



### **Material Disclosures**

Rocky Mountain News finance editor David Milstead reveals hidden stories from the world of finance. Contact him at [milsteadd@rockymountainnews.com](mailto:milsteadd@rockymountainnews.com).

## **Views on Bear Stearns and the Fed**

Monday, as shock reigned in the markets upon the ignominious fall of Bear Stearns, we asked a few questions of our economists and investment pros.

By the time you read this, you will have heard the Fed decided to cut the Fed Funds rate by three-quarters of a point in its Tuesday meeting - we and our respondents didn't know that when these questions were answered, however.

Here's a full list of Qs and As.

Our respondents:

Rich Wobbekind, Director of the Business Research, University of Colorado at Boulder Leeds School of Business

David A. Peterson, Registered Principal, Peak Capital Investment Services

Gregory Robert Anderson, GRAnderson Wealth Management Group

**David A. Twibell, President - Wealth Management, Colorado Capital Bank**

Donald Cassidy, President, Retirement Investing Institute

**1 When Bear Stearns spends a week assuring Wall Street that it has no liquidity problems, then has to give away the company over the weekend, why should investors believe anyone saying that things are OK?**

Rich Wobbekind: Because not everyone is Bear Stearns just like not every company was Enron. Still there may be more companies out there like Bear Stearns just like there were more companies out there like Enron. The public has every right to be skeptical at this point.

David Peterson: I'm not sure that anyone can be believed; although certainly not everyone out there is a liar. I think the stock price of these investment banking firms not only reflects the difficulty these firms are having, but also the high level of doubt associated with their credibility in giving investors the full picture.

Gregory Anderson: Investors should ALWAYS maintain a healthy skepticism about the legitimacy of any data they are collecting, and this scenario with Bear Stearns is a perfect reminder. While all the financial markets' regulations have reduced the chances that additional Enron and Worldcom-type collapses will occur, there will never be an environment that investors can just take everything at face value.

**David Twibell: They shouldn't. The real problem – and the one that should scare investors more than anything right now – is that even Bear Stearns' senior management didn't have a good grasp of their financial problems until things fell apart. To the extent the current credit crisis stems from a lack of confidence in the financial system – which I believe it does at this point – it's hard to rectify when even those closest to the situation lack accurate information.**

Donald Cassidy: In any problem situation, expect to be told things are fine and to not believe the official word. If they tell the truth, mass public reaction makes the problem get worse faster.

### **2 Has the rapid decline of Bear Stearns affected your view on whether the worst was over in the market's subprime/liquidity problem?**

Rich Wobbekind: Not directly because I had heard from individuals close to the market that the liquidity issue has been worsening over the last several weeks. Still I do think in general it will make all investors and CONSUMERS think a little more carefully about whether the worst is over which will have spillover effects in both the financial and real economy.

David Peterson: Failure of a large investment bank was our view of the worst possibility. We realized this was conceivable, especially for a firm like Bear Stearns that is heavily concentrated in the fixed income arena. Most of the other investment banking firms are more well-funded and more diversified.

Gregory Anderson: We are convinced that there may be additional announcements from other Wall Street firms, and we are encouraging investors to diversify with an eye toward quality and a longer time horizon.

**David Twibell: It may be a bit counterintuitive, but I think it brings us closer to the end. Historically, failures of large financial institutions like Drexel Burnham, Penn Central or Long Term Capital Management have signaled the end of a financial crisis, rather than the beginning of one. Whether we will follow the same pattern now or see some additional fire sales and bankruptcies remains to be seen, but once this process starts it tends to resolve itself fairly quickly.**

Donald Cassidy: No change. Still believe more shoes are yet to drop.

### **3 What do you think the Fed will do Tuesday, and how will Wall Street react?**

Rich Wobbekind: They will cut at least an additional 75 basis points and do everything in their power to assure they stand at the ready to straighten out the bad debt problems in the economy. I think the stock market will react favorably (as long as Lehman doesn't fall off the cliff). I am not sure how Wall Street pundits will respond however. They know that the federal funds rate, per se, is not the core problem. The Fed's willingness to buy bad loans last week and assume some of the bad Bear Stearns' debt this week should signal to Wall Street that they are seeing the larger problem. But is this problem larger than the Fed?

David Peterson: I think the Fed will cut interest rates by three-quarters of a percentage point, and I think Wall Street will react favorably. My concern is that the Fed will end up going too far and inflation will become a problem.

Gregory Anderson: We believe rates will drop again ... at least a half-point. Recently, the Fed's short-term actions have been received well by Wall Street and investors; however, this time around, the positive impact might not be so obvious, since it will be offset by the bad news of the Bear Stearns collapse.

