

## The Other Side of the Street September 28, 2008

**The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed – any of dozens of Fed press releases the past 14 months**

### Comments

Hi all, with the world in such upheaval I thought I might once again begin to circulate stories in the news and my comments thereon. Before jumping in, I would like to share some “macro thoughts” on this compendium:

- First and most importantly, I do not KNOW what will happen. I am passing along my thoughts and experts to highlight information that I think important for you to consider in making decisions for yourself. I do have a bias. My bias is that I do not believe the government can “fix” things and instead government intervention almost invariably has negative consequences. In the present instance, the government has engaged in policies that are incredibly destructive in the long term IMO. Whether this is the case or not may be largely unknown for decades.
- In the past several years I have warned that structured finance would blow up largely as it has. When I initially shared these ideas, the markets continued to go straight up and, to a large extent, my message was lost. Now that the markets have in fact collapsed and the structured finance debacle is on the front page, there is great interest in what I wrote years ago. Well, it is too late to go back and follow advice of years ago. The lesson is that it is extremely important to look not at what is “popular” but instead to consider the ideas that are not on the front page.
- Investing and your financial future is YOUR responsibility not mine, not your broker, not your financial advisor, not Cramer, not etc. . . . I firmly believe that there is more time spent in this country on figuring out fantasy football picks for the week than there is on trying to implement financial strategies for your lifetime. For the many of you that do not spend your waking hours following this stuff, the important thing IMO is to make sure you discuss with whomever it is that manages your money concepts such as those we set forth here. If your money manager does not have substantive responses and instead says anything such as “we are in it for the long haul”, tell you that you are “fully diversified” or spouts statistics on stocks always out performing, you are placing a great deal of faith in someone who has no idea what they are doing.
- Despite what the media would like you to believe, spending money you do not have is NOT a good thing. That is what credit is. It is a choice to spend money you do not have with the anticipation that the current benefit is more important than the future benefits you are trading away. Thus each time you make a purchase on credit think not in terms of what you are getting now, but instead

what you are giving up to get it. One of the things that has always been clear is that at some point credit growth would be impacted by the need to pay it back. This happens only if income grows to allow payment. If you are uncertain of that future income growth you are much better holding off on instant gratification IMO.

- If you are thinking that since markets are going down now might be a good time to try shorting stocks, keep in mind that 90% of mutual funds and I suspect a similar percentage of other investments have done equally as poorly. Shorting as with any other kind of investing has become much harder as a result of the destruction of reliability in markets. The midnight shorting bans, rewriting of tax provisions, market manipulations by releasing rumors to CNBC etc. being engaged in by the government simply cause volatility and chase our liquidity. A really good for instance is Wachovia Bank. Its liabilities have vastly exceeded its assets for a long time. However, that has not stopped the day traders from running the stock up 50% or more in a day. It also did not stop the government from re-writing the tax code so Wells Fargo could trump the agreement with Citibank on Friday. In the space of two weeks WB went from 9 to 23 to 80 cents to 7 bucks. During that time the “investors” we betting on a government bailout which they did not get and then in essence did get. There are hundreds of such situations. DO you want to start hoping you can get them right?
- There is absolutely NO meaning to your balance today, tomorrow or in six months. The sole meaningful balance in your accounts is what they are when you need to access the money and the buying power on that date as well as the liquidity involved in changing investment to cash. The obsession with valuation at all levels merely leads to very short term thinking. A great example IMO is the current silver and gold trade. Both are being punished in likelihood because there are lots of levered players being forced to sell. If you need to sell today you are screwed. If your position is to be held for the next 20 years, you welcome lower prices because you can buy more. The key is to understand WHY you own an asset and what your time horizon is. I do not care about the balance of any account I have other than the one I use for short term payments. I instead care about the margin available. This is so contrary to today’s attitudes as to boggle most of your minds. However, because I know what I want to do and why I hold things, I have no care for whether my ideas are popular at a given moment.
- Your kids do not need the latest shoes, travel soccer, horse riding lessons or whatever else “everyone else is doing”. You do not need a big screen tv, country club membership or “that dream vacation”. You need something to eat, a safe place to sleep and clothing. What ever your finances bring you will in all likelihood be able to take care of the later. The “standard of living” of McMansions, 6 MPG Hummers, TVs the size of your wall, \$250 blue jeans; thousand dollar purses etc, is GONE for the middle class. The new standard of living will be less. Get used to it.

- The time has come to prepare for the worst. This does not mean I expect a worst case scenario. It instead means it makes good sense to be prepared as long as the possibility is greater than zero. I suggest that all of you do the following: (i) make sure you have several weeks worth of canned goods and other non-perishables; (ii) same thing with clean water; (iii) keep your gas tanks at least  $\frac{3}{4}$  full at all times; (iv) keep a stock pile of cash at your home and keep several thousand in gold coins in your safety deposit box; (v) keep a months supply of any medicine you need; and (vi) be prepared for power outages by having plenty of flashlights. The foregoing should keep you comfortable if there is any temporary disruption in availability of cash in the financial system for any reason. As for what you should do? In my opinion you should make sure you have physical gold and a few weeks worth of cash at a minimum in your safe at home.

Now some “macro thoughts” on the current situation all of which are my opinions and all of which you should consider with the same skepticism that I encourage you to apply to any thoughts not your own. I believe that:

We are in a situation this Sunday October 5, 2008 that a crash in global equity markets is eminent. I believe so because:

- The credit markets are not functioning (nor are the equity markets). The global financial structure is dependent on immediate access to massive amounts of credit. Liquidity in markets is as well. Many of the violent swings are being caused not because of underlying issues in the fundamentals, but instead because levered players need to meet margin requirements and are throwing out the good with the bad. A review of conditions prior to major market crashes reveals that such lack of functioning of credit and lack of liquidity is a very ominous sign.
- Most specifically the problems in credit can be identified by GE and GS agreeing to pay Buffet 10% plus free calls on their stocks AND the fact the one month and our LIBOR rates have gone up everyday in the past week. These are clear signs that some very sophisticated people with tremendous access to inside information do not believe that the credit markets are going to improve in coming months. Should they fail to improve and start improving immediately, the logical effect will be an equity market collapse.
- The massive malfeasance underlying the sub-prime scams is now surfaced. The problems therein are miniscule compared to the malfeasance in the financial markets as a whole. This period will exceed the 1980s in terms of unsavory behavior both in scope and severity.
- The immediate failure of the latest scheme pretty effectively demonstrates that even the dimmest bulbs understand that the U.S. government can't do anything but make things worse at this point. The idea that we are once again going back to “well the Fed needs to cut interest rates” is comical. However, it is a great reason to continue to add to silver and gold positions.

- The actions of the Federal Reserve whether you agree with them or not are schizophrenic. **I have copied in the appendix hereto a number of the announcements – look for yourself and see if they inspire confidence (this is particularly important as another “Fed will save us” cut is coming in days).** They bounce from things are not so good to things are improving and back on about a monthly basis. The common thread “we are here and ready to take any action necessary” has been the same for 18 months. There is a new plan every few months, none of which have had any lasting effect. The message last spring was that there would be improvement in the second half. Needless to say that obviously did not happen. As we have discussed the entire credit market and currency system is based on faith not dollar for dollar collateral. I doubt anyone still has real faith and instead faith has been replaced with the fear of calling the emperor naked. There is tremendous wishing and hoping. It will not work.
- The picture on this weeks Economist has a person standing on the edge of a crumbling cliff. Had they asked for my input I would have had the person already on the way down. You can and should make your own assessments.
- Practically, if you had lots of cash and were waiting to buy good companies for a long term investment, why would you buy now? Long term investing does not mean throwing money away. Instead it requires the discipline to wait through uncertainty. There will be much lower equity prices in the next year. Why should anyone with a brain buy now and ride them down?

There is nothing funny about what is likely to happen next week. I have had more than one of you tell me I “am scaring you”. My response you should be very scared because the idea that we can’t have bad times because we have not of late is no different than it has been before every major crash. In fact, the most likely scenario for a crash is not when problems first surface but after the “experts” declare the problems to have been solved or well on the way to being solved (yes, just like NOW):

In closing, most of you have heard about the 1929 stock market crash and probably think of it as the worst of all time. You would be wrong if you do. The worst stock market crash happened not in 1929, but in 1930. For you see after the 1929 crash, pundits raced in to tell the world that the worst was behind, that the government would solve the problems, that stocks out performed, that buying the dips was the way to go, that the credit markets would improve, that the dollar would strengthen, that America would be on the road to recovery faster because it recognized its problems sooner, that in a more global economy one country would not tank the rest, etc. All that blue sky news led to a rally after the 1929 crash that topped out in the Spring of 1930. from that point through the eventual bottom in the summer of 1932 “Investors lost 86% of their money over this 813 day beast. If you had \$1000 on 9/3/1929 (beginning of the 4th worst crash, it would have gone down to a whopping \$108.14 by July 8th, 1932 (end of the worst crash) or an 89.2% loss. To recover from a loss like that, you would have to watch your portfolio go up 825%! The full recovery didn't take place until 1954, 22 years later! Worst Stock Market Crash Ever: Date Started: 4/17/1930 Date Ended: 7/8/1932 <http://mutualfunds.about.com/cs/history/p/crash1.htm>

## Stock Notes

- “As an investor, this bailout really isn’t going to change much,” Chris Mayer assures us. “I believe that the long-term trends we’ve identified and invested in are still in play. The energy, agriculture, water and infrastructure trends still march on. The government’s bailout plan does nothing to find new oil and gas deposits. It does nothing to help feed a hungry world or alleviate the growing shortage of arable land. It does nothing about purifying water or increasing water supplies. It does nothing about crumbling bridges, inadequate roads and power systems. “It may help to put the \$700 billion in perspective, too, when it comes to the power of some of those trends. Booz Allen Hamilton estimates that the world’s infrastructure -- power, water and transportation systems -- will need a \$41 trillion makeover out to 2030. That’s about equal to the value of all the stocks held in all the stock markets of the world. “Really, the bailout doesn’t even erase the losses created by all the toxic debt banks seem to be swimming in. The bailout simply shifts the burden of the losses. And guess who bears the cost? Taxpayers, of course.” DR

## Notes

- 10/01 – issues coming up will include the state and local budgets – both are under severe stress now and those situations will get much worse. Keep in mind property tax appraisals do not reflect any of this year’s fall right now. The prime sources of revenue are sales tax and property taxes. Further with the interest rate issues, the cost of borrowing is soaring and most entities have significant borrowing needs for capital projects. Also the federal government financial problems will decrease the likelihood of substantial top down assistance IMO.
- 10/01 – I continue to read about the merits of “shorting treasuries” I have reached out to a friend who runs a hedge fund to understand the mechanics better and will be contemplating whether such a trade makes sense for me. You may wish to discuss this with your financial advisors.
- Let’s see Buffet is foretelling Armageddon pleading with the US government for WS bailouts at the same time he is buying more than he has in years. Anyone else find that troubling (i.e. if things are so awful why is Buffet buying??? This also ties into the whole – the government will make money on the assets no one will buy. We are to believe that the same crowd who created this disaster will now somehow find value where the best investors in the world do not?) Even so, all eyes are on the Capitol. **If Congress doesn’t act soon, we’re facing “the biggest financial meltdown in American history,”** Warren Buffett warned this morning, ironically echoing the sentiments of the Bush administration. In the meantime, the Oracle has been buying up assets left and right as the market falls. Today, we learn Berkshire Hathaway’s MidAmerican Energy has purchased 10% of BYD, a Chinese electric car and battery manufacturer.
- And so that's where we find ourselves today. The experts are calling it a "show of confidence" designed to "bolster the market." But no, I'm no longer talking about Warren Buffett's deal with **Goldman Sachs** to "restore confidence." I'm talking about **Morgan Bank, Chase National Bank** and **National City Bank's** agreement to pitch in and buy shares of **US Steel (X)** at below market prices to try and thwart the panic on Wall Street

on October 25, 1929. Only a fool argues with facts based on Washington D.C. theories... unless, like me, he has the force of history and the violence of logic on his side: *"Warren E. Buffett, known as a sharp investor with an eye for undervalued securities, has agreed to pay \$700 million for a 12 percent stake in Salomon Inc., the parent company of Salomon Brothers Inc., Wall Street's largest investment banking house."* - September 28, 1987, *New York Times* Yes, September 1987, almost 21 years to the day. Minyanville

- As usual, Buffett's buy came with a caveat. "If I didn't think the government would act," Buffett said, "I wouldn't be doing anything this week. I would be undoing things this week. It would be a mistake to buy anything if the government were to walk away from this deal. The Paulson plan is absolutely necessary to avoid going over the precipice."
- Sales of new one-family houses in August 2008 were at a seasonally adjusted annual rate of 460,000, according to estimates released jointly today by the U.S. Census Bureau and the Department of Housing and Urban Development. This is 11.5 percent ( $\pm 11.7\%$ )\* below the revised July rate of 520,000 and is 34.5 percent ( $\pm 7.3\%$ ) below the August 2007 estimate of 702,000. The median sales price of new houses sold in August 2008 was \$221,900; the average sales price was \$263,900. The seasonally adjusted estimate of new houses for sale at the end of August was 408,000. This represents a supply of 10.9 months at the current sales rate.

