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Registered Investment Advisor

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NOVEMBER 2007 COMMENTS

HAPPY HOLIDAYS!

NOVEMBER MARKET ACTIVITY

During November, even after a strong price rally during the last week, the major US stock market indexes (S&P 500, Dow Jones Industrials, NASDAQ Composite) recorded substantial declines. At one point, the first two indexes had given up most or all of their gains of the previous ten months. International and Emerging Market indexes also declined substantially, but still have significant gains for the year. At the same time, US Treasury bond prices rose, as their yields declined to under 4%. Other high credit quality bonds also gained in price. However, prices of lower credit quality debt investments declined, as the markets rewarded safety over return. (See page 2 for all monthly and YTD figures.)

These price movements were accompanied by extreme volatility, which is the investment community's favorite word to explain sharp price movements, both up and down. This month marked the second time this year during which volatility measures reached similar heights, the first time occurring during the July-August period. As with our August Comments, we are devoting the entire Investment Concepts section (starting on page 5) to these price movements, and the reported factors driving these extreme changes.

While we continue to be disappointed when the stock market turns from a long term investment designed to capture the long-term growth of the US and world economies into a short-term casino, we also recognize that the recent price movements are heavily reported in the media, are of real interest to many people, and should be reported on by us as well.

CLIENT FORUMS

We are considering a series of client events, at which we would discuss a variety of investment topics of interest. We are still working on a brief survey which we would like to send to you, either in the US mail or by email, to get your feedback on the content and logistics of these events. We hope to be ready with this survey for the new year.

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Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.

COMMENTS: INDEX RESULTS for period ending NOVEMBER 2007

<u>STOCKS</u>	<u>YEAR</u>	<u>YEARS</u>	<u>YEARS</u>	<u>YEAR</u>	<u>YTD</u>	<u>NOV</u>
	<u>1999</u>	<u>2000-02</u>	<u>2003-05</u>	<u>2006</u>	<u>2007</u>	<u>2007</u>
Vanguard Total Stock Market Index Fund (1)	23.8%	(37.2%)	53.1%	15.5%	6.1%	(5.0)%
Standard & Poor's (S&P) 500 Index (2)	19.6%	(40.1%)	41.9%	13.6%	4.4%	(4.8)%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(48.4%)	41.8%	9.0%	12.4%	(3.8)%
Vanguard S&P 500 Value Index Fund (1)	12.6%	(26.2)%	63.2%	22.1%	1.6%	(5.2)%
Dow Jones Industrial Average Index (2)	25.2%	(27.5%)	28.5%	16.3%	7.3%	(4.5)%
NASDAQ Composite Index (2)	85.6%	(67.2%)	65.2%	9.5%	10.2%	(8.2)%
Vanguard Midcap US Index Fund (1)	25.0%	(18.3%)	83.9%	13.6%	6.1%	(5.6)%
Vanguard Smallcap US Index Fund (1)	19.6%	(24.2%)	87.5%	15.6%	1.9%	(7.4)%
Vanguard International Index Fund (EAFE) (1)	25.3%	(45.9%)	95.9%	26.6%	18.2%	(5.7)%
Vanguard Emerging Markets Index Fund (1)	61.6%	(29.5%)	162.7%	29.4%	39.4%	(12.1)%
Vanguard Real Estate Investment Trust Fund (1)	(0.4%)	47.5%	98.6%	35.1%	(12.0)%	(9.1)%
 <u>BONDS</u>						
Vanguard Total Bond Market Index (1)	(0.8%)	30.4%	11.1%	4.2%	6.6%	1.9%
Vanguard Intermediate Tax- Exempt Index Fund (1)	(2.9%)	23.7%	10.3%	4.4%	3.1%	0.9%
Vanguard Short-term Bond Index (1)	2.1%	25.8%	6.5%	4.1%	6.9%	2.3%
Vanguard Short Tax- Exempt Index Fund (1)	2.6%	13.8%	4.5%	3.2%	3.7%	0.4%
Vanguard High-Yield Bond Fund (1); starting 2002	NA	1.7%	30.7%	8.2%	1.5%	(2.0)%
Vanguard Inflation-Protected Bond Fund (1); starting 2001	NA	25.5%	20.0%	0.4%	11.8%	4.3%

NOTE: Three-year results start with a base of 100, and after each year's % change, the result for that year creates a new base. So if at the end of the first year the index is up 10%, then the new base is 110%; and if down 10%, then the new base is 90%. NOTE also that a decline of 50% requires a gain of 100% to get back to the starting value, which explains why NASDAQ, down 67%, would require a gain of 200% to get back to its starting value.

