to come, the trend on real personal income has turned negative.

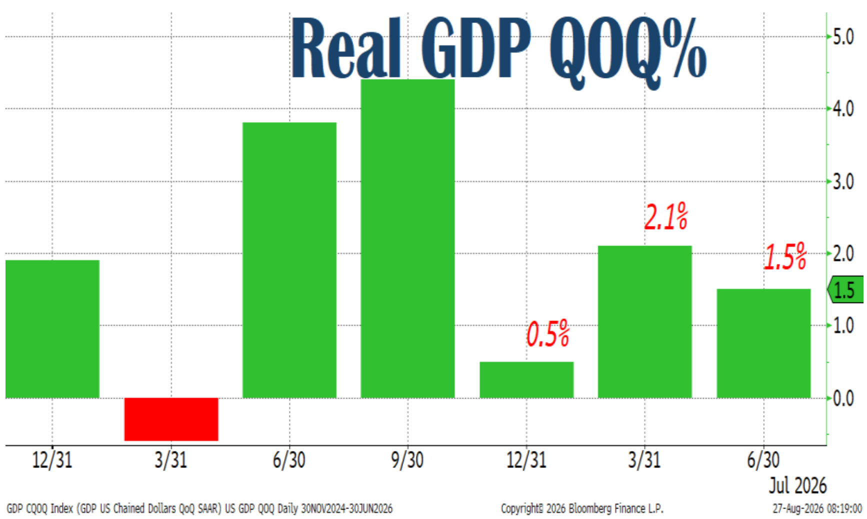


At the same time, the savings rate remains well below its long-term average of 5.7%. As households rebuild savings, consumer spending is likely to remain restrained. Frugality is the word.



"This quarter — the first quarter of 2026 — the United States of America's $30 trillion economy will exceed 5% growth." — Howard Lutnick, U.S. Commerce Secretary

Based on the incoming data, the ballyhooed "Golden Age" is nowhere in sight. To the contrary, the message was just more confirmation that Trump-O-Nomics has done nothing. Consider that as early as the opening months of this year, U.S. Commerce Secretary Howard Lutnick was promising Americans that we would see real GDP growth of at least +6% in 2026. Instead, the trend in real output, even with the One Big Beautiful Bill and the data-center construction boom, is down to around +1.5% at an annual rate.

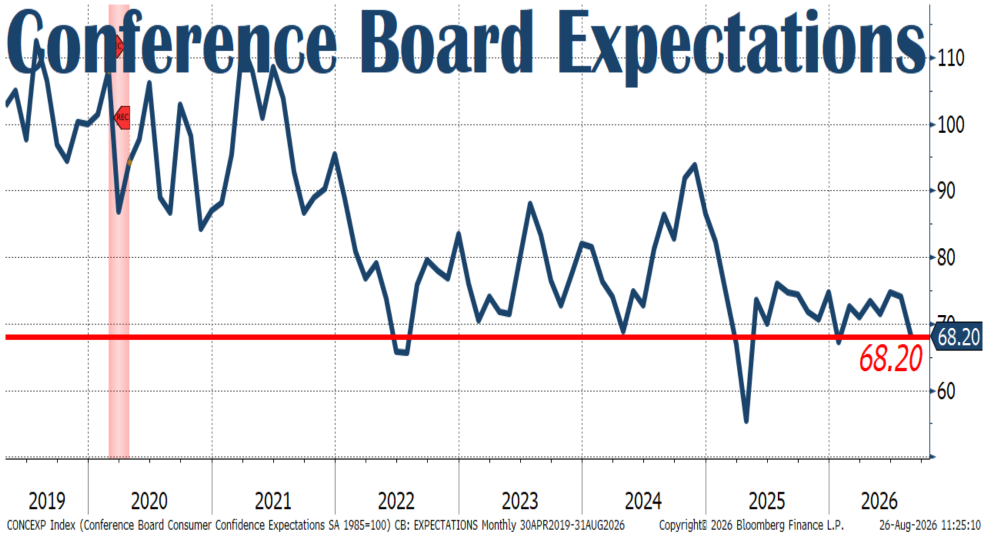


Bottom line: Economic growth is losing momentum as consumer spending slows, savings remain thin and much of the remaining expansion depends on AI investment and stock-market gains.

