

ALM First Partner's Report

By Angela C. Calvert
Executive Director

Is anyone else dizzy yet? The roller coaster ride we have all been on in regards to the value in the marketplace is enough to make the strongest of us feel slightly nauseous! Just as the financial industry began to feel some relief from margin compression and the inverted curve, uproars in the subprime market hit headlines which in turn hit value in every corner of the mortgage arena. While the initial blast has been somewhat quantified, the aftershocks continue and the unknown becomes our greatest fear. Buckle up, because the ride surely isn't over.

What is for certain?

While the markets may continue to hold a great amount of uncertainty, there is nothing uncertain about the ALM First Advisory Board. In April 2007, the second annual ALM First Advisory Board was selected and for the second time, tremendous value was provided to our company. The 2007 Advisory Board members are: Ron Barrick, CEO of Advantis Credit Union in Portland, Oregon; Bernie Winne, CEO of Boston Firefighters Credit Union in Boston, Massachusetts; MJ Coon, CFO of ENT Federal Credit Union in Colorado Springs, Colorado; and Kathryn Cook, CFO of Redstone Federal Credit Union in Birmingham, Alabama. This amazing group met for the first time in May in Dallas. The insight of the board was tremendous and the value will surely be felt by each client of ALM First in the upcoming months. In traditional ALM First style, we couldn't have all work with no play! The board and entire ALM First staff, attended the horse races at Lone Star Park where great fun was had and some even went home winners! (Others remain bitter, but I won't mention any names!) The partners would again like to express our gratitude for the time and effort brought forth by the Advisory Board.

Another certainty was the great success of the Annual ALM First Financial Forum, which was held in Beaver Creek, Colorado. The agenda was outstanding, the speakers were most enlightening and the camaraderie was never ending. This year's breakout sessions offered a wide range of topics from a current look at the economy to an in-depth look at the trends and behaviors of Generation Y — does everyone know who Jay-Z is? Other session topics included: credit union mergers and takeovers and a view from the regulators perspective and what to expect on your next exam.

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Additionally, the conference offered a valuable pre-conference workshop and a robust roundtable session all in the beautiful setting of the Colorado Rockies. However, we did manage to squeeze in a little fun during the conference!

On the Horizon

Just like the markets, ALM First continues to keep things interesting. A location for the 2008 ALM First Financial Forum has been chosen and it will be held on the beautiful island of Bermuda! While the location is wonderful, the agenda promises to be our best yet. Jot the dates down now for August 11th – 13th, 2008 and don't forget you'll need your passport for entry. We look forward to seeing everyone there!

Additionally, two new items are coming soon from an advisor near you. These



Managing Director Tom Manley leads the round table discussion during the Financial Forum.

items are the Liquidity Forecast Model and ALM First Peer-to-Peer. The Liquidity Forecast Model has been designed in-house to help you predict and manage your liquidity on a monthly basis. It will be web-based and easy to use. Look for this product to become available in the fourth quarter of 2007. Also coming is the ALM First Peer-to-Peer database. This will allow you, our clients, to compare and contrast your credit union with other clients of ALM First based on any measure you choose. This could include not only asset size, but more prudently asset makeup versus NEV ratio, making the comparison much more relevant. This, too, is being developed in-house and is targeted for a fourth quarter release.

On behalf of Emily, Tom and myself, as well as the entire staff at ALM First, we thank you for your continued business and look forward to a continued partnership.



Financial Forum attendees enjoy the view of the beautiful Rocky Mountains from the deck of Allie's Cabin.

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Recent Developments in the Mortgage and Fixed Income Markets

August 21, 2007

Prepared by:
Lisa K. McDaniel, CFA
Mike Manley

In recent weeks the bond markets have seized up and growing concerns over a liquidity crisis and full fledged market meltdown have left investors grappling with fear. While much of the initial concern stemmed from the ongoing deterioration in the housing market (particularly the subprime sector), new fears over a growing liquidity/credit crisis have mounted in recent days.

