HOUSING COULD BE THE NEXT CLOUD OVER THE STOCK MARKET

Jeff Weniger, CFA, Head of Equity Strategy

Economic conditions feel like they are deteriorating rapidly.

With losses in stocks, bonds and crypto, it's like you need to take out a personal loan to purchase a box of Cheerios. It's miserable, but then again, nobody is mailing back the keys to their house like they were in 2006. There's no job shortage either. More on that later.

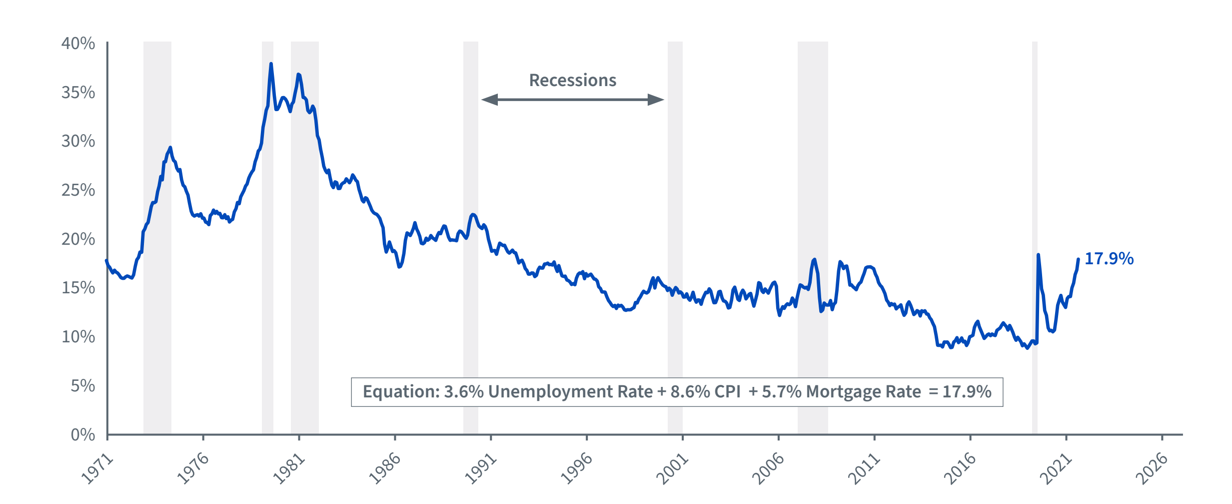
Because consumer prices rose furiously in the 1970s, a consumer health gauge known as the "Misery Index" used to make the rounds many years ago. The sum of inflation and the unemployment rate, the Misery Index is wiggling its way back into some macro pitchbooks.

As things stand, the unemployment rate is far from a problem; it's only 3.6%. The thing that is harrowing, and decidedly so, is the 8.2% year-over-year CPI rate. To me, the sudden spike in mortgage costs is equally as important, as it has put an end to many households' home purchase plans.

Figure 1 shows a “new” Misery Index that adds to unemployment and inflation the 5+% mortgage rates that now prevail. The sum of those three is up to 17.9% from sub-9% before the Covid lockdowns.

If our concern is the *level* of this New Misery Index, the problem is not yet acute. But if you look at it from a *rate of change* perspective, then the vertical nature of this spike is disconcerting indeed.

