

The Other Side of The Street October 14, 2007

Comments

In a great example as to the lengths to which the Street and your government are willing to go to continue to perpetrate the largest securities fraud in recent memory, Citi, BOA and JPM are setting up a fund of about \$80 billion to help revive the asset-backed commercial paper market. Whatever the stated purpose, the underlying reason relates to an avoidance of the market place putting a value on the garbage AAA rated CDOs and other derivatives. If the market is allowed to place a price on these illiquid instruments, it will be substantially lower than the current "model", which is a fictitious number created to inflate the values of these instruments.

It won't work. It will spawn billions in litigation. It is a sign that desperation has clearly taken over.

As an aside, if the credit markets are doing so well because of the Fed cut – as unequivocally stated by the government on numerous occasions, why is this chicanery needed to "avoid selling [\$320 billion in CDOs] at fire-sale prices, further roiling the credit markets,"? Answer – one can't solve a credit problem with interest rate cuts.

As for the markets, time is running out on the "rally". The next time down will be epic. When will it start?

We will see . . .

Credit

- Oct. 15 (Bloomberg) -- Citigroup Inc., Bank of America Corp. and JPMorgan Chase & Co., the three biggest U.S. banks, agreed to set up a fund of about \$80 billion to help revive the asset-backed commercial paper market, according to people familiar with the discussions. An announcement may come as soon as today, said the people who declined to be named because the decision isn't public. The fund will buy assets from structured investment vehicles, units set up to finance purchases of securities such as bank bonds and mortgage debt. Other banks may join the fund, which would help SIVs avoid selling their \$320 billion in holdings at fire-sale prices, further roiling the credit markets, the people said. The Treasury Department in Washington initiated the talks between the banks after a shutdown of the commercial paper market left SIVs and other sellers unable to borrow, forcing sales of about \$75 billion of assets. "Paulson definitely has the cachet to bring everyone to the table, because of his long experience on Wall Street," said Joe Mason, associate professor of business at Drexel University in Philadelphia and a former financial economist at the Treasury's Office of the Comptroller of the Currency. **[It used to be the government's role to prevent corruption of public markets and prevent fixing prices at above market rates. This is in fact an illegal act – to violate antitrust laws and allow the top three players in a market to intervene and set prices well above where the market would place them. You can be sure when this fails; the trial lawyers will step up**

where the SEC and Treasury have not. It is a shame they will not be indicted as co-conspirators]. **Citigroup, Bank of America Plan \$80 Billion CP Fund**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=an3jx1k2A8i8&refer=home>

- A sharp upswing in credit card defaults, for example, is joining the sharp upswing in mortgage defaults. Balances on consumer credit cards jumped at an annual rate of 11% in May and June. With two exceptions, that's the highest rate since the last recession in 2001-02. DR 10/10
- Milton Friedman, writing about the role of monetary policy, once wrote: "From the infinite world of negation, I have selected two limitations of monetary policy to discuss." For this champion of monetarism, the limitations at the time (1968) were the inability of monetary policy to peg interest rates and unemployment for more than limited periods. As we face a turn in the credit cycle, the effectiveness of monetary policy is again under scrutiny. The shift in monetary policy in the US and Europe is a key reason for buoyant equity markets even as credit markets remain dysfunctional. **Applying Friedman's language to financial markets, I have three propositions to negate – or at least to question. The first is that the credit crisis is over. Tensions in credit markets have certainly eased but there remains much that is not yet normal.** Deal flow has picked up. Investment grade bond and credit default swap spreads have fallen back from their recent highs, as have US dollar and sterling interbank rates. Banks have been admitting their losses from the credit seizure. **Even so, it is unlikely that markets will return to anything like the status quo ante. Confidence between lenders and borrowers remains low. The scramble for liquidity is still ongoing, as evidenced by euro interbank rates, which are still hitting new highs.** In a nutshell, reducing debt levels and addressing balance sheet issues have only recently begun. History suggests that the workout consequences in housing and the economy will be protracted. The second popular assertion stands in stark contrast. It is that the economic consequences of the credit brouhaha will be relatively benign and that global emerging markets will save the day. It is possible. Strong equity markets and the performance of consumer stocks associated with foreign sales, especially in emerging markets, offer proof of this. We could have a two to three quarter slowdown followed by the long-hoped for rebalancing of the global economy, notably between the US and China. Yet I do not think this is especially likely. **Housing, business and financial services generated almost 40 per cent of the growth rate of America's private sector gross domestic product in the 18 months to June, and over half of the UK's GDP growth rate. These numbers exclude the secondary effects on consumption from housing wealth. If these sectors are only flat in the coming year, growth will stall while also prolonging credit restraint.** There is no question that emerging markets are in a far stronger financial position. This should certainly help the global economy become less dependent on US growth, but only to an extent. Some, mostly smaller, countries in eastern Europe and central Asia have large foreign currency liabilities, which could cause problems if low interest rate currencies such as the yen strengthen further as the US dollar declines. Many countries are commodity exporters whose revenues will suffer as demand from Organisation for Economic Co-operation and Development countries falls. Asian exports are likely to suffer twice: first as a result of weaker OECD demand and then because more than half of China's imports are other Asian exports, which are re-exported. China's own boom also faces monetary policy questions with the political sensitivity of rising inflation. Finally,

the third proposition is that global capital flows, especially those attributed to sovereign institutions (central banks and sovereign wealth funds), will act as a bulwark against adverse outcomes in the foreign exchange and other markets. There are several examples of (smaller) SWFs buying stocks or making bids in the US and Europe but these are largely attracting publicity for political reasons. SWF assets of close to \$3,000bn are substantial but are only one-sixth of the size of global pension funds. Asset allocation flows are probably conservative. Not many central banks buy equities (yet) and certainly not as a major part of their asset allocation. Sovereign investing is an important new focus but we should not delude ourselves that it will alter economic outcomes. John Kenneth Galbraith also had the gift of powerful language. Referring to money, he said that: **“Over all history it has oppressed nearly all people in one of two ways: either it has been abundant and very unreliable, or reliable and very scarce”**. We are in the process of making this transition. Monetary policy faces stern tests of effectiveness as the credit cycle evolves. We need to understand its limitations. **The credit crisis: why it is still too early to relax** <http://www.ft.com/cms/s/0/5415a5b6-75cd-11dc-b7cb-0000779fd2ac.html>

