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Fiduciary*ALERT*™

CHRIS MCCONNELL & ASSOCIATES – JUNE 2011

"2,000X (times) leverage"™ caused housing bubble, Wall St bailout and Main St meltdown; and warnings to trustees for 2011 and beyond…

Historical returns of the major asset classes should be required knowledge among all investors, banks, regulators; especially trustees and fiduciaries. Real estate's average annual increase was about 10% annually since the 1980's; prior to that it was in the low single digits.

House price bubble caused by hidden "2,000X (times) leverage"™

Briefly, the likes of zero down home loans (100% loan-to-value) are 100 times leverage on house prices multiplied by 20:1 bank leverage equals "2,000X (times) leverage"™; Wall St controlled house prices on Main St, like a puppet on a string. Mortgages were overvalued by any measure, in addition to credit underwriting issues. A Wall St trader's email stated "100% LEVERAGE…NO MTM…IT'S ALL DEALER RISK" code that mortgage securities were not valued according to market or arms-length trades but internal proprietary traders' models, financed for pennies on the dollar.

Pennies on the dollar leverage exposed short term financing pressure and created the "Mother of all Margin Calls"

The government authorized $14T in aid to certain banks, due to funding concerns. (Separately, in the Rajaratnam case, a July 2008 call touches upon funding.) Mr Bernanke, expected banks to make new loans; instead Main St got shafted at the hands of a massive bank media and lobbying assault. One may ask why, still today, the Fed owns nearly $1T of MBS and the FDIC guarantees $247B of banks' and non-FDIC insured affiliates' debt. Issuers of, investors in MBS, direct and indirect counterparties face increased funding uncertainty.

Warning to Trustees for 2011 and beyond…are trustees ignoring the news; *again*?

CBS' 60 minutes , FDIC's Sheila Bair , and the New York Times have reported it, however, trustees, their lawyers, CPAs and financial advisers seem as if in a "what me worry?" mind set.

Are trustees insane? What's "it"? And will mortgage-burning parties get smoked?

1. One definition of insanity is doing the same thing over and over expecting different results. Example, trusts paying fees and costs only to get sub-benchmark performance repeatedly.
2. The "it" is serious, public warnings related to promissory note , mortgage deed ownership, securitizations, notices and or public records rules.
    a. Predatory lending, REMIC and or foreclosure violations are also on the list.
    b. Mortgage backed securities, since the 1980's, have been the girder of credit acceleration in the U.S. and later globally; causing returns to shift as above.

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Hidden "2,000X (times) leverage"™:
The cause of US housing bubble, "Bubble Banker" paydays, Main St's meltdown

Think I can fit a few more derivatives in here - oops I mean nuts?

Home court of information asymmetry, hence control, and manipulation; certain banks focused more on proprietary profits. SIFMA reports trillions in face amount of MBS were issued, but some banks *held* MBS supposedly "valued" at 20 times (or in some cases or intra-quarter much more) what they put down to control them in the so-called Shadow banking system often, according in 2007 to Mr Dudley in the Asset Backed Commercial Paper (ABCP) market. Bank's leveraged MBS and related exposures stealthily inflated house prices.

FDIC's Mr Cave stated *"Firms have deleveraged since the crisis, as measured by stronger leverage and risk-based capital ratios. Further, many of the complex structures that concealed additional leverage and exposure, such as structured investment vehicles and other off-balance-sheet conduits have been largely consigned to the history books. Cash and liquid securities represent larger percentages of the balance sheet, while reliance on short term debt has declined."*

How could so many millions of individuals borrow money from a handful of banks then collectively see trillions wiped out? If borrowers only knew…

It's seems abundantly clear some banks purposely hid their massive mortgage exposures (bets) in darkness, away from the sunshine of a market; from market participants; from investors and or customers, from regulators especially FDIC & SEC; perhaps from their insurance carriers; but not from their proprietary traders' models; fuel for years of record profits and likely *those very same traders' bonuses.* The "I know a secret" ruse was also hidden from fellow Americans, loan borrowers (and conceivably, all property owners) who thought home values were based upon a market; when the secret-holders knew they were contrived, literally based on a model. The US Chamber of Commerce supports full disclosure of "knowable risks" as here in 2011 testimony; see page 5, first paragraph.

