



President's Corner

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“CHEAP MONEY”

A BLESSING OR A DEMON OF OUR OWN DESIGN

With the subprime mortgage market reduced to rubble, and in our opinion the high yield debt market on very shaky ground, it is unbelievable that so many in the financial world remain seemingly blissfully oblivious.

Consider if you will, the risk premium in junk debt (as compared with treasuries). The spread is at a historic low. Over the course of the past twenty years or so, the margin between junk and treasuries has averaged some 5.40%. Earlier this month it touched 2.65%. That's less than 8% money for high risk borrowers!

Lenders are so concerned at the prospect of losing business that since the first of the year, over \$115 billion of debt has been re-priced. This represents 29% of all bank loans in the United States!

In 2006, a record 20.9% of new high-yield lending was to particularly credit-challenged borrowers. So far this year, that figure is at 33%. No exaggeration is required to pronounce unequivocally that money is available today in quantities, at prices and on terms never before seen in the 100-plus years since US financial markets reached full flower.

Led by private equity, borrowers have rushed to avail themselves of seemingly unlimited cheap credit. From a then-record \$300 billion in 2005, new leveraged loans reached \$500 billion last year and are pacing toward another quantum leap in 2007.

One should also consider today's margin debt levels in comparison to say levels in December 1999 – February 2000. (Figures available on www.nasdaq.com)

And just as the unwinding of the subprime mortgage occurred at a time of economic prosperity, the high-yield market could readily unravel before the next recession. With the balance sheets of many leveraged buyouts stung taut, a mild breeze could topple a few, causing the value of many leveraged loans to tumble as shaken lenders reconsider their folly.

Recent Equity Price Earnings Ratios:

	Current	Year Ago
Dow Jones Industrials	17.66%	20.50%
S&P 500	17.79%	16.70%
Russell 2000	42.89%	35.97%
NASDAQ Composite	35.38%	30.70%

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