

## January 7, 2007 Review

### Summary

When there is a huge decline in a couple of days with no material change in fundamentals such as the collapse Wednesday and Thursday in crude, it raises the question as to whether one or more overleveraged players has/have made a bad bet. It is also a practical lesson in the hazards of shorting volatility or strategies that look for income by shorting the mathematically improbable derivative outliers. Such severe moves provide insight as to what can happen when liquidity on one side of a trade dries up – there are huge moves until parties willing to take the other side of the trade can be found.

A reason why the average investor should care about the foregoing is that such an event is more and more likely in the financial markets as a result of exotic credit derivatives and it will not be easily contained like incidents in discrete markets such as oil futures.

### Credit

- Jan 8 - Consumer credit increased at an annual rate of 6-1/4 percent in November, owing mainly to brisk growth in revolving credit.  
<http://www.federalreserve.gov/releases/g19/current/default.htm>

### Commercial Real Estate

### Commodities

- Hugo Chávez, Venezuela's leftist President, yesterday announced plans to nationalise large tracts of the country's economy, vowing to transform the world's fifth-largest oil exporter into a Socialist state. In a move that will change the face of the Venezuelan economy, Mr Chávez vowed to nationalise the electrical and telecommunications industries, saying that they were "strategic sectors" that must come under government control. The country's largest publicly traded company, the telecom giant CANTV, will be expropriated. The President's plans also appeared to encompass Electricidad de Caracas, owned by the global power company AES. **Mr Chávez also appeared to announce that the Government would take over four multibillion-dollar heavy oil projects, owned by companies including BP, Total, ExxonMobil and Chevron.** [let's see. what is likely to have a longer term impact on the price of oil, this news or today's warm weather in New York????] <http://business.timesonline.co.uk/article/0,,9076-2537780,00.html>
- The secretive leader of a Nigerian terror group is threatening "a more ruthless" set of attacks on U.S. and European oil facilities, including burning workers alive on offshore oil rigs. Nigeria is the fifth largest supplier of oil to the United States, and security experts fear new attacks, in combination with parallel attacks in the Mideast, could lead to oil at \$120 a barrel and U.S. gasoline prices of \$5 to \$6 a gallon. **[But it unseasonably warm in New York this week and Wall Street ALWAYS looks nine months ahead. Of course they do.]** [http://blogs.abcnews.com/theblotter/2007/01/nigerian\\_terror.html](http://blogs.abcnews.com/theblotter/2007/01/nigerian_terror.html)

