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Evolution of a Crisis

It is now over a year since the global financial system teetered on the brink of collapse. The systemic risk was high and it was unclear how it would all turn out. Prior to the early November 2008 election it seemed the Republicans had no clue about what to do. It seemed to be left for the Federal Reserve Bank to figure it out, although Treasury also played a part. Since then money has been thrown at a lot of things. It's not clear that most added value, but they gave the system time to clean itself out.

Systemic Risk

Today the systemic risk is reduced, but more cleaning is needed. Even though Fannie and Freddie were taken over and mortgage loan liquidity is low, the FHA has continued to write loans and seems to be teetering itself. It's not clear why there are still multiple governmental organizations guaranteeing mortgage payments. This should be consolidated. AIG was initially taken over to allow payment of credit default swap payments and post collateral, but it is unclear today if anyone except investment banks would have toppled under that weight. It has always been odd to me that no counterparty risk was charged. These firms were paid in full with my tax dollars! Personally I would have paid off the contracts in decreasing amounts, perhaps 90 cents on the dollar for the first 6 months and decreasing 30% each 6 months until nothing was paid after 18 months. Rumors abounded at the time that Tim Geithner, then with the NY Fed, had been unduly influenced by Goldman over this and other deals. As more comes out over time, these rumors are getting closer to being substantiated. Geithner made it past his past tax underpayments to become the Treasury Secretary under the democratic administration, but at some point he will have to answer to this. Once Goldman's contracts have run out watch for AIG to be on a short leash and allowed to disappear.

Throwing Money Out the Window

What was Cash for Clunkers supposed to accomplish? Destroying the old cars means they aren't available for the next layer of used car buyers. It does not seem like that program was thought through beyond the public relations.

The stimulus program also was designed to help "shovel ready" projects and get people back to work. Instead Congress messed that up and spent it on who knows what at this point. I do know that the interstate going north from Omaha is undergoing major renovations, so at least some is being spent on maintaining roads. This was another opportunity lost as at least some should have added new projects like the CCC did during the 1930s. Instead we have 10% unemployment and a whole generation trying to be entrepreneurial at the same time. This might be the lasting legacy of the crisis. Big companies downsized so much that now they will need to outsource basic tasks. They

will like this because they don't have to pay benefits and can restructure at a moment's notice.

What to Call the Crisis?

It has been interesting to observe the press and how they describe the financial crisis since 2007. First it was called the sub-prime crisis, driven by loose underwriting for residential mortgages and optimistic ratings of pooled loans tranced into structured securities like CDOs and CDO-squareds. Then, about a year ago, the term financial crisis was introduced as it became clear that the crisis was much broader than mortgage loans. Now I have noticed it is being referred to as a recession. This does not do it justice as the systemic risk was much higher than in past recessions. This terminology says to buy on the dips because the long term will play out favorably. This dip could have easily been a cliff.

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