The Wall Street Bust

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For the week, the Dow was hit for 7.3% (down 22.2% y-t-d), and the S&P500 was clobbered for 9.4% (down 25.1%). Economically-sensitive stocks were, again, pounded. The Morgan Stanley Cyclicals sank 14.2% (down 30.8%), and the Transports dropped 13.0% (down 9.5%). The Utilities fell 6.0% (down 23.6%), and the Morgan Stanley Consumer index lost 5.2% (down 13.6%). The broader market was under heavy selling pressure. The small cap Russell 2000 (down 19.1%) and the S&P400 Mid-Caps (12.1%) were both hit for 12.1%. The NASDAQ100 sank 12.0% (down 29.5%), the Morgan Stanley High Tech index dropped 13.1% (down 30.6%), and the Semiconductors were hit for 11.5% (down 30.2%). The Street.com Internet Index fell 11.1% (down 23.5%), and the NASDAQ Telecommunications index sank 12.3% (down 27.5%). The Biotechs dropped 8.7% (down 6.7%). The Broker/Dealers declined 9.3% (down 43.2%), and the Banks dipped 0.6% (down 17.1%). With Bullion sinking about $42, the HUI Gold index was crushed for 18.3% (down 34.2%).

One-month Treasury bill rates dropped to 0.10% and three-month yields to 0.48%. Two-year government yields ended the week down 50 bps to 1.59%. Five-year T-note yields sank 42bps this week to 3.06%, and 10-year yields dropped 24bps to 3.61%. Long-bond yields declined 28 bps to 4.10%. The 2yr/10yr spread widened 26 to 201 bps. The implied yield on 3-month December '09 Eurodollars sank 56 bps to 2.96%. Benchmark Fannie MBS yields declined 6 bps to 5.43%. The spread between benchmark MBS and 10-year T-notes widened 18 to 182 bps. Agency 10-yr debt spreads widened 5 to 82.5 bps. The 2-year dollar swap spread increased 8.75 to 151.75, while the 10-year dollar swap spread declined 1.5 to 66. Corporate bond spreads were wider. An index of investment grade bond spreads widened 5 to 166 bps, and an index of junk bond spreads widened 42 to 688.

Debt markets were essentially frozen. Investment-grade debt issuance included Union Pacific $750 million, Interstate Power $250 million, and Wisconsin P&L $250 million.

I saw no junk, convert or international debt issuance this week.

German 10-year bund yields dropped 24 bps to 3.92%. The German DAX equities index dropped 4.4% (down 28.1% y-t-d). Japanese 10-year "JGB" yields were little changed at 1.445%. The Nikkei 225 fell 1.9% (down 28.5% y-t-d). Emerging markets remained under pressure. Brazil's benchmark dollar bond yields surged 42bps to 6.84%. Brazil's Bovespa equities index sank 12.3% (down 30.3% y-t-d). The Mexican Bolsa dropped 10.2% (down 22.2% y-t-d). Mexico's 10-year $ yields rose 11 bps to 6.10%. Russia's RTS equities index sank 16.7% (down 53.2% y-t-d). India's Sensex equities index sank 7.5%, with y-t-d losses rising to 38.3%. China's Shanghai Exchange was closed for a holiday week (down 56.4% y-t-

d).

Freddie Mac 30-year fixed mortgage rates added one basis point to 6.10% (down 27bps y-o-y). Fifteen-year fixed rates also increased one basis point to 5.78% (down 25bps y-o-y), while one-year ARMs declined 4 bps to 5.12% (down 46bps y-o-y). Bankrate's survey of jumbo mortgage borrowing costs had 30-yr fixed jumbo rates this week down 6 bps to 7.12% (up 20bps y-o-y).

Bank Credit rose $22.9bn to $9.576TN (week of 9/24), with a 3-week gain of $183.7bn. Bank Credit has expanded $363bn y-t-d, or 5.3% annualized. Bank Credit posted a 52-week rise of $651bn, or 7.3%. For the week, Securities Credit slipped $1.8bn. Loans & Leases jumped $24.8bn to $7.049 TN (52-wk gain of $474bn, or 7.2%). C&I loans jumped $23.8bn, with y-t-d growth of 10.3%. Real Estate loans gained $7.1bn (up 1.4% y-t-d). Consumer loans rose $5.2bn, and Securities loans jumped $23.9bn. Other loans declined $35.3bn.

M2 (narrow) "money" supply surged $166bn to $7.900 TN (week of 9/22). Narrow "money" has expanded $437bn y-t-d, or 8.0% annualized, with a y-o-y rise of $518bn, or 7.0%. For the week, Currency increased $3.7bn, and Demand & Checkable Deposits jumped $44.8bn. Savings Deposits ballooned $93.5bn, and Small Denominated Deposits gained $9.3bn. Retail Money Funds increased $1.8bn.

Total Money Market Fund assets (from Invest Co Inst) were little changed at $3.399 TN, with a y-t-d expansion of $286bn, or 12.2% annualized. Money Fund assets have posted a one-year increase of $507bn (17.5%).

There was no Asset-Backed Securities (ABS) issuance this week. Year-to-date total US ABS issuance of $129bn (tallied by JPMorgan's Christopher Flanagan) is running at 26% of comparable 2007. Home Equity ABS issuance of $303 million compares with 2007's $224bn. Year-to-date CDO issuance of $24bn compares to the year ago $286bn.

