

November 4, 2008

Black October

October 2008 will go down in history as one of the worst financial panics in history. It was not isolated to stocks or bonds, this panic encompassed every imaginable realm of modern finance. The shock was felt from commercial paper markets to foreign trade financing. Even the average Joe found that his credit card limits had been reduced. However the bright side to this is that October is finally over! The worst of the financial crisis is most likely behind us now since the world has come together to address some of the key issues. In the past few months governments have insured deposits, injected capital and cut interest rates. The combination of efforts should be enough to bring much needed calm and order to the financial markets.

Much of the grief in the last month was actually an unintended consequence of efforts to try to stabilize the system. For example, Ireland at the beginning of the month decided to unilaterally insure their bank deposits unfortunately depositors wanted the insurance so that caused a run on deposits in the other European countries. As each country was trying to deal with their issues separately they caused dislocations in other markets. Finally the G7 got together to address the issues in a joint effort and stopped the massive movements of capital.

The most substantial efforts that came out of this month were the capital injections into banks across the globe. Of the \$700B US bailout plan, \$250B is being used to buy stakes in banks thus shoring up their balance sheets. Europe, Asia and the Middle East have also injected billions of dollars into their banks during the month. This in effect deals with the solvency risk that was at the heart of the panic to begin with. If this program had been around to provide a few billion dollars to Lehman Brothers prior to its bankruptcy, we could have probably avoided Black October in the first place. The threat of further bankruptcies is reduced and now banks have

started to lend money to each other bringing LIBOR rates down substantially from their panic peaks. Rates for 1-Month LIBOR have come down from an October high of 4% to 2.18% (11/4/08). This is especially important to consumers with adjustable rate mortgages that are tied to Libor rates, so it should help reduce the number of foreclosures in the coming months.

The last of the major responses have been extensive interest rate cuts from Central Banks around the globe. These rate cuts will steepen the yield curve and allow banks to increase their profits as well as strengthen their financial position. Eventually we believe this will lead to more lending and improved credit conditions for businesses and individuals. There are consequences to pumping this much money into the system, but those issues will have to be dealt with after the crisis has been completely tamed.

In closing, we are pleased with the policy responses and believe the worst of the financial crisis is over. The repricing of risk and deleveraging will continue for the next few years. The recession will also cause economic fundamentals to continue to deteriorate over the next few quarters. The good news is that in the midst of all the selling there are good values to be had in almost all asset classes, so we will look to capitalize on these opportunities while managing the risks of a recessionary environment. Please contact us if you have any questions. We are always here to answer questions that you or your friends and family may have.

Thank You,

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