MIKE CHADWICK'S

MONEY MATTERS

ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

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London Fog

The financial world is full of acronyms, rates and indexes. Let's talk about a little known barometer that has become very important lately: LIBOR. LIBOR is an acronym for *London Inter-bank Offered Rate* and many bankers rely on it daily. This rate has implications for those across the globe from Newark to Detroit to Shanghai to Sydney. LIBOR is a critical ingredient in the global financial system, it helps set interest rates for many types of loans. LIBOR is calculated every morning in London by compiling data feeds from banks all over the world: it is a measure of the average interest rates that banks make on loans to one another. LIBOR is a key indicator of a bank's financial health because rates will rise if the health of a bank is going downhill. The LIBOR is much bigger than inter-bank financing: its value is the key mover for millions of debt contracts including mortgages and corporate debt. The recent financial dilemmas of banks has been evident by a sharp upward trend in the LIBOR.

The LIBOR is overseen by the British Bankers Association (BBA, come on, everything in finance has an acronym ☺) and they are currently concerned over the accuracy of this important gauge. The BBA is troubled that the current system involves voluntary statements of rates that banks are paying for money. There is no current need for documentation to prove the rates the banks claim they are paying. This is a scenario where banks may not want others to know what they're actually

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Inside This Issue

The Global Economy

The economy is so truly global today most people don't realize just how intertwined we all are. The housing and mortgage dilemma we have here is not isolated to the USA, it's happening in Europe and Asia as well, and will likely unfold in a similar but delayed pattern in those geographic areas. Our credit dilemma is causing foreign institutions to have massive write downs for US loans – UBS has just written off more for a total of $19 Billion and Credit Suisse Group has also had multi-billion dollar write-downs – all from US loans (both Swiss banks.) So much for Swiss bank accounts as safe havens and tax shelters, you may lose your capital in them! ☺ Many foreign governments have invested new capital in American firms as a result of the credit dilemma, brilliantly buying in at very depressed prices instead of running scared, as our news media would like us to.

In London, the troubled mortgage lender Northern Rock went down a path where the firm has become nationalized, where the taxpayers bail out the troubled mortgage banker. With this unfolding, every taxpayer in the UK will feel the effects of the real estate meltdown. This meltdown began in the US, but is now rippling across the globe and is equally painful in the UK. Taxpayers will assume almost $50 billion in debt on the Northern Rock deal – sounds to me like a marshmallow, not a rock! The UK Government believes it will endure some short-term pain but ultimately make money for taxpayers, a very real likely outcome. The UK Government has a history of doing this, stepping in on the following deals: Rolls Royce in 1971; British Leyland in the mid 70's; Johnson Matthey in 1984; Railtrack in 2001; and British Energy in 2002. UK consumers carry more debt than their American counterparts, another interesting statistic the media chooses not to share with you.

China has prospered like never before: its stock market

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paying to show an artificially strong exterior, when in reality there may be some cracks in the foundation. No specific evidence suggests this is happening but many experts agree there should have been earlier signs of the trouble in the financial sector had this tool done its job properly. Arguments currently on the table suggest the three month LIBOR rate should be 0.3% higher now if banks weren't fibbing on their reported rates.

LIBOR rates are provided daily in 15 different loan durations and 10 currencies. The loan durations range from overnight to one year, and some of the currencies include dollars, pounds, euros and kronas. Banks typically set their lending rates at a certain spread above LIBOR. The typical spread for a company with great credit would be 1% + LIBOR (currently 2.716%) resulting in a loan rate of 3.7165 -- a very attractive loan in my book. For a sub-prime mortgage borrower it may be LIBOR + 8% or 10.716%, not too good of a mortgage. If you are offered that rate retool your finances and wait a few years to buy a home when you can get a more fiscally-responsible mortgage.

