Quarterly Letter

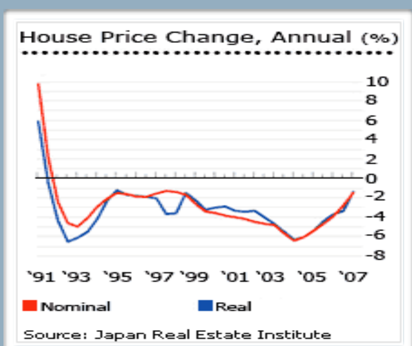
PROBLEM

At his first inauguration, late American president, Ronald Reagan said:

> "In this present crisis, government is not the solution to our problem; government is the problem"

How fitting for today! So too, is Albert Einstein's comment:

> "We can't solve problems by using the same kind of thinking we used when we created them"



SYMPTOM

Governments and individuals stress symptoms (*money,* rather than people's *attitudes* and *behaviour*) and so real problems aren't solved, but deepen! Subprime mortgagees need *attitude* make-overs to produce *behaviour* changes.

"Americans have come to regard a home as an A.T.M. with three bedrooms and 1.5 baths." *New York Times*, 26 March

The past few years have been *déjà vu* as I watched North American housing prices soar, then collapse in the U.S., but still *bubbling* in Canada. I worked in Japan from 1987 to 1994, during the infamous *bubble* period, when real estate and stock markets roared, peaking in 1990. Seventeen years on, the *bust's* effects continue! Japan's Nikkei 225 (Stock Market), and major real estate markets, haven't regained 1990 levels!

The U.S. subprime crisis is similar to Japan's bubble experience, with two main exceptions. First, Japan's high savings rates, and *lifetime employment,* softened initial market-crash effects. So, during the '90s, consumers just about maintained consumption rates—U.S. and Canadian consumers don't have those buffers. They used up their savings, and their jobs are less "secure."

Second, Japanese banks disclosed losses reluctantly, and only after several years, creating protracted uncertainty. In the U.S., financial institutions' losses have been *oozing* out, and surviving institutions are addressing their solvency.

Still, I don't see the U.S. applying a key lesson from Japan: We can't spend our way out of this crisis. *Money* isn't the problem!

Japan's main *problem* was corporate greed. To reflate the economy, the Government hiked spending. But, the Bank of Japan remained *in denial* until 1995 when it started cutting interest rates, which are near zero percent today. These actions didn't provide the spark needed, and apart from a few lackluster growth intervals, the economy deflated.

The U.S. *subprime crisis* flows, too, from corporate greed, fed by individual *greed, impatience, despair.* And like the Japanese, U.S. politicians have been throwing money at it.

With our Summer2007 letter as backdrop, I will update the subprime situation briefly, and look at steps individuals could apply to stem its deepening effects.

I pray excerpts from late American President Ronald Reagan's first term inaugural address on 20 January 1981 will help us understand issues and see solutions more clearly:

> "You and I, as individuals, can, by borrowing, live beyond our means, but for only a limited period of time. . . .
> In this present crisis, government is not the solution to our problem; government is the problem. . . ."
> Source: http://www.reaganlibrary.com/reagan/speeches/first.asp

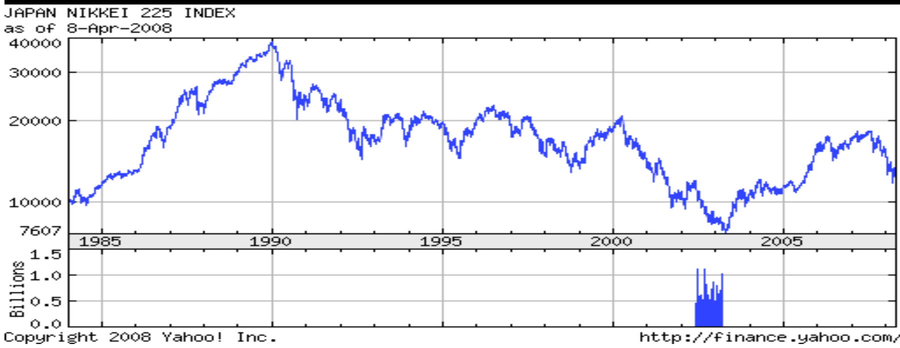
Money Triangle: 3Ms of Money

The *Money Triangle,*[1] will help show why money solutions fail. We can't manage money!

The Subprime Mortgage Crisis

Commentaries on this matter pinpoint sole culprits as *Vultures,* merchants who used predatory lending practices. Commentators' main solution focus on

[1] Each money transaction involves a merchant, money, and me—the money triangle. The merchant buys or produces goods or services to sell to me. Through clever, seductive advertising, he entices me to buy....he presents attractive financing as bait, hoping I will buy the product or service even if I don't need it. If I buy the product or service, I will use money as the means of exchange—in essence, as a bridge. I could use cash, cheque, debit card, credit card, IOUs ... anything the merchant will accept to exchange for his goods or present his services. ... I can't manage the merchant who decides the product, service, and bait.... I can't manage money; it's the bridge to get goods or services from the merchant to me.... That leaves me. Yes, I can manage me only --- Michel A. Bell, The *New* Managing God's Money—The Basics (Ontario, Managing God's Money, 2007) pages 32-33



adjusting mortgages' terms. They ignore borrowers' financial condition!

