

OBSERVATIONS ABOUT THE SEPTEMBER 2008 FINANCIAL CRISIS

As the airwave, newspapers and internet are filled with headlines, analysis and conjecture regarding the current financial situation in the U.S. economy we thought we would take the opportunity to add our two cents worth. Not that two cents is much of a bailout, however.

It is useful to remember that a crisis in the financial system is not necessarily the same as a crisis in the economy. There is overlap, but the entire economy does not rest on the fortunes of Wall Street.

First of all, no one – and we mean no one – exactly knows the ramifications of the measures put in place to forestall the worsening of current problems. We believe, however, that the steps taken by the government, and its various agencies, have been made with a pretty good grasp of what is pragmatic. Does that mean that there won't be long-term, unintended consequences that seem equivalent to the original problems? Who knows? However, the probability of forecasting the effects of future disruptions seems minor enough when compared to an almost certain, near-term catastrophe if nothing were done today.

Second, does the current “Wall Street” mess affect the entire economy? To some degree, yes, but we don't believe it will be to the extent to bring the entire economy to a screeching halt. We hope we're not myopic, or Pollyannaish, in our outlook but we still believe in the resilience of the U.S. economy. It has bounced back from energy shocks, real estate busts (Resolution Trust Corporation), overseas trouble (remember Long Term Capital Management in 1998?) and the internet bubble – we see no reason why “it's different this time”.

Finally, just exactly “how bad is it”? We really don't know. However, we do take exception to media pundits who are fond of comparing the current situation to the Great Depression. As we've all read, “thus and such” is as bad as it's been since the Great Depression. That most definitely IS NOT the same as being as bad as it was during the Great Depression. Here are a few examples:

During the early 1930's there were over 10,000 bank failures, or 40% of all banks in existence in 1929. During the current crisis we read that there have been 7 bank failures. Even given a greater number of banks 80 years ago, we do not believe that the numbers are even within “shouting distance”. Also, from 1989 to 1995, the RTC closed or resolved over 700 Savings & Loans, so really the commercial banking crisis of today is not even as bad as it was a mere 20 years ago.

Although mortgage default and foreclosure numbers are difficult to compare over distant time periods, we believe even using broad numbers puts this into perspective. The current foreclosure rate is roughly 2% of all mortgages outstanding (according to the U.S. Census roughly 30% of all homeowners DO NOT even have a mortgage). Although this 2% is materially higher than the normal 0.5% - 0.7% that we have seen over the last

several years it is a far cry from the estimated 25% foreclosure/default rate of the early 1930's. The worst since – yes, as bad as – definitely not.

Today's unemployment rate is 6.1%, the highest it has been in the last 5 years. Not a good number to be sure, but far below the 25% unemployment rate seen during the Great Depression. Also, look on any employment-related website today and you will find literally thousands of jobs available. This is in stark contrast to “Not Hiring” signs so prevalent 80 years ago when there simply were no jobs to be had.

In conclusion, we are not saying that there are no problems in the financial system, or the economy, today. Nor are we saying that these problems will simply go away if we ignore them. We do want to convey our belief in the U.S. economy and the free market system. We strive everyday to use our knowledge and experience to help our clients weather the storms that may come, and do so with confidence and optimism.

If you have any specific questions, or just feel like you would like to talk with us, let us know. We're here to make sure your investments are source of comfort, not concern.

Best regards,

Howard, Ward, Elizabeth, Ethel and Craig
The partners at Paragon Capital Management