Total Commercial Paper outstanding sank $95bn this week to a 3-year low $1.607 TN, with CP now down $178bn y-t-d. Asset-backed CP dropped $29bn last week to $724bn, with 2008 now showing a decline of $48bn. Over the past year, total CP has contracted $253bn, or 13.6%.

Federal Reserve Credit ballooned $254bn to a record $1.389 TN, with a historic 3-week increase of $457bn. Fed Credit has expanded $515bn y-t-d (77% annualized) and $527bn y-o-y (61%). Fed Foreign Holdings of Treasury, Agency Debt last week (ended 9/30) jumped $43.8bn to $2.466 TN. "Custody holdings" were up $409bn y-t-d, or 25.9% annualized, and $467bn y-o-y (23.4%).

International reserve assets (excluding gold) – as accumulated by Bloomberg's Alex Tanzi – were up $1.179 TN y-o-y, or 20.5%, to $6.925 TN.

Global Credit Market Dislocation Watch:

October 3 – Bloomberg (Duane D. Stanford, Gabrielle Coppola and John Detrixhe): "Almost 100 U.S. corporate treasurers gathered for an emergency conference call yesterday to warn each other that banks are using any excuse to charge more to renew lines of credit. 'Capital is fleeing to safety,' said Edward E. Liebert, treasurer of Rohm & Haas Co., who took part in the 90-minute call organized by the National Association of Corporate Treasurers. 'Interbank lending is not free-flowing any more,' said Liebert… chairman of the… trade

group."

October 1 – Bloomberg (Kelly Riddell): "Carmike Cinemas Inc., the third- largest U.S. theater chain by screens, suspended its dividend, while Duke Energy Corp., owner of utilities in five U.S. states, tapped $1 billion from a credit agreement and RC2 Corp., the maker of infant and preschool products, canceled an acquisition. The paralysis in credit markets is changing how U.S. companies do business as banks pull back on loans or make them prohibitively expensive. Some companies are closing plants and stores, postponing takeovers and grabbing any available credit in a fight for survival. 'If businesses don't have access to capital, smaller companies in particular, they might get wiped out,' said Alec Young, a… strategist at S&P's. 'It's impossible to quantify how expensive this crisis is going to be for Corporate America; there's unlimited downside.'"

September 30 – Bloomberg (Jeremy R. Cooke): "U.S. state and local government bonds are headed for their worst quarterly performance in as much as 14 years as a wave of Wall Street consolidation undermines support for the municipal market. Tax-exempt bonds have fallen 3.15 percent since the end of June, according to Merrill Lynch & Co.'s total-return Municipal Master Index. The quarter's decline may exceed the 3.18% drop in the second period of 2004, which was the steepest since the 5.75% decline in the first three months of 1994."

October 3 – Bloomberg (Jeremy R. Cooke): "U.S. states and municipalities were all but shut out of the tax-exempt bond market for a third week, as borrowers managed to sell less than 15% of a typical week's new fixed-rate issues, data compiled by Bloomberg show… 'This market has run into trouble again,' T.J. Marta, a fixed-income strategist at RBC Capital Markets… said… 'The most recent dislocation will exacerbate the negative developments already taking place for state and local government finances.'"

October 2 – Dow Jones (Cynthia Koons): "The junk bond market suffered its largest monthly decline in more than 20 years last month… The widely quoted Merrill Lynch Master II index was down 8.3% for September, spelling year-to-date returns of negative 10.6%… 'Underlying it all is just a breakdown of ordinary banking, the nuts and bolts of the credit markets, counter-party approvals, and the commercial paper market,' [Marty] Fridson said."

October 2 – Bloomberg (Pierre Paulden): "High-risk, high-yield loans posted their worst monthly performance on record as prices tumbled to new lows after Lehman Brothers Holdings Inc. filed for bankruptcy… The S&P/LSTA Leveraged Loan Index returned a negative 6.15% in September… Leveraged loan prices tumbled 8.57 cents in September to a record low of 79.8 cents on the dollar… 'There is pure turmoil in the financial industry and that's driving the leveraged loan market,' said Darin Schmalz, a Fitch… analyst…"

October 2 – Bloomberg (Bryan Keogh): "Yields over benchmark rates on U.S. speculative-grade bonds widened to the highest on record…. Merrill Lynch… data show. The gap between high-yield bonds and similar-maturity Treasuries jumped 28 bps to 1,124 yesterday, the most since Merrill began compiling spread data… in Dec. 1996. The previous high was 1,120 basis points on Oct. 10, 2002."

October 3 – Bloomberg (Justin Carrigan): "Money-market rates in Europe rose to records… The euro interbank offered rate, or Euribor, that banks charge each other for three-month loans increased to an all-time high of 5.34% today… The Libor-OIS spread, a gauge of cash scarcity among banks, widened to a record and Asian bank rates climbed to the highest

levels in at least nine months."

October 3 – Bloomberg (Denis Maternovsky and William Mauldin): "Developing nations' borrowing costs jumped to the highest in four years compared with U.S. rates while stocks headed for the worst week since 2002, as the global banking crisis drives investors from emerging markets… The extra yield investors demand on developing-nation bonds over Treasuries increased 14 bps to 4.45 percentage points, the highest level since 2004, JPMorgan Chase & Co.'s EMBI+ Index shows."

