

Chapin Hill Advisors, Inc. Market Comment
March 25, 2009

Toxic Asset Plan Lifts Markets

After months of inaction, the government has finally stepped it up in the last week. On top of last week's \$300 billion Fed buyback of 2-10 year Treasuries, Treasury Secretary Tim Geithner announced a new public-private facility to remove "toxic assets" from the books of financial institutions.

News of this new facility sent the market soaring with the Dow climbing 6.8% and the S&P rising over 7.1%. For the Dow this is the highest close since February 13th with a 19% rise from a low two weeks ago. The S&P ran up 22% since its March 9th low. However, both indices are still down 45% from the October 2007 highs.

Financials led the rally as they rose 16% for the day with some individual issues up over 20%. Energy was also up 8.2% as oil prices continued to rise.

Housing News Helps

Helping to aid the rally was the news that existing home sales rose 5.1% for February. Of course if you really looked through those numbers, it was mostly short sales and foreclosures taking place as investors see opportunities in others distress.

On Wednesday, new homes sales were up 4.7% versus a decline in January. Sales are now tracking at 337,000 versus the 322,000 level in February. Everyone wants to believe this is real but we are still in the bear camp on real estate. While there are opportunities if you are either an investor or a first time buyer who plans on remaining in place for a while, we feel there is more downside in both residential and commercial real estate.

We are currently working on a new estate account and they have a one bedroom apartment for sale in West Palm Beach for \$22,000 and it is not selling. Hard to believe you could purchase a one bedroom for that but there it is.

We continue to see clients who are upside down in their mortgage/home value ratio. If you can stay put, have a decent mortgage rate and can afford your payments, you can make it through. However, if your income goes down or you are forced to relocate due to a job opportunity, you could be at risk.

Anger over AIG continues

The furor continued over the AIG bonuses paid to their executives. Congress pushed through a bill that puts a 90% tax on bonuses received by employees of companies who took \$5 billion or more in government assistance. You may not have any sympathy for the senior exec who received millions, but this also affects the regular Joe's who need their \$10,000-30,000 bonuses to pay their regular

budget. It has been a standard for most financial companies for years so most people count on some level of bonus each year.

The anger was astounding as protestors marched in front of AIG's downtown Manhattan offices and went so far as to accost an executive in his driveway. One group hired a bus to go to executives' homes in Connecticut. It is definitely a Main Street versus Wall Street controversy.

Obama has now angered much of Wall Street so this past week you saw a "dialing down" of criticism and more remarks meant to assuage the financial crowd. Ken Lewis, CEO of Bank of America, declared on Wednesday that they would pay back the government loans quickly so they did not have a mass exodus of talent. The problem is that if they pay these funds back, their balance sheets still look pretty bad and they may have to cut out other areas of the business.

Dubai World sues Las Vegas project

Dubai World sued MGM Mirage this week to limit their exposure to more losses. The \$8.6 billion project is in jeopardy as tourism in Las Vegas plummets. Dubai is stopping a \$100 million payment due this Friday which puts the entire 67 acre project one step closer to bankruptcy.

Other institutions are trying to limit their exposure to areas of weakness and are pulling out of investments in foreign banks. This week, Goldman announced they are selling their 4.9% interest in Chinese bank ICIB.

More news around the world

While small cars in the US pile up at the dealership because of increased gas prices, Tata Motors is set to launch the world's smallest car in a lottery. The Nano looks like a toy car and is supposed to sell millions to the emerging markets population.

China made news again as they called for a new global currency to replace the dollar. This follows on their remarks last week about worries about the safety of the United States' debt. China is continuing to assess itself and also reflect on the world's growing unhappiness with the United States' role in the global financial crisis.

Countries continue to report slowdowns in growth and attempt different methods of stimulus. Germany expects their GDP to decline by 6-7% this year. The United Kingdom started a program similar to the Fed's by buying back their own government notes.

Back in the US, the repo man has a new tool for owners of used cars who are falling behind in their payments. The latest gizmo is a remote control device installed in the car which disables the car if you fail to make your payments. You may ignore the warning lights but when it starts beeping, you had better make your payment or have a dead car in your driveway!

Bonds not reacting

Wednesday's auction of notes did not go well as they attempted to issue \$40 billion on new debt. The Fed is trying to push interest rates lower to stimulate lending and mortgage origination by buying 2-10 year notes. They also assume that investors will be encouraged to own treasuries. However, investors are afraid of inflation and do not wish to lock in long term bonds with fixed rates at these levels if inflation raises its ugly head in 18-24 months as many fear.

Durable goods were reported early on Wednesday with a 3.4% increase versus an expected decline of 2%. One number does not make a trend but the markets are looking for good news so we had an early rally which faded by midday.

Bonds have not really responded to the toxic asset plan. A puzzling piece of this for us, unless we are really missing something....if an investor is willing to purchase some asset from a financial institution at "x" price, they would be doing so in anticipation of making a big profit. After all, even with the public/private partnership, these assets are supposedly very risky. So why would I want to sell an asset at say 25 cents on the dollar to an investor who hopes to double or triple their money, when I can leave the asset on my books and watch it grow in value??

The investment grade corporate bond index rose a bit this week in response to the plan but the index is still trading at close to 85 cents down from par or 100 last year. The subprime index – measured by AAA subprime ABX-He-AAA index is trading at about 25 cents on the dollar. Certainly indicating risk in that universe.

Near term outlook

We still do not feel you are off to the races in the markets. We do anticipate a rally into the beginning of April and consolidation throughout April into early May. After that we are looking for a rally into early July. However, the next few years we are likely to trade in a small range of 600 to 1000 on the S&P which roughly translates to 6000 to 10,000 on the Dow. You cannot just buy and hold and must remain vigilant in your portfolio.

As always, feel free to call or email us with questions and comments.

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