

Market Update – February 15, 2009

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

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PART 1: The Economy

Below, you will see summaries of the following **bad news**:

1. weak employment situation
2. widespread recession
3. dropping consumer confidence
4. drop in personal spending
5. decreased spending on food
6. drop in e-commerce sales
7. decreased business spending
8. decreased wholesale and business inventories (could be good news)
9. slowing global trade (including retail container shipments)
10. China is slowing
11. Eurozone is slowing

Employment situation is weak:

1. Weekly jobless claims fell 8K to 623K. Still higher than consensus. Thought was that prior week's jump of 40K was unsustainable, but we didn't get much of a pullback.
2. There were 2.7MM job openings in December 2008 (down from 4MM in Dec. 2007).
3. Approximately 3.6MM job losses since December 2007, with half in past three months.
4. More than 4.8MM people collected unemployment insurance last week.
5. Unemployment is at 7.6%. Hit 7.8% in 1992 and 10.8% in 1982.
6. In 1981-1982, first 13 months of recession saw 2.6% increase in unemployment. In this recession, we've seen 2.7% increase in 13 months.

US Recession is widespread. Moody's surveyed 381 cities and concluded:

1. 302 were already in deep recession
2. 64 more were at risk
3. 15 areas still expanding – mostly in Texas and Oklahoma

(Without television or ability to read, Oklahomans haven't been impacted by talk of recession.)

Consumer confidence fell 5 points to 56.2 in first two weeks of February. (In November, we saw lowest reading [55.3] since 1980.) Caused by deepening recession, accelerating job losses and skepticism over stimulus program. Current conditions index rose slightly, while expectation index dropped 8.7 points.

Personal spending fell 3.5% in Q4 (after 3.8% drop in Q3). First time we've had back-to-back 3% drops since data has been collected (1947). Will continue to drop with weak job market.

Real consumer spending for food fell 3.7% in Q4. Steepest decline in 62 years.

Caused by:

1. consumers trading down to lower priced items
 - a. lower priced restaurants
 - b. sales of private label food rose 10% in 2008
2. people eating what is in pantry rather than going to store

E-commerce sales fell 3% in Q4 (YOY). First time it shrank since measurement started in 2001. In Q4 2007, increase was 19% (vs. 2006).

Business spending fell 12.3% in Q4.

Wholesale inventories dropped 1.4% in December (following 7.3% drop in November). This is combination of:

1. lower oil prices
2. decreased demand for goods

Business inventories dropped 1.3% in December.

Global Trade Slowing – US exports fell 6% in December; imports fell 5.5%. Exports fell 19.7% in Q4. US trade gap fell 4%.

Retail container shipments into US are expected to decrease 11.8% in 1H of 2009. This means factories worldwide will slow. JC Penney said they will drop inventories by 10% and Saks will drop by 20%.

China is slowing:

1. January's exports dropped 17.5% YOY. 3rd month in a row. Decline is accelerating.
2. January's imports dropped 43.1%.
3. China's economy depends on exports (37% of GDP). (India is 13%.)
4. Inflation for prices leaving Chinese factories fell 3.3% in January – lowest in 2.5 years.
5. China's consumer inflation fell for 9th straight month to 1%.

Eurozone GDP fell 1.5% in Q4. Countries face worst recession in half century.

Below, you will see the following signs of **good news** (some of which is misleading):

1. retail sales increased
2. federal gov't spending increased
3. improvement in purchasing managers' surveys
4. LIBOR is lower
5. credit markets are opening
6. commercial paper market is improving
7. pending home sales improved in December

Retail Sales increased 1% in January (from December). First increase in 6 months. Apparel, electronics, on-line sales and restaurants increased. This was caused by:

1. deep price discounts
2. gift card usage

But, year over year, retail sales were down 9.7%. There's too much dismal anecdotal evidence from retailers to think that this monthly increase is a positive sign. May see downward revision next month.

Federal Government spending increased 1.9% in Q4. This offset the .5% drop in state and municipality spending.

