

WHY U.S. HOUSING MATTERS TO CANADA

It seems that lately every time the stock market has a bad day, it is blamed on the slump in the U.S. housing market. What is rarely explained is why this issue matters so much, and more importantly, what it means to Canadian investors.

In my view, the collapse of the U.S. housing market is the biggest threat to the North American economy and financial markets. In the rest of this newsletter, I will shed a little light on how housing influences other areas of the economy and the markets.

Why is U.S. housing collapsing while Canadian housing is relatively strong?

U.S. bank regulations are less restrictive than in Canada. This has led to a thriving “sub prime” mortgage market. Someone with a poor credit rating is far more likely to obtain a mortgage in the U.S. than in Canada. Often these mortgages were obtained with no money down, and at ultra low “introductory rates” of interest.

In the past twelve months, many of these “teaser” rates have been adjusted upwards and defaults have risen accordingly. The forced liquidation of these properties at a time of record construction activity has set up a vicious cycle of lower and lower prices. Many estimates have this continuing for up to another year.

What do lower housing prices do to financial markets and the economy?

1. Consumers stop spending – When home prices were rising, many consumers refinanced their homes to fund spending on cars, etc. Now that prices are falling, this major source of spending is being choked off.
2. Banks stop lending – A bank’s natural response to rising defaults is to tighten up on their lending standards. As a result, many legitimate businesses and individuals with good credit are being denied loans to protect capital to pay losses on bad loans.
3. The economy slows due to the effects outlined above.
4. The stock market struggles – Stocks are now pricing in the fact that the economy is slowing. Only time will tell us how much the economy will slow and how long it will last. A recession is not out of the question. The more the economy slows, the more difficult it will be for stocks to rise.

What to do? Get Defensive!

Generally speaking, portfolio managers reduce risk when conditions are deteriorating. This can be done in a number of ways.

1. Sell stocks and raise cash
2. Sell stocks and buy government or high quality corporate bonds
3. Sell growth stocks and buy defensive stocks. A defensive stock is one that is in a more or less recession-proof industry and usually pays dividends. Utilities and real estate investment trusts are good examples.

The comments and opinions expressed in this letter are the result of work done by Alan Tchabushnig. They may differ from the opinion of Blackmont Capital Inc. ("BCI") and should not be considered as representative of BCI, belief, opinion, or recommendations. The statements and statistics contained herein have been prepared by sources we believe to be reliable but we cannot represent that they are complete and accurate. This material is published for general information only. BCI assumes no liability for financial decisions based on this information. Readers should obtain professional advice before applying any ideas mentioned to their own personal situation to ensure their individual circumstances have been properly considered. BCI is an independently owned subsidiary of CI Financial Income Fund. CI Financial is a Canadian owned diversified wealth management firm, publicly traded on the TSX under the symbol CIX.UN. Blackmont Capital Inc. is a member of CIPF and IDA .