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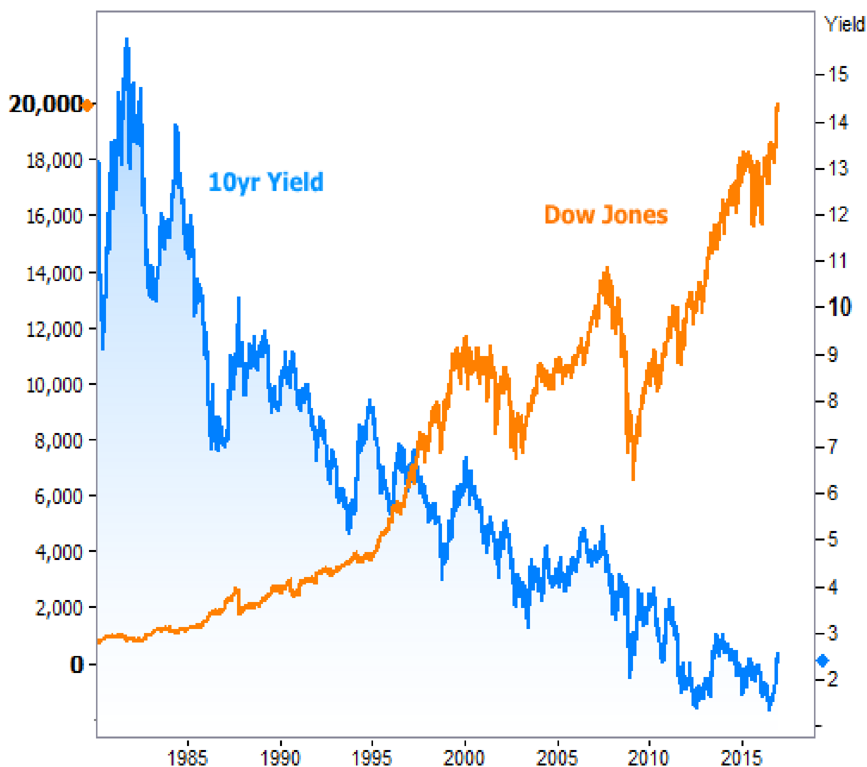
Does "Dow 20k" Matter For Rates/Housing?

As the new year gets underway, news stories about the Dow Jones Industrial Average hitting the 20,000 level are hard to miss. Given that stocks and rates moved higher together after the election, it's fair to wonder how this correlation might affect rates and housing.

There's no one-size-fits-all approach to this complex issue, but there are **a few easy observations**. First, let's address the conventional wisdom regarding stocks' and bonds' (the securities that drive "rates") correlation. This is **easy to test** with a quick glance at the long-term chart. We'll use the most quintessential benchmarks for stocks and rates: the Dow and the 10yr Treasury yield. Remember, conventional wisdom says the blue and orange lines should be on top of each other, for the most part.



This chart **crushes** conventional wisdom! It can be a bit of a **surprise** if you haven't seen a similar chart. In fact, this makes it look like stocks and bonds move in the **OPPOSITE** direction in the long run. Why would any other conventional wisdom even exist? A shorter-term version of the same chart provides the answer:

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.07%	+0.02	0.00
15 Yr. Fixed	6.45%	0.00	0.00
30 Yr. FHA	6.51%	+0.02	0.00
30 Yr. Jumbo	7.26%	0.00	0.00
5/1 ARM	7.02%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.86%	-0.01	0.00
15 Yr. Fixed	6.16%	+0.03	0.00

Rates as of: 6/28

Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.12	-0.05
MBS GNMA 6.0	100.23	-0.10
10 YR Treasury	4.4430	+0.0450
30 YR Treasury	4.6010	+0.0370

Pricing as of: 7/1 8:51AM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Jun 12	208.5	+15.58%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

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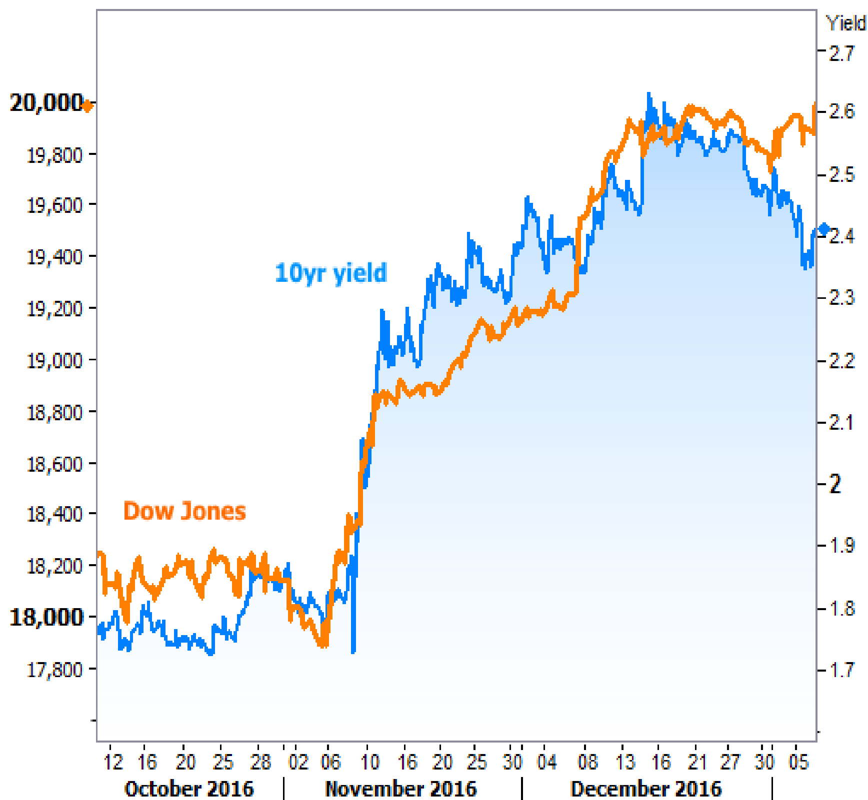

