

## The Other Side of the Street April 6, 2008

### Comments

“I don’t think we are halfway through the fallout, because to think what happens in the financial markets doesn’t affect the real economy is nonsense... This whole crisis underscores the conceit of many in the markets that we can pretend to understand the properties of complex asset structures when they have cyclical sensitivities, and we have not experienced those since they were created.” - Legendary investor George Soros

I sit on a sunny Sunday in Dallas contemplating what my valued added can be when one of the world’s greatest investors has stated the current state of events so clearly and succinctly. The answer is the insight I have from seventeen years of exposure to accountant liability cases. In that work I saw the underlying facts in frauds ranging into the billions of dollars. The one thing that they all had in common was they started small and then grew to a point where they exploded on the tortfeasors. The lesson in today’s financial markets? When the SEC revises rules to permit further delays in the marking to market of the toxic waste on corporate balance sheets, we are very near the so big it will explode state. A specific application? How about the Bear Stearns chief testifying that if only the Fed had taken the garbage on BSC’s balance sheet for collateral, BSC would have survived. The unasked in follow up question? What prevented Bear Stearns from leveraging down the last nine months after its hedge funds blew up and it was expressly on notice that potentially dire times lay dead ahead? The answer is simple, corporations are not limiting risk as a result of Fed bailouts, they are emboldened to take much greater risks. The game ends when it become clear that not even the Fed can bailout things out this time.

In stark contrast to the foregoing, there is now a formidable media consensus that either “THE bottom is in” or “A bottom is in.” Either way, those who use technical analysis, Ouija boards and/or cat entrails to “invest” seem convinced that buy buy buying is the way to go. That this could be occurring three weeks post BSC \$2 takeover and on the cusp of a disastrous earnings season is simply amazing to me. What is pretty clear to me is that in short order (days, weeks, months – who knows) very lower lows will be forthcoming.

Now a few other items of note:

- Last year I commented on the size of the public debt. I am sure it will not surprise you that the “update” does not paint a picture supportive of THE bottom. --- **US Public debt - 02/01/2007 \$8,694,902,769,091.18 [this is up nearly 40% in less than 4.5 years (9/30/02 \$6,228,235,965,597.16)]** <http://www.publicdebt.treas.gov/opd/opdpenny.htm> 03/27/2008 Total debt 9,412,362,408,343.83 Increase in last 14 months 718 billion, 8.2%
- The April 3 rally was attributed to a report that Merrill Lynch's (MER, \$45.89, 0.55, **Spy**) chief said the investment bank has sufficient cash and will not need to raise funds. In different news that day, the New York Fed chief giving testimony on how Bear Stearns when from in good shape to broke in three days commented as follows: Asked whether

supervisors should have known about Bear's deteriorating conditions, Geithner said ``it's hard to know," given that collapses ``can happen very fast."

- And last but certainly not least, the horrible jobs numbers on Friday were viewed as a positive by some because it raised the possibility of a 50BPS Fed cut in April. Once again I am willing to concede the Fed can cut all the way to zero. Does anyone out there really think that another 50 or 225 BPS is all that is needed to get the economy booming?????????

We continue to live in a time that will puzzle future financial historians in terms of the collective denial and/or the complete breach of fiduciary duty by those entrusted with managing others money.

### Stock Notes

- A slowdown in consumer spending caused **Family Dollar Stores (FDO, \$20.38, -0.73, Spy)** to post a sharp drop in second-quarter earnings. The company also lowered its outlook for fiscal 2008.
- April 4 (Bloomberg) -- **Microsoft Corp.** is examining whether to cut its \$44.6 billion offer for Yahoo! Inc. because a U.S. economic slowdown has hurt the Internet company's business, according to two people with knowledge of the matter. The companies haven't made progress on negotiations since **Yahoo** rejected the bid in February, and there are signs that Yahoo's business has since deteriorated, one of the people said. They declined to be named because the talks are private. The possibility of a lower bid may step up pressure on Yahoo Chief Executive Officer **Jerry Yang**, who had sought an alternative that would appeal to investors. Since then, Federal Reserve Chairman **Ben Bernanke** has said the U.S. may be in a recession after losses tied to the collapse of the subprime mortgage market. Reuters reported earlier that Microsoft was re-evaluating its offer. Yahoo spokeswoman **Tracy Schmalzer** and a representative for Redmond, Washington-based Microsoft declined to comment. Microsoft, the world's largest software maker, offered \$31 a share in cash and stock for Yahoo on Jan. 31. Sunnyvale, California-based Yahoo rejected the offer Feb. 11.
- Dell is to shut a manufacturing plant for what is believed to be the first time in its 24-year history as it struggles to slash costs and rebuilt its profit margins
- Lehman Brothers is considering halting all new loans from its two British subprime mortgage units and putting further pressure on borrowers with a chequered credit history
- J.P. Morgan Chase said it bought 11.5 million shares of Bear Stearns shares on the open market for \$140.7 million on March 24, according to a filing with the Securities and Exchange Commission. All the purchases, which were made out of working capital, were made to "increase the likelihood that the plan to rescue Bear Stearns will be completed," J.P. Morgan said in the filing. **[For those of you who care this was almost 30 million higher than the offer price (average price was 12.23). It also happened to be the day before Jimmy Cayne dumped his 6 million shares for 10.84 per share. Which would not only create a market for Jimbo but reward the middleman 1.39 or 10+%. For**

those of you who believe this is a coincidence, the tooth fairy will be calling on you soon.]

### Notes

- **“The financial shock that originated in the U.S. subprime mortgage market in August 2007,”** reads a report from the IMF leaked today, **“has spread quickly, and in unanticipated ways, to inflict extensive damage on markets and institutions at the core of the financial system...The global expansion is losing momentum in the face of what has become the largest financial crisis in the United States since the Great Depression.”**  
The fund went on to lower its 2008 global growth forecast for the third time since July, now down to 3.7% global GDP expansion. The IMF defines a worldwide recession as annual global growth slowing to below 3%. Secretary of the Treasury Hank Paulson called the IMF’s fears “overblown.”
- **"We've heard other financial institutions say that they, in fact, can't truly verify the full value of their securities,"** said Sen. Robert Menendez (D-N.J.). **"So if we don't have a valuation of these securities, how are we so confident?"**
- **The fall of the loan-backed securities market has caused the student loan industry to grind to a halt.** Not a single muni bond backed by a bundle of student loans was bought or sold during the first quarter, says Thomson Financial. That hasn’t happened in 40 years. Since lenders generate capital by securitizing loans in their portfolio, the collapse of the loan-backed securities market has crushed their ability to make new loans. Bloomberg reports that the two largest originators of these tranches, Brazos Higher Education Authority of Waco and the Pennsylvania Higher Education Assistance Agency, have simply stopped making new loans.
- Unemployment jumped 0.3% as well, to 5.1%, a three-year high. A host of economists had predicted a net job loss, but today’s numbers far exceeded their expectations.
- **A typical trip to the grocery store will cost you 9% more today than it did a year ago.** The Marketbasket Survey, conducted by the American Farm Bureau Federation, says a basket of things like bread, milk, eggs and pork chops will cost you \$3.50, or 8.9%, more this year than last. A five-pound bag of flour and a dozen eggs were among the items that saw the greatest rise in price. Both are up over 40% since January 2007.
- Meanwhile, the subprime contagion continues to spread globally. **German bank BayernLB announced a \$6.7 billion write-down this morning,** thanks entirely to U.S. mortgage investments gone bad. Because of these losses, the German bank was just barely able to make a profit in 2007, Bayern reps said.
- So far, U.S. homeowners have lost probably about 12% of the wealth they thought they had in their houses. The total capital value of the residential housing market is about \$20 trillion. So, a 12% loss is equal to about \$2.4 trillion. A few foreign housing markets have been hit harder – Ireland, Spain and Iceland, for example. The equity markets have been hit by similar losses. Equity funds alone have seen \$100 billion of cash pulled out by

nervous investors. But here – something curious – “In an ugly global crisis, U.S. markets not so bad,” another *WSJ* headline. In 2008, the Dow is down 7.9%. But foreign markets are down more. France has lost twice that amount. Germany has dropped even more – 18.7%. But the biggest losses are in the go-go markets of the East. Indian stocks have lost nearly 20% of their value. The Shanghai stock market has fallen 32%. Overall, non-U.S. and Canadian markets are down about 15% – meaning, that the world’s equities have taken a loss of about \$4.5 trillion in local currency terms...or about \$3 trillion when measured in dollars. (The dollar has gone down so that dollar-based investors have lost less on foreign markets than local investors.) DR

- Analysts will take aid and comfort from the performance of the U.S. market so far this year; they will see it as a sign of strength that American equities have sunk less than others. But it is really a sign of weakness. While foreign markets soared over the last 10 years, U.S. stocks went nowhere. Having not gone up, now they’re not going down. And while they are not going anywhere, the value of the dollar continues to fall – wiping out stockholders’ real wealth. In terms of what they can buy on world markets, U.S. stock market investors have lost 25% to 30% of their purchasing power over the last decade. They’ll probably lose another 30% over the decade ahead. DR

### Web links

#### Credit

- Fitch Ratings on Friday cut **MBIA's**([MBI - Cramer's Take - Stockpickr](#)) pristine credit rating, dealing the financial guarantor an unexpected blow after a mad dash to raise its capital reserves earlier this year. The ratings agency downgraded the insurer financial strength ratings on MBIA Insurance Corp. and its subsidiaries to AA from AAA and the long-term rating of MBIA Inc., the parent holding company of MBIA, to A from AA. Fitch assigned MBIA a negative rating outlook. The downgrade impairs MBIA's ability to win new business, as it relies on a Triple-A rating to backstop public and corporate debt. "Fitch believes MBIA's pro-forma claims paying resources at year-end 2007 of \$16 billion now fall below Fitch's AAA capital targets by a range of \$3.4 [billion] to \$3.8 billion, but are consistent with Fitch's updated standards for AA capital," Fitch said in a statement announcing the ratings action. "These figures fully consider the \$2.6 billion of capital already raised by MBIA earlier this year." MBIA's largest rival, **Ambac Financial**([ABK - Cramer's Take - Stockpickr](#)), and other smaller guarantors were hit earlier by downgrades, as ratings agencies fretted about their ability to pay claims as the packaged debt the firms insure plummeted in value. The guarantor, which last month [asked Fitch to cease](#) rating its financial strength, immediately responded with a press release in which it said it "respectfully disagree[d]" with the agency's decision. "MBIA has a balance sheet that is among the strongest in the industry with over \$17 billion in claims-paying resources, and has a high quality insured portfolio, factors which we believe enable MBIA to meet severe economic stress scenarios," CFO Edward Chaplin said in a company statement. The firm in March told *TheStreet.com* it hoped to [pick up market share](#) from its competitors after raising \$2.6 billion in capital from public and private sources and seeing its ratings affirmed by Moody's Investors Service and

