

Leeds Market Update -- April 19, 2009

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sandy.leeds@mcombs.utexas.edu

PART 1: The Bad News

Unemployment rose in 46 states during the month.

- a. 48 states showed payroll declines in March
 - (i) only ND and Mississippi had slight gains (300 jobs)
- b. highest unemployment rates:
 - (i) Michigan -- 12.6%
 - (ii) Oregon -- 12.1%
 - (iii) South Carolina -- 11.4%
- c. largest job losses
 - (i) California -- 62,100 jobs
 - (A) 11.2% unemployment
 - (B) good news: had lost 114K jobs in prior month
 - (ii) Florida -- 51,900 jobs
 - (iii) Texas -- 47,100 jobs
 - (iv) North Carolina -- 41,300 jobs
 - (A) unemployment rose to 10.8%

Foreclosures jumped in March. The moratorium is over.

- a. 175,199 foreclosures in March
 - (i) 44% increase
 - (A) rising unemployment
 - (B) tight credit markets (tough for some to refinance)
- b. pre-foreclosure filings (leading indicator) increased 5.8% to 225,131
 - (i) Q1 saw 604,590 pre-foreclosures
 - (A) up 15% from Q4
 - (B) up 17% YOY
- c. California saw 59% increase in foreclosures last month
 - (i) still down from September:
 - (A) state legislature has been trying to slow foreclosures
- d. Arizona and Florida are also hurting
 - (i) Arizona foreclosures jumped 45%
 - (ii) Florida foreclosures increased 1/3
- e. More than 2.1 million homes will be lost this year b/c payments can't be made
 - (i) This is up from 1.7 million homes last year

As expected, FHA guaranteed loans are doing horribly.

- a. 10.2% of borrowers who took out FHA-backed loans in Q1 2008 have missed at least two consecutive payments within first 10 months
 - (i) This was 9.4% in 2007
- b. 12.3% of 2007 loans are seriously delinquent (90 days)
- c. the overall delinquency rate is 7.46%
 - (i) Up from 6.16% a year earlier
- d. 14 of the 50 markets with highest delinquency rates were in California
- e. minimum downpayment is only 3.5% for FHA insured loans
- f. FHA loans were approximately 1/3 of mortgages in Q4 2008
 - (i) market share was 2% in 2006

Industrial production is still falling.

- a. industrial production fell 1.5% in March
- b. down 13% since recession began in December 2007
 - (i) worse than every recession since WWII

There have been record downgrades of companies by Moody's in Q1.

- a. 13.9% of companies had ratings cut by Moody's in Q1
 - (i) average ANNUAL rate was 12.5% for last 15 years
- b. only .5% of companies were upgraded in Q1
 - (i) average ANNUAL rate is 7.9%
- c. 9.7% of companies are on review for downgrade at end of Q1
13.5% of US junk issuers are expected to default by end of year
 - (i) 21.2% of European junk issuers are expected to default by end of year

S&P made some ugly predictions for the bond market.

- a. leveraged buyouts will help push corporate defaults to 14.7% in Europe
 - (i) estimate had been 11.1%
 - (ii) 2008 default rate was 4.5%
 - (A) 2008's rate was triple 2007 rate
 - (iii) US default rate was 8% for junk bonds in 2008
- b. between 90 - 112 companies will default
 - (i) large percentage will be those involved with LBOs
- c. 45% of LBO loans (\$86 billion) mature in 2013 and 2014

Mall owner General Growth Properties filed for bankruptcy protection.

- a. acquisition sprees resulted in \$27 billion of debt
- b. 2nd largest US mall owner behind Simon Property
 - (i) own and manage 200 malls
- c. shows troubles of commercial real estate
 - (i) can't refinance
 - (ii) this year, \$248 billion of commercial mortgages come due
 - (iii) mall values have declined 30%
 - (A) Green Street Advisors predicts 40% drop peak to trough
 - (iv) difficult to sell malls
 - (A) only 8 changed hands in largest 76 markets

More banks are being closed by the FDIC.

