The Campbell Real Estate Timing Letter

Separating likely probabilities from whims and pure hope

When to buy? … When to sell? Data speaks 10 times louder than opinions. Jan 15, 2016

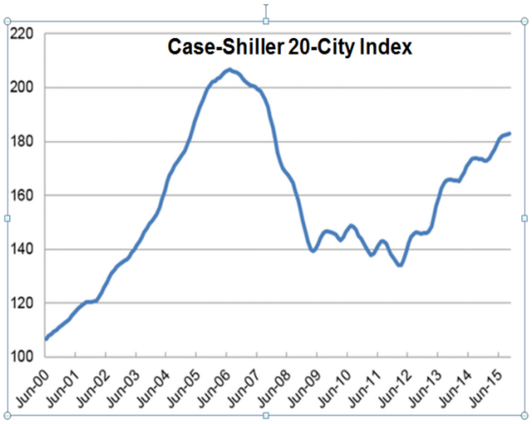
New Year, Same Trend for U.S. Housing Prices – UP!

Another year has come and gone. 2015 was good for residential property owners because we saw national housing prices consistently appreciate at a 5-6% year-over-year rate throughout the year.

What lies ahead in 2016

As we begin 2016, this uptrend is still intact – and the latest home price data shows that last year's modest year-over-year acceleration in home prices continues to be in motion.

The Case-Shiller 20-City Index rose at a 5.5% annual gain in October – up from the 5.4% annual growth registered in September. This was the fastest annual reading since August 2014, when prices climbed at a 5.6% rate.



As of October 2015 – as per the chart to the left – the 20-City Index is back to winter 2007 levels. It is 36.4% above its March 2012 trough – but it's still 11.6% below its July 2006 peak.

However if we adjust for inflation – which measures the purchasing power of the money you have either gained or lost in the U.S. housing market since July 2006 – the 20-City Index is still a staggering 28.4% below its peak of almost 10 years ago.

While all of Case-Shiller's 20 housing markets showed year-over-year gains in October, there was quite a bit of variation. San Francisco, Denver, and Portland (OR) had the highest year-over-year gains, with all three showing October gains that were 10.9% higher than one year ago.

Although all 20 Case-Shiller cities show 12 month annual gains, the worst performing cities were Chicago (+1.3%), Washington D.C. (+1.7%), and Cleveland (+2.2%).

Case-Shiller's 20 Cities:
% Change in Prices Since the Peak

While the Case-Shiller 20-City Index remains 11.5% below its peak of July 2006, the table below illustrates that some cities have performed significantly better than the national average – and some cities performed significantly worse. Thus, while all 20 cities tend to trend both up and down in sync with the national trend – with respect to the volatility in price movement, all real estate is basically local.

Case-Shiller City	Peak Bubble Index Reading	Oct 2015 Index Reading	% Change Since Peak Index Reading
Atlanta	136	126	- 7.4%
Boston	185	182	+ 1.6%
Charlotte	136	135	- 0.7%
Chicago	169	131	- 22.5%
Cleveland	123	109	- 11.4%
Dallas	126	156	+ 23.8%
Denver	141	174	+ 23.4%
Detroit	127	103	- 18.9%
Las Vegas	235	145	- 38.3%
Los Angeles	274	239	- 14.6%
Miami	281	205	- 27.0%
Minneapolis	171	141	- 17.5%
New York	216	182	- 15.7%
Phoenix	227	156	- 31.3%
Portland	181	189	+ 4.4%
San Diego	250	216	- 13.6%
San Francisco	218	218	0.0%
Seattle	192	185	- 3.6%
Tampa	238	174	- 26.9%
Washington D.C.	251	212	- 15.5%
20-City Index	207	183	- 11.6%

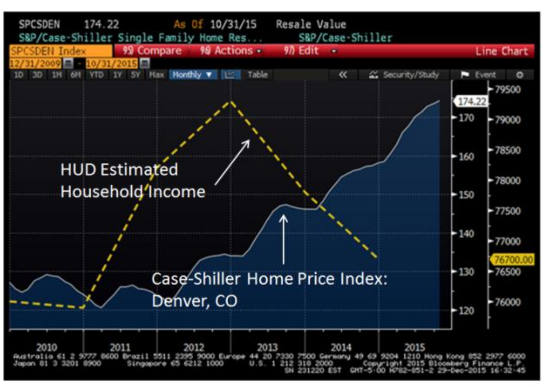
Based on October 2015 index readings, there are four Case-Shiller cities that have risen above their peak bubble prices, there are 15 cities that are still below their peak bubble prices, and there is one city that is at an unchanged price level.