- 1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.
- 2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

%	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
		<u>1999</u>					<u>2000</u>					<u>2001</u>			
S&P 500	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1			
NASDAQ	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3			
BONDS	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0			
Interm. Tax.															
		<u>2002</u>					<u>2003</u>					<u>2004</u>			
S&P 500	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8			
NASDAQ	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9			
BONDS	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0			
Interm. Tax.															
		<u>2005</u>					<u>2006</u>					<u>2007</u>			
S&P 500	(2.6)	0.9	3.1	1.6	3.7	(1.9)	5.2	6.6	0.2	5.8	1.6%				
NASDAQ	(8.1)	2.6	4.4	2.5	6.1	(7.6)	3.9	7.1	0.3	7.5	4.0%				
BONDS	(0.5)	3.0	(0.7)	0.6	(0.7)	(0.2)	3.8	1.3	1.4	(0.6)	2.9%				
Interm. Tax.															

NOVEMBER 2007 COMMENTS

STOCK index prices for US and international stocks declined significantly in November, along with extreme volatility, both up and down. This month's Investment Concepts section (starting on page 5) discusses the market activity for November in depth.

Even with the month's declines, the broad-based US stock indexes are still higher year-to-date (YTD), in a range of +4.4% (S&P 500) to +10.2% (NASDAQ Composite). Developed International and Emerging Market International stocks, also down substantially in November, continue to outperform the US indexes (YTD, +18.2 % and +39.4 % respectively), while the REIT sector continues as this year's underperformer (-12.4%) after years of outperformance. Growth stocks, after years of underperformance, are outperforming Value stocks (+12.4% to +1.9%). See page 2 for figures for the month, YTD, and since 1999.

BOND returns (price change plus interest) for the high credit quality part of the bond market were sharply higher for the month, while lower credit quality debt declined. High credit quality bond returns, at +6.6% YTD, are now higher than the returns for the Total Stock Market index, at +6.1%. Inflation Protected Treasury Bonds are +11.8% YTD. This "flight to quality" was exemplified by the movement of the benchmark 10-year US Treasury yield, which closed at the surprisingly low level of 3.97%. This was 50 basis points ("bps", each of which constitutes 1/100 of a percent) below the October closing level, which in turn had matched the low yield for this current interest rate cycle. The short-term rate controlled by the Federal Reserve remained at 4.50%, so short-term rates were significantly higher than longer-term rates. Bond returns for the month, YTD, and since 1999 are set out on page 2 above.

ECONOMIC NEWS impacting this month's price movements is discussed in detail starting on page 5.

From a longer-term standpoint, the current decade has seen a major bear market in stocks (3/00-3/03), followed by a more than 4 _-year recovery to current price levels. Relative to their 2000 highs, the Dow Industrials are 14% higher, the S&P 500 3% lower, and the NASDAQ still a stunning 47% lower. Thus, the annualized returns for all three indexes since 2000 are far below their long-term average annualized returns. The mutual fund company Vanguard notes that from 1926 through 2005, in only six of 80 years did stock prices fall within 2%, up or down, of the long-term annual average return of plus 10.4%.

However, going back further to the bull market that began in 1995, all three major indexes have remarkably similar average annual returns (ranging from 9.5% to 10.3%), slightly below the 10.4% average annual return for stocks dating back to 1926. As these returns converge, "regression to the mean," described by Swensen as "one of the most powerful influences in the world of finance" (pg. 154), seems apparent. But Vanguard's observation is also meaningful, since annual returns during the bull market were far higher than the long-term averages, and the returns from 2000-YTD 2007 have been far lower.

The moral: Stock returns are truly unpredictable and volatile in short time frames, and can be over long time periods as well, even with (so far) a fairly stable very-long-term average return. Key Questions: Your relevant time frame and tolerance for risk.

