



**BIONDO**  
**INVESTMENT ADVISORS**

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Presenter: Joseph Biondo, Jr., Chief Investment Officer

Thank you. Good afternoon to everyone and thank you for joining us today. We thought it would be appropriate to host this call today in light of the historic and unprecedented situation that we are all operating in today.

I wish that I was able to time this call better so that we would be pleased after a positive day in the equity markets, so I apologize.

I plan on sharing with you some of our thoughts on the current credit crisis, how we are proceeding in this current market and to leave some time for questions and answers at the end. Being that it is later in the day and I am sure you all want to get home for tonight's debate, my remarks should not last more than about 10 minutes.

How this financial crisis all began is important to understand. While there are many trying to assign blame to different sources, the reality is that it took both a long time and a series of events to create such a fine mess. Likewise, it will take both for this to unwind.

Going back to the 1990's, the central premise that the mortgage crisis was built on was that of an ownership society. This idea was propagated by politicians on both sides of the aisle and on the surface, was palatable to our society. The idea was that home ownership was part of the American Dream and that opening it up to more participants would have many societal benefits. Programs were created and backed by Government Sponsored Entities Fannie Mae and Freddie Mac. In essence, credit standards were loosened so that more people could purchase a home.

As we all remember, the dot-com bubble was burst in the middle part of 2000, which caused the economy to weaken. In its already weakened state, the US then suffered the terrorist attacks of 9/11 and a recession ensued. In order to stimulate economic growth, interest rates were slashed to unprecedentedly low levels which made money very cheap to borrow. At the same time more & more investors began to look for an alternative to stocks, having recent memory of being hurt in tech stocks. Also happening at this time were the Bush tax cuts, which made more money available in our system.

So now we had some key ingredients – cheap money, readily available money, loosened credit standards and investors looking for a place to invest. As stated previously, many were turned off to equities due to the recent memory of losses in the dot-com implosion. Bonds were paying paltry yields, as interest rates had been slashed to stimulate the economy. So the natural asset class became real estate, and the stage was set for the next bubble – which turned out to be not just real estate but credit markets as well.

Wall Street was not to be left out of the chance to exploit an investment opportunity. Preying on the administration's laissez-faire philosophy, investment banks lobbied for the ability to increase the caps on leverage from the traditional 12-to-1 to 40-to-1 and were successful. They also devised a way to securitize these mortgages by packaging groups of loans together and securitizing them with a new acronym-product, CDO's or collateralized debt obligations. In order to make these investments even more palatable for the buyers of these, Wall Street figured out a way to insure against default by creating CDS's, otherwise known as credit derivative swaps. The big problem was that these were created to act as insurance, yet every other insurance product in the world is regulated and these were not. So companies such as AIG wrote this business like crazy but never had to show the adequate reserves of capital in the event of default. Also occurring on Wall Street was a massive rebalancing of pension assets away from traditional investment managers into alternative strategies, also known as hedge funds. Many of these strategies were designed to provide uncorrelated returns to equities and applied heavy use of leverage. Along with European banks, hedge funds across the globe were the largest buyers of these CDO's and CDS's.

The point of discussing all of this is to illustrate how many different things needed to come together to form this problem. It is an attempt to dissuade you from believing the sound bites you hear on the news about who is to blame. There is much blame to go around – and it is a healthy process to analyze missteps so as to learn from them. I believe that many of these decisions that were made over these many years led to unintended consequences. This has been a failure on many levels – a failure of financial institutions, a failure of government and a failure of individuals. All of this failure has come to the realization of many at once, which has created the current crisis – and that is a crisis of confidence.

As you all know by now, in a convoluted manner, The Economic Emergency Stabilization Act of 2008 was passed and signed into law on Friday. While there were a lot of “extras” added to the legislation, the salient points are:

- \$700 billion available to the Treasury to buy distressed assets from certain qualifying financial institutions,
- This money will be doled out in stages, beginning with \$350 billion,
- Oversight of Treasury in how they proceed invest these dollars,
- FDIC insurance on bank deposits lifted to \$250,000 from \$100,000,
- A cap on compensation of the five highest ranking officers of companies that sell assets into the program, including claw back for bonuses granted previously.

