CLEARVIEW
INVESTMENT PARTNERS

The View

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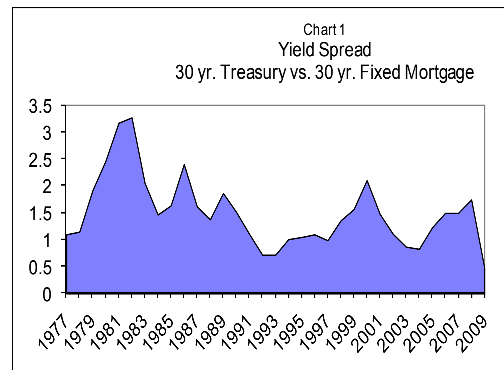
Batting 1,000...Off A Tee

"In theory there is no difference between theory and practice. In practice there is." Yogi Berra

In maybe an even more infamous quote the legendary Yankees catcher and later manager said, "*If you don't know where you are going, you might wind up someplace else*." These little epigrams highlight what many people in many towns across the country are thinking and what many folks in our line of finance suspect. The gist of it is that an academic is running the Federal Reserve and a Charlatan is at the helm of the Treasury. What we'd really like to understand is the rules of the game before it's played as well as the likelihood of being rewarded by subjecting ourselves to those rules. If, in fact, we don't know where we are heading and we have *dynamic* rules, then certainly, we will end up someplace else!

There is a constant chorus at the treasury and the FDIC for banks to start lending again (and not just to the best creditors). To any of us with waning credit access or otherwise this seems like a reasonable request. We actually view this as the bank's responsibility, and given that they seem to be the biggest beneficiaries of government intervention, we expect some compliance. Taking a closer look, however, reveals the conflicting signals being sent to our nations financial complex (much like the ironies present in Yogi Berra's most famous quotes). Recall that in March the Federal Reserve implemented a plan to buy $1 trillion of securities to help create liquidity in the market; $300 billion of treasuries and up to $700 billion of mortgage backed securities. This unprecedented intervention is ongoing and has contributed to the decades low mortgage rates seen today. For instance, a 30 year fixed rate conventional mortgage is currently about 4.75% at the retail level. That rate is largely subsidized by the Federal Government's buying of those mortgages through these aforementioned facilities. Compare that to a 30 year treasury bond yielding 4.5%. The yield pick up or spread between the two is at the lowest level that I found data for (32 years; Chart 1). The large banks have now become hypersensitive to

proper governance and are justified in buying only treasuries and foregoing mortgage and business lending. As a bank manager, why would you invest in a mortgage with an uncertain payback period, an unknown default risk, and a finicky market for liquidity all for just a paltry .25-.50%? The answer is you wouldn't, so the lending that should be taking place is not.



The Federal Reserve's program of buying mortgages (thus suppressing yields) is slated to end in the first quarter of 2010. This is where there becomes a double-bind situation which will likely force the Fed to remain committed to the program. The reasoning is that as the Fed pulls out of the mortgage market yields will raise to normal levels. This will severely slow home buying as the cost to own will certainly rise with rates. Additionally, as the Fed reverses their position of buying toxic assets from the banks in return for treasuries the banks will have to start back on the trail of liquefying their balance sheets by purging the unwanted real estate. This real estate is currently in limbo as the Obama administration tries to work out problem loans, a good number of which are on the Fed's balance sheet currently. There is a very large component of 'phantom' inventory of homes. These are homes that have not seen a mortgage payment from the borrower in over a year, may be owned by the bank (or Fed), but yet are not for sale in the open market. Essentially occupied by squatters or simply empty. This stalemate is also allowing the economic numbers to look much better, at least on the surface. Our suspicion is that once the massive accommodation is removed from the system the economy will slowly wither. Higher federal funds rates are not needed for this to happen; simply exiting the current liquidity programs would do it. There is something very un-American about all this and depositors as well as taxpayers should be very angry. The banks in their current state should be either be made to be utilitarian or left to survive or fail from their mismanagement. The idea of this quasi-capitalistic posture remains absurd, with taxpayers dollars and depositors low interest loans going to support the bank's health.

This point really leads us to the conclusion. The Federal Reserve,

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Treasury, and the government in general will likely use trial and error to reverse the decisions of the last year or so. It is precisely because the rules of engagement in the capital markets in the U.S. (many other places as well; and a topic for another day) are so ill defined that we at Clearview Investment Partners, LLC continue to take a very earnest and disciplined approach to investing our clients wealth. Our charge is simple: first do no harm (principal protection) and, second, engage our clients trust and capital to advance their goals.

Raymond M. Lombardo, CIMA
Managing Partner
Clearview Investment Partners, LLC