The Baltic Dry Index measures the cost of shipping raw materials (a leading indicator). It has bounced 174% since December (when it hit a 22 year low). The rally is being caused by China rebuilding iron ore inventories. This indicator has given two false signals in past two years.

Manufacturing purchasing managers' surveys improved slightly in US, Europe and China (argument: contraction is slowing).

Bank lending is easing – 3 month dollar LIBOR is at 1.23% (peaked at 4.82% on October 10).

Credit markets are opening – companies worldwide have sold \$264.4 billion of (non-gov't guaranteed) investment grade corporate bonds. Cisco issued \$4 billion of debt this week (for acquisitions, stock repurchases and to pay off \$500MM loan). CSCO already had \$30B of cash (but most of it is overseas and would be taxed if repatriated). This is evidence that companies that don't need cash can raise it.

More firms have been able to issue commercial paper without relying on Fed's facility.

Pending home sales increased 6.3% in December.

Some Big Picture Thoughts

IMF says US, Western Europe and Japan are already in **depression**.

Profits at large US companies dropped 32% last year – largest drop in 20 years. Expectation is that healthcare will provide largest percentage of this year's profits, followed by energy.

If the economy is still contracting by mid-year, **this recession will be longer** than 1981-82 and 1973-75 downturns, which each lasted 16 months.

The **deficit is expected to be between \$1.4 trillion and \$1.9 trillion this year**. If we hit \$1.9 trillion (and I'll take the over bet on this), our shortfall will be 13.5% of GDP. This would double the percentage level we reached during Reagan's presidency and will approach the 1942 level (as we joined WWII).

The **US is going to borrow as much as \$2 trillion**. Eventually, our credit rating could be hurt.

Moody's and S&P expect default rates on junk bonds to triple to 14% this year (from 4.5% last year). Media, entertainment, casino and hotels, carmakers and retailers are most distressed.

Oil demand is predicted to fall at the fastest rate since 1982. This would be the first time since 1982-83 that we would see two consecutive annual declines. China's demand is still increasing, but at a much lower rate. At one point this week, oil fell below \$35 / barrel.

Federal cigarette taxes will increase in April from \$.39 to \$1.01. A 10% increase in price reduces consumption 4%. Average price is currently \$4.32. At least 16 states are considering raising state taxes. States may not raise as much as expected – as sales drop.

Latin America is getting killed by drop in prices of soybeans, copper and oil.

Some Anecdotal Evidence on the Economy

High end is dead:

1. Saks January sales fell 24%. The laid off 1,100 people (9%). Lowered prices 20%.
2. Starbucks is promoting coffee and breakfast food for \$3.95 to fight \$4 coffee image.

Low end is strengthening. Dollar General said same store sales increased 9.4% in Q4.

One market researcher projected jewelry sales for Valentine's day to fall 5.1%. That surprises me...I'd expect a much higher drop.

Media is getting crushed:

1. Nationwide, 2009 television station ad revenue is projected to fall 20% - 30%.
2. Total single copy magazine sales fell 11% in 2H 2008. Total circulation (newsstand + subscription) fell less than 1%. People are shopping less and high prices encourage subscriptions. Subscription rates are often cheap because high subscription numbers help attract advertisers.
3. Muzak (my favorite band) filed for bankruptcy.
4. Sirius XM is preparing for the possibility of bankruptcy.
5. Clear Channel Communications used \$1.6B of credit and their debt is trading at very low prices. They took on \$17 billion of debt when they went private.
6. Charter Communications (4th largest cable company) said it would seek bankruptcy protection by April 1.

Shipping is hurting. Fed Ex cut 900 jobs (2.5%) at freight unit (avg package size of 100 pounds). Previously announced salary cuts. UPS said shipments dropped 8.2% in Q4.

Low end electronics is suffering:

1. LG Electronics (world's 3rd largest handset maker) said sales dropped 17% in January.
2. Pioneer said it would cut 10,000 jobs (27%) and exit the television market. Christmas sales fell 38%.

