



BULLS & BEARS

Volume 2 • Issue 25 • March 15 2009

HEADLINES

- China worried about safety of US Debt
- Buffet's Berkshire loses "perfect" rating
- Roche finally wins Genentech - for \$47 Billion
- Maddoff to plead guilty on 11 charges
- JPM, Citi, and BofA all report profitable start to the year

FINANCIAL MARKETS

DOW	7,223.98 , +9.01%
NASDAQ	1,431.50, +10.64%
S&P 500	756.55, +10.71%
OIL	\$46.25, +\$0.73
10 YR	98 8/32, -22/32
EURO	\$1.2927

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MARKET SUMMARY

Monday 03/09/09

Stocks extended last week's heavy losses, thanks in part to a gloomy outlook from the World Bank. In a report prepared for an upcoming meeting of the Group of 20, the bank predicted that the global economy will shrink in 2009 for the first time since World War II. The World Bank added that global industrial production could fall up to 15% from 2008 levels, with world trade swallowing its steepest decline in 80 years. Against this backdrop, investors paid little mind to billionaire investor Warren Buffett's reassurance that "Everything will be all right" in the long term. Instead, as yet another major merger-and-acquisition deal was struck between a pair of drug companies, traders expressed fears that not even the traditionally defensive pharmaceutical sector could provide a shelter from the ongoing recession, as the Dow tumbled 80 points.

Tuesday 03/10/09

Stocks jumped higher right from the start of the morning with Citigroup leading financial stocks into the black. The battered banking concern's CEO told employees that the firm was profitable during the first couple of months of 2009, and said Citi is on par to log its best quarterly performance since the third quarter of 2007. Adding fuel to the fire was Federal Reserve Chairman Ben Bernanke, urging mark-to-market rules reform, and assuring Capitol Hill that major financial institutions would not be allowed to fail. In a speech in Washington, the Fed chief also suggested that if efforts by the government can stabilize the banking sector, "there is a good chance the recession will end later this year, and 2010 will be a period of growth." The 3 major market indices logged their best performance in three months, as the Dow closed 400 points higher.

Wednesday 03/11/09

On the heels of the previous day's broad-based rally, stocks once again started out on a high note. However, today's action was more tentative, with the major market indices bouncing between positive and negative territory. Energy stocks led the day's pullback after the government reported an unexpectedly large build in crude inventories, while the Dow slipped into the red after briefly topping the 7,000 level in early trading. After leading the equities market higher on Tuesday, financial firms also struggled to maintain their positive momentum. Stocks finished the session nearly flat, with the Dow ending the day just 3 points higher.

Thursday 03/12/09

Stocks extended a 2-session winning streak today, thanks to a glut of good news from the blue chips. Pacing the advancing issues was General Electric, as shareholders let out a collective sigh of relief regarding a ratings cut by Standard & Poor's. The agency trimmed its credit rating on the conglomerate by 1 notch to 'AA+', calming fears of a deeper downgrade. Echoing its bellwether brethren was General Motors, ticking higher after assuring the Street that it doesn't need \$2 billion to avoid running out of cash after all. Not to be outdone, Bank of America CEO Ken Lewis said the firm has been profitable during the first couple of months in 2009 - news that fueled the financial sector to its longest string of gains since November 2008. Against this backdrop (combined with news that Ponzi schemer Bernie Madoff is behind bars), the equities market largely ignored dismal unemployment data, sending the Dow to a 240 point gain.

Friday 03/13/09

While the beaten-down Citigroup has dragged on the Dow during the past year, the bailed-out bank is making up for lost time this week. After heading up Tuesday's breakneck rally, Citigroup sparked early gains once again today. Investors reacted enthusiastically as Chairman Richard Parsons asserted, "Citi is actually one of the better capitalized banks in the world." Parsons also brushed aside lingering nationalization worries, saying he has "a lot of confidence" that Citi will remain privately held. The chairman's commentary contributed to early gains, but the equities market wavered today between positive and negative territory. Despite impressive weekly gains, many on Wall Street continue to believe that the bear market isn't dead, as the Dow edged another gain of 50 points.

THE WEEK IN QUOTES

"Of course, I regret recommending any stock ... I regret the fact that the market's down."

