

# Impressions

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## Things and Strings and Seal- ing Wax

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"O Oysters, come and walk with us!"  
The Walrus did beseech.  
"A pleasant walk, a pleasant talk,  
Along the briny beach:  
We cannot do with  
more than four,  
To give a hand to  
each."

The eldest Oyster  
looked at him,  
But never a word he  
said:  
The eldest Oyster  
winked his eye,  
And shook his heavy  
head--  
Meaning to say he did not choose  
To leave the oyster-bed.

But four young Oysters hurried up,  
All eager for the treat:  
Their coats were brushed, their faces washed,  
Their shoes were clean and neat--  
And this was odd, because, you know,  
They hadn't any feet.

Four other Oysters followed them,  
And yet another four;  
And thick and fast they came at last,  
And more, and more, and more--  
All hopping through the frothy waves,  
And scrambling to the shore.



The Walrus and the Carpenter  
Walked on a mile or so,  
And then they rested on a rock  
Conveniently low:  
And all the little Oysters stood  
And waited in a row.

"The time has come," the Walrus said,  
"To talk of many things:  
Of shoes--and ships--and sealing-wax--  
Of cabbages--and kings--  
And why the sea is boiling hot--  
And whether pigs have wings."

"But wait a bit," the Oysters cried,  
"Before we have our chat;  
For some of us are out of breath,  
And all of us are fat!"  
"No hurry!" said the Carpenter.  
They thanked him much for that.

"A loaf of bread," the Walrus said,  
"Is what we chiefly need:  
Pepper and vinegar besides  
Are very good indeed--  
Now if you're ready, Oysters dear,  
We can begin to feed."

"But not on us!" the Oysters cried,  
Turning a little blue.  
"After such kindness, that would be  
A dismal thing to do!"  
"The night is fine," the Walrus said.  
"Do you admire the view?"

"It was so kind of you to come!  
And you are very nice!"  
The Carpenter said nothing but  
"Cut us another slice:

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I wish you were not quite so deaf--  
I've had to ask you twice!"

"It seems a shame," the Walrus said,  
"To play them such a trick,  
After we've brought them out so far,  
And made them trot so quick!"  
The Carpenter said nothing but  
"The butter's spread too thick!"

"I weep for you," the Walrus said:  
"I deeply sympathize."  
With sobs and tears he sorted out  
Those of the largest size,  
Holding his pocket-handkerchief  
Before his streaming eyes.

"O Oysters," said the Carpenter,  
"You've had a pleasant run!  
Shall we be trotting home again?"  
But answer came there none--  
And this was scarcely odd, because  
They'd eaten every one.

From "The Walrus and the Carpenter, Lewis Carroll 1872

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## A follow up

It has become a regular state of affairs that the recipients of this letter actually read it for both content and apparently for errors. A number of readers pointed out errors in our last newsletter the Words of Wall Street.

The first alleged error was in the date. The letter was written during the summer using the header: Winter 2006. This was not a mistake. In Seattle, we only have three seasons, winter, late winter and road repair season.

The second was an actual mistake I referenced the incorrect speech in Henry V what I wanted to reference was the ST Crispian speech (Act 4, Scene 3).

Thanks to the Shakespeareans at Calyon for catching my error.

## **Why Lewis Carroll?**

There is so much happening so fast it is difficult to get perspective or offer any meaningful insight.

I quoted Lewis Carroll because in addition to being a very talented theoretical mathematician, and possibly a pederast he wrote Alice in Wonderland. His prose and wit in Alice describe a world without form or ready reference points like today.

## **How does a pervert connect to me as an investor?**

A good deal of the activity in today's world seems to be like Alice's adventures.

What was so crystal clear in those days following September 11, has now degenerated into name calling, invective, posturing and political gamesmanship which have done nothing to improve civility, civil defense or credibility. It has obscured the original issues. The events of 911 have given birth to conspiracy theories so bizarre only a defective would give them credence.

What should have been welcome tax relief is now tainted with class warfare and recrimination powered by clever propaganda and purposeful misdirection of facts and attempts to ignore reality

An attempt to correct a problem that everyone knows exists, the financial

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solvency of the Social Security system, became intergenerational warfare and fear mongering, stemming from colossal ignorance and the attitude “I have mine go away.”

