

Economic Outlook

Everybody who even remotely watches the financial networks knows that the only hot topic seems to be the sub-prime lending market and its spillover into the regular and more traditional mortgage market.

If we assume for just a second that the above is indeed the hottest topic, and therefore requires our immediate attention, then it is easily understood why so many make the imaginary leap to a major burst in the housing and real estate market.

Nothing could be further from the truth.

On the contrary, we are convinced that the real estate market is alive and well and continues to offer excellent opportunities for homebuyers and investors.

Before we substantiate this seemingly contrary economic outlook, let's review some of the popular notions as presented by Washington D.C.

1) FNMA and FMAC intervention:

The suggestion by politicians and economists, that easing the current investment restrictions for both agencies, allowing them to repackage less rated mortgages, will ease the current credit crunch in the international markets and provide more liquidity, is wishful thinking.

The mandates, as set forth by government policy, are meant to protect the investors from unnecessary risks associated with structured products wrapped around non-investment grade paper.

A regulated easing correlates directly with applying make-up in the evening and hoping it will make us look pretty two months later. A double header of a "Nip and Tuck" episode would have a more realistic effect.

2) Federal Reserve Policy:

Politicians are still confused to this date when it pertains to the real mandate of the Fed.

Mr. Bernanke has made it clear on several occasions, during his testimony to congress, that his primary objective is to control inflation based on multiple economic indicators. Fixing hick-ups or coming to the rescue with a band-aid is not part of the Fed's mission and distracts the FOMC from its real purpose.

The political pressure, primarily fueled by lobbyists, to lower interest rates, thereby easing the credit crunch and the pressure on mortgage banks, hedge funds and mutual funds, will wreck havoc on the inter-currency liquidity and will have long-term negative effects on the USD and the Treasury markets.

So, one might ask, how do we fix the bubble in the mortgage and housing market?

First of all, we need to agree that there are bubbles that require fixing.

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In our opinion, and judging by the core indicators, there is no bubble in the mortgage market.

On the contrary, local, regional and national banks continue to extend credit to potential homebuyers and investors all day long. They do not feel a credit crunch in the market and there are ample underwriters available to pick up the underlying notes. As long as the borrower presents and completes the required documentation, traditional and structured loans continue to be easily available at 6.5% or 7%.

The so-called bubble is nothing more than a balloon with plenty of air to carry on as usual. Bankers and real estate brokers understand very well that, in order to continue to inhale, one has to be willing to exhale and allow some air or steam to escape at regular intervals.

Currently, we are at such a rest pause, which allows all participants to reevaluate the product offerings and go back to basics.

The same applies to the secondary housing market. We have experienced exponential growth across the board, based on large demand. Such growth is only sustainable long term if and when the underlying fundamentals remain sound and rational.

The corrections we have witnessed in the last several months are a sign of blind exuberance being replaced by common sense.

While we do not expect a dramatic change in the market behavior for 2008, we project a return to normalcy by late 2009, early 2010 albeit in a more tempered, controlled but sustainable environment.

In contrast, we do not foresee the primary housing market to fully recover prior to 2011 at the earliest. The driving factors that control this sluggish recovery are the disappearance of previously available structured high-risk loans and the existing inventory in the market.

What to do during the market pause?

The opportunities to invest in the real estate market are omni present as are the financing tools to achieve your long-term goals. Your real estate broker and banker have the expertise to help and advise you on the realistic value of your investment versus the listed FMV as well as structure a financing plan to meet not just your financial needs, but more importantly your financial capabilities long-term.

Remember, it may seem that the current market is entirely buyer driven, but buyers be aware: the expectation of high and fast ROEs are gone, not to return to the market again for several years.

Instead, steady, reliable and sustainable growth combined with reduced but realistic returns are on today's menu.

Nick Doms
Chief Financial Officer

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Inter-Currency Markets

While many currency traders and the VIX predict a high probability of the Federal Reserve cutting interest rates by 25Bp as early as next month with at least one additional cut of 25Bp prior to year-end, we believe both indicators to be misleading to investors and to be solely based on the ripple effect of the sub-prime mortgage market.

The popular predictions are identical to finding mathematical proof of the correlation between a small hick-up of the St. Andreas fault with a future tsunami in Asia.

Of course, there is none to be found.

However, what can be found is the correlation between a tsunami in Japan as a result of the efforts to try to stop the earthquake, and here is the reason why.

Through the multitude of news surrounding the housing market, several important indicators have slipped by us almost unnoticeably.

When Warren Buffett announced his company had taken a major currency position in Asia, the vast majority of traders speculated Mr. Buffett wanted future exposure to the Yuan Renminbi.

Our conclusions, driven by global economic indicators, pointed towards a safer, consistent and more attractive opportunity in Asia Pacific, namely the JPY.

The investment strategy to shorten the USD versus the JPY is primarily driven by the persistent prediction that Europe will not be able to defend the Euro versus the JPY sufficiently in the next two years.

The effect will swiftly ripple through the global inter-currency markets and will weaken the USD even further, impacting the treasury markets, even if the BOJ does not increase the short-term interest rate and both the ECB and BoE raise their inter-bank rates.

The tip of this iceberg can already be spotted as we write and will become even more visible during 2008.

The continuing shrinking of the available liquidity in Europe increases the chances of this occurrence.

The second indicator to follow is the controlled movement of the Yuan, currently pegged to the USD.

While politicians, involved in trade negotiations, insist on a free-floating Chinese currency, we warn against such drastic intervention. A free-floating Yuan will show immediate results on our trade balance sheet with China. However, the long-term effects will be adverse and will seriously harm the position of the US economy as an important trading partner in the ever-flattening global arena.

We opt for long-term benefits rather than short-term pacifiers.

Nick Doms

Chief Financial Officer.