



Newsletter Vol. 13 Issue 2

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MACROECONOMIC MOVES AND MORTGAGE MARKET ANALYSIS

Rates Improve on Overseas Issues
(Week ending 1-8-2016)



Several events caused investors around the world to shift their holdings to safer assets. On Monday, Saudi Arabia cut diplomatic ties with Iran, raising tensions between these two major powers in the Middle East. On

Wednesday, North Korea announced that it had successfully tested a hydrogen bomb. Weaker than expected economic data in China released this week also was positive for mortgage rates. Investors are worried that China's economy may be slowing more quickly than had been expected. Investors reacted to these events by reducing the risk in their portfolios, primarily by selling stocks and buying bonds,

BEST BUYS THIS MONTH

- Conforming 30 yr. Fixed @ 3.375%
- Conforming 15 yr. Fixed @ 2.625%
- Conforming 5/1 ARM @ 2.375%
- High Balance Conforming 30 yr. Fixed @ 3.750%
- High Balance Conforming 15 yr. Fixed @ 2.750%
- Jumbo 30 yr. Fixed @ 3.750%
- Jumbo 5/1 ARM @ 2.625%
- FHA 30 yr. Conforming Fixed @ 3.000%
- VA 30 yr. Conforming Fixed @ 3.125%



Conforming to \$417,000 < High Balance Conforming \$417,001 to \$562,350 < Jumbo

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

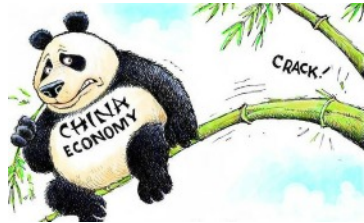


including U.S. mortgage-backed securities (MBS). The increased demand for MBS causes mortgage rates to decline.

Despite troubles abroad, the U.S. job market surged in December. Against a consensus forecast of 200K, the economy added 292K jobs in December. Upward revisions to prior months added another 50K. The U.S. added an average of 284K jobs over the last three months, and 2.65 million jobs were added in 2015.



Surprisingly strong job gains often cause mortgage rates to move higher. However, there was little net change in rates after this report. One reason is that average hourly earnings, an indicator of wage growth, fell short of expectations with a flat reading. The lack of wage inflation was positive news for mortgage rates.



Stocks Fall, Rates Improve (Week ending 1-15-2016)

Investors have grown more concerned that economic growth, particularly in China, will slow more rapidly than expected. In recent years, China has been responsible for a significant share of global economic growth, and changes in China's performance are felt in many countries. As a result, stock markets around the world posted another week of large declines. For mortgage rates, slower growth is positive since it reduces the outlook for inflation.

Weaker than expected U.S. retail sales data released on Friday also was positive for mortgage rates. In December, retail sales, excluding the volatile auto component, posted a slight decline from November. The consensus forecast was for a modest increase. Consumer spending accounts for about 70% of economic activity, making the retail sales data one of the most important reports each month.

Volatile Week (Week ending 1-22-2016)



Concerns about slower economic growth and low inflation prompted central bankers in Europe and Japan to hint this week that additional stimulus will be coming soon. On Thursday, the President of the European Central Bank (ECB) said that the ECB will consider more stimulus measures at its next meeting in March. Similarly, the head of the Bank of Japan suggested on Friday that more stimulus is on the way, possibly before the end of the month. If additional stimulus is announced, its type and its magnitude will determine its impact on mortgage rates.

Oil prices have been declining since the middle of 2014, and during this week they reached their lowest level in over a decade. This is one major factor holding down global inflation rates.

In the U.S., the consumer price index (CPI) data for December released on Wednesday revealed that 2015 saw the second lowest annual rate of inflation in the last 50 years with an annual increase of just 0.7%. The only year with a lower rate was 2008, and a large decline in oil prices was a big reason then as well.

It had been anticipated that the decline in home sales seen in November would roll into the results for December, but the rebound was much larger than expected. After falling 11% in November, existing home sales jumped 15% in December. The decline in November was mostly due to closing delays caused by new federal rules, which pushed the closings into December. For all of 2015, existing home sales reached the highest level since 2006.

