

Market Update – February 1, 2009

FEEL FREE TO FORWARD THIS TO ANYONE AND EVERYONE. The email list is growing and I'm enjoying it...

IF YOU RECEIVED THIS AND YOU WANT TO BE ON MY EMAIL LIST, SEND YOUR EMAIL ADDRESS TO ME AT SANDY.LEEDS@MCCOMBS.UTEXAS.EDU . STRANGERS ARE WELCOME.

PLEASE DO NOT EMAIL ME AT THE GMAIL ACCOUNT. OR BETTER SAID...YOU'RE WELCOME TO EMAIL ME THERE, JUST DON'T EXPECT A RESPONSE.

THIS IS NOT INVESTMENT ADVICE. THIS IS WRITTEN FOR EDUCATIONAL PURPOSES.

I LIFT SENTENCES AND FACTS FROM MANY SOURCES. MUCH OF THIS IS NOT MY INTELLECTUAL WORK.

CONTENTS

- 1. The Economy (p. 2)**
- 2. Financials (p. 9)**
- 3. The Bailout (p. 15)**
- 4. Industry News (p. 19)**
- 5. Assorted News (p. 21)**

Part 1: The Economy

GDP Fell 3.8% -- But That's Misleading

1. Q4 GDP dropped 3.8% (from the prior quarter).
2. Expectations were that GDP had dropped 5% - 6%.
 - a. The "better than expected" number is somewhat misleading.
 - i. GDP measures the value of all goods and services produced in this country, regardless of whether those goods were sold or not.
 - ii. In Q4, we produced a lot of goods that are now sitting in inventories. If we did not produce the goods that increased inventories, GDP would have dropped approximately 5.1%.
 - iii. As a result of this inventory buildup, future production will be slower.
3. The 3.8% drop was the largest since 1982. The postwar record is the 10.4% drop in 1958.
4. GDP would have also been lower had it not been for the 1.9% increase in gov't spending.
5. Exports fell at an annualized rate of approximately 20% in Q4.
6. Imports fell at an annualized rate of approximately 15%.
 - a. This is the 5th straight decline and does not bode well for foreign countries such as China and Japan.

Durable Goods Orders Dropped 2.6%

1. December's durable goods orders dropped 2.6%.
2. This was the 5th monthly decline in a row.
 - a. Orders dropped 8.5% in October and 3.7% in November
3. The drop was larger than expected.
4. Even worse, this number includes large gov't purchases of airplanes – meaning private demand was even weaker.
5. This number shows companies are preparing for a weak year and not purchasing equipment.

Depressing Facts About the Labor Market

1. The unemployment rate is 7.2%.
2. Employers cut 2.6 million jobs last year.
 - a. The vast majority of these cuts were in the last four months.
3. There are 4.8 million Americans receiving unemployment benefits (as of mid-January).
 - a. This is a record.
 - i. But realize we have more people in the country and work force.
 - ii. As a percentage, we're not as bad off as 1983...yet.
 - b. The bad news: this number would be 6.5 million if we included the 1.7 million people receiving extended unemployment benefits authorized by Congress last summer.
4. 588,000 people (seasonally adjusted) filed new claims for unemployment benefits last week.
5. Unemployment rose in every state in December.
 - a. The unemployment rate increased in every state and DC in December.
 - b. 48 states lost nonfarm payroll jobs last month; exceptions were:
 - i. Louisiana – benefiting from post-Katrina recovery
 - ii. DC – helped by federal spending
 - iii. Oklahoma – employment was unchanged (does this mean it stayed at zero?)
 - c. States are collecting less revenue and are being forced to cut budgets.
 - i. Unemployment resources are being exhausted.

Existing Home Sales Increased! New Home Sales Continue to Drop

1. December's existing home sales jumped 6.5% (from November).
 - a. Largest jump in seven years.
 - b. Home sales were still down 3.5% YOY.
2. New home sales dropped 14.7% in December.
 - a. This was a 44.8% drop YOY.
 - b. This was the worst month on record since 1982.
3. The reason for the discrepancy (existing home sales jumped, new home sales dropped)?
 - a. Approximately 45% of the existing home sales were:
 - i. banks unloading foreclosed properties; or
 - ii. homeowners selling for less money than they owe to lenders (referred to as a "short sale" in real estate)
 - b. new homes are not owned by banks (or individuals who are under water)
4. There are still 3.68MM existing homes listed for sale.
 - a. This is down 7.5% YOY.
 - b. Banks and loan investors own 845,000 homes as of December 1st.
 - i. They owned 460,900 last year.
 1. There are a lot more distressed sales to come.

