

The Other Side of the Street November 30, 2008

The Nikkei fell another 50% in 2008. The Japanese investor who bought stocks in 1982 when he was 35 years old is now 61...and his stocks are not worth a penny more! – Bill Bonner

Rates on home loans haven't fallen even after the Fed cut its key interest rate and yields on benchmark Treasuries tumbled. Average 30-year mortgage rates were 5.98 percent yesterday, little changed from the 2007 average of 5.95 percent, according to bankrate.com. – [sooooo . . . the 425 basis points in cuts did nothing and the solution will now be for the government to get directly involved in loaning money to those whose credit is not deemed worthy by the private sector . . . and I thought it was loaning money to those who could not pay it back that was the problem to begin with . . . what was I thinking????]

On Nov. 18, five days before he was forced to bail out Citigroup, Treasury Secretary Henry Paulson told Congress he was handing over to President-elect Barack Obama "a significantly more stable banking system where the failure of a systemically relevant institution is no longer a pressing concern rattling the markets." [they are either lying or have no clue – this is nearly verbatim what has been said in the days before the BSC, FRE, FNM, LEH, AIG, etc collapses. What it means that matters is that there are lots of land mines left]

ShopperTrak RCT, a retail industry research firm, said total Black Friday sales rose 3% this year, to about \$10.6 billion nationwide. Bill Martin, the firm's co-founder, said that given the headwinds facing the nation's merchants - a troubled economy, the traditional weakness in a presidential election year and the aftermath of the summer's record gas prices - the first day was pretty positive. "Under these circumstances, to start off the season in this fashion is truly amazing and is a testament to the resiliency of the American consumer, and undeniably proves a willingness to spend," Martin said in a statement. [I may be the only person who thinks this is sick, but I am in fact very tired of hearing that people who spend money they DO NOT HAVE is in some way noble. It is this very "willingness to spend" that has destroyed this nation financially. And by the way, unless you have provided a huge safety net in your financial wherewithal, going out and spending money on "gifts" right now is irresponsible per se]

Comments

This week past presents so many topics I don't know where to start. So I will start with a rant:

As noted above, irresponsible financial behavior is touted as a good thing. The idea that giving away things you bought on credit makes the annual year end spend-a-thon a “December to Remember” simply is an iteration of “there is a sucker born every day.” Perhaps, just like those who should have recalled the 2000-2 bear market before losing their asses again in 2008, those “resilient consumers” should think about the “January to Remember” when the credit card bills roll in. No one, and I repeat NO ONE, knows how deep or how long the next recession will be. Should you be counting on your financial future to be as rosy as it is now, you have a greater belief in winning the lottery than I do. The reality is that for most of you reading this, there is a strong likelihood that you will be facing significant financial distress sometime in the next several years. Thus, the real gift you can give those you love this year is to spend time with them, not over lever yourselves to give trinkets that will be in the July trash.

Now, let switch to the stupidity of last week on Wall Street. For those who can recall one full week back, the pundits had declared the world would end (that of the “breaking to new lows and our technical charts say Armageddon is here). Then came the miracle rally of Thanksgiving week. CNBC was abounding with claims that the rally demonstrated that “confidence has returned” to the markets. This is complete and utter nonsense. What happened last week is what happens whenever markets are left to the manipulators. The market “built” on the last hour manipulation the prior options expiration Friday by running up stocks up on the very low volume associated with half days and days off (there were 3 ½ trading days last week). This was particularly exacerbated by the month end mark ups that occurred.

So . . . what does it mean? It means that we could go up everyday until December 31 and it would not indicate any change in likely economic developments next year. Instead, it will be a tribute to some of the people being fooled all of the time. If your time horizon is beyond the next 31 days, you will be afforded a great SELLING opportunity. Most socks will trade at much lower valuations next year. The idea that if you don’t buy today you will miss out is one perpetrated by Wall Street. The only thing unknowable is how long and how high this year-end rally will last.

On a more macro topic, the idea has taken hold that the only fear we should have is of deflation not inflation. Now mind you six months ago the world was all a twitter about rampant inflation. The take away? That the “herd” (and I do mean all you “sophisticated” investors out there in institutional land) is once again being led over the cliff. I will make it simple. We are NOT going to have deflation when the U.S. government is adding debt by the trillions. What we will have instead is hyper inflation. When this happens the dollar will be obliterated vis-à-vis precious metals. It is hard to know what it will do vis-à-vis other fiat currencies because they are colored toilet paper as well. And if you think that you can rely on the Street to “see nine months ahead” and that you should listen to the herd, think back to those same clowns spouting that RE could never go down on a national basis. This was in fact the mantra for YEARS. It is these same people now telling you to watch out for deflation because inflation is dead. At some point you will all learn, if you have not already, that the markets do not give a flip what the “flavor of the moment” is. Continue to trade with the rest of the lemmings and you too can see what a hard landing is all about.

Stock Notes

- As I've been warning, **REITs are going to get wiped out**. Dozens will go bankrupt. If the mortgage bonds on commercial real estate are yielding 15%, the equities paying those mortgages are toast. Now, you might want to do two things with this information... One, sell short highly leveraged REITs – all of them. –Daily Reckoning
- Despite Secretary Paulson's claim he would lock up remaining TARP funds for the next administration, **the Treasury Dept. named Citigroup as its latest target for quasi-nationalization last night**. In a hasty Sunday deal that has become the hallmark of the "credit crisis," Citi managed to talk itself into a massive government aid package. Here's the meat of it: The Treasury, FDIC and Federal Reserve promise to backstop Citi's \$306 billion worth of troubled assets. Citi's on the hook for the first \$29 billion in losses, and the government is essentially on the hook for the rest. The Treasury will write Citi a check for \$20 billion, in addition to the \$25 billion Citi's already received from the TARP. In return, the government gets \$27 billion in preferred Citi stock. \$20 billion for the second stimulus check, \$7 billion as compensation for backstopping all those bad assets. This breed of Citi stock will pay an 8% dividend and comes with warrants to buy \$2.7 billion more in the future. The deal also insists the Citi pay no more than a 1-cent dividend over the next three years (except for the government's shares, of course). Employee compensation will also be drastically reduced.

Notes

- "Six Nobel prizes were handed out to people whose work was nothing but BS," says Nassim Taleb, author of The Black Swan. "They convinced the financial world that it had nothing to fear." **In the real world, Taleb explains, things are stable for a long time. Then, they blow up. Then, all the theories and regulators prove worthless. These blow ups are inevitable, but unpredictable...and too rare to be modeled or predicted statistically. "And they are almost always much worse than you expect."**
- Yes, the financial hotshots did all these things. And more. They sold the world on 'finance,' rather than making and selling things. Then, it was off to the races. Everybody wanted to bet. Perfecta, place bets, odds-on...double or nothing. **Of course, investors would have been better off at the race track. The track takes about 20%. In the financial races, Wall Street took 50% to 80% of all the profits. Before 1987, only about one of every 10 dollars of corporate profits made its way to the financial industry – in payment for arranging financing, banking and other services. By the end of the bubble years, the cost of 'finance' had grown to more than 3 out of every 10 dollars. Total profits in the United States reached about \$6 trillion last year; about \$2 trillion was Wall Street's share.** What happened to this money? Other industries use profits to build factors and create jobs. **But the financial industry paid it out in salaries and bonuses – as much as \$10 trillion during the whole Bubble**

Period. And now that the sector finds itself a few trillion short, it waits for the government to open its purse.

- **How much spending has been taken out of the U.S. economy?** Americans enjoyed “home equity withdrawal” of about \$800 billion per year – at the height of the bubble two years ago. And they saved nothing. Now, their saving rates must be going up fast (we have no data on this...yet)... and home equity withdrawals have almost disappeared. If the savings rate were to go to 10% of GDP that would mean about \$1.4 trillion taken out of the consumer economy. Minus also the \$800 billion in home equity withdrawal that no longer happens. If the government wanted to replace this, it would have to spend about \$2.2 trillion MORE each year. That would be on top of the budget deficit for 2008 – about half a trillion.
- But instead of bringing in someone who really knows how to keep prices from falling, Obama has appointed Timothy Geithner to head up the Treasury department. As head of the New York Fed, Mr. Geithner was practically in the room when the ‘bad stuff was going down.’ **He was the G-man...the government’s eyes and ears...right on-the-scene when Wall Street was packing its pipe bombs with subprime debt...filling its molotov cocktails with unsecured commercial debt...building its WMD with more than \$400 trillion of derivatives. Apparently, he didn’t see a thing!** Two of our English colleagues went to see economist Robert Shiller (of the Case-Shiller real estate survey) at the London School of Economics this week. They report that Shiller says he sent warnings to the NY Fed, while Geithner was in charge. **But the feds didn’t seem to care for his gloomy messages and stopped asking his opinion. Then, Shiller studied Geithner’s remarks during the bubble period and came to this conclusion: “He had no idea.”**
- Never before have we seen so much wealth disappear in such a short time. The latest report from MSCI shows the planet’s **losses from the sell-off of equities has now reached more than \$30 trillion – or more than twice the GDP of the U.S.A.!** And this is just stocks. Reported write-downs, write-offs and credit losses have reached almost a trillion. **And losses of housing prices in the United States alone – the only country for which we have reliable figures – has reached about \$5 trillion.**
- But our guess is that some things ARE coming to an end. The myths of Wall Street – “stocks for the long run”...“buy and hold”...hedge funds that don’t hedge...derivatives derived from nothing...millions in ‘incentive’ bonuses for executives. Or maybe the whole dollar-based world monetary system is going away? Keynesianism? Monetarism? The Efficient Market Hypothesis? Surely these silly theories have to go sometime too.
- **“The U.S. monetary base is now growing at an annual rate of 75.5%,”** reports John Williams. “For the two weeks ended Nov. 19, total reserves of depository institutions surged to \$652.9 billion, up from \$415.7 billion in the prior period. The latest numbers are up nearly 15-fold from August’s monthly average of \$44.6 billion, prior to the Fed’s extreme liquefaction in response to the current intensification of the systemic solvency crisis... “Against the prior two-week period, the St. Louis Fed measure gained 19.1%. Year-to-year growth rose to 75.5%, from 48.2% in the period before.” We’re watching these numbers with the intensity of a child who’s seen a dwarf for the first time. In the

battle against “deflation,” we’re expecting the government’s excessive bailout strategy to be akin to setting a match to tinder. “There is hardly a government in the world that has not in some way intervened to resist liquidation,” the writer Garet Garrett wrote back in 1933, “but the American government, the only one with a strong tradition against it, has been the least restrained of all.”

