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Housing Surge and Yellen Set for September

Friday, 9:20a EDT

A lot of news is buffeting the market, most of it good. The government just reported that housing starts rose to a greater than expected 1174 units. But what really surprised on the upside was housing permits – and indicator that often leads housing starts. Permits jumped to an eye-popping 1.343 units and are now up a whopping 30% over the last three months, one of the largest 3-month increases ever. If starts begin to match permits, this will indeed provide a good boost to the economy going forward.

Also reported was the consumer price index, which hit expectations on both the headline and core increases of 0.3% and 0.2% respectively. This brought the year over year numbers to 0.1% and 1.8%. Although the latter is close to the Fed target of 2%, the Fed bases its inflation monitoring on the PCE deflator, which usually runs about one-quarter to one-half percentage point below the CPI. Indeed the year-over-year core PCE deflator is up only 1.2% (this won't include June data until the end of the month.) There is much talk that world inflation has turned upward after the deflationary scares of earlier this year, making it far more likely that the Fed will raise rates. However, much of the recent rise in inflation is due to the bounce back of oil prices, which although they are narrowly excluded from core inflation, do creep into that statistic since energy in some form is involved in the production of virtually all goods and services.

Nevertheless, Yellen's testimony before Congress did seem to point to a September increase, which remains my prediction. At this point I believe there would have to be unexpected weak data (with respect to both inflation and real output) over the next two months to cause the Fed to defer. With Greece apparently out of the way, there is a low (but not impossible) probability that some crises will cause the Fed to defer. And unless oil prices fall significantly or real production turns downward (neither seems likely now) the stage is set for a rate increase. The event that the world has anticipated for almost two years will finally happen, and the world won't end. I can see the ten year at 3% by the year-end, but not much higher. And stocks could see a 5% to 10% rally from current levels.

Stocks are now within 1% of their all-time highs, with the Nasdaq index yesterday surpassing its June all-time high. With Google's great results yesterday (trading up 13% in the pre-market) today might reach another record high for the broader indexes.

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