

July 10, 2007 Review

Comments

Happy July 10th. Steve DiMaria (deserved senior class president Bay High 1975), man-made satellites and I (disgruntled senior class presidential candidate – think George Serb - Bay High 1975), all turn 50 this year. For Steve and I today is the magic day. Looking at the index charts, I wonder if today might also become known in future eons as the day the rally died.

As we have seen the past many years, one down day, week or month are meaningless in the grand scheme of things. So why would I be so bold as to make the statement in the prior paragraph? Too much refined sugar in the birthday cake or heat exhaustion from the candles are likely reasons. I would like to think, however, that it might also be a little bit more.

You may recall in past issues, I mentioned the “failed summer rally” as a possibly significant indicator. This is basically a situation where a market rallies for an extended period of time, then pulls back, rallies again but fails to make new highs. I am not certain whether Wall Street technicians would say the pattern fits if we drop from here, but 4 out of 4 retrievers on Willow Wood Lane think it might.

Putting away the Ouija board, there are also many other reasons to hope the return to sanity may be near. In no particular order . . .

- Research in Motion’s 30% run and gun on a 3 for 1 stock split and very questionable “earnings beat” announcement (channel stuffing, extending payables, and manipulating analysts on the tax rate might be another way to look at it). This is a page straight out of the spring of 2000. As is the exhaustion gap and record volume. Think back to the “final blaze of glory” many dot bombs and other ridiculously priced techs experienced on their way to 90-100% collapses in the ensuing months.
- The speed with which it was determined that the Bear Stearns hedge fund blow ups were non-issues. This is yet the latest iteration of everything is a buying opportunity. As we will see, it is until it isn’t.
- The suck of liquidity being pulled out of the system (i.e. banks tightening and junk debt going unloved)
- The pain of being overly leveraged in a non-liquid asset. See structured debt and the Bear Stearns hedge funds
- The ubiquitous calls that the economy is fabulous in response to any bit of bad news
- The years late recognition by the “ratings agencies” (soon to be know as “aiders and abettors” in plaintiff’s pleadings in a neighborhood near yours) that this isn’t your father’s AAA debt.

- The implosion in housing has finally reached a point where even the cheerleaders can't put any lipstick on it.

As always, we will see . . .

Happy Birthday Steve!

Credit

- July 10 (Bloomberg) -- Standard & Poor's said it may cut the credit ratings on \$12 billion of bonds backed by subprime mortgages, prompting investors to dump the securities. S&P is preparing to lower the ratings on 2.1 percent of the \$565.3 billion of subprime bonds issued in late 2005 through 2006 because the housing slump is worse than the company anticipated. **[Way too little, way too late.]** The announcement sent U.S. government bonds higher, the dollar lower and caused shares of financial companies to drop. "S&P's actions are going to force a lot more people to come to Jesus," said Christopher Whalen, an analyst at Institutional Risk Analytics in Hawthorne, California. "When a ratings agency puts a whole class on watch, it will force all the credit officers to get off their butts and reevaluate everything. This could be one of the triggers we've been waiting for." Investors criticized S&P, Moody's Investors Service and Fitch Ratings because their ratings on bonds backed by mortgages to people with poor or limited credit don't reflect the fastest default rate in a decade. **Prices of some bonds backed by subprime mortgages have declined by more than 50 cents on the dollar in the past few months while their credit ratings haven't changed. Insurers and pension funds may be among investors required to sell their bonds if they are downgraded, potentially driving down prices of \$800 billion in subprime mortgages and \$1 trillion of collateralized debt obligations, which package mortgage bonds into new securities. [this will be like the first domino tipping]** S&P said it is also reviewing the "global universe" of CDOs that contain subprime mortgages. Investors in CDOs alone stand to lose as much as \$250 billion, according to Institutional Risk Analytics, which writes computer programs for auditors. **[this is in all likelihood the notional amount and does not account for leverage, which will make it MUCH worse]** 'Continued Decline' "We expect that the U.S. housing market, especially the subprime sector, will continue to decline before it improves, and home prices will continue to come under stress," S&P said. "Weakness in the property markets continues to exacerbate losses, with little prospect for improvement in the near term." **[What of the past years weekly claims that "the bottom is in" and "this is a great buying opportunity"??????????] Almost 65 percent of the bonds in indexes that track subprime mortgage debt don't meet the S&P ratings criteria in place when they were sold, according to data compiled by Bloomberg. [Seems like more than 2.1 percent might become at issue doesn't it?]** S&P said today it plans to change the methods it uses to rate existing and new mortgage bonds to reflect the increased likelihood of mortgage defaults and losses. **[As you all know this problem has been identifiable since last summer. What do you think the chances are that**

these agencies come close to getting it right now?] **``We do not foresee the poor performance abating," S&P said. ``Loss rates, which are being fueled by shifting patterns in loss behavior and further evidence of lower underwriting standards and misrepresentations in the mortgage market, remain in excess of historical precedents and our initial assumptions."** [See prior comment. It cracks me up that this information is presented as if it is a revelation. Did you have a nice nap Mister Van Winkle?] `Stress Test'

- S&P's review covers ratings on 612 pieces of bonds backed by subprime mortgages. S&P will implement a ``stress test," of hypothetical scenarios to see how a bond will react. [please simply assume from here on, I am reiterating all prior comments about having been asleep at the switch] While most of the securities being reviewed by S&P have ratings of BBB+, BBB, or BBB-, the lowest-investment grade, some were rated as high as AA. The credit rating of any bond will be cut to CCC+, the sixth-lowest junk rating, if the test shows it would experience a principal loss within the next year, S&P said. Ratings will be reduced to B, the eighth-lowest rating, if the security may have a principal loss in the next 13 to 24 months. S&P will lower the rating to BB if the bond is projected to have a principal loss in the next 24 to 36 months. Declines in the ABX index indicate that investors believe the bonds are worth less than their ratings suggest. ``If you look at where the market was trading these bonds, they weren't trading like BBB bonds," said David Land, a portfolio manager in St. Paul, Minnesota at Advantus Capital Management, which owns \$783 million of mortgage bonds. S&P said it will reassess ratings and seek higher protection for investors on bond classes that rank directly above any security it downgrades, a change in practice. Criticism Accurate rankings for mortgage bonds and CDOs are important [do you think?] because the securities trade infrequently, making it difficult for investors to immediately value their holdings when market conditions change. [i.e. they are currently grossly overvalued on the books of hundreds if not thousands of highly leveraged hedge funds, investment banks, etc.] Instead, they often rely on sales of similar securities or computer models that use ratings and past performance of the underlying collateral to derive a value for their holdings. **Critics of the ratings companies include Bill Gross, chief investment officer at Pacific Investment Management Co. Gross, who runs the world's biggest bond fund, said last month that Moody's and S&P gave mortgage bonds investment-grade ratings because they were fooled by the ``six-inch hooker heels" of the collateral backing them.** CDO investors were jolted last month by losses in two hedge funds run by Bear Stearns. The firm was forced to inject \$1.6 billion into one fund after creditors began seizing assets. Response In response to the investor criticism, executives at S&P, Moody's and Fitch had said last month that they were waiting until foreclosure sales of homes proved that the collateral backing the bonds has declined enough to create losses. [S&P, Moody's and Fitch had said last month that they were waiting until the horse was out of state before locking the barn] S&P said it is acting now because many bonds issued in late 2005 and most of 2006 now have ``sufficient seasoning" to show delinquency, default and loss trends that indicated ``weak future credit performance. Many of the bonds S&P is reviewing were made up of loans originated by New Century Financial Corp., which filed for bankruptcy protection in April, and Fremont General Corp., which federal regulators forced from the subprime-loan business in March. [certainly

