

ALM First Partner's Report

by Angela Calvert, Partner

Just when you thought it was safe to go back in the investment waters, another shark surfaces re-instilling fears in an already skittish market. In mid-March, we woke up to news that the fifth-largest investment bank, the almighty Bear Stearns, was failing. Cash-strapped, the Wall Street bank was quickly rescued from the brink of collapse through a takeover by rival JPMorgan Chase for the rock-bottom price of \$236 million. After a weekend of frantic negotiations, Bear Stearns' board approved a stock-for-stock buyout at a valuation of just \$2 per share. In a sign of the desperation of Bear Stearns' plight, the deal was at a 94 percent discount to the bank's closing share price of \$30 the previous Friday (not to mention the \$159 price per share back in April 2007).

It seems ironic now that in last quarter's Partners' Report, Tom Manley quoted Steven Abrahams of Bear Stearns' in an early 2008 write up in "*Across the Curve*," stating "The lesson of last year: Imagine the totally unexpected, and buy an option on that." Touché.

While no one is truly isolated from the mess of today's financial marketplace, it should be noted that credit unions remain relatively unscathed. Yet, over the years, a number of market investors have criticized the credit union industry for being too conservative. Repeatedly, brokers have reprimanded credit unions for "leaving money on the table," while various others have voiced their opposition to using ALM risk measures as strategic guidance tools. It is this very discipline that now results in the stability of most credit union balance sheets, while the majority of investment groups outside our industry are facing the most serious struggle ever witnessed by this sector. Congratulations on a job well done!

Of course, we need to stay close to this discipline to maintain our industry's good standing. ALM First will host our annual 2008 Financial Forum, August 11 – 13 at the Fairmont Southampton Princess in Bermuda. Aside from the outstanding location, the agenda is packed with needed education, information and discussion opportunities which will benefit all attendees. As veteran attendees of our conferences will attest, the Financial Forum provides a great opportunity to spend one-on-one time with your ALM First advisory team and have a little fun along the way!

Though market conditions remain uncertain, our outlook for 2008 remains extremely positive. ALM First representatives will be speaking throughout the year at a variety of industry conferences in the United States and Canada. The full list can be found in our "On the Calendar" section of this newsletter. There are also a number of exciting new developments we are working on here at home. Keep your eyes peeled for new products and perhaps a new look.

On behalf of Emily, Tom and I, we welcome three new clients to the ALM First family. We look forward to partnering with you. And as it is always exciting to begin new relationships, we also thank all of our clients for your continued support of and confidence in ALM First.



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2008 ALM First Annual Financial Forum

The Fairmont Southampton - Bermuda
August 11 – 13



Early-bird registration for the Forum ends May 29th. Have you registered yet?

Don't wait any longer; make plans to attend the 2008 Annual Financial Forum today at the Fairmont Southampton in Bermuda. Visit the ALM First website at www.almfirst.com to view the agenda, hotel accommodations and to register for this great conference.

The agenda has been finalized and we truly have some wonderful speakers lined up for the attendees. We are honored to have John Tippetts, CEO of American Airlines Credit Union joining us to share the story of Joseph H. Tippetts' survival in the harsh Alaskan Terrain after his 1943 plane crash.

Diana Dykstra, CEO of San Francisco Fire Credit Union, and Jim Blaine, CEO of State Employees Credit Union, will join with John Tippetts for a panel discussion involving their credit union philosophies, where the industry will be in five and 10 years and what their goals and plans are.

After the events of this year you won't want to miss our two Wall Street economists who will join us to provide their take on the economy: Chris Low, Chief Economist for FTN Financial and Torsten Slok, Director, Global Economics for Deutsche Bank Securities, Inc.

The early-bird registration fee is \$790 per attendee through May 29th and \$850 thereafter for full registration. Financial Forum spouse/guest registration is \$650 and includes all meals.

Room rates for the Fairmont Southampton Princess are \$239 for single/double occupancy plus taxes, gratuities and resort levy. Please contact The Fairmont Southampton directly at 800.441.1414 and use our promotional code: "GRALM1" to make your hotel reservations by July 10th.



Please don't hesitate should you have any questions, please email Paula Beamis at pbeamis@almfirst.com or call 800.752.4628 xt.105.

**We hope you'll
make plans to join
us in Bermuda for
the 2008 Financial
Forum!**

What should be our balance sheet strategy given what is happening in the markets?

First and foremost, *drop your deposit rates – fast!*

We are presently in the most severe credit crisis for the modern era. The crisis is causing the government to take quick and drastic actions. The Fed has dropped the target Fed Funds rate from 5.25 percent in late October to 2.25 percent. Consequently, the 91 day T-Bill reached a low of 58 basis points (bps) on March 20, 2008. Yes, that is correct, 0.58 percent dropping from 5.0 percent in August of 2007. The two-year Treasury is hovering around 1.75 percent and the ten-year Treasury is around 3.50 percent. Mortgage rates are stubbornly high as liquidity for the purchase of loans remains low.

