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mortgagestraightTalk.com

Tel 760 726 4600

Cel 760 717 8584

Fax 760 639 0785

Rod@mortgagestraightTalk.com

IN THIS MONTH'S ISSUE

MORTGAGE MARKET MOVES AND ANALYSIS

Job Gains Exceed Expectations

Once again, investors mostly remained on the sidelines waiting for progress on the fiscal cliff talks and the European debt troubles. Headlines in these areas, along with Friday's Employment report, caused daily volatility, but mortgage rates ended the week with little change.

Friday's Employment data was stronger than expected. Against a consensus forecast of 90K, the economy added 146K jobs in November. Expected to increase to 8.0% from 7.9%, the Unemployment Rate decreased to 7.7%, the lowest level since December 2008. The decline was due to workers leaving the labor force, however, rather than job gains. Overall, investors feared weaker results, and the news was favorable for stocks and negative for bonds.

The last few weeks in December are traditionally a period marked by larger than usual price movements, due to thin trading volume. Usually the flow of news also winds down toward the end of the year. This year, however, there remain several major events which likely will have a significant impact on mortgage rates over the next few weeks, including a Fed meeting, the fiscal cliff talks, and deadlines on the Greek bailout. While there is no

way to know what net effect these events will have on mortgage rates, it is reasonable to expect a high level of volatility.

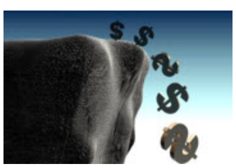
Mortgage Rates Rise after Fed Announcement

With little progress on the fiscal cliff talks and few surprises in this week's economic data, the Fed meeting was this week's big story. Policy changes announced in Wednesday's Fed statement raised investor concerns about higher future inflation, and resulted in mortgage rates ending the week a little higher.

The Fed announcement contained two major policy changes. The first, which was widely expected, is that the Fed will purchase $45 billion per month of long-term Treasury securities beginning at the start of 2013 to replace the Operation Twist program which expires at the end of this year. This will be in addition to the $40 billion of mortgage-backed securities (MBS) that the Fed now purchases monthly. The second change from the Fed was not expected. For the first time, the Fed announced that it will keep the fed funds rate at very low levels until certain economic targets are reached. Specifically, the fed funds rate will remain low until unemployment falls below 6.5% and inflation tops 2.5%.

Despite four years of extraordinary levels of Fed stimulus, the economic data released this week revealed that inflation is not a problem right now. This week's data showed that Core CPI, the most widely followed measure of inflation, was only 1.9%. The concern for investors after the Fed statement is that the Fed appears to be willing to tolerate a higher level of inflation in its efforts to boost the economy, and inflation is negative for mortgage rates.

Fiscal Cliff Talks Drive Mortgage Rates



The fiscal cliff talks were the primary influence on mortgage rates this week. As investor optimism for a deal rose and fell during the week, so did mortgage rates. For the week, mortgage rates ended just a little lower.

If no fiscal cliff deal is reached, the spending cuts and tax increases which will occur beginning January 1 are perceived as negative for stocks and positive for bonds. As a result, when comments from political leaders at the beginning of the week hinted at progress, mortgage rates moved higher and stocks gained. The reverse took place later in the week and especially on Friday following the failure in the House to pass the "Plan B" fiscal cliff proposal. The fiscal cliff talks most likely will continue to have a major impact on mortgage rates until a deal is reached.

The housing sector data released this week was encouraging. November Existing Home Sales rose 6% to the highest level since November 2009. Total housing inventory of available existing homes declined 4% to the lowest level since September 2005. November Housing Starts declined 3%, but Building Permits increased 4% to the highest level since July 2008. The December NAHB Home Builder Confidence index rose for the eighth consecutive month to the highest level since April 2006.

Housing Ends Year on High Note

The fiscal cliff talks were the primary influence on mortgage rates again this week. A lack of progress on reaching a deal caused investors to shift to safer assets such as bonds. As a result, mortgage rates ended the week a little lower.

The housing sector data released this week was again encouraging. November New Home Sales rose 4% from October to the highest level since April 2010 (when the homebuyer tax credit was about to expire). November Pending Home Sales, a leading indicator, also rose to the highest level since April 2010, and were 12% higher than one year ago. According to the National Association of Realtors (NAR) Chief Economist, Lawrence Yun, "Home sales are recovering now based solely on fundamental demand and favorable affordability conditions."