reasonable to wait until July before trying to figure out if there was a problem with any of these] Delinquencies and foreclosures are increasing for bonds issued in 2006, S&P said. **Total losses on all subprime transactions issued since the fourth quarter of 2005 are 0.29 percentage point, compared with .07 percentage point for similar transactions from 2000, which until now had been the worst performing this decade.** S&P also said doubt had been cast over some data it used after the Mortgage Asset Research Institute reported mortgage fraud had risen above industry highs. "Data quality is fundamental to our rating analysis," S&P said. "The loan performance associated with the data to date has been anomalous in a way that calls into question the accuracy of some of the initial data provided to us." **S&P May Cut \$12 Billion of Subprime Mortgage Bonds (Update5)**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aFS746x.HOnc&refer=home>

- June 29 (Bloomberg) -- Standard & Poor's, Moody's Investors Service and Fitch Ratings are masking burgeoning losses in the market for subprime mortgage bonds by failing to cut the credit ratings on about \$200 billion of securities backed by home loans. The highest default rates on home loans in a decade have reduced prices of some bonds backed by mortgages to people with poor or limited credit by more than 50 cents on the dollar and forced New York-based Bear Stearns Cos. to offer \$3.2 billion to bail out a money-losing hedge fund. Almost 65 percent of the bonds in indexes that track subprime mortgage debt don't meet the ratings criteria in place when they were sold, according to data compiled by Bloomberg. That may just be the beginning. Downgrades by S&P, Moody's and Fitch would force hundreds of investors to sell holdings, roiling the \$800 billion market for securities backed by subprime mortgages and \$1 trillion of collateralized debt obligations, the fastest growing part of the financial markets. "You'll see massive losses from banks, insurance companies and pension managers," said Joshua Rosner, a managing director at investment research firm Graham Fisher & Co. in New York and co-author of a study last month that said S&P, Moody's and Fitch understate the risks of subprime mortgage bonds. "The longer they wait, the worse it's going to be." **Loss Estimates** Rosner estimates that collateralized debt obligations, which have packaged thousands of bonds and derivatives into new securities, will lose \$125 billion. Institutional Risk Analytics, a Hawthorne, California-based company that writes computer programs for the four biggest accounting firms, says 25 percent of the face value of CDOs is in jeopardy, or \$250 billion. **Losses may rival the savings and loan crisis of the 1980s and 1990s. [or may dwarf them would be my guess]** The Resolution Trust Corp., formed by the U.S. government to resolve the thrift crisis, sold \$452 billion of assets at a cost to taxpayers of about \$140 billion. The current debacle threatens the growth of asset-backed bonds, securities that use consumer, commercial and other loans and receivables as collateral. That market, which includes mortgage securities, has doubled to about \$10 trillion since 2000, according to the Securities Industry Financial Markets Association, a New York-based trade group. Homeowners may be delinquent on mortgage payments for at least three months before foreclosure proceedings begin, and the process can be delayed if a borrower files for bankruptcy or fights eviction. Even when lenders repossess a home, the value of the mortgage isn't written down until the house is sold. Bondholders only see a loss if the price of a house is lower than the loan used as collateral for debt securities. "We're taking action as we see it," said Brian

Clarkson, Moody's global head of the structured products in New York. "We're not doing knee-jerk responses." **[we certainly don't want to get out in front of the issue and hurt our friends the investment bankers who are offloading this garage on retirement funds]** Increased Delinquencies More than 15 percent of the mortgages in the securities are at least 60 days delinquent and another 8 percent are in foreclosure, according to the bond trustee. Moody's and S&P say they are considering downgrading the debt. A total of 11 percent of the loan collateral for all subprime mortgage bonds had payments at least 90 days late, were in foreclosure or had the underlying property seized, according to a June 1 report by Friedman, Billings, Ramsey Group Inc., a securities firm in Arlington, Virginia. In May 2005, that amount was 5.4 percent. The increase in delinquencies means CDO investors, who sometimes use borrowed money to magnify their bets, may be holding securities that are riskier than their ratings indicate, said Bill Gross, chief investment officer at Pacific Investment Management Co., based in Newport Beach, California.

"The Petri dish turns from a benign experiment in financial engineering to a destructive virus," Gross, who oversees the world's biggest bond fund, said this week in a commentary on the firm's Web site. The companies gave the mortgage bonds investment-grade ratings, duped by the "six-inch hooker heels" of collateral that can't be trusted, he said. Thousands of Investors Thousands of investors own mortgage bonds, ranging from fund managers such as Pimco, a unit of Munich-based Allianz SE, to the **California Public Employees' Retirement System [i.e. the little guys who ALWAYS gets left holding the bag]**, the biggest U.S. public pension fund, and foreign banks like Fortis SA in Brussels. First Year Rankings "A lot of these should be downgraded sooner rather than later," said Jeff Given at John Hancock Advisors LLC in Boston, who oversees \$3.5 billion of mortgage bonds. The ratings companies may be embarrassed to downgrade the bonds, he said. "It's easier to say two years from now that you were wrong on a rating than it is to say you were wrong five months after you rated it." Fitch is "deliberate" in its actions, John Bonfiglio, the firm's head of U.S. structured finance ratings, said in an interview in his New York office. Fitch is a unit of Paris-based Fimalac AS. "I would not say we were slow." [no, because that would imply you acted, which as we know you have not] The ratings companies point out they have downgraded bonds less than a year after they were sold, the first time that has ever happened. S&P has lowered a total of 15 subprime bonds sold in 2005, or 0.31 percent of the total, and 32 sold in 2006, or 0.68 percent. "People are surprised there haven't been more downgrades," Claire Robinson, a managing director at Moody's, said during an investor conference sponsored by the firm in New York on June 5. "What they don't understand about the rating process is that we don't change our ratings on speculation about what's going to happen." [see prior comment about "while investment banks are offloading this garage to retirement funds] Bear Stearns Jolt Accurate rankings for mortgage bonds and CDOs become even more important because the securities rarely trade, so investors can't immediately value their holdings when market conditions change. Instead, they often rely on sales of similar securities or computer models that use ratings and past performance of the underlying collateral to come up with a value. UBS, Queen's Walk Other hedge funds are closing down or reporting losses because of subprime losses. Zurich-based UBS AG shuttered a hedge fund unit that saddled the biggest money manager for wealthy investors with 150 million Swiss francs (\$122 million) of first-quarter losses. **Queen's Walk Investment Ltd., a London-based fund, reported a loss of 67.7 million euros**

