

Imminent Housing Meltdown

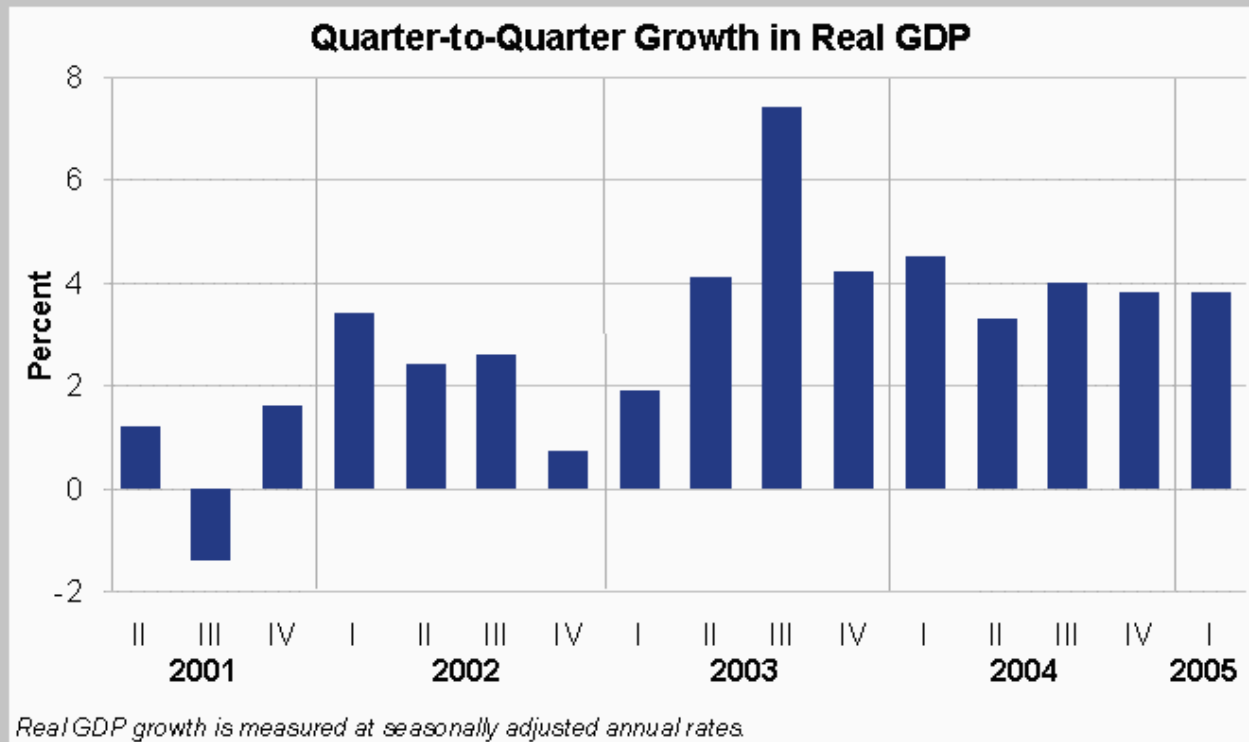
Hilton Head Island, SC

October 13th, 2005

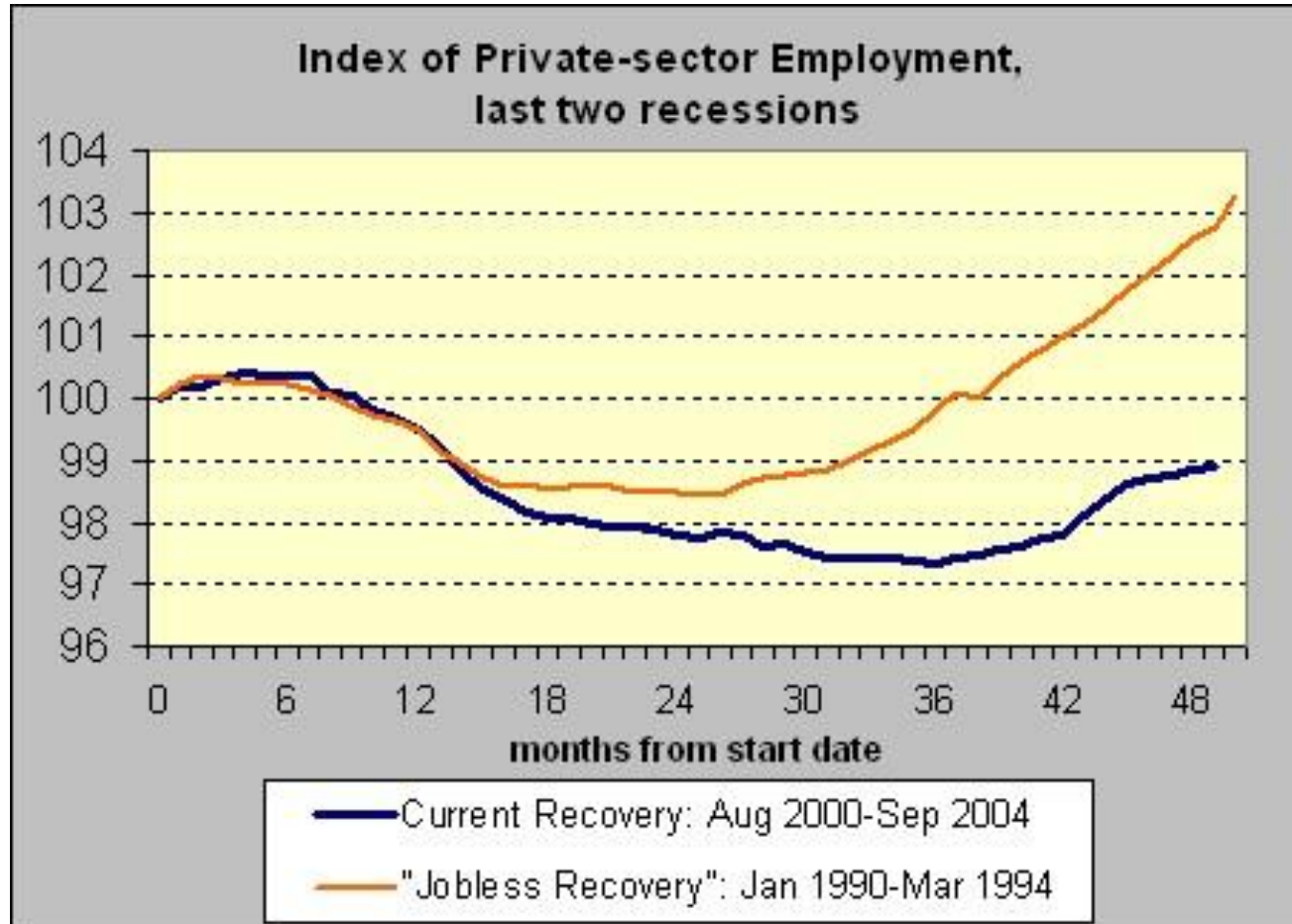
Dr. Jim Budzynski
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U.S. Economic Recovery

