



PHIL'S STOCK WORLD

HIGH FINANCE FOR REAL PEOPLE | FUN AND PROFITS

Dow Jones	11,092 (-1.0%)
S&P 500	1,189 (-0.8%)
NASDAQ	2,535 (+0.7%)
NYSE	7,500 (-1.5%)
Russell 2000	732 (+1.1%)
Oil	83.87 (+2.2%)
Gold	1,362 (+0.7%)

THIS WEEK'S NEWSLETTER:

MONDAY - WHEN IRISH BANKS ARE AILING

Irish PM Cowen reverses position, accepts bailout

TUMBLING TUESDAY - CHINA, KOREA AND EUROPE, OH MY!

North and South Korea exchange artillery fire

WEDNESDAY - WORKING TOWARD THE CLAMPDOWN

Spending cuts result in national strike

THANKSGIVING THURSDAY - STUFFING THE FUTURES

Plus a talk about Phil's trading philosophy

FLIP, FLOP FRIDAY - THIS WEEK IT'S EUROPE!

Euro mess drives Dollar up

THE WEEK AHEAD

BONUS SECTION: TUESDAY FOMC MEETING MINUTES AND COMMENTARY

The Thanksgiving feast is the centerpiece of a major U.S. holiday which is celebrated by people traveling to be with family, eating a little too much food, watching football games, and swarming the malls for Black Friday sales the next day -- as the Christmas season is right on its tail. It's a time during which we can slow down and take a moment to calmly reflect upon what are thankful for.

Unfortunately, the rest of the world was not in a reflective mood this week, nor was it inclined to be calm or even seemingly thankful. No, this was a week marked by [artillery fire between North and South Korea](#), the [launching of a major probe of Wall Street by the FBI](#), the [collapse of the Irish government](#) in the wake of its continuing banking crisis, and last, but not least, an agreement between [China and Russia to settle trades](#) between themselves using their own currencies rather than the US Dollar.

The collapse of the Irish government, combined with expectations that Portugal will be the next domino to fall in the European debt crisis, spurred investors to move into Dollar-denominated investments. As we anticipated, the Dollar strengthened, and was up strongly from 78.2 on Monday to 80.35 by Friday, up 2.7% for the week. Yet the equity markets ended the week mixed with the Dow and S&P down about 1%, the Nasdaq up 0.7% and Russell up 1.1%. Why? Because, as Phil put it, this was a "low-volume, B.S." week, not one that lent itself to making intelligent investments. He repeatedly recommended cash, cash and CASH to Phil's Stock World (PSW) members, along with a few very short term "hit and run" trade ideas.

The continuing crisis in Europe prompted ongoing discussions at PSW about what is really happening with the Irish banking crisis. Phil noted *"Let's keep in mind all this EU nonsense is nothing but hyena attacks, as most of these countries are not in that bad shape overall, and certainly no worse than we are. Maybe we're next! Anyone can be next. If the hyenas want to attack a country, they can attack any country where they can get traction on rumors that POTENTIAL bank losses exceed GDP - that's a banking failure."*

"Once the hyenas get just a small amount of people to believe the banks may fail, interest rates start going up (and big investors can give them a little push artificially, of course, to get the ball rolling). Once the banks have to borrow at higher rates, they'll need more capital reserves. Then the hyenas can scream that the banks were lying about their capital requirements and call for 'investigations.' That will convince people they are hiding something. After the rates go higher, and the banks need more capital, the hyenas can parade on TV saying that they knew all along. They can claim the banks are insolvent and EXTRAPOLATE that, at the rate things are going - the whole country will be bust in X amount of time.

"They can do this to anyone, anytime. This game will only end if we stop the speculators from profiting from it. The reason that there are no runs on banks in China and Russia isn't because their banks are more solid. I'll bet there are Chinese banks which have nothing but a fortune cookie in their vault, but the difference is in Russia and China they will cut your head off if you try to run their banks. In America, when you cause a run on the banks, all they care about is

how much you made so they can laud you as the next celebrity fund manager."

The European crisis is leading to increasing dissent in the European Union. Nigel Farage, leader of the UK Independence Party, gave an [impassioned speech Wednesday before the European Parliament](#), where he said,

"Now we have this situation in Ireland. I know that the stupidity and greed of Irish politicians has a lot to do with this. They should never ever have joined the Euro. They suffered with low interest rates, a false boom and a massive bust. But look at your response to them. What they're being told, as their government is collapsing, is that it would be inappropriate for them to have a general election. In fact Commissioner Rehn here said they had to agree to their budget first before they'd be allowed to have a general election."

As Commissioner Rehn shifted uncomfortably in his seat, Farage continued: *"Just who the hell do you think you people are? You are very very dangerous people, indeed. Your obsession with creating this Euro state means that you're happy to destroy democracy. You appear to be happy for millions and millions of people to be unemployed and to be poor. Untold millions must suffer so that your Euro dream can continue. Well it won't work. Because it's Portugal next, with their debt levels of 325% of GDP, they're the next ones on the list, and after that I suspect it will be Spain. And the bailout for Spain would be seven times the size of Ireland's and at that moment all of the bailout money has gone - there won't be anymore."*

The grand experiment of a common European currency appears to be failing, and has now reached a point where it is no longer advisable to simply assume that the Euro will remain a viable currency.



Monday - When Irish Banks are Ailing

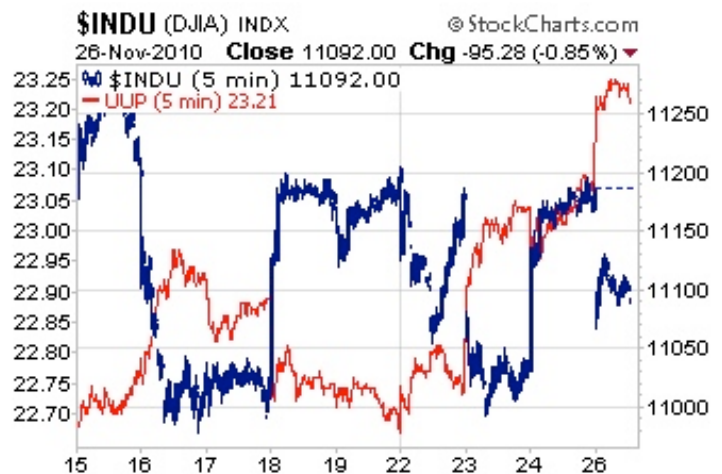


Ireland officially agreed to ask for financial aid early Monday morning, with Prime Minister Brian Cowen changing his position on the bailout after having publicly opposed it since the beginning of the crisis. Cowen was publicly taken to task for this, with Michael Noonan, finance spokesman for opposition party Fine Gael, saying that the government should be “ashamed that Fianna Fail [Cowen’s party] should be the ones to surrender sovereignty.” Moody’s announced in its weekly credit outlook that a “multi-notch downgrade” is the “most likely” scenario for Ireland’s current government bond rating of Aa2, although they do expect Ireland’s bonds to remain investment grade.

Events in Ireland took an unexpected turn Monday afternoon when the Green party, a junior partner in the coalition government (comprised of Fianna Fail, the Green Party and the Progressive Democrats), called for a General Election while protestors tried to storm the Parliament building in Dublin. Confronted with growing opposition from both within and without his coalition government, Cowen announced that he would dissolve the government and is expected to step down as Prime Minister after the budget is presented on December 7th. A general election to form a new government is very likely to be held early next year.

