

## The Other Side of the Street November 9, 2008

**Now we've lost our way; we don't believe in what made America great, and that was individual liberty. We've become too dependent on government. . . . The finances are in such disastrous shape because we can't survive without borrowing \$ 2.5 billion every day from overseas because of the current account deficit, and a country can't continue to do that. They can't continue to borrow from overseas and print money. They will come up short, and they can't just print the money – it just won't work. - Ron Paul**

Despite all the negative economic news, John Bogle, founder of the mutual-fund firm Vanguard, thinks we've hit a market bottom. "It seems to me that people have lost sight of the fact that the fundamentals have improved radically. The value of the U.S. stock market was \$18 trillion a year ago. And now it's about \$9.5 trillion or let's call it \$10 trillion with today's rally. **Anyone who believes that American business is worth \$8 trillion less than it was a year ago I think is a fool," said Bogle. [Possibly the most ignorant comment I have read. His assumption is that last year's exhaustion rally getting the last fool in, in some way established a reasonable valuation for equities. This would be much like someone stating that the Nasdaq at 5200 was properly valued in the spring of 2000. If you have any interest in a Vanguard product, now would be a good time to move it.]**

### Comments

Tomorrow is Veteran's Day, make sure you thank those who have served.

Meanwhile the last four days market action was very grim. As I noted on Dog Blog, the sell off today on the China half trillion bail out was eerily similar to the reaction accorded the Paulsen plan in September. Prior to today, I had thought like most that we were slipping into a 8-10K Dow trading range. I thought it would last through the end of the year. While this remains the likely course of events, today was spooky and we need to move to Crash Watch II as there remains a complete lack of liquidity.

The action in Goldman Sacs is ugly. I have a very small position simply so I remember to watch it every day. Stocks like Goldman are ones where inside street knowledge really is important (I mean the traders in New York, not SEC type "insider"). When a stock like Goldman gets beaten up, I wonder if there is information that they have some serious problems and are dumping assets.

Further American Express becoming a bank holding company is very ominous. This news just out tonight indicates they must be desperate for financing and need to access the Fed free cheese line to keep going. Makes me wish I had a much larger short position in COF.

So . . . while there remain a great number of reasons why the markets should be manipulated higher into year end, we might also be at a point where real market forces defeat the gamblers. I think that we are particularly susceptible to Crash II because there is so much betting being made by players who need a miracle finish to keep their jobs, funds, livelihood. One could safely assume that leverage is very extended and new lows will lead to massive margin calls. I suspect that such forces are what is keeping a lid on oil and the precious metals. Should that be

the case, expect the commodity complex to explode higher in January. The sale on gold and silver IMO will be over before the ball drops on Times Square.

In closing, THANKS VETRANS!!!!!!!!!!!!!!!

### Stock Notes

- **AIG's board is in the final stages of approving a large overhaul of its previous \$85 billion rescue plan from the U.S. government, according to people familiar with the matter. As part of the plan, the government is expected to roll back the length and interest rate of its existing loan, buy \$40 billion in preferred AIG shares through the U.S. Treasury's Troubled Asset Relief Program, and cancel the bulk of its credit default swap agreements via a massive purchase of their underlying real estate assets. There is also a plan to backstop AIG's securities lending portfolio. In all, the U.S. will end up with total exposure of some \$150 billion in investments. [Where is the outrage????????? How many more hundreds of billions before America wakes up????????????????]**
- **Nov. 8 (Bloomberg) -- Democratic congressional leaders urged Treasury Secretary Henry Paulson to use the \$700 billion rescue bill passed last month to provide temporary aid to the U.S. auto industry. House Speaker Nancy Pelosi and Senate Majority Leader Harry Reid sent a letter to Paulson today saying the rescue bill gives him "broad discretion to purchase, or make commitments to purchase, financial instruments you determine necessary to restore financial-market stability." [see prior note]**
- Nov. 3, 2008 Circuit City said it will close 155 U.S. stores, cut back openings and "aggressively" renegotiate some leases as the company deals with its deteriorating liquidity position. The move is the latest step for a company that has been unable to turn its fortune around the past several years and now finds itself further hampered by a weakening economy and turbulent credit market.
- Nov. 3, 2008 General Motors said U.S. car and light truck sales dropped 45% in October from a year earlier, and said it is moving up its year-end sales promotion. Ford Motor reported a 30% drop in U.S. vehicle sales for October, while Toyota's fell 23%. Adjusted for population growth, "this is probably the worst industry sales month in the post-WWII era," said GM North America executive Mark LaNeve.
- Yet another bank failed... Freedom Bank of Bradenton, Florida, became the 17th bank this year seized by regulators. Freedom, with \$287 million in assets and \$254 million in deposits, closed its doors yesterday. Fifth Third Bancorp will assume the deposits and buy \$36 million of assets – the four branches opened today as Fifth Third branches. In the face of mounting failures, the U.S. government now expects 1,800 publicly traded institutions to ask for bailouts.

## Notes

- U.S. job losses accelerated the last two months, pushing the unemployment rate to 14-year highs in October. Nonfarm payrolls, which are calculated by a survey of establishments, tumbled a larger-than-expected 240,000 in October. The unemployment rate, which is calculated using a survey of households, soared 0.4 percentage point to 6.5%, its highest since March 1994.
- As much as I want to believe otherwise, I don't think the worst is over for global stock markets. Yes, the week that just passed (October 27 to 31) was the best week for the Dow in 34 years. It rose by 10.5%. But what does this mean? It means that not since the week ending October 11, 1974, has the Dow risen so much in percentage terms. But let me remind you that October 1974 was not the low of the terrible 1973-74 bear market. Yes, it rose by a massive 14.1% that week in 1974, and ended the week at 658.17. But in the weeks to come, this would prove to be just another bear market rally. It would fall, ultimately, to a closing low of 577.60 on December 6. In fact, if we look at the best weeks ever on record for the Dow, **we see that they were all bear market rallies**. The week ending June 26, 1931, saw the Dow soar by 16.1%, its best ever. But the absolute low was still over a year away. In fact, except for that week in 1974 and last week, all of the best 15 weeks of the Dow took place in the 1930s, and most were bear market rallies.
- The funny thing is, the IEA will look like it knew what it was talking about in a couple of years when the Iranian, Mexican, Venezuelan, and Norwegian state oil companies – representing 25% of the world export supply – essentially go off line. The state-run oil companies are under-investing in future reserves and production because the governments take too much cash out of the oil companies to fund social "progress." This will seriously crimp supply and cause oil prices to soar.
- New foreclosures rose 50% in New York City and more than doubled in Seattle in October from a year earlier. Miami and Los Angeles saw 35% and 11% increases, respectively. The New York increase came from defaults in Queens, which had 12 of the city's 15 ZIP codes with the most foreclosures. According to PropertyShark, a Brooklyn-based real estate researcher, Los Angeles led the country with 2,389 foreclosures, followed by Miami with 861, NYC with 336, and Seattle with 150.

His argument is not far from the one we made six years ago. In the 1980s, Japan ran up stock and property prices in a spree of debt and leverage. Then, when the bubble popped, the usual monetary stimulus didn't work. The Bank of Japan cut rates to almost zero...still, few people were willing to borrow.

The economy did not recover; instead, it got worse and worse until 2005 – 15 years later – when stocks had lost 72% of their value, land was down 81%, and golf course memberships had sunk 95% from their peak.

The problem, he explains, was that it was a “balance sheet recession,” not a typical business cycle downturn. Companies, banks, and individuals had to pay down the debt that they had accumulated in the boom; they did not want to borrow more money, even at zero interest rates. For 7 years, from 1998 to 2005, net business borrowing went negative – meaning, businesses were paying off more debt than they were taking on.

This came as a shock to modern economists. Japanese officials were flummoxed. U.S. economists accused them of not acting swiftly enough...or not having the stomach to let the big banks fail. But almost no one seemed to understand what was really going on. They should have. Irving Fisher described it back in 1933, observing that when people who are deeply in debt get into trouble they usually sell assets. He called it a “stampede to liquidity.” Investors dump stocks and property for any price they can get – desperate to pay off their debts before they are dragged into bankruptcy.

This is the phenomenon known to economists as the “fallacy of composition.” What is good for every individual investor – cutting expenses, paying off debt – turns out to be bad for the economy itself. Asset prices fall. Sales fall. Unemployment rises. The slump deepens.

In Japan’s case, combined capital losses from land and stocks grew from 1990 until 2002, at which time they reached \$15 trillion – or 3 years worth of Japan’s GDP.

You can do the math yourself, dear reader. America’s GDP is about \$14 trillion. Multiply that times three and you get \$42 trillion. So far, the U.S. has lost about \$4 or \$5 trillion in housing prices...and maybe another \$6 trillion in stocks, for a total of about \$11 trillion, maximum. A long way to go...

“The position of the United States today is approaching that of Britain at the end of World War II. Britain had been the world’s dominant economic, political and military power, with the world’s reserve currency. But by 1946 it was militarily stretched beyond its capacity, and highly indebted. The U.S. took over the #1 spot and the dollar became the world’s reserve currency, with the pound falling from five-to-one in 1946, down to parity four decades later.

“The problem with being the world’s reserve currency is that more money is created than is necessary for the domestic economy’s needs. For decades, the United States has created far more dollars than it needs, but it didn’t matter so long as other countries were prepared to buy and hold those dollars. But those dollars still exist. As other countries lose confidence and diversity, those dollars eventually come back...”

**The stock market had its best “Election Day rally” yesterday in 24 years.**

Markets rallied across the board, with the S&P 500 booming 4%. The Dow and Nasdaq weren’t far behind. We suspect traders were more excited about the end of the election cycle than the possible election of either candidate.

Ironically, oil and energy companies led the way yesterday... some of the very organizations Obama has threatened to beat with windfall taxes and new regulations.

- **Ron Paul:** Well I don’t know whether hard is the right word, but it is aggravating. I never consider myself frustrated, because I came to Washington with full knowledge of how the system works. I know the system is bad, and I vote a certain way, I try to make the points on what’s wrong. Everything that is happening, **I’ve sort of expected, but it’s still pretty annoying to find out that people don’t respond to common sense, but hopefully they do before we have a tragic outcome like a financial or a dollar crisis.**

After that, the conditions are much tougher to come back with reforms, which we need, and **we also need a different attitude about the role of government.** We need an attitude that's different about what we are supposed to be doing overseas, as well as how we run this welfare state. And if we don't change our attitude then we're going to have an economic crisis, which surely could lead to a political crisis. **Q:** David Walker says in his talks that he thinks we've lost our way, that the idea of what America was a long time ago and what it could be is somehow getting away from us. Is this something that rings true to you? **Ron Paul:** **Oh yeah, we've lost our way because the majority of people – certainly in Washington – really don't care about the Constitution. The Constitution restrains government power and enhances personal liberty.** We've lost our way because we've given up on our faith and our conviction and our understanding how freedom works. **We don't believe free markets will take care of people.** Everybody has to have a safety net. Big businesses have a safety net, small businesses have a safety net, and poor people have safety nets. Medical care can't be delivered by the marketplace and housing has to be delivered by government, and they never look at the problems: whether there's going to be a housing bubble and whether medical care is not only getting too costly but it's not improving, and whether the military industrial complex takes over the system. **Now we've lost our way; we don't believe in what made America great, and that was individual liberty. We've become too dependent on government,** and yet, in spite of all those negative things I've just said and how bad Washington is and how bad the financial system is, in my travels around the country I'm really encouraged. Because so many young people today understand this and they're getting information off the Internet and different sources. So I think the undercurrent is very, very favorable and I think the next generation is not as tolerant for this acceptance of big government, and there's probably two reasons for that. I think they're attracted to the ideas and the principles of liberty, but also **I think they sense that we have problems and they don't know how they're going to pay these huge debts and these entitlement burdens that are coming.** They're sick and tired of the foreign policy, so in some way the problems are arousing a lot of people. As long as we do our job in spreading the ideas of freedom and emphasizing the rule of law and the restraint of government, there's reason to be hopeful. **Q:** **How would you characterize a generation of people who live beyond their means and pass that debt along to their children?** **Ron Paul:** I don't think people do it thinking, **"Let's see, how many benefits can we get from government and stick it to the kid's tab?" But in a way, financially, it looks like that.** But they can rationalize and say, "Well, I paid into these systems, I've been paying taxes, I just want to get some of my money back," not admitting the truth to themselves that all their money's been spent. I think it all came out of bad economic teaching of the Depression. In the early '30s when we had our Depression it was taught that capitalism and the gold standard caused all the problems, and therefore, you had to have government bailout programs and safety nets and they ushered in the whole age of welfarism, Social Security, and the government had to take care of us. At the same time, they had been taught ever since World War I that it is our obligation and responsibility morally to spread our values around the world. We have to have a war to spread democracy throughout. This whole generation accepted this but it was fallacious. It's based not on principles of liberty and self-reliance. It's based on the fact that, "well, we do need government to take care of us," **and they never ask the question, you know, "Who's going to pay for it?"** We

have dropped this moral constitutional approach to what we do, and yet a whole generation if not two or three have accepted this idea because we've been so wealthy and we're still doing pretty well on the surface. People seem to be doing pretty well. The tragedy is, it is all on borrowed money now. **The finances are in such disastrous shape because we can't survive without borrowing \$ 2.5 billion every day from overseas because of the current account deficit, and a country can't continue to do that. They can't continue to borrow from overseas and print money. They will come up short, and they can't just print the money – it just won't work.** Eventually that ends up in big economic problems.

