

## The Other Side of the Street November 4, 2007

### Comments

The public has been told for the last six weeks that the credit situation has improved because of the Fed Sept cuts. You read here that such pronouncements were not only spin, they also were untrue. You will read below that CIT revealed an additional 8-11 Billion in losses due to **“the further writedown reflected a series of rating agency downgrades of subprime related assets and “other market” developments since the end of the third quarter”**

We have now reached the point where there are no more lies left to tell. The financials are in shambles and their condition is only now seeping out. It is disgraceful that both the government and Wall Street have so misled investors in pathetic efforts to use the bully pulpit to “save” the equity markets. The sciolism demonstrated by the media in reporting these stories disturbing.

In other news of the week past, one of the momo favorites CROX, the shoe retailer came in with “just average” news. The stock dropped a little more than average – more than 30%. This is how the momentum game ends. CROX is headed much lower. The same fate awaits GOOG, RIMM, and all the other bloated momo names.

During my week off I visited my sister in Atlanta. I told her that I hope I have not become the boy who cried wolf to all of you. I know I have been way ahead of the market reaction to the structured finance scheme. At one point it paid to see the future on Wall Street. This time it simply made those with foresight appear mad. In retrospect, the thing that will appear mad is that the charlatans were able to fool so many so long.

In the past five years, buying stocks by throwing darts at the stock pages would have made an investor money. In the next five, shorting the same way will make you money.

In very late breaking news – i.e. as I was about to send. I saw the story about China and Hong Kong quoted below. It is my understanding that the Hang Seng rallied 40% plus AFTER it was announced that mainland investors would be allowed to buy Hang Seng shares. This news would appear to be disastrous to that trade. Keeping in mind that the global nature of investing can be a curse as well as a blessing, watch for an Asian contagion on this news.

We ARE seeing . . .

### Credit

- Nov 2 - The US Federal Reserve was forced to pump \$41 billion (£19.7 billion) into the financial system, the largest cash infusion since the September 2001 terrorist attacks, as fears of a fresh round of massive banking writedowns added to concerns on Wall Street and in London. **[but the credit markets have been improving the last 6 weeks or maybe not]**  
<http://business.timesonline.co.uk/tol/business/economics/article2788999.ece?EMC-B1tn=LOZGD4>

- Global investors succumbed to a new bout of jitters on Thursday amid concerns that a host of important financial institutions are nursing additional problems related to the troubled US mortgage market. Equity markets tumbled and bond prices rose in the US and Europe. US financial stocks endured their worst day in five years, with some of the worst falls suffered by large banks and smaller specialist credit insurers. **The biggest single reason for the decline in equities was the revival of worries that big banks in the US and Europe would unveil further credit write-offs. [Which of course happened today. Anyone who believes that the “bottom is in” deserves to lose their money. No one will know when the bottom is in except in retrospect. While there is little if any evidence a bottom is anywhere near, there is abundant evidence that the problem is the tip of the iceberg.]** Another focus of concern involved a less well-known pillar of the global financial system – smaller specialist insurers that provide credit guarantees to lenders and investors. Shares in Radian, a private mortgage insurer, fell 19 per cent, after its first quarterly loss, due to mortgage-related problems. MBIA and Ambac, the two biggest bond insurers in the US, have also experienced dramatic declines, amid fears they, too, could be nursing unseen subprime-linked problems. MBIA and Ambac – often called “monoline” insurers – say that they are well positioned and that their exposure to subprime assets is very small. **But analysts fear that a worsening of the crisis could result in their losing their top-notch credit rating. That, in turn, could trigger a “domino effect” that would cut the value of the bonds they have insured. The companies insure both complex securities backed by mortgages and less risky municipal bonds. [This is a really big deal. When asked 4 years ago the single best short, I said MBIA, which promptly went up the next year or so. However, my strength has always been analysis not timing☺]** These concerns triggered a sharp rise in the cost of insuring monoline debt against default. The broader cost of buying protection against default of a basket of European and US bonds also reached the highest level in several weeks. The rate of delinquencies among US mortgage borrowers, meanwhile, has doubled from the same period of last year, according to data from RealtyTrac. The main ratings agencies slashed to junk the ratings on more than \$100bn in subprime mortgage-backed bonds in the past month. The ABX index, which tracks such bonds, has fallen sharply in recent months. The riskiest slice of the index, which tracks bonds rated BBB-, has fallen about 80 per cent this year. <http://www.ft.com/cms/s/0/d0b545bc-88b1-11dc-84c9-0000779fd2ac.html>