	<u>S&P 500 (1)</u>		<u>DOW (1)</u>		<u>NASDAQ (1)</u>	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002 Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2003	1,112	(27)%	10,454	(11)%	2,003	(60)%
Year End 2004	1,212	(21)%	10,783	(8)%	2,175	(57)%
Year End 2005	1,248	(18)%	10,718	(9)%	2,205	(56)%
Year End 2006	1,418	(7)%	12,463	+6%	2,415	(52)%
Year-to-date 2007	1,481	(3)%	13,372	+14%	2,661	(47)%

Context: Prior Five-Year Gains in Bull Market of 1995 - 1999

	<u>S&P 500 (1)</u>	<u>DOW (1)</u>	<u>NASDAQ (1)</u>
End 1994	459	3,834	752
End 1999	<u>1,470</u>	<u>11,500</u>	<u>4,070</u>
Gain	1,011	7,666	3,318
Avg. Ann. %Gain: '95-'99; 5 years	26.2%	24.6%	40.2%
NOVEMBER 2007	1,481	13,372	2,661
Gain	1,022	9,538	1,909
Avg. Ann. %Gain: '95-11/07; 12.92 yrs	9.5%	10.1 %	10.3 %

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's fees.

INVESTMENT CONCEPTS:

November's Market Price Volatility

The following chart of stock prices during 2007 for the three major US indexes should serve as useful information for the discussion that follows:

	<u>S&P 500</u>	<u>YTD % Change</u>	<u>Dow Jones Industrials</u>	<u>YTD % Change</u>	<u>NASDAQ Composite</u>	<u>YTD % Change</u>
Year End 2006	1,418	-	12,463	-	2,415	-
July 19 High	1,553	+9.5%	14,000	+12.3%	2,720	+12.6%
Aug 16 Intraday Low	1,370	(3.4%)	12,456	(0.0%)	2,387	(1.2%)
Oct 9/31 High	1,565	+10.4%	14,165	+13.7%	2,859	+18.4%
Nov 26 Low	1,407	(0.8%)	12,743	+ 2.2%	2,541	+5.2%
Nov 30 Close	1,481	+4.4%	13,372	+9.1%	2,661	+10.2%

What information do these figures provide?:

1) All three indexes are still up for the year through November 30th, ranging from 4.4% to 10.2%. The S&P 500 is trailing the other domestic indexes because it has a heavier weighting to financial stocks than the other two indexes, and financial stocks have been at the center of the storm surrounding the markets these past five months.

2) These broad stock indexes have taken TWO round trips of more than 10% in the past five months, from July 19th to August 16th, and then again from October 9th to November 26th. Between August 16th and October 9th, the markets recovered all of the summer declines. These kind of significant, erratic price movements indicate a high level of volatility.

3) To understand the magnitude of a 10% change in stock prices, if the entire value of the US stock market approximates \$15 TRILLION, then a 10% change accounts for \$1.5 TRILLION. (Note: This approximate \$15 trillion valuation for the total US stock market is arrived at by taking the largest company's market value as of 12/31/06, namely Exxon Mobil at \$439 billion (source: WSJ, 2/26/07, R6), and relating that figure to the fact that Exxon Mobil comprised 2.8% of the Vanguard Total Stock Market Index fund as of 6/30/07 (source: Vanguard Fund Profile, pg. 59). It would take \$15 trillion in total market value for 2.8% to equal \$439 billion. (The six month gap in the figures should not materially affect the total valuation calculation).

4) Since the largest approximation of losses attributable to all current credit problems is \$300-\$500 billion (see pp 8-9), there appears to be more at work in the stock market's up and down price movements than can be attributed solely to credit problem losses. The Comments will now discuss the many factors affecting current market price moves.

The most comprehensive recent WSJ article discussing the current economic and market situation appeared on the November 27th front page, reporting on the market activity of November 26th. Stocks hit their lows for the month that day, before staging a four-day rally to close out November. The following factors were cited in the article (not organized as we have done here):

1) "Fears of credit squeeze and economic downturn" sent the Dow Jones Industrials 10% below their October peak, "while prices of US Treasury bonds soared as investors fled to their relative safety." "Banks are suddenly retreating (from lending money), and consumers who had been loose with their spending are counting their pennies more carefully. That has led to gathering gloom about the prospects of the world's leading economy, amid early signs of trouble overseas."

2) "Fears that financial institutions will reduce access to loans for businesses and consumers at a time when they most need them are leading some economists to revise their forecasts. Some are warning that a recession now looks like a bigger threat. Oil prices at near \$100 a barrel are adding to the concern."

