Stamper Capital & Investments, Inc.

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CLARK STAMPER's Winds of Major Trend Changes WEBLOG

On this Blog we are noting what we see as significant signals of a MAJOR CHANGE IN TREND that we believe should be considered for any investment program. (Please see our Annual Forecasts, Anatomy of a Credit Contraction, etc. for more specific topics at http://www.risk-adjusted.com/AnalysisMarketOpinion.html) To make it easier for others to verify the major trend change indicators, we normally tie our observations to specific articles in the general and business press. In reverse chronological order:

April 29, 2009, BLOOMBERG, **"Yankees Price Cut Signals Death of Superiority;"** This is a colorfully written article explaining how "...the New York Yankees, as we knew them, anyway, died yesterday afternoon at 3:33. In that instant they became just like any other professional sports franchise.....all it took was a single e-mail...from the office of George Steinbrenner's longtime mouth piece...." **"The gold standard of professional sports franchises had just announced a discount of its swankiest seats, a whopping 50% markdown to $1,250."**

May 20, 2008, BLOOMBERG, **"Barry Bonds, Justine Henin toil as Bummed Jocks;"** This is an article about what is going on currently in big time sports - we think it signals a major trend change.. Just last week Justine Henin, the top woman's professional tennis player (currently ranked number one) retired at the age of 25. Annika Sorenstam, regarded as the best woman golfer in modern times, also retired last week at age 37. Other articles have highlighted that these two are in what normally would be considered the primes of their competitive lives.

Now, this article comes out and to us emphasizes a major change in sports. **We believe the current rise in sports began with the bull market that started in 1982. We believe it could be topping with the equity & real estate markets.**

"**It must be difficult for sports radio junkies to understand that not every professional athlete finds fulfillment in fame and fortune"** - that is the opening line of the article and it highlights the actions of several very high profile, very successful athletes to support the change.

Justine Henin "Worn out, mentally and physically" at 25.

Barry Bonds "says, he hasn't played baseball since college."
Annika Sorensam "I have other priorities in my life"
Roger Federer "one eye on Pete Sampras's Grand Slam record and the other on what's next"
Andre Agassi "whose only regret is not focusing more attention on his charitable foundations sooner"

Dancing with the stars - The article highlights that current star athletes (as opposed to retired ones) are now on Dancing with the Stars:
Jason Taylor, football
Helio Castroneves, car racing

We wouldn't be that surprised to see similar themes written about in the investment world, similarly to what we saw and read about after the 2000 equity peak and during the "tech wreck."

February 8, 2008, BUSINESS WEEK (February 18, 2008 edition). Over the past year or so we have been forecasting a **"recognition of reality"** - normally, the market participants are too optimistic or too pessimistic versus reality. We believe they have been far far too optimistic for a long time and that when "reality hits" prices of risky assets will be drastically revalued downward. Based on all our previous analysis and this Business Week cover, we again think we are likely at that point of the crowd recognizing reality.

The title of Business Week's cover is: **"Credit On The Edge - The party was paid for with credit cards. The hangover will be a whopper."** They have a special in-depth section articles:
"The Credit Mess," "Credit - The Easy Money is gone for consumers just when they need it," "FICO - How much did the once-vaunted credit-scoring system contribute to the subprime fallout?"

These articles are very informative and cover what is currently going on in the credit contraction - for example, talking about the credit card squeeze - how banks are tightening up credit; raising rates, reducing loan limits, and cutting back on new card solicitations, etc.

Note, some may say, "oh, when you read about it in print - especially on the cover, the move is over." - in this case the credit crunch, economic slowdown and dropping prices of risky assets. HOWEVER; we would point out we have found that, more precisely, the bottom is when the major media says the current trend is never going to end. Also, **the major bottom would be when a total lack of interest is so strong that many financial publications cease to exist. You saw that at the bottom of the internet bust after the NASDAQ had dropped 78%!** - at that time several publications devoted to high tech and high tech investing ceased to exist. Not only that, a European stock index similar to the NASDAQ quit reporting. **Those are the signs of a true major bottom. We do not believe we are anywhere close to that yet.** As I think about it, you won't be seeing those infomercials for stock & commodity investing systems nor for buying real estate with nothing down - nor even out of foreclosure. At the major bottom people will likely be totally through with investing - it will be completely out of style.

January 3, 2008, BLOOMBERG, "Americans Sold Out to Foreign Firms at Record Rate;" This article highlights foreigners buying many of our domestic companies or taking large positions in them - like in Citibank, Commerce Bancorp, Godiva Chocolates, Morgan Stanley, etc. We would like to point out that, a-la the Japanese buying Rockefeller Center and Pebble Beach in 1989 at the market peak just before their stock market and their economy dropped precipitously and the U.S. saw a steep decline down into the 1991 bottom, **normally foreigners invest heavily in assets located in other countries near market tops.** This situation will likely also be true of all the emerging markets investments that have been made by Americans in foreign lands. Of course, we will see how it works out.

August 14, 2007, BLOOMBERG, **"Subprime-Infested Funds Drive Demand for [U.S.] Dollars;"** "The [U.S.] dollar is no longer the currency you love to hate. Now, it's the currency you can't live without." **"Last week's credit crunch has set off a worldwide RUSH for dollars as banks and fund managers scramble to pay back loans used to buy risky mortgage securities."** Well, this certainly is a Major Trend Change (that we have forecasted - see our **Deflation Watch weblog,** at http://www.risk-adjusted.com/Weblogs.html) - however, we would have titled the article: **Huge U.S. Dollar Short Covering Rally to Ensue.**

We want to make a few points about what is going on:
1). A huge U.S. Dollar short covering seems to be in process as borrowers of U.S. Dollar denominated debt are rushing to pay it off.
2). To get the U.S. Dollars to pay off loans, U.S. dollars are going up in value.
3). With U.S. Dollars going up, almost everything else will be dropping in price - other currencies, industrial commodities, financial commodities, gold, stocks, real estate. - Deflation (ugh).
4). Loans being paid down is a "credit contraction."
5). The demand for U.S. capital is likely an upward force on U.S. interest rates. As reported below, worldwide, central banks infused a record amount of liquidity into market to bring back down short term interest rates, which had spiked up unexpectedly, related to this credit contraction.

Yes, the U.S. Dollar is a "safe-haven currency" but we believe this is more of a credit-contraction-and-U.S.-Dollar-denominated-debt short covering rally than a flight to the U.S. Dollar safe-haven currency rally. However, we expect this trend to last a number of months or even over a year and to be pretty much in parallel with deflation and a drop in the prices of risky assets.

August 10, 2007, BLOOMBERG, **"Central Banks Add Cash to Avert Crisis of Confidence;"** "Central banks in the U.S., Europe, Japan, Australia and Canada added about $136 billion to the banking system in an attempt to avert a crisis of confidence in global credit markets." Wow, talk about a major change in trend. Continuing, "The Federal Reserve System, in a second day of action in concert with the European Central Bank, provided $38 billion of reserves and pledged more 'as necessary,' in a statement unprecedented since after the Sept. 11, 2001 attacks." This article makes two points for us. First is that it is a major change in trend - up until a few weeks ago you had people singing about liquidity. Now you have record injections to solve a liquidity crisis. Second, note it wasn't just the U.S. FED - it is central banks across the globe addressing the same root problem. What we are witnessing is a truly global phenomenon, as we forecast.