PART 2: The Stimulus Bill

Congress agreed on a \$787 billion stimulus bill. The big picture breakdown:

1. \$500 billion on social spending programs
2. \$287 billion in tax cuts

Some of the **key provisions** include:

1. expanded unemployment insurance
2. increased federal assistance to the poor (e.g., food stamps)
3. attempts to streamline healthcare delivery (e.g., subsidize laid off employees to buy into former employers' health plan)
4. local education spending
5. construction of highways and bridges, water treatment facilities and high speed internet
6. \$7,500 tax credit for first time home buyers
7. at least \$17 billion for renewable energy
8. compensation limits (see below)

Who Thought This Was a Good Idea?

Asking politicians to spend money is like asking a cocaine addict if he'd mind doing a few lines. The only thing that would have made this bill worse is if they decided to build more houses and subsidize more subprime loans.

Random Spending vs. Target Spending

You have to ask yourself...if the government flew planes and dropped \$800 billion in small bills across the country, would this solve our problem? The point is that you have to spend money to solve specific problems. Simply spending money is not a solution in itself. I know that's a really simple idea, but clearly there are some people in Washington who don't understand it.

If You've Ever Wondered...how do they come up with things like "3.6 million jobs will be created"? They examine the effect of gov't spending on GDP and apply a rule of thumb (like 1% of GDP = 1MM jobs). Scary. Damn scary.

Thoughts on the Stimulus Bill

1. The stimulus bill is 1000+ pages long. There was virtually no time between the resolution of the House and Senate bills and the ultimate vote. How do you feel about the fact that no one could have possibly read the whole thing before voting on it?
2. The cost exceeds the entire cost of the Iraq invasion since 2003.
3. This is not a short-term spending bill. In a matter of weeks, we've charted the course for future energy, health care and education spending.
4. People argue about the multiplier – will \$1 of gov't spending result in more than \$1 of GDP growth.
5. Once we increase spending, it is very difficult to reduce benefits. At that point, the multiplier effect will be closer to zero.
6. We are going to spend \$500 billion quickly. This is 25% of the government's annual spending. It's difficult to spend money quickly and wisely.
7. The mad rush to spend money meant that we really didn't analyze the provisions. When you're spending almost \$800 billion, does a \$50MM project really matter?
8. Eventually, we're all going to pay higher taxes as a result of this bill.
9. People wanted action (and they got it). Approximately 54% said that they wanted the Senate to pass a bill and 55% said that they would spend too much!
10. Congressional Budget Office says only 20% will be spent by September 30th, 2009.
11. CBO says that the real cost of the bill is \$3.27 trillion! This is a combination of:
 - a. \$744 billion in debt service
 - b. \$2.527 trillion in spending over next 10 years (if bill's 20 most popular programs are permanently extended)

Compensation Limits for TARP Recipients

1. Bankers' bonuses can't be more than 1/3 of total compensation.
2. Bonuses can only be paid with restricted stock.
3. Treasury can "claw back" compensation paid to top employees at TARP recipients.

As discussed in last week's update, these limits can cause a tremendous amount of problems. I really believe that most of this would have never happened if Merrill Lynch hadn't paid \$4.6 billion of bonuses after losing \$15 billion in Q4.

PART 3: The Bailout Plan

Key Parts of Geithner's Bailout Plan

1. Financial Stability Trust – Additional capital injections into banks. This will only happen after bank has “stress test” to see how it can handle worst case scenario. Apparently, our current regulators don't work and this will be better?
2. Public-Private Investment Fund – Work with private capital to remove bad assets from bank's balance sheets. As only my children can understand, the PP Fund should probably be known as the Poop Poop Fund. (I probably shouldn't knock this...taking in public money to subsidize private investors and buying crappy assets...Citi and BAC have apparently turned this into a business model.)
3. Consumer and Business Lending Initiative – Increased use of TALF (asset purchase plan to lower consumer financing rates and to make consumer financing available). They are trying to allow for securitizations again.
4. Foreclosure prevention – reduce mortgage payments and interest rates.

