

The Other Side of the Street January 13, 2008

Comments

This week is what one would expect to see now that the major top is firmly in place: Down days followed by nonsensical rallies (a rally because the Fed “will cut”/“is on the job”/“is ready to act”? Please!), followed by the floor dropping again. This action is typical and could last for weeks/months stair stepping down. The rallies are in part the “new shorts” who have no idea what they are doing and get shaken out on the upturns at losses until they are broke. The rallies also whipsaw both the “dip buyers” who missed the memo that the times have changed and the little guys who sold, saw things go back up and bought in only to sell again much lower. [If you are interested in whether this type thing is foreseeable, please look at excerpts from <http://www.maxiethedog.com/maxieblog/> posted in best of the dog. This is one of the rare periods of time when there is such a large disconnect that it can be traded profitably with below average risk.]

I am off to Ann Arbor for our last boot camp week. After this six day session, there are only two and three day monthly residencies on the road to September graduation.

The road to the bear market has been much longer. The whys have been documented in these pages. The irresponsible actions by your elected officials and those they appointed are frightening. The claims any of the current situation a surprise unconscionable.

It shall be a very long sunny afternoon in Jellystone Park . . .

Stock Notes

- AAPL’s growth was in the mature PC market with iPhone sales poor, Apple TV a bomb, and plummeting growth in iPod sales. **HTS**
- The long term prospects for companies such as GRMN, NetLogic (NETL), and RIMM are very poor **HTS**

Notes

Web links

Credit

- Jan. 11 (Bloomberg) -- The risk of Bank of America Corp. defaulting rose to the highest since at least November 2001 after the biggest U.S. bank by market value said it will

rescue Countrywide Financial Corp. Credit-default swaps tied to the bonds of Charlotte, North Carolina-based Bank of America increased 12 basis points to 92 basis points, according to broker Phoenix Partners Group in New York, suggesting deteriorating perceptions of credit quality. Bank of America may take on too many liabilities in its \$4 billion acquisition of Countrywide, the money-losing mortgage lender besieged by bankruptcy speculation, the contracts show. Bank of America would inherit the "heightened" credit risk of Countrywide's home equity loans and option adjustable-rate mortgages, analysts led by David Hendler at bond research firm CreditSights Inc. said in a report today. "There's probably a little doubt here," Brian Yelvington, a strategist at CreditSights in New York, said in an interview. "They say the due diligence is done, but is it?" Moody's Investors Service today said it may cut Bank of America's A financial strength rating. The ratings company said it may raise Countrywide Home Loans' Baa3 ranking. Credit-default swaps are financial instruments based on bonds and loans that are used to speculate on a company's ability to repay debt. They pay the buyer face value in exchange for the underlying securities or the cash equivalent should a borrower fail to adhere to its debt agreements. A rise indicates deterioration in the perception of credit quality. **Bank of America Credit Risk Increases on Countrywide Purchase**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aRgBATAK.v4E&refer=home>

- Jan. 10 (Bloomberg) -- American Express Co., the third- largest U.S. credit-card network, will take a \$440 million charge before taxes in the fourth quarter as more cardholders fail to repay their debts. The company fell 6 percent in extended trading. American Express expects earnings per share to grow 4 percent to 6 percent next year, the New York-based company said in a statement today. Credit-card companies have increased forecasts for bad loans as a weakening U.S. economy makes it harder for consumers to pay their debts. Capital One Financial Corp., the largest independent U.S. credit-card issuer, said today it may have \$5.9 billion in unpaid loans next year, compared with a prior forecast of \$4.9 billion to the "mid-\$5 billions." "We did see some negative credit trends among U.S. consumers during December, particularly in California, Florida and other parts of the country most affected by the housing downturn," Chief Executive Officer Kenneth Chenault said in the statement. **American Express Has \$440 Million Charge for Quarter**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=algi1VHxGk1g&refer=home>
- Jan. 9 (Bloomberg) -- The risk of companies defaulting on their debt rose a sixth straight day as concerns lingered that lenders including Countrywide Financial Corp. won't be able to ride out the worst housing slump in 27 years. Contracts on the Markit CDX North America Investment Grade Series 9 Index, a benchmark gauge of default risk tied to the bonds of 125 companies including Countrywide, climbed 3.75 basis points to 100 basis points as of 8:15 a.m. in New York, according to Deutsche Bank AG. The index is at the widest since the CDX indexes started trading four years ago. **Company Default Risk Rises Sixth Day; CDX Index Reaches Record**
http://www.bloomberg.com/apps/news?pid=20601087&sid=aDzt_9qmQ8&refer=home