- **Ron Paul:** Well, the worst thing is that the dollar's value is being eroded systematically every day, and that is since 1913. **Since we've had the Federal Reserve, we have lost about 96 percent of the value of the dollar.** If we don't course-correct, we're going to have a crash in the remaining value of the dollar, and you could lose it quickly. When a currency gets up to end stages, it goes quickly. A lot of people remember what happened in Germany when the German mark lost all its value. When that happens, there's runaway inflation, no controls, and economic breakdown. This usually invites a dictator – that's what helped usher Hitler into power. **So many countries have bitten the dust through inflation, even in ancient times. They didn't have printing presses, but they would dilute the metal or clip the coins and deceive and steal from the people – things the government shouldn't be doing.** This is a very serious problem and the biggest reality that we have to come to grips with is that we can't afford to pay all these bills, **and if we just pay for these bills by printing money, then we'll destroy the currency.** And that will be a much, much more painful reaction than us just tightening our belts and living within our means.
- **Q:** Do you see the housing bubble as somehow being tied to the lack of savings today?  
**Ron Paul:** **Alan Greenspan and I got into a little debate when I was complaining about no savings rate, and he says, "Yeah, but housing prices are going up, and therefore people have savings." I told him that he was getting savings confused with inflation, because as a consequence of inflation the nominal price of houses was going up, but that really isn't savings because as something like that can go up in price, it can also go down.** And that's exactly what has happened. In the old days, when I bought my first house, I went to a savings and loan, and somebody put money in that bank and I borrowed it **and I had to pay it back.** That's basically the way a market should work: Somebody should put money in the bank and you should borrow it out. Today, because we don't have any savings, we depend on the Fed, and the Fed creates too much money, lowers interest rates too much and then they create a bubble. How long has it been that many, many good economists have been predicting that the consequence that we're facing is the collapse of the housing bubble. When the markets finally realize how damaging this is and how pervasive it is and how it's going to affect all of our other markets, we're going to have a lot more unwinding to do and it's going to affect our whole economy, because housing is a significant part. I'm probably impressed that it hasn't stirred the markets up that much yet but I think in time this is going to be much more of an issue in the economy and on the financial markets than it is today.
- During the Great Moderation we were assured that our financial authorities had found the magic formula; henceforth, enlightened economic management, along with sophisticated, risk-dispersing financial instruments, would practically eliminate recessions and crashes.

There was no need to save for a rainy day, we were assured; because it would never rain! But now we have a downpour...with markets crashing and the world facing its biggest slump ever. And now we are told that markets have failed. Now, we need Barney Frank, Ben Bernanke and Hank Paulson to run our financial system. Wait a minute...we don't recall Ben Bernanke warning that the world faced a meltdown when he took over at the Fed in Feb. 2006. And wasn't Barney Frank the chairman of the House Financial Services Committee even as Wall Street was running amok, inflating the biggest asset bubble in history? We don't remember him holding hearings about the dangers it presented until after the thing blew up. And wasn't Hank Paulson the head of one of Wall Street's most go-go, derivative saturated, billion-dollar-bonus-driven firms while all of this was going on?

- Economic activity across European Union predicted to grind to a standstill next year with UK outlook particularly bleak

On paper, stocks are cheap. But out in the real world of commerce, corporate earnings are imploding. So maybe stocks are not as cheap as they seem. Americans are reigning in their spending and banks are reining in their lending. So what chance does this economy have?

Yesterday, General Motors reported its worst October sales since the Second World War, on a per capita basis. Based on raw sales numbers, however, GM's results were slightly better. They were merely the worst sales results since 1975. The rest of the world's auto manufacturers reported equally disastrous results for October. Many other industries are also swooning, which prompts two obvious questions:

- 1) If revenues are tanking, won't earnings also fall?
- 2) If earnings fall, won't share prices tank?

We know that stocks are cheap, at least cheaper than they have been during the last 20 years, but we don't know if they are "cheap enough"... whatever that moving target might be.

Therefore, since we do not know for certain whether the "bottom is in" or whether the bottom lies another 3,000 Dow points below us, let's conduct a little exercise. First, let's imagine that stocks are cheap enough to buy; Second, let's not forget to imagine that stocks might become even cheaper still.

- We've seen dozens of hedge funds halt redemptions and close shop, but never one this big... GLG, one of Europe's largest hedge funds with around \$23 billion in assets, will alert investors of a "liquidity review" this week. GLG is halting redemptions in its \$1.5 billion Market Neutral Fund for six months. It will also tell investors looking to withdraw from the \$2.5 billion Emerging Markets Fund that they will not receive a full return because parts of the fund are too illiquid to sell. The real trouble for GLG starts if assets fall to less than \$15 billion. At that point, the fund would breach a loan covenant and be forced to liquidate more positions.
- The American middle class was built by personal rectitude (hard work, saving, thrift), cheap energy, rising productivity, and the enormous surge in demand for American-made products and services following War World II. It cannot be "rebuilt" by the government

or any president. It was a wonderful byproduct of American capitalism, personal responsibility, and the huge growth in free markets globally over the last 100 years. The government cannot *give* anyone "the good life." Profits must be earned. Capital must be saved. And risks must be assumed to pursue growth.

- “The D-word is back,” says this morning’s *Financial Times* . “Could deflation be the next big shock to the financial system?” Where has the *FT* been? The world has never seen so much deflation. Stock markets around the world have deflated by about \$10 trillion. U.S. housing has deflated by about \$5 trillion. Oil has deflated to only half its high; it closed at \$64 on Friday. Gold, down \$13 on Friday, has deflated about 25%. Bear Stearns deflated to nearly zero. The Dow rose 141 points on Friday. But year-to-date, the U.S. stock market – as measured by the S&P 500 – is down 35%. That means that U.S. stockholders alone have suffered a loss of nearly \$5 trillion. And one in every five houses in America has sunk so low that it is now underwater; the mortgage level is higher than the value of the house. DR
- U.S. banks continued to tighten their standards on loans to households and businesses in the third quarter, according to a Federal Reserve survey of bank executives. Banks said the uncertain economic outlook and their reduced tolerance for risk also prompted them to reduce credit limits on existing credit card accounts to both prime and nonprime borrowers. [for details see excerpts below under housing finance and retail]
- Making no bones about the goal of his mission, Brown has said that he wants "hundreds of billions" of extra dollars from the oil-rich Gulf States, to be pledged to the International Monetary Fund. The IMF is already burning through its \$250 billion reserves, providing around \$30 billion in emergency loans to Iceland, Hungary and Ukraine in the past few weeks alone. Pakistan has also said it may call on the international body for a quick cash advance. Somewhere in the vicinity of \$5 billion should do the job, they reckon.
- the Institute for Supply Management said its index of manufacturing activity in the U.S. fell to 38.9 in October from 43.5 in September. The reading was below expectations of a more modest decline to 41.5 and is the worst outcome since September 1982.
- At the end of September, 30 states were in recession, according to **Moody's Economy.com**. Back in March, only five states were in recession: Arizona, California, Florida, Michigan and Nevada. Even in the last month, the picture has grown more dire. At the end of August, 27 states were in recession and a few were still expanding. But now, Moody's has determined that Hawaii, Minnesota and Utah have fallen into recession. Colorado, Massachusetts, Montana, New Hampshire and Texas are also no longer classified as expanding economies. They now are at risk of falling into recession.
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### Web links

### Credit

- Nov. 9 (Bloomberg) -- **The Group of 20 nations is prepared to act ``urgently" to bolster growth and called on governments to cut interest rates and raise spending as**

**the world's leading industrialized economies battle the threat of a recession. [The American cancer of trying to prevent short term pain by destroying the future has become our most significant export]** ``We stand ready to urgently take forward work and actions agreed by our leaders to restore and maintain financial stability and support global growth," the group said in the statement released today following a meeting in Sao Paulo. ``Countries must use all their policy flexibility, consistent with their circumstances, to support sustainable growth." Those measures include ``monetary and fiscal policy," it said. China, the world's largest developing economy, announced an economic stimulus package today worth almost a fifth of its output to sustain domestic demand as the credit crunch drags down growth from New York to Tokyo. Officials in the U.S. and Europe already have slashed borrowing costs and boosted spending in a bid to contain the effects of the slump. ``The solution to this crisis must be rapid," Brazilian Finance Minister **Guido Mantega** told reporters. ``We need to change the tire on the car while it's still moving." BRIC Plans Brazil, Russia, India and China, the so-called BRIC nations, plan coordinated measures to increase trade and capital flows among their economies, Russian Finance Minister **Alexei Kudrin** said in an interview. Mexican Deputy Finance Minister **Alejandro Werner** said slower economic growth and lower food and commodity prices justify cutting interest rates. Finance ministers and central bankers from the G-20 are laying the groundwork this weekend for a Nov. 15 heads-of-state summit in Washington. The ministers' talks end today. Recession **The International Monetary Fund is forecasting that the U.K., Japan, the euro region and the U.K. economies will all contract next year in their first simultaneous recession since the Second World War.** With slower growth damping inflationary pressures, central banks are likely to cut borrowing costs further, Canadian Finance Minister **Jim Flaherty** said. ``There are ongoing conversations about who plans to do what, when" on interest rates, Flaherty said. ``I expect that these discussions will lead to some degree of coordinated action." Some countries' maneuvering room on interest rates is still constrained by inflation pressures as weakening currencies increase the cost of imported goods, the draft statement said. The Brazilian government has spent \$5.1 billion defending the real in the past two months, while the Mexican peso fell by more than a quarter since July. ``In those economies facing currency depreciation and still suffering from second-round effects inflationary pressures may be more persistent," the statement said. ``In this context, monetary authorities will need to continue to carefully monitor economic developments including the consequences of financial de-leveraging in order to take appropriate action if needed." China's State Council said today the government will spend 4 trillion yuan (\$586 billion) by the end of 2010 as part of its stimulus plans, according to a statement on its Web site. The package, of which 100 billion yuan is earmarked for this quarter, will go toward low-rent housing, infrastructure in rural areas, as well as roads, railways and airports, the State Council said. ``We are closely watching the development of the financial crisis and the situation regarding global activity," **Zhou Xiaochuan**, governor of the People's Bank of China, said yesterday. ``If China can maintain domestic demand, it's helpful for global stability." China accounted for 27 percent of global economic growth last year, more than any other nation, the International Monetary Fund said in a report in April. **G-20 Ready to Urgently Boost Growth, Stimulus Needed**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=afct4fkQ5lpM&refer=home>