(\$91.2 million) last week for the year ended March 31. [November 3, 2006 lead story Grant's Interest Rate Observer title "Walk the Plank" – "In every credit boom, there is an obligation or security that crystallizes the spirit of the cycle. Queen's Walk Investment Ltd. Just might prove to be the beacon of remembrance of the '00s." Thus, eight months BEFORE this disclosure, Jim Grant identified the problem. As stated numerous times herein, if you wait until problems are confirmed, it is already way too late.] Cambridge Place Investment Management LLP, another London money manager, said yesterday that it will close Caliber Global Investment Ltd., a fund that had \$908 million of assets in March. A sweeping downgrade of bonds would lead to sales of assets by investors, banks and pension funds who operate under rules that would cause them to adjust their portfolios to reflect the new ratings. S&P, Moody's and Fitch have restricted their ratings changes on BBB- rated mortgage bonds to 1.3 percent of those outstanding, according to Credit Suisse analyst Rod Dubitsky in New York. About 80 percent of the remainder will eventually have their ratings reduced, he said. Abandoned Criteria "We're talking about massive, massive downgrades here," Dubitsky, the No. 2 asset-backed real estate debt analyst in last year's Institutional Investor magazine poll of researchers, said in a telephone interview. S&P abandoned seven-year-old criteria for determining a bond's protection against default in February. Under the old guidelines, S&P said a bond's "credit support" must be twice the rolling 90-day average of the sum of value of mortgages delinquent by three months or in foreclosure plus real estate that has been seized by the lender. Credit support for a bond is determined by looking at the number of lower-rated securities that would have to go bust before it suffered losses, the dollar amount of mortgages available to pay back the interest and the annualized interest the mortgages generate in excess of what needs to be paid to bondholders. The measure was one of four tests used by S&P, said Chris Atkins, a spokesman for the company, a unit of New York-based McGraw-Hill Cos. A failure to meet the credit support standard wouldn't have automatically resulted in a downgrade, he said. \$200 Billion Of the 300 bonds in ABX indexes, the benchmarks for the subprime mortgage debt market, 190 fail to meet the credit support standard, according to data released in May by trustees responsible for funneling interest payments to debt investors. Most of those, representing about \$200 billion, are rated below AAA. Some contain so many defaulted loans that the credit support is outweighed by potential losses. Fifty of the 60 A rated bonds fail the criteria, as do 22 of the 60 AA rated bonds and three of the 60 AAA bonds. All but five of 120 securities in BBB or BBB- rated portions of the mortgage-backed securities would have failed S&P's criteria, according to data compiled by Bloomberg. None have been downgraded, though S&P and Moody's have parts of three pools of securities linked to the index under review for a downgrade. Fitch has downgraded parts of three mortgage pools tied to the ABX and put four on watch for downgrade. "Warrant Our Attention" "Don't misunderstand me: I'm not saying these others are performing great," **Robert Pollsen, a director in S&P's residential mortgage surveillance in New York, said in an interview last month. "And they certainly might warrant our attention several months from now, which obviously we're going to do."** ["We are waiting for the blazing inferno to die down before we call the fire department. Once the house is burned up the fire should diminish"] **S &P, Moody's Hide Rising Risk on \$200 Billion of Mortgage Bonds**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aN4sulHN19xc&refer=home#>

- BST 25/06/2007 The Bank for International Settlements, the world's most prestigious financial body, has warned that years of loose monetary policy has fuelled a dangerous credit bubble, leaving the global economy more vulnerable to another 1930s-style slump than generally understood. **"Virtually nobody foresaw the Great Depression of the 1930s, or the crises which affected Japan and Southeast Asia in the early and late 1990s. In fact, each downturn was preceded by a period of non-inflationary growth exuberant enough to lead many commentators to suggest that a 'new era' had arrived", said the bank.** The BIS, the ultimate bank of central bankers, pointed to a confluence of worrying signs, citing mass issuance of new-fangled credit instruments, soaring levels of household debt, extreme appetite for risk shown by investors, and entrenched imbalances in the world currency system. "Behind each set of concerns lurks the common factor of highly accommodating financial conditions. Tail events affecting the global economy might at some point have much higher costs than is commonly supposed," it said. The BIS said China may have repeated the disastrous errors made by Japan in the 1980s when Tokyo let rip with excess liquidity. "The Chinese economy seems to be demonstrating very similar, disquieting symptoms," it said, citing ballooning credit, an asset boom, and "massive investments" in heavy industry. In a thinly-veiled rebuke to the US Federal Reserve, the BIS said central banks were starting to doubt the wisdom of letting asset bubbles build up on the assumption that they could safely be "cleaned up" afterwards - which was more or less the strategy pursued by former Fed chief Alan Greenspan after the dotcom bust. It said this approach had failed in the US in 1930 and in Japan in 1991 because excess debt and investment build up in the boom years had suffocating effects. While cutting interest rates in such a crisis may help, it has the effect of transferring wealth from creditors to debtors and "sowing the seeds for more serious problems further ahead." The bank said it was far from clear whether the US would be able to shrug off the consequences of its latest imbalances, citing a current account deficit running at 6.5pc of GDP, a rise in US external liabilities by over \$4 trillion from 2001 to 2005, and an unprecedented drop in the savings rate. "The dollar clearly remains vulnerable to a sudden loss of private sector confidence," it said. The BIS said last year's record issuance of \$470bn in collateralized debt obligations (CDO), and a further \$524bn in "synthetic" CDOs had effectively opened the lending taps even further. "Mortgage credit has become more available and on easier terms to borrowers almost everywhere. Only in recent months has the downside become more apparent," it said. CDO's are bond-like packages of mortgages and other forms of debt. **The BIS said banks transfer the exposure to buyers of the securities, giving them little incentive to assess risk or carry out due diligence.** Mergers and takeovers reached \$4.1 trillion worldwide last year. Leveraged buy-outs touched \$753bn, with an average debt/cash flow ratio hitting a record 5.4. "Sooner or later the credit cycle will turn and default rates will begin to rise," said the bank. "The levels of leverage employed in private equity transactions have raised questions about their longer-term sustainability. The strategy depends on the availability of cheap funding," it said. That may not last much longer. **BIS warns of Great Depression dangers from credit spree**

