The Round-Up: July 17th 2007

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North American integration is making the news again on both sides of the border, and on the other side of the Atlantic. Meanwhile, another large Canadian company - Alcan - becomes the subject of a takeover some describe as a symptom of Canadian economic suicide. The natural gas drilling crash affects Baker Hughes, the Chinese feel unwelcome in the Alberta oil patch and concerns are raised over the safety of LNG terminals in Québec.

In the US the subprime credit market problems are beginning to snowball, while the folly of relying on sophisticated risk analysis models based on the 'data' from 'liar's loans' becomes apparent. Wall Street's ability to value assets is called into question, the lawyers begin to get in on the act and the US tries to sell mortgaged-backed securities to China.

How cosy do we want to be with the Americans?

> Prime Minister Stephen Harper will be meeting in Montebello, Que., with U.S. President George W. Bush and Mexican President Felipe Calderón on Aug. 20 and 21.
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> These meetings seem to be kept deliberately low-profile. Do we, as Canadians, really want to continue down the road toward deep integration with the United States with regard to our resources?
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> In March 2005, Paul Martin, Vicente Fox and Bush met in Waco, Tex., to ratify the Security and Prosperity Partnership of North America (SPP). The SPP takes NAFTA's goal of continental economic integration much further by including security and foreign policy issues, and by speeding up the process of regulatory harmonization integral to the first Canada-U.S. Free Trade Agreement.
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> All this has been done quietly, resulting in a lack of public awareness or input. It should also be noted that all three North American governments seem to be moving quickly toward a continental resource pact, a North American security perimeter, and common agricultural and other polices related to our health and environment. To date, the public has been neither informed or consulted.
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> We should ask our members of parliament their position on these very important meetings, and when public input will be initiated.
>
> This is our country. Let's keep it strong and free.
>
> Elizabeth Eidt, Stratford

Bush and Calderon to Visit Canada - Canadians Completely Unaware of Looming North American Union

> In just over a month's time, on August 20, the most powerful president in the world will be arriving in Montebello, Quebec for a two-day conference. President George W. Bush will be meeting with Stephen Harper and their Mexican counterpart, Felipe Calderon. So far, the silence from the Canadian and American media has been deafening.
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> Talk to 90% of people on the street and they won't know about this upcoming conference, and if by a slim chance they do, they won't know the purpose of the meeting or why the leaders of Canada, United States and Mexico are meeting in the dog days of summer under what amounts to a veil of secrecy.
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> So, what's this upcoming conference all about, and why are the newspapers, radio and television keeping silent about it?
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> The purpose of the upcoming conference is to ratify the Security and Prosperity Partnership of North America, which was initiated by Bush, Martin and Fox in 2005 in Waco, Texas. Essentially, this so-called 'partnership' will result in what the politicians refer to as 'continental integration'-newspeak for a North American Union- and basically a harmonization of 100's of regulations, policies and laws.
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> In layman's terms, it means that once this 'partnership' has been ratified which is a fait accompli; we will be following in the footsteps of the European Union. It will mean that Canada will become part of the North American Union by 2010, and that our resources, agricultural, health and environment issues, to name a few, will be controlled not by Canada, but by the government of the North American Union.

U.S. to merge with Mexico and Canada?

> In his new book, "The Late Great USA: The Coming Merger With Mexico and Canada," Corsi weaves a sprawling theory in which multinational companies, the Bush administration, the Council on Foreign Relations, Democratic-leaning college professors and the governments of Mexico and Canada, among others, are all working -- not necessarily together, but in harmony -- to create a "North American Union." This NAU, Corsi says, will be similar to the European Union, breaking down national boundaries, establishing a single North American currency and potentially even leading to a rewriting of the Bill of Rights.

UK: Will the USA Invade Canada?

> Canada is now considered an unimportant good neighbor by the superpower to its south. A recent effort to create a "North American Union" (NAU) with Canada, the USA, and Mexico is a semi-secret effort by industrialists in these three nations. The goal is similar to the "European Union" in that it would allow low-cost Mexican labor and abundant

Canadian energy reserves to fuel the huge industrial machine of the USA and create the world's greatest economic power. The 1994 North American Free Trade Agreement (NAFTA) is the cornerstone of this union.

Few Americans know that Canada is the leading source of imported energy to the USA. They are the biggest source of foreign oil, natural gas, uranium, and even electricity. As energy costs recently doubled, Canada is becoming wealthy, at the expense of its southern neighbor.

[Truck tailspin puts dent in International Budget coffers]

Truck traffic continues to slump between the Twin Saults.
Photo: Brian Kelly - Sault Star

An ongoing slump in commercial truck traffic could cost the International Bridge as much as $400,000 US in anticipated toll revenues this year. For an operation that largely depends on crossing fees to pay for maintenance and capital projects and receives no government support, that's potentially very costly news.

Transport volume slumped 7.1 per cent in 2006 and is down another 10.2 per cent during the first half of 2007.If the trend continues, fewer than 110,000 trucks could cross between the Twin Saults this year. That would be the smallest number since 1993.

Commercial traffic represents about seven per cent of bridge traffic, but contributes nearly half of all toll revenue.In 2006, total toll revenue was $4,153,000 US. Of that amount, 48 per cent, or $1,998,000 US, was paid in commercial tolls.

"I'm somewhat concerned that this will have a significant impact on our financial resources," said Phil Becker, general manager of Joint International Bridge Authority.

