

The Other Side of the Street January 27, 2008

Comments

``The 75 basis-point cut was too much too quick," MacQueen says. Bernanke didn't get ``enough bang for his buck. He used a lot of ammo for very little reward.''

As you are all aware, the Fed once again tried to bail out Wall Street with an emergency 75 BPS cut Tuesday morning. By Wednesday afternoon the Street declared the bottom in just like it was in August when the VIX hit 37. Thursday the little guys were buying with both fists, just like in August. Then Microsoft reported earnings and futures soared. The markets gapped open Friday and were off to the races just like in August. Then suddenly the script changed. Instead of charging higher the market rolled over and went pretty much straight down the rest of the day. At least for a day, the calendar said 2008 . . . not 2007.

So the Fed has now fired 175 BPS in cuts with another 50 expected this week. If the script is followed, the Fed Funds rate will be down to 3.0, just 300 BPS left to zero. The latest salvo as with the prior cuts was cheered and then sold. The markets are now substantially below where they were when the Fed rode to the rescue. The markets seem to in fact be grasping that the problem has never been high interest rates, but instead a decimated credit system.

In other news of note, a 30 year old trader lost 7 BILLION USD at a French bank that had been perceived as one of the tops in the world in trading sophistication. If a highly regulated industry like a bank missed a 7 BILLION dollar problem, what are the chances that there are similar issues lurking in the unregulated hedge fund industry? By dollar reference, the entire LTCM issue was 4 billion (of course that was back in the day when a billion was a bunch).

While on the trip down memory lane, let us also recall that it was the Fed who brokered the behind the scenes deal that bailed out LTCM. That too lurked in the shadows until it was almost too late. One might wonder if in fact the 75 BPS cut and a now proposed 50 BPS this week have little to do with interest rates and everything to do with a behind the scenes deal to prop up one or more incredibly leveraged hedge fund whose liabilities might come CRASHING into world view. If that is in fact the case, all hell is about to break loose.

Even without exploding hedge funds, next week should be quite a challenge. Lots of earnings, lots of economic news and the aforementioned Fed meeting. Since the "good news" from Microsoft was sold hard on Friday, what does that indicate will happen if companies have bad news? How will the market justify a soft economy rally based on hoped for future Fed cuts when the Fed is already down to less than half its clip? And what about the Fed cut this week? less than a half and it disappoints, a half and it is sell the news and 75 BPS shows pure panic.

But on the bright side for bulls, the VIX hit 37 and that always means stocks rally. At least that is what they said on CNBC. Actually the whole hit 37 and rally is pretty much the August 2007 story. If you go back to the 2000-2 bear market, the VXO (the VIX at the time) had numbers well into the 40s and the market continued to plunge.

So either the big 37 was the only thing one needed to know in order to find the bottom, or it like any individual data point was one of thousands of pieces of information to filter. What happens this week remains to be seen. The specter of month end mark ups is there of course. One knows that both the momentum funds and quant funds have taken a tremendous beating, should there not be a month end rally it is one of more of those type funds that could be the trigger for the next leg down.

One can also assume that if the Wednesday lows break convincingly there will be a great deal of trader money on the wrong side of that move and an acceleration to much lower lows will be likely.

Will the last week of January be a blue sky week from 2007 or will it confirm that 2008 will be a much different time? I will go with George Soros (see below), the bulls can have Helicopter Ben, the VIX bottom is in and the whole CNBC cheerleading squad.

Stock Notes

- **Talk about bad timing... Bank of America and Wachovia both announced terrible fourth quarters this week.** Both banks revealed almost 100% drops in year-over-year earnings, thanks to the typical array of subprime losses, choppy markets and bad bets. Bank of America wrote down \$5.2 billion of CDOs, over 76% more than its CFO Joe Price predicted in November. Wachovia took a \$1.7 billion write-down. Wachovia reps also announced that they've set aside another billion and change for future losses. And after their acquisition of Countrywide in current market conditions, we suspect BoA is planning on more big short-term losses, as well.
- New York Attorney General Andrew Cuomo has launched an investigation into [Merck & Co.](#) and [Schering-Plough Corp.](#)'s handling of a controversial study of their cholesterol drug Vytorin. Mr. Cuomo has served the companies with subpoenas as part of a probe into whether the companies "deliberately concealed" negative results from the study, called Enhance, his office said in a news release on Saturday. WSJ online
- ATT "backed its '08 guidance, but analysts thought that might be too upbeat." IBD 1/25/08
- MOT tops for this Q but guides lower for next Q. IBD 1/24/08
- Wednesday midday lows at 1 PM eastern were NASDAQ 2202, SP500 1270 and Dow 11713. At 3 PM eastern were NASDAQ 2253 and Dow 11940. At 4 PM eastern were NASDAQ 2316, SP500 1338 and Dow 12270. The 625-point swing from bottom to top was the second largest in the Dow's history
- The Heng Seng suffered its largest drop ever on Tuesday
- The nine biggest up days in Wall Street history were all during the 2000-2 bear market

- “as we look ahead to 2008, we are not expecting market conditions to improve, and perhaps may continue to decline in the near term” Lennar CEO (one of the nation’s largest homebuilders).
- The stimulus package will allow FRE and FNM to accept larger loans, increasing their exposure to credit risk. Currently FNM and FRE guarantee about half of the \$10 trillion in mortgage debt. In Q4, 71% of new mortgages were FNM or FRE guaranteed. WSJ 1/26-7/08 A8.
- MILWAUKEE (AP) -- Harley-Davidson Inc. says riders concerned about the economy are throttling big purchases, like the company's classic motorcycles, sending its profit down 26.3 percent in the fourth quarter.CEO Jim Ziemer called the retail environment "challenging" for this year and said dealers report consumers are worried about the direction of the economy. They're holding off on larger purchases, like Harley-Davidson motorcycles, which start at \$6,695 but can often cost more than \$20,000 fully loaded. "The big thing is not lack of interest," Ziemer said in an interview. "People are waiting to see what happens with the economy before making big decisions."
- Investors are nervous because GOOG and YHOO get “a lot of their ad dollars from financial, real estate and retail sectors.” GOOG earnings Thursday, YHOO Tuesday. GOOG revs expected to be 3.44B. fewer searches will also hurt, people use the net to research things prior to purchase. If fewer searches, fewer clicks. The average number of GOOG searches fell from 4.4 million in Oct to 4.2MM in Nov to 4.0 in December. # of topic searches fell to 37.9 in December from 40.8 in November. IBD 1/28/08 A7
- EBAY beat top and bottom but gave weaker than expected guidance. IBD 1/28/08 A7

Notes

- **“Subprime” has been voted “word of the year”** by the American Dialect Society. The one-word solution for less-than-ideal lenders narrowly ousted buzzwords like “Facebook” and “waterboarding” for the top spot in 2007.
- **“I think we can expect further nastiness as we get fourth-quarter earnings results over the next several weeks,”** forecasts Chris Mayer. “If you’ll recall the unhappy third quarter, earnings shrank 8.3%. The market consensus is that earnings will shrink further. If true -- and I think it’s as good a bet as backing the New England Patriots -- it will be the first time the market has had back-to-back negative earnings growth in nearly six years.
- The unemployment rate has now risen 0.6% in less than 12 months. Historically speaking, any rise of more than 0.5% in less than 12 months also indicates a recession

- “Don't look now,” reports our friend Chuck Butler straight from his EverBank World Markets trading desk, **“but eurozone inflation is rising -- up 3.1% in November. Whoa, Nellie!**
- **At the same time, restaurants across the country are facing their worst market in at least four years,** reports the National Restaurant Association. The NRA's performance index dropped to 99 in November, the association recently reported, down 1% from October and its lowest level since 2003. The index is based on the responses to eight questions of the monthly Restaurant Industry Tracking Survey. The most telling facet of the index proved to be the Expectations Index, which dropped below 100 for the first time in the index's history. In no time in the NRA's history have restaurant operators been so pessimistic about the next six months.
- **“The current crisis is the culmination of a super-boom that has lasted for more than 60 years,”** adds the legendary investor George Soros in the Financial Times. **“The current crisis marks the end of an era of credit expansion based on the dollar as the international reserve currency.** The periodic crises [preceding the current crisis] were part of a larger boom-bust process... “Credit expansion must now be followed by a period of contraction, because some of the new credit instruments and practices are unsound and unsustainable. **The ability of the financial authorities to stimulate the economy is constrained by the unwillingness of the rest of the world to accumulate additional dollar reserves. Until recently, investors were hoping that the U.S. Federal Reserve would do whatever it takes to avoid a recession, because that is what it did on previous occasions. Now they will have to realize that the Fed may no longer be in a position to do so.”** Mr. Soros is famous for having made a billion dollars in one day betting against the monetary foolishness of Britain's elite back in 1992. **[Soros in my mind is one of the greatest investors of all time and he is so because he looks forward not backward]**
- Margin debt reached a record \$381 billion in July. It had dropped to \$322 in December. Barron's 1/28/08
- New York commercial RE values have fallen 20% from their peak. REIT have “a remarkable track record when it comes to predicting what will happen to prices of commercial real estate. “The public market is saying the drop is going to be dramatic.” For current REIT pricing to make sense, RE values “need to fall another 15%” The last time REIT readings were this bad was just before the early 1990s recession WSJ 1/26-7/08 B3
- The wind has left the sales of momentum traders. Example the Vanguard Growth Equity Fund which uses a momentum strategy is off 14% YTD after a 23% gain last year. WSJ 1/25/08 C1
- US consumers bought \$9.5 trillion in goods and services last year, China 1 trillion, Indian 650 billion; WSJ 1/26-7/08 A9

- Societe General discovered a rogue trader had cost the French bank 7.2 billion in losses, the largest trading loss ever. The bank blamed it in part on numerous missed opportunities by its back office supervisors who became aware on multiple occasions of suspect trading activity. The banks total exposure at the time it was discovered was over 75 billion dollars, twice the net worth of the bank. The trading was primarily large bets that the DAX and CAC would rise. Losses were covered up by recording false offsetting entries. WSJ 1/26-7/08 A3
- Societe General “is known internationally for its expertise in equity derivatives.” Risk Magazine awarded it the Equity Derivatives House of the Year for 2007. Its “computer systems are considered some of the most complex in banking for handling equity derivatives.” The rogue trader Kerviel’s “trades were winning [at the end of December 2007]. But after the holidays, the market turned against him.” The bank would not comment on the trades but said “had we not acted swiftly, the loss would have been 10 times worse.” WSJ 1/25/08 A12
- Italy could be on the “brink of recession real soon” WSJ 1/26-7/08 A2
- “The Fed has long argues that it only responds to stock prices insofar as they effect the economic outlook. . . . None the less officials say they were motivated not so much by Monday’s drop as the cumulative decline in stocks through January . . .” Criticism of Rate Cuts Mounts WSJ 1/25/08 A2
- In California 4Q07 defaults were double that of a year earlier. In Orange County ¼ of the homes listed for sale are foreclosed or homeowners trying to “short sell” which means selling for less than the note on the house. December sales in SF were the lowest in 20 years. Sales of homes have dried up in part “because of relatively high rates on jumbo loans”. WSJ
- GDP for 2007 – Brazil 1.3 trillion, China 3.4, India 1.1 Russia 1.2, and south Africa .3, total 7.3 trillion. State of California GDP 2006 – 1.7 trillion; US 10 trillion.
- Economists, executives and policy makers gathered at the World Economic Forum’s annual conference agreed that the 75 BPS cut “did little to smooth a rough road ahead.” John Mack MS said the problems that have developed over the past several years will not be solved in a week. WSJ 1/24/08 A9
- A Fed cut of either 50 BPS or 75 BPS coupled with the 75 this week would be the “steepest” rate cut in such a short period of time since 1982 WSJ [if memory serves that was when rates were coming down from double digits, not 4]
- Even with a pair of solid gains, the stock market remains in a downtrend. Headlines and rumors of headlines knock around the indexes day to day. . . . stocks tumbled almost unopposed for more than three weeks. It was only a matter of time before a rebound of some type took hold. It’s too soon to know whether this attempted rally has legs. Even if it does, almost no stocks are showing the

kind of technical and fundamental strength you want in a potential leader. Big Picture IBD Jan 25.

- An up tick in nationwide office vacancies is the first in four years. Softening markets include Southern California, Chicago, Minneapolis and Dallas. Office vacancy in Orange County rose 10% in Q4. IBD
- Tricet signals no ECB rate cut stressing inflation fighting over growth issues.
- CBO sees higher fed deficit in 2008 predicting \$250 B up from \$160B. this does not include any effect from the proposed stimulus plan, which would add another \$100-150B
- Companies are taking a “cautious approach to adding jobs”. Some economist say companies are moving more quickly to impose hiring freezes than in the past, much as they have learned to respond quickly to weakening demand by working down inventory and curbing production. State and local governments hurt by revenue drop offs tied to the housing crisis are also putting a hold on hiring. WSJ 1/24/08 A13
- Existing-home sales fell 2.2% to a 4.89 million annual rate in December, according to the National Association of Realtors. The median home price also declined to \$208,400 in December, down 6% from \$221,600 in December 2006. Inventories of homes fell 7.4% at the end of last month to 3.91 million available for sale, which represented a 9.6-month supply at the current sales pace. Sales of single-family existing homes fell by 13% in 2007, the biggest drop in 25 years.
- From California, we learn that the jobless rate has jumped to over 6%.
- The mid-cap FTSE 250 in Britain is down more than 20%. And the Japanese index – the Nikkei 225 – is down 24% since its high in July.
- Jan 22 – Todd Harrison – things that make me go hmmmmm - *How many times the media has used the word capitulation.* Were they around in 98? Or 2000? Or 1987 for that matter? True capitulation is when there are NO bids and the thought of owning anything makes you feel like you've eaten a bad clam sandwich.
- This morning the Federal Reserve moved to lower both the Federal Funds and Discount rates in an emergency cut for the first time since 2001. **This is also the first time in its history that the Federal Funds rate has been lowered 75 basis points** since the Fed Funds rate became the central policy-making tool. "The Committee took this action in view of a weakening of the economic outlook and increasing downside risks to growth. **While strains in short-term funding markets have eased somewhat, broader financial market conditions have continued to deteriorate and credit has tightened further for some businesses and households.** Moreover, incoming information indicates a deepening of the housing contraction as well as some softening in labor markets."

- **The most serious crisis since World War II is hanging over the US, with the likely recession to affect Europe as well, stated Hungarian-born stock market guru György Soros** in the Monday issue of the Austrian liberal daily *Der Standard*. The economic policy of the past few years has been formed by wrong decisions originating from “market fundamentalism,” the belief that the common interest is best served by individual decision-making and that attempts to maintain the common interest by collective action distort the market mechanism. There is not much to be expected from the economic stimulus package of \$130 billion to \$140 billion that was presented by President George W. Bush, either, Soros said. Now that the US restricted its guiding position by placing emphasis on military interventions, Europe has to take up a more active role in global affairs, said Soros at a podium talk in Vienna.
- what can be described as a market crash — we think the major market indices dropping approximately -20% in about a 3-month period qualifies. BMR

Weblinks

Credit

- **Consumer borrowing shot up to an annual rate of 7.4% in November, or \$15.4 billion**, reported the Fed. Credit card debt, as you’d expect, led the way during the start of the holiday season, spiking to an annual rate of 11.3% -- the seventh consecutive monthly increase. According to the Fed, total consumer credit has increased to a new all-time high of \$2.51 trillion. Not a dime of that consumer liability includes mortgage debt... the Fed’s credit report doesn’t include it.
- Jan. 25 (Bloomberg) -- **Federal Reserve Chairman Ben S. Bernanke is proving powerless to prevent a deteriorating commercial real estate market.** While the yield on 10-year Treasury notes fell 1.43 percentage points in the past three months to the lowest since 2003 following four interest rate cuts, **the cost of borrowing for apartment buildings, offices, retail properties and hotels climbed as much as 1.25 percentage points**, according to David McLain, principal and chief investment officer of Palisades Financial LLC, a private equity firm in Fort Lee, New Jersey. **“The market is locked up right now because there's a huge overhang of leveraged assets of every type, development deals that won't meet projections made last year when things were rosy,”** said David Tobin, a principal at New York-based Mission Capital Advisors LLC, which was involved in \$5 billion of asset sales last year. **“It will end just like the residential housing market.”** Bernanke's easing **hasn't stopped the \$3.2 trillion commercial market from starting a slide that mirrors the housing decline**, where prices have dropped for the first time since the Great Depression. U.S. commercial property prices probably will fall 10 percent in 2008 from last year's peak after rising 60 percent since 2002, said Dan Fasulo, director of market analysis at New York-based research firm Real Capital Analytics Inc. Late Payments **Delinquencies of securitized commercial mortgages may quadruple in the next 18 months to almost 4 percent,**

said Kenneth Rosen, an economist at University of California, Berkeley, who runs a real estate hedge fund. About 70 percent of commercial mortgages are pooled into commercial mortgage-backed securities that are sold to investors, Rosen said. Commercial loan rates are based on spreads, or the difference between the amount of money CMBS promise to pay investors over what the 10-year Treasury bill will pay. Different parts of the mortgage have varying prices depending on the risk profiles of the individual slices of the security. The first part of the loan is priced in correlation with the highest-rated, or AAA, piece of the security, said Scott A. Singer, executive vice president of New York-based Singer & Bassuk Organization, which arranges financing for property sales. The rest of the mortgage costs more because it's based on the other, riskier pieces, he said. **The spread for a security's AAA tranche widened to 125 basis points, or 1.25 percentage points, on Jan. 16 from 26 basis points a year earlier,** data compiled by Morgan Stanley show. Debt Service Yields for the B-rated slice, five risk levels below AAA, grew to 1,400 basis points, or 14 percentage points, above the Treasury bill, and averaged 901 basis points in the past year, Morgan Stanley said. A buyer could borrow \$1 billion -- not unheard of in the New York City market -- a year ago and expect to pay annual debt service of \$58 million, Singer said. Today that same mortgage would have an annual cost of \$76 million, he said. **``That's assuming you can find the money," Singer said. ``It's much harder now than it was a year ago.** The yield has widened partly because banks have tightened their bond-secured lending, according to a Jan. 11 report from JPMorgan Chase & Co. analysts in New York. Wall Street underwriters allowed lending guidelines to slacken because they needed the mortgages to feed the \$760 billion market for securities backed by commercial mortgages, said Scott Tross, a mortgage specialist and partner at the Herrick, Feinstein LLP law firm in Newark, New Jersey. Feed the Market **``Lending standards became more lax because people knew they wouldn't be keeping the loans on their books,"** Tross said. Moody's Investors Service, a unit of New York-based Moody's Corp., warned in April of a steady erosion in underwriting quality, and Standard & Poor's, a unit of New York-based McGraw-Hill Cos., said the vast majority of commercial mortgages in new bonds required payment of interest only, without any reduction in the loan's principal. Lenders responded. According to the Fed's Senior Loan Officer Survey, published in October, half the banks surveyed made loans more difficult to obtain in the third quarter of 2007. **The average down payment lenders required rose to 23 percent of the purchase price in the fourth quarter, the highest in three years, from 19 percent in the second quarter,** according to New York-based Merrill Lynch & Co. analysts Roger V. Lehman and Julia Tcherkassova. Loan Securitization **The number of new commercial mortgage-backed securities, which help fund loans, dropped 54 percent in the fourth quarter from a year earlier,** data compiled by industry newsletter Commercial Mortgage Alert in Hoboken, New Jersey, show. **Lehman Brothers Holdings Inc. analysts predict a more than 50 percent drop in CMBS issuance in 2008, making mortgages even tougher to get.** **``If banks can't securitize the loans, they won't make them," Tross said. ``There will be loans coming up for maturity that will be difficult to replace.** **Manhattan real estate investor Harry Macklowe, owner of the General Motors Building at 59th Street and Fifth Avenue, hired CB Richard Ellis Inc., the world's largest commercial broker, to find new investors or a buyer for the building as he tries to repay a \$7 billion debt by Feb. 9.** Ian Bruce Eichner, a New