<http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/06/24/cnbis124.xml>

Commercial Real Estate

Commodities

Currency

Diversification

Derivatives

Housing

- July 10 (Bloomberg) -- D.R. Horton Inc., the second-largest U.S. homebuilder, will report a third-quarter loss after orders plunged 40 percent and said it sees no sign of a housing rebound. "We expect the housing environment to remain challenging," Chairman Donald Horton said today in a statement. The Fort Worth, Texas-based company is planning a "significant" write-down in the value of its real estate and the shares fell to a three-year low. D.R. Horton said orders dropped in every region, with the biggest declines in California and the northeast. The average price for its houses slid 12 percent to \$233,672. Lennar Corp., the largest homebuilder by revenue, last month reported an unexpected second-quarter loss with revenue declining by the most in at least a decade. "All these companies face a lot of pressure," said Thomas Smith, an equity analyst at Standard & Poor's in New York. **"It's a tidal wave of trouble."** Shares of D.R. Horton fell 39 cents, or 2 percent, to \$19.40 in New York Stock Exchange composite trading, the lowest since July 2004. They've dropped 27 percent this year, compared with a 29 percent decline in the Standard and Poor's Supercomposite Homebuilding Index of 16 companies. D.R. Horton took 8,559 home orders in the fiscal third quarter, compared with 14,316 in the year earlier. The cancellation rate was 38 percent. The value of houses ordered plunged 47 percent to \$2 billion. No Recovery The number of net sales orders fell 53 percent in California and Reno, Nevada, the most of any region. In Horton's northeast region, containing Illinois, New Jersey and Pennsylvania, orders tumbled 42 percent. Orders dropped 41 percent each in its south central and southwest regions. Orders in the southeast fell 25 percent, the least of the company's regions. **"We believe housing operating fundamentals are likely to get worse before they get better given still significant levels of oversupply, coupled with first full-quarter impact from the subprime debacle and the corresponding tightening in underwriting standards,"** Robert Stevenson, an analyst at Morgan Stanley, said in a report today. He rates D.R. Horton shares "equal weight." **[but we still think it is ok to ride these pigs down – Mr. Stevenson has not changed his rating in the year and a half that DRH has dropped from 40 to under 20. apparently he is waiting for S & P to confirm there is a problem in housing]** **D.R. Horton to Report Net Loss After Orders Plunge**
<http://www.bloomberg.com/apps/news?pid=20601206&sid=a5Kda48URkMA&refer=realstate>
- July 10 (Bloomberg) -- Homebuilder Ryland Group Inc. said it will report a second-quarter loss after sales plunged because of "continued deterioration" in the housing market. The net loss will be \$1.25 to \$1.35 a share, Calabasas, California-based Ryland

said in a statement after the close of regular trading. The company also expects to incur pretax charges of up to \$155 million to write down the value of land and inventory in Arizona, California, Florida and Nevada. Ryland was the second U.S. homebuilder today to forecast a quarterly loss as the second year of the housing slowdown has cut demand and spurred a glut of unsold homes. Earlier, D.R. Horton Inc., the second-largest builder by revenue, said it will report a net loss in the fiscal third-quarter after orders slid 40 percent and it sees no sign of a housing rebound. Preliminary sales in the quarter totaled 2,521 houses, down 17 percent from a year ago, Ryland said. Closings tumbled 35 percent to 2,461 houses in the period ended June 30. The cancellation rate was 34 percent of gross orders, compared with 35.9 percent a year earlier. **Ryland to Report Net Loss as Housing Slump Persists**

http://www.bloomberg.com/apps/news?pid=20601206&sid=aEW6_pm35mDc&refer=realestate

- June 26 (Bloomberg) -- Lennar Corp., the largest U.S. homebuilder, reported a loss for the fiscal second quarter as the housing slowdown discouraged buyers and prompted price reductions. The net loss amounted to \$244.2 million, or \$1.55 a share, in the three months ended May 31, compared with a profit of \$324.7 million, or \$2, a year earlier, Miami-based Lennar said today in a statement. Revenue tumbled to \$2.88 billion from \$4.58 billion. Rising defaults among subprime borrowers and mortgage rates near an 11-month high are hampering sales for homebuilders even as they cut prices. The slump in housing has moved into its second year as prospective buyers hold off purchasing in anticipation prices will continue to fall. "As we look to our third quarter and the remainder of 2007, we continue to see weak, and perhaps deteriorating, market conditions," Chief Executive Officer Stuart Miller said in the statement. "We currently expect to be in a loss position in our third quarter." The average estimate of analysts surveyed by Bloomberg was for earnings of 7 cents a share, excluding some items. Shares of Lennar slid 98 cents, or 2.5 percent, to \$38.75 yesterday in New York Stock Exchange composite trading. They're down 26 percent this year through yesterday, compared with a 24 decline for a Standard & Poor's measure of 16 homebuilders. 'Dire Outlook' Concern about a protracted slump in housing was reinforced yesterday when the National Association of Realtors said sales of previously owned houses fell in May to the lowest level in almost four years. Purchases slipped 0.3 percent to an annual rate of 5.99 million and the supply of unsold houses jumped to a record. **Lennar Reports Second-Quarter Loss as Revenue Slumps (Update1)**
- June 25 (Bloomberg) -- Sales of previously owned homes in the U.S. fell in May to the lowest level in almost four years, reinforcing concerns about a protracted housing slump. Purchases declined 0.3 percent to an annual rate of 5.99 million, from a revised 6.01 million the prior month, the National Association of Realtors said today in Washington. The supply of unsold homes jumped to a record. The housing recession, the worst since 1991, is the biggest threat to an economy that's otherwise showing signs of recovering from a yearlong slowdown. The growing number of homes on the market and higher interest rates may further discourage buyers, economists say. "The slow bleed in housing continues," said Ethan Harris, chief U.S. economist at Lehman Brothers

Holdings Inc. in New York. ``The inventory adjustment is going to be slow and painful. This means we're in for more pressure on prices and more pressure on construction."

U.S. Economy: Existing Home Sales Approach 4-Year Low

http://www.bloomberg.com/apps/news?pid=20601087&sid=aTwky.4ib_u0&refer=home

Housing Finance

Macro Economic

- June 28 (Bloomberg) – [the following is a story from 1999 in America, only the names have changed] High above Shanghai, in an office reserved for stock market barons, Xu Yongyi swirls a flask of coffee, only breaking his rhythm to explain why money matters. ``It's not about being rich," asserts Xu, a 43-year-old **former factory worker** who says he turned 16,000 yuan (\$2,100) into 5 million yuan by trading shares. ``I want to rise above the masses and prove I'm a step ahead." Thirty floors below in the public trading room of Shenyin & Wanguo Securities Co., Xu's ascent inspires investors who sit at rows of boxy computer screens studying stock graphs and swapping tips. Former grade-school teacher Wu Ruiling, 68, recalls the days when the man she knows only as Dahu, or ``Big Account," would expound on stock-price movements over box lunches. ``We look up to him," Wu says. ``He analyzes the market so thoroughly; that's why he's so rich now." Aspiration and envy are key emotions driving China's stocks boom **as investors ignore warnings of a growing bubble to pursue quick riches and gain respect from friends and neighbors.** Rapid recoveries from two government-triggered sell-offs this year have deepened investors' belief that the market is immune to a crash. Traders such as Xu are role models. In a year when China's benchmark CSI 300 Index has doubled, Xu says the value of his shares, which include China's biggest sock maker, Langsha Group, have almost tripled. That earned him an upgrade from a ground-floor booth to the 30th-floor VIP room -- exclusive to those with portfolios of 5 million yuan or more. ``Big Pot of Rice" Xu jumped into the private economy, working as a bus driver and buying stocks for the first time. Today he is shopping for a 100,000-yuan Nissan Tiida compact and planning to send his 13-year-old daughter, Runru, to study in the U.S. after high school. ``For a long time, everyone ate from the same big pot of rice regardless of how much or how little they did, obliterating their sense of achievement," says Shi Junqi, a psychologist specializing in consumer behavior at Peking University. ``Stock-market investment helps restore that." Unlike business people who amass wealth through political connections and corruption, successful stock traders are respected for winning on their own merits, Shi says. Such is China's investing frenzy that an average of 300,000 stock-trading accounts has been opened every day since April, according to China Securities Depository & Clearing Corp. Trading by individual investors accounts for about 60 percent of market volume, estimates the Shanghai-based brokerage Guotai Junan Securities Co. In the U.S., individuals account for only 5 percent of trading as institutional investors dominate. **Soup Shop Dream** Since a four-year bear market ended in the third quarter of 2005, the CSI 300 has quadrupled. While the index fell as much as 16 percent the week of May 30, after the government tripled a share-trading tax, all the losses were recouped by the close of trading June 18. The index has fallen 1.4 percent since then because of concerns the central bank would raise interest rates. At Shenyin &

