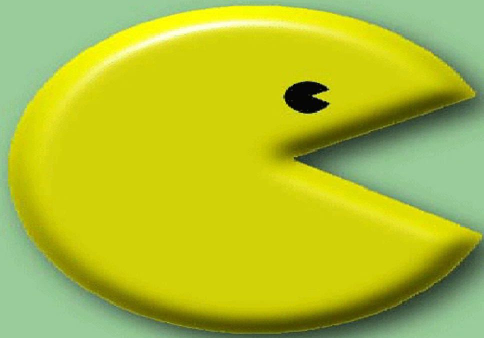

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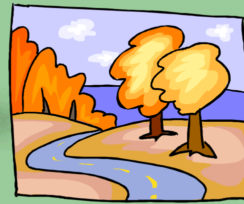

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TAX CUTS FOR THE WEALTHIEST 2%

In choosing to ignore our own financial history (the recession of 1937) Japan's lost decade(s) and Keynesian economics I asserted last month that policymakers had not put "Country First"—to use a recent election slogan, but instead themselves and more specifically their congressional seats. Currently, our economy is one in which consumers are reluctant to spend because they're worried about losing their jobs (if they haven't lost them already). Or, they are busy paying down debt. Companies, won't invest because they already have more than enough capacity to satisfy existing demand. This leaves government—the only remaining member of the economic triumvirate with both the means and the motive to bolster total spending substantially.

Yet in 2009, when economic stimulus legislation was proposed in Congress, many people insisted that extra government spending would do no good. While politics is known as the art of the compromise, the "compromised" result was a stimulus much smaller than the demand shortfall it was meant to address. And now, with the spending beginning to run out, even the Federal Reserve conceded that the U.S. economic recovery appears to be weakening. It is obvious to many that we are in the early stages of a deflation. To wit: in March the yield on U.S. 10-year bonds was nearly 4.01%, by this month it had plummeted 159 basis points to 2.42%.

Still stimulus OPPONENTS—a group that includes most Republicans in Congress and sometimes a handful of Democrats—have gone on to advocate cutting existing programs, like food stamps and Medicare. They have repeatedly blocked extensions of long-term employment benefits and have placed deficit fears ahead of job revival. Most recently, they have joined deficit hawks in calling for further spending cuts to prevent national insolvency—a threat the financial markets have discounted.

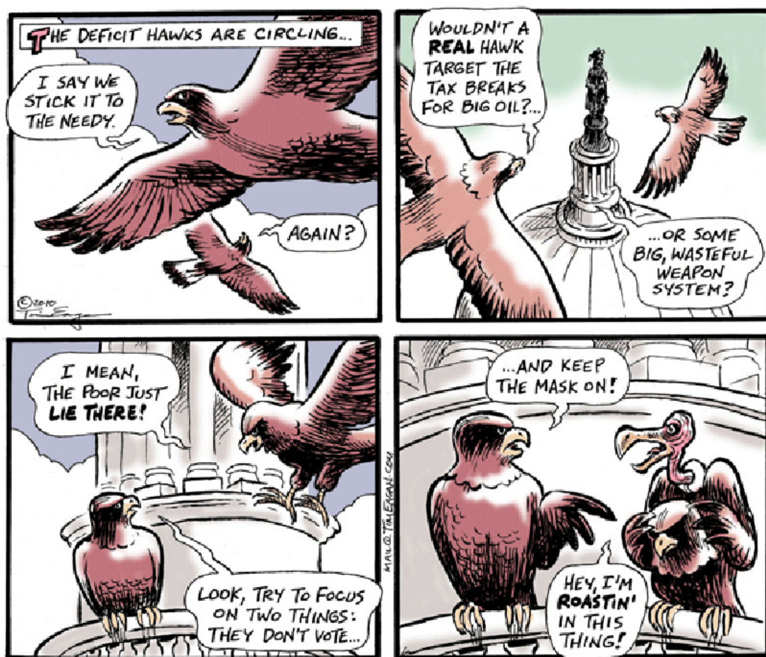
Yet these same stimulus opponents/deficit hawks want to extend the Bush tax cuts that are scheduled to expire at year-end, even though economists assert that those cuts have

already increased the national debt by hundreds of billions of dollars. Even Alan Greenspan who supported the tax cuts as chairman of the Federal Reserve and David Stockman, Ronald Reagan's budget director, have opposed their extension, as have former Treasury Secretaries Robert Rubin and Paul O'Neill. The current administration wants to eliminate the tax cuts for families earning at least $250,000 a year, and for individuals earning at least $200,000, the wealthiest 2% of the country. This would return them to the same levels that they were under Presidents Clinton and Reagan, back to 39.6% from the current 35%.