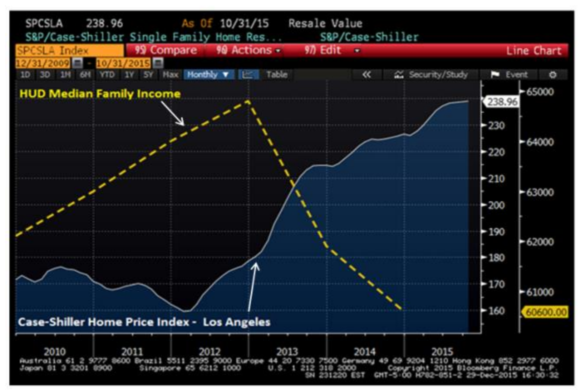
The four cities whose housing prices have risen above their 2006 peak values are Dallas (+23.8%), Denver (+23.4%), Portland (+4.4%), and Boston (+1.6%).

Other cities, however, are still well below their peak bubble highs, led by Las Vegas (-38.3%), Phoenix (-31.3%), Miami (-27.0%), and Tampa (-26.9%).

House Prices Have Risen Faster than Incomes

When the real estate bubble began inflating in 2002, house prices broke out of their historical range of 3.1-3.5 times incomes. They peaked at 4.8 in 2006, fell to about 3.0 at the bottom, and have now risen to 4.4 times incomes.





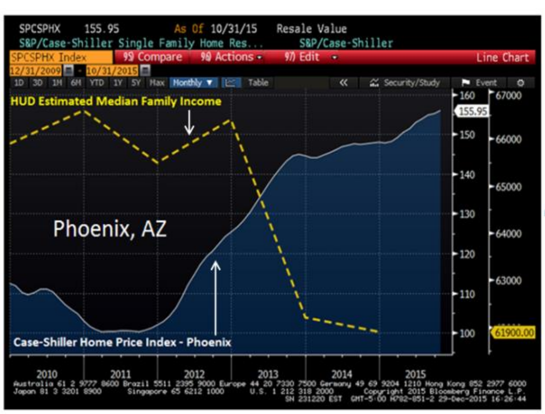
These four charts were created by Anthony B. Sanders, Professor of Finance at George Mason University in VA.

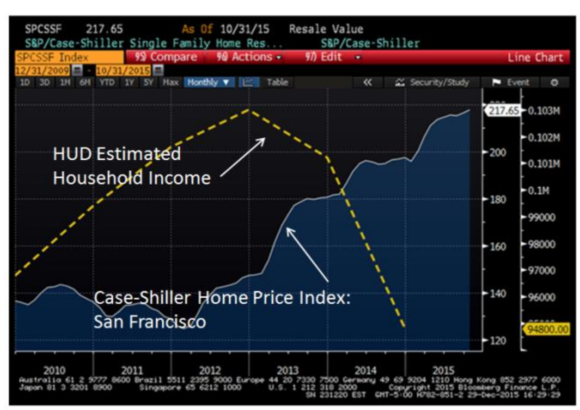
They show household incomes vs. Case-Shiller home prices in four cities from 2010-2015.

As you can see, home prices are rising while household incomes are falling.

Although this relation-ship is unsustainable in the long run – that doesn't mean it can't remain unsustainable a while longer in the short-run.

The risk, however, is there to see.





The Best Investment Advice for 2016

"It's tough to make predictions about the future," said the great baseball playing philosopher Yogi Berra, "especially about the future."

Yet we continue to try – especially during this time of the year when the mystics peer deep into their crystal balls to divine what's ahead. However since I started writing my Timing Letter 14 years ago, I've learned some valuable insights about the best way to invest (and manage risk) in the markets – and listening to forecasters who think they have the future all mapped out isn't one of them.

Instead, my biggest insight has been that investors should focus the vast majority of their time on what the trends are telling them to do – as opposed to what the economic soothsayers are saying the economy, the markets, and your favorite real estate market will do during the coming months or years.

Yes, a blind squirrel does occasionally find an acorn. But as Nassim Nicholas Taleb (author of *Fooled by Randomness*) might say, the odds of a soothsayer getting more than 50% of his predictions right over a 2-5 year period are as about as likely as a room full of monkeys typing out The Gettysburg Address.

What makes acting on market forecasts even more dangerous is not that they will be wrong – and odds are they will – but it's the natural tendency for humans to stick to a given forecast come hell or high water. Instead of adjusting to changing conditions, most investors get married to their outlook for the markets – which only proves they would rather be right than change their positions according to changing realities and make money. I know it sounds crazy but it's human nature: most people would rather defend a bad idea (or investment position) – and prove they are right – than admit they made a mistake (and change and be happy).