York developer who lost two buildings to creditors in the 1990s, defaulted on a \$760 million loan from Deutsche Bank AG last week for his Cosmopolitan Resort & Casino on the Las Vegas Strip. Deutsche Bank will continue to pay for construction while Eichner negotiates a new deal, according to Perini Corp., the project's general contractor. South Korea to U.K. Centro Properties Group, the Glen Waverley, Australia-based owner of U.S. malls, is struggling to refinance A\$3.9 billion (\$3.4 billion) of debt. Investors have wiped out 92 percent of the company's market value since Dec. 12. Two-thirds of Centro's A\$26.6 billion of shopping centers under management are in the U.S. In the U.K., Jones Lang LaSalle Inc., the world's second-largest commercial real estate broker, estimates transactions fell 60 percent during the last three months of 2007 to about 5 billion pounds (\$9.8 billion). Commercial real estate isn't slumping everywhere. South Korea's New Songdo City, a 1,500-acre (607-hectare), \$30 billion city that's being built from scratch, has received financing from a trio of South Korean banks, South Korean steelmaker Posco and New York-based Morgan Stanley Real Estate, said John B. Hynes III, chief executive officer of New York-based Gale International, the project's developer.

Lenders that supply the so-called second-tier, or mezzanine, financing, were charging about 11 percent a year ago in the U.S. due to competition from large, international banks, McLain said. Now the bigger banks have dropped out, **leaving the field to companies such as McLain's Palisades Financial private equity firm, which have a higher cost of funds and charge as much as 5 percentage points more than they did last year for the same loan,** he said. "That cheap money is gone," McLain said. "Almost overnight, we're in the game." No 'Liar Loans' The effects of aggressive lending are apparent in a Long Island, New York, retail center that's about 90 percent built, McLain said. Underwriters for the project estimated rents in the 60,000 square foot mall of more than \$30 a square foot, McLain said. McLain's projection, based on actual retail rents in the area, was about half that. **The mortgage on the property is \$6 million, McLain said. Palisades Financial will bid \$2.8 million, he said.** While lenders on both the commercial and residential sides have been aggressive in the past five years as property values climbed, there are differences between the two. In 2006, almost half of all subprime home loans, available to borrowers with bad or incomplete credit, required no documentation of income, according to data compiled by Zurich-based Credit Suisse Group. No-doc, or "liar loans" as they're called, don't exist in the commercial arena. About \$190 billion of subprime home loans will reset in 2008 to a higher interest rate, Credit Suisse reported. Commercial loans have fixed rates and usually cover 10-year periods. Commercial borrowers also have a higher level of experience, Lehman analysts said in a Dec. 12 report. **Linked Markets "Yes, they did take full advantage of the easy availability of leverage and at times have been over-optimistic about future cash flow streams from properties,"** the report said. "But they are more sophisticated than subprime borrowers, usually with an understanding of what they are getting into and with significant equity at stake." The retail and commercial real estate markets are linked, and they are both at the mercy of turmoil in global credit, said Michelle Meyer, a Lehman Brothers economist in New York. "Housing weakness is likely to lead to a weaker commercial real estate market because fewer houses mean demand for shopping and schools will decline," Meyer said. "The credit problems take it beyond the usual cyclical swings." **Bernanke's Easing Thwarted by Surging Commercial Mortgage Rates**

http://www.bloomberg.com/apps/news?pid=20601109&sid=aaK_r.bfo7TI&refer=home

- Jan. 25 (Bloomberg) -- Banks may need to raise as much as \$143 billion to meet regulators' requirements should rating firms downgrade bond insurers, Barclays Capital analysts said. **Banks will need at least \$22 billion if bonds covered by insurers led by MBIA Inc. and Ambac Financial Group Inc. are cut one level from AAA, and six times more for downgrades by four steps to A**, Paul Fenner-Leitao wrote in a report published today. Banks own \$820 billion of structured securities guaranteed by bond insurers, the report said. "This is a huge amount, but the assumptions we use are also very aggressive," Fenner-Leitao in London said in a telephone interview. The estimate shows how bank capital could be diminished in the event of significant downgrades, he said. Fitch Ratings cut New York-based Ambac Assurance Corp. by two levels to AA last week, and Moody's Investors Service and Standard & Poor's are reviewing Ambac and MBIA for downgrades, casting doubt on the credit quality of \$2.4 trillion of bonds the industry guarantees. Wall Street firms led by Citigroup Inc., Merrill Lynch & Co. and Bank of America Corp. raised \$72 billion from investors after reporting more than \$133 billion of writedowns and credit losses triggered by the collapse of the subprime mortgage market. New York's Insurance Superintendent Eric Dinallo met with executives of banks and securities firms this week to ask them to extend capital to bond insurers and stave off credit rating reductions. The regulator said yesterday its rescue plan will "take some time." Ambac rose today amid speculation that billionaire Wilbur Ross will buy the company. A deal may come within the next two weeks, the Evening Standard newspaper in London reported on its Web site. **Fitch is likely to cut the rankings of other bond insurers in the "very near term," with Financial Guaranty Insurance Co. at greatest risk, Fenner-Leitao wrote in the report.** The capital banks would need to raise includes stock and subordinated debt, the report said. **Banks May Need \$143 Billion for Insurer Downgrades**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aWaP6r1.18YI&refer=home>
- Jan. 25 (Bloomberg) -- Federal Reserve Chairman Ben S. Bernanke's emergency interest-rate cut this week is either just what the doctor ordered or grounds for malpractice, depending on which prominent economists and investors you consult. Stanford University Professor John Taylor says the move "made sense" and Harvard University's Martin Feldstein calls it a "very good thing." Morgan Stanley's Stephen Roach counters that the decision was "dangerous, reckless and irresponsible," and Nobel Prize winner Joseph Stiglitz says it resulted from "bad economic management." The divergence of views stems from the timing of the reduction, less than a day after stocks tumbled from Hong Kong to London, raising prospects of a slide in U.S. markets. While Bernanke has warned of the danger that "fragile" markets pose to the slowing economy, some analysts say he risks rewarding investors who simply made bad decisions. **"By easing aggressively on the basis of no new information, they're sending a message that they have to protect and defend the markets,"** Roach, Morgan Stanley's Asia chairman, said this week at the World Economic Forum annual meeting in Davos, Switzerland. The Jan. 22 reduction in the benchmark federal-funds rate by three-quarters of a percentage point was the largest in the two decades that it has been the principal tool of policy makers.

