

The Other Side of the Street March 9, 2008

Comments

This is another “catch up” where I am writing the comments on March 23 (and it is too late in the evening for comments).

Stock Notes

- In corporate news, **Intel's (INTC, \$20.00, -0.01, Spy)** stock closed relatively flat after the company lowered its profit margin outlook saying lower memory chip prices are taking a toll. The world's largest semiconductor maker said slumping prices for NAND flash would hurt profits more than expected. As such, Intel expects first-quarter profit margin to be 54% of revenue, give or take a percentage point. Previously, the company had estimated its profit margin to come in at 56% of revenue, with a similar range for error. Intel said all other guidance would remain unchanged, and it still expects to report revenue between \$9.4-\$10 billion dollars, versus analyst forecasts for sales of \$9.7 billion.
- **Carlyle Capital, a publicly traded affiliate of the Carlyle Group, said today it is experiencing the same default notices and margin call woes as we reported Thornburg Mortgage as having yesterday.** Lenders have begun liquidating securities from Carlyle Capital's \$21 billion portfolio. The group claims losses from its mortgage-backed portfolio have left it unable to repay its debts. Carlyle Capital's shares, which trade in Europe, fell 60% yesterday. We mention this for two reasons. One -- another seemingly safe investment group is biting the dust. Two -- the Carlyle Group is one of the most powerful, globally connected private equity joints on the planet. We can't help but think that if it couldn't dodge this bullet, no one can.
- In corporate news, Thornburg Mortgage (TMA, \$1.79, 0.14, Spy) said today that the \$610 million outstanding margin call it received "significantly exceeded its available liquidity." The jumbo mortgage lender also announced that it will restate its 2007 results in order to reflect the decline in value of its mortgage portfolio. Thornburg added that its liquidity issues combined with declining mortgage prices "have raised substantial doubt about the company's ability to continue as a going concern." Thornburg's stock plummeted, before rallying to close up 8.5%.
- **Standard & Poor's cut the credit rating of Washington Mutual yesterday.** WaMu, the U.S.'s largest savings and loan, now rests on the lowest rung of investment grade credit ratings, BBB. "We now believe that the severity of losses on all residential mortgages will be higher," said an S&P spokesperson, "and that the weak housing market will now be a longer cycle." WaMu stock fell 7% on the news and is now down over 60% in the past two quarters. This morning, The Wall Street Journal leaked news the bank is aggressively seeking injections from private equity firms and global sovereign wealth funds.

Notes

- Morgan Stanley's Stephen Roach: "The current recession has been set off by the simultaneous bursting of property and credit bubbles. The unwinding of these excesses is likely to exact a lasting toll on both homebuilders and American consumers. Those two economic sectors collectively peaked at 78 percent of gross domestic product, or fully six times the share of the sector that pushed the country into recession seven years ago. "For asset-dependent, bubble-prone economies, a cyclical recovery – even when assisted by aggressive monetary and fiscal accommodation – isn't a given. Over the past six years, income-short consumers made up for the weak increases in their paychecks by extracting equity from the housing bubble through cut-rate borrowing that was subsidized by the credit bubble. That game is now over." Roach goes on to compare America, circa 2008, to Japan at the end of the '80s. Japan ran loose credit policies in the '80s, which led to bubbles in stocks and property. America's loose monetary policies of the '90s led to a bubble in the stock market...and then an even bigger bubble in housing in the '00s. Faced with a meltdown in the '90s, Japanese authorities knew they had to 'do something' and they did – they took the recommended doses of both fiscal and monetary policy. But the medicine didn't work. "The toughest, and potentially most relevant, lesson to take from Japan's economy in the 1990s," Roach continues, "was that the interplay between financial and real economic bubbles causes serious damage. An equally lethal interplay between the bursting of housing and credit bubbles is now at work in the United States. "American authorities, especially Federal Reserve officials, harbor the mistaken belief that swift action can forestall a Japan-like collapse. The greater imperative is to avoid toxic asset bubbles in the first place. Steeped in denial and engulfed by election-year myopia, Washington remains oblivious of the dangers ahead."
- Jobs took a hit this morning, too. **U.S. nonfarm jobs fell by 63,000 last month, the Labor Department reports.** January numbers got revised down, too... from minus 17,000 jobs to minus 22,000. That's an "official" two-month, back-to-back loss in jobs. Worth noting, because in the past 40 years, there have never been two consecutive months of job losses that didn't coincide with a recession.
- Meanwhile, the unemployment rate declined slightly from 4.9% to 4.8%. Wait, did you say the unemployment rate *declined*? How did that happen? The unemployment rate is calculated using a separate household survey. The slight drop was triggered by a 450,000 decline in the size of the labor force, not a rise in employment. In other words, more people dropped out of the workforce last month and simply stopped looking for work. Also of interest in the report was the large increase over the past 12 months in the number of people working part time for economic reasons. According to the Bureau of Labor Statistics, this category includes people who would like to work full time but were working part time because their hours had been cut back or they were unable to find full-time jobs. That number, 4.9 million, was largely unchanged month over month, but was up by 637,000 over the past year. The unemployment rate may have edged lower, but the unemployment rate continues to increase.
- GM Vice Chairman Bob Lutz called industrywide sales last month "very disappointing" and said the difficult market conditions could continue for some time. **"We're in a very**

uncertain period," he said. "We still expect the economy to recover in the second half but it's by no means certain."

- The public's bill for maintaining **foreclosed properties** abandoned by lenders and investors may reach as much as \$50 billion this year, according to **Peter Sepp**, vice president of the **National Taxpayers Union** in Alexandria, Virginia. The U.S. Congress is considering various **bills** to help cover some of the costs to towns and cities for securing and policing the empty homes, Sepp said. "Our kids and our grandkids are going to be paying to take care of these properties, because the cost, at least at the federal level, will have to have to be financed through borrowing," Sepp said. U.S. Senate Majority Leader **Harry Reid**, a Nevada Democrat, introduced legislation last month to authorize \$4 billion in **federal funds** to help cities and towns maintain or demolish foreclosed properties. That dwarfs three similar bills now in Congressional subcommittees each seeking \$1 billion. Municipalities will see a decline in revenue from property taxes as **real estate prices** drop and foreclosures sap value from the surrounding neighborhoods, Moody's Zandi said. This year 1 million more homes will be **seized** by mortgage holders, Zandi estimates. Every foreclosed **property** reduces the worth of about 18 nearby homes, the Center for Responsible Lending said in a Feb. 25 report. That decline in real estate values may lower the tax base for cities and towns by as much as \$356 billion in 2008 and 2009, according to the Durham, North Carolina-based group.
- "About 10 months ago, mutual funds had one of the lowest cash ratios ever. They were fully loaded up with stocks. Now they realize that was a mistake. They must get liquid. And that's done by selling." Bert Dohmen's Smarte Trader
- Wild swings in the price of natural gas futures were crushing a Houston-based hedge fund. That fund **turned out to be Saracen Energy**. The fund supposedly took a short position in March 2009 gas futures and long April 2009, and got crushed between the trades as the prices fluctuated wildly. So how much did Saracen lose? Reuters put the losses at \$400 million. Platts had said \$700 million. Now Energy Hedge, a hedge fund newsletter, reports that the fund may have lost 41% of its assets in the trade. According to a 2006 report, Saracen had a market value of \$1.4 billion. The newsletter notes that Centaurus is also said to have lost money on natural gas trades this winter.
- U.S. retailers reported less-than-stellar results for February as a slowing economy weighed on consumers. However, for several companies sales exceeded expectations, easing some of the gloom in the sector. Wal-Mart posted a better-than-expected 2.6% increase in sales at its U.S. stores open at least a year, excluding fuel sales. Leading the way was "continued strength in the grocery, health and wellness and entertainment" segments, Wal-Mart said. The company forecast March sales at flat to up 2%.
- Merrill Lynch will discontinue mortgage originations and amended the terms of some notes, while Carlyle Capital said it failed to meet some margin calls. Merrill Lynch (MER \$49) is down after saying it will discontinue mortgage origination at its First Franklin subsidiary and will explore the sale of Home Loan Services. Merrill also said it is amending a notes offer by raising the conversion rate. Separately, Carlyle Capital (CARYF \$12), a division of the privately-held Carlyle Group, is adding to credit jitters after failing to meet a margin call of \$37 million on its \$22 billion portfolio of residential-backed mortgages. Carlyle said it expects to receive more notices.

Weblinks

Credit

- March 4, 2008 - WASHINGTON — Comptroller of the Currency John C. Dugan told a Senate Committee today that while the banking system is fundamentally sound, **it is being tested by large and unprecedented credit market disruptions plus the slowdown in the economy.** “Thus far national banks have been able to address a number of significant problems that have arisen while continuing to supply credit and other banking services to the U.S. economy – although there is no doubt that **credit standards have tightened,**” he said in testimony before the Senate Committee on Banking, Housing and Urban Affairs. **The Comptroller cited the liquidity support a number of large banks provided to asset-backed commercial paper conduits and structured investment vehicles or SIVs – often involving the painful recognition of losses – to restore more normal funding in these markets.** “Likewise, banks with concentrated positions in collateralized debt obligations backed by subprime asset-backed securities have recognized large losses – but have also raised large amounts of capital to offset these and other losses,” he said. However, significant market disruption issues remain to be addressed, such as the potential downgrades of monoline insurance companies; significant funding problems in the auction rate securities market; and severe constriction in the securitization markets for residential mortgage-backed securities, commercial mortgage-backed securities, and leveraged loans, he said. In addition, the economic slowdown and problems in the housing market have led to significant increases in reserves banks carry for such assets as residential construction and development loans; home equity loans; and credit card loans, Mr. Dugan said. **Community banks, with large concentrations in commercial real estate—and there are many of them—face real challenges in those parts of the country where real estate markets have slowed significantly.** “Unlike the unprecedented market disruptions of the last six months, these more traditional credit problems are familiar territory to bankers and supervisors,” he said. “The key to addressing them is for bankers to recognize problems early and manage through them, and that is exactly what our examiners are working with them to do.” The Comptroller also said there is a need to reemphasize some fundamental banking principles, including sound underwriting, diversification of funding sources, strong internal controls and risk management, and timely recognition of losses. “In each of these four areas – asset quality, liquidity, risk management, and reserves and capital – we remain alert to emerging trends and to findings that may trigger additional supervisory action,” he said. The Comptroller also said that current efforts to address foreclosure prevention and mitigation are very important to the OCC, since the nine largest national banks act as servicers for about 40 percent of all U.S. mortgages, including a significant number of subprime mortgages. Mr. Dugan said the OCC has supported a number of important efforts, including the work of the HOPE NOW alliance, and noted that last week the agency launched a new initiative that would require the largest national banks to report

key data on mortgages, including mortgage modifications. "We are requiring our largest national bank servicers to provide standardized reports on a range of mortgage metrics, not just for subprime adjustable rate mortgages, but for all mortgages," he said. "These data, which are consistent with the HOPE NOW metrics, will provide an important way to track mortgage performance against a broad range of indicators." Comptroller of the Currency John C. Dugan (<http://www.occ.gov/dugan.htm>)