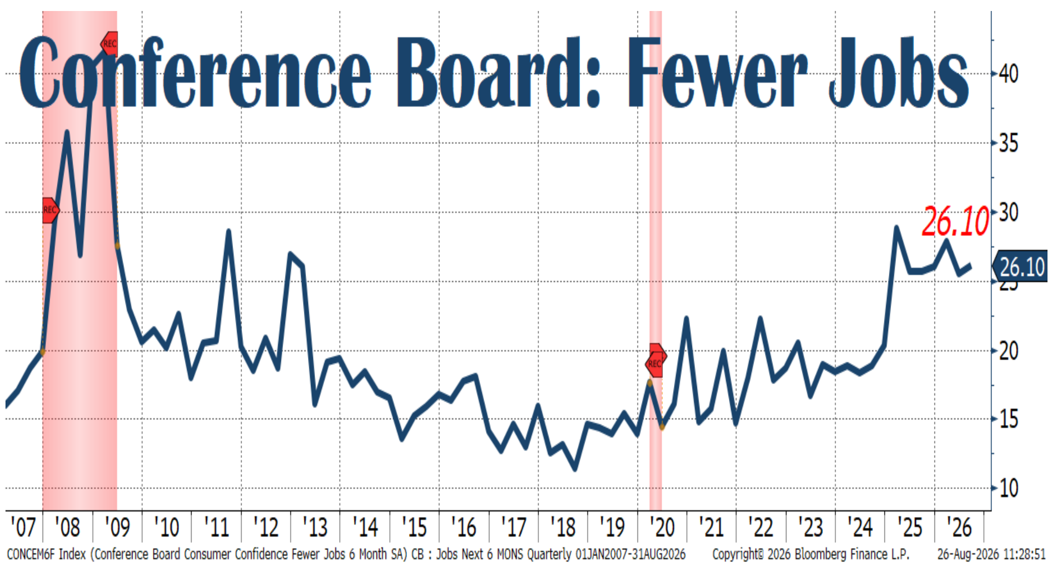
That loss of economic momentum is also showing in how consumers view the road ahead.

NOT SO GREAT EXPECTATIONS

The Conference Board's Consumer Confidence Index fell to 89.4 from 90.2, below the 90.2 forecast. The main weakness came from the expectations index, which dropped to a seven-month low of 68.2 from 74.0 in July.



Consumers also became more worried about jobs and income. Only 14.6% expect more jobs over the next six months, down from 16.4% and the lowest since April 2025. Meanwhile, 26.1% expect fewer jobs, up from 25.3%. Just 17.6% expect their income to rise, down from 19.5% in July and 20.7% in June — the lowest reading this year.



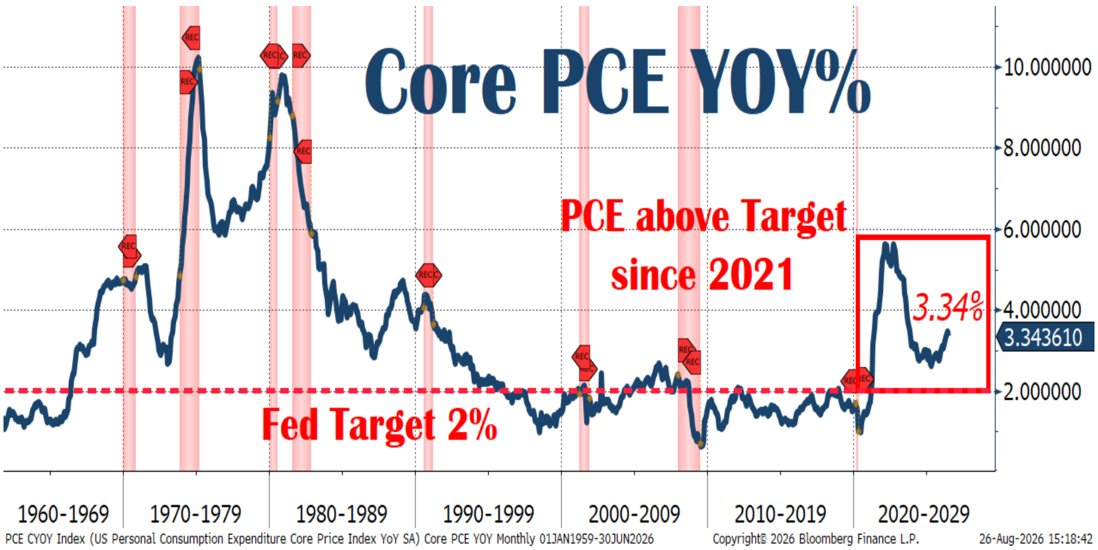
Expectations matter because they shape spending decisions. With consumers less confident about jobs and income, fewer are planning major purchases. The share planning to buy a home fell to 5.2% from 6.5% in July, the lowest since April 2025. Auto-buying plans also slipped to a seven-month low of 12.3% from 12.9%.