## Currency

## Diversification

## Derivatives

- A consensus is emerging among pension fund managers and their sponsors that derivatives instruments not only provide pension funds with greater risk protection but also enhance performance and are better at matching liabilities. Accordingly, many industry watchers expect their use to surge in 2007. The primary appeal of derivatives is the increased efficiency in a portfolio while also reducing risk in ways not possible in cash markets, said **Paul Trickett**, European head of investment consulting at **Watson Wyatt**. In addition, derivatives increase funds' choice of investment options **because they achieve exposures impossible through the use of physical securities**. [one reason being that covenants intended to prevent undue risk prevent the managers from investing in the underlying] While many structured products are not suitable for use by pension funds, there are applications for inflation-linked, interest rate and credit default swaps as well as, to a lesser extent, equity options. **Scott Donaldson**, senior investment consultant at **Hymans Robertson**, said risk reduction usually involves the use interest-rate swaps or inflation swaps in the form of a liability-driven investment strategy. Pension funds could implement such a strategy either by investing in pooled LDI funds run by managers such as **Barclays Global Investors** or **Insight Investment Management** or by awarding segregated mandates, he said. Increasing the efficiency of a fund's existing investment management usually involves changing the benchmark for existing managers and allowing them to make use of instruments such as interest-rate swaps and credit default swaps, which are often more liquid than the underlying assets. [they are more liquid until they aren't and then you have huge problems, not to mention that in underlying assets there is measurable counterparty risk, which is unknowable in publicly traded derivatives] **Derivatives Poised for Upsurge**  
<http://www.dailyii.com/article.asp?articleID=1117241&LS=EMS-116079>
- Fitch Ratings-New York-03 January 2007: Given the current state of the U.S. auto industry and manufacturer rating downgrades that have occurred throughout 2006, it is no surprise that the impact of an auto manufacturer bankruptcy on the performance of U.S. auto ABS transactions continues to pervade investors' thoughts, according to Fitch Ratings. The likely sequence of events and potential impact of a manufacturer bankruptcy on various auto ABS asset types are discussed in the following commentary. In particular, investors have focused their inquiries on transactions issued by entities related to Ford Motor Company (Ford; rated 'B' with a Negative Outlook by Fitch) and General Motors Corporation (GM; rated 'B' and on Rating Watch Negative). Each of Ford and GM, through finance company subsidiaries Ford Motor Credit Company (FC) and GMAC LLC (GMAC), respectively, has been consistently securitizing their auto loan, auto lease and dealer floorplan finance originations and are two of the largest issuers of auto ABS in the US. While ABS transactions have been structured to be bankruptcy-remote and excluded from consolidation into a manufacturer's bankruptcy estate, **the type of asset collateralizing the transaction can expose investors to magnified risks** that will likely result from a manufacturer bankruptcy. **A key risk facing investors in auto-related ABS is the impact to wholesale vehicle values leading up to and during bankruptcy proceedings, which could result in higher loss severity in defaults and**

vehicle repossessions. A second key risk is a potential negative impact on servicing quality, which may deteriorate due to cost-saving measures and which could drive delinquencies and, ultimately, losses higher. [both of these – declining asset values and decline in underlying debtor monitoring - would be factors in RMBS problems] With respect to GMAC, however, the recent completion of a sale of a 51% ownership interest to a consortium led by Cerberus may mitigate some of this servicing risk in GMAC ABS transactions. (For more information, see 'Fitch Upgrades GMAC LLC to 'BB+' & ResCap to 'BBB'; Outlook Positive', dated Nov. 30, 2006 and available on the Fitch Ratings web site at 'www.fitchratings.com'). The primary risks present in auto lease ABS transactions are credit risk and residual value risk, both of which would likely be affected by a manufacturer bankruptcy. Similar to auto loan ABS, which is discussed below, the credit loss component reflects lessee defaults. The residual value risk reflects the risk that the base residual value is greater than the market value of the vehicle at the time of disposition for vehicles not purchased by the lessee. The risk of servicing deterioration is also present in auto lease ABS transactions. Auto loan ABS transactions, like those backed by auto leases, typically have no performance or structural triggers tied to a manufacturer bankruptcy. The main bankruptcy related risks facing investors in auto loan ABS are increased exposure to severity of credit losses and the potential for servicing deterioration. Given the obligor credit profiles represented in prime auto loan ABS, an increase in loss frequency is not expected following a manufacturer bankruptcy. Fitch's rating analysis for auto loan ABS incorporates stresses of delinquency rates, loss frequency and severity, and recovery lags, among others. **Fitch Offers Crash Test of Manufacturer Bankruptcy Effect on U.S. Auto ABS**  
[http://www.fitchratings.com/corporate/events/press\\_releases\\_detail.cfm?pr\\_id=333492](http://www.fitchratings.com/corporate/events/press_releases_detail.cfm?pr_id=333492)

