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An Ongoing Dialogue from
The Delta Group

REVENGE OF THE 1 % LOAN (Part III) Dec., 2007

In our last musing, we opined about Easy Credit-the evil and deceptive 1% mortgage loans syndicated by Wall Street that dramatically over-inflated the housing market. Right on cue, the gravity of market bubbles took hold and scattered home owners, lenders and the like over the landscape. The meltdown has captured millions of homeowners with negative equity and unaffordable mortgages, lenders with foreclosed properties, and investment bankers with billions in losses.

Fighting for survival, investment bankers are begging overseas investors for capital infusions to stay solvent. The banking industry is consolidating as it did two decades ago in the S&L crisis of the late 80s. Step and repeat home builders are selling assets to maintain liquidity ratios demanded by their lenders and homeowners are leaving the keys in the door and the house behind. Essentially, the financial world is de-leveraging in the face of deflating asset values. The March 911 call from Bear Stearns to the Fed has focused their efforts as lender of last resort.

Wall Street lives to syndicate, converting an asset of any value into a saleable financial product. Internet companies of the late 90's with no long-term (or short term) viability was child's play compared to the sub prime loan nonsense that has wreaked havoc upon single family homes and condos. The former captured thousands of greedy video game investors, the latter millions of wannabe make a million while you sleep homeowners. Now these same amoral syndicators have taken commodity speculation from the pits in Chicago into the security exchanges of the world. Commodity investing is the new fad.

Heretofore, commodity investment had been left to high net worth investors and industry hedging of production costs. Now, even casual investors can buy oil (and other commodities) on the stock exchange via an ETF (exchange traded fund). Observers estimate that the increased investment (non industrial) demand (70%) has pushed oil prices 20% - 30% higher than they otherwise would have been, and this helped double the price of oil in the last year. Great-!

In the meantime, the combination of the lingering real estate recession and rising inflation is sucking the life out of our economy. The stagflation worry that we discussed in our year end newsletter has arrived. We are re-living the 70's, minus double digit interest rates. The Fed, forced to lower interest rates to boost the slumping economy, has inadvertently increased commodity speculation and aided in the dollar sell-off. The Fed is in a pickle, and consequently, so are the markets. By year end, the Fed may be forced to push interest rates higher to control inflation, rescue the dollar and squash commodity speculators.

The markets – down, directionless and lacking confidence – are reflecting the bear market sentiment of fear and panic. Certainly we will have to grind through 2008 before the economy gets back on its feet. The financial sector's health and stability will be the foundation of an advancing stock market. This healing process will conclude with a few hundred bank failures, with the weakened institutions merging with the stronger survivors and sanity returning to lending standards.

Remember the old adage: buy low and sell high. We will live to see better days.

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