

How to Speculate in Housing Futures and Options By Gary D. Halbert

Sometime in the near future, the Chicago Mercantile Exchange (CME) will introduce new housing futures and options markets. While other industries, such as agriculture and the financial markets, have access to a wide range of financial risk management tools, such tools have not been available to the housing industry – until now. The CME is continuing its tradition of innovation with the creation of the first comprehensive products to hedge risk in real estate.

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The CME housing futures and options will provide opportunities for protection in down markets, and extend to the housing industry the same financial tools that have been available in many other commodities for years. By providing a means of hedging exposure to home prices, they can diffuse the potential impact of sustained declines in housing prices. According to the CME, the new housing futures and options markets will:

1. Create a new means of risk transfer to a broad range of investors;
2. Have the potential for fostering stability in the housing industry; and
3. Provide an innovative way to participate in the real estate market without having to buy and sell properties.

The new futures markets will be based on the S&P/Case-Shiller Home Price Indexes. The housing futures and options are cash-settled to a weighted composite index of US real estate prices, as well as to specific markets in 10 major U.S. cities:

Boston, Miami, New York, San Diego, San Francisco, Washington, D.C., Chicago, Denver, Las Vegas and Los Angeles. Other cities are expected to be added in the future.

Karl Case and Robert Shiller are two widely-known economists at Yale. Some 20 years ago, they began developing various indices to measure home values. They believe their so-called Case/Shiller indices are the most accurate indicators of residential real estate values around the country.

While the new CME housing futures and options are targeted mainly at institutions and large homebuilders, they may prove attractive to individual homeowners and rental property owners and investors in general.

Home and rental property owners will be able to hedge their property values by shorting housing futures and protect from a downward move in prices. Investors who believe that housing prices will continue to increase will be able to go long in housing futures and benefit if prices do in fact go up. Of course, they can also lose if prices go down.

A spokesman for the CME told me in late March that the new housing futures and options will begin trading “sometime in the second quarter.” He also indicated that each futures contract would represent approx. \$70,000 in value. See my April 11 E-Letter for more details on the new housing futures.

It will be very interesting to see how these new markets are accepted, especially with home prices starting to soften in many parts of the country. As a warning, I would not recommend that most investors get in this market. Remember, futures trading is very risky, and risks can be even higher in a new market such as this. I'll keep you posted.

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