3) "Banks already have started to scale back consumer lending, tightening underwriting standards on everything from home equity loans to credit cards....Corporate borrowers now are facing the most restrictive borrowing terms that they have seen in four years....Corporate loans are growing more expensive compared with Treasury bonds. Companies that issue speculative or "junk" bonds are now paying interest rates that are more than 5% above the rates on ten-year US Treasuries. At the start of the summer, these companies were paying roughly 3% above Treasuries."

4) "Economists say the US economy is slowing significantly, with many forecasting growth in the current quarter at an annual pace of little more than 1%. While the Fed has cut interest rates twice since August (a total of 75 bps), it has hinted at hesitation to go further. One reason is the slumping dollar....A lower dollar can raise the cost of imports, aggravating inflation. If the Fed lowered rates further, it might encourage investors to dump the dollar in favor of higher yielding currencies."

Other articles repeated the themes set out above, and added additional points of concern:

1) A New York Times front page article (12/1/07) discussed "banks denying loans to many businesses, unwilling to bet scarce capital in a time of risk and uncertainty. A glut of unsold homes keeps prices falling and the construction industry in distress. And even the sharp fall in the price of oil (during the past week), which offered the comfort that higher energy costs might be easing, reflects a broader fear that global economic growth may slow as growth falters in the US. Looming large over the landscape is uncertainty about the size of losses still confronting banks and other financial institutions as they reckon with bad mortgages along with credit card debts, auto loans and the complex detritus of an era of loose money now over." This article also discusses a "government report that suggested the number of jobs created in the spring was far smaller than previously assumed."

2) "Federal Reserve officials, in a new and expanded forecast, expect the nation's economy to grow sluggishly next year and see risks of an even worse performance. They also expect food and energy prices to continue putting upward pressure on inflation, but say underlying inflation is now, and will remain, within the target range implied by their new forecast." The Fed cited a number of downside risks, including "markets could relapse or current tighter credit conditions could exert unexpectedly large restraints on household and business spending; adverse feedbacks in which economic weakness could lead to further tightening in credit conditions; and more severe contraction in the housing sector and a substantial decline in house prices." The factors that could add to inflation were "recent increases in energy and commodity prices, and the pass-through of dollar depreciation into import prices" (WSJ, 11/21/07, pg. A3).

3) Another article discussed the fact that even certain bad news factors do not affect local economies in the same way, and may even bring benefits (WSJ, 11/29/07, pg. A8). Examples: "California, Nevada, Florida and Arizona are bearing the brunt of the worsening housing slump, but they won't be hurt much by the higher home heating costs, which are set to punish the Northeast and Midwest. Energy producing states like Wyoming, Texas and Alaska are benefiting from higher fuel prices. The falling dollar has boosted exports from the farm states and the Pacific Northwest, but could eventually hurt consumers who buy goods made overseas....Retail sales are slowing in most areas as higher energy prices and lower housing prices weigh on consumers, but tourism is up across the country, as some cities have been deluged with foreign shoppers taking advantage of lower prices caused by the falling dollar. (Our note: the correct impact here is that foreign currencies buy more in the US as the result of the declining value of the dollar, not that prices in the US are lower.) But, the article states, "while different regions are affected differently, there is one common theme: just about every area is getting hit by something." In the housing market, "sub-prime mortgages have led to foreclosures across the country, but in and around the coasts, rampant speculation and creative financing fueled a price bubble that has popped, while in the Midwest, housing is taking a beating as people lose their jobs and see their incomes fall." The article notes that, so far, the national labor market has not been too adversely affected.

4) An article reporting on the lowered level of consumer confidence (WSJ, 11/28/07, pg. A4) begins that "the stock market's volatility and higher energy prices are depressing consumer sentiment, adding to the recession threat posed by unprecedented declines in home values....Consumer expectations now match the gloom seen around oil price shocks tied to the Iraq war in 2003 and Hurricane Katrina in 2005." (Our note: the stock market has been in a bull market since 2003, overcoming both of these low levels of consumer confidence).

