

The Other Side of the Street January 6, 2008

Comments

“I am not sure that reduction in rates is going to have as much traction as it did in the past **because so much of the problems now are problems of confidence in the financial sector** and of bank capital,”

- **Harvard University economist Martin Feldstein (head of the group that dates economic cycles in the U.S.)**

Another of the Goldilocks underpinnings bit the dust on Friday. Surprisingly the significant jump in the unemployment rate did not inspire the umpteenth knee jerk “Fed will cut” rally. It does raise an interesting question however, if the housing situation was so grim during robust employment, what will happen now that employment is falling too?

As to the market action. I am sure you read about how the employment number was the cause of the fall. I am certain you did not read that many stocks are now simply back to where they were the week before Christmas. Why does that matter? It demonstrates yet again that the market players blatantly mark up their inventory (i.e. run up prices) in the very low volume holiday period so they can get bigger bonuses (“performance” being judged by price on December 31, no matter how unrealistic that might be). This left the gamers with unwanted inventory to start the year, which brings into play at least a couple of things. The “full boat” coming in means there is less ammo to run up stocks in January and it means that there are potentially an awfully lot of players wrongly positioned for a big sell-off to start the year. Standard economics says that unwanted inventory is moved by lower prices.

In evaluating prices this weekend, I have been looking at hundreds of stock charts. They lead me to a firm conclusion that a major market top was put place in October. If I am correct, the downside is now well underway and it will be a VERY long time before a bull reemerges in US equities. I understand that this is not a new opinion from me. The length of time it has taken to get here is directly as a result of the unprecedented efforts by the US government to prop up a failing stock market, the ultimate failure of which efforts was plainly foreseeable. The “don’t fight the Fed” crowd still has its true believers (it is now “there will be a second half rally”). However, those true believers will do as well as the dip buyers who jumped on housing stocks based on the “it is contained to sub-prime” rhetoric of last spring. Edi Amine is still dead and the momentum game is too.

So what happens this week? Very hard to say. The “news” that brought us down on Friday is not “news” to anyone. Employment is a lagging indicator and the leading indicators rolled over months ago. So will this finally take out the tape? I suspect that bad behavior has been rewarded so long that there will be plenty of “dip buyers” at some point this week. They might well be countered by some warnings from corporations and further decay in the credit markets. Ultimately the ups and downs of this week are irrelevant. What matters is that it is an early spring afternoon in Jellystone and there are very hongry bears looking for picnic lunches.

NOTE: There is a new section below. It is stock notes and it has been created so I have all my notes in one place. It is NOT a recommendation on any stock or an indication of what I am buying, selling or holding. Please do not make any assumptions as to why I have include any information in that section.

Stock Notes

- **BIDU** there is a gap on the chart between 342 and 348 from a gap open on Nov 27. this was part of the being added to the NAZ100 insider trading that ran the stock from 305 to 400 in 4 days. Looks like the next downside support is in the 320 neighborhood.
- **JPM** is the biggest underwriter of high-yield, high-risk corporate bonds
- Big run up in **MELI** on Dec 14 was from Cramer comments – analogized it to GOOG and said “next BIDU”
- **INTC** “gained share” growing twice the industry rate of 2.9%
- **BIDU** has been on the top of the IBD HOT STOCK index since August 27 . . .in early December it became the first Chinese company added to the NAZ 100 . . . earnings for 2008 are projected to be \$4.07 up from \$2.30 this year (current price is 390, so forward PE 96 while growth is projected to be 76% - a substantial contraction from current growth rates)
- **Jan 1 distribution days, NAZ 5, SP550 4; IBD went to “under pressure” on Jan 3 and “in correction” on Jan 4.**
- Doug Kass on **AMZN** - That said, I pulled a far more interesting metric out of Wednesday's best-ever sales release that prompted me to short the stock late Thursday. Although the company did not report total holiday shopping figures, it did state that "Amazon's shipping peak (Dec. 10) saw 3.9 million packages shipped to more than 200 countries." From there I compared the peak shipping days' units sold that were mentioned in the previous three Amazon holiday "best ever" December holiday releases. Surprisingly, the 3.9 million units shipped during the peak shipping day in December 2007 was up by only 14.7% compared with the 3.4 million units shipped during the peak shipping day in December 2006. This is a sharp deceleration in the rate of growth from the December 2006 over December 2005 gain of 25.9%, and from the December 2005 over December 2004 gain of 35.1% Despite the clearly slowing rate of growth in units sold during peak shipping days over the last three years, Amazon is still flying high -- and trading rich. Its shares have leaped 142% in 2007, and at \$94 a share trade at a bloated 84 times estimated 2007 earnings and at 58 times 2008 consensus forecasts; its market value stands at nearly 3 times sales; its enterprise value (equity valuation plus debt) sits at 47 times cash flow; Amazon's

PEG ratio (price-earnings multiple divided by projected five-year growth rate) is a lofty 3.5 times; and its book value is 1 cent per share. Amazon's shares appears primed for a fall -- and apparently insiders agree. During the last six months, the company's management has sold over 1.1 million shares and purchased none.

- Ticker is **O** - Shares of Escondido, California-based retail property owner Realty Income Corp., which counts Buffets as its largest tenant, fell 58 cents to \$24.65 in New York Stock Exchange composite trading, the lowest since August. Citigroup Inc. analyst Jonathan Lit yesterday advised selling Realty stock because Buffets is close to breaching debt covenants and may file for bankruptcy.
- For 19 out of the last 20 years, **GM** operated at a capital deficit. We simply didn't make enough money selling cars to maintain our asset base, make new investments in future capacity, and pay our cash dividend. If you look at the numbers carefully, you see our total capital deficit over the last 20 years was \$275 billion. After we worked through our accumulated savings, we began borrowing money – more and more of it every year. So far this year, we've paid approximately \$4 billion in interest on these various liabilities. I estimated, in an earlier letter to you, that we would require about \$5.81 billion in cash from operations merely to pay the interest on our debts. I still believe that's an accurate forecast. Our global cost of borrowing continues to increase, as I thought it would. It now costs us 6.3% a year, on average, to borrow money, up from 5.84% last year. As more debts "roll over," this number will increase until it eventually strangles us. We are trapped, unable to let go of our legacy obligations and unable to pay for them.

Notes

- The stock market plunged Friday as the Dow has now seen its worst 3-day start since 1932 and the S&P 500 has seen its worst start to the new year since 2000
- **THE DECEMBER SPIKE IN THE UNEMPLOYMENT RATE** could qualify as the single most unsettling piece of economic data in an otherwise unsettling year. As reported Friday by the Bureau of Labor Statistics, the unemployment rate jumped to 5% in December, from 4.7% the month before. Just a little over two months ago, the Federal Open Market Committee declared that "most participants" expected the unemployment rate to "increase modestly" -- to an average of 4.8% or 4.9% by fourth-quarter 2008. At 5%, we are already above that level. Less than a month ago, when the last reading on the rate of joblessness was 4.7%, the forecast here was that it would reach "5.2% by year-end 2008" ([Economic Beat](#), Dec. 10). Well, we are already more than halfway to that level. Otherwise, to call a three-tenths of a percentage point spike in the unemployment rate unsettling is to make just enough of it, although hopefully not too much. The last 10 years of historical data show that the unemployment rate jumped that much in a single month only three times before -- all in '01, a recession year. [Barrons](#)
- the "probability models" developed by Credit Suisse economist Jay Feldman, with the help of econometrician Henry Mo. While Feldman's model for the chances of

recession over the next six months does not specifically use the unemployment rate, it does use two job-related figures: the percentage change in new jobless claims and in private-sector jobs on nonfarm payrolls. Other indicators include the stock market, the real interest-rate target on federal funds, housing permits, the University of Michigan Consumer Expectations Index, and headline inflation, measured by the personal-consumption-expenditure deflator. Reflecting the December data for private-sector nonfarm payrolls, released Friday, the Credit Suisse six-month model put the chances of an outright recession at 43% -- not as bad as 50-50, but much higher than the same model predicted a few months ago. It is also, needless to say, too close for comfort. **Barrons**

- BBY shares were down 8.6% at \$25.05. The company said it expects earnings for the year ending March 1 to come in between \$2.08 and \$2.11 a share. Analysts polled by Thomson Financial currently expect \$2.20 a share
- CVS and Walgreens report soft December sales – **what does it tell you about the economy when drug store sales disappoint?**
- Job losses announced last year in the financial services industry 147,000 (3 times greater than prior 2 years);
- Global chips sales “rose 2.3% in November despite steep price cutting and a weaker economy” **[presumably this is related to semi’s and not Pringles, either or, the idea of steep price cutting is to stimulate sales, so a 2.3% rise is VERY sad] WSJ**
- China’s sovereign wealth funds puts 20B in China Development Bank “to shore up the policy lender’s balance sheet” **WSJ**
- Major averages down in December and 4Q, but up for year **(first FED cut was Sept 18) IBD**
- Winners for 2007 – solar, energy, machinery manufacturers **IBD**
- Losers for 2007 – builders, lenders, retailers **IBD**
- Market winners – Shanghia (97%) India (47%) Brazil (43%) Dax (22%), Nasdaq (9.8%), Dow (6.4%), SP500 (3.5%) FTSE (4%) **IBD**
- Market losers – Nikkei (11%) **IBD**
- Growth beat value funds; big cap beat small cap **IBD**
- Yield on the ten year fell 67 BPS on the year **IBD**
- Tech top ten stories – “there was a Facebook, VMware and BIDU coming out of left field” . . . 1. apple Iphone; 2. GOOG the wireless company; 3 BIDU (see

stock notes; 4. GOOG buys double click; 5. VMware IPO; 6. Facebook valuation; 7. cleantech and greentech (cleantech = alternative energy); 8. entertainment goes on line (use of computers and mobile devices to watch movies and other video) 9. newspaper industry upheaval; 10. Wii is a hit (Nintendo game player)

