

MISH KNOWS BEST

WEB BUZZ 2008.03.10

From GlobalEconomicAnalysis.blogspot.com, *Mortgage Market Action Explained:*

“Spreads on U.S. corporate bonds on Thursday approached their widest levels since the bankruptcy wave of 2002 on worries about hedge fund selling of a wide range of corporate, mortgage and municipal bonds.

”Spreads, the extra yields that corporate bonds pay over US Treasuries, gapped out across the board, though banks and brokers were especially hard hit on fears of more writedowns as mortgage problems spread.

”‘Basically the gears of capitalism are pretty much grinding to a halt,’ said Mirko Mikelic, portfolio manager for Fifth Third Asset Management in Grand Rapids, Michigan. ‘What started as a little subprime problem has kind of morphed into a bigger problem for the bigger economy.’

”Average investment-grade spreads had closed on Wednesday at 264 basis points over Treasuries, just 8 basis points shy of a record set on Oct. 10, 2002, a year of massive bankruptcies, according to Merrill Lynch data going back to December 1996. Thursday's widening was likely to put the index at or close to a new record, analysts said.

”‘What's driving it is this massive deleveraging that's going on within some of the hedge funds and the mortgage bond funds,’ said Dan Sheppard, a director at Deutsche Bank Private Wealth Management in New York. ‘They can't make margin calls and so they're basically selling just about anything they can their hands on.’

”‘The key problem here is just zero liquidity out there,’ said Fifth Third's Mikelic. ‘Investment banks are not wanting to provide any liquidity across the board -- not in muni market, not in the mortgage market, not in the corporate market.’”

Turmoil in the credit markets. That’s the headline news these days. Everything is going down in price, except for treasuries. Treasuries are, of course, where we are invested. That’s the good news. The bad news is that as the treasury market is the only liquid market left, some selling is taking place there to meet margin calls—but that’s temporary, and a great buying opportunity.

“If you were by any chance wondering why mortgage rates were not following the Fed's slash and burn policy of lower rates, the long answer is” that lenders don’t have the capital. “The short answer is rising default risk.

”But let's not be too gloomy here.

”Other than overleverage, bad debts, sinking home prices, no jobs, shrinking wages, cash strapped US consumers, rising oil prices, a sinking US dollar, \$500 trillion in

derivatives not marked to market, rampant overcapacity, underfunded pension plans, looming boomer retirements, no funding for Medicaid, no funding for Medicare, and no Social Security trust fund, everything is just fine.

”And even though the Fed, central bankers in general, and governments combined to create this problem, the irony is nearly everyone is begging for them to fix the problem by encouraging still more speculation in housing, commercial real estate, and the markets.

”Sorry folks, it's the end of the line and payback time for the world's most reckless financial experiment in history. The deflation genie can't be put back in the bottle until leverage everywhere is unwound.”

Mish says it better than anyone else. Back in 2001, when addressing a real estate group about interest rates, we mentioned that mortgage rates would follow long governments down until lenders became nervous or concerned about concentration. At the time, spreads would widen. Friends, that day is here!