

QUARTERLY UPDATE

CWS CAPITAL PARTNERS LLC

CWS Capital Partners LLC

CWS

CALENDAR OF EVENTS

November 2012

CWS Capital Partners
Semi-Annual Conference Call

Thursday, November 22, 2012

Thanksgiving Day
CWS Offices Closed

Friday, November 23, 2012

Day after Thanksgiving
CWS Offices Closed

Tuesday, December 25, 2012

Christmas Day
CWS Offices Closed

Tuesday, January 1, 2013

CWS Office Closed in Observance of New Year's Day

January 15, 2013

4th Quarter 2012 Estimated Tax Payment Due

January 25, 2013

4th Quarter 2012 Quarterly Packages Mailed

April, 2013

CWS Annual Partners Meeting



www.cwscapital.com

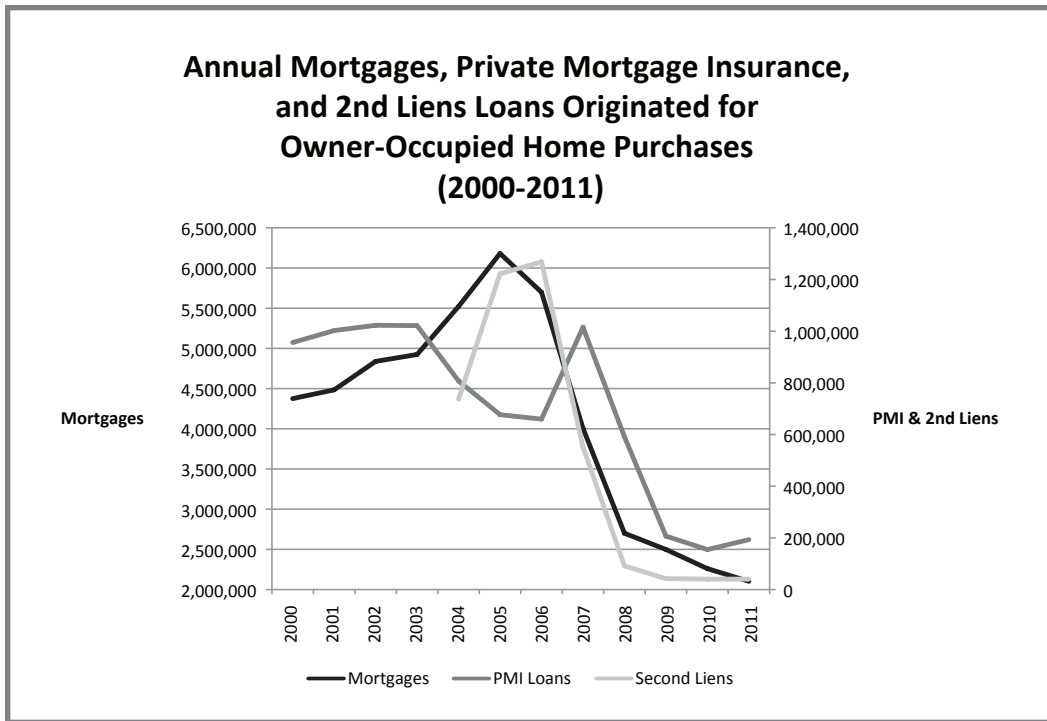
HERACLITUS, JUNG, AND THE ROAD TO DAMASCUS



By Gary Carmell

The graph at the top of page 2 speaks volumes about the collapse in the lending market for owner-occupied home purchases in the United States. This picture depicts one very frothy mid-2000s lending market in which a large percentage of purchasers supplemented their first mortgages with second liens while "protecting" lenders through the purchase of private mortgage insurance. We all know what happened to the housing market as loans went bad and credit tightened. Mortgage volume has dropped by approximately 67% from the peak for home purchases among owner-occupants.