- a. A NC bank and a bank in Colorado were shut down.
 - (i) brings this year's total to 23

Lending has slowed.

- a. The 21 largest banks had 6% less in loans outstanding in February.
- b. These banks received \$211 billion in federal funding.

China is slowing.

- a. China's YOY growth was 6.1% in Q1.
 - (i) This was the slowest growth in 10 years.
 - (ii) This was 4.5% slower than the growth rate in Q1 2008.

No surprise...venture capital firms can't raise money.

- a. only 40 venture capital funds raised money in Q1
 - (i) raised \$4.3 billion
 - (A) 40% drop from Q1 of 2008
 - (B) but an increase over the \$3.5 billion raised in Q4
- b. invested only \$3 billion this qtr (less than they took in) in 549 companies
 - (i) lowest investment level since 1997
 - (ii) down 47% from Q4
 - (iii) down 61% from Q1 2008
- c. clean technology saw big drop
 - (i) \$154 million into 33 companies
 - (A) 84% drop since Q4
 - (B) lowest level since 2005
- d. other drops:
 - (i) software -42%
 - (ii) biotech and medical devices -40%
 - (iii) internet -31%

A lot of M&A involves bankrupt companies.

- a. Globally, 67 M&A targets have been in bankruptcy this year.
 - (i) There were 34 in March.
- b. Bankruptcy M&A peaked at 87 in July 2002.
- c. Bankruptcies typically peak 18 months after recession starts.
 - (i) This might be misleading...
 - (A) recession is usually shorter than current recession

It's hard to keep up with education and health care costs.

- a. over last ten years:
 - (i) education costs have increased 5.91% / year
 - (ii) health care costs have increased 4.16% / year
 - (iii) wages and income have risen 3.7% / year
- b. in addition, our net worth dropped 18% last year

Airlines are still hurting.

- a. AMR lost \$375 million in Q1
 - (i) revenue dropped 15%
 - (A) avg fare dropped 4.5% YOY

GE's profit dropped 36% to \$2.74 billion.

- a. revenue fell 9%
 - (i) industrial business down 10%
- b. increased reserves to 1.6% of loans outstanding
 - (i) large banks are at 3 - 4%
 - (A) GE says its loans are totally different

PART 2: The Good News

We're seeing signs of optimism in the market (question is whether this is bear mkt rally):

- a. market is 23% above low
 - (i) bank stocks have rallied
- b. investors bought \$2.7 billion in junk bonds in one day and \$4 billion for week (most issued in week since June 2008)
 - (i) hospital operator HCA (\$1.5 billion)
 - (ii) cellphone tower operator Crown Castle (\$1.2 billion)
 - (iii) Seagate Technology sold second-lien notes (\$430MM)
- c. IPOs are coming to market and rallying
 - (i) Rosetta Stone rose 40%

Retail sales broke their winning streak this month, but the quarter was okay.

- a. US retail sales fell 1.1% in March after increasing in the first two months of the year
 - (i) sales had increased in prior two months:
 - (A) January increased 1.9%
 - (B) February increased .3%
 - (ii) sales of \$344.4 billion are just 1% above December's trough
- b. Overall, retail sales rose in Q1, meaning:
 - (i) GDP should not be shrinking as much as 6.3%
- c. Retail sales are 9.4% lower than a year ago
 - (i) 10% below June's peak
- d. Retail spending in Q2 should be helped by an increase in tax refunds.
 - (i) through April 3, individual refunds were up 15%

Consumer confidence has increased.

- a. rose from 57.3 to 61.9
 - (i) highest level since September
 - (ii) still at historically low levels
 - (A) 30 year low was 55.3 in November

American Express (higher end consumer) sees stabilization.

- a. American Express reported that defaults in March increased only .2% to 8.8%.
- b. CapOne increased their net charge-offs to 9.33% in March
 - (i) This is up 1.27% (not a sign of stabilization)
- c. The rate of loans delinquent 30 days fell at both firms.

