

# Economics Group

## Special Commentary

**Mark Vitner, Senior Economist**  
[mark.vitner@wellsfargo.com](mailto:mark.vitner@wellsfargo.com) • (704) 410-3277  
**Charlie Dougherty, Economist**  
[charles.dougherty@wellsfargo.com](mailto:charles.dougherty@wellsfargo.com) • (704) 410-6542  
**Matthew Honnold, Economic Analyst**  
[matthew.honnold@wellsfargo.com](mailto:matthew.honnold@wellsfargo.com) • (704) 410-3059

# Housing Chartbook: June 2019

## Lower Mortgage Rates Are Unlikely to Reinvigorate Home Buying

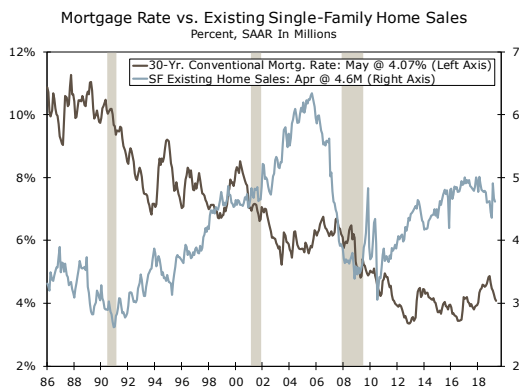
The sharp drop in mortgage rates this past month would normally be a panacea to a housing market that has stumbled recently under the weight of diminished affordability. Unfortunately, we believe even the latest drop in mortgage rates, which has seen rates on conventional 30-year mortgages fall below 4%, will not be enough to overcome the rising anxiety among potential homebuyers who sense that lingering trade tensions are putting economic growth at risk. The increased regulatory zeal in the technology sector may also crimp home buying, as rising antitrust momentum will soon make it more difficult for startups to raise capital, slowing growth in the fastest growing parts of the economy. Demand for refinancing existing mortgages is perking up, however, which may redirect household cash flow toward home improvements and consumer spending in general.

Our forecast for economic growth has been scaled back, largely due to the knock-on effects from the lingering trade rift with China. Global trade has slowed, and export-dependent economies like China, Japan and Germany have borne the brunt of that slowdown. The downshift in global economic growth is becoming more apparent in the nation’s manufacturing sector but is also weighing significantly on the energy and tech sectors. We now see real GDP rising 2.6% this year, compared with our earlier forecast of 2.8%. Job growth is also expected to be slower but should still be strong enough to pull the unemployment rate modestly lower over the next two years.

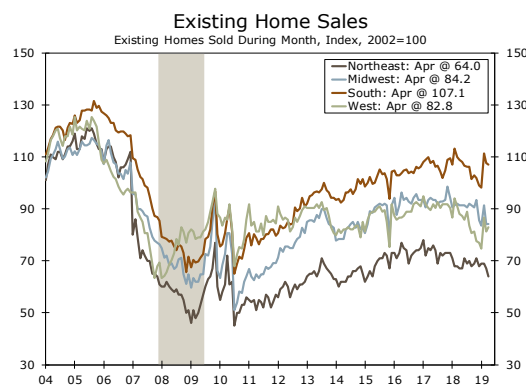
With growth slowing, interest rates have fallen substantially over the past month and the yield curve has fully inverted, with both the yield on the 10-Year and 2-Year Treasury Note falling below the federal funds rate. We now expect the Federal Reserve to cut interest rates twice this year, most likely in July and October. The interest rate for a 30-Year conventional mortgage has fallen below 4% and is more or less expected to remain there through the end of next year. Lower mortgage rates have bolstered homebuilder confidence, and sentiment among potential home buyers has also improved. Unfortunately, the affordability paradox facing potential buyers has not eased enough to provide a significant boost to home sales. We are still looking for modest gains in home sales and housing starts this year. But rather than igniting a resurgence in home buying, lower mortgage rates will merely cushion the blow from slower global economic growth.

*The latest drop in mortgage rates will not be enough to reignite the housing market.*

**Figure 1**



**Figure 2**



Source: U.S. Department of Commerce, Freddie Mac, National Association of Realtors and Wells Fargo Securities

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## Supply and Demand Will Likely Remain Out of Sync

While new construction is expected to gradually ramp back up this year, we are still looking for rather modest gains. Sales of new single-family homes are expected to rise 4.5% to a 542,000-unit pace. New single-family construction is expected to climb 1.9% off a much larger and more inclusive base. A larger proportion of new home construction will focus on more affordable product, which are homes priced close to or below the median for a metro area. Such homes are difficult to profitably build, however, which means inventories will likely remain thin.

*We are still looking for rather modest construction gains this year.*

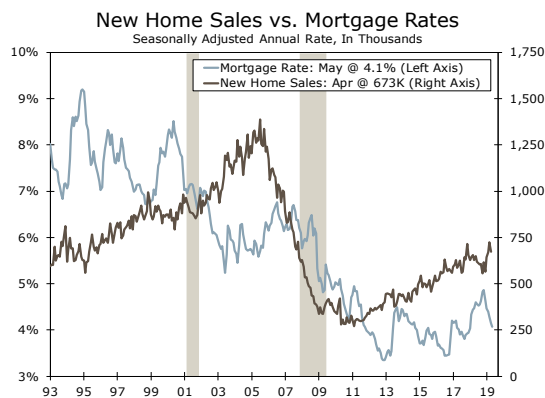
Homebuyers are still showing a greater preference for living in and around major cities, where land tends to be more expensive and relatively few in-fill opportunities are available. Many near-in suburbs are also rapidly urbanizing, making communities more walkable and creating more common space. These trends will likely keep residential development more heavily weighted toward multi-development than in past cycles and should also create more developments for townhomes, which are counted as single-family starts. The strongest areas for single-family starts are the exurban areas around rapidly growing cities in the South and the West, which are also urbanizing but to a lesser extent than closer-in suburbs. The primary hurdle to exurban development continues to be the high cost of building out infrastructure and complying with stricter environmental rules.

Condominium development remains a shadow of its former self. Demand for condominiums has struggled as foreign buyers have pulled back from many global gateway cities, including New York City, Boston, Washington, D.C., Miami, Los Angeles, San Francisco and Seattle. Many of these markets have also seen a dearth of domestic buyers following the enactment of the new tax law, which limits deductions on state and local taxes and mortgage interest. Apartment construction has flourished in many of these areas, with developers keeping in mind that an eventual exit strategy may be to convert rental apartments to condominiums. A wave of such conversions is unlikely for another cycle or two, however. After a rough start to 2018, we expect sales of existing condominiums to decline 2.7% for the year as a whole and look for new construction to fall 2%. Apartment construction is expected to rise modestly this year, as builders seek out more affordable markets in suburban areas and smaller metro areas.

*Our outlook for sales and construction has changed relatively little.*

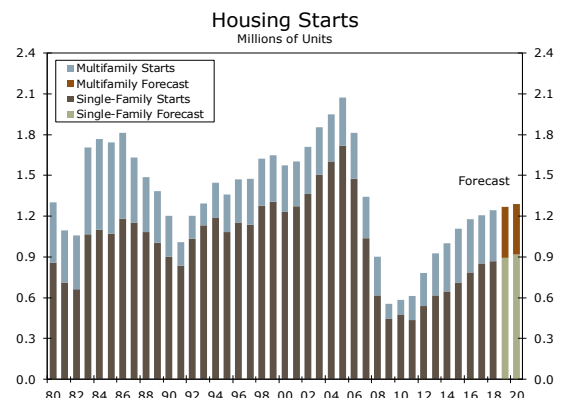
While the interest rate outlook has changed dramatically this past month, our outlook for sales and new home construction has changed relatively little. Interest rates are lower because global growth has slowed, partly in response to the lingering trade battle with China. We expect U.S. economic growth to slow to a 2% pace during the second half of 2019, which means job and income growth will also moderate. Consumers still feel reasonably optimistic about their employment and income prospects, which should provide some support for home buying. Sales of existing homes have struggled so far this year, but we expect sales to improve this summer, as more markets are seeing more negotiating power switching to buyers. We expect sales of single-family existing homes to rise 1.1% this year and look for price appreciation to average around 3.2% nationwide.