July 31, 2007, FORBES, **"Junking The Bond Market;"** **"[S&P] said 50.7% of the corporate bond market is now rated BB or lower, the first time this has happened,** marking a decade-long shift toward more aggressive finance strategies and the evolution of the leveraged finance market." "The ratings mix continues to deteriorate as firms borrow to buy back shares and make acquisitions.....However, the key force in the downward shift in the ratings distribution has been new entries into the bond market." "Through the first half of 2007, 70% of 158 new issues were rated B, according to S&P research." To us, that is something and, worse, probably on the eve of a credit contraction from the highest debt levels in history. We will be on the edge of our seats while watching how this all plays out. As most of you know, we are not constructive on the current economy and financial structures and we think the credit contraction will play out over a number of years.

July 9, 2007 - **More "reality recognition" articles** (see below):

7-8-07, GUARDIAN, "On Borrowed Time: Markets Stare into Abyss."
7-8-07, CBS NEWS (in conjunction with 60 MINUTES TV broadcast), "U.S. Heading For Financial Trouble?"

The last article is more significant since these important subjects were on a very mainstream television show, 60 Minutes. The show and the article highlight what the Comptroller General of the United States, the nation's top accountant, has to say about the fiscal condition of the U.S. " 'I'm going to show you some numbers...they're all big and they're all bad,' he says." He highlights the problems with Social Security, Medicare, rising healthcare costs and the retirement of the Baby Boomers - which we have highlighted several times before - but here it is on national T.V. on one of the most popular T.V. shows. What this means is that "America" is now ready to hear and face the bad news. His solution is "additional taxes," "restructuring these promises," and/or "cutting other [government] spending." We note that these are all anti-stimulus.

July 2, 2007 -- We at Stamper Capital have noticed a change in the reporting of financial events. Previously we noted that at certain times in the business cycle the article in the major financial press represent reality much more than other times. For example, during the tech bubble, the financial press was incredibly charitable to even the most outrages high-tech concepts, especially if a Company's name ended in DOT.COM. **The "reality**

recognition reporting" finally took place starting after the 2000 top was in and while the NASDAQ was making its 78% drop into late 2002.

With that recent history and with the much larger size of the real estate bubble, we believe pointing out this phenomenon is easier. **All the way up during the Real Estate Bubble, similar to the way up in the Tech bubble, all you heard was glowing praise - a new economic reality, etc.** Even through the real estate top from 2004 through late 2006 depending upon the region. NOW, however, you are starting to get the reality reporting on Liar Loans, Subprime Lending, Adjustable Rate Mortgage Resets, Collateralized Debt Obligations, etc. Here are some recent headlines on a lot of the topics we have been covering but the press has only covered very discretely, until now:

5-07-07, TELEGRAPH, "Credit Crunch will 'Shred Investment Portfolios to Ribbons.'"

5-26-07, YAHOO FINANCE, "Neighborhood Swayed by 'Liar Loans'."

5-29-07, BLOOMBERG, "Looming Crash Prompts Most Hires for Distressed Debt since 2002."

5-29-07, BLOOMBERG, "Subprime Fiasco Exposes Manipulation by Mortgage Brokerages."

5-30-07, BLOOMBERG, "CDO Boom Masks Subprime Losses, Abetted by S&P, Moody's, Fitch."

5-31-07, BLOOMBERG, "Banks Sell 'Toxic Waste' CDO's to Calpers, Texas Teachers Fund."

6-20-07, BLOOMBERG, "Rate Rise Pushes Housing, Economy to 'Blood Bath'."

6-22-07, BLOOMBERG, "SEC Investigating Insider Trading in Credit-Default Swaps."

6-22-07, BLOOMBERG, "Fitch, S&P Warn Investors about Subprime Mortgage CDOs, Bonds."

6-10-07, LOS ANGELES TIMES, "Public Sector Reels at Retiree Healthcare Tab."

6-25-07, TELEGRAPH, "BIS [Bank for International Settlements] Warns of Great Depression Dangers from Credit Spree."

7-2-07, BUSINESS WEEK (July 9th edition), "The Street's Next Big Scandal - Are traders and hedge funds colluding to profit from privileged information?"

Don't you detect a change in tone from "everything's honky-dory" reporting of the last several years? Importantly, besides the eye-popping information in these stories, there is really not all that much to add since, to us, they are very closely matching reality at this time. Normally, the fallout during the "reality recognition reporting" period is coincidently dropping prices like you saw in the stock market from 2000 down to 2002. Thus, to us, this change in reporting is likely a Major Trend Change Indication.

April 13, 2007, BUSINESS WEEK (April 23, 2007 edition), **"The Race to Build Really Cheap Cars;"** This very interesting and informative article is reviewed in detail on our **Deflation Watch Weblog,** at http://www.risk-adjusted.com/Weblogs.html . Some of the most telling quotes from a Major Trend Change perspective, are **"The shift to cut-rate wheels is jarring for an industry that has fixated for at least a decade on premium**

cars..." and **"So far this year, every major carmaker has announced its own 21st century Model T project."** Finally, "**Automakers will have to live with a [we add, NEW] trend of lower-cost vehicles. It is difficult but that's where the demand is [we add, NOW]."** To us, this is a major trend change from more and more expensive, better and better performance, and more and more luxurious automobiles, to cheaper lower end cars. This could be a very dramatic change in trend and it could signal similar trends in other goods and services.

March 9, 2007, REUTERS, **"Countrywide Financial Ends No Down Payment Lending;"** "Countrywide Financial Corp. ("CFC"-NYSE), the largest U.S. mortgage lender, on Friday [March 9, 2007] told its brokers to stop offering borrowers the option of a no-money down home loan, according to a document obtained by Reuters. A similar BLOOMBERG article (on 3-9-07) points out that "...other lenders that have started requiring borrowers to put at least 5% down on homes include Washington Mutual Inc. and General Electric Co.'s WMC Finance Co. unit.

That is the news - Our analysis of this news is that this loan underwriting measure is the official beginning of the Credit Crunch and Credit Contraction - which is a Major Trend Change. While we realize "at the time" it was easy for these companies to get caught up in the real estate bubble, probably a year from now (or even now) many people will be saying, **"what were they thinking?" making 100% loan to value loans**. It just goes to show how even the largest companies can get caught up in irrational business practices during certain cyclical times. Other related themes along these same lines are the "no-documentation loans" and "sub-prime lending." Years from now, people will think it unbelievable that such respected financial institutions at the time would make "no doc" loans or even "sub-prime loans."

As for our Major Trend Change Indications, a substantial increase in lending standards such as this (going from 100% loan to value to a max of 95% L-T-V) means less loans will be made. This experience is by definition a credit contraction. Two other "flies in the ointment" of the real estate bubble are the $1 trillion of adjustable rate loans that are re-setting in 2007 and by the end of 2008 and the admission of experts/authorities of the huge amount of underwriting (and outright fraud) to buyers that really did not qualify that happened as a result of the "no doc" and "sub-prime lending over the past few years.

This situation creates a One, Two KnockOut Punch for Real Estate:

1). **Punch One - lots of supply for sale on the market** as defaults step up and properties go back to the banks which then unload them on the market. Defaults from borrowers who can't make new payments when their adjustable rate mortgages reset; borrowers who purchased 100% L-T-V loans and can't make the payments; borrowers who didn't qualify in the first place, etc.

2). **Punch Two - Less Demand - Fewer buyers now** that the lending standards have been raised to 95% L-T-V and those who should not have qualified previously, definitely won't be qualifying in the future.

3). **Third Punch - Buyers who bought on Spec,** and this is a very large percentage of home ownership, will be flushed out. Thus, additional supply (and defaults).

