

NOT APOCALYPSE NOW

Media's a business... a big one. And fear is a blue-chip product. Recently, we've received questions from some of our clients concerning some of the (often apocalyptic) proclamations being made. While this is certainly a volatile time, putting the situation(s) in terms of DEFCON countdowns, such as CNN's Mr. Beck, or using words like "crash" and "plummet" with little or no evidence to back it up is simply irresponsible. We'd like to address some of the things you may be hearing (or, rather, being told) with a measured and fact-based response. **(For a similar response to the fall of Bear Stearns [CLICK HERE.](#))**

You may have heard some "prognosticators" (we use quotes here since many base their opinions on nothing more than a hunch and Cliff's Notes-like reports) proclaim that it is "extremely likely" and "unavoidable" that we hit a housing downturn that turns into a free fall, causing the worst collapse in our country's history and setting off another large wave of bank write-downs.

For us, this type of event is country miles from becoming reality. Despite a sixty percent increase in foreclosure activity from a year ago, foreclosures still represent just 0.17% of the entire U.S. housing market. According to real estate data firm RealtyTrac, foreclosure filings – an accumulation of default notices, auction sale notices, and bank repossessions -- totaled 223,651 in February, down 4% from January.

Speculation fueled much of the increase in home prices over the recent past. The National Association of Realtors reported that 37.2% of home purchases were made for a purpose other than the buyer's primary residence: 31.5% for investment and 5.7% for second or vacation homes. Additionally, while prices have declined, they are down just 9% in 2007 according to the S&P/Case-Shiller Home Price Index.

The median home price in the U.S. was \$221,900 in 2006, followed by a peak of \$223,500 in the second quarter of 2007, then finishing the year at \$217,800. If home prices were to fall another ten to twenty percent, not at all a certainty but the loose zone that several claim will mark an official freefall, then we would see the median home price fall to \$174,200. The median house price less than four years ago.

We, and many others, expected this. This wasn't a dog whistle; It was blaringly obvious. Home prices grew a stunning 12.5% annually for the five years ending 2006, a six-fold increase over the historical growth of home prices. Moreover, the regions that have suffered the greatest setbacks were also the beneficiaries of the lion's share of growth over the past five years.

Las Vegas watched home prices increase 104% over the 2002-2006 period, but have declined 15% over the last year. Miami, the hottest of the metro areas, posted a 126% growth then suffered an 18% decline last year. Phoenix had a 99% growth followed by a 15% decline.

Across the country, the declines still leave home prices well ahead of the curve. Releasing a little more steam is not just needed; it's welcome. (As a reference, the worst collapse in the country's history was between 1912 and 1921 when home prices fell 36%.)

We agree that banks will face another wave of asset write-downs, another ubiquitous pundit claim. And, it very well may be a wave of significant magnitude. However, it is important to remember that this is similar to updating your balance sheet and noting that your home is not as valuable as it was just a year or two ago. If we are fortunate enough to have owned a home for more than just the last few years, we have most likely lived through a period like this before. Most often the value returns. In the case of the banks and others writing down their mortgage investments,

they too will see great appreciation in the years to come – greatly inflating profitability.

However, just like us, if banks show fewer assets on their balance sheet, they too will suffer a decline in borrowing power or liquidity. With the exception of a few, a very notable few, most companies still have plenty of cash on hand and workers are still employed, which should keep the recession from being a deep and prolonged event. That doesn't even take into account the burgeoning consumer class worldwide who are now purchasing more and more goods and services produced by U.S. companies due to the weak greenback. The weaker dollar makes U.S. goods and services relatively cheaper for consumers around the world.

There's also a notion being bandied that homeowners that have larger mortgages than the current value of their home will simply walk away, leaving the bank to hold the bag. We simply find this fallacious and speculative. If these folks can make the monthly payments, they will continue to dream the American dream. Besides, they have far more to lose by default than the banks do.

We saw a housing bubble developing as far back as 2003 and which is why we reduced our exposure to all real estate by 50%, and stayed away from residential real estate.

Vegas, Miami and Phoenix, the examples listed about, represent the fourth, ninth and eleventh fastest growing metropolitan areas in the U.S. The increased demand for housing in these regions will contain some of the cold.

A final note as we move forward. We talk a lot about looking for opportunities, and there are plenty out there right now. We can do more than survive; we can thrive. When all others are selling, this is a time to be prepared to buy. And, despite the doomsayers, not be afraid.