Standard & Poor's. On just Thursday, MBIA issued a press release touting its guarantee of \$373 million of a \$3.0 billion bond issued by the North Texas Tollway Authority. The guarantor characterized the deal as an "indication of MBIA's enduring commitment to infrastructure finance at the state and local government level." [http://www.thestreet.com/s/fitch-downgrades-mbia/newsanalysis/financial-services/10410807.html?puc=\\_htmlbooyah](http://www.thestreet.com/s/fitch-downgrades-mbia/newsanalysis/financial-services/10410807.html?puc=_htmlbooyah)

- April 4 (Bloomberg) -- **Delphi Corp.'s exit from bankruptcy was delayed after its proposed lead investor pulled out, saying the biggest auto-parts supplier to General Motors Corp. failed to meet conditions of their \$2.55 billion agreement. Appaloosa Management LP cited what it said were violations of the accord, including failure to show that Delphi could get \$6.1 billion in exit loans. Delphi said in a statement that it has the financing, was ready to close on its plan today and is "prepared to pursue actions," without elaborating.** The termination puts more pressure on GM to help Troy, Michigan-based Delphi raise the funding to end more than two years in bankruptcy. GM shares fell 4.7 percent. Appaloosa, which acted a day before a deadline to end the investment deal without paying a \$250 million breakup fee, has objected to a larger role for the automaker. "The whole thing has been a disaster for GM, and this is just another chapter," said David Healy, a Burnham Securities Inc. analyst in Sierra Vista, Arizona. "Ultimately, Delphi is going to emerge from bankruptcy with proper financing, but it may take more contributions from GM or a wait until the credit markets improve." Delphi's options include scuttling its reorganization plan and creating a new one or trying to reassemble the investment group. The company, which contends that it has met all conditions of the investment agreement, also could attempt to force the investors to commit to the accord or pay a breakup fee. **Delphi Bankruptcy-Exit Investor Appaloosa Pulls Out** <http://www.bloomberg.com/apps/news?pid=20601087&sid=arNC2D6dAJPk&refer=home>
- April 3 (Bloomberg) -- **New York Federal Reserve Bank President Timothy Geithner said capital markets are still "substantially impaired" and policy makers and financial industry leaders must "act forcefully" to stem the crisis.** "What we were observing in U.S. and global financial markets was similar to the classic pattern in financial crises," Geithner said in testimony to the Senate Banking Committee. **He cited "a self-reinforcing downward spiral" of asset sales, "higher volatility, and still lower prices."** The New York Fed chief also said that the central bank's emergency actions to rescue Bear Stearns Cos. were aimed at halting a crisis that would have caused "protracted" damage to the economy. Fed Chairman Ben S. Bernanke told lawmakers that while the aid wasn't a Fed bailout of Bear Stearns, it was true that the central bank "bailed out the markets in general." Fed officials are trying to defend the aid to Bear Stearns as an emergency move to avert deeper damage to the U.S. financial system. **Lawmakers are scrutinizing the deal, concerned that government funds may be at risk and that regulators failed to recognize the mounting crisis.** Securities and Exchange Commission Chairman Christopher Cox defended his agency's performance during the Bear Stearns collapse, **telling lawmakers that the SEC succeeded in protecting consumers.** Bear's brokerage clients were "fully protected," achieving the SEC's mandate, he said at the hearing. "Very Fast" Fed officials have noted that the SEC

is the prime regulator of investment banks. **Asked whether supervisors should have known about Bear's deteriorating conditions, Geithner said "it's hard to know," given that collapses "can happen very fast."** Senate Banking Committee Chairman Christopher Dodd, a Connecticut Democrat, **said the SEC was "seemingly unaware" of Bear Stearns's plight.** Bear Stearns Cos. Chief Executive Officer Alan Schwartz told the committee that the fifth-largest U.S. securities firm may have survived if the Fed had acted sooner to lend money directly to investment banks. **"It is highly, highly unlikely in my personal opinion that we would be in the situation we find ourselves in today" had the Fed opened the window earlier, Schwartz said.** Bear Stearns tried to confront rumors about the firm's viability, which may have been intended to "induce panic," Schwartz said. He added that it would be "appropriate" to probe the source of the rumors, and that the Fed's discount window may help prevent future bank runs. Geithner's 22-page testimony included a narrative on the events that led to the Fed's emergency loan for Bear Stearns, and the economic consequences if the central bank hadn't stepped in. 'Low-End Price' **"Absent a forceful policy response, the consequences would be lower incomes for working families, higher borrowing costs for housing, education and the expenses of everyday life, lower value of retirement savings, and rising unemployment,"** said Geithner, who was lead negotiator during the decision to finance \$30 billion of illiquid Bear securities in the takeover by JPMorgan Chase & Co., the first transaction of its kind. JPMorgan Chief Executive Officer Jamie Dimon said his firm was the only one "in a position to help," and that it "kept the riskier and more-complex securities in the Bear Stearns portfolio for our own account." **Treasury officials, who conferred with Fed counterparts, recommended a "low-end" price for the Bear acquisition,** Treasury Undersecretary Robert Steel said at the hearing. "There was a view that the price should not be very high, or should be towards the low end" because of the government's involvement and risk of moral hazard, or protecting those who took on risk, Steel said. **The New York Fed presented a one-page description of the portfolio. The assets include investment-grade securities and residential and commercial mortgage loans, all of which were current on principal and interest as of March 14.** The staff of some lawmakers will be able to review the full list on a confidential basis, the statement said. Fed's Impact The portfolio also holds collateralized mortgage obligations, most of which are bonds of government-sponsored agencies such as Freddie Mac and Fannie Mae. The holdings include asset-backed securities, adjustable-rate mortgages, commercial mortgage-backed securities and collateralized mortgage obligations issued by companies other than the agencies. Geithner, vice chairman of the Fed's interest-rate setting Open Market Committee, said the central bank's actions to date **"have helped avert substantial damage to the economy, and they have brought a measure of tentative calm to global financial markets."** "Policy makers and financial market participants need to continue to act forcefully," and "their actions need to be proportionate to the challenges," Geithner said. **"The Federal Reserve System's response has helped reduce the risk of systemic damage to the financial system and thereby helped mitigate a potential source of downside risk to growth,"** he added. Money Markets The current financial crisis is the worst since the Great Depression, billionaire George Soros said in an interview yesterday. "This will probably not prove to be the final bottom" in financial markets, he said. **He added that the Fed's ability to help by lowering interest rates further may be limited given a falling dollar.**

Geithner, 46, has advised the board on several efforts by the Fed that increased credit to financial institutions in the past seven months. The New York Fed administers the System Open Market Account, which is involved in money markets on an almost daily basis to set the federal funds rate, the main policy rate, which now stands at 2.25 percent. Officials have cut the rate 3 percentage points since September. The New York Fed manages the Primary Dealer Credit Facility, an overnight-loan mechanism set up for government bond dealers after the Bear Stearns rescue, and the Term Securities Lending Facility, which allows bond dealers to swap their mortgage securities for the Fed's holdings of Treasury notes for 28 days. In a question-and-answer period, Bernanke said the primary dealer facility was put in place March 16 to prevent a run on other brokers, and said it would have to be closed once the emergency conditions in markets subsided.

**Monitoring Banks** The New York Fed has examiners at the "major investment banks" so the central bank has the "direct capacity to assess the financial condition of these institutions," Geithner said. Geithner also presented lawmakers with an outline for overhauling the regulation of financial markets and banks, which spans more than a half-dozen agencies. His recommendations included a consolidation of regulators, a "stronger set of shock absorbers" in the form of more capital and back-stop financing at large financial institutions, and broader authority by the Fed to respond to "systemic" instability, including emergency lending. Geithner took the helm of the New York Fed in 2003, and previously worked as a Treasury undersecretary in the Clinton administration, when he helped coordinate the U.S. response to the Asian financial crisis. **Geithner Says Markets Still 'Impaired,' Urges Action**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=asvwnLeUqWBk&refer=home>

- April 3 (Bloomberg) -- **SPQR Capital LLP**, the London-based investment firm co-founded by former Deutsche Bank AG executives, delayed opening a fixed-income hedge fund and may cut as much as half its staff, according to a person with knowledge of the situation. **"We expect these volatile markets to persist through much of 2008 and as a result, we envisage reducing our cost base in order to adapt to market conditions," SPQR said yesterday in an e-mailed statement. "Recent months have seen increasingly challenging credit markets and high levels of volatility."** Bertrand des Pallieres, Deutsche Bank's former co-head of principal finance in London, said a year ago he and his colleagues would start the fund to invest in assets such as credit derivatives and collateralized-debt obligations. They also planned to open an investment bank. **Des Pallieres** couldn't immediately be reached for comment. **SPQR Capital Delays Opening of Credit Hedge Fund, Person Says**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aJ1ZycYedIZc&refer=home>
- April 3 (Bloomberg) -- **Consumers fell behind on car, credit-card and home-equity loans at the highest level in 15 years during the fourth quarter, another sign the U.S. economy is slowing, according to an American Bankers Association survey. [NOTE – this is the last quarter of LAST YEAR – i.e. BEFORE things got really bad]** Payments at least 30 days past due increased across all eight categories of loans tracked, the Washington-based group said today in a statement. Late loans climbed 21 basis points to 2.65 percent of all accounts in a consumer-loan index created by the group. "It's an

indication of the degree of stress consumers are facing right now," said Nigel Gault, director of U.S. research at Lexington, Massachusetts-based Global Insight Inc. **“People overextended themselves, they took out loans they thought weren't a problem as long as house prices kept rising.”** Lenders including American Express Co., the third-biggest credit-card network, and Capital One Financial Corp. doubled reserves for soured debt in the fourth quarter amid the worst housing slump in a quarter century. **Overdue bank-card accounts reached 4.38 percent in the quarter, according to the ABA,** as the slowing economy made it harder for consumers to repay debt. **The overall increase was driven by late payments for car loans, which make up two-thirds of all consumer loans with fixed balances,** ABA chief economist James Chessen said in the statement. Auto loan delinquencies rose to 1.9 percent from 1.81 percent. Overdue mobile-home payments rose to 2.92 percent from 2.87 percent. **“A Broader Tale” “The rise in consumer credit delinquencies is consistent with a rapidly slowing economy,”** Chessen said. “Stress in the housing market still dominates the story, but it's a broader tale.” Federal Reserve Chairman Ben S. Bernanke acknowledged for the first time yesterday that a U.S. recession is possible because consumer spending, employment and homebuilding will deteriorate this year. The U.S. economy grew at an annual pace of 0.6 percent from October to December. Growth probably slowed to a 0.2 percent annual rate in the first quarter, according to the median estimate of analysts surveyed by Bloomberg News. Rising late payments will continue in the first half of this year, as “food and gas prices remain stubbornly high and income growth is anemic,” Chessen said. **MasterCard Inc. Chief Executive Officer Robert Selander said in a March 11 interview that U.S. consumers are spending more on gasoline and food, crimping spending for luxury items.** MasterCard is the second-biggest payment-card network after Visa Inc. “What we see is a mix change in how consumers are spending,” Selander said in the Bloomberg Radio interview. “With the price of gasoline up approximately 30 percent from where it was a year ago, with commodities prices up and working their way into prices at the supermarkets, consumers are spending more of their money now on gas and groceries.” **Overdue Consumer Debts Highest Since 1992, ABA Says** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aIjf7nleXUcY&refer=home>

