

## September 9, 2007 Review

### Comments

If all has gone well, you will be getting, in addition to the hard copy of this, a web link where you can go for past, current and future editions. The purpose of the website is a furtherance of this review – to share thought provoking commentary and articles that you will never get from the average “just send us your money and trust us” broker.

There will be plenty of time to discuss the website. However,

The time has come for all of you to think about the following:

Should you “buy the dip” because “the Fed will save us”? Before you do, get out your 2000-2 brokerage statements. Go through month by month and relive the pain and uncertainty that you lived through not knowing when the hell would end. Recall top to bottom the NASDAQ dropped 70%. Then recall the first rate cut was 50 basis points in January 2001 with the NASDAQ at 2,700. In October 2002 it hit 1,110.

Also, before you trust the fed, the Street, the government, etc., go through the “financial topics” website. Look at the nonsense they have been spewing the last year. Ask yourself, why should I trust ANY of them now?

Few if any of you are traders. I am. I would not be sharing my “the end is here” thoughts if I believed that we are about to see a six months or so drop on the way higher. I share these thoughts because I firmly believe that a “buy and hold” strategy is a disaster unfolding and the best time to get out of a bear market is RIGHT NOW. Don’t go down the first 20% and wish and hope. Don’t sell and then worry if the next week things bounce up. Get information from all sources you trust and make a decision for yourself. In May I wrote in these pages that I thought it likely the market would sell off, have a summer rally, sell again, have a failed rally and implode in the fall. We have just seen the failed rally. It is clear what I think the final step will be. However, in the finest tradition of Wall Street, I herein reiterate MY OPINION that:

**There will be a disastrous crash in the next six weeks or so. It will usher in a multi-year recession from which many 50 and older will never recover.** It has been foreseeable for years, only the timing in question. The reason the time is at hand? Because the Fed is impotent and the cut no matter what size will make that clear in short order. A cut will not cause credit quality to get better. A cut will lead to a knee jerk rally lasting between 20 minutes and 2 or 3 days. Then the carnage begins in earnest. When the August 16 lows break the market will go off a cliff.

As always – it is NOT my opinion that matters. I am not responsible for your financial future – YOU are. Hopefully these materials assist you in your decision making. As for crashes versus “buying opportunities”,

We will see . . .

## Credit

- Sept. 7 (Bloomberg) -- European Central Bank policy makers signaled their intention to raise interest rates further to contain inflation **once financial-market turbulence has abated**. The ECB is "in a process of adjusting interest rates" and "this process hasn't ended yet," council member Axel Weber said at a conference in Frankfurt today. The ECB and other central banks **have pumped more than \$400 billion into money markets to smooth lending between commercial banks. [and it is still not working, but such policies are very inflationary]** At the same time, the ECB has refused to shift its focus from fighting inflation as economic growth and declining unemployment leave companies with room to raise prices and wages. The ECB yesterday **added 42.2 billion euros** (\$57.7 billion) in emergency cash **as the U.S. housing slump threatened to curb economic growth**. [so European policy is addressing a problem the Fedheads say does not exist. The collapse of the U.S. subprime-mortgage market has made banks reluctant to lend, pushing up the cost of credit and causing turmoil on world financial markets. **Trichet Says ECB Determined to Act on Rates If Needed**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aS9QxLjXyCO8&refer=home>
- Sept. 6 (Bloomberg) -- Two regional Federal Reserve bank presidents declined to endorse a cut in the benchmark interest rate this month, as policy makers gauge the impact of the credit- market rout on the U.S. economy. **Atlanta Fed President Dennis Lockhart said he hasn't seen "conclusive" signs of a housing spillover into the broader economy and warned that inflation has yet to be contained. [should have waited a day for the employment report – a TRAILING indicator** St. Louis Fed President William Poole said it's not clear yet that the economy will "nose-dive" and he's not sure of the right response to housing and financial turmoil. The comments suggest some Fed officials may need more convincing before deciding to lower the main U.S. interest rate for the first time in four years when they meet Sept. 18. Most economists and investors expect the Fed to reduce the rate at least a quarter point from the current 5.25 percent to contain economic risks from housing and subprime-loan fallout. Lockhart won't vote on rates until 2009, while Poole is a voter on the Federal Open Market Committee this year. Poole was criticized by some analysts for saying in an Aug. 15 interview that only a "calamity" would justify lowering rates. Two days later, the Fed announced a surprise cut in its discount rate. Fed Chairman Ben S. Bernanke said Aug. 31 that the central bank will "act as needed to limit the adverse effects on the broader economy" from the tighter access to credit. The central bank today added \$31.25 billion to the banking system, the most in almost a month, amid continued stress in global financial markets. The European Central Bank pumped 42.2 billion euros (\$57.7 billion) into money markets today. No 'Spilling Over' Lockhart, 60, making his first speech on the economic outlook since succeeding Jack Guynn in March, said in Atlanta that "so far, I have not seen hard or soft data that provide conclusive signs that housing problems are spilling over into the broad economy." He cited "real-time information" from regional business contacts. Poole, speaking in London, said the Fed will not be "pushed into a decision." "What is not clear at this point is what the rate-policy response is to these changing events," said Poole, 70. "I don't think we should take for granted that the economy is going to nose-dive. It might be, but we need to gather every scrap of evidence. We just don't know

yet." Poole, a former Brown University economics professor, became the St. Louis Fed's president in 1998 and plans to retire next year. He dissented twice on interest rate decisions in 2001 and in 1998, each time in favor of tighter monetary policy. Three Concerns Lockhart said the Fed's current challenge is to balance three concerns: responding to economic risks, preserving gains against inflation and keeping the financial system stable. His comments indicate he may not yet see a reason to lower interest rates, as most economists and investors anticipate the Fed will do this month. Lockhart starts voting on rates in 2009. "Current readings of inflation represent progress, but not victory," Lockhart said, voicing concerns that Bernanke omitted from his last speech. "I would like to see inflation sustained at a somewhat lower rate -- with emphasis on 'sustained.' If inflation is allowed to accelerate, bringing it back down will be costly and painful." The Atlanta Fed chief said that while markets have responded "favorably" to the central bank's efforts to increase liquidity, "further volatility can not be ruled out." Still, he added that he's "confident that market conditions eventually will settle down." Poole said Fed officials "cannot be slaves to market expectations" for interest-rate cuts. "Having said that, the market expectation is important information for us and we should not ignore it," Poole said. FOMC Shift On Aug. 7, the Federal Open Market Committee voted to leave the main interest rate at 5.25 percent for the ninth straight time and reiterated that inflation was its main concern, though risks to economic growth had increased. Ten days later, the Fed was forced to cut the interest rate on direct loans to banks and shift its policy focus to growth. Bernanke said Aug. 31 that the central bank will do what's needed to prevent the credit-market rout from undoing the six-year economic expansion. He suggested the Fed is prepared to cut the so-called discount rate further or lower the key federal funds rate target as appropriate. "The balance of risk to the economy seems to have shifted," Lockhart said today. "We're facing greater uncertainty in the economic outlook." Two other Fed policy makers today didn't discuss the interest-rate outlook in their remarks. Fed Governor Randall Kroszner said turmoil in mortgage markets could further erode demand for housing in the U.S. and pose risks to the economy. San Francisco Fed President Janet Yellen said the financial turmoil illustrates how global markets can become volatile "suddenly." **Four Fed Bank Presidents Decline to Endorse Rate**

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- Sept. 6 (Bloomberg) -- **The European Central Bank pumped 42.2 billion euros (\$57.7 billion) into money markets to lower borrowing costs and said there's more to come as it shelved an increase in the benchmark interest rate.** Policy makers meeting in Frankfurt kept the refinancing rate at 4 percent, stepping back from an increase signaled on Aug. 2 by ECB President Jean-Claude Trichet, after the U.S. housing slump threatened to curb economic growth. "Financial-market volatility and reappraisal of risks over recent weeks have led to an increase in uncertainty," Trichet said today after the rate decision. "Given this high level of uncertainty, it's appropriate to gather additional information before drawing conclusions" on interest rates. The overnight deposit rate for euros fell the most in almost two weeks, to 4.05 percent, after the ECB loaned emergency cash to banks and Trichet said more funds will be provided. His comments, and the Bank of England's decision today to keep its main interest rate unchanged, came after an increase in the cost of credit that followed the collapse of U.S. subprime mortgages.