As reported previously around 40% of the recovery since 2002 is widely attributed to the real estate industry. Thus, we believe the collapse of the real estate bubble will create a huge negative ripple across the economy. We believe collapsing prices of real estate will most likely morph into deflation in many other categories - certainly prices of other risky asset classes.

January 8, 2006, NEW YORK, **"The Year of the Price Cut;"** This is from an entertainment-style magazine. **The subtitle is, "Overreaching is so 2006."** The author of this article utilized Streeteasy.com, an online database that gathers information on most listing in New York City, to find the largest price drops. It lists six - all six are the percent change from the previous asking price to the current asking price - so these are not transactions and these are the largest drops; however, it is still telling to us. The percent changes are:

41.6% drop
37% drop
36.4% drop
36.2% drop
34.8% drop
34.9% drop

One aspect of this reporting that is interesting to us is the fact that **an entertainment magazine is highlighting real estate price drops, a subject a large proportion of its readers probably are not thrilled about. Thus, the drop in prices is not new news but is likely confirmation of a trend that is already accepted.**

November 14th, 2006, THE MONTEREY HERALD, **"Purple Reign: Prince begins run of twice-a-week performances in Las Vegas:"** The point we want to make from this subject and article is that during the big bull market, **Las Vegas had "reinvented itself as a playground of family entertainment."** Hence, all the restaurants and theme parks, etc. Now - we would say **since the 2000 stock market top, Las Vegas "...has reverted to its more risque side with a vengeance, especially since gaming is increasingly available outside Nevada."** Our point is: the bull market is more wholesome and family oriented; the bear market is the opposite and this change in strategy of Las Vegas illustrates that idea. To us it confirms to us that we are in a bear market and have been since 2000 (even though the stock market has since taken out those tops when valued in U.S. dollars, it is not even close when valued in Gold or other currencies). Thus a confirmation of a major change in trend.

October 10, 2006, BLOOMBERG, **"Credit-Default Swaps Raise insider Trading Concerns;"** We think this is big. Credit-default Swaps (CDS) are basically an unregulated, unlisted futures/derivatives type contract written on changes in credit quality of various issuers. In this case, corporate issuers. The CDS market like other derivatives now dwarfs the market for the underlying securities. What is amazing is that "the total notional, or face, amount of contracts outstanding worldwide more than doubled in the past year to $26 trillion..." Wow, that is big. **Ok, now regulators are suspicious that "insider trading" related to equity acquisitions has been going on in the CDS market. "A London Business School study last year of 79 North American companies from 2001 to 2004 found "significant" evidence that [CDS] contracts were moving ahead of news that could affect credit quality."** Thus, while the Feds were monitoring equity prices and options and corporate bonds and found no fowl play, it appears that there was a lot going on in the CDS market. The article gives a good example related to the leverage buyout offer from Apollo to purchase casino operator Harrah's. **Harrah's CDS jumped 40% in price for the two weeks ending Sept. 29th, several days before the buyout offer was announced on October 2nd. Previous to the announcement Harrah's "stock was little changed."** Someone apparently knew something - The article indicates that bankers privy to deal information as their clients arrange financing are suspected in using that information to their advantage. It is interesting that, according to the article a Managing Director at Pimco wrote to regulators warning them of this situation in 2002. Our point now on this Major Trend Change Indications BLOG is that **while the information on these short comings has been around since 2002, attention is just now starting to focus on it** - thus, to us, because of the size and scope, we believe this could be a major trend change indication.

August 11, 2006, BUSINESS WEEK (August 21/26th edition), **"Where's the Passion - The Rolls Phantom is an engineering marvel. But sexy it's not;"** Wow, if this $330,000, 6,600 pound, v-12 Rolls-Royce that goes from 0 to sixty in 5.7 seconds isn't the quintessential sexy bull market icon, we don't know what is. The article says "BMW's new Rolls-Royce Phantom drives like a dream..." **However, when the reporter took it to a public location to do a photo-op, instead of interest and respect, "....[a guy] in the pickup behind me started blaring death metal and screamed for us to move."** (Note also that "death metal" would be considered a bear market group and form of music.) Also, the reporter got "ribbed" by his teammates when he took the Rolls to show off at baseball practice. The writer asks: "Why didn't the Phantom, with its massive presence and majestic chrome grill, get the respect of other exclusive rides?" His theory: "The flowing sensuality that has been a hallmark of classic Rollses has been replaced by a squared-off, almost austere Teutonic design. It doesn't have the princely presence of the Rolls of old." We would comment that that squared-off look with the grill and square lights and even the incredible 6,600 pound stature of it are all bull market themes. **We would also say the reason it didn't get much respect is because we are no longer in a bull market** - Another Major Trend Change. We would also comment that most bull market icons are likely going out of style rapidly or will be. **Then in the article, the reporter himself (and BW) disrespects the bull market icon by discussing & showing a picture of himself washing the Rolls in a self-serve car wash. I think it is fair to say you would never see such a picture of this type of vehicle in a major financial publication if we were in a bull market. Thus, we take this as a major trend change indication and verification - ugh.**

August 11, 2006, BUSINESS WEEK (August 21/26th edition), **"Cheap Chic;"** "Fed Up with the high prices urban kids pay for sneakers marketed by their basketball heroes, New York Knicks point guard Stephon Marbury is launching the StarburyOne, a $14.98 sneaker he'll wear on the court." The article points out this is 1/12 the price of Nike's $180 Air Jordan XX1. Wow! that is a huge difference in price; maybe we should put this on our **Deflation Watch weblog** page instead, at http://www.risk-adjusted.com/Weblogs.html . Of course, Michael Jordan is a bull market icon. I'm not familiar with Marbury's style of play but it is more likely akin to the bear market - more physical and bruising as opposed to Michael Jordon's finesse bull-market style.

August 4, 2006. There have been many article on different "conflicts," battles, war, and crime recently. **What is notable is the major trend change from few wars and battles and conflicts before the 2000 market top, to increasing numbers of conflicts and battles and wars since then, and especially the recent escalations this year globally and locally.** While I think everyone would easily notice that **change in trend** on a world level if they thought about it or it was pointed out to them, **we are also noticing it on a more local level.** Here in California there is more and more conflict in several areas. One is "illegal immigration." I believe the city of Costa Mesa has passed a resolution to enforce federal laws with respect to illegal immigration. What is interesting to us on this topic is that lots of people are talking about how "illegal immigration" is a problem but it doesn't seem to us that there is every any specific discussion about exactly what that problem is - why "illegal immigration" is actually a problem specifically? It seems to us that peoples conclusions on these types of topics is more of just a feeling rather than a thought-out reason or reasons. Even so, **the feelings seem to carry a lot of emotional heat**. One point is that this and other conflicts have recently arisen on subjects where the terms are very imprecise and people don't really know what others' reasoning is, and probably not even their own reasoning - what they know is that they are not as happy as they used to be and they are angrier now and there must be a reason - how about "illegal immigration" or "global warming," etc. (For the record, we don't believe "illegal immigration" is a problem per se - it could be there is a problem if illegals get benefits they don't pay for - but isn't that also true with a similar number of citizens? - maybe personal responsibility, other than group responsibility is the answer.) Besides globally, watch your local news and see if there hasn't been an increase in local problems, conflicts, and crime, etc. O.K. our main point here is that a change in trend from the big bull market of the 1980's and 1990's where everyone was relatively happy with few conflicts (real or imagined) peaking out around the 2000 market top, to increasing numbers and intensities of conflicts, both globally and locally has occurred and is occuring. We would also point out that conflicts have increased again coincidently with the May 2006 market tops. Thus, we believe that this type of trend change is often coincident with a change from a bull up market to a bear down market. Increasing conflicts and battles and wars and local crime, to us, is an indication to reign in the risk and a confirmation that we are in a bear market. Thus, this is a major change in trend to be aware of and to monitor.

