



FALL 2008

# Quarterly Update

NEWSLETTER OF BAKER BOYER WEALTH MANAGEMENT SERVICES

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“Turbulent Times”

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by Ted Cohan

It's Fall and we are in a very turbulent environment in which new words and government programs are hitting us every day. Acronyms and phrases like, TARP, FDIC insurance increases, commercial paper purchase plans, and equity purchases of private commercial banks have now taken over in the financial world. Politicians and other officials have also mentioned time and time again, “we have to do this...” or, “we have to do that...” I don't know about you, but I don't like it when someone tells me, “I have to” do anything. I want to know why I am being told to participate.

With that, I will dedicate this edition of the Baker Boyer Investment Newsletter to identifying the current stabilization plans offered by the Treasury and Federal Reserve and why they were implemented.

First, it is important to know that there are two main problems in the financial industry. The first is the long term viability of the financial sector. There have been so many write-downs of “toxic assets”, that it seems very few kept a level head during the roaring times of the housing bubble, (just for clarification: Baker Boyer Bank did keep its head and did not directly invest in these subprime investments or other risky derivatives). This lack of



banking fundamentals has left many banks damaged and their long-term survivability in question.

The second is the short term viability of all companies in general. What we now know as the Credit Market Crisis of 2008, which started in the financial sector, has poured into the realm of corporate and Main Street America. This means that as financial institutions continue to feel the pain of their risky investments, healthy banks refused to lend money to other banks and as a result, liquidity in the system dried up.

I will tackle the short-term issue first, as it is the most pressing issue at this time. When you think of the economy of the World, imagine the human body. It is a complex system that needs all the sub-systems within

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the body to function in order to survive. The most important of all the sub-systems is the cardiac system. The heart pumps blood to all parts of the body and circulates nutrients and oxygen throughout the entire muscular system through the largest arteries and the smallest capillaries. There is no part of the body that can survive without free and steady access to blood, and the heart is the pump that provides that blood to the entire body.

In the business world, the financial sector and the issuing of credit to businesses, both big and small, is the heart of the Global Economy. The issuance of credit and lending between companies and investors keeps cash, the lifeblood of the system, moving freely throughout the entire financial system. When credit and lending come to a complete halt or “freeze,” it doesn’t take long for very healthy companies to decay and die as their ability to receive the cash they desperately need is stripped from them. In other words, the World Economy suffers a heart attack.

Just like life in the human body, eventually businesses will die if their lifeblood is halted (e.g. payrolls won’t be paid, expenses and bills will become overdue, and lenders won’t receive payments on loans). We saw the result of this when panic set into the market in mid-September, as even very healthy companies became suspect and their immediate survival was called into question.

The US Government stepped in recently to offer assistance to healthy companies requiring short-term borrowing. This assistance was provided through the purchase of commercial paper on the open market. Commercial paper is very short-term fixed income paper (bonds) that companies sell on the open market. Think of them as CDs for corporations. As the credit crisis deepened in September, companies were faced with the horrible reality that current “CDs” were maturing and being paid out, but with the credit markets frozen, new “CDs” were not being sold. Very simply there was a lot of cash going out the door and new, fresh cash was not coming in to replenish the coffers.

Enter the US Government with their bold plan to purchase commercial paper on the open market, which acts as the temporary heart bypass machine until the actual heart of the system can be fully repaired.

This leads to the long-term nature of the current US Government Plan. The Troubled Asset Relief Program (TARP), is designed to take the audacious step of providing a more long-term fix to this problem. Since the core of the problem started in the financial sector and was compounded by the reluctance of healthy banks to lend to other banks in questionable financial health, the US Government decided to attack the problem at the source.

One of the many issues faced by banks who invested in Mortgage Backed Securities (MBS), was the inability to fairly price these assets in panic scenarios. Because these assets are inherently difficult to price, the safe harbor for corporate auditors is to price them at their lowest known price. However, in a fire sale of these assets, it didn’t matter if the MBS was being held for the long-term or not, it was “written down,” to what the panic market price was being quoted. This is an accounting practice called “Mark to Market,” pricing.

So, imagine if a bank held onto a number of mortgages that were paying interest and principal monthly and across the nation a very similar package of mortgages sold at a fire sale price of 22 cents on the dollar. Auditing standards may require the first bank to price their package of mortgages very close to that fire sale price.

The TARP program is designed so that the US Government can step into this market and strategically purchase bundles of loans off the books of banks to accomplish one of two objectives. Number one: the program will provide the bank in question with capital by purchasing off their books the MBS that were quickly losing value. Number two: the program also will set a new price for anyone who held assets similar to the ones purchased by the bank being assisted. In other words, the US Government will set the price of

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One of the most common questions we have been hearing lately is: “why don’t I see very many changes in my investments during this volatile time?” It is important to understand the overall investment philosophy of the Wealth Management (WM) Division of Baker Boyer.

Mark and I communicate with our fund managers on overall investment direction and global economic conditions. From those discussions WM decides if the fund manager is moving in the direction that is in the best interest of our clients. If we decide that the fund manager is moving in directions that run contrary to our investment philosophy we can move our assets to another manager who better fits the needs of our clients.

While Mark and I will occasionally make slight adjustments to the percentages we have invested with different fund managers, fairly active changes are being made within the fund itself, which is something clients do not see. The majority of both equity and bond funds we use make changes each week based on economic conditions. The equity funds will make strategic changes within different sectors and also will often reposition their cash positions from zero up to 20% or more during volatile times like these. Bond funds also rebalance their cash position and holdings quite frequently based on market conditions.

In conclusion, while the different funds in which we invest may appear to stay constant, the makeup of investments within each fund and within our client accounts are subject to active

management based on changing economic opportunities.

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# Experts



Experience Counts. You get one chance to make the right decisions that will affect your retirement. Let the certified experts of our Wealth Management Team review your goals and design a customized portfolio to make your retirement dreams a reality.

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a type of MBS with one purchase setting a new nationwide comparable that auditors can rely on.

The intention of the TARP plan is that banks will no longer have to fear lending to other banks and other companies. The cash hoard that has been accumulated in the system can flow freely to the companies and industries in dire need of the cash and the economy can once again move forward.

Both the short-term and long-term plans outlined by the Federal Reserve and the US Treasury seem to be sound in thought and significant enough to alter the landscape of the financial sector for decades to come. To further the analogy offered earlier, the short-term fix is a heart bypass machine and the long-term fix is a heart transplant.

Additional steps have also been taken to add capital to beleaguered banks through direct injections of cash resulting from the sale of preferred shares. Preferred shares are non-voting stocks that pay a high dividend.

This will allow the US Government to directly aid banks that have been damaged but can survive in the long-term, or at least until the US Government can assist them by re-pricing the MBS assets on their balance sheets.

These significant measures have now been taken up on a global scale. The European Union, along with individual governments within the EU, are aiding their banks and assuring their markets in much the same way the US has. This concerted effort to lessen the effects of a Global Recession is a far cry from the ineptitude of the Hoover Administration during the Financial Crisis of 1929. Many lessons were learned after the 1929 Crash and those lessons are being put into action during this current turbulence.

For more information regarding these "Turbulent Times," please logon to [www.bakerboyer.com](http://www.bakerboyer.com) and watch for video and audio presentations being produced for our clients.

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