# Caprin Asset Management, L.L.C.

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## The Housing Market: Slowdown or Bust?

1990-1991 saw the level of new home construction (housing starts) reach the lowest point in two decades and marked America's last large pullback in housing. That housing bust, fueled by the 1990-1991 recession, would rebound slowly over the next 15 years with housing starts peaking in 2003 – 2005. The culmination of this recent boom was 2.3 million new homes beginning construction in late 2005 – the greatest number in the past 30 years. Since 2005, however, housing starts have steadily tumbled from their 2005 apex by almost 40% prompting analysts and investors to ask: are we entering a 'collapse' in the housing market?

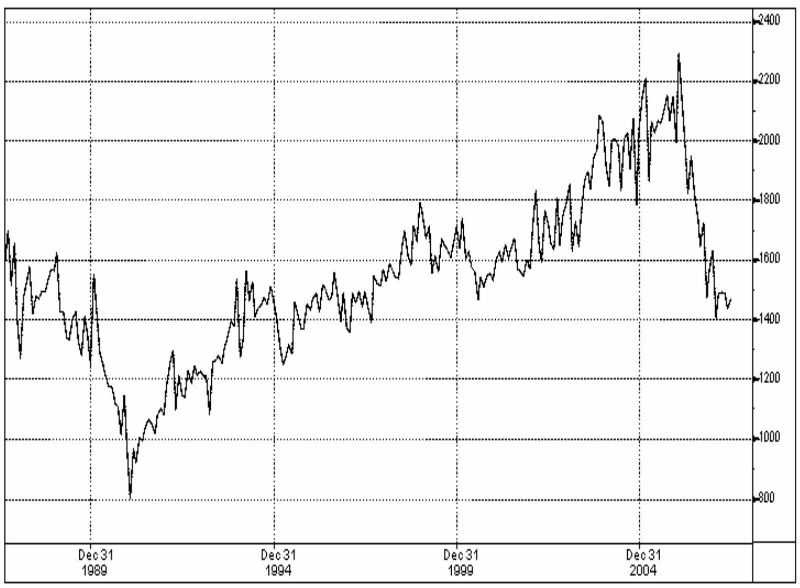


Figure 1. Monthly housing starts over past twenty years (in thousands)
*Source: Bloomberg*

In the bust of the early 90's, housing starts bottomed out at roughly 800,000 homes. Current activity is close to double that number, with 1.45 million new homes in construction. Although today's construction levels appear low relative to housing starts a couple years ago, the numbers are still historically strong. And the number of new homes sold today is more than double what it was during the early 90's pullback, suggesting a fair amount of relative strength in the housing market compared to the lows of two decades ago. These numbers imply that today's housing downturn is not a collapse but rather a reversion to historically average levels after a long period of rapid growth.

**Highlights:**

- **HOUSING MARKET CONTINUES PULLBACK; BUST SEEMS UNLIKELY**
- **EQUITY MARKET REMAINS CONSTRUCTIVE FOR ECONOMY**
- **GENERAL OPTIMISM HAS CAUSED BOND YIELDS TO RISE**
- **CAPRIN MAINTAINING OPPORTUNISTIC POSTURE FOR STRATEGY AND YIELD INITIATIVES**

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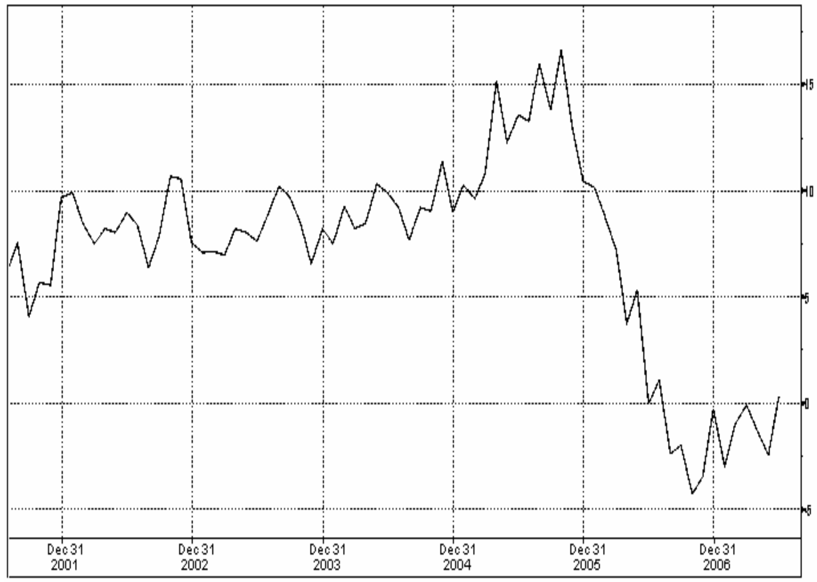


Figure 2. Year-over-year median home price change (%)
Source: *Bloomberg*

Today's housing slowdown, as expected, has prompted many investors to look elsewhere for asset appreciation. Average housing appreciation rates have been in the double digits in recent years but lately have fallen to approximately 3%. The renewed energy in the stock market thus is likely aided by investors searching there for new gains. The equity market's upward trend this year is a positive sign of the stability of this country's economy, as is our relatively low unemployment rate. Many similar indicators are suggesting that a recession is unlikely. Thus, our economy appears to lack a tipping point that would cause the housing slowdown to plummet further to a true bust.

## Caprin Strategy

One year ago, forecasters predicted a domestic real estate bust for 2007 that would act as a heavy drag on the U.S. economy and force Fed Chairman Bernanke and the FOMC to cut the Fed Funds Rate three times by March 2007. To the contrary, even though we have seen a housing downturn, strong global and domestic growth, declining unemployment rates, and healthy stock markets have kept sentiment quite positive, and the Fed has maintained its 5.25% rate for the past eight consecutive meetings. This transition to a more favorable economic outlook from a year ago to today has left the bond market in fair shape, with yields on longer-term bonds rising with forecasters' optimism. In recognition of the evolving outlook, Caprin is maintaining its current target duration of 4.25 years with a corridor on either side to afford portfolio managers flexibility to position portfolios advantageously in this shifting market. Caprin will be constantly looking for ways to improve our clients' yields and to defensively structure portfolios in preparation for newly arising market scenarios.