May 17, 2006, BLOOMBERG, **"U.S. Stocks Drop on Inflation Concern;"** This is an interesting headline and does tell the predominant line of thinking right now (even if it turns out to be incorrect). However, we believe this logic is looking backwards into the rearview mirror of what the statistics will look like through the end of April when released, **while what has happened over the past week is the real story. The real story is that the stock market and the commodity markets have had sharp reversals and have almost certainly (to us) transitioned into major downtrends.** Thus, to us, stocks aren't dropping from inflation worries, they are dropping because we have entered deflation with prices of almost everything (especially riskier asset classes like junk bonds and real estate) dropping. To be more clear: previously you had some items rising in price like commodities, healthcare, and stocks and real estate. More recently real estate had been stalling. You also had some things going sideways; salaries are a good example of sideways over the past several years. And, you had lots of items dropping in price: computers, electronics, soft goods, clothing, shoes, etc.- think anything sold by Costco.. **Most important to this discussion, as of a week ago, commodities and stocks have switched to dropping sharply. Thus, Prices of Pretty Much Everything are Now Dropping ====>and we conclude: deflation has most likely arrived.** We will know for sure, after the fact, in a few months, but the turnaround and drop in prices of stocks and commodities is striking so far and will most likely be accompanied by falling prices of other, less liquid, investment categories such as junk bonds and real estate.

January 29, 2006, BUSINESS WEEK (Feb. 6th edition), "Up Against It at 25;" This article is a book review of:

"STRAPPED - Why America's 20- and 30-somethings Can't Get Ahead"
and
"GENERATION DEBT - Why Now Is A Terrible Time To Be Young."

These books and this review brings a new genre to us, "Reality Recognition Books." The basic themes are that "Flawed government policies have forced many students to borrow huge sums for college. Once they enter an increasingly competitive workforce, these young people find that traditional benefits, such as health care, have become scarce. A consumer culture nudges them toward credit-card dependency. Meanwhile, an older generation of self-satisfied baby boomers will soon begin retiring, sucking up government resources." Although the review doesn't really point it out, we believe this situation will contribute to a class or age warfare of sorts. We are already starting to see this situation with respect to different benefits at municipalities based on when a person was first employed. **The fact that these books were published and reviewed tell us that a major change in trend with respect to the thinking about these programs and the related current cultural norms is taking place.**

January 27, 2006, BLOOMGERG, **"What Growth? Economy Is Getting Worse, Americans Say;"** This "under-the-radar-screen" article makes several points about "reality recognition" - what is being realized by Americans. We think these points derived from the poll this article is based on are so important that we are also including this story on our **Elements of Market Tops** and **Deflation Watch** **weblogs,** at http://www.risk-adjusted.com/Weblogs.html **.** The article begins:

"The U.S. economy was robust by almost every measure last year,....[but]...Most Americans don't buy it."

What is amazing, according to the Bloomberg/LA Times poll, is that **despite the rosy economic statistics,** "**By a 59% to 37% margin, Americans disapprove of the way Bush is handling the economy**...and, **by 47% to 22%, the public says the country is worse off economically** since Bush became President." We aren't making a political point here - the results of this poll beg us to ask: **If everything is so great, how come the majority don't like the way things are being handled and think they are worse off?**

The article goes on to mention most of the problems (we have covered previously that) Americans are coming to realize. The key seems to us to be **"The failure of incomes to keep pace with the economy...."** and relatedly, **"Real GDP growth has been relatively healthy, but most Americans don't feel it."**

What is remarkable that we alluded to above is that **"Most economic indicators contrast sharply with opinions expressed in the poll."**

That was the "reality recognition" part, now comes the "deflation angle:" "**More than three-fourths of the [poll] respondents say they will need to reduce spending if energy costs continue to rise** [cutting across party lines and income groups]...**Even among those earning more than $100,000 [annually], as many people say they would cut back because of energy prices as say they wouldn't."** We would say this is definitely not "inflationary psychology;" maybe it is "disinflation psychology" and more likely it is "deflationary psychology." Maybe a better way to characterize it is that it is not "expansionary psychology" but **is "contractionary psychology."** Thus, notice that, rather than indicating they would take on more debt (maybe a new draw down on the ol'equity in the house), **they are going to Cut Back - this is 75% of those polled including 50% of those making $100k or more!**

"Cutting Back," to us, is the end of the Credit Expansion and the beginning of a Credit Contraction. We believe a credit contraction from the current, record high levels of debt, will most likely result in general deflation. We believe this indication of Cutting Back is a major trend change indication.

October 11, 2005, BLOOMGERG, **"Katrina Bond Bailout No Sure thing, Snow Reminds Us;"** "Everyone who thinks the Federal Government is going to bail out municipalities that can't make their debt service payments because of hurricane Katrina have another thing coming." The tone and subject of this article/opinion is an update/confirmation of a major change in trend we noted on our first review on this Weblog on June 17th, 2004 (see below) **"Snow Says that No U.S. Company is 'too big to fail.'"** Back on June 17, 2004, we said: "Our view is that the subject of this article, the denial of a government bail out of United Airlines in the form of government-guaranteed loans, **could mark a huge change in the government bail-out cycle that started with Chrysler**. Mr. Snow's comments may **signal an end to the old-trend attitude** that the U.S. government would not let large businesses (or governments - think Argentina) fail."

This current article quotes Treasury Secretary John Snow saying, **"We should not set a precedent that the taxpayer is the first-dollar insurer in all disasters. A federal bailout in the form of Treasury guaranteeing municipal securities could result in a risk premium on Treasury issuance going forward. [Investors buy Treasuries] with the expectation they will not be obligated for state and local bonds."** Thus, the government bailout cycle did indeed seem to end in 2004 and our conclusion back in mid 2004 - "apparently, the bail-out party may have topped out - which, to us, **makes riskier investments much less appealing**" - still holds for us.

June 21, 2005, BLOOMBERG, "CNOOC may bid $20 billion for Unocal, Challenging Chevron;" The subject of this article is very interesting to us as **it may signal a huge change in trend.** The article is all about CNOOC, China's largest offshore oil and natural-gas producer thinking about out-bidding Chevron for the assets of U.S. oil company, Unocal. While the specifics of this article are somewhat interesting **we are much more interested in the big picture - what is China going to do with all those U.S. dollars it has been accumulating?** So far, they have been purchasing U.S. Treasury debt; however, this may signal the beginning of a new trend where, **rather than purchasing our debt, they begin purchasing our physical assets!** Thus, this transaction (whether completed or not) could just be the beginning of the proverbial leak in the dyke. The question that will follow if this does become a trend is: **will the powers that be in the United States allow it?** In the late 1980's, after Japan had been ruling the economic waters for some time, they began buying assets in the United States, principally real estate like Pebble Beach and Rockefeller Center and most of closer-by Hawaii. Of course, that beginning of the end of their economic reign. A more useful model might be the middle 1980's when the junk bond raiders started to "tee up" world class companies (like RJR Nabisco) - i.e. they would purchase them with junk bond financing and throw out the old guard. In this case, over time, there was an uproar and laws were changed, Savings & Loans could no longer buy junk bonds (and thereby no longer finance hostile takeovers). Of course, the result of such protectionism (even though it was domestic) was probably the downturn of the late 1980's and very early 1990's. **Thus, we will be watching very closely in the future to see if the powers that be in the United States take actions to create restrictions and limitations on currency and assets in the situation that a foreign power with lots of U. S. dollars starts purchasing our physical assets rather than our debt securities.**

