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Quarterly Newsletter
April 2008

Welcome

Dear Reader,

It seems like we just celebrated New Year and we are already on DST. Time flies when we are busy applying band-aids to stop the bleeding. Thank goodness we have a solid healthcare system for financial markets.
I have included a few more articles about different topics that I hope you will find interesting and informative.
As always, your comments and suggestions are welcome so I can continue to provide you with topics and information that interest you the most.
The graphs do not take into consideration any Fed. Fund rate cut, expected to be announced 3/18.

Happy reading and enjoy,

Nick Doms

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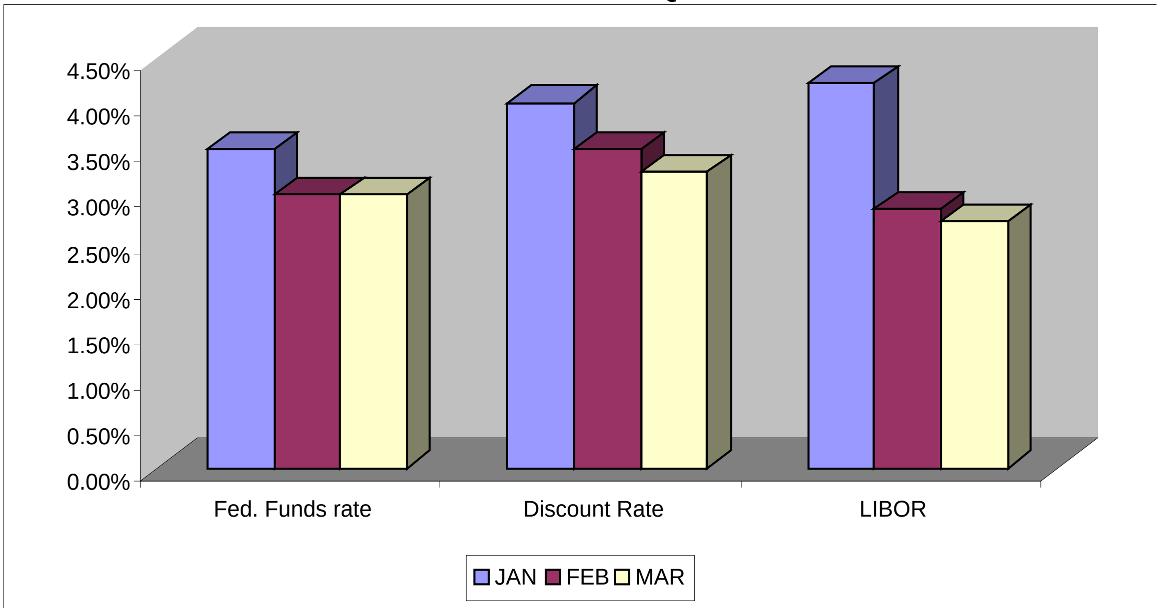
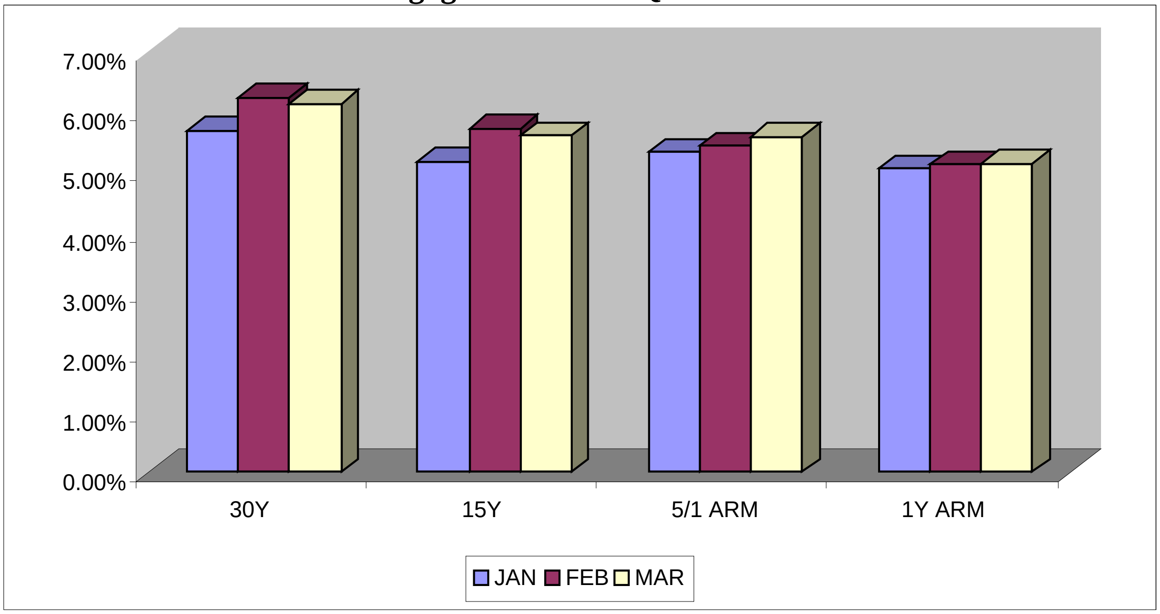
Graphs

