Steve Czech's - Anecdotes From The Road: "Consumers Are Trading Down & Trading In" - Volume IV., No. 36

Ladies & Gentlemen:

Hope all is well with you and yours!

Below, please find the latest installment of *Steve Czech's Anecdotes From The Road:" Consumers Are Trading Down & Trading In".* The following are some very interesting anecdotes I've gleaned from reading, meetings and conversations during the past week. (A pdf version is attached hereto for iPad users).

I hope you find the following useful and welcome the opportunity to discuss these at your convenience.

AMERICA ON THE ROAD TO RECOVERY: DAY 349

GM's STOCK PRICE AT THE IPO ON 11.18.10: $33.00/SHARE
GM's STOCK PRICE ON 10.7.11: $22.01/SHARE
ABSOLUTE % CHANGE FROM IPO PRICE: - 33.30%
ANNUALIZED % CHANGE FROM IPO PRICE: - 36.33%

ISN'T IT AMAZING…..

- …that the hooligans in the "Occupy Wall Street" protests (coming to a city near you) are condemning: (i) the Wall Street bankers who received bonuses & whose banks received bail out money; (ii) who repaid that bailout money; and (iii) who repaid that bailout money AT A PROFIT….YET these same hooligans had nothing to say this week when *GM* and *Chrysler* workers received signing bonuses from two companies who: (i) failed; (ii) were bailed out by the government; (iii) have yet to repay that bailout money; and (iv) who will likely never repay the U.S. government at par, much less generate a profit on that bailout money.
- Hmmmmm??????

NUMBER OF THE WEEK # 1: $838.0 MILLION

- This is the market capitalization of *American Airlines* on Friday, October 7, 2011 *(Source: Bloomberg, 10.9.11).*

NUMBER OF THE WEEK # 2: 2,775TH

- Prior to Tiger Woods' sex scandal, he was the 11th most effective product spokesperson in the world – on par with Bill Cosby.
- In the wake of his sex scandal and as of July 31, 2011, Woods was the 2,775th most effective product spokesperson in the world – on par with Dallas Cowboys owner Jerry Jones *(Source: Davie-Brown Entertainment, an Omnicom Group unit that tracks celebrities' appeal using online consumer polls, 10.6.11).*

NUMBER OF THE WEEK # 3: - 9.6%

- Few are unscathed by the bad economy, but the way it has damaged the prospects of America's young college graduates may be one of its most lasting legacies.
- The high unemployment they are now experiencing will leave many of them a step behind throughout their careers. When they do land a job, it often won't pay well.
- According to the *U.S. Census Bureau*, the median annual earnings of a worker 25 to 34 years old with a bachelor's degree but no graduate degree was $40,875 in 2010.
- That compares with $45,200 in 2000, *adjusting for inflation*.
- Older college-educated workers also saw their earnings fall, but not by nearly as much *(Sources: The U.S. Census & The Wall Street Journal, 10.8.11)*.

NUMBER OF THE WEEK # 4: 53

- This is the number of *Dodd-Frank* regulations that were required to be passed into law by 7.21.11 and which have not yet been approved *(Source: Bloomberg, 10.7.11)*.

QUOTE OF THE WEEK # 1:

- "Bank of America customers, vote with your feet! Get the heck out of that bank" – *Senator Richard Durbin (Democrat-IL) on the floor of the U.S. Senate last week responding to Bank of America's decision to institute a $5.00 per month debit card charge for its customers after the Durbin Amendment to Dodd-Frank cut the fees banks can charge on debit card transactions by 50% (Source: Fox News, 10.8.11).*
- ***Editor's Note:*** Those of you who follow politics know that Vice President Joe Biden (Democrat-DE) was referred to by his Senate PEERS as the "dumbest man in the Senate". Durbin, once again, has proven that he is more worthy of that title than Biden. Durbin's comment, which effectively calls for a run on the bank, is wildly irresponsible, in general, and particularly in the wake of *Bank of America's* well-publicized troubles that required it to be privately bailed out by Warren Buffett a few weeks ago. Durbin should be publicly reprimanded by Downgrader-in-Chief Obama and censured by the U.S. Senate.

