June 6, 2024

Morning Briefing

Housing, P/Es & Data Centers

Check out the accompanying chart collection.

Executive Summary: Supply and demand are out of whack in the US housing market, Jackie reports, with unusual forces bearing upon the inventory of homes for sale, home prices, mortgage rates, and affordability. If something's gotta give, it may be home prices—which could plateau or, in some oversupplied markets, even drop. … Also: a look at S&P 500 sectors' valuations now versus a year ago; the changes in some may surprise. … And in our Disruptive Technologies segment, a look at AI data centers' ravenous need for electricity, causing them to locate near existing power sources and investigate the potential of small modular reactors.

Homebuilding: Does Something Gotta Give? The appreciation of US home values over the past decade has been nothing less than spectacular. Low interest rates fueled the market momentum during the Covid pandemic, and a dearth of homes for sale kept prices rising even as mortgage rates climbed sharply in recent years.

There are signs of cracks in the housing market's foundation. A surge of building has led to excesses in new single-family and multi-family housing markets, particularly in Florida and Texas. A wave of selling among older folks—dubbed "the Silver Tsunami"—is feared. And with home affordability stretched after rapid rises in both mortgage rates and home prices, something may have to give. At best, home prices may plateau; in oversupplied markets like Florida and Texas, they may fall for the first time in years.

Let's take a broad look at where the housing market has been and what could affect where it is headed:

(1) *Prices near peak levels.* The prices of both new and existing homes have been on the rise. The median price of an existing single-family home rose to $399,000 in April, based on the 12-month average, up 2.6% y/y and double the $200,000 price fetched a decade earlier. Likewise, the median price of a new single-family home has jumped to $427,000, based on

the 12-month average, a percentage point below a year ago but up 59% from $269,000 10-years prior (*Fig. 1*). That's been good news for the S&P 500 Homebuilding stock price index, which has risen 38.1% over the past year and is up 517.4% since September 2013 (*Fig. 2*).

While the price of homes that were sold has risen, home sellers currently in the market are increasingly willing to negotiate on price. For the four weeks ended May 26, 6.4% of home sellers cut their asking price, Redfin *reports*, up from 4.4% in the same weeks a year earlier.

The median asking price dropped roughly $3,000 to $416,623 in the week ended May 26, the first price decline in six months. That said, the asking price is still 6% higher than it was a year ago.

(2) *Inventory increasing.* Active listings of homes for sale have risen 15.2% y/y, using a four-week rolling average, Redfin reports. It's the highest level of active listings since December 2022. New listings climbed 7.8% y/y.

Active listings are also sitting on the market longer: 46 days in May, up for the first time in eight months. And the percentage of homes that were off the market in two weeks (presumably sold in most cases) declined slightly to 45% from 49% a year ago.

Of particular concern is the jump in new homes for sale. At 480,000 in April, the number of new homes for sale has jumped 11.6% y/y and 48.6% since December 2019 (*Fig. 3*). It would take an unusually long time—9.1 months—to sell the new-home inventory at the recent pace of sales (*Fig. 4*).

Existing home inventories haven't increased as sharply. The number of existing homes for sale has jumped to 1.2 million, up from a low of 959,000 units in July 2023, but far below what's considered "normal" (*Fig. 5*). The supply of existing homes for sale in April could be sold in 3.5 months assuming that the recent pace of sales continues (4.0-5.0 months is considered a well-balanced market) (*Fig. 6*).

Inventories may continue to tick up. The National Association of Realtors' (NAR) pending home sales index surprised market observers by declining 7.7% m/m and 7.4% y/y in April to 72.3. It was the index's lowest level since April 2020 (*Fig. 7*).

(3) *Affordability is problematic.* With home prices on the rise and mortgage rates near record levels, home affordability remains elusive for many want-to-be homeowners. At a

recent 7.03%, the 30-year mortgage rate is off its recent high of 7.79% but far from the low of 2.65% (*Fig. 8*).

The increase in monthly principal and interest payments has outpaced the increases in median family incomes. As result, NAR's Housing Affordability *index* fell from 148.2 in 2021 to 98.2 in 2023, before edging up to 101.1 in March (*Fig. 9*).

(4) *What could turn cracks into a chasm?* After extremely low existing home sales volumes over the past two years, it's unclear who would have the upper hand if interest rates fall and pent-up demand from buyers and sellers is unleashed. Some believe a Silver Tsunami will hit the market. Folks 65 and older owned 32.1% of US homes in 2019. That percentage has gradually risen from 24.1% in 2009, according to a *report* by iProperty Management.

