

"Our Clients' Past Successes are Not Necessarily Indicative of Future Successes."

Stamper Capital & Investments, Inc.

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CLARK STAMPER's **Elements of Market Tops** **WEBLOG**

This weblog details elements of large market tops (like Real Estate) in real time beginning July 18, 2004 (see our Annual Forecasts <http://www.risk-adjusted.com/AnnualForecasts.html> to view our analysis during the 2000 stock market top and decline - remember the NASDAQ fell 78%!!!). As in our Deflation Watch weblog and our Major Trend Change Indicators weblog (both found at: <http://www.risk-adjusted.com/Weblogs.html>), we are presenting the information in conjunction with a re-interpretation and/or additional interpretation of articles we see in the media.

September 19, 2007 *** Well, our forecast for the market top in real estate is pretty much in - confirmed by the latest official statistics and numerous media articles. In addition the Fed's "surprise" cutting of the Discount Rate by 50 basis points a month ago and yesterday's Fed cut of the Fed Funds Rate by 50 basis points clearly indicates that the economy is in trouble. Thus, we have decided to stop posting to this Elements of Market Tops Weblog (to us, the top is in) and will continue on our new Anatomy of a Credit Contraction and Deflationary Downturn Weblog, found at <http://www.risk-adjusted.com/Weblogs.html> ***

August 28, 2007, HOUSTON CHRONICLE, "**Home Prices: Steepest drop in 20 years;**" "**U.S. Home prices fell 3.2% in the second quarter [of 2007], the steepest rate of decline since Standard & Poor's began its nationwide housing index in 1987, the research group said Tuesday.**" That pretty much says it. We note that this drop is across the country; we have documented many places where drops have been dramatically larger than that. We also emphasize that we believe we are still in the initial stages of the downturn, unfortunately.

August 13, 2007, LOS ANGELES TIMES, "**Credit Fears May Curb Home Sales - Some experts see pending deals fall out of escrow in part because of the turmoil in the mortgage market;**" This article highlights that loan terms are changing so quickly that it seems to be upsetting actually doing business in the real estate market. "What's unprecedented is the speed of the change of the available mortgage terms." A particular mortgage broker "...started seeing lenders change or eliminate their mortgage programs for riskier sub-prime loans about six months ago, and they seemed to do so every quarter. Then lenders started sending brokers notification of changes every month. Within the last week or so, their notices started coming EVERY DAY, and included changes in loan programs affecting EVEN THE BEST BORROWERS." The article tells

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about brokers having to call clients to tell them they can't get loans for purchases because the terms just changed.

April 13, 2007, CHARLOTTE OBSERVER, "**No Mortgage for Those with Good Credit;**" This article pretty much confirms our forecasts are coming true (unfortunately). "The abrupt end of a decade of easy lending has already moved home ownership beyond the reach of many people with lower incomes or credit problems. Now, Charlotte-area brokers say a much broader swath of people are facing barriers to borrowing."

"Interest rates also have climbed sharply on the largest loans, called 'jumbos,' because lenders can't resell them to Fannie Mae or Freddie Mac. The loans basically are reserved for the wealthy, but that's not enough comfort for lenders." **The difference between a smaller "conforming loan" and a "jumbo" used to be 0.20% per year - now it has jumped to a difference of 0.75% or 7.34% for a jumbo and 6.59% for a conventional.**

"The higher rates mean buyers have less money to spend." "That \$600,000 buyer will no have to look at buying a \$550,000 place or paying 10 per cent more per month for the same house versus last week."

July 31, 2007 - There are just too many articles to writeup now that reality is being recognized (see our **Major Trend Change Indicators** weblog at <http://www.risk-adjusted.com/Weblogs.html>) and the effects are snowballing. Also, the articles mostly match the forecasts we have already detailed (below and other weblogs) so we are just going to list the headlines:

7-31-07 BLOOMBERG, "**Moody's Says Some 'Alt A' Mortgages Are Like Subprime.**"

7-31-07 BLOOMBERG, "**Junk Bonds Have Worse Month in Five Years on LBO's, Subprime.**"

7-31-07 BLOOMBERG, "**U.S. S&P/Case-Shiller Home Price Index Declines 2.8%.**"

7-31-07 BLOOMBERG, "**American Home Can't Fund Loans, May Liquidate Assets.**"

7-31-07 BLOOMBERG, "**Corporate Bond Risk Soars as Subprime Mortgage Losses Spread.**"

7-30-07 BLOOMBERG, "**Five Signs That Subprime Infection is worsening.**"

7-28-07 BOSTON HERALD, "**Crisis of Confidence: Consumers Lose Faith.**"

7-28-07 CHICAGO TRIBUNE, "**Subprime Pain Spreads Into Office Market - As business volume plunges for real estate firms hurt by the housing slump, they and companies that service them are abandoning office space and leaving landlords and surrounding communities suffering.**"

7-27-07 O.C. REGISTER, "**Ripple Effect - While the slowing housing market is exacting a toll on some home-accessory retailers, the larger players are gambling on opening new stores in O.C.**"

7-27-07 O.C. REGISTER, "**O.C. Auto Sales Sink in First Half of '07.**"

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7-27-07 O.C. REGISTER, "**New-Home Sales Slump Persists Throughout U.S.**"

7-27-07 CBS MARKETWATCH, "**Around the Globe, Rout in Credit Markets Accelerates.**"

7-26-07 CBS MARKETWATCH, "**Subprime Could Create Global Crisis, Economist Says - World is one 'Bear-line' event away from liquidity freeze...**"

7-24-07 BLOOMBERG, "**Defaults on some 'Alt A' Loans Surpass Subprime Ones.**"

7-24-07 BLOOMBERG, "**California Home-Loan Defaults Rise to Decade High as Sales Dip.**"

We have not seen a proliferation of articles of this type since the 2000-2002 down draft. Remember during that period the S&P 500 fell around 50% and the NASDAQ fell 78%. We would not rule out such declines from the current credit contraction.

June 26, 2007 MARKETWATCH, "**Home Prices Fall at Fastest Rate in 16 years - S&P/Case-Shiller Index Shows Prices Down Annualized 2.7%;**" Well, the headline says most of it. This is "...the largest decline [in the index] since September 1991." The index started in 1987. Too bad the index does not go back to the 1960's. I would have been interesting to see what it reported for the top in 1974 and for the much larger top in 1979.

We want to point out that, according to the article, "The Case-Shiller index is considered a superior gauge of home prices compared to the median sales-price data released by the Commerce Department or the National Association of Realtors, because it **tracks multiple sales on the same property and is therefore not influenced by a different mix of homes sold in a period.**" We would add that it is probably less likely to be manipulated for political or other reasons. However, the Case-Shiller index is restricted to 20 cities.

This measurement of real estate prices is very interesting to us. Similar to this index, we have documented specific sales of multiple properties in Newport Beach which declined by over 60% from the 1979 top down to the real estate bottom in 1985 (two years after the stock market bottomed). Those drops were based on actual trades for specific houses in Newport Beach. When we see official statistics that show a little blip of a drop - we just laugh. The historical volatility of real estate has been dramatically more than we have ever seen reported; however, this Case-Shiller index may show the true reality. Of course that index is for the major cities. We have already reported articles on real estate in small cities citing price drops of over 20 percent in this current cycle.

May 29, 2007, YAHOO FINANCE, "**Neighborhoods Swayed by 'Liar's Loans' - Drawn into Real Estate Frenzy, A neighborhood Finds Home Loans Too Good to be True;**" This is a very telling article about what, at least in part, caused the real estate bubble. **The article details how mortgage brokers used a church basement to make presentations where it is alleged they talked people into buying properties they could not afford.** It is alleged that the brokers then basically "cooked the books" when filling out the loan applications. The stories of how the loan documents are astounding. For example, a woman receiving "\$1,800 a month in disability payments -- as she

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recovered from a collapsed lung -- and sometimes receiving child support of \$150 per week..." was described on the mortgage application as "...an administration manager for a medical supply company, earning \$114,000 per year." It is interesting that they are debating in court whether this was outright fraud or just someone helping another get a loan. Of course, the mortgage broker got thousands of dollars in commissions and fees.

It was kind of sad reading about how these lower income people were apparently snookered - of course, the mortgage brokers involved are "blaming the victims" - the borrowers, but the other victims are those whose lives were pushed out of balance by the easy credit (fraudulent or not) and the tumultuous rise and fall of real estate 'values.' We believe stories on this subject are just starting and will be coming out for years.

Other useful facts from the article are that "liar loans" are actually officially called "stated income loans" and that they are a huge part of the "sub-prime" market. **"Last year, nearly half of subprimes required little or no documentation of income,** a share that has nearly tripled since the start of 2000..." It also talks about a study "...of 100 stated loan applications last year [that] found **almost 60% exaggerated incomes by at least half.**" Another study "...found that **70% of mortgage defaults were linked to a significant misrepresentation on the original loan application.**" Well, with statistics like those, you can see how fraud contributed to the real estate bubble, and also how resolution back to reality is likely to contribute to deflating the bubble.

May 25, 2007, MARKETWATCH, **"Existing Home Sales Fall to 4-Year Low in April - Supply of Homes on Market Rises to 15-Year high;"** "Resales of homes fell 2.6% in April...the slowest pace in four years. Sales are down 10.7% since April 2006." They are talking about sales volumes, not sales prices. "The median sales price fell 0.8% year-over-year to \$220,000." Importantly, "...sales [volumes] fell in all for regions [in the United States]." We point out while values and fortunes of real estate are often regional, this bubble is national (and even international).

May 24, 2007, MSN MONEY/REUTERS, **"April New Home Sales Jump as Prices Fall;"** Of all the articles on this subject this is the only one that had a fair headline - the rest we found left off the important part - the record falling prices part. It is remarkable how the press is trying to paint this data as positive at least in their headlines. It is most likely a demonstration of social dynamics and peer pressure in the business environment. **The most important information is that "...builders slashed prices, pushing the median price of a new home to \$229,100 in April [2007] from \$257,600 in March [2007]" - we will calculate that for you - it was a drop of 11%!!! - another article pointed out that that 11% drop in median price was a record.** A similar 5/24/07 article (BLOOMBERG, "New-Home Sales in U.S. Jump 16% to 981,000 Pace in April) points out **"New-home sales, which account for about 15% of total home sales, are considered a better leading indicator of the market than existing home sales because they are recorded when a contract is signed rather than when the sales are closed. Most sales of existing homes are counted when a contract closes, usually a month or two later."** Based on that we would expect that reported sales of existing homes could

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increase over the next couple of months but that the median price will likely be dropping quite a bit. We will see.

May 20, 2007, ORANGE COUNTY REGISTER, "**High Roller of Home Loans - Daniel Sadek's Quick Loan Funding wrote \$3.8 billion in subprime loans - it appears his luck has run out;**" This is a fantastic story and article - the story of Quick Loan Funding and its founder/owner.

"Just five years ago he was selling cars. Then, in January 2002, he anted up \$250 for a state lender license and started selling home loans through his company, Quick Loan Funding. Over the next five years, Quick Loan wrote \$3.8 billion in mortgages, lending money fast - and often on onerous terms - to people with shaky credit." For our purposes that is the gist of the story - the article has great detail on the situation - we wouldn't be surprised if the story becomes a movie.

Upon reading/learning this 2002 start up wrote \$3.8 billion in mortgages, I don't see how anyone could say the real estate market and the credit markets haven't been and aren't in an incredible bubble.

According to the article, Quick Loan is on the ropes like most other lower quality mortgage companies that did so well previously, when the bubble was inflating.

May 13, 2007, THE ORANGE COUNTY REGISTER, "**Lending's Next Tsunami?"** There have been a few of these articles recently. They are talking about the next home lending tier above sub-prime, which is called **Alt-A**. "Alt-A loans (one tier above subprime) are for consumers who don't submit all the documentation for a traditional straight loan."

The industries' largest Alt-A lender, which made a record \$90 billion in loans last year, recently announced its "sour loans, and foreclosed real estate ballooned 75% to \$324 million." It also announced that "...the Company didn't sell a single dud loan in the first three months of the year [2007] because **no one wanted to pay what [the CEO] thinks they are worth.**" Normally, they unload their bad loans.

Cutting to the chase, an industry analyst said, "**Its eerie how the sub-prime troubles appear to be repeating in Alt-A.**" Basically, lending standards were lowered for Alt-A loans over the past several years including:

- 1) low or no documentation loans representing 81% of all Alt-A purchase loans made in 2006
- 2) loans with a one-year fixed "teaser" rate accounting for 28% of Alt-A purchase loans
- 3) an 88% average loan to value on the Alt-A loan, with 55% of borrowers taking out a simultaneous second mortgage, "suggesting such borrowers didn't pay mortgage insurance and borrowed the full value of the home.

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Many believe this is the end of the problem but we are believing that this is the beginning. Hopefully, the cycle has bottomed but we are much more skeptical. As the article points out there is substantial "reset" risk and the majority of these borrowers have little real equity after the simultaneous 2nd mortgages. In addition, as we have documented previously, credit standards are being raised and it may very well be that many of these borrowers will not be able to refinance. Thus, we think the correction in real estate has just begun, unfortunately.

May 9, 2007, BLOOMBERG, "**S&P to Require More Protection on Second-Lien Debt;**" The title pretty much says it. To us, this is more evidence of a credit tightening and a credit contraction.

May 1, 2007, BUSINESS WEEK (May 7th edition), "**Why This Slump is Different;**" Basically this article is all about how this time around, this real estate slump is different - interestingly before 2006 almost no one would even admit a real estate slump had ever occurred, now they are comparing them. Differences are:

- Never before have prices fallen so broadly.
- Prices slipped year over year, the first drop nationally since the depression.
- Foreclosure filings jumped 42% in 2006
- Those 30 days or more late on their payments increased 26% from last year
- Houses hitting the market with asking prices below the mortgage values

Ok those are some of the differences, but the main difference this article highlights is that "**lenders are wary of holding on to properties whose values could sink further.** And, unlike in previous cycles (ha, now they are admitting to cycles in the values of real estate), **a big chunk of the loans made recently are held not by federally insured thrifts or banks but by hard-charging hedge funds and other big investors that are aggressively pushing lenders to stop the bleeding.** What's more, the steep rise in **second mortgages** that accompanied the boom means lenders in foreclosure proceedings are increasing fighting one another for the scraps."

The result is a **whole new vocabulary** in real estate related to the deflating bubble. Most of the new terms in this article revolve around lenders trying to work out the bad loans - bad because the value of the underlying asset is worth less than the loan and the lender is going to default or already has:

- Payment Plans - The lender temporarily forgives missed payments
- Loan Modifications - The bank reduces payments permanently
- Pre-foreclosure Sale - With lenders approval, owner sells the home for less than the mortgage and the lender takes the loss
- Mod Squad - team of workout specialists helping borrowers renegotiate

This article is well written and extensive. We would add to it that the reason it is a national phenomenon is because it isn't really a real estate thing, it is a financing or credit thing. In fact, we believe, it isn't just national, it's world wide - a worldwide credit

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bubble. Also, though implied, the motivation of lenders to take such extreme actions is because the downside is dramatically larger than it has been before. The amount of relative debt is off the charts in real dollars and relative to real estate "values."

A related BUSINESS WEEK article, "**How the Bad News Could Get Worse**" details and expands the theme that real estate is much more of a tangled web this cycle. That the loans were packaged and sold by investment bankers into collateralized debt obligations (CDO's) and that, combined with second mortgages and home equity lines placed on top of first mortgages will make handling widespread defaults a long term nightmare to untangle as all the parties negotiate and sue each other.

We would say these two articles together are kind of a 'reality recognition' that could potentially lead to many parties heading for the exits all at the same time - while there is still "liquidity."

