2008 ANNUAL MARKET OUTLOOK

August 9, 2008

June, 2008. Consumer weak, No housing recovery

CHART

Consumer Retrenchment Underway

CASH AND SHORT TERM SECURITIES
%of Disp Inc
12
8
4
0
Increasing

HOME EQUITY PER HOUSEHOLD
Ann% Chg
10
5
0
-5
Shrinking

STOCKS AND MUTUTAL FUNDS
Ann% Chg
40
20
0
-20
Ditto

TOTAL CONTRIBUTION TO CONSUMER WEALTH*
%
3
2
1
0
-1
Now negative

PERSONAL SAVINGS RATE
%
4
2
0
-2
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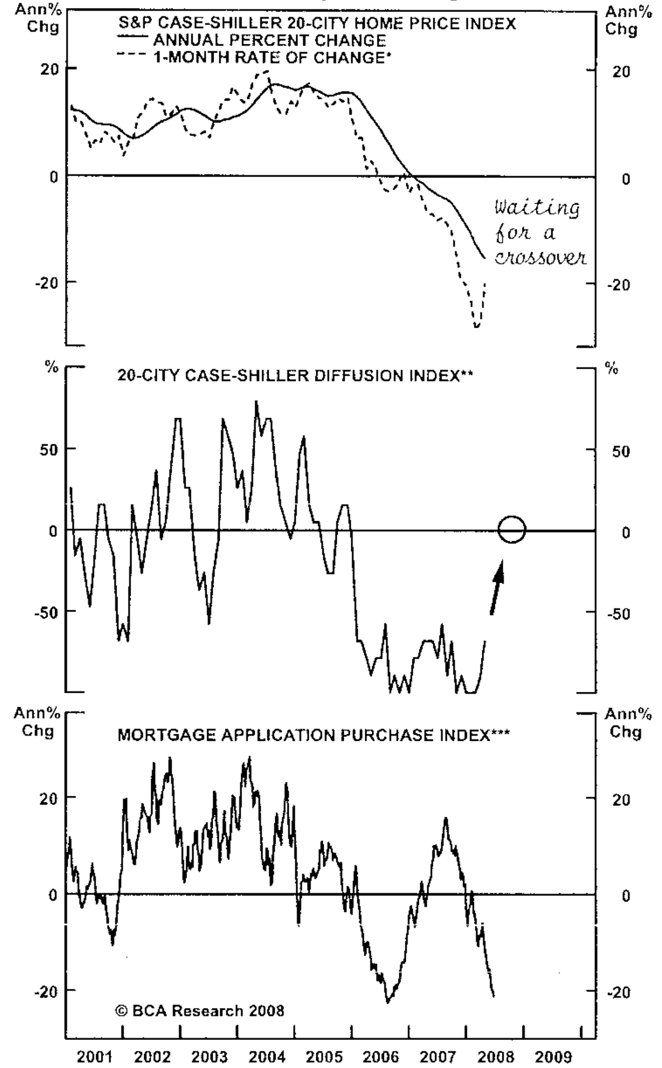
1999 2001 2003 2005 2007 2009

*TOTAL OF FINANCIAL MARKET AND HOUSING WEALTH, BASED ON:
4.5¢ PER DOLLAR OF FINANCIAL GAINS, AND
5¢ PER DOLLAR OF HOUSING GAINS ARE SPENT

No Sign Of Housing Recovery



*ANNUALIZED, SEASONALLY ADJUSTED
**DIFFUSION INDEX = NUMBER OF CITIES RISING MINUS FALLING
***4-WEEK MOVING AVERAGE, SOURCE: MORTGAGE BANKERS ASSOCIATION

but the pace of depreciation is still well below the 12 month rate of change (**Chart 10**). A crossover of these two time series combined with a rebound in the breadth of the index (panel 2) would signal a slowing in the pace of home price deterioration. Other signs of a possible inflection point include a pickup in mortgage purchase applications, a stabilization in inventories relative to sales, and a bottom in the ABX indexes. None of these show any improvement. New lows in the ABX indexes indicate that investor pessimism regarding subprime mortgage debt continues to deteriorate.

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8-1-08 WSJ

More Sectors Look Ripe For Job Losses

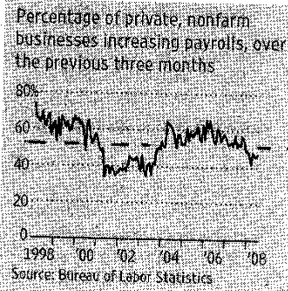
A HOT-AND-COLD job market might be getting colder.

The Bureau of Labor Statistics releases July unemployment and nonfarm payroll data Friday. Economists expect to see the jobless rate tick higher to 5.6% and payrolls shrink by 65,000 jobs, the seventh consecutive month of losses.

The job market clearly isn't booming. New unemployment claims have surged to recessionary levels, and 3.28 million people have been drawing claims for a week or more, the most since 2003. Consumer angst about the labor market is at its highest in four years, according to the latest Conference Board survey.

What isn't so clear is how much pain will reach beyond the sectors most brutalized during this downturn: manufacturing, construction and retail. That threesome has shed 658,200 jobs so far this year. All other private sectors combined have added 94,200 jobs. It is an echo of the bifurcation in corporate profits, where sectors outside of financials, housing and retail have held up OK.

But profit weakness has slowly started to spread. Job losses might follow. Businesses have been shedding temporary workers all year, always an omen of further layoffs. The financial sector has lost just 36,000 jobs this year, a number that seems likely to rise. Just 41.6% of private, nonfarm companies added new jobs in the three months ending in June, the lowest since August 2003.



Until these trends reverse, wage growth and consumer spending will be anemic, and the Federal Reserve will have little reason to raise interest rates.

Aug. 2008. Continuing weakness In jobs outlook.

Banks Sharply Reduce Business Loans

From Page A1

double-digit rates compared with three months earlier, according to an analysis of Federal Reserve data by Goldman Sachs. By mid-June, bank credit was declining at an annualized pace of more than 6 percent.

That is a drop of nearly $150 billion, an amount much larger than the value of the tax rebates the government has sent to households this year in an effort to spur economic activity.

Financial industry executives say tighter credit from major banks represents a swing back to a realistic assessment of risk, after years of handing out money with abandon. Those practices produced a mortgage crisis whose losses could reach $1 trillion, by many estimates.

"Before, they wouldn't verify income and they were loose on the valuations of collateral," said John W. Kiefer, chief executive of First Capital, a private commercial lender. "Now they're tightening down on the ability to repay. They go off the reservation, and now they come back to basics. It's preservation for many of them at this point. It's survival."

But if the newfound caution of American banks is prudent in the long run, the immediate impact is amplifying the troubles with the economy. The Federal Reserve has been lowering interest rates aggressively to make money flow more loosely and to spur economic activity.

The financial system is not going along: As banks hold on to their dollars, mortgage rates are climbing. So are borrowing costs for corporations.

Some suggest that the banks, spooked by enormous losses, have replaced a disastrously indiscriminate willingness to hand out money with an equally arbitrary aversion to lend — even on industries that continue to grow.

"There's been a lot of disruption in the credit market, and a lot of traditional lenders have really tightened up," said Gregory Goldstein, president of Macquarie Equipment Finance, which leases computer gear and other technology to companies. "Before, some of the standards they lent on were weak, but we think they have overshot and gone too far on the other end."

Such was Mr. Greenblatt's reaction, as he learned that an infusion of credit for his Baltimore factory would not come easily. His company has been enjoying double-digit sales growth. This month, it received the two largest orders in its history, he said.

"It was jubilation," he said. "I was doing the Funky Chicken."

The initial call to Wachovia left him dismayed.

"I'm stunned," Mr. Greenblatt said. "God is smiling on this factory. We're at such an exciting inflection point, and this is what a bank is supposed to do. There's sand in the gears."

No loan meant one fewer order for the factory in Chicago that makes the robot Mr. Greenblatt wants to buy, and fewer hours for workers there. It meant less business for the truck driver who would have hauled the robot to Baltimore, and no help-wanted ads for Marlin Steel Wire Products.

A scarcity of credit intensifies strains on an economy that is already shedding jobs.

Mr. Greenblatt eventually got oral approval for the loan, though after more than a week. He was still waiting for the money at the end of last week.

Wachovia, which lost $8.9 billion in the second quarter, declined to discuss the loan. But the bank confirmed that it has been reducing its lending in troubled areas of the economy.

"We've got industries that we consider to be stressed industries, and we're looking at those a lot harder," said Carlos Evans, a wholesale banking executive for Wachovia, listing as examples housing construction, building products and distributors for those goods. "Our loan growth slowing is more indicative of the economy than anything else."

Still, Wachovia's commercial and industrial loans grew by 13 percent in June compared with the prior year, Mr. Evans said.

"We're saying yes daily," he said.

But recent signs suggest that tight lending is spilling from housing into other areas of the business world. Companies with solid credit and profitable businesses can generally still get loans, but rates are higher and wait times are longer.

According to a survey of senior loan officers conducted by the Federal Reserve in April, 55 percent of American banks tightened lending requirements for commercial and industrial loans to large and midsize companies — up from about 30 percent in the previous survey, in January. About 70 percent of the respondents said they have made such loans more expensive.

"Banks will be much more cautious and keep raising the bar, and that will lead to an outright decline in total commercial and industrial loans," predicted Stuart G. Hoffman, chief economist at the PNC Financial Services Group in Pittsburgh. "Banks clearly have to rebuild their capital base. They're going to look a bit more nervously before they make those loans."

Until last summer, banks lent freely, banking experts say, because they sold most of the loans they issued, making them less concerned about whether the customer could handle the payments: If the loan went bad, that was someone else's problem.

But in the wake of the mortgage crisis, that system has all but shut down. Banks are now stuck with the loans they extend, making them more motivated to scrutinize their customers, particularly younger and smaller businesses.

"It's the small business guy who creates most of the jobs," said Mr. Kiefer, the First Capital chief executive. "If they can't borrow to employ people, then we've got a mess on our hands."

For the last six months, Saul Epstein has been trying in vain to get a $2 million line of credit for his company, Global Harness Systems. The company, based in Bala Cynwyd, Pa., has a factory in Mexico, where it makes parts for engines. The factory gets paid for its wares weeks after they have shipped, necessitating credit to finance the upfront costs of production — raw materials, labor, and transportation.

Mr. Epstein figured that getting a loan would be easy. Since he became chief executive last year, Global Harness has gone from break-even to profitable.

Bank denial of credit Is greater than total of Rebate checks!

8-4-08

WSJ

AHEAD OF THE TAPE

Fed's Cuts Seem Toothless As Rates Resist

IN THE FIGHT against the credit crunch, the Federal Reserve's interest-rate-cutting weapon seems to be clicking on an empty chamber.

Fed policy makers will gather in Washington Tuesday to discuss the economy and their target for the federal-funds rate, their main tool for managing growth and inflation.

By Mark Gongloff

The Fed has cut its rate target 3.25 percentage points since last September, trying to help the economy stagger through the housing crunch. Without those cuts, the economy might be in far worse shape than it is now.

Yet it's troubling that the cuts have done little to make credit any easier than it was a year ago.

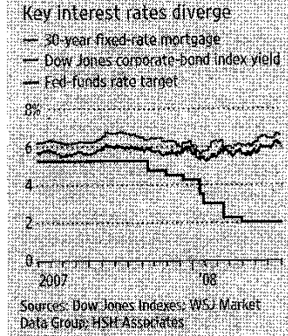
A fixed, 30-year mortgage went for 6.6% last week, according to HSH Associates, compared with 6.4% the day the Fed started cutting rates. Mortgage lenders are demanding tougher terms. U.S. auto makers are cutting back or eliminating auto leases.

Corporate borrowing costs are higher, too. The average yield of the high-rated bonds that make up the Dow Jones Corporate Bond Index has risen to 6.1% from 5.9%. Rates for riskier corporate borrowers have risen even further.

It is rare for such a wide array of rates to resist the Fed's ministrations for so long.

"In over two decades of experience on the Street, let's just say I have never seen this condition before, and [Ben] Bernanke has only read about it," Merrill Lynch's bearish chief North American economist, David Rosenberg, wrote in a note to clients.

This discussion needs a dollop of caveats: Inflation worries could be pushing market



Sources: Dow Jones Indexes; WSJ Market Data Group; HSH Associates

rates higher, meaning Fed rate cuts could be having the opposite of their intended effect. Market interest rates don't always march to the Fed's tune—they often dictate it, rising and falling in response to economic tremors long before the Fed gets around to moving its own rate target.

The biggest reason for the divergence between Fed funds and nearly every other interest rate is the credit crunch.

Banks have lost roughly $480 billion in the past year, but have raised only about $345 billion in new capital, estimates James Bianco, president of Bianco Research. Assuming they weren't overcapitalized before, that leaves them about $135 billion undercapitalized.

With leverage, that capital translates into roughly $1.9 trillion in lending capacity now off the market, he estimates.

Another way of putting it: The price for credit has shot higher largely because its supply has suddenly become constrained. That's not good news for the economy. It does mean the Fed likely won't tighten credit soon, despite what interest-rate futures markets expect or Fed hawks desire.

Given their inflation jitters, the Fed likely won't cut rates again soon, either. Under the circumstances, it probably wouldn't do much good anyway.

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WSJ Aug '08

Businesses Feel Pinch of Tougher Lending Standards

Terms Are Tightening As Market Is Roiled; Are Individuals Next?

By Justin Lahart

With the credit crunch on Wall Street entering its second year, a widening array of businesses are finding it tough to get credit. And with mortgage giants **Fannie Mae** and **Freddie Mac** roiling credit markets, individuals could soon find it harder to get a loan as well.

One company feeling the strain is Chrysler Financial, the financing arm of the Big Three auto maker that was carved out of the former DaimlerChrysler AG last year. The **Chrysler** LLC unit has $30 billion of short-term debt due to mature in early August. And bankers, led by **J.P. Morgan Chase** & Co., are pushing hard to get that debt renewed.

While a deal is likely to get done, people involved in the transaction say the terms could be onerous for Chrysler Financial, pushing up borrowing costs for consumers and auto dealers that depend on it for loans. (Please see article on page C1.)

Banks also are pulling back on the amount of rainy-day money they have been giving out to corporate clients in the form of loans called revolving-credit facilities. Retailers such as **Sears Holdings** Corp. and **Talbots** Inc. have struggled to renew revolving-credit facilities with their bankers in recent months. Other companies, including **Wal-Mart Stores** Inc., **AT&T** Inc. and **American International Group** Inc., have had to agree to tougher terms on such credit.

Overall, the value of credit held by banks in the second quarter shrank 1.5% from the first quarter, according to Federal Reserve data. That was the largest three-month contraction since 1948.

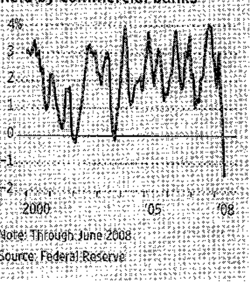
These tight credit conditions are particularly worrisome because the Federal Reserve has responded aggressively since the credit crunch emerged last July. The central bank has cut interest rates seven times by a total of 3.25 percentage points.

Despite those moves, "it's hard to make the case that financial conditions are especially stimulative right now," says UBS economist James O'Sullivan.

Credit-market woes have hammered the housing market and financial companies, but until recently they didn't appear to be hurting the rest of the economy so much. The latest data suggest that might be changing.

Credit is the lifeblood of economic activity. If it continues to be hard to get, despite the Fed's efforts to keep it flowing, that could spell trouble for an economy teetering on the edge of recession.

Investors had started to believe the Fed might be forced to raise interest rates later this year to fight inflation. But with credit tight, that looks less likely now.



The Fed's overnight target rate, at just 2%, is well below the rate of inflation. But that easy-money stance isn't translating into lower borrowing costs for companies and households. Many borrowers haven't seen a drop in the rates they get charged, despite the Fed rate cuts, which began last fall. Chrysler Financial, for instance, is likely to pay more to roll over its $30 billion debt than it did a year ago, when the credit turmoil seemed less severe.

The bear market in stocks also means that companies can't easily tap the equity market for cash.

Much of the decline in outstanding credit has been due to banks sharply reducing the amount of bonds and other debt securities held on their books, but the slowdown is apparent across all forms of lending. The heavy losses banks have taken on mortgage-related securities are forcing them raise cash levels, leading to tighter lending. Because they can't know what other problems might be lurking on their balance sheets, they are being especially cautious.

Payroll-services company **Paychex** Inc. has been seeing fewer new businesses starting up, which it attributes to the tighter credit climate. On a recent call with investors, Chief Financial Officer John Morphy said that Paychex itself felt the effects of banks' reluctance to lend when it went to open a line of credit.

"We're working with our No. 1 provider lead bank for the last 20 years. You can't believe what we've had to go through to get this," Mr. Morphy said. "And we're in great shape. They want dividend restrictions; they want all kinds of stuff. Now, in the end, we're going to get what we want, but it was a battle."

Fruit-and-vegetable processor **Del Monte Foods** Co. bought back $50 million of its stock in the second half of last year at an average price of $9.31 a share. At $7.76 a share, the stock is cheaper now, but rather than buy back more of it, the company says it is shoring up its cash holdings instead in order to reassure bond investors of its credit-worthiness.

"The credit market today is very uncertain, to say the least, and the last thing we want to do is in any way affect our credit rating," Del Monte Chief Financial Officer Dave Meyers told investors earlier this month. If Del Monte's credit rating was dropped a single notch, he suggested, the company's borrowing costs could rise by millions.

In a survey of chief financial officers at 468 U.S. companies last month, John Graham, a finance professor at Duke University's Fuqua School of Business, found that companies with low credit ratings, in particular, were seeing significantly higher credit costs and were having a hard time obtaining or renewing bank credit lines. Many companies said they were cutting back or delaying new investment plans, paring hiring plans and initiating cost-cutting programs as a result of tough credit conditions.

> ***Banks are pulling back on rainy-day money given to corporate clients.***

"When credit gets tight, money becomes more precious than ever," says Mr. Graham. "If you have it, you're not going to spend it, and if you can't get it, it affects your operations."

That applies to individuals, too. Ron Phipps, who runs Phipps Realty in Warwick, R.I., says banks are making even the most credit-worthy borrowers jump through hoops, asking for reams of documentation before granting a mortgage.

"The approach now is so hyper-risk-sensitive and labor intensive, it's very emotionally taxing," he says. "Somewhere along the way common sense has been replaced by the check-off menu."

David Stevens, who runs the mortgage operation at Long & Foster Real Estate in Fairfax, Va., worked at Freddie Mac from 1999 to 2005. He says that during his time there, the mortgage lender was never as stringent about the quality of mortgages it would accept as it is now.

With banks and other lenders cutting back, Fannie and Freddie have been "the only game in town as far as credit creation is concerned," said Goldman Sachs economist Jan Hatzius. If the mortgage giants, in an effort to raise their cash holdings, curtailed activity in the same way they did in earlier this decade in response too accounting problems, credit conditions could get oppressively tight, Mr. Hatzius says.

It's the sort of environment where, even with inflation heating up, it's hard to imagine the Fed raising rates, says Duke's Mr. Graham. "We don't need any more shoes dropping right now," he said.

—Liz Rappaport contributed to this article.

Wal-Mart & other blue chips paying up for credit

Europe Recession Fears Intensify

By Emma Charlton And Joel Sherwood

LONDON—European recession fears grew Tuesday as Denmark became the first European Union country to slip into a technical recession and a raft of weak data indicated others could soon follow.

The Purchasing Managers Index for the euro zone's manufacturing sector contracted in June for the first time in three years, dropping to 49.2 from 50.6 in May, research group Markit Economics said. A PMI reading above 50 signals an expansion in manufacturing, while a level below 50 indicates a contraction.

Europe's economies are currently facing a toxic combination of elevated inflationary pressures, higher oil prices, strong exchange rates, weakening global growth and tight credit conditions. Denmark, Spain, the United Kingdom and Ireland also face falling housing prices after a recent boom, trailing a trend set in the U.S. after a two-year lag.

Such concerns aren't expected to deter the European Central Bank from raising interest rates Thursday. The central bank for the 15 countries sharing the euro has signaled it plans to raise its key rate to 4.25% from 4%. The plan appeared to be cemented by news that euro-zone inflation soared to 4% in June—twice the ECB's targeted inflation ceiling.

European stocks fell sharply as traders worried about the region's growth outlook. Economists believe Italy, Spain, Portugal and Ireland to be at most risk of following Denmark into recession. The U.K. and France face, at best, near stagnation.

There is "mounting evidence that the euro zone is heading for a major economic slowdown... with a no-longer negligible risk of a recession," said Holger Schmieding, an economist at Bank of America.