QUOTE OF THE WEEK # 2:

- "Well, you can stop it because it – if you – if you say to the banks, 'You don't have some inherent right just to, you know, get a certain amount of profit if your customers are being mistreated.'" – Downgrader-in-Chief Obama in response to a question from George Stephanopoulos of *ABC News* about the Obama administration's ability to stop *Bank of America* from levying a $5.00 per month fee on its debit card customers.
- Reasonable people can disagree about which politician is more economically irresponsible – Obama who wants bureaucrats to dictate profit margins or the Senator who encourages a run on a bank from the floor of the U.S. Senate *(Source: The Wall Street Journal, 10.6.11)*.
- ***Editor's Note # 1***: Both of these "mensas" – Obama and Durbin - hail from Illinois and were/are Democratic Senators from Illinois. In the wake of their comments, is it any wonder that Illinois has now surpassed California and New York as the biggest fiscal basket case in the country? To those of you who are not from Illinois, please note the following: Obama, Durbin, Bill Daley and Valerie Jarrett are NOT reflective of the best that Illinois has to offer. In fact, they're reflective of the worst Illinois has to offer. Illinois is populated with smart, ambitious, hard-working, honest people, so please don't conclude otherwise based on the behavior of a few bad apples.
- ***Editor's Note # 2***: For the few people in this country who: (i) have an I.Q. higher than room temperature; and (ii) who are still trying to justify why they voted for Obama in the first place, Obama's response to George Stephanopoulos provides you with the air cover you need to capitulate.

PRESIDENTIAL INTERPRETATION – DOES DODD-FRANK PROHIBIT "HIDDEN FEES," OR ANY FEE?

- Sometimes when a President adopts his own view of reality, especially this one, it's hard to budge him off of it.
- *The Wall Street Journal* editorialized on 10.6.11 that *Bank of America's* planned $5 monthly fee on debit cards—in response to *Dodd-Frank's* revenue-reducing rules—is "perhaps the most transparent pricing change in the history of American finance."
- No matter. By the *Journal's* count, Obama in his hour-plus news conference on 10.6.11 elevated the specter of "hidden fees" at least four times.
- After saying the Republicans want to "allow banks to charge hidden fees," he said financial institutions "can't be competing on the basis of hidden fees" and then said: "I mean, basically the argument they've made is, 'Well you know what? This hidden fee was prohibited and so we'll find another fee to make up for it."
- Parsing that last, it's not clear whether Obama thinks *Dodd-Frank* prohibits just "hidden fees" or *any* fee.
- Obama ends this exploration by saying one purpose of his proposed consumer watchdog is "making sure transactions are transparent." The *Bank of America* fee *is* transparent. They publicly announced it in a press release.
- Which raises the question a reporter asked: Whether Obama thinks he can dictate how much profit companies make.
- "I absolutely do not think that," Obama replied. Our reading of the President's thoughts on fees, of any sort, suggests the contrary *(Source: The Wall Street Journal, 10.7.11)*.

103,000 VS. 1.1 MILLION - A TALE OF SEPTEMBER JOBS, 28 YEARS APART:

- Friday's September 2011 jobs report was a welcome surprise, a signal that another recession may be averted. With 103,000 new jobs in the month and an upward revision of 99,000 for July and August 2011, the jobs picture looks less bleak than it did a month ago. More Americans also started looking for work and the labor force expanded by 423,000, according to the *Labor Department's* household survey.
- However, the unemployment rate held steady at 9.1%, some 6.2 million Americans have been unemployed for more than six months, and the economy is producing far fewer jobs than you'd expect in a typical recovery from recession.
- Over the past six months the U.S. economy has created an average of 72,000 jobs a month, roughly half the 150,000 per month pace needed to chip away at the jobless rate. The hardest hit have been minority workers, with the jobless rate for blacks still 16%, Hispanics 11.3%, and teens 24.6%.
- As it happens, the biggest one-month jobs gain in American history was at exactly this juncture of the Reagan Presidency, after another deep recession.
- In September 1983, coming out of the 1981-82 downturn, American employers added 1.1 million workers to their payrolls, the acceleration point for a seven-year expansion that created some 17 million new jobs.
- The difference between then and now isn't the magnitude of the recessions but the policies the U.S. pursued to restore growth.
- In the Reagan expansion, spending and tax rates were cut, regulations were eased, and government was in retreat.
- Today, we've had a spending and regulatory boom, the threat of higher tax rates, and a general anti-business political climate. Policies have consequences *(Source: The Wall Street Journal, 10.8.11)*.