- GENEVA (Reuters) - A global credit crunch in financial markets has given many of the world's wealthy a lingering distrust of new-fangled "structured" investment products, even though many are no worse off. Private bankers attending a Reuters Wealth management Summit in Geneva, **said they believed the legacy of a liquidity crisis which seized up lending between banks and spooked investors would be to make the wealthy even more reluctant to put their money in instruments they could not readily understand**. The credit crisis was triggered by a meltdown in the U.S. market for subprime mortgage loans -- extended to borrowers with shaky credit histories -- which many banks packaged into complex bundles of securities and then sold on to investors. **"To the extent that things are called exotic, I think there is going to be less appetite for those,"** said Peter Flavel, Global head of private banking at Standard Chartered Plc. Demand for mortgage-backed securities, many of which received triple-A ratings from leading credit risk agencies, dried up over fears that exposure to subprime loans had undermined their intrinsic worth. **"My general rule is that if you cannot understand it in the first minute or two it's probably too complex to be selling and we tend to keep to the simpler structures,"** said Flavel. One of the features of the credit crunch, which caused outright panic in markets in August, has been the complexity of the financial structures which set it in motion. Many investors realized belatedly that they had put their money into investments they simply did not fully understand. **SIMPLICITY** Other private bankers agreed that there were virtues in simplicity even in the often rarified world of advising the world's wealthy on how to manage their money. "We certainly wouldn't be buying or promoting investments we didn't understand or thought they (clients) didn't have sufficient time to understand," said Mark Cunningham, Managing Director private banking at Bank of Ireland. For many of their more sophisticated clients, the recent market ructions may even provide them with fresh opportunities to make money. "We spoke very regularly to our clients, informing them what was going on. Hopefully with such disruption taking place there will be more opportunities going forward," said Jan Erik Frogg, head of the alternative investments business at Union Bancaire Privee. **Frogg said the market shakedown was a salutary correction after years of cheap credit steadily eroded risk premia and induced a**

false sense of security among many investors. Credit crunch feeds fear of structured finance <http://www.reuters.com/article/WealthManagement07/idUSL0834557420071008>

- **To Americans of a certain age and persuasion, savings are only dollars you haven't spent, yet. According to *The Wall Street Journal*, " more individuals have been borrowing from their 401(k) plans or taking hardship withdrawals in recent months."** The official statistics won't be released until next year, but a number of 401k plan providers report a "noticeable" uptick in the demand for loans. DR 10/9
- **October Investors are pessimistic about the outlook for issuance next year and have turned against complex structured credit derivatives products as credit conditions have worsened.** Hansol Kim, director in the corporate finance group at US insurer Financial Security Assurance, told a Securities Industry and Financial Markets Association conference in New York last week: **"Products such as constant proportion debt obligations have gone away and are not going to come back any time soon."** CPDOs were launched in August last year and were designed to enable investors to make leveraged bets using derivatives contracts sold on investment grade-rated companies traded in European and US derivatives indices. Their attraction was that contracts were sold on a rolling six-month basis and the chance of a constituent defaulting on its debt within that time was low. This means rating agencies awarded the products their highest ratings but they paid higher interest than similarly rated debt securities. Abhishek Bhutra, vice-president at hedge fund Old Lane, said: **"We are not a big fan of CPDOs. A slight change in the index leads to a huge swing in valuation and the products were structured using very aggressive assumptions."** A straw poll of conference delegates found they did not expect issuance of asset-backed collateralised debt obligations to recover next year. Collateralised debt obligations bundle together a portfolio of fixed income assets, such as asset-backed bonds, and divide the credit risk among different tranches. David Yan, head of CDO research at Credit Suisse, said: "ABS CDOs are not going to happen any time soon and when issuance returns, it might be at 2001 levels." Yan said there was \$500bn (€354bn) of asset-backed CDO issuance last year compared with \$100bn in 2001. There were \$54bn in ABS CDO deals in the second quarter of this year, which declined to \$16bn in the third quarter, according to Deutsche Bank. Participants also predicted CDO managers will merge. Managers are responsible for the construction and maintenance of portfolios and for maximising recovery rates when there are defaults. Last year 52 new managers issued \$52bn in CDOs. Alex Cigolle, chief investment officer of Strategos Capital Management, which specialises in mortgage and asset-backed securities, said: "There will be massive consolidation from several hundred managers to several large managers as scale will become important. Banks have taken on a lot of risk and will want to work with managers that can bring capital to the table." In contrast with the CDO market, participants said liquidity was returning to collateralised loan obligations, which repackage finance lent to private equity firms. Covenant-lite loans, a structure with looser loan requirements, were also predicted to continue for good companies. Last month, CLO issuance of \$7.8bn approached pre-crisis issuance levels. For most of last year, average monthly issuance of CLOs was between \$9bn and \$10bn, according to Deutsche Bank. Hans Christensen, chief investment officer at MJX Asset Management, said covenant-lite loans were the best-performing asset class last month.

