

Financial Cycles and Real Estate

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REALTOR® University Lecture

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Financial Cycles

“About every ten years, we have the biggest crisis in 50 years.”

-Paul Volcker

“The banking failures for the current year have been numerous, greatly aggravated by the collapse of unwise speculation in real estate.”

-Report of the Comptroller of the Currency, 1891

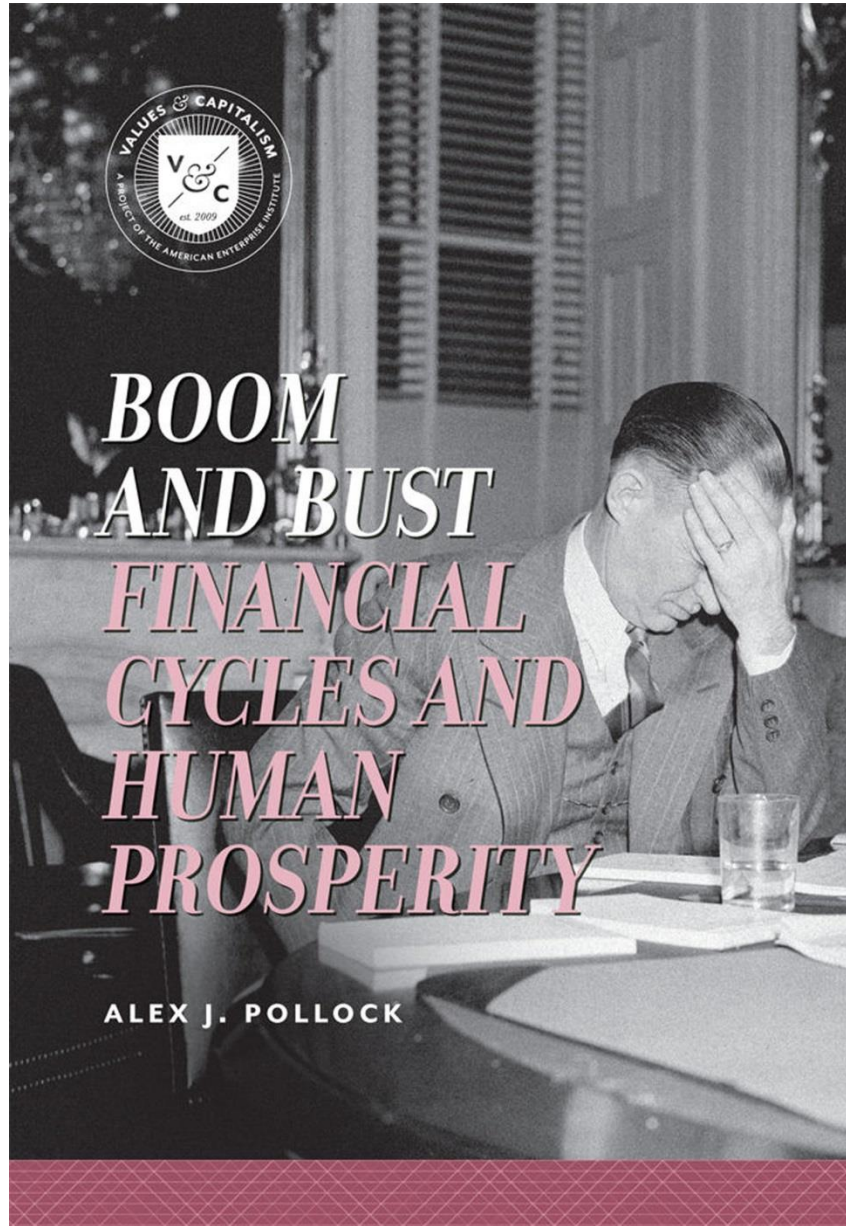
Political and Regulatory Overreaction

“In 1360, Francesh Castello, a failed banker, was beheaded in front of his bank.”