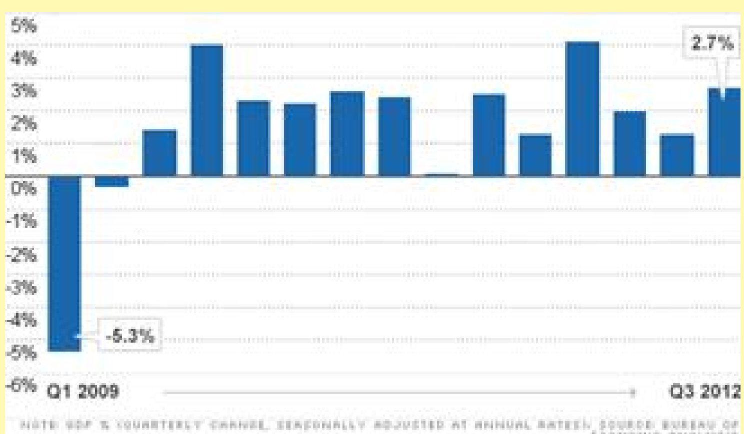
Housing ends the year on a definite upswing. Existing Home Sales rose roughly 10% during 2012, and the NAR forecasts a similar increase for 2013. Total housing inventory of available existing homes is at the lowest level since 2005. The October Case-Shiller 20-city home price index showed an increase of 4.3% from one year ago. In addition, mortgage rates end the year near record low levels, around 50 basis points lower than this time last year.

THE ANNUAL FORECAST FOR 2013

To provide some historical context for my forecast, I typically review the events of the past year and how closely my predictions mirrored reality before I venture as to where I think things are headed for the next 12 months. This year, I decided to do a recap of "That Was the Year That Was" in a pictorial format. Unfortunately, I couldn't find graphs (this early) for just 2012 by which to highlight the various aspects of the U.S. economy. The best I could do was to find graphs that went back 4 years to the onset of Obama's term of office.

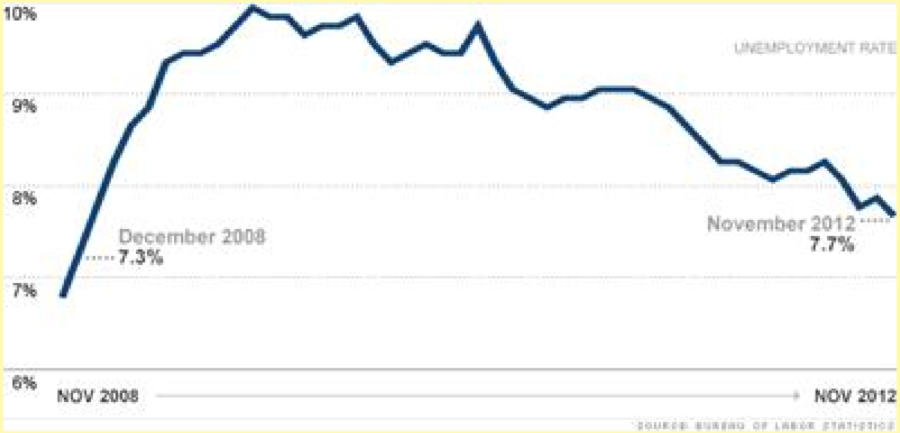
ECONOMIC GROWTH

The GDP has been growing and slowly recovering since the 1st half of 2009. The U.S. economy grew 2.7% in the third quarter.



Whereas the Federal Reserve expected the economy to grow in the range of 2.4 to 2.7 percent, I was not so sanguine and foresaw something more likely in the range of 2.2 to 2.5%, but "I allowed 2% might be more likely as Europe accounts for 20 to 25% of our exports and they appear to be entering a recession. The growth in GDP during the first 3 quarters of 2012 averaged 2.1%. Despite what the graph shows, the final estimate of **third-quarter GDP** growth was 3.1%, to late to be incorporated into the graph.

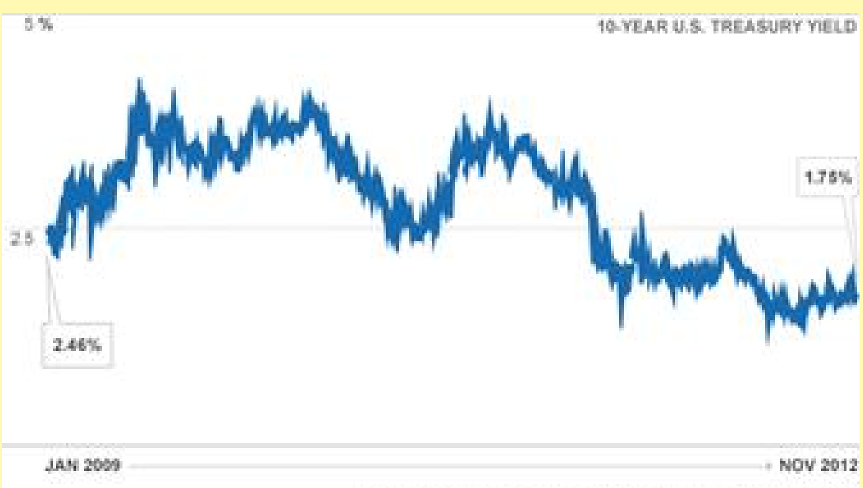
UNEMPLOYMENT



In January of 2012, unemployment was at 8.3%. Back then, I wrote "that as a resurgent economy begins to pick up some steam later in the year, "I foresee that it will crack 8% by the end of 2012". It managed to do so: The unemployment rate fell to 7.7% in November, the lowest level since December 2008, but the much of the drop was due to workers dropping out of the labor force.