### Web links

#### Credit

- 25 Sept FT **Financing for US states, cities and other municipalities has ground to a halt and borrowing costs have risen as the latest chapter of the credit crunch unfolds.** The upset in the public finance market is a symptom of the overall lock-down on capital this week as the bankruptcy of Lehman Brothers and uncertainty about a Federal bail-out has indiscriminately drained liquidity from the financial system. "It's the nature of what the borrowing is for – building a hospital and making sure Johnny and Susie have a school that is open – that makes a freeze in the muni-market significant," said Thomas Doe, CEO of Municipal Market Advisors (MMA). **"If you can't get access to the capital markets, you may have to raise taxes to generate the revenue for those projects."** In the last two weeks, roughly \$10bn in new municipal issuance has been shelved, including two issues from the state of New York. Yields on fixed-rate 30-year municipal bonds of the highest quality, or triple A rated, **were 5.24 per cent on Wednesday, the highest in six years** and up from 4.85 per cent on September 12, the last trading day before Lehman Brothers filed for bankruptcy, according to the MMA AAA benchmark index. Lehman was a counterparty to swaps contracts used for interest-rate hedging strategies with many municipalities. It remains unclear how those hedges will be unwound and what effect it will have on issuers and the municipal bond market in general. **The municipal bond market, once a sleepy corner of the investment universe, has been at the centre of the credit crisis almost since it began.** Yields surged this year when bond insurers, which had guaranteed about half of the market, ran into trouble because they had also guaranteed risky mortgage debt. The collapse of the

auction-rate securities market in February forced many municipalities to refinance, sometimes at higher rates. **“The primary market will be greatly reduced. There is less underwriting and buying capacity,”** says Tom Spalding, a portfolio manager at Nuveen Investments. **“Even when we get back to so-called normal, there will be a premium necessary to entice buyers.”** **US muni market hit by capital freeze**  
<http://www.ft.com/cms/s/0/746e4e50-8b3c-11dd-b634-0000779fd18c.html>

- Sept. 24 (Bloomberg) -- **The cost of borrowing in dollars increased after banks paid a record premium for cash at yesterday's Federal Reserve auction, underscoring the shortage of funds available on money markets.** The one-month London interbank offered rate, or Libor, for dollars rose 22 basis points to 3.43 percent, the highest level since January, the British Bankers' Association said today. Financial institutions paid 3.75 percent at the 28-day Fed term auction facility, or TAF. That's 57 basis points more than yesterday's one-month rate, the widest spread since the TAF program began in December. **“We've seen quite a bit of upward pressure in the past couple of weeks and the fact that the TAF came in at over 50 basis points above yesterday's one-month Libor will no doubt add to that,”** said Barry Moran, a Dublin-based money-market trader at Bank of Ireland, the country's second-biggest bank. **“It's a bit of a lottery as to where Libor will set.”** Demand for central bank loans backed by collateral surged this week as financial institutions hoard cash and balk at lending to each other on concern more banks will fail. Libor loans aren't secured and typically command rates above those of secured loans of similar maturities. **Demand for euros at today's European Central Bank auction of three-month loans was the strongest on record. The ECB allotted 50 billion euros (\$73.3 billion) at a marginal rate of 4.98 percent. That's the highest since 2000. Banks bid for 155 billion euros.** Rates Soaring As borrowing seized up last week following the collapse of Lehman Brothers Holdings Inc. and the U.S. government's takeover of insurer American International Group Inc., the overnight rate for dollars doubled to 6.44 percent, on Sept. 16. The cost of borrowing in euros for one month rose today to the highest level since December, according to the European Banking Federation. The euro interbank offered rate, or Euribor, climbed 6 basis points to 4.91 percent. The one-week rate climbed 4 basis points to 4.74 percent, the highest level since May 2001. Corporate bond sales in Europe dropped to the lowest weekly level in almost six years, while spreads soared to a record over benchmark rates, according to data compiled by Bloomberg. **Money-Market Rate Climbs as Bank Funding Constraints Worsen**  
[http://www.bloomberg.com/apps/news?pid=email\\_en&refer=home&sid=ahfOalHOb48w](http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=ahfOalHOb48w)

## Commercial Real Estate

## Commodities

## Currency

## Diversification

## Derivatives

Oct. 3 (Bloomberg) -- [National Rural Utilities Cooperative Finance Corp.](#) and [Hartford Financial Services Group Inc.](#) say widening credit default swaps show a disconnect between the health of their balance sheets and investor behavior.

“It's all attributable to the overall marketplace and nothing really specific to National Rural's credit,” Chief Financial Officer [Steven Lilly](#) said in a telephone interview. “Our credit remains strong as evidenced by the ratings and positive outlooks that we have.”

Credit-default swaps on Herndon, Virginia-based National Rural almost doubled since Sept. 22 to 164.7 basis points yesterday, CMA Datavision prices show. The company continues “to successfully access the marketplace when we need to at the levels that are appropriate for the credit rating of the company,” Lilly said. Moody's Investors Service [rates](#) its senior secured debt at A1 and senior unsecured debt at A2.

An increase in the contracts, used to hedge against losses or to speculate on creditworthiness, represents a decline in investor confidence. The cost to protect against corporate bond defaults has risen on concern that the credit-market crisis may engulf even some of the best-financed companies in the world, including [General Electric Co.](#) and [Boeing Co.](#)

The cost to protect against default by Hartford, [Prudential Financial Inc.](#) and [MetLife Inc.](#) soared to records and shares fell yesterday on speculation that turmoil in financial markets may be spreading to insurance companies.

“The Hartford's core operating businesses are performing well and our liquidity remains strong,” said [Shannon Lapierre](#), spokeswoman for the Connecticut-based insurer. “We are confident in our financial strength and in our ability to meet our commitments to customers.”

## Hartford Contracts

Credit-default swaps are financial instruments based on bonds and loans that are used to speculate on a company's ability to repay debt. They were conceived to protect bondholders against default and pay the buyer face value in exchange for the underlying securities should the company fail to adhere to its debt agreements.

One 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.

For Hartford, credit-default swap traders started demanding upfront payments to protect against a default yesterday as the contracts headed toward distressed levels.

The contracts were quoted at a mid-price of 9 percentage points up front in addition to 5 percentage points a year, according to Credit Suisse Group AG, meaning it would cost \$900,000 initially and \$500,000 a year to protect \$10 million of the companies' bonds from default for five years. That compared with \$525,000 a year and no upfront payment the previous day.

### Insurance Stocks Fall

[Stock prices](#) yesterday plunged 32 percent for Hartford, 15 percent for MetLife and 11 percent for Prudential on concern that the companies face losses as the value of fixed-income assets plunge amid the worst financial crisis since the Great Depression.

Part of the concern may stem from the collapse of [American International Group Inc.](#), which used a subsidiary to sell credit-default swap protection on securities linked to U.S. home loans before much of the market collapsed. AIG was seized after ratings downgrades triggered more than \$13 billion in collateral calls.

“Everyone's shell-shocked and has the mentality that if this can happen to AIG, it can happen to anybody,” said [Rob Haines](#), an analyst at independent fixed-income research firm CreditSights Inc. in New York. “It's completely not reflective of fundamentals.”

### Boeing Swaps

Boeing, whose credit default swaps widened 50 points in the past week to 145 basis points, said there's no reason for the market to question its liquidity. Contracts on Boeing Capital Corp., Boeing's financing arm, jumped 74 basis points to a record 185 basis points, CMA data show.

“If what is driving this is the fear that Boeing Capital will have to suddenly finance a whole host of deliveries, that is unfounded concern,” because customers with aircraft deliveries scheduled for at least the next year and a half have already identified non-Boeing financing, said [Todd Blecher](#), a spokesman at the Chicago-based company.

The world's second-largest maker of commercial planes had \$5.6 billion in cash and \$4.6 billion in marketable securities as of June 30. Chief Executive Officer Jim McNerney told employees in an e-mail yesterday there has been “little to no impact” on Boeing operations from the crisis.

### General Motors

For some companies, the situation may make it easier to see why swaps are rising.

[General Motors Corp.](#) saw its credit default swaps rise to a record after the automaker said Sept. 19 it was going to draw down the remainder of a \$4.5 billion revolving credit line to preserve cash because of the instability in the financial markets. Detroit-based GM, the largest U.S. carmaker, has lost almost \$70 billion since 2004.

“Maintaining strong liquidity is the top priority for the company,” said GM spokesman [Randy Arickx](#), who declined to comment specifically on trading activity. GM said July 15 that it would cut costs, sell assets and seek new debt to increase liquidity by \$15 billion by the end of next year. GM was added last month to the U.S. Securities and Exchange Commission's list of stocks temporarily protected against short sales.

Bond investors were also burned by what were once some of the highest-rated institutions. New York-based investment bank Lehman Brothers Holdings Inc., rated A2 by Moody's and A by Standard & Poor's until its collapse, filed for the biggest bankruptcy ever on Sept. 15.

The next day, New York-based AIG, the biggest U.S. insurer and rated A2 by Moody's and A by S&P, was forced to obtain an \$85 billion loan from the government in exchange for an 80 percent stake. **Credit Swaps Show Fear, Not Reality, Executives Say**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=a.01tHRJoe.k&refer=home>

## Housing

- **The President of HOV was on CNBC Wednesday morning. He was lamenting that it now costs more to rebuild a house than a house sells for. His point was he wanted more bailouts and wanted the government to act to boost home prices. This in and of itself is pathetic. However, think about what it means for a home builder if replacement cost is higher than sales. One would think there is not a better short around than the home builders and we are in fact short seven of them.**
- **The latest reading of the home price index showed continued record declines for home prices in July.** Both the 10- and 20-city measures boasted record declines, of 17.5% and 16.3%, respectively. And we hasten to note that the S&P/Case-Shiller HPI measures the percentage change based on one year ago. Measured against their highs, the 10- and 20-city home price composites are over 20% down. Seven metro areas have fallen in excess of 20%. Of the 20 markets the study monitors, not one registers a positive return over the last 12 months.

## Housing Finance

### Macro Economic

Oct. 4 (Bloomberg) -- [UniCredit SpA](#), Italy's biggest lender, will hold an extraordinary board meeting tomorrow to discuss a plan to boost its regulatory capital and settle investors' concern with its finances.

The Milan-based bank is considering paying its dividend in shares to hold on to about 3 billion euros (\$4.1 billion) in cash and bolster its Core Tier 1 capital ratio, *Il Sole-24 Ore* and Ansa newswire reported today without citing anyone. [Francesca Palermo](#), an UniCredit spokeswoman, declined to comment on the plan. The meeting will be in the afternoon, Ansa said.

UniCredit shares plummeted 24 percent during the first three days of last week. The stock then recovered some of the losses after Italy's stock-market regulator on Oct. 1 banned short sales of

banking and insurance stocks, and Prime Minister [Silvio Berlusconi](#) said he "won't permit speculative attacks" on banks.

"I heard that Unicredit is planning a capital increase and it is not a reason for concern," Berlusconi told reporters today in Paris after a meeting of European leaders. "It is a further guarantee that there are no dangers for the bank."

Consob, Italy's market watchdog, may have uncovered a case of short selling of UniCredit shares borrowed and sold on Sept. 30 and not delivered back to the lender as of yesterday's deadline, Ansa reported, without citing anyone. Italy's finance police are investigating the whereabouts of 60 million UniCredit shares valued at about 180 million euros, Ansa said.

### Spinoff

On Oct. 1, UniCredit announced it would spin off real-estate assets to boost its core Tier I capital ratio, a measure of financial strength, to a target of 6.2 percent by the end of the year, from 5.7 percent at the end of the second quarter.

UniCredit Chairman [Dieter Rampf](#) and Chief Executive Officer [Alessandro Profumo](#) are considering sales of other assets, both inside and outside of Italy, *Il Sole* reported today. Turkish bank [Yapi & Kredi Bankasi AS](#) may be one of the units sold, *Sole* said.

The financial crisis that left New York-based Lehman Brothers Holdings Inc. and Washington Mutual Inc. of Seattle bankrupt is spreading through Europe. Five banks were bailed out this past week by European governments.