**BOOM
AND BUST**
*FINANCIAL
CYCLES AND
HUMAN
PROSPERITY*

ALEX J. POLLOCK

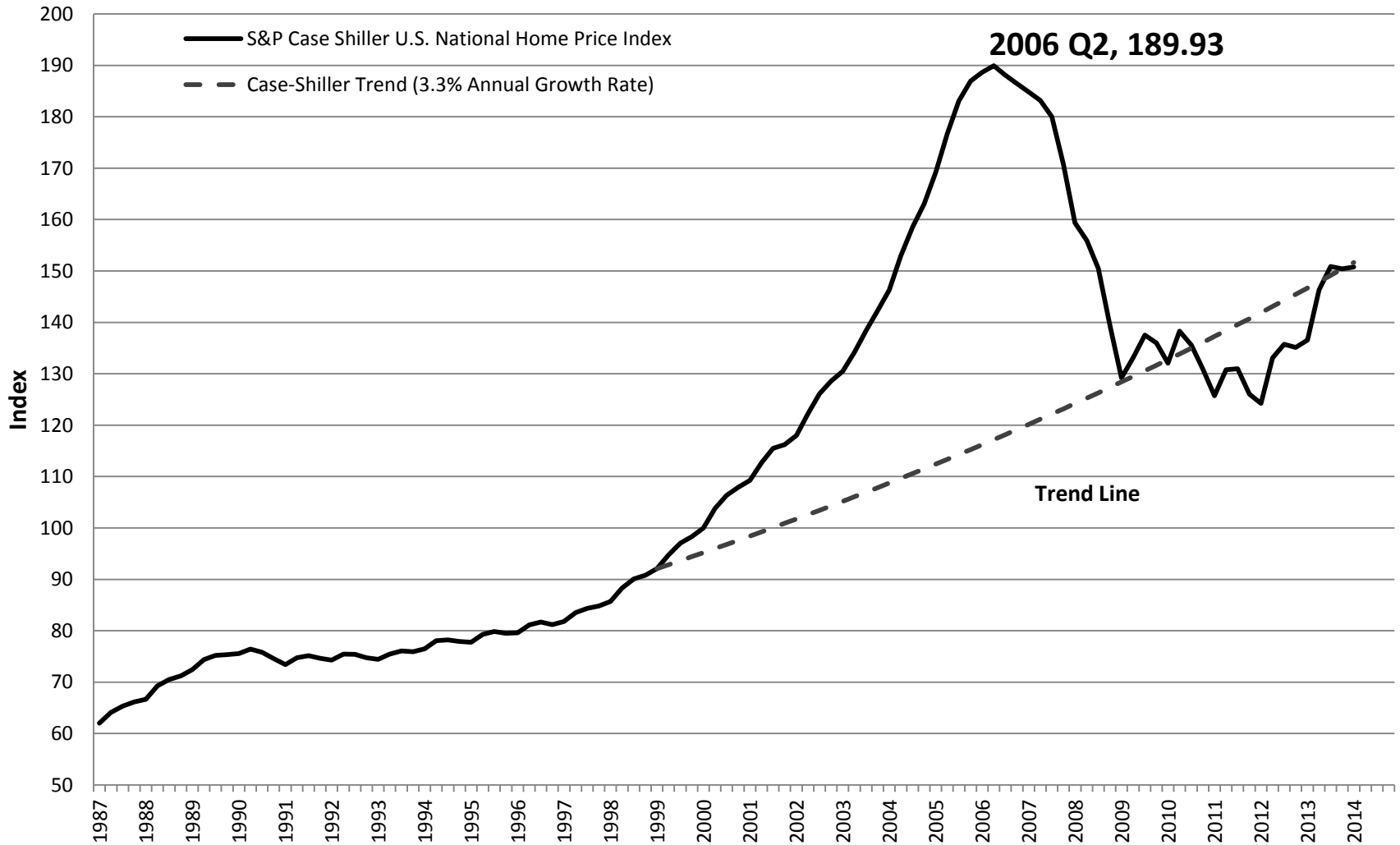


Cycles of Prices and Leverage

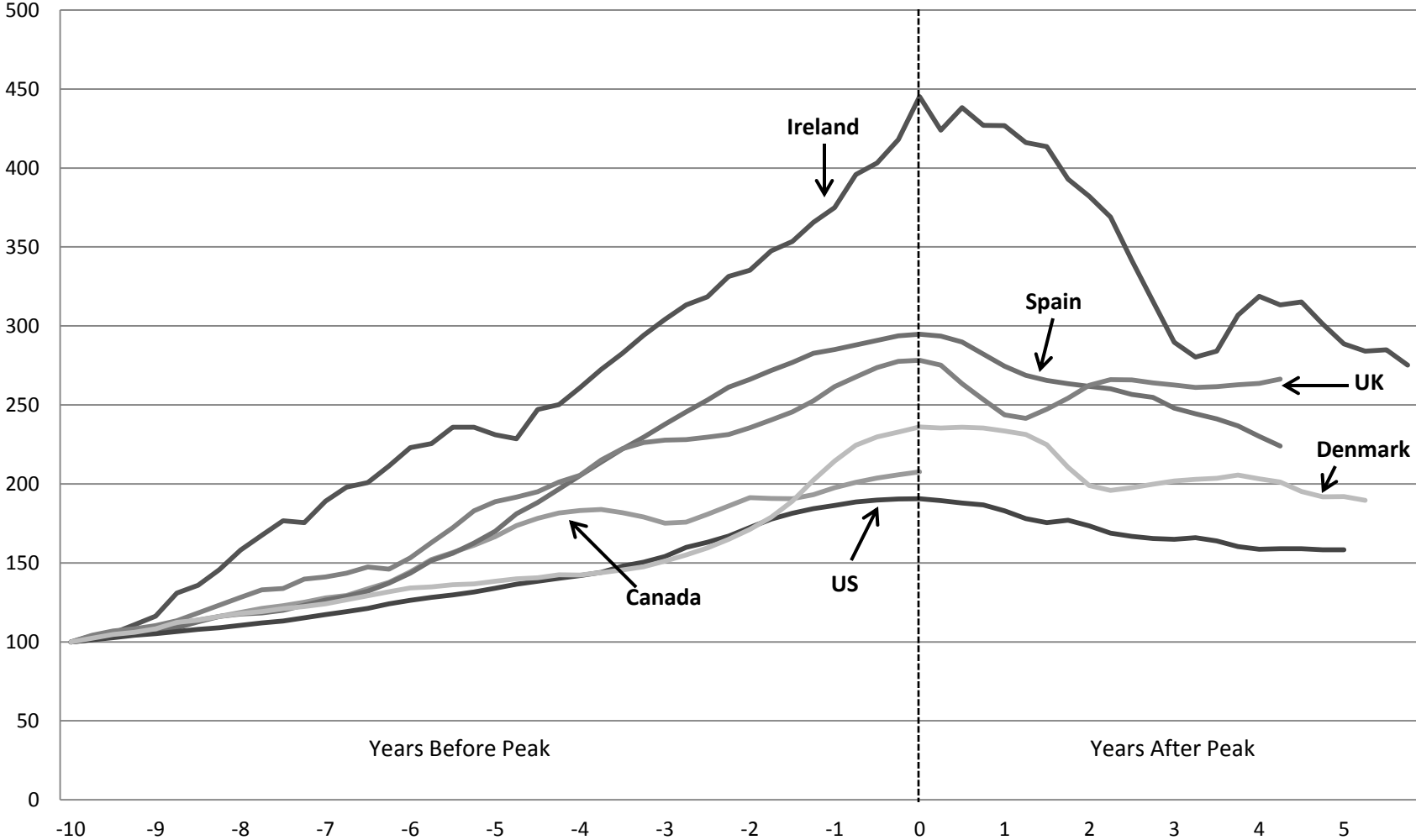
What is the collateral for a mortgage loan?