Stephen Sautel, managing director at Guggenheim Partners, a US financial services firm, said: “It has been the single biggest topic on investor calls. We approach them as senior secured bonds and feel we are adequately compensated for the lack of covenants.” Bearish credit investors reject complex structures <http://www.financialnews-us.com/?page=ushome&contentid=2348897236>

- Oct 7 - Investment banks are creating discounted securities to help them clear out billions of dollars of assets they had been holding for complex structured credit deals cancelled during the summer credit squeeze. Last week, Deutsche Bank **sold at a discount and for half its usual fee a \$2bn collateralised loan obligation (CLO)** – a bundle of differently-rated securities backed by a portfolio of loans. The deal referenced loans Deutsche had been holding ready for more than 10 other CLO deals stalled by the summer turmoil. Credit Suisse sold a similar \$1.7bn CLO deal made up of six so-called loan “warehouses”, and other banks are thought to be poised for similar sales. The deals help remove an overhang of loans in bank warehouses that has contributed to depressed loan prices as banks have been forced to liquidate CLO deals lacking buyers. **It also frees up bank capacity, allowing them to create new warehouses and attempt to restart the market if conditions improve. [the underlying assumption is that things will improve. There is no reason to believe that things will improve and, if they don’t this market will not bounce back.]** Michael Herzig, co-head of the collateralised debt obligation group at Deutsche Bank, said the deal was an attempt to clear the decks in the hope of future business. “The reason we did it was to set ourselves up to open new warehouses to buy loans at today’s higher yields.” The CLO market suffered a virtual buyers’ strike over the summer as investors recoiled from all complex structured credit products. The paralysis helped contribute to the credit squeeze, as CLO deals were among the biggest buyers of bank loans. To reflect the market’s lower prices, Deutsche’s deal priced the underlying loans at 98.5 per cent of face value, while the bank charged a 0.5 per cent fee, half its usual rate. Meanwhile, the underlying portfolio for the deal is static, **meaning the management fee is slashed to just 0.05 per cent, a tenth of the usual fee.** Kerry Kantin, analyst at Standard & Poor’s LCD, a research firm said: **“Having a group of asset managers jointly manage a CLO is uncommon, to be sure, but given challenging market conditions, innovation is the name of the game.”** **Banks offer deals to shift debt** <http://www.ft.com/cms/s/0/f0176af2-7501-11dc-892d-0000779fd2ac.html>
- Oct 7 - **Top private equity executives and their advisers are warning that the industry must change the way it raises and invests money** or risk being trapped in a growing “asymmetry” between cautious debt markets and booming equity markets. Instead of looking for the multi-billion-dollar “mega buy-outs” that became the staple diet of big private equity funds **but are now made impossible by the credit crunch**, they need to find different techniques, say buy-out veterans. **[these were a material reason why stocks soared. Now that they are gone, what will step up to replace this demand?]** “Deal flow will get back to how it looked two to three years ago,” says Philippe Costeletos, partner at TPG Capital. “In the current markets, it is more difficult to raise financing well above \$1.5bn. **The big public-to-private deals will be the main casualties of all this for some time.**” Even when debt markets do re-open, **it is unlikely to be with the same generous terms and leverage levels as before the credit crunch, suggesting private equity will struggle to finance deals**, especially if stock markets

continue on their bull run. **Buy-out veterans beware finance gulf**
<http://www.ft.com/cms/s/0/27f241c4-751e-11dc-892d-0000779fd2ac.html>

- Oct 7 – FT **The credit squeeze will force governments worldwide to make substantial changes to their budget plans, Rodrigo Rato, outgoing managing director of the International Monetary Fund, has warned.** Mr Rato said the credit squeeze **was a “serious crisis” that was not over yet and would curtail growth worldwide. “Policymakers should not think that the problems will stay at the desk of the bankers,” he said. “Problems are going to come to the real sector, come to the budgets – that is something we keep telling people.”** His comments came during an interview with the Financial Times in which he appeared to endorse European concerns about the decline in the dollar; a subject that threatens to be a cause of discord at the Group of Seven summit and IMF annual meeting this month. Mr Rato said the dollar is now “undervalued” on many measures – an unusually bold assessment. He warned against excess volatility in currency markets. “What we would like to see is not sudden changes,” he said. Eurozone finance ministers meet today in Luxembourg with the intention of hammering out a common position on the dollar in advance of the G7 and IMF meetings. The credit crisis was “not a storm in a teacup,” the IMF managing director said. While the crisis may not continue to rage with the same intensity as before, it would take “a few months, probably into next year” before liquidity, availability of credit and risk spreads would return to more normal levels, he said. Mr Rato said the market crisis “is going to have an impact on growth” and that this will force finance ministers to revise their budget assumptions. Many appear reluctant to do so, he added. Since the credit crisis originated in the financial markets of the “most sophisticated” economies, its impact would be felt “more quickly” in the US and to some extent in Europe and Japan rather than in the rest of the world, Mr Rato argued. “The US is going to slow down,” he said. “Growth in Europe looks less strong than before, and in Japan too – though Japan will probably stay [at about] potential.” But he cautioned against assuming the developing world could decouple completely from the US. “Everybody is going to feel some impact,” he said. The outgoing IMF chief said many of the big emerging markets are growing rapidly. But “to what extent they will keep that momentum will depend on how long the slowdown is in the US and Europe”. Mr Rato said emerging markets with large current account deficits would be much more vulnerable to changes in the availability and price of credit than those in a “more balanced situation”. Dominique Strauss-Kahn, a former French finance minister, is poised to take over from Mr Rato as head of the IMF at the end of October. **IMF head warns on impact of credit crisis** <http://www.ft.com/cms/s/0/a5b06b90-750f-11dc-892d-0000779fd2ac.html>

Commercial Real Estate

Commodities

- Oil prices sank below the \$79 level on Tuesday, continuing to weaken after a sharp fall in the previous session as a recovery in the dollar exerted pressure across commodity markets. **Commodities under pressure as oil sinks below \$79** [did you ever think you would live to see a story that touted oil at \$79 as being “under pressure”? I recall my Dad buying gas for 29 cents in the late 60s in Toledo – they were known for “gas wars”] <http://www.ft.com/cms/s/0/99e23f9a-7655-11dc-ad83-0000779fd2ac.html>

