

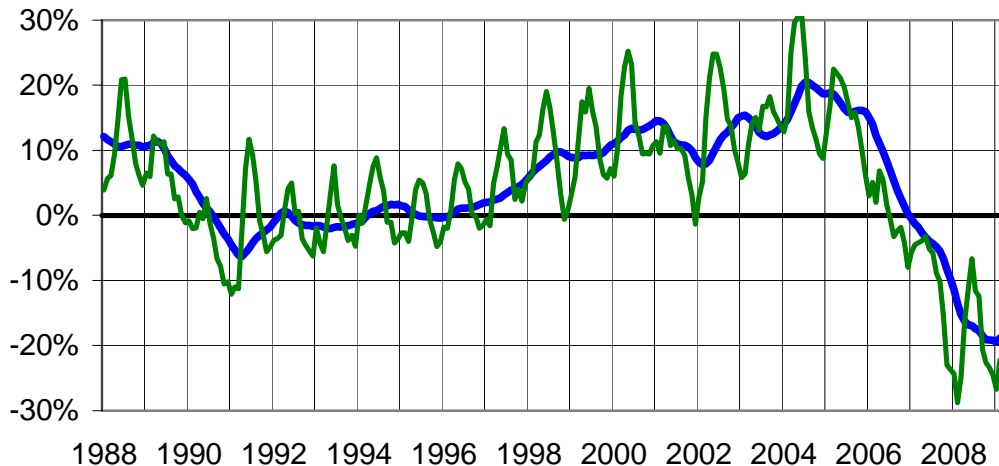
## MacroShares Major Metro Housing UP & DOWN Shares

By Ed Hynes, CFA

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A smidgen of good news came with the release of the S&P/Case-Shiller Home Price Indices this morning. Although single family home prices continue to fall at an 18.8 percent rate across the country, the decline seems to be stabilizing (Chart 1). For the first time in 38 months the 10-City Composite index's year over year performance improved from the previous month's report. While "one robin" does not make it spring, let us hope this "robin" is soon joined by more friends.

**Chart 1**  
**SP/CS Comp-10 Percentage Change**  
(Year/Year - Blue; Month/Month - Annualized - Green)



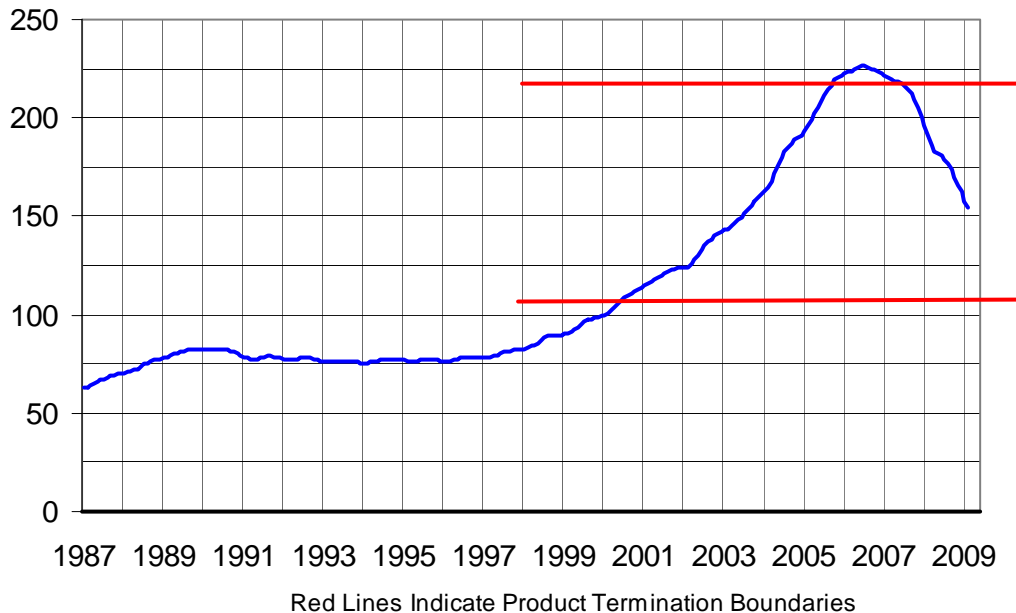
I suspect this news will embolden housing Bulls, but there is plenty of data in the report for the Bears to snarl that investors should not be fooled by a slight up-tick. For instance, while the large California cities have shown improvements for a few months, New York had its first year-over-year double-digit decline since 1981 and is headed in the wrong direction.

Up until now, these confrontations between housing Bulls and Bears have been mostly academic, but that is about to change. On May 11, a new product will start trading allowing investors to wager on where these indexes are headed in the longer term. The housing index space has seen new products fail before, and this new entry is complicated, but I think the MacroShares have a decent chance of success.

In very simple terms, there are two shares: the Major Metro Housing UP (ticker - UMM) and Major Metro Housing DOWN (DMM). When the product was designed each share was worth \$25 and together the pair is worth \$50. Based on today's Index of 154.70

(Chart 2), the UP shares now have an underlying value of \$21.55 and the DOWN shares \$28.45.

