Delta Financial Advisors

April 2008

Economic Comments

Chairman Bernanke and the rest of the Federal Reserve had a very busy month trying to stabilize the U.S. financial markets and economy. At an unscheduled early March meeting, the Federal Reserve initiated a new $200 billion lending facility available to Wall Street broker/dealers. As the national bank has only historically lent to banks, this move represented a substantial shift in the Fed's activities.

At the regularly scheduled meeting a week later on March 18, the Fed's rate setting committee cut overnight interest rates by ¾ percentage point to 2¼ percent. In making the unusually large rate cut, the committee emphasized the ongoing stress in the financial markets along with the continued contraction of the housing market. Facilitating this sharp move was data showing that consumer-price inflation had not accelerated in recent weeks as previously feared. Still, the Fed said that the risks of inflation had increased, even if price pressure was expected to slacken down the road.

As if these two aggressive actions were not enough, between these two meetings the Federal Reserve directly intervened in the financial markets by essentially forcing a major Wall Street brokerage, Bear Stearns, to sell itself to J.P. Morgan Chase (NYSE: JPM). To facilitate this transaction, the Federal Reserve invested $29 billion to insure the deal's completion.

Clearly, this is not your mother's Federal Reserve anymore. In a span of less than 2 weeks, the Fed lowered interest rates by one of the largest amounts ever, started lending funds directly to Wall Street firms and invested almost $30 billion to facilitate the purchase of a struggling securities firm.

Driving all of these actions has been the Federal Reserve's attempt to stabilize the rocky financial markets. Meanwhile, the economic impact of the Fed's action will take longer to unfold as even the Fed's first rate cut in September is yet to fully be realized much less the additional cuts of 2½ percentage points that have followed September's initial rate reduction.

The big challenge facing the economy in the after effect of the mortgage fiasco is the resulting wave of de-leveraging. Over the last 10 years, global capital markets grew almost 60% faster than economic growth. Given the hesitancy of most lenders to extend credit, we are now experiencing a vicious cycle of deleveraging on both a national and global scale.

The soundness of any financial firm depends on other firms having confidence that the firm has real assets standing behind its bets. Given the vast uncertainty now prevailing, firms are hoarding their cash rather than lending it out until they understand the full ramifications of the housing crash.

Looking at things more closely, other signs of a weakened economy continue to arise. The U.S. labor market in March lost another 80,000 jobs – led by employment downturns in the manufacturing and construction sectors. Accompanying the job loss was a spike upward in joblessness as unemployment moved from 4.8% to 5.1%, the highest level since the aftermath of Hurricane Katrina in the Fall of 2005.

Unfortunately, the housing slump does not look like it is finishing anytime soon as new housing starts were down by 0.6% in January. Reflecting the tighter job market and continued slump in housing, The Conference Board's consumer confidence index declined to its lowest level in 35 years. Just since the start of 2008, the index has declined by almost 30%.

Furthermore, employee wages have continued to lag behind price inflation as hourly salaries were up almost ½ percentage point less than consumer prices which rose 4.0 percent over the same period. And finally to cap off the recent "good" news, the dollar has continued to hit new lows against most major foreign currencies as it has declined by almost 14% over the last year. The small silver lining has been that exports have been surging, up 16% in the last year, versus import growth of less than 11%.

Where does all of this leave us moving forward? The Federal Reserve and Bush Administration are trying to weave a fine line between crafting a stimulus package which will restore market equilibrium and encourage business and consumers to spend and providing a bailout to the consumers and businesses that were busy speculating in the real estate markets. The question is how long will the hangover from this current bubble last. We continue to express optimism that the situation will start improving as the summer progresses.

Market Comments

To paraphrase the words of Winston Churchill, "the markets have nothing to fear but fear itself."

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Advisors, L.L.C.

Performance as of 03/31/08				
	Close	***Month***	***YTD***	***1 Year***
DJIA	12262.89	+0.12%	-7.01%	+1.58%
S & P 500	1322.70	-0.43%	-9.45%	-5.07%
NASDAQ Comp.	2279.10	+0.34%	-14.06%	-5.88%
	Month end yld.	***Prior Yr. end yld.***	***12 mo. prior yld.***	
10 yr. U.S. Treasury	*3.43%*	*4.03%*	*4.65%*	

Recently, there has been an abundance of fear to go around with estimates of the financial losses associated with the mortgage crisis topping $1 trillion. The defining event of the month was the near bankruptcy and then buy-out of Bear Stearns by JP Morgan Chase, NYSE: JPM. As negative rumors circulated on Wall Street about Bear Stearns, the company was forced to seek temporary loans from the Federal Reserve on March 13th. Bear Stearns' stock, which had already declined by 20% in prior weeks, plummeted almost 50% the following day as many took the Fed's action as a sign of last ditch desperation by Bear Stearns.

Over the week-end as almost all of Bear Stearns trading partners refused to extend it credit, the Federal Reserve forced the company to sell itself to JPM rather than declaring bankruptcy. What Bear Stearns experienced was a classic run on the bank. While seen often in the 1800s, this type of epic collapse in confidence has been rarely seen since the advent of the Central Banks. Although fundamentally profitable, the company had lost the confidence of other lenders and customers to conduct business with it.

One of the key reasons for a central bank is to prevent this type of bank collapse. Historically the collapse of one bank often created a vicious domino effect as customers became wary of doing business with other sound institutions. Fortunately, in the case of Bear Stearns, a domino effect was averted by the Fed's aggressive interest rate cuts and offers of loans to other Wall Street institutions.

As we look ahead to the remainder of the year, Wall Street remains remarkably bullish about corporate earning prospects. While earnings are expected to slip 8% for the first quarter and almost 2% for the second quarter, analysts still expect dramatic recovery in the year's second half peaking with a 61% gain in the year's final quarter. While 2007's final quarter was remarkably bad (considering the enormous write-downs realized in the financial sector), the huge recovery anticipated for the 4th quarter appears to be overly optimistic.

Yet, all is not gloom and doom as stock valuations in basically all sectors, except for the financial sector, have become more reasonable in the face of the recent market sell-off. One important bullish signal has been resurgent insider buying of securities. While not a short-term tool for market timing, it strongly suggests that company officers in the know are optimistic about their companies' stocks' prospects.

In the near-term we anticipate continued levels of elevated volatility as the markets continue to suffer from the mortgage bubble hang-over. However over the long-term, we remain confident that an appropriately designed portfolio will prove financially advantageous to those willing to ride out the market's periodic storms.

Planning Thoughts

As tax season is shortly winding up we wanted to re-visit the concept of funding 529 plans for children or grandchildren. There are two types of plans, pre-paid and savings plans. Pre-paid plans allow for tuition for in-state colleges to be pre-paid. Savings plans allow for funds to be applied towards any college. The benefits of these plans are several fold. First, the donor maintains control of the funds. Second, despite the continued control, the funds are not considered part of your estate. Third, the funds grow tax-deferred and are tax-exempt if used for higher educational. Finally, some states (including Louisiana) offer a tax deduction AND a partially matching contribution to their plans.

In summary, these plans represent an extremely attractive means of saving for higher education while maintaining a high degree of control. If you are not availing yourself of these options but anticipate having to pay for higher education, we would strongly urge you to consider establishing one of these plans. Please call us if you would like to discuss further the various nuances of these savings vehicles.

Delta Financial Advisors
Suite 1717
909 Poydras Street
New Orleans, LA 70112
(504) 522-9019
info@deltafinad.com