Mortgage Rates Helped by Central Bankers (Week ending 1-29-2016)

While Wednesday's Fed statement was consistent with the message predicted by analysts, investors responded by selling stocks and buying bonds. As expected, the Fed made no change in the federal funds rate or in its reinvestment policy for its Treasury and MBS holdings. In the statement, Fed officials modestly downgraded their assessment of the performance of the U.S. economy, and they expressed less confidence that inflation is on their expected path to rise to their target level. In addition, Fed officials said that they are "closely monitoring" developments in overseas economies. Some investors had hoped that the Fed would explicitly rule out a rate hike at the next meeting in March, but the statement kept open the possibility.

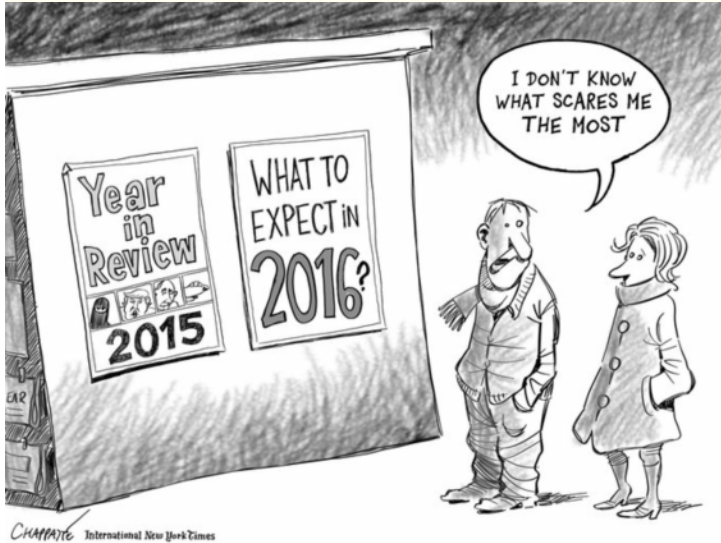
Friday's surprise move by the Bank of Japan (BOJ) was positive for global bond markets. The BOJ announced that it was cutting short-term rates to try to boost economic growth and inflation. While the BOJ made no change to its massive bond buying program, BOJ officials expressed a willingness to expand the program in the future if necessary. The BOJ announcement was favorable for U.S. stocks and mortgage-backed securities (MBS).

The two biggest U.S. economic reports released over the past week did nothing to conflict with the outlook for slower growth. Fourth quarter Gross Domestic Product (GDP) increased just 0.7%, down from 2.0% during the third quarter. For the entire year, GDP rose 2.4%, matching the level seen in 2014. Durable orders in December declined 5% from November, which was much weaker than expected.

ANNUAL FORECAST FOR 2016



I used to see the Annual Forecast issue as something of a chore because it involved so much research, but in the years since it has become an interesting academic exercise to see just how right or how wrong I was about the coming year. It's only a month into the New Year and what a year it's been thus far. Last year, I



wrote that "...growth should pick up in 2015...that rosy projections of improving growth in the pending have all too frequently had to be revised when that future did not subsequently materialize. But for the first time in a long while, that future appears to have finally arrived." Well, it did and it didn't. But, as in years past let's start with where we are currently.

WHERE WE'RE AT

Americans are making more money, finding more jobs and enjoying cheap gas prices. The U.S. fundamentals look good: economic growth, the job market, and corporate balance sheets. The American economy appears to be improving—although at an anemic pace—with GDP growth in 2015 coming in at 2.4%, but still better than much the rest of the world. America is still the world's preeminent economy. Meanwhile, the formerly trendy emerging economies like Brazil are suddenly

doing very badly and China is stumbling and the Russian economy is in retreat with a decline of 3.5% in 2015, not to mention the cost of propping up Assad in Syria. And while the U.S. economy is doing better than almost anyone else, we're definitely not immune to contagion.

None of these things look to change anytime, soon. GDP growth for 2015 was also hampered by lack of demand from buyers overseas and the strong dollar, which makes American goods more expensive abroad. The question remains whether the U.S. economy can withstand the weakness abroad.

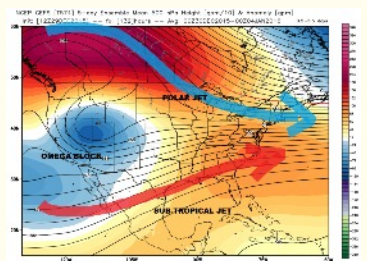
ECONOMIC GROWTH: Despite more jobs, higher disposable incomes (due to wage growth and cheaper gas) the American shopper didn't spend much during the recent holiday season. Concerns are rising that consumers won't be able to save the U.S. from heading into a recession if this continues apace. It's a big worry given that consumers make up about 70% of the U.S. economy and lately they haven't been opening their wallets much. U.S. manufacturing is already in a recession. The sector contracted for the fourth straight month in January, according to the key ISM index which tracks the industry's growth. All of this presents a complicated picture of the economy.