- **The Federal Reserve plans to increase its loans to banks this month as part of the ongoing Term Auction Facility operations. The Fed increased to \$50 billion each from \$30 billion the amount intended for auctions of funds planned for March 10 and March 24. What are these Term Auction Facilities and what does the increase mean?** In order to understand it, let's step back to last November for a moment and consider again why cash-strapped banks were not lined up at the Fed's Discount window to fill their pockets. The Fed's Discount rate is the cost of money available to Big Banks through the Fed's Discount "window." **The Fed is considered the lender of last resort for banks, which usually borrow from each other. So the stigma from borrowing publicly through the Fed's Discount window is pretty severe.** In fact, it's severe enough that some capital-starved banks have been selling off stakes to outside investors under less attractive terms. The Discount window is really the Payday Loan shop for banks, although the lending terms are far more attractive than Payday Loan terms. The problem is, who wants their neighbors to see them standing in line at the Payday Loan shack? **To get around this stigma, and to broaden the types of collateral banks could pledge, the Fed introduced the Term Auction Facility operations in December. The TAF's allow banks to borrow anonymously. How many banks are using it? A lot. The most recent auction included 72 banks.** In the statement released today on the Term Auction Facility expansion, the Fed noted (as they did back in December) that there is global coordination among central banks to ease credit conditions. "The Federal Reserve is in close consultation with foreign central bank counterparts concerning liquidity conditions in markets," the statement concluded at the bottom. Global coordination. Wow. Some have said today that we are seeing something unprecedented. But are we really? To understand the present credit market conditions in context, we need to go back to... *Shhhhh... don't say this too loudly...* 1930. What happened in 1930? The formation of the Bank for International Settlements (BIS). The BIS essentially laid the groundwork for global coordinated liquidity facilitation. After the end of World War I there was a deep distrust among countries, which magnified the global credit contraction conditions. Debt was massive at that time. Global markets seized up. According to Gianni Toniolo, author of "Central Bank Cooperation at the Bank for International Settlements, 1930-1973," Montagu Norman, governor of the Bank of England, wrote a letter in 1925 to his counterpart at the Federal Reserve Bank of New York, Benjamin Strong, saying, "I rather hope that next summer, we may be able to inaugurate a private and eclectic Central Banks' 'Club,' small at first, large in the future." That "hope" eventually became the BIS. Calm down, conspiracy theorists. The purpose was less nefarious than pragmatic. How can borrowing and lending begin again if no one wants to borrow or lend? Just as hyperinflations don't distinguish between productive and non-productive capital avenues, neither do deflationary credit contractions. It is easy to say with righteous indignation Just let the markets run their course!... until we are part of the course over which those markets are trampling. There's just one little problem. The

BIS was initially a failure. Among the first loans the bank intermediated were packages to Austria and Germany, neither of which helped those countries avoid financial crises. What is important is not that the BIS failed to stop financial crises, but why. The answer is that markets eventually chew through fiscal and monetary intervention in spite of us. So frequently - in fact, almost always - the cure is far worse than the disease. Just something to think about. Minyanville

- March 7 (Bloomberg) -- **MBIA Inc.**, under threat of a downgrade, asked Fitch Ratings to stop issuing credit rankings on its insurance units, saying the grades have become less valuable to investors, of little use to the company and too expensive to maintain. MBIA, the world's largest bond insurer, requested Fitch withdraw its financial strength ratings on units including the AAA rated MBIA Insurance Corp., the company said in a statement today. Fitch has been reviewing the rankings because of concern that Armonk, New York-based MBIA may not have enough capital to cushion losses on mortgage-linked securities it guaranteed. **“The fact that they requested the withdrawal of the rating takes a lot of gall,”** said **Martin Weiss**, president of Weiss Research in Jupiter, Florida, a financial company researcher. Fitch is alone among the top credit rating companies in continuing to consider a downgrade of MBIA. Moody's Investors Service and Standard & Poor's both affirmed the company last week on the heels of MBIA raising \$3 billion in capital, eliminating its **dividend** and shutting its asset-backed insurance business for six months to overcome losses on subprime mortgages. New York-based Fitch responded to MBIA's statement with a public release defending its research and fees. Fitch also included the letter from new MBIA Chief Executive Officer **Jay Brown** to **Keith Buckley**, managing director of Fitch's insurance ratings, and questioned whether it would be capable of properly evaluating the rankings without MBIA's cooperation. **“The unique nature of the financial guaranty sector could make maintaining the MBIA IFS and debt ratings difficult without access to the non-public details on their insured portfolio,”** Fitch said in a statement released late today. **‘Incompatible’** Less than 15 minutes later, MBIA sent out a second statement that raised the issue of how Fitch's ratings methods differ from other credit-rating companies. **“Fitch's coverage of the underlying credit quality of the transactions that MBIA insures is limited, and in turbulent times, the impact of this difference becomes significant, raising the risk of misinterpretation,”** MBIA said. **Fitch has been tougher on the bond insurers than Moody's and S&P, and has been proven right,** Weiss said. On Jan. 18, Fitch cut Ambac Financial Group Inc.'s insurance company rating to AA from AAA and may reduce the rating further. Fitch cited **“significant uncertainty with respect to the company's franchise, business model and strategic direction.”** MBIA disagrees with Fitch's model for capital allocation, spokesman **Willard Hill** said. He said MBIA doesn't know if Fitch plans to comply with its request. **“This is something we have been evaluating for a long time,”** Hill said. **“We're not aware of Fitch's current plans or intentions.”** **Fitch is demanding MBIA have more capital than required by S&P and Moody's to support the asset-backed securities it guarantees,** Hill said. That is **“incompatible”** with MBIA's plans to separate the company's businesses in the next five years, he said. **MBIA, Facing Downgrade, Asks Fitch to Stop Rating**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=allQb4NraLko&refer=home>

- March 7 (Bloomberg) -- **U.S. consumer borrowing rose in January as Americans spent twice as much on their credit cards as they did a month earlier. [keeping in mind the month before was December, this should scare you into next week]** Consumer credit increased by \$6.9 billion to \$2.52 trillion, the Fed said today in Washington. In December, credit gained \$3.7 billion, less than a previously reported increase of \$4.5 billion. The figures don't include borrowing secured by real estate, such as home-equity loans. **People once dependent on home-equity financing are turning to other forms of short-term financing after the collapse in subprime mortgages made it harder to qualify for loans. Personal income in January rose at a slower pace than inflation, and credit card usage in January rose for a second straight month.** "There's not much gas left in the tank," said Chris Rupkey, chief financial economist at Bank of Tokyo-Mitsubishi UFJ Ltd. in New York. "In the early stage of a recession, consumers tend to rely on credit cards to see them through the hard times." Economists had forecast January credit would expand by \$7 billion, according to the median of estimates in a Bloomberg News survey. After adjusting for inflation, spending stalled for a second month in January, increasing concern that the economy is headed for a recession. Consumer purchases account for two-thirds of the economy. Credit Cards Total borrowing increased at a 3.3 percent annual rate in January after rising at a 1.8 percent pace during December. **By category, revolving debt such as credit cards rose \$5.5 billion during January** and non-revolving debt, including auto loans, increased \$1.4 billion for the month. **It was the second-biggest January increase in revolving credit in the past decade, a period in which that category of borrowing averaged \$3.2 billion for the first month of the year.** Revolving debt is the kind that's capped at a designated amount and on which periodic payments are made. **Earlier today, the Labor Department said the U.S. lost jobs in February for the second consecutive month, adding to evidence the economy is already in a recession. Payrolls fell by 63,000, the most in five years, after a revised decline of 22,000 in January.** Lower Rates At its Jan. 30 session, the Fed panel lowered the rate by a half percentage point to 3 percent for the fifth reduction since September. Commercial banks, in turn, lowered their prime lending rate to 6 percent from 6.5 percent. The housing contraction, now in its third year, has hurt both borrowers and lenders. Mortgage foreclosures rose to an all-time high at the end of 2007 as borrowers with adjustable-rate loans surrendered their properties, the Mortgage Bankers Association said yesterday. Late payments and charge-off rates on credit cards will probably increase for the next year, according to a Feb. 11 statement by Moody's Investors Service in New York. **U.S. Consumer Borrowing Rose, Led by Credit Cards**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ad.CTXk312Y0&refer=home>
- March 6 (Bloomberg) – **[this was the wimper – the “bailout that wasn’t, but which twice cause tens of billions to change hand as the wall street shills pumped the market with rumors]** Ambac Financial Group Inc., the bond insurer seeking capital to salvage its AAA credit rating, raised \$1.25 billion in a sale of common shares. The 185.2 million shares were sold at \$6.75, compared with today's closing price of \$7.42. The company also plans to sell equity units, convertible into shares in 2011. Credit Suisse Group, Citigroup Inc., Bank of America Corp. and UBS AG managed the sale. The shares have fallen 95 percent since May, giving the company a market value of about \$754 million at

the close of trading on the New York Stock Exchange today. Ambac is scrambling to raise capital to save its AAA credit rating, which backs about \$556 billion of municipal and structured finance bonds. New York-based Moody's Investors Service and Standard & Poor's have said they may affirm Ambac's top rating following the equity sale. "Ambac's capital raise might save the company's AAA ratings in the short term, but the outlook for continued writedowns and impairment to capital clearly indicates that this is not an AAA industry," said [Peter Plaut](#), an analyst at hedge fund Sanno Point Capital Management in New York, before the sale was announced. **Ambac Raises \$1.25 Billion of Common Shares to Keep AAA Rating**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a4wvb.kZkuY8&refer=home>

