



What's New?

Feddern Financial Consulting Group Newsletter

October 14, 2009

KEYS TO THE BEGINNING OF A RECOVERY:

- 1. The Real Estate market must stabilize. If not reversing, at least not continuing to fall. *NEW HOUSING STARTS UP this past Spring and Summer because of seasonal factors but inventory still huge! The Nationwide COMMERCIAL COLLAPSE IS JUST BEGINNING!***
- 2. Unemployment must stabilize. If not reversing, at least not continuing to rise. Last report was lower! *IT'S ACTUALLY WORSE as a "%," Back to near 10% - BUT IT CONTINUES TO MOUNT @ OVER 300,000+ weekly.***
- 3. Corporate Earnings (profits) must stabilize. If not reversing, at least not continuing to fall. *A FEW POSITIVE SIGNS but mainly in TECHNOLOGY.***
- 4. Banks must begin to make loans again (especially to small businesses and potential home owners...albeit under ancient premises of buyers being qualified and of all things, a down-payment! *Lots of "hoopla" from the mega banks, but it appears that there's no real progress. They're "hoarding" any cash they can get their hands on. And now here comes the Regional problems compounded by PRIME loan and Alt-A resets!***
- 5. The DOLLAR has to decline. *It's started for REAL!***
- 6. Auto sales must stabilize at some NEW level. *Maybe started!***
- 7. The consumer must get "back in the game of consumin'" *NO WAY!***

ANALYSIS OF THE ABOVE: No Real Hope YET! -10/14/2009

Is the US on SALE?

When more than \$14 billion in merger-and-acquisition deals were announced in a single day two weeks ago, U.S. stock prices zoomed as investors embraced a suddenly more-bullish outlook.

As the following Monday demonstrated, any increase in deal-making activity tends to move markets higher: With the chance of windfall profits from a surprise buyout, investors tend to bid up shares of companies that might be buyout

candidates. It was the explosion of M&A deals two years ago that helped propel the Dow Jones Industrial Average to its Oct. 12, 2007 record high of 14,093.08.

The recent flurry of deals was just the beginning: It's the opening scene of a three-act financial drama that will take years to play out in our opinion. For U.S. investors, however, the Second Act is the key: It's where deep-pocketed foreign suitors step in and start snapping up marquee U.S. companies, prime real estate and household brand names. (Remember in the 1980s and early 1990s when Japan was accused of buying up huge amounts of real estate in Hawaii and California AND in New York City...like Rockefeller Center.) It's where some attentive investors believe that they can recoup some of the losses they've incurred in recent years just by being in the "right place at the right time."

And it's where America goes on sale.

Paying the Tab. Make no mistake. This had to happen. With U.S. budget deficits on the upswing, the dollar poised for a protracted tailspin into the abyss, and overseas investors searching for ways to diversify away from increasingly risky U.S. financial assets, don't be at all surprised when foreign investors accelerate their purchases of U.S. assets.

The U.S. government has committed itself to more than \$11.6 trillion in new programs, many of which will lead to increased – and choking – levels of U.S. debt.

The federal budget deficit for 2009 will reach a record \$1.6 trillion, more than three times 2008's record deficit of \$455 billion, the White House Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) said recently.

It will certainly get worse. From 2010 to 2019, the CBO says the deficit will balloon to \$7.14 trillion, while the White House projects a shortfall of \$9 trillion picture for the same period.

