

FINANCIAL MARKET

Análisis Económico, Financiero y Bursátil

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Economy

President [Barack Obama](#) proposed almost \$1 trillion in higher taxes over the next decade on the highest-earning Americans, Wall Street financiers, U.S.-based multinational corporations and oil companies to pay for permanent tax breaks for lower earners.

Obama's 2010 budget proposal, released today, would reinstate the top two Clinton-era tax rates of 36 percent and 39.6 percent, up from the 33 percent and 35 percent the richest Americans now pay. That would affect about 2.6 million taxpayers. The budget also would raise taxes on capital gains and dividends to 20 percent for top earners, up from the 15 percent set by former President [George W. Bush](#) in 2003.

The tax increases, which Obama vowed to impose as a presidential candidate, would take effect in 2011 and be the first on high-income earners since 1993. They also would reverse a course set by Bush of lowering the tax burden on the nation's wealthiest people.

'Obama Robin Hood'

"It's a clear repudiation of Bush's policy," said [Peter Morici](#), an economist at the University of Maryland in College Park. "It's more Obama Robin Hood."

Obama's budget would keep in place Bush's tax cuts that benefit lower- and middle-income earners, and it

preserves a sliver of policy that benefits the more affluent: A preferential tax rate on corporate dividends. Before Bush, dividends were taxed as ordinary income, at rates as high as 39.6 percent in the 1990s.

"It is a hugely positive step to keep that part of the '03 changes," said [Pamela Olson](#), who was the top tax official in Bush's Treasury Department when the tax rate on dividends was reduced. "It's good economic policy, good corporate governance policy and good tax policy."

Obama also proposes to stop the scheduled repeal of the estate tax next year and to impose a 45 percent tax rate on a married couple's estate valued at more than \$7 million.

Higher-income earners, primarily families with more than \$250,000 of income, would face an additional tax burden under a proposal to limit their itemized deductions. That provision would subject more of their income to tax.

Deductions Cap

The proposal would cap the value of deductions for things like charitable donations, mortgage interest and investment expenses at 28 percent for people in the top brackets, or 30 percent less than they would otherwise receive.

Senior Treasury officials speaking on background to reporters acknowledged the proposal would be controversial. They defended it, saying it still gives top earners a deduction worth twice as much as Americans in lower brackets receive.

In all, top-earning households would pay \$636.7 billion in additional taxes over the next decade, Obama's budget estimates.

[Linda Beale](#), a tax-law professor at Wayne State University Law School in Detroit, said "many will object to reinstating phase-outs for itemized

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deductions because of the complications that creates.”

Representative [Mike Pence](#) of Indiana, the No. 3 Republican leader in the House, said Obama can expect a wall of opposition to his proposed tax increase on top-earners. Roughly half of Americans earning \$250,000 are small-business owners, and the proposed increase will stifle the troubled economy, he said.

‘Overwhelming Opposition’

“There will be overwhelming opposition from the American people and House Republicans to the idea that we should raise taxes during a recession,” Pence said in an interview. “Raising taxes in a recession is not a strategy for recovery.”

Representative [Jeb Hensarling](#), a Texas Republican, said in an e-mail, “You cannot help the job-seeker by punishing the job creator.”

The higher taxes on individuals will largely be used to pay for expanded health coverage for lower-income Americans and to make permanent Obama’s tax breaks such as a payroll tax credit worth up to \$800 that was adopted on a temporary basis in the \$787 billion fiscal stimulus measure earlier this month.

“He’s being so generous at the lower-income level that making \$200,000 is going to be like falling off a cliff,” said Dustin Stamper, an analyst in the National Tax Office at Grant Thornton LLP. “Say what you want about the Bush tax cuts favoring the rich, but this is just becoming punitive.”

AMT Lives On

Obama’s budget also assumes Congress will continue to index the alternative minimum tax for inflation. The AMT is a parallel system that can impose higher rates on families earning between \$75,000 and \$500,000 when their deductions are too high relative to their income.

Executives at private-equity firms, venture-capital firms, some hedge funds and other partnerships that receive a 20 percent “carried interest” in the firm’s profits would see their tax burdens nearly triple under Obama’s budget.

