

The Countdown to Meltdown

The Federal Reserve rode to the rescue and apparently saved the economy and maybe the world. The pundits cheered and the markets roared, at least for a few days.

Unfortunately, the infusion of cash by central banks, and the lowering of interest rates, whether U.S. or foreign, will not address the current problem. The problem at hand is not liquidity. The problem is leverage and debt, which leads to mistrust and lack of confidence, and could ultimately lead to destruction. I've entitled this tomb Countdown to Meltdown because I truly believe we are on the threshold of arguably the most significant financial problem the world has ever known. **Hundreds of trillions** of dollars have been artificially created by the usage of derivatives, and even Warren Buffet has labeled derivatives as the enemy.

As you know by my previous emails, I have continually warned about the significant problems in the housing sector. Pundits say the sub-prime and alt-A mortgage portion of our GDP is only a small percentage. I don't disagree. However, since the average mortgage has been sliced and diced, and sold multiple times over, a \$500,000 mortgage supports **twenty times**, or **\$10 million** of investment paper. When you factor a twenty multiple, the percentage of GDP takes a quantum leap. From January to September of this year, **\$40 to \$50 billion** per month of adjustable-rate mortgages have re-set and created untold problems for banks, brokers, hedge funds, and mortgage companies (the majority of which have gone bankrupt.) Delinquencies and foreclosures are on the rise, and hitting record levels. Going forward, the re-set rate will be **\$50 to \$60 billion** per month. In January 2008, re-sets will be **\$80 billion**. In February 2008: **\$90 billion**, and in March 2008: **\$110 billion**. **The housing countdown has begun.**

The pundits continue to talk about the strength and resiliency of the consumer. Unfortunately, the consumer has been living on home equity withdrawals. With that source of funding drying up, consumers had to rely on credit cards. With their credit cards now maxed out, the consumer has now turned to in-store credit cards (example Target, \$61.35 as of 9/25/07.) Speaking of Target, they just announced that their credit card receivables are growing at a **greater** rate than their sales. As food prices rise, gasoline prices rise, and layoffs grow, the consumer could finally hit the wall. The last gasp could come this holiday season. Companies like Target, Wal-Mart (\$43.16 as of 9/25/07), Best Buy (\$46.01 as of 9/25/07), and Costco (\$59.38 as of 9/25/07) are already projecting consumer slowdowns and retrenchment. **The consumer countdown has begun.**

By February, more than likely, we will know who the Republican and Democratic Presidential candidates will be. I strongly believe that in January 2009, we will be inaugurating the first women President. Expect an increase in the capital gains and dividend tax rates. Expect political attacks on pharmaceutical companies and big oil companies. Expect class warfare. Whether these things happen, the stock market will probably anticipate accordingly, and the reaction could be quite violent. **The political countdown has begun.**

For the past two nights on CNBC's Fast Money television show, they have featured prominent stock market technicians. The first technician talked about Federal Express (\$104.59 as of 9/25/07) acting as a surrogate for the Transportation Index, which has shown decided weakness. The Transportation Index is the first indicator of weakness in the economy. Quite simply, if goods aren't being sold, they don't have to be shipped. The second technician talked about the big difference between stocks that are hitting significant highs, and those hitting significant lows, and the spread between certain well-known sectors, such as finance and technology. Historically, the stronger stocks have followed the weaker stocks down every time. Could history repeat? The technicians seem to think so. Two technicians, both worried. **The stock market countdown has begun.**

The talk of recession grows. The odds of the consumer failing grow. The odds of a populous president grow, and the calls of a financial unwinding and de-leveraging grow everyday.

In the 1980's, the Japanese lowered interest rates to zero. That action did not save the Japanese stock market, nor did it save the Japanese real estate market. In fact, it's just most recently that they've finally dug out. The difference this time is that the financial world is all interdependent on **trillions** of dollars of debt. From the smallest homeowner to the biggest money center bank, our economy has **borrowed** its way to happiness. Unfortunately, that game is over and the pain is about to begin. **The countdown to meltdown has begun.**

Till next time,

Bill

P.S. – Cash, selected short positions, and commodities are survival food.

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