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Source: http://www.federalreserve.gov/pubs/bulletin/2012/PDF/2011_HMDA.pdf

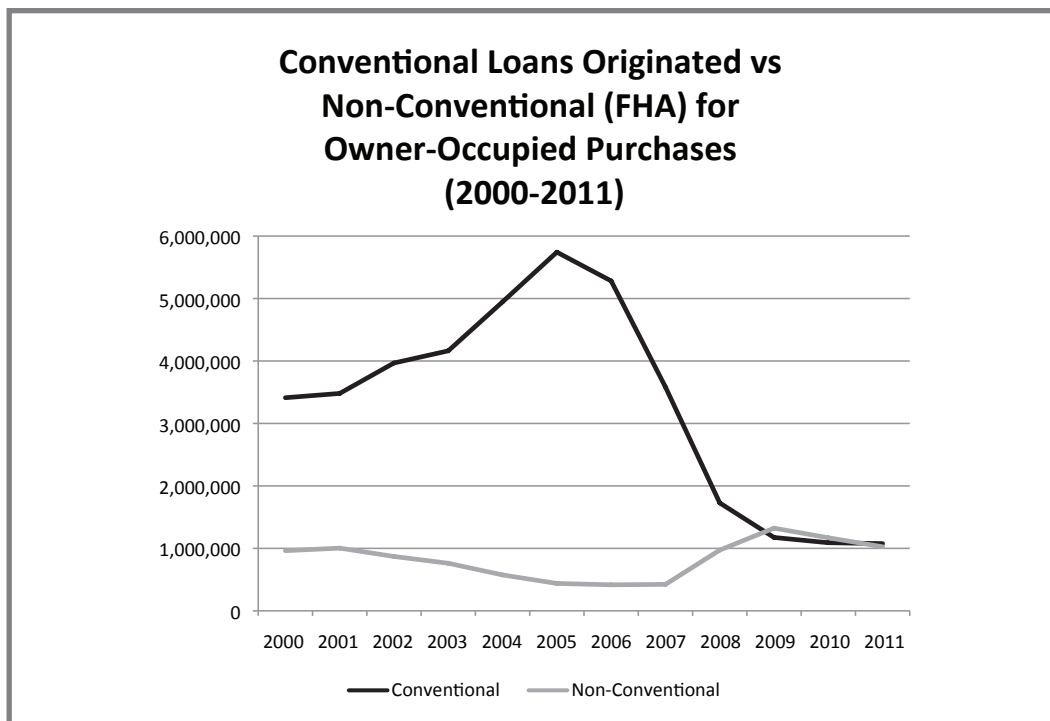
While the single-family home market has contracted significantly in terms of its market share of new household creations, apartments and rental homes have gained significantly. The key question with the housing market bouncing along the bottom is will apartments continue to prosper for the next five years or so or will we revert back to more of a traditional home ownership level of demand? To attempt to answer this question I will turn to philosophy and psychology to make the case that I think a fundamental shift has occurred in

the psyche of American society that will continue to keep mortgage credit standards tight and prospective interest among future buyers subdued. I would argue that the notion of home ownership is predicated on job stability and tenure, adequate savings, and sufficient down payments. None of these are present at anywhere near the numbers needed to bring about a material revival in home buying demand. We are in an environment of "insecure growth" where jobs are being created but people don't feel very confident about

staying employed or being in their jobs very long. In addition, there is inadequate savings to allow for people to purchase homes based on current credit conditions. Finally, originating mortgages is extremely profitable right now but with an uncertain regulatory environment and concerns about what happens if interest rates rise, banks are very hesitant to add more people to create greater lending capacity. The top 10 originators generate about 60% of the non-FHA related purchase originations and their new loan production for purchases has dropped dramatically while FHA's has increased significantly as the following graph shows:

I do not foresee a big increase in mortgage generating capacity among the big banks via process improvements and streamlined documentation because of the risk of having to buy back loans that go bad in the future. According to a July 20, 2012 article on Bloomberg.com,

Another hurdle is tighter credit standards from banks, which have been presented with demands to buy back more than \$80 billion of existing loans because of underwriting errors. Lenders are contractually required to repurchase loans if they were based



Source: http://www.federalreserve.gov/pubs/bulletin/2012/PDF/2011_HMDA.pdf

on faulty appraisals, false data about borrowers or paperwork mistakes.

