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EQUITIES PERSPECTIVE

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DJIA: 12,040

FedEx and UPS . . . a play on Housing? According to Fed Chairman Bernanke, homeowners are about to start mailing in their keys. Indeed, the situation is so dire he actually urged mortgage lenders to reduce principal on loans for the many whose homes are no longer worth as much as the amount they still owe. The Fed chairman warned that the number of homeowners under water, so to speak, is rising, and they may have no incentive to keep making payments. It has been clear for some time that the housing slump has dragged down prices and decimated the subprime market. But now comes foreclosure time, with filings up some 57% in January versus a year ago and actual repossessions up 90%. Many are left with mortgages that exceed the value of their homes, and now they're being hit with resets to low introductory rates. This year about 1.5 million loans – representing more than 40 percent of housing stock of subprime adjustable-rate mortgages – are scheduled to reset, while problems in the credit markets make refinancing all but impossible. Meanwhile, Homebuilders are well off their January lows?

Homebuilders have had a 50% rally from their lows, but like much of the market, and especially the Financials, they're teetering. This week the Financial Index (XLF) took out the mid-February lows and wiped out the potential base/turn there. The intraday January low is still there but, so to speak, we wouldn't bank on it. And you have to look no further than Citigroup (21) at a new low to see the Financials haven't quite yet discounted all the bad news. With that as a backdrop, it's hard to feel too secure in those Homebuilder lows. All the focus is on the problems created by "financial instruments" but in the end, all this paper is collateralized by someone's house. And that house, simply put, isn't worth as much as it used to be, and the downward trend shows signs of accelerating. Home prices in 20 major U.S. cities fell a record 9.1% and that price drop picked up for the seventh straight time. The solution to the mortgage mess, the financial mess, is simple, get home prices to stop going down. Doing that, however, isn't so simple.

To help stem the downtrend in home prices, enter Fannie (22) and Freddie (20). Federal regulators for Fannie Mae and Freddie Mac, the biggest buyers of American home mortgages, will remove limits on the amount of loans and securities the companies can own. The announcement came as Fannie Mae reported a $2.05 billion loss for 2007, and warned that home prices would sink further this year. Already these companies have had to raise capital and cut their dividends, and there is good reason to believe they will become increasingly capital constrained in coming months. Using book value as measured by usual accounting standards, Fannie is leveraged at 20-to-1 and Freddie at 30-to-1. Any massive expansion in loans envisioned as a bailout would hike those ratios, already two and three times greater than those of the 20 largest U.S. banks. Rather than playing savior to a housing market suffering steep home price declines, the charts suggest that like other major players in the mortgage market, they too might be lucky to survive the worst housing bust in decades.

Monday and Tuesday started lower, but managed to stave-off any real collapse. Given that, Wednesday's modest rebound, the first in six days, seemed encouraging. But Thursday's weakness left little to the imagination. The 213 point drop in the Dow paled next to the near 8-to-1 negative breadth. Just as those Financials overstated breadth on the way up, to some degree they're overstating things now. Still, 2800 declining stocks to 360 advancing, that pretty much says it all. Leaders maybe, but against that backdrop it seems unlikely that even the commodity stocks won't fold, at least short term. After all, have you seen Google (430) lately? As someone once said, in markets like this, in markets with divergences at the onset, eventually they get around to pretty much everything. The real damage, however, is where it all started, the Financials. And what seems particularly worrisome despite the weakness and despite the bad news is the lack of panic, at least outside of the Fed.

The rally from the January lows wasn't the best we've ever seen – no dynamic, buying stampede. Still, it wasn't the worst, and saw none of the breadth divergences that typically precede important weakness. But, it is what it is and for this rally, it looks over. Thursday was almost scary in it's weakness, particularly in the Financials. While the washout, intraday lows of January 22 remain as of Thursday, the averages are at new closing lows, having taken out the recent trading ranges. Certainly the market is stretched enough to bounce, but we face the real possibility the weakness could accelerate, resulting in another December-January phase of decline, ending in yet another washout low. Looking at the Volatility Index and volume, that type of low is yet some way away.