- March 30 2008 The challenges facing FGIC have deepened after Standard & Poor's cut the bond insurer's rating into junk territory and said the insurance provided by FGIC was now in effect worthless. S&P cut FGIC's insurance rating by six notches from A to BB, two steps below investment grade, citing its inability to raise capital or write new business. S&P said: “The credit characteristics of the underlying insured municipal, corporate, and structured transactions may be stronger than the FGIC-enhanced rating following the downgrade.” The move follows a downgrade from Fitch, which last week cut the insurer's rating to BBB from AA. The problems at FGIC are an extreme example of the havoc being wrought by bond insurers' exposure to subprime-tainted securities. Just four months ago, FGIC enjoyed a top-flight triple-A rating and was reassuring investors it was actively pursuing a plan to shore up its capital base. But after a series of multi-notch downgrades, a \$1.7bn mark-to-market loss on subprime-linked derivatives and increasingly intense regulatory scrutiny, FGIC's future is looking less certain. PMI Group, FGIC's principal owner, has also dismissed the possibility of contributing

additional capital. However, FGIC still intends to move forward with plans to address concerns about its viability and to restore its business franchise, according to a statement. It has sought approval from the New York State Insurance Department to hive off its municipal insurance unit from its riskier structured-finance operation, but progress on that front had been slow, said S&P. The rating agency said it was increasingly likely FGIC would be forced to go into “run-off” mode, meaning it would cease to write new business and simply tend to existing policy obligations. **S&P cuts FGIC rating to junk** <http://www.ft.com/cms/s/0/2bd051c4-fe8e-11dc-9e04-000077b07658.html>

- One of America’s leading banking associations has given warning that the United States faces a growing educational apartheid as some lenders withdraw from student loans amid new evidence that the credit crisis has spread across all types of borrowing. **In the past fortnight, some banks, including HSBC, have pulled out of the \$85 billion (£42 billion) a year US student loans market, fuelling anxiety that the turmoil that hit debt markets on Wall Street last summer is spilling over into the wider economy and making credit more difficult to secure for ordinary American households.** In the US, many undergraduates take out a federal guaranteed loan and top up their financial needs with a private loan from lenders such as Bank of America, JPMorgan Chase and Citi-group. In the academic year 2005-06, \$17 billion in private student loans was used to finance higher education. **Banks have become reluctant to offer private student loans because worsening credit conditions have meant that they cannot package up the loans and sell them on.** Although the brightest students who win places at America’s rich Ivy League universities will be affected less because of generous bursaries - which do not have to be repaid – less able students applying to other institutions are expected to face difficulty in securing private loans to fund their study. At one end of the field is Harvard University, with \$34 billion of endowments, and at the other are many community colleges and low-tier universities with limited resources. Joe Belew, president of the Consumer Bankers’ Association, said: “Some of the banks are getting out. Part of the reason is that Congress has cut the fees they could charge, making some loans pretty much unprofitable. **But part of the reason is that they can’t securitise the debt. The problems they have had with mortgage-backed debt – it’s the same thing at play in student lending.** “We have talked to some of the banks about this. It’s a painful decision to pull out because of the nature of the clientele – everyone wants to be in the business of helping people get ahead, but at the end of the day you still have to deliver value to shareholders. At the moment, it’s a fine line between hanging in there and pulling out. It’s a murky situation. **“If the overall market is contracting, then those students with poor credit scores or without the rich uncle co-signers [loan guarantor] may have real problems funding themselves.”** Last week, Iowa Student Loan said that it would soon stop offering private loans altogether. The group, which made 29,000 student loans last year, said: “This is really a reaction to the economy’s recent situation, the sub-prime market in particular.” Within the past fortnight, Montana Higher Education Student Assistance Corp said that a lack of appetite for buying debt such as student loans had led to its interest costs to finance such borrowing rising by a tenth, or \$3.4 million, since the beginning of February. Several members of Congress have urged the Bush Administration to stabilise the market after the National Association of Independent Colleges and Universities gave warning that student loans have become far harder and costlier to obtain since the credit crisis. Last October, as the credit crisis

on Wall Street was gathering pace, Washington introduced legislation limiting the returns that banks could extract from student loans. Concern over funding for students is also spreading to Ivy League institutions. The University of Pennsylvania's head of financial aid, William Schilling, has just written to banks demanding assurances they will continue to offer student loans. Speaking to The Times, Dr Schilling said: "We want the banks to tell us whether they will continue to offer [federal] loans and private loans for the next academic year. The key thing is not just whether they will lend at all, but what the terms will be." Dr Schilling said that although some of the loans are guaranteed by Washington and are therefore "very low risk", the market for them "has just gone away". **US credit crunch hits education as banks abandon student loans**  
<http://business.timesonline.co.uk/tol/business/economics/article3649021.ece?&EMC-Bltn=IJWAT8>

## Commercial Real Estate

### Commodities

- "Thirty-three countries around the world face potential social unrest because of the acute hike in food and energy prices," announced World Bank chief Robert Zoellick, one of the catalysts for yesterday's buying spree. For those nations, "there is no margin for survival."
- **Corn reached \$6 per bushel today for the first time in the history of the Chicago Board of Trade.** The toxic mix of biofuel demand and mandates, decreased 2008 planting expectations and [the lousy weather](#) we told you about yesterday has created a perfect storm -- excuse the pun -- for skyrocketing corn prices. Futures in Chicago have risen 30% this year already.
- Corn and wheat -- the American diet staples -- also shot up yesterday. **Wheat popped 4%, to \$9.36, in Chicago on word of exceptionally dry conditions in the Great Plains and abnormally wet soil in the Midwest.** Wheat traded as high as \$13 in March, but has since backed off.

## Currency

## Diversification

## Derivatives

- April 3 (Bloomberg) -- Lehman Brothers Holdings Inc., **seeking to get high-risk, high-yield loans off its books, created a \$2.8 billion collateralized loan obligation.** [a new iteration of creative accounting] Freedom CLO contains 66 loans, including debt the fourth-largest U.S. securities firm underwrote for buyouts, according to the indenture filed last week. **New York-based Lehman will hold a piece of the \$565 million subordinated note, the riskiest portion, according to the term sheet. The bank sold \$2.2 billion of bonds with investment-grade ratings.** [what does this sound like? If you said CDO's take a star!!!!] **Lehman joins Deutsche Bank AG and Credit Suisse Group in creating CLOs to reduce loans on their books without selling them in the**

open market. Banks have \$200 billion of buyout debt they can't easily sell after the price of leveraged loans tumbled to 88.8 cents on the dollar from 100 cents on the dollar last June, according to Standard & Poor's. [this is simply an accounting trick, they in effect are taking a loss by selling 2.8B for 2.2] ``Banks are focused on managing their exposure," said J. Paul Forrester, the Chicago-based head of the collateralized debt obligation practice at law firm Mayer Brown LLP. ``Balance sheet CLOs allow them to reduce the risk to the size of the subordinated tranche they are holding." Deutsche Bank created two balance sheet CLOs, both named Genesis, in September and November, according to Bloomberg data. Credit Suisse formed the \$1.7 billion Integral Funding in September. First Data, TXU Freedom contains loans to buyouts including KKR's First Data Corp., the Greenwood Village, Colorado-based payment processor, and power producer TXU Corp. of Dallas, purchased by KKR and TPG Inc. TXU was renamed Energy Future Holdings Corp. The portfolio also has loans that couldn't be sold to investors, including Sequa Corp., purchased in December by the Carlyle Group, and bank lines for companies such as Countrywide Financial Corp., the largest U.S. mortgage lender, and Imperial Tobacco Group Plc, the maker of Davidoff and West cigarettes, according to the prospectus. Loans for First Data trade below 90 cents on the dollar. **The Countrywide five-year revolving bank line is priced at 79.5 cents on the dollar, according to the prospectus.** Freedom CLO sold the bonds in a private placement. The \$2.2 billion in notes will pay interest of 2.25 percentage points above the three-month London interbank offered rate. That debt is rated A2 by Moody's Investors Service, the sixth level of investment grade, and an equivalent A from Standard & Poor's. **Lehman Creates CLO to Get Buyout Loans Off Its Books** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aeoqnMhRr4AE&refer=home>

## Housing

- March 31 Minyanville Existing home sales rose by 2.9% in February, the first significant rise in home sales since the housing market started to decline last year. I was in my car and listening to CNBC as commentators started to celebrate the bottom of the housing market. Since the credit crisis has its roots in the U.S. housing market, and will require a resolution of the housing market in order for credit markets to return to whatever will look like normalcy in the future, it's of more than passing interest to get a handle on the actual state of the housing market. So while this is about the U.S. housing market, it will also affect the credit markets worldwide, as well as impact China and other nations who sell to the U.S., because of the connection with consumer spending. This week we look at the data from sources that are actually involved in analyzing these markets. **Housing - Finding the Elusive Bottom** Let me acknowledge up front that much of what you will read is from two main sources. The first is John Burns of **John Burns Real Estate Consulting**, which he founded in 1989. John consults with over 2000 of the largest banks and homebuilders in the country (his client list is a who's who of banks, builders, and hedge funds). He has a reputation for solid research and pulling no punches. Some of his hedge fund clients were the ones you read about who made billions. (He wishes he had negotiated a percentage!) He's deeply involved in analyzing trends in the housing market. His web site is [www.realestateconsulting.com](http://www.realestateconsulting.com). He has graciously put the PowerPoint presentation that I'm working with on his site for you to read, should you

want to dig deeper. The second source is **T2 Partners**, a well-known value investing advisory firm in New York. They have a massive 76-page PowerPoint that you can review at your leisure at [www.valueinvestingcongress.com](http://www.valueinvestingcongress.com), crammed with facts on the true extent of the problems in the subprime mortgage markets. It's rather sobering. While the thrust of the presentation is to analyze the true extent of the problems at **Ambac** (ABK) and **MBIA** (MBI), there's a lot of data on the housing market as well. Remove sharp objects from your vicinity before you read it. So, the question we seek to answer today: Have we seen the bottom of the housing market? Was last month's small rise a sign of the bottom, as many on CNBC and elsewhere opined? First, let's look at five graphs from John Burns (out of several hundred that he graciously allowed me to review!). He points out that 16% is a national average, with some markets projected to do a lot worse. Here are his projections for the 20 largest markets. Note that in every market there are still more price reductions projected.



