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### The Housing Market Continues to Struggle

By Ed Hynes, CFA

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Homeowners and investors received a boatload of information on the US housing market this week. Overall, the data was mixed, but stronger than the market expected.

Starting Monday morning, Lennar Corporation, one of the nation's largest home builders, cut its profit outlook for 2006. Lennar cited "lower sales and higher cancellations ... [which are] primarily the result of speculators exiting the market and changing home buyer sentiment." Their CEO was later quoted as saying that there was a "wholesale evaporation" of speculators in the market, which hurts in the short term, but is healthy in the long term.

On the other hand, the Commerce Department reported that new home sales rose 4.6 percent in May from April. This was better than market expectations, although sales were still down 5.9 percent from the previous year.

Tuesday morning we were greeted with a release from the National Association of Realtors (NAR) on existing home sales. May sales fell 1.2 percent from April, to a 6.6 million unit annual rate, while the market was anticipating a slightly greater fall of 2 percent. Existing home sales make up around 85 percent of all home sales and this measure is a broader view of the housing market compared to new home sales.

The inventory of unsold homes continues to be troubling and in May rose 5.5 percent to 3.6 million. The inventory now equals 6.5 months supply at the current sales rate, up from 6.1 months in April. This is the highest inventory/sales ratio since May 1997.

On the positive side, the median price of homes sold in May held up well at \$230,000, up from a revised \$222,000 in April. However, if inventories continue to build, prices will likely weaken as we move away for the seasonally strong spring selling season.

The last report came on Tuesday afternoon when the S&P/Case-Schiller Indexes (CSI) were released. These indexes measure the prices of single-family residences and also serve as the underlying indexes for a new set of futures and options on futures traded on the Chicago Mercantile Exchange.

The CSI data reflects prices for rolling three-month periods and the recent information was for February, March and April. The CSI showed prices rose slightly vs. the three-months ending in March. The 10-city composite index was up 0.5 percent in May and

rose 10.9 percent over the last year. However, similar to last month's data, we continue to see a pronounced slowdown in the shorter term data. The one, three and six month data all show annualized growth rates of around 5 percent.

Where do home prices go from here? One place to look for answers is the new S&P/CSI housing futures market. These products are still struggling to get off the ground, but it is interesting to see how the markets reacted.

Overall the market moved higher after all this new information. Before the data was released, the 10-city composite index was predicting a fall in housing prices of 5 percent by the first quarter of 2007. Now the market is less pessimistic and expects prices to fall only 3 percent.

The activity of individual city futures contracts has been quite varied. So far, participants have ignored cities such as Denver, New York and Las Vegas and concentrated on Miami and Los Angeles as these two cities account for 50 percent of all trading.

Not surprisingly, investors have focused on the two cities with the largest price increases over the last year (Miami at 25 percent and LA at 17 percent). But interestingly, investors are forecasting a price drop of around 5 percent by early next year in these hot spots, more than most other cities. It will be curious to see how this plays out.

In summary, the housing market is weakening, but maybe not as fast as investors had expected. Stay tuned for more releases in the weeks ahead. If you are interested in more information on the housing futures contracts, please contact me.

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