

# Newsletter Vol. 11 Issue 7

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data was right on target with the forecasts in nearly every area.

The European Central Bank (ECB) took a middle of the road approach in easing its monetary policy. After weeks of hinting that further



monetary stimulus is needed to boost economic growth, ECB officials announced a rate cut on Thursday. They also will implement measures to encourage bank lending. Investors were most interested in hearing about a bond purchase program, but ECB President Draghi essentially just suggested that they were holding this key option in reserve to use in the future if necessary. The ECB stimulus did cause bond yields around the world to move a little lower.

## MACROECONOMIC MOVES AND MORTGAGE MARKET ANALYSIS

### SOLID JOB GAINS (Week ending June 6, 2014)

Ahead of two major economic events, mortgage rates moved higher early in the week. When there were few surprises in either the Employment report or the ECB announcement, though, mortgage rates recovered some of their losses and ended the week just a little higher. This was the first weekly increase in rates in six weeks.



After slowing over the winter due to unusually severe weather, the economy has seen job gains above 200K over the last several months. This was the first time in 14 years that job gains exceeded 200K for four straight months.

Against a consensus forecast of 210K, the economy added 217K jobs in May. The Unemployment Rate was flat at 6.3%. Average Hourly Earnings, a proxy for wage growth, were a moderate 2.1% higher than one year ago. The May Employment

### MANY FACTORS AFFECT RATES (Week ending June 13, 2014)

Mortgage rates were influenced by a wide range of factors this week, resulting in a good deal of volatility. Violence in Iraq, comments from the Bank of England, divergent US Treasury auction results, and mixed US economic data all had an impact this week. Overall, the unfavorable news slightly outweighed the favorable, and mortgage rates ended the week a little higher.

Improvement in the labor market is clearly good for the economy, but it is a negative factor for mortgage rates. Following solid job gains in last week's Employment report, this week's indicators also suggested that the labor market is gaining strength. The JOLTS report measures job openings and labor turnover rates. Because it helps to construct a more well-rounded view of labor market conditions, Fed Chair Yellen is a fan of this data. It showed

that job openings jumped to 4.5M in April. This was the highest level in seven years. In addition, a May survey of small businesses revealed that optimism rose to the highest level since September 2007. Small businesses are an important source of job creation.

While many factors affected mortgage rates this week, it was notable that one formerly significant report has lost much of its influence. The May Producer Price Index (PPI) showed a decline from April, while the forecast was for a small increase. This followed a much larger than expected increase in April. At the start of the year, the calculation of PPI was changed to include price changes in services in addition to goods. PPI now captures roughly 75% of the economy, up from around 33%, but the new components make the measure much more volatile month to month. As a result, investors are less likely to react to swings in the PPI data.

## **INFLATION DRIVES RATES (Week ending June 20, 2014)**



Inflation concerns were the main influence on mortgage rates this week. A surprising jump in CPI caused mortgage rates to rise on Tuesday. The Fed downplayed the threat of high inflation on Wednesday, however, causing mortgage rates to decline. The net result was that mortgage rates finished the week a little lower.

The May Consumer Price Index (CPI), one of the most widely watched inflation indicators, was 2.1% higher than one year ago. Core CPI, which excludes food and energy, was 2.0% higher, up from an annual rate of 1.6% just two months ago. Core CPI has now reached the Fed's stated target level for core inflation of 2.0%. Another inflation indicator released this week, the prices paid component of the Philly Fed report, also showed a sharp increase. Since expectations for future inflation are a primary factor in setting mortgage rates, this data was unfavorable for rates.

The impact of the negative news did not last long, however. While Wednesday's highly anticipated Fed statement was very similar to the prior one, Fed officials indicated little concern about inflation. Comments from Fed Chair Yellen suggested that current readings reflected normal volatility in monthly inflation data and that the recent uptick did not change the Fed's long-term forecast. In addition, Fed officials place more weight on a separate monthly inflation report, the Core PCE price index. Core PCE measures a different basket of goods than Core CPI, and Core PCE recently has provided readings a good deal lower than Core CPI. In short, looking at Core PCE, inflation remains well below the Fed's 2.0% target, giving them comfort in maintaining an accommodative monetary policy. Not all investors are as confident as the Fed that inflation will remain low, though, and this will be an important area to watch in coming months.