May 8, 2005 **"Reality Reporting"** - Sometimes we cannot find an article to help us make a point. **The point we want to make now is that we are noticing many more articles catching up to the reality of what we have been pointing out - turning from being blindly optimistic to a recognition or an admission of the current much much less attractive reality.** Generally we are ahead of the curve but when the media catches up, so does the public and things start to happen. **The catalyst for the movement to a more realistic and accurate viewpoint by the media and the public seems to be the downgrades of General Motors and Ford.** Of course, the bonds of those companies have been trading like "junk" for quite a while, but the recent downgrade to junk bond status of two of the largest companies in the United States seems to have brought a sense of reality to the perception of the press and the public. We are also seeing this in other areas such as a realization that, yes there is a housing bubble and yes, it looks suspiciously like the high tech/internet bubble. Now the press is admitting that the economy is not necessarily that strong. We saw articles last week, with respect to the Fed raising short term interest rates, that said something like: "The Fed decided fighting inflation was more important than worrying about the weakening economy" when weak economic numbers came out the same day the Fed raised rates. **Thus, although this change in perception is subtle, we believe it is evident and is an important indicator of a major change in trend;** unfortunately, in this case, from overly optimistic to a realism that is bluntly painful for most. The sad thing is that realism is quite a bit removed from the optimism most have been reading about and **as this shift occurs, valuations are most likely going to change rapidly with prices of riskier assets being downgraded rather dramatically in percent and also in a short period of time.** It will be like all of a sudden everyone agreeing that the P/E multiples of stocks are more than 2-3x normal and reducing trading prices of those stocks accordingly. To end on a more pleasant note, we do believe at some point near the bottom of the cycle, the perception will be overly pessimistic - that will be the bottom which will lead to a new wave up.

April 24, 2005, BUSINESS WEEK (May 2, 2005 edition), **"Stop Scapegoating China - Before It's Too Late;"** This article provides lots of good information on **protectionism** - why it is starting (or rather resuming), errors of fact of those proposing (and demanding) protectionist policies, and why protectionist policies most often do not work and are most often harmful - it also recommends solutions which we doubt will be enacted. **Importantly, we see the decline in protectionism as part of a bullish, expansionary trend and the increase in protectionism as a part of a bearish, contractionary trend.** Thus, this article boosts our case that a Major Change in Trend has Occurred. "Protectionist sentiment is on the rise in Washington, fueled by poor unemployment growth, real wage stagnation, and a record trade deficit. **Job growth in 2004 [in the U.S.] was nearly 40% below the level consistent with previous economic recoveries."** (Obviously, that last fact is very telling of the quality of the supposed "economic recovery" of the past couple of years.) Because of concerns about the weak job growth and the outsourcing of jobs abroad...."Congress is weighing legislation that would impose a 27.5% tariff on Chinese imports unless Beijing agrees to an equivalent appreciation of its currency." Promoters point out that China's exports to the U.S. are ....**"made by workers earning only 4.5% of the average U.S. factory wage."** However, the author, dean of the London School of Economics, makes the case that "the fate of the U.S. workers depends primarily on domestic conditions, not the trade gap" - that, in fact, ..."most of the losses stem from weaker exports, not soaring imports from China or elsewhere. **<u>The main source of the deficit isn't China's fixed exchange rate, low wages, or export subsidies, but the imploding U.S. savings rate</u>** - a fact Congress would rather ignore." She concludes...."these missing jobs stem from out metronomic choices, not our trading partners' unfair trade and currency policies." We think those choices are really microeconomic choices made by individuals that have resulted in mass over-consumption, financed by mass over-borrowing and a negligible savings rate. Basically, **we have consumed already, now we are going to have to pay the bill** - thus, at the same time, we are going to cut consumption so lessening demand is going to result in less products being produced which means fewer workers being hired at current wage rates, resulting in loan defaults and bankruptcies - etc.etc.etc. - ugh. Yup, its all part of a spiral of credit expansion, followed by credit contraction that will also result in deflation. Unfortunately, remember Murphy's Law - ugh. So we are in some big trouble even without protectionism raising its ugly head and the accompanying trade wars. But, **protectionism almost always raises its ugly head about now in the cycle - as a scapegoat**, just as the article's author points out. Now for the negatives of protectionism - the main point that she makes is that the foreign nations have been making huge purchases and hold huge positions in our currency. "**If China were to slash its purchases or its already substantial holdings of such securities - something it might be tempted to do in retaliation for punitive trade legislation - long term real [interest] rates would rise sharply and swiftly. The result could be a slowdown that damages the global economy and leaves American workers substantially worse off in terms of jobs, wages, and interest payments on their mortgages."** Wow, much to our surprise, she sounds a lot like us.

March 14, 2005, BUSINESS WEEK ONLINE, **"The Big Brands Go Begging in Europe;"** "Some of the globe's best-known consumer brands are struggling in the Old World." "Weak economic growth explains some of the slowdown." Etc. Etc. Etc. "Equally troubling for the big brands, **the private-label wave is sweeping into sectors such as cosmetics and baby products, where customers used to be more wary of straying from trusted names." Important, to our Deflation Watch, is that the increasing-sales-volume private labels "...typically cost 20% to 40% less than name brands."** Thus, to us, this could be part of the **change from the bull market where people would pay unbelievable premiums for "the brand" but to a bear market where people are switching in droves to private labels to cut costs - they are no longer willing to pay the premium.** Part of the problem stems from commoditization of many products. However, **we believe this change in psychology represents a change in trend that is larger than just that.** Of course, switching away from brands to lower cost private labels is certainly deflationary. Importantly, as Europe is somewhat ahead of the U.S. in the change from inflation to disinflation and now to deflation, we are likely to see this trend come to our shores and for brand names to take a back seat here in the U.S.

March 3, 2005, NEW YORK POST, "Economy's Debt Threat;" More **Warnings from Chairman Greenspan**. "**The Federal Reserve Chairman told Congress that its current budget habits are 'unsustainable' - and warned they're 'fiscally destabilizing' to our economy."** According to the article, Mr. Greenspan also "stressed it's time to dump Social Security as we know it and cut benefits." He is then quoted saying, "We may have already committed more physical resources to the baby-boom generation in its retirement years than our economy has the capacity to deliver." "When you begin to do the arithmetic of what rising debt levels implied by the deficits tell you - and add interest costs to that ever-rising debt at ever-higher interest rates - the system becomes fiscally destabilizing." The article then says, **"It's the third time in three weeks that Greenspan has gone to Capitol Hill to sell his beliefs for spending restraint..."** We believe that Greenspan has always know these "facts" but that now seems to be the opportune time to deliver that message (as opposed to during the bull market) - **We believe this timing of this message of restraint is happening because we are seeing a major psychological shift from expansion to contraction;** thus, Greenspan's comments and, more importantly, the reporting of them by the financial press without "sugar coating" them is, to us, **a major trend change indicator.**

March 1, 2005, BUSINESS WEEK ON LINE, "**Medicare in Worse Shape Than Social Security**;" The first sentence says most of it: "**A looming Medicare shortage is seven times ([7x]) the size of the one that Social Security faces and nearly four times the entire federal debt."** Greenspan chimes in that the Medicare problem is **"several multiples more difficult than is Social Security"** last month to a House committee. Bush said, "Once we modernize and save Social Security for a young generation of Americans, then it will be time to deal with the unfunded liabilities in Medicare." To us, tackling Social Security first does make sense. The Medicare shortfall dwarfs social security beginning out in 2024 as it grows at alarmingly fast rates where as Social Securities problems although smaller are much closer in time. In addition, Medicare has many more political issues and problems than even Social Security. We included the gist of this article because it points to **a major change in trend from surplus to deficit that will have to be funded, although out in the future, with real cash.**

