



August 4, 2006 – Is Housing Headed for a Soft Landing?

Why is this such an important question for investors? Some data:

- Since 2001, about 40% of the U.S. economy's growth is due to the increase in construction activity.
- Nearly two thirds of U.S. job growth since '01 is attributed to the housing boom.
- Almost one half of the U.S. banking systems assets are in mortgage loans. The largest amount in 60 years.

As housing goes – so goes the economy? Maybe. The rising role of housing to our economy should not be ignored. With 20 straight months of interest rate hikes by the Fed (the largest percentage increase over any two year period in the last 35 years) housing affordability has come under pressure. The rising cost of borrowing has historically had a negative affect on new housing starts and in housing related industries. The rate increases could be a cause for a sharp drop off in economic activity – as has been the case in recent economic history.

How bad could it get? The three major housing declines since 1970 give us a historical perspective. On average, from peak to trough, the three real estate recessions produced an average decline in new housing starts of 51%. The duration of the down cycle has been 26-55 months. The statistical top of the current housing boom was October, 2005. Since the peak, new housing starts are down 14.4% and we are 9 months into the downturn. According to John Burns of Real Estate Consulting, the current correction has been swifter than any of the prior three. The extent of this correction would be considered "soft" if it stopped now, but as Mr. Burns puts it: "We don't seem to have landed yet."

The landing will most likely vary by market. Job losses in the Midwest are a problem. Expected job growth is the #1 predictor of future home values in a particular area. Michigan lost 17,000 jobs in 2005, one of only two non-hurricane hit states to lose jobs for the year. Back in July 2004, I had an opportunity to speak with Harry Dent, one of the leading demographic researchers in the country. Based on the job issues facing Michigan and the reality of Baby Boomers moving out of the "rust belt", he predicted a 40%-60% reduction in state home values over the next 8-10 years. With higher priced homes (over \$400,000) being hardest hit. Mr. Dent's advice, "If you are going to sell your home in Michigan, do it now."

What will the current U.S. housing slowdown mean for investors? Only time will tell. We do know a significant portion of the economy is dependent on the housing sector and a hard landing would most likely not be good for the stock market or economy.

Have a great day,

Dave

Housing Data provided by Doug Kass of Seabreeze Partners L.P., John Burns of Real Estate Consulting, Inc. and Investors Business Daily

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