UniCredit shares closed at 3.08 euros yesterday, up 9.6 percent from the previous day, though still down 7 percent compared with the previous week's close. The stock has fallen 46 percent since the start of the year, compared with a 35 percent drop in the Bloomberg Banks and Financial Services Index. **UniCredit Directors to Meet on Capital Increase** <http://www.bloomberg.com/apps/news?pid=20601087&sid=a2RRR1.wY0Y8&refer=home>

Oct. 3 (Bloomberg) -- When Denmark's central bank bailed out Roskilde A/S and its 24 branches in July, there was barely a ripple in Europe's financial industry. Today it looks like the sign of a tsunami of soaring funding costs and falling house prices now crashing over banks from Iceland to Spain.

That may force some of the region's smaller banks to merge, after a week in which governments rescued lenders ranging from Brussels-based Dexia SA to Bradford & Bingley Plc of the U.K.

"There are some institutions that are weaker than others and they will suffer," said [Antonio Ramirez](#), an analyst at Keefe, Bruyette & Woods in London. "Some of these institutions will have to consider M&A as an option for survival."

In Ireland, Spain and the U.K., among the countries hardest hit by the housing slump, 14 banks with 2.7 trillion euros (\$3.7 trillion) of assets have at least 50 percent more loans than deposits,

according to data compiled by Bloomberg. That may put them at risk because they have to borrow to fund lending as credit markets seize up and interest rates rise.

Things are even more precarious in Denmark, where the central bank says loans outstanding equal 2.4 times deposits.

Smaller banks are most at risk because they tend to have lower credit ratings and have a harder time borrowing to fund their operations, said [Simon Maughan](#), an analyst at MF Global Securities Ltd. in London.

“It will be them that feel the funding pressure,” he said. “And that could well trigger them to seek mergers.”

Looking for Window

[Fionia Bank A/S](#) in Odense, Denmark, finalized a plan to sell debt in June and so far hasn't been able to do so. Instead, it is offering 5.75 percent interest on time deposits to attract customers and is reducing real estate loans.

“We have the weapons ready, but at the moment it's not possible for us to go,” said Chief Executive Officer [Finn Sorensen](#). “We're just looking for an open window.”

Sorensen declined to speculate on mergers. Fionia is down 57 percent this year on the Copenhagen Stock Exchange.

Denmark's central bank is in talks with the national bankers association to provide liquidity, Deputy Governor [Torben Nielsen](#) said in an interview, without offering specifics.

The initiative comes on top of a program that began Sept. 26 to offer credit to lenders with “excess capital adequacy.”

“I saw what they did on Friday as a very good move for smaller banks with good solvency where it's only the liquidity situation that could be a problem,” said [Henrik Lund](#), CEO of Naestved, Denmark-based [Max Bank A/S](#).

Rescue Efforts

He added that he was “comfortable” with the bank's funding and had no plans to seek a merger. Max Bank has dropped 79 percent this year in Copenhagen.

Banks' unwillingness to lend to each other helped force European authorities to rescue five lenders this week.

Belgium, the Netherlands and Luxembourg pumped 11.2 billion euros into [Fortis](#), while Belgium and France led a 6.4 billion- euro bailout of Dexia. Bradford & Bingley was seized by U.K.

authorities, Glitnir Bank hf was rescued by Iceland's Financial Supervisory Authority, and Hypo Real Estate Holding AG received a German government loan guarantee.

Ireland said it would guarantee the deposits and debts of domestic banks for two years, covering about 400 billion euros in liabilities at lenders such as Allied Irish Banks Plc, Bank of Ireland Plc and Anglo Irish Bank Corp.

#### 'Triple Whammy'

"It's a triple whammy on the banking sector," said Nick Barnes, head of international research at real estate consulting firm Knight Frank LLP in London. "The interbank lending market is dire, they may have toxic investments or have over-extended themselves, and income streams are drying up."

The cost of borrowing euros for one month at the euro interbank offered rate, or Euribor, climbed 3 basis points to a record 5.12 percent Oct. 2, the European Banking Federation said.

"Money is getting more expensive, when you can get it," Roskilde CEO Soren Kaare-Anderson said in an interview. "That's the key -- whether you can get it."

Mortgage lenders are also suffering as house prices decline.

Danish property prices fell 9.6 percent in the second quarter, the biggest drop in western Europe, a survey by Knight Frank showed. They dropped 8.1 percent in Ireland and 3.9 percent in the U.K.

#### Spanish Slump

Spanish prices declined 0.3 percent in the second quarter, after falling 0.4 percent in the first, the National Statistics Institute said Sept. 24. In Spain, delinquent loans climbed to 40.84 billion euros in July from 13.25 billion euros a year earlier, according to the Bank of Spain.

Some Spanish savings banks that are most exposed to the construction slump may be forced to merge, said [Manuel Romera](#), director of the financial industry department at Madrid's Instituto de Empresa business school.

Madrid-based Banco Popular Espanol SA, Spain's third-biggest bank, rose 5.5 percent on Sept. 16 on speculation it might merge with Banco Pastor SA. The stock has fallen 28 percent this year.

[Juan Echanojauregui](#), Popular's investor relations director, said the lender didn't need a merger. The bank's loan-to-deposit ratio dropped to 1.7 last month from 1.8 a year earlier, as it captured client cash at twice the rate it made loans, he said.

On Sept. 26, Fitch Ratings lowered the ratings on four savings banks, including Caixa Sabadell and Cajasur. A spokeswoman for Sabadell said the lender's liquidity position is "strong." A spokesman for Cajasur wouldn't comment.

"People ask me whether this or that bank is safe," Romera said. "I always say I don't know."  
**Europe's Real Estate Slump May Spark Wave of Local Bank Mergers**

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

**Retail**

**Retirement**

**Risk**

**Savings Rate**

**Tech**

**The Fed**

- Oct. 3 (Bloomberg) -- The \$700 billion rescue that the U.S. House considers today reflects the unintended consequences of decisions made by Treasury Secretary [Henry Paulson](#) and Federal Reserve Chairman [Ben S. Bernanke](#) since March. Beginning with the orchestrated purchase of [Bear Stearns Cos.](#) by [JPMorgan Chase & Co.](#), each step was a bold effort to forestall a collapse of the financial system. The economy grew in the first two quarters of this year, and financial distress eased for a while after the Bear Stearns rescue. **Still, each decision to bail out or not created more instability, leading to further runs on securities firms, banks and insurers.** "Every time you tinker with this delicate system even small changes can create big ripples," said [Dino Kos](#), former head of the New York Fed's open-market operations and now a managing director at Portales Partners LLC in New York. "This is the impossible situation they are in. **The risks are that the government's \$700 billion purchase of assets disturbs markets even more.**" Paulson and Bernanke insist that the program to buy troubled mortgages and other securities is needed to revive lending and restore stability to markets. **What they haven't discussed is the risk that they inadvertently make matters worse. By creating a government pool of distressed real-estate and bad debt, they could depress the housing market further.** Risk may become even more concentrated through a wave of bank mergers that, if unsuccessful, would stick taxpayers with an even higher bill. Conference Call The decision to launch the biggest bailout in history came on a Sept. 17 conference call, when Bernanke and Paulson pulled the trigger on a proposal etched out over several months. Over the previous two days, they let [Lehman Brothers Holdings Inc.](#) fail and seized [American International Group Inc.](#) The reaction to their visible hand: a rout in financial stocks, paralysis in the trillion dollar inter-bank loan market, and flight from money market mutual funds. **Treasury and Fed officials had long been uncomfortable with the way the safety net had to be expanded to catch Bear Stearns. Not a single creditor had suffered a default as the company was swept into**

**JPMorgan Chase & Co. with the help of a \$29 billion Fed loan. Stock investors received about \$10 each.** Their decision to pull back and let shareholders get wiped out in Fannie Mae, Freddie Mac, and then Lehman "sent shivers through investors," said Peter Kovalski, who oversees financial-services stocks for Alpine Woods Capital Investors LLC's \$12 billion portfolio. **"Everybody kind of backed off and said if this is the way the government is going to play the game, we don't want to risk our capital." [think about what he said – he is saying that unless the government will cover our losses we don't want to play – this is the sickness that caused the problems – it is the essence of moral hazard]** Assumptions Thrown Out Lehman's bankruptcy toppled other assumptions that investors had made. Bear Stearns, deemed too big to fail by the Fed and Treasury, had \$399 billion in total assets. Lehman Brothers had \$639 billion in total assets, possibly posing a bigger systemic risk than Bear. **"There was a perception, right or wrong, that after Bear Stearns, that in any firm as big, the senior debt holders would be okay,"** said Karl Haeling, head of debt distribution at Landesbank Baden-Wuerttemberg, New York, Germany's largest state-owned bank. "Obviously, that was the wrong bet." **Bernanke and Paulson began their discussions at the end of the day on Sept. 17, when the Standard & Poor's 500 Financials Index fell 8.9 percent. [so the head of the Fed and a cabinet member decided they did not like stock markets falling – see prior comment about how sick this is]** Investors concluded after the AIG takeover -- the price of an \$85 billion loan -- that any future federal aid would come at a similar cost, and they fled. "Oh, My God" "Are we imploding right here?" Joseph Saluzzi, co-head of Themis Trading LLC in Chatham, New Jersey, and his colleagues asked each other on Sept. 17. **Shares of Goldman Sachs Group Inc. were down 21 percent at noon and Morgan Stanley lost 36 percent. "People thought, 'Oh, my God, if Goldman's going out, we've got a real problem.'" [yep – if Paulson wouldn't take care of his company who would he take care of right?]** Lehman's collapse caused the Reserve Primary Fund, the oldest U.S. money-market fund, to write off \$785 million of debt issued by the investment bank, forcing the fund to break the buck, meaning its net asset value fell below \$1 a share. **The run on money funds, prompted in part by the government's decision to let Lehman fail, caused yet another extension of the safety net by the Treasury and Fed.** On Sept. 19, invoking Depression-era authority, the Fed's Board of Governors authorized its Boston branch to provide emergency loans to commercial banks to purchase asset-backed commercial paper from money mutual funds to help them meet shareholder redemptions. Paulson's Goal **The Treasury is gambling that the \$700 billion plan now being debated in Congress will kick-start capital markets and lending. [yes, the government is putting all their chips on the hard eight]** If the government is a buyer of mortgage securities, they will trade higher, Paulson told Congress. If the banks are cleansed of bad assets, they will find new capital and the cycle of lending will start again. Investors say once again the government's big-footing in the financial markets could create more problems than it solves. **Officials "have designed a financial bailout plan that is not only misdirected, but may further exacerbate problems in the housing market," says Eric Hovde, chief investment officer at Hovde Capital LLC, which manages \$1 billion in financial services stocks. "Just as foreclosure sales are pressuring housing prices today, government sales will only make matters worse." Paulson-Bernanke Steps Created 'Big Ripples,' Leading to Rescue**

<http://www.bloomberg.com/apps/news?pid=20601103&sid=aFzDKV89fQ0g&refer=us#>

Oct. 3 (Bloomberg) -- When [Sheila Bair](#) took over as head of the U.S. Federal Deposit Insurance Corp. in 2006, the agency was probably better known for the "FDIC" logo on the doors of the nation's banks than for anything it did.

Now Bair is at the center of the financial crisis, speeding the takeover of failing banks and pressing the mortgage industry to ease loan terms. And she's vaulted from the leadership of a once-sleepy regulator into the league of Treasury Secretary [Henry Paulson](#) and Federal Reserve Chairman [Ben S. Bernanke](#), winning praise from Democrats and Republicans.

"She has more power because of the situation on the ground," said Senator [Charles Schumer](#), a New York Democrat. "No one is going to put handcuffs on her."

"She's going to be Treasury secretary someday," said [Tim Adams](#), a former department undersecretary under President [George W. Bush](#) who worked with Bair when she was an assistant secretary.

In just the last week, Bair, 54, invoked never-before-used authority to avert a financial-system breakdown by brokering a deal for [Citigroup Inc.](#)'s to buy [Wachovia Corp.](#)'s banking operations. She seized [Washington Mutual Inc.](#) and sold it to [JPMorgan Chase & Co.](#) and convinced the Senate to temporarily increase the FDIC's insurance of individual bank deposits -- a move Paulson opposed.

The FDIC chairwoman is working to get Congress to bestow more power on the agency. On Wednesday, as the Senate was reworking the \$700 billion financial-market bailout bill to attract more votes, Bair tried to get lawmakers to cede control over how high FDIC insurance limits can rise.

### Shopping a Proposal

Over breakfast in the dining room off her office, she handed [Camden Fine](#), president of the [Independent Community Bankers of America](#), legislative language she wanted him to shop around on Capitol Hill.

Fine represents 5,000 community bankers, the sort of "Main Street" constituency that could help convince skeptical House members the bill was essential not just to Wall Street, but to their hometowns.

The proposal would temporarily lift the insurance limit on bank deposits to \$250,000 from \$100,000 and give the FDIC authority to change that limit without congressional approval.

