

Structural Logic

It's 2010: What Should Investors, Traders and More Importantly What Should We as Americans Do Now?

By John Bougearel, Author of Riding the Storm Out: What Do Investors Do Now?

Synopsis: This report reviews the merits and shortcomings of portfolio diversification, the upcoming “restructuring cycle” for CRE and LBO’s of the credit cycle boom that burst in 2007, and the bone-crushing impact this recession is having and will continue to have on unemployment and state and local budgets. Readers wishing to gain insight into the macro picture and challenges that we as traders and investors will be facing over the next three to four years please read on.

Risk is ubiquitous. Markets misbehave. Financial crises are hardy perennials. Wall Street crashed. The private sector blew up. Again! Yet in 2009 U.S. policymakers managed to extinguish the raging fires on Wall Street. By all appearances it would seem that our policymakers have orchestrated a successful rescue of both our stock market and by proxy our economy. And our policymakers do concur with that view:

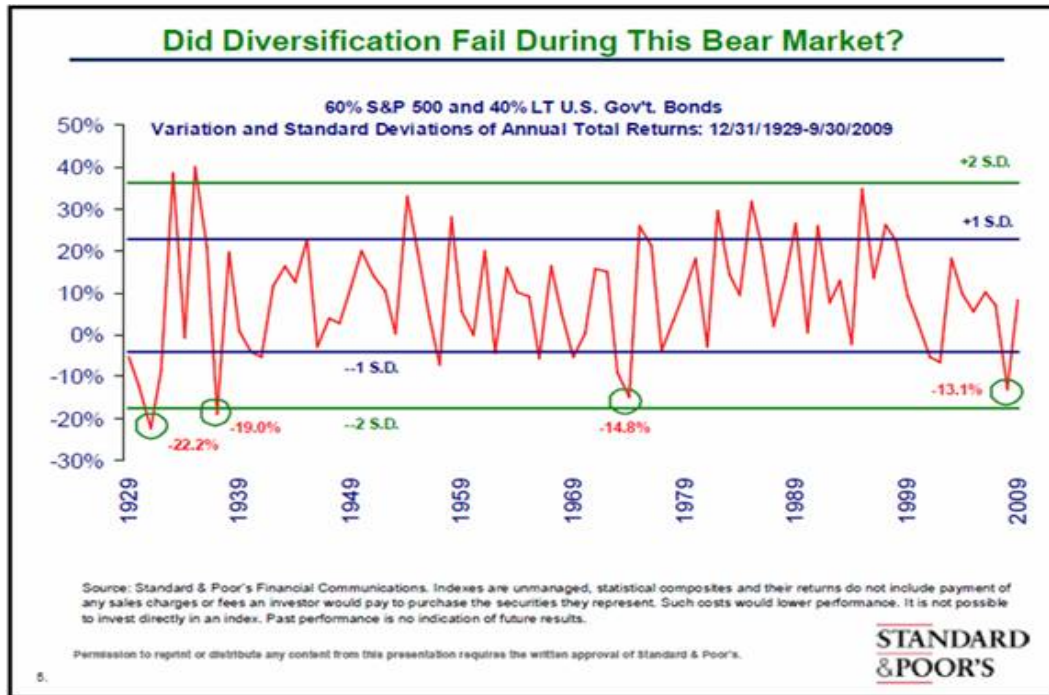
US Treasury Secretary Timothy Geithner told NPR’s Michele Norris in a December 22, 2009 interview that “the policies that the president put in place are helping lay the foundation for growth and job creation...American’s “can be more confident about their financial future, financial security” promising that “We’re not going to have a second wave of financial crisis. That is something that is not acceptable and we will prevent that.” Blah, Blah, Blah...

But have the “Nunca Mas” policies that the administration put in place, are they really sufficient? Have policymakers really tamed the misbehaving financial markets that hold the private sector of our economy hostage? Have they really brought to heel the marauding Wild West of the OTC Debt and Derivatives markets that drove our economy to the brink of a Great Depression? In short, can the US Treasury Secretary really claim that all is well, and will be well now? Most importantly, can Americans really be confident about their financial futures and secure in their jobs? Or is there to be a malevolent and violent backlash to the private sector boom that went bust in 2007-2009?

On general principles, history suggests risk has not been eliminated by the policies put in place in 2009. History indicates risk can’t be fully decomposed, nor can markets be fully tamed. And crises, well, crises, they just happen. Confronted with these realities, portfolio managers devised models long ago to help investors decompose market risks. It’s called diversification. Standard and Poor’s analyst Sam Stovall asked a pertinent question in 2009, “Did diversification fail during this bear market?” To answer his own question, Sam created a theoretical model charting the total returns of a weighted portfolio that was 60% SP500 equities and 40% long term US Govt Bonds. In 2008, it shows this diversification model lost -13%.

