

The Debit Crisis, Where It's Least Expected

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New York Times – The Indiana Children's Wish Fund, which grants wishes to children and teenagers with life-threatening illnesses, got an early Christmas gift nine days ago. Morgan Keegan, a brokerage firm in Memphis, made an undisclosed payment to the charity to settle an arbitration claim; the Wish Fund said it had lost \$48,000 in a mutual fund from Morgan Keegan that had invested heavily in dicey mortgage securities.

Coming less than two months after the charity filed its claim, and as a reporter was inquiring about its status, the settlement is a rare consolation for an investor amid all the pain still being generated by the turmoil in the once-bustling mortgage securities market. Before the Wish Fund reached its settlement, its mortgage-related losses meant that nine children's wishes would go ungranted.

Against the backdrop of all the gigantic numbers defining the subprime debacle, the Wish Fund's losses look like small potatoes. The crisis has generated almost \$100 billion in losses or write-offs at the world's largest financial institutions, cost a couple of Fortune 100 chief executives their jobs, wiped out billions of dollars in stock market value and hammered the reputations of the nation's top credit rating agencies. Reports of the devastation that foreclosures are wreaking on borrowers also bring home the effects of this remarkable financial mess.

Still, the Wish Fund's experience is instructive because so little has emerged about the losses that investors have incurred in these securities, perhaps because few holders have wanted to disclose them. Some investors may still not know how much they have been hurt by the crisis.

As this debacle unfolds, accounts of investor losses in mortgage securities will come to light. And Wall Street's role as the great enabler — providing capital to aggressive lenders and then selling the questionable securities to investors — will be front and center.

Richard Culley, a blind lawyer in Indianapolis, founded the Wish Fund in 1984; since then, it has granted 1,800 wishes to children ages 3 to 18. The fund has roughly \$1 million in assets and is not affiliated with the national Make-A-Wish Foundation. Local medical centers submit names for potential recipients.

The Wish Fund's foray into mortgage securities began in June, when Terry Ceaser-Hudson, the executive director, consulted her local banker, Steve Perius, about certificates of deposit coming due in the charity's account. She said the banker, with whom she had done business for 20 years, suggested that she invest the money in a

bond fund offered by Morgan Keegan. The firm is an affiliate of her banker's employer, Regions Bank.

Ms. Ceaser-Hudson's banker put her in contact with a Morgan Keegan broker to help her make a decision. Mr. Perius did not return a phone call seeking comment.

"I thought I was making a lateral move from the C.D.'s into this fund," Ms. Ceaser-Hudson said. "The broker said he'd put some thought into this and he had something perfect for the Wish Fund that was extremely safe."

That broker was Christopher Herrmann, and when Ms. Ceaser-Hudson met him at her banker's office, she quizzed him about the risks in the Regions Morgan Keegan Select Intermediate Bond fund, which he recommended.

"The first thing I said to him when I sat down was, 'I want to make sure that I understand this: you're telling me that this is as safe as a money market or C.D., because we cannot afford to lose one single penny,'" she recalled. "He said, 'This has been good for years,' so I thought, 'O.K.'"

On June 26, the Wish Fund put almost \$223,000 into the Morgan Keegan fund. The charity's timing could not have been worse. That same week, two [Bear Stearns](#) hedge funds, with heavy exposure to mortgages, were collapsing. Turmoil in the mortgage market, which had been percolating since late winter, was about to explode.

AT the helm of the Morgan Keegan fund was James C. Kelsoe Jr., a money manager at the brokerage firm's asset management unit, based in Birmingham, Ala. A longtime bull on mortgage securities, Mr. Kelsoe rode that wave and earned a reputation as a hotshot money manager. As of June 30, he also oversaw six other Morgan Keegan bond funds, which included about \$4.5 billion in assets.

One of Mr. Kelsoe's major suppliers of mortgage securities was John Devaney, 37, a flashy mortgage trader and founder of United Capital Markets, a brokerage firm in Key Biscayne, Fla. During the mortgage boom, Mr. Devaney built up a net worth of \$250 million, he told *The New York Times* in an interview early this year.

However much both men initially prospered from doing business together, some investors who wound up holding Morgan Keegan's mortgage securities were less fortunate — the Wish Fund, for example.

More than two weeks after Ms. Ceaser-Hudson invested in the Morgan Keegan fund, she received her first brokerage statement. She said she was stunned to learn that within days of its initial investment in the bond portfolio, the Wish Fund had lost \$5,000. By late September, with the credit markets frozen and the net asset value of the bond fund plummeting, Ms. Ceaser-Hudson ordered the stake to be sold. She received about \$174,000, representing a loss of 22 percent within 90 days.

On Nov. 2, she filed an arbitration case against Morgan Keegan, contending that Mr. Herrmann's investment recommendation was unsuitable for the Wish Fund and that he had breached his duty to it. A spokeswoman for Morgan Keegan said that neither Mr.

