

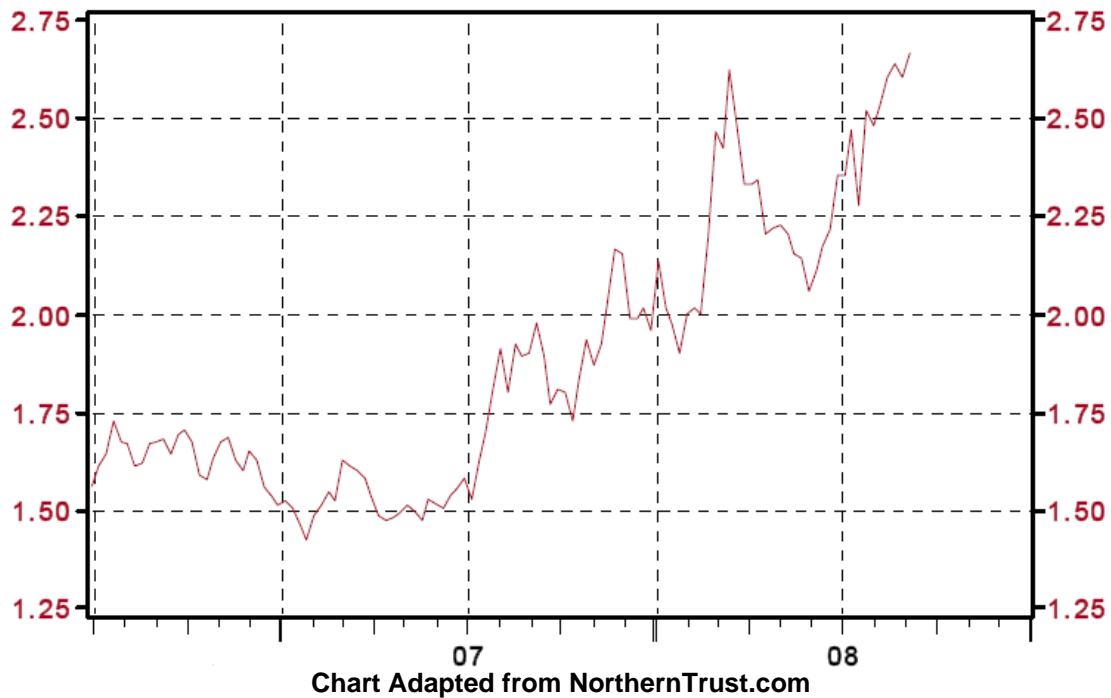
IT'S A NO GO

WEB BUZZ 2008.09.15

The largest and most important market in the world is the U.S. debt market. It dwarfs any other market anywhere by far. When it has trouble, which it certainly has now, everything else is at risk. Many look at the low rates orchestrated by the Federal Reserve, believing that money is easy and abundant, and economic conditions are sure to improve. Nothing is further from the truth.

We are experiencing a classic debt liquidation deflation, not seen since the Great Depression of the 1930s. We well remember addressing a group of real estate people back during the tech bubble bust when Greenspan lowered the federal funds to 1%. One of the attendees remarked that, as long as rates were low, the real estate market would boom. He was right then, but would not be now. Why? Because our economy has over-levered and can borrow no more. The market makers and banks are broke. The world has entered the fear part of the normal market cycle of greed and fear. Note the following chart depicting just one of the many yield spreads engulfing the debt markets. The lower government bond rates decline the higher the spread of other bond yields become. It is those other bond yields that make the economy go, and guess what—it's a no go.

**Spread: 30-year Fixed Rate Mortgage less 10-year Treasury Note Yield
percentage points**



My, How the Mighty Have Fallen: A Financial 9/11

When does a net worth of \$23 billion not amount to a hill of beans? When your assets are \$639 billion and your liabilities are \$613 billion. Think about it—how much does the market on your assets have to decline before you are broke? The answer is 3.6%.

Can you imagine operating a company on a leverage of 27 to 1? Can you imagine anyone buying their bonds as recently as June of this year?

Let us repeat again as we have for the last two years or so. Look at your hole card—we are facing a long, hard financial winter, where only high-quality assets make any sense at all. Again, as Will Rogers once said, “The return of your money is more important than the return on your money.”