

The Other Side of the Street October 21, 2007

Comments

Ben Bernanke and Hank Paulson are no dummies. They understand that in a finance-based, debt dependent economy, **we've already passed the point of no return.**

– Todd Harrison Editor Minyanville.com October 19

Whether the week past proves to be the final crest of the “Don’t Fight the Fed” buying surge or if it has days, weeks or months left remains to be seen. What is not in doubt is that credit problems are not fixed by interest rate cuts.

The most notable Friday news IMO was not the plunge in stock markets; it was instead the implosion of two SIVs. There will be many more. There is no longer any appetite for gristle repackaged as filet.

On Wednesday, I attended a webcast put on by Fitch ratings. Fitch along with Moody’s and S & P are the 3 ratings agencies of note that aided and abetted the structured finance/credit swaps/CDO scam. Thus, Fitch has no incentive to truthfully assess the situation. However, three of their executives presented a picture of a mortgage debt industry in catastrophic disarray. Comments included:

- There will be no new CDO structured deals the rest of the year
- The Fitch focus is on problems in 2006 and 2007 originations, but they have now seen some problems in the 2005 vintage (meaning they are still deluded into relying on historical data that earlier years are strong – they aren’t and, through adverse selection, they will be getting worse)
- Fitch is now revising its assessment of the ratings on all structured finance and has recognized that it must increase the risk associated with all of it (this is disastrous to the ratings. It means that even if things remain constant the ratings will be under pressure because the risk will be judged greater all other things remaining the same)
- There is “a significantly raised risk in tranches originally graded AAA”
- 30% of CDOs Fitch rates have been downgraded since “the summer”
- Defaults are now expected to run “well up into investment grade tranches”
- There is “no basis to assume this situation will improve in the near term”
- One or more CDO asset managers are likely to “become impaired”

- The SIV market “continues to be challenging”
- Auditing firms are “holding a hard line” on valuations (i.e. doing their jobs)
- MBS volume is “much lower” and the “composition is different”
- There is a “complete lack of interest in any sub-prime/alt a debt” and a lack of interest even in prime residential mortgage debt
- Provisions for losses on loans “will have to go up” it is a “doom and gloom” scenario
- We are “very early on in the process” of working through the problems
- There have been “sharp changes” in credit availability

On Friday, we saw the post-cut rally in the Dow and SP500 evaporate. The Dow jumped about 200 points and the SP500 30 immediately after the 50BPS cut on September 18. The Dow closed that day at 13,739 (up 336) and the SP500 at 1520 (up 43). Closing numbers Friday were Dow 13,522 and SP500 1500. Thus, both have completely given up their Fed cut jump. More importantly, the distribution days (down days) have had volume significantly higher than the up days.

The sole thing the government’s scheming and lying did both before and after the cut was to transfer wealth to momentum players. It did not in anyway enhance the global economic situation. In fact it caused further deterioration because the true believers have levered up even further and the down side catalyst will be that much stronger.

That the “buy the dip”, “don’t worry be happy” crowd has prevailed these last 12-18 months is astounding. That the return to sanity is now well underway, apparent.

Next week there will be further heartache in the debt markets. It is a matter of basic economics; the supply is much greater than the demand.

The Three Card Monty Fed and Treasury are out of tricks. The completely illegal Citi super SIV scam is in the process of failing. What comes next, one can only guess. Its lasting impact – NONE - preordained.

For you see this is not a New Era. Like the fall follows the summer and the winter follows the fall, it is the natural order for recession to follow unbridled excess. We are finally starting the cleansing. It will be a long, long while before “the bottom is in”.

We ARE seeing . . .

Credit

- Oct. 18 (Bloomberg) -- **Rhinebridge Plc, a structured investment vehicle run by IKB Deutsche Industriebank AG, said it may not be able to pay back debt related to \$23**

billion in commercial paper programs. Rhinebridge suffered a "mandatory acceleration event" after IKB's asset management arm determined the SIV may be unable to repay debt coming due, the Dublin-based fund said in a Regulatory News Service release. A mandatory acceleration event means all of the SIV's debt is now due, according to the company's prospectus. Rhinebridge, which was forced to sell assets after being shut out of the commercial paper market, said it must now appoint a trustee to ensure that the interests of all secured bondholders are protected. "The manager has been in contact with the security trustee to discuss the occurrence of the enforcement event and the mandatory acceleration event, and further information will be provided to investors in due course," the company said. Rhinebridge was set up by IKB in June to sell short-term commercial paper to invest in securities with longer maturities and higher yields, including mortgage-backed debt. SIVs worldwide have been forced to sell about \$75 billion of assets in the past two months to repay maturing debt as investors balked at buying securities linked to money-losing subprime mortgages. SIVs have different operating states to protect investors and allow the fund time to recover from a market slump. Enforcement is typically the last state, and is irreversible. Dusseldorf-based IKB had to be bailed out this year by a group led by German state-owned KfW Group because of potential losses related to subprime loans. **Rhinebridge Commercial Paper SIV Says May Be Unable to Pay Debt**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=axyxVSKokNfl&refer=home>

