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These are tough times but solid opportunities

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The end of the first financial quarter of 2008 resulted in a systemic market decline, reflecting Wall Street's conclusion that the U.S. may be headed toward a recession. Testifying before congress, the Federal Reserve chairman, Ben Bernanke, said, "The American economy could contract in the first half of 2008," a statement that meets the technical definition of a recession. The Washington Trust Co.'s Winter 2008 Economic Outlook suggested that market performance would be affected by: (a) the decline in consumer confidence to its lowest level since fall 2005, due to the ongoing weakness in the residential real estate market; (b) rising energy and food prices, as well as higher corporate financing costs, which have impacted inflation and challenged the Fed; and (c) the colossal write-downs and losses incurred by the nation's largest financial institutions. The effect of the collapse of Bear Stearns on market confidence was underscored by Bernanke, who explained that the Fed needed to intervene because, "With financial conditions fragile, the sudden failure of Bear Stearns likely would have led to a chaotic unwinding of positions in those markets and could have severely shaken confidence . . . and . . . cast doubt on the financial positions of . . . Bear Stearns's . . . counterparties . . . ." The Fed guaranteed $30 billion of Bear Stearns' positions, many of which may be residential collateralized debt obligations (CDO's). This signals a shift in focus for the federal government; an active hand approach. Treasury secretary Paulson recently unveiled a plan whereby the federal government will adopt a stronger regulatory posture in its administration of the financial markets, while Fed chief Bernanke encouraged congress to help homeowners caught up in the mortgage crisis. Bernanke believes the President's recently enacted stimulus package will bear fruit in the second quarter of this year, just in time to battle this elusive recession they are grudgingly acknowledging. Perhaps the current economic forces we are facing will be short-lived, perhaps not.

The effects of the housing market have stretched into other sectors, from the financial services sector, to the sporting world, which financed stadiums with variable rate public debt instruments. The issue never was solely a sub-prime lending problem, as it was originally billed. The credit-crunch is real, because in order to be a borrower, someone else has to be a lender. Mortgage companies, such as Blue Door Mortgage in Wellesley, have been pointing this out in their client letters for months.

When risk-averse investors abdicate the capital markets for treasuries, fearful of the losses that financial institutions have incurred from their CDO positions, the result is higher borrowing costs for those corporate borrowers able to secure capital by offering higher yields relative to the yields on comparable treasuries; and a dearth of capital for other corporate and individual borrowers due to asset class, appraisal/valuation or credit issues. These issues are not isolated to one sector of the economy; they affect all spheres of the marketplace.

Nevertheless, there is opportunity in tough times, and strategic business moves that can be made

will position the smart and the street-wise to take advantage of the inevitable boom cycle that will follow. Private businesses and investors can purchase failed projects at reasonable prices and complete them in time for the upward cycle that, with positive consumer sentiment can lead to an increase in consumer discretionary spending, new leases for rental apartments; the opening of new storefront businesses, and the warehousing facilities needed to service the increased consumer demand.

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