Rising delinquency rates and foreclosures have been mostly attributed to the subprime borrower and concentrated in states that have experienced auto-related weakness or excessive home price speculation. Yet, problems are expected to worsen around the country as adjustable-rate mortgages reset over the next several months through 2008. Subprime adjustable-rate mortgages account for about 9 percent of outstanding first-lien mortgages.

Subprime mortgage problems have been magnified through the use of Collateralized Debt Obligations (CDOs), where securities and loans were often pooled together, securitized, and sold to investors. Buyers for this type of CDO have all but vanished after Bear Stearns was forced to liquidate two hedge funds that were heavily invested in this market after the securities backing the funds deteriorated in value. Investors began flocking to get their money out of similar funds at the same time that the funds were struggling with the new valuations of their securities. The by-product of this was a market suddenly flooded with securities, and a rush to unwind the significant amount of leverage that was used to create these funds.

The situation has caused liquidity to deteriorate significantly in the mortgage market, making bids for whole loans and residential ABS securities hard to come by. Spreads on such securities have widened substantially, and are currently at or near historically wide levels on lower tier credit. Even valuations on AAA credit have nearly doubled the amount of spread investors typically demand to own such securities.

On the lending side, origination production volume continues to trend downward as originators increase rates and tighten standards (even for prime paper) in response to weak demand from loan purchasers, in turn driving many producers to retain more loans if their balance sheets permit. Housing was already expected to be a drag on economic growth; however the broad-based slowdown in mortgage lending may have a much larger impact on economic growth than previously thought as it is much harder for consumers to tap the equity in their homes for consumption of economic goods.

The subprime fallout hasn't been isolated to the United States. BNP Paribas (France's largest bank) was forced to shut down three funds that were heavily invested in US

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MBS. In response to the BNP Paribas announcement, the European Central Bank, the Federal Reserve, the Bank of Canada, and other central banks began injecting liquidity into the markets for short-term funds as panic ensued. This was not an ease in monetary policy, simply a stabilization of short-term rates. These central banks were merely pushing (market) lending rates back toward their targets. Overnight LIBOR rates spiked above 6.0 percent, and the effective Fed funds rate did the same, forcing the hands of the central banks. Central banks regularly provide liquidity to the markets for short-term funds. The difference in this case was the size of reserves needed to stabilize the market rates. Over a three day period the ECB and Fed injected more liquidity into the market than at any point in recent history, quantifying just how bad the liquidity crises had become.

The liquidity crunch spread to the commercial paper market, a critical source of short-term funding for many companies (especially mortgage issuers). Investors have shied away from the credit risk associated with commercial paper, particularly that tied to home loans, preferring T-bills instead. Central banks around the world have continued to inject extra reserves to maintain rate targets and increase systemic liquidity. The FOMC followed this up by temporarily dropping the discount rate by 50 bps to 5 3/4 percent and extending the term of loans from the discount window from overnight to 30 days. The Fed's discount window can accept a wide range of collateral - including unimpaired subprime loans - when previously term borrowings against such positions were not allowed.

We are still in the early stages of this new liquidity cycle. At this point it remains to be seen if tight liquidity will slow economic growth to the point that the Fed drops its inflation bias and turns its focus to the overall growth of the economy. Some think the lowering of the discount rate was the first step for the Fed in the easing of its inflation bias. The markets have fully priced in a Fed funds rate cut of 25 bps and the possibility that Fed funds may be cut by 50 bps at the September meeting.

Welcome to ALM First!

ALM First would like to welcome the following clients from the 2nd quarter:

Ledge Light Federal Credit Union
Groton, Connecticut
Bruce Fafard, President/CEO
\$153 Million in Assets

Eagle Legacy Credit Union
Arvada, Colorado
Sundie Seefried,
President/CEO
\$202 Million in Assets

Kinecta Credit Union
Manhattan Beach, California
Simone Lagomarsino,
President/CEO
\$3.7 Billion in Assets

ALM First 2007 Advisory Board

The ALM First Advisory Board was created two years ago and was established to provide guidance and input from a client perspective on the products and services of ALM First. Their input is an invaluable force behind the services we offer and develop for our clients.