"It may impact our ability to operate and maintain the bridge."

Truck traffic has headed one way, down, since June 2005. October 2005 marked the only month in the past two years that commercial traffic increased. The slump is the worst since an 11-month period that stretched from July 2000 to June 2001.

In June 2007, commercial numbers slumped 14.2 per cent compared to June 2006.

[Why Alcan is worth so much (hint: think water)]

Investors have heard it before, but the tune never seems to get old. Once again, a rising force in the East and its insatiable demand for raw materials has been crowned the driving force behind a mining mega-merger, this time, a $38.1-billion deal for Alcan. It's all about China, as the chorus goes. Just one small question: What if it's not?

When it came time for Tom Albanese to explain the biggest gamble of his life, when it came time for him to justify shelling out $38.1-billion (U.S.) for a company that wasn't worth half that much a year ago, the rookie boss of Rio Tinto PLC trotted out a familiar platitude.

"It's going to be all about the China story," he assured a group of reporters this week, just hours after tasting victory in a takeover battle for Montreal aluminum maker Alcan Inc.

Hmm. Where have investors heard that before? Amid the frenzied merger environment of the global mining industry, chief executive officers have routinely held up China as a key justification for their deal making and the hefty premiums they are willing to pay to get those deals done. China, as we all know, has a voracious appetite for raw materials and natural resources, and the world's top miners are only too happy to ride the coattails of the country's economic boom.

This is great if you produce copper, or nickel, or iron ore, all of which China desperately craves. But what if, like Mr. Albanese, you happen to be the world's largest aluminum company? How do you pin your hopes on a country that is not only the world's biggest producer of aluminum, with more than a quarter of global production, but one that makes more than it can actually use?

The answer to this question - a big part of it, anyway - resides in the riverside Saguenay Lac St-Jean region of Quebec. It is there that Alcan has staked out its claim as the most efficient large-scale aluminum maker in the world, thanks not merely to its investment in cutting-edge smelting technology, but to the munificence of the provincial government, which has subsidized the company by providing access to waterways that can be used to generate cheap power.

[Alarm over 'economic suicide']

The proposed acquisition of Alcan Inc. by the London- and Melbourne-based Rio Tinto Group is a symptom of "economic suicide" under way in this country, Montreal billionaire and shareholder activist Stephen Jarislowsky said yesterday.

Others use less dramatic language as they engage in the hollowing-out-of-corporate-Canada debate, but admit to growing concern over such deals as Rio Tinto's friendly $38.1-billion (U.S.) bid for Alcan. The Montreal-based aluminum producer is the 10th company on the TSX 60 to be taken over, or poised to be taken over, by a foreign company in the past three years, Jarislowsky noted.

Foreign takeovers are fueling the Canadian dollar, which is "going through the roof" and contributing to the woes of Canada's exporting and manufacturing companies, he said. "I think the Canadian government is wrong to let any of the 60 biggest companies get taken over by foreigners," said the founder and chairman of Jarislowsky Fraser Ltd., which manages $60 billion of other people's money.

[Germany strives to fend off flood of hungry dollars]

Germany is drawing up detailed plans to stop strategic assets falling into the hands of "giant locust funds" controlled by Russia, China, and Middle East governments. Finance minister Peer Steinbrück said "telecoms, banks, post, logistics, and energy" were among the sectors that would be shielded from sovereign wealth funds, the new state trusts that are fast swamping global asset markets.

It is the first time Berlin has begun to spell out which industries would be covered by the new code. In an added twist, he said "private finance houses" would also be restricted from taking over Germany's crown jewels, an apparent reference to Anglo-Saxon hedge funds and private equity groups.

Mr Steinbruck said it was time for Germany to learn a few tricks from France, Italy, and Spain, which all pursue industrial policies without apology. "We must have an active industrial policy," he said. Germany's lurch towards 1970s-style protectionism is the clearest evidence to date that the EU's fragile free-market consensus is breaking down under the strain of globalisation. Until now Berlin had been viewed as a member of the EU's "free-market" camp, albeit in a schizophrenic way. It often voted with Britain, Holland, and Scandinavia on key issues in Brussels.

Germany's radical shift follows the success of French president Nicolas Sarkozy in striking the words "free and undistorted competition" from the list of the EU's treaty objectives last month, a move that emasculated the chief enforcement arm of the EU's single market.

Beijing quits pipeline, blasts Ottawa

Beijing issued a scathing rebuke Thursday of the Harper government's unwillingness to attract Chinese investment and help sell Canadian oil to the Far East, as the state oil company PetroChina [PTR-N] said it was withdrawing support for a major pipeline between Alberta's oil sands and a West Coast port.

A senior Chinese oil executive blamed Ottawa for not doing more to help start the $4-billion Gateway pipeline project, which has been delayed by a lack of support from Canadian firms and challenged by native land claims along the proposed route to the Pacific coast.

Yiwu Song, vice-president of China National Petroleum Corp., one of the world's largest oil companies and parent of PetroChina, said Beijing felt the delays reflected an unwillingness to allow Chinese firms into Canadian markets. He added that China could find similar crude supplies elsewhere, notably Venezuela.

"The environment is not comfortable. We tried to come here and we can't," Mr. Song said during an investment conference in Calgary.

Canadian profits running dry, warns Baker Hughes

Oilfield services giant Baker Hughes Inc. of Houston is blaming Western Canada's natural-gas drilling crash for poor financial results, warning investors yesterday the company's second-quarter profit will fall short of market expectations....

