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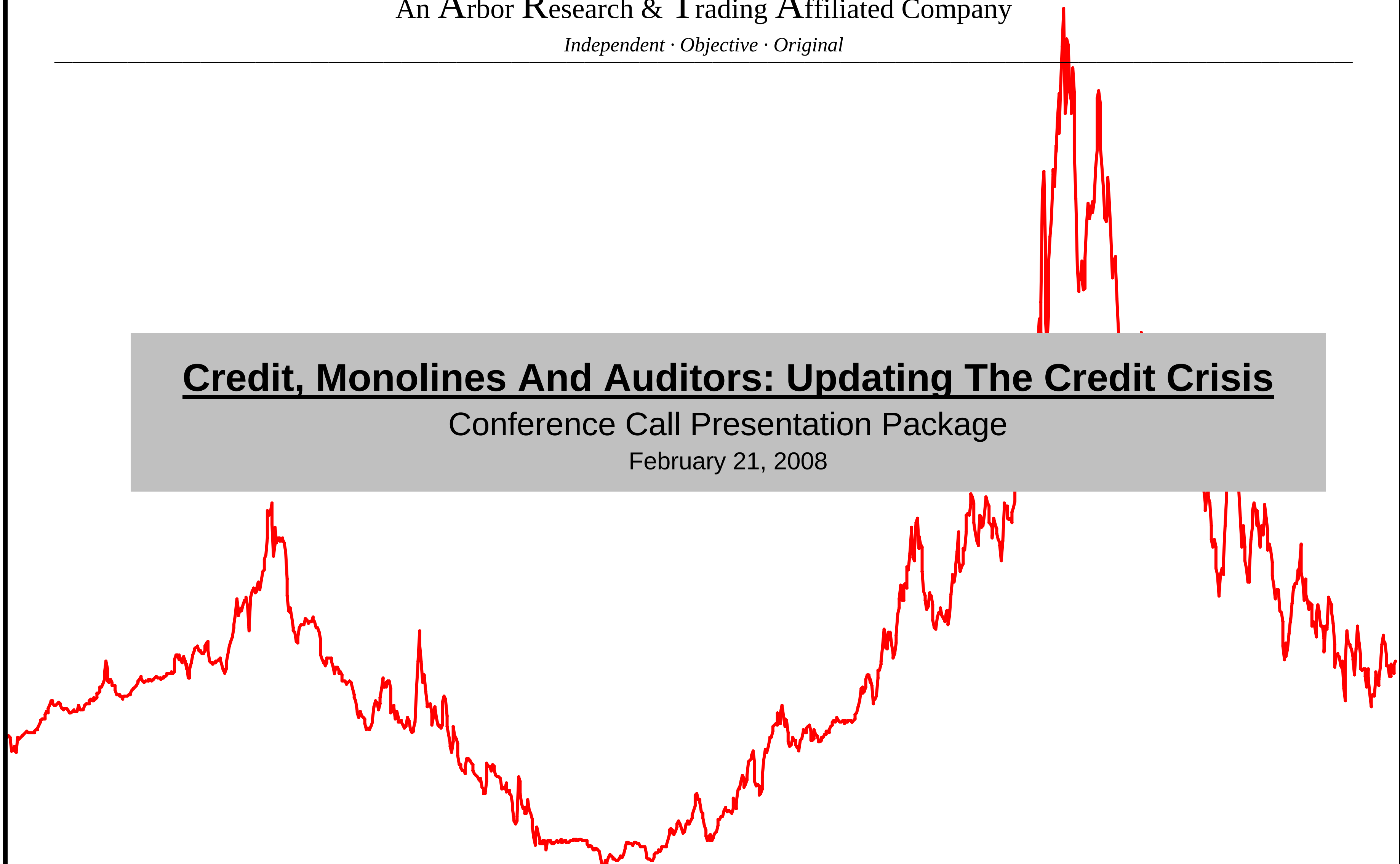
Credit, Monolines And Auditors: Updating The Credit Crisis

Conference Call Presentation Package

February 21, 2008



Long-Term Interest Rates - 1900 to 2007

Banking System Losses Through February 19 - 1

Writedowns & Unusual Charges						Sub-prime exposures					
Company	1H07	3Q07	4Q07	1Q 07	Total Loss	CDOs	Direct RMBS	Direct Subprime Lending	Other	Total Sub-Prime and Alt-A ex SIVs and Conduits	Leverage Loan Exposure
Citigroup		6,056	22,779		**28,835**	29,300	8,000	22,700		**60,000**	**43,000**
Merrill Lynch		8,900	16,725		**25,625**	5,089	5,488	1,131		**11,708**	**18,000**
Morgan Stanley		1,200	9,400		**10,600**	3,600	2,700	600	-5,100	**1,800**	**12,200**
Bank of America		1,841	7,410		**9,251**	8,176	593			**8,769**	**12,000**
JPMorgan		2,450	2,120		**4,570**	5,700	1,200	16,500	300	**23,700**	**26,400**
Washington Mutual		1,172	3,091		**4,263**		491	18,600		**19,091**	
Wachovia		1,527	2,700		**4,227**	821	1,695	2,000		**4,516**	**9,100**
Countrywide	884	2,982	1,879		**5,745**		293	48,196		**48,489**	
Bear Stearns		850	1,900		**2,750**	750	1,300	500		**2,550**	**600**
E*Trade		327	2,405		**2,732**			97		**97**	
Lehman Brothers	1,000	700	830		**2,530**	1,000	5,300			**6,300**	**10,000**
Goldman Sachs		2,400			**2,400**	400	2,900			**3,300**	**27,000**
AIG		1,216	4,700		**5,916**	234	25,900	6,100	62,400	**94,634**	
Wells Fargo			1,400		**1,400**			8,800		**8,800**	
SunTrust	13	209	744		**966**	7		1,700		**1,707**	
National City			750		**750**			6,000		**6,000**	
KeyCorp		53	274		**327**					**0**	
Fifth Third			132		**132**			163		**163**	
PNC			131		**131**					**0**	
US Bancorp			107		**107**			4,200		**4,200**	
BB&T			73		**73**			520		**520**	
Comerica			45		**45**					**0**	
Total U.S.	**$1,897**	**$31,883**	**$79,595**		**$113,375**	**$55,077**	**$55,860**	**$137,807**	**$57,600**	**$306,344**	**$158,300**
UBS	500	5,069	14,000	7,500	**27,069**					**65,500**	**11,100**
Credit Suisse		1,897	1,134	2,850	**5,881**					**4,300**	**39,960**
RBS		1,620	1,620		**3,239**					**8,247**	**29,725**
Barclays		3,000	1,471		**4,471**					**31,599**	**14,589**
Credit Agricole	453	803	2,600		**3,856**					**7,791**	
SocGen		476	2,870		**3,346**					**6,292**	
Dresdner (Allianz)	0	559			**559**					**2,943**	
Hypo Real Estate		6	546		**552**					**2,205**	
HSBC		4,325			**4,325**					**2,000**	
BMO			368		**368**					**2,000**	
Commerzbank	54	428	360		**841**					**1,801**	
IKB			8,918		**8,918**					**32,698**	
WestLB			7,250		**7,250**					**33,350**	
BayernLB			2,755		**2,755**						
NBC			575		**575**					**0**	
Scotiabank			230		**230**					**1,200**	**220**
Deutsche Postbank		90			**90**					**1,176**	
KBC		57			**57**					**1,044**	**7,500**
BNPP		554	1,257		**1,811**					**441**	
RBC			357		**357**					**604**	**1,000**
Unicredit					**0**					**391**	
CIBC			3,213		**3,213**					**0**	
Santander					**0**					**0**	
IntesaSanpaolo					**0**					**0**	
Mizuho			3,243		**3,243**						
Mitsubishi UFJ			517		**517**						
SMFG			930		**930**						
Total Non-U.S.	**$1,007**	**$18,883**	**$49,523**	**$10,350**	**$84,453**	**$0**	**$0**	**$0**	**$0**	**$205,581**	**$104,094**
Global Total	**$2,904**	**$50,766**	**$129,118**	**$10,350**	**$197,828**	**$55,077**	**$55,860**	**$137,807**	**$57,600**	**$511,925**	**$262,394**

Note 1: European quoted insurers covered by Deutsche Bank lost around a further Euro 4-5bn on subprime we estimate, so USD 6-7bn

Note 2: AIGs "other" exposure consisits of multi sector CDO credit derivatives where transactions have mixed colateral including subprime.

Note 3: In cases where 4Q07 has not been reported by the company, figures under writedowns are from company guidance for fourth quarter writedowns only.

Source: Deutsche Bank

Banking System Losses Through February 19 - 2

Company	Comments
Citigroup	net exposure for CDOs (gross is $39.8B), gross exposures for all other subprime exposures
Merrill Lynch	$2.7B
Morgan Stanley	leverage loan exposure declined from roughly $31Bil. At 3Q due to $4.4Bil in withdraws and $14.7Bil that closed; amt in other is related to ABS CDS.
Bank of America	$593 mil. includes net subprime exposure in warehouse and sales and trading;
JPMorgan	writedown due to weakening home equity loans via correspondant channels; exposure is consumer finance RE loans w/ FICO <620
Washington Mutual	Direct lending consisits of subprime home loans ($16.1B) and subprime home equity loans of ($2.5B);
Wachovia	leverage finance valuation gain of $93mil. Gross CDO exposure of $5bil. Includes $4.2B of exposure hedged with financial guarantors
Countrywide	Countrywide also has $40bil. Exposure to home equity which was separated from subprime. Direct subprime lending figure taken from 3Q07 presentation
Bear Stearns	exposures are gross, net short CDOs, $1.1B of securitiy amount is investment grade
E*Trade	writedowns include valuation charge due to sale of ABS portfolio include CDOs, some of the MBS port. and excess provsions
Lehman Brothers	
Goldman Sachs	4Q gain on leverage loans and mortgage writedown (est. to off set each each other)
AIG	Mortgage Guarantee $2.4Bil to subprime, $6Bil to Alt-A, CDO invesment portfolio has $234 mil; CDS mutil-sector CDO exposure w/ subprime net notional exposure is $62.4 Bil.; also have $2.5Bil. In exposure to SIV. Also has additional $17.1 Bil. Multi-sector CDO exposure for transactions that have no sub-prime.
Wells Fargo	CDO exposures include warehouse, $300M other is for sub-prime liq facility, jpm also has exposure to gross $15.5B CMBS and $6.4B alt-a. (also has $95B home equity)
SunTrust	SIV, excess provision and valuation charge
National City	excess provision and valuation charge, goodwill writedown
KeyCorp	excess provision and valuation charge
Fifth Third	excess provision and valuation charge
PNC	excess provision and CMBS charge
US Bancorp	charge due to ABCP money market fund valuation
BB&T	does not include $3.3B of alt-a
Comerica	excess provision
Total U.S.	
UBS	Post Q4 results, incl Alt-A, excl CMBS
Credit Suisse	CHF 1.6bn subprime CHF 2.7bn CDOs, also CHF 25.9bn of CMBS. CHF 27.1bn macro hedges
RBS	
Barclays	Includes Alt-A and monoline exposures. Also Barc have USD 24bn of CMBS
Credit Agricole	
SocGen	
Dresdner (Allianz)	
Hypo Real Estate	Over half CDO exposures is pre-2004 vintages
HSBC	
BMO	
Commerzbank	
IKB	
WestLB	
BayernLB	
NBC	$1.7Bil. Is sub-prime ABCP
Scotiabank	$1.2Bil. Is CDOs and CLOs
Deutsche Postbank	The exposure CDOs has an average content of 20% subprime
KBC	
BNPP	NB has not yet reported Q3
RBC	
Unicredit	Management comment is remaining exposure is minimal, likely due to hedging
CIBC	additional $2.46 Bil. in writedowns expected from ACA and further subprime deterioration
Santander	
IntesaSanpaolo	Does have conduit risk, but mainly Spanish SME paper
Mizuho	
Mitsubishi UFJ	
SMFG	
Total Non-U.S.	
Global Total	

Note 1: European quoted insurers covered by Deutsche Bank lost around a further Euro 4-5bn on subprime we estimate, so USD 6-7bn

Note 2: AIGs "other" exposure consisits of multi sector CDO credit derivatives where transactions have mixed colateral including subprime.