Home Prices Continue to Drop

1. November's home prices declined in each of the 20 regions tracked by the S&P / Case Shiller index.
2. The average drop is 18.2% YOY.
3. The 20 city index has fallen for 28 consecutive months.
 - a. Peaked in August 2006.
 - b. Declines accelerated at the end of 2008.
4. Home prices are down 25% from August 2006.
 - a. But...home prices rose 155% from 1999.
 - i. They have only reversed a fraction of that gain.
5. Phoenix and Las Vegas have both fallen over 30%.
 - a. SF, SD, LA and Miami have dropped more than 25%
 - b. Dallas has fallen the least – 3.3%.
 - i. Denver, Charlotte and Cleveland have dropped <5%.
6. During the Depression, home prices fell 30%.
 - a. They stopped falling in 1933.
 - i. The Depression lasted eight more years.

Consumers are Pessimistic

1. Consumer confidence (as measured by the Conference Board) dropped to 37.7.
 - a. This is the lowest reading since the series began (1967).
 - b. Only 10% of respondents expect their income to increase this year.
 - i. This is a bad sign for consumer spending.
 - c. In December, the survey was 38.6.
2. Consumer sentiment (as measured by the University of Michigan) rose to 61.2 in January.
 - a. The index had been at 60.1 in December and 55.3 in November.
 - b. Consumers expect 9% unemployment by year end.
 - i. Again, this does not bode well for consumer spending.

Bad Month for the Market

1. The Dow Jones Industrial Average fell 8.8% for January.
 - a. This is the worst January on record (113 years).
 - i. This may be slightly misleading...the market has been trading between 8,000 and 9,000 for a while now.
 1. We just happened to move from the top of the range to the bottom.
 - b. This is the 5th consecutive monthly decline.
 - c. The five-month decline of 31% is the sharpest since December 1937.
 - d. Only two stocks (in the DJIA) rose during January:
 - i. IBM (+8.9%)
 - ii. Kraft Foods (+4.5%)
 - e. Financials continued to lead the decline:
 - i. BAC (-53%)
 - ii. C (-47%)
 - f. January's direction has accurately forecast the entire year 75% of the time.
 - i. This has been correct 26 of the past 30 years.
2. Gold moved above \$900.
 - a. This likely reflects:
 - i. Fear in the stock market; and / or
 - ii. A long term inflation hedge.

The Fed Met and Released a Statement

1. Economy has weakened further since January meeting.
 - a. Industrial production, housing starts and employment have continued to drop sharply.
 - b. Consumers and businesses have cut back spending.
 - c. Global demand appears to be slowing significantly.
 - d. Some financial markets have improved.
 - i. Partly due to gov't efforts to provide liquidity and strengthen banks.
 - ii. BUT...credit conditions are still extremely tight for firm and households.
 - e. Expect a gradual economic recovery later this year, but...
 - i. The downside risks to that outlook are significant.
2. Inflation should remain subdued in coming quarters.
 - a. Energy prices and other commodities have declined in recent months.
 - b. Considerable economic slack exists.
 - c. Inflation could persist for a time below rates that foster economic growth and price stability in the longer term.
 - i. In other words, we're scared of deflation.
3. We'll use all tools available to foster growth and stability.
 - a. Focus on supporting the functioning of fin'l markets.
 - b. Stimulate the economy through open market operations.
 - i. Likely to keep Fed's balance sheet at a high level.
 - ii. Continue to buy agencies and MBS.
 1. Support mortgage and housing markets.
 2. Will expand purchases as necessary.
 - iii. We may have to buy longer term UST.
 1. If this will help private credit markets.
 - c. will implement Term Asset-Backed Securities Loan Facility
 - i. To help small businesses and individuals.

