



The Last Years vs. The Next 25 Years

Capital Markets and Interest Rates

Key West, Florida
October 22nd, 2009

Dr. Jim Budzynski, Managing Partner
MacroGain Partners
www.macrogain.com

July 17, 2007: The Day the World Changed

THE WALL STREET JOURNAL

WSJ.com

LEADER (U.S.) | AUGUST 6, 2007
LOSING HAND

How Bear Stearns Mess Cost Executive His Job

CEO Faults Spector For Mortgage Fiasco; Bonding Over Bridge

By KATE KELLY and SUSANNE CRAIG

On Wednesday James Cayne, the 73-year-old chief executive of Bear Stearns Cos., summoned him to his smoky, dimly lit office in midtown Manhattan.

The big securities firm Mr. Cayne had led as CEO for 14 years was under attack. Two of its hedge funds had blown up, costing investors more than \$1 billion, and its stock was under siege year alone. The way Mr. Cayne saw it, Warren Spector, Bear Stearns's co-president and the one cited as his likely successor, deserved some of the blame.



Warren J. Spector

He told Mr. Spector he had lost confidence in him. "I think it's in the firm for you to resign," Mr. Cayne told Mr. Spector, people from the conversation say.

Mr. Spector was taken aback, and responded that he'd been worried about the firm's problems, according to one of these people.

That conversation ended the close partnership between the two men, a connection forged years earlier by a common love of bridge, but it had become strained. Mr. Spector, a 49-year-old former mortgage banker, had become Wall Street's highest-profile casualty in the burgeoning mortgage market -- lending to risky borrowers -- has become a big problem

The trouble at Bear Stearns has spooked investors. Bear Stearns has long been known as one of the best risk managers on Wall Street. Its problems come despite repeated assurances from Wall Street that it has a handle on the booming market for mortgage securities. Bear Stearns, which has a huge market but a less diverse mix of other business than its investment-banking peers, has been the hardest hit. Its stock has fallen 28% since the beginning of June, and 6% on Friday alone. A Friday afternoon conference call intended to quell investors' fears about Bear Stearns's profitability attracted 2,200 listeners.

- **Bear Stearn's \$642 Million HGSCSELF Is Declared Worthless in a Letter to Investors**
- **The Fund Name Says It All – “ High Grade Structured Credit Strategies Enhanced Leverage Fund”**
- **Fund Meltdown Is First Step in Failure of the Firm Itself Months Later**
- **In Hindsight, the World Has Changed Forever as a 25 Year Trend Comes to a Close**

Last 25 Years vs. Next 25 Years

Last 25 Years

- Reagan Revolution
 - Lower Taxes
 - Deregulation
 - “Whipping Inflation” in the 1970s
- 25 Year Bull Market in Stocks and Bonds
- Global Finance Bubble



Next 25 Years

- ??????



“the other side of a bubble is flat”

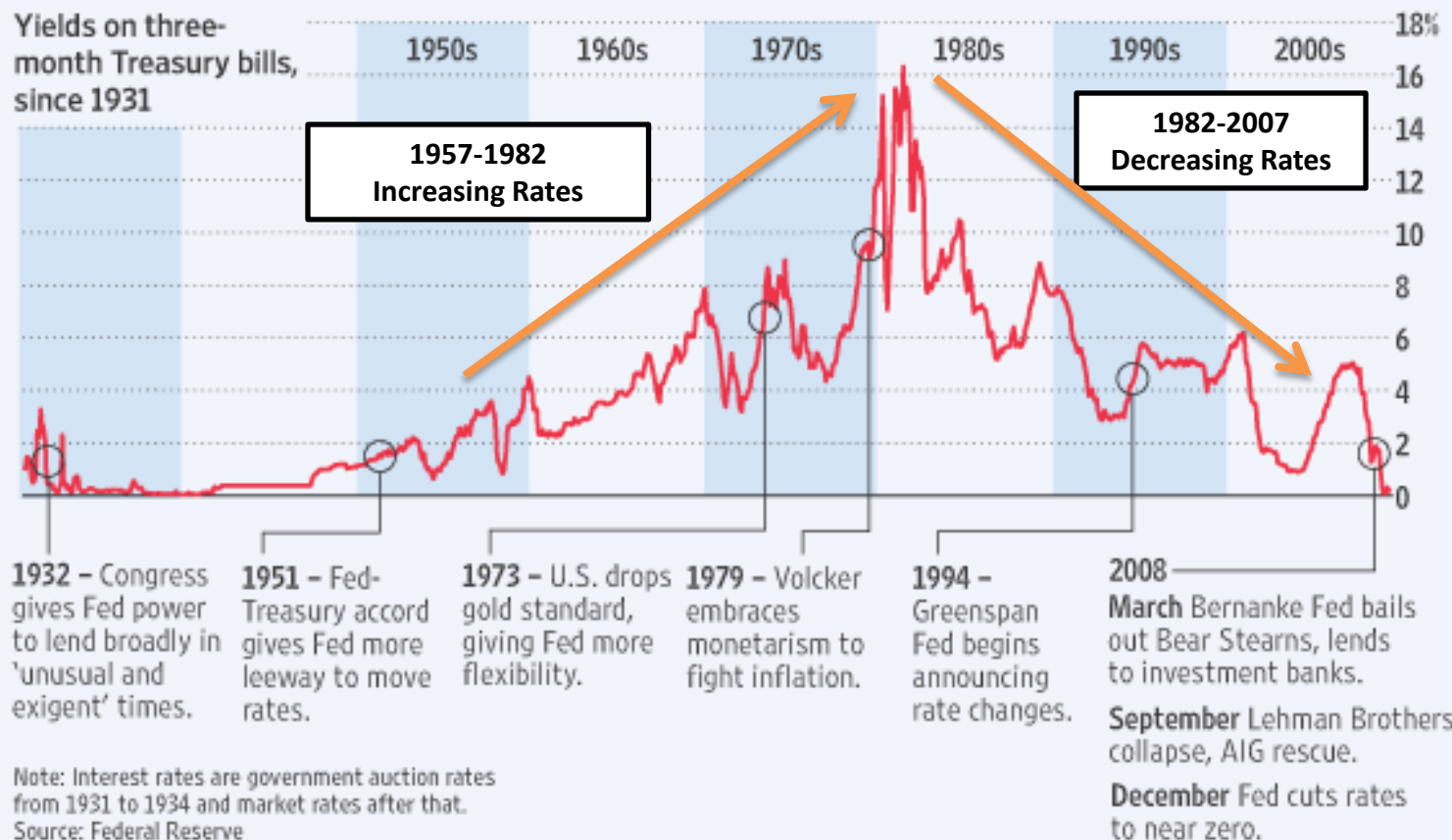
What Drives Stock Markets?