“The ECB finds itself in a dilemma,” said Rainer Guntermann, an economist at Dresdner Kleinwort in Frankfurt. “Economic fundamentals require at least one more rate increase and inflation concerns haven’t eased. On the other hand, it needs to deal with market turbulence.” Curbing Growth? Concern that defaults on U.S. home loans to people with poor credit histories would curb growth in the world’s largest economy prompted a slide in stock and commodity markets and pushed up corporate borrowing costs in early August. Central banks added more than \$400 billion to money markets since Aug. 9 to ease lending between banks. While those actions succeeded in reducing money-market rates for a time, by yesterday the overnight deposit rate for euros had climbed to 4.68 percent, the highest in six years. China ordered banks to put aside more money as reserves for the seventh time this year to cool lending and investment after inflation accelerated to a 10-year high. The country’s economy expanded 11.9 percent in the second quarter from a year earlier, the fastest pace in more than 12 year **ECB Pumps Extra Cash Into Markets, Shelves Rate Increase**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aRWTBNSxi47g&refer=home>

- Sept. 6 (Bloomberg) -- The Reserve Bank of Australia has widened the range of securities it's willing to buy to boost the amount of money available in the nation's banking system, as global money market rates climbed. Bank bills, top-rated bonds backed by residential mortgages and asset-backed commercial paper will be eligible for repurchase agreements, the central bank said today in a statement on its Web site. The Bank of Japan refrained from adjusting funds in the financial system today. Central banks in the U.K. and Europe yesterday injected funds into money markets to reign in borrowing costs, which climbed on concern finance companies will report further losses related to U.S. subprime mortgage defaults. The interest rate banks charge each other to borrow for three months in Australian dollar is at 7.065 percent, the highest in 11 years. “This will put a bit of calm back into the markets and improve the liquidity situation,” said Mark Bayley director of credit and structuring at ABN Amro Holding NV in Sydney. Central banks buy securities in so-called repurchase agreements, or repos, for a set period. At maturity, the securities and the cash are returned to the central bank.

**Reserve Bank of Australia Pledges Funds to Banks**

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- Sept. 6 (Bloomberg) -- The global credit rout, sparked by the U.S. subprime mortgage slump, may leave as much as \$34 billion of leveraged loans for railroads, tollways and other infrastructure projects “paralyzed,” according to analysts at Standard & Poor's. Surging appetite for infrastructure assets prompted the takeover of U.K. airport operator BAA Plc by Grupo Ferrovial SA, a Spanish construction company, and the acquisition of Associated British Ports Holdings Plc by Goldman Sachs Group Inc. last year. Banks, saddled with as much as \$332 billion of unsold leveraged loans, will now likely refrain from lending to infrastructure projects. “With the credit cycle turning, loosely structured and highly leveraged acquisition loans are looking shaky,” wrote Mike Wilkins, a London-based analyst at S&P, in a report published today. “Risks are likely to be exacerbated as credit markets become increasingly volatile and investor confidence fragile.” By loosening borrowing restrictions, or covenants, banks allowed infrastructure funds to increase debt levels and bid up the price of assets such as airports and utilities,

the report said. **Global Credit Rout May Paralyze Infrastructure Loans, S&P Says**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=adZRI14cRT2I&refer=home>

- Sept. 4 (Bloomberg) -- Standard & Poor's bought two businesses to improve its ability to analyze structured-finance transactions, as credit services face criticism for being slow to lower some bond ratings. Imake Consulting makes software that banks and accounting firms use to value structured finance deals, S&P said in a statement today. ABSXchange's Web site provides data and cash flow analysis. Terms of the purchase by S&P, the debt rating service owned by McGraw-Hill Cos., weren't disclosed. The closely held companies, founded by Trami Tran, are in Bethesda, Maryland. Standard & Poor's named a new president, Deven Sharma, last week after lawmakers and investors criticized the company for failing to judge the risks of securities backed by subprime mortgages. The structured-finance market includes residential mortgage-backed securities. S&P and Moody's Investors Service, both based in New York, failed to downgrade bonds backed by loans made in 2006 to subprime borrowers until July, when some securities had already lost more than 50 cents on the dollar. Subprime loans are made to borrowers with poor credit or high levels of debt. **Standard & Poor's Buys Companies for Debt Analysis**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a64URXoPtL40&refer=home>
- 4 SEPT - **[it is substantial – more on the order of coconspirators than aider and abettor]** Charlie McCreevy, the Internal Market Commissioner, will talk to members of the Committee of European Securities Regulators on Wednesday after asking last week for an urgent meeting to examine the turmoil of this summer. It will provide an opportunity for the regulators who advise the European Commission on securities legislation to give their assessment of recent events. They also will update Mr McCreevy on the report on rating agencies that he commissioned from them last year, which will be ready early next year. The former Irish Finance Minister has never hidden his reluctance to legislate on financial services, preferring softer measures, such as self-regulation. One European official said: “The fact that someone has lost money on the markets does not mean something has to be regulated.” In the past, however, Mr **European authorities are to step up their investigations into the responsibility of credit-rating agencies in the sub-prime mortgage crisis, as demands grow for greater regulatory control of their activities.** McCreevy has told the agencies, which award ratings for certain types of debt obligations, that they must improve their performance. He has questioned whether they suffer from a conflict of interest and has raised doubts over the quality of their judgment and whether they respond to changing events with sufficient speed. Mr McCreevy will also face calls on Wednesday from the European Parliament for the EU to require rating agencies to operate more transparently. Socialist MEPs have tabled a debate on the sub-prime crisis and will argue that the underlying problems stem from a lack of clear regulation. Pervenche Berès, a French Socialist who chairs the Parliament’s Economic and Monetary Affairs Committee, had asked Neelie Kroes, the Competition Commissioner, before summer to conduct an inquiry into rating agencies. The latest events are expected to reinforce that demand **Credit-rating agencies to be the subject of sharp scrutiny in Europe .**

[http://business.timesonline.co.uk/tol/business/industry\\_sectors/banking\\_and\\_finance/article2373869.ece?EMC-B1tn](http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article2373869.ece?EMC-B1tn)

- 4 Sept - The cost to banks of borrowing money over a three-month period hit a near-ten-year high yesterday as Britain's biggest financial institutions searched for medium-term funding to help them to ride out the turbulence in the credit markets. **The London interbank offered rate (Libor) for three-month sterling reached 6.74 per cent, beating last Friday's record. It is the highest since the Long Term Capital Management hedge fund crash sent shivers through markets in December 1998.** Barclays disclosed that it was paying the highest rate of all banks for three-month money, estimating that it would cost the bank 6.8 per cent – more than the Bank of England's 6.75 per cent penalty rate – to borrow sterling. That failed to dampen the bank's share price, which leapt almost 4 per cent to close at 638p yesterday after Bob Diamond, the chief executive of Barclays Capital, reassured the market that the bank had not made significant losses in the recent market turmoil. Meanwhile, Kensington, bought in May by Investec for £273 million, is the latest mortgage lender to react to rocketing Libor and a growing distaste among investors for risky mortgage-backed securities. The sub-prime specialist told brokers that its variable rate would rise from 7 to 7.8 per cent on Friday. It said that it planned to reprice and tighten the lending criteria on mortgages for people with a bad credit history. **Market turbulence sends up borrowing rates for banks**  
[http://business.timesonline.co.uk/tol/business/industry\\_sectors/banking\\_and\\_finance/article2381584.ece?EMC-B1tn](http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article2381584.ece?EMC-B1tn)
- Sept. 4 (Bloomberg) -- Synapse Investment Management LLC, the London-based hedge-fund manager which oversaw money for Landesbank Sachsen Girozentrale, shut one of three fixed-income funds because of "severe illiquidity" in the market. The Synapse High Grade ABS Fund was closed and some assets have already been sold off, said Mark Holman, who helped found the company last year with Graeme Anderson. The fund, whose main investor was Leipzig, Germany-based SachsenLB, didn't have any assets in U.S. subprime investments, he said. "We are going to look at starting new funds," Holman said in a telephone interview. "There are **enormous opportunities in the ABS market [everything is ALWAYS a buying opportunity - NOW – there is no such thing as waiting for a better day] caused by this enormous deleveraging and we intend to return with a fund that can exploit them.**" [let's see you are closing your current efforts because you mismanaged the market, but the good news is you can be relied on to now know a good opportunity and capitalize on it] Synapse had 500 million euros (\$681 million) under management in three funds at the end of July, according to its Web site, and now oversees about 300 million euros in its two remaining funds, Holman said. No one will lose his job at the company as a result of the fund closure, he said. Synapse joins a growing list of hedge fund casualties. Basis Capital Fund Management Ltd., based in Sydney, filed for bankruptcy protection last week for its Yield Alpha fund after the company said investment losses may exceed 80 percent because of defaults from mortgages to people with poor credit histories. Bear Stearns Cos., the fifth-biggest U.S. securities firm by market value, also has been forced to shut hedge funds. **Synapse Shuts Fund Because of Market 'Illiquidity'**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=alSAL.VqDIk4&refer=home>