April 24, 2007, BLOOMBERG, "**Subprime 'Liar Loans' Fuel Housing Bust with \$1 Billion Fraud;**" Basically this goes along with "bubble activities" we have documented over the years that contribute to a market becoming vastly overvalued. Turns out the industry has a nickname for "no doc" loans - yup, its "**LIAR LOANS.**" Interestingly, it turns out that it isn't usually the borrower, or at least not the borrower acting on their own, it is both borrower and the broker. "Borrowers and brokers commit fraud when they exaggerate the applicant's income, qualifying the borrower for a home he otherwise couldn't afford." "The brokers are just putting down on paper what the underwriters would require..." Liar loans "...soared to \$276 billion, or 46%, of all sub-prime mortgages last year from \$30 billion in 2001..." Well, this probably explains to us how all these buyers in Newport Beach can afford to purchase the couple of thousand new \$2.5 million to \$5 million dollar homes that were built recently. In the old days, even with a \$1 million down payment on a \$3 million dollar house you would have to "make" around half of the \$2 million mortgage or \$1 million per year in income to qualify. Even in "the O.C." there aren't that many people who make salaries like that. It will be interesting to see how this all unravels.

April 20, 2007, SACBEE, "**Property tax falling for 50,000 Sacramento County Homeowners;**" Information in this article confirms to a larger extent than has been publicized elsewhere that the real estate market is dropping harder and faster rather than less and slower. "Letters to 50,000 Sacramento County homeowners are being mailed today announcing **cuts of up to 10% in their fall property tax bills...**" This rollback will "erase about \$15 million in [annual] revenue for schools..." - which to us is potentially deflationary. "Thousands more homeowners in other area counties may see similar rollbacks." "Assessors say they make their decisions based on a home's Jan. 1 value -- a factor likely to trigger **more property tax rollbacks next year** if values stay flat or decline more in coming months." Some history that people in real estate seem to only now be able to recall: "**The rollbacks signal a REPEAT of the 1990's when recession and job losses pushed down are housing values and 30% of Sacramento County homeowners received property tax relief.**" Obviously they are only rolling back property taxes because the value of the real estate has dropped quite a bit.

March 9, 2007, REUTERS, "**Countrywide Financial Ends No Down Payment Lending;**" "Countrywide Financial Corp. ("CFC"-NYSE), the largest U.S. mortgage lender, on Friday [March 9, 2007] told its brokers to stop offering borrowers the option of a no-money down home loan, according to a document obtained by Reuters. A similar BLOOMBERG article (on 3-9-07) points out that "...other lenders that have started requiring borrowers to put at least 5% down on homes include Washington Mutual Inc. and General Electric Co.'s WMC Finance Co. unit.

That is the news - Our analysis of this news is that this loan underwriting measure is the official beginning of the Credit Crunch and Credit Contraction. While we realize "at the time" it was easy for these companies to get caught up in the real estate bubble, probably a year from now (or even now) many people will be saying, "**what were they thinking?**" **making 100% loan to value loans.** It just goes to show how even the largest companies can get caught up in irrational business practices during certain cyclical times. Other related themes along these same lines are the "no-documentation loans" and "sub-prime lending." Years from now, people will think it unbelievable that such respected financial institutions at the time would make "no doc" loans or even "sub-prime loans."

As for our Elements of Market Tops a substantial increase in lending standards such as this (going from 100% loan to value to a max of 95% L-T-V) means less loans will be made. This experience is by definition a credit contraction. Two other "flies in the ointment" of the real estate bubble are the \$1 trillion of adjustable rate loans that are re-setting in 2007 and by the end of 2008 and the admission of experts/authorities of the huge amount of underwriting (and outright fraud) to buyers that really did not qualify that happened as a result of the "no doc" and "sub-prime lending over the past few years.

This situation creates a One, Two KnockOut Punch for Real Estate:

- 1). **Punch One - lots of supply for sale on the market** as defaults step up and properties go back to the banks which then unload them on the market. Defaults from borrowers who can't make new payments when their adjustable rate mortgages reset; borrowers who purchased 100% L-T-V loans and can't make the payments; borrowers who didn't qualify in the first place, etc.
- 2). **Punch Two - Less Demand - Fewer buyers now** that the lending standards have been raised to 95% L-T-V and those who should not have qualified previously, definitely won't be qualifying in the future.
- 3). **Third Punch - Buyers who bought on Spec**, and this is a very large percentage of home ownership, will be flushed out. Thus, additional supply (and defaults).

As reported previously around 40% of the recovery since 2002 is widely attributed to the real estate industry. Thus, we believe the collapse of the real estate bubble will create a huge negative ripple across the economy. We believe collapsing prices of real estate will most likely morph into deflation in many other categories - certainly prices of other risky asset classes.

Feb 28, 2007, BLOOMBERG, "U.S. Economy: **Home Sales Tumble Most in 13 Years...;**" "New home sales in the U.S. tumbled last month by the most in 13 years..." The headline and first sentence give a good idea of what is going on as far as the real estate market.

Feb 27, 2007, BLOOMBERG, "**Risk Returns**, Not Just to the Subprime market;" "Problems in the subprime loan market have been front-page news for weeks, with **a total of 27 mortgage lenders going belly up since December [2006].**" Wow, that was a quick turn of events - 27 subprime mortgage lenders went belly up over a two month period!!! Just more evidence of the downturn in real estate and the economy. To be clear, we believe this is just the beginning.

January 8, 2007, NEW YORK, "**The Year of the Price Cut;**" This is from an entertainment-style magazine. **The subtitle is, "Overreaching is so 2006."** The author of this article utilized Streeteasy.com, an online database that gathers information on most real estate listings in New York City, to find the largest price drops. It lists six - all six are the percent change from the previous asking price to the current asking price - so these are not transactions and these are the largest drops; however, it is still telling to us. The percent changes are:

41.6% drop
37% drop
36.4% drop
36.2% drop
34.8% drop
34.9% drop

One aspect of this reporting that is interesting to us is the fact that **an entertainment magazine is highlighting real estate price drops, a subject a large proportion of its readers probably are not thrilled about. Thus, the drop in prices is not new news but is likely confirmation of a trend that is already accepted.**

January 7, 2007, NEW YORK TIMES, "**A Phantom Rebound in the Housing Market;**" This is a very interesting article because it explains how some of the statistics related to housing are potentially very misleading under the current circumstances. "But those who think that the worst may be over for the housing market should take another look at the data, economists say. For the figures on new-home sales have a strange wrinkle that, in the current environment, may lead the government to overstate sales (and to understate inventory) by up to 20 percent."

"New Home Sales" are tallied by the Census Bureau, "...but here's the rub: If a contract to buy a home, signed in November, is canceled in December, **the Census Bureau does not subtract the failed transaction from the number of sales, or add the house back to its inventory total.** In the last year, as the housing market has cooled, **the volume of cancellations has risen to epidemic proportions...**" "....as speculators who signed contracts to buy homes in new communities in hot markets like Florida simply

walked away from their deposits when they realized they couldn’t flip the houses for a quick profit."

Cancellations are running at 37% for Toll Brothers and 36% for Pulte Homes, for example, up from 18% and 17% the previous year, respectively.

A chief economist at the National Association of Home Builders has concluded that in November 2006, **cancellations constituted 38 percent of gross sales, compared with 26 percent in November 2005 and about 18 percent in the first half of 2005.**

"On its Web site, the Census Bureau acknowledges: 'As a result of our methodology, if conditions are worsening in the marketplace and cancellations are high, sales would be temporarily overestimated.' By how much?" **One analyst "... estimates that the government is overestimating the pace of annual sales by 100,000 to 150,000."**

Another analyst "...estimates that the differential is even greater. **'Given the rise in cancellation rates, it suggests that between 150,000 and 200,000 home sales are being counted that actually did not occur.'** ”

"Just as the rising tide of cancellations leads the Census Bureau to overreport sales in the short term, it leads the government to underreport inventories. **New homes on which contracts are not consummated are not added back into the inventory figure.** The most recent report found that the seasonally adjusted estimate of new houses for sale at the end of November was 545,000, or 6.3 months of supply. Given the high rate of cancellations, it’s likely that inventory is substantially higher."

"This much is clear: Given the failure of the reports to account for cancellations, demand isn’t as strong as it appears, and supply is greater than it seems."

Thus, we conclude, be careful using the reported statistics to infer that a sustainable rebound in the real estate markets is occurring.

December 18, 2006, THE ORANGE COUNTY REGISTER, "**Falling Prices Trap NEW Homebuyers;**" This article is about a situation here in Orange County where the market has kind of stopped. Basically, buyers purchased houses in a new development at between \$888,500 and \$770,000 in November 2006 with very little down and the builder subsequently cut the prices on its inventory by between \$100,000 and \$140,000, just a couple of months later. **Thus, the owners "market value" using a drop of \$100,000 has fallen by 11% to 13% very rapidly.** Because the buyers had little equity, they are now underwater and some of them are in adjustable rate mortgages. It is a very unfortunate situation. While the buyers are blaming the builder, we think the problem is really much larger - as we have documented previously, the buyers appear to have been trapped in a deflating housing/credit bubble and, while real estate is certainly regional, stories like this are popping up across the country. **To us, real estate is kind of turning into a game of "hot potato" as both builders and buyers are trying to avoid owning.**

THE WALL STREET JOURNAL ARTICLE, "**The New Word In Home Sales: 'Cancelled'**" (November 3, 2006) that we did not review, points out that "contract-cancellation rates for big builders were running around 40% -- about **twice as high** as last year's levels. That article was more about how the large builders are being stuck with inventory that is dropping in price. Anyway, **our point is that the market is having some air pockets to the downside,** unfortunately, for most - ugh. Also, we don't believe that we are anywhere near the bottom in real estate. We expect prices to drop fairly rapidly from here on out; however, they may drop slowly over a long period of time. Remember Japan is still in a deflationary climate 17 years after its 1989 peak.

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November 29, 2006, CNNMONEY.COM, "**Home Prices Post Record Drop in October [06] - Median [national] price sinks 3.5% from a year earlier, trade group sees more price declines ahead;**" In this case they are referring to existing (old) homes rather than new developments. "The price of existing homes sold [nationwide] in October [06] fell for the third straight month and posted the biggest drop on record..." "**The previous record drop was a 2.1 percent decline in November 1990...**" "While month-to-month declines in home prices are not uncommon, year-to-year drops had been rare before the recent housing slump."

November 29, 2006, BOSTON HERALD.COM, "House Prices Plunge: All Hub gains since March '04 vanish;" Boston seems to be leading the declines with other areas joining in shortly afterwards. This article highlights "**Boston house prices plunged last month at their fastest pace in more than 13 years, erasing all gains recorded since early 2004, new figures show.**" "It is also the sharpest 12-month pull back since 1993."

November 27, 2006, BUSINESS WEEK (December 4th edition), "A Good Time to Ask Santa for a New House;" Probably not - probably far too early in the cycle as the down draft is just getting started but the article does contain some recent information. "**The median price of a new home in September fell by 9.7% from a year ago, the largest annual decline since 1970.**" "**And it looks like prices in several markets will be heading even lower in coming months.**" "**And, the stock of completed new homes that remain unsold as of September [2006] grew by 46% from a year ago.**" We do not buy that the housing market is anywhere near the bottom.

November 22, 2006, DETNEWS.COM, "**The Incredible Deflating Housing Market;**" The title of this one pretty much covers it. This article is oriented around Detroit but most of the information will be true across the nation over the next few months.

October 16, 2006, THE SAN DIEGO UNION TRIBUNE, 'Foreclosure rates, default notices soar - Analyst credits rise to flattening house prices;" "**San Diego is experiencing mortgage foreclosure rates not seen for the past eight years, two monitoring companies reported yesterday.**" DataQuick reported **foreclosures jumped to 10x** the level they were a year ago and it reported the number of "**default notices**" **nearly tripled** the amount filed in September 2005. Importantly, "**the percentage of those defaults going to foreclosures last month was 35.6%, more than 7x** the 5% rate a year ago." Similarly, while "...only 62 properties were classified as 'R.E.O.' or real estate owned by banks - Still, that was **6x** the 10 R.E.O.'s counted in September 2005...." While the absolute numbers are still relatively low representing "...a fraction of the number recorded a decade ago during San Diego's last economic downturn," a spokesman for RealtyTrac commented, "**the recent increases reflect the 'first wave' of defaults and foreclosures stemming from the rise in adjustable-rate mortgages whose interest rates are rising too fast for some borrowers to afford.**" Thus, this is a "potential element of a market top" that is very much along the lines of what we have forecasted and have warned against and is definitely worth monitoring. The next unfortunate step, if

these foreclosures continue to step up is for transacted prices to start to fall as banks will be unloading the REO they accumulate from foreclosures.

October 8, 2006, BOSTON HERALD.COM, "**Condos going, going, cheap: Bidders get great deals on 31 units at Hub auction;**" Importantly, for this article, all condos that "...went up for pre-construction sale four years ago...sold for the asking price." With that said, "The 31 condos up for sale in the Folio building on Broad Street sold on average for **30% below** their asking prices" "-hundreds of thousands of dollars wiped off their value..." "The most expensive properties fell hardest. A \$1,760,000 **penthouse plunged \$600,000 to just \$1,140,000" or a 34% drop!** The article goes on to list several examples of 30% or more drops in price.

October 6, 2006, BUSINESS WEEK, "**More Scrutiny for High-Risk Mortgages;**" Wow, talk about legislation or regulation following economic reality. "Five agencies, including the Federal Reserve and the Federal Deposit Insurance Corp. issued [NEW] guidelines on Sept. 29th, **effective immediately**, on how banks should handle nontraditional mortgages...." such as adjustable rate mortgages (ARMs) and option-arms. "The guidelines could exacerbate the slowdown in the housing market. **A meaningful number of people who could borrow on very loose terms won't be able to do so in the coming months,**" on analyst commented. "While the guidelines are intended to protect lenders and consumers, the timing is inauspicious for a housing market **already in the throes of a downturn.**" That pretty much says it all. We note again that it seems regulation is following market reality - a concept to think about.

October 6, 2006, THE NEW YORK TIMES, "**Suit Says Neighborhood's Boom Was Build On Mortgage Fraud;**" A different article on mortgage fraud. In this article it appears to other than "Joe-average" working the system. But, the article does point out that pretty much everyone in the system was incentivized to work in ways that helped out the bad guys. -"If the deal doesn't go through, nobody gets paid." Basically, in May 2005, a group of people bought up 184 duplex homes in a down-and-out neighborhood of Indianapolis for an average price of \$50,000 each and sold them "less than a month later....for \$120,000 a piece to church secretaries, truckers, retirees and factory workers..." Previous to these transactions, "...as recently as September 2004 homes in this neighborhood sold in range for \$20,000 to \$65,000. **Of course the selling at more 2x the cost a month before was made possible because of credit or mortgages - and this is where the fraud comes in.** This time the bank that bought the mortgages is claiming it has been defrauded by the underwriters, who underwrote the mortgages to that bank's specifications - that is the quick version. We have a few points. **One is the concept of "value."** Everyone thinks "value" is in stone - that it is objective. We know that when using the word "value," certain phrases are implied or were implied at some time before "value" became such an abstract term. Think, value "to whom," and "on what basis," etc. Who is not to say Google isn't worth 100% more this month than last month - or vice versa - same with real estate. Now, "price" is a different matter. Prices being where transactions took place. However, who is to say that just because someone sold at the price of \$50,000 that a house isn't worth \$120,000 a month later, especially if it trades there or that is the new transaction price? We believe people have been lulled

into a false sense of security based on "inherent values." We believe that sometimes "values" can change dramatically up or down very quickly. However, usually the down drops are the sustainable ones. Thus, you should be very careful in risky markets where "values" are bandied about like they are cast in stone - it just isn't so. Our second point is that the fact that people would pay over 2x what someone else paid the month before, based on rents the "true values" must certainly be dramatically lower than that, that the underwriting process did not even alert anyone to these facts, and that the underwriting process most likely actually enabled the process S P E L L S "BUBBLE" to us - a bubble that can contract as fast as it inflated, unfortunately for some.