October 3 – Bloomberg (Katherine Burton and Tom Cahill): "Maverick Capital Ltd., Greenlight Capital LLC and The Children's Investment Fund Management LLP fell more than 12% in September as stock hedge funds posted record monthly losses and braced for client defections. Lee Ainslie's Maverick Capital declined 19.5% and Greenlight Capital, run by David Einhorn, was down 12.8%, according to investors… Children's Investment, overseen by Chris Hohn… fell 15%… Stock hedge funds fell an average of 8.6% in September, the biggest one-month loss since Hedge Fund Research Inc. began collecting data in 1990."

September 30 – Bloomberg (Alexis Leondis): "Reserve Management Corp.'s decision to liquidate its Primary Fund, the money-market mutual fund that had $40 billion of Redemptions, has investors in other Reserve funds wondering if and when they will get their cash. 'No one has told me when I'll get a payout. Both times I have called Reserve, it's the same answer — no news,' said Eric Olsen, 44, a software professional in Seattle, who has most of his retirement savings in the Reserve U.S. Treasury Fund. Olsen said his confidence is waning and he assumes he will lose money if the Treasury Fund is eventually liquidated. Reserve Primary Fund fell to 97 cents a share on Sept. 16 from losses on short-term debt issued by Lehman Brothers Holdings Inc. It was the first registered money-market fund in 14 years to fall below the $1-a-share price paid by investors, known as 'breaking the buck.' All 23 Reserve funds are closed to new investors and redemptions for funds, excluding Primary, have been delayed."

October 2 – Bloomberg (David Olmos and David Mildenberg): "Wachovia Corp. curbed access to a $9.3 billion investment fund used by more than 900 colleges to pay salaries, maintenance and other expenses and said it plans to sell the portfolio by the end of the year. Colleges can only redeem 34% of their investments in the short-term Commonfund because of the 'liquidity squeeze,' said Laura Fay, a spokeswoman for… Wachovia… Fay said the 'unprecedented environment' in the market contributed to Wachovia's decision to curtail the fund and plan its closure by Dec. 31…Whether the fund can provide all of the money to the colleges 'depends if some of the pressure eases in the market place,' Fay said. 'Our intent is to unwind the portfolio in as prudent a way as possible and provide as much liquidity as we can.'"

October 1 – Bloomberg (Neil Unmack): "Sigma Finance Corp., the $27 billion investment company run by London-based asset manager Gordian Knot Ltd., may hand 'significant' losses to bondholders if lenders start a firesale of assets, Moody's said… One of Sigma's lenders served it a notice of default, prompting the termination of a short-term loan agreement… That may cause other banks to close the contracts, known as repurchase agreements, Moody's said. To recover their investments, those banks may sell the assets Sigma pledged as collateral on the loans. Sigma posted $25 billion of its assets to banks under the repurchase agreements, known as repos, leaving $2 billion to repay $5.9 billion of bonds…"

October 1 – Bloomberg (Neil Unmack): "Sigma Finance Corp., the $27 billion structured investment vehicle managed by Gordian Knot Ltd., said it will cease trading and may appoint a receiver as a result of financial-market turmoil. 'In the meantime, both Gordian and Sigma are taking all necessary steps to ensure that the interests of all creditors of Sigma are safeguarded,' the fund said… 'Sigma will not be making any payments to counterparties during this period.'"

October 2 – Bloomberg (Ambereen Choudhury and Elisa Martinuzzi): "The pace of mergers and acquisitions declined 28% this year as the credit crisis checked companies' ability to fund deals… Companies announced takeovers valued at $2.37 trillion in the first nine months of the year, down from the record $3.29 trillion in the year-earlier period… The value of U.S. mergers dropped 35%, while dealmaking in Europe and the Middle East declined 28%, the data show. Only takeovers in Asia, excluding Japan, increased, showing an 11% gain."

October 3 – Bloomberg (Maria Levitov): "Russia faces a 'very difficult situation' on the interbank loans market as banks have all but stopped lending to each other, Interfax cited Deputy Finance Minister Dmitry Pankin as saying."

October 1 – Bloomberg (Bradley Cook): "Russian companies must repay $120 billion of foreign loans by 2010, Interfax reported, citing central bank First Deputy Chairman Alexei Ulyukayev. About $40 billion of that is due this year and $80 billion next year…"

Currency Watch:

October 3 – Bloomberg (Carlos Caminada): "Aracruz Celulose SA, the world's biggest eucalyptus-pulp maker, dropped the most in a decade… after saying it may lose about $1 billion from derivative investments… The Brazilian currency's 22% slump since Aug. 1, after a four-year winning streak, is leading to losses for commodity exporters who sought to hedge against a weaker dollar."

The dollar index surged 4.4% to 80.31. For the week on the downside, the Brazilian real declined 9.8%, the Australian dollar 6.9%, the Norwegian krone 6.2%, the Swedish krona 6.1%, the Euro 5.7%, the Danish Krone 5.7%, the South Korean won 5.6%, the South African rand 4.8%, the Canadian dollar 4.5%, the Mexican peso 4.3%, and the British pound 3.9%. Examining this week's rout in some of the "emerging" currencies, the Iceland krona declined 16.3%, the Romanian leu 10.6%, the Hungarian forint 8.2%, the Czech koruna 7.3%, the Polish zloty 6.9%, the Turkish lira 6.3%, the South Korean won 5.6%, and the Chilean peso 5.4%.