Senate Banking Committee Chairman [Christopher Dodd](#) said no to giving that kind of discretion to the agency, and the language was left out. Bair will bring it up again, Fine said.

## 'Destroyed the Market'

To be sure, she has angered investors. Some Wachovia shareholders blame her for wiping them out when she helped engineer the sale and warn that other banks will suffer for it.

"That destroyed the market," said [Peter Kovalski](#), senior portfolio manager at Alpine Woods Capital Investors LLC. "Taking over a healthy, well-capitalized bank, the way they did, now investors are not going to be willing to invest in any bank."

Those angry investors may get a reprieve because Wells Fargo & Co. offered \$15.1 billion for Wachovia, valuing the company at \$7 a share, outbidding Citigroup's \$2.16 billion offer for parts of the troubled bank. Citigroup has demanded Wachovia terminate the Wells Fargo deal.

"The FDIC stands behind its previously announced agreement with Citigroup," Bair said in a statement today. "The FDIC will be reviewing all proposals and working with the primary regulators of all three institutions to pursue a resolution that serves the public interest."

## Industry Reluctance

Bair's efforts to prod mortgage lenders to reduce loan principals for borrowers in danger of losing their homes have been met with reluctance from the industry. And some analysts say she hasn't done enough to clear out insolvent banks.

"She really hasn't shown her mettle in aggressively seizing banks and helping to sort out solvency issues," said [Joseph Mason](#), an economist at Louisiana State University.

Still, Bair -- a lifelong Republican who has made a career in regulation with a decidedly non-Republican bent -- has stood out in an administration that's been criticized for going easy on oversight.

Bair, who has pushed banks to carry less debt and for strong net capital standards, has been "a tougher regulator in a reasonable way than most Bush appointees," said House Financial Services Committee Chairman [Barney Frank](#), a Massachusetts Democrat.

## Spreading Crisis

And in the last two years, as the crisis has spread to the broader financial system, she's been getting out in front of fellow Republicans, including Bernanke and Paulson.

In September 2006 she told a [Fannie Mae](#) conference she was concerned that the proliferation of non-traditional mortgages such as option ARMs was a danger to the banking system. In March 2007, she called for "aggressive" foreclosure relief.

Two months later, as Paulson declared the housing market crisis more than half over, Bernanke echoed Bair and called on lenders and the government to intensify efforts to prevent home foreclosures.

“She was one of the first to say that you couldn't just do it by interest rates, that you had to reduce the principal and that you couldn't just do it one by one,” Frank said in an interview. Bair wasn't available for an interview.

### Making a Point

When Bair found herself in control of IndyMac in July, she used the bank to make her point. She suspended foreclosures on \$15 billion worth of mortgages and sought to work out deals for the 60,000 borrowers who were behind in payments.

“My hope is that the program for IndyMac Federal Bank will be a catalyst for others across the country to modify their loans more rapidly and systematically,” she told lawmakers at a hearing last month.

The Independence, Kansas, native was an adviser to former Senator [Robert Dole](#) throughout the 1980s before taking on roles at the Commodity Futures Trading Commission and the New York Stock Exchange. In 2001, she joined the Treasury Department.

She didn't fit in easily with the Bush administration's free-market, anti-regulation ethos, former associates said.

She spoke out in support of strong consumer protection and wasn't afraid to preach the virtues of regulation. She left Treasury in 2002 to teach at the University of Massachusetts at Amherst.

“I didn't know how I would replace her,” said Adams, who was Treasury chief of staff at the time.

### Virtues of Regulation

Bair doesn't shy away from acknowledging the problems in banking. More of them will fail, she told Bloomberg News in a Sept. 26 interview.

“The number will go up,” she said. “Banks overall continue to be safe and sound and very well-capitalized.”

At an event at the National Press Club a few days earlier, she said the most high-profile problems are coming from non-banks.

“There is some virtue to regulation,” she said. **Bair Turns Once-Obscure FDIC Into Power in Crisis**

<http://www.bloomberg.com/apps/news?pid=20601109&sid=aj3KhFB4NveY&refer=home>

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## Don't Fight The Fed

Oct. 4 (Bloomberg) -- U.S. President [George W. Bush](#) signed a \$700 billion financial-market rescue plan into law, **calling it a ``decisive action to ease the credit crunch that is now threatening our economy.''**

The bipartisan legislation was sent yesterday to Bush after it was approved by the House, reversing its Sept. 29 rejection of the measure, which had sent global stock markets plunging. The bill, approved on Oct. 1 by the Senate with \$149 billion in tax breaks to attract House votes, authorizes the government to buy troubled assets from financial institutions reeling from record home foreclosures. It also affirms regulators' power to suspend asset-valuing rules that companies blame for fueling the crisis.

``This was a difficult vote for many members of the House and Senate, but voting for it was the right choice for America's economy and for taxpayers like you," Bush said in his weekly radio address today. ``I appreciate their efforts to help stop the crisis in our financial markets from spreading to our entire economy.''

The House [approved](#) the measure 263-171 yesterday, four days after rejecting an earlier version by 228 to 205. The bill's defeat caused a 778-point drop in the Dow Jones Industrial Average, prompting dozens of lawmakers to switch their vote on the package, the government's largest step into the markets since [Franklin Roosevelt's](#) New Deal.

### 'Stopping the Panic'

``The issue is stopping the panic," said [Adam Posen](#), deputy director of the Peterson Institute for International Economics in Washington. ``The plan's not perfect, but it's certainly better than doing nothing. Now Treasury has to be very aggressive about purchasing a wide range of assets very quickly.''

The [Dow Jones Industrial Average](#) fell 1.5 percent to 10,325.38 in New York on concern the bailout won't be enough to unlock credit markets and prevent a recession. The S&P 500 declined 1.4 percent to 1,099.23 and the Nasdaq Composite Index slipped 1.5 percent, to 1,947.39.

House Majority Leader [Steny Hoyer](#), a Maryland Democrat, called the package ``critical to stabilizing our economy.''

Passage of the rescue bill drew praise from financial authorities in Asia, where stocks had earlier posted the sharpest weekly drop in 13 months on concern the bailout may fail to stimulate demand for the region's exports.

### Asian Praise

China's [central bank](#) said it hopes the rescue will enhance cooperation and coordination with the U.S. and among other countries to stabilize global financial markets.

“All countries should take the responsibility to cooperate, as we share the same interest and goal in facing this crisis,” the People's Bank of China said in a statement on its Web site.

Japanese Finance Minister [Shoichi Nakagawa](#) called the package “very ambitious” and “a plus for financial conditions in the U.S. and globally.”

Bush made more than a dozen phone calls to Republican lawmakers to lobby for the bill. The bill was backed by 172 Democrats and 91 Republicans. Over two-thirds of Democrats voted for the measure while fewer than half of Republicans supported it. On Sept. 29, the 140 Democrats voting for the plan were joined by 65 Republicans.

### Stock Market Drop

“The stock-market drop on Monday served as a wake-up call to a lot of people,” said Representative [John Yarmuth](#), a Kentucky Democrat who announced he was switching his vote in favor of the bailout plan.

House leaders had said they wouldn't set a vote on the revised measure unless they were sure it would pass.

A group of Republicans Oct. 2 tried to offer an alternative that would spend only \$250 billion until the end of the year.

Representative [Spencer Bachus](#) said that out of “prudence” Congress should appropriate only the \$50 billion a month the Treasury could distribute this year.

The Democratic-controlled Rules Committee rejected the amendment, saying any changes to the measure would require Senate action, delaying the start of the program. The Senate approved the legislation on Oct. 1.

### Republican Opposition

Some Republican lawmakers opposed the measure yesterday, defying Bush and the party's congressional leaders.

“If Congress bails out some firms and sectors, how can it say no to others?” said Representative [Jeb Hensarling](#) of Texas.

Treasury Secretary [Henry Paulson](#) and Federal Reserve Chairman [Ben S. Bernanke](#) proposed last month the largest intervention in financial markets since the Great Depression, in a three-page outline.

They said it was needed to prevent the spread of economic turmoil sparked by a record number of home foreclosures. Among the victims were [Lehman Brothers Holdings Inc.](#), which was forced into bankruptcy last month, and [Fannie Mae](#), [Freddie Mac](#) and [American International Group Inc.](#), which were taken over by the government.

Paulson urged Congress to immediately give him almost unchecked legislative authority to take action. Lawmakers responded by demanding increased oversight, more aid to prevent foreclosures and limits on executive compensation at companies that benefit from the program.

Bush endorsed a compromise, saying it was needed to prevent a painful recession.

### Local Governments Hit

Credit-market turmoil is hitting local governments. U.S. states and municipalities have managed to sell about \$700 million of tax-exempt [bonds](#) this week, less than 15 percent of a typical week's new fixed-rate issues.

California Governor [Arnold Schwarzenegger](#) wrote Paulson, saying that his and other states may need emergency federal loans to maintain government operations if the credit crunch continues.

“This credit crisis has the power to grind the U.S. economy to a halt,” Schwarzenegger wrote in a letter e-mailed to Paulson.

Companies lobbied in support of the rescue measure. Automakers said tougher loan standards partly accounted for a 27 percent plunge in U.S. auto sales last month.

The market for commercial paper, short-term borrowing by businesses, suffered the biggest one-week drop on record, the Federal Reserve said Oct. 2. The amount of commercial paper outstanding fell by \$94.9 billion, or 5.6 percent, during the week ended Oct. 1.

### Helping Main Street

“This is not a bailout for Wall Street anymore,” [Carolyn McCarthy](#), a New York Democrat who represents suburbs near New York City, said on the House floor yesterday. “This is about the small stores on Main Street.”

Still, House lawmakers earlier this week rejected the agreement that congressional leaders reached with the administration, with many saying it was too risky and costly.

The Senate then sweetened the package -- and enlarged the legislation to 450 pages -- by linking the rescue plan to a temporary increase in the limit on federal deposit insurance to \$250,000 from \$100,000.

The Senate also tied the package to a two-year extension of tax breaks that will save individuals and corporations about \$149 billion over the next decade, a move popular among House Republicans. The provisions include \$17 billion in credits for the development of solar, wind and other forms of renewable energy.

### McCain, Obama

Democrat [Barack Obama](#) and Republican [John McCain](#) returned from the presidential campaign trail to vote for the plan in the Senate this week.

Obama said he had talked to several lawmakers in an attempt to generate support for the legislation.

“There were a number of members of Congress who had voted no that I talked to,” Obama said in Glenside, Pennsylvania.

“And I think more than anything what they wanted was some assurance that this \$700 billion was not going to a few banks but that in fact, that it is designed to ensure that the credit markets are working for Main Street.”

McCain, in comments in Flagstaff, Arizona, said the bill “isn't perfect and it's an outrage that it's even necessary.”

“The action Congress took today is a tourniquet,” he said. “Further action is needed and it shouldn't take a crisis to get this country to act.”

The bill also affirms the U.S. Securities and Exchange Commission's authority to suspend an accounting rule that bankers and other corporate executives say exacerbates their troubles.

The so-called fair-value standard requires companies to review assets and report losses if their values decline. Lawmakers, the American Bankers Association and companies including [American International Group Inc.](#) have urged the SEC to suspend or ease the rule, saying it forces firms to report deeper losses than needed on assets such as subprime mortgages.

Federal Reserve Chairman [Ben S. Bernanke](#), applauding enactment of the rescue plan, said the central bank will keep using “all of the powers at our disposal” to ease the credit crisis. **Bush Signs Bank Rescue to End Threat to Economy'**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=ad4VH6tMLj9Y&refer=home>

## Wall Street

Oct. 2 (Bloomberg) -- One of the stock market's latest villains is a 32-year-old self-described “math geek” from a Minneapolis suburb who won't move to Wall Street unless they let him wear flip-flops. [Matthew Paschke](#), who manages the \$165 million [Grizzly Short Fund](#) at the Leuthold Group, says short sellers like him have become scapegoats for the financial crisis that's wiped out \$20 trillion from stocks and brought down Bear Stearns Cos. and Lehman Brothers Holdings Inc. “The whole witch hunt is unfounded and it's frustrating,” said Paschke, a father of three, in Leuthold's 46th floor offices overlooking the Mississippi River. “**They're changing the rules on the fly, so for those of us that make our livelihood in this business that becomes a very, very difficult proposition.**” Moreover, the ban may prolong the downturn by propping up companies that borrowed heavily and took on too much risk, he says. The Grizzly fund has returned 41 percent this year. Through August it almost tripled the average gain for hedge funds specializing in bearish bets. Paschke declined to identify any companies his fund shorts. “Short

selling is out of control," Brooks said. "There should be a huge economic cost to the hedge fund who decides they shouldn't borrow the shares." Short sellers such as David Tice, who runs the \$1.08 billion Prudent Bear Fund, and James Chanos, president of the \$7 billion hedge fund Kynikos Associates Ltd., say their funds don't engage in naked shorting. Paschke says his firm doesn't either. Dressed for Success Paschke was born in Minnesota and married while attending the University of Northern Iowa in Cedar Falls. He says he's "Midwest-rooted." Working at Leuthold, which advises two-thirds of the biggest U.S. money managers, allows Paschke to wear shorts and sandals to the office and spend weekends wakeboarding with his family on Prior Lake near his home, about 20 miles (32 kilometers) southwest of downtown Minneapolis. Living more than 1,000 miles from Wall Street also provides perspective on the crisis that has spurred almost \$600 billion in writedowns and credit losses tied to subprime mortgages, he said. No Emotion The Grizzly fund, which is always 100 percent short and usually bets against 60 to 75 companies, trimmed its holdings in financial companies to about 16 percent of its balance four days before the SEC banned short sales, Paschke said. The proportion has since fallen to 12 percent. On Sept. 2, financial shares accounted for 26 percent of the fund, Leuthold's Web site showed.