Any attempt by a public figure to reach beyond the everyday wisdom is treated in the same manner as Alice’s Queen “execution first, trial latter.” We have become so hardened in our attitudes that we are unwilling to look beyond our own noses to see the dangers we face.

We face the fact that mere suspicion of criminal activity is sufficient to turn a person’s life into the living hell of endless media focus. So eager are we to ameliorate every perceived injustice that we have rules on the books banning inappropriately directed laughter (?). In North Carolina, we saw a prosecutor so eager to defend the rights of a woman allegedly raped that he rushed to judgment and prosecution with breathtaking abandon, with no thought to the ruination this could cause other.

At the same time, we continue to repeat the mistakes of the recent past by thinking that we can negotiate and temporize with incarnate evil, that we can endlessly rob Peter to pay Paul. Certain segments of the population act like the little Dutch boy with his finger in the dike, only in our case we are somehow trying to assure ourselves that largest economy in the world can somehow hold back the flood of globalization.

We see the nanny stateism of government passing legislation to control be-

havior from spitting on the sidewalk to smoking to bullying.

Yet at the same time, that supposed paragon of rationality and efficiency, the bond market continues to trade at credit spreads so narrow as to be ridiculous. The stock market soars upward on golden wings as if it has endless thrust and no stall problem.

All of these things we see happening along with the vague uneasiness, the feeling of unfulfillment, the paranoia, the desire to believe every conspiracy are consistent with the hinge points of great social and economic change. These are times when the rope of attachment to past certainties frays leaving us dangling over the chasm of uncertainty.

There are some constants with change. The first is that change itself is constant, the delta or rate speeds up or slows down but there is never a period without change. Second, the full effects of change can never be predicted. Individuals who have guessed rightly or wrongly about change are the stuff of legends.

Change does not have to be grand in scale in fact most large changes result from the accrual effect small changes whose compounding effects can only be seen from a historical perspective. I have the feeling that a number of small changes are beginning to coalesce into big changes.

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One of the changes, of course, was the end of the bull market in 2000. The terminal phases of bull markets feature various excesses that have to be worked off. The most dramatic work off was in the **.com** stocks which fell with the grace of an unpowered helicopter.

There was, for example, the relaxation of the standards for acceptable rates of return in corporate spending. Billions of dollars flew out the door with uncertain expectations of return. Many of those billions failed to achieve even the anemic return standards, think of the AOL/Time Warner merger.

For some time as a spoken or unspoken national policy, we have attempted to engage repressive nations by using our economy as platform to finance their economic growth. That policy has been realized by providing consumer markets for the goods produced by lesser-developed nations. In this manner, we have exported our inflation, caused by excess money chasing goods at high velocity, to nations who could produce goods at lower prices thereby importing disinflation.

Japan is the best historical example of this policy and the current beneficiaries of this largess are India and China.

This has been a very comfortable relationship for the United States but there are signs that it is ending. If we are no longer able to count on cheap imported goods our inflation could rise and that would have a damaging effect on the securities markets.

The flood of money and its low cost has led to a real estate boom creating financial structures in homeowner's balance sheets that look like something right out of Rube Goldberg. (Google Rube Goldberg and you will understand). Interest only, option ARMS, Combo Hybrids and other jargon tripped off the lips of would be speculators as they ran faster and faster to get a seat on the train. It was and is reminiscent of the end of the stock bubble.

WASHINGTON, Dec. 19 /PRNewswire/ -- A new Center for Responsible Lending (CRL) study reveals that 2.2 million American households will lose their homes and as much as \$164 billion due to foreclosures in the subprime mortgage market. Titled, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," the CRL study is the first comprehensive, nationwide review of millions of subprime mortgages originated from 1998 through the third quarter of 2006.

CRL's research suggests that risky lending practices have triggered the worst foreclosure crisis in the modern mortgage market, projecting that one out of five (19.4%) subprime loans issued during 2005-2006 will fail.