-Jim Cramer, CNBC host, responding to criticism from Comedy Central's Jon Stewart for recommending stocks that later fell

"He is going to be sentenced for 150 years. I hope he lives a very long life.."

-Richard Friedman, a certified public accountant who lost more than \$3 million to Bernard Madoff's investment scheme

"It's called a tap."

-Tom Demott, chief operating officer of Encore Associates, a consumer-goods advisory firm, on the economical substitute for bottled water, for which sales have dropped 11%

"Even trash has become worthless."

-Tian Wengui, a Beijing resident who collects garbage to receive small payments for recycling

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HOW LEVERAGE HAS 'DE-GLAMORIZED' PRIVATE EQUITY *By Siddharth Arora, Carnegie Mellon University*

It would be worthless to go on about the 'credit crunch,' simply because the term has almost been abused across every printed publication there is. The concept of leverage has undergone major changes in its definition. What was previously employed to boost returns for investors and shareholders of companies in the good old times, has now come back to stab them in the back due to the freezing of the debt markets. Private Equity (PE), a glamorous industry that has historically thrived on this easy flow of leverage to achieve increasing internal rates of return is now in shambles. It is vital to understand why leverage is so important to PE before we dig deeper into the problems of today.

The Concept – Leverage & Cash Flow

Private equity groups typically use leverage (debt) to increase the return on the firm's invested capital. The amount of leverage employed is normally determined by the target's ability to service the debt with cash generated through operations. Because of the aggressive use of leverage, often, the cash flow a business generates in the early years following the acquisition is almost entirely consumed by the debt service.

The Good Times

The combination of low interest rates, depressed stock prices, and rising corporate profits created ideal conditions for private equity firms to flourish. Using dollops of cash and bushels of debt, they were able to snap up solid companies on the cheap - in 2002 buyout prices averaged just four times cash flow (defined as earnings before interest, taxes, depreciation, and amortization, or Ebitda). In a typical deal a private equity shop would borrow about 70% of the purchase price (those loans go on the acquired company's balance sheet, often doubling or tripling its debt load).

With that kind of leverage, even modest improvements in the company's profits generated huge returns for the private equity firms and their investors. In some cases, they paid themselves dividends that allowed them to recoup their entire investment within a year. And to top it off, they raked in huge fees from the companies for arranging the deals and the financing, as well as for managing the business. (The deals also got a boost from Uncle Sam. The in-

terest on all that debt is tax-deductible, so the companies saw their tax bills drop drastically.) The math made the buyouts bulletproof.

The Bad Time- NOW

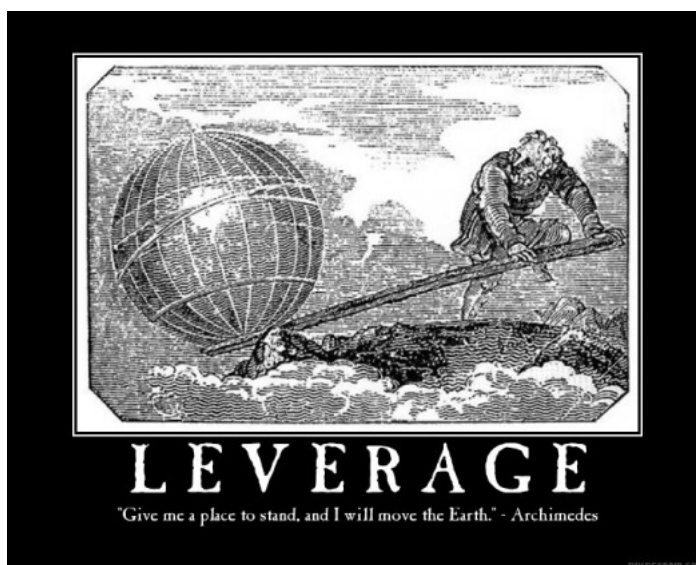
The wholesale withdrawal of leverage for mega deals has tested the business models of even the largest private equity houses. New investment deal flow has dried up and the higher degree of leverage in their portfolio companies

