

It's still early in the credit crunch

By Brad Carlson

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Two Idaho investment pros don't envision the sub-prime credit crunch fading away anytime soon.

Daniel Wiggins, principal in Boise registered investment advisory firm Talisker Investment Group LLC, said the housing market is likely to take years to correct, as houses are less liquid than many securities.



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-Daniel Wiggins
Talisker Investment Group

Housing liquidity is less of a concern to long-term owner-occupants than to investors who bought with intention to sell for a quick profit, he said. The Boise area saw plenty of buying by investors in 2005-06, he said.

"You can't have a period of boom without a subsequent period of decline or decay,"

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Credit crunch lingers for Idaho

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Wiggins said. "This is basically the first or second inning of this credit crunch."

It's definitely going to get worse in 2008, he said, due to the magnitude of mortgages that are going to adjust in just the first quarter. Wiggins said he expects the crunch to continue into 2009 and possibly into 2010.

Bonds riskier than U.S. Treasury carry a higher yield, but this spread had narrowed in recent years to nearly historic lows, said Bob Maynard, chief investment officer for the Public Employee Retirement System of Idaho.

"You have a re-pricing of risk, at least in the high-yield area," he said.

Sub-prime mortgage defaults rose and sub-prime debt spreads widened to greatly slow the issuing, buying and reselling of riskier debt.

There was a lot of borrowing and repackaging, and a lack of transparency, Maynard said.

"Until there is some certainty out there, you are going to see this volatility in the market," he said. "And because this is an area where there isn't instant transparency such as in hedge funds, it will be like a slow unrolling."

Sept. 30 is the deadline for many hedge funds to respond to cash-out orders from investors, Maynard said. After that time, analysts will have a better feel for how long the credit crunch will last, he said.

Wiggins said recent illiquidity in the credit markets reflects a lack of buyers

- and some would-be buyers becoming sellers, if they can find takers. At the same time, the credit market is struggling to assess all risks and thus to establish prices.

"When lenders package mortgages into bonds, there can be more risk to the bond buyer than you would be originally aware of," he said.

Hedge funds, private equity firms and pension plans significantly contributed to the credit crunch by facilitating trading and distribution of credit default obligations that were backed by sub prime loans, he said. They used the proceeds to fund investments or to generate cash flow.

"All of a sudden, when some of these bonds defaulted, there was no more cash flow and principal," Wiggins said. Investment entities sold stock instead, driving down stock markets, he said.

In the state retirement system, 30 percent of investments are in fixed-income securities, with no debt that is not priced every day, Maynard said. PERSI doesn't own hedge funds or residential real estate. Its private equity, commercial real estate and Idaho commercial mortgage investments are well positioned, he said.

The fund lost less than 1 percent in July.

Wiggins said interest rates will rise if foreign investors demand a higher yield to justify owning a dollar-denominated asset, given that the U.S. dollar is in decline compared to a number of currencies.