Reflecting the Economy "Doing it at this time, I think it made sense," Taylor, author of a landmark monetary-policy formula and the Treasury Department's top international official from 2001 to 2005, told Bloomberg Television. "The timing certainly was based on market performance, but the amounts are not far off the mark given the state of the economy." While the Standard & Poor's 500 Index lost 1.1 percent the day of the Fed's interest-rate cut, it has since rebounded more than 3 percent in two days, ending a five-day losing streak. The index is still down 14 percent since touching a record in October. Traders anticipate a further half-point rate cut at the Fed's meeting Jan. 29-30. **That would put the overnight interbank lending rate at 3 percent and bring the cumulative reduction to 2.25 percentage points in less than five months, the deepest cut since 2001, when the U.S. entered its last recession.** This week's change in rates was the first between meetings since 2001 **and the closest to a Federal Open Market Committee gathering in 16 years.** "A Bad Precedent" **"I am concerned that they moved a week before a scheduled meeting, seemingly in direct response to global equities, and that sets a bad precedent,"** says Mickey Levy, chief economist at Bank of America Corp. in New York. **"Waiting a week would not have affected the thrust of monetary policy."** By contrast, former Fed governor Lyle Gramley says that "this was a necessary move, and highly desirable." Up until this week, Bernanke and his colleagues were "timid," he says. "The Fed just didn't recognize the severity of this crisis and therefore didn't act in a timely fashion," says Gramley, now a senior economic adviser at Stanford Group Co. in Washington. "Had the Fed not done it, it would have been considered not just in a slumber but in a coma." SocGen's Rogue Yesterday, Societe Generale SA said a rogue trader caused a 4.9 billion-euro (\$7.2 billion) trading loss at the Paris-based bank. It started unwinding positions linked to European stock index futures on Jan. 21, though Philippe Collas, the head of asset management at the bank, said "it's not possible" that caused the slump in equities. **Policy makers were convinced by late December that increasing volatility in financial markets reflected a weakening U.S. economy and that further rate reductions were needed,** said the official. "The key issue for the Fed is the U.S. markets and the U.S. economic growth, and from this perspective we have had problems for some weeks now," says Christophe Donay, head of economic research and investment strategy at Landsbanki Kepler in Paris. "The cut is not the problem," Donay says. "The communication is key. The Fed has to explain clearly to the market why it did what it did in order to avoid a panic scenario. From this point of view, the Fed still lacks clarity in its speeches." The Fed's Impact Others stress that the magnitude of the Fed's action will be what counts. "Everyone is criticizing the Fed but they lowered the cost of capital by 18 percent," says Dan Genter, who helps manage \$2.8 billion as president of RNC Genter Capital Management in Los Angeles. "That is going to be an overall life preserver to the economy, and it is a huge dose of antibiotics to the financial sector." The Fed's unscheduled move has been a frequent topic of discussions in Davos. Billionaire investor George Soros said the Fed is "doing the right thing," just not quickly enough. "I think the Fed is well behind the curve, and has been reacting instead of being proactive," he said. **"The Fed rate cut showed that the Fed can be pushed around by the markets,"** says Nick Parsons, head of market strategy at National Australia Bank Ltd.'s NabCapital unit in London. **"The Fed is a follower and not a leader. In an attempt to gain control, the Fed has lost credibility."** **Maneuver Room**
By lowering rates by three quarters of a percentage point in one go, the central bank

may be leaving itself less room to maneuver as the outlook develops, says Mark MacQueen, partner and portfolio manager in Austin, Texas, at Sage Advisory Services Ltd., which oversees \$5 billion. **“The 75 basis-point cut was too much too quick,” MacQueen says. Bernanke didn't get “enough bang for his buck. He used a lot of ammo for very little reward.”** Feldstein said in testimony to the Senate Finance Committee yesterday that the Fed should reduce its main rate by “at least” a half point next week. At the same time, the idea of separate fiscal stimulus “deserves attention” because of the risk that rate cuts won't be as effective as in the past. **Bernanke Earns Feldstein Cheers, Roach Jeers for Emergency Cut**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=awFn7moHTXv0&refer=home>

Commercial Real Estate

Commodities

Currency

- **Monetary officials in Zimbabwe unveiled the \$10 million bill this morning.** Inflation is out of hand over there. According to the BBC, Zimbabwe's incredible monetary decline over the last eight years has brought on an estimated 50,000% inflation rate. The new \$10 million bill will be little more than a tiny bandage on a gaping, festering wound. Halting the Zimbabwean dollar's nose dive to worthlessness is all but impossible. The new bill is mostly “designed” to elevate pressure on banks, which are unable to keep up with monetary demand. Queues form around the corner of banks every morning, and most are out of cash by lunch. At a black market exchange rate of around US\$1 per 2.5 million Zimbabwe bucks.... there's not enough paper bills to fill the demand.

Diversification

Derivatives

- And here's something else to worry about. Bill Gross, head of PIMCO, the world's biggest bond fund, calls it the “shadow banking system.” He's referring to the way money and credit fly around the globe, courtesy of the very same “sophisticated” and “free” institutions that created such prosperity for so many people in the financial industry. Banks recognize that not all their loans will be repaid. They operate on margins of safety, with reserves set aside for when things go wrong. But in the worlds of swaps, hedge funds and derivatives...slick operators can invest billions with no margins of safety...and no reserves. The result, Gross says, could be catastrophic: “But today's banking system, as pointed out in recent Investment Outlooks , has morphed into something entirely different and inherently more risky. Our modern shadow banking system craftily dodges the reserve requirements of traditional institutions and promotes a

chain letter, pyramid scheme of leverage, based in many cases on no reserve cushion whatsoever. Financial derivatives of all descriptions are involved but credit default swaps (CDS) are perhaps the most egregious offenders. While margin does flow periodically to balance both party's accounts, the conduits that hold CDS contracts are in effect non-regulated banks, much like their hedge fund brethren, with no requirements to hold reserves against a significant 'black swan' run that might break them. "According to the Bank for International Settlements (BIS), CDS totaling \$43 trillion were outstanding at year end 2007, more than half the size of the entire asset base of the global banking system. Total derivatives amount to over \$500 trillion, many of them finding their way onto the balance sheets of SIVs, CDOs and other conduits of their ilk comprising the Frankensteinian levered body of shadow banks." DR

Housing

- Jan. 24 (Bloomberg) -- Sales of existing homes in the U.S. fell more than forecast in December, capping the biggest annual slump in 25 years and the first decline in prices since the Great Depression. Purchases fell 2.2 percent to an annual rate of 4.89 million, the National Association of Realtors said today in Washington. For all of last year, sales of single-family homes declined 13 percent and prices dropped 1.8 percent, the first decrease since records began in 1968 and probably the first since the 1930s, the group said. Falling property values and stricter borrowing terms will lead to more foreclosures and depress housing for most of this year, economists said. Investors anticipate the Fed will cut interest rates again next week in an effort to prevent the downturn from exacerbating weakness in the broader economy. "There is likely to be little or no increase" in gross domestic product this quarter, Harvard University economist Martin Feldstein told the Senate Finance Committee in Washington today. **"The probability of a recession in 2008 now exceeds 50 percent. If it occurs, it could be deeper and longer than the recessions of the recent past."** Economists had forecast sales to fall to a 4.95 million annual rate from November's previously reported 5 million pace, according to the median estimate of 71 economists in a Bloomberg News survey. Projections ranged from 4.75 million to 5.15 million. **Jobless Claims** A separate report today showed fewer Americans filed first-time claims for unemployment benefits last week. Initial jobless claims decreased by 1,000 to 301,000, the lowest in four months, indicating companies are reluctant to fire workers until they get a better read on the economic slowdown. Resales fell in all four regions led by a 4.6 percent decline in the Northeast. The combined median sales price for homes and condominiums last month fell 6 percent to \$208,400 from December 2006 and was down 1.4 percent for all of 2007 from the previous year, the NAR said. "I do expect sales to remain soft through the first quarter and possibly the second quarter," said Lawrence Yun, the real-estate agents group's chief economist. The number of homes for sale at the end of December fell 7.4 percent to 3.91 million. At the current sales pace, that represented 9.6 months' supply, down from 10.1 months in November. **Inventories** Elevated inventories leave builders with little incentive to break ground on new projects and push down prices on new and existing homes. The Commerce Department is scheduled to report new home sales next week. Purchases of

new houses, which account about 15 percent of the market, fell to a 12-year low in November. Builders broke ground in December on the fewest houses since 1991, making last year's decline in homebuilding the worst in almost three decades, the department said Jan. 17. New home sales are considered a leading indicator of the market because they are tabulated when a contract is signed. Sales of existing homes reflect contract closings, which typically come a month or two later. Sales of single-family homes decreased 2 percent to a 4.31 million pace, the fewest since 1998, according to today's report. Sales of condos and co-ops dropped 3.3 percent to a 580,000 rate. Slump to Continue The housing slump ``may continue to be a drag on growth for a good part of this year," Fed Chairman Ben S. Bernanke testified to the House Budget Committee on Jan. 17. Policy makers this week cut the benchmark overnight lending rate between banks by three-quarters of a percentage point in the first emergency action since 2001. Futures markets suggest the central bank will probably lower the rate again at the next scheduled meeting on Jan. 29-30. Mortgage rates are also dropping, making homes more affordable to those able to get financing. The Realtors group's affordability index in November and October was at the highest level in more than two years. Still, concern that prices will keep falling may continue to keep many buyers out of the market, economists said. Buyers May Wait ``Would-be homeowners are not going to jump into the market to buy new homes no matter how much prices have dropped until they get a solid feeling that prices have bottomed," said Ellen Zentner, an economist at Bank of Tokyo-Mitsubishi UFJ Ltd. in New York. Meritage Homes Corp., a builder whose biggest markets are Texas, Arizona and California, said last week that that fourth- quarter revenue fell 25 percent because of declining orders. For all of last year, closings fell 28 percent. **``It is clear that these are extremely difficult times for all homebuilders,"** Chief Executive Officer Steven J. Hilton said in a statement.

