



June 9, 2008

Bill O'Grady, Chief Investment Strategist

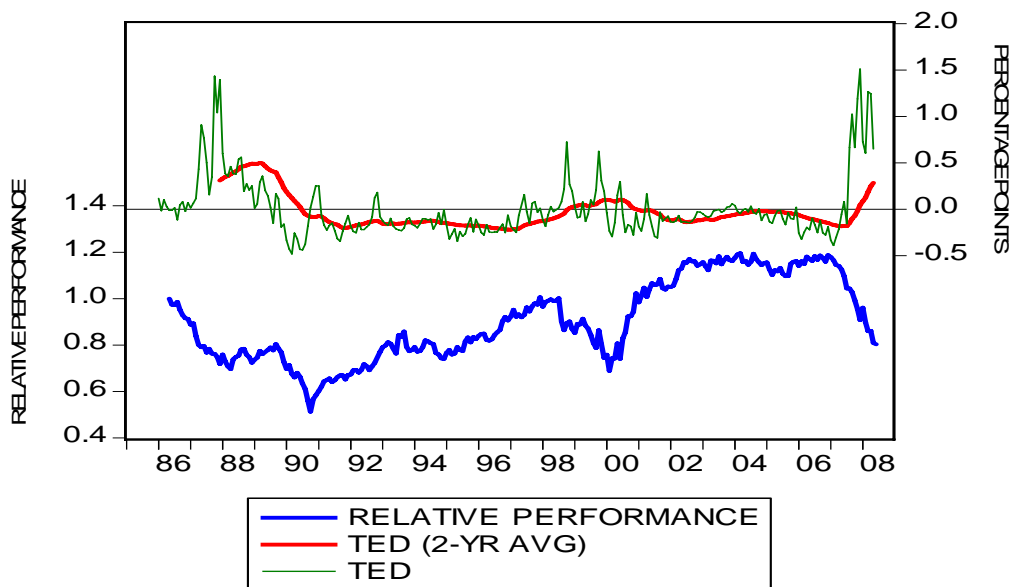
## Revisiting Financials

- In April, we examined the financial sector in this publication. Recent weakness in the sector suggests we revisit our earlier work.
- The financial sector continues to languish, the worst performer in the S&P 500 year to date, down 16.6%. Usually, easier monetary policy is a supportive factor for this sector but persistent concerns about the credit markets and worries about another round of writedowns and the need to boost capital are all factors weighing on these stocks. A series of adverse headlines this week has put further pressure on the sector.
- In addition to the Federal Reserve lowering interest rates, the central bank has taken aggressive steps to keep the financial markets functioning. These include creating a new discount window, the Term Auction Facility, which allows banks to swap various forms of debt for liquidity and the virtually unprecedented step of opening the discount window to investment banks.
- At some point, we believe these measures will work and the financial system will begin to function normally. Given the weakness in financials, there is a natural tendency to “bottom fish” and begin buying aggressively in this sector. Recovery will likely occur when the credit markets start functioning normally and so figuring out when this moment arrives is important. We are currently evenweight financials in our sector recommendations, but as discussed in the Chart of the Week, when credit market conditions improve, history would suggest the financial sector will likely outperform the S&P 500.
- One of the ways to measure confidence in the financial markets is the spreads between various debt classes. For example, since early March, the spreads on mortgage-backed securities to Treasuries have narrowed by 70 basis points from their April highs and the spreads of high-yielding securities to Treasuries have by a bit more than 200 basis points in the same time frame. This suggests buyers are starting to view the wide spreads on this debt as a potential investing opportunity, which is an indicator of confidence.
- Our favorite indicator in measuring financial system sentiment is the T-bill less Eurodollar (“TED”) spread. It is the topic of our Chart of the Week.

*Bill O'Grady has been named Chief Investment Strategist for the combined firm, responsible for providing broad-based macro analysis of domestic, foreign and commodity markets. Since joining A.G. Edwards in 1989, he has covered the debt, foreign exchange and energy futures markets as director of Futures Research, as well as performed short-term technical analysis of equities and monitored the effect of geopolitical, political, economic and social events on the equity markets as assistant director of Market Analysis. Bill was previously the Chief Global Investment Strategist at A.G. Edwards and is frequently quoted in the major media, including the Financial Times, the Wall Street Journal, CNBC and Bloomberg.*

## Chart of the Week:

### THE "TED" SPREAD AND FINANCIALS



For illustrative purposes only. This does not reflect the performance of any specific investment. Past performance is no guarantee of future results

Sources: Haver Analytics, Wachovia Securities

The upper lines on this chart shows the “TED” spread, the difference between three-months Libor (Eurodollar) yields and three-month T-bill yields. The spread is normalized to account for the differences in yield levels. We include a two-year average of the spread to show the underlying trend. The normalized spread can be used as a measure of the degree of stress in the financial system. During stable periods, Libor yields are modestly higher than T-bill yields; the latter is backed by the Federal government whereas the former is backed by the strength of the bank behind it. Libor is a good measure of bank funding costs and shows how confident banks are in lending to each other. Historically, during periods of financial market stress, investors flee to the safety of T-bills, lowering their yield. At the same time, they shun Libor deposits due to the lack of government guarantee which raises their yield. This process widens the TED spread.

The lower line of the chart is the financial sector’s relative performance to the S&P 500. A rising number indicates financials are outperforming the broader index; a declining number indicates the opposite.

Historically, during periods of financial stress, the TED spread widens. When this widening occurs, note that the financial sector tends to underperform the broader market. On a normalized basis, the TED spread, though improving, is currently very wide. Despite this improvement, the TED spread still suggests the financial system remains under pressure, and so, until this spread begins to persistently narrow, we believe it is too early to begin overweighting the financial sector.

**Bill O’Grady (314) 955-3064**

Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. The S&P 500 is an unmanaged, weighted index of 500 stocks providing a broad indicator of price movement. The Reuters-CRB Continuous Commodity Index is an unweighted geometric average of 17 individual commodity prices. Individual investors cannot directly purchase an index. Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that these movements or trends can or will be duplicated in the future.

**Additional Information Available Upon Request**

Wachovia Securities is the trade name used by two separate, registered broker-dealers and nonbank affiliates of Wachovia Corporation providing certain retail securities brokerage services: Wachovia Securities, LLC, Member NYSE/SIPC, and Wachovia Securities Financial Network, LLC, Member FINRA/SIPC. 0608-89040

Securities and Insurance Products		
Not Insured by FDIC or Any Federal Government Agency	May Lose Value	Not a Deposit of or Guaranteed by a Bank or Any Bank Affiliate