How much can a price change?

The U.S. Housing Bubble: Case-Shiller National Home Price Index Values 1987-2014

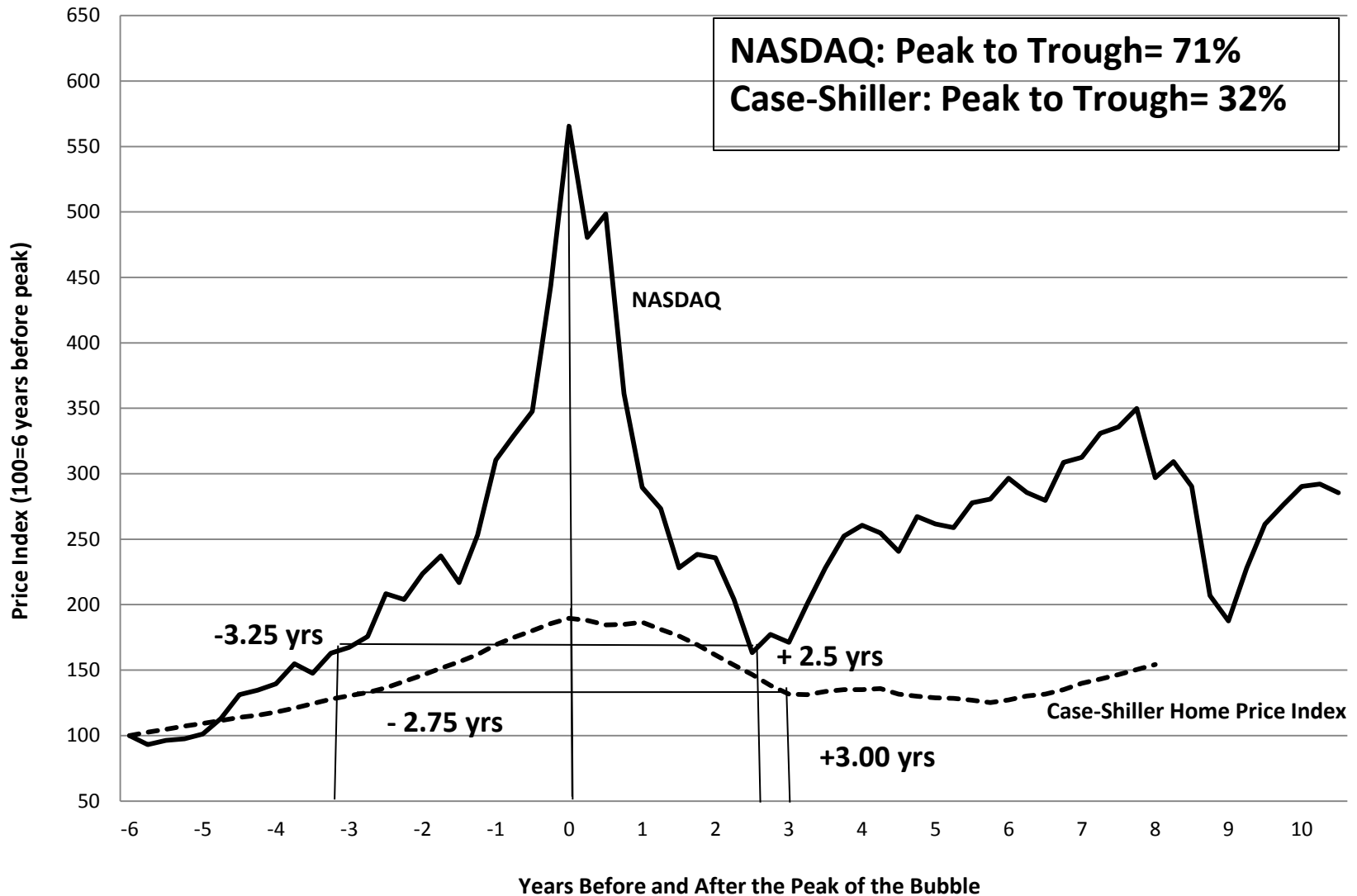


International Comparative Housing Bubbles



Source: Bloomberg

Comparative Bubbles: NASDAQ v. House Prices



10-YR Treasury Note Rate

Fearful Symmetry

1950-2014



It's Easier to be Brilliant than Right

“The mercantile community will have been unusually fortunate if during the period of rising prices it has not made great mistakes. Such a period naturally excites the sanguine and the ardent; and the ablest and cleverest the most.”