Note 3: In cases where 4Q07 has not been reported by the company, figures under writedowns are from company guidance for fourth quarter writedowns only.

Source: Deutsche Bank

Banking System Capital Raised

Total Banking System Capital Raised

As of January 31, 2008

Firm	Infusion ($blns)	Investor	Stake
UBS (a)	$ 10.00	Government of Singapore Investment Corp.	10.00%
	$ 1.90	Unidentified Middle Eastern Investor	2.00%
Citigroup	$ 6.80	Government of Singapore Investment Corp.	3.70%
	$ 7.70	Kuwait, Prince Alwaleed, Capital Research, Capital World, Sandy Weill, Public Investors	4.1%*
	$ 7.50	Abu Dhabi Investment Authority	4.90%
Bank of America	$ 13.00	Public Investors	5.50**%
Societe Generale	$ 8.20	Public Investors	13.00%**
WestLB	$ 3.00	State of North Rhineland Westphalia, savings banks associations, regional governments	***
Merrill Lynch	$ 4.40	Temasek Holdings	9.40%**
	$ 6.60	Korean Investment Corp, Kuwait, Mizuho	10% - 11% **
	$ 1.20	Davis Selected Advisors (U.S.)	2.60%**
Morgan Stanley	$ 5.00	China Investment Corp.	9.90%
Canadian Imperial	$ 1.50	Li Ka-Shing, Manulife, Caisse de Depot, OMERS	6.10%**
	$ 1.20	Public Investors	5.00%**
Barclays (b)	$ 3.00	China Development Bank	3.10%
	$ 2.00	Temasek Holdings (Singapore)	2.10%
Bear Stearns (c)	$ 1.00	Citic Securities Co. (China)	6.00%
Total*****	**$ 83.90**		

Source: Bloomberg

***** Estimate based on Government of Singapore's Stake
****** Estimate based on share prices announced by the firms
******* WestLB isn't public traded
******** Total reflects figures before rounding.
(a) UBS shareholders will vote February 27 on an alternative plan, which proposes that current shareholders provide the funds rather than the Government of Singapore and unidentified investor.
(b) Barclays Plc arranged its transaction during an unsuccessful bid to buy ABN Amro Holding NV last year.
(c) Bear Stearns also invested the same amount in Citic

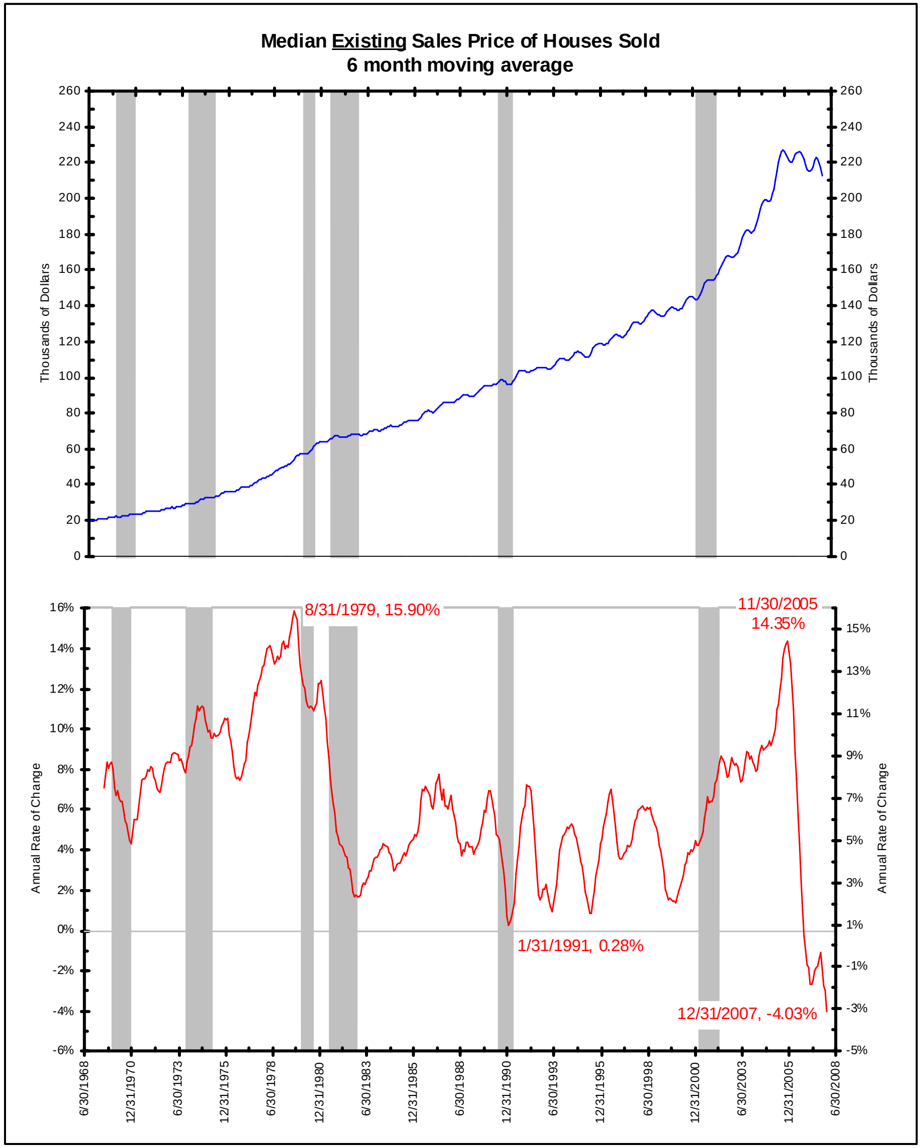
What Is The Real Cause Of The Credit Crisis?

From Our Newsclips/Daily Commentary

What exactly is the problem behind the credit crisis? Most commentators believe the problem is the falling prices of structured securities (i.e., declining CDO prices). Simply, they argue that banks are losing money and this is affecting everything. This is why they argue the "solution" is to either freeze mortgages or prevent foreclosure. They think this is a banking system problem and are acting accordingly.

While it is accurate to say the banking system has problems, we believe this is a symptom of the real problem, not the cause. That is, the real problem is home prices are falling on a nationwide basis. The underlying assumption that drove structured securities and all the complicated mortgages was that nationwide home prices do not fall. Individual markets can and do fall, but not nationwide. After all, what are the three rules of real estate? Location, Location and Location. Some even argue there is no such thing as a nationwide home market. It's all a bunch of loosely related local markets.

The chart to the right shows the median price of a house sold (smoothed by using a six-month moving average). Home prices are falling on a year-over-year basis for the first time since 1991, and for only the second time in the last 37 years.

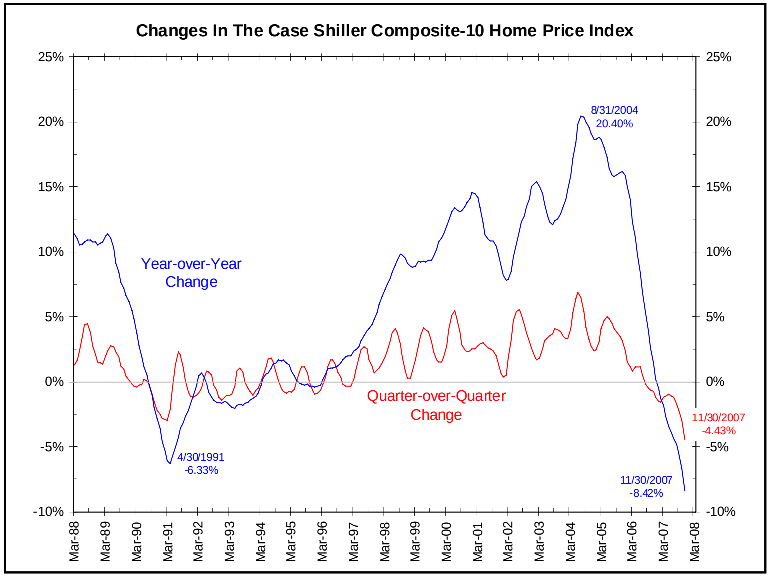


Measuring Nationwide Home Prices

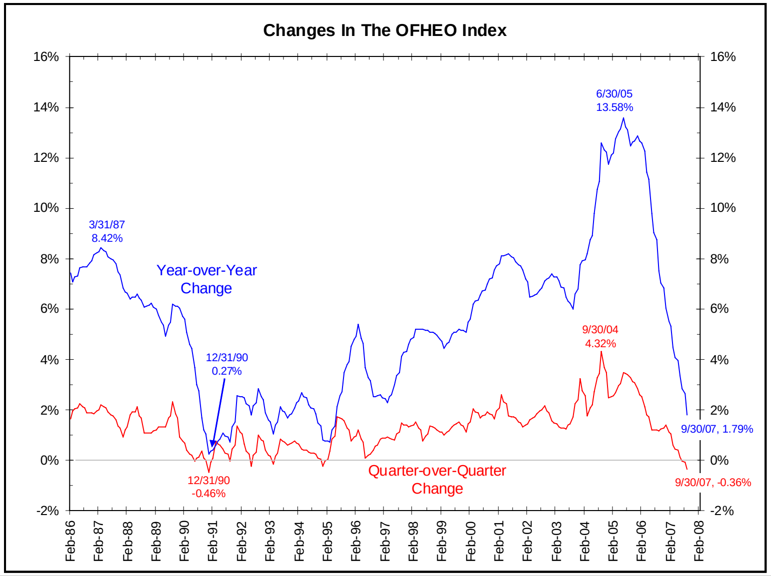
From Our Newsclips/Daily Commentary

The chart to the right, showing prices of existing home sales in the 10 largest cities, shows a similar trend to the Median Sales Price chart on the previous slide. It shows the worst nationwide home price decline since 1991 with no signs of abating.