Most of their carried interest currently is taxed at the 15 percent rate for long-term capital gains. Obama is asking Congress to tax the profit share as ordinary

income, arguing that it’s a form of wages; under his plan, most executives would pay 39.6 percent.

That proposal will likely reignite a debate that was waged by Congress in 2007 when the House of Representatives approved the change and the Senate never considered it.

Corporate Tax Increase

Obama proposed \$353.5 billion in higher taxes on corporations over the next decade, the bulk of which would come from “reforming” rules that allow U.S.-based multinational corporations such as [General Electric Co.](#) to defer U.S. tax on profits they earn overseas. GE has about \$75 billion offshore on which it has never paid U.S. taxes, according to its regulatory filings.

The Treasury officials said they were preparing a more detailed plan on overhauling the international tax rules, which they may make public in the next month.

Obama’s budget estimates that such changes and beefing up Internal Revenue Service enforcement of international tax rules would generate \$210 billion in additional revenue over the next decade. He also proposed to limit tax shelters by requiring they serve a business purpose by redefining the tax code’s “economic substance doctrine.”

‘Last-In, First Out’

Obama’s budget would end a tax-accounting technique called “last-in, first out,” or LIFO, that primarily benefited oil and gas companies when oil topped \$100 a barrel but is widely used across industries.

Republican senators in April 2006 floated such a tax increase but backed off after [Exxon Mobil Corp.](#) Chairman and Chief Executive Officer [Rex Tillerson](#) called the proposal a “backdoor windfall-profits tax.”

In addition to oil companies, the repeal of LIFO would hit retailers, automakers and makers of non-automotive heavy equipment, textile makers, consumer products, drug companies, alcohol and tobacco manufacturers and wholesalers when times are good, according to tax experts.

The accounting method has been commonly used since the 1930s and is viewed as the most accurate measure of income for financial statement purposes, according to the congressional Joint Committee on Taxation, a nonpartisan panel.

A plan to reinstate an expired oil and chemical excise tax to fund hazardous waste cleanup would generate \$6.6 billion between 2010 and 2014, according to the budget.

Stocks

U.S. [stocks](#) fell for a second day as concern health-care profits will be hurt by a White House overhaul of the medical system offset a rally in banks spurred by the administration's request for more financial-rescue funds.

UnitedHealth Group Inc. and [Humana Inc.](#) slid at least 12.8 percent and Eli Lilly & Co. lost 4.7 percent on concern Obama will cut Medicare payments to insurers and raise rebates drugmakers must provide to patients on Medicaid. [SLM Corp.](#), known as Sallie Mae, tumbled 31 percent as the president proposed ending its student loan subsidies. JPMorgan Chase & Co. and [Wells Fargo & Co.](#) gained more than 6 percent as Obama's budget proposed as much as \$750 billion in new bailout funds.

"You've got to be glued to your screen, not only to watch prices, but to see what's coming out of Washington," said [Michael Mullaney](#), a Boston-based money manager at Fiduciary Trust Co., which oversees \$9.5 billion. "The rhetoric out of Washington is going to be the primary driver of the market."

The [Standard & Poor's 500 Index](#) decreased 1.6 percent to 752.83 after rising as much as 1.9 percent in early trading. The Dow Jones Industrial Average lost 88.81 points, or 1.2 percent, to 7,182.08. The Russell 2000 Index fell 2.1 percent. Two stocks dropped for each that rose on the New York Stock Exchange.

Deepening Recession

Benchmark indexes fluctuated between gains and losses throughout the afternoon as the decline in health-care stocks was offset by gains in banks. The market turned lower in the final 80 minutes of trading as financial shares pared their advance after the Federal Deposit Insurance Corp. said the banking industry posted a collective loss in the fourth quarter for the first time in 18 years.

The early advance in benchmark indexes came even after government reports signaled the recession is intensifying. Orders for durable goods slid more than economists forecast, initial jobless claims

unexpectedly rose and sales of new homes sank to a record low.

The S&P 500 has dropped 17 percent so far this year following a 38 percent tumble in 2008, its worst year since the Great Depression.