- Walter Bagehot, 1873

It's Easier to be Brilliant than Right – 2

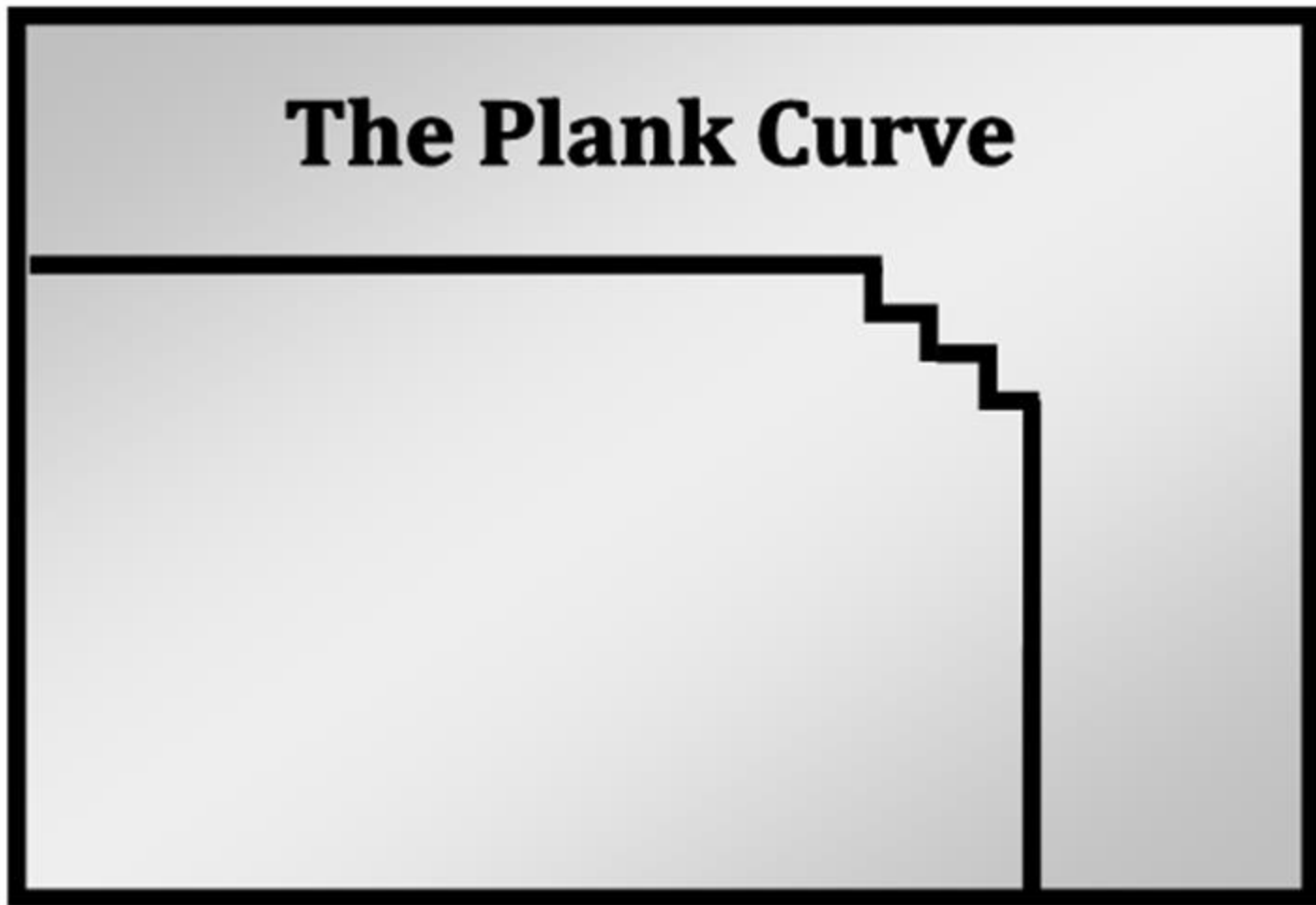

“There is nothing so disturbing to one’s judgment as to see a friend get rich.”

“I can calculate the motions of the heavenly bodies, but not the madness of people.”


-Isaac Newton

The Plank Curve

Liquidity Available



Perceived Risk and Generalized Fear



The source is Alan E. Grunewald and Alex J. Pollock, 'Money Managers and Bank Liquidity,' 1985.

“Risk is the price you never thought you would have to pay”

For example:

Fannie Mae and Freddie Mac

Total Profits 1971-2006: \$106 billion

Total Losses 2007-2011: \$256 billion

Net Results 1971-2011: \$150 billion loss

Housing Busts

Recent authority:

“The duration of housing price declines has been long lived, averaging roughly six years.”

-Carmen Reinhart and Kenneth Rogoff

Ancient authority:

“Pharaoh had a dream: out of the river there came up seven cows, sleek and fat, and they grazed among the reeds. After them, seven other cows, ugly and gaunt, came up out of the Nile...And the cows that were ugly and gaunt ate up the seven sleek, fat cows.”

