

## September 2, 2007 Review

### Comments

**Because America's economic brain is a myopic computer programmed for instant gratification, not long-term planning. Years of brainwashing focuses on the latest fashions, today's store sales, Wall Street's relentless minute-to-minute trading. We assume that "tomorrow will take care of itself," and that the government will bail us out, like the Fed did recently with the discount rate. But, Walker warns, you can't trust government with your future: [for the rest of this article go down to article of the week]**

The exhibition season has drawn to a close. The veterans will be playing for keeps starting this first full week of September. The bit players will return to the bench. Their meaningless late August play quickly forgotten. We shall soon be seeing Hail Mary's that matter. Oh and pro football is about to start.

In the real game played at Wall and Broad, the time for atonement has arrived.

First - personal updates. Belle continues her own personal rally. She has a phenomenal fighting spirit and is back to at least 80%. Doubtful she makes it back the full 100, but I wouldn't count it out either. As many of you know, she has a spot under my desk we call "work." The little soldier showed up for work a few days ago. On her own. Just punching in. I have also reached a milestone having finished the first MBA school year. The following is based in part on knowledge acquired in Ann Arbor. Most of it is based however not on learning about business but instead learning about economics, psychology and history. Those disciplines, not the efficient market theory and other B-school buzz words dictate what is about to happen IMO.

And what I believe is about to happen is a once in a generation or so collapse. This will not be the fabled "dip buying" opportunity. It will instead be a NASDAQ 2000-2 bloodletting from which many never recover. The whys have been documented herein for months. The timing an educated guess. The underpinnings of the guess:

The big boys are already headed for the exits. The volume shows it.

The veterans have been moving out for months. The rookies stepping up.

The Fed meets on September 18. The wishers and hoppers think the market can't drop before then. We will watch and see.

My money says the short term debt rollovers will not go well. Lots of sellers few buyers. This will soon overwhelm the central bankers' efforts to keep hope alive.

The warnings season will start very early (it actually already has). This time pulling down the numbers will matter. Just like in 2000, things will go from rosy to awful because of just in time inventories and other such advancements.

The accelerant on all of this will be the exotic derivatives as well as the mispriced equity derivatives (Black Scholes assumes volatility is constant – it won't be and the horribly mispriced outliers will explode like fireworks on the 4<sup>th</sup> of July).

The fallacy of mark to model will be exposed for the fraud it is. This will be the beginning of a loss of wealth unseen in terms of dollar amount. It will also be the creation of wealth for those who play it correctly.

October equity options expire October 19. Seven weeks. Intel closed above 25 last Friday. I have a range of October puts going as low as 17.50 Says here the 17.5s are in the money two Fridays after Columbus Day.

Mister Sunshine indeed.

We will see . . .

## Credit

- Aug. 30 (Bloomberg) -- Treasury three-month bill yields fell for a third day as investors fled asset-backed commercial paper and opted for the safety of government debt. **Yields of asset-backed commercial paper due tomorrow rose to the highest in six years [this is a credit quality issue and will not be "solved" by rate cuts]** as outstanding debt in the short-term instruments fell for a third week. Demand for the Treasury's \$13 billion auction of five-year notes was the highest since September 2006. **There's that fear of commercial paper** that's driving people into the bills market," said Nasri Toutoungi, who oversees \$23 billion of bonds in Hartford, Connecticut, at Hartford Investment Management Co. **It's becoming irrational. [what was irrational was how little risk was priced in the last many years]** **Commercial paper outstanding has fallen \$244.1 billion, or 11 percent, in the past three weeks, suggesting the Fed's reduction in the discount rate has yet to entice buyers back into the market.** More than 20 companies and funds including Cheyne Finance and Thornburg Mortgage Co. failed to sell new paper as investors fled to safer investments. The five-year note auction drew \$2.74 for every \$1 sold, the most since the September 2006 auction. For the past 12 sales, the bid-to-cover ratio, which gauges demand by comparing total bids with the amount of securities offered, averaged \$2.36. The notes drew a yield of 4.248 percent. The average forecast of 10 bond trading firms surveyed by Bloomberg News was 4.245 percent. The securities, which mature in August 2012, yielded 4.245 percent in pre-auction trading. The yield on the current five-year note fell 6 basis points to 4.25 percent, according to Cantor Fitzgerald LP. The price of the 4 5/8 percent security maturing in July 2012 rose 1/4, or \$2.50 per \$1,000 face amount, to 101 21/32. Bank of England The Bank of England, acting as the lender of last resort, extended 1.6 billion pounds (\$3.2 billion) at its highest rate, suggesting commercial banks are reluctant to provide credit. Australia's Basis Capital Fund Management Ltd. has sought bankruptcy protection for one of its hedge funds. **We're**

