Housing Exposed

Timing is Everything

**by Kim Magana,
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Of the several asset classes I advice, analyze and recommend, single family houses can be the most rewarding and daunting investment.

It is very important to acknowledge this seemingly docile investment has gone through some tremendous bull markets and of course, severe give backs (bear markets) in the last 100 years - especially in high beta markets such as California, New York, Florida and recently Nevada. This cyclical nature of housing will continue going forward.

What is especially amazing is that the average annual return has been only 3.6% over the long term (barely outpacing inflation) versus the S&P 500 stock index 9.6% average per year. Some markets such as the High Desert are at 0% annual over the last 20 years plus, though the price moves in between have been truly mind boggling.

Therefore in order to protect and build wealth in this investment vehicle, *timing* is very important along with keeping emotion and greed in check. But hold on… Pundits and real estate promoters will say you cannot time home prices, there is no crystal ball and home prices always go up.

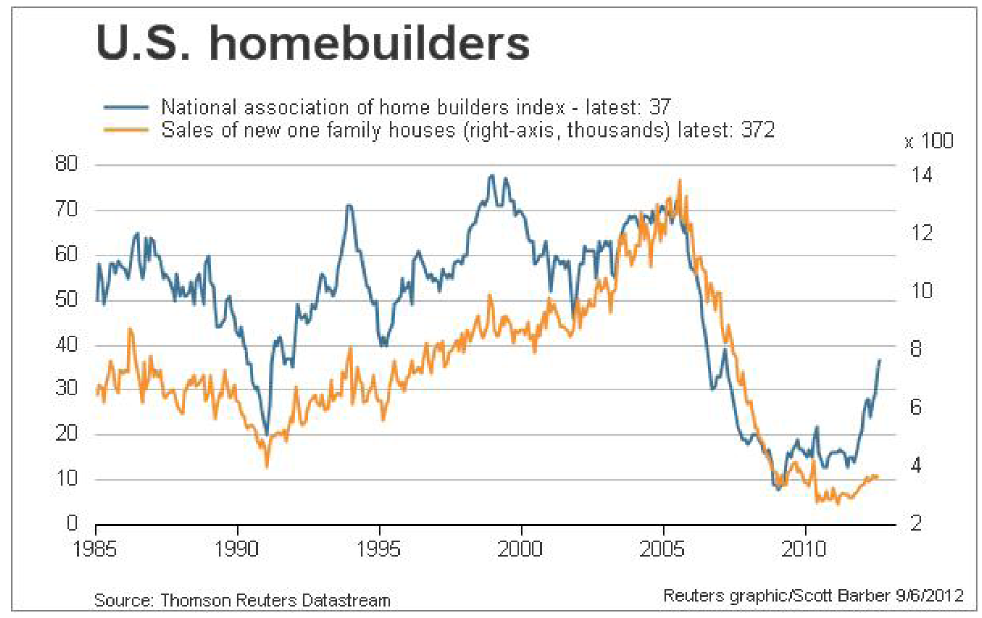
We learned from 2006 to the present that this is not true. National home prices dropped 35% and High desert prices down a whopping 70-80%. If you were fortunate to have sold near the highs and enter the market now at the lows, the change in your household balance sheet to the upside is life altering.

A home is a unique investment because you get to live in, raise a family in, enjoy and sometimes fall in love with your sticks, concrete and dirt. The big plus is you can sell your prime residence tax free up to a $500,000 profit if you lived their two out of the last five years. Other real estate holdings can be sold with a 15% Federal capital gain tax if held more than one year.

Still, the timing is tricky. How many CPAs or advisors informed their clients they should get out of the real estate market in 2005? That is where the emotional peril comes in, making it very difficult to sell during bubble tops.

Think back to the housing boom years of 2004 through 2006. Everyone was jumping on the band wagon: real estate promoters, new licensed agents, banks, cities stepping up their building department staff and raising impact fees, mortgage brokers gone wild, wall street and their securitization of mortgage loans, speculators with their liar loans, and neighbors ATM-ing their house for materialistic fantasies. Then there were the builders setting record highs in new home sales (see chart) and pouring unsustainable supply into the market.

