

Basic Points

Jurassic Park Avenue

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Basic Points

An Investment Journal

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Jurassic Park Avenue



All financial crises are alike, in that they all come from a sudden shrinkage of liquidity, which is caused by the explosive interaction of cupidity and stupidity. At that point Fear, which had been an unprofitable and unfashionable constraint, takes charge.

Yet all financial crises are unique, because economies, technology and financial markets evolve rather rapidly, so each decade's follies and flaps have some special characteristics.

We are instructed that Virtue is its own reward. That is scant consolation, in the early years of each new boom, for prudent investors with vivid recollections of the markets' punishment for those whose lack of virtue had been most conspicuous. The boom is defined and driven by new groups of risk-takers who throw caution to the wind, borrowing big at the small costs available early in the new cycle, and then winning big. Their prosperity and arrogance grow even faster than their leverage and their assets under management. More and more of the conservatively cautious, under pressure from disgusted clients, are forced to concede that "it's different this time," and place their bets.

What is different this time is that the assets whose overvaluation triggers this crisis aren't overvalued stocks or other tradable instruments; they are the potentially perilous products of brilliant engineers—the high finance equivalent of the runaway raptors of *Jurassic Park*.

This month we try to catch this market's falling knife long enough to describe it and predict its ultimate destination.

We are leaving our cautious Recommended Asset Mix unchanged.

We also take this opportunity to wish Mr. Bernanke well and continue to encourage him to resist the pressure to send his very best imitation of the Greenspan Put to the very rich debt denizens of Jurassic Park Avenue. This financial crisis was created by people who are fabulously wealthy compared to average Americans. They—not poor homeowners—would be the biggest winners if the Fed slashes rates. Malefactors should be punished—not rewarded.

Recommended Asset Allocation

Recommended Asset Allocation (for U.S. Pension Funds)		
	Allocations	Change
US Equities	27	unch
Foreign Equities		
European Equities	7	+1
Japanese and Korean Equities	5	-1
Canadian and Australian Equities	6	unch
Emerging Markets	11	unch
Bonds		
US Bonds	12	unch
Canadian Bonds	4	unch
International Bonds	11	unch
Cash	17	unch

Bond Durations		
	Years	Change
US	4.50	unch
Canada	4.75	unch
International	4.25	unch

Global Exposure to Commodity Stocks	
Energy	33
Agriculture	25
Base Metals & Steel	22
Precious Metals	20

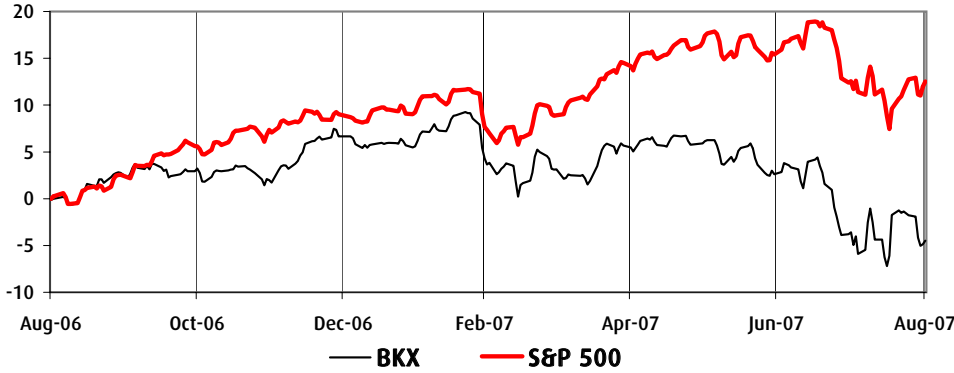
We recommend these sector weightings to all clients for commodity exposure—whether in pure commodity stock portfolios or as the commodity component of equity and balanced funds.

Jurassic Park Avenue

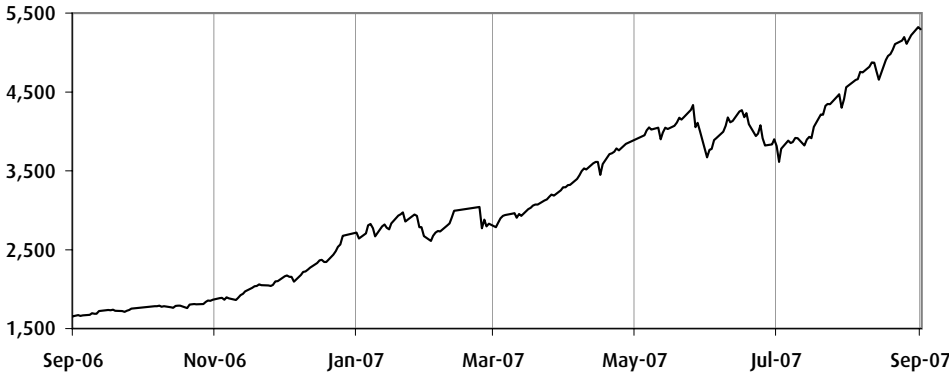
S&P 500
September 2001 to September 2007



Relative Strength of the BKX vs. S&P 500
September 2006 to September 2007



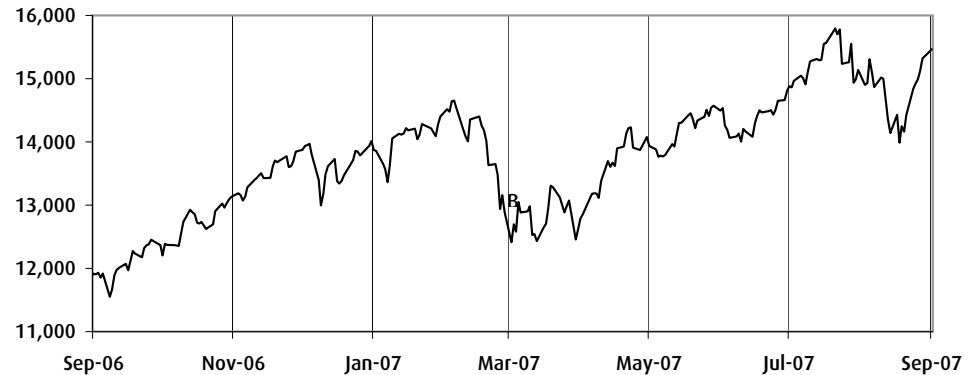
Shanghai Stock Index
September 2006 to September 2007





After a century to get over its resentment toward the very rich, America is experiencing its second Gilded Age...

**Bombay Sensex
September 2006 to September 2007**



1. *The Second Gilded Age*

After a century to get over its resentment toward the very rich, America is experiencing its second Gilded Age, and once again Park Avenue is its premier address.

The first was the era of the Rockefellers, Carnegies, Fricks, Vanderbilts and their ilk. They turned post-Civil War America into the mightiest industrial nation on earth, and their prodigious philanthropy continues to enrich America—and the world.

The “Robber Barons” remain objects of disdain for the intellectual elites, even among those who fawn on today’s super-rich. In part, this contempt comes because those eminent American Victorians were proudly pious men who believed in the Protestant Ethic. John D. Rockefeller described great wealth as “A gift from Heaven signifying, “This is my beloved son, in whom I am well pleased.” Andrew Carnegie, who began his career as an impoverished bobbin-winder, gave away \$380 million, (leaving less than \$2 million to his heirs), mostly to libraries across North America and Scotland, arguing that the working man could benefit from libraries only by putting in the kind of time and effort that would please God.

Social scientists such as R.H. Tawney and Max Weber argued that industrialization and economic progress—first in Britain, then America—were due, in great measure, to the widespread acceptance of the Protestant Ethic in those nations. The mainstream Protestant churches where the industrialists and financiers of the 18th and 19th centuries worshipped have, in recent decades, become increasingly modernized and marginalized, and would no more spout the “primitive piety” of the Protestant Ethic than they would denounce the United Nations.

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None of those barons ever were—or ever expected to be—bailed out by Washington when they got overextended. The ethics of the time were that capitalism was a system that relied on rewards and discipline so it would have been immoral to use public resources to rescue them from their own mistakes. That belief system has been expressed in our time as “Capitalism without punishment is like religion without Hell.”

It is different this time.

The American billionaires of the Second Gilded Age who have created the current liquidity crisis come from investment banking, hedge funds, and Private Equity. They do not cite Divine Right as justification for their wealth, or for their insistence that they be permitted to continue paying income tax on such profits as they pay themselves from their tax havens in the Caribbean at just 15%—rather than the 35% that others pay. Many of them atone for this apparent lack of concern for the federal deficit by financing blogs and political candidates who demand that the 35% rate of tax on everyone else be increased—while the 15% rate is left alone. That approach to dealing with the deficit is gaining ground. Leading Democratic Presidential candidates and Congresspersons are supporting the 15% rate for hedge funds and Private Equity partners, while Bush and his core backers remain opposed to *all* tax hikes. The articulate spokesman for the American poor, John Edwards, who calls for major tax increases on the rich, has not made the hedge fund tax rate a target of his righteous wrath. It may be captious to note that a part of his large fortune is invested in Fortress, the hedge fund that pays him a consulting fee. Among its operations, the fund is a large subprime mortgage investor.