getting a steady drumbeat of fallout from the downturn in subprime," said T.J. Marta, a fixed-income strategist in New York at RBC Capital Markets, the investment-banking arm of Canada's biggest lender. "What has surprised us is the amount of fear that has gripped the market." Yields of three-month bills fell last week to a two-year low as money market funds dumped asset-backed commercial paper in favor of the shortest-term government debt. Companies that depend on commercial paper will continue to face funding problems as investors refuse to buy debt secured by assets including subprime mortgages, according to Tom Jenkins, London-based analyst at Royal Bank of Scotland Group Plc. These so-called structured investment vehicles will need to sell as much as \$43 billion of assets as their access to money dries up, Jenkins wrote in a report today.

**Corporate Bond Risk** The risk of owning corporate bonds rose on renewed concern hedge funds may be forced to sell assets because they can't refinance borrowings, according to traders of credit-default swaps. Contracts on the CDX North American Investment-Grade Index, a benchmark for the cost of protecting bonds against default, rose 4 basis points to 73 basis points, according to Phoenix Partners Group. The iTraxx Europe Index rose 2 basis points to 48 basis points in London, JPMorgan Chase & Co. prices show. The yield on the two-year Treasury note fell 4 basis points to 4.11 percent. The yield will climb to 4.66 percent by Dec. 31, according to a Bloomberg News survey of 63 economists, with the most recent forecasts given the heaviest weightings. The Treasury's \$18 billion auction yesterday of the securities drew the most demand since at least 1992. Ten-year Treasury note yields, which fell more than 3 basis points to 4.53 percent, were 42 basis points higher than two-year note yields, near the widest spread in a week. The so-called yield curve steepened as credit market turmoil prompted investors to shift from riskier assets into short-dated government bonds.

**Fed Rates** The Fed on Aug. 17 lowered the discount rate on direct loans to banks by half a percentage point to 5.75 percent to help avert the credit crisis. It held its main lending rate at 5.25 percent 10 days earlier. The U.S. economy expanded in the second quarter at the fastest pace in more than a year as exports surged and business spending accelerated. Growth was revised up to a 4 percent annual rate, according to a report today from the Commerce Department in Washington. The economy grew at a 0.6 percent pace in the first quarter.

**Treasury Bill Yields Fall as Investors Avoid Commercial Paper**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aLaZ7ThTrVyQ&refer=home>

## **Commercial Real Estate**

## **Commodities**

## **Currency**

## **Diversification**

## **Derivatives**

- Aug. 29 (Bloomberg) -- Cheyne Capital Management Ltd., whose Queen's Walk mortgage bond fund reported losses in June, may be forced to sell assets backing a \$6 billion commercial paper program after a global credit market rout. The Cheyne Finance