It was one big party and no one wanted to leave. This is the greed part, making it almost impossible to take your once-in-a-lifetime *tax free* profits. And of course you were told by the "experts" that houses only go up in value - an absolute myth.



I was a lone wolf in the wilderness as I sold all my real estate holdings and tried to usher family members and clients out of this feeding frenzy created by the crowds of mass delusions.

As we enter the seventh year of this brutal bear market we see the carnage left behind: a recession, foreclosures, short sales, and people who lost homes that multiple lenders actually owned, FDIC bank closures, many financial institution bankruptcies, record low new home sales (see chart), municipalities suffering and government institutions Fannie Mae and Freddie Mac on taxpayer life support.

By now, crowds have left or been carried out of the housing market, and home prices have reverted to the mean, and in some cases way below replacement cost, allowing single family homes to be the most affordable they've been in a long time, especially with historically low mortgage rates.

This painful give back and correction that has been endured will put the bear into hibernation so housing prices can bottom out and begin a slow trend higher as pent up demand and new household formation absorb supply.

In the fullness of time there will be another housing speculative fervor; therefore, make sure your advisers can help you recognize a bubble and navigate "the largest investment you will ever make" – **A House**. ■

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Bond Bubble

What You Don't See Coming

**By Jose Palafox
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One of many things an advisor should do for their clients is to look for risks they don't see coming.

In 2005 we started telling our clients and anyone who would listen, to sell their real estate holdings unless they planned on holding it for the next 30 years. Some listened and some didn't, as at the time the now very visible bubble in easy mortgages and over inflated values did not seem to have an end in sight.

Contrary to all popular opinion, I sold my own house in the summer of 2005. I rebought 3 ½ years later at half the price. Why do I bring this up? Is there another supposed safe investment that I believe is soon to burst? The answer is yes.

The investment I am talking about has had a very good run - up more than 50% in value since spring of 2009, plus a yield as high as 16% and the now low 5.8%.

You can probably guess from the numbers that I am talking about High Yield Bonds, otherwise known as junk bonds.

Droves of individual investors and institutions managing pension and foundation money have been flocking to High Yield in search of better, safer returns without the volatility of the stock market. It is this insatiable appetite that has raised the red flag.

$30 billion have poured into junk bonds in the month of August already. High Yield issuers are taking advantage by filling the demand. In other words, investors are buying everything that is issued in hopes that the payout and increase in price will continue.

In a world of historically low rates, people are willing to ignore the risks and bet that the great returns will continue. But you ignore the facts at your own peril.

Bonds in general have done well because interest rates have come down significantly over the last few years. Bond prices rise when interest rate go down and fall when interest rates go up. The Fed has promised to keep Rates low until 2014. This has lulled many into the rate trap. That does not mean that investors (the Market) and economic conditions will not push rates higher on the long end sooner than 2014.

Already recently we have seen Treasury yield start to move up. No one can predict exactly when rates will normalize and move back up, but the consequences could be devastating to investors who thought they were safe by avoiding the stock market.

In our firm we have already begun taking profits from our junk bond position and redistributing them into higher grade and shorter duration bonds. These will be affected far less, but won't be immune when rates rise.

In our practice I see many new clients that come in with their portfolios almost all in the bond market. When I ask why their answer is, "Well I didn't want to lose money in the stock market and my broker said this was safer and even showed me a three year return with stellar performance." This has played out to be true, but the key is that it is in the past.

Valuations have skyrocketed and the market easily is digesting the newly issued bonds. I also mention that during the same time frame the stock market has more than doubled, while almost everyone continues to bash the results.

As in 2005 when money kept pouring into real estate, today money is pouring into bonds, and more specifically High Yield bonds. I say buyer beware. The signals are there of a coming top, and the bursting bubble takes no prisoners. ■

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