

The Other Side of the Street July 13, 2008

Comments

Hi, it is 6 p.m. central and I am back from Ann Arbor. While on the plane ride home, I was shown and read a Vanity Fair article on the Bear Stearns meltdown and sale. As I read the article, I thought about how this weekend the very same thing was going on re Fannie Mae and Freddie Mac. We have now seen the result of the government scramble to shore up those two before trading opens in Australia shortly.

Whatever the short term implications, the long term outcome is assured. This is the last gasp “trust us we are the US government” play. It will not work. Far from assuring anyone with a long term perspective it instead confirms that the credit situation is out of control.

Despite the language that the government will buy FNM and FRE equity, this will not save the common. It will be worth nothing. I intend to buy LEAP puts tomorrow on both. I also am going to switch from a very defensive “sell outlier calls” strategy in my personal accounts to buying LEAP puts. We have finally reached the point where a major collapse in the next year is certitude. The sole question is how many will be duped into believing that today’s announcement is “another buying opportunity”. If any of you might fall into that class, look at the “too the moon” rally after the September 18, 2007 Fed cut and declaration that all was well and or the Spring Fling that ended a month ago.

I will also be buying GLD calls and otherwise bolstering my metals positions. The dollar will collapse now that the government has officially placed itself on the hook for trillions more in debt.

I would also urge all of you to get a copy of a book. We were given excerpts of it in the international strategy class we are beginning. It is called “Political Economy of the Asian Financial Crisis” by Stephan Haggard copyright 2000. I read the introduction and the first chapter. The parallels between the major economic events in Asia in the 1990s to the 2007-???? Global financial crisis being lead by the US government are striking. I plan on writing a more in depth piece as time permits but will simply give you this one sentence excerpt for now:

However, features of the financial and corporate sectors – rapid lending growth, high corporate leveraging, excessive risk taking, and declining return on capital – increased vulnerability to external shocks and magnified their effects – Page 17

On a different note, I will alert you all that there are changes coming at my end. I began writing this several years ago to warn friends and family about what was certain to unfold as a result of the structured finance problems. I spent considerable time gathering details and trying to allow each of you to draw your own conclusions. Hopefully you have acted and are not now sitting on the 20% plus in losses from those heady “Don’t Fight the Fed” days of last October when the blowhards at CNBC ran a DOW NEW ALLTIME HIGH trailer through the day for weeks. The losses have just begun.

Because there is no longer a purpose in providing extensive details as the story has finally reached the front page, this commentary and attached articles will either be substantially revised or discontinued all together. I hope that I have helped at least make you aware of what is coming and that you have taken measures to preserve your wealth and limit your exposure to the dollar.

Game over

Paulson Statement on Freddie Mac, Fannie Mae: Full Text

July 13 (Bloomberg) -- Following is the text of a statement issued today by Treasury Secretary Henry Paulson:

Fannie Mae and Freddie Mac play a central role in our housing finance system and must continue to do so in their current form as shareholder-owned companies. Their support for the housing market is particularly important as we work through the current housing correction.

GSE debt is held by financial institutions around the world. Its continued strength is important to maintaining confidence and stability in our financial system and our financial markets. Therefore we must take steps to address the current situation as we move to a stronger regulatory structure. In recent days, I have consulted with the Federal Reserve, OFHEO, the SEC, Congressional leaders of both parties and with the two companies to develop a three-part plan for immediate action. The President has asked me to work with Congress to act on this plan immediately.

First, as a liquidity backstop, the plan includes a temporary increase in the line of credit the GSEs have with Treasury. Treasury would determine the terms and conditions for accessing the line of credit and the amount to be drawn.

Second, to ensure the GSEs have access to sufficient capital to continue to serve their mission, the plan includes temporary authority for Treasury to purchase equity in either of the two GSEs if needed.

Use of either the line of credit or the equity investment would carry terms and conditions necessary to protect the taxpayer. Third, to protect the financial system from systemic risk going forward, the plan strengthens the GSE regulatory reform legislation currently moving through Congress by giving the Federal Reserve a consultative role in the new GSE regulator's process for setting capital requirements and other prudential standards.

I look forward to working closely with the Congressional leaders to enact this legislation as soon as possible, as one complete package.

Last Updated: July 13, 2008 18:00 EDT

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aNHPA3k7pAAQ&refer=home>

Stock Notes

Notes

- "This is a good beat for Alcoa," [Jeremy Blackman](#), an analyst at Hester Capital Management, said today in a Bloomberg Television interview from Austin, Texas. "It looks like they did a good job" passing on higher aluminum prices to customers.

Web links

Credit

- July 8 (Bloomberg) -- A U.S. Securities and Exchange Commission investigation into credit-rating companies found the firms improperly managed conflicts of interest and violated internal procedures in granting top rankings to mortgage bonds. A 10-month review of [Moody's Investors Service](#), [Standard & Poor's](#) and [Fitch Ratings](#) found analysts contributed to fee discussions and weighed losing clients over certain ratings, the Washington-based SEC said in a [report](#) released today. Employees also cast doubt on the quality of some ratings, the SEC said, declining to link firms to specific findings. "We uncovered serious shortcomings at these firms," SEC Chairman [Christopher Cox](#) said today at a news conference. "When there were not enough staff to do the job right, the firms sometimes cut corners." Pension and money-market funds bought AAA-rated securities backed by mortgages to the riskiest borrowers because they offered higher returns than government bonds with the same ratings. In many cases, credit raters were paid by investment banks selling the bonds, prompting regulators and lawmakers to question their independence. The SEC report describes an e-mail in which an analyst refers to the market for collateralized debt obligations as a "monster." "Let's hope we are all wealthy and retired by the time this house of cards falters," said the e-mail, which was sent Dec. 15, 2006, to another analyst at the same firm. Market Share Analysts also weighed the risk of losing market share if they assigned certain ratings, the SEC said. "I am trying to ascertain whether we can determine at this point if we will suffer any loss of business because of our decision and if so how much," said a 2004 e-mail an analyst sent to a senior business manager. The SEC said it found no evidence such considerations affected "rating methodology or models." In another internal communication, two analysts at a rating company discussed whether they should grade an offering. "One analyst expressed concern that her firm's model did not capture 'half' of the deal's risk, but that 'it could be structured by cows and we would rate it,'" the SEC said. [Lori Richards](#), the head of the SEC's inspections unit, said her office discussed its findings with the agency's enforcement division, which probes and prosecutes wrongdoing. That