*Click to enlarge image*

The reasons for the declines are many. Let's look at a few. **First, we simply built more homes than the nation could absorb. In 2005 alone, there were 48% more housing-related transaction than there should have been.** Note in the graph below the large rise since 2000 of transactions above the expected sales trend line. Sales are now back to that trend line, but are expected to fall further. **Burns projects that sales activity will drop another 30%, to 1995 levels, and that will happen relatively soon. This is going to mean that homebuilding is going to be forced to slow even more.** Burns projects that permits to build new homes will fall anywhere from 32% to as much as 70% in the top 20 markets. The large majority of those markets haven't seen permits fall even half as far as Burns thinks they will. **Reality has not yet kicked in for many homebuilders. New and existing home inventories are hovering in the 10-month range and are likely to rise further as foreclosures put more homes on the market. This will likely mean that a buyer's market for at least another 3-4 years is the most likely scenario.**



*Click to enlarge image*

All this speculation created 3.5 million excess homes that need to be filled. There are about 2,000,000 more homeowners than long-term trends would indicate, and many of

these are buyers who used questionable mortgages to buy a home and are now in the foreclosure process. And as we will see later, it's going to get worse before it gets better.



*Click to enlarge image*

**But with the dramatic drop in the availability of subprime mortgages, we have reduced the number of potential home buyers. In many markets, the affordability of housing simply prices out many potential middle-class buyers.** And potential buyers of rental properties have not seen prices drop to where they can make a profit by buying and renting the homes. The following graph shows that nationwide it costs almost twice as much to buy a home as to rent. I know that it would cost me much more than twice in monthly costs to buy a condo or home that is the equivalent of my apartment. I can't mentally justify the extra expense today, although that may change, as there are a lot of condominiums coming onto the market this year in Uptown Dallas. It will be interesting to see if prices drop. Note the rise in the differential between renting and buying since 1998.



*Click to enlarge image*

But here is where the picture gets clouded. There are parts of the country where homes are quite affordable. Note the difference in affordability between the coasts and the middle of America. So, we have to be careful when we talk about the crisis in housing.

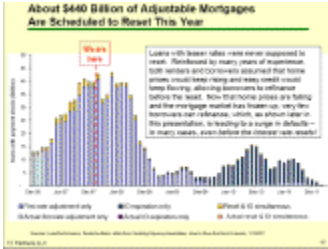
All real estate is local.



*Click to enlarge image*

Let's look at a few more facts. **Due to falling interest rates, a typical adjustable-rate mortgage, or ARM, buyer saw his buying power rise 55% from 2000 to 2004.** Since

**then there has been a 21% deterioration.** That has helped lower sales traffic for new homes to the lowest level since they began collecting statistics in 1985. But on a note of optimism, Burns notes the housing market is extremely cyclical. We have had times of extreme distress before, which typically last 3-5 years, and this one too shall pass. Burns projects that sales should be higher than current levels by 2012. Median resale prices will bottom out in 2010, only about 16% below the top. **Bottom Line? There is no Bottom in Sight** Burns' most likely timeline is that resale stability will come back by 2011, and it will be even earlier for the homebuilders. He's projecting 6,000,000 home sales (new and existing) in 2008, but falling to only 4,000,000 in 2009. Low sales volume and high foreclosures will delay inventory reduction, which is required for there to be a stable market. **This means that home ownership will fall to 66% of the population in 2009 from the recent high of 69%. He thinks that may overcorrect to 65% in 2010.** When I asked him why the overcorrection, he said it has to do with psychology. Housing will go from the greatest investment in 2006 to a bad one by 2009. The market typically overcorrects at the end of every cycle. It will take rising prices to lure the marginal homebuyer back into the market. We discussed the recent rise in the price of the homebuilder stocks, which he attributes to short covering. Many of the homebuilders, public and private, are selling land at 16% of book value, or are trying to. He suggests that many of the privately owned homebuilders are in the worst shape. Bottom line? We are nowhere near the bottom in the home markets. **Where is the Value in Housing?** In a lengthy presentation, the partners at T2 Partners state that we're still in the early innings of the bursting of the housing and credit bubbles - a theme I've also stated for quite some time. **Let's look at some facts they present. 8.8 million homeowners will have mortgage balances equal to or greater than the value of their homes by the end of March . . . 30% of subprime loans written in 2005 and 2006 are already underwater. . . . Nearly 3 million homeowners were behind on their mortgages at the end of 2007, with 1 million at risk of imminent foreclosure. . . . As of the end of last year, 5.82% (!) of all mortgages were delinquent, the highest level in 23 years. . . . 0.83% were in the process of foreclosure, also an all-time high. . . . When you look at just subprime mortgages, you find that 20% are delinquent (the number is rising rapidly), and almost 6% were in foreclosure. . . . Finally, the average American's percentage of equity has fallen below 50% for the first time since 1945. The Real ARMs Race** As an example, 5% of home sales in January of 2007 in San Diego were foreclosures. In January of this year, 34% of existing home sales were foreclosures. This is going to turn into a monster wave as ARMs reset in the coming years. As T2 notes: *"Loans with teaser rates were never supposed to reset. Reinforced by many years of experience, both lenders and borrowers assumed that home prices would keep rising and easy credit would keep flowing, allowing borrowers to refinance before the reset. Now that home prices are falling and the mortgage market has frozen up, very few borrowers can refinance, which, as shown later in this presentation, is leading to a surge in defaults -in many cases, even before the interest rate resets!"*



Click [to](#) [enlarge](#) [image](#)

***Mortgage lending standards became progressively worse starting in 2000, but really went off a cliff beginning in early 2005. The worst loans are those with two-year teaser rates. As the subsequent pages show, they are defaulting at unprecedented rates, especially once the interest rates reset. Such loans made in Q1 2005 started to default in high numbers in Q1 2007, which not surprisingly was the beginning of the current crisis." Look at the following chart, which shows the serious plummet in lending standards. How could a rating agency look at the statistics, which they surely had, and suggest that the probability of repayment would be the same as for loans made prior to this period? I mean, seriously. When 15% of loans in 2006 were for 100% loan-to-value with no documentation? Cue the lawyers.***



Click [to](#) [enlarge](#) [image](#)

*"The crisis has continued to worsen as even lower quality loans made over the remainder of 2005 reset over the course of 2007, triggering more and more defaults. It takes an average of 15 months from the date of the first missed payment by a homeowner to a liquidation (generally a sale via auction) of the home. Thus, the Q1 2005 loans that defaulted in Q1 2007 are leading to foreclosures and auctions in early 2008. Given that lending standards got much worse in late 2005, through 2006, and into the first half of 2007, there are sobering implications for expected defaults, foreclosures and auctions in 2008 and 2009, which promise to drive home prices down dramatically." And here is the most ominous quote in the entire 76 pages: ***"In summary, today we are only seeing the tip of the iceberg: an enormous wave of defaults, foreclosures and auctions is just beginning to hit the United States. We believe it will get so bad that large-scale federal government intervention is likely."*** I sadly agree. In an election year, it will take a brave politician to resist the siren call of "caring." 2,000,000 potential foreclosures, which is rather typical of the estimates **Merrill Lynch (MER)** may have to write down another \$4.5 billion this quarter, with other banks also continuing to add to their losses. And it's going to get worse. There were \$828 billion dollars of securitized first-lien mortgages made in 2005-7 that were comprised of loans that have little or no historical precedent in terms of documentation or loan-to-value. Another \$56 billion in second-lien mortgages*