-Genesis 41

“Loans which cannot be repaid will not be repaid.”

-Pollock's Law of Finance

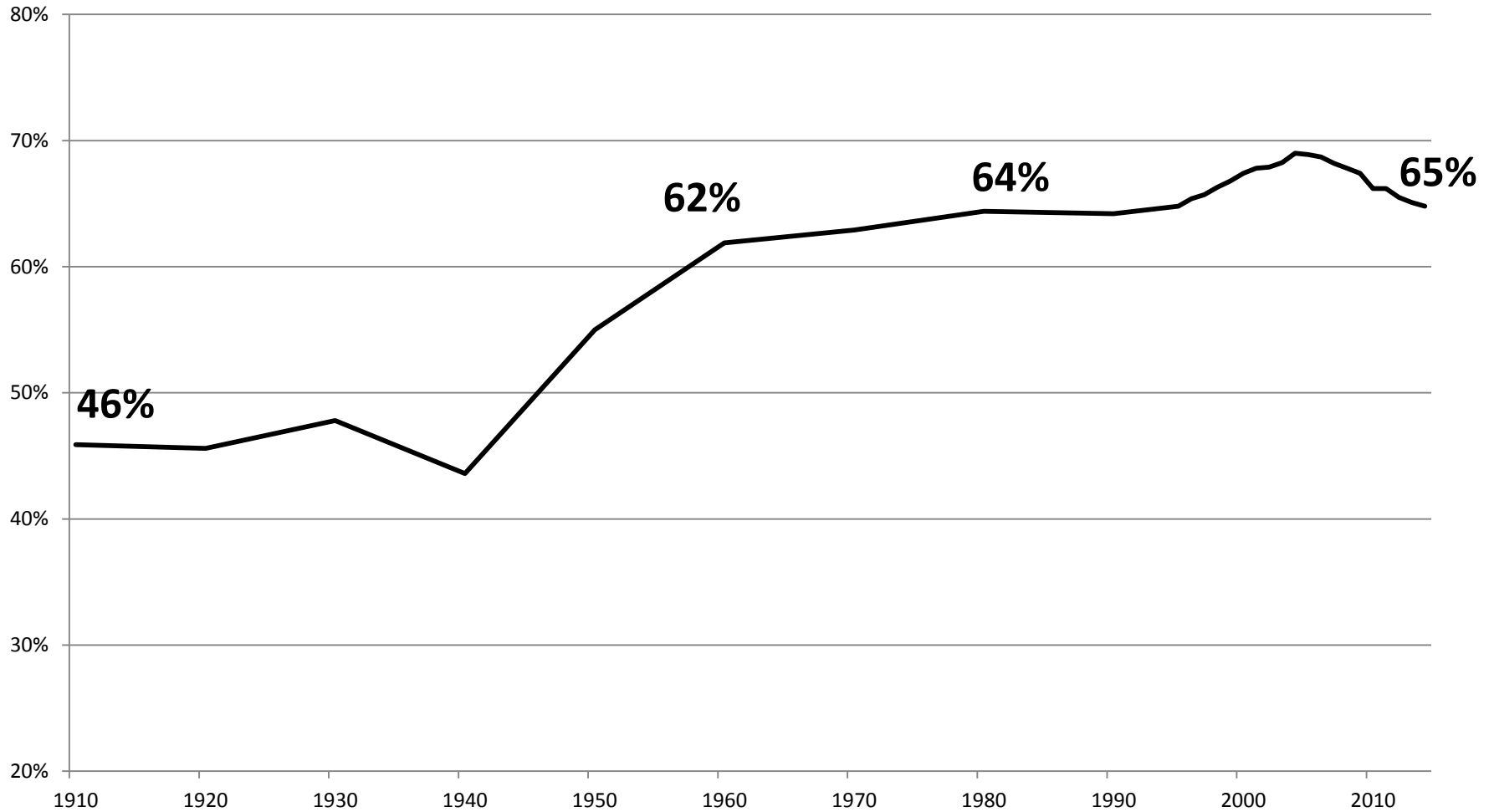
Failures of Imagination

“Many things which were considered impossible nevertheless came to pass.”