...."The sequential decline in the second quarter of 2007 compared to the first quarter of 2007 primarily results from significant deterioration of activity and profitability in Canada --particularly in the drilling and evaluation segment," said Baker Hughes, which has international operations and sells products and services for oil and natural gas drilling, ahead of results due out on July 27.

U.S. sales slump bad for Canada

Canada's largest customer is not in a buying a mood, and that's not good news for the export-reliant Canadian economy. U.S. consumers, their wealth and confidence eroded by the deepening depression in that country's housing market, kept a tight grip on their wallets last month, sending retail sales tumbling 0.9% - the steepest drop in two years - and surprising analysts who had expected a modest increase.

A survey this month for a major Canadian financial institution found U.S. consumers have since become even more pessimistic about the outlook for their economy, investments and, most important, their jobs.The reports follow the Bank of Canada's warning this week that one of the "main downside risks" to the Canadian economy is the impact on spending of the collapse in the U.S. housing boom.

And that's not surprising, since nearly 80% of Canadian merchandise exports go to the U.S. market, 22% directly in the form of consumer products. But even exports of non-consumer products would be hit by a widespread retreat in consumer spending that would weaken the overall U.S. economy.

Rabaska: too hot to handle?

A terror attack on a liquefied natural gas tanker could have "the force of a small nuclear explosion," warned Lord Levene, chairman of the fabled Lloyd's of London insurance group, in a 2004 speech to the Houston Forum.

That kind of talk helps fuel opposition to a proposal to build an LNG terminal near Lévis.

The Quebec cabinet has already approved one LNG port at Gros Cacouna, in a sparsely populated area of the Lower St. Lawrence not far from Rivière du Loup. This fall, the Charest government will decide whether to approve the Rabaska project on the opposite side of the St. Lawrence River from Quebec City, in a bucolic zone of waterfront property, potato fields, campgrounds and country homes.

Rabaska would be built on a stretch of the St. Lawrence where three 735-kilovolt transmission lines, carrying electricity from Churchill Falls, Labrador and Hydro-Québec's Manic dams, cross from Île d'Orléans to Lévis.

Beneath those power lines, LNG tankers from Algeria, carrying up to 216,000 cubic metres of liquefied natural gas, would have to navigate a channel that narrows to 305 metres and has a depth of 12.5 metres at low tide - a tight fit for the 315-metre-long tankers that draw 12 metres of water.

['Titanic syndrome' holding sway]

> People should have paid more attention to what Denis Latrémouille had to tell the hearings on the Rabaska liquefied natural gas terminal proposed for Lévis, said federal Liberal leader Stéphane Dion, who was in the region earlier this week.
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> Latremouille was Quebec director of maritime safety for Transport Canada before he retired in 1998 after 35 years with the Coast Guard and the federal government.
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> In his 62-page brief presented in January, Latrémouille told the federal-provincial joint commission looking into the proposal that the 305-metre channel leading to the Rabaska port on the south shore of the St. Lawrence River is too narrow and its 12.5-metre depth at low tide is too shallow for the big tankers to safely navigate.
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> The promoters of Rabaska wanted a channel at least 15 metres deep and only at high tide is there 15 metres of water. Latrémouille noted the current, tides and ice conditions in the channel would make it difficult to manoeuvre a 315-metre-long LNG tanker in the channel where the bulk carrier Alcor ran aground in 1999, with serious hull damage. The Alcor sank when its rudder jammed for just 15 seconds, he said.
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> "To maintain the belief that it is impossible for an LNG tanker to sink in the North Crossing with a perforation of its outer hull is, in my humble opinion, the Titanic syndrome," he told the commission.

[Non-natives support Algonquins' mining rallies]

> Prospectors hoping to make the case for a multimillion-dollar uranium mine north of Kingston are furious that their access to the site is being denied by Eastern Ontario Algonquins.
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> But the Algonquins appear to be winning the battle for local public opinion, attracting a growing number of non-natives to rallies against the mining project. Two weeks after the June 29 Day of Action, the dispute is turning into the latest test for governments and the Ontario police in managing a standoff between natives and a non-native business.
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> The Ontario government has put a renewed focus on nuclear energy as a key part of future plans to reduce greenhouse-gas emissions. A company called Frontenac Ventures has staked out thousands of acres and was about to commence sample drilling when two non-status Algonquin communities, Sharbot Lake and Ardoch Lake, joined forces to block access to the land in support of their claim that it belongs to them.
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> Over the past two weeks, they have maintained a protest blocking a road into the site, and intermittently marched on Highways 509 and 7 to raise awareness of their campaign. The Algonquins and their supporters say their aim is to protect traditional native lands and area drinking water from radioactive contamination. They also note that the land is part of the Ottawa River watershed, meaning any accidents could contaminate the drinking water of the nation's capital.

[Many Canadians fear third world war looms]

> A poll suggests the likelihood of another world war sits heavy on the minds of many Canadians. At the same time, the CP-Decima Research survey indicates a majority of Canadians reject the prospect of their country becoming part of the United States.
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> The online poll found 46 per cent of respondents thought there will be another world war within the next 50 years. Almost one-in-four said they think it will happen in less than 100 years, while 13 per cent thought it would take longer. Seventeen per cent said it would never happen.
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> If a third world war were to take place, it would involve nuclear bombs and start in one of the world's hot spots, says Canadian historian Michael Bliss.
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> "We'll be lucky if nuclear weapons aren't used in the next 20 years in the Middle East,"said Bliss.

