

US Macroeconomics

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If Recession is Still Ahead, Stocks Will Make New Lows

The stock market is a leading indicator of the economy. Prices peak and bottom before real GDP does. Housing is also a leading indicator of the economy. At present, it is in recession with a recovery being unlikely until mortgage rates meaningfully drop. They are still much too high.

The 30-year conventional mortgage is 6.50%, which is down from 7%-plus last October but still 261 basis points above last year, which is a near 70% jump. This jump mostly accounts for what has been a significant deterioration in housing affordability. For example, affordability over the past three months has been hovering at its lowest readings since early 1986.

Until the Fed pivots, thereby allowing mortgage rates to fall, housing will weaken further and remain at depressed levels. This tells us that nationwide recession risk remains high. This should concern some equity investors because housing and equities tend to bottom around the same time. And when they do not, stocks lead housing by only two months.

In the table below, we show the peaks and troughs in housing starts and the S&P 500 for all the business cycles since 1960 (excluding the pandemic). There were three times when starts led stocks, and five times when stocks led starts. But the housing lead was much longer, and when housing lagged, it was not for long.

Starts bottomed before equities by five months in 1970, nine months in 1981 and by a full year in 2001. In the five times that equities bottomed first, they led by only two months. In this cycle, stocks bottomed last October. But housing remains in freefall. Starts fell 4.5% in January and were down 21% over the past 12 months.

If recession is still ahead, which is what housing suggests, then is it likely that stocks have not yet bottomed. This is because they have never led a trough in starts by more than three months. And given housing's track record, this time is unlikely to be different.

Housing Starts and Stock Market Bottoms		
	Business Cycle Troughs	Time
Housing Starts	Dec 60	2m lag
S&P 500	Oct 60	
Housing Starts	Jan 70	5m lead
S&P 500	Jun 70	
Housing Starts	Feb 75	2m lag
S&P 500	Dec 74	
Housing Starts	May 80	1m lag
S&P 500	Apr 80	
Housing Starts	Nov 81	9m lead
S&P 500	Aug 82	
Housing Starts	Jan 91	3m lag
S&P 500	Oct 90	
Housing Starts	Oct 01	12m lead
S&P 500	Oct 02	
Housing Starts	Apr 09	1m lag
S&P 500	Mar 09	

Sources: Census, FRB, Haver, SMBC Nikko

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