-Freeman Dyson

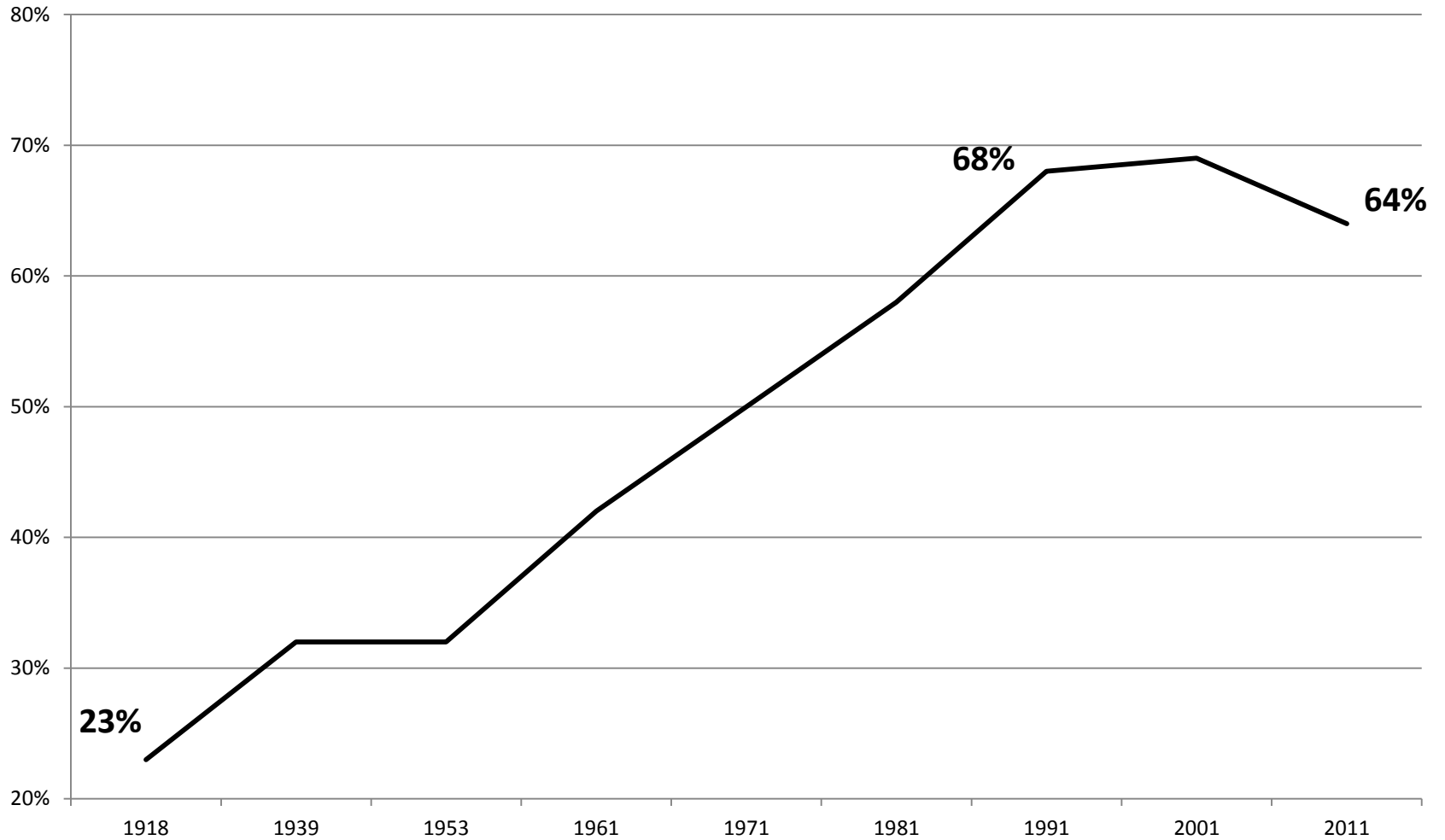
100-Year U.S. Homeownership Rate

1910-2014



Source: United States Census Bureau

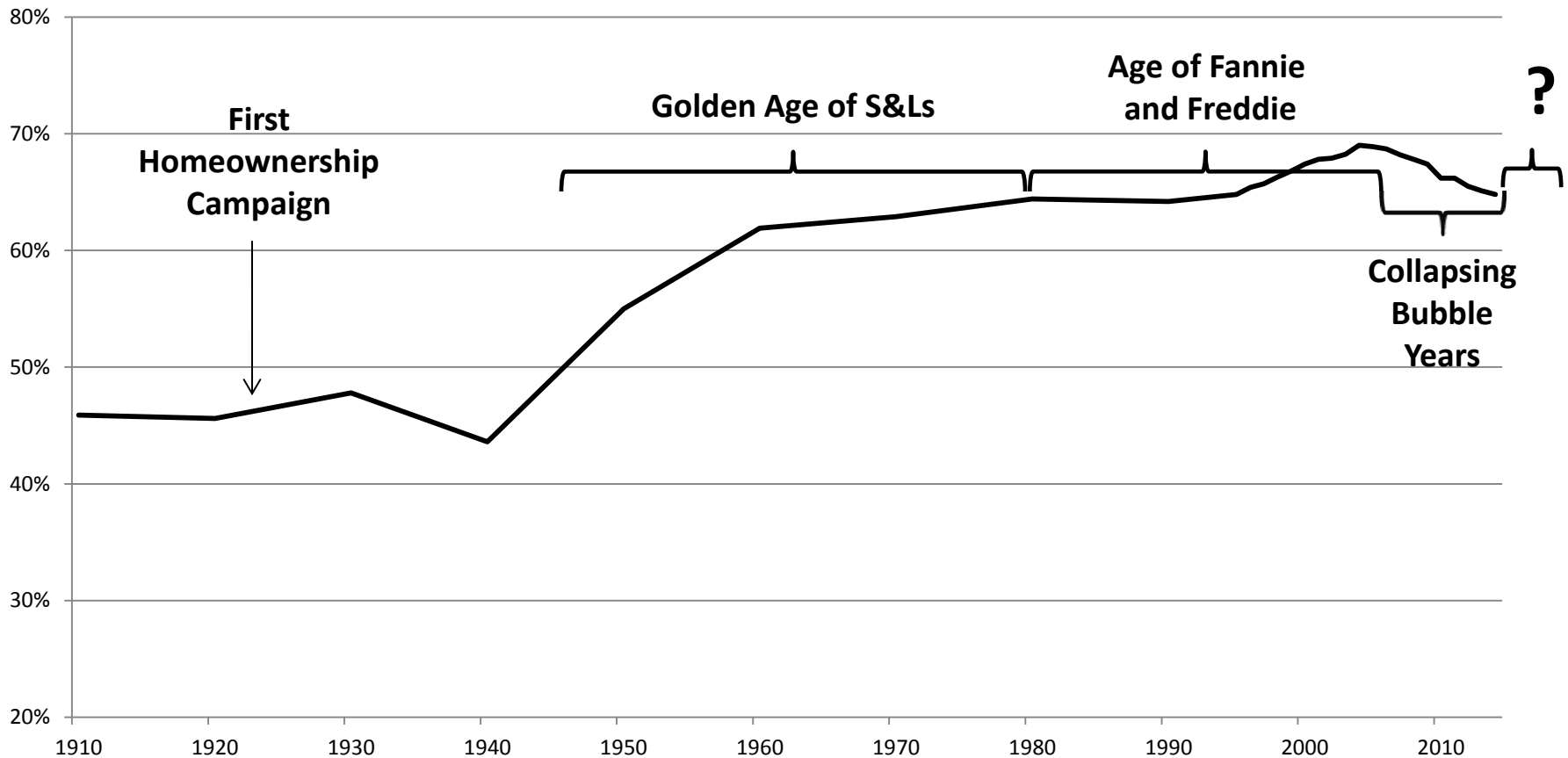
England Long-Term Homeownership Rate 1918-2011