- Oct. 15 (Bloomberg) -- Citigroup Inc., the biggest U.S. bank, said mortgage delinquencies and consumer lending will deteriorate for the rest of the year after earnings fell 57 percent in the third quarter. Citigroup had its biggest drop in more than a month in New York trading after Chief Financial Officer Gary Crittenden on a conference call **said borrower defaults are "accelerating."** Chief Executive Officer Charles Prince, who has overseen a 17 percent drop in the company's stock this year, said momentum "continues very strong" in most of the company's businesses. **[Maybe they have a significant foreclosure practice]** Since Prince became CEO in 2003, Citigroup shares are virtually unchanged, compared with a 29 percent jump at Bank of America Corp., the second-largest U.S. bank by assets. Wall Street Writedowns **The results included about \$6.5 billion of costs for fixed-income trading and underwriting losses and consumer loans gone bad.** Like Wall Street rivals Goldman Sachs Group Inc., Morgan Stanley and Merrill Lynch & Co., Citigroup had to write down the value of mortgages, asset-backed securities and corporate loans held on trading books or in its underwriting business. Late Payments The percentage of U.S. real-estate loans where borrowers were more than 90 days behind on payments climbed to 1.8 percent, from 1.4 percent in the second quarter and 1 percent a year earlier, Citigroup said. **Investors were further disheartened after Crittenden said capital ratios -- a measure of the bank's ability to handle a business decline -- have fallen below the company's target, according to Kersting.** The bank now has to divert spare capital away from share buybacks, Crittenden said. **Citigroup Net Falls 57 Percent on Fixed-Income Losses**
http://www.bloomberg.com/apps/news?pid=20601087&sid=azM5eB9Qw_KE&refer=home

Commercial Real Estate

Commodities

- Oct. 18 (Bloomberg) -- Crude oil rose above \$89 a barrel in New York for the first time after the U.S. dollar declined to a record low against the euro, enhancing the appeal of commodities as an investment. Investors purchased oil on speculation the Federal Reserve will cut borrowing costs to bolster the U.S. economy. Oil reached records the past four days on concern Turkey will use military force against Kurdish rebels in northern Iraq, a step that the U.S. says may damage Iraqi security and disrupt oil supplies. ``Most commodities are priced in the U.S. dollar, so the drop on the dollar has an immediate effect,' said Peter Beutel, president of Cameron Hanover Inc., a New Canaan, Connecticut, energy consultant. ``The price in dollars needs to go higher to reflect the true value of the commodities." **Oil Rises Above \$89 to a Record as Dollar Drops Against Euro**
http://www.bloomberg.com/apps/news?pid=20601087&sid=a0c7s0VQ._98&refer=home
- Oct. 16 (Bloomberg) -- Crude oil traded above \$86 a barrel after rising to a record yesterday on concern oil shipments may be disrupted if Turkish forces pursue Kurdish militants in Iraq. **Oil Trades Above \$86 After Rising on Turkey-Iraq Border Tension** [I left this in as, by the end of the week, \$86 per barrel was a bargain]
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aR7tQfAVjrZU&refer=home>

Currency

- As if to honor "Black Monday," **the N.Y. dollar index hit 77.4 yesterday -- an all-time low.** The index was created in 1973 to measure the dollar's effectiveness in a post-Bretton Woods world... where all the major currencies of the world were floating freely, backed by nothing more than the confidence in the governments that sponsor them. The dollar has never been as low as it is today. On Jan. 26, 2007, the same index stood at 85... the high for the year. **In 2002, when Ben Bernanke made his infamous "helicopter speech," the index was at 120. It has fallen over than 40% in five years.** The high point for the dollar was reached back in 1985, when the index topped 160. DR 10/19

Diversification

Derivatives

- Ken Lewis is not a happy camper. Or, as the **Bank of America** boss put it himself even better: "I've had all the fun I can stand in investment banking at the moment." On leveraged loans, BofA actually managed to avoid the worst excesses of the buy-out boom. The bank's pain came more in trading credit and structured products, such as mortgage-backed securities, where, at the risk of simplifying, the hedging did not work out as planned. Overall, it is not looking pretty for Wall Street. Who knows what the return profile will look like for CDOs, given how little data there is on underwriting

revenues. With regards to leveraged loans, the comparisons are a little easier, albeit on a back-of-the-envelope basis. From 2004 to 2007, JPMorgan, Goldman Sachs, Citigroup, Lehman Brothers, and BofA, earned aggregate revenues of roughly \$14bn from financial sponsors, according to Dealogic. The write-downs announced over the past quarter alone amount to between \$5bn and \$5.5bn. Lop those off the revenues, adjust for taxes and compensation and you end up with what looks like a pretty underwhelming return. **Bank of America** http://www.ft.com/cms/s/9cc6c84c-7dae-11dc-9f47-0000779fd2ac,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F1%2F9cc6c84c-7dae-11dc-9f47-0000779fd2ac.html