The U.S. economy can cover that shortfall in one of two ways: By issuing debt or by selling assets. Those "assets" will include U.S. companies. And the willing suitors will include China, Singapore, Japan and Russia:

Four to Watch

•**China:** With \$2.3 trillion in reserves and some of the top government-controlled investment funds on earth, China will obviously be a major suitor of U.S. companies and real estate. The country wants to diversify away from such

dollar-denominated financial assets as U.S. Treasury bonds. As the U.S. dollar continues to skid, those financial assets will erode in value. Shifting into non-financial assets is one solution. And it's already happening. Government-controlled "sovereign wealth funds" (SWFs) will be major buyers. China Investment Corp., the Red Dragon's \$200 billion sovereign fund, plans to apportion \$2 billion across three buyout funds – including one managed by (wouldn't you know) Goldman Sachs Group Inc. (NYSE: GS) and another that's operated by Oaktree Capital Management LP. All three of the CIC funds specialize in distressed-asset investing in such areas as U.S. real estate and infrastructure.

•Japan: This Asian giant is taking \$100 billion from its underperforming \$1.5 trillion national pension fund to create a government-controlled investment fund (sovereign wealth fund). Thirty percent will be devoted to emerging-market investment plays. But the rest will be deployed into such long-term investments as natural resources, energy and food production. And that's not all: Japanese investment bank, Nomura Securities (NYSE ADR: NMR) this week announced that it would be doubling its U.S. staff – no doubt in part to reap a windfall in fees by advising suitors and targets as the buyout frenzy escalates.

•Singapore: The country's sovereign wealth fund (SWF) – the Government of Singapore Investment Corp. (GIC) – shrewdly timed its stock market moves, exiting many of its positions before the global financial crisis reached its apex. It's restored many of those positions, and now will be looking to deploy some of its remaining cash in bargain-basement stocks.

•Russia: Russia has its own sovereign wealth fund, but one of its private investors is making a splash in the U.S. market. Russia's richest man, Mikhail Prokhorov, is buying 80% of the National Basketball Association New Jersey Nets and a 45% stake in the team's new arena. Prokhorov will be the first non-North American to control a major U.S. sports franchise (in a separate move that further underscores our premise, a Chinese investor is buying a minority stake in the Cleveland Cavaliers, the basketball team that features NBA superstar LeBron James).

Not the 1980s Buyout Frenzy

It seems to us that this surge in U.S. takeovers will involve a slew of overseas players, it's no surprise that China will be the dominant player. We've written about China on many occasions in these Newsletters. You may access ALL of them on our website: www.fedderngroup.com But don't expect a repeat of what happened with Japan in the U.S. market back during the 1980s. Japan's success as an exporter – coupled with a strong tariff policy that protected its home market from imports – pumped up the yen and led to a massive buildup of cash in both Japan's corporate coffers and among its consumers. That spawned an era of

easy credit, and that fueled a frenzy of stock-and-real estate speculation unrivaled since the U.S. Great Depression.

According to William Patalon III, Executive Editor of Money Morning, *“Almost overnight, Americans found themselves talking about the invincible “Japanese superman,” an unstoppable juggernaut who never made mistakes. The newly wealthy Japanese were viewed with fear. Japanese cars filled American roadways and parking lots (even at the “Big Three” automakers, General Motors Corp., Ford Motor Co. (NYSE: F) and Chrysler Group LLC). Japanese cars filled American roadways, and Japanese-owned companies treated the U.S. market like it was a private rummage sale. Suddenly, Universal studios, Columbia Records, Rockefeller Center and the Pebble Beach golf course (with its lonely cypress tree) all had new – overseas – owners.*

Fortune magazine carried a piece entitled, “Where Will Japan Strike Next?” U.S. lawmakers sounded the alarm. And so did the late author, Michael Crichton, whose alarmist book, “Rising Sun,” was made into an equally alarmist – but no less fun to watch – feature film that starred Sean Connery and Wesley Snipes.

At the height of the hullabaloo, Japan boosters regularly claimed that the land beneath the Imperial Palace in Tokyo dwarfed the value of the entire state of California – an argument that could be substantiated mathematically with actual market values. After all, in 1989 back in Japan’s Ginza district, prime office space was going for \$139,000 a square foot.