**Figure 3**



Source: U.S. Department of Commerce, Freddie Mac and Wells Fargo Securities

**Figure 4**



National Housing Outlook

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP, Percent Change	1.6	2.2	1.8	2.5	2.9	1.6	2.2	2.9	2.6	2.1
Residential Investment, Percent Change	-0.1	13.0	12.4	3.9	10.1	6.5	3.3	-0.3	-2.5	1.5
Nonfarm Payroll Change (Avg. Monthly)	173	181	192	251	227	193	179	223	158	131
Unemployment Rate	8.9	8.1	7.4	6.2	5.3	4.9	4.4	3.9	3.7	3.5
Home Construction										
Total Housing Starts, in Thousands	608.8	780.6	924.9	1,003.3	1,111.9	1,173.7	1,202.9	1,250.0	1,270.0	1,290.0
Single-Family Starts, in Thousands	430.5	535.3	617.7	647.8	714.6	781.5	848.9	875.7	892.0	915.0
Multifamily Starts, in Thousands	178.3	245.3	307.2	355.5	397.3	392.2	354.0	374.3	378.0	375.0
Home Sales										
New Home Sales, Single-Family, in Thousands	305.0	369.0	429.0	439.0	501.0	561.0	613.0	617.0	645.0	662.0
Total Existing Home Sales, in Thousands	4,260.0	4,660.0	5,090.0	4,940.0	5,250.0	5,450.0	5,510.0	5,340.0	5,395.0	5,450.0
Existing Single-Family Home Sales, in Thousands	3,787.0	4,128.0	4,484.0	4,344.0	4,646.0	4,838.0	4,892.0	4,742.0	4,810.0	4,865.0
Existing Condominium & Co-op, in Thousands	477.0	528.0	603.0	591.0	608.0	614.0	619.0	601.0	585.0	585.0
Manufactured Homes										
Total Shipments, in Thousands	51.6	54.9	60.2	64.3	70.5	81.1	92.9	96.6	95.0	95.8
Percent Change	3.1	6.3	9.7	6.8	9.7	15.0	14.5	3.9	-1.6	0.8
Home Prices										
Median New Home, \$ Thousands	227.2	245.2	268.9	288.5	294.2	307.8	323.1	326.4	328.0	335.0
Percent Change	4.8	7.9	9.7	7.3	2.0	4.6	5.0	1.0	0.5	2.1
Median Existing Home, \$ Thousands	166.1	176.8	197.1	208.3	222.4	233.8	247.2	259.3	267.5	276.0
Percent Change	-3.7	6.4	11.5	5.7	6.8	5.1	5.7	4.9	3.2	3.2
FHFA Purchase Only Index, Percent Change	-4.2	2.9	7.1	5.1	5.3	5.9	6.6	6.6	5.0	4.4
S&P Case-Shiller C-10 Home Price Index, Percent Change	-3.5	0.3	11.7	7.9	4.6	4.5	5.3	5.4	3.4	3.2
Interest Rates - Annual Averages										
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.27	0.52	1.13	1.96	2.31	2.00
10-Year Treasury Note	2.78	1.80	2.35	2.54	2.14	1.84	2.33	2.91	2.27	2.40
Conventional 30-Year Fixed Rate, Commitment Rate	4.46	3.66	3.98	4.17	3.85	3.65	3.99	4.54	3.93	4.00

Forecast as of: June 18, 2019

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, FRB, FHFA, FHLMC, National Association of Realtors, S&P, Wells Fargo Securities

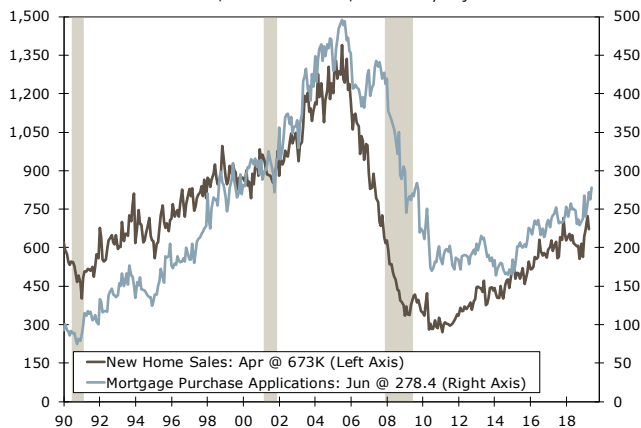
## Mortgages

- Lowered expectations for economic growth have pulled conventional mortgage rates back below 4%. Mortgage rates had fallen about one percentage point since peaking in late November.
- Hopes that lower rates would unleash pent-up demand and lead to a surge in activity in the spring buying season were perhaps a bit overblown. Lower rates have certainly helped to stem the slide in home sales and have brought applications back above the highs hit earlier last year. But, we expect applications to rise more modestly in coming months.
- A steady upward trend in mortgage applications reflects the overall improvement in buying conditions. Year-to-date purchase applications are around 4% higher compared to the same period last year. Lower rates have also led to a rebound in refi applications.

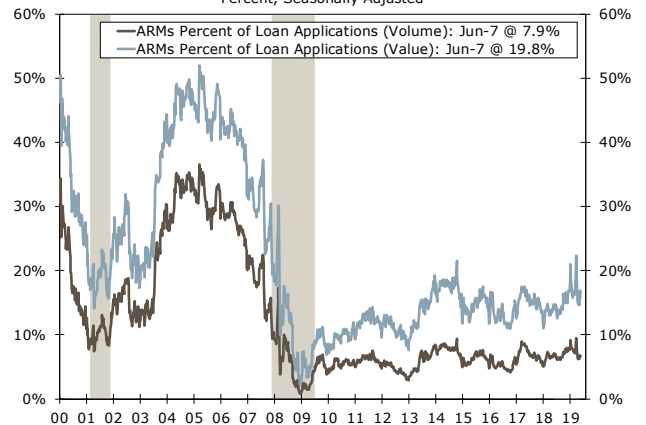
Conventional Mortgage Rate vs. 10-Year Treasury Yield  
Percent



New Home Sales vs. Mortgage Purchase Applications  
Thousands, Index 1990=100; Seasonally Adjusted

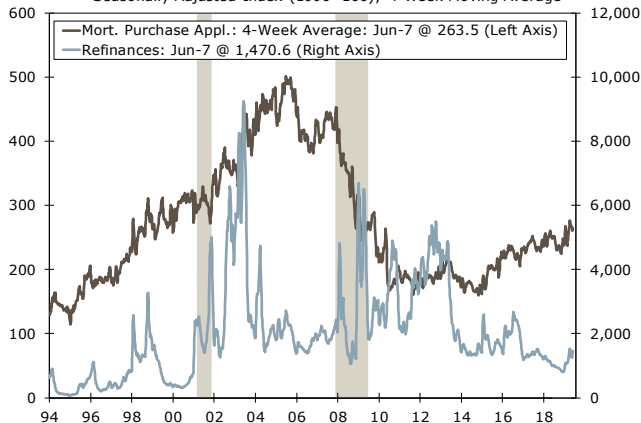


Mortgage Applications  
Percent, Seasonally Adjusted



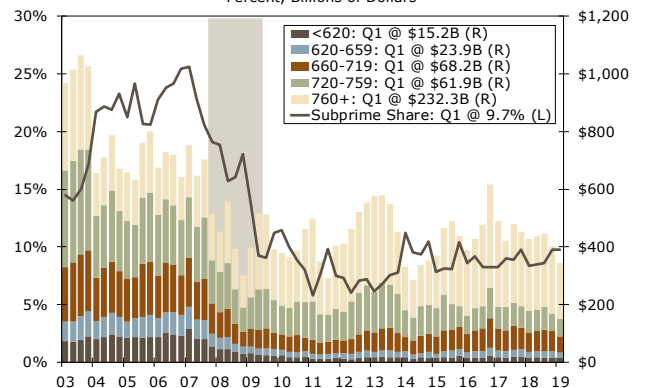
Mortgage Applications

Seasonally Adjusted Index (1990=100); 4-Week Moving Average



Mortgage Origination by Credit Score

Percent, Billions of Dollars

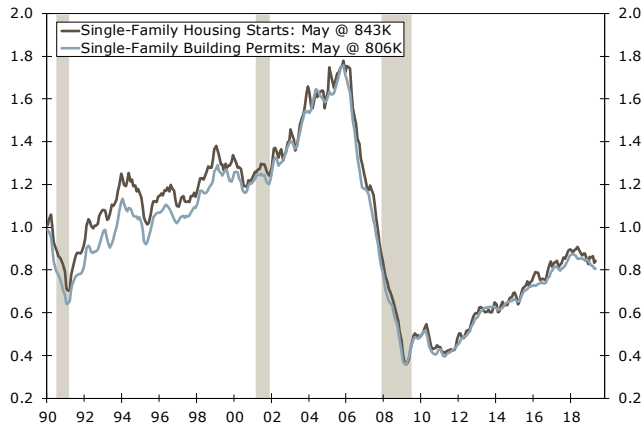


Source: MBA, FHLMC, Federal Reserve System, U.S. Dept. of Commerce and Wells Fargo Securities