- Oct. 19 (Bloomberg) -- Cheyne Finance Plc and IKB Deutsche Industriebank AG's Rhinebridge Plc, two structured investment vehicles that bought securities backed by home loans, **defaulted on more than \$7 billion of debt as the value of their holdings fell**. The companies borrow in the short-term debt market and use the proceeds for buying mortgage-backed bonds and collateralized debt obligations. **Falling market prices for assets forced the companies to declare all of their debt due this week**. Concern about losses from the companies drove two-year Treasury notes to their biggest weekly gain in five years. **Credit-default swaps rose the most in three months this week after the companies warned they faced difficulties**. "The fallout from the credit crisis is far from over," said Jim Reid, head of fundamental credit strategy at Deutsche Bank AG in London. **There are probably more skeletons in the closet. The problem is knowing when and where they are going to emerge.** Rhinebridge, set up and run by a unit of Dusseldorf-based IKB, missed payment on \$65 million of commercial paper yesterday after revaluing collateralized debt obligations, Fitch Ratings and Standard & Poor's said. **Rhinebridge has \$791 million of commercial paper and a portfolio with a face value of \$1.1 billion, S&P said**. The market value of the assets is now 63 percent of face value, having fallen \$69 million since Oct. 16 alone, S&P said. Revaluations of CDOs of asset-backed securities have caused a "dramatic" fall in value, the rating company said. Cheyne Bailout "The proceeds from assets if they were to be sold in the short-term would be below the amount required to make payment on senior liabilities," S&P said in a note about Rhinebridge today. Receivers from Deloitte & Touche LLP are trying to organize a bailout of Cheyne Finance by restructuring its debt or selling its assets. **Cheyne Finance hasn't paid commercial paper that matured after the receivers' announcement on Oct. 17, S&P said**. Cheyne Finance's managers said its assets are worth 93 percent of face value, enough to pay back all of its \$6.6 billion of senior debt, S&P said. CDOs of asset-backed securities make up 6 percent of Cheyne Finance's holdings. Ratings companies have slashed their assessment of bonds backed by U.S. mortgages as losses spread. Concern that the housing crisis may deepen escalated this week after Federal Reserve Chairman Ben S. Bernanke said the slump may last through next year. **Moody's Investors Service said last month it will assume its rankings for many subprime mortgage-backed bonds issued since July 2005 are too high when it assesses new collateralized debt obligations**. CDOs package pools of mortgage securities and slice them into pieces with varying degrees of risk, from AAA to unrated portions. **Mainsail II Ltd., a SIV set up by London-based hedge-fund manager Solent Capital Partners LLP, said yesterday it had assets with a face value of \$1.48 billion and debts of \$1.65 billion**. **Cheyne, IKB SIVs Default on Commercial Paper as Assets Fall**

<http://www.bloomberg.com/apps/news?pid=20601208&sid=aG5Nw73ZH6Tg&refer=finance>

- Oct. 19 (Bloomberg) -- **Credit-default swaps rose the most in three months this week as plans for an \$80 billion fund to rescue structured investment vehicles failed to prevent two funds warning they may be unable to repay all of their debt. [Since the actual date this monstrosity could have gone into business is months away, the real impact was to have been jawing the market into believing help was on the way. It did not even work for the week. Parlor tricks will not cut it any more]** The iTraxx Europe index of 125 companies with investment-grade ratings increased as much as 7.5 basis points to 37.25 basis points including a 2.25 basis-point jump today, JPMorgan Chase & Co. prices show. The CDX North America Investment Grade Index has climbed 10 basis points this week, according to Deutsche Bank AG, the biggest weekly increase since July 27. It rose 1.75 basis points today to 56 basis points. Rhinebridge Plc, the SIV run by Dusseldorf, Germany-based IKB Deutsche Industriebank AG, said yesterday it's unlikely to repay all its debt, a day after receivers said a fund run by London-based Cheyne Capital Management Ltd. will stop paying creditors. Former Federal Reserve Chairman Alan Greenspan said a fund initiated by Treasury Secretary Henry Paulson to help SIVs avoid a fire sale of \$320 billion of assets may harm investor sentiment, Emerging Markets reported on its Web site today. SIVs, which borrow in the commercial paper market to fund purchases of asset-backed securities, have been forced to sell about \$75 billion of assets as investors retreated from all but the safest debt. **SIV losses are adding to concern that the fallout from record U.S. mortgage foreclosures may be worse than analysts expected. [The problem is not foreseeability; all of this has been foreseeable for more than a year. The problem has been the refusal of those in the public and private sector entrusted with a duty to act responsibly abdicating entirely that duty.]** Credit-default swaps on Wachovia Corp. today widened 2 basis points to 48 basis points, according to Phoenix Partners Group, after the fourth-largest U.S. bank missed analyst's earnings estimates. The Charlotte, North Carolina-based lender reported \$1.3 billion in writedowns for mortgage-backed securities and loans for leveraged buyouts. Bank of America Corp., the second-largest U.S. bank, said yesterday that profit fell 32 percent in the third quarter because of about \$4 billion in trading losses, defaults and writedowns. Super SIV 'Flop' ``The news flow turned out to be even more negative this week, with earnings jitters, macro concerns and accelerating fears that the Super SIV fund will be a flop, putting pressure on credits," Jochen Felsenhiemer, head of credit derivatives strategy at UniCredit SpA in Munich, said in a note to clients today. **The cost to protect the bonds of 25 European banks and insurers included in the iTraxx Financial subordinated index soared 15 basis points to 47.5 basis points this week, according to JPMorgan, the biggest weekly jump since July 27.** Contracts on the iTraxx Crossover Series 8 Index of 50 European companies with mostly high-risk, high-yield credit ratings increased 8 basis points to 321 basis points today, according to JPMorgan. Leveraged Loans Credit-default swaps, contracts conceived to protect bondholders against default, pay the buyer face value in exchange for the underlying securities or the cash equivalent should a company fail to adhere to its debt agreements. A basis point on a credit-default swap contract protecting \$10 million of debt from default for five years is equivalent to \$1,000 a year. The LCDX Series 9 index, a gauge of confidence in the U.S. leveraged loan market that falls as