My 2015 forecast stated what feels like a bit of déjà vu:

The U.S. economy isn't off to a great start in 2015. It's a reprise of what we saw in 2014. The culprit? Global warming: a severe winter in the North, South, East and Mid-west and a drought in the West.

The only difference a year ago is that the West is not experiencing a drought (although it was still trying to recover from one). And 2015, was a frigid replay of 2014. Now, as then, the jet stream had shifted the Polar Vortex eastward and further south, paralyzing the Midwest, much of the South and the Eastern Seaboard while the West saw mid-winter record highs in the 80s and 90s. Who can doubt that climate change is real as the evening news is replete with increased droughts, floods, tornados and other weather phenomena? Time will tell whether the blizzards and the associated costs and lost productivity are enough to send the U.S. economy into negative territory again this winter.



I thought 2015 would be a breakout year, but what I did not see (nor did much of the rest of the world) was that oil would plummet from \$80 to \$30 a barrel. So, a growth in GDP came in not at the 3.1% I had predicted but at only 2.4%. In the past, I seem to have erred on the side of optimism. For 2016, I am decidedly more pessimistic than in years past and conclude that GDP growth will be closer to 2.3%.

EMPLOYMENT: America's employment picture made major progress on a number of measures last year. More people found full time jobs. And, the numbers of people who sought full-time jobs but could only find part-time jobs—called involuntary part-time workers—fell by 760,000 workers over the year to 6 million in December, down from a peak of 9.2 million workers in 2010. The number of people unemployed for six months or longer fell by over 600,000 last year, too. The labor participation rate, though, remained unchanged at 62.7%. More young college graduates are landing jobs and their incomes have risen. All totaled for 2015, the nation added 2.65 million jobs capping a two year back to back gain that was the 2nd best year since 1999.



Most business areas added jobs, but the big winners in December were construction, health care and business services. Those three industries accounted for half of December's job gains. Energy jobs, however, continued to fall as the collapse in oil prices kept up pressure on the industry. The industry cut back 8,000 jobs in December for a total of 130,000 jobs lost for all of 2015.

Another bright spot was that black workers had an impressive month and year of jobs gains after suffering the most during the recession and recovery. The black unemployment rate fell to 8.3% in December from 9.4% in November. That's still much higher than other demographics but a year ago the black unemployment rate was at 10.4%.

All those signs of progress are reassuring at a time when there are renewed fears about the global economy. When jobs are added, people have more money in the wallets to spend, and American consumers are the major engine behind U.S. economic growth.

Wages have been one of the last indicators to turn the corner in the U.S. recovery and they're finally gaining momentum. In 2015, wages grew 2.5%, no doubt aided (at least in part) by the successful movement to raise the minimum wage. Yet, the unemployment rate improved to 5%. I had forecast it to be 5.2%. For 2016, I predict that unemployment will drop to 4.7%.

THE FED & INTEREST RATES: I correctly observed that *“encouraging signs of increased hiring point to a better-performing economy in 2015; the economic pace is likely to remain well below levels that would call for appreciably higher interest rates.”* As I mentioned earlier, I thought the economy would grow faster than it did, so when I predicted 30 yr. mortgage rates at 4.25% by the end of 2015, I was wrong, wrong, wrong! They ended at 3.625%.

Fed officials, worried about the strength of the economy and the job market, held off on raising the Fed Funds rate (its benchmark rate) for much of 2015. They remain determined to err on the side of caution. But, in December, the Fed gave its vote of confidence by raising its key interest rate for the first time in nearly a decade. The decision was mainly driven by the job market's progress. So, the Fed sees the economy continuing to grow in 2016. Although it raised the Fed Funds rate from 0.25% to 0.50%, it begs the question: Was the Fed a bit premature?



The Fed prediction in December was that it planned to raise rates by about one percentage point in 2016, most likely in four discrete steps. Given what we have seen happening in the stock and bond markets in the past month, I don't see that happening. I would estimate a more likely scenario would be one, or maybe two ¼ point raises, but only if the global economic growth permits. By the close of 2016, I believe the rate on a 30 yr. fixed conforming is apt to still be under 4.00%.