Bernanke on Buybacks

Bernanke mentioned the buyback issue in testimony to Congress this week after outlining the central bank's options to stoke the economy, including additional mortgage-bond buying. Bank of America, which has scaled back home lending after more than \$40 billion of costs tied to faulty mortgages and foreclosures, said outstanding buyback claims surged by more than \$6 billion last quarter to \$22.7 billion.

"With that hanging over their heads, they're really, really defensive," said Terry Wakefield, a mortgage industry consultant in Mequon, Wisconsin, who helped start a home lending unit for a Prudential Financial Inc. predecessor. "Lenders just keep asking for more and more and more documentation, not because they think it has any value but because they think it will help them if there's a buyback demand."

For homeowners, that's made the

process of getting a loan more onerous, dissuading some from trying to replace their debt, and strained the industry's limited capacity to process the paperwork, he said. It's also getting more expensive. Origination and title fees on a \$200,000 loan averaged \$4,070 last year, up from \$3,118 in 2008, Bankrate.com surveys show.

Exit Strategy

The role of third-party mortgage brokers, who once "aggressively sought to refinance their clients as soon as rates fell," has also diminished, Buchta said.

Source: <http://www.bloomberg.com/news/2012-07-20/refinancing-seen-peaking-without-more-capacity-mortgages.html>

So where do philosophy and psychology come in to play in my analysis? To wrap up my 25th anniversary tour of lessons learned and timeless wisdom, I will turn to Heraclitus and Carl Jung. Heraclitus was a pre-Socratic, Greek philosopher who left very few writings for posterity. What did get passed on to the world, however, were epigrams that were quite enigmatic and

thought provoking. Heraclitus' overriding philosophy had to do with the constancy of change. All is flux, nothing stays still. All that endures is change. To exemplify this he said, "You can't step into the same river twice", as it is always changing. This is particularly relevant today given the mind boggling changes that are taking place in the world through more rapid communication and technological advances.

I want to focus on one epigram in particular but I thought I would share a few of the ones that I also like very much. These include:

Many fail to grasp what's right in the palm of their hand.

This is very important being in the apartment business. It is critical for us to stay focused on what we do best, particularly because we are participating in one of the strongest cycles we have ever experienced.

A wonderful harmony is created when we join together the seemingly unconnected. Those who approach life like a child playing a game, moving and pushing pieces, possess the power of kings.

I am a metaphorical thinker and puzzle lover so this one is near and dear to my heart as I think powerful insights can occur when synthesizing seemingly unconnected variables. It becomes easier and more fun doing it by approaching it as a game.

If all things turned to smoke, the nose would become the discerning organ. When there is no sun, we can see the evening stars.

We have experienced a number of very severe downturns and it is during trying times that we have to reach deep down within to find the fortitude and creativity to find the necessary solutions to the problems we are facing. These experiences allow us to tap into more of our senses and intuition to hopefully better see ahead in the future to avoid the same problems.

It is disease that makes health pleasant, hunger that makes fullness good, and weariness that makes rest sweet.

No sweetness without the sorrow.

Dogs bark at what they don't understand.

I have found that it is vitally important to think independently, to try to understand issues deeply, and block out the superficial noise emanating from an ill-informed place. Now let's move on to the big one; the one that I think is most applicable to how it impacts CWS and our investments.

That which opposes produces a benefit.

This is the idea that everything is becoming its opposite at all times. Another name for it is **enantiodromia** and has great relevance to the U.S. housing market and the shift to a renter nation. It is the tendency of things to change into their opposites, especially as a supposed governing principle of natural cycles and of psychological development. America went collectively insane with its unhealthy focus on creating an ownership society related to housing. It was completely unbalanced and generated terribly negative consequences as people were given credit to purchase an expensive, illiquid asset with high transaction costs. This was especially counterproductive at a time which required more and more geographical flexibility

as people change jobs much more often than they used to. When this is combined with such financial inflexibility resulting from minimal down payments, inadequate savings to cushion income interruption or unanticipated expenditures, and high debt levels, particularly for student loans, it was a recipe for disaster. Eventually there is such an extreme to one way of thinking that it causes a breakdown that requires it to swing the other way. That is why Heraclitus said "that which opposes produces a benefit" because it often times represents a good check and balance to make sure things don't go to extremes. And this is beneficial for renting as the nation swings psychologically the other way from salivating over home ownership to almost detesting it.