- Jan. 9 (Bloomberg) -- MBIA Inc., facing the crippling loss of its AAA credit rating, sliced its dividend and will raise \$1 billion in the sale of notes. The shares jumped in early trading. MBIA, the world's largest bond insurer, reduced its quarterly payment to 13 cents a share from 34 cents and will sell notes to shore up capital, according to a statement today. The value of contracts made to protect securities has fallen by \$2.1 billion, creating losses of \$200 million last quarter, MBIA said. Fitch Ratings, which had given Armonk, New York-based MBIA until the end of the month to raise money, said the plan may be enough to stave off a downgrade. MBIA, Ambac Financial Group Inc. and other insurers came under scrutiny by Fitch, Moody's Investors Service and Standard & Poor's after a slump in the credit quality of the debt they insure, including collateralized debt obligations, or CDOs. A sale of notes would "effectively address the existing capital deficiency," Fitch analysts Joo-Yung Lee and Thomas Abruzzo said in a statement today. **MBIA Cuts Dividend, to Raise \$1 Billion After Losses**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=azOSw.G6g1O4&refer=home>
- Jan. 8 (Bloomberg) -- The global default rate on high-yield, high-risk bonds, which finished 2007 at a 26-year low of 0.9 percent, will jump more than fivefold by the end of 2008, according to Moody's Investors Service. The high-yield default rate will increase to 4.8 percent this year and reach 5 percent by the end of 2009 because a weakening economy and ratings cuts will cause more issuers to miss their interest payments, Moody's analyst Kenneth Emery in New York said in a report released today. "We believe December 2007 likely marks the low point of the current default rate cycle as several issuers have missed interest payments in recent weeks," Emery said in the report. That "should translate into upward pressure on default rates as the 30-day grace periods on these issuers' bonds expire and they become actual defaulters," he said. Missed payments last week by Buffets Inc., the largest operator of buffet-style restaurants in the U.S., and Florida homebuilder Touse Inc. raised concerns that corporate defaults will increase as a three-year housing slump slows the economy. **Junk Bond Defaults to Rise Fivefold, Moody's Says**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aVw0FKg6va6k&refer=home>
- Access to credit became more difficult for both companies and households last quarter, while lenders hit by wholesale funding worries and house price gloom expect to restrict credit even further, the Bank of England said on Thursday. **The Bank's quarterly survey of credit conditions showed lenders had "materially" reduced availability of mortgage finance in the past quarter**, although in the previous quarter's survey they had expected households to be largely unaffected by the credit squeeze. A net balance of 25 per cent expected to tighten credit further over coming months. Thursday's survey suggests tighter credit availability has been significant in the recent housing market slowdown, although lenders expect demand for all types of mortgages to fall over the next three months and default rates, so far little changed, to increase. **Lenders' responses suggested their lower risk appetite could reflect increasing difficulty in raising capital or transferring risk off their balance sheets through securitisations.** However, their outlook for the coming months was influenced more strongly by concerns about the economy and housing market than by tighter funding conditions. "The

persistence of the problems, and indeed the deterioration in conditions in the run-up to Christmas, has clearly taken its toll,” said George Buckley, economist at Deutsche Bank. Some analysts said the survey, conducted in November and December at the peak of credit market turmoil, could be more gloomy than was justified by the relative calm recently. But Malcolm Barr, economist at JPMorgan, said its weak tone, plus dismal news from the US manufacturing sector, “significantly raises the odds of a cut at next week’s monetary policy committee meeting”. Alan Clarke at BNP Paribas said: “Why would the MPC wait until February?” But wider spreads on both prime mortgage and buy-to-let borrowing would “limit the support to the housing market of further cuts in the base rate”, said Kelvin Davidson at Capital Economics. The Bank said funding constraints had also led lenders to cut credit availability for corporate borrowers of all sizes – especially in the beleaguered commercial property sector – by raising rates and fees and tightening non-financial conditions. **Bank sees further curbs on credit this year** <http://www.ft.com/cms/s/0/d2194592-ba0d-11dc-abcb-0000779fd2ac.html>

Commercial Real Estate

Commodities

Currency

Diversification

Derivatives

- Jan. 9 (Bloomberg) -- Merrill Lynch & Co. eliminated the job of Theo Constantinidis, head of a unit that developed custom-tailored debt products, and is negotiating his departure from the firm, three people familiar with the matter said. Constantinidis was offered lesser positions at Merrill and isn't likely to accept them, said the people, who didn't want to discuss the matter publicly because the talks haven't concluded. He led the fixed-income department's structuring group, set up in August 2006 to develop and sell tailored debt products. Chief Executive Officer John Thain is overhauling Merrill's debt business after \$7.9 billion of third-quarter writedowns on subprime home loans and mortgage-linked securities led to a record loss and the departure of his predecessor, Stan O'Neal. In October, Merrill ousted its worldwide head of debt trading, Osman Semerci, who set up the group that Constantinidis ran. **“The asset-backed market and structured credit desks have had a lot of upheaval in the past year,”** said Zaheer Ebrahim, a recruiter at Kennedy Associates in London. **Merrill Cuts Constantinidis's Debt Post, People Say**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a6lDiQf0.RxI&refer=home>
- Jan. 9 (Bloomberg) -- Bear Stearns Cos., the fifth-largest U.S. securities firm, is closing a hedge fund that invested in asset-backed securities, abandoning a salvage plan after the fund plummeted at least 39 percent last year. The Bear Stearns Asset Backed Securities fund, which in August held about \$900 million of investments backed by assets including home mortgages, dropped 21.4 percent in November alone, the New York-based company told investors in a Dec. 20 letter obtained by Bloomberg News. The fund lost