European stocks climbed for the first time in five days as Royal Bank of Scotland Group Plc planned to put assets into a U.K. government insurance program and UBS AG replaced its chief executive officer.

Health-care stocks in the S&P 500 slid 5.1 percent as a group, the biggest drop since Dec. 1. UnitedHealth tumbled 13 percent to \$20.07. Humana sank 19 percent to \$23.64. [Aetna](#) lost 11 percent to \$24.03.

Health-Care 'Waste'

The budget outline from the White House would stop the "waste" in government payments to Humana and companies like it that provide health plans for the elderly. It would also squeeze discounts to drugmakers that supply medicines to the poor.

Eli Lilly and Co., whose shares posted a daily gain only twice in the past three weeks, fell 4.7 percent to \$31.04 after saying it would lose "several hundred million" dollars in annual sales if Obama's health-care plan is approved.

Merck & Co., maker of asthma treatment Singulair, dropped 6.7 percent to \$26.04 for the biggest slump in the Dow average.

"If you're a buyer of equities, you're buying future earnings and corporate earnings are in absolute freefall," Douglas Cliggott, chief investment officer of Greenwich, Connecticut-based Dover Management LLC, told Bloomberg Television.

S&P 500 profits fell 35 percent in the fourth-quarter, the biggest decline since records started in 1998. Income is forecast to shrink 33 percent this quarter, Bloomberg data show.

GM Slumps

General Motors Corp. had the Dow's second-steepest loss, tumbling 6.7 percent to \$2.38. The automaker reported a \$30.9 billion annual loss, the second-biggest in its 100-year history, and is expected to ask the Treasury for more cash to survive through 2009.

Obama's budget proposal also includes almost \$1 trillion in higher taxes on the 2.6 million highest-earning American citizens and companies to pay for

permanent tax breaks for lower earners. It would reinstate the top two Clinton-era tax rates of 36 percent and 39.6 percent in 2011, up from the current 33 percent and 35 percent. Taxes on capital gains and dividends for top earners would rise to 20 percent from 15 percent.

'Not Fair'

"Markets know bigger government is a bad thing," said [Chris Guinther](#), chief investment officer of Silvant Capital Management, which oversees \$4 billion in Atlanta. The government's plans to revive the financial system and the economy are "not well thought out and they're not fair."

[SLM](#), the largest U.S. student lender, tumbled \$2.59 to \$5.80 for the biggest loss since Oct. 1. Obama urged an end to government subsidies for student loan providers. Shifting to direct student loans from the government would save more than \$4 billion a year, which would be used for more student aid, he said.

JPMorgan rallied 6.1 percent to \$23.05. [Wells Fargo](#) added 7.1 percent to \$14.40.

A senior administration official, speaking on condition of anonymity, said the White House hasn't decided whether the \$750 billion in additional aid to the financial industry will be needed. He said it will be put in the budget as "placeholder."

Bank Rally

An S&P 500 index of [banks](#), which gained 7.6 percent today, is up 30 percent over the past four days, poised for a record weekly climb. The group pared an advance of as much as 12 percent after the FDIC said the nation's banks posted a loss in the fourth quarter for the first time since the savings and loan crisis in 1990 and institutions on the its "problem list" rose 47 percent to 252 lenders in the quarter ended Dec. 31 from 171 in the preceding quarter.

American International Group Inc. increased 13 percent to 52 cents. The insurer may get a backstop from the U.S. government to protect against further losses on credit-default swaps, according to a person familiar with the matter who declined to be identified because the talks are private. As of Sept. 30, AIG provided protection on more than \$300 billion of assets through credit derivatives.

Goldman Sachs Group Inc. and UBS AG strategists cut their year-end forecasts for the S&P 500 today on

expectations earnings will keep declining. [David Kostin](#) at Goldman Sachs lowered his estimate to 940 from 1,100 and said the index may fall as much as 15 percent in "the near term." UBS's [David Bianco](#) cut his prediction to 1,100 from 1,300.