The Problem

There were no details! No one has any idea of how this will work. Geithner, who is clearly a smart guy and ran the NY Fed, seemed naïve. Did he really think that people were going to be happy hearing his goals? This was best explained by a DEMOCRATIC Senator. Robert Menendez (a Democrat from New Jersey) said, “there's not a hell of a lot to get a sense of.” The market dropped 5%.

There was a report that the Obama administration met with lawmakers on Monday night to brief them on the plan (prior to Tuesday's announcement) and there was laughter in the room. That probably should have been Timmy's first clue. As a general rule, regardless of whether your mother tells you that you're doing a good job, you should probably ask for some other feedback.

The Real Problem

The real problem is that these politicians want to do something that's impossible. They want to remove the bad assets from the banks without making it appear as if taxpayers are bailing out the system. This is impossible with the approaches they are considering. Whether we overpay for these assets or whether we guarantee a price for them (insurance), we're ultimately paying.

They also are claiming that the private investors will ultimately value these assets. That's a joke. Private investors will be valuing the government's insurance. I don't have to value the assets if I know that my downside is \$X. The government will still be the one forced to do the valuation...if they have any intention of not doing this blindly.

My Thoughts

I believe that we need to do the following:

1. Take 30 days and require full reporting of all credit default swaps; all swaps that are not disclosed are not enforceable.
2. Take 30 days more to understand any systemic risks from these swaps.
3. Force all banks to write assets down to market values.
4. Force troubled banks into receivership and convert some of the debt to equity.

If we do this, the banks are recapitalized and we're done. The shareholders are wiped out and the debtholders will become the owners. The debt will not lose that much value (and therefore the credit default swaps will not trigger huge losses). There's absolutely no reason that taxpayers should pay for this bailout while shareholders and creditors maintain their position. This is the risk they took. When we're done, we need to increase the capital requirements of banks – because our existing rules didn't work.

I guarantee you that if we were offering advice to foreign countries (and we weren't the morons that were in this mess), this is exactly what we would tell them to do.

It's a Shame You Work for a Living...

If you were home on Tuesday, you could have watched Tim Geithner's visit to the proctologist. It was televised on CNBC on Tuesday. Playing the role of the doctor were numerous Senators. It was like showing up for your proctology exam at a teaching hospital and seeing the 15 newbies in the class all put on their glove.

When he left, he saw a whole new set of doctors (Congressman) smiling and putting on mittens, rather than gloves. They were getting ready for the next day's patients – the bank CEOs.

If You Wonder if We Ever Had a Serious Problem

Rep. Paul Kanjorski, a member of the Financial Services Committee was on C-SPAN and told the following story about Thursday, September 15th, when the Federal Reserve noticed a tremendous draw down of money market accounts in the US. Approximately \$550 billion was removed electronically in a couple of hours. He said:

"The Treasury opened its window to help. They pumped \$105 billion into the system and quickly realized that they could not stem the tide. We were having an electronic run on the banks. They decided to close the operation, close down the money accounts, and announce a guarantee of \$250,000 per account so there wouldn't be further panic. If they had not done that, their estimation was that by 2 PM that afternoon, \$5.5 trillion would have been drawn out of the money market system of the United States. It would have been the end of our economic system and our political system as we know it." Just to be clear...I'm assuming this would be a bad thing?

Don't Forget

The market for these toxic assets is effectively closed. As discussed last week, no one is going to sell these assets when the gov't may buy them for inflated prices. No one is going to buy them when they may be able to buy them with government insurance in the future.

Good Idea...

Apparently, the new administration made a decision to not consult with Paulson's team. As a result, they struggled through all of the same plans that the prior administration had already analyzed and determined couldn't work. That was a good idea, because we're not in a rush...

The Best Description I Heard About All of These Plans:

We're all capitalists on the way up and socialists on the way down.

PART 4: Financials

Wells Fargo CEO John Stumpf...

"The problem is many media stories on this subject have been deliberately misleading. These one-sided stories lead you to believe every employee recognition event is a junket, a boondoggle, a waste, or that it's for highly-paid executives. Nonsense! Because of the misperceptions these stories have created, Wells Fargo has decided to cancel all its major annual recognition events for its team members for the rest of this year."

