

How I See It

A man once said “*When all others around you are losing their heads, and you’re staying calm, maybe you just don’t understand the situation.*” It would seem the current euphoric stock market environment would be enough to change my thinking on the basic strategy that I’ve employed for the managed portfolio these past several months. On the contrary. It hasn’t changed my opinion, it has re-enforced it. My opinion that deep seeded problems are fomenting in the economy, and that sooner rather than later, they will be evident, continues to be strong. Even as I write this, information keeps coming forth. Trouble is brewing. However, the majority choose to ignore these facts and write them off as “*this time, it’s not important.*” Over the next several days, I want to share with you my thoughts on housing, precious metals, energy, interest rates, and the markets at large.

As you know, I have been and continue to be negative on the homebuilding industry. However, with Larry Kudlow, Jim Cramer, all of CNBC, a noted homebuilding CEO, and the chief economist of the National Homebuilders Association, shouting from the rooftops that the bottom is in for the housing industry, these stocks started their upward trek. For many days this past fall, the upward momentum was relentless. People not owning them wanted to get in, and those shorting them wanted to get out. It seemed that there was no end in sight. What made me take the contrary viewpoint? It seemed like David against Goliath.

I’ll start with simple facts. If a house has a dollar put down to hold it, it is concluded as a sale. This inflates sales figures. If the sale is cancelled, it is not withdrawn from the sales figures. This accounting trick inflates sales. In addition, this cancelled house is not added back into inventory. This accounting gimmick understates housing inventory for sale. This over-stated sale and understated inventory makes for suspicious data. Further, **REAL** new annual home sales are falling, and continue to fall at record levels, from 23% to 44%.* In addition, cancellations in housing contracts are growing at record levels.

The newest problem which has been around for a year, but now must be admitted and reported, is the continued re-negotiation of land options that homebuilders are holding. If they cannot re-negotiate them, as most can’t, they must write them off as a forfeiture. Because of this problem, the fourth-largest homebuilder in the nation will have suffered its first annual loss in a decade. Couple this with rising delinquencies on loans and foreclosures accelerating to record levels, and I think you can see why I agree with homebuilding CEO Stewart Miller who sees: “*No tangible visible evidence of a market recovery.*” So how has his company done since peaking in December? It’s experienced a nearly 10% drop from its top, with just a smattering of information coming out. Miller indicated that 2007 doesn’t look pretty for the homebuilders, and it’s being reflected in his stock price. Each homebuilder will reflect the same story. I believe the worst is yet to come.

As much as the data coming from the homebuilders themselves can be spun, the true status is in the labor and materials being provided. For quite a while, I have used, as a surrogate for the true condition of housing in the United States, two segments for analysis: Construction services and building products provided to professional homebuilders and contractors. The construction segment provides framing, concrete, plumbing, other construction trades, managing labor, and construction schedules, as well as sourcing materials to production homebuilders. The next segment distributes building products and manufactures building components, such as lumber, millwork, floor and roof trusses, and wall panels. It also provides construction services to professional homebuilders and contractors.

If houses are not being built, there's no need for materials and labor. This is the true test. The analysts are projecting that sales in these areas in 2007 will be down 19%.** A representative company, since peaking in late September, has fallen 20%. That could be another very strong indication of things to come. I could go on and on, but I think you get the point.

Lastly, look around your neighborhood. Are houses selling quickly, or are they selling at all? Does construction continue, or have projects been discontinued? Has your house appreciated in the last six months, or depreciated? And I haven't even talked about the negative impact of re-financing, adjustable-rate exotic mortgages, and negative home equity. All in all, not a pretty picture and signs that we've just seen the top of the iceberg, not the bottom, as many proclaim. I believe the homebuilding industry will continue to decline, thereby providing the potential for gains in the next several months. **That's how I see it.**

Bill

Next: The precious metals, gold and silver

Sources:

**Yahoo, Tuesday January 9th*

***Yahoo*

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