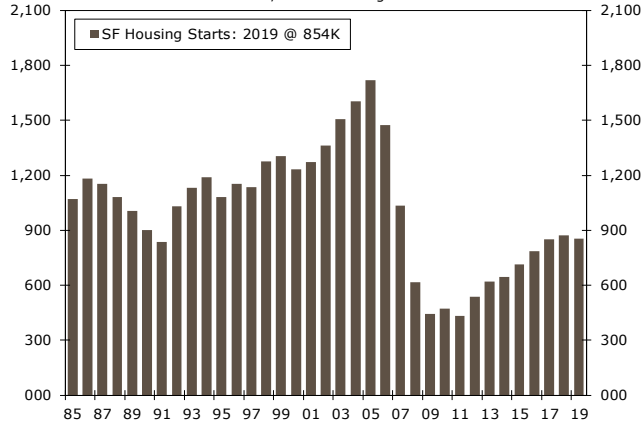
## Single-Family Construction

- New single-family construction has struggled to gain traction. Year-to-date single-family starts are running 5.1% below last year. Some of that drop may be due to unusually wet winter weather, particularly in the South, where the majority of new construction takes place. Uncertainty about trade negotiations and how they may impact employment, building costs and interest rates also likely weighed on starts.
- Should the Fed cut rates, as we expect, building activity should get a boost later this summer. We look for lower interest rates to be modestly supportive of new construction rather than trigger a resurgence.
- While the number of built-for-rent units fell to 5,000 in Q1, the share of total starts in this category remains elevated alongside a still-low homeownership rate.

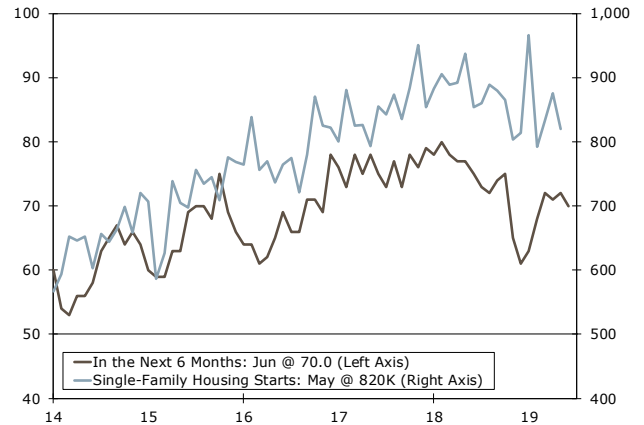
Single-Family Housing Starts vs. Building Permits  
SAAR, In Millions, 3-Month Moving Average



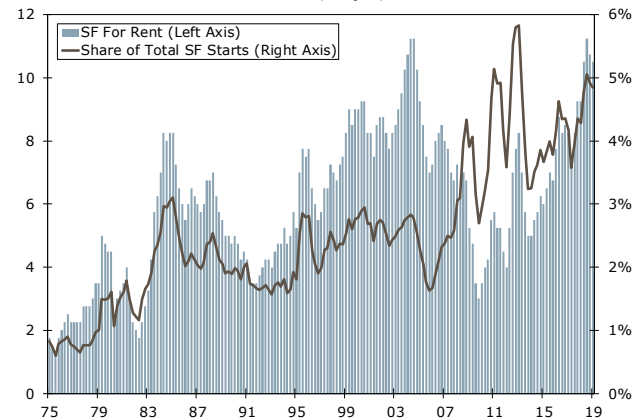
Single-Family Housing Starts  
Thousands, Annual Average of SAAR



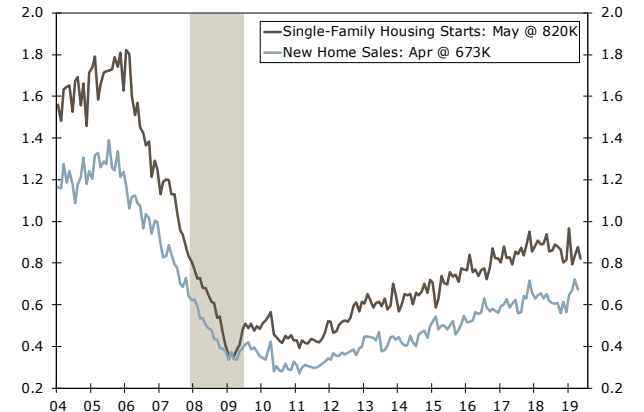
NAHB Expected Single-Family Home Sales vs. SF Starts  
NAHB Housing Market Index



Single-Family Homes for Rent  
Thousands of Units, 4-QMA; Percent



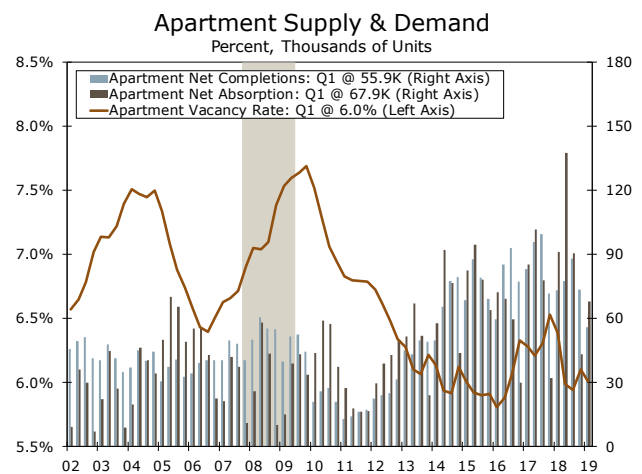
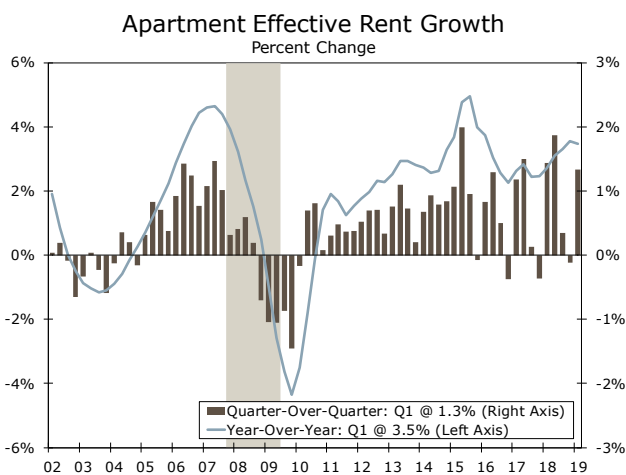
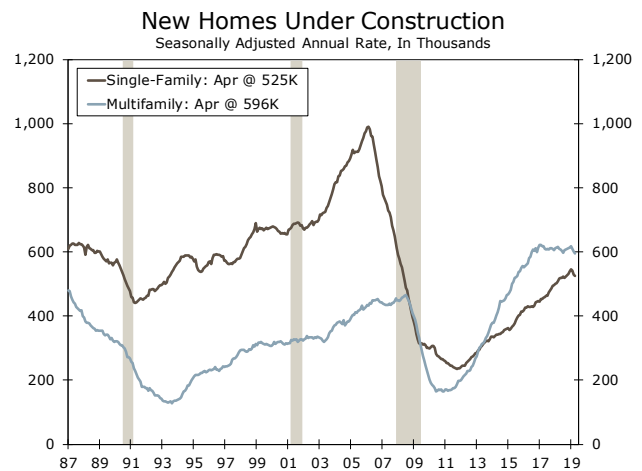
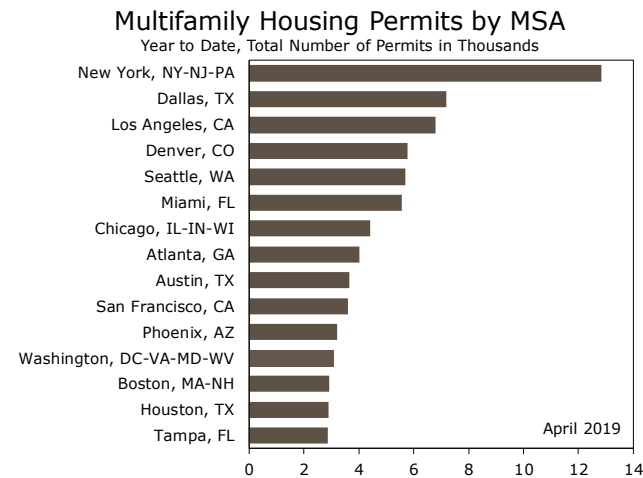
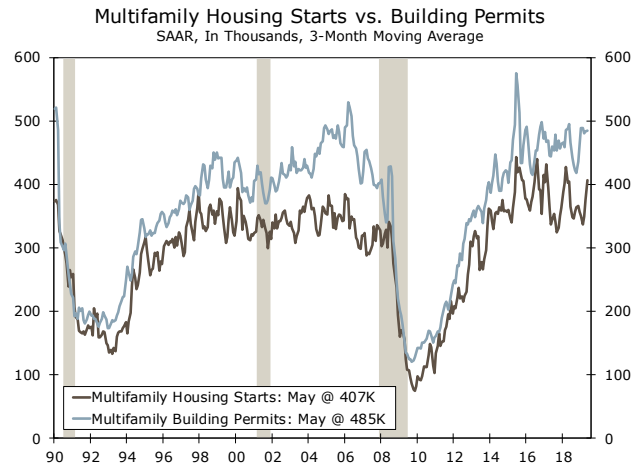
Single-family Housing Starts vs. New Home Sales  
Seasonally Adjusted Annual Rate, In Millions



