

Profitis Capital Services LLC

U.S. Real Estate

December 28, 2010
Market Commentary

Snapshot: Home Prices

Recent home price data seems to indicate that the rally of the 1st half of 2010 was mainly a function of D.C.'s tax incentives.

According to the latest Case-Shiller numbers¹:

Composite 10 City Index (nsa)
-1.97% 3 month change ending October, 2010

Composite 20 City Index (nsa)
-2.39% 3 month change ending October, 2010

Nonetheless, the rise in home prices has still outstripped the rise in consumer prices. From January, 2000 to October, 2010, the Composite 10 City Index jumped over 59%. Consumer prices (Consumer Price Index, nsa) rose just over 29% in that time span.

This comparison is not intended to establish a level at which home prices will reach equilibrium, but to illustrate how far home prices soared relative to one measure of the general price level. It has been our contention that a house is a depreciating asset, requiring maintenance, upgrades and modifications simply to sustain current market value. A house is replaceable and as such, home prices should not materially (in the long run) exceed the movement in the general price level of the economy.

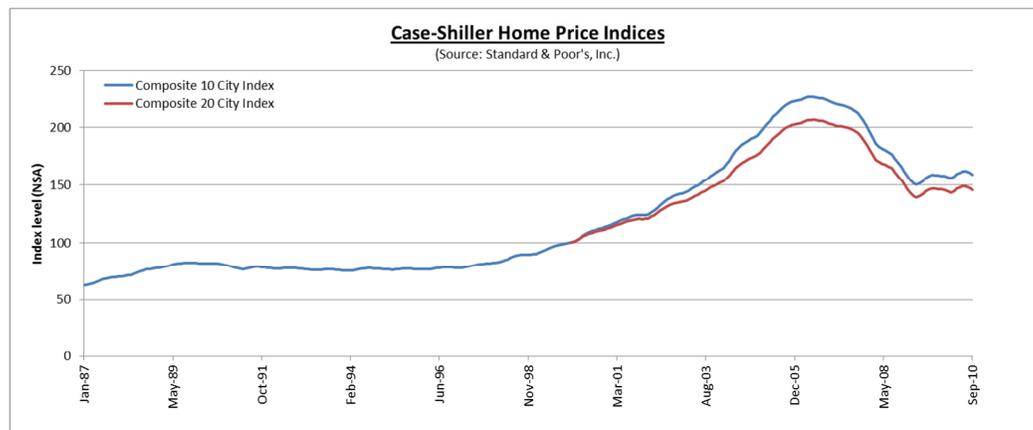
Since further correction in home prices is still needed, our main concerns for bank valuations are *second lien loans (including home equity loans) and goodwill*. These issues are the subjects of a separate report.

226.29

*Peak level of the Case-Shiller
Composite 10 City Index
(nsa), achieved in June, 2006.*

Chart 1: Home Prices

Home prices have retreated to the levels of April, 2010. The qualifying deadline (contract signing) for the home-buyer tax credit was April 30, 2010.²



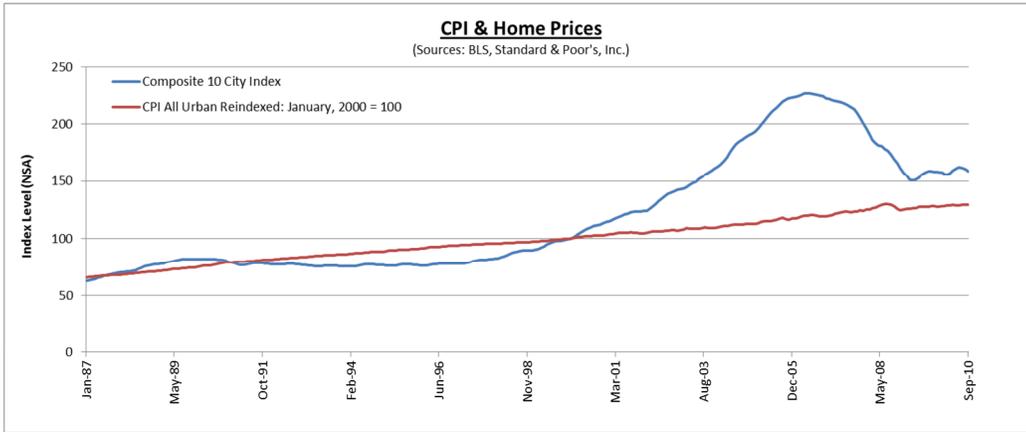
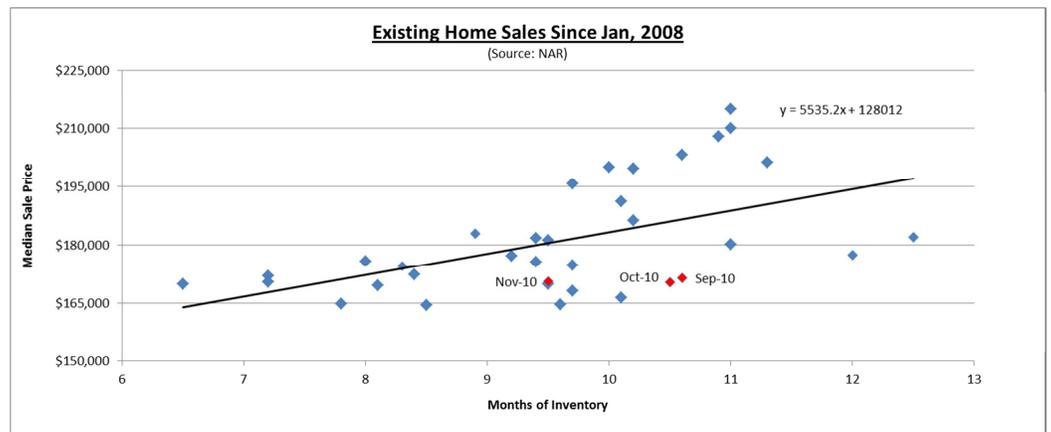


Chart 2: Home Prices & the General Price Level
The rise in home prices materially outstripped the increase of the general price level for most of the 2000s.

Chart 3: Existing Home Sales & Prices

According to the adjoining simple regression, home prices would need to fall another 5.73% to reach a six month inventory. This level is generally considered to reflect a healthy housing market.



¹ <http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indices/en/us/>

² <http://www.irs.gov/newsroom/article/0,,id=206291,00.html>

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