'Critical Signposts'

"We have seen some progress with regard to two critical signposts on the way to a sustained rally: passage of a fiscal stimulus plan and some clarity surrounding the Financial Stability Plan," wrote [Kostin](#). "However, we have yet to see any improvement in two other key signposts: home price stabilization and declines in financials' losses."

Soaring unemployment and foreclosures drove sales of new homes in the U.S. down 10 percent in January to an annual pace of 309,000, the lowest level since data began in 1963, the Commerce Department said today. The median price decreased 13.5 percent, the most in almost four decades.

International Business Machines Corp. rose the most in three weeks, adding 3.6 percent to \$88.97. The biggest computer- services company reaffirmed its full-year [profit](#) forecast, saying it still sees 2009 earnings of at least \$9.20 a share. Analysts surveyed by Bloomberg estimated \$9.08 a share.

Las Vegas Sands Corp. increased 32 percent to \$2.85 for the biggest gain since October. Sanford C. Bernstein & Co. initiated coverage of the casino company controlled by Sheldon Adelson with an "outperform" rating.

Treasuries

Treasuries fell for a third day as the government sold \$22 billion of seven-year notes in the last of three auctions this week as it issues an unprecedented amount of debt to spur the U.S. economy.

Declines were led by 10- and 30-year [securities](#). The administration forecasts a budget deficit of \$1.75 trillion in the fiscal year ending Sept. 30. That's 23% higher than a forecast by economists at primary dealer Goldman Sachs Group Inc., and equivalent to about 12 percent of the nation's gross domestic product.

"The more spending you have to have, the more Treasuries you will have to issue, and that means more pressure on prices," said [Andrew Brenner](#), co-head of structured products and emerging markets in New York at MF Global Inc.

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The [two-year](#) yield rose one basis point, or 0.01 percentage point, to 1.09 percent at 2:57 p.m. in New York, according to BGCantor Market Data. It touched 1.11 percent, the highest since Nov. 28. The 0.875 percent security due in February 2011 fell 1/32, or 31 cents per \$1,000 face amount, to 99 18/32. The rate climbed from a record low of 0.60 percent on Dec. 17.

The 10-year [note](#)'s yield rose five basis points to 2.98 percent. It slid to a record low of 2.04 percent on Dec. 18 and averaged 4.65 percent in the past decade. The 30-year [bond yield](#) increased six basis points to 3.65 percent.

U.S. stocks declined, with the [Standard & Poor's 500 Index](#) falling 1.3 percent.

'It Never Ends'

Treasuries pared losses after today's seven-year note sale yielded 2.748 percent, compared with an average forecast of 2.715 in a Bloomberg News survey of seven trading firms. The government last issued seven-year notes in April 1993, when it sold \$9.76 billion. The notes at that auction drew a yield of 5.58 percent. The government sold a record \$94 billion of notes this week.

The seven-year auction's so-called bid-to-cover ratio, which gauges demand by comparing the number of bids to the amount of securities sold, was 2.11. Indirect bidders, a class of investors that includes foreign central banks, were awarded 38.7 percent of today's sale. Comparable data is not available from the government.

"The biggest difficulties will be in the next few seven-year auctions," said [William O'Donnell](#), a U.S. government bond strategist at UBS Securities LLC in Stamford, Connecticut, one of the 16 primary dealers required to bid at Treasury auctions. "We're going to get a very hefty slug of supply. As the saying goes, if you miss an auction this week, you'll get another auction next week. It never ends."

Possibility of Default

The U.S. is borrowing so much that it may have trouble paying the money back, said [Jaemin Cheong](#), a bond trader in Seoul at Industrial Bank of Korea, the nation's largest lender to small- and mid-sized companies.

"Yields are headed higher," Cheong said in an interview. "More issuance will be needed to support

the economy. The possibility of default is more and more as time passes."

President [Barack Obama](#) is depending on [investors](#) from overseas to help fund his \$787 billion economic plan. [China](#) is the largest overseas holder of Treasuries, with \$696.2 billion, followed by [Japan](#), which has \$578.3 billion.

The administration forecast gross domestic product to shrink 1.2 percent in 2009, followed by an expansion of 3.2 percent in 2010. That's more optimistic than economists' estimates for a 2 percent contraction this year and 1.8 percent growth next year, according to the median forecast in a Bloomberg News survey.