has given rise to greater stresses. Gone are the days of cheap debt and massive leveraging. Private equity firms are having greater challenges demonstrating that their business models of larger, highly leveraged deals are still valid. Conceptually, the problem is that the cost of financing leveraged buyout transactions by issuing high-yield debt securities in the public capital markets has recently shot up significantly. Conditions in the debt markets have gone from bad to worse, and thus PE firms have had to

rely on financing commitments provided directly by investment banks or other sources in order to consummate pending transactions or finance future transactions. Such financing is significantly more costly, with terms that are significantly more restrictive, than financing that was, until the end of 2007, available to these PE firms in the public capital markets. More costly and restrictive financing has adversely impacted the returns of leveraged buyout transactions and, therefore, adversely affected results of operations and financial condition of all private equity industry players, whether giants or dwarfs.

Conclusion

Although private equity deals have reduced by more than 70% in 2008, there is still a lot of promise for 2009, albeit of a different kind. The fundraising environment is bound to be tougher and the market may shrink. Large institutional investors' own challenges and exposures may oblige some to reduce their allocations to private equity. Industry experts signal that it will be 2010 before a generally more attractive and available exit market emerges. We'll just have to wait and watch what happens. Times are rough but exciting too. And there is opportunity.



OPEC PROTECTS OWN INTERESTS *By Daniel Sholler, University of Pennsylvania*

The Organization of Petroleum Exporting Countries (OPEC) wields considerable power in the international economy. Its influence goes beyond the oil market and affects areas such as currency, politics, and the democratization of the global economic system.

Much of the controversy surrounding OPEC involves the politics of the cartel. The nations comprising the organization include Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela. The decision-making is often said to protect not only the interests of the oil-producing sector of the countries, but their political interests as well.

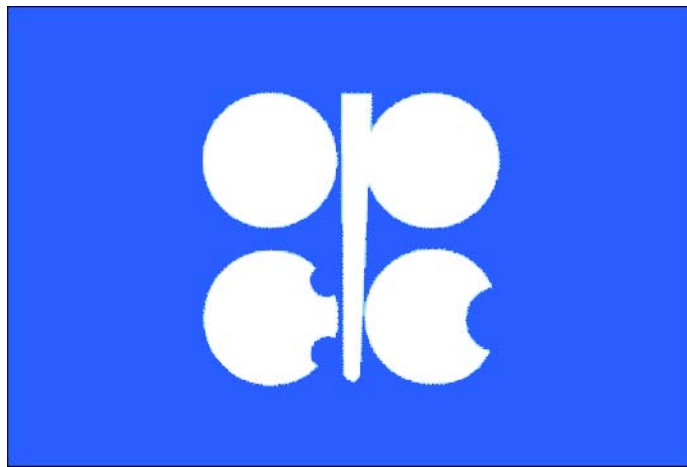
This political aspect of OPEC has led to several conflicts between nations. In 1973, a group called the Organization of Arab Petroleum Exporting Countries within OPEC placed an embargo against the United States and Western Europe for their support of Israel. In addition, the effect of war on oil prices has long illustrated the overwhelming impact of OPEC on both politics and the economy. Marked disunity in the organization has caused lows in the price of oil, such as during the Iraq-Iran War and late 1990 conflicts.

Facing new difficulties unlike these inter-organizational conflicts, OPEC has recently met in response to the growing economic crisis. A March 15 meeting in Vienna was aimed at tackling declining international oil prices and deciding on the production measures to be taken. In recent months, production has been cut across the OPEC countries as well as in non-OPEC nations. Three cuts have been made in 7 months and at an average of 4.2 million barrels per day, Bloomberg News reports. Despite the attempts, oil prices remain in the cellar.

The danger of low oil prices is two-fold. For the oil-producing countries, investments in crude oil will diminish and cut profits. This change will lead to instability of prices for consumers, an unwelcomed

occurrence in the current economic situation. According to CNN News, Minister of Petroleum of Angola Jose Maria Botelho de Vasconcelos intends to strategize and respond until oil reaches a price that “a price that satisfies consumers and also attracts investments.”

Lower investment capital is not the only reason for lower prices. The crude oil reserve throughout the globe appears to be high, slashing prices throughout the world. The other more apparent factor is the deepening economic recession, which has produced several reactions by OPEC and non-OPEC nations.



