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Weekly Financial Article for the Week of August 13, 2007

The Fed, The Credit Crunch & You

The Federal Reserve injects billions into banks, just in time.

Last week, the Federal Reserve became the lender of last resort for the U.S. economy. It poured \$38 billion in temporary funds into the banking system, because of a need for liquidity. The Fed hasn't done this since the aftermath of 9/11, and it may do even more.

The "credit crunch" has spread. In the last few months, investors and economists worldwide have closely watched a) the growing number of home loan defaults and foreclosures in the overvalued U.S. real estate market, b) the subsequent collapse of U.S. mortgage lenders such as New Century and American Home Mortgage, and c) the subsequent reaction of other lenders to do away with riskier loans. Economists hoped this crisis could be contained in the housing sector. But in the last few weeks, the problem rippled out as the cost of capital grew more expensive. Private equity funds and hedge funds couldn't easily arrange corporate mergers and buyouts, which soured Wall Street. Venerated investment banks Bear Stearns Cos. and BNP Paribas had to rescue entire investment funds built around subprime mortgages. Quite simply, credit is tightening globally – and it hurts corporate and individual investors.

The impact on you. Interest rates are poised to rise. So if you own a small business, you might want to hold off on borrowing. If you're thinking of buying a home and you have excellent credit, you'll find mortgage rates in your favor. If your credit rating is middling or poor, you will find fewer mortgage options. If you need to sell your home, you are facing a market with fewer buyers, and one in which buyers have greater power.

How long will the crunch last? Many economists believe we are seeing a short-term "credit correction". Jack Malvey, who serves as chief global fixed income strategist for Lehman Bros., told *USA Today* that "when you look into the history of these corrections, from 1973 to 2002, we've had about 14 of them, and they tend to burn themselves out over one to three months." The Fed may ride to the rescue again (perhaps as soon as next week) by providing even more liquidity or by cutting interest rates.

Quote of the week. "There are two kinds of people in the world: those who divide the world into two kinds of people, and those who don't." – Robert Benchley

Riddle of the week. A sundial is a timepiece that has the fewest number of moving parts. Which timepiece has thousands or even millions of moving parts? (Read the answer here next week.)

Answer to last week's riddle: An echo.