The “Robber Barons” would be appalled that many of today’s super-rich, who created this crisis, are ganging up on the Fed to demand a series of rate cuts—“to help poor homeowners.” According to published income statistics, the average employee—including the janitor—of investment banking and hedge fund firms in New York and Greenwich, earns far more in a month than most Americans earn in a year. If the Fed capitulates, those rich will get a whole lot richer, but the poor will not. James Grant calls this proposal “socialism for the rich.”

This is the first time in our experience that the stock market has been subjected to wave upon wave of fear, trembling and selling, entirely because of conditions originating outside the stock market itself.

**“Capitalism
without punishment
is like religion
without Hell.”**



**Those diehards
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are not so much
citing history as
rewriting it.**

We entered this business just in time for the disastrous stock markets of 1973-74, witnessed the Continental Illinois panic of 1984 which nearly provoked a worldwide collapse, were on Wall Street twenty years ago as conditions were deteriorating in preparation for the Crash of 1987, and suffered through the real estate-driven bear market of the early 1990s, the LTCM panic of 1998, and the Triple Waterfall Crash of technology that began in 2000.

In each of those cases, except the Continental Illinois collapse, equities were substantially overvalued going into the bear market. In all other plunges, the stock market had substantial endogenous risk, although the selloff was usually led by a few highly vulnerable sectors—including the banks.

This time, the NYSE financials, which provided a disproportionate share of total earnings growth, are once again leading the retreat. The difference is that the overall market is trading roughly at its average p/e of recent decades. In relation to ten-year Treasuries, the US market is a bargain.

Moreover, one can make a strong case for the proposition that stocks should trade at higher multiples than was the case in past cycles. Our lifetime has seen victories over National Socialism in Germany, Bolshevik Socialism in the USSR, and over Old Left socialism in North America, Europe and most of the world. Those triumphs for liberal concepts over Socialist dogma gave the world global free trade, deregulation, and, momentarily, the adoption of capitalist incentives and deregulation in China, India and in many other previously Socialist Third World nations—and in lower taxes almost everywhere. (e.g., top income tax rates in the US and UK were over 75% until the Thatcher-Reagan era.) Stocks *should* trade at higher multiples when companies have bigger and better playing fields—at home and abroad—to demonstrate their competitiveness, and when dividends and capital gains are not taxed at punitive rates. Those diehards who keep insisting that stock prices have been too high for too long, and who use long-term average valuations that include the Depression, World War II, the high tax and high tariff years from 1946-1983, and the high inflation years of the Seventies—are not so much citing history as rewriting it.

When we published *God Bless America*, two weeks after 9/11, we argued that the new War on Terror would mean that a Cold War-style p/e factor was once again appropriate. We now see that, although Islamic radicalism and jihadism in the age of nuclear proliferation are, like Nazism and Communism, mortal challenges to Western-style freedoms, these forces have not *yet* attained such horrific power that p/es should revert to Cold War levels. Given the EU's and Russia's eagerness to sell advanced technology and weaponry to Iran on credit, Ahmadinejad will get the Bomb, but he is unlikely to share it

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with Osama, let alone Chavez. The genie is out of the bottle in the region of the world where bottled genies were invented. However, this genie won't go back in the bottle after granting three wishes. We can expect more of what we have had—bombings and beheadings or threats of bombings and beheadings in New York, London, Paris, Madrid, Bali, Mumbai, Toronto, Karachi, Baghdad, Israel, Gaza, Egypt, and everywhere else where a few fanatics use Western technology to attack the West. But the world has learned to live with this latest evidence that savagery is a component of human DNA that needs to be suppressed—not stimulated—whether in Communist cells, Hitler youth rallies, or jihadist madrassas.

(Personal note: the writer was having dinner with friends in Guelph, Ontario on August 22nd, when we heard a loud bang. We all thought of a bomb, but in Guelph? We ran out to the street. Yes, a letter bomb had exploded a block away, but it had been safely detonated by the bomb squad. The bomb, police said, was powerful enough to have blown the recipient's head off. There had been press reports of two other letter bombs in the Toronto area, one of which had injured its recipient. Eight days later, Toronto police nabbed an Adel Arnaout, a landed immigrant from Lebanon working as a security guard. Police found three other bombs in his rented car and detonated them, after driving in convoy, and under cover from helicopters, from the north of the city to the lake shore, shutting down parkways and bridges. Mr. Arnaout has been charged with three counts of attempted murder and one of inflicting serious injury. Although the letter bombs had been a big story in Ontario, the arrest of the bomber, the shutdown of traffic in East Metro, and the detonation of three bombs was *not* carried by the politically-correct *The Globe & Mail* on its front page. The big story the *Globe* featured was the announcement that Al Gore was coming to Victoria, B.C. to have high tea and discuss the real threat to the world—global warming.)

The technology that has sent stock markets into tailspins created debt products for some of the leading investment banks, hedge funds and a few Private Equity firms. Some of them reside on Park Avenue, but what they share is a secular faith in the glories of new financial structures that are born and bred electronically—and priced according to models, not markets. Their spawn have multiplied like the Jurassic velociraptors, and their rapacity devours resources needed for the health of free financial markets.

The revulsion against Enron and some of the more egregious tech frauds of the 1990s triggered (1) Congressional passage of Sarbanes-Oxley, a panic-driven approach to financial regulation that assumed that most—if not all—CEOs and CFOs were greedy Gullivers who had to be restrained by Lilliputian ropes, and (2) a major expansion of class action tort litiga-

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**The Great New Thing
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Avenue creation of
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creatures...**

tion in which named plaintiffs were given shares of stock and substantial bribes by rich tort lawyers who sued virtually any company whose stock price slumped; in most cases, the companies paid the lawyers their *danegeld*, and stockholders got the equivalent of Cracker Jack prizes.

According to the Newtonian physics of markets, these actions spawned two reactions:

1. Private Equity, which had been a relative bit player in public markets, grew beyond all imagination, fueled by absurdly large quantities of absurdly cheap money. Their mushroom growth helped to reprice US mid-cap (and, later, large-cap) stocks, and to flood US banks and debt markets with junk paper. Driving this astonishing expansion was a superbly seductive argument in favor of privatization: you escape the mind-numbing pettifoggery of Sarbox, *and* the chicanery of tort lawyers by going private.
2. Once IPO prospectuses reached telephone book size to cover all the potential issues that could trigger a Sarbox-based class action suit, the case for designing, developing and marketing highly-sophisticated debt investments sold only to institutions became almost irresistible. Spend your money on mathematical geniuses, not on lawyers.

2. Mad Scientists of Jurassic Park Avenue?

Drexel Burnham pioneered the mortgage-backed bond-equivalent instruments that became the backbone of investment-grade institutional bond portfolios. Then came Collateralized Mortgage Obligations that linked multitudes of conventional mortgages and other high-quality residential debts together. As these instruments proliferated, they continued to trade actively—and remained publicly priced.

The Great New Thing in this decade has been the Jurassic Park Avenue creation of fiendishly complex fixed income creatures called Collateralized Debt Obligations that combined investment-grade conventional mortgages with jumbo mortgages, Home Equity loans, piggyback mortgages, Alt-A mortgages and Subprime Mortgages, including low-end Subprimes, the so-called Ninja mortgages—No Income, No Job, No Assets, otherwise known as “Toxic Waste” and even other CDOs. What made these synthetic products so successful was that their complex computer-created formulas were designed with the assistance and advice of Moody’s, S&P, and/or Fitch. The “independent rating services” advised on the apportioning of ingredients of diverse quality that would, through electronic alchemy, become the inves-

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tors' Gold Standard—AAA paper. There were almost no corporations left anywhere which had Triple A ratings, so the Joyously Jurassic creatures eventually made up a major component of the total supply of the most desirable debt instruments. They were never designed for public trading. Like Michael Crichton's velociraptors, they were kept caged and fed with just the right kind of valuations to avoid disaster.

The geniuses behind this development are PhDs in mathematics and/or physics. They have created hundreds of billions of dollars' worth of financial creatures with electronic DNA who exist within databases. One could call their doctorate-holding parents "Procreators of Hidden Debts."

Each of these newly-spawned triumphs of tendentious mathematics was valued according to the experience of mortgage defaults and foreclosures since the products first became major components of the housing market. *In other words, soaring house prices were built into the valuation formulas.* The housing bubble moved from the real estate ads into software, wherein it was accorded immortality. In this Brave New World, homeowners who couldn't make their mortgage payments wouldn't be foreclosed; they would just keep refinancing their mortgage, credit card and home equity debts by paying their friendly mortgage brokers higher and higher fees for putting their loans into newly-spawned CDOs—at 100% or so of their homes' endlessly rising values.