The Fed's Next Move

A Reuters poll of top Wall Street banks found 11 of 13 respondents expect the Fed to hold rates near zero until at least 2010 while 9 of 12 said the central bank would step in at some point to buy U.S. government bonds. The thing that I found intriguing about this survey was that there are 13 top Wall Street banks.

Some Things to Think About With the Economy

1. High unemployment could have a disparate impact on the banks.
 - a. If unemployment rises towards 10%, people who were a good credit risk will lose their jobs and default on loans.
 - b. This will put a tremendous strain on bank's capital.
 - c. The typical assumption is that every percentage point increase in unemployment up to 9% will result in a 1% increase in write-offs.
 - d. There is a fear that once we go above 9%, the charge-off rate will be even greater than the increase in unemployment.
 - i. The idea is that really high unemployment means prime borrowers are losing their jobs. These people often have higher balances.
2. Companies in developing countries need to raise \$200 billion in external debt in 2009. Markets had closed to such borrowers.
3. Unfortunately, the first states to feel the pain of recession are getting worse, not better.
 - a. Nevada's unemployment rate increased to 9.1% from 8.1%.
 - b. Florida rose .7% to 8.1%.
 - c. California's jobless rate increased .9% to 9.3%.
4. The British pound has fallen to a 23 year low.
 - a. They have a recession, a banking crisis and surging government debt.
 - b. They can't raise rates to protect the currency – it would kill the economy.
 - c. Remember how one investment bank after another was taken out and shot? Lets hope this isn't what happens with currencies.
 - i. Currently (amazingly), the dollar has been seen as a strong currency. The argument is that the dollar is "not as bad" as other currencies.
 1. I frequently use this argument with Jenny – telling her that I'm not as bad as some of my friends. There are two lessons to be learned from this:
 - a. Always have some friends who are true dirt bags.
 - b. This argument doesn't work for long.
5. George Soros said that the current crisis could be worse than the 1930s and that the banking system needs \$1.5 trillion.
6. Muni bonds are offering higher yields than USTs.
 - a. This hasn't happened in 50 years.
 - i. Your after-tax return will be much higher (if no default) b/c you are not taxed on munis.
 - ii. This reflects fear of municipalities with rising unemployment.
7. The UN said that 40 million more people (worldwide) could lose their job by the end of this year.

A Few Pieces of Anecdotal Evidence

1. American Express said its customers reduced spending by 10% in the fourth quarter.
 - a. The company wrote off 6.7% of its loans, up from 5.9% in the third quarter and 3.4% in the year earlier period.
2. There were 76,000 job cuts announced worldwide on Monday.
 - a. This included:
 - i. Caterpillar (20,000)
 - ii. Pfizer (8,000)
 - iii. Sprint / Nextel (8,000)
 - iv. Home Depot (7,000)
 - v. ING (7,000)
 - vi. Philips (6,000)
 - vii. Corus (3,500)
 - viii. Deere (700)
3. Apple's same store sales dropped 17.4%.
 - a. Visitors fell only 1.8%.
 - i. In other words, people are shopping, but not buying.

Part 2: Financials

Thain Defends Himself

Former ML CEO (fired last week by BAC) made the following assertions:

1. BAC knew of ML's Q4 losses – they were not a surprise to them.
 - a. Argued that his CFO was BAC's former Chief Accounting Officer and that he knew all positions.
2. Argued that the majority of losses came from “legacy positions” – in other words, these securities were bought / created while Stan O'Neal was in charge.
 - a. Any money manager who says this is a complete loser.
 - i. Are you not responsible for the securities that were on your balance sheet if they were already on there?
3. BAC was “completely plugged into” the amount of discretionary bonuses awarded.
 - a. BAC pushed ML to change ratio of cash to BAC stock to 70/30 from 60/40.
4. The discretionary bonuses were 41% lower than 2007.
 - a. Apparently, he doesn't understand that ML lost \$28 billion last year and helped drive the economy into recession. Normally, people don't receive bonuses for that. But, every firm is different...
 - b. Also said that the total bonus pool was substantially less than the amount allowed under the merger agreement.
5. The office that he inherited from Stan O'Neal would have been difficult to use.
 - a. But spending \$1.2MM on his office was a mistake. (You think?)
 - i. He will reimburse the company.
6. He only pursued a merger with BAC after it was clear that BAC would not do a deal with LEH. He said that he did not want to make a transaction with LEH less likely.
 - a. If you believe this, I've got some Miracle Growth shampoo I'd like to sell you (the container is almost full...).

