# Q&A: State of the U.S. Housing Market

We recently sat down with Sam Dunlap, Portfolio Manager of the Angel Oak Multi-Strategy Income Fund, to discuss the current state of the U.S. housing market. Overall, he remains bullish on the housing market, albeit his forecast calls for home prices to begin to normalize to match inflation over the medium term. His comments are below:

**Q: The national real estate market has been robust for several years, with frequent bidding wars in desirable areas. Could you weigh in on when and how the recent interest rate hikes will impact the housing industry?**

A: We continue to be bullish on the housing market in spite of recent rate hikes as the Federal Open Market Committee (FOMC) continues to gradually tighten monetary policy. Our bullishness is due to a robust labor market, a unique supply/demand dislocation in the U.S. housing market, a prudent residential mortgage credit expansion, and historically low long-term mortgage rates. The official unemployment rate is at historic lows of 4.0%, and we expect it will trend to the low 3% range by next year. Jobless claims (Figure 1), a leading indicator for the health of the labor market, are at levels last seen in the 1960s. Wages are also finally beginning to meaningfully rise in the post-crisis period, increasing 2.7% year-over-year last month.

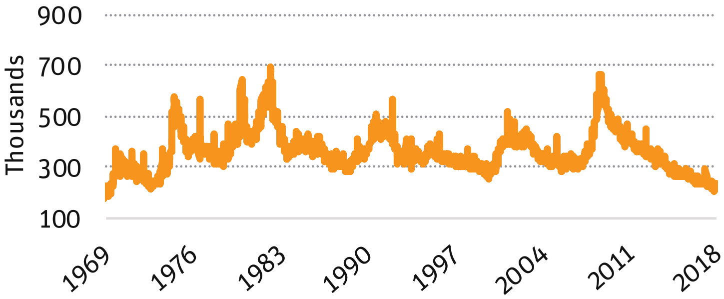
A recent Morgan Stanley report notes that the millennial generation comprises approximately 88 million people between the ages of 15 and 34. This is the largest generation in American history, and has been characterized as the age group experiencing the most rapid rate of household formation. Over the next five years, we expect 1.5 million annual household formations, nearly twice the level for the post-crisis period to date. Robust demand for homes is expected amid historically tight supply. For example, the inventory of single-family homes as a percentage of total households has never been this low (Figure 2). Most important for the millennials, this unique supply/demand dynamic exists in an environment where mortgage credit availability is finally expanding. Despite recent increases in certain overheated markets, home prices remain affordable at the national level, and despite recent FOMC tightening and rising interest rates, the effective rate of mortgage interest in the U.S. is still near all-time lows (Figure 3).

**Q: What might happen to the residential real estate market over the next few years? Will housing prices stall and fall?**

A: As mentioned above, the unique supply/demand dislocation in the U.S. housing market has been very supportive for single-family home prices, and we expect them to continue to rise well above headline inflation over the near term. However, we do think home prices will slowly begin to normalize closer to the pace of headline inflation over the medium term as affordability ultimately begins to become a factor. For example, the S&P Case-Shiller Index (Figure 4) recently rose 6.4% in April, which was the 72nd straight month of year-over-year home price appreciation, but April was the first month the index saw its first year-over-year decline in the past 18 months, falling from 6.5% year-over-year

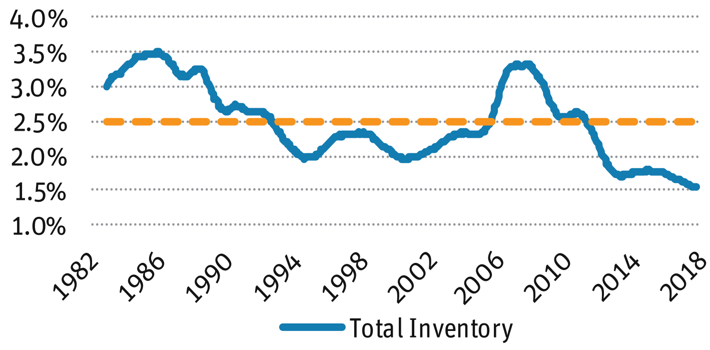
Sam Dunlap
Senior Portfolio Manager
Angel Oak Capital Advisors

**FIGURE 1: JOBLESS CLAIMS**



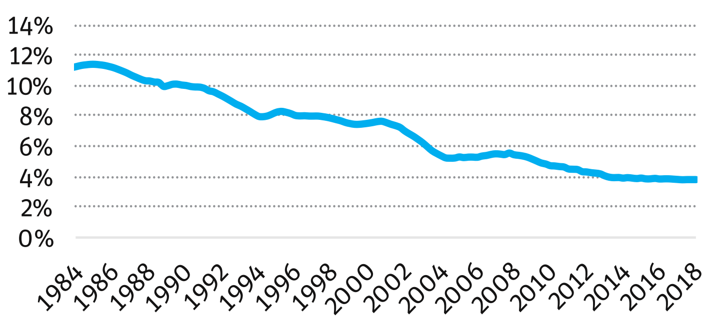

Source: Bloomberg as of 6/30/18.