## Commercial Real Estate

- Sept. 5 (Bloomberg) -- U.S. commercial real estate prices may fall as much as 15 percent over the next year in the broadest decline since the 2001 recession as rising borrowing costs force property owners to accept less or postpone sales. "People aren't willing to do deals right now," said Howard Michaels, the New York-based chairman of Carlton Advisory Services Inc., which has arranged financing for real estate purchases including the Lipstick Building in midtown Manhattan. "The expectation is that prices will come down." Investors in July bought the fewest commercial properties since August 2006 and apartment building acquisitions were down 50 percent from June, data compiled by industry consultants at New York-based Real Capital Analytics Inc. show. Archstone-Smith Trust in August postponed its \$13.5 billion sale to a group led by Tishman Speyer Properties LP until October. Mission West Properties Inc., the owner of commercial buildings in Silicon Valley, said on Aug. 13 that the company's \$1.8 billion sale may fail after a bank withdrew funding. "**There are so many deals falling apart,**" said David Lichtenstein, chief executive officer of Lakewood, New Jersey-based Lightstone Group, an owner of more than 20,000 apartments and 30 million square feet of office and retail space. "**People who can get out are getting out.**" Higher Costs About 930 commercial real estate transactions valued at \$5 million or more closed in July, preliminary data from Real Capital show. That count could climb as much as 15 percent when all of the month's deals are tallied, which would still be the lowest this year, said Dan Fasulo, director of market analysis for Real Capital. Average prices for commercial properties might drop 5 percent to 15 percent in the next two years depending on the type of property and its quality and location, said Matthew Ostrower, an industry analyst at New York-based Morgan Stanley, the second-largest U.S. securities firm by market value. Michael Knott, a senior analyst at Green Street Advisors Inc., a real estate research firm in Newport Beach, California, **estimates commercial prices may fall about 10 percent in the next 12 to 18 months and up to 15 percent in the office market during that period.** Shares Fall The Bloomberg Office Property Index fell as much as 2.7 percent, led by SL Green Realty Corp., Manhattan's largest office landlord. Commercial real estate brokers and managers declined. CB Richard Ellis Group Inc., the biggest commercial broker, dropped as much as 9.7 percent. Jones Lang LaSalle Inc., the second-largest, fell as much as 3.5 percent. Commercial mortgage rates have climbed as defaults rose in the subprime part of the residential real estate market. About six months ago, a 30-year commercial loan with 5 to 10 years of interest-only payments would have cost the borrower about 120 basis points more than the yield of the 10-year Treasury note. A similar loan would now cost about 160 to 200 basis points more than the 10-year Treasury's yield of 4.6 percent, data compiled by New York-based Cushman & Wakefield Sonnenblick Goldman show. The increase has halted a rally that lifted prices for office buildings, apartments and hotels to records this year. **The average price paid for high-quality office properties in city centers reached \$291 a square foot, up from \$188 in 2005 and almost double the average \$152 in 2001,** Real Capital reported. **[a/k/a a bubble]** Capitalization Rates Real estate investors typically purchase properties with the expectation that the yield will outstrip conventional investments and make their financing affordable. When prices for prime urban office buildings fell in 2002, capitalization rates, or a property's net operating income divided by the purchase price, rose to an average 9.25 percent,

according to Chicago-based data provider Real Estate Research Corp. That was almost 500 basis points more than the average rate of 10-year Treasury bonds at the time. Such yields attracted investors and by this year's first quarter, the average cap rate had fallen to 6.5 percent. New York-based Blackstone Group LP, manager of the world's largest buyout fund, purchased Sam Zell's Equity Office Properties Trust for \$23 billion in February to gain about 540 office buildings in the U.S. That worked out to a capitalization rate of about 5.3 percent, a record low for an acquisition of a real estate investment trust, according to Green Street Advisors. Including debt, the price was \$39 billion. `Fear in the System' Regency Centers Corp. lost an equity partner in May for the \$80 million purchase of four shopping centers in Florida because financing costs exceeded the projected cash flow, said CEO Martin ``Hap" Stein in an interview. Jacksonville, Florida- based Regency is the third-largest company by market value in the Bloomberg REIT Shopping Center index. ``You've got a lot of fear in the system from the capital markets," Stein said. ``**As far as the pricing of credit, it was greed six months ago and it's fear today.**" [wait and see how much fear there is in 18 months] Tighter credit standards at banks has given an advantage to investors with ample cash, said Joaquin de Monet, CEO of General Electric Co.'s Arden Realty Inc. All-cash buyers might include insurance companies, pension funds and REITs. **Commercial Real Estate in U.S. Poised for Price Drop**  
<http://www.bloomberg.com/apps/news?pid=20601206&sid=aBsr6uF2r7bw&refer=real estate>

## Commodities

- Sept. 4 (Bloomberg) -- Crude oil rose above \$75 a barrel in New York for the first time in a month on speculation U.S. oil and gasoline supplies fell last week and signs that OPEC won't raise output when ministers meet. The days of gasoline supply available in the week ended Aug. 24 were the lowest since at least 1991, the Energy Department said last week. Libya became the third OPEC member this week to recommend the group leave production targets unchanged when it meets on Sept. 11. The organization, which produces 40 percent of the world's oil, cut output twice last year to bolster prices. **Crude Oil Rises Above \$75 in N.Y. on Signs of U.S. Supply Drop**  
[http://www.bloomberg.com/apps/news?pid=20601087&sid=a1CjD7y\\_OnsA&refer=home](http://www.bloomberg.com/apps/news?pid=20601087&sid=a1CjD7y_OnsA&refer=home)

## Currency

- Sept. 6 (Bloomberg) -- European Central Bank President Jean- Claude Trichet said the bank is waiting to see what effect the global financial-market turmoil will have on economic growth before deciding whether to raise interest rates further. ``Financial-market volatility and reappraisal of risks over recent weeks have led to an increase in uncertainty," Trichet said at a press conference in Frankfurt today. ``Given this high level of uncertainty it's appropriate to gather additional information before drawing conclusions" on interest rates. The ECB left its key rate at 4 percent today and added

42.2 billion euros (\$57.7 billion) in emergency cash as the U.S. housing slump threatened to curb economic growth. The collapse of the U.S. subprime-mortgage market has made banks reluctant to lend, pushing up the cost of credit and causing turmoil on world financial markets. The ECB governing council will "pay great attention" to all developments on financial markets, Trichet said today. He said the key rate is "still on the accommodative side." "Acting in a firm and timely manner, we will ensure that risks to price stability don't materialize," he said. "This is all the more important at times of financial-market volatility and increased volatility." **Trichet Says ECB Awaits Data Before Deciding on Rates [if your remains static and the Fed cuts, you can kiss the dollar goodbye. BUY GOLD]**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=a.OjU6ugGBNs&refer=home>

