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Subject: Top Gun FP Client Note: The Hammer And The Helicopter

> Treasury will have authority to issue up to $700 billion of Treasury securities to finance the purchase of troubled assets. The purchases are intended to be residential and commercial mortgage-related assets, which may include mortgage-backed securities and whole loans.
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> - Treasury Department Press Release, "Fact Sheet: Proposed Treasury Authority To Purchase Troubled Assets", Saturday September 20
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> Hank is just the most hyperactive, get-it-done kind of guy who's always trying to get the problem solved and move on. He's impatient to fix things. Ben is much more low-key. He's very thoughtful. He's an incredible thinker, listens well, analyzes well and is not intimidated by anyone. It's probably a great pair.
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> - Alan Hubbard, former National Economic Advisor to President Bush, on Treasury Secretary Paulson and Fed Chairman Bernanke, quoted in the NY Times "A Professor And a Banker Bury Old Dogma", Sunday September 21

Back when he played football at Dartmouth, Treasury Secretary Hank Paulson earned the nickname "The Hammer". From a now famous 2002 speech in which Fed Chairman Bernanke suggested the government could in essence drop money from a helicopter to prevent deflation he became known as Helicopter Money or Helicopter Ben. Last week, together The Hammer and The Helicopter put together a historic bailout that will be a subject for the history books.

Early in the week, there was panic in financial markets the likes of which have not been seen since the Crash of 1987. The S&P 500 dropped by more than 4% on both Monday and Wednesday. The "Fear Index" (VIX) spiked as high as 42 midday Thursday. The yield on the 3-month T-bill dropped to 0.04% on Wednesday meaning that investors were willing to lend money to the Federal government for 3 months for essentially no interest - just for the assurance that their principal was safe. That, more than anything, shows the level of panic that existed. Everything was being sold - stocks, bonds, commercial paper, money market mutual funds - and nothing was trusted.

It was amidst this maelstrom that Fed Chairman Bernanke put an end to an ongoing series of conference calls among Fed, Treasury and Government officials about what to do when he said: "We have got to go to Congress." The plan Bernanke and Paulson briefed the President and Congress on on Thursday involved using taxpayer money to buy up a huge amount of toxic mortgage assets that are weighing down the nation's preeminent financial institutions. Wind of this caused markets to reverse course Thursday and surge higher. The Dow gained almost 1000 points and the S&P more than 100 Thursday afternoon and Friday.

On Saturday, the Treasury released more details on the plan they presented to Congress. ***They are aiming to borrow up to $700 billion in order to buy up toxic mortgage assets from the nations financial institutions.*** Since this circumstance is relatively unusual with only one buyer and many sellers, a reverse auction appears to be the mechanism that will be used to set the prices. That is, the financial institutions themselves will offer to sell their toxic assets at a price and the Treasury will purchase the ones that strike them as the best deal.

The issue of the price paid is a crucial one. Will the Treasury buy assets at market values, at values that the banks have marked to, or what? Answering that question will determine how much of the losses will be shouldered by the financial institutions and how much by taxpayers. ***My sense here is that Paulson and***

Bernanke will want to avoid any whiff of a bailout, especially for Wall Street. If that's correct, then while this proposal will certainly add liquidity and capital to bank balance sheets, it won't be an unmitigated windfall.

Either way, I think those who believe this marks the end of the bear are mistaken. It will add liquidity and capital to bank balance sheets and will likely shift at least some of the ultimate losses from these toxic securities from the private sector to the public sector. It will dominate the financial markets for the near term and have effects on the real economy. But it doesn't stop the fallout in the housing market or its effects on consumer spending, employment and overall economic activity.

Here's how the week looked:

S&P: +0.27%

Wilshire: +0.92%

Top Gun: +3.44%

And Year-To-Date:

S&P: -14.53%

Wilshire: -13.07%

Top Gun: +21.33%