More optimistically, only 49.2% of folks aged 30-34 and 62.0% of folks aged 35-44 owned homes as of 2019 versus nearly 80% of those 65 and older. That could mean there are young buyers waiting in the wings for affordability to improve.

A residential real estate downturn, if it arrives, may be more regional than the sweeping housing meltdown of 2007. Far more homes have been built down South in recent years than across the rest of the country, accommodating the many transplants from California, New York, and New Jersey. There were 611,000 single-family new home starts in the South in April compared to 232,000 in the West, 131,000 in the Midwest, and 57,000 in the Northeast (*Fig. 10*).

But recently, signs of weakness have appeared in the southern markets. Of the 10 metropolitan areas where sellers are most likely to cut their listing price, five are in Florida and two are in Texas, according to an April 25 Redfin *report*.

The Florida housing market has been hurt by new-home price cutting, increased home insurance rates, and decreased affordability. Instead, buyers are turning to North Carolina or Tennessee for better values, Redfin reports.

There was also a surge in multi-family construction in recent years that may have led to a glut in available apartments and could put a lid on rental increases in some markets. Multi-family building permits jumped to a recent high of 813,000 units in February 2023, nearly double the 423,000 of five years ago. It since has dropped back to 463,000 units (*Fig. 11*).

"About half a million new apartments opened in 2023, the most in 40 years. Based on what is already under construction, analysts expect a similar number to be completed in 2024," a June 4 *WSJ* *article* reported. If increased supply puts pressure on rents, individuals may opt to rent instead of buying a home, and older homeowners may decide to move into apartments instead of remaining in their homes.

Austin appears to be one of the cities with an apartment glut, and its rents are down 7% over the past year, more than in any other US city, a March 18 *WSJ* *article* reported.

Analysts are calling for S&P 500 Homebuilding industry's revenues to climb 5.2% this year and 6.6% in 2025 (*Fig. 12*). Earnings are forecast to increase 6.1% this year and 7.8% in 2025 (*Fig. 13*). If new-home inventories don't drop, we'd wonder whether those forecasts can be achieved.

Strategy: A Look at P/Es. Over the past year, the S&P 500 has climbed almost 25% with its forward P/E rising as well, to 20.6 from 18.1 a year ago. The forward P/Es for most S&P 500 sectors inched up by 1-2 points over the past year. Outliers include large jumps in the Industrials and Materials sectors' forward P/Es and the Consumer Discretionary sector's forward P/E's small decline.

Here are the stats: Real Estate (33.3 currently, 33.1 year ago), Information Technology (28.6, 25.7), Consumer Discretionary (23.4, 24.0), S&P 500 (20.6, 18.1), Industrials (20.4, 17.0), Consumer Staples (19.8, 19.3), Materials (19.7, 15.6), Communication Services (18.7, 16.8), Health Care (18.5, 16.5), Utilities (16.9, 16.8), Financials (14.8, 12.5), and Energy (11.9, 9.8) (*Fig. 14*).

Let's look at some of the industries forward P/Es:

(1) *Industrials.* Many industries in the Industrials sector have benefitted from massive federal spending to encourage the development of domestic semiconductor manufacturing and green technologies. The boom in global defense spending to support Israel and Ukraine has also been beneficial.

These Industrials industries have seen substantial y/y jumps in forward P/Es: Construction & Engineering (31.0 currently, 23.2 a year ago), Environmental & Facilities Services (28.5, 26.3), Electrical Components & Equipment (24.5, 19.6), Aerospace & Defense (24.4, 20.6), Industrial Machinery & Supplies (21.4, 19.0), Building Products (20.1, 15.9), and Trading Companies & Distributors (19.7, 14.6).

(2) *Consumer Discretionary.* The decline in the Consumer Discretionary sector's forward P/E partly reflects the Broadline Retail industry's shrinking forward P/E (34.7, 52.3). Its largest company is Amazon, with a stock price that's risen 44.3% y/y and expected EPS growth to match (from $2.90 in 2023 to an estimated $4.18 this year and $5.39 in 2025).