I Wouldn't Spend That Bonus Yet...

1. NY Attorney General Andrew Cuomo is investigating:
 - a. The payment of bonuses to ML employees after huge losses.
 - b. Whether directors and shareholders were misled about losses.
 - c. Why BAC did not disclose ML's condition was deteriorating (before BAC shareholders voted on the transaction).

We Started 2008 With Seven Major Financial Firms Based in NY

1. LEH failed.
2. BSC and ML were acquired.
3. MS and GS have converted to commercial banks.

Limits on Salaries and Bonus

Senator Claire McCaskill (Missouri) wants to limit salaries and bonuses to \$400,000 for executives of any firm that receives bailout money. She referred to bankers as “a bunch of idiots” on Wall Street. Personally, I think that this language is completely inappropriate. It’s demeaning to idiots.

Bonuses

1. Wall Street bonuses were ~\$18.4 billion for 2008.
 - a. This was 44% lower than the \$32.9 billion paid in 2007.
 - i. The average bonus was 36.7% lower b/c the bonus pool was split between a smaller number of workers (people were fired).
 1. There were 187,800 workers in the securities industry in October, 2007;
 - a. 168,600 (10.2% less) in December, 2008.
 - b. This was approximately equal to 2004’s bonuses.
2. These firms lost \$35 billion in 2008.
 - a. This is triple their 2007 losses.
3. From 2002 – 2008, the five biggest Wall Street firms paid \$190 billion in bonuses.
 - a. They had \$76 billion in profits during the same period.
 - b. Last year, the firms had a combined net loss of \$25.3 billion, but paid bonuses of \$26 billion.

My Opinions on the Bonus Issues

1. If you worked at a company that lost billions of dollars, played a major part in driving our economy into recession causing millions of people to lose their jobs, and laid off a significant number of your co-workers, would you expect a bonus?
2. I understand that salaries are low and bonuses are how you make your money. But then, it really isn't a bonus, is it?
3. The idea that we have to pay you these bonuses in order to keep you is absurd. Where are you going to go? To other investment banks? To hedge funds? To private equity firms? To some other firm that is impressed with your ability to run a company and an entire country into the ground?
4. I realize that you're smart and you work hard. But here are some things to think about:
 - a. You're not that smart. I taught you and I'm not that smart.
 - b. We all work hard. Sometimes it doesn't work out. Get over it.
5. The idea that you worked in a division that made money and you shouldn't be penalized for other divisions is absurd. You should proudly display your diploma from "The Terrell Owens School of Teamwork and Unselfishness."
 - a. And I'm sure that you didn't take some of the profits (in past years) when those other divisions were profitable?
6. Your firm took government money and then paid you a bonus. If you can't see the problem with that, you have serious issues.
7. Imagine that you were a shareholder who saw his stock lose 80% of its value. How much bonus would you think was appropriate?
8. You made a decision to trade life for money. You lost, but you still want to be paid.
9. In sum, you've surrounded yourself with people who keep repeating that you all deserve bonuses because you're smart and you work hard. In reality, you have been in an industry that has been tremendously profitable and has screwed a tremendous number of people, governments and businesses by promoting horrible transactions and toxic securities. This has largely turned out to be purely a wealth transfer over the last seven years. Shareholders and investors have lost and you have won.

Some Thoughts on Bank of America (BAC)

1. The Board of Directors should have fired Ken Lewis this week. They didn't. I'm tempted to buy some Bank of America stock. Am I bullish? Have I been sniffing glue again? No and no. I want to go to the annual meeting. Can you imagine how much fun that will be!
2. BAC employees were apparently ecstatic when they heard Thain had been fired. It sounds like the merger is going pretty well.
3. BAC has deferred all bonuses bigger than \$50K until 2010 and beyond. They will get 1/3 in 2010, another 1/3 in 2011 and 1/3 in 2012. How do we expect these people to behave toward their co-workers from ML who received \$4 billion last month and 70% of it was in cash? Apparently ML was afraid of employees leaving, but BAC isn't. Finally, shareholders and employees are aligned – they all hate Ken Lewis.

