



President's Corner

May 2008

Issue 0508-01

CLEAR AND PRESENT DANGER II

We Believe today's crisis (and yes, there is a crisis) has its roots in a culture of greed and credit run amok which will be quite painful to correct.

On April 10th of this year, an article written by Paul Volker (formerly a towering figure in the financial markets) titled "On Thin Ice", appeared in the Washington Post. We have excerpted the first two paragraphs of Mr. Volker's article:

"The U.S. expansion appears on track. Europe and Japan may lack exuberance, but their economies are at least on the plus side. China and India – close to 40% of the world's population – have sustained growth at rates that not so long ago would have seemed, if not impossible, highly improbable.

Yet, under the placid surface, there are disturbing trends; huge imbalances, disequilibria, risks – call them what you will. Altogether the circumstances seem to me as dangerous and intractable as any I can remember, and I can remember quite a lot. What really concerns me is that there seems to be so little willingness or capacity to do much about it."

Additionally, we observe that Mr. Volker noted "there seems to be so little willingness to do much about it!" Indeed our government seems, to us, to be interested (desperately) in stimulating our economy through consumer spending, through historically unprecedented and in our view unsound, means. Two notable examples are the current "stimulus package" in the form of a cash giveaway and reverse mortgages. In our view, consumers are tapped out and have been spending way beyond their means for a very long time. Please see our letter of December 2006.

Mr. Volker also recently addressed the economic club of New York. Below we attempt to summarize his remarks:

- The United States as a whole has become addicted to spending and consuming way beyond our capacity to produce.
- "Financial Legerdemain"¹ and other techniques have disguised the problems for some time, but it's time to return to "painful but necessary adjustments".
- Private sector bankers enjoy the benefits when things go well, but do not share in the downside when things go poorly.

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- He pointed out that the Federal Reserve's job is to act as 'Custodian of the Nation's money and to protect its value and resist chronic pressures towards inflation.' To put it another way, the Federal Reserve's job is not to bail out irresponsible bankers and load up its balance sheet with shabby paper (low quality mortgage bonds purchased from the very bankers who created this mess in the first place).

We wish to reiterate our prior advice concerning reductions (or eliminations) of participation in the equity markets in most portfolios. Please see our issue 0108-01 concerning our comments on fixed income and money markets. Back issues of these letters are available at www.polarinvest1.com in the President's Corner section.

As always, please call us for ideas and an assessment of your particular situation.

¹ It means "slight of hand". We had to look it up too!

Polar Investment Counsel Inc is a federally registered investment advisory firm and broker dealer which manages customer accounts on a fee or commission basis. The firm's senior principal, Michael Jordan, has nearly thirty-five years of industry experience.

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