

## Thought for the Week: Monday, August 22<sup>nd</sup>, 2011

### Whose Advice can you Trust?

Have you ever seen a medical doctor smoking a cigarette and thought, “Gee, that doesn’t seem right?”

What would you think if you visited a dentist who had bad teeth? And how keen would you be to pay an overweight fitness instructor?

At the risk of “judging a book by its cover,” wouldn’t you politely decline a consultation in all of the above situations?

So why do people still get financial advice from financial organizations that ran out of cash in 2008 and 2009 – financial companies that couldn’t plan their own expenses beyond one single week?

Is there something inherently wrong with taxpayers asking a representative of an organization to help devise a financial plan when the same taxpayers had to financially bail out the same organizations?

#### The Fed’s Secret Loans

Last week saw the publication of Secret Government Loan data to top financial firms during the 2008 Credit Crisis. The chart to the right provides details.

This is money that was provided to the listed companies “in addition” to the previously disclosed bailout amounts.

“These are all whopping numbers,” said Robert Litan, a former Justice Department official who served on a commission probing the causes of the savings and loan crisis. “You’re talking about the aristocracy of American finance going down the tubes without the federal money.”

Neither Fidelity nor Schwab appear on the list – that’s because they did not indulge



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in many of the leveraged practices that created the issues for those that are on the list. They were able to run their businesses without secret emergency loans.

### **Just how Big is Whopping?**

The total amount secretly loaned, according to a Bloomberg News compilation of data obtained through Freedom of Information Act requests, months of litigation and an act of Congress, equaled approximately \$1.2 Trillion.

The \$1.2 Trillion peak on Dec. 5, 2008 -- the combined outstanding balance under the seven lending programs tallied by Bloomberg -- was almost three times the size of the U.S. federal budget deficit that year and more than the total earnings of all federally insured banks in the U.S. for the decade through 2010, according to data compiled by Bloomberg.

As a further indication of the depth of the hole large financial institutions dug for themselves; \$1.2 Trillion is about the same amount U.S. homeowners currently owe on 6.5 million delinquent and foreclosed mortgages.

The Fed has said it had "no credit losses" on any of the emergency lending programs, and a report by Federal Reserve Bank of New York staffers in February said the central bank netted \$13 billion in interest and fee income from the programs from August 2007 through December 2009.

But most taxpayers are probably thinking the same as U.S. Representative Walter B. Jones: "Why in hell does the Federal Reserve seem to be able to find the way to help these entities that are gigantic?" said Walter at a June 1 congressional hearing in Washington on Fed lending disclosure. "They get help when the average businessperson down in eastern North Carolina, and probably across America, they can't even go to a bank they've been banking with for 15 or 20 years and get a loan."

### **The How's and Why's?**

The Why is easy: financial institutions were leveraged way beyond any safety level. Their liquidity ratios were totally inadequate and regulators had no way of either understanding or testing their real situation. Moreover, these corporations were generating profits from the passing of all manner of paper between themselves.

One example is something we call "Share Hypothecation." Basically, one company holding client-owned shares can loan those shares to another company for a fee which they keep. The company borrowing the shares may do so to facilitate short trading.

Firms were "able to reuse clients' assets to raise cash for their own activities," the Financial Crisis Inquiry Commission wrote in its final report, published in January 2011.

The How is more complex. Over a dozen lending programs were employed by the Fed in response to the credit crisis including: the Fed's discount window, the last-resort lender for troubled banks, and six temporary measures: the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility; the Commercial Paper Funding Facility; the Primary Dealer Credit Facility; the Term Auction Facility; the Term Securities Lending Facility; and so-called single-tranche open market operations.

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Many firms borrowed from two or more programs through multiple subsidiaries, all disclosed separately in the Fed data. The central bank didn't detail how much each borrower had outstanding from all programs on any given day, a measure of vulnerability during the crisis.

Bottom line: The Fed scraped the cash from wherever it could without having to formally disclose the loans. Disclosing the loans may have further undermined the financial system and its major players.

### **Trusted Financial Advice?**

Let's recap the information above, mainly taken from Bloomberg's excellent research:

- Massive loans were secretly provided to the financial "too big to fail" companies because they were way too highly leveraged. They abjectly failed to manage the financial risk in their business.
- The leverage was partly created by companies who loaned out other people's securities without coverage if these people wanted their securities back.
- These risks dwarfed the financial system in size while no effective regulation existed to limit or prevent such practices.

Who do you go to for your Trusted Financial Advice?

Where can you obtain impartial feedback on risk?

Who can you rely on to fully disclose all the costs and leverage within your investments?

In our opinion, the world is changing fast. The smaller, independent financial advisor who operates to a fully disclosed, fiduciary standard may be more able to provide impartial trusted advice.

After all, the chubby fitness instructor; the dentist with bad teeth and the financial advisor who can't manage their own finances generally have one thing in common:

They care more about their money than the subject they provide advice on.

### **Basic Math**

And would you listen to a Math professor who can't add up?

So why listen to the big companies who use S&P Credit Ratings when S&P make \$2 Trillion "basic math" mistakes?

If your advisor is not on the list above and survived the 2008/2009 crisis without a secret, emergency Government loan, you have probably found someone who cares about you and your finances.

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