Wanguo Securities, human-resources consultant Guan Fengxian checks her stocks at one of the terminals small investors line up to use. Nearby is a chef from the adjoining restaurant and the building's cleaning lady. Guan, 30, says her dream is to make enough money to open a soup shop with two friends -- and quit her job. Guan opened her trading account in early June, during the market sell-off. She bought 1,000 shares in Hunan Valin Steel Tube & Wire for about 7 yuan apiece; they have risen to 9.18 yuan. Guan says she's waiting to plow an additional 160,000 yuan, most of her savings, into the market. **“I'm not afraid,” says Guan, tightening her clutch on a pink Mickey Mouse wallet. “Our economy is doing so well; nothing could possibly go wrong, right?”** Foreign Vultures Such confidence defies warnings from former Federal Reserve Chairman Alan Greenspan and Hong Kong billionaire Li Ka-shing who last month said shares were too expensive. Xu says he ignores such comments from abroad. “These foreign interests want to get in on the action themselves but can't because the market has risen too much,” he says. “That's why they are talking down the market, so they can swoop in and pick up some cheap stocks.” Government support for the stock market is guaranteed because it is selling state-owned shares to pay for future pension obligations and education programs, Xu says. “If we take a beating in the stock market, the government takes a beating too,” he says. “There's no reason the government would want to smash the stock market.” Chinese shares are among the most expensive in the world, trading at about 45 times reported earnings. By comparison, shares trade for an average of 17 times earnings on the Hang Seng Index in Hong Kong and 18 times on the Standard & Poor's 500 Index in the U.S. “Herd mentality prevails in Chinese society,” Shi says. “If they see everyone around them -- neighbors, friends and colleagues -- trading stocks, they would want to follow.” Ironically, government-triggered market declines may provide the impetus for future surges. Chastened by Declines **“With each plunge, investors become more immune to market volatility,” says Yao Maogong, chief trader at Shanghai Securities Co. “Chinese investors don't pay much attention to ratios; as long as the market trends up, they think it's safe.”** [this is a worldwide problem, not just a Chinese issue] Some Chinese investors are chastened by the recent sell-off. Retired school teacher Wu had “tens of thousands” wiped off her portfolio. While she hasn't sold stocks, Wu has stopped buying and talks gravely of the stock-market plunge in 2001 that cut the value of her holdings in half. Still, investors like Xu and Guan insist **things are different this time.** [things are different “this time” until they aren't. we will see when that occurs in China. My guess is very soon] The current Chinese leadership under Premier Wen Jiabao knows the country needs a viable stock market to fund social services and allow companies to raise money, Xu says. Xu says: “There's no way the government would let the stock market crash.” **China at 45 Times Earnings Fed by `Herd Mentality,' Government**

<http://www.bloomberg.com/apps/news?pid=20601109&sid=avEi.Ghs11yQ&refer=home#>

Retail

Retirement

Risk

- 26 June 2007 - The United States faces a severe credit crunch as mounting losses on risky forms of debt catch up with the banks and force them to curb lending and call in existing loans, according to a report by Lombard Street. The group said the fast-moving crisis at two Bear Stearns hedge funds had exposed the underlying rot in the US sub-prime mortgage market, and the vast nexus of collateralized debt obligations known as CDOs. "Excess liquidity in the global system will be slashed," it said. "Banks' capital is about to be decimated, which will require calling in a swathe of loans. This is going to aggravate the US hard landing." Charles Dumas, the group's global strategist, said the failed auction of assets seized from one of the Bear Stearns funds by Merrill Lynch had revealed the dark secret of the CDO debt market. The sale had to be called off after buyers took just \$200m of the \$850m mix. "The banks were not prepared to bid over 85pc of face value for CDOs rated "A" or better," he said. "God knows how low the price would have dropped if they had kept on going. We hear buyers were lobbing bids at just 30pc. **"We don't know what the value of this debt is because the investment banks shut down the market in a cover-up so that nobody would know. There is \$750bn of dubious paper out there in the form of CDOs held by banks that have a total capitalization of \$850bn."** US property writer Paul Muolo described the Bear Stearns crisis as the "subprime Chernobyl", saying the bank had created a "cone of silence". Lombard Street's warning comes as fresh data from the US National Association of Realtors shows that the glut of unsold homes reached a record of 8.9 months supply in May. Sales of existing homes slid to an annual rate of 5.99m. The median price fell for the 10th month in a row to \$223,700, down almost 14pc from its peak in April 2006. This is the steepest drop since the 1930s. The Mortgage Lender Implode-Meter that tracks the US housing markets claims that 86 major lenders have gone bankrupt or shut their doors since the crash began. The latest are Aegis Lending, Oak Street Mortgage and The Mortgage Warehouse. **"There isn't a recovery about to happen,"** said Ara Hovanian, head of the building group Hovanian Enterprise. Nouriel Roubini, economics professor at New York University, said there were now concerns about "systemic risk fall-out" from the Bear Stearns debacle as investors look more closely at the real value of CDOs. "These highly illiquid securities have been priced so far on unrealistic and distorted credit ratings as the ratings industry has been complicit," he said. "They have not been re-rated in a way that is consistent with rising subprime default rates. "That is why Wall Street is in a panic. "Losses will be massive once these assets are correctly priced to market." Lombard Street said the Bear Stearns fiasco was the tip of the iceberg. The greatest risk lies in the "toxic tranches" of lower grade securities held by the banks. **Much-trumpeted claims that banks had shifted off the riskiest credit exposure on to the asset markets was "largely a fiction",** said Mr Dumas. **The worst of the US property crisis has yet to hit since there is an overhang of \$2,000bn of mortgages with adjustable rates which have yet to be reset. Many borrowers could see payments jump by half, or even double.** At the same time, a spike in 10-year US bond yields by 0.65 percentage points over the last six weeks has drastically repriced the cost of fixed mortgages, knocking

away a key prop for the US housing market. "With defaults at their highest in the 37 years that records have been kept, it could be a long hot summer," said Mr Dumas.
<http://www.telegraph.co.uk/money/main.jhtml;jsessionid=OPXAKKXYVQDL1QFIQMFCFGGAVCBQYIVO?xml=/money/2007/06/26/cnusecon126.xml>

