

US Rising Housing Cost a Burden for the Dollar

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On the front pages of USA's top newspapers, the New York Times and the Chicago Tribune are articles this week regarding the burden of higher housing costs on the US middle class. At a time when the housing market is losing steam and prices are falling, homeowners can no longer fall back on the rising value of their home as a basis for taking on higher mortgage payments.

Over the past 2.5 years, the Federal Reserve has increased interest rates from 1.00 percent to 5.25 percent, which means that, for some, housing costs may have increased by more than 50 percent. For over a year RIO has been warning members of the increasing danger in this market. Both our weekly reports and RIO Quarterly News have carried articles on this. For example, Page 48 of our Ten Years of Success issue features an article entitled "**US Mortgage Market Collapse**", which highlights the persistent interest rate hikes by the Federal Reserve and the big risk this poses for the US consumer, economy and the US dollar. Today's newspaper reports are clear evidence that all is not well. In my expert opinion, having bought and sold hundreds of properties in several different countries over the years, I would strongly advise readers again, that should you own residential property in the US, it is likely to suffer a serious drop in value.

US residents working in the US are feeling the squeeze!

The number of people paying at least 30% of their gross income on housing increased significantly over the past five years. In New York City, at least 50% of people spend 30% of their income on housing. In Southern California, this balloons to 74%. The most surprising figures are found in Boulder, Colorado and College Station, Texas where more than 45% of people with mortgages spend at least 50% of their income just on housing. This goes to show how stretched US consumers are at the moment. The savings rate in the US is negative as we have said in several reports, with more and more people dipping into their savings to fund their spending.

Will the Housing Market Turn Around?

Unfortunately, RIO predicts that the US housing market situation will most likely worsen before they get better. In a detailed report last year RIO highlighted the fact that, with over a \$1 trillion worth of adjustable rate mortgages resetting this year, there are still more homeowners that will face the burden of higher mortgage costs. New and existing home sale figures have been very disappointing over the past few months and inventories are rising overall. Short term reprieve comes from the drop in oil prices which has made matters a lot easier for the average consumer and could keep them spending for a bit longer but, if the housing market continues to worsen, we believe that the only solution would be for the Federal Reserve to step in and lower interest rates. By doing so, they would reduce the rates at which these adjustable rate mortgages are reset, which would help to reduce some of the housing market costs. We feel that the Federal Reserve is not quite ready to take that step at

the moment, because the extent of the downturn in the housing market is still unknown; as usual they are again waiting on evidence of a significant impact on consumer spending.

RIO predicts a rate Cut would be Negative for the US Dollar.

Interest rate cuts are good for the consumer, because they reduce mortgage rates and credit card payments but, at the same time, they can have a very negative impact on the US dollar. On that note, the RIO options account, which trades in Dollar/Sterling and Dollar/Yen exchanges, has not seen much action lately. In fact those who watch the currency markets will know that trading has been extraordinarily quiet. Everyone is sitting on the sidelines waiting to jump into the next big trade. The Federal Reserve has kept interest rates on hold since August, and recent economic data has warranted no further changes to interest rates for the time being. One reduction is usually followed by more and, in a world where money shifts from country to country in seeking higher and growing yield, a rate cut by the Federal Reserve could lead to a mass exodus out of the US dollar. This would benefit currencies such as the Euro, British Pound and Japanese Yen.

Our recommendation is; sell the Dollar and hedge any possible down side by investing in a top performing alternative currency Fund. **Members who chose to invest in the RIO Prestige Performance Fund, selling US Dollars to Sterling to do so, have already benefited from the weakening Dollar. The fact that RIO Prestige Performance Fund is still RIO's top performing Fund this year just puts the icing on the cake; with an average gain of 2.49% per month through August 05-August 06 it is a hard act to follow. The same trend continued during September, adding a further 1.06 % to the overall gains. To date, the record shows 12 gaining months and one losing month since August 05 with the underlying asset of the Fund, RIO Prestige Performance UK Ltd, having a very strong start to October.**

In overall terms, however, RIO does not expect the Federal Reserve to bring out the axe until next year, so there is still time to re-position portfolios!

William Gray

Executive Chairman.