**Quarterly
Change in
Real GDP
(Seasonally
Adjusted at an
Annualized
Rate)**



U.S. Jobless Recovery



**From U.S.
Employment
Perspective,
Current
"Recovery"
Is One of the
Weakest on
Record**

Has U.S. Growth Created Minimal New Jobs?

Unbalanced Trade in a Flat World



- **Manufacturing Migration**

- Manufacturing Is Rapidly Migrating to Countries with the **Lowest Labor Cost** and Highest **Tax Breaks, Educational Incentives,** and **Subsidy Packages**
- **China Driver; Malaysia, Thailand, Brazil, Ireland, Mexico, Vietnam, Eastern Europe** Following

- **Digitization and Service Migration**

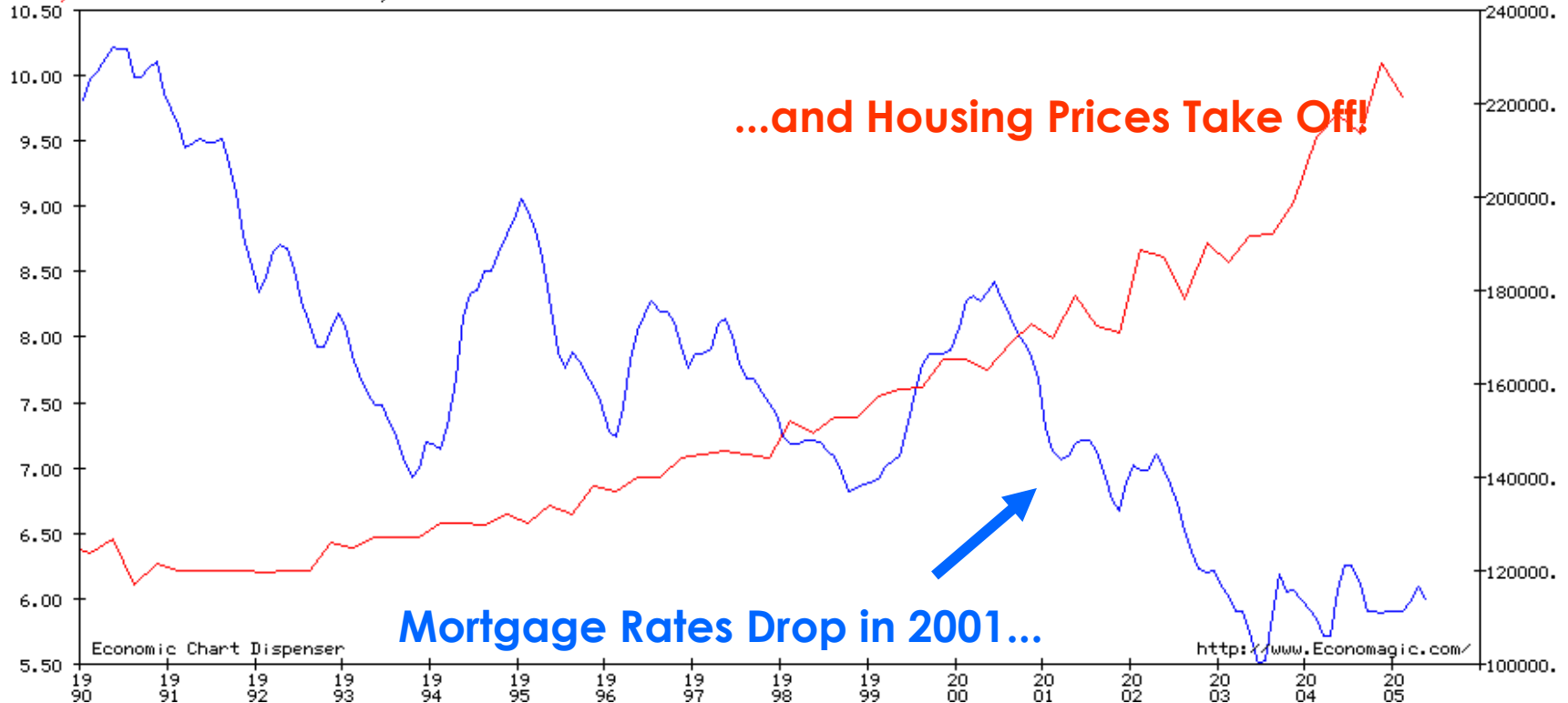
- All Knowledge Work Is Being Digitized and **Significant Amounts Are Migrating** as Well
- Interoperability, High Speed Connections Provide Infrastructure
- **Low Labor Costs for Highly Educated Workers** Provide the Motivation