- Nov. 6 (Bloomberg) -- The most comprehensive report on unregulated credit-default swaps didn't disclose bets in the section of the more than \$47 trillion market that helped destroy American International Group Inc., once the world's biggest insurer. A report by the Depository Trust and Clearing Corp. doesn't include privately negotiated credit-default swaps that insurers such as **AIG, MBIA Inc. and Ambac Financial Group Inc.** sold to guarantee securities known as collateralized debt obligations. It includes only a "small fraction" of contracts linked to mortgage securities, according to **Andrea Cicione** at BNP Paribas SA in London. New York-based DTCC's data, released on its Web site Nov. 4, showed a total \$33.6 trillion of transactions on governments, companies and asset-backed securities worldwide, based on gross numbers. **While designed to ease concerns about the amount of risk banks and investors amassed on borrowers from companies to homeowners, the report may have missed as much as 40 percent of the trades outstanding in the market, Cicione said.** The data are "likely to underestimate the amount of net CDS exposure," Cicione, who correctly forecast in January that the cost of protecting European companies from default would rise, said in an interview. "A broadening of the coverage to the entire market is what investors really need." "Increased Transparency" DTCC released the data as dealers and investors in the market seek to counter criticism that the market has amplified the financial crisis. The Nov. 4 report showed, for example, that \$15.4 trillion of contracts linked to individual companies, governments and other borrowers were created. After canceling out contracts that offset one another, though, sellers of that protection would have to pay \$1.76 trillion if all underlying borrowers defaulted and debt holders recovered nothing. \$440 Billion AIG first disclosed to investors in August 2007 that it held more than \$440 billion of credit-swap trades linked to CDOs. The New York-based company was brought to the edge of bankruptcy in September after the value of the transactions plunged. The insurer was forced to come up with more than \$10 billion in collateral to back the contracts after its debt rankings were cut. It accepted an \$85 billion government loan in exchange for ceding control to the U.S. MBIA and Ambac, previously the world's two biggest bond insurers, lost their top AAA ratings earlier this year because of potential losses on credit swaps sold to guarantee CDOs backed by home loans. Moody's Investors Service cut New York-based Ambac's bond insurance rating four levels yesterday to Baa1, three steps above junk, because of potential losses on the derivatives. **A market survey this year by the New York-based International Swaps and Derivatives Association, which includes credit swaps on CDOs and other contracts that may not be captured by DTCC's Trade Information Warehouse, estimates more than \$47 trillion in gross contracts are outstanding.** "Gaps" The Federal Reserve Bank of New York, which urged dealers to curb risks and improve transparency in the credit swaps market over the past three years, said regulators will continue to push for more disclosure. Among the information the Fed wants to see are prices at which the derivatives trade, according to a New York Fed spokesman. **"There appear to be gaps,"** said **Henry Hu**, a law professor at the University of Texas in Austin who has pressed for the creation of a data warehouse encompassing all privately negotiated derivative trades to offer a better understanding of their risks. "Hopefully, regulators are getting more information," he said. **Because the DTCC registry captures only commonly traded contracts that can be confirmed over electronic systems, not every swap trade is in the company's report, spokeswoman Judy Inosanto said. Among those not included are credit-default**

**swaps on CDOs, she said.** MBIA, the Armonk, New York-based insurer crippled by ratings downgrades earlier this year following losses from such contracts, has said it sold \$126.3 billion in guarantees on slices of CDOs backed by corporate bonds, mortgages and other debt. Ambac sold \$60.7 billion in guarantees on these so-called tranches, mostly through credit swaps, the company said. CDO Losses Insurers including AIG, MBIA and Ambac typically sold protection on the highest ranking slices of such deals, meaning they'd be required to make good on payments only after a substantial part of the underlying debt defaults. The failures of Lehman Brothers Holdings Inc., Washington Mutual Inc. and three Icelandic banks that were widely held in CDOs linked to corporate debt caused no losses on tranches MBIA guaranteed, **Mitchell Sonkin**, the company's head of insured portfolio management, said in a conference call yesterday. New York-based Lehman and WaMu, based in Seattle, filed for bankruptcy. Iceland's government took over its three biggest lenders last month after they were unable to raise short-term funding, triggering pay-outs on credit-default swaps. Some investors holding the riskier slices of CDOs that weren't guaranteed lost more than 90 percent because of the bank failures. **“The worry is that these bespoke tranches are being eaten away, and who knows if and when these losses will get realized,”** **Tim Backshall, chief strategist at Credit Derivatives Research LLC in Walnut Creek, California, wrote in a note to clients yesterday.** **Credit Swap Disclosure Obscures True Financial Risk** <http://www.bloomberg.com/apps/news?pid=20601109&sid=aKKRHZsxRvWs&refer=home>

Nov. 7 (Bloomberg) -- Global financing costs fell as money markets were awash with cash and central banks slashed interest rates, led by the Bank of England's 1.5 percentage point reduction, the U.K.'s biggest cut in 16 years.

The **rate** Australia's banks charge each other for three-month loans fell 13 basis points to 4.99 percent as of 10:07 a.m. in Sydney, capping the biggest weekly decline since January 1990. The **London interbank offered rate**, or Libor, for three-month loans in U.S. dollars dropped 12 basis points to 2.39 percent yesterday, the lowest level since November 2004.

Money rates have declined since central banks worldwide joined to flood the banking system with an unlimited supply of dollar funding and governments offered bailouts and guarantees to financial institutions. Policy makers in Asia-Pacific region's five biggest economies, along with Europe, the U.K. and the U.S. have all cut interest rates in the past two weeks.

“Over the course of the past three weeks we have seen significant improvements in Libor,” **Michael Cloherty**, an interest-rate strategist in New York at Bank of America Corp., wrote in a report dated yesterday. Still, swap spreads haven't narrowed as rapidly as lending rates, which shows “the market expects a longer period of more gradual improvement than previously,” he said.

While three-month dollar Libor has fallen for the past 19 days, it's still 139 basis points more than the Fed's target rate for overnight bank loans, compared with an average of 22 basis points in the five years before the current credit crisis began in August 2007. A basis point is 0.01 percentage point.

Libor, the benchmark for \$360 trillion of financial products worldwide, is set by a panel of banks in a daily survey by the British Bankers' Association before noon in London.

### Greenspan's Gauge

The **difference** between Libor and the overnight indexed swap rate, a measure former Fed Chairman **Alan Greenspan** uses to gauge the state of money markets, narrowed 12 basis points to 183 basis points yesterday. That compares with 87 basis points on the last trading day before Lehman Brothers Holdings Inc. filed for bankruptcy on Sept. 15 and an average 11 basis points in the five years before the crisis started.

The difference between the yield on Australian three-month bank bills and the overnight indexed swap rate, a similar measure of funding availability, dropped to 50 basis points today, the lowest since Lehman filed for bankruptcy.

The **European Central Bank** cut its main refinancing rate by a half-percentage point yesterday to 3.25 percent, while the Bank of England lowered its target 1.5 percentage points to 3 percent, the lowest since 1955, as policy makers tried to limit damage caused by the worst banking crisis in almost a century. Both central banks were expected to make half-point reductions, according to economists surveyed by Bloomberg News. The Bank of Korea announced a quarter-point cut today to 4 percent.

### Deposits Drop

Australian banks reduced deposits held at the Reserve Bank of Australia to A\$5.88 billion (\$3.9 billion) yesterday, the lowest since Sept. 16, the RBA said today on its Web site. The deposits reached a record A\$11.2 billion on Oct. 20 as Lehman's collapse led to a seizure in interbank lending.

Overnight deposits held by European institutions with the ECB fell from a record and borrowing slid to a six-week low at an auction. Financial institutions lodged 274.5 billion euros (\$354 billion) in the central bank's **deposit facility** yesterday at 3.25 percent, down from 295.9 billion euros the day before. They also borrowed 3.5 billion euros from the ECB at the emergency overnight marginal rate of 4.25 percent, the lowest amount since Sept. 25. **Global Money Rates Fall on Cash Infusions, Interest-Rate Cuts**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a9jy34m16CVM&refer=home>

- **The Bank of England slashed its lending rate by 150 points yesterday.** Its overnight rate is now down to 3%. The move shocked U.K. investors, who were anticipating a 50-point cut -- 75 points at most. The 1.5% slash is a record for the BoE, and lending rates there are now at their lowest level in more than 50 years. Fearing having its thunder stolen by the BoE, the European Central Bank announced a 50-point cut shortly after. The eurozone rate is now down to 3.25%.

Nov. 5 (Bloomberg) -- **Credit card companies were shut out of the market for bonds backed by customer payments in October for the first time in more than 15 years, as investors**

**shunned the debt amid the global credit freeze.** A weakening job market and a looming recession are making it harder for consumers to make monthly payments, eroding confidence among investors about the safety of credit-card-backed bonds. It's the first month since April 1993 that there have been no sales, according to [Wachovia Corp.](#) data. Issuers sold \$17.1 billion of the debt in October 2007, the data show. "Nobody is eager to put money to work given the uncertainty in the market," said [James Grady](#), a managing director at [Deutsche Bank AG's](#) asset management unit. **"When you think it can't get worse, it continues to get worse. There is not a demand" for these bonds. Top-rated credit card-backed securities maturing in three years traded at a gap, or spread, of 475 basis points over the London interbank offered rate, or Libor, during the week ended Oct. 30, JPMorgan Chase & Co. data show, 25 basis points higher than the previous week. The debt was trading at 50 basis points more than Libor in January.** The higher cost to sell the bonds makes it more expensive for banks and credit card companies to fund loans to customers. New York-based [American Express Co.](#) paid 160 basis points more than Libor at a Sept. 11 sale of the securities compared with 30 basis points over the benchmark at a similar sale in October 2007, Bloomberg data show. Job Losses One-third of employers in October planned to trim payrolls in the next six months, while 17 percent projected an increase in hiring, the National Association for Business Economics said on Nov. 3, the biggest disparity since the economy emerged from the last official recession in 2002.

U.S. credit-card lenders may report record high customer defaults in 2009, Fitch Rating said in a Nov. 3 statement. **Consumer spending, which comprises about 70 percent of the U.S. economy, dropped at a 3.1 percent annual pace in the third quarter, the first decline since 1991 and the biggest since 1980, the Commerce Department said last week.** The slowdown caused the economy to contract last quarter at the fastest pace since the 2001 recession. U.S. retail sales may have fallen for the first time in seven months in October, the International Council of Shopping Centers said yesterday.

#### Debt Sales

Sales of credit card asset-backed debt are down 29 percent to \$60.3 billion from a year ago, according to JPMorgan.

American Express used the Federal Reserve's commercial facility program for the first time on Oct. 29 as available funding shrank.

The lender is slashing 10 percent of its work force as part of a plan to cut costs as cardholders failed to repay loans at almost twice the rate of a year earlier. The job cuts "will help us to manage through one of the most challenging economic environments we've seen in many decades," Chief Executive Officer [Kenneth Chenault](#) said in an Oct. 30 statement.

American Express was forced to set aside \$1.4 billion for loan losses, according to an Oct. 30 statement.

American Express has **lost** 47 percent of its market value this year on concern that higher funding costs and rising defaults will hurt profit. The shares fell \$1.99, or 6.7 percent, to \$27.83 today in New York Stock Exchange composite trading.

Bank of America Corp., JPMorgan and Citigroup Inc. also rely on the asset-backed market to fund their credit card portfolios, but the banks' large deposit bases give the firms another option to fund originations, Deutsche Bank's Grady said.

