



**August 15, 2008**

**1:45 PM EDT**

## **Inside this issue**

[Let's Review](#)

[How We Got Into This Mess](#)

[Drivers cut back by 30B miles](#)

[Heritage Capital In The USA Today](#)

[Heritage Capital In The Connecticut Post](#)

[Friends And Family Plan](#)

## **Let's Review**

~~~~~

I have grown accustomed to getting peppered with questions any time the stock market goes into a tailspin. And it's basically the same question or two. "When will we hit bottom?" is the first one. And "how bad do you think it will get?" is the other one.

Rarely, do I hear from folks worried about the stock market peaking during a rally. I guess it's just human nature. When times are good, we tend to let our guards down and expect it to continue forever.

In 2008, during some of the most volatile, gut wrenching markets in history, I received more questions and comments on energy than the stock market. Almost everywhere I go, people want to talk about the price at the pump or how this would never end.

And it's not just the professional market. I hear it on the train, in taxis and during casual hotel conversation on the road. Friends who used to always want to argue about sports, immediately begin chatting about soaring energy

prices.

When I first wrote about this topic in April, I planned on writing one article and moving on. And that turned into two articles, which turned into three. So here we are on part III, which is going to be on the long side. Grab a cup of coffee, sit back and relax.

In [Part I](#), I discussed the fundamental differences between stocks and commodities. They basically act as polar opposites. In [Part II](#), I delved into the reasons behind the dramatic surge in energy prices. That's where I want to start, to reiterate how this mess unfolded.

## How We Got Into This Mess

~~~~~

As I mentioned before with bubbles in the past, the landscape has to be primed. It has to be like a perfect storm of sorts to endure. In late 1998, the price of crude collapsed to only \$11 per barrel. Yes, you read that right. Bottled water was more expensive than oil! During the post 9/11 recession, after a significant rally, crude oil sank to just \$15 per barrel.

So, clearly, something dramatically changed the world in just a few short years.

To begin with, with price so low, consumers rarely gave much thought to their behavioral patterns. They just kept buying those gas guzzling SUVs as commutes to work grew longer and longer. Winter thermostats were kept much higher than needed since it just wasn't that costly to keep toasty.

I vividly recall locking in our heating oil price in early 2002 at 79 cents per gallon for the next 12 months. I only wish that could have been 12 years!

With stocks in a long-term bear market at that time and the economy in recession, Greenspan & Company pushed interest rates down to historically low levels, and kept them there for an abnormally long time. This resulted in a long-term bear market in the US dollar.

Since the energy complex is priced in US dollars, very low rates punish the dollar, thereby pushing up the price of oil and other commodities. Adding to that was the increased energy demand from emerging countries like China and India.

At the same time oil prices began to march higher, our government made a tactical decision to fill the Strategic Petroleum Reserve, which essentially stores enough crude oil in western salt mines to ensure US demand for at least a year. Just think about the enormity of the US government placing buy orders in the crude oil pits for years on end!

Moving on, Wall Street saw the huge potential for commodity related exchange traded funds, ETFs. These would very similarly to the popular SPY and QQQQ, giving non futures related access to almost every investor.

While Wall Street created a massive meal of commodity derivatives for the world to eat, many pension funds decided to increase their allocations to the asset class. Now moving the commodity weighting from 2% to 8% doesn't seem like much, imagine if you are running a \$50 billion fund! And think of all the public and private pension funds who openly expressed their desires to increase commodity exposure!

And with Wall Street and the pension funds diving in head first, they were not playing the same game as other investors. You see, in the commodity markets, there used to be very firm rules on exactly how much of a given commodity you could own. The reason being, so no one entity could corner the world's supply, like the Hunt Brothers tried to do in silver almost 30 years ago.

In today's case, somehow Wall Street and the pension funds were given exemptions from standard positions limits, along with being able to "hide" from various reporting requirements. So while the rules prevented an energy company from acquiring too much of an asset, they allowed the financial folks to do just that!

Can you now understand how we got to where we were in July? It really did take the perfect storm to prime that pump. Along the way, as the final leg higher in energy began, every single Wall Street firm was positive on oil, similar to how they were on technology in late 1999 and housing in 2006.

And when my forecast that the energy bubble would not last was so easily dismissed by a well known expert during a tv [interview on CNBC](#), I had a pretty good feeling that the peak was getting closer in time.