(3) *Other notables.* Nvidia's earnings growth has increased almost as much as its stock price, which has fed into the Semiconductors industry's increase in forward P/E (31.8, 26.3). The Semiconductor Materials & Equipment industry's forward P/E has jumped more, by roughly five points to 26.3.

The forward P/E for the Copper industry, which includes only Freeport-McMoRan, has surged with the price of copper (28.0,16.0). Regional Banks' forward P/E has bounced from depressed levels (9.9, 6.9). Weight-loss drugs may have helped the Pharmaceuticals industry's forward P/E gain (18.6, 14.7). Conversely, the forward P/E of Personal Care Products has tumbled (20.1, 34.1), and air has come out of the Casinos & Gaming industry's forward P/E (16.3, 22.7).

Disruptive Technologies: Data Centers Follow the Power. Data center operators are expected to double their consumption of US electricity from 17 GW in 2022 to 35 GW in 2030, according to McKinsey & Co. *research*. The skyrocketing demand reflects in part the use of high-power semiconductors to run artificial intelligence (AI) programs.

Operators are scrambling to line up electricity for new data centers. Some new data centers are being built near existing nuclear plants to take advantage of the clean energy source. Others are locating near electricity produced using the inexpensive natural gas being pumped out of Texas's Permian Basin. Another group is exploring new sources of power, including small nuclear reactors.

Here's a look at data centers' hunt for electricity:

(1) *Picking a neighborhood wisely.* Data centers are locating near inexpensive sources of electricity. For that reason, Amazon Web Services (AWS) purchased the Columbus Data Center located next to the 2.5 GW Susquehanna nuclear power plant in Salem, Pennsylvania for $650 million. AWS plans to build up to 15 data centers on the 1,600-acre campus, as a June 3 *article* in Data Center Frontier discussed.

Data centers are also being built around the Permian Basin in Texas to be near electricity produced using abundant, inexpensive natural gas. Utility CPS Energy, which serves the

San Antonio region, “is gearing up for a tenfold increase in demand from data centers … by 2033,” a March 20 *article* in Government Technology reported.

(2) *Going nuclear.* Building a large-scale nuclear reactor takes years before going online. Companies are hoping that small modular reactors (SMRs) will be a credible alternative. Unfortunately, SMRs aren’t expected to receive approvals for operation until 2030, and data centers aren’t expected to deploy them for 10-15 years.

Microsoft has hired folks to develop SMRs to power data centers, The Register reported in a January 23 *article*. Last year, the company signed a power purchase agreement for 50 MW of power from Helion Energy, which aims to build the first nuclear fusion power plant (for more developments in nuclear fusion, see our August 24, 2023 *Morning Briefing*).

Likewise, Google is hunting for someone to head its data center climate strategy, a March 11 Data Center Dynamics *article* reported.

(3) *Shopping for customers.* Power generating companies are also looking at data centers as prime customers willing to enter long-term contracts and fund the construction of new power facilities. Oklo, a nuclear fission power startup with backing from Sam Altman, plans to build a pipeline of data center customers, a March 22 *article* in Data Center Dynamics reported. NuScale reportedly has agreed to provide 24 SMRs to Standard Power’s data centers in Ohio and Pennsylvania.

Calendars

US: Thurs: Productivity & Unit Labor Costs 0.3%/4.6%; Initial Claims 215k; Atlanta Fed GDPNow 1.8%; Merchandise Trade Balance $69.8b; Natural Gas Storage. **Fri:** Nonfarm Payrolls Tota & Private 185k/170k; Average Hourly Earnings 0.3%m/m/3.9%y/y; Unemployment Rate 3.9%; Consumer Credit; Wholesale Inventories 0.2%; Baker Hughes Rig Count; Cook. (FXStreet estimates)