“True finance companies are in a less advantageous position,” Grady said. “Their funding costs will be considerably higher.” **Credit Card Bond Sales at Zero, First Time Since 1993**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=awS5vZQvmwd4&refer=home>

- Monday Bloomberg Libor Declines The London interbank offered rate, or Libor, that banks charge for three-month loans in dollars dropped 17 basis points to 2.86 percent, the lowest level since the collapse of Lehman Brothers Holdings Inc. on Sept. 15. The rate has declined for 16 straight days, a sign that as much as \$3 trillion of emergency funds provided by governments to resuscitate bank lending are working.
- The October 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months.<sup>1</sup> The survey included two sets of special questions: The first set asked domestic and foreign banks about changes in the dollar amount of commercial and industrial (C&I) loans according to whether they were drawn under preexisting commitments; the second set asked domestic banks about changes in credit limits on existing credit card accounts for prime and nonprime borrowers. This article is based on responses from 55 domestic banks and 21 U.S. branches and agencies of foreign banks. In the current survey, large net fractions of domestic institutions reported having continued to tighten their lending standards and terms on all major loan categories over the previous three months. **The net percentages of respondents that reported tightening standards increased relative to the July survey for both C&I and commercial real estate loans, as did the fractions reporting tightening for all price and nonprice terms on C&I loans.** Considerable net fractions of foreign institutions also tightened credit standards and terms on loans to businesses over the past three months. Large fractions of domestic banks reported tightening standards on loans to households over the same period. Demand for loans from both businesses and households at domestic institutions continued to weaken, on net, over the past three months. **In response to the special questions, significant net fractions of large domestic banks and U.S. branches and agencies of foreign banks reported increases in C&I loans drawn under preexisting commitments. Moderate fractions of all banks, on net, reported increases in C&I loans not drawn under such commitments. Domestic banks reported reducing credit limits on existing credit card accounts both to prime and to nonprime borrowers, citing a less favorable or more uncertain economic outlook, reduced tolerance for risk, and declines in customer credit scores as important reasons for the decreases.** About 85 percent of domestic banks—up substantially from 60 percent in the July survey—reported having tightened lending standards on C&I loans to large and middle-market firms over the past three months. About 75 percent of such respondents indicated that they had tightened their lending standards on C&I loans to small firms over the same period, a somewhat larger fraction than in the July survey. Significant majorities of domestic respondents indicated that they had tightened price terms on C&I loans to firms of all sizes, with notable fractions

reporting considerably tighter terms. **On net, about 95 percent of U.S. banks reported having tightened the costs of credit lines to large and medium-sized firms, while nearly 90 percent reported such tightening for smaller firms. Nearly all banks—up from roughly 80 percent in the July survey—noted that they had increased spreads of loan rates over their cost of funds on C&I loans to large and middle-market firms, while about 95 percent of respondents, more than in the July survey, reported having widened spreads on loans to small firms.** Substantial fractions of respondents also reported increasing premiums charged on riskier loans to firms of all sizes. In addition, the fraction of domestic respondents that reported having tightened non-price-related lending terms on C&I loans to firms of all sizes over the survey period increased significantly relative to the July survey: **Higher fractions of banks reported having reduced both the maximum size and the maximum maturity of loans or credit lines to large and middle-market and to smaller firms. Additionally, roughly 75 percent of respondents reported having tightened covenants on loans to large and middle-market firms, and about 70 percent reported having tightened covenants on loans to small firms.** Substantial majorities of the domestic institutions that **experienced weaker loan demand over the past three months pointed to decreases in customers' needs to finance investment in plant and equipment, to finance inventories, and to finance customer accounts receivable as reasons for the weaker demand.** **The October 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices** <http://www.federalreserve.gov/boarddocs/SnLoanSurvey/200811/>

## Commercial Real Estate

## Commodities

- Nov. 7 (Bloomberg) -- Crude oil fell below \$60 a barrel in New York for the first time since March 2007 as a global economic slowdown cuts demand for fuels. **Oil has dropped 15 percent since Nov. 4, the biggest three-day decline in more than four years.** Employers in the U.S., the world's biggest oil user, likely eliminated 200,000 jobs in October, the 10th consecutive month of declines, a government report out later today may show. "The focus hasn't shifted from demand and that remains a weight that oil and commodities have had a difficult time throwing off," said **David Moore**, a commodity strategist at Commonwealth Bank of Australia Ltd. in Sydney. "If you're looking for a short-term downside risk to the oil price, then that jobs number is it." Oil for December delivery declined as much as 80 cents, or 1.3 percent, to \$59.97 a barrel on the New York Mercantile Exchange, the lowest since March 22, 2007. It was at \$60.27 a barrel at 9:45 a.m. Singapore time. Prices, which have tumbled 59 percent since reaching a record \$147.27 on July 11, are down 37 percent from a year ago. Yesterday, oil fell \$4.53, or 6.9 percent, to \$60.77 a barrel. Oil has plunged 11 percent this week on reports that the U.S. has shed jobs, reinforcing concerns that the country has entered a recession that will limit gasoline and diesel fuel consumption. U.S. fuel demand during the past four weeks averaged 19.1 million barrels a day, down 6.7 percent from a year ago, the Energy Department reported Nov. 5. Gasoline consumption over the period was down 2.3 percent at 9 million barrels a day. Jobless Claims **The number of Americans filing first-time unemployment benefits rose to the highest since 1983, a Labor**

**Department report showed yesterday. Companies in the U.S. cut an estimated 157,000 jobs in October, the most in almost six years, a private report by ADP Employer Services based on payroll data said Nov. 5.** Brent crude oil for December settlement fell as much as 81 cents, or 1.4 percent, to \$56.62 a barrel on London's ICE Futures Europe exchange at 9:23 a.m. Singapore time. The contract yesterday declined \$4.44 or 7.2 percent, to settle at \$57.43 a barrel, the lowest since Feb. 14, 2007. **Crude Oil Falls Below \$60 in New York, Lowest Since March 2007** <http://www.bloomberg.com/apps/news?pid=20601087&sid=amHAEsH7yR6U&refer=home>

- Nov. 6 (Bloomberg) -- Rio Tinto Group and BHP Billiton Ltd., the world's second- and third-largest iron ore exporters, **may be forced to cut prices by 15 percent next year, ending six years of gains, because of slowing demand from steel mills in Asia.** Contract prices for benchmark Australian ore for the year starting April 1 may fall to 122.96 cents per dry metric ton unit, or about \$78 a metric ton, from a record 144.66 cents, according to the median estimate of 11 analysts surveyed by Bloomberg News. "Iron ore prices are obviously going to be softer going forward," Paul Adams, head of research at D.J. Carmichael & Co., said by phone from Perth. "Compared to a year ago, the Chinese steel mills now have the upper hand in negotiations." The worst global financial crisis since the Great Depression has curbed demand from builders and carmakers, damped prices and prompted steel mills in Asia, Europe and the U.S. to curb output. Cia. Vale do Rio Doce, the world's biggest exporter of iron ore, had its 2009 earnings forecast cut by almost a quarter by Goldman Sachs Group Inc. **ArcelorMittal, the world's biggest steelmaker, said yesterday it will slash production by as much as 35 percent in the U.S. and 30 percent in Europe after prices tumbled. The Luxembourg-based company forecast earnings will slide as much as 48 percent to \$2.5 billion in the fourth quarter.** "There's no doubt steel production has been cut," John Veldhuizen, an analyst at BBY Ltd., said by phone from Sydney. "We have probably seen peak commodity prices." Cash prices for ore imported by China, the world's largest buyer, slumped for an 11th straight week to at least 13 percent lower than contract prices. Prices at Qingdao, China's biggest port handling the ore, fell 100 yuan to 540 yuan (\$79) a metric ton in the week ended Oct. 31, the lowest since at least June 2006, according to Beijing Antaike Information Development Co. **Output in China, the world's largest steelmaking nation, declined 9.1 percent in September, the Brussels-based World Steel Association said Oct. 22. Global production will fall 5 percent in 2009, Peter Marcus, managing partner of research firm World Steel Dynamics, said from Kaohsiung, Taiwan this week.** Oversupplied Market "Clearly the steel production cuts have been quite sharp and quite significant to date," Alex Tonks, a Sydney-based commodities analyst at Citigroup Inc., said by phone. "It is certainly slowing down and the market on our numbers will be oversupplied" in 2009, he said. To be sure, Merrill Lynch & Co., Credit Suisse Group and Macquarie Group Ltd. expected prices to remain unchanged at a record, according to the survey. "Closures of high-cost Chinese iron ore operations are expected to prevent a much bigger fall," Macquarie said in a Nov. 5 report. About 20 percent of China's output is losing money and further production may be cut by the end of the year, Macquarie said. The forecasts in the Bloomberg survey ranged from 40 percent cut to no change. **Chinese steelmakers have started initial talks for 2009 contract iron ore prices with Vale, Rio Tinto and BHP, Shan Shanghua, secretary**

**general of the China Iron & Steel Association said Oct. 23. Talks are expected to be ``very difficult'' given the slowing global economy, he said.** Vale withdrew demands for an extra 12 percent price increase this year from Chinese steelmakers, customer Baosteel Group Corp. said this week. Maanshan Iron & Steel Co. and Shougang Corp. have said they are cutting output. **Rio, BHP May Cut Iron Ore Prices by 15%, Analyst say**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aCGlmlK.B3X8&refer=home>

## Currency

- Information Clearing House started off a recent issue with quote from Kenneth Gerbino, who is referred to as “former chairman of the American Economic Council”, who notes, “Historically, the United States has been a hard money country. Only [since 1913] has the United States operated on a fiat money system. During this period, paper money has depreciated over 87%.” In contrast, when the dollar was gold and gold was the dollar, “During the preceding 140 year period, the hard currency of the United States had actually maintained its value. Wholesale prices in 1913 were the same as in 1787.”

## Diversification

### Derivatives

Nov. 5 (Bloomberg) -- Credit-default swap traders wagered the most on debt of Italy, Spain and Deutsche Bank AG, according to a Depository Trust & Clearing Corp. report that gives the broadest data yet on the unregulated market.

A total \$33.6 trillion of transactions are outstanding on governments, companies and asset-backed securities worldwide, based on gross numbers, the DTCC said in the [report](#) released on its Web site yesterday. After canceling out overlapping trades, investors have taken out a net \$22.7 billion of contracts based on Italy's debt, \$16.7 billion against Spain and \$12.5 billion on Deutsche Bank of Frankfurt, the report shows.

“The bigger the outstanding amount of debt, the bigger the volume of credit-default swaps,” said [Philip Gisdakis](#), a Munich-based credit analyst at UniCredit SpA. “Sovereigns have huge debt outstanding. Deutsche Bank has a huge balance sheet, so it's quite understandable it's at the top of the list.”

The DTCC, which operates a central registry of credit-default swap trades, released the data after U.S. authorities blamed the unregulated market for exacerbating the credit crisis that led to almost \$690 billion in bank losses and writedowns.

The level of credit-default swaps reported by DTCC is smaller than previous estimates. The Bank for International Settlements estimated contracts of \$57.9 trillion outstanding in May. DTCC's data may calm concerns that investors and dealers have too much at risk, said [Brian Yelvington](#), a New York-based strategist at fixed-income research firm CreditSights Inc.

## `Right Direction'

“Far too much mistrust has been engendered by the lack of transparency,” Yelvington said. “There's still a lot here that's not captured. But it's a step in the right direction.”

Trading in credit-default swaps, which pay the buyer face value in exchange for the underlying securities should a borrower fail to adhere to its debt agreements, exploded 100-fold during the past decade.

The credit-default swaps market has moved beyond its origins of protecting banks from loan losses to a way for hedge funds, insurance companies and asset managers to speculate on the creditworthiness of companies, governments and other borrowers, including homeowners. Billionaire investor [Warren Buffett](#) has called credit-default swaps a “time bomb.”

The collapse of Lehman Brothers Holdings Inc. contributed to a decline in financial markets last month because no one knew how many credit-default swap contracts were outstanding on the securities firm, how many the company had written or who held them. They are private contracts between two parties, don't trade on an exchange and aren't processed through a central clearinghouse, making it virtually impossible for the public to assess the amount wagered on the debt. Estimates ranged as high as \$400 billion, though the actual amount turned out to be \$72 billion, the DTCC said.

## Trading Data

After subtracting redundant trades, only \$5.2 billion of trades actually changed hands, DTCC said last month, the first time it had released such information from its data warehouse.

Dealers have been trying to reduce the number of contracts outstanding by tearing up overlapping trades, helping reduce the net number of transactions and allaying concerns that the market was too large. The Federal Reserve and the European Central Bank are pushing dealers to create a clearinghouse to act as a counterparty on each trade, eliminating the risk of one side defaulting.

The DTCC, which is controlled by a board of members including [JPMorgan Chase & Co.](#) and [Goldman Sachs Group Inc.](#), doesn't list contracts on all companies, governments and other securities beyond the top 1,000 in the registry, on which there are a net of \$183.3 billion. And there's not a clear accounting of what may exist beyond the registry.

## Spain, Italy

Investors have focused wagers on debt of industries and countries that may be most affected by a credit crisis entering its 15th month. The Spanish economy is headed toward its first recession in 15 years amid a slump in its housing market and banking and finance shares have dropped as the credit seizure caused some to collapse.

Credit-default swaps on Italy were quoted at 107.5 basis points today, CMA Datavision prices on 10-year contracts show, after reaching a record 138 basis points on Oct. 24. The contracts have more than doubled since August. Today's price represents a cost of \$107,500 a year to protect \$10 million of debt for 10 years.

Contracts on Spain climbed to 112 basis points on Oct. 24, from about 47 basis points at the start of September. They have since dropped back to 78.5 basis points.

The ECB met with regulators, lenders and investors this week to discuss ways of increasing transparency in the default swaps market on its side of the Atlantic. A central counterparty is an "appropriate solution" for reducing risk, the ECB said in a statement. Auctions this week are meantime settling default swaps on debt of Iceland's three biggest banks.