Currency

- **M3 Growth at 36-Year High.** Based on roughly 24 days of 30 days of reporting, the preliminary estimate of year-to-year growth in the SGS-Ongoing M3 measure hit 14.6%, up from 13.9% in August, and at the highest reading since November 1971. That was two months after Richard Nixon closed the gold window in August of 1971. Annual M2 growth for September was about 6.8%, up from 6.7%. Part of the relative gain in M3 last month appears to be a movement of cash into larger time deposits and such, as market perceptions have shifted towards a further easing by the Fed. The SGS estimate will be finalized after next week's reporting. [this is from a subscription service run by an economist who translates the government propaganda into actual numbers] **M3 Annual Growth Highest Since November 1971** <http://www.shadowstats.com/cgi-bin/sgs/article/id=923?login=7879644>
- Managing directors of the International Monetary Fund are traditionally circumspect when talking about currency values. But with only a few weeks left in the job, Rodrigo Rato is unusually forthright. “Right now the dollar is undervalued” on many measures used by the IMF to evaluate currencies, he says, though he adds that it was “certainly overvalued a few years ago”. His remarks in an interview with the FT follow the sharp decline in the dollar against the euro and some other freely floating currencies in the aftermath of the credit squeeze and Federal Reserve interest rate cut. Mr Rato – who hands over the leadership of the IMF to Dominique Strauss-Kahn at the end of this month – says these financial and economic developments create a “new scenario for global imbalances” that policymakers need to “keep an eye on”. He warns against excess volatility in currency markets – a standard IMF mantra, but one that takes on added significance in times like these. “Sudden movements in the currency markets are not what we need.” Mr Rato clearly regards concern over the dollar-euro exchange rate as only part of a more complex global story. This also involves currencies such as China’s renminbi that are formally or informally tied to the dollar and therefore fall when it falls. He says that, “independent of the value of the dollar”, it would be “in the interest of China” to adopt a more flexible exchange rate to help it manage its domestic economy and that this case is “becoming stronger”. More currency flexibility from China would also help its neighbours, he says. Many emerging economies, particularly in Asia, are afraid to allow their currencies to appreciate against the dollar for fear of losing competitive advantage to China. The outgoing IMF chief also hints at unease about Japan’s yen, which remains weak in part because of ultra-low interest rates.

“Normalisation of monetary policy in Japan is an important medium-term objective.” Currencies will be a strong theme of the IMF’s annual meetings later this month. But finance ministers are also expected to use the gathering to discuss the broader implications of the crisis in credit markets. Mr Rato says it is vital that the world learns lessons “without renouncing financial liberalisation and financial globalisation – because that is at the heart of the success of the world economy”. He urges developing nations not to draw the wrong conclusions and stymie the development of their own financial markets. That said, Mr Rato believes there are plenty of questions that do need to be addressed. These include “transparency questions” relating to banks’ exposure to off-balance-sheet vehicles, “methodology questions” regarding ratings agencies and incentives in credit markets, and questions over the structure of “regulatory systems”. He says it is a “fact” that hedge funds have generally come through the crisis well so far and that incidents of hedge fund distress have not caused systemic strains. But this should not preclude further consideration of hedge funds by international policymakers. He says the credit squeeze creates downside risks for growth around the world. But, he adds, inflation risks remain, noting that commodity prices remain high and there is little spare capacity in the world economy. Mr. Rato will leave with his ambitious goal of reforming the IMF to make it more relevant to today’s global economy only partly achieved. But he says there is now broad agreement on its future agenda, including shareholding reform, a new income model, possible new crisis prevention tools and a core role evaluating the spillover effects on the world economy from countries’ exchange rate and other economic policies. **Rato speaks his mind on dollar**
<http://www.ft.com/cms/s/0/e230bb46-7510-11dc-892d-0000779fd2ac.html>

Diversification

Derivatives

- Oct. 10 (Bloomberg) -- Goldman Sachs Group Inc., the world's biggest securities firm, said its holdings backed by pools of bonds and loans dropped 53 percent in the third quarter, the second consecutive decline amid a global credit contraction. The “fair value” of retained interests in collateralized debt obligations and loan obligations sank to \$1.77 billion at the end of August from \$3.79 billion three months earlier, the New York-based firm said in a regulatory filing. Investments in mortgage-backed securities fell 16 percent. Wall Street firms including Goldman wrote down the value of mortgage-backed securities and high-yield loans during the third- quarter after record U.S. home foreclosures and the collapse of two Bear Stearns Cos. hedge funds that bet on home loans quashed investor demand for high-risk debt. Goldman was more adroit than Morgan Stanley, Lehman Brothers Holdings Inc. and Bear Stearns in trading to offset the losses, enabling the firm to post its highest-ever quarterly fixed-income revenue last month. Goldman's filing today doesn't say whether its holdings shrank because the firm marked them down, or sold them, or both. “There was nothing in the mortgage space

that didn't decline in value," David Viniar, Goldman's chief financial officer, said in an interview after the Sept. 20 earnings report. "Anything we had was down." Still, Goldman said at the time that mortgage profits rose "significantly" in the third quarter after the firm took offsetting positions that rose in value as the price of mortgages and related securities dropped. Diminished Appetite Revenue in Goldman's fixed income, currency and commodities division, the firm's largest, rose 71 percent to a record \$4.89 billion -- even after \$1.48 billion of losses for marking to market the value of non-investment grade credits. Today's filing with the U.S. Securities and Exchange Commission shows how dwindling investor appetite has drastically slowed Goldman's business of packaging home loans into bonds. The firm securitized \$2.86 billion of residential mortgages during the three months ended Aug. 31, down from \$18.63 billion a year earlier. For the first nine months of the year, securitization of residential mortgages totaled \$22.9 billion, down by more than half from \$55.2 billion a year earlier. Goldman also reported today that it reaped more than \$100 million from trading on 23 days during the quarter, up from 16 days in the second quarter and equal to 23 days in the first. Goldman made a loss on 18 days, including six when it lost more than \$100 million, according to the filing. There were five days in the quarter when its losses overshot its calculation of average value at risk. That compares with three days when losses exceeded VAR estimates in all of fiscal 2006. The 53 percent drop in the firm's retained interests in CDOs and CLOs follows a smaller decline last quarter, when the value of the holdings fell 29 percent to \$3.79 billion from \$5.35 billion three months earlier. Goldman CDO, CLO Holdings Fall 53 Percent in Quarter
http://www.bloomberg.com/apps/news?pid=20601087&sid=a_yGdtIgtK0&refer=home

