

VANDERBILT *Ave.* ASSET MANAGEMENT

Emad A. Zikry, President and Chief Executive Officer

Let it snow, Let it snow, Let it snow...

Being stuck in LaGuardia Airport during a blizzard while trying to get home for your wife's birthday (ultimately unsuccessfully I might add) isn't fun. After a couple of hours you have read and re-read all the research you have brought along. After a couple of more hours you have read and re-read even the parts of the newspaper that you would normally disdain. Eavesdropping on your fellow travelers cell phone conversations is no longer an option (if it ever was) because all the good stuff has been said and all you will hear is whining and complaining which you are doing to yourself anyway. The book you brought with you is now your only time-passing resource and rationing it makes sense because the shops have closed and you have no idea how much longer you will be waiting. In short, you are left with a lot of time to ponder the state of the world, your business and your life. My ruminations on my life are hardly within the purview of a fixed income management mandate, and worldviews are best left to politicians, pundits and philosophers. That leaves thoughts about our business as fair game, so here are a couple of them.

Four letters, C, M, I, S. That is what my thoughts came down to. Four letters that have profoundly effected how I must now view the business in which I have chosen to make my career. Why these four? Because these four letters make the difference between "omission" and "commission" and between "mistake" and "take".

For years, I have steadfastly believed that the vast majority of errors on Wall Street fell into two categories: mistakes, or sins of omission. For instance, someone might have asked for a bid when they meant an offering – mistake. Or a salesman might leave out any negative aspect of a new issue offering when giving the sales pitch – sin of omission. These things are not good, but they are not malicious or malignant. Sure there were the exceptions, Ivan Boesky and Marty Segal come to mind, but those seeking to line their own pockets were just that, exceptions. Billions of dollars worth of securities get traded each day based on no more than the spoken word of one participant to another. We are overwhelmingly women and men of honor. That has been my belief for nearly thirty years. Recently, that belief has been shaken.

The ever-widening scandal in the mutual fund industry has thrown fistful after fistful of sand into the here-to-fore silky gears of my belief. Sins of omission have become sins of commission, where actions that may or may not have been legal but certainly were not right, were done with intent. This intent is what removes the "mis" making "mistake" into "take". This is wrong, it is an embarrassment to our profession and those involved should be ashamed. They must also be taken to task.

I am convinced this will happen, but then again, I have a dog in this fight...I still want to believe.

The second topic relates to new issue offerings. These days it seems that the folks at investment banks believe that it is a feat deserving kudos when a new issue bond is many times oversubscribed and tightens significantly in spread to Treasuries when it is free to trade. This is admittedly not a bad thing for those of us who buy new issues that pass our process. So, perhaps I should not look a gift horse in the mouth. But I got to thinking, isn't the issuer of the bonds paying the investment bank a not insignificant fee to effect a borrowing for them? Doesn't that obligate the investment bank to try and do so at the lowest possible borrowing rate required to get the deal placed?

Let's say I am the CFO of XYZ Corp. I wish to do a 10 year \$500 million financing. I select "Dewey, Cheatem and Howe" (apologies to the boys on "Car Talk" on NPR) to issue the debt for me. They price the deal at an interest rate 100 basis points over comparable Treasuries. At this price they receive five times as many offers to buy, as there are bonds available for sale. They allocate the available bonds to the potential buyers and call the deal a "blowout". Now the bonds are in the secondary market, and there are still a lot more people wanting to buy than there are people wanting to sell. The price on the bond responds to market forces and rises. This causes the spread to Treasuries to narrow by let's say 10 basis points. What does this mean to me as the CFO of XYZ Corp.? It means that since the coupon on the deal could have been 10 basis points lower, I now have the honor of paying 10 basis points more per year for the \$500 million I borrowed than I would have had to if Dewey et al had priced the deal to the actual market. That equates to an incremental interest cost of \$500,000 per year for 10 years, a grand total of \$5,000,000. Now admittedly, the banker has a balancing act to do, because overpricing a deal and having it not sell will tarnish the borrowers' name in the market and can be quite costly in the long run. But this is the expertise for which I paid several million dollars in deal fees. It seems to me that the pendulum has swung too far in one direction.

Maybe the chance to just sit back and think, a luxury we so often deny ourselves in this 24/7 world, is a silver lining in these blizzard clouds. Another, for me, is a chance to remember the last few lines of Robert Frost's "Stopping by Woods on a Snowy Evening" modified ever so slightly to fit this essay:

"These thoughts are lovely, dark and deep,
But I have promises to keep.
And miles to go before I sleep.
And miles to go before I sleep."

We are working hard to fulfill our promise of diligent effort to help achieve your goals, and we know that we have "miles to go before we sleep".

Odds and Ends

I guess the mess at Parmalat means that accounting shenanigans are not a U.S. monopoly after all. Or just someone trying to milk the company?

Its gallows humor, but you have to chuckle that the people that Herb Allison let go from TIAA-CREF call themselves "Herb-icides".

Business headlines do not often give me cause for a wry grin, but when I read that Roto-Rooter is buying a hospice company, I can't help myself. "...and away goes Grandpa down the drain...?"

Vanderbilt Research Team