The process recalls that other triumph of mathematical geniuses—the Long-Term Capital Management data base—that only went back five years, and had no provisions for a Russian default.

When a Goldman fund stuffed with toxic software spawn faced disembowelment and had to be bailed out, the CEO described market conditions as "25th standard deviation events occurring every day." Upon inquiring how often a 25th standard deviation event is likely to occur, we were informed it is expected once every 100,000 years.

We are familiar with Harold Wilson's oft-quoted maxim that, in politics, a fortnight is an eternity, but we had not realized that billions upon billions of dollars were being bet on the assumption that the expected risk of mortgage default was calculated to include, for averaging purposes, the time shortly after our African ancestors had learned to walk erectly. Perhaps the Street will consider including anthropologists and professors of pre-history along with the mathematicians in their modeling teams, now that it seems that Really Big Wheels rely so heavily in their investing on what happened in the years before the invention of the Wheel.

**The geniuses behind
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"Procreators of
Hidden Debts."**



**Bear Stearns’
revelations stopped
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What has ensued
can be justly termed
“the Bear market.”**

For a few years, these splendidly arcane software-spawned products prospered and proliferated, sucking up many hundreds of billions of dollars, euros, yen and Swiss francs. Then, investors discovered that the pricing models for US residential mortgages were based, in large measure, on the assumption of an endlessly rising tide that would lift all debts—and, it now appears, on Alan Greenspan’s assurance that interest rates wouldn’t rise.

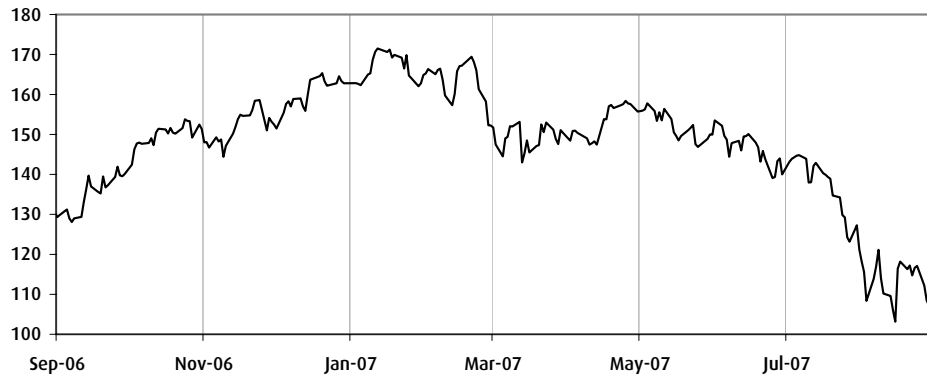
As word began to spread that the payment, repayment and collateral assumptions behind not only the subprimes but several layers above them within these elegant structures were fatally flawed, financial markets worldwide began to totter.

The sequence was as follows:

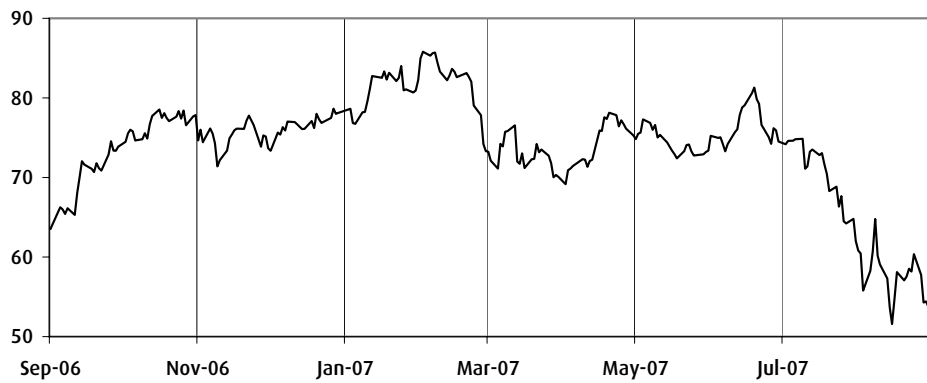
1. Home prices stopped climbing and began to show signs of weakness. Homeowners in default could no longer continue their pattern of refinancing—and getting even more cash for boats, cars, and vacations. Credit card debt began climbing nationally even faster than house prices once had.
2. Foreclosure rates skyrocketed: as of July, they were up 93% over 2006.
3. Worried holders of the software-spawned structures tried to sell them to the Street, only to learn that their effective value was, in morbid Street lingo “Offered...Without.”
4. Bear Stearns, a Park Avenue star, found that two of its heavily-promoted hedge funds were collapsing. One was partially bailed out; investors in the other were told they could expect little, if any, return on their investment. The fallout from Bear Stearns’ revelations stopped the bull market at an even 14,000 for the Dow. What has ensued can be justly termed “the Bear market.”
5. Subprime shock migrated from Wall Street to Main Street and across the world. Two small German state banks and a small Dutch bank had to be bailed out because of losses on US CDOs. China reported large exposure. Even Singapore reported losses. (We assume none of the geniuses will plan a vacation there; undesirables are unwelcome and flogging is prescribed for a wide range of lesser offences than bilking billions from global investors, including the careless disposal of chewing gum.)
6. Major investment banks’ share prices plunged.

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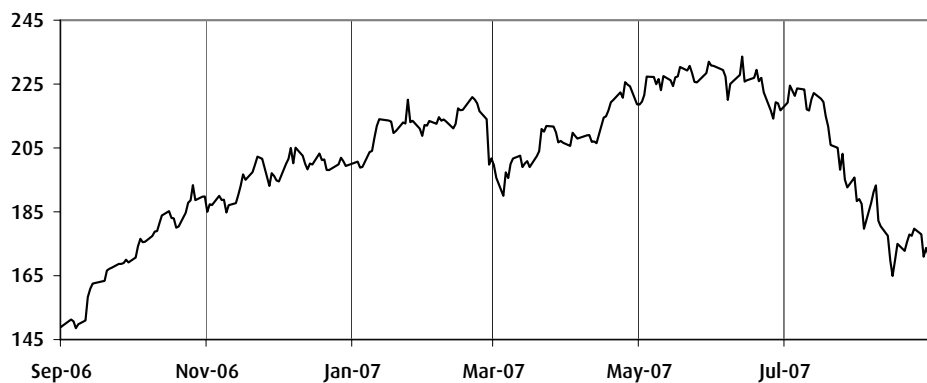
Bear Stearns (BSC – NYSE)
September 2006 to September 2007



Lehman Brothers (LEH – NYSE)
September 2006 to September 2007



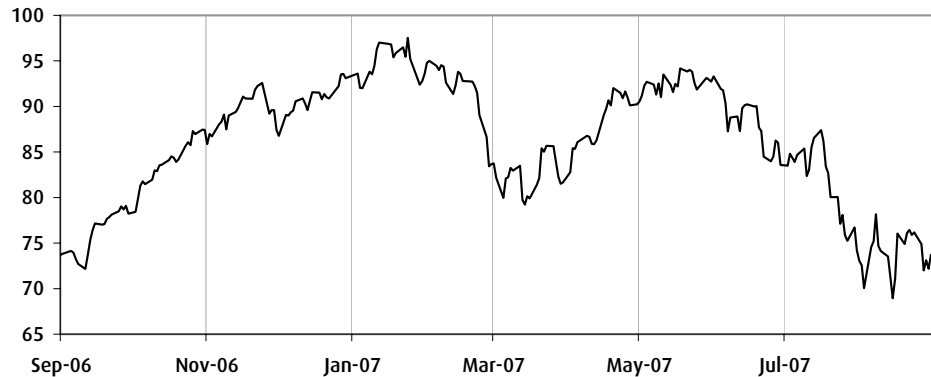
Goldman Sachs (GS – NYSE)
September 2006 to September 2007





***In a bear market,
financial stocks
trade on their
balance sheets.***

**Merrill Lynch (MER – NYSE)
September 2006 to September 2007**



The unvarying rule about financial-led bear markets:

In a bull market, financial stocks trade on their earnings.

In a bear market, financial stocks trade on their balance sheets.

What makes this crisis unique, and what makes predicting its progress so difficult, is that no one—absolutely no one—knows what all the “Jurassic Park Avenue” products on the balance sheets of hedge funds, investment banks, and bond mutual funds are actually worth. The irrepressible Warren Buffett commented that he would love to be weighed according to a model, but he has to use a scale.

The entire history of bank regulation since Paul Volcker first convened a Basel committee to create rules and regulations for valuing global institutions has been based on market values and risk-adjusted market values. We now know that many major banks chose to escape the strictures of those rules by loading up on mortgage products that had never ever been valued in the markets. All those hymns to the virtue of transparency and harmony in financial reporting were sung by people who turned out to be elegant, sophisticated skills who employed brilliant, sophisticated mountebanks.