LLC fund has been selling investments and has enough cash to repay commercial paper due through November, London-based hedge fund company Cheyne Capital Management said in a statement. Standard & Poor's cut Cheyne Finance's ratings yesterday, citing the deteriorating market value of its assets. Companies that depend on commercial paper, debt due in 270 days or less, are facing funding shortages as investors refuse to buy debt secured by assets including U.S. subprime mortgages. Rhinebridge Plc, a fund managed by Dusseldorf-based IKB Deutsche Industriebank, yesterday said it sold \$176 million of assets after it couldn't find buyers for its short-term debt. "We will see more names fall by the wayside," said Tom Jenkins, an analyst at Royal Bank of Scotland Group Plc in London. "The sales will look increasingly distressed." Cheyne Finance has drawn on all three of its emergency funding facilities and will continue to sell assets to meet its liabilities. Cheyne is working on recapitalizing or restructuring the company and extending its debt maturities. Profits Cut Cheyne also runs Queen's Walk Investment Ltd., a fund that invested in mortgages and reported in June a loss of 67.7 million euros (\$92 million) in the year ended March 31. Funds like Cheyne Finance, so-called structured investment vehicles, typically sell commercial paper and use the proceeds to purchase bonds with longer maturities. HBOS Plc, the U.K.'s largest mortgage lender, said last week that it would repay about \$35 billion of commercial paper owed by its Grampian Funding LLC unit as contagion from the subprime slump drove up the cost of borrowing. More than 20 companies, including San Francisco-based Luminent Mortgage Capital Inc. and Thornburg Mortgage Co. in Santa Fe, New Mexico, have been unable to roll over asset-backed commercial paper. Thornburg said earlier this month that it sold \$20.5 billion of securities at about 95 cents on the dollar to pay down commercial paper it couldn't refinance. "Investors are not going to refinance you in this environment," said Craig Saalman, credit strategist at JPMorgan Chase & Co. in Sydney. KKR Affiliates On Aug. 15, Fitch Ratings said Kohlberg Kravis Roberts & Co. affiliates KKR Atlantic Funding Trust and KKR Pacific Funding Trust may have to sell securities because of losses. There are about \$385 billion outstanding in structured investment vehicles and 23 percent of their assets are mortgage securities or collateralized debt obligations that often hold mortgages, according to an Aug. 9 report by Bear Stearns Cos. Near-term sales from the vehicles because of losses in the market value of subprime mortgage securities may total \$23 billion, Bear Stearns said. The Cheyne portfolio is primarily invested in "real estate securitizations" and none of the assets have had downgrades, S&P said. Structured investment vehicles often aren't backed by credit lines from banks like asset-backed commercial paper programs, of which there are \$1.05 trillion outstanding. S&P lowered the credit rating on the commercial paper issued by Cheyne Finance by two levels to A-2 from the highest level of A-1+. The rating on senior debt was cut six levels to A- from AAA. The average yield on the highest rated asset-backed commercial paper with one-day maturity has risen 0.71 percentage point this month to 6.04 percent as investors have fled funding linked to subprime mortgages, according to Bloomberg data. Securities of subprime mortgages to people with poor credit or high debt have lost value because of the highest delinquency rate in four years. **Cheyne May Liquidate Commercial Paper Unit on Losses (Update1**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aNghAuJeACA4&refer=home>

- Aug. 28 (Bloomberg) -- RBS Greenwich Capital Markets Inc., the securities arm of Royal Bank of Scotland PLC, has "resized" a department that deals with collateralized debt obligations, according to a statement. [one would assume this was not upgrading to "supersize"] Sales of CDOs, which are used to repackage loans, bonds and other assets into new securities, have fallen after investors grew more concerned about their holdings of U.S. subprime- mortgage bonds and buyout loans. About \$16.1 billion of CDOs were sold this month through Aug. 24, compared with \$60 billion in June, according to JPMorgan Chase & Co. "We have resized our CDO business to meet market demand," Fred Matera, head of CDOs for RBS Greenwich, said in an e-mailed statement. "We intend to continue to be an active player in the CDO market going forward, and are confident that we have the necessary resources and team in place to meet future demand." Peter Ward, a spokesman for the Greenwich, Connecticut-based unit, didn't immediately respond to requests for more information. Since June, ratings firms including New York-based Standard & Poor's have downgraded billions of dollars of CDO securities, some rated as high as AAA, following investments in bonds backed by U.S. subprime and second mortgages that they downgraded first. With the warnings about bonds from eight more CDOs today, S&P has said it may cut ratings on \$4.95 billion more of the debt amid unexpectedly high defaults on subprime mortgages, made to borrowers with poor credit, or on home equity loans. S&P has cut ratings on \$5.45 billion of mortgage-bond CDOs since June. Ed Cahill, the head of European CDOs at Barclays PLC, the U.K.'s third-largest bank, left that company last week. RBS was the 15th largest underwriter of CDOs worldwide in the first half of this year, selling \$7.5 billion of the securities, according to Asset-Backed Alert. It sold \$34 billion of new asset-backed securities in total, or the third most, according to the newsletter.

