

August 5, 2007 Review

Comments

The bridge collapse in Minnesota this week provides a stunning example of how quickly the world can change. Sadly, it also can be used as an analogy to what I believe we will be seeing in the near future in the credit derivatives market in particular and the global financial markets in general.

- Like the bridge, there are abundant warning signs that all is not well
- Like the bridge, while many agree repairs are in order, virtually no one is concerned that the whole thing will fail.
- Like the bridge, each day there is not a failure, there is an incremental increase in the belief that there will not be a failure.
- Like the bridge, the entire structure is dependent on hidden pieces, the soundness of which an average person can not evaluate.
- Like the bridge, the chance of a complete failure is remote, but the consequences are catastrophic.
- Like the bridge, IMO it is too late to save the structure and the only recourse for most is to make sure they are not on the bridge when it goes.

As for what your troll under the financial bridge is seeing:

- The expected progression from sub-prime to alt a and prime has occurred
- Credit standard tightening is well underway
- The market for risk is disappearing.
- The spreads continue to widen
- The action in the major averages of down, up and down again was not evident in the housing, housing lenders and Bear Stearns. For them the week consisted of down a lot, down a little and then way down. The 2 day midweek “rally” was futures driven and not institutional buying

For the week ahead, the fed will be of great interest. My crystal ball predicts: If they stand pat, there will be a sell off. If they change the message there will be a spike and then a sell-off. And, if they cut, there will be a substantial knee jerk rally that will be heavily sold by the smartest players and eventually sold by all. It is now much too late to save the bridge.

I will stick my neck even further out and opine that within 75 days we will see a major market dislocation. Are you ready??????

We will see . . .

Credit

- Aug 13 edition – Business week **The ultimate worry is that the trouble in the junk markets will spread to traditional corporate bond markets and create a full fledged credit crunch that will threaten the economy.** [Not a threat at this point, it is instead an eventuality. This is like saying that the threat in the eye of the hurricane is that it might get windy soon] . . . **AHM [now in bankruptcy] borrowers were those with generally good credit histories – an indication that the mortgage mess is no longer confined to risky subprime [no kidding] The Pain Moves Beyond Subprime**
- Aug. 1 (Bloomberg) -- Macquarie Bank Ltd., Australia's largest securities firm, said investors in some of its high-yield funds may lose as much as 25 percent of their money amid the fallout in U.S. subprime mortgages. The bank's stock slumped. Macquarie Fortress Investments Ltd. was forced to sell assets and use the proceeds to reduce borrowings and comply with lending covenants, it said in a statement. Investors in notes from Sydney-based Fortress may lose A\$300 million (\$255 million), the Australian newspaper reported earlier. Macquarie joins Australian hedge funds Absolute Capital Group Ltd. and Basis Capital Fund Management Ltd., and New York-based Bear Stearns Cos. in suffering from the widening impact of delinquencies on U.S. home loans to people with poor credit. Funds like Fortress, with loans to people with good credit, are losing value as buyers flee the debt market. **“The concern is that the contagion looks like it's spreading and some of the bigger names are now being dragged in,”** said Shane Oliver, who helps manage the equivalent of \$83 billion at AMP Capital Investors in Sydney. **Macquarie Says Fortress Funds Value May Fall 25%**
<http://www.bloomberg.com/apps/news?pid=20601208&sid=ahMhkiRGaITo&refer=finance>
- July 30 (Bloomberg) -- The risk of owning corporate bonds surged by a record as losses on U.S. subprime mortgages at Germany's IKB Deutsche Industriebank AG triggered concerns of global market contagion. Contracts on 10 million euros (\$13.8 million) of debt included in the iTraxx Crossover Series 7 Index of 50 European companies increased as much as 60,000 euros to 504,000 euros, according to JPMorgan Chase & Co. The CDX North American Investment-Grade Index rose \$16,000 to \$97,000, Deutsche Bank AG prices show. Investors are fleeing corporate credit in the fastest selloff in seven years, Barclays Capital said today. The rout that began in mid-June when two Bear Stearns Cos. hedge funds almost collapsed spread worldwide as Blackstone Group LP stepped in last week to support Sydney-based Basis Capital Fund Management Ltd. and ABN Amro Holding NV's co-owned Absolute Capital Group Ltd. froze investor accounts. **“It's pure fear,”** said Gary Jenkins, a partner at London-based hedge fund Synapse Investment Management, which manages \$650 million of debt assets. **“It's fear**

of the unknown, fear of hedge funds unwinding, fear of knock-on effects of the subprime meltdown." **Corporate Bond Risk Surges by Record as Subprime Losses Spread**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a4CHnE.bPy6s&refer=home>