Short-Term Rates First Quarter 2008



Mortgage Rates First Quarter 2008



Sovereign Wealth Funds

Since the start of the sub-prime market crisis, all of us have heard more and more about foreign investments in our financial system and all of us have become more familiar with the Sovereign Wealth Funds terminology.
Before I tackle the rational behind this continuing trend, which we will witness for several decades to come, it is important to understand what and who these funds really are.

A sovereign wealth fund is not private equity but represents a government owned and managed fund. These funds are made up of excess government capital and are derived from trade balance excess and income due to higher exports.
In most cases, primarily the Middle East, these funds are the result of higher oil exports, because of the demand, but are also due to the weak dollar and the hike in oil prices, which continues to prevail.
In other cases, such as China, India and Japan, these funds derive their capital from either fast growing economies (China and India) or from high savings rates (Japan).

While many Americans may question whether we should allow, through regulatory approval, for other countries to inject capital in US built and based companies and before we condemn or condone such, we need to keep in mind one important thing.

We currently live in a fast growing and evolving global economy and there is no turning back. It is a fact we have to accept and will have to live with, but in the end, and if you think long-term, there are plenty of benefits to reap for all of us.

Keeping that in mind, here is what I see and think about the influx of foreign capital, whether it is in the financial sector, corporate America, our ports or any other sector.

The Pros:
-The fact alone that foreign governments inject capital in our economy means they have confidence in our future and our performance. They are confident that the American economy will grow again at a sustainable rate and therefore will provide a good return on their investment.
-Given that our financial system, primarily our investment banking system, has suffered and continues to suffer from the sub-prime fallout, the foreign capital injection is much needed in order to strengthen the capital base and balance sheet of banks such as Citigroup, Morgan Stanley, Merrill Lynch and Bear Stearns.
This much-needed capital cannot be provided by US private equity firms or by hedge funds.

-The extra capital provides our companies with the required reserves and liquidity to deal with the current financial crisis and protects the shareholders from further potential revenue and dividend reduction. It also stimulates our economy overall and long-term by solidifying the corporate capital base.

The Cons:
-Once a foreign entity owns a certain percentage of a US company, it is to be expected that such entity will request a seat on the Board of Directors and request decision-making power. As of now, no sovereign wealth fund owns more than 10% of the outstanding capital. The reason for this is that any ownership above the 10% limit needs regulatory approval through an official SEC filing.
So far, no foreign entity has requested any voting or decision making power, but expect this to occur very soon.
After all, there is no such thing as capitalization without representation.
-The possibility exists, at this point in time, for a “rogue nation” to inject capital in our economy because they have the financial resources to do so.

Having said the above, we need to carefully balance our decisions and think long-term about the benefits, keeping in mind the circumstances within which the capital influx occurs.
If we take drastic actions and a tough stance on either side of the equation, then we will lose our economic position globally.
Allowing all foreign capital to freely move into US companies, because we are in dire need of cash, means we risk losing control. Therefore we need a tempered regulation and a review/approval process that allows capital to flow in, but restricts the decision making process of such investors.
Prohibiting all foreign capital to be injected will result in a protectionist attitude, with repercussions for US companies, by not being allowed to expand and invest globally.

