

July 22, 2007 Review

Comments

The CDO derivative train is over the cliff. The sole remaining question is how long until it hits the ground.

The dollar is in a similar free fall

Housing values will drop for years

High yield is imploding

None of these stories are new. All were easily foreseeable.

Dow 14000.

Wall Street shills and University finance professors would have you believe the market is always right. But which market?

We will see . . .

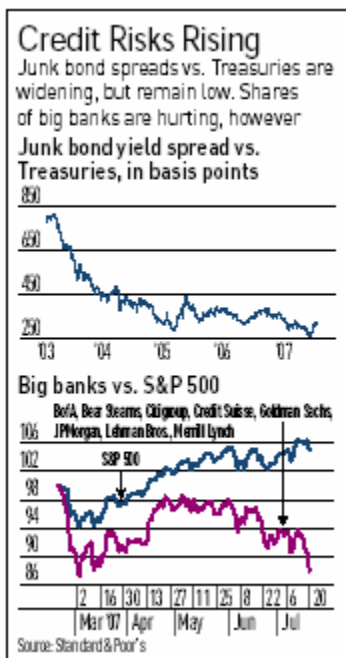
Credit

- July 24 (Bloomberg) -- The extra yield investors demand to own the riskiest bonds surged to the highest in more than 18 months as a measure of their risk increased and a mortgage lender reported more consumers fell behind on home-equity debt. High-yield spreads relative to U.S. Treasuries jumped 17 basis points to 361 basis points, the fourth one-day increase of 15 basis points or more this month, according to Merrill Lynch & Co. index data. The increase puts July on course to become the worst month for junk-rated debt premiums in more than five years. A basis point is 0.01 percentage point. High-yield spreads have widened 68 basis points this month, just shy of the 69 basis points they increased in March 2005. Prior to that, the biggest widening was in June 2002, when spreads surged 147 basis points. **Yield Premium on Junk Debt Rises to Most in 18 Months**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=apJ6kd2F2R00&refer=home>
- July 24 (Bloomberg) -- **The cheap financing that fueled the leveraged buyout boom is over, [and so is the game]** according to Bill Gross, manager of the world's largest bond fund. "The tide appears to be going out for levered equity financiers and in for the passive owl money managers of the debt market," Gross, chief investment officer at Pacific Investment Management Co. in Newport Beach, California, wrote today in his monthly commentary on Pimco's Web site. The shift "promises to have severe ramifications for those caught in its wake." Gross's comments come as investors balk at buying the riskiest bond offerings. Their resistance has increased borrowing costs and will bring an end to lax financing standards, Gross said. A growing lack of confidence has "frozen" future lending and potential investors, backing up the market for high-yield new issues so that "absolutely nothing is moving," wrote Gross, "**They're frozen**

because they don't trust the ratings," [nor should they] Gross said in an interview today. "It's a subprime to corporate debt type of phenomena that's freezing buyers and making for an extreme backup in terms of supply." Losses on U.S. mortgage securities are prompting investors to demand higher risk premiums on debt sold by buyout firms. **At least 35 bond and loan transactions worldwide were canceled or restructured in the past five weeks** The CDX North American High-Yield Index of 100 companies with non-investment grade ratings fell as much as 0.5 to 92.75, according to broker Phoenix Partners Group. That implies the cost to protect \$10 million of the bonds climbed to as high as \$488,000. **KKR, Blackstone Find 'Tide Is Going Out,' Gross Says**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aYujmjlDmvpq&refer=home>