Commercial Real Estate

Commodities

Currency

- July 30 (Bloomberg) -- The yen traded near a three-month high against the euro as a slump in global stocks caused traders to repay Japanese currency loans used to fund higher-yielding investments. The Australian and New Zealand dollars, favorites of so-called carry trades, dropped as corporate debt markets slumped worldwide, increasing the cost of takeovers. The ruling coalition of Japanese Prime Minister Shinzo Abe lost its upper house majority yesterday, prompting Japanese stocks to decline. "This is all about risk reduction, causing the unwinding of the yen carry trade," said Kenichi Yumoto, a senior currency dealer at Societe Generale SA in Tokyo. "Investors are betting stock prices will fall due to the political uncertainty." **Yen Trades Near Three-Month High Against Euro**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=acPLn8k1UAo0&refer=home>

Diversification

Derivatives

- July 30 (Bloomberg) -- Citadel Investment Group LLC bought most of the assets of Sowood Capital Management LP **after the Boston-based firm's two hedge funds plunged more than 50 percent amid the rout in credit markets. The losses in July were caused by "severe declines" in the value of Sowood's corporate bonds and loans,** Jeff Larson, the firm's founder, said today in a letter to investors. Sowood sold to Chicago-based Citadel when it couldn't meet demands from lenders for more collateral. **"I'd be surprised if they were the only one, given the volatility in the markets," [you will not be surprised Martin]** Martin Fridson, chief executive officer of FridsonVision LLC in New York, a high-yield debt research firm, said about Sowood. **Sowood, which had managed \$3 billion, is the largest hedge-fund firm crippled by the crisis in the markets for riskier debt such as subprime mortgages and bonds that fund leveraged buyouts.** As buyers disappeared and prices declined, losses forced New York-based Bear Stearns Cos. to close two funds. Basis Capital Fund Management Ltd. and Absolute Capital Group Ltd., both of Sydney, froze investor accounts. **Sowood's Alpha Fund Ltd. lost 57 percent in the month and its Alpha Fund Ltd. lost 53 percent. The funds have plunged 56 percent and 51 percent for the year.** Assets as of July 30 were about \$1.5 billion. "Devastating" "A loss of this magnitude in such a short period is as devastating to us as it is to you," Larson, a former Harvard University endowment manager said in the letter. "We are very sorry this has happened." The firm will start returning what's left of investors' money "as soon as it can," the letter said. Sowood uses

a variety of strategies, including trading in convertible bonds, commodities, bonds and stocks. The firm's spokesman, Shawn Pattison, declined to comment. **The firm didn't own subprime loans made to borrowers with poor credit histories or mortgage-backed securities, [so much for "it's contained in sub-prime]** Megan Kelleher, Sowood's general counsel and a managing partner, said on July 27. Sowood borrowed to make investments, and owned about \$6.4 billion in stocks as of March 31, according to a U.S. Securities and Exchange Commission document. Bond prices have dropped even as the global corporate default rate hovers near its lowest in 12 years. Most companies beat analysts' earnings estimates in the second quarter. The premium investors demand to own investment-grade corporate bonds instead of Treasuries widened 20 basis points last week to 128 basis points, according to index data compiled by Merrill Lynch & Co. Spreads on high-yield bonds rose 91 basis points to 428 basis points, the highest since May 2005, Merrill indexes show. A basis point is 0.01 percentage point. `Dominoes Falling' **"First you had the low end of the food chain in trouble, subprime, and then it moved up, and now it's like dominoes falling,"** said Bradley Alford, a former investment manager at the Duke University endowment who runs Atlanta-based asset-management firm Alpha Capital Management LLC. **"This is rewriting the way you analyze risk every day."** Citadel Returns **"A manager does a direct sale to somebody like Citadel when they don't think they'll be able to get anything appropriate on the open market,"** said Donald Brownstein, chief executive officer of Stamford, Connecticut-based Structured Portfolio Management LLC. The hedge-fund firm, which oversees \$650 million, invests in mortgage-related securities. **"People with levered positions have been unable to trade out, so they've had margin calls and are effectively stuck."** Griffin, 38, founded Citadel in 1990 after trading convertible bonds from his dorm room at Harvard. He has diversified the firm, which now trades everything from stocks to weather futures. He's returned more than 20 percent a year since 1998. **[Keep your eye on Citadel. Either they know something no one else does or they are way out on a risk limb. I would venture the latter]** Harvard's Support Larson, 49, opened Sowood in 2004 and early investors included his previous employer, Harvard, which put in \$500 million. **Citadel Takes Over Most Sowood Assets After 50% Loss**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a8dqghrHvaNA&refer=home>

