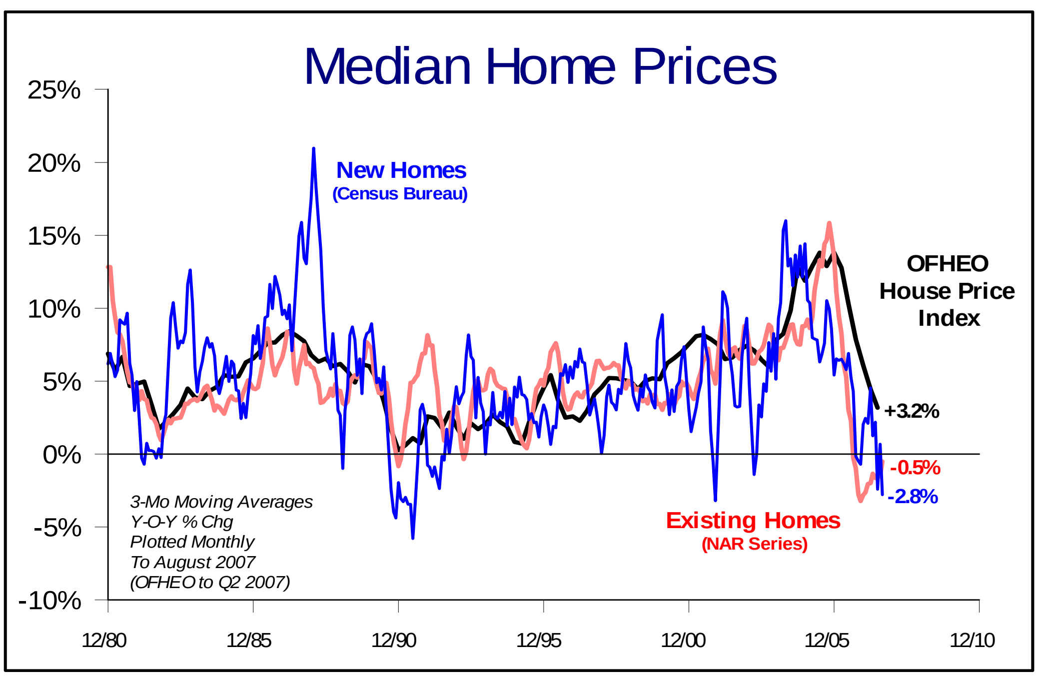
New home sales slump –

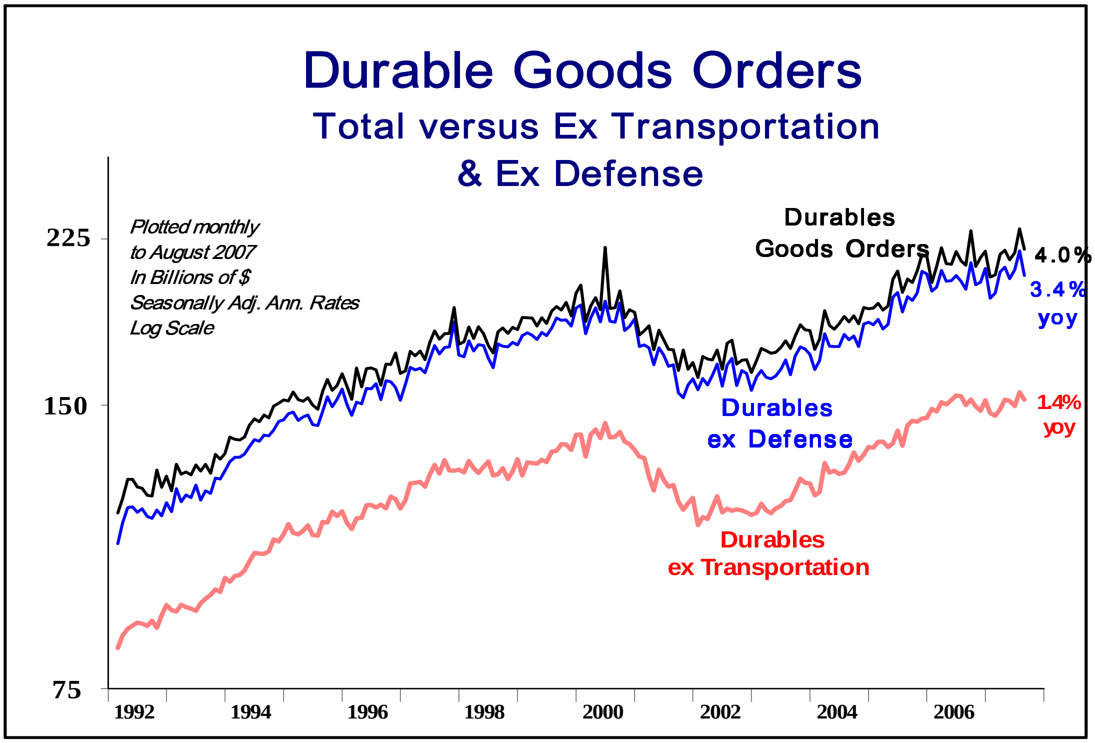
September 27…The credit crunch took a larger-than-expected toll on new home sales in August. The 8.3% decline in sales from July's pace put sales at their lowest rate in more than seven years. The median sales price for new single family homes fell by 7.5% from the year-earlier period, but prices may have to go lower in order to clear out the inventory of unsold homes, which remained at close to a record level (6 months). With the inventory of existing homes (reported Tuesday) expanding to a 10 months' supply, it looks like there has got to be more pain in home prices before the market turns. The CEOs of Fannie Mae and KB Homes both said today that 2008 will be a tough year for housing.

- **Once again, stocks managed to stay on the plus side Thursday despite economic news that could have sent them lower**. It could be that equity investors have factored in bad news on housing for the foreseeable future. Also, stocks may have gotten a boost from the unexpected drop in initial unemployment claims for the latest week. Today's release of the final revision of Q2 GDP didn't seem to generate much response in the market. For one thing, the 3.8% annual rate of growth reported today was in line with expectations (around 4.0%). Moreover, investors may feel that what happened in Q2 doesn't have all that much relevance now that the Fed has begun to easy monetary policy. On Thursday the Dow rose 0.3%, while Nasdaq and the S&P 500 each added 0.4%. Stocks in the energy sector rose as oil prices jumped by more than $2.50 a barrel on concerns about tensions with Iran. The bond market, in contrast to stocks, seemed to be anticipating slower growth with prices rising along the length of the yield curve. A good response to the five-year Treasury auction also helped bonds. The 10-year Treasury was up nearly half a point on Thursday, and its yield was down five basis points to 4.57%.



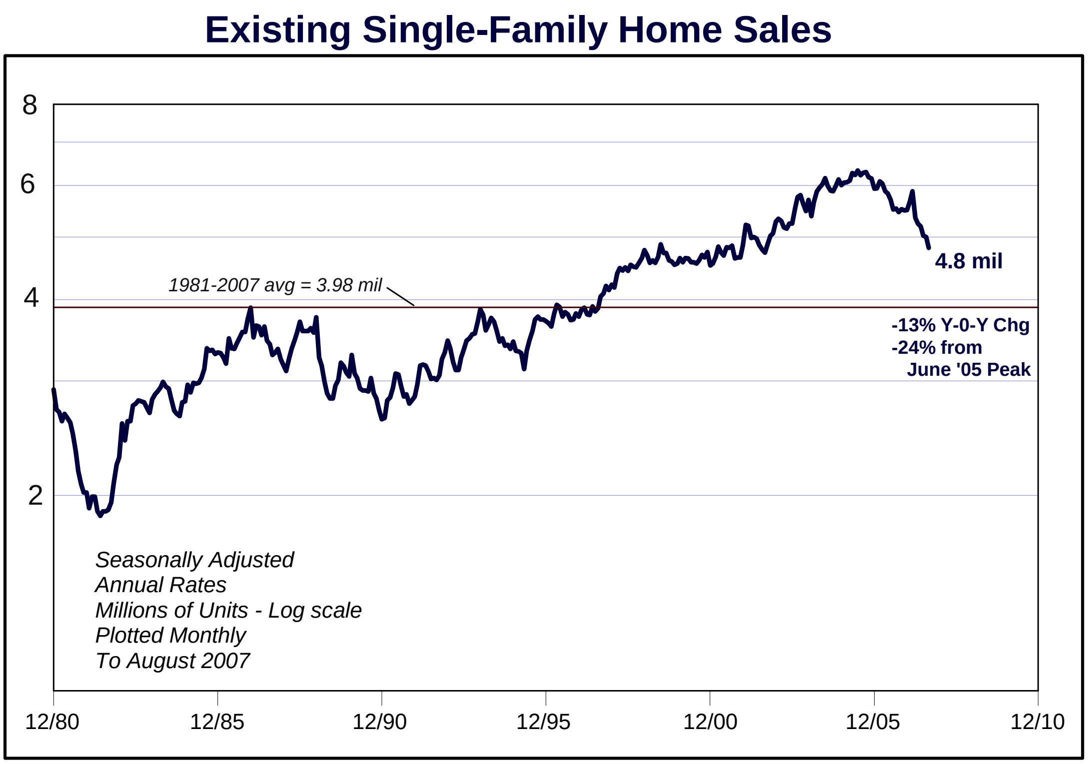
INVESTMENT OUTLOOK…For all the turmoil, the major stock market averages are ending Q3 with respectable returns and not far off their July highs. Pretty clearly, the Fed's 50 basis-point rate cut has investors looking beyond the current economic difficulties (and anticipating more rate cuts). Still, rate cuts are not a panacea for all of the economy's debt problems, and some pullback or meandering in stock prices wouldn't be surprising in Q4. Lower short-term interest rates will ease the pain on adjustable rate mortgages, but housing will remain an impediment to economic growth for some time to come. Continuing episodes of stock and bond market volatility appear likely in the short run; further out, the outlook for economic growth and corporate earnings is improving, but with a modicum more inflation, in our view.