Since 2002, the federal budget has been chronically short of revenue. According to calculations by the Center on Budget and Policy Priorities, if the tax cuts of the Bush years had never been enacted, publicly held debt at the end of 2009 would have been about $5.2 trillion, or 37 percent of gross domestic product. Instead, it was $7.5 trillion, or 53 percent of G.D.P. (it now stands at 60 percent). The truth is, the Bush tax cuts were not affordable when they were passed and they are not affordable now.

Tax cuts for low-, middle- and upper-middle-income taxpayers should be temporarily extended because those taxpayers tend to spend most of their income and the economy needs consumer spending. Tax cuts for the rich can safely be allowed to expire because wealthy taxpayers tend to save rather than spend their tax savings. The revenue from letting these expire would be better spent on job-creating measures.

But, the deficit hawks see no hypocrisy in their advocacy of extending the tax cuts. The common thread in their contradictory policy recommendations is that it curbs the scope of government. Neutral observers could reasonably conclude that they are just the latest salvos in a longstanding "starve the beast" strategy. Starve-the-beast proponents have a point. There is waste in government, and by following their wishes, we eliminate some of it. But most government programs exist because of morality and voters wanting them. The ones most likely to be cut are those with the least influential supporters, which are not always the most worthy targets.



Using the revenue from reinstating taxes on the top 2% will generate about $700 billion in revenue that could be used to bolster spending in a host of ways. Because most poor and middle-income families consume their entire income, higher tax rates for those families would indeed deprive the economy of much-needed short-run stimulus. But extending the Bush tax cuts for the wealthiest families would be one of the worst possible ways to stimulate spending. Letting the tax cuts expire will not significantly reduce the current consumption of the well-off.

Because state and local government budgets are in shambles, hundreds of teachers, police officers and firefighters are being laid off every week. Federal grants could keep them on the job. States around the country have also been allowing thousands of miles of asphalt roads to deteriorate back to gravel, even as skilled workers and heavy equipment stand idly by. The eventual bill for repaving those roads will add much more to deficits than if we had maintained them properly in the first place. Extending unemployment benefits, rebuilding our infrastructure, and aid to states and local governments will generate more economic activity than putting it in the pockets of the wealthiest taxpayers who would save rather than spend the money.

THE MONTH IN REVIEW

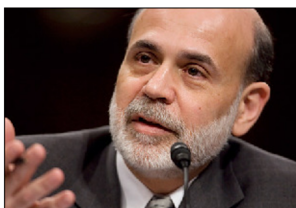
8/2-8/6 A **208-point rally on Wall St.** ushered in the first trading day of August. The Institute for Supply Management **(ISM) index of U.S. manufacturing dropped to 55.5** in July from 56.2 in June. Any score above 50 indicates growth in the manufacturing sector. The National Association of Realtors (NAR) reported that **pending home sales declined 2.6% in July** as compared with the previous month. **Personal income and consumer spending were both flat** in June, according to the Commerce Dept. Despite a net loss of 131,000 jobs in July the **unemployment rate remained unchanged at 9.5%.**

8/9-8/13 The **yield on the 10 yr. Treasury note slipped to 2.82%** on Monday; this past March it was at nearly 4%. At the conclusion of its meeting, Tuesday, the **Federal Reserve conceded** that the **U.S. economic recovery appears to be weakening.** Stocks fell off a cliff from the outset Wednesday, plummeting some 265 points by day's end. The sharp sell-off was attributed to a report showing the U.S. trade gap widening and a global economic contraction. **Jobless claims hit 484,000** this week, a 5-month high. After two months of declines, **retail sales rebounded in July**, the government said Friday.