allows the division to "come to their own conclusion about whether an enforcement action is appropriate," Richards said. Law Violations The SEC can bring cases for law violations, including fraud involved with the sale of securities. It's unclear whether the agency could target credit-rating companies for some of the actions highlighted in its report because it only gained authority to inspect and write rules for the firms last year. S&P, a division of New York-based McGraw-Hill Cos., will "continue to take any additional steps needed to improve our processes," company spokesman Edward Sweeney said. "Moody's has initiated a wide range of reforms," said Anthony Mirenda, a spokesman for the New York-based firm. The SEC hasn't informed Fitch, a unit of Paris-based Fimalac SA, of "any finding" that is "inconsistent" with the company's code of conduct, spokesman David Weinfurter said. McGraw-Hill rose 56 cents, or 1.5 percent, to \$38.53 at 4:01 p.m. in New York Stock Exchange composite trading. Moody's Corp. rose 38 cents to \$33.45. Credit-rating companies were criticized by investors and Congress after the collapse of the subprime-mortgage market last year showed flaws in the AAA rankings for thousands of asset-backed bonds. The world's largest banks and securities firms have taken \$401 billion in losses and writedowns, forcing them to raise almost \$319.7 billion in capital. Curbing Conflicts The SEC report cited "remedial actions" credit raters have agreed to such as continually reviewing whether they have enough staff and examining whether internal procedures adequately prevent them from being influenced by underwriters. The firms will also review whether they provide enough disclosure about how they rate mortgage bonds. "Investors can have confidence that these firms will address the problems that we found," Richards said. The SEC recommendations are "polite bureaucratic prose for saying we're not cracking down on them," said John Coffee, a securities law professor at Columbia University in New York. The SEC last month proposed rules and other changes for credit raters, including measures to curb conflicts of interest that Cox today said would also address the regulator's findings. The agency acted to reduce investment firms' reliance on ratings by saying it may stop requiring money-market funds to buy short-term debt carrying a high ranking. SEC commissioners also proposed rules to bar credit raters from ranking a bond if they advise underwriters how to gain a higher rating. Additional rules under consideration include restricting gifts to credit-rating analysts from employees at investment banks and a requirement that companies label asset-backed securities using symbols different from the rankings placed on corporate and municipal debt. **SEC Ratings Probe Reveals Conflicts in Grading Debt**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aIewdZU2.amE&refer=home>

Commercial Real Estate

Commodities

- July 8 (Bloomberg) -- Crude oil fell more than \$5 a barrel, the biggest decline in three months, as signs that the global economy may slow prompted investors to sell commodities. Oil in New York has dropped more than \$9 since reaching a record \$145.85 a barrel on July 3. Gold, silver, copper and corn also declined. The U.S. economy has sagged amid credit-market and housing slides. Contracts to buy previously

owned homes fell more than forecast in May, signaling prices have yet to bottom. "All the bad economic news is making people take a second look at commodities," said [Michael Lynch](#), president of Strategic Energy & Economic Research in Winchester, Massachusetts. "Commodities were purchased as a hedge against inflation. A global recession is looking more likely, and it's the greatest weapon in the fight against inflation." Crude oil for August delivery fell \$5.33, or 3.8 percent, to settle at \$136.04 a barrel at 3:02 p.m. on the New York Mercantile Exchange, the biggest drop since March 31. Futures have fallen 6.4 percent over the past two days, the biggest two-session decline since March 19 and 20. Prices are up 87 percent from a year ago. An index of pending U.S. home resales fell 4.7 percent following a revised 7.1 percent gain in April that was greater than previously reported, the National Association of Realtors said today in Washington. The prospect of further price declines may be discouraging offers, while rising mortgage rates and tougher lending standards make it harder to qualify for loans. "There is more concern about the U.S. economy," said [Kyle Cooper](#), an analyst at IAF Advisors in Houston. "There was a feeling that the U.S. doesn't matter because of growth elsewhere, but the country is still responsible for about 25 percent of world oil consumption." Recession Concern Sales of services and manufactured goods in the U.K. fell in the second quarter, posing "serious risks" that the economy will tumble into a recession, the British Chambers of Commerce said today. An index based on a survey of 4,758 services companies fell to minus 2, the lowest since 1992, from 17, according to the London-based lobby group. "We have strong concerns about the sharp rise in oil prices," the Group of Eight said in a statement today in Tokyo, where the leaders are holding their annual summit. "The world economy is now facing uncertainty and downside risks persist." The U.S. is "very close to a disaster" because it imports almost 70 percent of its oil, investor [Boone Pickens](#) said during an interview with CNBC, unveiling a strategy to limit the country's dependence on foreign crude. Pickens, founder and chairman of Dallas-based BP Capital LLC, made his comments as Congress has been investigating the role of speculators in oil's rise over the past year. Pickens said the gains are because global demand exceeds supplies. Iranian Statements Oil also fell today as negotiations continued between Iran and western governments over the country's nuclear program. President [Mahmoud Ahmadinejad](#) dismissed the possibility of a war with the U.S. and Israel over his country's nuclear work, saying Iran is trying to avoid conflict. "We're making the utmost effort for providing peace and security at the world level," the Iranian president told reporters today in Kuala Lumpur, where he is attending a summit of the Eight Islamic Developing Countries. "Don't worry, there won't be any war in the future. Mainly they are focusing on some sort of propaganda or psychological war." Iran has said it may blockade the Strait of Hormuz, the shipping lane for a fifth of the world's crude, if its nuclear facilities are attacked. The country has the second-biggest proved oil reserves and is the second-biggest producer in the Organization of Petroleum Exporting Countries. "There's been some reassurance about the dispute with Iran, which is taking some of the risk premium out of the oil market," said [Rick Mueller](#), director of oil practice at Energy Security Analysis Inc. in Wakefield, Massachusetts. Brent Oil Brent crude oil for August settlement declined \$5.44, or 3.8 percent, to settle at \$136.43 a barrel on London's ICE Futures Europe exchange, the biggest drop since March 19. Prices climbed to a record \$146.69 on July 3. [The UBS Bloomberg Constant Maturity Commodity Index](#), which tracks 26 raw materials, declined 2.6 percent to 1,633 today,