INFLATION: Last year I wrote: *“The Labor Department's monthly report on job openings, hiring and firing showed a continuation of a trend that has been under way for more than a year: the ratio of openings to people hired matches some of the highest levels on record which suggests that they will have to make those jobs more attractive to fill those openings with higher pay, improved benefits, better working conditions or a combination of these benefits. As a result, I expect consumer prices to pick up in 2015, along with wages.”*

But again, I was wrong because due to the steep decline in energy prices, which more than offset the strong gains I expected for wages. Inflation was a scant 0.7% for 2015 versus what I thought would be the case at 1.8%.

THE STOCK MARKET: The current bull market has been going on for over seven years. That's a good bit beyond the typical market upswing that lasts between 3.5 to 4 years. The U.S. market hasn't even had a correction—where a market falls 10% or more—since the summer of 2011. Several economists have been shouting for months that stocks looked overvalued—not that they were not at dot-com bubble levels, but they were well above average. Despite the historical precedent, optimists pointed to the improving U.S. economy. But many expected that as growth and hiring picked up that it would keep powering stocks higher. But that certainly did not come to pass in 2015. Even though I stated that “I wouldn't be surprised if we were on the brink of a 10% market correction,” I thought the market would rebound from it before the year's end and like so many others hoped to see a gain of 8 to 9% for the year. Instead, the Dow closed on 12/31/15 at 17,425; it had begun the year at 17,823. I was off by about 1800 points!



The old adage “Once burned, twice shy,” comes to mind here. I believe 2016 is looking to be a fairly flat year for the market because of three big warning signs:

1. **A slowing economy:** Pretty much every economist has cut growth forecasts for the first quarter of 2016. Beyond GDP growth, many other economic indicators have disappointed in recent weeks. Manufacturing and spending—both by business and consumers—have come in below expectations.
2. **Earnings are flat and profits are declining:** The strong U.S. dollar and a slowing economy are hurting corporate profits.
3. **Where's the demand?** For most investors the big picture question is whether American and global consumers and businesses will start spending. .

One hallmark of this and last year's market has been its extreme volatility. Even though it's early we have seen several days with three and four-hundred point swings from peak to trough in a day. I suspect this volatility has much to do with oil's slide from \$80 to \$30/barrel. I expect this volatility to continue throughout 2016.

But market volatility also seems to presage that something's in the offing. The bond market has an uncanny way of predicting downturns when it sees the yield curve flattening which is usually not a good sign. The yield on the 10-Year U.S. Treasury has tumbled below 2% to 1.75%. Yields fall when investors are buying bonds. Yields are typically not this low.



Stock markets around the world panicked in January and early February over fears that the global slowdown led by China and falling oil prices reinforced the idea that things were worsening. There's a significant and growing disparity between the stock market and the economy. But the problem now is that much of the rest of the world is not doing well. The question is how well can the U.S. economy buck what is happening globally?

Those major headwinds are expected to abate a bit in 2016. But if this year teaches investors anything, it's that markets continue to be unpredictable.

HOME PRICES: As I have observed in the past all real estate is local. What I mean by that is that San Diego County's numbers are not reflective of the nation as a whole, but both the county's and the nation's rise exceeded expectations. Last year, I went with Case-Shiller's estimate of San Diego's housing price appreciation of 5.2%. But, as of November 2015 (the latest available figures) San Diego homes exceeded expectations and came in at 6%. As for the country as a whole, it similarly beat the predicted 4.6% and home prices rose by 7.6%. The increases were attributable to a combination of low-inventory, increased demand and favorable mortgage rates. In addition to the aforementioned, housing is being supported by a strengthening labor market and rising rents (up 4% in 2015) which bodes well for a good housing market in 2016. San Diego home prices should approximate last year's gains and top 6%, while nationally I believe that increasing demand for single family properties will yield an appreciation of 5.5%