Europe's job market also is showing signs of erosion. Euro-zone unemployment increased for the second straight month in May, rising by approximately 67,000 after an increase of 52,000 in April, Eurostat data showed Tuesday.

The U.K. and France face, at best, near stagnation.

Activity levels in three of the currency bloc's four largest economies wilted, with only Germany showing expansion over the month.

"France is clearly heading in the same direction as Spain and Italy, which are both contracting at alarming rates," said Jacques Cailloux, an economist at Royal Bank of Scotland.

Outside the euro zone, U.K. purchasing managers stunned financial markets, undermining the pound's latest run at the $2 marker.

The U.K. manufacturing PMI measure plummeted to 45.8 in June from 49.5 in May, showing an accelerated deterioration in business conditions.

"The news just goes on getting worse for the U.K. economy," said Michael Saunders, an economist at Citigroup. "Today has brought another sharp fall in house prices plus signs that—even with the stimulus from the low pound—manufacturing activity is heading into recession."

The Nationwide Building Society reported its closely watched house-price index fell for the eighth straight month. Prices in June were 6.3% lower than a year earlier—the biggest annual decline since 1992.

A housing slump also contributed to Denmark's slide into two consecutive quarters of contraction from the previous quarter, a widely accepted definition of a technical recession.

Danish first-quarter gross domestic product fell a seasonally adjusted 0.6% on a quarterly basis after the economy in the fourth quarter contracted 0.2%, data from Denmark's national statistics agency showed.

The Irish and Portuguese economies both contracted in the first quarter and are threatened with another in the second quarter. Italy narrowly averted a second consecutive GDP contraction in the first quarter, but faces another test in the second quarter. Spain, while still in positive territory, also is seen at risk as business activity plummets.

The PMI surveys showed Italian manufacturing activity in June recorded a sharper than expected drop to 46.9 from 48.0, the lowest level since December 2001 and below market forecasts of 47.5.

In Spain, manufacturing activity as graded by purchasing managers sank to its lowest level since records began in 1998, falling to 40.6 in June from 43.8 a month earlier.

Once the "hope" of American exporters, the European Economy is sliding towards recession.

Exports, Stimulus Plan Prop Up Economy

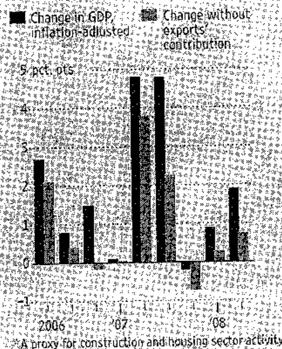
GDP Rose 1.9% In Second Quarter, But Job Woes Loom

WSJ 8-1-08

BY KELLY EVANS, ANTON TROIANOVSKI AND SUDEEP REDDY

Trading Up

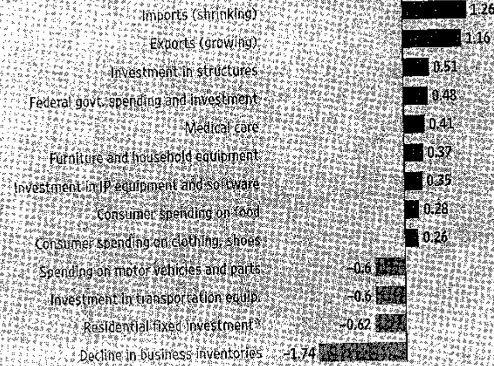
Exports have boosted the U.S. economy through a weak period



*A proxy for construction and housing sector activity

Additions and subtractions

Major contributors to the change in second quarter GDP, contribution in percentage points



Source: U.S. Commerce Department

The U.S. economy grew at a modest pace in the second quarter, due to strong exports and government-stimulus checks, but a faltering labor market signaled there may be worse news to come.

Gross domestic product—the economy's total output of goods and services—grew at a 1.9% annual rate in the second quarter, after adjustment for inflation, following a meager 0.9% pace in the first quarter, the government said. Newly revised data showed for the first time that the economy contracted at a 0.2% rate in the final three months of 2007, raising the prospect that a recession may have begun at the end of last year. Previously, the government said the economy expanded at a 0.6% rate in last year's final quarter.

Meanwhile, the labor market showed signs of deterioration, as initial jobless claims soared to their highest level in five years. Some of the increase may have been linked to a government extension of unemployment benefits.

The report helped to end a two-day stock rally. The Dow Jones Industrial Average declined 205.67 points, or 1.8%, to end at 11378.02, though it edged up 0.2% for the month in the first monthly gain since April.

The economy this year has proved surprisingly resilient in the face of tighter credit, soaring energy prices, a tumbling housing sector and consumer gloom. "It's quite remarkable that we're still managing to get some growth," said Wachovia Corp. economist Mark Vitner. But he added, "The fourth quarter and the first quarter of next year are going to be very challenging."

Many households got a bit of breathing room as a result of the economic-stimulus payments, which totaled $91 billion since the end of April. Consumer spending rose 1.5% during the quarter, faster than the 0.9% increase in the first quarter.

Lorne Holland, a 33-year-old pathologist in Denver, said his wife had spent the money on five tons of rock to landscape a new house. He called his stimulus check "just a drop in the bucket" compared with how much members of his household owed for their cars and home.

For some consumers, the stimulus checks are only offsetting other pressures they're facing. "I could use all the money that they give me, but I don't think it's going to solve anything," said Rick Brown, 24, an Atlanta-based airline pilot for Delta Connection. Mr. Brown said he used his $600 check to pay off some of his debts, but he still has more than $65,000 in student loans outstanding.

The impact of the checks is likely to fade in coming months, which could cause consumers to curtail spending, especially with the labor market souring.

The government's July employment report, which will be released Friday, is likely to show the seventh consecutive month of job losses and perhaps another rise in the unemployment rate, currently at 5.5%. The government said Thursday that new claims for unemployment benefits jumped by 44,000 last week to a seasonally adjusted level of 448,000, the highest in five years. Though the figure was likely boosted by the expanded government benefit, the underlying trend points to further deterioration in the labor market.

Employment weakness could threaten growth into next year as laid-off workers cut back on purchases. Wage growth remains modest as workers fearful for their jobs lose negotiating leverage. A separate Labor Department report Thursday showed labor costs rose 0.7% during the second quarter. Compared to a year earlier, employee compensation rose just 3.1% in the second quarter, not enough to keep up with inflation.

> *The economy this year has so far proved surprisingly resilient.*

The slow growth in wages should relieve some pressure on the Federal Reserve to raise interest rates as inflation rises. The figures suggest spikes in energy and food prices aren't yet driving an inflationary cycle throughout the economy.

The Fed's policy committee is expected to keep its interest-rate target unchanged at 2% when it meets next Tuesday, and many forecasters believe that level will hold at least through the end of the year. Officials are worried about continuing financial turmoil and a possible pullback in bank lending.

Consumer spending has slowed but been surprisingly resilient over the last year. Many economists now worry it could slow sharply as wages stagnate. "It's going to be a frugal future," says David Rosenberg, an economist at Merrill Lynch.

Turmoil in housing is threatening to hold consumers back even more. Residential investment declined about 16% during the second quarter.

For the second quarter, a sharp drawdown in business inventories hurt GDP substantially. However, if companies have already drawn down the supply of products on hand and don't have further to cut, that could provide a cushion for GDP in coming quarters.

Strong export growth is the biggest factor keeping the economy out of recession. Exports rose 9.2% during the second quarter, while imports declined 6.6%. The weak dollar makes U.S. goods more competitive in overseas markets, while making imports pricier for American consumers.

Cummins Inc., a maker of engines and fuel systems with customers in more than 160 countries, this week reported its best quarter for sales and profit in the company's 89-year history. About 61% of sales during the period went to countries outside the U.S., the company reported, compared with 51% last year.

Praxair Inc., the largest maker of industrial gases in North America, noted in a recent earnings call: "While domestic demand has fallen, exports are picking up the slack, and so our volumes have been generally strong."

Still, many parts of world are slowing down themselves as rising prices take a toll on consumers and businesses. Euro-zone inflation rose to 4.1% in July from a year earlier, the highest since data were collected starting in 1997. The jobless rate in the zone is 7.3%. As in the U.S., the effects of the global financial turmoil are beginning to have an effect on European economies.

Even with the decline in U.S. GDP in the fourth quarter, the U.S. economy has not met one common definition of a recession—two straight quarters of declining GDP. The National Bureau of Economic Research, the generally accepted arbiter of business cycles, defines a recession more broadly as "a significant decline in economic activity spread across the economy, lasting more than a few months."

GDP is only one of five gauges the group follows to date recessions. Only one of the others—sales in the retail and manufacturing sectors—started a decline in the fourth quarter of the year. Other figures—employment, industrial production and personal income—appear to have peaked early this year.

The NBER's committee is unlikely to make a recession call soon, preferring to wait until it's sure one really is occurring or has occurred. It didn't declare the March 2001 start to that year's recession until November, which it later determined was the recession's endpoint. Also further revisions to GDP data, including the fourth-quarter decline, are possible.

"It doesn't mean much, because it's a very small single-quarter decline," Victor Zarnowitz, who has been studying business cycles at the NBER since 1952 and serves on the recession-dating committee. "There is no formal evidence of a recession. There is no cyclical decline yet."

Exports and rebate checks bring us 1.9% GDP, now what ?

The Tax Rebate Was a Flop. Obama's Stimulus Plan Won't Work Either.

NYT 8-6-08

By Martin Feldstein

Congress enacted the tax rebate program earlier this year because it perceived a growing risk of recession. In addition, it feared monetary policy alone would not be effective because of the dysfunctional credit markets. As American taxpayers know, most of the rebate checks have now been mailed and cashed.

Those of us who supported this fiscal package reasoned that the program would boost consumer confidence as well as available cash. We hoped the combination would cause households to spend a substantial fraction of the rebate dollars, leading to more production and employment. An optimistic and influential study by economists at the Brookings Institution projected that each dollar of revenue loss would increase real GDP by more than a dollar if households spent at least 50 cents of every rebate dollar.

The evidence is now in and that optimism was unwarranted. Recent government statistics show that only between 10% and 20% of the rebate dollars were spent. The rebates added nearly $80 billion to the permanent national debt but less than $20 billion to consumer spending. This experience confirms earlier studies showing that one-time tax rebates are not a cost-effective way to increase economic activity.

These conclusions are significant for evaluating the likely impact of Barack Obama's recent proposal to distribute $1,000 rebate checks to low- and middle-income workers at an estimated cost of approximately $65 billion. His plan, to finance those rebates with an extra tax on oil companies, would reduce investment in refining and exploration, keeping oil prices higher than they would otherwise be.

Here are the facts. Tax rebates of $78 billion arrived in the second quarter of the year. The government's recent GDP figures show that the level of consumer outlays only rose by an extra $12 billion, or 15% of the lost revenue. The rest went into savings, including the paydown of debt.

For a more comprehensive picture, we can see how households divided their overall increase in disposable personal income—that is, household income including the rebates and net of income taxes and payroll taxes—between additional consumer outlays and saving. The official GDP figures show that disposable personal income increased between the first and second quarters by some $98 billion (one-fourth of the annualized figure of $393 billion shown in the government report), up from an increase of $22 billion between the final quarter of 2007 and the first quarter of 2008. So disposable personal income rose by an additional $76 billion, a bit less than the rebates because of declining employment and reductions in other sources of income. The corresponding rise in consumer outlays increased to $36 billion from $24 billion. So the additional $12 billion of consumer spending was less than 16% of the extra $76 billion of disposable personal income. By comparison, savings rose by $62 billion, or five times as much.

These quarterly GDP figures are supported by the more detailed monthly data on income and spending in May and June. According to the government statisticians, the tax rebates in May were $48 billion, accounting for almost all of the $50 billion rise in household disposable income between April and May. In contrast, consumer spending in May rose by less than $6 billion. In June, the rebates were $28 billion. Consumer spending rose by only $5 billion, showing no evidence of an additional delayed effect of the May rebates.

> The best thing Obama could do for the economy is stop threatening a big tax hike.

The evidence of a very limited effect on spending is also clear in the monthly retail sales—a measure that is narrower than total consumer outlays because it excludes things like utility bills and rent. Retail sales were $342 billion a month in January through April and rose to only $346 billion in May and June.

Although press stories emphasizing that the rebates induced additional consumer spending were technically correct, they missed the important point that the spending rise was very small in comparison to the size of the tax rebates.

A recent, widely reported academic study by Christian Broda and Jonathan Parker showing that the rebates led to increased spending on nondurable items (like food and drugs) does not contradict the implication of the more comprehensive data—on national retail sales and total consumer spending—that the induced rise in consumer outlays was small relative to the size of the rebate.

The small rise in spending in response to these tax rebates is similar to what previous studies of one-time tax cuts found. It also corresponds to what both basic economic theory and common experience imply. Although someone who receives a permanent annual salary increase of $1,000 typically would increase his annual spending by an almost equally large amount, a $1,000 rise in wealth caused by a share price increase or a tax rebate would raise spending only gradually over a number of years.

All of the evidence on one-time tax rebates implies that the Obama plan to send $1,000 rebate checks would do little to raise consumer spending and stop the decline in employment. If the past is an indicator of what would happen, the $65 billion he proposes to spend on this plan would raise consumer spending by only about $10 billion, or less than one-tenth of 1% of GDP.

The distinction between one-time tax rebates and permanent changes in net income is also important for the debate about Mr. Obama's proposal to raise income and payroll taxes. Because those tax increases would be permanent, they would cause a substantial reduction in consumer spending and aggregate demand. Moreover, as taxpayers begin to focus on the possibility of such a future tax hike, they will reduce spending without waiting for such legislation to be enacted. If Mr. Obama is looking for a way to stimulate the economy, he could begin by discarding his proposal to increase future taxes.

Mr. Feldstein, chairman of the Council of Economic Advisers under President Reagan, is a professor at Harvard and a member of The Wall Street Journal's board of contributors.

Martin Feldstein cites increased Consumer sales equal to only 20% Of rebates mailed out.

New Steps to Aid Economy Are Advocated

By Deborah Solomon

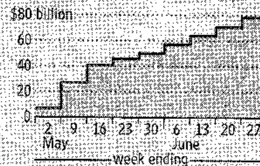
Reuters

Short-Lived Boost

The government has sent out billions of dollars to taxpayers...

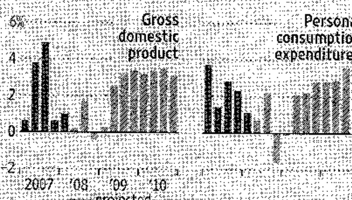
Cumulative amount of economic-stimulus payments

WSJ Aug '08



But the plan may not have a long-term positive impact

Adjusted for inflation, change from the previous quarter at an annualized rate



Sources: Treasury Department (stimulus payments); Commerce Department (historic GDP, PCE); Global Insight (GDP, PCE projections)

WASHINGTON—As the last batch of stimulus checks show up in mailboxes, some economists and Democrats are rumbling that the government needs to again intervene to prop up the flagging economy.

The $152 billion stimulus package was meant to provide a short-term boost to the economy, and many economists believe it prompted Americans to spend more money. But by July 11, most of the checks will have been sent out, and much of the benefit is expected to fade by August even as fears of a recession continue to percolate.

Already, Lawrence Summers, the former Clinton Treasury Secretary, and Robert Shiller, the Yale economist, are advocating some sort of additional stimulus. Democrats on Capitol Hill are discussing legislation to boost the economy. And the presidential candidates are also mulling ways to spur growth.

Still, there's little agreement about what form a second stimulus should take or how quickly it should happen. Some favor another round of rebate checks, while others advocate investment in infrastructure.

There are also plenty of people, including some economists, who think another short-term stimulus package is the wrong way to go, arguing that it does little to fix the underlying problems plaguing the economy.

"You can't put a Band-Aid on a cancer," said Merrill Lynch economist David Rosenberg.

The U.S. economy grew at just 1% in the first quarter, buoyed in part by the stimulus checks. While similar growth is expected for the second quarter, analysts are concerned about what will happen later in the year as the impact fades. Consumer confidence has plunged amid concerns about jobs and soaring prices for oil, fuel and other commodities. Inflation remains a concern and the Federal Reserve is likely finished with its interest-rate cuts. Economic projections show weakness throughout this year and into the first quarter of 2009.

The stimulus checks boosted retail sales and consumer spending but their impact has been blunted by the continued rise in oil prices. In a speech last month, Treasury Secretary Henry Paulson acknowledged that rising gas prices had undercut the government's effort.

"While the stimulus is making our economy stronger than it otherwise would have been, the headwind of high energy prices has the potential to lengthen the economic slowdown," Mr. Paulson said.

On Monday, President Bush signed a bill including an extension of unemployment benefits, which could give unemployed workers additional money to spend. Beyond that, the administration has no plans to push another round of stimulus.

"Obviously we're always looking at ideas and always looking at the economy and people are talking about these things but we thought the stimulus done already was big enough to make an impact," said Phillip Swagel, Treasury's assistant secretary for economic policy.

Some top economists say there's little choice but to do something more. Mr. Summers said the U.S. could be in for a long economic downturn and that Congress should move quickly.

"Given that recessions associated with financial problems are never short and that the storm clouds are gathering rapidly there's far more risk of stimulus being too late than too early," Mr. Summers said. Among his remedies: Infrastructure investment, which he said would help create jobs, bolster the construction industry and provide a cash infusion to municipalities. Mr. Shiller, in a recent New York Times column, argues for more rebate checks.

Sen. John McCain, who backed the stimulus checks and has proposed cutting taxes, is considering whether another round of checks makes sense, according to an economic adviser. "We're looking right now to see if there is any merit in trying that again," the adviser said. The adviser added that checks won't solve the underlying problems of low housing prices and rising costs.

Sen. Barack Obama, who didn't vote on the stimulus package, has talked about infrastructure spending to spur economic growth.

House Speaker Nancy Pelosi (D., Calif) wants to send financial aid to states and fund infrastructure projects, according to her spokesman. House Financial Services Chairman Barney Frank (D., Mass.) is backing legislation that would give cities and states $15 billion to buy foreclosed properties.

Mr. Frank said he doesn't support another round of checks because it will be treated more like a permanent tax cut. "They're more likely to be saved the second time around," he said.

Some economists say focusing on short-term fixes is the wrong way to approach the problems. And they question whether it's really appropriate to try to bolster the economy when it's still growing, albeit sluggishly.

WSJ.com

QUESTION OF THE DAY: At this point, has the government done enough to stimulate the economy? Weigh in, at **WSJ.com/Question**

Everyone has an idea: more infrastructure, more rebates, Financial aid to states, tax cuts, etc… but the bottom line Is the economy is too weak to regenerate itself.

Are the Hunters Low on Magic Bullets?

Investors Are Grappling With the Fear That Regulators Can't Slay This Bear

BY E.S. BROWNING

ONE REASON the stock market has had trouble rebounding: Investors are beginning to think the U.S. Federal Reserve is running out of the ammunition it has used to support the stock market in past months.

Despite repeated intervention by the Fed and central banks and regulators worldwide, no one seems to be able to prevent further damage to banks and other financial institutions. Shares of mortgage-finance giants **Fannie Mae** and **Freddie Mac** slid more than 45% last week alone. At week's end, investors got a further jolt when California bank **IndyMac Bancorp** Inc., a big mortgage lender with some $32 billion in assets, was seized by federal regulators.

ABREAST OF THE MARKET

The Fed still has plenty of money to lend to ailing banks and other institutions. Investors expect that, if government-chartered Fannie Mae and Freddie Mac get into direr straits, the Fed and/or the Treasury Department will devise a program to keep them afloat.