Web links

Credit

- [this is yet another really good example of how one can't solve a credit problem with interest rate cuts – the reason the spreads are rising is a repayment concern – i.e. a credit problem] Jan. 4 (Bloomberg) -- From Sacramento and Albany to Boston and Tallahassee, politicians in state capitals across the U.S. are wrestling with the biggest increase in borrowing costs in three years as they struggle to shore up budget deficits widening on the national housing slump. **The extra yield investors require on 10-year bonds from California, Florida, Massachusetts and New York relative to benchmark tax-exempt rates doubled** since July to the widest since at least 2004, according to data compiled by Bloomberg. California's gap grew to 0.44 percentage point from 0.20 percentage point, adding \$24 million in extra interest over 10 years for every \$1 billion borrowed. **The cost to borrow for roads and schools is rising as property values drop and consumers cut spending, reducing sales- tax revenue that funds about one-third of state budgets.** Thirteen states face cash shortfalls totaling \$30 billion next fiscal year, the Center on Budget and Policy Priorities, a Washington research group, said in a Dec. 18 report. "We're looking at 2008 as a very tough year," said Craig Elder, a fixed-income analyst with Robert W. Baird & Co.'s private wealth unit in Milwaukee, which oversees \$60 billion in assets, including municipal bonds. Officials in 24 states said the housing slump is cutting tax receipts, according to a survey released last month by the National Conference of State Legislatures. Respondents in 18 states said they are concerned the trend may continue through the middle of 2008, three times as many as a year earlier. Worst Performance **State and local government bonds had their worst performance in eight years during 2007 as investors sought the safety of Treasuries.** Municipal debt gained 3.29 percent, while U.S. government bonds rallied 9.06 percent, according to Merrill Lynch & Co. indexes. Florida bonds due in 2017 yield 0.27 percentage point, or 27 basis points, more than benchmarks, up from 10 basis points in July and more than 10 times the difference in February, according to a Bloomberg index of state general obligation debt. The difference in yield, or spread, between 10-year bonds sold by New York and benchmark rates rose to 32 basis points, up from 13 basis points in July and triple the levels of 11 months ago. Spreads on Massachusetts bonds of the same maturity grew to 20 basis points from 9 basis points in July and 1 basis point in February. Rising yield premiums mean higher debt costs for taxpayers because some states may need to increase borrowing to pay for projects as reserves diminish. "Tight on Cash" **"Should the economy slow and cause states to be tight on cash, there could be more issuance for capital projects that may have been funded by budget surpluses in the past,"** New York-based Bear Stearns Cos. analysts Jerry Solomon and Hannah O'Brien Rupert said in a Dec. 13 report. "Many municipalities will be forced to rely on public finance for projects that cannot be postponed." In Florida, which doesn't have an income tax, the Legislature slashed \$1 billion out of the current fiscal year's budget because the sluggish

housing market will cause revenue to decline for a second consecutive year. Maryland raised taxes by about \$1.3 billion a year. Indiana Governor Mitch Daniels ordered state agencies to hold back spending by 5 percent. New York Governor Eliot Spitzer must close a \$4.3 billion hole in next year's budget, up from \$3.6 billion projected in August, according to the state's Division of Budget. Wall Street Losses **The New York agency cut its estimate for personal tax collections by \$500 million in the current year and \$650 million in fiscal 2009 beginning** April 1 amid losses on subprime-related securities by Wall Street banks, which generate about 20 percent of the state's tax revenue. Earnings at the seven largest financial firms based in New York City fell almost 65 percent in the third quarter from a year earlier, according to an October report by state Comptroller Thomas DiNapoli. **A survey by the National Governors Association and the National Association of State Budget Officers found states were tapping reserves, curbing tax cuts and raising spending at a slower pace.** State spending will expand 4.7 percent to \$686 billion during the current budget year, the smallest increase since 2004, the survey said. Revenue growth from sales and income taxes may slow to 2.9 percent from 5.6 percent last year. California Yields The housing slump is forcing states to dip into cash stockpiled when the real estate boom helped pull municipalities out of the slump that followed the bursting of the Internet stock bubble. States added \$52 billion to their reserves from 2003 to 2006, according to the state budget officers group. They cut taxes and boosted spending that fell below the rate of inflation after the 2001 recession. Improving finances also led to higher credit ratings for California and New York. Yields on 10-year California bonds fell more than half a percentage point relative to benchmarks to a low of 12 basis points in 2006 from 79 basis points in 2003. **California had its credit outlook changed to "stable" from "positive" in November by Standard & Poor's, signaling the state is unlikely to get a higher debt rating after two upgrades to A+ since 2003. Governor Arnold Schwarzenegger said in December he will declare a fiscal emergency to reduce the \$3.3 billion shortfall in this year's budget.** Extra Interest **The state, the biggest borrower in the \$2.6 trillion municipal market, plans to sell about \$8 billion of bonds by June and \$12.7 billion in the fiscal year beginning July 1, 2008,** not including refinancings, according to figures released in October by Treasurer Bill Lockyer. **The extra yield demanded by investors since July may add \$497 million in interest on the planned borrowings, assuming an average maturity of 10 years.** Much of the budget news is already priced into the debt, making state bonds attractive, said Philip Fischer, a municipal bond analyst at New York-based Merrill Lynch & Co. **[any news is always a buying opportunity]** Cheap Bonds During the economic slump that began in 2001, spreads on California's bonds didn't widen to the levels they're at today until rating companies lowered their assessment of the state. Florida's spreads reached a high of 31 basis points in 2004, while New York's peaked at 40 basis points the same year. **"The market has anticipated credit deterioration everywhere,"** Fischer said. "The bonds are already very cheap." Unlike earlier in the decade, when the stock market crash touched investors across the country, the effects are mainly hurting states that benefited most from the real estate bubble. "Housing prices and the boom was broadly felt and the downturn, in terms of going from hyper growth to correction, is most evident in the states that had the biggest run-up," said Raphael at Fitch. **California Leads Borrowing Cost Rise on Housing Slump**

<http://www.bloomberg.com/apps/news?pid=20601109&sid=aNCGKKPXpS8w&refer=home>

- WASHINGTON (AP) -- Late payments on a cluster of consumer loans, including those for autos, home improvement and certain home equity loans, climbed in the summer to their highest point since the country's last recession in 2001. **The American Bankers Association reported Thursday that the delinquency rate on a composite of consumer loans increased to 2.44 percent in the July-to-September quarter.** That was up sharply from 2.27 percent in the previous quarter and was the highest late-payment rate since the second quarter of 2001, when the economy was suffering through a recession. **Payments are considered delinquent if they are 30 or more days past due. The survey is based on information supplied by more than 300 banks nationwide.** Late payments on credit cards, meanwhile, dipped during summer. The delinquency rate on credit cards dropped to 4.18 percent in the third quarter, down from 4.39 percent in the second quarter. The association's quarterly survey of consumer loans painted a mixed picture of how people are managing their debt. It suggested that some people feel more squeezed than others. A severe housing slump and weaker home values have clobbered some homeowners -- making it difficult, or even impossible for some to pay their monthly mortgages. Foreclosures surged to record highs and more homeowners fell behind on their payments during the third quarter of last year, the Mortgage Bankers Association reported last month. A drop in home prices left some people stuck with balances on their home mortgages that eclipsed the worth of their home. Others got burned when low introductory rates on their mortgages jumped to much higher rates, which they couldn't afford. "Consumer loans directly related to the housing market were hit the hardest," said James Chessen, chief economist at the American Bankers Association. **"We anticipate delinquency rates will continue to rise on these types of loans in the fourth quarter of 2007, reflecting continued weakness in the housing sector."** **Late payments on home equity lines of credit jumped to 0.84 percent in the third quarter. That was up from 0.77 percent in the second quarter and was the highest since the final quarter of 1997. The delinquency rate on home-equity loans in the third quarter rose to 2.28 percent, a two-year high. Meanwhile, the delinquency rate on "indirect" auto loans -- which are arranged through dealerships -- jumped in the third quarter to 2.86 percent, a 16-year high.**
Deadbeat America: Late Payments Soar

<http://www.abcnews.go.com/print?id=4080978>

- Jan. 3 (Bloomberg) -- Buffets Inc., the largest operator of buffet-style restaurants in the U.S., failed to make a coupon payment on \$293 million of debt, sending the bond prices plunging to a record low. Buffets, a closely held company based in Eagan, Minnesota, didn't pay interest yesterday on its 12.5 percent notes maturing in 2014, according to Matthew Lee, a customer service representative at U.S. Bank National Association in St. Paul, Minnesota, the trustee for the debt. The missed payment sparked concerns that corporate defaults are starting to escalate as the worst home sales market since 1981 slows the economy. Touse Inc., the Florida homebuilder that lost 99 percent of its market value in the past year, also missed interest obligations on \$485 million in debt, the company said in a regulatory filing yesterday. "Default rates are going to start to increase" this year, said Katalin Kutasi, a principal and the investment manager for

distressed debt at hedge fund Kellner DiLeo & Co. in New York, which manages \$300 million. "A lot of them are going to be consumer-sensitive companies." Bond Prices Fall

Buffets's 2014 notes fell as much as 10.5 cents to a record low of 29.5 cents on the dollar to yield 48.7 percent, or 4,535 basis points more than similar-maturity Treasuries, according to Trace, the bond price reporting system of the Financial Industry Regulatory Authority. Debt that trades at a spread of 1,000 basis points or more is considered "distressed," indicating investor concern about default. A basis point is 0.01 percentage point. The company operates more than 600 restaurants under a variety of names including Old Country Buffet, Ryan's, Fire Mountain and Tahoe Joe's Famous Steakhouse. Bon-Ton, Rite-Aid

Bonds of other high-yield companies, such as department store chain Bon-Ton Stores Inc. and drug-store Rite-Aid Corp., **also fell today on "recognition that things aren't going to be getting better any time soon,"** Kutasi said. MAAX Corp., the Canadian bathroom-fixture maker, also missed a Dec. 15 interest payment on its \$150 million of 9.75 percent notes due in 2012, the Montreal-based firm said in a Dec. 18 statement on its Web site. **Rite-Aid, the third-largest U.S. drugstore company, said today that same-store sales fell 0.5 percent last month, the biggest decline since April 2005.** Buffets Ratings Cut

Buffets's loss in the quarter ended Sept. 19 widened to \$5.3 million from \$1.1 million a year ago, the company reported in November. The leverage requirement for its bank loans tightened on Sept. 20, forcing it to maintain a ratio of debt to earnings before interest, taxes, depreciation and amortization of less than 5.75 times, down from six, according to Standard & Poor's. S&P lowered Buffets's credit rating one level in November to CCC, suggesting potential default, saying the restaurant operator was likely to breach the covenant as the company had a leverage ratio of 5.98 times in September. The 2014 securities are rated Caa3 by Moody's Investors Service and CC by S&P, the third and second-lowest speculative-grade ratings above default. Tousey, which said in a regulatory filing in November that it has \$1.7 billion in debt, is considering a restructuring that may include a bankruptcy filing. Tousey's \$200 million of 9 percent debt due in 2010 rose 4 cents to 46.75 cents and yields 48 percent, or 4,466 basis points more than Treasuries, according to Trace. The securities are rated C by Moody's and S&P. **Buffets Misses Coupon Payment; Bonds Fall to New Low**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=amLmTGN6Tcnk&refer=home>