ALM First would like to extend our heartfelt thanks and appreciation to the current members of the Advisory Board: Ron Barrick, CEO, Advantis Credit Union; Bernie Winne, CEO, Boston Firefighters Credit Union; M.J. Coon, CFO, Ent Federal Credit Union; and Kathryn Cook, CFO, Redstone Federal Credit Union.

The Advisory Board along with the principals and staff of ALM First enjoyed a night out at the horse races at Lone Star Park on May 10th, 2007.



Ask Emily



I am a director of a credit union and have been reading about failures involving CDOs and CLOs, what is the difference between these investments and a CMO?

If you are asking the question due to owning CMO securities (collateralized mortgage obligation), don't fret, from a credit perspective, there is a *huge* difference between an agency backed CMO security and a CDO security (collateralized debt obligation). CMO securities are backed by first lien mortgage loans. The underlying collateral of *agency* CMOs are conforming mortgage loans that have the de facto obligation of the United States Government.¹ CMOs made headline news in the mid-1990s due to interest rate risk not credit, as some of the higher yielding securities extended in weighted average life as rates rose, producing significant price losses. Most CMOs that are held today by natural person and corporate credit unions are safe, short term investments with a minimal amount of both credit and interest rate risk.²

CDOs are financial vehicles that bundle different kinds of debt, ranging from corporate bonds to mortgage pass-through securities, to debt backed by credit cards and cut this debt into "slices". These slices are sold to investors in the form of bonds. While the slices contain the same type of debt, they differ in terms with some paying higher interest rates and subsequently standing to lose the most should the debt become delinquent. CDOs have been around for over 20 years; however, they have become much more popular in recent years and are core drivers behind the surge in leveraged buyouts. Although they too have a degree of interest rate risk, recent losses have been caused by deterioration of the underlying collateral, specifically sub-prime mortgages. Looking at the collateral backing these investments can be mind-numbing, but to further complicate things, synthetic CDO structures can be purchased that are leveraged, multiplying losses.

CLOs (collateralized loan obligations) are giant pools of bank loans bundled together by Wall Street and sold off to investors also in slices. The main distinction between CDOs and CLOs are that CDOs usually contain mortgages in their pools. Both CDOs and CLOs aim to spread default risk. Unlike the efficient CMO market, investment offerings in these products (especially CLOs) are often private and largely unregulated, trading is very thin, and the securities are very hard to value. Case in point, in the recent Bear Sterns debacle, the fund priced these securities with a 6.75% loss in April and was forced two weeks later to solidify a loss of about 18%.

Hopefully your credit union does not own CDOs in its investment portfolio; which by the way are illegal investments for federally chartered credit unions. Owning CMOs can be a good or bad thing depending upon its structure; however, when it comes to credit risk, there is no comparison.

"Most CMOs that are held today by natural person and corporate credit unions are safe, short term investments with a minimal amount of both credit and interest rate risk."

¹ Federally chartered credit unions can purchase CMOs backed by non-conforming loans rated AA or better. Credit losses on AAA rated securities are rare.

² To learn more about CMOs, see the following Ask Emily articles; July 04, December 02, June 02, and March 02

ALM First Financial Institute 2008

The Gaylord Texan, Grapevine, Texas
January 29-31, 2008

The summer is quickly coming to a close and with it begins the fall planning and budget process for next year. Perhaps you're considering the training needs of your staff in 2008. Then consider the ALM First Financial Institute which will return to The Gaylord Texan in Grapevine, Texas on January 29-31, 2008.

The Institute offers ALM education sessions and training for credit union employees and board members in two tracks: Balance Sheet Management and Investments.

Financial performance is everyone's responsibility. When planning your educational requirements for 2008, be sure to include The Institute for your CEO, CFO, board of directors, and management staff. CPE credits will be offered for each session attended.

Watch our website for registration details and the full agenda. We look forward to seeing you in January!