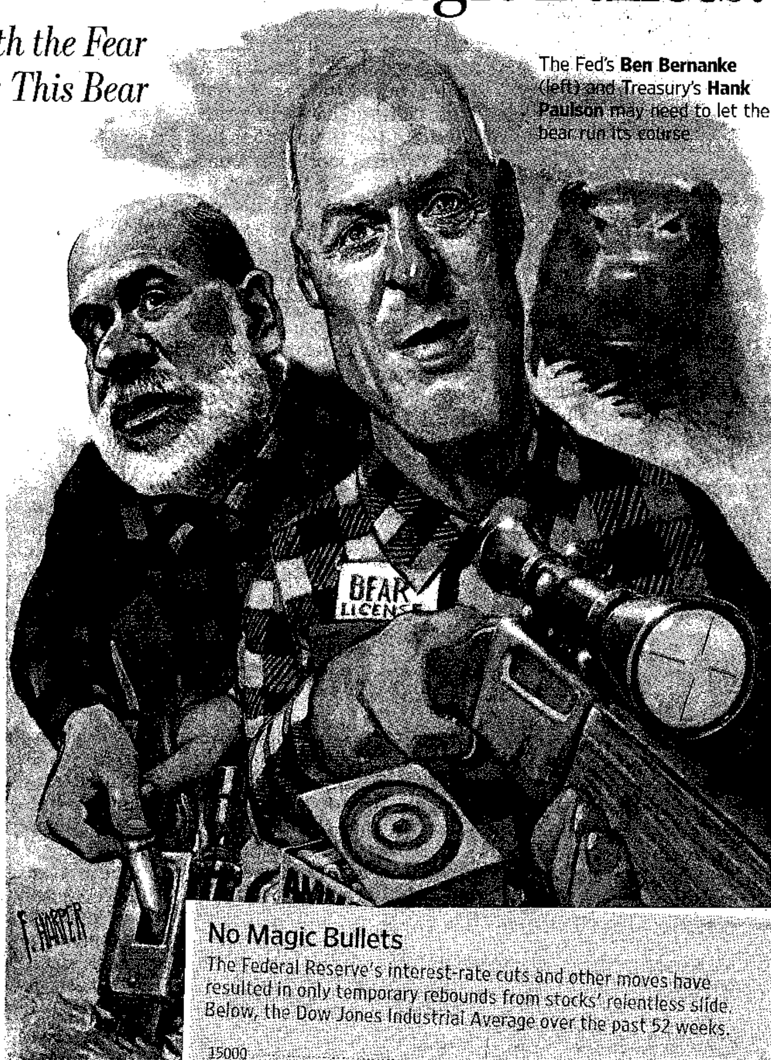
But the high-profile shock treatment that the Fed used last autumn and winter—most notably, a series of sharp interest-rate cuts—isn't as readily available anymore. Since last summer, the Fed has knocked more than three percentage points off its target short-term lending rate, pushing it to 2% from 5.25%.

The Fed also announced a series of lending programs to support banks and brokerage firms. Any new government effort to help Fannie and Freddie could temporarily give markets a boost. But investors are coming to grips with the fact that the big rate cuts have been made, the market and the economy remain in trouble, and now they may have to tough it out.

"I don't think the Fed can shake its magic wand and right everything in the capital markets," says Ethan Harris, chief U.S. economist at Lehman Brothers. "They are trying to buy time for the economy to lick its

wounds and recover," make that happen ov Fed may wind up cu half a percentage poi til later this year or

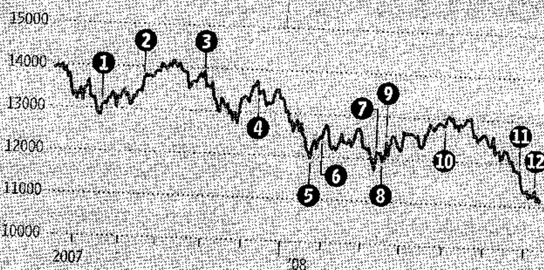
Markets and the l dilemma of the sort investors and policy nomic boom ends.



The Fed's **Ben Bernanke** (left) and Treasury's **Hank Paulson** may need to let the bear run its course.

No Magic Bullets

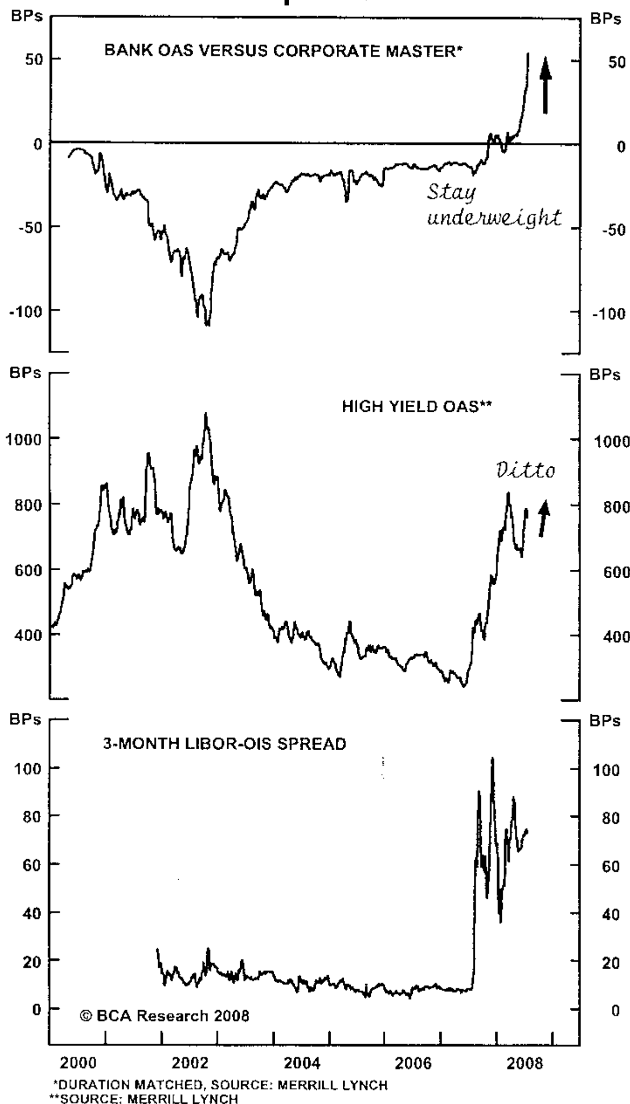
The Federal Reserve's interest-rate cuts and other moves have resulted in only temporary rebounds from stocks' relentless slide. Below, the Dow Jones Industrial Average over the past 52 weeks.



1. **Aug. 17, 2007:** Fed cuts discount rate half a percentage point
2. **Sept. 18:** Surprising half-point cut in fed funds rate target to 4.75%
3. **Oct. 31:** Fed funds rate target cut to 4.5%
4. **Dec. 11:** Target cut to 4.25%
5. **Jan. 22, 2008:** Target cut to 3.5%
6. **Jan. 30:** Target cut to 3%
7. **March 11:** Fed expands securities lending program
8. **March 14:** J.P. Morgan agrees to buy Bear Stearns
9. **March 18:** Target cut to 2.25%
10. **April 30:** Target cut to 2%
11. **June 25:** Fed keeps rates unchanged
12. **July 8:** Bernanke announces plans to shore up mortgage lending

Source: WSJ Market Data Group

CHART 2
Little Relief For Spreads



*DURATION MATCHED, SOURCE: MERRILL LYNCH
**SOURCE: MERRILL LYNCH

lending spreads remain elevated; and, last week Indymac experienced a run on its branches after the takeover by the FDIC (**Chart 2**).

Fed Chairman Bernanke sounded cautious last week, highlighting the downside risks to the economy (due to sinking housing prices, tightening credit conditions and higher energy prices). As a prudent central banker, he also warned about up[...] the FOM[...] economic[...] worse. Al[...]

remarkably resilient, due to healthy balance sheets and a weak dollar, growth will slow in the second half of the year. Consumers are proving cautious despite the rebate checks (which are going into savings and paying for gasoline). The panic over F&F underscores that the financial shock-waves from the burst housing bubble are not over, and credit availability will be a problem for a long time as deleveraging rolls on.

Investors remain wary because policymakers' approach to economic/financial problems have been reactive, piecemeal and aimed at treating only the symptoms of the problem, not the source. A more proactive and broader approach may be needed – one that helps the financing, and reduces the selling pressure, in the housing market. Otherwise, the economic slump will roll on and asset prices will remain under pressure. Private sector borrowing rates have not followed policy rates lower since last autumn, adding to the economic drags. There is little the Fed can do about market-set rates, underscoring that the ball is in the fiscal court.

Jumbo mortgage rates have eased slightly in the past two weeks, but need to decline a lot more (**Chart 3**). Importantly, fears of ever-sinking collateral values will not end until there is some light at the end of the housing tunnel. To this end, existing home inventories need to follow new home inventories lower to provide any hope that house prices will stabilize (**Chart 3**). A decisive trough in housing prices will be a lagging indicator for the financial markets, but it will be critical in order for investors to believe that the foundations under the economy are being shored up sufficiently to justify some risk-taking, i.e. a sustained rally in financial and housing related assets needs some [...] over. [...]cisive [...]turn [...] in the Homebuilders survey at the top of the list.

…"the ball is in the fiscal court"… i.e. moreGovernment spending and/or tax cuts are needed, just as in 2001-02

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Economy Takes Spotlight

WSJ Aug '08

McCain Seeks Tax Cuts; Obama Touts Stimulus Plan

By Christopher Cooper
And Elizabeth Holmes

The presidential candidates are turning back to a sharp battle over the economy this week, with John McCain emphasizing energy relief and tax cuts and Barack Obama advocating a second stimulus package that has a taxpayer rebate at its core.

Faced with a near-flat economy, spiraling gasoline and food prices and a credit crunch that has sparked foreclosures and sent the stock market into bear territory, Sens. Obama and McCain are both angling to become the wage earner's friend.

Both have come up with a grab bag of proposals, most already familiar to many voters.

Sen. McCain's campaign has dusted off some of President George W. Bush's unfulfilled promises: balancing the federal budget within four years and revamping the nation's Social Security system. But he left some questions unanswered Monday after a campaign appearance in Denver. Though aides said he pledged to balance the budget within four years, the campaign didn't say how he plans to do this, beyond cutting pork, which many analysts and government watchdogs say is unlikely to get him there. Moreover, he has promised tax cuts in the past and promised them again Monday—"I will cut them where I can"—which will make it harder to close a spending gap.

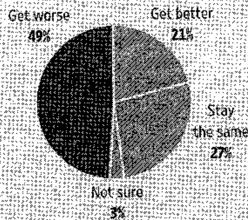
Sen. McCain made his budget-balancing promise in the spring before backing off the pledge, saying it might take eight years instead.

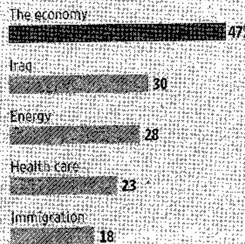
Though Sen. Obama criticized his Republican rival for adopting too many failed policies from President Bush, Sen. Obama is also borrowing from the current administration with his proposed stimulus package.

This week, both men are offering up a bit of populist meat that may not spur the economy. Sen. McCain admitted as much, telling a campaign crowd Monday that his plan for a suspension of the gasoline tax isn't wowing economic experts.

Weighing Change

As voters brace for a sustained economic downturn, many are looking for substantial changes in how the issue is addressed.





Source: WSJ/NBC News telephone poll of 500 registered voters conducted June 6-9; margin of error: +/-4.4 percentage points

*Combined first and second priorities

"Some economists don't think much of my gas-tax holiday," Sen. McCain admitted. "But the American people like it and so do small-business owners."

Both men are proposing economic solutions that are unlikely either to pass Congress or to have major immediate impacts on the economy if they are implemented. Sen. Obama's stimulus package, which he has been talking about in recent weeks, faces a deeply uncertain future in Congress, given that the Bush administration is against it.

"A few days ago, I called on Sen. McCain and all members of Congress to come together—Republicans and Democrats—in support of this $50 billion stimulus package," Sen. Obama said Monday in remarks prepared for a speech in North Carolina but delivered to a handful of reporters instead, after his plane developed mechanical problems. "And so while I haven't received a response from Sen. McCain yet, I look forward to hearing one soon."

Sen. Obama also renewed some promises he has made in the past: not to raise taxes on families making less than $250,000 annually; to eliminate all income taxes on retirees making less than $50,000 a year; to expand the child-care tax credit; and to eliminate capital-gains taxes on small businesses. He proposes to pay for much of this by ending the war in Iraq, which costs taxpayers about $100 billion a year.

Sen. Obama's campaign rhythm was disrupted when his charter plane developed a problem, shortly after lifting off from Chicago Monday. A crewman said pilots were having difficulty getting the plane level; it was diverted to St. Louis and landed without incident. The campaign scratched a planned event in Charlotte, N.C.

Sen. McCain has included his own longer-term proposals that seem unlikely to affect the current economic situation. In a speech in Denver Monday, he outlined three of them—a plan to expand oil drilling off the U.S. coasts, a call to develop 45 new nuclear-power plants and a cry to deploy so-called clean-coal technology to take advantage of U.S. reserves. Clean-coal technology doesn't yet exist; experts say the other two proposals would take 10 years or more to become reality.

For Sen. McCain, the economy talk served as a platform for the relaunch this week of his campaign, which has undergone a recent staff shuffle. The message wasn't new: He advocates free trade and tax cuts, coupled with fiscal restraint in Washington.

Following his three-day trip to Latin America last week, he came out swinging against Sen. Obama, at one point mocking the Illinois senator's campaign motto. For someone with a motto of " 'Yes, we can,' Senator Obama's agenda sure has a whole lot of 'No, we can't,'" Sen. McCain said. The McCain campaign followed the speech with a flurry of conference calls and news releases, most branding Sen. Obama a high-tax advocate.

Sen. Obama had his own riposte on Sen McCain's economic proposals: "It hasn't worked, it won't work, and it's time to try something new."

Sen. McCain's town-hall-style events often lead to contentious exchanges that have nothing to do with the campaign theme of the day. When a wheelchair-bound woman who attended the Denver event asked him to support the Community Choice Act, pending legislation that would provide equal access for community-based services, such as home attendant care, Sen. McCain said: "I will not, because I don't think it's the right kind of legislation." Three people in wheelchairs left the event a few minutes later.

Sen. Obama will be talking economic policy in Atlanta Tuesday and Washington Wednesday. Sen. McCain will be in Washington Tuesday and campaigning in Ohio Wednesday.

WSJ.com

QUESTION OF THE DAY: Who would be a better steward of the U.S. economy? Weigh in at **WSJ.com/Question**

Candidates promise stimulus…

Listen to the 56,000

NYT 8-6-08

When the Federal Reserve asked for comments on its proposed rules on abusive credit card practices, an astonishing 56,000 poured in. Most were from outraged consumers. They told of interest rates skyrocketing when they paid an unrelated bill late. They complained of unwarranted late fees and pushed-up due dates. One Pennsylvania customer fumed: "I'm fed up with credit card company tricks that drive us deeper in debt."

This anguished deluge should send a clear message to leaders in Washington. The Federal Reserve should swiftly adopt its proposed rules against unfair or deceptive credit card practices. But the real burden to curb these abuses falls on Congress.

For too long, members of Congress have shirked the responsibility to ensure fair lending to credit card customers and have listened more intently to the banking lobbyists. A low point came in 2005, when Congress passed a bankruptcy law that was badly tilted against borrowers. It gave extra protections to lenders against unscrupulous debtors. But it also made it much harder for people to declare bankruptcy, even when the economic crisis was caused by sickness or family tragedy.

Ronald Mann, a Columbia Law School professor, has argued that the law creates a "sweat box of credit card debt." As borrowers become "distressed," the credit card issuer has more time to pile on interest charges and fees until the client actually goes bankrupt. As heartless as that bankruptcy law has been for beleaguered consumers, the Democrats, who have controlled Congress since 2006, have not fixed it.

They did take one step forward last week. By a 39-to-27 vote, the House Financial Services Committee approved a credit card holders' bill of rights that was sponsored by Representative Carolyn Maloney, Democrat of New York. It would stop credit card companies from raising interest rates on balances incurred under an old rate. It would let consumers pay off loans with higher interest rates first. And it would stop unfair late fees and "universal default," the practice of raising interest rates on accounts in good standing when a borrower falls behind on other bills. This borrowers' bill of rights should move quickly to the House floor, and Christopher Dodd, the Democratic chairman of the Senate Banking Committee, should support similar legislation in his chamber.

The banks are openly fighting both the Maloney bill and the Federal Reserve rules. They warn of unintended consequences, mainly that less credit would be available to consumers. They also argue that most card holders are happy and that the complaints are just "anecdotal."

The huge file of comments at the Federal Reserv contains plenty of anecdotes, and there are surely many more where those came from. Congress should give consumers what they need and deserve — fair and clear lending rules for credit cards.

Here's an idea!

1) **Listen to the people**
2) **The consumer may eventually need debt relief.**

Record deficit expected in 2009

Report faults slow economy, tax rebates

By Richard Wolf
USA TODAY

7-28-08

WASHINGTON — The White House has increased its estimate for next year's deficit to nearly $490 billion, a record figure that will saddle the next president with deepening budget problems in his first year in office, a report due out today shows.

The projected deficit for the fiscal year that begins Oct. 1 is being driven higher by the continuing economic slowdown and larger-than-anticipated costs of the two-year, $168 billion fiscal stimulus package passed by Congress, said two senior administration officials with direct knowledge of the report. In February, President Bush predicted the 2009 deficit would be $407 billion.

The budget update shows this year's deficit headed under $400 billion, at least $10 billion less than projected, according to the two officials. That's partly because tax revenue held up reasonably well despite the weaker economy.

The rising deficit for 2009 marks a sharp turnaround for Bush's fiscal legacy. He inherited a $128 billion surplus when he came into office in 2001. It soon turned to red ink because of a recession, the Sept. 11 attacks and the war on terrorism.

Curbing the deficit will fall to Bush's successor and the next Congress following a time when taxes were cut and major spending initiatives were undertaken, including the wars in Iraq and Afghanistan, transportation projects, farm subsidies, Medicare prescription drug coverage and a recently passed expansion of veterans' education benefits.

2 views of the deficit
■ Reagan to Bush 43, 2A

The actual 2009 deficit could climb still higher because the new projection does not reflect full funding for the wars.

In addition, a worsening economy could add to the red ink by reducing tax revenue and increasing safety-net payments, such as jobless benefits and food stamps.

Both presidential candidates have proposed tax cuts that could further swell the deficit. The nonpartisan Tax Policy Center estimates that Republican John McCain's cuts would cost $4.2 trillion and Democrat Barack Obama's $2.8 trillion over 10 years. Neither candidate has specified major spending cuts he would make to reduce the deficit.

"The picture's looking pretty dark out there," said Sen. Judd Gregg, R-N.H., top Republican on the Senate Budget Committee.

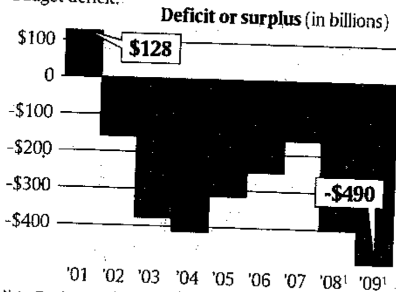
He credited Bush's tax cuts with creating six years of economic growth but "on the spending side, their record is not good."

White House budget director Jim Nussle said that despite the surplus Bush started with, he faced a deficit in defense, intelligence and homeland security that had to be bolstered after 9/11.

"This is not just a mathematical exercise," he said in an interview with USA TODAY. Nussle said an economic recovery and a renewed effort by Congress to control spending could rein in the deficit.

Bush proposed in recent years to slow the growth of spending in programs such as Social Security, Medicare and Medicaid. Those efforts were ignored by Congress — most recently last week, when the House voted to sidestep a provision of the 2003 Medicare prescription drug law that would have required lower Medicare spending.

The biggest budget deficit recorded to date was $413 billion in 2004. In today's dollars, that would be about $478 billion. As a share of the economy, the 2009 deficit would be 3% to 4%, below the post-World War II record of 6% set in 1983.



By Julie Snider, USA TODAY

12

Catch 22. Massive new spending planned by Both parties just at the start of yawning Medicare shortfalls

Our two largest states choking on unbalanced budgets.
Sen Dodd "…no checks will be coming from the Federal Govt…"

California Budget Impasse Enters Eighth Week After Deadline

By JIM CARLTON 8-4-08

SACRAMENTO, Calif.—California enters its eighth week after a budget deadline with no deal in sight between Republican and Democratic lawmakers on a spending plan, a delay that brings the nation's most populous state closer to having to slash services deeper and borrow at premium rates.

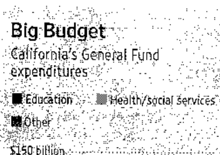
Already, Gov. Arnold Schwarzenegger on July 31 ordered layoffs of 22,000 part-time and temporary workers, instituted a hiring freeze and lowered the pay of minimum-wage state workers from a higher state level to the federal one.

If a budget isn't passed soon, California will be faced with having to take out high-interest loans to meet its cash needs—a prospect that could compound its problems, as the state copes with an estimated $15 billion deficit for the fiscal year that began July 1. Analysts say the loans may be necessary to cover ex-

among only a handful that require a "supermajority" for budget approval, not just a simple majority; as a result, any spending plan has to meet with the approval of the minority party. That has proved such a difficult proposition that California's budget has been passed on time only four times in the last 20 years.

In the latest showdown, Mr. Schwarzenegger, a Republican, and the Democrat-run legislature are at odds over how to close a shortfall that has ballooned because of an economic slowdown that has depleted tax revenues. Spending in the recent growth years had increased faster than the state's ability to rein in expenses.

