



FAMILY MANAGEMENT CORPORATION

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CAPITAL IDEAS

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“The Debt End”

1982, 1989, 2007 . . . what do those years have in common?

They are all years in which the banks’ overextension of credit came back to bite them. In 1982, it was loans to oil producing nations; in 1989, it was loans on commercial real estate, and in 2007, it has been residential mortgage loans. The overextension of credit always leads to the same result, and it has never been the end of the world.

The Federal Reserve realized that the economy was in trouble and responded with half point rate cuts. It was good and necessary medicine, and the effects have already been felt very positively in the stock and bond markets.

This, in turn, should help consumer psychology, and at the end of the day, that is the most important element in U.S. economy. Indeed, 70% of our Gross Domestic Product relies on the U.S. consumer. What is troubling in that sector is that delinquency rates for consumer loans have soared to their highest level in six years.

The stock market has reached a new record, and it does seem quite impressive, unless, of course, one factors in inflation. The fact that stock prices tend to rise over time should not be surprising.

The price of almost everything rises over time, thanks to inflation. Each year the U.S. government prints more money, which is the main reason that the price of groceries, cars, clothing, and yes, stocks keep going up. Of course, incomes are rising also.

This does not mean that stocks have been a wonderful investment recently. They have not been. The S&P 500 Index reached 1563 recently – that is slightly higher than the peak it reached in 1999. What this means is that while the prices of everything have gone up significantly in the last seven years, the price of stocks have barely budged!!!

This is the essence of what happens after bubbles; the recovery usually takes a long time. The normal pattern after a huge boom is years (sometimes decades) in which an investment does not keep pace even with savings accounts. This clearly does not make for very gratifying all-time records.

Merrill and Citigroup's major write downs of over \$5 billion each point to the tremendous excesses in the last few years. More write downs will follow, and may, in our opinion, remain covered up until they are seen by the light of day. While interest rates remain low and the yield curve remains positive (short term rates are approximately 1% lower than long term rates), many financial institutions can put band aids on their problems. Let's hope that this will see us through to the next up cycle.

No matter where one looks, political leadership seems shaky. The exception to this is Putin, who has a very high approval rating and seems to be consolidating his power day after day. Keep a close watch because it is our belief that major political battles will emerge as a new "cold war" takes shape.

It is so hard to believe that President Bush vetoed the recent childcare bill. Mr. Bush will be remembered for fighting terrorism, and that is about it. The country seems to be stalled, and the current situation is certainly a validation of the constitutional term limit!

The great risk to the economy is the weakness of the dollar. Should foreigners who buy treasuries decide to bail, the deficit will have to be financed in large measure by domestic investors. This will necessitate higher interest rates. In turn, this could hurt the economy. We believe that the equilibrium that currently exists will continue, and except for the normal bumps, it will be business as usual.

We believe now is a good time to look at real estate, especially in undiscovered areas. I recently visited upstate Bethel Farms (www.bethelfarms.com) in upstate New York and was delighted by it's scenery (Remember Woodstock!).

Stay diversified and nimble and do not be married to any stock or idea.

Gene Fowler, a screenwriter in the 1960's wrote, "I am glad that I paid so little attention to good advice; had I abided by it I might have been saved from some of my most valuable mistakes".

We hope that our advice is invaluable.

As always,

Seymour W. Zises

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