

---

# The Idle Speculator™

A publication of Symmetry Capital Management, LLC

February 11, 2009

---

## What Happened???

Stock markets tanked big yesterday, following the release of Treasury Secretary Geithner's planned remarks on the administration's planned response to the financial crisis. We take a look at what might have triggered the sell off, both within his remarks and in other areas, and provide our assessment of those factors and whether stock markets overreacted to them.

### A Bruising Welcome

With his tenure as Treasury Secretary already off to a rough start, stock markets gave Tim Geithner's remarks on the Administration's plan for financial markets a resounding drubbing. The S&P 500 fell almost 4% from the release of his written remarks at 11:00AM EST to the close:



*Illustration 1: S&P 500 intraday performance 2/10/2009*

However, if we take Fed Chairman Bernanke's testimony to Congress into account, which started shortly after 1:00 PM EST, Geithner appears to have been responsible for only 2.3% of that decline. We also believe that news of Congressional infighting over the stimulus bill might have played a role. Whatever the causes, the day saw a renewed flight to assets that proved defensive in 2008 – U.S. Treasuries, the Japanese Yen, and gold.

We've gone over Geithner's speech, in which he articulated the following principles:

- The policy response will be “comprehensive and forceful”.
- It will be sustained until recovery is firmly established – the government will not

'apply the brakes too early'.

- It will require strong taxpayer protections and transparency.
- It will be “designed to mobilize and leverage private capital, not to supplant or discourage private capital.”
- The government “will act to prevent the catastrophic failure of financial institutions.”

Beyond these, we see several points that might have upset market participants. First, the plan description was long on principles and similar ideas. But it's apparent that the plan is still in the developmental stage, and Treasury was ill prepared for a roll out. In hindsight, it might have been better to delay the announcement yet again, given the impossibility of satisfying the high expectations that preceded it. Hence Treasury's admissions that it might not have managed expectations well.

Second, there might have been some concerns about Geithner's proposal for “comprehensive stress testing” of banks, perhaps because it would be a waste of time and resources, or perhaps because people are concerned about what they might find at some banks. Dana Millbank of the Washington Post offered a great metaphorical criticism:

...Geithner had few details to offer yesterday. Instead, at the heart of his plan, he proposed a stress test. "First, we're going to require banking institutions to go through a carefully designed comprehensive stress test," he announced. "This borrows the medical term." The medical clarification was probably unnecessary. The real question was why he would propose a stress test when other medical procedures would seem to be in order for the banking system -- an enema at the very least, if not a heart-lung transplant.”  
(<http://www.washingtonpost.com/wp-dyn/content/article/2009/02/10/AR2009021003277.html?hpid=topnews>)

Finally, the plan was most glaringly short on solutions to the mortgage crisis. This aspect is thought by many to be the most important piece of any financial market support package, and it apparently hasn't made much progress. It might imply that the solution is as complex as the problem, and/or that the Administration is still a long way from developing an internal consensus. By itself, that might have been enough for a 2%+ sell off.

### More Alphabet Soup?

As a public service, we've plucked the newest acronyms from this package so that readers can stay on top of the alphabet soup. They are:

- FST – Financial Stability Trust, which will administer the stress testing and provide capital infusions using “funds from the Treasury as a bridge to private capital. The capital will come with conditions to help ensure that every dollar of assistance is used to generate a level of lending greater than what would have been possible in the absence of government support. And this assistance will

come with terms that should encourage the institutions to replace public assistance with private capital as soon as that is possible.” The latter objective could come into conflict with the principle of 'not applying the brakes too early'.

- PPIF – Public-Private Investment Fund, which will “with the Fed, the FDIC, and the private sector...establish a Public-Private Investment Fund. This program will provide government capital and government financing to help leverage private capital to help get private markets working again. This fund will be targeted to the legacy loans and assets that are now burdening many financial institutions.” This is the 'bad bank' analogue, and will be targeted at real estate related assets, and by using private asset managers, it supports the principle of leveraging private capital. Some folks could make a lot of money picking over the carcasses in the system. Hopefully tax payers won't be crowded out entirely.
- CBLI – Consumer and Business Lending Initiative, in coordination with the Fed, designed to restart the securitization system “for sound loans made to consumers and businesses.” This will expand the Fed's TABSLF program to “small business lending, student loans, consumer and auto finance, and commercial mortgages,” and also support small business “credit from community banks and large banks [by] increasing the federally guaranteed portion of SBA loans, and giving more power to the SBA to expedite loan approvals.”

Notably, the mortgage and foreclosure piece of the plan has no acronym as of yet.

### [Congress, Here to Help!](#)

Stock market volatility and Congressional sessions seem to go hand in hand. Via a daily e-mail from U.S. News and World Report's Political Bulletin service, we learned that House Democrats were pushing back hard against the changes made to the stimulus bill in the Senate compromise:

House Democratic leaders spent Tuesday pushing back against pressure from both sides of the aisle in the Senate, warning moderate Republicans that their bluffs would be called, and signaling to Senate Majority Harry Reid (D-Nev.) that his hopes for a quick, painless conference were potentially premature...During a lengthy caucus meeting, where Democratic members railed against the cuts the Senate compromise made to education funding and aid to the states, Pelosi told the members that she agreed and would seek to appoint conferees who push for changes to those reductions.