Robert Shiller notes that homes prices are down 8.42% over the past year. Home prices are also 9.4% off their June 2006 peak and back to May 2005 levels. It is noted that this index was started in 1988, but **the current decline in home prices is likely the worst since World War 2.**



Another measure we would like to illustrate is OFHEO's home price index. This index is compiled from Fannie and Freddie guaranteed or conforming mortgages (OFHEO is their regulator). Those with conforming mortgages represent the strongest sector of the housing market (about 40% of all mortgages). While these prices are not falling like the two measures above, they are still plunging near their worst levels ever and are probably not near their ultimate low.



Long-Term View Of Housing Prices

Floyd Norris (NYT Blog) – [(Jan 14) A Bear's Questions]
David A. Rosenberg, a Merrill Lynch economist, is out with a report today that concludes that home prices need to fall another 20 percent or more to get into reasonable territory relative to rental prices. ... "Finally, the question must be asked: if the first 7 percent downleg in home prices could manage to trigger …

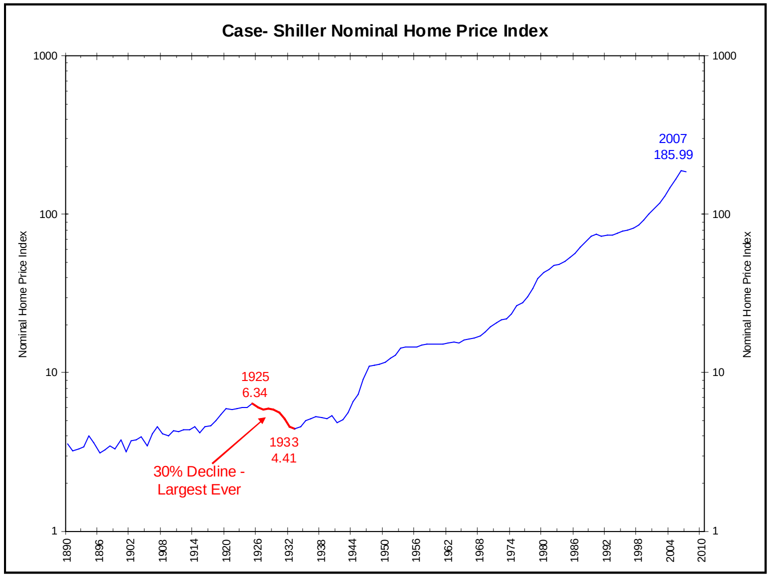
1. Almost $100 billion in write-downs in the banking sector;
2. A 65 percent year-over-year surge in foreclosures;
3. The highest residential real estate loan delinquency rate in 20 years; and,
4. A 20 percent plunge in S&P financials …

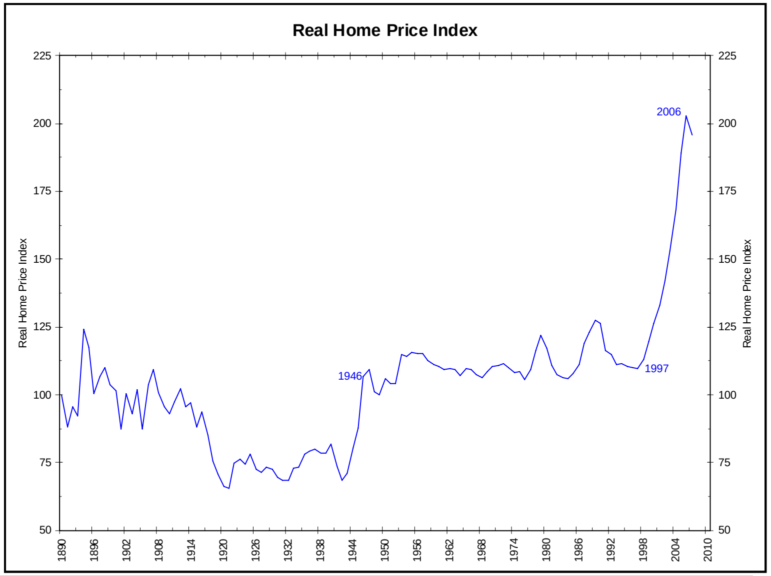
… **then what, pray tell, will the next 20-30 percent have in store?**

We have conducted a tremendous amount of research illustrating how markets respond to recessionary episodes and **concluded that no asset class or equity sector is even priced for a plain vanilla downturn.** There is a significant risk that the flavor may end up being more 'rocky road' than 'plain vanilla'. We say this because the combination of accelerating residential real estate deflation and a contraction in credit will trigger a secular rise in the savings rate at a time when a slackening labor market puts a firm lid on personal income growth."

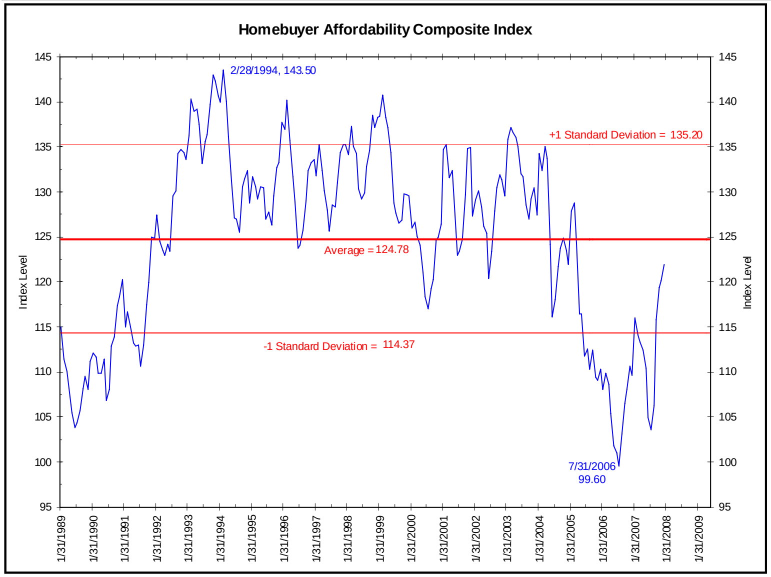
Robert Shiller notes that the worst housing decline occurred from 1925 to 1933 when home prices fell 30% on a nominal basis. However, Shiller points out that nominal home prices were only up 21% from 1921 to 1925. So the resulting bust took them to 20+ year lows. He argues that the multi-year low was more important than the magnitude of the drop.

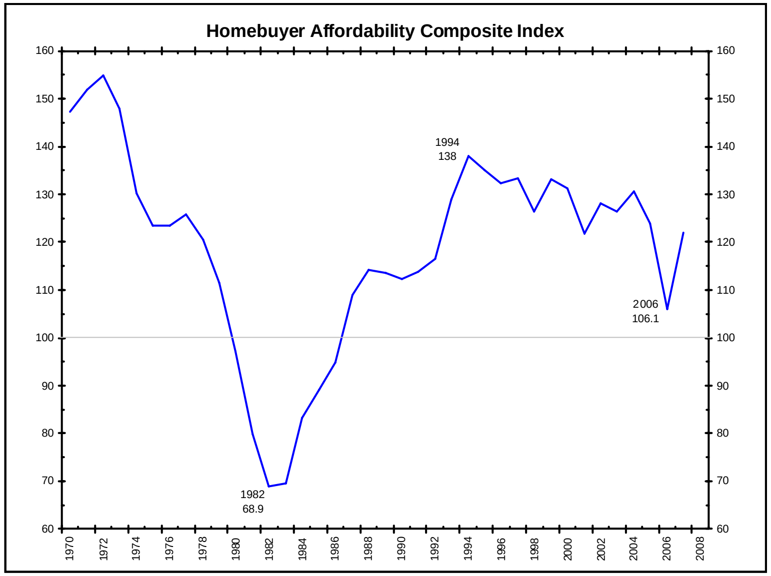
So when Shiller says that home prices could fall a similar amount, he carefully notes that home prices advanced far more from 2000 to 2006 than they did in the 1920s. So a similar decline would not result in a multi-decade low. The second chart shows home prices deflated by CPI (aka "real" home prices). The rally from 1997 to 2006 was not only unprecedented, but orders of magnitude larger than any other rally. This is why Shiller thinks home prices could fall nearly 30%.





The Problems With The Affordability Indices





***The Washington Post* - Don't Blame Subprimes**

Those Bad Loans Were Just a Response to Our Real Problem

The issue of affordability is not news to the major players in real estate. Each month, lenders, developers and government agencies study the National Association of Realtors' Housing Affordability Index. This index provides a way to track whether housing is becoming more or less affordable for typical households nationwide; it incorporates changes in key variables such as home prices, interest rates and incomes.

For the most part, the index is excellent for charting the strength of the market. But it has a few big flaws: First, it assumes that a borrower makes a 20 percent down payment and that the maximum mortgage payment is 25 percent of a household's gross monthly income. That used to be standard, but today many buyers can't meet this criteria. Second, it ignores patterns in the overall relationship between incomes and home prices and could therefore miss a growing bubble -- if interest rates are dropping, say, affordability could appear to be stable even if prices are rising and incomes are falling. Lenders, developers and the government could still miss trouble brewing under their noses.

Another problem is that this index is based on very broad averages. It tracks the whole country and the four major regions (the Northeast, South, Midwest and West). But the gap between the major markets and the national numbers has been widening rapidly, making the national figures all but worthless for millions of Americans. So even if the numbers look good nationally, and they do, housing affordability indexes for metropolitan areas confirm the impression of millions of home buyers -- that homes aren't affordable where the jobs are.

Comment – The author brings up some good points about these indices. The chart on page 10 measures income against home values, as the author suggests should be done, and it shows home prices are still too high.

Pushing On A String

How Much Has The Fed Helped?

Interest Rate	6/28/2007 FOMC Meeting	2/20/2008	Change
U.S. Government Rates			
Target Federal Funds Rate	**5.25%**	**3.00%**	**-2.25%**
3-Month Treasury Bill	4.76%	2.23%	-2.53%
2-Year Treasury Note	4.94%	2.02%	-2.92%
10-Year Treasury Note	5.10%	3.91%	-1.19%
Long-Term Corporate Rates			
Merrill Investment Grade Corporate Master	6.08%	5.75%	-0.33%
Merrill High Yield Master 2 Index	8.11%	10.44%	2.33%
Short-Term Corporate Rates			
Overnight Eurodollar Rates	5.40%	3.15%	-2.25%
3-Month Eurodollar Rates	5.36%	3.08%	-2.28%
30-Day Asset Backed Commercial Paper	5.33%	3.31%	-2.02%
30-Day Non-Financial Commercial Paper	5.26%	2.91%	-2.35%
30-Day Financial Commercial Paper	5.25%	3.05%	-2.20%
Mortgage Rates (National Average)			
1-Year Adjustable Rate Mortgages	5.50%	4.98%	-0.52%
30-Year Fixed Rate Conforming Mortgages	6.29%	5.83%	-0.46%
30-Year Fixed Rate Jumbo Mortgages	6.50%	6.77%	0.27%
Home Loans	7.69%	7.77%	0.08%

A Better Measure Of Home Price Valuation?