Intel says that the market is stabilizing.

- a. sales of \$7.1 billion were down 26% YOY
 - (i) Q1 sales of the atom processor (for low cost laptops) were down 27%
- b. 55% drop in YOY net income for Q1 2009
 - (i) gross margins of 45.6% were down from Q4 53% and Q3 59%
- c. expect notebooks to grow
 - (i) notebook shipments are expected to grow 15 - 20% this quarter
 - (ii) desktop shipments should be steady or shrink

Fed's Beige Book reports signs of stabilization.

- a. Five of the 12 Federal Reserve districts showed moderation in rate of decline.

Labor Department said initial unemployment claims dropped.

- a. weekly claims fell from 663K to 610K
 - (i) far below 655K expectation
 - (ii) lowest level since January
 - (iii) could be statistical fluke from Good Friday
- b. GS says that claims peak six to ten weeks before end of recession
- c. four week moving average is 651K
 - (i) dropped by 8,500
 - (A) GS says a drop of 30K to 40K would provide evidence it peaked
- d. 6MM people are receiving jobless benefits
 - (i) highest since 1967 (when data started)
 - (ii) 2.1MM are receiving benefits under extended program
 - (A) provides 20 to 33 additional weeks on top of 26

Existing home sales increased in February.

- a. 5.1% increase in existing home sales in February
 - (i) largest increase in 5 years
 - (ii) driven by foreclosure sales

New home construction continues to fall. We need this in order to stabilize housing.

- a. construction of new homes and apartments fell 11% in March
 - (i) much of this was from apartments
- b. construction of new homes matched February's level -- 510,000 units
 - (i) second lowest on record (January was lowest)
 - (ii) single family units remained at 358,000
 - (A) 3 straight months near this low level

Prices are falling! (Of course, we don't want deflation.)

- a. CPI is .4% lower YOY
 - (i) first yearly price decline since 1955
- b. core CPI (excluding food and energy) is up 1.8% YOY
- c. monthly drop was .1%
 - (i) core was up .2%

PPI (wholesale price index) fell.

- a. Wholesale prices fell 1.2%
 - (i) Had increased .1% in February.
- b. Wholesale prices have fallen 3.5% in last year
 - (i) largest drop in 60 years
- c. Food and energy prices dropped last month:
 - (i) Gas prices dropped 13.1%
 - (ii) Food fell .7%

GS is looking for opportunities in private equity.

- a. GS raised \$5.5 billion for a fund to buy discounted private equity holdings
 - (i) Banks are expected to be big sellers of their holdings.
 - (ii) Banks own 25% of private equity investments.

PART 3: Financial Institutions

Goldman Sachs reported good numbers.

- a. Q1 profit was \$1.81 billion
 - (i) earned \$1.51 billion in Q1 2008
 - (ii) helped by increase in:
 - (A) fixed income, currency and commodity divisions
 - (iii) hurt by:
 - (A) banking and private money management
 - (iv) compensation rose b/c revenue rose
 - (A) but 7.2% fewer employees
- b. company changed fiscal year
 - (i) Moved from FY ending in November to FY ending in December
 - (ii) \$780 million -- amount GS lost in December, 2008
 - (A) not included in this quarterly report
 - (B) \$2.7 billion in fair value losses in December
 - (1) \$1 billion of this was for non-investment grade loans

GS wants to pay back TARP.

- a. GS raised \$5 billion (they borrowed \$10 billion)
- b. GS does not want to have compensation limits
 - (i) Last year, 953 GS employees (1 in 30) received at least \$1MM
 - (ii) In 2007, Blankfein received \$68MM in pay.

JPM reported strong results.