- Jan. 2 (Bloomberg) -- Centro Properties Group, facing a Feb. 15 deadline to refinance A\$3.9 billion (\$3.4 billion) of debt, said it is seeking buyers for the company. The owner of 700 U.S. malls will consider offers for all of the company or for assets including its Australian and U.S. funds, it said in a statement today. It may also recapitalize or issue more stock, the Melbourne-based company said. **Centro, Struggling to Refinance Debt, Puts Itself Up for Sale**
- <http://www.bloomberg.com/apps/news?pid=20601087&sid=aN8tb1fmGBo0&refer=home>

Commercial Real Estate

Commodities

- Jan. 2 (Bloomberg) -- Crude oil reached a record \$100 a barrel and gold soared to the highest ever, leading a commodity surge as the dollar's slump against major currencies enhanced the appeal of raw materials as hedges against inflation. Spot gold climbed to \$860.10 an ounce, and wheat and soybeans jumped more than 3 percent. The UBS Bloomberg Constant Maturity Commodity Index gained 2.2 percent today to a record after climbing 22 percent in 2007. The dollar fell on speculation the Federal Reserve will cut borrowing costs in an attempt to bolster the U.S. economy. **“The most salient buzzword in 2008 is going to be inflation,”** said Michael Pento, senior market strategist for Delta Global Advisors Inc. in Huntington Beach, California, which manages about \$1.4 billion. **“The Fed is lowering interest rates and vastly increasing the money supply. They're further fueling inflationary expectations.”** “What brought us here is still with us,” said Harry Tchilinguirian, an analyst at BNP Paribas SA in London. “The dynamic of strong winter demand, declining consumer country inventories, and geopolitical tension against a backdrop of tight spare capacity are all kept in place.”
Inflation Concerns The Fed's interest-rate cuts sparked inflation concerns. Some investors buy commodities to hedge against rising consumer prices, and the falling dollar makes raw materials priced in the U.S. currency cheaper for buyers holding other currencies. **“Anything priced in dollars has to move higher to make up for the declining dollar,”** said Ron Goodis, futures trading director at Equidex Brokerage Group Inc. in Closter, New Jersey. “It looks like lower interest rates as far as the eye can see. People are putting their money where their memory is, and that's in commodities” after the rally last year, he said. Rising wealth from Shanghai to Sao Paulo is leading to better diets and straining grain supplies just as record energy prices boost sales of biofuels. Wheat and soybean prices jumped almost 80 percent last year, and corn last month climbed to the highest in 11 years. Soybeans, Wheat Soybean futures for March delivery rose 34.5 cents, or 2.8 percent, to \$12.4875 a bushel today on the Chicago Board of Trade. The price earlier reached \$12.64, the highest since June 1973. U.S. farmers planted the fewest acres in 12 years to sow the most corn since 1944. Wheat futures for March delivery rose 30 cents, the most allowed by the CBOT, or 3.4 percent, to \$9.15 a bushel. The price reached a record \$10.095 a bushel on Dec. 17 as global demand eroded worldwide inventories. **Commodities Surge, Led by Oil at \$100, Record Gold**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aY..ejtyNGyQ&refer=home>

Currency

- Jan. 3 (Bloomberg) -- The Australian and New Zealand dollars fell to the lowest in four weeks against the yen as rising concern the U.S. economy will slip into recession dimmed the appeal of higher-yielding currencies. Australia's currency dropped the most in six weeks and New Zealand's had the biggest loss in three weeks versus the yen as U.S. stocks posted the worst start to the year since 1983. A report yesterday showing the largest decline in U.S. manufacturing in five years prompted investors to sell higher yielding-assets bought with loans from Japan. **“We've returned to the U.S. recession**

risk theme, which is bad for equities and bad for risk appetite," said John Kyriakopoulos, a currency strategist at National Australia Bank Ltd. in Sydney. **``The Australian and New Zealand dollars are going to underperform, especially against the yen."** The Australian dollar slid 1.8 percent, the biggest loss since Nov. 21, to 96.68 at 12:00 p.m. in Sydney from late in Asia yesterday. It touched 96.20 yen, the weakest since Dec. 6. The currency advanced to 88.32 U.S. cents and touched 88.48, the highest since Dec. 13, as Australia's bond yield advantage over the U.S. widened. More Sluggish Investors exited so-called carry trades after Federal Reserve minutes from the Dec. 11 meeting showed yesterday policy makers said the economy in 2008 will be **``somewhat more sluggish"** than they anticipated in October. The Institute for Supply Management's factory index fell in December to 47.7 in the U.S., the lowest reading since April 2003. In contrast, a report yesterday showed Australian manufacturing expanded at the fastest pace in more than five years in December. **Australian, N.Z. Dollars Decline to Four-Week Low Against Yen**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aoF8uKXo5U6E&refer=home>

- Jan. 2 (Bloomberg) -- The world's biggest foreign-exchange traders say the best performing emerging market currencies will decline against the U.S. dollar this year as economic growth slows and price swings increase. Brazil's real, Turkey's lira and South Africa's rand may weaken at least 3.75 percent after gains of more than 14 percent in 2007, according to the median forecasts of banks and securities firms surveyed by Bloomberg News. The lira and rand last fell in 2006, while the real has strengthened for five straight years. **Slower U.S. growth will reduce demand for exports that make up 60 percent of less-developed economies,** said Brian Coulton, head of global economics at Fitch Ratings Inc. in London. Swings in exchange rates may widen the most since 2004 as credit-market losses spread, according to prices of benchmark options to buy the yen against the dollar. **``It's going to be a tough year ahead,"** said Arnab Das, global head of foreign-exchange research in London at Dresdner Kleinwort, the most accurate forecaster in the second half of 2007 among 31 firms surveyed by Bloomberg. The rand will weaken 12 percent to 7.70 against the dollar from 6.812 by year-end and the lira will depreciate 8.5 percent to 1.27 per dollar from 1.1698, he said. Analysts and money managers expect declines even after investors increased holdings of emerging market stocks and bonds by a record of about \$45 billion last year, according Boston-based EPFR Global, which tracks mutual fund flows. Gap Narrows Bonds of less-developed countries now pay 2.31 percentage points in extra yield compared with U.S. Treasuries, down from 10.4 percentage points in 2002, according to New York-based JPMorgan Chase & Co.'s Emerging Market Bond Index. The yield on Brazil's 6 percent bonds due in January 2017 dropped 47 basis points, or 0.47 percentage point, to 6.17 percent last year, compared with 4.07 percent on the benchmark 4.25 percent Treasury note that matures in November 2017. Turkey's 11.875 percent bonds due in 2030 fell 24 basis points to 6.81 percent, while the U.S. 5 percent bond due in May 2037 yields 4.5 percent. Investors flocked to bonds of developing countries as all U.S. Treasuries except 30-year bonds yielded less than the Federal Reserve's 4.25 percent target rate. **``We've seen an indiscriminate increase in the exposure to the emerging markets,"** said Maxime Tessier, head of foreign exchange in Montreal at Caisse de Depot et Placement, which manages \$145 billion. **``Having high interest rates is probably not going to be**

sufficient for a currency to do well anymore." Hedge Funds Hedge funds focusing on emerging markets returned at least 19 percent on average in the last four years and were the most profitable group among the 7,000 funds tracked by Hedge Fund Research Inc. in Chicago. September and October were the best months in almost two years with returns of 4.64 percent and 4.74 percent, HFR said. Russia's default in August 1998 triggered a flight from risk that drove down the real almost 20 percent and the rand 14 percent. Volatility of the one-month dollar-yen option jumped to 29 percent, almost three times the 12-year average. Volatility on the same option reached 23.5 percent on Aug. 17 last year, as the collapse of the subprime mortgage market increased corporate borrowing costs. Wider swings in exchange rates makes securities in other currencies less appealing by increasing risks that investors will lose money. **Highest Yields** "The last couple of years people bought the likes of Turkey and Brazil because they had the highest yields," said Ram Bhagavatula, a portfolio manager at Combinatorics Capital, a hedge fund in New York. "Unless the reward for taking on higher volatility is there, the market will gravitate toward the safer assets." **Slower Growth** Emerging markets may suffer because the U.S. economy slowed to a 1 percent annualized growth rate in the fourth quarter, according to a Dec. 11 Bloomberg survey of 63 economists. Former Treasury Secretary Lawrence Summers said Dec. 20 that a recession is "quite likely" in 2008. Former Federal Reserve Chairman Allan Greenspan has given it about even odds. A recession would increase volatility and weaken emerging market currencies, said Fitch's Coulton. Their dependence on exports has increase from 40 percent a decade ago, he said. **Real, Rand, Lira Rallies Are at Risk as Yields Fall (Update1)**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aYZcfhfvN7rY&refer=home>

Diversification

Derivatives

- Almost \$6.5bn worth of complex debt securities face fresh downgrades by Standard & Poor's because of their exposure to US mortgage-backed bonds, the credit rating agency said Friday. The news will add to the pain for investors in such instruments and follows downgrades issued to \$3.7bn worth of similar instruments on Thursday from S&P. In all, the agency has either downgraded or placed on review more than \$77bn worth of collateralised debt obligations (CDOs) that have direct exposure to the crisis in the US mortgage markets. Structured finance CDOs have been the worst affected segment of the market for complex debt products. They had become increasingly important in the growth of the broader CDO and securitisation industry in recent years because they were used to repackage bits of other deals that proved difficult to sell. The potential CDO downgrades announced Friday come as a direct result of downgrades given to nearly 800 mortgage-backed bond deals by S&P in late December. About two-thirds of the deals put on review Friday are so-called high-grade structured finance CDOs, which means they invested mostly in the safest AAA- and AA-rated slices of mortgage-backed bonds and similar securities. Downgrades and defaults among CDOs accelerated in the final months of last year with more than 2,000 downgrades issued in November alone, the worst ever month for CDO downgrades, according to analysts. **\$6.5bn of CDOs face ratings downgrades** <http://www.ft.com/cms/s/0/e9fd1746-baef-11dc-9fbc-0000779fd2ac.html>