- Sept. 3 (Bloomberg) -- Hugo Chavez's economy is starting to unravel in the currency market. While Venezuela earns record proceeds from oil exports, consumers face shortages of meat, flour and cooking oil. Annual inflation has risen to 16 percent, the highest in Latin America, as President Chavez tripled government spending in four years. Exxon Mobil Corp. and ConocoPhillips are pulling out after Chavez demanded they cede control of joint venture projects. The currency, the bolivar, has tumbled 28 percent this year to 4,750 per dollar on the black market, the only place it trades freely because of government controls on foreign exchange. That's less than half the official rate of 2,150 set in 2005. Chavez may have to devalue the bolivar to reduce the gap and increase oil proceeds that make up half the state's revenue. **Chavez Economy Unravels as Venezuela Currency Weakens [wow a weak currency hurting an economy – thank goodness that could never happen here]**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aTUqRT3KYeY0&refer=home>

## Diversification

## Derivatives

## Housing

- Sept. 6 (Bloomberg) -- **The number of Americans who may lose their homes to foreclosure reached a record in the second quarter as late payments by subprime borrowers surged to one out of every seven loans.** Lenders began the process of seizing properties on 0.65 percent of U.S. mortgages in the second quarter, an all-time high, the Mortgage Bankers Association said in a report today. In the first quarter, that figure was 0.58 percent. The percentage of subprime borrowers making late payments increased to 14.82 from 13.77. Foreclosures are rising as real estate prices tumble in a third of U.S. real estate markets tracked by the National Association of Realtors and as state and federal lawmakers seek to stem delinquencies. Investors have abandoned the market for mortgage backed securities, spurring 100 home loan companies to halt operations or seek buyers. The ensuing scarcity of credit is making things worse, said Doug Duncan, MBA's chief economist. "We will see delinquencies and foreclosures rise for another quarter or so," Duncan said on a conference call today. "Home prices are

falling as rates are resetting higher, making it difficult for people to refinance." Fed Action President George W. Bush last week directed the Federal Housing Administration to guarantee loans for delinquent low-and middle-income borrowers. The Federal Reserve has cut the interest rate it charges banks by half a percentage point to 5.75 percent to help reduce the liquidity crisis and Chairman Ben Bernanke has said the central bank will do what's needed to prevent a credit rout. Senate Banking Committee Chairman Christopher Dodd unveiled legislation yesterday to strengthen protection for mortgage borrowers, including banning lenders from steering borrowers into subprime loans when they qualify for prime loans. **"People are losing their homes because of the lending practices that are out there that are indefensible in my view,"** Dodd said today in a conference call with reporters. **[the government – a day late and a dollar short]** About half of U.S. banks have raised their standards for subprime borrowers and 14 percent have made it more difficult for the most credit-worthy customers to get financing, the Federal Reserve said in July. **'Irrational Borrowing'** Almost half of the foreclosures started during the quarter were on subprime adjustable-rate mortgages, said Jay Brinkmann, vice president of research and economics for the Washington-based bankers trade group. Those types of loans represent just 7.3 percent of all outstanding mortgages, he said. **"We've got a history of irrational borrowing, irrational lending, irrational homebuilding, and we now are getting an irrational market response to these numbers,"** **[what is irrational is a belief that this problem is anywhere near over. Those getting out now will do better than those who hag around]** Brinkmann said in an interview. Investors and lawmakers have reacted to the jump in foreclosures without considering that most homeowners are paying their loans on time, he said. Late payments of all types of mortgages rose to 5.12 percent, the highest since the second quarter of 2002, when it was 5.27 percent, the bankers group said. Delinquencies were at a 28-year low of 3.72 percent in the first quarter of 2000, the beginning of a five-year real estate boom. Subprime borrowers with adjustable-rate loans made late payments at a rate of 16.95 percent in the recent quarter, up from 15.75 percent in 2007's first three months. The delinquent share of fixed-rate subprime loans was 10.99 percent, up from 10.25 percent. **"The assumption was that home prices would go up forever, which of course is never a good bet to make,"** Bethune said. The median price for a previously owned home in the U.S. likely will slip 1.2 percent in 2007 to \$219,300, the first national decline on record, and the new-home median likely will drop 2.3 percent to \$240,800, the first decrease in 16 years, according to an Aug. 8 forecast by the National Association of Realtors. Sales of previously owned homes probably will fall 6.8 percent to 6.04 million in 2007, the lowest since 2002, the trade group said. **Sales of new homes, which make up about 15 percent of the housing market, probably will tumble 19 percent to 852,000, a 10-year low, the Chicago-based trade group said.** The Mortgage Bankers report is based on a survey of 44.2 million loans by mortgage companies, commercial banks, thrifts, credit unions and other financial institutions. **U.S. Home Foreclosures, Delinquencies at Record High**

[http://www.bloomberg.com/apps/news?pid=20601206&sid=a0V97a\\_RmiMY&refer=realstate](http://www.bloomberg.com/apps/news?pid=20601206&sid=a0V97a_RmiMY&refer=realstate)

## Housing Finance

- Sept. 6 (Bloomberg) -- WarehouseOne, the New Jersey firm that specializes in financing smaller mortgage companies, stopped offering so-called warehouse loans until markets improve. **The company, which provides credit used by about 100 mortgage banks, is ``winding down'' for now because loans ``destined'' for certain buyers aren't being bought at agreed-upon prices,** President Gary Hoyer said. Some buyers such as American Home Mortgage Investment Corp. and First Magnus Financial Corp. failed, while others such as Bear Stearns Cos. and Morgan Stanley backed out of commitments to buy the loans, which Trenton-based WarehouseOne uses as collateral, he said. **``It doesn't matter if they're in business or not in business, they're just not reliable in terms of being counterparties right now,"** Hoyer said in a telephone interview today. **``You bang your head against the wall a couple of times and you realize it feels good when you stop."** More than 100 mortgage companies have been forced to close, shut operations or find buyers since the start of last year as foreclosures rose to a record. NovaStar Financial Inc., the Kansas City, Missouri-based subprime lender, and Regions Financial Corp., the Birmingham, Alabama-based bank, also have shut warehouse-lending units this year. Buyers have sought ways to back out of agreements to purchase mortgages because resale prices have plunged amid falling demand for securities backed by home loans, David Lykken, president of Austin, Texas-based mortgage consulting firm MBSD LLC, said in an interview last week. **``This happens in every major meltdown,"** he said. **WarehouseOne Halts Mortgage Bank Loans, Blames Buyers** <http://www.bloomberg.com/apps/news?pid=20601208&sid=aBYW7ZCp4rhw&refer=finance>
- Sept. 6 (Bloomberg) -- H&R Block Inc. shareholders elected hedge-fund manager Richard Breeden to the board, **putting more pressure on the company to shut its subprime mortgage unit** and divest others not tied to the business of preparing tax returns. **Breeden has pressed Chief Executive Officer Mark Ernst to close money-losing Option One Mortgage Corp.,** rather than waiting to complete a sale that may take until the end of this year. While Cerberus Capital Management LP has agreed to buy Option One, prospects for the sale have dimmed as subprime defaults rose and deals for rival lenders including Accredited Home Lenders Holding Co. collapsed. **``Uncertainty and Jeopardy' ``Breeden will not have an easy ride because Option One is still there,"** said Scott Schneeberger, an analyst at CIBC World Markets Inc., in an interview last week. **``When he started his campaign to join the board, the sale looked set to happen. Now it's in complete uncertainty and jeopardy." Breeden said dealing with Option One will be the first item of business when he sits with the board. ``Whether it happens one month from now or two months, Option One will be gone,"** he said. **Ernst said last week he will consider closing Option One if the sale isn't completed by the end of the year.** He said he's asked Cerberus to modify the deal, possibly including only the mortgage servicing business that handles billing and collections while closing the lending platform. Ernst said today that the sale will be concluded at the end of December. If Cerberus decides by then that the original accord has been violated and walks out, that would be fine for H&R Block, Ernst said. The company will no longer inject cash to prop up the business, keeping operations to a minimum until the end of the year, he said. Mortgage Losses **Option One, which H&R Block bought in 1997, has generated more than \$1**

