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Some Positive Housing News

The path of the business cycle follows a regular pattern. However, the timing, extent, and duration of each cycle can vary widely.

Last month we wrote that the economy is in an over-supply condition. We explained how such a condition would self correct once excess inventories were sold because cuts in supply would overshoot. We also said that with low interest rates and an aggressive fiscal stimulus package, the stage was set for excess inventories to be absorbed.

This month we are seeing evidence of such a progression begging to occur in the housing market. Over the past two weeks we have had a number of housing related reports. Existing home sales rose 6.5% in December to a seasonally adjusted rate of 4.74 million units. Regionally, sales in the Northeast declined 1.4%, Midwest sales increased 4%, the South rose 7.4% and the West rose 13.6%. Additionally, the total housing inventory fell 11.7% in December to 3.68 million existing homes available for sale. This represents a 9.3 month supply at the current sales pace, down from an 11.2 month supply in November. Pending home sales also rose 6.3% in December. Pending home sales measures contracts signed that have yet to close.

The National Association of Realtor's Housing Affordability Index is showing that housing is at its most affordable level since they began the index back in 1970. The primary reasons behind the current affordability is falling home prices and low mortgage rates. In the news release, the President of the National Association of Realtors says that homes are selling for less than replacement construction costs in much of the country.

Meanwhile, single family housing starts declined 15% in December to a seasonally adjusted annual rate of 550,000 units.

Household formation tends to increase by 1.2 million per year. Historically, housing demand is tied to household formation. With approximately 200,000 homes torn down and rebuilt each year, new households would need about 1 million new homes built each year. However, homebuilders have scaled back production to levels below the long term level of

demand because existing homes on the market are being sold at prices less than the construction costs.

With subprime mortgage resets expected to be lower in 2009 than in 2008, and government programs in the works to reduce foreclosures and increase incentives to purchase a home, we should see a continuation of the reduction of excess housing inventory. As the inventory of homes are sold, home prices will firm, and homebuilders will need to increase construction because currently there are not enough new homes being built to meet the long term level of demand.

The age groups that matter most in terms of forecasting housing demand are the age group of 25 to 30, when people buy their first house, and the age group of over 55, when people purchase a second home, or move from their full nest home into a home for retirement. Based upon birth statistics, over the next 10 years, the number of people aged 25 to 30 will increase almost 15% and the number of people over 55 will also sharply increase.

Of special interest to our local readers, population growth in the south and west, especially in Arizona, coupled with an expected increase in migration of the people over age 55 to warmer climates, supports the view that Arizona's housing market will eventually rebound.

Beyond the housing numbers, the Commerce Department reported an uptick in retail sales for the month of January, and the Conference Board's Index of Leading Economic Indicators rose modestly in December. While such news does not necessarily make for the light at the end of the tunnel for the economy, up is better than down. And it is more important to focus on data series that lead the economy rather than employment statistics that tend to turn well after the stock market and the economic recovery have already taken place.

ASSET ALLOCATION: With cash continuing to yield very little, and our current over allocation to investment grade bonds in place, we expect to increase exposure to equities as we see more evidence of improving conditions, including more details as to the government's plan to resolve the credit crisis.

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