Source: U.S. Department of Commerce, National Association of Home Builders and Wells Fargo Securities

## Multifamily Construction

- The second wind the apartment market experienced last year is showing no signs of abating. Though highly volatile on a monthly basis, multifamily starts have risen for three consecutive months.
- Permit data indicate more strength forthcoming. Over the past year, multifamily permits have been running 27% ahead of starts, pointing to a robust potential pipeline of future construction.
- Despite significant new supply, the apartment vacancy rate remains low at 6.0%, and the overall rental vacancy rate remains near a 35-year low.
- Construction continues to be heaviest in the rapidly growing Sunbelt metros and in tech-driven markets facing a shortage of affordable for-sale homes.



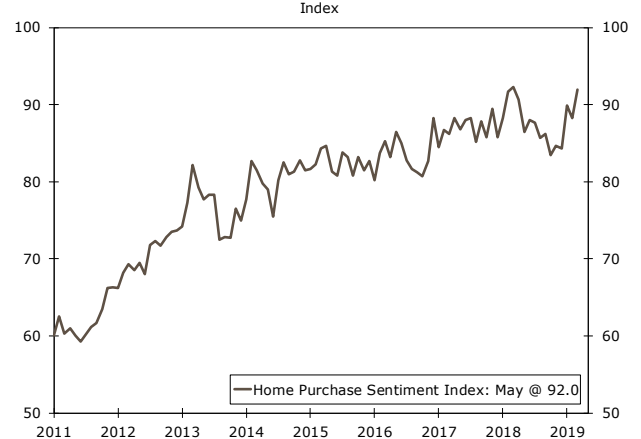
Source: U.S. Department of Commerce, CoStar, Inc. and Wells Fargo Securities



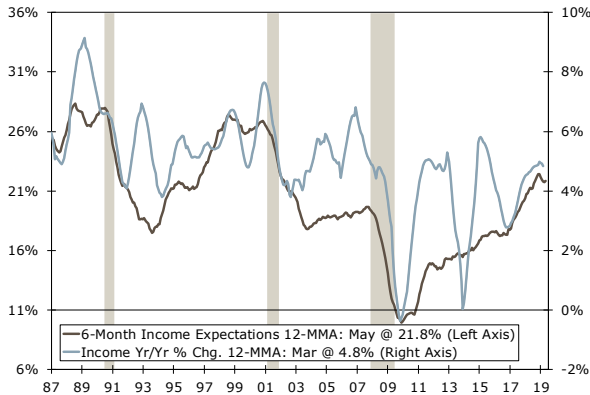
## Buying Conditions

- Easing price gains, rising wages and lower mortgage rates have improved buying attitudes. With very low inventories of homes priced at or below the median, however, buying conditions remain mixed at best. Price drops are more prevalent at the high end.
- Fannie Mae Home Purchase Sentiment rose 3.7 points in May to 92 and is close to its previous high hit last May. The series is relatively short, however.
- The National Association of Realtors' Housing Affordability Index was 154.7 in Q1, up from 142.4 last Q2. Affordability is now back near the levels seen before home sales buckled late last year.
- Builders slashed prices late last year. The move bolstered affordability but left many builders hesitant to get back ahead of demand anytime soon.

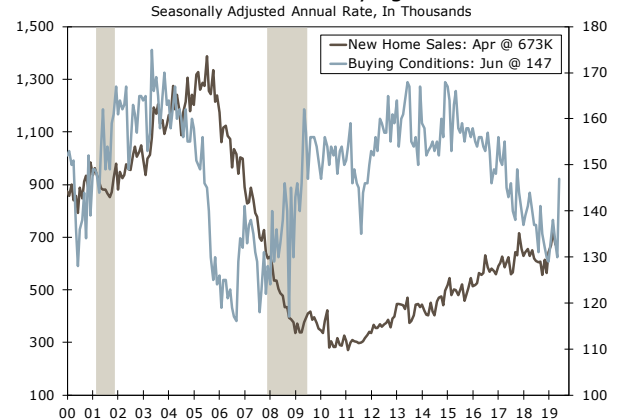
Fannie Mae Home Purchase Sentiment Index



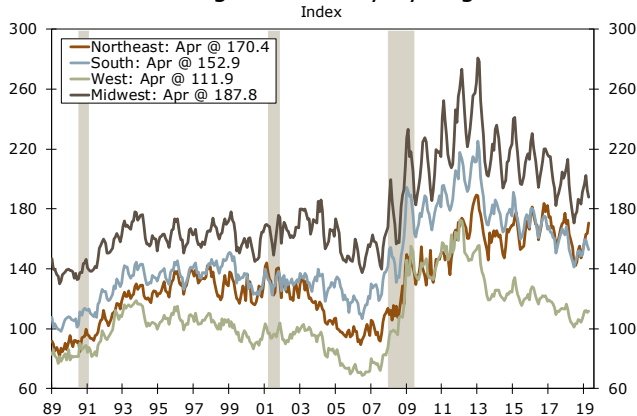
Consumer Confidence vs. Disposable Income  
Pct. Consumers That Expect Incomes to Increase; Percent



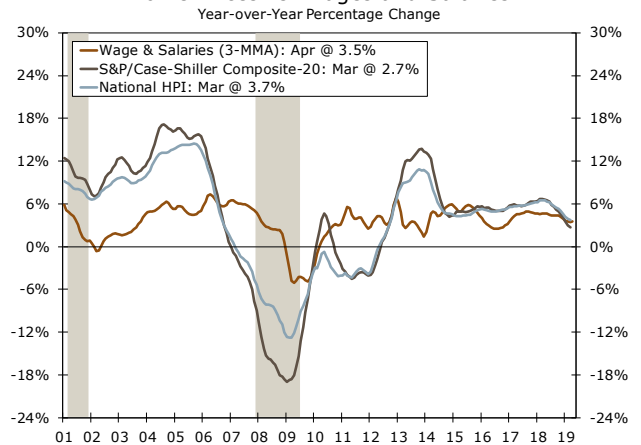
New Home Sales vs. Buying Conditions



Housing Affordability by Region



Home Prices vs. Wages and Salaries

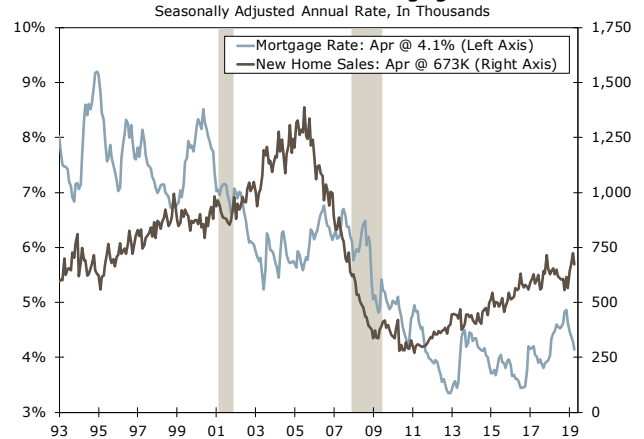


Source: University of Michigan, National Association of Realtors, The Conference Board, S&P, Fannie Mae, U.S. Dept. of Commerce and Wells Fargo Securities