more than \$300 million between August and the end of November. Bear Stearns said it would return \$90 million in cash to investors immediately. The fund's remaining assets, which the company valued at about \$500 million as of Nov. 30, will be sold and the proceeds refunded over an unspecified period of time, according to the letter. Bear Stearns spokeswoman Jane Slater confirmed the letter's contents. **“Based on continued market deterioration, we believe that a furtherance of the strategy, even under a longer lock-up, would not be in the best interests of investors,”** Bear Stearns said in the letter. The fund's 39 percent decline last year through November could be revised “given the difficult market conditions that continue to exist,” according to the letter. **The closure adds to the list of hedge fund casualties at Bear Stearns, which shut down two others in July as the value of their mortgage-backed securities sank.** Their failure helped trigger the collapse of the subprime mortgage market, as investors stopped buying securities linked to home loans made to borrowers with poor credit histories. August Statement Bear Stearns's decision to shut down the Asset Backed Securities fund was a change from its statement in August, when it said it would keep the funds open after blocking withdrawals by investors. **“This says that Bear Stearns is still not being honest and forthright with clients whose assets have been entrusted to them,”** said Steven Caruso, a New York-based partner with law firm Maddox Hargett & Caruso PC whose clients include investors in the Bear Stearns hedge funds. Those investors include hedge funds, institutional money managers and wealthy individuals. Colin Gordon will remain portfolio manager of the fund while assets are sold and money is returned to clients, according to the investor letter. ‘Fully Paid’ The asset-backed securities fund Bear Stearns opted to close last month had less than 0.5 percent of its investments in securities linked to subprime loans, the firm said in August. Bear Stearns sought to restructure the fund last year in a way that would have barred investor withdrawals for two years. Faced with mounting losses, it abandoned that reorganization, according to the Dec. 20 letter. “The fund is unleveraged and has fully paid for all of the securities it owns, so we believe we are well situated to sell assets and further distribute cash to investors in a reasonable time frame,” Slater, the Bear Stearns spokeswoman, said today. **Bear Stearns Shuts Asset-Backed Hedge Fund After Loss**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a9I6nA1AzktU&refer=home>

Housing

Housing Finance

- Jan. 11 (Bloomberg) -- Robert Shiller, Yale professor of economics and co-creator of the S&P/Case-Shiller Home Price indexes, said the falling U.S. housing market may cut the value of Countrywide Financial Corp., the mortgage lender being acquired by Bank of America Corp. “There’s a tendency for people to under appreciate the risk of the housing market,” Shiller said. “I might have a lower valuation of Countrywide than Bank of America does.” Charlotte, North Carolina-based Bank of America, the biggest U.S. bank by market value, agreed to buy Countrywide, based in Calabasas, California, for about \$4 billion, taking over the largest U.S. mortgage lender during the worst housing slump in 26 years. A record number of foreclosures has contributed to home price declines that leave many borrowers owing more on their mortgages than their homes are worth. Shiller

compared the housing slump to a "tidal force." "Maybe Countrywide and Bank of America are going to have some problems going forward," he said. "When people see that their houses are worth a lot less than their mortgage balance, they have an incentive to default. The troubled mortgages that Countrywide already has will be followed by even more troubled ones." Countrywide, founded in 1969 by Chief Executive Officer Angelo Mozilo, gives Bank of America about 9 million borrowers and fees from servicing \$1.5 trillion of mortgages. In past years, Countrywide has been responsible for one out of every five U.S. mortgages. **Shiller Says Bank of America May 'Have Some Problems'**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aHeHO9MJTiU&refer=home>

Macro Economic

- Jan. 12 (Bloomberg) -- U.K. economic growth slowed to the weakest pace in two years during the fourth quarter, the National Institute of Economic and Social Research estimates. The economy expanded 0.5 percent in the final quarter of 2007, compared with 0.7 percent in the three months through September, the London-based group, which advises the Bank of England and the Treasury, said in an e-mailed statement today. That would be the slowest pace since the third quarter of 2005. **U.K. Economic Growth Weakens to a Two-Year Low, NIESR Says**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aukW6uyxcXF&refer=home>
- Jan. 11 (Bloomberg) -- Federal Reserve officials signaled they've shifted their stance in favor of taking out greater "insurance" against the growing risk of recession. Fed Governor Frederic Mishkin said today that policy makers must be ready to abandon "inertia" and act "decisively" in cases of major financial disruptions. Philadelphia Fed Bank President Charles Plosser, whom economists consider to be the toughest on inflation, said he's now most concerned about consumer spending. The comments, following Chairman Ben S. Bernanke's speech yesterday pledging "substantive additional action," spurred traders to predict a faster and deeper pace of interest-rate cuts. That strategy would be a break from the forecast-driven policy approach to date, Fed watchers said. Mishkin joined Bernanke in stating the strategy is now one of "insurance." "I am delighted the Fed is moving in a very different direction," said former Fed governor Lyle Gramley, now a senior adviser at the Stanford Group in Washington. "Risk-management is what they should be doing." Mishkin, 57, a former collaborator with Bernanke on academic research, said in New York today that "waiting too long to ease policy could result in further deterioration of the macroeconomy and might well increase the overall amount of easing that would eventually be needed." **Disappointing Markets** While the Fed cut the benchmark rate by a half-point, more than anticipated in September, officials have since disappointed some investors by refusing to commit to a series of reductions. When lowering borrowing costs in October and December by a quarter-point each, policy makers refrained from saying that growth was a bigger concern than inflation. By the time they met Dec. 11, officials acknowledged that the Fed's stance "appeared to be somewhat restrictive," minutes of the session showed last week. **"They underestimated the magnitude of the credit shock,"** said Brian Sack, senior economist