So let me get this right...because the evil media is creating a misperception, I'm not going to do what I consider to be the right thing. I'm not going to reward the people that I think should be rewarded. I smell a Real Man of Genius Award. Seriously, is this leadership?

Citi CEO – Vikram Pandit

Some people have complained that Pandit has not purchased any stock since becoming CEO. Would you buy stock in an insolvent bank?

From Masters of the Universe to Masters of the Obvious

Goldman Sachs CEO: Lloyd Blankfein

"I have never seen a wider gulf between the financial services industry and the public," he wrote. "Many people believe -- and, in many cases, justifiably so -- that Wall Street lost sight of its larger public obligations and allowed certain trends and practices to undermine the financial system's stability."

Morgan Stanley CEO John Mack said events during the credit crisis have "made clear the need for profound change" in the financial system. The firm decreased leverage, increased transparency and cut risk and changed its compensation structure, he said in the draft testimony.

The Hearings

In 2006 and 2007, the eight chief executives who appeared before the House Financial Services committee received \$401 million in total compensation. The combined stock market value of their companies has plunged 69% since the Dow Jones Industrial Average peaked in October 2007.

The value of the auto industry hearings...several of the bank CEOs took the Amtrak to DC. Others took commercial flights. How dreadfully common of them.

Representative Michael Capuano, a Democrat from Massachusetts said, "you come to us today on your bicycles, after buying Girl Scout cookies and helping out Mother Teresa, telling us we're sorry. We won't do it again. America doesn't trust you anymore."

Banks Trade Like Speculative Penny Stocks

Pull up some charts on bank stocks. BAC traded as high as \$7 last week and below \$5.50. Some regional banks lost more than 30% in the last two weeks. The reality is that these are speculative stocks, some of them will have a heart attack if they truly take a stress test and shareholders should lose.

Bank Lending Has Actually Done Well

1. Q4 results from major US banks showed growth across all lending categories: commercial, consumer and real estate.
2. Lending by domestic commercial banks grew 5.3% during 2008 and at a 5.5% annualized rate in Q4.
3. Jamie Dimon (JPM CEO) said, "our consumer loan balances increased by 2.1% in the fourth quarter, while overall personal consumption expenditure in the country decreased by 2.3% over the same period." (I haven't looked, but it would be interesting to see how much of this is in the form of new loans and how much is in the form of existing loans increasing in size.)

The Real Problem is the Inability to Securitize

1. securitization accounts for more than 70% of credit in the economy (according to the American Bankers Association)
2. issuance of asset backed securities is down 90% (YOY)

The Bonus Backlash

In 2008, a year in which many firms lost tens of billions of dollars and had to be rescued by taxpayers, Wall Street paid itself more than it did in 2000 (the peak of the tech bubble). All of these compensation limits are ridiculous...but the banks brought a lot of these problems on themselves.

Cuomo wrote a letter to Barney Frank detailing NY's investigation into ML's bonuses. He said that the top 149 bonuses totaled \$858MM and 696 people received over \$1MM. As a result, the idea that the average bonus was \$91,000 seems disingenuous.

Ken Lewis Changes Mind

BAC reversed course on their plan to defer bonuses to employees. They are paying many bonuses in the next six months (rather than deferring them and paying in 2010 - 2012). As discussed in earlier issues, the deferral plan did not work well as they worked side-by-side with the ML buddies who received cash. Go figure...Ken Lewis made a decision too quickly and wanted to reverse course. Who would have ever expected that?

More Job Losses in the Financial Industry

UBS reported a \$7 billion loss and said that it would cut 2,000 jobs. Royal Bank of Scotland (RBS) is looking into the possibility of cutting 2,300 jobs. I hate to see these two banks get hurt. At least they had the honesty to make BS part of their names.

PART 5: Housing

Is This Good News in the Housing Market?