The White House forecast an annual average yield for 10-year Treasury notes of 2.8 percent this year and 4 percent in 2010.

The 10-year note yield will reach 3.08 percent by the fourth quarter of this year, according to the weighted average of 58 economists surveyed by Bloomberg News, and 3.69 percent by the second quarter of 2010, according to the weighted average of 43 economists.

The Three Elements

China's top banking regulator said today the country will pay attention to safety, liquidity and profitability when deciding whether to buy more U.S. debt.

"How much we will invest in U.S. Treasuries will depend on the three elements," said China Banking Regulatory Commission Chairman [Liu Mingkang](#) at a press conference in Beijing.

Losses by U.S. Treasuries are 0.3 percent in February and 3.4 percent so far in 2009, compared with a 1.7 percent gain in the same period a year ago, according to Merrill Lynch & Co.'s U.S. Treasury Master Index.

The [yield gap](#) between two- and 10-year notes widened by four basis points to 1.87 percentage points.

TED Spread

Money markets show the world's biggest banks see no recovery before 2010.

The premium banks charge each other for short-term loans, the so-called Libor-OIS spread, rose above 1 percentage point last week for the first time since Jan. 9. Contracts traded in the forward market indicate the gauge, which measures banks' reluctance to lend, will

remain higher for the rest of the year than before Sept. 15, when the bankruptcy of Lehman Brothers Holdings Inc. froze credit markets.

The difference between what banks and the Treasury pay to borrow money for three months, the so-called TED spread, rose to 99 basis points from 91 basis points on Feb. 10.

Currencies

The yen slid beyond 98 per dollar for the first time since November on speculation governments' support for banks and Japan's recession discouraged investors from taking refuge in the currency.

The dollar fell against the pound and the Canadian dollar after President [Barack Obama](#) proposed as much as \$750 billion in new aid for the financial industry and the U.K. extended guarantees on distressed assets of banks, reducing demand for the safety of the world's reserve currency.

"The safe-haven currencies are trading on a weak tone," said [Benedikt Germanier](#), a currency strategist at UBS AG in Stamford, Connecticut. "Recovery in risk appetite is what's moving things."

The yen slid 1 percent to 98.38 per dollar at 4:20 p.m. in New York, from 97.39 yesterday, touching 98.71, the weakest level since Nov. 10. Japan's currency depreciated 1.1 percent to 125.24 per euro from 123.92 after reaching 126.08, the weakest level since Jan. 8. The dollar traded at \$1.2734 per euro, compared with \$1.2723.

The pound increased 0.7 percent to \$1.4302, while the Canadian dollar gained 0.5 percent to C\$1.2512 versus the greenback as higher-yielding assets became more attractive.

ICE's [Dollar Index](#), which tracks the U.S. currency versus the euro, yen, pound, Canadian dollar, Swedish krona and Swiss franc, fell 0.2 percent to 87.727. It touched 88.254 on Feb. 18, the strongest level since a 2 1/2-year high reached Nov. 21.

Ukraine's Currency

The Ukrainian hryvnia strengthened as much as 5.6 percent to 8.4100 against the dollar, the biggest gain of all 171 currencies tracked by Bloomberg. The hryvnia tumbled to a record close of 9.2900 per dollar earlier this week after Moody's Investors Service said it may cut the nation's credit rating, which it did the next day.

The dollar pared its decline against the euro after the [Standard & Poor's 500 Index](#) fell 1.6 percent as concern insurers' earnings will be hurt by Obama's overhaul of the health-care system overshadowed a rally in banks spurred by his request for more financial-bailout funds.

Europe's [Dow Jones Stoxx 600 Index](#) climbed 2.2 percent on Royal Bank of Scotland Plc's plan to put 325 billion pounds (\$462 billion) of investments into a state insurance program and shift toxic assets to a new unit after posting the biggest loss in British history.