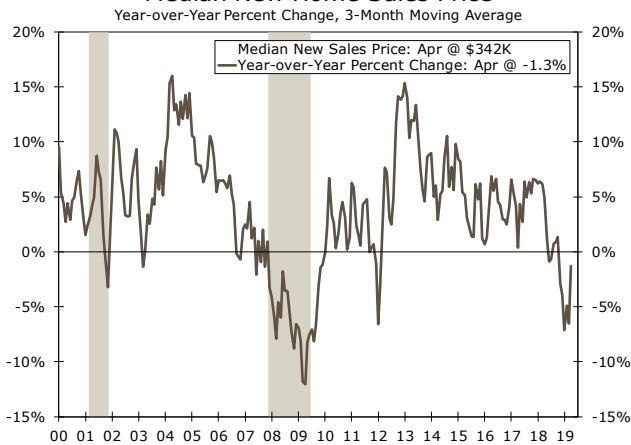
## New Home Sales

- New home sales are outperforming resales. Although sales fell 6.9% in April to a 630,000-unit pace, they are still running 7.0% above their year-ago pace. Furthermore, April was the first monthly decline of 2019, and was off of an upwardly revised March number which showed sales reached a cycle high 723,000-unit pace that month.
- In addition to lower mortgage rates, new home sales have likely been helped by builders offering discounts to clear rapidly rising inventories. A sharp focus on the fast-growing entry level segment also helped. Still, builders had to slash prices late last year.
- Year-to-date, sales are up 10.7% in the South and 5.4% in the West. The Midwest is down 0.9%. Sales in the Northeast, which is the smallest region for home building, are down 19.2%.

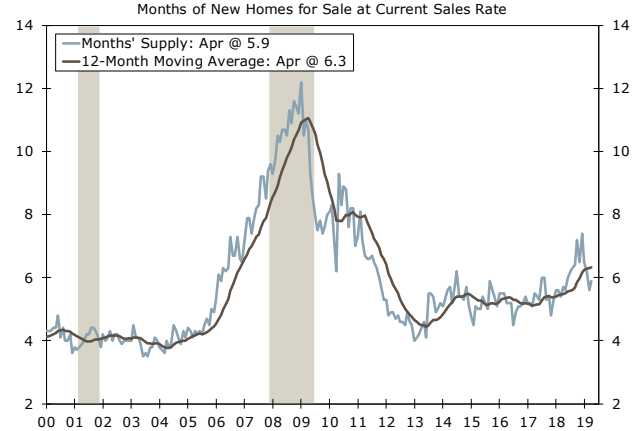
New Home Sales vs. Mortgage Rates



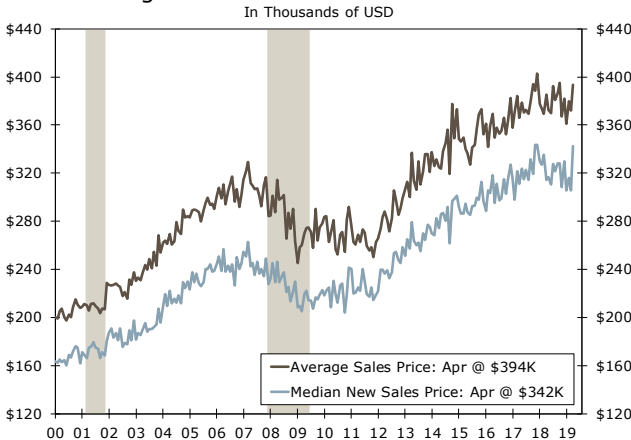
Median New Home Sales Price



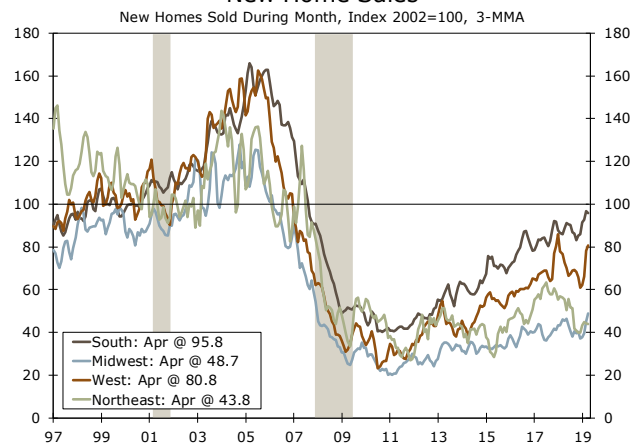
Inventory of New Homes for Sale



Average and Median New Home Sale Price



New Home Sales



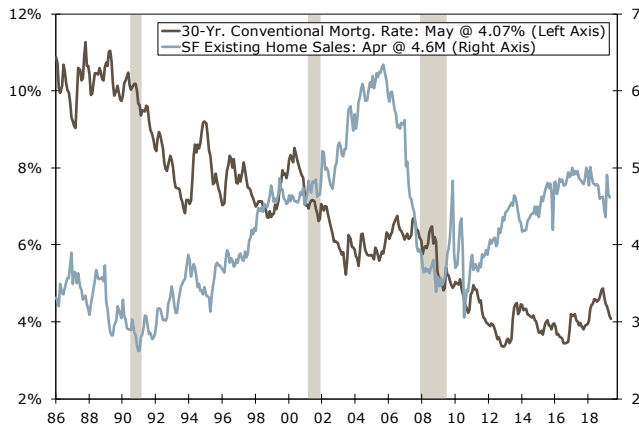
Source: U.S. Department of Commerce, Freddie Mac, FHLMC and Wells Fargo Securities



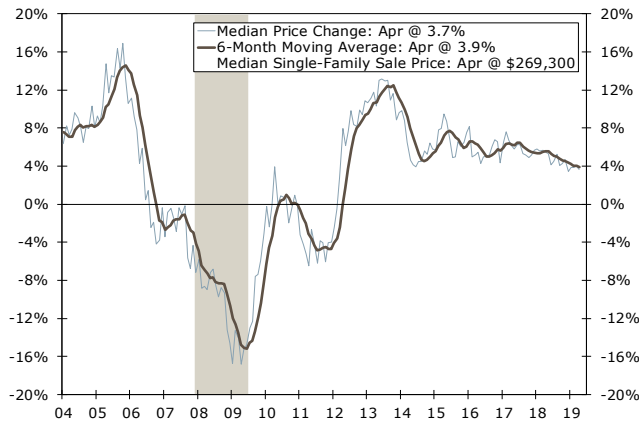
## Existing Home Sales

- Existing home sales have not yet received a major pop from lower mortgage rates and moderating price growth. The situation has stabilized, however.
- During April, resales fell well below expectations, dropping 0.4% to a 5.19 million-unit pace. Sales have now declined in five out of the past six months, yet are running just slightly below their year-ago pace.
- A structural mismatch between strengthening entry level demand and scarce entry level supply is likely playing a role in this year's underwhelming sales.
- A significant breakout in existing home sales is unlikely this year, but sales should be stronger than they have been the past few months. We expect a rebound in May, and potentially even a major catchup number given recent gains in pending sales.