- July 30 (Bloomberg) -- Deutsche Bank AG analyst Eugene Xu recognized **a financial train wreck** in the making two years ago when he predicted "quite probable" losses from the least creditworthy home loans in America's runaway property market. Now Germany's largest bank is poised to reap a bonanza of at least \$270 million and as much as \$540 million from a strategy that enabled its traders to sell subprime mortgage loans with derivatives contracts that appreciated as the U.S. housing market suffered its worst slump in 16 years. **Mortgage defaults would surge as soon as price appreciation slowed, Xu wrote in September 2005.** Since then, Deutsche Bank traders, led by Greg Lippmann, sold ABX index contracts, providing 200 million euros (\$272 million) of revenue in the first quarter and possibly another 200 million euros in the past quarter, assuming the position wasn't changed, said Kinner Lakhani, the top-rated banking analyst at ABN Amro Holding NV in London. Subprime `Contamination' The ABX-HE-BBB-06-1 index, tied to mortgage-backed bonds with the lowest investment-grade ratings, fell

17 percent last week, increasing this year's drop to more than 60 percent, according to London-based Markit Group Inc., administrator of the ABX indexes. Cracks in LBOs Deutsche Bank was paid almost \$550 million of fees by leveraged buyout firms in the first half for advising and financing takeovers, data compiled by New York-based Freeman & Co. and Thomson Financial show. That may drop in the second half as LBO firms scale back their record pace of acquisitions. Last week, Deutsche Bank was among banks forced to hold on to 5 billion pounds (\$10.1 billion) of loans for Kohlberg Kravis Roberts & Co.'s purchase of U.K.-based pharmacy chain Alliance Boots Plc as investors balk at riskier assets following losses in the U.S. subprime mortgage market. "Deutsche Bank was well prepared for the subprime crisis," Weese said. "Others clearly got caught on the wrong foot" of loans to people with bad credit records, he said. Dillon Read Capital Management LLC, one of UBS's hedge-fund units, **collapsed in May after more than \$120 million of losses from mortgage-related holdings.** Dillon Read probably cost UBS another 150 million francs in the second quarter, said Clark, who has a "market perform" rating on UBS. "**We know UBS still had trading exposure to subprime at least at the start of May and they would have had difficulty unwinding those positions,**" Clark said. The debacle led to the ouster of Peter Wuffli as chief executive officer earlier this month. **The traders started selling the ABX index contracts in late 2006 because they "felt that the U.S. mortgage market was probably overheating and would potentially soften,"** Deutsche Bank Chief Financial Officer Anthony di Iorio said in May. Deutsche Bank was among the firms that helped create the ABX.HE index in January 2006. The credit-derivatives index provides mortgage-backed bondholders with insurance against defaults on U.S. home loans. Bondholders can use the index to hedge against losses spurred by an increase in mortgage defaults or to bet on the credit quality of the debt. "**Most of the participants in this market are real money investors who don't employ irresponsible leverage ratios,**" [wow, what a great call] he told the Financial Times on July 12. Losses are concentrated in subprime loans made in 2006, he said. Goldman, the biggest U.S. securities firm by market value, said last month that lower demand for mortgage-backed bonds caused the biggest quarterly drop in its fixed-income revenue in almost four years. **Deutsche Bank Payday Burgeons on Subprime Mortgage Trading Bets**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aRhYrqG0ok0M&refer=home>

Housing

- Aug 13 edition – Business week – **In January, industry analysts predicted that the 10 biggest builders would average EPS of \$3.67 for 2007. The latest forecast is for a loss of \$1.18. Bonfire of the Builders** p. 29
- Aug 13 edition – Business week – **A July 27 census report shows a 44% drop in the number of new households formed in the year ending June 2007 to only 891,000. . . . It is likely to take 2-3 years for excess supply to be soaked up. [still grossly optimistic in my view] Another reason for those empty houses** p. 33 (article addresses the gross over estimation of future demand obtained by projecting extraordinary household creation growth in 2004-5)