In the week leading up to the ban, Morgan Stanley and Goldman Sachs Group Inc., the last two independent securities firms on Wall Street before they converted into deposit-taking banks, had the biggest one-day drops on record. Paschke says it is unlikely short sellers alone caused the declines.

He notes that almost two-thirds of the companies on the SEC's banned list have fallen below their closing price on Sept. 18, the day before the restrictions were put into place.

Paschke, who holds a bachelor's degree in finance with a minor in math and earned a master's in business administration from the University of Minnesota, doesn't visit companies and rarely goes on earnings calls to decide which stocks to short.

He relies instead on mathematical models he helped develop that use 17 measures. The quantitative-based strategy, Paschke says, keeps him from getting "emotional" about individual companies and holding onto short positions that lose money.

"Money managers tend to get married to a name," he said. "They fall in love with all these things that take their eye off the ball. We strive to avoid that." **Short-Selling 'Math Geek' Not Naked, Covered in Blame**  
<http://www.bloomberg.com/apps/news?pid=20601109&sid=a4JOcJNafRyQ&refer=exclusive>

## I Disagree . . . and why

[Article of the week:](#)

## Best of the Dog

Friday, September 19, 2008 at 07:48 CDT

### **the government meddling, not short selling is the problem**

in what one would hope is the final final card left to play

the government has (a) stopped short selling - this is entirely a PR move. short selling is not the problem. short sellers are a grain of sand on the beach. if the entities being shorted were worth substantially more than the current valuations, they would have had NO problem raising equity. the fact that the LEH's of the world went under had NOTHING to do with short sellers. instead it had everything to do with an understanding their liabilities far exceeded their assets. (b) created further bailouts using taxpayer money to reward those who made stupid bets.

the short term impact is to steal more money from those who think and give it to those who don't. sadly this is a national past time lately.

the intermediate term impact is a collapse of the stock market, which in fact ceased to function properly years ago.

the longer term impact is a substantial decline in the U.S. in living standard as the burden of paying for all this is dumped on your children and grandchildren.

what will be interesting today is not where we open but where we close.

the dog thinks it will be much lower than the open and that this latest scheme fails within 3 weeks.

Posted by Maxie  
(0) [Comments](#) • [Permalink](#)

<http://www.maxiethedog.com/maxieblog/index.php?P30/>

### **appendix**

## 1987 Timeline

Many people remember the events leading up to October 19, 1987. Unfortunately, very few of them recall the specifics. When many people talk about the dramatic drop in the overall stock market, they either blame a single cause ([portfolio insurance](#)) or treat the market fall as if it were something that came from out of the blue. Far from being a lightning strike or an act of God, the crash was a single event caused by a complex series of interconnected events. Hopefully after perusing the timeline we have constructed to review the events leading up to the crash, you will come to the same conclusion.

## **January 1, 1987**

The year opens with bond yields near their lowest levels in nine years. Corporate treasurers have been issuing debt like it is going out of style, coining more than \$200 billion in notes during all of 1986 -- two times the level of debt issued in 1985. A healthy market for junk bonds -- bonds issued that are considered below "investment grade" -- has helped tremendously. "With bond rates expected to remain at low levels, investment bankers predict that corporations will continue to flock." (New York Times, Jan. 2, 1987)

## **January 8, 1987**

The Dow Jones Industrial Average closes at 2,002.25, breaking the 2,000 level for the first time. Trading volume swells to 194.5 million shares and most other stock indices set records as well. Optimism abounds that the string of records will bolster investor confidence and bring new investors into the market.

## **January 22-23, 1987**

**The Dow Jones Industrial Average leaps 51.60 points to 2145.67 on January 22, making its largest one-day point rise ever. Although well below any record for a percentage gain, the news is taken as another indicator that demand for stocks remains strong. The euphoria is slightly eroded the next day when the Dow plunges 114 points in 71 minutes on January 23. Program trading based on the difference between the value of stock futures and the cash market is blamed for the swing. Treasury Secretary James Baker expresses concern about the "excess" volatility.**

## **February 5, 1987**

The Securities Exchange Commission (SEC) announces that it is moving well beyond its initial focus in its investigation of Ivan Boesky. This case, coupled with half-a-dozen others that will break over the next few months, will make insider trading household words. Boesky's investigation hinges on a \$5.3 million invoice to Boesky from Drexel Burnham Lambert, the firm that made junk bonds popular. The SEC wants to know why Drexel sent one of its major customers a bill for that amount. The SEC further subpoenas Guy O. Dove, another large junk bond customer of Drexel and continues to gather records on other Drexel customers.

## **February 9, 1987**

Former Lazard Freres & Co. investment banker Robert M. Wilkis is sentenced to two concurrent prison terms for participating in an insider trading scheme with Dennis B. Levine. Wilkis allegedly earned \$4 million in two offshore accounts as a result of trading based on inside information. Randall D. Cecola receives a five-year suspended sentence for his role in the scheme.

## **February 12, 1987**

The next round of insider trading allegations taints Goldman, Sachs and Kidder, Peabody. Robert Freeman, Richard Wigton, and Timothy Tabor are all arrested and charged with insider trading violations. Federal prosecutors allege that the three have made millions of dollars based on insider information.

### **February 13, 1987**

Prominent investment banker Martin Siegel pleads guilty to a number of tax and securities charges. Siegel coughs up \$9 million in fines, faces up to ten years in prison, and admits that he was the informant who fingered Freeman, Wigton, and Tabor. Siegel also narcs on Boesky, stating he got \$700,000 after he supplied information about ongoing corporate takeovers he was privy to as a result of his job at Kidder, Peabody. Siegel worked at Kidder, Peabody for 15 years before moving to Drexel Burnham in February of 1986. Some pundits question whether or not the takeover boom can continue due to the investment banking profession being tainted by these alleged improprieties.

### **February 18, 1987**

Robert Prechter, an Elliott Wave guru who is currently peddling a book forecasting a crash, states that he thinks the Dow Jones Industrial Average will hit somewhere between 3,600 and 3,700 in 1988. The actual high for the year is 2193.75 in December.

### **March 5, 1987**

The investigation into Drexel Burham Lambert heats up after the government subpoenas more than a dozen of its clients. The probe has obviously expanded beyond Boesky and Drexel's basic practices in the junk bond and investment banking arena. Based on interviews, journalists conclude the government is looking for systematic violations in insider trading laws. Drexel is now officially under siege by U.S. prosecutors.

### **March 11, 1987**

The ever-vigilant SEC snares Merrill Lynch's Nahum Vaskevitch in its growing inside trading web. The agency alleges that Vaskevitch fed information to Israel-based David Sofer about as many as twelve mergers or acquisitions that he was privy to in his role as head of international mergers and acquisitions.

### **March 12, 1987**

PaineWebber broker Gary Eder and a number of other PaineWebber employees are indicted for tax evasion. Although unrelated to the flurry of insider trading allegations, the fact that they were helping clients to filter money out of their accounts in ways that avoided reporting gains to the IRS does nothing to help Wall Street's increasingly tarnished image.

### **March 16, 1987**

No one is safe from the long arm of the SEC. Takeover master Carl Icahn announces that he is under investigation for possible violations of securities laws. Although the specific takeover under scrutiny was not specified, the Chairman of TransWorld Airlines appears unperturbed by the news.

### **March 19, 1987**

The Boesky probe brings down West Coast broker Boyd Jefferies. Jefferies agrees to plead guilty to two felony charges related to manipulating stock prices. Jefferies is forced to resign as president of Jefferies & Co. and is barred from the securities business for at least five years. The firm agrees to a permanent injunction against breaches of securities law and to censure.

### **March 21, 1987**

The fall of Jefferies & Co. quickly sucks American Express Shearson Lehman Brothers and Salomon Brothers into the inquiry. Both firms are subpoenaed as part of the investigation of stock manipulation, focusing on the firms underwriting practices, as well as those of the American Express majority-owned Fireman's Fund unit.

### **March 30, 1987**

Wall Street's first quarter ends with a bang. Stock prices worldwide have surged 22% after netting out the dollar's decline. Companies took advantage of this by issuing more stock and bonds. IDD Information Services estimated that companies issued \$87.7 billion in the first quarter alone, up 27% year-over-year. Unfortunately for stockholders, it is here at the end of the first quarter that the dollar's continued decline started to hurt stock and bond holders. The Dow Jones Industrial Average slumps 57.39 to 2,278.41 and bond prices fall to their lowest levels since last fall.

### **April 9, 1987**

A former director of a Federal Reserve bank becomes embroiled in the insider trading mess. Robert Rough is accused by a number of witnesses of leaking market-sensitive information to Bevill, Bresler & Schulman. In an unrelated charge, the former president of the brokerage, Gilbert Schulman, is accused of participating in a scam involving Treasury bonds to cover up the firm's losses. Against this backdrop, Treasury bonds rise to above 8.0% for the first time in 13 months.

### **April 16, 1987**

As if the opinion of Wall Street could not get lower, 15 employees of various Wall Street firms are arrested by Federal agents and charged with selling cocaine. Furthermore, they are charged with trading drugs for information, stock, and lists of preferred clients. To emphasize the amount of drugs flowing to Wall Street, the New York City Police Department states that 114 people were arrested for buying and selling cocaine on the streets and in parks around the financial

district so far in 1987. Two undercover agents who were part of the Federal bust state that cocaine is either used or accepted by 90% of the people on Wall Street.

### **April 23, 1987**

Bond fund redemptions accelerate as the prices of bonds continue to plunge. Many are concerned that the falling dollar could revive inflation. Prices of bonds are off as much as 10% since the end of March after rising nearly 100 basis points. Ivan Boesky pleads guilty to conspiracy to lie to the government. Boesky is released without bail and his sentencing is scheduled for August 21. The same day, Guinness PLC takes a \$206 million charge partially related to the firm's relationship with Boesky.

### **April 27, 1987**

The Drexel Burnham Lambert probe is now focusing on the Beverly Hills office of Michael Milken, the man behind the company's high-yield bond operation. The government is being helped along by Charles Thurnher, a Drexel executive with intimate knowledge of the company's operations.

### **April 29, 1987**

The dollar and bond prices both plummet after the House of Representatives passes an amendment to take measures to reduce the trade surpluses held by many Asian nations. Many fear that foreign investors, particularly the Japanese, now will not participate in the Treasury's quarterly funding auction. Representative Dick Gephardt is behind the legislation.

### **May 16, 1987**

**Speculative companies with little more to offer than interesting stories account for many of the year's best performing stocks.** Among them are: AT&E Corp., a company developing a wristwatch-based paging system; Copytele, a company that makes flat-panel video display products; Carrington Labs, up on speculation that a drug it has can reduce AIDS symptoms. Analyst Evelyn Geller of Blair & Co. says of AT&E, "The thing could trade anywhere -- up to 30 times earnings. So you're talking about \$1,000 a share.... You can't put a price on this -- you can't. You don't know where it is going to go. You are buying a dream, a dream that is being realized." Although Geller speaks specifically of AT&E, her comments can be taken as a general indicator of the type of analysis that has caused these price eruptions. AT&E, for its part, no longer trades.

### **May 17, 1987**

An article in the New York Times discusses the many investment banks that are considering cutting personnel due to impending bad times. Rising inflation, a widening insider trading scandal, and rising bond yields are blamed for the pessimistic outlook.

### **May 19, 1987**

Besieged Drexel Burnham Lambert publishes a study it conducted of 23,000 U.S.-based companies with sales of at least \$25 million and pointed out that less than 800 qualified for investment grade bond ratings. This is a transparent attempt to shore up public opinion regarding the company's junk bond operations, which have come under scrutiny due to the expanding insider trading investigations.