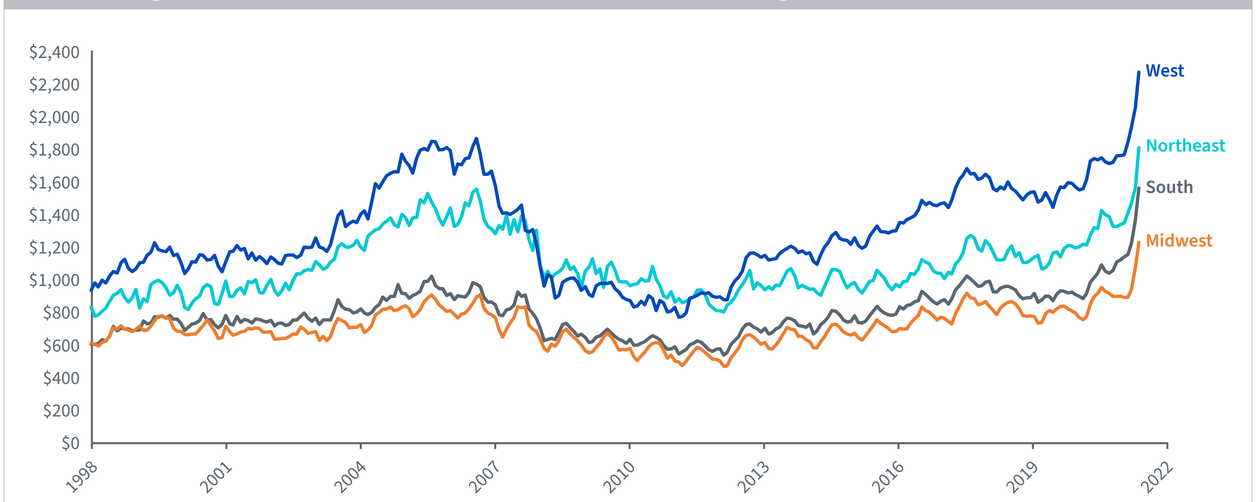
Figure 1: A New Misery Index



Source: Bureau of Labor Statistics, Freddie Mac as of May 2022.

Figure 2 shows the housing costs from the National Association of Realtors Survey of Homebuyers. Unfortunately for prospective buyers, the spike in the chart only captures data through April, so it is likely to be even higher when we are apprised of the May and June survey, which will capture higher mortgage rates. For large chunks of those months, buyers were locking in rates that were about a full percentage point higher than the rate levels that prevailed during the spring. As the summer data arrives, this chart should pop even higher.

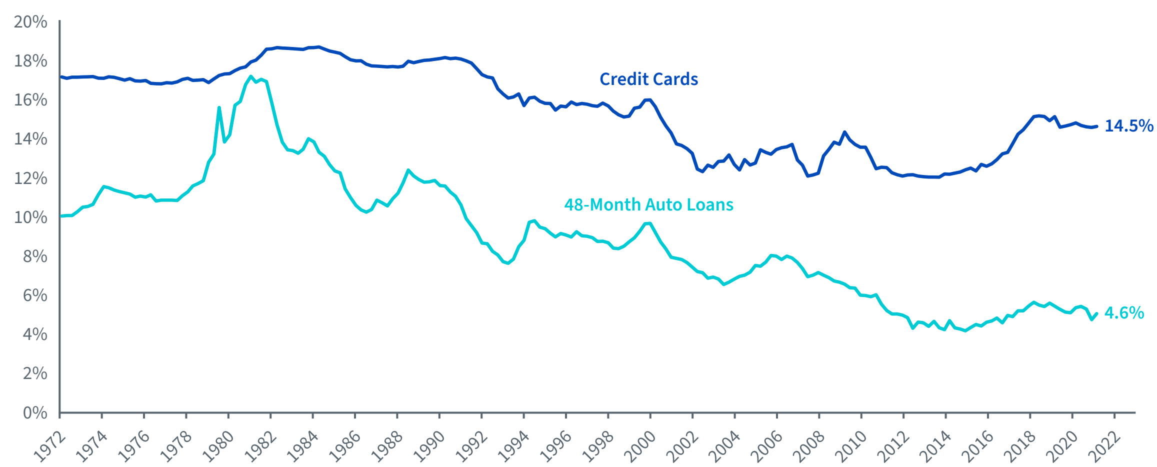
Figure 2: National Association of Realtors Survey: Housing Payment, Principal + Interest



Source: Refinitiv, National Association of Realtors, as of April 2022.

Let me contrast this fright in mortgage rates with something that is better news on the interest rate front: nothing much has changed with lending costs on credit cards and auto loans (Figure 3). It's heartening, but then again, cold comfort when you need King Midas money to purchase something as frugal as a beaten up 2012 Toyota Corolla.

