

Week of January 21, 2008

Market Comment

Last week was a maelstrom— particularly if you are a shareholder in any of America's public corporations. Stocks sold off in a flurry unseen since late 2001 because of heightened recessionary concerns that caused Federal Reserve Chairman Ben Bernanke and President Bush to propose an economic-stimulus package. The package, subject to revision, is expected to include \$800 rebates for individuals and \$1,600 for households, as well as tax breaks to encourage business investment.

Housing was a leading factor in heightening concerns. On that front, builders broke ground on 14% fewer houses than forecast, dropping to an annual rate of 1.006 million units in December, the lowest since 1991. Meanwhile, building permits declined by the most in 12 years, suggesting the slump is

unlikely to improve as it enters a third year.

The continuing subprime mortgage saga played a supporting role as well. Citigroup, JP Morgan, and Merrill Lynch all reported multi-billion dollar write-downs related to their subprime mortgage portfolios, causing their share price to sink to levels unseen since the turn of the century.

The good news is that mortgage rates continue to improve. Fixed-rate home mortgages fell again last week, according to Freddie Mac's survey. The national average interest rate on the benchmark 30-year, fixed-rate loan averaged 5.69%, down from 5.87% a week ago and 6.23% a year ago. Meanwhile, the 15-year fixed-rate loan averaged 5.21%, down from 5.43% a week ago and 5.98% a year ago. Both the 30- and 15-year fixed-rate mortgages are at their lowest levels since July 2005. What's more, rates are likely to remain low into the foreseeable future as inflation fears continue to abate.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
State Street Investor Confidence	Tues. Jan. 22, 10:00 am, et	65 Index	Moderately Important. Investors will show less confidence on subprime mortgage and recession concerns.
Mortgage Applications	Wed. Jan. 23, 7:00 am, et	None	Important. Refinance and purchase activity continue to rise on lower rates and lower home prices.
Existing Home Sales (December)	Thurs. Jan. 24, 10:00 am, et	4.97 Million (Annualized)	Important. Sales are expected to hit a multi-year low, but lower rates and lower home prices could suggest a bottom is near.

A Better Interpretation

Housing was on everyone's mind last week: New housing starts hit a multi-decade low at the same time many homebuilders reported record losses. Less salient commentators presage more doom-and-gloom, opining that homebuilders are facing an unmitigated disaster.

They're not. What's occurring in the housing market is a basic market-economics phenomenon. Homebuilders are cutting production and lowering prices. The result is a drop in the median home price. These lower prices, in turn, move more inventory, which, in turn, spurs a recovery. Homebuilders are simply experiencing a period of re-equilibrium that lower

prices and reduced supply will eventually mitigate.

The same phenomenon is occurring in the mortgage markets. Mortgage rates are falling, which will increase demand, while supply is contracting, which will help with re-equilibrium. The result is that mortgage demand has been trending higher while rates have been trending lower, according to recent Mortgage Bankers Association data.

Re-equilibrium isn't a painless process, to be sure. We are not going to earn as much money per home sale as we did in the recent past anytime soon, but lower prices – both in financing and physical property – will do more to stimulate an eventual recovery than any interventionist package the government can devise.

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