#### GE Capital, Merrill

In total, about \$15.4 trillion of transactions were linked to individual corporate, sovereign and asset-backed bonds worldwide at the end of October, the DTCC data showed. About \$14.8 trillion was tied to indexes.

Among companies, GE Capital Corp., the finance arm of General Electric Co., New York-based Morgan Stanley, Merrill Lynch & Co. and Goldman Sachs Group Inc. had the biggest dollar amount of contracts tied to their debt on a net basis, after Deutsche Bank, Germany's biggest lender, DTCC said. New York-based Merrill agreed in September to sell itself to Bank of America Corp.

The net figures are the maximum that sellers would have to pay to buyers if the borrowers defaulted, DTCC said.

#### Netting Trades

Turkey, Italy, Brazil, Russia, GMAC LLC, and Merrill Lynch & Co. had the biggest gross amount of contracts outstanding on their debt as of Oct. 31. Turkey alone had \$188.6 billion of default swaps written against its debt. The gross amount doesn't take into account offsetting trades. After netting the trades, there were \$7.6 billion outstanding on Turkey.

The industry should "get the word out about the small size of these risks compared to the notional amounts on which the contracts are based," said [Mark Brickell](#), chief executive officer of Blackbird Holdings Inc., which provides an electronic trading system for derivatives, and former chairman of the International Swaps and Derivatives Association.

Criticism of the market intensified in September after the collapse of Lehman and the U.S. government's bailout of American International Group Inc., which faced bankruptcy after credit-rating downgrades forced it to post more than \$10 billion in collateral on credit swap trades that had plunged in value.

#### Cox on Disclosure

U.S. Securities and Exchange Commission Chairman [Christopher Cox](#) called for authority to regulate the credit swaps market, saying the lack of disclosure and the web of connections between dealers in the market threatened the stability of the financial system. The Federal Reserve Bank of New York, which has spent the last three years pushing dealers to curb risks in the credit swaps market, last week said it welcomed the DTCC's disclosure.

“Publishing this data will provide greater transparency in a critical market,” [Tim Ryan](#), head of the Securities Industry and Financial Markets Association, said in a statement today. “This is an important initiative upon which the industry will continue to build.” [http://www.bloomberg.com/apps/news?pid=email\\_en&refer=home&sid=auQSTZnaO5JY](http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=auQSTZnaO5JY)

## Housing

UK house prices are now nearly 15 per cent lower than 12 months ago, according to the Nationwide, with the price of an average house dropping by £30,000 to £158,872. But when will the house price crash end and how far will prices fall? Should buyers grab a bargain now, or wait another year, or even longer. Times Money asked five experts for their predictions on when the market will hit rock bottom. Here are their answers. And have your say in our poll below.

**Martin Ellis – chief economist, Halifax Prediction: Another 8% fall** “We are predicting a 20 per cent fall over 2008 and 2009 – so as we calculate that prices have already fallen by 12.4 per cent, we would expect roughly another 8 per cent fall before prices start to bottom out at the end of 2009. **“There’s a lot of uncertainty surrounding the economy and unemployment figures in particular at the moment, so it’s very hard to say when prices will start to recover. Prices certainly won’t bounce back quickly.”**

**Jonathan Davis – housepricecrash.co.uk Prediction: Another 35% fall** “The market will not bottom out until spring 2011, by which point there will be a 40 to 50 per cent drop from when house prices were at their peak in August last year. **“If you remember the last house price crash in 1988, it took until 1994 for the market to recover, so a good four or five years. There is no reason whatsoever to suppose the market will recover any quicker this time.** “It is far too early to bag a bargain – people should not be buying for at least another two years. We are only one year into the crash, and it has a long way to go yet.”

**Yolande Barnes – Savills Prediction: Another 10% fall**

“We are forecasting a 25 per cent drop from when house prices were at their peak last year, so that means we’ve got about another 10 per cent to go. Whilst we expect prices to bottom out during 2010, the prospect of recession means we do not expect prices to start recovering anytime soon. Houses will not regain their 2007 value until about 2014, or possibly 2013 in the south-east.”

**Nicholas Leeming – propertyfinder.com**

**Prediction: Another 10% fall**

“There will be a further drop of about 10 per cent throughout 2009, before the market starts to level out at the end of the year. It will take a while for the effects of the Government bail-out to

filter through – the capital markets will not be freed up until maybe the third quarter of 2009, when we can expect to see more mortgage transactions and a gradual recovery of the market.”

**Nick Bate, UK economist, Merrill Lynch**

### **Prediction: Another 10% fall**

“There will be a 25 per cent drop from the market peak last summer – we have already seen about a 15 per cent drop, so we have about another 10 per cent to go. “However, no one can say with any confidence exactly where prices will be in a year’s time – but it will certainly be a long time before prices recover to the levels we saw last year. With unemployment rising and people becoming less credit worthy, banks may continue to be reluctant to lend for some time, and this will lead to a very muted recovery.” **Five experts predict how much further house prices will fall** [http://timesbusiness.typepad.com/money\\_weblog/2008/11/the-house-price.html](http://timesbusiness.typepad.com/money_weblog/2008/11/the-house-price.html)

### **Housing Finance**

- **“Obama will try to give the market at least one thing it desperately wants,”** suggests Dan Denning, “some mechanism to separate bank balance sheets from falling U.S. house prices.” “He's going to revive the Depression-era Home Owners’ Loan Corporation (HOLC). That federal agency was set up to prevent foreclosures in the 1930s by purchasing distressed mortgages from lenders and then renegotiating both the term and the size of the loan with borrowers. You can see how it would appeal to policymakers at the moment. “Some version of the HOLC is what you should expect. Rather than providing banks with fresh capital and asking them to modify mortgages for distressed homeowners, the federal government can simply do the job itself. It will finance the HOLC the same way it's financing everything else (borrowing money). The borrowed money goes to the banks for recapitalization and the purchase of dodgy mortgage securities. Then, the HOLC refinances those 7 million Americans into 30-year mortgages with lower interest rates and a lower valuation on the house. **“Of course, there are massive problems with it, not least that it encourages people to quit paying their mortgage now and wait for the bailout. But we don't have time for problems today, just illusory solutions. Keep hope alive.**
- **Questions on residential real estate lending.** Large majorities of domestic respondents reported having tightened their lending standards on prime, nontraditional, and subprime residential mortgages over the previous three months. About 70 percent of domestic respondents—down from about 75 percent in the previous survey—indicated that they had tightened their lending standards on prime mortgages.<sup>2</sup> Responses differed somewhat by bank size, with about 80 percent of the largest banks, but only 55 percent of the smaller banks, reporting tighter standards for prime borrowers. About 90 percent—up slightly from July—of the 29 banks that originated nontraditional residential mortgage loans reported having tightened their lending standards on such loans.<sup>3</sup> All 4 of the banks

that responded to the survey's question about lending standards on subprime loans indicated that they had tightened their lending standards on such loans over the past three months.<sup>4</sup> About 50 percent of domestic respondents—a somewhat higher fraction than the roughly 30 percent in the July survey—experienced weaker demand, on net, for prime residential mortgage loans over the past three months. A higher net fraction of large banks than smaller banks reported a decline in demand. About 70 percent of respondents—up from roughly 45 percent in the July survey—indicated weaker demand for nontraditional mortgage loans over the same period. Each of the 4 domestic banks that originated subprime mortgage loans reported weaker demand for such loans over the survey period, compared with 4 of the 7 banks that reported originating subprime loans in the July survey. **On net, about 75 percent of domestic respondents, similar to the fraction in the July survey, noted that they had tightened their lending standards for approving applications for revolving home equity lines of credit (HELOCs) over the past three months.** About 25 percent of domestic banks, on net, reported weaker demand for HELOCs over the past three months, more than double the fraction that had reported weaker demand in the July survey. <http://www.federalreserve.gov/boarddocs/SnLoanSurvey/200811/>

## Macro Economic

- Nov. 6 (Bloomberg) -- Japan's recession will be shallower than the U.S. and Europe because damage from the global credit crisis has been limited, the Cabinet Office's top economist said. "The depth of Japan's recession won't be as severe as those of the U.S. and Europe because of the relatively healthy financial system," **Jun Saito**, an adviser to Economic and Fiscal Policy Minister **Kaoru Yosano**, said in an interview yesterday in Tokyo. "The pressure for adjustments in capacity, labor and inventory is smaller than that of previous recessions." Japanese banks are still **lending** to each other as well as to companies, setting them apart from counterparts in the U.S. and Europe. The world's second-largest economy has become more resilient to global shocks after three recessions since 1990 forced companies and banks to fire workers and clean up debt. Japan's financial institutions recorded about \$15.6 billion in subprime mortgage-related losses as of June, according to the nation's financial regulator, a fraction of the \$690 billion in writedowns and credit losses suffered by financial companies around the world. The difference between what banks and governments pay to borrow money for three months, known as the TED spread, is 40 basis points in Japan, compared with 222 basis points in the U.S. and 200 basis points in Europe. **Japan's Recession May Be Shallow, Cabinet Office Economist Says**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aIXTlpJHsEok&refer=home>
- Nov. 3 (Bloomberg) -- Forget last week's record **20 percent** gain in emerging-market stocks. Hard times are ahead for equities in Brazil, Russia, India and China, some of the world's biggest money managers say. Even with developing-nation shares trading at their **cheapest** levels in a decade, financial crises in Hungary and Pakistan that required international rescue packages and concern that economies from Turkey to Argentina are also teetering prompted investors to pull out of emerging-market funds at a record pace.

RBC Capital Markets cut its estimates on Oct. 23 for 2009 economic growth in Brazil to 2.5 percent from 4 percent and Russia to 4 percent from 6 percent. That may undermine analysts' forecasts for a 14.5 percent increase in earnings at a time when the global credit crunch seized up lending from Sao Paulo to Seoul and a slump in 24 of 25 developing-nation currencies last month inflated the costs of repaying dollar-denominated debt. **BRICs See No Relief Even as Rally Lures Stock Bulls**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aZwI8vU6TNwo&refer=home>

- Three million homeowners, or more than a fifth of households, could end up in the trap of negative equity, with mortgage debts larger than the value of their property, as house prices continue to plunge, new City estimates show. Bank of England calculations that the numbers caught in negative equity could soar from about half a million at present to 1.2 million by 2011, are seen as too optimistic in the bleakest assessment yet of the threat. Michael Saunders, of Citigroup, says that the Bank's estimates are too optimistic since they are based on a survey of households where homeowners are asked for details of their own debts, financial assets and property value. Mr Saunders points to previous Bank research which showed that individuals tend to overstate the value of their homes by up to 20 per cent, and understate debts by 10 to 15 per cent. Adjusting for this bias, he calculates that a likely further drop of 15 per cent in house prices — on top of the 15 per cent slide over the past year — will leave between 2.5 and 3 million homeowners in negative equity. This would exceed the peak of 1.8 million, the number of people who were in this predicament in the early Nineties.  
<http://business.timesonline.co.uk/tol/business/economics/article5069045.ece?&EMC-Bltn=NNVBS9>
- The European Commission forecast that the European economy would “grind to a standstill” in 2009, with growth slowing to just 0.2 per cent. The EC also said several EU economies were now “in or close to a recession”, amid weaker investment, tighter financing conditions and rising unemployment. The EC called for coordinated efforts to support the European economy, similar to the widespread bailout schemes currently being offered to banks across Europe.