“Nas closing in on goal - do they make it over the hump or double top? Those of you who did not have the faith to roll QIDs now have another chance and the brave and the bold may want to pick up the WEEKLY QQQQ \$53 puts at .45 if we get another poke there (now .55).” - Phil

The weekly QQQQ \$53 Puts went from .45 to a high of \$1.25 before ending Tuesday at \$0.98, for a 110% gain.



The Euro ended the day down, while the Dollar was up from 78.2 to 78.8 by noon, before dropping to 78.6 at the close. The Dow... well, the opposite - down, then up. We’ve put our UUP vs. INDU chart here so that everyone can see the consistent mirror imaging of the moves in the Dow with the moves in the Dollar. The Dollar popped early thanks to the continuing Ireland / Euro crisis, and the Dow dropped. Later in the day, as the Dollar pulled back from its earlier highs, the Dow turned right around and went back up, closing the day down only -0.22% at 11,179. The S&P was down -1.16%, closing at 1,198. The Nas escaped the gravitation pull of a strong dollar ending the day up 0.55%, closing at 2,532.

Phil noted the interesting activity on the Nasdaq early Monday morning, saying “Look at that Nas fly - they are really jamming it up this morning! 2,530 was about Friday’s top-out and 2,532 goes back to the Friday before that so watch that line for a proper break up on the Nas.” The Nasdaq bounced down from the 2,532 line like it had hit a brick wall, fluttered about for a couple of hours, and then dropped sharply before turning around to recover with a gain for the day.

Phil observed “Wow, that turned fast! What a joke that the Nas can pop from 2,500 to 2,530 in 30 mins and then all the way back down 30 mins

later - as I said this morning - an untradable market unless you are a real cowboy day-trader."

After having established the utility of the 2,532 line, Phil then discussed a trade idea for the cowboy day-traders among his members, based on the weekly QQQQ \$53 puts, which is shown in the box on the previous page. You can see the result of the trade on the chart below. Phil's message -- what we try to show at Phil's Stock World is: *"It's perfectly OK to stay in cash when you can take small plays like this and make the occasional double - better than trying to grind out 4% on 25 positions at risk, isn't it?"*

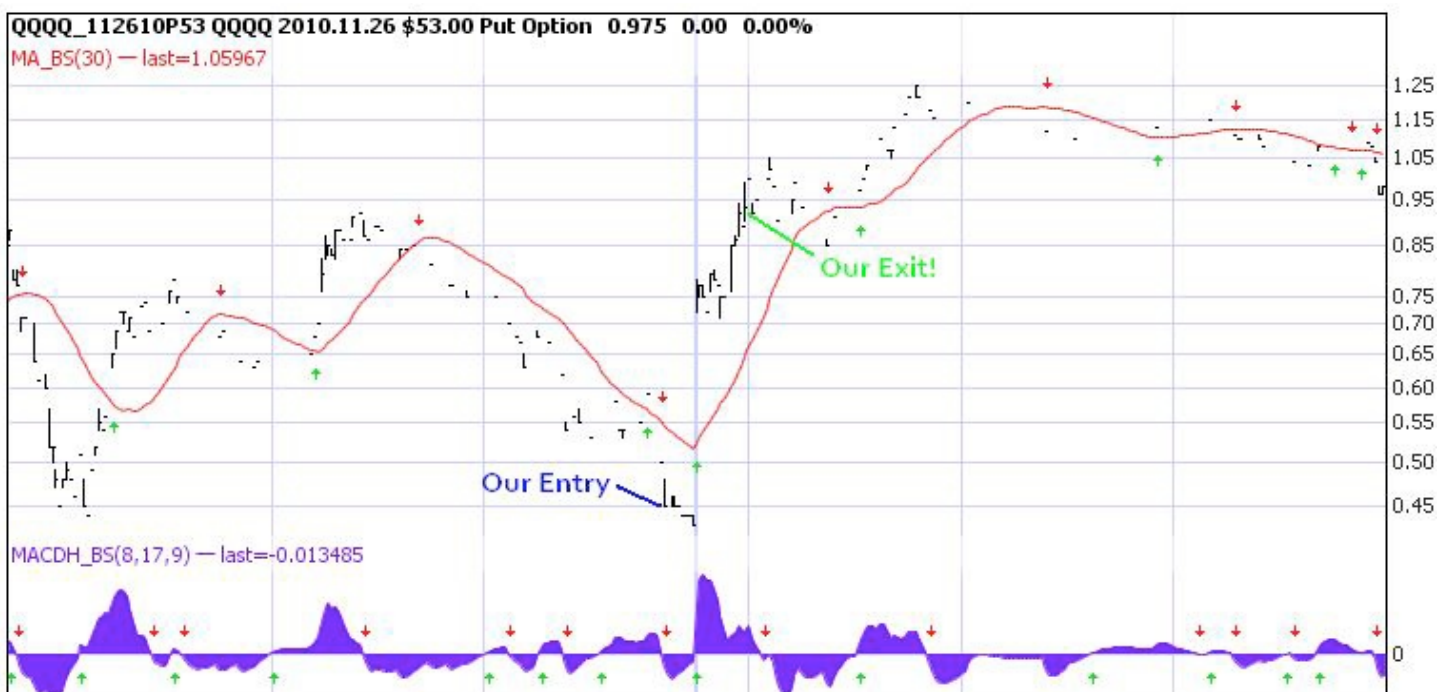
Reports that the Federal Bureau of Investigation [raided the offices of three different financial establishments](#) was another market mover, as a wide-ranging three-year investigation into insider trading kicked into high gear, with civil and criminal probes examining whether insider trading rings reaped profits illegally. [Although hedge funds were the initial targets of these probes](#), they quickly expanded to bankers, independent analysts and research boutiques.

Among other investigations, prosecutors and regulators are looking into allegations regarding the leaking of information about upcoming health-

care mergers by Goldman Sachs bankers in ways that benefited certain investors. [Financial stocks took a hit on the news](#), with Morgan Stanley, Credit Suisse, UBS, Deutsche Bank, Bank of America, Goldman Sachs and JP Morgan all down between 1.5% and 3.4% for the day.

Rounding up Monday's news, QE2 is still causing controversy, with the credibility of the Federal Reserve now coming under "historic attack" according to former Fed Governor Frederic Mishkin. [In an interview with CNBC](#), Mishkin said that the Fed had done a "poor job" of justifying quantitative easing: *"The credibility of the Fed has been hurt not only by the issue of not putting this into a long-run context, but secondly by the tremendous dissension from the committee, which again is unprecedented. I'm a little surprised there hasn't been more done internally to rein this in."*

While Mishkin believes that QE2 is likely too small to make a difference, he pointed out that the Fed would have to do much more to justify its current position, saying *"The Fed can recover from this. It's not over yet, but boy they've got a lot of digging out of the hole right now and I hope they proceed in that direction."*



Tumbling Tuesday - China, Korea and Europe, Oh My!



Tuesday was a busy news day. North Korea and South Korea [exchanged artillery fire](#), Chinese stocks [continued to slide](#) as China struggles with runaway inflation, Ireland was reeling in the wake of its financial crisis as the fiscal contagion appeared ready to [spread to Spain and Portugal](#), and the U.S. government's investigation into alleged insider trading expanded as [mutual funds Wellington Management](#) and [Janus](#) received [requests](#) for documents from the FBI in relation to the insider trading probe.