The production rate is expected to be steady until the next Oil Ministerial Conference on May 28. At that point, a decision must be made as to whether production should be cut again or if the market will require different action. OPEC apparently has the global economy in mind, as a cut in production would raise prices and hinder economic resur-

gence.

“They’ve decided that, in the medium term, the danger to the global economy was greater than the danger of high inventories,” David Kirsch, an analyst from PFC Energy in Washington, said in a Bloomberg interview. “A rollover should be sufficient to draw down inventories to acceptable levels by the third quarter.”

Lower oil prices are one of consumers’ only advantages in the recession, saving them lost money in a troubled economy. OPEC leaders agreed that a fourth production cut would lead to much higher prices that would be intolerable in the current market. Instead of cutting more, the leaders decided to make a more concerted effort in assuring that OPEC members are completely complying with current quotas. They also reiterated their commitment to bringing the global economic downturn to a halt, a promising assertion in an unstable time.

VALUATION METRICS *By Alexander Muhr and Matthew Riley, University of Southern California*

Being able to determine the financial strength of a company is vital to valuing it. This is done through reading the fine print on financial statements and analysis of the numbers therein. Before we can get started on the metrics, you must first know the different statements that are available and how to access them. There are two main SEC forms that can be accessed through Yahoo!Finance.com or directly from EDGAR Online. These statements are called the 10-Q Quarterly Report, and the 10-K Annual Report. As implied by their names, the 10-Q is issued quarterly and contains information about the previous quarter's results, while the 10-K informs investors of the previous year's results.

Within the SEC filings are the accounting statements—the Balance Sheet, Income Statement, Cash Flow Statement and the Statement of Owner's Equity. Although the numbers from these statements are telling of a company's financial strength, it is important to read through the rest of the report to find out the activities of the company and how the financial numbers were ascertained. Once you have read through the report, you can begin to calculate the following ratios with relative certainty. It is our hope that you will be able to use them in your future stock analyses.

Gross Margin

$(\text{Revenue} - \text{Cost of Goods Sold (COGS)}) / \text{Revenue}$
Gross Margin tells you how much money the company makes from each sale – after their cost of making the product or service. The margins vary for different sectors and industries, but comparing these ratios to competitors, historical margins for the company or future margins for the company may yield valuable information about how the company is maturing, changing or dealing with a shifts in its target markets.

Operating Margin

$(\text{Revenue} - \text{All Operating Costs}) / \text{Revenue}$
Operating Margins take the Gross Margin and adds in the extra costs of running the business – such as administration, marketing, etc. These margins also vary by business, but if you look at it the same way as Gross Margin, you should find great companies.

Net Margin

$(\text{Revenue} + \text{Non-Operating Revenue} - \text{Total Costs}) / \text{Rev-}$

enue

Net Margin adds in more costs like taxes and interest payments on debt. Again, the same scenario as above, they vary and by looking at competitors and past trends, you should find great businesses.

Return On Assets

$\text{Net Profit} / \text{Total Assets}$

Here you are looking for how much money is earned off of the assets of a company – which includes cash, property, machinery, etc. This metric is more company specific, and if you can find business that yield 25%+ that is very good.



Return On Equity

$\text{Net Profit} / \text{Total Equity}$
ROE shows you how much profit is being yielded from the net worth of the company. This metric can be misleading because if a company has a high amount of debt, the

yield will be higher. But if there is little debt, then look for 25%+.

Return On Invested Capital

$\text{ROIC} = (\text{EBIT} * (1 - \text{Tax Rate})) / \text{Invested Capital}$

$\text{Invested Capital} = (\text{Total Assets} - \text{Cash} - \text{Tax Accounting} - \text{Investments}) - \text{Current Liabilities}$

$\text{EBIT} = \text{Operating Profit}$

ROIC is a good metric to look at because it tells you how much money is being earned from dollars that is being used specifically to earn money. Again, a rate of 25%+ is very good.

Operational Cash Flow

$\text{Cash Flow From Operations} / \text{Current Liabilities}$

OCF is an important consideration because it allows you to see if the cash flow a company is generating is enough to pay off its debts. Look for an OCF that is greater than 1.