- Central banks around the world have pumped trillions of dollars into the global money supply in order to resuscitate the worldwide financial system. In the last 12 months, agencies of the U.S. government alone, have provided, or promised to provide, an astronomical \$8 trillion worth of bailouts, loans and guarantees. Out of that \$8 trillion total, the Federal Reserve is providing \$5 trillion, more than \$2 trillion of which is actual cash. These funds don't exactly come out of nowhere, but almost. When central banks pump lots of credit and currency into the financial system, good things can happen for a while. The cost of borrowing money falls, which encourages people to take chances they might not otherwise take. When lots of people take lots of chances at the same time, the economy tends to expand, share prices tend to go up and everyone is happy. But over the long term, an excess of money-creation tends to produce an excess of inflation.
- The Washington Post sums it up beautifully. “A year ago, the central bank had assets of \$868 billion, of which about 90 percent was in Treasuries. Last week, it had assets of \$2.2 trillion on its books, of which 22 percent was in Treasuries.”
- the Morgan Stanley index showed a worldwide loss of equity value of some \$30 trillion. By Wednesday, we got an update: another \$2 trillion had been lost.
- Since September, we have experienced ten 90% down-days. I think we are in an extended panic-crash stage of the bear market. **Ultimately, we should see a huge counter-move rally – the "experts" will label this as "a new bull market." They will be wrong. It will be the rally that lures in the eager amateurs who are convinced (hoping) that the bear market is over. Actually, this bear market is now just one year old. I don't believe that a bull market that lasted 26 years can be corrected by a one-year or even a two-year bear market.** - *Richard Russell, author of the Dow Theory Letters:*
- Brian Sullivan, CEO of search firm CTPartners, predicts layoffs in the financial-services industry will accelerate in coming months, with job losses doubling to 350,000 worldwide by mid-2009. Reductions of that magnitude would equal 20% of the global financial workforce before the credit crisis began. "This is the financial equivalent of World War II," Sullivan said. "It's unprecedented. You're seeing a seismic shift in the population of banking. Without the massive leverage that's been in the system, the business of some of these big investment banks simply isn't going to be there. You'll go back to the investment banks of the 1960s and '70s."
- The public will not invest in investment banks, private-equity firms, or hedge funds. All of the remaining public structures (Blackstone [BX], Fortress [FIG], GLG [GLG]) will eventually collapse or go private. And without the public to backstop the losses and the risks, leverage will be permanently reduced. Most of the activities of the financial sector are not profitable without lots of leverage. Financial sector employment will fall just as much as the leverage. And the sector will have to deleverage by at least 50% – probably more.

Web links

Credit

- Nov. 26 (Bloomberg) -- The Federal Reserve's new \$800 billion effort to combat the financial crisis is designed to make credit more accessible to shaken consumers who aren't sure they want more debt. Households and lenders may not respond much because of the wealth destruction from plunging property and stock values, and the deepening economic slump, economists say. That means banks may end up returning the Fed's new liquidity through deposits at the central bank. **"We are sort of spitting in the wind," said Michael Darda, chief economist at MKM Partners LP in Greenwich, Connecticut. "Banks won't be throwing a lot of loans out there when they fear -- rationally -- those loans may not be paid back."** Policy makers aim to kick-start markets for loans to students, car buyers, credit-card borrowers and small businesses with a new \$200 billion program. Backed in part by the Treasury, the Fed will become a new buyer in the market for consumer loans at a time when many traditional holders of the assets, such as off-balance sheet bank units, have collapsed or been dissolved. The announcement of the new efforts yesterday came amid rising criticism that officials were excessively focused on saving Wall Street firms, with the Citigroup Inc. rescue Nov. 23 the latest example. President-elect Barack Obama said repeatedly in the past two days he'll compose a plan to help "Main Street" as well as the financial industry. 1966 Powers Obama and congressional Democrats have also pushed for a stronger response to the housing crisis. **The Fed responded yesterday, invoking authority first granted in 1966 to buy \$500 billion of mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae.** Along with a \$100 billion plan to buy the corporate debt of Fannie, Freddie and federal home loan banks, the step marks the central bank's biggest foray into a type of quantitative easing. That's an unorthodox monetary policy tool that goes beyond setting short-term interest rates. The central bank has already cut its benchmark rate to 1 percent. "Rates are going to be kept down for a long time, the Fed's balance sheet is going to be expanded for a long time," said John Ryding, chief economist at RDQ Economics, New York. "It does, as we have argued, represent a very significant quantitative easing." Mortgage rates and yield premiums on Fannie and Freddie debt tumbled after the announcement. The average U.S. rate for a 30-year fixed mortgage ended at about 5.5 percent after starting the day at 6.38 percent, according to Bankrate Inc. Markets React The spreads on most of Fannie's and Freddie's \$1.7 trillion of corporate debt and \$4.1 trillion of mortgage-backed bonds over comparable Treasuries tumbled to the lowest levels since early October. The cost to protect against defaults on corporate bonds and on securities backed by commercial mortgages also declined. **The question remains whether the lower rates will have much impact on the flow of credit and the economy. While the Fed has expanded its balance sheet by \$1.3 trillion so far, banks have left much of the liquidity on deposit at the central bank itself, as so-called excess reserves. The surplus stood at \$604 billion on Nov. 19.** Bank regulators have tried to cajole lenders, saying they "expect" them to lend, in a guidance letter issued Nov. 12. The Fed's most recent quarterly survey of bank loan officers showed that 70 percent of domestic firms had tightened lending standards for their best mortgage borrowers in the third quarter, and 60 percent had raised standards on credit-card loans. 'Non-Functioning' "The root of the problem is our securitization markets are

non-functioning,” said **Josh Rosner**, managing director at New York research firm Graham Fisher & Co. “We have capital problems at the banks so they can’t take over.” While officials yesterday contested claims that the Fed is undertaking quantitative easing, they acknowledged that the central bank’s new actions will result in another injection of funds into the system. Officials said their objective is to affect credit markets rather than to target money supply. **The Bank of Japan is the only major central bank to deploy quantitative easing in modern times, from 2001 to 2006. Current Governor Masaaki Shirakawa said in May that the policy “was very effective in stabilizing financial markets,” while at the same time it had “limited impact” in resolving Japan’s economic stagnation of the time because banks wouldn’t lend and companies wouldn’t borrow.** Fed Meeting Fed officials next meet on Dec. 16-17, when economists anticipate they will cut their target rate for overnight loans between banks to 0.5 percent. The central bank expanded the meeting to two days, making it likely that the Federal Open Market Committee will explore the options for conducting policy with rates near zero percent. “We can’t look back to recent history” as a guide for what to do, **Mark Gertler**, a New York University economics professor who has collaborated with Fed Chairman **Ben S. Bernanke** on research, said in a Bloomberg Television interview. **“We really do have to make it up as we go along.”** Yesterday’s announcements continue the trend of the Fed and Treasury taking on more risk with public money, while private sector balance sheets contract. Earlier this week, the two agencies and the Federal Deposit Insurance Corp. offered a backstop for a \$306 billion portfolio of Citigroup assets. Under the new Term Asset-Backed Securities Loan Facility, the Treasury will use taxpayer funds to protect the Fed against the first \$20 billion of losses, or 10 percent, of \$200 billion in exposure to AAA rated securitized consumer debt. Risk to Taxpayer “I am willing to believe that these things that are rated AAA might have a maximum 10 percent loss if the assets behind them never changed,” said **Ann Rutledge**, a principal at R&R Consulting in New York, which specializes in structured finance. “The collateral in credit card asset-backed securities changes.” Ratings may be harder to judge when credit quality is deteriorating. Also, the government has less information than issuers, who could back the bonds with assets that pose the most risk of declining quality, Rutledge said. Officials yesterday said the risk of loss is minimal, and noted that the Fed will put haircuts on the value of the ABS that it takes on. Treasury Secretary **Henry Paulson** said the mortgage debt purchases are a “great investment for the taxpayer” because the government already stands behind Fannie and Freddie. **Fed Risks ‘Spitting in the Wind’ With New \$800 Billion Pledge**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=ag3TJyGD73qk&refer=home>