Figure 3: U.S. Lending Rate, Credit Cards & Auto Loans

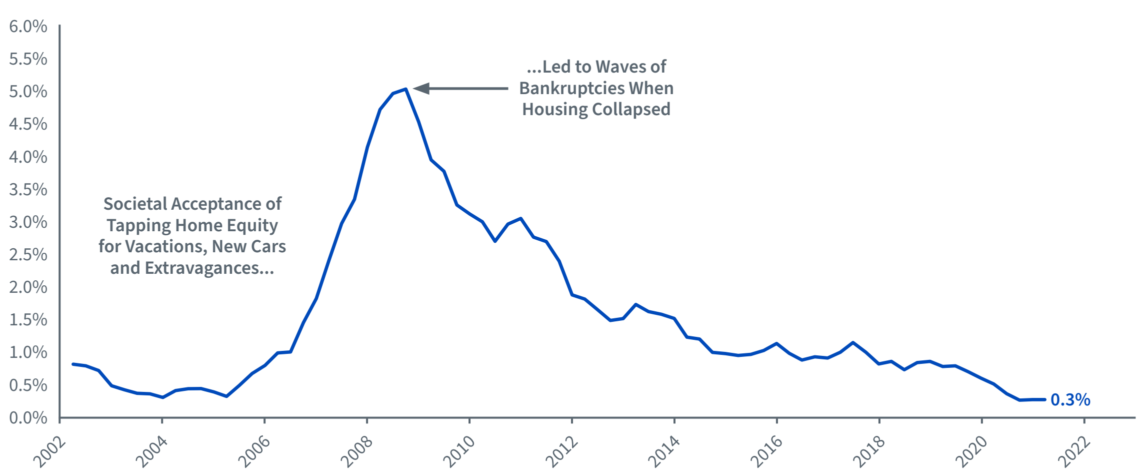


Sources: Refinitiv, National Association of Realtors, as of March 2022.

Here's another chart, and I'm not sure if it's good news or bad news.

Delinquencies in home equity lines of credit (HELOCs) are at generational lows (figure 4). That means there are entire neighborhoods where not one family is behind on their HELOC payment.

Figure 4: U.S. Household Debt, % New Seriously Delinquent Balances, Home Equity Line of Credit (HELOC)



Sources: Refinitiv, Federal Reserve, as of Q1 2022.

The last thing anyone needs is 2005–2007 redux, where the house next door is vacant, and the bank hasn't sent a crew to cut the grass or clean up the fallen tree branches from last month's thunderstorm.

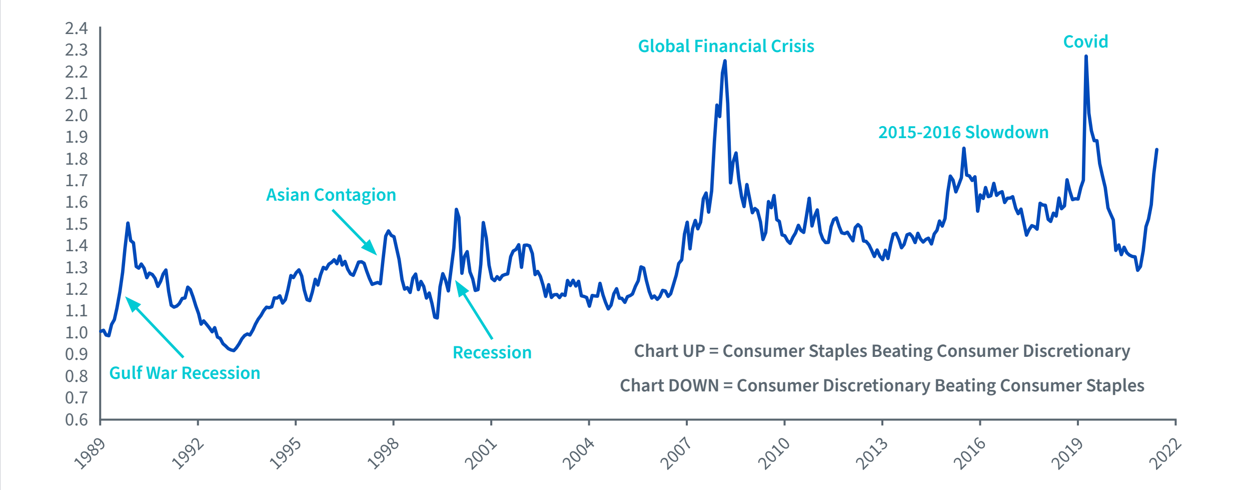
The "only" thing that could upend housing like that is if the current surfeit of job postings evaporates. The stock market is telling us that, though a freezing up of the labor market may not be a probability, it is certainly a possibility.