Commodities Watch:

October 3 – Bloomberg (Glenys Sim): "Copper, corn and silver drove commodities toward their biggest weekly decline in more than 50 years on concern that the worst financial crisis since the Great Depression will push the U.S. into recession. Commodities, as measured by the Reuters/Jefferies CRB Index of 19 raw materials, have tumbled 9.9% this week…"

Gold dropped 4.7% to $837, and Silver sank 16.7% to $11.13. November Crude declined $13.97 to $92.92. November Gasoline fell 15.3% (down 10.6% y-t-d), and November Natural Gas declined 3.5% (down 1.6% y-t-d). December Copper sank 15%. December Wheat declined 10.6% and Corn fell 16.4%. The CRB index dropped 10.4% (down 9.0% y-t-d). The Goldman Sachs Commodities Index (GSCI) fell 11.2% (down 4.4% y-t-d).

China Watch:

September 28 – Bloomberg (Nadine Elsibai): "China's Premier Wen Jiabao said the impact from the current financial crisis in the U.S. may 'affect the whole world.' 'U.S. finance is closely connected with Chinese finance,' Wen said… 'If anything goes wrong in the U.S. financial sector, we are anxious about the safety and security of Chinese capital,' Wen said…"

October 2 – Bloomberg (Nipa Piboontanasawat): "China's manufacturing activity contracted for a second month, a CLSA Asia-Pacific Markets survey of purchasing managers showed."

Japan Watch:

September 30 – Bloomberg (Jason Clenfield and Toru Fujioka): "Japan's industrial production fell at the fastest pace in at least five years in August, the unemployment rate rose and household spending tumbled, deepening the slump in the world's second-largest economy. Factory output dropped 3.5% from July… The jobless rate climbed to a two- year high of 4.2% and purchases by households slumped 4%, the most since September 2006, the government said."

October 1 – Bloomberg (Makiko Kitamura): "Japan's fiscal first-half auto sales slumped to the lowest in 34 years as rising unemployment and decade-high inflation sapped demand for new vehicles. Sales in the six months through September fell 2.9% to 1.54 million vehicles…"

India Watch:

October 1 – Bloomberg (Kartik Goyal): "India's manufacturing grew at the slowest pace in 14 months in September as demand for goods eased because of higher costs, a key gauge showed."

October 3 – Bloomberg (Anil Varma): "India's rupee slumped to the lowest since 2003 as Asian stocks slid, adding to speculation investors will take money out of the region. The currency is set for its eighth weekly loss, the longest drop since December 2005…"

Asia Bubble Watch:

September 30 – Bloomberg (Netty Ismail): "Asia hedge-fund closures jumped 19% this year, with the industry set to shrink for the first time as clients withdraw more money after funds in the region underperformed rivals in the U.S. and Europe. 'It is likely that we'll see a net reduction in the number of Asian hedge funds through this current year,' Peter Douglas, principal of… GFIA Pte… said… 'Almost without exception, the managers that we talk to in Asia are seeing capital outflows, some of it is minor, some of it major.'"

Latin America Watch:

October 2 – Bloomberg (Joshua Goodman and Sebastian Boyd): "Latin America's fastest economic expansion in 30 years may be coming to an end as the global credit crunch stunts investment and squeezes demand for the region's commodities. 'We're in a serious economic crisis,' Colombian Vice President Francisco Santos said… 'Financing is going to get scarcer and scarcer, and that means that investment is going to be difficult to attract.'"

Central Banker Watch:

October 2 – Bloomberg (Scott Lanman): "Commercial banks and bond dealers borrowed $348.2 billion from the Federal Reserve as of yesterday, an increase of 60% from the prior week amid a worsening credit freeze. Loans to commercial banks through the traditional discount window rose about $10 billion to $49.5 billion… The total surpassed the previous record after the 2001 terrorist attacks. Borrowing by securities firms totaled $146.6 billion, up from $105.7 billion. Under a new emergency program announced Sept. 19, banks borrowed $152.1 billion as of yesterday to buy commercial paper from money-market mutual funds, more than double a week ago."

October 3 – Bloomberg (Brian Swint and Svenja O'Donnell): "The Bank of England said it will extend the range of collateral it accepts… 'In these extraordinary market conditions, the Bank of England will take all actions necessary to ensure that the banking system has access to sufficient liquidity,' Governor Mervyn King said…"

Unbalanced Global Economy Watch:

September 30 – Bloomberg (Jennifer Ryan): "The U.K. economy grew at the weakest annual pace since 1992 in the second quarter as the financial crisis curbed investment, construction and industrial production. Gross domestic product rose 1.5% from a year earlier…"

October 2 – Bloomberg (Brian Swint): "U.K. financial institutions plan to scale back loans to companies and households in the final three months of the year, threatening to deepen the economic slump. Banks reduced the availability of credit in the third quarter by more than they had anticipated and predict credit will become scarcer as both supply and demand for loans drops, the Bank of England said…"

September 29 – Bloomberg (Jennifer Ryan): "U.K. mortgage approvals slid in August to the lowest since at least 1999 as the global credit squeeze prompted banks and building societies to curtail loans."

October 2 – Bloomberg (Svenja O'Donnell): "U.K. house prices had the biggest annual drop since at least 1991 in September as the financial crisis intensified, Nationwide Building Society said. The average cost of a home plunged 12.4% from a year earlier to 161,797 pounds ($287,658)…"

October 1 – Bloomberg (Brian Swint): "U.K. manufacturing contracted at its fastest pace in 16 years last month, adding to concerns about a recession as the financial crisis cripples lending."

October 2 – Bloomberg (Brian Swint): "U.K. labor unions clinched bigger pay raises for employees in the three months through August as record oil prices pushed inflation to the fastest pace in a decade, Incomes Data Services said. The median salary settlement rose to 3.8%…"

October 1 – AFP: "Ireland's 12-month unemployment rate surged to 6.3% in September, the highest rate since November 1998, official figures showed Wednesday."

