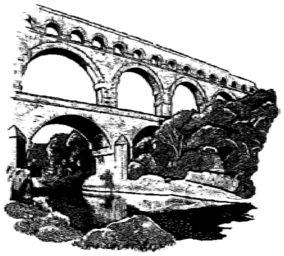

Ignorance is temporary. Stupid is forever.

The news is filled with stories of folks who may lose their homes because of the subprime mortgage crisis. Some stories are heartbreaking. Others not so much. Presidential wannabes are all over the story with pleas for the government to bail out those homeowners who are in over their heads. I'm not sympathetic with this view because "government" can't bail out anything. The government is you and me, the financially responsible people who pay their bills, mortgages and taxes on time. The following article was taken directly from the front page of the December 17 *Wall Street Journal*. I eliminated several sentences but have retained the essence of the story. Karen and Steve Oropeza "complicated their lives by overextending themselves," according to the *Journal*.

> On Calle Canon Road, residents say they were drawn to the street by the two-story, 4,000-square-foot homes, built on some of the biggest lots in the area . . . The Oropezas arrived at Calle Canon Road in 2004 . . . Public records show they paid $557,000 for a four-bedroom house and took out a $500,000 mortgage. Her husband is an area manager for an auto-parts retailer and she is a purchasing manager for a firm that sells dietary supplements . . . As property values skyrocketed, they refinanced three times, most recently in late 2006, for $835,000, Mr. Oropeza says . . . The couple says they used some of the money they pulled out of the house for home improvements, such as a backyard waterfall. But Mr. Oropeza says the bulk was used to pay off credit-card arrears. "We were in a vicious cycle of refinancing our home to get out of debt," he says. "We banked on selling the house, but that's where we failed."
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> The couple listed the house several times, even before the final refinancing, which raised their monthly payments to about $6,300. Earlier this year, they were asking $839,000 for the house. Meanwhile, Mr. Oropeza expected to be transferred to Texas, so the couple began house hunting there in 2006. In June, they bought a 3,600-square-foot home for $283,000 in the Houston suburb of Katy, Mrs. Oropeza says. "It was easy. We had good credit. The deal was done in seven days."
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> In the run-up to their move, she says, the couple lived off credit cards to "make sure we had cash for the house payments" in Corona. They packed up in June, and then took their 9-year-old son and 2-year-old daughter on a long-planned Caribbean vacation. They returned . . . and drove to Texas . . . Mrs. Oropeza says that she and her husband recently bought a Lexus and a Chevrolet Suburban with no money down. She denies that the family intended to abandon the house. The choice was straightforward, she says: "It was easier to keep the house in Texas than the one in California."
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> The couple stopped making their Corona mortgage payments in June, triggering a notice of default 90 days later and starting the countdown to foreclosure. The family is now living in Texas. But Mr. Oropeza says he no longer expects a transfer, so every other week, sometimes more often, he says he flies west to make his usual rounds of retail locations in the Inland Empire. Mrs. Oropeza says she travels to Orange County every three weeks for her job.
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> After the government-brokered mortgage plan was announced, Mr. Oropeza says he called the toll-free help line and left a message, though he doubts he will qualify to get his Corona house back . . . "We're sad because there goes our credit, and because people think we are a bunch of flakes who walked away from the house and tried to make money," Mrs. Oropeza says.

I think "flakes" is close but throughout the last three years of profligacy I have to ask, "Where was the adult supervision?" Mr. Oropeza states that the better part of the quarter-million dollar refinancing money went for payments on credit cards that he was already behind in paying. And once they bought the Texas house, it was back to the credit cards. No, Mrs. Oropeza. You aren't flakes. You are dopes.

In Arizona, years ago, folks pondered why one would keep pickup truck payments current while letting the house payment slide. The only answer was that you could live in the truck but you couldn't drive your house to work. It is impossible for me to feel sorry for the Oropeza family but, if someone had said "NO" along the way, it may have provided the jolt these people needed to end this spiral. I blame their plight on what I call the "bonus culture" fostered by business today.

We all know what it is. Employers tell their employees that when certain goals are met, the employee will get a bonus.

