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Son, We Should Be There

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I should have saved one of last week's article titles, "When The Bungee Cord Snaps" for this week! Tuesday's early stock market action saw one of the "rare" times when the cord was on the verge of snapping, just like we witnessed in January and March.

As with almost all significant stock market bottoms (and it's still a bit too early to confirm that was THE bottom), the headlines were about as grim as they ever get and focused on another financial crisis.

Last August, if you can remember that far Fair article on the final weeks of Bear and it makes great reading. If you are the least bit curious on how the soap opera unfolded from an "insiders" point of

view, I suggest picking up a copy.

All that happened going into this week was the second largest bank failure in history, along with the pending destruction of the two most important cogs in the entire U.S. mortgage industry, Fannie Mae and Freddie Mac.

Was Tuesday the ultimate bottom for the Dow and S&P 500? We will have to watch the action in the market over the coming days and weeks. We do know that it was "A" low as evidenced by the huge surge in trading volume, especially in the most beaten down sectors, like the financials.

We also saw some true signs of despair and desperation on Monday and Tuesday as many, many folks finally threw in the towel and sold. Volatility did spike higher and the usually wrong option traders rushed to buy downside protection.

As has been quoted all over the place, the number of New York Stock Exchange stocks making 52 week lows exploded to one, if not the, highest reading ever. Now keep in mind that there are more stocks traded now than in the 1980s and 1970s, but the comparisons are very valid. That is a clear sign of capitulation and has usually been very timely in marking significant market bottoms.

back, we had the implosion of the Bear Stearns hedge funds. In January, the ultimate low was created by a rogue trader at Societe Generale, forcing mass global liquidations in the equity markets. Apple's earnings miss the very next day was just icing on the cake!

And in March, we all recall the sad collapse of Bear Stearns, which ended up more as a run on a bank than capital problem. A good friend recently emailed me the Vanity

While I would have preferred to see price collapse even deeper during the day, like we saw in January and March, sometimes you don't always get exactly what you want. Markets have an amazing ability to rhyme instead of repeating and this looks like another one of those cases.

I've been watching for signs of a low since mid June, and while there were plenty of fakeouts, this one looks to have the most credibility.

But that doesn't mean the market is totally out of the woods and we won't see any weakness the rest of the summer. There's still a chance that prices could come back down and revisit Tuesday's levels, but that would be the less likely scenario and a gift for the bulls to reload.

In January, Bernanke & Co. sharply lowered interest rates, flooding the system with money and staving off a potential global collapse. Depending on your stance, that either coincided with the stock market bottom or caused it.

In March, the Federal Reserve, through a series of historic measures, including allowing investment banks to use the discount window, effectively put a backstop in place to "save" Wall Street. Those measures make it very difficult for many of the firms to experience the same fate as Bear Stearns.

And earlier this week, the Fed, Treasury and SEC, changed the rules again. This time, they attacked the professionals who profit by using "illegal" short selling techniques. Short selling is the exact opposite of buying. Investors profit dollar for dollar as a stock moves lower instead of higher.

In order to sell short a stock, you (your broker) actually borrow that stock from someone who owns it and then you can short sell in the market. For years, against the rules, institutions have used "naked" short selling, whereby stocks are sold into the market without securing the borrowing first.

Earlier this week, the SEC officially outlawed this practice for the stocks of Fannie Mae, Freddie Mac and all of the Wall Street dealer firms like Merrill, Morgan, Lehman and Goldman. This essentially took much of the gunpowder away from the bears, thereby preventing future bear attacks on stocks already in collapse.

If you're a market historian, you know that the government similarly changed the short selling rules way back in the 1930s in an attempt to stabilize a market that was in freefall. And it did work.

Turning back to the IndyMac failure, without doing extensive research,

I looked at the most prolific bank failure ever, Continental Illinois back in 1984. Similar to today, the market was in the process of its third move lower and that event marked a low that was never seen again!

In early 1991, a period I have referenced again and again, Bank of New England was rescued by the FDIC in another very high profile mess. That was also in the midst of skyrocketing energy and food prices, a housing bust, credit crunch and recession. And, the U.S. was just days away from launching an air and ground assault to expel the Iraqi army from Kuwait.