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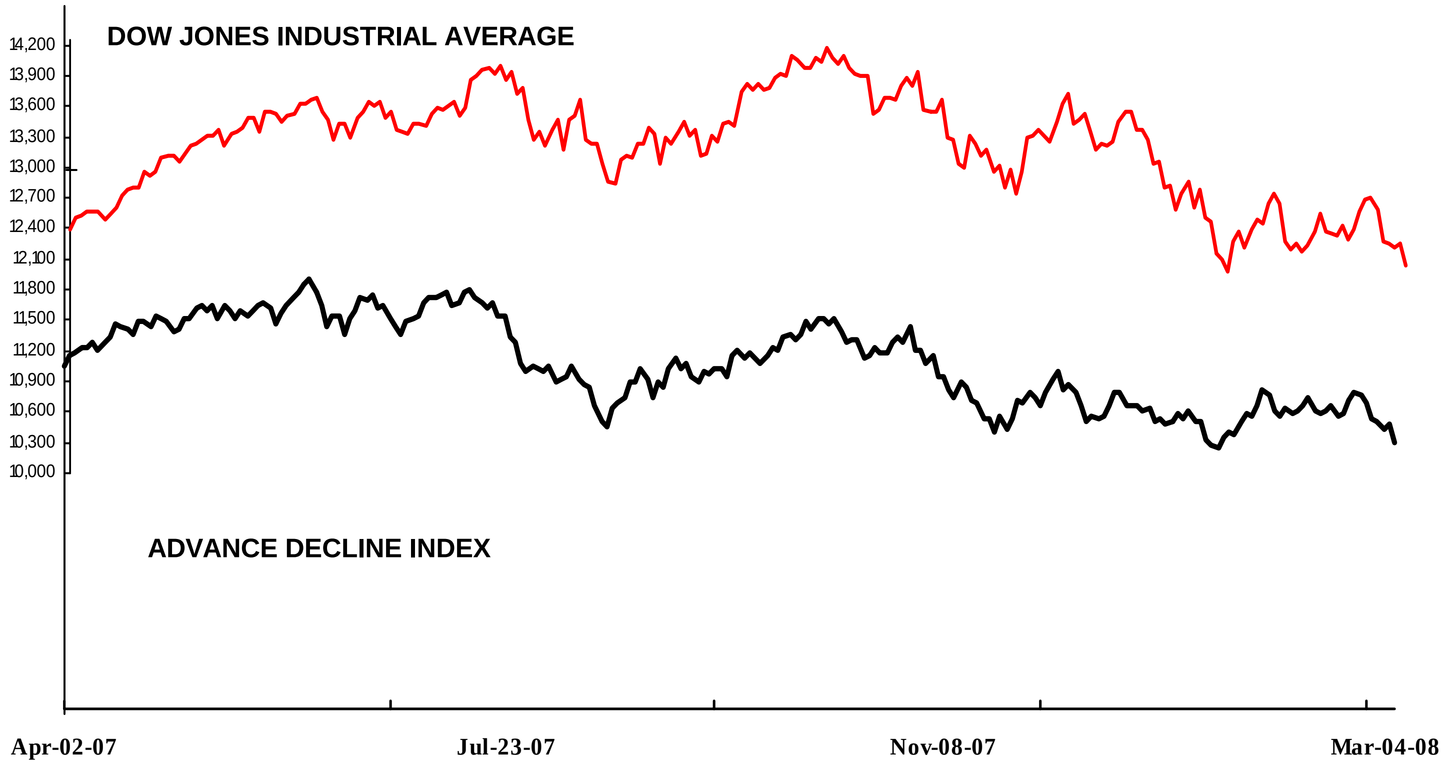
STOCK AVERAGE VS. AVERAGE STOCK



HOMEBUILDERS (XHB - 19) – DAILY

FINANCIAL INDEX (XLF - 24) – DAILY

CITIGROUP (C - 21) - DAILY

FANNIE MAE (FNM - 22) - DAILY

GOOGLE (GOOG - 433) - WEEKLY

VOLATILITY (VIX - 25) - WEEKLY