- July 23 - Credit markets are in the midst of a stress test, as debt investors weigh ongoing fallout from the subprime mortgage sector. It could spell an end to easy money that's fueled record gains for the financial sector and equity markets even as economic growth turned sluggish. The 10-year Treasury yield fell to a six-week low of 4.95% on Friday as investors fled risk. Troubles began months ago when falling housing prices and surging inventories of unsold homes spurred rising mortgage defaults. That spurred dozens of failures at mortgage brokers such as New Century and led to the near-collapse of two subprime-heavy hedge funds at Bear Stearns. Now fears are mounting that rising risk is making debt investors of all stripes more finicky. **A Bridge Loan Too Far** Citigroup said Friday it couldn't sell debt to investors in four buyout deals in the second quarter while warning of more such problems to come. Bank shares fell Friday — as they have in recent weeks — on concerns they'll be stuck with bridge loans on their balance sheets. JPMorgan head Jamie Dimon noted "kind of a little freeze in the marketplace" for high-yield debt used to finance many of the huge deals in recent months. **"There's been an amazing complacency about risk throughout the financial sector. That's got to come to an end,"** said David Wyss, chief economist at Standard & Poor's. Fears of a precipitous drop in demand and drastic repricing of lending terms set deal makers on edge. Chrysler is facing worries over how it'll fund the \$62 billion in debt needed for its buyout by Cerberus Capital Management. Alliance Boots said Friday it will rework terms of the \$18.5 billion debt for its buyout by private equity giant Kohlberg Kravis Roberts. Investors' loss of appetite comes at a particularly bad time given the amount of debt up for offer. Private equity firms need to fund some \$300 billion in debt for current deals, according to Bear Stearns. "There's an avalanche of levered loans that have to be financed. That's the main worry right now," Mark Kiesel, a senior portfolio manager at bond giant Pimco. "If you look at credit spreads now and you were to base your decision solely on fundamentals you'd be buying or adding a lot more risk. But everyone is afraid of the train coming down the tracks." Private equity stars Blackstone Group and MF Global, Man Financial's brokerage, have both seen their newly issued shares falter following recent IPOs. But debt investors, though jittery, still aren't running for the hills. Yield spreads between junk and high-quality debt remain at historically low levels, despite some recent widening. **No Spillover So Far** So does all this bad news mean we're headed for a "credit crunch" where interest rates soar, stocks tank, and only the biggest firms can secure proper funding? "I think the risks of a credit crunch are more elevated than they have been in a long time," said Matt Eagan, vice president and manager of fixed income securities at Loomis, Sayles & Co.

“Subprime was a bit of a spark” that caused investors to become more risk averse, but he noted that “high-grade companies continue to come to the market and they’re not having as much trouble” raising money. St. Louis Federal Reserve President William Poole echoed that sentiment. While calling punishment for abusive lending practices “swift, harsh, and without prejudice,” he didn’t see subprime woes hurting the overall economy. In all, defaults outside of the subprime mortgage sector are still relatively low. Consumers are still making credit card payments while spending remains solid. “We’re not seeing much sign of subprime issues spreading to the rest of the economy,” S&P’s Wyss said. “The rest of the economy is continuing to chug along at a pretty good pace. The spillover effect so far — the collateral damage — has been pretty limited.” Will Subprime Woes End The Easy Money That Lifted Market? *BY KIRK SHINKLE*
 INVESTOR'S BUSINESS DAILY



Commercial Real Estate

Commodities

Currency

- July 24 (Bloomberg) -- The dollar declined to the lowest in more than two months against the yen and weakened against the 10 most-active currencies on speculation subprime mortgage losses will deepen and reduce demand for U.S. assets. The dollar fell to a 26-year low against the pound and the weakest since March 1985 versus New Zealand's currency. **The subprime rout is spreading with Basis Capital Fund Management Ltd., an Australian hedge fund, hiring Blackstone Group LP to advise on limiting its losses.** “The subprime market is a concern and the U.S. economy is going to be slower than anticipated,” [remember just weeks ago when “the subprime issue was contained”] said Paul Chertkow, head of currency strategy at Bank of Tokyo-Mitsubishi UFJ Ltd. in London. “There's no good reason to think the dollar's going to appreciate. [Sydney-based](#)

Basis Capital said it hired Blackstone after two of its funds ran into trouble by investing in the unrated, riskiest portions of so-called collateralized debt obligations. These portions are first in line for any losses when borrowers fall short on mortgage payments. **Japan's nine biggest banking groups have more than 1 trillion yen (\$8.3 billion) of combined holdings in products backed by U.S. subprime mortgages,** Nikkei News reported. ``The housing market has yet to hit bottom," [far from hitting bottom, it has just begun to drop in earnest] said Antje Praefcke, a currency strategist at Commerzbank AG in London. ``The widening of U.S. credit spreads continues to eat away at dollar support." **An index of the dollar's value against six major currencies was near the lowest since 1995. A further slump may erode demand for U.S. securities from some investors abroad,** [other apparently will simply decide to lose money] according to Adam Cole, a senior currency strategist at RBC Capital Markets Ltd. in London. **Dollar Falls to Two-Month Low Against Yen on Mortgage Concerns** <http://www.bloomberg.com/apps/news?pid=20601087&sid=agSOSc6Xtxs4&refer=home>

