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Bernanke & Paulson Put In For Overtime

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Another Sunday night... another weekend of government engineered rescue plans. This week, the players are Lehman, Merrill Lynch and AIG. And I thought I had it "tough" today with two of the three kids all day.

They didn't buy my idea to hang out, read, nap and watch football! Instead, it was mini golf, hotdogs, clam rolls and chicken nuggets before heading to the local farm for fresh, homemade ice cream. If that wasn't enough, after getting home and falling asleep on the floor, I was awakened by the kids' brilliant idea to wash my car.

Figuring that would surely put them over the edge to exhaustion, I acquiesced, only to watch a soap and water battle ensue for an hour! So, this update is going to be brief, by my standards since I am the one who is exhausted!

Can you imagine what Hank Paulson and Ben Bernanke must be thinking? Their predessessors, John Snow and Alan Greenspan had relatively "cushy" jobs compared to them. It's hard to imagine Greenspan and Snow burning the midnight oil weekend after weekend after weekend.

So when Paulson and Bernanke signed on to their posts, they likely had their work schedule in their minds for the next few years. And I would bet that neither ever thought in their worst nightmare that it would involve 7 day workweeks trying to keep the dam from breaking.

Bu that's exactly what it has become since August 2007. A tireless and endless stream
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of potential levee breaks, threatening the entire global financial system. Having only researched the 1930s (obviously I wasn't alive), I surmise that this period is the closest parallel in terms of the state of the financial system.

Who Will Be Next?

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So, we have another weekend where the masses are eagerly awaiting some kind of deal/bailout/rescue for Lehman Brothers. Rumors had it that Bank America and Barclays were trying to get a deal done, but the lack of a government backstop, like JP Morgan had with Bear Stearns was a deal breaker.

And it just crossed the wires that Bank America bought Merrill Lynch for $29, more than 50% higher than its Friday closing price. But Lehman was left out in the cold, and could file for bankruptcy protection within hours. So we have good news, bad news.

The fact that B of A did this deal at such a premium to the current stock price should restore a little confidence in the markets, but it will be far outweighed by Lehman's collapse. The government apparently stood by their statement that no federal money was going to used to save Lehman. However, it's likely that the Fed further relaxed the kinds of collateral it would take at the discount window and other facilities.

If you are curious why the government intervened with Bear and not Lehman, it's because of the state of the markets. In March, the Bear collapse happened almost overnight, blindsiding the markets and government. They really had no choice as it would have caused a massive systemic problem rippling around the globe.

Lehman has been "in the works" for weeks, if not months and people had plenty of time to prepare. It's certainly not good, but should not threaten the system. Without reading the details and hearing the scuttlebutt, my guess is that the Merrill takeover was probably orchestrated by the government, as a preemptive strike before that firm was targeted next.

What This Means For Monday

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If you look at the markets through last Friday, they certainly absorbed an ocean of bad news so far this month. But they have really held up well, relatively speaking. We've seen our fair share of sharply lower openings, but only one kept moving down all day. The others saw stability by lunch with an afternoon rally taking hold. Usually, that's not the sign of a market about to collapse.

But these are unique times. In my 20+ years in the business, I can only recall one period like this, where the morning or afternoon (or weekend) headlines overran everything else and changed on a dime. That was in the 4th quarter of 2000 when the presidential election was contested.

Clearly, this is much more serious. One of my close friends who happens to be among the smartest fundamental investors I know, keeps asking me how can this kind of extreme volatility occur? How can stocks open 2% higher on the Fannie/Freddie rescue, collapse from there, rally sharply again and then collapse again?

It's dizzying! But this is what happens at the tail end of major declines. Volatility spikes to historic levels, exactly the opposite of what we see at major peaks.

Unless a miracle happens after I hit "send" and Lehman gets bought, you can expect the exact opposite of last Sunday's message when it looked like we would see a monster 2-3% rally at the open. I would expect a 2-3% decline Monday morning with calls for the world coming to an end. Again, the reverse of last week's bailout when the world was suddenly okay!

The key for tomorrow is what happens after the first 30-60 minutes. Will stocks stabilize and begin to move higher or be in for a complete rout? If you want this mess to end sooner than later, you really want to see Monday end in a bloody mess and open sharply lower again on Tuesday, breaching the lows we saw on July 15. Then, the stage can be set for stabilization and a reversal.

I would also imagine that gold continues the rally it started on Friday and the dollar falls again. Energy should also rally, the beneficiary dollar weakness, an extremely oversold condition and Hurricane Ike. It would speak volumes, long-term, if oil cannot get off the canvass with all of these short-term tailwinds.

That's it for me. I can barely keep my eyes open and it's going to be an early morning and long day. I ended up watching Rocky and Rocky II for the 100th something time last night and finished up with Diane Keaton and Jack Nicholson's, Something's Gotta Give. I feel asleep with 30 minutes left in that better than good flick and have to watch the ending before I forget about the movie!

Hope you had a nice and peaceful weekend.

Especially during these extremely turbulent and tumultuous times, please don't hesitate to contact me with any questions or comments, even if you only want to bounce an idea.

Now is not the time to be complacent with your money! The weekend's events are part of an ongoing process to delever the entire financial system. It's not over and more banks will be layed to rest.

Reprint Of FDIC Article From July

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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
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email. I am happy to help you.

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,

Paul Schatz
President
Heritage Capital LLC

1 Bradley Road Suite 202
Woodbridge CT 06525

203.389.3553 Phone
203.389.3550 Fax

www.InvestForTomorrow.com

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