Some Thoughts About the Banks

1. For years, we believed that banks made their money packaging and selling securities. In fact, the banks were holding a lot of these securities and that killed them.
2. There were \$750 billion of Option ARMs issued from 2004 – 2007.
 - a. These mortgages allow you the option of paying less than the interest payment – meaning there is “negative amortization.”
 - i. Negative amortization is finance speak for “your loan is getting bigger and you're going to eventually be screwed.”
 - b. Now, approximately 55% of these loans are under water (where the borrower owes more than the house is worth).
 - c. 28% of option ARMs are delinquent or in foreclosure.
 - i. Another 7% have already been taken back by lenders.
 - ii. To get context:
 1. 6% of prime mortgages are in trouble.
 2. 6.9% of prime jumbo mortgages are delinquent.
 - a. This was 2.6% the prior year.
 3. Just over 50% of subprime are in trouble. There were \$1.9 trillion of subprime mortgages issued during same period. (A similar amount of jumbo mortgages was issued during the same period.)
 - d. The delinquency rate was 23% in September – problems are accelerating.
 - e. GS estimates that a further decline of 10% in home prices will lead to a 61% default rate for option arms issued in 2007 and 50% for all option ARMs.
 - f. BAC recently added \$750MM to its reserves, blaming Countrywide and option ARMs.

This Week's News About Citi

1. Apparently, Citi was purchasing a \$50MM corporate jet (from an earlier contract). The rumor is that the Treasury Dep't told them not to.
2. People are referring to Citi's two divisions (that they are breaking into) as Citi and Shitty.
3. Citi's CEO (Vikram Pandit) has said that banks are well capitalized if you look at Tier 1 Capital. Of course, he said a similar thing last year. I'd be well capitalized if the government gave me \$45 billion in TARP money and guaranteed \$306 billion of my assets. (And unfortunately, investors are now looking at tangible equity, not Tier 1 capital.)

Wells Fargo is Under Attack

1. WFC lost \$2.55 billion in Q4. Wachovia (which was acquired on Dec. 31) lost \$11.17 billion. Combined, they lost \$13.72 billion.
2. WFC's tangible common equity is 2.68% of assets.
 - a. Compare this to:
 - i. GS 5%
 - ii. JPM 3.83%
 - iii. BAC 2.6%
3. WFC has \$57.7 billion of option ARMs that were not marked down at the time of the Wachovia deal (and another \$37.6 billion that were)
4. WFC's stock was above \$37 in Q4. This month, it went below \$15 and is currently around \$19.

Other News About Financials

1. Legg Mason reported its biggest quarterly loss in history.
2. Moody's is reviewing GE's AAA rating.
3. Barclays said it will earn a profit (before tax) well above the consensus estimate of \$7.4 billion.
 - a. This is higher than its market cap.

With All This Bad News, Why Did Bank Stocks Bounce at the Beginning of the Week?

One reason – there was hope that the government was going to put more money into the banks. In other words, people were celebrating the wealth transfer from taxpayers to shareholders.

Morgan Stanley Forecaster Leaves

Abhijit Chakrabortti of Morgan Stanley (MS) was the #1 market forecaster in 2008, and now he's resigning after just 17 months at the bank. His 2008 prediction for the Standard & Poor's 500 Index was the most accurate on Wall Street and still missed by 622 points! Chakrabortti predicted the S&P would finish last year at 1,525.

Where does someone who makes such prescient market calls go next? I'm not sure. But, next time you call The Psychic Hotline and the guru answers the phone, "hello, this is Abhijit," you'll know who you're talking to.

Are These Guys Really this Dumb?