- Jan. 4 (Bloomberg) -- The risk of companies defaulting rose the most in more than two months this week after U.S. reports showing a slowdown in jobs growth and manufacturing stoked concern that the economy will sink into a recession. **Credit-default swaps tied to the bonds of mortgage lender Countrywide Financial Corp., homebuilder Lennar Corp. and Citigroup Inc., the biggest U.S. bank by assets, increased. Defaults may rise almost seven-fold to 2.25 percent this year,** analysts at New York-based JPMorgan Chase & Co., the biggest underwriter of high-yield, high-risk corporate bonds last year, said in a report yesterday. **The U.S. economy is "very close" to recession, "if not there already,"** Bill Gross, who manages the world's largest bond fund as Pacific Investment Management Co.'s chief investment officer, said in an interview on Bloomberg Television. Contracts on the Markit CDX North America Investment Grade Series 9 Index of 125 companies rose 5 basis points to 88.75 basis points today, according to Deutsche Bank AG. The index climbed 11 basis points this week, the biggest increase since the period ended Oct. 19. A basis point is 0.01 percentage point. **In Europe, contracts on the Markit iTraxx Crossover Series 8 Index of 50 companies with mostly high-risk, high-yield credit ratings jumped 20 basis points to 388, according to JPMorgan. The index rose 50 basis points** this week, Bloomberg data show. Jobs Report 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; a decline, the opposite. Averting Recession? Economic growth may accelerate in the second half of 2008 and the U.S. economy is likely to avoid a recession, Edward Lazear, chairman of the White House's Council of Economic Advisers, said in an interview on Bloomberg Television. "I think we very narrowly avoid a recession, but it will feel like a recession for many people throughout the economy," said Scott MacDonald, head of research at Aladdin Capital Management LLC in Stamford, Connecticut, which manages \$20 billion in assets. "And it can be argued that parts of the U.S. economy are already in recession." Contracts tied to the debt of Calabasas, California-based Countrywide moved deeper into distressed levels on concern that the company will continue to lose money amid the housing slump. The lender lost \$1.2 billion in the third quarter, its first quarterly loss in 25 years. Risk of Default Traders demanded 19.5 percent upfront and 5 percent a year to protect Countrywide bonds from default for five years, Phoenix prices show. The cost rose from 16.5 percent upfront and 5 percent a year yesterday. Investors demand upfront payments when they see a high risk of default. Contracts on Miami-based Lennar, the biggest U.S. homebuilder, climbed 13 basis points to a record 666 basis points, according to CMA Datavision in New York. Credit-default swaps on SLM Corp., the biggest U.S. educational lender known as Sallie Mae, rose 40 basis points to 405 today, according to Phoenix. The Reston, Virginia-based company said it plans to become more selective in the business it does and cut services to borrowers as it struggles to restore its financial standing. The Markit iTraxx Europe index of credit-default swaps on 125 investment-grade companies rose 5 basis points to 61.25, JPMorgan prices show. The Markit LCDX Series 9 index, a gauge of confidence in the U.S. high-yield, high-risk loan market that falls as sentiment worsens, dropped 0.65 point to 96.15, the lowest in more than a month, according to Goldman Sachs Group Inc. The index dropped 4.3 percent since Oct. 15.

High-yield, high-risk, or junk, bonds are rated below Baa3 by Moody's Investors Service and BBB- by Standard & Poor's. **Credit-Default Swaps Have Worst Week in More Than Two Months**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aQGApjmgY05c&refer=home>

- Jan. 4 (Bloomberg) -- **State Street Corp., BlackRock Inc., Societe Generale and Deutsche Bank AG units are among 28 managers of mortgage-linked collateralized debt obligations deemed at risk of being unable to fully pay off their most-senior classes.** About **\$64 billion** of CDOs, which repackage pools of assets into new securities with varying risks, **have experienced so-called events of default since mid-October** after a slump in the credit quality of their holdings, according to data sent to clients yesterday by Charlotte, North Carolina-based Wachovia Corp. analyst Justin Pauley. Harding Advisory LLC and Tricadia CDO Management LLC each manage five of such failing deals, the most. **“Most managers that have done a number of transactions are on there,”** said Andrew Chow, who oversees about \$7 billion in asset-backed bonds and related derivatives at SCM Advisors LLC in San Francisco, including securities within CDOs. **CDOs containing mortgage bonds represented the largest source of about \$100 billion of debt-related losses at the world's largest financial firms last year** as record subprime loan delinquencies, surging defaults on other home loans and the highest foreclosure rates on record led to unprecedented downgrades and price drops among mortgage bonds and related CDOs. CDO default events can force a CDO to divert all of the money generated by its collateral toward repayment of its most senior classes at the expense of other investors, or it can lead to liquidation. Such decisions are governed by contracts, which typically call for votes among some or all noteholders. Citigroup Inc. and Merrill Lynch & Co., the New York-based financial companies that ousted their chief executive officers after writedowns stemming from CDOs, underwrote the most CDOs in 2006 and 2007. Banks that decided to keep many of the mortgage-bond CDOs classes least exposed to defaults when underwriting the debt did so in “a state approaching complacency,” Erik R. Sirri, the head of the Securities and Exchange Commission's market regulation division said in a November speech. Downgrades Losses on those classes may total \$77 billion for the world's biggest banks and securities firms and \$29 billion for bond insurers, according to a JPMorgan Chase & Co. report in November. The estimate represents credit losses after foreclosures on homeowners, not changes in CDO values. Moody's Investors Service downgraded more than \$60 billion of mortgage-linked CDOs in October and November, and began last month with \$174 billion under review for cuts. Standard & Poor's, which today placed \$6.4 billion of CDOs under review because of cuts last month on \$22.9 billion of second-mortgage bonds, has downgraded or placed under review about \$77 billion of CDOs. The ratings services have often lowered even junior AAA rated classes of CDOs to non-investment-grade levels when a default event arises. **State Street, BlackRock Manage Some CDOs in Default**
http://www.bloomberg.com/apps/news?pid=20601087&sid=a8KK0_1pB9z0&refer=home

- Jan. 3 (Bloomberg) -- From 2005 through the middle of '07, two of Wall Street's oldest firms were locked in an embrace that proved damaging to both. Merrill Lynch, founded in 1914, sold hundreds of millions of dollars worth of collateralized debt obligations to hedge funds run by Bear Stearns, started in 1923. Some 90 percent of the face value of the CDOs was loaned to Bear by Merrill, as is normal in such transactions. **When the prices of the funds' CDO holdings started to fall in June, Merrill demanded that the firm increase collateral in what's known in the debt markets as a margin call.** Bear Stearns executives pleaded for time, arguing that the forced sale of their assets would push down all CDO prices. Merrill Lynch officials brushed off the entreaty, according to people involved in the discussions. In June, the hedge funds, run by Ralph Cioffi, sold \$3.8 billion of CDOs to meet margin calls by Merrill and other lenders that were following its lead. The fire sale led to a further drop in CDO prices. Among those that lost value: \$23 billion of CDOs Merrill held on its own books. In October, Merrill wrote down the value of all of its mortgage-backed holdings, including CDOs, by \$7.9 billion and declared a loss for the third quarter. "It was in Merrill's interest to wait it out and allow the Bear Stearns funds to recapitalize, so they wouldn't have to re-price their assets," says William Fitzpatrick, a financial services analyst at Racine, Wisconsin-based Optique Capital Management, which oversees \$1.7 billion. Optique held both Bear and Merrill shares; it sold all of its Merrill shares in 2006 and dumped its remaining Bear shares in July, Fitzpatrick says. **\$850 Million Seized** Both Bear Stearns and Merrill Lynch declined to comment on the matter. Merrill is a passive, minority investor in Bloomberg LP, parent of Bloomberg News. On June 15, Merrill Lynch seized \$850 million of the CDOs from Cioffi's funds -- as lenders are allowed to do when their margin calls aren't met -- and tried to sell them in the market. When the firm received bids of 20 cents on the dollar, it abandoned the effort. In July, Cioffi's funds declared bankruptcy, losing \$1.6 billion of investors' money and triggering the repricing of CDOs around the world. Giving Bear Stearns a chance to shore up the hedge funds might have allowed time for Merrill Lynch to reduce its CDO portfolio or buy hedges against it, Fitzpatrick says. In June, before the funds' problems became public, there were market players who were still willing to underwrite credit default swaps on CDOs. That opportunity disappeared after the Bear funds' failure. "The end was inevitable," Fitzpatrick says. "But Merrill could maybe have bought some time if it hadn't blown the whistle on the Bear funds." Divorce might have been in order. Merrill filed its petition too soon. **In Unforgiven Margin Call, Bear Funds Failed on Merrill CDOs**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aT2LrbPYb7wU&refer=home>

Housing

Price of existing homes fell 3.3% Y over Y Nov **IBD**

Housing Finance

Macro Economic

- Jan. 6 (Bloomberg) -- Harvard University economist Martin Feldstein, **head of the group that dates economic cycles in the U.S., said the odds of a recession are more than 50 percent after a report showing the unemployment rate jumped.** "We are now talking about more likely than not," Feldstein, president of the National Bureau of Economic Research, said in an interview yesterday in New Orleans. "I have been saying about 50 percent. This now pushes it up a bit above that." The jobless rate rose to 5 percent in December, the highest in two years, from 4.7 percent in November, a government report showed last week. Payrolls rose by 18,000, the least since August 2003. The U.S. economic expansion is cooling after a third- quarter surge as the housing slump enters its third year and consumer spending slows. Former Federal Reserve Chairman Alan Greenspan and ex-Treasury Secretary Lawrence Summers are among those raising the prospect of a recession. **The rise in joblessness will hurt consumer confidence, Feldstein said in the interview.** He was in New Orleans to speak at an economics panel discussion on productivity that was part of the annual meeting of the Allied Social Science Associations. **"Consumers, with essentially no growth in jobs in December, are going to be more nervous about the future," said Feldstein, 68. "They are going to be a little more reluctant to spend, and that is going to put a further drag on growth in 2008."** The Federal Reserve's decisions to lower interest rates and pump billions of dollars into the banking system may not be enough, and the U.S. will need fiscal measures, such as temporary tax cuts, to stoke growth, he said. Problem of Confidence **"I am not sure that reduction in rates is going to have as much traction as it did in the past because so much of the problems now are problems of confidence in the financial sector and of bank capital,"** he said. "So that is why I have been saying we need some kind of a fiscal stimulus." Feldstein has headed the NBER, which like Harvard is based in Cambridge, Massachusetts, since 1984. He also served in the post from 1977 to 1982. Feldstein plans to step down from the NBER in June to conduct more research on his own, his assistant, Norma McEvoy, said in September. **Feldstein Says U.S. Recession Is More Likely After Jobs Report** <http://www.bloomberg.com/apps/news?pid=20601087&sid=acU95NFzpSNY&refer=home>
- [Because I do not have a category "how absurd" – I will put this here. The sole reason for such a silly policy is to - wink wink - let the clowns on wall street know that they can have more "Fed will cut" rallies and ignore any and all facts by interpreting anything said as a "sign the Fed is on the job". What a sorry joke this whole thing has become] Jan. 5 (Bloomberg) -- Federal Reserve Vice Chairman Donald Kohn said the central bank has increased its communication on policy views to the public in the wake of the financial-market "turmoil" that began in August. **Fed officials have tried to signal when the central bank's reading on the economic outlook shifted "materially" in between regular meetings,** Kohn said in a speech in New Orleans. "We have tried to provide more information than usual to reduce uncertainty and clarify our intentions." Kohn spoke before a week in which Chairman Ben S. Bernanke and six other Fed policy makers are scheduled to deliver remarks. The speeches come amid increasing signs of