We are on the verge of entering a brand new era of globalization and we are walking on new ground. But we are not the only ones; every other country experiences the same effect.

Let’s be careful and thoughtful about our opinion and decision-making.
In the end, all industrialized nations and emerging economies will succeed together or not at all.
Let’s move towards the former rather than the latter.

ND – 2/21/2008

Recession or Inflation

We live in strange times lately and things don't seem as simple as we may think.
I have written several articles about the interest rate cuts and how I think about the consequences.
This time, I want to put into perspective how complicated circumstances can be and how it affects the decision making process if and when you are the Chairman of the Federal Reserve.

Let's first look at the how we got where we are today:
-August 2007: the first signs of sub-prime loans are slowly becoming visible and we know problems are about to occur.
-September 2007: the Fed eases by 50 Bp because of fears of an economic slowdown due to the housing market and the credit crunch.
-October 2007: the Fed eases another 25 Bp.
-December 2007: the Fed eases by 25 Bp in anticipation of bad GDP and unemployment figures for the 4th quarter.
-January 2008: the Fed eases first by 75 Bp and one week later by 50 Bp bringing the actual Fed rate from 5.25% to 3.00% in three months.

Where we are today:
It is widely expected that the Federal Reserve will again lower interest rates in March by another 50 Bp at least and possibly 75 Bp. We will know the answer to that by the time this newsletter gets published.
But let's not focus on that. Instead, let's focus on the economic scenario that is playing out, which is very unique and worth looking at.

Under normal circumstances, a local economy is inflationary, deflationary or stagnationary. This means that anticipated monetary policies control the M1 and M2 to predict the economic growth.
In other circumstances, foreseen or unknown, we see a period of recession or exponential growth.

When we look at our economy today, we see a mixed reaction.
Our GDP is very low, currently at 0.6% growth, which means we are in a recession or very close to one, depending on who you ask. I say we are already in a recession as I write.
On the other hand, we experience inflationary pressure with the latest CPI figure of 0.4 and a core CPI figure of 0.3 for the month of January.

What does that mean and how should one react to it?
The question may seem simple, but the answer is not. Most definitely not when you preside over the largest central bank in the world.

-The recession phenomenon:

Our economy is contracting very fast due to the impact of the housing market, the credit crunch and the reduced liquidity in general.
Our consumer spending has dramatically been reduced, retail sales are sluggish, unemployment is up, and oil and food prices are rising, among other factors.
The normal monetary intervention in this scenario would be to lower interest rates to revive consumer spending and thereby re-ignite the economy.
But wait.
There is another economic scenario playing out at the same time.

-The inflation phenomenon:

The inflationary pressure is up due to higher food prices and manufactured goods in general. Even excluding energy and oil, the core CPI jumped in January. The record high commodity prices play a very important role in the inflationary pressures we witness today.
The monetary policy in this scenario would be to tighten the market by raising interest rates in order to control inflation.

Now you know where I am going with my train of thought.
If we see both scenarios play out at the same time, then one action will contradict the other. So what should the Federal Reserve do in this case?
The answer lies in what is really important in the long-term.
My point of view is this.
Forget about the recession, the housing market, the credit crunch and the lack of liquidity.
Focus on the inflationary pressures, which have a direct impact on consumer spending for every American.
Control the CPI and PPI by keeping interest rates at the current level. Raise interest rates in the third and fourth quarter of 2008 until inflation is under control. The recession and the underlying drivers of such will ultimately take care of itself and can be influenced by monetary tools available other than interest rates.

While this may very well be a contrary view, just evaluate this for a second:
Have the interest rate cuts helped alleviate or solve the problems in the housing market or the credit and liquidity crunch?
The answer is no.
Good! Then raise interest rates, curb inflation and position our economy so we have playroom in the sandbox and we are not finding ourselves watching everybody else play while we sit by, quietly watching from the playground.