After doing this for a while, something gets into your bones that gives you an intense urge to double-check the jobs market whenever investors dump the Consumer Discretionary sector as they have in 2022.

Figure 5 shows the performance of staid Consumer Staples stocks relative to their cyclical peers in the Consumer Discretionary sector. Before this year's action, I see only three moves on the chart that witnessed such a quick and bold spike. Those three were the Gulf War recession, the Global Financial Crisis and COVID-19.

All pink-slip situations.

Figure 5: S&P 500 Equal-Weight Consumer Staples Relative to Consumer Discretionary

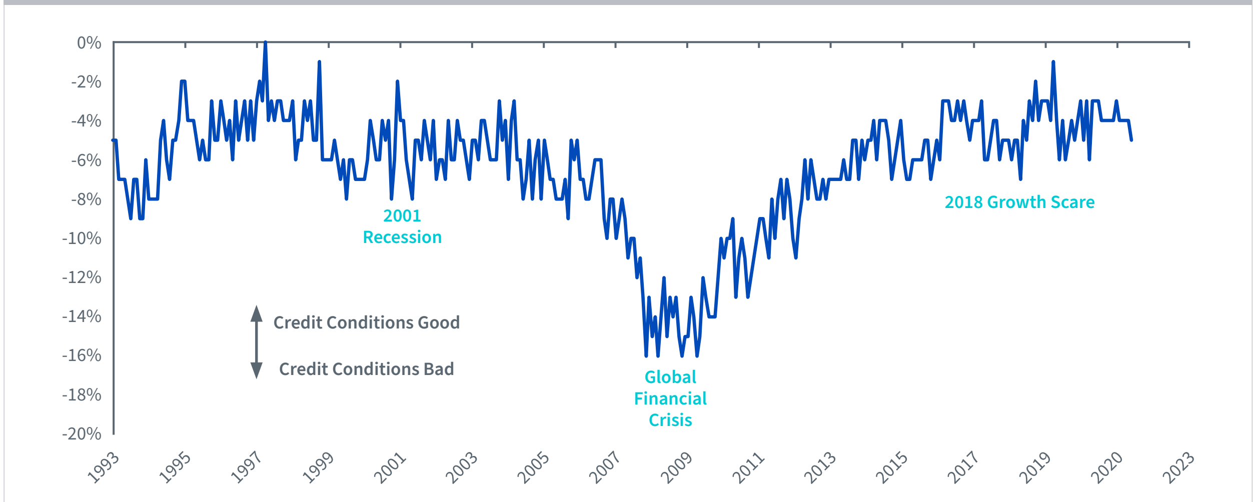


Source: Refinitiv, as of 3/29/22. Indexes are total returns. Past performance does not guarantee future results. You cannot invest directly in an index.

Fortunately, the people who do the hiring don't seem too concerned. The National Federation of Independent Business (NFIB) survey shows that small businesses, by and large, can find loans if they need them (figure 6). So long as that's the case, it's good news for hiring.