Source: United Kingdom National Statistics

U.S. Housing Finance Eras

100-Year U.S. Homeownership Rate 1910-2014



Source: United States Census Bureau

The Role of Government

“The subprime mortgage problems are contained.”

-Common official statement, 2007

“We had no choice but to fly by the seat of our pants, making it up as we went along.”

-Secretary of the Treasury Paulson
about the financial crisis

The Role of Government in Housing Finance (and in general)

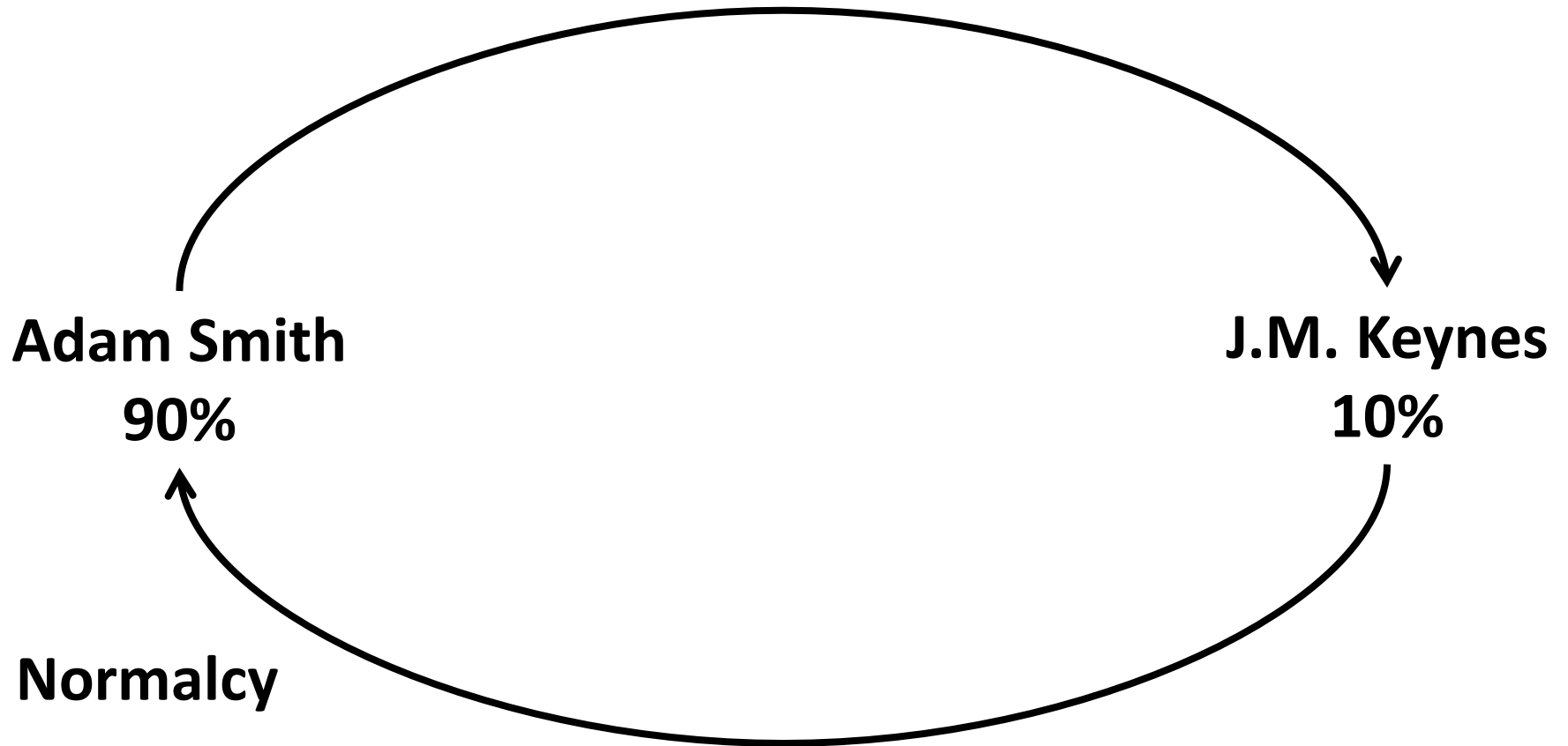
Two Theories

- Adam Smith
- J.M. Keynes

The Pollock Proposal

- Adam Smith—90%
 - Normal Times
- J.M. Keynes—10%