[Housing sales may be worse than data show]

> Here's a scary thought about the housing market: Things may be far worse than what's already being revealed by the troubling government and industry statistics. At issue is what goes into sales price data and what does not. When those numbers are crunched, many of the incentives that sellers are using to lure buyers - including cash rebates - aren't being included. That suggests prices may be falling faster in many markets than is now being reported.
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> The same goes for how the mortgage-application indexes don't account for the implosion of lenders. That could have the effect of masking a slowdown in demand, which is why the housing market could be in for rough sailing much longer than most anyone anticipates.
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> There certainly has been plenty of bad news, but it might not even be giving a full picture of how difficult things really are. For instance, the Commerce Department reported at the end of June that the median sales price of new homes fell 0.9% in May from a year ago, after tumbling 10.9% in
> April. But those numbers don't include the thousands of dollars in lavish incentives like plasma televisions, pool installation and closing costs that sellers are increasingly using to woo buyers. That means a home selling for $600,000 gets reported for that price even though all those extras technically are reducing the net sale price.
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> Sales incentives at Lennar Corp., one of the nation's biggest builders, averaged $43,700 a home in its fiscal second quarter, up from $24,700 in the same quarter last year. And it isn't just builders piling on the incentives - it's spilling over to the existing-home and foreclosure market, too.

[Can Wall Street be trusted to value risky CDOs?]

The complex models that Wall Street uses to analyze risky investments in subprime mortgages may be as suspect as some of the securities themselves. With a surge in defaults on subprime home loans jolting credit rating agencies and two Bear Stearns hedge funds in recent weeks, some fear that these models may overlook swift market downturns or corrupt loan data. That could spell further turmoil for credit markets.

The worry is that well-heeled hedge funds, Wall Street proprietary trading desks and ratings agencies may be too optimistic when analyzing or valuing exotic mortgage investments. As a consequence, future drops in market prices may be more severe and possibly trigger panic selling by sophisticated investors.

"These models end up breaking down rather dramatically during abnormal times," said Andrew Lo, a finance professor at Massachusetts Institute of Technology. "And, of course, those are exactly the times that we should and need to worry about."

Ratings companies like Moody's Investors Service use computer models to help predict losses on thinly traded debt investments called collateralized debt obligations, or CDOs, that are often tied to pools of high-risk home loans. The models help the agencies determine what rating a security merits. Because securities in the $1 trillion CDO market trade infrequently, it is difficult for hedge funds and other investors to mark their values to recent sale prices, called "marking to market."

Hedge funds instead use mathematical models of their own to estimate and report the value of their CDO holdings to investors -- a practice known as "marking to model." Recent troubles at hedge funds run by Bear Stearns, Braddock Financial Corp. and United Capital Markets have highlighted the problems inherent in that approach. Even so, fund managers are resisting market views on the value of subprime assets and continuing to "mark to model," claiming declines represent short-term volatility.

Which Is Not What the Big Bucks Are Paid For

We seem to be on the verge of the revelation that pricing models and rating models and value-at-risk models and Excel spreadsheets and 10-key calculators only work when all of the relevant data inputs are collected and verified. Sit down, folks. If this keeps up, we will learn that those fancy automated underwriting systems that have been using the borrower's unverified assertions about income and the broker's bald-faced lies about the sales contract and the appraiser's idle musings about the market appetite for more granite countertops are producing unreliable estimates of default probability . . .

They shoot fund managers, don't they?

Some lessons from securitisation crisis

It is relatively easy to sell the high-grade investment bonds to institutional investors such as pension funds and insurance companies, which mostly have to buy investment-grade-rated debt. But the mezzanine, and particularly the equity, issues are difficult to dispose of.

This is where the hedge funds join in. Investment banks often set up their own hedge funds whose objective is buying and trading the bank equity and mezzanine tranches of the CDO. If housing prices appreciate, this obscure equity instrument that is not traded anywhere appears more worthy. Higher house prices acted as cushions against sub-prime borrowers defaulting. The slice of CDO equity gets marked up in value much faster than the underlying houses.

The hedge funds are now star performers and are rewarded by further outside investment. The hedge funds then lose no time leveraging their risk by borrowing money using their high-performing but illiquid assets as collateral. The MBS cycle is fully in motion. The hedge funds start marking up the value of their equity CDOs on the basis of rising house prices. The lending banks see the equity looking better and better, and lend more and more cash against it to the hedge funds.

The money lent by the banks against the equity goes back to the hedge funds, which buy more CDO equity from the investment banks, who in turn buy more MBS from the mortgage lenders, which provide more money to sub-prime borrowers, who then buy more houses, pushing prices up higher. This is the background story of the Bear Stearns hedge fund problem today. If CDOs stop buying MBS, then a major source of liquidity dries up. That tightening of credit could affect house demand, thereby turning the virtuous circle of recent years into a vicious one of falling home prices.

Housing troubles begin to snowball

Those of us who felt we understood the speculation that had occurred believed quite strongly that once housing peaked, there would be real trouble for the economy and, by extension, the asset classes impacted by a housing bust.

The problems have taken a long time to play out, largely because of what we've recently come to discover but probably could or should have known all along: that the building blocks of the housing ATM -- more accurately referred to as structured credit -- were created in such a way that these securities were rarely marked to market. Rather, they were allowed to be marked to a model, based on a variety of assumptions. Essentially, therefore, one's assets were impaired only when the ratings companies downgraded them.