Energy bears were in very short supply and the public appetite for energy stories grew immensely. As I have mentioned before, on June 18, the television show *Black Gold*, which chronicles the lives of oil workers, was launched.

That eerily reminded me of the two shows that began in 2000, one focusing on the soap opera lives of Wall Street investment bankers, and the other on the wild times as a Wall Street trader. If you recall, the timing coincided with the beginning of the worst bear market in 30 years.

And just last year, two shows that I enjoyed very much, *Dirty*, *Sexy Money* and *Big Shots*, both focused on money, greed and extravagance as the economy and bull market were peaking. So, by the time a given theme really reaches Main Street, more often than not, it's about to reverse.

I eagerly await a show based on the foreclosure market to signal the ultimate bottom in housing!

As much as I wanted to finish the series in this issue, it was going to add an

awful lot of content after this. With the rest of the article written, I'll send it out early next week so I don't overwhelm you, or worse, put you to sleep!

## Drivers cut back by 30B miles

~~~~~

By **Larry Copeland** and **Paul Overberg**, USA TODAY

Americans drove 22 billion fewer miles from November through April than during the same period in 2006-07, the biggest such drop since the Iranian revolution led to gasoline supply shortages in 1979-80.

The numbers released Wednesday may reflect more than a temporary attitude change in consumers toward high gas prices, Transportation Secretary Mary Peters said. Previously, she said, "people might change their pattern for a short period of time, but it almost always bounced back very quickly. We're not seeing that now."

The decline in total miles traveled, though only 1%, means that many drivers are cutting back far more because the number of drivers and vehicles grows by 1% to 2% a year. Americans are driving about the same number of miles as in 2005, when the USA had 8 million fewer people, according to a USA TODAY analysis of Federal Highway Administration data. The declines are sharpest on rural roads, indicating that people are cutting back on long-distance and vacation trips.

"It's not a blip," said Marilyn Brown, professor of energy policy at Georgia Tech, citing data showing surging transit ridership, dropping sales of sport-utility vehicles and sharply increased demand for gas-efficient vehicles. "I think the difference between now and 1979, when prices were comparable when you adjust for inflation, is there's a sense of sustained pain. There's a sense that the era of cheap energy is a thing of the past."

Among potential impacts of Americans driving less:

- Drivers might notice "some reduction" in traffic congestion, said Tim Lomax of the Texas Transportation Institute. "But over several months, the typical commuter will adjust their driving patterns," he said. "If they normally leave at 6 a.m., they might find they're getting to work without congestion, so they'll say, 'I'm going to spend an extra 15 minutes sleeping or reading the paper and leave at 6:15.' You get enough people doing that and you're back to congestion."

- Housing patterns could change as more people buy houses closer to work or find jobs closer to home, Lomax said. "We might not be seeing so much of that right now since so many people are upside down on home loans because of the mortgage crisis," he said.

- A shift in the way the nation pays for roads, bridges and transit. As people drive less, the federal Highway Trust Fund - derived from gasoline and diesel taxes - is receiving billions less, Peters said. She's promoting tolling and making drivers pay more during peak hours.

David Snyder, 40, an engineer in Internet operations at Turner Broadcasting in Atlanta, is moving from suburban Alpharetta to a new project near downtown. "It costs more than \$60 a week in gas, and that's not including parking," Snyder says of his current costs. "That's this week. It might be \$75 by next week."

## Heritage Capital In The USA Today

~~~~~

Regulators try to thwart 'bear raids' on stocks

[http://www.usatoday.com/money/markets/2008-07-20-naked-short-selling-rule\\_N.htm](http://www.usatoday.com/money/markets/2008-07-20-naked-short-selling-rule_N.htm)

By Adam Shell, USA TODAY NEW YORK - An emergency order by Wall Street regulators to combat "bear raids" on vulnerable financial stocks, launched by traders that profit when stocks go down, goes into effect Monday. But the rule's main intent - to help stem quick, steep stock declines that create financial panic - actually kicked in right after the Securities and Exchange Commission announced investor protections on Tuesday night.

Wall Street pros credit the ruling, which makes it harder to engage in a trading technique known as "naked" short selling, with helping fuel a 534-point three-day rally on the Dow Jones industrials and a 21% gain for the S&P 500 financial sector.

The SEC crackdown targets short sellers, who hope to make money by selling borrowed shares and buying them back at lower prices. A naked short sale occurs when the trader does the trade without actually borrowing the shares, which can intensify the downward pressure on a stock.