3. LBO Debt

While the stock market attempted to come to terms with the idea that even Goldman Sachs couldn't seem to manage risk any more (as evidenced by the hideous performance of its flagship hedge funds and the scary performance of its stock), another Street-spawned debt problem took investors' attention.

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The big banks had been falling all over themselves trying to outbid each other to finance Private Equity takeovers of public companies. As one PE titan admitted recently, when the Street was so eager to shower him with low-interest, covenant-free debt at the level of nine to twelve times the earnings of a company his firm considered buying, how could he say No? (We could paraphrase his behavior as “The debt made me do it.”)

Who would be willing to take such smelly paper off the hands of the investment banks? Answer: until recently, thousands of institutional investors across the globe were eager to help the Street keep the PE party going.

Then, four developments ended the grand PE party:

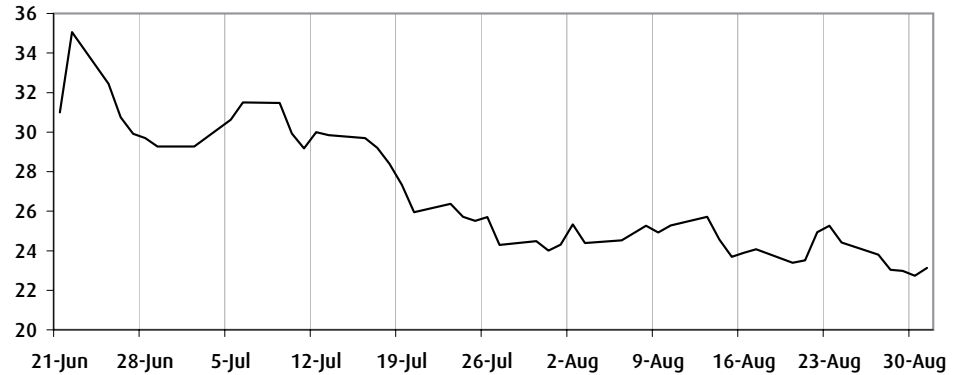
1. Credit spreads began to widen from absurdly cheap to merely cheap.
2. Recognition dawned that an additional \$300 billion of dubious-quality paper was on its way once major PE deals closed. This paper would be used to finance the entire cost of buying yet more companies at big premiums to their previous market price, plus paying a huge dividend to the buyers (for all their hard work in making the bids). The acquired companies' credit ratings would go from good quality to odoriferous junk in the time it would take a witch to deliver a curse.
3. Stephen Schwarzman threw a multi-million-dollar 60th birthday party for himself that drew precisely the opposite kind of response he had expected. What was meant to be a tribute to the new master of the universe was widely seen as crass, not class. Would you want him as the boss of an acquired company that had long prided itself on its traditions of decorum and excellence? Is Caligula your idea of a really neat emperor, even if you reside far from Rome in Transalpine Gaul?
4. Mr. Schwarzman, who had long cited freedom from quarterly earnings short-termism and Sarbox as reasons why PE firms could outperform their competitors even when their balance sheets were heavily burdened with debt, successfully floated an offering of stock in Blackstone at \$31. Intraday, the stock touched \$38 before pulling back. (Whoever paid \$38 may become the Wall Street equivalent of Steve Bartman, famed as the archetype of Chicago futility, because his interference with a Cub outfielder cost the team a trip to the World Series.) The proceeds of the offering briefly boosted Mr. Schwarzman's stated wealth in the Billionaire Bragging stakes.

**Is Caligula your
idea of a really
neat emperor...**



**Mr. Schwarzman's...
timing for selling
the public a share
in his company was
magnificent.**

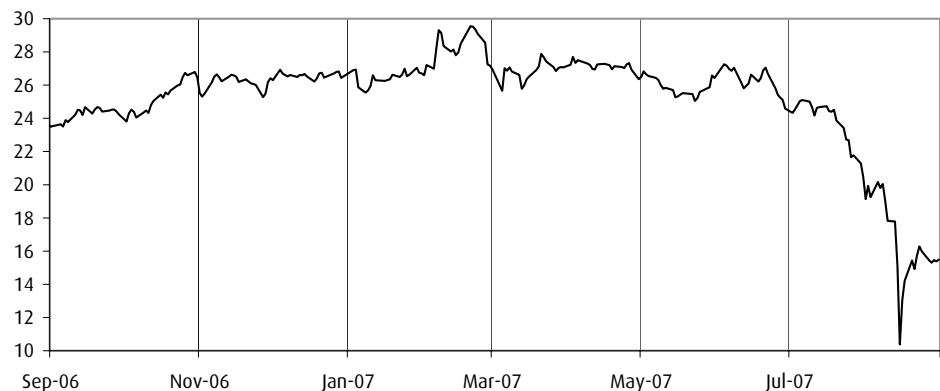
**Blackstone (BX – NYSE)
July 2007 to September 2007**



SubPrimal Screams

Whatever doubts anyone might have had about Mr. Schwarzman's wisdom in buying companies, his timing for selling the public a share in his company was magnificent. The stock market peaked and plunged almost immediately thereafter, as fears of a housing collapse that would trigger a recession roiled the markets. His rival, Henry Kravis, who had also rather suddenly discovered that privacy wasn't such a wonderful thing after all, was too late with his me-too attempt to take KKR public. (It didn't help that his publicly-traded affiliate, which invested in mortgage paper, cratered, due to inability to roll over short-term debts.)

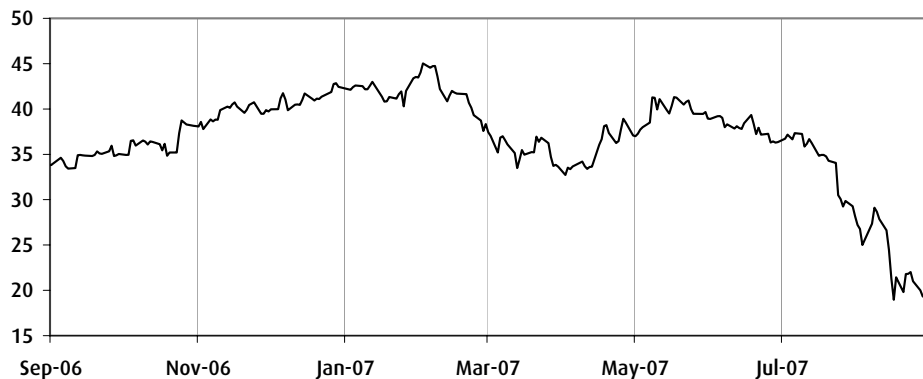
**KKR Financial (KFN – NYSE)
September 2006 to September 2007**



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Leading the market down was Countrywide Financial, the nation's largest mortgage issuer, and long the superstar S&P financial stock.

**Countrywide Financial (CFC – NYSE)
September 2006 to September 2007**



**Mr. Bernanke,
mimicking
Deng Xiao Ping,
said, in effect,
“To borrow is
beautiful!”**

Its now-famous chairman, Angelo Mazilo, had, coincidentally, been selling his stock almost as heavily as CFC was selling mortgages before the storm broke. Thanks to his prudent divestiture of the overwhelming proportion of his shares, Mr. Mazilo can take a somewhat relaxed attitude toward the housing market and CFC's share of the national economy. Nevertheless, he joined the more-famous Jim Cramer in a plea to the Fed to save the economy from recession. Mr. Cramer's primal (or subprimal) screams that the Fed act NOW became a hit on YouTube.

The Fed *did* act—but it wasn't what the mortgage issuers and Jurassic geniuses expected. Nor did it end the market selloff.

This was Ben Bernanke's first test of coolness under fire. And he passed it.

His response was creative. He called a teleconference meeting of the Federal Reserve Board—not the Open Market Committee—and cut the Discount Rate a half-point. He also widened the range of acceptable repo securities from merely Treasuries, and later expanded the time for loan repayment. He also redefined the bankerly virility test: in the past, any banker who rushed to the Discount Window was deemed to be in desperate shape. Mr. Bernanke, mimicking Deng Xiao Ping, said, in effect, “To borrow is beautiful!”

The fast-evolving Bernanke strategy, as confirmed in his Jackson Hole speech last week, reflects the fast-evolving liquidity drought, which is centered in the disappearing market for short-term commercial paper—particularly Asset-Backed Commercial Paper (ABCP).



...the prospects of rate boosts in September are somewhat more remote than a Nobel Peace Prize for George Bush.

ABCP had become a multi-trillion-dollar asset class in North America and Europe that operated as a parallel universe to the global banking system, which has been operating under Bank for International Settlements regulatory architecture based on the Basel Accords. ABCP has been the mechanism for spectacular growth in financing consumer loan products through packaging in vehicles that convert risky loans such as autos, home equity and low-quality mortgages into AAA products through self-replenishing pools.