- June 25 (Bloomberg) -- Bear Stearns Cos. may have to salvage the second of its two teetering hedge funds after offering \$3.2 billion last week to bail out the first one, Merrill Lynch & Co. analyst Guy Moszkowski said. Investors "can't rule out" the chance that Bear Stearns will "stump up even more for a similar, more-leveraged, fund," Moszkowski, who rates the firm a "buy," wrote in a note to clients today. He estimated that the second fund, the Bear Stearns High-Grade Structured Credit Enhanced Leveraged Fund, owes about \$7 billion to its financiers. Bear Stearns, the biggest broker to hedge funds, is struggling to keep the funds from collapsing after losses on securities backed by home loans led lenders including Merrill Lynch to demand more collateral. By assuming the loans, New York-based Bear Stearns is protecting the funds' investors while increasing the risk to the firm itself, according to Moszkowski. "In its two decades as a public company, we do not believe Bear Stearns has faced a situation of this magnitude," Moszkowski wrote. Russell Sherman, a spokesman for Bear Stearns in New York, declined to comment. Bear Stearns raised almost \$2 billion from investors for the two funds and borrowed more than \$10 billion against that equity to make bigger bets and earn higher returns. The Bear Stearns High-Grade Structured Credit Fund, which was bailed out last week, had had "something like 40 consecutive quarters of profitable performance" before the losses, Chief Financial Officer Samuel Molinaro said on a June 22 conference call. Little Choice Bear Stearns had little choice but to come to its rescue, Moszkowski wrote. "Investor and lender expectations are different for a fund managed by a large securities firm rather than a stand-alone hedge fund manager," he said in the note. "Whether legally remote from the parent company or not, a fund managed by a large securities firm would generally not be expected to be allowed to go belly-up." Lenders to the second fund haven't been repaid. "It's not yet clear that the firm won't ultimately feel the need to provide support here as well," Moszkowski wrote. Bear Stearns, the fifth-biggest U.S. securities firm by market value, may become more vulnerable to a takeover because of the funds' losses and the bailout, he said. "If the firm is not able to resolve its position without a meaningful loss, we think likelihood of a sale rises materially," Moszkowski wrote in a separate note on Friday. He estimated that a buyer probably would pay at least \$185 per share, or twice the firm's book value. [in the wall street land of make believe everything is a buying opportunity]
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a81k3uNUnVvk&refer=home>
- June 24 (Bloomberg) -- The private equity business is near a cyclical high and the volume and size of buyouts may fall in coming months, said the chairman of Clayton Dubilier & Rice Inc. "The level of activity, the character of transactions, the size of the transactions; all of these appear to be at a cyclical high," Joseph L. Rice III said in an interview in Singapore. "We are pretty close to the peak." Buyout firms raised \$210 billion in 2006, 57 percent more than a year earlier, according to London-based research company Private Equity Intelligence Ltd. They announced a record \$701.5 billion in takeovers, according to data compiled by Bloomberg. "For the longest time, we had this

wall of liquidity. There has been an under-pricing of risk, and shocks can occur," said Nouriel Roubini, chairman of Roubini Global Economics LLC and a professor at New York University's Stern School of Business. "Private equity is one of the manifestations of this excess amount of leverage." Clayton Dubilier, together with Bain Capital LLC and Carlyle Group, bought a supply unit of Home Depot Inc., the world's largest home-improvement retailer, for \$10.3 billion on June 19. The buyout business is cyclical, and the last dip took place in 2000-2001, said Rice, who spoke at the World Economic Forum conference. "Since then, it's been a pretty steady rise. That may lead you to conclude that we are getting pretty close to a peak and that some event may cause us to tip over."

Private Equity Cycle Nears Peak, Says Clayton's Rice

<http://www.bloomberg.com/apps/news?pid=20601010&sid=aJ3DRIMGkMgM&refer=news>

Savings Rate

Tech

Wall Street

- June 25 (Bloomberg) -- Bear Stearns Cos. is getting a taste of its own medicine. It was Bear Stearns, the biggest broker to hedge funds, that nine years ago declined to join 14 other investment banks in the bailout of Long-Term Capital Management LP. Then last week, as New York-based Bear Stearns pleaded for help to rescue two of its hedge funds teetering on the brink of collapse, many of the same firms refused to come to its aid. Merrill Lynch & Co., which pumped \$300 million into LTCM, said no and seized \$850 million of bonds held as collateral for loans it had made to the funds. Lehman Brothers Holdings Inc., JPMorgan Chase & Co. and Cantor Fitzgerald LP also pulled out, leaving Bear Stearns to sort through the wreckage of bad bets on subprime mortgage bonds and collateralized debt obligations. "There is a good analogy to Long-Term Capital," said Anthony Sanders, a former director of mortgage-bond research at Deutsche Bank AG who starts next month as a professor of finance and real estate at Arizona State University's W.P. Carey School of Business in Tempe, Arizona. "They were all friends with Bear Stearns when they thought the spreads were huge. Now that the market has turned, Bear's standing there like the lone grizzly." "**Equity investors will not know the ultimate impact of the subprime market problems until the slow-motion train wreck of rising mortgage delinquencies and defaults is played out over the rest of this year,**" Hintz, who works in New York, said in a June 21 report. "As one of the largest fixed-income houses and MBS underwriters, Bear is in the challenging point of the cycle where the potential downside performance risk of the company is greater than the upside performance potential." Tailspin Starts The decline turned into a tailspin last month when Bear Stearns Asset Management, which had more than \$29 billion of "structured-credit assets" as of Dec. 31, suspended redemptions in the Bear Stearns High-Grade Structured Credit Enhanced Leveraged Fund. Barring investors from withdrawing money from a hedge fund typically is the first sign of an impending collapse. Amaranth Advisors LLC, the \$9.5 billion hedge fund that made wrong-way bets on natural-gas prices, took similar steps in the days before it failed in September. Bear Stearns's enhanced fund and the Bear Stearns High-Grade Structured Credit Fund, a similar pool that wasn't as highly

