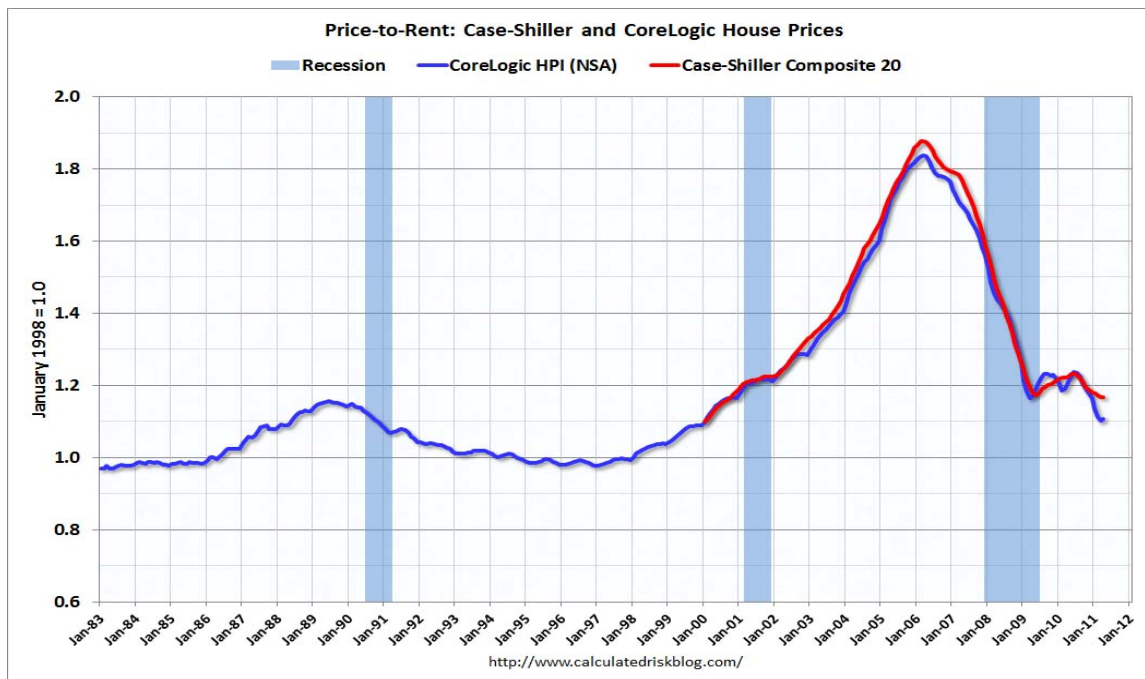
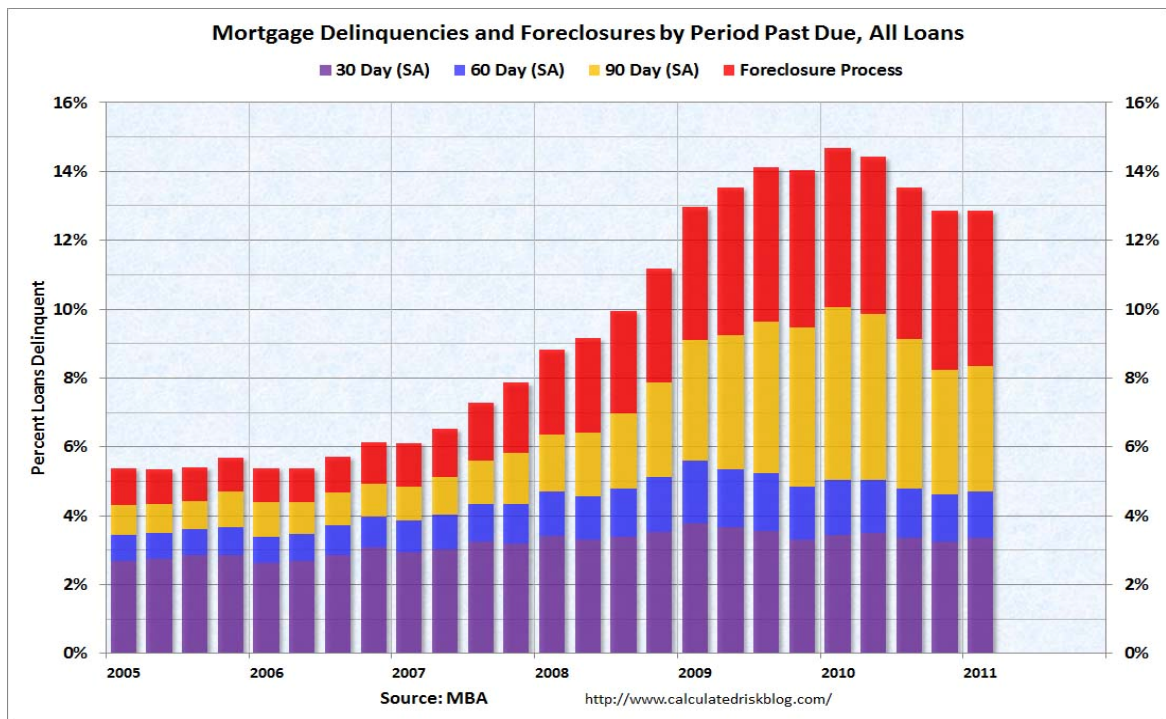




