ALMnews

ALM First
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ALM First Partner's Report

by Tom Manley, CFA
Partner

The recent market activity gave our staff and the participants of January's ALM First Financial Institute a lot to talk about. The Institute was our best one to date. The feedback that we received from the participants was outstanding, and the staff had a wonderful time visiting and working with our clients.

The successful Institute gives us a great springboard to launch into the ALM First Financial Forum, which will be held from August 11 – 13 at the Fairmont Southampton Princess in Bermuda. We expect this Forum to be absolutely the finest event we have ever produced. Be sure that your passport is valid and ready to go, because the wait times to get a new passport can be lengthy these days.

With 2007 being ALM First's best year ever, we have much to look forward to in the coming year. In the months leading up to the Financial Forum, you can expect to see a few changes in what we offer. You can also expect to see our name a little more frequently in the trade publications. Most of all, however, we will focus in 2008 on refining our current service packages with an emphasis on quality control and leveraging our new organizational structure. Our vision at ALM First is to be a strategic partner to each of our clients – not a vendor of service, but a team of people that you can rely on for expert advice and premier service at any time. It is a lofty goal, but it's one that we strive to achieve each and every day.

Of course, 2008 will not be without challenges. It was a little over a year and half ago when Emily, Angela and I sat down in the audience of a conference and listened to the head economist of a well-respected, major Wall Street investment firm talk about the pending sub-prime problem. He said it was largely a sectoral matter that would not greatly affect the overall economy. I remember thinking at the time that this was a brazen thing to say, considering that housing is the foundation of the U.S. economy. Oddly, to us anyway, this economist wasn't the only major firm economist espousing this viewpoint.

Roll forward to today, and we find the Federal funds target rate 225 basis points lower than where it was just six months ago. Fed Chairman Ben Bernanke recently testified that more rate cuts can be expected, and major dislocations of liquidity are popping up in unsuspecting markets. I will quote Steven Abrahams of Bear Stearns' Across the Curve publication: "The lesson of last year: Imagine the totally unexpected, and buy an option on that."

Even as we launch into the rocky economic environment of 2008, we at ALM First are excited about the prospects of our relationships with all of our business partners and the opportunities that the new day will bring us all. From Angela, Emily and myself, we thank you for your business.

Inside this issue

2008 ALM First Financial Institute is a Wrap

The Gaylord Texan on Lake Grapevine once again played host to the ALM First Financial Institute from January 29th – 31st.

The Institute is a two-day seminar that the staff of ALM First conducts, centering on discussing and learning more about risk, investments and economic analysis. The Institute is designed to be a hands-on course for those that do the asset liability management work at your credit union.

Two learning tracks were offered this year — ALM and Balance Sheet Management and Investment Management and Strategies. Some of the discussion topics included: Interest Rate Risk using gap, NII and NEV; ALCO Best Practices; Understanding Economic Statistics; Financial Events and Their Effect on Interest Rates; Investment Portfolio Strategies; and case studies.

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A popular session was *Rates, Curves and the FOMC* presented by Tom Manley, CFA. The presentation objectives were to understand the component makeup of an interest rate; discuss the role of inflation on interest rates; identify the various shapes of yield curves and the theories that attempt to describe the shapes; discuss how shifts in the yield curve impact return and to review the Fed and the FOMC and how they interact with the market.

"*The Rates, Curves and the FOMC* presentation was valuable because it did a good job on building a foundation for the rest of the workshop," said one Institute attendee.

Another attendee said, "It is a good refresher course on the technical definitions of the terms we throw around every day."

The workshop was a success with quality presentations, good food and good people.

ON THE CALENDAR

Financial Solutions Symposium
March 26, 2008
Omni ChampionsGate Resort
ChampionsGate, Florida
Emily M. Hollis' topic is: "If Your Balance Sheet is Stable, What Are Strategies You Can Use for the Next 18 Months?"

