

Weekly Report

US residential real estate – opportunity or illusion?

The precipitous fall in existing home sales from 6.49 million in November to 5.05 million in January has raised doubts regarding an eventual recovery in the residential real estate market. Over coming months, we will gain a clearer picture to what extent stimulus measures, notably the first-time homebuyer tax credit and mortgage purchases, have supported promising trends in existing home indices that started to occur in the summer of 2008. In fact, home prices still hover around the lows last reached in 2002, but year-on-year price changes consistently moved up since April 2009. Inventory levels, which represented the stickiest hurdle, not the least due to record foreclosures, only recently experienced a significant reduction. In the new home sales area, inventories reached the lowest level since spring 1971. Housing starts and building permits undershot the 70's level by far and seemingly form a bottom more recently. The extreme soft activity in homebuilding is also reflected in the homebuilder confidence, which nevertheless recovered from an estate deemed "desperate". The combination of low mortgage rates and attractive house prices pushed homebuyer affordability to the absolute record level. Given the encouraging trends in inventories and prices, we judge that homebuyer affordability will lead to effective house purchases, particularly in an environment where insecurity in respect to the employment situation has tempered. We are still cautious on the commercial space, though, as the peak in losses has probably not yet occurred. We consider homebuilders as very attractive at current levels.

Foreign Exchange

The first day of March started with fireworks of merger announcements: the largest deal involves Prudential PLC, potentially acquiring the Asian operations of American International for \$ 35.5 billion in cash and stocks. Market participants raised concerns that Prudential needed to sell GBP in order to buy this crown jewels of the US company. While such an amount is normally not sufficient to move a currency, the news fell on an already very negative sentiment, which was enough to psychologically break the \$ 1.50-level. Macro-economic-wise, figures have been mixed. UK business investments not just dropped far more than expected, but the rate of decline surprisingly accelerated to 5.8 %. Concerns over fiscal problems recently accentuated when a shortfall in January of GDP 4.3 billion was revealed and polls pointed to the possibility of a hung parliament, which may hinder deficit cutting measures. Comments by Mervyn King indicating that the BOE may re-start its quantitative easing program did not help either. Even upward GDP revision failed to turn the currency around.

	Short-term trend	Last
EURUSD	→	1.3535
USDCHF	→	1.0815
USDJPY	→	89.198
GBPUSD	→	1.4997

Fixed Income

February proved to be a zero-sum game for Treasury holders. Rising yields in the first part of the months have evaporated in the latter part of the month on some disappointing economic statistics such as a sharp decline in existing home sales, stronger levels of initial claims and a substantial loss in consumer confidence. The highly observed Fed chairman's Ben Bernanke testimony additionally left the impression that interest rates would remain low for an extended period. He argued that the struggle in residential and commercial real estate as well as the languishing state of the US job market with the rising number of long-term unemployed were in particular reasons for concern. Additionally, inflation was anticipated to remain subdued with the CPI remaining within the 1.75-2.00 % ranges. We, however, still expect interest rates to rise as consumer spending grew, business investment is anticipated to get firmer, particularly in the IT field, international trade has rebounded and financial markets have improved. The labor market might have been impacted by hefty winter storms in February but should soon show new job creation.

	Forecast end 10	Last
US 10y T %	4.80	3.61
Fed funds	2.25	0-0.25
Bund 10y %	4.00	3.10
ECB rates	1.50	1.00

Stocks

The massive earthquake in Chile with 8.8 in magnitude will potentially lead to supply constraints. There were previously already concerns in respect to inefficiencies as well as infrastructure problems, which have certainly accentuated after this horrible natural catastrophe. We have taken a position in Xstrata (XTA LN), which has an important copper operation, as a consequence. The company reported slightly better than expected results in February. It holds several growth projects in pipeline, amongst them 3 copper projects that are awaiting board approval this year. Coal is another crucial division, contributing roughly 38 % to the group's EBITDA. With spot prices at or above the contract price of \$ 85/t until April 2011, earnings risks in this area seem limited. The interesting commodity mix and gearing should benefit XTA in an improving macroeconomic recovery. Price target GBP 13. Which single stock is preferred in the US homebuilding space? We consider DR Horton (DHI) as attractive. First time buyers, which are currently benefiting from the federal homebuyer tax credit, represent roughly 50 % of revenues. Price target \$ 16.

	Forecast end 10	Last
S&P 500	1230	1115
NASDAQ	2450	2272
DJ STOXX 600	270	249
SMI	7000	6791