the biggest decline since March 19. Gold fell for a fourth day. The U.S. dollar rose against the euro, limiting the appeal of commodities as a hedge against inflation. The currency climbed 0.5 percent to \$1.562 per euro at 3:13 p.m. in New York, from \$1.5726 yesterday. "Any time the dollar moves higher, you are going to see folks shift away from the commodity markets," Mueller said. **Oil Tumbles as Signs of Slowing Economy Spur Commodity Selling**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=at0fvIMZdiKs&refer=home>

Currency

- July 8 (Bloomberg) -- The Federal Reserve may hold off on its first interest-rate increase since 2006 until policy makers judge that financial markets are stable enough to allow the central bank to withdraw its lending backstop for Wall Street. **[this is very dollar unfriendly and of course being ignored by the pundits]** Raising rates while at the same time removing securities dealers' access to direct loans from the central bank would be a double hit to markets that officials probably want to avoid, Fed watchers said. **The Fed also may have a hard time justifying higher borrowing costs before it has a plan for ending emergency lending to nonbanks.** The timing difficulty, along with continued strains in credit markets, means traders may be mistaken in estimating the odds of a rate boost by year-end at 74 percent. "We think they'll wait until 2009," said [Brian Sack](#), who used to head the Fed's monetary and financial market analysis group before he joined Macroeconomic Advisers LLC as senior economist in Washington. Successfully dealing with an end to the Primary Dealer Credit Facility is "a hurdle for credit markets to get past before the Fed will likely start tightening," he said. Bernanke, who prompted expectations for a rate increase when he said last month the Fed would "strongly resist" a rise in inflation expectations, said today officials may extend the securities dealers' access to loans into 2009 as long as emergency conditions "continue to prevail." Fed Powers The Fed started the PDCF in March, invoking its powers under "unusual and exigent circumstances" to forestall a collapse in confidence after the near-bankruptcy of [Bear Stearns Cos.](#) New York Fed President Timothy Geithner, who spearheaded the central bank's rescue of Bear Stearns, said June 9 that the Fed's emergency measures would be in place as long as markets remained distressed. Persistent credit strains may leave officials unwilling to end the PDCF in September, after they said March 16 it would last for "at least" six months. Credit-default swaps on [Lehman Brothers Holdings Inc.](#), [Merrill Lynch & Co.](#) and [Morgan Stanley](#) debt are trading close to their highest since March. The contracts let investors bet on the risk that a company will default on its bonds. Another gauge of financial stress watched by the Fed has also remained elevated. The difference between the overnight indexed swap rate, a measure of what traders expect for the Fed's benchmark rate, and three-month interbank loans in dollars was 0.78 percentage point yesterday, about the same as the start of May. 'Severe Stranglehold' In addition, **commercial-bank loans** outstanding have dropped to their lowest level since March, Fed statistics show. That will "put a severe stranglehold on economic growth," said former Fed governor [Lyle Gramley](#). Raising rates in such an environment "would be a very risky strategy," said Gramley, now senior economic adviser at Stanford Group Co. in Washington. "I don't think they're going to do that, and I think markets have been premature in jumping to that conclusion." The Federal Open Market Committee on June

25 kept its target rate for overnight loans between banks at 2 percent, ending a series of seven reductions since September. Futures prices on the Chicago Board of Trade indicate investors place 47 percent odds the Fed will raise the benchmark rate to at least 2.25 percent at or before the Sept. 16 meeting. That probability is 74 percent for the end of the Dec. 16 FOMC gathering. One at a Time "They're going to pick one instrument at a time to tighten policy," predicted New York-based Merrill Lynch economist [Drew Matus](#), who used to work at the New York Fed. While nothing would prevent the Fed from taking such action, increasing the cost of credit while at the same time lending to Wall Street may spur criticism the central bank is misusing its emergency authority. The Fed is only supposed to lend to nonbanks under emergency circumstances when no other "adequate" credit is available. The PDCF and the Fed loans to secure Bear Stearns's takeover by JPMorgan Chase & Co. were the first extension of funds to nonbanks since the 1930s. Richmond Fed President [Jeffrey Lacker](#) and Philadelphia Fed chief [Charles Plosser](#) have already criticized the PDCF for raising the danger of future financial crises by increasing incentives for firms to take on more risk. The PDCF was one of three tools the Fed introduced since December to combat the credit crisis. The central bank has a \$200 billion program of lending Treasuries to the primary dealers in U.S. government bonds. The Fed also auctions \$75 billion of cash loans to commercial banks every two weeks. "If those tools work, then monetary policy can go back to addressing what it should be addressing, which is inflation," [John Ryding](#), the founding partner of RDQ Economics in New York who used to work as an economist at Bear Stearns and at the Bank of England, said in an interview with Bloomberg Radio. "The problem is, I think it's clear, that there's still a lot of fragility in the system."