CU Conferences – Detecting Fraud and Managing Risks
June 3, 2008
Sheraton on the Falls Resort in Niagara Falls, Ontario, Canada
Angela Calvert's topic is: "ALM Tools to Forecast Liquidity and Strategies"

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"

ALM First Financial Forum
August 11th – 13th
The Fairmont Southampton Princess
Bermuda

VACORP Financial Strategies Conference
September 17, 2008
Richmond, Virginia
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"

2008 ALM First Annual Financial Forum

Imagine lush tropical gardens, shimmering pink sand beaches, azure blue seas and spectacular sunsets, and you have envisioned yourself in Bermuda at the 2008 ALM First Financial Forum on August 11 – 13. Attendees will enjoy the beauty of the Fairmont Southampton which overlooks the islands beaches and gardens. Guests of the Southampton can hit the links for a round of golf, grab a racket for a tennis match, snorkel their way around the reefs, ride the waves on a jet ski, explore the island on a scooter, or enjoy award-winning cuisine. Visit http://www.fairmont.com/Southampton for more information.

As you imagine yourself playing golf or relaxing by the sea, don't forget that we are in the process of putting together an impressive agenda of workshops and breakout sessions for you. The early-bird registration fee is $790 per attendee before May 29th and $850 thereafter for full registration. Financial Forum spouse/guest registration is $650 and includes all meals. Families with children attending the evening functions may incur a nominal charge.

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.

Full details and registration information will be available soon via our website. If you have any questions, please email Paula Beamis at pbeamis@almfirst.com or call 800.752.4628 xt.105.

Ask Emily

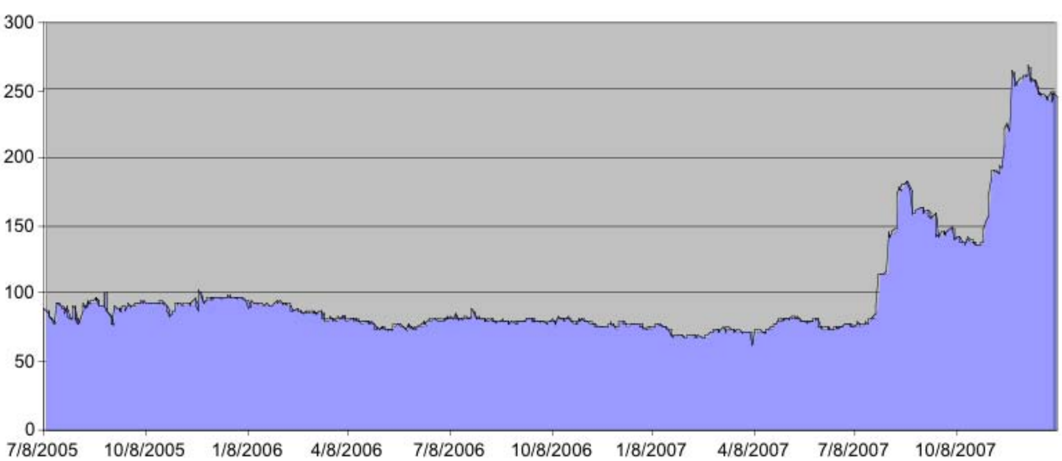
I read your article on FHLMC and their unrealized security losses. On one hand, I am scared to invest in anything; on the other hand, I am seeing yields close to 6 percent on securities backed by non-conforming loans. Are those safe? I don't want to be hit with losses.

Your fear is exactly why there is a growing spread between Treasury rates and other investment alternatives. But remember, there is a vast difference between unrealized losses and *actual* principal losses as defaults are realized.

AAA non-conforming first lien mortgage loans are trading at wide spread variances, specifically from 150 basis points over the relative Treasury to as wide as 300 basis points. We have been buying select non-conforming loans after rigorous analysis for those credit unions that understand the risk. Although a key determinant of yield is the projected weighted average life, spreads vary even amongst equal weighted average maturity securities. Although you don't mention what type of non-conforming loans you are considering, those yielding "close to 6 percent" are generally backed by hybrid adjustable rate mortgage loans[1]. The chart below shows the dramatic widening of AAA rated securities backed by 5/1 hybrid mortgage loans. Although these adjustable rate mortgage loans can have high average FICO scores, it is imperative to conduct a thorough analysis to assess the risk. An investor needs to understand the underlying collateral and support of the bond prior to purchase instead of simply relying on the rating.

