Blue Bridge
Wealth Management Consultants Inc.

BULLETIN
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Feature Article
September

By Rolf Spielmann

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European Observer
Worse doesn't always come to worst...

By Luc Granger

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In Focus
Homeownership Gap

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Market Watch
Selection of Financial and Economic Indicators

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Year-to-date	-3,96%	0,56%	-6,84%	-5,90%	1,64%	-7,51%
Year-over-year	5,46%	12,42%	5,22%	2,81%	9,62%	-0,45%
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Year-to-date	-3,47%	-0,54%	-11,32%	-5,58%	-16,33%	-11,84%
Year-over-year	6,44%	8,43%	-4,45%	-0,58%	-15,90%	-5,77%
Commodities	**GOLD**	**COPPER**	**CRUDE**	**WHEAT**	**LUMBER**	**CRB**
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September, although the holidays are over, it is a welcome time, a break from the hot summer and a return to the old comforting routine. With it also comes a review of market conditions, and what we see ahead may not be terribly negative, but neither is it overly positive, hence volatility will likely be considerable. Looking back over the past months and all the contradictory news items and economic indicators, one realizes how much uncertainty there is about global growth. Seemingly every positive story, come to think of it almost every story, is contradicted. The solutions of the past, reckless deficit spending and cheap money, have brought results, but also the realization that they are not long term solutions. The world remains burdened with huge principal repayments, and interest costs which are increasing due to the sheer size of the growing mountain of public debt.

Government policies which do not lead to positive long-term results instead lead to doubts, to cynicism and even bitterness. The political class which gains favor by implanting ill-conceived short-term solutions is willing to mortgage the future. Policies should not be designed to please for the moment; instead, they should express a society's long-term vision. And that is where the problem is found. As shorter and shorter-term solutions are implemented, the public grows increasingly anxious about the longer term, for as every responsible head of household knows, the two week holiday in the sun which was purchased on credit will diminish the quality of life over the next few years as the loan is paid off. Borrowing does not bring long-term enjoyment, it brings increased responsibilities and belt-tightening.

For those who fear deflation more than inflation this is an important consideration. We have asked before, where will the consumption power come from in a fast aging world inhabited by over indebted individuals and governments? Ultimately lenders will demand their money back, or else they will look for more security.

This brings us back to a theme we addressed last month. An investment is a judgment call on the integrity of management. Managers of corporations need to proof more finesse and knowhow as well as trustworthiness than politicians who are elected for a certain period of time to afterwards benefit from generous pensions. A responsibly-led corporation is thus a better credit risk than an AAA government, for one has a long-term goal while the other lives for the moment or for reelection. Think twice about blindly trusting government debt. And take advantage of volatility, for responsible companies with interesting products always come out on top!

By Rolf Spielmann, CFA
Senior Vice President of BLUE BRIDGE®

Worse doesn't always come to worst…

(Translated from French)

As happens every year, the post-vacation period elicits all sorts of concerns. This year, the situation is perhaps a notch higher on the worry scale, to the extent that, after almost three lean years, the world's economic players have begun to believe in recovery. At this point, a new disappointment could send the economic and financial world back into a fit of self-sustained pessimism from which it will be especially hard to emerge. The "bears" are counting on this strong return of defeatism to take their revenge. After two years of errors linked to excess pessimism, the Cassandras are on the rebound thanks to the Greek crisis, and they have taken wing with the publication of indicators pointing to a slowdown in growth in the United States and the euro zone. With that, the spectre of debt deflation – forgotten for more than a year – has returned to haunt us.

Sadly, the worst-case scenario is quite nasty: despite moves toward an upturn, Western economies have not found a sustainable road to growth and will sink quickly into a new recession. With budgetary and monetary manoeuvring room exhausted, it will no longer be possible to support the economic machine, which will thus move into a phase of long Japanese-style deflation. With this stagnation, a serious social crisis will quickly set in. To try to stop the haemorrhage, many countries will let their budget deficits run wild, using low interest rates on government bonds as justification.

And there is how the trap is closing. As with the Greek situation, investors will end up saying "no" to a lax budgetary approach, generating a sudden flare-up in interest rates on treasury bills and thus a compulsory crash for countries that have not shown a minimum of restraint. These include the southern European countries, especially France, which forms the second pillar of the euro zone after Germany.

Clearly, we can't hide our heads in the sand: this catastrophic scenario is possible. However, it is still likely to be avoided this year. Fears of an American W-shaped dip are greatly exaggerated. After the strong recovery in late 2009 and early 2010, the United States is simply experiencing a logical slowdown. There is thus absolutely no reason to panic. Also, while job numbers remain disappointing, it must not be forgotten that these have traditionally been a lagging indicator of economic activity. Moreover, employment grew again in the spring and, after a summer pause, should move ahead smartly in the coming months. It is therefore only a matter of time.