## Housing

- Aug. 28 (Bloomberg) -- LandAmerica Financial Group Inc., the third-largest U.S. title insurer, said it will cut 1,100 jobs, or about 8 percent of its workforce, by the end of the year to reduce costs as mortgage originations decline. **LandAmerica to Cut 1,100 Jobs as Mortgages Dwindle**  
<http://www.bloomberg.com/apps/news?pid=20601103&sid=a8vDbt.N73Cs&refer=news>
- Aug. 28 (Bloomberg) -- Americans' confidence dropped by the most since Hurricane Katrina two years ago, in the first report to reflect the credit-market turmoil in August. The survey underscores the Federal Reserve's concern that risks to the six-year economic expansion have "increased appreciably." **Separate figures showed home prices suffered the biggest decline since at least 2001.** The New York-based Conference Board's index retreated to 105 this month, from 111.9 in July. Economists had forecast a reading of 104, according to a Bloomberg survey. Property values in 20 metropolitan areas decreased 3.5 percent in June from a year earlier, according to a report today by S&P/Case-Shiller. "Consumers are obviously paying attention to what's going on and are a little worried by it," [if they are just worried "a little" they are as clueless as you Adam] said Adam York, an economist at Wachovia Corp. in Charlotte, North

Carolina. "We are not expecting them to spend the way we thought they would a few months ago." **The Case-Shiller report also showed that prices nationally dropped 3.2 percent in the second quarter from a year before.** That compares with a 1.6 percent year-over-year drop the prior quarter. The Reuters/University of Michigan preliminary index of consumer sentiment fell to its lowest in a year this month, it reported Aug. 17. The ABC/Washington Post Consumer confidence index fell to minus 20 in the week ending Aug. 19, its lowest level since October 2005. **U.S. Economy: Confidence Weakens by Most in Two Years**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aHWquW5D3270&refer=home>

## Housing Finance

- Aug. 29 (Bloomberg) -- The interest rate charged for one- year adjustable loans jumped last week by the most since the Mortgage Bankers Association began keeping records in 1996. The report demonstrates the difficulty some home buyers face in securing affordable financing. The organization's mortgage applications index fell 4 percent last week to 615.2. The group's purchase and refinancing gauges each decreased for a second week. Banks, forced to hold loans rather than resell them as securities because demand has dried up, are charging higher rates for riskier mortgages. The housing slump will worsen as banks restrict the availability of credit and falling real- estate prices prevent owners from tapping home equity for extra spending money, economists said. "If rates go up and credit gets tighter, that is going to lead to a drop in demand on top of what we have already seen," said Abiel Reinhart, an economist at JPMorgan Chase & Co. in New York. "That is going to have an adverse impact" on the economy through the first half of 2008, he said. **U.S. MBA's Mortgage Applications Index Dropped 4%**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=aY6DSVLzZ93I&refer=home>

## Macro Economic

- Aug. 28 (Bloomberg) -- A Chinese central bank official said a stronger currency, growing trade surplus **and accelerating inflation are potentially "destabilizing"** to the world's fastest-growing major economy. Zhang Tao, deputy international department director of the People's Bank of China, said today in Beijing at the Third Beijing-Tokyo Forum that **failure to deal with them may lead to an economic "turning point."** **[for you "don't worry it's a global economy" fans]** **China Inflation, Currency Pose Problems, Central Banker Says**  
<http://www.bloomberg.com/apps/news?pid=20601068&sid=aEgWfMARIEI0&refer=economy>
- Aug. 28 (Bloomberg) -- President George W. Bush said the war in Iraq is part of an ideological confrontation with Islamic extremism and sharpened accusations that Iran is underwriting terrorism throughout the Middle East. In a speech **intended to rally support** for his strategy in Iraq and the rest of the region, Bush singled out Iran as a threat to

stability and freedom and said the U.S. won't shy away from challenging "the regime that sits in Tehran." **Bush Says Iran Poses Danger by Supporting Extremists [our former governor needs to stop fiddling and watch the economic inferno outside his window]**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aIj6LU1SfMvU&refer=home>

