

An Exchange of Opinions: #2 – Teach Your Children to Invest
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If you've missed some of the prior articles, basic guidelines on successful investing are in my book "Stairway to Wealth" available at LuLu.com

Questions of general interest will be addressed in this column. Due to space limitations, not every question can be discussed in print although I'll try to respond at least once to every phone call (818) 500-9966. This month's first question comes from a recent conversation with S. McM. (Los Angeles, CA):

Q: I've personally been trying to teach my children to invest, but they learn nothing even though they've obviously been exposed to excellent instruction. Do you have any thoughts on the matter?

When we were a young, country parents took it upon themselves to instruct their children how to grow crops and raise farm animals so when they became adults they would not be dependent on the charity of strangers. For the same reason, it is now crucial that a child be taught how to invest. Strangers are dreadfully unreliable.

Consider this scenario: Little Amelia's mother started dressing her in designer clothes about the time the toddler began walking. Amelia originally didn't know any different, but her mother thought it was cute and Amelia learned from her. By the time she'd turned twelve she had trained you to pay for her Apple iphone (unlimited talk / text), her Louis Vuitton handbag, ("But everybody has one!") and her \$350 sunglasses. Amelia, the little cost center, is running you over a \$1,000 a month just to accessorize.

Once she gets a little older, you may prod her through some state liberal arts college but upon graduating with a bachelor's degree in liberal arts she'll be competing for waitressing jobs with high school dropouts having six years experience. So who's going to pay her mid-five figure tuition bill? With her income from the Cheesecake Factory running not much over minimum wage, she can't even pay for her sunglasses and her handbags and her iphone! You're hoping she'll no longer expect those things? Good luck with that!

The problem, as you can see, is twofold. First is to not accustom little Amelia to things she won't later be able to afford. Secondly, to teach her to not overspend her income. It's like night driving: don't drive faster than your lights.

So how to do this? How to have a good chance of training your child (1) to control her appetites and (2) to eventually to support herself? The answer, possibly, is "matching funds".

Obviously, she must be some minimum age before you even start this sort of thing, and it should be self-extinguishing at some reasonable point in the future when you no longer have to make any contribution to her maintenance at all.

Consider the following conversation:

You'll soon be nine, won't you? Nine is an important age, it's the age when you start to assume grown up responsibilities. So far, because you were a child, you've been receiving a small allowance just for being a member of the family. You didn't have to do anything for it. It was yours to do with as you wished.

But next week, when you become nine, you will begin your voyage towards adulthood. At that time we'll increase your allowance to \$1.00 a week. That's a lot more than your current 25 cents. It's not free, however; you'll be expected to earn the difference by helping around the house with chores suitable to your age. If you do the chores cheerfully and in a timely manner you will receive the full \$1.00 every Saturday. If you don't, then deductions will be taken and you will earn less, but it will never go below the quarter you're getting now.

As part of your increasingly adult responsibilities you will need to start paying for a portion of the things you want. We will, of course, continue to pay for your basic needs – that's "need", not "want" – with no co-pay from you. Think food at the family table, shelter, a basic wardrobe.

You will almost certainly want things beyond the fundamentals we provide, and for those, during your 9th year, you will be expected to pay 10% of the cost. We will pay the rest. So, for example, if you want a sweater from H&M that costs \$18.00, you will have to contribute \$1.80 out of your allowance.

Next year, when you're 10, your household chores will increase a little but so will your allowance. At that time we will pay for 80% of your needs and you will have to pay for the remaining 20%.

Becoming an adult means you will have privileges not available to children. But in exchange, adults pay their own way. To help you in this transition, your co-pay will continue to increase every year as you approach adulthood. When you are 18 you will legally be an adult and you'll be responsible for your entire costs. We'll be very proud of you. Now, let me introduce you to the concept of saving ...