**Chart 2**  
**SP/CS Comp-10 Index**  
Index = 100 in January 2000



Red Lines Indicate Product Termination Boundaries

If the Index goes up from its initial value of 162.17 between now and the product's expiration in November 2014, the assets from the DOWN shares will pay the UP shares 3 times the percentage increase in the Index based on the initial \$25. Alternatively if the Index falls, the UP shares will pay the DOWN shares a similar amount.

Let's run through an example. The initial Index level is 162.17 and both shares start at \$25 and will be worth \$25 if the Index is at that level in November 2014. If the Index increases 10 percent from 162.17 to 178.39, the DOWN shares will pay the UP shares 3 times the 10 percent change or 30 percent of \$25; which equals \$7.50. With the additional \$7.50 the UP shares will be worth \$32.50 (\$25 + \$7.50) at expiration while the DOWN shares will be worth only \$17.50 (\$25 - \$7.50).

The underlying mechanisms of these shares, when paired together as one UP and one DOWN share, is similar to Exchange-Traded Funds (ETFs). And like ETFs, the paired shares should equal their "Paired Trusts" Net Asset Value (NAV) of \$50 and therefore pairs of shares can be created and redeemed. However, while the pair will trade at the NAV, the individual UP and DOWN shares do not need to trade at their respective NAVs and in fact, the success of the product depends on them trading on future expectations, not today's NAV.

Some investors may remember a similar product that was based on the price of oil. One of the problems with that product was that most investors did not realize the “market” price was where investors thought oil would be when the shares expired in 20 years and it was not designed to track the spot price. Hopefully, with more education on the Housing Shares and making the expiration much shorter, these problems can be overcome.

The offering price ranges are \$13.20-16.50 and \$33.50-36.80 for the UP and DOWN shares respectively. The midpoints of these ranges (\$14.85/35.15) imply an Index level in November 2014 of 140.22. This is 13.5 percent below the initial Index level but only 9.4 percent below the Index’s most recent level. (As a shorthand calculation, as long as the Trust’s combined NAV is exactly \$50, every \$1 change in the share price equals 2.1624 Index points.)

As I hope is clear, investors need to be careful and understand that the price of these shares represent expectations, not the current Index levels. If you think the Index will fall from its current level of 154.70 and buy the DOWN shares at \$35.15, you will only make money at expiration if the Index closes below 140.22. However, in the meantime if “expectations” improve or deteriorate the shares may offer other profit or loss opportunities.

The underlying Index is the S&P/Case-Shiller Composite-10 Home Price Index (SP/CS Comp-10) which measures single-family housing prices in the country’s 10 largest cities. The index weights cities by the value of their housing stock and almost 50% of the Index is accounted for by New York (27.2%) and Los Angeles (21.2%). At the other end of the spectrum is Las Vegas which receives a lot of attention, but only has a weight of 1.5%.

The S&P/Case-Shiller Indexes use a technique called “Repeat Sales Methodology” for measuring the change in home prices. When a home is sold “at arms length” they look for the previous sales transaction of that exact same house and calculate the change in price with a few minor adjustments if necessary. Investors should note that foreclosure sales “at arms length” are included in the index; while newly built homes are not included as there is no “previous” sale. More information on the index is available on the S&P website.

The Index, published at 9:00 a.m. on the last Tuesday of each month, is a rolling three-month average and released with a two-month time lag. So for example, the data just released on April 28 was for the three-month period of Dec/Jan/Feb.

As with any new structured product there are a number of issues investors should be aware of and preliminary prospectuses are available at MacroMarkets’ website <http://www.macromarkets.com>. The site also has information on the fund’s relatively rich 1.25% expense ratio and the details of the initial IPO process via an auction system which starts April 28.

Some of the critical concerns for investors will be the shares’ liquidity and bid/offer spreads. When futures contracts on this Index started trading a few years ago, things

started out pretty well, but then faded quickly. MacroMarkets hopes the IPO process and Dutch auction rectify these problems. For instance, the IPO will not be launched without substantial demand. In addition, the Dutch auction process insures some “price discovery” prior to listing.

On the Dutch auction, although the public will be kept in the dark during the process, (unless a re-filing is required due to a significantly revised price range or some other reason) investors should monitor the auction results closely and see if any opportunities pop up.

Investors who plan on actively trading the shares should also understand the seasonality of the Index. Home prices tend to get a boost in the 1<sup>st</sup> half of the year and slow down in the 2<sup>nd</sup> half. Obviously, none of this matters at expiration, but it can be important when analyzing trends from month to month. For instance, for the release on June 30 it will be good to know that June’s published Index has shown an increase in the rate of change versus the previous month in 17 of the last 21 years. On the other hand, January’s release has shown a decline in the rate of change vs. December in 20 out of 21 years.

As explained above, any gain for the UP or DOWN shares is funded by the other fund on a leveraged basis. Since the losing fund can eventually run out of money, the whole structure will shut down and terminate if the Index moves more than 33.3 percent (outside the range of 108.12 to 216.22) for three consecutive months and either the UP or DOWN shares will get all \$50 (see Chart 2). If the Index gets close to either limit, but especially the lower one in the foreseeable future, expect traders to shift their focus from the likely Index level in 2014 to the probability of an early termination and as they do the DOWN shares may move quickly toward \$50. I am not predicting future Index levels, but if prices continue to fall at their recent rate of about 19%, the Index will reach its lower limit in February of 2011.

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