- Aug. 28 (Bloomberg) -- Federal Reserve officials put aside concerns about the rising cost of credit at their Aug. 7 meeting **because they weren't convinced a slowdown in inflation would last**, minutes of the gathering said. Ten days before the Fed was forced to cut a key interest rate, the Federal Open Market Committee was given lower growth forecasts by staff economists, and noted that "strains in financial markets" jeopardized the expansion. Further turmoil might require a response, the panel acknowledged, though that sentiment didn't appear in the statement after the meeting. "Policy makers would need to watch the situation carefully," the central bank said. "For the present, however, given expectations that the most likely outcome for the economy was continued moderate growth, the upside risks to inflation remained the most significant policy concern." **Policy makers underestimated the contagion from subprime credit markets to less risky borrowers, the minutes showed. "Funding had become more costly and difficult to obtain for riskier corporate borrowers, but there had been little net change in the cost of credit for investment-grade businesses," the Fed said. [I want you all to keep in mind these are the guys who you all are counting on to bail you out. What a frightening lack of grasp of the obvious]** Borrowing Costs The yield premium investors demand to buy investment-grade corporate bonds compared with benchmark Treasury securities had jumped almost a quarter of a percentage point in the two weeks before the Aug. 7 meeting. The gap widened to 1.47 percentage points on Aug. 21, the highest in four years, Merrill Lynch & Co. data show. "The mistake the Fed made is that the market was clearly coming unglued prior to the meeting," said Scott Miner, who helps oversee \$24 billion of stocks and bonds at Guggenheim Partners LLC in Santa Monica, California. By maintaining the inflation bias, "it telegraphed to the market that this Fed was really out of touch with how severe the credit dislocation was." At the same time, the minutes showed officials may have given more weight to economic-growth risks than their statement suggested. JPMorgan View While the Aug. 17 statement acknowledged such dangers "increased somewhat," the minutes go a step further by alluding to the possibility of an interest-rate cut and noting that policy makers would monitor the situation, Bruce Kasman, chief economist at JPMorgan Chase & Co. in New York, said in a research note. As of three weeks ago, policy makers "expected a return to more normal market conditions, but recognized that the process likely would take some time," the minutes showed. They noted that "mortgage loans remained readily available to most potential borrowers," and the "supply of credit to finance real investment did not appear significantly diminished." [see comments above – frightening, just frightening] Cash Injection **Three days after officials met, [see again comment above – and then go back and see prior issues of the Review. This has been a train wreck in motion for months]** the Fed pumped \$38 billion into the banking system -- the most since the 2001 terrorist attacks -- in its first effort to contain the credit crunch. The effort failed to quell the upheaval, as the amount outstanding of commercial

paper, a key short-term financing tool for some finance companies, slid the most in six years. The following week, with borrowing continuing to dry up, the Fed took steps unprecedented in recent years: it cut the rate on direct loans to banks and issued a new outlook that recognized economic risks had risen "appreciably" and omitted any mention of inflation. **Fed Put Inflation Skepticism Above Credit Concern**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aUF6Y8ilbQRw&refer=home>

## Retail

## Retirement

## Risk

## Savings Rate

## Tech

## Wall Street

- Aug. 29 (Bloomberg) -- U.S. Senator Charles Schumer asked Countrywide Financial Corp. to waive prepayment penalties, help refinance loans and take other steps to help homeowners struggling to make mortgage payments on subprime loans. Schumer called on Countrywide, the biggest U.S. mortgage lender, to change its broker commission structure and stop charging "above-market fees" that he said take advantage of unsophisticated consumers. The New York Democrat addressed reporters in Washington today. "Today I am calling on Countrywide, as our nation's largest lender, to bury its bad business practices and reverse some of the damage it has already inflicted on our housing market," Schumer said. Schumer, a member of the Senate Banking Committee, has been among the most vocal lawmakers pressing for tighter restrictions on mortgage brokers. He introduced legislation in May that would establish federal standards for brokers, including requiring them to assess a borrower's ability to repay at a loan's highest interest rate. **Schumer Urges Countrywide to Help Refinance Loans [CFC is near bankruptcy but the government wants them to voluntarily give up revenue – one can merely wonder how bad this will get]**  
<http://www.bloomberg.com/apps/news?pid=20601087&sid=awEPiw05s9.E&refer=home>
- Aug. 29 (Bloomberg) -- Standard & Poor's said business conditions for securities firms are worse than in the second half of 1998 and revenue from investment banking and trading could fall 47 percent in the final six months of this year. The rating company said it conducted a "stress test" designed to measure the "ability of investment banking businesses to withstand such scenarios." The conclusions don't constitute a forecast, S&P said in a statement. "This is more severe than in 1998," when investment-banking and trading revenue fell 31 percent in the second half following Russia's debt default, S&P analyst Nick Hill said in the statement. At the time, revenue from fixed-income, currencies and commodities was negligible or even negative, he said. As in 1998, firms are likely to cut bonuses to stay profitable, said Hill, who is based in London. In a