Fast-forward to last February and March, which saw the implosion of a couple of dozen subprime lenders. Wall Street reacted by proclaiming the problem "contained." Though I essentially laughed at that sanguine response, now I understand what it meant: Those in the know understood that nothing was going to be marked to market, so the subprime-loan-originator implosion didn't matter.

Next, we saw the blowup of Bear Stearns' High-Grade Structured Credit Strategies Enhanced Leverage Fund. That happened, in part, because manager Ralph Cioffi had tried to hedge some of its weaker credits with an ABX index that did get marked to market. Thus the fund lost money and was hit with redemptions.

At the time, I said that redemptions were going to force price discovery into the market -- although, as Jim Grant so eloquently put it in a recent issue of Grant's Interest Rate Observer -- Bear Stearns had a totally different opinion: "Price discovery could wait until the return of blue skies and normal pulse rates. The first order of business was price suppression."

Subprime lawyers take aim at Wall Street

> U.S. class-action lawyers who have sued subprime mortgage lenders are now scrutinizing Wall Street banks that sold packages of risky loans to investors and credit analysts that served up top ratings on the securities.
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> Litigation stemming from the collapse of the subprime mortgage market is expected to grow as more investors run for cover after suffering losses on bonds tied to mortgage-backed securities. Plaintiffs' lawyers say they want to know more about the relationship between the credit-rating services and investment banks that assembled complex debt structures known as collateralized debt obligations, or CDOs, tied to risky mortgages. Two leading rating services this week downgraded billions in subprime debt, but critics say they should have acted earlier.
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> "There's no question that there is a careful examination going on right now of what role the rating agencies played here, what they knew and when they knew it, as well as the investment banks," said Gerald Silk, a partner at plaintiffs' law firm Bernstein Litowitz Berger &Grossmann LLP.

Time to Face the Music

> This week, bond rating agencies Moody's and Standard & Poor's finally announced downgrades on billions of dollars of bonds backed by subprime mortgages. Though the cuts will certainly not reflect the full weakness of the bonds, and will not include nearly as many issues as they should, they nevertheless amount to the beginning of the end of the phony mortgage investment market and the unrealistically high home prices that it helped support.
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> In a sign of desperation, the U.S. has dispatched Housing and Urban Development Secretary Alphonso Jackson to Beijing to beg the Chinese to use some of their $1.3 trillion in foreign reserves to buy more U.S. mortgage backed securities. Talk about chutzpa! We bash them publicly, but behind the scenes we go hat in hand seeking their help. If the Chinese have any sense they will send the Secretary packing. After all, why should they use Chinese taxpayer money to bail out the U.S. housing market by purchasing securities that no American would touch with a ten-foot chopstick?
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> Is it just me, or haven't I seen this movie before? In the 1990's, the very Wall Street firms that created these securitized mortgage products were busy packaging worthless dot.com start-ups into multi-billion dollar IPOs. Back then the game involved in-house analysts slapping "strong buy" ratings on companies that the investment bankers themselves knew were worthless. This time around, the bankers persuaded ratings agencies such as Moody's and S&P to rubber stamp investment grade ratings on mortgage backed bonds that the bankers knew were extremely risky.
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> Unfortunately, investors have very short memories when it comes to these scams. They don't understand the profit motives that are behind Wall Street's cleverest strategies. Whether it's worthless companies or worthless bonds, Wall Street will sell anything if it can make a buck, no matter what it has to say or do to make the sale. The biggest problem for investors is that the riskier the investment, the more profit Wall Street

makes selling it.

In its defense, S&P claims that their ratings were based on faulty data. This doesn't hold water because it would have been obvious to anyone with a drop of skepticism (and the agencies are supposed to have gallons) that the assumptions about mortgage performance were overly optimistic at best and completely unsound at worst. It is not by accident that "no documentation" loans have long been referred to by all levels of the mortgage industry as "liar's loans". Did the rating agencies possess some deep reservoir of faith in human financial honesty that everyone else lacked?

Options market expects a drop in U.S. stocks

For the past month, bets in the options market against the Standard & Poor's 500-stock index have exceeded, by a two-to-one margin, wagers that it would rise. That is the longest stretch since Bloomberg News began compiling the data in 1995. That is seen as a warning sign that the market is due for a decline of 5 to 10 percent, according to managers at Morgan Stanley Global Wealth Management, National City Private Client Group and Russell Investment Group.

"People are starting to realize that in the second quarter we're not going to have blowout earnings," said Nick Raich, the director of research at National City in Cleveland, Ohio. "The bears could come out of the woodwork." The S&P 500 rose to a record of 1,552.50 on Friday as the Dow Jones industrials hit a new high of 13,907.25.

But the Leuthold Group, whose flagship fund has beaten 99 percent of similar funds during the past five years, expects the S&P 500 to slide as much as 19 percent by the end of the year. The options market is "a bell ringer," said David Darst, chief investment strategist at the Morgan Stanley private banking unit. "On a short-term basis, the market's ahead of itself and could have a pullback."

Darst said the market could drop as much as 10 percent. The increase in so-called put options coincides with the analysts' outlook for the worst corporate earnings since 2002.