at Macroeconomic Advisers LLC in Washington. **“The markets got it a lot faster than the Fed and now they are catching up.” [the markets still do not get that a credit problem this large can not be fixed by the Fed]** Plosser, 59, said he's “certainly” open to more rate cuts, in an interview with PBS's Nightly Business Report today. By contrast, when he spoke Nov. 27 he warned that the Fed's rate cut the previous month posed a risk to inflation expectations. “The most thing we are concerned about right now is consumer spending,” Plosser said today. Boston Fed President Eric Rosengren, 50, said today in South Burlington, Vermont that declining house prices are “likely to dampen consumer and business confidence in spending.” ‘Gasoline on the Fire’ “Rosengren, Plosser and especially Mishkin arguably poured more gasoline on the fire” after Bernanke's remarks, Ian Morris, chief economist at HSBC Securities USA Inc., said in a note to clients. “The market is betting that the Fed may cut in an inter-meeting move,” wrote Morris, who yesterday doubled his rate-cut call for this month to a half-point. Traders anticipate at least a half-point reduction in the target rate for overnight loans between banks this month, according to contracts quoted on the Chicago Board of Trade. Odds of 0.75 percentage point of reductions this month jumped to 34 percent, from zero yesterday, futures show. That suggests some investors see the chance of a move before the Federal Open Market Committee meets Jan. 29-30, with an additional cut when it gathers. Bernanke's Opportunity Bernanke, 54, will have another opportunity to send signals on rates Jan. 17, when he testifies on the economic outlook before the House Budget Committee. This week's shift may have been driven by the Labor Department's Jan. 4 report showing the jobless rate jumped to 5 percent in December, economists said. The figures also showed the first decline in private-sector employment since 2003. “We stand ready to take substantive additional action as needed to support growth and to provide adequate insurance against downside risks,” the Fed chief said to the Women in Housing and Finance and Exchequer Club in Washington. “The committee must remain exceptionally alert and flexible.” **Fed Signals Shift as Traders Anticipate Deeper Rate Reductions**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aZiMmJ3kmeP4&refer=home>

- Jan. 11 (Bloomberg) -- **U.S. Treasury Secretary Henry Paulson said the U.S. economy slowed “rather materially” at the end of 2007, and any stimulus package should be put into effect quickly. “We are looking at things that could be done quickly,” Paulson said. “Time is of the essence.”** Paulson's comments, in an interview on Bloomberg Television's “Political Capital with Al Hunt,” were the clearest signs yet that the administration is likely to propose a package of tax cuts and other fiscal measures to spur growth in President George W. Bush's State of the Union address on Jan. 28. Paulson, sounding more pessimistic than previously on the economy, said that consumers face a variety of challenges, including declining house prices, rising energy costs and a weaker job market. **“There are signs” the economy “is slowing down fairly rapidly,”** he said. “If something were to be done here, I think the focus would be on something that's temporary and that could get done and make a difference soon.” Democratic leaders in Congress have pledged to work with Bush on a package of measures to buttress consumer confidence and avoid a recession. A government official, who declined to be identified, said the administration is looking at tax rebates aimed at low- and middle-income Americans and tax breaks for business investment as part of a potential stimulus

package. Easier Path Paulson, acknowledging that Bush can't convince the Democratic-led Congress to make his 2001 and 2003 tax cuts permanent, said that it would be easier to get agreement on temporary measures designed to speed help to the economy. "If there is a stimulus, I think the purpose would be to help the economy this year," the former chief executive officer of Goldman Sachs Group Inc. said. Economists from Harvard University's Lawrence Summers, a former Treasury secretary under President Bill Clinton, to Lawrence Lindsey, the former director of Bush's National Economic Council, have backed a budget package. The fiscal steps would complement interest-rate cuts by the Federal Reserve. Fed Chairman Ben S. Bernanke signaled yesterday he is prepared to make deeper rate reductions, pledging "substantive additional action" to aid the economy. Avoid Recession Paulson said he expects the U.S. will avoid a recession, helped in part by record exports. Yet he acknowledged the U.S. economy is heading for tougher times. "There are risks to the downside," he said. Homebuilding has declined for seven straight quarters and Fed officials say it may take at least six more months before the industry rebounds. Paulson said the housing market poses the biggest threat to the economy and made clear he expects home prices to continue to fall. "There's no doubt that this hasn't run its course yet," he said. The unemployment rate rose to 5 percent in December, the highest in two years, from 4.7 percent the previous month. Paulson called the latest jobs numbers another challenge for the economy and consumers. The economy has also been buffeted by losses in the banking and financial industry, as companies have been forced to write off billions of dollars on investments in mortgages and loans went bad. Countrywide Financial Corp., the nation's biggest mortgage lender, agreed today to be taken over Bank of America Corp. after speculation surged this week the lender would be forced to file for bankruptcy. Paulson declined to comment specifically on the merger. He did say the Treasury was encouraging banks and other financial institutions to strengthen their balance sheets by raising more money from investors so they won't have to cut back on lending. **Paulson Says Time `of the Essence' in Any Stimulus**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aGGmbW51WBO0&refer=home>

