



President's Corner

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TURNING GOLD TO LEAD

In the past, we have mentioned on numerous occasions the dangers of “creative mortgage financing”, and the dangers such tactics may pose for what most are calling a “housing bubble”, the personal financial health of many of these borrowers, and the economy in general. A few years ago, mortgage features such as “no money down” and “interest only” became not only available, but to some very attractive. Decades ago such speculative tactics were not available.

Then, just when you think you have heard everything, recently the CNBC's daily financial programming has been running ads narrated by such senior citizen luminaries as Robert Wagner and Pat Boone encouraging senior citizens to investigate the possibility of a “reverse mortgage”, while using such terms as “government insured loan”.

Finally, today's Wall Street Journal (2/21/2007) has shined a bit of the light of truth on the innovative financing being used in the currently fashionable private equity craze (WSJ Article; What's Aiding Buyout Boom: Toggle notes. In layman's terms, such arrangements offer the issuer the right to among other things defer interest payments until the bond actually matures (and without other traditional default covenants). Presently, corporate debt default rates are at an all time low (less than 1% – small wonder with lending tactics such as these available!). The article points out that with such low default rates (and the perception of less risk) such “creative financing” is likely to continue, so long as there are no problems. However, in 2006 companies issued \$624 billion in speculative debt, up from 389 billion in 2005! According to Standard & Poor's leveraged commentary and data group, some 30% of companies issuing debt in 2006 carry junk ratings (B+ or below) compared with 7% in 2002. Does anyone remember Michael Miliken or Drexel Burnham or the old adage about history repeating itself?

The credit bubble is alive, well, and growing. This is a terrific party, with signs of being ruled by greed, not prudence, let alone fear or caution.

Mis-steps may include a problem with the growing hedge fund community recently estimated at \$1.3 trillion and with derivative contracts worth maybe \$350 trillion. Another terrorist attack. A widening Middle East war or perhaps just a tax increase.

The firm restricts the use of leverage on the part of its' clientele beyond the levels allowable under industry standards and does not knowingly allow “creative financing” of customer investment portfolios.

Recent Equity Price Earnings Ratios:

Dow Jones Industrials	20.88%
S&P 500	17.95%
Russell 2000	38.18%
NASDAQ Composite	37.20%

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