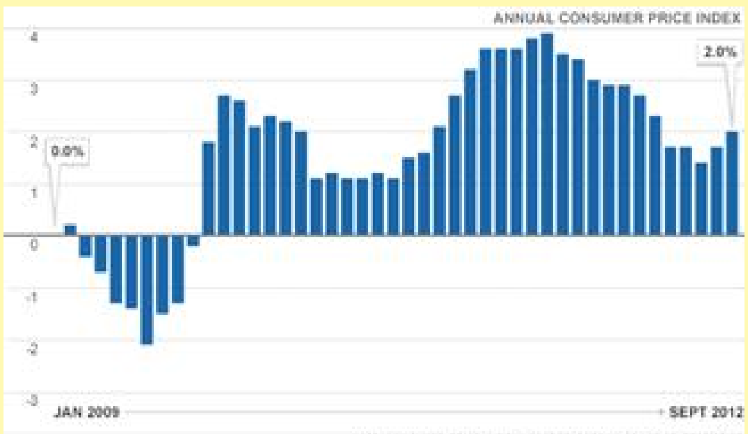
INTEREST RATES

Uncertainty about the austerity measures and tax increases caused investors to gravitate to the safety of government-backed U.S. Treasuries, sending 10-year yields tumbling. I didn't include interest rates among my 2012 predictions, but I confess I did not think they would tumble as low as they have this past year.

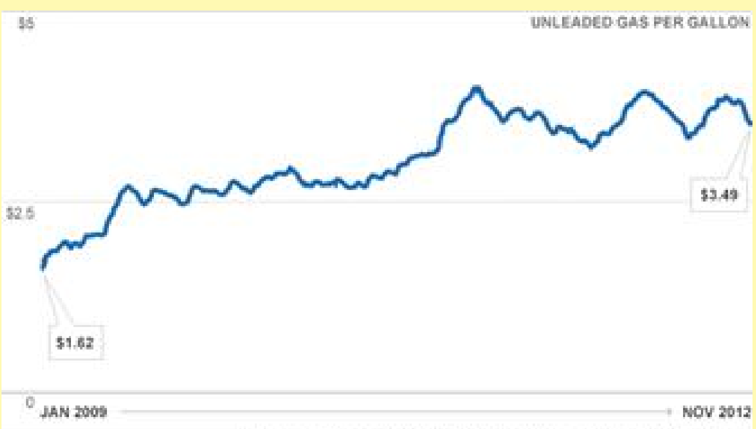


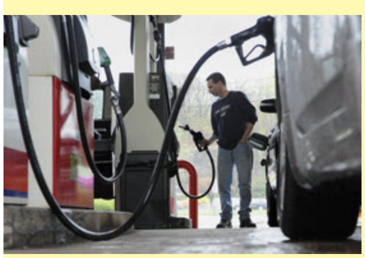
INFLATION

Another area I omitted from last year's forecast was inflation because it didn't seem to merit much comment as it seemed in line with the Fed's target of 2%. Gas and food prices have had a few temporary growth spurts in the past few years, but overall, inflation has remained relatively low, held back by falling home prices and stagnant wages. Core prices, excluding gas and food have risen 1.9% percent in the last year, below the Federal Reserve's target of 2 percent.



GAS PRICES

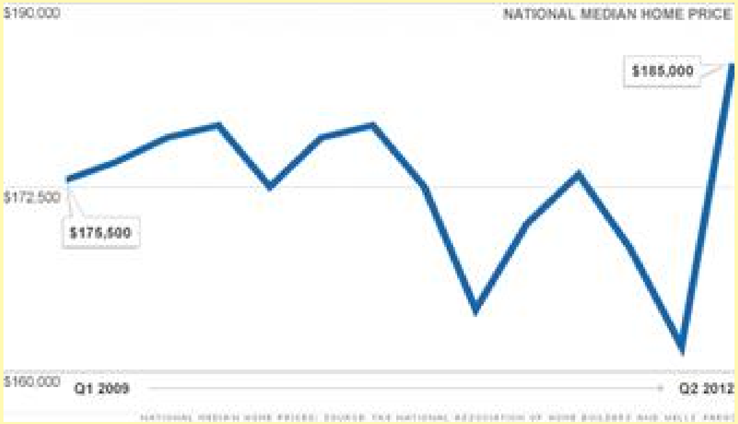




Gas prices topped out at nearly $4 a gallon in mid-2011, and came pretty close again in 2012. Since then, prices have fallen back a bit. In 2012, I didn't address gas prices per se, but I referenced this about oil:

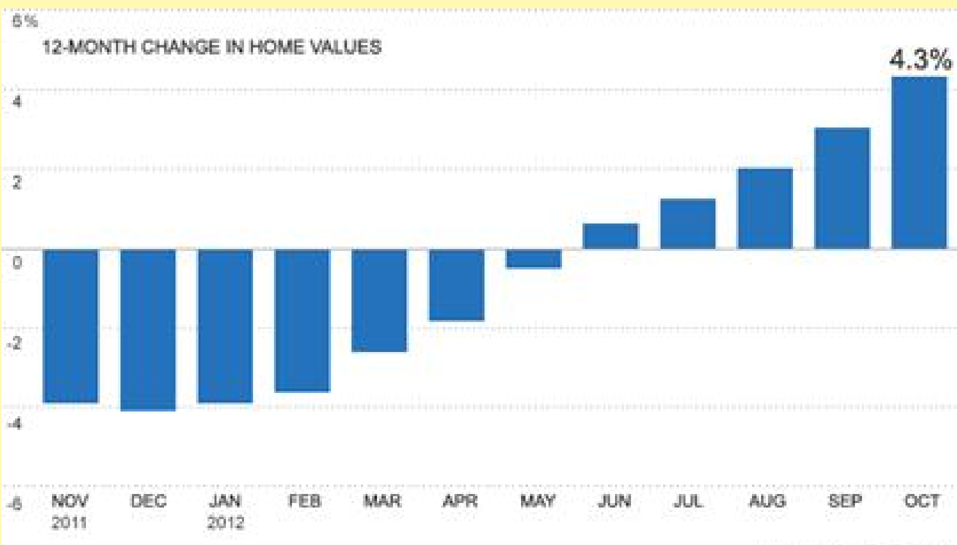
"Demand in much of the developed world has been flat or declining in the last couple of years, partially due to the recession and partly due to consumers opting for more fuel efficient vehicles. I agreed with most analysts in that I thought prices during 2012 would remain in the $90-$100/bbl range for most of the year."

HOME PRICES



Home prices have seesawed since the start of Obama's term. Lifted in 2010 on the back of the Recovery Act's homebuyer tax credit, prices later fell when the credit expired. After a 3–year slump, housing appears to be finally recovering.

Home prices have seesawed since the start of Obama's term. Lifted in 2010 on the back of the Recovery Act's homebuyer tax credit, prices later fell when the credit expired. After a 3–year slump, housing appears to be finally recovering.

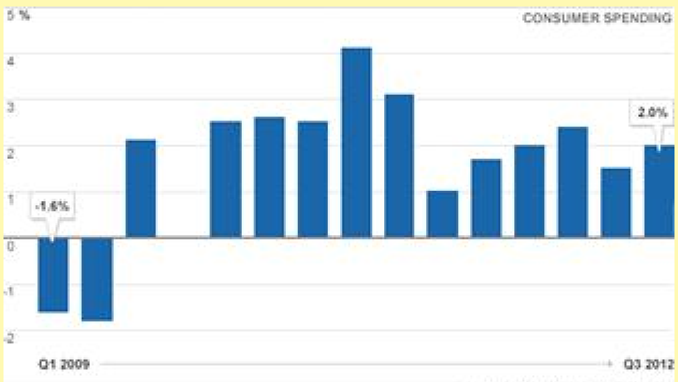


The index shows prices up 4.3% in October , the best improvement since May 2010.

Last year, I noted that “There’s a lot of pent-up demand in the residential market which could foster an active and busy 2012. Home sales are likely to rise about 3 percent next year with prices up an average 2 percent nationwide. Fourth-quarter figures are not available yet, but as you can see, I was not far off the mark.

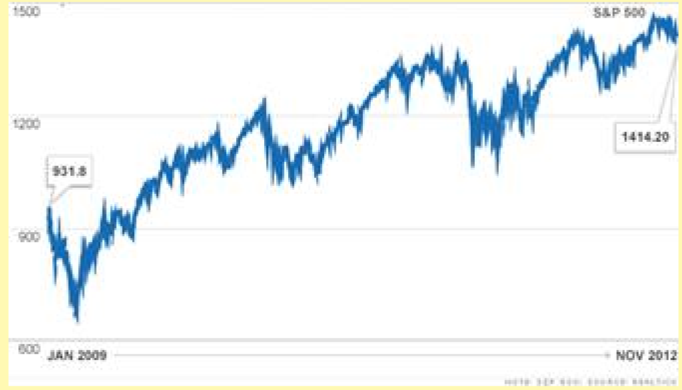
CONSUMER SPENDING

Amid slumping home prices and rising unemployment, consumers pulled back on their spending during the recession. Stimulus programs temporarily boosted auto sales and home purchases in 2009, but since then, spending has picked up only gradually. Consumers are still focusing on deleveraging by paying down debt instead. Most economists correctly predicted a decline in growth in '12 of 6%, down from the 7.4% of 2011's.