5) Another article (WSJ, 11/26/07, front page), discussing the interrelationship of the current factors affecting the economy and the market, states that "by itself, the housing slump seems unlikely to choke off US economic growth. Home construction accounts for less than 5% of the nation's gross domestic product. But if banks curb their lending in response to billions of dollars of mortgage-related write-offs, or if consumers cut their spending as home values fall and gasoline prices rise, it could knock the economy out of its delicate balance."

The article discusses factors that may slow the growth in overseas economies, and then returns to comment on the US economy as follows: "economists take heart from the US economy's proven ability to withstand shocks, financial and otherwise. So far this decade, the economy has faced terrorist attacks and a historic technology stock bust with nothing but a mild recession. Since then, it has continued to grow despite the war in Iraq, soaring oil prices, and the destruction and dislocations wrought by Hurricane Katrina. All the while, consumers kept spending and corporate profits soared." The article then discusses the actual and expected declines in corporate earnings for the third quarter of 2007, the projected fourth quarter, and into 2008. The financial and consumer discretionary sectors, which include home builders and auto makers, have been the weakest performers of late.

We think this presentation of mostly negative factors provides a backdrop for the following observations on our part:

1) We have been trying to relate the media reporting on the dollar losses associated with the credit problems from mortgages and other debt related securities to the declining values in the prices of stocks. (We have found no article that provides a coordinated presentation of such figures). We do know that Citibank and Merrill Lynch reported highly publicized losses in the \$10 billion range, with presumably more write-offs to come. But these figures, while obviously presenting major problems to the specific companies, would not reasonably explain stock market price declines measured in the trillions. So we kept looking for more figures on the likely magnitude of the losses associated with these credit problems. Ben Stein, the economist who writes regularly in the Sunday NY Times, and who we have quoted extensively in previous Comments, stated, on the WSJ Report TV program of Sunday, November 25th, that he estimated the overall losses attributable to the credit problems at \$100 billion. (See page 10 for more from Ben Stein.)

Both the NY Times and WSJ reported (11/23/07, pg. C3 and C2 respectively) that the Paris-based Organization for Economic Cooperation and Development (OECD), whose purpose is to "help governments with economic, social and governance issues," estimated that losses in the distressed mortgage sector could reach \$300 billion. The two articles contained interesting observations from the OECD report. The NY Times article stated that, according to the OECD, "losses on sub-prime loans – those made to the least creditworthy borrowers - would cost lenders \$125 billion, and that factoring in so-called Alt-A mortgages, ones given to people with better credit but still not high-end, the overall loss level of \$300 billion looked feasible. The loss numbers reflect not just the value of the mortgages but also the total cost to lenders of a bad mortgage, once they have foreclosed on and sold the house to recoup at least part of their losses. But the organization also said that much will depend on how banks react to future defaults. Banks and other investors are exposed to the mortgage market through securities backed by housing loans. The problem in financial markets could force write-offs far in excess of what the actual defaults turn out to be. By contrast, if they can hang on until the American housing market bottoms out and allows a fuller picture of what losses are, those losses can probably be absorbed with relatively little shock. The most important variable the markets are facing right now is time. . . . If the worst situation was to occur, banks would constrict lending to the rest of the economy."

The WSJ article quoted the OECD report: "As adjustments have often occurred in waves, and as higher funding costs take typically several months to have their full impact on companies or consumers, it may well be that the recent correction is only a precursor of a more protracted downturn... The report also said that financial institutions and policy makers need to buy time to ensure an orderly end to trouble, and that the fund being set up by major US banks to pool securities of ailing special-investment vehicles (SIVs) was a useful mechanism."

Another estimate of loss that received some press (WSJ, 11/8/07, pg. C3) came from the chief credit strategist at Royal Bank of Scotland, who estimated that the "credit crunch will cause \$250 billion to \$500 billion of losses at banks and brokerage houses around the world. The estimate includes not just losses on sub-prime mortgage-related bonds, but also the effect of a new accounting standard that... will force companies to put values on opaque securities and could lead to write-downs of as much as \$100 billion... The total of write-downs of Wall Street firms so far (early November) was \$30 to \$40 billion... The last big crop of write-downs occurred in 2002, when another accounting change prompted losses related to impairment of goodwill and soured Internet assets of roughly \$100 billion... The upper end of this range is more than the US has spent on the Iraq war, and about equal to the market values of the three largest US banks, Citigroup, JPMorgan Chase, and Bank of America, put together."

