



THE MORE THINGS CHANGE...

With the inauguration over, President Obama has wasted little time getting legislation in front of the Congress. A massive \$900 billion dollar stimulus package is already in print and being put up for vote. Not surprisingly, the bill received only Democrat support with Republicans wanting more input before signing off support to a final bill. Our hope is that we are not being governed by the idea that "any action is better than no action", but one of thoughtful planning. The government should intervene in economic issues only when it is absolutely necessary, not because they can. The Bush administration repeatedly beat the drum for a free market work its own way through the current financial situation. As in most times, the best path is most likely somewhere in the middle. This has proven to be a tough road to hoe for many who are not used to the heavy consequences.

The banking system has always been somewhat of an anomaly, in that "banks are willing to lend you money when you don't need it, but when you really need money, they won't lend it." Unfortunately, this has never been more clearly demonstrated than now. Because of this irregularity, the federal government has been trying to help "encourage" banks to do their jobs. Regrettably, by lowering interest rates to a flat level has caused banks to be more cautious because their margin spreads are squeezed. Why take the risk of loaning money if you can't charge enough interest to make a profit.

Most likely, the U.S. Government will become the bank that our current predicament needs by buying the toxic assets (mortgage backed paper and other questionable debt). While this will result in some negative response by Congress and some citizens, the government can actually come out ahead. If the government "bank" buys the bad assets from the banks at a discount, when investors in the private sector buy them back in the future the price will be higher than they are now. Buying low and selling high sounds familiar!! If the government "bank" overpays for the assets, then the taxpayer is left to foot the bill for the difference. If it underpays for the assets, then the liquidity provided to the banking system will prove to be inadequate and therefore ineffective in providing a fix to the system.

The crux of the issue remains the same since the beginning, pricing the homes that are the basis for the mortgage loans written on them. Once the house prices stabilize, the mortgage loans can be appropriately priced, the loan packages can be accurately written down and a market can be established for them. The liquidity follows!!

A quiet stock market rally occurred in December 2008. The rally was a direct result of the calming sense that financial market was stabilizing. It wasn't until after the first week in January that we had some news that the banks aren't out of the woods yet and the market immediately retreated. We will not see a sustained rally in stocks until the banks sector finds solid footing.

The market's forty percent drop in 2008 was a combination of two things, a U.S. economy in a recession and a financial crisis. The economic recession was responsible for about 20% of the downturn. The financial crisis and panic was responsible for the other twenty percent. As a result, once the crisis and panic subsides, the market has a short term upswing potential of around 20%. The economic struggles will take longer to recover, but will begin to show in the market over the next few years. Because our portfolios dropped significantly less than the overall market last year, our portfolio's recovery time will be shorter than the market.

Thank you for your continued trust.