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(Some additional thoughts on the housing market)—Thanks Keith Hawkins for sending this to me.

Seeking Alpha

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The Housing Market: Myth Vs. Reality

| Apr. 11, 2015 9:24 PM ET | 88 comments | Includes: BZH, DHI, ITB, IYR, KBH, LEN, PHM, PKB, REM, REZ, RYL, TOL, XHB

Disclosure: The author is short KBH, DHI, RYL. **(More...)**

Summary

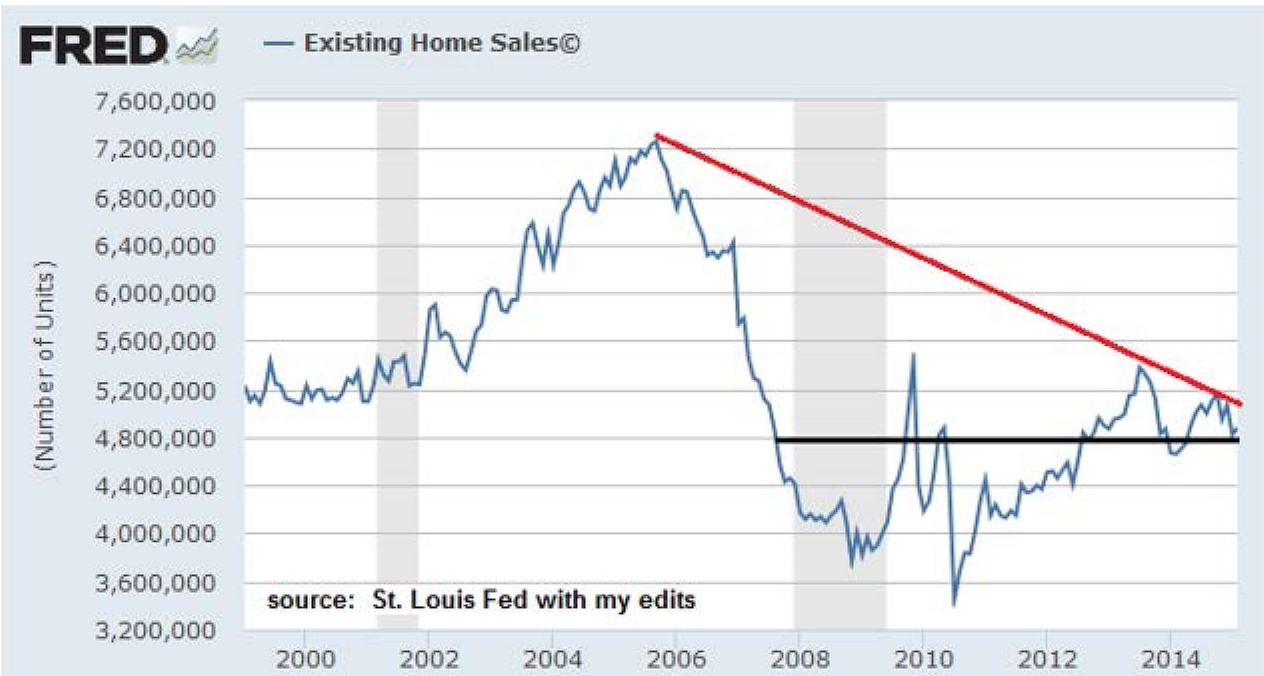
- The housing market bubble that burst in 2005 is still deflating.
- The bounce in prices and volume since 2010 was artificially created by the Fed/Government.
- Underlying data shows continued deterioration in housing market fundamentals.

The mainstream media in this country has been promoting the idea that the housing market is recovering for a few years. A perfect example of this is an article by Bloomberg News about a week ago titled, "This New Indicator Shows There's No Bubble Forming" (article link). The "indicator" is Nationwide Insurance's "Leading Index of Healthy Housing Markets." It was clear that Bloomberg did not research the validity of Nationwide's new housing market "indicator" before it published its article. But I did.