separate report, Moody's Investors Service estimated revenue losses of 10 percent or less due to loan markdowns for the five largest U.S. investment banks in the second half of 2007. The Moody's team, led by senior vice presidents Peter Nerby and Blaine Frantz in Jersey City, said its stress tests predict "positive, albeit depressed, earnings and a respectable level of profitability" possibly boosted by higher equities and derivatives trading volume in volatile markets. **S&P Says Rout May Hurt Wall Street More Than in 1998**

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aD2T8JdjWCbQ&refer=home>

## I Disagree . . . and why

[Article of the week:](#)

PAUL B. FARRELL

If we are Rome, Wall Street's our Coliseum

Comptroller General warns (again), we're 'bankrupting America'

By [Paul B. Farrell](#), MarketWatch

Last Update: 7:28 PM ET Aug 27, 2007

ARROYO GRANDE, Calif. (MarketWatch) -- What do Cassandra, "Chicken Little," the "Boy Who Cried Wolf" and David Walker, America's Comptroller General and head of the U.S. Government Accountability Office, all have in common?

Nobody pays attention to them!

Well, at least not until it's too late. Or till a brutal catastrophe wakes us up, forcing us into action. History's a great teacher, but so few graduate. Nobody listened to Churchill's warnings, until Hitler invaded France. We sat on the sidelines till Pearl Harbor.

It takes a 9/11. Before the direct hit, history lessons are academic. The David Walkers of the world are merely tolerated. We're polite, but nobody's really listening. In fact I missed his recent talk in Chicago. ...

- even though the Comptroller General may be the only Washington insider we can trust to tell us the unvarnished truth ...
- even though he was interviewed on "60 Minutes" in March, where he admitted that elected officials don't want to hear that they're "bankrupting America" ...
- even though he's now on a "Fiscal Wake-up Tour" traveling across America taking his message directly to the people in town-hall style meetings ...
- and even though he's one of my heroes, and I encouraged readers to make him a write-in candidate during the 2006 elections. [See previous Paul B. Farrell.](#)

Except for a short piece in London's Financial Times, Walker's warnings were generally ignored by the American press, by the public and even by the very Congress that hired him and has the power to do something, yet still refuses to heed his warnings.

We're in denial, tuning out ... Americans just don't want to hear this modern day Cassandra's wolf cries about the sky falling ... ignoring history, we're determined to wait till the last minute, until the sky does fall, until the wolf does bite us.

So why did I do a double-take and listen? Because this time Walker used the "R" word. No, not recession, but "Rome." Listen:

"America is a great nation, probably the greatest in history. But if we want to keep America great, we have to recognize reality and make needed changes ... There are striking similarities between America's current situation and that of another great power from the past: Rome.

"The Roman Empire lasted 1,000 years, but only about half that time as a republic. The Roman Republic fell for many reasons, but three reasons are worth remembering: declining moral values and political civility at home, an overconfident and overextended military in foreign lands, and fiscal irresponsibility by the central government. Sound familiar?"

