



## Letter to the Editor

August 12, 2008

The following letter is in response to our article [The Size, Scope, and Future of the Sub-Prime Crisis](#), which appeared on February 12, 2008:

Dear Editor:

Your article on the sub prime crisis was very good and one of the few that correctly identified the actual problem: A simple lack of confidence. All paper transactions, from the acceptance of a dollar bill at a gas station up to the purchase of a US treasury bonds, require counterparty confidence. Confidence in the viability of these pieces of paper with no tangible value is the molecular bonding that keeps the financial system working. Without it systemic Armageddon would occur. Thank you for correctly illustrating this in your article. Since none of the chattering chipmunks in the media seem to “get it,” the general public has been whipped into a frenzy by inaccurate and incomplete reporting and see the problem as something that it isn’t. Now we have the politicians getting involved and I pray that they don’t give us another Sarbanes Oxley.

I do take issue on a few points.

To assume that all sub prime paper is underwater and was purchased with no money down is inaccurate. Many sub prime loans are seasoned and even after declines are above water vs. the properties’ market value. In the final analysis, after workouts are completed, real losses on US mortgages will be less than \$50 billion and more like \$25 billion, in my view.

Write offs at banks and brokers do not just reflect foreclosures but rather are mark-to-market ledger entries adjusting the value of mortgage and other debt instruments based on actual transactions (market value). The Fed values collateral for reserve requirements using actual prices in an organized market, recent prices in an auction market, or through pricing services such as Kenny. Many of these market valuations reflect severely distressed conditions where there are absolutely NO bids for instruments. Many of these securities and mortgages are high quality, performing and not distressed yet due to their complexity attract no buying. This has cascaded to a worldwide credit crisis because banks, major brokers and hedge funds are required to either deposit additional capital or sell their securities to meet the margin calls or reserve requirements due to market pricing of the collateral. The banks and brokers may have the last laugh, though, as many of these investments will pay their interest



and return their principal resulting in eye popping earnings comparisons in 2009 and 2010 when they are priced to more accurately reflect their value.

Finally, I am impressed that your contributors are able to predict the real estate market so accurately. We hope that they will ring a very loud bell when the bottom is reached just like they rang it at the top of the market to warn us to get out. Let's be honest, predicting market bottoms and tops is a fool's game. No one can know these things and to imply that it can be done is misleading and dangerous. In my experience though, when "experts" say we are going down 30% more, it is a great indicator that we are at or very near a bottom.

Respectfully,

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