- Aug 13 edition – Business week – **The number of vacant houses and apartments went up by more than 1 million in the last 12 months. Another reason for those empty houses.**
- July 31 (Bloomberg) -- Home prices in 20 U.S. cities fell the most in at least six years, suggesting the housing recession has yet to touch bottom. The S&P/Case-Shiller index of home prices in 20 metropolitan areas dropped 2.8 percent in May from a year ago, led by declines in Detroit and San Diego, according to the report issued today by Standard & Poor's and MacroMarkets LLC. The drop was less than the median forecast of four economists surveyed by Bloomberg News. The declines indicate that housing will continue to hamstring the world's largest economy, economists say. A glut of unsold properties and mounting defaults are forcing builders to scale back construction and hindering consumer spending as homeowners are less able to borrow against home equity. **``Things are getting worse rather than better," said Sal Guatieri, senior economist at BMO Capital Markets in Toronto. ``If home prices keep falling, eventually consumer confidence and spending will take a hit."** **U.S. S&P/Case-Shiller Home Price Index Declines 2.8% (Update3)**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=ad3oXZru.R2w&refer=realestate>
- July 30 (Bloomberg) -- U.S. foreclosures rose 58 percent in the first half of 2007 from a year earlier, led by California and Florida, as more homeowners fell behind on their monthly mortgage payments, RealtyTrac Inc. said. Lenders sent notices of default, scheduled auctions or repossessions to 573,397 properties in the January to June period, the Irvine, California-based seller of foreclosure data said in a report today. California foreclosures surged 170 percent to 104,572, the highest in the nation, and Florida gained 77 percent to 64,250. Homeowners with adjustable-rate loans who are seeing their payments jump are finding it harder to avoid foreclosure by selling or refinancing their properties as the U.S. housing slump worsens. The inventory of homes for sale, measured in the time it would take to sell them all, was 8.8 months in June, matching the prior month as the highest since 1992, the National Association of Realtors said last week. **``Foreclosure activity shows no sign of slowing down,"** James Saccacio, RealtyTrac's chief executive, said in the report. The results today reflect a new methodology by RealtyTrac. The company for the first time reported on what it calls ``unique addresses," or properties that have had at least one foreclosure-related legal filing. In previous reports, RealtyTrac had only reported the number of legal filings, which could have resulted in properties being double and triple counted. **Mortgage Foreclosures Rise 58 Percent in First Half**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=atyRhsAzoAes&refer=realestate>

Housing Finance

- July 31 (Bloomberg) -- Shares of MGIC Investment Corp. had their biggest one-day loss and Radian Group Inc. tumbled the most in eight years after the home-loan insurers said their stakes in a subprime mortgage company, **valued at more than \$1 billion last**

month, may now be worthless.

<http://www.bloomberg.com/apps/news?pid=20601206&sid=amdvyZMTn6Ek&refer=realstate>

- NEW YORK, July 30 (Reuters) - MGIC Investment Corp. (MTG.N: [Quote](#), [Profile](#), [Research](#)), a mortgage insurer, said on Monday that it could be forced to write down the entire value of a \$516 million investment it has made in a venture which invests in the credit risk of subprime mortgages. **MGIC says investment in subprime venture at risk** <http://www.reuters.com/article/marketsNews/idUKWNAS868320070730?rpc=44>
- NEW YORK (Reuters) – July 30 - GMAC, the finance company in which General Motors Corp (GM.N: [Quote](#), [Profile](#), [Research](#)) sold a majority stake, posted a 63 percent decline in second-quarter profit on Monday, hurt by losses in its home lending unit. Net income fell to \$293 million from \$787 million a year earlier. The company's Residential Capital LLC unit posted a net loss of \$254 million, compared with a profit of \$548 million a year earlier, hurt by what GMAC called "severe illiquidity" in the market for subprime mortgages. **GMAC profit falls 63 pct as home loans weigh** <http://www.reuters.com/article/hotStocksNews/idUSN3042480520070730>
- July 30 (Bloomberg) -- The collapse in subprime mortgages doesn't pose "any threat to the overall economy," U.S. Treasury Secretary Henry Paulson said last week. He would, wouldn't he? He's hardly going to advocate we all stock up on tinned food and bottled water in our basements. The tremors from the subprime debacle are vibrating throughout the interconnected web of modern global financial markets. Derivatives, corporate debt, loans and bank stocks are all getting trashed. Here are five reasons to expect the turmoil to worsen. Don't Bet on Helicopter Ben . . . A week ago, traders in the futures and options markets were pricing the chances of December interest-rate cuts from the U.S. Federal Reserve at about 21 percent. Prices now suggest a 47 percent chance that Fed Chairman Ben Bernanke will sanction lower borrowing costs to rescue the mortgage market, based on July 26 closing levels. The rapid turnaround in interest-rate expectations shows the financial community is far from convinced that the wider economy is immune from the woes afflicting particular pockets of the bond and credit markets. Is Helicopter Ben, as he was dubbed early in his monetary- policy career, really going to fly over the global financial markets and shower investors with dollar bills in the form of cheaper money? Even a hint that the Fed might be planning a rescue would be a signal that the outlook is bleaker than officials have admitted so far. . . . Do Bet Against Moody's Investors made more than 23 million bets against Moody's Corp.'s share price in the month to mid-July, according to Bloomberg data on the total amount of stock that was sold short and hasn't been repurchased yet. Those trades, known as short interest, have surged from 18 million in mid-June, and have almost quadrupled in the past four months. The Fundamentals of Leverage The global default rate among corporate borrowers with ratings below investment grade declined to 1.4 percent in the second quarter from 1.5 percent in the first quarter, according to Moody's. Just eight borrowers defaulted on \$3.2 billion of debt in the first half of the year. The default rate is now at its lowest level in more than 12 years. That hasn't prevented the iTraxx Crossover index, a barometer of creditworthiness for 50 European companies, from surging to as high as 440 basis points last week, up from about 260 basis points two weeks ago and a low for the year of 170 in February. The higher the index, the less confident investors are about the outlook for corporate bonds. **Once fear grips a leveraged market, the so-called credit fundamentals aren't**