Although Nationwide offers no detail regarding the sources for the data it uses, the variables in its index are employment, demographics, the mortgage market and house prices. The fact that Nationwide does not disclose any details about its index other than the parameter labels makes the quality level of the metric highly suspect. My email inquiries about the index went unanswered and phone call messages were not returned.

The section of Nationwide's website that describes its housing market index contains a quarterly report that summarizes the company's assessment of the housing market across the country. The report is a pdf file that reads like a marketing brochure for the housing industry. I was curious to understand Nationwide's motive behind publishing this highly fatuous housing market report. As it turns out, Nationwide also owns a bank that offers mortgages, home equity loans and home equity lines of credit. I suspect that Nationwide is using this index as marketing tool for its mortgage and home equity underwriting business.

Let's look at some facts regarding the housing market. Bloomberg is correct in one sense: a housing bubble is not about to burst. The housing bubble burst in 2005/2006. That bubble was never allowed to fully deflate. What's occurred since the Fed began pumping $3.6 trillion of printed money into the banking system is a dead-cat bounce in the housing market:



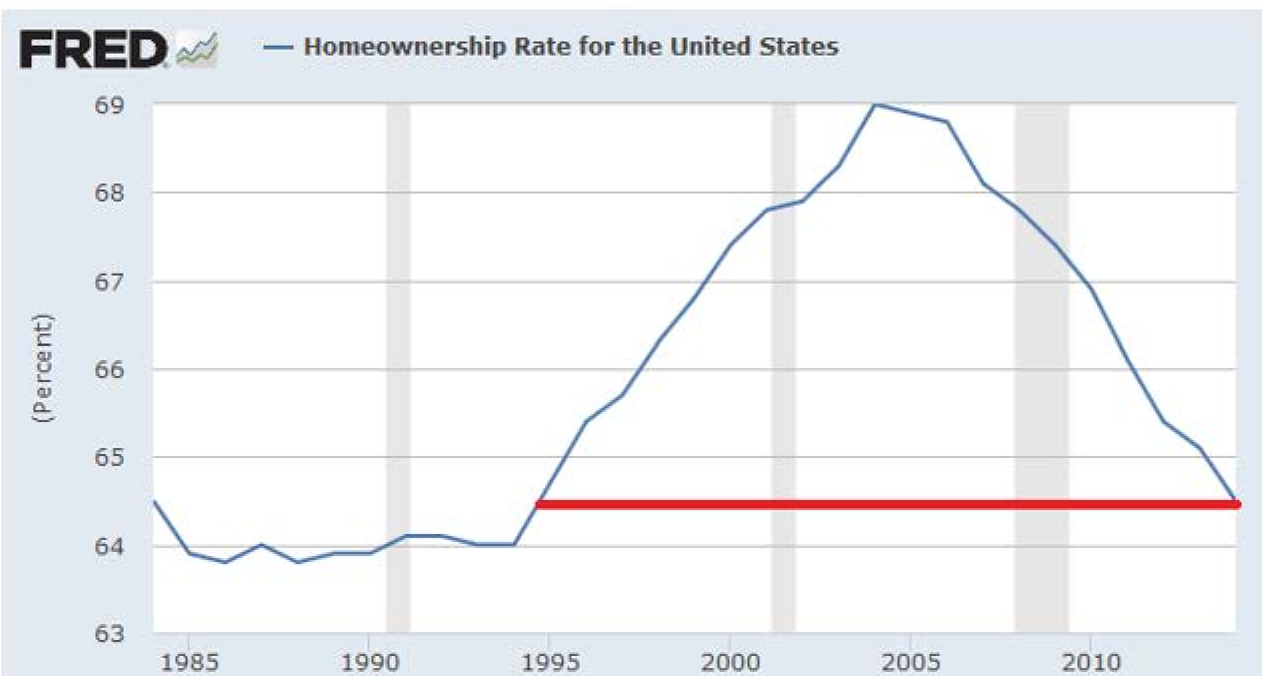
The chart above shows the seasonally adjusted, annualized rate of home sales reported monthly by the National Association of Realtors. What the graph shows is a series of "dead cat" bounces in sales volume that occurred primarily from Fed and Government intervention policies. For instance the spike in 2009-2010 was triggered when the government implemented a first-time homebuyer tax credit effective between 2008 and 2010. The bounce that occurred after 2010 was primarily fueled by big investment funds buying hundreds of thousands of foreclosed and distressed homes. The government offered zero-percent financing to any big fund that bought big portfolios of foreclosed homes from Fannie Mae and Freddie Mac.