**billion in losses for the company in the past five quarters. H&R Block Elects Breeden Slate as Sale Prospects Dim**

<http://www.bloomberg.com/apps/news?pid=20601208&sid=aymUGJFe6.z0&refer=finance>

- Sept. 6 (Bloomberg) -- Lehman Brothers Holdings Inc., **the brokerage that shut its subprime mortgage business last month, is cutting 850 more jobs**, [focus on the word more and then look at the point later in the story where they now have it right. We will see won't we] mostly at a U.S. subsidiary catering to borrowers with better credit scores, as the nation's faltering housing market takes its toll on Wall Street. Lehman, the biggest underwriter of U.S. mortgage bonds, is also closing its Korean home loan business, the New York-based firm said in a statement today. The bulk of the firing will be at Aurora Loan Services LLC, the U.S. unit that makes so-called Alt- A loans to borrowers whose credit ratings fall just short of standards for regular prime mortgages. National City Corp., Ohio's largest bank, said today that it too would sever 800 employees and take a \$200 million pretax charge in the third-quarter because of losses in its mortgage business. ``As the outlook in these parts of the mortgage market remain negative, it makes sense to cut down capacity," said Brad Hintz, an analyst at Sanford C. Bernstein & Co. in New York, referring to Lehman's announcement. ``This is good, solid management doing what it should be doing." Home loans to borrowers with poor credit histories and heavy debt loads are coming back to haunt securities firms and banks, after helping fuel the U.S. housing boom this decade. Brokerages including Lehman and Bear Stearns Cos. profited by packaging the loans into highly rated bonds. Now investors are shunning the securities, after late payments rose during the first quarter to the highest level in more than four years. `Sized Correctly' During the next three months, the number of Americans at risk of losing their homes to foreclosure reached a record, as late payments by subprime borrowers surged to one out of every seven loans, the Mortgage Bankers Association said today. In August, Lehman said it would close its U.S. subprime-mortgage unit, resulting in 1,200 job losses and \$54 million in costs. ``We now have a business that is sized correctly for the current environment," said Ted Janulis, global head of mortgages at Lehman, in the company's statement. ``We will continue to look at other origination opportunities in global markets." **Lehman Brothers to Cut 850 More Jobs in Mortgage Unit**

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

- Sept. 6 (Bloomberg) -- The number of Americans who may lose their homes to foreclosure rose to a record in the second quarter and late payments by subprime borrowers surged to one out of every seven loans. The share of all U.S. mortgages entering foreclosure rose to 0.65 percent in the second quarter, an all-time high, from 0.58 percent in 2007's first three months, the Mortgage Bankers Association said in a report today. The number of subprime borrowers making late payments rose to 14.82 percent from 13.77 percent. In the quarter, 2.73 percent of prime borrowers made their mortgage payments at least 30 days late, up from 2.58 percent in the first quarter, the report said. The Mortgage Bankers report is based on a survey of 44.2 million loans by mortgage companies, commercial banks, thrifts, credit unions and other financial institutions. **U.S. Mortgage Foreclosures, Delinquencies at Record, MBA Says**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=a0K8kRi1AnHw&refer=home>

- Sept 5 - WASHINGTON (AP) -- **A third of home loans** originated by mortgage brokers failed to close in August as investors shied away from riskier borrowers, a new survey says. The survey of 1,700 mortgage brokers sponsored by trade publication Inside Mortgage Finance comes as numerous lenders that catered to subprime borrowers with weak credit close down and lenders back away from riskier lending practices common in recent years. "There's a problem with funding commitments not being honored," by lenders, said Thomas Popik, who designed the survey for Washington-based research firm Campbell Communications. Three years ago, Popik said, a survey of real estate agents found that **only 4 percent** of transactions failed to close on average. **The survey also found that some homebuyers backed away from deals last month.** Some may be waiting to see if market improves, while some sales may fall apart because sellers are unable to get financing for their new home, Popik said, noting that sales agreements often are contingent on buyers selling their current home. The survey also found that nearly half of borrowers with adjustable rate mortgages were not able to refinance their loans. That's a major concern of policymakers as an estimated that 2.5 million mortgages given to borrowers with weak credit will reset at higher rates by the end of next year, according to the Federal Deposit Insurance Corp. Mortgage brokers account for about one-third of total mortgage originations, and have originated a larger share of loans to riskier borrowers, so the percentage of failed loans in the entire market may be smaller. Nevertheless, the results provide another indication of how the housing market's troubles are continuing. Total subprime lending was down more than 50 percent in the first half of the year as lenders pulled back from risky loans. Countrywide Financial Corp. was the top subprime lender, followed by Citigroup Inc., HSBC Holdings PLC, Merrill Lynch & Co. subsidiary First Franklin Financial Corp. and Wells Fargo & Co, according to Inside Mortgage Finance **Mortgage Broker Survey Finds 33 Percent of Home Loans Failed to Close Last Month** [http://biz.yahoo.com/ap/070905/home\\_loan\\_survey.html?.v=1](http://biz.yahoo.com/ap/070905/home_loan_survey.html?.v=1)
- Sept. 4 (Bloomberg) -- U.S. bank regulators facing the worst housing slump in 16 years called on mortgage lenders to stave off foreclosures by easing cash-strapped borrowers' home payments. The Federal Reserve and the Treasury Department asked companies that process mortgage payments to identify homeowners at risk of falling behind when their loans "reset" to higher interest rates, the agencies said in a joint statement today. Lenders should try to refinance at lower rates to keep families from losing their homes, the regulators said. "We encourage servicers of securitized mortgages to reach out to financially stressed homeowners," Fed Governor Randall Kroszner said in a statement. The recommendation underscores the federal government's concern that the subprime-mortgage market's collapse could hurt the broader U.S. economy. Late payments by homeowners with poor credit histories or heavy debt loads rose to almost 14 percent of U.S. subprime mortgages during the first quarter, the highest in more than four years. Investor aversion to securities backed by home loans has spread to other high-yield, high-risk corporate bonds, making it harder for companies to raise money. "Unprecedented" Move The public move by the regulators is "extraordinarily unprecedented" since regulators have historically made such recommendations behind the scenes, said Gilbert Schwartz, a former associate general counsel at the Fed. Regulators are taking a voluntary approach since "securitization transactions are contractual in nature" and

“regulators can't force institutions to breach these contracts,” said Schwartz, now a partner at Schwartz & Ballen LLP in Washington. “This essentially is a signal to financial institutions that we won't criticize you if you incur expenses or losses for providing assistance to borrowers,” Schwartz said. **Regulators Urge Refinancing of Securitized Mortgages**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aJGlt0ZWoiXY&refer=home>