Given that a total equity portfolio comprised of the SP500 lost 39% in 2008 (before dividends), it is clear that this particular diversification model may have absorbed some of the shock for investors because the losses in the SP500 had been partially offset by 19% year-end gains (before interest) in the 30 year Gov’t bonds. At first blush, Stovall’s diversification model appeared to have been a fairly effective if rather blunt tool in 2008.

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But is diversification sufficient? Sam's diversification model dating back to 1929 shows a highly erratic model whipsawing in and out of negative territory. What is more, as we shall see, Stovall's diversification model behaved much like a boomerang in 2008-2009. On balance, if diversification could fully tame market risk, the oscillations shown in this model should have been much smoother. The premise of diversification, then, appears valid, but insufficient to protect investors from excess market volatility.

Upon closer examination of Stovall's model, too, it was only by a bizarre sequence of non-recurring events in the final 2 months of 2008 that even made it at all possible for the long term bonds to offset the steep losses in the stock market. To wit, most of the 30 year treasury's 19% gains in 2008 occurred after Ben Bernanke's December 1 2008 quantitative easing statement and his December 16 2008 race to embrace a zero interest rate policy. Barring these extraordinary policy actions in December 2008, there would have been little to no offset holding long term government bonds. Moreover, the fixed income holdings of actual balanced portfolios for most investors were not 30 year long term bonds. Hence it is likely that the majority of balanced portfolios did not benefit at all from the special actions of Ben Bernanke in December 2008.

If diversification is not a stand alone tool, what then can investors do to smooth out market risk and volatility inside their balanced portfolios? I submit that investors take a slightly more active risk management approach than simple diversification. Returning to Stovall's theoretical model, we note the bear market of 2008-2009 exposed a boomerang effect in total returns. What goes up largely in one year tends to go down significantly in the next. During years that produce high returns in long term bonds as happened in the 30 year bond in 2008 (up 19% y-o-y before interest), it would have made sense for investors to reduce their exposure to long term bonds in 2009 when the 30 year lost more than 16% y-o-y of its value. Likewise, during years that produce high stock market returns such as 2009 did (up 23.4% y-o-y), investors should anticipate that subsequent years are apt to reflect lower or negative stock market returns (for example, what could potentially occur in 2010-2012) as valuations and other market considerations might become unsustainable.

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Taking an active risk management approach towards diversification for investors entails rebalancing asset allocation mixes to reflect shifts in market risks. Investors can rebalance equity and fixed income weightings upward or downward on an annual basis to achieve the desired mix. For example, in the three years subsequent to 2009's positive equity returns, the proper allocation mix of a diversified portfolio might be 40% equity and 60% fixed income, or less depending on your risk tolerance.

Rebalancing one's asset allocation mix is an underutilized tool. Investors tend to neglect rebalancing their portfolios much because they are generally advised to just overweight equities when they are young and overweight fixed income when they are old (I suffered from this flawed approach to investing in the 1987 crash). Overweighting equities does nothing to help a younger investor avoid downside market risks. To illustrate this simple but very important point, consider the theoretical young investor that made his or her initial equity investment in the SP500 on January 1 2000. Ten years later on January 1 2010 that initial investment would be down 25%. So much for that head start in life!

When the stock market misbehaves erratically, it behooves investors to heed these market signals and rebalance downward to reduce their equity exposures for a spell until the headwinds pass. Once the storm passes, then it is time to consider rebalancing these equity positions upward or not. While 2009 did generate generous stock market returns for investors it won't be too long now before the market risks and headwinds we faced in 2007-2008 return.

The balance of this report will address the potential malevolent and violent backlash American's will face in 2011-2014 from the private sector boom of 2004-2007 that went bust. Specifically, this report will look at how the restructuring cycle of the debt created in the previous 2004-2007 commercial real estate the leveraged buyout (LBO) boom era will impact the economy and the lives of nearly all Americans in 2011-2014, notwithstanding the Treasury Secretary Geithner's false reassurances. Moreover, readers should pay heed to the prevalence of "lax underwriting" standards for commercial real estate (CRE) loans and the "covenant-lite" structures of the LBO loans during the boom years. The lack of safe and sound underwriting standards for both CRE and LBO loans during the boom cycle present downside risks to the debt restructuring scenarios presented below.

Before presenting the details of the up and coming restructuring cycle, it is worth pausing for a moment to consider the investment advice President Obama gave Americans on March 3 2009: "What you're now seeing is, profit and earning ratios are starting to get to the point where buying stocks is a potentially good deal if you've got a long term perspective on it." Unfortunately, President Obama looked right past the heap of trouble the financial markets and U.S. will face in 2011-2014. This will likely prove to be a big mistake, comparable to the mistake Greenspan made in 2004 when he advised folks to secure their homes using ARMs.