Bottom line: Consumer confidence weakened as households grew more pessimistic about jobs and income, reducing plans for major purchases such as homes and autos.

Even as consumers become more cautious, inflation remains the key constraint on how much relief the Fed can provide.

STILL ABOVE TARGET

The Fed closely watches core personal consumption expenditures (PCE) inflation, which removes volatile food and energy prices. In July, core PCE rose 0.2%, as expected. That does not suggest inflation is heating up again. However, core inflation was still 3.34% from a year earlier, well above the Fed's 2% target.

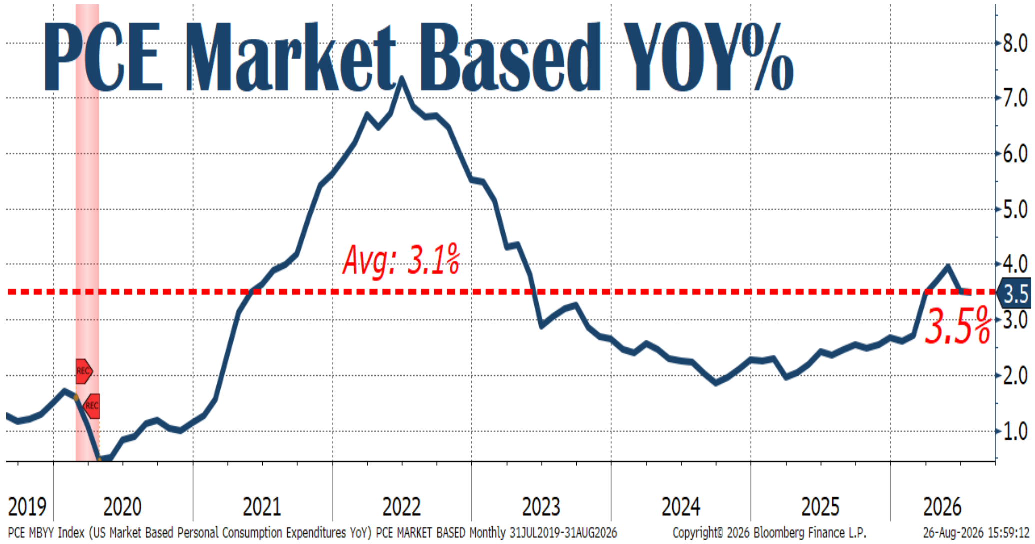


Looking at June and July together, core PCE increased at a 2.4% annual rate, the slowest two-month pace since April 2025.