February 28, 2005, DALLASNEWS.COM, **"Social Security May Be in Trouble by '08;"** This article is about Fed Chairman Greenspan's recent testimony on Social Security. The article does not quote him directly but summarizes Greenspan's remarks - we will assume it is accurate since it makes sense to us. Mr. Greenspan was being questioning by Congress about the possibility of the issues with Social Security being a "manufactured problem." Some Congressmen were somewhat skeptical of Bush attaching the coming Social Security shortfalls because **2052 is "the date the Congressional Budget Office** estimates the Social Security Trust fund will be exhausted and benefits will have to be reduced..." and **2042 is "the date the Social Security trustees** estimate for the same event." **Of course, Mr. Greenspan's date of 2008 is "just three years away."** The article goes on to explain the huge differences in timing. **"The answer is one word: cash.** Mr. Greenspan is following the cash, not government accounting." Mr. Greenspan uses the Social Security Trustees' "high cost" cash estimates (which have been the most accurate and are so because we keep living longer and longer) "which has Social Security and Medicare down to just $14 billion in 2009 and is negative thereafter. However, **Mr. Greenspan is concerned that the bond markets will realize this and a year or two earlier, say 2008**, will begin focusing on this increased demand for cash (the cash short fall will be funded by Treasury Issuance) and rates will begin rising rather rapidly. **"That is why [Greenspan's] looking for trouble in 2008."**

The article makes some other good points - the best one to us is that the "interesting" accounting the government (and especially politicians) has used to its advantage to **"claim" surpluses during "1998, 1999, and 2000 when the total government debt [actually] rose by $291.7 billion,"** has essentially run out of gas now that we are talking **real cash payments to recipients and not just liability accounting entries. This is a major change in trend and Greenspan seems to think the markets will react a few years before it actually begins to happen.**

February, 22, 2005, BUSINESS WEEK (Feb 28, 2005 edition), **"They're Opting Out of Options;"** We have touched on this specific subject previously but this short article brings some statistics making our case up to date. "Companies have sobered up to new rules, which take effect in June [2005], requiring that they treat stock options as an expense. **The number of new grants at America's 200 largest companies declined for the third straight year in 2003, with nearly two out of three companies cutting back. Compensation experts say that trend continued through 2004 and will accelerate in 2005."** Companies are replacing their options with other forms of compensation such as restricted stock; however, "Others are simply reducing option grants without offering a replacement." We think our take has been reinforced - that the law changes have resulted in less compensation as we expected and that the law change and the result so far are another indicator of a major change in the market for risky assets from bull to bear.

February 7, 2005, BLOOMBERG WEALTH MANAGER (February edition), "Yield Spreads - Two Heads Are Better Than One, The Old Saw:" What grabbed my attention with this article was its **compelling graph** (14 years ending 12-31-2004) - with the accompanying caption: "**The yield premium in high-yield bonds over the 10-year Treasuries dropped in 2004 to its lowest level in years, suggesting that the bull market in junk bonds maybe over.**" The graph is of the difference in yield between the very low risk U.S. Treasury 10 year bond and the yield of the average junk taxable bond. When the difference is wide, junk bonds have upside from credit quality improvement - when the difference is tight as it is now (at record tightness), the junk bonds have little upside and very little downside protection (in Stamper Capital terms). The "spread" as the yield differential is called is the lowest it has been in ten years. We would like to point out that these record tight junk bond yields are spread at near-record low U.S. Treasury rates; thus, giving low quality investments tremendous downside potential from their relative yield going up and from the benchmark U.S. Treasury 10 year yield increasing - accordingly, we feel a "double whammy" is definitely in the cards. The reason this is a "wind of major change" is that the yields are so low and the spread so tight that the only practically move is a change in direction - up in yield (down in price) - i.e. this situation is almost certainly a market top. As for major tops - we have pointed out how tops are fanned with different indices peaking at different times (as opposed to major bottoms where most indices converge to a point). Thus, we view this top as probably one of the final tops in this huge credit inflation cycle which had large cap stocks peaking out in 2000 and small cap stock indices peaking out 2004.

December 16, 2004, LOS ANGELES TIMES, "Frye's Unofficial Margin Widens - San Diego's Disputed Mayoral Election Appears Likely to be Settled in the Courts as the Sides Weigh Their Legal Opinions:" This is a story I should have included previously. For those who have not been following the mayoral election in San Diego, there is something interesting going on. A **write-in candidate**, Donna Frye, the wife of well know surfer Skip Frye and who has minimal experience in the public sector, will potentially win the election for mayor of San Diego, taking it away from the Republican and Democratic candidates. The election took place back in November but has been hung up because write-in candidate Frye has more votes if ballots with her name written in but without the circle filled in are counted - either way she beat out the Democrat and was just shy of beating the Republican if the votes without the circles darkened are not counted. Who ends up winning based on this technicality is not the story we are interested in here. **We are interested in the story of how a previously unknown can, at the last moment, become a write-in candidate and get more votes that the Democratic candidate and get essentially the same amount of votes as the Republican if not more in a city the size of San Diego!** To us this situation is a possible wind of major trend change. Obviously something is amiss in San Diego and the people are not too happy about it. Previously we have documented San Diego's budget and pension problems. Having a non-mainstream political write-in win could mean major changes to how things are done in the future.

December 16, 2004, AOL BUSINESS NEWS, "**Accounting Board Says Firms Must Expense Stock Options**:" The headline pretty much says it. "The nation's accounting rule maker decided Thursday that companies will have to begin deducting the value of stock options from their profits next year..." We hear a lot of noise on both sides on whether this is good or bad. We believe the most important consideration is how this will impact the earnings of the firms that have not been expensing these costs. Even though many executives disagree, we believe that the result will be that, going forward, earnings of those companies will be less than they would have been without the new rules. We also believe that total compensation to executives at those companies will be falling. **Thus, it could be good for the shareholders because it will help reign in excessive compensation; however, it will also result in lower levels of earnings going forward which could negatively impact equity prices**. We see this rule change as a reflection of part of the major trend change that we have been documenting - the result will most likely be a drop in compensation of those who received stock options in the past and a drop in the prices of stocks who issued lots of stock options in the past.

December 12, 2004 LOS ANGELES TIMES, "**For Savings, Nowhere to Go But U**p:" The subject of this article has been out for a couple of weeks but I had missed a couple of chances to clip the articles. Fortunately, this featured article contains **the very striking graph of the "U.S. Personal Savings as a Percentage of Personal Disposable Income, Annual Data**." The striking part is that the graph starts out in 1980 at the top left of the chart at 10.7%, goes up for a year or so to just over 12% before cutting a 45 degree angle, heading down fairly consistently to the bottom right to its record low of 0.9% (actually, the article points out that in October 2004 it bottomed at 0.2%!!!). The article points out that "in the 1970's and the early 1980's that rate of savings was between 9% and 11%! So, basically **the rate has dropped very consistently from 11% in 1980 to what will probably be its bottom of the last couple of years at below 1%**. The article points out that this incredible drop coincides with the incredible drop in the managed Federal Funds rate - that people were getting less on their savings as interest rates dropped so they are saving less. The article also points out that those with assets whose values rose probably felt those rises offset their need to save. We agree with that and also want to emphasize a couple of points: 1). The drop in the savings rate not only coincides with interest rates going down (and bond prices rallying) but also almost lock step with the bull market in stocks from 1982 to between 2000 to 2004 depending upon which indices you are following. 2). **Just like interest rates hitting a floor, the savings rate mathematically cannot get much lower and will almost certainly rise**. 3). If people increase their savings, that means they are not going to be spending that money on other things - which could lead to possible deflation and falling asset prices. 4). Not only is the savings rate at a record low level, I guess it makes sense that debt levels are also at maximum high levels - however, actually, these facts counter-act the argument that people did not save because they were more wealthy because of rising asset values - it is more likely that they felt they were - or were just living in a land of suspended disbelief. 5). We believe having the savings rate reverse the current downward trend and rise substantially does not mean that most asset prices will be rising - quite the contrary - The area that will be hit the worst will be those involved with luxury or "unneeded" conspicuous consumption items. We have already started to see this decline in value - the fortunes of "branded" products - at the low end, Coke, for example - people are switching to much cheaper private labels or are consuming cheaper alternatives. At the higher end, automobiles - we have record discounts and great values but manufacturers and dealers still have record inventories - ugh.