Exceptions to the Rule

Even though human beings aren't very good at predicting the future – and that's true whether we're talking about next week, next month, and especially next year – there are exceptions to the rule. While I believe that that most market forecasts are useless, there are two kinds of predictions that do have value to investors. One is based on the assessment of probabilities and the other is based on the assessment of risks.

With respect to probabilities, it's about understanding the world for what it is – which enables smart investors to anticipate some reasonably high probability results if they act at certain times. Based on the cyclical nature of real estate, for example, they know when to make big real estate bets when the odds favor them – such as at market cycle bottoms. They also know how to avoid catastrophic mistakes that result from investing at or near market cycle peaks – when the risk of a market downturn is high.

By incorporating probabilities into their strategies, investors can not only win big, but they can avoid losing big. I would therefore argue that the more you know about how to identify the peaks and bottoms of real estate cycles, the greater the probability that you will know how to best manage risk and make high probability predictions about the future.

Speaking of probabilities, I will never forget the first time I laid my eyes on Robert Shiller's long-term chart of real U.S. housing prices in 2005. (which I have repeatedly shown in past issues of this Timing Letter). The chart was 115 years of historical inflation-adjusted house prices – and you would have had to be blind <u>not to see</u> that a massive bubble was being formed, and that a spectacular mean-reverting crash would soon follow.

The second type of valuable predictions is the result of risk-based assessments. These forecasts are not about precise market timing – instead they are assessments of looming danger. For example, when housing real prices have risen above real household incomes – or when housing affordability for California is approaching 17% on a statewide basis – you must be aware that risk is high and this is probably not the best time to be buying real estate, even if properties are being purchased as a long-term hold.

If you are buying real estate under the above two risk-based conditions, it is highly likely that you are becoming greedy when you should be getting fearful – and this is clearly not what good risk managers do.

The Trouble with Predictions: Why They're Usually Wrong

"People can't predict how long their marriages will last, how their new jobs will turn out, or how long they will be happy with newly acquired objects," says Nassim Talib, "so what makes you think we can predict the markets?"

The bottom line is that over the years, a multitude of researchers have studied the track record of forecasters – and their findings show that no one has ever been able to predict what the markets will do with any kind of long-term consistency or accuracy.

Even though forecasts tend to be consistently wrong, the media loves them. Why? Because predictions attract a lot attention and are therefore good for business. That's why the financial media – in print, television, and radio – likes to dazzle us with a relentless parade of convincing sounding fortune-tellers that are always willing to give us their vision of things to come.

Why are the markets so difficult to predict?

It's because markets are driven by the actions and complexities of human behavior. Thus, the study of human behavior is a social science – which means price movements are the result of a complex system of social interaction, psychology, and hope, fear, and greed. As opposed to the physical sciences, there are no constants in human action. This means there is no good way to predict social events – there is only guessing.

During media interviews – or during my speeches – I am always amused when I get asked "Where will housing prices be 1-2 years from now?" I am always happy to respond honestly and say "I don't know. I can't see the future – I can only see the trends today."

Regardless, most investors love predictions because (1) knowledge of the future is, and has always been, one of the most desperately sought human goals; and (2) because it's only natural to experience worry, anxiety, and trepidation about how changes in the markets are going to impact our financial well-being.

A More Profitable Way to Invest

Here's my investment advice for 2016: Ignore the forecasts – and follow trends instead. If you could know next month's or next year's asset prices today, everyone would be rich. So the sooner you figure out no one has a special crystal ball, the better off you will be.

Those who make predictions are going to be right some of the time – but more often than not, it's usually the result of pure dumb luck. However when it comes to long-term performance, it will be the trend followers – and not the economic prophets – that will make the higher and more dependable investment returns.

As I look back over the years, I've learned to live by the four following investment axioms:

1. First, there is no certainty in the markets – only uncertainty. That's why you should never become complacent about any position you have.
2. Second, because of the uncertainty in the markets, it is imperative that you have an investment strategy that keeps you agile and nimble – and tells you when to act.
3. Third, capital preservation is as important as capital appreciation.
4. Fourth, no strategy is guaranteed to always make you money. That's why it's more important to judge it by its longer-term performance – and not by its performance during any one year.

The markets are a colossal engine of human emotion – and no one can predict what the collective marketplace is going to think, feel, or do at any given time. That's why you cannot take forecasts seriously.

Of course we all wonder what will happen in the future – and we all worry about it. But paying heed to market prognostications is not the answer to your worries – and more often than not, acting on them turns out to be a mistake. Successful investors do not act on market movements that will supposedly happen in the future – but instead react to what is happening in the markets today. And that's what trend following and managing risk is all about.