leveraged, speculated mostly in collateralized debt obligations, securities that mostly hold pieces of junk-rated corporate bonds, mortgage bonds, high-interest loans, derivatives or even other CDOs. CDO Buyer Sales of CDOs skyrocketed to \$503 billion in 2006, according to estimates from Morgan Stanley. Ralph Cioffi, 51, the funds' manager at Bear Stearns, was among the biggest buyers of CDOs backed by subprime mortgages, home loans to people with poor credit ratings or heavy debt loads. **“They looked at these high yields, this growing market, and they forgot the basic concept of risk and return,” Sanders said. “They got caught drinking their own Kool-Aid.”** Adding Leverage Bear Stearns raised almost \$2 billion from investors for the two funds and borrowed more than \$10 billion against that equity to make bigger bets and earn higher returns. On a June 22 conference call, Bear Stearns Chief Financial Officer Samuel Molinaro said the high-grade fund, which was older, had had “something like 40 consecutive quarters of profitable performance.” The enhanced fund was started about 10 months ago. The funds borrowed money by pledging CDOs as collateral for loans in so-called repurchase, or repo, agreements. One lender who dealt with the funds said a transaction might involve buying \$100 million of securities from the funds for \$95 million, with the funds agreeing to buy them back for \$95 million plus interest. The \$5 million difference provided a cushion in the event a fund couldn't make good on the loan. The enhanced fund increased leverage by taking on so-called mezzanine debt from Barclays Plc, the third-largest U.K. bank, people with knowledge of that arrangement said. In all, the two Bear Stearns funds dealt with 17 different financiers, according to Douglas Lucas, a UBS AG bond analyst in New York. Merrill on June 19 began auctioning off \$850 million of collateral, eventually selling a portion of that. At least seven other lenders, including New York-based Lehman and Frankfurt's Deutsche Bank, also circulated lists of CDOs and other bonds, according to traders who considered making bids. “If I were Merrill today, I'm sure I would do the same thing they're doing, which is to protect my position,” said Clayton Rose, a former JPMorgan vice chairman who attended the 1998 meeting at the New York Federal Reserve where Wall Street chiefs met to craft a bailout plan for Long-Term Capital Management, the Greenwich, Connecticut-based hedge fund run by John Meriwether. Spokesmen for all the lenders declined to comment. London-based Barclays said in a statement that its position was “not material” to the bank's earnings. Molinaro described the situation on the June 22 call with analysts. “There have been some counterparties who have moved to liquidate collateral,” he said. “When you have difficulty raising liquidity to meet margin calls, more margin calls come and it becomes a bit of a vicious circle.” No Strings Attached Marin came back with a second proposal at about 8 a.m. on June 21. Bear Stearns would provide \$3.2 billion of financing for the high-grade fund, enough to cover all the outstanding repos, so long as the lenders agreed to withhold any margin calls on the enhanced fund for a set period. Again the banks balked. Finally, at about 3 p.m. that day, Bear Stearns offered an unconditional bailout for the high-grade fund. Investors in the enhanced fund, which at its peak borrowed more than 10 times its equity, may get little if anything back unless Bear Stearns steps up with a salvage plan. Merrill Lynch analyst Guy Moszkowski said in a note today that Bear Stearns investors “can't rule out” a second bailout and estimated that the enhanced fund owes creditors \$7 billion. Recoveries in the high-grade fund will depend on how CDO prices fare as Bear Stearns reduces leverage over the next few weeks. Traders who participated in auctions of the

funds' assets last week said some bids were lower than 30 cents on the dollar, as investors tried to test the depths of the meltdown. `Adequately Secure' ``Further deterioration in the market or further declines in underlying collateral values will impact all of that," Molinaro said on June 22. ``But we think based upon the information that we have right now, which of course seems to change by the minute, that we do feel that we are adequately secure there." The bailout of the Bear Stearns fund is the largest since LTCM, which received more than \$3.6 billion in 1998. In the case of Long-Term Capital, lenders agreed to invest equity in the fund after William McDonough, the New York Fed's president at the time, arranged the rescue effort to prevent a shock to the financial system. The firms then sold assets over time to limit the impact of LTCM's collapse. For now, the trouble at Bear Stearns hasn't mushroomed into a crisis. Moody's Investors Service and Standard & Poor's, the two largest debt-rating companies, both said June 22 that the bailout doesn't put Bear Stearns's credit at risk. Capital Tied Up Investors are less sure. Credit-default swaps based on \$10 million of Bear Stearns bonds rose \$1,000 to \$49,000, the highest in more than two years, according to composite prices from CMA Datavision. The increase in the cost of the five-year contracts indicates a deteriorating view of the firm's credit quality. The prospects are dimmer for Bear Stearns shareholders. Even if the firm doesn't sustain losses on the loan, \$3.2 billion of its \$75 billion in equity and long-term debt capital will be tied up, possibly for months. That's money Bear Stearns can't use for proprietary trading or underwriting. ``I would have liked to see them shut down the funds, admit their mistake and move on, instead of doing this internal bailout," said William Fitzpatrick, who helps oversee more than \$1 billion, including Bear Stearns shares, at Johnson Asset Management in Racine, Wisconsin. ``Clearly, it's increasing Bear's risk." Bear Stearns also invested about \$35 million in the funds, Molinaro said on the conference call. Wall Street Implications The situation may have wider implications for Wall Street, where firms including Goldman, JPMorgan and New York-based Citigroup Inc., the largest U.S. bank, manage tens of billions of dollars in hedge funds, according to Moody's. Even if those products are handled on an arms-length basis, as they were at Bear Stearns Asset Management, the parent company may face pressure to take action in times of distress. Moody's analyst Blaine Frantz said that ``moral responsibility" is a concern because ``it raises important questions around potential reputation risk." ``Asset management is typically a low capital intensive, low-risk business," Moody's said in a June 22 statement. ``Bear will need to maintain a delicate balance as it seeks to protect its reputation, support value for the fund investors, and protect the firm from collateral losses." For all the criticism it faced over Long-Term Capital, Bear Stearns has no regrets. In a May 21 discussion at the Mortgage Bankers Association in New York, Alan ``Ace" Greenberg, the 79- year-old chairman of Bear Stearns's executive committee, said the crisis was overblown. ``People are being told today that Long-Term Capital had America on the precipice, ruined America, ruined the financials," Greenberg said. ``Nonsense. It never was even close." **Bear Stearns Rivals Reject Fund Bailout in LTCM Redux (Update2)**

<http://www.bloomberg.com/apps/news?pid=20601109&sid=a2mbR8rPyzto&refer=home>

I Disagree . . . and why

[Article of the week:](#)

- June 22 (Bloomberg) -- In the two decades since it shook the world's investment markets down to their foundations, a strange thing has happened to the Crash of 1987. Go looking for it on a historical stock chart, and you find nothing more than a modest little bump -- a brief pause in one of the longest and strongest financial booms the world has ever enjoyed. As anyone who lived through the '87 crash will testify, it looked, sounded and felt like much more than that at the time. It remains an event worth remembering for anyone with money to manage -- both for all that has changed in the past two decades, and for some things that haven't. In a span of less than two months, from Aug. 25 to Oct. 19 in '87, the Dow Jones Industrial Average fell from a then-record closing peak of 2,722.40 to 1,738.74, for a drop of 36 percent. More than half of that carnage, a 508-point loss, occurred in a single trading session on Monday, Oct. 19. At mid-1987, as now, stocks were riding high after five years of gains. Then, as now, Wall Street was alive with the spirit of financial innovation -- manifested in those days by such phenomena as program trading of stocks and computer-based portfolio insurance strategies, today by the explosive growth of derivatives. Trouble Stirring Then, as now, most of the news on economic growth was good. But interest rates were rising in the bond market, clouding future growth prospects and increasing the competitive allure of bonds in comparison with stocks. Then, as now, concern over a weakening dollar made for a jittery mood in currency markets around the world. No doubt this list of parallels could be extended if we were so inclined. It is already long enough to make one fundamental point -- now, as then, it's a dangerous world out there. As events unfolded in 1987 and thereafter, no recession loomed in the U.S. and world economies. Though many people feared it would become a kind of self-fulfilling prophecy, the crash never inflicted much perceptible harm on industry and consumers. In late 1987 and early 1988, the Federal Reserve, under new Chairman Alan Greenspan, lowered its target rate on overnight bank loans to 6.75 percent from 7.25 percent. By the end of the first quarter, 1988, the Fed was comfortable enough with conditions to begin raising short-term rates again. Rapid Recovery Blue-ribbon commissions studied the whys and wherefores of the crash, without ever agreeing on any single definitive cause. Some new procedures were adopted in the markets to deal with future runaway movements in prices. By August 1989, a scant two years after all the trouble started, the Dow had recovered all of its lost ground. Recently, the average has traded around 13,500 -- about five times where it stood before the 1987 decline began, and almost eight times its closing low on Oct. 19 of that year. With the benefit of hindsight, the crash can be labeled one of the great stock-buying opportunities of this or any generation. As a lesson of history, that's of limited value. Yes, the '87 crash proved to be a bargain-hunter's bonanza. That by no means assures us that the next calamity of this sort will turn out the same way. More definitely, this episode shows us to what amazing extremes markets can go independently of whatever happens in the world around them. Long-term, without question, the stock market is linked to the progress of the world economy; short-term, all bets are off. Overshadowed From the perspective of 20 years later, a look back at the crash of '87 drives home one more compelling point. The fact that the decline looks so small on the charts today tells us something about the amazing scope and power of the surge in growth that surrounded it. The crash was a big deal. The worldwide boom we are living through is far bigger still -- so big it was able to dwarf what we might otherwise remember as one of the worst financial disasters of all time. **Twenty Years Later, Echoes Linger From '87 Crash: Chet Currier**
<http://www.bloomberg.com/apps/news?pid=20601039&sid=a0H38pxnYrtA&refer=home#>

