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- ➔ **Housing rises:** One sector poised to benefit from a stronger U.S. economy is housing. Demand should remain strong this year as a solid job market and rising wages continue to support the industry. Longer-term, data suggest there are not nearly enough homes to meet the demand of the millennial generation. Homebuilders do face challenges, however. Profitability has been squeezed, and a clampdown on undocumented workers could aggravate the problem.
- ➔ **Markets in Review:** Last week equities were mixed, with the S&P 500 ceding 0.4% and international equities, as represented by the MSCI EAFE Index, up 0.4%. Bond prices fell on the week, with the 10-year Treasury yield at 2.57% Friday, up from 2.48% the prior week. Commodities overall, as measured by the Bloomberg Commodity Index, fell 3.3% last week, with WTI crude shedding 9.1% to \$48.50 a barrel and gold falling 2.4% to \$1,204.70 per ounce.
- ➔ **Looking Ahead:** In the U.S, attention this week will be focused on the data and comments forthcoming from the Federal Open Market Committee (FOMC). While a rate hike is all but assured, market participants will be searching for indications of the path going forward. In Europe, the Bank of England will meet to set policy rates for the United Kingdom. (For more see page 3.)

Housing rises



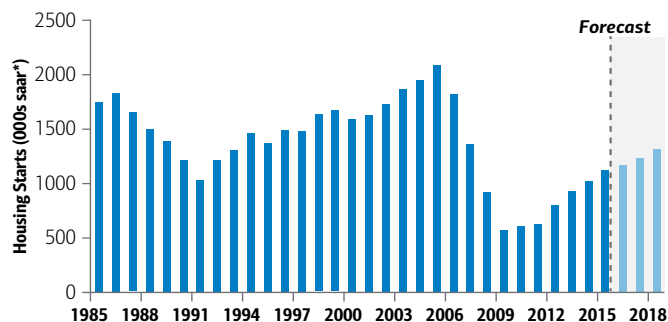
We've seen an upward ticking of economic indicators, from consumer sentiment to investor and business outlooks, and one sector poised to benefit from a stronger U.S. economy is housing.

The housing market has been slowly coming back since 2008 in accordance with the broader economic recovery. Between 2006 and 2007 housing prices peaked as they began to outpace Americans' income levels. As they rose, the rate of foreclosures in the U.S. also began to climb as the increase in interest rates made it increasingly difficult for homeowners to pay their mortgages. The U.S. housing market ushered in a recession as crisis in the mortgage and credit markets continued, and by 2008 the Case-Shiller Home Price Index suffered its largest drop in history.

Lagging rather than leading the cycle

The U.S. housing market is cyclical, meaning it moves in tandem with the business cycle, and it's usually a leader in the cycle. However, while it played that role in 2008 as one cause of the recession, this time it's lagging the business cycle. In recent months the U.S. economy has improved as employment levels have moved higher, with data suggesting we are reaching full employment. Wage growth has continued and should help bolster consumer spending. It was not until late in 2016 and early this year, however, that we have finally started to see the U.S. housing market make a bumpy recovery.

Exhibit 1: The homebuilding recovery is projected to continue



Source: BofA Merrill Lynch Global Research, U.S. Census Bureau. Data as of March 6, 2017. (*seasonally adjusted annual rate)

Although new and existing home sales declined in December, this year has started off strongly, with housing starts and building permits both up. In January single-family starts rebounded 1.9% from the previous month. The National Association of Homebuilder's sentiment index reached a cyclical high of 70 in December—a level not seen since 2005. Even more recently, existing U.S. home sales climbed higher than forecasts as sales of previously owned homes climbed for the fifth time in six months to the highest levels since 2007.

Housing demand should remain strong in 2017 as a solid job market and increased wages continue to support the industry. BofA Merrill Lynch (BofAML) Global Research expects the

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S&P Case-Shiller home prices to increase 4.2% in 2017 and 3.0% in 2018. It sees sales of new homes rising from 625,000 to 675,000 in those years and sales of existing homes from 5,525,000 to 5,600,000. It also projects orders at publicly held homebuilders to grow 8% in 2017, and continue rebounding into 2018 (see Exhibit 1).

