

Forget The Spin, Bankrupt Bear Stearns Was Given Away To Calm Markets

By Chris Ciovacco
Ciovacco Capital Management
March 17, 2008

Graph 1: Are You Concerned About Leverage Now?



I have been on Wall Street for fifteen years, and fully appreciate how the market will read the "purchase" of Bear Stearns for \$2 per share is anybody's guess. As a manager of risk, I see the following:

- It is obvious Bear Stearns was bankrupt and could not have continued as a viable entity.
- Rather than have them declare bankruptcy, the FED engineered a plan to have JP Morgan "buy" Bear Stearns for \$2 per share. A price of \$2 per share means the market was too optimistic in the

last 14 months when Bear's stock fell from \$169.33 in January 2007 to \$30 per share as of Friday's close.

- A price of \$2 per share tells you the market greatly underestimated the risk associated with holding leveraged securities backed by mortgages.
- Unfortunately, Bear Stearns is not the only firm to hold large quantities of leveraged securities backed by mortgages.
- Therefore, the market may be greatly overestimating the value of several other firms, which hold these leveraged bets backed by questionable collateral.
- Bloomberg reported the \$240 million "paid" for Bear is about 1/4 the value of Bear's headquarters in Manhattan. That means Bear, as an ongoing entity, was a liability as of Sunday. This is not surprising considering the rush for the exits by customers in the last few weeks and the loss-ridden portfolio of securities on Bear's books. Add the possibility of lawsuits against Bear's actions, and JP Morgan in effect said Bear is a liability in its present form, we will not buy it, but we will take it for \$2 per share to help shore up confidence since the FED has asked us nicely.
- If Bear Stearns went from having a \$169 stock in January of 2007 to being virtually worthless today, it makes you wonder what other firms may follow a similar path to insolvency.

Stocks Trying Hard to Make a Technical Stand

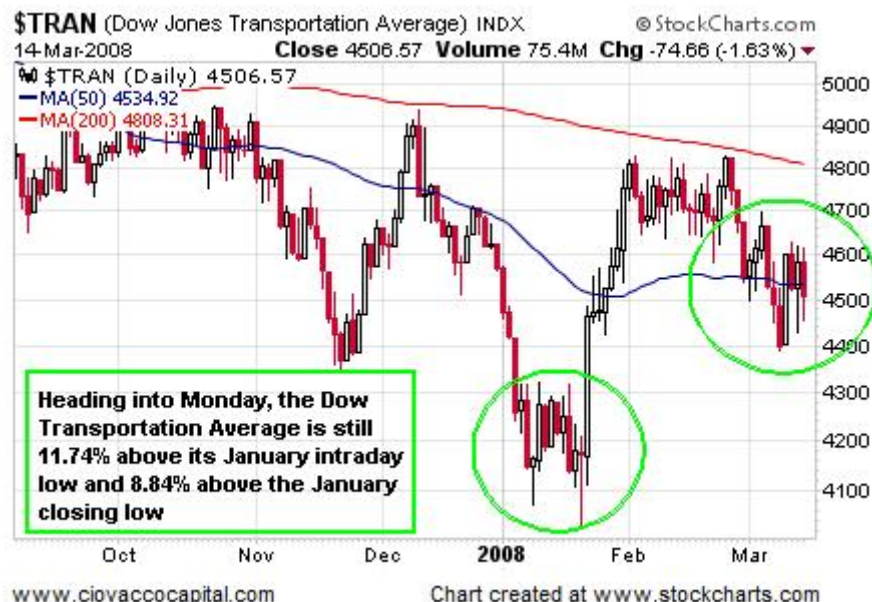
Editor's Note: The text below was written before the \$2 per share sale of Bear Stearns was announced. The levels still apply from a technical perspective. Technical analysis employs charts and indicators in an attempt to understand market trends. Fundamental analysis is the "story" of what's happening with the economy, a stock, or market sector. Technically, the global stock markets appear to be trying their best to form some type of bottom near current levels. If the January lows are not significantly breached, technicians will view this circumstance as an intermediate positive for stocks. If these lows do not hold, it will strengthen the secular bearish case.

Graph 1: S&P 500 as of close March 14, 2008



Confidence increases in an environment where the fundamentals (the “story”) align with the technicals (the charts). For several reasons, including the widespread unwinding of leveraged positions, the fundamental news is not expected to improve anytime soon. However, a technical intermediate rally is possible from current levels. With plenty of cash waiting to move off the sidelines, even a technical rally could be quite powerful. At the moment the fundamentals and technicals favor more pain ahead for investors. The technicals are trying hard to make at least an intermediate turn.

Graph 2: Dow Transports as of close March 14, 2008



The purpose of technical analysis is to understand what has happened and what is happening. To be a good technician, you need to keep an open mind and have the ability to put your personal fundamental biases aside. Heading in to Monday’s open, a good technician should see negative trends in stocks, which are attempting to form a bottom. Time will tell.



Chris Ciovacco is the Chief Investment Officer for Ciovacco Capital Management, LLC. More on the web at www.ciovaccocapital.com

All material presented herein is believed to be reliable but we cannot attest to its accuracy. The information contained herein (including historical prices or values) has been obtained from sources that Ciovacco Capital Management (CCM) considers to be reliable; however, CCM makes any representation as to, or accepts any responsibility or liability for, the accuracy or completeness of the information contained herein or any decision made or action taken by you or any third party in reliance upon the data. Some results are derived using historical estimations from available data. Investment recommendations may change and readers are urged to check with tax advisors before making

any investment decisions. Opinions expressed in these reports may change without prior notice. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell or a solicitation of an offer to buy or sell the securities mentioned. The investments discussed or recommended in this report may be unsuitable for investors depending on their specific investment objectives and financial position. Past performance is not necessarily a guide to future performance. The price or value of the investments to which this report relates, either directly or indirectly, may fall or rise against the interest of investors. All prices and yields contained in this report are subject to change without notice. This information is based on hypothetical assumptions and is intended for illustrative purposes only. PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS.