

# DOUGLASBRADLEY LLC

## Personal Financial Advisors

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## DOUGLASBRADLEY'S MONEYWISE

### Financial News and Insight from an Independent Advisor

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### Common Concerns

*[We try to avoid being negative in our communications since the media can be so "doom and gloom". We prefer to view ourselves as simply being realistic. On the surface, the following article may sound like dire predictions, but in our view all market conditions can give rise to profitable investments. i.e. DouglasBradley is able to find the silver lining in every dark cloud and use it to our clients advantage. We're proud to say we protected our clients' accounts in the technology meltdown of 2001/2002 as well as the most recent downturn.]*

Each month for MoneyWise we attempt to come up with useful and insightful topics for our readers. It is not easy - but we aren't complaining either. The range of topics has spanned taxes, estate planning laws, the economy, and the world's stock markets to name a few. The aim is for MoneyWise to serve as a tool that you can act on as well as be informed by.

In line with these goals, this month's MoneyWise is based on a recent lunch conversation among a group of long-time friends of Brad. The group included a former bank president, a senior corporate executive, and the top producing salesman worldwide for a multi-national software firm. Each brought their own insights and perspectives to the discussion, but their concerns and hopes for the economy were centered around three main themes - namely, the future direction of interest rates, real estate foreclosures (residential and commercial), and unemployment. We thought we'd summarize the views of the group to share with MoneyWise readers.

#### History Doesn't Repeat Itself, But It Rhymes

For those who remember the double-digit interest rates (and inflation) of the 1970s, don't be surprised if we see the same again. After declining for decades, the consensus was that higher interest rates are in our future. In fact, we've already seen a sharp jump in mortgage rates over the past few weeks. The group bases their views on several factors.

First, reversion to the mean. Simply stated, over the long-term interest rates have averaged higher than present levels; meaning interest rates will naturally rise back toward the long-term average.

Second, the US Treasury has been printing literally billions of dollars to save the banks and other sectors of the economy. This money is all borrowed from lenders such as China and oil-rich countries in the Middle East. But, they simply do not want to lend us any more. The only way for the US to attract money from these lenders and others like them in the future is to pay more attractive (i.e., higher) interest rates.

Third, with the government borrowing so much money it is "crowding out" borrowers such as businesses and individuals. In order to compete with the US government for loans, these non-governmental borrowers will need to pay higher interest rates.

### Despite All the Talk, Look for More Foreclosures Ahead

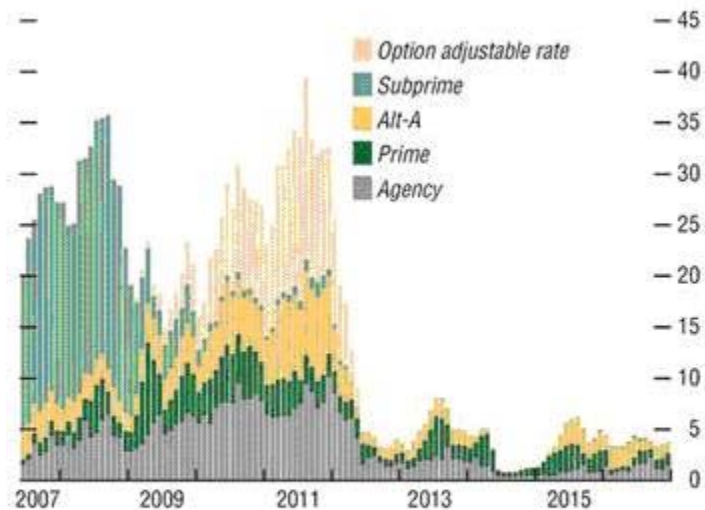
The consensus was that despite all the talk of a rebound in home sales, the inventory of unsold homes and foreclosures will continue to severely limit the ability of the banks and the general economy to quickly recover. In fact, the banks, in the groups' view, have taken no concrete steps to address the toxic assets on their books. No one could understand how the same banks who were on their last legs no more than 6 months ago were now reporting huge profits - when nothing material has changed!

Compounding matters was the observation that commercial real estate has yet to experience its expected decline. With the meaningful drop in business activity and lower employment, less commercial space is needed. How would you like to hold a mortgage/lease on a Chrysler dealership after it was notified that they lost their franchise?

Simply said, it is not possible that all the highly leveraged office buildings and retail complexes are not teetering on major defaults. We are likely to see default rates increase next year and into 2011 as five-year loans made in 2005 and later start to come due because those mortgages were based on overly optimistic forecasts of income growth and inflated property values.

Finally, the forecast for the next wave of residential foreclosures was raised. These are for the Option ARM and Alt-A mortgages we've spoken about many times in the past. We are going to again to use a graphic from Credit Suisse to make our point.

**Figure 1.7. Monthly Mortgage Rate Resets**  
(First reset in billions of U.S. dollars)



Source: Credit Suisse.

Make note of the spikes expected later this year and early next year. Homeowners with no equity in their homes and facing rising mortgage rates are simply not going to be able to refinance their homes at terms that will be acceptable. Hence, just like last time, we can expect to see foreclosures gaining steam about six months after the each of the peaks.

On a positive note, we can now see that by the end of 2011 the foreclosure mess will finally be behind us.

### **The Economy Will Start to Recover Before Employment Does**

The feeling of the group was twofold. First, current unemployment rates do not accurately reflect the true hardship because the reported numbers do not include the underemployed and those who have simply given up looking for a job. Second, unemployment will continue to rise to above 10% regardless of when a recovery starts.

While our elected leaders may talk of seeing the "green shoots" of a recovery, the data suggests otherwise. Companies are still cutting back to employment levels commensurate with more realistic expectations for future growth and other industries are simply being lost forever. It will take time for new companies and industries to replace them and grow. As new jobs are created and hope returns, many of those who have given up and are no longer counted in the unemployment numbers will restart their job searches and go back into the unemployment percentages. This will keep the unemployment readings high for many years to come.

It is the expectation that just as the economy resets so will employment patterns - with employees gravitating to new, exciting, and profitable areas of the United States' next, inevitable 20-year boom cycle.

### **We're Here to Help**

DouglasBradley's truly independent analysis correctly anticipated the stock market decline more than a year ago and we positioned our clients' investment assets accordingly. As a result their accounts have been protected during this downturn. In that same spirit, we've found plenty of attractive investment opportunities despite the challenging scenarios outlined.

We keep reading about people who are frustrated by their financial advisors lack of communication and the firm's inability to provide any advice other than to "stay the course". At DouglasBradley, we always have a "plan of attack" and keep our clients in the loop. If you're ready to try something that doesn't involve a wing and a prayer then give us a call to chat. We are happy to share our ideas and proud to share our performance over the past year.

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