When banks need to borrow money, they call each other directly or contact a loan broker, such as ICAP PLC in London. The bulk of bank loans take place between 7am & 11am London time. In broker terms, a "Yard" of money is a Billion in the designated currency. These folks aren't playing with kids or Monopoly money here, this is real loot! ☺

The financial dilemma that started this summer has caused many banks to not want to lend to one another for more than a week, essentially drying up the short-term loan market, which was full of 3 month deals a year ago. The world's governments are doing all they can to lubricate this system, but it's ultimately a trust issue. If the decision makers cannot trust the information they're given they do nothing. It's very important the bankers trust the LIBOR but some don't anymore and have begun relying on other data to set their standards. The big fear is that a major player will go bust and all the loans given to them will evaporate. These interbank loans were often viewed as guaranteed and paid about the same rate as US Treasuries. Now with the uncertainty the loans currently carry a 1.58% spread above the Treasury – far from guaranteed contracts.

The system will eventually get worked out and running smooth again, but in the interim expect money to be harder to get, requiring better underwriting, higher rates and much more complete documentation. This will ultimately restore faith in the system. ☺

Ivy League Scholarships

The coveted Ivy League may become much more affordable for average families. While UCONN costs about $19,000 a year many of the Ivy League schools are over $50,000 annually. With the big time name and price tag comes a big time reputation – and one the schools don't want tarnished. The endowments these institutions have is mind-bending, and current political pressure has forced them to change the way they award scholarships to their students.

Historically the colleges would provide loans and "packages" above and beyond what a family is expected to contribute to their teens college, known as the expected family contribution (EFC). If your EFC is $20,000 then the balance of the $50,000 tuition bill is provided for you in a package of loans, work study and grants. The new benevolent rules for financial aid may make a private Ivy League school no more costly than a flagship public university. That sounds too good to be true, but it isn't. First your kid needs to be smart enough to get into the schools. Even UCONN is tough to get into these days. When I was a kid if you could fog the mirror you were in. Today with the great sports programs they turn away 49% of applicants. Harvard turns away 91% of applicants. So the kids need brains either way.

The formulas colleges use to determine financial aid are changing in the private sector. Ivy's will no longer include home equity in the formulas, nor will they look at the non-custodial parent for divorced couples, both of which they used to do. If you earn between $120,000 and $180,000 you'll be expected to contribute 10% of your income to college. The emphasis is still on income so if you have a big income year it'll hurt your aid. The assessment on income can be as high as 47% for parental income so those high earners will likely be writing checks, not cashing them from grants. Don't use this as a de-motivator – continue to earn as much as you can, you'll still be better off at the end of the day. Earning an extra $10,000 one year will not reduce grants by $10,000. You're expected to contribute a slice of income, not all of it. I'd much rather earn $600,000 this year and write a check for college than earn $35,000 and get a full scholarship. Knowing how to play the game always helps!

The assessment on parental assets is 5% on the institutional formula and 5.64% on the Federal formula. Certain assets – retirement plans, annuities, insurance, etc. - aren't counted in some formulas but are included in others.

A child's assets are always assessed at 35%/year – that's 140% over the 4 years of college, wiping out anything the rugrats accumulated. Call the office to discuss this anytime. ☺

Noteworthy News! ! !

- Congratulations to Mike & Jennifer Stanczyk on the birth of their first daughter, Molly Madeline! The joys of rugrat # 1, they'll have fun galore but no sleep for the coming months! ☺
- Congratulations to Kay Tolles on the purchase of her new home in Washington State! ☺
- Congratulations to Eleanor Shemesh on her new job in NYC at OC Worldwide! ☺
- Our condolences to the Gugliotti family on the passing of Mikes father Angelo, a wonderful husband, father, friend, grandfather and man.