Thus, this trend downward to the record low savings rates also corresponds to record increases of consumption by U.S. citizens financed by saving less and less and by borrowing more and more. Of course, this all goes along pretty much with what we have been documenting over the past several years. **We believe that the combination of CONSUMPTION SATURATION (people owning pretty much everything already) combined with their record high debt levels and concerns about retirement will result in the savings rate rising (and debt being liquidated) - unfortunately, that rise will more likely result in a drop in the price of most risky asset classes (stocks, junk bonds, real estate, etc.) because psychology will have changed => PEOPLE will be willing to spend less and less (prices drop) as they save more and more. To us, this is a major change in trend.**

November 20, 2004 THE NEW YORK TIMES, "Germans Weigh Taking Stocks Off Wall Street:" "Several German companies, which rushed to have their shares traded on exchanges in the United States during the bull market of the late 1990's, are **now seriously thinking about abandoning the [U.S.] market**." It turns out that in the wake of the recently implemented regulations here in the U.S. (including the post-Enron Sarbanes-Oxley Act of 2002), German companies are less willing to bear the legal costs, liability and the bureaucracy of complying with the rules. The article also highlights other reasons such as that..."German companies have lost much of their sheen among investors, as the German economy has limped through a recession and a barely perceptible recovery." (Their "recovery" is barely perceptible also - See our Deflation Watch story on Japan, dated 11-18-04.) Interestingly, even if de-listed, any company that had been listed and has more than 300 stockholders in the United States must remain registered with the S.E.C. Thus, delisting is much more difficult than deregistering. To us, this change of heart of foreign companies is a part of the major trend change essentially away from overvaluation toward undervaluation. We believe the change of heart is a reflection of the regulatory and investment climate that increases costs and decreases values.

November 7, 2004 - this is another subject which we haven't read about but which we think should be covered - our title is: "**Money Supply Growth Continues to Contract**:" We were just noticing that the M2, M3, and MZM measures of the United States Money Supply have been going essentially sideways since May of 2004: M2 is up slightly but definitely slowed, M3 is almost unchanged, and MZM (Zero Maturity Money Supply) actually has negative growth from May. However, we also noted that there was a similar slow down late last year with no completely disastrous results. But when we looked at the long term charts back to 1995 we noted a distinct slowdown in the rate of growth of all three measures:

	Highest Annual	Lowest Annual	Current Annual
M2	12.29% Sept 2001	2.51% Aug 2004	about 4%
M3	13.30% Dec 2001	3.08% Dec 2003	about 4%
MZM	21.40% Dec 2001	2.04% Aug 2004	about 3%

(rates are annual rates of change, based on a rolling 52 week calculation)

What you cannot see from the chart is that the trend in all three was pretty much Steady Downward from late 2001 to around now, except for M3 whose annual rate of growth bottomed last December but has only gone up slightly since then. Thus, the trends are definitely a slowing of these monetary growth measures which indicates to us a possible monetary contraction which could lead to economic difficulties including the rapid fall of the prices of riskier assets - overvalued stocks and real estate, for example.

October 26, 2004 BLOOMBERG, "Divided **SEC Adopts Rules Subjecting Hedge Funds to Oversight**:" This article reviews the finalization of the SEC's decision on regulating hedge funds that we reviewed previously on July 1, 2004 (below). Importantly, "The rule [just passed], approved over the opposition of many in the $866 billion hedge fund industry that caters to the wealthy, gives agency inspectors power to examine hedge funds' books." The new rule takes effect in 2006, so just over a year away. Importantly, about 40% of the hedge funds are already registered with the SEC - those already registered are mostly the larger ones. Our take is that a major trend change like this one toward more stringent oversight often results in relative underperformance of the categories weakest participants.

October 18, 2004 THE WALL STREET JOURNAL, "Insurers Reel from Spitzer's Strike:" This is one of many current (and many more to come) articles about New York Attorney General Eliot Spitzer's latest exams and discoveries. To us it a major change of trend from the "live and let live" of the bull market to much much closer scrutiny in the bear market - another step in the dramatic change in psychology from bull to bear. Besides, being a step in the major change in investment psychology, we point out that those in the insurance industry that were making huge amounts based on certain now-questionable agreements, will possibly lose a portion of their disposable income in the future - thus, we would expect that the market of goods for the very wealthy, which has so far been unscathed in the bear market, could begin to tumble as purchases of these types of goods are curtailed somewhat.

October 11, 2004 THE DALLAS MORNING NEWS, "**Is Tide of Debt Turning**?" We would have named titled this article, "**Credit Expansion Over, Credit Contraction Begins**." This short article makes a few very good points. "For only the fifth time in the last decade, consumers paid down their debts in August [2004]. Economists had been predicting an increase of $5.9 billion. They got a decline of $2.4 billion - quite a swing." Also, "...revolving debt including credit cards fell by $3.4 billion in August, marking the sixth decline in seven months." Thus, in our minds, this article documents the change from credit expansion - the one that created all the bubbles (NASDAQ, High Tech, Housing, Collectables etc.) has ended and now we are in a credit contraction. Importantly, what went up in the credit expansion, will most likely drop in the credit contraction.

August 30, 2004 - On Friday, August 27, 2004 Alan Greenspan spoke in Jackson Hole, WY at a central bank conference. Below are several of the articles which highlighted his thoughts: AOL NEWS, "**Greenspan says Social Security, Medicare Must be Cut;**" BOSTON HERALD, "**What if there was nothing left? Social Security Disaster Looms, Greenspan Warns**;" BLOOMBERG.COM, "**Greenspan Sees Risk of 'Painful' Changes for Retirees;**" "INDEPENDENT.CO.UK, "**Greenspan Blows a 'Jackson Hole' in Candidates' Election Promises**;" WASHINGTON POST, "**Greenspan Urges Look At Senior Benefit Costs**;" THE NEW YORK TIMES, "**Warning Anew About Retiree Expectations**." Importantly, Mr. Greenspan's comments were much more direct than previously. He stated in "blunt," unambiguous language that the Social Security and Medicare social entitlement programs are not solvent in the long run and that fairly dramatic changes need to be made now in order to properly address them. He spoke of "increasingly stark choices" including decreasing promised benefits, extending ages when benefits can be taken, and increasing taxes, along with baby boomers increasing their own personal level of savings. His message basically was: **expect less than you have been lead to believe and plan on making up the difference yourself**.