**David Twibell: The futures market is currently pricing in a 100 bps cut in the fed funds target rate, and I think that's probably what will happen. I'm in the minority, but I don't think the economy needs a cut of that magnitude. What we really need is more targeted interventions like the recent \$200 billion Term Securities Lending Facility to help distressed financials, along with a coordinated effort between the Fed and Treasury to halt the recent U.S. dollar meltdown.**

Donald Cassidy: I think it will not drop rates the 75 BPs the street was hoping, and that will disappoint the street.

#### **4 Is the Fed helping, or making things worse by seeming to be ineffective? (Or do you disagree the Fed seems ineffective?)**

Rich Wobbekind: I certainly think the Fed waited too long to act. That said if the Fed didn't pursue some of the steps it has pursued recently who knows how bad the financial crisis would be. They do seem to be late at each step but some of the steps they have taken recently I seriously doubt they ever wanted to make. In some sense they had to wait to take those steps.

David Peterson: I believe the Fed is being as effective as it can be. The financial markets are spooked right now, and the Fed doesn't have the magic potion to solve this, but I do believe that several of the moves will ultimately help Wall Street regain confidence.

Gregory Anderson: Although the Fed has not responded as quickly as Wall Street would have liked, the market intervention will prove to be more effective over time. Keep in mind, the Fed does not exist strictly for the benefit of Wall Street, nor should it.

**David Twibell: I actually don't agree that the Fed has been as ineffective as many people believe. You have to remember the Fed only has a limited number of tools at its disposal. The recent term auction and lending facilities were right on the mark in my opinion, as were the recent rate cuts. The problem is that the Fed simply cannot solve the current credit crisis on its own.**

Donald Cassidy: The Fed has been ineffective because it has been trying to fix a liquidity problem by lowering rates. Working on wrong problem, as is now obvious to all. They hoped not to have to take the new more effective measures so as not to expose how tough the problem was/is. Past tense on that hope.

#### **5 Where can investors put their money today to minimize risk?**

Rich Wobbekind: If minimizing risk is the only goal an FDIC insured bank account would accomplish that goal. If an individual wants some of their portfolio to remain invested in non-bank assets there are certain areas of the market that have seemed to be relatively resilient. This resiliency is based largely on either worldwide demand for the products or the fact that some of these are considered a good hedge against inflation. This list would include agriculture, energy, and minerals.

David Peterson: The answer to this depends on the type of risk at issue. Ultimately, I believe a broadly diversified portfolio that includes stocks, bonds, cash and hard assets will help investors survive downturns like this and reward them when the market turns around. Long-term bonds did very well today, and if we are headed for a recession should help moderate portfolio losses.

Gregory Anderson: A diverse investment portfolio that has international exposure should do well in these uncertain times, or at least buffer against them. We continue to see opportunities in non-traded, commercial real estate investment trusts that provide stability and strong cash flows. It also helps to have investments in items that are not correlated to the financial markets – like Barry Bonds' record-establishing home run baseball!

**David Twibell: I tempted to say under their mattress after a day like today. The economy is experiencing a very unique confluence of events including an historic credit crisis, mass deleveraging by many financial institutions, and a meltdown in the housing market. Until these conditions start to abate, it will be hard to find any low-risk investments outside cash and very short-term Treasury instruments.**

Donald Cassidy: T-Bills if you want to minimize risk. Be on short side to hedge or make money.

#### **6 Did investors overreact, under-react or get it right in today's trading?**

Rich Wobbekind: Given what we don't know I think the reaction was about right. Indication of more confidence in the bigger DOW companies is warranted.

David Peterson: Who knows? I think this is one of those things that only time will tell.

Gregory Anderson: We don't blame investors for reacting strongly to recent news items that are affecting and reflecting the state of the economy; and we certainly expect to see that reaction most noticeably among short-term investors. We have long been preaching the benefits of a long-term approach to investing, and those investors can view these events with a certain amount of detachment.

**David Twibell: It's too early to tell. What I gathered from today's action is that investors are scared and confused. Volatility spiked to record levels, internals were terrible, and other than big sell-offs in brokers and commodities, the whole day was just a series of whipsaws back and forth. The fact most indices closed near their highs is positive -- as is the fact we avoided a huge meltdown following the Bear Stearns news – but I think it's going to take more than one trading day for investors to digest everything that's been thrown at them recently.**

Donald Cassidy: Probably reacted accurately. This is not the bottom yet, and failure to have a selling climax this morning showed that in people's minds we are not collectively at the panic stage yet. "To be continued."