CCB FINANCIAL SERVICES
Located at
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# A PERFECT STORM

By Bob Rockwell, CFP®, MS

Well, don't we live in interesting times? The old saying that "the future is unknowable" has certainly proved to be true. I can't tell you how many times I've been told "you can't lose money investing in land because they aren't making anymore of it". Maybe they're not making any more land, but they're sure making more of it available for construction.

Our current situation is the result of investment banks, like Merrill Lynch, packaging hundreds of low rated sub-prime mortgages into an investment product that was re-sold to investors worldwide. The details of this are mind-numbingly complicated, but in a nutshell: the thinking is that the chances of default on a single sub-prime mortgage is high` but, if you package hundreds of these in an investment, only a small percentage will *historically* default. They take this small percentage of defaults and carve them out of the mortgage pool and sell them to high risk investors. This leaves the rest of the mortgage pool *historically* at very low risk of default.

This means that the rating agencies can now give an AAA rating to this part of the investment. An AAA rating is the highest rating you can get; the same as U.S. Treasuries. So, these investments are considered essentially risk free. The problem is that the rating agencies worked with the investment banks to advise them on how to "structure" these investments in order to get the coveted AAA rating.

Now, think about this: the rating agencies used *historical* default rates of the last 10 years. How many people with sub-prime mortgages had to default (go in to foreclosure) over the last 10 years? Not many because if you couldn't pay your mortgage, you could just re-finance at a lower rate and get cash-out due to higher real estate appraisals. Even on those that defaulted, the bank thought they could sell the property for more than was owed.

So, how bad can you lose? Plenty: when people own property that they can't afford and can't re-finance because real estate appraisals are dropping as there are not buyers. Now you have a mess! People and governments worldwide invested in what they thought were risk-free investments rated AAA and used these as collateral for other investments. Some, especially Hedge Funds, cranked it up a notch and only put 10% down as collateral; this effectively multiplied gains or losses by 10 times. Everyone accepted them as being "Good as Gold". Now, all of a sudden, the default rates on these sub-prime investments rated AAA are sky rocketing, and the value of these investments is plummeting.

No one knows what they are worth anymore, and they won't buy them or accept them as collateral. This is why Bear Stearns was essentially bankrupt. They couldn't sell or use their sub-prime investments as collateral to pay their bills. The government couldn't risk Bear Stearns' failure to pay its bills, because very large institutions like banks were relying on Bear Stearns' payments to pay their own bills. If Bear Stearns became insolvent, these institutions (counter parties) wouldn't be able to pay their own bills, and the dominoes start falling.

So, who's to blame for this mess? There is one common theme applicable to all parties involved. It's called commissions or other forms of compensation based on making a sale. Everyone involved was paid for making a transaction happen without any regard for the end results of the transaction.

It's a 'PERFECT STORM'.
Consider the following:

- Real estate was assumed to always go up in value so anyone who could acquire real estate did, even if they couldn't afford it.
- Mortgage Brokers were paid generous commissions to facilitate mortgages without any liability if those mortgages went bad.
- Banks that funded these mortgages knew that they only had to hold these mortgages for a short time until they could re-package them and sell them to investments banks.
- Investment banks could buy these sub-prime mortgages with high interest rates for cheap and "structure" a pool of them with AAA ratings and sell them at high prices.
- Rating agencies were paid to rate these investments by those selling them so they helped the investment banks to "structure" these investments to receive AAA credit ratings.
- Hedge Funds Managers were being paid 2% of assets and 20% of any profit. This compensation arrangement encourages taking very high risks in order to maximize potential profit. How about the losses? No biggie; Hedge Fund Managers don't share in losses. Hedge Funds would then multiply their gains and losses by 10 times, because they put 10% down and borrowed 90% to make these investments.
- Investors paid high prices for these AAA rated investments, because they were considered safe and are now left holding the bag of these sub-prime mortgages until maturity unless they can sell them which it turns out, they can't.

If we can hold out long enough, I think real estate values will stabilize and all these "structured" investments will have a value. Alter all, "they aren't making any more land"! In the meantime, nobody knows who will make their mortgage payments and who won't. But, we'll get through this just like every other crisis, some better than others. Rest assured, I never invested any of your money in this mess, because it seemed *"too good to be true"* and it turns out it was.

## WHAT'S INSIDE:

In the first installment of the CCB Financial Services Quarterly Newsletter, Bob will comment on the economy and how we managed to get in this mess.

Heidi will address Health Insurance concerns and offer solutions to those problems.

Lynn talks about the ease in which we do business in opening accounts and servicing them.

## Heidi's Happenings:

"Nobody likes their health insurance" a quote that I hear often in my line of work and one that I find true most of the time. If this quote applies to you, I'd like to offer my help in finding you some solutions.

As the newly appointed and licensed Fixed Products, Health and Life Insurance Agent at CCB Financial Services, I am here to help. I have had experience with Health Insurance companies and I know how frustrating they can be with messages left never to be returned, several different automated menus to go through before you get to an actual person, and little information even when you do talk to "someone": I have been there. My goal is to make Health Insurance as easy as possible for you. As your local, friendly agent I can service your account in many ways. Not only can I find any type of Health Insurance plan that you are looking for, I can also run quotes for you or your business, find a plan that better suits your needs and be the kind of agent you need. I pledge no telephone menus, quick answers to questions, returned phone calls and service with a smile. 503-668-2575

## Lynn's Lookout:

I may see "paperwork" when I sleep, but you don't have to! My aim is to make it so easy to open an account, or accounts, that it simply comes down to signing your name. For current clients, we can do it over the phone or by mail, or you can just stop by so we can visit. Your time and convenience is very important to us here at CCB Financial Services. 503-668-2530.

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