The central idea behind the legislation is to attempt to unfreeze the credit markets. What has happened in recent weeks and months is a hoarding of capital by financial institutions for fear of further losses on these distressed assets. For depository institutions, there is also a fear of bank runs, which seems to be what brought both Washington Mutual and Wachovia down in recent weeks.

Starting from the top, the Treasury will have great latitude as to what qualifies as a distressed asset. While the most troubled assets appear to be mortgages and this is where the Treasury will concentrate their efforts, banks will be able to submit bids for other assets as well.

Having the money available in stages should not affect the implementation of the plan. Since a new administration will be taking office in January, this makes sense to ensure a more orderly transition. I will say that in my opinion, either candidate that wins ought to ask Hank Paulson to stick around for a year or so, as he has been the primary architect behind the plan.

Raising the level on FDIC insurance was also an important step, although I think a higher level should still be considered, as it does not take a very large business to have that kind of balance in a checking account to meet its short-term obligations.

Of great interest to me was that yesterday, day one in effect of the new plan, the Federal Reserve took advantage of the new powers granted in the bill by announcing that it will begin to pay interest on the reserves it holds. This is important and powerful because banks with excess cash no longer need to sell their excess to other banks, which in effect drove the federal funds rate lower. In recent weeks, the effect has been a federal funds rate close to zero at the end of the day, which puts pressure on banks’ margins and hurts profitability.

In addition, the Fed announced that it is increasing the Term Auction Facility to \$600 billion from \$300 billion and that it plans to be up to \$900 billion by the end of this year. In effect, the Fed will be printing money for itself, not having to borrow from Treasury. By going it alone, the Fed will increase the size of its balance sheet, which if loaned out will have a multiplier effect. The Fed will flood the banking system with so much money that they will have to do something with it other than to hoard as in recent weeks. This will take some time, as confidence is low and needs to be restored, but extremely important.

At first blush, the sound of the printing presses may seem to present an inflation problem. I believe that is the wrong bet to make right now. With continued worries about economic pressures, hard assets and commodities should be kept in check while paper assets, such as high-quality equities, agency securities, and both mortgage backed and corporate bonds should see sharp increases in prices.

We would like to see the Fed compliment all of these actions with a large rate cut. In fact, Bernanke spoke today and it appears that this is on their agenda in coming weeks. While the actions taken so far reduce the need for such rate cuts, this is a problem that needs everything thrown at it, if for no other reason than to restore confidence.

I realize that I am an equity investor and I have spent most of this time discussing the credit markets. However, these issues are what is driving both fundamentals and psychology in the stock market today. I will not sit here today and tell you the fundamentals are all sound, we've had too much of that. I won't tell you that our performance hasn't suffered – it has.

I am telling you that this is the process of bottoming and that we see light at the end of the tunnel. I am telling you that good companies will be stronger because of this. Any business that is run properly will gain share as competitors wither. As painful as it is in the short-run, this will leave in its wake a great long-term setup. While we have been avoiding the addition of many new investments over the past couple of months and have tried to step as gingerly as possible, with each passing day we become more and more optimistic. We have been adding to our core positions in recent days and will continue to do so in a systematic manner so as to take advantage of what we see as attractive investment opportunities.

Earnings season is on the way starting next week and we believe we will see that the sky has not fallen and it is our opinion that in many cases, too dire a scenario has been priced in to many individual securities. We believe that we are very close by many measures to an important shift in direction and will continue to use the environment to make sure that our portfolios are well positioned given our outlook over the next 12-24 months.

I would again like to thank you for taking the time to listen in today. We understand that these are difficult times and we hope that we have helped to alleviate some concerns. If you have any questions that you would like to address after the call, please feel free to call our office at your convenience.

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