## **Q1 GDP Surprise (Week ending June 27, 2014)**

It was another good week for mortgage rates. Weaker than expected economic growth data and increased concerns about Iraq were favorable for mortgage rates. These factors outweighed the negative impact of improving data in the housing sector, and mortgage rates ended the week a little lower.

The biggest surprise this week took place when first quarter Gross Domestic Product (GDP), the broadest measure of economic growth, was revised substantially lower from -1.0% to -2.9%. This was the fastest rate of decline since the first quarter of 2009. The news caused mortgage rates to move lower. The improvement in mortgage rates may have been even greater, but investors took into account that unusually bad winter weather was the main cause. Consumers postponed shopping, and businesses scaled back inventories. Much of the missed economic activity during the first quarter was simply delayed, and GDP growth is expected to rebound to around 3.5% during the second quarter.



The housing data released this week showed nice improvement. Existing Home Sales for May increased 5% over April's, which was the largest monthly gain since August 2011. Total inventory of existing homes available for sale rose 2% to a 5.6-month supply. New Home Sales for May jumped 19% from April to the highest level since May 2008. The April Case-Shiller 20-city home price index showed that home prices were 11% higher than one year ago.

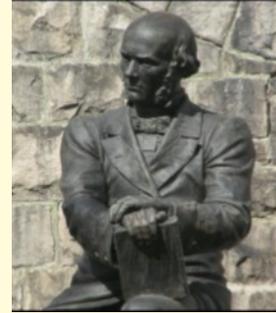
# THE STATE OF THE UNION



This is the fifth of my multi-part series on the macroeconomics of political and social issues that weigh heavily on our “State of the Union”. As Theodore Parker, an early American Transcendentalist observed:

*The arc of the moral universe is long, but it bends toward justice.*

While economics relies heavily on numbers and statistics it is invaluable indicator of the costs and benefits associated with “being on the right side of history”.



## THE WAR ON DRUGS

America’s longest armed conflict is the one against drugs, a war that Richard Nixon declared over 42 years ago. It rages still and at a pace that would startle many citizens. It is waged daily, on farmland and streets from Colombia to Mexico to Detroit. It has put millions of people behind bars, and has dramatically influenced our culture and worldview.

Less than a year after the President’s avowed War on Drugs, the Republican-led Shafer commission sought to calm Americans and temper the president’s claims. The Shafer commission concluded that the drug problem would “not collapse our society,” and noted that “the compulsive use of alcohol remains the nation’s most serious drug problem.” Further, it cautioned against a “drug abuse industrial complex,” that could perpetuate the problem, and called for a review of programs that might be doing more harm than good. It even recommended abolishing penalties for private use and possession of cannabis. Nixon ignored these conclusions, and the nation forged onward with a strategy that increasingly emphasized force over treatment.



The evil associated with drugs is derived from subjective values that are often arbitrary. Just why certain (illegal) substances are singularly more evil than legal substances, like alcohol, has not been explained. Addiction is also a relative and ubiquitous phenomenon. Some people are more susceptible to addiction than others and some 'needs' are more addictive than others. Probably the most addictive substance in our civilization is tobacco—yet no one has suggested making it illegal.

The widespread propaganda that illegal drugs are 'deadly poisons' is a hoax. There is little or no medical evidence of long term ill effects from sustained, moderate consumption of uncontaminated marijuana, cocaine or heroin. If these substances—most of them have been consumed in large quantities for centuries—were responsible for any chronic, progressive or disabling diseases, they certainly would have shown up in clinical practice and/or on the autopsy table. But they simply have not. In fact, more people die from prescription drugs than that of cocaine, heroin, and all other illegal drugs combined.

People associate the drug trade with crime and violence; yet these aren't caused by the drugs themselves, but from the enormous profits to be reaped from their being illegal. This is what is quintessentially pernicious about our current drug policy.



As I stated at the outset of this series, economics, through quantification, points out the costs and benefits which eventually lead to “being on the right side of history”. As a matter of policy it is no different here. Let’s examine this policy from the standpoints of the pros, the cons, and the various costs.