UM EMBA

- June 25 (Bloomberg) -- The record \$2.5 trillion of mergers so far in 2007 shows no sign of reversing the 15-year trend that has most shareholders on the losing side of acquisitions while enriching the executives and bankers who arrange them. UniCredit SpA shares dropped 10 percent since Italy's largest bank announced plans in May to buy smaller Rome-based rival Capitalia SpA for almost \$30 billion. U.K. drugmaker AstraZeneca Plc lost 9 percent of market value after unveiling its \$15 billion bid for MedImmune Inc. two months ago. Sacyr Vallehermoso SA, the Madrid-based builder, fell 19 percent since bidding in April for French rival Eiffage SA. The laggard stock performance isn't just a short-term phenomenon. About 58 percent of acquisitions completed from 1992 to 2006 reduced shareholder returns, according to an analysis by Boston Consulting Group Inc. of more than 3,200 transactions. Meantime, securities firms stand to earn \$25 billion of fees from arranging deals announced in the first five months of this year, industry consultants at New York-based Freeman & Co. estimated. "There are few home runs for shareholders," said David Harding, co-head of the global mergers group at Boston-based consulting firm Bain & Co. and co-author of "Mastering the Merger," published by Harvard Business School Press. "It's a different picture for the investment banks." DaimlerChrysler Take Daimler-Benz AG's 1998 purchase of U.S. automaker Chrysler Corp., one of the worst corporate blunders of all time. Former Daimler Chief Executive Officer Juergen Schrempp hailed the \$36 billion deal as "an historic agreement that will change the face of the auto industry." Chrysler CEO Robert Eaton predicted DaimlerChrysler AG would become the world's largest automaker within three years. Instead, Schrempp's decision wiped out about \$12.6 billion of market value in nine years. Last month, Daimler handed control of Chrysler to New York-based private-equity firm Cerberus Capital Management LP for about 5.5 billion euros (\$7.5 billion). "They were trying to mate two elephants from different parts of the world," said Roy Smith, a finance professor at New York University, who ran Goldman Sachs Group Inc.'s London office in the 1980s. Investors have more at stake in 2007 after companies announced \$2.5 trillion of takeovers, up 38 percent from last year's record first half, according to data compiled by Bloomberg. The average size of the deals jumped about 40 percent to \$300 million. Investment bankers have a vested interest in promoting the biggest mergers because they earn fees of as much as 0.5 percent on deals valued at more than \$1 billion. "Rock Stars" Executives do big deals in an attempt to increase shareholder returns by gaining new sources of income. Yet many also are lured by a "celebrity" culture of dealmakers egging them on to do deals, Bain's Harding said. "They're being treated like rock stars when they get ready to announce a deal," Harding said. "It gets very seductive." Difficulties underestimating the cost benefits of a deal or integrating teams mean shareholders lose, which was the case in 2001 when Munich-based insurer Allianz SE acquired Dresdner Bank AG for \$21 billion. Senior bankers including Bruce Wasserstein, co-founder of Wasserstein, Perella & Co., and at least half a dozen other investment bankers left Dresdner in the seven months following the Frankfurt-based bank's sale to Allianz. The Allianz takeover was plagued by issues before it even happened. Dresdner spent 620 million euros in 2001 for a reorganization that included cutting jobs and merging with Wasserstein Perella, which it had acquired earlier that year for \$1.56 billion. Allianz shares are down 40 percent since the Dresdner purchase was announced. Bank of America "There's a risk that if a company migrates

away from their core business it may fail," said Jeremy Batstone, an equity strategist at Charles Stanley & Co. Ltd. in London. To be sure, investors have reaped the rewards of major deals including Chevron Corp.'s \$44 billion takeover of Texaco Inc. in 2001. Chevron shares jumped 75 percent since the deal was completed. Bank of America Corp. shares climbed 20 percent since the acquisition in 2004 of FleetBoston Financial Corp. and Mittal Steel Co. shares, now Arcelor Mittal, rose 50 percent in less than a year after its \$38 billion acquisition of Luxembourg-based Arcelor SA. While acquisition success remains rare, there have been improvements, data compiled by Bain & Co. show. Shares of U.S. companies that made acquisitions beat their benchmark indexes 45 percent of the time from 2002 to 2005, up from 26 percent in the five years through 1999, Bain said. "Every transaction is different," said Adrian Mee, London-based head of European mergers and acquisitions at Lehman Brothers Holdings Inc. "Where there is sound strategic and financial logic, as well as good execution, M&A transactions create substantial value for shareholders." Fight for ABN Amro Lehman is the No. 5 merger adviser this year behind Goldman, Citigroup Inc., Morgan Stanley and JPMorgan Chase & Co., all based in New York, according to Bloomberg data. Goldman Chief Financial Officer David Viniar said June 14 that the firm's backlog of pending deals surpassed the record set in the second quarter of 2000. Banks and financial-services companies alone account for \$1.3 trillion of deals announced this year, about half of the total. The biggest deal would be the \$100 billion takeover of Amsterdam-based ABN Amro Holding NV by a group led by Royal Bank of Scotland Group Plc or London-based Barclays Plc. Half of this year's deals are in Europe. Leveraged buyout firms have raised \$215 billion this year, fueling much of the takeover activity in 2007 and the investment-banking fees that come with it. Acquisitions by LBO firms accounted for \$510 billion, or 21 percent of M&A so far this year, Bloomberg data show. **Shareholders Get Poorer as Record M&A Pay Bankers Record Fees**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aCnYtsEGB4eY&refer=home#>