were made with little or no attempt to actually and properly value the loans. These are loans that are likely to be in trouble. **A realtor friend in Dallas tells me she is involved in a "short sale," or an offer to the bank to buy a home for less than the mortgage on the home. They are offering \$560,000 for a home with a first-lien mortgage of \$620,000.yeah I said that doesn't sound too bad. Then she told me there was a second-lien mortgage for over \$400,000 that will be completely wiped out. We are talking about a home that lenders were willing to loan over \$1,000,000 on a year ago, that is going to sell for less than 60% of that.** \$1 million dollars in a Dallas suburb will buy you a lot of home. There has been no bubble here. And now, evidently \$560,000 will buy you a great home. Securitized second-lien mortgages are in real trouble. There are still tens of billions to be written down. And many of these loans were (and still are) rated AAA, don't you know! In a series of slides, T2 Partners graphically shows how lending standards plummeted in 2005-7. Default rates for June 2005 no-documentation loans (so-called liar's loans) are already over 30% in some categories. T2 projects that for no-doc loans from late 2005 and on, default rates could climb to over 70%! Citigroup projects that mortgage losses will exceed \$300 billion. T2 thinks this is way too low. They look at several mortgage-backed securities and slice into them. In one, the average loan is only 17 months old. Already 20% of the loans are 90 days delinquent or worse, and another 9% are 30-60 days delinquent. Statistics suggest that 65% of these loans will go on to become 90 days or more and then into foreclosure. And the interest rate resets have not even started! Go back to the second chart from T2. The combined loan-to-value of the loans made in 2006 was 89%. That means the average loan from 2006 is already underwater. 33% were made with 100% financing. With home values down in some areas by 40%, the temptation to simply walk away is going to be large. It will take many years for a homeowner to have any equity. One bright spot? Homes in the bubble areas are going to once again become affordable to middle-class citizens. Teachers, policemen, and firemen who could not afford to live in the cities they worked for will now have an opportunity, as will the young who have yet to buy their first home. It's time to hit the send button. So, let's wrap things up. Those who think we are close to a bottom in the housing bubble are engaged in wishful thinking. You read above what those who really do their homework are saying. If we had more space, I could give you even more statistics and forecasts from Gary Shilling, Greg Weldon, Dr. Nouriel Roubini and others who do their homework, rather than trying to see a trend in one month's statistics. Many of the home sales from February are foreclosures. Those are going to rise. The key pieces of data to look at will be the months of supply of homes for sale and foreclosures. Until the supply of homes gets back to 6 months, we will probably not have seen the bottom. Until we have worked through the millions of foreclosures that are in front of us, it is hard to think in terms of a bottom. We are in a recession, and that means rising unemployment and falling consumer spending. It means tighter profit margins. Etc. It is going to take a long time for the economy to recover. Welcome to Muddle Through. One final thought: If we do end up with a government bailout, and I agree that it's likely, I sincerely hope that no one who cannot document that the information they submitted for their no-documentation loan was accurate will be given any assistance. If you lied, you do not deserve taxpayer money. If you took out a loan on which you could not demonstrate that you could make the payments, just because you wanted to profit from a resale of a home which was "surely" going to rise, you should not get taxpayer money.

For every person we help like that, we keep a house from going down to a price that someone who deserves a home and has played by the rules could buy. Just my take. *John Mauldin, Best-Selling author and recognized financial expert, is also editor of the free Thoughts From the Frontline that goes to over 1 million readers each week. For more information on John or his FREE weekly economic letter go to: <http://www.frontlinethoughts.com/learnmore>. <http://www.minyanville.com/articles/MER-MBI-abk/index/a/16483>*

- March 31 (Bloomberg) -- **New York City's residential real estate market is showing the first signs of fallout as U.S. banks and securities firms cut the most jobs in seven years. Manhattan apartment sales fell in January and February from a year earlier and new properties came to the market at the fastest pace since at least 2000, according to data from New York-based real estate appraiser Miller Samuel Inc.** Transactions slid 6.4 percent to 3,250, while the number of condominiums, co-operatives and townhouses for sale at the end of last month climbed to 6,225, 15 percent more than at the start of the year. Declining sales indicate that the nation's most expensive urban property market may founder this year as Wall Street retrenches, said Miller Samuel President **Jonathan Miller** in an interview. Financial companies have taken at least \$208 billion in asset and mortgage-related writedowns. They've cut 34,000 jobs in the past nine months with more to come from the takeover of **Bear Stearns Cos.** "It's very much of a concern because while the share of jobs being lost is relatively small, the income effect is large," said **Marisa Di Natale**, senior economist at Moody's **Economy.com**, based in West Chester, Pennsylvania. "**Wall Street bonuses and salaries in particular have been propping up the Manhattan real estate market.**" **Bear Stearns Fallout** At developer **Ian Schrager's** 40 Bond St., the avant-garde lofts created by Pritzker Prize-winning architects Herzog & de Meuron aren't holding their prices. The Corcoran Group recently cut the price of a three-bedroom, 2,600-square-foot apartment by about 8 percent to \$5.5 million. The unit features wide-plank Austrian smoked oak floors, 11-foot ceilings and access to spa services. **Manhattan apartment prices have more than tripled over the last 10 years as employment and population climbed and crime plummeted.** The last time year-over-year prices dropped for a quarter was at the beginning of 2002, just after the Sept. 11 terrorist attacks. The last annual decline was in 1995, after the Federal Reserve increased **interest rates** seven times in a year. **JPMorgan Chase & Co.'s** planned buyout of Bear Stearns, once the fifth-largest U.S. investment bank, is rattling buyers and sellers now, said **Gregory J. Heym**, chief economist for Terra Holdings LLC. The closely held company owns residential brokers Brown Harris Stevens and Halstead Property LLC. **Price Gains** "**The amount of uncertainty, at least as long as I've been following the market, is unprecedented,**" said Heym. Bear Stearns, based in New York, employs about 14,000 people worldwide and paid \$2 billion in 2007 bonuses. Property prices are continuing to rise, for now. They gained almost 14 percent to a median of \$850,000 in the first two months of this year, Heym said. Miller, Terra Holdings and Corcoran will report first-quarter results this week. Condo and co-op prices rose throughout last year, gaining 6.4 percent in the fourth quarter of 2007 compared with a year earlier, according to Miller Samuel. Nationwide, the Chicago-based **National Association of Realtors** reported the first annual decline in median U.S. house prices since the Great Depression. **High End Up** The high end of the New York City market is the hottest. Buyers in the top 10 percent, those anteing up at least \$2.8 million, paid 28

percent more in the three months ended Dec. 31 than a year earlier, according to Miller. Sales at the Plaza, the famed hotel recently converted to condominiums, and the newly constructed 15 Central Park West have topped \$6,000 a square foot. Former Citigroup Inc. Chairman Sanford Weill paid \$42 million for his 15 Central Park West condo. **The market is changing for what Brown Harris Stevens broker John Burger calls the "middle luxury" category of \$3 million to \$7 million apartments.** Many brokers are scaling back sellers' expectations. "In 2006 and 2007, they looked at the last 12 months' worth of sales and priced their apartments at 10 percent more," Burger said. "Today they are sitting down with the soon-to-be listing broker and saying 'Do you think we can get what they got in '06?'" Miller estimates the number of deals closed in Manhattan has fallen 6.4 percent and Heym at Terra says they have dropped about 4 percent. Neil Binder, co-founder of the Bellmarc Cos., said contracts signed at his firm in January and February were down 20 percent. **More Job Cuts Finance jobs drive the Manhattan market. The median apartment price has roughly tracked Wall Street bonus income since 1997, according to Miller. Employment at investment banks accounted for almost 15 percent of the city's total privately paid wages in the first quarter of 2006,** according to the U.S. Bureau of Labor Statistics. "Any time you lose financial sector jobs that's problematic for the city economy because these jobs are so much more highly compensated," said Ronnie Lowenstein, director of the New York City Independent Budget Office. Future real estate gains are in jeopardy over the next two years because Wall Street may cut another 25,000 jobs by 2010, Di Natale estimates. Sellers are feeling the pinch. Prudential Douglas Elliman Real Estate broker Liviya Abramov dropped the price of a West Village apartment almost 11 percent to \$715,000 after the one-bedroom with a doorman and garden failed to lure a buyer. "I had to convince my seller," Abramov said. "It's the market." **Manhattan Home Market Slows as Wall Street Cuts Jobs**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=ablSPpNgcHsY&refer=home>

## Housing Finance

## Macro Economic

- April 1 (Bloomberg) -- Confidence among Japan's largest manufacturers fell to a four-year low as Toyota Motor Corp. and Canon Inc. struggle with the yen's rise and a deepening U.S. slump. The Tankan index of manufacturer sentiment slid to 11 points in March from 19 in December, a second quarterly decline, the Bank of Japan said today in Tokyo. The median estimate of 30 economists surveyed by Bloomberg was for a drop to 13 points. Waning confidence among large makers of cars and electronics, the exporters that have driven the nation's growth, may prompt the Bank of Japan to follow the U.S. Federal Reserve in lowering interest rates. Large companies said they plan to cut capital spending by 1.6 percent this fiscal year, the worst projection since the economy emerged from a recession in 2002. "Japan will probably have a mild recession in the first half of 2008," Glenn Maguire, chief Asia-Pacific economist for Societe Generale SA in Hong Kong, said on Bloomberg Television. "The two major drivers -- investment and exports - are clearly at risk." **Japan Tankan Business Confidence Falls to 4-Year Low**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=a2ww82G9Z648&refer=home>

- March 31 2008 - The euro rose to a record high against sterling and reversed earlier losses against the dollar on Monday **after an unexpected rise in eurozone inflation. Lifted by rising food and energy prices, headline inflation in the region hit 3.5 per cent in February, up from 3.3 per cent in January, and the highest reading since June 1992.** Meanwhile, economic sentiment in the eurozone fell to a 28-month low in March, led by a decline in confidence in the services and construction sectors. "The latest batch of Eurozone data makes grim reading for the European Central Bank as it reveals a very unappetising mix of slowing growth and rising inflation," said Martin van Vliet at ING. "But the fresh surge in inflation will encourage speculation that the ECB will keep interest rates on hold in coming months," he added. The euro hit a record high of £0.7967 against sterling, with the pound further undermined by numbers showing UK house prices fell for a sixth-consecutive month. Hometrack, the research company, said prices fell 0.2 per cent in March, taking annualised house price inflation to just 0.4 per cent. By late morning in London, the euro was up 0.3 per cent to £0.7948. The pound fell 0.2 per cent against the dollar to \$1.9896. But an early bounce for the dollar against the euro faded, leaving the US currency down 0.1 per cent at \$1.5808. Meanwhile, the euro climbed 0.4 per cent to ¥157.26 against the yen. Euro bounces on surprise inflation jump [http://www.ft.com/cms/s/0/6a51bde0-ff0e-11dc-b556-000077b07658.html?nclick\\_check=1](http://www.ft.com/cms/s/0/6a51bde0-ff0e-11dc-b556-000077b07658.html?nclick_check=1)
- March 31 (Bloomberg) -- Japan's manufacturers cut **production** in February for a second month as the U.S., the country's biggest export market, verged on a recession. **Output** fell 1.2 percent from January, when it slid a revised 2.2 percent, the Trade Ministry said today in Tokyo. The median estimate of 32 economists surveyed by Bloomberg News was for a 2 percent drop. The first back-to-back declines in production in nine months indicate companies including Canon Inc. are concerned world demand will slow as the U.S. economy grinds to a halt. Economic and Fiscal Policy Minister **Hiroko Ota** said last week the U.S. slowdown may start to take its toll on the emerging markets where Japan ships more than half its exports. "Output is at an adjustment stage," said **Naoki Murakami**, a senior economist at Goldman Sachs Group Inc. in Tokyo. "The drop might be softer in the next two months but we don't see signs of a production recovery yet." Companies surveyed said production will rise 2 percent in March before falling 1 percent in April. The yen weakened to 99.95 per dollar as of 10:58 a.m. in Tokyo from 99.24 before the report was published. The yield on Japan's 10-year bond fell 2 basis points to 1.25 percent. Reports last week showed a deepened housing slump is taking its toll on American consumers and that the U.S.'s six-year expansion may be ending. Japan's economy is also worsening, with unemployment rising in February, household spending stalling and inflation quickening to the fastest pace in a decade. Tankan Survey Growth in the U.S., the world's largest economy, will slow to 1.5 percent in 2008, according to the median estimate of 82 economists surveyed by Bloomberg News. That would be the slowest pace in seven years. The Bank of Japan's quarterly Tankan survey of business confidence, due tomorrow, will probably show that sentiment among the country's biggest manufacturers fell in March to its **lowest level** in four years. The yen's rise and record oil prices are eroding profits, just as the U.S. slowdown is hurting sales. **Canon**,