## THE PROS

- It keeps some people from trying and using drugs.



## THE CONS

- It is a victim-less crime, the only person who is a “victim”, if you will, is the person choosing to use.
- By prohibiting something, the price of the prohibited commodity is bid up. So, prohibition not only inflates the price of drugs it also keeps their cost artificially high. The more effective prohibition is, the more the costs increase, and concomitantly, the greater the resultant revenues.

For example, in the countries where cocaine and heroin are produced, they sell for about 1 percent of their retail price in America. In developed nations, cocaine sells for about \$3,000 per ounce—almost twice the price of gold. And the supply of cocaine, unlike that of gold, can be cheaply and quickly expanded. If cocaine were legalized, a \$2,000 kilogram could be Fed-Exed from Colombia for less than \$50 and sold profitably in America for a small markup from its price in Colombia, and a \$5 rock of crack might cost 25 cents. Criminalization drives the cost of the smuggled kilogram in America up to \$20,000. About \$500 worth of heroin or cocaine in a source country will bring in as much as \$100,000 when parceled out in gram packets on the streets of an American city. All the cops, armies, prisons, and executions in the world cannot impede a market with that kind of tax-free profit margin. It is the illegality that permits the obscene markup, enriching drug traffickers, distributors, dealers, crooked cops, lawyers, judges, politicians, bankers, businessmen. Therefore, vigorous enforcement means higher prices and higher revenues for drug dealers.

- And cartels have oceans of money for corrupting enforcement because drugs are so cheap to produce and easy to renew. So it is not unreasonable to consider modifying a policy that gives hundreds of billions of dollars a year to violent organized crime. Marijuana probably provides less than 25 percent of the cartels’ revenues.



- It also keeps the cost of drugs high because the demand curve for drugs is extremely inelastic, meaning that people don’t change their drug consumption very much in response to changes in prices.
- Drug addicts will do whatever it takes to get the money needed for the artificially inflated price of drugs. That means stealing your wallet or your car, and maybe your life in the process. When we repeal drug laws, drug addicts will be able to support their habit by working at McDonalds. This may sound callous or unfeeling, but it makes this point clear: they are going to get it one way or another, and when the cost drops to one fifth of its present value, at least they will be hurting NO ONE ELSE but themselves.



- It imprisons hundreds of thousands of non-violent people who will (after jail) never become productive. Mandatory sentences result in someone selling drugs getting more time than someone who commits murder.

- It ruins the lives of many people—making their employment more difficult with a record. It gives the police far too much arbitrary power. Do not piss off a cop. All he has to say is that he found a pill, a vial or glassine packet in your glove box, and you may be facing 20 years in prison as a mandatory sentence, resulting in the instant dismantling of your life.



- Since they are illegal, the purity and potency of drugs is unknown. Deaths by overdose are attributable to the lack of quality assurance.
- It causes death by spreading diseases such as AIDS by making needles illegal.
- It has killed untold thousands in South and Central America and corrupts governments there.
- It causes corruption of police. Drugs disappear from lockups. Some are on the take. Some turn their head the other way from those who are.

- It causes disrespect for law. Sheriff's departments across the country are now funding a significant portion of their income from property seized from American citizens by using asset forfeiture laws. The police are confiscating from the public to finance their own operations. They are, in effect, addicted to the drug war, also. Some will obviously be against any attempt to end it—it is their sustenance. In 80% of these cases, no one is even charged with a crime.



- The profits promote gang warfare (fighting over drug turf) which has ruined much of our cities. The money is used to commit violent crime, become well armed, kill each other, police, and innocent people and children in the crossfire.
- It makes police work much more dangerous than it needs to be. They are out-gunned, because the criminals have massive monetary resources from drug sales.
- It results in racial profiling & increases racial tension.
- It has contributed to the deterioration of the American family—1/3 of all black males are in prison, on parole, or on probation. It causes the demoralization of police because they see the ineffectiveness and futility of their undertaking.
- It takes police concentration and resources off of REAL crime: theft, murder, arson, rape, and fraud.