Bernanke to stress price worries before Congress

Federal Reserve Chairman Ben Bernanke is likely to tell Congress this week the central bank is more worried U.S. inflation will flare than it is that housing market turbulence will seriously damage the economy. Bernanke looks set to emphasize that the Fed's main concern remains the risk that inflation fails to moderate as it expects when he appears before the House of Representatives' Financial Services Committee on Wednesday at 10 a.m. EDT.

He will deliver similar testimony the next day before the Senate Banking Committee. The two days of testimony are part of a twice-yearly ritual in which the Fed chairman presents the central bank's monetary policy report. The report will contain updated forecasts for growth, inflation and unemployment. While price rises have moderated when volatile food and energy costs are stripped out, Bernanke is expected to stress that core inflation -- which dipped for the third straight month in May to 1.9 percent --

needs to drift a bit lower and stay there for a while before the Fed is satisfied.

"Fed officials believe that holding down inflation is the principal challenge over the next several years, and they are not inclined to tolerate much backsliding after the hard-won improvement in core inflation over the past 12 months," said Roger Kubarych, an economist for UniCredit/Bayerische Hypo-und Vereinsbank in New York.

[Rising Food Prices May Give Bernanke, Central Bankers Heartburn]

Rising prices for food, from yogurt in the U.S. to steak in South Africa, are causing heartburn at the world's most powerful central banks.

The fastest increase in food-commodity prices in at least a decade has already led monetary authorities in England, Mexico, Chile and South Africa to lift borrowing costs. It is also sowing doubts about the U.S. Federal Reserve's focus on core inflation, which excludes food and energy, and about China's gradual approach to tightening credit.

As Fed Chairman Ben S. Bernanke prepares to deliver his semiannual report to Congress this week, central-bank officials worldwide are anxious that climbing costs may trigger consumer concerns about faster inflation. To keep them from being self-fulfilling, some of the biggest economies might have to push interest rates higher.

``Central banks are more conscious than they've ever been of the danger of allowing inflation expectations to become unmoored,'' says Louis Crandall, chief economist at Jersey City, New Jersey-based Wrightson ICAP LLC, a unit of ICAP Plc, the world's largest broker for banks and other institutions that trade in financial markets.

[Greenspan: Defaults hurt economy]

Former Federal Reserve Chairman Alan Greenspan said he expects the fallout from subprime-mortgage defaults to spread to other parts of the economy, especially if home prices decline.

"If prices go down, we will have problems - problems in the sense of spillover to other areas," Greenspan said yesterday in Florida. While he hasn't seen such spreading yet, "I expect to."

[US Turns To China To Save Mortgages]

The Bush Administration is urging China's central bank to buy more government-backed mortgage bonds, Bloomberg reports, in an effort to sustain financing for US home loans in the midst of the subprime mortgage crisis. The Secretary of the US Department of Housing and Urban Development is in Beijing to persuade the PBoC to buy more securities from Ginnie Mae - a seller of US mortgage products which, unlike Fannie Mae and Freddie Mac, are government guaranteed. China has delved into Ginnie

Mae securities previously, but not in any significant fashion.

China has, however, increased its foray into mortgage products in general over the past three years. Investments totalled US$107.5 billion at June 2006, up from US$3 billion three years earlier. The HUD hopes to direct China's recycling of US$1.33 trillion of foreign reserves into its Ginnie Mae products ahead of others, as they offer the government guarantee for the same credit rating. China has established a US $200 billion fund to explore investments offering higher returns than the ubiquitous US Treasury market.

U.S. Urges China to Buy Mortgage-Backed Securities

The Bush administration is urging China's central bank to buy more government-backed mortgage bonds in an effort to sustain financing for U.S. home loans.

U.S. Department of Housing and Urban Development Secretary Alphonso Jackson is in Beijing to persuade the Chinese central bank to buy more securities from Ginnie Mae, a corporation under HUD that guarantees $417 billion in federally insured, fixed-rate mortgages.

"It's not a matter of whether they're going to do more business in mortgage-backed securities," Jackson told reporters in Beijing. "It's who they're going to do business with"

HUD aims to tap China's $1.33 trillion of foreign-currency reserves, the world's largest, after surging defaults on subprime mortgages caused the near-collapse last month of two hedge funds run by Bear Stearns Cos. Moody's Investors Service on July 10 cut its ratings on $5.2 billion of bonds backed by subprime mortgages, which are loans taken by borrowers with poor or limited credit histories. Standard & Poor's yesterday downgraded $6.39 billion of such bonds. Fitch Ratings said it may lower ratings on $7.1 billion.

Ginnie Mae is "in a better position than most to offer mortgage products because, unlike Fannie Mae and Freddie Mac, it provides the full backing of the U.S. government, Jackson said. Mortgage securities offer China's central bank better returns than U.S. Treasury bonds at the same level of credit risk, he said. China held $414 billion in U.S. Treasuries as of April, according to data compiled by Bloomberg.

Subprime woes hit U.S. city tax rolls

These days, the best Maria Bautista can do is offer her sympathies. Ms. Bautista is the branch manager of the Maryland office of Premier Mortgage Funding Inc., a Clearwater, Fla.-based mortgage company with 500 branches specializing in subprime mortgages.

She is seeing a steady stream of new homeowners, who with the collapse of the subprime mortgage market in the United States, spurred largely by sinking home prices in many areas including suburban Washington, are now facing higher financing charges -- and, in increasing numbers, foreclosures -- as their mortgages come due.

"Many, especially in the Latino community, have adjustable rate mortgages coming due," Ms. Bautista says at her office in the heart of the Latino community of Wheaton, Md., where she supervises 12 brokers. "I just don't know how to help them."

