

**Breaking Commentary: Fear and Loathing on Wall Street**

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There's no rest for the weary these days, certainly those of us charged with keeping interested parties up to speed on the financial breaking news. Today was a day for the record books, with the Dow closing down 777 points—the largest point decline on record and the biggest percentage drop since September 17, 2001 (the first day of trading after 911). A few short hours after we posted the initial version of my Monthly Strategy Report (MSR), titled “Sympathy for the Devil” the Economic Stabilization Act of 2008 went to the House floor for a vote, but did not pass.

**It is a Main Street problem, too**

Today reflects the decimation of confidence within the financial system and Main Street may be learning the hard way that this is a crisis that spans across every street, not just Wall Street. There were heads of small companies today making it publicly known they would not be able to make payroll without credit market relief, not to mention getting access to credit for capital spending and consumer loans. Banks and brokers have halted lending, even in the short-term, as they struggle to restore their capital after \$586 billion in credit losses and writedowns to date. The bankruptcy of Lehman Brothers added to fears among banks they wouldn't be repaid by counterparties, driving up the cost of short-term loans between banks.

Treasury Secretary Henry Paulson expressed his animated disappointment in the decision by the House, but vowed to “work with fellow regulators and use all the tools at our disposal, as we have over the last several months, to protect our financial markets and our economy.”

**The vote**

The House voted 228 to 205 against the bill (the details of which are detailed in my MSR). Democrats voted 140 to 95 in favor, while only 65 Republicans backed the bill with 133 opposing it. Even before today, Paulson had warned it would be a “grave mistake” for Congress to curtail or delay the legislation. On Saturday, he was quoted as responding to New York Senator Charles Schumer with: “I'm doing this for you as much as for me. If we don't do this, it's coming down on all our heads.” His warnings proved true today.

Rates in the \$7 trillion-per-day market for borrowing and lending securities to fund day-to-day business and consumer operations show that the logjam in credit markets is back to the level seen after the March collapse of Bear Stearns.

It is, of course, election season and many lawmakers up for re-election were swayed by overwhelming opposition from constituents in their home districts, who swamped the Capitol switchboard with phone calls urging Members to vote against the bill. Leaders of

both parties kept the 15-minute vote open for nearly 40 minutes in a desperate attempt to convince enough members to switch their “no” votes.

### **What’s next?**

In the immediate aftermath of today’s vote, both parties pointed fingers at the other in an attempt to assess blame. Leaders of both parties huddled this afternoon to determine what next steps should be taken. At this time, the path forward is not clear. House Financial Services Committee Chairman Barney Frank, one of the key architects of the plan, said this afternoon only that he would be assessing “the economic reaction” to the House vote before taking further steps.

House Speaker Nancy Pelosi said after the vote that she and other Democrat leaders stand ready “to take another bite at the apple” and try to come to a final solution. The House adjourned this afternoon so lawmakers could return home for the Jewish holiday of Rosh Hashanah, which begins at sundown. The Senate, too, will not be in session tomorrow. Members of the House were not planning to return to Washington until after the November election; it now appears that an attempt to revive the financial rescue package will be undertaken and Members are expecting to be summoned back to Washington later this week. We do expect that leaders in Congress will try to come up with a way to find the necessary dozen votes to pass the package, and will return to session on Wednesday or Thursday. The Senate may try to make slight modifications to the proposal and begin action in that chamber, where support appears to be stronger.

### **Fed pumping again**

But the failed vote wasn’t the only news of the day. Among other actions, the Federal Reserve announced it would pump an additional \$630 billion into the global financial system, flooding banks with cash to alleviate the worst banking crisis since the Great Depression. The Fed increased its existing currency swaps with foreign central banks by \$330 billion to \$620 billion to make more dollars available worldwide. The Term Auction Facility (TAF), the Fed’s emergency loan program, will expand by \$300 billion to \$450 billion. The European Central Bank, the Bank of England and the Bank of Japan are among the participating authorities.

Back in the United States, the Federal Deposit Insurance Corporation (FDIC) helped Citigroup buy the banking operations of Wachovia after the latter’s shares collapsed.

As we now know, and as was reflected in the market’s weakness prior to the House vote, the credit crisis is reverberating through the global economy, forcing European governments to rescue four banks over the past two days. The MSCI World Index of stocks in 23 developed markets sank 6%, the worst single-day performance since its creation in 1970. Now, we await the opening of the Asian markets overnight, and it’s not going to be pretty.

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