worth the paper you print your spreadsheets on. The yield on the benchmark 10-year U.S. Treasury note has declined to about 4.8 percent from as high as 5.3 percent seven weeks ago, as investors seek the warm, comforting embrace of the U.S. debt market. ``While the fundamentals, such as global growth and corporate balance sheets, are at their best for arguably decades, the technicals are as bad as we've ever known them and arguably the worst in the era of leveraged finance," Jim Reid, a London-based credit strategist at Deutsche Bank AG, said in a research note last week. ``**Never has so much money been thrown at and been levered up in credit and never has there been such a liquid derivatives market to hedge risk.**" It's Like Money in the Bank After peaking at about 511 points on May 23, the Standard & Poor's index of 92 U.S. financial stocks declined more than 10 percent through July 26, while the S&P 500 index fell just 2.6 percent. In the five years through the end of 2006, the financial index posted a total return of more than 56 percent, outpacing the 34 percent delivered by the benchmark index. Here's a scorecard of some of the world's biggest banks, from wherever the shares reached their high for this year compared with closing prices on July 26. Bear Stearns Cos. is down almost 28 percent. Royal Bank of Scotland Group Plc is down 21 percent. Deutsche Bank AG is down 18 percent. JPMorgan Chase & Co. is down 17 percent. Goldman Sachs Group Inc. is down almost 17 percent. Citigroup Inc. is down almost 14 percent. So much for the golden age of finance. Not-So-Fizzy Drinks Failing to finance deals that have already been agreed on is one thing. Struggling to find a buyer for a business with some of the world's best-known brand names is another. So last week's news that Cadbury Schweppes Plc extended the deadline for selling its U.S. drinks unit is a worrying sign that the cash to do a deal might not be there at an acceptable price, no matter how thirsty investors are for Dr Pepper and 7-Up sodas. Every day brings a new failure. Borrowers ranging from Manchester United Plc, the world's fourth-biggest soccer club by revenue, to billionaire Barry Diller, chairman of Internet travel agency Expedia Inc., have failed to find lenders to refinance debt or fund share buybacks. ``The debate is whether this is simply a risk re-pricing in financial markets, or something that will spill over into the broader economy," says Charles Diebel, head of European rates strategy at Nomura International Plc. ``**The more prolonged this credit event is, the more risks of a contagion.**" **Five Signs That Subprime Infection Is Worsening: Mark Gilbert**
<http://www.bloomberg.com/apps/news?pid=20601039&sid=ageDhNv.n1A4&refer=home>