Mr. Schwarzenegger has already gone to the well to sell more than $10 billion in bonds to cover past deficits. So he has proposed a $101.8 billion general fund budget—a 1.6% decrease from the last fiscal year—that relies heavily on spending cuts and raising new money through



Note: fiscal years end June 30
Source: Legislative Analyst's Office, California

Gov. Schwarzenegger signs an order eliminating 22,000 part-time and temporary positions last week in response to California's ongoing budget crisis.

Associated Press

fornia voters would approve it in a proposed initiative. "No one has ever done this before in California," said Michael Cohen, a di-

such as couples earning more than $321,000 a year. They propose reinstating higher tax brackets for higher-income

with a vow not to raise taxes, remains under pressure from members of his own party to hold fast to that promise. Indeed, Michael Villines, leader of the Assembly's Republican minority, said that when the former action-movie star turned 61 on July 30, he sent him a birthday present—a talking photo that said, "Just remember: no new taxes."

The two sides remain far apart on other issues. The legislature, for example, wants to provide $2.2 billion more for K-12 schools and community colleges than the governor's plan. Mr. Schwarzenegger is also seeking across-the-board cuts in various social-service programs, which Democratic legislators reject.

Many Democrats also were angered by the governor's surprise layoffs last week, which they regard as a hardball tactic aimed at forcing them to give in. "I was hoping he would stand up there and say we need to make sacrifices," said state Senate

the legislature isn't going to do its job, I am going to act."

As a result of the bad blood, even Democratic lawmakers are divided on whether a budget can be approved in time to stave off further fiscal woes.

Assembly Speaker Karen Bass, for example, predicted a deal would be reached by mid-August. Mr. Perata, however, said: "I ain't telling you that. I think we're going to go down to the wire."

Political observers said a compromise could be struck in what state politicians regard as loopholes—moves that might not look like an outright tax increase. For example, the Legislative Analyst's Office estimates that the state could save about $1 billion this year by suspending net operating-loss deductions for personal income and corporation taxes.

For his part, Mr. Schwarzenegger remained hope-

Governor Looks to Washington to Help Dig New York Out of a Financial Hole

NYT 8-1-08

By JEREMY W. PETERS

WASHINGTON — Amplifying his case that New York faces a grave financial crisis, Gov. David A. Paterson asked the federal government on Thursday for assistance and said that social programs like education and health care were not immune from cutbacks.

His remarks, delivered to the National Press Club just before back-to-back meetings with members of Congress; the treasury secretary, Henry M. Paulson Jr.; and Ben S. Bernanke, the Federal Reserve chairman, were the surest sign yet that the governor and the State Legislature were headed toward a confrontation over where to trim the budget.

Two of the Legislature's leaders, Dean G. Skelos, the Senate majority leader, and Sheldon Silver, the speaker of the Assembly, have been explicit in their opposition to any cuts in school financing.

Mr. Paterson's trip to Washington was part of a carefully orchestrated and highly visible effort by the governor to put a spotlight on the state's financial problems. In a televised address on Tuesday, he said he would call the Legislature back from recess for a special session on Aug. 19 to address next fiscal year's projected budget shortfall, which he announced had grown to $6.4 billion from $5 billion in the past three months. And on Wednesday, he asked the Legislature to help cut $1.2 billion

A statement that 'no area is sacred' means health care and schools face cuts.

out of this year's budget.

But his comments on Thursday raised the ante even higher as he identified for the first time specific programs that could face cuts.

"I don't have to tell state officials the areas that we're obviously going to have to cut. They're going to be the areas where we spend a lot of money — in our educational system, which we desperately need as an investment for our future, in our health care facilities," Mr. Paterson said after his speech.

He later added: "No area is sacred because we face such a skyrocketing deficit."

He coupled his calls to rein in state spending with a promise that New York would not forget to help residents who are losing their jobs and their homes.

"Government is more than just balancing budgets," he said. "We balance budgets, but we must also balance priorities. Compassion is not optional, neither is common sense."

Mr. Paterson said the federal government also had a critical role in aiding New York's recovery, and he asked Congress to provide the state with assist-

ANDREW COUNCILL FOR THE NEW YORK TIMES

Gov. David A. Paterson outlined the state's financial problems in a speech at the National Press Club and in meetings with officials in Washington.

ance for various programs, like heating oil subsidies for low-income households, and help to improve the state's infrastructure, like highways and waste treatment plants.

"We are going to have to turn to the federal government for help," said Mr. Paterson, who did not put a dollar amount on the assistance the state needs. "The federal government is going to have to put more into the states

that support it in the next couple of years before we have what will be a national crisis."

New York, which as one of the largest and wealthiest states contributes a significant portion of federal tax revenue, does not appear to be getting its fair share in return, he said.

But it is far from certain that the federal government will be willing — or even able — to assist states at a time

when it faces a projected record deficit next year, having to pay for two wars and facing a contracting national economy.

Mr. Paterson acknowledged that New York may not be able to look to Washington for all of the assistance it needs.

"I'm optimistic about the meetings, but I don't want to count my eggs before they hatch," he said as he left a meeting in the Capitol with Senator Christopher J. Dodd, a Connecticut Democrat who is the chairman of the Senate Committee on Banking, Housing and Urban Affairs.

Mr. Dodd, who said he was startled to learn from Mr. Paterson that New York's tax revenue from Wall Street had plummeted so far, cautioned that states should not expect Washington to rescue them.

If states expect a check from the federal government, Mr. Dodd said, "the checks — they just aren't there."

In his remarks at the National Press Club, Mr. Paterson was not all gloom and doom. He sprinkled bits of humor into his grim pronouncements on the health of the state's economy. After the speech, he was asked what lessons he had drawn from the scandal that brought down his predecessor, Eliot Spitzer, who was caught on tape arranging to meet a prostitute in a Washington hotel.

"Be careful when you come to Washington," Mr. Paterson said.

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Medicare reduced by 10.6 percent

Most Kansas lawmakers speak out against decision

By Barbara Hollingsworth
The Capital-Journal

Published Saturday, June 28, 2008

Medical care options may be reduced after lawmakers packed up and left Washington, D.C., this week without stopping a 10.6 percent decrease in Medicare reimbursements made to physicians.

Primary care physicians with the Cotton-O'Neil Clinic will stop accepting new Medicare patients on Tuesday as a result of the cuts that go into effect that day.

"We urge citizens to communicate with your elected officials and ask for their support to repeal cuts to their Medicare benefits," said Kent Palmberg, chief medical officer for Stormont-Vail HealthCare, of which Cotton-O'Neil is a division.

Legislation was needed to block cuts that otherwise occur automatically under a formula. Congress has blocked similar cuts in the past.

Jerry Slaughter, executive director of the Kansas Medical Society, said he was hopeful lawmakers could make a fix when they resume meeting July 7, following a break for the Fourth of July. Even with hopes of a change, he said the inaction this week created problems.

"At this point it will be disruptive," Slaughter said. "There's just no way to avoid that."

Nearly every member of the Kansas Congressional delegation lined up behind the Medicare legislation this week. It breezed through the House on a 355-59 vote, with the support of all four members from Kansas.

But in the Senate, the legislation fell just short of mustering the 60 votes needed to pass the measure under expedited rules. Sen. Sam Brownback, R-Kansas, fell out of line with other members of the state's delegation, voting against shutting down debate so senators could vote on the measure. Phone calls and an e-mail sent to Brownback's office on Friday weren't returned.

President Bush has threatened to veto the legislation, which would cut spending on private Medicare Advantage plans — plans that studies have found to cost more than the traditional Medicare program.

Sen. Pat Roberts, R-Kansas, supported the legislation.

"I urge my colleagues to put politics aside to pass this bill for seniors and our health care providers," Roberts said in a statement released by his office. "I hope the Congress and the administration can work together to adopt these reforms as soon as possible."

14

Rep. Nancy Boyda, D-Kansas, said she was shocked when she received word that the

We attempt to curtail Medicare deficits in June 2008...

Cotton-O'Neil Clinic

Division of Stormont-Vail HealthCare

....and Medicare shuts down for new patients...

July 1, 2008

To our Medicare patients:

Cotton-O'Neil Clinic has had a long-standing commitment to provide access to high quality health care for our patients. However, recent actions by Congress are making it increasingly difficult to cover the costs of providing care to our Medicare patients.

On July 1, Medicare cut physician payments by 10.6 percent. Just like every other business and household, our costs are increasing steadily. **Because Congress did not stop these cuts, all of our primary care physicians have regretfully closed their practices to new Medicare patients as of July 1, 2008.**

You can help ensure that your access to high quality health care is not further reduced by taking a few minutes to contact your congressional representative. We appreciate the members of our Kansas delegation who supported efforts to reverse the cuts and hope Senator Sam Brownback will change his position and vote to support your Medicare benefits.

We have provided the names and contact information for our senators and representatives on the back of this letter. We have also included some important discussion points.

This was a very hard decision for us. We hope you join us in efforts to convince Congress to reverse these significant cuts to your Medicare providers.

Respectfully,
Cotton-O'Neil Clinic
Primary Care Physicians

After Enacting Pension Cuts, Europe Weathers a Storm

By CARTER DOUGHERTY

FRANKFURT — Social Security is known as the "third rail" of American politics, and fiddling with retirement benefits can prove politically fatal in Europe too. Yet, in recent months and years some Europeans have tried to defuse the time bomb posed by millions of retirees receiving government benefits.

Italy gradually raised the retirement age to 59. France increased the tenure requirement for government workers to receive full pension benefits to 40 years of service. Germany curtailed annual government pension increases and raised the retirement age by two years, to 67.

But inflation and a squeeze on living standards for older workers are fueling a backlash, leading some governments to reconsider — or even suspend — approved reforms.

The fears of European workers are not unwarranted. Forty percent of Belgians over 75, for instance, will live in poverty by 2016, according to the National Pensions Office in Brussels, in part because of lower pensions.

Such statistics are one reason why even maintaining recently enacted reforms is proving difficult. Another is Helmut Polzer.

In a fit of rage last August, Mr. Polzer, a retired real estate developer from near Munich, wrote his first letter to the editor in 50 years of reading his local newspaper, complaining about German politicians turning pensioners into "paupers." Almost as an afterthought, he suggested a solution.

"I would be happy if the millions of pensioners — our numbers are growing — and all citizens disadvantaged by politics finally found their way into their own political party," Mr. Polzer wrote to the newspaper, Münchner Merkur.

Weeks later, Mr. Polzer, 70, was presiding over a meeting to create the Pensioner Party, which plans to field candidates in regional elections this autumn on a platform of creating a more generous pension system.

While still a nascent operation, the Pensioner Party's message resonates broadly with voters in Germany and Europe. With a higher birth rate and greater immigration, the United States faces a less acute problem with government pension benefits, despite periodic flare-ups over Social Security and fears about the long-term fiscal stability of the pension systems for many state and local government workers.

Most of the costs of an aging American society have to do with skyrocketing health care costs — far less of a problem in Europe. The widespread use of private pensions and employer-based savings plans in the United States also eases the pressure on taxpayers to pay retirement costs.

But in much of Europe, the need for

Continued on Page 5

Changes in public pension rules have caused
May, marchers in Marseille, France, proteste(

NYT 8-6-08

.... Mass protests over envisioned cuts in Retirement benefits in Europe may presage events in the U.S.

...keep in mind the vast financial impact of these deficits:

1) **Bullish for gold**
2) **Upward pressure on interest rates due to increased borrowing**
3) **Can trigger disgorgement of housing just when the housing Boom may be recovering!**

PREDICTABLY, OUR "LEADERS" COMPLETELY AVOID DISCUSSION OF THE TICKING BABY BOOM FINANCING CRISIS.. "PAINFUL ACTION" NEEDED..

Presidential Candidates Shrink From Budget Issue

Worsening Fiscal Picture Looms, But Hopefuls Prefer Not to Look

BY JACKIE CALMES
Washington

ONE THING UNITES ALL the presidential candidates, of both parties: None are honestly facing up to the huge budget challenges that will confront the next White House resident.

In fairness, if any of them did, voters probably wouldn't give them the keys.

The next president will be inaugurated just as the first of 78 million post-World War II baby boomers begin to retire, and in his or her first term they will be making their claims on Medicare, Medicaid and Social Security. Annual deficits will start climbing, even without any of the new spending that the candidates promise for defense and domestic programs.

War costs will continue to pile up. Net interest on the national debt, to creditors in China and elsewhere, already is one of the single-largest spending items, and growing fast.

Meanwhile, revenue will be many billions less than projected. That is because all the candidates have promised to fix or even repeal the alternative minimum tax—which was intended for rich tax-evaders but not indexed for inflation—so that the AMT won't hit the increasing millions of middle-class voters due to be ensnared otherwise.

Even as Democrats and Republicans on the campaign trail are vaguely promising "change"—and making it sound easy—back in Washington the director of the nonpartisan Congressional Budget Office, Peter Orszag, testified on Capitol Hill in mid-December about the nation's long-term budget outlook, and he wasn't optimistic. "Under any plausible scenario, the federal budget is on an unsustainable path—that is, federal debt will grow much faster than the economy over the long run," he said. And that, he added, means more borrowing from abroad, and less investment and income growth at home.

The main culprit, according to the budget office's latest report, is the projected explosion in costs of health care, exacerbated by the rising claims of aging baby boomers. "Therefore," Mr. Orszag said, "efforts to reduce overall government spending will require potentially painful actions to slow the rise of health-care costs." An economist, Mr. Orszag is a Democrat, but his message echoes that of his Republican predecessor as CBO director, Douglas Holtz-Eakin, who is now the chief economic adviser to presidential candidate and Arizona senator, John McCain. Yet pain isn't something candidates talk about.

Mr. McCain does stand out among Republicans, and some Democrats, for having a detailed proposal to constrain health-care costs. And he and former Republican Sen. Fred Thompson emphasize more than others in both parties the need for cost-saving changes to Medicare and Social Security, if not the specifics. On Social Security, Mr. McCain—like most Democrats—would consider raising revenue by lifting the cap on wages subject to Social Security payroll taxes (the 2008 cap is $102,000). Mr. Thompson's more politically risky plan would reduce the initial level of benefits to future retirees, using a formula similar to one Mr. Bush floated in 2005—unsuccessfully.

All the Republicans favor extending the Bush tax cuts, which otherwise would expire in the next presi-

Please turn to page R11

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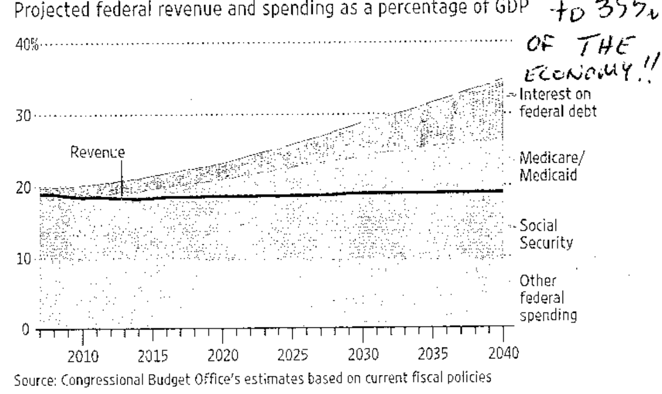


Source: Congressional Budget Office's estimates based on current fiscal policies

Candidates Shy From Budget

Continued from page R1

dent's first term, and rule out any income-tax rises. When quizzed about Social Security's looming instability, all of the Republicans say they support letting workers divert payroll taxes to personal accounts. But that would add to the program's financial woes for decades, requiring additional taxes, benefit reductions or borrowing—which is why Mr. Bush's own proposal never went anywhere even in a Republican-led Congress.

Despite the country's worsening fiscal picture, the Republicans' platforms don't sound all that different from Mr. Bush's back in 2000, when the country was at peace, running a surplus and paying down the debt. Besides echoing his call for overhauling Social Security, they favor more tax cuts, look to market-based remedies for health-care savings and promise deep cuts in other federal spending, without specifics.

But even slashing the overall federal budget—which ranges from agriculture subsidies and parks to research and weaponry—wouldn't avert the crisis that Mr. Orszag and others forecast: As CBO data consistently show, the ballooning costs are mostly in Medicare and Medicaid, and to a lesser extent Social Security and interest on the federal debt—not in the annual appropriations that include much-criticized "earmarks" for lawmakers' special projects.

The Democratic candidates are even less inclined to detail how they would curb the growth of Medicare and Social Security. Their party considers both programs its legacy. Neither they nor the Republicans would reverse the prescription-drug benefit that Mr. Bush added to Medicare, though its long-term costs dwarf the government's entire tab for Social Security's unfunded obligations. Democrats, in fact, would expand the drug benefit to do away with the so-called doughnut hole, where a beneficiary's coverage lapses before kicking in again when costs reach catastrophic levels.

Unlike Republicans, Democrats also aim for universal health care, to cover the 47 million uninsured, and propose new spending and tax incentives for energy and technology innovations, arresting global warming, and for education and college aid. They also promise to restore pay-as-you-go budgeting to the federal government. The biggest offset they offer to "pay" for their proposals is ending Mr. Bush's tax cuts for the richest Americans, typically those making more than $200,000 a year.

But what sounds like an all-purpose source of revenue is anything but. Eugene Steuerle, a senior fellow at the nonpartisan and centrist Urban Institute think tank, and a former Reagan Treasury official, says that returning income-tax rates for the wealthy to pre-Bush levels would mean about $50 billion a year. While no small amount, that is less than a third of the fiscal 2007 deficit. It would cover no more than half the revenue cost of overhauling the AMT, and a few months of Medicare's cost increase.

Whoever is elected, Mr. Steuerle says, "still must either retract many of the promises made to the middle class, increase its taxes, or both. Right now, the leaders of both political parties consider it political suicide to lead the way."

EU Pain Is Dollar's Gain

Fed, ECB Outlooks Should Set Course For the Currencies

N4T 8-4-08

BY DAN MOLINSKI

With the European economy showing wear and tear, the U.S. dollar this week might be able to extend its recent advance against the euro without even having to work for it.

"We're referring to the dollar's recent rise as euro and sterling weakness rather than dollar strength. That's the context we'd put it in," said Robert Sinche, head of global currency strategy at Bank of America.

FOREX VIEW

While the U.S. economy is still slumping and jobless rates have risen steadily, things in some corners are at least starting to look up. In contrast, data from the 15-nation euro zone point to serious signs of weakness, which indicates problems there might be worse soon.

Such a view suggests the U.S. Federal Reserve may begin to increase interest rates in coming months, which supports the dollar, while the European Central Bank may keep rates unchanged, or consider lowering them to spur growth.

That view is likely to be either reinforced or smacked down this week as the Fed and the ECB each decide on interest rates and present their economic outlooks.

If the view is reinforced, look for more dollar gains, with the euro perhaps dropping toward $1.53. But if ECB officials indicate that future rate increases remain at least a possibility, then the euro might trade back to within a few cents of its record high of $1.6040, reached in July.

Friday in New York, the euro was at $1.5541 from $1.5599 late Thursday. The dollar was at 107.75 yen from 107.89 yen, while the euro was at 167.45 yen, from 168.29 yen. The U.K. pound was at $1.9737 from $1.9823, and the dollar was at 1.0514 Swiss francs from 1.0473.

Of the two central-bank meetings, the ECB's will likely create the most fireworks in currency markets. Any signs from ECB President Jean-Claude Trichet that indicate the euro-zone economy is slowing sharper than previously thought may be a serious negative for the euro.

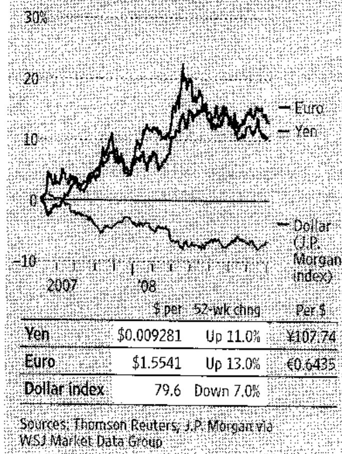
Analysts say references to reduced inflation expectations also would cause the common currency to decline. Lower inflation would make it less likely that the ECB may introduce more euro-supportive interest-rate increases in the coming months.

In the U.S., the FOMC statement after Tuesday's meeting might provoke dollar-supportive reactions if it indicates a drop in oil prices is providing a lift to the economy. But it might work against the dollar if investors take it to mean that lower oil is keeping down inflation and will keep the Fed from considering rate increases.

Currencies table on page C4.