While much of the focus of the collapsing subprime market has been on mortgage lenders and investors, such as hedge funds, the fallout from tightening lending rules and dropping house prices is starting to spread into unexpected areas.

Some communities are finding things are worse than they had expected. In Manassas, Va., just southwest of Washington, the city council had figured there would be a modest 2.5% drop in residential assessments for fiscal 2009. But that has proved to be way off even before the fiscal year starts. Housing values are already off 6% and there are 20% more homes for sale now than there was this time last year.

The problem is not limited to the Washington area alone. For example, Delaware recorded 2,962 mortgage foreclosure filings in fiscal year 2007, which ended June 30, up 20% from the state's previous record in 2003.

"Most of these stories are very sad, whether it's a medical bill or divorce or just, 'My God, what did we do? We can't afford this,' " says Loretta Forsythe-Walsh, chief deputy of the New Castle County, Md., Sheriff's Office, which sells foreclosed properties at sheriff's sales every second Tuesday of the month.

Not only are municipal tax bases eroding, there are other costs. Each abandoned house can cost a municipality up to US$20,000 in unpaid taxes and utility bills and for upkeep and maintaining essential services, according to a report by the Joint Economic Committee of the U.S. Senate.

Dollar to collapse?

Disregard all hysteria. The ailing Greenback will not collapse this year, not in ten years, not in twenty years, not in half a century. There is no credible currency against which it can collapse. (Unless you count gold). None of the world's rival power blocs have the economic and demographic depth to challenge American dominance.

Yes, we have a dollar rout on our hands. The markets have suddenly begun to discount a nasty crunch in the US as the subprime debacle spreads through the credit markets. The prospect of rate cuts by the Federal Reserve is drawing closer, knocking away the dollar's yield prop. Investors have switched reflexively to the euro as the default currency.

This cannot last. It assumes that Europe has "decoupled" from America and now has the umph to go it alone. German finance minister Peer Steinbrueck played to this illusion on Monday when he professed to "love the strong euro"- (directly contradicting testimony he gave to the European Parliament earlier this year).

Whether or not Germany is really that immune to an exchange rate of $1.38 to the dollar (Professor Peter Bofinger- one of the country's five "Wise Men"- insists adamantly that it is not), it is in any case a foolish error to treat Germany as if it were a proxy for the whole eurozone. In reality, it has become the nemesis of Euro-land.

While the Teutonic Tiger is indeed springing back to life after a decade-long slump, it is doing so by conquering market share from the Club Med bloc in what amounts to a beggar-thy-neighbour shift within the euro-zone. This has a zero-sum flavour to it.

France, Spain, Italy, Portugal, Greece, and latterly Ireland are all facing very serious trouble. They are at or near the top of the cycle. Housing bubbles caused by ultra-low interest rates (geared for Germany, when Germany was down -- the dirty secret of EMU) are starting to burst. Club Med's share of global exports is collapsing.

[Soft Corals "Melting" Due to Warming Seas, Expert Says]

Soft coral communities in tropical waters may literally be melting away because of bleaching events, which have been dramatically accelerated by global warming, a leading expert says.

Unlike their hard coral cousins, soft corals have no stony outer skeletons to leave behind when they die. Instead their fleshy branches extend uncovered from reefs, where they grow alongside hard corals. This means that soft corals simply vanish in response to environmental stresses.

"I have observed sites before and after bleaching in Okinawa, Japan, and it was remarkable to see a massive disappearance of soft corals," said marine biologist Hudi Benayahu, head of the Porter School of Environmental Studies at Tel Aviv University. "You can't imagine this was the same site. Just two years passed and the entire area was deserted, lifeless."

[Polar bears face more trouble, study finds]

Increasing numbers of pregnant polar bears are coming to land to give birth instead of staying on the thinning Arctic sea ice, a trend that signals a bleak future, a U.S. Geological Survey study has found.

Data from northern Alaska show that the proportion of the bears' dens that are on pack ice declined from 62 percent between 1985 and 1994 to 37 percent from 1998 to 2004, according to the study, which was published Thursday in the journal Polar Biology.

The scientists based their findings on 89 females that were captured and collared and then followed using satellite technology. Ice floating in the Arctic Ocean will continue to melt, making polar bear dens there too unstable to survive the winter, according to global warming scenarios.

At the same time, the sea ice in autumn will retreat so far from shore that the bears cannot swim across the expanse of water to reach land, which in recent years has been as far as 125 miles, the study said. Unlike other bears, polar bears don't hibernate through the winter but continue to hunt seals. The pregnant females, however, dig dens into snow either on the ice or on the land. In northern Alaska, in the Beaufort Sea in the Arctic Ocean, most prefer ice dens, some 400 miles offshore.

But during the past 30 years, summer ice has been shrinking 9 percent per decade, according to NASA satellite data. In the winter of 2005 and 2006, the sea ice reformed to 5 to 6 percent below its average size.

[Ice sheets tell a scary new story]

There was a thunderously important comment that went largely unnoticed in the reports published last spring by the United Nations Intergovernmental Panel on Climate Change (IPCC).

The comment noted there was a possibility polar ice sheets might be more vulnerable than predicted, because climate computer models didn't take into account recent observations. But there was no consensus on the significance of the shortcoming, the IPCC said.