From Our Newsclips/Daily Commentary

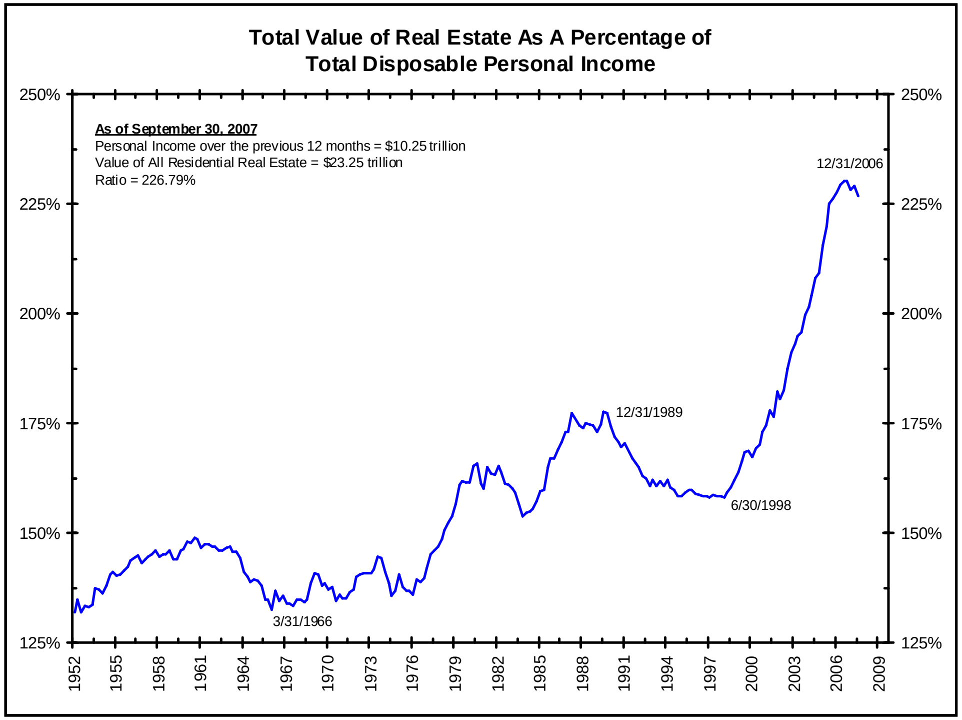
(continued from page 8)

We have argued that the "center of the financial universe" right now is residential real estate. As it falls, havoc reigns over the financial system. Yesterday on CNBC Richard Gaylord, the president of the National Association of Realtors, was interviewed (link provided in Feb 12 Newsclips). If you can believe it, he said now is a good time to buy real estate. Stunning stuff from a real estate broker.

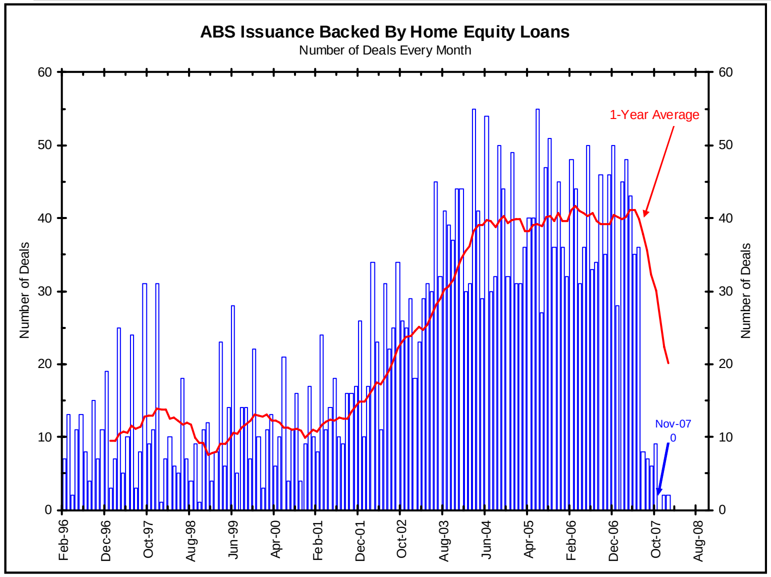
However, in the interview, he did say that it is a buyer's market because sellers are **now** cutting prices to move inventory. He then gave an anecdotal story of how he personally sold two homes last weekend after the sellers cut the price (do real estate have anything but anecdotal stories?).

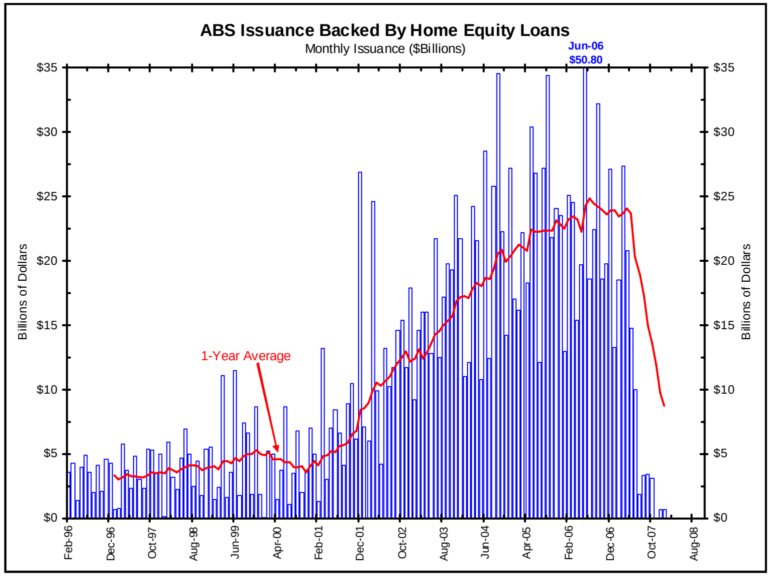
In other words, Gaylord just argued that home prices are going to sink lower. And with lower prices comes markdowns of CDOs, more losses at the monolines and even more pain in the financial sector.

This chart shows a measure of home price valuation - housing value versus income. It suggests that homes are still overvalued.



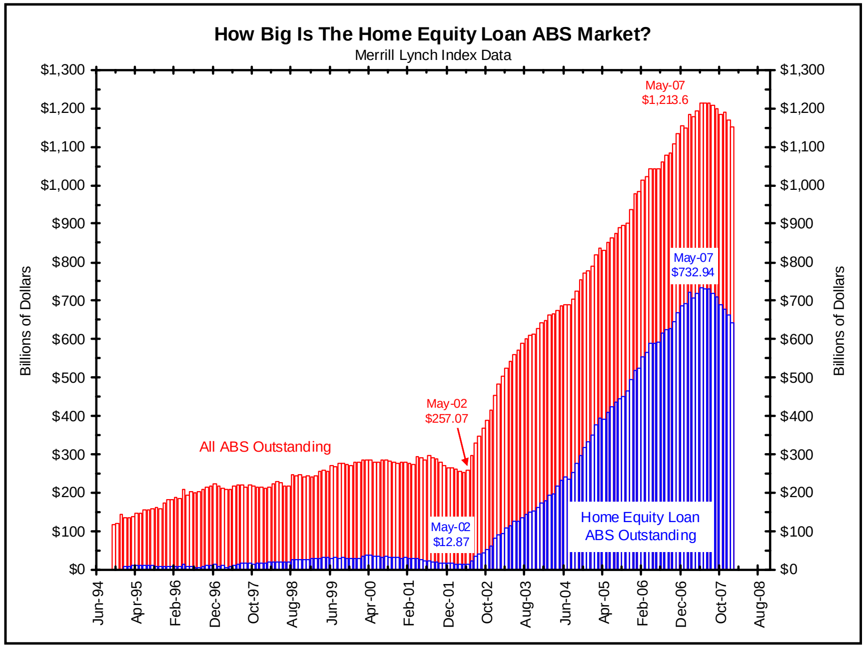
ABS Issuance Disappears





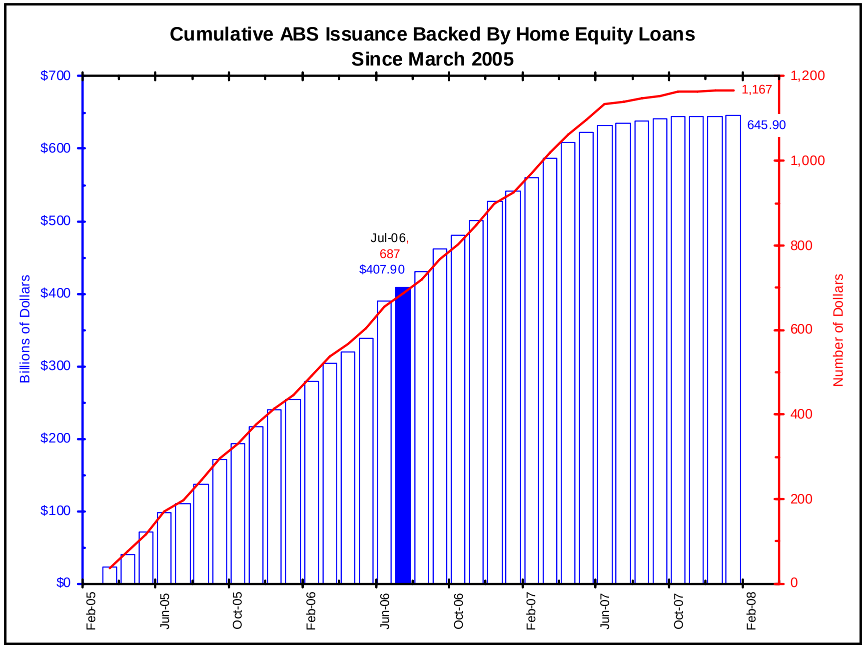
The top left chart shows the number of home loan asset-backed deals issued every month (blue bars) and its 1-year average (red line). After averaging about 40 deals a month between 2003 and 2007, it has collapsed to just three deals in the last three months. The bottom left chart shows the same measure.

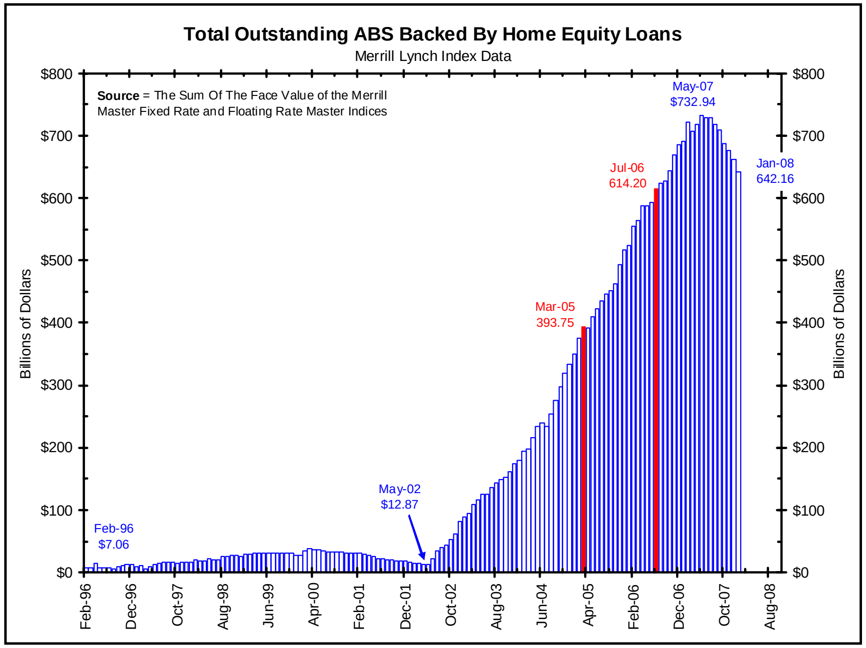
The chart below shows the size of the ABS market. Overall is in red and home loans is in blue. Thanks to no home loan deals being done, the entire asset-backed market is shrinking to a degree never seen before.