History lessons

**Truth is, Americans rarely learn from history. We're short-term thinkers, reactors. Crises turn us on! In fact, we love setting them up, tempting fate, waiting at the brink of disaster ... even when we have intelligence warning us of an eminent attack.**

**Why? Because America's economic brain is a myopic computer programmed for instant gratification, not long-term planning. Years of brainwashing focuses on the latest fashions, today's store sales, Wall Street's relentless minute-to-minute trading. We assume that "tomorrow will take care of itself," and that the government will bail us out, like the Fed did recently with the discount rate. But, Walker warns, you can't trust government with your future:**

**"Unfortunately, our government's track record in adapting to new conditions and meeting new challenges isn't very good. Much of the federal government remains overly bureaucratic, myopic, narrowly focused and based on the past. ... Hurricanes Katrina and Rita brought that point home in a painful way ... Public confidence in the ability of government to meet basic needs was severely shaken ... If our government can't handle known threats like natural disasters, it's only fair to wonder what other public services may be at risk."**

Walker's the one person in America with a nonpartisan, solidly analytical understanding of America's economic future, backed by 3,000 GAO employees analyzing every possible scenario ... and yet, his message is largely ignored. Nobody wants to hear the Comptroller General (or anyone else) warn us that ...

"Entitlement reform is especially urgent. Unless we reform Social Security, Medicare, and Medicaid, these programs will eventually crowd out all other federal spending. Otherwise, by 2040 our government could be doing little more than sending out Social Security checks and paying interest on our massive national debt."

We've written often about this "coming storm." See previous Paul B. Farrell.

Debt burden

But here it's coming from the one Washington insider who knows the facts and has no "axe to grind." Walker delivered a powerful speech in Chicago, titled "Transforming Government to Meet the Demands of the 21st Century." And it boils down to the single problem that'll destroy America from within ... oppressive debt from out-of-control spending:

"Transforming government and aligning it with modern needs is even more urgent because of our nation's large and growing fiscal imbalance. Simply stated, America is on a path toward an explosion of debt. And that indebtedness threatens our country's, our children's and our

grandchildren's futures. With the looming retirement of the baby boomers, spiraling health-care costs, plummeting savings rates, and increasing reliance on foreign lenders, we face unprecedented fiscal risks."

After reading Walker's speech the real reason nobody listens suddenly hit me. He's too nice. Too rational. Too matter-of-fact. Maybe he should go wild like cable-TV showman Jim Cramer, throwing a childish tantrum to get Daddy Bernanke's attention, forcing him to drop the Fed's discount rate. And yet, if our economy and markets are ever going to be "transformed," it'll take a cool, rational, long-term thinker like Walker, not a myopic stock market fanatic going ballistic, demanding a quick-fix from daddy!

When Walker talks, he undoubtedly has in the back of his mind Cullen Murphy's bestseller, "Are We Rome? The Fall of an Empire and the Fate of America." You can find many online analyses of Murphy's six scary parallels between America and Rome:

1. Self-centered aggrandizing of the capital city
2. Overextended military unsuited for global empire
3. Myopic, distrusting, isolationist view of the world
4. Big government, too complex, unmanageable, risky
5. Privatization of public responsibilities breeding greed
6. Porous borders and failed immigration policies

But the scariest of all parallels is not one either Walker or Murphy see between the two empires. The scariest parallel is Wall Street with millions of daily duels to the death.

Wall Street is a metaphor for the Coliseum where Romans fought not just individual duels, but fought a much deeper battle for the heart and soul of the republic -- and lost. The Coliseum was symbolic of their obsession with wealth and material excesses, destroying its values, exposing its vulnerability ... until eventually Rome was overrun by outsiders. "Sound familiar?"

Here's Walker's history lesson for Wall Street: "It's useful to remember at the end of the 19th century, the original Dow Jones Industrial Average consisted of 12 stocks. These were all powerful companies, the leaders in their fields. Names like National Lead, U.S. Rubber, and Tennessee Coal and Iron were the Microsofts and Wal-Marts of their day. It's sobering to realize only one of the original 12 Dow Jones companies survives today, and that's GE. The rest couldn't adapt to changing conditions and either merged with competitors or went out of business."

Makes you wonder if maybe, just maybe, Wall Street itself might eventually look like today's crumbling Roman Coliseum ... and take "The Empire" down with it?

<http://www.marketwatch.com/news/story/if-we-rome-wall-street/story.aspx?guid=%7bE71DF12D-6F67-4D51-8A77-1AA17A4C57BC%7d&print=true&dist=printTop>

**UM EMBA**