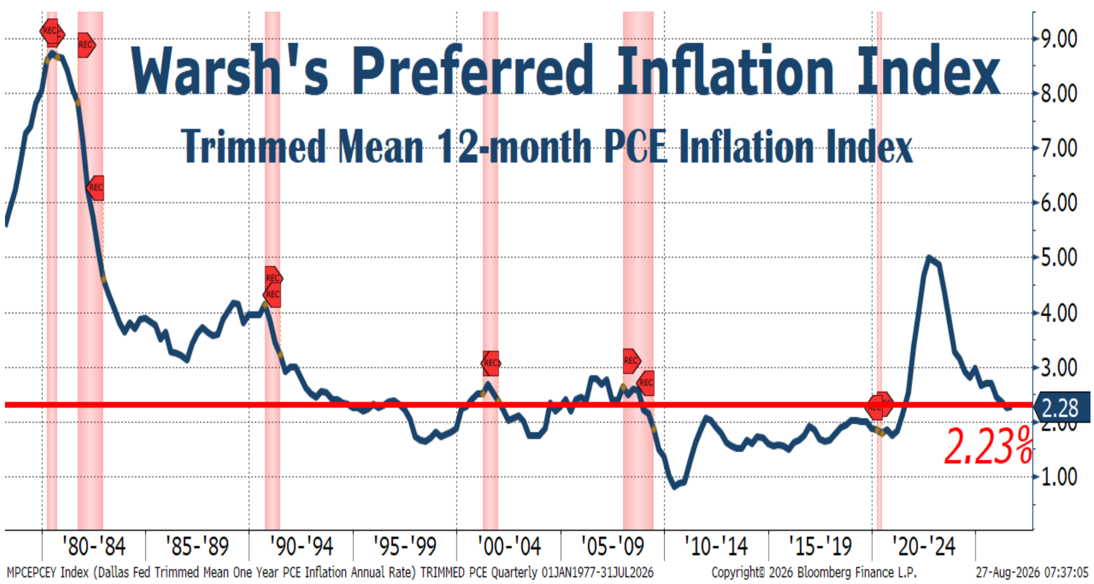
- Goods prices fell 0.1% in July, marking the second straight monthly decline.
- Services inflation was somewhat stronger at 0.3%, but much of that increase came from a sharp 1.2% rise in financial services and insurance costs rather than broad inflation across the economy.

While service inflation has been the problem, something looks off in the data, largely because the Bureau of Economic Analysis (BEA) must estimate parts of the services sector. Financial services are a major example. Commission rates usually change very slowly because the industry is highly competitive. However, when the stock market rises, the dollar value of commissions rises too, and the government counts that increase as inflation — even though the underlying fee rate may not have changed. This can make inflation look higher than it really is. In July, the core PCE report showed financial services prices jumping 1.2%. That increase alone added nearly one-tenth of a percentage point to the overall monthly inflation reading.

Meanwhile, the market-based core PCE measure focuses on prices "observed" in actual transactions rather than estimated prices and is a helpful cross-check on whether inflation is broad-based and truly affecting consumers. In July, the index also rose just 0.2% and has remained at or below that pace for three straight months.



In addition, even though the Treasury market largely ignored it, the July PCE inflation report contained some encouraging news. The Dallas Fed's trimmed-mean measure (Warsh's preferred inflation metric) rose at a 2.2% annual rate, which suggests most prices — after stripping out the monthly noise — were rising at a pace close to the Fed's 2% goal. Year over year the rate held at 2.3% — still slightly above the Fed's target, but down from about 2.7% a year ago.



Anecdotally, the New York Times posted an article titled, **"Americans of All Incomes Head to Dollar Stores to Stay Frugal."** Dollar General and Dollar Tree both reported higher sales and store traffic as rising gasoline prices and financial stress pushed consumers to trade down. That follows similar comments from Walmart and Home Depot, which described shoppers as increasingly frugal and focused on value. Even higher-income households are showing up at dollar stores. So, where exactly is the inflationary impulse?

Dollar General CEO Todd Vasos told investors:

"Most notably, higher and more volatile fuel prices have forced customers to further prioritize purchases with a focus on value and affordability. The consumer is relying more on that $1 price point; we have got real plans to expand that $1 price point to offer even more value for the consumer."

Likewise, Walmart and Target have also said they are cutting prices and plan to continue doing so to attract financially stressed households. Not everyone owns a portfolio stuffed with AI stocks, but plenty of consumers are carrying a share of roughly $1.4 trillion in unpaid credit-card balances. As Walmart CEO John Furner put it,

"We'll do everything we can to keep prices as low as we can for customers throughout the rest of the year." Why? Because "our core customers continue to be financially constrained, with a variety of factors impacting their budget."

So, is this the environment in which the Fed wants to raise rates?

