



The Empowered Future Report

Short-term thoughts about long-term matters...

July 3, 2007

Quote of the Day: “To build may have to be the slow and laborious task of years. To destroy can be the thoughtless act of a single day.” --Sir Winston Churchill

Golf recap:

A quick thanks to those of you who joined us at Raccoon Creek Golf Course last week for an afternoon of golf lessons! We had an excellent PGA Pro instructor who spent time with each individual helping to improve various aspects of their game.

For those of you who missed it, watch for your invite next summer...

-Allison

The new Web site is up and running!

For those of you who received numerous emails regarding our new site, thank you for your patience while we worked out the various technical bugs that often accompany a project of this size...Anyway, the site is ready for you to use: www.altiusfinancial.com. This is the new site to reach Account View, which, if you haven't signed up for this online account service and would like to, please email Allison@altiusfinancial.com. Make sure to visit Mike's blog under the “Latest Thinking” section. We hope you enjoy the site!

Once again we've been seeing in the news that some "hedge" fund managers are not so smart. A couple of big hedge funds on Wall Street are in trouble, because they bought big portfolios of sub-prime mortgage pools using leverage. Now, first it is important to note that the word 'hedge' used to mean reducing your risk, as in "hedge your bets." However, some of these "hedge" funds don't do that at all; instead they add more risk buying very risky assets using leverage, i.e. using borrowed money. So, we always look under the hood of hedge funds to see if they really are hedging their bets.

The description "sub-prime" for these mortgages is probably an understatement. Some of you may have seen me on 9News a couple months ago where I was interviewed on this very topic. We referred to these programs as "perfect weather mortgages" where both the borrower is counting on optimistic assumptions about everything from interest rates, to their bonus, to their old car not needing a new clutch for another couple years, to...well, you get the idea. These are mortgages with little, no, or negative principal required from the borrower. We would indeed call that "sub-prime". In effect, they are a bet on the part of the lender that house prices will rise, creating principal, and thereby reducing the risk of the loan. We heard that house prices had been red hot and were poised for a correction quite a while ago, and we all know that the Federal Reserve started hiking interest rates in June of 2004, stopping at 5.25% a year ago. Consequently, we saw home building start to fall in the summer of 2005 and house prices turn down a bit later. And, we started hearing about the sub-prime mortgage problems early this year. Now, we are intimately familiar with the problems associated with hindsight investment criticism, but with all this information in hand some time ago, what on earth were these hedge fund managers, their investors and lenders (some usually astute financial firms) thinking?

We can't help but comment on the double standard in the media and among politicians who for years pressured lenders to not discriminate against those with poor credit history and shaky finances. Now the pendulum swings the other way and we have those same pundits blaming lenders for not having discriminated enough and of having made too many risky loans. Surely there are lots of bone-headed loans out there but the economic illiteracy of the media and congress never ceases to amaze us. But this doesn't get those

hedge fund managers off the hook - staying with highly levered bets on very risky mortgage loan pools with ample negative information well in hand looks pretty silly to us.

So, what does this situation mean for the broader credit markets? In our opinion, not too much. Sub-prime mortgages are a small part of the total mortgage market, and we do not see a widening impact on other mortgage pools where borrowers have made significant down payments. There may be some volatility if other hedge funds reduce their leverage and sell assets, but we do not see fundamental linkage to high yield company debt or REIT's. Nor do we yet see significant linkage to the broad stock and bond markets. So, while we are watching these developments closely, we do not see the need for portfolio repositioning over this issue. Vince and I agree that this is mostly another example of the U.S. capital markets taking a bunch of silly portfolio managers, investors, and lenders out to the woodshed. And that is a good thing that maintains discipline in credit markets.

Have a happy 4th of July!!

As always, please call us with any questions or concerns.

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