It was a bottom that was never revisited again!

In short, momentum has swung from the bears to neutral or the bulls, depending on your position. At a MINIMUM, the stock market should rally 10%, but it's likely to be more. We'll know for sure after the first pullback and the market's digestion of Google's, Microsoft's and Merrill's earnings misses. Also keep on eye on what's leading and lagging.

Finally, more than a few folks have asked me whether oil has peaked. As you know, my opinion has been to expect a move to \$150 in the short-term, but "cooler" times would be seen by Labor Day.

The decline from the recent top certainly looks and feels much different than any decline this year. It's very possible that the back of the bull market is being broken as I type this. I'll have more on this next week.

## **Bank Failures Set To Rise Dramatically**

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Long-time readers and friends were certainly not surprised about the IndyMac failure since I've discussed that bank, in particular, and nine others for over a year as possible FDIC bailouts. One of my closest industry friends began alerting me to potential bank problems when I was still singing the perma bull tune in the second quarter of 2007. This was right after New Century Financial fell apart on sub prime woes, but the stock market digested it and marched to further all time highs.

While I laughed at him at that time, I started to watch the trading action in a list of bank stocks for signs that trouble was brewing. The turning point for me came over the summer when most sectors were hitting new highs, but the usually strong financials could not get off of the floor.

Thankfully, our sector strategy snuffed this out too, well in advance, and we never trafficked in that sector.

Since IndyMac's failure, I received a number of calls and emails asking which bank would be next and how to protect your money from this. First, I would make sure to familiarize yourself with the FDIC protection limits. Click here. [FDIC Basics](#)

Next, I would learn what is and is not covered by the FDIC by clicking here. [FDIC Coverage](#)

Finally, please feel free to call or email me with any questions. Please don't be complacent and think your bank is "safe" or too big to fail. If you've watched or listened to Hank Paulson or Ben Bernanke lately, they've told you, in no uncertain terms, that the government will not bailout every institution, especially the banks.

As I have mentioned many times in this letter in 2008, you can fully expect to see bank failures. IndyMac may have been higher profile than the other FDIC takeovers so far, but it was only one in what will be a series of bank bustouts.

Why do I see more collapses ahead? Not long ago, I read a small blurb online stating that the FDIC quietly received Congressional approval to essentially DOUBLE their staff. Yes, you read that right. It's all about supply and demand.

Why would the FDIC ask Congress for an enormous increase in resources?

Because they foresaw a huge upswing in demand in the form of bank

rescues. So you should expect a whole lot more of this to continue. Now, the vast majority are going to be very small banks that only garner attention in their immediate media market. But, I have no doubt that we'll see a few regionals or super regionals going by the waist side.

Who pays the tab for all this? The short answer is the FDIC through fees from member banks. And the more failures, the more that is charged to those banks. The long answer is that WE pay for this mess through much higher fees from the banks as an almost direct pass through.

So this is the climate we are in for a while, very similar to the early 1990s, as I've mentioned over and over and over. Back then, the cost of the entire S&L crisis was roughly \$1 trillion on the back of a \$4.5 trillion GNP (Gross National Product).

I was recently asked by a few folks what my estimate was for the entire credit crisis. Although "only" about \$500 billion has been realized so far, I have to believe that we are looking at a final number between \$1 trillion and \$2 trillion. That includes the mortgage disaster, bank failures, Wall Street, etc.

And while \$1 trillion or \$2 trillion is a shocking and nauseating number, our GDP (Gross Domestic Product) is now more than \$12 trillion, so this is clearly not as costly as the S&L crisis. But, it will take a sufficient amount of time to filter through the financial system and economy.

The silver lining in this generation disaster is to remember that during the same period in the 1990s, the stock market RALLIED more than 20% over the next year and more than 50% over the next three years!

Again, if you have ANY questions or comments on this, please don't hesitate to call or email. I am happy to help you.