So what's going on here? How can stocks and bonds be **telling such different stories** depending on the frame of reference?

The answer is simply that stocks and bonds **do** indeed tend to go through **phases of high correlation** in the shorter term. The shorter the time frame, the more reasonable it is to expect correlation. This fits with the conventional wisdom of investors moving money out of one sector and into another (i.e. "buy stocks, sell bonds!").

The correlation breaks down in the longer-term because rates are **cyclical**. That means they tend to cycle in a confined range. Even though that range is up for debate (after all, some countries have seen their 10yr rates drop below 0%), its cyclical nature is not. **No one** expects the 10yr yield to break its ceiling from the early 80's--not even close.

Stocks, on the other hand, can theoretically maintain linear, or even exponential growth **forever and ever**. Only the most apocalyptic scenario would bring stocks back to early 80's levels. To oversimplify the point, the 30 biggest companies in the US would have to lose 90% of their value. Not even the most pessimistic forecasters would entertain such a possibility.

Bottom line: stocks can keep moving higher over time if companies keep growing. Rates, on the other hand, can only go so high before economic and monetary forces will act to bring them back down. The **big, unanswerable question** is "how high will rates go this time around?"

Some say that the decades-long trend toward lower rates over, and the new long term trend will be toward higher rates. **Before you lose sleep** over that, let's look at the scale of the problem. The following chart will help. The post-election rate spike is circled so you can see where it fits in, longer-term.

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To be clear, the recent rate spike was **absolutely abrupt**, but several past rate spikes covered much more distance overall. Additionally, the current rate spike hasn't even come close to definitively breaking the ceiling of the trend (the upper of the two parallel lines).

That's **not** to say the trend **won't** break. Naturally, if the trend is downwardly-sloped, and if I just argued that rates will hold a cyclical/sideways pattern in the longest of terms, the trend must be defeated at some point.

The only thing that's debatable is **HOW** that process will unfold: quickly and painfully, or slowly and tolerably? Late 2016 rate movements were defending against a "quick and painful" scenario where Trump's new policies stoked the fires of economic growth and inflation (both bad for rates) which in turn would prompt the Fed to raise rates more quickly (thus adding upward pressure on longer-term rates like mortgages).

The Fed **confirmed** that assumption in the release of their December meeting minutes this week, saying that rates could need to be raised more quickly to whatever extent new fiscal policies were successful in promoting growth and inflation. But rates **fell** in response, suggesting markets **already** assumed as much, and that mid-December marked a near-term ceiling.

From here, it continues to be the case that we're waiting to see how Trump's policies evolve and how much of an effect they ultimately have on growth and inflation. With December's highs hopefully behind us, rates are **more likely** to carve out a sideways range as they wait for the next major cue. That range could be fairly wide, given the scope of the movement over 2 months.

As long as the recent ceiling remains intact, the **damage to housing markets** will be relatively contained. (Note: the previous newsletter had several charts showing the effect of 2013's rising rates on home sales, thus providing a baseline for the aforementioned "damage.")

"Pivot points" seen in the following chart can help us keep an eye on how rates are doing. In general, breaking below these pivot points is good, but such breaks can also serve as cues for markets to push back in the other direction, as seems to have been the case this week when 10yr yields hit 2.34% and promptly bounced back to 2.42%.