Borrowers, too, tout similar messages. But, they knew they couldn't afford their original subprime mortgages! They have bad credit. What were they thinking when they signed these loans?

I condone neither Vultures nor defaulting mortgagees' actions. Probably, mortgages will be the most significant agreements mortgagees enter in their lifetime. Before committing, shouldn't they understand *key conditions?* Even so, when events go awry, is *reneging* agreements the solution? Does blaming others for our decisions absolve us from effects of our poor choices? Ignoring blatant risks hoping for huge rewards has big costs! Can we *eat* our cakes and *have* them?

We glimpse the real problem from a closer look at Vultures *(merchants)* and mortgagees' *(me)* behaviour?

Merchants

Greedy merchants lost billions of dollars lending to *high risk* clients, both parties seeking *high returns.* Merchants packaged and sold these high risk loans as good quality investments.

The *gamble* of sustained, rising house prices failed. Borrowers reneged on loans, and related high yield securities became worthless. According to MortgageDaily.com, last year, 148 American mortgage companies failed, and 22 have failed in 2008 first quarter.

There is more. The U.S. Government rescued *Bear Sterns* with $29 billion of taxpayers' money! And several financial institutions wrote off *and* incurred huge losses in 2007, over $150 billion to date:

- Merrill Lynch - US$ 24.5 billion
- Citigroup - US$ 22.1 billion
- UBS (Swiss) - US$ 18.4 billion
- HSBC - US$10.7 billion
- Morgan Stanley - US$ 9.4 billion
- CIBC (Canada) - US$ 3.2 billion

To fix a problem, first, identify it! Should we (governments, shareholders, bondholders) give Vultures more money to get out of their self inflicted mess? Albert Einstein said,

> " We can't solve problems by using the same kind of thinking we used when we created them" Source: http://rescomp.stanford.edu/~cheshire/EinsteinQuotes.html

If Vultures don't change fundamentally, giving them more money, reinforces bad practices:

- Greed and exploitation
- Poor stewardship
- Poor Board oversight
- Excessive reward for executives irrespective of performance

Recent and upcoming shareholders' meetings include several shareholder-initiated resolutions to deal with the real issue: greedy, overzealous, unaccountable executives and Boards. Most resolutions will fail for lack of support. But, shareholders mustn't give up. We need to become more active and vote our shares. One hundred, 1000, 5000 shares are not too small to effect change; each vote can make a difference. This is how we attack the *problem* directly.

Me

I think the greater problem is the individual consumer. Our *impatience, greed, selfishness, gullibility, despair,* cause us to try to get stuff even when we know we can't afford them. Vultures know this, feed on it, and we get hurt. Vultures will continue to entice us to upgrade, take new mortgages, refinance old mortgages, get home equity loans.

Stop! More debt will crush us, generate greater stress, and more dependence on Governments. London based *National Institute of Economic and Social Research* reported that the ratio of *household debt to personal income*[2] is 1.62 in the U.K. and 1.42 in the U.S..

To compound the subprime crisis, these days, consumers accept longer mortgages (40 years in Canada 50 years in USA) not realizing this doesn't provide affordable housing, but *bondage!*

Today, what can we do about the real issues? Here is the crux: can today's income support your *standard of living*? Do you know *money management* means *lifestyle management?* So, effective solutions to so-called money problems, will flow from realistic lifestyle changes, not refinancing *unaffordable mortgages!*

Examine your loans, their terms, your options, and decide on a 12-month path after reflecting on these steps:

1. Accept *your financial position;* try to understand and change decision procedures that led here.
2. Accept your *life-stage,* adjust your lifestyle. "Creep" before you walk: it's acceptable to rent, save a realistic down payment, and then buy a home with a mortgage that fits your income. It's acceptable, too, to move to an area with lower housing costs.
3. Record all spending for at least one month and then *start obvious lifestyle* changes to stop identified leakages.
4. Write a GPS* guide for the next 12 months: set realistic *goals,* matching *plans,* and *spending plans.*
5. Before you spend, pray, recall the money triangle, consult your GPS guide.
6. Look for unneeded assets (stuff of value) you could sell to lower debts. Sell only after prayer and reflection.
7. In the next six months, align your housing costs to fit your GPS guide.

Mortgages are more controlled in Canada than the U.S.., and so, our subprime market is small. Still, the housing bubble will burst here ... sooner than we think! Folks will be hurt. Will our solutions recognize the main problems ... greed, impatience? Will we learn from the U.S. and Japan? Will we be in denial?

***GPS Guide**

Goal - Your destination; what you plan to do - where you plan to go
Plan - Steps to get there
Spending plan - Estimate of the plan 's cost in time and money

[2] Vanier Institute of the Family, reports that since 1990, Canada's personal debt jumped from 91% to 131% [ratio of 1.31] of disposable income.