danger to the U.S. economic expansion, including a jump in the unemployment rate to a two-year high and a contraction in manufacturing. Traders anticipate the Fed will cut interest rates again Jan. 30. Still, investors "should understand" that officials "do not coordinate schedules and messages, and that members' views are likely to be especially diverse" when circumstances are rapidly changing, Kohn said. Kohn held out Bernanke's last speech on Nov. 29 as a signal of a change in the Fed's views. The chairman said at the time that volatility in credit markets had "importantly affected" the economic outlook and declined to repeat the Federal Open Market Committee's October statement that inflation and growth risks were about equal. The Fed then cut rates on Dec. 11. 'Let People Know' "We have attempted to let people know when our views of the macroeconomic situation had changed materially between FOMC meetings," said Kohn said in prepared remarks at the National Association for Business Economics panel discussion, part of the Allied Social Science Associations annual meeting. Separately, Kohn said today that the FOMC's new forecasts for inflation three years out do not represent an "explicit numerical definition of price stability," something the committee decided against, but rather the inflation rate that is "acceptable and consistent with fulfilling our congressional mandates." Kohn, who said in 2003 that he was "skeptical" about a price target, chaired a subcommittee of officials that coordinated work on the Fed's communication review that began in 2006. He suggested in September that his doubts about the idea had eased. Inflation Expectations "I expect that our new projections will provide some of the benefits of an explicit target in better anchoring inflation expectations while not giving up any flexibility to react to developments that threaten high employment," Kohn said today. **Kohn Says Fed Is Trying to Signal When Views Shift Materially**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aKeJB8ShWCVk&refer=home>

- Jan. 5 (Bloomberg) -- **The pace of inflation in France, already at a three-year high, will quicken in 2008** relative to last year, fueled by higher prices for oil and commodities, French Finance Minister Christine Lagarde said. "We will without a doubt have more inflation in 2008 than in 2007," Lagarde said in an interview today with France Info, a Paris-based radio station. The 70 percent increase in oil prices over the past year pushed France's inflation rate to the highest in more than three years in November. French consumer prices rose at an annual rate of 2.6 percent in the month, up from 2.1 percent in October, Insee, the Paris-based national statistics office, said Dec. 13. Crude-oil prices reached a record \$100.09 on Jan. 3 in New York. "There is imported inflation because of factors that are external, like the increase in the price of oil and commodities," Lagarde said. "I doubt the price of oil will fall in 2008. **The same goes for agricultural commodities. Global demand remains strong and we can't stop the Chinese and Indians from seeking more to meet their growing needs.**" France's rising prices are mirrored elsewhere in Europe. **European inflation stayed at the highest in more than six years** in December as food and energy costs soared, heightening concern among central-bank policy makers that rising prices will fuel bigger wage increases. Consumer Spending **In France, higher gasoline and food costs have already had an impact on consumer spending.** Retail sales fell for a third month in December and purchasing of manufactured goods, which accounts for about 15 percent of the economy, dropped 0.1 percent in November. **French Inflation to Accelerate in 2008, Lagarde**

Says

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aXwere4I9FFU&refer=home>

- Jan. 4 (Bloomberg) -- Bill Gross, manager of the world's biggest bond fund, said the Federal Reserve may not be able to avoid a recession even if central bank policy makers lower borrowing costs by at least another percentage point. "I'm not sure if the Fed can do that by reducing rates to 3.5 percent or 3 percent or even lower," Gross, the founder and chief investment officer of Pacific Investment Management Co., said in a Bloomberg Television interview. **"The Fed has been behind the curve for a long time."** "Very Weak Economy" "The increase in unemployment of this magnitude certainly is indicative of a very weak economy," Gross said. Gross also said he was "impressed" with the Fed's move to increase the size of two scheduled auctions of emergency loans by 50 percent to \$30 billion, beginning with the next offering on Jan. 14. The two previous such auctions held by the Fed last month helped lower the London interbank offered rate, a benchmark for some bank loans. The three-month Libor rate for dollars fell to 4.62 percent today, the lowest since January 2006, according to the British Bankers' Association. Libor Versus Bills The rate is 1.43 percentage points more than Treasury bill yields, after being as much as about 2.2 percentage points higher than bill yields last month. The gap averaged about 0.4 percentage point from 1998 until August, when banks became reluctant to lend to each other because of losses on subprime mortgages. The auctions "ultimately lower the Libor spread to Treasuries," Gross said. "It's a step in the right direction." **Pimco's Gross Says Fed May Not Avoid a Recession** <http://www.bloomberg.com/apps/news?pid=20601087&sid=a2Mh1M1LhNDo&refer=home>
- Jan. 3 (Bloomberg) -- **U.K. retail stocks fell the most since 2001 after DSG International Plc said profit will miss analysts' estimates and Next Plc forecast a fourth year without same-store sales growth, adding to concern about consumer spending.** The 20-member FTSE 350 General Retailers Index slid as much as 6.2 percent, the biggest drop since Jan. 11, 2001. DSG, Europe's second-biggest consumer electronics seller, paced the decline, falling as much as 23 percent. Shares of Next, Britain's third-largest clothing retailer, dropped as much as 8.6 percent. Rising mortgage repayments combined with higher taxes, utility bills and food prices have caused Britons to pare their spending. The number of visitors to U.K. retail outlets fell 2.6 percent last month, Experian Group's Footfall said yesterday, and consumer confidence in the country fell the most in at least three years in November, according to Nationwide Building Society. "People are going to be very, very wary of the sector for the first half of 2008," David Jeary, an analyst at Investec Securities, said today by phone. **Today's statements "make the outlook in the near future blacker than people were thinking."** DSG, the owner of Currys and PC World stores in the U.K., said pretax profit for the year through April will be 40 million pounds (\$78.9 million) to 50 million pounds below estimates. **Sales at stores open at least a year fell 1 percent in the 11 weeks ended Dec. 29, the retailer's busiest period of the year.** Interest Rates The "disappointing" holiday "reflects, in our view a slowdown in the consumer trading environment," Chief Financial Officer Kevin O'Byrne said on a conference call. "We are more cautious than we might have been" before Christmas. The Bank of England on Dec. 6 cut its benchmark interest rate for the first time in two years after five rate increases since August 2006 threatened

economic growth. Britons are burdened by a record 1.4 trillion pounds in debt. Rising food prices and a housing slump have hurt retail sales in the U.S., where the National Retail Federation has forecast this holiday season may be the slowest-growing in five years. DSG shares slid as much as 25 pence to 82.25 pence in London and traded at 82.5 pence at 1:07 p.m. local time. A close at that level would represent the steepest daily percentage drop since Bloomberg records began in 1988. Shares of smaller rival Kesa Electricals Plc fell as much as 10 percent. The decline in retail stocks extended across Europe. The Bloomberg Europe Retail Index dropped as much as 4.5 percent, with Inditex SA sliding as much as 4.9 percent in Madrid and Hennes & Mauritz AB falling as much as 3.1 percent in Stockholm. Estimate Cut DSG's pretax profit was reduced by about 30 million pounds in the holiday period by consumers waiting until after Christmas to purchase products at lower prices, O'Byrne said. "In the U.K. particularly, we certainly saw delayed spending," he said. Panmure Gordon & Co. analyst Christian Koefoed-Nielsen cut his estimate of DSG's pretax profit for this fiscal year by 18 percent to 255 million pounds. Analysts had expected the retailer to make pretax profit of about 298 million pounds, according to the median of 24 estimates compiled by Bloomberg. Next shares declined as much as 144 pence to 1,522 pence in London and traded at 1,559 pence at 1:07 p.m. local time, heading for their lowest close since Jan. 3, 2006. Sales at stores open at least a year and unaffected by openings of nearby Next outlets fell 3.2 percent in the 21 weeks through Dec. 24, the company said today. Next had forecast a drop of 1 percent to 3.5 percent on that basis in the second half. "Extremely Cautious" The Leicester, England-based retailer is "extremely cautious" about the outlook for 2008 because of the increased demands being placed on shoppers' incomes, it said in a statement. Next's same-store sales have dropped for almost three years as Marks & Spencer Group Plc, the U.K.'s biggest clothing retailer, has won back shoppers with new fashions. Next also said today that pretax profit would be between 492 million pounds and 502 million pounds in the year to Jan. 26. That's more than the 490 million-pound average estimate of 24 analysts compiled by Bloomberg. Earnings were helped by growth in sales at the Next Directory catalog and Web shopping unit. Online sales in the U.K. probably rose 82 percent to 17.6 billion pounds in the fourth quarter of last year as more people shopped on the Web, according to trade group IMRG. **U.K. Retailers Slide; DSG, Next Fuel Spending Concern**
<http://www.bloomberg.com/apps/news?pid=20601102&sid=aiJ...RTohCs&refer=uk>

- Jan. 3 (Bloomberg) -- Asian stocks declined, sending a regional benchmark to a two-week low, **after a decline in a U.S. manufacturing index boosted concern the world's largest economy is headed for a recession.** Samsung Electronics Co., Asia's largest maker of chips and mobile phones, and BHP Billiton Ltd. retreated on speculation demand for the region's electronics and raw materials will wane. National Australia Bank Ltd. led a drop by banks on concern weakening U.S. growth will widen credit-market losses. The manufacturing report "lifts the probability of a global slowdown that will affect everything from European to Asian assets," said Hans Kunnen, who helps manage the equivalent of \$128 billion at Colonial First State Global Asset Management in Sydney. "The outlook is not good." The MSCI Asia Pacific excluding Japan Index lost 0.5 percent to 523.49 as of 8:25 a.m. in Hong Kong, poised for its lowest close since Dec. 21. The benchmark slid 0.7 percent yesterday on reports that showed the economies of South Korea and Singapore are slowing. Japan's markets are shut for a fourth day. South

Korea's Kospi index slid 1.1 percent, while Australia's S&P/ASX 200 Index dropped 1.4 percent. U.S. stocks declined on the first day of trading this year, sending the Dow Jones Industrial Average to its worst start since 1983. The Institute for Supply Management's factory index fell to 47.7, from 50.8 the prior month, the Tempe, Arizona- based group said yesterday. The figure was lower than forecast by any economist surveyed by Bloomberg News. **Asian Stocks Fall on U.S. Economic Outlook; Samsung, BHP Drop** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aP6aKLpeI2zw&refer=home>