the nation's largest camera maker, forecast that belt-tightening among U.S. consumers will cause sales in the Americas to fall for the first time in nine years. [Toyota Motor Corp.](#), Japan's biggest carmaker, this month said the company may miss its 2008 sales target because the yen's gains make its cars more expensive overseas. The rising cost of steel is also making each sale less profitable, it said. The yen has risen 14 percent against the dollar this year. BOJ 'Flexible' The risk of a slowdown has investors betting the Bank of Japan will reverse its policy and cut interest rates this year. Traders see a 59 percent chance the central bank will lower the key [rate](#) from 0.5 percent by December, according to JPMorgan Chase & Co. calculations. Three central bank policy makers -- acting Governor [Masaaki Shirakawa](#), Deputy Governor [Kiyohiko Nishimura](#) and board member [Miyako Suda](#) -- this month said that the bank is ready to take "flexible" policy steps if needed. "Recent remarks by BOJ policy makers suggest the bank could cut rates if needed because downside risks are emerging," said [Hiroaki Muto](#), a senior economist at Sumitomo Mitsui Asset Management Co. in Tokyo. "They've already laid the groundwork for a cut." Still, demand from Asia and Europe has so far helped manufacturers weather the drop in U.S. sales. From a year earlier, production rose 4.2 percent, today's report showed. Output has increased for 31 months on a year-on-year basis. 'Still Holding Up' "There's no question that there's a severe downturn in the U.S. economy, almost certainly a recession, but the rest of the world is still holding up," said [Julian Jessop](#), chief international economist at Capital Economics Ltd. in London. **Japan Factory Output Falls 1.2%, Second Monthly Drop**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aPLs316XAcWU&refer=home>

## Retail

## Retirement

## Risk

## Savings Rate

## Tech

## Wall Street

- April 3 (Bloomberg) -- [Bill Miller's](#) Legg Mason Value Trust posted the biggest first-quarter drop since opening 26 years ago on losses from longtime holdings such as [Sprint Nextel Corp.](#) and newer bets including Bear Stearns Cos. The [\\$12.2 billion fund](#) fell 20 percent, trailing all but four of 660 rivals that buy stocks of companies with market values of more than \$15 billion, according to data from [Morningstar Inc.](#) in Chicago. Last year, Miller lost 6.7 percent, including dividends, compared with the average 6.2 percent gain among similar mutual funds. The manager, whose 15-year record of beating the [Standard & Poor's 500 Index](#) came to an end in 2006, is lagging behind the U.S. benchmark for the third straight year. It's his longest slump since he joined Baltimore-based [Legg Mason Inc.](#) in 1981. "It's been an absolutely hideous quarter, but you cannot write him out," [Russel Kinnel](#), director of fund research at Morningstar, said in an

interview. "He's had uncanny luck in previous years where everything worked out, but this time he's been where you just didn't want to be." **Bill Miller Has 'Hideous' Quarter With Old, New Picks**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aIBwPNN5DgUY&refer=home>

- April 3 (Bloomberg) -- Bear Stearns Cos. Chief Executive Officer Alan Schwartz said the fifth-largest U.S. securities firm may have survived if the Federal Reserve had acted earlier to lend money directly to investment banks. **Schwartz discussed such a change in Fed lending rules with Senate Banking Committee Chairman Senator Christopher Dodd at a meeting "some months ago," the senator said at a congressional hearing today where Schwartz testified.** Dodd didn't say whether the idea was proposed to the central bank then. The Fed agreed to provide emergency funding to New York-based Bear Stearns on March 14 after a run on the company put it on the verge of bankruptcy. Two days later, after brokering an agreement for JPMorgan Chase & Co. to buy Bear Stearns, the central bank said it would start lending to securities firms directly for the first time since the Great Depression. **"I do believe that as a policy measure, had the discount window been opened to investment banks for their high-quality collateral, I think it is highly, highly unlikely in my personal opinion that we would be in the situation we find ourselves in today,"** Schwartz told members of the Senate Banking Committee. Schwartz said the Fed's rescue effort on March 14 didn't help, partly because it singled out the firm in trouble, which exacerbated the panic about Bear Stearns. Even if the Fed had then let investment banks borrow from the central bank directly, it may have been too late to save his firm, Schwartz said. Didn't Seek Capital Bear Stearns didn't seek new capital to strengthen the firm as markets were under pressure because it didn't have the billions of dollars in writedowns some competitors did, Schwartz said. Analysts, including David Hendler of Creditsights Inc., have suggested such a move may have pre-empted the concerns about Bear Stearns's financial health. Citigroup Inc., Merrill Lynch & Co. and 15 other financial institutions have raised more than \$142 billion of fresh capital since July. Schwartz agreed to sell Bear Stearns to JPMorgan for a fraction of its value last month. **The run on his firm happened because false rumors were spread, Schwartz said. "It looked like there were people that wanted to induce panic," Schwartz told the Senate panel. "There are lots and lots of reasons why people can have a financial motivation to induce panic."** [would not have mattered if not over levered] Investments banks' ability to borrow directly from the Fed should become permanent to prevent similar runs, Schwartz said. Because the barriers between commercial banking and investment banking were removed with the repeal of the Glass-Steagall Act in 1999, securities firms need to have the same access as commercial banks do, Schwartz said. **Bear May Have Survived If Fed Acted Earlier, CEO Says**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aBS7S8GY1v4c&refer=home>
- April 1 (Bloomberg) **[April Fools in US – things must be wonderful, contraction is less than expected – it is all a buying opportunity fans. Get them before they go DOWN]** -- Manufacturing in the U.S. **contracted less than forecast** in March, **easing concern that less consumer spending and business investment will cause a deeper**

**economic slump.** The Institute for Supply Management's **manufacturing index** increased to 48.6 from 48.3 in February. **Fifty is the dividing line between contraction and expansion.** The Commerce Department reported in Washington that **construction** spending in February also dropped less than economists had forecast. Traders pared bets on a half-point interest-rate cut by the Federal Reserve this month **as the reports indicated the economy may have a shallower recession.** [so are we actually now having a recession? Oh, right that is "priced in"] Exports are helping sustain factories as domestic demand falters, the ISM report showed. **"The bottom line is this economy is still contracting; the good news is it's not a huge amount,"** said Nariman Behraves, chief economist at Global Insight Inc., a Lexington, Massachusetts, forecasting firm, on Bloomberg Television. Data, along with Fed efforts to stabilize financial markets, point to a "short and fairly mild" recession, he said. Economists **forecast** the ISM measure would fall to 47.5, according to the median of 71 projections in a Bloomberg News survey. **"The economy is entering a recession, but not falling off a cliff," said Robert Dye, senior economist at PNC Financial Services Group in Pittsburgh.** "So far, it looks to be a short and shallow event." **New Orders The ISM gauge of new orders decreased to 46.5, the lowest since October 2001, while a production measure fell to 48.7 from 50.7. Supplier deliveries rose to a 53.6 reading, from 50.1 in the prior month.** [i.e. forward indicators worse back ward looking indicators better – bottoms in!!!!!!!!!!!!!!!!!!!!] A measure of **exports** climbed to 56.5 from 56 in February. The group's inventory index fell to 44.9 from 45.4 and its gauge of order backlogs improved to 47.5 from 45. The **employment** index increased to 49.2 from 46. Higher energy costs are also hurting companies' profits and their ability to spend on employment and on equipment and projects. **The ISM's measure of prices paid increased to 83.5 from 75.5 in February. Economists surveyed by Bloomberg News forecast the prices paid component would fall to 75.** The purchasers' group changed the composition of the headline index this year to a simple average of the orders, production, employment, supplier deliveries and inventory measures. Previously, the components were given different weights. **Best Predictor The orders index by itself is the best predictor of economic growth in the current or next quarter, according to a study issued yesterday by Seamus Smyth, an economist at Goldman Sachs Group Inc. The inventory gauge, the only other component to have had predictive ability, has become less significant since 2000, the report said. [And how did that do? Oh, yes – IT SUCKED – "ISM gauge of new orders decreased to 46.5, the lowest since October 2001"]** Regional surveys in recent weeks signaled manufacturing contracted last month. Reports from the Federal Reserve Banks of Philadelphia and New York and a survey yesterday from a purchasing managers' group in Chicago all pointed to a contraction. Profits dropped 3.3 percent in the fourth quarter from the previous three months, the Commerce Department said on March 27. It was the second consecutive decline. **Spending Stagnates** Consumer spending, which accounts for more than two-thirds of the economy, has been stagnant since December and businesses have cut **orders** for long-lasting goods in the first two months of 2008. Plummeting **confidence** in the economy and lower profits indicate spending is unlikely to rebound in coming months. Industry figures today are forecast to show **sales of cars** and light trucks fell to a 15.2 million annual pace last month from 15.3 million in February, according to analysts and economists surveyed. U.S. auto sales fell 5.4 percent in January and February compared

with the same time in 2007 and may drop this year to their lowest total in a decade. Some automakers are offering bigger discounts to drum up demand as gasoline prices soar to a **record** and mounting defaults prompt banks to make it more difficult to borrow. "There's a lot more economic uncertainty than we thought," **Mark LaNeve**, North American marketing chief for General Motors Corp., the world's largest automaker, said in a Bloomberg Television interview on March 19. "With consumers in a pinch and some of the liquidity and credit issues we are experiencing in the economy, we are being more aggressive with incentives." The manufacturing slump deepened in February as factories turned out fewer cars and appliances and made less furniture. Industrial production dropped a greater-than-forecast 0.5 percent, according to figures from the Fed issued last month. The slowdown in spending and investment indicates the economy grew at a 0.1 percent pace in the first three months of the year following a 0.6 percent pace of expansion in the fourth quarter, according to the median estimate of economists surveyed by Bloomberg last month. **U.S. Economy: ISM Index Unexpectedly Rose in March**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=ahALLiZvihv8&refer=home>

