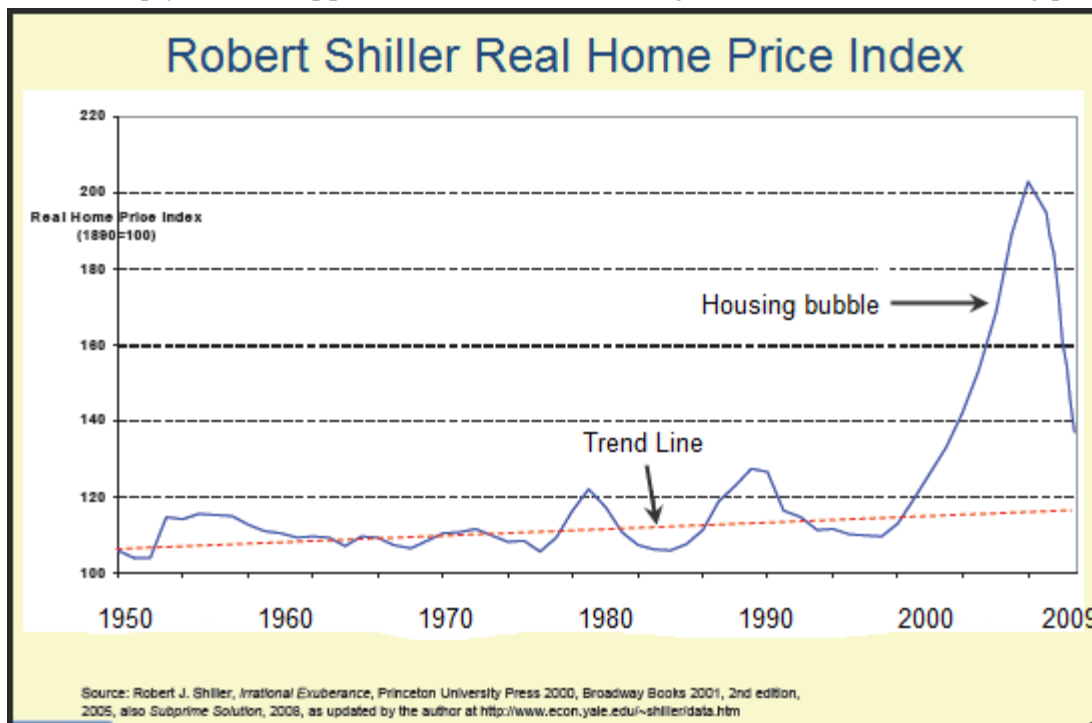


June 23, 2009 – Has Housing Bottomed?

U.S. housing is the straw that stirs the drink of the global economy. Yes, I did mean global, as financial institutions around the globe hold our toxic mortgages. It will be difficult for the economy and stock market to hold onto gains without a bottom in housing. A housing bubble of epic proportions got us into this mess. Losses from foreclosures and mortgage-backed securities (MBS) created by Wall Street “whiz kids” (who packaged up a bunch of sub-prime mortgages and sold them as AAA rated debt) needs to end before our economy can forge out a bottom. It will likely take some time to complete; maybe 10-15 years to work the losses from excess leverage out of the system before real growth begins.

I know there are many pundits saying housing has bottomed, and the U.S. is on the road to recovery, and the stock market has enjoyed a nice bounce (still just a bear market bounce in my opinion) but the charts simply do not support their views on housing. Here is a chart of housing prices from 1950-2009.



Prior to the last decade, housing has been increasing at less than ½ of 1% per year after inflation. But then housing prices exploded. Easy money policies by the Federal Reserve and relaxed lending standards pushed by Congress and mortgage brokers, such as interest-only mortgages and no money down were the primary causes of the housing bubble. Does the curve above look like it has bottomed to you? Prices need to stop falling or losses in the financial system will continue.

To determine how far housing prices need to fall to hit bottom, we look at the chart. The home price index is currently about 138. It will have to fall at least to the trend line, and will likely overshoot as it did after the mini bubbles of 1980's and 90's, before hitting bottom. The bigger the bubble, the harder the fall, so an overshoot of the trend line will likely go deeper than in the past. But if we assume a best case scenario, and prices only overshoot to the downside as much as after smaller bubbles, I see the Index falling to about the 110 level. A 20% decline from current levels and about 50% from the peak.

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