- March 6 (Bloomberg) -- The cost to protect corporate bonds from default soared to a record as hedge fund failures and rising bank funding costs stoked concern that a financial institution may collapse. Credit-default swaps tied to Citigroup Inc., Bank of America Corp., JPMorgan Chase & Co. and Wachovia Corp., the nation's four biggest banks, climbed to the highest on record. Benchmark gauges of credit risk in the U.S., Europe and Asia also set records. Contracts on CIT Group Inc., the largest independent commercial finance company in the U.S., approached distressed levels. "There's so much concern about a market failure," said [Gregory Peters](#), head of credit strategy at Morgan Stanley in New York. "It's a situation where there's just a general lack of trust, and there's a heightened fear of the unknown." The perceived risk rose as Carlyle Group's publicly traded mortgage bond fund failed to meet margin calls and investors speculated that [Ambac Financial Group Inc.](#), the world's second- biggest bond insurer, won't be able to raise enough capital to keep the AAA rating that it stamped on \$556 billion of securities. Washington Mutual Inc., the largest U.S. savings and loan, had its credit ratings lowered to two steps above junk by Standard & Poor's as a report showed mortgage [foreclosures](#) rose to an all-time high at the end of 2007. Speculation also increased that New Mexico mortgage lender Thornburg Mortgage Inc. will be forced into bankruptcy after the company said it received a default notice from its bankers. "Never, Ever" Credit-default swaps on the benchmark CDX North America Investment-Grade Index climbed as much as 21.5 basis points to a record 186 basis points, according to Deutsche Bank AG. The index, which ended the day at 185, has surged more than 107 basis points this year. "I've been in this market for 30 years, I'm one of the senior citizens of the bond market, and I have never, ever seen such a confluence of negative events," said [Marilyn Cohen](#), who manages \$215 million in fixed income investments as president of Envision Capital Management in Los Angeles. "Clearly the Fed has been rendered impotent on doing anything to end this credit crisis." Credit-default swaps on New York-based [Citigroup](#), the biggest U.S. bank by assets, climbed 17 basis points to 207 basis points, according to broker Phoenix Partners Group. Contracts on Bank of America and JPMorgan, the second- and third-biggest banks, rose 15 basis points to 135, Phoenix prices show. Charlotte, North Carolina-based Wachovia jumped 55 basis points to 305 basis points. Risk of Default Sellers of contracts on CIT demanded 16 percent upfront and 5 percent a year to protect the New York-based company's bonds from default for five years, according to Phoenix. That means it costs \$1.6 million initially and \$500,000 a year to protect \$10 million in CIT bonds. The cost is up from \$740,000 a year

yesterday. Upfront payments are demanded when investors see a heightened risk of imminent default. Contracts on Seattle-based Washington Mutual increased 158 basis points to a record 700 basis points, according to CMA Datavision. Credit-default swaps are financial instruments based on bonds and loans that are used to speculate on a company's ability to repay debt. A rise indicates deterioration in the perception of credit quality; a decline, the opposite. The **extra yield** investors demand to own investment-grade bonds rather than Treasuries widened 8 basis points to 272 basis points, matching a record high set in 2002, according to Merrill Lynch & Co. Spreads last reached that level on Oct. 10, 2002, according to Merrill Lynch index data, three months after WorldCom Inc. filed for the largest bankruptcy in history. Raise Capital Ambac, which needs to raise capital to preserve its AAA rating because of potential losses on mortgage-linked securities it guaranteed, said yesterday it will seek to raise \$1.5 billion through equity offerings. That disappointed investors who were expecting as much as \$3 billion in capital that would be backed by banks. It also fueled concern that bank balance sheets are being squeezed, said **Chuck Moon**, head of investment-grade credit at Hartford Investment Management Co. in Hartford, Connecticut. "It put a lot of fear in the marketplace as to whether or not that meant any concerns by the banks themselves about their capital or liquidity situations," Moon, who manages about \$30 billion in investment-grade credit, said in an interview. The world's banks and securities firms have reported \$181 billion in asset writedowns and credit losses since the beginning of 2007. Bear Stearns Credit-default swaps on Bear Stearns Cos., the securities firm that had its first-ever loss last quarter because of mortgage-asset writedowns, rose 60 basis points to 405, Phoenix prices show. The widening on the banks and securities firms contracts has been exacerbated by growing concerns that clients on the other side of trades will lose money if companies can't meet their obligations. A hedge fund, for example, that has \$200 million in trades with a bank may seek to limit some of that risk by buying credit-default swap protection on the bank itself. "Everybody is keyed on risk management in this environment," said **John Tierney**, a strategist at Deutsche Bank in New York. "I would suspect a fair amount of institutions are basically just hedging more as standard operating procedures." Credit-default swaps pay the buyer face value in exchange for the underlying securities or the cash equivalent should a borrower fail to adhere to its debt agreements. A basis point on a credit-default swap contract protecting \$10 million of debt from default for five years is equivalent to \$1,000 a year. Contracts on the Markit iTraxx Europe index of 125 companies with investment-grade ratings rose 14.5 basis points to 142, JPMorgan Chase & Co. prices show. The Markit iTraxx Crossover Index of 50 companies with mostly high-risk, high-yield credit ratings increased 35 basis points to 617. In Asia, the Markit iTraxx Japan index rose 10 basis points to a record 134.5 in Tokyo, Morgan Stanley prices show. **Corporate Bond Risk Soars as Concerns of Bank Failures** **Grow**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=a6W8u14KzJh4&refer=home>

- March 6 (Bloomberg) -- **Yields on agency mortgage-backed securities rose to a new 22-year high relative to U.S. Treasuries as banks stepped up margin calls and concerns grew that the Federal Reserve may be unable to curb the credit slump.** The difference in yields, or spread, on the Bloomberg index for **Fannie Mae's** current-coupon, 30-year fixed-rate mortgage bonds and 10-year government notes widened about 21 basis

points, to 237 basis points, the highest since 1986 and 103 basis points higher than on Jan. 15. The spread helps determine the interest rate homeowners pay on new prime mortgages of \$417,000 or less. The markets have become "utterly unhinged," William O'Donnell, a UBS AG government bond strategist in Stamford, Connecticut, wrote in a note to clients today. A lack of liquidity has "led to stunning air-pockets in price levels."

Investors are realizing that banks have little room to make new investments amid rising losses and a flood of unwanted assets, said Scott Simon, head of mortgage-backed bonds at Pacific Investment Management Co. The world's top banks have reported more than \$181 billion in asset writedowns and losses, been stuck with \$160 billion of leveraged buyout loans, and bailed out \$159 billion of structured investment vehicles. "Everything is telling you the financial system is broken," Simon, whose Newport Beach, California-based unit of Allianz SE manages the world's largest bond fund, said in a telephone interview today. "Everybody's in de-levering mode." Agency mortgage securities outstanding, which are guaranteed by government-chartered Fannie Mae and Freddie Mac or federal agency Ginnie Mae, total almost \$4.5 trillion, about the same size as the U.S. Treasury market. No Savior The widening spreads prompted speculation the government may step in to support securities guaranteed by Fannie Mae and Freddie Mac, said Tom di Galoma, head of U.S. Treasury trading in New York at Jefferies & Co., a brokerage for institutional investors. The Treasury Department said the rumor isn't true. **"The Fed can't really save the mortgage market," di Galoma said. "As they keep cutting, mortgage rates aren't going lower."** The spread of current-coupon fixed-rated securities guaranteed by Ginnie Mae against 10-year Treasuries has climbed 55 basis points this month to 205 basis points, also the highest since the 1980s, according to Bloomberg data. Debt guaranteed by Ginnie Mae is explicitly backed by the U.S. government, and based on loans already insured or guaranteed by its agencies. A basis point is 0.01 percentage point. Carlyle Margin Call Carlyle Group's publicly traded mortgage bond fund, which raised \$300 million in July and used loans to buy about \$22 billion of agency mortgage securities, failed to meet margin demands and has received a notice of default. In margin calls, banks demand more collateral on their loans because of falling prices. Lenders have been imposing "additional collateral requirements" outside of margins call, Carlyle said today. "The capital issues at commercial banks are making them, in general, reluctant to lend, so lending is either harder to find or when you do find it, it's more expensive or the other terms are more-limiting." Steven Abrahams, an analyst with Bear Stearns Cos., said in a telephone interview yesterday. "If there's less money to finance positions and less balance-sheet available to warehouse positions, the markets are going to become more volatile," he said. Carlyle Capital Corp. missed four of seven margin calls yesterday totaling more than \$37 million, the Guernsey, U.K.- based fund said today in a statement. Thornburg Mortgage Inc., the Santa Fe, New Mexico-based owner of "jumbo" mortgages and securities backed by adjustable-rate loans, said yesterday it received a default notice from JPMorgan Chase & Co. Next to Blow Up "The single biggest concern right now is who's the next hedge fund to blow up, and how big are they," Arthur Frank, the New York-based head of mortgage-backed-securities research at Deutsche Bank AG, said in an interview today. "The more the market widens, the more likely it is that another leveraged player has to sell, so it does feed on itself." Bloomberg current-coupon indexes represent the average of yields for the two groups of bonds with prices

just above and below face value, the ones that lenders typically package new loans into. Prices for agency securities backed by adjustable-rate mortgages with five years of fixed-rates fell 0.63 percent this month through yesterday, according to Lehman Brothers Holdings Inc. index data. Fixed-rated securities fell 1.66 percent, according to the New York-based company. The various classes of collateralized mortgage obligations used to repackage agency bonds collectively have fallen 0.9 percent, according to Merrill Lynch & Co. index data. "Traders are putting their phones down and backing slowly away from their desks," O'Donnell said today in a telephone interview. "Relatively little" agency mortgage-backed securities are being traded, Pimco's Simon said. **Agency Mortgage-Bond Spreads Rise; Markets 'Utterly Unhinged'**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=amqe6g6EHgdE&refer=home>

- March 3 (Bloomberg) -- **Philadelphia's \$4 billion pension deficit is causing the city's retirement-fund manager to shun Treasuries at a time when the Bush administration needs him most. Yields on 30-year U.S. bonds that fell to a record low of 4.10 percent this year are forcing pension funds to favor equities, corporate debt and commodities in an attempt to cover unfunded liabilities and meet return objectives of about 8 percent.** Even the federal government's own Pension Benefit Guaranty Corp. said on Feb. 19 that it plans to shift \$15 billion to stocks from debt. "The reality is there's not a lot we can do" other than buy high-risk securities to close a pension shortfall in a short period, said Chris McDonough, chief investment officer of the Philadelphia Pensions Department. The sixth-largest U.S. city will probably also issue debt, he said. Fixed-income holdings at 1,100 funds fell to 23 percent in 2006 from 27 percent in 2003, said Dev Clifford, a consultant at financial market research firm Greenwich Associates in Greenwich, Connecticut. Results of a survey covering 2007 will be released this month and likely show that funds own an even smaller percentage of bonds, he said. Philadelphia's predicament couldn't come at a worse time for George W. Bush, whose administration forecasts a \$410 billion budget deficit for this fiscal year ending Sept. 30, approaching the record of \$413 billion set in 2004. The figure may eventually reach as much as \$800 billion, according to Bill Gross, manager of the world's biggest bond fund at Pacific Investment Management Co. in Newport Beach, California. Supply Swamp **The budget shortfall will force the Treasury Department to increase its borrowing by 145 percent from \$163 billion, according to UBS Securities LLC, swamping the market just as longer-maturity debt turns into a money-loser for investors.** Treasuries due in 30 years, a favorite of the \$7.8 trillion pension industry because they allow managers to best match assets and liabilities over time, fell 0.66 last month, after returning 2 percent in January and 10.4 percent in all of 2007, according to Merrill Lynch & Co. index data. Pension funds hold about \$44 billion, or 20 percent, of the \$205 billion in Treasuries maturing in 20 years or longer, Greenwich Associates estimates. "In the long run I don't know if there's going to be too much value" in **Treasuries**, said Jeremy Wolfson, who oversees \$8.5 billion as chief investment officer at the City of Los Angeles Department of Water and Power Pension Fund. He said the fund will pare its debt holdings to 25 percent from 35 percent and raise its holding of non-U.S. assets such as international stocks to 24 percent from 15 percent over the next four years. Declining Demand The yield on the benchmark 4 3/8 percent bond due in