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## Commercial Real Estate

## Commodities

## Currency

## Diversification

## Derivatives

- November 4 2007 FT Chuck Prince on Sunday resigned as chairman and chief executive of **Citigroup after the bank revealed pre-tax losses in its subprime mortgage-related holdings of between \$8bn and \$11bn.** Citi said the further writedown reflected a series of rating agency downgrades of subprime related assets and “other market” developments since the end of the third quarter. Mr. Prince said that “given the size of the recent losses in our mortgage backed securities the only honourable course for me to take as chief executive officer is to step down”. Robert Rubin, the former US Treasury secretary, will take over as chairman and Sir Win Bischoff, former head of Schroders and now chairman of Citi Europe, will be temporary chief executive. Mr. Prince resigned at an emergency board meeting which had been called to consider his future and further losses the company faces as a result of the subprime mortgage crisis. Citi **recently announced \$1.6bn of losses on its mortgage-backed securities for the third quarter,** [assuming the announcement reliable that means the losses in the last month have been 5 times higher – this in “firming credit markets”] the which prompted the departure of several senior executives including Tom Maheras, head of all Citi’s capital markets operations. **But the value of mortgage securities packaged into collateralised debt obligations has fallen further in recent weeks sharply increasing the losses Wall Street banks face.** Stan O’Neal was last week ousted as chairman and chief executive of Merrill Lynch, after an \$8bn writedown on its mortgage-related holdings. Some investors hope the departure of Mr. Prince could lead to a change of strategic direction, including disposals or even a full-scale break-up of the group.  
[http://www.ft.com/cms/s/0/1f946522-8b06-11dc-95f7-0000779fd2ac.html?nclick\\_check=1](http://www.ft.com/cms/s/0/1f946522-8b06-11dc-95f7-0000779fd2ac.html?nclick_check=1)

## Housing

### Housing Finance

- Nov. 5 (Bloomberg) -- The U.S. housing slowdown that propelled 10-year Treasuries to their biggest gains since 2002 may soon make the same securities laggards in the government bond market. The notes returned 9.6 percent since mid-June as investors sought a haven from credit market losses caused by subprime mortgages, Merrill Lynch & Co. index data show. Sales of bonds backed by housing loans have dropped 20 percent this year as home purchases declined, according to Citigroup Inc., reducing the need for longer-maturity Treasuries as a hedge. Fund managers may ``no longer buy the 10-year

Treasury" to protect their holdings, said Ajay Rajadhyaksha, head of interest rate strategy in New York at Barclays Capital Inc., one of 21 primary dealers of U.S. government securities obligated to bid at Treasury auctions. **The mortgage market's influence over Treasuries has increased as the amount of home loans quadrupled to \$10.9 trillion since 2001**, according to the Mortgage Bankers Association in Washington. More than \$6 trillion of securities backed by home loans are outstanding, compared with \$4.5 trillion of U.S. government debt securities, data compiled by the Treasury show. **[Keep in mind a "return to normal" in this market is not a return to last year or 2005. there is a tremendous drop to "normal"]** **Subprime Contagion May Claim 10-Year Treasuries as Next Victim**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=agC9y13IzHt0&refer=home>