- Jan. 11 (Bloomberg) -- China and the U.S.-South Korean alliance have begun planning for military intervention in case the Kim Jong Il regime in North Korea collapses, according to two newly published studies -- one of which foresees a race to occupy and control the impoverished communist country. "If the international community did not react in a timely manner as internal order in North Korea deteriorated rapidly, China would seek to take the initiative in restoring stability," says a Jan. 3 report by Washington's Center for Strategic and International Studies and the U.S. Institute of Peace. The report says its unnamed Chinese sources see North Korea as stable for the moment, "but they worry that the potential for instability may grow." Meanwhile, U.S. and South Korean military planners were scheduled to complete by the end of 2007 a contingency plan for controlling the spread of weapons of mass destruction and dealing with refugees fleeing North Korea in the event of a collapse, according to an article in the January/February issue of the U.S. Army journal Military Review. To beat China to the punch, joint planners should go farther and prepare for a South Korean occupation of the North, argues the author, Army Capt. Jonathan Stafford. **China, U.S. Make Plans for**

North Korea Collapse, Reports Say

<http://www.bloomberg.com/apps/news?pid=20601087&sid=act8mDkXaQtQ&refer=home>

- Jan. 11 (Bloomberg) -- China's trade surplus narrowed in December and money-supply growth dwindled, signaling that the fastest economic expansion in 13 years may have peaked. The trade surplus shrank to \$22.7 billion from \$26.2 billion in November, the Chinese customs bureau said in Beijing today. M2, the broadest measure of money supply, rose 16.7 percent to 40.3 trillion yuan (\$5.55 trillion) from a year earlier, the smallest increase in seven months, the central bank said. Exports grew at the slowest pace in two years, indicating that recent yuan gains, the cooling global expansion and cuts to export-tax incentives on polluting industries are beginning to bite. **The central bank is still likely to take more measures to limit credit, ease inflation from an 11-year high and prevent the economy from overheating.** "China's economic expansion may have peaked last year," said Wang Tao, an economist at Bank of America Corp. in Beijing. "China needs to tighten monetary policy further, given that new loan growth may rebound." **China Trade Surplus Narrows, Signaling Economic Growth May Cool**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=am82SATUiWIU&refer=home>
- Jan. 10 (Bloomberg) -- Japanese stocks fell, led by real-estate companies, after Credit Suisse Group said U.S. subprime-mortgage losses may prompt overseas investors to sell their property holdings in Japan. Sumitomo Realty & Development Co., Japan's third-largest developer, plunged 5 percent. "Foreign investors who actively invested in Japanese real estate could decide to sell their Japanese real estate holdings," Yoji Otani, an analyst at Credit Suisse, wrote in a note to clients. Semiconductor-related shares surged after Tokyo Electron Ltd., the second-largest supplier of semiconductor equipment, said orders rose 16 percent more than it had forecast last quarter. **Japan Stocks Fall After Credit Suisse Sees Real-Estate Sell-off**
http://www.bloomberg.com/apps/news?pid=20601087&sid=aWHB_JIlaFXs&refer=home
- NEW YORK (Reuters) - Goldman Sachs on Wednesday said it expects the U.S. economy to drop into recession this year, prompting the Federal Reserve to slash benchmark lending rates to 2.5 percent by the third quarter. In a note to clients, Goldman said real gross domestic product would contract by 1 percent on an annualized basis in both the second and third quarters. For all of 2008, the investment bank said GDP would rise by 0.8 percent. The unemployment rate will rise to 6.5 percent in 2009 from the current 5 percent, it said. The weakening economy will force the Fed to lower policy rates by an additional 1.75 percentage points from the current 4.25 percent. Starting in September, the Fed cut rates at the last three meetings of the Federal Open Market Committee, reducing the target rate on loans between banks by 1 percentage point from 5.25 percent. Goldman strongly advises fund managers to overweight health care, consumer staples, energy and utilities. They are significantly underweight consumer discretionary, financials, industrials, materials and information technology. The three

most significant changes to their sector recommendations are the reduction in the financial sector weighting by 300 basis points to 14 percent, the information technology weighting by 400 basis points to 15 percent, and the increase in their health care weighting by 300 basis points to 17 percent, the firm said. Their reduced allocation to financials reflects weak fundamentals and their declining weight in the S&P 500. The reduction in information technology reflects that the group has been the second-worst performing sector in both the six months leading up to a recession and during the first phase of a recession, Goldman said. The health care weighting change reflects strong performance of the group during the six months leading up to and during the first phase of a recession in addition to an attractive valuation, Goldman said. On Monday, Merrill Lynch economist David Rosenberg said the jump in U.S. unemployment in December confirmed that the economy was entering a recession. **Goldman Sachs sees recession in 2008**

http://news.yahoo.com/s/nm/20080109/bs_nm/usa_economy_goldman_dc_2;_ylt=AsXgCFYwrXCWUGHQzl0E77UE1vAI

