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## Bear Market Celebrities

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### Summary

- BAC's repayment announcement is being perceived as a credit positive event by the equity markets...we see it as providing positive credit market sentiment...but is BAC's announcement really a credit positive?
- Initial Jobless Claim numbers continue to track toward that magic 300K to 350K number...
- Fitch and the other rating agencies appear to be "farming-out" their economic and credit analysis to the FED...
- FED gave BAC its "seal-of-approval." The "seal-of-approval" should be interpreted to mean that the FED truly believes that the US economy is entering a sustainable economic expansion...ITS TRULY PUTTING ITS MONEY WHERE ITS MOUTH IS...
- Credit upgrades of bank subordinate debt is likely to enable high yield investors the ability to buy more of the debt and stay within credit risk limits.

Bank of America's (BAC) announcement that they would completely repay the government's TARP investment was probably greeted with high fives and smiles across the company's entire platform. *Good for them!* BAC...remember them....they were one of those companies that the bear market celebrities identified as destined to be nationalized or fail by May 2009 and then be completely broken up amidst a bombed out US economy. BAC was "to-big-to-be-saved" by the US Government support and policy initiatives rather than "to-big-to-fail" in many circumstances. The bear market celebrities sold tickets to conferences that preached about how nationalization or failure was "unavoidable" and that it would lead to widespread credit losses to investors that owned securities in even the highest portions of their capital structure. *(Is the opposite happening now...are investors listening to analysts preaching about the inevitability of a solid economic recovery? Do not think we are at that point yet...)*

Another couple of industries that the bear market celebrities have continued to lambast are the bond insurer and the mortgage insurer industries. These industries were some of the first industries to suffer when the original sub-prime credit crisis began. They are also likely to remain under pressure for the foreseeable future *(especially with the high unemployment levels)* but they do not appear to be heading

toward an immediate extinction. Remember how some analysts had even published the date when regulators would take over Ambac and “trigger a default event ” even though the process would have obviously destroy claims paying ability rather than protect claims paying ability. *(A little hysteria within a recovering market always provides trading opportunities.)* Although this fear has materially driven down the equity price of these companies...the basic investment idea was to bet that state insurance regulators would make stupid decisions.

The steadying of job losses and the return of economic growth makes it less likely that state regulators, in our opinion, will make this type of decision. *(Can you also imagine the lawsuits if ABK was to file...investors would claim fraud....and all CDO commutations and insurance payments over the past five years might be considered to be a false conveyances. That would make the Madoff unwind look like a plain vanilla hedge fund shut down after a bad year.)*

From a credit perspective, S&P upgraded ABK counterparty rating on Tuesday to CC from SD. In laymen’s terms they were upgraded from “just about dead” to “critical condition.” Depending on how individual banks evaluate their credit risk, the upgrade could allow banks and insurance companies to increase the “value” of their ABK insured wrapped transactions. The upgrade also indicates that at least one rating agency believes that the ABK’s insurance portfolio is likely to remain in a sustainable period of run-off...a clear positive for market stability. The improving economy might also enable the rating agencies to further upgrade ABK in late 2010, although we do find it highly improbable that ABK will recover its investment grade rating in the next 3-5 years without a merger or large capital injection. The lack of an investment grade rating makes it unlikely that banks and insurance companies will be able to completely reverse related impairment charges.

## **POSITIVE CREDIT MARKET MOMENTUM...NOT A CREDIT POSITIVE FOR BAC**

The announcement that BAC is going to repay their TARP investment should provide the entire financial sector with some much needed positive equity market momentum. This momentum may actually provide incentive for investors to re-engage with the toxic asset trade that provided solid gains in August and September.

Investors should also take heart in the “seal-of-approval” the US Government is providing BAC. The “seal-of-approval” should be interpreted to mean that the FED truly believes that the US economy is entering a sustainable economic expansion...its putting its...

**To receive the remainder of the report including our investment conclusions, please call Brian McClive at 480.563.2054 or email Brian at [bmclive@mshowells.com](mailto:bmclive@mshowells.com)**

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