Diversification

Derivatives

- July 24 (Bloomberg) -- The Wall Street money-machine known as collateralized debt obligations is grinding to a halt, imperiling \$8.6 billion in annual underwriting fees and reducing credit for everyone from buyout king Henry Kravis to homeowners. **Sales of the securities -- used to pool bonds, loans and their derivatives into new debt -- dwindled to \$3.7 billion in the U.S. this month from \$42 billion in June, analysts at New York-based JPMorgan Chase & Co. said yesterday. The market is ``virtually shut," the bank said in a July 13 report.** Investors are shunning CDOs after the near-collapse of two hedge funds run by Bear Stearns Cos. that owned the securities. Standard & Poor's downgraded bonds from 75 CDOs as mortgages to people with poor credit defaulted at record rates. Concern about losses on home loans are rattling investors across the credit spectrum. ``We're walking on thin ice," said Alexander Baskov, a fund manager who helps oversee \$25 billion of high-yield debt for Pictet Asset Management SA in Geneva. ``**People are trying to find value and the right price and right now nobody knows what it is. Pretty much everyone is in the dark.**" [i.e. this is a very illiquid market where a "lots of sellers – no buyers" could take root] Investors are demanding yields 10 percentage points higher than benchmark rates to compensate for the risk of losses on some of the lower investment-grade rated parts of CDOs, up from 4 percentage points at the start of the year, according to data compiled by Morgan Stanley in New York. Deals Pulled The shakeout is leading firms from Maxim Capital Management in New York to Paris-based Axa Investment Managers to delay or scrap planned CDO sales. Maxim began buying mortgage bonds for a new CDO after completing its second deal in March. Chief Investment Officer Doug Jones in New York said he slowed the purchases, having acquired only a third of the assets planned, partly because the bank underwriting the deal grew concerned it could lose money as volatility increased. He declined to name the underwriter. ``We don't want to get too far along and create something that's not sellable," said Jones, who manages \$4 billion of CDOs. **Banks are becoming more skittish about providing credit lines, called warehouse financing, managers use to buy assets that go into CDOs in the months before the securities are issued,** [i.e. liquidity is drying up] said James Finkel, chief executive

officer of Dynamic Credit Partners. The New York-based company manages \$7 billion in 10 CDOs and a hedge fund. The slowdown comes as private equity firms such as Kravis' Kohlberg Kravis Roberts & Co. and Blackstone Group LP, both based in New York, need to borrow at least \$300 billion in coming months to finance acquisitions, according to Baring Asset Management in London. **Buyout groups rely on CDOs for 60 percent of the loans to finance U.S. acquisitions, according to JPMorgan.** More Bailouts? ``CLOs have been instrumental in funding the surge in LBOs and pushing down loan spreads," said Gunnar Stangl, the Frankfurt-based head of index and bond strategy at Dresdner Kleinwort, a unit of Allianz SE, Europe's biggest insurer. ``They provide constant institutional demand for leveraged loans." **CDOs also financed growth in lending to home owners with poor credit or high debt, known as subprime mortgages.** [That worked out well didn't it?] About \$50 billion of home loan debt rated BBB and BBB- went into CDOs in 2006, almost the same as the total sales of mortgage backed securities with identical ratings, Citigroup Inc. analysts estimated in a report in April. ``For the last 18 months the majority of subprime ABS was bought by another securitization vehicle that issued further bonds," the Citigroup analysts said. **The five biggest managers of U.S. CDOs include New York- based Bear Stearns** [that would be the same Bear Stearns that lost 100% of investors money in tow hedge funds investing in this junk they were/are selling] and Zurich-based Credit Suisse Group, according to S&P. Their annual fees range between 0.04 percentage points to 0.75 percentage points of the amount of underlying collateral, depending on the type of the CDO and its performance. Drexel Creation Collateralized debt obligations were created in 1987 by bankers at Drexel Burnham Lambert Inc. [think bankrupt in 1990, Milken sent to jail] Sales of the securities surged to \$503 billion last year from \$84 billion five years ago, according to Morgan Stanley. Sales reached \$251 billion in the first quarter, the Bank for International Settlements in Basel said last month At the opposite end, insurers, banks and other CDOs tend to buy the less risky portions with AAA credit ratings that pay 23 basis points to 150 basis points more than benchmark interbank lending rates, according to Morgan Stanley. Governments selling AAA bonds typically pay interest at the interbank rate or less. Buyers of the least risky portion of a CDO underwritten by Credit Suisse this month were offered annual interest 22 basis points above benchmark rates. The CDO, called Avoca CLO VIII Ltd., managed by Avoca Capital in Dublin, pooled 508 million euros of high-yield loans. About 69 percent of the deal was rated AAA. A basis point is 0.01 percentage point. Investors are steering clear of new CDOs following the Bear Stearns debacle. Ralph Cioffi, the 22-year Bear Stearns veteran who managed the two money-losing hedge funds, tried to minimize risk by buying the top-rated portions of CDOs. `Unprecedented Declines' **The funds were wiped out by ``unprecedented declines" in the value of AA and AAA rated securities, Bear Stearns wrote to clients last week.** [unprecedented only if you believe they were appropriately rated AA or higher, which they were not. Rating them AAA was akin to selling a junk yard as a new car because if you sorted through the wrecks you could find sufficient parts to build a "new car"] The losses triggered a selloff across credit markets because of concerns that a fire sale of CDOs would mean losses for holders of even the least risky debt and that fewer sales of new CDOs would reduce demand for bonds and loans. ``**If the experts are getting it wrong that says something,**" [yes it does – it says 'watch out below'] said Kevin Lyne-Smith, who helps oversee \$100 billion as managing