- Jan. 9 (Bloomberg) -- Marks & Spencer Group Plc, the U.K.'s biggest clothing retailer, fell the most in at least 19 years in London trading after an unexpected decline in holiday sales. The shares slid as much as 21 percent after Marks said today that revenue fell 2.2 percent at stores open at least a year in the fiscal third quarter ended Dec. 29, the first same-store sales drop in 2 1/2 years. The median estimate of eight analysts surveyed by Bloomberg was for growth of 1.1 percent. Chief Executive Officer Stuart Rose, who was knighted last month after reviving sales during three years leading the company, said conditions for the London-based retailer will "remain tough" through 2008. Britons have cut back on purchases as higher mortgage payments, taxes, utility bills and food prices weighed on income. "To see them decline to such an extent has really surprised the market," said Bryan Roberts, global retail research manager at Planet Retail in London. "Expectations were very high. They've been in full recovery mode for the last 12 to 18 months." **Marks & Spencer Shares Slide on Unexpected Sales Drop**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aUOvs6nNuVsk&refer=home>
- Jan. 8 (Bloomberg) -- U.K. retail sales rose at the slowest pace since March 2006 and house prices declined for the first quarter in seven years, adding to the case for the Bank of England to cut interest rates again. **U.K. Retail Sales Gains Slow, HBOS House Prices Fall**
http://www.bloomberg.com/apps/news?pid=20601087&sid=a_9JLTSRkT_c&refer=home
- During the credit boom, senior executives at the world's largest investment banks often argued that businesses had improved in two significant ways. They had become better at managing trading risk. And their pay structures were more flexible, allowing them to cut costs rapidly in a downturn. The subprime meltdown, which has so far been responsible for almost \$40bn of losses at Citigroup, Merrill Lynch, Morgan Stanley and UBS, has put paid to the first claim. The second also looks unlikely to survive the current bonus round. This should have far-reaching consequences for how investment banks are valued in

future. Ever since they abandoned the partnership structure, investment banks have struggled with how to pay employees. During the boom of the late 1990s they used long-term guaranteed contracts to lure and retain top bankers. But when business dried up, the bonuses still had to be paid. In recent years, a different approach has become the norm on Wall Street and in the City of London. Banks structured bonuses to include a greater proportion of restricted stock, which is released over several years. And they set explicit targets for compensation costs as a proportion of revenues, typically around 50 per cent. The pitch to investors was simple: we may give our staff half of everything they bring in, but this will rise and fall in line with the state of the business. Besides, as shareholders, their interests are more closely aligned with yours. This formula worked well in boom years, but is beginning to creak. Of the Wall Street banks that have released fourth-quarter earnings so far, the two most affected by the subprime meltdown reported sharp increases in their compensation ratios. In 2007, Morgan Stanley's wage and bonuses bill rose 18 per cent, to \$16.6bn. This in a year when the bank's revenues fell 6 per cent, it wrote off \$9.4bn in subprime losses, and was forced to raise \$5bn from China Investment Corporation. At Bear Stearns, the bonus pot shrank by a fifth, but revenues fell more than a third.

Battle for talent There is a certain logic to this largesse. The subprime losses are generally the work of a small number of people working in the fixed income division. Meanwhile, other parts of the business have enjoyed record years. If mergers and acquisitions bankers or commodities traders suffer for mistakes elsewhere in the organisation, they are likely to leave. It may be in the bank's interests to pay to keep its best people, even if there's not much left for shareholders. This argument fails to acknowledge the fact that all employees benefited when the fixed income operations were raking in the profits during the credit boom, and should probably share in the losses. It also highlights a fundamental flaw in the bonus culture: that costs and benefits associated with risk-taking are not equally shared. Successful traders can make a fortune, while those that fail have little more to lose than their jobs. What's more, the annual merry-go-round means banks can end up paying bonuses on trades that subsequently prove extremely costly. Changing this would require a sustained, co-ordinated effort from the banks. This seems unlikely given their continued battle with hedge funds for the best talent. Some banks have weathered the storm better than others: Goldman Sachs's compensation to revenue ratio actually fell in 2007. Others may be more disciplined in managing costs. Even so, the crisis is a timely reminder that investment banking is a business where investors are engaged in a joint venture with employees. Shareholders should never forget that they are very much the junior partners. Equities catch-up Last Friday's stock market sell-off on both sides of the Atlantic suggests that equity prices are finally catching up with events in the credit markets. For much of the past six months, equity prices have suggested the credit squeeze was limited to the financial markets. Excluding the sell-off in bank shares, the major share indices seemed to be largely unaffected. But it seems fanciful to assume that the deleveraging in the banking sector – the engine for credit creation – will not have an effect on the broader economy. Weak US jobs data suggest the housing slump and higher borrowing costs are biting. It will be months before we know whether the US has slipped into recession. But it is significant that equity investors have started to discount this outcome. **The flaw in the logic of investment banks' largesse** <http://www.ft.com/cms/s/0/9a68e5f8-bc88-11dc-bcf9-0000779fd2ac.html>