Economist Gary Shilling and many housing analysts are forecasting additional declines in residential home values. The catalysts are presumably the large inventory of existing homes publicly marketed for sale, a large shadow inventory of homes that will be put on the market once prices are perceived to have stabilized, and the large volume of foreclosed properties that must make its way through the pipeline. The following chart presents trends in the S&P Case-Shiller index of home values in 20 major metropolitan markets across the U.S. from 1983 through April 2011. Note the sharp increase in values beginning in 1999 and running through 2006 when the index peaked - and the sharp decline thereafter. The index leveled off during the period when the tax credit for first time homebuyers was in place, with the recent moves again lower. Shilling forecasts an additional 20% decline over the next two years. Robert Shiller, who helped develop the index, recently stated that home prices in many of these markets would likely fall another 10%-15% implying that the index would eventually reach its lower long-term mean.



The following graph shows the mortgage delinquency and foreclosure rates from 2005 to the present with the average around 4% - 5% through 2008. In May 2011, the delinquency rate was almost 8%, lower than in 2010 but well above its normal level. The May foreclosure rate of 4.1% was close to its near-term peak indicating that foreclosures might continue to remain high. For housing to rebound we need to see foreclosures moderate and the inventory of existing homes decline.



Breaking News

- JPMorgan Chase currently holds \$154 billion of mortgages in portfolio. CEO Jamie Dimon announced that the bank would be liquidating its portfolio by 10%-15% per year until the portfolio is close to zero. The bank charged-off \$1 billion in the second quarter related to foreclosure activity. For the first six months of 2011, JPMorgan Chase earned almost \$11 billion.
- ConocoPhillips announced that it was splitting the company into two businesses - a production company and a refining company - each with its own publicly-traded stock.
- Retail sales rose modestly last month, an indicator that consumer spending was not yet accelerating enough to increase GDP growth.

Let's Make a Deal

Tensions are rising as Republicans and Democrats argue about the federal debt ceiling. President Obama declares that he wants a deal by today, but walks out of a meeting with Republicans because they won't stop talking about a short-term increase in the deficit. Senate Minority Leader, Mitch McConnell, proposes that President Obama have the responsibility of raising the debt ceiling in an attempt to place the blame on Democrats when the ceiling is eventually raised. President Obama wants a grand program involving \$4 trillion in deficit reduction which would require tax increases. Republicans are adamantly opposed to any tax increases. The public wants Congress and the President to do the right thing – have a plan to put people back to work and lower the deficit. Congress should focus on the long-term benefits of deficit reduction and not just short-term political gain.

Upcoming Events

- The results of stress tests on European banks are revealed today. Which, if any, firms will be pressured to raise additional external capital? How much will they need to raise? How will the markets respond?