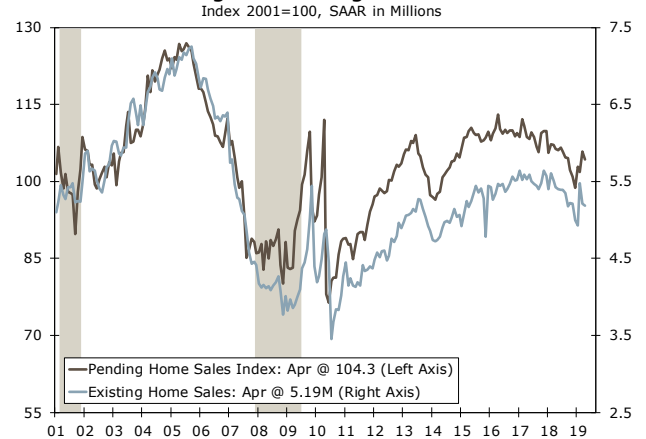
Mortgage Rate vs. Existing Single-Family Home Sales  
Percent, SAAR in Millions



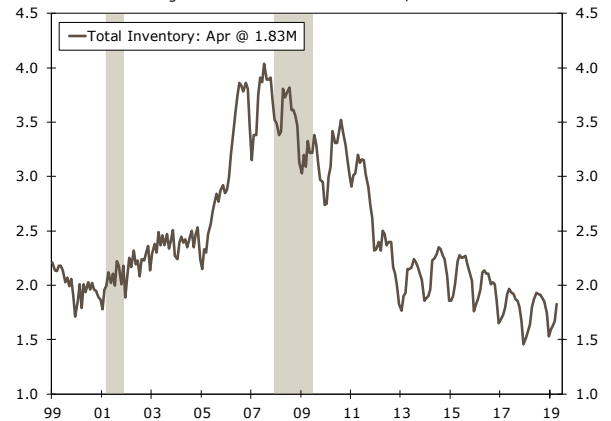
Median Single-Family Existing Home Price  
Year-over-Year Percentage Change



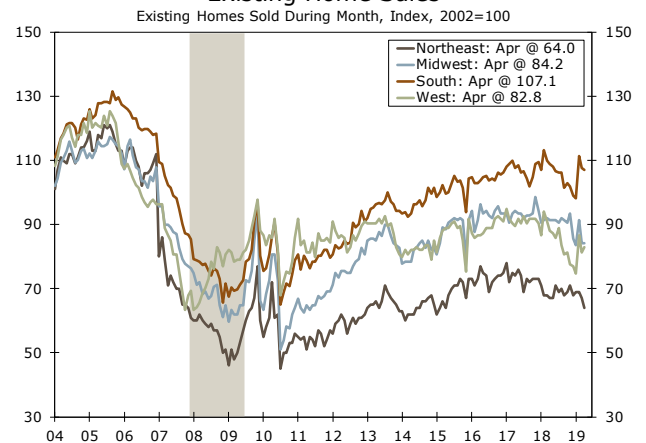
Pending vs. Existing Home Sales



Inventory of Existing Homes for Sale  
Existing Homes for Sale at End of Month, in Millions



Existing Home Sales

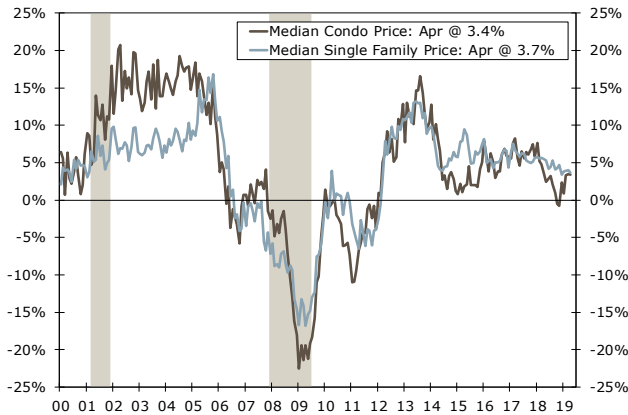


Source: National Association of Realtors, Freddie Mac, and Wells Fargo Securities

## Condos and Co-Ops

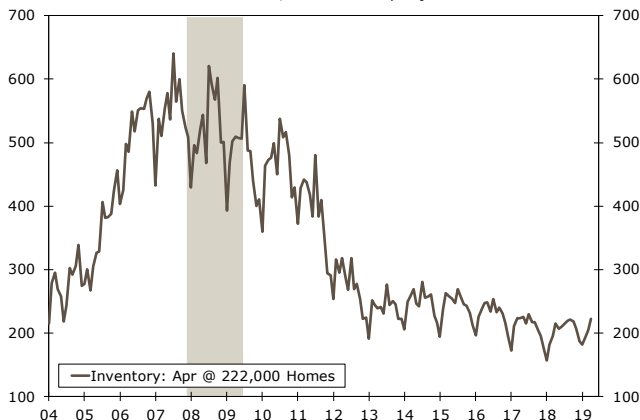
- Sales of condominiums and co-ops have struggled this year, with sales through the first four months of 2019 trailing the same period last year by 8.5%.
- The condominium market is dominated by large global gateways, such as New York City, Boston, Washington, Miami and Chicago. Slower global growth and a strong dollar have clearly cooled demand. Chinese buyers have also pulled back, impacting major West Coast markets like Los Angeles, San Francisco and Seattle, reflecting slower Chinese economic growth and some backlash from the trade war.
- Construction of condominiums remains well below long-term norms, which has helped keep for-sale inventory low amid the recent weakness in demand.