ND – 02/21/2008

The Housing Market

I don't need to reiterate the current condition our national and local housing market is in. All it takes is a drive around on a sunny weekend and you cannot keep track of all the colorful "For Sale" signs and the "For Sale by Owner" signs.
Personally, I like the signs on top of it or across that read "Just reduced".
I don't see signs that read "Under Contract" or "Sold", at least not a lot of them.

Now that the latest figures for January and February sales are available, we get a more accurate picture and one I predicted in August last year, while real estate agents kept claiming that this was the time to buy and there were great deals to be found.
How about a serious reality check?
Instead of trying to convince investors and home buyers that this was and is the time to buy because otherwise they will lose out, I translate this in plain English as meaning: this is a great time for me to sell something because otherwise I will not have any commissions.
Now I know I got the attention of the real estate agents that read my newsletter.
Don't get offended, just relax and continue to read, it will be worthwhile if you are interested in a financial and economic perspective.

These are the facts:
-Housing prices are down in general, except for certain regions (Mid-West).
-Inventory is up again by 5.5%.
-Foreclosures are up and continue to rise.
-ARM loans continue to be reset.

Before you interpret this as all bad news or more to come, I want to point out a few things.

Housing prices:
The fact that housing prices are down again in January/February is very normal. These prices will continue to fall and will have to fall in order to reach a much-needed equilibrium in the market place.
The proof is in the pudding and here is just one of the scenarios that occur everywhere.

A lonesome buyer agrees on a purchase price with a seller and signs a contract for the agreed upon price.
The buyer applies for a standard 80% loan, is in good financial standing and the bank performs their due diligence by appraising the property.

The appraisal reveals that the property is worth less than the agreed upon sale price and therefore the approved loan amount is insufficient to cover the estimated 80% coverage.
The deal unwinds and nothing happens other than a buyer walking away, a seller having to start over again and a real estate agent missing out, not only on commission but also valuable time and efforts.
This is reality and it happens very frequently across the country.
Who is at fault, if anybody at all?
In my opinion, the seller and real estate agent should take responsibility for unwinding agreements because of over-stating the property value to begin with.
If sellers do not learn to accept the fact that their property is no longer worth the same as the selling price of their neighbor’s house two years ago, then they should stay where they are and pull it off the market.
In addition, real estate agents should not just blindly accept listings but instead should educate their potential clients of the real market conditions and manage expectation levels.
The Barbie and Ken days are over. This is a time for true professionals that are knowledgeable and understand the underlying fundamentals of the market.

While some analysts continue to tell clients that the market is scratching or scraping the bottom and therefore we are at the end of our fall, I do not share that same opinion. We have not seen the bottom yet, let alone touched it. However, we are getting closer and that is the good news.
Wait until the third or fourth quarter; let the markets take a deep breath while we all lick our wounds.
Then some can stop their therapy sessions and anxiety medication and we can all be normal again or as best as we possibly can.

Inventory:
It is not surprising nor should it be alarming that the inventory keeps going up. Part of the explanation is of course that sellers list their property but do not want to reduce their asking price because they are not in a hurry to sell.
The other phenomenon that impacts these national statistics is the fact that for the first time ever, foreclosures are now becoming part of the MLS listings. Banks who are forced to foreclose on an existing home no longer wish to manage the sale of such property, but rather seek the professional assistance of a real estate agent.
An increase of 5.5% in national inventory does not necessarily mean extra bad news for the housing market, but reflects a shift from previous Courthouse fire sales to MLS managed sales.

Foreclosures:
Foreclosures are expected to continue to rise as the market continues to refinance the ARM and sub-prime mortgages.

Independent of any financial rescue package that comes from Washington DC, the fact is that none will ever be big enough to save all.

However, if a presidential candidate can figure out where to find all the funds to bail out every American that defaults on their mortgage payments, I will personally address the Democratic National Convention and make a plea to restructure the mortgages of every hard-working American who pays his/her bills on time, their car payments on time and their mortgage on time.
That is of course after I convince every American to simply default on every bill and invoice they receive so that the “donkey” can come to the rescue with his or her big checkbook.

