Sean Hanlon, CFP®
Chairman, CEO and
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Food, Clothing, Shelter; Shelter Part Still Not Good

08/30/11

Warren Buffet was interviewed by Charlie Rose on Bloomberg a week or so past and the conversation reminded me of an indicator that we follow here at Hanlon. Before getting into that indicator and chart, let me repeat portions of what Mr. Buffett had to say about housing.

> *And those people who have a $22 trillion asset at the peak saw the value shrink dramatically. That's -- that's affecting two-thirds of the households in the United States. That had incredible impact on the economy and we won't come back big time until we've worked off the excess inventory that was created during our binge on housing a few years back. But housing -- housing is way bigger than construction workers. Unemployment will fall significantly in my view [later he would mention below 7%] when we get back up to a million housing starts because it won't just be construction workers, it will be our carpet workers where we've laid off 6,000 people, and it will be our brick workers. And go up and down the line. So the big recovery -- we've recovered our corporate profits. We've recovered in terms of getting the banks back in shape, banks are in good shape now. We've recovered in all kinds of areas. I mean it could even be a million [housing starts] or two, we will have and unemployment will fall dramatically.*

Thanks Warren, I could not have said it better myself.

Now, back to that indicator and chart. In March, I shared with you a chart of the S&P 500 Index plotted against the NAHB/Wells Fargo Housing Market Index (HMI) and identified how these indices display a level of correlation. I pointed out from the chart that housing tends to lead stocks; in some instances as much as two years, and in others perhaps a couple months or quarters.

When I wrote the Commentary, I was not looking at the chart as necessarily a market predictor, but instead presented it to demonstrate the correlation that exists between these two indices. The point of that Commentary, which I revisit today, is that movements in the S&P 500 Index are typically forecast by a precursory movement in the HMI. Where was the HMI forecast for a rise in the S&P 500 index that started in 2009? There was none! Housing was and continues to show a flat-line. That does not bode well for equity prices.

In Figure 1, you can see that housing continues to be flat, as depicted by the Red-line. This stagnation in housing may be an important indicator in itself, forecasting a continued lack of direction and increased volatility like we have seen since the beginning of the year in the equity markets.

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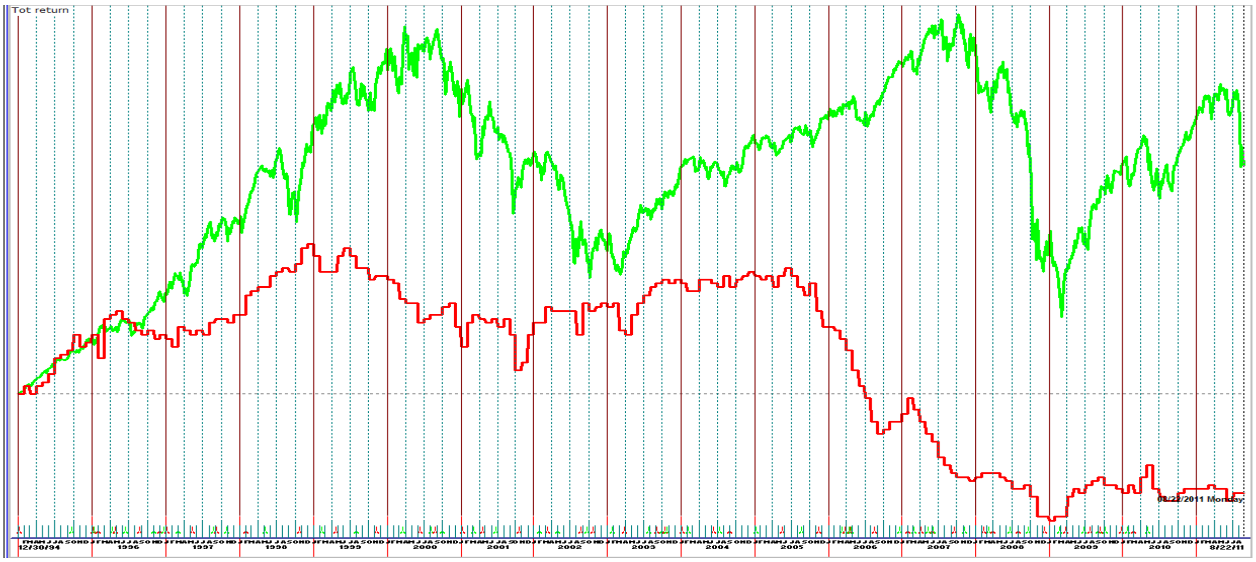
Market Commentary

S&P 500 Index (Green) versus the Wells Fargo Monthly Housing Market Index (Red) – 1/95 to 8/11



Source: FastTrack Figure 1

In March, we concluded the Market Commentary with the following statement: “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.”

As you are aware, Hanlon Investment Management began its tactical move out of equities on June 17th after noticing an increase in volatility present in the markets. This move was prudent as the sharp market declines in early August left investors searching for safety. Minimizing volatility, and more specifically downside risk, has always been at the forefront of our proprietary tactical strategy and we continue to actively monitor our portfolios.

Thank you,

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