- July 30 (Bloomberg) -- American Home Mortgage Investment Corp. shares plunged 44 percent after the lender delayed payment of the quarterly dividend and reported ``major" writedowns of its loan and security portfolios. The stock of the Melville, New York-based company fell to \$6.03 as of 8:25 a.m. in premarket trading today. On Friday, they closed at \$10.47 in New York Stock Exchange composite trading. American Home said in a statement late Friday that the board decided to delay common dividends and may halt payments on preferred shares until it obtains a ``better understanding" of how ``disruptions" in the mortgage market will affect its balance sheet and liquidity. The company said it reduced the value of assets on its books and that Wall Street firms and lenders are demanding more collateral. ``The recent and severe erosion in the global debt markets was rapid and unforeseen," RBC Capital Markets analyst James Ackor wrote today in a report. ``We are increasingly concerned that American Home's management does not have a firm grasp on the external issues facing the company." Ackor cut his

rating to "sector perform-speculative" from "outperform-average." Delaying the dividends will allow American Home to retain about \$42 million in cash each quarter, KBW Inc. analyst Bose George wrote in a note. The lender specializes in Alt-A mortgages, an alternative for A-rated borrowers who can't satisfy all the terms for a regular "prime" mortgage. American Home said in June that second-quarter earnings would be lower because homeowners didn't keep up with payments, forcing the company to buy back loans that had been sold to investors. **American Home Mortgage Shares Plunge After Dividend Delayed**
http://www.bloomberg.com/apps/news?pid=20601087&sid=aAxU_Jt9KSLU&refer=home

Macro Economic

- July 31 (Bloomberg) -- Ben Craster says he'll be drinking less beer this summer, and Christine Baines is cutting back on clothes and cosmetics. They're among the millions of Britons preparing for a mortgage crunch. Craster, a London designer, and Baines, a company director from Knutsford, England, will have to arrange new home loans as fixed-rate discounts expire on mortgages they took out two years ago. The Bank of England has raised borrowing costs five times during the past year, increasing the average monthly mortgage payment by about 100 pounds (\$200), according to the Council of Mortgage Lenders. About 2 million discounts will end during the next 18 months, the council said. The wave of refinancing threatens to slow consumer spending, which has boosted U.K. economic growth almost every quarter for the past decade, and may hurt stocks of retailers such as Tesco Plc and Marks & Spencer Group Plc. "We have a fixed-rate squeeze coming," said Alan Clarke, an economist at BNP Paribas in London. "Consumers are going to bear the brunt of a slowdown." **U.K. Consumers Cut Back on Beer, Shoes as Mortgage Crunch Looms**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=ajbnu9l2U8XA&refer=home>

Retail

- July 31 (Bloomberg) -- Personal spending in the U.S. increased in June at the slowest pace in nine months, while a gauge of inflation rose less than forecast, suggesting slower growth is easing price pressures. The 0.1 percent rise in spending reported by the Commerce Department today, which matched economists' estimates, followed a 0.6 percent gain in May. The personal consumption expenditures index -- a price measure closely watched by the Federal Reserve -- also rose 0.1 percent, excluding food and energy. Consumer spending, which accounts for more than two-thirds of the economy, is ceding its role as the expansion's driver as exports and business investment pick up. At the same time, more jobs and rising incomes will prevent spending from slowing even more, analysts said. "**Consumer spending is definitely a source of concern,**" said Nariman Behravesh, chief economist at Global Insight Inc. in Lexington, Massachusetts, who accurately forecast both figures. "Inflation does look very tame." **U.S. June Consumer Spending Up 0.1%, Inflation Slows**

<http://www.bloomberg.com/apps/news?pid=20601068&sid=ah1hBXdTZfvI&refer=economy>

- July 30 (Bloomberg) -- European retail sales fell the most in three years in July, the Bloomberg purchasing managers index showed, adding to evidence that economic growth in the 13-nation euro region may have peaked. A gauge measuring retail sales declined to a seasonally adjusted 46.2, the lowest since May 2004, from 48.2 in June. The index is based on a survey of more than 1,000 executives compiled for Bloomberg LP by NTC Economics Ltd. That was the third month in a row the index was below 50, which indicates a contraction. Higher interest rates and a 14 percent increase in gasoline prices this year have hampered consumer spending in the 13 euro nations. That's increasing the economy's dependence on investment and exports just as the euro's climb to a record against the dollar makes goods more expensive abroad. "European growth will certainly be slower overall than the strength we saw last year," said Susana Garcia-Cervero, an economist at Deutsche Bank AG in London. "Interest rates, an appreciating euro and rising gas prices will take their toll on the economy eventually." **European Retail Sales Fall Most Since 2004, PMI Shows**
<http://www.bloomberg.com/apps/news?pid=20601205&sid=anGUzkOmNzZQ&refer=consumer>