September 29th, 2006, LOS ANGELES TIMES, "**More Home Buyers Stretch Truth, Budgets to Get Loans;**" We believe this article points out enough facts to not only label the housing market a "**bubble**" but a "**mania**." "Lenders filed 4,228 reports of suspicious activity in the region [Southern California] during the first eleven months of the government's fiscal year [ending 9-30-06]." "...**the FBI and industry experts say the trend...reflects growing deceit by AVERAGE BORROWERS who overstated their income, exaggerated their assets or hid their debts simply to qualify for a mortgage in the region's sky-high housing market.**" Thus, this isn't normal criminal types but "**average borrowers**" - regular people - ugh. "There's more of the little guy running around - people committing fraud for housing," said, Ronda Heilig, the [Federal] Bureau's mortgage fraud program manager." So there are two things going on here. **One is that a lot more normal people apparently were rampantly committing mortgage fraud - that makes it a potential "mania" to us - the average person trying to keep up with the irrational herd.** The second point is that **these people are almost certainly not going to be able to service their mortgages - they are going to default and their houses will most likely be sold, causing further supply/demand imbalances** in what will probably be proved to be an overvalued "bubble" market in most regions.

September 11, 2006, BUSINESS WEEK, "**How Toxic Is Your Mortgage?**" This is the cover story for that issue and it contains a lot of interesting information about Option Adjustable Rate Mortgages (O-ARMs). We will stick to just a few points. A main point with these O-ARMs is that the borrower has the choice (the option) to pay the monthly payment or to have the lender make a large part of the payment and increase the loan balance by the payment the lender makes for the borrower. Of course, the "adjustable part" of the O-ARM means that the monthly payment will eventually reset - usually a year or two after the original loan was taken out. And, in the recent episode for essentially all such borrowers, interest rates have gone up fairly dramatically so the monthly payment has gone up a lot on the reset, accordingly. Whether the borrowers understood what they were getting into will be debated likely for many years to come.

The article gives a good example of the situation for a particular O-ARM borrower: The fellow was making the \$1697 minimum payment and, after a couple of months, realized the minimum payment was putting \$1,000 of new debt onto his loan balance every month. He could see this was going to lead to disaster. **However, his alternatives were limited. He could refinance out of the O-ARM into a standard mortgage at a monthly payment of \$2,524** - quite an increase from the monthly payment he was

making. Unfortunately for some borrowers, there is a large **prepayment penalty of thousands of dollars** to prepay their O-ARMs and often there are upfront fees on the new longer term, fixed rate loan - refinancing costs in one example are estimated at \$15,000. (Currently, lower long term rates have been helping to ease the pain of borrowers changing to fixed rates, but this could change at any moment).

Another point - the lender can book, as income, part of the payment it makes for the borrower. **We wonder if the lender then increases its loan loss reserves as certainly the credit quality of the loan is dropping as the Loan-to-value ratio is deteriorating** (loan balance going up without the underlying asset increasing in value). **The article spends some time explaining how lending standards were lowered pretty much across the board during the real estate ballooning period.** Also, the article is referring to this income as **"deferred interest" or "phantom income" because the lender is able to book income while not only not receiving cash but making the cash payment for the borrower.**

There were \$182 billion O-ARMs written in 2004 and 2005 and an additional \$83 billion this year, according to the article. **Importantly, for some large lenders, this "deferred interest" represents very large amounts of earnings - like 67%** for FirstFed Financial Corp. The article points out that Countrywide, "America's No. 1 mortgage lender" has ARM on its books equal to **"38% of its total mortgages held..."** And, get this, **"Three-quarters of the Company's Option ARM borrowers chose the cheapest mortgage payment** [(we interpret that as being the one which increases the loan balance the most)], according to its latest earnings release..." Wow - so a huge proportion of borrowers are digging themselves further into a hole - ugh.

Classic Bubble Recipe - Thus, it is easy to see, that without this financing technique and lowering lending standards, many buyers would not have been able to "purchase" real estate - accordingly, prices of homes likely would never have risen so high & Now, will likely drop as that this financing technique is collapsing on the borrowers who will likely have to sell their homes or give them to the lenders, unfortunately.

August 15, 2006, BLOOMBERG, **"Imax Says SEC Investigating Accounting; Shares Drop;"** - posted August 9, 2006 - additional articles on the BLOOMBERG: August 10, 2006, "IMAX; downgraded to sell from hold;" and previous to that: **"IMAX: Sony to join in bidding for Imax; now four players interested; auction process robust;"** This situation definitely has lots of elements of a market top. First, the big screen format company, IMAX, which has publicly-traded stock, is up for sale by its board of directors. Bidding interest was expected to be "robust" and the stock was trading publicly at around \$8.25 per share or an equity market capitalization of \$332 million. Nine buyers including Sony and private equity fund Elevation Partners, which features U2 lead singer Bono as a backer, assure that the valuation is strong. We ask sarcastically with perfect 20/20 hindsight: maybe it is too low? "Investors" move the stock price up by 31% to \$10.85 per share or an equity market cap of \$437 million over the next couple of weeks. Then, a huge swing over less than two weeks as explained by some analysts:

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"exhibitor interest appears to have cooled"

"signings [have] slowed, due to weakness in IMAX box office receipts"

interest in digital cinema has slowed

"revenue recognition policies are under review by the SEC"

"[IMAX] management failed to find a financial buyer or investment partner"

then, **IMAX shares plunged 48% in just over a week!**

One key to us is that what everyone thought was a "reasonable valuation" changed in a heart beat - the new valuation is 48% lower or lower by \$212 million (\$5.59 per share) just like that. Thus, we think, when you say "value," you should say: "value based on which metrics?" or more importantly: "value to whom?" what if there isn't a buyer? One of the bankers trying to sell the Company said, "As the financial buyers analyzed the company, including the debt financing available, it became clear that a significant equity check likely in excess of \$300 million was required to acquire the company in the range of valuation that the board of directors sought." That is very interesting because the valuation of the publicly traded equity when this thing started was \$332 million so what the board was wanting seems reasonable. Of course, now the equity is trading much lower at \$225 million. It just shows how quickly "value" can change in the current environment. Maybe the Company was worth more if they could get a lot of debt financing and the markets weren't offering any - that's what the banker's explanation sounds like. **Maybe "value" is more dependent upon financing than people realize.**

Another key to us is that the bidding process was a "trigger" that showed the public equity valuation was too high.

August 14, 2006 - **Real Estate** - We have spoken about and highlighted the broad market top in real estate for some time on this blog. Over the past couple of months, I have chosen not to write much on the subject because there have been so many "reality recognition articles" written and because it seems that it must be rather obvious to most that real estate has slowed and has turned down in several regions across the country - it is in pretty much all the media. **We believe from now on it will be pretty much a self-documenting story.**

May 17, 2006, BLOOMBERG, "**U.S. Stocks Drop on Inflation Concern;**" This is an interesting headline and does tell the predominant line of thinking right now (even if it turns out to be incorrect). However, we believe this logic is looking backwards into the rearview mirror of what the statistics will look like through the end of April when released, **while what has happened over the past week is the real story. The real story is that the stock market and the commodity markets have had sharp reversals and have almost certainly (to us) transitioned into major downtrends.** Thus, to us, stocks aren't dropping from inflation worries, they are dropping because we have entered deflation with prices of almost everything (especially riskier asset classes like junk bonds and real estate) dropping. To be more clear: previously you had some items rising in price like commodities, healthcare, and stocks and real estate. More recently real estate

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had been stalling. You also had some things going sideways; salaries are a good example of sideways over the past several years. And, you had lots of items dropping in price: computers, electronics, soft goods, clothing, shoes, etc.- think anything sold by Costco.. **Most important to this discussion, as of a week ago, commodities and stocks have switched to dropping sharply. Thus, Prices of Pretty Much Everything are Now Dropping ==>and we conclude: deflation has most likely arrived.** We will know for sure, after the fact, in a few months, but the turnaround and drop in prices of stocks and commodities is striking so far and will most likely be accompanied by falling prices of other, less liquid, investment categories such as junk bonds and real estate.

April 21, 2006, BOSTON HEARLD.COM, "**Foreclosure rates in Hub through the roof;**" Another "reality recognition" article. This one talks about the longer term problems of issuing easy credit. "Shady mortgage operators have been flooding unbelievably easy credit in to Boston's neighborhoods. But the payment on all those high-interest rate, no-money-down loans may no be coming due in a tidal wave of foreclosures slamming into the city's poorest ZIP codes." Foreclosures are up "...a 63% increase over last year." As bad as that increase is, certain neighborhoods are worse according to the article. "Bank notices of intent to foreclose have shot up 118 percent in Ward 18, which covers mattapan and Hyde Park." Then it states, that the "horror stories are even worse" than the statistics and it goes in to a few heartbreaking specific stories. Our point is that the slowdown is spreading - ugh.

April 21, 2006, DENVER POST, "**Home Seizures' Ripple Effect;**" Another "reality recognition" article. "Thousands of home in foreclosure could put Colorado's housing market under severe stress this summer, according to real estate experts."

April 16, 2006, SEATTLE POST-INTELLIGENCER, "**Home Equity Lines of Credit have Cooled;**" The article reviews the fact that the **rates on most equity lines of credit have about doubled** over the last 21 months - that most credit lines are indexed to the **"prime rate" which has risen from a low of 4% to 7.75% currently.** An example couple had their **interest rate rise from 5.25% initially to almost 10% currently.** While the article gives the information, it doesn't really highlight the conclusions other than "unfortunately, the [refinancing] window has closed for some people" - it is more concerned with refinancing. We are more concerned that peoples' cost of ownership has jumped up but their income has not. We believe that the result will be a drop in the purchased of other items. Easiest and most likely to be cut before defaulting on a mortgage due to higher interest rates maybe: cable T.V., DSL internet hookups, cellular phones, eating out, etc.

April 16, 2006, AOL MONEY & FINANCE, "**Foreclosures Pick Up with Midwest Hardest Hit;**" "As home-price appreciation has tapered off and mortgage rates have risen, foreclosures have started to pick up, with the Midwest region hit the hardest." Foreclosures across the U.S. have been hovering around historic lows over the past several years. But, "now, a survey of the latest data confirms, that is starting to change, with an uptick across the U.S. in foreclosure rates and mortgage

delinquencies.....**Nationally, the number of mortgage loans that entered some stage of foreclosure rose to 117,259 in February, up 68% from the same month a year earlier....according to online-foreclosure data service RealtyTrac."** And, delinquencies are up as well. Experts quoted in the article try to downplay the significance since the absolute levels are still quite low. However, while the levels are still very low, the change in direction and the rate of change and the underlying fundamentals are indicating to us a likely change in trend that should be taken seriously.

March 25, 2006, LOS ANGELES TIMES, "**The Land of the Open House:**" I am writing this one up a few weeks after it was published. It was on the front page of the LA Times. It is a bit shocking that apparently there have been no other stories or media outlets covering this subject - but I guess no one wants to highlight the bad news. OK here it goes: This is a long article that is basically a "**case study**" of how a market can **collapse**. Here, the author is chronicling what has happened in Merced, California, "once the state's hottest housing market..." Merced's price appreciation over the last five years was at 142%, one of the top five in the U.S. according to government figures. "After five increasingly wild years, the great real estate boom appears to be coming to a close. the Commerce Department reported Friday that sales of new homes nationwide plunged by 10.5% in February, about five times the drop analysts predicted." While the impact has yet to be felt across the country, "**the good times have already ended here (in Merced, CA), in the same way slamming into a wall reduces your speed. A house will fetch 20% less today than it did last summer, brokers say, assuming it finds a buyer at all.**"

The article goes into trying to explain the baffling 142% rise over five years of Merced real estate (before it "hit the wall"). "This was a **classic bubble**, where people paid increasingly higher prices because they were sure that someone would come along and pay even more." - The Greater Fool Theory. How people from Berkeley would see something in Merced that would be worth 3-4x as much back at home and would bid it up. However, **the incomes in Merced certainly don't support rising prices at \$14,257 per capital or about 2/3rds the state average. "Fewer than 3% of Merced families can afford a house, according to the National Association of Home Builders' latest survey."** We conclude, most of the homes are owned by speculators.

The Boom was fueled by by wild financing schemes. "Before the escalation began, 8 out of 10 home buyers in Merced County got a safe, fixed-rate loan..." "**By last summer 80% of the buyers in Merced got adjustable rate loans.**"

Now that the boom is over, the Merced Sun-Star's Sunday real estate section has 40 pages of ads. New development are offering out loud, discounts of \$40,000 and the sales people are advising the buyers to ask for a bigger discount. Rents are very low since the housing bubble begat a housing construction boom - "Every other house here is for rent" - so there is no pressure to buy. We at Stamper Capital would say that, in fact, it is now a "**deflationary mindset**" where people will wait because they "**know**" the price will be dropping in the future.

Some houses are marked with signs: "Red Tag Special."

Here is the scene that really depicts what is now going on: **"The only thing worse than the real estate market here is the market for real estate agents. They've been coming down to the Auto Toyz and Auto Store used-care lots looking for work. Everyone who applied recently, about eight people, they were all realtors..."** So not only are prices dropping, but the volume of sales (and sales commissions) is drying up - meaning the only way to get out of a property is to drop the price even more - ugh.

March 20, 2006, BALTIMORESUN.COM/THE WALL STREET JOURNAL, **"Millions Face Squeeze on Mortgages - Many borrowers can expect large payment increases as interest rates reset;"** This article contains lots of useful information about the mortgages that have financed the housing boom. **"More than \$2 trillion of U.S. mortgage debt, or about a quarter of all mortgage loans outstanding, comes up for interest rate resets in 2006 and 2007, estimates Moody's Economy.com..."** One expert comments that he "...projects that about one in eight households with adjustable-rate mortgages that originated in 2004 and 2005 will default on those loans." Using the figures provided, **we translate that into \$250 billion in mortgage defaults!!**

Another expert comes up with similar figures - He estimates that about 7.7 million of adjustable rate loans made between 2004 and 2005 represent \$1.9 trillion of debt. Of those, he **estimates that about 1.4 million households face a jump of 50% or more in their monthly payments once their initial low-payment periods run out.** Another 1.6 million households will suffer smaller increases that are still likely to strain their finances. **He figures that about 1.4 million of those households will default and would cause about \$110 billion of losses for lenders.**

In regards to discretionary spending the article also mentions a "barrage of negative trends" that will make it tougher for strapped borrowers to make their payments much less qualify for refinancing their mortgage loans:

1. Regulators are pressing to raise or tighten their lending standards.
2. Credit-card companies have recently started requiring higher minimum payments, thus, diverting cashflow.
3. Energy costs are up sharply.
4. Property taxes are up.
5. Most of these lenders have little equity left in their homes.

A couple of examples of peoples mortgages resetting are given. One on an typical adjustable rate mortgage going up from 7.46% to 9.46%, this summer, its first reset.

The dangers of the so-called "2/28 mortgage" is also discussed. This is where the loan is to sub-prime borrowers and has a very low interest rate for the first two years and then is reset every six months for the next 28 years until it matures, is refinanced, or defaults. The example given had an initial rate of 7.1% when the loan was made two years ago. Now, two years later, based on current rates it will reset up the maximum limit of 3% to 10.1%!! Six months from now, given rates at where they are right now, it

would reset up again at 11%. **Thus, in less than a year, the rate (and monthly payment) has gone up 40%!**

It seems the future we have been writing about and warning about is arriving - ugh.