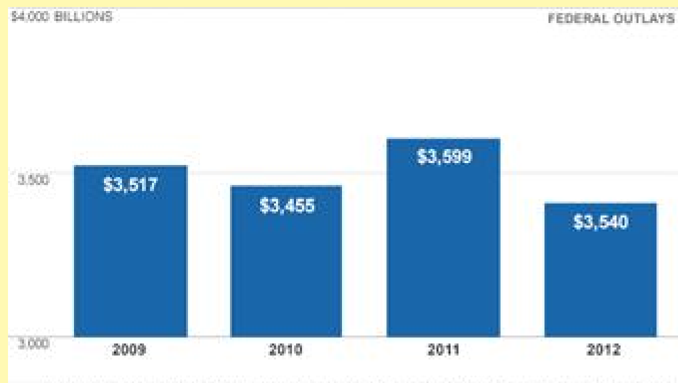


STOCKS

Since president Obama's inauguration the Dow Jones Industrial Average has gained roughly 70%, an extremely strong performance—the fifth best for an equivalent period among all American presidents since 1900. The market started 2012 with the best quarter in years, but then the European debt crisis and a slowing U.S. economy spooked investors. This time last year I said, "I would expect a Dow of around 12,500 for 2012 which is where it was in early December. But then, the Dow rose over 600 points (4.8%) in the final month to close the year at 13,104 for an increase of 7.26%.

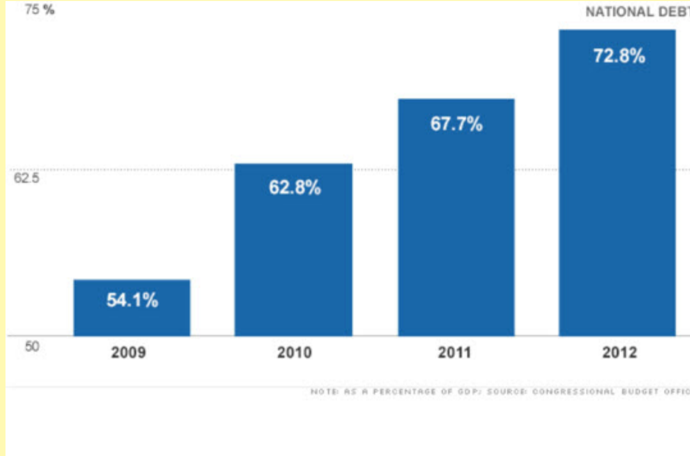


GOVERNMENT SPENDING



The bank bailout and federal stimulus programs aimed at juicing the economy pushed up spending significantly in fiscal 2009, which began in October of 2008. Revenue, meanwhile, fell to 60-year lows as the economy slumped and millions of people lost their jobs. That, in turn, increased safety net spending.

NATIONAL DEBT (% OF GDP)



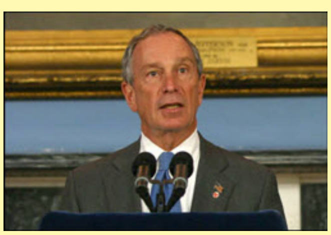
The financial crisis of 2008 spurred spending increases (but not enough) to stem the pain of the downturn. Many of those emergency measures will end, so for the next decade annual deficits should be much lower than they've been recently.

WHAT LIES AHEAD:

THE FISCAL CLIFF BROUHAHA

Since it has occupied so much media attention for the past several months, it would be remiss not to comment on the supposed "fiscal cliff" that we are in imminent danger of going over. First off, there is no cliff. But, won't we be plunged into a recession? Not necessarily. The reality is more of a decline, a gradual downward slope. The economic contraction won't happen immediately.

As Michael Bloomberg, the mayor of New York, has observed, "You cannot balance the budget without



raising revenue and cutting expenses." There is no reputable economist that remotely thinks you could do this without doing those two things—one of which is anathema to the Republicans, and one of which is anathema to the Democrats. Among the Republicans' core principles are lower tax rates which is a very peculiar position for people supposedly horrified by the budget deficit.

