



THE BIG GET BIGGER – THIS IS PROGRESS?!

Wachovia

- One of the biggest and best managed banks in the U.S.
- Recently acquired Golden West Financial, one of the best managed Savings & Loans in the U.S. – founded in the 1970's by the Sandler, from Oppenheimer.

Bank of America

- Formerly BankAmerica, formerly San Francisco, formerly itself defunct – now resurrected – has quietly (overnight) bought Wachovia! Or will it be Wells Fargo?
- Also buying Merrill Lynch!!!?

THIS PROMPTS ME TO WRITE!! – AS FOLLOWS:

Foundations of “the problem” – there are many – virtually all related to housing. How can housing be a problem in a period of low interest rates?

This is how (Part I):

- Minimum down payments, if any, required.
- Financing is non-recourse to other assets of the borrower.
- Both interest charges and real estate taxes are tax deductible.
- ARM's and VRM's did not adjust gradually enough.
- Interest rates were unusually low as the housing market was used to grow the economy.

The consumer would be stupid not to take this deal!!! (albeit not carefully reading the fine print).

This is how (Part II):

- Wall Street creativity and packaging then took over, and many income products were created, “protected” and often insured.
- “Packages” were sold and re-sold globally, adding leverage and fees in layers – but not cash or good analysis.
- Heavy incentives to sell existed everywhere – nobody intending to have adequate funds on hand in case of any defaults!

What happened?:

- The music stopped, when it was discovered that there were termites in the chairs and many legs were beginning to wobble!!
- After essentially a free ride, the ARM's and VRM's moved to market and the householder could not carry the loan – after using this period to continue to borrow for a boat, SUV, etc. all on the assumption that house prices always went up.
- Wall Street had, in turn, borrowed 10x – 30x the face value of the mortgage package – exponentially compounding the problem.
- Financial institutions are required to mark-to-market quarterly, even though credit impairment may only be short term.

Hence, balance sheets become unbalanced and lending effectively stopped!

The Result:

Incredible as it seems, in the supposed model of free world capitalism and democracy – “The Excited States of America”:

*An entire sector of Wall Street has been eliminated:

- Lehman, Bear Stearns, etc., had no cash – it was all paid out and spent on helicopters and The Hamptons.
- Chartered banks do have cash – they are “inheriting” whatever they wish.

It is too bad that unwise and inordinate incentive plans (the best and worst of capitalism) “forced” this to happen.

It will take a long time to unwind, for at least two fundamental reasons: a) the magnitude of the leverage and b) the opacity and/or complexity of the derivatives.

P.S. Even today, one can buy furniture or a car with little, if any, money down, and no payments until 2009/10. Smaller ticket items, but the same problematic inducements.

It seems we must always learn the hard way!

**Vanishing Act
(N.Y. Times – September 28, 2008)**

Investment Bank	Year Founded	Now
Merrill Lynch	1914	Bought by Bank of America
White Weld	1895	Bought by Merrill in 1978
Lehman Brothers	1850	Became Shearson, Lehman, American Express in 1983 Bankrupt filing 2008.
Loeb Rhoades	1937	Bought by Shearson in 1979
E.F. Hutton	1904	Bought by Shearson in 1988
Salomon Brothers	1910	Merged with Citicorp in 1998
Smith Barney	1937	Merged with Citicorp in 1997
Morgan Stanley *	1936	Will now become bank holding company
Dean Witter	1924	Bought by Morgan Stanley in 1997
Goldman Sachs*	1869	Will now become bank holding company
Bear Stearns	1923	Now acquired by J.P. Morgan Chase
Donaldson, Lufkin	1959	Bought by Credit Suisse in 2000
Alex Brown & Sons	1800	Acquired by Bankers Trust, then Deutsche Bank 1998/99
Paine Webber	1880	Acquired by UBS in 2000
Kidder Peabody	1865	Acquired by Paine Webber in 1993

* The “survivors”. Also, of interest – in 1955, when the Ford Motor Company went public, there were more than 750 dealers in the syndicate!

Good original research began its demise in the mid 1970s upon the introduction of negotiated commissions on Wall Street. This was progress!?!