- January 2 2008 FT According to new polls, the economy is the number one issue for American voters. A million homeowners may lose their homes because of the subprime mortgage crisis and millions more face difficulties getting credit. Energy costs are up, consumer confidence is down. We are poised for recession. Washington is abuzz with plans to prevent the economy falling into recession. All the main presidential candidates are offering ideas for keeping the economy afloat. President George W. Bush wants to freeze mortgage rates while helping giant banks to unfreeze their credit by means of a giant bankruptcy process requiring so much government intervention as to make even a Democrat blush. Democrats are toying with middle-class tax cuts and increased spending on infrastructure to stimulate the economy. Pressure is mounting on the Federal Reserve to cut interest rates further. But none of these fixes will help much, because they do not deal with the underlying anxieties gripping American voters. The problem lies deeper than the current slowdown. It is only tangentially related to the business cycle. **The fact is, middle-class families have exhausted the coping mechanisms they have used for more than three decades to get by on median wages that are barely higher than they were in 1970, adjusted for inflation. Male wages today are in fact lower than they were then; the income of a young man in his 30s is now 12 per cent below that of a man his age three decades ago. Yet for years America's middle class has lived beyond its pay cheque.** Middle-class lifestyles have flourished even though median wages have barely budged. That is ending and Americans are beginning to feel the consequences. The first coping mechanism was moving more women into paid work. The percentage of American working mothers with school-age children has almost doubled since 1970 – from 38 per cent to close to 70 per cent. Some parents are now doing 24-hour shifts, one on child duty while the other works. I call these families Dins – double income, no sex. But we reached the limit to how many mothers could maintain paying jobs. **We turned to a second coping mechanism. The typical American now works two weeks more each year than he or she did 30 years ago. We are veritable workaholics, putting in 350 more hours a year than the average European, more even than the notoriously industrious Japanese.** But there is also a limit to how long we can work. As the tide of economic necessity continued to rise, we turned to the third coping mechanism. We began to borrow, big time. **With housing prices rising briskly through the 1990s and even faster between 2002 and 2006, we turned our homes into piggy banks through home equity loans. Americans got nearly \$250bn worth of home equity every quarter in second mortgages and refinancings. With credit cards raining down like manna from heaven, we bought plasma TV sets, new appliances, vacations. With dollars artificially high because foreigners continued to hold them even as the nation sank deeper into debt, we summoned inexpensive goods and services from the rest of the world.** But this can no longer keep us going, either. The

era of easy money is over. With the bursting of the housing bubble, home equity is drying up. Defaults on home equity loans have surged to the highest level this decade. Automotive and credit card debt is next. Personal bankruptcies rose 48 per cent in the first half of 2007, probably even more in the second, which means a wave of defaults on consumer loans. Meanwhile, as foreigners shift out of dollars, we will no longer have access to cheap foreign goods and services. The anxiety gripping the American middle class is not simply a product of the current economic slowdown. The underlying problem began around 1970. Any presidential candidate seeking to address it will have to think bigger than bailing out lenders and borrowers, or stimulating the economy with tax cuts and spending increases. Most Americans are still not prospering in the high-tech, global economy that emerged three decades ago. Almost all the benefits of economic growth since then have gone to a relatively small number of people at the top. The candidate who acknowledges this and finds ways truly to spread prosperity will have a good chance of winning over America's large, and increasingly anxious, middle class. **The era of easy money is over** *The writer is professor of public policy at the University of California at Berkeley. He is former US secretary of labour and author of Supercapitalism, soon to be released in the UK* http://www.ft.com/cms/s/0/a7f69da8-b947-11dc-bb66-0000779fd2ac.html?nclick_check=1

- Jan. 2 (Bloomberg) -- **U.S. stocks tumbled, led by banks and computer companies, after the biggest decline in manufacturing in five years sent the Dow Jones Industrial Average to its worst start since 1983.** Intel Corp., the largest semiconductor maker, fell the most in almost a year after Bank of America Corp. lowered its rating and investors speculated companies will spend less on technology. Caterpillar Inc., the largest maker of earthmoving equipment, and International Business Machines Corp., the biggest computer services company, led the Dow Jones Industrial Average to a 1.7 percent plunge. The Standard & Poor's 500 Index lost 21.20, or 1.4 percent, to 1,447.16, the most to start a year since it fell 2.8 percent on Jan. 2, 2001. The Dow average slipped 220.86 points to 13,043.96. The Nasdaq Composite Index decreased 42.65, or 1.6 percent, to 2,609.63. More than three stocks fell for every one that rose on the New York Stock Exchange. The decline in the Institute for Supply Management's manufacturing index "increases the odds we're going to go into a recession, and recessions are associated with bear markets," Brian Gendreau, who helps manage \$12 billion at ING Investment Management in New York. **The ISM index dropped to 47.7, the lowest since April 2003 and the first reading below 50 since last January.** The report, combined with a rise in the price of oil to a record \$100 a barrel, spurred concern that a slowdown in spending will halt the five-year economic expansion. Treasuries Rally Two-year Treasuries rose the most in more than three weeks after the ISM report, while the dollar fell against the euro and yen, as traders increased bets the Federal Reserve will lower the benchmark interest rate half a percentage point at its next meeting. Concern that credit-market losses will curb bank lending and spur a recession sent the S&P 500 down 3.8 percent in the fourth quarter, cutting the gauge's 2007 gain to 3.5 percent. Financial shares in the S&P 500 fell 2.5 percent, extending a 21 percent slide in 2007 that was their biggest in 17 years. Intel lost \$1.31 to \$25.35, leading semiconductor makers in the S&P 500 to a 3.7 percent retreat, the biggest since July 2006 and the most among 24 industry groups in the index. **Profit growth that exceeds analysts' estimates "will be hard to come by,"** Bank of America analyst Sumit Dhanda wrote in a note to clients

today. Bank of America trimmed its forecast for semiconductor sales growth this year to 7 percent from 11 percent. "If we get a cyclical drop in the economy then we have to worry about traditional credit losses coming in, which would be a second shoe to drop for the financials," said Alan Gayle, senior investment strategist and director of asset allocation at Trusco Capital Management in Richmond, Virginia, which oversees \$17 billion of equities. Wall Street strategists forecast gains for U.S. stocks in 2008. **The S&P 500 may climb 11 percent in 2008, extending the five-year bull market, according to the average forecast from 15 strategists surveyed by Bloomberg.** Analysts are bullish even as economists predict a slowdown in the U.S. Gross domestic product probably grew at an annual rate of 1 percent in the final three months of 2007 and will expand 1.5 percent this quarter, according to the median forecast of economists polled by Bloomberg last month. That compares with 4.9 percent growth in the third quarter of last year. "The manufacturing sector of the economy is indeed contracting and that's certainly not good news and contributes to the view that we're headed towards a recession," said Hugh Johnson, who oversees about \$725 million as chairman of Johnson Illington Advisors LLC in Albany, New York. "For the first part of this year when there's not a lot of confidence in earnings, the markets are not going to do well." Profits among S&P 500 members are forecast to rise 15.1 percent in 2008, the average estimate of analysts surveyed by Bloomberg, after growth slowed to an estimated 1.4 percent last year. Most of the gain is predicted in the third quarter, when analysts expect earnings to increase by 19.7 percent. Crude Rally Crude oil futures touched \$100 a barrel for the first time, extending last year's 57 percent climb reflecting demand growth outpacing the industry's ability to find deposits. Schlumberger Ltd., the world's largest oilfield-services provider, rose \$2.21 to \$100.58. **Energy shares were the only industry group in the S&P 500 to rise as natural gas futures also climbed,** reaching a one-month high. Shares of department stores and discounters in the S&P 500 lost 2.1 percent. U.S. retail sales rose 2.3 percent last week at stores open at least a year as consumers slowed spending during what may have been the worst holiday shopping season in five years, the International Council of Shopping Centers said. Retailer Stocks Bed Bath & Beyond Inc., the largest U.S. home-furnishings retailer, fell \$1.03 to \$28.36, a five-year low. J.C. Penney Co., the third-largest department store chain, declined \$2.34 to \$41.65. **Amazon.com Inc. was the biggest gainer in the group, adding \$3.61 to \$96.25, after Citigroup predicted market share gains and recommended investors buy the shares.** Interest-rate futures show the odds of a half-point cut on Jan. 30 increased to 26 percent from nothing, with the remainder of the bets counting on a quarter-point cut in the Fed's target for the overnight lending rate between banks. **U.S. Stocks Drop, Sending Dow Average to Worst Start Since 1983**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=anRr7uV4igtU&refer=home>

- Jan. 2 (Bloomberg) -- Intel Corp., Qualcomm Inc. and other computer-related stocks sank today amid concern about slowing growth in corporate budgets and limited prospects for profit increases this year. **Intel fell 4.9 percent after Bank of America Corp. cut its recommendation on the Santa Clara, California-based chipmaker and seven of its peers.** [this was just the start, it fell another 10% the next two days] Qualcomm Inc. declined 2.4 percent following a court's decision to bar it from selling some products. The Nasdaq Composite Index decreased 42.65, or 1.6 percent, to 2,609.63 at 4 p.m. New York time. As the economy slows, technology spending growth in the U.S. will drop to

4.8 percent this year from 5.3 percent in 2007, according to Forrester Research Inc. in Cambridge, Massachusetts. That will mark the third straight year of slowing budget increases, the researcher said. **“A lot of money moved into technology, thinking it was going to be a safe haven,”** said Larry Valencia, who helps oversee \$11 billion at UMB Asset Management in Kansas City, Missouri. **“If the U.S. slows and all the other economies slow to some extent, then tech takes a pretty good hit.”** The industry weathered the collapse in subprime mortgages better than most last year. The Nasdaq-100, composed almost entirely of computer-related stocks, rose 19 percent, compared with the 3.5 percent gain in the Standard & Poor's 500 Index and the 6.4 percent advance in the Dow Jones Industrial Average. **Intel, which rose 32 percent in 2007,** declined \$1.31 to \$25.35 in Nasdaq Stock Market trading, the biggest drop in almost a year. **“Companies, whenever they are pressed against the wall, will cut capital expenditures,”** Caughey said. “They scale back on IT projects and they don't order new software.” Intel, the world's biggest computer-chip maker, and other semiconductor companies will see slower sales growth in 2008 as the economy cools and inventory builds for motherboards that hold computer parts, Bank of America analyst Sumit Dhanda in New York said in a note. He cut his rating on the stock to “neutral” from “buy.” Dhanda also downgraded Advanced Micro Devices Inc., Intel's only competitor in personal-computer processors. He recommends selling the stock, along with LSI Corp. and National Semiconductor Corp. Advanced Micro fell 36 cents to \$7.14 in New York trading. Still, some technology stocks will weather a slowdown better than others, analysts said. **Internet companies such as Google Inc. and Yahoo! Inc. will benefit from growth in the online ad market, buoyed by demand in Europe and emerging markets such as China and India,** [another “it is contained to subprime comment” – the European economies are as stressed as the US and China will not hold up with recessions in Europe and here] JPMorgan Chase & Co. analyst Imran Khan wrote today in a note. Global spending on ads that accompany Internet search results will increase 39 percent to \$30.5 billion this year, he said. **Intel, Technology Stocks Fall Amid Budget Concerns** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aEVIc2gc35VI&refer=home>