Low Mortgage Rates Fuel Housing Bubble

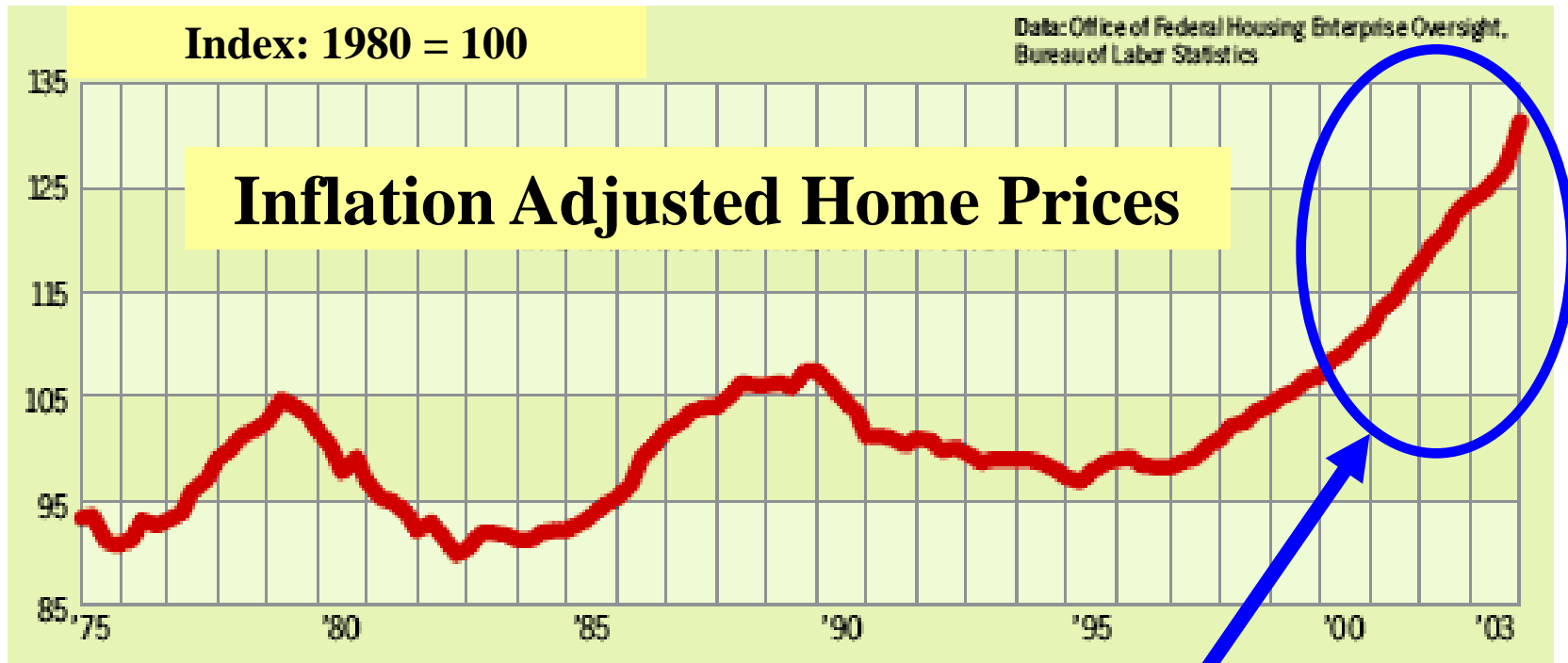
U.S. Mortgages Rates vs. Housing Prices, 1990-2005

← Contract Interest Rate (%): Terms On Conventional Single Family Mortgages, Fixed-Rate 30-Year Nonjumbo Loans: TABLE1