As I have detailed in previous articles, the big investment fund buying faded starting in late 2013. The graph above shows the trend of declining existing home sales volume since mid-2013. Moreover, several funds are looking at cashing out of their holdings: Cashing Out Of The Bet On America. As I've stated previously, when the big investment funds look to unload portfolios of investment homes in order to cash in apparent price appreciation, it would trigger a flood of home listings.
You can also see the from the red line I added to the graph above that, since 2006, home sales volume has been in a longer-term secular downturn. The black horizontal line roughly measures the "median" level

of home sales that has occurred during this dead-cat, stimulus-induced sales bounce. The current average level of sales is slightly higher than 50% of the peak level of sales in 2006. But in 2006 mortgage rates averaged 6.75%. Currently mortgage rates are below 4%, with one government program making 0% mortgages available. Contrary to the "housing recovery" mantra of the media and Wall Street analysts, what is occurring in the housing market in terms of transactions volume does not in any way define a "healthy housing market recovery."

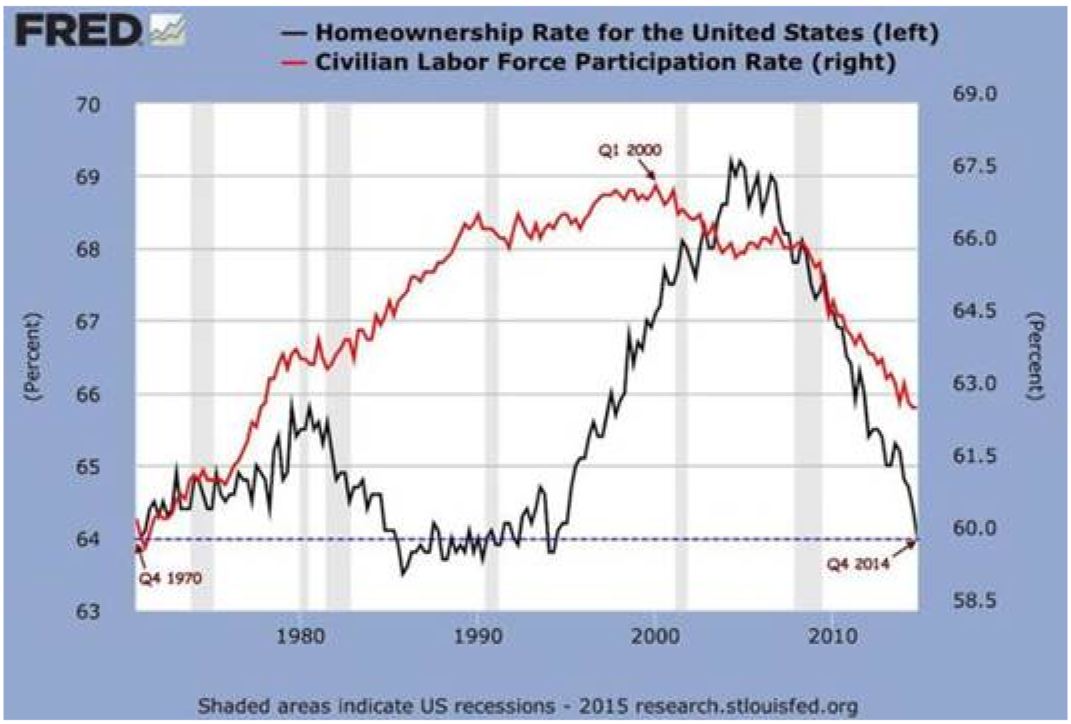
The Bloomberg article promoting the Nationwide Insurance housing index describes the housing market as being "in its best shape since 2001." Ironically, it was just after the tech bubble burst in 2000 that Alan Greenspan began inflating the money supply as means of inflating the housing bubble. Everyone remember when Greenspan referenced "home equity" as being the equivalent of a cash ATM (automatic teller machine)?