## Retail

- **American retailers, for example, posted their worst month in eight years during October**, says this morning's monthly retail sales report. The Thompson Reuters same-store sales index fell 0.7% during the month, twice as bad as the Street anticipated. Wal-Mart, as usual this year, was the bright spot. It managed to increase sales by 2.4% year over year, better than analysts expected.
- Nov. 5 (Bloomberg) -- Luxury retailers may suffer the industry's biggest reversal of fortune during the holidays as the global financial crisis dents the wealth of the richest Americans. **Sales at Saks Inc., Nordstrom Inc. and Neiman Marcus Group Inc. stores open at least a year may decline as much as 3 percent in November and December after advancing 5.2 percent a year earlier, according to the International Council of Shopping Centers trade group.** The 8.2 percentage point swing may be the

biggest of the seven retail segments that the New York-based ICSC tracks. **The drop in demand may signal that America's wealthiest consumers are retrenching more than the rest of the country, avoiding luxury purchases while the U.S. loses more jobs and home foreclosures rise. [How obscene is that statement? America's wealthiest consumers might have to forego that \$5,000 handbag while main stream America has their house foreclosed on. This is the news from world centric New York and you wonder how those on the Street allowed their greed to destroy the country????]** **“Conspicuous consumption is less fashionable,”** said Melissa Otto, a senior investment analyst at American Century Investments in New York who tracks the luxury retail market. “There is a psychological ethos now that people don't want to jump out and be big spenders.” Tomorrow Seattle-based Nordstrom will probably report a 13 percent October sales decline, and Saks's drop may be 12 percent, according to the average estimates of analysts surveyed by Retail Metrics LLC. Dallas-based Neiman's sales will retreat 14 percent, said Carla Casella, an analyst at JPMorgan Chase & Co. Luxury Vs. Discount For five years luxury retailers outpaced low-priced chains. The projected drop this year would be the group's first since 2002, the year the ICSC began keeping the records. Among the sectors, discounters may see the biggest improvement this holiday season, more than doubling their gain in sales at stores open at least a year to 2.5 percent from 1.1 percent a year earlier, the group estimated. Even as the U.S. economy began to slow in recent years, luxury retailers proved largely resilient, said George Whalin, president of Retail Management Consultants in San Marcos, California. “I don't see that happening this year at all,” Whalin said. Connecticut, Long Island Connecticut-based luxury clothing retailer Mitchells is among those making adjustments. Co-President Bob Mitchell said his company had to let staff go because of the spiraling financial crisis. **Sales, which held steady in September, faltered in October, he said yesterday in a telephone interview. The job cuts at the company, which sells Prada and Hermes, were “not major,” Mitchell said.** “In October, business was definitely more challenging,” Mitchell said. “People are still buying luxury products, but they are buying less. People are taking a little bit of a breather.” Westport, with a median family income of \$193,540 and a median home price of \$1.2 million, ranked fifth in CNNMoney.com's 2008 survey of top-earning U.S. towns. Greenwich came in 14th. ‘Not Feeling Rich’ As U.S. consumer spending has slowed, Saks shares have sunk 74 percent this year, and Nordstrom's have lost 56 percent. Neiman Marcus is owned by Warburg Pincus LLC and TPG Inc. Affluent consumers are holding back after more than 100,000 financial-sector employees lost their jobs and the values of stock portfolios and homes shrank, said the group's chief economist, Michael Niemira. **“The rich are not feeling rich,” said Niemira. “So they are not spending to the same degree.”** Lisa Blair, a 38-year-old New Yorker who works for a skincare company, plans to spend about \$3,000 on holiday gifts this year, a 40 percent drop from 2007. “It's just not the time to spend a lot of money,” said Blair, whose household income is above \$200,000. “We're just not sure about the economy.” Decreasing Confidence Confidence among U.S. buyers of luxury goods fell to the lowest level in at least four years, led by a drop in spending by the wealthiest Americans, Unity Marketing said Oct. 17. So-called ultra-affluents, with annual incomes of at least \$250,000, cut spending by 20 percent in the first nine months of the year, according to the Stevens, Pennsylvania-based company, whose Luxury Consumption Index slid almost 11 points to 40.3 at the end of the third quarter. The

figures include purchases of fashion accessories, automobiles, home furnishings and dining. The wealthy are also trimming spending because "they don't want to appear out of step" with their employees, said Harrison Group's Jim Taylor. His Waterbury, Connecticut-based luxury research firm in mid-September surveyed 614 individuals with a median income of \$325,000. **Jewelry, fashion and accessories will be the categories that are scratched off holiday shopping lists the most, he said.** For luxury department stores, sales declines at this time of the year will hurt. Nordstrom, which has 108 namesake stores, garnered 23 percent of its annual revenue in November and December last year. The more than 200 luxury department stores may not be the only ones feeling left out this holiday season. Secondary people on shopping lists will also get dropped, Taylor predicted. "We're going to cut out the brothers and sisters this year." Omitting siblings is exactly what Blair plans to do. She said she'll focus on gifts for kids, including her own 15-month-old son. For her mother, Blair bought Hermes tableware, on sale. "Christmas is my favorite time of year in Manhattan, and it's a wonderful time if you have children," Blair said. "We'll make it work. We'll cut out where we have to, and we won't where we don't." **U.S. Luxury Retailers Face Grimmiest Holiday Season** [http://www.bloomberg.com/apps/news?pid=20601109&sid=aL0rw1\\_zsfWk&refer=home](http://www.bloomberg.com/apps/news?pid=20601109&sid=aL0rw1_zsfWk&refer=home)

- Nov. 3 (Bloomberg) -- U.S. auto sales plummeted 32 percent in October to the lowest monthly total since January 1991, led by **General Motors Corp.'s 45 percent slide**, as reduced access to loans and a weaker economy kept consumers off dealer lots. Ford Motor Co. reported a 30 percent drop in car and light-truck sales from a year earlier and **Toyota Motor Corp.'s declined 23 percent.** Honda Motor Co.'s slid 25 percent, Nissan Motor Co.'s were down 33 percent and Chrysler LLC's fell 35 percent. **"If you adjust for population growth, it's the worst sales month in the post-World War II era" for the industry, said Mike DiGiovanni, GM's chief sales analyst, on a conference call. "Clearly we're in a dire situation."** Industrywide U.S. auto sales fell for the 12th straight month, extending the longest slide in 17 years. Tight credit, falling consumer confidence and the weakening economy, the same forces that suppressed buying in September, hurt automakers again last month. **The seasonally adjusted annual sales rate for the month was 10.6 million, the lowest since February 1983, the Woodcliff Lake, New Jersey-based provider of industry statistics said in a statement. The October 2007 rate was 16 million, Autodata said.** "People are feeling a hell of a lot less flush than they've felt in the better part of a generation," said Joe Phillippi, an analyst at AutoTrends Consulting in Short Hills, New Jersey. "Everybody is taking it on the chin right now." Industry sales in 2009's first half will be "sobering," Jim Farley, Ford worldwide marketing chief, said on a conference call. **Sales this year may fall to fewer than 14 million vehicles, from 16.1 million in 2007, Ford sales analyst George Pipas said on the call.** GM, the largest U.S. automaker, reported sales of 168,719 cars and light trucks, compared with 307,408 a year earlier. The Detroit-based company sold 53 percent fewer pickup trucks, sport-utility vehicles and vans, including a 35 percent drop for the Chevrolet Silverado, GM's best-selling U.S. vehicle. None of the company's eight divisions posted a sales gain. GM offered employee prices to all customers in August and September. The incentive caused "sales to be pulled ahead into September," said Tom Libby, a Troy, Michigan-based analyst at market-research firm J.D. Power & Associates. Toyota, Honda, Nissan Toyota, the largest Asian automaker, reported sales of

152,101 vehicles, down from 197,592 a year earlier. The Toyota City, Japan-based company last month offered no-interest financing on 11 car and light-truck models. That promotion will continue at least through November, the automaker said today. **Some automakers said they may see sales improvements in November and December because of the U.S. presidential election tomorrow and end-of-the-year promotions. "We're going to have a better month" in November, Nissan's Castignetti said in the interview. "Beginning tomorrow, one way or another, this seemingly endless campaign finally gets closed. Whether you like it or not, you'll know what's going on." [Highlighted simply because I can't imagine a more bizarre statement – what in the world should the Presidential election have to do with people buying cars??????]** `True Test' Ford's Farley said that "most manufacturers will start year-end promotions in early November. The true test will come in the first quarter of next year, the first half of next year." The 12-month streak of declines in vehicle sales is the longest such stretch since the 14 months that ran through December 1991, according to Autodata. <http://www.bloomberg.com/apps/news?pid=20601087&sid=a5PrXcWxGKQ0&refer=home>

- **Questions on consumer lending.** Large fractions of domestic banks again reported tightening standards on both credit card and other consumer loans. **Nearly 60 percent of respondents indicated that they had tightened lending standards on credit card loans, while nearly 65 percent of respondents indicated that they had tightened lending standards on other consumer loans over the past three months.** Higher net fractions of large banks reported tightening standards on both categories of consumer loans than did smaller banks. About 50 percent of banks reported having raised minimum required credit scores on credit card accounts over the past three months, and 60 percent reported having raised minimum scores on other consumer loans over the same period, responses that were little changed from the July survey. **About 60 percent of respondents also reported having reduced the extent to which credit card accounts were granted to customers who did not meet their bank's credit-scoring thresholds, and a similar fraction of respondents reported a reduction in granting other kinds of consumer loans for that reason.** Also, significant net fractions of respondents reportedly raised minimum required down payments, as well as spreads of loan rates, on consumer loans other than credit card loans. **Half of domestic banks indicated that they had become either somewhat or much less willing to make consumer installment loans over the past three months, up from 35 percent in the July survey and the largest fraction in more than two decades.** About 50 percent of respondents, on net, indicated that they had experienced weaker demand for consumer loans of all types over the past three months, up from 30 percent in the July survey. **Special questions on existing credit card limits.** Two special questions asked domestic banks to indicate whether they had raised or lowered credit limits on existing credit card accounts and, if they had lowered limits, to give possible reasons for the change. About 20 percent of domestic banks, on net, reported having reduced credit limits on existing credit card accounts to prime borrowers; about 30 percent of larger banks and 10 percent of smaller banks had lowered such limits. Roughly 60 percent of banks had lowered limits on existing credit card accounts of nonprime borrowers; no banks reported raising limits to those borrowers. About 95 percent of banks that had reduced limits cited a less favorable

or more uncertain economic outlook and reduced tolerance for risk as reasons for the action. **Large majorities of respondents also cited a decline in customer credit scores and missed payments by customers on credit card loans and other loans at their bank.** <http://www.federalreserve.gov/boarddocs/SnLoanSurvey/200811/>

## Retirement

## Risk

## Savings Rate

## Tech

Nov. 6 (Bloomberg) -- [Qualcomm Inc.](#), the largest maker of mobile-phone chips, said the U.S. financial crisis will hurt future earnings and showed it already had a \$327 million impact on profit.

Soured investments in failed banks Lehman Brothers Holdings Inc. and Washington Mutual Inc. pulled down Qualcomm's earnings per share by 15 cents in the quarter ended Sept. 28. It was also hurt by investments in Fannie Mae and Freddie Mac, the mortgage financiers taken over by the U.S. government in September.

Qualcomm said sales [this quarter](#) may fall as much as 6 percent, which would be the first decline since 2001. That forecast aligns it with other technology companies that predicted a shrinking economy will curb demand for their products.

What makes Qualcomm stand out is the effect its investments have already had on profit. The company wrote off about \$100 million of investments in the troubled financial firms and has an additional \$1.2 billion that may be impaired, Qualcomm President [Steve Altman](#) said today in a phone interview. **``It's really difficult to forecast in this environment," said Altman. ``We disclosed that we have unrealized losses of \$1.2 billion and it's possible that that could be impaired if market conditions don't improve over time.** The company, based in San Diego, began shifting its investments from equity to bonds earlier this year, Chief Financial Officer [Bill Keitel](#) said today on a conference call. The impairment reported today affected about 3 percent of Qualcomm's \$11.3 billion in cash and securities, the company said. Investment Writedowns Net income in the period ended Sept. 28 fell 29 percent to \$878 million, or 52 cents a share, from \$1.13 billion, or 67 cents, a year earlier, when Qualcomm had a one-time tax gain. Investment impairments in fiscal 2008 totaled \$502 million, up from \$16 million in 2007 and \$20 million in 2006. Net investment income fell to \$96 million, or 3 percent of total net income, in 2008 from \$743 million, or 22 percent, last year. Qualcomm fell 1.7 percent to \$32.50 in after-hours trading after dropping \$2.12 to \$33.05 at 4 p.m. New York time in Nasdaq Stock Market trading. The stock has lost 16 percent [this year](#), compared with a 46 percent decline by the 18-member Philadelphia Semiconductor [Index](#). **Qualcomm Profit Shows \$327-Million Spillover From Credit Crisis**

[http://www.bloomberg.com/apps/news?pid=20601087&sid=akinHbH4\\_kNo&refer=home](http://www.bloomberg.com/apps/news?pid=20601087&sid=akinHbH4_kNo&refer=home)

## The Fed

### Wall Street

Nov. 6 (Bloomberg) -- U.S. stocks slid, sending the market to its biggest two-day slump since 1987, after jobless claims jumped and the shrinking economy crushed earnings at companies from Blackstone Group Inc. to News Corp.