It appears that credit unions are somewhat reluctant to drop deposit rates as rates offered by local competitors remain stubbornly high; however, remember that money market funds have dropped to 2.25 percent (or less) and stocks are suffering!

Some dealers expect overnight rates to drop to 1.50 percent only to be followed by a rapid rise in rates as the crisis subsides. The Federal Reserve must then revert to fighting inflation so be careful in going out too far on the yield curve.

The Federal Reserve has come to the market with three new channels to provide liquidity to the street. The Fed established the Term Auction Facility (TAF) in which direct loans are made to banks and can be backed by a wide variety of collateral, including subprime mortgages. The auctions were increased from the initial \$60 billion to \$100 billion per month. They also established the Term Security Lending Facility (TSLF) which allows primary dealers to borrow as much as \$200 billion of Treasury securities from the Fed's \$713 billion portfolio. This is critical in allowing dealers to lighten illiquid inventory. Collateral accepted in this "debt swap" includes AAA-rated residential and commercial mortgage-backed securities which is unprecedented. The Fed then opened the discount window to the primary dealers (although with tighter restrictions on collateral) through its Primary Dealer Credit Facility (PDCF), which has saved one and possibly three broker dealers from bankruptcy. The extraordinary measures taken by the Federal Reserve will allow dealers to pledge AAA-rated performing ABS securities and should help to alleviate dealer capital constraints.



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Ask Emily

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Treasury Secretary Henry Paulson's "Blueprint for Regulatory Reform" has proposed a plan for a broad overhaul of the financial services regulatory structure. He contends that the current structure of regulating banks, securities firms and insurance companies is outmoded and that the Federal Reserve should expand its oversight beyond banks. Under the plan, which would take years to implement, the SEC and Commodities Futures Trading Commission (CFTC) would be combined, as would the OTS, the OCC the FDIC and the NCUA.

So what should you do?

- Lower your deposit rates, particularly CD's.
- If you can, issue prime, non-conforming mortgages to your membership. Jumbo loans can attract rates over 6.50 percent, and although default rates have risen in prime loans, they are still well worth the risk.
- For those with more risk tolerance, there continue to be great investment opportunities out there in non-conforming AAA- rated securities that have excellent credit support. Some hybrid prime adjustable rate mortgage securities are yielding close to 7 percent. Just remember, there can be huge variance in risk amongst AAA-rated securities these days. Stay away from the 2006 and early 2007 vintages and check and double check the credit support with credit shocks.
- Additional income can be generated by leverage strategies using investments such as agency hybrid securities. Borrowing rates are historically low and mortgage spreads are historically high. Again, be careful with duration mismatches of the leverage trades.

I plan to describe in detail some sample leverage strategies next month which will offer suggestions for potential transactions and highlight key areas on which to focus.

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Economic Indicators

Tom Manley, CFA | Partner



With the news laden with stories about the troubled economy, it can be hard to discern what information is important to know and which directly affects credit unions. There are two perspectives to consider which are helpful in giving an indication of where the economy is headed.

Balance-sheet Perspective

The first consideration for credit unions is a balance-sheet perspective. Because credit union balance sheets are dominated by assets and liabilities, which are financial contracts, a credit union's well-being is particularly susceptible to incipient (unexpected) inflation. To that end, credit unions should be very sensitive to changes in expected inflation. They also need to have a thorough understanding of how inflation impacts the credit union through asset-liability management analysis.

Keynesian economic theory states there should be a correlation to overall economic output (and the dollar demand that results) and inflation. Therefore, if there is a lot of economic activity, one might suspect inflation, too. Thus, if credit unions are experiencing loan demand, inflation can be a concern.

In today's economic environment, it can be helpful to monitor the following:

- **Gross Domestic Product (GDP):** Credit unions should watch the GDP release for two reasons: to get a sense of economic strength (loan demand) and to gauge the Fed's monetary stance. Fed Funds rates > nominal GDP = tight monetary policy. Fed Funds rates < nominal GDP = easy monetary policy.
- **Personal Consumption Expenditure (PCE):** The PCE gives credit unions a window into the Fed's thinking on inflation.
- **Retail Sales:** Retail sales measure the total receipts at stores that sell durable and nondurable goods. Consumer spending accounts for two-thirds of GDP and is, therefore, a key element in economic growth.
- **MBA Purchase Applications Index:** The Mortgage Bankers' Association compiles a variety of mortgage loan indexes. The purchase applications index measures applications made at mortgage lenders. This is a leading indicator for single-family home sales and housing construction. Credit unions should monitor the index in relation to their own lending trends in mortgages.
- **Motor Vehicle Sales:** Because many credit unions are very active in vehicle lending, it is important to watch the level and trend of this monthly measure of domestic sales. It is also helpful for credit unions to monitor what the auto manufacturers are doing on an incentive basis. When GM offers zero-percent financing for 60 months on the purchase of new GM trucks and cars, credit unions may see loan demand shrink.