- An uncertain economic environment is causing companies to take a more sceptical look at new technology investments, says Anne Mulcahy, chairman and chief executive of **Xerox**, the US documents company. Her comments, in an interview with the Financial Times, are the latest indication that fallout from the subprime mortgage crisis and concerns about a US economic slowdown could cause companies to rethink spending on big IT projects – a key source of sales growth for technology companies. **“The hurdle rate for making investments has gone up in general,” said Ms Mulcahy. “I think what we see in the US is heightened anxiety. We see the financial services industry tightening their belts, and rightfully so, based on the impacts there.”** Ms Mulcahy’s comments followed a warning in November by John Chambers, chief executive of Cisco Systems, the world’s biggest networking company, who said it had experienced “softness” in orders from big US customers. He said Cisco had seen a sharp fall-off in orders by financial services firms – traditionally among the biggest purchasers of IT equipment – many of which have been lumbered with big writedowns triggered by the credit squeeze. **Xerox warns companies cutting IT spending**
<http://www.ft.com/cms/s/0/d6675ae8-bc7f-11dc-bcf9-0000779fd2ac.html>
- Gordon Brown on Sunday warned Britain’s economy faces a “dangerous” year ahead as he battled against rising energy prices and higher pay awards that he fears could undermine his pledge to “break the back of inflation”. Although he insisted Britain’s economy was strong, the prime minister saw dark clouds gathering across the Atlantic, including last week’s sharp rise in unemployment that raised fears of a serious US downturn. Surveying the US economy, the fall-out of the credit crunch and global inflationary pressures, Mr Brown told the Observer, the British Sunday newspaper: **“This is a difficult and dangerous situation for the world economy.”** But he remains confident the British economy will dip only slightly this year before recovering in 2009, a view founded on a belief that inflation has been largely tamed, allowing the Bank of England to cut interest rates. But the situation remains fragile, a fact implicitly recognised on Sunday by Alistair Darling, chancellor, who personally intervened to question why energy companies were imposing double-digit price rises. Mr Brown also admitted **more needed to be done to “break the back of inflation”**, starting with a continued insistence on below-inflation pay rises for public sector workers, in spite of an independent review recommending more. Both Mr Brown and Mr Darling have used New Year interviews to highlight the perils facing the British economy, insisting the underlying conditions are sound and that they are taking “tough decisions” for the long term. The last thing Mr Brown or Mr Darling want is for consumers to take fright and to start tightening their belts excessively and both have refused to urge households to change their behaviour. Mr Brown on Sunday said he was taking decisions for “the long haul” – seen by some as a hint at an election in 2010. **UK faces dangerous year, says Brown**
<http://www.ft.com/cms/s/0/e76df190-bc97-11dc-bcf9-0000779fd2ac.html>

Retail

- Jan. 9 (Bloomberg) -- Holiday sales in the U.S. climbed 4.5 percent, ahead of ShopperTrak RCT Corp.'s forecast, as retailers lured customers with discounts on clothing and electronics. The gain exceeded the projection of a 3.6 percent increase, ShopperTrak said in a statement today. Customer visits dropped 2.7 percent during November and December from a year earlier, the firm said. "This holiday traffic slide mirrors the trend seen throughout 2007 of consumers visiting retail locations less but spending more," the Chicago-based research firm said. Sales were helped by a surge in spending the final weekend before the Christmas holiday, ShopperTrak said. Wal-Mart Stores Inc., Macy's Inc. and Kohl's Corp. offered last-minute promotions to attract cash-strapped shoppers in the face of the worst housing slump in 27 years and gasoline costs that exceeded \$3 a gallon. Other analysts and research firms have projected holiday sales may be the worst in at least five years. The National Retail Federation has forecast a 4 percent rise, the smallest since 2002. The International Council of Shopping Centers said yesterday that sales at stores open at least a year climbed "a little under" its 2.5 percent forecast during the final two months of 2007. Many retailers report December sales results tomorrow. Target, Wal-Mart
Lauri Brunner, a retail analyst at Thrivent Investment Management in Minneapolis, said ShopperTrak's findings "don't seem to foot" with numbers she looks at. Target Corp. said last month that same-store sales for December may decline. "Look at Wal-Mart and Target, two of the largest retailers out there, and look what they're going to do in December," said Brunner. Thrivent oversees \$70.6 billion in assets. Wal-Mart said Dec. 6 that same-store sales would rise between 1 percent to 3 percent during the month. ShopperTrak measures foot traffic in shopping centers and malls using more than 50,000 video devices and derives its estimate for a total sales increase in part from past U.S. Commerce Department sales data. The ICSC bases its forecast on surveys of as many as 60 retail chains and looks at same-store sales. Same-Store Sales Same-store sales results, which are smaller than overall revenue, are considered a key measure of a retailer's performance because they exclude locations that have recently opened or closed. Specialty-apparel sales, which exclude most discounters and department stores, slowed in December from a year earlier after a decline in consumer purchases of women's clothing, MasterCard Advisors' SpendingPulse said. Total sales of women's apparel fell 3.8 percent last month, Michael McNamara, vice president of research and analysis at MasterCard Advisors, said in an interview today. "The economic environment is not as robust as it was a year ago," McNamara said. Men's clothing sales climbed 1.6 percent in December and shoes rose 5.9 percent, according to MasterCard Advisors. Internet sales surged 32 percent. **ShopperTrak Says Holiday Retail Sales Climbed 4.5%**
<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aP7GHXxcdatg>
- The prospect of a consumer spending slowdown in the important US market clouded the upbeat mood Sunday at the start of the global consumer electronics industry's biggest annual jamboree in Las Vegas. At the same time, sharply falling prices for some consumer gadgets this year, and slow development of the digital services needed to stimulate demand for more devices, are forecast to cause parts of the US market to shrink compared with 2007. **Growth in consumer tech spending this year is likely to dip to 6 per cent, according to an estimate from the Consumer Electronics Association.** That