investor confidence deteriorates, dropped 0.3 point to 99, according to Goldman Sachs Group Inc. It reached 98.9 yesterday, the lowest since Series 9 started trading Oct. 3. It has fallen 1.2 points this week. **SIV Concerns Trigger Worst Week for Credit in Three Months**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a9PmfXOZrS08&refer=home>

Housing

- **They may not have attracted the same attention as US numbers, but Japanese housing data paint a similarly bleak picture. Housing starts in August fell 43 per cent to the lowest level in more than four decades. Japanese housing**
http://www.ft.com/cms/s/da7dc6fe-7d4f-11dc-9f47-000779fd2ac,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F1%2Fda7dc6fe-7d4f-11dc-9f47-000779fd2ac.html
- The property boom of the past ten years has left the British housing market in danger of following the slump in American house prices, the International Monetary Fund said yesterday. **In a bleak warning, the IMF found that homes in Britain were overpriced by up to 40 per cent** — far more than the overpricing in the US before the current property slump began there. The finding will fuel fears over housing market prospects after growing evidence recently that prices have already begun to fall in some parts of Britain. The warning came as it emerged yesterday that the Bank of England discussed whether to lower interest rates this month to shore up Britain's growth. But there was substantial reluctance among the Bank's Monetary Policy Committee to rush into lowering borrowing costs, with only one of the nine-strong panel voting for a rate reduction. The IMF report said: **"The extent of house price overvaluation may be considerably larger in some national markets in Europe than in the US. The estimates suggest that a number of advanced economies' housing markets outside the US could be vulnerable to a correction."** House prices in Britain now stand at about nine times average annual earnings — up from about five times in 2001. Average national house prices have risen threefold since the early 1990s, from about £60,000 to about £200,000 now. In its twice-yearly report on world economic prospects, the IMF warned Europe's governments that the tighter lending conditions for homebuyers caused by the worldwide squeeze on credit could lead to a serious correction in excessive house prices. "The steady increase in interest rates has already contributed to some cooling of these housing booms, and recent developments are likely to have a further dampening impact," it said. The IMF, however, did qualify its pessimism, saying that there were "considerable uncertainties" in its model, which did not take in key factors in Britain such as shortages of supply, boosts to prices from immigration and greater affordability due to the availability of mortgages. **UK house market is 'heading for crash'**
http://business.timesonline.co.uk/tol/business/money/property_and_mortgages/article2681755.ece?EMC-Bltm