Diversification

Derivatives

- July 8 (Bloomberg) -- CDOs are back. Collateralized debt obligations that helped drive banks to \$400 billion of writedowns and credit losses are finding buyers under a different name: Re-Remics. **Goldman Sachs Group Inc., JPMorgan Chase & Co. and at least six other firms are repackaging unwanted mortgage bonds as sales of CDOs composed of asset-backed securities fall to less than \$1 billion this year from \$227 billion in 2007 because of the global credit crunch.** Re-Remics contain parts that are structured to guard against higher losses on underlying loans than most CDOs, allowing holders to sell or retain other sections at lower prices that can translate to potential yields of more than 20 percent. "It's just the reincarnation of the CDO," said [Paul Colonna](#), who manages more than \$100 billion as chief investment officer for fixed income at GE Asset Management in Stamford, Connecticut. "The mechanics are the same, but you're getting in at a much different level of valuation." GE Asset Management has considered buying the debt, Colonna said. The [General Electric Co.](#) unit may also have Re-Remics made out of bonds it owns if disposing of the riskier pieces boosts the securities' overall value. **Re-Remic stands for "resecuritizations of real estate mortgage investment conduits," the formal name of mortgage bonds.** Sales of the securities may help revive the market for new home-loan debt, according to [Bernard Maas](#), an analyst in New York at credit-rating firm DBRS Ltd. "Look to Restart" "The

hope is that by moving illiquid bonds to interested parties, the structured-finance community can look to restart," he said. More than \$9.3 billion of Re-Remics were created in the first five months of 2008, almost triple a year ago, according to Inside MBS & ABS. The debt represented 47 percent of mortgage bonds issued in the period, excluding those guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. A record \$25 billion of Re-Remics were formed in 2007, the newsletter said. Sales in 2008 may exceed that, according to Sharon Greenberg, a Barclays Capital analyst in New York. **Unlike most CDOs, Re-Remics don't own debt or credit-default swaps based on the lowest-ranking subprime mortgage-bond classes. They are composed of AAA rated bonds backed by so-called Alt-A mortgages, issued to borrowers with higher credit scores who don't prove their incomes, seek higher debt ratios or buy investment properties. [I reserved opinion until I got to this part. I can not opine these are repackaged disasters waiting to happen.]** Few Bonds While CDOs are backed by more than a hundred bonds, Re- Remics typically combine fewer than a dozen, allowing holders to more easily analyze the debt. **Holders of mortgage bonds use Re-Remics to separate better- quality from riskier debt. That increases the chance the higher- ranked debt will retain its AAA rating, enhancing its value enough to boost the total worth of the mortgage pool, said Doug Dachille, chief executive officer of New York-based First Principles Capital Management LLC, which oversees \$7 billion in fixed-income investments.** Lower-ranked pieces of the Re-Remics would be the first to record losses from defaults on the underlying mortgages, once lower-ranking bonds from the initial deals are wiped out, Dachille said. A bond trading at 40 cents on the dollar could be split into a piece worth 80 cents and another piece that could then be sold cheaply enough to offer returns as high as 20 percent, Dachille said. Banks advised by First Principles bought lower-yielding senior pieces and some are also considering buying the bonds for their pension funds, he said. The firm is also starting a fund for pension clients that would invest in the debt, Dachille said. `Credit Support' **``A lot of the stuff they wouldn't buy without the additional credit support," he said. ``They're happy with the 7.5 percent return. They just wanted greater certainty that they're going to get that 7.5 percent return."** Transamerica Life Insurance Co., a unit of the Hague-based Aegon NV, is among holders of Re-Remics created this year by Lehman Brothers Holdings Inc., according to data compiled by Bloomberg. Reliance Standard Life Insurance Co., a unit of Wilmington, Delaware-based Delphi Financial Group Inc., owns a Re-Remic created by Countrywide Financial Corp., the data show. Cindy Nodorft, an Aegon spokeswoman, declined to comment. Bernard Kilkelly, a spokesman at Delphi, didn't return a message. **``It's one of the few cases where re-securitization actually increases, rather than destroys, value,"** said Scott Simon, head of mortgage-backed bonds at Pacific Investment Management Co. He wouldn't disclose whether the Newport Beach, California-based firm, the world's largest fixed-income manager, has bought the debt or used Re-Remics to repackage debt held by its funds. \$370 Billion Commercial banks and savings-and-loans held more than \$370 billion of non-agency mortgage bonds on March 31, according to Federal Deposit Insurance Corp. data. Much of that can only be sold at fire-sale prices after record subprime-mortgage defaults and home-price declines sparked losses on the underlying loans. **``This is an attempt to shake things up," said Scott Kirby, who manages about \$20 billion of structured-finance securities at Ameriprise Financial Inc.'s RiverSource Investments LLC in Minneapolis. ``There's a lot of**

paper floating around that's having difficulty finding a home." CDOs, once the fastest-growing part of the debt markets, tumbled to zero cents on the dollar and credit ratings on some AAA pieces were cut to junk levels. Goldman Sachs, based in New York, had about \$15 billion of residential-mortgage securities on its books as of May 30, Chief Financial Officer **David Viniar** said on a conference call last month. New York-based JPMorgan's investment bank had \$12.8 billion of prime and Alt-A securities as of March 31, according to an investor presentation in April. **Lehman** had \$15 billion of home-loan assets as of May 30, CFO **Ian Lowitt** said on a conference call last month.