Blackstone, the largest private-equity firm, fell 12 percent after posting the biggest quarterly loss in its 18 months as a public company. News Corp. sank 16 percent after the media company controlled by [Rupert Murdoch](#) said ad sales decreased. Chevron Corp. fell 6.4 percent as oil tumbled to a 19-month low, while an unexpected decrease in chain-store sales dragged down 25 of 27 shares in the S&P 500 Retailing Index.

“We're a long way from the end of the economic challenges,” said [Mike Morcos](#), who helps manage \$1 billion at Old Second Wealth Management in Aurora, Illinois. “Earnings next year are going to be significantly lower and estimates are going to continue to come down.”

The [Standard & Poor's 500 Index](#) fell 5 percent to 904.88, extending its two-day loss to 10 percent. The Dow Jones Industrial Average retreated 443.48 points, or 4.9 percent, to 8,695.79. The Russell 2000 Index of small U.S. companies declined 3.7 percent to 495.84. The MSCI World Index of 23 developed markets lost 5.9 percent to 925.09.

The two-day tumble following Election Day wiped out more than half of the market's rebound from a five-year low on Oct. 27. Both the S&P 500 and Dow average posted their biggest two-day slides since plunging more than 24 percent as rising borrowing costs helped spur the market crash of October 1987.

### Europe Slides

BP Plc led a 5.6 percent retreat in Europe's benchmark index even after the Bank of England unexpectedly cut its benchmark interest rate by 1.5 percentage points to 3 percent to contain damage from a recession. Switzerland's central bank and the European Central Bank reduced their main lending rates by 50 basis points.

The S&P 500 is down 38 percent this year, poised for the steepest annual retreat since 1937. The benchmark for U.S. equities has plunged 42 percent since its record in October 2007 after the U.S. economy shrunk in two of the last four quarters.

The VIX, as the Chicago Board Options Exchange Volatility Index is known, climbed 17 percent to 63.68. The measure tracks the cost of using options as insurance against declines in the S&P 500.

“It's just been a steady, steady sell,” said [Alan Gayle](#), the Richmond, Virginia-based senior strategist at Ridgworth Investments, which oversees about \$70 billion. “The pain and

frustration and anxiety of these volatile moves from one day to the next has discouraged a lot of investors to move to the sidelines."

### Lost Jobs

About 481,000 workers filed [initial jobless claims](#) last week, the Labor Department said today in Washington, exceeding the 477,000 projected by economists surveyed by Bloomberg News. The number of people staying on benefit rolls was the most since February 1983.

A report tomorrow will probably show U.S. employers eliminated jobs in October for a 10th consecutive month, based on economists' estimates.

Earnings at companies in the [S&P 500](#) that have reported third-quarter results fell 9.2 percent on average, Bloomberg data show. Analysts expect full-year profits to drop 7.7 percent, according to a compilation of analysts' estimates.

S&P 500 energy companies lost 6.1 percent as a group, as oil declined for the third time this week. Crude for December delivery retreated 6.9 percent to \$60.77 a barrel, the lowest settlement since March 2007.

Exxon Mobil, the world's largest oil company, tumbled \$3.73 to \$69.96, while Chevron Corp. slid 6.4 percent to \$70.11.

### Tech Slump

Cisco Systems Inc. declined 2.6 percent to \$16.94. The biggest maker of networking equipment forecast the first revenue drop in five years because of the financial crisis.

Advanced Micro Devices Inc. tumbled 11 percent to \$3.17. The second-largest maker of personal-computer processors plans to cut 500 jobs, about 3 percent of the workforce, as part of its effort to return to profitability.

Technology companies in the S&P 500 lost 5.4 percent collectively. Dell Inc., Intel Corp. and Hewlett-Packard Co. fell more than 5 percent.

Amazon.com Inc. sank 9.2 percent to \$47.22. The largest Internet retailer was cut to "hold" from "buy" at Citigroup Inc., which noted the shares' surge of as much as 36 percent since third-quarter results and concerns consumer spending will slow.

### GM's Survival

General Motors Corp. had the steepest decline in almost a month, tumbling 14 percent to \$4.80. The largest U.S. automaker is focused on winning government aid to survive through 2009, not to help a merger with Chrysler LLC, as it uses cash faster than it forecast, people familiar with the plans said. GM plans to give an update on liquidity when it reports third-quarter results tomorrow.

Tyco Electronics Ltd. fell the most in more than a year, slumping 12 percent to \$16.78. Fiscal fourth-quarter profit slid 55 percent on restructuring costs and the company forecast a ``significant" drop in sales and earnings this period.

News Corp.'s Class A shares tumbled \$1.53 to \$8.26. Fiscal 2009 profit will drop in the ``low to mid teens" in percentage terms, the company said after previously forecasting a gain of 4 percent to 6 percent.

Financial stocks in the S&P 500 fell 6.7 percent as a group, led lower by Bank of America Corp. and Wells Fargo & Co. The group is down 52 percent in 2008 as the slowing economy raises concern banks will be hit by more bad loans after the subprime mortgage market's collapse led to \$690 billion in credit losses worldwide.

#### Blackstone's Loss

Blackstone tumbled \$1.05 to \$7.55 after the financial crisis eroded the value of the businesses and real estate it has acquired, triggering a quarterly loss excluding items of \$502.5 million. Blackstone had been expected to break even, based on the average estimate of seven analysts in a Bloomberg survey.

Wells Fargo declined 9.2 percent to \$28.77 after the biggest bank on the U.S. West Coast said it plans to sell stock to fund the purchase of Wachovia Corp. The bank also said losses from the acquisition will be less than previously expected.

The bank, which disclosed the share offering yesterday in a statement, had said it would raise as much as \$20 billion to fund the deal. That was before the Treasury said it was buying \$25 billion of Wells Fargo's preferred shares.

#### Libor Declines

The slump in financials came even as the London interbank offered rate, or Libor, for three-month loans in dollars dropped 12 basis points to 2.39 percent today, the lowest level since November 2004, according to the British Bankers' Association.

Las Vegas Sands Corp., billionaire Sheldon Adelson's casino company, posted the biggest drop since becoming a publicly traded company with a 33 percent plunge to \$7.85 after saying it may default on debt and face bankruptcy.

Big Lots Inc. plunged 26 percent to \$17.31 for the steepest decline in the S&P 500. The largest U.S. seller of overstocked and discontinued items said third-quarter profit may be below its prediction.

October same-store sales fell 0.9 percent at U.S. chain stores, the first drop in seven months, and declined 4.2 percent excluding Wal-Mart, the International Council of Shopping Centers said. Economists surveyed by Bloomberg had projected a 0.7 percent increase.

Excluding the effect of the shifting Easter holiday, it's the first decline since at least 2000, according to research firm Retail Metrics LLC.

## Grocers Gain

[Whole Foods Market Inc.](#) climbed 1.7 percent to \$10.48. The largest U.S. natural-foods grocer received a \$425 million equity investment from [Leonard Green & Partners LP](#).

Kroger Co., the biggest U.S. supermarket chain, added 1.1 percent to \$26.99. Safeway Inc., the third-largest, rose 2 percent to \$22.03.

Analysts are lowering fourth quarter and 2009 profit forecasts for U.S. companies as third-period results miss projections at the highest rate in almost 11 years.

Companies in the S&P 500 may see fourth-quarter earnings advance 15 percent, down from 42 percent projected at the end of August, according to a Bloomberg survey of analysts. Profits in 2009 may grow 13 percent, analysts say, compared with the 24 percent predicted two months ago. **U.S. Stocks Tumble in Market's Worst Two-Day Slump Since 1987**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aovYs15vXGf0&refer=home>

- Published: November 3 2008 23:31 | Last updated: November 3 2008 23:31 **One of Goldman Sachs's flagship hedge funds, run by two of the Wall Street bank's most talented traders, has lost close to \$1bn since its launch in January in further evidence of the crisis facing the industry.** Goldman Sachs Investment Partners, which was hailed in January as one of the biggest hedge fund launches, raising more than \$6bn, has told investors that it had lost \$989m by September. It said the fund was down about 13 per cent in the third quarter. Year-to-date performance fell about 15.5 per cent in the year to September. The managers said: **"We are disappointed with our performance." But they added: "GSIP is not alone in producing disappointing returns this quarter and this year. "We anticipate that these results will lead to net outflows from the hedge fund industry."** Hedge funds have had a horrible year with asset prices in free fall, redemptions at record levels and banks imposing tougher conditions on lending, prompting some managers into fire-sales. GS Investment Partners, which imposed a two-year lock-in at launch and has a strong bias towards equities, is managed by Raanan Agus and Kenneth Eberts, former heads of proprietary trading desks at Goldman. The fund was launched after a poor year for the bank's quantitative, or computer-driven, hedge funds which were hit hard in August 2007 forcing the bank to inject \$3bn to rescue its Global Equity Opportunities fund. More than half of GS Investment Partners' losses in the third quarter was from its investments in commodities, basic materials, metals, mining, energy and agriculture. But like many multi-strategy funds diversified across equity, credit markets and convertible bonds, GS Investment Partners was hit hard by losses on convertible bonds – debt instruments that can convert into equity. It said returns from the convertible asset class had been "abysmal". The Hedge Fund Research convertible bond index showed returns had dipped 20 per cent in the year to September. The falls accelerated sharply in October. Assets in Citadel's largest fund, Kensington multi-strategy fund which has about \$13bn under management, fell 37 per cent in the year to

October 27. Deephaven Capital Management in the US has told investors that it was suspending withdrawals from its \$1.6bn Global Multi-Strategy fund and working on "a plan for the continuation of the fund" after suffering in virtually every market in which it was invested.

**Goldman fund loses \$990m after 10 months**

[http://www.ft.com/cms/s/0/d05d7116-a9e9-11dd-958b-000077b07658.html?nclick\\_check=1](http://www.ft.com/cms/s/0/d05d7116-a9e9-11dd-958b-000077b07658.html?nclick_check=1)

- Nov. 3 (Bloomberg) -- **UBS AG, Switzerland's largest bank, faces dozens of claims in the U.S. from clients who bought "100 percent principal protected notes" issued by Lehman Brothers Holdings Inc. that are now almost worthless.** Six attorneys hired to represent clients in the cases say UBS brokers touted the so-called structured notes as low-risk investments and failed to emphasize they were unsecured obligations of Lehman, which filed for bankruptcy in September. State regulators are fielding so many calls about Lehman's notes they're considering a task force to investigate the sales, said Rex Staples, general counsel for the North American Securities Administrators Association Inc., a group of 67 state and provincial regulators based in Washington. **"The sales pitches were that it's good for retirement accounts, and good for the safe, fixed-income part of people's portfolios as an alternative to owning stocks, because it's less risky,"** said Seth Lipner, a lawyer in Garden City, New York, hired by two holders of Lehman notes sold by UBS, including a 65-year-old accountant who says he lost \$1.4 million in retirement savings. "Of course, it turned out to be more risky." Any awards for investors would add to the financial industry's burgeoning costs for compensating individuals who bought supposedly safe investments that crumbled in the credit crunch. **Banks and securities firms, including Zurich-based UBS, Citigroup Inc. and Merrill Lynch & Co., already have had to swallow more than \$3.6 billion in fines and market losses on auction-rate securities they had to buy back from clients under orders from the U.S. Securities and Exchange Commission and regulators in New York, Massachusetts and other states.** UBS Woes UBS had to take a charge of \$900 million related to the auction-rate probe. It is also being investigated by the SEC for the sale of derivatives and investment contracts to state and local governments, and the Internal Revenue Service is looking into whether it improperly helped U.S. clients evade taxes. **Kristopher Kagel, a UBS spokesman in New York, said the bank "properly sold" Lehman's structured notes to its clients. "The offering materials clearly identified Lehman as the issuer and discussed all the relevant risks and features of the product," Kagel said. A state task force on structured notes would be similar to the one convened earlier this year that investigated the auction-rate market. Regulators have been concerned about structured notes for some time and "now the complaints are beginning to come in at a fairly rapid clip," Staples said. Structured Notes "Structured notes, sometimes marketed as "structured equities" or "hybrid financial instruments," are constructed by banks and Wall Street firms from a combination of bonds, stocks, commodities, currencies and derivatives. About a third of the \$114 billion sold last year in the U.S. promised full or partial principal protection.** The banks, which rely on market borrowings to finance their loans, trades and investments, sold more structured notes to retail clients as the credit crisis made plain-vanilla bonds more expensive to issue in institutional debt markets. Sales of the notes quadrupled in the U.S. during the past four years, About \$8 billion of Lehman structured notes were outstanding as of September, including \$2.8 billion sold this year. **The New York-based firm was**