 - Times of Crisis

The Cincinnatian Doctrine



The Cincinnatian Doctrine

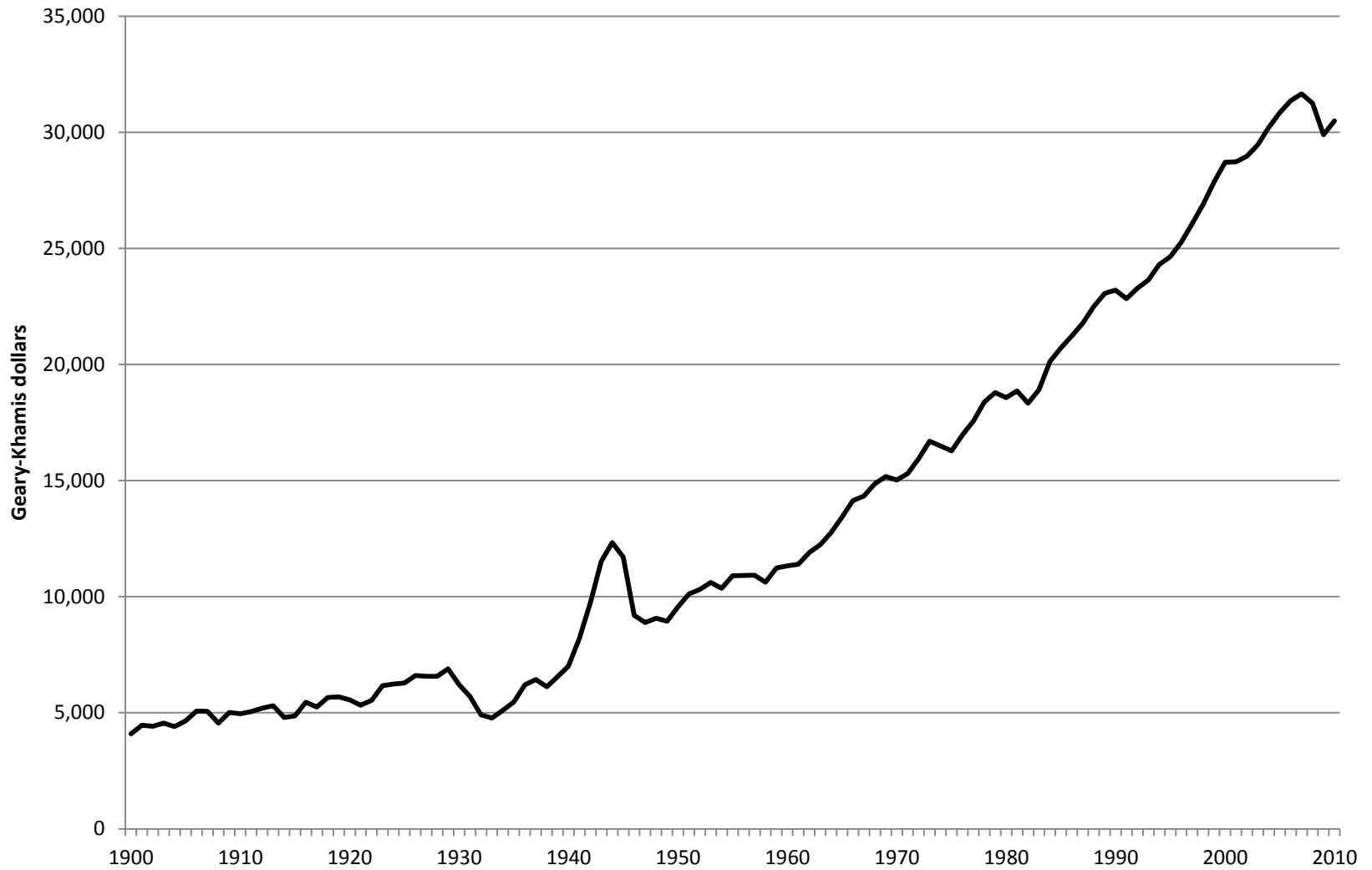
The Key: Withdrawing after the crisis

The Model: The Roman Hero Cincinnatus
(flourished 5th century B.C.)

“The Modern Cincinnatus”: George Washington

Contrast: Dodd-Frank, Fannie-Freddie, Fed

U.S. Per Capita Real GDP since 1900



Source: Maddison Project

In Sum

“The capitalist process progressively raises the standard of life of the masses. It does this through a series of vicissitudes.”

-Joseph Schumpeter

“A period of transition is a period between two periods of transition.”

-Jacob Viner