Book Value Per Share

$\text{Stockholders Equity} - \text{Preferred Stock} / \text{Number of Shares Outstanding}$

Book Value is an excellent tool to assess a company's intrinsic value to see what it is really worth. You want the Book Value Per Share to be higher than the stock price.

BLACK MONDAY – MARKET CRASH OF 1987 *By Robith Salim, Carnegie Mellon University*

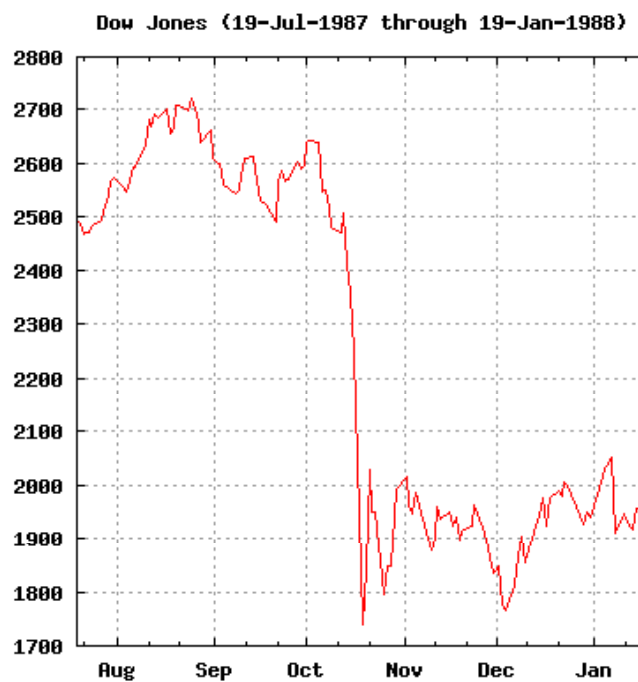
In market terms, ‘Black Monday’ is the term given to Monday, October 19, 1987 when stock markets around the world crashed. The crash began in Hong Kong, spread west across Asia to Europe, and finally hit the United States after markets had shown significant decline. In the United States, the Dow Jones Industrial Average lost 22.6% of its value or \$500 billion dollars on the day.

An extremely powerful bull market had started in the summer of 1982. The investors’ confidence kept growing, motivating them to buy in anticipation of further capital gains. This Bull market was fueled by hostile takeovers, buyouts and mergers. The overreaching philosophy of time was that companies would grow exponentially by purchasing other companies. Companies were scrambling to buy each other out. During this time, companies would sell junk bonds to the public in order to raise capital to buyout other companies. Junk bonds are simply bonds that have a very high risk of loss, hence paying a larger interest rate. Initial Public Offers (IPOs) were also becoming a major driver of the market. As before any bubble burst, the investing public was of the firm belief that the market would always go up.

However, many shady IPOs and conglomerates proliferated which the Stock Exchange Commission (SEC) failed to prevent. In early 1987, the SEC conducted numerous investigations of illegal insider trading, creating a wary stance from many investors. Furthermore, inflation was now becoming a concern because of the economic growth. To temper the inflation, the Feds raised the short term interest rates. However, this had an adverse effect on stocks. To protect their stocks from dipping further, many institutional trading firms started using portfolio insurance. Portfolio insurance is a practice that uses future contracts as an insurance policy. Those people that hold these contracts can make money as the market crashes, thereby offsetting any losses in the stock holdings. As these large institutional firms started using portfolio insurance, the futures market was taking in billions of dollars within

minutes, causing the futures market and the stock market to crash from instability. Furthermore, the stock holders all wanted to sell simultaneously but were unable to do so because there weren’t any buyers left.

Within a single day, the Dow Jones Index lost 500 Billion dollars. Markets in every country from all around the world collapsed in the same fashion. When individual investors heard that a massive stock market crash was happening, they all simultaneously tried to call their brokers, without much success. Many people lost millions instantly. Some individuals, who had lost fortunes, went to the extent of shooting their broker. Several brokers were killed, despite the fact that they had no control over the market action. The majority of investors were selling because they “saw everyone else selling”. This irrational mentality was one of the main reasons behind this huge market crash.