## Macro Economic

- Sept. 7 (Bloomberg) -- The U.S. economy unexpectedly lost jobs in August for the first time in four years, raising the risk the economy may stall in the second half and serving as a warning for the Federal Reserve to lower interest rates. **Employers cut 4,000 workers from payrolls, compared with a revised gain of 68,000 in July that was smaller than previously reported, the Labor Department said today in Washington. The unemployment rate held at 4.6 percent as almost 600,000 people left the workforce.** “Rate cuts will be right around the corner,” Chris Rupkey, senior financial economist at Bank of Tokyo Mitsubishi UFJ Ltd. in New York, said before the report. “At this stage, they don't need the cover of any more weak economic data to act.” **The drop in jobs is the clearest sign yet that the deepening housing recession and turmoil in credit markets are hurting the wider economy.** Payrolls are one of the main factors, along with sales, incomes and production, that help determine the starting point of economic contractions, and today's report may raise the odds the Fed reduces rates even before the Sept. 18 meeting. Economists surveyed by Bloomberg News had forecast that payrolls rose 100,000 during the month, according to the median of 88 estimates, compared with an originally reported 92,000 gain in July. None of the analysts foresaw a decline, as predictions ranged from 35,000 to 140,000. Revisions subtracted 81,000 workers from payroll figures previously reported for June and July. Wages gained 3.9 percent in August from a year earlier. Workers' average hourly earnings rose 5 cents, or 0.3 percent, after a 0.3 percent increase the previous month. Source of Losses  
Manufacturers, builders and the government led the drop in payrolls last month. Factory payrolls slid by 46,000, the most since July 2003, after slipping 1,000 a month earlier. Economists had forecast a drop of 10,000 in manufacturing employment. Payrolls at builders dropped by 22,000 after falling 14,000 a month earlier. Government payrolls decreased by 28,000. Service industries, which include banks, insurance companies, restaurants and retailers, added 60,000 workers last month after boosting payrolls by 78,000 in July, the report showed. Retailers added 12,500 jobs after hiring 5,000 in July. Average weekly hours worked by production workers held at 33.8. Average weekly earnings gained to \$591.50 last month from \$589.81 the prior month. Fed Chairman Ben S. Bernanke last week said the central bank would do what's needed to prevent the credit-market turmoil from undoing the six-year economic expansion. “Act as Needed” The Fed “continues to monitor the situation and will act as needed to limit the adverse effects on the broader economy that may arise from the disruptions in financial markets,” he said at the Kansas City Fed's annual symposium in Jackson Hole, Wyoming. Bernanke said the

Fed would "pay particularly close attention to the timeliest indicators" since data prior to August didn't capture the credit crisis. Futures contracts are pricing a certain cut in the benchmark federal funds rate at the central bank's policy meeting Sept. 18. The Labor Department's employment survey of businesses covers the week of Aug. 12, at the height of the decline in global stock markets, suggesting the figures won't reflect the full extent of the damage done by the subprime tumult. Job and wage growth are needed to help sustain consumer spending, which accounts for more than two-thirds of the economy, as home values fall and loans become more difficult to get. Spending slowed to a 1.4 percent annual pace in the second quarter, down from 3.7 percent the previous three months. Paring Workforce First American Corp., the largest U.S. title insurer, said this week it would cut 1,300 jobs, or about 3 percent of its workforce, to reduce costs as home sales slow. LandAmerica Financial Group Inc., a Richmond, Virginia-based title insurer, said Aug. 28 it will eliminate 1,100 jobs in the second half of 2007 to reduce costs as mortgage originations decline. Lehman Brothers Holdings Inc. and Accredited Home Lenders Holding Co., both in the U.S., and HSBC Holdings Plc in London said last month they would cut a total of 3,400 jobs as tremors from the collapse of the subprime-loan market spread through the economy. At least 15 mortgage companies have filed for bankruptcy and about 50 have stopped lending or shut down entirely. Declines in residential construction have detracted from overall growth for the last six quarters, and the housing slump is prompting economists to warn of rising risks of recession. Harvard University economist Martin Feldstein, who heads the group that dates U.S. contractions, said Aug. 31 there is a "significant risk" of a recession. "Downturns in housing construction have almost always been followed by a downturn in the economy, by a recession," Feldstein said in an interview from Jackson Hole. "My judgment is there is enough of a risk that the Federal Reserve should be responding to that risk" by cutting interest rates. **U.S. Payrolls Fell 4,000 in August; Jobless Rate Holds at 4.6%**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ajhV9Gbe1GOo&refer=home>

- Sept. 6 (Bloomberg) -- Federal Reserve Bank of Atlanta President Dennis Lockhart said he hasn't seen conclusive signs that the U.S. housing recession has harmed the wider economy and warned that inflation has yet to be contained. "So far, I have not seen hard or soft data that provide conclusive signs that housing problems are spilling over into the broad economy," Lockhart said in his first speech on the economic outlook since taking office in March. He cited "real-time information" from regional business contacts. Lockhart said the Fed's current challenge is to balance three concerns: responding to economic risks, preserving gains against inflation and keeping the financial system stable. His comments indicate he may not yet see a reason to lower interest rates, as most economists and investors anticipate the Fed will do this month. Lockhart starts voting on rates in 2009. "Current readings of inflation represent progress, but not victory," Lockhart said, voicing concerns that Fed Chairman Ben S. Bernanke omitted from his most recent speech, on Aug. 31. "I would like to see inflation sustained at a somewhat lower rate -- with emphasis on 'sustained.' If inflation is allowed to accelerate, bringing it back down will be costly and painful." Lockhart, 60, succeeded Jack Guynn, who always voted with the majority on interest-rate decisions and retired last October. "Settle Down" The Atlanta Fed chief said that while markets have responded "favorably" to the central bank's efforts to increase liquidity, "further volatility can not be ruled out." Still, he

added that he's "confident that market conditions eventually will settle down." On Aug. 7, the Federal Open Market Committee voted to leave the main interest rate at 5.25 percent for the ninth straight time and reiterated that inflation was its main concern, though risks to economic growth had increased. Ten days later, the Fed was forced to cut the interest rate on direct loans to banks and shift its policy focus to growth. Bernanke said Aug. 31 that the central bank will do what's needed to prevent the credit-market rout from undoing the six-year economic expansion. He suggested the Fed is prepared to cut the so-called discount rate further or lower the key federal funds rate target as appropriate. "The balance of risk to the economy seems to have shifted," Lockhart said today. "We're facing greater uncertainty in the economic outlook." Avoid Recession Lockhart, answering audience questions after his speech, said the Fed's objective is to do "everything possible" to avoid a recession. Today, the three-month rate that banks charge each other for dollars held at a seven-year high, indicating lenders remain reluctant to offer cash for longer than a few days because of concern U.S. subprime-mortgage losses will spread. In the \$1.93 trillion commercial-paper market, which is used by companies for short-term debt needs and has shrunk for four straight weeks, Lockhart said there are "encouraging signs that liquidity is resuming." The new Atlanta Fed president argued for a "deliberate and measured response to financial-market turbulence," distinguishing between measures to ensure that markets function properly and "monetary actions aimed at cushioning the economy from the impact of financial market instability." Retreat From Risk Investors "feasted" on cheap capital in recent years, and now there is a "broad retreat" from riskier practices, Lockhart said. He cited some estimates that banks have been unable to sell \$400 billion of leveraged loans to investors and are now holding the debt on their own books. Yesterday, in the Fed's Beige Book regional business survey, district banks reported that the credit-market's effects on the broader economy were "limited" beyond the housing industry. At the same time, there was more "uncertainty about when the housing market might turn around," the Fed said. Lockhart said today that one of his guiding principles is to "let markets work," and said that "unwarranted intervention in financial markets raises concerns about moral hazard." Still, the Fed is responsible for the stability of the financial system, he added. Before joining the central bank, Lockhart was an international business professor at Georgetown University in Washington and managing partner at private-equity firm Zephyr Management LP. He held positions with Citibank and Citicorp, now Citigroup Inc., for almost two decades. Lockhart is one of five Fed policy makers delivering public remarks today. St. Louis Fed President William Poole said in London that signals from the U.S. labor market are "largely favorable." Fed Governor Randall Kroszner said U.S. housing demand could weaken further, while San Francisco Fed President Janet Yellen told a conference that global financial markets can become volatile "quite suddenly."