## Housing

- Jan 9 D.R. Horton (DHI \$25) reported net sales orders in fiscal 1Q fell 28% from a year ago to \$2.3 billion. Though its order cancellation rate fell from 40% to 33% sequentially, the company said its cancellation rate remains above normal levels, conditions "remain challenging" and it continues to offer sales incentives in many markets.
  - MERITAGE HOMES CORP. said that Q4 net sales dropped sharply as demand slowed in most markets. Revenue at Meritage fell 21%, but beat analysts' expectations. The company also said it expected land and inventory charges in Q4 to reduce earnings by \$1.25 to \$1.50 a share. Meritage reported net sales of 1,201 homes totaling \$356 million in the latest quarter, down significantly from 2,072 orders totaling \$723 million a year earlier.  
<http://q1.schwab.com/s/r?l=248&a=1302566&m=1006245a42c1005007237a&s=rb070109>
  - UBS says default rates on sub-prime loans have doubled...to 8% of the total. Since 2002, more than \$1 trillion in such loans have been written. And now, many of them are going sour. In October, for example, foreclosure rates in the sub-prime market were running 42% greater than the year before. And in November came news that some of the packaged securities backed by sub-prime mortgage loans were being downgraded by Moody's - barely six months after origination. Downgrades are common - mortgages go bad as people die, get divorced or go broke. But it usually takes longer than six months.
- DR**

- Max Fraad Wolff in the Asia Times "If we use 2005 dollars and the CPI-U (consumer price index for urban consumers), average weekly earnings decreased by about \$1 per week over the 30-year interval 1975-2005," writes Wolff. "The folks have thus stopped saving and have taken on massive amounts of housing and consumer debt." Wolff continues: "In 1999, total outstanding household debt was \$6.4 trillion. As of the end of the second quarter of 2006 total outstanding household debt was \$12.3 trillion. "Household debt has increased by almost as much since 1999 as the sum total of all debt accumulated by all households across the preceding 220-year history of the [United States]. In 1999, household mortgage debt stood at \$4.4 trillion. At the close of the second quarter of 2006 it had more than doubled to \$9.33 trillion. **In 1999, consumer credit outstanding was measured at \$1.6 trillion. "Today, this stands at approximately \$2.4 trillion dollars, signaling a 50% increase in less than seven years.** This is usually soft peddled and talked down by comparison to skyrocketing housing values. Household assets held as real estate increased by \$9 trillion from 2000-2006. This might be called the mother of all modern bubbles. Yet household net worth struggled up by a mere \$1.2 trillion. Net worth badly lags housing values because of waves of cashing out. When these waves crash ashore it will be with massive destructive force." Even though house prices were rising, owners' equity as a percentage of household real estate actually fell from 58% to 54%. In other words, people 'took out' so much wealth from their houses that they ended up with a lower percentage of ownership than they had had before - even at today's high prices. As prices go down, their 'equity' will fall even further. For many homeowners, it will disappear altogether. "Americans keep refinancing and re-mortgaging. Why?" asks Wolff. "There really is only one answer: desperation. **Freddie Mac informs all those who dare to look that 90% of its refinanced loans resulted in new balances at least 5% higher than the previous loan.**" [as previously stated, this situation is even worse than these stats suggest since a third of homes are owned free and clear leaving those who are leveraged even more leveraged than debt to equity on the population as a whole would indicate]. **DR**

## Housing Finance

- January 4, 2007 Dozens have recently been indicted in mortgage fraud cases in Denver and Cleveland, where foreclosure rates are among the highest in the nation. A Denver grand jury has indicted Jorge Castan Camacho for forging personal identification so he could fraudulently buy and sell homes. Camacho, who owned and controlled USA Mortgage Lending Capital Corp., is accused of using his victims' identities to purchase properties and then failing to make the mortgage payments. Officials are still unsure how much victims in the fraud cases have lost beyond their good credit histories. A spokeswoman for the Denver district attorney's office says the monetary loss exceeds \$100,000 and will grow as mortgage companies foreclose on the properties and resell them. In another unrelated mortgage fraud case in Cleveland, a grand jury indicted 59 companies and individuals on 269 charges of using false information to obtain \$2.85 million in home loans. Eleven more defendants are expected to be indicted today. The buyers and sellers are accused of using false information to obtain loans for at least 38 properties.  
<http://www.realtor.org/RMODaily.nsf/pages/News2007010406?OpenDocument>