- Nov. 26 (Bloomberg) -- **Funding costs in Asia’s biggest financial markets increased as concerns about a deepening global recession overshadowed U.S. efforts to revive consumer credit, prompting banks to slow lending.** Tokyo’s three-month interbank lending rate rose a 13th day to 0.858 percent, the highest this month. Singapore’s three-month U.S. dollar rate, or **Sibor**, rose a second day, adding 1.2 basis points to 2.205 percent. **Hong Kong’s** rate, **Hibor**, jumped by the most in more than a week, adding 4.6 basis points to 1.95 percent. **“The situation regarding the health of global banks remains doubtful,”** said **Hiroaki Takahashi**, an economist in Tokyo at **Japan Center for International Finance**. **“With the global recession, consumers in South Korea**

and Japan will also find it difficult to borrow from banks, given that business conditions could worsen.” Banks are reluctant to lend to companies as earnings slump after Japan, Europe and the U.S. entered their first simultaneous recessions since World War II. **Toyota Motor Corp.’s** debt rating was cut by Fitch Ratings, the first such downgrade in 10 years, as the U.S. auto slump damps earnings at the carmaker. Banks, brokerages and funds are cutting jobs amid almost \$1 trillion of writedowns and credit losses since the start of 2007. **The three-month London interbank offered rate, or Libor as the global benchmark borrowing cost is known, rose this week even as the Federal Reserve committed \$800 billion to unfreeze credit for homebuyers, consumers and small businesses and rescued Citigroup Inc. by guaranteeing \$306 billion of its troubled assets and toxic debt. The Libor-OIS spread, a gauge of cash scarcity among banks, widened three basis points to 173 basis points.** Credit markets, which began seizing up after BNP Paribas SA halted withdrawals on three funds in August 2007, froze after the bankruptcy of **Lehman Brothers Holdings Inc.** on Sept. 15, spurring governments and central banks around the world to bail out financial institutions and pump cash into money markets. Hong Kong **The U.S. economy, the world’s largest, shrank more than estimated in the third quarter as consumer spending plunged by the most in almost three decades, the Commerce Department said yesterday. Interbank lending rates for all maturities from overnight to 12 months jumped in Hong Kong, while costs rose on overnight to nine-month money in Singapore, today’s fixings showed.** South Korean banks are still paying close to a record rate to swap won for dollars. The Hong Kong Monetary Authority hasn’t injected cash into money markets this week, after pumping in HK\$32.3 billion (\$4.16 billion) last week, as the local dollar moved away from the stronger end of its trading band. “With the exchange rate at what it is now, there is no more need for further liquidity injections,” said **Dariusz Kowalczyk**, chief investment strategist at CFC Seymour Ltd. in Hong Kong. “There’s no more pressure on interest rates to come down on that.” Australian Banks Australian funding costs declined for the first day in seven. The **difference** between the rate Australian banks charge each other for three-month loans and the overnight swap rate, a measure of funding scarcity, fell six basis points to 50 basis points at 10:40 a.m. in Sydney, retreating from yesterday’s three-week high. The measure averaged 11 basis points in the five years to July 1, 2007. The Reserve Bank of Australia pumped A\$1.49 billion (\$970 million) into the financial system today after estimating the shortfall would be A\$2.4 billion. Banks yesterday increased deposits held at the RBA by A\$828 million to A\$4.2 billion, the central bank said today on its Web site. The **rate** Australian banks charge each other for three-month loans increased by less than one basis point to 4.48 percent. **Asian Money Market Rates Rise as Recession May Slow Lending**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aUiWJtJaPhNI&refer=home>

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Commercial Real Estate

Commodities

- Nov. 23 (Bloomberg) -- **Venezuela** will call on the Organization of Petroleum Exporting Countries to reduce oil output by 1 million barrels before year-end, Energy and Oil Minister **Rafael Ramirez** said. The country, which pumps about 11 percent of the oil produced by the exporters' cartel, also wants to ensure that all members are complying with the production cut of 1.5 million barrels a day that they agreed to Oct. 24, Ramirez said today in Caracas. Venezuela will propose the additional reduction at a Nov. 29 meeting in Cairo that OPEC scheduled as oil prices declined. It is smaller than the 1.5 million barrels that Abu Dhabi said would be needed to keep oil prices high enough to support oilfield investment. **“We have to ensure this cut is implemented before the end of the year” to insure inventories do not continue to expand, Ramirez said. “Because of the reduction of demand, there exists an important oversupply in the market of at least more than 1 million barrels a day,” he said.** Ali Rodriguez, the South American country's finance minister and the former president of OPEC, said today's lower prices may cause future oil shortages. Price Swing “Because of the violent price crash, many projects that were in progress and others that were being proposed are frozen or slowed,” he said. “If low prices remain for a long period, surely there will be an oil shortage for lack of investment, and even having enough oil there may not be enough products for lack of investment in refineries.” Venezuela's proposed 2009 government budget assumes an average price of \$60 a barrel for its **benchmark** oil basket, which last week sold for \$40.68. It also assumes oil output of 3.6 million barrels a day, higher than the government's estimate of about 3.3 million barrels a day. **Venezuela Calls for Million-Barrel OPEC Cut This Year**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aq7kSE8WdWao&refer=home>

Currency

- The Fed's balance sheet has grown by 133% in the past 12 months. Traditionally, growth over 10% was seen as too aggressive The Fed's balance sheet crossed \$1 trillion for the first time in September. It then broke through \$2 trillion Nov. 5. And according to Federal Reserve Bank of Dallas estimates, it could top \$3 trillion by 2009 Federal Reserve bank credit is up 1,560% from this time last year. “Our Federal Reserve seems hellbent on making Argentina look like Switzerland in terms of monetary restraint. Why is this ballooning balance sheet inflationary? The Federal Reserve increases its assets by buying stuff -- financial assets of banks and others. The Federal Reserve pays for these assets by creating money that did not exist before. That's it. Simple as pie. “Of course, our government is not acting alone. Central banks across the globe are doing the same thing, if with somewhat lesser vigor, at the moment. “In any event, it means paper money will buy less. We may see nominal prices -- for oil and gold and metals -- continue to fall in the short term, but long term, look for huge reflation in 2009.”
- Nov. 24 (Bloomberg) -- The world needs more dollars. The United States is preparing to provide them. In an all-out assault on capitalism's worst crisis since the Great

Depression, the U.S. is taking on the role of both lender and borrower of last resort for the global economy. **The Federal Reserve, which has already pumped out hundreds of billions of dollars, might formally adopt a policy of flooding the world financial system with even more money.** The Treasury, on course to borrow some \$1.5 trillion this fiscal year, may tap global capital markets for even more to finance a fiscal stimulus package of as much as \$700 billion and provide additional bailout money for banks. “You want to do everything you can when you’re facing the threat of a deflationary breakdown of the economy,” says **Michael Feroli**, a former Fed official who is now an economist at JPMorgan Chase & Co. in New York. **He sees the central bank cutting the overnight lending rate to zero in January and holding it there throughout the year.** Fed Chairman **Ben S. Bernanke** and Treasury Secretary **Henry Paulson** are being forced to pull out the stops because the extraordinary actions they’ve taken so far have failed to gain much traction. Credit markets are collapsing, **stock prices** are plunging and the world economy is sinking into a recession. And the dollar has risen as loss-ridden banks worldwide husband their resources, even after receiving generous dollops of liquidity from the Fed. **The U.S. currency has surged about 17 percent against the euro -- signaling demand for still more dollars -- in the two months since the crisis deepened after the failure of Lehman Brothers Holdings Inc. Meanwhile, gold is down almost 25 percent from its peak in March. [this reminds me very much of when the U.S. equity markets went on an upward tear last fall. I received hate mail telling me how nuts I was to believe that the vaunted U.S. equity market could ever go down. Similarly I have had more than one email taunting me since gold went down a couple of hundred bucks. The outcome will be very similar, but it does give me another chance to point out how childish the average American investor has become (i.e. I want my bottle now or I will cry).]** As the Fed has stepped up its efforts to combat the credit crisis, its balance sheet has mushroomed. **Assets rose to \$2.2 trillion on Nov. 19 from \$924 billion on Sept. 10, just before the bankruptcy of Lehman Brothers shook the global financial system. The central bank’s holdings are likely to increase further. “I would not be surprised to see them aggregate to \$3 trillion -- roughly 20 percent of GDP -- by the time we ring in the new year,”** Dallas Fed President **Richard Fisher** told the Texas Cattle Feeders Association on Nov. 4. Only the Start That may be only the start if the Fed cuts its benchmark rate, now at 1 percent, to zero and adopts what economists call a policy of “quantitative easing.” Under such a strategy, it would concentrate on expanding the amount of reserves in the banking system because it could no longer reduce the cost of that money. **The Bank of Japan followed this policy in the early part of the decade as it struggled to rescue the world’s second-largest economy from the grip of deflation. Its balance sheet eventually rose to the equivalent of about 30 percent of gross domestic product, says Tom Gallagher, head of policy research for International Strategy and Investment Group in Washington. [and that policy really worked out well]** “The Fed could blow through the BOJ’s ceiling,” he adds - - ballooning the central bank’s holdings to more than \$4 trillion. Much of that money will come from abroad. “Foreigners don’t seem to be interested in any kind of risky U.S. asset,” says **Brad Setser**, a former Treasury official now at the Council on Foreign Relations in New York. So, “instead, they are buying Treasuries.” **That includes China, which recently passed Japan as the biggest holder of Treasuries.** On Nov. 3, the department tripled its estimate of planned debt sales in the