February 7, 2006, BLOOMBERG, "**Toll Says 1st-Qtr Orders Plunge 29%**; Cuts Forecast;" This article is about Toll Brothers, the largest U.S. builder of luxury homes. Importantly, Toll "...said fiscal first-quarter orders plunged 29% and cut its 2006 sales forecast as **buyers waited to see whether prices would fall.**" Buyers waiting to see whether prices will fall is a "**deflationary mindset.**" The article also points out that **Toll's stock has fallen 48% since its peak on July 20, 2005** and that the prices of shares of most other home builders have also been plunging. We take this information as another indicator that the real estate market has topped. Also, we believe the magnitude of the drop in Toll's share price is probably a reasonable indicator for the drop in prices of real estate that have risen substantially over the past several years.

January 27, 2006, BLOOMBERG, "**What Growth? Economy Is Getting Worse, Americans Say;**" This "under-the-radar-screen" article makes several points about "reality recognition" - what is being realized by Americans. We think these points derived from the poll this article is based on are so important that we are also including this story on our **Major Trend Change Indicators** and **Deflation Watch** weblogs. <http://www.risk-adjusted.com/Weblogs.html> The article begins:

"The U.S. economy was robust by almost every measure last year,....[but]...Most Americans don't buy it."

What is amazing, according to the Bloomberg/LA Times poll, is that **despite the rosy economic statistics, "By a 59% to 37% margin, Americans disapprove of the way Bush is handling the economy...and, by 47% to 22%, the public says the country is worse off economically since Bush became President."** We aren't making a political point here - the results of this poll beg us to ask: **If everything is so great, how come the majority don't like the way things are being handled and think they are worse off?**

The article goes on to mention most of the problems (we have covered previously that) Americans are coming to realize. The key seems to us to be "**The failure of incomes to keep pace with the economy....**" and relatedly, "**Real GDP growth has been relatively healthy, but most Americans don't feel it.**"

What is remarkable that we alluded to above is that "**Most economic indicators contrast sharply with opinions expressed in the poll.**"

That was the "reality recognition" part, now comes the "deflation angle:" "**More than three-fourths of the [poll] respondents say they will need to reduce spending if energy costs continue to rise [cutting across party lines and income groups]...Even among those earning more than \$100,000 [annually], as many people say they would cut back because of energy prices as say they wouldn't.**" We would say this is

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definitely not "inflationary psychology;" maybe it is "disinflation psychology" and more likely it is "deflationary psychology." Maybe a better way to characterize it is that it is not "expansionary psychology" but is **"contractionary psychology."** Thus, notice that, rather than indicating they would take on more debt (maybe a new draw down on the ol'equity in the house), **they are going to Cut Back - this is 75% of those polled including 50% of those making \$100k or more!**

"Cutting Back," to us, is the end of the Credit Expansion and the beginning of a Credit Contraction. We believe a credit contraction from the current, record high levels of debt, will most likely result in general deflation. This situation is an element of a major market top and change in psychology and human action.

January 5, 2006, BUSINESS WEEK (January 9th, 2006 edition) - several Business Week stories: We have talked a few times since mid-2005 about "reality recognition" - when "the herd" finally realizes and acknowledges major negative realities that they have been diligently avoiding for years - like a heard of ostrich taking their heads out of the sand to find that their delusions (this time of inflated wealth and investment safety) are just that - delusions - well, in this case it is basically a 50 year old belief in the "free lunch" that is about to be shattered. From the **January 9, 2006 edition of BUSINESS WEEK**, below, we have noted several "reality recognition" articles with very brief commentary:

"Should The Dow Ditch General Motors? - GM's troubles are skewing the index and battering investors who bet on it" - You probably already know much about how GM is floundering under tremendous competition, waning demand by saturated (and broke) consumers and unbelievable pension deficits and accounting.

"Property Market On Ice - How Deutsche Bank has chilled German real estate funds" - The German Fed closed a \$7.2 billion real estate fund to "conduct an unscheduled revaluation of the fund" - meaning most likely a "sharp markdown of the underlying assets." Yes its in Germany, but the bubble and its problems are worldwide. We think it will likely be shocking to see how fast prices of real estate can fall. In this case, they might fall before owners can exit.

"So Many Lenders, So Few Takers - As housing slumps, the roof is falling in on the overbuilt mortgage industry" - Talks about the tremendously overbuilt mortgage industry and what is happening now that mortgage refinancings have peaked. The Mortgage Banking Association ...**"expects mortgage originations to fall by 18.6% in 2006."** Note the precision in their forecast - uhm. The article focuses on problems the industry and its players will likely encounter; however, we point out that most of the "recovery" since 2002 was in the housing/finance area and this downturn will almost certainly ripple across the entire economy.

"A New Abacus For Pensions - The FASB rules on post-retirement accounting are changing. Benefits could suffer" - Talk about understatement - for the S&P 500, company liabilities are expected to increase ... "by a couple of hundred billion dollars." We have covered this subject numerous times but here it is again. Importantly, the phase

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in of "reality accounting" is: "numbers on their balance sheets by the end of 2006" and more accurate recognition of pension plan gains and losses by 2009.

So, we conclude by emphasizing our point that we expect all this increasing reality recognition is due to hit the prices of risky assets at any moment.

December 19, 2005, THE BOSTON GLOBE, "**Sellers Chop Asking Prices As Housing Market Slows - Cuts of Up to 20% Are Now Common As Analysts See Signs Of A 'Hard landing'**" - As grim as the article's title reads, the content is even worse:

Median prices are down 7% over the past two months.

- don't annualize it - ugh

Reductions in asking prices of 10% to 20% are common.

In Cambridge, price cuts averaged \$300,000!!!

Consultants are talking about a "hard landing"

- that is a first in major-media print as far as we know

"Agents said pricing cutting began last summer (2004) but accelerated in the past two months and is far more frenzied than in 2004.

- this is key to us because **we still claim real estate peaked in mid-2004**

"...those who need to sell quickly - may have no choice but to entertain offers they would have scoffed at months or even weeks ago."

- see how quickly things change for "less liquid investments"

The article is in reference to the market in the Boston area; however, we expect that articles like this will be common place across the U.S. in the near future.

October 14, 2005, BUSINESS WEEK (October 24, 2005 edition), "**Another Fishy Hedge Fund;**" October 13, 2005, BLOOMBERG, "**Wood River Sued by SEC over Endwave Stake, Audits;**" Not another one - ugh. Apparently, the managers of Hedge Fund manager Wood River "bet the ranch" and lost, among other mistakes. They invested **more than 65% of hedge fund assets in Endwave** ("ENWV"-NASDAQ), a Sunnyvale-based supplier of wireless-communications equipment. This investment represented more than 40% of Endwave's outstanding shares (and Wood River, failed to file the 13-d required when an owner goes over the 5% ownership threshold, among other possible missteps). **Unfortunately, "shares of Endwave have declined by [a whopping] 76% since July [2005.]** "One investor with \$49 million in Wood River tried **unsuccessfully to redeem the money beginning in late July...**" Thus, few investors have gotten any of their money out thus far.

Attorney's for Wood River claim "There was no self-dealing. There was no personal enrichment. There was no fraud." But what there was was gross miss-management - also, the firm apparently lied about its auditor and accountant and failed to make certain regulatory filings. Our point is that while, according to the articles, there were numerous red flags, **the real culprit (so far) was a terrible investment mistake in both choice and relative size.** Similarly to the problems at the Bayou hedge funds (outlined, below), **there were several institutional investors and professional marketing firms that**

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were sucked in. As with Bayou and Refco (see next review) **you have to wonder how many wake-up calls it will take before hedge fund investors question whether it is worth the risk?** "Over the past five years the number of hedge funds has doubled, to more than 8,000 and the assets they manage has likewise doubled, to \$1 trillion, according to hedge Fund Research Inc. in Chicago." If investors do decided to take their money out of the game, the implosion would likely be quicker than that exceptionally rapid growth. Further, some market prognosticators, like ourselves, speculate that the growth of hedge funds, where the manager gets a percent of the upside without participating on the downside, has been a recipe that has kept the values of riskier assets up at absurd levels.

October 13, 2005, BLOOMBERG, "**Refco Halts Client Withdrawals, Cash Isn't Sufficient;**" Wow!!! I do not think people are getting the impact from that headline that they should - to us, this is another wake up call to investors, especially those in hedge funds that invest in derivatives or "less liquid" investments. This is one of a slew of articles that have recently been detailing the implosion of Refco ("RFX"-NYSE), what was until this week the largest independent provider of execution and clearing services for exchange-traded derivatives and also a provider of prime brokerage services in the fixed income and foreign exchange markets - it offers clearing services on derivatives exchanges and Over-the-counter markets. It seems Refco, which **had its IPO just this August 2005**, had **used accounting tricks to hide \$430 million of unpaid debts dating back to 1998**. This revelation started a "run on the bank" with many of its customers, who had \$4.9 billion with the company on 8-31-05, running to pull their money out. However, **we believe that fraudulent accounting could be the proverbial tip of the iceberg**. The prices of the Company's stock and junk bonds have already plummeted and trading of its stock has been suspended. Not only that but a **moratorium of 14 days** was placed on customer withdrawals and **the SEC has suspended withdrawals of equity capital for 20 days. This all to stop the "run."** We believe a "run" would not be a problem if there were not some "**liquidity**" issues. While Refco has \$4.9 billion in customer accounts, according to the Bloomberg (which most likely got its data from the S1 filed along with Refco's recent IPO) total book-valued assets are \$ 74.3 billion with total book-valued liabilities at \$74.1 billion and only \$209 million of book equity. Now, we are thinking that if "cash isn't sufficient," then assets must be liquidated (to meet withdrawals) and the problem with a run is if the assets are "illiquid." "Illiquid" assets are generally those that cannot be sold at the level they are valued at within a fairly short period of time. This is where the rubber meets the road: Are the assets going to be able to be sold at the levels they are booked at? We don't know but we believe many of these assets are booked at "the lower of cost or market" or at market if in a trading account - other wise they are booked at amortized cost. **The key is that the liability claim will be at 100 cents on the dollar but the value for the assets upon sale maybe far less than represented on the books - that is why you have all the moratoriums and suspensions - to allow for the sale of these assets at non-fire-sale levels.** Now this would not be that much of a problem if the assets were very liquid and of very high quality but some of Refco's assets are exchange-traded derivatives, which are most likely evaluated properly, but some are "over-the-counter" derivatives whose values could turn out to be worth a lot less than expected just a week ago - we should know in a matter of

weeks. **If the values are out of whack, this will likely be a big wake-up to owners of hedge funds using less liquid strategies.**

October 6, 2005, BOSTON HEARLD.COM, "Hub **Foreclosures go 'Through Roof;'**" This article is about the recently surging rate of foreclosures in Massachusetts. "It's through the roof at this point," said Jeremy Shapiro, President of ForeclosuresMass.com, which yesterday reported that **foreclosoure filings rose 95% in Suffolk County, which includes Boston, and 107% in Essex County in August [2005]."**

ForeclosuresMass.com tracks year-over-year increases in "notice of default" filed by banks as a first step in seizing homes for mortgage non-payment. Generally, these notices are filed by banks when borrowers are three months delinquent on mortgage loans. **"A lot of people pulled out equity with a refinancing, but if they suddenly run into hardship, there's no money left," Shapiro said, "that equity is gone."** We believe this story will turn out to be very common across the United States and abroad, unfortunately.

September 20, 2005, BOSTON HERALD.COM, "**REALTORS LONELY AS SHOPPERS STAY HOME:**" This quote from the article pretty much sums it up: "Brokers say some of this past weekend's open houses [in Boston] **attracted no would-be buyers** at all." To us, that is the experience of "**illiquidity**" that people who own real estate have not experienced during the price run-up but will most likely often experience as the market tops and drops. We still believe the real estate market topped in most markets in mid to late 2004. This article would support our position - lack of liquidity doesn't usually happen right at the top but on the way down and usually months or even years after the top. The article continues, "Experts say open houses [in Boston] historically attract at least a half-dozen shoppers - and as many as 20 or more in recent 'boom' years. But John Ford of Ford Realty Inc. said **NO ONE SHOWED UP AT ALL this weekend at about half of his firm's Beacon Hill open houses.**" For those who don't know, Beacon Hill is a premier neighborhood. When the downturn picks up more steam, articles like this one will likely be common place. As explained below and on our **Major Trend Change Indicators** weblog, <http://www.risk-adjusted.com/Weblogs.html>, we believe reality recognition is at hand.

September 2, 2005, THE WALL STREET JOURNAL, "**Did Bayou Bet With Con Artists?**" BLOOMBERG.COM, "**Bayou Duped Investors Since 1998, Prosecutors Allege,**" THE WALL STREET JOURNAL, "**Scandal Puts Spotlight on Hennessee Group;**" These three articles and many more over the past few days have reviewed the fraud at the Connecticut-based hedge fund, Bayou Management. The articles cover the basics - we are going to jump to some possible conclusions. Key to us are that not only did Bayou cheat its clients by taking millions in undeserved fees and get new investors to invest by lying about performance, importantly, **their investment schemes really lost money! - including \$35 million of losses in its Bayou Superfund in 2003 according to THE WALL STREET JOURNAL - that was just for one year and just for one of the four funds that Bayou managed.** Also, the Company created a fraud accounting/auditing firm that it claimed was auditing the hedge fund books. Thus, the whole fiasco was quite a sham based on a host of lies. Not only that but "Bayou's

investors included wealthy individuals and institutions..." Bayou also used professional "marketers and consultants to attract investors..." Plus, the frauds most likely started not long after Bayou's operations commenced in 1998.

Here is where we are going to add our two cents: **Big boys (individuals investing in hedge funds generally have to have over \$1 million of liquid assets), Institutions, and professional Consultants (that are supposed to be watch dogs) all got hoodwinked for over five years!** This was not a small scandal - **investors invested over \$300 million** according to the U.S. Attorney's complaint that was filed. All these people dropped the ball. In an article we reviewed about hedge funds on August 3, 2004 (see review far below) we highlighted that "Assets [of hedge funds] have increased from under \$100 billion in 1992 to \$900 billion at the end of 2003; the number of hedge funds has gone from under 1,000 to 7,000 over the same period of time. **What is striking to us is that the graphic for the number of [hedge] funds is parabolic and getting nearly vertical on the right side.**" That review also highlighted that because hedge funds comprise such a large segment of the investment market, mathematically it is impossible for that category to outperform. Recently hedge fund investors have posted poor performance (as we forecasted) and some investors have been removing their money. **Now, we are concerned that the exposure of the Bayou Scandal will likely result in hedge fund investors re-thinking their hedge fund investments - and will probably result in withdrawals. Of course, most hedge funds are incredibly highly leveraged (think Long Term Capital) and liquidations will create a credit/debt contraction of sorts. Cutting to the chase - the exposure of this fraud could cause "a run" on hedge funds (both well managed and poorly managed), the category whose out-sized growth and leverage has contributed considerably to several asset bubbles. This forecast is perfectly in line with the end of the parabolic rise we documented previously. As we have mentioned several times previously, parabolic uptrends usually end in dramatic downside reversals. If the hedge funds begin to liquidate quickly, it will cause more than a ripple through the investment world.** Thus, to us, fraud and its exposure is a typical element of a major market top (unfortunately).