The Dollar gained strongly amid rising concerns about European debt and the conflict in Korea, climbing to a high of 79.76 before dropping to 79.55. And yes, the Dow dropped, as did the S&P and Nas, all down between 1.27% and 1.46% for the day.

Investor concerns about Ireland are well justified as they are [two weeks away from a budget vote](#), and if they can't agree on the terms of the bailout (that many didn't want in the first place), then all bets are off. Pimco's Mohamed El-Erian [said that Ireland risks a "major bank run"](#) unless European officials act quickly to calm the current turmoil. *"The numbers so far have shown that the Irish banking system has been bleeding deposits. It will seriously undermine the prosperity of this country for a generation. The first thing they must do is execute on what they announced this weekend -- which is a big external aid package and steps by the Irish government."*

Last but not least on the news menu, the Fed released its Federal Open Market Committee (FOMC) minutes, which Phil commented on, and which has been added as a special section at the end of this week's newsletter. The minutes showed that Fed officials strongly disagreed about the merits of QE2 and the effect it would have on the Dollar, but they generally supported the program. The minutes also included some rather

dismal comments about employment, pointing out that the workforce participation rate for September was lower than it was earlier in the year, meaning that the total percentage of people employed continues to decline regardless of what the headline "unemployment" numbers may show.

Inside Chat:

Skdoyle asked Phil: *"Regarding the HMY play. I'm a little confused on what we are trying to achieve. I'm somewhat new to options, and I haven't seen a play that is buying the stock, and then selling in-the-money (ITM) calls and ITM puts. From the Think or Swim (TOS) risk graphs it seems like this play would lose if HMY continues to rise."*

HMY/Skdoyle - Very beginner question and most of the answer can be found under ["How to Buy Stocks for a 15-20% Discount"](#). I strongly recommend you read the [New Members guide](#) and take the reading suggestions seriously so you can get the most out of chat discussions and trade ideas. If you sell a \$10 put, then the stock can either be put to you if HMY is below \$10 or the puts expire worthless with HMY over \$10 on the expiration day. It's a binary event, and either way you keep the money you sold the put for, so there's \$1.10 in your pocket. If you sell a \$7.50 call, you collect \$5 and it's the same binary event - either HMY is under \$7.50 and the calls expire worthless or HMY is over \$7.50 and the caller will pay you \$7.50 to purchase your stock, which will net you \$13.60 back at the end of the cycle (if over \$10). So you lay out \$11.75 to buy HMY and you sell the \$7.50 calls for \$5 and the \$10 puts for \$1.10 and that drops your net outlay to \$5.65. I don't care what TOS says you have because those are the FACTS... That is why you must take the time to learn the strategies - we have years of incorrect education to undo before we can make you a better trader!

Wednesday - Working Toward the Clampdown

Wednesday was a strong up day for the markets, with the Dow up 1.37%, the S&P up 1.49% and the Nas up 1.93 at the close. What propelled the markets so powerfully upward? The [University of Michigan Consumer Sentiment numbers](#) came in at 71.6 versus expectations of 69.5 for the month of November. This combined with a better than expected [Initial Jobless Claims report of 407K](#) as compared to expectations of 435k helped to spark a strong rally.

But what was really going on with Wednesday's rally? It was a very low volume day, so there wasn't much in the way of conviction behind it. The unemployment numbers released were based on a short count of four days, not five. Because most claims are counted Friday through Thursday, and since Thanksgiving week is a short week and no claims are processed on Thanksgiving Thursday, there was one day missing from the total count, resulting in a lower total number. You'd think that would be obvious, but the media largely missed that, and instead trumpeted the headline number as if it indicated real improvement in unemployment.

More distressing than the obvious distortion of the headline unemployment numbers was the unadjusted data buried further down in the report, the one that uses actual initial claims under state programs. [It showed a total of 462k, an INCREASE of 52k](#), from the previous week. The mainstream financial news didn't happen to pick up on that particular tidbit of information.

As far as the University of Michigan Consumer Sentiment numbers, [Tyler Durden of Zero Hedge asked](#), "why does the market pretend to trade (based) off an index as discredited and flawed as the UMichigan Consumer Sentiment? As a reminder, the UMichigan survey is conducted over the phone and includes a paltry 300 households

for the preliminary numbers and 500 for the final one. This happens once a month. On the other hand the [ABC News Consumer Comfort Index \(CCI\)](#) represents a rolling average based on telephone interviews with about 1,000 adults nationwide each week. There is thus no point in even comparing polling methodologies: it is imminently obvious that UMichigan is geared to not create a broad sample narrative but as narrow one as possible. Furthermore, there have been occasional allegations in the press that UMichigan goalseeks its periodic calling list in a way that affords a desired question outcome."

The ABC News Consumer Comfort Index reported numbers that were somewhat less cheery than the ones reported by UMichigan. Their CCI currently stands at -47 on a scale of -100 to +100, marking 135 weeks in a row with numbers below -40.

Overemphasizing bogus numbers and ignoring useful numbers is all part and parcel of how things are done by the big boys to move the markets. Nonetheless, our motto at Phil's Stock World is "We don't care IF the game is rigged, as long as we can figure out HOW the game is rigged and place our bets accordingly."

Early morning in Member's Chat Phil talked about the bogus nature of Wednesday's rally, and his plan for the day was to let the market move up and then look for possible short-term shorting opportunities that could be closed out over the next day or so, in anticipation of a pullback. Later in the morning Phil posted a trade idea, saying "SPY (Dec 03) \$119 puts down to .83 - I'm still going to like them over the weekend, no matter how cheap they get." The SPY Dec 03 \$119 puts closed at \$1.44 Friday, for a 73% gain.

Thanksgiving Thursday - Stuffing The Futures

The U.S. markets were closed on Thursday for Thanksgiving. Phil posted in Member's Chat and took advantage of the holiday to answer questions in great detail. One member in particular, new to Phil's Stock World, posted an thoughtful question about a trade idea involving JPMorgan (JPM) (see box below for the JPM trade). Phil replied with an in-depth response that is an excellent introduction to what Phil's Stock World is all about. We have posted the question and response here:

From Wednesday's Inside Chat:

"JPM would be a nice pickup at \$35 in March so selling the \$35 puts for \$1.55 is free and the net on the Jan \$35/\$37.50 bull call spread is \$1.70 so .15 for that \$2.50 spread is also a nice potential profit on low commitment." - Phil

JCB posted *"Hi Phil. Happy Turkey day to you and your family. I am new to the site and had a couple of questions about the JPM trade you suggested (Wednesday). It seems that you like a lot of the bull call spreads while selling a put. My question is do you put in an initial stop (in case of substantial decline in underlying price) and where if so? Secondly how do you adjust this type of trade if it goes down quickly or steadily? I am assuming if it continues to go up and you can capture the majority of the spread - you would sell out before expiration."*

Phil replied "Welcome JCB! The idea of the "artificial buy/write" is that we REALLY WANT to own JPM for the net price so it's not about setting a stop. If you think of the trade that way, you probably won't last in it because your net in is .10 so where are you going to stop out - at a 100% loss? 200%? 1,000%? If you lose 2,000% on the trade, that's \$2 and you end up owning JPM for net \$37. If you are SCALING IN PROPERLY (and see strategy section, read the linked articles and the comments on those articles) then you have made, at most, a 25% commitment to own the stock at \$37 so the

question becomes - at what point do not want to be 50% invested in JPM? If you net \$37 on your first round and JPM ends up at \$27 - then you own JPM at an average of \$32 with the stock at \$27. If you REALLY intend for JPM to be a long-term hold, then this probably won't bother you much. Only if your fundamental outlook on JPM has changed since you bought it should you be concerned in round one of a position - if not - then you are getting a very cheap entry on your remaining 75% allocation, right?