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- **Consumer Confidence:** The Consumer Confidence monthly survey of 5,000 consumers gauges the public's perception of economic conditions. Growing confidence leads to more retail sales, home sales and job growth.
- **Stock Indices (DJIA, S&P 500):** If stocks are doing well, you can expect a loss in share growth. If stocks aren't doing well, expect shares to rise.

Market-rate Perspective

A second consideration helpful to credit unions when evaluating economic changes is to monitor indicators that quickly and dramatically effect market interest rates, particularly while the credit union is engaged in making market-rate decisions. The most effective measure of this is the employment situation.

The employment situation is the most anticipated economic release each month and accounts for the majority of release-related market volatility. Although the headline number is the unemployment rate, market participants are most interested in the number of new, non-farm jobs created. For the past three months, there has been negative job growth – usually a strong sign that the economy is entering a recession.

For today's credit unions, keeping a finger on the pulse of the economy and staying abreast of changes in the markets can be a full-time job. But focusing on key indicators – particularly those impacting balance sheets and market interest rates – can help credit unions monitor today's economic environment and know what strategic adjustments to consider to stay on target.

ALM First Appreciates Survey Participation

On April 30, ALM First administered a satisfaction survey to its clients. For those clients who participated in the survey – thank you for your time and consideration.

“Providing that type of feedback allows ALM First to grow and evolve in order to better meet client's needs,” says Margot Strong, director of business development. “We appreciate each response.”

The results of the survey will be used to enhance or change product offerings as well as fine-tune customer service levels and responsiveness.

ON THE CALENDAR

CU Conferences - Detecting Fraud and Managing Risks

June 3, 2008

Sheraton on the Falls Resort
Niagara Falls, Ontario,
Canada

Angela Calvert's topic is:
"ALM Tools to Forecast
Liquidity and Strategies"

NCUA Region 3 Capital Markets Training Session

June 17th & 18th

Charleston, SC

Angela Calvert, Tom Manley
and Lisa McDaniel will be
presenting

CUNA Economics and Investments Conference

August 4, 2008

Hilton Suites – Chicago
Magnificent Mile

Emily M. Hollis' topic is:
"ALM Strategies for the Current
Interest Rate Environment"

Financial Managers Society Regional Workshop

Sept 8, 2008

Los Angeles, CA

Emily M. Hollis' topic is:
"Investment Strategies"

VACorp Financial Strategies Conference

September 17, 2008

Emily M. Hollis will be
speaking

New Jersey CUL 74th Annual Meeting and Convention

September 22

Trump Taj Mahal
Atlantic City, NJ

Emily M. Hollis' topic is:
"Optimizing the Balance Sheet"

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Digital Credit Union Excellence Award

For a third time, Digital Federal Credit Union, based in Marlborough, Mass., presented ALM First with a Business Partnership Excellence Award for service during 2007.

In its seventh year, the award is in recognition of businesses that provide service to DCU in a fashion that supports its mission and vision and helps make a difference in the lives of DCU members.

"We are humbled to receive this recognition for a third time," says Emily Hollis, partner. Everyone at ALM First works hard to please our clients and a "job well done" response feels great."

Employee spotlight



Jason Haley Fixed Income Strategist

I recently joined ALM First in April, after spending six years on the sell-side of the securities business, most recently with Cantor Fitzgerald. My responsibilities at ALM First include trading all fixed-income products for our clients and providing economic and market commentary. I also focus on searching for additional opportunities that offer added value in the fixed-income and funding markets for clients. My previous experience on the sell-side gives me greater insight into the mechanics of the capital markets, which helps me maximize efficiency and value in ALM First's trading relationships.

I received my master's degree in finance and my bachelor's degree in marketing from The University of Mississippi. In my spare time, I hang out with my two-year old son, William, and my wife Polly. A favorite pastime of mine is cooking, and each year I compete at the Memphis In May World Barbecue Championship.

ON THE CALENDAR

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AICPA National Conference on Credit Unions

October 20, 2008
Grand Hyatt San Francisco
Emily M. Hollis' topic is:
"Credit Risk in a Recession
Environment"

The Building Blocks of ALM for Credit Unions

Presented by FMS & CUES
December 8 & 9, 2008
Omni Parker House
Boston, MA
Emily M. Hollis will be
presenting

Welcome to ALM First!

ALM First would like to welcome the following clients from the first quarter:

City County CU of
Fort Lauderdale
Fort Lauderdale, Florida
Bill Marquardt
\$268 Million in assets

RTN FCU
Waltham, Massachusetts
Richard Wright, CEO
\$549 Million in assets

Police FCU
Marlboro, Maryland
Danny Gregg, CEO
\$135 Million in assets

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