

Market Comment

Predicting the bottom of the real estate slump has been as frustrating as predicting the weather. Last week was no different, as sales of both existing and new homes tumbled through most analysts' predications.

Indeed, previously owned home sales fell in August to an annual rate of 5.5 million, the lowest in five years, while new-home sales declined 8.3% to an annual pace of 795,000, a level unseen in seven years. Adding insult to injury, the median new-home price dropped 7.5% from August 2006 to post the biggest plunge since 1970.

Despite housings' seemingly endless fall, a slowing economy doesn't appear to be in the cards, at least for the relevant future. The economy grew in the second quarter at a revised 3.8% annual pace, the most in more than a year. The gain compares favorably to the 0.6% increase posted in first three months of the year.

Surprisingly, housing woes have yet to dim consumer optimism (which is a good thing). In fact, consumer spending rose 0.6% in August. The increase was the largest in four months and followed a 0.4% increase in July, suggesting consumers still expect better days ahead.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
Institute of Supply Management (ISM) Index (September)	Mon. Oct. 1, 10:00 am, et	53 Index	Important. Sub-indexes within the report are expected to show low inflation in the manufacturing sector.
Pending Home Sales (August)	Tues. Oct. 2, 10:00 am, et	1.0% (Increase)	Important. Sales are expected to show slight improvement after July's large drop.
MBA Mortgage Applications	Wed. Oct. 3, 7:00 am, et	None	Important. Rising long-term rates are slowing refinance and purchase activity.
Employment Situation (September)	Fri. Oct. 5, 8:30 am, et	Unemployment Rate: 4.7% Hourly Wages: 0.3% (Increase)	Very Important. Higher unemployment and low wage growth could portend lower interest rates.
Consumer Credit (August)	Fri. Oct. 5, 3:00 pm, et	\$8.2 Billion (Increase)	Moderately Important. The expected increase is within historical ranges and should have little impact on interest rates.

A Call to ARMs

The Federal Reserve's recent fed-funds rate cut is positively impacting the yield curve, which is once again normal (short-term rates are lower than long-term rates). A normal yield curve is desired; it is the most conducive environment for profitable lending, since most lenders borrow short and lend long.

Normalization of the yield curve is readily reflected in recent mortgage prices. Last week, rates rose on long-term fixed-rate mortgages, while they fell on the short-term adjustable-rate variety, with the 30-year fixed-rate mortgage rising nine basis points to 6.42% and the one-year Treasury-indexed adjustable-rate mortgage falling five basis points to 5.60%, according to Freddie Mac's weekly survey.

The widening yawn means ARMs are becoming more attractive relative to fixed-rate mortgages. But the share of mortgage applications for ARMs continues trending down (thanks in no small part to negative press), and two weeks ago reached the lowest level since March 2003, according to the Mortgage Bankers Association.

Admittedly, borrowers are about as open to ARMs as MoveOn.org is open to George W. Bush. That's unfortunate; hysteria and finger-pointing are overriding sound economics. A recent Business Week article titled "Surprise: 'Toxic' Mortgages Are the Best" (which can be found at businessweek.com) explicates – in thought-provoking logic – why ARMs can be appropriate (indeed, advantageous) financing instruments for disciplined borrowers.

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