Trends to Watch in California's Major Housing Markets

As trend-watchers, the two tables below focus on key real estate data that tell us which way housing prices for California's major markets are likely to move in the next 3-6 months. The data is through Nov 2015.

NOVEMBER 2015 DATA	Col 1 Median Sales Price of SFH's	Col 2 Median Sales Price: YOY % Change	Col 3 Home Sales: YOY % Change	Col 4 Months of unsold Inventory currently for sale	Col 5 Months of Unsold Inventory: YOY % Change
California	$475,000	+ 6.8%	- 1.6%	4.2	- 2.0%
Los Angeles	$457,870	+ 5.5%	- 5.5%	4.4	+ 0.4%
San Francisco	$1,323,860	+ 13.8%	- 10.5%	1.8	- 20.3%
San Diego	$554.550	+ 12.8%	+ 0.8%	4.3	- 13.9%
Santa Clara County (San Jose)	$965,000	+ 13.5%	- 1.3%	2.0	+ 7.7%
Sacramento County	$291,100	+ 9.7%	+ 10.9%	2.8	- 23.7%
San Bernardino/ Riverside County	$286,710	+ 7.8%	- 1.4%	5.0	- 2.2%

Data Source: California Association of Realtors

Column 1 shows the November 2015 median sales prices for CA single-family homes – and the year-over-year (YOY) % changes are shown in Column 2.

Column 3 shows the November 2015 trends for existing home sales. When the trend is up, housing prices are likely to rise – and when it is down, they are likely to fall.

Column 4 shows the months of unsold inventory for sale. When the index is greater than 6, it means it's a buyer's market and prices are likely to fall. When the index is less than 6, the market favors sellers – and prices are likely to rise. Column 5 shows the YOY trends for months of unsold inventory. A rising trend indicates supply is increasing faster than demand, and a falling trend indicates demand is increasing faster than supply.

NOVEMBER 2015 DATA	Col 6 Notice of Defaults	Col 7 Notice of Defaults: YOY % change	Col 8 New Home Building Permits: 6-month average ending July 2015	Col 9 New Home Building Permits: YOY % change
California	4,432	- 15.4%	8,260	+ 15.2%
Los Angeles	1,108	- 12.9%	2,977	+ 32.7%
San Francisco	22	- 43.6%	1,058 (inc Oakland)	+ 19.6%.
San Diego	348	- 13.2%	671	+ 26.6%
San Jose	109	- 24.3%	695	- 26.9%
Sacramento	203	- 21.5%	577	+ 68.7%
San Bernardino/ Riverside	835	- 9.3%	780	- 21.1%

Data Sources: PropertyRadar.com and Census Bureau

Column 6 shows the total number of Notice of Defaults for Nov 2015 – and the YOY trends are shown in Column 7. Falling trends are correlated with rising home prices – and rising trends with falling home prices.

Column 8 shows the total number of new home building permits (the six month average) for Nov 2015 – and the YOY trends are shown in Column 9. Positive trends favor rising home prices – and negative trends favor falling home prices.

Current Housing Trends for 17 Major U.S. Cities

The table below shows data through OCT 2015. Here's how to read the table and determine what it is telling you. If housing prices are likely to rise in any of the 17 cities, the Market Momentum (MM) reading for October 2015 will be a positive number – and if prices are likely to fall, the October 2015 MM reading will be a negative number. This tells you whether the primary trend of the market is up or down – and whether you should be invested in the market for potential price appreciation, or if you should be out of the market to protect your capital from loss. (Note: changes in home prices are calculated from Case-Shiller Home Price Indexes.)

It is also valuable to know whether a housing market is getting stronger or weaker relative to the primary trend. This can be determined by comparing the latest Market Momentum reading (October 2015) to the MM reading from four months ago (July 2015). If the reading has become more positive compared to four months ago, it tells you the market is getting better relative to the primary trend. If it has become more negative compared to four months ago, it tells you the market is getting worse.