- Oct. 15 (Bloomberg) -- Federal Reserve Chairman Ben S. Bernanke said the housing slump will be a "significant drag" on U.S. growth into next year, though evidence of a broader impact on spending is limited. "The Federal Reserve will continue to watch the situation closely and will act as needed to support efficient market functioning and to foster sustainable economic growth and price stability," Bernanke said in a speech to the Economic Club of New York today. **Credit markets have improved, he added, while a full recovery will take time and we may well see some setbacks.** [There is NO evidence that RMBS or ABS credit markets are improving – they are continuing to deteriorate and that is why the SIVs are failing. Pretty sick that the Fed head continues to lie to the little guys] Bernanke's speech, his first on the economy since August, comes as investors pared expectations for an interest-rate cut this month. Retail sales increased in September and jobs and wages picked up, suggesting consumers are weathering the worst housing slump since 1991 and reduced access to credit. "The ultimate implications of financial developments for the cost and availability of credit, and thus for the broader economy, remain uncertain," Bernanke said today. **It remains too early to assess the extent to which household and business spending will be affected" by the housing recession.** [how absurd, it is simple to assess what will happen, just as it was simple to know the subprime problem would surface and drag down the credit markets] Answering questions after his speech, Bernanke said while central banks can't be "indifferent" to exchange rates, data show the effect of a falling dollar on prices is "relatively small." Bernanke's speech described the events leading up to the Fed's discount rate cut in August and half-point cut in the benchmark lending rate Sept. 18, and the thinking behind policy makers' actions. The September reduction exceeded most economists' forecasts. Managing Risk **Risk management considerations also played a role in the decision, given the possibility that the housing correction and tighter credit could presage broader weakening in economic conditions that would be difficult to arrest,** he said. "I would like to know what those damn things are worth," Bernanke joked, referring to the products that investors have shunned in the credit rout. "This episode has revealed a weakness in structured credit products," namely the difficulty in coming up with valuations in periods of stress. **The economy's performance so far this year has been reasonably good,** [the Titanic was making reasonably good progress across the Atlantic until it hit and iceberg] and evidence "has been limited" that the housing recession is hurting household spending, Bernanke said. **The market for U.S. commercial paper expanded for a second straight week during the period ended Oct. 10 as investors regained their appetite for short-term debt. Corporate bond sales this year are nearing \$1 trillion.** [yes, after dropping 314 billion (more than 15% of the total market) from July to September, in the week ended October 17, CP outstanding increased a robust 1.3 billion leaving it just 6.2 billion less than SEPT EOM] Futures contracts on the Chicago Board of Trade indicate a 32 percent chance the central bank will cut the overnight lending rate between banks a quarter-percentage point at its Oct. 31 meeting, compared with 48 percent odds a week ago. Bernanke Says Housing to Remain 'Drag' on U.S. Growth (Update3) http://www.bloomberg.com/apps/news?pid=20601087&sid=a_6erMJbqHYs&refer=home

Housing Finance

- Homeowners are feeling the effect of higher interest rates according to figures that show mortgage lending fell 12 per cent last month. The Council for Mortgage Lenders said the monthly fall in gross lending to about £30bn was more than double the decline usually seen in September, while the annual increase in volume of 2.5 per cent was the lowest in two years. It is predicting further falls in lending as the impact of the credit squeeze is felt. The figures, which include remortgaging, equity withdrawal and lending for house purchases, will not yet reflect any cutback in household lending resulting from the credit squeeze. "In the coming months, we expect to see monthly lending levels dip below their 2006 levels for the first time this year as rate effects are exacerbated by the recent liquidity problems in the mortgage market," said Michael Coogan, CML director-general. The figures confirm surveys that have signaled a slowdown in housing market activity and the rate of house price growth. The International Monetary Fund has warned that the UK is among countries most at risk of a housing market downturn. **Higher interest rates hit home** http://www.ft.com/cms/s/0/a714f946-7db2-11dc-9f47-0000779fd2ac.html?nclick_check=1
- Oct. 19 (Bloomberg) -- PMI Group Inc. dropped 11 percent and rival U.S. mortgage insurers fell in New York trading after Standard & Poor's put the company's credit and financial strength ratings on negative "creditwatch." Standard & Poor's made the change after Walnut Creek, California-based PMI said yesterday it will post a surprise third-quarter loss because borrower defaults "significantly worsened" in September. Creditwatch means action is likely within 90 days on PMI, the industry's second-largest company behind MGIC Investment Corp. MGIC was put on creditwatch Oct. 17. PMI said yesterday it will lose about \$1.05 a share in the third quarter and it withdrew 2007 earnings forecasts amid the worst U.S. housing slump in 16 years. A day earlier, MGIC said it won't be profitable in the fourth quarter or 2008. Mortgage insurers help lenders recoup losses when homeowners don't pay. "We believe it is probable -- though not certain -- that all seven major mortgage insurers will report underwriting losses in 2008," S&P said in a separate statement today. **PMI, Mortgage Insurers Fall on S&P Ratings Action** http://www.bloomberg.com/apps/news?pid=20601206&sid=ak4YDbvSD_A0&refer=real estate
- Oct. 19 (Bloomberg) -- Wachovia Corp., the bank that's spending more on acquisitions than its biggest competitors, reported earnings that missed analyst estimates after \$1.3 billion in writedowns for mortgage-backed securities and loans for leveraged buyouts. Net income fell 10 percent in the third quarter, the first decline in six years, to \$1.69 billion, or 89 cents a share, from \$1.88 billion, or \$1.17, a year earlier, the Charlotte, North Carolina-based company said today in a statement. Excluding merger costs, Wachovia earned 90 cents a share, compared with the \$1.04 average estimate of 19 analysts surveyed by Bloomberg. Chief Executive Officer Kennedy Thompson spent more than \$30 billion in the past two years to buy mortgage lender Golden West Financial Corp. and the A.G. Edwards Inc. brokerage firm, sparking investor concern that he overpaid at the peak of the housing and stock markets. Wachovia shares have declined

