The Other Side of the Street May 3, 2009

Overview Comments

This is a day late, but allows me to opine that we are back in the insane world of 2003-7 investing that I thought we had left behind. It is interesting that the things that have a readily ascertainable value (think MSFT, are not the ones soaring 15-30% a day). Instead it is the heavily shorted garbage stocks such as the financials who no longer have to produce accurate accounting statements. We have been there before and it does not end well for those who buy.

Macro Thoughts

China is definitely buying gold and definitely beginning to not buy treasuries in the size that did to provide credit to the U.S. consumers. This is not good for the dollar.

Topics of interest

Reasons this rally will not be the beginning of the new bull

Insider buying in April is the lowest since July 1992. If these prices are so wonderful, why aren't the inside guys loading up the wagon? One might posit that the insiders do not see value in the shares at these levels. Further, the pace of insider selling is the highest since the market peaked in October 2007.

Government pronouncements of thawing credit markets

- Geithner has said repeatedly that the "vast majority" of U.S. banks have more capital than regulatory guidelines indicate. The stress tests are designed to ensure that firms have enough reserves to weather a deeper economic downturn and sustain lending to consumers and businesses. 'Thawing' Markets He also said there are signs of "thawing" in credit markets and some indication that confidence is beginning to return. – April 2009

Some hard numbers on how "stressful" the stress test was

- "Furthermore, some say the conditions under which the most extreme stress test scenarios have been set are not harsh enough for a severe recession. Under a "baseline" scenario, the government tested balance sheets with a 2% decline in gross domestic product, and unemployment averaging 8.4% for 2009. The more severe conditions included a 3.3% GDP dip, with unemployment averaging 8.9%. Many economists and observers have said they expect unemployment to sail above 10% by the end of the year, and the economy contracted 6.1% during the first quarter alone." WSJ article

A view beyond what is expedient today

- The abrogation of contractual rights in this country continues unabated. The latest installment is the strong arming to get first line holders to give up contractual rights so they can "share the pain" in Chrysler's demise. While Obama gets lots of political points pandering to the current "scapegoat someone mentality for the following diatribe against those who would assert contractual rights, it further destroys the credibility of the capital market system. Why should an investor buy bonds with first line status if they contractual right has no meaning and if the populace can make sure they "share the pain"? The natural recourse of this will be that such investors will need a greater risk premium in the future. But alas, there is no thought in Washington as to the future repercussions of their actions is there?
- Obama: *While many stakeholders made sacrifices and worked constructively, I have to tell you some did not. In particular, a group of investment firms and hedge funds decided to hold out for the prospect of an unjustified taxpayer-funded bailout. They were hoping that everybody else would make sacrifices, and they would have to make none. Some demanded twice the return that other lenders were getting. I don't stand with them. I stand with Chrysler's employees and their families and communities. I stand with Chrysler's management, its dealers, and its suppliers. I stand with the millions of Americans who own and want to buy Chrysler cars. I don't stand with those who held out when everybody else is making sacrifices. And that's why I'm supporting Chrysler's plans to use our bankruptcy laws to clear away its remaining obligations so the company can get back on its feet and onto a path of success.*
- Reality (from the S & A Digest): Obama's remarks are demonstrably false. A group of 20 creditors, the self-dubbed "non-TARP Chrysler lenders," refused the government's lowball offer for their *secured* bonds. Through a press release, the "non-TARP Chrysler lenders" said they offered to take a 40% haircut on their bonds, even though they were senior creditors and lenders lower down the priority chain were "being given recoveries of up to 50% or more and being allowed to take out billions of dollars." And Obama's bit on standing "with Chrysler's employees and their families and communities" is nonsense. Who do you think invests in these hedge funds that refused the deal? Pension funds, teachers' unions, and school endowments to name a few... Should these "communities" be punished for the sake of Chrysler's employees... many of whom are union employees who stubbornly refused to take pay cuts until it was too late? That's the big problem with socialism: Instead of allowing the market to decide who wins and who loses, you have politicians picking. Just imagine what's going to happen to the lending decisions of the banks that have taken TARP money... It's going to be a debacle. Welcome to Amerika.

The ghost of Christmas Future:

- **"While many in the media are now saying that things are looking up, and that the worst may now be over, I think it's just begun,"** says Doug Casey, confirming Bill's outlook. "For starters, stocks are cheap relative to where they've been over the last five years, but they're not cheap relative to historic bottoms (e.g., 1 times book, around 6-8 times earnings – after big earnings cuts – and 6-10% dividend yields). Treasuries are in a bubble. And as hard as it has fallen, residential property has not yet bottomed." "But the worst is yet to come. And I'm not talking about student loans, car loans and credit card debt. Or Social Security, Medicare and Medicaid. Or the looming bankruptcy of most states and many municipalities. The real crisis will be in pension funds, commercial real estate and life insurance companies. The life insurers own mostly commercial real estate, mortgages and bonds; many will be totally busted, even before people start cashing in their whole life policies. You don't even hear about these three things in the press yet." "Of course, that's all in addition to the fact half of U.S. hospitals are currently running at a loss – even before legions of the poor start really overwhelming their emergency rooms. And the balance of trade deficit has yet to turn around and go positive – which will be devastating to both the dollar and the average American's standard of living."

