First Trust
Monday Morning OUTLOOK
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"New Bubble" Talk, Premature

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That was fast. A little over two years ago, we declared that housing had not only bottomed, but was about to start its first real growth spurt since the bubble (Housing At An Inflection Point 11/2/2011). While some agreed, others expressed polite disagreement or, in some cases, incredulity.

While we may not get everything right, this time we couldn't have timed it better. Housing starts are up about 65%, new home sales are up more than 50%, existing home sales have turned the corner, and national average home prices are up around 15%. But now, instead of admitting they were wrong, the naysayers have immediately jumped on the "new bubble" bandwagon. In essence, the are saying, "if it's good, it can't be real," and "anything good, must end in another crash."

We don't doubt that another bubble could *eventually* develop. After all, the federal government is still too heavily involved in housing. Twenty-two percent of mortgage borrowers are making down-payments of less than 10% (thanks to the FHA), while Fannie and Freddie are providing long-term financing at very attractive rates.

Meanwhile, the Fed is holding rates too low, and "tapering" doesn't mean "tightening," it just means the Federal Reserve is adding to banks' excess reserves at a slower rate.

None of this is lost on us. We understand the implications. But, just because a few players on the team are cheating, that doesn't always mean that a victory was all due to those players. In other words, there's no clear evidence that home prices are already out of line with fundamentals.

One measure of a bubble is price-to-rent ratios, calculated using the Fed's quarterly report on the market value of owner-occupied real estate versus the Commerce Department's estimates of rent. Since 1959, the typical Price/Rent ratio has been 15.

At the peak of the 2003-2008 housing bubble, in early 2006, the P/R ratio hit an all-time high of 20.8. This means that national average home prices were about 40% higher than rents said they should be. The ratio then bottomed at 12.8 in late 2011, with home prices 15% below normal.

After the price gains of the past two years, the P/R ratio was back up to 14.7 in the third quarter of 2013, the most recent for which we have data and we estimate it ended last year at 15, with home prices fairly valued. In other words, there is no evidence of a bubble in housing.

Although the pace of home building is up substantially from a few years ago, this is necessary to keep up with population growth. And, more supply should hold the lid on home price gains. We look for home prices to continue to rise in the year ahead, but more moderately than last year, while rents rise as well. In other words, while conventional wisdom moves from "no recovery possible," to "new bubble" territory, we see a market functioning reasonably well.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-14 / 7:30 am	Retail Sales – Dec	+0.1%	**-0.1%**		+0.7%
7:30 am	Retail Sales Ex-Auto – Dec	+0.4%	**+0.4%**		+0.4%
7:30 am	Import Prices – Dec	+0.4%	**+0.4%**		-0.6%
7:30 am	Export Prices – Dec	+0.1%	**+0.1%**		+0.1%
9:00 am	Business Inventories – Nov	+0.3%	**+0.3%**		+0.7%
1-15 / 7:30 am	PPI – Dec	+0.4%	**+0.4%**		-0.1%
7:30 am	"Core" PPI – Dec	+0.1%	**+0.1%**		+0.1%
7:30 am	Empire State Mfg Survey – Jan	4.0	**3.3**		1.0
1-16 / 7:30 am	Initial Claims – Dec 11	325K	**338K**		330K
7:30 am	CPI – Dec	+0.3%	**+0.3%**		0.0%
7:30 am	"Core" CPI – Dec	+0.1%	**+0.1%**		+0.2%
9:00 am	Philly Fed Survey – Jan	8.5	**8.7**		7.0
1-17 / 7:30 am	Housing Starts – Dec	0.991 Mil	**1.025 Mil**		1.091 Mil
8:15 am	Industrial Production – Dec	+0.3%	**+0.2%**		+1.1%
8:15 am	Capacity Utilization – Dec	79.1%	**79.1%**		79.0%
8:55 am	U. Mich Consumer Sentiment- Jan	83.5	**83.0**		82.5