Carl Jung is one of the most influential and famous psychologists the world has ever known. He was Swiss but his influence expanded to the rest of Europe as well as the United States. He was a big believer that universal and personal truths lie deep in the sub-conscious and are often conveyed and related to through myths, symbols, and dreams. Jung also expanded on the concept of enantiodromia in a psychological context and it turns out that it has great relevance to what has been happening to the collective

American psyche in terms of housing and how renting is the countervailing psychological response. Jung states:

"[T]he emergence of the unconscious opposite in the course of time. This characteristic phenomenon practically always occurs when an extreme, one-sided tendency dominates conscious life; in time an equally powerful counterposition is built up, which first inhibits the conscious performance and subsequently breaks through the conscious control.

When... anything of importance is devalued in our conscious life, and perishes—so runs the law—there arises a compensation in the unconscious... No psychic value can disappear without being replaced by another of equivalent intensity." (C.G. Jung 1958, CW 6, para. 709)

A more simple translation of Jung's theory is that when things get so out of balance in terms of what we believe in that we cannot even contemplate the possibility that the opposite can be a reality, we end up suppressing this opposite position so intensely and so deeply in our psyche that we set ourselves up for an explosive manifestation of this opposite belief when

something shatters our faith in what we originally thought. It's akin to a reformed smoker who absolutely despises smoking and smokers after he or she quits. This is what I think happened in the U.S. housing market. For decades we were told that the American dream was owning a home and that renting was throwing money away. It was so ingrained in our collective psyche that I believe it is a wonderful example of an entantiodromia. Once the cracks appeared in the housing market and home prices started falling and people began to realize that their homes could become a financial and emotional albatross, they started entertaining the notion that renting could be not only ok, but could be a very viable and healthier option.

The Road to Damascus

I think one of the great examples of this comes from the conversion of Paul on the Road to Damascus. Paul was intensely anti-Christian and was involved in the stoning of Stephen (an ardent supporter of Jesus). When I read any sacred text I personally get the most from it when I process it metaphorically or symbolically as opposed to literally. Therefore when I read this is I see a great example of what I think has been

happening in American society regarding its changing attitudes towards home ownership and renting. When he speaks of persecuting Christians I think of being a zealot for home ownership and someone who despises renting.

"As for me, I once thought it was my duty to use every means to oppose the name of Jesus the Nazarene. ... my fury against [Christians] was so extreme that I even

pursued them into foreign cities. On one such expedition I was going to Damascus, armed with full powers and a commission from the chief priests, and at midday as I was on my way ... I saw a light brighter than the sun come down from heaven. It shone brilliantly round me and my fellow travelers. We all fell to the ground, and I heard a voice saying to me in Hebrew, 'Saul, Saul, why are you persecuting me? It is hard for you, kicking like this against the goad.' Then I said:

Michelangelo's Depiction of Paul's Conversion



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Who are you Lord? And the Lord answered, 'I am Jesus, and you are persecuting me. But get up and stand on your feet.'

I would assert that Americans have gone through a more subtle, but still powerful conversion from being zealot home owner proponents to ardent supporters of the possibilities of renting. Just like Paul was able to regain his vision after his conversion, so too will our society as renting allows for much more peace of mind, the flexibility to move

without large transaction costs, the ability to build and rebuild savings and credit, and the potential to take more personal risk in terms of career choice because of not being tied down by a mortgage. I truly believe that renting is the solution to help heal our society's financial wounds from the excesses of 2003-2007 and to allow people to have the flexibility to make the necessary adaptations to the ever-changing economy and society that we are all experiencing and trying to understand.