I could go on for pages with other excesses but those above segue nicely into what I want to say so I will exercise the power of the editor.

Bull markets and success tend to mask poor decisions. Poor decisions often become poor only through the lens of time. This is why people are still arguing about the events of the distant past and their effects on today. We have yet to see the full impact of the excesses since many of their causes are still in place.

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When the stock market was nearing its peak, the premium demanded for purchasing risk, (buying stocks) was 1.50% to 3.00% down from a more normal 5% to 7%. When people do not demand payment for risk, they are demonstrating lack of fear. Lack of cognition of risk levels is fertile ground for poor decisions.

In the bond market, risk is easily materialized by the different yields between issues of different credit quality. The base line is the yield on US Treasury bonds. Normally, the spread between BB bonds and Treasuries is 4% to 7%. Currently, it is more like 1.50%, which is excessively low.

Some of my friends particularly at Penn Capital are going to argue that the spreads are not so narrow as to pose risk but I am not convinced.

These narrow spreads are occurring when we have two huge issuers of bonds, GM and Ford teetering on the edge of bankruptcy. The effect of bankruptcies of this size will have a chilling effect on the markets. Yet investors are still willing to accept returns that do not compensate for the risk they are taking.

Those who continue to believe in the efficient market hypothesis will argue that the risk of default is already priced into the markets, again I am not convinced. The markets can stay irrational longer than a person can stay solvent.

One thing can be said with certainty, when credit spreads get this narrow it

usually is precursor to an impending credit event.

There are to be sure circumstances that are interdicting normal market analysis. The effects of the large number of hedge funds and private equity firms who believe they are hedging away the risks are one factor. The worldwide demand for yield by investors approaching retirement and still feeling the sting of the end of the bull market is certainly another factor. The demand from India and China to recycle our consumer dollars in the bond markets is another. Still in all investors are not demanding compensation for the risk they are taking.

Regardless of the arguments over risk premium, there are national and international policy issues that pose unappreciated risk. This letter is not a political organ but when the incoming Speaker of the House calls publicly for a 100% tax on capital gains and denies that a rising market benefits everyone it should wake someone up that things might change!

There is a real danger that the Democrats who deserved to win, will take their victory as a sign that everyone is unhappy with the direction of everything and attempt to make broad changes in fiscal, monetary, social and foreign policy. That would be a disastrous mistake and would have devastating effects on the capital markets.

Message to the Democrats: you were elected because the Republicans gambled and lost in Iraq and because the Republicans forgot they were supposed

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to be the party of smaller government. The fact is that most people like their lives.

If the incoming party acts like as Americans first and a political party second and puts the welfare of the entire nation first they will do a great service. Continued partisanship to the exclusion of government and leadership will result in loss of power.

The change in power in Washington poses another risk to the capital markets. Whatever your opinion of the rightness or wrongness of the Iraq situation or of George Bush as President or the war on terror we are at a critical junction. What happens next in Iraq will shape the future of many nations including our own.

The rise of a militant stream of religious zealotry is always worrisome, but when that fanaticism is founded on the basis that death is a preferable to life, it poses a direct contradiction to the fundamental concepts of western civilization. The struggle between these two great ideas will change the paths of both Islamic nations and of the west. So titanic is the struggle that it is almost Tolkeinesk.

Any thing that affects the nature and actions of the developed world and the future of 1 billion Moslems is going to affect the capital markets, yet people are not paying for that risk.

**Thanks Dennis, now you have scared the crap out of me during the Holidays**

From the above it would be natural to assume that I am terribly bearish about

the future of the stock and bond markets and of the United States in general. That assumption would be wrong.

In actual point of fact, I am quite bullish on the future. In this business one has to be optimistic, but that does not mean you do not worry and worry is what I do best. It is just too easy to be bearish.

I am bullish because behind the narcissistic self-centered part of the boomer generation is a whole mass of people who are going to change the world. They have seen the follies of their elders and learned the lessons. They are saving at incredible rates since they know that partisanship will deny them Social Security.