- It has resulted in absolute violations of the Bill of Rights—search and seizure laws, asset forfeiture laws, government snooping in our bank accounts. Before The War on Drugs, police appeared at the front door with a warrant and asked to enter. Now they show up in full SWAT gear and just break down the door. There is no constitutional authority for the federal government to be involved in the legality or illegality of drugs. At least during alcohol prohibition they acknowledged they needed to pass a constitutional amendment.

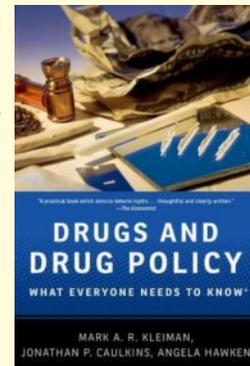


- It keeps people from "coming out of the closet"—admitting addiction & getting REAL help, because they fear going to prison.

- It tempts some people to want to taste of the “forbidden fruit” and thereby encourages them to try drugs. Dealers, aka “pushers,” have almost nothing to do with initiating drug use by future addicts; almost every user starts when given drugs by a friend, sibling or acquaintance.

## SOCIETAL COSTS

- In recent decades the U.S. has experienced a surge in its prison population, quadrupling since 1980, partially as a result of mandatory sentencing that came about during the "war on drugs."
- America has 5% of the world's population, but 25% of the prisoners. We lock up more people than any other country on earth. More than half of the people in prison are there for non-violent drug offenses. More Americans are imprisoned for drug offenses or drug-related probation and parole violations than for property crimes.
- In “Drugs and Drug Policy: What Everyone Needs to Know,” policy analysts Mark Kleiman, Jonathan Caulkins and Angela Hawken argue that imprisoning low-ranking, street-corner dealers is pointless: A \$200 transaction can cost society \$100,000 for a three-year sentence. And imprisoning large numbers of dealers produces an army of people who, emerging from prison with blighted employment prospects, can only deal drugs. Which is why, although a few years ago Washington, D.C., dealers earned an average of \$30 an hour, today they earn less than the minimum wage (\$7.25).
- But this choice has consequences: And although America spends five times more jailing drug dealers than it did 30 years ago, the prices of cocaine and heroin are lower than 30 years ago.
- Some say that if we end drug prohibition, thousands of people will immediately start using lots of drugs and the streets will be unsafe. Well, I have news for you - the streets are already unsafe, because of drug prohibition. Ask yourself, if drugs were re-legalized tomorrow, would you start injecting heroin into your veins? Of course not! "But my neighbor will!" Give him more credit. Some will, yes. But look at the pros and cons again. The first and only pro, "It keeps some people from trying and using drugs.", is probably immediately offset by the first "con", some who would not have tried it, will be tempted to by its “forbidden fruit” status. Then you are left with the other eighteen or so "cons".



## THE ECONOMIC COSTS

- Over the past 40 years, it has cost the nation nearly \$2 trillion dollars. The drug ban has also given rise to a vast global black market, estimated to be worth \$320 billion.
- In 2007, around \$74 billion was spent on corrections. The total number of inmates in 2007 in federal, state, and local lockups was roughly 2,500,000. State prison spending varies widely, from \$60,076 a year in New York to \$14,603 in Kentucky. In California in 2008, it cost the state an average of \$47,102 a year to incarcerate an inmate in a state prison. From 2001 to 2009, the average annual cost increased by about \$19,500. New York City is an expensive place to live for just about everyone, including prisoners. The city paid \$167,731 to feed, house and guard each inmate last year, according to a study the Independent Budget Office released in 2013. The average annual cost of incarceration in the U.S. is \$31,286 per inmate per year.



## OPPOSITION

- Given that the War on Drugs has been such a debacle, it begs the question why it wasn't ended long ago. The reason it has remained in tact is because that it has become a multi-billion dollar business: it provides employment benefits to attorneys, bail bondsmen, police officers, corrections officers, private prison contractors, etc. For example, the prison guards unions in the USA are at the forefront in the promotion of prison sentences for trivial drug offences. It clearly underscores that the case for the war on drugs has much to do with thousands of government workers involved in the justice system have an economically vested interest in the incarceration of drug users. The profit motive is also instrumental in marijuana growers being opposed to its legalization.
- And, for the very same reasons, the tobacco companies and the alcohol industry do not welcome competition. They most certainly do not want people to turn away from the addictive but legal drugs that they are most happy to provide them with. For example, the more that people smoke pot, the less are they likely to drink alcohol. Indeed, the alcohol industry seems to be one of the biggest contributors when it comes to keeping the drugs war alive.
- "Illegal drugs are bad for you," all the pharmaceutical companies will agree. And they agree to the tune of millions of dollars in donations. Why? Because if people, for example, are content to smoke pot, they might well not use the legal drugs that the pharmaceutical companies would prefer them to use. Consequently, handsome contributions to continue the War on Drugs are provided by the "legitimate" drugs companies.