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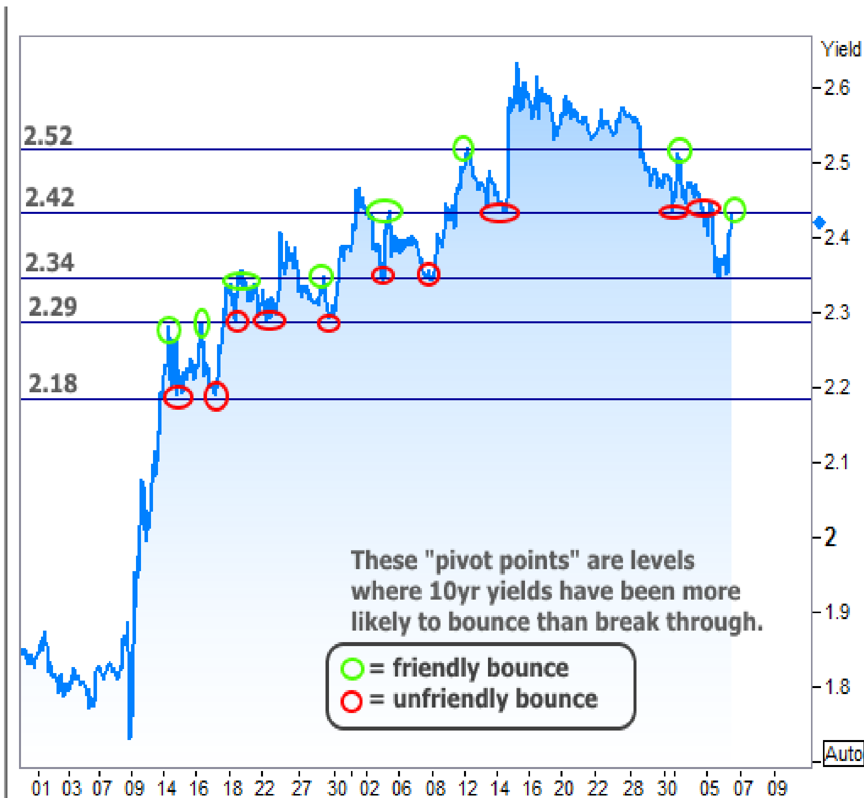

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Jan 03				
10:00AM	Dec ISM Manufacturing PMI	54.7	53.6	53.2
10:00AM	Nov Construction spending (%)	+0.9	0.6	0.5
Wednesday, Jan 04				
9:45AM	Dec ISM-New York index	727.4		720.5
Thursday, Jan 05				
8:15AM	Dec ADP National Employment (k)	153.0	170	216
8:30AM	w/e Initial Jobless Claims (k)	235	255	265
10:00AM	Dec ISM N-Mfg PMI	57.2	56.6	57.2
10:00AM	Dec ISM N-Mfg Bus Act	61.4	61.0	61.7
Friday, Jan 06				
8:30AM	Dec Non-farm payrolls (k)	+156	178	178
8:30AM	Dec Unemployment rate mm (%)	4.7	4.7	4.6
8:30AM	Dec Average workweek hrs (hr)	34.3	34.4	34.4
8:30AM	Dec Private Payrolls (k)	+144	170	156

Event Importance:

No Stars = Insignificant
☆ Low
★ Moderate
★★ Important
★★ Very Important

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Date	Event	Actual	Forecast	Prior
8:30AM	Dec Average earnings mm (%)	+0.4	0.3	-0.1
8:30AM	Nov International trade mm $ (bl)	-45.2	-42.5	-42.6
10:00AM	Nov Factory orders mm (%)	-2.4	-2.2	2.7
Monday, Jan 09				
3:00PM	Nov Consumer credit (bl)	+24.53	18.48	16.02
Tuesday, Jan 10				
10:00AM	Nov Wholesale inventories mm (%)	+1.0	0.9	0.9
Wednesday, Jan 11				
7:00AM	w/e Mortgage Market Index	379.2		358.5
Thursday, Jan 12				
8:30AM	Dec Import prices mm (%)	+0.4	0.7	-0.3
8:30AM	Dec Export prices mm (%)	+0.3	0.1	-0.1
Friday, Jan 13				
8:30AM	Dec Retail sales mm (%)	0.6	0.7	0.1
8:30AM	Dec Producer Prices (%)	+0.3	0.3	0.4
8:30AM	Dec Core Producer Prices YY (%)	+1.6	1.5	1.6
10:00AM	Jan Consumer Sentiment Prelim	98.1	98.5	98.2
10:00AM	Nov Business inventories mm (%)	+0.7	0.5	-0.2
Wednesday, Apr 05				
2:00PM	FOMC Minutes			

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Real Talk

At The Rate Shop, we're not your average mortgage banker. We specialize in bringing you ridiculously low interest rates that will make you wonder what the other guys are doing. In fact the ONLY objection we ever hear is “your rates sound too good to be true”. Well they’re not, and here is why…

After 15 years in the retail banking world I was frustrated with the high interest rates that came from that business model. As I looked around at all the bloated layers of management and their expensive salaries and the overhead of running a larger company (think rent costs, employee health and benefit costs, payroll taxes, and on and on) it dawned on me that I was a part of the problem, and the solution, for me at least, was so easy to see.

Start my own mortgage brokerage shop. No expensive executive salaries, no expensive building to pay rent at, no unnecessary employees and all the costs that are associated with that. What happens when you cut out all the fat? You can provide lower rates and lower closing costs. It’s simple. Now here is the best part, you still get great service from a local Kansas City Lender. My mission is to let everyone know that low rates and great customer service are NOT mutually exclusive.

Thanks for coming along on this journey where Low Rates meet Great Service. The two do NOT have to be mutually exclusive. It’s just a lie that the big box mortgage companies have been telling you for years. Don’t believe me? Give me a call or shoot me a text on my personal cell phone today and compare my rates and costs up against any other lender in the country, and be prepared to be blown away.

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