ARM Loans:
It does not worry me so much that previously signed loans get reset and refinanced through a standard fixed-rate mortgage. What does worry me is that after the complete disaster with sub-prime loans we all witnessed, that even today mortgage brokers continue to entice borrowers to sign ARM loans independent of the disclosure that interest rates are expected to rise again and knowing very well that 1, 3 or 5 years from now these loans will have to be reset at a higher rate.
One would think that mortgage brokers, with a balance sheet that is at serious risk, would know better than to make the same mistake twice.
At least banks know better than that. While some may point fingers at them for implementing stricter borrowing requirements, they advise and decide in the borrowers best interest from a long-term perspective.

ND – 02/29/2008

The Inter-Currency Market

An interesting phenomenon continues to develop in the foreign exchange markets, primarily between the USD/ JPY and Euro.
If I just focus on the parity or disparity between the USD and Euro, and knowing that in mid 2006 we saw exchange rates of 1.20, today we are witnessing a further decline in the USD value to a record low of 1.56.
Many analysts and economists will be quick to point out that a low USD is good for the economy because it stimulates exports and therefore improves the US trade balance sheet.
The other explanation is that the borrowing cost to fund the budget deficit is cheaper because interest rates are low.
While I do not disagree with the above explanation, it seems that the proponents are only looking at one side of the equation and are afraid to look at the other side.
Here is the other side of a weak USD:
-Our economy, through corporate revenue and income, is primarily driven by revenue derived from manufactured goods produced overseas by American companies and not through exports.
-Our imported goods, and we have plenty of them, become more expensive with a weaker dollar. Yet the irony in one sector, the automotive industry, is that a Toyota or a Mazda is still cheaper than a Ford or a GM, even with a very weak USD.
-The continued rise in oil prices is sustained by the weakening of the USD, at least partially, but it definitely has an effect on the commodities markets.

I foresee a further decline in value of the USD for the remainder of 2008, although not at the same pace as we witnessed throughout 2007. With further rate cuts expected by the Federal Reserve this year and an expected Fed Funds Rate to hover around 2.00% or less to battle recession, expect the USD to weaken to 1.65 – 1.70 by year-end.

The decline of the USD versus the JPY is a different scenario and is due to two underlying reasons.
The first is the slow but continuous growth of the Japanese economy and the expectation that the BOJ will have to raise interest rates to curb their potential inflation.
However, the largest reason for the USD to flirt with a 102.00 level is the carry trade in the market. Money market traders are speculating against the USD and seeking short or mid-term shelter through swaps and reversed swaps, which influence the foreign exchange market.
The latter does not necessarily paint a clear picture from a long-term perspective, but until these trades start to unwind, it is the reality.

Look for the JPY to strengthen in 2008 and if the barrier of 100 JPY/USD is touched or crossed, then we will find ourselves in a freefall and at the lowest exchange rate since 1995.

The AUD and NZD remain strong, due to underlying fundamentals of strong and sustainable economic growth, and will strengthen slightly further during 2008.

The ZAR remains strong although there are no economic data to support such except for the strong performance of precious metals, gold in particular. I believe that the value of the ZAR is inflated and cannot be sustained at the current levels unless the unemployment rate, the GDP and the economic growth changes in 2008.
I do not expect any of these indicators to change soon.

In general, and watching smaller local currencies, I think the risk investors should take into consideration is whether smaller economies such as Thailand, Malaysia, South Korea, Vietnam and Taiwan can continue to keep their foreign exchange rates versus the USD in a manageable and controllable bandwidth.
The second comment I will make is that the weakness of the USD puts pressure on their exports and therefore their balance sheet and GDP.
Knowing that their reserves are not as exhaustive as a European or Japanese economy, will they be able to keep buying USD to offset the upward pressure on their local currency?
My point of view is that if the scenario of a continuing weak USD persists for a long period of time, that we risk creating the opposite of the Asian currency crisis we witnessed in 1998, only the consequences will be far greater because this time it will disrupt the long-term capital markets.

ND – 3/1/2008

TAFs and TSLFs

When the Federal Reserve announced the launch of Term Securities Lending Facilities (TSLF) on March 11th, I couldn't help but include an article about it in this newsletter.
For many months, I have been critical of the Fed's actions and monetary policies, but this latest creative intervention has restored my faith in Bernanke.
I will explain below why this is such an important step and how it will affect the liquidity and the economic outlook for the second half of 2008.
Let me start by giving a brief description of the products now available to financial institutions.