Global: Thurs: ECB Interest Rate Decision & Deposit Facility Rate 4.25%/3.75%; Eurozone Retail Sales 0.2%; Germany Factory Orders 0.6%; Spain Industrial Production; Italy Retail Sales 0.3%; European Parliament Elections; Lagarde. **Fri:** Eurozone GP 0.3%q/q/1.0%y/y; Germany Industrial Production 0.1%; European Parliament Elections; UK Halifax House Price Index 0.3%; Japan Leading Inex 111.8; Lagarde; Nagel. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull-Bear Ratio fell for the second week to 3.16 this week after climbing the prior four weeks (to 3.45 from 2.15). It was at 4.43 nine weeks ago—which was the highest reading since February 5, 2018. Bullish sentiment fell for the second week to 57.6% this week, following a four-week rise of 13.2ppts to 59.4% from 46.2%—which was the lowest percentage since late October. Meanwhile, bearish sentiment edged up for the second week to 18.2% this week after falling the prior four weeks by 4.3ppts (to 17.2% from 21.5%). It was at 14.1% in early April—which was the fewest bears since 12.6% in late January 2018. The correction count edged up for the second week to 24.2% this week after falling the prior three weeks by 9.9ppts, to 23.4% from 33.3%—which was the highest since early October 2023. Turning to the AAII Sentiment Survey (as of May 30), optimism about the short-term outlook for stocks decreased significantly during the latest reporting week, while pessimism and neutral sentiment rose. The percentage expecting stock prices to rise over the next six months sank 8.0ppts to 39.0%—though remains above its historical average of 37.5% for the 29th time in the past 30 weeks. The percentage expecting stocks to fall over the next six months edged up 0.4ppts to 26.7%, with pessimism below its historical average of 31.0% for the fourth time in seven weeks. The percentage expecting stock prices will stay essentially unchanged over the next six months jumped 7.6ppts to 34.2%, with neutral sentiment below its historical average of 31.5% for the fifth time in 11 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady w/w at a 22-month high of 13.1% during the May 30 week. That's up from a 24-month low of 12.3% during the March 30, 2023 week and just 0.3pt below its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.8pts above its seven-year low of 10.3% during April 2020. Forward revenues rose less than 0.1% w/w to a new record high. Forward earnings rose 0.2% w/w to a record high too. It had hit that mark during the September 21 week for the first time since the June 16, 2022 week. Revenues and earnings had been steadily making new highs from the beginning of March 2021 to June 2022; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth rose 0.1pt w/w to a 20-month high of 5.4%. It has gained 3.1pts from its 33-month low of 2.3% during the February 23, 2023 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. The forward earnings growth forecast rose 0.1pt w/w to a 31-month high of 12.4%. It's now 9.1pts above its 31-month low of 3.3% during the February

16, 2023 week. That's down from its 23.9% reading at the end of April 2021, which was at its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 4.7% in 2024 (unchanged w/w) and 5.6% in 2025 (unchanged w/w) compared to a revenues gain of 2.2% in 2023. They expect an earnings gain of 10.6% in 2024 (unchanged w/w) and a 14.2% rise in 2025 (unchanged w/w) compared to an earnings gain of 2.4% in 2023. Analysts expect the profit margin to rise 0.7ppt y/y to 12.6% in 2024 (unchanged w/w), compared to 11.9% in 2023, and to rise 1.0ppt y/y to 13.6% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E ticked down 0.1pt w/w to 20.6 after hitting a seven-week high of 20.8 several weeks earlier, and remains below its 26-month high of 21.1 at the end of March. That's up from a 30-month low of 15.3 in October of 2022. It also compares to 23.1 in early September 2020, which was the highest level since July 2000, and to a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio edged down 0.02pts w/w to 2.70 from a 28-month high of 2.72. That's up from a six-month low of 2.22 during the October 26 week and compares to a 31-month low of 1.98 in October 2022. That also compares to a record high of 2.88 at the end of 2021 and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Looking at the 11 S&P 500 sectors during the May 30 week, five had forward revenues that rose w/w, and six had forward earnings that moved higher. This led to a gain in forward profit margins too, as five sectors moved higher w/w on that measure. Information Technology was the only sector with forward revenues at a record high this week, but these seven sectors remained less than 1.3% below their recent records: Communication Services, Consumer Discretionary, Consumer Staples, Health Care, Industrials, Real Estate, and Utilities. The three remaining sectors have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. When adjusted for the incoming transfer of five former Tech sector firms in March 2023, Financials' forward revenues would be at a record high. Information Technology is also the only sector with record-high forward earnings this week. However, these five sectors were in that camp in very recent weeks: Communication Services, Consumer Staples, Consumer Discretionary, Industrials, and Utilities. Financials would be too when adjusted for GICS changes in March 2023. Among the remaining four sectors, two still have forward earnings down more than 20.0% from their post-pandemic highs: Energy and Materials. Looking at the forward profit margin, nearly all of the sectors are showing signs of recovering from their early 2023 forward profit margin lows. Consumer Discretionary and Information Technology are the only sectors with a forward profit margin at a record high this week. In recent weeks, Communication Services and Industrials were in that camp as well. Energy's forward margin is improving now from its 23-month low of 10.4% in February, while those of Consumer Staples and Health Care remain at or slightly above their record lows. The annual profit margin is expected to fall y/y in 2024 for Energy, Materials, and Real Estate and improve for the other eight sectors. Here's how the S&P 500 and its 11 sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (26.9%, a new record high this week), Financials (19.0, down from its 19.8 record high in August 2021), Communication Services (17.7, down from its 17.8 record high several weeks earlier), Real Estate (16.9, down from its 19.2 record high in 2016), Utilities (13.8, down from its 14.8 record high in April 2021), S&P 500 (13.1, unchanged at a 91-week high, but down from its record high of 13.4 achieved intermittently in 2022 from March to June), Materials (11.1, up 0.1pt to a 37-week high, but down from its 13.6 record high in June 2022), Energy (10.8, down 0.1pt w/w and down from its 12.8 record high in November 2022), Industrials (10.7, down from its 10.8 record high in early April), Consumer Discretionary (9.1, a new record high this week), Health Care (8.6, unchanged w/w at 0.1pt above its record low at the end of April and down from its 11.5 record high in February 2022), and Consumer Staples (6.9, unchanged w/w and down from its 7.7 record high in June 2020).

