



portfolio positions

Tony Carideo



THE BUBBLE ORACLE

Why are we surprised when the bubble pops?

Way back in ancient times—September of 2006—Keith Tufté, president and CEO of Longview Wealth Management in Eden Prairie, kicked out an exceedingly depressing gloom-and-doom newsletter that posited the question: **“Is the housing bubble about to burst?”**

Ridiculous! Of course it wasn't. Prices were going to the moon! Right.

Obviously, Tufté was onto something. A veteran money manager and analyst, Tufté's pedigree includes a six-year stint at J. P. Morgan Investment Management, then 15

years as an analyst, portfolio manager, and director of equity research at Ameriprise Financial Advisors (now RiverSource Investments, the investment arm of Ameriprise Financial). Most recently, he worked at Cargill-owned Black River Asset Management. He launched his own firm last year, focusing on investment management, tax advice, and estate planning. Tufté, by the way, is a long-time student of investment bubbles and their dynamics.



Keith Tufté, president and CEO, Longview Wealth Management

You were warning about a housing bubble in 2006. What market conditions tipped you off?

KT There are a number of things I look for in a typical investment bubble: the rapid escalation of prices beyond a normal historical pattern, the use of leverage, and buying the assets just because prices are going up, with little thought of valuation. In the housing bubble, people who typically weren't investors in homes before were buying multiple homes—first-time homebuyers who couldn't really afford them—and lots of people were buying second homes in parts of the country they weren't really familiar with. The other thing you look for in bubbles is a huge increase in the supply of the asset. In this case, we saw huge increases in the new-home supply because the prices were so high.

Was there any indication back in 2006 that the housing bubble would also trigger the tremendous dislocation we've experienced in the fixed-income market—particularly in some of the exotic securities—and the financial sector in general?

KT Any time you have a financial bubble, a common theme is the increased use of leverage or some sort of creative financing that allows the bubble to get much more out of control than it normally would. In the housing bubble, we had the banking industry getting extremely lenient and creative with their lending standards. So at the time, I think it was obvious that the banks and people investing in mort-

gage bonds were going to be in trouble when the bubble burst. With the more creative fixed-income structures, it has taken people a while to figure out how much exposure they really had. That's one problem we've had in this credit meltdown: A lot of these new creative structures were not very transparent.

When the housing market was peaking, a lot of commentators asserted that the unwinding of that market was going to be more of a “slow-motion collapse,” given the long-term nature of real estate investments. Have you been surprised at how quickly this bubble has burst?

KT I really haven't. If you look back at the history of investment bubbles, they always unravel rather quickly. It just feeds on itself, and people are always surprised by how quickly it happens.

Did you anticipate that the shock waves from this collapse were going to be as widespread as they've become?

KT I think most people have been surprised at how far and how quickly this has spread. Many of the large banks in Europe and Asia have run into significant problems because of U.S. subprime mortgage exposure, which is something I was surprised at and many others were, too. In addition, [the problems] spread to many other kinds of securities that many of us thought were safe, such as the money-market funds.

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“Mind the Gap”

How the subprime aftermath affects the average investor.

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The late economist Hyman Minsky theorized that markets tend to lurch from crisis to crisis. Do you believe that we are doomed to stumble along, from bubble to bubble to bubble?

KT *When one looks at history, we've had some sort of investment bubble once or twice every decade. Investors have short memories. You would think they would learn from one bubble to the next, but as 5 or 10 years pass, people tend to forget. The problem is human nature; people get greedy, and everyone wants in on the party.*

Some have argued that we're in a commodities bubble right now—in particular gold. What do you think?

KT *I think the most recent bubbles right now are the Chinese stock market and to a lesser extent the short-term Treasury bond market. Massive amounts of money have rushed into the Chinese market over the past few years, and into the U.S. Treasury bond market over the past year. Commodities and the oil market are also showing many of the signs of a bubble. In all cases, commodities are subject to the whims of supply and demand, psychology, and greed and fear. Those asset classes have all had huge runs, and I think the forces of supply and demand are likely to bring them back to some sort of normalized price levels, as they always have.*

How much of all this is Alan Greenspan's fault?

KT *It was partially Alan Greenspan's fault, but I put more of the blame on regulators in the financial industry and the banking industry. There were plenty of people talking and warning about all this creative financing going on in the mortgage market. It just got more and more ridiculous. First it was adjustable-rate mortgages with low teaser rates, then it was mortgages where [the buyer's] income and employment weren't checked, then it was interest-only loans, then option-arm loans, where you don't even pay the entire interest you owe each month, but your principle goes up each month. This sort of thing was going on in 2005 and 2006. Where were the regulators in California, where a huge percentage of these option-arm loans were being given to people without the lender doing credit checks, and they were able to borrow 100 percent of the house's value, and they weren't even paying the interest they owed each month?*

What are you telling your clients now in order to prepare them for any additional market dislocations?

KT *I'm still nervous about the financial stocks. It's very difficult to try to call the bottom in the financials. It's still very unclear how much longer this may go, how much further this may spread. If the financial [stocks] have to raise additional capital, that's going to dilute current shareholder [values]. In my portfolios, in the equity area, we're leaning toward large-cap growth. And in the fixed-income area, I don't see anything that's terribly attractive right now. Treasuries are very unattractive, and I'm not trying to pick a bottom in mortgage bonds. Basically, I'm holding more cash rather than bonds. I think that cash and equities have a better outlook than bonds going forward.*

What are you doing on the international side?

KT *I still like international stocks, but we're sticking with the developed markets. We're avoiding the Chinese market, and we don't have any exposure to emerging markets.*

Are you trying to invest with an eye toward the end of a U.S. recession, assuming that we're either in one now or in a significant slowdown?

KT *Yes. I'm bullish on equities. I think equities are cheap and I think the market always anticipates and looks forward six to 12 months. I think 12 months from now, the U.S. economy will be better than it is today, and I think the markets are going to start discounting that in the very near future. **TCB***