First Trust
Monday Morning OUTLOOK
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# Higher Rates Won't Crush Housing

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In the past 7 ¾ years, we have consistently urged investors to separate their politics from their investing. It's way too easy to say, "Their guy is in the White House; so everything must be awful – and if anything good happens, it must be fake, or a 'sugar high'."

We agree that higher tax rates, more regulation and increased government spending are wet blankets on economic growth. We also think these policies hurt the very people they're designed to help. But, for the past 7 ¾ years, entrepreneurs still found ways to create wealth. That is why we urged equity investors to stay positive.

And now that the US government is experiencing a change in management, we suspect the scare stories will come from the other side. The first is that housing will be crushed by higher interest rates. With 10-year Treasury yields (and mortgage rates) up about 50 basis points, all else equal, some homebuyers are being priced out of the market.

But all else is never equal. Interest rates are up for a *reason*, and that reason includes expectations for faster economic growth and perhaps a little more inflation. But growth and inflation mean faster wage growth, more jobs, and expectations of rising rents and housing prices.

Mortgage rates are still around the average in 2013-14, while personal income in that same period is up 11.4%. Yes, home prices are up about 15% versus the 2013-14 average, while rents are up 9%. However, home prices were still artificially low in 2013-14 relative to rents, so it's natural and normal that price gains have temporarily outstripped rents.

To assess fair value for home prices, we use the Fed's measure of the asset value of owner-occupied residential real estate and compare it to the Commerce Department's measure of the rental value of these homes. That measure signaled home prices were nearly 40% above fair value by 2005. They also signaled that by 2011 prices were the lowest relative to rents in more than 50 years. Right now, the same measure says home prices are in the middle of the normal range versus rents. In other words, there is no bubble to pop.

The main way housing contributes to economic growth is through home building and the fundamentals suggest continued increases in the pace of construction. Based on population growth and scrappage, we should be starting about 1.5 million homes per year, versus the 1.2 million we've actually started in the past 12 months.

If higher interest rates are supposed to be so bad for the economy, why haven't the last several years of historically low interest rates generated anything more than modest Plow Horse economic growth? Rates have been low, in part, because of bad government policies that reduce economic growth. Removing those hurdles to growth will boost rates, but won't be a headwind for the economy in general or housing in particular.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 11-29 / 7:30 am | Q3 GDP Second Report | 3.0% | **3.1%** | | 2.9% |
| 7:30 am | Q3 GDP Chain Price Index | 1.5% | **1.5%** | | 1.5% |
| 9:00 am | Consumer Confidence – Nov | 101.5 | **101.5** | | 98.6 |
| 11-30 / 7:30 am | Personal Income – Oct | +0.4% | **+0.4%** | | +0.3% |
| 7:30 am | Personal Spending – Oct | +0.5% | **+0.5%** | | +0.5% |
| 8:45 am | Chicago PMI – Nov | 52.5 | **50.7** | | 50.6 |
| 12-1 / 7:30 am | Initial Claims – Nov 26 | 252K | **252K** | | 251K |
| 9:00 am | ISM Index – Nov | 52.3 | **52.3** | | 51.9 |
| 9:00 am | Construction Spending – Oct | +0.6% | **+0.6%** | | -0.4% |
| *Afternoon* | Total Car/Truck Sales – Nov | 17.7 Mil | **17.7 Mil** | | 17.9 Mil |
| *Afternoon* | Domestic Car/Truck Sales – Nov | 14.0 Mil | **13.9 Mil** | | 14.1 Mil |
| 12-2 / 7:30 am | Non-Farm Payrolls – Nov | 180K | **163K** | | 161K |
| 7:30 am | Private Payrolls – Nov | 170K | **153K** | | 142K |
| 7:30 am | Manufacturing Payrolls – Nov | -2K | **-2K** | | -9K |
| 7:30 am | Unemployment Rate – Nov | 4.9% | **4.8%** | | 4.9% |
| 7:30 am | Average Hourly Earnings – Nov | +0.2% | **+0.2%** | | +0.4% |
| 7:30 am | Average Weekly Hours – Nov | 34.4 | **34.4** | | 34.4 |