→ US: Median Price of Houses Actually Sold

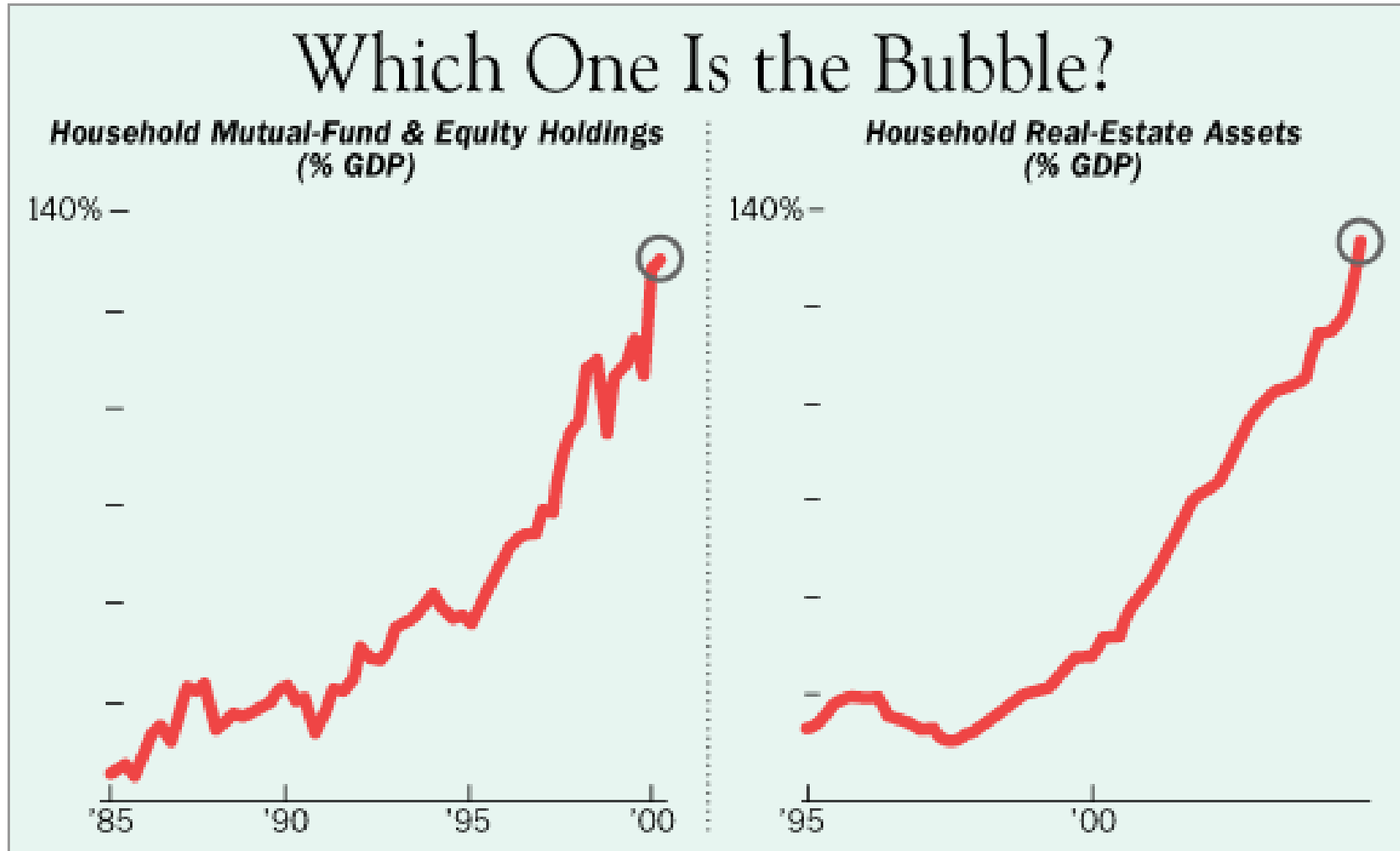


Housing Price Explosion



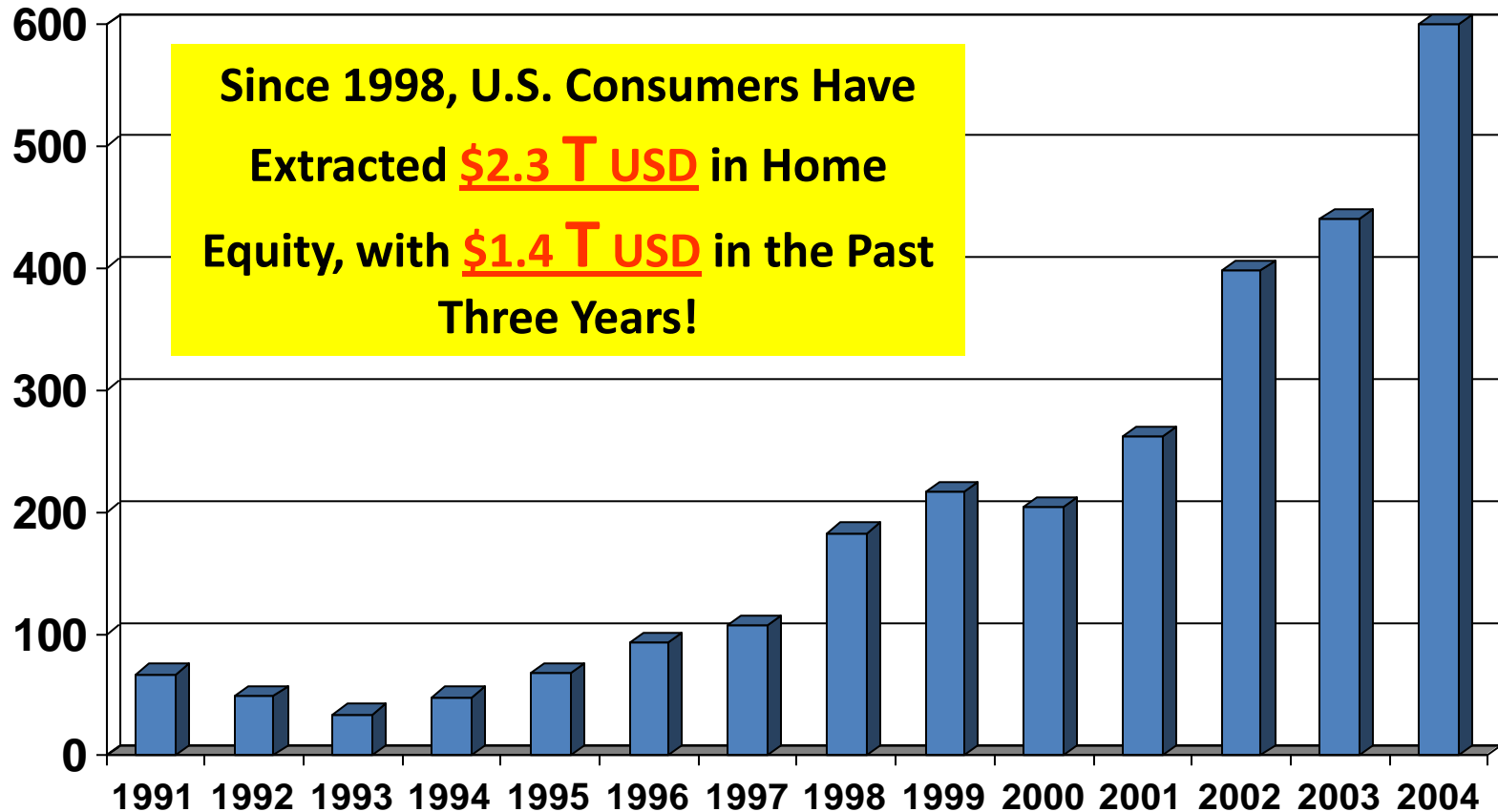
Since 2000 Home Prices Have Exploded...

1999 All Over Again?



Net U.S. Home Equity Extraction

B \$USD



Federal Reserve Board September 2005

Housing and the U.S. “Recovery”

- **Dominating U.S. Economic Activity Since 2001**

- Real Estate Accounts for **70%** of the Rise in Household **Net Worth**