Housing Finance

Macro Economic

- Jan. 28 (Bloomberg) -- **The U.S. economy may already be in recession; other countries might not be far behind.** Japan, Britain, Spain and Singapore, which together represent about 12 percent of the world economy, are vulnerable as fallout from the U.S. worsens their economic weakness. **Even emerging markets, including China, are likely to suffer as exports to the U.S. wane.** The result: Global growth may decelerate close to the 3 percent pace economists deem a worldwide recession, from a 4.7 percent rate in 2007. ``Some form" of global recession ``is inevitable at some point," former Federal Reserve Chairman Alan Greenspan said in a speech in Vancouver last week. The developing slump puts pressure on central bankers in Japan, the U.K. and the euro region to follow the lead of Fed Chairman Ben S. Bernanke, who last week accelerated interest-rate cuts in the U.S. with an emergency move to lower the benchmark rate by three-quarters of a percentage point. Policy makers may follow that with another cut of as much as half a point after a two-day meeting that starts tomorrow, futures trading indicates. ``The odds are shifting toward a more significant global monetary easing," says Richard Berner, co-head of global economics for Morgan Stanley in New York. Jim O'Neill, **chief economist at Goldman Sachs Group in London, says growth in the**

first half of 2008 may be the ``weakest since 2002 and maybe even 2001," during the last global downturn. ``The economy is slowing everywhere," he says. No Contraction A worldwide recession doesn't require a global contraction in output, which rarely happens; economists at the International Monetary Fund say it would take a slowdown in global growth to 3 percent or less. By that measure, three periods since 1985 qualify: 1990-1993, 1998 and 2001-2002. **The contagion from the U.S., which according to the IMF represents about 21 percent of the global economy, is spreading via multiple channels.** Less spending by American consumers and companies reduces demand for imported goods. The meltdown of the U.S. subprime-mortgage market has pushed up credit costs worldwide and forced European and Asian banks to write down billions of dollars in holdings. Tumbling U.S. stock prices are dragging down markets elsewhere. ``We'll see more collateral damage," says Allen Sinai, chief economist at Decision Economics in New York. ``The risk of a global recession is rising." Such a catastrophe, while increasingly possible, isn't yet probable, economists say. Sinai puts the odds at 20 percent. Nariman Behraves, chief economist at Global Insight in Lexington, Massachusetts, reckons it's about 30 percent. Postponing a Forecast The global implications of a U.S. recession dominated discussions last week at the World Economic Forum in Davos, Switzerland. **In Washington, the IMF postponed publication of its latest world economic forecast, originally due Jan. 25, to take into account recent market turbulence.** Japan's economy is particularly at risk. Its housing market is slumping as stricter building-permit rules drag home starts to a four-decade low. A drop in construction demand led Tokyo Steel Manufacturing Co., the nation's biggest maker of steel girders, to lower its profit forecast Jan. 22. **``Japan is on the brink of a recession,"** says Hiroshi Shiraishi, an economist at Lehman Brothers Japan Ltd. in Tokyo. ``Exports are supporting the economy, but with the U.S. slowdown they're likely to lose momentum." Yen's Toll The yen's 13 percent rise versus the dollar in the last six months is also taking a toll. The Japanese currency reached a 2 1/2-year high of 104.97 to the dollar last week and traded Jan. 25 at about 107. That is near the break-even point for Japan's exporters, who say they can remain profitable as long as the currency is weaker than 106.6, according to a government survey. Kozo Yamamoto, head of the ruling Liberal Democratic Party's monetary policy panel, urged the Bank of Japan to cut its benchmark interest rate, already the lowest in the industrialized world at 0.5 percent. ``Concerns over a recession are emerging not only in the U.S., but in Japan as well," Yamamoto said in a Jan. 23 interview. ``The BOJ should cut rates back to zero immediately." **Singapore may already be in a recession. Its economy contracted for the first time in 4 1/2 years in the fourth quarter as factory output slowed and electronics exports dropped. The cooling local real estate market worsened the slowdown for financial services firms.** Credit Crunch Housing is also slumping in the U.K., where loans for home purchases dropped to a two-year low last month. ``The credit crunch moved into its fourth month in December," Michael Coogan, director general of the Council of Mortgage Lenders in London, said Jan. 21. ``Lending volumes are likely to remain weak for the next few months." Retail sales fell in December by the most in 11 months. ScS Upholstery Plc, owner of 96 sofa stores in the U.K., said Jan. 14 that earnings will suffer after ``disappointing" December and January business. The U.K.'s biggest nightclub owner, Luminar Group Holdings Plc, said Jan. 18 that sales growth slowed as Britons spent less on nights out. ``It's a gloomy picture for the consumer," says

James Knightley, an economist at ING Financial Markets in London. "The prospect of recession is becoming more realistic." BOE Prediction Retailers Tesco Plc and Marks & Spencer Plc this month called for interest-rate cuts to help consumers, who have 1.4 trillion pounds (\$2.76 trillion) of debt. Economists surveyed by Bloomberg predict the Bank of England will lower its main rate a quarter percentage point, to 5.25 percent, on Feb. 7. **Spain is also grappling with a housing boom gone bust.** Banco Bilbao Vizcaya Argentaria SA, Spain's No. 2 lender, predicts property prices will fall this year and building permits will drop 25 percent. With more than 18 percent of gross domestic product coming from construction, Spain's economy is particularly susceptible to weakness in real estate. "The main problem lies in construction but it has already spread to other sectors," says Gilles Moec, senior economist at Bank of America in London. With other European countries, including Germany, showing signs of slowing, European Central Bank President Jean-Claude Trichet faces pressure to abandon his tough anti-inflation stance and cut interest rates. "We'll see rate cuts in the European Union and in the U.K. this year," Barclays Plc President Bob Diamond said Jan. 24 in Davos. Misplaced Hopes **Hopes that China's fast-growing economy can take up the slack from a U.S.-led slowdown seem misplaced. "If there is weakness in the world economy, the impact on the Chinese economy will be very serious,"** says Yu Yongding, director of the Chinese Academy of Social Sciences and a former adviser to the central bank. China's growth slowed to a year-over-year pace of 11.2 percent in the fourth quarter, from 11.5 percent and 11.9 percent in the third and second quarters, respectively. **In Davos, Klaus Kleinfeld, chief operating officer of Alcoa Inc., the world's third-largest aluminum producer, said he foresees "a difficult year. I don't think the world can decouple itself from what's happening in the U.S."** **Global Recession Risk Grows as U.S. 'Collateral Damage' Spreads**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aXcxvZBhKLM4&refer=home>

- Jan. 28 (Bloomberg) -- Fortis, Belgium's biggest financial- services company, said it meets capital and solvency requirements even when its holdings in subprime collateralized debt obligations are valued under "very stringent scenarios." End-of-year solvency will probably surpass regulatory requirements, Fortis, based in Brussels and the Dutch city of Utrecht, said in a statement yesterday distributed by Hugin. Fortis will keep its dividend policy unchanged, the company also said. **Fortis shares dropped to the lowest since August 2002 on Jan. 25 in Brussels trading after Dresdner Kleinwort cut its recommendation on the stock to "add" from "buy" on concern the bank may have further writedowns on subprime-related assets and may need to raise as much as 10 percent new capital.** Fortis doesn't need to sell common stock or dilutive equity-linked securities and isn't considering such a sale, it said. "This is good news for Fortis shareholders," Joost de Graaf, who helps manage the equivalent of about \$881 million euros at Kempen Capital Management in Amsterdam, said in an interview yesterday. "There's no need to issue new shares and therefore no dilution and the dividend policy remains the same," said De Graaf, who doesn't hold Fortis shares. If the bank applied its standard model for valuing impairments, the calculation would result in a full-year profit for Fortis of about 4 billion euros (\$5.9 billion), the company said. Profit would be 1 billion euros higher if the sale last year of its stake in the CaiFor insurance joint venture with La Caixa, Spain's largest savings bank, were to be included in the

calculation. "Fortis is reviewing the value of its subprime CDO portfolio on an ongoing basis," the company said in the statement yesterday. **Even under very stringent coverage assumptions based on the most recent and presently available market information and data**, Fortis's capital and solvency requirements would still be met." Fortis expects loan-loss provisions for the remaining part of the portfolio to remain within the guidance given in previous communications, the company said. Fortis, which has an asset-backed credit portfolio of 51 billion euros, is scheduled to report full-year earnings on March 7. The bank, which was formed in 1990 through the merger of Dutch insurer NV Amev, Belgian insurer AG Group and Dutch bank VSB, plans to keep the cash dividend at the same level as last year and pay out a final 2007 dividend of 59 cents a share, the company said. Fortis in November repeated its forecast that full-year profit before divestments will be 4.2 billion euros. The company yesterday also said it's "fully on track" in completing its 24 billion-euro financing plan for the acquisition last year of ABN Amro Holding NV businesses. The preparation of the integration of the businesses is progressing according to plan, Fortis said. **Fortis Meets Capital, Solvency Requirements; to Keep Dividend**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aGZMTEuVbUpo&ref=r=home>