Yes, they are rude, coarse, uncivil and irreverent. They dress very poorly and their choice of music is abominable but time will rub off the sharp edges and leave the fine details

I am bullish because one of the truisms of the late Peter Drucker is coming true. A world united in economic communion is inherently a more peaceful place.

I think in the end the threat of the rise of militant Islam is less than the sum of our fears. I do not mean to minimize the risks posed by semi literate fools drenched in the blood of innocents, armed with nuclear weapons. They will strike us several times before this is over, but Islam is a dying religion and culture and these are its last gasps at power.

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We are going to have to fight the most insane of the Islamists. It will be long, dark, messy and dirty and we will have to do things that we will make us uneasy and are likely to suffer large casualties we will win in the end

No religion or society can be powerful for long by relegating 50% of its population (its women) to chattel status. Such relegation in Islamic nations is a direct violation of Koranic Law and it will not stand for long.

I am bullish because technology is advancing into areas that offer substantial opportunities to ameliorate some of the most intractable human problems in areas such as bio fuels, solar energy and the more efficient use of carbon energy.

Technology is no longer the exclusive purview of the western world its magic is spreading to the dark places of human existence. Technology alone has the power to improve the lives of massive numbers of people quickly. When people have a reason to live, they are less susceptible to demagoguery and fanatics.

Technology offers the opportunity to prove that the Malthusians, neo Malthusians, crypto Malthusians and their ilk wrong. Technology and the capital markets offer the chance to improve the environmental quality of life worldwide.

Technology can extend life spans and at the same time increase food production while streamlining distribution what a remarkable event in human history.

It will be a challenging time but it will be exciting for all concerned and it will be unpredictable. In the end, the old rules will reassert themselves. Wise investments given time and nurturing will produce returns that will satisfy the most critical person.

## The Year

When I was growing up, I was told never to criticize myself because there were always plenty of others around to do that and always be modest about your accomplishments. I do not live out the first lesson, no one is more critical of me than I am. That is why I tell people I have a real ass for a boss.

The second is something that I have attempted to live out. I have not trumpeted accomplishments in the past because I felt that there was little to crow about and I still feel that way. Any success I have had in the investment industry has come because of the clients of the firm and you the non-client readers of this letter.

By some happen stance I have fallen in with the most wonderful group of people I have ever known. Someday I hope that I can get you all in the same room because I know all of you would like each other. They tell me that a financial advisor's clients will always reflect his or her personality. If you all are a reflection of me then I must be a pretty good guy.

This year was a great year for our clients, for Sweetwater as a firm and for me personally. After many years of part

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time help, I hired an assistant. Susan is twice divorced, once widowed and raised six kids so she is eminently qualified to deal with me. She has been a godsend by helping me keep up with the paperwork and responding to client needs.

We have also added a great number of new relationships over the year almost all of whom came from referrals from existing clients. At the same time, we only lost one client during the year.

The number of women clients at the firm continues to increase which is still amazing to me. Our Native American business has prospered with several new relationships in place and a few more pending. We garnered some press coverage during the year (I am sinfully proud of these so copies are available for the asking).

It was also a good year because of people who helped me improve myself. People like Nicole Coulter and Miriam Lawrence at Horseshoek and the members of my practice study group who coached me and prodded me to do better and materialize the value of our service.

It was good year because of Harry Fong at Calyon and Bill Morehouse at A G Edwards, Chris Guttilla at Lehman, Mike Taylor at Stone and Youngberg, Sunny Dhody and Cheryl Goldstein at Deutsch Bank and the thousands of others I talk to every year.

In the end however, it was a good year because of you and the trust you have in me. Though all of you I have come to

realize my true place on earth and for that I have a lot to be grateful. Thank you seems so inadequate.

## **Final Words**

As 2006 rolls away, we all have a lot to be thankful for. We have homes and heat; we have food and cars to drive. We do not have to stand in long lines for gasoline or bread. We are not being hunted and killed for our beliefs; we have opportunities to both succeed and to fail. Unique in all the world we have the right to determine which fork of life we will take.

Be grateful. From the bottom of my heart, I wish you all a Merry Christmas and all my hopes for a prosperous, joyous and healthy new year.

*Dennis Gibb*