Term Auction Facility (TAF)
For the longest time, the Federal Reserve has made borrowing to financial institutions possible through the use of what is typically referred to as the "Window". Banks that cannot use the inter-bank borrowing facility either because of lack of available funds or other reasons, could and still can go to the "Window" and borrow directly from the Fed. at an overnight discount rate.
However, this type of borrowing has created a certain negative stigmatism because it has always been considered to be an attempt of last resort and therefore is easily interpreted by competitors as a first sign of financial trouble to come for the institution involved.
With the creation of TAF, institutions can not only bypass this last resort borrowing, but also have access to longer term borrowing needs.
In addition, the TAF allows the borrower to collateralize the loan with a wider variety of liquid and high rated paper.

Term Securities Lending Facility (TSLF)
On March 11th, The Federal Reserve implemented a very creative plan that allows financial institutions to borrow up to 28 days. It also allows all institutions to use any collateral currently held on their books. This means that the Federal Reserve is willing to accept CMOs, DMOs and structured products and therefore will assume the risk associated with such in exchange for AAA US Treasuries.
Given the high liquidity in the Treasury market, this allows the banks to raise capital in the secondary market to continue to meet their lending needs.
Add to this that the Federal Reserve has agreed to execute reciprocal currency swaps with the ECB.

What does all of this mean for the liquidity and credit markets?
We have seen a very tight liquidity market for several months, not just in the US but also globally. This crunch directly affects the banks and mortgage brokers and has resulted in

a tightening of available and approved loans locally and nationally, independent of credit or payment history.

Both interventions will initially be met with skepticism and it will take another quarter to really see the results trickle through to the local level.

It will also have a very positive effect on the US economic outlook because now things are starting to look up for the latter half of the year. That does not mean we are out of the woodworks yet, but at least there is hope that the recession will be shallower than foreseen and we will be able to generate a slight positive growth in the third and fourth quarter independent of the high food and energy prices.

One final thought:
The good news is that finally the Federal Reserve is getting serious about facing the housing, liquidity and credit problems head on.
This is what most of us have been waiting for since last year and I hope the Federal Reserve makes this option permanent and will renew the 28-day loan automatically until the markets are completely stabilized.
The second comment I will make, and one that I personally applaud and welcome, is the close collaboration between international central banks. We are finally getting out of the mode of focusing exclusively on America and show willingness to resolve any economic issues from a global perspective. This is a step in the right direction and one that is much needed. I will address this issue more elaborately in the next newsletter because of its importance and impact.

ND – 03/12/2008

Headlines

Sitting on the top of the fence

Remember the song?
The lyrics have changed a little bit and we should sing:
"Sitting on the top of the fence,
Watching the problem roll in, not away.
Sitting on the top of the fence,
Wasting time, time….."
I don't know about you, but I hate sitting on the fence, one because it is boring and two because it hurts my cute behind after a while.
Sellers should make a decision about what they really want and should take a look around.
Buyers are sitting comfortably on their green pastures.
They are looking at you and waiting for you sellers to make up your mind on which side you choose to fall: a buyer with cash in hand for a reduced sale price, or an empty pasture with no bids because of the high asking price.
It is time to decide.
Remember, the longer you sit and wait, the more the market will hurt.
Come and graze on our pastures.
Life is good here every day.

ND – 03/07/2008

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Please rescue me!

Dear Mr. Paulson and Mr. Bernanke,

My neighbor informed me that you have put a rescue package together for him so he can keep his house.
I have a high credit score, pay my mortgage on time and am not delinquent on any of my bills.
I also have a good savings and IRA account for my retirement.
I would like to request the following:
-Lower my mortgage rate from 5.85% to 4.75%.
-Lower my remaining principal balance by $50,000 to reflect the reduced FMV.