Restructuring Needed **``There are ample bonds that would fit the description of needing restructuring," [let's see very high supply, debt on investment banks books, well above average returns and being sold as "low risk", is this a history essay on the junk bond crisis? Oh, no it is supposedly a "new" idea. Another old concept underlies this – there is a sucker born every minute]** Greenberg, the Barclays analyst, said. **Banks can increase the total credit quality of their assets by selling off lower-rated pieces and keeping the better part, Matthew Jozoff, an analyst at JPMorgan said. [for those playing at home this in fact means they intend to improve their books by selling the crap to their clients.]** Avoiding downgrades also would prevent the banks from having to hold more capital to protect against losses on the debt. **Goldman spokesman Michael Duvally, JPMorgan spokeswoman Tasha Pelio and Lehman spokesman Mark Lane declined to comment.** Riskier Re-Remic mortgage **securities are ``natural fit" for hedge funds,** according to a June 27 report by JPMorgan's Jozoff and John Sim. **The debt offers higher potential yields at a time when it's difficult to borrow to boost returns, they wrote.** Re-Remics have repackaged so-called non-agency mortgage securities, which lack explicit or implied government guarantees, for at least 15 years. Re-securitizations of agency mortgage bonds date to the mid-1980s under First Boston's **Laurence Fink**, now chief executive officer of **BlackRock Inc.**, and **Lewis Ranieri** of Salomon Brothers, now chairman of **Ranieri & Co.**, **Franklin Bank Corp.** and **Root Markets Inc.** Today's Re-Remics are ``an opportunity for dealers to find liquidity and to move bonds out of their inventory," said DBRS's Maas. **Toxic CDOs Given Up for Dead Coming to Life With Pension Funds**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=a0TGMrBy2PyE&refer=home>

Housing

Housing Finance

Macro Economic

Retail

Retirement

Risk

Savings Rate

Tech

The Fed

- **July 8** (Bloomberg) -- The Federal Reserve may extend securities dealers' access to direct loans from the central bank into 2009 **as long as emergency conditions ``continue to prevail,"** Chairman Ben S. Bernanke said. **``The Federal Reserve is strongly committed" to financial stability and is ``considering several options, including extending the duration of our facilities for primary dealers beyond year-end,"** Bernanke said in a speech to a conference in Arlington, Virginia. Bernanke also endorsed proposals to set up a federal liquidation process for a failing investment bank. The Treasury should ``take a leading role in any such process, in consultation with the firm's regulator and other authorities," he said. **The comments reflect the Fed's assessment last month that financial markets ``remain under considerable stress," even after the Fed started the unprecedented lending programs in March. Bernanke at the same time is aiming to address criticism that the Fed's loans to Wall Street may encourage more reckless lending, sowing the seeds of future crises.** The Fed chairman didn't comment on the outlook for the economy or monetary policy in the prepared text of his remarks today to a Federal Deposit Insurance Corp. forum on mortgage lending. Treasury Secretary **Henry Paulson** and JPMorgan Chase & Co. Chief Executive Officer **Jamie Dimon** are also scheduled to speak at the event. Lending Programs The Fed's Primary Dealer Credit Facility, which provides direct loans, and the Term Securities Lending Facility, which auctions as much as \$200 billion in Treasuries, were created in March in response to the credit crisis and collapse of Bear Stearns Cos. Both programs are aimed at the 20 primary dealers in U.S. government debt. Bernanke's speech today marks the first time he has indicated how long he may extend both programs, **which were created under the Fed's authority to lend to nonbanks in ``unusual and exigent circumstances." Officials in March said the PDCF would last for ``at least" six months.** The Fed is working with the Securities and Exchange Commission and securities dealers ``to increase the firms' capital and liquidity buffers," Bernanke said. One gauge of financial stress watched by the Fed has remained elevated. The difference between the overnight indexed swap rate, a measure of what traders expect for the Fed's benchmark rate, and three-month interbank loans in dollars was 0.78 percentage point yesterday, about the same as the start of May. **``Although short-term funding markets remain strained, they have improved somewhat since March,"**

Bernanke said. Bernanke's comments on the resolution authority are in line with Treasury Secretary **Henry Paulson's** July 2 statement that "any commitment of government support should be an extraordinary event that requires the engagement of the executive branch." **Bair's** Call FDIC Chairman **Sheila Bair** has also said an agency should be given such liquidation authority for investment banks. The FDIC has that power over lenders whose deposits it insures. In the case of commercial banks, the use of taxpayer funds in an emergency requires the approval of two-thirds majorities of the FDIC and Fed boards, and of the Treasury secretary in consultation with the president. "Despite the complexities of designing a resolution regime for securities firms, I believe it is worth the effort," Bernanke said today. "In particular, by setting a high bar for such actions, the adverse effects on market discipline could be minimized." Bernanke endorsed several ways for the Fed and other U.S. agencies to gain more oversight of investment banks and financial markets. Congress should legislate "consolidated supervision" of investment banks and other big securities firms, with the unspecified regulator having authority over capital, liquidity holdings and risk management, he said. **The Fed itself should also get "explicit oversight authority" over payment and settlement systems, putting the Fed on par with counterparts from around the world, Bernanke said.** New Responsibility Congress may consider giving the Fed responsibility for "promoting the overall stability of financial markets," Bernanke said. Still, "it would be particularly important to make clear that any government intervention to avoid the disorderly liquidation of firms on the verge of bankruptcy should use clearly defined tools and processes," he said. The Fed will play a part in setting capital cushions at securities firms under an agreement yesterday with the SEC designed to dispel concern a failing financial company without central bank oversight could threaten the economy. The Fed and SEC will collaborate in determining "guidelines or rules concerning the capital, liquidity and funding" arrangements of investment banks, the accord said. They will also cooperate in designing "risk management systems and controls" for securities firms. **Bernanke Says Fed May Extend Wall Street Lending Access to 2009**
http://www.bloomberg.com/apps/news?pid=20601087&sid=aSvgnK_7DdYU&refer=home

