

The Financial Crisis 9/27/08

I have attached an outline of my thoughts on the current financial crisis. In fact, it is much more a collapse of the housing market that has been driving one financial titan after another to failure. With bank flows frozen, which are impacting everything from money market funds to municipal bonds to business lending, the impact on Main Street will be severe. We need some kind of bailout package ASAP to save everyone from this systemic financial system failure.

The housing market will require a long workout period. Perhaps the "Bailout" will help to accelerate the process. I have included a chart that shows that over the very long-term that housing prices mirror inflation. This has made home ownership the consumer's best and largest inflation hedge over the long-term. The real price (based on 2007 price index) of a house stayed right around \$125,000 through most of the past century. Then we invented a slew of different mortgage products and threw the rule book out the window. As a result, during this decade the real price of a house soared to \$225,000, or about 80% above "normal". I calculate that the most recent "real house price in 2007 dollars" is down to \$190,000. Since this is a simplistic approach and does not take into consideration home size, amenities or location, this is only a rough guideline of the trend of home prices. Nevertheless, this picture could mean we have along way to go! Please see the attached chart.

Moments of panic do provide buying opportunities. Starting in July 2007 as the financial debacle started to unfold, I sold equities and took family account cash holdings to around 40%. Since that time cash levels have generally ranged between 25-40%. Recently I presumed that we will have a "bailout package". Therefore our most recent moves have been to reduce cash levels to the lower 30s. Over the past two weeks I have put in place a buy package, of what I hope, are ten finance company survivors, for example, JP Morgan Chase and Wells Fargo. At the same time I have been buying selectively in US and international stock markets, which are down 20-35% over the past year. I look to continue to add to stocks, depending on developments. In addition, this chaotic disruption has also made municipals bond look attractive once again compared to US Treasuries, which everyone has bought in a flight to quality. Additions to Munis are under consideration.