July 2, 2005, CNNMONEY, "**Housing may sting more than dot.com bust;**" Another "reality recognition article" (see below for more info on that tag) but **now a housing crash similar to the dot.com bust is a foregone conclusion - the question is, according to this article, will it..."make the 2000 tech bust look tame in comparison.**" And, this is from CNNMoney (Money Magazine) - a considerably mainstream publication. Quote: "Whether it's a national bubble or just pockets of regional froth, an end to [the] surge in home prices could inflict economic harm that would make the 2000 tech bust look tame in comparison." **"If prices were [even] to merely level off, it could subdue the property-linked activity that has stimulated spending and job growth -- crucial supports to the U.S. economy."** The article is based largely on the results of a study just published by the IMF. It is very interesting because until just recently everyone (except us and a few others) was in denial that there has ever even been a housing bust - now they say: **"The IMF study found that while stock market collapses are more frequent; housing busts do a lot more damage."** So not only do they bust but their busts historically cause a lot more damage than an equity

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collapse. This is because **"the output loss associated with the TYPICAL housing price bust (about 8% of GDP) was twice as large as that associated with a TYPICAL equity price bust"** the study said. Thus, now housing and equity busts are "typical." To us, this is "reality recognition" on a huge scale by a major mainstream publication. The main part of the article and the IMF study is that, especially in the recent "recovery" a huge amount of the employment gains and economic activity have been housing industry related and that will most likely dramatically decline when the "typical housing price bust" happens - unfortunately.

June 22, 2005, THE CLARION LEDGER, **"Beware of Junk Bonds, Experts Say;"** This is the first of what we are calling a **"reality recognition" article** related to Junk Bonds. We believe throughout all the cycles of the junk bond market since 1984 that we have never ever seen one. Sure, we have seen articles warning about the junk bond market after it has gotten hammered for a few years, like at the bottoms in 1991 and 2002 but never near a top. In reverse, we most often seen article recommending junk bonds near the top like in mid 1998. That is why we call it a "reality recognition" article - the information, to us, is correct at the correct part in the cycle. To make this more clear, the junk bond market rallied through 2003 and 2004 all the way up to almost even to the 1998 all time top (based on credit quality yield spread differentials). **So we find it very refreshing but highly unusual that an article warning about a particular asset class like junk bonds is being written so close to the top - the recent top was January 2005 and we believe that the drop in the prices of risky assets has really just started and will continue for some time - for junk bonds, the last down cycle lasted from 1998 to 2002.** On our our **Major Trend Change Indicators Weblog** <http://www.risk-adjusted.com/Weblogs.html> page we elaborated on the significance of the appearance of these "reality recognition" articles and said the following : **"Thus, although this change in perception [from far to optimistic to much more realistic] is subtle, we believe it is evident and is an important indicator of a major change in trend;** unfortunately, in this case, from overly optimistic to a realism that is bluntly painful for most. The sad thing is that realism is quite a bit removed from the optimism most have been reading about and **as this shift occurs, valuations are most likely going to change rapidly with prices of riskier assets being downgraded rather dramatically in percent and also in a short period of time."** Thus, to us, the appearance of "reality recognition" articles at this point in the business cycle will most like turn out to be confirming indicators that market prices are going to return to historical valuation levels - i.e. downward.

June 22, 2005: Today more of what we are again seeing what we are calling **"reality recognition" articles:**

"Double Bubble Trouble," DALLAS MORNING NEWS, 6-21-05

"Home buying getting riskier," MIAMI HERALD, 6-21-05

"The Scary News on Housing Piling Up," ST. PETERSBURG TIMES, 6-22-05

"S&P Citing Option ARMs, Sees Growing Risks for Home Loans," THE WALL STREET JOURNAL, 6-22-05

"Avoid Bubble Trouble in the Real Estate Market," MORNINGSTAR,

6-21-05

These all revolve around the real estate and mortgage funding bubbles. Most of them make some very good points, most of which we have reported on previously but are now appearing in the national and local media. "Double Bubble Trouble" makes one point we have seen elsewhere but have not written on and adds another related point. First, **"since the recovery started in November 2001, employment in housing and related industries has accounted for 43% of payroll growth."** Then, **"since the Federal Reserve started raising interest rates last June [2004], housing's contribution to job growth has shrunk to 13%."** The irony to the reporter is that **"the future of the housing market is tied to employment conditions in the economy"** and that **"the performance of the housing market has played a visible role in payroll growth."** She doesn't say it but, now that she makes her very valid points, **the situation, to us, is better described as a CIRCULAR PYRAMID rather than a bubble.** She also points out that "the real reason why delinquencies and foreclosures are tame"....even with housings contribution to job growth shrinking is **because "when those buyers get into trouble with their unaffordable homes, they've so far been able to unload them at a profit."** So, to us, the parts of the CIRCULAR PYRAMID are:

- lower interest rates contributing to rising housing activity and prices
- higher housing activity leading to 43% of payroll growth
- sustained payrolls sustaining higher real estate prices
- higher housing prices leading to fewer foreclosures

Our summary is that now, the lynch pin of the "structure" is being pulled - the Fed is raising short term interest rates - which, along with unsustainably high housing prices, is causing housing activity to wane - which is causing housing activities contribution to wage growth or stability to fall But prices are still high so we have not seen delinquencies go up. She concludes with **"The debate reminds us that falling prices not only will coincide with higher foreclosures, they also will be accompanied by millions of pink slips."** We hope not but we believe that will be the likely scenario as this circular pyramid unwinds.

June 21, 2005: Today and over the past couple of days we have seen a dramatic increase in the type of "reality recognition" articles that we pointed out had just begun to show up in May - see our Major Trend Change Indicators Weblog page, <http://www.risk-adjusted.com/AnnualForecasts.html>, for more information. We are not going to go through the articles as we have pointed out all of these things previously. The key point is that now the major media has finally jumped on board:

"If Housing Bubble Pops: Look Out!," NEW YORK POST, 6-21-05

"On Personal Finance | Navigating the Housing Bubble,"

PHILADELPHIA INQUIRER, 6-21-05

"Housing Market Tumble Forecast - Economists see bubble bursting by late next year," SAN FRANCISCO CHRONICLE, 6-21-05

"UCLA says state home prices may be time bomb," THE ORANGE

"Our Clients' Past Successes are Not Necessarily Indicative of Future Successes."

COUNTY REGISTER, 6-21-05

"UCLA Economists Still See a Bubble in Housing Market," THE LOS ANGELES TIMES, 6-21-05

To be fair, three of those articles are related to UCLA's latest quarterly forecast. However, there have been numerous other "reality recognition" articles that we have skipped over the past few weeks and what is striking is how the press has made the news of UCLA's negative statements and forecast so much more prominent than previously.

June 20, 2005, THE LOS ANGELES TIMES, **"Giving In to Bubble Pressure;" This is another "reality-recognition article"** that we have been referring to recently. There have been gobs of them so we are trying to be selective. This article details how a public policy professor at UCLA has announce he is **"shorting the Los Angeles housing market."** He isn't actually shorting it but he has sold his 2,700 square foot house for a 62% gain over "the price he paid in 1997 and the cost of a sizable remodeling in 2001." What he has done is rent a much smaller two bedroom apartment closer to campus. Here is the "reality recognition" part - "Kleiman was driven to sell by three considerations: **One**, he had already racked up an impressive, but unrealized gain on the property. ("I had a good ride; why be a pig?" **Two**, he thought he had too much net worth tied up in one volatile asset. That thought was starting to keep him up at night, a classic manifestation of investor anxiety. **Finally**, the fundamentals of the housing market were telling him that the recent price rises in L.A. real estate couldn't continue." And, the article goes into more specific explanations of number three that we have recounted numerous times previously. **He says, "In my dreams, we get a crunch and I put the same money back into the market for 50% more house."** We believe his dream has a high probability based on our previous work.

June 16, 2005, THE NEW YORK TIMES, **"The Trillion-Dollar Bet on Interest Rates - homeowners take risks in a bid for lower mortgage payments;"** This is another **"reality-recognition article"** that has just begun to surface recently as we have pointed out in our Major Trend Change Indicators Weblog, <http://www.risk-adjusted.com/Weblogs.html> . It is actually somewhat of a riot to us that these articles match so closely what we have been saying over the past couple of years - why did it take them so long to report the reality is a question we ask ourselves - but it is typical of market cycles. Anyway, the article talks about "the trillion-dollar bet that mortgage rates will remain near record lows for at least a few more years." This article gives some very specific situational examples and possible and probable outcomes of disaster that we won't rehash here. We have seen other such articles and **the main point is that come a year or so from now a huge amount of interest-only adjustable rate mortgages are going to start having a payment due and that if rates are anywhere higher than they are now, many home owners are not going to be able to make their mortgage payments and their car payments and their credit card payments in full.**

June 9, 2005, THE WALL STREET JOURNAL, **"In Treating U.S. After Bubble, Fed Helped Create Threats;"** To us, this is another "point of recognition" article that we were referring to in early May in our Major Trend Change Indicators Weblog

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<http://www.risk-adjusted.com/Weblogs.html> . The article's most shocking quote is: "**Mr. Volcker thinks a crisis is likely. Investor confidence could fade 'at some point,' he said, with 'damaging volatility in both exchange markets and interest rates.'**" Of course, Mr. Volcker is Paul Volcker, former Chairman of the Federal Reserve of the United States. The crisis is in regards to the gross miss-allocations of resources created by our over consumption of foreign goods financed by record levels of U.S. Treasury debt and mortgage debt (from refinancing on overpriced domestic real estate) both of which are held in record numbers by foreigners. Although, the article spends lots of print explaining the situation, Mr. Volcker's quotes are quite succinct: "If I were a biologist I'd call this a perfect example of symbiosis," former Fed Chairman Paul Volcker mused in a February speech at Stanford University. 'Contented American consumers matched against delighted foreign producers. Happy borrowers matched against willing lenders. The difficulty is, the seemingly comfortable pattern can't go on indefinitely.'" The article's author continues - **With respect to imbalances in the U.S. current account deficit, oddly low long term interest rates, and oddly high real estate prices, "the debate is over how, not whether, the global economy rebalances: Will it be smooth, through some combination of declining dollar and accelerating foreign demand? Or will it be chaotic, with a dollar collapse, much higher U.S. interest rates and perhaps a global recession?" Thus, the problem and its huge size, which didn't really exist in the press just a few months ago is now a forgone reality!!! - the current issue is the speed of the work out of the miss-allocations - slowly (like Japan in its 15th consecutive year of recession) or in a collapse of some sort.**

May 30, 2005, WASHINGTONPOST.COM, "**A Bane Amid The Housing Boom: Rising Foreclosures;**" As we pointed out in early May in our Major Trend Change Indicators Weblog, <http://www.risk-adjusted.com/Weblogs.html>, suddenly, we are seeing more and more articles that catching up to the reality of what we have been pointing out - turning from being blindly optimistic to a recognition or an admission of the current much less attractive reality - this is one of those articles. The article talks about a "**foreclosure epidemic**" that has hit the lower-income homeowners and **real estate's "'dark side'** - a sharp rise in foreclosures that is destroying the single greatest generator of personal wealth for most Americans." "**Foreclosure rates rose in 47 states in March [2005]**, according to Foreclosure.com, an on-line foreclosure listing service...Even in New York City and Boston, where real estate markets are white-hot, foreclosures are rising in working-class neighborhoods." Thus, it is an epidemic in lower-income neighborhoods and is now working its way into working-class neighborhoods - our concern is that next will be middle class neighborhoods and then upper-income. "**We are clearly seeing a spike in foreclosures in a number of our major urban areas, Said Julie L. Williams, acting U.S. Comptroller of the Currency**, whose agency regulates the nation's banks. It can lead to a downward spiral for neighborhoods. If we are not careful, the American dream can quickly turn into the American nightmare." And the article gives a few specific examples of that happening to various individuals and families. Here is more from the **Comptroller of the Currency: "We've produced a new class of lenders willing to take on riskier and riskier borrowers at a very high price. Many of the products are nothing more than time bombs."**

April, 28, 2005 - "**Stock Indices Break Long Term Trend Lines**" - Ok, that is our title - every so often we can't find an article referring to some topic that we want to review - this is the case with what we just noticed when looking at some graphs that we were running on the Bloomberg data system. We noticed: **Most major stock indices have broken their long term support lines** - most of them broke about two weeks ago, yet we have not seen any media stories pointing this out. **Breaking long term support lines were:**

- the Dow Jones Industrial Average**
- the S&P 500**
- the Dow Jones Transports**
- the NASDAQ**
- the S&P Small Cap Index**
- the Philadelphia Gold and Silver Index (XAU)**
- the Value Line Arithmetic Average**
- the Russell 2000**

Every large index we have checked has broken long-term support lines (in April 2005) except the Dow Jones Utility Index. Often investors and traders using technical analysis determine that when a trend line is broken, the new trend is established and will continue. Remember that breaking support lines is a confirming or lagging indicator - all of these indices actually topped in late 2004 or early 2005 and have been trending down for most of 2005 so far. **We believe that this recent top is the final rebound top from the 2002 bottom and that the downtrend from the 2000 top is resuming** - this scenario couples with our [January 2005](#) and [January 2004](#) (and previous) annual forecasts, <http://www.risk-adjusted.com/AnnualForecasts.html>, of a "**right-tilted W**" structure with the left top being 2000, the left bottom being late 2002, the middle top being January 2005 (which is lower than the January 2000 top) and the bottom being a few years from now. We will see. If we are correct, the market for risky asset classes has one of the rockiest roads in history directly ahead.

April 24, 2005, BALTIMORESUN.COM, "**Empty Homes Might Be Undoing of Speculators;**" This is a very interesting article. Normally when an article like this has been published, it is after there are lots of facts supporting it - thus, normally, the usefulness of such an article is low since, in essence, the information is too late. However, this article seems to be ahead of the curve. **"Ok now we have a housing bubble. How do we know? Real estate professionals, who aren't even allowed to think that homes might be, uh, overpriced, are publicly worried."** Actually, now that I think of it, it reminds me of when professional equity portfolio managers with the longest tenure and the best records were saying that the stock market was so grossly overvalued that they could not find anything to buy but no body seemed to listen - they just didn't get the "new paradigm." Ok, back to this real estate article: **"Speculators snapping up homes they won't live in and may not be able to rent have given the market a new tier of foam and raised chances it will all end badly, pros say."** **"There is a 'growing presence of investors or speculators or whatever you want to call them, especially in hot housing**

markets,' says David Seiders, chief economist for the National Association of Home Builders. 'I don't think we've ever had to deal with something of this magnitude before,' he adds, or if they did, it was long ago and unmeasured." "Everybody is buying them for investment...they're all for rent [the empty homes being talked about]...You can't hold onto these things [without tenants]. The idea is for the renter to pay for them. But that's not happening. There's too many of them." Pretty much a rehash of the warnings we have been giving but here it is in print. Also, we do believe this has happened several times in Orange County, California. Back in the mid 1970's, the late 1970's and in the late 1980's before the 1990 top there were very similar instances of overspeculation buy rookie buyers who later got burned. I believe it was in Orange County, Ca in the late 1980's that almost half of the adults in the county had real estate licenses.

