



MADISON'S TIMBER PREVIEW

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Investors, analysts, and markets are waiting for September and October US housing starts to be released next week, even as other data and company financial reports are pouring in.

Recently updated forecasts by the National Association of Home Builders (NAHB) indicate that US housing starts are expected to rise to a seasonally adjusted 1.15 million rate in 2014, from 924,000 this year.

Most lumber industry executives said any further gains in lumber prices likely would be in line with this anticipated incremental rise of housing starts, according to *MNI Market News* Monday.

"We expect demand to be roughly the same in 2014," said Mark Pawlicki, a spokesperson for Sierra Pacific Industries, based in Anderson, CA, and the second-largest lumber producer in the US. "We're looking for no major bump in the graph."

"[Lumber] Buyers have been cautious," Pawlicki said. "They don't buy out in front of the market, and they don't build inventories."

Mark Jaffe, president of Friend Lumber, a lumber retailer in Hudson, NH, said price volatility this year caused mills to cut production to levels at which they thought they could sell immediately, rather than building up stocks.

"The prices went down so low that the mills didn't come back up [production]," he said to MNI.

Any further increase in the rate of housing starts is likely to produce an uneven response from lumber prices even if they end up reflecting demand from the housing industry, Jaffe said.

"As housing gets more active, there is a tendency for increased production but it goes in fits and starts," he said.

One sign that housing prices are continuing their recovery is the high spike in institutional spending that's been happening in the construction sector. Recently, several construction stocks have experienced growth in purchasing from hedge funds, mutual funds, and the like.

In a striking example, Home Depot's profits rose a whopping 43 per cent last quarter, beating analyst estimates.

This might not be such a big deal in its own right if Home Depot weren't such a helpful microcosm of consumer sentiment, said *Kapitall Wire* Thursday. As the country's largest home improvement store, investors always pay close attention to Home Depot for clues as to how the housing market, and the American economy as a whole, are recovering.

As if in confirmation, Andres Cardenal of *Motley Fool* wrote Wednesday that home improvement retailers like Home Depot, Lowe's, and Lumber Liquidators are reaping the benefits from the estate recovery and reporting rock-solid financial performance for investors.

"Even if valuations are getting stretched, these companies are firing on all cylinders and their recent highs might be justified," said Cardenal.

These companies are priced for growth, and so far all three are delivering the kind of performance expected of companies with their respective valuations. As long as the real estate recovery continues providing

strong tailwinds and they keep capitalizing on the opportunity, these home improvement retailers are building on sound foundations.

The NAHB reported existing home sales in October fell 3.2 per cent from September, to a seasonally adjusted 5.12 million units. That's an annualized estimate of single-family homes, townhouses, condominiums and co-operative apartments.

The sales rate peaked at 5.39 million units in July and August and has fallen 5 per cent since. The NAHB blamed higher interest rates and lack of inventory for the October decline. But odds are existing-home sales will total about 5.1 million units for the year, up 9.8 per cent from 2012 -- potentially making it the best sales year since 2007.

About 2.1 million homes were for resale nationally in October, little changed over the last seven months. At current sales rates, that represents a five-month supply. Traditionally, a six-month supply of homes is considered normal.

First time buyers remain on the sidelines, representing 28 per cent of all home purchases, which is below the historical average. That rate has fallen below 30 per cent for 7 straight months. At the same time, cash purchases remain elevated and account for about 31 per cent of home purchases. Investors snapped up 19 per cent of the market, similar to the September sales figures.

Sales in coming months are also expected to be hampered by a lack of inventory on the market and a government shutdown that has halted some final property transactions.

House prices may be an impediment to housing, as they are up about 10 per cent from a year ago. The median price was US\$199,500 in October, up 0.5 per cent from September, and 12.8 per cent from a year ago. But the price can fluctuate wildly. It was US\$154,700 in the Midwest, US\$171,500 in the South, and US\$284,000 in the West, which reflects high prices in California.

But to hear Home Depot and Lowe's executives talk about the market, rising home prices are a good thing. Purchases of US\$500 or more of building materials were up 8.6 per cent in 3Q for Lowe's, compared with just 3.6 per cent for purchases of US\$50 or less. Home Depot said sales of US\$900 or more grew 10.3 per cent from a year ago. That's 20 per cent of total sales. Sales of US\$50 or less -- also 20 per cent of sales -- were up just 3.1 per cent for Home Depot.

This new round of home investment has barely started, however. Sales still haven't recovered to pre-recession levels, both companies said. And interest rates haven't been a factor.

The National Association of Home Builders/Wells Fargo Housing Market Index (HMI) remained at 54 in November, the Association said Monday. This marked the sixth consecutive month that more home builders viewed market conditions as good rather than poor.

Current sales conditions stayed at 58, while expectations for future sales fell one point to 60. Buyer traffic was the index's worst-performing component, dropping one point to 42.

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