

EMAILBLAST

An Ongoing Dialogue from
The Delta Group

REVENGE OF THE 1 % LOAN
March, 2007

Almost four years ago, in the depths of the worst market sell off since the Great Depression, I wrote an email blast called "Three Card Monty", which dealt with investor funk and loss of confidence in the stock market. The loss of confidence related to profits being stolen (Enron), self-generated (Arthur Andersen) or manipulated (Merrill Lynch). Faith in the system had been eviscerated by charlatans posing as fiduciaries. We learned that, without faith, prices fall to levels that reflected panic and the emotional distress of people wanting to hold cash – cold hard cash they could feel

Well, bankruptcies, jail time, millions in fines, new regulations, and ultimately profits brought faith back into our markets and positive returns to our balance sheets.... and, another "system" meltdown. As we mentioned in our annual newsletter, the real estate bubble is deflating and the consequences are playing themselves out in the market place. Last month, news of rising foreclosures and defaults in the sub-prime (sub-par credit) mortgage segment sent the stock market reeling.

As was the case in the tech bubble fiasco, responsibility for the system failure encompasses many, including mortgage brokers (no money down apps), realtors (prices always go up), rating agencies (shhhhhh!), investment bankers (have I got a deal for you), regulators (problems! what problems?), and finally, Alan Greenspan (variable rate loans are best) himself. And, let us not forget the final culprit, the greedy wannabe homeowner whose signature on the bottom of the falsified application made this whole charade possible.

Authorities worry that this sub-prime "contagion" will spread. As prices fall and equity disappears concurrent with rising payments on upward adjusting mortgages, foreclosures will snowball, sending inventories higher and prices still lower. You get the picture. The virtue of leverage is controlling large amounts of capital with small amounts of equity. The dark side of leverage is the unwinding of each and every dubious transaction, and the loud sucking sound of evaporating home equity that we never really had.

Ahhhh! . . . this would be capitalism in its less than finest hour. Stay tuned as the drama unfolds. With all things being circular, this will become a great opportunity to buy low in the previously over-priced markets. Stay tuned for future blasts.

Eric Dahl

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