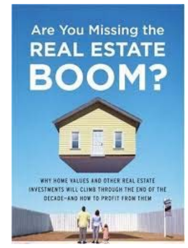
SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Market Observations
June 2016



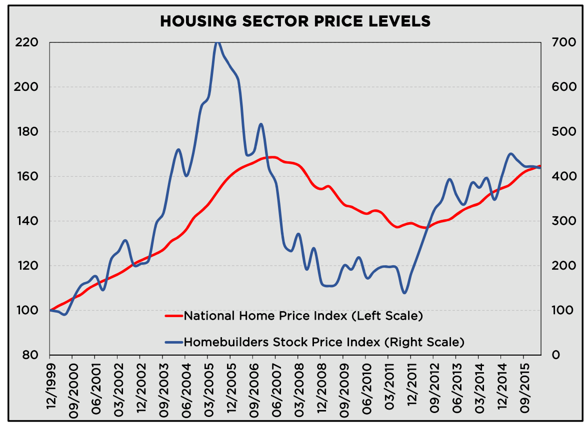
COMING BACK

The U.S. housing sector was the epicenter of the Great Recession. Boom and bust characterized the cycles for everything related to housing. After nine years, the national average home price is poised to reach its prior high. Does this mean the housing sector is fully recovered?

Perspective

From the turn of the millennium to the 2007 peak, the average U.S. home price accelerated at a +7.5% annual growth rate, 50% above its long-term average rate. Chart I shows the resulting 68% cumulative increase in the average home price from 1Q2000 to 1Q2007. The boom in stock prices related to the housing sector was even more dramatic. The index of homebuilder stock prices shown in Chart I increased seven-fold from 1Q2000 to 2Q2005. It was notable that homebuilder stock prices peaked well-before home prices and had fallen -40% before the home price boom ended. The national average home price now appears ready to surpass its prior historical high. The level of homebuilder stock prices has posted a strong recovery of +200% from its cycle low but remains -40% below the historical peak.

Chart I



The boom and bust of the housing sector can be seen in other measures. Chart II shows trends both in residential construction activity and in construction employment. From its peak in 3Q2005, residential construction activity collapsed –58%. Activity has recovered +55% over the past 5½ years but remains well-below the prior peak and 11% below 1Q2000. Residential construction over time has averaged about 4.7% of the total U.S. economy. A return to this average would add about one percent to overall growth. The cycle in construction employment has been less pronounced in percentage terms. However, the tally in jobs has been severe with 3.0 million jobs lost and only 1.1 million recovered.

Chart II

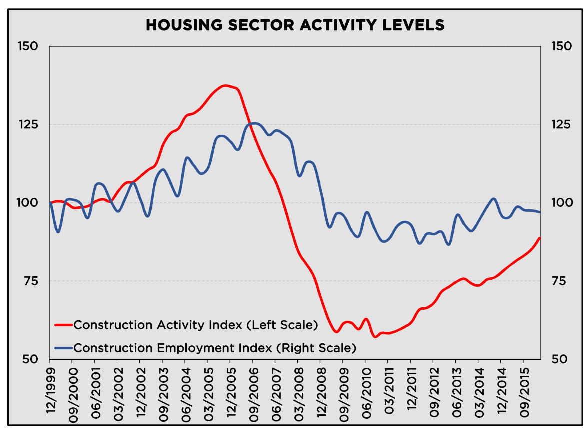
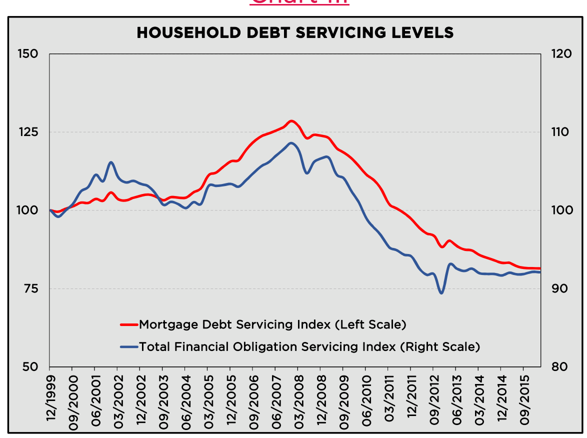


Chart III shows trends in servicing levels for both mortgage debt and all financial obligations. Creative financial structures and liberal lending terms led to a +29% increase in the amount of disposable income going to mortgage payments. In the aftermath of the Great Recession, debt servicing levels have remained relatively low. As a result, households are in a favorable position for positive contributions to economic growth generally and housing activity specifically.

Chart III



Investment Implications

The assets of many households are diversified through the ownership of both homes and investment portfolios. While shelter rather than investment is the primary motivation for home ownership, changes in the value of home equity impact an owner's sense of well-being. Recovery in the values of both homes and investment portfolios from Great Recession lows has positive implications for those directly affected as well as the economy in general.

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