final three months of the year to a record \$550 billion. Paulson told a conference in Washington Nov. 17 that the U.S. will issue some \$1.5 trillion worth of Treasury securities in the fiscal year that began Oct. 1. That number, too, could grow. [Lawrence Summers](#), Treasury secretary under President [Bill Clinton](#) and an adviser to President-elect [Barack Obama](#), told the same conference that the U.S. needs a “speedy, substantial and sustained” stimulus package to aid the economy. More Government Spending “Government may have to spend \$600 billion to \$700 billion next year to reverse the downward cycle,” [Robert Reich](#), another Obama adviser and a professor at the University of California at Berkeley, wrote in his personal [blog](#) Nov. 9. [Kenneth Rogoff](#), a professor at Harvard University in Cambridge, Massachusetts, and former chief economist at the International Monetary Fund, says the new administration will also have to ask Congress for more money to repair the financial system, over and above the \$700 billion already authorized for Paulson’s Troubled Asset Relief Program. **“By the time all this ends, the TARP is going to be closer to \$2 trillion than \$1 trillion,” ISI’s Gallagher says.** Paulson has already committed \$290 billion from the program to buy preferred shares in banks and troubled insurer [American International Group Inc.](#) **There’s always a danger the Fed and Treasury may go too far, setting the stage for a big rise in inflation or another asset bubble down the road as the economy revs up and investors get back their nerve. That’s what happened in the early part of the decade as ultra-easy Fed policy and Treasury tax cuts helped fuel a credit boom since gone bust.** Bernanke and Paulson might welcome a bit of that exuberance right now -- even at the risk of higher inflation later -- as they try to prevent the biggest credit catastrophe in decades from sending the economy into a deflationary nosedive. “It’s true that, over the long run, too much money creates inflation,” says [Lyle Gramley](#), a former Fed governor now at the Stanford Group Co. in Washington. “But they’re trying to keep the economy from going over the precipice and into the abyss.” **Recession’s Grip Forces U.S. to Flood World With More Dollars**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aCqvVS7Zk7ZQ&refer=home>

Diversification

Derivatives

- Nov. 25 (Bloomberg) -- **Timothy Geithner was among the first policy makers to shine a light on the unregulated \$47 trillion credit-default swap market back in 2005.** The New York Federal Reserve president has struggled since then to get dealers to carry out reforms. The industry has yet to launch a structure to safeguard against market-wide losses in case a dealer fails, though its leaders expect to get one off the ground by the end of the year. Geithner, selected yesterday by President-elect [Barack Obama](#) to be his Treasury secretary, has made clear that such a step is crucial to help contain the mushrooming credit crisis. **“In classic Tim and New York Fed style, the work has been done behind the scenes, among technocrats, largely by consensus,” [on first blush one might think this not so bad – however in light of the 7 trillion cost, it is no feather in his cap that he knew about this problem 3 years ago and allowed things to get to where they did]** said [Adam Posen](#), a former Fed official who is now at the

Peterson Institute for International Economics in Washington. “The downside is that it takes awhile to get consensus.” Geithner may not have the luxury of time in his new job as he faces a credit crisis that has morphed into a global recession. Bank Capital In the current crisis, Geithner, 47, was the Fed’s point man in the rescues of Bear Stearns Cos. and American International Group Inc., and tried to stem market turmoil after the decision to allow [Lehman Brothers Holdings Inc.](#) to fail. In August, he put his staff to work figuring out how much capital major banks would need if the economy worsened, foreshadowing the steps Treasury Secretary Henry Paulson later took to invest some \$125 billion in the country’s largest banks. **Geithner’s skills and limitations as a consensus-builder perhaps show up most clearly, though, in his handling of credit- default swaps, where he played a leading role in trying to make the market safer and more stable.** Trading in credit-default swaps, which were conceived to protect bondholders against default, exploded 100-fold the past decade as investors increasingly used them to speculate on creditworthiness. The contracts pay the buyer face value in exchange for the underlying securities or the cash equivalent should the borrowers fail to adhere to their debt agreements. Unregulated Market The big problem Geithner faced in trying to get a handle on the market: It was unregulated, so he lacked authority to make changes on his own and had to depend on his powers of persuasion. **The New York Fed chief began pressing banks in September 2005 to reduce trading backlogs that could prove dangerous should a crisis hit. An average 17 days’ worth of unsigned trades had piled up on dealers’ books, threatening to undermine the market if a wave of defaults hit.** A lax system for unwinding and reassigning trades left dealers at times unsure of who was on the other side of their trade. It took dealers a while to respond. A year later, they had cut the backlog of unsigned trades by 70 percent and doubled the number of deals that were electronically processed. After the collapse of Lehman Brothers in September sent market participants scrambling to cover an estimated \$2 trillion of trades, the New York Fed chief stepped up pressure on the dealers to act. On Oct. 7, he summoned the dealers and fellow regulators to the New York Fed. This time, he included futures exchanges at the meeting -- Chicago-based [CME Group Inc.](#), [Intercontinental Exchange Inc.](#), [NYSE Euronext](#) and Frankfurt-based futures exchange [Eurex](#) -- in a bid to put competitive pressure on the dealers to come up with a satisfactory plan. The strategy worked. After three meetings in two weeks, the dealer-owned Clearing Corp. agreed to be acquired by Intercontinental Exchange, one of the exchanges vying for a piece of the market. That paved the way for the launch of at least one clearinghouse by the end of the year. **“He oversaw the massive expansion in the credit-default swaps market, which arguably is what is behind much of the crisis today,” said Mann, whose firm manages about \$9 billion.** **Geithner Struggled to Get Movement on Swap Dangers**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=apmehm8f5JA0&refer=home>

Housing

- Housing starts, the measure of builders breaking ground on new homes, fell 4.5% in October, to an annual rate of 791,000. The Commerce Dept.’s been keeping track of this sort of thing in 1959 -- never has the annual rate been this low. Never. Same with the

department's gauge of building permit applications. They plunged 12%, to an annual rate of 708,000. That's 1,000 homes worse than the previous low, set in March of 1975.

- From their peak, all Case-Shiller home price indexes are down at least 20%. Phoenix, Las Vegas, San Francisco and Miami are falling the fastest. Dallas and Charlotte are still the "outliers," having fallen only 2-3% over the past year. "All three aggregate indexes," reports David Blitzer, chairman of the index, "and 13 of the 20 metro areas are reporting new record rates of decline. Looking at the returns of the U.S. National Index, prices are back to where they were in early 2004."
- Lest we forget what begat the crisis, here's a reminder: **The average existing home sold for 11.3% less in October 2008 than the year before** -- the largest year-over-year decline since the National Association of Realtors (NAR) started keeping track in 1968. Yet over the past decade, the global financial system -- nay, the consumption habits of the entire West -- had been retooled on the false assumption that real estate and housing would not fall in value.

Housing Finance

- 3.07% of prime mortgages were in foreclosure or at least 60 days late on payments in the second quarter, says the Mortgage Bankers Association. The previous record of 1.9% was set back in 1985. "Jumbo prime" mortgages are getting it the worst. Those super-sized loans, so big even Fannie Mae and Freddie Mac wouldn't securitize them, are defaulting at a rate of 7.5%. That's three times larger than during the same period in 2007.

Macro Economic

- Nov. 26 (Bloomberg) -- The U.S. sank into a deeper recession as consumer spending, the biggest part of the economy, dropped in October by the most since the 2001 contraction, economists said before a government report today. Purchases fell 1 percent after declining 0.3 percent in September, according to the median forecast in a Bloomberg News survey. Orders for long-lasting goods, sales of new houses and consumer sentiment also fell, other reports may show. The biggest spending slump in **three decades** is likely to persist as **home prices** fall and job losses mount, threatening the holiday sales outlook at retailers from **Zale Corp.** to **Best Buy Co.** Faltering demand has caused the Federal Reserve, Treasury and President-elect Barack Obama to ratchet up plans to ease the credit crisis. "Consumers are likely to continue to pare back spending," said **Michelle Meyer**, an economist at Barclays Capital Inc. in New York. The pullback is "setting the stage for a bleak holiday shopping season." The Commerce Department's spending figures are due at 8:30 a.m. in Washington. Estimates of the 72 economists surveyed ranged from declines of 0.4 percent to 2 percent. **Incomes** probably grew 0.1 percent, the smallest gain in three months, the survey also showed. Also at 8:30 a.m., Commerce may report that

orders for **durable goods**, those meant to last several years, fell 3 percent in October, according to the survey. **Excluding** transportation equipment, orders probably fell 1.6 percent, a third consecutive decline. Sentiment Fades The Reuters/University of Michigan's final estimate of **consumer sentiment** for this month, due at 10 a.m., probably fell, approaching June's 28-year low, according to the survey median. A jump in firings is one reason Americans' moods have darkened. A Labor Department report at 8:30 a.m. may show **initial claims** for jobless benefits last week held close to the 16-year high reached the prior week, according to the survey. Retailers are concerned about the November-December holiday season, which brings in one-third or more of annual revenue. Zale, the biggest U.S. jewelry chain by stores, yesterday rescinded its annual forecast, saying in a statement that it "does not believe it can reliably gauge likely holiday performance or sales in the balance of fiscal 2009." Today's spending report is also likely to confirm that inflation is retreating as demand wanes. The Fed's preferred price gauge, which is linked to purchases and excludes food and fuel costs, was probably unchanged in October, according to the survey median. It would be the first time in almost two years it didn't increase. Bigger Drop Consumer spending **dropped** at a 3.7 percent annual pace in the third quarter, more than the government had previously forecast and the biggest plunge since 1980, revised Commerce figures showed yesterday. The economy shrank 0.5 percent, also faster than initially estimated. The freeze in credit is restricting purchases of expensive goods from cars to homes. To lure buyers, **Ford Motor Co.**, the second-biggest U.S. automaker, said it will offer employee pricing to all buyers through Jan. 5, on almost all 2008 and 2009 Ford, Lincoln and Mercury models. A Commerce report at 10 a.m. may show **new-home sales** dropped in October to a 441,000 annual rate, a 17-year low, according to the median forecast in the Bloomberg survey.