- Over **40%** of New Private-Sector Jobs Have Been Housing Related

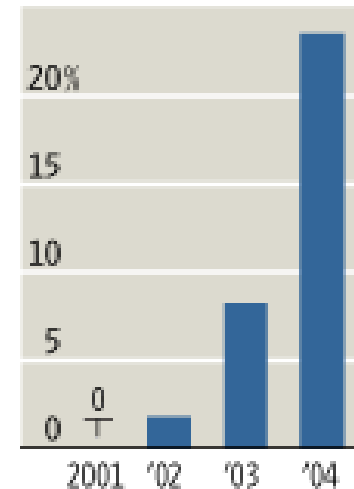
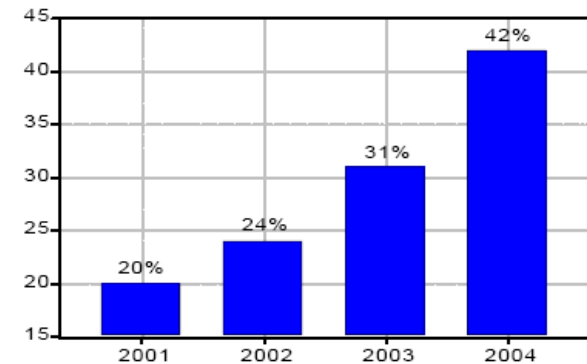
- **Overleveraged**

- 42% of First Time Buyers Made **No** Down Payment
- Subprime Market **28% Share** (vs. 5% in 2000)

- **Stretched & Speculative**

- Homeowner Affordability at **13 Year Low**
- 23% of 2004 Sales “Investors”; 13% Second Homes

