Capital
INVESTMENT SERVICES
of America, Inc.

# Market Commentary

September, 2013

# No Fed Tapering – Yet!

On September 18th the Federal Reserve surprised most investors by announcing it had decided not to taper the amount of their monthly bond purchases. Before the announcement, most economists and analysts expected the monthly purchase rate to be lowered by $10 to $15 billion. This expectation was based upon the interpretation of prior Fed comments suggesting tapering would be data dependent. This surprise announcement has many investors asking why they did not taper and when will they start tapering.

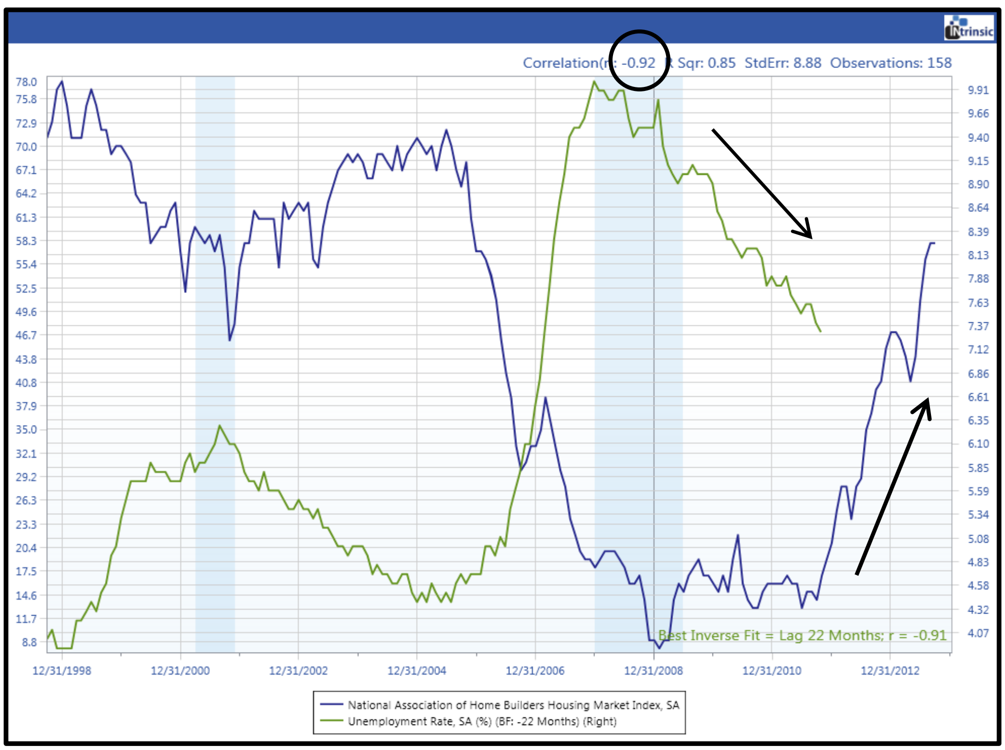
As an investor, the question of *when* tapering begins is of greater importance. One leading indicator that suggests that the Fed will revisit the tapering question again relatively soon is the Housing Market Index (HMI).

Each month the National Association of Home Builders conducts a survey of builders and asks them about the current rate and the expected rate of sales for single-family homes for the next six months. In addition, builders are asked to rate the traffic of prospective buyers. Scores for each component are used to calculate an overall index known as the Housing Market Index (HMI).

Historically, this HMI has been a strong leading indicator for the unemployment rate, consumer confidence, and interest rates.

## Lower Unemployment Rate

This chart shows the HMI (blue line) compared to the unemployment rate (green line) over the last 15 years. When the HMI is advanced 22 months, it demonstrates a 92 percent *negative* correlation to the unemployment rate. In other words, improvements in the HMI over the last 22 months suggest that the unemployment rate will continue to decline.