1. The Financial Times filed a lawsuit against Steve Schwarzman's Blackstone Group on Wednesday for sharing an FT username and password instead of setting up separate accounts for its employees. (If these guys can't afford separate subscriptions to FT, I hardly think they are going to be hiring bankers away from their jobs...)
2. Dick Fuld (from Lehman) transferred his house to his wife – he sold it to her for \$100. Either he did something really bad (and I'd love to hear that story) or he's trying to shield assets from litigation. This should look pretty good in court...

Part 3: The Bailout

Is TARP Working?

1. The argument has been made that TARP is not working. The largest 13 banks received \$148 billion of taxpayer capital (TARP). Their outstanding loan balances dropped \$36 billion (1.4%) b/t Q3 and Q4.
2. In addition, a survey of 569 companies revealed that 59% felt constrained due to lack of credit.
3. But...in past recessions (which were less severe), lending has sometimes dropped much more. I'm not convinced that TARP hasn't helped significantly.

The Basics Behind the Fiscal Stimulus Plan

1. the House passed an \$819 billion bill. The Senate is working on a \$900 bill.
2. The House spending bill has 3 pieces:
 - a. \$365 billion for bridges, highways, etc.
 - b. \$180 billion for jobless benefits and Medicaid
 - c. \$275 billion tax relief package
3. Not one Republican voted in favor of the bill. In addition, 11 Democrats voted against it. I feel good that we have the greatest financial crisis of our lifetime and these jackasses can't work together. It's really encouraging.
4. Approximately half of this money will be spent in 2009 and 2010. In other words, these bills are also full of social programs and changes that are long term and not solely designed to solve our current problems.
 - a. The CBO projects that only \$525.5 billion of the stimulus plan will get into the economy within 19 months.

The House Voted Against the Second Installment of TARP

The House voted 270 – 155 to not release the second installment of the TARP plan. But, the Senate had already voted to not block it. The way that the bill had been written, the money would be released if either the House or the Senate didn't vote to block it. (In other words, only had to vote that way.) I guess this is the safe thing to do when you are up for election in less than two years.

A Few Special Provisions to Think About

Once the final bill is passed, we'll see plenty of lists of provisions that are outrageous. Until then, here are some things to think about:

1. The House Bill requires American steel to be used in the infrastructure projects. US exporters are freaking out – b/c they know that this will lead to trade wars. Germany is already complaining that our bailouts of GM and Chrysler are protectionism.
2. Part of the bill allows companies to defer income taxes that are triggered when they repurchase their distressed debt at a discount. This is a windfall to private equity firms.
 - a. A BCG survey (of 328 private equity portfolio companies) found that ~60% had debt trading at distressed levels.
3. The House bill expands healthcare access to the unemployed.
4. There is a \$335 million program that helps prevent sexually transmitted disease. Apparently, Representatives must have thought that this was necessary with as much as taxpayers are being screwed. My guess is that GM will declare itself to be a brothel in order to get some of this money.

The Treasury Continues to Wrestle With Options to the Banking Problem

1. Buy common stock.
 - a. Positives:
 - i. Gives the gov't upside.
 - ii. Increases bank's common equity.
 - b. Negatives:
 - i. Will dilute shareholders (not sure this is a problem).
 - ii. Effectively nationalizing the banks.
2. Convertible Bonds
 - a. Positives:
 - i. Gov't receives interest.
 - ii. Upside – can convert to stock.
 - b. Negatives:
 - i. Doesn't solve the common equity problem for banks.
3. Start Bad Bank
 - a. Positives
 - i. Gets bad assets off books.
 - b. Negatives:
 - i. How will we price assets?
 - ii. What assets will we buy?
 - iii. What will bad bank look like? (See below for answer.)
4. Insure bank's assets.
 - a. Positives:
 - i. Lenders will not worry about losses.
 - ii. Can wait and see how these assets pay off (without speculating).
 - b. Negatives:
 - i. Insurance business and pricing is very complex.
 1. Similar pricing issues to bad bank problem.

The Bad Bank Alternative

There's been a lot of talk about the bad bank alternative. It will be virtually impossible to price these assets (as discussed in prior updates). Price them too high and it's simply a wealth transfer. Price them too low and the banks have further writeoffs. In addition, which assets do you buy – the list of “toxic assets” has grown significantly (and could include prime loans).

