

# Pensions & Investments

The International Newspaper of Money Management

September 15, 2008

## INVESTING

# Treasury takeover is met with relief

By Isabelle Clary

Many money managers are at least somewhat confident that the U.S. government's takeover of mortgage giants Fannie Mae and Freddie Mac is a turning point in the rambling credit crisis because it eliminates the single largest potential cause of systemic risk to the financial system.

"I'm very thankful they (U.S. officials) took this action ... that ultimately will be viewed as a turning point," said Phillip N. Maisano, chief investment strategist at BNY Mellon Asset Management, New York, with \$1.1 trillion in assets under management.

"If they had not acted ... it would have been financial Armageddon," Mr. Maisano added. His comment echoed the warning of "financial tsunami" and "debt liquidation of historic proportions" that William H. Gross, chief investment officer at Pacific Investment Management Co., Newport Beach, Calif., had sounded a few days before the rescue.

Treasury Secretary Henry Paulson announced on Sept. 7 that the Federal Housing Finance Agency was taking control of the two government-sponsored enterprises. Together, the Federal National Mortgage Association, Washington, and the Federal Home Loan Mortgage Corp., McLean, Va., are backing \$5 trillion of the \$12 trillion in outstanding U.S. mortgages. In comparison, the U.S. gross domestic product stands at \$14.3 trillion.

The feeling of relief was felt across the investment spectrum in a *Pensions & Investments* survey that drew responses from 327 investment professionals: 28.7% said the bailout was "definitely" or "probably" a turning point in the credit crunch; another 47.7% said "possibly."

### Containment possible

The problems plaguing the housing and financial markets are not likely to disappear overnight, but the GSE rescue makes it possible to contain and solve them over time, those interviewed said.

"One of the more fruitful actions taken by the Treasury is its program to purchase the GSE's mortgage-backed securities," said Tony Crescenzi, chief bond market strategist at Miller Tabak + Co., New York, who noted the importance of forward-looking measures.

Mr. Crescenzi was referring to the Treasury Department's plan to buy new mortgage-backed securities from the GSEs through 2009, starting with \$5 billion this month. Such a move is necessary because making funding available to new homebuyers is key to the housing market recovery, he said.

In an early sign that confidence is returning to the debt markets, the 30-year fixed-rate mortgage rate fell to 5.93% in the reporting week ended Sept. 10, down from 6.35% in the prior week. John Lonski, managing director at Moody's Investors Service, New York, anticipated a further 65-basis-point drop. Also, foreign central

banks' holdings of agency paper dropped by a smaller \$2 billion, in the week ended Sept. 10, Federal Reserve data showed.

James Paulsen, chief investment strategist at Wells Capital Management Inc., Minneapolis, with \$220 billion under management, said the market knew all along that the GSEs were backed by the guarantee of the U.S. government.

"Where this has made the most noticeable difference has been in the drop in mortgage interest rates and yields on mortgage-backed securities," Mr. Paulsen said. He said the Treasury Department's and Federal Reserve Bank's efforts during this crisis were essentially "confidence boosters."

As part of becoming conservator of both Fannie and Freddie, the Treasury Department agreed to invest up to \$100 billion in each agency's preferred stock, as well as inject capital if the GSEs' liabilities were to exceed assets.

To Robert Haas, senior treasury associate at National Railroad Passenger Corp. in Washington, the parent of government-owned Amtrak, the GSE rescue is a must-win play.

"It looks at if they (federal government) have played their last card," Mr. Haas said. "There is really no other option to revive the mortgage market."

### No panic

Another sign that confidence may be returning to the financial world is that the market did not give in to panic while troubles mounted at Lehman Brothers

Holdings Inc. in the days immediately following the GSEs' takeover. At press time, Wall Street's fourth-largest firm was looking for a buyer while officials in Washington reportedly signaled that a Bear Stearns-type rescue was not in the cards.

"Wall Street is ready to allow someone to fail, and this might be good and make people more confident," Mr. Paulsen added.

Most money managers agree that removing the threat of a GSE collapse helps contain other financial problems from spreading elsewhere.

"Yes, we have turned a corner because the Treasury's action takes a catastrophic scenario off the table. Fannie Mae and Freddie Mac were huge dominos, Lehman is a smaller domino," said Byron Snider, president of West Oak Capital LLC, Westlake Village, Calif., with \$250 million in assets under management.

"Stabilizing the liquidity in the mort-

gage sector is going to be a critical part of getting the financial services industry back on track," said Mr. Snider, who invests in high-grade bonds and stocks.

Benjamin Hughes, assistant treasurer of the \$604 million Georgia Firefighters' Pension Fund, Conyers, Ga., said the GSE rescue might be a crucial element in the outcome of a major investment made by the fund.

Between September 2007 and May 2008, Mr. Hughes' fund boldly invested \$50 million in short-maturity, high-grade collateralized mortgage obligations, which were selling at a 30% to 60% discount.

"The GSE action is contributing to changing the psychology. We have invested a significant amount (of the fund) by buying these securities that were selling at depressed values and were irrationally discounted," Mr. Hughes said. "The paper is performing, we are not experi-

encing any delinquency, and we think that the phantom decline in market value will be recouped."

For some investors, the government's takeover of Fannie and Freddie already has yielded some benefits.

"There are more problems to be resolved before we truly hit a bottom, but we are in the seventh inning. I'm still concerned about the deleveraging theme underlying the economy and which has not completely played out yet. But the 800-pound gorilla has been dealt with," said Patrick Bresnehan, director of macro strategies at PanAngora Asset Management Inc., a Boston-based quantitative investment firm with \$21 billion in assets under management.

Mr. Bresnehan said his firm's portfolio included yield curve positions that "got a nice little pop from the market reaction that took place starting on Monday." ■