



## Thank God It's Friday!

March 23, 2007

We've had the best market week since last July. As we celebrate this recovery, we'd like to look into one of the issues that has plagued stocks triggering the sell off. Subprime mortgages have littered headlines in recent weeks and have been largely blamed for the recent sell-off on Wall Street. These types of loans have been integral in the housing surge this decade, but perspective needs to be maintained in terms of the impact on the markets and our overall

economy.

First; the definition. A subprime loan is a type of loan offered at a rate above prime (currently 8.25%), to individuals who do not qualify for prime rate loans. Usually, subprime borrowers don't qualify with the traditional lenders due their spotty credit history or low income—clear indicators that they would be high risk of default. Forty percent of mortgage originations last year qualify as subprime.

Lending standards have become lax in recent years, with a surplus of “creative” and “aggressive” loans such as adjustable rate mortgages and stated income loans requiring little or no documentation of collateral. With interest rates at historical low levels—and “teaser” rates as low as 1%, it's no wonder that American consumers have been grabbing up loans like kids set loose in a candy store.

There's no question that many borrowers will not be able to pay when their adjustable mortgage rates are ratcheted up—some by 50% or more. When housing prices were booming, no one cared—borrowers would either refinance or sell for a large gain. Flat home prices have taken away these options, and the big question is: just how far and wide will the pain be felt?

We say: not very far. Even if a quarter of the \$650 billion outstanding sub-prime loans went bad, this is only a drop in the bucket of the US debt market, estimated at \$40 Trillion (yes, that's a “t”). The worry is that tightening lending standards and foreclosures will cause debt-laden American consumers to (finally) curb their spending habits. This would slow economic growth.

Of course, a lot of pain could be avoided if consumers would listen to their grandmas and not borrow more than they can repay. It's too late for many, but the fall-out can present opportunities for the astute.

	March 23, 2007	December 29, 2006	Percentage of Change
DOW JONES	12,481	12,463	+0.14%
S&P 500	1,436	1,418	+1.26%
NASDAQ	2,448	2,415	+1.36%
10-year Bond YIELD	4.61%	4.71%	-2.12%
			*When yield goes up, prices go down