UPDATE: THE FEDERAL RESERVE'S "OPERATION TWIST'S" IMPACT ON U.S. BANK PROFITS:

Background:

- The following appeared in the 9.25.11 installment of *"Anecdotes"*.
- The *Federal Reserve (the "Fed')* served up something of a double-whammy on 9.21.11 for U.S. commercial banks.
- The central bank said it would "twist" $400 billion of its $1.66 trillion in Treasury holdings into longer-dated debt. This was more than the $300 billion markets had been expecting, but a bigger surprise was that about 30% of the purchases would be in the 20- to 30-year range.
- So while the 10-year Treasury note was pretty well priced for the *Fed's* actions, the bigger move came in the 30-year bond. Its yield fell to almost 3.0%, from 3.20% before the *Fed's* announcement. That 3.0% rate will prove particularly painful for U.S. insurers and pension funds, which need to invest at the longer end of the yield curve.
- Banks are less exposed so far out. However, the decline in the 10-year yield means banks will continue to feel the pain of a flattening yield curve and super-low rates.
- A flattening yield curve and super-low rates puts further downward pressure on bank's net interest margins.
- And the bigger sting, for banks, perhaps came in the *Fed's* downgrading of the economic outlook in its statement. While the *Fed* had previously cited deteriorating economic conditions, it now says there are "significant" downside risks and "strains in global financial markets."
- That's further confirmation that commercial loan growth, and with it a normalization of bank earnings, will continue to prove elusive. In that case, banks will have a tougher time dealing with the margin pressure exerted by lower rates.
- Granted, the *Fed's* decision to roll over maturing mortgage securities, as opposed to reinvesting the proceeds in Treasuries, should help reduce the widened spread between mortgage rates and the 10-year.
- That may bolster refinance activity, and fees for banks.
- The downside is that, longer term, banks will earn less from new mortgages or have to reinvest funds in lower-yielding securities.
- Lower bank profits leads to lower capital levels and lower capital levels lead to lower lending capacity.
- Even worse, few economists expect the *Fed's* actions to have a meaningful economic impact. And a pickup in growth is ultimately what financial stocks need, not moves that fiddle with the yield curve *(Source: The Wall Street Journal, 9.22.11)*.

Update: "We Have No Incentive To Lend"

- As the 10 year Treasury Note's yield has declined from 3.00% to 2.00%, the cost of a 3/1 ARM mortgage at my bank declined from 4.25% to 3.00% (Note: the 3/1 ARM rate tracks the 10 year Treasury yield).
- Last week, the 10-year Treasury yielded as low as 1.72%.
- Hence, I called my banker to see where the 3/1 ARM rate was as I would like to refinance my mortgage if the 3/1 ARM rate dropped to 2.75%, which should have happened based on the historical relationship between the 10 year Treasury yield and 3/1 ARM.
- My banker replied that, despite the fact that the 10-year Treasury yield had declined to 1.72%, the bank's 3/1 ARM rate had INCREASED to 3.25%.
- I replied that it was obvious to me that the bank is no longer interested in making 3/1 ARM rates.
- She replied, "That's correct. We have no incentive to lend and less desire to put loans on the books at these unacceptably low rates against the backdrop of a housing market that continues to decline with no bottom in sight".

- So much for Quiz-Kid Bernanke's goal of driving intermediate-to-long-term interest rates down to stimulate purchases and investments.
- It's hard to spend cheap money when banks won't lend it.