A reversal was inevitable. On Dec. 29, 1989, the Nikkei 225 Index topped out at 38,957.44, before closing at 38,915.87. By the following September, it had nearly been halved – and there was still much more bloodletting to go (despite several subsequent rallies up over the 20,000 threshold, the Nikkei ultimately bottomed at 7,830 in April 2003. [Editor’s Note: The global financial crisis sent the Nikkei to new lows: The benchmark Japan index bottomed at 7,173.10 in early March of this year.]”

The fallout from that early 1990s meltdown basically undid every advance that Japan had made. By early 2004, houses in top Japanese cities were selling at one-tenth their peak value, and commercial real estate was selling for less than 1/100th of its peak-market value. Although one could easily argue that the peak values weren’t real to start with, all told, an estimated \$20 trillion in stock market and real-estate wealth had been vaporized.

U.S. investors ended up buying back all the marquee properties that Japan had taken over.

When it comes to the Asia market, no one is closer or knows it better than Money Morning Investment Director Keith Fitz-Gerald, who lives part of each year in Japan and who just returned from one of his investment-research forays to

Mainland China. And Fitz-Gerald notes that *“risk-diversification is only one catalyst for China’s increased interest in the U.S. market. The companies China is looking at say a lot about its overall strategy. Indeed, China is looking at companies in four situations:*

•Brand Barons: *During his recent visit to China, insiders told Fitz-Gerald that China’s leading players are quietly reviewing the world’s Top 100 brands, looking to see which ones might be for sale – and more importantly, which of those brands would provide a new owner with intimate insights on managing and marketing a global brand.*

•Connection Kings: *Several years ago, China plunked down \$3 billion for a stake in The Blackstone Group LP (NYSE: BX), the U.S. private-equity powerhouse, after which the China Development Bank anted up \$3.03 billion for a piece of Barclays PLC (NYSE ADR: BCS), the old-line, European banking legend. Many so-called “experts” say that China overpaid. That’s irrelevant, Money Morning’s Fitz-Gerald says. With these moves, China acquired unprecedented access to the global financial markets, some of the best investment-banking expertise in the world, and lined up a steady flow of opportunities for its \$2.3 trillion in foreign reserves, says Fitz-Gerald, who also is the editor of The New China Trader global investing service.*

•Weakened Rivals: *China is scouring the globe for companies that are market stalwarts, despite having fallen on tough times. These companies may well qualify as the “distressed assets” that the Goldman- managed fund will ferret out. But their marriage with their China-based counterparts will create a much-stronger whole.*

•Enabling Industries: *China is focusing on the development of infrastructure, energy, communications, transportation and water. Investors would do well to look for buyout candidates in these sectors. As these buyouts accelerate, they could ignite controversies akin to those spawned by the wave of Japanese takeovers in the late 1980s and early 1990s. The shrewdest investors will avoid this trap, focusing instead on the windfall profits they can make – as well as the benefits these suitors could create in an economy that continues to struggle.”*

Fitz-Gerald also advised investors to consider the long-term implications – and the reality that, over time, everything reverses. The Second Act of this takeover drama may be where China, Japan, Singapore and others buy up U.S. assets. But this drama is a long-term performance. And in Act Three, those properties may well come back into U.S. hands.

For instance, despite all the controversy that Japan caused with its wave of takeovers of marquee properties, it no longer owns any of those. It eventually

sold each of them back to U.S. investors; and at substantial discounts from their purchase price.

It's only after that occurs – no matter how many decades it takes – will the curtain finally come down, and the final story written, on this exciting and potentially profitable global investing drama.

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All of our past Newsletters are available on our Website at:

www.fedderngroup.com

We continue to receive more and more inquiries about our Down-side Risk Management disciplines along with our group of recommended money managers. We appreciate your “referrals.” It’s the main way we continue to build our business.

*Call us anytime: 502-442-0363 **502.442-0363 Direct 800/258-1502 Toll Free 502/442-0365 Fax 502/552-2049 Cell***

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