Wall Street

- [had this in before I left for Ann Arbor, obviously you all know the the FDIC stepped in 3 days later] July 8 (Bloomberg) -- **IndyMac Bancorp Inc.**, the U.S. mortgage company that stopped most of its lending as losses mounted and capital deteriorated, blamed Senator **Charles Schumer** for "elevated levels of deposit withdrawals." Schumer's comments last month about the lender's reliance on deposits purchased from third parties are causing customers to pull their money and making it harder to raise funds, the company said in a regulatory filing today. Schumer responded calling IndyMac a "junior version" of **Countrywide Financial Corp.** and said bad lending practices date back several years. **IndyMac**, based in Pasadena, California, said yesterday that it's firing half its employees and is working with regulators on a new business plan after failing to raise capital. The demise of **IndyMac**, the second-largest independent U.S. mortgage lender last year behind **Countrywide**, would be the biggest since the bankruptcy of **American Home Mortgage Investment Corp.** in August. "They're in the unfortunate position of being a

specialty mortgage entity at a time when mortgage assets are out of favor," said [Christopher Wolfe](#), an analyst at Fitch Ratings in New York, in an interview. Fitch reduced IndyMac's debt four levels today to CC from B-. "Our rating suggests there's a high degree of doubt that they can" survive, Wolfe said. IndyMac fell 27 cents to 44 cents at 4 p.m. in New York Stock Exchange composite [trading](#), reducing its market value to \$44 million from more than \$3.4 billion in mid-2006. Schumer Letters

Schumer, the New York Democrat, sent letters last month to home-lending regulators including the Federal Deposit Insurance Corp., warning of a potential collapse. Those comments led to additional restrictions on the bank's borrowings and caused its so-called operating liquidity to dwindle to about \$1.7 billion, the company said in the filing today. IndyMac spokesman Evan Wagner declined to comment beyond the company's statements. The lender lost almost \$900 million in the nine months ended in March and its second-quarter loss will exceed the \$184 million reported in the prior period, IndyMac said. Because it doesn't have enough capital to meet the "well capitalized" threshold set by regulators, IndyMac said it can't fund its lending with deposits acquired through independent brokers. IndyMac's request for a waiver from the FDIC to allow for brokered deposits hasn't been approved, the company said. "We don't expect to be able to raise capital until there is more stability and less uncertainty in the housing and mortgage markets," IndyMac Chief Executive Officer [Michael Perry](#) said in a statement yesterday.

Alt-A Loans At the bank branch adjacent to its headquarters, spread across a coffee table were blue brochures entitled, "Your Insured Deposits: FDIC's Guide to Deposit Insurance Coverage." There were no lines forming at the branch today. IndyMac specialized in so-called Alt-A mortgages that usually didn't require borrowers to provide documentation on their incomes. The lender said it is working with regulators on a new business plan while it curbs lending and will slash its 7,200-strong workforce by 53 percent. "IndyMac was one of the banks that was using relatively weak underwriting standards on the basis that housing prices would continue to rise in value," said [Jason Arnold](#), an analyst at RBC Capital Markets in San Francisco, in an interview yesterday. "With [prices](#) coming down, that became the bottom card in the house of cards built by these lenders." The company's key asset is its Southern California retail bank network with 33 branches and \$18 billion in deposits, mostly insured by the FDIC, Arnold said. IndyMac's inability to find a buyer or attract capital, even amid pressure from regulators, reflects continued concern over the declining value of its loans, he said. IndyMac agreed to sell most of its retail mortgage branches to Prospect Mortgage. The deal gives the Northbrook, Illinois based-company more than 60 branch offices with 750 employees, Prospect said today in an e-mailed statement. **IndyMac Blames Senator's Comments for Withdrawals**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aaB4cryHdFfk&refer=home>

- July 8 (Bloomberg) -- U.S. [stocks](#) rallied the most in a month, led by banks and transportation companies, after JPMorgan Chase & Co.'s chief executive officer said losses in credit markets will ease and oil posted its biggest drop since March. Bank of America Corp. advanced the [most](#) since 1990, leading financial shares to their best gain in more than three months, after JPMorgan's [Jamie Dimon](#) said buyers are returning to some types of mortgage products. [Fannie Mae](#) and [Freddie Mac](#) rebounded from their lowest levels in more than 13 years after a regulator said the mortgage-finance companies shouldn't have to raise more capital. [United Parcel Service Inc.](#) and [Wal-Mart Stores Inc.](#)