April 19, 2005, AOL BUSINESS NEWS, "Housing Starts In Steepest Drop in 14 Years;" **"Housing starts plunged 17.6% in March [2005], marking their steepest drop in more than 14 years,** as groundbreaking for both single-family and multi-family homes tumbled, a Commerce Department report showed Tuesday." According to the article Wall Street was expecting a much smaller drop of 4.8%. Permits for future groundbreaking also dropped more than expected, 4%, versus the average analyst's forecast of 0.3 percent. **We point out that these are the building professionals who are cutting back - when you see that you have to ask, What do they know or are concerned about that the general public is unaware of?**

April 7, 2005, CFO.COM, **"More than \$100B in Debt Coming Due - The largest quarterly repayment in about five years comes as interest rates are rising, especially for longer maturities;"** We haven't focused much on interest rates. However, if you look at our Fund's performance, you should be able to see that we have been in the right place at the right time - and you can look at our annual January forecasts to see what we have been thinking - basically that interest rates are heading up and the credit quality yield spreads (the difference between yields of low quality buyers compared to yields of high quality buyers) will be widening Short term and long term interest rates have been heading up since mid 2003 with the most obvious move in short term interest rates. Credit quality yield spreads tightened throughout 2004 but have probably begun the widening process with the kickoff being the dramatically increasing yields of General Motors which has seen its fortunes plummet and is on the cusp of being downgraded to junk-bond status. Ok now this article: Importantly, yields (and prices) are driven over the long run by supply and demand, and when there is a big change in Supply and Demand over the short run you can really see some movement. The article highlights that kind of change, this time in Supply. **"According to the FINANCIAL TIMES, between \$113.6 billion and \$117.3 billion of debt will come due during the next three months, citing Fitch Ratings and Thompson Financial, respectively. This is the largest quarterly repayment in about five years, the paper added."** So we are quoting an article quoting an article but the information is still useful. Also, "Credit spreads have been widening lately, due in part to profit warnings from General Motors and the accounting scandal engulfing American International Group (AIG)." However, an analyst at Lehman Bros says, "The reality is that most borrowers have probably already pre-funded these

maturities....," but, he goes on to hedge himself, "It's significant in itself that it's the biggest quarter for some time, but it won't necessarily have a great market impact." We will have to wait and see. **We expect rates to continue to rise and for credit quality yield spreads to widen out dramatically as elements of this huge, global market top in risky assets seems to be in place and a drop in the prices of risky assets is highly likely - rising interest rates will just exacerbate the problems.**

April 6, 2005, MSNBC NEWS, "**Real estate's 'dirty little secret' - 'Appraisal inflation' a worry for housing experts;**" "It is often referred to as 'appraisal inflation' and it could be the dirty little secret of the housing industry. **The practice - when real estate appraisers bend the numbers to satisfy clients and stay in business - is a growing problem, according to real estate experts. Appraisers say there is pressure on them to inflate home values...**" The article quotes a survey of 500 appraisers that "**found 55% of them personally fell pressured by sellers, agents, and even lenders to inflate home values by 10%.**" The article points out "**structural problems in the appraisal business, such as the fact that many lending institutions that hire appraisers profit from the outcome.**" It then points out "The issue could evolve into something similar to the savings-and-loan scandal of the late 1980s..." We believe it is part of the social cycle that creates manic investment tops. It is similar to what happened in the NASDAQ in the late 1990's. **It happens when less sophisticated buyers enter a market and base their decisions not on long term benchmarks like how much they can rent a building for or how much of a dividend can a stock pay but based on the most recent trades.** The problem is in these manic cases the last trades are made by other less sophisticated buyers. These newbie's are being egged on by the professional who are getting fees and commissions based on transactions. Then when it becomes "common knowledge" that real estate or stocks only go up, that thinking just adds fuel to the fire. Until the bottom drops out and the NASDAQ drops 68% in less than two years. Ok back to this article - the **sellers who want the highest price** and the **buyers who need a high appraisal since they are borrowing against the asset** and the **agents who get a commission** and the **banks who are getting loan fees ALL have a vested interest in the highest appraisal** and can point to where other houses traded recently, **no matter how irrational those trades were. Thus, it is a self-fulfilling cycle on the way up - But it is also a self-fulfilling cycle on the way down (think NASDAQ, 1929, Tulips, etc.) The trick is figuring out exactly when the cycle is going to reverse - which is difficult since it is irrational. To that end, we have highlighted many indications on this and other pages of our website.**

April 5, 2005 - LENDING TREE, "**Negative Amortization Mortgages;**" This is not actually an article from a periodical, it is off a website that connects borrowers with lenders. It was pointed out to me by a friend, KGK (thank you), when I was telling him about the shocking 'interest only, adjustable rate' loans in the LA TIMES article of April 3, 2005. Yes, the 'negative amortization' loan is even more shocking than the 'interest only, adjustable.' For those who do not know what a 'Neg Am' loan is, **it is a loan where the borrower pays no principal and pays a payment that is even less than the interest that is being charged. The result of that setup is a lower than normal monthly payment and a loan balance that grows by the amount of negative**

amortization each month. It is really shocking that lenders would make such loans to shaky borrowers, but borrowers who otherwise could not qualify are the ones most likely to borrow this way. **According to the web site, negative amortization loans are often made in an adjustable rate mortgage (ARM) format.** Thus, the negative amortization could increase if interest rates move up if the payment is fixed, or the negative amortization could stay the same and the monthly payment could rise to cover the cost of rising interest rates. Importantly, according to KGK, they are making quite a few of these loans down in Florida. It is pretty easy to see that borrowers are taking on a lot of potential risk with these loans. In reference to using Neg Am mortgages to speculate, the article says, **"but if the house doesn't appreciate, you are stuck with a great big mortgage."** Pretty funny to read about, but sad when it happens in real life. **To us, more elements of an irrational market top.**

April 3, 2005, LOS ANGELES TIMES, **"They're In - but Not Home Free - Many Californians have 'interest-only' loans. They might be living on borrowed time;"** Wow - this is quite an article on how leveraged up the housing market is and how susceptible it is to a down turn - And, the article begins on the First Page of the Main Section - as opposed to being buried in the business section where most will not read it. There are so many good and shocking points that I am going to have to really cut to the chase: **48% of the mortgage loans made in California in 2004 were "interest only, adjustable" (as opposed to fixed or simply adjustable) up from fewer than 2% for 2001. "The boom in interest-only loans...is the ENGINE behind California's surging home prices." To us, these interest only, adjustable rate loans are TICKING TIME BOMBS - typically they are interest only for a three year term, then the borrower also has to pay principal in addition to the interest and, here is where the spark hits the explosive, the monthly payment jumps up by "as much as a third" due to rising rates and even when the principal component kicks in. Thus, the person used in an example in the article has a "Day of Reckoning of Nov. 1, 2007." With 48% of the loans issued in 2004 being 'interest only, adjustable' a number of fuses have been lit. "...hundreds of thousands of other homeowners in the state [of California] will have to find ways to cope [with dramatically higher mortgage payments] - or will have to sell. In the most dire scenario, if they owe more on the home than it's worth, they'll simply walk away. Abundant foreclosures could spark a downturn in the entire housing market, leading to the long-eared bursting of what some call a housing bubble." (REMEMBER THIS IS THE FRONT PAGE OF THE LOS ANGELES TIMES)** The article makes some other good points: "When the price of houses in California soared 17% in 2003 and 22% in 2004, **a CURIOUS THING HAPPENED: instead of home ownership decreasing because fewer people could afford houses, it rose to record levels.**" - Sounds to us like the NASDAQ in 1998 and 1999 - the higher the price went, the more overpriced the asset was but the higher it went anyway- totally irrational - but it still happened to the NASDAQ and it has happened in the real estate market - **this is an element that is typical of very irrational markets at a market top - think about Tulips in the 1800's when a bulb was selling for the equivalent of a house!!!** Back to the article: It gives a terrific example of how this type of financing allows people to buy something they could not otherwise qualify for. To summarize, a homebuilder (who is not named) had 90 buyers pre-qualified by a lender;

however, the homes were not to be finished for another six months so the builder tightened the loan criteria. "He didn't want buyers to sign up for a house and then get frightened into canceling by rising rates." So he raised the credit threshold from a fully variable loan to a mortgage that was fixed for the first three years. **Now only 15 of the 90 qualified - 83% no longer qualified!!!!** - The article doesn't state the obvious conclusion directly - when rates go up just a bit, the number of buyers that can get financing is going to drop through the floor - the article ties it all back to the title - just because a buyer has bought, doesn't mean they will be able to keep it.

March 31, 2005, USA TODAY (on AOL News), "**Album Sales Numbers Have Taken a Tumble;**" We previously reviewed the downturn of the music industry a few times over the past couple of years as an indicator of the economy's strength or lack thereof. Most what we highlighted had to do with cancelled concerts due to lack of demand for seats, declines in the prices of new CD's and also declines in the volumes of CDs sold. This new article relates to declines in volumes (despite the 30% cut in prices). "Fans have bought 134.8 million albums this year, compared with 143.3 million in the same period last year, **a 6% slide**, according to Nielsen SoundScan. [However;] at the same point in 2004, album sales were roughly ahead of 2003 by 9%. **Thus, because of the usefulness of the previous downturn in the music industry, even with the pirating excuse, we are focusing on the end of the current rebound (from the 2002 bottom) and the resumption of the music industry's decline in the first quarter of 2005. It could be that this industry's downturn turns out to be a very accurate indicator of the resumption of the major economic contraction which began in 2000, bottomed in late 2002 and most likely topped out just recently in December 2004/January 2005 - only time will tell but the state of popular culture is often a good indicator of where the economy is heading.**

March 7, 2005, LOS ANGELES TIMES, "**China Stock Market Misses Out on Boom - Despite a roaring economy, share prices are down 40% since 2001**, forcing many firms to raise capital in Hong Kong or the U.S." Wow - I bet most people did not know that. "**Stocks plunged 15% last year (2004) in mainland China, more than any other market.**" The index they are talking about is China's Shanghai National Stock Index and also the Shenzhen. In the article, most of those interviewed blame the decline of their equity prices on problems like "insider trading, fraud, and a lack of financial disclosure [that] are undermining investor confidence." However, we take a different tack. **We believe the stock market is a leading indicator of where an economy is heading - not vice versa.** So to us, these problems coming to light correspond with a negative bear market mood that has first shown up in falling prices of equities and will most likely later show up in their economy which has been growing at an astounding 9.5% in 2004. **Thus, this is an element of a market top because we believe this downward price action in China is a leading indicator of where indices in other countries are probably heading.**

March 1, 2005, CNNMONEY, "**New Home Sales Tumble 9.2%;**" The first sentence covers most of it: "New home sales tumbled 9.2% in January, the government reported Monday, coming in well below Wall Street forecasts, and economists expressed mixed

opinions about what was next for the nation's housing market." This new home sales volume drop was a comparison of December 2004 to January 2005. "By region, sales [volumes] posted **the sharpest drop in the Midwest in January, down 40.3 percent and fell 17.1 percent in the Northeast...**" More important than the drop in sales volumes (although it is definitely an element of a market top) is that **"the median price of new homes sold in January 2005 hit \$199,400 down 4.8 percent from the same period [January 2004] last year."** From this information **we conclude that median prices must have peaked in 2004.** More shocking (especially since you did not see it in the major media) is that **the median price drop from December 2004 to January 2005 was even greater at a 13.2% decline.** Not only that, "January [2005}'s **supply [of new houses] was the highest since June 2000...**" We see lots of "elements of a market top" in residential real estate in these figures.

February 24, 2005, THE NEW YORK TIMES, "**Fannie Mae Scrambles for New Ways to Raise Capital;**" We first covered this story far ahead of the pack in our articles: "Freddie Mac, Fannie Mae & the Apex of the Real Estate Cycle" in the 2nd Quarter 2003 edition of our quarterly newsletter, THE WEALTH PRESERVER and "Real Estate Subsidy Problems" in the 1st Quarter 2002 THE WEALTH PRESERVER. Our review of this current article is basically an update of our September 27, 2004 commentary on the BLOOMBERG article, "Fannie Mae to Correct Accounting and **Boost Capital:**" on our Deflation Watch web page, <http://www.risk-adjusted.com/AnnualForecasts.html>, and an accompanying review we did on the same date on this web page.

Back then (before Fannie recently admitted that it would have to lower its earnings by \$9 billion due to improper accounting treatment of its derivatives portfolio - announced 2 months ago) Fannie had just agreed to raise its capital account to exceed its minimum by 30%. Based on our calculations back then, we estimated it needed to raise approximately \$4.7 billion of capital **or** lower its amount of outstanding loans by roughly \$235 billion (4.7 divided by the 2% minimum capital percentage we estimated at that time). Subsequently, Fannie was able to raise \$5 billion in preferred stock (which it gets to count as capital) in December 2004. It also cut its dividend in half to retain and restore future capital and "it has been steadily selling off its enormous portfolio of mortgages to reduce the overall size of its assets..." as we forecast could help them with the capital ratio mathematical target that they agreed to - however; that reduction has only been by \$14.6 billion so far from \$904.6 billion down to \$890 billion..

Oops - Then, about 2 months ago, Fannie and the SEC announced that Fannie would have to write off approximately \$9 billion in earnings due to improper accounting for its derivative's portfolio. To keep its capital ratio at the agreed upon level, using our simple formula, we estimate that this write down will require them to raise an additional \$9 billion of new capital or lower its amount of loans outstanding by roughly by \$450 billion! (9/.02). We didn't cover that story then as it was essentially what we had just forecast - that there would likely be more problems and that it would result in capital needing to be raised or fewer loans being made or loans being sold off. What is more important to us is that we said, "We believe that either of these actions is essentially a **"credit contraction" that is deflationary - it will make the cost to finance a house go**

up, which will make the price people are willing to pay for that house drop. Rates up, prices drop - just like bonds."

Now the newest bombshell: "On Wednesday [February 23, 2005] [Fannie Mae announced] that its primary regulator had discovered a host of new potential accounting violations at the Company that had raised a fresh set of 'safety and soundness concerns.'" Thus, our previous argument that accounting irregularities at Fannie Mae will likely lower its accounting capital which will have to be raised up by issuing new capital (which will be much more difficult this time around as they are already \$9 billion in the hole even after the recent \$5 billion preferred stock infusion) or by shrinking their asset base (read make fewer new loans and sell off older loans) is deflationary. Before this newest announcement we were estimating they were already going to have to raise \$9 billion of new capital or shrink their loan base by around \$450 billion. The newest bombshell of violations are most likely going to be write-downs that will make the situation worse. Again, this is all deflationary - even more so now - because, this time, they probably will not be able to raise capital and, thus, will have to dramatically shrink their balance sheet. In that case, instead of providing liquidity into the system, they will be taking it out, which will raise the cost of borrowing to finance a house - and - rates up, prices drop in real estate - just like bonds. Thus, this is clearly an element of a market top if it plays out the way we are seeing it.

February 21, 2005, BLOOMBERG, "**Barclays Opens Up a Pandora's Box of Derivatives: Mark Gilbert;**" This is a very interesting article about the derivatives market worldwide. Apparently, a large percentage of the credit derivatives created and sold early in the markets history - prior to mid-2002 - have seen their credit quality deteriorate. "Some 16% of securities that had AAA ratings in January 2002 lost their top grade in the next few years." This deterioration in credit quality (and price) has resulted in a lawsuit by the purchaser against the banker/issuer of a specific issue. In that case the credit quality is said to have dropped by 11 levels from averages of AAA thru BBB down to BBB- thru CC, well below investment grade.

The article points out that "**The case raised the tantalizing prospect of a whole basket of dirty derivatives laundry airing in public.**" Since then a second lawsuit has been filed. Now the article's author asks, "So here's the question: **How many other owners of the \$350 billion of collateralized debt that was in the market by mid-2002 are forming a line to sue their bankers?**" Then, he makes the point that "**It's easy to see why even a bank convinced of its innocence would rather pay off a litigant than see details of its derivatives dealing pored over in a lawsuit.**" Finally, another analyst is quoted pointing out, "**there's never only one cockroach.**"

So, there is a lot of important points made in this article as far as "elements of market tops" is concerned. The article makes the case that credit quality has deteriorated on the derivatives issued prior to mid-2002. That a couple of lawsuits have resulted. That if the case is defended, we might get our first real glimpse of what really goes on in the derivatives market and how they are accounted for. **The article doesn't make the point**

but definitely implies that what we see if that happens might be far from pretty.

Finally, that if there are a few problems that have resulted in the recent lawsuits, there will probably be more. Thus, if the spot light of the court is turned on derivatives, disclosure will almost certainly be vastly more than it has been in the published financial statements. This new "transparency" (a word I think is most often misused but is very appropriate here) could bring to light all sorts of problems of issuers, underwriters and owners that have so far been obscured from view - think Fannie Mae. If that is true, this really will have been an element of a major market top.