Consumer Spending in U.S. Probably Dropped by Most in 7 Years

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aomY7mzKjA.0&refer=home>

- Nov. 24 (Bloomberg) -- Indonesia will cut rupiah bond auctions by a third and borrow from the World Bank and Australia to fund its 2009 budget gap as the global crisis damps investor appetite, said a finance ministry official. The central government also will sell debt to oil-rich provinces such as Riau and East Kalimantan in Borneo to help **fund** plans to build roads, ports and power stations, said **Rahmat Waluyanto**, director general of the finance ministry's debt management department. The government will cut spending on cars and offices to narrow the deficit to 1 percent of gross domestic product next year, from a previous estimate of 1.5 percent. "We won't compromise on spending for infrastructure and other programs on social welfare," Waluyanto said in an interview in Jakarta on Nov. 21. "In a crisis, the government is supposed to increase fiscal stimulus." Indonesia's local-currency bonds handed investors a 21 percent loss this year, the worst performer of 10 local-currency debt indexes compiled by HSBC Holdings Plc, as the rupiah weakened 22 percent. Foreign ownership of bonds fell 16 percent to 89.99 trillion rupiah (\$7.6 billion) as of Nov. 18, from a peak of 106.66 trillion rupiah in August, the Finance Ministry said on its Web site. Budget Deficit The \$433 billion economy has run a budget deficit since the 1998 financial crisis, selling rupiah- and dollar-denominated bonds to help fund spending. The government is also seeking loans from the Asian Development Bank and Japan International Cooperation Agency. Indonesia, which this year raised \$4.2 billion from international bond sales, aims to complete agreements to

borrow from such agencies by early next year, he said. "To replace debt financing from the international market, the government has been approaching the World Bank, the Asian Development Bank, Japan and the government of Australia," Waluyanto said. "If the financing is there, the government is still willing to increase the deficit to 1.3 percent or 1.5 percent." **Indonesia Will Cut Bond Sales, Rely on World Bank, Australia**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a6l0BDeS8JVo&refer=home>

- Nov. 23 (Bloomberg) -- **Amlak Finance PJSC and Tamweel PJSC, Dubai's two-largest mortgage lenders, will be taken over by a government-owned bank as the global financial crisis squeezed their access to credit and slowed the regional property market.** Amlak and Tamweel, whose stocks have fallen more than 80 percent this year, will "merge under" Abu Dhabi's state-owned Real Estate Bank, the United Arab Emirates' Ministry of Finance said late yesterday in a statement. The transaction has the "blessing" of Dubai ruler **Sheikh Mohammed bin Rashid al-Maktoum**. No terms were disclosed, though the deal will be based on "international best practices," the statement said. "It seems to be a direct federal intervention to support the struggling entities," said Dubai-based **Raj Madha**, senior banking analyst at EFG-Hermes Holding SAE, the largest Arab investment bank by market value. "The move will provide substantial federal support to these lenders and access to cheap funding." Amlak and Tamweel's "business plans are not sustainable and have to be changed," **Nasser bin Hassan Al Shaikh**, Amlak's chairman said Nov. 19. The mortgage industry "as a business model has been challenged all over the world." Amlak and Tamweel in October said they started "exploratory discussions" about a possible merger. Both mortgage lenders had also applied to the central bank for a banking license. Dubai, home to the world's tallest building and man-made palm-tree shaped islands, may be the most vulnerable place in the Persian Gulf to lower crude prices as real-estate and debt financing pose risks, **Citigroup Inc.** said Nov. 18. Dubai may need help from Abu Dhabi and the U.A.E. to fund a surge in borrowing, according to Moody's Investors Service. **U.A.E. Takes Over Mortgage Lenders Amlak, Tamweel**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ayg4qgY5.VQc&refer=home>

Retail

- Nov. 26 (Bloomberg) -- **Toyota Motor Corp.**'s debt rating was cut by Fitch Ratings, the first such downgrade in 10 years, as the U.S. auto slump damps earnings at the carmaker with the industry's best credit. Fitch cut Toyota's senior unsecured debt rating to AA from AAA with a negative outlook on the company, it said in a report today. A lower debt rating raises borrowing costs for Toyota, potentially hindering its ability to offer interest-free loans to boost sales in the U.S. The automaker slashed its profit forecast 56 percent earlier this month after higher fuel costs and the credit crunch pushed industrywide October U.S. sales to the lowest level since 1983. "Toyota is suffering severely from the ongoing turmoil in the global automotive sector," said **Tatsuya Mizuno**, director at Fitch Ratings, in the report. "The negative developments in the industry are so substantial and fundamental that even the strongest player -- Toyota -- can no longer

support a `AAA' rating." The rating cut is the company's first since Moody's Investors Service reduced its long-term debt rating from Aaa to Aa1 in 1998. Moody's raised the company back up to Aaa in 2003. Standard & Poor's has rated the carmaker AAA since 1985. **Toyota Rating Cut to AA by Fitch, Outlook Negative**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=alpH1eJ8IE9o&refer=home>

- Nov. 24 (Bloomberg) -- **General Motors Corp.**, in danger of running out of cash this year, will seek to negotiate a cut in debt levels and new union work rules to help boost its chances of winning federal loans, people familiar with the plan said. The largest U.S. automaker also may ask to delay a \$7 billion payment to a union retiree health fund, drop more brands and rework an accord with **GMAC LLC** to prove it can survive and repay the government, said the people, who asked not to be named because the details haven't been presented to Congress. **Directors** are scheduled to meet by phone today, Nov. 26 and Nov. 28, and then gather Nov. 30 and Dec. 1 to review the plan, the people said. GM expects to produce a 10- to 12-page public report for a Dec. 5 congressional hearing and an 80-page semi-private report with background material, the people said. **Besides courting a skeptical Congress, Wagoner would have to persuade debt holders to go along with paring GM's debt and the United Auto Workers to amend its 2007 labor contract. The debt and union accords likely won't be done by Dec. 2, the people said.** GM now has \$43 billion in debt, and will need to reduce that total significantly, even after a government loan that may be \$12 billion, the people said. Analysts have said any increase in GM's debt load will make it uncompetitive. Bonds Tumble GM's 8.375 percent bonds due in July 2033 fell 1.8 cents to 17 cents on the dollar Nov. 21, the lowest price ever, according to Trace, the bond-price reporting system of the Financial Industry Regulatory Authority. The yield rose to 49 percent. **After burning through \$6.9 billion in cash last quarter, GM said Nov. 7 that it had \$16.2 billion as of Sept. 30, raising the prospect of falling short by year's end of the \$11 billion minimum needed to pay monthly bills.** GM has said a bankruptcy filing would be a "disaster." The plan to be presented to Congress may call for rescheduling the cash payment due in 2010 to the UAW trust fund for medical retirees' bills, possibly to allow the government debt to be repaid first, the people said. Such a move would require the consent of the UAW, as would GM's bid to adjust work rules such as the so-called jobs bank that determines how long union workers are paid when factories are idled or closed. Changes to the health fund also would need approval in federal court. **Debt Agreements** The automaker expects to comply with agreements that federal debt be senior to other borrowing and that the government gain equity and oversight into GM, Ford and Chrysler in exchange for aid, the people said. Investors have pummeled GM shares on concern that the automaker may collapse, driving down the stock 88 percent this year for the worst plunge among the 30 companies in the **Dow Jones Industrial Average**. GM gained 18 cents to \$3.06 on Nov. 21 in New York Stock Exchange composite trading. "My expectation is we're going to see something," House Majority Leader **Steny Hoyer**, a Maryland Democrat, said yesterday on "Fox News Sunday" about the prospects for automakers presenting a survival plan to Congress next month. "What we need is to show how they're going to be accountable and secondly how they're going to be viable in the long term," Hoyer said. "Those are the two key questions they have to answer." **GM Said to Seek Cut in Debt, New Union Rules to Win U.S. Aid**