"There is a vast difference between unrealized losses and actual principal losses as defaults are realized."

5/1 Hybrids - Spreads of Non-Conforming Loans



Continued from page 4

Credit support can be measured several ways:

The first dollar loss credit default rate (CDR)

The dollar credit enhancement of the investment pool

The credit coverage ratio

The first dollar loss CDR is a calculation which shows how much of the pool would have to default at an assumed loss recovery rate prior to losing principal. There are asset backed securities held by credit unions in the industry that consist of 25 percent subprime loans. Credit enhancements are so high on these types of securities that defaults would have to rise to 100 percent of the mortgage pool with a 50 percent loss recovery rate prior to principal losses. Even with the subprime loans, investors should feel very comfortable holding on to these types of securities for the chances of 100 percent of the pool defaulting is remote.

The dollar credit enhancement is the dollar amount of credit supporting the security. The credit support coverage ratio is a ratio which provides market participants the ability to determine the support coverage, based on assumptions for the performance of the loans within the delinquency pipeline.

AAA rated securities backed by hybrid mortgages can have credit enhancements as high as 13 percent. That credit enhancement percentage allows for a 12 percent CDR combined with a 30 percent loss severity prior to any principal loss to the investor.

It is difficult to imagine that loans with average FICO scores of 750 would have such severe losses; however, these loan rates will adjust higher should interest rates rise, in which case the mortgage holder might not be able to keep up. This is indeed why the FOMC is keeping rates low in an attempt to restrain defaults from their continual rise.

"Although these adjustable rate mortgage loans can have high average FICO scores, it is imperative to conduct a thorough analysis to assess the risk."

[1]*Hybrid mortgage loans are adjustable rate mortgages that are fixed for a period of time, generally, 3, 5, 7, or 10 years after which they float off of an index and typically reset on an annual basis thereafter.*

Interest Rate Predictions Generate Two Winners

Each year at one of her speaking engagements, Emily M. Hollis holds a Rate Prediction contest asking the audience to predict where interest rates will be in six months. The winners each receive a prize of $100.

Hollis held the 2007 contest on August 8 at the National Directors Conference in Las Vegas. On that day, she reported the following rates: overnight Fed funds 5.25%, 2-year Treasury 4.63% and the 10-year Treasury 4.86%. Audience members then made their six-month predictions.

On February, 8, 2008 rates were: overnight Fed funds 3.00%, 2-year Treasury 1.93% and the 10-year Treasury 1.97%.

"This year's contest had an interesting result as very few people had predicted a drop in rates," said Hollis.

A winner was selected from each session Hollis spoke at. And, the winners whose predictions were closest to the actual rates are:

Session 1:
H. Bruhn from First Community FCU in San Angelo, Texas.
Predictions – 4.25% funds, 3.75% 2-year and 4.95% 10-year

Session 2:
Bernard Wisniewski from Merck Employees FCU
Predictions – 4.25% funds, 4.0% 2-year and 1.97% 10-year

ALM First congratulates both winners!

Employee spotlight

Brian Park

Financial Analyst

I joined ALM First in 2007 as a financial analyst and am responsible for preparing NEV analysis and performing various "what-if" analyses for our clients. In addition, I also assist clients in their budget preparations. My job is very enjoyable and I look forward to learning new ways to ensure client satisfaction.

Prior to joining ALM First, I worked as an analyst for an electronic payments company. I graduated from Southern Methodist University with a bachelor's degree in finance and a bachelor's degree in economics. In my spare time, I'm taking flight lessons with plans to become a licensed pilot.

Welcome to ALM First!

ALM First would like to welcome the following clients from the 4th quarter:

Denver Fire Department FCU
Denver, Colorado
Mark Lau, President/CEO
$97 Million in Assets

Paragon FCU
Montvale, New Jersey
Richard Rays, President/CEO
$378 Million in Assets

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

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