



# MORTGAGE MATTERS...

Week of August 16, 2010

## Market Comment

Since the beginning of the year, we've been saying the housing recovery is predicated on a jobs recovery. And although we've been encouraged that we've been making progress on the jobs front in recent months, the latest weekly unemployment-insurance claims news leaves us a little concerned – with claims growing to a six-month high of 484,000. We'd like to say it's an anomaly, but the four-week average has been moving up as well. Unfortunately, this trend doesn't bode well for the August employment report.

We can take some comfort knowing that foreclosure filings dropped 9.7 percent in July, compared to the same year-ago period, to post a second-consecutive month of year-over-year declines, according to RealtyTrac. Nevertheless, there were over 325,000 properties that received a filing, which marks the 17th-consecutive month that foreclosure activity exceeded the 300,000 level. The good news is that the trend remains mostly down in the top-ten metropolitan-statistical areas RealtyTrac follows and that the usual suspects – Nevada, Arizona, and Florida – continue to skew the data.

Even though job growth is weakening, we still think home prices will remain stable. The NAR reported that the median price for resales of single-family homes increased in 100 of the 155 metropolitan areas it tracks, with the national median price for a single-family home posting at \$176,900 in the second

quarter of 2010, a 1.5 percent gain compared to the second quarter of 2009.

We'd be remiss not to mention the obvious: the NAR's report included a rush to take advantage of expiring federal tax credits. This artificial stimulus has a few pessimistic market watchers expecting home prices to ease in subsequent months. To be sure, the NAR's third-quarter report could show some price easing, but recent monthly price data from Case-Shiller and the Federal Housing Finance Authority suggest, if not an up trend, at least a stable pricing environment in most metropolitan areas.

Mortgage rates, in contrast, are in an obvious downtrend. We regularly see the 30-year fixed-rate mortgage quoted in the 4.25 percent vicinity (with points and no risk adjustments), and the 15-year fixed-rate loan regularly quoted in the 3.75 percent-to-4.00 percent range.

So why the relentless downtrend in mortgage rates? The most recent decline came courtesy of a rush to buy Treasury 10-year notes, which pushed their yield down to a 16-month low. (Treasury yields influence mortgage rates.) In addition, Federal Reserve officials announced plans to buy \$18 billion of Treasury debt and Treasury Inflation Protected Securities through mid-September. These purchases could further constrict Treasury yields; thus, helping keep mortgage rates low – likely through the end of summer.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
Housing Market Index	Mon, Aug. 16, 10:00 am, et	15 Index	Important. A slight improvement is expected, but homebuilder sentiment remains sour.
Housing Starts (July)	Tues, Aug. 17, 8:30 am, et	560,000 (Annualized)	Important. Starts are stabilizing following the post-tax-credit fall off.
Producer Price Index (July)	Tues, Aug. 17, 8:30 am, et	All Goods: 0.2% (Increase) Core: 0.1% (Increase)	Important. Producer prices remain subdued, but an unexpectedly higher posting could move interest rates.
Industrial Production (July)	Tues, Aug. 17, 9:15 am, et	0.5% (Increase)	Moderately Important. Capacity utilization rates continue to increase, but remain below maximum levels.
Mortgage Applications	Wed, Aug. 18, 7:00 am, et	None	Important. Application activity has eased, though purchase activity remains positive.
Leading Indicators (July)	Thurs, Aug. 19, 10:00 am, et	0.1% (Increase)	Important. Recent weakness in manufacturing is weighing on the economic outlook.

## What Does Warren Think?

We are speaking of Warren Buffett of course, Omaha, Nebraska's legendary investing sage. In August 2009, Mr. Buffett penned a *New York Times* op-ed warning that lawmakers will be tempted to let the Federal Reserve print money (an inflationary, usually interest-rate raising strategy) to deal with the growing national debt.

Today, Mr. Buffett is taking no chances. He recently shortened the duration of the portfolio of bonds held by Berkshire Hathaway (investors shorten bond duration when they expect inflation, lengthen it when they expect deflation), the company in which he serves as CEO. In short, Mr. Buffett is expecting in-

flation, not deflation, to be the overriding economic concern in the not-too-distant future.

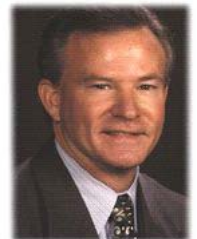
Mr. Buffet has been right, in that the Fed has printed more – a lot more – money over the past year, but so far has done so with impunity. But it's worth keeping in mind that within a system as complex and as unwieldy as our national economy, inflation doesn't just pop up when expected; the timing is unpredictable, and it will likely happen faster than the market anticipates. Therefore, we still don't believe procrastinating for lower rates is a worthwhile strategy, nor do we believe it's a worthwhile strategy to bet against someone who has been so often right as Warren Buffett.

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Keeping up-to-date on market fluctuations allows you to bring greater value to your clients.