8/16-8/20 **The yield on the 10-year note fell to** a 17th month low of **2.58%** from 2.68% late Friday. **Work began on fewer homes than forecast in July and building permits fell to the lowest level in more than a year,** indicating little evidence of a rebound in U.S. construction following an expired tax credit. The **Producer Price Index**, a measure of wholesale inflation, **increased 0.2%** in July, after dropping 0.5% in June. **Applications for mortgage refinancing hit a 15-month high last week** as interest rates remained near historic lows. **Thursday, the market withered under another day of**

triple-digit declines due to weak earnings reports and a 9-month high for jobless claims**.**

8/23-8/27 **U.S. stocks tumbled 133-points Tuesday** after a report showing a worse-than-expected plunge in home sales reignited fears about an economic slowdown. **The National Association of Realtors said previously-owned home sales plummeted 27% in July** compared to the prior month, while condominium sales tanked 28.1%. **New home sales unexpectedly fell to the lowest level on record in July, dropping 12.4% in July,** the government reported. **Credit card debt fell to an 8-year low this quarter,** according to TransUnion. The number of **first-time filers for unemployment insurance fell more than expected last week**, according to a weekly government report released Thursday. **Federal Reserve Chairman Ben Bernanke acknowledged Friday that the U.S. economic recovery had slowed** and added that the Fed is prepared to take "unconventional measures, if necessary." **Second-quarter GDP was revised to an annual growth rate of 1.6%. The market rallied at week's end, closing up 164-points.**



8/30-8/31 A government report showed that **personal income rose 0.2% in July, while consumer spending rose a modest 0.4% in July. Stocks fell 140-points,** Monday, amid worries about the U.S. economic recovery. **The Consumer Confidence Index,** a key measure of consumer morale, **rose to a reading of 53.5 in August,** from an adjusted 51 in July. Economists were expecting the index to come in at 50, according to consensus estimates from Briefing.com. But the index is still painfully low, falling far below 90 -- a level that typically indicates a stable economy.

RATE SUMMARY:

Mortgage rates edged DOWN this past month.
* Conventional conformings IMPROVED an 1/8th to 3/8ths
* Jumbos were TRIMMED in a range of an 1/8th to 3/10%.
* Governments (FHA/VA) were BETTER by .25%.

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

THIS ISSUE'S TOPIC: HOUSING TRENDS IN A BIPOLAR MARKET

Perhaps "bipolar" best describes the current homebuyer market. There are two separate forces pulling it in opposite directions, and experts aren't yet sure which path the market will take. On one hand, sales and prices are rising (ever so slightly), indicating recovery. On the other hand, so are repossessions, which most obviously do not. And then there are the millions of foreclosures that need to be sold but haven't yet been listed—the so-called "shadow inventory" that could derail a real recovery, if they flood the market. The prognosis is negative in the short run but turning positive in 2011. Home prices have been steadier in recent months, recently experiencing their first year-over-year rise in more than three years. Still, there are some strong negatives dragging on the market.

1. Bank repossessions are on track to surpass a million homes in 2010. But at least foreclosure filings fell in April, the first time since RealtyTrac began reporting.

2. More than a quarter of borrowers are "underwater," meaning they owe more than their homes are worth.

3. "Strategic defaults" -- where underwater homeowners walkway even when they can still afford to pay—accounted for 34% of all foreclosures in July, according to DataQuick.

But there is one factor that has experts really worried: homes that are ready to be sold, but haven't been put on the market. Right now, there could be more than 4.5 million homes in "shadow inventory," according to a recent report by Barclays Capital. This so-called shadow inventory is a recent phenomenon. In the past, inventory was either tight or it wasn't. But now, with home prices so low and so many foreclosures on the market, both homeowners and banks have been waiting to put properties on the market. But as more sellers put their homes up for sale, supplies increase, which depresses prices again.

Still, the fall-off in home values, that took the median price of a house down almost 30% since 2006, looks to be in its final stages in most places. Three-quarters of the nation's 384

metropolitan areas will see prices down less than 5% a year from now, according to projections from Fiserv and Moody's Economy.com; 10% seem poised for modest increases. In this environment lie new challenges and opportunities for homebuyers, sellers, owners, and investors. Whether one is a buyer or a seller it would behoove one to understand the key trends affecting this shifting market.

1. Distressed properties will keep prices under pressure.

For a while last year it might have seemed as if the long-awaited housing recovery was just about here. Home prices stopped falling in spring, and have stayed fairly stable since, according to the Case-Shiller housing index. Sales rose from their recessionary lows, and inventories came down from their highs. But the pickup turned out to be short-lived. In May & June **existing home sales** ebbed, while **new home sales** fell off a cliff in May and rebounded in June. In July, **sales of existing homes** plummeted further and inventories are now at 12 ½ months. Economists predict that the national median price for a single-family home will dip another 5% to 10% before finally bottoming by year-end or early 2011. Much of this is attributable to the glut of distressed properties spilling onto the market. More than 3 million homes are expected to get foreclosure notices this year, according to RealtyTrac, a foreclosure listing website, as job losses strain with their mortgage payments.