**FIGURE 2: SINGLE-FAMILY INVENTORY AS % OF HOUSEHOLDS**




Source: Morgan Stanley as of 6/30/18.

**FIGURE 3: HISTORICAL U.S. MORTGAGE INTEREST RATES**




Source: Bloomberg as of 3/31/18.

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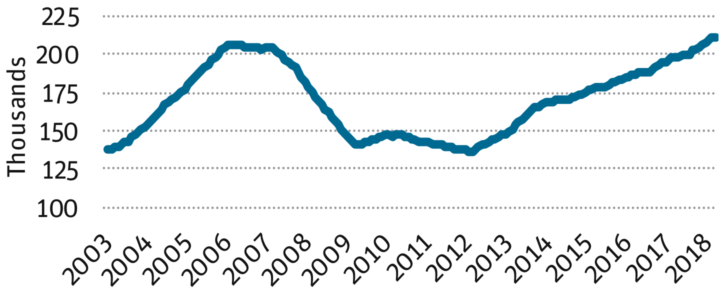
in March. In addition, the Consumer Price Index (CPI) rose 2.9% in June.

**Q: Will buyers be shut out of the market?**

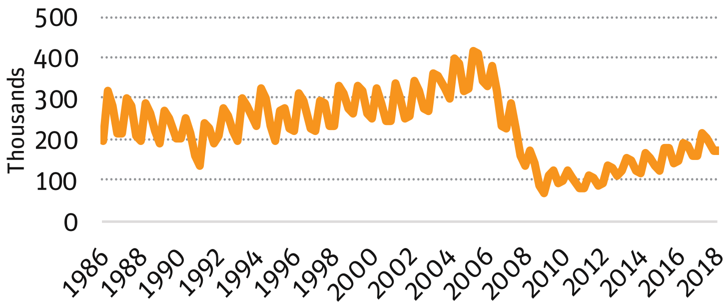
A: Currently, we do not think that homebuyers are shut out of the market. While some markets, particularly on the West Coast, continue to lead the pace of home price appreciation, housing remains affordable at the national level. For example, despite the recent rise in home prices and mortgage rates, housing affordability is well above historical averages, albeit not at the incredibly attractive levels seen in 2011-2012 when the housing market was still reeling from the fallout from the credit crisis. We also believe that the unique housing supply shortage will begin to correct itself over the medium term as the pace of single-family housing starts ultimately normalizes and approaches long-run averages (Figure 5). Moreover, mortgage credit availability is finally beginning to expand nearly ten years after the credit crisis, which we believe is a prudent expansion needed particularly for first-time millennial homebuyers.

**FIGURE 4: S&P/CASE-SHILLER 20-CITY HOME PRICE INDEX**




Source: Bloomberg as of 5/31/18.

**FIGURE 5: U.S. SINGLE FAMILY HOUSING STARTS**




Source: Bloomberg as of 3/31/18.

**About Angel Oak Capital Advisors, LLC**

Angel Oak Capital Advisors is an investment management firm focused on providing compelling fixed income investment solutions for its clients. Backed by a value-driven approach, Angel Oak Capital Advisors seeks to deliver attractive risk-adjusted returns through a combination of stable current income and price appreciation. Its experienced investment team seeks the best opportunities in fixed income with a specialization in mortgage-backed securities and other areas of structured and corporate credit.

As of June 30, 2018, Angel Oak Capital Advisors had approximately $9.1 billion in assets under management across its mutual funds, private funds and separately managed accounts.

For more information, please visit www.angeloakcapital.com.

**DEFINITIONS AND DISCLOSURES**

**Consumer Price Index (CPI):** An index that measures the changes in the price of a certain collection of goods and services bought by consumers in an effort to measure inflation.

**S&P CoreLogic Case-Shiller 20-City Composite Home Price Index:** The Index seeks to measure the value of residential real estate in 20 major U.S. metropolitan areas.

**Mutual fund investing involves risk; principal loss is possible.**

Past performance does not guarantee future results. Index performance is not illustrative of fund performance. It is not possible to invest directly in an index. For fund performance please call 855-751-4324.

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