- January 3, 2007 Mortgage Lenders Network USA, a large lender of subprime mortgages, says it has stopped accepting applications for new loans. It is "currently exploring strategic alternatives" for its wholesale business lines, according to telephone recordings on at least two of its four wholesale lending offices. MLN, based in Middletown, Conn., which last year is reported to have lent more than \$12 billion, is the fourth lender to withdraw from the subprime market in the last two weeks. Ownit Mortgage Solutions has declared bankruptcy and shut down, citing "the current unfavorable conditions of the mortgage industry." Also, Option One Mortgage, a unit of H&R Block Inc., and ACC Capital Corp., the private holding company for Ameriquest Mortgage Co. and affiliates, are both for sale. All of these companies rely on investment banks to provide the capital for their loans. Merrill Lynch & Co., JPMorgan Chase & Co., Credit Suisse First Boston, among others, invest the cash through a line of credit, then turn the loans into bonds for sale to investors. As the subprime market has gone south, the bonds' attractiveness has declined and potential buyers have run in the other direction. The bankers have demanded repayment, leaving the lenders out of money and facing bankruptcy.  
<http://www.realtor.org/RMODaily.nsf/pages/News2007010301?OpenDocument>

## Macro Economic

- Jan 8 Banks and building societies expect the burden of bad loans **to soar** in the first quarter of the year as cash-strapped borrowers come under mounting financial strain. In a CBI survey, 30 per cent of banks and 78 per cent of building societies said that they expected a rise in bad loans in the first three months of the new year. The majority said that they expected the volume of new-loan approvals to decline over the same period. **[couldn't happen here could it?] Banks expect bad loans to rise further as insolvencies mount** <http://business.timesonline.co.uk/article/0,,9063-2536225,00.html>
- Jan. 8 (Bloomberg) -- Marc Faber, who predicted the U.S. stock market crash in 1987, said global assets are poised for a "severe correction" and it's time to sell. "In the next few months, we could get a severe correction in all asset markets," Faber said in an interview with Bloomberg Television in New York. "In a selling panic you should buy, but in the buying mania that we have now the wisest course of action is to liquidate." Faber, founder and managing director of Hong Kong-based Marc Faber Ltd., advised investors to buy gold in 2001, which has since more than doubled. His company manages about \$300 million in assets. The bullish outlook of traders in everything from bonds, equities and commodities to real estate and art suggests valuations are peaking, Faber said. Last year, the Morgan Stanley Capital International World Index of developed stock markets jumped 18 percent, while a survey of Wall Street's biggest bond-trading firms predicted U.S. Treasuries will post the best gains in five years during 2007. **[I subscribe to his news letter and think he is well thought out, which is about all you can ask for]** **Global Markets Face `Severe Correction,' Faber Says**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aYICqUAes9aw&refer=home>
- Jan. 3 (Bloomberg) Earlier today, another private report showed that companies in the U.S. unexpectedly shed 40,000 jobs in December, the first decline since April 2003. The decrease followed a gain of 158,000 in November, according to an ADP Employer

Services report based on data from 307,000 businesses with almost 18 million workers on payrolls. `Eye-Opener' ``This is certainly an eye-opener," said Douglas Porter, deputy chief economist at BMO Capital Markets in Toronto. ``If employment is beginning to weaken, that would knock a leg out of the economy. This raises the stakes for Friday" when government figures are released. Following the ADP report, economists at Morgan Stanley and Goldman Sachs Group Inc. were among those that pared estimates of how many jobs the Labor Department will report were created last month. The median December payroll estimate of economists surveyed by Bloomberg News fell to 100,000 from 115,000 prior to the ADP figures. **Construction spending in November was restrained by an eighth consecutive decline in private residential projects**, the Commerce Department report showed. A 1.4 percent gain in private non-residential construction, reflecting increases in spending on transportation projects, hotels and commercial space, helped offset the 1.6 percent decline in residential building. **U.S. Economy: Manufacturing Rebounds From Contraction**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a.5yaFK11Nhk&refer=home>