City	Last Signal	Price Change Since Last Signal	Market Momentum Reading: July 2015	Market Momentum Reading: October 2015	Primary Trend
Phoenix	Buy – Jan 2012	+ 51.8%	+ 6.5	+ 9.3	Up
Denver	Buy – Jun 2011	+ 38.3%	+ 8.5	+ 7.2	Up
Washington DC	Buy – Jun 2010	+ 14.1%	+ 1.6	+ 1.4	Up
Miami	Buy – Jul 2011	+ 45.4%	+ 10.9	+ 6.7	Up
Tampa	Buy – Sept 2012	+ 29.3%	+ 8.1	+ 9.5	Up
Atlanta	Buy – Aug 2012	+ 31.6%	+ 8.4	+ 7.7	Up
Chicago	Buy – Jan 2013	+ 17.6%	+ 2.1	+ 2.2	Up
Boston	Buy – Feb 2012	+ 26.3%	+ 7.7	+ 9.8	Up
Detroit	Buy – Jun 2010	+ 47.7%	+ 4.6	+ 5.0	Up
Las Vegas	Buy – Aug 2012	+ 51.0%	+ 8.8	+ 6.3	Up
New York	Buy – Aug 2012	+ 9.2%	+ 2.5	+ 1.7	Up
Cleveland	Buy – May 2012	+ 9.4%	+ 3.8	+ 3.3	Up
Dallas	Buy – Jun 2011	+34.4%	+ 10.0	+ 13.2	Up
Seattle	Buy – Mar 2012	+ 41.2%	+ 8.5	+ 8.0	Up
San Diego	Buy – May 2012	+ 41.0%	+ 6.2	+ 8.5	Up
Los Angeles	Buy – Aug 2010	+ 36.1 %	+ 12.0	+ 8.4	Up
San Francisco	Buy – Mar 2012	+ 72.9%	+ 13.4	+ 11.0	Up

The Market Momentum (MM) readings for October 2015 show that 17 of the 17 cities were in primary uptrends – which include all three major California cities that I follow: San Diego, Los Angeles and San Francisco. There were also 17 cities in primary uptrends a year ago (October 2014).

The MM readings were more positive for six cities in October as compared July – two less than was reported in my November 2015 Timing Letter. This means that 11 out of 17 housing markets have lost strength from July 2015 to October 2015.

Dallas was the strongest city in October 2015 – with an MM reading of +13.2. San Francisco (+11.0) and Boston (+9.8) were the 2nd and 3rd strongest cities.

For the 11th month in a row, Washington DC was the weakest housing market I follow – with a MM reading of +1.4 in October. New York was the 2nd weakest market – with a MM reading of +1.7.

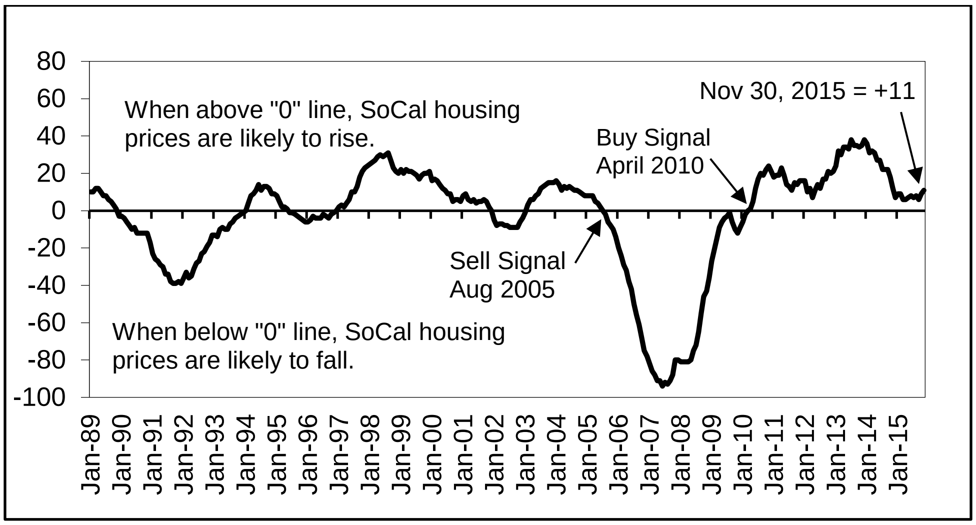
If you compare the MM readings for the last 4 months (July 2015 vs. October 2015), the three cities that became stronger at the fastest rates were Dallas (+ 3.2), Boston (+2.1), and Tampa (+1.4). The three cities that became weaker at the fastest rates were Miami (- 4.2), Los Angeles (- 3.6), and Phoenix (- 2.8).

Let's now take a look at the Southern California real estate market, and find out what the key data is telling us about where housing prices are likely to go.

Real Estate Crash Index

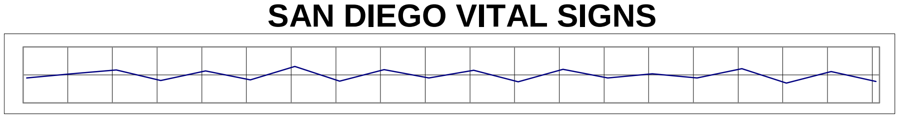
The Real Estate Crash Index gave us a +11 reading as of Nov 30, 2015 – the highest monthly reading since Dec 2014. The all-time record high for the Crash Index was +38 in December 2013. This forward looking indicator is telling us that Southern California housing prices are likely to rise for the next 3 to 6 months. As seen in the chart below, a "buy signal" was flashed when the "0" line was crossed to the upside in April 2010.