In return, I promise that I will spend my extra available cash in your economy, which will help you to recover from the current recession.
I have already turned in my Ford Taurus (Made in Mexico) for a brand new Toyota Camry (Made in Kentucky).
I don't buy toys from China, because I don't have children. I don't buy groceries at Food Lion, because a Belgian conglomerate owns them. Instead, I buy everything at Publix or Kroger, good old-fashioned American companies (I think).
I stopped buying French and Swiss cheeses and now only eat Cheddar.
I still have a problem when I buy milk because I can't figure out where that comes from, but I think it comes from

California because the commercial says they have “happy cows”.

I hope you understand that I do everything in my power to assist where I can.
I would appreciate it if you could put me too on the rescue list, even though I don’t qualify for foreclosure or bankruptcy.
Thanks in advance for your immediate attention to this urgent problem.
I am looking forward to receiving your check in the mail because I really want to go shopping at Home Depot so I can fix and buy my neighbor’s house.

Sincerely,

ND – 03/05/2008

We would like to start another feature in our quarterly newsletter called: “Letters to SiRuDo”
Please send your comments, questions and suggestions to:
ndoms@sirudorealty.com

Your letters will be published anonymously and all questions will be answered.

Ethanol and Soybeans

Once upon a time, the health conscious vegetarians decided to convince the American consumer to:
“DRINK SILK, NOT MILK”
Because we are an obese, health conscious consumer society, people bought silk because it has more vitamins, it does not originate from an animal and it tastes good.
Last year, the “let’s save the world” environmentalists, a.k.a “save the whale and the seal”, decided to sleep with Washington DC.
After the orgies were over, our politicians decided we needed more corn to make ethanol.
We subsidized all the farmers who were willing to plant corn instead of soybeans.
But then I got confused, because what will happen to my silk?
My precious healthy silk got so expensive; I had to switch back to milk.
Today, my health is deteriorating again because of my change in diet (again), but why complain.
I think about these poor cows out there that are no longer fed with luscious ears of corn, but instead get tasteless artificial food.
Ask Schwartzenegger whether they are still smiling. At least my car is, but my wallet is not.

ND – 03/08/2008

Breaking News

The Bear Stearns Story

March 17th and not even 8:00 am yet, here comes another shocking story to hit the markets like an 18-wheeler.
The US Treasury and the Federal Reserve have done it yet again. Every time they spend a weekend together on a luxury retreat, they come up with solutions that are highly questionable.
This time, the mark was clearly Bear Stearns (BSC) and had been since March 11th when Goldman Sachs refused to close a deal with BSC due to high counter-party risk. The interviews with Ace Greenberg (ex-CEO) and Alan Schwartz (current CEO) did not put the markets at ease, and by Friday, BSC traded at its lowest level.
Today, BSC is no more and has been acquired by JP Morgan Chase for the pitiful amount of $ 236 million. In addition and part of the deal is that the Fed. takes on an additional $30 billion in bad and illiquid debt and issues two new regulations:
-The "window" is now available to everybody, including investment banks.
-The borrowing time was extended from 30 days to 90 days.
As if the above was not enough, the Fed. also lowered the discount rate by 25 Bp to 3.25%.
Where in the world was the Fed. last week when they knew BSC was in financial trouble?
What if the above interventions would have been implemented a week ago?
My answer to that is simple.
BSC would be alive and functioning, although with difficulty.
Today, all shareholders have seen their stock dwindle to a mere 1% of its value a week ago.
But that is not the worst part. The acquirer has made an unprecedented move. Pending shareholder's approval (60 days from now), they have already seized full control of BSC and started firing people at the beginning of the workday.
JP Morgan Chase owns the Bear Stearns building and content, independent of shareholder approval.
What deal will be negotiated next over another weekend?
Lehman Brothers? Countrywide? MFGlobal? AMBAC? MBIA?
Whose shareholders will be diluted again and left hanging to dry?
Who will explain to the BSC employees that their company pension plan (entirely invested in company stock) is worth pennies or nothing at all?
Remember Enron?
Sounds about the same, doesn't it.
Here's what is next for the BSC employees:
-If you worked in Investment Banking, you have lost your job.
-If you worked in Clearing House and Prime Brokerage, you will be sold again to a competitor before the end of the year.
Shame on you JP Morgan Chase!
ND – 03/17/2008