It is experiencing its worst-ever crisis. Countrywide Financial was among the first big issuers to find it could not roll over its maturing paper. The contagion spread across the US, into Canada and then into Europe. Hundreds of billions' worth of commercial paper has evaporated.

The banking system might ordinarily step into the breach, snapping up the offerings of AAA paper, and keeping the short-term markets liquid. However, many major US and European banks are overstuffed with junk paper from LBOs, and are collectively on the hook for \$300 billion more.

In the past, issuers could rely on an uncritical mass of institutional investors desperate for debt products that paid a few basis points above bank paper. However, the new Black Hole of Calculating Institutional Investors has discovered the splendors of T-Bills with the fervor of former atheists who have just received nocturnal visits from angels.

The major asset class with the widest swing in yields for the past six weeks has been T-Bills. Yields have ranged from less than 2% to 4.8%—without any change in the fed funds rate.

The liquidity drought has forced major central banks to inject hundreds of billions' worth of funds into local markets. These massive injections frequently lead to temporary *de facto* cuts in the official central bank lending rates.

Because central banks have eased credit in three ways—in acceptable loan duration, in quality of assets accepted on repos and even in terms of the range of financial institutions eligible for aid—monetary bases are growing dramatically without any changes in official rates. Bernanke's formula has been adopted by the European Central Bank, and local Landesbanks in Germany, choked with US Jurassic creations, are getting emergency aid from commercial banks and the ECB. Only the Bank of England has remained aloof from this rush to reliquify. The central banks now frantically shoveling out loans on a widening range of acceptable security had previously been monetarily hawks. The Bank of Canada and the ECB had been readying their market participants for rate boosts in September. Now, the prospects of rate boosts in September are somewhat more remote than a Nobel Peace Prize for George Bush.

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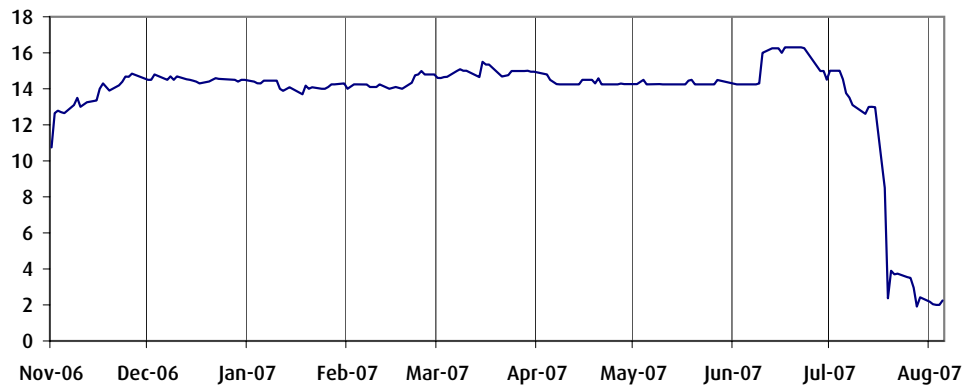
Special Note to Wiccans and Triskaidekaphobes

In Canada, a newly-public Asset-Back issuer named Coventree kicked off a crisis by announcing it could not roll over its maturing paper. The entire Asset-Backed Commercial Paper market collapsed. An astonishingly long list of public companies revealed that they had substantial exposure to Coventree paper. As of writing, there is talk of litigation against Canadian banks for failing to come to the aid of the ABCP issuers. National Bank has bailed out a company it sponsored, but the outlook for many of the other companies is murky. The effect on consumer credit in Canada has been sufficiently severe that the Bank of Canada is said to be scaling back its forecasts for economic growth and inflation.

That's a big deal for such a small company. But its name suggests it had a special destiny.

**Coventree...
its name suggests
it had a special
destiny.**

Coventree (COF – TSX) November 2006 to September 2007



The company went public in November. Since the name Coventry had been used by many other companies, the promoters came up with this special spelling.

They obviously weren't students of history.

A coven tree was usually a willow or rowan. Historically, under the Old Religion, which was active across Europe even before Stonehenge was built, twelve members of a coven would dance in a circle around the thirteenth member. The Church made sustained efforts over the centuries to wipe out paganism (as it chose to call it) and coven members were called witches. Any evidence in one's home or farm of symbols involving the number 13 was sufficient to lead to prosecution and likely death by drowning or burning at the stake. That is why 13 became an unlucky number: triskaidekaphobia (fear of #13) was a survival strategy.



**Where did all
the liquidity go?
Did it evaporate due
to global warming?**

Coventree, like many other issuers of ABCP, seems to have increased its investment risks as rapidly as the supply of its paper outstanding. Ultimately, it could not find buyers for its paper. Corporations who borrow short, lend long, and take risks that are not fully disclosed to the market cannot expect to live long once central banks have become serious about tightening.

As Fate had decreed, on August 13th Coventree was unable to place new asset backed commercial paper to fund the repayment of previously issued ABCP that had matured. Its fall from financial grace has cast a freezing spell on the Canadian financial system, which may or may not be relieved by the Bank of Canada's first caress.

But going broke is a lesser punishment than being burnt at the stake.

In the spirit of political correctness, (because Wiccans are, in fact, protected under Canadian law, and even the Army must make provision for their right to rites), Wiccans, please take note of this sad story—but don't take any notes issued by Coventree.

Where Are the Flows of Yesteryear?

It seems so long ago that everyone who mattered (and, we confess, us), said the world was awash in liquidity. When he was still a relatively obscure Fed member, Ben Bernanke coined one of the most-quoted *aperçus* of our time—"the global saving glut." (It is usually misquoted as "savings.")

Where did all the liquidity go? Did it evaporate due to global warming?

Liquidity is partly quantifiable, partly transactional, and partly psychological.

The most usual measure is total dollar-adjusted global liquidity, which adds US monetary aggregates to their equivalents in the major industrial nations, adjusted for their currencies' values.

As investors learned to their despair in 1987, that number was a snare and delusion. When a crisis developed in the Eurodollar market and investors began fleeing from the dollar and from dollar-based securities, the resulting dollar drought produced a global financial crisis.

Paul Volcker set in motion the procedures to rectify this problem, putting large financial institutions with Eurodollar assets and liabilities onto a common financial footing for reporting and regulatory purposes, which meant liquidity could flow more freely across institutional and geographic boundaries. Relaxation of foreign exchange controls, improved technology, and development of the Internet greatly facilitated this process. The emerging markets remained largely outside, until the restructuring of the global finan-

Basic Points

cial system in 1998 when China entered the system as a full-scale participant, setting the renminbi's trading range against the yen and the dollar. In this decade, most of the leading Third World economies switched from their history of having high levels of external dollar-denominated debt and inadequate forex reserves, to having modest levels of dollar-denominated debt and robust forex reserves—which were overwhelmingly invested in dollars. To these growing dollar hoards were added a new breed of investor—sovereign wealth funds. They were repositories of excess export revenues, usually from commodities, and were also overwhelmingly invested in dollars.

Here are some of the major influences on the supply and use of global liquidity in this decade:

1. China, which has the world's fast-growing economy, has a savings rate of 40%.
2. The US savings rate fell from small to tiny to minuscule to negative—yet interest rates fell and credit spreads contracted to barely-perceptible levels.
3. To finance its Current Account deficit, the US has been drawing down more than 75% of global cross-border savings. There may not be a global saving glut, but there most assuredly has been a global saving glutton.
4. Until it finally took off, China had the worst-performing stock market of any economy in the world. That meant that most of China's prodigious savings had to be exported or the nation's interest rate structure would have been under sustained downward pressure, which would have triggered inflation. Now that China's stock market is worth more than Japan's, it will be an increasing source of pressure on available savings—leaving fewer savings available for markets abroad.
5. Japan's Triple Waterfall Crash appeared to end after Koizumi won the first-ever election in which the people voted on a real program of reform, rather than on a succession of wrinkled gerontocrats from the mislabeled Liberal Democratic Party. However, Japan's interest rates remained the world's lowest, and the development of the euroyen market meant that the yen became the borrowing currency of choice for hedge funds and investment banks' trading departments. The bottom end of the yen's trading range against the dollar (110-122) was set by Beijing nearly nine years ago with the advent of what we have called "The Great Symbiosis." The yen's fluctuations within that band have had enormous impact on the value of high-interest-rate currencies, US fixed income products, commodities, stocks and derivatives.