- a. revenue increased \$25 billion
 - (i) 45% increase
 - (A) some is Bear Stearns related
- b. \$2.1 billion profit in Q1
 - (i) \$1.6 billion from investment banking
 - (ii) \$638 million was from fair value acctg marking down their own debt
 - (iii) took \$10 billion charge in mortgage and credit card portfolios
 - (iv) Q1 2008 profit was \$2.4 billion
- c. said that they could repay gov't tomorrow (if they wanted to)
 - (i) said that they didn't need to raise money to do this
- d. Tier 1 Capital was 11.3%
 - (i) excluding TARP, it is 9.2%
 - (ii) \$27.4 billion of reserves
 - (A) 4.53% of total loans
 - (B) C, WFC and BAC average 2.74%

JPM sold debt that was not backed by FDIC.

- a. sold \$3 billion in 10 year senior notes
 - (i) 3.5% premium over UST (6.32% yield)
 - (ii) if issued insured bonds, spread would have been .2% to .5%
- b. had also sold \$2.64 billion on March 25
- c. had previously sold \$40 billion of FDIC backed bonds
 - (i) banks have issued \$238 billion in FDIC backed bonds
 - (A) since program began, only \$33 billion in non-guaranteed debt

Even Citigroup earned a profit!

- a. reported a gain of \$1.6 billion
 - (i) first profit in 18 months
- b. many are skeptical about the earnings number:
 - (i) \$968 million of gains
 - (A) including \$704MM from sale of Redecard
 - (ii) \$2.7 billion gain because fair value accounting:
 - (A) lets them mark down their outstanding debt
 - (1) odd to have a gain b/c no one wants your debt
 - (iii) reserved less this quarter than last quarter
 - (A) \$2.4 billion in Q1 vs \$3.7 billion in Q4
 - (iv) \$638 million added from new mark-to-market gains

Citigroup debt is behaving different than its stock.

- a. debt not guaranteed by FDIC has 6% - 13% spread to UST
 - (i) insured debt has .4% to .6% premium

UBS is hurting.

- a. announced 8,700 layoffs
 - (i) in 2007, they employed 83,800 people
 - (ii) after these cuts, they'll have 67,500 (most of them miserable)
- b. plan to cut 15% operating costs
- c. expect to report Q1 loss of \$1.76 billion
- d. they are starting a distressed emerging market asset fund
 - (i) is this an excuse for them to buy their own stock?

Pressure is building at BAC to separate CEO and Chairman positions.

- a. last year, a similar vote gained 37.6% of the vote

Amount of credit is falling.

- a. Treasury said that 21 largest banks receiving TARP funding offered 2.2% less credit
 - (i) 16 of 18 banks increased mortgage originations in February
 - (A) 35% increase in mortgage lending (month over month)
 - (ii) originations of new credit-card accounts fell 2.7%
 - (iii) many banks also lowered credit card limits
- b. it's impossible to know how credit would have fallen without TARP

TARP banks are under fire for charging fees and high rates.

- a. BAC doubled rates to 14% on many of their cardholders and is imposing fees of \$10 on some transactions
- b. C is offering \$5,000 loans that have 30% interest rate
- c. Pacific Capital Bancorp is giving tax refund loans with rates > 100%
- d. USB and WFC are giving loans that allow customers to access direct deposits before they hit the account; effective rate is 120%
- e. realize that deposit account charges are large part of bank revenues:
 - (i) \$39.5 billion in 2008
 - (ii) 25% of revenue
 - (iii) average overdraft fee is \$27.50

China now has the largest bank -- Industrial and Commercial Bank of China.

- a. \$1.3 trillion in deposits
 - (i) Mitsubishi UFJ Financial has \$1.29 trillion
 - (ii) JPM has \$1 trillion
- b. owned 4% by GS and 75% by China

PART 4: Auto Industry

The Treasury Dep't told GM to be ready for bankruptcy by June 1.

