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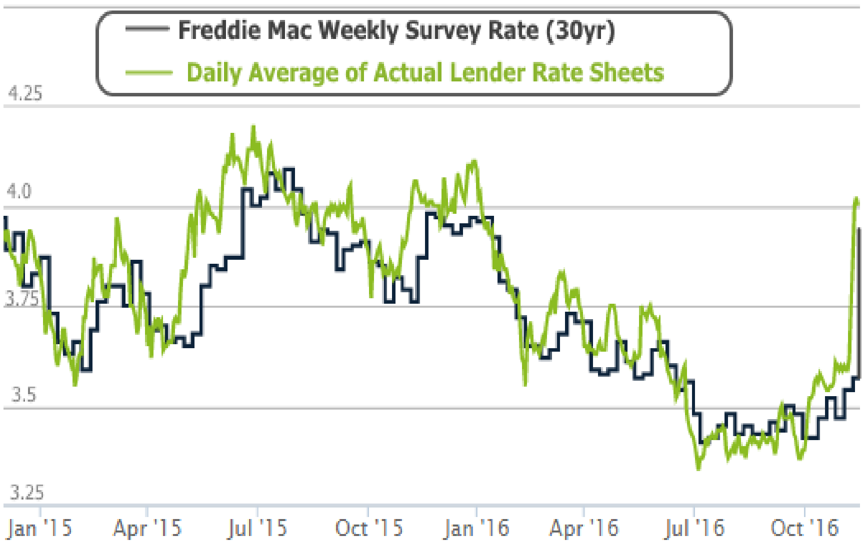
Why Did The Election Kill 2016's Rates and Can They Come Back?

Political fallout aside, the election has really shaken up financial markets. While the evening news is more apt to focus on the stock market recovery, it's getting harder and harder to ignore the **destruction of 2016's low mortgage rates**. Even the slower-to-react Freddie Mac rate survey caught up with the reality we'd already discussed last week.



Clearly, the election was a catalyst, but why, exactly, are rates responding like this and what are the chances they can **come back?**

For bond markets (which dictate rates), the issue with the election isn't so much about **who** won, but rather, the widespread consensus that the **other** candidate would win. Markets **LOVE** to price-in as much of the future as they can reasonably foresee. With Clinton, that future was seen as a relative status quo.

The Trump victory started a scramble. Investors were left to guess what Trump's actual policy path might look like and what the effects would be on financial markets. One of the most prevalent conclusions last week was that the election made a Fed rate hike more likely, which was in turn pushing mortgage rates higher.

Although Fed rate hike expectations have moved up a bit, they **certainly don't** account for the move seen in longer term rates. This is plain to see in the

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.89%	0.00	0.00
15 Yr. Fixed	6.33%	+0.01	0.00
30 Yr. FHA	6.33%	+0.01	0.00
30 Yr. Jumbo	7.05%	0.00	0.00
5/1 ARM	6.58%	0.00	0.00
Freddie Mac			
30 Yr. Fixed	6.77%	-0.09	0.00
15 Yr. Fixed	6.05%	-0.11	0.00

Rates as of: 7/22

Market Data

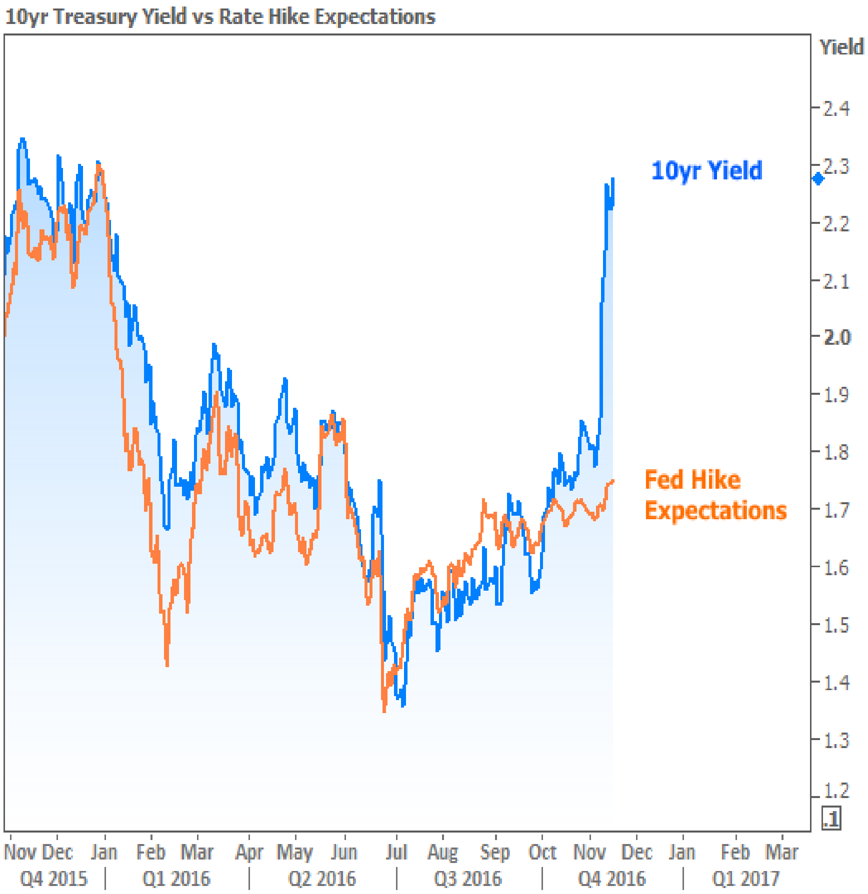
	Price / Yield	Change
MBS UMBS 5.5	99.39	-0.01
MBS GNMA 5.5	99.78	+0.00
10 YR Treasury	4.2276	-0.0249
30 YR Treasury	4.4472	-0.0253

