

HAL'S SPEECH MARCH 5TH

In the few minutes allotted to me, I will lay out the theme of this series of informal Thursdays get-together entitled, "An Evening with the Schmidts". The premise is simply that in exchanging information and ideas, we can more readily identify and expand our options, make informed choices and execute them with a greater degree of confidence.

With a little help from economic history it is possible to re-orient ourselves in the now-fractured business cycle and navigate our way through the financial meltdown.

Let me explain; most people have been almost completely blind-sided by the collapse of highly innovated and complex derivatives called mortgage backed securities or MBS!

Chairman Bernanke publically stated that even the Fed didn't see it coming, a rejoinder picked up by the investment banks who sold this stuff on 20% commission and who excused their performance on the basis that this was a brand new form of security.

But, why were my suspicions aroused early enough to warn my newsletter subscribers?

To answer the question, I will take you on a whirlwind trip to Paris. We will stay at the elegant LeGrande Hotel decorated in Louis the 14th motif, with ornate chairs with red velvet seats, tasseled drapes, magnificent 10' high beveled glass mirrors, and crystal chandeliers. Once we are settled in, we will meet in the lobby and leave through the perfumery gallery, and exit on to the Rue De La Paix. A few minutes' walk will bring us to the Place Vendome, where the Napoleon column now stands, and we will travel backward in time to the year 1796, where you will witness an extraordinary sight.

The French Revolutionary Government, having issued securities backed by mortgages on confiscated church properties as a form of currency in a vain attempt to revive the economy were engaged in the public burning of huge bales of the notes.

From 1:00pm till night fall more cart loads are brought and committed to the flames in front of the incredulous throng.

Finally the citizens themselves began to disperse, but then returned with their own bundles of notes and heaped them on the blaze. When all was consumed a great cheer went up.

Our next stop is Cleveland, Ohio, where we set our watches to mid year 2008.

A German bank is foreclosing on nearly 20% of lower income neighborhoods. A group of lawyers, led by Paul Swanson, have gone to court on their behalf demanding the bank produce original copies of their mortgages.

The bank declines and requests the Judge ignore the plaintiff's demands.

The lawyers discover that the bank has, in fact, sold the mortgages on, where they were securitized not once but, apparently, three times over.

The judge finds in favor of the plaintiffs on grounds the German bank has no standing before the court because they no longer own the mortgages.

The homeowners stay put and word spreads like wildfire across the Great Lakes Area.

In both the French and Cleveland examples, mortgage-backed securities have been replicated and securitized multiple times without the knowledge of the end recipient, whether they were hedge funds, pension funds, foreign banks, or individuals. In the case of the US, the Government has opted not to burn the toxic securities, probably for environmental reasons, but instead buy them up with taxpayer's money.

Now back in Upper Lake, let's discuss another point, the now often repeated comparisons of the present economy with the Great Depression. Are they valid? Can we expect the same results if the bailout doesn't work?

Let's return to Mr. Bernanke, whom we know is a student of the Great Depression. He believes the Fed's response in the 1930's was a mistake and he has vowed to alter the outcome this time around and is taking massive, even radical steps in this direction.

There are two other significant difference:

One is the fact that in 1929, we were on the gold standard, and the other was that people had personal savings. These three differences guarantee a different outcome, which requires different responses and counter-measures.

In the five meetings ahead, we will construct generic business models to suit actual conditions as we expect them to unfold and present a road map for informed decision making.

Finally, let me leave you with a thought that bad economic times do not beget bad decisions; it is boom conditions, when almost any plan will fly that allow bad decisions.

No matter how difficult the times there is always ample scope for good decision making.