"The problem is, many people take these long-term investing strategies and play them like day trades. That is not what they are and if you read through Member Chat (and the [New Member Guide](#) strongly encourages reading at least a month of posts and comments to get up to speed) you will regularly see people "testify" that they now "get it" as they begin to see how easy and consistent long-term profits can be using these simple strategies. More and more they begin to drift away from day trading. I have explained many, many times that a person who aims towards making "just" 20% a year has an excellent chance of succeeding using these strategies and that 20% a year CONSISTENTLY turns \$100,000 into \$619,173.64 in just 10 years and \$3.8M in 20 years - do we really need to be greedy and "go for" bigger gains when staying conservative can make a nice retirement?

"If you are doing well enough to retire in comfort on your long-term investments and you have some extra cash - THEN you can afford to do a little gambling and if you happen to make more than 20% a year (assuming that's your goal) THEN you can afford to put a little aside in a more aggressive portfolio but trying to make more than 20% a year is gambling, pure and simple and if you kid yourself that you are an investor while attempting to make the big scores, then you are only fooling yourself and imperiling what you have.

"So when we make calls of buy/writes or artificial buy/writes, these are for long-term trades and we don't intend to mess with them at all. If

you have a \$100,000 portfolio, you generally want to allocate \$10,000 for each position and scale in with \$2,500 entries and, of course, you wouldn't have more than 10 running at a time. Using this strategy, you will make 20% or more on \$25,000 and you will not use your \$75,000 EXCEPT when you are offered an exceptionally low price to add to one of your existing positions. As you are taking 20% downside protection at the outset and as you can easily roll a 10% loss, a stock would have to be about 30% off before you even bother to double down.

"If IBM, for example, fell to \$90 and I had bought it at \$130 hedged to \$100 - I would be THRILLED to buy more IBM at \$100. Don't buy stocks you aren't ANXIOUS to double down on. So I have 10 positions at 25% allocations and six of them get called away and two I roll and two I double down on. How much additional cash have I moved off the sidelines? No more than \$5,000 more and it's for buying things like IBM at \$90, not some junk momo company that has no value. Over time, your portfolio gets more and more full with very good stocks purchased at very low prices and you are constantly rolling your cash only into other stocks that get very, very cheap - it's a kind of self-reinforcing bargain-hunting system.

"This is very boring for many investors as it takes years to develop a full portfolio (65-75% invested) but how would you like to be sitting on a portfolio of AAPL at \$85, IBM at \$80, BA at \$50...? That's what we end up with (relatively) over time - the kind of portfolio you can happily retire on and sell calls (no more puts) for income down the road. In between, when we have a lot of cash, there are plenty of stupid margin tricks we do to make extra money. Not so much now when the VIX (volatility) is low but whenever it heats up we can sell puts on stocks we may be fishing for. There are also high-probability plays like Peter D's short strangles and I'll be introducing another guy next year who is an expert at Iron Condors who will run an excruciatingly dull strategy that can make you 10% a month.

"I am not a fan of day trading. I do it for fun the way I play craps for fun but I play poker for money! Stocks are the same way - you have to have a very clear line between your investing and gambling and have different cash management strategies for each."

"If you are a new reader - I swear to you that I may be a cynic but I am NOT a pessimist - this is just a crappy market to invest in and I call them as I see them. Did you know that newsletter revenues go down significantly when the outlook is pessimistic? People don't want to hear bad news so the pressure is on to give you the sunshine and lollipops point of view.

Yes, there are bearish newsletters but they are always bearish and have a niche audience. I'm talking about the neutral ones. Not to mention the vast majority of funds are bullish funds, and that can't change, so they NEED you to be bullish on something and put your money into the market so they can charge you fees. You won't hear very many hedge fund managers saying "I think you should be in cash" because they are not "Cash Fund Managers" and they don't get paid for doing nothing.

So beware of the charlatans, they have the floor and they will tell you ANYTHING to get your money off the sidelines. We have a short week, we're heading into the holidays and these are very uncertain waters so why not just relax and have a happy Thanksgiving with the family as there will be tons of investing opportunities in December and, of course, next year, so we're not going to miss anything by skipping this low-volume BS and having a nice, relaxing week.

Will I still make picks? Sure I will, I love making picks! But let's just keep things in context and have some fun rather than trying to come up with an investing premise in an un-investable market." - Phil

Flip, Flop Friday - This Week It's Europe!

Friday was a holiday-shortened trading day, with the markets closing three hours early. News of more [artillery fire in North Korea](#) helped to rattle traders as tensions continued to rise between North and South Korea. The Irish banking crisis, combined with concerns about possible future bailouts for Portugal and Spain, also weighed on the markets. Spanish Prime Minister Jose Luis Zapatero [warned investors that they would lose money betting against Spanish debt](#), while Portugal's Finance Minister said that the [EU cannot force his government to accept a bailout](#).

This week the executive arm of the European Union, the Brussels-based EU Commission, [floated a proposal to double the size of Europe's \\$588 Bn bailout fund](#). Phil opined, *"That should cover Spain but Italy can still be questioned and, if Spain and Italy go - why not France? This madness never ends when people like Bill Gross can attack*

Inside Chat:

Rainman asked Phil: *"How long before the collapse of the euro?"*

Collapse/Rain - I don't think the Euro is likely to collapse. They can print just as much money as we can to shore up their members - it's really just a matter of what Germany decides to do. Germany can't afford to let its export customers fall apart or it will be next anyway so it's one of those "all hang together or certainly all hang separately" kind of deals.

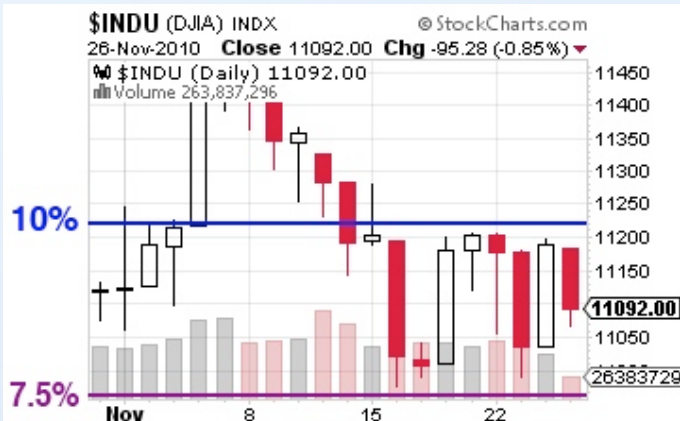
countries with hundreds of Billions of leveraged capital."

U.S. markets were sharply down at the open and stayed down all day, with the Dow losing 0.86%, the S&P losing 0.75% and the Nas losing 0.34% on an exceptionally low volume day. The Dollar was up and ended the week at 80.35.