## PRESCRIPTIVES:

- Decriminalize possession of small amounts of any drug for personal use. That will have little impact on overall demand for illicit drugs, but it will significantly reduce the arrest and incarceration of millions of people worldwide, most of whom are poor and often members of vulnerable minority groups. It will also cut down on low-level corruption by police."
- Truth is also this: Drug abuse is different from drug use, just as alcoholism is different from the weekend cocktail party. Rather than fight the abuse war from a moral, shame-on-you posture, which doesn't work with any age, we might try a medical model that educates with facts and urges human wisdom.

## BENEFITS OF LEGALIZING DRUGS

1. Legalizing drugs would make our streets and homes safer.
2. It would put an end to prison overcrowding.
3. It would free up police resources to fight crimes against people and property.
4. It would unclog the court system.
5. It would reduce official corruption.
6. It would save tax money. State and federal governments spends roughly \$44 billion to enforce the drug laws every year—all to no avail. A 2010 Cato institute study found: "that drug legalization would reduce state and local government expenditures by \$25.7 billion and this savings would accrue to state and local governments, and roughly \$19 billion to the federal government. Legalization would also



generate tax revenue of roughly \$46.7 billion annually if drugs were taxed at rates comparable to those on alcohol and tobacco. About \$8.7 billion of this revenue would result from the legalization of marijuana, \$32.6 billion from the legalization of cocaine and heroin, and \$5.5 billion from the legalization of all other drugs."



For years drug war bureaucrats have been tailoring their budget requests to the latest news reports. When drug use goes up, taxpayers are told the government needs more money so that it can redouble its efforts against a rising drug scourge. When drug use goes down, taxpayers are told that it would be a big mistake to curtail spending just when progress is being made.

**7. It would cripple organized crime and terrorist groups.** A large part of the extraordinary profits of drug lords come from the illegal nature of their business. If you remove the illegal nature, profits will drop. When profits drop, inevitably the violence will also decrease."



**8. Legal drugs would be safer.**

**9. Legalization would help stem the spread of AIDS and other diseases.**

**10. It would curtail the increasing erosion of personal liberty.**

## POLITICAL CONSENSUS

In 1990, 24 percent of Americans supported full legalization. Today, 50 percent do. In 2010, in California, where one-eighth of Americans live, 46 percent of voters supported legalization.

## CONCLUSIONS

The war on drugs has been a dismal failure. It's high time to end prohibition. Prohibition is a textbook example of a policy with negative unintended consequences.

## HOME PRICES JUMP NEARLY 11% IN APRIL



Home prices jumped nearly 11% in April, and are now up more than 22% from the bottom three years ago. Still, they are 18% below the peak set in July 2006, according to S&P/Case-Shiller. And price gains are slowing. "Although home prices rose in April, the annual gains weakened," says David Blitzer of S&P Dow Jones Indices. "Last year some Sunbelt cities were seeing year-over-year numbers close to 30%, now all are below 20%."



Low mortgage rates, which the Federal Reserve is expected to keep reined in through mid-2015, and gains in the job market should continue to help the housing market, according to Blitzer. Home sales are being supported by all-cash buys and low supply, said Blitzer. And he says qualifying for a mortgage is still a problem. "First time home buyers are not back in force," he said.

# TOP 10 THINGS YOU NEED TO KNOW WHEN BUYING A HOME



As we head into the home-buying season what follows are some things to consider:

## 1. Don't buy if you can't stay put.

If you can't commit to remaining in one place for at least a few years, then owning is probably not for you, at least not yet. With the transaction costs of buying and selling a home, you may end up losing money if you sell any sooner—even in a rising market. When prices are falling, it's an even worse proposition.