#### **June 4, 1987**

Kidder Peabody pays a record \$25.3 million to settle outstanding insider trading charges against the firm. One of the charges settled was that the 80% General Electric-owned brokerage conspired with a small firm led by Ivan Boesky to illegally trade stocks.

#### **July 17, 1987**

**Crude oil prices hit \$22.39 per barrel, up from only \$16.40 in March and the high \$17 range at the beginning of the year. Although prices would fall back to the \$20 range in August and stick there until the crash, the 11% increase in crude oil prices from the beginning of the year created a lot of anxiety over inflation. It was inflation anxiety in part that drove yields on the 30-year government bonds higher and higher.**

#### **July 22, 1987**

Treasury bond markets stand in disarray as government bond yields continue to climb. The 30-year bond touches 8.79%, its highest level since early June and well up from 8.5% on July 14. This jump marks the beginning of a massive bond swoon that will carry the yield as high as 10.22% on August 15.

#### **August 24, 1987**

Standard & Poor's reports that 158 companies listed on the New York Stock Exchange have split their stock so far in 1987. Most anticipate the year will be a record for stock splits and Standard & Poor's forecasts a total of 250 by the end of the year. The yield on the 30-year government bond hits 8.98%. The next day, the Dow Jones Industrials hit 2722.4 -- a high that will not be breached until exactly two years later on August 24, 1989.

#### **September 29, 1987**

The 30-year Treasury hits 9.77%, its highest level since December of 1985. Traders describe a discouraging environment where everyone has Treasuries to sell but no one is buying. The Dow Jones Industrial Average has already fallen to 2590.6, 4.8% below the all-time high hit the month before.

#### **October 6, 1987**

A rally in bond prices since the Sept. 29 fizzles and equity prices begin to feel the downward pull of the long bond's gravity for real. The Dow Jones Industrial Average drops 3.47% to 2548.63 on

volume of 175.6 million shares. Waves of computerized selling make it difficult for the market to maintain equilibrium. Many pundits blame **portfolio insurance** for the accelerated decline. Two days later long bond yields stand at 9.91%.

### **October 12, 1987**

**Confidence among the major investment banks begins to deteriorate.** Salomon will dismiss 12% of its municipal bond workforce and will re-examine how much space it needs in New York City. The volatile, downward market in bonds has caused profits at the nation's largest investment bank to plummet. Sources say that 800 employees will get the axe. The next day Kidder Peabody announces that it will cut its municipal bond trading operations by 35%.

### **October 14, 1987**

**The Dow Jones Industrial Average drops a record 95.46 points to 2412.70. The Dow will tumble another 58 points the next day, taking the venerable index down more than 12% from its all-time high hit on August 25. Pundits blame a widening foreign trade deficit that is fueling the dollar's descent and consequently weighing on bonds.** The Japanese yen and the Swiss franc have both risen substantially in the past two months. Computerized trading, possibly a result of portfolio insurance, has led the downward charge.

### **October 16, 1987**

Iranian missiles hit a U.S.-flagged tanker off of the coast of Kuwait. Only five months before, an Iraqi missile hit the U.S. frigate Stark, killing 37 sailors. **Fears of heightened tensions as a result of the inevitable U.S. retaliation drive the Dow Jones Industrial Average down 108.35 points to close at 2246.74 on record volume.** The yield on the 30-year bond stands at 10.12%. Treasury Secretary James Baker voices concern about plunging stock prices, although he states that they have dropped "from a very high level." Many economists take the dramatic rise in bond yields that have precipitated the tumble in stocks as a sign that the Federal deficit and the balance of trade both need to be addressed.

### **October 17-18, 1987**

**The weekend before the crash, millions brood over what is perceived to be a worsening economic picture and become increasingly concerned about tensions in the Middle East. With the risk-free yield on a 30-year bond at 10.12%, only a hair below the long-term annual return from the stock market of 10.60%, many must be wondering why they are in stocks at all. Government officials decry bond yields as "needlessly high" and based on "exaggerated fears of inflation."**

### **October 19, 1987**

In the early morning, two U.S. warships shell an Iranian oil platform in the Persian Gulf. Combined with a myriad of economic factors, this helps to set off an unprecedented 508 point downpour in the Dow Jones Industrial Average, leaving it at 1738.74. The 22.6% deluge is the

worst one-day beating the index has taken since hostilities were initiated in World War I and causes the 12.8% decline of October 28, 1929 to pale in comparison. The Dow is down 983.66 points since August 25, a 36.1% decline. Chaos reigns on the trading floor as many specialists simply give up, flooded with orders. Volume hits 604.3 million shares, almost twice the prior record of 338.5 million set on October 16. Many economists cast dire predictions, noting the 1929 crash preceded the Great Depression.

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Although investors stand about today, white-knuckled and awaiting the next crash, it remains obvious that many of the principal drivers leading to the 1987 crash are not present today. The rise in bond yields, crude oil prices, and the trade deficit combined with the collapse of the dollar and general investor confidence all provided the context for the collapse in stocks. Although valuations were near all-time highs prior to the crash, the valuations themselves did not drive the crash -- it was the exogenous events that muddled economic forecasts and that in the end wrecked havoc with bond prices that provoked the cataclysm. Like a closed room filling with gas from a leaking pipe, it is hard to blame the resulting explosion completely on the poor soul who struck a match.

In 1987, bond yields went from 7.28% to 10.22% in nine months. If a similar move in yields were to begin today, yields on 30-year Treasuries would have to increase to 9.0% by July of 1998. What institutional money manager in late 1987 would think twice about nabbing bonds yielding 10.22%, very close to the historical average return from stocks? Not very many. This swelling in the yield of the average bond was driven by increasing fears of inflation, the falling dollar, the widening trade deficit, and rising oil prices -- all culminating in mid-October when tensions in the Persian Gulf increased after the attack on the U.S. frigate Stark. Volatility in the stock market had been exacerbated for months leading up to October 19th because of all these factors -- the crash was the culmination of all these factors, not some natural disaster or force of God.

Looking over the historical record, the collapse of confidence in Wall Street also appears critical to the collapse in equity prices. With Milken, Boesky, Siegel, and Freeman all were pulled into court, this was a strike at the elite of arbitrage and mergers and acquisitions. The level of corruption and unfair practices that was revealed as routine on Wall Street in the ten months leading up to the crash can compare only with the systematic abuses recorded in the late 1920s that led to the Securities Act of 1933, the Securities Exchange Act of 1934, and formation of the Securities and Exchange Commission. Although it is hard to say with any certainty that this was a crucial pre-existing factor, it seems clear in retrospect that as more saw Wall Street as a rigged game, they were less likely to remain confident in the face of mounting anxiety.

Certainly concrete things like program trading and portfolio insurance also had a role in the sudden, spectacular collapse on October 19th. However, a muddled economic picture that drove bond yields up nearly 3.0% and diminished confidence in Wall Street created a backdrop that made a fall almost inevitable. Perhaps the reason so many can claim they "called" the crash was because even at the time this backdrop of rising yields and increased skepticism was clear. Although over the past few years we have seen short, sharp drops in the market driven by

increased uncertainty about the economy or various industries, it seems impossible when one looks at the historical record to come to any other conclusion -- crashes occur after bond yields explode and confidence begins to waver, not before. People who talk of stock market crashes, major drops on the scale of 1987, as if they just happen are ignoring the facts.

<http://www.fool.com/features/1997/sp971017crashanniversary1987timeline.htm>

- OCTOBER 15, 2007

### **Looking Back at Black Monday: A Discussion With Richard Sylla**

**By ANNELENA LOBB**

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The magnitude of the Oct. 19, 1987, Black Monday stock-market crash can still unnerve even the most seasoned investors.

The Dow Jones Industrial Average dropped by 508 points that day to close at 1738.74, a 22.6% slide. The crash rippled into other global financial markets and stirred fears of another Great Depression. Markets haven't seen such a steep one-day loss in percentage terms since then, even amid such episodes as the 1997 Asian financial crisis; the aftermath of the Sept. 11, 2001, terror attacks, when the Dow shed 684.81 points on Sept. 17; or this year's credit meltdown.



Richard Sylla

Could something like Black Monday happen again? The Wall Street Journal Online asked Richard Sylla, the Henry Kaufman Professor of the History of Financial Institutions and Markets and Professor of Economics at New York University's Stern School of Business, to put the crash in its historical context and to consider whether markets could ever face a comparable plunge.

\* \* \*

**Q:** *What happened in the period leading up to Black Monday?*

### Remembering Black Monday



- [WSJ Video](#): More than 20 years have passed since the market experienced one of its worst days in history. Veteran-floor broker Ted Weisberg of Seaport Securities speaks to WSJ.com's David Gaffen about the infamous day.
- [Crash Comparison Chartbook](#) -- See how the Black Monday crash of 1987 compares with other dramatic stock-market drops, including the Great Crash of 1929, the first day of trading after the 9/11 attacks, and more.
- [Then & Now](#) -- What's changed, and what's stayed the same, on Wall Street and in the rest of the world since 1987.

**A:** There was a long period when the stock market didn't do much, [as the economy experienced] years of high inflation. But we saw an upsurge from a low point in 1982. The market paused in 1984, and in 1985 through 1987 there was a rapid run-up again, on the order of the mid- to late-1990s, at least in terms of percent gains. Then, in October 1987, there's that huge drop.

In 1987 itself, the market rose rapidly all the way to August. Every two to three weeks, it seemed the Dow gained 100 points. Inflation had come down, the economy was better. [Ronald] Reagan was president, and there was some optimism. And new financial technology was coming in -- futures, index futures, portfolio insurance, program trading. Later, these were instrumental in the crash.

**Q:** *What are your recollections of the day?*

**A:** By around noon, people were talking. The market was down a lot, and it actually was down by much more than it seemed because the ticker was running behind. [Just over] six hundred million shares traded that day. It doesn't sound like a lot today, but that volume was unprecedented then. In the 1960s, 10 million shares traded on a big day.

**Q:** *Why do you think the crash occurred?*

**A:** The external, or macroeconomic reasons, included disputes between the U.S. and European countries, particularly Germany, about foreign-exchange rates and interest rates in October. Jim Baker was Treasury Secretary. He was publicly disagreeing with his German counterpart, and markets like a united front. There were fears about inflation, and the Fed didn't have the confidence of the financial community that it has today.



NYSE

Traders swarmed the floor of the New York Stock Exchange on Black Monday.

The internal reasons included innovations with index futures and portfolio insurance. I've seen accounts that maybe roughly half the trading on that day was a small number of institutions with portfolio insurance. Big guys were dumping their stock. Also, the futures market in Chicago was even lower than the stock market, and people tried to arbitrage that. The proper strategy was to buy futures in Chicago and sell in the New York cash market. It made it hard -- the portfolio insurance people were also trying to sell their stock at the same time.

**Q:** *What exactly is portfolio insurance?*

**A:** When the market goes down, you want to insure against too big a loss, so you sell stock and move into cash to limit losses on your portfolio. Once the market starts to go down, portfolio insurers sell to make sure you don't lose even more. But they're also assuming buyers will be there, and on that day, the buyers disappeared and that pushed prices down very fast. Portfolio insurance depends on an unlimited amount of liquidity. But when everyone's heading for the exits at the same time, it's not going to work.

Portfolio insurance got a bad name -- you haven't heard much about it since that time. This event showed there was a flaw in the model -- the assumption buyers would always be there. But liquidity dries up. So much of financial theory is based on the notion that you are a small player in a very big liquid market, but a big drop means that assumption turns out to be wrong. Liquidity isn't always there. We had another lesson in 2007. Liquidity can dry up sometimes.

**Q:** *People talk about program trading in conjunction with Black Monday. What is it?*

**A:** A vehicle through which to execute portfolio insurance. But people who also were not necessarily pursuing portfolio insurance could also program a computer. You want to limit losses, so if a stock falls, say, 10%, you instruct the computer to sell. Stocks fell fast that day, and it triggered computers to sell even more. They mindlessly sold when the market dropped. Portfolio insurance was an early version of what we might call modern risk-management techniques. Now similar things are used, but there are also hedging strategies where you buy in one market and sell in another. Some ideas behind it carried on.



NYSE

Following the market after Black Monday

**Q:** *What do you remember about the aftermath of the crash?*

**A:** I think it was a major shock. There were some interesting debates -- guys that argued strongly that markets were always rational were questioned. They said their theories were right, but they were challenged a bit by this. And some serious business leaders, at first, thought it was sign of another depression. But people forgot about it in the months after. By 1990, even 1989, the market was back up above where it was in 1987. Maybe 1987 had a little bit of an echo effect in the early 1990s, when the market was not so exuberant. But by the mid-1990s, the market was exuberant again.