In order to extend the tax cuts for 99% of income earners, to avoid cutting unemployment benefits for 3 million people, to preserve tax credits for low-income working families, and to reduce the alternative minimum tax on many middle-class families, Democrats acceded to Republican demands that the tax rates would increase by 4.6% on only those earning more than $400,000 per year or couples earning more than $450,000 per year (the richest 1%). The estate tax is increasing from the current 35% to 40%, but only on estates of more than $5 million—another unnecessary giveaway to the very richest families. Capital gains and dividend tax rates go up to 20 percent from the current 15 percent, but again, only for families making $450,000 or more per year. All of this goes to show ho much Republicans have gotten for their intransigence

But the battle is far from over. Negotiators have pushed back the deadline until February for the arbitrary spending cuts known as "the sequester". And Republicans are waiting for the Treasury to hits it debt limit in a few weeks, hoping to once again extort more spending cuts.

ECONOMIC GROWTH: The Federal Reserve lowered its 2013 growth outlook to between 2.3% and 3%. A better economy is likely in 2013, but the gains won't be clear until at least midsummer. Though a grand bargain between Congress and the White House to avert the damaging effects of the "fiscal cliff" would alleviate the uncertainty that has dampened business spending and hiring over the past year, any policy shifts included would need time to take effect.

GDP growth in the first quarter isn't likely to exceed an annualized pace of just 1% or so. Ongoing financial woes in Europe and sluggish growth in China will temper export demand, while changes to take-home pay will weigh on consumer spending domestically.

Look for considerably more vigor in the second half of the year, with GDP growth chugging along at a marginally better pace. Consumer confidence, already the highest in five years, will likely continue to improve, as home prices and employment rise. And with productivity gains waning, businesses will be forced to step up hiring and/or business spending on equipment and technology. Given the political climate in Washington, I believe GDP for 2013 in more likely to be in the range of 2-2.2%.

UNEMPLOYMENT: It's a bit like the chicken and the egg controversy over which came first. In order for hiring to pick up there needs to be a definite, sustained improvement in consumer spending. In order for that to happen there has to be renewed consumer confidence among consumers that they won't be unemployed, underemployed or laid off in the future that would enable them to spend more.

Resolution of the political debate over taxes and spending should lead to a brighter picture in 2013. As GDP picks up in the second half, net job creation will push toward the 2 million mark for the year—a modest but significant increase from the 1.8 million seen in 2012. Moreover, the unemployment rate, still uncomfortably high at 7.7% will head lower, to say, 7.4% by year's end.

THE FED & INTEREST RATES: As expected, the Fed announced a fourth round of Bond Buying (known as Quantitative Easing or QE4) in an effort to continue to spur on economic growth and keep home loan rates low. Fed officials said they would begin buying $45 billion of Treasuries each month beginning in 2013, and would also continue buying $40 billion of mortgage-backed securities. But what really took the markets by surprise was the Fed's decision to tie the Fed Funds Rate (the rate banks charge each other for lending money overnight) to the Unemployment Rate. Instead of

sticking with their plan of maintaining low rates until "at least mid-2015," now the Fed is going to hold the Fed Funds Rate steady as "long as the Unemployment Rate remains above 6.5%," which it forecasts will stay that high until late 2015. It currently stands at 7.7%. Look for the rate on 10-year Treasury notes, a benchmark for mortgages, to inch higher but remain below 2% and stay there into spring 2013. As next year unfolds, increasing demand for mortgages, business loans and other credit will result in only a very modest increase in rates.

INFLATION: The drop in the CPI in the waning days of 2012 will comfort monetary policymakers at the Federal Reserve, who intend to keep interest rates low through next year to boost economic growth. They don't see inflation as a problem in 2013 and continue to emphasize that their primary goal is to help the economy grow faster. Gasoline and food prices hold the key to next year. Food prices, which rose this past year because of the drought, will remain elevated in the coming year. If gasoline prices don't behave enough to offset another uptick in food prices, inflation in 2013 will be a bit higher than in 2012. Odds are inflation next year will match this year's 2% rate.

OIL: Oil is currently trading in the area of $85-90/barrel. Most analysts expect that trend to continue in 2013. The slowly healing U.S. economy and rising demand for oil abroad will likely push crude oil prices up a bit, to as much as $95 a barrel by early spring.

HOUSING: Despite the typical winter doldrums, the housing market is continuing to pick up steam. Look for the housing prices to increase by 8% in 2013. In fact, housing should add about 0.5% to GDP next year, a bit more than this year. Persistently tight lending standards will prevent a stronger performance. Sales of about 5.1 million existing homes next year are anticipated, up slightly from this year's 4.6-million pace. The pickup in new home sales will also accelerate, with about 430,000 new homes sold next year, compared with 365,000 this year.

Builders will get busier, too. As inventory continues to dwindle and builders' confidence rises, housing

starts will climb, reaching 875,000 or so next year. Starts rose 3.6% in Oct. over the previous month, mostly because of a 10% jump in multifamily housing starts. But permits for single-family homes are also on the rise—growing at their fastest annual rate since July 2008, a sign more building is on tap.