In addition, one in every four homeowners with a mortgage now owes more on that loan than the house is worth. A growing number of these owners are making a strategic decision to default—18% of delinquent borrowers were purposely behind, according to a recent study by Experian: they're choosing to walk away rather than pour money into a home that will take years to regain its value. Meanwhile, short sales—where a lender agrees to let a homeowner sell for less than he owes—are also expected to spike, reports Moody's Economy.com. Contributing to the jump is a streamlined approval process and a new government program that gives servicers financial incentives to arrange short sales instead of foreclosing on a troubled property.

If you're hoping to sell your house this year, don't try to compete with repossessed properties on price. Instead, play up your advantages: a home in move-in condition (get your house inspected and do the repairs before you list it) and the possibility of a quick deal. To reassure prospective buyers that they're not getting a lemon, toss in a one-year home warranty that will pay to fix problems like a broken furnace or hot-water heater. Cost: about $350.

2. Big homes are lagging small ones in the recovery.

The market for larger, more expensive homes is hurting. The inventory of homes for sale priced at $750,000 to $1 million is now 20 months, vs. 12+ months for homes in the $100,000 to $250,000 range, the National Association of Realtors reports. Many people don't feel comfortable making a large financial commitment these days, and fewer can meet stricter standards for the jumbo loans often needed to buy these homes. Shifting tastes are also a factor.

In response to dwindling demand for bigger residences, the median size of a new home shrank to 2,100 square feet in 2009, down from 2,300 three years ago, the National Association of Home Builders says. Size typically dips in a recession, but it is believed that this time the trend will stick beyond the recovery.

Trade-up buyers who want bigger houses will find the best deals this year. The big question is when to make your move. If you can, hold off in anticipation of further price drops, since the high end of the market will be especially hard hit. Whenever you make your move, base your bid on comparable sales over the prior 60 days rather than the home's list price. Coming in 5% to 10% lower than the comps is a smart starting point.

If you plan to sell a big house, try to unload your property quickly before prices dip further. Setting the right price at the outset is key: If you go too high, many buyers won't even look, knowing you'll probably have to go lower later. One price reduction is okay, but when you start to see multiple reductions, it raises a red flag.

You may be able to expedite a sale with aggressive pricing, i.e., listing your home for slightly below what comparable homes have sold for in the past couple of months. Another ploy to attract more traffic: Offer a larger cut—say, 3.5% vs. 3%--to the buyer's agent. True, you'll pay a little more in total commissions. But

that's preferable to having to lower your price by 5% to 10% later if your house doesn't sell.

As for smaller homes, investors and first-time buyers will have a tougher time finding deals. Homes in good locations are getting multiple bids and are often selling above the listing price. So if you find a house you love, don't bid less than similar homes that have sold for in the past two months. You can find the median difference between listing and sales prices in your area at zillow.com under Market Reports.

3. Financing for condos, second homes, and jumbos is tougher.

To qualify for a new mortgage at the lowest rates, the requirements are a bit more onerous. Ideally, borrowers will need 10% down or 10% equity in their home and a credit score of 720 or higher; one's mortgage, insurance, and property taxes shouldn't exceed 31% of one's gross income and no more than 41 - 45% can go to paying debts of any kind. Exceptions: Borrowers need only 3.5% down for an FHA loan, and can refinance with less than 10% equity through the HARP program.

The standards are even more rigorous for anyone buying a condo or a vacation or investment home, or who will need a jumbo. Many banks will approve a condo loan only if the building is at least 70% occupied by owners, which is often problematic for new construction. Meanwhile, jumbo borrowers and investors must often put 30% to 35% down. These loans are seen as riskier, consequently the underwriting guidelines are more stringent.

NOTE: Don't shop for a new home without being pre-qualified for financing. You don't want to find your dream home only to discover you don't have enough cash for the down payment the bank requires or closing costs. A necessary first step is to contact a mortgage broker regarding financing because they represent between 10 to 30 different lenders and they will know which programs you are likely to qualify for and which lender is more apt to approve borrowers with particular financial issues. If you are declined by one lender they can shop you to another, whereas if you are turned down by a bank or credit union you will have to start the application process all over again with each new lender. Also, brokers have access to wholesale rates that are most often better than the retail rates of national banks. Plus, most realtors won't even work with you unless they're sure you'll qualify for financing.