Unlike the market crash of 1929, the market quickly recovered instead of going into a depression. This was because the Fed immediately intervened and lowered the short term interest rate to prevent a depression from happening. Furthermore, the market started on a Bull Run again. This was powered by companies buying back stocks that were undervalued after the severe market crash. Additionally, the Japanese Nikkei index was embarking on its own bull market. This tremendous momentum helped pull the US stock markets to new heights never seen before.

Despite the loss of millions to many individuals, some benefits came as a result of the 1987 stock market crash. For example, the circuit breakers system was implemented, which electronically stops stocks from trading if they plummet too quickly. This will prevent any future one day vertical drops, like what happened in 1987. The significant difference between the market crash of 1929 and the market crash of 1987 was that the former ushered in the great depression while the latter propelled the US stock market to the future.

THIS WEEK IN BARRONS... *By r.f. culbertson, Carnegie Mellon University*

THOUGHTS:

We are in the first stages of this crash, and once again the media, driven by the real money handlers are selling you a line. Look at the bank bail outs. Why are mutant banks being force fed taxpayer money? The standard line is that it will save us from a complete economic crash. Could it be that the real reason the banks are being bailed out is because the big hitters, are all shareholders in the Federal Reserve. Please **DO NOT FORGET** - the FED is a privately owned banking concern, and it's share- @usagold.com holders are **SECRET!** Yes, you read that correctly. No one, not even the President of the U.S. knows exactly who the shareholders are of the Federal Reserve, nor can he see their books. Yet these individuals set our monetary policies. Well, over the years we've come to know that the big shareholders are the big investment banks. The **VERY** banks that flooded the world with toxic derivatives and are now being bailed out by the taxpayer.

Remember - we went on record back in 2004 telling you all that the housing run up, and the crash it will cause was **NOT** an accident. This was a perfectly executed plan. The bankers made trillions in profit, and when the wheels fell off, they cried to the FED, the FED squeezed the politicians and "boom" we the people are now paying for their private islands and \$25,000 wines.

If you think "normal" was anything that happened between 1996 and 2008, you are sadly mistaken. Most of the gains in our economy were based upon nothing more than ever expanding credit and credit derivatives. Trillions in credit card expansions, trillions in refi money, and trillions in commercial loans. Now that all of that has come to something of an end, all the economic activity and all the growth that free wheeling credit provided is gone. Last year, credit card companies reduced their credit limits by trillions and trillions more will be cut this year. Refi's for cash extraction have gone by wayside. Wages have been stagnant for 15 years, and layoffs over a half a million a month are common. I'm here to propose that there's virtually no chance of anything like the last 15 years behavior happening again - not for many years.

TIPS:

So let's assume you had \$5,000 to invest in something?

First, if any of you invested in the FAS (as we recommended last week) well congratulations you're up over 100% already. Just note, there's a bit of congestion here at the 5 dollar mark and it might struggle a bit. If it clears this however, it could rock - so be ready - in case you missed the first leg of this upturn.

Because the dollar is being debased to the tune of another 12 trillion in bail out's and pledges, Gold will be the single best way to offset the damage. It might not make you rich, but it will at least let you hold onto some buying power. I'm still a firm believer that gold hits 1500 minimum and frankly 2500 is probable in the following years.



In terms of the general market, it seems like we are finally getting the mindless romp higher that we expected over the last 5 weeks. If this bounce can start to get people believing that the worst is already over, a lot of people are going to try and make all their money back by piling in. That would feed on itself, and we could see a really rip snorting run for the roses. I'm looking for the DOW to get over 7350 in order

to put more money to work.

I "think" the rally is real, and it's rewarding us so far. I think it's going to grow legs, but **PLEASE** be cautious. A wicked reversal on some horrid news is not out of the question.

The XLF could bust free of this 8 dollar congestion and if it does, you're going to see 10 in relatively short order.

Watch the DBA here at 23.77. A move over 24.00 could bring in some interested buyers.

As much as I think technology is actually in worse shape than people realize, watch the SMH. It's hit a high of around 19.30 a couple times since Dec, and looks like it wants to challenge it again. Don't bog down in the reality that no one is actually buying anything like big screen TV's, watch the stocks instead.

Good luck folks, this feels pretty good so far and is well overdue. Let's see if it romps or we roll over again.

Again - be careful and see you next week.

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