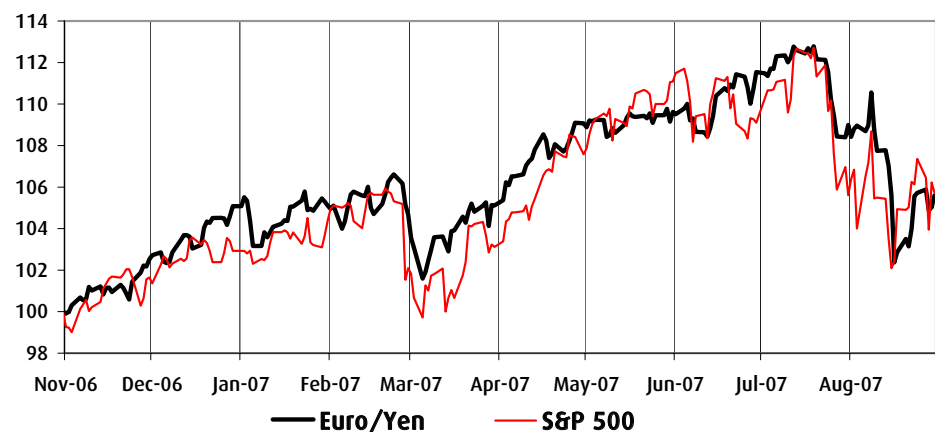
Japan's...first ever election in which the people voted on a real program of reform, rather than on a succession of wrinkled gerontocrats...



...with the growing importance and flexibility of the euroyen and euro pools...The financial world became less crisis-prone.

6. The advent of the euro and the abolition of the predecessor currencies greatly expanded global liquidity, because the value of liquid financial assets in the Eurozone approximated the value of dollar-based liquid assets.
7. All previous crises and crashes since 1973 had the Eurodollar market as their epicenter, because Eurodollars were the only large pool of interbank activity that were not directly under the sway of a central bank. Therefore, with the growing importance and flexibility of the euroyen and euro pools, what we have called *real, effective global liquidity* expanded faster than the growth rates of monetary aggregates and global forex reserves. The financial world became less crisis-prone.
8. Flaps occurred occasionally in global markets in recent years when the Bank of Japan contracted the euroyen pool. The most dramatic was April-May 2006, when the BOJ drained 30 trillion yen from its monetary base in an operation that, *inter alia*, stopped gold from breaking through \$700 and copper from breaking through \$4. As we described those events, (see *Basic Points*, May and June 2006), they came after publication of a paper by BOJ economists that had been edited, with recommendations, by Ben Bernanke just before he became Fed Chairman. That paper showed how euroyen rates fostered speculation in currencies, commodities and other assets. Gold wasn't soaring this year, the euroyen pool was liquid, and, by mid-July, everything seemed right with the world. The Dow and S&P went to alltime highs.
9. The new global financial importance of the euroyen and euro pools have been repeatedly documented by Dennis Gartman, whose daily letter is a must-read. He continually updates the chart that compares the performance of the yen to the euro to the performance of the S&P.

**Euro/Yen versus S&P 500
November 2006 to September 2007**



10. Since 2004, we had, from time-to-time, seen reports about sustained large-scale German investment in US mortgage products. We wondered why anyone who didn't need to own US mortgage products would want to own paper issued by Fannie or Freddie—because both have practiced phony accounting at levels that make Enron look as restrained and reliable as Berkshire Hathaway—let alone in Jurassic-style computer-modeled products. Then we remembered a bit of Brit wit we heard in London long ago: “When the Americans are buying, sell them what they want; when the Germans are buying, sell everything.” Once again, as we read reports of previously-obscure German banks going down because of Jurassic products, we conclude that late-to-the-party Germans helped make a market top.

**“...when the
Germans are
buying, sell
everything.”**

The Banks and the Drought in the Asset-Backed Commercial Paper Market

The unwillingness of investors to take further dollops of vastly overpriced and undercovenanted LBO debt from PE takeovers has strained the capacity of banks to step up and back the Asset-Backed Commercial Paper market.

The banks' problems are compounded by evidence that subprime slime is working up through other grades of mortgage products. In particular, unfolding stories that dubious or outright fraudulent overvaluations had become the norm for some mortgage issuers argues for bleak times ahead for holders of non-market-priced products—including many investment banks and the hedge funds they sponsor.

But it will get worse.

The stock market's tumble came amid widespread publicity that hundreds of billions' worth of subprime and other adjustable rate mortgages will be resetting to sharply higher interest rates over the next 18 months. With default rates already at the levels last seen during the depths of the 1991 real estate recession, how will homeowners handle big increases in their monthly payments?

It is likely going to get much worse for the real value of Jurassic Park Avenue products. How important are they to the balance sheets of the major investment banks?

Do they put their Tier One exposures at risk? Residential mortgages have been given generous capital allocation rules under the Basel Accords, given their history of tiny loss ratios. But comparing the riskiness of conventional



The supply of fools eventually runs out, and the system seizes up.

mortgages allotted to 70% of actual home value, granted to people with excellent credit records, to the kind of toxic waste pumped into the new-age products is like comparing the risks from confronting a charge by an Italian cavalry unit to those from an attack by a Panzer division.

Like most investors, we have had to learn a new vocabulary for understanding the risks to the banking system. We had, perhaps naively, assumed that Basel I and II had purified the big banks—whose bad behavior had put the global financial system at risk on numerous occasions. Now we learn that some of them might bear more than casual resemblance to the Enron model of using Special Purpose Entities to keep risks off the balance sheets and inflate returns on equity.

We knew they had conduits, which, as we understood, were bank-sponsored vehicles for handling various kinds of consumer loans and credits. The banks have been standing behind those vehicles.

The banks have also had various kinds of relationships to various kinds of new credit issuers financed in the ABCP market. Coventree is one such firm, which grew spectacularly until its business model imploded.

As all investors in commercial paper know, the only way a credit issuer can afford to pay a higher than T-Bill rate is to take credit and/or duration risks with its loans. So we have little sympathy for those companies who took Coventree paper to pick up a few basis points over bank paper. They knew—or ought to have known—there was a higher level of risk. That a number of junior Canadian mining companies invested major portions of the capital they had raised to build new mines in Coventree paper must have prompted many stockholders to want to drop their treasurers down mine shafts. Investing in Northern Moose Pasture Mines is a big enough risk in itself without its treasurer reaching for a few basis points in yield from a company that hadn't been around any longer than Northern Moose.

Writing in the *Financial Times*, the urbane Martin Wolf observes that this decade's enthusiasm for expanding the issuance of short-term paper far beyond the banking system was based on the argument that sophisticated investors could make their own appraisals of risk, and thereby increase their investment returns. He says that what really happened was that the decision on credit quality was extended to those who were unable to make sound appraisals. The supply of fools eventually runs out, and the system seizes up.

Basic Points

The situation is different with bank entities we've been hearing about lately—Structured Investment Vehicles (SIVs) and their riskier relatives, SIV-Lites. SIVs can buy a range of debt products, whereas SIV-Lites (according to the *Financial Times*) buy only mortgage-backed bonds and CDOs. In Jurassic terms, these are theoretically benign animals—not raptors or T-Rexes. The banks analyze each asset that goes into the SIVs, and buy them only if they meet the banks' tests for assets they are willing to put on their balance sheets.

The SIVs issue Asset-Backed Commercial Paper to finance their acquisitions, and investors happily buy it because it's bank-backed.

The problem is that an increasing percentage of AAA-rated CDOs held by SIVs have, in effect, been re-rated to AAAwful. The banks loaded their SIVs with such products, because their durations were either unpredictable or likely to be longer than the banks felt comfortable holding in their Basel-regulated accounts. The banks knew they had duration risk, but they are now horrified to find out that they have really serious credit risk as well. That has been the problem for those small German banks which suddenly became world-famous.

The *Financial Times* estimates that there are roughly \$400 billion in SIV assets that have fundamental duration mismatches and unknown—but scary—credit risks.

Late last week, Barclays discovered the problems of trying to hold liquidity within leaky SIVs. It borrowed 1.6 billion *pounds* from the Bank of England's emergency Discount Window, and pumped 1.6 billion *dollars* into a SIV Lite whose commercial paper the markets would no longer accept, because of the SIV's huge exposure to US CDOs. It also indicated it would be looking at funding other SIVs. It was revealed that Barclays had, in a creative dash of Anglo-Saxon finance, designed a SIV for Sachsen LB, the German bank whose failure has forced the resignation of the finance minister of Saxony. Barclay's stock has been so badly hammered that its offer for ABN Amro now looks like the high water mark of mergermania.

What is clear is that these chaotic debt markets are challenging for even the best-managed banks. State Street's investment group has one of the best reputations in the industry. Its Limited Duration Bond Fund, an institutional vehicle, lost 37% of its value during the first three weeks of August and is down 42% in the past year, according to a report in *The Globe & Mail*. That kind of hit suggests that the managers have recently applied some stern valuation criteria to exotic items in their portfolio, and concluded that their previous valuations—model-based—were no longer appropriate. Remember: State Street has been a top tier fixed income manager for a very long time.