Restructuring the Debt of the 2004-2007 Boom

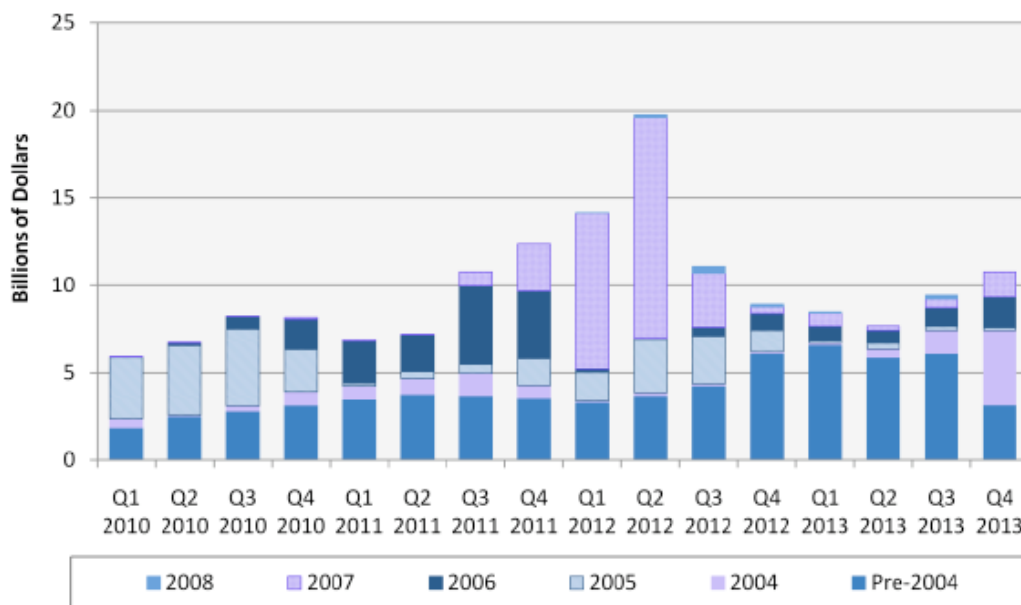
What most folks are probably unaware of is that the credit that went towards creating the commercial real estate and leveraged buyout boom during 2004-2007 needs to be refinanced between 2011-2014, because these types of loans typically have 5 to 7 year maturations. The risk, simply put, is that the values on the bulk of those loans are simply not worth today what they were three to five years ago. Nor will these loans be worth what they were during the boom years when it comes time to refinance the terms of those loans. The bust of the boom years has created a funding gap between assets and liabilities for both commercial real estate and for LBO loans. In industry parlance, the assets are simply not worth as much as the liability that they assumed during the credit creation boom. That asset/liability mismatch gap will have to close. Call it

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the Great Convergence Trade if you like. Whatever you choose to call it, the convergence is going to create quite a bit of unpleasant turbulence over the next three years, and not for just the borrowers of these loans, but for all Americans.

Conflicting with the Treasury Secretary’s assurances that another financial crisis is unacceptable and would never happen again, the February 2010 Congressional Oversight Panel (COP) forecast \$200 to \$300 billion in losses coming from the commercial real estate loans, the bulk of which will hit the economy in 2011-2014, peaking in Q2 2012.

Figure 32: CMBS Maturity Schedule By Vintage²⁴³



Commercial property values, they noted, had fallen more than 40% since the beginning of 2007. They added: “A significant wave of commercial mortgage defaults would trigger economic damage that could touch the lives of nearly every American. Empty office complexes, hotels, retail stores could lead directly to lost jobs. Banks that suffer... could grow more reluctant to lend, which could in turn further...accelerate a negative economic cycle...hundreds more community and mid-sized banks could face insolvency...their widespread failure could disrupt local communities...and extend an already painful recession.” This, just months after Americans were promised never again! For the full COP report on CRE: <http://cop.senate.gov/documents/cop-021110-report.pdf>

From the COP:

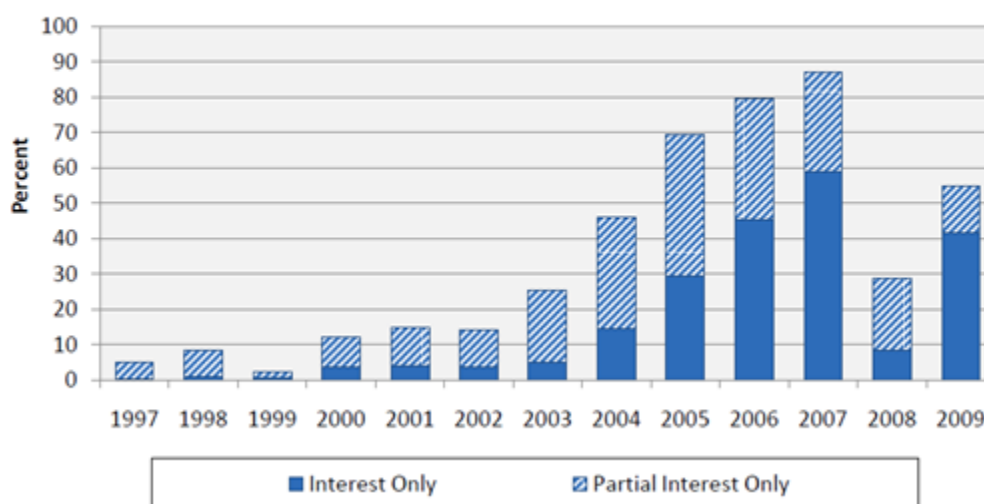
Commercial real estate concerns are not new. The nation experienced a major commercial real estate crisis during the 1980s that resulted in the failure of several thousand banks and cost taxpayers \$157 billion (nominal dollars). The boom and bust that occurred during the 1980s was characterized by commercial property values that fell between 30 and 50 percent in a two-year period... Between 1986 and 1994, 1,043 thrift institutions and 1,248 banks