The inventory of existing homes for sale narrowed down to 4.8 months, down from 5.9 months in September. Still inventory reduction remains very uneven. Places such as Phoenix, San Diego and San Francisco are seeing significant declines in the number of unsold houses and rising home prices on the rise, while in hard-hit New York, New Jersey and Florida, the market remains glutted. The combination of a drop in foreclosures, near record-low mortgage rates, and lower unemployment mean that there are more buyers interested in purchasing few available homes. That in turn, has lifted prices.

CONSUMER SPENDING: Consumers are gaining more confidence in the economy and the pent up demand over the past 5 years is what spurred the gains Q3 & Q4 I expect this to continue into 2013. Retreating auto sales from gangbuster growth earlier in the year and

Hurricane Sandy, which altered shopping plans in the Northeast in late October, also contributed to the November decline. But going forward, the storm will provide a boost for building supply stores, home furnishing retailers and other businesses that can help rebuild storm-damaged areas. After modest holiday sales, I expect a pickup in consumer spending in the second half of the year as the economy shows more pep. That should help spark retail sales growth of about 5% for 2013 as a whole, though it's less than the estimated 6% gain in 2012.

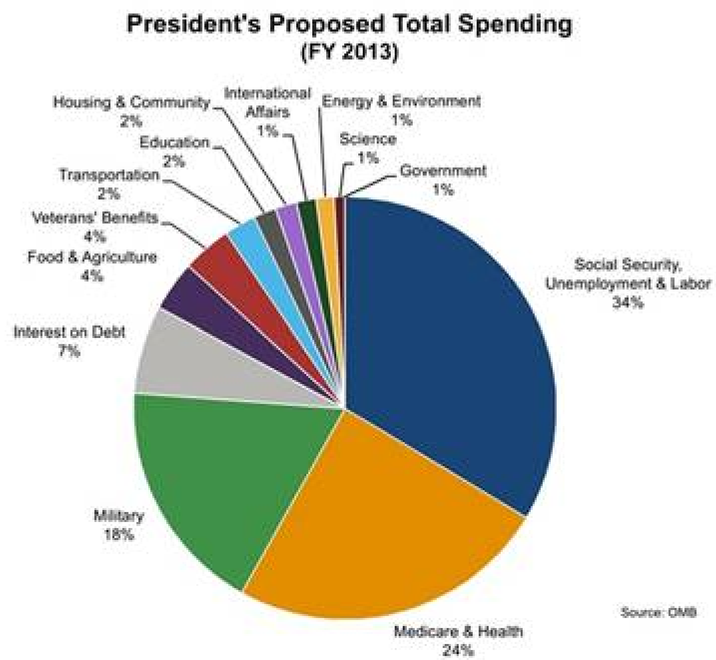
THE STOCK MARKET: In January of 2012, the market gained approximately 400 points,

but like the previous year it fared well in early months only to lose it back during the 2nd half of the year. I would expect a reversal of that this coming year with the economy showing more pep in the 2nd half as the economy picks up steam. My feeling is that the Dow will close out 2013 at 14,000.

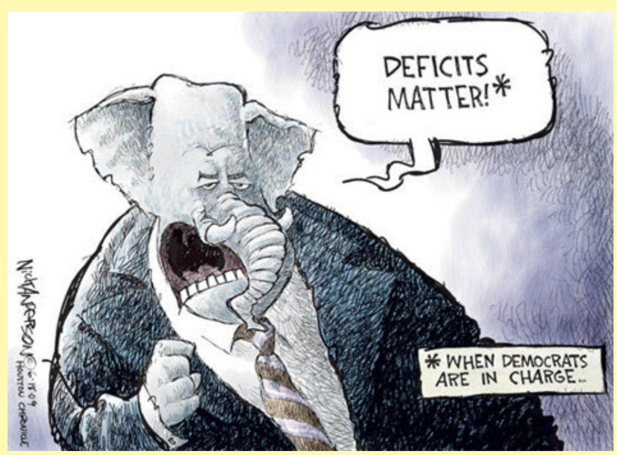
TAXES, GOVERNMENT SPENDING, AND DEFICITS: There is simply no way to

balance the budget without raising revenue and cutting expenses. The need to raise taxes might not have been needed had the Bush-era tax cuts never been implemented. But now, revenue is desperately needed to mitigate the deficit, yet Republicans have remained adamant about limiting a tax-hike of 3.6% to the richest 1% of the populace, even though this minority of "have-mores" have benefitted disproportionately over the past three decades and are more than able to afford it.