September 26…Durable goods orders fell 4.9% in August. A 41% decline in volatile civilian aircraft orders accounted for the lion's share of the decline; ex transportation, orders declined 1.8% in August. While these numbers sound ominous – they were below expectations of a 4.0% decline overall and a 1% decline ex transportation – some of the sting is removed by the fact that in June and July combined durable goods orders rose around 8%. On a smoothed basis, i.e., over the last three months, durable good orders were up nearly 4% compared to the same period a year ago, the biggest increase since last November. Durable goods shipments declined 1.6% in August after rising 4.0% in July; however, inventories continue to show little growth and unfilled orders are still rising, both of which bode well for the manufacturing sector. Overall, we would classify the August durable goods data as disappointing, but not too worrisome yet after the recent strength in new orders. We will be looking for a better tone in durable goods orders in coming months to stoke healthy activity in the manufacturing sector that will be needed in the fourth quarter and in 2008 to offset weak housing and possibly sluggish consumer spending.



- **Despite the week durable goods report, stocks were in positive territory for all of Wednesday.** The Dow closed up 0.7%, the S&P 500 added 0.5% and Nasdaq gained 0.6% for the day. Some observers suggested that the durable goods report was actually good for stocks because it makes further rate cuts from the Fed more likely. The quick end of the UAW strike against GM, which rose three points or nearly 9% today, was also a positive for stocks on Wednesday. Treasury bonds started the day lower, rallied as the auction of two-year T-bonds generated healthy demand, then eased again to close just about unchanged except for the 30-year, which rose about an eighth of a point. Oil also was volatile, declining early in the session as the weekly inventory report showed higher-than-expected inventories of crude oil, distillates and gasoline, then reversing course to close up 77 cents to $80.30 a barrel as traders began to worry about a new tropical storm in the Gulf of Mexico.

September 25…Consumer confidence fell to an 18-month low in September, due in part to ongoing weakness in the housing market, where single-family home resales hit a five-year low last month. A softer labor market, combined with credit market volatility and ongoing weakness in home sales and prices, appears to have damped retail sales. Within the Conference Board's confidence index, "jobs plentiful" respondents exceeded "jobs hard to get" by just 3.6 percentage points (25.7% vs 22.1%), producing the lowest net jobs figure in 13 months. Also reported this morning was a second week of decline on the order of 1% in chain store sales, prompting the International Council of Shopping Centers to lower its estimate for same store sales growth in September to 2%-2.5%. The Case-Shiller home price report for July (out at 9:00am) and the existing home sales data for August (out at 10:00am) showed further declines in housing, although the numbers were close to expected levels: the Case-Shiller 20-city index was down 3.9% year-on-year; existing single-family home sales declined 3.8% and the median sales price for existing homes was basically flat with the August 2006 level – a slightly more robust indication than Case-Shiller and an indication that home sellers are reluctant to reduce their asking prices, which comports with the rise in unsold home inventories to a 10-month supply, highest in at least seven years.