This can have devastating implications for the economy. Consumer finance is built on the "originate-to-distribute" (OTD) model. These charts show this model is broken. If ABS deals do not pick up, it will lead to even tighter credit standards and will be a bigger drag on the real economy. The OTD model is all we have now. For the economy's sake, it has to show signs of life real soon.

Deals Under Water?

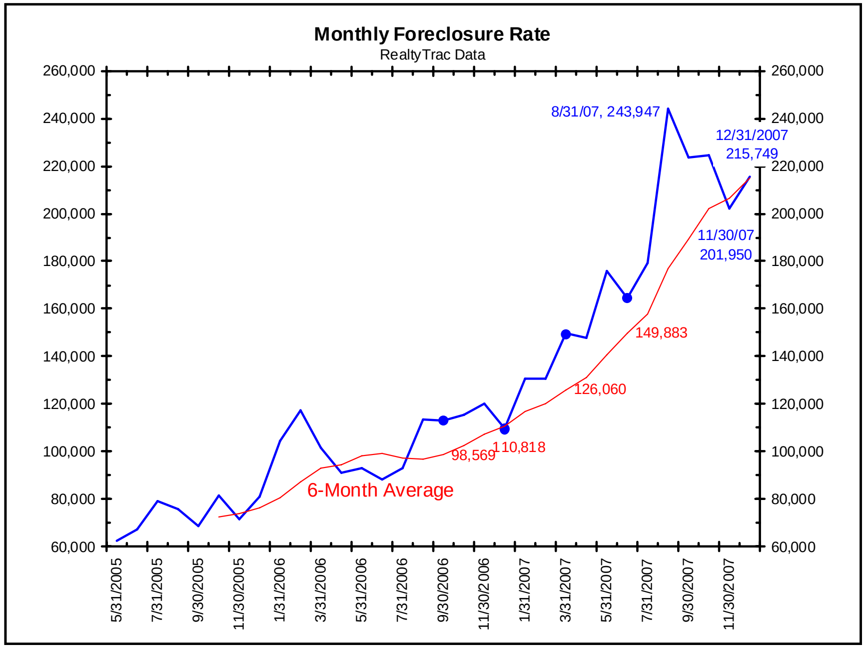




Will 2008's Buzz Word Be "Walkaway"?

***Housing Wire (Blog)* - Fitch Places $139 Billion of Subprime RMBS on Negative Watch, Cites 'Walk Aways'**
In Fitch's opinion the contraction in the mortgage markets has contributed to an acceleration and deepening of home price declines, and has eliminated the option to sell or refinance a home to avoid foreclosure for many borrowers. **Additionally, the apparent willingness of borrowers to 'walk away' from mortgage debt has contributed to extraordinarily high levels of early default, which is particularly noticeable in the 2007 vintage mortgages.**

Comment - Every day for the last few weeks we have noted that many in the housing industry are worried about the trend of "intentional foreclosures." In the story above Fitch shows its concern. But, this has also been featured in a segment on CBS's *60 Minutes*, in a letter by Countrywide, on (serious) websites that show you how to do it, by the head of *Moody's*, and on the quarterly investor conference call by Wachovia and Bank of America.
This is more than an interesting curiosity. Refusing to pay a mortgage when one has the ability to do it, because home prices are falling, is a real trend. We believe it is being fueled by the large body of borrower-friendly foreclosure laws set up over several decades. In other words, homeowners used to "beg borrow and steal" because they thought home prices only went up. So, greed drove them to do whatever was necessary to pay their mortgage in order to hold onto their home. Now that they have little-to-no equity and do not believe home prices are going to rise anytime soon, they are walking. The law is set up to allow them to do this in an easy and convenient way. Financial market participants must consider this trend and we believe they are not.



***CBS News* - 60 Minutes, January 27 Transcript**
STEPHANIE VALDEZ: Why pay a $3,200 payment on a 1200-square-foot home? It makes no sense.

STEVE KROFT: That's what you agreed to do when you bought the house.

STEPHANIE VALDEZ: Fine. If the value is going up. But we're not going anywhere. The price or the value is going down. It makes no sense because we will never be able to refinance and get a lower payment. There's no way.

STEVE KROFT: You're saying, essentially, that you're going to stop making payments on it? You're just gonna let it go into foreclosure?

STEPHANIE VALDEZ: You know, that's the only advice we've gotten so far is walk away from the home. We don't want to do that to our credit. Why can't our mortgage company work with us?

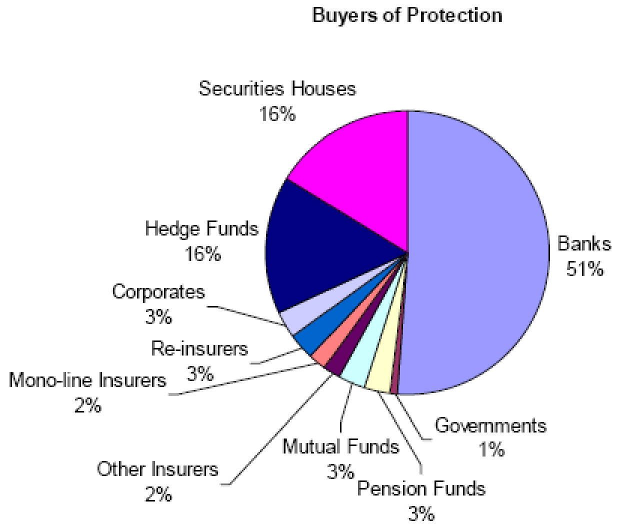
The Monoline Insurers

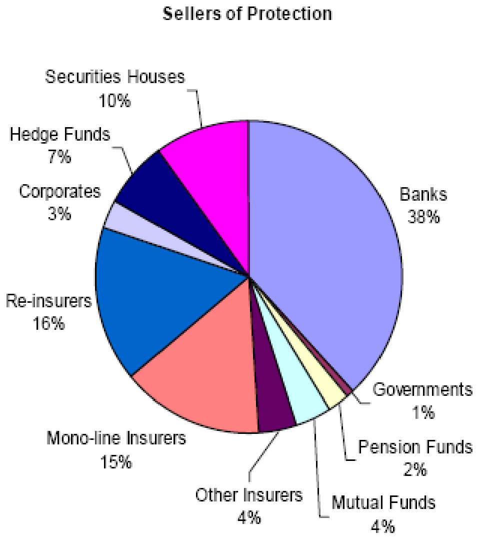
From Our Newsclips/Daily Commentary

•***Alea (Blog)*** - CDS : Who Is Suffering ?
Source BBA, sorry no link

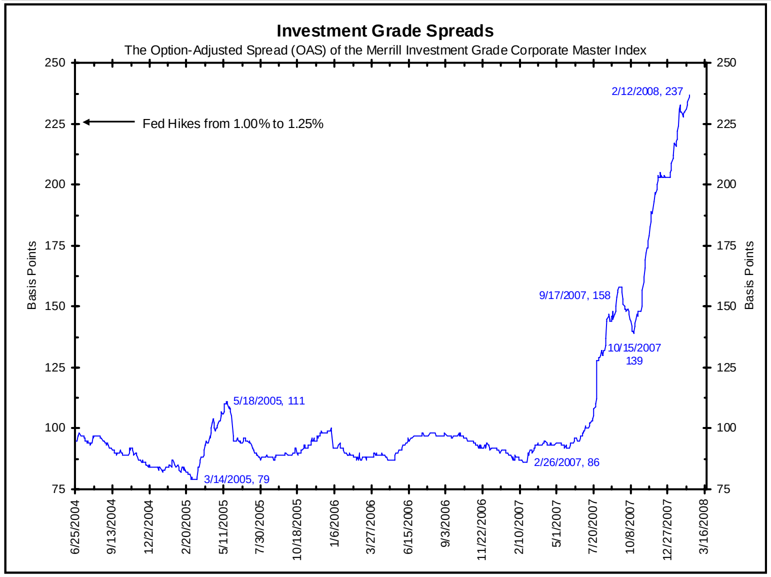
Comment - Looking at the pie charts to the right, which groups are the biggest net sellers of protection? After netting the 15% sellers and 2% buyers, it is the mono-line insurers at 13%. The closely related re-insurers coming in second (sellers of 16% and buyers of 3%). After these two groups only the "other" insurers at 2% (sellers of 4% and buyers of 2%) and mutual funds at 1% (sellers of 4% and buyers of 3%) are even net sellers of protection. Every other group is a net buyer of protection, including the commercial banks, securities houses and hedge funds.

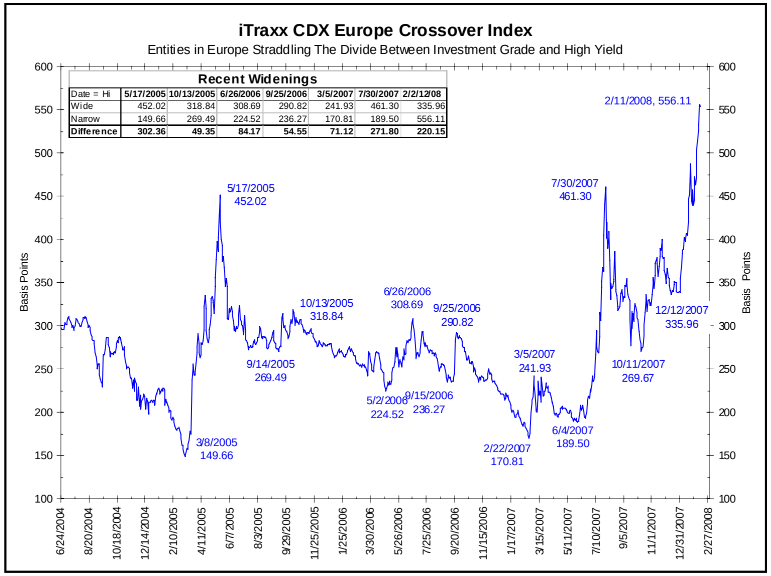
Wall Street worries that an insolvent monoline would pose a big counter-party risk. These charts suggest this worry is valid.





Credit Down And Stocks Up, A Re-Run Of August Coming?





Recent Widenings

Date = Hi	5/17/2005	10/13/2005	6/26/2006	9/25/2006	3/5/2007	7/30/2007	2/2/12/08
Wide	452.02	318.84	308.69	290.82	241.93	461.30	335.96
Narrow	149.66	269.49	224.52	236.27	170.81	189.50	556.11
Difference	**302.36**	**49.35**	**84.17**	**54.55**	**71.12**	**271.80**	**220.15**

From Our Newsclips/Daily Commentary

The hallmark of the current environment is the equity market **lags** the credit markets. However, it is the equity market that sets the tone for everything else. So, no matter how bad the credit market gets, as long as the equity markets are holding together, no problems are perceived.