#### **Lockhart Sees No Sign Housing Harming Broader Economy**

<http://www.bloomberg.com/apps/news?pid=20601068&sid=aVteh.tsvnsk&refer=economy>

- Sept. 5 (Bloomberg) -- The Federal Reserve found the effects of the August credit-market rout on the broader economy "limited" beyond the housing industry, according to its regional business survey. "Outside of real estate, reports that the turmoil in financial markets had affected economic activity during the survey period were limited," the Fed said in the survey, which concluded before Aug. 27 and was released today in

Washington. "Economic activity has continued to expand" nationwide, the Fed said in the Beige Book report, named for the color of its cover. The assessment carries more weight than usual ahead of the Sept. 18 meeting to set interest rates, because regular monthly economic reports fail to capture the impact of the credit-market sell-off. Chairman Ben S. Bernanke said last week that "we will pay particularly close attention" to information from regional business contacts. While tighter lending standards were having a "noticeable effect on housing," several banks reported that "credit availability and credit quality remained good for most consumer and business borrowers," the Beige Book said. Two Fed districts reported "a moderate pace" of expansion, three districts described an economy expanding at a "modest rate," and four districts reported a slower pace of expansion. The New York Fed cited "continued expansion." Worst Since 1982 The collapse of the housing boom is taking its toll. Residential construction has subtracted from economic growth for six straight quarters, the longest streak since 1982, and lopped 0.6 percentage point off the expansion in the second quarter. "Most districts reported weak or declining residential sales and declining or stable prices," though there were some pockets of strength, the Fed said. At the same time, commercial real estate was "generally stable to expanding" with "somewhat tighter credit conditions," the Fed said. Manufacturing expanded at the slowest pace in five months in August as buyers cut orders of furniture and computers, the Institute for Supply Management's index showed yesterday. The report is one of the first indicators to provide a glimpse of how the mortgage crisis may be affecting spending. In the Beige Book, most districts reported gains in manufacturing, with four reporting "solid growth" and two saying activity was "mixed." Auto Sales In a sign the credit crisis has yet to bite some industries, sales of automobiles exceeded forecasts last month. Industry figures released yesterday showed purchases ran at a 16.3 million annual pace last month, the fastest since April. According to the Fed, auto sales were "slow or subdued" in many areas, with seven districts reporting "sluggish" new vehicle sales, the Beige Book said. Retail sales were "generally positive." Data for past months showed the economy picked up pace in the second quarter and inflation receded. Gross domestic product rose at a 4 percent annual rate from April to June, the Commerce Department said Aug. 30, up from an initial estimate of 3.4 percent. Retail sales in the survey period were "generally positive, with increases characterized as modest to moderate," the Fed said. The Fed's preferred inflation gauge, which excludes food and energy costs, rose 1.9 percent in the year to July, the same rate as the previous month. The measure has fallen from 2.5 percent in February. "Most districts reported little change in overall price pressures," today's report also said. The Beige Book's regional anecdotes are gathered through hundreds of telephone calls, news clippings and personal contact by the staff of the 12 Fed banks, whose districts cover all 50 states. The anecdotes are designed to supplement quantitative forecasts of the Board of Governors staff. **Fed's Report Says Economic Effect of Market Turmoil 'Limited'**

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

- Sept. 4 (Bloomberg) -- Federal Reserve officials, wrestling with a housing recession that jeopardizes U.S. growth, got an earful from critics at a weekend retreat arguing they should use regulation and interest rates to prevent asset-price bubbles. Otmar Issing,

former chief economist at the European Central Bank, and Stanley Fischer, head of the Bank of Israel, were among guests at the Fed's summer symposium in Jackson Hole, Wyoming, to challenge the hands-off approach. Fed Governor Frederic Mishkin reiterated his view in a paper at the conference: Officials should only respond to the effects of asset prices on the outlook for economic growth and inflation. "The position that 'this isn't an issue for central banks' has lost some support," Issing said in an interview at the gathering, which ran from Aug. 30 to Sept. 1. "The tide is turning." The criticism -- **one academic paper gave the Fed an 'F' for its handling of housing** -- may spur policy makers to strengthen regulation of lending practices that helped fuel the three-year mortgage boom that's now unraveling. Chairman Ben S. Bernanke, 53, has promised to draft new rules by year-end. **Controversy on how to handle asset prices has been stoked by two crashes in the past decade.** Some economists blame former Fed Chairman Alan Greenspan for not raising rates enough to curb the Internet-stock boom in the late 1990s. That soured in 2000, contributing to a U.S. recession the next year. **Monetary Policy Faulted By cutting rates to a four-decade low in 2003, the Fed inflated property values, Ed Leamer, head of an economic forecasting group at the University of California at Los Angeles, said at the conference. The ensuing housing slump, the worst since 1991, and the credit-market turmoil that followed, threaten to undo the six-year economic expansion.** "Central banks, probably on more occasions than they would like to admit, should respond to asset-price bubbles," said Fischer, who taught economics at the Massachusetts Institute of Technology when Mishkin, 56, and Bernanke worked on doctorates there in the 1970s. Fischer, 63, also served as deputy managing director of the International Monetary Fund. **Rosengren Answers Finally, Eric Rosengren, president of the Boston Fed, responded that the central bank's oversight of mortgage lending is limited. The Fed doesn't supervise non-banks, such as finance companies. "I'm not sure bank supervision is going to be equipped to deal with many organizations that are completely outside of depository organizations," said Rosengren, 50, who took office in July. Fed, Blamed for Asset-Price Inaction, Is Told 'Tide Is Turning'**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=aLsu9feQITDY&refer=home>

- Sept. 4 (Bloomberg) -- **The pain from higher borrowing costs may be spreading as consumers and businesses follow investors in shying away from risk, increasing the odds of a recession.** "While there is no basis for predicting a recession right now, the risks have surely gone up," says former Treasury Secretary Lawrence Summers, now a professor at Harvard University in Cambridge, Massachusetts. "The combination of softness in the housing sector, contractions in credit, increased uncertainty and volatility, and losses in wealth make the chances significantly greater now." Though reports show a strong start to this year's third quarter, economists will be watching this week for U.S. auto sales and August employment to see whether spending and the job market might follow housing into a slump. **'Fear in the Markets'** "We're taking the pulse of the economy a little more frequently," says Jonathan Basile, an economist at Credit Suisse Holdings in New York. "If the spillover from the credit crunch gets into autos, it would be the second major sector to fall and would solidify a lot of the fear in the markets." **More Pessimistic Confidence is critical at key junctures in the economy. If**

**consumers and companies turn more pessimistic about the outlook and cut back on their spending, such gloominess can prove to be self-fulfilling, triggering a recession.** [If? How about when or as?] A sudden drop in consumer confidence at the end of 2000, coupled with a contraction in manufacturing and a two-year-low in motor-vehicle sales, helped set the stage for the last recession, which began in March 2001. The omens today aren't particularly promising. An index of global business confidence compiled by Moody's Economy.com in West Chester, Pennsylvania, fell in late August to its lowest level since the middle of the U.S.-led invasion of Iraq in 2003. Consumers are also showing signs of being spooked by the turmoil in financial markets. U.S. consumer confidence tumbled last month by the most since Hurricane Katrina struck two years ago, according to the Conference Board, a private research group in New York. `Significant Risk' ``**I think there's a significant risk of recession now,**" says Martin Feldstein, president of the National Bureau of Economic Research, the unofficial arbiter of when recessions begin and end. ``The consumer will be spending less. The most recent consumer confidence numbers are down. That's going to be reinforced by everything happening in the housing market." Americans have ``pulled back on buying big-ticket items; and pulling back means that unless there is a rate cut, you will have a recession," Michael Jackson, chief executive officer of AutoNation Inc., said in an interview Aug. 29. AutoNation, based in Fort Lauderdale, Florida, is the largest U.S. auto retailer. The pace of car and truck sales in the U.S. has dropped for seven consecutive months, the biggest string of declines in at least 31 years, according to data compiled by Bloomberg. Economists forecast little change for August when car makers report sales figures today. Rising Incomes Still, Karl, who estimates the chances of a recession at about 35 percent, says the effect of the credit crunch on jobs will be temporary. **He expects that consumers are more likely to pause than retreat for as long as incomes continue to rise.** [the tooth fairy might come too, but I would not invest on that prospect] Earnings increased 3.9 percent in July from a year earlier, according to the Labor Department. [let's see how income does in housing, mortgage generation and investment banking in the next year] **Recession Risk Rises as Consumers Feel Pain of Tighter Credit** <http://www.bloomberg.com/apps/news?pid=20601087&sid=aASZZ45C7f.k&refer=home>