## 2. Start by shoring up your credit.

Since you most likely will need to get a mortgage to buy a house, you must make sure your credit history is as clean as possible. A few months before you start house hunting, get copies of your credit report. Make sure the facts are correct, and fix any problems you discover.

## 3. Aim for a home you can really afford.

The rule of thumb is that you can buy housing that runs about two-and-one-half times your annual salary. But you'll do better to use one of many calculators available online to get a better handle on how your income, debts, and expenses affect what you can afford.

## 4. If you can't put down the usual 20 percent, you may still qualify for a loan.

There are a variety of public and private lenders who, if you qualify, offer low-interest mortgages that require a small down payment.



## 5. Buy in a district with good schools.

In most areas, this advice applies even if you don't have school-age children. Reason: When it comes time to sell, you'll learn that strong school districts are a top priority for many home buyers, thus helping to boost property values.

## 6. Get professional help.

Even though the Internet gives buyers unprecedented access to home listings, most new buyers (and many more experienced ones) are better off using a professional agent. Look for an exclusive buyer's agent, if possible, who will have your interests at heart and can help you with strategies during the bidding process.

## 7. Choose carefully between points and rate.

When picking a mortgage, you usually have the option of paying additional points—a portion of the interest that you pay at closing -- in exchange for a lower interest rate. If you stay in the house for a long time—say three to five years or more—it's usually a better deal to take the points. The lower interest rate will save you more in the long run.

## 8. Before house hunting, get pre-qualified.

Getting pre-qualified will save you the grief of looking at houses you can't afford and put you in a better position to make a serious offer when you do find the right house.

## 9. Do your homework before bidding.

Your opening bid should be based on the sales trend of similar homes in the neighborhood. So before making it, consider sales of similar homes in the last three months. If homes have recently sold at 5 percent less than the asking price, you should make a bid that's about eight to 10 percent lower than what the seller is asking.



## 10. Hire a home inspector.

Sure, your lender will require a home appraisal anyway. But that's just the bank's way of determining whether the house is worth the price you've agreed to pay. Separately, you should hire your own home inspector, preferably an engineer with experience in doing home surveys in the area where you are buying. His or her job will be to point out potential problems that could require costly repairs down the road.

# RATE SUMMARY

Mortgage rates ended precisely where they began a month earlier



\*Conforming programs—No difference ↔

\*Jumbos—zero change ↔

\*Governments—FHA & VA conforming and High Balance were 1/8<sup>th</sup> better ↓

**FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO:**

[www.mortgagestraighttalk.com](http://www.mortgagestraighttalk.com) The rate sheets are updated every Friday.

# MORTY'S MAILBAG



There were no letters in the mailbag, this month.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to be identified as a "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is [morty@mortgagestraightTalk.com](mailto:morty@mortgagestraightTalk.com)



# BEST BUYS THIS MONTH

- CONFORMING 15 YR. FIXED 2.875%
- CONFORMING 5/1 ARM 2.625%
- HIGH BALANCE CONFORMING 30 Yr. FIXED 3.990%
- HIGH BALANCE CONFORMING 15 Yr. FIXED 2.990%
- JUMBO 30 yr. FIXED 3.875%
- JUMBO 5/1 ARM 2.750%
- FHA CONFORMING 30 Yr. FIXED 3.250%
- VA CONFORMING 15 Yr. FIXED 2.750%
- FHA 30YR. HIGH BAL. CONF. FIXED 3.375%
- VA 30YR. HIGH BAL. CONF. FIXED 3.500%
- HOMEPATH 30 YR. FIXED 3.875%
- DU REFI PLUS/ OPEN ACCESS 30-YR. FIXED 3.990%



I ALSO DO:

- COMMERCIAL LOANS (more than 4 units)
- "HARD MONEY" LOANS
- REVERSE MORTGAGES
- FOREIGN NATIONALS
- DELAYED FINANCING
- STATED INCOME LOANS
- MANUFACTURED HOMES
- ASSET DEPLETION LOANS



# MORTGAGE MIRTH

Bigamy is having one wife/husband too many. Monogamy is the same.