- a. GM has \$28 billion of debt that must be converted to equity to avoid bankruptcy
 - (i) bondholders had previously been offered 90% of the equity
 - (A) this will be reduced if US takes equity stake (for debt)
- b. US has loaned GM \$13.4 billion
- c. GM's pension was underfunded by \$13.5 billion as of December 31st
 - (i) this could be a substantial problem for the PGBC
- d. \$20.4 billion is owed to health care fund
- e. In bankruptcy, the US would need to provide substantial DIP financing:
 - (i) \$5 - \$7 billion -- the amt that US would need for the "good GM"
 - (ii) \$70 billion -- the amt that the US would need to provide to the "bad GM"

GM is accelerating plans to close 1,700 dealerships.

- a. GM had 6,200 dealerships at end of 2008
- b. The goal was to get to 4,100 in five years. Now, it's quicker.
 - (i) 200 dealerships closed in the first quarter
- c. When GM closed 2,800 Oldsmobile dealerships, they paid over \$1 billion.
 - (i) Now, they will not pay anything.

VW is closing in on Toyota as the top selling car manufacturer!

- a. goal is to be #1 by 2018
- b. VW is being helped by strong German incentives and sales
 - (i) new registrations in Germany increased 19%
 - (A) VW has about 1/3 market share
 - (ii) Toyota's grew 43% in Germany, but only have 4.4% share
- c. in Q1 2008:
 - (i) VW delivered 1.57 million cars
 - (ii) Toyota delivered 2.41 million cars
- d. Q1 2009 estimates:
 - (i) VW -- 1.42 million cars
 - (ii) Toyota 1.23 million cars
 - (A) US drops 36%
 - (B) Japan drops 31%
- e. VW is also catching Toyota in market cap
 - (i) Toyota -- \$133 billion
 - (ii) VW -- \$100 billion

PART 5: Random

No one can retire.

- a. Only 13% of workers say they're confident they'll have enough for retirement according to study from Employee Benefit Research Institute
 - (i) lowest level since survey started 19 years ago
- b. 41% are somewhat confident (down 2% YOY)
- c. 20% of retirees says they are confident that they'll be secure
 - (i) one year ago, 40% of retirees were confident
- d. we're seeing changed behavior:
 - (i) 81% of those who have lost confidence are spending less
 - (ii) 65% of workers are saving money for retirement
- e. we still don't save enough
 - (i) average worker sets aside 7% per year
 - (ii) we really need to put aside 14%
- f. unfortunately, some people are not in the ballpark
 - (i) ~50% said they have less than \$25K in savings
 - (ii) ~20% have less than \$1,000
- g. some people don't know where the ballpark is or what game is being played
 - (i) 41% of employees who don't have a pension believe that they do
 - (ii) Bureau of Labor Statistics says that 20% of private employees have pension
 - (iii) Approximately 43% have 401(k)
- h. most people don't really know how much they need to retire
 - (i) 44% said they have calculated how much they need to retire
 - (ii) 44% said that they guessed

Oregon is suing Oppenheimer as the result of losses in college savings plan.

- a. suing for \$36.2 million
- b. fund losses:
 - (i) 36% last year
 - (ii) 10% this year
- c. 66,000 accounts affected

State revenues keep dropping.

- a. state and local sales tax revenue fell 6.1% in Q4
 - (i) greatest drop in 50 years
- b. personal income taxes down 1.1%
- c. corporate income taxes down 15.5%
 - (i) lower taxes
- d. Q1 looks equally bad:
 - (i) 12.8% drop so far

States are in trouble.

- a. the stimulus bill will only offset 40% of the losses in state revenues
- b. programs for vulnerable groups have been cut in 34 states

Help save California!

- a. California is planning on selling \$15 billion of notes and wants the fed'l gov't to guarantee it
- b. Municipal bonds secured by taxes have a cumulative default rate of .03% from 1986 - 2007

Delinquent taxpayers are increasing.

- a. Nationwide Tax Relief (helps delinquent taxpayers resolve tax issues):
 - (i) says calls are up 280%

The Obamas did okay last year. (I need to write a book...)