US Economic Indicators

ADP Employment (*link*): "Job gains and pay growth are slowing going into the second half of the year," noted Nela Richardson, chief economist of ADP. "The labor market is solid, but we're monitoring notable pockets of weakness tied to both producers and consumers." *Private payrolls* increased a smaller-than-expected 152,000, below the consensus estimate of a 175,000 increase and the smallest gain this year. Service-providing jobs climbed 149,000 in May, while goods-producing industries increased only 3,000. Within *servicing-providing* industries, transportation & utilities (55,000) posted the biggest monthly gain, followed by education & health services (46,000), financial activities (28,000), and other services (20,000). Leisure & hospitality jobs, which had the top spot in April, rose only 12,000 in May. Information services (-7,000) and professional & business services (-6,000) jobs were cut back during the month. Within *goods-producing* industries, construction (32,000) jobs continued to lead the pack, with the manufacturing (-20,000) and natural resources/mining (-9,000) sectors losing jobs. According to the report, the yearly rate for *job-changers* fell for the second month in a row from 10.1% to 7.8%, while pay growth for *job-stayers* held steady for the third straight month at 5.0%.

Global Economic Indicators

Global Composite PMIs (*link*): Global economic growth was the fastest in a year in May. The *C-PMI* climbed to 53.7 in May, its seventh consecutive month of expansion, with economic activity expanding in all of the nations covered except France—which fell back into contractionary territory following a brief trip above. The *NM-PMI* rose to a 12-month high of 54.1 last month, posting above its manufacturing equivalent for the 17th straight month, though the trend in manufacturing also strengthened in May, climbing to a 22-month high of 50.9. *By country*, the fastest growth was registered once again in India, its twenty-third successive month at the number one spot, while rates of expansion also improved in the US, the Eurozone, China, and Japan. *Total business* increased for the seventh straight month in May, climbing at its best pace in a year. The report notes the breadth of the upturn in orders was positive, with all of the nations covered seeing growth and increases in each of the six global sub-industries—business services, consumer goods, consumer services, financial services, intermediate goods, and investment goods. *Looking at pricing,* both *input* and *output* prices ticked higher in May, with both price measures stronger in the global service sector than in manufacturing.

US Non-Manufacturing PMI (*link*): The US service sector rebounded into expansionary territory in May, after contracting in April for the first time in 15 months. April's *NM-PMI* climbed back above the breakeven point of 50.0 in May, jumping to a nine-month high of 53.8, from 49.4 in April. The *business activity* measure soared 10.3 points (to 61.2 from 50.9)—posting its strongest performance since November 2022, while the new orders (54.1 from 52.2) gauge moved further above 50.0. Meanwhile, the employment (47.1 from 45.9) measure contracted for the fifth time in six months, though at a slower pace. The supplier deliveries (52.7 from 48.5) gauge moved into expansionary territory for the first time since January—indicating a slower supplier delivery performance. On the *inflation* front, the price index (58.1 from 59.2) showed an easing of prices pressures, down from January's 11-month high 64.0. It was at a record-high 84.5 at the end of 2021.

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