is barely half the 11 per cent recorded in 2007 and 13 per cent the year before, although the trade body's estimates have proved overly conservative in recent years. In spite of those headwinds, however, electronics businesses appear poised to fare better than most other consumer-dependent sectors this year, according to forecasts by industry analysts and executives. At an estimated \$162bn, the US accounted for slightly less than one-quarter of total consumer purchases of TVs, PCs, mobile phones and other electronics, making it an important bellwether of global demand. Shawn DuBravac, the CEA's chief economist, warned that US consumers might become more cautious in the first half in response to housing market dislocation, increasing their spending again in the second six months. But he forecast consumer caution would have little impact on electronics makers as buyers shift spending in favour of home entertainment systems. "They're certainly more insulated than household durables and appliances, as well as cars," said Tobias Levkovich, chief US equity strategist at Citibank. Half of discretionary spending in the US comes from the top 20 per cent of wage earners, so electronics products should continue to do well. The boom in sales of flat-screen and digital TVs and a shift to high-definition video appear likely to underpin the next phase of growth. The CEA believes sales should increase 13 per cent this year to \$30bn. **Consumer sales of desktop and notebook computers are likely to fall by 2 per cent.** Digital camera sales are also forecast to fall by 1 per cent. Revenues are unlikely to pick up until services to print pictures directly from a camera prompt consumers to upgrade, said Mr DuBravac. **Spectre of US slowdown haunts tech fair** <http://www.ft.com/cms/s/9b084804-bc84-11dc-bcf9-0000779fd2ac.html>

Retirement

Risk

Savings Rate

Tech

Wall Street

Don't Fight The Fed

I Disagree . . . and why

[Article of the week:](#)

Best of the Dog

Thursday, January 10, 2008 at 15:52 CDT

last update today 4 CT

the bulls lost big time today. there was very heavy selling into the close

the horsemen and china nets (the "bull market" leaders) were all red.

today confirms the dead cat bounce is on life nine.

I expect tomorrow to be down . . . BIG

August lows go on very heavy volume next week.

Thursday, January 10, 2008 at 6:50 CDT

from this morning's IBD "Big Picture"

at first glance yesterday "might seem to suggest some welcome resilience"

However:

"declining stocks outnumbered advancing issues" on both NYSE and Nasdaq
the Nasdaq had dropped 8 straight days - a market in a down trend "will always . . . show a few signs of life"

the Nasdaq's nine biggest price gains all occurred during the 2000 to 2003 bear market
during the past few days leading stocks have begun to crumble "that's typical of a down trending market"

Tuesday, January 08, 2008 at 20:54 CDT

let's see how those horsemen did

was it a rally for old 2007 or was it big guys manipulating the tape to hand bags to little guys?
you be the judge . . .

from this morning:

at 10 CT horses are as follows:

AMZN 90.48 UP 1.66
RIMM 102.27 UP 2.38
AAPL 180 - UP 2.87
GOOG 655.17 UP 5.92

and my honorary horse:

BIDU 354.50 UP 10.15

from this evening:
at 10 CT horses are as follows:

AMZN 87.88 DOWN .94
RIMM 96.44 DOWN 3.39
AAPL 171.25 DOWN 6.39
GOOG 631.68 UP DOWN 17.57

and my honorary horse:
BIDU 345.21 UP almost an entire dollar

now who could have seen that coming Homer???????

so what comes next?

the bear says the rug gets pulled on AMZN (a trade lower than 75) and BIDU (a trade below 300) before the closing bell rings on the 3rd Friday of 2008.

Tuesday, January 08, 2008 at 10:15 CDT

the horsemen ride again!

it is 2007 again for the day

beta chasing in its full glory. however unlike the fun game of we all get rich played last quarter. this game is "run up the betas so we can short them at higher prices"

at 10 CT horses are as follows:

AMZN 90.48 UP 1.66
RIMM 102.27 UP 2.38
AAPL 180 - UP 2.87
GOOG 655.17 UP 5.92

and my honorary horse:
BIDU 354.50 UP 10.15

these moves will suck in the "I want to buy buy buy" little guys, knock out the "I can short too" novices and roil the options.

in my world there is only one way to respond - buy puts on the cheap, particularly Feb puts, in particular the AMZN 80s at the blue plate special price of 3.75.

It is fun to be a bear in a world that thinks it good news the Fed is cutting