



*Those who cannot remember the past are condemned to repeat it. Santayana*

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## WINTER WARNING



### Life Is Unfair, Fragile and There Are No Guarantees

During a recent press conference, Treasury Secretary Paulson revealed that the U.S. Government had reconsidered its original bailout plan and decided to cancel plans to purchase illiquid / troubled mortgage-backed securities, in favour of "a more timely effective step" of taking direct equity positions in financial institutions, via a capital purchase program. Mr. Paulson further stated that "banks must also continue lending" and that his focus remains the promotion of bank lending and credit availability. As I have stated in two previous newsletters "it is difficult to force bankers to lend money, when they are not in a mood to do so."

Indeed, \$250 billion (U.S.) has already been earmarked, through the Troubled Asset Relief Program (TARP), for nine major American financial institutions via the Treasury's purchase of senior preferred shares which carry an annual dividend of 5%. As the world's central banks, (including the European Central Bank; the Bank of England; the Bank of Canada; the Bank of Japan; as well as the central banks of Switzerland, Australia; Czechoslovakia and South Korea), have all recently scrambled to cut administered interest rates, the Federal Reserve Board has continued to lead the parade by lowering the Federal Funds rate to 1%, matching the historic low level set by former Chairman Alan Greenspan earlier in the decade. All of the above begs the question, to what select group of credit worthy individuals does Secretary Paulson expect U.S. banks to lend money at a profit within the current recession, when they are forced to accept a 5% cost of capital?

Moreover, how will Goldman Sachs afford to pay Warren Buffett a 10% annual dividend on his recently purchased \$5 billion (U.S.) worth of Goldman preferred shares? Since this deal was struck just one month ago, Goldman's common shares have been halved in price on the NYSE and closed on Monday, November 17th. at \$62.49 (U.S.).

### A Fool and His Money Are Soon Parted

The soaring U.S. debt picture, from the fiscal deficit and the national debt level; to the current account deficit and the trade deficit; portends ominously for the future of the U.S. dollar. The real challenge for the new Obama administration will be to maintain the loyalty of foreign buyers of U.S. Treasury note and bond issues, during a prolonged period of increasing supply. The above, notwithstanding, in a recent interview on CBS 60 Minutes, President Elect Obama clearly stated his three main priorities upon assuming office on January 20, 2009, to wit: arrange an additional stimulus package for the U.S. economy, engineer a bailout package for the automotive industry and create a program to forestall the proliferation of residential foreclosures. It appears that the Obama administration is about to learn the hard way that an extant chronic debt situation cannot be solved by the issuance of more debt.

### The Buck Doesn't Stop Here Anymore

At the G-20 Summit which took place in Washington last weekend, the leaders of the 20 countries agreed to work together to provide more fiscal stimulus to their respective economies, but deferred decisions on other economic concerns, such as accounting, transparency and risk management, to another meeting scheduled for April 30, 2009, to be convened in London. In the meantime, British Prime Minister Gordon Brown and French President Sarkozy are attempting to arrange a January meeting in Paris to continue discussions regarding the Euro zone economic recession. In a communiqué, the G-20 renewed their pledge to improve the supervision of banks and credit rating agencies, scrutinize executive pay and tighten controls on complex derivatives. However, the leaders were unable to agree on a co-ordinated global stimulus effort because the Bush administration has resisted the idea. Moreover, President Bush acknowledged that expanding the group from the traditional seven industrialized powers to twenty countries, heightened the risk that nothing substantive would be achieved. Basically, the Bush administration is in the process of passing the buck to the forthcoming Obama administration.

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