SOUTHERN CALIFORNIA HOME SALES FALL 20 PERCENT

What a difference a tax credit makes. Southern California home sales plummeted 20.6 percent in July from one month earlier, and were off 21.4 percent from one year earlier. It appears that home buyers advanced the window of their summer purchases by 2-3 months to take advantage of the expiring tax credits.

Meanwhile, the median price paid for a Southland home fell to $295,000 last month, down 1.7 percent from the $300,000 seen in June, but up 10.1 percent from a year ago. During the current housing cycle, the median hit a low of $247,000 in April 2009, and a high of $505,000 in mid-2007, just as the mortgage crisis got underway.

Foreclosure sales accounted for 34.2 percent of resales, up from 32.8 percent in June, but down from 43.4 percent a year ago. FHA loans were used to finance 36 percent of all home purchases last month, down from 38.8 percent last month and 39.2 percent last year. Jumbo loans accounted for 18.4 percent of last month's sales, up from 17.6 percent last month and 15.2 percent a year ago.

HOME PRICES INCH UP NATION-WIDE, BUT JUMP LOCALLY

The weak economy and continued high unemployment has kept housing markets cool. As a result, the median price of a single-family home crept up just 1.5% to $176,900 in the second quarter, according to a report released by the National Association of Realtors. Meanwhile, the San Diego-Carlsbad-San Marcos area has seen a whopping 13.1% jump. The Riverside-San Bernadino-Ontario area fared even better with a 17.8% increase, while the Los Angeles-Long Beach-Santa Ana area rose a more modest 9.3%.

THE FED'S TOUGHTEST FOE: DEFLATION

Battling inflation has historically been a major aim of the Federal Reserve. But central bank policymakers now have an even bigger worry: deflation. Prices have been slowing for three months. And members of the Federal Reserve openly voiced concerns about deflation at their last meeting. The Fed now expects inflation of barely 1% this year, not including food and energy prices.

While spending less on purchases may sound appealing to consumers, falling prices and wages can cause much more havoc than rising prices. Businesses respond to declines in prices by cutting output and jobs. Why invest in making something to sell if the price you'll get for it will drop? Consumers hold back on buying for the same reason. The result is a downward spiral that can bring about a depression in a worst case scenario, or a prolonged period of economic stagnation, in the best case.

It isn't that inflation in itself is a good thing. It's that the low inflation is a symptom of too little demand. One of the biggest worries among economists is that fighting deflation is much tougher than turning back inflation. With its key interest rate already near 0% for the last 18 months, the Fed can't cut rates to spur the economy. Until a couple of months ago, most experts assumed the Fed's next step would be to raise rates in order to reduce the risk of inflation. The central bank's next moves are now less clear.

One of the biggest problems is that banks are hoarding too much cash. Banks are required to keep a certain amount of cash in reserve accounts at their local Federal Reserve Bank. Right now, they collectively have $1 trillion in excess reserves in those accounts. That's partly because the banks are worried about the economy and the ability of borrowers to repay loans. But the Fed also encourages them to do so by paying them 0.25% interest. It has been suggested that the Fed follow the lead of the Swedish central bank last year and establish a negative interest rate on those excess reserves, charging banks to keep excess cash, rather than paying them. That could encourage banks to push money out the door.

Other economists argue the problem isn't banks' willingness to lend, but rather weak demand because of the recession. It's easy to choke off demand. But you can create all the incentives to spend you want, and it won't necessarily work. Some are looking for the Fed to start pumping more money into the system by resuming purchases of mortgages and long-term treasuries as it did in 2009. It could even expand the assets it would purchase. The Fed is looking at new steps it could take if deflation starts to take hold, including charging banks for excess reserves and purchases of new classes of assets, such as corporate debt and even stocks.

SPECIAL(S) OF THE MONTH:

Conforming 30 yr. fixed @ 4.00%
Conforming 15 yr. fixed @ 3.625%
Conforming 5/1 ARM @ 2.875%
Jumbo 30 yr. fixed @ 5.125%

MORTY'S MAILBAG

Q. I see that you mention various indexes or economic indicators in your Month in Review section, but I never see much in the way of what one is to derive from them.

A. My bad. A couple of other readers have lodged similar complaints about a presentation of raw data without a satisfactory explication of their significance. I have severe space limitations because the Month in Review feature is actually a compilation of my Week in Review postings that I email to realtors. When space permits I do try to elaborate a bit on their relevance. What follows are some of the indicators that I regularly mention and their relevance as well as some that have fallen out of favor over the years.

Recently, the value of many indicators has become suspect. Data that was once seen as prescient a few years ago is all but considered worthless today, while others that were once shunned are now in the spotlight. A new list has been devised of "Hot or Not" economic indicators, along with a couple that will always remain classics.