**Q:** *Could a drop like the one that occurred on Black Monday happen again?*

**A:** It can happen again. These things have been going on for 400 years. We had a minicrisis this year -- it didn't affect the stock market all that much, but it certainly affected credit markets. Central banks seem to understand these things better now and react more quickly, but it depends who's running the bank and how quick they are. The last three Fed chairmen and central bankers in Europe seem to be very competent, but we can't guarantee ourselves that in the future. We had bad central bankers in the 1970s and the 1930s.

<http://online.wsj.com/article/SB119212671947456234.html?mod=US-Stocks#printMode>

1929 crash

[http://mutualfunds.about.com/od/1929marketcrash/1929\\_Stock\\_Market\\_Crash.htm](http://mutualfunds.about.com/od/1929marketcrash/1929_Stock_Market_Crash.htm)

Black Thursday

The roaring twenties or the Jazz age was a time of intense stock market speculation. There may never be a time again like the 1920s, where talk about investing dominated almost every conversation. As reported by John Brooks in *Once in Golconda*, a British Correspondent, after arriving in New York in 1929, reported "You could talk about Prohibition, or Hemingway, or air

conditioning, or music, or horses, but in the end you had to talk about the stock market, and that was when the conversation became serious.”

People believed the market could go nowhere but up. Despite hard-earned lessons from a Florida real estate bubble in the mid 1920s and even many volatile days (mostly down days) in September of 1929, investors did not hold back. Until Thursday, October 24th – a day that will live in infamy as “Black Thursday.”

## **Black Thursday**

Black Thursday was the first sign of the end of a great bull market. What goes up, must come down. And come down it did. However, Black Thursday was not the nail in the coffin (that comes on [Black Monday](#) and [Tuesday](#)). In fact, Black Thursday involved a great comeback. Here's how the story goes:

12.9 million shares changed hands on Black Thursday (a new record – 4 million shares was considered a busy day back then). Most of the panic took place in the morning hours. The ticker tape machine fell behind by an hour and a half leaving investors madly scrambling to sell their investments without even knowing the current prices. Panic set in. People gathered outside the exchanges and brokerages, police were dispatched to insure peace. Rumors were flying. By 12:30 pm, the Chicago and Buffalo Exchanges closed down, eleven well-known speculators had already killed themselves and the NYSE closed the visitor’s gallery on the wild scenes below. Reporters learned that an important meeting was taking place at the office of J.P. Morgan and Company, involving many of the most important men in banking. After the meeting broke, Thomas Lamont, senior partner at Morgan – a company founded by a man who had help stop a panic in 1907, made the following statement to newspaper reporters: “There has been a little distress selling on the Stock Exchange... due to a technical condition of the market” and that things were “susceptible to betterment.”

The market moved up a bit after Lamont’s statement, but the real recovery came at 1:30 pm, when self-confident Richard Whitney, vice-president of the NYSE and floor broker of J.P. Morgan and Company, walked into the exchange floor. The crowd went silent. Everyone expected an announcement that the NYSE would be closed. Instead, Richard Whitney surprised everybody... Whitney asked for the latest bid on U.S. Steel. “195” someone shouted. Then he promptly announced that he was buying 10,000 shares of U.S. Steel at 205. He immediately received 200 shares and then left the rest of the order with the specialist. He continued to make similar orders for over a dozen more stocks. Fear evaporated as investors became worried that they would miss the new boom. The market would have closed much higher if stop loss orders from earlier that day hadn’t been triggered during the upward surge. Needless to say, the recovery on Black Thursday was impressive, but so was the massive sell off earlier in the morning that gave it its name.

Friday and Saturday morning sessions held steady as everyone became optimistic with the market’s ability to recover. These feelings were squashed on Black Monday.

## **Black Monday**

Following [Black Thursday 1929](#), the stock market was much calmer - it was up a bit on Friday and down a little on Saturday. People were optimistic, knowing that the market could bounce back from Thursday and that the bankers had stepped in. This false sense of hope would end on Monday.

## **Black Monday**

Black Monday was a terrible day in the market. Unlike the Black Thursday, no "hero" stepped in to regain investor's confidence. Richard Whitney did not walk into the NYSE and the bankers and Mr. Lamont didn't make comments until after market close and those words weren't that optimistic. Volume levels were very high (around 9.25 million shares) **as speculators began to realize that no one could save the market. Speculators could only hope that the damage wouldn't be too bad.**

Black Monday was the 2nd worst day in U.S. stock market history. The worst day in history wouldn't come for 58 more years (October 19th, 1987), which also happens to be a Monday and is also referred to as "Black Monday."

Just 1 week earlier, on Monday the 21st, investors had their first glimpse of the three Black Days as the volume was high (6,091,870 shares) and the ticker tape fell seriously behind forcing people began to sell blindly. Over the next week, the market turned people into fools. Perhaps the biggest fool at the time was Professor Irving Fisher.

Well known, trusted Yale University economist, Irving Fisher stated on the 21st, "[the market was only] shaking out of the lunatic fringe" and went on to explain why he felt the prices still have not caught up with their real value and should go much higher. On Wednesday the 23rd, he announced in a banker's meeting "security values in most instances were not inflated." Fisher also announced **"The nation is marching along a permanently high plateau of prosperity." Before Black Thursday, Monday and Tuesday, Fisher was considered an investment prophet.** Though he was recognized for his contributions to technical economic theory, monetary theory and index numbers in later years, these three Black days crippled Irving Fisher's reputation.

Black Monday is usually considered a precursor to the worst day in stock market history – the nail in the coffin, [Black Tuesday](#).

## Black Tuesday

Black Tuesday is notorious for being the worst day in the U.S. stock market, but in terms of percentage loss, the honor goes to Black Monday (1987 and 1929). To understand what makes it the worst day, read on.

## **Black Tuesday - October 29th, 1929**

Combine the worst features of [Black Thursday](#) with the worst features of [Black Monday](#) and you get Black Tuesday. On Thursday, a record 12.9 million shares traded and the ticker tape fell

behind one and a half hours. On Black Tuesday, a new record of 16.4 million shares were traded and the ticker tape fell behind by two and a half hours! On Monday, the stock market suffered a record one-day loss of around 13 percent. On Black Tuesday, the market suffered a loss of about 12 percent.

Like the previous "Black Days," the top bankers held a meeting during the day about the market. Only this time they met twice – once at noon and again in the evening. Once again, Thomas Lamont spoke with the press, but this time it was mostly business. Rumors were that the bankers were selling stocks rather than stabilizing the market. He dispelled the rumors, but did not offer the positive remarks that the previous tragic days featured.

Here is what the Seattle Times wrote about Black Tuesday:

*"A veritable bedlam of activity reigned in leading stock brokerage houses in Seattle today as the greatest avalanche of security selling known to history was launched on New York exchanges. Executives and clerks, worn by almost constant application to duty for days past, and with little respite gained by the Saturday afternoon and Sunday intermission breasted the great tide of buying and selling orders with philosophical resignation... Curiosity seemed to prompt attendance of the greater part of the milling throngs in the board rooms." (The Seattle Times, October 29, 1929)*

**By the end of November, investors had lost \$100 billion in assets in what was later called "The Great Stock Market Crash." In just two months, September and October, the stock market had lost 40 percent of its value. Black Tuesday usually marks the point where the Roaring 20's ended and the Great Depression started. The stock market would continue to fall until bottoming out in July of 1932 with the Dow at 41.22, down 89.2% (from 381.17 to 41.22. The stock market wouldn't recover for another 22 years!**

**The Fed**

**Release Date: October 3, 2008**

**For immediate release**

I applaud the action taken by the Congress. It demonstrates the government's commitment to do what it takes to support and strengthen our economy. The legislation is a critical step toward stabilizing our financial markets and ensuring an uninterrupted flow of credit to households and businesses.

**The Federal Reserve will continue to work closely with the Treasury as it undertakes these new initiatives. We will continue to use all of the powers at our disposal to mitigate credit market disruptions and to foster a strong, vibrant economy.**

**Release Date: August 5, 2008 [this was 60 days ago! How did they do looking ahead???)**

**For immediate release**

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 2 percent.

**Economic activity expanded in the second quarter, partly reflecting growth in consumer spending and exports.** However, labor markets have softened further and financial markets remain under considerable stress. Tight credit conditions, the ongoing housing contraction, and elevated energy prices are likely to weigh on economic growth over the next few quarters. **Over time, the substantial easing of monetary policy, combined with ongoing measures to foster market liquidity, should help to promote moderate economic growth.**

Inflation has been high, spurred by the earlier increases in the prices of energy and some other commodities, and some indicators of inflation expectations have been elevated. The Committee expects inflation to moderate later this year and next year, but the inflation outlook remains highly uncertain.

**Although downside risks to growth remain, the upside risks to inflation are also of significant concern to the Committee. The Committee will continue to monitor economic and financial developments and will act as needed to promote sustainable economic growth and price stability.**

**Release Date: July 30, 2008**

**For release at 8:45 a.m. EDT**

The Federal Reserve today announced several steps to enhance the effectiveness of its existing liquidity facilities, including the introduction of longer terms to maturity in its Term Auction Facility. In association with this change, the European Central Bank and the Swiss National Bank are adapting the maturity of their operations.

<b>Federal</b>	<b>Reserve</b>	<b>Actions</b>
Actions taken by the Federal Reserve include:		
		<ul style="list-style-type: none"><li>• Extension of the Primary Dealer Credit Facility (PDCF) and the Term Securities Lending Facility (TSLF) through January 30, 2009.</li><li>• The introduction of auctions of options on \$50 billion of draws on the TSLF.</li><li>• The introduction of 84-day Term Auction Facility (TAF) loans as a complement to 28-day TAF loans.</li><li>• An increase in the Federal Reserve's swap line with the European Central Bank to \$55 billion from \$50 billion.</li></ul>



These actions are described in detail below.

*Extension of the PDCF and TSLF*  
In light of continued fragile circumstances in financial markets, the Board has extended the

PDCF through January 30, 2009, and the Board and the Federal Open Market Committee (FOMC) have extended the TSLF through that same date. These facilities would be withdrawn should the Board determine that conditions in financial markets are no longer unusual and exigent.

The PDCF provides discount window loans to primary dealers, collateralized by investment-grade securities. The interest rate charged is the primary credit rate (discount rate) of the Federal Reserve Bank of New York. Under the TSLF, the Federal Reserve Bank of New York conducts weekly auctions of 28-day loans of Treasury securities to primary dealers. Loans under the TSLF are collateralized by a range of government and private securities.

*Auctions of TSLF Options*  
The FOMC has authorized the Federal Reserve Bank of New York to auction options for primary dealers to borrow Treasury securities from the TSLF. The Federal Reserve intends to offer such options for exercise in advance of periods that are typically characterized by elevated stress in financial markets, such as quarter ends. Under the options program, up to \$50 billion of draws on the TSLF using options may be outstanding at any time. This amount is in addition to the \$200 billion of Treasury securities that may be offered through the regular TSLF auctions. Draws on the TSLF through exercise of these options may be collateralized by the full range of TSLF Schedule 2 collateral. (Schedule 2 collateral includes Treasury securities, federal agency debt securities, mortgage-backed securities issued or guaranteed by federal agencies, and AAA/Aaa-rated private-label residential mortgage-backed, commercial mortgage-backed, and asset-backed securities.) Additional details of this program will be announced once consultations with the primary dealer community have been completed.

*Eighty-four-day Term Auction Facility Loans*  
Beginning on August 11, the Federal Reserve will auction 84-day TAF loans while continuing to auction 28-day TAF funds. Specifically, the Federal Reserve will conduct biweekly TAF auctions, alternating between auctions of \$75 billion of 28-day credit and auctions of \$25 billion of 84-day credit. Currently, the Federal Reserve auctions \$75 billion of 28-day funds every two weeks. During a transition period, the amount of 28-day credit being auctioned will be reduced to keep the amount of TAF credit outstanding at \$150 billion. A schedule of TAF auctions and applicable terms and conditions can be found at <http://www.federalreserve.gov/monetarypolicy/taf.htm>.

Under the TAF, the Federal Reserve auctions term funds to depository institutions, secured by a wide variety of collateral. All depository institutions that are judged to be in generally sound financial condition by their local Reserve Bank are eligible to participate in TAF auctions.

*Increase in Swap Line with European Central Bank*  
The European Central Bank (ECB) and the Swiss National Bank (SNB) have informed the Federal Reserve that, in association with the lengthening of the maturity of the Federal Reserve's TAF loans, these central banks will also make 84-day funds, as well as 28-day funds, available at their dollar auctions. The FOMC has authorized an increase in its dollar swap line with the ECB to \$55 billion from \$50 billion in order to accommodate a temporary increase in the ECB's dollar

auctions as the ECB shifts some of its auctions to 84-day terms. The size of the SNB's swap line remains at \$12 billion. These swap lines are authorized through January 30, 2009.