Now, a team led by James Hansen, head of NASA's climate agency, has published a study that identifies what's going on at the poles, and confirms the vulnerability of the ice sheets. Its findings throw into question all the conclusions reached by the IPCC.

In particular, the study says ocean levels could rise by metres this century, not centimetres as the UN panel suggested. Worse still, what's occurring in polar ice fields could flip the world into much faster and far more devastating global warming than predicted by the IPCC. This kind of fast transition has happened in the past – many times, according to paleoclimatic records, the Hansen study says – and it can happen now.

If it does occur, the study warns, it could produce runaway global warming powerful enough to raise sea levels 25 metres, as happened about 3.4 million years ago. The study directly contradicts the IPCC, which expected the Antarctic ice sheet to get bigger, "due to increased snowfall." Instead, ice fields in West Antarctica could collapse if current trends are not reversed, the study says.

[Flash! US Media Ignore Scary Story! Impossible You Say?]

Once again the American media, so quick to hype absurdly improbable risks and disasters like West Nile Virus or Ebola outbreaks, has ignored a real one: in this case the likelihood that global warming disaster is much more imminent than the recent Intergovernmental Panel on Climate Change report has led us to believe. The bad news, so far completely ignored in the mainstream US media, comes from James Hansen, the top climate expert at NASA's Goddard Institute for Space Studies.

Hansen, lead author of a new scientific study published in the May issue of the British journal, Philosophical Transactions of the Royal Society, says that the slow melting of the Greenland and West Antarctic Ice Sheets predicted by the IPCC as the basis for their estimate of a rise in sea levels of only 59 centimeters (less than two feet) by the end of this century is wildly off the mark and doesn't fit current data on ice melting.

Hansen, saying that recent evidence of melting at the poles shows ice melts much differently, and faster, than once assumed, warns that a few degrees' rise in temperatures in northern regions could produce much worse results. While he says we could see a resulting rise in sea levels over this century of several meters (bad enough), he also warns that with only the widely predicted 5-6 degree Fahrenheit rise in this century that the IPCC has predicted, the earth could see these two huge ice sheets collapse almost entirely over the next century, with a resulting sea rise of some 80 feet or more.

‘That would be enough to wipe out most of the world’s coastal cities and populations, and to cause massive climate change. (The US, for example, could kiss New Orleans, much of the Gulf Coast, the Florida peninsula, and most of the East Coast goodbye.)

Raft of flaws found in popular carbon offsetting schemes

A television documentary has uncovered flaws in a series of carbon offsetting schemes intended to make good the global warming gases emitted by flights and other polluting activities.

An episode of Dispatches on Channel 4 on Monday entitled "The Great Green Smoke Screen" will show academics and environmentalists questioning the ethics and impact of offsetting - and suggesting that offsetting schemes have not been effective as claimed.

Study debunks solar warming claims

A new study on solar activity dismantles one of the key arguments of climate skeptics, its author says, that the sun’s radiation and not greenhouse emissions are behind global warming. The key finding of the study, published in the Proceedings of the Royal Society, is that since the mid 1980s solar radiation levels have been declining at a time when there have been increasing average surface temperatures on Earth.

The scientists who conducted the study, Mike Lockwood, from Britain’s Rutherford-Appleton Laboratory, and Claus Froehlich from the World Radiation Centre in Switzerland, say their findings should settle the debate of the Sun’s role in climate change once and for all."Over the past 20 years, all the trends in the sun that could have had an influence on Earth's climate have been in the opposite direction to that required to explain the observed rise in global mean temperatures," their paper states.

While solar energy output from the Sun increased during the 1960s and 70s, it has been falling since a peak in 1985. Yet the ten warmest years since reliable weather records began in the mid-1800s have all been since 1990. "The temperature record is simply not consistent with any of the solar forcings that people are talking about,"Professor Lockwood is reported as saying by The Guardian.

The solar energy explanation for climate change human greenhouse emissions is a central claim of the British TV series, The Great Global Warming Swindle, which in part prompted Lockwood to undertake the study. Some climate scientists have accused the makers of being selective and misrepresenting the evidence on what’s causing global warming.

Iceland ranks top in happy citizen table

> Iceland is the leader in a league table judging the European country best able to give citizens a long and happy life. Estonia comes bottom of the 30-nation survey while the UK lurks below Romania, at number 21 in the chart.
> The European Happy Planet Index used carbon efficiency, life satisfaction and life expectancy to rate the countries. The survey, published by the New Economics Foundation and Friends of the Earth, reveals that Europe is now worse at creating well-being than it was 40 years ago.
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> "Countries like Iceland clearly show that happiness doesn't have to cost the earth," said Nic Marks, founder of the foundation's Centre for Well-being. "Iceland's combination of strong social policies and extensive use of renewable energy demonstrates that living within our environmental means doesn't mean sacrificing human well-being."

How the Far Right Targets Africa: Guns, Foundations and Free Trade

> "Creating an African Command," write the two analysts in a Heritage Foundation study entitled U.S. Military Assistance for Africa: A Better Solution, "would go a long way toward turning the Bush Administration's well aimed strategic priorities for Africa into a reality."
>
> While the Bush Administration says the purpose of AFRICOM will be humanitarian aid and "security cooperation," not "war fighting," says Ryan Henry, principal deputy undersecretary of defense for policy. The Heritage analysts were a tad blunter about the application of military power: "Pre-emptive strikes are justified on grounds of self-defenseAmerica must not be afraid to employ its forces decisively when vital national interests are threatened."