Heritage Capital In The New Haven Register

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Thursday, June 26, 2008

Fed leaves rates alone - for now  
By Angela Carter, Register Staff

The Federal Reserve answered one question Wednesday by leaving a key interest rate unchanged, but it remains to be seen whether the nation's central bank will eventually raise rates to control inflation before the presidential election in November.

The Fed's Federal Open Market Committee has the power to cut interest rates to spark consumer and business spending and economic growth, or to raise interest rates to ease inflation by slowing spending and growth.

The committee voted 9-1 against raising its federal funds rate, the interest rate that banks charge each other, which left it at 2 percent.

"It's unusual and rare to do anything with rates before an election," said Paul Schatz, founder and president of Heritage Capital LLC in Woodbridge.

Advertisement But Peter Gioia, vice president and economist for the Connecticut Business & Industry Association, said that if the European Central Bank raises rates, which would strengthen its currency, the euro, that could force the Fed's hand earlier.

"There are foreign pressures to support the dollar," Gioia said.

The Wednesday decision marked the first time in 10 months that the Fed did not reduce rates at its regular meetings.

At its last meeting in April, the committee reduced rates by a quarter-point and signaled that the rate cuts could be coming to an end.

"This is an important meeting. It's big news," Gioia said. "They're much more concerned about inflation than growth right now."

In a short statement released Wednesday, the second day of the Fed meeting, committee members said overall economic activity continues to expand, but cited some inflationary pressures, including softening labor markets and stressed financial markets.

"Tight credit conditions, the ongoing housing contraction, and the rise in energy prices are likely to weigh on economic growth over the next few quarters," the statement said. "The committee expects inflation to moderate later this year and next year."

Schatz said the Fed action had already been priced to the financial markets based on earlier signals in speeches by Fed Chairman Ben Bernanke. "That was welcome and expected," Schatz said.

The Fed has meetings coming up in August, September, October and December.

"The committee will continue to monitor economic and financial developments and will act as needed to promote sustainable economic growth and price stability," the Fed statement said.

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## **Heritage Capital In The Connecticut Post**

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Memry Corp. sold for \$77m

ROB VARNON

Article Last Updated: 06/25/2008 12:41:22 AM EDT

A local investment adviser sees an Italian company's \$77.7 million acquisition of Bethel-based medical device materials maker Memry Corp. as the beginning of a long expected deluge of foreign investment in America.

In an all-cash deal, Milan, Italy-based SAES Getters Group will pay \$2.51 per outstanding share for Memry. The deal, announced Tuesday, is expected to close in September, pending shareholder and regulatory approvals. Both boards have signed off on the deal. Shares of Memry Corp. closed up 94 cents to \$2.39 in Tuesday trading on the American Stock Exchange.

With a weak dollar and lots of value locked up in publicly traded American companies, Paul Schatz, president of Woodbridge-based investment adviser firm Heritage Capital, said: "We're going to get into a period like the '80s and '90s. Remember when Japan was buying everything?"

He said that sparked protectionist talk and he expects the same this

time around when Middle Eastern companies, fat with oil money, and Europeans who have the advantage of a strong currency will be coming over in large numbers.

The flood could also be sparked because the dollar, according to Schatz, is starting to climb in value and the window of opportunity for bargain hunting might be closing.

One euro was worth \$1.56 Tuesday. The dollar's low point was in April when one euro was worth more than \$1.60. Schatz said he believes the dollar will pull back one more time before finishing the year near where it started (in the \$1.40 per euro range) or a little stronger.

From Memry Corp.'s vantage, this was a deal to boost competitiveness and one of convenience.

Robert Belcher, Memry's chief executive officer, said the deal with SAES Getters Group will provide his company more financial backing to pursue larger clients and new technology. As a small publicly traded company, Memry found it was difficult to act upon opportunities - such as acquisitions - because of the drag on earnings created by regulatory requirements. "The cost of corporate compliance has gone through the ceiling," Belcher said. The company has also watched its customers consolidate, forcing Memry to try to keep up with sales to companies that are expanding operations.

In this environment, Belcher said, executives started to look at ways to compete and even considered taking the company private. But Belcher said the best value to shareholders was to sell the company.