October 3 – Bloomberg (Simon Packard): "The slump in Europe's commercial real estate market will be deeper and more protracted than expected, JPMorgan Chase & Co. analysts

said, as an ‘explosion’ of 340 billion euros ($471 billion) in property sales hits the market by next year. Publicly traded real estate developers plan to sell about 20 billion euros of shops, offices and warehouses mostly in forced sales, according to estimates… The sales represent 7.3% of the companies’ assets… “

October 1 – Dow Jones (Neil Unmack): “Spanish car registrations fell 32% on the year in September, Spanish car manufacturers’ association Anfac said Wednesday.”

October 1 – Bloomberg (Maria Ermakova): “Moscow’s decade-long building boom is falling victim to the global credit crunch as record high interest rates squeeze developers in the world’ third most expensive property market. ‘Loan rates have climbed to ridiculous heights and the terms are very short,’ said Dmitry Lutsenko, a board member at Mirax Group, the… company that’s building the Federation Tower, which will be Europe’s tallest skyscraper…”

September 28 – Bloomberg (Denis Maternovsky): “Russian developers are cutting apartment prices in the regions as a decline in mortgages lowers demand for housing, Vedomosti repoted. Sales of new apartments in Rostov-on-Don are down 40% this month from August, while sales in St. Petersburg have fallen by half since the spring…”

September 30 – Bloomberg (Jacob Greber): “Australian home-buyers increased borrowing at the slowest pace since 1986 and house-building approvals fell for a second month, stoking speculation the central bank will cut interest rates by half a point next week.”

September 30 – Bloomberg (Mike Cohen and Nasreen Seria): “South African credit growth eased to an annual 18.6% last month, the slowest pace in more than three years, as higher interest rates crimped consumer spending on cars and furniture.”

Bursting Bubble Economy Watch:

September 28 – Wall Street Journal Asia (Bob Davis): “The success of the pending rescue of the U.S. financial system probably depends as much on the central banks of China and the Middle East as on the U.S. Congress and Federal Reserve. The U.S. is turning to foreign governments and other overseas investors to buy a good chunk of the as much as $700 billion in Treasury debt that would be sold to finance the bailout. Foreign investors are also needed to shore up the depleted capital of the nation’s financial institutions, as evidenced by the plan of Japan’s Mitsubishi UFJ Financial Group to buy a large stake in Morgan Stanley, which is weighed down by bad debt and market distrust. This is a bittersweet moment in U.S. economic history.”

October 2 – Bloomberg (Sharon L. Lynch): “Home prices dropped in 24 of 25 U.S. metropolitan areas in July from a year earlier… Las Vegas had the biggest drop on a per-square foot basis, falling 33%… Radar Logic Inc. said… Los Angeles, Phoenix, Sacramento and San Francisco each dropped about 28%. Three of the five worst-performing markets were in California. ‘Buyers are increasingly reluctant,; Radar Logic CEO Michael Feder said…”

October 2 – Bloomberg (David Wilson): “U.S. homeowners may end next year with the least amount of equity in their houses since 1984, according to Michael R. Widner, a Stifel Nicolaus & Co. analyst. Widner projected that home equity, as tracked by the Federal Reserve, will decline to $4.23 trillion in 2009, after adjusting for inflation. The estimate is less than half of the record $8.63 trillion in March 2007…”

October 2 – Wall Street Journal (Matthew Dolan, John D. Stoll and Sharon Terlep): "U.S. auto sales reached a 15-year low with a double-digit decline in September as tightening credit and a financial system in crisis appeared to overwhelm any optimism about moderating gas prices. Sales of cars and light trucks fell 27% to 964,873 last month, down from 1.31 million a year earlier, according to Autodata Corp. The seasonally adjusted annualized selling rate was 12.5 million units down from 16.19 million in September 2007, the research firm said."

September 30 – Bloomberg (Alex Lange): "U.S. new-vehicle dealership closures may rise as much as 40% this year as slumping sales and surging borrowing costs cut into profits, the National Automobile Dealers Association said today. As many as 600 may shut down or consolidate with other dealers, equal to about 3% of the total… That compares with 430 a year ago."

October 2 – Dow Jones (Shara Tibken): "Sixty-one U.S. companies defaulted on their debt in the first three quarters of 2008, nearly quadruple the number last year. More than half were since late May, according to… S&P. Nine U.S. companies defaulted in September, including Lehman Brothers… and Washington Mutual… Through the first five months of 2008, the year-to-date total was 28, which was already more than the 16 seen all of last year and the 22 from 2006. The U.S. speculative-grade default rate climbed to 2.68% in September from 2.5% in August…"

October 2 – New York Times (Louis Uchitelle): "Some small companies say they are no longer able to get loans from newly cautious banks as credit tightens across the country, and even those who do qualify are increasingly reluctant to borrow and expand, fearful of overextending themselves in the midst of the financial crisis. Alan Petrucci, whose small factory near Chicago makes metal molds that other manufacturers buy to form plastic parts, says his bank recently offered him an additional loan. Though orders for his molds are still plentiful, Mr. Petrucci says he will borrow only to upgrade existing machinery, not to expand. 'We are bracing for the downturn that is coming,' Mr. Petrucci said. 'It is coming; there is no question about that.'"