- Jan. 25 (Bloomberg) -- Even in France, many people haven't heard of Caisse des Depots & Consignations. Yet they regularly cross paths with the 192-year-old state-owned institution, whose assets reach into every part of the economy. With assets of 405.5 billion euros (\$599.2 billion), CDC is also France's largest institutional investor. It has stakes in half of the companies in the benchmark CAC 40 Index. The stakes include 2.0 percent of Societe Generale SA, which said yesterday that bets on stock-index futures by a 31-year-old employee caused it 4.9 billion euros in trading losses, the largest in banking history. "The Caisse des Depots is a bizarre but typically French monster that mixes public and private sector activities," says Philippe Francois, a researcher at Ifrap, the French Research Institute on Public Services, a Paris-based study group advocating free market economics. "It's a caricature of how the French government operates." President Nicolas Sarkozy, elected last year on promises to shake up the economy, indicated he may tighten his grip on the bank. Though the National Assembly oversees CDC, its chief executive officer is named by the president. Defending the Nation **Sarkozy says he plans to use CDC to help protect French enterprises from speculative investors and foreign sovereign funds.** "The Caisse des Depots is an instrument of this policy of defending and promoting the nation's primordial economic interests," Sarkozy said at a news conference on Jan. 8, during which many questions dealt with his romance with former model Carla Bruni. Funds May Shrink Now that the European Union has told France it must allow all banks to sell the accounts starting this year, those funds may dwindle because the banks may steer savers toward their own investment products, de Romanet says. Sarkozy supported the EU order, overruling de Romanet's objections. Saving Club Med In 2004, Mayer brokered a deal to bail out money-losing Paris-based resort company Club Mediterranee SA. Accor SA, the French hotel group then 4.5 percent owned by CDC, bought 29 percent of Club Med -- including CDC's 7.7 percent stake -- for \$303 million. "While it may occasionally be necessary and even profitable for the bank to influence a company's management, this shouldn't be the norm," Lagarde said. De Romanet says his next task is to figure out which areas the bank should focus on

in the future. In January, he began reviewing CDC's activities to see what could be trimmed. "We can't be everywhere," he says. "We must focus our resources." Whatever de Romanet decides, Sarkozy's government may have other ideas. **Sarkozy Pledges to Use French Bank for Protectionism**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aF..beZi3BGA&refer=home>

- Jan. 27 (Bloomberg) -- The housing slump in the U.S. took a turn for the worse at the end of 2007, bringing the economy to the brink of recession and prompting businesses to curb hiring and spending, economists said before reports this week. Growth slowed to a 1.2 percent annual rate from October to December, a quarter of the previous three months' pace, according to the median estimate of economists surveyed by Bloomberg News. Other reports may show the jobless rate held at a two-year high this month **and consumer spending cooled in December**. Americans' **willingness to consume** [sad that this is stated as a negative, the "bottom will be in" when consumers are focused on a balance between spending and saving] may be faltering as property values and stock prices fall at the same time that the unemployment rate and fuel costs climb. Federal Reserve policy makers will probably lower the benchmark interest rate this week for the second time in nine days as more economists predict the six-year expansion already has, or will soon, come to an end. "We'll probably see a very flat employment situation and consumer and business spending is going to be vulnerable," said Brian Bethune, director of financial economics at Global Insight Inc. in Lexington, Massachusetts. "A mild recession seems the most likely outcome." Homebuilding was probably slashed by 28 percent last quarter, marking the eighth consecutive drop and the biggest since 1982, according to a forecast by economists at Lehman Brothers Holdings Inc. in New York. "The housing recession has hit the economy in a series of rolling shocks," said Michelle Meyer, an economist at Lehman. Sales of new houses last year probably fell by the most since record keeping began in 1963, a Commerce report tomorrow may show. **Consumer spending, which accounts for more than two-thirds of the economy, probably held up last quarter, preventing growth from slowing even more**, economists said. Still, purchases in December rose just 0.1 percent, according to the survey median ahead of a Commerce Department report Jan. 31. The gain would be the smallest since September 2006, signaling spending started to fade at the end of the year. Consumers will be under even greater pressure in 2008 as construction, manufacturing and financial-service firms continue to cut jobs and other employers boost payrolls at a slower pace. Economy 'Deteriorated' **"There is likely to be little or no increase in real GDP in the current quarter"** because "virtually every economic indicator -- including credit conditions, housing and employment -- has deteriorated during the past month," Harvard University economist Martin Feldstein said in Senate testimony Jan. 24. Feldstein, who heads the National Bureau of Economic Research in Cambridge, Massachusetts, and is a member of the committee that determines when U.S. recessions start and end, said the odds of a slump had risen to more than 50 percent. A Labor Department report on Feb. 1 may show payrolls rose by 65,000 in January, according to the median estimate, after an 18,000 December gain. It would be the smallest two-month increase since August-September 2003. The jobless rate probably held at 5 percent for a second month, according to the survey median. The 0.3 percentage-point increase in unemployment in December and a downturn in factory activity spurred concern the economy was already

in recession. Factories Contract **The decline in manufacturing probably intensified this month. American factories contracted in January at the fastest pace since the start of the Iraq War in 2003, economists project a report from the Institute for Supply Management Feb. 1 will also show.** The jobs report on the same day may show manufacturing payrolls shrank by 20,000, according to the survey. Caterpillar Inc., the world's largest maker of bulldozers and excavators, said last week that fourth-quarter earnings rose 11 percent as demand from China, Russia and South Africa helped overcome slower sales in the U.S., where recession is "a definite threat." "While we expect anemic growth in the U.S. economy, we continue to see positive conditions for our sales in most of the rest of the world," Chief Executive Officer Jim Owens said in a statement. **Growth May Have Weakened, Hiring Slowed: U.S. Economy Preview** <http://www.bloomberg.com/apps/news?pid=20601087&sid=a9mbAhtQBeGU&refer=home#>

- Jan. 24 (Bloomberg) -- **California may need to borrow as much as \$9 billion later this year to pay bills, as the most populous U.S. state faces its biggest cash shortage since 2003, [maybe all those \$300 checks in the stimulus package should be used to pay bills instead of buying iPhones?]** a budget official said. Governor Arnold Schwarzenegger's finance office estimates the state will need to sell \$9 billion of short-term notes in September to cover cash needs for the fiscal year that begins July 1. That compares with \$7 billion borrowed in November for this year's operations. The cash crunch springs from slowing revenue growth over the last 12 months following the worst housing market slump in 16 years. **Schwarzenegger last year saw a budget surplus transformed into a \$14 billion deficit. Fitch Ratings has warned that California's credit ratings on \$49 billion of debt are in danger because of the cash shortage.** "It's a reflection of the fact that we need adequate cash reserves in what we expect to be a difficult budget year," Schwarzenegger's budget spokesman H.D. Palmer said in a telephone call. The \$7 billion in notes sold in November come due in June. Schwarzenegger's budget for the current fiscal year includes money to repay that loan. The notes sold this coming September must be repaid by July 2009. The \$7 billion note offering last November marked the first increase in so-called revenue anticipation securities since 2003, when California sold a record \$23 billion of one-year notes and two-year warrants. Those bonds closed a hole during a budget crisis that led to the recall of then-Governor Gray Davis and credit-rating downgrades. Short-term borrowings decreased since then as revenue climbed. In response to the growing deficit, Schwarzenegger on Jan. 10 proposed across-the-board cuts of 10 percent on state spending and invoked never-before-used emergency powers to force lawmakers to pare \$3 billion from the current budget and free up cash to pay bills. To conserve cash for July and August, Schwarzenegger wants lawmakers to delay \$4.7 billion in payments scheduled by the fiscal year-end, June 30. **Included on that list is \$1.3 billion owed to schools and community colleges, \$814 million for social services programs, \$584 million due to the California State Teachers' Retirement System for a special account that protects older pensioners from inflation, \$500 million in gas tax revenue that belongs to local road and bridge districts and \$454 million to health-care providers.** California, the biggest borrower in the municipal bond market, is rated A+ by Fitch Ratings and Standard & Poor's, their fifth-highest rankings, and a comparable A1 by Moody's Investors Service. **Only Louisiana has lower credit ratings among states. California Budget Office Says \$9 Billion More Needed for Bills**

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

- Jan. 22 (Bloomberg) -- **Almost half of the world's biggest stock indexes fell into a bear market** as mounting concern about a U.S. recession dragged down banking and retail shares across Asia, Europe and Latin America. The MSCI World Index's 3 percent decline yesterday, the steepest since 2002, left benchmarks in France, Mexico, Italy and 35 other countries at least 20 percent below their highs in the last year. The Standard & Poor's 500 Index may post its biggest decline since 2001 when the U.S. market resumes trading today after the Martin Luther King Day holiday, futures showed. UBS AG and Bank of China Ltd. led financial companies lower after banks lost more than \$100 billion on credit investments. Bang & Olufsen A/S and Wal-Mart de Mexico SAB were among consumer stocks that tumbled amid signs the world's biggest economy is shrinking. Even with MSCI World valuations at the cheapest since at least 1995, some of the biggest investors say stocks may fall further. **"I'm struggling to find a catalyst that will turn this market around," Bob Parker, who helps oversee more than \$600 billion at Credit Suisse Asset Management in London, said in a Bloomberg Television interview. "What we need is evidence that the write-offs in the financial-services sector are behind us, and we are probably only going to get that in the second quarter. Clearly the market situation is fairly ugly at the moment." [What he failed to foresee was the computerized manipulation of the futures on Wednesday that ran the Dow up 600 points in 3 hours. But perhaps he was looking beyond last week at the reality of the situation.]** Sept. 11 Europe's Dow Jones Stoxx 600 Index yesterday tumbled the most since the Sept. 11 terrorist attacks, sending it into a bear market, commonly defined as a drop of more than 20 percent in a 12-month period. Hong Kong's Hang Seng Index slumped the most in six years. The MSCI World Index of 23 developed markets is down 17 percent from its Oct. 31 record. The MSCI gauge of developing nations also reached a bear market yesterday. Declines in Lima-based Cia. Minera Milpo SA and Tainan, Taiwan-based Catcher Technology Co. led this year's 14 percent retreat. **Japan became the first of the world's 10 biggest stock markets in November to enter a bear market since the summer's U.S. subprime mortgage collapse. China followed later that month before the benchmark CSI 300 Index recovered and rose 162 percent for the year. [Up 162% for the year. Reminds me of the 100% rise in the NASDAQ in 1999. Look for a similar follow up in China]** Among 80 equity national equity benchmarks tracked by Bloomberg, indexes in Argentina, Australia, Austria, Belgium, Bulgaria, Chile, Colombia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Hong Kong, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Mexico, Namibia, the Netherlands, Norway, Peru, Poland, Portugal, Romania, Singapore, Spain, Sweden, Switzerland, Sri Lanka, Turkey, Venezuela and Vietnam also have dropped at least 20 percent from recent highs. "We've seen panic selling," said Matthias Jasper, head of equities at WGZ Bank in Dusseldorf, Germany. "Particularly small investors lost their nerve. These people are selling with conviction." **The slump has made stocks cheap by historical standards. [It is ALWAYS a buying opportunity]** The 1,953-member MSCI World is now valued at 14.1 times its companies' profits, the lowest since at least 1995, according to data compiled by Bloomberg. Europe's Stoxx 600 has a price-to-earnings ratio of 10.7, the smallest since at least 2002. **Fed funds futures show that 72 percent of traders expect the Federal**