In sum, everyone has said that we have no idea what a bad bank will look like. I think this is ludicrous. I can tell you exactly what it will look like...Bank of America. They bought crappy assets (Countrywide) and overpaid for others (ML). When the gov't buys them, they'll say that they are paying a fair price. If you want to know who you are in this analogy, you're the Bank of America shareholders. Sorry.

Bringing Light to the Sausage Making Process

Treasury plans to make public on a weekly basis any communications from public officials and others regarding specific financial institutions. The idea is to de-politicize the process and reduce the role of the lobbyists.

A Few Random Thoughts / Ideas About the Bailout

1. How do you feel about the fact that we've already given \$300 billion to BAC and C and the bondholders haven't lost money? And the shareholders still own the banks? Taxpayers now own 6% of BAC and 7.8% of C.
2. One of the big problems with nationalization is that investors will wonder if JPM and WFC are next. In addition, if the banks belong to the gov't, there will be tremendous pressure to not foreclose and to lend money.
3. Republicans claim that any nationalization plan is Obama moving us toward socialism. Apparently, these free market men of genius prefer bankruptcy.
4. The budget deficit is predicted to reach \$1.2 trillion, not including the plans being considered right now.
5. Since mid-January, the US Treasury bond has increased from 2.20% to 2.68%. This reflects supply fears (that the gov't will have to borrow more – and they will issue more debt).
6. Analysts think we have \$1.2 trillion to go:
 - a. Goldman Sachs economist Jan Hatzius recently said global credit losses may approach \$2.1 trillion. He estimated that banks worldwide have already absorbed about \$975 billion in losses.
 - b. FBR Capital Markets analysts said eight of the largest U.S. financial institutions need up to \$1.2 trillion in new common equity.
7. The Fed's Commercial Paper Funding Facility has had some success.
 - a. The amount of three-month debt in this facility has dropped significantly. This implies that borrowers have been able to return to the private market.
 - b. There is incentive to return to the private market, as the Fed is charging relatively high short-term rates.
8. Goldman Sachs sold \$2 billion in ten-year notes without government backing. This is significant news.
9. A Minnesota congressman has drafted a bill that would prohibit selling credit default swaps unless you owned the specific bonds. This is absurd. Credit default swaps are insurance. They allow us to short bonds and supply pricing information.
 - a. The solution to this issue is to treat these instruments just like insurance. We have capital requirements for insurers. We need significant capital requirements here. But outlawing insurance is the kind of asinine idea that I'd expect from a congressman.

Part 4: Industry News

Chrysler's Real Men of Genius

Chrysler is asking dealers to keep their inventories at roughly the same levels they were at toward the end of last year, even though sales are expected to slump further this year. Maybe we could do this on a macro level and stuff the channel until we're out of recession? (It turns out that we did do this to some extent during Q4.) This is just more Chrysler absurdity. All that happens when you stuff the channel is that demand will eventually fall to zero. Inventory builds and dealer orders will completely stop. In addition, your dealers will have difficulties because they are financing these cars.

Ford's Earnings

1. \$5.9 billion quarterly loss
 - a. 2X expectations!
2. full year loss was \$14.6 billion
 - a. worst loss in company's 106 year history
 - b. 2007's loss was \$2.72 billion
3. Q4 revenue was \$29.2 billion
 - a. 2007 Q4 was \$45.5 billion
4. 2008 revenue was \$139.3 billion
 - a. 2007 revenue was \$173.9 billion
5. cash balance of \$13.4 billion at end of year
 - a. burned through \$5.5 billion in Q4
 - i. less than \$7.7 billion in Q3
 - b. drawing down \$10.1 billion in credit lines
6. cutting production 41% this quarter
7. plan to reduce costs by \$4 billion this year
8. ended 2008 w/ 75,000 employees in North America
 - a. had 122,000 in 2006

Ford said it has no plans to seek direct government loans without a "significant event." That's funny because I wouldn't buy a Ford unless there was a significant event.

Ford expects to be profitable in 2011. (I expect that my hair will grow back, and I will be playing in the NFL in 2011.)