Median Condo & Single Family Home Price  
Year-over-Year Percent Change



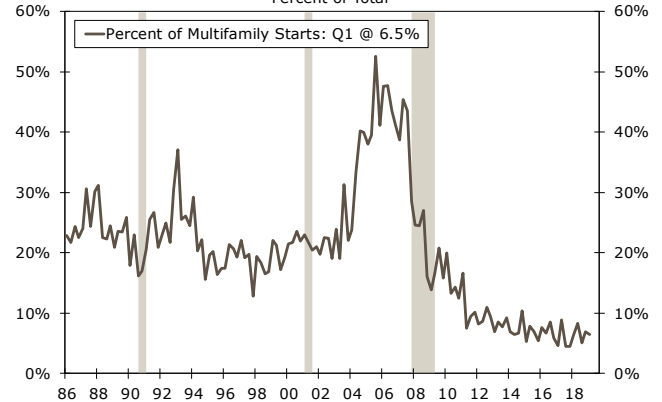
Condo Inventory

In Thousands, Not Seasonally Adjusted



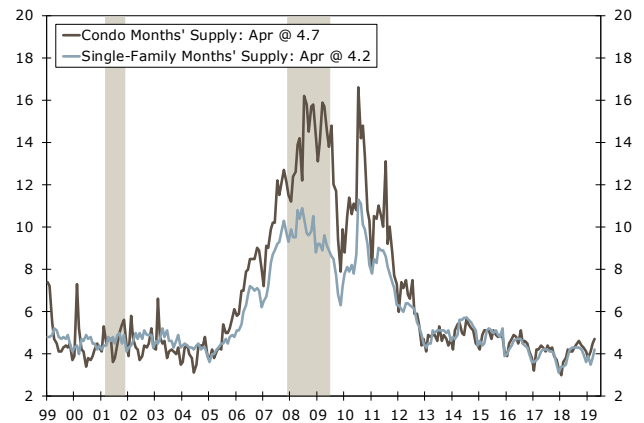
Multifamily Starts Intended for Sale

Percent of Total



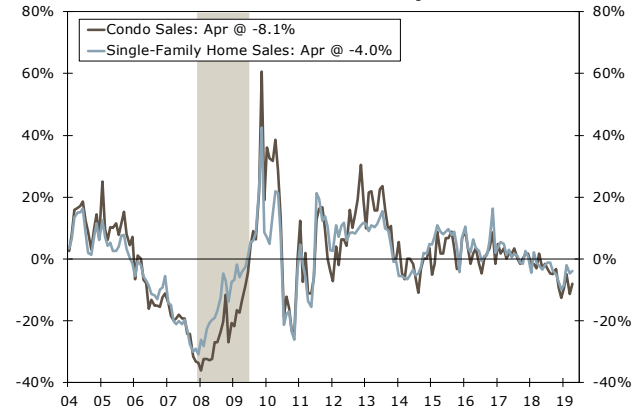
Existing Home Supply

In Months, Seasonally Adjusted



Single-Family Home Sales & Condo Sales

Year-over-Year Percent Change

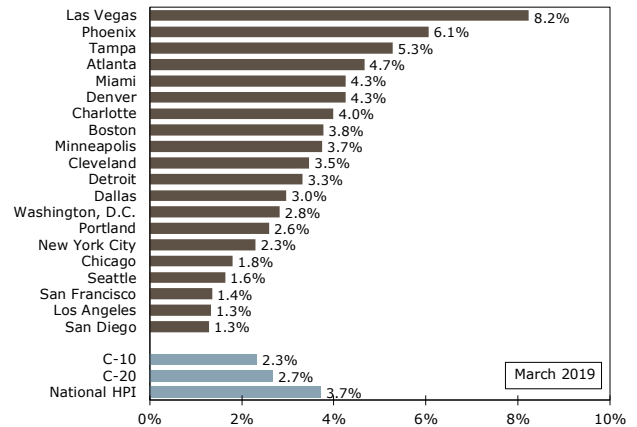


Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities

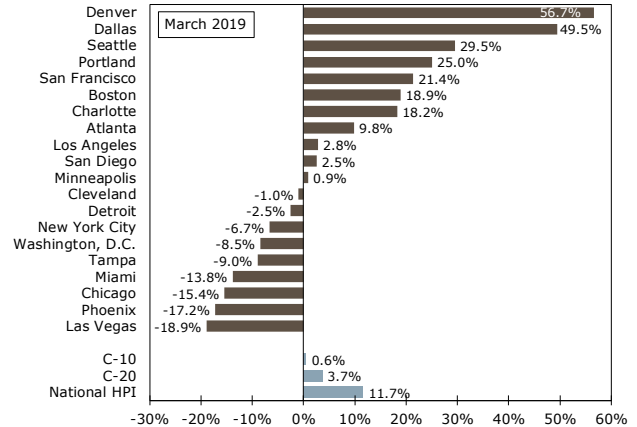
## Home Prices

- Home price appreciation continues to cool amid softer sales and a shift in demand for more entry level housing. The S&P CoreLogic Case-Shiller index eased to 3.7% year-over-year in March.
- While certain metro areas have cooled considerably, the decline in price appreciation has been fairly widespread. Markets with exposure to overseas buyers have cooled the most, however. Price gains still vary considerably across the nation, with the largest price gains generally confined to markets experiencing rapid job growth.
- Las Vegas easily remains the hottest major market, with prices rising 8.2%. Seattle, on the other hand, has seen a dramatic slowing, with prices climbing just 1.6% this past year, down from 12.9% a year ago.

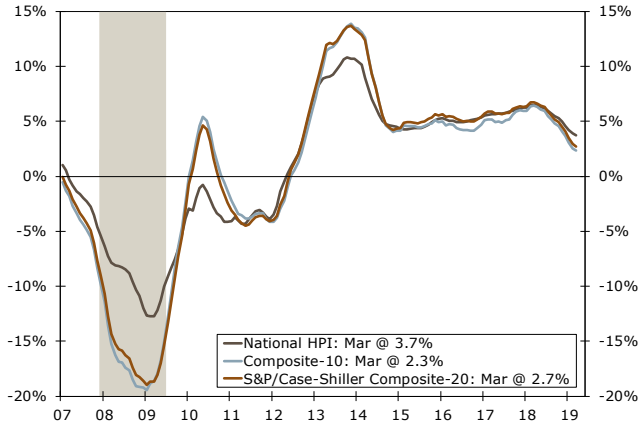
S&P CoreLogic Case-Shiller Home Prices  
Year-over-Year Percent Change, NSA



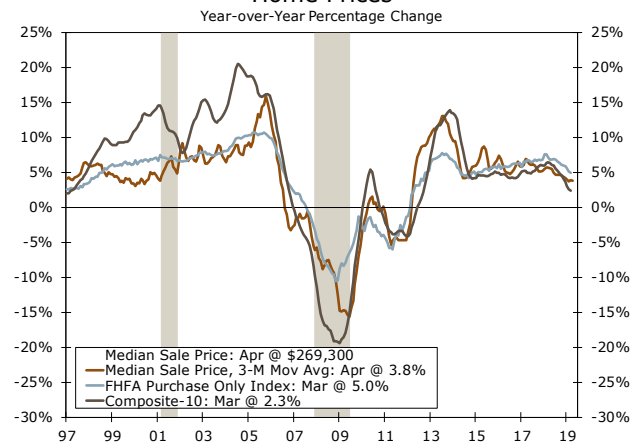
S&P CoreLogic Case-Shiller Home Prices  
Percent Change from Previous Peak, NSA



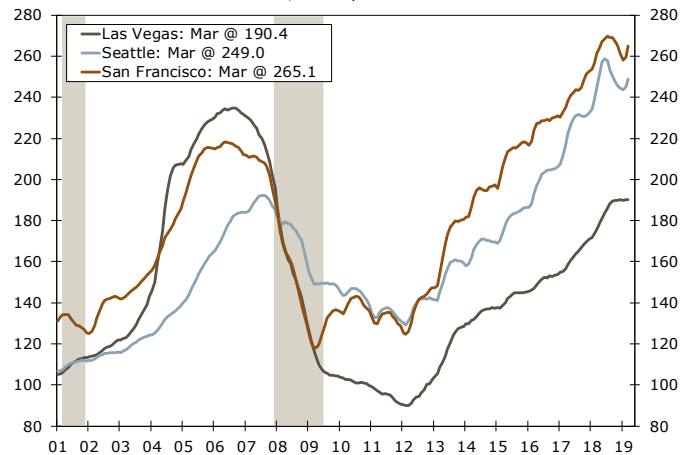
S&P CoreLogic Case-Shiller Home Price Index  
Year-over-Year Percentage Change



Home Prices



S&P CoreLogic Case-Shiller Home Price Index  
Index, January 2000=100

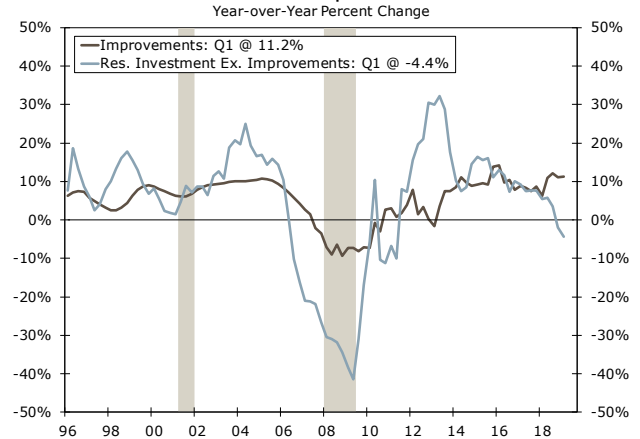


Source: National Association of Realtors, U.S. Dept. of Commerce, S&P, FHFA and Wells Fargo Securities

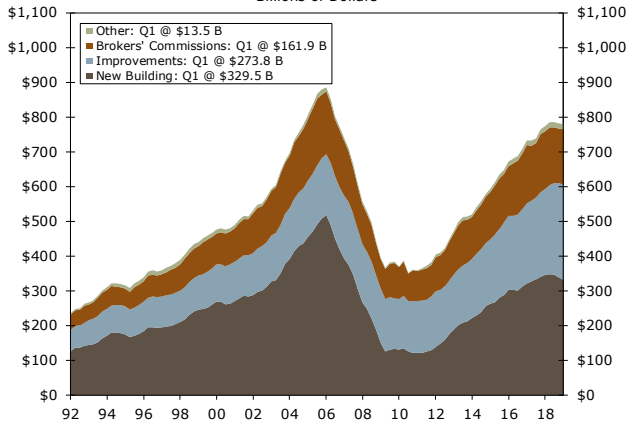
## Renovation and Remodeling

- While spending for renovations and improvements has been a bright spot, some slowing may be on the horizon. Building material retail sales, which the BEA uses to model the improvement spending component of GDP, softened to just a 1.8% year-over-year gain on a three month moving average basis during May, the slowest pace since 2012.
- According to the NAHB, the backlog of remodeling jobs remains fairly high, although growth has moderated recently. Similarly, the Harvard JCHS expects a deceleration to below-average growth by 2020. Consumer confidence remains high, and lower borrowing costs should provide some modest support for remodeling projects. Floods in the Midwest and South should also bolster spending, but recoveries from floods tend to be slow.