February 7, 2005, THE LOS ANGELES TIMES, "**In Riverside County, Housing Market Shows Definite Signs of Slowing - No More Queues of Eager Buyers. Now Builders Are Cutting Prices and Offering Incentives;**" The title pretty much sums it up. Important to us is that the article highlights that **this regional market peaked in the middle of 2004**, which we have called as the peak for residential real estate in the United States in general - **"...the rate of increase in the median price of a new single-family home DECLINED 8 percentage points from the second quarter of 2004 to the fourth quarter.** Also, to us, it indicates declining prices or deflation: "Last fall, houses in Forecast Homes' Hidden Meadows subdivision ... were starting in the mid to high \$400,000's - these days, prices are starting in the high \$300,000s." A recent buyer complained, the builder is advertising the same models for "\$34,000 less" than the builder had just sold to him. Also, "... in the last three months of the year, new-home sales plunged 54% compared with the same three months in 2003...;" thus, a classic sign of a market top - declining volume of transactions.

February 5, 2005, THE INDEPENDENT, "**Personal Bankruptcies hit all-time high as debt levels rise,**" and, THIS IS LONDON.CO.UK, "**Bankruptcies leap by a third;**" These articles are about what is going on in England. We believe the current huge credit deflation is global with most of Europe somewhat ahead of the situation here in the United States; thus, we think a look at what is going on over there may be very insightful. Basically, **bankruptcies were up by 28% for 2004 versus 2003 with the final quarter of 2004 having 35% more bankruptcies than the final quarter of 2003.** The articles point out that the rise in bankruptcies seems to be attributable to high debt levels combined with rising interest rates - as situation similar to what exists in the United States.

January 8, 2005, THE ORANGE COUNTY REGISTER, "**Sales of New O.C. Homes Tumble;**" This article is talking about the fall in sales volumes not sales prices; however, generally sales volumes fall, then prices fall. The article points out that **"...new-home sales in Orange County fell 27% in the four weeks ending December 28th [2004] vs. the same period a year ago. By comparison, sales of previously owned detached houses fell 6% and previously owned condos dipped 2%."** Remember generally you will see the volume in the least quality area fall last and that is what we are seeing here. **"Overall, home sales [volumes] for all types of abodes declined 9% in the four weeks vs. a year ago."** The article also covered orders for future new homes in California. Standard Pacific, Orange County's largest homebuilder, reported a 36% drop in new-home orders for the fourth quarter of 2004 compared to the same period of the previous year.

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"...William Lyon Homes of Newport Beach reported its new-home orders in California dropped by 39% in the fourth quarter vs. the year before." Thus, the possible top in prices of residential real estate back in the third quarter of 2004 is becoming more and more likely.

December 30, 2004, BUSINESS WEEK (January 10, 2005 edition), "**The Mortgage Biz Has Lost its Fizz - Goodbye, Refi boom. Hello, Sinking Profits and Industry Consolidation:**" The topic of this article could easily be an accurate metaphor for the U.S. economy, similarly to the airline industry that we have documented numerous times previously. Major points of the article are: that the "...refi boom [has been] largely over since April [2004]" **..with overall mortgage activity going from a peak of \$1.2 trillion in the third quarter of 2003 down to nearly half of that amount in the same quarter of 2004** including a 72% drop in refis for the third quarter of 2004; earnings of mortgage origination companies are plunging; **the industry is awash in overcapacity; "an intense pricing war has broken out, squeezing profits throughout the industry;" "some firms have begun downsizing** to adjust to the end of the ref boom;" and, a new round of consolidation is expected in 2005. **Thus, this bubble appears to be over with demand plummeting at the same time that the industry is awash in overcapacity.** The "fierce price war" has resulted in lenders dropping their fees by 40 basis points from 2 points over the ten year to 1.60 basis points over the 10 year Treasury - i.e. **a kind of deflation.** I guess the most important point is that, to us, the end of the refi boom in April 2004 and the accompanying beginning of the end of people raiding their home equity at that same time seem to correspond to the topping of the real estate market beginning in May/June of 2004. It makes sense because that would essentially be the beginning of the end of the credit explosion.

December 27, 2004, THE ORANGE COUNTY REGISTER, "**Big Business Running Scared - Even with Record Profits, Corporations Shun Reinvestment - and Limit Growth:**" This is an Editorial by Robert J. Samuelson. The editorial highlights and brings up-to-date a point we have made previously - that businesses are not investing their cash, they are simply accumulating it. He brings up the point that even though their profits have rebounded very nicely, **businesses are not plowing their cash into new investments.** Similarly to the article (below on December 16th) about the fall in housing starts, we ask, **What do you think these business executives realize or are concerned about that their shareholders have yet to figure out?**

December 23, 2004, CNN/MONEY, "**New Home Sales Tumble:**" **"Sales [of newly manufactured homes] tumbled 12% last month** to an annual rate of 1.125 million new homes, the government reported, **coming in well below most economists' forecasts. It was the weakest sales pace since July and the sharpest percentage decline since January 1994.**" Sales of new homes last month "faltered in every region except the South..." **"The average new home sales price fell 5%...while the median home price fell 8%...."** **"While the month-to-month price drops aren't that unusual, the drop in November helped pull prices lower from a year earlier, which is far less common."** Ok so newly manufactured home sales have taken quite a hit which is why housing starts have also taken quite a hit - see the next article. However, on December 29th, 2004

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BLOOMBERG along with others reported, "Previously Owned Home Sales Rise to Record." Thus, new home sales tumble and old home sales rise to a record of total homes sold during a month - the percent increase for old home sales was 2.7%. **Importantly, new home sales are recorded at signings and old home sales are reported at contract closings, so the resales of old homes LAG the reality of what is happening by about a month and a half.**

December 16, 2004, AOL BUSINESS NEWS, "Housing Starts Post Largest Drop since 1994:" **"Housing starts unexpectedly plummeted 13.1% last month (November 2004), the biggest dive in nearly 11 years,** as groundbreaking activity fell sharply across the nation..." We ask, **What do you think these professional homebuilders know that the general public has yet to figure out?** It probably has to do with interest rates going up and housing prices being far too high.

December 17, 2004, THE ORANGE COUNTY REGISTER, "Schwarzenegger's day of reckoning:" This is an editorial that makes some very good points about the problems being faced in California. **"Despite a prosperous economy putting more of the taxpayers' money in the state treasury, the California budget crisis is getting worse."** How can that be you ask - the short answer is because **costs are growing even faster!!!!!!** - ugh. Schwarzenegger is having "limited success at reining in spending" - so far, we might add. The editorial points out that the general fund revenue grew 5.2% last year and is projected to grow by 4.3% this year. However, **"the every continuing, ever-growing deficit is there because the legislature has already passed laws that will increase state spending by a mind-numbing 39% over the next five years,' or 7.8% per year"** according to State Senator John Campbell. Thus, you can see what the problem is, especially considering the State is already in the hole. The editorial speculates that Schwarzenegger and his finance team will get the word out in order to get the needed cuts. We believe we already started to see the beginning of that strategy with his talks about cutting costs beginning early in 2005. **Our point is that California will be going from an expansion of spending and programs and compensation which has lasted decades to a contraction of such - thus, an element of a possible market top.**

December 16, 2004, SAN DIEGO UNION-TRIBUNE, **"County's Housing Prices in Pullback:"** "San Diego County housing prices dipped \$2,000 [from September to November 2004] to a median of \$487,000....however, the slight decline was overshadowed by a \$10,000 drop from August to November [2004] in the median price of single-family resale homes, the largest segment of the market." **The all-time high (so far) was \$525,000 in August 2004 - we believe that may be the all time top for a long long time.** The article points out that "an all-time peak of \$730,000 in the 92008 ZIP code (Carlsbad) occurred in **May [2004]** - thus, to us demonstrating how the real estate is a very regional market and stratified by price and how the top is **"fanned" with different markets topping at somewhat different times (as opposed to market bottoms when you see convergence).** Also, according to the article, "month-over-month prices may be down in San Diego County because there are more homes for sale. According to Sandicor, **there were 9,129 listings on the market yesterday, compared with an average of 3,754 in December last year.**" To us, that is an element of a market

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top - more supply given everything else equal means prices are going to drop; however, if psychology changes prices can also drop on less supply. **"At current sales rates, the current inventory of homes on the market would take more than 70 days to sell, compare with 26 days last year."** To us, that longer time to sell is another possible indication of a market top - the next step is that you cannot sell near your original offer but must drop it. If the psychology of expecting real estate to go up 20% every year (like the NASDAQ was thought to before 2000) changes back to reality, the bottom could fall out and prices could drop precipitously. We have figured previously that fair value based on incomes is down at least 50% from current levels and markets typically move through fair value on the upside (as currently) and also on the downside.

December 14, 2004, AOL NEWS, **"Why Are So Many Insiders Selling? - November Sales Rates Reach Highest Level in More Than Four Years:"** The key with this article is that the recent insider selling is at levels last seen near the market highs in 2000. Insiders are defined as executives and other top officers and directors. Such huge selling by insiders is not necessarily an indication of a market top or that the insiders think their company's shares are overvalued. Often, there are other reasons. However, at these market nose bleed levels and because such a similar situation existed near the previous peak it is definitely an element of a market top. Look at the numbers:

\$6.6 billion insider stock **sales** in November 2004

Compared to only **\$144 million** in inside stock **purchases** in November 2004
\$7.7 billion insider stock sales in August 2000, previous peak

November 23, 2004, THE BOSTON HERALD, "Economic 'Armageddon' Predicted:" **This is a very interesting article about a presentation Stephen Roach, chief economist at investment banking giant Morgan Stanley gave to a private audience.** No press were allowed but, apparently, the article's author, who was not named (i.e. no byline) was able to get a copy of the presentation. In the article/presentation, Mr. Roach makes many points that we have made over the past couple of years and concludes (according to the article) that "American has no better than a 10% chance of avoiding economic 'Armageddon.'" Of course, we are not sure if those are his actual words, but the point is well taken to be very careful about not owning over-valued risky assets whose prices could drop precipitously if the economy were to turn down. According to the article, Mr. Roach sees a 30% chance of a slump soon and a 60% chance that 'we'll muddle through for a while and delay the eventual Armageddon.'" "In a nutshell, Roach's argument is that America's record trade deficit means the dollar will keep falling. To keep foreigners buying T-bills and prevent a resulting rise in inflation, Federal Reserve Chairman Alan Greenspan will be forced to raise interest rates further and faster than he wants." - We have been making that exact same point (in slightly different words for quite a while now and think that it has already started to happen). An interesting fact he points out is that "to finance its current account deficit with the rest of the world, he said, American has to import \$2.6 billion in cash. Every working day. That is an amazing 80% of the entire world's net savings." "The result [of Greenspan defending the U.S. Dollar by raising interest rates]: Consumers, who are in debt up to their eyeballs, will get

pounded." Household debt at record levels. Half of new mortgage borrowing having flexible rates, "leaving borrowers much more vulnerable to rate hikes." Blah Blah Blah - very much what we have been saying for quite a while (and so has Mr. Roach) except that now it carries more weight with the twin deficits much more in focus and the record low level of the U.S. dollar as compared to the Euro. I believe this statement is the author of the article - "Less a case of 'Armageddon,' maybe, than of a 'perfect storm.'" - That wording is interesting because we have been calling this possible worst case "the perfect storm" for several years now. Anyway, we found the article and Mr. Roach's comments very interesting and it gives a sort of stamp of recognition as to the possibility of the major market top which we believe we are seeing.

November 21, 2004, STAR TRIBUNE, "High-Stakes Holidays:" The first couple of sentences give you the idea: "**Americans entered last year's holiday shopping season flush with tax-refund checks and proceeds from home refinancings. This year, in the wake of continued job uncertainty, flat wages and higher prices for food and gasoline, many have turned more tightfisted.**" That being said, we will be watching this Christmas selling season very closely to get an accurate feeling for how strong the economy really is. Our feeling is that this Christmas selling season is highly likely to be a bust and if it is, bloated prices of risky assets could be in trouble.

November 6, 2004, THE GUARDIAN, "**Household debt leads to Record Bankruptcies:**" This article is referring to the situation in England (including their housing slump) that we have been reviewing as we see most of the problems in the U.S. Economy being reflected worldwide. In this case England's situation seems to be a bit ahead of ours and, thus, can most likely shed some light on our future. In England, "the number of individuals going bankrupt has hit a record high, government figures revealed yesterday in fresh evidence that over-indebted households are struggling to cope with recent interest rate rises. During the third quarter of 2004, 11,967 people were declared insolvent, up 31% on the same quarter a year ago, according to figures from the Department of Trade and Industry." **The rise in bankruptcies is the tenth quarterly increase in a row!** Obviously, you can see that we believe the same thing will likely happen on our shores.

November 5, 2005, BUSINESS WEEK (November 15th edition), "**Pop Goes the Housing Bubble:**" This article is about what is happening in England - we believe that most of the problems of the U.S. are being reflected somewhat ahead of ours worldwide. "Five quarter-point hikes in interest rates, to a three-year high of 4.75% have pricked Britain's housing bubble and cooled off the economy. In fact, **the air is coming out faster than expected** and economic growth has slowed sharply." That pretty much sums up what is going on over there. We believe that Greenspan will have to raise rates to protect the dollar which has slumped as other countries have raised their interest rates. Unfortunately, we believe that further U.S. rate rises will prick our own housing bubble (which probably peaked earlier this year) and the stock market. Stay tuned.

October 25, 2004 BUSINESS WEEK (November 1st edition), "**Homebuilders are Stretched Thin - Even as demand Falls, They're Taking on Debt to keep Up their**

Pace: This article details the build up of housing inventories and debt to finance them of the 14 largest publicly traded home builders. "As a result, those inventories [of newly built homes] now stand at the highest level relative to sales in seven years." To fund the construction, lack of sales and inventory buildup, the 14 builders "laid out \$373million more cash than they took in....compare that with the much more modest \$73 million 'burn rate' builders went through..." last year. The point of the article is that these homebuilders appear to be overleveraged just as interest rates are going up and housing sales are cooling. The article also includes a couple of graphs - One graphic shows the "days required to sell inventory" which has been rising pretty steadily since 2001; thus, to us, **demonstrating a typical element of a market top - slowing momentum and a divergence between prices going up and the time it takes to sell them - these are "classic" occurrences of a market top as are increasing unsold inventories and increasing debt levels.**

The article also highlights the build up in inventories in Las Vegas, previously one of the hottest real estate markets. "...**the Las Vegas bubble has burst - inventories of unsold existing single-family homes in Las Vegas shot up from 1,400 in February [2004] to more than 15,000 in September [2004]" thus by a factor of more than 10x.** Because real estate is so regional, one area will most likely lead the other areas and it looks like Las Vegas is the leader this time.

October 19, 2004 INDEPENDENT NEWS, "**House Price Falls 'Steepest For Nine Years:'**" This article is about the real estate market in Britain which is also in a bubble and is probably a leading indicator of things to come in the United States. The article's first couple of sentences get your attention quickly, "House prices are falling at their steepest rate for nine years...**The Royal Institution of Chartered Surveyors said the drop, the biggest since 1995 and the second consecutive fall, was a reaction to three hikes in interest rates over the summer.** Inquiries from prospective purchasers were down for the fifth consecutive month and the number of unsold properties rose to its highest level for almost a year." The article also points out that "the National Association of Estate Agents said the average property price in the UK has fallen for the fourth consecutive month..." Actually, that would pretty much match May/June 2004 as the top, which is what we believe will turn out to be the case for most markets here in the United States.