Forex Race

The yen and the euro against the dollar, and the dollar versus the currencies of the major trading partners of the U.S. (J.P. Morgan trade-weighted index)



	$ per	52-wk chng	Per $
Yen	$0.009281	Up 11.0%	¥107.74
Euro	$1.5541	Up 13.0%	€0.6435
Dollar index	79.6	Down 7.0%	

Sources: Thomson Reuters; J.P. Morgan via WSJ Market Data Group

Growth in Money Supply, Credit Slows in Euro Zone

7-28-08

BY MONICA HOUSTON-WAESCH

FRANKFURT—Money-supply growth in the euro zone eased in June amid slowing credit growth, removing one motivation for the European Central Bank to increase interest rates. The declines in money and credit growth come as business and consumer sentiment are weakening sharply and oil prices are falling, all of which point to lower inflation rates ahead.

The ECB uses monetary data to get a glimpse of inflation 18 months out and longer. Prior to June, money and credit growth had been strong for years, foretelling the buildup of inflationary pressures that has become evident this year.

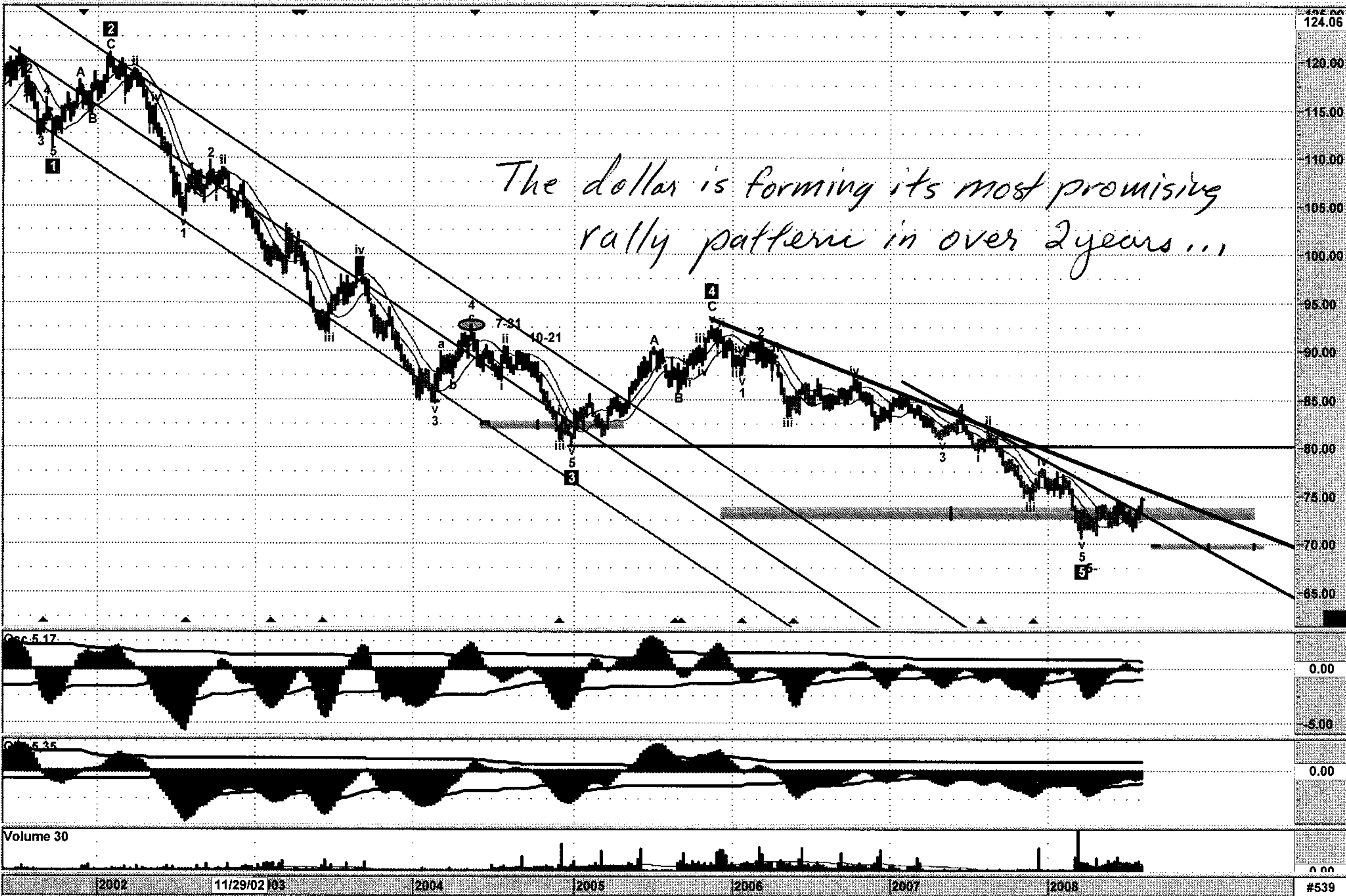
While economic data have been pointing to a slowdown for several months, money-supply data released Friday will likely cause the ECB to take notice.

Broad M3 money-supply growth in June slipped to an annual rate of 9.5%, the slowest rate since November 2006, after a downward revision in May data to 10.0% from 10.5%.

M1 growth, often regarded as a more accurate indicator of activity, fell by nearly a full percentage point to a new all-time low of 1.4%. The last time the growth of M1 data was anywhere near as low was in March 2001, when the euro zone narrowly escaped recession. "The signal is now flashing red," said Holger Schmieding, chief European economist at Bank of America.

ECB policy makers have been edgy about higher prices. Euro-zone annual inflation hit 4% in June, more than double the pace of the bank's comfort zone, a rate just below 2%. The ECB raised its policy rate by a quarter percentage point on July 3, bringing the rate to 4.25%. Friday's monetary statistics remove a big slice of the pressure for another increase.

....as European economy weakens, So do European currencies vs. the dollar


US $ Index 1600, Weekly - Advanced GET ©2008 Trading Techniques, Inc.
08/08/08
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The dollar is forming its most promising rally pattern in over 2 years...
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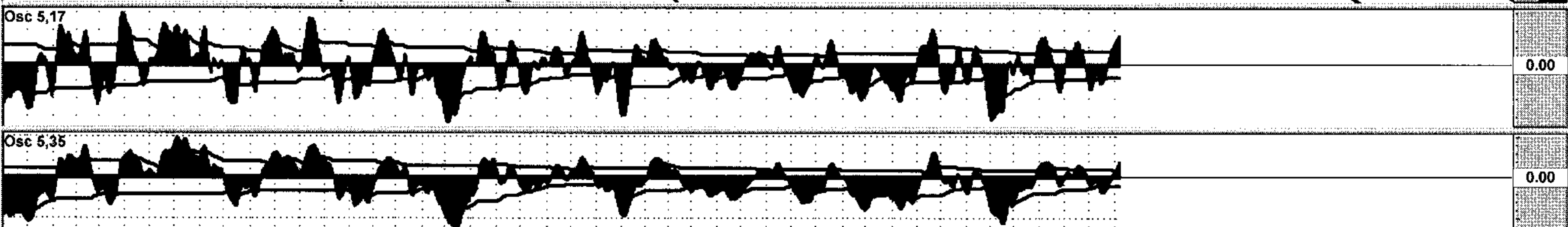
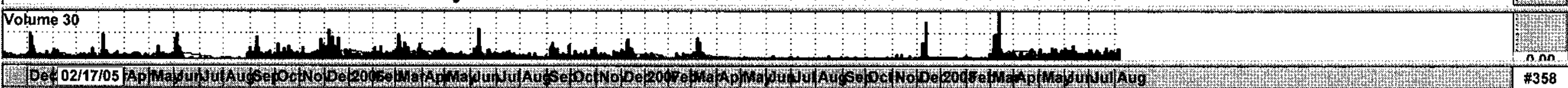
US $ Index 1600, Daily - Advanced GET ©2008 Trading Techniques, Inc.

7-23-08

IMF Says Global Imbalance to Stay

Weak Dollar Helps Narrow the Gap, But Oil, Yuan Weigh

BY TOM BARKLEY

WASHINGTON—The dollar's decline has brought the currency in line with its fundamental value, but global imbalances in current accounts will likely take longer to correct because of high oil prices and China's tightly managed currency policy, a top official from the International Monetary Fund said.

"While the dollar depreciation is helping to reduce the U.S. current-account deficit, it has not been sufficient to alleviate imbalances and risks," said John Lipsky, first deputy managing director at the IMF, in a speech at the Brookings Institution on Tuesday. "Rather, new misalignments may be emerging and risks may be shifting."

While the dollar has moved as close to its medium-term equilibrium value as it has been in a decade, the euro has borne the brunt of the adjustment and is now overvalued, Mr. Lipsky said. China's yuan remains "significantly undervalued," despite recent appreciation against the dollar, he said.

John Lipsky

Mr. Lipsky acknowledged that the dual crises of financial turmoil and surging commodity prices will likely complicate and delay the task of reducing global imbalances. In particular, he noted that record energy prices should continue to push up surpluses in oil-exporting countries.

Thus, policy changes that are necessary to right the imbalances "will need to be implemented flexibly as circumstances have changed, and we accept that large imbalances may be with us for longer than we had originally envisaged," he said.

This is the latest of several major addresses Mr. Lipsky has given this year on challenges facing the world economy, with the IMF seeking to reassert its global-watchdog role as demand for its lending resources has declined.

The messages have shifted as global economic conditions have undergone rapid changes. In March, Mr. Lipsky urged IMF members to stand ready to boost spending to stimulate demand and to rescue troubled financial institutions if the credit crisis deepened. In May, fighting inflation became the focus, with economic stimulus taking a back seat.

In May, Mr. Lipsky warned that the drop in the dollar wasn't helping to reduce the risk of global imbalances. With the euro and other flexible currencies doing most of the adjusting, he called for China and other emerging Asian countries to push forward with exchange-rate and other financial revisions.

Tuesday, Mr. Lipsky sounded a note of optimism that a more balanced global economy will be within reach over time, seeking to counter doubts that the U.S. current account gap will narrow significantly.

The drop in the dollar, which hit a new low against the euro last week and has depreciated 25% in real effective terms since early 2002, has so far led to only a "modest" decline in the U.S. current account gap. The deficit fell from an all-time high of nearly 7% of gross domestic product late in 2005 to around 5% of GDP in the first quarter of this year. By comparison, the more than 30% decline in the dollar from 1985 to 1991 brought the current account into balance from a deficit of 3.5% of GDP in 1987.

However, the adjustment in the current account balance has actually been similar over the two periods, Mr. Lipsky said, when taking into account the impact of present high oil prices on the U.S. deficit and the lack of large money transfers that other governments made to the U.S. during the first Gulf War in the early 1990s.

Mr. Lipsky also expressed confidence that the dollar would retain its role—albeit somewhat diminished—as the world's reserve currency. "Notwithstanding the dramatic claims by some, there is no doubt that the dollar will retain the central role, even though it may gradually share the stage with other currencies to a greater degree than at present," he said, saying that the euro would assume a greater role in reserves, as well.

…. Assuming an impressive dollar rally, keep in mind that longer term the "goal" is to strengthen currencies of developing economies that have built up large reserves.

Gold CMX 1600, Weekly - Advanced GET ©2008 Trading Techniques, Inc.

08/08/08 O: 912.70 H: 915.30 L: 870.30 C: 870.70

GOLD IS CAPPED as long as DOLLAR RALLYS

Gold CMX 1600, Daily - Advanced GET ©2008 Trading Techniques, Inc.

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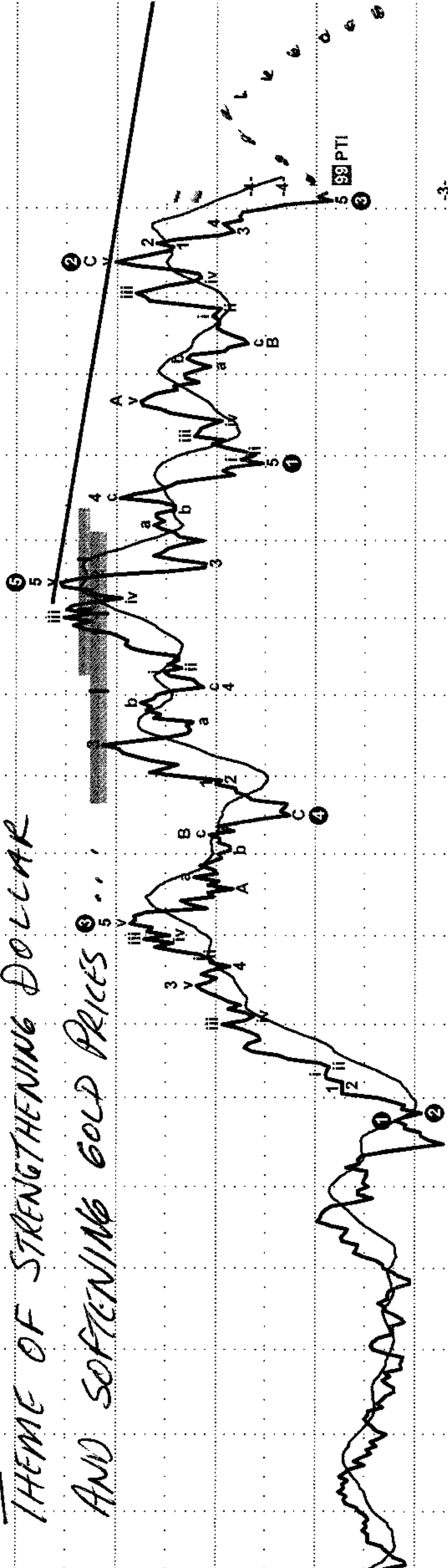
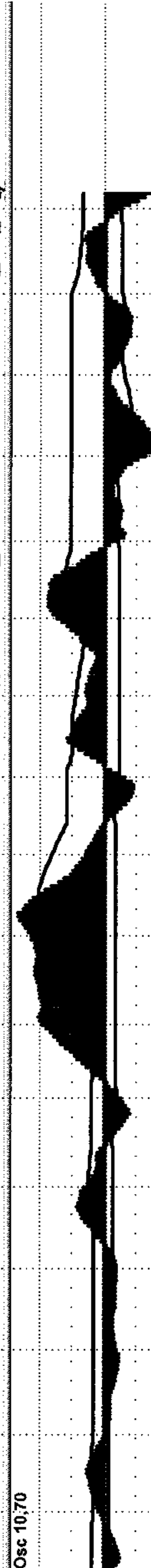
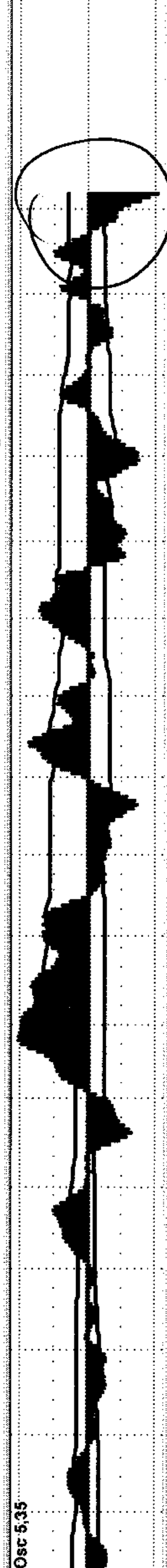
Weakness in Gold stocks confirms weak metal







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CRUDE TOP IS MUCH MORE THAN "ORDERLY SELLOFF"... MORE LIKE A PARABOLIC PLUNGE...

HO00A (Perp 2000), Weekly - Advanced GET ©2008 Trading Techniques, Inc.

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... DITTO FOR HEATING OIL...

THIS TECHNICAL APPEARANCE INCREASES THE CHANCE THAT THE ENERGY HIGHS ARE IN FOR THE YEAR...

... DESPITE THE STRONG OCT-DEC SEASON AHEAD...

....increasing chance energy highs are in for the year...

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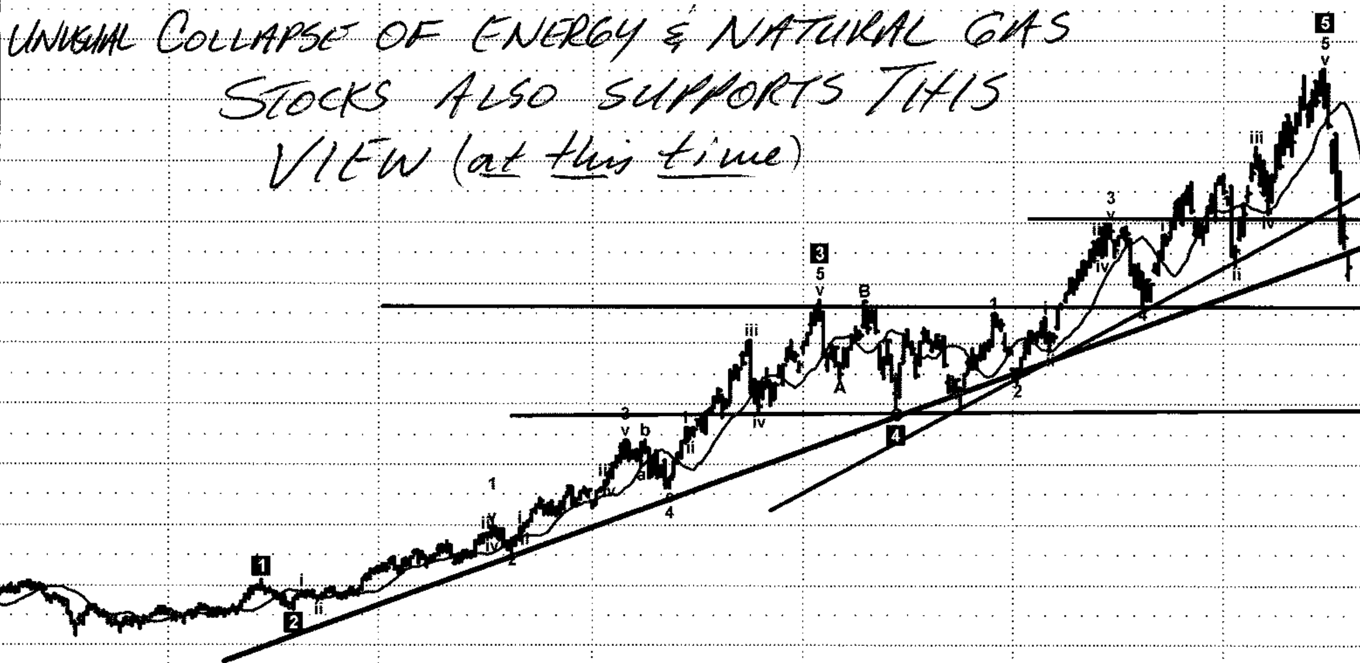
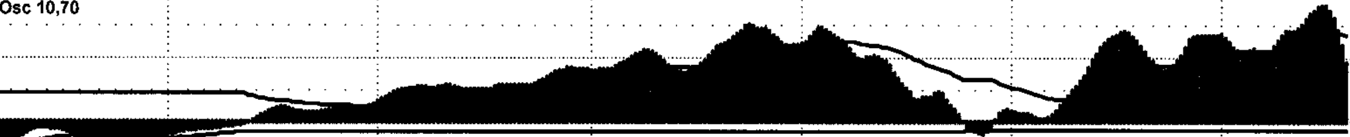
FSPNaturalGas - FSP Natural Gas, Weekly - Advanced GET ©2008 Trading Techniques, Inc.