director at Julius Baer Holding AG's private banking division in Zurich. **Even with the widening in CDO spreads, the funding cost remains at around the average over the past five years for deals backed by leveraged loans. Defaults by speculative-grade companies slid to a 25-year low of 1.12 percent worldwide in June, Standard & Poor's said. [The foregoing is another iteration of the mindless "just look at what happened" analysis. It does not matter what just happened. It matters what is going to happen. And what it going to happen is that all these platitudes will be proven to be as wrong as "sub-prime is great/sub-prime is not in trouble/the problem is just sub-prime/etc.]"** Sales of CDOs were booming until the Bear Stearns funds collapsed. [the Titanic was floating until it sank] New deals are up 30 percent this year to \$313 billion, according to JPMorgan. Deals are still being completed. [and this should comfort us?] London-based Elgin Capital, a fund manager co-founded by Michael Clancy, who formerly helped run Merrill Lynch's credit trading operation, sold 400 million euros of CLOs in July. BNP Paribas SA, based in Paris, underwrote the sale, offering yields for the BB- rated portion at 425 basis points over interbank rates, less than the spread of 480 basis points on similarly rated securities it sold in May 2006. **KKR, Homeowners Face Funding Drain as CDO Machine Shuts Down**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aG18rnNeuGxc&refer=home>

- July 18 (Bloomberg) -- Bear Stearns Cos. told investors in its two failed hedge funds that they'll get little if any money back after "unprecedented declines" in the value of securities used to bet on subprime mortgages. "This is a watershed," said Sean Egan, managing director of Egan-Jones Ratings Co. in Haverford, Pennsylvania. **"A leading player, which has honed a reputation as a sage investor in mortgage securities, has faltered. It begs the question of how other market participants have fared."** Estimates show there is "effectively no value left" in the High-Grade Structured Credit Strategies Enhanced Leverage Fund and "very little value left" in the High-Grade Structured Credit Strategies Fund, Bear Stearns said in a two-page letter. The second fund still has "sufficient assets" to cover the \$1.4 billion it owes Bear Stearns, which as a creditor gets paid back first, according to the letter, obtained yesterday by Bloomberg News from a person involved in the matter. Bear Stearns, the fifth-largest U.S. securities firm, provided the second fund with \$1.6 billion of emergency funding last month in the biggest hedge fund bailout since the collapse of Long-Term Capital Management LP in 1998. The losses its clients now face underscore the severity of the shakeout in the market for collateralized debt obligations, or CDOs, investment vehicles that repackage bonds, loans, derivatives and other CDOs into new securities. More broadly, the risk of owning corporate bonds soared to the highest in two years in Europe and rose in the U.S., credit- default swap prices show. Ralph Cioffi, the 22-year Bear Stearns veteran who managed the two funds, sought to minimize risk by investing in the top- rated portions of CDOs. Under Cioffi, 51, the funds also borrowed money in an effort to boost returns. Instead, as defaults surged on subprime mortgages, they grappled with "unprecedented declines" in the values of AAA and AA securities, Bear Stearns said in the letter. Market Implications "That has implications for credit weakness in the next several days and weeks," said Peter Plaut, an analyst at New York-based hedge fund Sanno Point Capital Management. "There's going to be more risk aversion." In an interview with the New

York Times published on June 29, Bear Stearns Chief Executive Officer James E. "Jimmy" Cayne said the debacle was a "body blow of massive proportion." Sanford C. Bernstein & Co. analyst Brad Hintz estimated in a July 16 report that Bear Stearns's profit may decline 6.8 percent this year as the firm restricts lending to hedge funds and declining demand for mortgage bonds cuts trading revenue. As prices of CDOs slumped, lenders demanded more collateral, forcing the funds to sell assets and mark down the value of their investments, creating a vicious cycle. The leverage magnified the losses, wiping out investors' capital, Michael Hecht, an analyst at Bank of America Corp., said today in a report. Hecht doesn't expect the funds' losses to reduce Bear Stearns's shareholders' equity and recommends buying the stock. Bear Stearns itself invested about \$35 million in the funds, Chief Financial Officer Samuel Molinaro said on a June 22 conference call. The firm bailed out the larger pool to keep lenders from auctioning off assets and driving down prices. **Bear Stearns Tells Fund Investors 'No Value Left'**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ao3.vbiiZJZM&refer=home>