## Retail

- Sept. 6 (Bloomberg) -- Office Depot Inc., the world's second-largest office-supplies chain, scaled back plans for store openings for the second time this year and said profit will decline in the third and fourth quarters as small-business customers pare purchases. The retailer fell 6.4 percent in New York trading. Office Depot intends to open 100 locations in 2007, Chief Financial Officer Patricia McKay told investors today in New York. That's down from a projection of 125 in July and 150 earlier this year. McKay said Office Depot reduced its planned openings for 2008 to 125 to 150 stores, down from 200. **Small-business customers and consumers have reined in spending because of the slump in the housing market, McKay said.** The drop in demand at stores seen in the second quarter continued in the third quarter through August, and profit margins may not

improve until the first half of 2008, she said. **Office Depot Cuts Store Openings, Sees Profit Decline**

[http://www.bloomberg.com/apps/news?pid=20601205&sid=aU\\_aVYbNla28&refer=consumer](http://www.bloomberg.com/apps/news?pid=20601205&sid=aU_aVYbNla28&refer=consumer)

## Retirement

## Risk

## Savings Rate

## Tech

Sept. 6 (Bloomberg) -- National Semiconductor Corp., the maker of chips for mobile devices such as Apple Inc.'s iPhone, said fiscal first-quarter net income fell 29 percent after it passed on some sales contracts to improve profit margins. Profit declined to \$85.6 million, or 30 cents a share, from \$120.1 million, or 35 cents, a year earlier, the Santa Clara, California-based company said today in a statement. Sales dropped 13 percent to \$471.5 million in the period ended Aug.

### 26. **National Semiconductor Profit Falls as It Refocuses**

<http://www.bloomberg.com/apps/news?pid=20601204&sid=aCgoSM61JILY&refer=technology>

## Wall Street

- Sept. 5 (Bloomberg) -- Global Advisors LP, the commodities hedge fund firm co-founded by former JPMorgan Chase & Co. trader Daniel Masters, is shutting two of its three funds after losses in all commodity markets this year. The \$60 million Global Advisors Commodity Investment fund and the \$4 million Global Commodity Index Plus fund will return money to investors at the end of the month, the London-based company said in an e-mailed statement today. "It's been frustrating," co-founder Russell Newton said in a telephone interview. "Some investors don't understand the changes in volatility in these markets. Commodity traders can have years of great returns and years of bad ones." Newton and Masters, a former head of JP Morgan's global energy business, founded Global Advisors in 1999. The company, which managed as much as \$400 million in mid-2005, will continue to run the \$100 million Global Commodity Systematic fund. The fund, which relies on computers to decide when to buy and sell contracts, has lost 0.6 percent this year and returned an average 15 percent annually since being formed two years ago. **Global Advisors to Shut Two Commodity Hedge Funds**  
[http://www.bloomberg.com/apps/news?pid=20601087&sid=aZkz\\_UtSTkP8&refer=home](http://www.bloomberg.com/apps/news?pid=20601087&sid=aZkz_UtSTkP8&refer=home)
- Sept. 5 (Bloomberg) -- ABN Amro Asset Management's **Francois Moute, one of Europe's best investors in U.S. stocks, started preparing for hard times more than a year before markets slumped in July.** Since early 2006 he has slashed his net holdings of shares from 85 percent of assets to 60 percent, the lowest he's allowed. Almost one-quarter of his \$343 million U.S. Opportunities fund now bets against indexes. The only

equities he is buying are those of U.S. commodity companies selling in emerging markets, such as oil-service provider Schlumberger Ltd. Moute's fund has ranked in the top 5 percent in the past three years among 541 European-based funds tracked by Morningstar Inc. that invest in North American stocks. It has returned 8.3 percent this year, compared with a 3.9 percent advance for the Standard & Poor's 500 Index, the benchmark. **“The current credit crisis is a serious one but it's the tip of the iceberg,” Moute, 62, said in a telephone interview from his Paris office. “There is too much complacency. It's probably more serious than the equity market is pricing in.”** [his age is not surprising. Anyone over 50 remembers lean times, the current whiz kids do not – nor are they exposed to reality in b-school finance or NY] ABN Amro's Moute Cuts Stock Holdings on ‘Tip of Iceberg’ Fears  
[http://www.bloomberg.com/apps/news?pid=20601109&sid=a\\_Khyl1WHKIY&refer=home](http://www.bloomberg.com/apps/news?pid=20601109&sid=a_Khyl1WHKIY&refer=home)

- Sept. 4 (Bloomberg) -- U.S. investors are returning from summer vacation to the **cheapest stock market in almost 12 years, and some of the biggest fund managers say they're ready to load up on shares of technology, energy and industrial companies.** [We will revisit this latest “pumping” effort in two months – suffice it to say the same was said months ago when the PE was higher] Software makers in the Standard & Poor's 500 Index are valued at an average 20.8 times estimated profit, the lowest since at least 1995, [a decade in which the average was abnormally high – historical average is 12 – oh that’s right it is different this time] according to data compiled by Bloomberg. Industrial companies trade at 18.4 times earnings, lower than their average of 23.4 this decade. Oilfield-services provider BJ Services Co. last month was the cheapest in almost six years. While the benchmark for American equity tumbled 9.4 percent between July 19 and Aug. 15 on concern the worst housing slump in 16 years would slow economic growth, the index gained in August for the first time since May. **President George W. Bush and Federal Reserve Chairman Ben S. Bernanke reassured investors last week that they would prevent losses in credit markets from ending the six year expansion.** [Silly that this matters to anyone] “The market's probably seen the worst of it,” said Fritz Meyer, the Denver-based senior investment officer for AIM Investments, which oversees \$160 billion. **“The Fed ultimately will ride to the rescue.”** [This is in fact the entire bulls’ case. The crash occurs when it becomes clear the Fed is toothless – it will happened and soon] Stocks are **“on sale”** and managers are **“finding opportunity everywhere,”** Meyer said. [If you have any assets with AIM, you should be scared out of you shoes by Mr. Meyer] The S&P 500's average price-to-earnings ratio of 16.8 for August was the lowest since November 1995, according to monthly data compiled by Bloomberg. Market Rebound The slump, the steepest since March 2003, wiped out \$1.41 trillion in market value. **The S&P 500 rebounded 4.8 percent after the Fed on Aug. 17 unexpectedly lowered the interest it charges banks and the index ended the month 1.3 percent higher.** [dead cat bounce – failed rally pick your favorite] Cheap Growth The slump in stocks was **“driven by psychology rather than by fundamentals or valuations,”** [sadly I am sure he believes this – it is in fact a fundamental problem when credit markets seize up but that requires a level of thinking no longer prevalent in the “it always goes up world] said Darst, who oversees \$728 billion. “The bull market can continue.” ‘Falling Knives’ Valuations for many stocks aren't attractive enough to go

``bottom-fishing," said Patricia Edwards, who helps manage \$11.9 billion at Wentworth, Hauser & Violich in Seattle. The slump caused by defaults on mortgages to people with poor or limited credit has hurt the profit outlook for companies such as homebuilders and financial firms. ``Catching falling knives is a dangerous art and not one I have perfected," said Edwards, the firm's managing director. ``They're only cheap if the earnings hold up, and there's not a lot of confidence with the E portion of their P/E ratios." [you have to be a patient reader to get to this point, which is very well taken] ``The storm has passed its peak," said Kleintop, who helps oversee \$165 billion as chief market strategist at LPL in Boston. Technology and industrial shares are ``going to be the leaders as we emerge and retrace our way back to new highs." [another panicked seller when new lows occur – I LOVE these guys] **Cheapest Stocks in 12 Years Greet Investors After Summer Swoon**  
[http://www.bloomberg.com/apps/news?pid=20601109&sid=ayv0\\_Y9dkSkc&refer=home](http://www.bloomberg.com/apps/news?pid=20601109&sid=ayv0_Y9dkSkc&refer=home)

## **I Disagree . . . and why**

Article of the week:

**UM EMBA**