19 percent since the Golden West purchase was announced in May 2006, trailing Citigroup Inc., Bank of America Corp. and JPMorgan Chase & Co., the three biggest U.S. banks. "The market is telling you that there are going to be some difficulties in the near term," said Steve Gutch, the Rochester, New York-based research director at Clover Capital Management, which oversees \$2.6 billion and owns Wachovia shares. "A lot of the negative news is priced into the stock," said Gutch, who spoke before earnings were released. **Wachovia Net Drops 10% on Mortgage, Loan Writedowns** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aOKnOE1VBCHw&refer=home>

Macro Economic

- Oct 19 – Caterpillar earnings announcement - In 2008, "a weak U.S. economy is expected to continue but be more than offset by solid economic and industry growth in most of the world outside the United States." **Many U.S. industries important to our sales are in recession,** Cat said. "Through the first nine months of this year, housing starts were down 26%, and we expect housing starts for the full year 2007 to be 1.4 million. Nonmetals mining and quarrying is down 18%; coal mining, 4%; nonresidential construction contracting, more than 2%; and freight movements, 2%. **We expect further deterioration in most of these industries in the fourth quarter.**" For next year, Cat is predicting that the U.S. economy will grow at about 1.5%, even slower than in 2007. "Our outlook reflects U.S. housing, nonresidential contracting and quarrying declining further. For the major U.S. machinery end markets, only coal mining shows a reasonable possibility of improvement."
- Oct. 19 (Bloomberg) -- Asian stocks fell after Bank of Japan Governor Toshihiko Fukui said problems stemming from U.S. subprime mortgage losses persist and have increased "uncertainty" in financial markets. **Asian Stocks Decline, Led by Mitsubishi UFJ, on Fukui** **Comments** http://www.bloomberg.com/apps/news?pid=20601087&sid=atVN.TnRP_eI&refer=home

Oct 18 - **The world economy remains at serious risk of suffering deeper turmoil in financial markets that could trigger a severe global downturn, the International Monetary Fund (IMF) said yesterday, as it sharply cut forecast growth in key economies next year.** In a stark warning that the squeeze in lending markets worldwide could spiral into a full-scale credit crunch, **the IMF said "financial market conditions remain a major source of down-side risks to the global outlook"**. But despite its relatively sanguine central forecast, Simon Johnson, the IMF's chief economist, emphasised: "The world economy has entered an uncertain and potentially difficult period. **The financial turmoil of August and September threatens to derail what has been an excellent half decade of growth.**" The IMF's main forecast is for global growth to slow next year to a still "solid" 4.75 per cent from 5.2 per cent this year, substantially because of the US being unlikely to see any rebound in growth in 2008. However, the fund said it judged there is at least a one in six chance that global growth will tumble to 3.5 per cent or less in the coming year, which would mark the weakest performance since 2002.

Risks from the markets' upheavals were at the top of the IMF's list of threats. **“There remains the distinct possibility that recent turbulent conditions could continue for some time and generate a deeper “credit crunch” than envisaged in the baseline scenario, with considerably greater macro-economic impact,”** it said. “The most likely outcome is a gradual return to more normal market conditions. Nevertheless, conditions in financial markets remain volatile and the stress in credit markets may continue despite efforts by central banks.” Should market turmoil deepen, the fund said that this would spell tighter lending conditions for “even high-grade borrowers” among both households and companies. America would be hardest hit by the resulting toll on growth, but Europe was also likely to be severely affected. **Turmoil could cause a global credit crunch, IMF warns**
<http://business.timesonline.co.uk/tol/business/economics/article2681435.ece?EMC-B1tn>

Retail

Retirement

Risk

Savings Rate

Tech

Wall Street

- With more than 225 initial public offering deals expected to be compiled by December, this will be the busiest year for IPOs since 2001, said Linda Killian, a partner at Renaissance Capital, an independent research firm that focuses on the IPO market. Speaking last week at the 10th Annual Financial Advisor Symposium in Chicago, Killian said that the IPO market is experiencing, well, a renaissance that's a long way from the aftermath of the tech wreck. “We think our research has proven [IPOs] to be a valuable way to deliver both diversification and performance,” said Killian, whose firm provides IPO research for Wall Street brokerage houses, investment banks and institutional investors. Renaissance Capital is the advisor to the IPO Plus Aftermarket fund (IPOSX), which delivered a one-year return of 25.6% (as of Oct. 15) versus the S&P's 14.9% return. But it comes with a steep expense ratio of 2.50%, and its annual turnover rate of 260% makes it better suited for tax-advantaged retirement accounts. Killian's firm launched the Renaissance IPO Index in September, a float-weighted benchmark that tracks the IPO market, and she said Renaissance hopes to turn the index into a fund in the near future.
- Oct. 18 (Bloomberg) -- Billionaire Warren Buffett said his Berkshire Hathaway Inc. won't buy a stake in Bear Stearns Cos. and that mortgage lender Countrywide Financial Corp. still isn't cheap after falling 61 percent this year. Buffett also said Berkshire sold all its shares in PetroChina Co., a company that has been the target of a divestment campaign by human rights groups. **Buffett denied a New York Times report published last month that said he might buy as much as 20 percent of New York-**