The number of homes listed for sale dropped 2.5% in January (a month when inventory usually increases). Over the past 25 years, the average January increase is 8.7%. Unfortunately, there are plenty of possible explanations:

1. recent price cutting by banks allowed them to clear more foreclosed home
2. some sellers are keeping their house off the market (despair or prices are just too low)
3. December inventories didn't shrink as much as usual

US Home Foreclosure Filings

1. Foreclosure filings totaled 274,399 in January
 - a. this was down 10% from December
 - b. but December filings were up 17% (from November) and 41% (YOY)
2. Foreclosures actually completed in January dropped 26% from December to 72,694, the lowest total since April.
 - a. This was still 11% higher from a year earlier.
 - b. The decline in January from the prior month largely reflects a moratorium on foreclosures imposed late last year by Fannie Mae and Freddie Mac. Some states and mortgage servicing companies have also taken steps that delay the foreclosure process.

There Are Plenty of People Who Need Help

1. Mortgage companies had yet to initiate foreclosure actions on nearly 65,000 mortgages that were more than 180 days past due in November.
2. More people have been falling behind on payments. Some 8.6% of mortgages were at least 30 days past due in December, up from 8.45% in November and 5.4% a year earlier.
3. Moody's predicts 1.5 million homes will be lost to foreclosure in 2009, up from 1.4 million in 2008 and 750,000 in 2007. That forecast takes into account greater efforts is to modify the loan terms.

A report from Moody's says:

1. home prices will stabilize by the end of the year
2. the national Case-Shiller home price index will decline by another 11% from Q4 (2008) for a total drop of 36%
3. by the end of this downturn, home prices will have declined by 10% or more in nearly 62% of the nation's 381 metro areas. In approximately 10% of the areas, the drop will exceed 30%

Of course, Moody's also issued AAA ratings to a lot of CDOs that are now rated CCC.

S&Ls to Suspend Foreclosures

1. The Office of Thrift Supervision called for the savings and loan institutions it regulates to suspend foreclosures on owner occupied homes until the Administration completes a plan to help many borrowers reduce payments on home mortgages.
2. The Administration's initiative has a \$50 billion price tag and is expected this week.
3. At present, many loan modification plans call for holding monthly housing related payments to 38% of pretax income. The new formula, designed to be a national standard, is likely to be as low as about 31%.
4. Lower payments also may be made available to people who haven't yet fallen behind but are in danger of doing so.

US Bank Chiefs Also Agreed to Halt Foreclosures

Bank CEOs (testifying on Wednesday) agreed to suspend mortgage foreclosures for three weeks so that the government could finalize its financial rescue plans.

A Few Things to Think About in Anticipation of the Upcoming Mortgage Giveaway

1. Mortgage servicers are limited in their ability to modify terms of mortgages because so many mortgages are packaged into securities.
2. Homeowners may have to agree to give away some upside if prices recover. How is this going to happen? It sounds like an administrative nightmare (but it sounds good politically).
3. Is this only going to apply to your primary residence? How will we know which one this is, if you own more than one house?
4. Should we consider home equity loans or credit card debt or auto loans when doing a modification?
5. Are some homeowners going to participate in schemes in order to qualify?
6. Modifications are no guarantee that everything will be okay. More than 40% of borrowers (who had their mortgage modified) were at least 60 days past due eight months after their loan was modified. (Interestingly though, 47% of loan modifications completed in November resulted in HIGHER payments for borrowers – typically because unpaid interest and fees were added to the loan balance.)

More Downgrades

1. Moody's downgraded an additional \$23.89 billion of commercial mortgage backed securities amid concerns that losses would grow from increased leverage, reduced reserves to pay debt and loan losses.
2. This follows an announcement last week that it would review the ratings of \$300 billion of commercial real estate loans.
3. Including the latest round of downgrades, \$62.09 billion of CMBS has been downgraded by Moody's in the past week.