- **A major US real estate appraisal company was accused on Thursday of conspiring with one of the country's biggest banks to inflate home prices in a scheme that New York state officials said helped fuel the mortgage crisis.** Andrew Cuomo, New York attorney-general, filed a lawsuit against First American saying its eAppraiseIT subsidiary gave in to pressure from Washington Mutual, the biggest savings and loans group in the US, to use a preferred list of appraisers who allegedly provided inflated values for homes. **First American in mortgage fraud probe** <http://www.ft.com/cms/s/0/1a339b84-88c2-11dc-84c9-0000779fd2ac.html>

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## Macro Economic

- November 4 2007 China has in effect frozen a proposal to allow mainland citizens to buy shares in Hong Kong, a decision that threatens to undercut the recent surge in the former colony's equities market to record highs. Wen Jiabao, the premier, has attached four conditions to final approval for the scheme, all of which are so open-ended that Beijing could take months, if not longer, to permit it to go ahead. "[We] should make scientific judgment and analysis on what impact the massive funds flooding into Hong Kong's financial market would have," Mr. Wen said in a highly unusual intervention delivered to Hong Kong reporters during a visit to Uzbekistan. His comments cap two months of messy policy infighting over the proposal between rival agencies in Beijing with conflicting interests in management of the country's financial system and capital account. The "through-train" to the Hong Kong stock market was announced in August by the State Administration of Foreign Exchange, a body under the central bank, and sparked an immediate spike in the territory's share prices. **China puts Hong Kong share plan on ice** <http://www.ft.com/cms/s/0/4b3556dc-8b01-11dc-95f7-0000779fd2ac.html>

**Retail**

**Retirement**

**Risk**

**Savings Rate**

**Tech**

**Wall Street**

- Merrill Lynch & Co. has been hiding its mortgage losses through deals with hedge funds, sources told The Wall Street Journal. In recent weeks, Merrill Lynch has been asking the hedge funds to take on mortgage-related securities, which would keep losses temporarily out of sight, insiders said to the Journal. This may have caught the Securities and Exchange Commission's eye: The report said that the regulatory body is inspecting the firm to see how it has been valuing its mortgage securities and whether it knew that its mortgage problem was larger than it had let on this summer. **Merrill said to hide losses behind hedges [I can't tell you if this is true or not. I can tell you that such illegal activity would be completely in keeping with the history of Wall Street and the type of behavior that I think currently rampant in those "great P/E " numbers. And yes I spent 17 years as an attorney litigating cases involving such behavior.]** <http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20071102/REG/71102006/-1/INDaily01>
- In the wider market, leading shares fell sharply for a second day in a row amid continuing worries over the financial health of banks on both sides of the Atlantic. The session's main talking point was undoubtedly Barclays, which slumped to its lowest level for more than two **years amid rumours that it had approached the Bank of England for emergency funding.** A further bear story suggested that Barclays had been talking down its own numbers at investor meetings in the US. However, dealers quickly realised Barclays bought 5.75m of its own shares for cancellation on Thursday, which it would not have done if it needed a Bank bail-out. <http://www.ft.com/cms/s/0/eb707544-891e-11dc-b52e-0000779fd2ac.html>
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**Don't Fight The Fed**

- "While significant uncertainty continues to prevail in financial markets," Citigroup expects that capital ratios "will return within the range of targeted levels by the end of the second quarter of 2008," while maintaining the current dividend, the company said. **In an announcement indicating they missed a month ago by a factor of 5 or more in estimating the current losses, CITI notes that the blue sky will be back soon.**

**I Disagree . . . and why**

[Article of the week:](#)

Media/Entertainment

## GDP = Grossly Disappointing Press

By Marek Fuchs

Special to TheStreet.com

11/3/2007 10:57 AM EDT

URL: <http://www.thestreet.com/newsanalysis/mediaentertainment/10388169.html>

The coverage of Gross Domestic Product is, as longtime readers know, probably the most consistently dodgy work that the business media perform and, well, reading it generally makes me want to poke fingers in my eyes.

The dance has been played time and again over the years. The Commerce Department reports a GDP figure and the business media parrots it straight and, worse, they pontificate at length as to what this figure says about the economy.

Why is this perpetual mistake so pathetically bad?