STEVE JOBS: 1956 – 2011:

- As you know, Apple co-founder Steve Jobs passed away on 10.5.11 from complications associated with pancreatic cancer.
- I had just landed in Dallas Wednesday night when I received the news and, like most people, spent the balance of the night watching tributes to Jobs on cable news channels.
- While watching those tributes, I had a flashback to my business school days as I was in my second year at The University of Chicago when Jobs returned to Apple.
- One of my classmates on that day, a German national from Munich, said to me upon hearing the news on July 9, 1997, "Apple is ka-put! It will never survive".
- I asked him why he thought that and he replied without hesitation, "Apple customers LOVE their computers. PC customers USE their computers. Apple is a fad!"
- The day Jobs returned to Apple on July 9, 1997, Apple's market cap was $3.0 billion and Jobs' salary was $1.00 (not a typo) *(Source: Reuters, 10.9.11)*.
- The day Jobs died, Apple's market cap was $342.8 billion and Jobs' salary was $1.00 (not a typo) *(Source: CNBC, 10.9.11)*.
- Jobs revolutionized the personal computer, movie, music, mobile phone and television industries and enabled productivity to increase to levels heretofore never thought possible (imagine iChatting with your child at 35,000 feet in an airplane with a device the size of a cigarette pack).
- In the interest of full disclosure, I am not an Apple customer. I use H-P PCs and Lenovo laptops. The only Apple product I own is an iPod although my wife and daughter own MacBooks, iPods, iPhones and iPads.
- That said, I'm in a growing minority as evidenced by what I saw on my flight home to New York Thursday night from Dallas.
- As I was walking back from the galley to my seat on the Boeing 757, I noticed that every person in every row from row 36 to my seat in row 18 had either an iPod, iPad, iPhone or MacBook…*every single passenger*!
- Finally, I had dinner recently with the owner of several Lexus dealerships in New York and Connecticut. This person was complaining about how difficult it is to generate extra profit on entertainment systems in cars in the wake of the iPad's introduction. The reason? Parents can buy two iPads for their kids to watch TV or movies in their cars for half the price of a standard automobile video system. As a result, car video system sales are declining and auto dealer profit margins are declining as the mark-up on automotive video systems is huge.
- May Steve Jobs rest in peace and may the Good Lord's perpetual light shine upon him.

UPDATE: ANECDOTES FROM THE CREDITOR'S BALL:

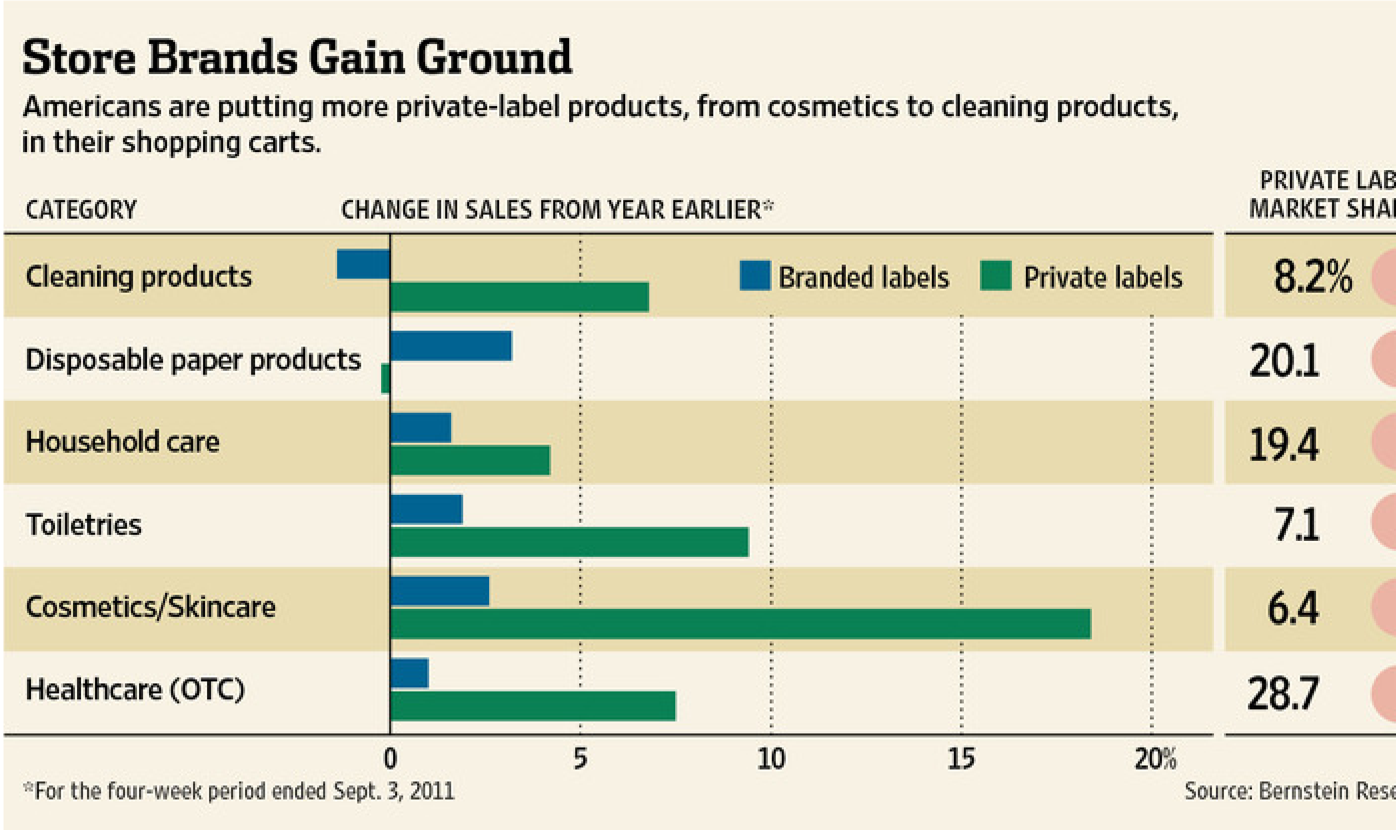
Background - Sales Mix:

- The following appeared in the 9.11.11 & 9.25.11 installments of *"Anecdotes".*
- Executives told me that essentials (i.e.: food and pharmaceutical sales) are holding up well but sales of items such as house wares, apparel and seasonal merchandise are weak and/or declining.
- Recall that we've been telling you that retailers have moved from offering consumers a selection of "good-better-best" to "cheap-cheaper-free" as consumers are becoming increasingly pinched.
- These executives said that they are getting "enormous" pressure to lower their price points on all of their goods.

- ***The focus is no longer price-per quantity. The focus is on “get me a package at the lowest price-point possible regardless of the quantity because my customer only has $1.00 per week to spend on shampoo”.***
- What’s frightening about this approach is that this type of marketing - i.e.: give me the lowest priced unit you can make – is the same type of marketing that consumer product companies use in emerging or developing markets in third-world countries, not developed countries like the U.S.
- One executive told me that prior to the crisis, approximately 40% of his sales were generated on the 15^{th} and 30^{th} of each month (payday). Today, nearly 70% of his sales are generated on the 15^{th} and 30^{th} of each month. This person runs a general merchandise company that caters to lower-to-middle class consumers.