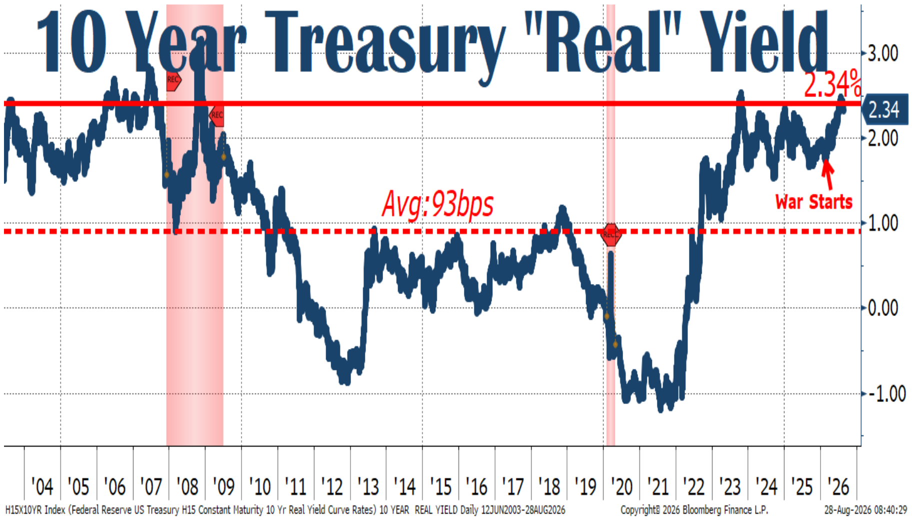
Here's the reality. The central bank remains fixated on the fact that core inflation has exceeded its 2% target for five years. But that is backward-looking. What matters is where inflation is headed now. Much of the overshoot reflected supply shocks that monetary policy could not fix, and research suggests core inflation would already be near target without them.

Bottom line: Inflation remains too high on a year-over-year basis, but current price pressures are narrowing and moderating. The data do not make a compelling case for a September rate hike; holding rates steady remains the more defensible choice.

Even so, the Fed's next move remains anything but obvious, with the data offering ammunition to both sides of the debate.

A FED HIKE WOULD BE OVERKILL

Since the U.S.-Iran war began, Treasury yields have risen across the board. The 2-year, 10-year, and 30-year yields are each up more than 60 basis points. Most of that increase reflects higher inflation-adjusted yields, not greater inflation fears. For example, the 10-year real yield has risen nearly 70 basis points to about 2.34%, while expected inflation remains near 2.3%. In other words, financial conditions have tightened sharply even though the Fed has not raised rates.



The Fed funds rate is only one policy tool. What matters most is what households and businesses actually pay to borrow. Many loans are tied more closely to the 10-year Treasury yield. With mortgage and auto loan rates near 7%, borrowing is becoming a serious problem.

TV pundits keep saying the economy is handling high interest rates well. But the stock market is sending a different message. The sectors most sensitive to borrowing costs are already struggling. From their peaks, homebuilders and autos are down 23%, consumer finance 14%, media and entertainment 12%, discretionary retailers and retail real estate investment trusts (REITs) 7% and residential REITs 5%.

Finally, the table below highlights why the Fed has NO reason to hike. Look at all the variables below and where they reside today compared to what they were flashing back in March 2022, when the Fed embarked on its prior tightening cycle (keeping in mind that the funds rate is +325 basis points higher today).

With nearly every major indicator cooler than it was at the start of the last tightening cycle, another rate hike would risk solving a problem that is already fading.

March 2022 vs. Today

Measure	Today	March 2022
Fed Funds Rate	*3.50%-3.75%*	*0%-0.25%*
Job Finding Rate	*23.6%*	*29.9%*
Job Openings Rate	*4.4%*	*7.5%*
Hiring Rate	*3.4%*	*4.4%*
Year-Over-Year Payroll Growth	*+0.2%*	*+4.9%*
Year-Over-Year Unit Labor Cost Growth	*+1.4%*	*+6.1%*
Year-Over-Year Real GDP Growth	*+2.1%*	*+4.0%*
Year-Over-Year Nominal GDP Growth	*+6.5%*	*+11.3%*
Year-Over-Year Productivity Growth	*+2.2%*	*-1.1%*
Core Consumer Price Index Inflation Rate (Year Over Year)	*+2.5%*	*+6.5%*

Case-Shiller Home Price Inflation (Year Over Year)	*+2.1%*	*+20.7%*
Year-Over-Year Change in the Unemployment Rate	*-20 basis points*	*-240 basis points*
Year-Over-Year Growth in M2	*+5.4%*	*+9.6%*
Year-Over-Year Growth in Bank Credit	*+6.3%*	*+9.6%*
Year-Over-Year Growth in Fed Balance Sheet	*+1.5%*	*+16.3%*

Bottom line: Market rates have already tightened financial conditions by roughly the equivalent of several Fed hikes. With borrowing costs near 7% and rate-sensitive sectors weakening, another Fed increase would risk worsening the slowdown.

