



**CEDAR HILL**  
*WEALTH MANAGEMENT*

**A WHITE PAPER ON MADNESS II**  
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In October of 1999, we wrote our clients that the technology frenzy and heightened stock valuations were not sustainable. We find ourselves in a polar position today: a de-leveraging environment where borrowed capital made poor investments and Wall Street is suffering from the foolish creation of exotic instruments sold to those who did not inquire. Yes, another period of madness. The markets seem to be throwing “the baby out with the bathwater” and punishing solid firms and investments in a rush to liquidity. At one point yesterday, T Bills sold at a negative yield - the price paid by panicky investors was more than the maturity value!

The phrase “throwing out the baby with the bathwater” stems from ancient England where the tub was filled only once and the head of the family was the first to bathe, then the wife or oldest child, and then the baby. The landscape is much the same a thousand years later. The ‘tub’, filled with over-leveraged investments and incomprehensible financial instruments, first bathed the mortgage market where loans were made to those that could not afford homes and to speculators as well, then the financial engineers of Wall Street, and finally, doubters of institutional solvency, some real, some imagined. Part of the blame rests with policy makers who insisted that all deserved to own homes, regardless of ability to pay, as well as with unscrupulous mortgage brokers who encouraged endless re-financings (a “no brainer” according to spot radio ads). Part of the blame rests on the shoulders of short sellers who profited not by analysis, but by planting false seeds of doubt in the press. A great deal of the blame, however, lies with the greedy creators of investments, sliced and diced many times over and sold to those who should have known better and those who had no idea of what they were buying.

Would Indy Mac have had a “run on the bank” if a Senator did not misuse confidential information supplied by a Federal Agency? Would Bear Stearns have gone under if rumors of a failure to honor obligations were not spread? (Yes, they did have highly leveraged and imprudent investments in their funds, but that is a different matter.) Would AIG be in a controlled bankruptcy if Eliot Spitzer, that paragon of virtue, had not entered a personal vendetta against the octogenarian founder of the firm and forced him out? It will take years to sort out the truth about all of the above, which is far beyond the scope of our comments.

So what do we know? We know that many investments today are selling at irrationally low prices, just as many were selling at irrationally high prices in 1999. Valuations in many sectors of the stock market are more attractive than any time in the last six years. Less-liquid asset classes such as preferred stocks and MLPs have been particularly punished as the absence of buyers led to unprecedented yields on these securities.

In the Wizard of Oz, Dorothy said to her dog, “Toto, I don’t think we are in Kansas anymore.” One of the outcomes of this financial tornado will be a de facto nationalization of markets and procedures. The U.S. Government has taken on considerable debt and will take on far more to restore confidence at home and abroad. In the RTC crisis of 1989-90, regulators sold assets of failed institutions and did not absorb the losses as the Treasury is now doing.

So where does our posturing lead us? In our opinion, the financial tornado has created a new landscape, an environment ripe for the picking of sound investments. It is not the end of the world...it is the end of mindless investing and unrestrained credit. Although these are scary times, we are reminded of the words of Warren Buffett: “The time to get interested (in stocks) is when no one else is.”

We welcome your thoughts.

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