**selling the notes as late as August**, while it was racing to find capital weeks before being swept away by what Chief Executive Officer **Richard Fuld**, 62, called a "financial tsunami." Worth 14 Cents **UBS, the fifth-biggest brokerage firm in the U.S., sold about \$1 billion of Lehman's structured notes in America, according to Kagel.** The largest brokerages -- Merrill Lynch, Citigroup's Smith Barney and **Morgan Stanley** -- weren't big distributors of Lehman's notes because they mostly sell their own products, said a person with knowledge of the matter. Lehman's Sept. 15 bankruptcy leaves holders of the notes waiting in line with other senior unsecured creditors for what's left of their money. **Notes with full principal protection are trading at 10 cents to 14 cents on the dollar, according to New York-based SecondMarket, which provides a marketplace for securities that are illiquid, or barely trade.** The Lehman bankruptcy also put a damper on the structured- notes market, with new issuance in the U.S. slowing to about \$98 million a day in the 45 days following Lehman's bankruptcy, compared with about \$263 million a day in the year through Sept. 15, according to mtn-i. Hong Kong Protests The business took another blow in early October when the Federal Deposit Insurance Corp. said it plans to exclude "derivative-linked products" and "debt paired with any other security" from the bank-debt guarantees offered as part of the government's plan to stabilize financial markets. The growing number of irate investors in the U.S. adds to those from Hong Kong, Singapore and Taiwan who have demanded refunds from banks that sold structured notes linked to Lehman. **DBS Group Holdings Ltd.**, Southeast Asia's largest bank by assets, said on Oct. 22 that about 4,700 investors in Singapore and Hong Kong may lose their entire investment in Lehman notes. The Singapore-based bank estimates it may have to pay as much as S\$80 million (\$54 million) to compensate noteholders. About 200 protesters marched through Hong Kong's financial district on Oct. 31, stopping at banks that sold Lehman notes, the Associated Press reported. They held signs that read: "Major bank fraud" and "My money gone, I don't want to live." 'Off the Hook' In the U.S., investors are starting to come "out of the woodwork" after learning in quarterly statements that their Lehman investments are almost wiped out, said Jeffrey Kaplan, a Miami lawyer who specializes in securities-arbitration claims. "Our phone is ringing off the hook," Kaplan said. "The vast majority of calls we've taken are investors with accounts at **UBS.**" Scott Silver, an attorney in Coral Springs, Florida, said he was hired by more than 40 clients after he issued an Oct. 8 press release announcing his willingness to investigate claims on behalf of buyers of Lehman structured notes. Some investors had read stories about the Hong Kong claims, he said. "People are livid," Silver said. "They feel that the investment was misrepresented to them. They didn't appreciate that it was tied to the credit risk of Lehman Brothers." **Jacob Zamansky**, a securities-arbitration lawyer in New York, said he has been retained by at least five clients who collectively purchased "several million dollars" of structured notes issued by Lehman. Clients 'Crushed' "There were a lot of notes sold through UBS," Zamansky said. "Clients are telling me that these were pitched as relatively safe instruments. The principal was protected and the only variable would be in the rate of return that was received. It appears that there were misrepresentations."

- **James Sallah**, a securities-arbitration lawyer in Boca Raton, Florida, said he's been contacted by "dozens of clients" and retained by a local 74-year-old doctor whose \$5 million account at UBS dropped by 50 percent, including \$400,000 of losses on Lehman structured notes. "You've got people who wanted preservation of capital and now have

just gotten crushed," Sallah said. Investor arbitration claims filed with the Financial Industry Regulatory Authority in Washington have increased this year for the first time since they peaked in 2003 after the Internet-led stock-market bubble burst. There are claims for losses on preferred shares in Fannie Mae and Freddie Mac, the mortgage-finance companies seized by the U.S. government, and for bond mutual funds, including Charles Schwab Corp.'s YieldPlus Fund. **``Arbitrators tend to be dubious of investors who claim their brokers told them information that was directly contradicted by written materials, even if it was in the fine print,''** Gross said. **``The customer is required in many jurisdictions to read the written materials, and often anything in writing trumps the oral statements that were made.''** **``Bankruptcy risk is inherent in any investment involving a corporate entity in the U.S.,'** Styracula said. **``If you don't understand that it's a note, and you're not reading the prospectus, then that's a buyer-beware scenario.''** Lipner, the Garden City lawyer who's also a law professor at Baruch College in New York, said one of his clients bought Lehman notes issued in February that came with a brochure promising that **``at maturity, you will receive a cash payment equal to at least 100 percent of your principal.''** The last in a list of 13 risk factors was: **``An investment in the notes will be subject to the credit risk of Lehman Brothers.''** **He expects awards may be bigger in cases stemming from the credit crisis because arbitration panelists may have more sympathy for the losers: conservative investors who asked their brokers for investments that protected their principal.** **``The tech sales played to people's greed,''** Lipner said. **``Here, what they sold appeared to be safe and therefore played to people's fears.''** **Lehman Good-for-Retirement Notes Worth Pennies for UBS Clients**  
[http://www.bloomberg.com/apps/news?pid=20601109&sid=aBJ\\_0ULSgrjY&refer=home](http://www.bloomberg.com/apps/news?pid=20601109&sid=aBJ_0ULSgrjY&refer=home)

- Nov. 3 (Bloomberg) -- Blue Mountain Capital Management LLC froze its largest hedge fund after clients asked to pull a **``meaningful percentage''** of their money even as it outperformed the industry average by almost 10-fold this year. The \$3.1 billion Blue Mountain Credit Alternatives Fund declined 2.4 percent through October, compared with the 19.6 percent loss by the **HFRX Global Index** compiled by Chicago-based Hedge Fund Research Inc. Withdrawals were suspended so Blue Mountain wouldn't be forced to sell assets in falling credit markets, the firm said today in a letter to clients. **``This shows that nobody is immune from the huge investor outflows in the industry at the moment,''** said Matt Simon, analyst at New York-based Tabb Group, a financial-services consulting company. Investors fleeing the worst financial crisis since the Great Depression have forced hedge funds such as Deephaven Capital Management LLC and RAB Capital Plc to halt redemptions. In most cases, the funds have underperformed competitors. The Deephaven Global Multistrategy Fund was down 15 percent this year through September and lost an additional 10 percent in October. **Several of Blue Mountain's fund-of-funds shareholders were under ``liquidity pressures'' from their own clients, Blue Mountain Chief Executive Officer Andrew Feldstein said in the investor letter, a copy of which was obtained by Bloomberg News.** **``We are not comfortable with this state of affairs,''** Feldstein wrote. **``If we were to unwind or sell positions to meet current redemptions, the severe liquidation costs would be borne inequitably by the remaining investors.''** **Investors may pull as much 25 percent of their money from hedge funds by the end of the year, Morgan Stanley said in an Oct. 24 report. Combined with**

**investment losses, industry assets may shrink to \$1.3 trillion, a 32 percent drop from the peak in June, the New York-based bank said.** A spokesman for Blue Mountain, which oversees \$5.5 billion from offices in New York and London, declined to comment. The Blue Mountain Credit Alternative fund has returned an average of 45.8 percent annually since inception. The fund seeks to profit from discrepancies in the prices of securities in the corporate loan, bond, credit and equity derivatives markets, a strategy known as relative-value trading. The firm's \$1.1 billion equity alternatives fund has lost 0.9 percent this year through October, while its \$400 million BlueCorr fund has returned 21.3 percent, according to the investor letter. Blue Mountain offered investors a plan that includes waiving the notice and lock-up provisions of the Blue Mountain Credit Alternative fund for all clients. Investors have until Nov. 10 to decide whether to redeem their existing investment or exchange all or part of their investment with any one or more of three share classes. **Blue Mountain Freezes \$3.1 Billion Credit Hedge Fund**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=afLyPPpU0yK4&refer=home>

## Don't Fight The Fed

### I Disagree . . . and why

[Article of the week:](#)

# The Best Income Investment for Inflationary Times

By Tom Dyson

Last week, the Federal Reserve pledged \$30 billion each to South Korea, Mexico, Brazil, and Singapore. The Fed also offered New Zealand a \$15 billion line of credit... and invited the Australians to borrow \$30 million, too.

We're entering a recession. It could turn into a depression. To prevent this, the U.S. government – in concert with the Brits, the Euros, and a few other governments around the world – is plowing money into the global financial system.

They'll design new bailout packages. They'll start nationalizing companies. They'll start new public spending projects. And they'll lend money to anyone who wants it. Expect new roads, bridges, and railways everywhere. Depending on how bad it gets, maybe they'll even start a war. Wars are the best way to get an economy out of recession. They get everyone working again and funnel billions from the government into the private sector.

Where does this money come from? Inflation. But right now, the market doesn't care about inflation because investors are more worried about deflation and depression. So no one's complaining. It's the perfect environment for governments to increase their power.

But inflation is coming... It's going to take incredible amounts of new paper money to pay the piper back for the party of the last five years. I call this landscape "Paulson's New

World." And today, I'm going to tell you how income investors can survive and prosper in Treasury Secretary Henry Paulson's New World...

First, focus on hard-asset investments.

During inflation, you want to own hard assets... things like gold, power plants, toll roads, oil wells, machinery, and land. Say a loaf of bread costs \$1. Then the Feds double the money circulating. Now that loaf must sell for \$2.

Hard assets that pay dividends are the best of both worlds. Your principal rises as excess paper money inflates the value of your asset. Your dividends rise as excess paper money makes the value of output increase.

Second, focus on the safest possible companies.

Weak economic times are actually great for the strongest and smartest players in an industry. Weak players go bankrupt... So strong players can buy up their assets cheaply and increase their market share. Plus, investors seek safety in the strongest and most stable companies.

A major upheaval is coming... particularly in the way Americans deal with money. Expect new regulations, new emergencies, and major volatility. Banks will hit the wall. Money markets are not safe. That's why I like companies that sell cheap, everyday items... like soda, oil, cheap food, and cigarettes.

To profit from Paulson's New World, my favorite investments come from a select group of securities called "Bonded Trusts."

Bonded Trusts are 100% hard-asset investments made of steel, copper, energy, labor, and large amounts of capital. They're among the safest investments in America. They operate critical sections of America's national infrastructure network. The government supports them. Consumers cannot live without them. Bonded Trusts pay dividends that rise with inflation, so you'll never be left behind. In fact, eight of the largest Bonded Trusts raised their dividends in the last two weeks.

Most Bonded Trusts operate oil and gas infrastructure, like pipelines, processing plants, and storage tanks. America simply cannot function without these businesses. And the sector is having a banner year... Giant new gas discoveries in Wyoming, Texas, Oklahoma, and Appalachia have propelled demand for energy infrastructure. It's producing record cash flows, generating record dividend payments, and growing faster than ever before.

The technical name for a Bonded Trust is "master limited partnership" (MLP). MLPs are the American equivalent of Canadian income trusts. They pay no tax. They return all their profits to unitholders (another word for shareholders) in large monthly distributions. Close to 100 MLPs trade in the stock market. And they're the absolute best place to look for big, safe dividends.

In the last two weeks, eight of the largest Bonded Trusts in the sector posted dividend increases for the third quarter of 2008. They are the perfect investments to profit from Paulson's New World. Consider allocating a portion of your portfolio to them.

think that's why corporate insiders in the MLP business are now frequent buyers of their own shares. They realize these stocks are extremely attractive to investors. Here is a list of MLPs with the largest insider buying the past 90 days:

Company	Ticker	3-Month Buy
TEPPCO Partners	TPP	\$7.7M
NuStar GP Holdings	NSH	\$7.2M
Energy Transfer Equity	ETE	\$5.3M
NuStar Energy	NS	\$4.9M
Duncan Energy Partners	DEP	\$3.0M

### **Best of the Dog**