Here are a few of Greenspan's quotes: "If we have promised more than our economy has the ability to deliver to retirees,....as I fear we may have, <u>we must recalibrate our public programs so that pending retirees have time to adjust</u>....If we delay, the adjustments could be <u>abrupt and painful</u>." "The decade-long acceleration in productivity and economic growth has seemingly muted the necessity of making such choices" between reduced benefits or higher taxes. "But how these deficits are addressed can have profound economic effects." Increasing payroll tax contributions could make the problem worse, by possibly reducing the incentives for workers to continue working. **Government resources even under the most optimistic economic assumptions on growth and productivity will be inadequate to provide baby boomers with the level of benefits their parents got**.

Ok the keys from a **Major Trend Change Indicator's perspective** is that here is the nation's leading economist (Greenspan) declaring that major changes need to be implemented immediately - he said "haste is critical." While, the mainstream media has yet to focus on this story, importantly, the focus has been stepped up in the business press. Also, Greenspan has spoken of these problems before, but not in such a straightforward, "blunt" manner and several other experts have spoken up that the problem is even worse than Greenspan has indicated. Thus, we see this "admission of the problem" by a very prominent United States Government Official as the beginning of a change of the major trend. **Unfortunately, the steps that need to be taken to fix this problem such as lowering benefits and increasing savings (accompanied by lowering consumption) are deflationary**.

July 27, 2004, THE WALL STREET JOURNAL, "**Independent Research Hits Wall Street** - Starting Today, Major Firms Must Provide Clients With Stock Recommendations by Outsiders": The title gives the gist this article. "Beginning today, 10 of the nation's biggest brokerage firms - among them First Boston, Morgan Stanley and Citigroup's Smith Barney unit - must provide clients with a second, independent source of research in addition to reports by the firms' own analysts." This situation was required as a $1.4 billion SEC settlement resolving charges that the brokers issued "tainted" research due to conflicts of interest between their investment-banking interests and brokerage (security sales) interests. (To us, it is difficult to see how this conflict of interest can really ever totally be mitigated; to us, a "buyer beware - you can't necessarily trust these guys because they are conflicted and have a large monetary payoff - so take what they say with a big grain of salt" statement by authorities would be about the best solution.) A key point of the article is that the ten firms are required to hire an outside consultant who selects outside firms to provide the independent research - thus, the head of investment banking will not be able to influence the researcher (hopefully). The article also points out that the independent research will often contradict the brokerage research and customers will have to figure out how to deal with that difference. We have two main points on this situation: First, the settlement itself is a major trend change indicator from pretty much the "throw-caution-to-the-wind, anything goes" of the high-tech-1990's bubble to the now ever-more-restrained situation - in other words, if the investor-regulator attitudes hadn't already changed (to more restraint), this settlement would not have been reached; thus, to us, the settlement itself is already a reflection of the change in mood of the general public and regulators. Second, you can imagine that, in comparison to previously, the individual investor will not be blanketed with one-sided research from the companies and people that are so conflicted. **Thus, we would expect that, rather than pushing the market and prices of their investment-banking clients' stock up to the stratosphere, the research will push prices back to more normal valuation levels which are about half of what they are now** - See our previous annual forecasts, where we detail that "fair value" based on average multiples of dividends and earnings is around 4,500 to 5,000 on the DOW - considerably lower than currently.

July 1, 2004, THE WALL STREET JOURNAL, "**SEC Pushing Proposal to Regulate Hedge Funds**": "On July 14, the SEC plans to formally propose a rule requiring hedge-fund advisers to register with the agency....The SEC is expected to vote 3-2 [to pass the proposal]..." To us, this is another major change from "hands off" during the major bull market to the area of increased regulation and re-regulation. While some analysts do not think the SEC will find much, given the sizeable problems that were allowed to grow in the very heavily regulated and audited corporate and mutual fund arenas, we think it is reasonable to expect that a few problems will be found in the completely unregulated and mostly unaudited area of hedge funds. Again, we believe this "end of the party" increase in regulation, rightly or wrongly (we believe a "buyer-beware" warning is probably a better method), could result in a drop in asset valuation levels of some hedge funds having non-exchange traded investments. **As for timing - remember the exposure of major corporate and mutual fund problems (and subsequent re-regulation) coincided with the end of the major bull market (topping early 2000) and with the subsequent huge drop (down into 2002).** We believe the initial regulation of hedge funds could coincide with similar declines in the prices of higher risk investments..

June 28, 2004 BUSINESS WEEK (July 5th edition), "**A Wal-Mart Settlement: What it might look like - Damages for sex bias would be just the start. After that could come an entire change of culture**": We think that Business Week probably has this one right as stated in the last part of the article's title - it could cause or represent **an entire change of culture** - but we think it is bigger than Wal-Mart.. This article is about the huge sex bias class action lawsuit that was just certified against Wal-Mart. Our comment is that it is part of a bigger **change in trend from the "hands off business, anything goes" of the bull market to the new stepped up regulation or re-regulation of business**. While the article questions, "Would such a deal bog Wal-Mart down in bureaucracy...?", we question if this and other recent step-ups in regulation or re-regulation will essentially lower investment values overall?

June 24, 2004 USA TODAY, "**SEC vote could radically change fund boards**": This article is about the SEC's new rule (just passed) that the Chairman of the Board of a mutual fund must be independent of the fund manager. Many people do not understand that the shareholders of a Fund actually own it (not the manager) and that the Fund's board selects the manager, which is almost always the firm that put up the time and money to start the Fund. Thus, previous to this new rule, most often the Chairman of the Fund was also the Chairman of the Fund Manager. The new rule also requires 75% of the board members to be independent. We think this change could be part of a change in trend - possibly away from the mutual fund structure that accompanied the great bull market (ending 2000) to some other structure(s) (like private accounts, partnerships, etc.). We believe it could be a signal of a large change in the investment arena. Importantly, the article points out that about 2,000 funds do not currently have a board that is 75% independent and about **80% of all mutual funds will have to replace their Chairman. This is really big to us because the result could change the incentives and the way people act in a huge segment of the industry (the driver of the old bull market)**.

June 23, 2004 BLOOMBERG, "**U.S. SEC Loosens Short-Selling Rules on 1,000 Stocks**": Basically, they are eliminating the "up-tick" rule (in phases). We quote from the article, "Today's rule change suspends a practice followed for the last 60 years that let investors sell most stocks short only when share prices were rising. Short selling generates profits when share prices decline and the technique can accelerated a falling market. The SEC began to regulate the trading technique after speculators used it to drive down stocks during the 1929 market crash." Given our view that the market's fair value is down about 50% from current levels (see our annual forecasts), you can understand why we think this is a curious reform at this time. We note that in the junk bond, taxable market where short selling is used quite often, prices seem to be valued or evaluated at more reasonable levels (especially in down markets) than in the high yield municipal bond market where short selling rarely occurs. Thus, **we think that anything that makes short selling easier could push prices closer to real long term value levels (which we believe is downward for equities in general)**.

June 17th, 2004 BLOOMBERG, "**Snow Says that No U.S. Company is 'Too Big to Fail'**": Our view is that the subject of this article, the denial of a government bail out of United Airlines in the form of government-guaranteed loans, **could mark a huge change in the government bail-out cycle that started with Chrysler**. Mr. Snow's comments may **signal an end to the old-trend attitude** that the U.S. government would not let large businesses (or governments - think Argentina) fail. This article quotes U.S. Treasury Secretary, John Snow, "**But I don't think we can ever take the view that businesses are too big to fail. To take that view is to set in motion all sorts of very unwelcome behavioral incentives.**" Thus, apparently, the bail-out party may have topped out - which, to us, makes riskier investments much less appealing.

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