As shown in the below table of Vital Sign Readings, all five Vital Sign indicators are in trends that are friendly to price appreciation, and none are in a trend that is unfriendly to price appreciation.



Vital Sign Readings

SAN DIEGO VITAL SIGNS

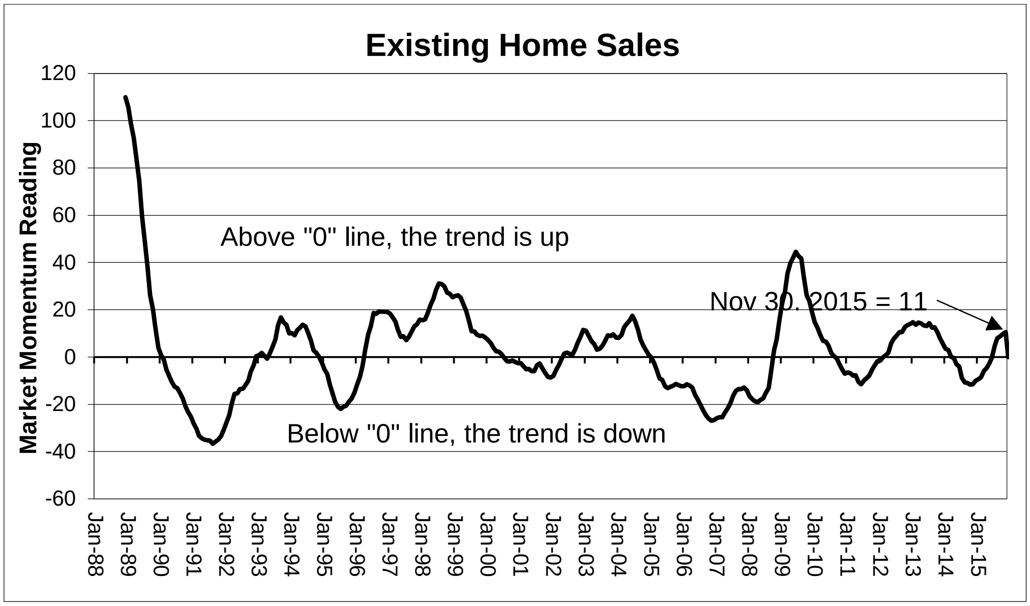


Vital Sign Indicator	Month-End Sept-15	Month-End Oct-15	Month-End Nov-15	Market Momentum Reading Nov 30, 2015
Existing Home Sales	3,396	3,142	2,500	+11
New Home Building Permits	396	862	880	+19
Notice of Defaults	410	410	369	-10
Foreclosure Sales	139	146	185	-10
30-Yr Fixed Mortgage Rates	3.89%	3.80%	3.94%	-9

Sources: CoreLogic/DataQuick, Census Bureau, S.D. Recorder's Office, Federal Reserve Board

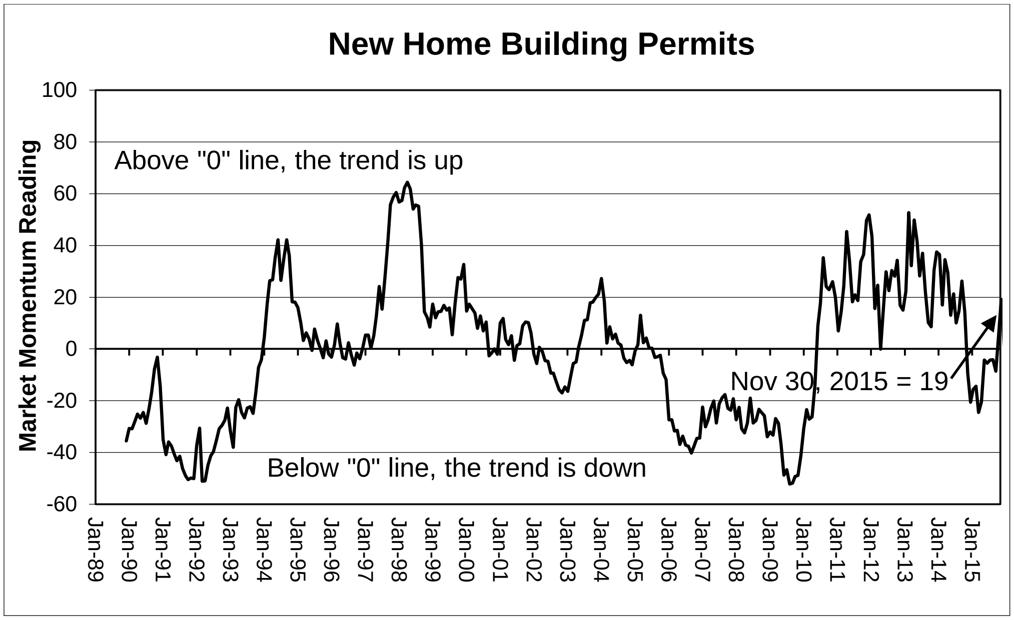
IMPORTANT NOTE: While my Vital Sign trend indicators are based solely on statistical data derived from the San Diego real estate market, the trend signals they send have historically worked with equally good accuracy for the Los Angeles, Orange County, and many other California real estate markets. Thus, please be aware that I often use the words "Southern California" and "California real estate markets" interchangeably.

