

Headwinds or Wilma

"Headwinds" is the new CEO word in defining current economic conditions. CEOs refer to sailing jargon, either from overhear their crew or the company's communications department tactfully telling the world that things do not look good and don't blame us.

G. Kennedy Thompson, CEO of Wachovia Corp., informed investors that the bank and its competitors were facing "headwinds.".... "Big headwinds."¹

On Jan. 17, Rick Wagoner, CEO of General Motors Corp., told auto analysts at a New York conference to brace themselves for unfavorable conditions. "As we look out, we've got to be realistic [that] we are facing some tough headwinds, particularly here in the U.S. with a relatively weak industry."

The financial institutions may start to refer to headwinds as upcoming Wilmas. S. Florida sure does remember the event. The financial institutions are still trying to grasp the impact of the subprime meltdown and its devastation. The markets have taken heed and are devaluing those high risk corporate loans and this week municipal bonds showed unusual weakness. UBS announced that it had more write offs bringing its write down to \$18 Billion. Yes 18 Billion. The consumer's debt load is at an all time high. Consumer confidence reached a 16 year low today (February 15, 2008). Consumer spending comprises two thirds of GDP and a softening in this area combined with housing, financials, and manufacturing softness could create the perfect storm, but then again Bernanke's maneuvers might move the headwinds out to sea.

The Fed chairman forecast a further drop in home building and related activities, and said a softer jobs market, higher energy prices and falling home values could be expected to weigh on consumer spending in the near term.



Tighter credit is also likely to continue to hold growth back, he said.

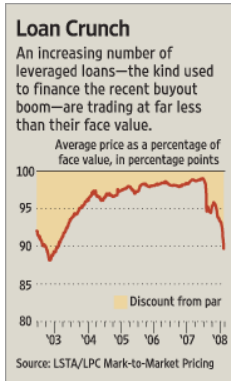
"A significant worsening in financial conditions or in credit availability would certainly be a warning bell that we need to take further actions," Bernanke said. Like Bernanke, Paulson said he saw the economy dodging a recession. "I believe that we are going to continue to grow, albeit at a slower rate, but risks are to the downside," he said. ²

February 14, 2008 the credit crunch surfaced unexpectedly in the municipal bond market. "There's just a tremendous amount of fear about how many more credit market shoes are going to drop. Corporate bonds are being affected, munis are impacted," said Michael Darda, chief economist at MKM Partners LLC in Greenwich, Connecticut. "There's a stench of fear that refuses to break."

¹ **Weather Metaphor
Casts Blame Overboard;
The Greenspan Effect**
By DIONNE SEARCEY
February 11, 2008; Page A1

² By Mark Felsenthal
February 14, 2008

Bernanke said he saw no imminent threat of bank insolvencies but said more write-downs are likely.



The value of the leveraged loans has dropped precipitously in the last couple of quarters from near 99% to 85% as of the first part of February. World wide financial institutions continue in a world of hurt from the “subprime” meltdown. Add to this a 15% decline in the bonds being held could spell even bigger trouble for this sector.

“Citigroup barred withdrawals from a hedge fund after a big bet on corporate loans went bad.”³

Mr. Paulson discussed the financial melt down, its causes and the positive actions financial institutions should take. Since August, U.S. financial institutions alone have written off more than \$150 billion in assets and raised \$95 billion in new capital, according to Treasury Department figures. If the institutions have to add billions of leveraged loan losses to the subprime losses the rest of the world will own an even larger portion of our financial institutions.

“Over the weekend, the world's top banking authorities warned that the U.S.-led economic slowdown and continued uncertainty about securities could lead banks to further reduce their lending, and choke off economic activity.

It is our understanding that the regulators are out in full force reviewing loan portfolios and credit officers are tightening lending standards.

With that in mind, the report said, financial institutions should quickly recognize the “realistic value” of the securities in their portfolios, and disclose exactly how they determine the risk in their holdings⁴

How can you have transparency on the one hand and not allow regulators to do their job. At this point we have not seen good companies being thrown out with the bad. As a matter of fact we continue to see banks acting a little too slowly to crises. A year ago a term sheet just about a guarantee of a refinancing. That no longer is the case. Banks are look closer at historical results and projections. Recent history is not a sign that all is well and cash is free flowing.

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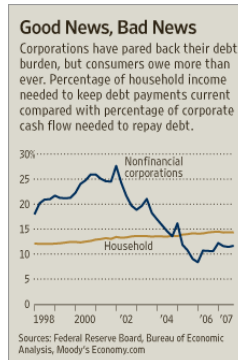
We do not know the exact size of the leveraged loan issue but my sense is that it dwarfs the subprime mess. Private Equity and Hedge Funds have been on a buying frenzy over

³ February 15, 2008 WSJ

⁴ **Liquidity Pressure
Could Come Back
As Economy Slows**
By MICHAEL M. PHILLIPS and YUKA HAYASHI
February 11, 2008; Page A2

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the last few years. Chrysler is probably the largest example of a huge deal in trouble. . It appears Chrysler is going to try and downsize to its core business. Focusing on marketing profitable well selling lines and eliminates a proliferation of small dealerships. This will no doubt result in the closing of factories, retail stores, increase unemployment, and increase office vacancy across the country. Not significant as a percentage of GDP unless you are one of the unlucky dealerships. We do not question the strategy that may actually be a decade too late.



The consumer is awash in debt with more than 14% of consumers' after-tax income targeted to pay interest and principal on their debts. This is a record high. The number has been trending up since the mid-1990s

Exacerbating the problem for households, most families' biggest asset, their homes, is falling in value in most locations. The median price on a single-family home fell 6.5% last year, according to the National Association of Realtors. Many analysts expect the decline to continue this year. That is bad news for consumers who have been tapping their home equity as a source of spending and, often, to pay off other debts.

The consumer makes up two thirds of the US economy. The wealthy are wealthy the poor are poor but the vast middle is in trouble. Home heating bills have soared, the gas for the SUV is consuming a larger portion of disposable income and education bills continue to arrive in the mail. The consumer has no place to turn. At some point GDP has to suffer, those Chinese factories slow down, and sole revenue countries dependent on oil look to the stars for a solution for a population in need of food.

The Washington solution is to give every tax filing man, woman, and child a \$600 / \$300 gift with a catch here and there. Does not this country have enough debt to deal with? During a speech last month a prominent banker likened this solution to Viagra, great for two hours and then what. An article in the Wall Street Journal felt it was like "the road tripper who pounds an energy drink to stay awake on a long-haul drive: He gets a short-term jolt, and then gets even sleepier. Similarly, the economy is about to start chugging the Red Bull of interest-rate cuts and tax rebates, which could briefly lift it from its doldrums."⁶

Is this cycle the same as the past with a solid hit of cash to Middle America enough to continue those people consuming and spending? Will those \$600 checks go for goods and services or for the heat or food bill is a good question. Some financial advisors are suggesting that the client save the money. What was that fowl word "save". America save, God forbid.

⁶ By MARK GONGLOFF
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