The yen dropped 1.7 percent to 140.71 against the pound and 1.4 percent to 78.57 versus the Canadian dollar as traders bet the deteriorating Japanese economy will lead to deflation. Japan's currency was headed for an 8.4 percent loss against the dollar in February, the biggest monthly drop since 1995.

Japan's Trade Deficit

Japan's trade deficit increased in January to the widest in two decades as exports slumped by 46 percent, the Finance Ministry said yesterday in Tokyo. A Cabinet Office report showed last week that the world's second-largest economy shrank in the fourth quarter by the most since the 1974 oil shock.

"We are going back to basics in currency trading in that the current-account balance will drive currencies," said [Stephen Jen](#), London-based chief strategist of the foreign-exchange and emerging-market sales and trading group at Morgan Stanley. "The implosion of the trade balance in Japan is exactly the reason why the yen has weakened."

Japan's currency will depreciate to 115 per dollar by year-end should the global economy start to recover in the second half, according to Jen.

The yen's decline against the dollar may be tempered as the currency approaches resistance at 98.90, a 50 percent Fibonacci retracement of the dollar's drop from the August high of 110.66 yen to the January low of 87.13 yen, according to [Tomoko Fujii](#), a rates and currency strategist at Bank of America Securities-Merrill Lynch Japan. Resistance is a level where sell orders may be clustered.

Euro Versus Dollar

The euro was poised for a 0.6 percent loss against the dollar in February, its second straight monthly decline, on concern financial turmoil in Europe will worsen,

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supporting the case for policy makers to lower interest rates.

Confidence in the economic outlook dropped to the lowest on record in February, the European Commission said today, increasing pressure on the central bank to loosen monetary policy. German unemployment rose in February by a seasonally adjusted 40,000 to 3.31 million, a fourth straight monthly increase, the Federal Labor Agency said.

S&P cut Ukraine's credit rating yesterday by two levels after it downgraded Latvia's debt to junk. The euro dropped 1.7 percent versus the dollar on Feb. 17, when Moody's Investors Service said the credit ratings of Austrian, Swedish and other banks with subsidiaries in eastern Europe may be cut as economies in the region deteriorate.

"The financial crisis and the budget problems in Europe are in the early stages," said [Nick Bennenbroek](#), head of currency strategy at Wells Fargo & Co. in New York. "The downtrend for the euro is there."

Brazil's real strengthened for a second day on speculation new aid to the U.S. financial system may help pull the world's largest economy out recession.

The real rose 0.4 percent to 2.3589 per U.S. dollar at 3:09 p.m. New York time, from 2.3691 yesterday.

President [Barack Obama](#) asked for as much as \$750 billion in aid to shore up the financial industry in his first budget proposal. The funds would come on top of the \$700 billion rescue package the U.S. Congress approved last October.

"The expansionist measures in the U.S. and around the world, especially those aimed at the financial system, are an effective way to restore confidence," said [Reginaldo Alexandre](#), vice-president of the Brazilian Association of Analysts and Capital Markets Investment Professionals, or Apimec.

Gains in commodities, which account for almost two-thirds of Brazil's exports, also helped boost the real. Crude oil, a Brazilian export, rose to the highest level in a month.

Yields on Brazil's local-currency bonds and overnight futures contracts fell after the country's broadest measure of inflation advanced less than analyst expected.

The IGP-M price index calculated by the Getulio Vargas Foundation rose 0.26 percent in February, less than the median forecast of 0.41 percent in a Bloomberg survey of 29 economists.

The yield on Brazil's zero-coupon, local-currency bonds due in January 2010 declined 15 basis points, or 0.15 percentage point, to 10.81 percent. The yield on the overnight futures contract for July delivery slid 11 basis points to 11.26 percent.

Bids Rejected

Brazil's central bank didn't accept any bids to buy reais in the currency market at three auctions today.

The bank said yesterday it would buy reais with U.S. dollars in three auctions in the foreign-exchange market to prop up the Brazilian currency. The contracts included an agreement to re-sell the reais at a later date, the central bank said in a statement.

"The central bank probably didn't think the bids were interesting enough, so it didn't see the need to buy reais at just any rate," said [Alex Martins](#), a currency trader at Futura Corretora in Sao Paulo.