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Housing Continues to be an Ominous Sign for Stocks

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Everyone knows that housing was at the epicenter of the 2008-2009 financial crisis. Too many people were granted too many mortgages with too little down payment, at too low of interest rates. The housing industry met all that with too many homes, townhouses and condos. A bubble grew and popped, and all the king's horses and all the king's men are having trouble putting Humpty Dumpty back together again. It was recently reported by Corelogic that the equity securing mortgages associated with home owners that are behind in payments is \$750 billion less than the mortgage values. Of course there are millions of mortgage loans that are current, and millions of mortgages that are very well secured by substantial positive equity; but the mortgage picture and housing remain a very weak part of the economy.

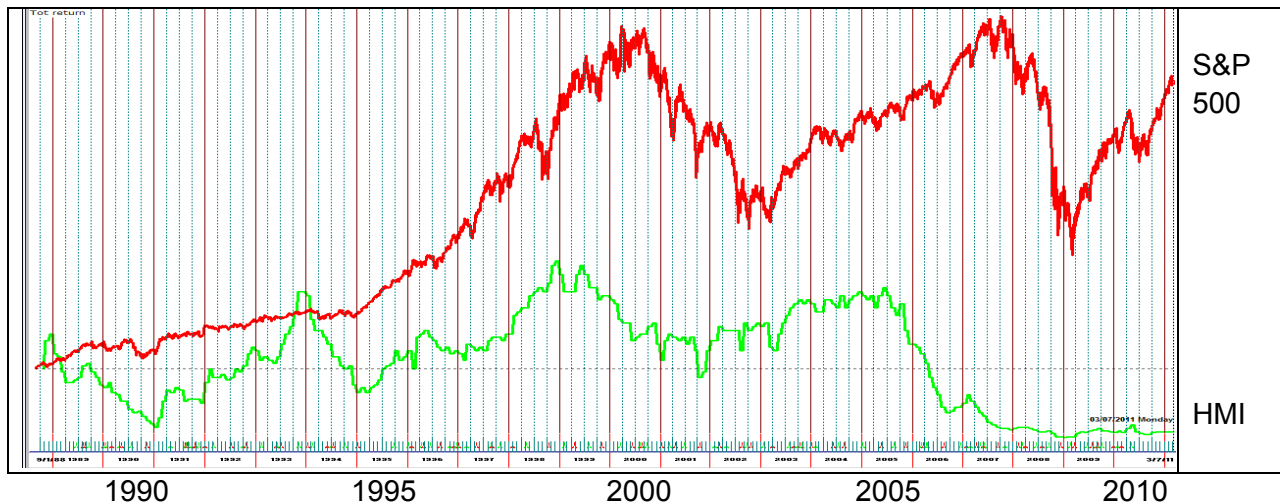
Some say that housing is economically important, but not so important as to be a necessity to economic recovery and continued expansion. The argument goes that housing represents a very small portion of GDP and therefore its impact is not as important as tax rates, economic stimulus, interest rates, trade, defense spending, consumer behavior, unemployment, etc.

Here at Hanlon, our favorite tool for investment management is reviewing the charts. To us, the charts tell the purest, most factual story. Charts represent the price history of investments and the economy, reflecting every opinion of every person that has capital at their disposal and the decisions they make with that capital. Currently, the charts are generally telling a positive story about the stock market and risky asset classes in general, although the Japan nuclear incidents are very much impacting that market as well as some others. The trends, technicals, and breadth all continue to show signs of potential further gains in many risky asset classes. We continue to remain bullish on risky asset classes until the charts tell us differently, which can happen at any time. I know you don't like to read that. You want more certainty and insight into the future. Sorry, we do not do that here at Hanlon; instead we take it all one day at a time, ready to make substantial changes if necessary to attempt to mitigate downside risk.

Recently a chart caught our eye and we share it with you below. It is a chart of the S&P 500 Index plotted against the NAHB/Wells Fargo Housing Market Index (HMI). Clearly there is some type of correlation occurring between these two indices. Specifically, from this chart alone, you can see that housing tends to lead stocks. In some instances housing leads as much as two years prior and in others perhaps a couple months or quarters.

See how the HMI forecasted the S&P 500 Index drop before 2000? The bottom and rise before 2003? The drop in 2007? But alas, where is the HMI forecast for a rise in S&P 500 Index that started in 2009? There is none. Housing has gone flat-line, at best, like in the emergency room when the staff doctor, with paddles in hand, yells "clear!" Being students of the charts, and of course of history itself, we are aware that there are long periods of time, anywhere from 10 to 20 years or longer, where the major equity indices do not break above previous highs. These periods are not so much caused by a lack of earnings growth; instead they are normally caused by a compression of P/E ratios. The P, price, must fall, while the E, earnings, continues to grow. Many believe that the high of the year 2000 was a "ringing in a new market era" and thus began one of these long periods of time where the major equity indices do not set new highs.

S&P 500 Index vs. NAHB/Wells Fargo Housing Market Index (HMI) 1988 - 2011



If that is true, then the stock market highs we saw in 2000, which were revisited in 2007, could be the highs for years to come. Yes, there were slightly new highs in 2007, ever so slightly for some of the major domestic equity indices, but not by much. You can see the range bound nature of the S&P 500 Index on the chart above.

Perhaps housing is providing us some insight as to what the future holds for equities. If so, the end of this latest equity appreciation may not be that far off and a tactical navigation out of equities into better performing, better relative strength asset classes might be around the corner. Hanlon Investment Management specializes in this tactical asset allocation.

Thank you for the opportunity to be of service,



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The Housing Market Index (HMI) is based on a monthly survey of NAHB members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next 6 months as well as the traffic of prospective buyers of new homes. The S&P 500 index is unmanaged; Investors cannot directly invest into the S&P 500. The S&P 500 is comprised of 500 widely held securities considered to be representative of the stock market in general. Investors should understand that the performance data presented comparing the four managed composites to the S&P 500 varies greatly and that depending upon the holdings within each composite, the volatility of the composite may be higher or lower than that of the S&P 500. PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS. The performance of this index does not reflect any fees and charges associated with individual investments or investment advisory accounts. Hanlon Investment Management, Inc. ("Hanlon Investment Management") is an SEC Registered Investment Adviser with its principal place of business in the State of New Jersey. Hanlon Investment Management and its representatives are in compliance with the current registration and notice filing requirement imposed upon registered investment advisers by those states in which Hanlon Investment Management maintains clients. Hanlon Investment Management may only transact business in those states in which it is notice filed, or qualifies for an exemption or exclusion from notice filing requirements. This Research Perspective is limited to the dissemination of general information pertaining to its investment advisory services. Any subsequent, direct communication by Hanlon Investment Management with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of Hanlon Investment Management, please contact Hanlon Investment Management or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). For additional information about Hanlon Investment Management, including fees and services, please visit our website at www.hanloninvest.com. Please read the disclosure statement carefully before you invest or send money.