<http://thehill.com/leading-the-news/pelosi-not-cracking-under-conference-pressure-2009-02-10.html>

Meanwhile, Democrat Senator Max Baucus claimed that the final bill would be closer to the Senate's version, and moderate Republican Senators Specter, Collins, and Snowe each asserted that they would not vote for a bill that involved any significant changes to the Senate's compromise version.

## Et Tu, Ben?

As far as we can tell, President Obama's midday speech and Q&A in Florida did not seem to have much impact on the market. However, Fed Chairman Bernanke's remarks to the Committee on Financial Services may have. While we don't see much in his written remarks, it was widely noted that he admitted the possibility of “stagflation”, after saying in February 2008 testimony that the U.S. was “nowhere near” the possibility of a 1970s repeat. Granted, we're biased given that we've been predicting a period of stagflation in coming years, but we think this admission could have shaved the next 1.7% off of the S&P.

On a side note related to the stagflation idea, we took note of comments made by a Saudi Oil Minister:

Saudi Arabia Oil Minister Ali Naimi warned that promoting the growth of renewable fuels too quickly could create a "nightmare scenario" of too little investment in oil at a time when renewables aren't ready to pick up the slack.

The remarks, spoken to oil executives in Houston, Texas, on Tuesday, come at a time when President Barack Obama's administration is embarking on an ambitious path to steer the U.S.'s energy policy away from fossil fuels. Mr. Obama has said he will establish a national renewable electricity mandate and a carbon cap-and-trade system this year.

"A nightmare scenario would be created if alternative energy supplies fail to meet overly optimistic expectations, while traditional energy suppliers scale back investment," he said at the Cambridge Energy Research Associates oil conference.

Admittedly, as the WSJ piece observed, “Mr. Naimi's warning comes at a time when OPEC members are feeling the pain of low crude prices.” However, this is the 'supply destruction' mechanism through which future inflation (and if you're unfortunate enough to live in a slow or no growth region, stagflation) occur. It has been happening throughout the global supply chain for raw materials since the crisis began in earnest, and this dynamic could come back to bite consumers – and central bankers - in the years ahead.

## Cause for Concern?

Perhaps surprisingly, no. We think yesterday's reaction was overdone. Of course, if you follow our writing, you know that we don't see anything to get terribly excited about as far as broad stock market indices go. In fact, we still expect equity prices in the aggregate to move sideways or downward for the next few years. But credit markets did not react as dramatically to Geithner's statement as stock markets, while options markets, as measured by the CBOE's volatility index, were relatively well behaved, at least compared to recent months. Stock markets can be reactionary and volatile, and while this might be sensible given equity holders' position in the capital structure of a business or an economy, wide swings in stock prices sometimes have to be taken with a grain of salt.

Geithner's remarks also had some positives, in our view. First, they demonstrated that regulators and policymakers seem to have a good grasp of the errors they made leading

up to the crisis, particularly in the area of Fed monetary policy. Second, they acknowledge the critical importance of international cooperation, with Geithner planning to work closely with G7 and G20 finance ministers in coming days and weeks (though somewhat oddly, Geithner also plans to meet with governors of Italy's central bank – which is hardly the fulcrum on which sound central banking practices have turned in the past). Finally, the decision to continue expanding the focus of the plan to almost all forms of domestic credit, and to maintain cooperation with the Fed and FDIC, seem rather sound. If the final details relating to mortgages and foreclosures have any merit, this plan won't be as horrible as the stock market indicated yesterday.

On that last point, we would note that elsewhere in his remarks, Geithner affirmed the importance of addressing the mortgage and foreclosure crisis, and his boss singled it out for mention in Fort Myers an hour later:

We know that in order to address our economic crisis, we must address our foreclosure crisis. I know Fort Myers had the highest foreclosure rate in the nation last year. I know entire neighborhoods are studded with foreclosure signs, and families across this city feel like they're losing their foothold in the American Dream. So we are going to do everything we can to help responsible homeowners here in Fort Myers and other hard-hit communities stay in their homes. ([http://www.nytimes.com/2009/02/10/us/politics/10text-obama.html?\\_r=1&pagewanted=2](http://www.nytimes.com/2009/02/10/us/politics/10text-obama.html?_r=1&pagewanted=2))

Finally, we note – with some awe and warm feelings – that Rep. Barney Frank is striking a very dovish tone in a CNBC interview this morning, and in a Congressional hearing with bank executives that's unfolding at this moment. Specifically, he stated that the financial crisis arose not from deregulation, but from an absence of regulation over recent financial market innovations. This might lose him some points with fellow House Democrats and the MoveOn.org crowd, but it's a very dovish development for the financial system. It's even a bit right of our position, as we strongly believe that there were errors in deregulation, primarily in the SEC's Consolidated Supervised Entity Program circa 2004 (see page three of our 2009 Outlook, available online at <http://www.symmetrycapital.net/idlespeculation/20090209.pdf>).

**DISCLAIMER: Symmetry Capital Management, LLC is a Pennsylvania registered investment advisor that offers discretionary investment management to individuals and institutions. This publication is for informational, educational, and entertainment purposes only. It is not an offer to sell or a solicitation to buy securities. Any mention of investable companies and/or securities is incidental and for illustrative purposes only. Principals and clients of Symmetry Capital Management, LLC may hold long, short, or derivative positions in any securities mentioned.**