

THE FEDERAL FUNDS RATES AND THEIR EFFECT ON THE PORTFOLIO OF HOMEBUILDING SECURITIES

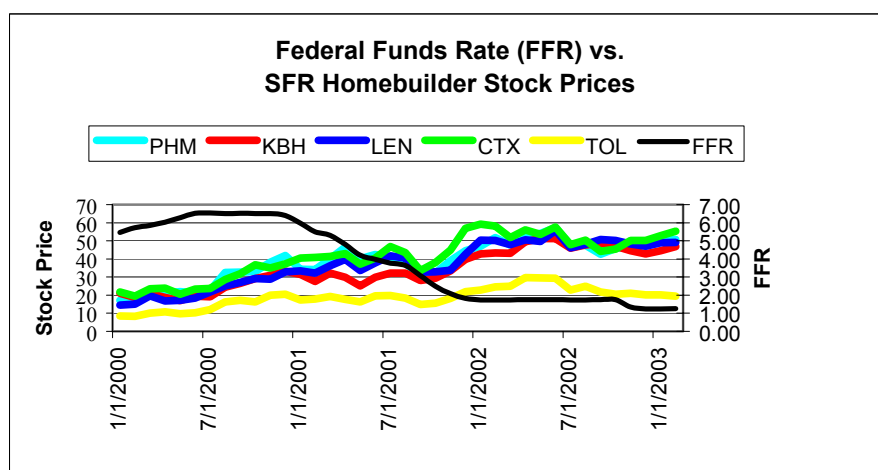
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ABSTRACT

The purpose of this paper is to analyze and compare the Homebuilder's sector and its correlation to Federal Funds Rates fluctuations during both the recent housing market boom in an effort to better predict a correction.

THE DATA AND METHODOLOGY

There were two (2) kinds of data used for this research: 1.) The average Federal Funds Rates (FFR) taken from the first market date of that given month; and 2.) The adjusted closing price of the top five (5) (Market Share) Single Family Residential (SFR) Homebuilder securities. Historical FFR data was collected from January 1988 to December 1992, and from January 2000 to December 2003.



The above chart compared the FFR to SFR Homebuilder stock prices from January 2000 to March 2003. The chart indicates a correction in the housing market beginning in 2000. Following a brief period of SFR stock price decline in conjunction with the rising FFR, these stocks began to reflect the forecasted decline of interest rates predicted by the FOMC. In fact, we see a steady increase in these stock prices approximately 6-months prior to the Fed reducing the FFR. This can be at least in part due to the language being used by the Fed in that the market could expect the lowering of the FFR.

ANALYSIS AND CONCLUSIONS

Can future SFR stock prices be dictated by the fluctuations in the FFR? This is the question that analysts and Wall Street are debating. The vast amounts of money that has flowed into mortgages these past few years is believed by many to have created an emerging housing bubble. This study found that an analysis of historical data of the FFR, and SFR Securities does in fact indicate a negative correlation. The data affirms that FFR fluctuations can and will influence SFR stock prices.