February 2008 fell 17 basis points last week to 4.40 percent after Federal Reserve Chairman Ben S. Bernanke told Congress that central bankers are ready to reduce interest rates further to keep the economy from a recession. The yield was little changed today at 4.41 percent as of 2:45 p.m. in Tokyo. The U.S. began regular sales of 30-year Treasuries in 1977. **More pension officials are hiring outside managers who favor alternative investments to run their funds**, indicating "the proportion in something like Treasuries would be going down," Clifford said. The \$240 billion California Public Employees' Retirement System, the largest U.S. pension plan, agreed at a Feb. 19 board meeting to hold between 0.5 percent and 3 percent of its assets in commodities, spokesman Clark McKinley said. Calpers, facing pressure from state and local governments to boost returns, would reduce its bond holdings to 19 percent from 26 percent. \$731 Billion Short **U.S. states owe an estimated \$2.73 trillion in pension and benefit payments to retirees over the next 30 years, according to a December report from the Pew Center on the States. They are short almost 27 percent, or \$731 billion, of that amount.** The Government Accountability Office said last week that 58 percent of 65 large state and local pension plans were adequately funded in 2006, down from 90 percent in 2000. **Such studies may overstate the health of pensions because they are allowed to include expected returns in determining their funding gap**, said Mark Ruloff, director of asset allocation at Arlington, Virginia-based consultant Watson Wyatt Worldwide Inc. That gives them further motive to "get rid of Treasuries" and buy stocks, he said. Credit Crisis Declines this year in stocks, hedge funds and other investments make those assets too dangerous, said Chriss Street, treasurer of Orange County, California, which has a \$2.3 billion plan that is 71 percent funded. The Standard & Poor's 500 Index is down 9.4 percent this year. "This is the worst credit crisis in the last 25 to 30 years and that's not going to change," said Street, who has recommended the fund buy five-year Treasuries. "It's a good time to own bonds." Falling Treasury yields have made other fixed-income investments more attractive, said Barbara Novick, vice chairman and head of the account management group in New York at Blackrock Inc., which manages \$513 billion in fixed-income assets. **Bush Deficit at Record as Treasuries Deter Pensions**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=a6fTHIHgTnqs&refer=home>

- March 3 (Bloomberg) -- U.S. states and local governments may extend the worst slump in municipal bonds on record as they replace as much as \$166 billion of auction-rate securities. California, Boston's biggest hospital and Duke Energy Corp. are converting their bonds to other types of tax-exempt debt after auction failures drove rates as high as 20 percent. The potential supply equals almost 40 percent of the municipal securities sold last year, overwhelming a market that tumbled 4.9 percent last month, according to indexes maintained by Merrill Lynch & Co., which began compiling market data in 1989. Rates increased last month as investors shunned the securities on concern the insurers that guaranteed the debt may be downgraded, and as dealers refused to buy bonds that went unsold at auctions. The higher borrowing costs are squeezing states and towns just as slowing growth threatens to cut revenue. **"It's a supply tsunami,"** said Robert Fuller, principal of Capital Markets Management LLC in Hopewell, New Jersey, a financial adviser to municipalities. "All of that is going to be redone and it's going to be redone"

fast," he said of auction-rate bonds. **Twenty-one states face budget deficits in fiscal 2009, including 16 that are short at least a combined \$30 billion**, according to the Washington-based Center on Budget and Policy Priorities. **For at least a decade, auction-rate bonds allowed municipalities, closed-end funds and student lenders to borrow long term while getting short-term rates with securities whose yields are reset by bids every seven, 28 or 35 days.** When there aren't enough buyers, the auction fails and rates are set at a level determined in official statements issued at the initial bond sale. Investors are suddenly left holding securities they may have wanted to sell. **The market started falling apart last month as banks from Goldman Sachs Group Inc. to Citigroup Inc. permitted thousands of auctions to fail by not buying bonds that went unsold.** At least 60 percent of auctions failed to attract enough bidders since Feb. 13, based on Bank of America and Bloomberg data. There were fewer than 50 failures in total from 1984 through 2007, Moody's Investors Service said. "We're in a brave new world right now," said Ross Berger, head of proprietary municipal credit and a portfolio manager at Wells Fargo Bank in San Francisco. **"When you've got many issuers representing hundreds of billions of dollars trying to restructure their bonds all at once, there's obviously a glut," said Paul Rosenstiel, California's deputy treasurer. "It doesn't make for any easy solutions."** **Auction Supply 'Tsunami' Foreshadows Deeper Municipal Losses**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aVrsXHX1VrtQ&refer=home>

Commercial Real Estate

Commodities

- March 3 (Bloomberg) -- Gold, silver, platinum and palladium may be the best-performing financial assets this year as inflation and slowing growth erode the value of the world's major currencies, bonds and stocks. Precious metals have risen at least twice as fast as the euro and yen in 2008 and returned six to 20 times as much as U.S. Treasuries. The Standard & Poor's 500 Index and all other major gauges of equities are down. Gold for immediate delivery reached an all-time high of \$984.95 an ounce today, while silver traded at \$20.19, the most expensive since 1980. **Investors are using metals to preserve their buying power as the U.S. dollar falls to a record and inflation accelerates.** Gold, platinum and palladium may gain at least 30 percent this year as Federal Reserve Chairman Ben S. Bernanke prioritizes cutting interest rates over controlling consumer prices, said Ron Goodis, a trader at Equidex Brokerage Group Inc. in Closter, New Jersey, who has been buying and selling gold since 1978. Platinum, Palladium Platinum and palladium -- sister metals used to make jewelry, catalytic converters for cars, and dental crowns and bridges -- have advanced even more this year. Platinum futures in New York gained 42 percent and touched a record \$2,214.50 an ounce Feb. 22. It may advance to \$3,000 by yearend, said Goodis, who correctly predicted its surge earlier this year. Palladium will probably reach \$750 an ounce by June, a 29 percent gain from the current price, he said. Silver will advance to \$25 an ounce sometime this year, estimated David Davis, an analyst at Credit Suisse Standard Securities in Johannesburg. 'Under Your Bed' "You can't find a currency that you trust as a store of value, so you create a

new one," said Robert Fullem, vice president of U.S. corporate foreign-exchange sales at Bank of Tokyo-Mitsubishi in New York. "Safety ends up being a piece of metal. You can stick it under your bed, and sometimes that's your best bet." Gold, which once backed the U.S. dollar and British pound, reached a 20-year low of \$253.20 in July 1999 as U.K. Prime Minister Gordon Brown, then the chancellor of the exchequer, spearheaded an effort to sell the precious metal and invest in government bonds. Northern Rock Run **That year Peter Ward, a mining analyst at Lehman Brothers Inc., predicted the metal would hover at about \$280 over the following three to four years, as other central banks followed Brown's lead. By the end of 2003, it was at \$417 because the dollar had been falling. Ward declined to comment last week, and New York-based Lehman estimates gold will average \$880 in 2008.** Gold & Silver Investments Ltd., a Dublin-based precious metals broker, said demand for gold there jumped 20 percent from mid-September to mid-October as the subprime crisis spurred depositors at Northern Rock Plc to make the first run on a U.K. bank in more than a century. **Gold Beats Financial Assets as Investors Seek Haven**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aW3XIyD8iXnE&refer=home>

Currency

- March 8 (Bloomberg) -- **The dollar fell to a record against the euro** and to an eight-year low compared with the yen as the U.S. lost jobs for the second straight month in February, adding to concern that the economy is in a recession. The U.S. currency fell for the fourth straight week against the euro as the labor report bolstered speculation the Federal Reserve will cut interest rates by 0.75 percentage point to 2.25 percent this month. The euro gained after European Central Bank President **Jean-Claude Trichet** held rates at a six-year high of 4 percent and said there is "strong upward pressure on inflation," signaling he's in no hurry to cut rates. "The news of the U.S. economy is unremittingly bleak," said **John McCarthy**, director of currency trading at ING Financial Markets LLC in New York. "The dollar looks under pressure." The dollar touched \$1.5459 per euro yesterday, the weakest level since the euro's debut in 1999, before recovering to trade at \$1.5355, for a 1.2 percent drop this week. The U.S. currency traded at 102.67 yen, after falling to 101.43 yen yesterday, the lowest since January 2000. The dollar also sank to a historic low of 1.0135 Swiss francs after the government said the U.S. lost 63,000 jobs in February, following a drop of 22,000 in January. The median estimate in a Bloomberg survey was for a gain of 23,000 last month. **Dollar Falls to Record Against Euro as Economy Nears Recession**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aNS6Fme.yNpg&refer=home>
- March 3 (Bloomberg) -- The dollar declined to a three-year low against the yen on speculation banks will report more losses from the collapse of the U.S. subprime-mortgage market. The currency fell for a fifth day, dropping below 103 yen for the first time since January 2005, and was within 1 cent of its weakest ever against the euro as stocks dropped and the cost of protecting corporate debt from default rose to record highs. The dollar slipped before an industry report forecast to show manufacturing in the U.S. dropped to the lowest level since April 2004. "Dollar risks are here to stay,"

Benedikt Germanier, a Stamford, Connecticut-based currency strategist at UBS AG, the second-biggest currency trader, wrote in a note to clients. Investors "are reducing dollar exposure with U.S. downside growth risks," he said. The dollar weakened to 102.62 yen, the lowest since Jan. 28, 2005, before trading at 102.89 at 6:42 a.m. in New York, from 103.74 on Feb. 29. It traded little changed at \$1.5180 per euro at the end of last week, when it reached \$1.5239, the lowest since the European currency's debut in January 1999.