based Bear Stearns, the fifth-largest U.S. securities firm, during an interview on News Corp.'s Fox Business Network. **“That was an incorrect story,” he said. “We were not taking a stake. That one had no basis.”** [then why did he wait 3 weeks to address it – answer because he like all the other powers that be are scared to death that this market is going to implode and he was doing his part to allow misinformation to influence the little guys into believing there would be a White Christmas in the Caymans] Didn't Buy Hovnanian The Berkshire chairman said he was in contact with Calabasas, California-based Countrywide as the company's stock fell in August amid a cash shortage brought on by the worst housing slump in 16 years. He never bought any shares of Countrywide or Hovnanian Enterprises Inc., the largest U.S. luxury homebuilder and the subject of takeover speculation. The Red Bank, New Jersey-based company has dropped 70 percent this year. Neither stock is undervalued, he said. **Buffett Avoids Bear Stearns, Countrywide** **Financial**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aScsDTnJd5M8&refer=home>

- Oct. 18 (Bloomberg) -- Bank of America Corp., the second-largest U.S. bank, plans to cut back investment banking after about \$4 billion in trading losses, defaults and writedowns caused third-quarter profit to drop 32 percent, more than analysts estimated. **Bank of America Earnings Drop on Loan Writedowns**
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aUbhXBucGiYw&refer=home>
- Oct. 15 (Bloomberg) -- Hong Kong's most expensive stock market in three years looks cheap to investors at Templeton Asset Management Ltd. and Baring Asset Management Inc. The Hang Seng Index, dominated by Chinese companies, traded at 19.2 times earnings last week, the highest since March 2004, after the benchmark rallied 41 percent since mid-August. That doesn't faze Templeton's Mark Mobius and Baring's Hayes Miller, who together oversee almost \$100 billion, because stocks in Shanghai are three times as expensive. **Based on cash flow, Hong Kong is the cheapest among the 20 biggest markets, data compiled by Bloomberg show. [maybe all those other markets are ridiculously valued too (and maybe the past is no indicator of future success when moving from a solid economy to a recessionary one)] “It's crazy to have that kind of a discount,” said Mobius, who's buying Hong Kong-listed shares of Chinese energy companies, banks and materials producers for the \$45 billion he oversees from Singapore. “The only way to describe it is obscene.” [concurring on “obscene” and “crazy” dissenting on in which direction]** Fund managers are getting more optimistic after the Chinese government said on Aug. 20 that some of its citizens will be allowed to invest in Hong Kong shares. Household savings in China total \$2.3 trillion and JPMorgan Chase & Co. estimates \$60 billion of that may flow into Hong Kong in the next year. The Hang Seng Index climbed 2.4 percent today to 29,540.78, **a record close. [yes a record close but an obscenely undervalued record close per Mr. Mobius]** Investors may be getting too optimistic because the policy changes haven't taken place yet, said Henderson Global Investors' Michael Kerley. Officials at China's bank regulator delayed the plan on Sept. 5, concerned about a potential exodus of funds from stock exchanges in Shanghai and Shenzhen. “I'm not a big believer in the arbitrage story,” said Kerley, who helps manage \$126 billion at London-based Henderson. “It's people buying

into the market on expectations instead of real money flows." Almost all of this year's **48 percent gain [yes but an obscenely low 48% gain]** took place since the government announcement. The Hang Seng advanced 3.6 percent last week and climbed above 29,000 for the first time. The 2007 gain compares with 40 percent for the Morgan Stanley Capital International Emerging Markets Index, 10 percent for the Standard & Poor's 500 Index and 7 percent for the Dow Jones Stoxx 600 Index of European shares. Cheaper Than China The 10 most expensive Hang Seng stocks include six companies based in Beijing, Shanghai or Shenzhen. **As of the previous close, their shares traded between 34.9 times and 62.8 times profit, Bloomberg data show. The same stocks are valued at 42.5 to 70.4 times on China's mainland exchanges. After more than tripling in the past year, shares in the Shanghai Composite Index traded at an average 50.7 times profit last month, the widest gap with the 40-member Hang Seng since the start of 2002. [still a bargain compared to Pets.com's infinite PE in 2000 – oh they went under you say – IGNORE the man behind the curtain, EVERYTHING is ALWAYS a buying op]** "That's going to be the benchmark for the domestic investor," said Miller, who helps manage \$48 billion at Baring in Boston. "There will be less and less of a distinction to be made between mainland China and the Hong Kong market. **This is kind of a one-off chance.**" **["this time it is different" but really really different because the last time it was different it really turned out to be not different at all]** Of the 45 Chinese companies with equities traded both at home and in Hong Kong, the so-called H shares are about 34 percent cheaper than their yuan-denominated A shares. Hong Kong is "a gateway to invest in China," said Fifth Third's Wirtz. "The opportunities are on the Hong Kong side of the coin because that's the cheap market relative to mainland China." **Hong Kong-China Stocks' 'Obscene' Gap Lures Investors**
<http://www.bloomberg.com/apps/news?pid=20601109&sid=anI76aDJGi6Y&refer=home>