October 1 – Bloomberg (Alexis Leondis): "More than one-third of U.S. parents have decreased or stopped saving for their children's college education because of the economic decline, according to a survey by Fidelity Investments."

MBS/ABS/CDO/CP/Money Funds and Derivatives Watch:

September 30 – Bloomberg (Bob Willis): "House prices in 20 U.S. cities declined in July at the fastest pace on record, signaling the worst housing recession in a generation had yet to trough even before this month's credit crisis. The S&P/Case-Shiller home-price index dropped 16.3% from a year earlier, more than forecast, after a 15.9% decline in June. The gauge has fallen every month since January 2007… Banks will probably stiffen lending rules even more in coming months to limit losses, indicating residential real estate will keep contracting and consumer spending will continue to falter. 'The fact that house prices quickened their slide before the worst point in credit markets hit this month does not bode well,' said Derek Holt, an economist at Scotia Capital…"

September 29 – Bloomberg (Bradley Keoun): "A brochure pitching $1.84 million of notes sold by Lehman Brothers… in August, a month before the firm filed for bankruptcy, promised '100 percent principal protection.' Buyers had 'uncapped appreciation potential' pegged to gains in the S&P's 500 Index, the brochure said. In the worst case, they would get

back their $1,000-per-note investment in three years. Only the last in a list of 15 risk factors mentioned the biggest danger: 'An investment in the notes will be subject to the credit risk of Lehman Brothers.'"

Real Estate Watch:

October 3 – Bloomberg (Hui-yong Yu): "Vacancies in U.S. office buildings rose to 13.6% in the third quarter from 13.1% in the second, the biggest one-quarter jump since the second quarter of 2002, according to Reis Inc… 'Rent growth has stalled in a broad cross-section of the nation's markets and concessions have widened as demand for space has weakened," said Sam Chandan, chief economist of Reis."

October 1 – Wall Street Journal (Maura Webber Sadovi): "The bankruptcy filing by Lehman Brothers Holdings Inc. helped to spark the debate in Congress over how the government should respond to the global financial crisis. It also had repercussions in Washington, D.C., that went beyond the Capitol steps. Uncertainty over the future of Lehman's real-estate holdings in the city is casting a shadow over the future of the area's commercial-building sales. For years Washington had been one of the country's hottest commercial real-estate markets… Today, values of Washington-area commercial buildings are tumbling as they are in most parts of the country due to the financing drought and deteriorating economy. The impact there likely will be magnified as Lehman's properties get dumped on the market. 'D.C. was certainly one of [Lehman's] main targets,' said Dan Fasulo, managing director at Real Capital Analytics."

Speculator Watch:

October 2 – Bloomberg (Chanyaporn Chanjaroen and Tom Cahill): "Funds of hedge funds will need to pull more than $100 billion before year-end to meet investors' demands for cash, exacerbating market drops as hedge funds sell assets, according to London-based advisory firm Clontarf Capital. 'Certain funds of hedge funds in Europe are fearing redemptions of up to 25% of assets by the end of the fourth quarter,' said Aoifinn Devitt, founder of Clontarf… 'There has been a wave of liquidating and de-leveraging and this is likely to continue.'"

October 1 – Bloomberg (Warren Giles): "Gottex Fund Management Holdings Ltd., a Swiss and U.K. money manager, will halt redemptions of its ABI Fund Ltd. and unwind its ABL Portfolio Ltd. fund after fraud allegations at a unit of Petters Group Worldwide. The allegations against Petters make it difficult to assess 'the value of investments by the ABI Fund in underlying funds exposed to the Petters business,' Lausanne, Switzerland-based Gottex said… Petters Group Worldwide, the owner of Polaroid Corp. and Sun Country Airlines Inc. and investor in companies including Enable Holdings Inc., was raided in Minnesota by FBI and other federal agents last week. Gottex oversaw $15.6 billion for clients as of June 30, down from $16 billion at the end of 2007."

October 2 – Dow Jones (Judith Burns): "A Chicago-area hedge fund is among those saying it has been stung by an apparent fraud by Petters Co. Inc., a private holding company whose investments include Fingerhut, Polaroid and Sun Country Airlines. Lancelot Investment Management… is the latest fund to say it has been burned. It joins several normally tight-lipped hedge fund firms that have come forward recently to claim they've been duped by… Petters. Total investor losses aren't known, but could exceed $2 billion, according to some estimates."

October 1 – Bloomberg (Tom Cahill): "Lehman Brothers Holdings Inc.'s bankruptcy probably means the end of hedge-fund manager Oak Group Inc. after 22 years in business. John James, who runs the Chicago-based firm with $25 million of assets, didn't buy Lehman stock or debt. Instead, his potentially fatal mistake was to rely on the bank's prime brokerage in London, a unit that provides loans, clears trades and handles administrative chores for hedge funds. He's one of dozens of investment managers whose Lehman prime-brokerage accounts were frozen… 'We're probably going out of business and liquidate, game over,' James said. 'We've lost 70% of our assets.' The list of funds trapped in the Lehman morass keeps growing. London-based MKM Longboat Capital Advisors LLP said last week it will close its $1.5 billion Multi-Strategy fund… LibertyView Capital Management… told investors on Sept. 26 it had suspended 'until further notice' attempts to calculate the value of its funds… Managers with a smaller percentage of assets in Lehman limbo include Harbinger Capital Partners, Amber Capital LP and Bay Harbour Management LLC, which are each based in New York, and RAB Capital Plc and GLG Partners Inc., both in London."

