Taking Stock: Muni bond-insurers down, but not for the count

by Malcolm_Berko

Dear Mr. Berko: Please give me your thoughts on MBIA and AMBAC, the two large insurers of municipal bonds. How did they get into such trouble that they now trade at 10 percent of their high prices last year? I'd like to buy 500 shares of each stock. What do you think of their chances of recovery?

C.H.

Moline, Ill.

Dear C.H.: In a time zone not too distant from today, when Merrill Lynch, Bear Stearns, CitiGroup and Morgan Stanley still bore some semblance of honor and trust, Ambac Financial Group Inc. (ABK-$9.41) and MBIA Inc. (MBI-$11.62) were trading in the $90s and $70s, respectively. Well Merrill, Morgan, Bear and Citi (now partially owned and controlled by their Arab and Asian investors) put their imprimatur on hundreds of billions of dollars of subprime securities and their actions destroyed the balance sheets of these two municipal bond insurance companies.

MBI now trades $11.62 down from $73 in May and ABK at $9.41 a share is down from its $96 high, also in May. Wall Street firms have a penchant for getting themselves in hot water together. And the subprime, collateralized debt obligations (CDOs) are a sad example. While those investments were collapsing, federal prosecutors contend that Merrill and others conspired to rig the values of these investments so they could be sold to investors at significantly higher prices. This is a criminal investigation and should give Merrill's municipal, corporate and government bond customers some real cause to pause.

Well in every black cloud even a blind hog can find an acorn and that nut is right in front of your nose. Both companies are too important to be allowed to falter. Imagine the myriad hundreds of billions of dollars of municipal bonds whose guaranties are dependent upon strength of the balance sheets of MBI and ABK. And imagine the brouhaha that would occur if thousands of bonds, issued by cities, counties and states, suddenly lost their triple-A ratings. A fracas, a rumpus and ruckus would ensue; the muni bond market would be in a dither while bond values in personal, bank and mutual fund portfolios would be all over the grid.

To compound the problem, many states, counties and cities would find it very difficult to fund their cash flow with new bonds. Within months our economy could begin to grind down, creating a financial chill that would slow commerce to a crawl. Hospitals, schools, police departments and other public services may be forced to reduce or eliminate their activities, unemployment might increase and there may be a lot of unhappy citizens walking the streets.

MBI, ABK and (nonpublic) Financial Guaranty Insurance Co. are too important to our economic well-being to be allowed to fail. I believe they will survive, they will be bailed out and I want you to recall how Congress rescued Chrysler from bankruptcy in early 1991 and be mindful that Congress also formed the Resolution Trust Corp. in 1989 in response to the insolvencies of 749 savings and loan associations.

MBI just raised $1 billion via a new issue offering and sure as shootin', MBIA should soon have its sails set at full mast. I'm certain as sunrise that it will happen - sooner rather than later.

Unequivocally, indubitably and absolutely, "Yes" I'd buy 500 shares of both MBI and ABK and I'd do it quick as a bunny. And I'd also buy 500 shares of Ambac Financial Group 5.950 percent Debentures of Feb. 28, 20133 (AKF) trading at $15.05, yielding 9.9 percent and callable at $25 as well as 500 shares of the STRATS 2007-01 6.70 percent AMBAC Financial (GJW-$14.15) that yield 11.8 percent and callable after Aug. 15, 2012 at $25. It's sort of like shooting craps but I got a good feeling that the dice may be slightly shaved in your favor.

Please address your financial questions to Malcolm Berko, P.O. Box 1416, Boca Raton, FL 33429 or e-mail him at malber@comcast.net.