With the EU spiraling out of control, and threats of war in Korea, you might think it would be great for gold but, as Phil wrote, *"then you wouldn't be a PSW Member because we know it's ALL about the Dollar. Money flying out of the Euro doesn't go into gold, it goes to Dollars and Yen and a rising Dollar is NOT good for gold. We'll get a nice move down in gold if the dollar moves back up. Our re-entry point on gold is \$1,150 so we have about \$200 to go (down 14%), which would correspond to the Dollar at 88. That will be fun to watch if the Dollar gets a real squeeze but, at the moment, we are only counting on the Dollar hitting 82 as that's the 200 dma. Woe unto the commodity pushers if it breaks over that mark so stabilizing the Euro will be critical this weekend for commodity bulls."*

Watching Must Hold Levels

11/12/10	Dow	S&P	NAS	NYSE	Russell
BREAKOUT LEVELS	11500	1220	2600	7750	725
UP 10% (MUST HOLD)	11220	1177	2420	7500	700
UP 7.5%	10965	1146	2365	7280	672
UP 5%	10710	1123	2310	7140	666



The Week Ahead

We have been tracking the “Beta 3” pattern (chart below) for weeks, and now, if this pattern is going to hold up, we might expect to see a correction any day. On the other hand, the opposite force, the Permanent Open Market Operations (POMO) force, is going to be in play all of next week.

Monday is going to see not one, but **two POMO operations by the Fed** (one outright Treasury Inflation Protected Securities purchase, and one outright Treasury Coupon purchase), as the second round of quantitative easing continues. Furthermore, every day next week is going to be a POMO day, with a total of approximately \$39 Bn worth of purchases to be made during the week.

Zero Hedge’s Tyler Durden had an **interesting observation about how the markets closed this week**, saying “Earlier we pointed out that today was trending to be one of the lowest volume days in history. A volume surge accompanying a panic dump into the close managed to pull the daily volume just barely higher than last Xmas eve (though still about 60% of last Black Friday). What is more relevant is that just after the market

*closed, the bottom fell out. ES closed at the lows of the day (contrary to amusing flashing and epilepsy-inducing CNBC “breaking news” propaganda stating just how much better compared to the day’s low the S&P was trading at End Of Day) as the entire world woke up just after 1 pm realizing that Monday has that very deja vu-ish September 15, 2008 aftertaste. Not surprisingly, VIX exploded to the week’s highs, well past the Korean war threats, and a 14% move in one day. And, yes, that old backstop gold, pulled a VIX. What is **most** relevant, is that something big is happening just behind the scenes: ZB volume explodes to 608K, while the CME Ultra Treasury volume of 349K surpasses the prior record of 237k. Monday may just be a very interesting day as faith in the bailout machinery no longer works, and the Fed’s **two POMOs** will mark the point where Brian Sack officially jumps the shark.”*

On a more optimistic note, Pharmboy suggested a trade idea using a buy/write strategy for buying Merck ([MRK](#)) at a discount:



"With the current market environment unclear, and the recent market run from September to November, we at PSW want to invest in companies that are safer bets for the long term. Merck (MRK) has announced good clinical trial results for a novel cholesterol reducer (CETP inhibitor), has a P/E of ~12, a dividend rate of 4.4% (higher than any CD or Treasury), and its pipeline remains one of the stronger ones in the industry. If the Bush tax cuts are not extended, the dividend will be taxed at the nominal tax rate, so the following position is suggested for an IRA or Roth (an IRA or Roth will protect the dividend income).

"In my opinion, MRK is going to stay range bound for a while, and the strikes chosen give a buy/write using [Phil's 15-20% discount strategy](#). Buying the stock at ~ \$35 and selling the Jan13 35 calls and the Jan13 30 puts for \$4 and \$4.15, respectively, reduces the cost basis by \$8.15. If the stock trades above \$35 on Jan. 18, 2013 and is called away, a gain of 23% plus dividends would result, while the puts would expire worthless. If the stock stays range bound, between \$30 and \$35, one would collect the whole \$8.15 premium on both ends plus dividends, and end up owning the stock.

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We end with some helpful advice from Bloomberg's Jonathan Weil, on the topic of "What to Do When the FBI Raids Your Hedge Fund", which we have summarized on the cover of our future best-selling pocket handbook, as shown on this page. We hope this will prove helpful to anyone in need of this sort of advice.

Next Week's Economic Calendar

Monday 29	Tuesday 30	Wednesday 1	Thursday 2	Friday 3
11:00 AM: 4-Week Bill Announcement	8:55 AM: Redbook	8:15 AM: ADP Employment Report	8:30 AM: Jobless Claims	8:30 AM: Employment Situation
11:30 AM: 3-Month Bill Auction	9:00 AM: Case-Shiller Home Price Index	10:00 AM: ISM Manufacturing Index	10:00 AM: Pending Home Sales Index	10:00 AM: Factory Orders
11:30 AM: 6-Month Bill Auction	10:00 AM: Consumer Confidence	10:30 AM: EIA Petroleum Status Report	4:30 PM: Money Supply	10:00 AM: ISM Non-Mfg Index
2 POMO DAY(!)	POMO DAY	POMO DAY	POMO DAY	POMO DAY

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Special Bonus Supplement - Tuesday

FOMC Highlights



Editor's Note: Below are the Federal Open Market Committee (FOMC) minutes which were released on Nov. 23rd. Phil uses colors in the text of the FOMC minutes to indicate what he sees as positive (green) and negative (red) for the economy. Phil's comments (blue) appear in this section in quotes and bold Italics.

The 11/03/10 meeting opened with a short discussion regarding communicating with the public about monetary policy deliberations and decisions. Meeting participants supported a review of the Committee's communication guidelines with the aim of ensuring that the public is well informed about monetary policy issues while preserving the necessary confidentiality of policy discussions until their scheduled release. Governor Yellen agreed to chair a subcommittee to conduct such a review.

Developments in Financial Markets and the Federal Reserve's Balance Sheet

*The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets since the Committee met on September 21, 2010. He also reported on System open market operations, including the continuing reinvestment into longer-term Treasury securities of principal payments received on the SOMA's holdings of agency debt and agency-guaranteed mortgage-backed securities (MBS). The Open Market Desk at the Federal Reserve Bank of New York purchased a total of about \$65 billion of Treasury securities since the Committee decided, on August 10, to begin reinvesting such principal payments. **Purchases were concentrated in nominal Treasury securities with maturities of 2 to 10 years, though some shorter-term and some longer-term securities were purchased along with some Treasury inflation-protected securities (TIPS).** Over the intermeeting period,*

the Desk also conducted a number of small-value tri-party reverse repurchase operations with the primary dealers and with money market mutual funds that have been accepted as counterparties for such operations; these transactions, which the Desk conducted to ensure continuing operational and systems readiness, used Treasury securities, agency debt, and agency-guaranteed MBS as collateral. In addition, the Federal Reserve conducted another small-value auction of term deposits to ensure the continued operational readiness of the term deposit facility and to increase the familiarity of eligible depository institutions with the auction procedures. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions over the intermeeting period.

*The Manager described the tentative plans the Desk had prepared for implementing a possible Committee **decision to expand further the System's holdings of longer-term Treasury securities.** Purchases would continue to be concentrated in nominal Treasury securities with remaining maturities between 2 and 10 years, with some purchases of shorter- and longer-term securities and of TIPS; with this maturity distribution, newly purchased securities would be expected to have an average duration of 5 to 6 years, essentially the same as the average duration of the System's existing holdings of Treasury securities. The Desk planned to publish additional information about its transactions to increase the transparency of, and encourage wider participation in, future purchase operations. The Desk judged that if it continued reinvesting principal payments from the Federal Reserve System's holdings of agency debt and agency MBS in longer-term Treasury securities, then it **could purchase additional longer-term Treasury securities at a pace of about \$75 billion per month while avoiding disruptions in market***

functioning. The Manager indicated that implementing a sizable increase in the System's holdings of Treasury securities most effectively likely **would entail a temporary relaxation of the 35 percent per-issue limit on SOMA holdings under which the Desk had been operating;** whether, and to what extent, the System's holdings of some issues would exceed 35 percent would depend on the specific securities that dealers choose to offer at future auctions. Finally, the Manager summarized the implications for the Federal Reserve's balance sheet and income statement of alternative decisions that the Committee might make about the size and maturity distribution of the SOMA's securities holdings. Participants discussed the Desk's tentative operational plans; they also discussed the potential effects of an expansion of the System's holdings of longer-term securities on financial markets and institutions and on the economy, and the channels through which those effects could occur.

