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What does the Fannie/Freddie Bailout Mean to You?

It has been several days now since the federal government put these two government sponsored entities (GSEs) under conservatorship, and we're just beginning to see a few implications of this bold move. Essentially it's an outright takeover of Fannie Mae and Freddie Mac, and it may just provide some needed lubrication to the housing market.

Specifically, in the several days since the takeover, rates on 30-year fixed mortgages have plunged from last week's average rate of 6.31% to 5.75%. This is quite a drop, especially considering that in July, rates were around 6.69%. Such low rates, combined with an 18% drop in housing prices nationwide from their 2006 peak, should begin to entice potential buyers to enter the market. This should serve to bring down the current high levels of inventories, a move that would start to normalize the housing market.

It's definitely good that the federal government is now committed to providing as much capital to the two GSEs as they need, as they begin to increase somewhat their portfolio of mortgages over the next two years. In addition, the U.S. Treasury will apparently also begin actually buying new Fannie and Freddie mortgage-backed securities, something that has never happened before but should serve to jump-start the mortgage industry. Sure, this whole takeover will hit taxpayers where it hurts by inevitably increasing the federal deficit, but at least it will bail us out of a portion of the interminable credit crisis.

Nothing, however, will magically get us out of the whole credit crisis, but I hope that this move by the Federal Reserve will help stabilize conditions within financial markets over time. Keep in mind, however, that this will certainly not be instantaneous, even though

mortgage rates have already declined. Both Robert Shiller and Mark Zandi, prominent economists, agree that we probably have at least 9 months to go with the housing decline. The total nationwide decline might, they say, end up being 25%, which means we have another 7% drop to go. And, of course, these are just estimates.

What does this say about your portfolio? Well, keep in mind that stocks tend to look out 6 to 9 months into the future, discounting whatever good or bad events can be perceived. So a lot of the nastiness that's currently going on, e.g. with Lehman Brothers and Washington Mutual, may already be incorporated into stock prices. The problem, however, may be that there are still other shoes to drop in this whole mess, and since we cannot anticipate them, further turmoil in the markets may be at hand.

One thing that's good for us is that no IFA clients own Fannie or Freddie stock, either outright or through mutual funds. As you may have heard, stockholders will suffer greatly due to the federal takeover. A few of you own GSE bonds, but they will continue to do great, as they have been even during this crisis.

If you'd like to discuss your asset allocation mix in light of current market conditions, feel free to contact me. Keep in mind, however, that there is no way for us to forecast what will happen to stocks over the next year or so. We could well have further declines, but if the market, in its collective wisdom, senses a light at the end of the tunnel, you may well miss out on the next surge. So, as you know, I generally counsel clients to stick to the long-term asset allocation mix we have developed and that should see you in good stead.