The only damper lies in the fact that investors no longer know how to take their time. This leads to a perpetual headlong rush, meaning that markets will continue to follow a stop-and-go pattern. In other words, they will continue to go from fears of recession to hopes of sustainable recovery in a matter of days. Volatility will thus remain especially high, but the trend on equity markets will be an upward one.

After a hot and tough post-summer return almost everywhere in the world, both in economic-financial and social terms (especially in France), the autumn and late 2010 are likely to bring us some pleasant surprises. Downward movements in stock prices should thus be perceived as opportunity phases that should not be missed. At the same time, those who remain caught up in pessimism and who invest only in government bonds risk waking up with a hangover in the coming months, when bond rates will be getting back to more normal levels, substantially above the current floors.

By Luc Granger, Founding associate
Intuitae Family Office

The Homeownership Gap

An important aim of US public policy is to sponsor homeownership. It is part of the American dream and it is part of the average American's sense of entitlement. US homeownership peaked between 2004 and 2006 at 69% and it has now fallen to 67.2%. But is this impressive percentage real, or does it hide an unfortunate truth?

The Federal Reserve Bank of New York's Current Issue of May 2010 addressed this issue. It concludes that there is a substantial "homeownership gap", by which is meant the difference between the official and the effective rates. The official rate claims that the ownership rate stands at 67.2%, and it includes negative equity homeowners. If those are factored out, on a national level the rate is 61.9%, the effective rate.

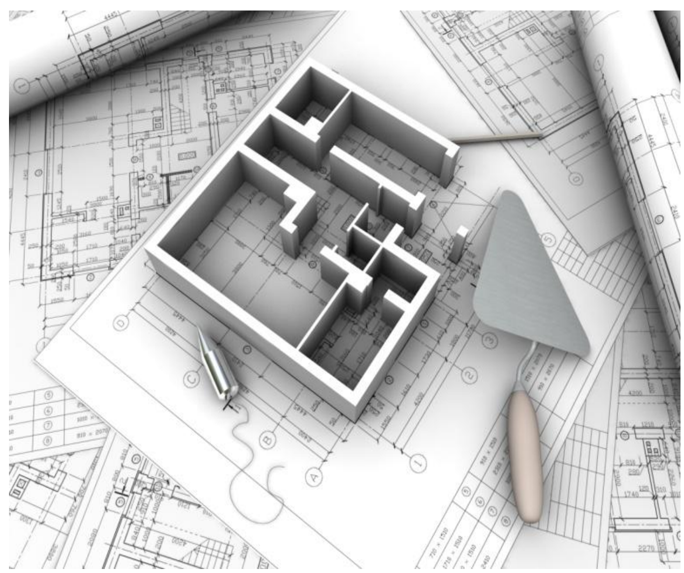
While this may not sound so dramatic, the picture changes when we look at large metropolitan areas. Effective homeownership rates are below 50% in Detroit, in New York City, San Diego and San Francisco. Las Vegas has an effective rate of 19.3%, meaning that over 80% of homeowners have negative equity.

This means that unless house prices improve substantially, many negative equity homeowners will become renters in years ahead because, as the study outlines, they will be unable to save enough to cover the negative equity, the transaction cost of selling their existing home and to make a down payment on another home.

The extent of negative equity can be measured by the loan-to-value (LTV) ratio for each mortgage at origination. Assuming a cost of 6% to sell a property, of the nonprime mortgages whose current LTV is greater than 100, 90% would take longer than 5 years to reach an LTV of 94 through the scheduled debt pay-down process. The median mortgage in this group would take more than 12 years to reach a LTV of 94.

To overcome this, substantial savings would be needed. How significant would they need to be? The study mentions that because it is estimated that more than 6 million households are in negative equity, the numbers imply an annual savings increase for the nation of $92 billion for 5 years. Personal saving as defined in the National Income and Product accounts averaged roughly $465 billion during 2009, yielding an average personal saving rate of 4.3%. All else being equal, the researchers calculate that for these borrowers to remain homeowners under their assumptions, personal saving must rise about 20% a year for 5 years. The personal saving rate would have to rise about 0.8% to 5.1%.

That is sobering and is a far cry from the Automatic Teller Machine that a house used to be a few years ago. With so much negative equity, no considerable rebound in house prices should be expected anytime soon. And savers cannot be spenders, hence consumption will suffer. Not an upbeat scenario, but surely a realistic one!



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