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Gaylord Texan at night



Gaylord Texan Lone Star Atrium

Watch our website for registration details and the full agenda. We look forward to seeing you in January!

ALM First 2008 Annual Financial Forum

Believe it or not before this year's Forum was even underway we were already in the throes of planning for next year. As Angela mentioned in the Partner's Report, the 2008 Financial Forum will be held on the beautiful island of Bermuda. Get your passports ready; mark your calendar for August 11th, 12th, and 13th and make plans now to join us!

A few facts about Bermuda:

Official Currency: \$1.00 Bermudian = \$1.00 U.S.

Taxes: No sales tax in Bermuda

Travel Times: Approximately 2 hours from the East Coast of the U.S.

Travel Documents: As of January 8th, 2007, U.S. citizens, including infants and children, returning to the U.S. must have a valid passport. From this date, passports will be the only recognized travel documents for American travelers returning to the U.S.

Air Carriers: American Airlines: non-stop from New York (JFK) and Miami
Continental: non-stop from New York (Newark)
Delta Air Lines: non-stop from Boston and Atlanta
Jet Blue: non-stop from New York (JFK)
US Airways: non-stop from Washington D.C., Philadelphia and Charlotte, North Carolina seasonal
United Airlines: Chicago seasonal

Temperature: Average of 78 degrees from April to November

We're in the process of negotiating the details with the Fairmont Southampton and hope to have everything finalized shortly. Information will be posted to our website in the coming months.



*Make plans
now to join us
in Bermuda!*

LA DOTD FCU selected as Credit Union of the Year.

Congratulations to LA DOTD FCU for being selected by NAFCU as Credit Union of the Year in the below \$150 million category.

NAFCU's 2007 awards competition, "A Tribute to Innovation & Inspirations," honors the Professional of the Year, Federal Credit Union of the Year and Volunteer of the Year. Six winners were named from two asset-size categories – less than \$150 million and \$150 million or more. The awards competition is open to all NAFCU members and honors the credit union community's best performers.

"All of us at LA DOTD Federal Credit Union are honored to have been selected as the Small Credit Union of the Year. We are grateful to our members for allowing us to serve them, because without them, we wouldn't have a credit union," says Cary Anderson, president and CEO of LA DOTD FCU. "I am very proud of my board, leadership team and staff; their dedication and teamwork made this award possible."

LA DOTD Federal Credit Union was established in February 1939 with the original mission to provide comprehensive financial services to Louisiana Department of Transportation and Development employees and their family members.

Employee spotlight



Stacey Wilkerson, ALM Specialist

I joined ALM First in June of 2005 as a Financial Analyst analyzing and preparing client ALM reports. I still perform these tasks; however, I have since become an ALM Specialist. My additional responsibilities now include working directly with some of our Silver ALM clients. I've also had the opportunity to work on the development and implementation of some of our new online services which include: ALM First On-Demand and our new Liquidity Forecast Model.

I graduated from Texas Tech University with a bachelor's degree in Finance and Management Information Systems. This August, I graduated from the University of Dallas with a master's degree in Financial Services.

Now that I've finished school, I am in the process of re-adjusting to having free time again. So, I have decided to begin training for my fourth marathon. Additionally, my one year old Boxer puppy, Peanut, has started enjoying more trips to the dog park!

On the Calendar

VACORP FCU Financial Strategies Conference

September 13, 2007

Richmond, Virginia

Emily Hollis' Topic is:

"ALM and Investment Options"

Economics, Investments and A/LM Seminar

Hosted by the Maryland/District of Columbia Credit Union Association, October 23, 2007

Columbia, Maryland

Cullen Coxe and Mike Manley

will present:

"Is the Economy Headed Higher - Or Off a Cliff?"

"ALM Strategies in Flat Yield Curve Environment"

"The Role of Investments in Your Credit Union"

WesCorp Credit Union Outlook

September 19, 2007

Bellagio Hotel,

Las Vegas, Nevada

Tom Manley's Topic is:

"Developing a Portfolio Strategy to Fit Your ALM Needs."

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