Mortgage Rates Explain Housing Weakness

***e*Research Corporation** is pleased to provide a weekly commentary, authored by Tom McClellan, entitled "The McClellan Chart-In-Focus", which is a free technical analysis article published each week.

In this article, Mr. McClellan explains why the U.S. housing market is weak.

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Bob Weir, CFA
Contributing Analyst

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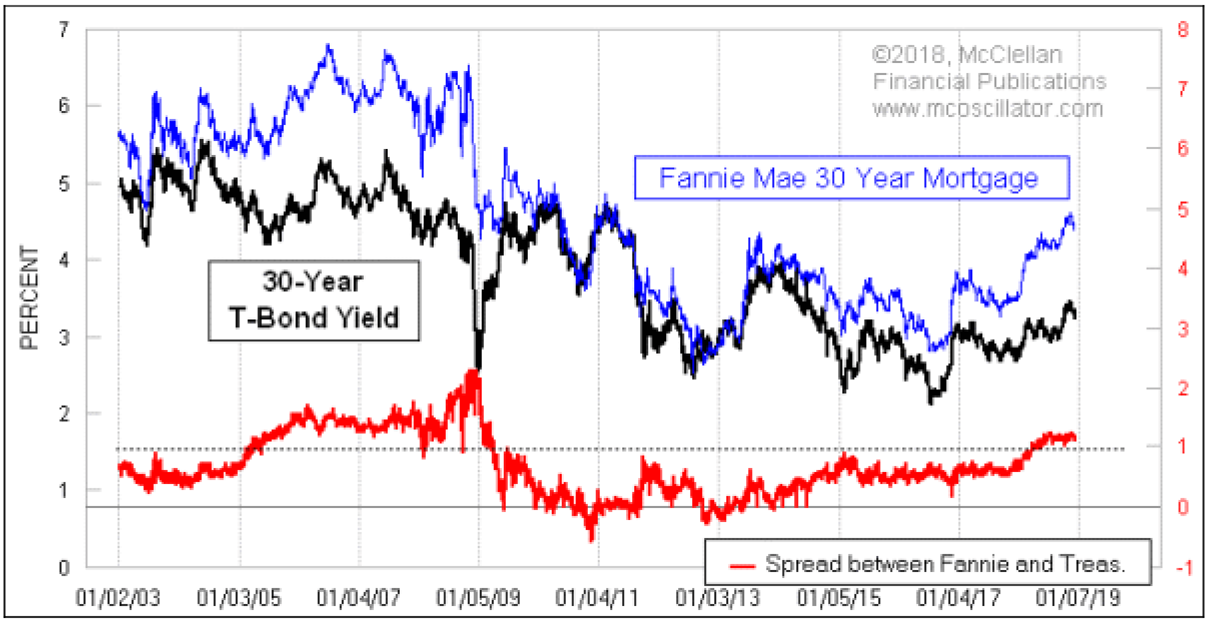
The McClellan Chart-In-Focus

by Tom McClellan (bio at end)

Mortgage Rates Explain Housing Weakness

Housing sector stocks have been among the worst performers in 2018, and analysts are pointing to many different reasons, including the newly imposed U.S. tariffs on Canadian softwood lumber. But an easier explanation arises when we look at interest rates.

Mortgage rates are not yet empirically "high". I bought my first house with a 13% mortgage, so rates that start with the number 4 still seem pretty low, at least to me and my ge-ge-generation. The key insight contained in this week's chart, below, is that mortgage rates are high compared to 30-year T-Bond rates. Both rates have been rising in 2018, and the 30-year mortgage rate has been more than a full percentage point above the 30-year T-Bond yield for most of 2018.



Most of us remember the "Housing Bubble" of the early 2000s, and we remember that the housing sector started getting into trouble beginning in 2005. That was when this spread between mortgage rates and T-Bond yields first rose above 1 percentage point. That seems to be the magic threshold. Keeping the spread under 1 point is stimulative to the housing prospects. Seeing it go over 1 point is when the pain comes.