Nevertheless, *the chart has a toppy look, doesn't it?*

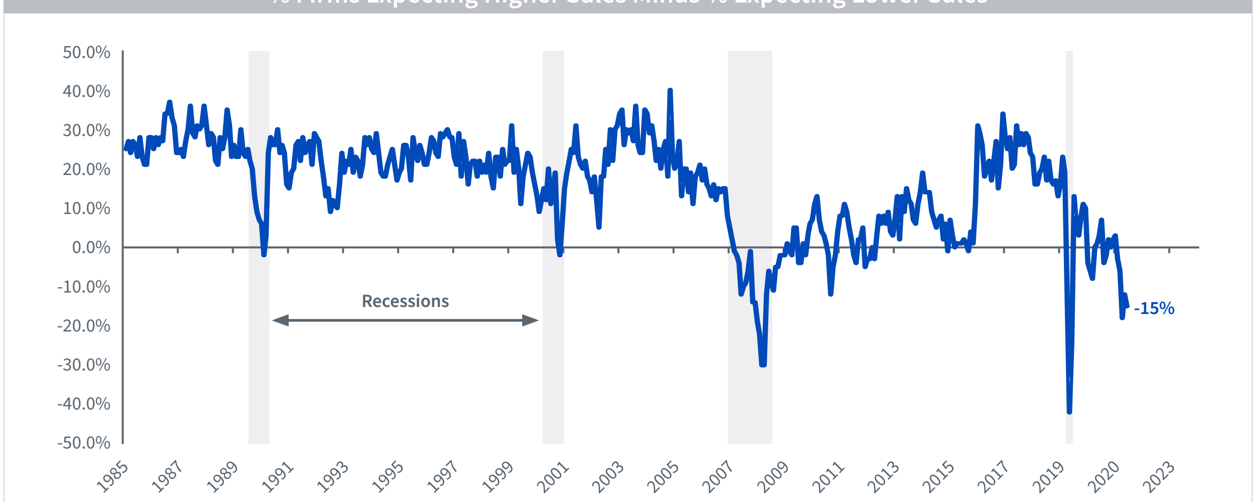
Figure 6: National Federation of Independent Business (NFIB) Survey, Credit Conditions, Percentage Positive Minus Percentage Negative



Sources: Refinitiv, NFIB, as of May 2022.

The NFIB survey has another question that is particularly unnerving: most firms are telling the small business trade association that they expect declining sales.

Figure 7: National Federation of Independent Business (NFIB) Survey, % Firms Expecting Higher Sales Minus % Expecting Lower Sales



Source: NFIB, as of May 2022.

Unquestionably, our society in 2022 is still a far cry from anything remotely resembling the days when we had to watch helplessly as Bear Stearns, AIG, Wachovia and the rest were dragged out by their collars.

Tech stocks, home builders, crypto, NFTs, bonds and a host of other asset classes are down heavily this year. Energy stocks are essentially the "only" thing working, and you can add Utilities to the list if you consider sideways chopping action to be a moral victory in 2022. Beyond those two sectors, most everything else is having a rough go of it.

My concern is that we are entering the "self-fulfilling prophecy" portion of the cycle, where portfolio losses stop people from going out to dinner and managers from hiring new workers.

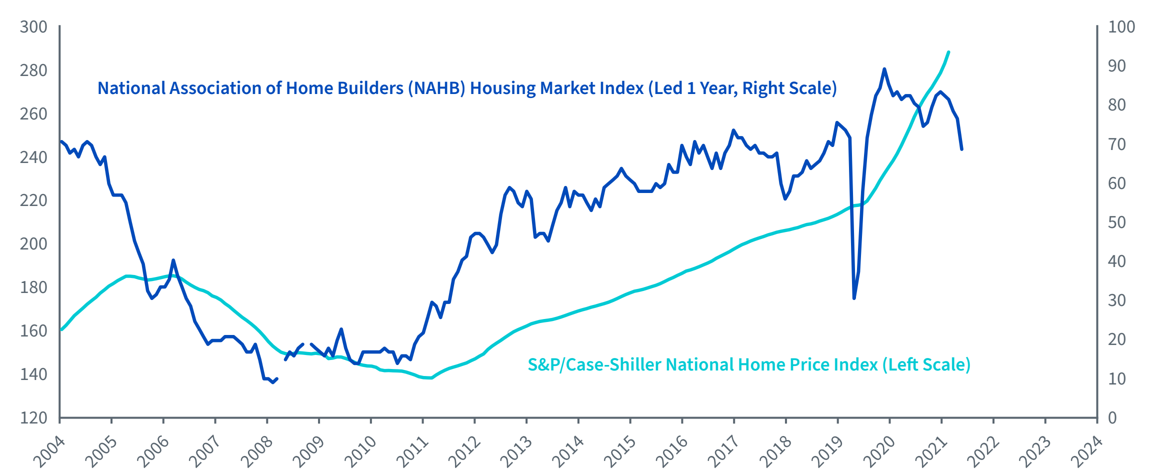
At this point, the most important metrics are the ones that give us an idea of future labor conditions and house prices.

