Brother Can you Spare a Loan?

1st Quarter -2008

The first quarter of 2008 was an eventful one. Bear Sterns stock fell over 90% and will probably cease to be an independent company. One of the more interesting things about Bear (which started as an investment bank in the 1920's) is that they did not layoff one employee during the Great Depression. Yet with J.P. Morgan taking them over at about 10 dollars a share- down from their all time high of $171 per share last year- it seems likely that 7,000 employees or about one half of their work force will lose their jobs over the next year. How could a company that survived the Depression evaporate in what seems like a blink of an eye? It certainly was not easy back then when this sad song was written:

"Brother, Can You Spare a Dime,"

> They used to tell me I was building a dream, and so I followed the mob,
> When there was earth to plow, or guns to bear, I was always there right on the job.
> They used to tell me I was building a dream, with peace and glory ahead,
> Why should I be standing in line, just waiting for bread?
> Once I built a railroad, I made it run, made it race against time.
> Once I built a railroad; now it's done. Brother, can you spare a dime?
> Once I built a tower, up to the sun, brick, and rivet, and lime;
> Once I built a tower, now it's done. Brother, can you spare a dime?

Brother…told the story of the American dream collapsing around our proud parents and grandparents who worked so hard for that dream and then had to wait on a bread line or beg for money. Yet in that very difficult era Bear Sterns did not lay off one person. Now 77 years later that company was brought down because no one would spare a loan. There is an uncomfortable relationship between the bank run that placed us in the Great Depression and the credit crunch that has led to this recession. Once the public had lost faith in the banks the scare that started with the market collapse would inevitably lead to the Great Depression.

Our current economic problems also had its beginnings in the reach for the American dream not so dissimilar to the old days. Low interest rates and aggressive lending by the banks placed many marginal people into houses that they really could not afford. For a short time it seemed that more Americans than ever could own their own homes. Once housing prices started to slow down the underlying problems of the subprime loans started to emerge as credit problems. Unfortunately subprime was just the tip of the iceberg. CDO's (Collateralized Debt Obligations), SIV's (Structured Investment Vehicles), and finally CDS (Credit Default Swaps), started to be brought to our attention. Many institutions used these financial derivatives designed by PhD's in math and physics not to be transparent but to be opaque. They allowed the investment banks (Bear among them) to generate a great amount of fees using illiquid investments that were rated high as long as investors were willing to buy them. A question that I asked over a year ago was if one Subprime loan was below investment grade how could a basket of 1000 subprime loans get a AAA rating?

In June two hedge funds created by Bear Sterns went belly up losing billions for so called sophisticated investors. As the credit crunch worsened banks and other institutions refused to allow many of the new manufactured financial products as collateral for necessary loans. MBIA and AMBC the municipal bond insurance companies started to write down assets and investors became fearful that they might default on their insurance promises; investors then became worried about their bond insurance depressing even secure Muni-bonds. The major investment banks, Citibank, Bear Sterns, Merrill Lynch etc. had to recognize major losses as they were forced to write down assets by ten's of billions of dollars. Banks were afraid to lend to each other or to consumers, effectively creating a near run on the credit market not seen since the Great Depression. Our economy was grinding to a halt as homes were being foreclosed and no one could borrow at any cost. Then the Federal Reserve started to take action lowering interest rates at record rates, injecting liquidity into the system by easing restrictions to get access to their funds. Finally both the Fed and the Treasury department took the unprecedented step of arranging for the buyout of Bear Sterns by JP Morgan and created liquidity where there was none and history may look upon the month of March as a great success of government intervention that if not taken could have started a worldwide recession. However Bears Sterns became the sacrificial lamb.

I am not pining for the loss of Bear Stern, however I am clearly dismayed about the impact that its collapse will have on its employees. I am mourning because Bear was one of the great manufactures of the alphabet soup of derivatives that helped create this credit mess. But many innocent employees and investors may lose everything.

Now we stand on a new path; yes the first quarter was bad with the S&P 500 down 9%, Muni bonds losing money, international stocks down as much or even more than the US market, the dollar continuing to fall and gold and oil hitting all time highs.

If this sounds bleak it is not my intent, remember this information is the past and we have to deal with the future. Fed Chairman Ben Bernanke along with Treasury Secretary Henry Paulson accomplished over the last few weeks what the government was unable to do during the Depression probably preventing a "run" on the banks loosening credit requirements; probably setting our economy on a better course and possibly minimizing the course of this recession. We now believe that the market is starting to show us some bargains and we will begin to reduce our cash positions this quarter. I still think that the ride will still be a little bumpy over the next few months but over the long term I feel more confident and expect to see some light at the end of the tunnel. Remember investing is not always easy; sometimes it seems that the right course is to sit on the sidelines, when we feel that way it is almost always the best course to push ahead because more money is made when things look scary and more risk is taken when everybody thinks that the market can only go up.