

COWLITZ BANK

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TRUST SERVICES

Uncertainties

The current economic crisis began in the housing sector, when a bubble in residential real estate prices deflated. Financial dominoes began falling, beginning with subprime mortgages and derivative instruments built from them. Most observers believe that the worst is behind us now. The stock market indices set their lows in March 2009, and the economy began growing in 2009's third quarter.

But has the housing market, the trigger for the recession, really bottomed? The news is decidedly mixed.

Home sales were up in October, and home prices nationally rose modestly. The Standard & Poor's/Case-Shiller home price index posted its fifth consecutive monthly increase, up 0.4% from September. Sales then fell 11.5% in November, to a seasonally adjusted annual rate of 355,000.

How could that be? Mixed messages from Washington, D.C., may be the culprit. With the temporary tax credit for first-time home buyers scheduled to expire November 30, many deals probably were accelerated into October or dropped in the belief that they could not be closed by the deadline. As it turned out, Congress granted a short extension of the home-buyer's tax credit and also expanded the pool of eligible purchasers beyond first-timers. Because the new credit begins to expire before next year's peak home-selling season, its effect on the market is hard to predict.

Luxury homes

Equally disturbing, the default rate for mortgages of more than \$1 million rose to nearly double the national average for homes overall. Some 7.4% of all U.S. residential mortgages were 90 days or more overdue in September. Just 6.3% of loans of \$250,000 or less were overdue, while 12% of those exceeding \$1 million were in arrears. The steps taken by Congress to stabilize home prices don't reach the luxury market. The home-buyer's tax credit is barred for purchases of homes for \$800,000 or more.

An estimated 25% of mortgages are "upside down," that is, the home value has fallen below the amount of debt owed on it. Banks can cut their losses by accepting "short sales" of homes for less than the amount of the debt. According to the Office of Thrift Supervision, short sales tripled to 40,000 in the first six months of 2009, compared to the year-earlier period.

These developments have some observers worried about a "double-dip" retreat in housing prices.

Consumer spending

Early numbers on the fourth quarter's retail sales put the sector into the black, if only slightly. Retail sales were up a modest 1.3% in November, contributing to an overall increase in consumer spending of 0.5%. That's the best showing since May 2009, when the economy received a boost from the tax relief embedded in last year's \$787 billion stimulus program.

Stocks in 2010

The stock markets ended 2009 in positive territory. As the year began, many feared that would not be possible, especially in the darkest days of March. But stock prices recovered quickly, faster than many investors expected.

Market observers expect strong earnings next year. Estimates for the per share earnings of the S&P 500-stock index range from \$72.52 to \$77.54, depending upon the analytical approach taken. The market already has built strong earnings into current prices, because the index traded at year-end at 15 times the more optimistic earnings estimate. That's near the historical average.

Strong earnings depend upon a growing economy. The fact that third-quarter growth was twice revised downward, from the initial 3.5% to 2.2%, is disheartening. Although some economists estimated 4% growth for the fourth quarter, few are projecting sustained growth at that level in the coming year. High unemployment will continue to be a problem through 2010, creating additional drag on the economy.

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