- **April 1, 2008 [this is a great April's fool spoof – “bottoms in” in Europe too!!!!!!!!!!!!]** **UBS** charged higher, leading European bourses into positive territory as the bank unveiled a new rescue package sparking hopes of a turning point in its fortunes. In late afternoon trade, the pan-European FTSE Eurofirst 300 jumped 2.6 per cent to 1,295.28, Frankfurt's Xetra Dax was 2.4 per cent higher at 6,693.17 and in Paris the CAC 40 gained 2.8 per cent to 4,839.53. UBS topped the leaderboard, surging 12.9 per cent to SFr32.60 after the bank posted \$19bn in additional writedowns and said it would spin off an ailing portion of its business and launch its second capital raising in as many months. The news gave a boost to Swiss archrival **Credit Suisse**, which rose 7.6 per cent to SFr54.45, and lifted French peers **Societe Generale and BNP Paribas** 8 per cent to €66.94 and 6.9 per cent to €68.30. Germany's **Commerzbank** rose 6.8 per cent to €21.14. Banks shrugged off the news of a surprise €2.5bn writedown from **Deutsche Bank**, which opened flat and then rode the rising tide in the banking sector 4.1 per cent higher to €74.84. The rally in financial stocks "tells you that people have been expecting bad news to hit. People are beginning to see the light at the end of the tunnel," said Edmund Shing, European Equities Strategist at BNP Paribas. "The medicine has now been taken and people are hoping that the recovery will be on the way," he added. **UBS leads European markets higher** [http://www.ft.com/cms/s/0/77b311a2-ffd4-11dc-825a-000077b07658.html?nlick\\_check=1](http://www.ft.com/cms/s/0/77b311a2-ffd4-11dc-825a-000077b07658.html?nlick_check=1)
- March 31 (Bloomberg) -- **Lehman Brothers Holdings Inc. is selling at least \$3 billion of new shares to bolster capital and squash speculation about a cash shortage that pushed the stock down 42 percent this year.** Lehman, the fourth-biggest U.S. securities firm, will offer 3 million convertible preferred shares, the company said in a statement today. Demand for the shares was already three times greater than the amount offered as of 6:30 p.m. in New York, according to a person familiar with the offering who declined to be identified before the sale is completed tomorrow. "We still maintain that we don't need capital, but we've realized that perception is the dominant issue in today's markets," Chief Financial Officer **Erin Callan** said in an interview. "This is an

endorsement of our balance sheet by investors." Lehman, led by Chief Executive Officer **Richard Fuld**, fell as much as 48 percent on March 17 on speculation the New York-based firm would face the same cash shortage that broke Bear Stearns Cos. following a run on the company. Merrill Lynch & Co., Citigroup Inc. and Morgan Stanley have also raised cash from investors after more than \$200 billion of writedowns and losses tied to the collapse mortgage markets at the world's biggest financial companies. **Shares Fall The stock fell 2.8 percent \$36.60 in New York trading after the market's official close, while credit-default swaps declined, showing investors believe Lehman's ability to pay debts has improved. Lehman closed at \$37.64 during the regular session.** Credit-default swaps tied to Lehman's senior unsecured bonds narrowed 15 basis points after the announcement to 285 basis points, according to broker Phoenix Partners Group in New York. A decline signals improvement in investor confidence. Terms of the offering include a coupon payment of 7 percent to 7.5 percent. The conversion premium will be 30 to 35 percent above the current stock price, according to people familiar with the offering who declined to be identified. "They have to make their balance sheet stronger in this environment," said CreditSights Inc. analyst **David Hendler**. **"Banks and brokers need to write down their weak positions, and they need capital in order to do that."** The capital increase will provide "financial flexibility," the firm said in the statement. Lehman said on March 18 that it had \$30 billion of cash and \$64 billion in assets that could easily be turned into cash. **The securities firm has access to an additional \$200 billion from a Federal Reserve credit facility, according to Prashant Bhatia, an analyst at New York-based Citigroup. [only if they get the entire amount allocated to the market.]** Reality Check Bhatia upgraded his recommendation for Lehman to "buy" from "neutral" last week, saying the stock price drop was overdone. "Reality will trump fear," Bhatia wrote on March 28. "Lehman has ample liquidity to run its business." The firm's net income declined 57 percent in the quarter, less than analysts estimated, because of a \$1.8 billion writedown on mortgage assets. Merger advisory fees jumped 34 percent, investment-management revenue surged 39 percent and equities rose 6 percent. Bear Stearns, formerly the fifth-largest U.S. securities firm, was forced to sell itself to JPMorgan Chase & Co. this month at a fraction of its market value with financial support from the Fed. Merrill Lynch raised \$6.6 billion in January by selling preferred shares to a group including the Kuwaiti Investment Authority and Japan's Mizuho Financial Group Inc. Lehman announced the financing after the close of regulator trading on the New York Stock Exchange, where shares closed 23 cents lower at \$37.64. **Lehman to Sell \$3 Billion of Shares to Raise Capital** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aUgPn6SJeHIU&refer=home>

- March 30 2008 **Bank of America** is considering scrapping the sale of its equities prime brokerage business, after receiving only lukewarm interest from potential bidders including Barclays Capital of the UK and France's BNP Paribas. People close to the situation stressed that no final decision on the prime brokerage unit, which has been up for sale for more than three months, had been made. However, some of the dozen-plus groups that had expressed an initial interest in bidding for the business said that over the past week they had been told that BofA might take the business off the market. Delaying or scrapping the sale of the prime brokerage unit, which focuses mainly on US hedge

funds, would set back BofA's plans to scale back its investment banking operations. Competition for the prime brokerage unit, which is believed to have had revenues of more than \$180m last year, weakened this month after JPMorgan Chase's cut-price acquisition of Bear Stearns. JPMorgan had been seen as an early front-runner for BofA's business but its need for a prime brokerage unit was filled by the purchase of Bear, which has a highly regarded and profitable prime brokerage unit. Both Barclays and BNP are believed to retain an interest in BofA's business because of its strong presence in the US market. However, people close to the situation said that the indicative offers tabled by potential bidders had not matched BofA's expectations. BofA and Barclays declined to comment. BNP said it did not comment on market rumours. BofA's decision to sell its equities prime brokerage came after Ken Lewis, chief executive, said last year he had endured all the "fun" he could handle in the investment banking business. The comment, which Mr Lewis later said he regretted, came after BofA reported a 32 per cent drop in third-quarter income following big trading losses. The results were the worst of Mr Lewis's tenure as head of the bank, which is the largest in the US by market value. In addition to selling the equities prime brokerage, BofA said in January that it would cut 650 jobs in its global investment banking and markets business and scale back in structured products such as collateralised debt obligations. Some analysts suggest that BofA's attempt to build its own full-service investment bank has failed and that Mr Lewis will try to buy an existing bank. The most mentioned names are Morgan Stanley and Merrill Lynch, both of which would give BofA an extensive retail brokerage network. Morgan Stanley has an industry-leading prime brokerage business and Merrill has been growing in the business. Bank of America's prime brokerage was ranked highly by customers in the 2008 "Global Custodian" magazine poll, the most closely watched in the industry. "In the domestic market where it competes, Bank of America outscores the top three prime brokers in five out of nine service areas and by a lavish margin on client service," the report said. But customers noted that the brokerage, which operates only in the US, was limited by its failure to offer a global service. Last year the group made a push to expand into Asia, but had limited capabilities in foreign markets and securities.

**BofA may scrap prime brokerage unit sale** <http://www.ft.com/cms/s/0/0fea244c-fe77-11dc-9e04-000077b07658.html>

## Don't Fight The Fed

- [It has been a while since we had a "don't fight the fed" article. IF they cut 50 there will be just 175 left to zero!!!!] April 4 (Bloomberg) -- **The Standard & Poor's 500 Index rose, capping its biggest weekly gain in more than two months**, as a rally in commodity producers overshadowed a jump in unemployment and a worsening outlook for bank profits. **Exxon Mobil Corp.** led energy shares to a five-week high after oil climbed above \$106 a barrel, the dollar fell against the euro **and speculation grew that the Federal Reserve will cut interest rates by half a percentage point this month.** JPMorgan Chase & Co. helped drag the Dow Jones Industrial Average lower as analysts increased their loss estimate for Washington Mutual Inc. and **Fitch Ratings revoked MBIA Inc.'s AAA insurance grade.** **[it was a whole month ago that the market**

**repeatedly rallied because the monolines would not have their ratings cut – now that it happens, not even top line news]** The S&P 500 added 1.09 points, or 0.1 percent, to 1,370.4 after falling as much as 0.5 percent following the government's report that payrolls declined for a third month. The Dow slipped 16.61, or 0.1 percent, to 12,609.42. The Nasdaq Composite Index increased 7.68, or 0.3 percent, to 2,370.98. On the New York Stock Exchange, 919 stocks advanced and 935 declined. **“We see it as a positive sign that you get a bad economic report and stocks are moving up,”** said Damon Barglow, a Boston-based managing director at Eastern Investment Advisors, which oversees about \$1.7 billion. “The commodity-based stocks are performing quite nicely. People are thinking Fed cuts are going to drive the dollar down and commodities higher.” Stocks opened lower after the government said payrolls decreased by 80,000 in March and the jobless rate rose to 5.1 percent from 4.8 percent. Economists surveyed by Bloomberg News estimated payrolls would shrink by 50,000 workers and the unemployment rate rise to 5 percent. Weekly Advance **The S&P 500 climbed 4.2 percent in the week after plans to raise \$19 billion in fresh capital at UBS AG and Lehman Brothers Holdings Inc. sent the benchmark for American equities to its best start to a second quarter in 70 years on April 1.** The Dow rose 3.2 percent in the week and the Nasdaq added 4.9 percent. **MBIA retreated 68 cents to \$13.61. The world's largest bond insurer would need as much as \$3.8 billion more in capital to deserve an AAA rating,** Fitch said. ‘Big Wild Card’ Washington Mutual fell \$1.32, or 11 percent, to \$10.17 for the biggest decline in the S&P 500. Keefe, Bruyette & Woods Inc. analysts wrote in a research note that higher credit losses will cause a wider-than-expected loss at the largest U.S. savings and loan this year and will erode earnings in 2009. Bank of America, the second-biggest U.S. bank, fell 96 cents to \$39.41. JPMorgan analysts cut their 2008 earnings estimate and said the second-largest U.S. lender may report about \$5.4 billion of debt-related writedowns in the first-quarter. “The big wild card is the credit crunch,” said Brian Gendreau, who manages \$12 billion in asset-allocation funds at ING Investment Management in New York. **“It's more widespread than any of us thought and we don't know the extent to which it's going to spill over to the rest of the economy.”** [“than any of us thought” – I think that sums it up nicely, although it does infer thinking which is a major stretch] **S&P 500 Climbs, Led by Commodity Producers; Exxon Shares Gain** [http://www.bloomberg.com/apps/news?pid=20601087&sid=aJAtxfv7nr\\_8&refer=home](http://www.bloomberg.com/apps/news?pid=20601087&sid=aJAtxfv7nr_8&refer=home)

