

**Stan Barker**

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**From:** John W Hamilton [jwh@hamiltonadvisors.com]  
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NEW COMMENTARY - 04/13/08

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April 10, 2008

### HUMPTY DUMPTY SAT ON A WALL

These are some of the most interesting times we can recall in the financial markets during our combined 111 years of experience.

We are witnessing history in the making. We are watching changes that not only are affecting the global financial markets but many that will influence our lives and those of our children from this time forward.

The lead article on the April 9<sup>th</sup> *Financial Times* was titled "Subprime crisis to cost nearly \$1,000bn." To us Yanks, \$1,000bn means One Trillion dollars, and that is a real pile of dinero.

This calculation was made by the IMF (International Monetary Fund), and the paper's first paragraph read:

"The financial sector faces potential losses of nearly \$1,000bn as a result of the credit crisis, the International Monetary Fund said yesterday, warning of further losses and writedowns on prime mortgages, commercial real estate, leveraged loans and consumer finance."

"The estimate came as minutes revealed that the staff of the Federal Reserve and 'many' of its policymakers believe the US economy will contract in the first half of this year – a commonly used definition of recession.

"The deterioration in credit has moved up and across the credit spectrum," Jaime Caruana, head of monetary affairs and capital markets at the Fund (IMF) said.

"The estimate is set out in a gloomy Global Financial Stability Report, which challenges the more optimistic tone in the markets since the rescue of Bear Stearns by the Federal Reserve and JPMorgan

Chase. The report says ‘systemic risks have risen sharply’ since October.”

What is important to note is that now, more than ever, we are immersed in Global Financial and Economic markets. Positive events and negative events are instantaneously reflected around the world. If our economy falters, Europe will not be far behind nor will be the rest of the world’s major economies and financial markets.

That is why when U. S. job losses – non-farm payrolls – dropped 80,000 in March the Federal Reserve was urged to reduce interest rates again. The cost of lowering rates even further, however, is that while the economy and employment may be stimulated, the rate of inflation may also be stimulated leading to further weakness in the dollar. If there is a free lunch, we are unable to find it.

Last month when the Federal Reserve stopped the run on Bear Stearns (BSC), it took measures – many highly controversial - that it had never taken before. The Fed took action to prevent what very well could have been a truly catastrophic series of events.

We have heard from knowledgeable sources that BSC’s cash declined from \$12 Billion to \$1 Billion in one day, and J P Morgan Chase’ (JPM) first offer was to pay Bear Stearns’ stockholders \$2.00 per share. Bear Stearns’ stock traded at \$172.61 on January 18, 2007, approximately fourteen months ago. Within days after the \$2 per share offer JPM upped the ante to \$10 per Bear Stearns share.

Initially the Fed guaranteed J P Morgan Chase \$30 Billion to stop the run on Bear Stearns. Later, as we learned that J P Morgan Chase intended to acquire Bear Stearns, the terms were changed to have JPM absorb the first billion dollars of losses, if any (over a 10-year time span), with the Fed guaranteeing Morgan against a total of \$29 billion of losses to be paid for with taxpayers’ money instead of the original \$30 billion of taxpayers’ money.

What is even more significant, in our estimation, is our belief that J P Morgan Chase was the only U. S. bank strong enough to take on this assignment. We are enclosing an April 2, 2008 list compiled by Bloomberg of losses/write-downs in the Billions of dollars taken by 15 of the largest commercial and investment banks from the beginning of 2007. The total is \$170 Billion – not Million. This list does not begin to tell the story.

How does all this affect us? In the first three months of 2008 the Dow Jones Industrials lost 1001.93 which is said to be its largest first-quarter decline in the history of the index and that the S&P’s 500 index’ five-month losing streak was the longest since October 1990.

We repeat our comments of last month:

“We are witnessing a meltdown in financial markets coupled with an economic recession and simultaneous inflation (prices of commodities soaring) where every day brings new challenges; and while we may not like it, the job is to deal with it and to make the best of it. Given time and patience, opportunities will arise, and we plan to be in a position to take advantage of them when the time is right.

*“Yes, my friends, there’s Trouble right here in River City, and Mr. Market doesn’t like it.”*

The above comments are about just a few of the events that resulted in the first quarter of 2008 being one of the worst in many years, and the question is whether we have bottomed and can move up from here. Experts make plausible arguments on each side, but the economy will be the final determinant.

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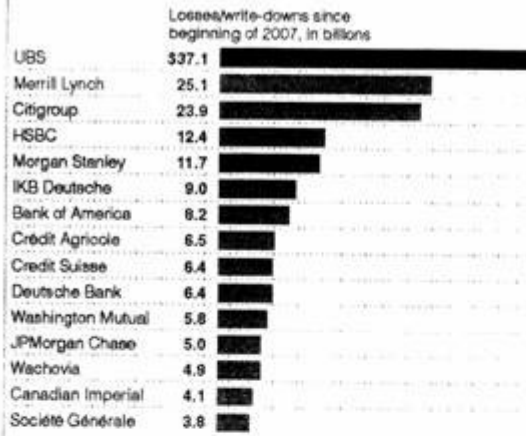
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April 2, 2008

### Stung by Subprime

Many of the world's largest banks have suffered billions in losses in recent months because of their exposure to subprime loans in the United States.



Source: Bloomberg

THE NEW YORK TIMES