Housing

- Oct. 8 (Bloomberg) -- St. Joe Co., **Florida's largest private landowner, plans to eliminate 760 jobs, sell about 100,000 acres of land and scrap its dividend** to contend with the worst housing slump in 16 years. The company will also sell the Sunshine State Cypress Mill, 190 homes and about 1,200 developed home sites, Jacksonville-based St. Joe said today in a statement. Foreclosures Soar **The housing decline may push Florida's economy into recession as early as this year**, said Mark Zandi, chief economist at the West Chester, Pennsylvania-based Moody's Economy.com, who owns a home in Vero Beach, Florida. Florida has been hard hit as speculators abandoned the market and foreclosures have soared. In August, Florida had 26,203 foreclosure notices, ranking it the second highest in the nation after California. Existing single family home sales fell 24 percent in July in Florida and the median price fell 5 percent to \$237,500, according to the Florida Association of Realtors. The job cuts at St. Joe **amount to more than 75 percent of the company's 938 employees** as of Feb. 1. St. Joe has held a total of 800,000 acres of land. **St. Joe to Cut 760 Jobs, Sell 100,000 Acres of Land**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aakMOTrIWSso&refer=home>
- Oct. 6 (Bloomberg) -- Foxtons, a discount real estate agency that pioneered selling homes at a 3 percent commission, joined mortgage lenders as a victim of the declining U.S.

housing market and filed for bankruptcy protection. **Foxtons Files Chapter 11, Following Other Lenders'**
http://www.bloomberg.com/apps/news?pid=20601206&sid=ar4pCJBC_Ftk&refer=realstate

Housing Finance

- **Oct 10 – Downey Financial (DSL)** dropped 4% in early trading after the savings and loan warned that rising loan losses will lead to a loss for the third quarter. The Newport Beach, Calif.-based bank said it expects to post an operating loss of \$23 million, or 84 cents a share. Analysts had expected Downey to make \$1.08 a share in the third quarter, according to Thomson Financial. During the third quarter, the bank took an \$82 million provision for credit losses. The provision will increase its allowance for loan losses to \$144 million, or 1.22% of loans held for investment, it said. Downey also took a \$9 million writedown on certain real estate held for development to reflect "declines in the value of single family home lots in which the company is a joint venture partner," it added. "We are clearly disappointed with our third-quarter results," said Daniel Rosenthal, Downey's president and CEO. **"The continued weakening and uncertainty relative to the housing market, coupled with third-quarter disruption in the secondary mortgage markets, unfavorably impacted our borrowers and the value of their loan collateral. This has been particularly true in certain geographic areas such as the greater Sacramento and Stockton areas of Northern California and San Diego county. As a result, single family loan delinquencies, as well as losses from foreclosures, rose significantly** during the third quarter and led to this quarter's large increase to the allowance for losses." Downey operates 168 branches in California and Arizona. Downey joins big banks including **Citigroup (C)** , **Washington Mutual (WM)** and **Sovereign Bancorp (SOV)** in taking big hits tied to the downturn in the housing market as well as this summer's credit crunch. **Rosenthal added that the bank has further tightened its lending guidelines, implemented a loan modification group to work with borrowers and provided resources to dispose of homes acquired through foreclosure on a timely basis. [it is a CREDIT problem, not an interest problem]**
<http://www.thestreet.com/pf/newsanalysis/banking/10383718.html>
- Oct. 9 (Bloomberg) -- Thornburg Mortgage Inc., the Santa Fe, New Mexico-based mortgage provider, lost \$1.1 billion selling bonds backed by adjustable-rate home loans as rising defaults eroded demand for the securities. The company's previous estimate for the loss was \$863 million, it said in a statement today. Thornburg, which has fallen by more than half on the New York Stock Exchange this year, declined as much as 12 percent after the announcement. "The losses were greater than expected from the credit crunch in August," said Jason Arnold, an analyst for RBC Capital Markets in San Francisco. "They have a little bit smaller asset base. That certainly doesn't help out on the earnings side and will also have a greater impact on book value." Thornburg, which has sold \$22 billion of "high quality" adjustable-rate mortgages since Aug. 10, concentrates on so-called jumbo loans, which exceed the \$417,000 limit that government-chartered Fannie Mae and Freddie Mac can buy. Borrowers are having difficulty refinancing or selling homes because lenders have tightened standards following a surge in defaults by people with poor credit histories or heavy debts. "The

global dislocation of the mortgage finance and credit markets this past summer has had a greater impact on our balance sheet than we initially estimated," Larry Goldstone, Thornburg's president and chief operating officer, said in the statement. "We have begun to see a modest improvement in financing conditions since August." [i.e. the freefall has abated to simply a checked fall] **Thornburg Raises Loss Estimate From Mortgage Sales**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=a17uwB7.1CMA&refer=home>