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failed, with total assets of approximately \$726 billion (approximately \$1.19 trillion in 2009 dollars)

Lax underwriting was also evident in CMBS [Commercial Mortgage-Backed Securities] deals from 2005 to 2007. In the late 1990s, only six to nine percent of the loans in CMBS transactions were interest-only loans, during the term of which the borrower was not responsible for paying down principal. By 2005, that figure had climbed to 48 percent, and by 2006, it was 59 percent.

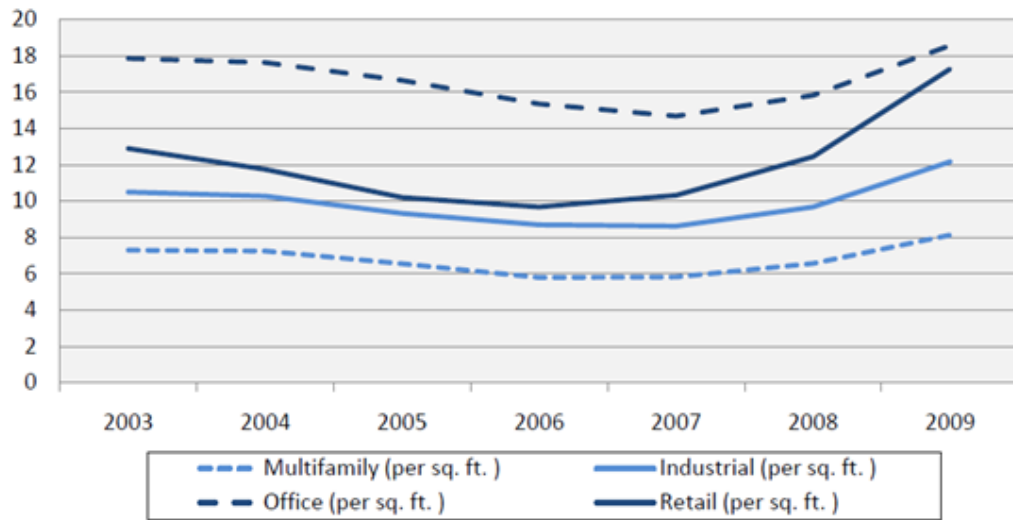
Figure 6: Percentage of CMBS that were Interest-only and Partial Interest-only at Origination, by Year⁶⁵



Current average vacancy rates and rental prices have been buffered by the long-term leases held by many commercial properties (e.g., office and industrial). The combination of negative net absorption rates and additional space that will become available from projects started during the boom years will cause vacancy rates to remain high, and will continue putting downward pressure on rental prices for all major commercial property types. Taken together, this falling demand and already excessive supply of commercial property will cause many projects to be viable no longer, as properties lose, or are unable to obtain, tenants and as cash flows (actual or projected) fall.

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Figure 9: Commercial Real Estate Average Vacancy Rates by Property Type¹⁰⁰



Commercial real estate markets currently absorb \$3.4 trillion in debt, which represents 6.5 percent of total outstanding credit market debt. Foresight Analytics, a California-based firm specializing in real estate market research and analysis, calculates banks' exposure to commercial real estate to be even higher than that estimated by the Federal Reserve. Drawing on bank regulatory filings, including call reports and thrift financial reports, Foresight estimates that the total commercial real estate loan exposure of commercial banks is \$1.9 trillion compared to the \$1.5 trillion Federal Reserve estimate.

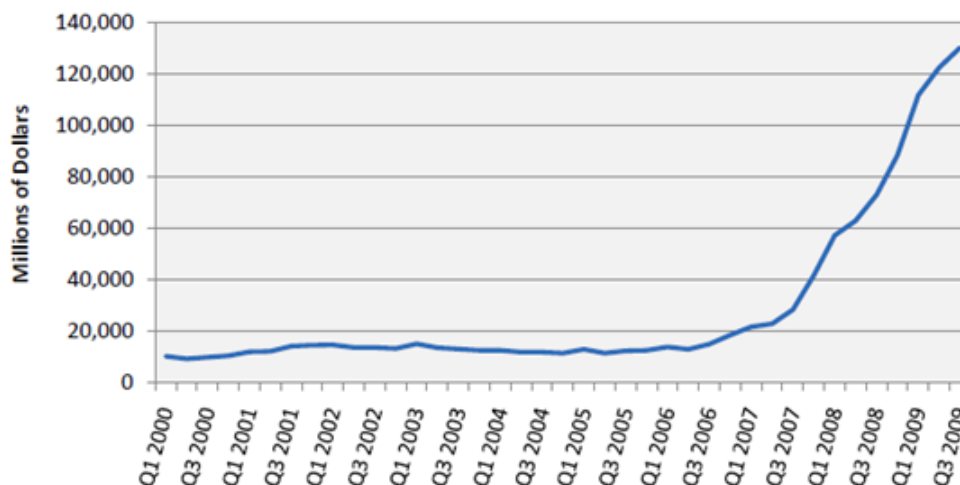
Figure 21: Total Commercial Real Estate Securitized¹⁴⁶