### **Bottom's in!!!!!!!!!!!!!!!!!!!!!!!**

- As we noted earlier this week, the recently muted reaction to bad economic data from the markets is a good sign that a bottom may indeed be in, as investors have accepted that a recession is here and believe stocks are priced appropriately. We would continue to cautiously put cash to work on weakness and are starting to become just a tad more optimistic about the near-term outlook for stocks. Still, it is a buyer's market out there, so trade accordingly. Bull Market Report

## I Disagree . . . and why

### Article of the week:

- March 30, 2008 *This column originally appeared in the weekend edition of The Wall Street Journal.* SAN DIEGO (MarketWatch) -- You would think that by now public companies that monkey with their numbers would get the hint: Suing critics almost always backfires. If nothing else, lawsuits or other attempts to discredit short-sellers, bearish analysts and others -- including financial journalists -- are often, in an oddly backhanded way, confirmation that the critics will be proved right. The latest company to learn that lesson the expensive and embarrassing way -- and perhaps the most stunning example of why companies shouldn't attack their critics unless they absolutely, positively have reason to do so -- is Biovail, a Canadian drug company. Two years ago, it sued a handful of critics, including Gradient Analytics, an independent research firm, on racketeering charges for engaging in what it called "a massive, illegal and continuing stock market manipulation scheme." Central to the allegations, according to the lawsuit, "was and remains short selling." Short-sellers, of course, bet that stocks will fall. As a result, they often are automatically portrayed as the bad guys. That is why Biovail's lawsuit made a splash, and why its claims went on to become the centerpiece of a report on the CBS show, "60 Minutes," about how hedge funds allegedly colluded with analysts to drive down its stock price. It didn't matter, apparently, that at the time Biovail was under investigation by the Securities and Exchange Commission. As a result of the publicity surrounding Biovail's claims, the SEC launched a probe of Gradient, which was eventually dropped, leading to the ultimate of ironic twists: In recent days, Biovail was sued by the SEC on charges of accounting fraud based, in part, on the same charges levied by Gradient and David Maris, who had been an analyst at Bank of America Corp. Maris was originally named in the suit, but his name was later dropped. After being sued by the SEC, Biovail quickly settled without admitting wrongdoing, by paying \$10 million. The company, which hasn't withdrawn its lawsuit, has declined further comment. The Biovail flap is reminiscent of the time AremiSoft, a software company, sued a bunch of hedge funds and my employer at the time, TheStreet.com, for market manipulation and disseminating false information. The suit was dropped after the SEC, in one of those odd turns, sued AremiSoft for the very things I had reported. AremiSoft filed for bankruptcy reorganization, and the firm no longer exists. As for Biovail, Gradient and Maris, who now works for a hedge fund, say they feel vindicated. [Gradient President Brad Forst adds, however, that "there's something wrong with this when we have to spend years and millions of dollars \(defending lawsuits\) to do our job."](#) Indeed there is, but as long as there are people betting that stocks will fall, and others reporting on what they are saying, there will be companies that think they can make themselves look more credible, while diverting attention away from the bad stuff, with a lawsuit. Sadly, especially for shareholders who foot the bill, that is just the way it is. [All this is worth remembering in the wake of the collapse of Bear Stearns Companies. Inc. Accusations flew across Wall Street accusing hedge funds of shorting Bear stock and then conspiring to drive it down by pulling their accounts. This may ultimately turn out to be true, but it doesn't disguise the fact that Bear was the riskiest player in a risky industry during a very risky time. Successful short-sellers figured this out before everyone else. Related items Short sellers -- and the SEC: One other thing companies may want to consider, before filing suit, is](#)

that the SEC doesn't turn away tips from anybody. "It's not unusual for short-sellers to come to us with allegations of misstatements by companies," says Andrew Calamari, associate director of the New York office of the SEC, which oversaw the Biovail suit. "We get many types of referrals every year, and we do evaluate them because short sellers have to be taken at face value. They're not, as a matter of logic, just shorting a stock to bring it down, but they're shorting because they think it's a bad company. Sometimes they're right; sometimes they're wrong." Always early. How to stop analyst intimidation: Maris, who left Bank of America shortly after the Biovail flap, believes the government should do more to help analysts blow the whistle on intimidation of their work. He suggests that the SEC create a hotline for analysts to call "without fear of retribution from anyone if they are suspicious of wrongdoing at a company or if they feel intimidated in any way." Great idea. *Herb Greenberg is senior columnist for MarketWatch and contributor to CNBC television based in San Diego. He does not own stocks (except for shares of his employer), and he does not sell individual stocks short or invest in hedge funds.* By Herb Greenberg, MarketWatch <http://www.marketwatch.com/news/story/story.aspx?guid=F441F3B5C7F14AB28A85A000D6D23936&siteid=nbc&print=true&dist=printTop>

- The Grand Delusion Rally By RANDALL W. FORSYTH **DID A LETTER RELEASED LATE FRIDAY by the SEC about an arcane accounting rule provide the spark that set off the stock market's explosive rally this week?** Led by financials, the Dow Jones Industrial Average Tuesday recouped nearly 400 of the 1,000 points it surrendered in the first quarter. The Financial Select SPDR surged 7% in the session, halving the nearly 14% negative first-quarter total return in the exchange-traded fund's net-asset value, as calculated by Morningstar. Fuel, air and a spark are required for combustion. You can have a full tank of gasoline, but a blocked air filter or a fouled spark plug will prevent an engine from starting. In this case, the spark may have come from a letter posted on the Securities and Exchange Commission's Web site Friday afternoon regarding Statement of Financial Accounting Standards 157, which attempts to deal with the knotty problem of placing a "fair value" on a company's assets. Easier said than done, especially for inscrutable assets, such as derivatives, that SFAS 157 places in so-called Level 3. Those have no "unobservable inputs," in the parlance of the Financial Accounting Standards Board. Or, as former Defense Secretary Don Rumsfeld might have defined them, these are "known unknowns." We may know what collateralized debt obligations are, but who knows what they're worth? (For the record, Level 1 assets are those for which there are active quoted markets. Level 2 assets may not have quoted prices, but there are comparable assets to provide "observable inputs" that can impart some information about their values.) **Late Friday, the SEC tried to clarify one aspect of this accounting arcana for these topsy-turvy times. Companies should use market prices to value assets, even when markets are less liquid than normal -- "unless those prices are the result of a forced liquidation or distressed sale."** "Ay Caramba!" as Bart Simpson might say. **This lets everybody off the hook.** These days, when it comes to a CDO or anything that's not an off-the-rack security, the holder is apt to contend that any sale is "a forced liquidation or distressed sale." **That means those assets shouldn't be marked to market, but marked to model or, as some cynics say, marked to myth. In other words, the SEC's clarification of SFAS 157 gives financial companies lots of leeway in valuing assets, and avoiding writedowns. Those**

**writedowns have hit earnings as well as the balance sheet.** Limiting those helps stockholders on both scores; the lesser impact on earnings is obvious, while the mitigating the balance-sheet impact means a reduced need to raise capital, which is apt to be expensive or dilutive, or both. But if the reduced values don't have to be recognized, per the SEC's missive, financial companies don't have to suffer their effects in terms of writedowns. No harm, no foul, in effect. To be sure, financial stocks also took heart from Lehman Brothers' ability to raise \$4 billion, which the investment bank swore it didn't need, via a convertible preferred offering and **UBS'** announcement of a \$19 billion writedown. The markets seemed to say the worst is over. Surely, after UBS' monster writedown, that should be it. And Lehman's financing indicates banks can readily refill the coffers drained by credit losses. **But to Bank of America's credit analyst Jeffrey Rosenberg, the market's response represented the proverbial victory of hope over experience. Weren't Citigroup's losses suppose to mark the nadir? Or was it Merrill's writeoffs? Or the Bear Stearns debacle?** Or perhaps it was the license given by the SEC not to mark to market anything in a distressed sale. For the moment, these developments have jolted the market from what Market Semiotics' Woody Dorsey called their "double purgation lows" resulting from massive negativity about financials. Shorting financials had gotten to be a rather crowded trade, as had being long commodities and Treasuries and short the dollar. All those positions reversed dramatically in Tuesday's trade. **But beyond the market's sugar rush, the medium-term implications are less positive. "The SEC's actions [on SFAS 157] seem to create a safe harbor for those institutions that would choose to obscure their exposures," writes Joshua Rosner of Graham Fisher & Co. In other words, it provides a pass-fail option where the students can argue that nobody deserves an F. But there are consequences for institutional investors' not owning up to the value of what they own. "A failure of institutions to rectify opacity will propel us further down the road toward a Japanese-style 'lost decade,'" Rosner contends. For now, the markets would rather party in the dark and not let unpleasant truths intrude.** [http://online.barrons.com/article\\_print/SB120708204912281325.html](http://online.barrons.com/article_print/SB120708204912281325.html)

### **Best of the Dog**

**Tuesday, April 01, 2008 at 19:23 CDT**

#### **it is all wonderful again**

for the 3rd time in a month the Dow trades up a rounded 400. in my perusal of evening news, I have yet to find anyone who thinks this is not the harbinger of blue sky at least in the short term

let me be the first.

stocks went up today because they went up. no other reason.

the credit markets continue to be a disaster

upcoming earnings will either be bad or the companies will be manipulating the numbers

and the bottom is years away

however, today was yet another day in which bad investing was rewarded. this will end soon