Dollar Falls to 3-Year Low on Speculation Debt Losses to Spread
<http://www.bloomberg.com/apps/news?pid=20601087&sid=adLWB6U043jo&refer=home>

Diversification

Derivatives

- March 6 (Bloomberg) -- **Credit trading models used by Wall Street have gone haywire, raising company borrowing costs even as Federal Reserve Chairman Ben S. Bernanke cuts interest rates.** General Electric Co. is one of five U.S. companies rated AAA by both Standard & Poor's and Moody's Investors Service, making its ability to repay debt unquestioned. Yet when the Fairfield, Connecticut-based firm sold 2.25 billion euros (\$3.35 billion) of five-year bonds last week, its annual interest payment was \$17 million higher than on a sale nine months ago. Borrowers from investor Warren Buffett's Berkshire Hathaway Inc. to Germany's HeidelbergCement AG face the same predicament. **Yields** on \$5.12 trillion of corporate bonds tracked by Merrill Lynch & Co. average 2.05 percentage points more than U.S. Treasuries, the most since at least 1997. The higher costs are an unintended consequence of securities that allow investors to speculate on corporate creditworthiness. **So-called correlation models used to value them have become unreliable in the fallout from the U.S. subprime mortgage crisis. Last month some showed the odds of a default by an investment-grade company spreading to others exceeded 100 percent -- a mathematical impossibility, according to UBS AG.** "The credit-default swap market is completely distorting reality," said **Henner Boettcher**, treasurer of HeidelbergCement in Heidelberg, Germany, the country's biggest cement maker. "Given what these spreads imply about defaults, we should be in a deep depression, and we are not." **Hedging Losses** The problem started in the second half of last year when subprime mortgage delinquencies started to rise, causing investors to retreat from complex instruments such as synthetic collateralized debt obligations, or packages of credit-default swaps that became hard to value. The swaps are contracts based on bonds and used to speculate on a company's ability to repay debt. As values of CDOs began to fall, banks that had sold swaps underlying the securities started to buy indexes based on them instead, a method of hedging their losses on portions of the CDOs they owned. The purchases are driving the cost of the contracts higher, raising the perception that company bonds tied to the swaps are suddenly riskier and leading investors to demand higher yields throughout the corporate debt market. The Markit CDX North America Investment-Grade Index, a gauge of credit-default swaps on 125 companies from Wal-Mart Stores Inc. to Walt Disney Co., has more than doubled since the start of the year. It jumped as much as 21.5 basis points today to a record 186 basis points, according to Deutsche Bank AG. The index dropped to a low of 29 in February

last year. Undermining Bernanke **The \$1.5 trillion CDO market is undermining Bernanke's attempts to lower borrowing costs. The Fed cut its target rate for overnight lending between banks by 2.25 percentage points to 3 percent since September, and even debtors with the safest ratings are paying more. Money-market rates for euros and pounds climbed to the highest since mid-January yesterday, signaling the global squeeze on short-term bank lending may be returning.** The financing unit of GE, the world's most prolific borrower, sold the 4.875 percent five-year bonds last week at a yield 1.29 percentage points higher than similar-maturity government rates, Bloomberg data show. Last May, the company issued 750 million euros of 4.375 four-year notes at a spread of 0.27 percentage points. The additional expense stems from credit-default swaps tied to GE's bonds. Their cost climbed to a record 165 basis points on March 4 from 12 points a year earlier, according to CMA Datavision in New York.

Broken Models Banks bought more contracts on indexes containing GE's swaps after CDO pricing models broke down, sending the so-called default correlation to more than 100 percent last month from 60 percent in July, according to research from Zurich-based UBS. The programs, which computed the value of the highest-rated portions of CDOs, implied that all companies in the CDX index would default if just one did. Banks often hold these senior tranches after arranging the CDOs for investors. **"The banks that have been using correlation to calculate their risk will have to go back to scratch," said Janet Tavakoli, president of Chicago-based Tavakoli Structured Finance. "By using correlation models as the main means of risk management, the engineers threw out sound banking practices."** Investors have shunned all but the safest government debt since subprime mortgages roiled credit markets. Seven-year CDOs tied to investment-grade swaps have lost almost 18 percent of their value since June, according to data from New York-based JPMorgan Chase & Co.

Compounding Declines **The mathematical breakdown is compounding the decline by creating a vicious circle. As the cost of the swaps on the CDX index increases, the models signal a greater risk of defaults, and vice versa.** A bank holding \$100 million of the highest-rated portion of a swap-based CDO now has to buy \$60 million of swaps to maintain its hedge against losses, JPMorgan said. A year ago, it would have had to buy \$10 million. **"The recent unwind and activity in that market is also causing activity in our name,"** said GE spokesman **Russell Wilkerson**. Swaps linked to GE's financing unit are included in 67 percent of European CDOs, more than any other company, according to S&P. **Before the subprime collapse, the burgeoning CDO market had the opposite effect. Increasing demand for the underlying assets helped lower U.S. corporate bond yields to 1.28 percentage points over similar-maturity government notes in February 2007, the smallest spread since 2005, indexes from New York-based Merrill show. Synthetic CDOs pool swaps, while others package loans or bonds.**

'Key Factor' **"It's the key factor that brought spreads to irresponsibly tight levels up to the end of the second quarter of last year,"** said **Nigel Sillis**, director of fixed-income and currency research at Baring Asset Management in London. **"Now we're seeing the reverse, except that the impact is far more negative than it was ever positive."** One way to make the models useful again is to reduce the amount banks expect to recover from defaulted bonds to 30 percent of face value from 40 percent, according to analysts at UBS and New York-based Citigroup Inc. Banks would still have to buy more default protection though, keeping the pressure on borrowers. **"The**

unwinding of structured credit is eating away at the fabric of the corporate bond market," said Suki Mann, a credit strategist at Societe Generale SA in London. "The increase in credit-default swaps is making it far too expensive to borrow."
Credit Swaps Thwart Fed's Ease as Debt Costs Surge
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aDvSNAreJrOw&refer=home>

- March 6 (Bloomberg) -- Jefferson County, Alabama, in a move that may cost it \$184 million, said it wouldn't pledge reserves against \$5.4 billion of interest-rate swaps tied to sewer debt that its bankers may demand. While county officials say filing for bankruptcy isn't being considered, they concede it's an option. That prompted Standard & Poor's to lower the county's general obligation bond rating three levels to A from AA. Earlier today, the company cut the \$3.2 billion sewer debt three levels to CCC, the eighth highest non-investment grade, and said the rating could move up or down in the short-term. "With county officials still discussing the option for county bankruptcy, depending on the outcome of these discussions, there could be an impact on holders of the county's other warrants and bonds," said S&P analyst James Breeding in a news release. **Jefferson County, its interest expense on \$3 billion in floating-rate obligations skyrocketing, is caught in a faltering credit market that has more than doubled costs for many borrowers in the municipal-bond market. Investors are no longer willing to trust much of the insurance backing the bonds, as the guarantors face subprime mortgage losses, leaving the county paying interest rates as high as 10 percent.** While Collins said filing for bankruptcy was an option, "it's not something that they're considering," said Leigh Butler, a Collins aide. The county will not cut jobs, dip into its pension fund or curb health and other benefits to generate cash to bail out the sewer system, Collins wrote to employees. Compounding the problem, interest-rate swaps the county bought from JPMorgan, Bear Stearns Cos., Bank of America Corp. and Lehman Brothers Holdings Inc. to shield it against rising borrowing costs have backfired. The floating rates it pays on its bonds have climbed while the variable rate banks pay the county under the agreements has declined, pushing interest costs higher. **In a disclosure to investors late yesterday, the county said the counterparties to its swaps could terminate them "upon notice to the county, in which event the county would be obliged to pay the resulting termination payment."** JPMorgan spokesman Brian Marchiony and Lehman spokeswoman Kerrie Cohen declined to comment on whether they would terminate the swap contracts. Spokespeople from Bear Stearns and Bank of America couldn't be reached immediately. The firms are all based in New York except Bank of America, which is located in Charlotte, North Carolina. Financial advisers and lawyers for the county met with bankers in New York earlier this week to discuss a possible debt restructuring, Collins said in an interview March 4. She didn't immediately return a call seeking comment on the latest disclosures. The county, on the advice of JPMorgan Chase & Co., refinanced about \$3 billion of sewer debt in 2002 and 2003 using floating-rate debt, mostly insured by FGIC Corp. and XL Capital Assurance, whose coverage is rated A and A-, respectively, by S&P. \$6 Million Additional After the insurers' ratings were cut from AAA in January, rates on the county's floating-rate bonds soared when dealers failed to find buyers for the securities or use their own capital to purchase them. The county said it paid \$6 million more in interest on its sewer debt in the four months ended Jan. 31. The surging debt costs initially led credit-rating companies to

cut the county's sewer bonds to near junk status. That, in turn, triggered clauses in bond and derivative contracts that gave banks the right to force the county to post collateral on the swaps and buy back as much as \$847 million of floating-rate debt. Officials in a Feb. 28 notice said they were unable to assure investors that revenue generated by the sewer system would be sufficient to pay the obligations, which are payable from customer bills. That led S&P to cut the county's sewer debt rating to B and Moody's to lower the ranking to B3, both below investment grade. CCC Rating The latest S&P sewer bond rating of CCC means that county's debt "is currently vulnerable to nonpayment," according to S&P's ratings definitions. "In the event of adverse business, financial, or economic conditions, however, the obligor is not likely to have the capacity to meet its financial commitment on the obligation." **County fixed-rate sewer debt insured by FGIC and maturing in 2027 traded as high as 92.6 cents on the dollar today and as low as 82 cents on the dollar for a 7.126 percent yield.** Municipal bond lawyers who specialize in distressed issuers say that the county would declare bankruptcy as a "last resort" because it would effectively freeze the county's ability to borrow and create a stigma that may last for years. About \$2.2 billion of the sewer debt consists of auction-rate securities, long-term securities whose interest rates are set every 7, 28 or 35 days. The county has experienced failed auctions on \$869.45 million of the obligation, causing rates to rise to as high as 6.25 percent on Feb. 25, up from 4.7 percent on Jan. 22. "In one form or another, they want to eliminate FGIC and XL," said Scott Fairclough, a New York City-based investment banker with Birmingham-based Sterne, Agee & Leach Inc., which has proposed a restructuring plan to the county. As of Dec. 31, the county had \$2.4 billion of interest-rate swaps on its sewer debt with JPMorgan, **\$1.6 billion with Bear Stearns**, \$643 million with Bank of America and \$190 million with Lehman Brothers. It also has additional swaps with JPMorgan on other bonds. In a swap, two parties agree to exchange payments over a period of time that can last as long as 30 years. Typically, one agrees to pay a fixed rate and the other to pay a variable rate that changes with a benchmark index or formula defined in the contract. The contracts generally have provisions requiring the parties to pledge assets in the event their credit rating is lowered to a certain level. **Alabama County Won't Pledge \$184 Million for Swaps** <http://www.bloomberg.com/apps/news?pid=20601087&sid=ad4wa8GK8oHU&refer=home>

Housing

- In turn, this next item should come as no surprise to you: **For the first time since World War II, the average American homeowner's debt exceeds the equitable value of their home.** According to a Federal Reserve study released yesterday, the percentage of equity in U.S. homes has fallen below 50% for the first time since 1945. Homeowners' percentage of equity slipped to 47.6% in the fourth quarter. The Fed began tracking these equity numbers in 1945. Odds are this is the worst reading since the Great Depression. Moody's recently estimated, too, that 10.3% of all homeowners will have zero or negative equity by the end of the month.
- NEW YORK (Reuters) - Wall Street banks are facing a "systemic margin call" that may deplete banks of \$325 billion of capital due to deteriorating subprime U.S. mortgages, JPMorgan Chase & Co <JPM.N>, said in a report late on Friday. JPMorgan, which sent

a default notice to Thornburg Mortgage Inc. <TMA.N> after the lender missed a \$28 million margin call, said more default notices and margin calls were likely. The Carlyle Group's mortgage fund also failed to meet \$37 million in margin calls this week. "A systemic credit crunch is underway, driven primarily by bank writedowns for subprime mortgages," according to the report co-authored by analyst Christopher Flanagan. "We would characterize this situation as a systemic margin call." The credit crisis that began about a year ago will likely intensify after Friday's weak February U.S. employment report "that most definitely signals recession," JPMorgan said. Indeed, corporate bond spreads widened to a new record on Friday, surpassing levels seen in October 2002 during a boom in bankruptcies following the dot-com crash. U.S. employers cut payrolls in February for a second consecutive month, slashing 63,000 jobs, the biggest monthly job decline in nearly five years, the U.S. Labor Department reported on Friday. "The weak February employment report points to an economy in recession," JPMorgan said. The JPMorgan report included a revised bleaker forecast for subprime-related home prices. The bank now sees prices falling 30 percent, from its prior 25 percent forecast. Those prices have declined 14 percent since mid-2006, JPMorgan said. <http://www.cnbc.com/id/23534170/for/cnbc/>