Kelsoe nor Mr. Herrmann would comment for this article. “Jim Kelsoe is fully focused on managing his fund portfolios during these volatile market conditions,” said the spokeswoman, Kathy Ridley.

The Morgan Keegan fund, which had assets of about \$1 billion in March, is down almost 50 percent this year. It was weighted with risky and illiquid mortgage-related securities.

For example, at the end of September, the intermediate fund in which Ms. Ceaser-Hudson invested had almost 17 percent of its assets in mortgage-related securities — including collateralized mortgage obligations, home equity loans and pools of mortgages that were again combined into collateralized debt obligations. Mortgage exposure in the six other portfolios that Mr. Kelsoe manages ranged recently from 5 percent to 14 percent.

For several years, Mr. Kelsoe’s embrace of mortgage securities paid off for his clients. His fund was started in March 1999 and generated positive returns each year until 2007. Through the end of 2006, it had an average annual return of about 4.5 percent, after taxes.

Mr. Kelsoe’s love affair with mortgage debt paralleled that of Mr. Devaney, one of those colorful and cocky Wall Street figures who appear during market booms only to sink from sight in the ensuing busts.

Living in a home on the Intracoastal Waterway, Mr. Devaney surrounded himself and his family with Renoirs and Cézannes. Outside floated his 142-foot yacht called Positive Carry, a reference to borrowing money at a lower rate than you receive on your investment. He also owned the house that was used as the setting for the [Al Pacino](#) film “Scarface.”

In addition to running United Capital, Mr. Devaney also oversaw United Real Estate Ventures and several hedge funds with roughly \$650 million under management as of early this summer. In July, he halted redemptions in the hedge funds as the market swooned for his favorite mortgage securities.

A 2004 profile of Mr. Devaney in US Credit magazine said that he considered Mr. Kelsoe one of his most valued customers. United Capital Markets, the article said, was most often a buyer of bonds from Wall Street and mortgage issuers; the firm had far fewer clients to whom it sold those securities. One of the biggest buyers was Mr. Kelsoe and his mutual funds.

“I have found John to be very aggressive in his ability to find interesting trading ideas,” Mr. Kelsoe was quoted as saying of Mr. Devaney in the profile.

Mr. Devaney did not return a phone call seeking comment.

Thomas A. Hargett, a lawyer at Maddox Hargett & Caruso in Indianapolis, represented the Wish Fund in its arbitration claim against Morgan Keegan. He declined to discuss the settlement struck by the firm and its former client. But he did say that “at the end of the day, your everyday broker and many investment

professionals did not understand the risk associated with these complex derivative mortgage investments.”

The independent directors who served on the Regions Morgan Keegan mutual funds' board also may have misjudged the risk.

The board includes Jack R. Blair, nonexecutive chairman of DJO Inc., an orthopedic equipment company; Albert C. Johnson, an independent financial consultant; W. Randall Pittman, chief financial officer of [Emageon Inc.](#), a health care information systems company; Mary S. Stone, a certified public accountant and [University of Alabama](#) professor; and Archie W. Willis III, a former first vice president at Morgan Keegan who is president of Community Capital, a financial advisory and real estate development company.

Another director, James Stillman R. McFadden, is chief manager of McFadden Communications, a commercial printing concern that does work for Regions Bank, government filings show. Between 2005 and June 30, 2007, Mr. McFadden's firm received \$2.46 million in revenue from the relationship, or 5 percent of his company's sales during the period.

Because most of the directors did not own shares in the devastated bond funds, they have not been hurt by their sharp decline. Among the six independent directors, only two owned shares in the funds as of last September: Mr. McFadden owned between \$1 and \$10,000 worth, while Mr. Willis owned between \$10,001 and \$50,000 worth, according to regulatory filings.

The Morgan Keegan spokeswoman said that none of the directors would be available to discuss their oversight or ownership of the funds.

Now that the Wish Fund's complaint has been settled, Ms. Ceaser-Hudson can carry on the organization's work.

Among the wishes that the charity recently granted were a family trip to Yellowstone National Park for an 8-year-old girl, Mary Ann, and her family and a meeting earlier this month between 14-year-old Samantha and Miley Cyrus, the [Disney](#) television star who plays Hannah Montana. (The Wish Fund did not release last names of recipients.)

In mid-December, Ms. Ceaser-Hudson set up a shopping spree, complete with limousine transportation, for Sabe, a 3 1/2-year-old handicapped boy with leukemia. Last April, Andrew, 17, got his wish to meet [Peyton Manning](#), the Indianapolis Colts quarterback, and to attend a team practice. The teenager, who had cancer, died a week after his wish was granted.

“What we do try to do is make every single wish a quality wish, no matter what the cost,” Ms. Ceaser-Hudson said. “We try to make it something the family and child will always remember.”