Vital Sign Indicator #1: Existing Home Sales



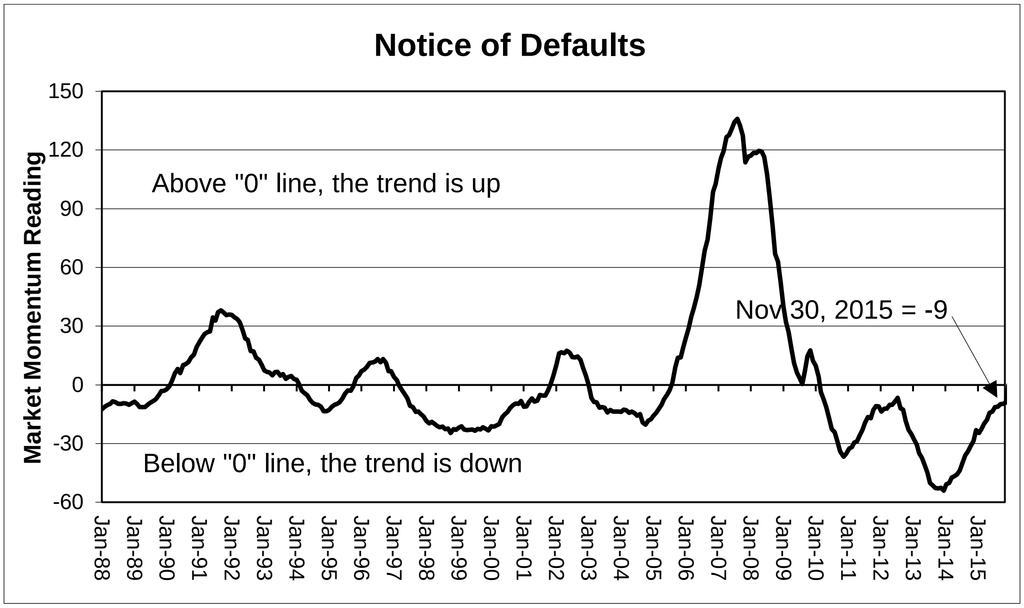
There were 2,500 Existing Homes Sales in Nov 2015, giving us a trend reading of +11. This is the 5th straight month that the Market Momentum reading has been in positive territory. It has been statistically proven that Existing Home Sales are an excellent leading indicator for predicting the future direction of housing prices. The 12-month moving average (MA) was 3,280 in Nov 2015 – the highest reading since Feb 2014.