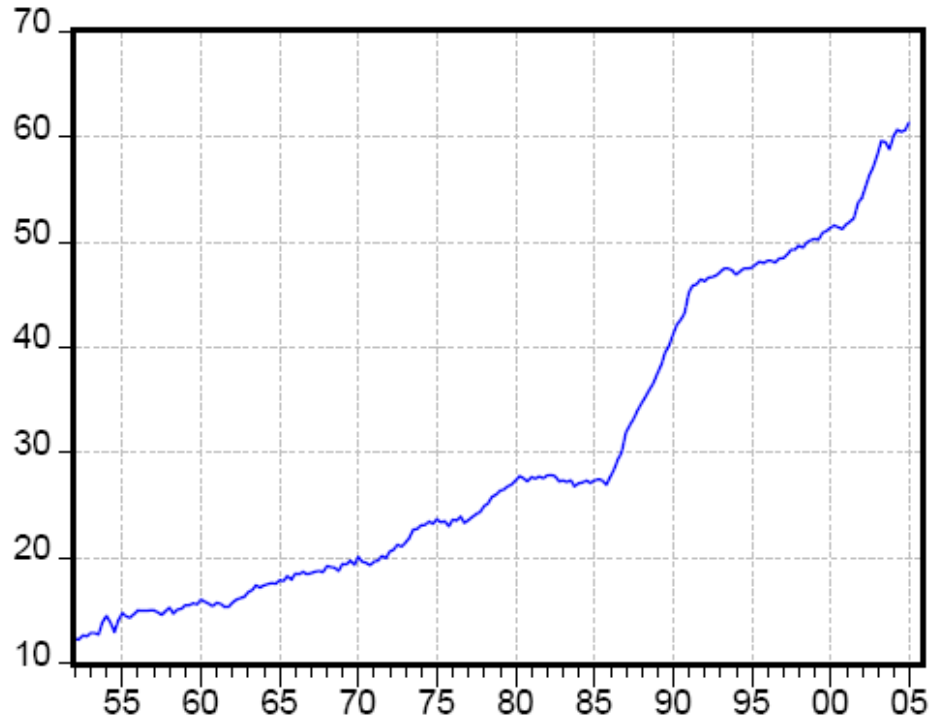
Purchase-Mortgage Originations with Piggyback Home Equity Loans (percentage)



% of Sub-Prime Loans with Interest Only or Adjustable Rate Payments

U.S. Banks Dependence on Mortgage Income

U.S. Chartered Commercial Banks: Mortgage-Related Assets* / Total Bank Credit
%

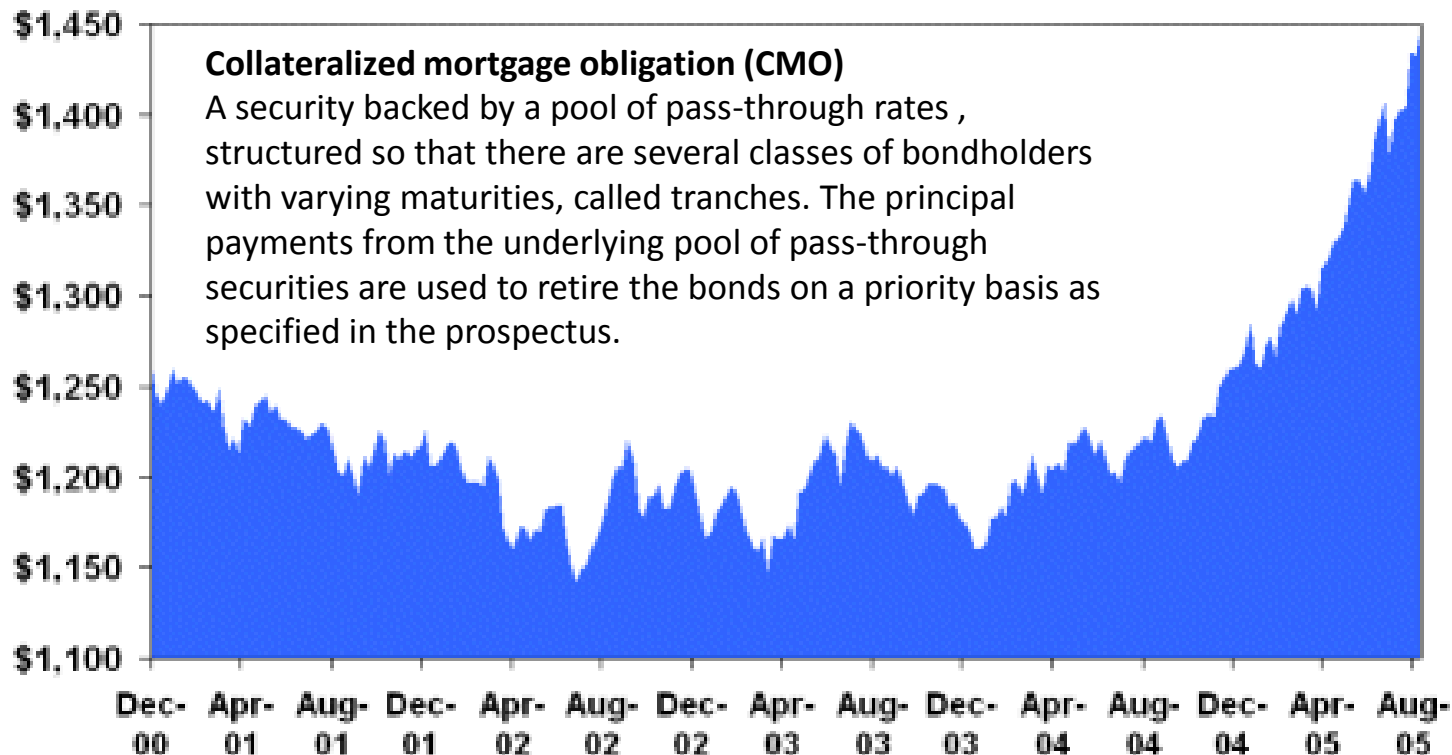


* Sum of mortgages, mortgage-backed securities and liabilities of GSEs.