Get the Assets in the Wife's Name

We continue to hear stories about CEOs "selling" their house to their wife. Dick Fuld (Lehman) sold his house to his wife for \$100. Bob Nardelli (Chrysler) has done the same. Stan O'Neal (ML's CEO before John Thain) has also (reportedly) sold to his wife. (Everyone is wondering if she will hire John Thain to come in and redecorate.) I also sold our house to my wife for \$100. But the joke was on her. It's only worth \$30. (She didn't realize that the bricks are actually rented.)

Not a Six Sigma Event

One commentator noted that there are too many people who are describing events as "six sigma" events (i.e., very low probability). Seeing a person with a \$30K salary default on their option ARM on a \$600,000 house really doesn't qualify as six sigma.

PART 6: The Auto Industry

If This Doesn't Piss You Off...

GM is considering taking back part of Delphi. Delphi had been spun off from GM so that they could sell to other auto manufacturers. GM has some financial responsibility to Delphi, but Delphi does not currently qualify for gov't aid. The idea is that GM would be able to qualify for more aid if Delphi was part of GM. Delphi is operating under bankruptcy protection right now.

Bob Lutz Retires

Bob Lutz is retiring from GM, effective the end of the year. He is widely respected within the industry. He has been a driving force behind the Chevrolet Volt. Lutz turned 77 this week. He said that GM's cars look stylish to him and all his buddies.

Lutz also made the comment that he doesn't understand how Americans could hate an American industry. I really don't think that's the case. I think Americans are completely frustrated at the idea that we can't produce the best cars in the world. It defies logic.

Widespread Cutbacks

1. GM said it will cut 10,000 white collar jobs this year (14% of its salaried workers worldwide).
 - a. They are also cutting salaries 3% to 10%
2. GM is offering retirement incentives to 22,000 of its 62,000 UAW employees. GM is offering up to \$20,000 in cash plus a \$25,000 voucher toward a car purchase.
 - a. It's hard to believe that anyone without another job lined up is going to take four months salary and a disposable car.
3. Toyota is offering buyouts to US workers for the first time. They are also:
 - a. Cutting the workweek of some American plants by 10%
 - b. Eliminating bonuses for 3,000 executives and salaried employees
 - c. Eliminating wage increases for the foreseeable future
 - d. Reducing or eliminating spring bonuses to hourly workers
4. Nissan said they would cut more than 20,000 jobs worldwide and:
 - a. Seek aid from Japan, the US and elsewhere
 - b. Shift some production out of Japan
 - c. Suspend their goal of 5% annual revenue growth

Corporate News

1. The French government said it would give it \$8.4 billion in low interest loans to Renault and Peugeot. The local auto sector employs 10% of the French workforce. I think that the US should subsidize these manufacturers. They make GM and Ford look impressive. (Supposedly, these manufacturers are catching the German manufacturers. There's a real compliment...you're almost as high quality as Volkswagen.)
2. There is talk about Chrysler reorganizing with Cerberus' ownership declining and the UAW, Fiat, and bank lenders owning the rest.
3. Rumors are that GM will ask that the gov't either give them more money or provide debtor in possession financing. DIP financing would probably be the way to go – let them reorganize and renegotiate contracts with the unions.

Chrysler Succeeds...

In recent weeks, I've spoken about Chrysler's arm-twisting to get dealers to buy more cars. They reached their goal and received 78,000 orders. Now what?

Scrapping Cars

In a normal year, 5% of cars and light trucks are sold for scrap. With roughly 250MM vehicles in this country, that means we need to sell 12MM vehicles per year, just to keep up. Estimates from scrap yards are that the number of cars being scrapped has fallen 40% to 50%. Interestingly, Germany is giving incentives (\$3,222) to scrap cars and it is working.

UNIT 7: News from the Markets

Our Banker Hates Us, But Our Financing Remains

China will continue to buy US Treasury bonds even though it knows the dollar will depreciate because such investments remain its “only option” in a perilous world, a senior Chinese banking regulator said on Wednesday.

Mr Luo said, “We hate you guys. Once you start issuing \$1 trillion-\$2 trillion. . .we know the dollar is going to depreciate, so we hate you guys but there is nothing much we can do.” Newsflash Mr. Luo...but for your cheap labor and willingness to finance us, you’re not on the top of our list either.