The SEC order requires short sellers to take possession of the stock. Previously, a short seller could simply ask a broker to locate the shares, which made it easier and faster to profit in a falling market.

The SEC's move is designed to combat what critics say are the rumors, market manipulation and runs on stocks similar to the events that led to the demise of investment bank Bear Stearns in mid-March.

"The SEC essentially took much of the gunpowder away from the bears," says Paul Schatz, president of Heritage Capital.

It also likely prompted traders involved in naked short selling to reverse their bets by buying back shares - pushing stocks up sharply in the process - ahead of today's official enforcement of the SEC's order, says Todd Clark, trader at Nollenberger Capital. Falling oil prices and better-than-expected profit news from banks also helped stocks.

The order will be in effect until July 29 and involves 19 financial firms, including Freddie Mac and Fannie Mae. Both stocks came under heavy assault from short sellers early last week after the government said it would backstop the two mortgage giants if necessary. Freddie shares rose 75% in the three days ended Friday, but are still down 86% from their 52-week high. Fannie rebounded 90% but remains 81% off its high within the past year.

"The action aims to stop unlawful manipulation through naked short selling," SEC Chairman Christopher Cox said last week.

## **Heritage Capital In The Connecticut Post**

~~~~~

Webster Parent Reports Loss

Rob Varnon

Webster Financial Corp., the parent of Webster Bank, said Tuesday write downs related to poorly performing assets, not actual cash losses, led to a net loss of \$28.9 million, or 56 cents per diluted share, in the second quarter.

James Smith, the company's chairman and chief executive officer, said the bank is well positioned to not only weather a difficult economy, but also take advantage of opportunities as they arise.

Excluding these charges, Smith said, the operating income for the bank in the second quarter 2008 was a positive 42 cents per share.

For the second quarter 2007, Webster reported net income of \$24.4 million, or 47 cents per diluted share.

Smith said the bank has taken steps to create "a fortified balance sheet."

To that end, Webster increased the provisions for credit losses to \$25 million in the quarter and during the three-month period raised \$225 million by issuing convertible preferred stock.

The bank's board of directors announced a 30-cent dividend payable on Aug. 18 to owners of common shares on or before Aug. 4.

The report disappointed some analysts, including Collyn Gilbert of Stifel, Nicolaus & Co. Inc., who said Webster has not met her earnings projections since September 2005.

"It's the same thing," she said of this earnings report. "They need to demonstrate some positive performance and operations."

Gilbert said there always seems to be something in the way of Webster having a break-out quarter where analysts can truly see this bank perform to potential.

In comparison to other Northeast banks, Gilbert said, Webster's performance is near the bottom. She cited Webster's decision to make loans outside its core New England

market as one reason for its lagging performance. That's a move the Waterbury bank is still paying for in write-offs, she said.

Webster reported \$53.1 million in impaired asset write downs and increased its provision for credit losses to \$25 million.

Gilbert maintained a hold recommendation on Webster.

Shares of Webster closed up 79 cents to \$18.39 in trading on the New York Stock Exchange. According to Webster, its non-performing assets increased \$68.8 million, to \$182.1 million in the quarter. The largest portion of this loss was from a commercial real estate development that turned sour and cost the bank \$36.6 million. Total assets for the second quarter 2008 was \$17.5 billion, compared to \$17 billion in the second quarter 2007. It said core deposits increased \$38 million from a year ago, representing a 58 percent jump.

Webster has also begun implementing its OneWebster initiative to trim costs and maximize earnings.

In January, the bank asked all employees to develop ideas to cut costs and enhance revenue; they produced 3,500 of them, Smith said. The bank reviewed 2,500 and began implementing some of the more than 800 ideas it selected to roll out, which should lead to approximately \$40 million in annual savings. For example, Webster did not have a centralized purchasing system for office supplies, so each group within the company was ordering its own supplies. There will be about 96 job eliminations, Smith said, but those will come over the next two years.

Webster's actions stand in stark contrast to banking giant Wachovia.

Wachovia Bank, which reported a net loss of \$8.86 billion on Tuesday, said it will cut about 10,750 of its approximately 120,000 jobs.

Paul Schatz, president of Woodbridge-based Heritage Capital, said Webster is among the "Ws" he's avoiding right now; he's not buying Webster, Wachovia or Washington Mutual, Schatz said.

"The banking system is not in great shape," Schatz said, and the Ws are in particularly bad positions. He said he expects them to be acquired. Schatz was clear that his opinion is limited to these businesses' stock performance.

Schatz said the banks to watch right now are the ones that weren't buying insurance and mortgage lenders during the boom, but were sitting back and socking away capital for this day.

"JPMorgan is going to own the world," Schatz said, alluding to the bank's large war chest and its moves in this down economy, which included buying up Bear Sterns.

Smith, however, said the ideas OneWebster adopted weren't just about saving money, but will also allow the bank to expand its market share.

The bank is looking to roll out a number of new products to capture a wider market. Employees identified several areas where the bank could expand services, including a "Second Chance Checking Account."

Smith said that will provide a no-frills checking account to people who would not

otherwise be financially qualified to open an account. The bank has not set a date for introducing this product.

2008 second-quarter results: A loss of \$28.9 million, or 56 cents per share

2007 second-quarter results: Income of \$24.4 million, or 47 cents per share

Biggest hit: Non-performing assets grew \$68.8 million to \$182.1 million, with much of that coming from a commercial real estate development that turned sour and cost the bank \$36.6 million.

## **Friends And Family Plan**