Year	Percent Securitized
1970	.1%
1980	1.5%
1990	3.8%
2000	18.9%
2007 – 3rd Q (peak of securitization)	27.9%
2009 – 3rd Q	25.4%

The current lack of investor appetite for CMBS greatly constrains the ability of commercial property owners to obtain permanent loans to pay off construction loans or to refinance existing permanent loans. And without the ability to do so, outstanding commercial real estate loans have a reduced chance of repayment, unless the original lender provides funds for refinancing.

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Figure 26: Commercial Real Estate Delinquencies for All Domestic Commercial Banks²¹⁹



Note from the foregoing COP report that the “current” lack of investor appetite for CMBS is largely a reflection of and attributable to the lax underwriting standards that were applied to the original loans when written in 2004-2007. It is not a bold predictive statement to infer that investor appetite for CMBS is probably going to be next to non-existent through 2014 (see Figure 6 above). An absence of investor appetite for CMBS presents upside risks to the COP’s forecast of \$200-\$300 billion in losses stemming from commercial real estate loans. And in turn, this would mean even more job losses in the private sector and lost revenues to State and local governments.

At the same time Americans find themselves shell-shocked from the commercial real estate markets, suffering banks are also going to be assaulted by a huge surge of refinancing required by the LBO and M&A loans maturing in the 2011-2014. Unfortunately, like commercial property values that have fallen 40% since the beginning of 2007, the equity valuations of many of these LBO’s and M&A’s have fallen similarly. Banks obviously won’t be in a position to refi the original loan amounts. So, it would not surprise to see a series of LBO and M&A defaults triggering corporate bankruptcies resulting in the loss of even more American jobs.

According to [McDermott Will & Emery’s Gary Rosenbaum and Jean Leblanc](#), “debt issuances for leveraged buyout (LBO) transactions surged from \$71 billion in 2003 to \$669 billion in 2007. The majority of these LBO’s were covenant-lite deals, meaning that the loan documents contained few or no financial covenants.” In short, we should expect to find material omissions, similar to the material omissions Greece made with respect to its sovereign debt obligations (with a little help from their friends at Goldman Sachs, its nice to have such helpful friends in investment banking) in many of the transactions that occurred during the LBO boom. Material omissions in one’s financial statements, prospectuses, sales literature erode ones financial credibility, whether you are a sovereign or a corporate entity.

Sure, material omissions can readily be overlooked during the private sector boom. But just try getting away with the discovery of material omissions when it comes time to restructure the loans 5 to 7 years after the private sector boom has gone bust and remains busted. Corporate borrowers may find themselves shunned by the investment community altogether and locked out of any chance of refinancing. While that may be just deserts for private equity and corporate executives, defaults and bankruptcies in the LBO space will

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create significant collateral damage to their employees who suddenly find themselves out of a private sector job. In turn, this means even more lost revenues for state and local governments.

Rosenbaum and Leblanc note that the friendly environment LBO borrowers found themselves in during the boom years has vanished, they “[will be facing a decidedly different environment as their 2005-2006 vintage credit facilities mature during the next few years. First, they will find fewer refinancing options](#)” as the number of potential providers of new loans have declined. In fact, many of the loan providers such as Lehman Brothers have been “disappeared” by the shock of the last financial crisis. The LBO investors such as Citi, Bank of America, Wells Fargo, etc. are still experiencing financial difficulties of their own. So of the investors that are still around and had “[previously provided a significant amount of liquidity are no longer actively participating in the lending market.](#)” The forward-looking story for borrowers in the LBO space is the same as the forward-looking story for commercial real estate borrowers; namely a lack of investor appetite.

The current lack of investor appetite for LBO restructuring can in part be attributed to a few reasons. First, the mismatch between assets and liabilities, that is, the borrowers’ assets simply do not match the amount they borrowed during the boom years. And secondly, the lack of investor appetite can in part be attributed to lax underwriting standards in those covenant-lite deals. The underwriting of these loans by the commercial and investment banks were simply not credible. Worse, the commercial and investment banks could simply refuse to eat their own cooking and refuse to provide new financing terms altogether. In fact, these financial vultures will more than probably be placing short bets against many of the commercial real estate and LBO borrowers shortly before their loans mature. Thus, the reckless and fraudulent lending activities of 2004-2007 could have circular and self-reinforcing negative consequences in 2011-2014.