The **Institute of Supply Management's manufacturing index** (ISM) is everybody's current darling. It's a very good series, one of the best out there because the survey quizzes manufacturers on new orders, production, employment, and inventories, among other topics. The index has a very nice record for predicting growth and employment. The ISM numbers are compiled monthly, making them relatively timely. Released on the first business day of the next month, they don't have time to get stale. And what's the ISM telling us now? The July index fell to 55.5% from 56.2% in June. Any number over 50% shows that more firms are expanding than contracting.

Credit spreads are also very much in vogue. Even those who don't think financial market indicators tell us much about the overall economy keep a close eye on them, if only because they're worried that the next blowup will come from the financial sector. The credit spread–or difference—between three-month LIBOR and overnight index swaps is one such indicator. On June 1, it stood at about 31.325 basis points, up from about 10 basis points before the Greek credit crisis. That number shows how much players in the capital markets are willing to trust each other. If the spread starts to climb, you've got continued risk that counterparties are fearful of transacting with each other.

Employment data, say many economists, is in some ways the most important. But employment numbers are subject to maddening revisions, making any non-farm payroll data of any single month totally ridiculous. Economists say the revisions are the worst right around inflection points—right when accurate data could potentially be most useful. The solution is to try to find a trend based on the past six months of data. April's data showed 290,000 jobs created, and May's numbers at about 500,000, but June & July reversed the trend with net losses for both.

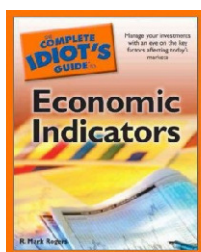
Anything released weekly. For all the respect accorded measures such as gross domestic product and indexes of leading economic indicators, economists complain that by the time they're released, they don't contain much that's new. The markets move so instantaneously that you can't wait for the Gross Domestic Product (GDP) or the monthly jobless numbers to come out. You have to anticipate it. That's where weekly numbers come in: jobless claims,

weekly same-store sales and mortgage applications among them. As with employment data, a single report is of limited use, so economists typically look at 4- to 8-week moving averages of those 'weekly' numbers.

Raw Commodity Prices. One of the series that failed miserably in the last cycle was raw industrial commodities prices. At one time, the prices of commodities actually reflected demand for that particular good. More recently, it became stylish in a great many pension funds not to own oil companies but to own oil. The demand among investors buoyed commodities prices even as demand from those who actually needed the products was fading. In the first half of 2008 many economists were saying, 'This can't be a recession, commodities prices are still strong," when In fact we were six months into a recession. Two Journal of Commerce commodities indexes fell sharply in May, leading some remaining believers in this indicator to see bearish times ahead.

Housing data. In 2007, housing was "the quintessential indicator of where we would be going. Then housing indicators such as sales levels, building levels, and permits all continued to climb without the job and wage gains that were supposed to propel them. Strong housing indicators didn't mean a strong economy; they pointed to a bubble. The data has fallen into disfavor because of its unreliability. In April, sales of previously-owned homes rose to a five-month high, but in July, sales of existing homes plunged 27.1%). Now when economists talk about housing numbers, they're more likely to be looking at weekly mortgage applications.

The Classics:



GDP is the mother of all economic indicators in the U.S. for the simple reason that it pretty much encompasses everything else. But by the time it's released, a lot of its revelations are no longer new, greatly diminishing its predictive value. Still, the GDP is so revered, that it allows someone who sees a little bit of GDP growth inside a recession to take a policy position that is 100% wrong–such as raising interest rates. First quarter GDP rose at an annualized rate of 3%, compared with 5.6% in the last quarter of 2009.

The yield curve is the granddaddy of economic indicators. In 2007, an inverted yield curve wasn't widely taken as a sign that the U.S. was headed for a recession. Many thought rates on long-term Treasurys were being kept artificially low because of purchases by the Chinese central bank. The yield curve is a no-brainer. Ignore it at your own risk. The yield curve is steep, which is consistent with the fact that the financial sector has had a good run.

Since uncertainty seems to reign these days, perhaps it's not surprising that other major indicators, such as consumer confidence and stock market prices, have no clear consensus. Now, it's hello, ISM Manufacturing Index, and so long housing data!

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

Definition of a **shotgun wedding**: A case of wife or death.

If you'd care to share one that you've heard, please email it to me at.... **Rod@mortgagestraightTalk.com**