Release Date: July 13, 2008

**For immediate release**

The Board of Governors of the Federal Reserve System announced Sunday that it has granted the Federal Reserve Bank of New York the authority to lend to Fannie Mae and Freddie Mac should such lending prove necessary. Any lending would be at the primary credit rate and collateralized by U.S. government and federal agency securities. This authorization is intended to supplement the Treasury's existing lending authority and to help ensure the ability of Fannie Mae and Freddie Mac to promote the availability of home mortgage credit during a period of stress in financial markets.

**Release Date: June 25, 2008**

**For immediate release**

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 2 percent.

Recent information indicates that overall economic activity continues to expand, partly reflecting some firming in household spending. However, labor markets have softened further and financial markets remain under considerable stress. Tight credit conditions, the ongoing housing contraction, and the rise in energy prices are likely to weigh on economic growth over the next few quarters.

The Committee expects inflation to moderate later this year and next year. However, in light of the continued increases in the prices of energy and some other commodities and the elevated state of some indicators of inflation expectations, uncertainty about the inflation outlook remains high.

The substantial easing of monetary policy to date, combined with ongoing measures to foster market liquidity, should help to promote moderate growth over time. Although downside risks to growth remain, they appear to have diminished somewhat, and the upside risks to inflation and inflation expectations have increased. **The Committee will continue to monitor economic and financial developments and will act as needed** to promote sustainable economic growth and price stability.

**Release Date: May 2, 2008**

**For immediate release**

**Central banks have continued to work together and to consult regularly on liquidity conditions in financial markets.** In view of the persistent liquidity pressures in some term

funding markets, the European Central Bank, the Federal Reserve, and the Swiss National Bank are announcing an expansion of their liquidity measures.

<b>Federal</b>	<b>Reserve</b>	<b>Actions</b>
The Federal Reserve announced today an increase in the amounts auctioned to eligible depository institutions under its biweekly Term Auction Facility (TAF) from \$50 billion to \$75 billion, beginning with the auction on May 5. This increase will bring the amounts outstanding under the TAF to \$150 billion.		

In conjunction with the increase in the size of the TAF, the Federal Open Market Committee has authorized further increases in its existing temporary reciprocal currency arrangements with the European Central Bank (ECB) and the Swiss National Bank (SNB). These arrangements will now provide dollars in amounts of up to \$50 billion and \$12 billion to the ECB and the SNB, respectively, representing increases of \$20 billion and \$6 billion. The FOMC extended the term of these reciprocal currency arrangements through January 30, 2009.

In addition, the Federal Open Market Committee authorized an expansion of the collateral that can be pledged in the Federal Reserve's Schedule 2 Term Securities Lending Facility (TSLF) auctions. Primary dealers may now pledge AAA/Aaa-rated asset-backed securities, in addition to already eligible residential- and commercial-mortgage-backed securities and agency collateralized mortgage obligations, beginning with the Schedule 2 TSLF auction to be announced on May 7, 2008, and to settle on May 9, 2008. The wider pool of collateral should promote improved financing conditions in a broader range of financial markets. Treasury securities, agency securities, and agency mortgage-backed securities continue to be eligible as collateral in Schedule 1 TSLF auctions.

**Release Date: April 30, 2008**

**For immediate release**

The Federal Open Market Committee decided today to lower its target for the federal funds rate 25 basis points to 2 percent.

Recent information indicates that economic activity remains weak. Household and business spending has been subdued and labor markets have softened further. Financial markets remain under considerable stress, and tight credit conditions and the deepening housing contraction are likely to weigh on economic growth over the next few quarters.

Although readings on core inflation have improved somewhat, energy and other commodity prices have increased, and some indicators of inflation expectations have risen in recent months. The Committee expects inflation to moderate in coming quarters, reflecting a projected leveling-out of energy and other commodity prices and an easing of pressures on resource utilization. Still, uncertainty about the inflation outlook remains high. It will be necessary to continue to monitor inflation developments carefully.

The substantial easing of monetary policy to date, combined with ongoing measures to foster market liquidity, should help to promote moderate growth over time and to mitigate risks to economic activity. **The Committee will continue to monitor economic and financial developments and will act as needed** to promote sustainable economic growth and price stability.

**Release Date: March 18, 2008**

**For immediate release**

The Federal Open Market Committee decided today to lower its target for the federal funds rate 75 basis points to 2-1/4 percent.

Recent information indicates that the outlook for economic activity has weakened further. Growth in consumer spending has slowed and labor markets have softened. Financial markets remain under considerable stress, and the tightening of credit conditions and the deepening of the housing contraction are likely to weigh on economic growth over the next few quarters.

Inflation has been elevated, and some indicators of inflation expectations have risen. The Committee expects inflation to moderate in coming quarters, reflecting a projected leveling-out of energy and other commodity prices and an easing of pressures on resource utilization. Still, uncertainty about the inflation outlook has increased. It will be necessary to continue to monitor inflation developments carefully.

Today's policy action, combined with those taken earlier, including measures to foster market liquidity, should help to promote moderate growth over time and to mitigate the risks to economic activity. However, downside risks to growth remain. **The Committee will act in a timely manner as needed** to promote sustainable economic growth and price stability.

**Release Date: March 16, 2008**

**For immediate release**

The Federal Reserve on Sunday announced two initiatives designed to bolster market liquidity and promote orderly market functioning. Liquid, well-functioning markets are essential for the promotion of economic growth.

First, the Federal Reserve Board voted unanimously to authorize the Federal Reserve Bank of New York to create a lending facility to improve the ability of primary dealers to provide financing to participants in securitization markets. This facility will be available for business on Monday, March 17. It will be in place for at least six months and may be extended as conditions warrant. Credit extended to primary dealers under this facility may be collateralized by a broad range of investment-grade debt securities. The interest rate charged on such credit will be the same as the primary credit rate, or discount rate, at the Federal Reserve Bank of New York.

Second, the Federal Reserve Board unanimously approved a request by the Federal Reserve Bank of New York to decrease the primary credit rate from 3-1/2 percent to 3-1/4 percent, effective immediately. This step lowers the spread of the primary credit rate over the Federal Open Market Committee's target federal funds rate to 1/4 percentage point. The Board also approved an increase in the maximum maturity of primary credit loans to 90 days from 30 days.

**Release Date: March 14, 2008**

**For immediate release**

**The Federal Reserve is monitoring market developments closely and will continue to provide liquidity as necessary** to promote the orderly functioning of the financial system. The Board voted unanimously to approve the arrangement announced by JPMorgan Chase and Bear Stearns this morning.

**Release Date: March 7, 2008**

**For immediate release**

The Federal Reserve on Friday announced two initiatives to address heightened liquidity pressures in term funding markets.

First, the amounts outstanding in the Term Auction Facility (TAF) will be increased to \$100 billion. The auctions on March 10 and March 24 each will be increased to \$50 billion--an increase of \$20 billion from the amounts that were announced for these auctions on February 29. The Federal Reserve will increase these auction sizes further if conditions warrant. To provide increased certainty to market participants, the Federal Reserve will continue to conduct TAF auctions for at least the next six months unless evolving market conditions clearly indicate that such auctions are no longer necessary.

Second, beginning today, the Federal Reserve will initiate a series of term repurchase transactions that are expected to cumulate to \$100 billion. These transactions will be conducted as 28-day term repurchase (RP) agreements in which primary dealers may elect to deliver as collateral any of the types of securities--Treasury, agency debt, or agency mortgage-backed securities--that are eligible as collateral in conventional open market operations. As with the TAF auction sizes, the Federal Reserve will increase the sizes of these term repo operations if conditions warrant.

**The Federal Reserve is in close consultation with foreign central bank counterparts concerning liquidity conditions in markets.**

**Release Date: January 30, 2008**

**For immediate release**

The Federal Open Market Committee decided today to lower its target for the federal funds rate 50 basis points to 3 percent.

Financial markets remain under considerable stress, and credit has tightened further for some businesses and households. Moreover, recent information indicates a deepening of the housing contraction as well as some softening in labor markets.

The Committee expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.

Today's policy action, combined with those taken earlier, should help to promote moderate growth over time and to mitigate the risks to economic activity. However, downside risks to growth remain. **The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed** to address those risks.

**Release Date: January 22, 2008**

**For immediate release**

The Federal Open Market Committee has decided to lower its target for the federal funds rate 75 basis points to 3-1/2 percent.

The Committee took this action in view of a weakening of the economic outlook and increasing downside risks to growth. While strains in short-term funding markets have eased somewhat, broader financial market conditions have continued to deteriorate and credit has tightened further for some businesses and households. Moreover, incoming information indicates a deepening of the housing contraction as well as some softening in labor markets.

The Committee expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.

Appreciable downside risks to growth remain. **The Committee will continue to assess the effects of financial and other developments on economic prospects and will act in a timely manner as needed** to address those risks.

**Release Date: December 11, 2007**

**For immediate release**

The Federal Open Market Committee decided today to lower its target for the federal funds rate 25 basis points to 4-1/4 percent.

Incoming information suggests that economic growth is slowing, reflecting the intensification of the housing correction and some softening in business and consumer spending. Moreover, strains in financial markets have increased in recent weeks. Today's action, combined with the policy actions taken earlier, should help promote moderate growth over time.

Readings on core inflation have improved modestly this year, but elevated energy and commodity prices, among other factors, may put upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.

Recent developments, including the deterioration in financial market conditions, have increased the uncertainty surrounding the outlook for economic growth and inflation. **The Committee will continue to assess the effects of financial and other developments on economic prospects and will act as needed** to foster price stability and sustainable economic growth.

**Release Date: October 31, 2007**

**For immediate release**

The Federal Open Market Committee decided today to lower its target for the federal funds rate 25 basis points to 4-1/2 percent.

Economic growth was solid in the third quarter, and strains in financial markets have eased somewhat on balance. However, the pace of economic expansion will likely slow in the near term, partly reflecting the intensification of the housing correction. Today's action, combined with the policy action taken in September, should help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and promote moderate growth over time.

Readings on core inflation have improved modestly this year, but recent increases in energy and commodity prices, among other factors, may put renewed upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.

The Committee judges that, after this action, the upside risks to inflation roughly balance the downside risks to growth. **The Committee will continue to assess the effects of financial and other developments on economic prospects and will act as needed** to foster price stability and sustainable economic growth.

**Release Date: September 18, 2007**

**For immediate release**

The Federal Open Market Committee decided today to lower its target for the federal funds rate 50 basis points to 4-3/4 percent.

Economic growth was moderate during the first half of the year, but the tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth more generally. Today's action is intended to help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and to promote moderate growth over time.

Readings on core inflation have improved modestly this year. However, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.

Developments in financial markets since the Committee's last regular meeting have increased the uncertainty surrounding the economic outlook. **The Committee will continue to assess the effects of these and other developments on economic prospects and will act as needed** to foster price stability and sustainable economic growth.

**Release Date: August 17, 2007**

**For immediate release**

Financial market conditions have deteriorated, and tighter credit conditions and increased uncertainty have the potential to restrain economic growth going forward. In these circumstances, although recent data suggest that the economy has continued to expand at a moderate pace, the Federal Open Market Committee judges that the downside risks to growth have increased appreciably. **The Committee is monitoring the situation and is prepared to act as needed** to mitigate the adverse effects on the economy arising from the disruptions in financial markets.

**Release Date: August 10, 2007**

**For immediate release**

**The Federal Reserve is providing liquidity to facilitate the orderly functioning of financial markets.**

The Federal Reserve will provide reserves as necessary through open market operations to promote trading in the federal funds market at rates close to the Federal Open Market Committee's target rate of 5-1/4 percent. In current circumstances, depository institutions may experience unusual funding needs because of dislocations in money and credit markets. As always, the discount window is available as a source of funding.

**Release Date: August 7, 2007**

**For immediate release**

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 5-1/4 percent.

Economic growth was moderate during the first half of the year. Financial markets have been volatile in recent weeks, credit conditions have become tighter for some households and businesses, and the housing correction is ongoing. Nevertheless, the economy seems likely to continue to expand at a moderate pace over coming quarters, supported by solid growth in employment and incomes and a robust global economy.

Readings on core inflation have improved modestly in recent months. However, a sustained moderation in inflation pressures has yet to be convincingly demonstrated. Moreover, the high level of resource utilization has the potential to sustain those pressures.

**Although the downside risks to growth have increased somewhat, the Committee's predominant policy concern remains the risk that inflation will fail to moderate as expected. Future policy adjustments will depend on the outlook for both inflation and economic growth, as implied by incoming information. [this was the last major announcement that did not state the Fed was “ready to act to save the World” interestingly it was days before the first blow up]**

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Thomas M. Hoenig; Donald L. Kohn; Randall S. Kroszner; Frederic S. Mishkin; Michael H. Moskow; William Poole; Eric Rosengren; and Kevin M. Warsh.