Yesterday, because the equity market was sharply higher, the problems in the credit markets were perceived to be getting better. However, as the two charts below show, the credit markets are definitely **not** better. In fact, investment grade credit spreads made a new wide yesterday.

Last July we saw the same thing; the equity market was doing well but the credit markets were not. So as far as most people were concerned, there was no problem. In August when equities caught up to credit and turned sharply lower, it was called a crisis.

Again, for the last year, the credit markets have been leading the equity markets.

Buffett presented a monoline bailout plan that was good for him, not the financial markets. The basic problem for the credit markets still exists.

(next page)

Stocks And Credit Diverge In A Big Way!

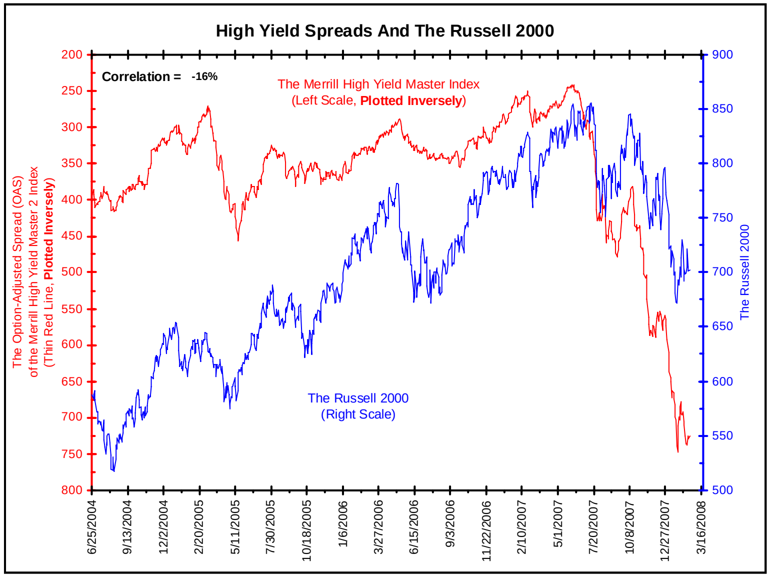
The correlation between stocks and credit spreads was nearly 90% prior to June 1st; that has fallen toward 50% since. As these charts show, the divergence appears to be increasing.

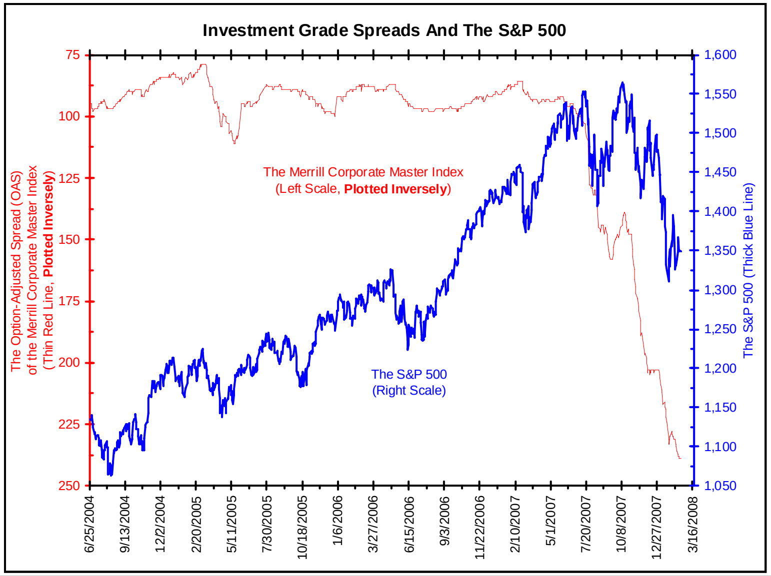
Stock and credit traders apparently have distinctly different views of the economy and the corporate outlook. Credit traders are much more bearish and their bearishness has intensified in recent days.

We do not have sufficient data to measure which one has the better track record. Corporate OAS started in 1997. That said, it is our impression that credit traders understand the problems in the credit markets much more than stock traders. To be blunt, we have met many equity managers who have a hard time even explaining the basics of the problem.

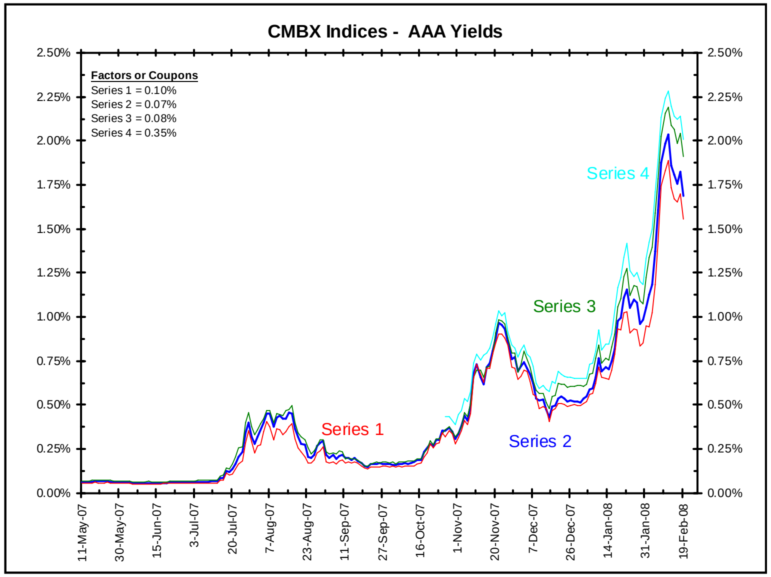
An intriguing alternative is stocks remained priced for control. Mergers, acquisitions and other corporate actions from whatever source – sovereign funds? – would be reflected in the price of ownership but not in the price of lending.

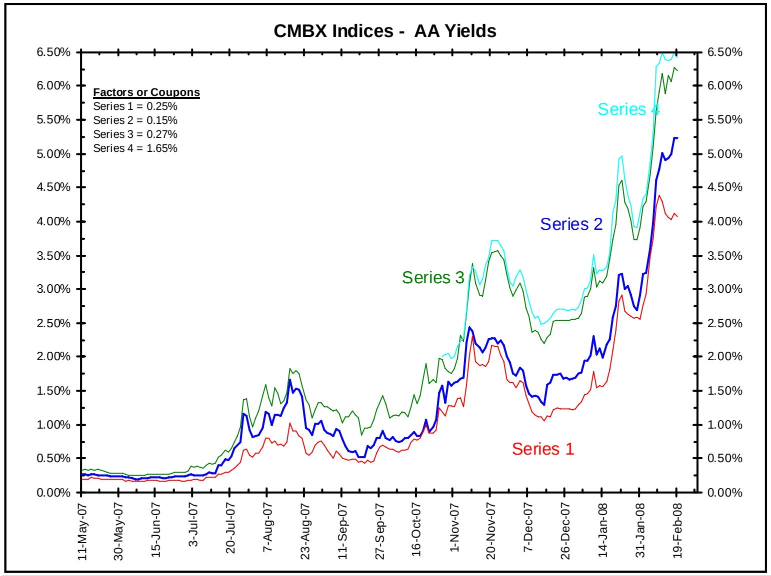
If this last possibility is incorrect, credit traders' bold bearish statement is a warning stock investors should heed.



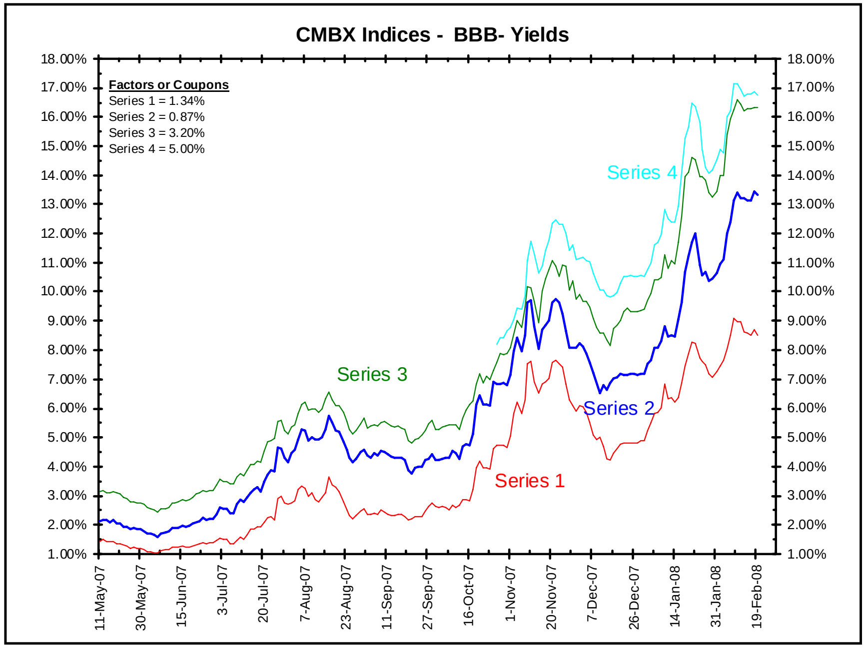


The Commercial Mortgage Market Becomes Worse

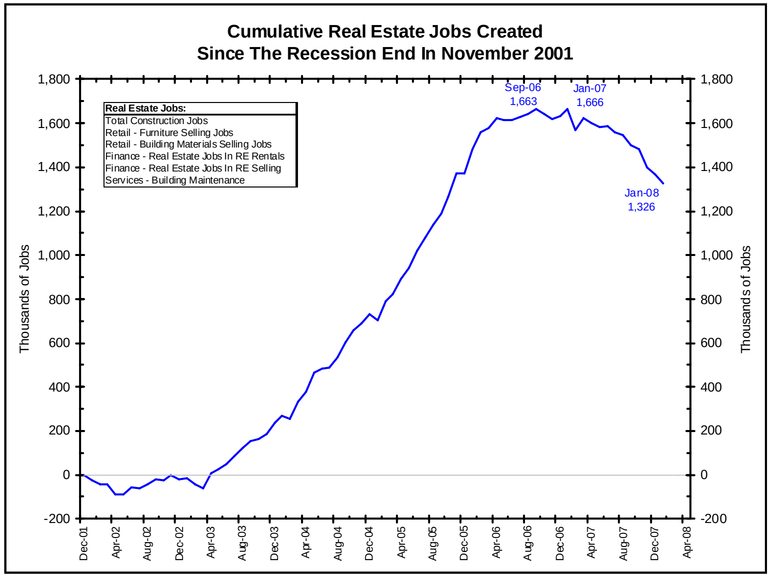




Just as the ABX market screamed problems were brewing in subprime, the CMBX market is saying the same for commercial mortgages. One difference – commercial mortgages are a larger market than residential subprime.