- a. reported adjusted gross income of \$2,656,902
 - (i) paid \$855,323 in fed'l income tax
 - (ii) donated \$172,050 to charity
- b. Bidens reported AGI of \$269,256

The bankruptcy lawyers are happy.

- a. Weil Gotshal asked a fed'l judge to sign off on \$55 million fee for representing Lehman
 - (i) could bring in \$200 million by end of case
 - (A) would exceed the \$159 million they earned from Enron
 - (ii) during this qtr, they billed 100,000 hours
 - (A) lead attorney is asking \$950 / hour
- b. other expenses include:
 - (i) \$200,000 for business meals
 - (ii) \$439,000 for computerized research
 - (iii) \$115,000 for local transportation
 - (iv) \$287,000 for duplicating charges at 10 cents / page
- c. nearly a dozen other firms have submitted requests for \$27 million

Politicians are hurting.

- a. January and February donations are down 23%
 - (i) compared to same place in election cycle in 2007
- b. contributions by corporate fund-raising arms declined 6%

More CEOs received pay raises last year.

- a. survey of 946 companies from the Russell 3000
 - (i) 480 received pay raises
 - (A) average compensation was \$5.4 million
 - (ii) 463 had pay cuts
 - (A) average compensation was \$3.9 million
- b. median salary was up 7%
- c. CEO perks were up 13%
- d. some firms are changing the factors they consider for bonuses
 - (i) Xerox will no longer consider revenue growth!

Bernie is switching teams...

- a. Bernie Madoff's two opening day tickets for the Mets sold for \$7,500.
 - (i) Rumor has it that he now associates with the Nationals.

People continue to buy guns.

- a. Since November, 7 million people applied to buy guns
 - (i) that does not capture guns sold at gun shows in some states
- b. in Q1, there were 4 million requests
 - (i) 27% increase YOY

Obama wants a high speed rail. (My daughter wants a pony.)

- a. wants to use \$8 billion in stimulus money
- b. said he would budget an additional \$5 billion in next five years

So far this year, emerging markets have outperformed.

- a. emerging markets are up 12% YTD
 - (i) China, Russia and Brazil are up > 20%
- b. developed markets outside of US and Canada are down 9%
- c. DJIA is down 7.9%

Delta has stopped outsourcing call centers to India.

- a. call center rep in India is paid \$500 / month
 - (i) 1/6 of what American rep makes
- b. US companies comprise 60% of clients for India's call centers

Leverage is good!

- a. \$3.4 billion of new money went into leveraged ETFs last month

Calpers hedge fund investments lost 19.6% in 2008.

- a. slightly worse than average hedge fund loss of 19%
- b. since 2002, Calpers has made 4.3% / year from hedge funds
 - (i) trails 4.7% average hedge fund return

Lehman is sitting on 500,000 pounds of uranium.

- a. This is slightly less than the amount needed to build one bomb...
 - (i) or fuel one nuclear plant for a year

Ebay is planning to spin off Skype.

- a. Ebay paid \$3.1 billion for Skype in 2005
- b. they wrote Skype down by \$1.4 billion in 2007
- c. Skype had \$551 million in revenue in 2008
- d. spin-off in 2010

These young kids love their Twitter.

- a. the service attracted 9.3 million unique visitors to their site in March
 - (i) 131% increase from February
 - (ii) that's more than 5MM new visitors
- b. users tend to be news junkies
 - (i) 2X to 3X more likely (than avg web user) to visit top news sites

Google's numbers weren't great.

- a. revenue rose 6.2% (YOY) to \$5.51 billion
 - (i) declined 3% from Q4
- b. quarterly profit increased 8.9% to \$1.42 billion
 - (i) reduced expenses (including job cuts)
- c. user clicks on job ads increased 17%

The ultimate stupid promotion...

- a. Capitol Chevrolet in Austin is offering 100 shares of GM stock with car purchase
 - (i) at Friday's close, this was \$186
 - (ii) apparently, they were trying to give away something that would lose value even faster than their cars