Update: Strapped U.S. Consumers Are Unable To Trade Back Up To Branded Goods From Private Label:

- Retailers are coming to terms with a new reality: the consumer who traded down from branded products to private label during the recession and never came back.
- Buffeted by high unemployment, heavy debt loads, falling home values and high food and gas prices, these shoppers have been whipped into a permanent state of consumer caution. They buy only what they need, avoid premium labels, clip coupons and scour sales.
- *Wal-Mart Stores Inc.* Chief Executive Mike Duke told analysts in a recent conference call that paycheck-cycle shopping is more pronounced than ever, with shoppers stocking up shortly after getting paid on the 15^{th} and 30^{th} of each month, then moving to smaller product sizes toward the end of the month when they run short of money.
- "Consumers are fragile, fatigued and fed up," said Chris Christopher, senior economist at *IHS Global Insight*, citing wage stagnation, food inflation and high gas prices.
- Retailers and manufacturers are figuring out how to appeal to these new "forever frugal" consumers—rather than pin too much hope on economic rebound.
- Some are waiting longer to pass on higher costs, whether for food or cotton. *Coca-Cola Co.* and other companies have added new packages at small sizes and lower price tags. Some retailers are holding the line on hiring, even as they head into their busiest season of the year. Many stores are expanding their selection of cheaper private-label products and some are offering credit cards with across-the-board discounts. The Depression-era layaway has made a comeback.
- Heading into the holidays, retailers are in a bind. Many of them placed their orders back in early spring when the stock market was rising and the economy appeared to still be rebounding. But lackluster back-to-school sales signal that the holidays aren't likely to be free-spending for many shoppers. Now retailers are worried they will have too much merchandise.
- Eight of the 16 large retail chains that retail analyst Ed Yruma covers for *KeyBanc Capital Markets* said their inventories had risen faster than sales when they reported second-quarter profit results in August.
- It is an ominous sign indicating that chain stores' profit margins will be squeezed if they have to resort to bigger than planned discounts to move merchandise.



- Echoing the sentiments of many other retailers, Jonathan Ramsden, chief financial officer of teen retailer *Abercrombie & Fitch Co*., told Wall Street analysts in a conference call in August 2011 that his company is increasingly concerned about "the potential double-dip recession...that has increased in terms of the likelihood over the last few months."
- Apparel stores face a double whammy. Many had hoped to raise prices this fall to recoup the cost of cotton, which soared last year and hit historic highs in March 2011 before a recent pullback.
- Now they worry that strapped consumers will resist price increases. If purchases stall, retailers will have to resort to cutting prices instead.
- "The only lever the retailers have is discounting," said Yruma. "Clothing isn't like fine wine; it doesn't get better with age."
- Yruma expects retailers to offer the sort of promotions that will preserve as much profit margin as possible. For example, instead of slashing prices, he says, stores will try more "buy one, get half-off a second item" promotions.
- *Wal-Mart* is courting shoppers with a return to a Depression-era strategy: layaway.
- Increasingly strapped *Wal-Mart* customers, 20% of whom don't even have bank accounts, demanded that *Wal-Mart* bring back layaway, which it canceled in 2005. The world's biggest retailer—which has seen two years' worth of declines in comparable-store sales—finally acquiesced in time for this Christmas.
- Other stores such as *Sears Holdings Corp.* and *Toys "R" Us Inc*. brought back the layaway plans during the recession and reported a sales boost.
- *Target* has a different weapon to snare a bigger share of pocketbooks. About a year ago, *Target* began rolling out a credit and debit card that offers a 5% discount on all purchases. The card effectively makes *Target's* prices equivalent or less than its competitors, *Target* Chief Executive Greg Steinhafel said in a recent interview with the *Wall Street Journal*. Shoppers who use the card increase their spending about 50% each visit, he added. In the spring, *Lowe's Corp*. began offering a similar 5%-off branded credit card.

