Mortgage Matters...

Keeping up-to-date on market fluctuations allows you to bring greater value to your clients.

Week of January 31, 2011

Market Comment

We hope we see marked improvement in the home-builder sentiment index on its next release, because the news on new home sales in December was better than just about anyone expected, jumping 18 percent to an annual unit rate of 329,000. What's more, supply came down and prices jumped. The former fell to 6.9 months, versus 8.4 months in November, and the latter jumped 12 percent to a median $241,500.

We did say "marked" and not "phenomenal." As encouraging as the news on new-home sales was, it wasn't perfect. The fall off in purchase applications over the past few weeks points to a fall off in new-home sales for January. In addition, much of the improvement was concentrated in the West, not evenly distributed throughout the regions. Then again, it rarely is. Real estate is, after all, local.

Overall, though, we remain encouraged. This and the previous week's existing-home sales report is good news for housing. Now it's a matter of seeing if the winning streak can be strengthened and extended.

Some in the financial media speculated that the buying rush was tied to December's jump in mortgage rates, which encouraged home shoppers to hop off the fence and act. We tend to agree with the speculators. We've been saying over the past half-year that rising rates would be more stimulative than dissuasive. Expecting lower prices and then getting them over an extended period lulled people into an unwarranted sense of certainty and nonchalance. The rate hikes over the past two months have shocked the market back to reality and motivated many people to act.

Another shock could be forthcoming for price-deflation proponents. The S&P/Case-Shiller home price index showed a year-over-year price decline in November, with a 0.4 percent decline for the composite 10 index and an adjusted 1.6 percent decline for the composite 20 index. David Blitzer, chairman of the index committee at S&P, warned that "A double-dip could be confirmed before Spring." Blitzer defined a double-dip as both the 10- and 20-city composite indexes setting new post-peak lows.

We are not so sure in light of December's data on median home prices. There is also the issue of money supply, which has increased dramatically over the past two years and is set to continue increasing this year. The Federal Reserve is confident it can manage any spike in inflation, but we remain circumspect. Inflation often works like pouring a new bottle of ketchup: You keep smacking the bottom of the bottle repeatedly and nothing comes out. You smack it again and find you have ketchup (and price increases) all over the place.

The prospect of sudden inflation is a primary reason we continually warn borrowers and buyers not to procrastinate. Mortgage rates continue to hold steady, and to us, that's an opportunity to act. However, the 30-year fixed-rate loan continues to parallel movement in the 10-year Treasury note, and the 10-year Treasury yield is itching to move higher.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
Personal Income & Outlays (December)	Mon., Jan. 31, 8:30 am, et	Income: 0.4% (Increase) Outlays: 0.5% (Increase)	Important. Spending habits reflect improving consumer confidence.
Construction Spending (December)	Tues., Feb. 1, 10:00 am, et	0.2% (Decrease)	Important. Spending levels are stabilizing after months of decline.
Mortgage Applications	Wed., Feb. 2, 7:00 am, et	None	Important. Concerns over lower home prices and stagnating rates are slowing activity.
Productivity (4th Quarter 2010)	Thurs., Feb. 3, 8:30 am, et	Federal Funds Rate: 0.0% to 0.25%	Important. The Fed will hold the fed funds rate low, but a few board members are considering raising it.
Pending Home Sales Index (December)	Thurs., Jan 27, 10:30 am, et	0.2% (Increase)	Important. The long-run trend reflects persistent strength in manufacturing.
Employment Situation (January)	Fri. Feb. 4, 8:30 am, et	Unemployment Rate: 9.4% Payrolls: 150,000 (Increase)	Very Important. Unexpected strength in hiring could prompt the Federal Reserve to re-examine its low-interest-rate policies.

Money on the Move

Correlations between asset classes are always on the move and always changing: when one asset class gets hot, the others tend to cool. In case no one has noticed, the stock market is hot these days. In fact, the two leading stock-market benchmarks – the Dow Jones Industrial Average and the S&P 500 Index – are posting multi-year highs.

We broach this point to note that money invariably moves to the hot asset class, and in today's market, that's stocks. This money also invariable moves at the expense of the former hot asset class, and the former hot asset class is Treasury securities. As money leaves an asset class, the required expected return on that class rises to reflect its diminishing popularity and to entice money to return.

As we noted above, mortgage rates are tethered to Treasury rates. We also noted that inflation would get rates moving higher, but so will money moving away from Treasury securities into other asset classes. We think this notion of asset rotation is one more arrow in the quiver of those of us expecting higher mortgage rates in 2011.

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