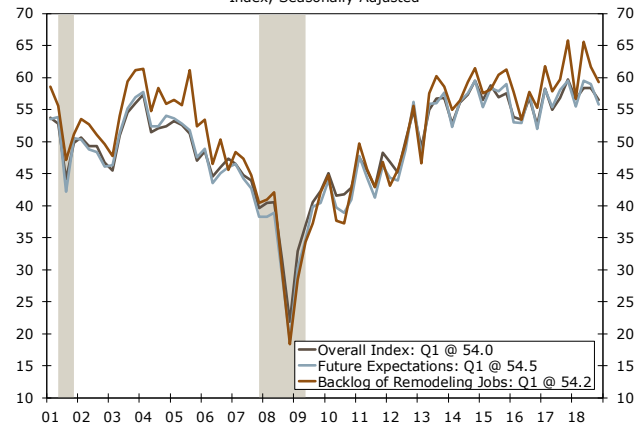
Residential Improvements



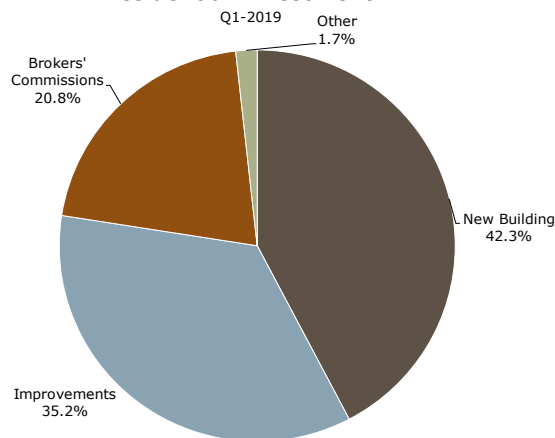
Residential Investment  
Billions of Dollars



NAHB Remodeling Market Index  
Index, Seasonally Adjusted

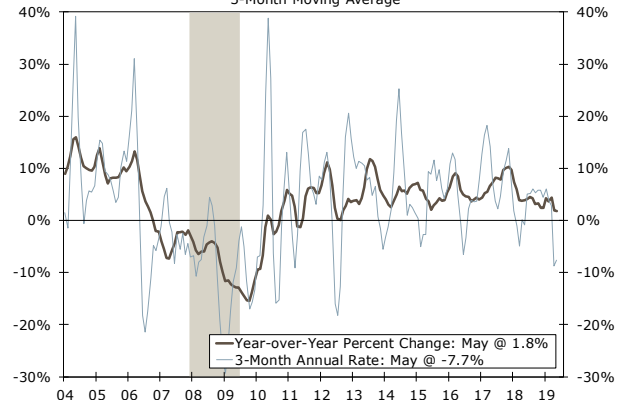


Residential Investment



Retail Sales

Building Mat, Garden Equip. & Supply Stores  
3-Month Moving Average

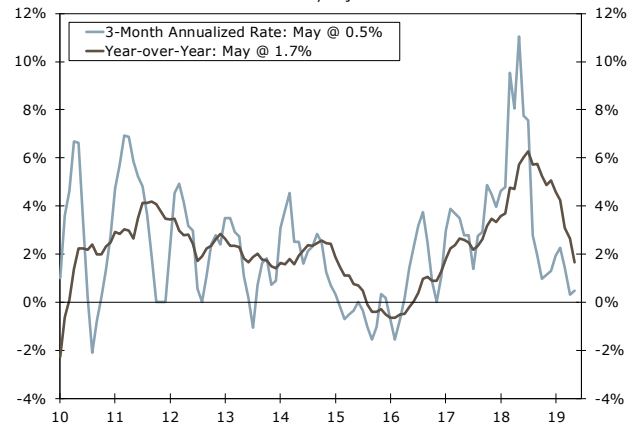


Source: Harvard Joint Center for Housing Studies, U.S. Dept. of Commerce, NAHB and Wells Fargo Securities

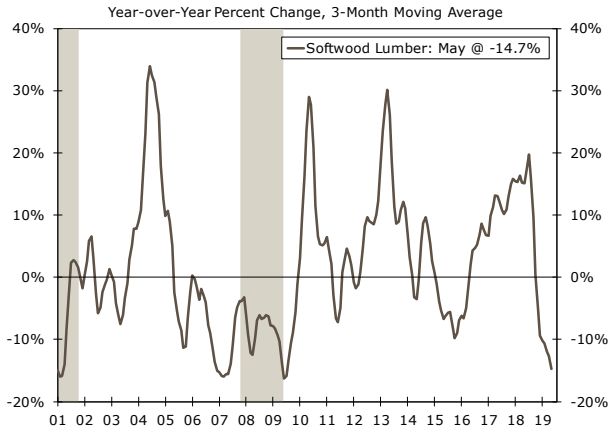
## Construction Costs

- Construction costs have been a major impediment to a more robust housing recovery. Recently a dichotomy has emerged, as many material costs are in outright deflation while labor costs continue accelerating.
- Inflation as measured by the broad producer price index of materials & components for construction has eased to a sub-2% pace, after hitting 6% just last year. Lumber prices are down more than 10% year-over-year after surging nearly 20% in 2017.
- An escalating trade war threatens to drive up prices on an assortment of new building materials, home décor items and furniture produced in China. Stone, bricks, floor tiles, kitchen cabinets, pipes and tubes and light fixtures are included on a lengthy list of goods which may be exposed to new tariffs.

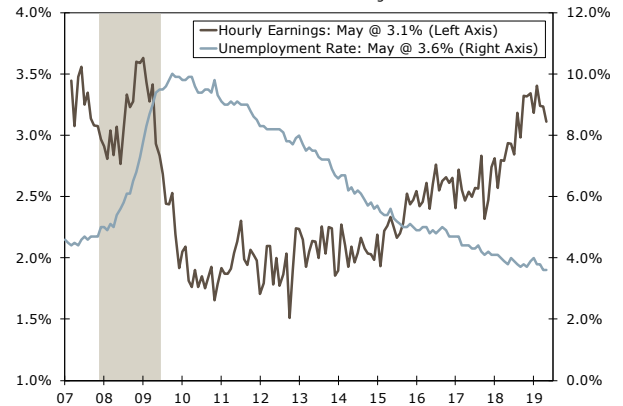
PPI: Materials & Components for Construction  
Seasonally Adjusted



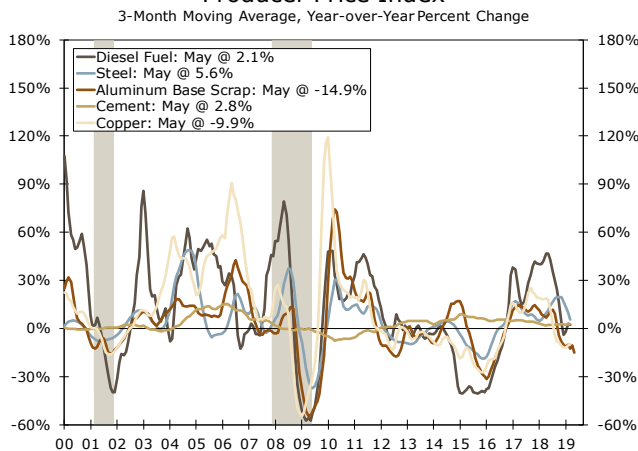
Softwood Lumber Prices



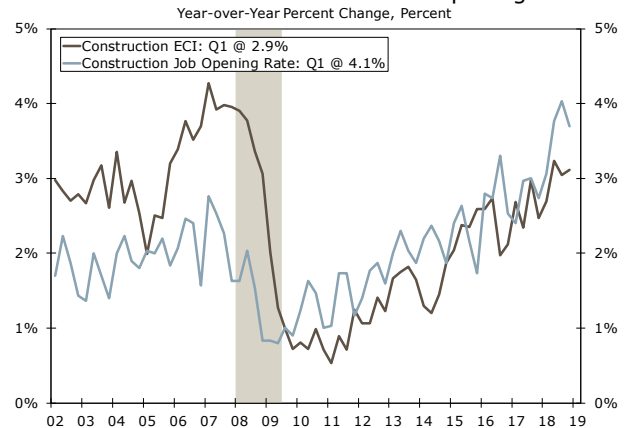
Average Hourly Earnings and Unemployment  
Year-over-Year Percent Change of AHE



Producer Price Index



Construction ECI vs JOLTs Job Openings



Source: U.S. Department of Labor and Wells Fargo Securities

## Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com

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