The employer assumes the bonus promise will make the employee work harder and that achieving the goals will make everyone better off, including the employer. Well, my feeling is that the bonus prospects put the interests of the employee ahead of the interests of the business. The quality of the customer or the quality of the credit is not considered. Make the sale and move on to the next one. Let the company worry about customer issues. Isn't that what the Collection Department is for? So what if a bunch of sales go south? It isn't my problem. " I got my bonus!" Companies don't foster this "me first" mentality deliberately but their actions cause it. And it is reinforced because, at the first sign of trouble, the company pleads poverty and issues thousands of pink slips. Loyalty to anything other than self is discouraged when employees think they work for a bonus and not a paycheck.

The "get while the getting is good" culture can be found every day in every transaction. The cash register ringer asks if you want to save 15% today by opening a store credit card. It's part of their performance evaluation. Branch bank office personnel push variable rate loans, investments and annuities on customers because it is part of their bonus package. (No credit is given for a simple deposit.) Discount stock brokers push higher-yielding money market funds even though the higher yield comes with higher risk. Mutual funds that perform well are rewarded with more investor money and a large bonus for the fund manager. Investment bankers have the opportunity to earn large bonuses for packaging up bad loans and the reselling the package to investors. The professional investors in those loans earned bonuses because the funds under their control earned a few tenths of a percent more than an arbitrary index. And, as stock investors, we want our companies to report ever-increasing profits which drives up stock prices. High stock prices mean bonuses for the executives. The higher the price, the bigger the bonus. Since executives are paid with stock options tied to the stock price, is it any wonder some of them cut corners or lied to investors to keep the share prices high?

Twenty years ago when I worked at a bank my boss told me he wanted to start a bonus program based on how well my accounts did against an arbitrary average. I refused to play because I thought such a program would not be in the client's interests. Assume that I was close to my bonus bogey in October and needed to beat the market by just a little bit to qualify. Are the trades I do in October appropriate for the portfolios or are the likely to boost results enough to get the bonus? Can the accounts take more risk so I can be rewarded? Since management could never know what motivated my trading activity, the bonus program would have been impossible to control.

Control was, and is, the problem the major investment banks have to deal with today. Other than Goldman Sachs, it seems that every other major capital markets firm finds themselves with too many risky assets and too many people who were responsible for buying them. Sure, Citigroup replaced Charles Prince and Merrill Lynch replaced Stan O'Neil, both top executives, but top executives just set the working environment. Where are the announced firings of the people who bought the bad paper? They probably won't be replaced quickly because they are the ones who know where the skeletons are buried. The newspapers even reported that many who worked for the firms that lost billions of dollars would be paid bonuses anyway because they were too valuable to lose to another firm down the street.

The subprime mess won't go away soon. As we end 2007, Morgan Stanley, Citigroup, UBS and Merrill Lynch have announced a combined loss in funny securities and derivatives of $42.7 billion. Recently, conservative Wells Fargo announced $1.4 billion in pretax losses. Even more losses are expected when hundreds more banks report after the first of the year. Washington will scramble for answers even though Washington helped create the problem with easy credit and lax regulation. Demands that Fannie Mae and Freddie Mac buy mortgages to shore up the mortgage market are silly and shortsighted. The financial statements of these two governments-sponsored companies were in such disarray two years ago the companies couldn't file timely reports with the regulators or the public!

Two decades ago, a noted Wall Street banking analyst made a presentation at the then Phoenix Society of Financial Analysts. His report was glowing: "Buy the banks!" During question time I asked how he could "value a business when every five years they write off five years of earnings." His reply startled me. "That's what my wife asks me." I was startled because wives have a way of going directly to the point regardless of the sophistication of the presentation. The fact that his wife didn't believe him or his analysis made me wary of bank stocks to this day. I have always known that any fool could lend money. It takes real talent to get it back. Clearly the lenders who were dealing with the Oropeza family were less interested in getting their money back than in getting a bonus for making the loan. The banks who bought the Oropeza's loans were more interested in the fee income than in the quality of the asset being acquired. We have been here before and will be here again, just with different names and faces. Stupid is forever.

HAPPY NEW YEAR!

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