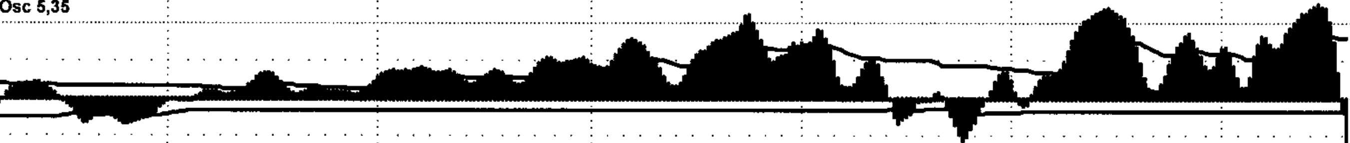


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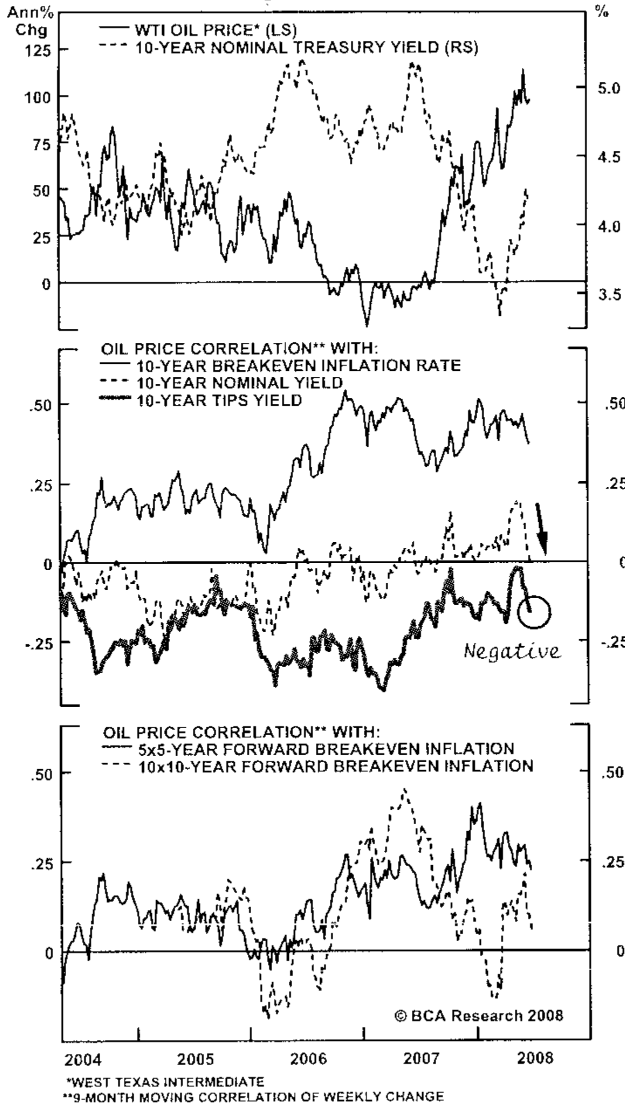
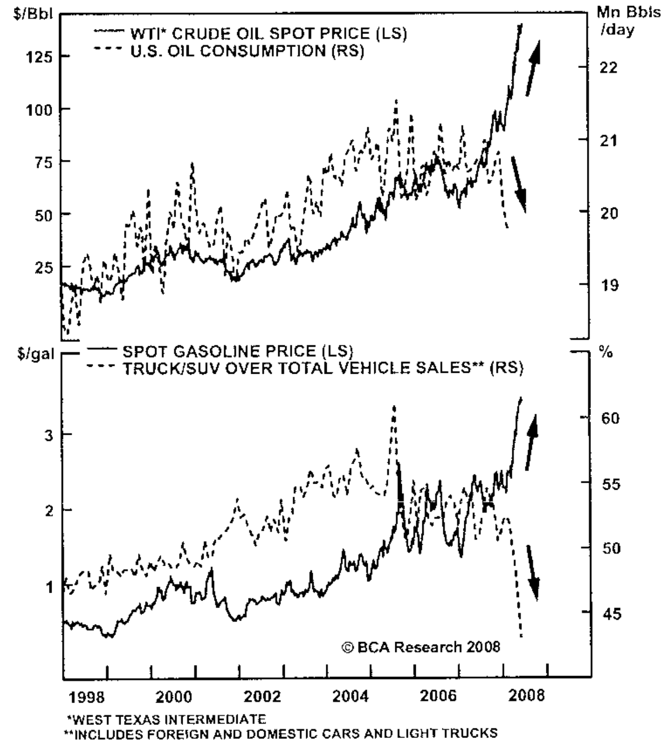
CHART 5
Oil And Treasury Yields



*WEST TEXAS INTERMEDIATE
**9-MONTH MOVING CORRELATION OF WEEKLY CHANGE

CHART 6
Demand Destruction Has Begun



*WEST TEXAS INTERMEDIATE
**INCLUDES FOREIGN AND DOMESTIC CARS AND LIGHT TRUCKS

as the markets treat the escalation in energy prices as inflationary — even in the short term – the Fed is bound to take action to suppress pricing pressures. The alternative would be far more damaging for the long end of the Treasury curve as investors priced in a policy mistake. In the end though, v
do, that t
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bring do\
nents of t
will disperse and the yield curve will bull steepen.

Chart 6 is key: at $3.00 gasoline is a "pinch" on the Consumer. At $4.00 it warps consumer behavior. $4.00 was unsustainable, at least short-term

Consequently, we remain comfortable with our underweight stance in inflation protection. Evidence of pass-through from oil to long-term inflation expectations is muted. Short term inflation expectations as determined from the inflation swap market have surged along with the increase in energy prices, but the relationship reverses as one moves out to longer maturities (**Chart 7**).

Surveys of inflation expectations reveal the same lack of persistence beyond the near term (**Chart 8**). For example, while the Michigan survey shows that inflation expectations for the next 5-10 years have started to edge higher, most of this occurs in the
one year and
orward rate of
expectations
d. The
ows a similar
result.

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US 10 Yr T-Note, Weekly - Advanced GET ©2008 Trading Techniques, Inc.

08/08/08 O: 115.06 H: 115.63 L: 114.22 C: 115.59

US 10 Yr T-Note, Daily - Advanced GET ©2008 Trading Techniques, Inc.

08/07/08 O: 114.88 H: 115.63 L: 114.88 C: 115.59

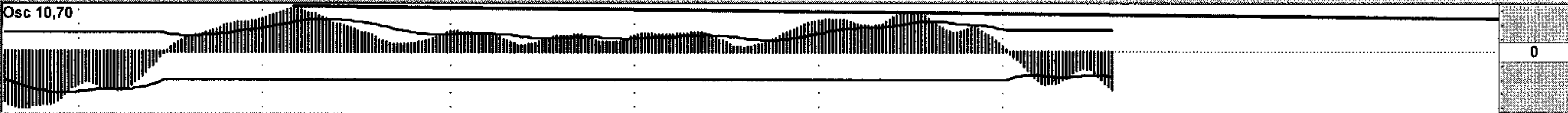
TREASURY NOTES MEANDER SIDEWAYS...

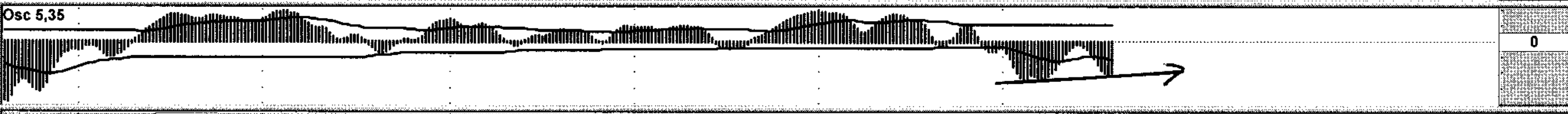
waiting for direction from other markets...

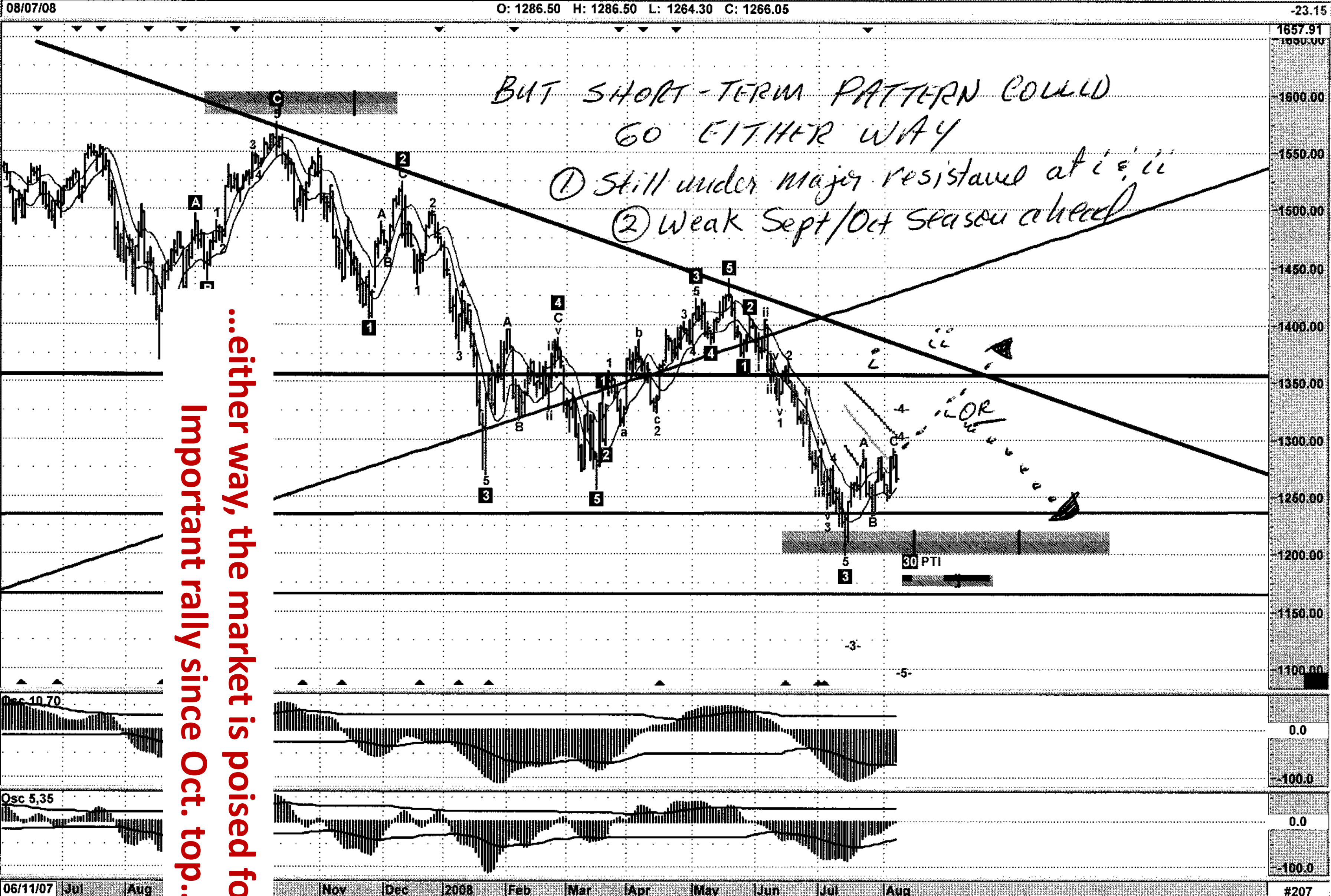
*SPX - S&P 500 Index, Weekly - Advanced GET ©2008 Trading Techniques, Inc.

08/08/08 O: 1260.15 H: 1291.65 L: 1247.45 C: 1266.05 +5.75

LONGER-TERM S+P IS IN PLAUSIBLE BOTTOMING ZONE...







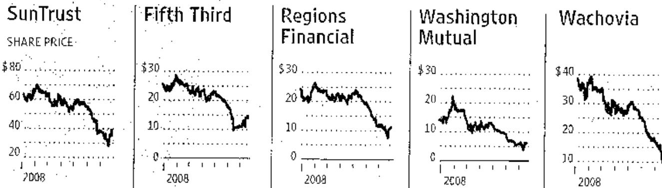
…either way, the market is poised for most Important rally since Oct. top…

Strong rally on bad news... hopeful sign

Five Banks Post Losses—and Their Stocks Soar

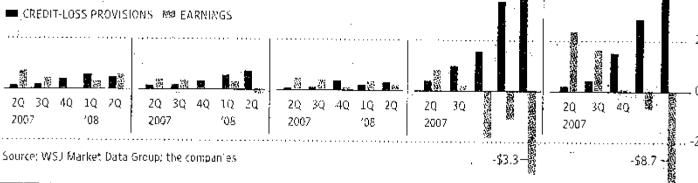
Many Investors Bet The Worst Is Past; Some Bears Flee

By Paulo Prada And Robin Sidel



Five Banks' Pain

The five financial institutions above had a combined second-quarter net loss of $11.6 billion vs. year-earlier profit of $4.7 billion. Their combined credit-loss provision was $13 billion vs. $837 million a year earlier.



Source: WSJ Market Data Group; the companies

Five of the largest U.S. financial institutions, led by **Wachovia** Corp. and **Washington Mutual** Inc., reported combined quarterly losses of more than $11 billion. But their shares jumped an average of 14% on rising hopes that battered bank stocks have fallen about as low as they can go.

The buying frenzy, also fueled by short sellers covering bearish bets, was at odds with the mostly somber assessment by bank executives Tuesday of the shaky loans and struggling economy bedeviling the industry.

In a sign of the loan woes likely to haunt them for years, Wachovia, Washington Mutual, **SunTrust Banks** Inc., **Fifth Third Bancorp** and **Regions Financial** Corp. socked away nearly $13 billion in loan-loss provisions. Wachovia, Regions and Fifth Third also slashed their dividends in order to conserve cash.

Financial stocks are up 31% in the past five trading days. The five big lenders that reported quarterly results Tuesday have climbed by an average of 60% over that period. Tuesday's gains increased their combined stock-market value by $11.6 billion—almost identical to their total losses in the second quarter.

The rally in bank stocks since the middle of last week could make it easier for capital-hungry banks to raise additional capital. In recent weeks, private-equity firms and other investors have expressed growing reluctance to pump money into struggling lenders, partly because of their falling stock prices.

Even though many bank chief executives insist they can weather the current crisis without outside help, a sustained bank-stock rebound would give them more flexibility to bolster their balance sheets without having to sell shares at prices far below their current levels.

Wachovia, based in Charlotte, N.C., said it is laying off 6,350 workers, representing 5.3% of its work force, and will leave an additional 4,400 positions va-

Please turn to page C7

Some Hit Hardest Are Looking to Sell Mutual-Fund Arms

By Diya Gullapalli

Despite the rally in banks stocks, struggling banks are still trying to raise capital, and some of the hardest hit are now considering selling their lucrative money-management units to raise cash.

National City Corp. is working with Morgan Stanley to shop its **Allegiant Funds** operation, according to people familiar with the matter. The division manages about $30 billion, about half of which is in its more than 30 mutual funds. The possibility of such a sale arose earlier this year when National City raised $7 billion in capital, including from a private-equity firm.

FUND TRACK

Fifth Third Bancorp is in the early stages of reviewing a sale of its **Fifth Third Asset Management** unit, which has about $22 billion in assets, say people familiar with the matter. Fifth Third's stock is down 47% this year.

Another possible seller is **KeyCorp**, though the firm has resisted entreaties for its **Victory Capital Management** unit. This ... $60 billion

...but as for news, how far can we rally without better visibility on the nature and scope of proposed (or organic stimulus)?

In 2002 we rallied on:

① Tax rebates ② TAX CUT ③ Housing Boom ④ Market wealth effect

... what will it be this time?

AHEAD OF THE TAPE

By Mark Gongloff

Oil vs. Banks: A Fight With No Winners

7-28-08

HALFWAY through earnings season, it's become pretty clear how this one is going to play out: Another bar fight between the energy and financial sectors that puts everybody in the middle at risk.

With 249 reporting so far, companies in the S&P 500 are on pace to see earnings per share fall 17.9% from a year ago, according to Thomson Reuters. That figure includes estimates for companies that haven't reported yet. It's a bit worse than the 17.1% first-quarter fall and marks the fourth-straight quarter of shrinking earnings, one quarter shy of a record. Analysts again were too rosy in their forecasts; when reporting season began, they expected a decline of 11.5%.

Estimates still too rosy in Q2!

In profits, as in stock prices, financials have been eviscerated, while energy has frolicked in cash.

Strip out financials and energy, and S&P 500 earnings are on pace for a meager 2.8% increase. Lose the troubled home builders and auto makers for an even more finely tuned measure of "core" profits, and the gain improves to 5.4%.

Core earnings have decelerated this year due to higher costs, slower sales and other woes. As recently as the fourth quarter, S&P 500 earnings ex-financials, energy, home builders and autos were up 11.3%. Ex-energy and financials, earnings rose 9.7%.

"Profitability is not falling off a cliff outside of the disaster areas," says Brian Rauscher, director of portfolio strategy at Brown Brothers Harriman. "It's been more like an iceberg melting—it's been glacial."

S&P 500 year-over-year earnings growth, quarterly data

■ Excl. energy and financials

■ Excl. energy, financials, home builders and auto makers

Source: Thomson Reuters

Core profits could keep dripping away. The full U.S. economy hasn't fully experienced the knock-on effects of the financial crisis and soaring energy prices. The global economy is showing signs of catching a sniffle, if not a cold, from the U.S., which threatens the thus-far-resilient profits of multinationals. A stabilizing dollar won't help; past declines had fattened overseas profits when ported back home.

Having learned nothing despite repeated burns from hot stoves, analysts doggedly continue to forecast a stirring earnings rebound in the second half. There's no reason to believe they'll be right this time.

are they STILL too rosy forecasting 2H of 2008?

Rally is sustained by earnings. Still suspicious at this point…

Earnings down, but not as much

USA TODAY

Overall, several sectors see some improvement

By Matt Krantz
USA TODAY

7-31-08

Investors who have grown used to swallowing bad earnings are finding the news this quarter a little easier to choke down.

Nearly 300 companies in the Standard & Poor's 500 index have reported results, and so far, second-quarter earnings are down 19.0% from a year earlier, S&P says. Thomson Reuters, which uses different methodology, says earnings are down 17.9%.

While the slide, caused largely by massive losses at banks and other financial companies, is hardly anything to applaud, the situation actually is improving. Earnings fell 25.8% in the first quarter and 30.8% in the fourth quarter of 2007, S&P says. "Outside of financials and automakers, it's been fairly decent," says John Butters at Thomson.

Wall Street appears to be taking notice. The Dow Jones industrial average gained 186 points to 11,584 Wednesday — despite oil jumping $4.58 to $126.77 a barrel — bringing its two-day gain to 453 points, or 4.1%. But that only slightly patched recent damage (the Dow is 18.2% off its high), and analysts say there is still reason for unease, including:

▸ **The energy effect.** Weak earnings and write-downs from financials continue to drag down profits. Optimists point to the fact that S&P 500 earnings would be up 7.8% if financials are taken out, Thomson says. But most of that gain is from 25% growth in the energy sector. Strip out energy as well as financials, and growth is just 3.0%, Butters says. Oil companies were top gainers Wednesday.

(1) ▸ **Performance vs. expectations.** The mix of companies beating and missing estimates has improved the last three quarters. So far, 68% of companies beat forecasts, and 21% missed them, compared with the 63% that beat and 26% that missed the past three quarters, Thomson says. Historically, 20% miss estimates, so misses are still higher than normal.

(2) ▸ **The elusive bottom.** Analysts hoping the economy rebounds and that year-over-year comparisons are about to improve are calling for 10.5% growth in the third quarter and 59.3% in the fourth.

But analysts were consistently too optimistic in the downturn. "We keep hearing the bottom is near, and three months later, we hear it again," S&P's Howard Silverblatt says. The expectation on July 1 that second-quarter earnings would be down 11.5% now appears way off, Thomson says.

Earnings views for the rest of 2008 also will prove too hopeful because government programs temporarily propped up corporate earnings, says Rod Smyth of Riverfront Investment Group.

What is most worrying isn't what companies are earning now, Smyth says, "but what they're going to earn once the tax (rebate) money is spent."

Optimistic outlook

While expectations for second- and third-quarter earnings came down the past month, estimates for a big gain at the end of 2008 remained steady. Earnings changes expected as of:

Quarter	July 1	Now
2Q 2008	▼ 11.5%	▼ 17.9%
3Q 2008	▲ 12.6%	▲ 10.5%
4Q 2008	▲ 59.3%	▲ 59.3%

Source: Thomson Reuters

▸ Starbucks reports loss, more closures, 2B

MIXED VIEW ON EARNINGS

(1) The "Beat/Missed" ratio may be improving

(2) 3rd Quarter is "optimistic" at 10.5% growth and 4th Quarter seems fantastic at 59.3% growth estimate.

- How do you get to 59.3% Q4 growth with an economy in this condition??

Are these realistic? If not this is a major headwind… Look for market reaction in seasonally erratic late Sept/ Oct., when all of this may get sorted out, one way or the other…

…Alternatively, the market may hang it's hat on a "coming Stimulus" regardless of which candidate is elected…

Can foreign earnings hold up ??

Profits' Rise Made Fall Even Harder

By FLOYD NORRIS

Corporate profits earned in the United States rose much more rapidly from 2005 through 2007 than had been earlier reported, making the subsequent fall seem even more precipitous, government figures showed Thursday.

The revised figures may help to explain the sense of pessimism that has been reported in surveys of consumers and business executives, said Robert Barbera, the chief economist of ITG, an economic research company. Pointing to the previous profit figures, some commentators had suggested there was more gloom than the economic data seemed to justify.

First-quarter profits earned in the United States by American companies have fallen 18 percent from their peak, the revised figures show, rather than the 11 percent previously reported.

That decline has been partly offset by soaring overseas profits for American companies. On Thursday, the government raised its estimate of those profits in the first quarter, even as it reduced its estimate of profits earned in this country.