“ **Wow, this is quite a thing to "yadda, yadda" over!**

Staff Review of the Economic Situation

The information reviewed at the November 2-3 meeting indicated that the economic recovery proceeded at a modest rate in recent months, with **only a gradual improvement in labor market conditions**, and was accompanied by a continued low rate of inflation. Consumer spending, business investment in equipment and software, and exports posted further gains in the third quarter, and nonfarm inventory investment stepped up. But **construction activity in both the residential and nonresidential sectors remained depressed**, and a significant portion of the rise in domestic demand was again met by imports. **U.S. industrial production slowed noticeably in August and September, hiring at private businesses remained modest, and the unemployment rate stayed elevated.** Headline consumer price inflation was subdued in recent months, **despite a rise in energy prices**, as core consumer price inflation trended lower.

Private businesses continued to increase their demand for labor only modestly. In September, private nonfarm payroll employment remained on a gradual uptrend, and the average workweek of all private-sector employees was unchanged for a third month. **In addition, the number of individuals working part time for economic reasons moved back up for a second month, and the available measures of job openings and hiring were still low.** The unemployment rate remained at 9.6 percent in September, leaving the average rate for the third quarter only slightly below its average over the first half of the year. Long-duration unemployment continued to recede somewhat but was still very high. Indicators of layoffs remained elevated, although initial claims for unemployment insurance drifted down a little during October. **The labor force participation rate in September was unchanged at a level lower than earlier in the year.**

After rising rapidly from mid-2009 to mid-2010, **industrial production decelerated in August and edged down in September.** In the manufacturing sector, output gains across a wide range of industries were smaller in recent months, and **capacity utilization leveled off at a rate still well below its longer-run average.** Production of motor vehicles picked up during the third quarter as automakers replenished dealers' stocks, but motor vehicle assemblies were scheduled to drop back in coming months. **More broadly, October surveys of new orders received by manufacturers suggested that demand for factory goods had continued to increase.**

Real personal consumption expenditures (PCE) rose at a moderate rate in the third quarter. Rising equity prices likely resulted in some further improvement in net worth over the same period. However, **real disposable personal income, which rose strongly in the first half of the year, increased only slightly in the third quarter.** As a result, the personal saving rate dropped back somewhat in the third quarter, although it remained near the high levels that have prevailed since late 2008. Bank lending standards were still relatively tight, and household borrowing

remained low. **Surveys taken in September and October indicated that consumers were slightly more pessimistic about the economic outlook than earlier in the year.**

“ **Nobody’s working and nobody’s happy about it.**

Activity in the housing market remained exceptionally weak. Although sales of new and existing homes turned up in August and September, the still-low level of demand suggested that the payback for the earlier boost to sales from the homebuyer tax credit had not yet faded. **Moreover, despite further declines in mortgage interest rates in recent months, other factors continued to restrain housing demand, including consumer pessimism about the outlook for jobs and income, the depressed rate of household formation, and tight underwriting standards for mortgages.** In addition, the **moratoriums recently announced by some banks on the sale of properties they had seized in foreclosures were likely to damp home sales further in the near term.** Starts of new single-family houses rose somewhat in August and September, but **the pace of construction was still noticeably below the already-depressed level of the preceding year.** New homebuilding appeared to be weighed down by the backlog of unsold existing homes and tight lending conditions for acquisition, development, and construction loans.

After a very strong increase in the first half of the year, **business investment in equipment and software posted a smaller, but still solid, gain in the third quarter.** Nominal shipments of nondefense capital goods from domestic manufacturers remained on a moderate uptrend through September. But rising demand for equipment and software during the third quarter was also satisfied in part by a further rise in imports of capital goods. Near-term indicators of business spending on equipment and software were generally positive. New orders for nondefense capital goods, excluding aircraft, continued to

outpace shipments through September. Credit conditions improved further in the third quarter, particularly for larger firms with access to the capital markets. **Financing flows to smaller firms, which are more dependent on banks, were more subdued.**

“ **In short, the rich continue to get richer and the big fish are fed by the banks so they can gobble up the small and, as we know, it’s the small businesses that do all the hiring and the big businesses that do all the outsourcing so we are, day by day, encouraging exactly the kind of behavior that is destroying this country!**

Real nonfarm inventory investment was estimated to have picked up during the third quarter. Rebuilding of dealers’ stocks of motor vehicles accounted for part of the step-up, but some of it likely reflected another large increase in imports. **In August, inventory-to-sales ratios for most industries remained well below their previous peaks.** Surveys of purchasing managers in September and October indicated that most did not perceive their customers’ inventories to be too high. Business investment in nonresidential structures was about flat in the third quarter as another strong increase in spending for drilling and mining structures offset **further declines in outlays on commercial and industrial buildings.**

Consumer price inflation remained low in recent months. The total PCE price index increased slightly in September as consumer energy prices moved up noticeably for a third month. The core PCE price index was unchanged in September, and the 12-month increase in this index continued to trend down. At earlier stages of processing, the rise in producer prices for intermediate materials remained moderate in September, but **prices of globally traded industrial and agricultural**

commodities accelerated considerably in October, reflecting in part the lower foreign exchange value of the dollar as well as concerns about supply for certain commodities. In September and October, survey measures of households' short- and long-term expectations for inflation remained in the ranges that have prevailed since the spring of 2009.

Labor compensation rose at a moderate rate in the third quarter. Private-sector wage increases, as measured by both average hourly earnings of all employees and the employment cost index (ECI), remained subdued. However, according to the ECI, employer benefit costs accelerated this year after posting a very small increase in 2009.

The U.S. international trade deficit widened in August, after narrowing in July, as a modest increase in nominal exports was more than offset by a strong increase in imports. Following widespread declines in July, most major categories of imports rebounded in August, with imports of consumer goods and capital goods exhibiting particular strength. **Imports of petroleum products also increased substantially, reflecting both higher volumes and higher prices.** The increase in exports was concentrated in agricultural goods, partly boosted by rising prices, and in services; most other major categories either declined or were flat.

Recent indicators of foreign economic activity suggested that growth abroad had slowed appreciably after midyear. Following an unsustainably high rate of expansion in the second quarter, growth of real gross domestic product (GDP) in the emerging market economies appeared to have slowed markedly, notwithstanding an apparent acceleration in economic activity in China. **Real GDP growth apparently moderated in the advanced foreign economies as well.** In the euro area, industrial production rose sharply in August, but purchasing managers indexes moved down in recent months. The German economy continued to perform strongly, while **recent data showed weakness in the peripheral euro-area countries. A**

reacceleration of food and energy prices helped push up inflation abroad, albeit generally to still-moderate levels, in the third quarter.

“

That EDZ hedge is looking pretty good again, isn't it?

The one from October is already a big winner so it's not like we didn't see this coming way back.