September 26, 2004 THE NEW YORK TIMES, "Reading Fannie Mae's Scary Cookbook:" This is an excellent article on the "**shocking expose" on Fannie Mae**, the second largest debtor in the United States (after the U.S. government itself). To us, the article is pretty much a confirmation of what we thought would probably come to light when we published, "Freddie Mac, Fannie Mae & the Apex of the Real Estate Cycle" in the 2nd Quarter 2003 edition of our quarterly newsletter, THE WEALTH PRESERVER and "Real Estate Subsidy Problems" in the 1st Quarter 2002 THE WEALTH PRESERVER In The Times' article's first paragraph, another title was offered: "**In the Kitchen with Fannie: How top Cook the Books for Fun and Profit.**" The crux of the story is that management cooked the books to meet profit requirements so they would maximize their own personal compensation bonuses - that all the carefully crafted media

malarkey about stable, low risk earnings and cash flow was just that - baloney. Of course, it cooked the books by manipulating the accounting of its interest and credit hedges and swaps. Now, here is the key, after all the smoke from the most recent investigation had cleared, **"the company is grossly undercapitalized."** That the company is grossly undercapitalized was one of the highlights we made over a year ago and The Times article makes now - "Its equity capital of roughly 2% is much lower than the 8% required of A-rated banks." Here is another key - **"...the company's risk controls and accounting systems were exceedingly weak and lax."** The article points out that these problems are probably typical in the industry. Thus, concluding, **"...Fannie Mae is probably not alone in playing fast and loose with financial reality."** The Times' article was based on a report written by the Office of Federal Housing Enterprise Oversight, which is the Company's regulator. Importantly, **"this is only an interim report, meaning that there is more to come."** We decided to include the review of this article in Elements of Market Tops because it is clear to us that we could easily see a reduction of subsidized mortgage money from Fannie Mae (and probably from Freddie Mac also) which will help to push housing prices down more quickly. Follow our [Deflation Watch](#) link, <http://www.risk-adjusted.com/AnnualForecasts.html>, to see why Fannie Mae having to raise its capital ratios (which was agreed to the day after this Times article was published) is most likely deflationary.

August 26, 2004 CNNMONEY, "Pop goes the Bubble?": Of course, when we see that headline we ask, which one? oil, real estate, etc. This article is talking about real estate. To us, the most important fact in this article is that **"...the Las Vegas market, which posted the biggest price gains in the second quarter, is suddenly dead in the water."** We expect that will turn out to be true with all real estate markets.

August 26, 2004 BBC NEWS, "London **oil drops** to \$40 a barrel": "In New York, light crude reached \$43, down 27 cents for **a fall of 13% from the record of \$49.30 reached a week ago.**" We are using this article's information to document the very quick drop and the fact that we expect that "the top is in." Since this top in oil was of the "blow off" variety, we expect the drop to continue to be even faster than the rise. Also, we want to emphasize that when the media and all sorts of non-market experts proclaim knowledge about prices and markets, the top is usually right around the corner - for example, recently about oil - many scientists who are experts on how to make oil, etc. were quoted to the equivalent of "high oil prices are here to stay" or "oil can only continue to go up from here," etc.; however, as with the internet's "new paradigm," they will most likely be wrong and the market will collapse even more quickly than it rose.

August 25, 2004 AOL BUSINESS NEWS, **"New Home Sales Tumble More Than Expected"**: "New home sales fell more than expected in July to their lowest pace since December....a government report showed on Wednesday." This article documents what we see as the end of the housing bubble (which we think topped in June 2004) and the beginning of the precipitous drop in prices we are expecting. In addition to the sales volume drop the article points out that **"inventories of homes available for sale...ballooned** to a 4.2 month's supply, the highest level since February 2003."

"Our Clients' Past Successes are Not Necessarily Indicative of Future Successes."

August 18, 2004 THE LA TIMES, "L.A. County Home Prices Cool Off, Slightly in July": This article provides useful information on the Southern California real estate market. One of the important points it makes is that **the median house price in Los Angeles County was down 2% from June to July 2004**. Of course, the article quotes experts downplaying it as a temporary or healthy slowdown; however, as we stated below, we think the market may well have topped out in June overall (of course, real estate is regional). In fact, quoting from the article, **"In June, all regions but Orange County hit record median-price highs, Orange County's median peaked in May."** Since I'm from Orange County, I like to think that the people are smarter in Orange County and that is why real estate topped here, one month early. In that quote we assume "all regions" means either in Southern California or in California, to us it doesn't make that much difference, the point is we may in fact be past the peak - we will have to wait and see. The article also pointed out that "all categories were down slightly from June." So not only were all areas down but all categories (like single family houses, condo's, etc.) were down. Important information from an "Element of Market Tops" perspective is that **LA County's "housing inventory doubled in the last 60 days to a six-week supply from a three week supply."**

August, 18, 2004 SAN DIEGO UNION-TRIBUNE, "Prices gain as inventory of unsold housing soars": This article says that "housing prices in San Diego County set another record last month [July, I think], but there are signs of a real estate slowdown fed by greedy sellers, wary buyers and confusion in the economic outlook." **It points out that the inventory of unsold homes has increased by 50%** from 5,995 [I believe this number is from July of last year] to 8,987 currently. Importantly, while the median home price was up \$8,000 from June [I presume June 2004, last month], "resale condominiums was the only housing category to reach a new high." Thus, **median for single family houses was down, only condos were up and they were up quite a bit**. The article mentions the increase in the condo market and the market for converting apartments to condominiums [which we think is probably skewing the data]. Important from a "Elements of Market Tops" perspective is that condo buyers are generally the least sophisticated and marginal buyers - they are usually the last to get sucked into the market top. We will know in a few months if that is again the case.

August 3, 2004 "Investment Outlook - Lemonade for Sale," PIMCO Bonds by Bill Gross. In this very well written and interesting article, well know U.S. Treasury Bond portfolio manager, Bill Gross, explains that because of the incredible proliferation of **hedge funds**, the average hedge fund must under perform the market given their high fee charges and the fact that they essentially are the market. He then tells readers how they can construct their own hedge-fund-like vehicle at a much lower cost. In the report he has a graph of hedge fund assets plotted along with the number of hedge funds. Assets have increased from under \$100 billion in 1992 to \$900 billion at the end of 2003; the number of hedge funds has gone from under 1,000 to 7,000 over the same period of time. **What is striking to us is that the graphic for the number of funds is parabolic and getting nearly vertical on the right side**. Just as in the examples below (silver, which has already dropped 33% in one month, and oil and real estate which have yet to drop), we believe this parabolic curve is the structure of a blow off top - **a blow off top that**

will be resolved by a dramatic drop in the number of hedge funds. While Mr. Gross doesn't address the shape of the graph, he gives the fundamental reasons why the number of hedge funds most likely will plummet - with so many owning the market and such high fees they are certain to under perform on average. **We would like to add that the number of hedge funds will probably drop if there is a large drop in the value of the investments that they invest in.**

July 30, 2004 - We could not find a timely article on this topic to leverage off of so we did our own. Here is our headline, "**Oil Has All the Signs of a Blow off Top.**" Earlier today we were researching the multitude of tops in the prices of most asset classes (see "Is the Entire World Declining?" in the Deflation Watch section of our website, <http://www.risk-adjusted.com/AnnualForecasts.html>), when we looked at oil. We knew oil was putting in new highs because that subject is about all the financial media has been talking about consistently over the past few months (despite all the other asset classes heading downward since the beginning of the year). **Low and behold, the graph of oil prices is parabolic up (rising at an increasing rate) with the right side being nearly vertical.** In an article dated July 18th, 2004, that we reviewed below on this page, we pointed out the recent blow off top (and precipitous decline) in **silver** -with its parabolic rise starting from \$4.50 per ounce in June of 2003 up to \$8.25 per ounce in early April 2004 - followed by its 33% decline in just about a month down to \$5.50 per ounce in early May 2004. We said, "Importantly, **once the parabolic shape is near vertical, our experience is that it almost always crashes down precipitously [just] like the 33% one month drop...silver just experienced.**" In the case of oil, its price graph is now essentially nearly vertical on the right side but probably has a little bit more to go. However, **our main point is the same, we think oil is going to come crashing down in the classic resolution of a parabolic rise with a nearly vertical right side.**

July 30, 2004, THE ORANGE COUNTY REGISTER (July 28th edition), "House Prices May Have Hit the Ceiling": This is a well written article with some information which will likely prove to be very useful. While the article's title implies only that house prices may not go up anymore, the article asks, "Is this lethargy a healthy return to a more normal pace of business - or the start of **another ugly downturn?**" Although the author doesn't answer the question, we especially like his words, "another" and "ugly" in the context of a real estate down turn since many are not aware that real estate at least on a regional basis has definitely had its ups and its ugly downs. Ok, now down to the article hard facts: according to data from the California Association of Realtors, "June's supply of traditional single-family homes for sale represents the biggest stockpile in nearly four and a half years." In addition, the California Association of Realtors "estimated there was 3.9 months' worth of inventory on sale...That's up from 2.1 months in May [2004]. An up from 0.6 months - yes, less than three weeks - in March [2004]." It is from that data that the author, Jonathan Lansner, concludes and we concur, "There is zero doubt the Orange County housing market has cooled." He also points out that, while the prices of houses in Orange County have been rising (28% over the last year), according to Real Data Strategies, the real estate sales activity it tracks is down a stunning 34% from a year ago. **Thus, you have the classic signs of a market topping: a divergence between prices rising and 1) volume slowing, 2) increasing supply, and 3) increasing time**

required to make a sale. We conclude from the data and other work that the real estate top, at least in Orange County, is in.

July 20, 2004, ORANGE COUNTY REGISTER, "California home prices hit record level in June": We won't spend much time on the rise in the prices as we have reviewed them in the articles below; however, this article points out that prices are up about 23% from a year ago and up about 4% from the previous month (part of the parabolic rise in an article below). To us, this article makes two key points: 1). **the blow off in June 2004 was part of a "buying panic"** related to fears interest rates would rise, 2). **the "buying panic" appears to have abated.** To us, this is huge. It totally demonstrates that the buyers in this market are not "sophisticated" at all. When interest rates rise, the value of an asset in general falls - this is true with bonds and when using most equity valuation models, etc. - it is pure and simple math and it will prove itself to be true with real estate too. Yet, these so-called "sophisticated" real estate investors (and their conflicted advisors) had a buying panic thinking this was their last chance to get in (before interest rates rise and they cannot afford a house) - **to us, it is - it is their last chance to get in before interest rates rise and credit dries up causing the real estate market to collapse.** In fact, the second key could most likely be a correct market call - "the panic buying has abated" - why? to us it could very well be that the top is in! - **all those last buyers that panic-bought are "spent" and that is why buying abated** - we think it is unlikely that they all realized that when interest rates go up, asset values go down - if so, they would be selling like crazy - like they most likely will try to do in the not-to-distant future. Unfortunately, by then, there might not be any available credit and you can just imagine what houses would sell for if you had to purchase then with 90% cash down.

July 18, 2004, NEW YORK POST, "Rate Rise could Bankrupt Debtors": Amazingly, this article, which is in the definite minority, gets it very right as far as we are concerned. And we quote, "Low-rate mortgages, credit cards and auto loans have allowed the average American to live above his or her means." That is pretty much the articles theme. Of course, it says that when rates rise, the party is over and bankruptcies will be rampant.

July 18, 2004, SAN DIEGO UNION, "Buyers turn to creative, risky financing for homes": Another article indicating a typical major market top. This article is all about the "creative financing" that is being used in the housing market. "It was the only program where we could get the type of house we wanted in the location we wanted with **no money down.**" The article is talking about interest only loans, now-down-payment mortgages and a host of other creative financing packages. One very aggressive financing program highlighted is the Option ARM, or negative amortization loan where the borrower pays only part of what's owed early on in the life of the loan, including only part of the interest!!! The unpaid interest is added to the loan's balance creating "negative amortization" whereby the homeowners end up owning more than they originally borrowed. Why would anyone do that? we ask - because they are **speculating** that the price will rise faster than their negative amortization.

The article states that "in May [2004], **72 percent of homes in San Diego County were bought with adjustable-rate loans**, up from 45% in May 2003...." "Back in 2000, there was basically one lender that offered 100 percent financing...Today, there are 43..." The article doesn't call it a "buying panic" but quotes, "They're so frenzied to get into the market because they are fearful that the opportunity to buy a house is going to slip away with rising interest rates." - to us, that mentality is very typical of a "buying panic" blow-off market top and will most likely prove to be disastrous for the "investor."

The article highlights more elements typical of a major market top - **experts will talk about a leveling of price but never mention the possibility of it going down** and we quote, "Experts warn that negative amortization loans, interest-only loans and 100% mortgages could spell trouble **if the market flattens**." Also, "if home values **stall**, these borrowers won't build much, if any, equity in their homes." And, "If values **flatten**, 100% borrowers might find themselves stuck in their homes." Very typical comments - we think the whole thing is ludicrous - without the credit, prices would be down 75% - from these price levels and levels of available credit it is almost certain that prices will fall precipitously yet no one will say it!

However, the article makes a very eye-opening point - "Just adding principal to the payment - spread over 25 years instead of 30 - would boost the monthly bill by roughly 30%. Add an interest rate increase of 2 percentage points, typically the boost when the loan rolls into its adjustable phase, and the **monthly bill increases by more than 60% [!!!!!!]**." You can only imagine what will happen when this market starts dropping - we believe it will easily go down 2x faster than it went up.

The article makes a very important point, "some in the mortgage industry say the increased popularity of creative mortgages has contributed to soaring home prices by allowing buyers to qualify for larger loans." **That is pretty much our point - that without all this credit, the market would be dramatically lower in price and when cheap and easy credit disappears, we could easily see a housing market crash even worse than from the 1979 top down to the 1985 bottom - a drop of 67% in Southern California.**

July 18, 2004, LOS ANGELES TIMES, "Not Everyone is doing cartwheels over 'Flipping'": The graphic accompanying in this article really caught my eye. The part of the graph the article concentrates on is the Percentage of Southland home sellers who had owned their homes six months or less. That curve was interesting but what was **spectacular** to me was the accompanying graph of the **Median Home Price** in Southern California. This graph was "**parabolic up**" and **near vertical on the right side (which should be then end of the upward move)**.

Long term students of many markets over long periods of time know that a market that is "parabolic up" is most likely experiencing a blow off top. A very good recent example (not in the article) is that of **SILVER** which had a **parabolic rise** from \$4.50 per ounce in June of 2003 up to \$8.25 per ounce in early April 2004 before dropping by 33% in about a month to \$5.50 per ounce in early May 2004. Importantly, **once the parabolic shape is**

near vertical, our experience is that it almost always crashes down precipitously like the 33% one month drop in silver just experienced.

Thus, based on the parabolic, near vertical rise in house prices shown, we believe it is highly probable that the market for housing, at least in Southern California, will take a dramatic, rapid fall in the near future. Of course, the fall will not take place in one month as silver just did but will take place over many many months and even a couple of years due to the much larger scale and all the regulatory and legal obstacles in the real estate market. However, we do believe that liquidity could dry up so fast that, while prices would not be reflected downward as fast, few would be able to actually exit their real estate position as new buyers would have essentially no access to credit and would be unable to purchase.

The Flipping article's subtitle is "The tactic of buying and quickly selling homes has experts on watch for a market downturn. But **few foresee a '90s repeat.**" To us, it is actually amazing that the article brings up the housing downturn of the early 1990's that accompanied the recession of 1991. As normal in "blow off tops" only a very small minority (probably the most knowledgeable) point out the dangers and they are not taken seriously. The article gives more than expected time to nay-sayers but spends the majority of its coverage quoting the more average owner, investor or analyst with quotes like "Real estate isn't much of a gamble in a market as hot as Southern California's has been for the last 12 months, " or "I don't think we are in a big speculative bubble right now...." or " there doesn't look like there are super-dangerous levels of speculation occurring." However, the opinions of the flippers or short term investors highlighted are much more realistic. Our opinion is that the market is wildly speculative and heading for a precipitous decline.

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