By the latest measure, first-quarter overseas profits were the highest they have ever been for American companies — up 25 percent from the third quarter of 2006, when domestic profits peaked.

Overseas profits, while impor-

Continued on Page 7

NYT 8-1-08

Overseas earnings are crucial to American Companies, How will these earnings trend with a stronger dollar & weaker foreign economies?

A Sharper Rise, and Fall, in Profits Than Stated

From First Business Page

tant to shareholders, do not reflect the performance of the American economy or the prospects for employment in this country. Surveys show that both business executives and consumers expect declines in jobs in America in coming months.

The figures show that more than a third of profits earned by American companies are now made overseas. In the first three months of this year, the proportion was 35 percent, nearly twice what it was a decade ago.

The revised data shows that profits of American companies are down 7 percent over all, rather than the 2 percent previously reported.

The revised figures were contained in the revisions of the gross domestic product numbers issued Thursday by the Bureau of Economic Analysis, a part of the Commerce Department.

Brent R. Moulton, the bureau's associate director for national economic accounts, said the new figures reflected preliminary data from the Internal Revenue Service for 2006, and revised figures for 2005. For 2007

Soaring overseas profits, for which the government raised its estimate, partly offset declines at home.

and 2008, the changes reflect assorted revisions in estimates of the performance of various industries.

Because the figures are largely based on tax returns, the eventual totals are used as clear indicators of overall economic performance of American businesses, both privately owned companies and those owned by shareholders.

The revised figures indicate that in the third quarter of 2006, when domestic profits of American companies peaked, the annual rate of profits was $1.27 trillion, $100 billion more than had previously been estimated. That figure fell to $1.04 trillion in the first quarter of this year, the lowest rate since the third quarter of 2005.

By contrast, the overseas profits of American companies came in at an annual rate c $557 billion in the first quarter of 2008, an ir crease of more than $100 billion from th 2006 quarter.

The profit figures in the government re port represent operating profits, nc changes in the value of assets. That polic means that the profit figures for financial ir dustries estimated by the government ar now far higher than the ones being reporte to shareholders. Mr. Moulton said tha write-downs of the value of securities, c write-offs of bad loans — which have cos banks tens of billions of dollars — are not ir cluded.

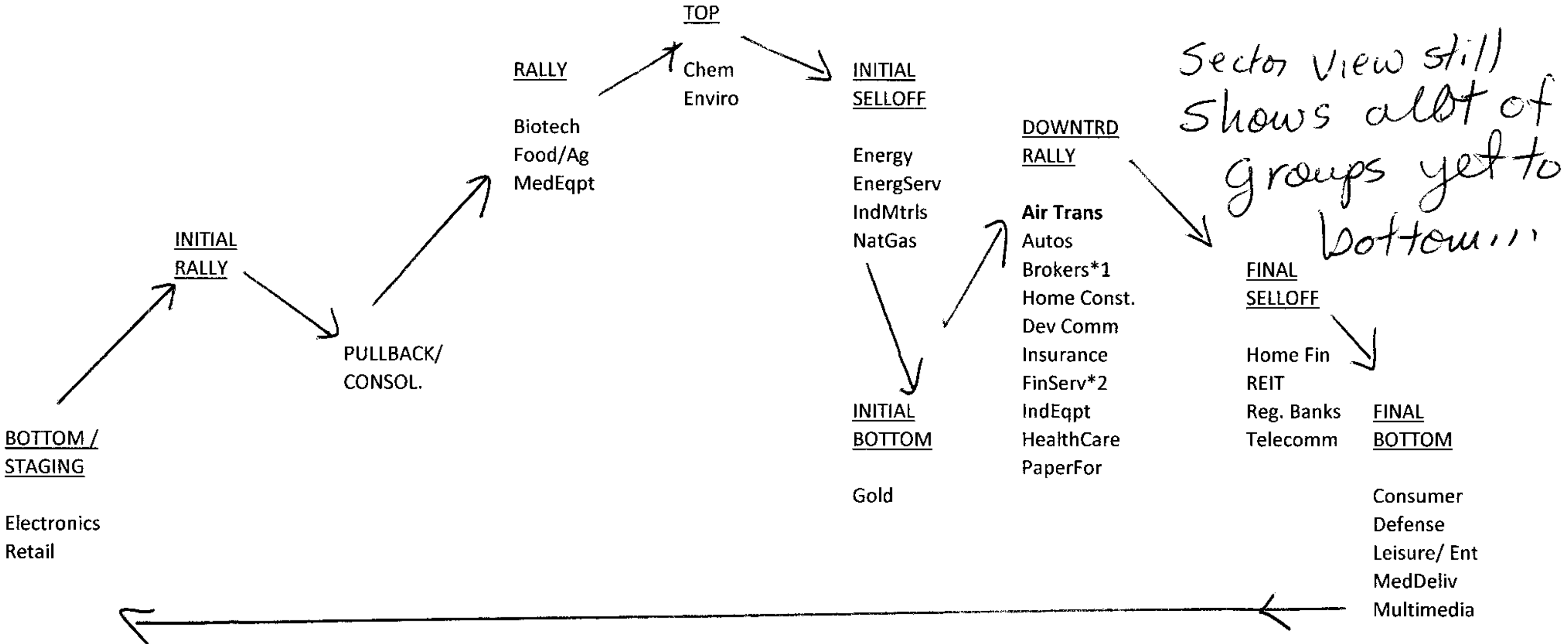
Were they included, it seems certain tha the decline in profits earned in the Unite States by American companies would b even larger than was indicated by the fig ures released Thursday.

NYT 8-1-08

Quotation of the Day,
Page 3, every day,
Inside The Times.
The New York Times.

U.S. INDUSTRY GROUP MARKET TRENDS

As of Aug. 7, 2008



Sector View still shows alot of groups yet to bottom…

UNCLEAR, FAVORS UPSIDE

UNCLEAR / SIDEWAYS
Business Services, Cyclical, Software, Technology
Transportation

UNCLEAR, FAVORS DOWNSIDE
Computers

…this increases the chance that the index will at least re-test their lows,

NOTES:

(from May) *1: March 17 and April 15 area lows for Brokers are key to continuing overall market upside support.
(from June) Brokers now look like a re-test of their lows
Today: Continuing weakness in Brokers is a primary argument in favor of indices needing at least one more low re-test in Oct.

(from May) *2: May 2 area highs for Financial Services is a key area that probably must be broken if the broad market is to return to bull trend
Today: Continuing weakness in Financial Services is a primary argument in favor of indices needing at least one more low re-test in Oct.
Note, "weakness" MAY come in the form of a failed re-test of the July lows.

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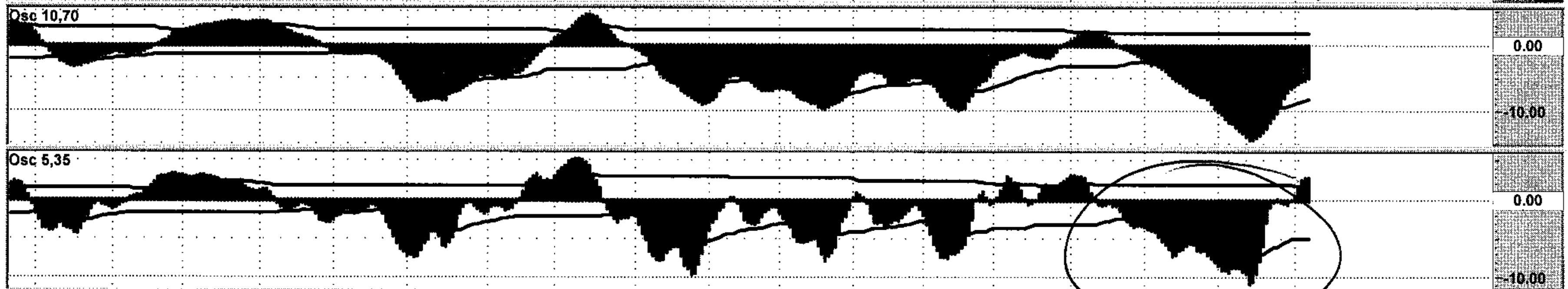

FSPConsumerInd - FSP Consumer Ind, Weekly - Advanced GET ©2008 Trading Techniques, Inc.

08/08/08 O: 18.060 H: 18.840 L: 18.060 C: 18.430

THE LONG OUT-OF-FAVOR CONSUMER SECTOR FORMING A PLAUSIBLE BOTTOMING PATTERN

Osc 10,70

Osc 5,35

2003 05/23/03 2004 2005 2006 2007 2008 #286

FSPConsumerInd - FSP Consumer Ind, Daily - Advanced GET ©2008 Trading Techniques, Inc.

08/07/08 O: 18.430 H: 18.430 L: 18.430 C: 18.430

... BUT MUST BREAKTHROUGH RESISTANCE LINES TO ESTABLISH A RALLY

Osc 10,70

Osc 5,35

Mar Apr 05/17/07 Jun Jul Aug Sep Oct Nov Dec 2008 Feb Mar Apr May Jun Jul Aug #391

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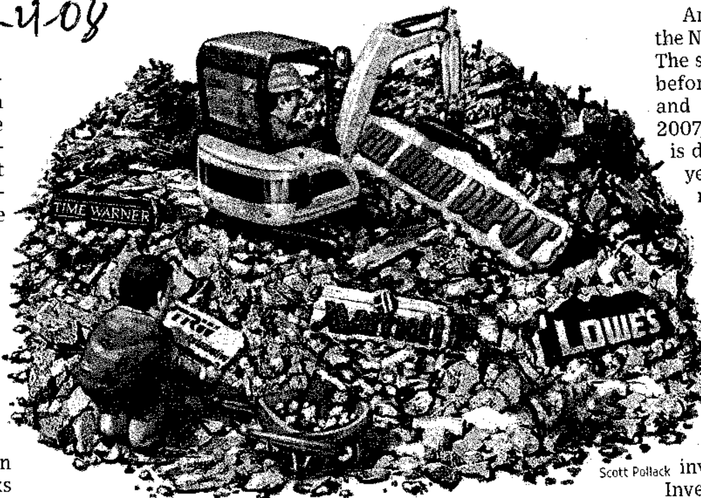
Pearls in the Consumer-Stock Rubble

The 'When' Question Hinges on Americans' Feeling More Free to Spend

TOM LAURICELLA 8-11-08



Scott Pollack

INVESTORS TRYING to position their portfolios for an eventual rebound in the stock market face a difficult task: The stocks that ially lead a recovery—finan-ls and companies that make sell goods and services di-:tly to consumers—are the ɛs with the riskiest outlook. With many investors believ-; that banks and brokerage firms are facing an extended period of struggles, a strategy tilting toward beaten-down ısumer-discretionary stocks ıy seem tempting.

ƎREAST : THE ARKET

And while it may make sense those with a long-term hori-ı of a year or two to start nib-ıg now, they should keep the a-Seltzer handy; those stocks ıld fall further before they be-a recovery.

Worries about the consumer e dominated recent sessions, ling the Dow Jones Industrial rage down 0.4% last week to ?6.32, down 15% for the year. ' stocks of consumer-discre-ary companies in the Stan-l & Poor's 500-stock index down 14%.

'hese companies deal in ɡs that people don't necessar-ɛed, and they often are on the ɛy side: autos, entertainment restaurants. (That is distinct consumer staples, such as from supermarkets, where :s are down just 5.6%.)

For months, one trade has worked—heavy positions in energy producers and other materials stocks as well as companies with a big portion of their customer base outside the U.S. Now, there is a debate about whether it is finally time to move back into companies focused on U.S. consumers in preparation for an economic rebound.

On the one hand, most consumer stocks are down sharply in price and are cheap by many measures. Many have trailing price/earnings ratios below that of the S&P 500's 16.7. But consumers could be only in the early stages of a historic pullback in spending, which would mean that the worst news for investors still could be on the way.

David Giroux, manager of the **T. Rowe Price Capital Appreciation Fund**, is among those wading into the troubled waters of stocks such as **Marriott International** Inc., **TRW Automotive Holdings** Corp. and **Time Warner** Inc.

"This is a great time for long-term investors to be buying these types of names," he said. "There's no risk that these companies are going to go under, there's no risk that the business models are flawed." A turnaround will come, he said. "It's all a question of 'when' and not 'if.' "

Consumer stocks were among the first to slide last year as the real-estate market became unglued. "These stocks face headwinds, but those headwinds are more than priced in," said Burns McKinney, a portfolio manager on the **Allianz NFJ Dividend Value Fund**.

Among the top holdings of the NFJ fund is **Home Depot** Inc. The stock ran into troubles long before the housing downturn, and really was hammered in 2007, losing 33% of its value and is down an additional 11% this year. It is changing hands at roughly 12 times the last 12 months of earnings.

"The stock is valued where it was a decade ago, even though earnings per share have quadrupled," said Mr. McKinney. In addition, he said, its dividend yield is near a record high, just south of 4%.

James Swanson, chief investment strategist at MFS Investment Management, said declines in home sales should start to work in favor of home-improvement companies. "People are staying longer" instead of moving, he said. "They're going to begin to tinker with their own premises, and the home-improvement names have already been beaten way down."

But Robert Doll, chief investment officer for equities at money manager BlackRock Inc., is skeptical. "The further away from the U.S. consumer and those who lend to the U.S. consumer, the better," he said.

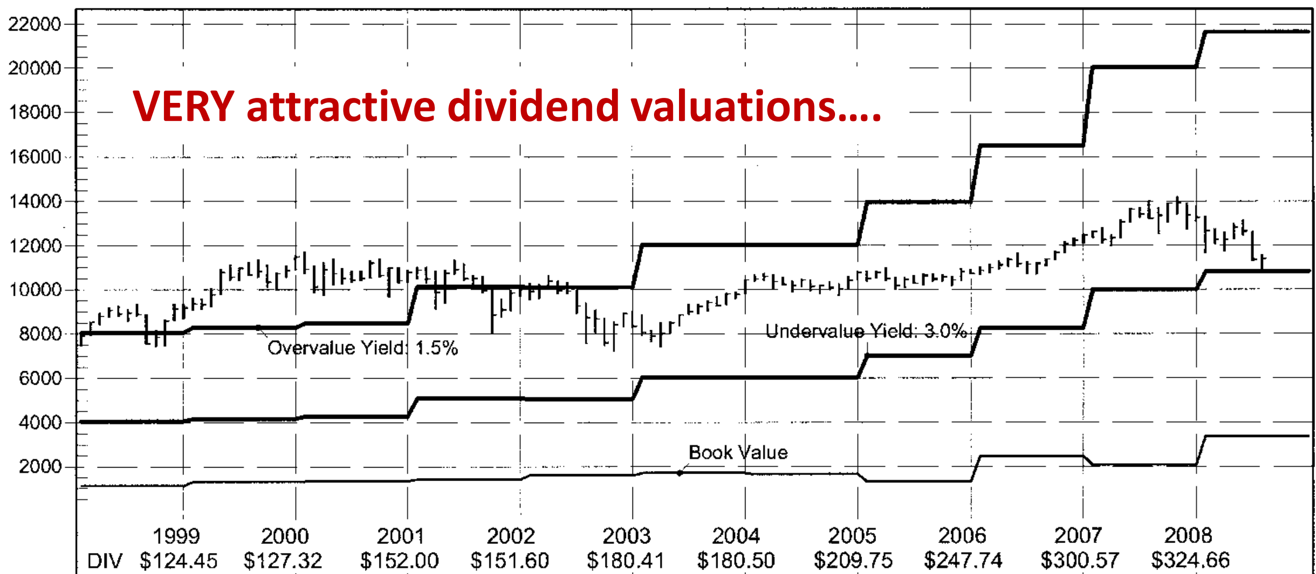
Recent developments reflect the difficulties confronting consumer and other cyclical companies. Last week, the parent company of restaurant chains Bennigan's and Steak and Ale filed for bankruptcy protection. On Fri-

Please turn to the next page

IQT INVESTMENT QUALITY TRENDS
for the enlightened investor
FIRST-AUGUST 2008

AN ILLUMINATING CONCEPT

When all other factors which rate analytical consideration have been digested, the underlying value of dividends, which determines yield, will in the long run also determine price. The key to value, therefore, lies in yield as reflected by the dividend trend. Individual stock prices fluctuate between repetitive extremes of high dividend yield and low dividend yield. These recurring extremes of yield establish Undervalue and Overvalue price levels. When a dividend is raised, the Undervalue and Overvalue price levels are raised automatically so they will continue to reflect the historically established yield extremes. Each stock has its own distinctive high and low yield characteristics and must be evaluated individually.



	CURRENT			POTENTIAL TO OVERVALUE				POTENTIAL TO UNDERVALUE			
	PRICE	ANN DIV	DIV YIELD	POINTS UP	% UP	HIGH PRICE	LOW YIELD	POINTS DOWN	% DOWN	LOW PRICE	HIGH YIELD
DOW JONES INDUSTRIAL AVERAGE	11400	$324.68	2.84%	10245	90%	21645	1.5%	577	5.0%	10823	3.0%
DOW JONES UTILITY AVERAGE	481	$15.81	3.28%	46	9.6%	527	3.0%	217	45%	264	6.0%

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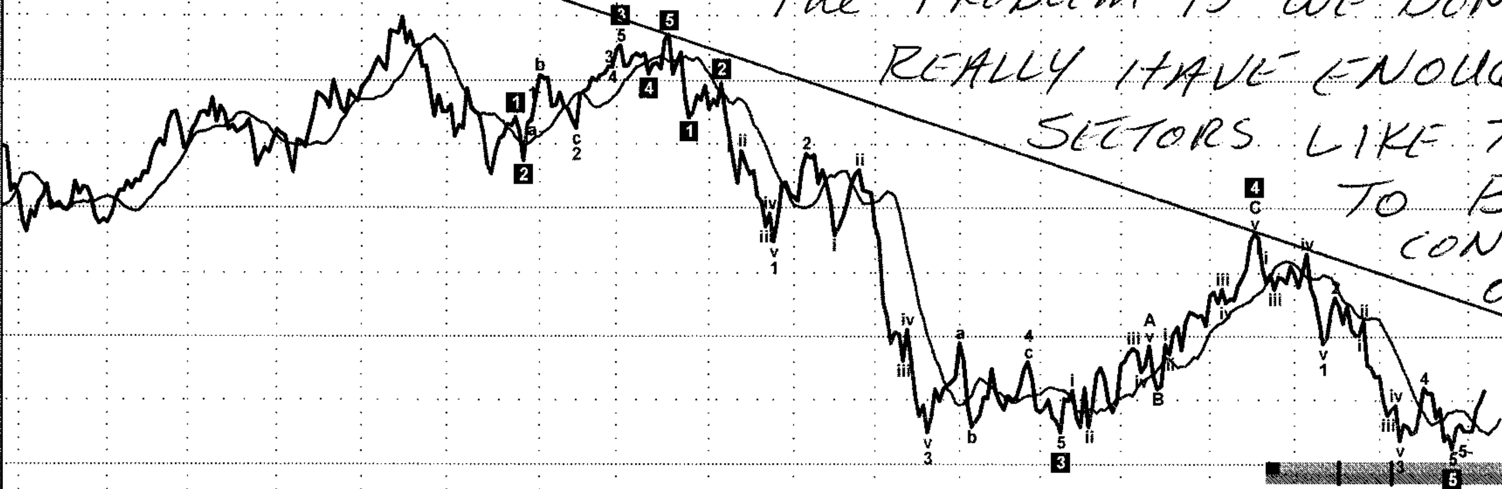
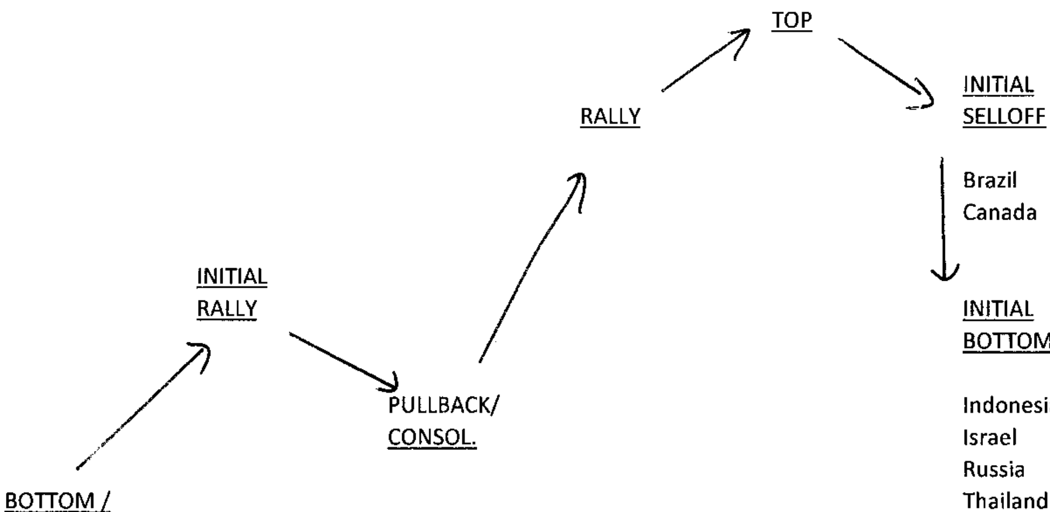


GLOBAL STOCK INDEX TRENDS

As of Aug. 7, 2008



INITIAL BOTTOM
Indonesia
Israel
Russia
Thailand

DOWNTRD RALLY
Chile
India

FINAL SELLOFF
Australia
France
Korea
Malaysia
Sweden
Taiwan

FINAL BOTTOM
China Region
Germany
Hong Kong
Italy
Japan
Netherlands
Singapore
Turkey
U.K.