******Now mortgage borrowers, investors, insurers, state and federal governments and GSE's may have a few new reasons to consider putting some loans and securities all the way back to the banks.******
In 2005, S&P's Ms Bovino issued the aptly named "Who will be left holding the bag?"

CRA's home ownership peak was 2004. Many loans were not for first home purchases, but cash-out equity re-financings and or for second, third, and fourth "to be flipped" properties. Cash out, mortgage equity withdrawals conveniently spiked official US economic growth. Many sub prime loans conformed to size limits only, credit underwriting standards eroded.

No one forced any banker ever…at any point any bank could have said "no" but…
In any case, there were no news reports whatsoever that any bankers were ever forced to: 1) issue any mortgage, 2) create any mortgage backed security or CDO; 3) hold and value same upon a non-diversified, over-concentrated balance sheet nor 4) make leveraged bets, whether on or off balance sheet or offshore. In 2009, eight "Too Big to Fail" bank CEO's all agreed with Congress' admonishment about safety and soundness; for decades, bank charter bedrock, not 2009.

Few checked out Bernie Madoff…trustees and advisers are not paid to assume:
When it comes to your home do you know if your chain of title is broken? If your mortgage documents were not properly handled, as court room testimony portends, it could be a problem.

If you're a trustee, there's a job to do. **Find out** 1) if your mortgage chain of title is broken, 2) who owns your note, 3) how many times it's been transferred or assigned, 4) if payments have been accounted for correctly in accordance with your note. **Find out** if 1) your trust account has been paying fees , costs and expenses which 2) you may be unsure of and or 3) not getting value in return; waste of trust assets is a prohibited transaction. (Note: IRA and Rollovers are trust accounts; spouses and beneficiaries are parties.)

Chris McConnell, AIFA®, McFid, BFD expert since 2003™, an independent resource for training, education, audits, litigation support and expert witness services to investors, trustees, beneficiaries and counsel since 2003.
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A few closing comments:

Some say the banks erred in measuring "tail risk" – this is one thing; baloney. It has all to do with a simple, massive hiding of speculative, leveraged bets upon trillions of MBS* on and off balance sheet for proprietary traders' bonus compensation and firm profit. In 2007, Citigroup's CEO Mr Prince said "as long as the music is playing you gotta dance." Music and dancing are delightful, but neither fits the definition of any insured bank's safety and soundness.

A brief example showing how some banks spiked their profits from leveraged bets on MBS;

A bank issues a mortgage at 7% interest, they bundle it in with hundreds of others and create what's known as a mortgage "backed" security (investment) and they get a fee upfront. Before the bubble years banks would typically sell these MBS to investors (another fee); during the housing bubble however, some of the largest banks did not tend to sell (foregoing a fee) most of the new MBS. They held them for themselves; and financed the 7% mortgage in the short term commercial paper money market at 2%; making a 5% profit. So on a billion in face amount of MBS, profit would be $50 Million ($1B x 5%) annually. Learning from hedge funds, banks could borrow the same $1B short term at 2%; but they could control (leverage) $20B in MBS face amount; and here's where the music kicks in – profit went from $50 Million (in the unleveraged example) to $1B ($20B x 5%) annually! Leverage, stated another way is assets owned but NOT fully paid for. In this example, $20B of MBS were owned, but only $1B was paid for. The Fed ultimately paid for ($19B in this example) them via the bailout. Some banks intra-quarter were effectively leveraged at well over 20:1; with some over 30:1 or more. As little as a 3 to 5% decline meant they had NO remaining equity, wiped out; insolvent; and we know that arms-length bids of 50 or 60 or 80 were reality – based than bank's model – based bids of 90 or 95.

****THE factor which bank models failed to appreciate; trillions of MBS created, traded and valued where? In darkness. Last, one might say that then and still now "financialization has overtaken the real economy".***

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