But even if another Fed hike is unnecessary, long-term rates may remain elevated for reasons the central bank cannot easily control.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

At the Jackson Hole Symposium, Fed Chairman Warsh ratified the view that the central bank is more concerned about inflation than about the labor market. He expressed that his primary "concern" was on the inflation front.

To wit:

"And while this summer's PCE and CPI readings were better than expected, they do not tell me that underlying trends have meaningfully improved."

Warsh sees demand as solid despite weaker GDP growth. He described the labor market as stable, consumers as healthy and AI-related business investment as brisk.

He also dismissed slower wage growth as an unreliable guide to inflation. That differs from Powell's view that lasting inflation usually requires pressure from the labor market.

Warsh acknowledged that inflation has eased but focused on the slower pace of improvement. Over the past year, 54% of items in the PCE basket rose more than 3%. That is below the post-pandemic peak of 77%, but well above the 32% average before the pandemic.

He also said commodity prices should be watched for signs of renewed inflation pressure. Warsh noted that market-based inflation expectations remain stable but warned that such measures often look reliable until they suddenly are not.

Markets viewed the speech as hawkish. The odds of a September rate hike jumped to 59.5% from 35.5% on Fed Chair Kevin Warsh's comments at Jackson Hole. The two-year Treasury yield rose 10 basis points to 4.34%. However, the 10-year yield rose only 3 basis points while the 30-year yield fell 2 basis points to 5.22%. Short-term bonds reacted to the tougher policy tone, while long-term bonds welcomed Warsh's clear commitment to lowering inflation.

All that said, it will be the data that tell the tale. Last Friday, the Market News International Chicago Purchasing Managers' Index collapsed from 57.6 in July to 47.1 in August (contraction), the University of Michigan's Consumer

Sentiment Index retreated to 51.7 in August from 55.2 in July and the preliminary benchmark payroll revisions over the year to March 2026 were -79,000 instead of being +183,000.

I think Warsh is putting too much lipstick on the pig when it comes to his assessment of the economy (then again, Fed chairmen rarely sound negative); he is underestimating the degree of slack in the labor market, and the reality is that we are seeing a gap open up between the supply side and the demand side of the economy. Therefore, he didn't say anything to change my view of weakening economic growth ahead, core inflation continuing to soften and that there is no need for the Fed to be doing anything.

Here's the reality. Warsh can talk tough on inflation, but he can't act tough. Today's fiscal position is much weaker than it was during the Volcker era.

- 1980 debt/GDP: 31% vs 120% today
- Interest/tax receipts: 10% vs 21% today
- Deficit/GDP: 2.6% vs 6.3% today

Warsh has two options:

1. Fight inflation and blow up the bond market.
2. Sacrifice the USD to save the bond market.

I believe he will opt for the second option.

The bottom line is that financial markets are driven by narratives. The narrative in rates today is all about inflation and fiscal problems. But the narrative going into 2027 is going to be all about either the success or failure of AI. If AI succeeds and tech companies generate trillions in revenue, AI will be massively deflationary and push rates lower.

If AI does not work out, the bubble bursts and the Nasdaq is down 50% as investors rotate out of equities into Treasuries and long rates fall dramatically.

In both scenarios, long rates are going to be lower.

Despite widespread negative sentiment, bonds still offer an attractive risk/reward tradeoff at these levels. Inflation looks less durable than advertised, the economy looks weaker than markets want to admit, and the Fed risks tightening into a slowdown driven more by supply shocks, oil headlines and speculative excess than by genuine demand-led inflation.

Stay patient, stay liquid and use today's unusually hated bond market to add duration selectively before the Fed and the data force the market to rethink the path of policy.

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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.