2) It is fair to say from a discussion of these loss figures, which range from \$100 billion to \$500 billion, that there is much still unknown in this situation. Adding to the unknowns, and beyond any analysis based on numbers, there is the very large question of how successful government intervention and private sector actions are likely to be in the many efforts now underway to ease the credit crisis. These actions include:

a) The Federal Reserve has lowered the short-term interest rates it controls from 5.25% to the current rate of 4.5%, during the last two times its has met. There is the usual debate among observers of the Fed, and possibly the Fed members themselves, over whether additional rate reductions are coming. In a WSJ article reporting on Fed Chairman Bernanke's most recent speech (11/30/07, pg. A2), he is quoted as saying that "these developments (referring to the housing downturn and related mortgage turmoil) have resulted in a further tightening in financial conditions, which has the potential to impose additional restraint on activity in housing markets and in other credit-sensitive sectors." The article states that "Fed officials are increasingly paving the way for a rate cut at their December 11th meeting, barring a significant improvement in either market conditions or economic data."

b) A plan, first reported on Friday, November 30th (WSJ, front page), to "extend the lower introductory interest rate on home loans for certain borrowers who will have trouble making payments once their mortgages increase." The plan is still in the process of being worked on by the US Treasury department and a "coalition, including mortgage servicers – the companies that collect loan payments - lenders, investors and mortgage counselors... The mortgage servicers in the coalition represent 84% of the overall sub-prime market." An article the next day (WSJ, 12/1-2/07, front page) states that "many of the particulars need to be worked out, including how long the interest rate freeze would last and which sub-prime borrowers would be eligible for relief."

c) Federal Reserve and other central banks in Europe have “extended loans for longer-than-usual terms,” in response to the current situation in which “banks and other financial firms’ persistent reluctance to lend to one another is creating a logjam in the credit markets that is pushing central bankers to get creative.” The article continues by discussing other steps that might be, but have not yet been, taken to improve the situation (WSJ, 12/1-2/07, pg. B1).

d) The investment in Citigroup by Abu Dhabi’s investment fund, which totaled \$7.5 billion for a 4.9% interest in the bank. “The cash infusion comes weeks after Citigroup dismissed its chief executive and announced that the huge New York bank faces as much as \$11 billion of losses as a result of the credit crunch that began this summer (WSJ, 12/1-2/07, pg. A11).

e) The private arrangement, involving a number of the major banks most affected by the credit crisis, to set up a fund with \$75 to \$100 billion, to purchase securities held in so-called Structured Investment Vehicles (SIVs). The SIVs were funds “set up by the banks to derive income from securities held off their balance sheets....In the current credit crisis, investors’ reluctance to extend credit to SIVs has raised concerns....The intent is to calm the markets by buying good, highly-rated securities from the SIVs. But the fund is still weeks away from coming into operation” (WSJ, 11/2/07, pg. A9). (This fund is the one referred to in the OECD report, discussed in the WSJ article, on pages 8 and 9.)

3) The economist Ben Stein, writing in Sunday’s NY Times Financial section (12/2/07, front page), makes some observations that reflect our views on the current problems impacting the markets. The relevant portion for us involves Stein’s analysis of a position paper by a GS economist, which states that “the sub-prime mess would get worse and worse, and get so bad that it would affect aggregate lending extremely adversely and slow down growth....When highly leveraged institutions like banks lost money on sub-prime, they would cut back on lending to keep their capital ratios sound – and this would slow the economy.” Stein’s response states that the paper “omits the highly likely truth that the Fed would step in to replenish financial institutions’ liquidity if necessary. In a crisis, the Fed would pump cash into the system to keep lending on track.” Stein writes that the paper “was saying that the financial system would possibly not be able to adjust to a level of financial losses that are **large on an absolute scale but small compared with aggregate credit or the gross domestic product** (our emphasis). The paper postulates that lenders would have to retrench so deeply that lending would stall and growth would falter – an event that has not happened on any scale in the postwar world, except when planned by the central bank.”

Our Final Observation: the size of the US and world economies, and the reactions to the current problems by governments and the major private institutions involved, make it more likely than not that the problems that seem so large as presented in the daily media are not so large as to cause lasting damage to the economy. To quote again from Ben Stein, referring to the writer of the GS paper: “He is much like many economic journalists and commentators who sell newsprint by selling fear.”



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