Staff Review of the Financial Situation

The decision by the Federal Open Market Committee (FOMC) at its September meeting to maintain the 0 to 1/4 percent target range for the federal funds rate was widely anticipated.

However, yields declined as market participants reportedly interpreted the language of the accompanying statement to imply higher odds of additional asset purchases and a longer period of exceptionally low short-term interest rates. Investors took particular note of the statement's indication that inflation was below the levels consistent with the FOMC's dual mandate for maximum employment and price stability. In the weeks following the FOMC meeting, Federal Reserve communications, along with economic data releases that continued to point to a tepid economic outlook, appeared to reinforce market expectations that additional policy accommodation would be forthcoming in the near term.

Yields on nominal Treasury coupon securities and those on TIPS declined, on net, over the intermeeting period, largely in response to Federal Reserve communications and somewhat weaker-than-expected economic data releases. Five-year inflation compensation increased over the intermeeting period, and forward inflation compensation 5 to 10 years ahead also rose. Anecdotal reports pointed to the increased likelihood of additional asset purchases by the Federal Reserve and to FOMC communications noting that the Committee viewed underlying inflation as somewhat below the levels judged to be most consistent with the Committee's dual mandate as factors contributing to lower yields

and to the increase in inflation compensation over the period. Yields on investment- and speculative-grade corporate bonds declined somewhat more than those on comparable-maturity Treasury securities, leaving risk spreads slightly lower. In the secondary market for syndicated leveraged loans, prices of loans continued to move up and bid-asked spreads narrowed a bit further.

Conditions in short-term funding markets were generally stable over the intermeeting period. In dollar funding markets, spreads of term London interbank offered rates (or Libor) over those on overnight index swaps edged up but remained at levels similar to those observed prior to the emergence of euro-area concerns earlier this year. Spreads on unsecured financial commercial paper and on asset-backed commercial paper remained low. Rates on repurchase agreements (repos) involving various types of collateral were little changed on net. Bid-asked spreads in most repo transactions generally declined while changes in haircuts on different types of repo collateral were mixed.

Broad U.S. stock price indexes rose, on balance, over the intermeeting period, reflecting investor expectations of further monetary policy accommodation and better-than-expected third-quarter earnings news; option-implied volatility on the S&P 500 index was little changed. The spread between the staff's estimate of the expected real return on equities over the next 10 years and an estimate of the expected real return on a 10-year Treasury note—a rough measure of the equity risk premium—narrowed a bit but remained at an elevated level. Bank stocks generally underperformed the broader market amid concerns about the handling of mortgage foreclosure documents and possible lack of compliance with securitization agreements.

Net debt financing by U.S. nonfinancial corporations was very strong in September, with sizable gross corporate bond issuance across the credit spectrum and a substantial increase in commercial paper outstanding, but data for October pointed to a moderation in these flows.

Issuance of syndicated leveraged loans in the third quarter remained near the average pace recorded in the first half of the year. Measures of the credit quality of nonfinancial corporations remained solid. The pace of gross public equity issuance from seasoned and initial public offerings by nonfinancial firms remained moderate in September and appeared to slow in October.

Commercial real estate markets remained strained. Commercial mortgage debt in the third quarter was estimated to have declined at a rate similar to the drop in the second quarter, and **the delinquency rate for securitized commercial mortgages continued to climb in September.** However, some signals offered modest encouragement. In particular, **vacancy rates for commercial buildings stabilized in the third quarter, and the pipeline of new commercial mortgage-backed securities picked up a bit from very low levels.**

Residential mortgage refinancing activity moved up in late September and early October, from an already high level, as the average interest rate on fixed-rate mortgages fell further over the intermeeting period. **In contrast, the level of applications for mortgages to purchase homes remained anemic. Total consumer credit contracted in August at a pace roughly in line with the declines posted earlier in the year.** Issuance of consumer asset-backed securities was solid in September. Consumer credit quality generally continued to improve, though delinquency rates remained elevated.

“**That’s actually the first green anything we’ve had on CRE all year so an actual good sign there...**”

Bank credit edged up in September and October, as brisk growth in banks' holdings of securities more than offset a further decline in total loans. **Commercial and industrial (C&I) loans turned down in September** after having increased

slightly over the two previous months. A moderate net fraction of banks reported, in their responses to the October Senior Loan Officer Opinion Survey on Bank Lending Practices, that they had eased standards on C&I loans and narrowed spreads of C&I loan rates over their cost of funds; demand for such loans reportedly declined, on net, over the preceding three months. Commercial real estate loans, home equity loans, and consumer loans contracted. However, closed-end residential mortgage loans on banks' books increased modestly for the second month in a row.

Over September and October, **M2 expanded at an average annual rate that was noticeably above its pace earlier in the year**. The growth rate of liquid deposits moved up, while **small time deposits and retail money market mutual funds continued to contract**. The compositional shift likely reflected the relatively attractive yields on liquid deposits. Currency growth strengthened, with indicators suggesting strong demand from abroad.

The dollar declined about 3 percent against a broad array of other currencies during the intermeeting period (17 FRIGGIN' DAYS!!!), depreciating even more against the euro and the yen. In addition, Chinese authorities allowed the renminbi to appreciate slightly against the dollar. Market commentary highlighted the possibility that major central banks would further ease monetary policy, and the Bank of Japan expanded its asset purchase program and reduced its policy target rate to a range of 0 to 10 basis points. Benchmark 10-year sovereign yields generally declined in the major advanced foreign economies, but the overnight rate in the euro area increased as the European Central Bank continued to allow the amount of liquidity provided to the banking system to decline. Spreads relative to German bunds on the 10-year sovereign bonds of most peripheral euro-area countries either declined or were little changed over the period, but **Irish sovereign spreads**

moved higher on concerns over the fiscal burdens associated with losses in the Irish banking sector. Major equity indexes in the euro area and in the United Kingdom increased moderately, whereas the Nikkei index declined.

Several emerging market central banks tightened monetary policy, including the People's Bank of China. Against the backdrop of interest rate declines in many of the advanced economies, as well as heavy capital flows toward emerging market countries, many emerging market currencies strengthened, reportedly prompting further official intervention in foreign exchange markets.

“ **A little heads up from the Fed on Ireland would have been nice!** ”

Staff Economic Outlook

Because the recent data on production and spending were broadly in line with the staff's expectations, the forecast for economic activity that was prepared for the November FOMC meeting showed little change to the staff's near-term outlook relative to the forecast prepared for the September FOMC meeting. However, **the staff revised up its forecast for economic activity in 2011 and 2012**. In light of asset market developments over the intermeeting period, which in large part appeared to reflect heightened expectations among investors that the Federal Reserve would undertake additional purchases of longer-term securities, **the November forecast was conditioned on lower long-term interest rates, higher stock prices, and a lower foreign exchange value of the dollar than was the staff's previous forecast**. These factors were expected to provide additional support to the recovery in economic activity. Accordingly, the unemployment rate was anticipated to recede somewhat more than in the previous forecast, although the margin of slack at

the end of 2011 was still expected to be substantial.

The staff's forecast continued to show subdued rates of headline and core inflation during 2011 and 2012. However, *the downward pressure on inflation from slack in resource utilization was expected to be slightly less than previously projected, and prices of imported goods were anticipated to rise somewhat faster*. As in previous forecasts, further disinflation was expected to be checked by the ongoing stability of inflation expectations.

“Wow, they are backpedaling already as they see they've let the inflation genie out of the bottle.”