Table 1: BofAML Global Research housing forecasts

	Annual Average	
	2017	2018
S&P Case-Shiller prices (% change, yoy)	4.2	3.0
Existing home sales (000s, saar)	5,525	5,600
New home sales (000s, saar)	625	675

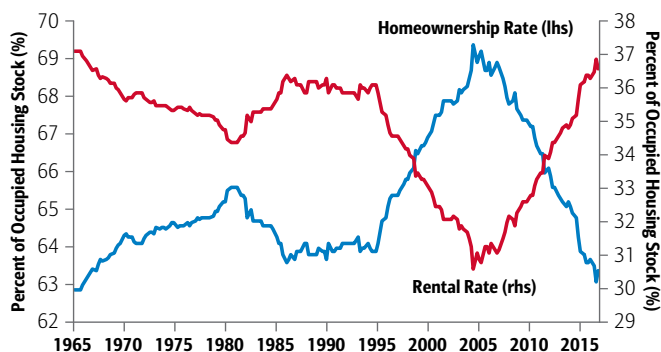
Source: BofAML Global Research, U.S. Census Bureau, National Association of Realtors, S&P Case-Shiller. (S&P Case Shiller prices are annual average, 4Q/4Q.)

Longer-term, millennials should drive demand

Demographics are an important consideration too. For the past decade, many of the millennials not living in their parents' house have been renting apartments, driving an increased demand in that segment of the home market. Four out of five people under age 25 who live independently choose to rent, while about 66% of those 25 to 29 do so and more than 50% of people in their early 30s. Millennials have not been moving as much as members of earlier generations at the same stage of life, and when they do, more of them rent than buy, according to a survey by the Pew Research Center.

Today, rental rates for households headed by people 30 to 64 are the highest in three decades, though we expect to see a shift in the coming years. While the number of renter households is likely to increase to between 4 million and 4.7 million by 2023 as millennials move toward their peak spending years, we expect them to gradually become homeowners. Going forward, we expect a reversal driven by millennials in the housing trends that have dominated the marketplace for the last 10 years, including the rise in the rental rate and decline in the homeownership rate (see Exhibit 2).

Exhibit 2: Millennials have driven up the rental rate



Source: BofA Merrill Lynch Global Research, U.S. Census Bureau. Data as of March 6, 2017.

According to the U.S. Bureau of Labor Statistics, the millennial cohort now averages 27 years old. The Bureau states that housing consumption increases dramatically between the ages of 25 and 45, and we expect this generation to drive demand. Data suggest there are not nearly enough homes available to meet the demand of the millennial generation.

Baby boomers are also contributing to the housing market by either staying in their homes longer, boosting spending on renovations and improvements, or by becoming renters. According to the Joint Center for Housing Studies at Harvard University, between 2001 and 2011, 24% of households headed by people over 70 have made the transition from owning to renting.

There are still risks

Homebuilders do face challenges as profitability has been squeezed over the past year. As inflation ticks up, their costs will continue to rise, weighing on profitability. Additionally, as we move toward full employment, the labor market has tightened, leading to higher wages. A clampdown on undocumented workers could also present a risk for builders. According to BofAML Global Research, they account for 5% of the total work force in the U.S., but about 12.7% in construction, and many of them have left the country during the recession and not returned. Immigration reforms could result in a labor shortage that drives up costs by 10% in 2017. Given that labor costs represent roughly 25% of the sale price of a home, this headwind could weigh on affordability. An increase in interest rates could also reduce the affordability of purchased homes and therefore demand for them.

Portfolio Considerations: BofAML Global Research indicates that existing home sales data reveal a lack of housing supply relative to demand. The need for inventory should underpin single-family home construction and support home builders. Construction companies stand to gain as well from the home improvement and renovation segment.

Increasing availability of mortgage credit should be a tailwind for the housing market: As the loose lending standards of the early- and mid-2000s were abruptly tightened in the wake of the financial crisis, households with lower credit ratings could not get an affordable mortgage. This situation has been gradually changing since early in the decade, however, and policy proposals from President Trump suggest that we may have a loosened regulatory environment that could lead to even greater flows of credit. Banks should benefit as demand for home loans continues to grow. We have already seen mortgage applications pick up after the election and hold steady into 2017.

