

Homebuilder Sentiment Increase Nice But Meaningless

The production side in any industry tends to have a bullish bias, and this is a good thing, no doubt. Would you want your food supply dependent on some manic-depressive farmers? I rest my case.

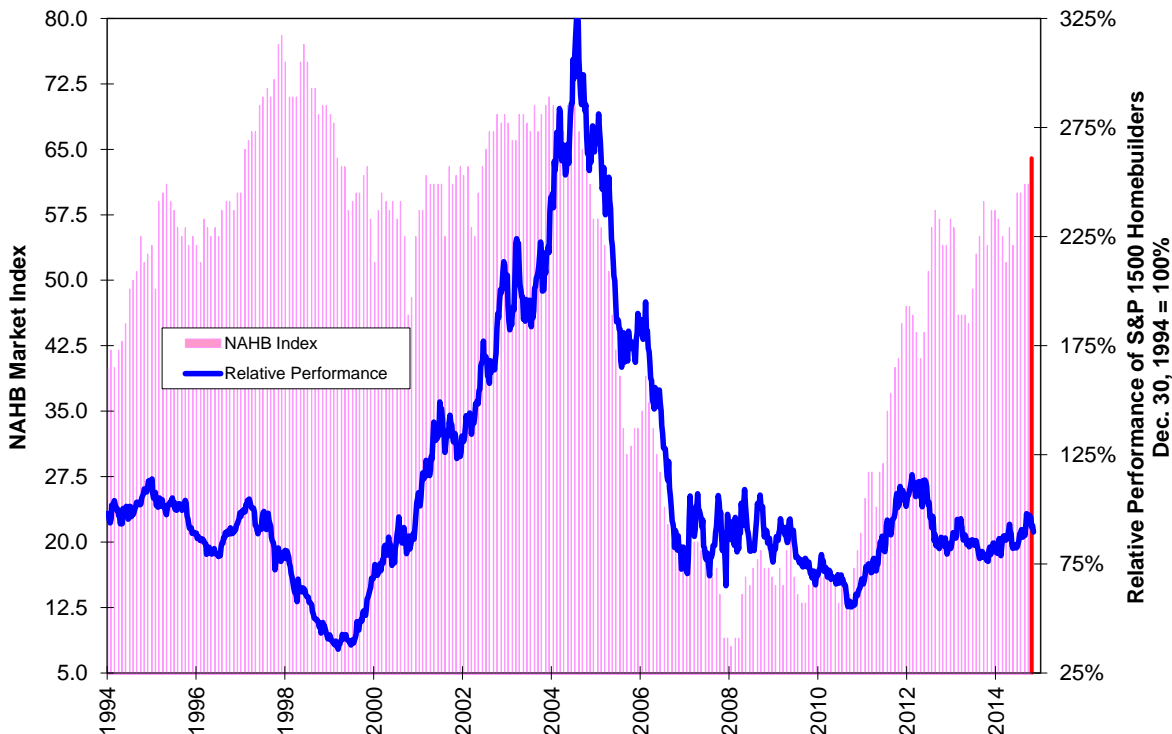
Monday's news the National Association of Homebuilders' (NAHB) market sentiment index reached its highest level in ten years served both as a reminder of how long and how deep the housing recession was and how bullish homebuilders, who often build homes speculatively, can be. You would think from the sentiment data we were back in the 2005 era of housing starts. Not quite: Total housing starts in September 2005 were 2,151; compare this to September 2015's 1,206.

Relative Homebuilder Returns

The relative performance of the S&P 1500 Homebuilders index vis-à-vis the S&P 1500 Supercomposite hit a post-crisis peak in January 2013 and has retreated 22.71% since then. The S&P 1500 Homebuilders index has gained 10.16% against the S&P 1500's total return of 42.52% over this period.

However, the NAHB sentiment index and its aforementioned ten-year high is continuing the divergence from relative stock market return begun in January 2013. In addition to the homebuilders' innate bullishness, this strong sentiment reading is supported by the resilience in both housing starts and permits, which have increased 26.80% and 26.08%, respectively, since the January 2013 local maximum in relative performance.

Homebuilders' Confidence High Versus Relative Performance



You do not have to be an eagle-eyed data analyst to compare the relative equity performance of homebuilders to the NAHB index and see more divergence than parallel or leading action over the past two decades. Relative performance was sluggish during the 1990s tech boom as investors preferred high-growth issues over homebuilders; that reversed during the subsequent dotcom bust. The NAHB index rose during the mid-1990s and while it was in a

definite uptrend between 2002 and 2005, it hardly reflected the strong relative performance of homebuilders. Both measures were smashed during the housing bust; we really should expect nothing else. The post-2009 period has seen the NAHB index rise regardless of the small downturn in relative performance in 2011 and its subsequent rise in 2012.

Restated, the NAHB index is an attitude and is worth nothing to you as an investor. The relative performance of homebuilders is a measurable behavior and it is telling you not to get excited.

Note On Mortgage Rates

While homebuilders' confidence has advanced during the recent decline in mortgage rates, this has not been a very statistically robust relationship at all since the end of the financial crisis due to the numerous interventions in the mortgage market and the residual effects of the housing market crash.

Once again, it is best to treat the rise in homebuilders' confidence both as a pleasant diversion and as an independent variable with no predictive value for the future state of the housing market.

Homebuilders' Confidence Rising As Mortgage Rates Decline