This is important because the Fed has been on the record stating its desire to see improving employment conditions as prerequisite to start tapering.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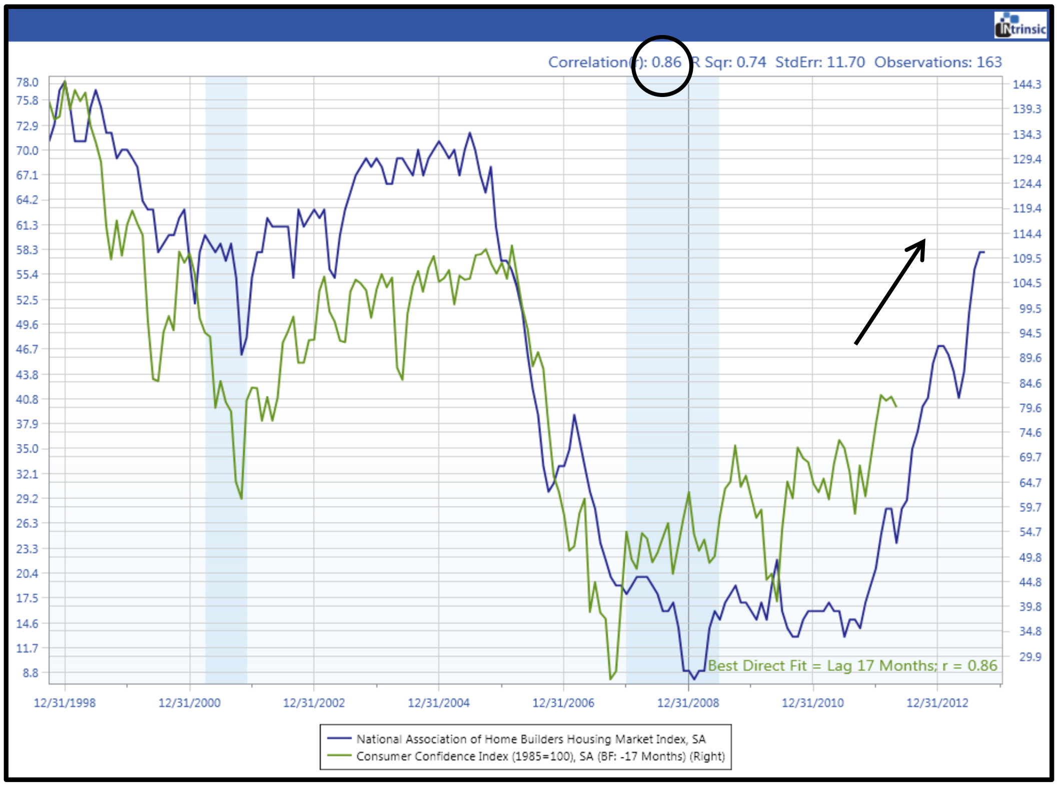
## Higher Consumer Confidence

On the chart to the right, the HMI (blue line) is presented versus the consumer confidence index. In this case, when the HMI is advanced 17 months there has been an 86% positive correlation over the last 15 years. The pickup in the HMI over the last 17 months suggests consumer confidence will continue to rise. Rising consumer confidence will also lend support for the Fed to begin tapering.





## Higher Interest Rates

Not surprisingly, an improving HMI index has also pointed to a rise in the 10-Year Treasury interest rate. Presented in the chart to the left are the HMI (blue line) and the 10-Year Treasury rate (green line), both since 1998. Advancing the HMI by 21 months results in an 86% *positive* correlation over this period. Therefore, the rebound in the HMI off its bottom in late 2011 suggests the 10-Year Treasury rate will trend higher over that next 21 months.

If the historical relationships between the HMI and the unemployment rate, consumer confidence, and 10-Year Treasury rate continue to hold, it is likely the Fed will need to seriously consider tapering bond purchases soon.

## Further Stock Gains

We believe improving unemployment, consumer confidence, and higher 10-Year Treasury rates will not only convince the Fed to start tapering but it also translates into increasing investor confidence and likewise higher stock valuations. Higher valuations and continued earnings growth should drive further stock market gains.

We remain focused on understanding the current trends in fundamentals because it gives us the best probability for success.

*For more information on this or any other topic of interest, feel free to contact us*