But let's take a look at the homeownership rate in the United States, which is graphically tracked by the Fed:



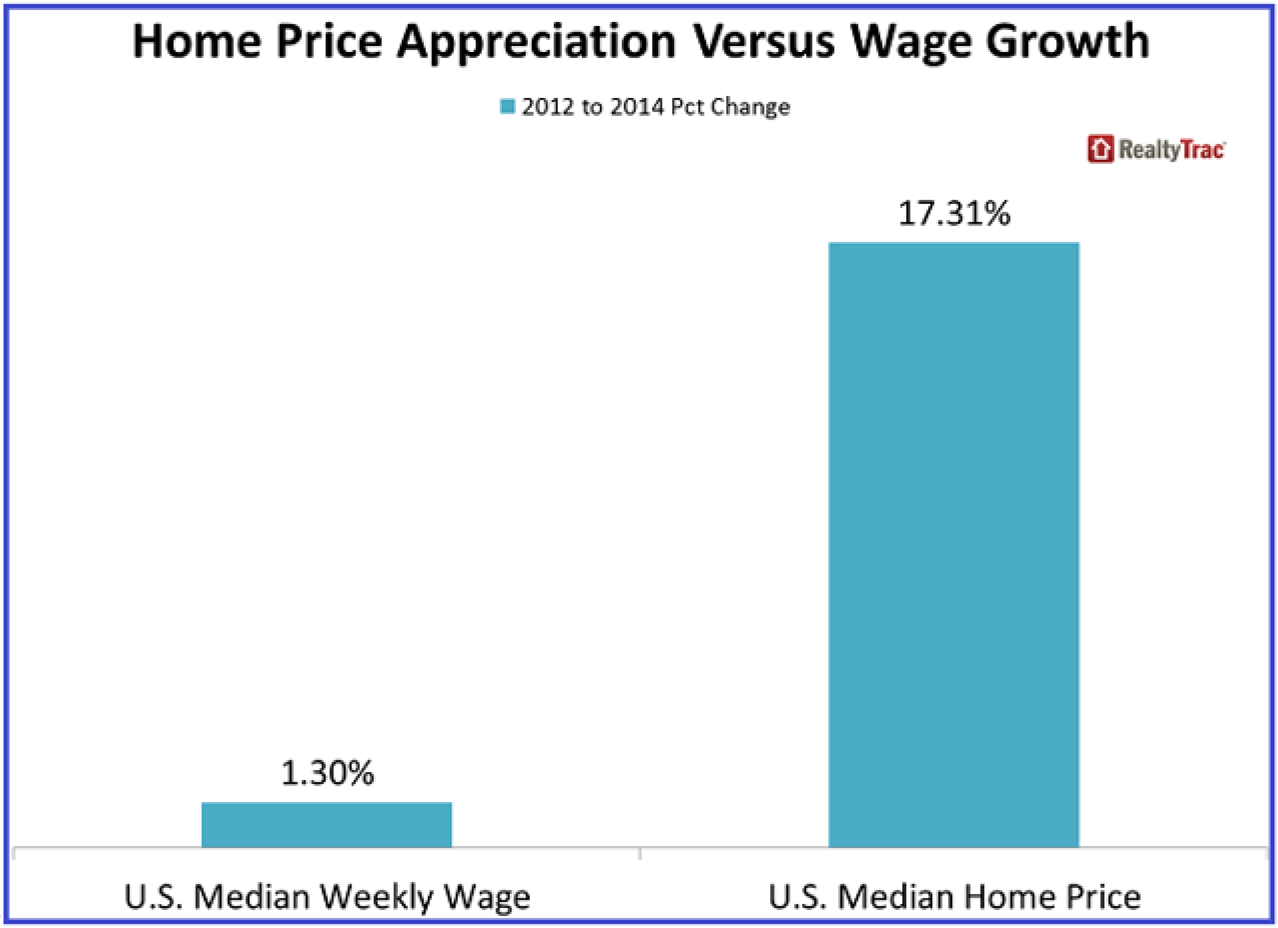
As you can see from the graph above, since hitting a peak in 2004, the rate of homeownership in the United States has plunged. The red line I added to the Fed's graph shows that current rate of homeownership is back to where it was in late 1994. Shown in this context, it can only be described as Orwellian propaganda for Bloomberg to describe the current housing market as "healthy." In fact, the information conveyed by the graph above is that the housing market is fundamentally in a state of deterioration.