Fuel for the Fire?

Financial Sector Commercial Paper Outstanding

(\$billions - thru 8/17/05)

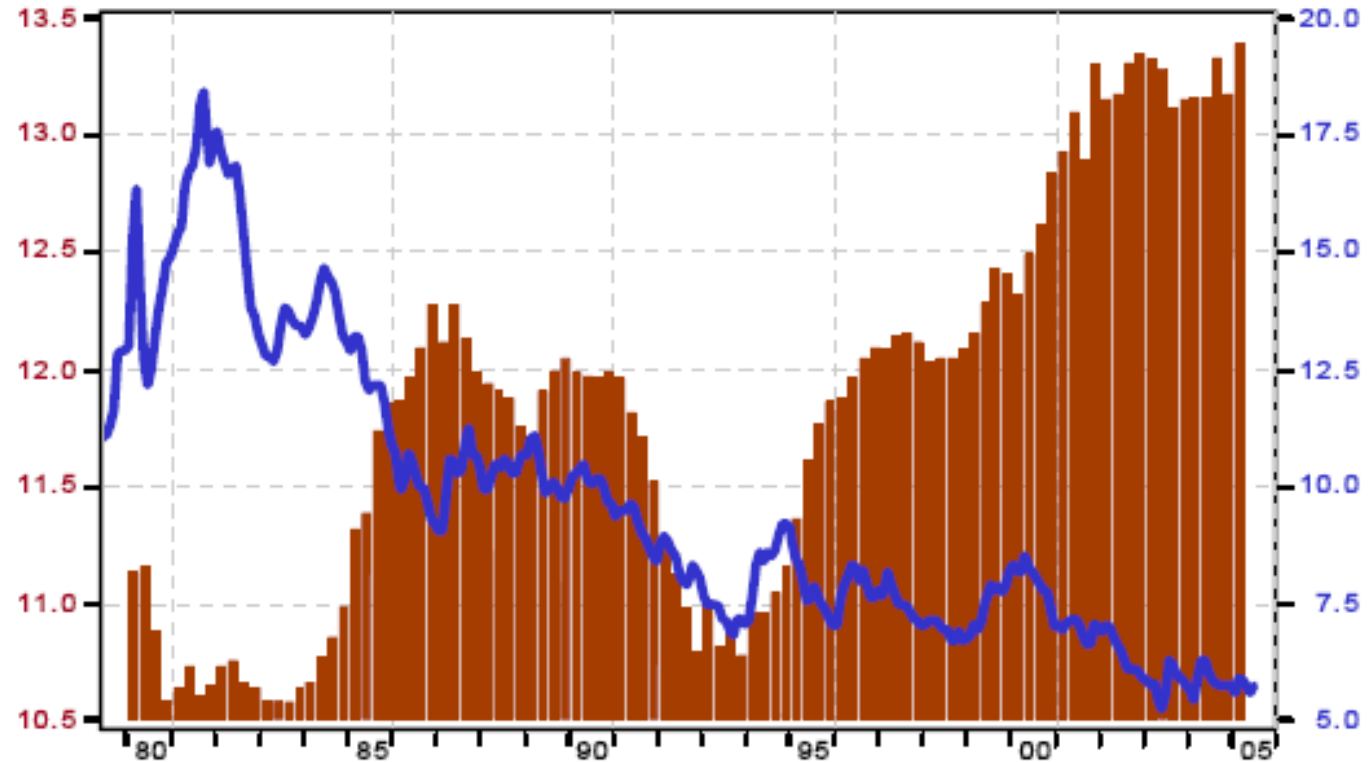


**CMOs Will
Make a US
Housing
Slowdown a
Global
Recession
Risk!**

If you think consumers are stretched now...