climbed as crude tumbled more than \$5 a barrel. The Standard & Poor's 500 Index jumped 21.39 points, or 1.7 percent, to 1,273.7. The [Dow Jones Industrial Average](#) climbed 152.25, or 1.4 percent, to 11,384.21. The [Nasdaq Composite Index](#) added 51.12, or 2.3 percent, to 2,294.44. Almost four stocks gained for each that fell on the New York Stock Exchange. "Oil prices have had a stranglehold on the stock market for the last year or so and anyone that's a long-term equity investor needs to see oil prices come down," said [Jack Ablin](#), who helps oversee \$65 billion as chief investment officer at Harris Private Bank in Chicago. Eight of 10 industries in the [S&P 500](#) advanced as the benchmark for U.S. equities pared its tumble from an October record to less than 19 percent, below the 20 percent threshold that signals the start of a so-called bear market. The plunge in oil prices pushed energy shares in the index to the lowest level since May 1. Banks Rally [Financial shares](#) in the S&P 500 climbed 5.8 percent as a group, rebounding from yesterday's five-year low. "The capital side of the crisis will ease," JPMorgan's Dimon said in a speech in Arlington, Virginia, where he said he supports regulatory efforts to protect homeowners from foreclosure. Federal Reserve Chairman [Ben S. Bernanke](#) earlier told the conference that the central bank may extend securities dealers' access to direct loans into 2009. Bernanke said the Fed "is strongly committed" to financial stability. Banks also rose after the regulator for [Freddie Mac](#) and Fannie Mae, the largest U.S. mortgage-finance companies, said they have enough capital to survive a slump in the housing market and meet new accounting rules. "Adequately Capitalized" "Fannie and Freddie are adequately capitalized," [James Lockhart](#), the director of the Office of Federal Housing Enterprise Oversight, said in an interview with Bloomberg Television today. "They are fulfilling their function." Fannie and Freddie tumbled yesterday after Lehman Brothers Holdings Inc. analysts said that a change in accounting rules may force Fannie Mae to add \$46 billion of capital and Freddie Mac to add \$29 billion. Fannie rallied \$1.88, or 12 percent, to \$17.62 today, while Freddie added \$1.55, or 13 percent, to \$13.46. [Bank of America](#), the second-largest U.S. bank by assets, surged \$2.01, or 9.3 percent, to \$23.54. Citigroup Inc., the biggest, and JPMorgan, the No. 3, each climbed more than 5 percent. Crude oil for August delivery fell 3.8 percent to \$136.04 a barrel in New York on concern that the global economy may slow further. Oil dropped almost \$10 since reaching a record \$145.85 a barrel on July 3. [UPS](#), the largest package-delivery company, rallied \$2.50, or 4.3 percent, to \$60.40. Wal-Mart, the world's biggest retailer, gained \$2.20, or 3.9 percent, to \$59.11. Drugmakers Climb The [S&P 500 Health Care Index](#), which has lost 11 percent this year, jumped 2.9 percent today after S&P's equity strategists upgraded the group to "market weight" from "underweight," saying "a prolonged period of underperformance has discounted many of the fundamental headwinds facing the sector." Biogen Idec Inc., the world's largest maker of multiple sclerosis drugs, rallied \$4.07, or 6.9 percent, to \$62.94 and led the group's advance. [Office Depot Inc.](#), the second-largest retailer of office supplies, fell the most since its 1988 initial public offering, tumbling \$3.29, or 32 percent, to \$7.12. The company said sales slid and second-quarter earnings deteriorated more than it earlier forecast. Energy Retreat Energy shares fell 1.6 percent, the most among 10 industries in the S&P 500, as oil declined. [Noble Corp.](#), the third-largest U.S. offshore oil driller, led declines in 34 of 39 energy companies in the S&P 500, sliding \$2.38, or 3.9 percent, to \$58.38. Massey Energy Co., the fourth-biggest U.S. coal producer, fell \$1.41, or 1.9 percent, to \$73.81. Producers of raw materials were the second-biggest drag on the

market after energy companies as corn, gold, copper and other commodities retreated on concern that the sagging global economy will erode demand. [The UBS Bloomberg Constant Maturity Commodity Index](#) has dropped 4.6 percent in the past three sessions. [Freeport-McMoRan Copper & Gold Inc.](#), the world's largest publicly traded copper producer, slid \$4.38, or 4 percent, to \$105.21. [Alcoa Inc.](#) had the steepest decline in the Dow average, losing \$1.06, or 3.2 percent, to \$32.33. After U.S. markets closed, the third-largest aluminum producer reported second- quarter profit of 71 cents a share, excluding a 5-cent charge. That topped the 65-cent average estimate of analysts surveyed by Bloomberg. Alcoa rose \$1.32, or 4.1 percent, to \$33.65 at 4:53 p.m. in New York. Alcoa is the first Dow average company to post second- quarter results, beginning an earnings season that will probably mark the longest streak of consecutive profit declines for S&P 500 companies since 2002. Earnings for [S&P 500 companies](#) probably shrank for a fourth quarter, falling 11.2 percent, according to the average estimate of analysts surveyed by Bloomberg. Profits at banks, brokerages and insurers in the S&P 500 fell 60 percent in the second quarter, according to the estimates. **U.S. Stocks Gain Most in Month on Lower Oil, Dimon's Outlook**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aPozp.Rb0d3Y&refer=home>