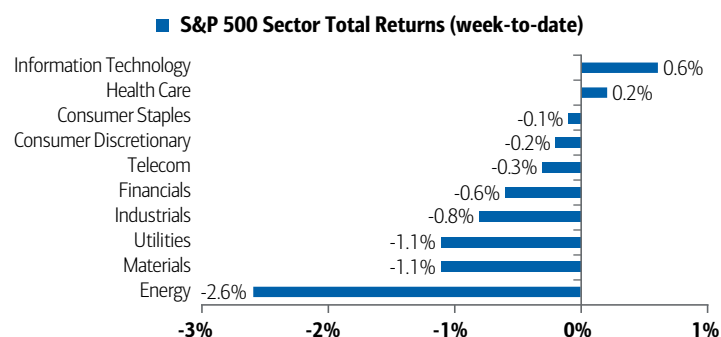
In addition, increasing demand for home owner's insurance should bolster insurance companies.

Markets in Review

Trailing Economic Releases

- The U.S. Bureau of Labor Statistics released its February nonfarm payrolls report, which registered gains of 238,000 jobs, surpassing the consensus estimate of 200,000 and January's addition of 227,000.
- The Bureau of Labor Statistics also reported 0.2% month-over-month growth in average hourly earnings in February. The rise follows one in January of 0.2%. Wages have been increasing in the U.S., helping bolster consumers and the economy more broadly.
- In the Eurozone, the European Central Bank kept rates stable while offering commentary perceived by many to be optimistic, especially as it pertained to a reduced likelihood of downside risks materializing.

S&P 500 Sector Returns (as of last Friday's market close)



Equities

	Level	Total Return in USD (%)		
		WTD	MTD	YTD
DJIA	20,903.0	-0.4	0.5	6.4
NASDAQ	5,861.7	-0.1	0.7	9.1
S&P 500	2,372.6	-0.4	0.4	6.4
S&P 400 Mid Cap	1,710.9	-1.6	-1.0	3.3
Russell 2000	1,365.3	-2.0	-1.5	0.8
MSCI World	1,845.9	-0.1	0.5	5.7
MSCI EAFE	1,763.9	0.4	0.7	5.1
MSCI Emerging Mkts	926.1	-0.5	-1.0	7.6

Fixed Income

	Yield (%)	Total Return in USD (%)		
		WTD	MTD	YTD
ML US Broad Market	2.71	-0.5	-1.2	-0.3
ML 10-Year US Treasury	2.57	-0.5	-1.6	-0.7
ML US Muni Master	2.62	-0.2	-0.8	0.4
ML US IG Corp Master	3.48	-0.8	-1.4	0.1
ML US HY Corp Master	6.02	-1.2	-1.2	1.7

Commodities & Currencies

	Level	Total Return in USD (%)		
		WTD	MTD	YTD
Bloomberg Commodity	170.6	-3.3	-3.9	-3.6
WTI Crude \$/Barrel ¹	48.5	-9.1	-10.2	-9.7
Gold Spot \$/Ounce ¹	1,204.7	-2.4	-3.5	4.6

Level	Current	Prior Week End	Prior Month End	2016 Year End
EUR/USD	1.07	1.06	1.05	1.05
USD/JPY	114.79	114.04	116.96	116.96

Source: Bloomberg.¹ Spot price returns. All data as of last Friday's close. Past performance is no guarantee of future results.

Looking Ahead

Upcoming Economic Releases

- On Wednesday, the Federal Open Market Committee will conclude its March meeting. Markets overwhelmingly anticipate a hike of 0.25% in the Federal Funds rate. With employment and inflation data having picked up, and voting members acknowledging as much in recent statements, investors look forward to comments from Chairwoman Janet Yellen and the Summary of Economic Projections to indicate the future pace of tightening.
- Also on Wednesday, the U.S. Bureau of Labor Statistics will release February's core Consumer Price Index (CPI), which excludes food and energy. BofAML Global Research estimates a 0.2% increase month-over-month after a January rise of 0.3%. Consumer inflation has maintained its uptrend into 2017.
- On Thursday, the Bank of England's Monetary Policy Committee is expected to keep its benchmark interest rate level at 0.3%. With the proceeding of Brexit prompting uncertainty, the U.K. central bank is expected to remain accommodative for the foreseeable future.

BofA Merrill Lynch Global Research Key Year-End Forecasts

S&P 500 Outlook	2017 E
Target	2,450
EPS	\$129.00
Real Gross Domestic Product	2017 E
Global	3.5%
U.S.	2.1%
Euro Area	1.5%
Emerging Markets	4.6%
U.S. Interest Rates	2017 E
Fed Funds (eop)	1.38%
10-Year T-Note (eop)	2.85%
Commodities	2017 E
Gold (\$/oz-period average)	\$1,286
WTI Crude Oil (\$/bbl-eop)	\$59.00

All data as of last Friday's close.

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