Macro Economic

- Corporate America is braced for the worst period of economic uncertainty since the start of the decade as the credit squeeze and the housing meltdown heighten the risk of a US slowdown. US chief executives say the economic outlook has not been so difficult to read since the last recession in 2000-01. They warn that in spite of signs of a pick-up, the threat of an economic contraction is still alive. Conflicting economic indicators and volatile business conditions make it difficult to take strategic decisions such as whether to hire or fire staff, or increase or slash capital expenditure, business leaders told the Financial Times. They said they would watch the third-quarter earnings reporting season, which begins this week, to gauge whether companies had managed to cushion the twin blows from the housing crisis and the liquidity squeeze. Earnings growth is expected to have sagged to an average annual rate of 0.8 per cent in the third quarter, the slowest pace since 2002, Thomson Financial says. "The economic environment is uncertain because over the summer the economy was thrown a number of curve balls and it is unclear what the long-term impact of that is going to be," said Jim Tisch, the chief executive of **Loews**, the hotels-to-pipelines conglomerate. **Corporate America racked by uncertainty**
http://www.ft.com/cms/s/0/00eb67c0-769c-11dc-ad83-0000779fd2ac.html?ncllick_check=1
- Oct. 10 (Bloomberg) -- Bank of England Governor Mervyn King suggested he's reluctant to cut interest rates to shield lenders from increased credit costs and predicted more "turmoil" in financial markets. "The current turmoil in financial markets is not over," King said in a speech in Northern Ireland late yesterday. The benchmark interest rate "will not be set now to insulate the banking system from the re-pricing of risk. But you can be sure that we will do whatever is necessary to keep inflation close to the 2 percent target." The comments damp speculation that the Bank of England will follow the U.S. Federal Reserve in lowering its main rate to support economic growth. U.K. inflation won't stay around the central bank's 2 percent target unless the economy slows, King said, repeating a forecast made before the jump in credit costs. "We will be monitoring closely the impact of tighter credit conditions on demand and output in the coming months," King said. "With investors more wary of risks, banks will find it harder to raise funds. So credit will not be so readily or cheaply available to businesses and households." **King Suggests He Won't Reduce Rate to Shield Banks** [based on what he did in Sept another person completely lacking in credibility]
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aMXswJYtVvFM&refer=home>

- This equity rally lacks conviction. The Dow Jones Industrial Average and the S&P 500, the most watched US indices, have retouched all-time highs, suggesting a belief that the summer money-market crisis is behind us. But they seem exhausted by the effort. Meanwhile, European markets remain below their highs. The sectors that benefit most from economic growth – materials, financials and consumer discretionary stocks – still lag behind their July highs, as do smaller companies. The rally is led by US multinationals and, spectacularly, by the biggest emerging markets. Why? It looks like the rally is about two related bets: that the dollar will continue to weaken and that the Fed will make money cheaper with more cuts to the Fed Funds rate. That explains the surge of funds into emerging markets and the outperformance of companies with profits outside the US. They benefit from a weak dollar. Both those bets look in jeopardy. Since its low at the end of September, the dollar has enjoyed a bounce this month. It is up about 1.5 per cent from its lows against a trade-weighted index. Last week's US jobs report, better than had been expected, may have helped. That in turn pushed down the fear of a recession by a notch. It also weakened the case for another interest rate cut by the Fed. Significantly, the weakness of the dollar now appears to be worrying the Fed. Last week, three Fed governors made speeches about the dollar. They said it was "part and parcel" of rate-setting decisions, and that they paid "great attention" to it. Usually months go by without the Fed mentioning the exchange rate. If the dollar starts to fall again, it may reach a point where the Fed feels obliged to step in. To do this, it would have to abandon rate cuts. That could end the liquidity-fuelled party in the emerging markets. **The Short View: Weak dollar** <http://www.ft.com/cms/s/0/4c1d9cf4-75c0-11dc-b7cb-0000779fd2ac.html>
- Oct. 8 (Bloomberg) -- Ryder System Inc., the largest U.S. truck-leasing company, said third-quarter earnings were less than it forecast because a weakening economy cut demand for commercial trucks. Ryder fell as much as 7.7 percent in New York trading. Ryder blamed its fleet-management business, which provides trucks and services such as fueling and maintenance to commercial customers. Those include retailers such as Wal-Mart Stores Inc. and Home Depot Inc., said Todd Fowler, a KeyBanc Capital Markets analyst. That business accounted for \$2.03 billion, or 62 percent, of Ryder's \$3.25 billion in first-half revenue. Investors had thought that because Ryder is a rental business, the company was more insulated from the freight slump than others in the trucking industry, Fowler said in an interview. **"Economic conditions have softened considerably in more industries beyond those related to housing and construction,"** Ryder said in the statement. **"Consequently, freight and shipment levels have weakened to a greater extent than previously anticipated."** **Ryder Says Earnings Missed Forecast; Shares Decline**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=azHirEfeOaN8&refer=home>
- Oct 8 - Asia's listed companies and their investors have taken advantage of buoyant equity markets this year to raise record funding via follow-on share offerings, according to new data. The volume of follow-on issuance across Asia, excluding Japan, reached \$71.5bn in the first nine months, a 72 per cent rise on the same period last year, Thomson Financial found. **Follow-on funding at new highs in Asia**
<http://www.ft.com/cms/s/0/d9738602-7518-11dc-892d-0000779fd2ac.html>

Retail

- Petsmart (PETM \$32) is struggling after lowering same-store sales guidance and its profit outlook. The pet supply retailer said consumer weakness may be hurting its business, [as a member of a pack of five (Kajun is clearly the Alpha, not me) this would be one of the last areas of cutbacks, I think many PetSmart shoppers are like me. Inference, things are grim]

Retirement

Risk

Savings Rate

Tech

Wall Street

- Oct. 10 (Bloomberg) -- Morgan Stanley, the world's second- biggest securities firm, said its quantitative strategy traders lost \$390 million during a single day in **August as their computer models failed to account for** "widespread" investor selling. **[Mathematical models will never quantify human behavior. LTCM proved it. That lesson never took hold because of the Fed bailout. It is reliance on mathematical models that will cause the crash – merely a matter of time because despite the latest Fed bailout, the problem is TOO large this time.]** The company's traders lost money on 13 days during the quarter ended Aug. 31, the New York-based firm said in a quarterly regulatory filing today. "The largest loss days resulted from losses associated with quantitative strategies in early August 2007, when these strategies were adversely affected by widespread portfolio reductions," the company said. Morgan Stanley said last month that the quantitative strategies group lost \$480 million during the quarter **after being caught off-guard** when other investors sold securities to reduce borrowings. Separate areas of the equity sales and trading unit made up for the losses, enabling it to report \$1.8 billion of revenue for the third quarter, up 16 percent from a year earlier. The firm's quantitative trading group, like hedge funds run by Highbridge Capital Management LLC, Tykhe Capital LLC and Goldman Sachs Group Inc., uses mathematical models to pick investments. Such "quant" models began posting steep losses in late July and early August as surging defaults on subprime mortgages triggered a crisis of confidence in credit markets. Stock-market declines followed. **The funds were forced to sell more-liquid stock investments to raise cash and reduce debt. [i.e. they were horribly overleveraged]** The selling confounded the funds' computer models. Stocks that they anticipated would decline in price rose, and shares that they expected to rise instead fell. Morgan Stanley disclosed today that daily **trading losses during the quarter exceeded the firm's trading value-at-risk calculation on six days [theoretically this should NEVER happen, yet it happened 25% of the trading days in August]** during the quarter. The filing with the U.S. Securities and Exchange Commission also shows that the firm's traders generated more than \$100 million of revenue on about 19 days during