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Retirement

Risk

Savings Rate

Tech

The Fed

- Nov. 25 (Bloomberg) -- **The Federal Reserve took two new steps to unfreeze credit for homebuyers, consumers and small businesses, committing up to \$800 billion. The central bank will purchase as much as \$600 billion of debt issued or backed by government-chartered housing-finance companies. It will also set up a \$200 billion program to support consumer and small-business loans, the Fed said in statements today in Washington.** With today's announcement, the central bank is starting to use some of the unorthodox policy tools that Chairman **Ben S. Bernanke** outlined as a Fed governor six years ago. Policy makers hope the initiatives will bring down the interest rates on mortgages and consumer loans, offsetting the withdrawal of private-sector financing. "They're trying to put funds into the system, trying to unfreeze these markets," said **William Poole**, the former St. Louis Fed president, in an interview with Bloomberg Television. "Clearly, the Fed and the Treasury are beginning to take a large amount of credit risk." The Fed will purchase up to \$100 billion in direct debt of **Fannie Mae**, **Freddie Mac** and Federal Home Loan Banks after the yield premiums on those securities jumped. It will also buy up to \$500 billion of mortgage-backed securities issued by Fannie, Freddie and Ginnie Mae, a government agency that insures bonds. Fannie and Freddie have about \$1.7 trillion of corporate debt outstanding and \$4.1 trillion of mortgage-backed securities. **Mortgage Rates Rates on home loans haven't fallen even after the Fed cut its key interest rate and yields on benchmark Treasuries tumbled. Average 30-year mortgage rates were 5.98 percent yesterday, little changed from the 2007 average of 5.95 percent, according to bankrate.com. In that time, the Fed has cut its target rate for overnight loans between banks by 4.25 percentage points, to 1 percent. [i.e. we got NOTHING, but the pensioners lost their income and Bernanke is still viewed as a solution????????????????] Bernanke said in a November 2002 speech that as the rate approached zero, the central bank could consider buying mortgage bonds or U.S. Treasuries to finance government spending. "It's very important that lending continue to be available" because "the economy is turning down pretty dramatically," Treasury Secretary Henry Paulson said at a press conference in Washington. He also said \$200 billion is just the "starting point" for the Fed's program to buttress consumer and small-business loans. [So it is not only home lending that matters, but we also need to support those who abuse credit cards????? How about telling people who can't afford to buy crap to wait until they either have cash or sufficient wherewithal to merit credit????] Quantitative Easing The Fed won't be removing cash from other parts of the financial system to make up for**

the purchases, government officials told reporters on a conference call. They rejected any comparison with Japan's so-called quantitative easing effort to combat deflation, saying that the Fed's objective is to buttress credit markets rather than ramp up money. "The aim of credit policy is focused on narrowing credit spreads, as opposed to expanding the money supply," said Mark Gertler, a New York University economics professor who has collaborated with Bernanke on research. "The hallmark of this crisis is unusually high credit spreads which are dampening borrowing and spending across the economy." **"It can certainly improve credit conditions for consumers,"** said Derrick Wulf, who helps manage \$70 billion in mostly fixed-income assets at Dwight Asset Management Co. in Burlington, Vermont. Beyond Banks The asset-backed securities program is similar to the Fed's effort to bring down the cost of financing for commercial paper, the short-term debt companies issue to finance payrolls and other expenses, because it goes beyond banks. **"What the Fed has been trying to do is get a sense of what works and what doesn't work,"** Wulf said. **"One of the things that has worked is the commercial paper facility."** [so nearly two years into the problem the Fed is still trying to "see what works" . . . does this mean they are done "standing by??"] "The cheaper that they could issue their debt, the more aggressively they should be able to buy mortgages in the secondary market," said Alan Bosworth, director of agency trading at Vining Sparks in Memphis, Tennessee. Treasury Buying **A separate Treasury program for buying debt linked with home loans has already quadrupled, from about \$7 billion, a government official said on condition of anonymity. [There is no end to the currency destruction. None. If you don't own gold you better develop an appetite for government cheese.]** The Treasury will provide \$20 billion of "credit protection" to the Fed for the TALF, using funds from the \$700 billion financial-rescue package. The Treasury said in a statement that the facility may expand over time and cover other assets, such as commercial and private residential mortgage-backed debt. Under the TALF, the New York Fed will auction a fixed amount of loans each month for a one-year term. Assets will be held in a special-purpose vehicle. The program will stop making new loans at the end of next year unless the Fed Board of Governors extends the program. Lenders providing credit under the TALF "must have agreed to comply with, or already be subject to," executive-compensation restrictions in the October bailout law, the statement said. Separately, in a sign of disagreement among Fed officials, seven of the 12 district banks opposed lowering the rate on direct loans to banks before the Oct. 28-29 policy meeting, the central bank said in meeting minutes released today. Timing of Purchases The Fed will start buying the direct debt of government-sponsored enterprises -- Fannie, Freddie and a dozen federal home loan banks -- through primary dealers in government debt from next week. The purchases of mortgage-backed securities will be done through asset managers, and officials aim to begin the effort by year-end. Purchases of both types of debt "are expected to take place over several quarters," the Fed said. Treasury staffers are in regular communication with President-elect Barack Obama's team, officials said. New York Fed President Timothy Geithner, Obama's pick to be Treasury secretary, was involved in today's plans, though not in a capacity with the new administration, officials said. **Fed Commits \$800 Billion More to Unfreeze Lending**
http://www.bloomberg.com/apps/news?pid=20601087&sid=ai_aErzotzx8&refer=home

- Nov. 23 (Bloomberg) -- Congress will send President-elect Barack Obama an economic stimulus package the day he takes office Jan. 20, two Democratic lawmakers said today. **Senator Charles Schumer of New York said on ABC's "This Week" program that the package will be between five and \$700 billion. [this will go straight on top of the trillion plus deficit for next year. Anyone who thinks that we will not have rampant inflation is a dope]** House Majority Leader **Steny Hoyer**, of Maryland, said on "Fox News Sunday" that he believed the Inauguration Day goal would be met, but he declined to put a price tag on the bill. "I think Congress will work with the president elect starting now and will have a major stimulus package on his desk by Inauguration Day," Schumer said. "I think it has to be deep. My view it has to be between five and \$700 billion." **House Speaker Nancy Pelosi said any stimulus package must be several hundred billion dollars. "The sooner we do one, the smaller it can be," she said on the CBS "Face the Nation" program.** Tax Cuts Obama's stimulus plan involves an infusion of cash for middle-class tax cuts, rebuilding roads, bridges and schools, building broadband Internet access and investing in clean energy. Obama strategist **David Axelrod** suggested that Obama might consider delaying a repeal of Bush administration tax cuts for the wealthy by allowing them to expire as scheduled at the end of 2010. "Those considerations will be made," he said. The president-elect is "committed to getting middle-class tax relief in the pipeline quickly, and there's no doubt that we're going to have to make some hard decisions in order to pay for the things we need," Axelrod told Fox today. "The main thing right now is to get this economic recovery package on the road, to get money in the pockets of the middle class." Senator **Carl Levin**, a Michigan Democrat, opposed allowing the tax cuts "for the upper brackets" to expire, saying on CNN's "Late Edition" program that Congress should move more quickly to end them. "We just can't afford to continue them," he said. **Obama Will Get Stimulus Bill First Day, Democrats Say**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aB6h8oowkQto&refer=home>

Wall Street

- Nov. 27 (Bloomberg) -- The C\$52 billion (\$42 billion) purchase of **BCE Inc.** by private-equity firms may collapse, erasing the last vestiges of a leveraged-buyout boom that ground to a halt almost 18 months ago. BCE said yesterday that the takeover may unravel following auditor **KPMG's** opinion that the parent of Bell Canada, the country's largest phone company, would be insolvent once saddled with \$39 billion of new and existing debt. The acquisition, announced in June 2007 and set to close Dec. 11, would have been the second-biggest LBO behind the 2007 purchase of energy producer **TXU Corp.** by **KKR & Co. LP** and **TPG Inc.** The BCE deal, led by Ontario Teachers' Pension Plan, Madison Dearborn Partners LLC and Providence Equity Partners Inc, is the biggest remnant of a record \$1.42 trillion of LBOs in 2006 and 2007. Its demise would be more evidence of how private-equity firms have shifted from multibillion-dollar buyouts to shopping for distressed companies amid a dearth of financing and a deepening global recession. **"BCE is really an Old World transaction," said Randy Schwimmer,**

senior managing director and head of capital markets of New York-based Churchill Financial LLC. “In the New World, private equity buyers are looking to tease out value wherever it can be found, whether that’s in smaller new issues, distressed paper or mining their own portfolios.” Blackstone Group LP, the world’s largest private-equity firm by assets, is seeking to buy distressed debt through its GSO Capital LP arm, which it acquired earlier this year. Commitments to distressed funds rose 28 percent to \$33 billion during the first half of the year, according to London-based researcher Preqin Ltd. ‘Premium-Priced Deal’ **“Everything is different now,” said Randal Stephenson, senior managing director at New York-based Pali Capital Inc., which advises companies on mergers and acquisitions. “Bell Canada was a full-value, premium-priced deal. No one’s willing to do the sorts of things they did six months or a year ago.”** Announced private-equity deals have dropped more than 70 percent to \$202 billion so far this year, according to data compiled by Bloomberg. The biggest transaction this year was the \$7 billion stake bought by investors led by TPG Inc. in Washington Mutual Inc. That investment evaporated five months later when the U.S. government seized Washington Mutual’s assets, wiping out the TPG-led group’s \$2 billion in equity. The lack of deals results from a dearth of Wall Street financing. Private-equity firms relied on banks including JPMorgan Chase & Co., Citigroup Inc. and Merrill Lynch & Co. for loans and bonds to fund transactions. Eager to reap the fees for arranging such financing, banks competed to provide buyout firms with the best terms, including the ability to pay off debt by issuing more debt, or so-called covenant-lite loans, that made defaults less likely. Mortgage Defaults Those banks stopped making new commitments in August as subprime-mortgage defaults triggered an aversion to other types of debt, including leveraged loans, a staple of LBO financing. Wall Street firms were left holding more than \$350 billion in committed loans they’d expected to sell to investors, according to fixed-income research firm CreditSights Inc. in New York. At least \$55 billion of LBOs have fallen apart since last year. The botched transactions include J.C. Flowers & Co.’s agreement to buy SLM Corp., the student lender known as Sallie Mae; casino operator Penn National Gaming Inc.’s deal with Fortress Investment Group LLC; and KKR’s plan to buy Harman International Industries Inc. Citigroup, based in New York, and Frankfurt-based Deutsche Bank AG agreed to lead the financing for the BCE deal, which totaled \$34 billion, according to government filings. The lack of financing makes new deals difficult, and private-equity firms are struggling to put their record-setting buyout pools to work. Blackstone, manager of the world’s biggest buyout fund at \$21.7 billion, teamed with Bain Capital LLC and NBC Universal to buy The Weather Channel for about \$3.5 billion in July. Financing Unavailable Blackstone last year bought Hilton Hotels Corp. for \$20 billion. Blackstone executives have acknowledged that financing for deals that size isn’t available as potential investors hold on to cash. “You had a situation with a rising tide for a while,” said Paul Schaye, managing director of New York-based Chestnut Hill Partners, which helps private-equity firms find deals. “Now the water is completely gone. All the boats are sinking.” The remaking of Wall Street, with banks including Goldman Sachs Group Inc. and Morgan Stanley getting government money and converting to bank holding companies that are subject to stricter regulations, may further delay a return to dealmaking. “It’s easy to imagine a scenario where we don’t have normalized markets again until 2011,” said Sean Ryan, an analyst at Sterne, Agee & Leach in New York. He pointed to the 1988 purchase