- Oct. 15 (Bloomberg) -- Wilbur Ross, the billionaire who specializes in resurrecting failed companies, is betting the U.S. mortgage market will rise from the dead. "We're looking at everything that's in trouble," said Ross, founder of New York-based WL Ross & Co., in an interview. He **won [how about we check in next year this time and see what he really "won"]** an Oct. 5 auction for the home-loan servicing unit of Melville, New York-based American Home Mortgage Investment Corp. Ross agreed to pay between \$435 million and \$500 million for the right to collect payments and maintain escrow on about \$45.3 billion of mortgages from the biggest residential lender to go bust this year. The number of borrowers behind on their payments hit a five-year peak in the second quarter, the Mortgage Bankers Association reported. The figure may climb by the end of 2007 as interest rates jump for 450,000 borrowers with subprime adjustable mortgages, according to data compiled by UBS AG and Credit Suisse Group. Subprime mortgages go to borrowers with bad credit. Delinquent Borrowers Default rates of Alt-A mortgages are difficult to predict because they are a new product, said Steve Moyer, a director at Santa Monica, California-based Tennenbaum Capital Partners LLC, which oversees about \$7 billion. The same is true of adjustable-rate mortgages, he said. "Brave New World" Almost half the home loans made during the past two years were adjustable, according to Inside Mortgage Finance, a trade newsletter. That means borrowers pay a lower interest rate the first two or three years and higher rates later. "It will be a brave new world now for all of us, how those loans will perform with declining home prices," Moyer said. Most Loans Ever **The U.S. home-loan market has \$10 trillion of loans outstanding,**

the most ever, according to data compiled by the Federal Reserve. [and now the pipeline for selling that debt has stopped. How do you think that will work out Homer?] Subprime mortgages made up about 20 percent of the mortgages issued last year and about 11 percent in the first half of 2007, according to Inside Mortgage Finance. "There's nothing wrong with lending to weak credit," Ross said. **"There is something wrong with doing it at discount rates and without proper documentation and without conservative appraisals."** Ross won't predict how much longer tightened credit will pinch the mortgage industry. The time frame doesn't matter, said Kirsch of American Residential Equities. "He's not building for today, he's building on the future," Kirsch said. "He's banking on the fact it's a cycle and he'll be ready to roll when it comes around." Wilbur Ross Sees Mortgage Market Rise After Subprime
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aHDstMvtkhbA&refer=home>

Don't Fight The Fed

- Hong Kong's most expensive stock market in three years looks cheap to investors at Templeton Asset Management Ltd. and Baring Asset Management Inc. **[the Hang Seng will be cut in half- put it in 3 inch headlines]**
- "The market is telling you that there are going to be some difficulties in the near term," said Steve Gutch, the Rochester, New York-based research director at Clover Capital Management, which oversees \$2.6 billion and owns Wachovia shares. "A lot of the negative news is priced into the stock," said Gutch, who spoke before earnings were released. **[there is no such thing as bad news to these people, only buying opportunities.]**
- **The market for U.S. commercial paper expanded for a second straight week during the period ended Oct. 10 as investors regained their appetite for short-term debt. Corporate bond sales this year are nearing \$1 trillion. [yes, after dropping 314 billion (more than 15% of the total market) from July to September, in the week ended October 17, CP outstanding increased a robust 1.3 billion leaving it just 6.2 billion less than SEPT EOM]**

I Disagree . . . and why

Article of the week:

- I hope I am but I fear I'm not. More likely, the structural imbalances are *cumulative*, which is to say that the longer we push out the cyclical ebb and flow of the business cycle, the harsher the other side of that trade will be. **Ben Bernanke and Hank Paulson are no dummies. They understand that in a finance-based, debt dependent economy, we've already passed the point of no return.** That's why they shifted the rules at the discount window and jump-started "The Working Group for Financial Markets." They know the stakes and they're fighting for their livelihoods and legacies.
<http://www.minyanville.com/articles/1987-DJIA-google-baidu-morgan+stanley->

[bank+of+america-washington+mutual/index/a/14549](#) This is an excerpt from an article by Todd Harrison on a paid service (so I can't share the entire article). However, as you all know, I agree completely with the first two sentences in para 2.

UM EMBA