Housing

- July 24 (Bloomberg) -- **California mortgage defaults rose to the highest level in a decade** in the second quarter as falling home sales and higher interest rates battered the housing market. Homeowners received 53,943 default notices, more than double the 20,909 filed a year ago, DataQuick Information Systems, a La Jolla, California-based provider of real estate data, said today in a statement. Last quarter's default level was the highest since the fourth quarter of 1996, when 54,045 notices were recorded in California. Most of the loans that went into default in the second quarter were originated between July 2005 and August 2006. Loan originations peaked in August 2005. At the top of the market, when price appreciation rates topped 10 percent, lenders let many households stretch their finances beyond what they could afford, DataQuick said. Those borrowers are now at risk of default. "More to Come" "We're going through a lot of that activity," DataQuick analyst John Karevoll said in an interview. "There's more to come." Default notices are the first step in foreclosing on a home. Such notices in the second quarter rose 15 percent compared with the previous three months. **About half of homeowners stop the process by catching up on payments, refinancing or selling their homes to pay down debt, DataQuick said. A year ago the figure was 88 percent.** The number of defaults resulting in foreclosures is the highest since DataQuick began keeping records. The previous high was in early 1994, when about 30 percent of defaults resulted in foreclosures, Karevoll said. Only 55 percent of homeowners are able to avoid foreclosure because a greater number now have multiple loans on their properties. In the past, when a homeowner had just one mortgage, the lender would often allow the borrower to sell the home for less than the amount owed on it and take the loss, known as a short sale, Karevoll said. **The number of homes lost to foreclosure totaled 17,408 in the second quarter, the highest in DataQuick's statistics, which date back to 1988. [which obviously includes the 1989-90 price declines in California]** The losses were up 58 percent from the previous quarter and ninefold from a year earlier. The prior peak of foreclosure sales was in the third quarter of 1996, when they totaled 15,418.
California Home-Loan Defaults Rise to a Decade High

<http://www.bloomberg.com/apps/news?pid=20601206&sid=aHGzlx.mCNI&refer=realestate>

- July 20 (Bloomberg) -- In the middle of the biggest glut of condominiums in more than 30 years, Miami developers keep on building. The oversupply will force prices down as much as 30 percent, the worst decline since the 1970s, and help push Florida's economy into recession as early as October, said Mark Zandi, chief economist at West Chester, Pennsylvania-based Moody's Economy.com, who owns a home in Vero Beach, Florida. "Florida is the epicenter for all the problems that exist in the housing industry," said Lewis Goodkin, president of Goodkin Consulting Corp. and a property adviser in Miami for the past 30 years, who also foresees a recession. "The problems we have now are unprecedented and a lot of people will get burnt." Thirty-seven new high-rise condos and 20,000 new units are being built in Miami's 1,040-acre downtown, where sales fell almost 50 percent in May, according to the Florida Association of Realtors. The new units will join the 22,924 existing condos in Miami-Dade County that were for sale in April, according to Jack McCabe, chief executive officer of McCabe Research & Consulting LLC in Deerfield Beach, Florida. That's the most unsold units since McCabe began tracking sales in 2002. "The market is as close to a depression as Miami has seen in 30 years," Eichner said. "There's a gargantuan supply of homes and the overwhelming preponderance were built for speculators, not for people who are living there." Buyers Walking Away With sale prices falling, McCabe said he expects up to 50 percent of them to walk away from their deposits in the next 18 months rather than complete the sales. Many "flippers" closed on their units and now can't sell them, said Michael Cannon of Integra Realty Resources-Miami Inc., leaving completed condo towers with floors of dark windows and empty balconies. The Jade Residences at Brickell is an example, Cannon said. The 338-unit, 48-story waterfront tower, a block from the Brickell Avenue financial district, opened in August 2004 with buyers willing to pay as much as \$5 million snapping up all the units. Now, the new owners have listed 112 condos for sale and 17 units totaling \$15 million are in foreclosure. **Prices Fell In the 1970s, when condos were a new product, Florida developers built 500,000 units and prices fell 50 percent, said Brad Hunter of MetroStudy, a research firm in West Palm Beach.** "The difference is, back then they were two-story condo buildings that had \$50,000 units," Hunter said. "Nowadays they are \$700,000 units in 20-story buildings. Instead of building too much stuff that people could afford like we did then, this time we built too much stuff that people can't afford." A lot of the inventory 30 years ago was sold off and converted to rental apartments, Goodkin said. That solution won't work now because prices have soared and properties coming on the market will compete with existing condos whose prices have plummeted, he said. Goodkin said opportunistic investors will buy construction loans from banks at a discount of 30 percent or more. "The vultures are in the trees," Goodkin said. "Reality has become the new pessimism." "This is dumbfounding to me," Rosser said. "It's a building boom in the middle of a housing bust." **Miami Condo Glut Pushes Florida's Economy to Brink of Recession**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=a4qa.rYTWyYA&refer=home>