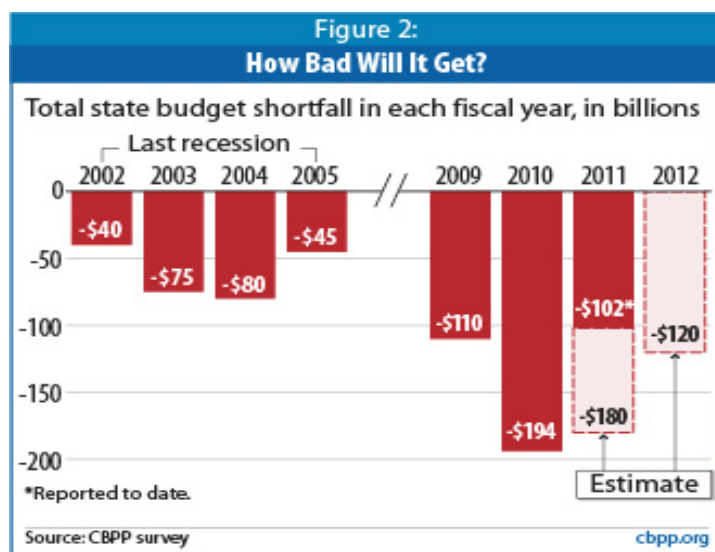
To the extent that financial intermediaries will be willing to work with LBO borrowers, “[lenders are showing extreme caution in refinancing many of these loans, leading to more defaults and bankruptcy filings.](#)” Many LBO borrowers “[find themselves without any realistic refinancing prospects.](#)” Standard and Poors estimate that corporate loan defaults will skyrocket from 4.5% in 2008 to 14% or higher in 2010. And what is worse, the schedule of non-financial corporate borrowers LBO debt maturities will “[increase each year until they peak in 2012](#)” concurrent with the schedule of commercial real estate loan maturations peaking in Q2 2012.

Rosenbaum and Leblanc conclude that “[companies with bad business models as well as strong businesses burdened by overlevered balance sheets need to confront the reality of today’s frozen credit environment and other recessionary pressures. To adopt a wait-and-see approach is risky, savvy borrowers need to meet head on the current challenges by exploring deleveraging devices and other options that will be evolving during the remainder of this restructuring cycle.](#)” LBO borrowers that fail to meet the current challenges head-on will lead to a whole new wave of corporate bankruptcies and folks entering the unemployment ranks.

The already high unemployment rate is creating a huge burden on most state and local governments throughout the country, and from the foregoing it seems as if the state and local government burdens will only worsen over the next few years. This view is consistent with the forecasts from the [Center on Budget and Policy Priorities](#)’ Jan 28 2010 report, which noted that the recession is causing more than 41 states to report budget shortfalls. Budget shortfalls in fourteen states are estimated to exceed 17% of their General Fund Budgets in 2010:

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As we look ahead to 2011 and beyond, states' fiscal prospects remain extremely weak. Indeed, historical experience and current economic projections suggest 2011 will be worse than 2010. Taking all these factors into account, it is reasonable to expect that for 2011, shortfalls are likely to hit \$180 billion [and] at least \$120 billion in fiscal 2012. This means that after taking into account the federal Recovery Act dollars that are likely to remain available for fiscal year 2011 (approximately \$40 billion), states will still have to close shortfalls of some \$260 billion for fiscal years 2011 and 2012 combined. If revenue declines persist as expected in many states, additional spending and service cuts are likely.



Expenditure cuts are problematic policies during an economic downturn because they reduce overall demand and can make the downturn deeper. When states cut spending, they lay off employees, cancel contracts with vendors, eliminate or lower payments to businesses and nonprofit organizations that provide direct services, and cut benefit payments to individuals.

Federal assistance is lessening the extent to which states need to take pro-cyclical actions that further harm the economy. The American Recovery and Reinvestment Act enacted in February [2009] includes substantial assistance for states. The amount in ARRA to help states maintain current activities is about \$135 billion to \$140 billion over a roughly 2 ½-year period. Most of this money is in the form of increased Medicaid funding and a “State Fiscal Stabilization Fund.”

But it now appears likely the federal assistance will end before state budget gaps have abated. **The Medicaid funds are scheduled to expire in December 2010**, which is just halfway through the 2011 fiscal year in most states. States will have drawn down most of their State Fiscal Stabilization Fund allocations by then as well. So even though the 2011 budget gaps may well be larger than those for 2010, there will be less federal money available to close them. States are likely to respond with spending cuts and tax increases even larger than those that have already been enacted.

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Such measures in most states will take effect with the 2011 fiscal year — that is, in July 2010, thereby reducing aggregate demand and weakening the economy at a critical moment in its recovery. If states get no further federal assistance, the steps they will have to take to eliminate deficits will likely take a full percentage point off the Gross Domestic Product. That, in turn, could cost the economy 900,000 jobs next year.