What we're hoping to accomplish is to create, over time, young adults with the responsibilities that used to be expected with the rank. That's something you seldom see anymore. It's dreadfully common to see children in their mid-30's moving back in with mommy and daddy, an arrangement that pretty much shouts out to everyone that the parents failed their primary job, that of turning their children into responsible adults. Matching funds would go a long way towards shortstopping that embarrassing situation.

Even if the children are approaching middle age, it's not too late to begin the matching funds program. It'll just cost you more.

Q: I know it's complicated, but just exactly how did our current financial crisis come about? J.S. (Pacific Palisades, CA)

Eventually it'll probably be figured out, but right now I'm not sure anyone really knows. With that disclaimer, it seems to me that the first notice was given when the prices of single family homes rose to unsustainable levels. How do you know they were unsustainable? Because listing times extended more and more.

Do you remember how folks used to buy a home in Phase I of a new development and sell it, still un-lived in, at Phase IV? The developer arranged for prices to increase with each Phase, so there was a built-in profit, and the speculators just rode the train. But as listing times got longer and longer it became obvious that buyers had stopped buying, Speculators had nobody to flip the house to.

But it didn't stop with unsustainably high prices. Mortgage terms tightened, as well.

Speculative buyers often financed their purchase with NINJA loans. *No Income, No Job, No Assets*. These loans may have been funded by the bank, but they were immediately sold on the secondary market to investment bankers (the now defunct Lehman Bros. was a big player) who turned them into Mortgage Backed Securities (MBS). MBS's were a stream of income supported by the mortgage payments that were supposed to be paid by these NINJA borrowers. Risky? Not at all. First, mortgages had an historically low default rate. Secondly, third parties gave the securities their highest AAA credit rating and wrote insurance on them. Thirdly, interest rates were trending down and had been since President Reagan. Lowering interest rates increase the principal value of any MBS's you may have lying about (it's a capitalization issue: NOI divided by Interest Rate equals the current value of the MBS. We've discussed this before).

Convinced of their investment acumen, these investment bankers held an awful lot of MBS's in inventory. They were highly rated, insured, gave a good interest rate and the principal value seemed to increase almost by itself. What's not to like?

But, as somebody once said in another context, "money is the mother's milk of" commerce. And even though those MBS's gave a stream of monthly interest payments, investment banks often needed operating capital between payment dates. Think of them as if the investment banks operations were funded by a series of payday loans. The banks really didn't want to sell the MBS's: they liked owning them, but they needed working capital. What if they ... I don't know ... *borrowed* against the MBS's? Enter the repo market. The Repurchase Market was a small miracle because nobody ever lost, until they did.

Those idle MBS's we have? Why don't we borrow against them, short term, like Elizabeth said? What'll happen is we'll create an auction market where folks that want to make a

good return on short term, very liqued debt instruments can bid to lend us money collateralized by secure (remember, MBS's are both highly rated and insured) single family mortgages..

So here were Lehman Brothers (as noted, a big player in the repo market) and others getting good interest lending long term on the underlying mortgages while borrowing short term at a much lower annualized rate. *Goodness, Winston, it just doesn't get any better than this!* Then, one day, the news came out that mortgage defaults were up and it all stopped.

With individual defaults up, the underlying value of the MBS's offered as security declined. The lenders demanded more security which most of the investment banks could not provide. What we had were lenders who were not paid when their loan came due and could not sell the collateral they held.

Suddenly, big banks were insolvent (WAMU? Wachovia?). Mortgages became really hard to get because qualifying standards suddenly became onerous. With harder financing on top of reduced sales, the real estate market really went south, forcing the value of repo's to decline further, and the cycle spiraled out of control. Thus, the various stimulus programs.

That's how I think it happened, but nobody really knows yet.

Klarise Yahya is a Commercial Loan Broker. If you are thinking of refinancing or purchasing five units or more, Klarise Yahya can help. Find out how much you can borrow! For a complimentary mortgage analysis, please call her at (818) 500-9966 or email at KlariseYahya@SBCGlobal.net