- July 8 (Bloomberg) -- [Michael Steinhardt](#), the investment pioneer whose hedge funds returned more than 20 percent a year for almost three decades, said U.S. stocks will keep falling even as "contrarian" buy signals abound. Record oil prices and the credit-market slump that spurred more than \$400 billion in asset writedowns and loan losses at banks worldwide will prevent the market from rallying, Steinhardt, 67, said in a Bloomberg Television interview today. The [Standard & Poor's 500 Index](#) declined 19.99 percent from its October record through yesterday, just short of the 20 percent threshold of a so-called bear market. "There are genuine, solid, fearful reasons for a bear market," Steinhardt said. "I don't think we're at a bottom." He added, "I can think of only one quick fix, which is a dramatic, substantial drop in the price of oil." Steinhardt was 19 when he started his Wall Street career as a securities analyst after graduating in 1960 from the Wharton School of the University of Pennsylvania. In 1967, he opened New York-based Steinhardt Management Co., which produced hedge-fund returns averaging 24 percent a year for the next 28 years. He closed the firm in 1995 when it had \$2.6 billion under management to pursue philanthropy. He is chairman of WisdomTree Investments Inc., a New York-based asset-management firm that offers exchange-traded funds. 'Inexplicable' Advance Crude oil surged 88 percent in the past year and reached a record \$145.85 a barrel on July 3. Some of that advance is sustainable, Steinhardt said. "A lot of it's political, a lot of it is inexplicable, but I don't think oil at \$100 a barrel is very difficult to imagine," he said. "If there were a will in the key centers of power in this country to get the price of oil down, it would come down." The Federal Reserve, which cited rising oil prices last month after ending its most aggressive monetary easing in two decades, should raise interest rates "a little bit" to restrain inflation, which is on the verge of accelerating, Steinhardt said. Consumer prices in the U.S. climbed 4.2 percent in the year through May and probably rose at a 4.5 percent pace in June, according to a Bloomberg News survey of economists. Rising bets against U.S. stocks and growing pessimism among investors, usually indicators that it's time to purchase shares, are giving a false buy signal, he said. 'This Time It's Different' "There is rarely a moment such as this where as a contrarian, one sees so many reasons technically, stock

market- wise to be bullish. I can't imagine a circumstance where a market is more available, more ripe for a rally than this one," Steinhardt said. Still, "this time it's different," he added. [General Motors Corp.](#), Ford Motor Co., airlines, banks, mortgage lenders and brokerages, "companies and industries that heretofore had been sacrosanct," are in jeopardy amid higher inflation and slowing economic growth, he said. GM, the biggest U.S. automaker, retreated 72 percent for the [Dow Jones Industrial Average's](#) biggest loss since the measure's record high in October. "It's an extraordinary phenomenon where that which was the heartland of America is now so, so sick and not easily vulnerable to improvement," Steinhardt added. **Steinhardt Says Stocks Will Extend Drop on Banks, Oil**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ah.AIaUVQY1M&refer=home>

Don't Fight The Fed

I Disagree . . . and why

Article of the week:

Best of the Dog

[for point of reference I email this the morning of July 10. Obviously it took less than a day for the FNM and FRE news to top the headlines]

Thursday, July 10, 2008 at 19:19 CDT

While the big dog's away...

Your dogblogger is in Ann Arbor and claims he can not get on the computer (we suspect it has something to do with 70 and sunny weather in Michigan).

But in any event phoned in the following:

Today is yet another day showing that there is much more downside to this market.

Apparently coal is the new tech. garbage like JRCC is trading like momentum of old. As long as this type thing is rewarded in the very short term it shows the complete lack of understanding of the severity of the economic situation by the "traders". Much like the petulant spoiled child who goes unpunished, this bad behavior will continue.

On a more global note, FNM and FRE are in very deep trouble as we have noted for years. The value of the equity is ZERO unless yet another government bailout happens. With the trash talk on the Hill today I would assume even the Fed might be reluctant to bail out the gamblers on these two.

Sunday, July 06, 2008 at 07:47 CDT

Comments July 6

from the OSS

Happy 3Q! Or will it be?

I face a constant tension between getting these comments out on a weekly basis on the one hand and capturing what I think are the salient stories and providing insightful analysis on the other. Today is more of the former and less of the later.

I will tell you having reflected on the last couple of years in preparing a separate essay, the only true outlier to me is that it has taken so long for the investment community to appreciate that this time it is really different. In fact, we still today see every downturn met with claims that “the bottom is in” or searches for “buying opportunities. Meanwhile Bloomberg reports that “global financial stocks have led declines that wiped about \$11 trillion from equity markets worldwide this year.” [Bloomberg July 4, 2008]

Further, we still see the wishers and hopers cling to a long disabused belief that the government will solve the problems they in fact created. Even a casual review of the past eighteen months establishes that the Fed has been clueless, their actions taken reactionarily and ineffectively and that they in fact have frittered away all their potential impact with NO long term positive results. It is and has been my opinion that we are finally seeing a return towards the reality of economics. Poor capital allocation and myopic focus on today’s news leads to systemic overvaluation and leverage that must be corrected by extensive LOSSES to those who paid no heed to risk versus reward.

We are in the very early stages of this process despite what the political hacks in DC are trying to sell.

So what for 3Q? I suspect that the belief that the government, which is now largely reduced to rhetoric, can alter the laws of economics will continue to erode. I believe that we will see one significant “bottom is in AGAIN knee jerk” rally based on the recent “if it is down it must be a ‘good buy’” investment philosophy of the under 40 crowd. I believe that said rally will be sometime this summer. I believe that the true carnage will commence in the fall. I believe this not because I see any reason to support a rally but instead because bad investing has been rewarded so long that it will take a long while to eradicate it.

I also see another catastrophic series of credit failures. Credit will continue to dry up and banks will begin to fail in numbers. Employment will continue to decay. People will continue to be able to spend less because there are no more places to borrow. In essence, the economic world will begin to function as it should.

I then foresee another series of revelations as to criminal acts on Wall Street that will make Enron, Drexel, and even Ponzi pale in comparison.

Where this ultimate leads is a blank canvas. I suspect it leads to the rise of Asia as the center of the financial world and retirements full of broken dreams for the boomers who thought they could spend at will and allow their capital assets to appreciate themselves into retirements of luxury.

As stated before, the piper must be paid. And it is almost time . . .