A possibility would be for the federal government to reduce state budget gaps —by extending the Medicaid funds over the period during which state fiscal conditions are expected to still be problematic, rather than cutting them off in December 2010. The federal government could also provide additional assistance to states for education through the State Fiscal Stabilization Fund.

Of course, the policy recommendations by the Center for Budget and Policy Priorities for the US government to provide additional fiscal stimulus to state and local governments and what State Governors expect to receive from the federal government may conflict with President Obama January 2010 announcement to freeze government spending for three years beginning in FY 2011 (October 2010). The Center for Budget and Policy Priorities noted in their [January 28 2010 press release](#):

As states begin preparing for the third year of a fiscal crisis brought on by the recession, governors' new budget proposals contain cuts to core services — like education and health care — and state workforces well beyond those they have already made. The proposals threaten to increase hardship and unemployment.

At least eight governors' budget proposals assume that Congress will extend the increased federal funding for Medicaid enacted in last year's Recovery Act, the report explains. If Congress doesn't extend it, those states likely will make deeper and broader cuts than their governors are now proposing. Without further federal aid, the actions states will have to take to close their budget gaps could cost the economy 900,000 jobs.

“One of the most effective ways Congress can boost the economy and protect jobs is by making sure that Recovery Act assistance for states' doesn't dry up halfway through the coming year, which would force states into even bigger budget cuts that could stall the fragile economic recovery,” Johnson explained.

The Center for Budget and Policy Priorities noted, in their [February 18 2010](#) report, not surprisingly, that demand for state services actually rise during recessions. They argue that cutting more of these services now will only exacerbate the problem. Yet cutting more services is exactly what state governors are planning to do with their 2011 budgets.

With tax revenue still declining as a result of the recession and budget reserves largely drained, the vast majority of states have made spending cuts...because revenues sources used to pay for these services declined due to the recession. At the same time, the need for these services did not decline and, in fact, rose as the number of families facing economic difficulties increased... Budget pressures have not abated and, in fact, are increasing. Because unemployment rates remain high — and are projected to stay

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high well into next year — revenues are likely to remain at or near their current depressed levels...

Cuts to state services not only harm vulnerable residents but also worsen the recession — and dampen the recovery — by reducing overall economic activity

Over the past two months governors have been submitting their budget proposals for the upcoming 2011 fiscal year (which begins on July 1, 2010 in most states). The majority of governors have now released their budget plans, and these proposals reflect the continued fiscal difficulties that states will face in the next year.

[Bloomberg's investigative journalists Christine Richard and Darrell Preston](#) report that state and local governments struggling to survive the recession are now “[seeking concessions from creditors of public projects, including bond insurers.](#)” The concessions local governments are seeking pose a new threat to the bond insurers or “monolines” that are currently backing \$1.16 trillion of public debt. The monolines were almost bankrupted in 2007-2009 from \$11.6 billion of claims on collapsed securities backed by mortgages.

“It is a worst-case scenario if the dynamics of the municipal bond market change,” said [Rob Haines](#), an analyst who covers the bond insurance business at CreditSights Inc., an independent research firm in New York. “The companies have modeled in virtually no losses.”

Last year, 183 tax-exempt issuers defaulted on \$6.35 billion of securities up from \$317 million of tax-exempt defaults in 2007 says Miami Lakes, a Distressed Debt Securities Newsletter,

For more than three decades bond insurers paid few claims, allowing them to back bond payments that were 140 times their assets. Insurers described their business as one of “zero-loss underwriting,” meaning that each guarantee was expected to result in no claims under the worst probable scenario envisioned by their models.

Rising municipal claims may deplete the remaining regulatory capital of some bond insurers and speed intervention by regulators, said Haines of CreditSights. Any regulatory takeover may trigger termination payments on billions of dollars of credit default contracts written by the bond insurers, a scenario that forced a government bailout of [American International Group Inc.](#) in September 2008.

Americans are going to have to absorb a lot hits in 2011-2014. Hopefully one of those hits will not be another AIG on our hands!

To summarize, banks already suffering from bad residential loans will find the refinancing required by the previous commercial real estate (CRE) and LBO boom a heavy strain in 2011-2014. The banks that do survive will probably only be able to refi maybe 60 or 70 cents on the dollar to CRE and LBO borrowers. Worse, the commercial real estate, M&A's, and LBO's that can't withstand 30% to 40% haircuts will probably end in the graveyards, thus incurring another round of substantial job losses in the private sector. .

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It is little wonder that the banks lending has been curtailed and will continue to contract for several more years. It is also little wonder the Basel committee and the FASB granted the banks until 2013 to get their balance sheets in order and meet stricter reserve requirements. That is precisely because the peak of the loan restructuring cycle for CRE and LBO borrowers will be in 2012. I have always feared that the shock therapy of the last crisis may just be a prelude to the financial shock that is coming in 2012 for many Americans.

Unfortunately, US Secretary Treasury Geithner cannot make promises that America will not face another financial crisis without having a false ring to it. Not given the way the banks structured all these various types of loans from the previous boom that need to be refinanced in 2011-2014.