Housing Jobs – The Engine Of Growth That Now Drags

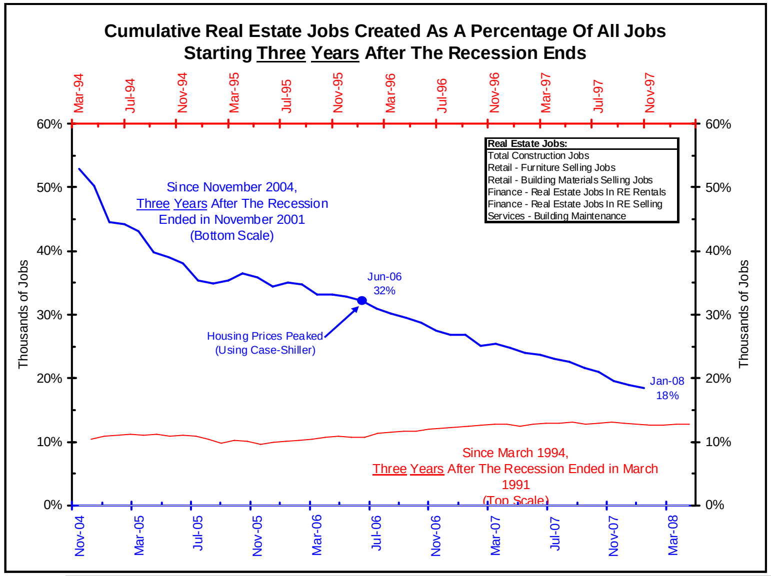


Cumulative Real Estate Jobs Created
Since The Recession End In November 2001

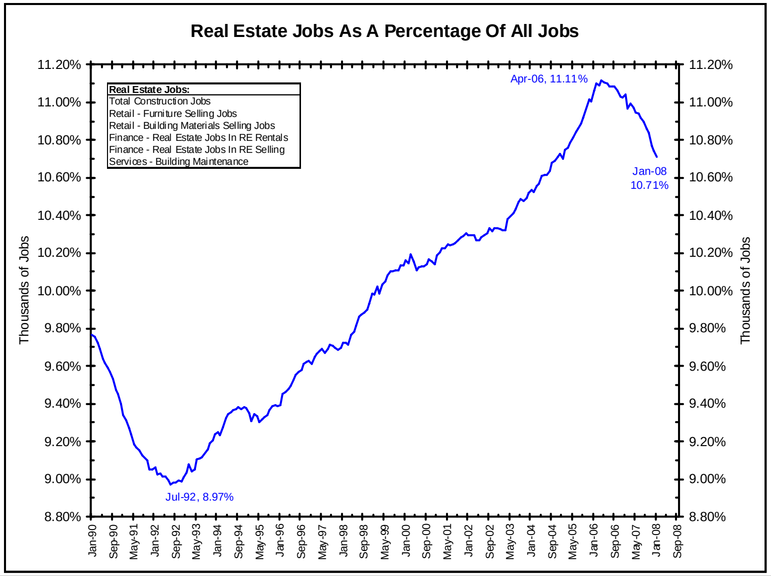
The chart to the upper left shows total growth of jobs related to housing. It starts at the end of the last recession, November 2001. Between November 2001 and September 2006, 1.66 million jobs were created thanks to housing. Since September 2006, about 300,000 of these jobs have been lost.

How does this compare? The lower left chart shows cumulative real estate jobs created as a percentage of all jobs. The blue line is the current recovery. The red line is the 1990 recovery.

The chart below shows real estate jobs as a percentage of all jobs. It has varied between 9% and 11% over the last 18 years. During the 1990s recovery, real estate jobs accounted for about 11% 13% of all jobs created (red line bottom left), about in line with their overall numbers. **However, this recovery has been dominated by real estate jobs** (blue line lower left chart). For the first five years of this recover, from November 2001 to real estate prices peaked in June 2006, these jobs accounted for 32% off all jobs created. Now that housing is slumping these jobs are being eliminated and dragging down overall employment growth to a degree never seen by this sector.



Cumulative Real Estate Jobs Created As A Percentage Of All Jobs
Starting Three Years After The Recession Ends

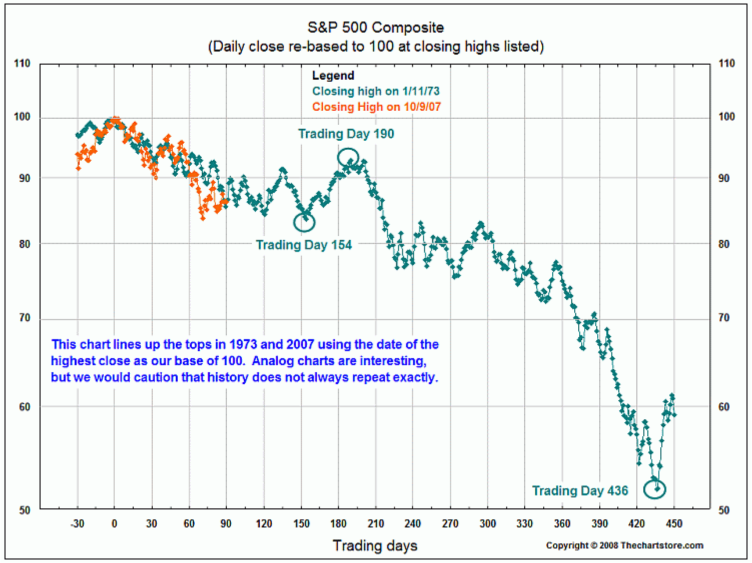


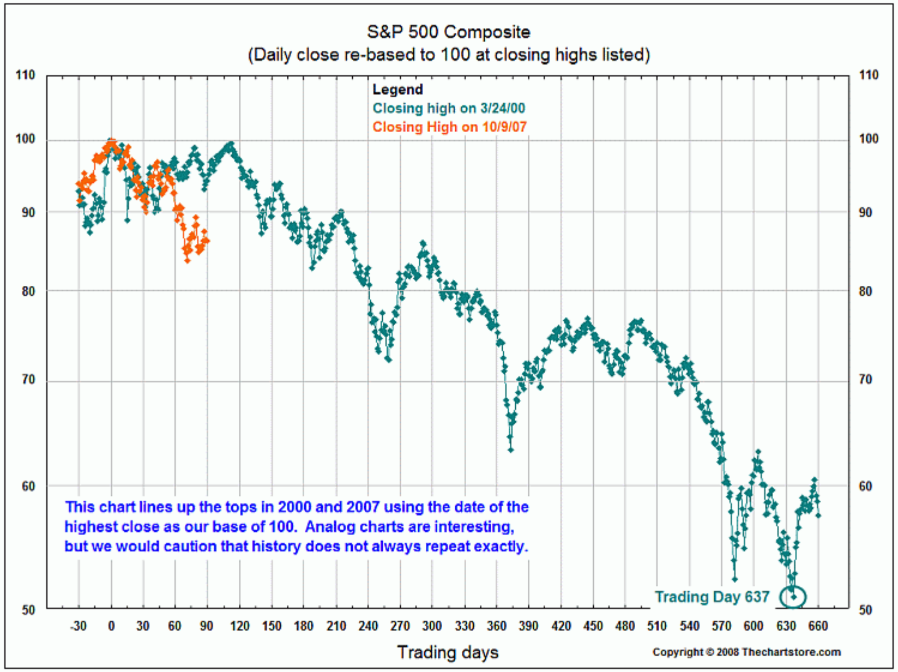
Real Estate Jobs As A Percentage Of All Jobs

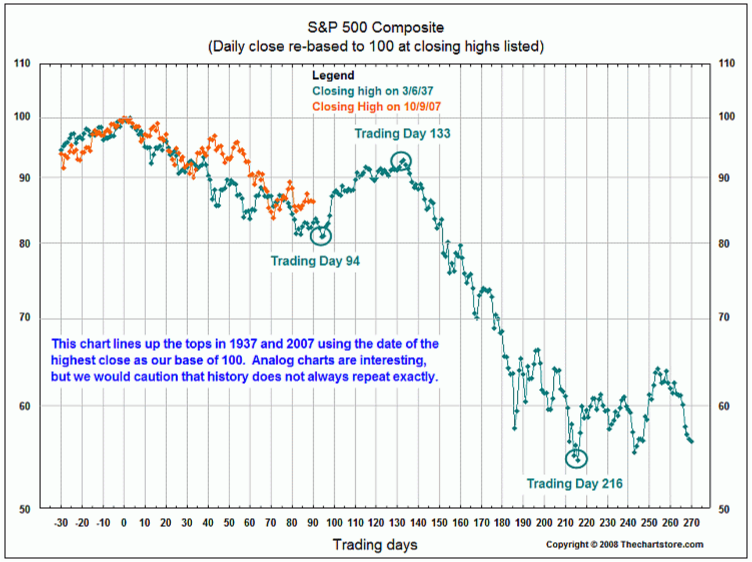
Comparing The Current Decline To Previous Bear Markets

Many think the stock market has been "destroyed" by the credit crisis. Therefore, current levels are depressed and represent a "great buying opportunity."

These charts compare the current decline (orange line on all charts, starting October 9, 2007) to the bear markets of 1973 (upper right), 1937 (lower right) and 2000 (below). They show that the current decline is fairly typical for a secular bear market and could have a lot more downside.





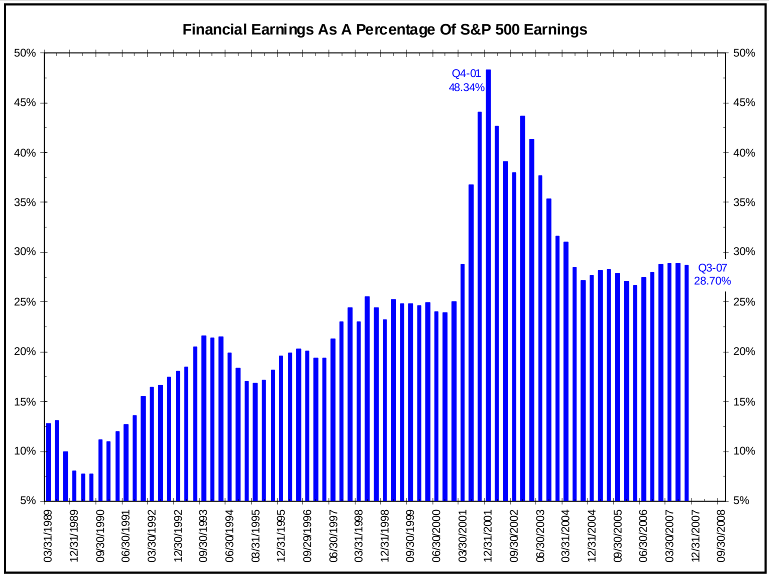


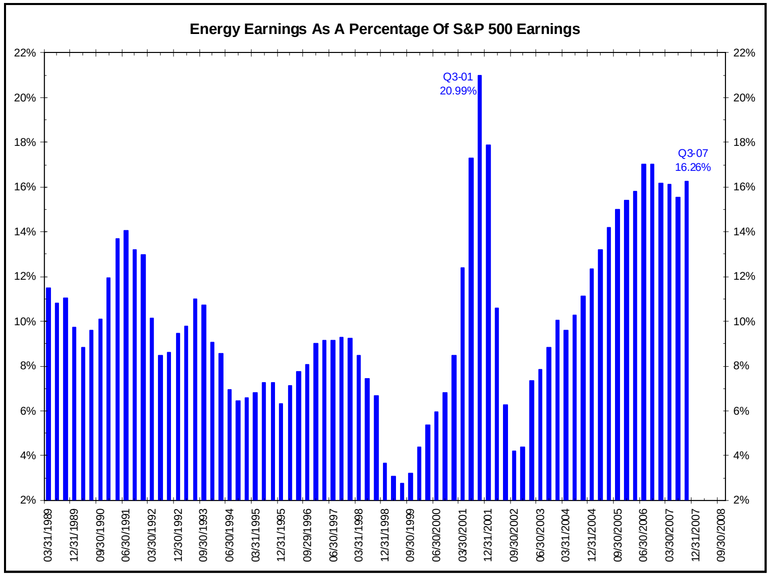
Source: The Chart Store

Breaking Down Earnings

The Associated Press - Financials Cause Slide in S&P 500 Profit
With roughly half the companies in the Standard & Poor's 500 having reported fourth-quarter results, banks and brokerage have proven to be the biggest drag on the overall earnings picture. Profit declined 22 percent from the year-ago period for all the S&P components -- but, **stripping out banks and brokerages, earnings for the index's component companies would be up almost 12 percent.** . . . Global banks and brokerages have written down almost $150 billion due to steep losses from investments tied to the subprime mortgages that went sour last year as interest rates rose and the housing market slumped. Many financial institutions have been forced to secure more capital to shore up their finances, and analysts believe more charges for bad investments are ahead. These losses have caused financial companies' fourth-quarter earnings to come in well below Wall Street expectations. Banks and brokerages made up about two-thirds of the companies that missed analyst projections during the quarter.