Muni Watch:

October 3 – Bloomberg (Jerry Hart): "U.S. states and municipalities from New York to California are facing deteriorating finances as investors shun their bonds in a credit market averse to all but the safest debt and a slowing economy erodes revenue. New York Governor David Paterson called for a special legislative session to confront a budget deficit that has ballooned to $1.2 billion and Massachusetts Governor Deval Patrick ordered spending cuts as states and cities from Louisiana to Illinois canceled debt sales."

October 2 – Bloomberg (Michael McDonald): "Massachusetts Governor Deval Patrick said he is seeking budget cuts amid financial market turmoil that forced the state this week to cancel plans to borrow money to fund operations. The governor, citing a $223 million shortfall in tax collections, ordered a spending reduction of 7%… The state this week canceled the sale of commercial paper as investors boycotted the markets."

October 1 – Bloomberg (Jerry Hart): "A Florida low-interest loan program for counties stopped new financing after Wachovia Corp. refused to extend a letter of credit and investors were slow to buy the notes that fund the program's loans. The Florida Local Government Finance Program turned down loan requests from Volusia, Holmes, Gadsden, Clay and Alachua counties, Cragin Mosteller, communications director for the Florida Association of Counties… said… The loans fund projects such as library and courthouse construction, landfills and water and sewer plants. Officials running the program told counties this month that Wachovia won't extend the letter of credit that supports the commercial paper backing the program's loans. They also said Morgan Stanley was having trouble remarketing the notes to investors. 'We're experiencing problems rolling the paper over,' John Yonkosky, chairman of the Florida Local Government Finance Commission, said… 'Most of our buyers are mutual funds, and people are looking to put money in cash or Treasuries now.'"

October 1 – Bloomberg (William Selway): "Jefferson County, Alabama, won't make an $83.5 million payment on some of its $3.2 billion of sewer bonds, as it continues to seek more time to negotiate an end to the debt crisis that has pushed it close to bankruptcy."

New York Watch:

September 29 – Bloomberg (Michael Quint): "New York state may lose as much as $3.5

billion of tax revenue and 40,000 financial industry jobs because of losses on Wall Street, according to state comptroller Thomas DiNapoli."

October 3 – Bloomberg (Adam L. Cataldo): "New York Mayor Michael Bloomberg said taxes will 'probably' have to rise to help close the city's $2.3 billion budget gap for the next fiscal year."

California Watch:

October 2 – Los Angeles Times (Marc Lifsher and Evan Halper): "California Gov. Arnold Schwarzenegger, alarmed by the ongoing national financial crisis, warned Treasury Secretary Henry M. Paulson on Thursday that the state might need an emergency loan of as much as $7 billion from the federal government within weeks. The warning comes as California is close to running out of cash to fund day-to-day government operations and is unable to access routine short-term loans that it typically relies on to remain solvent. The state of California is the biggest of several governments nationwide that are being locked out of the bond market by the global credit crunch. If the state is unable to access the cash, administration officials say, payments to schools and other government entities could quickly be suspended and state employees could be laid off. Plans by several state and local governments to borrow in recent days have been upended by the credit freeze. New Mexico was forced to put off a $500-million bond sale, Massachusetts had to pull the plug halfway into a $400-million offering, and Maine is considering canceling road projects that were to be funded with bonds. California finance experts say they know of no time in recent history when the state has sought an emergency loan of this magnitude from the federal government. The only other such rescue was in 1975, they said, when the federal government lent New York City money to avoid bankruptcy."

Crude Liquidity Watch:

September 28 – Bloomberg (Fiona MacDonald): "Kuwait's inflation rate accelerated to 11.35% in June from 11.1% in May on increases in the cost of housing and food."

The Wall Street Bust:

I still owe readers a thorough analysis of the Q2 2008 Flow of Funds. For now, I'll just point out some data relevant to The Current State of Acute Fragility.

Looking back, Total Non-Financial Debt (NFD) expanded $578bn during 1994. By 1998, NFD growth for the year had surpassed $1.0 TN. Non-Financial Credit increased $1.153 TN in 2001, $1.415 TN in 2002, and $1.676 TN in 2003, before reaching the $2.0 TN milestone in 2004. Incredible as it was, debt expansion then surged over the next fateful three years. Growth rose to $2.319 TN in 2005, $2.428 TN in 2006 and then to last year's record $2.561 TN.

Importantly, this historic Credit Inflation inflated asset prices, incomes, corporate cashflows/earnings, government revenues, and various types of spending throughout the U.S. and global economy. It was a self-sustaining Bubble bolstered by ongoing Credit excesses, asset inflation and resulting purchasing power gains. But NFD growth slowed sharply to an annualized $1.726 TN during this year's first quarter and then sank to $1.127 TN annualized during the second quarter. Credit growth is now in the process of collapsing.

At this point, there is clearly insufficient Credit expansion to support inflated asset markets;

incomes and household spending; corporate cash flows and investment; and government receipts and expenditures. Lending markets are frozen, securitization markets broken, corporate and muni debt markets in disarray, derivatives markets in shambles, and the leveraged speculating community is engaged in panic de-leveraging. As a consequence, the over-indebted household, corporate and state & local sectors now face a devastating liquidity crisis.