LARGE "KNOT" OF GLOBAL INDICES YET TO BOTTOM.

In alternative interpretation, several of the "Final Bottoms" might be considered forming rally staging patterns.

... MANY ARE CLOSE TO BOTTOM BUT NEED AT LEAST A BLIP RETEST..!

UNCLEAR, FAVORS UPSIDE

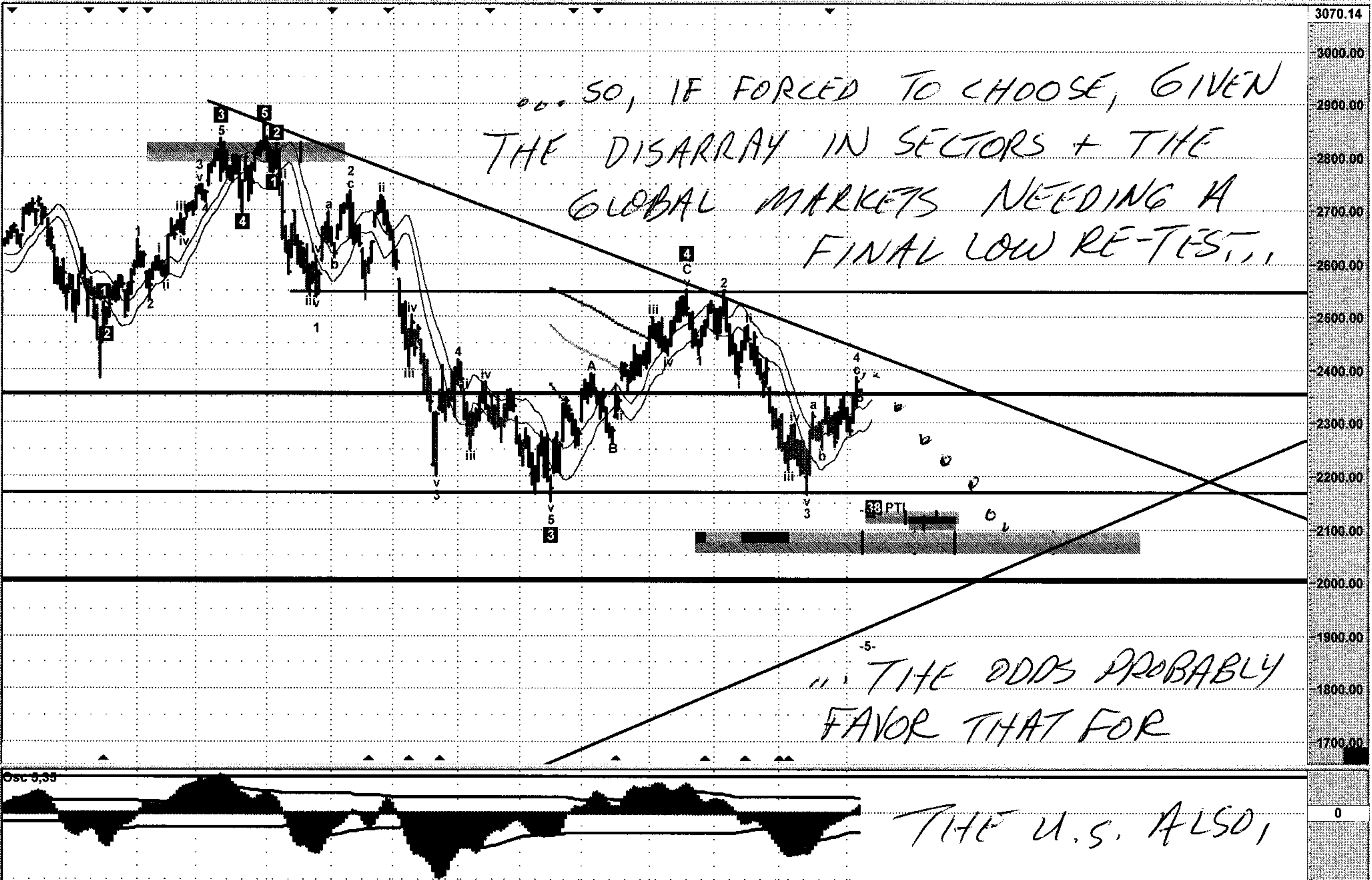
UNCLEAR / SIDEWAYS

UNCLEAR, FAVORS DOWNSIDE
Mexico

NOTES:

GLOBAL STOCK MARKET SUMMARY — 8/7/08

		SYM	2007-08 HIGH	2008 LOW	LOW DATE	LOW % OFF HIGH	CURR PRICE	TREND COMMENTS
NORTH AMERICA. Mixed picture. USA more constructive while Canada and Mexico still have further technical downside								
Canada	iShare	EWC	$36.68	$26.40	1/22	28%	$29.83	Toppy appearance. Needs lower low to form rally base.
Mexico	iShare	EWW	$65.00	$47.52	1/22	27%	$53.73	Toppy appearance. Needs lower low to form rally base.
U.S.A.	Dow Indus		14,280	10,731	7/15	25%	11,431	(1) NOTE SYNCHRONICITY OF MANY BOTTOMS
	NASDAQ		2,861	2,155	3/17	25%	2,362	
	S&P		1,576	1,200	3/17	24%	1,266	
ASIA-PACIFIC. Majority of these markets are either in final downlegs or forming plausible bottoms needing perhaps a blip re-test of lows								
Australia	CEF	IAF	$18.50	$13.29	8/6	28%	$13.29	Erratically bearish
China Region	CEF	JFC	$32.99	$18.51	3/17	44%	$23.26	Technically forming plausible bottom from '07 high
Hong Kong	iShare	EWH	$24.00	$15.63	7/15	35%	$16.03	Technically forming plausible bottom from '07 high
India	CEF	IFN	$70.90	$31.89	7/15	55%	$40.08	Short-term bottoming but may have another leg down to go.
Indonesia	CEF	IF	$14.20	$9.10	7/15	36%	$9.12	Short-term bottoming but may have another leg down to go.
Japan	iShare	EWJ	$14.78	$11.44	8/7	23%	$11.46	Short-term bottoming, may need at least slight re-test
Korea	iShare	EWY	$74.76	$46.86	7/15	37%	$48.55	Short-term bottoming, may need at least slight re-test
Malaysia	iShare	EWM	$14.01	$9.61	7/3	31%	$9.83	Likely to take out '08 low shortly. Thereafter re-assess
Singapore	iShare	EWS	$15.60	$11.64	3/10	25%	$11.77	Very interesting bottoming formation. Look for longside opportunities
Taiwan	iShare	EWT	$18.19	$12.61	1/7	31%	$13.22	Likely to take out '08 low shortly. Thereafter re-assess
Thailand	CEF	TTF	$14.65	$9.01	7/16	38%	$9.88	Likely further downside after current blip rally
EUROPE Similar patterns to Asia. Majority final downlegs or bottoming patterns needing blip re-test of lows								(2) GLOBALLY THIS HAS BEEN A SIGNIFICANT -33% BEAR MARKET
France	iShare	EWQ	$40.00	$29.77	7/16	26%	$31.56	At least one more blip re-test of low needed for plausible bottom
Germany	iShare	EWG	$36.50	$28.01	7/15	23%	$28.84	ST Pullback thereafter retest of high looks most likely.
Italy	iShare	EWI	$36.35	$25.23	7/16	31%	$26.24	Slight blip new low would put in plausible bottom, at least short-term
Netherlands	iShare	EWN	$32.71	$23.14	7/16	29%	$29.79	Slight blip new low would put in plausible bottom, at least short-term
Russia	CEF	TRF	$92.21	$45.17	8/6	51%	$46.53	At short-term bottom. However after any rally a re-test is likely.
Spain	iShare	EWP	$68.12	$50.85	7/15	25%	$51.98	Slight blip new low would put in plausible bottom, at least short-term
Sweden	iShare	EWD	$38.75	$24.23	7/15	37%	$32.24	At least one more blip re-test of low needed for plausible bottom
U.K.	iShare	EWU	$25.88	$18.92	7/16	27%	$19.80	Slight blip new low would put in plausible bottom, at least short-term
MIDEAST								
Israel	CEF	ISL	$25.78	$15.73	7/10	39%	$16.65	After any near-term rally, a re-test of the July low is likely.
Turkey	CEF	TKF	$29.60	$11.20	7/15	62%	$13.78	Forming long-term bottom. One re-test of the 7-15 low still likely.
S. AMERICA. Further downside likely.								
Brazil	iShare	EWZ	$102.01	$74.80	8/5	27%	$75.91	Bull market broken. In initial selloff phase
Chile	CEF	CH	$24.00	$15.25	7/16	36%	$16.71	Current rally likely to fail and head towards a re-test of '08 lows.
GLOBAL AVERAGE SELLOFF:					(2)	33%		Notes: 1)"ST": Short-term; "LT": Longer-term 2) Indonesia & Turkey are 2006 high.


*OTC - NASDAQ Composite, Daily - Advanced GET ©2008 Trading Techniques, Inc.
08/07/08
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...SO, IF FORCED TO CHOOSE, GIVEN THE DISARRAY IN SECTORS + THE GLOBAL MARKETS NEEDING A FINAL LOW RE-TEST...
...THE ODDS PROBABLY FAVOR THAT FOR
THE U.S. ALSO,
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WARREN BUFFETT DISCUSSES THE EFFECTS OF INTEREST RATES ON STOCK PRICES

The last time I tackled this subject, in 1999, I broke down the previous 34 years into two 17-year periods, which in the sense of lean years and fat were astonishingly symmetrical. Here's the first period. As you can see, over 17 years the Dow gained exactly one-tenth of one percent.

Case 1:

• DOW JONES INDUSTRIAL AVERAGE

(1) → Dec. 31, 1964: **874.12**
Dec. 31, 1981: **875.00**

1 point in 17 years!!

And here's the second, marked by an incredible bull market that, as I laid out my thoughts, was about to end (though I didn't know that).

Case 2:

• DOW INDUSTRIALS

(2) → Dec. 31, 1981: **875.00**
Dec. 31, 1998: **9181.43**

Skyrockets next 17!!

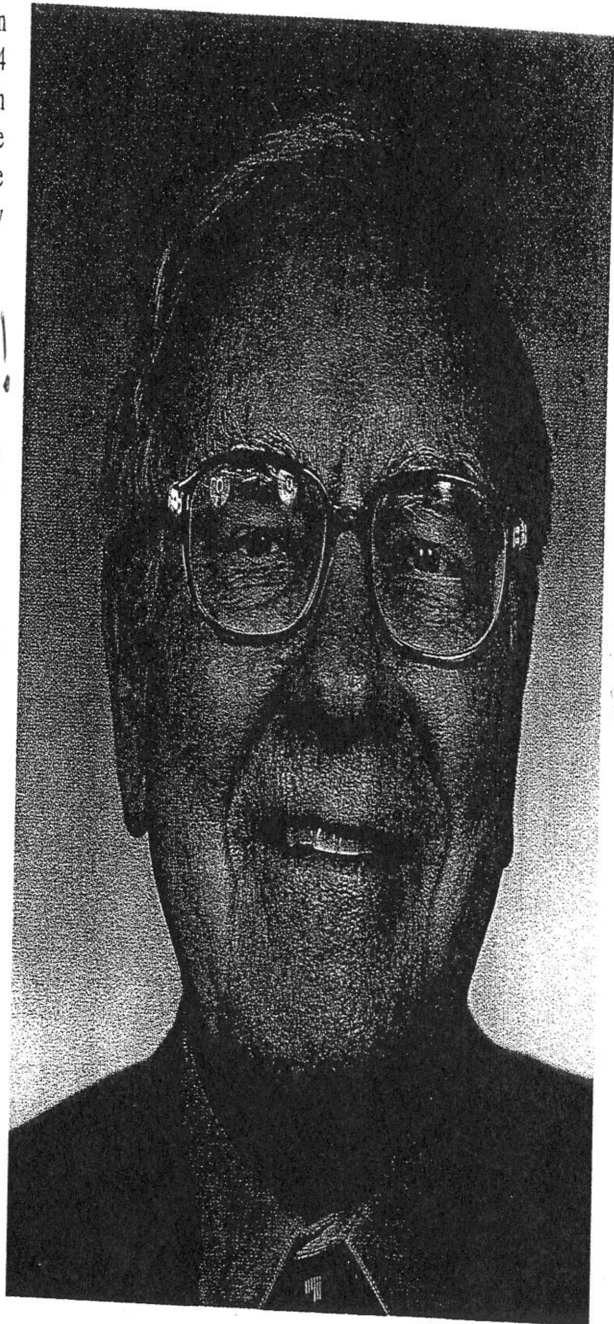
Now, you couldn't explain this remarkable divergence in markets by, say, differences in the growth of gross national product. In the first period—that dismal time for the market—GNP actually grew more than twice as fast as it did in the second period.

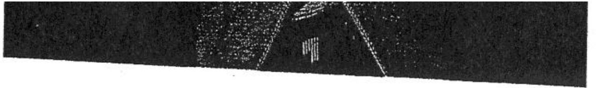
• GAIN IN GROSS NATIONAL PRODUCT

1964–1981: **373%**
1981–1988: **177%**

So what was the explanation? I concluded that the market's contrasting moves were caused by extraordinary changes in two critical economic variables—and by a related psychological force that eventually came into play.

Here I need to remind you about the definition of "investing," which though simple is often forgotten. Investing is





Here I need to remind you about the definition of "investing," which though simple is often forgotten. Investing is laying out money today to receive more money tomorrow.

That gets to the first of the economic variables that affected stock prices in the two periods—interest rates. In economics, interest rates act as gravity behaves in the physical world. At all times, in all markets, in all parts of the world, the tiniest change in rates changes the value of every financial asset. You see that clearly with the fluctuating prices of bonds. But the rule applies as well to farmland, oil reserves, stocks, and every other financial asset. And the effects can be huge on values. If interest rates are, say, 13%, the present value of a dollar that you're going to receive in the future from an investment is not nearly as high as the present value of a dollar if rates are 4%.

So here's the record on interest rates at key dates in our 34-year span. They moved dramatically up—that was bad for investors—in the first half of that period and dramatically down—a boon for investors—in the second half.

The impact of Rising vs. falling Interest rates

• INTEREST RATES, LONG-TERM GOVERNMENT BONDS

Dec. 31, 1964: **4.20%**
Dec. 31, 1981: **13.65%**
Dec. 31, 1998: **5.09%**

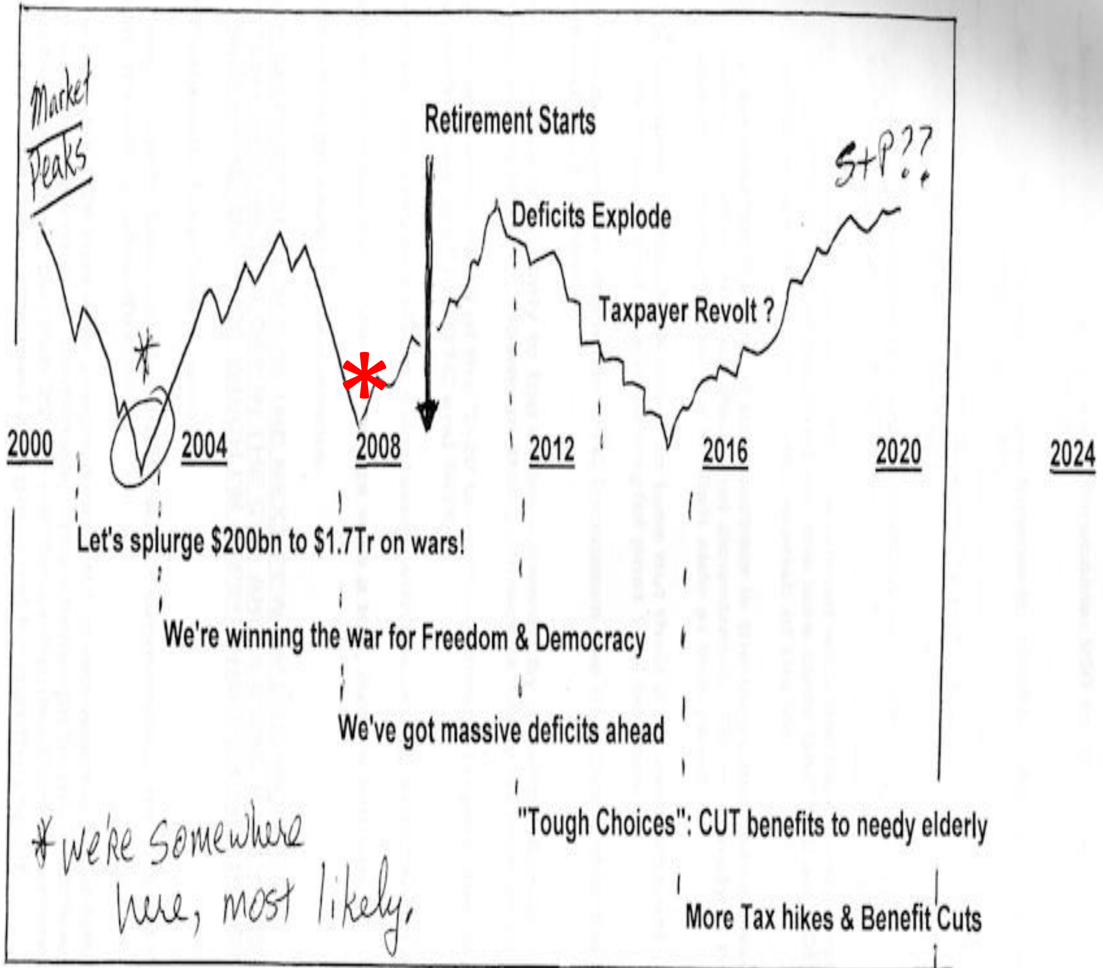
The other critical variable here is how many dollars investors expected to get from the companies in which they invested. During the first period expectations fell significantly because corporate profits weren't looking good. By the early 1980s Fed Chairman Paul Volcker's economic sledgehammer had, in fact, driven corporate profitability to a level that people hadn't seen since the 1930s.

The upshot is that investors lost their confidence in the American economy: They were looking at a future they believed would be plagued by two negatives. First, they didn't see much good coming in the way of corporate profits. Second, the sky-high interest rates prevailing caused them to discount those meager profits further. These two factors, working together, caused stagnation in the stock market from 1964 to 1981, even though those years featured huge improvements in GNP. The business of the country grew while investors' valuation of that business shrank!

And then the reversal of those factors created a period during which much lower GNP gains were accompanied by a bonanza for the market. First, you got a major increase in the rate of profitability. Second, you got an enormous drop in interest rates, which made a dollar of future profit that much more valuable. Both phenomena were real and powerful fuels for a major bull market. And in time the psychological factor I mentioned was added to the equation: Speculative trading exploded, simply because of the market action that people had seen. Later, we'll look at the pathology of this dangerous and oft-recurring malady.

Two years ago I believed the favorable fundamental trends had largely run their course. For the market to go dramatically up from where it was then would have required long-term interest rates to drop much further (which is always possible) or for there to be a major improvement in corporate profitability (which seemed, at the time, considerably less possible). If you take a look at a 50-year chart of after-tax profits as a percent of gross domestic product, you

BABY-BOOMER RETIREMENT:
THE SILENT "BLACK HOLE" of FINANCE



WILL MARKETS MOVE "SIDEWAYS", PULLED BY THE GRAVITY of ENTITLEMENT FINANCING DEMANDS OVER THE NEXT 20 YEARS??

***Here we are at the 2008 bottom, on a chart drawn In January 2003!**

Stewart M. Bishop, Publisher
FullHouseTrader.com