Short Sales

When most of us think of a short sale it's on a stock – sell the stock at today's price and buy it back at a lower price tomorrow, and pocket the difference. If the price goes up you lose, the opposite of most stock buyer's intentions. The beauty of the world of finance – we can make money if stocks go up or down. This trading technique is becoming quite popular with real estate and here is how it works. Houses today are worth quite a bit less than they were just a year or two ago. For those who bought at or near the peak, and are trying to sell now, their house is worth less than the mortgage balance. Lenders are sometimes willing to write off the loss, as it typically costs less than foreclosure. A foreclosure usually costs the bank 40% of the loan amount, where a short sale typically costs 19% of the loan amount.

It's not easy to do, but there are so many homes out there in this predicament it's becoming very popular. Short sales currently count for 18% of total home sales, the largest amount ever recorded. The deals are hard to process. The buyer, seller and mortgage servicer all need to agree and the mortgage servicers never move quickly – it takes an average of 6.5 weeks for the mortgage servicer to get back to the prospective dealmakers, and they often don't counter-offer. They just accept or reject the deal.

If homeowners have multiple loans on the property it slows the process. It's estimated that 20% of short sales are completed as listed, where 85% of traditional sales are completed as listed. This is just the beginning, don't get too excited yet about real estate deals.

But it doesn't hurt to start to look and get a feel for prices so you'll know when a good deal appears. ☺

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is up 400% in the past two years, but down almost 40% year to date. The Chinese government has conveniently blamed the downturn in stock prices to the US home bubble, but that's a fallacy because China prohibits free movement of capital in and out of China. This will produce a big popping bubble to contend with in the coming years. People here worry about investment accounts going down 5% or 10%. How would it hurt to lose 40%? That's what Chinese investors are feeling, and they aren't allowed to diversify to other countries.

People see the problems in Detroit as the big three automakers struggle to keep pace with the Japanese competition here. What most consumers do not see is the domination of US automakers in emerging markets and foreign lands, where the big three are gaining market share, not losing it. The US doesn't need to dominate every form of business. Americans need to understand this and not worry about it.

China has inflation running at close to a double digit clip – you think inflation here is a problem lately? Chinese consumers spend a third of their income on food. How will increasing food prices change the diets and lifestyles of the Chinese people? We worry about fuel prices – we don't spend a large percentage of our income on fuel, about a fifth of what American's spent in the 1970's when the last fuel run-up happened. If we spent a third of our budget on fuel I'd be worried about it – it hurts but won't change our lives too much. This fuel craze has just been stoked by Venezuela passing a new "Oil tax" on oil drilled from Venezuelan properties. When the price of a barrel of oil is over $70 a barrel, the state will tax any price above $70 at 50%. So if the price goes above $100 a barrel, the tax rate rises to 60%. This same government has decided it will no longer partner with oil companies and is now in a court battle with ExxonMobil. Most oil companies have pulled out of the area, but a few continue to deal with Chaves' games. Oil rich Venezuela also grapples with its citizens not having enough food. When the country expects to rake in an extra $9 billion a year on this oil tax, how can people be starving? There is a potential mind-bending oil discovery off the coast of Brazil, still under wraps until all of the engineering is complete.

German business executives have recently come under the spotlight for the same shameful behavior their American counterparts displayed at the beginning of this decade. Peter Hartz, former personnel chief at VW, received a two year sentence for bribing labor representatives with money and prostitutes. The German real estate meltdown is moving and this wage inequity is fueling that fire. You can't live in 2008 America on an island, we're all together in this world! ☺

Money Quiz

Last month's quiz had no winner. The 10th highest paid CEO earned $26.6 Million vs $16.0 million for the 10th highest paid major league baseball player. I'm taking the MBA over MLB ☺☺ ☺

This month's challenge is to tell me what the average annual total return for the S&P 500 index has been over the 10 years ending 03/31/08. The winner will enjoy dinner on us at Chili's. BTN 050508

The Dangerous 4

This isn't about a crew of mafia thugs who are out to whack someone, it's about the four most dangerous words on Wall Street – "this time is different." Not only are these words dangerous, they're quite expensive. Many times in the past these words have slid from peoples' lips who subsequently paid very high prices. Currently we are hearing these words in the energy sector. We heard them until about a year ago in real estate. In the late 1990's it was technology. In the early 1990's it was commercial real estate. In the 1980's it was savings & loans. In every case where these words were uttered by investors soon thereafter those investors ate their words.

