

## Gateway Securities



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### **Sub-prime crisis seen spilling over into 2009 (International Herald Tribune)**

They dubbed it "The Survivors' Conference." Early this month, 2,000 people who handle asset-backed securities for a living crowded into a ballroom at the JW Marriott hotel in Orlando, Florida, not far from Disney World, to hear speaker after speaker explain why 2008 may be their worst year ever.

But the sub-prime crisis, which has claimed the jobs of three chief executives and prompted more than US\$45 billion in write-downs at the world's biggest banks, may end up spilling into 2009. "These events tend to become deeper and play out longer than most people initially expect," said Michael Mayo, an analyst who covers securities firms at Deutsche Bank in New York. "This is one of the slowest-moving train wrecks we've seen."

The tumbling US housing market will continue to inflict damage. Mortgage-backed securities and collateralised debt obligations containing those securities are falling in price and will not find their footing anytime soon.

That is because most of the sub-prime mortgages, which provide collateral for US\$800 billion in securities, have yet to go bad, said Christopher Whalen of Institutional Risk Analytics, based in Hawthorne, California. "The collateral is not yet problematic," Whalen says. "That's the next big shoe to drop."

Whalen said that defaults would soar as the rates of low-interest "teaser" mortgages held by borrowers with poor credit move up. At the end of August, about US\$46 billion in sub-prime loans, representing 225,000 homes, had defaulted, according to Credit Suisse Group.

The number will more than triple to US\$143 billion by the middle of 2009, the bank forecasts. Total sub-prime loan defaults will top out at about US\$270 billion, or 1.52 million homes, in 2010 or later. A report Tuesday November 20 was expected to show US housing starts falling to a 14-year low in October, the prospect of further declines in property values having weighed on demand. Economists surveyed by Bloomberg News forecast construction falling 1.8% to an annual rate of 1.17 million homes.

"Until housing prices bottom out, the write-downs won't stop," said Peter Kovalski, who helps manage more than US\$12 billion at Alpine Woods Investments, based in Purchase, New York. Rating companies, under fire from investors for applying their highest ratings to CDOs that included securities backed by sub-prime loans, are downgrading the debt.

Late last month, Moody's Investors Service cut ratings on CDOs tied to US\$33 billion of sub-prime mortgage securities.

Wall Street profits are also plunging in the fourth quarter. Citigroup, the second-largest CDO issuer in the first half of 2007, may post a loss in the final period, according to the average estimate of 23 analysts compiled by Bloomberg News. That is after the bank reported a write-down of as much as US\$11 billion, which cost its chief executive, Charles Prince 3rd, his job.

At the five biggest securities firms -Lehman Brothers Holdings, Morgan Stanley, Bear Stearns, Goldman Sachs and Merrill Lynch -earnings are expected to fall 8.3% in 2007 from a record US\$30.6 billion in 2006, according to analyst estimates.

Lower profits mean more firings. Bank of America, JPMorgan Chase, Bear Stearns, Citigroup, Lehman Brothers and Morgan Stanley announced more than 24,000 job cuts in the first 10 months of 2007.

**Gustavo Dolfino, president of Whiterock Group, an executive search firm based in New York, says he expected the firms to fire thousands more.**

The sub-prime debacle may echo through the economy the way the popping of the internet bubble did -hurting consumers and growth years later. The 39% drop in the Nasdaq Composite Index in 2000 eventually led people to yank money from their mutual funds, Mayo said. The US economy fell into recession in March 2001.

At the conference in Orlando, investors concerned about another recession were in no mood for the usual festivities. The party thrown by Bear Stearns -the first Wall Street bank to experience a subprime blowup -was almost empty at 9 p.m., with 10 people commiserating with beer and calypso music.

Bose George, an analyst at Keefe, Bruyette & Woods attending the conference for the first time, has an equally glum outlook on the already slowing US economy. He said a decline in home equity loans would curtail consumer spending.

"Credit is a huge driver of growth, and it's hard to see how this isn't going to have an impact on the economy," George said. "Things are going to get worse."

There's one bright spot for George: He'll have more time for research. Six of the 15 companies he used to cover, including American Home Mortgage Investment and New Century Financial, have gone out of business.