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Following is a series of our thoughts on the continued turmoil in financial markets. Some were generated in response to inquiries, some mere observations of our own.

Is this 1929 revisited? Two big differences. First, the period preceding the Great Depression was marked by extreme speculative growth in stocks – the Dow Jones Industrial Average had expanded from around 60 in 1921 to roughly 400 in 1929, a rise of more than 500%! Obviously stocks have not performed like that over the past eight years, so there is much less speculation to come out, and prices are reasonable compared to earnings. Second, more important, the government then was raising rates to support the dollar. In sharp contrast, the Federal Reserve today is lowering rates and adding significant liquidity via other mechanisms, such as the newly recreated TARP program which goes active next week. Banks need to start lending again!

Warren Buffett said he's buying – shouldn't we buy, too? We agree with Buffett's opinion that over the next five, ten or *twenty* years – the investment horizons he mentioned in his recently penned NY Times article – stocks should perform well compared to alternatives. But what of the next five months? The next five *days*? Stocks appear cheap, but that doesn't mean they can't get cheaper. Volatility is extreme, and stocks that seem inexpensive are moving in 10% to 20% increments, sometimes intraday. We have seen stocks that trade at *a discount to the cash on their books* drop double-digit percentages. Market bottoms tend to form over an extended period of time, not in a single day or few weeks, and we think the long-term opportunities will persist for some time.

Alright then, why are things so volatile? The most probable cause of ongoing market volatility is continued forced-selling by hedge funds. Fresh rumors of hedge fund liquidations appear weekly, if not daily. There is even a web site that tracks hedge fund “implosions.” So the tail is wagging the dog, and the seemingly endless selling pressure from liquidating hedge funds remains a significant headwind to market stabilization.

Here's a conspiracy theory: the hedge fund implosion is a part of the Treasury's plan. Just a week ago we learned of an email message from ex-Lehman Brothers boss Dick Fuld, following a meeting with Treasury Secretary Henry Paulson, in which he stated “they (the Treasury) want to kill the bad hedge funds and heavily regulate the rest.” And why not? 30-to-1 leverage in an unregulated market should have never been allowed. In the early 1980s, ex-Fed Chairman Paul Volcker choked off inflation by aggressively raising rates; painful medicine at the time, but better for the long run. Today, Paulson seems to be trying to choke off excessive leverage by destroying the hedge funds. Painful medicine today, better for the long run.

The credit default swap (“CDS”) market remains problematic. Settlements are coming in lower than expected, which means the companies that sold CDS insurance are on the hook for bigger payouts. For example, in the Washington Mutual case, CDS sellers must dole out more than 40 cents on the dollar. Reportedly there was \$80 to \$90 billion in CDS written on WaMu. Who sold CDS arrangements? Insurance companies, investment banks, some mutual funds, hedge funds ... and lots of the same investor groups in Europe.

Europe is a problem. Rates are much too high in Europe and need to come down aggressively. Henry Kissinger once asked, “Who do I call if I want to call Europe?” We don't know, Henry. Given the emerging every-country-for-itself attitude, we're not sure they do either.

The “bailout,” aka the “Paulson Plan,” aka the \$700 billion - \$850 billion - \$1.3 trillion rescue plan, begins next week. That's right, it hasn't even left the ground yet. But soon!

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