- March 6 (Bloomberg) -- U.S. mortgage foreclosures rose to an all-time high at the end of 2007 as borrowers with adjustable-rate loans walked away from properties before their payments increased, the Mortgage Bankers Association said today. New foreclosures jumped to 0.83 percent of all home loans in the fourth quarter from 0.54 percent a year earlier. Late payments rose to a 23-year high, the organization said in a report today. "We're seeing people give up even before they get to the reset because they couldn't afford the home in the first place," said Jay Brinkmann, vice president of research and economics for the Washington-based trade group. The Bush administration is urging lenders to avert foreclosures by modifying mortgage terms amid the worst housing slump in a quarter century. The Federal Reserve has slashed its benchmark interest rate twice this year to try to avert the first recession since 2001. The central bank yesterday said the net worth of U.S. households decreased by \$532.9 billion during the fourth quarter as home values fell. **The share of all home loans with payments more than 30 days late, both prime and fixed-rate loans, rose to a seasonally adjusted 5.82 percent, the highest since 1985, the bankers' group said in today's report.** Buyers 'Overstretched' About 40 percent of all foreclosures are homeowners with prime or subprime loans who couldn't make their payments before the reset, Brinkmann estimated in an interview. Another 23 percent are borrowers who received some form of loan modification, typically a freezing or a reduction of their rate, and then default, he said. Forty-two percent of new foreclosures in the fourth quarter were people with adjustable-rate subprime mortgages, given to borrowers with limited or tainted credit records, according to the report. Those types of loans accounted for about 7 percent of all mortgages, the report said. **It comes down to an overstretching of buyers to get into homes they couldn't afford and an overextending of credit by lenders who were more willing to take risk,** Brinkmann said. Another 20 percent of new foreclosures were prime adjustable-rate mortgages, which accounted for 15 percent of all home loans, according to the report. Late Payments Data **Twenty percent of adjustable-rate subprime loans had late payments in the fourth quarter, a number that excludes the one of every eight mortgages already in foreclosure,** the bankers group said in their report. The

share of late payments for adjustable prime loans was 5.51 percent, from 3.39 percent a year earlier, and the foreclosure inventory rose to 2.59 percent, almost tripling from a year earlier. The Mortgage Bankers survey examines 46 million residential home loans, about 80 percent of the market. The study gives percentages without providing the number of loans they represent. Homebuilding executives, economists and securities analysts predict the housing market won't begin to recover until at least 2009. U.S. sales of new and existing homes probably will fall to 5 million this year, a drop of 33 percent from the all-time high of 7.46 million in 2005, before rising to 5.23 million in 2009, Freddie Mac said in a March 3 forecast. **Freddie Mac and Fannie Mae, the biggest U.S. mortgage finance companies, have posted their largest-ever losses as rising defaults boosted credit costs. Fannie Mae had a \$3.55 billion loss in the fourth quarter, the Washington-based company said Feb. 27. Freddie Mac reported \$2.45 billion fourth-quarter loss the following day.** The Mortgage Bankers survey came on the same day that the National Association of Realtors reported that the number of Americans signing contracts to buy previously owned homes was unchanged in January. The Realtors' index of signed purchase agreements held at 85.9, higher than forecast and the second-lowest level since the Chicago-based group began keeping records in 2001. **U.S. Mortgage Foreclosures Rise as Owners 'Give Up'**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aPb48hRS1hJQ&refer=home>

Housing Finance

- **Nearly 6% of all U.S. homeowners were in some form of mortgage delinquency during the fourth quarter of 2007.** That's an all-time high. According to this morning's Mortgage Bankers Association report, the U.S. is currently enduring historic levels of foreclosures... at least since it started keeping track in 1985. Not surprisingly, adjustable-rate mortgages led the way. Foreclosure rates have doubled year over year in both prime and subprime ARMs.
- **SAN FRANCISCO (MarketWatch) - Why are interest rates on 30-year fixed-rate mortgages rising even as the Federal Reserve slashes interest rates and yields on Treasury bonds fall?** The answer is that the mortgage market is short of roughly \$1 trillion in capital, according to Paul Miller, an analyst at Friedman, Billings, Ramsey. The modern mortgage market works with lots of leverage, or borrowed money. Investors, including hedge funds and mortgage real estate investment trusts, buy mortgage securities, but finance a lot of their purchases with this leverage. FBR's Miller estimates that \$11 trillion of outstanding U.S. mortgage debt is supported with roughly \$587 billion of equity. That's a leverage ratio of 19 to one. But last year's subprime meltdown has undermined confidence in the home loans that back these mortgage securities. Now the banks that finance most of these leveraged mortgage investments have started to pull back and impose margin calls, demanding more cash or collateral to back their loans. This has sparked a de-leveraging cycle in which some highly leveraged mortgage investors have to sell assets to meet margin calls. Forced selling pushes prices lower, sparking more margin calls, which in turn produces more selling and even lower prices. When debt prices fall, yields rise, and that's what's happening to mortgage securities -

even those backed by government sponsored entities including Fannie Mae (FNM) which are considered the safest. "The immediate impact is that [interest rates on] 30-year fixed-rate mortgages will have to increase relative to Treasuries," FBR's Miller wrote in a note to clients on Friday. "That is why we are experiencing pressure on mortgage rates despite the downward movement on the 10-year bonds." Rates on 30-year fixed mortgages usually follow the movement of 10-year Treasury bonds, but this relationship has broken down as de-leveraging in the financial system takes hold. The difference, or spread, between yields on "agency" mortgage securities backed by Fannie and Freddie and those on Treasuries rose to a 23-year high this week, Miller noted. "It is the leverage game playing havoc with the system," he wrote. There are two ways to resolve the problem. Either inject \$1 trillion of new capital into the mortgage market, or allow prices of mortgage securities to fall (and interest rates on home loans to climb), Miller said. The mortgage market won't be able to raise \$1 trillion, so prices have to fall, he warned. "There is no quick fix here," the analyst said. "It will take about six to 12 months for the pricing pressure to alleviate on these mortgage assets." "This will be painful, but it must be allowed to play out in an orderly fashion in order for the mortgage market to achieve equilibrium," Miller concluded. **Mortgage market needs \$1 trillion, FBR estimates** <http://www.marketwatch.com/news/story/mortgage-market-needs-1-trillion/story.aspx?guid=%7b359B5377-39DB-4C8B-9178-C45726A45272%7d&dist=TNMostRead&print=true&dist=printTop>

- March 8 (Bloomberg) -- **Countrywide Financial Corp. is being probed by the U.S. Federal Bureau of Investigation for possible securities fraud, the Wall Street Journal reported, citing unidentified law enforcement officials and finance industry executives.** The probe, which is at an early stage, is focusing on whether Countrywide officials made misrepresentations about the company's financial position and the quality of its mortgage loans in securities filings, the newspaper reported, citing four unidentified people with knowledge of the matter. Fifteen other subprime companies are under scrutiny by federal agents and prosecutors in relation to possible mortgage- origination fraud, conflicts of interest and practices used to package mortgage-backed securities for sale to investors, the newspaper said. Countrywide Chief Executive Officer **Angelo Mozilo** testified yesterday before the House Oversight and Government Reform committee, which questioned why CEOs received hundreds of millions of dollars in compensation while shareholders took the brunt of millions in writedowns from subprime mortgages. **FBI Probes Countrywide Over Possible Fraud, WSJ Says** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aQnOK60Ts2xk&refer=home>
- March 7 (Bloomberg) -- **Thornburg Mortgage Inc.**, the home lender that's lost 95 percent of its market value in the past year, may go out of business because the provider of "jumbo" loans can't meet \$610 million of margin calls. **Bankers have agreed to freeze their demands for payment while Thornburg tries to raise enough cash before a deadline of midnight tonight, according to a company statement.** Falling prices for mortgage assets and the company's shrinking liquidity "have raised substantial doubt" about Thornburg's ability to keep operating, the statement said. Cash ran short at least twice since August at Santa Fe, New Mexico-based Thornburg, and Citigroup Inc. analyst **Donald Fandetti** said this week that bankruptcy is possible. Investors are shunning

all except the safest debt, driving down prices on mortgage assets, and Thornburg's bankers want more collateral to protect themselves against losses. "Quite simply the panic that has gripped the mortgage financing market is irrational and has no basis in investment reality," Larry Goldstone, chief executive officer of Thornburg, said in the statement. Thornburg, which fell as much as 35 percent in New York Stock Exchange composite trading, closed officially at \$1.79, an 8.5 percent gain, based on three trades at the end of the session. The stock then returned to its previous level, changing hands after hours at \$1.33, 19 percent below yesterday's close. Shooting the Customers Thornburg plans to restate 2007 earnings after the value of its mortgage-backed assets declined, the company said. The lender expects to record a \$427.8 million charge, the statement said. Home lenders including Thornburg pledge mortgage-backed securities as collateral to obtain financing. Debt markets that trade those securities have seized up as investors grow more concerned about record U.S. defaults and foreclosures. **That's left creditors no place to sell these securities, and so it's forcing them to shoot their customers,** said Christopher Whalen, managing director at Institutional Risk Analytics, a financial consulting firm in Hawthorne, California. "Thornburg is an unfortunate victim." Thornburg received \$1.78 billion in margin calls since Dec. 31 through March 6, and had covered \$1.17 billion, the company said in a filing today. Comeback Predicted The company had been predicting a comeback from a \$1.1 billion third-quarter loss last year that forced it to suspend lending and the quarterly dividend. Both were later resumed and Thornburg earned \$64.8 million in the fourth quarter. **Thornburg specialized in so-called jumbo mortgages of more than \$417,000, which typically were used to buy more expensive homes.** Until recently, such loans were too big to qualify for purchase by government-sponsored entities such as Fannie Mae. Trading for such "non-conforming" loans has come to a standstill, cutting off a source of funds for mortgage companies and pushing down the value of their holdings. More than 100 halted operations or sought buyers last year. The company's demise would reduce liquidity even more, said Keith Gumbinger, vice president of HSH Associates, a mortgage-market research firm based in Pompton Plains, New Jersey. **No one has had anything bad to say about Thornburg; they have served the good-quality, high end of the market,** Gumbinger said. **It's been a good, well-run business that is taking a beating because of market conditions.** Standard & Poor's said this week that the credit quality of Thornburg's mortgage portfolio "remains extremely sound." Bill Gross, who manages the world's largest bond fund, said on CNBC that his firm paid hundreds of millions of dollars for debt from Thornburg. **Thornburg Can't Meet Margin Calls, Survival in Doubt**