Housing Finance

- July 24 (Bloomberg) -- Countrywide Financial Corp., the biggest U.S. mortgage lender, reported a third straight quarterly earnings decline and reduced its 2007 forecast as the rout in subprime mortgages spread to less risky borrowers. Second-quarter net income declined 33 percent to \$485.1 million, or 81 cents a share, from \$722.2 million, or \$1.15, a year earlier, the Calabasas, California-based company said in a statement today. It was expected to earn 91 cents. Revenue fell 15 percent to \$2.55 billion. Countrywide shares dropped as much as 8.3 percent, the most since August 2006, after the company said overdue payments on home-equity loans reduced second-quarter earnings by \$388 million. Chief Executive Officer Angelo Mozilo said he expects "difficult housing and mortgage market conditions to persist" through 2007. "What really surprised people was the guidance," said Paul Miller, an analyst at Friedman Billings Ramsey Group. "I don't think any investor is going to be that confident with mortgage banking earnings until '09." The company slashed its profit forecast for 2007 to \$2.70 to \$3.30 a share. In April, it predicted \$3.50 to \$4.30 a share. Late Payments Countrywide retains a portion of the loans it packages and sells to investors. The value of those "residuals" declines as borrowers miss payments on the underlying loans. The company said late payments picked up on home-equity loans that were used as collateral on such securities, hurting profit by 40 cents a share. **The provision for loan losses jumped to \$292.9 million from \$61.9 million a year earlier, as it set aside \$181 million for prime home-equity loans in its banking unit. [please re-read this if you wish to believe that the problem is contained – this is not a typo – these are PRIME, not SUB-PRIME loans]** U.S. home sales in 2007 will drop to their lowest level since the start of the five-year housing boom in 2001, Freddie Mac forecast on July 9. The world's second-largest mortgage buyer said buyers are finding it more difficult to finance purchases because of higher mortgage rates and stricter lending guidelines. Home Sales Drop Mortgage-banking earnings for the quarter fell to \$320 million from \$630 million a year earlier. The company made \$183 million from selling subprime loans to investors, down from \$200 million. Gain-on-sale from prime loans, or those to borrowers with better credit, rose to \$1.04 billion from \$972 million. Countrywide extended \$123.1 billion in new loans, a 15 percent rise from a year earlier. **Countrywide's Net Declines 33 Percent on Home-Equity**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=amhxbSYFnM0Y&refer=home>

Macro Economic

- July 23 (Bloomberg) -- The rising cost of goods the U.S. imports from China may be an early warning signal that central bankers from the U.K. to India are about to pay a price for a cause they've championed: globalization. China, a source of cheap manufactured products for the past two decades, may be starting to export inflation as the world economy grows at the fastest pace in a generation. Prices of U.S. imports from China increased 0.3 percent in May from the previous month -- "the first sign I've seen that this

disinflationary pressure" from China's cheap goods may be fading, former Federal Reserve Chairman Alan Greenspan said last month. Prices rose 0.3 percent again in June, the biggest back-to-back increase since record-keeping began in December 2003. With monetary policy makers struggling to contain pressures from other forces beyond their control -- increased trade, faster capital flows and record commodity prices -- officials including Bank of England Governor Mervyn King and New Zealand's central bank Governor Alan Bollard may have to raise interest rates or maintain them at higher levels for longer than they might prefer. "Domestic monetary policies may nowadays be less potent in controlling domestic inflation than in the past, a disturbing thought for central bankers," says Joachim Fels, chief global fixed-income economist at Morgan Stanley in London.