- *Target* attracts a more affluent customer than *Wal-Mart*. Households with income of $75,000 or more have largely resumed their pre-recession shopping patterns at *Target*. But the families making $50,000 to $75,000 are stressed, Steinhafel says, as they try to keep up with food and gas prices, health insurance premiums and stagnant wages.
- "They are trading down, consolidating shopping trips to save on gas and generally not spending a lot on discretionary purchases," Steinhafel said.
- *Target* is in a better position to cater to that stressed consumer than it was during the recession. About two years ago, it began adding fresh grocery and expanded dairy and frozen food in its discount stores, making its stores more of a one-stop destination. By the end of the year 1,500 of the chain's 1,800 stores will house the new format.
- Dollar stores sales boomed during the recession and moderated only somewhat as the economy appeared to improve. Now, renewed pressure on consumers are lifting their sales again. *Dollar General Corp.* raised its full-year sales guidance to between 4% and 6% from 3% to 5% when it reported second quarter earnings in late August.
- Rick Dreiling, chief executive officer of *Dollar General*, says the economic climate has bred two new types of dollar-store customers. One group, squeezed by high gas and food prices, is trading down to *Dollar General*, finding its prices on brand-name goods cheaper than rivals.
- With these customers in mind, *Dollar General* sells smaller package sizes, so the outlay is smaller, a big selling point especially for shoppers who run out of money at the end of the month.
- The second group of customers is what Dreiling calls "the trade-ins," people who can afford to shop elsewhere, but choose to go to the dollar stores. "They are the new consumer, who exercises frugality and smart shopping," Dreiling said in a conference call with analysts.
- *Dollar General* has slowly passed along higher foods prices to customers and has backed off of some price increases if sales suffered. The company has seen strong response to a new category of private-label health and beauty products it introduced early this year under the brand name *Rexall*, which was once a pharmacy chain.
- Looking forward, Dreiling said, "We see more of the same—customers who are continuing to struggle." *(Sources: Bernstein Research, HIS Global Insight, KeyBanc Capital Markets & The Wall Street Journal, 10.4.11).*

UPDATE: THE BIGGEST TRADE BARRIER – THE BUCKS STOP AT THE WHITE HOUSE (Free Trade Agreements w/South Korea, Colombia & Panama):

Background:

- Recall from the 8.21.11 installment of *"Anecdotes*", we told you that Obama keeps talking about his desire to have the South Korean, Colombian and Panama Free-Trade Agreements (the "Free-Trade Agreements") passed by Congress.
- On 9.4.11, we told you that (Surprise! Surprise!), despite Obama's repeated desire to pass the aforementioned agreements, the White House has yet to send those agreements to Congress to be voted on.
- As noted, Congress can't pass bills that they don't physically have.
- Obama again said in his 9.8.11 speech that he wanted Congress to pass the aforementioned Free-Trade Agreements.
- As of Friday morning, 9.9.11, the White House STILL has not sent the aforementioned Free-Trade Agreements to Congress.

Update:

- The White House finally sent the aforementioned Free-Trade Agreements to Congress on Monday, October 3, 2011.

UPDATE: THE FRAUD KNOWN AS "GREEN/CLEAN ENERGY/TECHNOLOGY":

Background:

- Recall from the 8.21.11 installment of *"Anecdotes*", that *Solyndra*, a manufacturer of solar panels, received a $535 million *Department of Energy* loan guarantee in 2009 as part of the Obama administration's economic stimulus package.
- *Solyndra* filed for Chapter 11 bankruptcy protection on 8.31.11.

Update:

