



FAMILY MANAGEMENT CORPORATION

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CAPITAL IDEAS

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“The Truth”

It was the spring of 1994 and President Clinton decided to introduce an enormous “home ownership initiative” that would eventually loan over one trillion dollars to people who did not qualify for a mortgage.

Thus, \$200 billion a year for five years was pumped into the banking system with a directive to provide mortgages to those who were previously unqualified. So heavy handed was that initiative that the government was prepared to penalize banks (“The Community Reinvestment Act”) that did not lend to sub-prime candidates.

The Banks realizing the risk in holding these mortgages got approval to securitize these mortgages. Simply put, they sold them off to the public markets by creating income securities.

In fact, before 9/11, the Bush Administration tried to inhibit this reckless lending, but the planes hit, and the rest is history—Is everyone guilty and no one to blame?

The recent market gyrations have turned cowboys into cowards – remember the old song “Buddy can you spare a dime”? The answer now is, “no pal, I put it into sub-prime!”

As of the writing of this letter, Secretary Paulson has announced the “institutionalization of the cure”. (The Resolution Trust Corporation type answer to the problem)

The Government has injected billions of dollars into the financial system, plus it has guaranteed loans and values of publicly traded money funds. (I am proud to say that at Family Management we held only Treasury backed money funds for our clients.)

The markets breathed a sigh of relief and rallied stunningly on September 18th and 19th. Short selling of financial stocks (799 companies to be exact) was temporarily banned. Short sellers ran for the hills and regulators beamed as the markets snapped back.

Oil has retreated from its high and is hovering above \$100 per barrel! High oil prices encourage conservation and innovation. Low prices encourage complacency and lethargy. We need high oil prices to keep the pressure on our politicians to legislate change!!!

Given the government's need to raise capital, we believe that selling assets such as toll roads and airports will emerge as a viable solution. We believe that this is a good idea.

We also believe that saving AIG was the right idea. Not only did the government save our financial system from systemic problems, but the American taxpayer also is likely to make good money from this investment.

The American spirit is truly unique. Despite the sub-prime mess, look at how important home ownership is to the average American. The American Dream is real, and we applaud the risk takers who plucked down their money in an effort to provide nests for their families!

Treasuries remain an important investment for foreign central banks – as of August 27th, their holdings stood at \$1.44 trillion. Government Agency notes and bond investments stood at \$971 billion. Japan now holds approximately \$583 billion of treasuries and China has the second largest stash at \$503 billion. Thank G-d for our trading partners who buy our debt to help finance our ever increasing deficit. We believe that they should be included in the Treasury package.

Back to today's headlines: Liposuction is what the government wants to do to the bad mortgages held by the largest American institutions. If the fat is gone, is the patient healthy or not? The answer is that the U.S. economy has been kicked in the stomach... (euphemism)

Don't be fooled into believing that we will bounce right out of this – we do not believe so. Thus, be extra careful with your finances. This is a time to save and refill the cabinet with supplies for the inclement weather ahead. We expect a long period of sluggish economic activity before the clouds clear.

We also believe that the normal retirement age should be lifted to seventy. With the increased longevity in this country, this would make sense from both a sociological and economic point of view.

We are optimistic about America's future no matter who wins the White House. Whoever wins, will be faced with greater problems than any President since FDR. Since 9/11, America has been on the defensive. Not realizing it, we slowly lost the upper hand on the economic front. It's time for America to put its house in order. We owe that to our children and grandchildren.

Each of us has a duty to participate. Don't think like the crowd and don't get lost in it!

As always,

Seymour W. Zises

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