Retirement

Risk

Savings Rate

Tech

Wall Street

- July 31 (Bloomberg) -- On Wall Street, Bear Stearns Cos., Lehman Brothers Holdings Inc., Merrill Lynch & Co. and Goldman Sachs Group Inc., are as good as junk. Bonds of U.S. investment banks lost about \$1.5 billion of their face value this month as the risk of owning the securities increased the most since at least October 2004, according to Merrill indexes. Prices of credit-default swaps based on the debt imply that their credit ratings are below investment grade, data compiled by Moody's Investors Service show. The highest level of defaults in 10 years on subprime mortgages and a \$33 billion pileup of unsold bonds and loans for funding acquisitions are driving investors away from debt of the New York-based securities firms. Concerns about credit quality may get worse because banks promised to provide \$300 billion in debt for leveraged buyouts announced this year. **Bear, Lehman, Merrill, Goldman Traded as Junk, Derivatives Show**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=afHmD6FZ2Wpw&refer=home>
- Your investment dollars at work - And on that note, this little piece of irony: **U.S. securities firms now employ a record number of full-time employees.** Firms added

10,000 employees in June, bringing the grand total to at least 848,300 souls hitching their wagon to this bubble of bubbles. 5minforecast@agorafinancial.com

- July 30 (Bloomberg) -- Citadel Investment Group LLC took over Sowood Capital Management LP's credit holdings after the Boston-based hedge-fund manager suffered losses on corporate bonds and loans. Terms weren't disclosed. Sowood, which manages \$3 billion, said July 27 that returns fell as investors fled riskier debt such as subprime-mortgages and bonds used to fund leveraged buyouts. The risk of owning corporate bonds soared today to the highest on record in the U.S. and Europe, credit-default swaps show. Sowood, started by former Harvard University endowment manager Jeff Larson, uses a variety of strategies in trading convertible bonds, commodities, bonds and stocks. As of March 31, the fund owned about \$6.4 billion in stocks, according to a U.S. Securities and Exchange Commission document. Harvard's \$30 billion endowment, the largest for a university, was to increase its allocation to Sowood's hedge fund and a separate private-equity fund this year, according to a December statement from Sowood. The private-equity fund was spun off this month as Boston-based Denham Capital Management LP. **Citadel Takes Over Sowood Capital's Credit Holdings**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aT31Y.pPjvAs&refer=home>
- NYSE Regulation has censured and fined Smith Barney \$50 million for trading and record-keeping violations. The regulatory arm of the New York Stock Exchange said that the unit of Citigroup Global Markets Inc. failed to supervise trading in mutual fund shares and variable annuity mutual fund sub-accounts, **failed to prevent illegal market timing by its brokers [illegal means "intentionally"]** and did not maintain adequate books and records. Thirty-five million dollars will be paid in disgorgement, a \$10 million penalty will be placed distribution fund to compensate impacted customers who invested in the mutual funds, and \$5 million will be paid to the State of New Jersey related to a "separate regulatory matter arising out of the same conduct." CITI Fined \$50MM **[don't kid yourself, those brokers are working for you – ha]**
<http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20070730/FREE/70730004/-1/INNewsExtra01>
- July 30 (Bloomberg) -- The biggest losses in equity and credit markets in five years are making the U.S. stock bulls more bullish. The Dow Jones Industrial Average posted its steepest gain since 2003 on July 12, two days after tumbling on Standard & Poor's plan to cut credit ratings for bonds backed by subprime mortgages. The benchmark for America's biggest companies climbed to a record the next week, following a decline sparked by losses in Bear Stearns Cos. hedge funds. Some of the world's largest investors say the S&P 500's biggest slump since September 2002 last week now offers them even more opportunities to profit. "You look at earnings, you look at ongoing takeovers, and I'm happy to increase holdings as valuations improve," said Andy Brough, who helps oversee \$7.6 billion at London-based Schroder Investment Management Ltd. "You make money buying shares when markets are falling, and that is what I've been doing." **[a cynic might think that all this bullishness is from the fully invested who want others to jump in. as for Andy, he should read about catching a falling knife.] Bulls Load Up on Stocks in Worst Rout Since 2002 [the page one headline that led to this link was even worse: Stock**

Bulls Grow More Bullish as Global Equity Markets Lose \$2.1 Trillion]

<http://www.bloomberg.com/apps/news?pid=20601087&sid=af.kJ6fM0cPc&refer=home>

I Disagree . . . and why

Article of the week:

Aug. 3 (Bloomberg) -- The U.S. subprime-market rout that wiped out \$2.1 trillion from global share values last week has "got a long way to go," said Jim Rogers, who predicted the start of the commodities rally in 1999.