Pricing as of: 7/23 7:00AM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Jul 10	206.1	-0.19%
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%

following chart (10yr yield is a benchmark for longer-term rates, like mortgages).

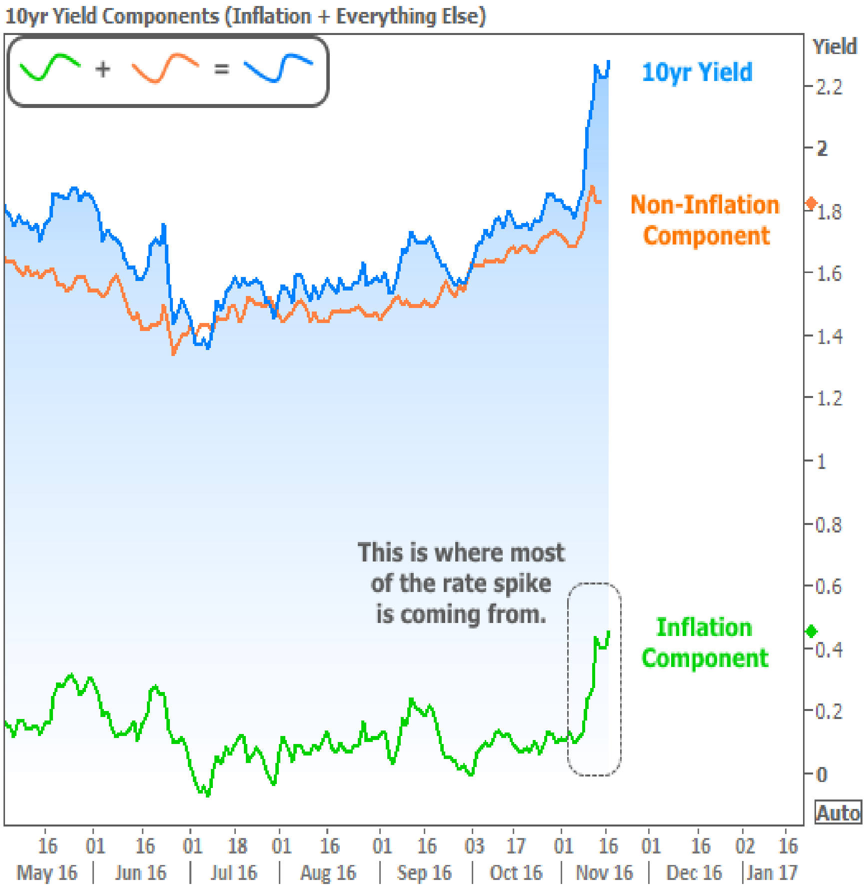


If not Fed fears, then **what other insidious enemy** has bond markets so scared? There are actually **several**. These include any number of the following (in order of importance and apparent level of certainty):

- Together with a unified GOP congress, Trump is expected to create inflation through increased infrastructure spending, protectionist trade policies, and lower taxes. (Lower taxes + higher spending = the need to print more Treasury debt, or plain old growth. Both would push rates higher. Protectionist policies could raise the cost of imports, which could add to inflation).
- The infrastructure spending possibilities and potential tax cuts have boosted equities markets. Some investors think this is an opportunity to get out of bonds and back into stocks.
- All of the above increases the likelihood that the Fed will hike rates in December. This was already assumed, but now more so. Many investors think the domestic situation makes December a perfect opportunity for Europe to announce that it will taper its asset purchases (thus decreasing overall demand in bond markets, which is bad for rates).
- While it may not have been anything more than a hollow campaign threat, Trump did mention the possibility of "renegotiating" with America's creditors, which is never good for interest rates.
- While it may also have been a rhetorical threat, if Trump were to follow-through on mass-deportation goals, that could have an inflationary effect, as it implies an increase in the cost of labor.