http://www.bloomberg.com/apps/news?pid=20601087&sid=aKZs2g_19abk&refer=home

- March 6 (Bloomberg) -- **Citigroup Inc., the fourth-largest U.S. home lender by new loan volume, plans to pare its U.S. residential unit's mortgage and home-equity holdings by about \$45 billion, or 20 percent, over the next year. Citigroup's CitiMortgage division will decrease its total holdings mainly by making fewer loans that can't be sold,** CitiMortgage Inc. President Bill Beckmann said in a telephone interview today. "We will look for opportunistic sales, but we're not counting on that, considering current market conditions," Beckman said. Citigroup plans to be selling about 90 percent of the home loans that the company makes through his unit by the third

quarter, up from 65 percent last year, according to a statement today. **The New York-based bank's plan will further cut financing available to U.S. borrowers, as investors flee even government-guaranteed mortgage bonds.** Lenders including Wells Fargo & Co. and Countrywide Financial Corp. have already restrained direct home lending, depressing prices for mortgage securities and making it more costly for consumers to obtain loans. "For a long time there was a lot of cash sloshing around the markets, and that cash has dissipated," Darcy Morrison, who analyzes asset-backed securities at Wachovia Corp.'s Tattersall Advisory Group, said in an interview today. "Banks aren't writing mortgages faster than they can breathe anymore." Citigroup's move reflects Chief Executive Officer Vikram Pandit's push to commit the company's balance sheet only to assets producing higher returns, Beckmann said in the interview. Pressure on the company's capital ratios from the credit market contraction are speeding a reduction in mortgage holdings that would have occurred eventually anyway, he said. Citigroup posted a record loss of \$9.8 billion in the fourth quarter. It raised \$7.5 billion in November from Abu Dhabi and said in January it was getting another \$14.5 billion from investors including the governments of Singapore and Kuwait. The company will probably report a loss again in the first quarter, according to analysts at Merrill Lynch & Co. and Goldman Sachs Group Inc. **Citigroup to Cut Mortgage Holdings by \$45 Billion in Next Year**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aFwhx1dqve7I&refer=home>

- March 5 (Bloomberg) -- **Ambac Financial Group Inc.** tumbled 19 percent in New York Stock Exchange trading after the bond insurer's plan to raise \$1.5 billion failed to allay concern that it may lose its AAA credit rating. Investors had anticipated banks would be part of a bailout that would raise as much as \$3 billion, enough to overcome record losses on subprime-mortgage debt. Instead, the New York-based company will seek buyers for \$1 billion of common shares and \$500 million of equity units, according to a statement today. "This wasn't what the market was hoping for," said Robert Haines, an analyst at CreditSights Inc., a bond research firm in New York. "There's no bailout. It's just a capital raise, and there's no guarantee they'll get it done." Ambac shares dropped and credit-default swaps rose, indicating worsening perceptions of credit quality, even though Standard & Poor's and Moody's Investors Service said today they would probably confirm the company's AAA rating after the offering. With such a limited capital raising, Ambac may not be able to keep its AAA rating for long, said Peter Plaut, an analyst with hedge fund Sanno Point Capital Management in New York. "Ambac's capital raising might save the company's AAA ratings in the short term, but the outlook for continued writedowns and impairments to capital clearly indicates that this is not a AAA industry," Plaut said. Split Sale Ambac, larger competitor **MBIA Inc.**, and the rest of the industry stumbled after expanding beyond municipal insurance to guarantees on collateralized debt obligations that have since tumbled in value. Bond insurers with AAA ratings have guaranteed \$2.4 trillion of debt. The loss of Ambac's top rating would cast doubt on \$556 billion of municipal and asset-backed securities insured by the company, forcing some investors to sell the debt and others to reduce their holdings. **Ambac** fell \$2.02 to \$8.70 today in New York Stock Exchange composite trading. The shares have tumbled 90 percent in the past year. A \$1 billion equity offering would about double the amount of shares outstanding. Credit-default swaps tied to Ambac's AAA rated insurance unit rose 10 basis points after the announcement to 530 basis points, according to CMA Datavision

in London. A basis point on a credit-default swap contract protecting \$10 million of debt from default for five years is equivalent to \$1,000 a year. Bank Losses Credit-default swaps are financial instruments based on bonds and loans that are used to speculate on a company's ability to repay debt. They pay the buyer face value in exchange for the underlying securities or the cash equivalent should a borrower fail to adhere to its debt agreements. A rise indicates deterioration in the perception of credit quality; a decline, the opposite. **Banks would lose as much as \$70 billion if the top-rated bond insurers lose their credit ratings**, Oppenheimer & Co. analysts estimated in January. MBIA's ratings were affirmed by Moody's and S&P last week. The offerings will be managed by Credit Suisse Group, Citigroup Inc., Bank of America Corp. and UBS AG, Ambac said in a filing. **Forecasts for losses on CDOs `vary widely,' Ambac said in a filing for its offering today.** Some of the underwriters are forecasting Ambac could take larger losses on CDOs than the company or S&P are forecasting, according to the filing. Cutting Dividend MBIA retained its top rating after the Armonk, New York- based company raised \$3 billion, agreed to stop insuring asset- backed debt for at least six months and said it would separate its municipal and structured finance businesses within five years. Responding to pressure to shore up capital, Ambac cut its **dividend** last week and said it will suspend writing guarantees on debt, including mortgage-backed bonds, to bolster capital, echoing MBIA's plan. Ambac abandoned plans in January to raise \$1 billion in a stock sale after a plunge in the company's **shares**. Eight banks then formed a group to help Ambac find new ways to raise money. The declining value of those guarantees led Ambac to a record \$3.2 billion **net loss** last year and contributed to the share price slump. **Ambac Seeks \$1.5 Billion in Stock, Equity Unit Sales** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aCinvOgvhVUQ&refer=home>

- March 3 (Bloomberg) -- Fannie Mae and **Freddie Mac**, the biggest sources of financing for U.S. home loans, reached an agreement with New York Attorney General **Andrew Cuomo** to buy mortgages only from lenders that adopt new standards intended to ensure independent home appraisals. **The new rules announced today prohibit mortgage brokers from selecting appraisers and lenders from using in-house staff to do valuations for any home loans the government-chartered companies purchase. Lenders will also be barred from using appraisal management firms they own or control. [while a great idea, as with the other good ideas, it is much too late and will in fact hamper not enhance recovery]** Cuomo opened an investigation of the U.S. mortgage industry last year as **foreclosures** among subprime borrowers climbed to a five-year high. The New York probe strikes at the foundation of the mortgage business, which profited from lending money to homeowners and repackaging the debt into securities sold to investors. **`We believe the appraisals were often fraudulent because there were conflicts of interest and pressure on the appraisers,'** Cuomo said. Fannie Mae and Freddie Mac also will pay \$24 million to create an independent organization to implement and monitor the new standards, Cuomo said. The accord covers appraisals for mortgages originated on or after Jan. 1, 2009. **In November, he sued First American Corp., the largest U.S. title insurer, for allegedly inflating home values under pressure from Seattle-based Washington Mutual Inc.** First American has since asked the U.S. District Court in the Southern District of New York to dismiss the lawsuit, saying only the U.S. government has authority to regulate savings and loans and

appraisers. **Fannie, Freddie to Overhaul Appraisals in Cuomo Deal**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aSUcfdxfq4xs&refer=home>

Macro Economic

- March 5 (Bloomberg) -- **Treasury Secretary Henry Paulson may need to revise his strategy for stemming record U.S. home foreclosures after Federal Reserve Chairman Ben S. Bernanke urged lenders to forgive portions of some loans.** Bernanke's call, in a speech yesterday to bankers in Orlando, Florida, went beyond a Paulson-backed plan that focuses on renegotiating interest rates. With his remarks, the Fed chief joined the heads of the Office of Thrift Supervision and Federal Deposit Insurance Corp. and congressional Democrats in proposing stronger actions than Paulson to alleviate the worst housing recession in a quarter century. "This puts enormous pressure on Paulson," said Michael Barr, a former Clinton administration Treasury official who is now professor at the University of Michigan Law School in Ann Arbor. "Treasury's response so far has been insufficient." Paulson's increasing isolation may spur him to demand faster results from the Hope Now alliance of mortgage lenders he helped set up last year, or to consider new measures. Bernanke's speech highlighted a deepening threat from house prices dropping below mortgages, something Paulson played down the day before. **The positions of Bernanke and Paulson have evolved since both at the start of last year claimed that the jump in subprime mortgage delinquencies was "contained."** Bernanke has since proposed tighter regulations to stop abusive lending practices and sent notices to banks urging loan modifications. Paulson's focus has centered on private initiatives. Paulson, asked about Bernanke's remarks in an interview yesterday with American Public Radio's Marketplace program, said **"there will be instances where lenders are going to clearly see that the best solution for them which is less costly than a foreclosure is going to be a writedown of principal on a mortgage."** 'More Effective' That stopped short of Bernanke, who said at a conference of the Independent Community Bankers of America that "more can, and should, be done" to limit foreclosures. He added that principal reductions "may be a relatively more effective means of avoiding delinquency and foreclosure" than renegotiating interest rates. Bernanke also said "the current housing difficulties differ from those in the past, largely because of the pervasiveness of negative equity positions." By contrast, Paulson said in an interview with Bloomberg Television on March 3 that "almost too much" has been made out of negative equity. **FDIC Chairman Sheila Bair said last month that lenders "should be more aggressive about writing down principal."** OTS Director John Reich proposed a plan for refinancing mortgages at current home prices, with loan servicers getting certificates that can be redeemed if values rise by the time the property is sold. **The call for forgiving portions of home loans may spur opposition from bond investors concerned it will reduce the value of mortgage-backed securities, which have already slid and caused banks to post billions of dollars of credit losses.** "We could not imagine that the policy response would be to pour napalm on the fire," said Julian Mann, who helps manage \$3.4 billion of bonds at First Pacific Advisors LLC. "I'm going to demand higher and higher rates" to buy mortgage debt if the collateral is altered, he said. Mortgage servicers "should have a clear basis for concluding" that borrowers are unable to make their payments before

reducing loan principal, the American Securitization Forum, a New York-based lobbying group, said in a statement. Government Funds Bernanke has also indicated a greater willingness to consider using government funds. He told lawmakers last week that it was "worthwhile" to consider using public money if the housing contraction worsens. Paulson said the use of taxpayer money was a "non-starter." Paulson has reversed course in the past. Last year, he opposed raising the \$417,000 limit on mortgages that Fannie Mae and Freddie Mac are allowed to buy and package into bonds. He agreed to a temporary increase in January, saying he "got run down by a bipartisan steamroller" in negotiating with Congress. "The risks are very high that the steamroller is not going to be stopped," said Mark Zandi, chief economist of Moody's Economy.com in West Chester, Pennsylvania. "The window's going to close very quickly, and they have about six to 12 weeks to figure out what's next." **Bernanke Call for Mortgage Forgiveness Puts Pressure on Paulson**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aV6kqOuYFc5E&refer=home>