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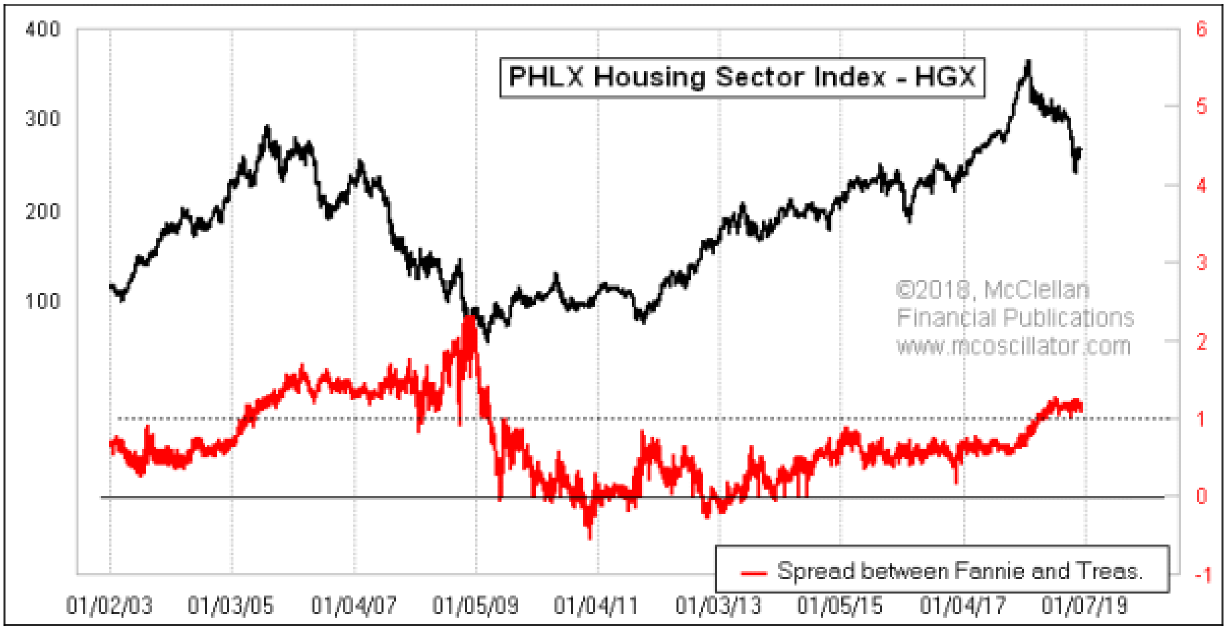
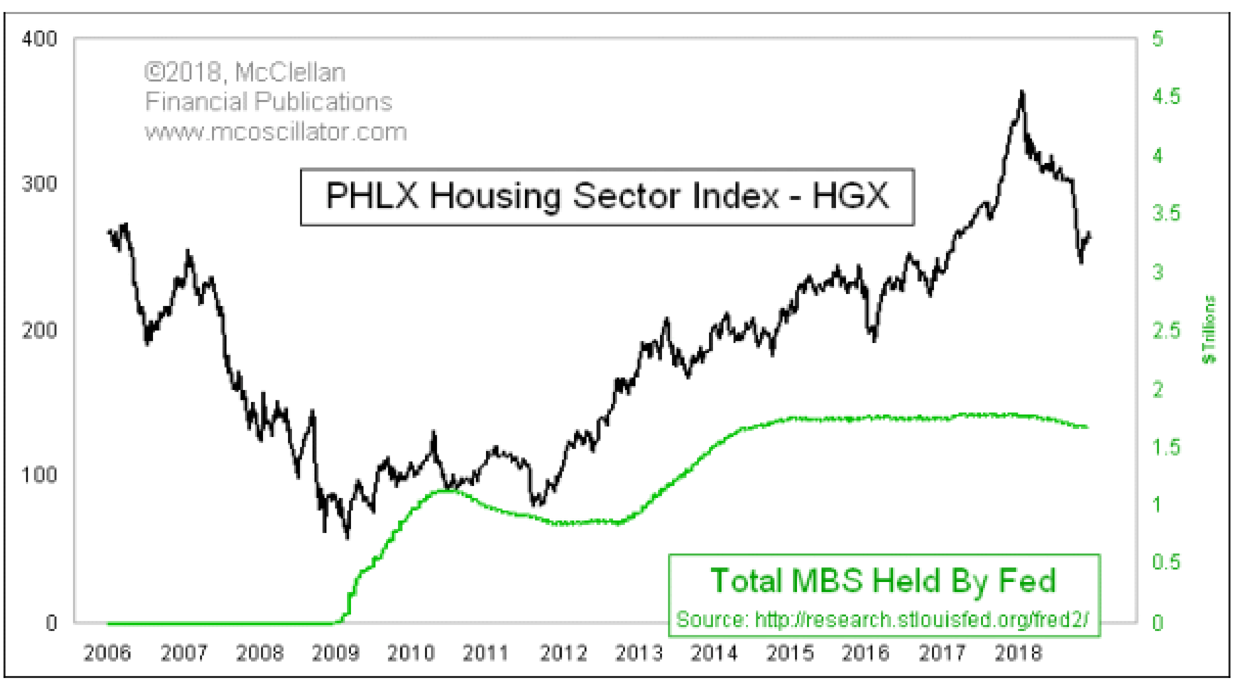
To see that point more specifically, here is that same spread between mortgage rates and 30-year Treasury yields, compared to the HGX Index:



This allows us to see that in both 2005 and 2018, the point when the spread went above 1 percentage point was the moment when the trouble started for the HGX. And the decline in the housing sector ended in 2009 once the spread finally dropped back below 1 point.

So why is this spread up above 1 point now? One partial answer is that a former buyer and holder of mortgage-backed securities (MBS) has now turned into a seller. The Federal Reserve started buying MBS notes in addition to T-Bonds and T-Notes as part of its quantitative easing (QE) programs. Now the Fed is paring its holdings, and has turned into a net seller of MBS. So the rest of the bond market has to take up that supply, and it is currently demanding a premium of greater than 1 point over Treasuries.



If the Fed panics and restarts QE in 2019, or if they even just halt the $50 billion per month rate of sales of Treasuries and MBS, then the housing sector could finally see some relief and start to find its footing again.

Tom McClellan, Editor,

The McClellan Market Report

BW: Information on Tom McClellan and *The McClellan Market Report* and *The Daily Edition* is provided below.

ABOUT THE AUTHOR

Tom McClellan

Tom McClellan has done extensive analytical spreadsheet development for the stock and commodities markets, including the synthesizing of the four-year Presidential Cycle Pattern. He has fine-tuned the rules for inter-relationships between financial markets to provide leading indications for important market and economic data.

Tom is a graduate of the U.S. Military Academy at West Point, where he studied aerospace engineering, and he served as an Army helicopter pilot for 11 years. He began his own study of market technical analysis while still in the Army, and discovered ways to expand the use of certain indicators to forecast future market turning points.

Tom views the movements of prices in the financial market through the eyes of an engineer, which allows him to focus on what the data really say rather than interpreting events according to the same "conventional wisdom" used by other analysts.

In 1993, he left the Army to join his father in pursuing a new career doing this type of analysis. Tom and his Father spent the next two years refining their analysis techniques and laying groundwork.

In April 1995 they launched their newsletter, The McClellan Market Report, an 8-page report covering the stock, bond, and gold markets, which is published twice a month. They utilize the unique indicators they have developed to present their view of the market's structure as well as their forecasts for future trend direction and the timing of turning points.

A Daily Edition was added in February 1998 to give subscribers daily updates on their indicators and also provide market position indications for stocks, bonds, and gold. Their subscribers range from individual investors to professional fund managers. Tom serves as editor of both publications, and runs the newsletter business from its location in Lakewood, WA.

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