Reserve to cut its benchmark rate to 3.5 percent from 4.25 percent on Jan. 30. [3 days later AFTER the 75 BPS emergency cut another 50 BPS is "priced in"] Banks and consumer stocks have failed to recover even after policy makers lowered the target rate for overnight loans between banks three times since September from 5.25 percent. Changing Tide "The U.S. rate cut expected at the end of the month should be a support for stocks," said Kilian de Kertanguy, a fund manager at Cholet-Dupont Gestion in Paris, which oversees \$2.3 billion. "I'm not sure that it's a bear market. It's more like the tide is changing." Shares of Zurich-based UBS, Europe's biggest bank by assets, have dropped by almost half since the Stoxx 600 reached a six- and-a-half-year high on June 1. Beijing-based Bank of China, which has the largest subprime-related holdings among Asian banks, has plunged 33 percent since the end of October. Bang & Olufsen, whose luxury consumer electronics are used in Audi sports cars, fell the most ever in Copenhagen trading on Jan. 9 after reducing its forecast for annual earnings. The Struer, Denmark-based company's shares have lost 38 percent this year. Mexico City-based Wal-Mart de Mexico, Latin America's largest retailer, fell the most since February 2007 yesterday, for a decline of 7.4 percent this year. "It's kind of a panic attack," said Franz Wenzel, deputy director of investment strategy at Axa Investment Managers in Paris, which oversees \$647 billion worldwide. "We remain cautious." **Stock Drop Pulls 38 Indexes Into Bear Market;**

	Banks	Lead	Plunge
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- Jan. 22 (Bloomberg) -- European finance ministers said a global stock-market slump and an economic slowdown in the U.S. threaten to slow growth in Europe more than forecast. "The economic situation and financial markets are highly volatile and uncertain, a good deal more uncertain than usual," Luxembourg Finance Minister Jean-Claude Juncker said yesterday in Brussels after presiding over a meeting of counterparts from the euro region. "If there is a real slowdown in the U.S., obviously that would be felt in the euro zone." Global stocks tumbled yesterday, with the Dow Jones Euro Stoxx 50 falling by the most since 1991, on concern that the U.S. will fall into a recession. Juncker said forecasts for European growth will need to be revised down and that an economic contraction in the U.S. can't be ruled out. Stock-market volatility has heightened "uncertainty" on the outlook for economic growth in the 15 nations that use the euro, according to an EU briefing document obtained by Bloomberg News. The draft document was discussed at yesterday's meeting of finance ministers. Still, "it would be a mistake to fall victim to excessive pessimism," Juncker told a press conference after the meeting. "We shouldn't overreact to events on the stock exchange," he said. "Growth forecasts in Europe are now much better than in the U.S.," European Union Monetary Affairs Commissioner Joaquin Almunia said at the press conference. "Our forecasts in November won't be achieved, but they won't be far from being achieved." Economic Growth Juncker said Jan. 13 that predictions for 2008 economic growth in the euro region may need to be revised to around 1.8 percent. The European Commission in November forecast expansion of 2.2 percent this year, after 2.6 percent growth in 2007. The euro rose to a record high of \$1.4968 versus the dollar on Nov. 23. Against the currency of the U.K., the biggest market for the euro region's exports, the European currency reached a record 76.06 pence on Jan. 14, threatening to weaken sales abroad. The currency's gains aren't enough to prompt the Group of Seven industrialized countries to change their language

on foreign-exchange markets when they meet in Tokyo next month, said Juncker, who also is Luxembourg's prime minister. "We see no reason to change policy in terms of exchange rates," he told reporters. "Between now and the Tokyo meeting, we have time to fine-tune the message." **Borrowing Costs** The European Central Bank has so far refused to follow the Federal Reserve and the Bank of England in lowering borrowing costs as contagion from the U.S. housing recession spreads, arguing that inflation pressures are too strong. With economic prospects dimming, the euro fell to a five-month low against the yen and declined for a fifth day against the dollar. "We are worried," Spanish Economy Minister Pedro Solbes said yesterday. "We have to follow what is happening every hour." The slowdown is undermining policy makers' hopes that the region will avoid the fallout from the subprime mortgage collapse in the U.S., which drove up global credit costs. Industrial output fell enough in November for economists at Royal Bank of Scotland Group Plc to declare that manufacturing has slipped into its first recession since 2001, while investor confidence in Germany crumbled to the lowest since 1992. "The least we can say is that we live in interesting times," Juncker said. "That's about the only positive thing I can say." **EU Ministers Say Stock-Market Rout, U.S. Slump Threaten Europe**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aniICRyKNKBk&refer=home>

Retail

Retirement

Risk

- Jan. 24 (Bloomberg) -- In August, Keishi Hotsuki went to his boss at Merrill Lynch & Co. to protest. Hotsuki, who was co-head of risk management, said the firm's decision to wager \$3 billion on indexes of mortgage-related securities was too big a gamble. He lost the battle, and three months later, he left the company partly because of his objections to the trade, according to people familiar with the matter. As the subprime crisis has unfolded, spurring at least \$133 billion in writedowns and credit losses and claiming the jobs of four chief executive officers, the risk managers charged with preventing those kinds of disasters have largely languished on the sidelines. Banks, emboldened by three years of record profits, failed to heed warnings of their risk managers or give them enough power and data to do their jobs, says Joseph Mason, a professor of finance at Drexel University in Philadelphia who researches risk management. Merrill Lynch spokeswoman Jessica Oppenheim declined to comment on the details of Hotsuki's departure. Now, risk managers are back in vogue -- at least for the moment. "They will get more power as firms make a visible show of assessing their risk management," says Samuel Hayes, 72, a professor of investment banking at Harvard Business School in Boston. "**And they will be curtailing risk taking for a while.**" On Jan. 15, after Citigroup Inc. reported a \$9.8 billion fourth-quarter loss -- the biggest in its 196-year history -- new CEO Vikram Pandit said on a conference call that he would be a "hands-on participant" in risk management. **Merrill's Risk Chiefs** Merrill Lynch also posted a

record \$9.8 billion loss in the period. John Thain, 52, who became CEO in December, created two chief risk officer positions that report to him. Co-chief Noel Donohoe was hired in January and had served as the head of risk at Goldman Sachs Group Inc. until 2005. Edmond Moriarty, the former head of counterparty risk at Merrill, is the other co-chief. Morgan Stanley, which has written down \$9.4 billion, says risk chief Thomas Daula will answer to the chief financial officer rather than the head of trading. Bear Stearns Cos. is also considering changes after \$2.6 billion of writedowns. "It's not just risk management but the whole risk culture," says Alan Schwartz, who replaced James "Jimmy" Cayne as CEO of New York-based Bear Stearns in January. "We have to make sure our risk management and trading management are working together." Misleading Information Wall Street firms have long viewed risk managers as advisers, not decision makers. They are there to support the bankers and traders who generate revenue. At JPMorgan Chase & Co., which took a \$1.3 billion writedown in the fourth quarter, the risk department for investment banking has 700 employees. Risk managers build sophisticated models to predict potential losses from investments and to set overall trading limits. The bankers and traders are supposed to consider the findings of risk managers in deciding whether to reduce or hedge bets. It doesn't always work that way. **For one thing, risk managers often rely on traders to give them the data and formulas they need to do their jobs. That's what happened with collateralized debt obligations -- packages of securities that are based on home mortgages and other loans. CDOs, whose values dropped as much as 100 percent from July to December, don't have readily available market prices because they're thinly traded.** In many instances, **traders gave risk managers insufficient or misleading information about the pricing models for the securities, making their task more difficult,** says Cubillas Ding, an analyst at Boston-based Celent LLC, which advises financial services firms on risk management. Goldman's Rotation "The front lines and risk management have to cooperate more, the latest crisis has shown," Ding says. "Chief risk officers need to get the right information." Goldman Sachs escaped subprime-related writedowns partly because it insists that risk managers and traders work together. Goldman CEO Lloyd Blankfein said during a November investor conference that the firm rotates people between trading and risk management so they better understand both sides of the business. "We place a lot of importance on communication between revenue and control areas," said Blankfein, who was formerly the head of fixed-income trading at the New York-based firm. Traders -- even those who rose to superstar status as banks wagered more of their own money -- are also more likely to listen to the warnings of risk chiefs that report directly to CEOs, says Bruce Foerster, who was a managing director at Lehman Brothers Holdings Inc. before starting advisory firm South Beach Capital Markets in Miami. Smaller Bets Lehman's new head of risk, former CFO Christopher O'Meara, had been the firm's public face on quarterly earnings calls. He reports to CEO Richard Fuld; the former top risk manager was supervised by the chief administrative officer. "Risk management should be an independent function that closely interacts with the business at the onset of the transaction," O'Meara, 46, says. Banks that hand more authority to risk officers will likely make smaller bets and hedge more, and that may trim profits, Foerster says. New York-based Morgan Stanley says it's curbing its risk-taking. "I think we have been sprinting, and I think we are going to be jogging right now for a while," CEO John Mack said during a December conference call. **Atonement Comes to**

