

# HAYES ASSET MANAGEMENT LLC



<u>Index Returns (Year to Date)</u>	<u>Treasury Yields</u>	<u>Commodities (Year to Date)</u>
DOW JONES INDUSTRIALS ↓ <b>14.20%</b>	6 Month T-Bill 1.87%	Oil ↑ <b>29.16%</b>
NASDAQ ↓ <b>12.30%</b>	2 Year Note 2.51%	Natural Gas ↑ <b>23.50%</b>
STANDARD & POOR 500 ↓ <b>13.70%</b>	10 Year Bond 3.95%	Corn ↑ <b>26.53%</b>
WILSHIRE 5000 ↓ <b>12.60%</b>	30 Year Bond 4.57%	Wheat ↓ <b>27.00%</b>
LEHMAN BROS AGGR. BOND ↑ <b>1.09%</b>		Gold ↑ <b>10.00%</b>
	* through July 31, 2008	

Over the years we've had success making money for our clients who own companies in the financial sector. However, we are now in a period when one's convictions are truly being tested. In the New York Times Global Edition of July 19-20, Floyd Norris expressed our feelings exactly about financial stocks and their recent performance. He compared the situation to 1990 and 2000 which were both bad times for financials, but were followed by strong rallies. As practically everyone knows, the past 52 weeks have been the worst for financials since The Great Depression. During our tenure in this business there have been only two times, Fall 1990 and Spring 2000, when financial stocks have underperformed the S&P 500 index. In 1990, like today, banks were overexposed in certain lending areas and some of them failed and Citicorp was even mentioned as a possible casualty. Sound familiar? In 2000, technology stocks were in vogue and nobody wanted to own "risky" value stocks like financials. But historically, times like these have been great times to buy financial stocks. Although it is an understatement to say that our latest investments in this area were made a little early, our decision now is how do we take advantage of the current market environment? Our bank positions are similar to our insurance positions back in the late 1990s when we owned mid to small cap insurance companies which had underperformed. We decided to sell them and use the proceeds to buy

the larger insurers, Allstate and Chubb, while their prices were also down. Since that worked out well we will probably use the same tactic this time and sell some of the poorer performing banks and reinvest those dollars in the larger banks and/or investment banks.

Besides investing our clients' money in common stocks we have a fair amount invested in the municipal bond market generating tax-free income. The normally staid municipal bond market has been greatly affected by the current credit crisis. The culprit again is derivatives, or structured products created by Wall Street banks. The derivatives that are causing the uproar in the municipal market are pools of sub-prime mortgages and auction rate securities. The sub-prime mortgages backdoored their way into the municipal market through bond insurers like MBIA and Ambac.

The bond insurers began to insure pools of sub-prime mortgages, straying from their bread and butter business of insuring municipal securities. On June 20, 2008, those bond insurers lost their coveted AAA rating due to their exposure to the sub-prime mortgages. MBIA went from AAA to A2 and Ambac from AAA to Aa3. Those downgrades caused all the municipal bonds insured by the insurers to lose their AAA rating!

**(continued on back)**

*As always, we would like to thank you for your business - Hayes Asset Management Team*

Fourteen years ago, Orange County, CA declared bankruptcy; today Jefferson County, AL is on the verge of declaring bankruptcy. The fiscal ailments of both these municipalities should be blamed on highly leveraged derivative trades not shortfalls in tax revenues or excessive spending. Auction Rate Securities (ARS) are at the heart of the problem for Jefferson County, as well as for many individual investors, non-profits and corporations. ARS are debt issued by municipalities, student-loan organizations, or anyone else who wants to borrow long term at short term interest rates. This is achieved through auctions held every 7, 14, 28, or 35 days. These securities were marketed to investors as liquid short term investments, higher yielding substitutes for money markets and/or cash. Once the credit crisis got into full swing the ARS market froze. No one showed up to the auctions. That left investors holding investments that could not be priced or sold, and issuers like Jefferson County trying to entice people back to the auction with yields in excess of 10%. So much for cheaper financing for the issuer and safety and liquidity for the investor! We at Hayes Asset Management did not get caught up in the ARS mess because we stayed with our plan of keeping our fixed income investments in short-term bonds, with maturities ranging from six months to eighteen months and diversifying across many issuers. With interest rates so low we felt it did not pay to extend maturities farther out into the future.

Recently two bills, The Municipal Bond Fairness Act and The Municipal Bond Market Support Act, have been proposed to the House of Representatives. Since only one city has ever defaulted

on a municipal bond in the last 50 years, these bills would no longer force municipalities to pay millions in taxpayer dollars to insure bonds that are extremely unlikely to default. They would also make tax-exempt municipals more accessible to financial institutions. We hope these bills will be enacted into laws. Going forward we expect high quality municipal bonds to be excellent investments in the present, as well as the foreseeable future.

During the second quarter we added to our position in Pfizer and eliminated our position in Allstate. We were able to buy Pfizer, which yields a dividend of over 7%, at prices not seen since 1997. We decided to sell our Allstate position after record flooding and tornadoes devastated the Midwest.

We'd like to end this issue on a positive note. It certainly seems as though the news can't get much worse. Perhaps another look at MBIA can provide a hopeful scenario. In early July, MBIA traded as low as \$4.00 a share, after trading as high as the mid \$60's in late 2007. MBIA is currently trading around \$11.00, almost three times the panic price of six weeks ago. Hopefully, Fannie Mae and other financials will follow a similar pattern. We feel the time is near for calmer heads to prevail. Be assured that we at Hayes Asset Management are monitoring the situation closely. Should you have any questions, we would be happy to hear from you.

*Congratulations to Peter Borello, Research Analyst, who recently passed Level 2 of the CFA exam. Just one more exam to go for CFA Certification!*

### *Find the Value of Hayes Asset Management*

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- Equity Accounts
- Fixed Income Accounts
- Balanced Accounts
- Mutual Fund Accounts

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- Individuals
- Corporations
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- Retirement Plans

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