by KKR of RJR Nabisco Inc., the \$30 billion which stood as the biggest LBO on record until 2006. "After all, how many years did it take for RJR Nabisco to get eclipsed?" Ryan said. **LBO Boom's Last Vestiges Would Disappear With BCE Deal's Demise**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=a8dMgJAPDAv0&refer=home>

- Nov. 25 (Bloomberg) -- The deal to rescue the world's best-known bank was pieced together by regulators over Domino's pizza in near-empty offices one block from the White House. Citigroup Inc., whose operations in more than 100 countries range from mortgages to microfinance, received a government rescue package to protect the bank from losses on \$306 billion of toxic assets. **The attempt showed how quickly regulators are forced to move when investors dump the shares of large, interconnected financial institutions.** Like Bear Stearns Cos. in March and Lehman Brothers Holdings Inc. in September, Citigroup lost investors' confidence. **"They've got to stop this thing. It's just turned into a snowball,"** Brian Barish, who oversees about \$6 billion as president of Cambiar Investors LLC in Denver, said after Citigroup shares plummeted. **On Nov. 18, five days before he was forced to bail out Citigroup, Treasury Secretary Henry Paulson told Congress he was handing over to President-elect Barack Obama "a significantly more stable banking system where the failure of a systemically relevant institution is no longer a pressing concern rattling the markets."** 52,000 Jobs The next day, Citigroup shares fell 23 percent to their lowest since May 1995. The bank said it would wind down seven failed off-balance-sheet funds. That ended attempts by Chief Executive Officer **Vikram Pandit**, who announced two days earlier he was eliminating 52,000 jobs, to salvage the investments after at least \$2.2 billion of writedowns this year. Then things got even worse. Citigroup declined 26 percent on Nov. 20 as investors became increasingly concerned that a U.S. recession would weaken banks further. Even a pledge that morning by Saudi billionaire **Prince Alwaleed bin Talal** to boost his stake in the New York-based bank from under 4 percent to 5 percent couldn't buoy the shares. Pandit and Chief Financial Officer **Gary Crittenden** held a worldwide conference call the next morning to reassure employees, said two people who listened to it. Pandit said he didn't plan to sell the Smith Barney brokerage unit or to disassemble the company, according to the people. The call came as the board, led by Chairman **Win Bischoff** and independent director **Richard Parsons**, prepared to meet the same day at bank headquarters. **'No Real Plan'** Citigroup shares fell 20 percent more, prompting analysts and investors to predict that the U.S. government would rescue the bank while corporate-governance critics blamed directors for the company's predicament. **"The board has let Pandit flounder with no real plan for creating value either for its customers or its shareholders,"** Richard Ferlauto, director of corporate governance at the American Federation of State, County and Municipal Employees in Washington, said in an e-mail. At the Fed, officials had previously been in talks with Citigroup about finding a solution to the company's toxic assets. The discussions didn't gain urgency until last week as Citigroup shares collapsed, just as Bear Stearns's did before the Federal Reserve arranged a takeover by **JPMorgan Chase & Co.** in March. Bernanke Meets At 5 p.m. on Sunday, Nov. 23, Fed Chairman **Ben S. Bernanke** convened a meeting of the board of governors, with **Elizabeth Duke** and **Donald Kohn** attending in person and **Kevin Warsh** and **Randall Kroszner** phoning in, said a person familiar with the discussions. **During the 45-minute session, officials voted to**

recommend the government deem a ``systemic risk'' exception to federal law so the Federal Deposit Insurance Corp. could guarantee Citigroup's assets, according to the person. New York Fed President **Timothy Geithner**, Obama's nominee for Treasury secretary, spoke with Paulson and Bernanke throughout the talks, though not with Citigroup. In the middle of the meeting, Paulson called Bernanke, telling him that he and FDIC Chairman **Sheila Bair**, whose agency guarantees bank deposits and some debt, were still negotiating details, according to the person. Meanwhile, about 20 staffers were working at FDIC offices a block from the White House, subsisting on Domino's pizza for dinner at around 8 p.m. and working on the deal until about 11:30 p.m., according to a person familiar with the matter. The agency's board met at 10 p.m., discussing the package for about 30 minutes before the vote to aid the bank. 10 Percent As part of the bailout, Citigroup will cover the first \$29 billion of pretax losses from the \$306 billion, in addition to reserves it already set aside. The bank will accept 10 percent of any losses above that amount, with the government responsible for 90 percent. The Treasury would shoulder the next \$5 billion in losses, and the FDIC up to the following \$10 billion. The Federal Reserve would make a loan to cover the remaining assets if deficits continue to widen. President George W. Bush said the decision to aid the bank was made as he conferred with Paulson by phone Sunday while flying back from Peru and the Asia Pacific Economic Cooperation forum. After moving to prop up Citigroup, Paulson called Senate Majority Leader Harry Reid Sunday night at his Nevada home to tell him that the administration had reached an agreement with the bank, according to the Democrat's spokesman, **Jim Manley**. **Citigroup's \$306 Billion Rescue Fueled by Pizza From Domino's**

<http://www.bloomberg.com/apps/news?pid=20601109&sid=ar.ByjvMr3YI&refer=home>

- Nov. 25 (Bloomberg) -- **Citigroup Inc.** Chief Executive Officer **Vikram Pandit** laid blame for the bank's streak of losses and decimated stock on prior management's "tremendous concentration" of real estate assets. "What went wrong is we had tremendous concentration in the sense that we put a lot of our money to work against U.S. real estate," Pandit, 51, said today in an interview with PBS's **Charlie Rose** show scheduled to air tonight. **"It's a lot easier to get into these situations than it is to get out of them."** Citigroup's stock last week fell below \$5 for the first time since 1994, sparking concern that customers might pull their money and destabilize the New York-based bank, which has \$2 trillion in assets and operations in more than 100 countries. The government on Nov. 23 agreed to support the company with a \$20 billion capital injection and a shield against losses on \$306 billion of mortgages and other troubled loans. **"We raised capital from the government and we actually bought insurance from the government," Pandit said. "When your risks are that large you can't go to Aetna, you have to go to the government."** Analysts and investors, including **Christopher Whalen** of Institutional Risk Analytics, have said the bank should be broken up and its businesses run by stronger companies, and **HSBC Holdings Plc** Chairman **Stephen Green** said yesterday the London-based firm would consider buying the "right" assets from Citigroup in the event of a breakup or sale. Pandit said Citigroup, the second-biggest U.S. bank by assets, will emerge from the crisis as a "high-end retail bank" serving "clients that need our globality. We've gotten rid of a lot of businesses, we're going to get rid of a lot more over time." Management 'Intact' **The company has received a total of \$45 billion of cash infusions from the government over the past month.** The U.S. aid

package left the bank's current management in place, attracting criticism from investors such as [Peter Solomon](#), a former Lehman Brothers Holdings Inc. vice chairman who is chairman of Peter J. Solomon & Co. in New York. "It's very hard to say we should invest all this money in Citigroup and leave Citigroup management totally intact," said Solomon, who was also counselor to the Secretary of the Treasury under President [Jimmy Carter](#) and a deputy mayor for economic policy for New York City Mayor [Edward Koch](#). "If a private-equity firm made an investment in Citigroup, how many board members would it ask for?" **Pandit Says Citigroup 'Went Wrong' With Real Estate**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ap84CRQcqHmk&refer=home>