- Jonathan Silver, head of a government loan program that awarded $535 million in guarantees to solar-panel maker *Solyndra LLC*, is leaving the *Energy Department* for a position at a Washington think tank.
- Silver's departure follows heavy criticism in Congress over the program, which Republicans have called a waste of taxpayer dollars. However, the *Energy Department* denied that the move was linked to the controversy, saying Silver decided in July 2011 to leave after his office completed loan guarantees at the end of the 9.30.11 fiscal year.
- "Under his leadership, the loan program has demonstrated considerable success," said Energy Secretary Steven Chu.
- Silver, a former venture capitalist, became chief of the Obama administration's clean-energy *loan* program in November 2009, two months after the program made the *Solyndra* loan guarantee. He presided over one of the largest U.S. investments in clean energy, with the program backing more than $35 billion in loans in less than two years. The program, which originated in the George W. Bush administration, received funding under the 2009 economic-stimulus bill.
- When Silver took over, many people believed the *Energy Department* was moving too slowly. He built a team of lawyers and technical experts to speed up loan reviews. In the final month before the stimulus-funded portion of the program expired on 9.30.11, ***<u>his office closed about $7.9 billion worth of deals, including $4.7 billion in the final week</u>***.
- "Silver's resignation does not solve the problem," said Rep. Fred Upton (R., Mich.), the chairman of the *House Energy and Commerce Committee*, and Rep. Cliff Stearns (R., Fla.) in a statement that criticized the "mad rush" to close deals before the deadline.
- Last month, Silver came under harsh questioning at a House oversight hearing, as Republicans repeatedly asked whether the *Solyndra* deal was rushed or subject to undue influence from a Democratic donor who held a stake in the firm. Silver said the deal underwent intense due diligence and "clearly wasn't rushed too fast."
- Republicans also focused on the agency's decision early this year, carried out on Silver's watch, to help keep *Solyndra* afloat with a restructuring. The deal allowed some private investors to move ahead of the government in line to be paid back if Solyndra had to be liquidated. Silver said that was the best bet for taxpayers at the time.
- Silver will be a fellow at *Third Way*, a think tank, where he will focus on developing ways for the government to help finance clean-energy technologies.
- "The projects that we've underwritten I think are the base for American development going forward," Silver said in an interview this summer. "I think we've been able to lay the foundation for progress in years to come." *(Source: The Wall Street Journal, 10.7.11).*
- ***Editor's Note****:* The fact that a LOAN program was run by a venture capitalist, lawyers, "technical experts" and not a single commercial banker is nothing short of astonishing and will likely result in massive losses within this program. I have spent 23 years on Wall Street, including several years during which I worked with venture capital firms to raise money for their portfolio companies. Virtually every VC I worked with (and I worked with some of the biggest and best) would show up with one page financial projection…an

income statement. No balance sheet, no cash flow statement and no statement of retained earnings. Why? Because most VCs don't understand debt, they only understand equity. They don't borrow money, they raise equity. Their analysis is not focused on repaying the money from operating cash flow. Their analysis is focused on getting a return from a sale of IPO. Hence, the money extended to these start-ups should be in the form of equity with the upside going to the government, not debt.

BUSINESS FACTOIDS:

- ***U.S. Financial Stress On The Rise***: The St. Louis Fed's Financial Stress Index, which is based on interest rates, stock & bond option prices and other measures, climbed 1.08 in the week ended 10.7.11 from 0.97 a week earlier. That was the highest level of stress the gauge registered since September 2009, though well below its peak of 5.37 posted during October 2008 *(Sources: The Federal Reserve Bank of St. Louis & The Wall Street Journal, 10.7.11).*

- ***U.S. Budget Deficit Hits $1.3 Trillion In Fiscal 2011***: The U.S. government ran an estimated $1.3 trillion budget deficit in fiscal 2011, ended 9.30.11, the same amount as in the previous year, according to the *Congressional Budget Office ("CBO*"). The *CBO* said the $1.3 trillion deficit was equivalent to 8.6% of U.S. GDP, down from 8.9% in fiscal 2010 and the third highest deficit-to-GDP ratio since 1945. The Obama administration has now generated $xyz trillion of budget deficits since taking over 2.75 years ago and is responsible for two of the three highest deficit-to-GDP ratios in the past 66 years *(Sources: The Congressional Budget Office & The Wall Street Journal, 10.8.11).*

- ***U.S. Mall Vacancy Rate Hits Record High In Q311***: Highlighting the pressure on retailers, a survey showed vacancy rates at U.S. malls hit a new high in Q311, as retailers scaled back space or backed out of opening new stores in an uncertain economy. The average vacancy rate at malls in the top 80 U.S. markets ticked up to 9.4% in Q311 from 9.3% in Q211, according to data released on 10.7.11 from real-estate research company *Reis Inc.* The vacancy rate marked the highest *Reis* had on record since the firm started tracking mall data in 2000 *(Sources: Reis, Inc. & The Wall Street Journal, 10.7.11)*.

Should you have any questions re: the aforementioned, please don't hesitate to ask.

Sincerely,

Stephen J. Czech
email: **sczech@sjccapital.com**

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