Complicating Policy The increasing integration of the world's economies isn't fully understood, even by those who have benefited the most from expanding international trade and investment. Fed Chairman Ben S. Bernanke has said it may complicate policy making, and the benefits of cheaper imported goods are, at least, countered by higher costs for raw materials and energy. Booming global demand is already forcing up food and commodity prices and squeezing spare productive capacity at a time when more investment from abroad weakens central banks' grip on the supply of money in their economies. The International Monetary Fund predicts that the amount of slack will shrink to 0.1 percent of global gross domestic product in 2008 from 0.4 percent last year. Officials and economists will debate the shifting dynamics of globalization and its impact on monetary policy during the next two days at the European Central Bank in Frankfurt. Speakers at an invitation-only forum include ECB President Jean-Claude Trichet and Fed Governor Frederic Mishkin.

Quickest Pace The conference comes as China, the world's fourth-largest economy, reports the quickest pace of growth in a dozen years, pushing inflation to 4.4 percent in June. On July 21, China raised its benchmark rate to an eight-year high of 6.84 percent. In the past, central bankers have harnessed the effects of low-cost production from China and other countries such as India to hold down interest rates and stimulate domestic growth. The Organization for Economic Cooperation and Development in Paris estimates that globalization knocked as much as 0.2 percentage point off inflation in rich nations from 2000 to 2005, even as the world economy sped up and buoyed raw-material costs. Now, when "inflation is above target, the cost of reducing it has been increased," says Robert Lind, chief economist at ABN Amro Holding NV in London. Interest rates in the U.K. and the 13-nation euro area are already the highest in six years, with officials hinting more changes may be on the way.

A 'Growing' Risk The Bank of England's policy makers highlighted import prices as a "growing" inflation risk and one of the reasons for this month's increase in the benchmark rate to 5.75 percent. It isn't only the cost of imported goods that troubles King. On May 16 he said that British house prices are "heavily influenced by what is happening overseas, independent of U.K. monetary policy," as wealthy foreigners purchase property. New Zealand's Bollard is expected to raise the official cash rate to a record 8.25 percent this week, in part because overseas orders for butter and milk are pushing up dairy prices. The Bank of Canada this month increased its key rate for the first time in more than a year to 4.5 percent partly because of surging investment in the western province of Alberta to develop the world's largest pool of oil reserves outside the Middle East.

China's Exported Inflation May Signal Interest-Rate Pressures

<http://www.bloomberg.com/apps/news?pid=20601087&sid=a8DNBoVWx36M&refer=home>

Retail

Retirement

[I saw this and thought it might be of interest to some of you. As most of you know by now, I think the upcoming currency freefall will make even cd's risky investments, so view cds as a way to lose money more slowly.]

CDARS: Seeing the Forest for the Trees

Hey, Big Saver, it's now possible to receive up to \$30 mln in **Federal Deposit Insurance Corp.** coverage through multiple CDs at one bank. The Certificate of Deposit Account Registry Service – CDARS, or “cedars”, like the trees – saves running around town and dealing with several banks to keep your CDs below the \$100,000 threshold for FDIC coverage. Through the program, your funds are split into amounts below the FDIC limit and divided among member banks to ensure full coverage. CDARS is a deposit placement service offered through the Promontory Interfinancial Network. It's designed to help community and regional banks attract and retain large deposits.

Here's how CDARS works:

- You make deposits through a single member bank.
- Your funds are divided into CDs of less than \$100,000 each to ensure that principal and interest receive full FDIC insurance coverage.
- The CDs are issued to member banks in the Promontory Interfinancial Network.
- When funds are sent out of one bank, an equal amount is sent to the originating bank from other members of the network. This keeps the entire amount of the deposit in the community of origin while assuring full FDIC coverage.
- A bank making CDARS transactions can select its own interest rate and therefore doesn't have to pay an artificially high national brokered rate to attract new funds.
- The smart customer therefore shops around for the best rate.
- The customer deals with one bank, receives one monthly statement and earns a single interest rate.

In general, local or regional banks offer the CDARS program while major banks such as **JP Morgan Chase (JPM)**, **Wells Fargo (WFC)** and **Wachovia (WB)** do not. The CDARS program is available through 1,650 banks in all 50 states and the District of Columbia – think Apple Bank for Savings, Security First Bank of North Dakota or Alaska First Bank & Trust.

The American Bankers Association has endorsed the product, saying “CDARS allows banks to offer customers security as well as the convenience of one-stop shopping. It’s good for banks, depositors and the economy.”