Furthermore, the Nationwide Insurance housing market health index uses "demographics" as one of its measurement variables. From a demographic standpoint, the data trend depicted in the graph above is anything but "healthy." Additionally, there is a high correlation rate between the continuous decline in the Labor Force Participation Rate and the homeownership rate (graph courtesy of "M Stevens"):



As this chart above shows, the demographics that would support a healthy housing market have been deteriorating at a rapid rate since the housing bubble popped in 2005/2006.

Both the financial media and Wall Street have pointed to inexorably rising home prices as evidence that the housing market is healthy and in a state of recovery. However, the Achilles' Heel of a healthy housing market is rapidly rising prices. The graphic below produced by RealtyTrac shows that from 2012-2014, home prices rose at rate that is 13 times greater than the rise in the U.S. median weekly wage:



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Home prices have been driven higher since 2010 by a combination of the Fed artificially driving interest rates to record low levels and the direct injection of $1.7 trillion into the housing market via the Fed's mortgage QE policy. In its attempt to stimulate the housing market, the Fed has only stimulated rampant housing price inflation.

The Fed's housing market intervention policies have created a massive misallocation of capital by both homebuilders and home buyers. Homebuilders have built up a record level of inventory on their balance sheets. Moreover, the artificially induced rise in home prices is a massive wealth transfer mechanism from home buyers to home sellers.

Finally, let's circle back to the assertion by Nationwide Insurance that the housing market is in "its best shape since 2001." 90% of all home buyers and 93% of all new construction home buyers use a mortgage. Because of the high correlation between the use of mortgages and home purchases, the validity of seasonally adjusted annualized rate home sales metrics can be measured against mortgage purchase applications.

The Mortgage Bankers Associations reports mortgage applications (refinance + purchase) on a weekly basis. According to the most recent weekly report, mortgage purchase applications are 31% lower than in 2001. In the context of nearly 14 years of population growth and near-record low mortgage rates, this metric represents a housing market in which sales volume has significantly deteriorated in comparison to the market in 2001. It further invalidates the Nationwide housing market healthy index and demonstrates the complete lack of integrity in the Bloomberg News report on the subject.

The fundamentals underlying the housing market can thus be said to anything but "healthy." In fact, the evidence presented above shows a reality in which the fundamentals that drive the housing market continue to deteriorate. The homebuilder stocks have streaked higher recently in correlation with the general stock market. But p/e ratios now are higher than they were for the builder stocks in 2005/2006. Debt and inventory levels are also higher now for most builders than they were when the bubble peaked. This is especially true in relation unit sales levels, which are about one-third of what they were at the peak.

Although this is a difficult period for short-selling any stock, speculators who are patient with their shorts and have room to add to positions when the stocks move higher will eventually be rewarded. Homebuilders tend to move twice as much in either direction as the stock market in general. When shorting stocks, no one can possibly time shorting the market perfectly. Often you are very wrong before you are right. But when you are right you can make a small fortune quickly. I continue to be short KB Homes (NYSE:KBH), DR Horton (NYSE:DHI) and Ryland (NYSE:RYL). I have a nice profit in KBH but am underwater in my DHI and RYL shorts. I have been patiently adding to those two shorts in order to "average up" my cost basis. I also like shorts in Toll Brothers (NYSE:TOL), Pulte (NYSE:PHM), Beazer (NYSE:BZH) and Lennar (NYSE:LEN).

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