~~~~~

Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

<http://www.investfortomorrow.com/newsletter.asp>

You can also forward this email to family and friends by hitting the "forward email" hotlink at the bottom of this email.



## To Your Financial Success,



**Paul Schatz**  
**President**  
**Heritage Capital LLC**

**1 Bradley Road Suite 202**  
**Woodbridge CT 06525**

**203.389.3553 Phone**  
**203.389.3550 Fax**

**[www.InvestForTomorrow.com](http://www.InvestForTomorrow.com)**

Published by Paul Schatz. Copyright (C) 2008 Heritage Capital, LLC. All rights reserved.  
StreetSmarts is produced and distributed regularly via email by Paul Schatz of Heritage Capital, LLC  
1 Bradley Road, Suite 202 Woodbridge CT 06525 Phone (203) 389-3553 Fax (203) 389-3550 - [www.InvestForTomorrow.com](http://www.InvestForTomorrow.com)  
Heritage Capital, LLC is an independent RIA not associated with any financial institution. Data used in this publication is gathered from reliable sources, although completeness and accuracy cannot be guaranteed. Performance results do not take into account any tax consequences and are not predictive of future results. This publication does not give any specific investment advice, does not provide financial planning services, or consider any individual's financial situation, needs or goals. This publication may not be reproduced or retransmitted in whole or in part without the consent of the author, Paul Schatz.

### Important Disclosure Information

Heritage Capital LLC ("Heritage") composite performance results represent time-weighted actual performance results for continuously managed Heritage accounts, which individual accounts Heritage believes to be representative of its investment management process (i.e. mutual funds and exchange traded funds) for each specific strategy during the corresponding time period. The composite performance results reflect the reinvestment of dividends and other account earnings, and are net of applicable account transaction and custodial charges, and the separate fees assessed directly by each unaffiliated mutual fund and exchange traded fund holding that comprised each account, and the maximum investment advisory fee that the accounts would have incurred (by applying the Heritage's current investment advisory fee of 2.00% as set forth in its current written disclosure statement) during the corresponding time periods.

Please Note: Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, equal the performance results reflected, or equal any corresponding historical benchmark index. The historical index performance results for all historical benchmark indices do not reflect the deduction of transaction and custodial charges, or the deduction of an investment management fee, the incurrence of which would have the effect of decreasing indicated historical performance results. The historical performance results for all indices are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of a Heritage program meets, or continues to meet, his/her investment objective(s). A corresponding description of each index is available from Heritage upon request. It should not be assumed that Heritage account holdings will correspond directly to any such comparative benchmark index. The Heritage performance results do not reflect the impact of taxes.

For reasons including variances in the investment management fee incurred, market fluctuation, the date on which a client engaged Heritage's investment management services, and any account contributions or withdrawals, the performance of a specific Heritage client's account may have varied substantially from the indicated portfolio performance results.

In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise Heritage immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investments purchased and/or investment strategies devised or undertaken by Heritage) will be profitable.

Information pertaining to Heritage's advisory operations, services, and fees is set forth in Heritage's current disclosure statement, a copy of which is available from Heritage upon request. Performance results have been compiled solely by Heritage, are unaudited, and have not been independently verified. Heritage maintains all information supporting the performance results in accordance with regulatory requirements.