Unintended consequences –

- When I heard about the new tax scheme to tax all foreign income for corps, the first thing I thought about was that corporations would simply leave the U.S. This piece covers all of what I was thinking: "OBAMA! says it's time for U.S. corporations to pay their "fair" share of America's taxes. To that end, he is moving to close tax loopholes that permit multinational corporations headquartered in the U.S. to keep their foreign earnings offshore and untaxed. I'll spare you the details... but the net result is easy to understand: the largest tax increase on U.S. corporations since 1986. The move will surely play well to OBAMA!'s fans, who sincerely believe giving the government more resources will make our country a better place. It doesn't occur to these people that any lasting reduction to a corporation's global profitability will injure the company's shareholders. It also doesn't seem to occur to these folks that for many large multinational companies, their foreign earnings are larger than their U.S. earnings. Paying U.S. taxes on a business you own in China or India doesn't make much sense. Why keep your headquarters in America, when most of your business is overseas?"

Markets

Equity

Fortunately I was late and have the benefit of seeing what happened this Monday May 4. It was another massive short covering that then pushed the indexes through resistance. This will bring about more “bottom is in” blue skies talk. I suspect it will be enough to put the kibosh on my “fail right here thoughts. The question now becomes are we looking at an extended period of time when markets trade without regard to fundamentals (this is in essence what happened from 2003-7). I doubt it, but it has crossed my mind.

Credit

TBT is now over 50. Very hard to think about playing in this market since the Fed has promised to meddle in the market. Without the market manipulation, buying the TBT would be a great thing to do. With the interference in free markets, I am not willing to play in this sand box.

Gold and Silver

They are both getting pounded. Why? I am not entirely sure. What I am entirely sure of is that the end game of all this printing will be rampant inflation. Thus for those who truly have a multi-year approach, now is a very good time to buy bullion. I just read an article recommending some specific places to buy bullion. I have used a different firm but found them to be overpriced. When I have the ability to buy bullion again I will be picking off this list:

- With this incredible interest in gold, it's worth a fresh look at where to go for the best deals in bullion... and what the wait times and premiums are. Here are the dealers that have consistently treated their clients (and our readership) well over the years:

  Kitco (Kitco.com; 1-877-775-4826). All bullion products are available at Kitco and can be shipped within 24-48 hours of a paid order. Premiums are slightly higher than our other dealers recommended below, but what's particularly attractive at Kitco is that you can get silver for less than 1% over spot... Its pool account is currently charging only 14 cents over spot (premium fluctuates daily), which is a great way to build your silver holdings while waiting for physical premiums to come down.

  The Coin Agent (thecoinagent.com; 1-888-494-8889; thecoinagent@gmail.com). Wayne Lemonier currently offers immediate delivery on paid orders for all gold coins except the Eagle, which takes two weeks.

  Premiums for gold coins are 6% over spot for Maple Leafs, 6.5% for Philharmonics and Krugerrands, and 7% for Eagles (one of the lowest in the industry).

  Silver bars are at the lowest premium we know of: A 10-ounce silver bar costs $1.75 per ounce over spot, and 100-ounce bars are only $1.50 per ounce over spot. American silver Eagles are spot + $4.50, and silver Canadian Maples are spot + $4. Shipping and handling for silver is $20 per 100 ounces.

  Border Gold (bordergold.com; 888-312-2288 ext. 7). Both gold and silver Maple Leafs are readily available and can ship the day an order is paid. Border told us premiums are slightly higher this year than last because the Royal

Canadian Mint raised its prices.

Premiums on gold Maple Leafs are only 5.5%, one of the lowest in the industry. Shipping and insurance is $25 for one or two coins. A one-ounce gold bar is spot + $25; 5-ounce and 10-ounce bars are available in limited quantities at spot + $22 per ounce.

The one-ounce silver Maple Leaf is $4 over spot for up to 99 coins and then $3.25 per coin. Both 10- and 100-ounce silver bars cost $2.50 above spot, with the 100-ounce silver taking a week to deliver.

ASI (assetstrategies.com; 1-800-831-0007). Gold Maple Leafs, Philharmonics, and Krugerrands can be shipped immediately upon a paid order, with American Eagles currently taking about three weeks.

One-ounce gold coins are 7.5% to 8% over spot; Eagles are 8.5% to 9%. One- and 10-ounce gold bars can be had at 6%. One-ounce silver Eagles are $4.30 over spot. A 100-ounce silver bar is $2.20 per ounce, and a one-ounce bar is spot + $2.50. Costs for junk silver vary but average about $2.20 per ounce over spot.

Trading

Past week

The gold trade did not work. It was another painful foray.

Upcoming week

We have taken some more hits on way out of the money short calls (that got brought into play by 30 and 50% moves in underlying stocks in a couple of days). We have accordingly decided to let go of the burning pots and will be very unlikely to venture in before there is much more clarity

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