- Direct Drivers (Fundamentals)
 - Innovative Technologies (Productivity)
 - Global Growth, Demographics and Demand
 - True Corporate Earnings
- Indirect Drivers
 - Direct Government Support
 - Credit Availability/Liquidity/Leverage
 - Currencies
 - Balance Sheet Manipulation
- Behavioral Drivers
 - Risk Appetite/Animal Spirits
 - Business and Investor Sentiment

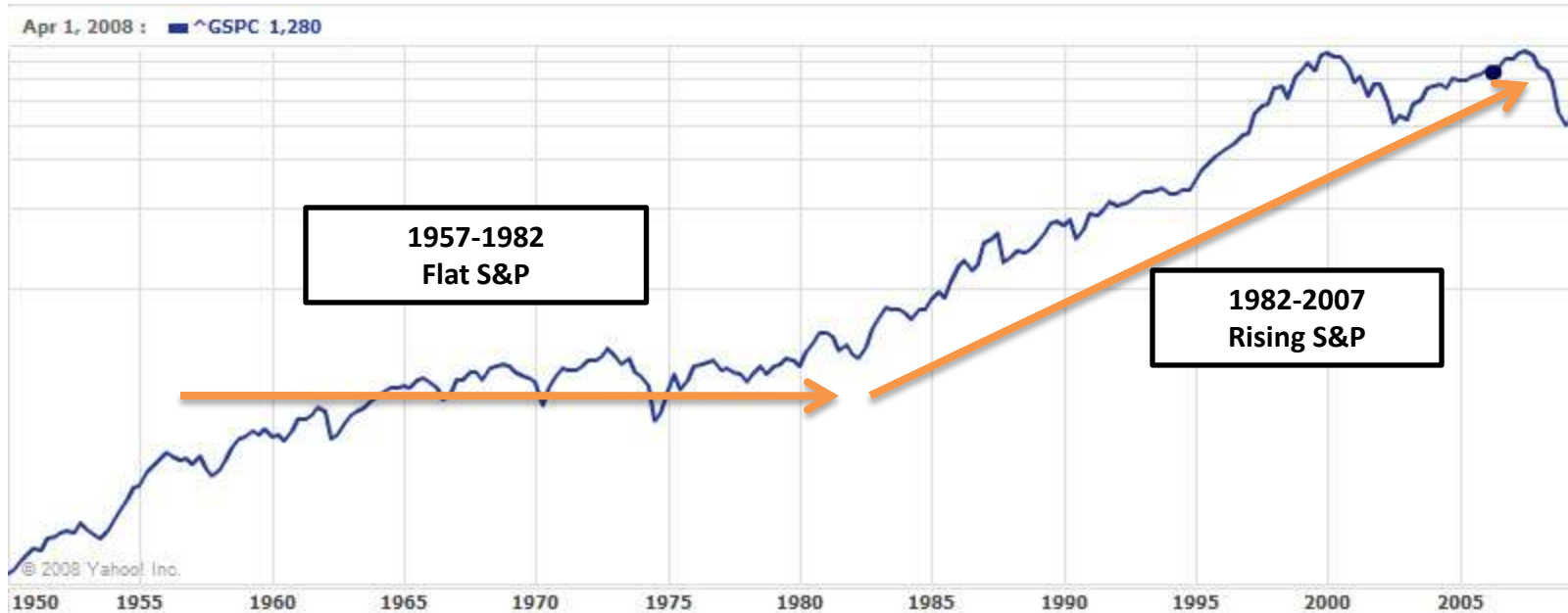
**Our 25-Year Bull
Market in the U.S.
Has Been Long on
Indirect and
Behavioral Fuel
and Short on
Fundamentals**