[Click here to see a slideshow of expert tips and facts about the CDARS program!](#)

Risk

Savings Rate

Tech

- July 23 (Bloomberg) -- Texas Instruments Inc., the largest maker of mobile-phone chips, reported a 74 percent drop in second-quarter profit after the sale of a sensors business last year. The shares fell after revenue missed analysts' estimates. Net income dropped to \$610 million, or 42 cents a share, from \$2.39 billion, or \$1.50 a share, in the same period a year ago, the Dallas-based company said today in a statement. Revenue declined 7.4 percent to \$3.42 billion, trailing analysts' average estimate of \$3.45 billion. Chief Executive Officer Rich Templeton sold the sensors unit last year, part of an effort to focus on more profitable products as sales slow. The company blamed its shrinking revenue last quarter on “lower demand across a broad base of products.” **Texas Instruments Profit Falls 74% After Sale of Unit**
http://www.bloomberg.com/apps/news?pid=20601087&sid=a7l_7xDjaNc8&refer=home

Wall Street

- **[this is much like the seven tobacco heads stating in front of a Congressional Subcommittee that they had no evidence smoking caused cancer]** July 23 (Bloomberg) -- **On Wall Street, where the most lucrative credit markets are barely limping thanks to the worst housing slump in a decade, there isn't a chief executive officer who will tell you there is a crisis. [we will see won't we]** A few weeks after **Merrill Lynch & Co. CEO Stanley O'Neal said he saw “no clear signs” [he might wish to visit his optometrist]** that rising delinquencies on subprime U.S. mortgages were hurting the rest of the debt markets, borrowing costs for non-investment grade companies rose to the highest in nine months. ServiceMaster Co., US Foodservice and 19 other companies have canceled bond sales because nobody wants to buy them. JPMorgan Chase & Co. CEO Jamie Dimon told investors on a July 18 conference call that waning demand for loans used in leveraged buyouts was “a little freeze.” Two days later, an index that measures the default risk of the loans weakened to a record. Investors' confidence is being shaken as losses spread beyond subprime mortgage securities to corporate financings. Federal Reserve Chairman Ben S. Bernanke said July 19 that he's watching for signs that falling housing prices have spilled over to the rest of the economy, citing studies that show credit market losses from subprime mortgages may reach \$100 billion. “I don't think anybody

can say with great conviction that this is an isolated problem to a couple of small mortgage companies," said Walter Todd, a fund manager at Greenwood Capital Associates in Greenwood, South Carolina, who helps oversee about \$800 million. `No Disaster' June was the worst month for U.S. high-yield bonds in almost two years, with a loss of 1.69 percent, indexes created by New York-based Merrill that track the performance of fixed-income assets show. They're down another 1 percent in July. O'Neal told a gathering of state treasurers in New York last week that ``not even a sharp downturn in one market today necessarily portends financial disaster in another." [ask LTCM about that] `A Challenge' Lehman Brothers Holdings Inc. Chief Financial Officer Christopher O'Meara told investors on a June 12 conference call that ``**we continue to believe that subprime market challenges are and will continue to be reasonably contained.**" Bear Stearns Cos. CFO Sam Molinaro told analysts on June 14 that while the declining value of subprime bonds was ``a challenge" for the firm, ``**it hasn't spilled into other areas of the market.**" ``Subprime continues to be weak" and yet ``**there's very little effect on other credit markets,**" David Viniar, the CFO of Goldman, said on a June 14 conference call with reporters **The comments from Molinaro and Viniar came five days before Bear Stearns offered to provide \$3.2 billion in loans to help rescue a money-losing hedge fund.** The fund, run by its asset- management unit, invested in subprime mortgage-related securities. The amount was later lowered to \$1.6 billion. **No Contagion** Goldman Sachs is the world's biggest fixed-income, currency and commodity trader, with \$14.3 billion of revenue from those markets last year. It also manages the largest buyout fund and collects the most fees from private-equity firms. Securities firms worldwide got about \$27.4 billion in revenue last year from underwriting, trading and holding bonds backed by mortgages and other assets, according to a June 4 report by Kian Abouhossein, a London-based analyst at JPMorgan. **Executives last week said shrinking demand for high-yield debt won't pose a serious problem.** Jeff Edwards, Merrill's CFO, said it reflects ``selectivity" that's ``healthy." Merrill Lynch is a passive minority investor in Bloomberg LP, the parent of Bloomberg News. Dimon of New York-based JPMorgan, the largest arranger of loans rated below investment grade, said he isn't ``particularly concerned" about loans that the bank has been stuck with after failing to sell them to investors. Wall Street CEOs and CFOs ``are talking their books," said Tim Backshall, chief strategist at Credit Derivatives Research LLC, a Walnut Creek, California-based firm that advises clients on how to invest in the market for credit-default protection. ``The amount of talking seems to indicate they are worried." **CEOs See `No Clear Signs' of Crisis as Woes Intensify**
http://www.bloomberg.com/apps/news?pid=20601109&sid=aP8R7z4eB_cU&refer=home

I Disagree . . . and why

Article of the week:

UM EMBA