Savings Rate

Tech

Wall Street

- Jan. 28 (Bloomberg) -- Tumbling equity markets prompted 24 companies this month to halt plans for initial public offerings, the most in at least a decade. Tommy Hilfiger Corp., the fashion brand owned by London-based buyout firm Apax Partners Worldwide LLP, Denmark's Dong Energy A/S, and Chinese department store operator Maoye International Holdings Ltd. are among companies that have withdrawn or postponed sales, according to data compiled by Bloomberg. **“Unless we have a fairly dramatic shift, the IPO market is going to be pretty dormant,”** said Chris Kelly, head of the capital markets practice at law firm Jones Day in New York. **“IPO investors don't want to buy into an investment that has a decent likelihood of going down.”** The MSCI World Index fell 14 percent since reaching a record on Oct. 31 as subprime-mortgage defaults sparked a worldwide credit crisis and threatened to send the U.S. economy into recession. The Bloomberg IPO Index, which tracks new stocks in their first year of trading, dropped 9 percent in the past year, while the Standard & Poor's 500 Index declined 6.4 percent. Mexico, Sweden, France, Poland and Australia are among the more than 40 countries whose benchmark indexes have slumped more than 20 percent from their highs of 2007, the common definition of a bear market. Europe's Dow Jones Stoxx 600 Index has tumbled as much as 24 percent from a six-year high on June 1. In the U.S., the S&P 500 dropped 14 percent from its record reached in October. Apax's Hilfiger Apax bought Hilfiger in 2005 for \$1.6 billion after its red-white-and-blue-splashed clothing lost favor with teenagers. Tommy Hilfiger, which first went public in 1992, had planned to return to the market by listing shares in Amsterdam. The market decline also derailed the IPO of Dong Energy, which would have been Denmark's biggest in more than a decade, while Maoye cited “current turmoil in international capital markets” for its scrapped plans. In the U.S., the largest deal to get pulled was the \$345 million sale of Imperium Renewables Inc., a Seattle-based biodiesel producer, which withdrew due to “unfavorable market conditions.” The VDAX-New, a gauge of European stock-market volatility derived from prices paid for options on Germany's DAX Index, closed Jan. 23 at its highest since May 2003. The Chicago Board Options Exchange Volatility Index, or VIX, derived from prices paid for S&P 500 options, almost tripled in the past year. Done Deals The window is still open to go public. So far this year, 50 companies have raised \$7 billion in IPOs globally, up from \$2.1 billion in 43 issues last year during the same period. The U.S. IPO market accounts for 41 percent of the global tally, with nine companies having raising \$2.9 billion, according to Bloomberg data. Of those, \$2.3 billion have been by blank-check companies. Also called special-purpose acquisition companies, the firms don't have operations and are formed to acquire another business. The largest was the \$920 million raised by billionaire investor Nelson Peltz for Trian Acquisition I Corp. on Jan. 23. RiskMetrics Group Inc., which provides corporate governance and risk management products to investors and corporations, gained 36

percent on Jan. 25 after raising \$245 million in its IPO. IPC The Hospitalist Co., the North Hollywood, California-based company that assists hospitals in providing services, raised \$83.2 million on Jan. 24. Williams Pipeline Partners LP, the Tulsa, Oklahoma-based operator of natural gas transportation and storage services, raised \$325 million on Jan. 17. The shares have fallen about 3 percent since their debut. Scrapped sales span continents and industries. Grupo Lamosa SAB, a Mexican real-estate and building-materials company, said last week it would postpone a planned \$280 million share sale because of market conditions. Philogen SpA, an Italian company that develops drugs to treat cancer and arthritis, suspended plans for an IPO after stock markets tumbled. Global Green Tech Group Ltd., a Hong Kong-based maker of personal-care products, canceled a planned HK\$2.41 billion (\$309 million) IPO by unit Bio Beauty Group Ltd. because of "market conditions." **Stock Market Decline Delays Highest Number of IPOs in 10 Years**

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CNBC

Some Experts See Market as Bottoming Out

Thursday January 24, 3:26 pm ET

There's lots of talk out there about whether the stock market hit bottom yesterday. You could turn to any number of market gurus, but a theory we've heard from a few is that yesterday's lows may be the bottom for now, and what happens next will be decided in part by the strength of the economy and of course, the Fed.

Also today's deal between congressional leaders and the White House on a stimulus package is seen as a good sign and a necessary ingredient for the economy. News of the deal pushed up stocks.

BlackRock Vice Chairman Bob Doll was on "Squawk Box" this morning (see video below) and he's someone who sees another low coming before the market ultimately turns:

"It's typical for these sorts of markets in these periods of chaotic movement. I think your technician is your best friend."

"You get a panic, throw in the towel, high volume cathartic bottom."

That was surely the case early yesterday, before that big 600-odd point upswing.

Doll: "Now we're in the rally phase, which can last a bit longer. And...there's the slow painful torture of a re-test, where we will ask the tough questions."

Those questions, Doll says, are whether there will be a global recession; whether the financial system gets fixed, and whether inflation becomes a problem.

Doll: "The markets will finally say 'We'll make a bottom' and that will be that, but that will be weeks and maybe a few months away."

Today, the market is taking a bit of a breather. Financials were a leader in yesterday's rally. They are mixed today, with the group about 0.8 percent higher. Energy tops the gainers list, up 3 percent, though those safe haven utilities are down 2.1 percent. Tech is a top performer and is up about 2.2 percent. Microsoft (NasdaqGS:MSFT - [News](#)) is one of those stocks that are up, ahead of its earnings after the bell.

Traders describe today's trade as quieter, less frantic, without the panicky volume. Retailers, like Home Depot (NYSE:HD - News) and Lowes (NYSE:LOW - News) , good performers yesterday, gave up gains and companies across the entire group are down multiple percent. That group had a good run Tuesday and Wednesday, a big beneficiary of this week's surprise Fed rate cut.

Doll: "When the dust does settle, I think we'll have some improvement in the former losers. That is the credit sensitive financials and consumer discretionary, but if the world economy holds up, all be it weaker, which is our guess, some global cyclicals will come back."

There's a view that the market will turn to become more of a stock picker's market. Doll agrees, and sees sector investing as less attractive. He recommends investors now "play closer to neutral."

- **[this clown is on CNBC – the market loses triple figures on the Dow and nearly 50 on the Comp and this is THE DAY the bottom is in. Folks, the Bottom will be in years from now and NO ONE will be watching CNBC – think 2002 ratings]** Markets: The "End Of The Beginning" For A Bottom? Jan 22 – 4:07 PM ET This was a big day. The Dow rallied more than 300 points off its initial lows; we essentially moved sideways since one hour after the open. What does it mean? The most important development is we have broken the "sell on the rally" mentality; bears have had the rhetorical upper hand for over a month, **but they were unable to mount even a modest late day selloff. [not sure what he was watching, the Dow dropped more than 100 in the last 20 minutes, the COMP 25 and the SPX 12 – those are pretty big non-numbers to a country boy]** To be sure, it was still a down day, with three stocks declining to every two advancing. Bears also argue that today was characterized by short covering, as the sectors that were most shorted--financials, retailers, and home builders--have rallied the most. That's true. And stocks with stronger fundamentals--pharmaceuticals, techs--have been on the downside. But we hit several extreme technical levels at the open, which are indicative of at least a short-term bottom: 1) The CBOE Volatility Index (VIX) hit the highest level since 2002 at the open, and then quickly fell back, though still at elevated levels; this indicates fear spiked up dramatically. 2) New lows hit the highest levels since 2002 On top of that, beaten up markets rallied: a) The U.K.'s FTSE index moved 7.5 percent from its high to its low to end at the highs of the day. b) Brazil's index moved 5.5 percent from its high to its low and ended near its high. AAPL is the big test after the bell. If they put up good numbers, and then sells off, bears will say it's a sign we are not at the bottom. Does today's action mean we are at a bottom? No, but at the very least bulls can argue it is the START of a bottoming process. **The "End Of The Beginning" For A Bottom?** http://www.cnbc.com/id/22788068/site/14081545?__source=yahoo%7Cheadline%7Cquote%7Ctext%7C&par=yahoo

Don't Fight The Fed

I Disagree . . . and why

[Article of the week:](#)

UM EMBA

Best of the Dog

Friday, January 25, 2008 at 08:39 CDT

the big bear is taking the day off

but not before noting that this morning's gap open after in line news from MSFT (it was not increased guidance as the media wishes to hype) will LIKELY be a short selling point

the bear had a bad week, which can happen in this business. when it does, it is important to refocus on the long term and take a day or so off.

long term I have no doubt what we are doing. short term, I have a burned hand from touching a hot stove, which is always a good lesson.

Have a great Friday!!!!