This week's rebound in equity markets hasn't persuaded Rogers, 64, to pull out of bets that U.S. investment banks and homebuilders are heading for further declines.

"This was one of the biggest bubbles we've ever had in credit," Rogers, chairman of New York-based Beeland Interests Inc., said in an interview from Hong Kong. "I have been and am still short the investment bankers in America. I'm also short homebuilders."

The Morgan Stanley Capital International World Index plunged 5.3 percent last week, its worst weekly drop in five years, on concern defaults among subprime mortgages may be spilling over to other credit markets and hurting earnings and takeovers. Further losses may be in store even after the index, which tracks \$32.6 trillion of stocks, advanced 0.7 percent this week.

"Given the stage of the credit cycle that we're in now, we would have to expect more negative news popping up," Beat Lenherr, who oversees \$7 billion as chief investment officer for Asia at LGT Bank in Liechtenstein AG, said late yesterday in an interview in Singapore. "The market sentiment is a bit nervous to the degree that every bad news is answered with selling."

No Big Disaster

Some investors say sustained consumer spending and jobs growth may help offset the impact of mortgage defaults.

A report due later today may show that payrolls rose 127,000 after a 132,000 gain in June, according to the median estimate of economists surveyed by Bloomberg. The jobless rate is forecast to hold at 4.5 percent for a fourth month, near a six-year low.

"Subprime will not derail the economy and we're not calling for a big disaster," said Hans Goetti, Singapore-based managing director at Citi Private Bank, which has assets of \$100 billion in Asia. "Consumer spending will not fall off the cliff as a result."

The MSCI World Index today climbed 0.1 percent, its fourth gain this week, as investors speculated that better-than-forecast earnings will help offset the impact of mortgage losses.

Financial Stocks Down

A measure of financial companies such as Countrywide Financial Corp. has dropped 3.7 percent so far this year, the only group to decline within the MSCI World Index. Countrywide Financial, the biggest U.S. mortgage lender, said yesterday it has "significant" sources of short-term funding after the slump in demand for loans pushed some rivals toward bankruptcy.

Shares of Bear Stearns Cos. fell 13 percent last week after two of its hedge funds failed because of the subprime crisis. Merrill Lynch & Co. is down 3.6 percent this week, heading for its third weekly decline, while stock in Lehman Brothers Holdings Inc. is 5.9 percent lower.

The housing slump may extend into 2008 because of stricter mortgage standards and a glut of properties. IndyMac Bancorp Inc. yesterday said it is joining rival lenders in making "very major changes" to home-loan standards and charging higher rates because of a slump in mortgage securities.

U.S. homebuilders rose yesterday, pushing a Standard & Poor's index of 16 such companies to a 4.1 percent gain, the measure's biggest advance in six months. The index has dropped 35 percent this year after the worst housing slump in 16 years left eight homebuilders nursing quarterly losses of \$1.97 billion.

Beazer Homes

Beazer Homes USA Inc.'s stock jumped 14 percent yesterday, the most ever, after hedge fund Citadel Investment Group LLC almost doubled its stake in the homebuilder. The company has lost almost three-quarters of its market value this year.

"This is the only time in world history when people were able to buy houses with no money down and in fact, in some cases, the builders gave them money for a down payment," Rogers said. "So this bubble is the worst we've had in housing and it's going to be the worst before its over cleaning it out."

China is a market that Rogers isn't selling even as the fallout from subprime drag on share prices worldwide, he said. He's sold his other emerging market holdings as stock gains outstripped the prospect for earnings, Rogers added.

"China's the next great country in the world and we must learn about investing in China, because that's where fantastic fortunes are going to be made in the next century," Rogers said. "I would be looking at China very carefully."

The CSI 300 Index last week jumped 8.4 percent. The index had gained 2.7 percent to a record as of 2 p.m. in Beijing, heading for its fourth weekly gain in a row. The benchmark has more than doubled this year and is the best performer among 89 stock indexes tracked by Bloomberg.

"I'm not of a mood to pronounce the end of the world just yet," said Hans Kunnen, who helps manage \$117 billion at Colonial First State Global Asset Management in Sydney. "You only have to go back three years to see how debt was being priced as if there was no risk at all. Well,

there is risk, and it's simply being priced back in." **U.S. Housing Is Among `Biggest Bubbles,' Rogers Says**

<http://www.bloomberg.com/apps/news?pid=20601109&sid=a2Rnaf9tZJbA&refer=home>

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