NOTE: (The top 1% of Americans now has a greater collective net worth than the entire bottom 90 percent. The top 1% of taxpayers receives more than 70 percent of all capital gains, while the bottom 80 percent receives only 6 percent). A logical way to help raise the additional needed revenue would be to tax capital gains at the same rates as ordinary income. The enormous income inequality that currently exists is on-going evidence that tax reform is both needed and remains long overdue. Often the best route to wealth in America isn't competing in the market place, but lobbying Congress for a tax break. That's why there are six lobbyists for every member of Congress from the health care industry alone.



As you can see from the pie chart above, the largest piece of the pie goes to entitlements such as Social Security, pensions, unemployment benefits. The other major entitlement expenditure, health care costs, accounts for 24 percent of the U.S. budget and growing. The Supreme Court upheld the Affordable Health Care Act in 2012. While the health care law is not perfect, its purpose was to contain health care costs by reducing excessive provider payments and by giving providers incentives to be more efficient, as well as a government mandate that the 50 million uninsured buy insurance so that their emergency room services were no longer borne by the public at large—all seemingly worthwhile goals. These cost containment features will cut the nation's long-term fiscal imbalance and reduce the projected deficit within Medicare by three-quarters. The health care law starts the arduous process of shifting the medical payment system away from an emphasis on quantity of care and toward an emphasis on quality. It will not be fully implemented until 2014. Reining in health care costs is crucial because, in the long run, it is vital to taming the deficit.



The **federal deficit** fell to $1.1 trillion in the 2012 fiscal year, down from about $1.2 trillion a year earlier. Deficits are not as pressing a problem as economic recovery. Ironically, when the Republicans were in power, it was, the then current VP, Dick Cheney, who proclaimed that "Deficits don't matter!" Now that they are no longer in the White House they seem to matter a great deal to the Right. The deficits will shrink in the near term as the economy recovers. But by the end of the decade, they will breach the $1 trillion mark again, even if the economy is performing well, mainly because of chronically low taxes and rapidly rising health care costs. After a resolution of the tax-cut/fiscal cliff debacle, the next debate is likely to be over the debt ceiling. The last one cost the U.S. its triple-A credit rating and the government came within 10 hours of a default.

Europe's economy is expected to shrink this year and have negligible growth next year, while the U.S. economy is expected to grow a bit more than 2 percent this year and next. While Germany and Britain chose Republican-endorsed austerity, the U.S. under Obama chose a muted stimulus that was partly negated by austerity in state and local government. This once again demonstrated that it's empirically wrong to advocate austerity in the middle of a downturn not only doesn't help but leads to even higher ratios of debt to economic output. Since Keynes, it's been understood that in a downturn, governments should go into deficit to stimulate demand; that's how we got out of the Great Depression. Regular readers know that I and many economists argued from the beginning that the dire warnings of a fiscal catastrophe were all wrong, that budget deficits won't cause soaring interest rates as long as the economy is depressed and ironically, the biggest risk to the economy is that we might try to slash the deficit too soon. By slashing government programs, more people are thrown out of work and on to the unemployment roles, with less income, consumers cut back on spending, which triggers further lay-offs, which causes GDP to fall, which results in lower revenues. (When GDP falls, the federal tax take always falls substantially more in percentage terms). And so on, the vicious spiral continues on with more cuts, layoffs, reduced consumer expenditures and lower revenues.

CONCLUSION: There are a number of sources of underlying strength in the economy, but for growth to gain traction; political leaders need to avoid the broad tax increases and spending cuts that are still being debated. In major respects, little has changed since last year: Our still depressed economy needs more fiscal stimulus. When we need to be investing in education, infrastructure and innovation there is still a misguided emphasis on austerity. Recovery in the U.S., though lackluster, still trumps Europe's.

RATE SUMMARY

Rates are the same as last month with a few minor exceptions.

***Conforming loans—conforming 15 yr. fixed is 1/8th cheaper; 5/1 ARM 1/8th more**
***Jumbos—No Change**
***Governments—1/4% cheaper for the High Balance programs**

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO:
www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

SPECIAL(S) OF THE MONTH

- Conforming 30 yr. fixed @ 3%
- Conforming 15 yr. fixed @ 2.375%
- Conforming 30 yr. fixed High Balance @ 3.25%
- Conforming 15 yr. fixed High Balance @ 2.625%
- Jumbo 30 yr. fixed @ 3.375%
- FHA/VA Conforming 15 yr. fixed @ 2.5%/2.625%
- FHA/VA High Balance 30 yr. fixed @ 3%/2.875%
- DU Refi Plus Conforming 30 yr. fixed @ 3%
- HomePath Conforming 30 yr. fixed @ 3%

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 identified as "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

MORTGAGE MIRTH

The things that come to those that wait may be the things left by those who got there first.

NEXT ISSUES TOPIC:

Odds and Ends