Pensions Must Look Ugly

Pension deficits for the S&P 500 were \$376 billion at the end of 2008. Fortunately, we can make up the difference with all of our earnings...ugh. Just another thing to put on our tab.

Preferred Stock is Crushed

Yields on Citi’s preferred stock was above 25% this week. (In other words, the price is so low that if they keep paying their preferred dividend, you’ll be earning 25% / year.) BAC was around 20%, WFC is near 11% and JPM was near 9.5%. Preferred shareholders were wiped out in the Lehman bankruptcy.

There are two types of preferred stock:

1. traditional preferred stock – ranks below debt and above equity in bankruptcy
2. trust preferred – ranks above some debt

Mutual Fund Inflows in 2008

US mutual funds had net inflows of \$420 billion. Most of this was to cash products. Equity and bond funds lost 2% of AUM to redemptions.

Some Notes from the Credit Markets

1. see notes in the Economy section – credit markets have seen large issuance. Companies sold \$146 billion of debt in January, the best month since last May.
2. But, there is a 5.20% premium on investment grade debt. Two years ago, it was closer to 1%.
3. Jumbo mortgage rates are 6.91% (approximately 1% higher than the start of 2007).

PART 8: Random Stories

Mexico is Not Safe

Cartels killed some 530 police in Mexico last year, some of them corrupt officers who were working for rival gangs.

One Year Can Change A Lot of Things

Only a year ago, universities faced a congressional inquiry because of widespread concern that they needed to spend more of their endowments on financial aid for students. Now, colleges are finding that state laws aren't letting them spend enough.

Money Impacts People's Behavior...Who Would Have Known?

A new study showed that smokers who are paid to quit succeed far more often than those who get no cash reward. Approximately 20% of all US adults smoke, which is down from about 25% 10 years ago. According to the Federal Center for Disease Control and Prevention, smoking costs companies about \$3,400 per smoker, or about \$7.18 per pack of cigarettes, in health care bills, reduced productivity and absenteeism. It's my dream to make a living by being paid to give up smoking, drinking and porn.

More Cabinet Problems

The President's efforts to include three Republicans in his cabinet failed this week when New Hampshire Republican Senator Judd Gregg withdrew from consideration as Commerce secretary. He said that his differences with the Democratic White House ran too deep. Had the news not previously reached New Hampshire that the president was a Democrat? This is not to take away blame from the Administration...Mr. President, you do realize that you nominated someone for Commerce Secretary who had previously voted to eliminate the Commerce Department?

It's hard to believe we have such high unemployment when we can't even fill the cabinet posts. It turns out that this may be evidence that the Republicans were right – higher tax rates do lead to less work. When nominees realize that they will actually have to pay taxes, they don't seem to want the job.

The Energy Department is Almost as Successful an Investor as Me

By the end of 2009, the Energy Department's 35 years of spending on clean energy research will exceed the total inflation-adjusted cost of the Apollo program. After all that spending, renewable sources make up 7% of America's energy portfolio – approximately the same percentage it comprised 30 years ago.

Dow Cuts Dividend

Dow cut its dividend for the first time in 97 years. We discussed this in previous weeks. I think that they are making a mistake by paying any dividend at all. They either need to save money to purchase ROH or they need to make the case that they should be allowed to back out of the deal. Either way, the dividend should be zero.

Thank Goodness For the SEC

The SEC reached a partial agreement with Bernie Madoff. The agreement prevents him from working in the financial industry again. Thank goodness we have the SEC to protect us. Actually, I shouldn't joke about that...Ken Lewis probably sees value in the Madoff name.

New Stores Opening

Microsoft is going to open up a chain of stores (this is not a joke; or better said, it is a joke, but it's true). Apple must be quaking in their boots. I know that I quake sometimes when I laugh too hard. Wait a second; quaking might not be what I actually do. My guess is that the store will take too long to open each morning and will shut down unexpectedly four to six times per day.