the quarter. **Morgan Stanley Traders Lost \$390 Million in One Day**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aUkBuixre03o&refer=home>

- Oct. 10 (Bloomberg) -- The Calyon trader fired last month for alleged unauthorized trading that led to 250 million euros (\$353 million) of losses said his bosses knew what he was doing and considered him a "golden child" of the New York office. "There was nothing deceptive or rogue," Richard "Chip" Bierbaum, 26, said in an interview. "My positions were reported on a daily basis. It did not blow up. I expect there were some losses but nowhere near the amounts they are discussing. I was the golden child of credit trading in New York." Calyon, the investment banking unit of Paris-based Credit Agricole SA, France's second-largest bank, said on Sept. 18 that it had an "unusually large market position" that was "above the authorized limit" and would cause third-quarter profit to fall "sharply." While Calyon didn't identify the people involved, Bierbaum, whose stepfather is a descendent of John Jay, the first chief justice of the U.S., said he was fired and blamed for the trades on indexes linked to derivatives. The losses would be the biggest from unauthorized trading since John Rusnak's currency bets cost Dublin-based Allied Irish Banks Plc \$691 million in 2002. Management failures to oversee derivatives traders allowed Nick Leeson to bankrupt Barings Plc and Yasuo Hamanaka to hide \$2.6 billion of losses from copper futures at Tokyo-based Sumitomo Corp. while their employers remained ignorant. "Isolated Incident" "The bank maintains that this is an isolated incident and the work of an individual trader who did not respect our risk procedures and who breached our trading limits," Calyon spokeswoman Anne Robert said in an interview last week in Paris. "The losses were the result of the cost to unwind these unauthorized positions." **Calyon Trader Fired for Losses Says He's No Rogue**

<http://www.bloomberg.com/apps/news?pid=20601109&sid=a9T1UaFhjVYw&refer=home>

- **Record highs were a theme for US and Asian equities on Tuesday, as renewed merger and acquisition activity gave investors further reason to believe the worst of the recent credit squeeze was firmly behind them.** Among Tuesday's deals, French family-owned Sonepar said it was eyeing a €2.5bn bid for Dutch electronics distributor Hagemeyer, while British brewer SABMiller announced a joint venture with US rival Molson Coors. In New York, the S&P 500 and the Dow Jones Industrial Average both set record closes and new intra-day peaks. A late rally in stocks was ignited after the release of the minutes from the last Federal Reserve policy meeting, at which US interest rates were cut by 50 basis points. **Overview: M&A pushes equities higher [recall that record M & A activity is one of about a dozen data points to watch for in market tops – already a record year and now six weeks from a credit collapse, back at it again]**
<http://www.ft.com/cms/s/0/2307c02e-7688-11dc-ad83-0000779fd2ac.html>
- **[another – "it is all good" one to remember]** Oct. 10 (Bloomberg) -- The U.S. economy will skirt recession even as the housing slump takes a bigger bite from growth, according to a survey of economists. **The economy will grow at an annual rate of 1.8 percent in the fourth quarter, 0.4 percentage point less than forecast last month, according to the median of 71 analysts participating in Bloomberg News's monthly survey.** Estimates for the first six months of next year were also reduced. Sales of furniture, appliances and building materials will slow as plunging home sales and falling property values erode consumer confidence, economists said. The Federal Reserve will follow last

month's interest rate cut with a quarter-point reduction before the end of December, the survey shows. Housing is an "ongoing train wreck," said Seamus Smyth, an economist at Goldman Sachs Group Inc. in New York. **"The Fed is forward looking, and things aren't going to get better in housing any time soon."** [this the same Fed who had to reverse policy in a three day period in August because it failed to see that the credit market HAD been imploding for months] Economists at Goldman Sachs reduced their estimate for growth this quarter to 1.5 percent, a half point less than they predicted last month. They slashed the growth rate for the first half of next year by a full percentage point to 1.25 percent. **U.S. Economy to Avoid Recession as Housing Sinks, Survey Shows**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aJiIt0iWXSU&refer=home>