SIV-Lites buy only mortgage-backed bonds and CDOs. In Jurassic terms, these are theoretically benign animals—not raptors or T-Rexes.



...major banks are facing monstrous liquidity strains because their SIVs are too heavily committed to AAAwful Jurassic CDOs.

You can bet the bank regulators in Basel are taking note of the risks to bank balance sheets. A skeptic might wonder whether some banks took on such huge risks in off-balance-sheet entities to defeat the whole purpose of the Basel rules. Paul Volcker and his successors wanted to ensure that there wouldn't be future financial crises because of banks that had (1) borrowed short and lent long in illiquid investments, or (2) borrowed short and lent badly in terms of credit risks, or (3) both of the above.

Many big and previously reputable banks have, we now know, been practicing Strategy (3) on a grand scale.

We have had far too much experience with crises caused by bank misbehavior to be comfortable as we ponder the implications of these revelations of foolishness and mountebankery in the banks.

Although Stephen Schwarzman's birthday bash attracted widespread snickers, the Deutschebank celebration for 500 of its more successful investment bankers in Barcelona drew less comment—sneering or otherwise. The bank paid the Rolling Stones a reported \$5.4 million for entertaining the assembled rainmakers—\$10,800 per productive head. Depending how serious the global financial crisis become, the event may become more famous in the future than it was at the time: the date was July 12th. If the Bank sold stock market futures—or calls on its own stock—at the time it was delivering Mick Jagger his check, it could easily have recouped the costs of the bankers' bacchanal.

It is one thing if the losers from Jurassic CDOs are levered hedge funds, and the population of instant billionaires is thereby reduced.

We—and the global financial system—can surely live with that.

But major banks are facing monstrous liquidity strains because their SIVs are too heavily committed to AAAwful Jurassic CDOs.

The surge in Libor and Euribor interbank rates, which has driven the TED Spread and its euro and sterling equivalents to panic zone levels, is due, we are told, to banks' unwillingness to lend to each other because they need to hoard liquidity to back their own suspect SIVs.

In other words, the basic purpose of the Basel rules for banks has been undermined.

Basic Points

Too many banks created too many SIVs because they wanted to lever up their earnings without putting the assets and liabilities on their balance sheets. Now they have to hang on to such truly liquid assets as they can, in order to respond to the market's decision that it's no longer eager to live with SIVs.

The financial world was a far safer place when the bankers abided by both the letter and the spirit of Paul Volcker's great reforms.

We can only hope that investors in non-financial stocks will not share in the punishment that will probably be meted out to the banks that let their legal departments find exquisitely sophisticated ways to get around the constraints of the Basel rules.

A Modest Proposal:

We earn our living by analysing markets. We are, therefore, at something of a loss to handicap this market activity because it is rooted in an unknowably large population of investment creatures that are not marked—except in supremely tolerant computer programs—to market.

We have been surprised by the suddenness and scale of the drought in the commercial paper markets of North America and Europe. We have been pleased that central banks have managed to offset much of the systemic impact of this drought by astonishingly huge cash infusions.

But this process in which man-made monsters drain liquidity from the debt markets we can follow is fatiguing and frustrating. We have publicly recommended that Wall Street deal with this overpopulation by controlling the work of the PhDs who spawn these systemic polluters. What is needed is to control the capacity of the Procreators of Hidden Debts. What is needed is the financial equivalent of vasectomies for the Jurassic Park systems.

As long as CDOs and other exotica were a small part of financial markets, there was justification for the Street's enthusiasm in hiring mathematicians who would otherwise be performing socially useful work.

But the population explosion of Jurassic creatures can only be halted through a cessation of new creation of Jurassic products or with a crash and a recession.

How can major investment banks who owe their wealth and power to open, transparent financial markets justify creating so many creatures which would perish in the cold light of market pricing like vampires forced into sunlight?

What is needed is the financial equivalent of vasectomies for the Jurassic Park systems.



Would a soup company be allowed to sell soups with 2% sewage content?

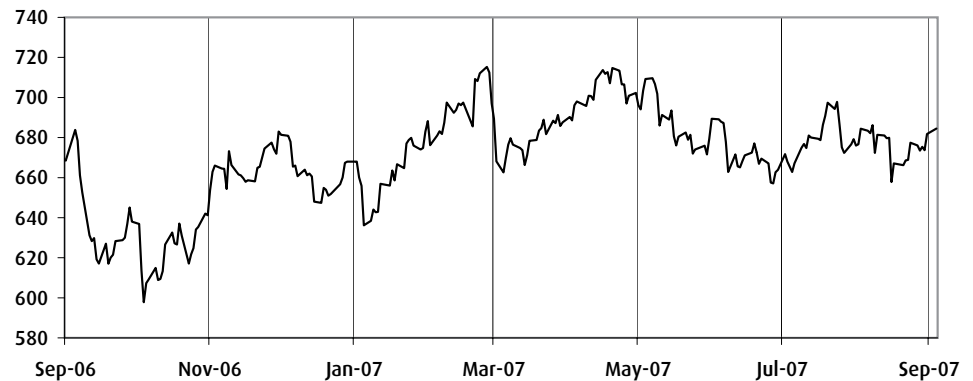
Surely the people involved in creating and trading the market-based and priced structured equity and commodity products must resent the bad name the reckless debt product creators are giving to all structures.

When will credit agencies stop applying AAA labels to products containing toxic waste and Alt-As? Would a soup company be allowed to sell soups with 2% sewage content?

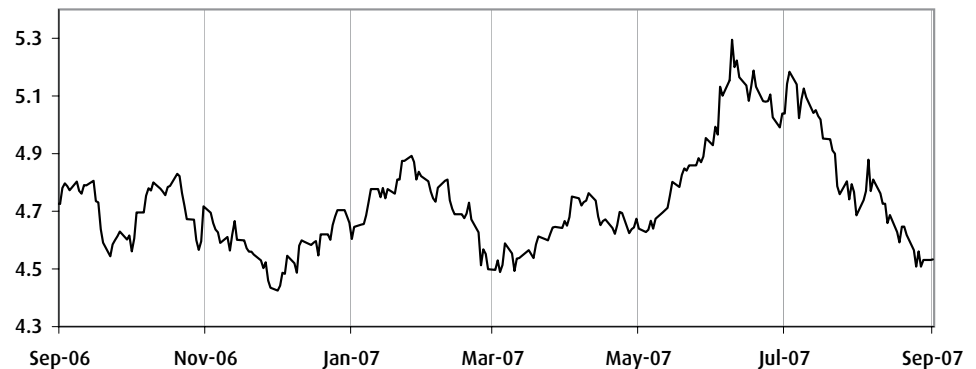
When will bond investors take the pledge against buying any more of these financially lethal creatures?

Is There Still Mold on Gold?

**Gold Futures
September 2006 to September 2007**



**Ten-Year US Treasury Notes Yield
September 2006 to September 2007**



Basic Points

In April, we told you, in effect, to lighten up on bonds and increase exposure to gold.

We argued that food inflation was about to join energy inflation, and that wage inflation was next. We also argued that the huge subsidy to US debt markets from foreign investors was unlikely to last. That meant that credit spreads would revert to normal, and that the yield curve would also go back to normal.

At that point we shared the general bullishness about the economic outlook. We took the view that the housing bubble had been on Page One for nearly a year, and no train wreck predicted that far in advance ever does much damage.

We had in March published, *"DON'T ASK! DON'T TELL! IT'S SUBPRIME TIME!"*, but, after reading what we could find and talking to a few experienced bond investors, we underestimated the scale of penetration of the institutional bond market by unacceptably risky product. We also failed to anticipate the last-minute flood of LBOs that would swamp the banking system with unmarketable products.

We had been expecting a stock market correction, but thought it would be a relatively painless affair.

We never anticipated the freeze-up of the commercial paper markets—here and abroad. That freeze-up is the equivalent of severe central bank tightening on consumer credit. Coming at a time when millions of recent mortgagors no longer had equity in their homes as the basis for refinancings or home equity loans, it meant that the risk level in the economy had suddenly spiked.

It also meant that investors would run to government bonds. As risks suddenly became repriced, the effect on bond markets was dramatic.

Result: Treasury yields are back to where they were when we published on April 13th.

For a while, we looked good with our bond call. It turned out we were just lucky—and the financial system was about to enter a string of collective bad luck, arising from years of poor management of risks by major investment banks, hedge funds, and Private Equity firms.