- NEW YORK (Dow Jones) -- Banks kicked off 2008 on a downbeat note, as a handful of lenders disclosed new write-downs, provisions and plans to shore up weakened capital bases. **“The fourth quarter will likely shape up to be one of the worst in recent memory,”** Mark Fitzgibbon, banking analyst at Sandler O'Neill & Partners, wrote in a note to clients on Wednesday. National City Corp. (NCC) garnered the most attention as its board voted to slash its quarterly dividend in half. The company also said it's laid off 900 workers and will bolster capital as it becomes the latest to detail its exposure to the subprime-mortgage debacle. Meanwhile, Zions Bancorp (ZION) announced \$55 million of new write-downs and charges, while Horizon Bancorp (HBNC) set aside an extra \$1.4 million to cover potential loan and lease losses. **National City Cutting Dividend, Jobs** <http://www.nasdaq.com//aspxcontent/newsstory.aspx?textpath=20080102\ACQDJON200801021329DOWJONESDJONLINE000560.htm&cftime=01%2f02%2f2008%20+1%3a29PM>
- Jan. 2 (Bloomberg) -- **Manufacturing in the U.S. shrank the most last month in almost five years, triggering speculation that the Federal Reserve will cut interest rates by half a percentage point to stave off a recession.** The Institute for Supply Management's factory index fell to 47.7, from 50.8 the prior month, the Tempe, Arizona-

based group said today. The figure was lower than forecast by any economist surveyed by Bloomberg News. Fifty is the dividing line between contraction and expansion. Stocks fell and Treasury notes climbed as the report suggested the housing-market rout is spreading to the broader economy. The ISM's gauge has now fallen six straight months, the longest losing streak since the eve of the economy's last contraction in 2001. **“Right now we're not expecting a recession, but after this report we may have to revisit that forecast,”** said Kenneth Kim, an economist at Stone & McCarthy Research Associates in Skillman, New Jersey, which had the closest estimate in the Bloomberg survey. “There's probably more pain and contraction to come” in manufacturing, he said. Economists' Estimates Economists predicted the index would fall to 50.5, according to the median of 69 forecasts in a Bloomberg News survey. The manufacturing gauge, which covers about 12 percent of the economy, averaged 52.2 last year, down from 53.9 in 2006. The December reading was the first below 50 since January 2007. The ISM's measure starts pointing to a recession across the economy when it falls below 41.9 for two straight quarters, according to Norbert Ore, chairman of the institute's manufacturing survey. **“I don't see sufficient evidence yet to have grave concern about recession following this,”** Ore said in an interview. “I would want to see what January and February look like” before drawing a conclusion. A report from the Commerce Department showed spending on construction projects unexpectedly rose in November as work on schools, power plants and factories helped overcome cutbacks in homebuilding. The 0.1 percent increase followed a 0.4 percent drop the prior month that was smaller than previously reported. Rising Prices The group's index of prices paid rose to 68 from 67.5. Economists surveyed by Bloomberg had expected the measure to fall to 65. **The decrease in today's overall manufacturing index reflected a decline in new orders to the lowest level since October 2001.** ISM's new orders index fell to 45.7 from 52.6. The production measure fell to 47.3 from 51.9. The report follows others that show manufacturing weakening. The Philadelphia Federal Reserve's business gauge for December contracted for the first time in a year and the Richmond Fed's measure also was negative. Orders for durable goods excluding transport equipment fell 0.7 percent in November, held back by a drop in defense procurement and machinery demand, the Commerce Department said on Dec. 27. Inventories of such goods unexpectedly rose and economists said they will remain watchful as to whether that will detract from economic growth later on. The inventory index in today's report declined to 45.5 from 46.9. Figures less than 50 mean manufacturers are reducing stockpiles. Inventories Stockpile building added 0.89 percentage point to third- quarter economic growth and helped boost growth to the fastest rate in four years. Slower consumer spending and continued housing weakness the last three months of the year probably brought down economic growth in the quarter to a 1 percent pace, one-fifth the rate it did from July through September, according to a Bloomberg News survey taken last month. The ISM's gauge of export orders fell to 52.5, from 58.5. Increased exports had helped shield some companies from the effects of slowing U.S. demand last year. Some economists, including Michael Gregory at BMO Capital Markets in Toronto, expect that to change as growth in foreign countries slows. “I think the last few months you've had a change in attitudes in a lot of major markets outside the U.S.,” Gregory said. **U.S. Economy: Manufacturing Shrinks Most Since 2003**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=awukKZ8gftMY&refer=home>

- Jan. 2 (Bloomberg) -- **U.K. manufacturing growth slowed more than forecast in December and a gauge of factory prices fell to a nine-month low, giving the Bank of England room to cut interest rates further.** An index based on a survey of more than 600 manufacturers dropped to 52.9, compared with 54.3 in November, the Chartered Institute of Purchasing and Supply said today in London. Economists forecast 53.8, according to the median of 20 estimates in a Bloomberg News survey. A measure of factory output prices fell to the lowest since March. Manufacturers' margins are set to be squeezed as tighter credit conditions make customers more reluctant to spend, while rising energy prices boost production expenses. The Bank of England cut rates for the first time in two years last month to limit damage to economic growth from higher market credit costs. Today's report "adds to the concerns that we were already having," said Holger Schmieding, chief European economist at Bank of America in London, in an interview. "The manufacturing sector was supposed to be the bright spot in the U.K. Rates here are at a slightly restrictive level, and the U.K. economy definitely no longer needs that." Manufacturing Slump Manufacturing climbed 0.5 percent in the last three months of 2007 from a year earlier, slowing from a revised 10.3 percent in the July-September period, the trade ministry said. **Singapore's electronic exports have dropped each month since February, mired in the worst slump in five years. South Korea yesterday lowered its growth forecast for 2008, pointing to the likelihood of slowing exports. Taiwan is also predicting an easing in overseas shipments this year which it said will make its growth target "highly challenging."** Hynix Semiconductor Inc. Chief Executive Officer Kim Jong Kap last week told employees of the world's second-largest maker of memory chips, based in Ichon, South Korea, that "a difficult period" is foreseen for the first quarter or the first half. Financial Services Singapore's services industry climbed 8.3 percent from a year earlier, matching the growth rate in the previous three-month period. **Economists said demand for financial services probably eased as the rout in global credit markets increased risk aversion** and the city-state's government implemented measures to cool the property market. Global stock markets have lost \$1.6 trillion in value since October and the collapse of the subprime-mortgage market in the U.S. triggered more than \$80 billion in writedowns among the world's largest banks. "Singapore's financial services industry has been affected by the shadow of the subprime problem," Seah said. "Investors are more cautious and that has slowed down activity." **Singapore's GDP Unexpectedly Shrinks on Weaker Output** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aAMTtzgVm6UU&refer=home>

Retail

- Jan. 3 (Bloomberg) -- **General Motors Corp., Ford Motor Co. and Toyota Motor Corp. said U.S. auto sales fell in December, capping the worst year in a decade, and predicted that 2008 probably won't be any better.** GM's sales of cars and light trucks dropped 4.4 percent from a year earlier. Ford's total tumbled 9.2 percent, while Toyota's fell 1.7 percent. Toyota moved up to second in annual sales, pushing Ford from the spot it had held since 1931. "It's certainly going to wrap up to be a fairly dismal year as far as

vehicle sales have moved along," Michael Robinet, an analyst at CSM Worldwide in Northville, Michigan, said in an interview on Bloomberg radio. He also said he expects Toyota will pass GM as the world's largest automaker, after the U.S. company regained the lead in last year's third quarter. The average price of a gallon of gasoline rose 31 percent for the year to \$3.04 on Dec. 31, according to the American Automobile Association. The Reuters/University of Michigan final index of consumer sentiment for December declined to 75.5, the lowest since October 2005. **GM, Ford, Toyota December Sales Fall; Honda's Rise**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=abJW3vRFepMI&refer=home>

Retirement

Risk

Savings Rate

Tech

Wall Street

- Jan. 4 (Bloomberg) -- **Merrill Lynch & Co. was subpoenaed by Massachusetts regulators after the value of collateralized debt obligations the brokerage firm sold to the city of Springfield plunged 91 percent because of losses tied to subprime mortgages.** Secretary of State William Galvin yesterday issued the request for information to New York-based Merrill. Galvin, the state's top securities regulator, said in an interview today he wants the names and details of the CDOs by 3 p.m. Jan. 10. Merrill said it will cooperate with the investigation. U.S. state and local governments including Florida, Montana and Orange County, California, are vulnerable to losses as complex investments once sold as less risky high-yielding instruments are now backed by collateral that no one wants. The market for CDOs, loans and mortgages packaged into new securities, has frozen up after surging subprime defaults led to unprecedented rating downgrades. **“There are a whole range of concerns, including how the investments were presented to the city of Springfield and whether these were inappropriate investments for a city,”** Galvin said. “We don't want to pre-judge but just want to assess the information.” The investment by the Springfield Finance Control Board, the municipal body that manages the city's finances, is valued at \$1.2 million, down from \$14 million a year earlier, according to Galvin. The finance board has hired Boston-based law firm Goulston & Storrs to investigate the investment, Springfield officials said in a statement. Massachusetts Attorney General Martha Coakley has also started a probe into the matter, which was reported earlier today by the Boston Globe. **‘Fully Accountable’ The Springfield finance board said it ‘believes that Merrill Lynch can and should be held fully accountable for any potential losses.’** The chairman of the Springfield finance board is Chris Gabrieli, who ran unsuccessfully for Massachusetts governor in 2006. Gabrieli, a venture capitalist, was defeated by Deval Patrick. **Merrill, the world's largest brokerage, holds a total of \$23 billion of CDOs on its books.** In October, the firm wrote down the value of all its mortgage-backed holdings, including CDOs, by \$7.9

billion and declared a loss for the third quarter. "Given Springfield's precarious financial position, we want to know how much they knew about what they were investing in," Galvin said. **Merrill Lynch Probed by Massachusetts' Galvin on CDOs**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aFdypeT4yJ2Y&refer=home>

