



We Don't See No Stinkin' Bubbles!

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**by Brian S. Wesbury and Robert Stein
of First Trust Advisors**

Now that we're eight years into a bull market, some investors just assume something has to go wrong. As a result, we see lots of stories and get lots of questions about "bubbles," as in "what market or sector is in a bubble already?"

Auto sales have been declining lately. In eight of the last nine months (we have data through April), US sales of cars and light trucks have been lower than the same month in the prior year. So some claim the auto sector must be a bubble that's bursting. But the real story is much more benign.

Fundamentals, like driving-age population growth and scrappage rates suggest autos should sell at about a 15.5 million annual rate. Sales were below that level in 2008-12 (five straight years!). Part of that problem was due to the recession in 2008-09. But sales were unusually slow in 2010-12 and we see the above-trend pace of sales in 2014-16 as "catch up."

Now we expect sales to gradually slow back down to a 15.5 million pace. That's not a bubble bursting, though. It's just the end of the catch up period. Consumers will just buy other items instead.

Others claim home prices are getting frothy. But using a price-to-rent ratio, national average prices are very close to the long-term norm relative to rents. (We use asset values generated by the Federal Reserve and rent prices generated by the Commerce Department's GDP statisticians.) Regardless, home builders need to pick up the pace of construction or home prices and rents will accelerate.

Yes, household debts are at a new record high. But household debts relative to assets are at one of the lowest points since 1990.

Is there a bubble in student loans? We think many students are paying too much for college whether they're paying for it with loans or up front. So, yes, in a sense that's a bubble, but it's one directly caused by government policy which will saddle some students with debts they have trouble repaying and taxpayers with larger budget deficits. But since so much of it runs through federal lending, defaults aren't going to bring down the financial system.

Are stocks broadly overvalued? Not even close. Our capitalized profits model, which uses economy-wide profits, suggests the bull market has further to run even if interest rates move up substantially. In December, we forecast the S&P would hit 2,700 by year-end 2017. A roughly 21% gain for 2017 seemed ambitious to many investors back then. But, as of Friday's close, we're less than 12% away. (Link to Dec 27 MMO)

Eight years into the bull market in stocks, the only plausible bubble we see is that bonds are still too pricey. For all the talk of bubbles, they just don't seem to exist.

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