Memry Corp., founded in Stamford, is now based in Bethel. It has more than 200 employees in Bethel and in the Dayville section of Killingly and in Menlo Park, Calif. Belcher said he does not expect any closings or job losses from the deal.

SAES is a 60-year-old Italian company with a reputation for investing in research, Belcher said. The Italian firm is looking to diversify, however, in light of changes in the television and computer monitor markets.

Belcher said SAES is moving into other highly technical manufacturing areas.

SAES makes vacuum tubes used for TV sets, lamp, monitors and industries that need vacuum-sealed devices to contain ultra pure gases.

Memry reported net income of \$166,000 for the quarter ended March 31, compared to a net loss of \$460,000 for the same period in 2007.

For its 2007 fiscal year ended June 30, 2007, Memry earned \$51.7

million in revenues and reported \$300,000 in net income. SAES noted Memry is substantially debt free.

While Schatz sees this as the beginning of a deluge of acquisitions, state Department of Economic and Community Development International Division Director Costas Lake said he still sees some hesitation out there. Lake said his office, which helps companies find partners, acquisitions or establish new businesses in the state, is working with a lot of foreign companies, but many remain cautious.

He could not reveal the names of any companies, but said they are based in Germany, Holland, France, Spain and China.

The Europeans especially seem to be concerned after being burnt in the U.S. housing crisis, he said.

Some Europeans lost lots of money when U.S. mortgage-backed securities went bad due to a large number of defaults.

While Lake said the mood is cautious, he agreed the window of opportunity might be closing for foreign investment because the dollar will probably rebound.

"It can't continue to be as weak as it is," he said. A devalued dollar would continue to drive up inflation here, the world's largest consumer market, which would slow spending and the world's economy.

IRS Raises Standard Mileage Rate

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On Monday, the IRS announced that it has increased the standard mileage rate for the final six months of 2008 in recognition of rising gas prices. The rate will increase to 58.5 cents per mile for all business miles driven from July 1, 2008 through December 31, 2008. This is an eight cent increase from the 50.5 cent rate that is in effect for the first six months of 2008.

Taxpayers can use the optional rates to calculate the deductible costs of operating a vehicle for business, charitable, medical, or moving purposes.

Purpose Rates for 1/1/08 through 6/30/08 Rates for 7/1/08 through 12/31/08

|                |            |            |
|----------------|------------|------------|
| Business       | 50.5 cents | 58.5 cents |
| Medical/Moving | 19 cents   | 27 cents   |
| Charitable     | 14 cents   | 14 cents   |

The IRS usually updates the mileage rate once a year in the fall for the next calendar year.

"Rising gas prices are having a major impact on individual Americans. Given the

increase in prices, the IRS is adjusting the standard mileage rates to better reflect the real cost of operating an automobile," said IRS Commissioner Doug Shulman. "We want the reimbursement rate to be fair to taxpayers."

### Connecticut Raises Minimum Wage

Effective January 1, 2009, the minimum wage in the state of Connecticut will increase to \$8.00 per hour. On January 1, 2010, the minimum wage will increase to \$8.25 per hour. Currently the minimum wage in Connecticut is \$7.65 per hour. These amounts are higher than the federal minimum wage of \$5.85 per hour.

In addition, the gratuity allowance for tipped employees other than bartenders earning minimum wage will essentially increase from \$2.24 per hour to \$2.48 per hour as of January 1, 2009, while the gratuity allowance for tipped employees serving as bartenders earning minimum wage will essentially increase from \$0.63 per hour to \$0.88 per hour as of January 1, 2009.

**If you have any questions concerning our tax updates, please contact Randy Harrison, CPA at [rharrison@mhpcpa.com](mailto:rharrison@mhpcpa.com) or (203) 789-1040. 700 State Street, 4th Floor · New Haven, CT 06511 Phone: (203) 789-1040 · Fax: (203) 789-4455 · [www.mhpcpa.com](http://www.mhpcpa.com)**

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## Friends And Family Plan

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Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

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To Your Financial Success,



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