## Retail

- Jan. 3 (Bloomberg) -- General Motors Corp. and Ford Motor Co.'s December U.S. sales each fell 13 percent on lower demand for pickup trucks and sport-utility vehicles, capping the industry's first annual decline since 2003. Toyota Motor Corp.'s sales for the month rose 12 percent. GM finished with its seventh straight yearly slide, and its shares fell 4.1 percent **The December sales left GM with its lowest annual total since 1970 and Ford with its sixth yearly decline in a row.** High fuel prices and a weaker housing market damped demand for light trucks, such as pickups and SUVs, the majority of sales for U.S.- based automakers. Toyota, benefiting from more fuel-efficient models and a better reputation for quality, posted its 11th consecutive yearly increase. U.S. sales of cars and light trucks fell 3.6 percent last month to 1.43 million from 1.48 million a year earlier, according to Woodcliff, New Jersey-based Autodata Corp. **Full-year sales dropped 2.6 percent to 16.56 million from 16.99 million, for the lowest total since 1998. GM, Ford U.S. December Sales Decline;**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aa5WZqG3tEMU&refer=home>

## Retirement

- As the first members of the US baby boom generation start to turn 60 this year, millions of them will face a challenge even more daunting than rising health care costs and disappearing pensions: our research suggests that they will be forced to retire far sooner than they had hoped. Equally troubling, most baby boomers significantly underestimate the cost of retirement and hold unrealistic expectations about how they will finance it. Meanwhile, most financial-services firms have not stepped up to the challenge of helping this generation prepare for the golden years. **For starters, people nearing retirement need financial plans specifically designed for them, but fewer than one-third of the respondents aged 55 and older reported that their financial providers had helped them create one. Further, more than half of the average retiree's net worth resides in real estate, yet only 3 percent of the respondents had discussed gaining access to**

**that home equity with their financial institutions. What US workers don't know about retirement**

<http://e.mckinseyquarterly.com/WORT0216CD4C4977E7120332928BBO>

## **Risk**

- Following healthy double-digit returns in 2006, hedge funds that invest in distressed securities are poised for a repeat performance this year, according to speakers at a recent HF conference. Distressed strategies returned between 13-15%, according to early reports from several indices, and **as default rates remain at historic lows** of between 2-3%, the demand for investment in such strategies should remain robust, according to **Marti Murray of Murray Capital Management**, speaking at the **Parker Global Strategies' 2007 Hedge Fund Outlook** conference. Returns should likewise remain high to go along with rising demand from corporate and private equity investors for M&A activity, Murray said. Sectors to watch for the greatest opportunities, according to *Financial News*, reporting on the event, are auto suppliers, airlines, paper and packaging, home building, sub-prime lending and healthcare. But before betting too much of the bank in distressed securities, Murray warned, beware of factors that can dash high hopes, such as a spike in default rates, major losses in banking and p.e. sectors and recession. **[i.e. the trade will continue to be chased thus compacting returns and increasing risks until it stops working or worse. Note this "return" is based on historically low defaults]**  
<http://www.dailyii.com/article.asp?PositionID=2597&ArticleID=1117277&LS=EMS115916>
- **[and from the "Nothing can ever go down again" department:]** Those long faces on short sellers are probably not likely to disappear in 2007. **Thanks to healthy major indices in almost every area** where hedge funds invest – equity markets, commodities, even debt -- **it's going to take a lot of hunting to find short opportunities that will pay off, according to market watchers at a conference late last month.** "We're having a tremendous amount of trouble finding short ideas," said **Paul Mamily of Kinetics Advisers**, adding that his firm will likely "be more long than short," as he bemoans the short-idea shortage. The debt market also defied expectations and produced no relief for short sellers, with double-digit gains against a super low 2% default rate, a feat that the market may very well repeat this year. "Being short almost anything was a painful experience," **Marti Murray of Murray Capital Management** told the audience. Likewise, commodities were no friend to short-sellers, as **Leigh Goehring**, managing director of **Chilton Investments** predicted that "shorting natural resource markets is going to be difficult in 2007, and admitted that he "just doesn't have any great thematic [shorting] ideas." Short sellers, says *Reuters*, may still get a break, but only through the misery of others, such as a bird-flu outbreak in Asia, recessions or the always reliable interest-rate hikes. Or, as blogger **Jeff Matthews** is quoted as saying: an Iraqi civil war, currency "panic" in Thailand and seizure of corporate assets around the world can spawn short opportunities. Still, Matthews notes in his blog *Jeff Matthews Is Not Making This Up*, that there is a trend that hedge fund managers appear "to be shedding their short-selling identities in order to attract money, precisely at a time when markets are hitting new highs. **2007: A Long Year For Short Sellers**  
<http://www.dailyii.com/article.asp?PositionID=2597&ArticleID=1117248&LS=EMS115885>

