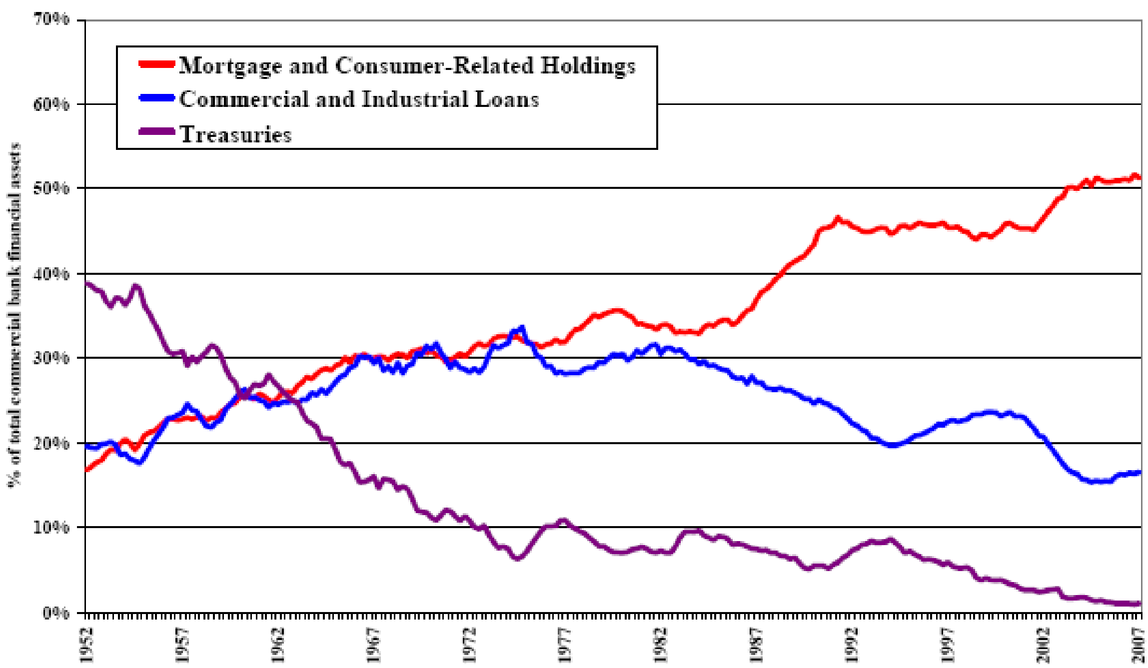
LOOKS LIKE THIS IS IT
WEB BUZZ 2007.11.19

It is becoming more and more evident that the American consumer is backing out of the consumption mode. For example, chain store sales have been weak for two months in a row. Business capital spending, which was never robust in comparison to prior expansion periods, also seems likely to slow. Why? We have adequate capacity as it now stands, and corporate profits appear to have topped out for this cycle.

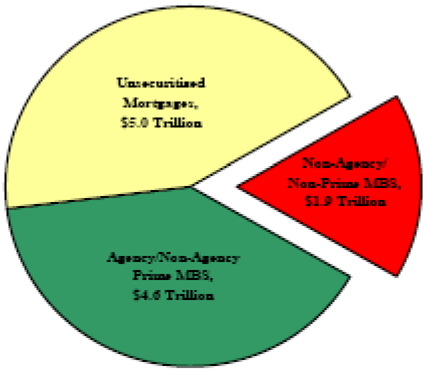
Obviously, the financial conditions of the banking sector, both commercial and investment, have been dealt a rather harsh blow with the problems of the mortgage business. Please note the chart below, which details the change in investment profile of the banking industry's portfolio over the years.

Banks rely more on real estate and consumers



Mortgage and consumer-related holdings include real estate and mortgage loans, Agency holdings and consumer loans; source: the Federal Reserve

How Much is at Risk?



Mortgage Crisis, Today

$$\frac{\$1.9\text{ Trillion}}{\$13\text{ Trillion Nominal GDP}} = 15\%\text{ of GDP}$$

RTC Crisis, early 90s

$$\frac{\$369\text{ Billion}}{\$5.8\text{ Trillion Nominal GDP}} = 6\%\text{ of GDP}$$

Graphs Adapted from Annaly.com

It seems as if all banks are quite dependent upon mortgage interest for their stream of portfolio income. The housing sector, in our opinion, will be in decline for at least two more years. The business cycle tide is going out and, as Warren Buffet once said, it is only then that one discovers who has been swimming naked.

It appears the only real growth sector of the economy is exports, which is due to the relative strength of the foreign economies and, of course, the weakness of the dollar. But again, when we catch cold, the rest of the world economy–which is dependent upon our imports–gets the flu. It's quite possible the recession has already started and we don't and won't know it until later.