- **Despite the generally soft numbers out today, compounded by weak results at homebuilder Lennar, stocks held their own Tuesday, with the Dow up 0.1% and Nasdaq gaining 0.6%.** The S&P 500 was today's weak index, ending flat largely on setbacks in the consumer discretionary and energy sectors offset by strength in tech shares. The nearby crude oil futures price fell back below $80 a barrel, while the dollar continued to hit new lows. In the bond market, big early gains gave way to more selective price increases: the 5-year Treasury was the best part of the curve, gaining six 32nds in price while the long bond suffered a decline of similar magnitude. The yield on the 10-year T-note closed at 4.63%, having hit a low of 4.56% earlier in the trading day.

September 24…Last week's 50 basis-point interest rate cut by the Fed is having diminishing returns in the stock markets. The S&P 500 retreated about 0.5% Monday, as investors shift their attention from the likely effects of Fed rate cuts to economic news in the here and now. As the third quarter comes to a close, this week's economic releases bring data on home sales, home prices and durable goods orders, the latter of which may (or may not) provide evidence that business investment will increasingly be an offset to the weak housing market. The bond market was little changed today, crude oil futures backed off a bit more from last week's highs, and the dollar was down an iota against a basket of major foreign currencies. Such circumspection as is seen in today's stock market action is not entirely a bad thing, since it would be unrealistic to expect the Fed's rate cut to fix all of the world's problems. Investors have already begun to focus on the next FOMC meeting (October 30-31) and to speculate on how many rate cuts lie ahead. Fed funds futures trading suggests that the Fed will cut its target fed funds rate by another 50 basis points to 4.25% by the end of 2007.

- **A poll of *Wall Street Journal* readers today finds stagflation the most likely problem for the U.S. economy ahead.** The sample size is neither large (5000 voters) nor representative (these are strictly *WSJ* readers), but the findings are of interest nonetheless. At 5:00 EDT, the tally is as follows: stagflation, 37%; recession, 30%; inflation, 23%; none of these, 10%.

- **General Motors workers walked off the job Monday when contract talks failed to meet a 10:00 deadline.** The nationwide strike, which hinges on issues of job security and management efforts to establish a separate trust to assume responsibility for some $55 billion in projected worker/retiree health benefits, represents the first major contract-related strike since a 13-day strike of 25 facilities in 1984. GM has roughly 75,000 U.S. workers, and it could tolerate (and even benefit from) a short strike that brings inventories into better alignment with sales. A prolonged strike does not appear likely.

September 21…Fed Chairmen, past and present, did wonders for stock prices and book sales this past week. Bernanke met with his fellow members of the Federal Open Market Committee in the Mariner Eccles Building on Tuesday and appeared before the House Financial Services Committee on Thursday; Greenspan appeared just about everywhere else.

- **Bernanke and the other FOMC members voted unanimously to cut the fed funds rate target from 5.25% to 4.75% on Tuesday, producing a nearly unanimous rise in stock prices.** The S&P 500 rose 2.9% on the day, the best rise in 4½ years (since just after the market's double bottom of March 2003). By week's end, the Dow, S&P 500 and Nasdaq Composite were all back to within 2% of their July price peaks. With the Fed's surprising 50 basis-point cut, there was much discussion of whether the so-called Greenspan put has now become the Bernanke put. That is, isn't this another bailout of the market by the Fed, creating moral hazard and encouraging the sort of risky lending that contributed to the subprime problem in the first place? In the short term at least, the stock market has few qualms about the Fed's move, while bond investors have become more leery of renewed inflation.

- **Flogging his new book, *The Age of Turbulence: Adventures in a New World,* Alan Greenspan flitted hither and yon to help propel it to the top spot on Amazon.** It is hard to believe that anyone who listened to or read Greenspan's many speeches and testimonies over the course of his 18 years as Fed chairman is running to Amazon to start turning the 544 pages of this work – although with the help of writer Peter Petre, the work surely has a lower fog index than Greenspan's usual gyroglyphics. Give Greenspan credit: his admission to The Daily Show's Jon Stewart that he's no better forecaster today than he was when he began as an economist some 50 years ago shows a true appreciation of the forecaster's game. Then again, it may have been another instance of false modesty by the Maestro. To our way of thinking, it is not "maestro" but Chance the gardener from *Being There* that comes to mind when we think of Greenspan. (What is a garden but a green span, after all?) Greenspan certainly inflicted a Chance-like level of misapprehension among listeners and readers – and now we learn that this was his intent all along. Oh, sure, we'll probably all wade through *Turbulence* but probably without much enjoyment. And how much wisdom can one expect from the exercise, when Greenspan didn't even get the title right? Since 1987, the U.S. economy and markets have more accurately been described as the Great Moderation.

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