## Savings Rate

## Tech

## Wall Street

- Jan. 9 (Bloomberg) -- U.S. and European regulators, turning a spotlight on one of Wall Street's most profitable businesses, are conducting a joint probe into whether banks and securities firms set strict enough limits on loans to hedge funds. The U.S. Securities and Exchange Commission, the Federal Reserve Bank of New York and the Financial Services Authority in London met last month with some of the biggest lenders to the hedge-fund industry, seeking information on how they decide the amount of collateral required, SEC Commissioner Annette Nazareth said in an interview in Washington. Swiss and German authorities were also involved. "The purpose of the meetings was to discuss margin practices," Nazareth, 50, said. "It was a fact-finding effort." Any move to raise margins as a result of the probe **may crimp the \$8 billion a year in fees that securities firms collect providing hedge funds with prime-brokerage services such as lending and clearing trades.** Bear Stearns Cos., one of the three largest prime brokers, generates at least 30 percent of its profit catering to hedge funds, according to estimates by Brad Hintz, an analyst at Sanford C. Bernstein & Co. in New York. **Hedge funds, which use margin loans to add leverage and increase the size of their trading bets, would have a harder time making money.** Hedge-Fund Borrowing Examined by Fed, SEC, European Regulators  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aMFZqx2S1aWg&refer=home>
- WASHINGTON, Jan 8 (Reuters) - A Republican senator critical of Fannie Mae, the mortgage finance giant that recently restated over \$6 billion in flawed earnings, said on Monday that the company's top regulator should release a report on Fannie's lobbying efforts. **The regulator, the Office of Federal Housing Enterprise Oversight, had said last May in a special exam of the company's accounting scandal that Fannie had used its lobbying power to interfere with its examination.** Fannie Mae, like fellow housing finance company Freddie Mac, is a government sponsored enterprise that operates under congressional charter and is designed to provide liquidity to the housing finance market. In a May settlement with OFHEO, Fannie Mae had promised the regulator an independent review of its lobbying efforts and to create a new "control environment" for the activities of in-house lobbyists and outside consultants. An outside law firm delivered the independent review to OFHEO in November. Reuters requested a copy under the Freedom of Information Act, but OFHEO denied the request, saying the document was privileged information since it was produced as part of its examination of the company. Senate Banking Committee member John Sununu, Republican of New Hampshire, told Reuters on Monday it would be appropriate for the report to be released because Fannie Mae benefits from its government ties. "It is absolutely appropriate and responsible for (Fannie's) lobbying activities in Congress to be scrutinized carefully," Sununu said in a statement. Fannie Mae has promised to ease its government relations work. **But the company spent \$5.28 million lobbying Congress in the first half of**

**2006, or \$80,000 more than it spent in the second half of 2005. [this is how a company can go years without filing financial statements and never face delisting]**