U.S. Interest Rates Over 50 Years

Turning Points | The Federal Reserve is heading for tumultuous changes



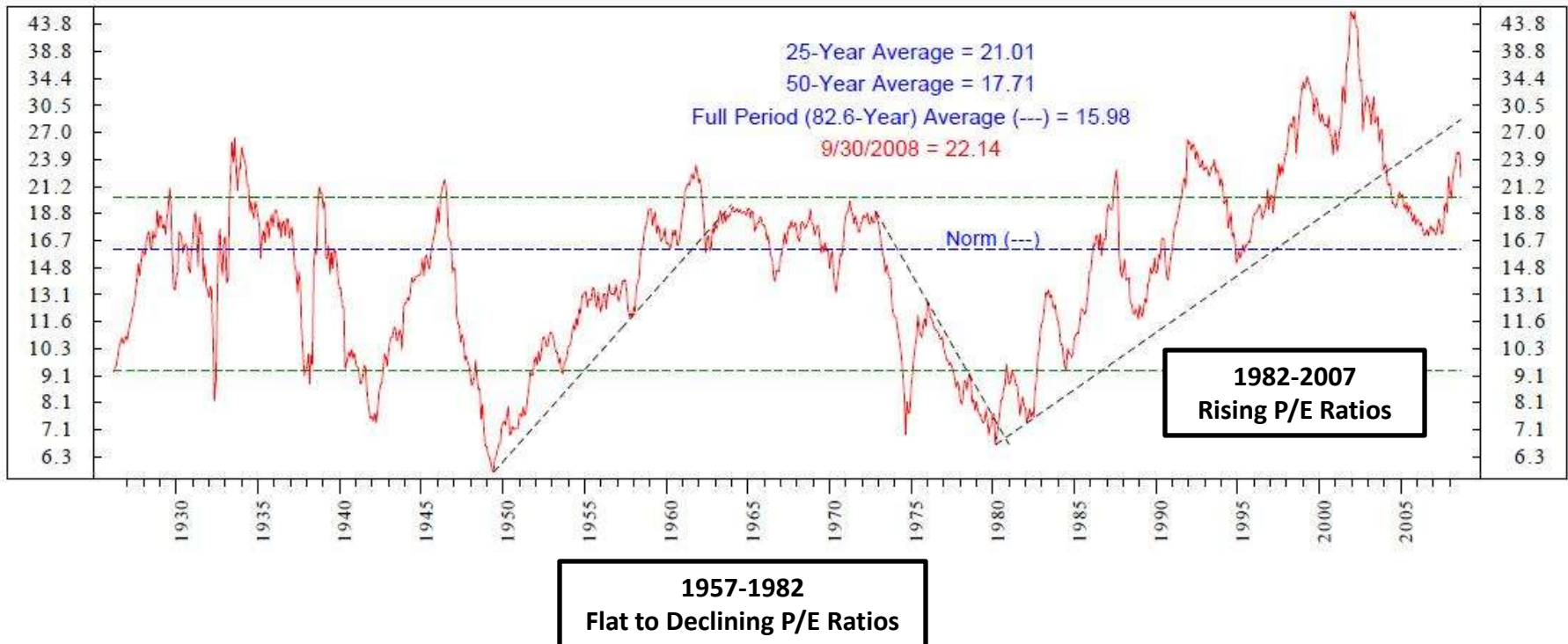
S&P 500 Performance Since 1950



***Declining Interest Rates Drive Markets Higher –
Why?***

Stock Market P/E Ratio Since 1930

S&P 500 P/E



Value of Cash Flows from a Business Becomes More Valuable If the Alternative to Investing in the Business (T-Bills) pays Less

Today's PE in the Stratosphere



Today's Stock Market Prices Assume That Earnings Explode and Real Interest Rates Remain Negative

Summary

- 1982-2007: 25 Year Period of Declining Interest Rates
 - Now Coming to and End
- Equity Multiples Have Grown for Most of the Past 25 Years
 - But Were Flat to Down the Prior 25 Years
- The Piper May Well Be Paid Soon
 - Multiple Contraction for Many Years