- Swiss hedge fund **Infiniti Capital** has learned the truth may hurt, but lack of it hurts even more. Zurich-based Infiniti is just one of the many investors that are contemplating lawsuits against **Bear Stearns** over two failed subprime-related hedge funds. It seems, however, at least according to *Investor Daily*, that a similar action isn't in the offing against another hedge fund loser, Australia's **Basis Capital**, in which Infiniti also invested. "Basis never lied to us," Infiniti portfolio manager **Iain Hamilton** told *ID*. **Infiniti is accusing Bear Stearns of underreporting the extent of its exposure to subprime. "Bear Stearns told us it [was] 6%," said Hamilton, "but it had 40% hidden elsewhere."** Had we known [the truth]," he noted, "we would never have had an allocation [to the BS hedge funds] at levels we did – namely 3.25%. **Truth Has Bear Consequence**
<http://www.institutionalinvestor.com/Article.aspx?ArticleID=1450327&LS=EMS144216#>
- Oct. 8 (Bloomberg) -- Skittishness over the U.S. stock market's record-setting rally is reaching a crescendo **among options traders who are preparing for a crash**. Investors are paying the most ever to protect against a drop in the Standard & Poor's 500 Index, data compiled by Morgan Stanley show. The gap between the price of so-called put options on the benchmark for U.S. equity and the cost to wager on further gains has averaged about 8 percentage points since August. **That's more than the previous high in July 2001, before the index dropped 34 percent and fell to the lowest this decade**. The widening spread is a warning for OppenheimerFunds Inc. and Harris Private Bank, which oversee more than \$300 billion and say the bearish bets indicate stocks may fall Price Swings The advance hasn't dispelled concern among traders in U.S. options. **They are pricing in the highest risk of an equity- market decline since the technology-stock bubble burst at the start of the decade**, according to Carl Mason, head of U.S. equity-derivatives strategy at Morgan Stanley in New York. Mason says implied volatility, a measure that calculates expected price swings of an underlying asset and is used as a barometer for options prices, shows many investors are betting that stocks may fall. **The gap shows there's "an awful lot of nervousness," said Mason. "A lot of investors don't want to get caught out."** [i.e. lots of people looking for the exit at the same time] **The last time the skew steepened as much was in July 2001, when it touched 8.24 percentage points, according to Morgan Stanley's data. In the following 15 months, the S&P 500 tumbled as the U.S. economy suffered its first recession in a decade.** "We're going to keep moving higher," said Wilson, co- director

of equity strategy at Memphis, Tennessee-based Morgan Keegan, which manages \$120 billion. Investors are "foolishly buying" protection, he said. David Tice, who runs the \$789 million Prudent Bear Fund in Dallas, is more pessimistic. He owns S&P 500 put options because stocks could "easily" decline by more than 50 percent in the next 12 months to 24 months. Tice says the latest rebound only delays an inevitable crash, comparing it to when "somebody falls out of a 95-story building." "They haven't hit the ground yet," he said, "But they're getting closer and closer." **Stock Market Stumble Presaged as S&P 500 Options Spread Widens**
<http://www.bloomberg.com/apps/news?pid=20601103&sid=aKIRaKrHXSLI&refer=news>

- Oct. 8 (Bloomberg) -- Somewhere in the wreckage of securities backed by subprime mortgages and the resulting seizure in the credit markets, **is a new paradigm** [a "new paradigm" Haven't seen this since the dotcom "new paradigm". When you see phrases like this popping up, the time is near] on Wall Street where Goldman Sachs Group Inc., increasingly perceived as the world's biggest hedge fund, will report record earnings for 2007. While Goldman, the largest securities firm by market value, insists that it caters to the needs of clients and has never been anything but customer-driven, New York-based Goldman also is considered No. 1 in proprietary trading and manages more hedge funds than anyone except JPMorgan Chase & Co. Goldman may be the most prominent example of the transformation of the securities firm that behaves more like a hedge fund. Like New York-based Goldman, Morgan Stanley and Lehman Brothers Holdings Inc. also will report record earnings this year, according to analyst estimates compiled by Bloomberg. Like hedge funds, Goldman uses its capital to take bigger trading risks than rivals. The firm's so-called value at risk, a measure of how much the bank estimates it could lose from trading in a single day, rose to \$139 million in the third quarter, up 51 percent from a year earlier to the highest ever, according to company reports. The increase was most pronounced in interest rate-related risk, which almost doubled to account for about 40 percent of the total. On a similar basis, New York-based Morgan Stanley, the second-biggest U.S. securities firm by market value, said its trading VaR was \$87 million in the quarter, up 55 percent from a year earlier. Lehman, the fourth-biggest firm, said VaR was \$96 million, citing "a combination of higher levels across a range of products for the period and a higher level of risk associated with an increase in fixed-income related assets." Since taking over in 2002, Merrill Chief Executive Officer Stanley O'Neal has pushed the firm to match its rivals by expanding in proprietary trading and private equity, businesses that put more of the company's capital at risk in exchange for higher returns. **Goldman Record Income Shows New Wall Street in Market Shakeout**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aHlubJwmBR6I&refer=home>
- Oct 7 - US companies are facing fresh pressure from regulators and shareholders to rein in excessive executive pay as research shows chief executives have been paid up to 10 times more than their top lieutenants. The average total compensation for a S&P 500 chief executive was about twice as much as the second most highly paid executive last year, **according to a study** conducted for the Financial Times by the research group, Salary.com. **Business under pressure over CEO pay**
<http://www.ft.com/cms/s/0/f4125948-74ff-11dc-892d-0000779fd2ac.html>

Don't Fight The Fed

- Google Inc. shares may surge 17 percent to \$714, according to Lehman Brothers Holdings Inc., which said the operator of the world's most popular Internet search engine may introduce a mobile phone as early as February. [Google May Surge to \\$714 \[I love the precision of the specific dollar amount. Nicely distinguishes it from the pull it out of my ear \\$1,000 price tag Henry Blodgett put on Amazon in 2000\]](#)
- **VIX Sounds All Clear For Stocks** Bernie Schaeffer, Option Advisor 10.08.07, 11:30 AM ET CINCINNATI, OHIO - The broad market continued to rally last week **despite ongoing concerns about weakening economic conditions, subprime woes and earnings warnings from a number of banks.** [\[ignore the man behind the curtain\]](#) The tech-laden Nasdaq Composite jumped 2.9% last week, hitting a six-and-a-half-year high. Elsewhere, the Dow Jones industrial average charged 1.2% higher, while the S&P 500 Index gained just over 2%; both indexes tagged new all-time highs during the week. Furthermore, the S&P 500 finally closed above the 1,553.11-level, which marked the March 2000 high for the index. The Russell 2000 Index sprinted nearly 5% higher last week, moving firmly above former resistance at the 800-level. The index's next major challenge from a chart perspective is the 850-level. This region, which is now only 0.61% above the index, halted the index's rally in June and July. [\[It's all good!!!!!!!\]](#)

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I Disagree . . . and why

[Article of the week:](#)

UM EMBA