Washington puts aside free market ideology

by Eric Hoesgen & Dennis Hoesgen

Despite decades of free-market rhetoric from Republican and Democratic lawmakers, Washington has a long history of providing financial help to the private sector when the economic or political risk of a corporate collapse appeared too high. The effort to save Fannie Mae, Freddie Mac and AIG is only the latest in a series of financial maneuvers by the U.S. government that include the rescue of the military contractor Lockheed Aircraft and the Penn Central Railroad under President Richard Nixon, the shoring up of Chrysler in the waning days of the Carter administration and the salvage of the U.S. savings and loan system in the late 1980s.

More recently, after airplanes were grounded because of the terrorist attacks of September 11, 2001, Congress approved $15 billion in subsidies and loan guarantees to the faltering airlines. Now, with the U.S. government preparing to save Fannie Mae, Freddie Mac and AIG only six months after the Federal Reserve Board orchestrated the rescue of Bear Stearns, it appears that the mortgage crisis has forced the government to once again shove ideology aside and get into the bailout business.

"If anybody thought we had a pure free-market financial system, they should think again," said Robert Bruner, Dean of the Darden School of Business at the University of Virginia. (*International Herald Tribune*)

The United States has a $3 trillion federal budget, a national debt the size of a black hole and a graduated income tax that drains wealth from the middle class (mostly) for the benefit of the wealthy. That Fannie, Freddie and AIG are to be nationalized is not exactly a surprise.

The closest historical analogy to the Fannie-Freddie crisis is the rescue of the Farm Credit and savings and loan systems in the late 1980s, said Bert Ely, a banking consultant who has been a longtime critic of the mortgage finance companies. The savings and loan bailout followed years of high interest rates and risky lending practices and ultimately cost taxpayers roughly $124 billion, with the banking industry kicking in another $30 billion, Ely said. Even if the rescue of Fannie and Freddie ends up costing tens of billions of dollars, the savings and loan collapse is still likely to remain the costliest government bailout to date, said Lawrence White, a professor of economics at the Stern School of Business at New York University. "The S&L debacle cost upwards of $100 billion, and the economy is more than twice the size today than it was in the late 1980s," he said. "I don't think this will turn out to be as serious as that, when over 2,000 banks and thrifts failed between the mid-1980s and mid-1990s

Bank and savings and loan insiders spent more money buying shares of their companies in May, June and July this year than in any previous three months in at least two decades, betting that financial institutions are bouncing back from the credit-market crunch. Insiders, including bank directors and executives, bought $296.2 million of their own stock in the period, according to data compiled by the Washington Service. That's the most since the research firm began tracking the data in November 1986. “It clearly indicates that management, directors, and insiders are confident in their ability to see their way through these tough times,” said Standard & Poor's analyst Jack Bartko in an interview September 3.

Financial companies around the world recorded more than $500 billion in write-downs and credit losses this year amid the collapse of U.S. mortgage markets, and were forced to raise more than $360 billion in capital. On July 15, the Standard & Poor's 500 Index reached the lowest since 2005 after investors lost confidence in a government plan to rescue mortgage companies Fannie Mae and Freddie Mac. The government recently seized the two companies. Bankers are smart insiders - they understand when to sell and when to buy. That's why they're bankers.

We are gratified that big banks are buying their shares in large quantities. Were we in a similar business, we would do the same thing. But what we certainly don't look forward to down the road is the inevitable spate of articles lauding bankers' far-sightedness in buying when everyone else – the so-called "little people" – were panicking and selling. It's no miracle when there's a central bank behind you, backing your every miserable move with the full faith and credit of millions of citizens of a powerful Western nation.

No, you would buy too, if you could see to the centre of your industry and knew what others can only guess - that those who print the money will print enough to keep you afloat no matter what. As we consider this phenomenon, it occurs to us that for once we can act like bankers as well. Assuming that the entire central banking mechanism isn't overturned at the end of all this, those bankers buying back stock do indeed stand to make a killing. If we can bring ourselves to act that way, we could surely buy bank stock, too. We haven't, though. We're too busy buying gold and silver stocks again.

Uncertainty in this market is at an all time high, in our opinion. This has caused the markets to free fall over the last several months. Gold and silver retreated significantly, erasing 12 months of gains, only to see a stunning turnaround with gold trading at over US $900/oz. and silver at US $13.51/oz. by September 22. Oil has also rallied to over US $108 per barrel. We think this represents a major opportunity. We were not surprised the U.S. dollar recently rallied with an election just around the corner, but the rally was short lived. The twin deficits in the U.S. continue to grow and the dollar has resumed its downward trend, resulting in the rise of precious metal prices. Even the hard-hit TSX Venture Exchange has seen a turnaround in the past few days and has hopefully bottomed out.

Based on these events, we are sticking with some of the companies that are well capitalized and stand to be leaders in the next leg of the bull market in resource-based stocks. The key to successful investing is to have a superior level of knowledge about the companies in which you are investing.

A company that we know intimately is **Galena Capital Corp.** [FYI-TSXV]. They recently released more assays from their Maureen Project in Mexico. The best results from these holes returned 17.51 grams gold/tonne and 342.7 grams silver/tonne over 9.1 metres (6.8 metres true width), including 125.63 grams gold/tonne and 2,174.8 grams silver/tonne over 1.0 metre, and also including 46.17 grams gold/tonne and 1,263.1 grams silver/tonne over 0.7 metres (0.33 metres true width). In our opinion, this is a world class discovery.

Look for undervalued companies with good assets and good management. In our opinion, the long-term bull market in commodities is not over. There are opportunities in the resource market, like Galena, that in the months ahead will have seemed like "no brainers". Buy smart. Be a contrarian. Stay ahead of the curve.

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