There is no question there are issues in the world today – banking has slowed, water is scarce in massive urban areas, pollution is a big factor in China & other developing nations, global warming is partially due to human activity, some people are in too much debt, energy prices are out of control, the dollar is weak against foreign currencies…..I can go on and on with the issues. In the history of the world there have always been big issues, and they've always been worked out. This time will not be different, it'll all work out and we'll have effective solutions to the current problems. The other thing that is for sure is when these problems are solved we'll have new problems to deal with, guaranteed! To succeed with investments, be fearful when others are greedy and greedy when others are fearful, people are as fearful today as they have been since 9/11. I'm getting greedy! Call to discuss this anytime! ☺

California Dreaming

The images that come to mind are beautiful beaches and virtually perfect weather.

California Public Employees Retirement System (CALPERS) is the largest pension fund on the planet. This typically conservative investment giant got caught dreaming on California real estate prices, allowing a "this time is different" attitude to influence its investment decisions, believing that the run-up of real estate prices would never end. The fund poured almost $1 Billion into a several thousand acre piece of residential property just north of Los Angeles.

With the current real estate meltdown in full swing, CALPERS will likely see its investment fade to black as the property will likely go into foreclosure. In real estate they always say, location, location, location. Well, the location doesn't get much better than southern California. The other argument for land is that they're not making any more of it. That is true in theory but the developers in Dubai have made more land, they've made islands, hundreds of them.

At the end of the day the real estate boom made huge profits for home builders at the expense of the average Joe. Now as real estate deflates banks are tightening lending standards. CALPERS has nearly $21 Billion, or 8% of its assets, invested in real estate and is one of the largest land owners in the country – a very dangerous play in today's climate.

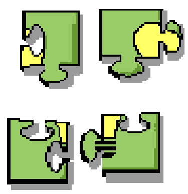
This isn't the only bad deal for CALPERS. CALPERS also invested heavily in M/W Housing Partners and has since lost 53.6% of its investment in the past 12 months. A similar investment in Hearthstone Housing Partners II has since lost 40.2% in the same period.

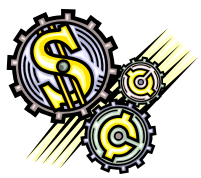
It all comes back to avoiding emotional mistakes such as chasing returns: not only do average investors do it, some professionals do it. Constant media coverage of "hot" and newsworthy items proves to be too powerful a force for some to resist.

I'll argue much of what the media covers with Hollywood starlets is far from newsworthy – unless you're trying to teach kids how not to grow up to be an idiot! Are you California Dreaming? ☺

Inspirational Quotes

- Men are not prisoners of fate, but only prisoners of their own minds, *Franklin D. Roosevelt*
- Be faithful to that which exists within yourself, *Andre Gide*
- Life without love is like a tree without blossoms or fruit, *Kahlil Gibran*
- Anytime you suffer a setback or disappointment, put your head down and plow ahead, *Les Brown*
- Let's not limit our challenges, instead, let's challenge our limits, *author unknown*





We can piece the puzzle together and make your money work for you. ☺

Kids Korner

Kids Accounts?

Kids can have accounts too. My rugrats have UGMA (Uniform Gift to Minor) accounts that they can use as bank accounts. These accounts are set up at a mutual fund firm, but allow deposits and withdrawals for any purpose (i.e. not limited to college or higher education). If the kid wants a car, computer, or Barbie dolls, the money is fair game. An adult needs to be the custodian until the child reaches age 21 in Connecticut. There are no limits for deposits and you can have as many as you'd like.

If you use these accounts, I suggest spending them dry by the student's age 14 because they can hurt you for college financial aid purposes. ☺ ☺

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