



## THE DANA VIEWPOINT

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### ***HERE THEY COME TO SAVE THE DAY***

The common stocks of Fannie Mae (FNMA) and Freddie Mac (FHLMC) suffered a further meltdown on Friday on fears that the two giant mortgage leaders do not have enough capital to avoid failure from continuing foreclosures in the mortgage market. FNMA and FHLMC currently guarantee over \$5 trillion in US mortgages. This is about one-half of the entire mortgage market. FNMA and FHLMC have long been seen as having the implicit backing of the US Government even though they are publicly held companies. First, the good news. There is no way that the government will allow these companies to fail. The old adage that they are too big to fail will hold true. The further good news is that there are viable solutions:

1. They can continue to raise funds through the issuance of long- and short-term debt or preferred stock. Granted, the market is a little skittish now, and they would be forced to offer higher rates of return, but because of the implicit government backing, it would work.
2. They can eliminate their dividends. FHLMC alone would save \$650 million a year.
3. The *Wall Street Journal* has suggested that Treasury and Congress step up now with a public capital injection. This would involve some taxpayer risk, but the downside would be limited.
4. The Fed could open the discount window as they did in the Bear Stearns meltdown. The problem with this, of course, is that it sets a bad precedent. Investors would then take more risk, assuming the government would always be there to bail them out.
5. The government could take over FNMA and FHLMC. Very bad solution. It would add \$5 trillion to taxpayer debt.

On Tuesday, July 15, FHLMC completed a very successful short-term bond offering totaling \$3 billion. The final good news is that this part of the mortgage market has been long overdue for a house cleaning (pun intended).

What about the market for ARMs (adjustable rate mortgages) securitized by FNMA and FHLMC? Prices for these pools of mortgages have held steady through all the negative press. Principal and interest is guaranteed by the agencies, and, of course, there are the houses for collateral. Further, the implicit government guarantee will probably become explicit. Foreclosures are a small part of the mortgage market, but they make the biggest headlines.

Keep in mind that final solutions to this situation are not in place yet, and the news changes daily. Please feel free to contact any portfolio manager at Dana if you have any questions regarding the market.