- Nov. 24 (Bloomberg) -- **UBS AG, Switzerland's biggest bank, charged inflated fees at an \$11.7 billion U.S. real-estate fund by overvaluing some commercial properties, a former official alleges in his wrongful-termination lawsuit.** Richard Trusz, 52, who was managing director and head of valuations at UBS Realty Investors LLC in Hartford, Connecticut, said in court papers that before being fired in August he repeatedly clashed with his bosses over returning fees to clients, including public pension funds in Alaska and Iowa. **"No disclosures have been made to clients, no errors have been corrected to reflect accurate information for the respective quarters and no excess fees collected by defendant UBS Realty have been refunded,"** Trusz said in a Sept. 22 complaint filed under the state's so-called whistleblower law in Superior Court in Hartford. UBS Trumbull Property Fund LP, a private real-estate investment trust, inflated real-estate valuations by as much as \$100 million in late 2007 and the first half of this year, according to the lawsuit. Trusz's lawsuit doesn't say how much the REIT may have charged in excess management fees. Challenging Management The REIT charges investors fees ranging from 0.6 percent to just under 1 percent of assets under management, according to a November 2007 memorandum from a client, the Wyoming [State Loan and Investment Board](#). UBS declined to discuss fees. **One disputed valuation in the lawsuit involves a Texas shopping mall, the Galleria Dallas. UBS Realty told investors the mall was worth \$517.5 million in the second quarter, according to court papers, overriding an independent appraisal that would have reduced it by \$33.1 million. At the same time, UBS was challenging a local tax appraisal of \$348.6 million as "substantially excessive," according to a separate lawsuit filed by the bank's representatives in Dallas County District Court.** The higher value generated larger management fees, Trusz said, while a lower assessment would reduce UBS's tax levy. **UBS Overvalued Property by \$100 Million, Fired Executive Says**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aE3unrW9nV4E&refer=home>
- Nov. 23 (Bloomberg) -- A purchase of [Citigroup Inc.](#) would "significantly" add to Goldman Sachs Group Inc. or Morgan Stanley's earnings as long as the U.S. government absorbed losses on the embattled bank's assets, according CreditSights Inc. Buying Citigroup "would be significantly accretive to [Goldman](#) and [Morgan Stanley](#)'s earnings as the potential buyer would be acquiring a significant future earnings stream for a relatively low price," [David Hendler](#), an analyst at CreditSights in New York, wrote in a report yesterday. The buyer "would probably receive government support if it was needed." "We sense that Citi's board will also recognize the difficult chain of events

which can be brought about by its low stock price, and prefer to take action in the next few days or weeks,” Hendlar wrote. **Citigroup issued a statement last week saying the company has “a very strong capital and liquidity position and a unique global franchise.”** Spokeswoman **Christina Pretto** didn’t return phone calls seeking comment today. Debt-Market Funding Goldman Sachs and **Morgan Stanley** were the two biggest U.S. securities firms before converting to bank holding companies in September. Citigroup’s \$2 trillion of assets would have to be booked by any acquirer at current market values, which could translate into about \$100 billion of writedowns, CreditSights estimated. To help facilitate a transaction, the Federal Deposit Insurance Corp. could provide loan-loss support or the U.S. Treasury could contribute money from the \$700 billion Troubled Asset Relief Program passed by Congress in October, the report said. Intervention Even without an acquisition, the government could intervene if Citigroup’s depositors start to withdraw money because the company would be considered an institution whose failure could threaten the entire financial system, the report said. “Government intervention could take place under the purview of one or more of several federal departments, including the Treasury department, TARP program, the Federal Reserve, or the FDIC,” Hendlar wrote. Citigroup’s debt remains on review for downgrade by both Moody’s Investors Service and Standard & Poor’s. Moody’s rates Citigroup’s **senior unsecured debt** Aa3, while S&P has an AA- rating. A downgrade to A1 by Moody’s or to A+ by S&P is possible as the bank’s falling stock price could be deemed to hamper the company’s “financial flexibility,” the report said. A single-A rating at the parent-company level should be manageable as long as the company’s banking subsidiaries maintain double-A ratings, CreditSights said. **JPMorgan Chase & Co.**, now the biggest U.S. bank by assets, managed to endure with single-A ratings earlier in the decade, the report notes. “That said, Citi does not disclose what additional collateral it might need to post if it faced a downgrade to high- A territory, so we do not have any hard numbers as to whether a downgrade would cause a sizeable collateral call,” the report said. **Goldman, Morgan Stanley May Want Citigroup, CreditSights Says**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a.N9XSkr4KfE&refer=home>

Don’t Fight The Fed

I Disagree . . . and why

[Article of the week:](#)

Your Road Map to the Bull Market in Gold

By Jeff Clark, editor, *BIG GOLD*

Does this sound like your world?

You trudge to the office, nervous about keeping your job. Some of your friends are out of work. The economy struggles, and recession seems just around the corner. Stores where you once shopped are now closed. Americans are still shooting and being shot at in the Middle East. The price of oil is far off its peak but remains high.

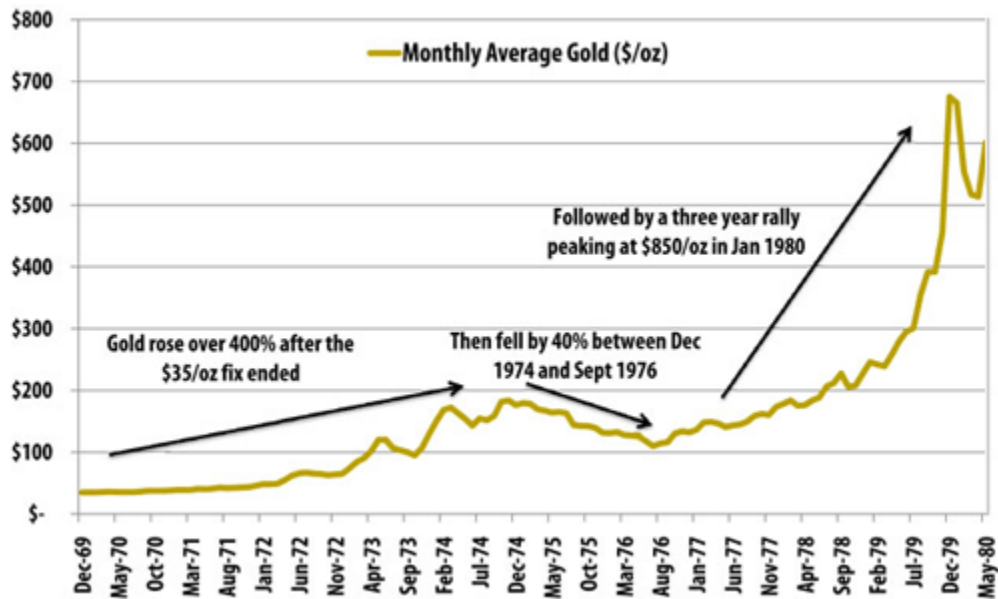
The government has promised action, but frankly you don't like the president's ideas nor trust the government's judgment, since they don't seem to notice that the budget and trade deficits are huge and show no sign of easing.

You invested in some gold and gold stocks, but they're all down. Everything has lost value. Things are looking grim indeed.

If any of this sounds familiar, you've got a good memory. It's what was happening in November 1975.

Yes, things didn't look so rosy back then, either. And yet look how November 1975 fits into gold's bigger picture:

Gold During the 1970s Bull Market



Now compare that chart to today's...

Gold During the Current Bull Market



You'll see that from 1970 to 1974, gold rose 400%. In our market (2000 to 2008), gold climbed 290% to its March 2008 peak.

From 1974 to 1976, gold fell 40%. In the current market, gold has fallen 31% in eight months, a much steeper decline.

Finally, during the three-year rise leading to gold's peak of \$850 in 1980, it gained 670% from its 1976 low.

This year's gold price has been behaving much as it did in 1975.

So where will the price be a few years from now? I can tell you that Casey Research expects gold's chart to look more and more like the 1970s before this is over. The U.S. government has only very recently fired the starting gun for racing inflation, but it has fired it very loudly.

In just the last two months, the Fed has increased the basic money supply (cash in circulation plus deposits held by commercial banks at the 12 Federal Reserve Banks) by nearly 50%. Nothing close to such a rapid increase has ever happened before in the U.S. It's the kind of news that normally comes only from desperate banana republics. And it always means rapid price inflation is on the way.

What the Federal Reserve has done in the last two months guarantees high inflation. But the timing is unknown. In fact, it's unknowable.

Looking at the past, a pop in the basic money supply gets felt strongly throughout the financial markets within six months or so. But that's just the average experience, with some inflationary episodes running much faster and others running much slower. And our current situation is anything but average – very recent but extreme money growth colliding with a years-old but extreme credit crisis.

So we'll have to sit and let the timing show itself. And if what you are sitting on is gold, you

should sit comfortably. Patience served gold investors well in the mid-70s. It will serve them well again.

Regards,

Jeff Clark

THIS IS A SPOOF

Somali Pirates in Discussions to Acquire Citigroup

By Andreas Hippin

November 20 – The Somali pirates, renegade Somalis known for hijacking ships for ransom in the Gulf of Aden, are negotiating a purchase of Citigroup.

The pirates would buy Citigroup with new debt and their existing cash stockpiles, earned most recently from hijacking numerous ships, including most recently a \$200 million Saudi Arabian oil tanker. The Somali pirates are offering up to \$0.10 per share for Citigroup, pirate spokesman Sugule Ali said earlier today. The negotiations have entered the final stage, Ali said.

"You may not like our price, but we are not in the business of paying for things. Be happy we are in the mood to offer the shareholders anything," said Ali.

The pirates will finance part of the purchase by selling new Pirate Ransom Backed Securities. The PRBS's are backed by the cash flows from future ransom payments from hijackings in the Gulf of Aden. Moody's and S&P have already issued their top investment grade ratings for the PRBS's.

Head pirate, Ubu Kalid Shandu, said: "We need a bank so that we have a place to keep all of our ransom money. Thankfully, the dislocations in the capital markets has allowed us to purchase Citigroup at an attractive valuation and to take advantage of TARP capital to grow the business even faster."

Shandu added, "We don't call ourselves pirates. We are coastguards, and this will just allow us to guard our coasts better."

Best of the Dog