<http://q1.schwab.com/content/rb/2007/01/08/1302350.html>

- In a record year for leveraged buyouts, **Kohlberg Kravis Roberts** paid more than \$837 million in fees to investment banks in 2006, more than any other private equity firm, according *Financial News*, citing data from **Thomson Financial** and **Freeman & Co.** *FN* reports that in the first 11 months of last year, KKR increased its fee costs 300% higher than in all of 2005. KKR's fee expense represents close to 10% of the \$11 billion investment banks raked in last year for their work on nearly \$700 billion in deals. "The financing is there. The appetite is there," **Larry Slaughter** of **JPMorgan Chase** in London told *FN*, adding that 2007 may see a record buyout of more than €40 billion (US\$53billion) [in a leveraged buyout all these fees end up as debt on the acquired companies balance sheet. It is insane and the day of reckoning is on the way]  
<http://www.dailyii.com/article.asp?PositionID=2753&ArticleID=1117550&LS=EMS115822>
- Jan. 5 (Bloomberg) -- One morning in October, a money manager named Seanna Johnson flips on her computer and watches the screen fill with numbers. In front of her is a list of 100 Japanese stocks she should buy or sell. The shares had been picked overnight by computer software at San Francisco-based Barclays Global Investors, where Johnson, 39, manages three hedge funds. BGI insiders call the program the Optimizer. "Which stocks should I hold and which should I short?" Johnson asks. To find the answer, she turns to the Optimizer, which crunches corporate earnings data and dozens of other variables for almost every stock in the world. BGI is one of the most powerful forces in money management today. It's a den of finance Ph.D.s, mathematicians and other disciples of quantitative analysis, or quants. BGI quants design investing strategies for thousands of stocks, bonds and currencies and then use computers to pick which ones to buy and sell. **[LTCM II????????]** Barclays **PhD's Build Hedge Fund Giant Inside No. 3 UK Banks**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aowli5PoEE6w&refer=home>
- Secretary of State William F. Galvin said yesterday his ongoing probe of the relationship between Swiss bank **UBS AG** and certain hedge funds stems from broader concerns about the practices of a lightly regulated corner of the financial services industry. "The bigger issue," Galvin said yesterday, "is, what is to be the role of hedge funds in the financial system? Hedge funds are like the jet stream that affects all the other weather, and can have a disruptive effect at a time when we're saying to most investors . . . 'you're on your own.'" Correcting earlier reports, Galvin said he has not issued subpoenas to UBS, but rather that bank officials have agreed to provide testimony about the firm's relationship with hedge fund traders who operate out of UBS's Boston office . Specifically Galvin is trying to determine whether the hedge funds are paying for the office space through higher-than-normal trading fees to UBS, but aren't disclosing the arrangements to their investors. Like other investment banks, UBS leases space in its Boston and New York offices to the hedge fund traders in hopes they will become more significant clients someday. **"It's an unusual relationship, and unusual relationships in the financial-services industry generally portend problems,"** Galvin said. **Galvin**

**sees wider hedge fund worries**

[http://www.boston.com/business/globe/articles/2007/01/03/galvin\\_sees\\_wider\\_hedge\\_fund\\_worries/](http://www.boston.com/business/globe/articles/2007/01/03/galvin_sees_wider_hedge_fund_worries/)

- Jan. 3 (Bloomberg) -- Home Depot Inc. Chief Executive Officer Robert Nardelli's \$210 million severance package drew criticism as an "outrage" and threatened to escalate the debate over whether U.S. executive pay is excessive. Nardelli, 58, was ousted after Atlanta-based Home Depot's shares dropped 7.9 percent and the company lost market share to Lowe's Cos. during a six-year reign in which he earned \$225 million. Nardelli's exit pay includes \$20 million in cash and compensation earned and not yet received. **The average pay for chief executives rose to 369 times that of the average worker in 2005, up from 131 times in 1993 and 36 times in 1976**, according to a study by Kevin Murphy, a finance professor at the University of Southern California. **Nardelli Exit Package Called 'Outrage,' May Heighten Pay Debate**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aI7fAyAMAI2A&refer=home>

Article of the week:

It certainly would not have come from the sports page.