We are today witnessing the Acute Stage of Bursting Credit Bubble Dynamics. It's an absolute debacle, and there's little our well-intentioned policymakers can do about it other then try to slow the collapse. To be sure, there were momentous effects to both the Economic and Financial Structures during the Bubble period between 1994's $578bn Non-Financial Debt Growth and 2007's $2.561 TN. It is also worth noting that Financial Sector Debt expanded $462bn in 1994 compared to $1.753 TN in 2007. Mortgage debt almost doubled in the six years 2002 through 2007 to $14.0 TN, while Financial Sector borrowings rose 75% to $16.0 TN. This Credit onslaught fostered huge distortions to the level and pattern of spending throughout the entire economy. It is today impossible both to generate sufficient Credit and to main previous patterns of spending. Economic upheaval and adjustment are today unavoidable.

Over the years I've chronicled this historic Bubble in Wall Street Finance. It is worth recalling today that Wall Street assets began year 2000 at about $1.0 TN and ended 2007 at $3.0 TN. The ABS market surpassed $1.0 TN in 1998 and ended 2007 at $4.5 TN. GSE assets surpassed $1.0 TN in 1997 and ended last year at almost $3.4 TN. Agency MBS surpassed $2.0 TN in 1998 and closed 2007 at almost $4.5 TN. "Fed Funds and Repos" reached $1.0 TN in 2000 and ended 2007 at $2.1 TN. This Bubble in Wall Street Finance was one of history's most spectacular Credit expansions. It also comprised the greatest use of speculative leverage ever.

Despite last summer's collapse in private-label MBS and related markets, the faltering Wall Street Bubble nonetheless persevered up until the Lehman collapse. While it was problematic that overall system Credit growth had slowed markedly, there remained key sectors of Credit and risk intermediation that remained very much in expansionary mode. In particular, GSE-related obligations, bank Credit, and money market fund assets had expanded rapidly in spite of the subprime collapse. Importantly, the speculator community had maintained easy access to cheap finance. As I have noted often, despite the unfolding bust in mortgage and risk assets, market faith in "money" and the core of the system had held steadfast. This all ended abruptly three weeks ago with the Lehman filing.

Today, confidence has been shattered, and Wall Street finance is a complete and unsalvageable bust. The spigot for Trillions of finance – that for years fueled the asset markets and U.S. Bubble economy – has been essentially shut off and dismantled. In particular, Wall Street finance was a mechanism for intermediating higher-yielding riskier loans. This finance provided rocket fuel for both residential and commercial real estate markets – and the attendant wealth effects. Wall Street finance also grew into the key source of finance for auto purchases, student loans, Credit cards, municipal finance and various business enterprises. Many of these loans were of a risk profile unappealing to traditional bank lending – and, hence, provided the type of higher yields quite appealing to the speculator community.

And, importantly, as the stature of Wall Street finance grew its impact upon the real economy became embedded deep into the Economic Structure. Or, stated differently, risky

loans came to play a major role in determining spending and investment patterns throughout the "Bubble" economy. Wall Street finance became a major direct and indirect generator of household incomes and corporate profits. Moreover, Wall Street finance came to dominate the flow of finance both in and out of the securities markets. Wall Street could create its own liquidity and funnel it into the U.S. and global markets – and earn unimaginable returns in the process.

It is today impossible to comprehend the full ramifications from The Bust in Wall Street Finance. Yet we can be rather certain that for the foreseeable future much less Credit and liquidity will be directed to the asset markets. And, at the same time, there will be significantly less Credit Availability for riskier loans of all varieties – for the household, business, financial and the government sectors. Few appreciate that these dynamics are extremely problematic for the U.S. Bubble Economy – an economic system that had come to a large extent to be governed by asset-based and high-risk lending. These dynamics are at the heart of today's Acute Financial and Economic Fragility and the resulting imploding markets.

The leveraged speculating community played such an integral role in the overall Credit Bubble and, more specifically, to the Bubble in Wall Street Finance. They were instrumental in both spurring financial sector Credit creation/leveraging, while directing this Flood of Finance to the asset markets. And the more the leverage and the greater the Flow to inflating markets, the higher the returns generated by this expanding pool of speculative finance. And the greater the returns, the more robust the "investment" flows into the hedge fund community – spurring more leverage and more potent fuel for additional self-reinforcing asset inflation. Well, this historic speculative Bubble is now in the process of blowing up. One of the greatest manias ever – surely The World's Greatest Episode of "Ponzi Finance" – is absolutely coming apart. And the wreckage is accumulating in all markets – everywhere.

Here at home, our maladjusted economic system will only be sustained by somewhere in the neighborhood of $2.0 TN of new Credit. It's simply not going to happen. The $700bn from Washington would seem like an enormous amount of support. In reality, it's nowhere even close to the amount necessary for systemic stabilization. To the $2.0 TN or so of new Credit required this year (and next) add perhaps as much as several Trillion more necessary to accommodate speculative de-leveraging (liquidations forced by huge losses). Importantly, the Bust in Wall Street Finance has ensured that insufficient liquidity will be forthcoming to maintain inflated asset prices and sustain the Bubble economy – creating catastrophe for the leveraged speculating community.

The "Freidmanites" thought they understood the (post-crash) policy mistakes that led to The Great Depression. They believed the "Roaring Twenties" was the "Golden Age of Capitalism." The great bust could have been avoided with a simple ($5bn or so) banking system recapitalization. As we are witnessing today, the issue is not some manageable amount of new "capital" to replenish banking system losses. Instead, the predicament is the massive and unmanageable amount of new Credit necessary to, on the one hand, sustain a mal-adjusted Bubble Economy and, on the other, the Trillions more required to accommodate a gigantic speculative de-leveraging. I have a very difficult time seeing a way out of this terrible mess.

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