Well, these reporters draw their myriad conclusions without ever deigning to mention that the number is very likely to be revised -- sometimes on the order of 50%. In other words, their initial conclusions about the economy are often proved wrong and they know it's going to happen because it has happened repeatedly. Put that in your 800 words of definitive conclusions and smoke it.

When revisions come out, their articles about new conclusions often include a disingenuous turn of phrase like: "Analysts were surprised by the extent of the revision, which made clear that the economy was on more solid [or less certain] footing than previously expected."

For readers who swallow the Kool-Aid of one political party or another, put that Styrofoam cup down. It's no time to toast. This has happened under every political party and the revisions have gone every which way.

Just this week, the Commerce Department released the third quarter's first, fleeting, temporary, prone-to-evaporation number, and we'll get to the reporting on it, which has improved slightly under my scythe. (Although we've had a bit of a relapse since two quarters ago. Bad habits die hard and come back to life like zombies.)

More importantly, we'll isolate the several different manners you now see GDP reported, from good to beyond horrible. (If you want to refresh your mind through a darkness tour of past mistakes, which are most remarkable, please read some of my past work. I have neither the time nor strength of heart to recount them here.)

Anyhow, here's the breakdown in coverage, by type. Pay attention and you'll know what to look for and save yourself a lot of grief.

**Perfection:** For obvious reasons, I don't frequently grant work by *TheStreet.com* the coveted Business Press Maven "Nod of Approval" award, but, quite simply and inarguably, this piece is the standard-setter for Gross Domestic Product coverage. In a staff-written piece, this was the fifth sentence, laying out all the issues and qualifiers and telling you what to look for and when:

"The figure is the first of three that will ultimately be released on the third quarter. Revisions are not uncommon. The second pass, the so-called preliminary estimates, will be available Nov. 29."

**Decent:** This is the fourth sentence in *The New York Times* and, though I would have wanted more fill-out and a labeling of the Gross Domestic Product number when it is first mentioned as "preliminary," what're ya gonna do? I'll take it. Here's the line, set way up high, to let readers know that everything they read after might be proved irrelevant in a matter of weeks:

"The report from the Commerce Department is a preliminary estimate of gross domestic product in July through September, a volatile period that included the bleakest moments of the summer's subprime mortgage collapse."

**Horrific:** Examples of the horrific are as plentiful as children coming down off of sugar highs in these days after Halloween. Look at an article in the renowned and revered Wall Street Journal, which offers this headline: "GDP's 3.9% Surge May Be Tough to Match."

They do this with no qualifier like: "If it's not revised downward by a factor of 50% or so."

Anyhow, within the body of the article, there is no Surgeon General's warning that the following conclusions garnered for this article might be hazardous to your pocketbook. Nor is there even the perfunctory use of a word like "preliminary" thrown in there, which we see elsewhere, the lowest bar to

hurdle, but at least one that technically sets the record down accurately, even if it does not do enough to draw investor attention to that accuracy. What can be worse than no mention?

**Welcome to Worse Than Horrific Land.**

This is what drives The Business Press Maven to drink ... even more. Today's business media environment is filled with so much talk and follow-up talk. But even publications that manage to slip the now obligatory "preliminary" into their first report on GDP, drop the mention in subsequent reporting. It is, from that point on, taken as a matter of fact.

When *The New York Times* soon reported on the **Fed's** decision to lower rates, there was no preliminary. That initial, fleeting, written in lemon-ink GDP rate was effectively set in stone:

"Yet just a few hours before the Fed announced its decision, the Commerce Department reported that the nation's gross domestic product expanded at a healthy pace of 3.9 percent in the quarter that ended Sept. 30."

Any investor who did not know better was confused and you can't tell me the publication did not know any better. They knew enough to put in a disclaimer on this essential number the first time. If that does not earn a dreaded Business Press Maven Back of the Hand award, I'm not sure what does <http://www.thestreet.com/pf/newsanalysis/mediaentertainment/10388169.html>

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