- Jan. 1 (Bloomberg) -- **PHH Corp., the New Jersey-based mortgage and auto-leasing company, scrapped a \$1.8 billion sale to General Electric Co. and Blackstone Group LP after the buyout firm said banks reneged on an agreement to lend the money. Blackstone's banks refused to finance the purchase of PHH's mortgage division, the New York-based private-equity company said in an e-mailed statement today. The lenders, JPMorgan Chase & Co. and Lehman Brothers Holdings Inc., declined to comment.** PHH "will determine in due course whether to continue to explore the company's strategic alternatives," Chairman A.B. Krongard said in a statement today. GE agreed in March to buy the whole company for \$31.50 a share and keep the leasing unit. The shares haven't traded at more than \$28 since Sept. 17, when PHH said the banks might fail to raise the funds. **A record \$186 billion of private-equity purchases such as the acquisitions of Harman International Industries Inc. and Affiliated Computer Services Inc. collapsed last year, after losses tied to subprime mortgages cut demand for the higher- yielding loans and bonds used to finance buyouts. JPMorgan, Citigroup Inc., Goldman Sachs Group Inc. and Morgan Stanley have offered discounts of up to 10 percent to clear a backlog of debt after a record \$787 billion in leveraged buyouts last year.** "Blackstone was prepared to close its end of the transaction using the financing that in March was originally committed to be made available," the buyout firm said in the e- mailed statement. "We regret that the banks are now unwilling to provide financing under the terms they originally agreed to." Blackstone didn't name the banks, which PHH identified in the Sept. 17 statement. A termination fee of \$50 million is being sought from Blackstone by PHH, based on the agreement's terms. GE, based in Fairfield, Connecticut, was to buy the vehicle-leasing unit through its commercial finance division. **Leveraged buyouts declined to \$203.4 billion in the second half from \$583.7 billion in the first six months as the subprime debt market collapsed.** Interest rates on loans rated B rose to 4.28 percentage points more than the three-month London interbank offered rate, a lending benchmark, from a low of 2.13 in February, according to Standard & Poor's. Lower premiums earlier in 2007 allowed private-equity firms led by Kohlberg Kravis Roberts & Co. and Blackstone to pursue the biggest LBOs ever. **PHH Scraps Sale to GE, Blackstone After Lenders Balk**
http://www.bloomberg.com/apps/news?pid=20601087&sid=ahnnpn_sqGFrc&refer=home
- Jan. 2 (Bloomberg) -- **The steepest yearend slump in global stocks since 2000 left equities with the cheapest valuations in more than 30 years as inflation accelerated and the U.S. economy showed signs of slowing. [this is in here to show the bullishness that continues to dominate Wall Street. It will take years to wring this out]** AT&T Inc. and other telephone company stocks became the least expensive group in the MSCI World Index compared with the cash they produced. Shares of ABB Ltd., the world's largest builder of power networks, and competing engineering companies failed to keep pace with earnings growth. A majority of Japan's companies trade at less than half their net assets as profits and wages contract in the world's second-largest economy. **"Equities on a valuation basis should be worth more," said Robert Doll, 53, who oversees \$1.3 trillion as chief investment officer of global equities at BlackRock Inc.**

in Plainsboro, New Jersey. ``The devil's advocate argument says, `But wait a minute, that's based on some notion of earnings and how do you know the earnings are going to be there?' That's going to make it tougher for markets." **Stocks fell to the lowest last month relative to bonds since the 1970s according to the so-called Fed model, which was cited by former Federal Reserve Chairman Alan Greenspan a decade ago.** [this the same Greenspan who declare sub-prime one of the greatest financial inventions ever in 2005] Equities yield 4.17 percentage points more in projected earnings than 10-year government bonds paid in interest at the end of 2007, according to an analysis of 29 countries by New York-based Lehman Brothers Holdings Inc., the fourth-largest U.S. securities firm by market value. September 1974 The gap is now the widest since September 1974, when adjusted for volatility, the data show. The last time the spread was wider, equities outperformed debt by 24 percentage points in the next 12 months, according to Lehman. The MSCI World dropped 2.7 percent last quarter, trimming its 2007 advance to 7.1 percent. The last time the gauge of 23 developed markets posted a decline for the final three months of the year was in 2000 as the Internet bubble burst. The Standard & Poor's 500 Index, the benchmark for American equity, rose 3.5 percent in 2007, the second-smallest annual advance of the five-year bull market. The Dow Jones Stoxx 600 Index of European companies and Japan's Nikkei 225 Stock Average snapped four-year winning streaks, losing 0.2 percent and 11 percent, respectively. `Graham-Type Stocks' ``Japan is the only developed country left where you have what I would call Benjamin Graham-type stocks," said Eveillard. Graham developed value investing in the 1930s and his disciples include billionaire Warren Buffett, the chairman of Omaha, Nebraska-based Berkshire Hathaway Inc. ``You're paying less than nothing for the businesses." ``The valuations we're seeing are laying the foundations for a good rally in stocks just as soon as this uncertainty in credit markets dissipates," said Brown, 54, who oversees about \$280 billion as head of investments at Schrodgers in London. ``The wild card out there is, what if we don't get back to normal?" **Cheapest Stocks Since 1974**

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Don't Fight The Fed

I Disagree . . . and why

Article of the week:

PAUL B. FARRELL

Winning attitude

Ten resolutions that will help you survive the coming bear market

By Paul B. Farrell, MarketWatch

Last update: 5:01 p.m. EST Dec. 31, 2007

ARROYO GRANDE, Calif. (MarketWatch) -- In a rare Fortune interview several years ago Warren Buffett warned that America was "selling the farm" to live "high on the hog." Forget the hog: that dream's gone, and the farm may not be far behind.

The next few years will rival the 2000-2002 bear-recession. Here's why. And how you can avoid sinking with it.

"Selling the farm" was a perfect metaphor for the coming downturn. During the recent bull, Wall Street became totally addicted to easy credit, junk mortgages and snake-oil derivatives. The Fed and Treasury loved it, too, denying the massive bubble buildup, adding fuel to Wall Street's greed. Deja vu the 90's "irrational exuberance."

Now the crisis is metastasizing: Hundred of billions of dollars in write-offs reducing shareholder equity, hundreds of millions of dollars in severance pay to CEO losers. Worse yet, Wall Street's insiders rubbed salt in their shareholders wounds by passing out \$38 billion of the shareholders' profits in bonuses, averaging more than \$600,000.

Now the biggest of all insults: Our capitalist system is so dysfunctional that lately the market has taken to cheering as Wall Street's incompetent bankers hide their mistakes by selling huge chunks of America's equity to China, Singapore, Abu Dhabi and other sovereign funds -- with more sell-offs coming.

Not long ago these same foreign buyers were happy to reinvest their accumulated trading reserves in safe, cheap U.S. Treasuries. No more. The dollar's credibility stinks. And yet, America's leaders continue running up huge trade deficits to feed our insatiable addiction to oil, cheap toys and outsourced jobs. No wonder foreigners don't want our IOUs, they want equity ... just as Buffett warned us:

"We were taught in Economics 101 that countries could not for long sustain large, ever-growing trade deficits. Our country has been behaving like an extraordinarily rich family that possesses an immense farm. In order to consume 4% more than they produce -- that's the trade deficit -- we have, day by day, been both selling pieces of the farm and increasing the mortgage on what we still own."

Unfortunately, our leaders just don't get it: America's high-on-the-hog, deficits-don't-matter lifestyle is unsustainable. Wall Street knew this would happen, but was in total denial, self-absorbed in its greed-is-good world milking the subprime-credit bubble.

This follows an all too familiar historic pattern that fits all bubbles. Burton Malkiel summarized it in his classic "A Random Walk Down Wall Street:" **"Greed run amok has been an essential feature of every speculative boom in history. In their frenzy for money, market participants throw over firm foundations of value for the dubious but thrilling assumption that they too can make a killing by building castles in the air. Such thinking can, and has, enveloped entire nations."**

Swooping in from across the seas

Foreigners see our problems, even if our "nation" cannot: "The adjustment in the U.S. housing market has just begun," Kazuo Mizuno, chief economist of Mitsubishi UFJ Securities tells Bloomberg. "It will probably bottom out in three or four years. Meantime, this will keep buffeting consumption, employment and the dollar. ... Now is the beginning of the end to dollar standard system." They get it: America's excesses put the entire "farm" on the auction block.

Similar warnings come from Europe: **Peter Spencer, chief economist of ITEM Club ("Independent Treasury Economic Model"), a leading British economic forecaster, says, "the central banks are rapidly losing control ... they are allowing the money markets to**

dictate policy." A scary scenario: Another major policy error by the central banks and "this could make 1929 look like a walk in the park."

Trust no one. Play it conservative, because 2008-2010 will repeat of the harsh lessons of the 2000-2002 bear-recession. ■

Best of the Dog

Wednesday, January 02, 2008 11:03 Central

Get out of my house

To all you day-traders, quant heads, long momentum devotes, IBD 100 savants, and true believers:

1. turn your calendar – 2007 is over
2. go buy a copy of Graham and Dodd's Security Analysis
3. skip the racing section of the newspaper and instead read the front page headlines such as this one from today "U.S. Manufacturing Contracted in December, ISM Says"
4. Get a copy of Steam's only hit put it on your Ipod and press repeat one

In November 2000, right wing zealots stood outside the Vice President's residence and chanted "get out of Chaney's house" Likewise I am providing you all notice that your time in power has come to an end. The trend that has been your path to wealth the last five years has changed. 100+ forward PE retailers will no longer go up every day just because your Ouija boards indicate "the spirits say BUY". In a recession - AND MAKE NO MISTAKE WE ARE IN ONE – people buy groceries, electricity, gas (although at \$100 per barrel oil, not as much as they need), booze and cigarettes, not the latest fad \$500 gadget. So be smart and cash your chips in and wait for the next time the trend is your friend if all you know is buy buy buy. Of course the real momo traders understand that making money trading a downward trend pays too. And as a special message to all those AMZN cheerleaders who bought either the upgrade or the "breakout" in hour one today, go ahead and pick up your nickels earned his morning (reference to those who try to pick up a nickel in front of a steam-roller) while you can (AMZN trading just above 96 at this post). This morning's trip down 2007 memory lane has trapped a great number of little guys who within an hour of buying had to start praying that they could just get out even. Now get your boxes packed, my movers are waiting . . .