**We never
anticipated the
freeze-up of
the commercial
paper markets...**



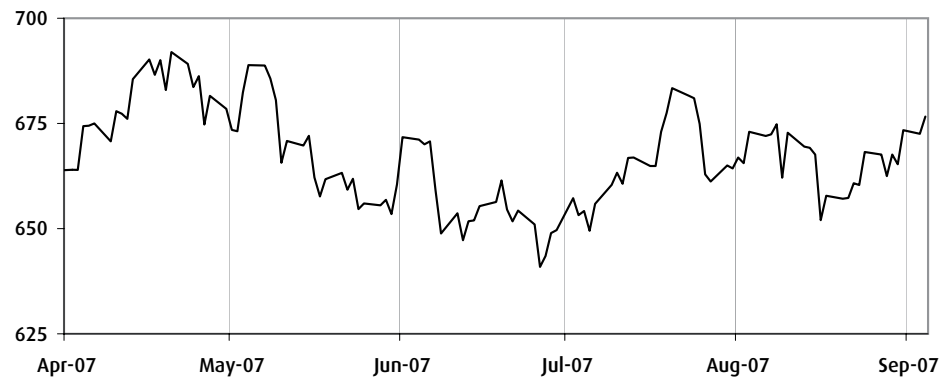
Gold did act as a sort of Store of Value...by doing nothing in particular...

Had we known back then that the global financial system would be put at risk by software-spawned debt creatures, we would have predicted a record price for gold.

For weeks, we have been wondering why investors have not rushed into gold.

Instead, T-Bills have been exciting and gold has been boring. Veteran gold bugs, who have long argued that the global financial system is a house of cards, must be deeply conflicted in recent weeks: their predictions of doom are being fulfilled, but almost nobody is seeking solace in gold.

Gold
April 2007 to September 2007



The stories of financial institutional misbehavior tend to justify the allegations of the most seriously paranoid people who are not forcibly confined in institutions for the insane. This should be a Golden Age for Gold Bugs.

Gold *did* act as a sort of Store of Value during the summer stock and bond selloffs, by doing nothing in particular, recalling a song from *Iolanthe* about the phlegmatic behavior of another venerable institution during a period of crises:

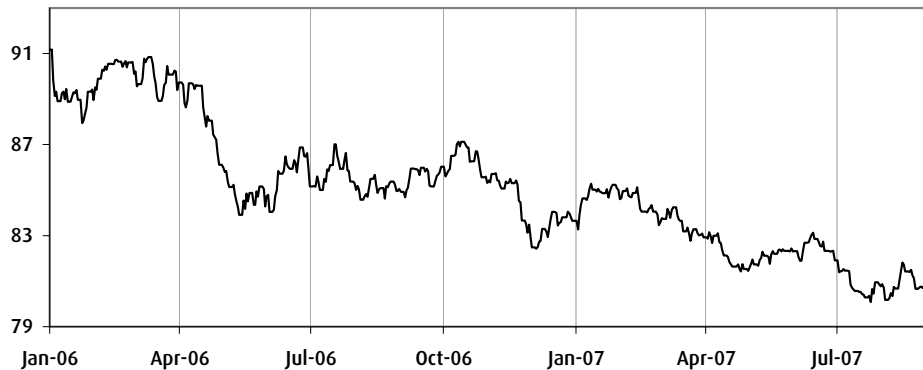
*When Wellington thrashed Bonaparte
In good King George's time,
The House of Lords
Throughout the war
Did nothing in particular,
And did it rather well.*

Basic Points

What will it take to make gold break out of its torpor?

Most likely, it will take a breakdown of the dollar, which keeps tantalizing market watchers by threatening to break through 80 on the DXY.

**US Dollar Index (DXY)
January 2006 to September 2007**



**Alfred North
Whitehead wrote,
“The laws of physics
are the laws of Fate.”**

Will it happen?

Yes, we still believe so. Gold looks to us to be the greatest bargain it has been in many a year.

The Intersection of Jurassic Park Avenue and Main Street

In *Jurassic Park*, brilliant scientists labored long and hard to achieve amazing breakthroughs, and were shocked when their lab-spawned creatures began to run wild. Their pride in their acts of creation blinded them to the risks they created. They even struggled to prevent anyone from killing off their creations until, too late, their creations turned on them.

Alfred North Whitehead wrote, “The laws of physics are the laws of Fate.” He argued that those who want to understand the future of humanity should read Sophocles, Aeschylus, and Euripides. In their tragedies, humans are unable to escape their Fates, and the punishment for their hubris is terrible.

Already, the markets’ response to its shock that AAA can mean AAAwful has been sudden droughts in the commercial paper markets of the US, Canada and Europe.



Autumn is nearly here, a time when stocks often take their cues from leaves.

The crunch on the creation and distribution of US consumer credit paper from the Jurassic depredation is as if the Fed had delivered a surgical strike against American consumers. Their indefatigability and optimism were the conditions precedent to the global economic recovery after the pain and suffering from the idiocy of the Tech Triple Waterfall and the horror of 9/11.

Writing in the *Telegraph*, Niall Ferguson reminds us how long it took for the US to recover from the Vietnam defeat and from the capital market chaos of the inflationary 1970s. He suggests that Iraq and the housing/mortgage debacle could be replays of those sad times.

We respect him greatly, but we think he is too pessimistic. Nevertheless, we recognize that whatever the odds against a US recession were three months ago, they have lessened now. A fed funds cut now would unleash more speculation by the gang that gave us this mess, without necessarily stimulating greater economic activity. It would likely lead to a dollar collapse, rather than a continuation of the benign devaluation process that has already helped the US trade balance.

We believe the global economy can survive a mild US recession, and still believe that equities tied to strong growth in demand from Third World consumers—food, fuels and metals—are core investments, regardless of the near-term prospects for the American economy.

With the recent recovery, the stock market has largely recovered from its July swoon and August angst. We do not believe the adjustment to a sharply reduced placement for the US within the global economy is priced into US stocks, particularly US financial shares.

Those risks could get priced soon: Autumn is nearly here, a time when stocks often take their cues from leaves.

INVESTMENT RECOMMENDATIONS

1. Remain underweight US and global Financial stocks, particularly Wall Street investment banks. They are the carriers of the contagion. Canadian bank stocks will suffer less than others, because Canada's big banks have such a protected competitive environment at home. Historically, the patient investor has never lost money owning one of the Big Five Canadian bank stocks—this should continue to be true as long as they stick to their knitting.
2. Remain overweight commodity stocks, using the suggested sectoral weights shown in our Recommended Asset Mix. (The weightings are for whatever commodity stock exposure you carry, whether a small fraction of a large equity portfolio, a pure commodity portfolio, or within the equity portion of a balanced fund.) The commodity bull market lives.
3. Maintain bond durations below benchmarks. If Bernanke is forced to ease, that will be bond-bullish briefly at best. With unemployment so low, and the dollar so weak, a cut in the fed funds rate will be seen as an inflationary capitulation by the world's biggest debtor.
4. US investors should use Canada bonds as partial substitutes for Treasuries. Canada has been running fiscal and trade surpluses for more than a decade, and its currency is fundamentally strong. Canadians should not invest in US bonds—unless fully hedged.
5. Food inflation is becoming a worldwide problem. There are no cheap answers to rising prices for grains, meats, and dairy products. There are no cheap agricultural stocks—based on historic p/e ratios—but this is the first cycle in modern history when food shortages are due to prosperity in the Third World, particularly China, and not to crop failures. The bull market in ag shares is still in its early phase.
6. The proliferation of ETFs gives investors new low-cost means of managing equity portfolio risks. Consider, in particular, the shares that allow investors to be short Financial stocks. By owning these shares, you reduce your portfolio's endogenous risk.



7. We have not changed our view that this equity selloff need not be the beginning of a major bear market. All major central banks have been tightening for years, so a correction was overdue. If the manmade systemic risks prove not to be of monstrous proportions, some reliquification should be sufficient to prevent a major bear market. Problem: no one has any real idea of the extent of the problem caused by CDOs, SIVs, and other triumphs of modern technology. Nevertheless, the world beyond Jurassic Park Avenue looks healthy.
8. As BMO Capital Markets rails analyst Randy Cousins argues, the railroad stocks are great long-term investments that have corrected rather severely. They have superb franchises, and excellent management.

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Berkshire Hathaway	BRK	
Blackstone Group	BX	
Countrywide Financial	CFC	
Coventree	COF.TO	
Dow Jones	DJ	
Fannie Mae	FNM	1
Freddie Mac	FRE	1
Goldman Sachs	GS	3, 4
KKR Financial	KFN	
Lehman	LEH	1, 3, 4
Merrill Lynch	MER	3, 4
Moody's	MCO	
NYSE Euronext	NYX	
State Street	STT	

(1) BMO Capital Markets or its affiliates owns 1% or more of any class of common equity securities of the company.

(2) BMO Capital Markets or its affiliates makes a market in the security.

(3) BMO Capital Markets or its affiliates managed or co-managed a public offering of securities of the company in the past twelve months.

(4) BMO Capital Markets or its affiliates received compensation for investment banking services from the company in the past twelve months.

(5) BMO Capital Markets or its affiliates expects to receive or intends to seek compensation for investment banking services from the company in the next three months.

(6) BMO Capital Markets has a actual, material conflict of interest with the company.