Wireless

Verizon's profit rose 12% from a year ago. Users continue to spend more on text messaging, email and internet access. Verizon added 1.2 million new customers – bringing its total to 72.1 million. Verizon and AT&T have been helped by Sprint Nextel's struggles. AT&T is providing service for Apple's iPhone and Verizon is providing service the Blackberry Storm. A recession is a great time to see what people value most.

Law

The Wall Street Journal reports that the recession is battering US law firms and their cutting jobs. Law firm profits on average were down 8% to 12% last year, after 15 years of consistent profit growth. In reality, lawyers (and firms) that focus on securities work and transactional work are going to be hurt. Those that focus on litigation and bankruptcy are going to be fine. One problem that struggling firms have is that the top producers want to move to the most profitable firms where they can get the largest bonus. Selling yourself to the highest bidder...I wish I could find an analogy here...

Shocking News – Dow Doesn't Close Deal with Rohm & Haas

Dow said that it was unable to close its deal with Rohm & Haas at the current time and would know more by June 30th. ROH's stock dropped 13%. ROH filed a lawsuit against Dow. It's really amazing how quickly they generated a 70 page complaint. It's almost enough to make you wonder if they had thought this was coming. It reminds me of the time that Jenny tried to back out of marrying me. Just ask Jenny – litigation leads to many happy marriages.

Dow's CEO has said that he can't close the deal without having stable financing. Much of the financing that has been lined up is short term – a one year loan. I understand his plight. One time, I tried to pay \$90,000 for a \$20,000 car and some lenders were reluctant to loan me money. Bastards.

In business school, we often talk about a company's duty to maximize shareholder value. Tree huggers raise their hands and ask about the environment. The HR students say, "what about the employees?" The operations people talk about suppliers. We respond, "blah, blah blah...running the company in the most efficient way will maximize value and help all stakeholders in the long run." But here, you have a true shareholder vs stakeholder battle. The shareholders want their \$78. But, the result is going to be that Dow has overpaid and thousands of people from Dow and ROH will lose their job. This is a true wealth transfer from stakeholders (as well as Dow's shareholders) to ROH's shareholders.

One final note that could have an impact on this deal...Dow has been warned that they may be downgraded to junk status. Overall, it's been a pretty good year for them.

Part 5: Assorted News

Intel became the 16th company to grant shareholders advisory votes on executive pay. None of the votes will be binding.

China Blames US

Chinese Premier Wen Jiabao blamed the US-led financial system for the world's financial crisis. He did not name the US. Rather, he blamed an excessive expansion of financial institutions in blind pursuit of profit, a failure of government supervision of the financial sector, and an unsustainable model of development, characterized by prolonged low savings and high consumption. Chinese leaders have felt burned by a series of bad experiences with US investments.

He said that he wished he had more time to give a longer speech, but he had to get back to work reducing barriers that were slowing China's theft of technology. He also needed time to persecute people who had the audacity to want religious freedom.

Debtor-in-Possession Financing is Hard to Get

1. Companies have greater risk of liquidation because of the difficulty in getting DIP financing.
 - a. This is financing that is provided to companies that have filed for bankruptcy.
2. There has been no substantial increase in DIP volume in 2008, even though there has been a significant increase in bankruptcies.
3. Many participants in the market (such as GE Capital) are less active in the market. Firms have to rely on existing creditors.
4. People talk about the Big 3 surviving bankruptcy. They analogize to the airline industry. But who is going to finance this?

Solution to the Tax Deficit

Obviously, we have a huge tax deficit. But, I believe that there's a relatively simple solution. If we can get these joker politicians to pay their taxes, I think we'd be okay. Late in the week, we heard that Tom Daschle (who has been nominated as Sec'y of Health and Human Services) cheated on his taxes. Among his transgressions:

1. \$250,000 of car service that he did not include
2. \$88,333 of consulting income that he did not include
3. \$15,000 reduction of charitable deductions

Here's my opinion...I voted for Obama and I'm confident that I voted for the right person. But Daschle is either incredibly negligent or he's a lying, cheating dirt bag. Personally, I doubt that he's negligent. He sure seemed to figure out his mistakes when he got nominated. Politicians like this shouldn't be confirmed; they should be indicted.