

## News or Noise: Housing Starts Surge, Yellen Speaks, and Japan Grows

By David Fisher, Chief Investment Officer

Last week was a week made up of lots of little stories. Nothing jumps out as creating an inflection point for the markets or global economies—thus, by our definition, nothing was newsworthy. However, we did note several interesting tidbits that confirm a few of our themes. Economic data was mixed but generally showed a move toward global synchronization, with the U.S. getting back on its feet after a harsh winter and international economies improving.

We also noted some unique activity in China with a few highly speculative stocks. *The Financial Times* reports that “since Wednesday, more than \$30bn has been wiped from the combined market capitalisations of Hanergy Thin Film, and two listed units of Goldin Group.”<sup>1</sup> Though not everyday corporate identities for U.S. investors, the companies are relatively large—and favorites of retail investors in China. It is too soon to know if these are early tremors of an issue to be more concerned with, but we are watching.

The theme of income inequality is also on our mind. A new law in Los Angeles would raise minimum wages to \$15 per hour by 2020. Warren Buffett opined in Friday’s *Wall Street Journal* that such proposals would “distort our market system,” adding that “any plan to sizably increase the minimum wage ... would almost certainly reduce employment in a major way.”<sup>2</sup>

The two stories above are interesting but are just worth pondering. The stories we want to address in more detail all touch on market and economic information from last week.

### No. 1: Good Data from Housing

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One of the major economic data points last week was a solid figure for new home starts. With poor weather in the first quarter, most analysts were expecting a solid bounce—and they were proven



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correct. For the month, housing starts surged more than 20% and ended at a level not seen since November 2007. The gains were broad-based by geography and property type, but the extra-large bounce in poor-weather regions of the Northeast and Midwest shows that a lot of the move was to make up for bad weather. Setting aside the weather, the data shows real ongoing strength, and this should help the economy as we go through the summer.

The annualized rate of starts was 1.135 million. Though not yet back to historic replacement/population growth (around 1.5 million), starts are trending in that direction. In the first four months of this year, housing starts are running 5.5% ahead of the same period last year. Notably, single-family starts are a solid 7.6% ahead. That second figure is especially important, as the economic impact of single-family starts is three times that of a multi-family start.

New applications for building permits also rose 10.1%, which provides decent visibility into future trends. As an additional indicator of housing strength, Home Depot posted solid earnings last week, with both revenue and profits beating expectations. Same-store sales for Home Depot grew 7.1% in the U.S., which is a very solid figure.

We continue to think that housing is slowly improving to normal levels, helping the economy along the way. Last week's information does not provide any news that would question that view.

## No. 2: Rate Hike off the Table for June

News

Noise

It was an active week for the Federal Reserve with the release of last month's meeting minutes and a major speech by Fed Chair Janet Yellen on Friday. The April minutes provided relatively clear guidance that a June rate hike is unlikely. That said, the minutes leave open, and Yellen reiterated on Friday, that the Fed fully expects rates to rise "this year."

As data has continued to show growth struggling over the past few months, several economists have pushed back their expectations for liftoff coming in December or even next year. But with the comments on Friday, we continue to believe that the September timing remains the most likely.

The biggest challenge for the Fed remains the messaging of a rate hike to minimize the risk of market volatility. To that point, Yellen continued to state that the path of future rate hikes would likely be modest and that it would take "several years" for rates to get back to historically normal levels. In all cases, the Fed has made clear that rate hikes would remain a data dependent decision and that action would be based on "meeting-to-meeting" review.

Former Fed governor Donald Kohn (now with the consulting company Potomac Research Group) discussed the minutes during a conference call last week. He believes that the two primary conditions for the Fed to act—employment conditions and inflation expectations—will be in place by September and that the Fed would rather act before the presidential election cycle fully heats up. He also believes that consensus views that Yellen is overly dovish are misinterpreted. He believes she works hard to build a consensus on the Fed. The overwhelming theme of the statement and minutes from the April meeting was the word *transitory*—one can infer that the Federal Reserve is trying to make the point that liftoff is desired by the majority of members this year.

The market did move on these two stories. Two-year Treasury rates pushed higher by 7 bps (0.54 to 0.61) on the week and the dollar strengthened by more than 1%—evidence that investors had increased the odds of an early start than they had a week ago.

## No. 3: Japanese GDP Solid, but Is It Sustainable?

News

Noise

Japan posted solid growth in gross domestic product (GDP) for the most recent quarter—up an annualized 2.4%. The data somewhat overstates the underlying trend growth, as a significant component was inventory increase. But residential and business investment and consumer spending were all reasonably strong, providing confirmation that forward growth is likely. Also, the inventory build provides a hopeful sign that companies are relatively confident in the outlook.

Of course, the Japanese economy has had many false starts over the last few decades. The wage growth figures remain weak, and without growth in pay, consumer spending can't be maintained. Additionally, total consumer spending levels remain below where they were in late 2013 before the most recent VAT increase. But our research providers have continued to get more comfortable with the idea that a long-term shift in Japan could be underway. Corporate fundamentals are improving, Western-style shareholder positive actions are increasing and the environment for structural reform is getting more fertile. Though many economists continue to express caution that the pace of growth is not running higher, the world is starting to realize that Japan may actually be turning the corner.

### Sources

1. Josh Noble, et al., “ETFs Endure Goldin-Hanergy Rollercoaster,” *The Financial Times*, May 26, 2015
2. Warren Buffett, “Better Than Raising the Minimum Wage,” *The Wall Street Journal*, May 22, 2015.

#### **What Is News or Noise?**

*Like most of you, we are inundated with information on our phones, in our email inboxes and on the Internet. Clearly, the world doesn't need another investing blog to reprocess stale information or reformat the day's useless headlines. Thus, in our investment blog, “News or Noise,” we've taken up the challenge of sorting through the infinite bits of background noise and seeking the few truly newsworthy nuggets of information. What are the stories today that are likely to be meaningful for investors in the future? A very small number of headlines are important, and of those, many are immediately processed by investors. Only a tiny fraction of all the new data is truly relevant and underappreciated.*

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