

# Investment Matters

For the quarter ended March 31, 2015

## Will Rate Hikes Kill Housing?

The Great Recession, which clobbered the economy in 2008-09, had its roots in the collapse of the housing market. Because most houses are purchased with borrowed money, housing has always been quite sensitive to mortgage interest rates. These rates have been very low since 2009.

Despite this stimulus the housing industry has grown slowly since 2009. New home construction is proceeding at only about 40% of the peak rate in 2006. Housing starts in February were actually lower than the same month last year. This weak performance suggests that the housing industry may be unusually fragile at this time.

Recent announcements by the Federal Reserve that they intend to begin raising interest rates later this year have led to concern for the housing market. The fear is that a fragile market will be deeply impacted by even a small increase in rates.

This view was recently countered by Brian Westbury, Chief Economist for First Trust. He observes that the weak market report in February was largely due to the unusually cold and snowy weather in much of the country. He notes that although new construction may have been curtailed in February, actual new home sales, which are less dependent on the weather, were up nearly 8%.



THE PACE OF HOUSING STARTS, ALTHOUGH RISING, IS STILL FAR BELOW THE 2006 PEAK

Although the housing industry is sensitive to many factors including weather, interest rates and price levels, in the long run it is

unemployment is down; wage growth is picking up; average weekly earnings were up 2.6% last year.

The rising cost of renting is another factor favorable to homebuilding. The interest rate on a 30-year mortgage is almost exactly equal to the current growth rate of rents. Historically it has been about 3% higher. Why would someone rent when the cost of owning is the same. Those who can qualify will mostly opt for buying a house until mortgage rates are considerably higher than they are today. Don't worry about housing.

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most dependent on supply and demand. Right now it looks like demand is growing faster than supply. Based on population growth and the loss of existing houses from fires, teardowns and natural disasters, Mr. Westbury estimates that housing starts will rise 50% in just the next 2-3 years.

Other factors are also driving up demand. Job growth has improved;

**“Housing... demand is growing faster than supply.”**

## IRA Tips & Tricks

It is tax time and you might be asking yourself questions about your IRA: Can you contribute this year? Can your spouse contribute? Should you switch to a Roth IRA?

Unfortunately, the answer is usually, “it depends...”. The rules for IRAs are complex and the penalties for making mistakes can be severe. Unless you are confident that what you are planning to do complies with the law and is most advantageous to you in the long run, it is best to seek professional advice. That said, here are some thoughts.

The 2015 contribution limit for a traditional IRA is \$5,500 up to age 50 and \$6,500 thereafter. For this you get an immediate tax deduction. There is no high income limit but you must have earned income at least equal to the value of the contribution. You may not be able to make any contribution if you are covered at work.

Consider a Roth IRA. Although there is no tax deduction for a Roth IRA contribution, the money grows tax free for the rest of your life and there are no required Minimum Distributions after age 70 and 1/2. Contribution rules are also different for a Roth IRA so it is wise to seek professional help.

Many people fail to realize that they can make an IRA

*Continued on page 2.*

**IRA: continued**

contribution for their non-working spouse, either to a Roth or traditional IRA. Again, take the time to be certain you are following the rules.

Many people fail to name a beneficiary of their IRA. This is a serious mistake. Not only does a beneficiary form trump the general instructions in your Will but it allows the IRA to continue tax free as an Inherited IRA long after your passing. Both primary and contingent beneficiaries should be named so this tax advantage cannot be lost if the primary beneficiary passes before you do.

Lastly, do not rely on the IRA trustee to keep your beneficiary designation. The information could be lost. Keep a copy with your important papers.

Despite a weak February report, new job growth has averaged 261,000 per month for the last six months.

## Not Widely Known

**I**n 1992 Americans spent about \$162 on food from grocery stores for every \$100 spent at restaurants. Over time, restaurant spending has gradually increased so that spending for each category is now equal.

**B**ased on the energy equivalent cost of ethanol vs. gasoline, the mandated inclusion of ethanol in gasoline adds about \$47 to the annual fuel cost for each driver in the U.S.

**A**verage hourly wages have increased 428% in the 42 years since 1972. Over the same period the increase in the Consumer Price Index for new vehicles (adjusted for quality improvements) has risen only 167%.

**O**n March 9<sup>th</sup> the bull market in stock prices entered its 7<sup>th</sup> year. The price of the S&P 500 has more than tripled over that time period.

**C**rude oil production in the US reached 9.28 million barrels per day during the second week of February, the highest level of domestic oil output since April 1973, almost 42 years ago.

**O**ver the last 12 years, the average annual hedge fund returned 7.5% per year vs. the S&P 500 Index which recorded an 11.1% average return. Hedge funds outperformed in only three of the last 12 years.

**I**n 1980 41.5% of young adults aged 18-34 indicated that they had never been married. More recently that number had climbed to 65.9%.

**H**ouseholds are shrinking. The average number of people in a U.S. household has dropped from three in 1973 to 2.5 in 2013, a 16% decline.

**A**mazingly, in the entire history of the United States, there have only been two sitting US presidents who have visited the New York Stock Exchange while in office: Ronald Reagan in 1985 and George W. Bush in 2007.

**A**ccording to the Census Bureau 23.7% of all American households have no earned income and the percentage of two-earner households has declined from 45% to 40% in the last 40 years.

**L**argely because of the American Shale Revolution, the US produced 88.5% of the energy consumed last year (through October) which was the highest level of energy self-sufficiency since 1985, almost 30 years ago.

**T**he sales revenue from just the top ten US manufacturing industries totaled \$4.84 trillion in 2014, which was equivalent to Japan's entire GDP of \$4.8 trillion last year, and about \$1 trillion more than Germany's entire estimated GDP of \$3.875 trillion in 2014.

**T**he Congressional Budget Office recently raised its forecast for the 2015 government budget deficit by \$18 billion to \$486 billion, equal to about 3% of the entire U.S. economy.

**W**hen asked what percent profit on each dollar of sales the average manufacturing company made after taxes, a random sample of Americans recently guessed 36%. The correct answer is 6.5%.

## The Bottom Line: 3/31/2015

Market Indicator	Current Value	One Year Change
Large company stocks (S&P 500 Index)	2068	12.7%
Small company stocks (S&P Small Cap Index)	720	8.7%
Short term interest rates (3 Month T-Bill Yield)	0.1%	No change
Long term interest rates (10 Year T-Bond Yield)	1.9%	From 2.6%
Inflation (Consumer Price Index)	235.2	-0.1%
Energy (West Texas Intermediate Crude Oil)	\$47.496bbl.	-53.2%
The economy (Inflation adjusted GDP)	\$17.7 trillion	2.4%

**QUOTABLE**

*"Treat all economic questions from the viewpoint of the consumer, for the consumers' interests are the interests of the human race."*

Frederick Bastiat, Economist

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