Here's my call: a recession in the back half of this year or in 2023 is more probable than what I infer to be the Street's consensus.

I struggle to find many grizzly housing bears or anyone who will even entertain a cold spell in the labor market. Housing and jobs don't need a deep freeze to upset the apple cart; they might only need to get a little icy to trigger downward revisions to economic forecasts.

One last chart. Do you know who isn't so confident about housing? People who build houses (figure 8).

Figure 8: Home Builder Sentiment Has Diverged from Home Prices



Sources: S&P/Case-Shiller, Refinitiv, NAHB. Home prices as of February 2022, builder sentiment as of May 2022.

What worked in 2022's first five months was a defensive posture, low volatility strategies, dividend concepts—anything that was considered too boring for the go-go stock market of 2020 and 2021. This is not a stock market for the bold, but for the cautious. I think what has been holding up relative to the broad market—the "boring" buybackers and value stocks, embraced by people who were told they didn't "get it"—will continue to hold up. This is especially so if the Street fully comes around to putting a big question mark on house prices and labor conditions this summer.

Glossary:

“Misery Index”: An informal measure of the state of an economy generated by adding together its rate of inflation and its rate of unemployment. Bond: A fixed income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental). Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living. Cryptocurrency (crypto): A digital or virtual currency that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend. Freddie Mac: Freddie Mac (the Federal Home Loan Mortgage Corp.) is a government-sponsored enterprise that purchases, guarantees and securitizes home loans. Home equity lines of credit (HELOCs): A home equity line of credit is a loan in which the lender agrees to lend a maximum amount within an agreed period, where the collateral is the borrower’s equity in their house. Inflation: Characterized by rising price levels. Macro: Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies. National Association of Realtors Survey of Home Buyers: An annual survey conducted by the NATIONAL ASSOCIATION OF REALTORS® of recent home buyers. National Federation of Independent Business (NFIB): An association of small business owners in the United States. Non-fungible token (NFT): A financial security consisting of digital data stored in a blockchain, a form of distributed ledger. Recession: Two consecutive quarters of negative GDP growth, generally characterized by a slowing economy and higher unemployment. Stock: A stock (also known as equity) is a security that represents the ownership of a fraction of a corporation. This entitles the owner of the stock to a proportion of the corporation’s assets and profits equal to how much stock they own. Units of stock are called “shares.” Value stocks: Stocks whose share prices are lower relative to their earnings per share or dividends per share. Investors pay less for these stocks because their earnings or dividend growth expectations going forward are lower.

Index Definitions

National Association of Home Builders (NAHB) Housing Market Index (HMI): A gauge of builder opinion on the relative level of current and future single-family home sales. The S&P CoreLogic Case-Shiller National Home Price Index: Measures the changes in the sale prices of single-family homes across the U.S. S&P 500 Equal Weight Consumer Staples Index: An index that imposes equal weights on the index constituents included in the S&P 500 that are classified in the GICS consumer staples sector. S&P 500 Equal Weight Consumer Discretionary Index: An index that imposes equal weights on the index constituents included in the S&P 500 that are classified in the GICS consumer discretionary sector.

Important Information

Investors should consider the investment objectives, risks, charges and expenses of the Funds carefully before investing. A prospectus containing this and other information is available by calling 866.909.9473 or visiting www.wisdomtree.com. Investors should read the prospectus carefully before investing.

This material contains the opinions of the authors, which are subject to change, and should not be considered or interpreted as a recommendation to participate in any particular trading strategy or deemed to be an offer or sale of any investment product, and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Unless expressly stated otherwise, the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

Jeff Weniger is a Registered Representative of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.