Vital Sign Indicator #2: New Home Building Permits



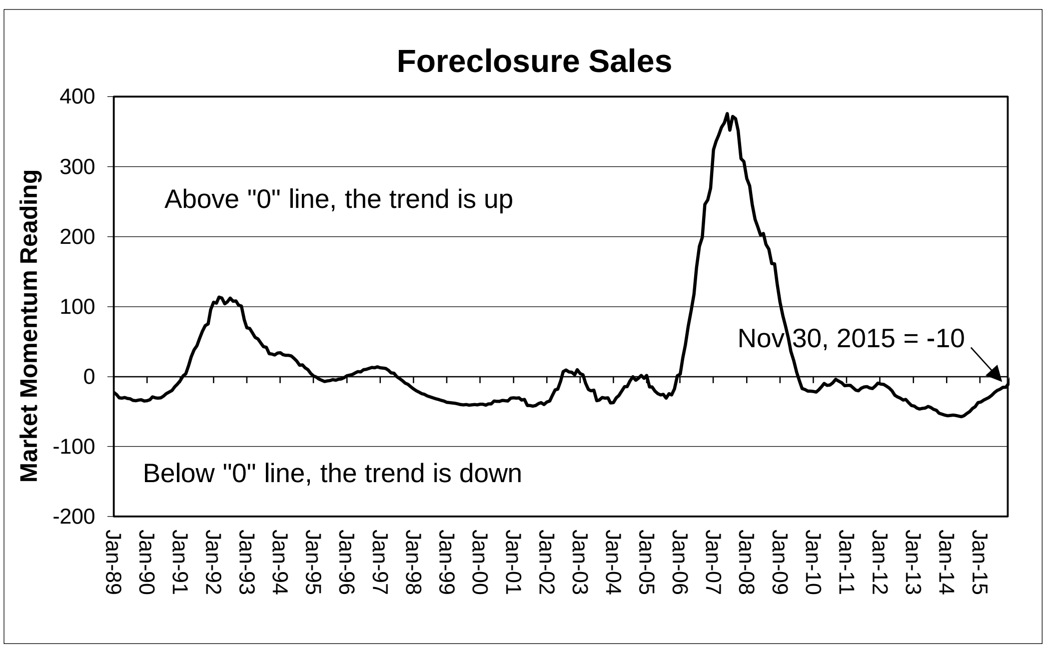
There were 880 New Home Building Permits pulled in Nov 2015. This produced a Market Momentum reading of +19 – which is only 2nd straight month that this key indicator has been in positive territory. New home building permits are a good leading indicator as to what will be the future strength of the SoCal economy and its real estate markets. The 12-month moving average (MA) was 713 in Nov 2015 – its highest reading since Sept 2014.

Vital Sign Indicator #3: Notice of Defaults



There were 369 Notice of Defaults in Nov 2015, which produced a Market Momentum reading of -9. This tells us that mortgage defaults are in a downtrend, which is a positive sign for both the San Diego economy and its housing market. The 12-month moving average was 440 in Nov 2015 – the lowest reading since Dec 2005.

Vital Sign Indicator #4: Foreclosure Sales



There were 185 Foreclosure Sales in Nov 2015, which produced a Market Momentum reading of -10. This key indicator has now been in a downtrend for 76 straight months. The 12-month moving average was 152 in Nov 2015 – the highest reading in seven months.

Vital Sign Indicator #5: Interest Rates

In the last week of December 2015, Freddie Mac reported that 30-year fixed rate mortgages moved above 4.0% for the first time in five months – up from 3.95% in the previous week. The historic low for 30-year rates was 3.31% in November 2012.

The increase came a few weeks after the Federal Reserve raised short-term interest rates 0.25% -- which was the first rate hike since 2006.

A year ago at this time, 30-year fixed rate mortgages averaged 3.83%. Because mortgage rates have <u>risen</u> 0.18 percentage points since then, today's home buyers can afford about 2.0% "less home" as compared to 12 months ago. Thus, if you could afford a $400,000 home in December 2014, you could only afford to pay $392,000 for that same home today (assuming that your household income stayed the same).

Final Words

"I have long felt that the only value of market forecasters
is to make fortune-tellers look good."
– Warren Buffett

We are at that time of the year when the pundits make their predictions for the coming 12 months. My prediction, however, is the same this year as it was last year and as it was the year before – namely that the prevailing trends are likely to continue to move in any given direction until something changes and causes them to move in the opposite direction.

As real estate investors, we've had the wind at our back for the last 4-5 years – and still do. In fact, physical real estate was the only winning major asset class in 2015 – stocks, bonds, commodities, and gold were all losers. However, never lose sight of what the market giveth, the market can take away.

You can't predict – but you can prepare. Following trends will limit your downside risk – which is something all intelligent investors should find interest in. The U.S. is experiencing the largest build-up of debt and unfunded government promises in human history. Thus, you never know when the next moment of truth will be upon you – but the next trend change could determine your financial destiny for many years to come – or maybe even the rest of your life.

I wish all of you a happy and prosperous new year!

Robert M. Campbell
858-481-3235

PS: Re-subscribe for one year ($135.00) and I will add one FREE issue to your subscription. Re-subscribe for two years ($265.00) and I will give you a beautiful 1921 Morgan silver dollar.

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<u>Subscription rates</u>: $135.00 per year (6 issues). Individual issues are $30.00 each.
<u>How to read the Vital Sign charts</u>: All charts use the statistical tool called "momentum analysis" to determine trend changes in the marketplace. Trend changes are signaled when the "0" line is crossed. When the market momentum reading is above the "0" line, it means the trend is up. When the market momentum reading is below the "0" line, it means the trend is down. Consult the *book Timing the Real Estate Market* for a complete understanding of these charts, how to construct them, and how to interpret them.