- March 3 (Bloomberg) -- **Manufacturing in the U.S. shrank at the fastest pace in almost five years and construction spending fell the most since 1994 as the economy moved closer to a recession.** The Institute for Supply Management's factory index dropped to 48.3 in February from 50.7 the previous month, the Tempe, Arizona-based group said today. Fifty is the dividing line between contraction and expansion. At the same time, the Commerce Department reported that spending on building projects slumped 1.7 percent in January, more than anticipated. The Dow Jones Industrial Average fell 0.1 percent to close at 12,258.9 in New York. Investors anticipated a weaker manufacturing report after the National Association of Purchasing Management-Chicago said last week that business activity weakened. The ISM's new orders decreased to 49.1 from 49.5, while a production measure dropped to 50.7 from 55.2. A gauge of supplier deliveries fell to 50.1 from 52.8 in the prior month. The group's measure of prices paid decreased to 75.5 from 76 in January. **Today's factory survey corroborates other regional business polls in the past two weeks that showed factory activity, which accounts for about 12 percent of gross domestic product, contracted in February.** A Philadelphia Fed gauge showed the deepest contraction in seven years, while the Fed Bank of New York's economic index was the weakest in almost five years. Orders Slump Government data also have pointed to a slowdown. Orders for durable goods excluding transportation equipment fell in January for the third time in the last four months, Commerce said last week. Factory production stalled in January, with car output falling, the Fed said Feb. 15. **Declining home construction will drag on growth again this year, costing jobs and undermining the consumer spending that accounts for two-thirds of the economy. As property values decline, Americans feel less wealthy and buy fewer televisions and cars.** Sales at General Motors Corp., Ford Motor Co. and Toyota Motor Corp., the three biggest auto retailers in the U.S., fell in February from a year earlier, according to industry data issued today. General Motors and Ford each announced deeper reductions in production for next quarter. Demand for cars is at the "low end" of the range forecast, said George Pipas, chief sales analyst for Ford, in Dearborn, Michigan, on a conference call last week. **U.S. Economy: Factories, Construction Spending Drop**

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

- March 3 (Bloomberg) -- Federal Reserve Bank of Philadelphia President Charles Plosser said the benchmark interest rate is now below the level recommended by "many" monetary-policy theories and should be raised when financial markets stabilize. **"We are now, perhaps, in a period of extraordinary circumstances and have deviated from the benchmarks suggested by simple rules," Plosser said in prepared remarks to a conference in Arlington, Virginia. "Such deviations should be temporary and limited and promptly reversed when conditions return to normal." [the problem is "when will conditions return to normal"?)** Plosser's remarks indicate he may agree with the assessment of some Fed officials at the January policy meeting that the Fed might need to raise rates at a "rapid pace" when the economy recovers. Chicago Fed President Charles Evans said three days ago that taking back rate-cut "insurance" can make clear that the Fed is committed to containing inflation. "The current turmoil in financial markets has already had a significant impact on the economy and has the potential to continue to restrain economic growth going forward," Plosser said today. The Philadelphia Fed chief said last month that the "aggressive" rate cuts will help U.S. growth return to its 2.7 percent trend rate next year. Plosser said today that "monetary policy makers should continue to pursue their efforts to develop and put into practice more rule-like behavior" for setting interest rates. Having clear rules helps keep the public's expectations for inflation stable, he said. **Plosser Signals Rate-Cut Reversal Needed**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=ay0gCAXZt37A&refer=home>

Retail

Retirement

Risk

Savings Rate

Tech

Wall Street

- March 6 (Bloomberg) -- **Evan "Brent" Dooley, the 40-year-old wheat trader whose wrong-way bet cost MF Global Ltd. \$141.5 million,** lost his house and car in a 2002 bankruptcy and borrowed from family and friends after earlier reversals. **MF Global, the largest brokerage of exchange-traded futures contracts, fired Dooley from its Memphis office last week after discovering he had "substantially exceeded his authorized trading limit."** The company said it immediately tightened risk controls and ordered an outside review. **It hasn't explained why a man with Dooley's history was allowed to bypass company security.** "These are sophisticated, smart people who

should have known better," says Mark Williams, a finance professor at Boston University. **``There's no question when you have a loss of this magnitude that there's a breakdown in controls.''** MF Global spokeswoman Diana DeSocio said that when the company put Dooley on commission, it requested a credit check that missed his bankruptcy record. **Last week, MF Global's Davis told analysts that Dooley, trading for his own account, was able to amass ``significant positions'' on wheat futures contracts ``very, very quickly'' between midnight and 6 a.m. Feb. 27. Expecting the price of wheat to fall, Dooley traded more than 15,000 contracts covering 75 million bushels on the Chicago Board of Trade,** said a person familiar with the matter who declined to be identified because the information is private. The value of the position ranged from about \$800 million to \$1 billion, based on overnight trading prices. ``There were a few isolated trading terminals on retail execution desks inside the company that didn't have buying-power controls on them," Davis said. The limits weren't in use to allow faster trading, he said. The trades were discovered internally and are no longer possible, Davis said. Brent Dooley's 2002 personal bankruptcy filing lists \$390,590 in unsecured debts linked to two commodities brokerages in Memphis and Chicago. On federal income tax returns between 2002 and 2005, he reported \$90,000 in personal trading losses. He worked part-time at the commodities brokerage McVean Trading & Investments LLC while attending what now is known as the University of Memphis. He graduated in December 1990 with a bachelor's degree in finance, according to a copy of his resume. Before joining MF Global as a non-employee associate in 2006, Dooley worked at six other commodities firms. ``I have tremendous fundamental and technical knowledge of all futures markets," he said in a resume in the divorce file. **MF Global's Dooley Lost House Before Bad Bet on Wheat**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=axeRxfcktg4&refer=home>

- Current and former bankers at JPMorgan Chase and Co. of New York, UBS AG of Zurich and other banks are under criminal investigation. The Justice Department and the Securities and Exchange Commissions have been seeking evidence of bid-rigging by banks that sell interest rate swaps and investments to municipal issuers. These probes follow audits from the Internal Revenue Service, which questioned whether banks charged the municipalities too much for the investments, according to Bloomberg. Those being probed include Peter Ghavami, formerly the co-head of municipal derivatives at UBS, who is the target of a grand jury investigation by the antitrust division of the Department of Justice, according to BrokerCheck filings with the Financial Industry Regulatory Authority. JPMorgan Chase is also under scrutiny by the Justice Department and the SEC's Philadelphia regional office, according to the firm's annual report, which was filed on Friday. The two offices have been conducting parallel investigations of "possible antitrust and securities violations" relating to the bidding or sale of guaranteed investment contracts and derivatives to muni issuers. The period in question is between 2001 and 2005.

Don't Fight The Fed

I Disagree . . . and why

[Article of the week:](#)

Get the Lowdown on the 401(k) Debit Card

'GMA' Financial Contributor Mellody Hobson Gives the Pros and Cons of the Card

March 3, 2008 —

As the threat of recession looms, some people are searching for extra cash to supplement their incomes.

People used to use their homes as piggy banks, but the mortgage crisis has led many to tap into their 401(k)s and now there's even a new debit card that lets you get money from your retirement savings just as you would a checking account.

"Good Morning America" financial contributor Mellody Hobson tells you the smartest way to handle your money and gives you the pros and cons of the new 401(k) debit card plan.

1. How does the 401(k) debit card work?

There is a financial services firm in New York that is now marketing a debit card called Reserveplus, which allows employees an easy way to tap into their 401(k) retirement savings.

The card is essentially a debit card that allows you access to money from an approved 401(k) loan. Like with any 401(k) loan, an employee applies for the loan with his employer.

If the loan is approved, rather than having the loan amount deposited into your checking account, it is deposited into an account and can be accessed through a debit card.

2. Is this a good way for people to cover their expenses when they are a little short or is this a bad idea?

It is a really bad idea. The notion that you can access your 401(k) savings through a debit card is really troubling. I am a huge fan of debit cards as an alternative to credit cards.

As you know, they are an easy way to avoid the trap of overspending because you can only spend what you have in your account unlike a credit card, which lets you run up a balance in excess of what you can afford.

The problem with a debit 401(k) card is that you are really spending money that you do not have. That money should be under lock and key and used only for your retirement, not for a new flat-screen TV or spring vacation.

In some ways it is even worse than a credit card because the money is expensive to borrow and it prevents your nest egg from growing.

If we look at the math you will see what I mean:

Melody's Math:

An individual with \$20,000 saved in a 401(k) account who contributes \$100 every month, assuming an average annual return of 8 percent, would have almost \$364,000 saved for retirement in 30 years.

However, the same individual who borrows \$10,000 from the plan pays the loan back over five years and stops contributing to the plan while paying back the loan. That same individual would have just \$203,000 -- a difference of about \$161,000.

An easy rule of thumb to remember: Every \$1,000 you withdrawal from your 401(k) plan equals about \$10,000 less in retirement income.

3. As troubling as the math sounds, you still say more and more people are taking out a loan on their retirement plans?

The reality is, with a slowing economy and trouble in the housing market, consumers are relying on their retirement savings more than ever to pay their bills.

A survey by the Transamerica Center for Retirement Studies revealed that 18 percent of workers had a loan outstanding from their retirement plan in 2007, which is up from 11 percent the previous year. In fact, there are about \$320 billion of outstanding loans on 401(k) assets -- a truly frightening number.

4. Are there any conditions under which you would say it's OK to take money out of your 401(k)?

Generally speaking, money invested in your retirement accounts should not be touched until retirement. The one exception is if you have an emergency and have a financial need related to health or even a death.

In fact, most employer-sponsored 401(k) plans allow for these type of "hardship loans." In most cases, even the hardship loans incur a 10 percent penalty and are taxed at ordinary income.

If you absolutely have to take out a loan from your 401(k), you need to prioritize this loan and pay it off first. Also, if possible, do your very best to try and continue to make contributions

toward your plan, especially if your employer offers a company match. Passing up this match is the same as saying "no" to free money for your retirement.

4. What should you do if you're in a pinch and need money?

During times of hardship, your first step should be to assess your spending and find ways to cut back. What expenses in your day-to-day activities can you live without? If you are really in a bind and must get a loan, consider a home equity line of credit. Using your house to pay for major expenses and to cover you in a financial shortfall is a much better vehicle than tapping into money that will undoubtedly be your lifeline in your retirement years.

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UM EMBA

Best of the Dog

Thursday, March 06, 2008 at 10:38 CDT

another groundhog day

horrible credit news

FNM, FRE, and related dropping like stones yet the high betas have had a significant bid all day. the computer momo programs have not been recalibrated for reality and will continue playing the "wee we're breaking away" game until really hard hits knock them down many more times.

currently dow down 100 naz down 4.

BIDU at 250 and MELI at 42 are playing "weeeeeeeeeeeee"

The bear says DOW wins DOW wins and the little "wee players" cry in their porridge by days end.