< Household Debt Service Ratio
SA, %

Contract Rates on Commitments: Conventional 30-Yr Mortgages, FHLMC >
%



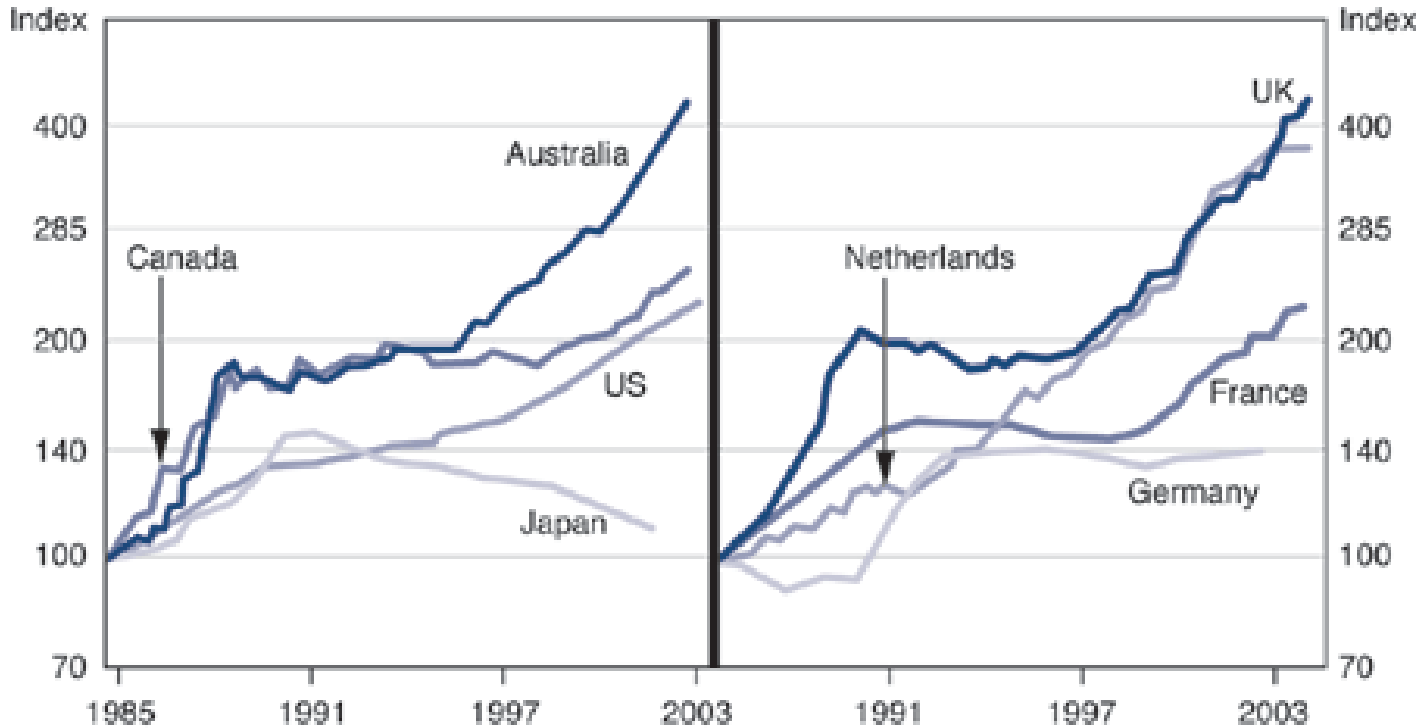
Source: Federal Reserve Board /Haver Analytics

Global Housing Inflation

PIMCO 10.04

House Prices

1985 = 100, log scale



Sources: BIS, REIA

**The U.S. is
not the only
overheated
housing
market!**

Wall Street Journal
October 12th, 2005:



Greenspan Repeats 'Speculative Excesses' Warnings

Federal Reserve Chairman Alan Greenspan, in a speech at the National Italian American Foundation in Washington, repeated his recent suggestion that the economy's flexibility and low volatility in recent decades had **encouraged "speculative excesses."**

Some critics have accused the Fed of fomenting those excesses by keeping monetary policy too easy, fueling a stock bubble in the 1990s and some foamy housing markets in the current decade. Last month, he said it was "not realistic" to expect the Fed to fight such irrational exuberance.

Summary – Housing

- U.S. **Housing**, After Five Years of Expansion, Is **Due for a Correction**
- Reduction in the Availability of Cash out Refinancing Funds Could **Negatively Impact U.S. Consumer Spending**
- Questionable Loan Practices and CMOs Could Cause **Challenges for Lenders and Bondholders**
- Many **Other Countries** Have Overheated Housing Markets As Well

On Your Investments....

If Jim is right, where will the most pain occur and where will be the best places to weather the storm?

Note: Jim could be wrong. This is not professional investment advice.

Where will the most pain occur?

- Real Estate
 - Homebuilders, Materials, Agents
- Financial Services
 - Especially Banks, Mortgage Lenders, REITS
- High Consumer Consumption Driven
 - Consumer Discretionary (e.g Best Buy)
 - Mid to High End Retail
- Long Bonds
 - Higher Interest Rates Will Hurt Them

Places to Weather a Storm?

(I could be wrong but....)

- Warren Buffett Has Placed a \$20 B Bet Against U.S. Dollars by Investing in Foreign Currencies
 - Short Term **Foreign Bond Funds** (Unhedged) **10%**
- Inflation Is Possible Strategy to Reduce U.S. Debts
 - **Oil, Commodities, Silver, Gold** (Volatile - Buy on Dips) **15%**
 - **TIPS** (Treasury Inflation Protected Securities) **10%**
- Some Foreign Stocks Will Get Hurt Early in a Liquidity Squeeze But Established Markets Are Cheap Long Term on a Valuation Basis
 - Short Term: **Germany, Japan** (U.S. Creditors) **10%**
 - Long Term: **BRICs** (Brazil, Russia, India, China-Dips) **10%**
- U.S. Defensive Stock Sectors
 - **Consumer Staples, Utilities, Health Care** **20%**
- The Ultimate Safe Place:
 - **Cash** - Be Ready to Buy When Things Get Cheap! **25%**