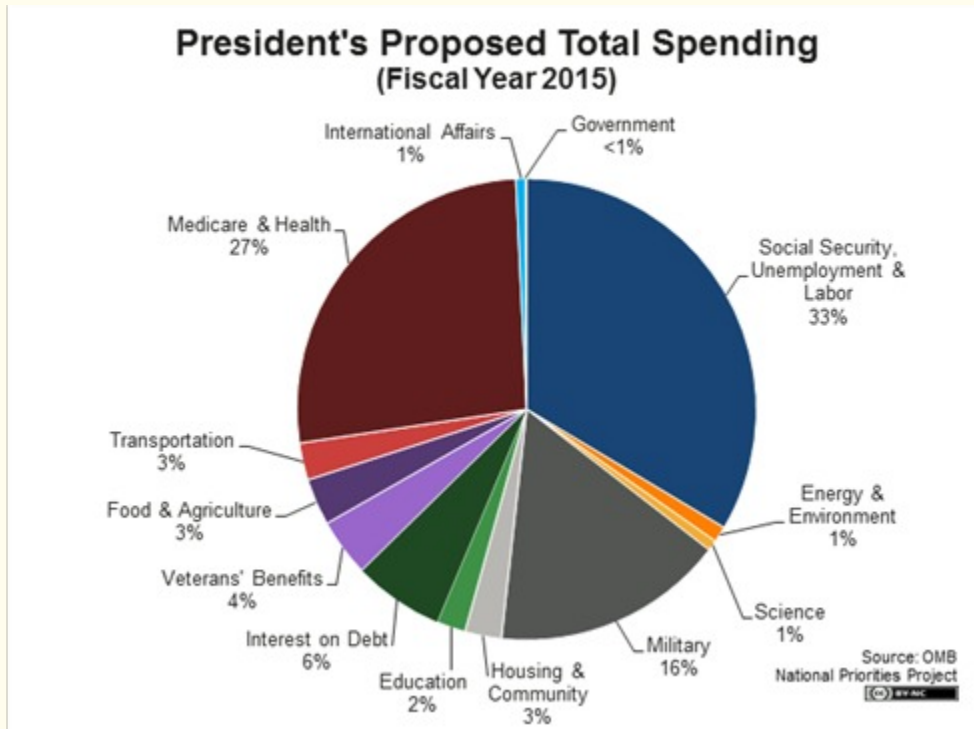


OIL: The big news this year was the stunning drop in oil prices to less than half of what they were a year earlier. I, along with so many others, was blind-sided by the drop. I expected to see oil trading in the \$90/bbl price range. My bad. Falling oil prices are suppressing the already sluggish pace of inflation. Typically, an oil price decline is like a tax cut, leaving more money in consumers' pockets to spend elsewhere. That should spur growth. Oil prices remain under downward pressure and that's taking a toll on the U.S. energy industry since the United States is not only a leading oil consumer but also a leading producer. Lower oil prices also spell smaller revenue for some of our energy companies. Domestic production becomes unprofitable below \$60 a barrel, so further investment in them may become unprofitable if prices fall too far. Despite oil's prevailing low price, OPEC members have refused to cut prices perhaps partly to retain market share to combat natural gas prices and the growth of "renewables".

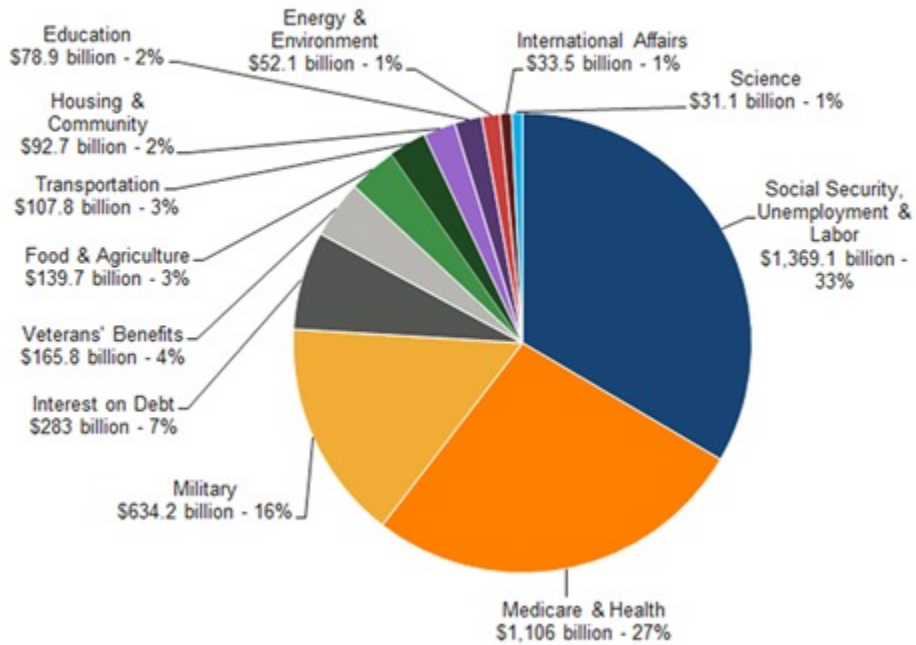
RETAIL SALES: American consumers and businesses haven't been spending much in recent months. There was hope that extremely low gas prices across the country would spur people to head to the shops and buy, buy, buy. But so far, that's not happening. Retail sales will be aided by a better jobs market, higher wages and improved consumer confidence.



TAXES, GOVERNMENT SPENDING, AND DEFICITS: For this last category I have decided to simply reproduce the President's 2015 Budget followed by the one for 2016. As you can see from the pie charts below, the largest piece of the pie goes to entitlements such as Social Security, pensions, unemployment benefits. Entitlements and the military's budget have remained unchanged at 33% and 16%, respectively.

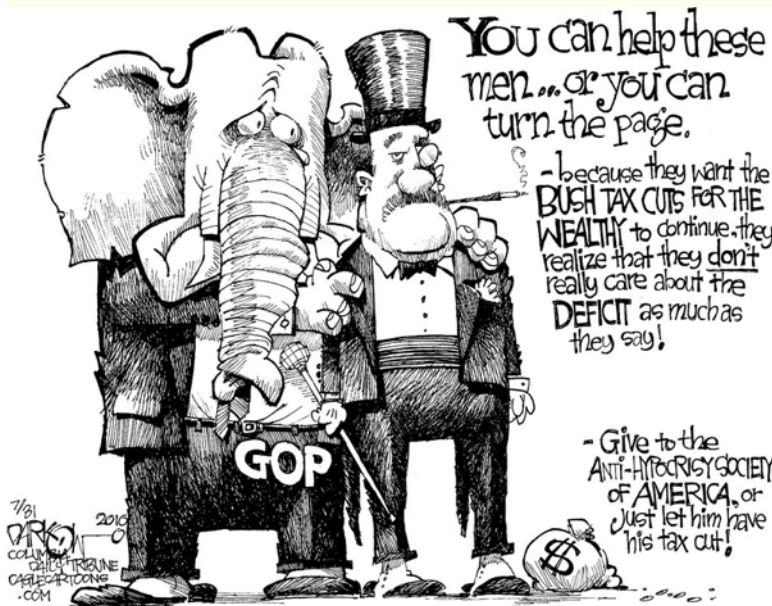


President's Proposed \$4.1 Trillion Total Spending Budget (FY 2016)



NATIONAL PRIORITIES PROJECT nationalpriorities.org

Source: OMB, National Priorities Project



The other major entitlement expenditure, health care costs, accounts for 27 percent of the U.S. budget, the same as last year's. The combination of rising tax receipts and falling spending has caused federal borrowing to plunge. This has actually been a bad thing because premature deficit-cutting damages our recovering economy—in fact; we'd probably be closer to full employment now but for the unprecedented fiscal austerity of the past 5 years.

As in years past, Republican obsession with cuts to taxes and domestic spending continues to dominate the budget debate. For instance, on the debt/spending issue, Congress should be borrowing money at these unusually low rates to invest in a 10-year upgrade of our crumbling infrastructure (roads, bridges, seaports, airports, rail lines and telecommunications) and in a huge

funding increase for our national laboratories, research universities and institutes of health, which are the gardens for so many start-ups. Together, such an investment would stimulate sustained employment, innovation and the wealth creation to pay for it.

CONCLUSION: The economy seems poised for another year of solid, but modest growth. The wild card is the rest of the world. As in years past, we need to be investing for the longer term in education, infrastructure and innovation. Instead, we have slashed spending on important domestic needs while doing little to address job creation, immigration and tax reform. The members of Congress, and particularly the Republican majority, could do much more to help if they only would act to advance the broad interest of the public rather than the narrow interests of their party.

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

RATE SUMMARY

In the past month, rates fell considerably↓

- * Conforming programs — dropped 3/8th of a percent↓
- * Jumbos—fell between 0.25 to 0.5% ↓
- * Governments—declined by 0.25%↓



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.

MORTGAGE MIRTH

Nothing makes me more productive than the last minute.