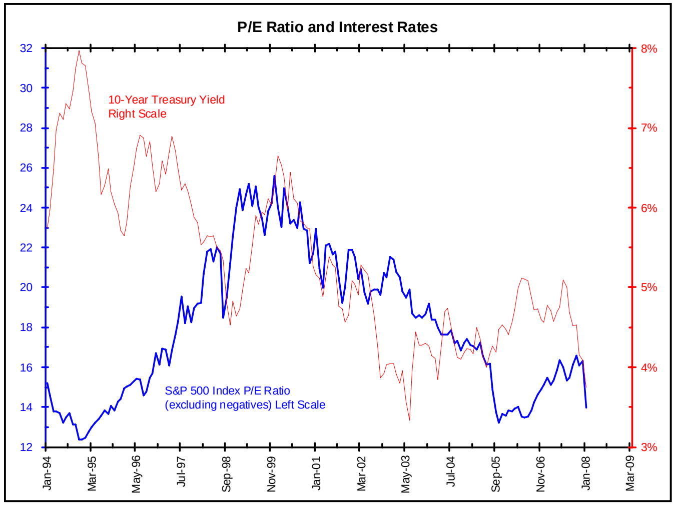
Comment - As the charts below show, the financial sector accounts for 28.70% of the S&P 500's earnings, while the energy sector accounts for 16.26%. By this measure, these are the two biggest sectors in the S&P 500. Combined, they account for almost 45% of all earnings. Unfortunately, as the *Wall Street Journal* table above points out, both of these sectors have the potential to drag down the overall earnings number in the near future.

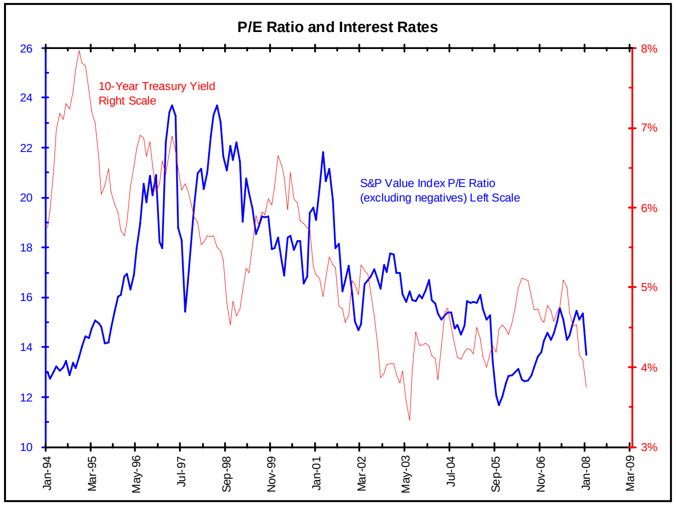


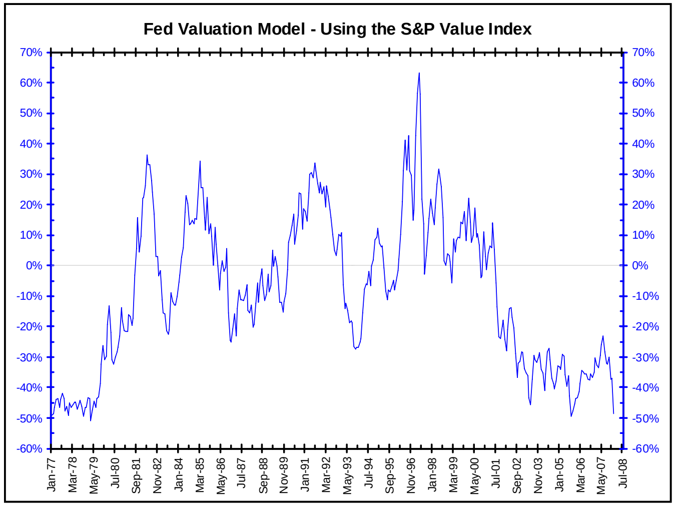


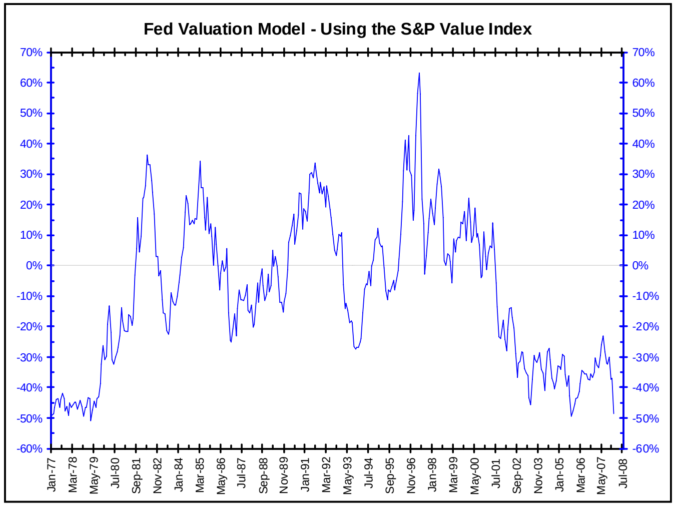
P/E Ratios, Low But Always Been This Way

Much is being made of lower p/e ratios (top charts) suggesting the stock market is cheap. That is the sound of one-hand clapping. These ratios must be compared to something. The logical choice is interest rates– the so called "Fed model." (bottom charts). This benchmark shows stocks are indeed cheap. But this has always been the case since 2002. Following this measure and one would have made the case stock were cheap at their October all-time high.





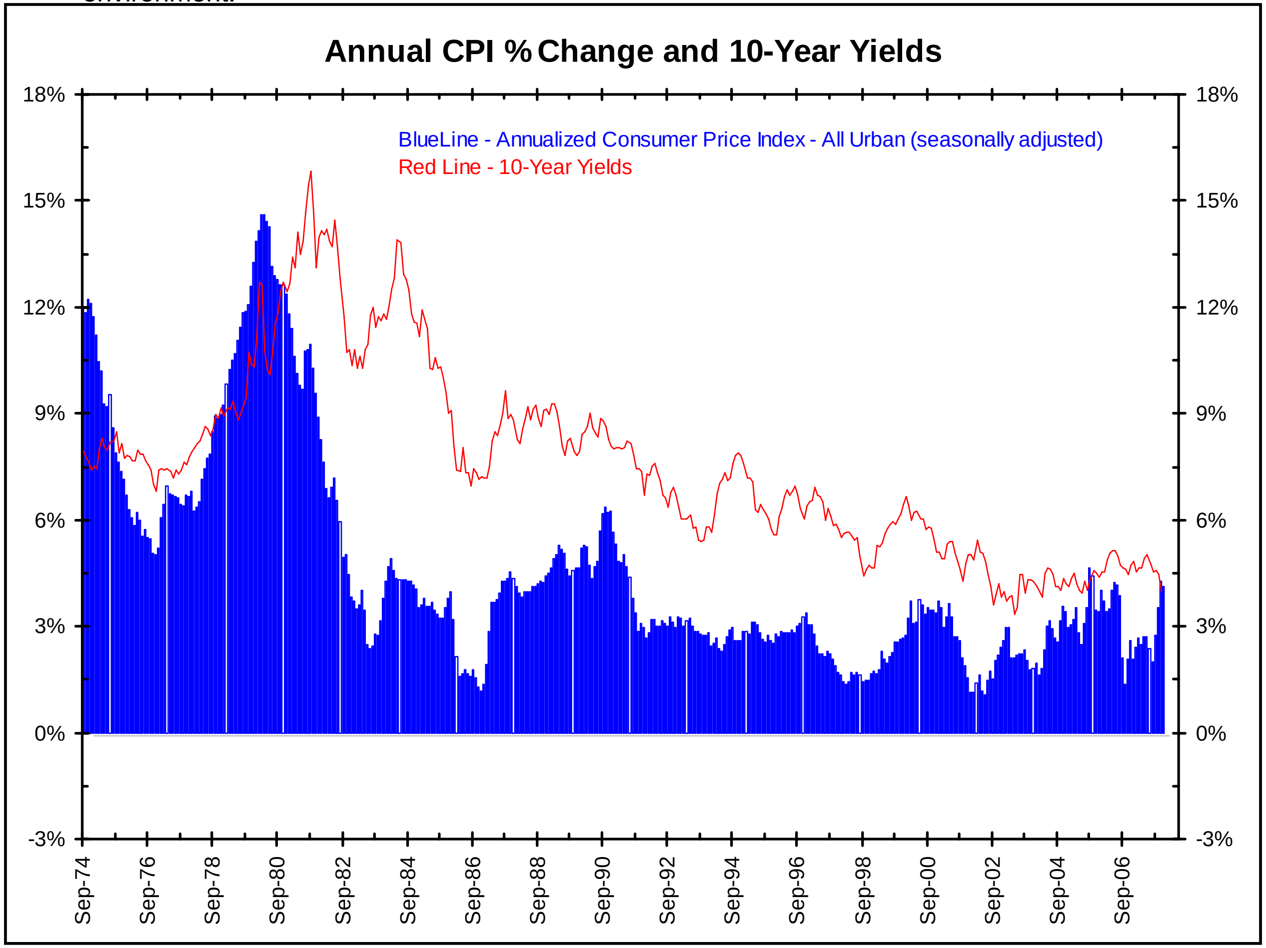




Negative 10-Year Yields

Currently the yield of the 10-year note (red line) is **less** than the year-over-year change in overall ("headline") inflation (blue bars). This is only the second time since 1980 this has occurred (the other occurred last year on a one-month gasoline-driven spike in CPI).

10-year notes have **no** inflation premium in their yield. So why are they trading at this level? We believe Treasury securities are considered "stock market crash insurance" in this environment.



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