The CRE and LBO loan maturations peaking in 2012 amount to financial weapons of mass destruction with delayed fuses. The next seizure in the credit markets will coincide with the peaking of these loan maturations. For the Treasury Secretary to claim there won't be a second wave to this financial crisis, that they can prevent that, that Americans can be confident about their financial futures and job security is just so much Blah, Blah, Blah. At the very least, market forces will sorely test Mr. Geithner's hypothesis that all is well and will be well now.

In its totality, the restructuring cycle that lies ahead is largely about funding the debt-to-equity gap between the overvalued commercial real estate and LBOs. Present day cash flows and valuations can not support the totality of the CRE and LBO debt issuance that occurred during the 2004-2007 credit cycle. Haircuts, defaults, bankruptcies, will have to be taken. The present mismatch between liabilities and assets, the gap, will have to be closed. The risks posed by this restructuring cycle in the CRE and LBO spaces will also be significantly heightened by fraudulent material omissions; namely, the widespread prevalence of the lax underwriting standards and covenant-light loan documentation.

As the full force of the 2011-2012 restructuring cycle gets underway, the equity and credit markets will once again founder. Investors can rest assured credit spreads will widen during this time window. When this happens, balanced portfolios will experience a boomerang effect. As the equity and corporate debt markets are repriced downward, long term treasuries will provide investors valuable diversification. Until the restructuring cycle in the CRE and LBO space reaches and passes its peak, thereby closing most of the unfunded gap between assets and liabilities, investors that are overexposed to the equity markets will be hurt. Once the Great Convergence between assets and liabilities are properly matched in the private sector, equities will outperform and investors overexposed to long-term treasuries will then be hurt. Hence the principle of the boomerang effect which will recur in balanced portfolios that are structured similarly to the Standard and Poor diversification model above.

With all this doom and gloom, however, isn't there any silver lining for investors? Well yes, actually there is! Once the restructuring cycle clears all these private sectors unfunded liabilities the private sector of America should be on a much safer and sounder foundation. Then the US Treasury Secretary can say that a foundation for growth and job creation is in place and stand more than a 50-50 chance of being right. Such news will bode well for both the economy and the stock market. But, in the meantime, prudent investors must hunker down. The next great opportunity for stock market, and even commercial real estate investors won't arrive until the peak of the next financial crisis which looks like it is going to hit apocryphally in 2012. Crises precede opportunity. Opportunity only exists if the crises are successfully resolved and that opportunity can't happen until we have passed through the peak of the loan restructuring cycle in 2012.

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The private sector should be lean and mean and ready to grow substantially by 2013. The only thing left for Americans to worry about once the private sector has been stabilized will then be the funding the public sectors liabilities; namely the US government's financial and social obligations to medicare and social security.

The public sector to be sure, will be forced to undergo a restructuring cycle as well. But this will occur at a much later date and so is a story for another day. However, looking past 2014, if the U.S is to remain an operational viable going concern, "how it goes about it will be crucial to its success" says [Richard Duncan](#) "The lesson the US must learn from Japan is not to waste that money building bridges to nowhere, but instead to use the money wisely to restructure the economy to restore its viability. This global crisis will not end until the United States restructures its economy and restores its long-term viability. Getting the private sector safe and sound foundation by 2013 is the first prerequisite.

In the meantime, there is one other extremely significant and patriotic thing that would behoove all Americans (us, the little people, the forgotten people) to do between now and the next financial aftershock. And I urge everyone to do it. In the meantime...we can move our money and we can move our credit cards out of the bad banks and into good banks, into banks that are safe and sound. We can start transacting with the good bankers at good banks. This is a feel good opportunity for us all.

As Arianna Huffington and Rob Johnson put it: "If enough people who have money in one of the Big Six (bad) banks move it into smaller, more local, more traditional community banks, then collectively we, the people, will have taken a big step toward re-rigging the financial system so it becomes again the productive, stable engine for growth it's meant to be. It's populism at its best." By far and away, this is the best thing we can do as Americans to keep ourselves and our local communities above water. As Richard Duncan would put it, it's the wisest use our money to restructure our economy and restore its long-term viability.

Leaving our money sitting on the ledgers of the big banks is a waste of our capital resources. In their present weakened financial condition, and until the restructuring cycle passes, many banks can only hoard not lend. Deposits on the balance sheets of the big banks have the net effect then of building bridges to nowhere as far as the eye can see. There is only one hitch, how do we find the George Bailey's in our communities to do our banking business with? Well that matter has been solved for us thanks to the volunteer services of Institutional Risk Analytics (IRA, they're the good bank analysts).

Simply go to <http://moveyourmoney.info/>. Click on the button that says Find A Bank Or Credit Union. Put in your zip code. Get a list of sound community banks near you. The IRA only list banks that get a grade of "B" or better according to its (A+ - F) rating system.

That's all folks, be ready to hunker down by 2011, and see you in 2013!

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