With the exception of the modest increase in Fed rate hike odds, the overwhelmingly unified theme here is **inflation**. In general, rates will rise for a few key reasons: lower credit quality, stronger growth prospects, and higher inflation expectations. Of those three, inflation has vastly more power to rock rates' world, especially when inflation expectations suddenly change based on fiscal or monetary policy.

If we strip out the inflation component of 10yr yields and isolate it on a chart with the non-inflation-related components, **everything becomes clear**.



Keep in mind, of course, that this rate spike is **made worse** by the level of uncertainty over the ultimate policy path. Bond markets have to account for a wider range of risks, and it's much safer for bond traders to be **overly defensive** of the worst-case scenario until it can be ruled out.

In the coming weeks, to whatever extent such a scenario **can** be ruled out (or even toned down), we could see rates ease back a bit. But until that happens, take a cue from bond traders: expect the pain to continue until it stops. **Don't try to catch the falling knife.** The chance of timing it right isn't worth the risk of losing a digit (on your hand or on rate sheets).

While we ponder rates' fate, why not add a **layer of concern** by asking ourselves what a surge in rates would mean for the housing market. It was hard not to wonder about such things after this week's impressive surge to 9yr highs in Housing Starts. The past few reports are just now starting to break the stagnant trend from 2015 to mid-2016, and even though rates aren't the final word for residential construction, a sustained rate spike will make it hard to build on the exciting new trends.

Housing Starts and Building Permits

Subscribe to my newsletter online at: http://housingnewsletters.com/thomaspayne

Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Nov 15				
8:30AM	Oct Retail sales mm (%)	+0.8	0.6	0.6
8:30AM	Oct Import prices mm (%)	+0.5	0.4	0.1
8:30AM	Oct Export prices mm (%)	+0.2	0.2	0.3
8:30AM	Nov NY Fed manufacturing	+1.5	-2.50	-6.80
Wednesday, Nov 16				
7:00AM	w/e Mortgage Market Index	436.3		480.5
8:30AM	Oct Core Producer Prices YY (%)	+1.2	1.5	1.2
8:30AM	Oct Core Producer Prices MM (%)	-0.2	0.2	0.2
9:15AM	Oct Industrial output mm (%)	0.0	0.2	0.1
9:15AM	Oct Capacity utilization mm (%)	75.3	75.5	75.4
10:00AM	Nov NAHB housing market indx	63	63	63
Thursday, Nov 17				

Event Importance:

No Stars = Insignificant
Low
Moderate
Important
Very Important

Date	Event	Actual	Forecast	Prior
8:30AM	Oct Housing starts number mm (ml)	1.323	1.156	1.047
8:30AM	Oct Building permits: number (ml)	1.229	1.198	1.225
8:30AM	Nov Philly Fed Business Index	7.6	8.0	9.7
8:30AM	Oct Core CPI mm, sa (%)	+0.1	0.2	0.1
8:30AM	Oct Core CPI yy, nsa (%)	+2.1	2.2	2.2
8:30AM	w/e Initial Jobless Claims (k)	235	250	254
8:30AM	w/e Continued jobless claims (ml)	1.977	2.020	2.041
10:36AM	Yellen Congressional Testimony			
Monday, Nov 21				
1:00PM	2-Yr Note Auction (bl)	26		
Tuesday, Nov 22				
10:00AM	Oct Existing home sales (ml)	5.60	5.43	5.47
1:00PM	5-Yr Note Auction (bl)	34		
Wednesday, Nov 23				
8:30AM	Oct Durable goods (%)	+4.8	1.5	-0.3
10:00AM	Oct New home sales-units mm (ml)	0.563	0.593	0.593
10:00AM	Nov U Mich Sentiment Final (ip)	93.8	91.6	91.6
11:30AM	7-Yr Note Auction (bl)	28		
Friday, Nov 25				
2:00PM	Thanksgiving Day			

Update: Buyer Broker Agreement

After requests from real estate companies, a nonprofit consumer watchdog group the Consumer Federation of America has developed a list of factors to consider when creating a buyer contract in preparation for upcoming practice changes in the industry.

CFA released its "Proposed Criteria for Evaluating Home Buyer Contract Forms" on Tuesday. The 15 criteria focus on the contracts' form — whether the documents are readable and understandable — and content — whether they are fair to homebuyers.

-the document's expiration date (CFA recommends buyers asks for a three-month contract and never sign one longer than six months)
-the right to terminate the contract
-the disclosure that compensation is negotiable
-the broker's compensation clearly stated and that the buyer broker can't receive additional compensation for facilitating a sale
-that any additional fees, such as for showing a home, will be deducted from the broker's commission if there is a successful sale
-that the commission is due only if there is a successful closing
-that buyers have an obligation — for no longer than 60 days, CFA recommends — to pay a broker who earlier showed them a home they purchased after the contract ended
-seller concessions paid directly to buyers
-dual agency not pre-approved by the contract
-an explanation of how a broker treats different buyer clients interested in the same property
-that buyers should not be required to first go through mediation or arbitration if they have a complaint

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