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, all meeting participants-the six members of the Board of Governors and the heads of the 12 Federal Reserve Banks-provided projections of output growth, the unemployment rate, and inflation for each year from 2010 through 2013 and over the longer run. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks. Participants' forecasts are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, meeting participants generally agreed that the incoming data indicated that output and employment were continuing to increase, but only slowly. *Progress toward the Committee's dual objectives of maximum employment and price stability was described as disappointingly slow*. Participants variously noted a number of

factors that were restraining growth, including *low levels of household and business confidence, concerns about the durability of the economic recovery, continuing uncertainty about the future tax and regulatory environment, still-weak financial conditions of some households and small businesses, the depressed housing market, and waning fiscal stimulus*. Although participants considered it quite unlikely that the economy would slide back into recession, *some noted that continued slow growth and high levels of resource slack could leave the economic expansion vulnerable to negative shocks*. In the absence of such shocks, and assuming appropriate monetary policy, participants' economic projections generally showed growth picking up to a moderate pace and the unemployment rate declining somewhat next year. *Participants generally expected growth to strengthen further and unemployment to decline somewhat more rapidly in 2012 and 2013*.

“As long as we don't have any shocks - we might be OK! How comforting...”

Indicators of spending by households and businesses remained mixed. *Consumer spending was expanding gradually*. Participants noted that households were continuing their efforts to repair their balance sheets, a process that was restraining growth in consumer spending. *Sluggish employment growth and elevated uncertainty about job prospects also continued to weigh on household spending. With respect to business spending, contacts generally reported that they were investing to reduce costs but were refraining from adding workers or expanding capacity in the United States*. Energy producers were an exception. Participants observed that firms had generated rising profits, but that business contacts indicated those gains largely reflected cost-cutting rather than top-line growth in revenues. A number of businesses continued to

report that they were holding back on hiring and capital spending because of uncertainty about future taxes, health-care costs, and regulations. But concerns about actual and anticipated demand also were important factors limiting investment and hiring. Firms continued to report strong foreign demand for their products, particularly from Asia.

Participants noted that the housing sector, including residential construction and home sales, remained depressed. Foreclosures were adding to the elevated supply of available homes and putting downward pressure on home prices and housing construction. Some participants saw disputes over mortgage and foreclosure documents as likely to delay the eventual recovery in housing markets. Commercial real estate markets also were weak, and the availability of credit for commercial real estate transactions remained limited, but low interest rates were helping stabilize prices.

Participants agreed that progress in reducing unemployment was disappointing; indeed, several noted that the recent rate of output growth, if continued, would more likely be associated with an increase than a decrease in the unemployment rate. Participants again discussed the extent to which employment was being held down, and the unemployment rate boosted, by structural factors such as mismatches between the skills of the workers who had lost their jobs and the skills needed in the sectors of the economy with vacancies, the inability of the unemployed to relocate because their homes were worth less than the principal they owed on their mortgages, and the effects of extended unemployment benefits on the duration of unemployed workers' search for a new job. Participants agreed that such factors were contributing to continued high unemployment but differed in their assessments of the magnitude of such effects. Many participants saw evidence that the current

unemployment rate was well above levels that could be explained by structural factors alone, noting, for example, reports from business contacts indicating that weak growth in demand for their firms' products remained a key reason why they were reluctant to add employees, and job vacancy rates that were low relative to historical experience. A number of participants noted that continued high unemployment, particularly with large numbers of workers suffering very long spells of unemployment, would lead to an erosion of workers' skills that would have adverse consequences for those workers and for the economy's potential level of output in the longer term.

Hey, you know what will fix this? Cutting benefits, of course. Not! I can't believe the lack of discussion of this issue in the MSM as 2M of their viewers/readers are about to drop off unemployment - that's 2% of US households cut off with nothing at Christmas - you would think someone would care... Really... Anyone???

Participants saw financial conditions as having become more supportive of growth over the course of the inter-meeting period; most, though not all, of the change appeared to reflect investors' increasing anticipation of a further easing of monetary policy. Most longer-term nominal interest rates declined, real interest rates fell even more, credit spreads tightened, and equity prices rose, in part reflecting better-than-expected corporate earnings reports. Inflation compensation rose noticeably, returning to a level more typical of recent years. Participants noted that credit remained readily available in debt markets and from banks for

larger corporations, and there were some signs that credit conditions had begun to improve for smaller firms that obtain credit primarily from banks. Banking institutions reported signs of improving credit quality. Improvements in household financial conditions were contributing to better performance of consumer loans. However, **banks continued to report elevated losses on commercial real estate loans, especially construction and land development loans**. Participants noted the risk of losses at financial institutions stemming from investors putting mortgages back to sellers if the quality of the loans was misrepresented when the mortgages were sold into securitization vehicles.

Measures of price inflation had generally trended lower since the start of the recession; the same was true of nominal wage growth. Most participants indicated that underlying inflation was somewhat low relative to levels that they judged to be consistent with the Committee's statutory mandate to foster maximum employment and price stability. While underlying inflation remained subdued, **meeting participants generally saw only small odds of deflation, given the stability of longer-term inflation expectations and the anticipated recovery in economic activity**. They generally did not expect appreciably higher inflation, either. While prices of some commodities and imported goods had risen recently, **business contacts reported that they currently had little pricing power and that they would continue to seek productivity gains to offset higher input costs**. Small wage increases, coupled with productivity gains, meant that unit labor costs were lower than a year earlier. Many participants pointed to substantial slack in resource utilization, along with well-anchored inflation expectations, as likely to contribute to subdued inflation for some time. A few participants expected that continuing resource slack would lead to some further disinflation in coming years. **However, a few others thought that the exceptionally accommodative stance of**

monetary policy, coupled with rising prices of energy and other commodities as well as rising prices of other imports, made it more likely that inflation would increase, within a year or two, to levels they judged consistent with the Committee's dual mandate.

WOW! That is a sick statement. They are HAPPY that low wages plus commodity inflation and rising import prices will allow inflation to increase. TOTALLY the wrong kind of inflation (not demand-driven) and they even say that companies will seek more efficiencies (ie. outsourcing and layoffs) to offset the prices they can't pass on to bankrupt consumers. On this basis alone I call for a full impeachment and removal of the Fed - to be replaced by cartoon bears if constitutionally possible!

Participants generally agreed that the most likely economic outcome would be a gradual pickup in growth with slow progress toward maximum employment. They also generally expected that inflation would remain, for some time, below levels the Committee considers most consistent, over the longer run, with maximum employment and price stability. However, participants held a range of views about the risks to that outlook. Most saw the risks to growth as broadly balanced, but many saw the risks as tilted to the downside. Similarly, a majority saw the risks to inflation as balanced; some, however, saw downside risks predominating while a couple saw inflation risks as tilted to the upside. Participants also differed in their assessments of the likely benefits and costs associated with a program of purchasing additional longer-term securities in an effort to

provide additional monetary stimulus, though most saw the benefits as exceeding the costs in current circumstances. Most participants judged that a program of purchasing additional longer-term securities would put downward pressure on longer-term interest rates and boost asset prices; some observed that it could also lead to a reduction in the foreign exchange value of the dollar. Most expected these changes in financial conditions to help promote a somewhat stronger recovery in output and employment while also helping return inflation, over time, to levels consistent with the Committee's mandate. In addition, several participants argued that the stimulus provided by additional securities purchases would help protect against further disinflation and the small probability that the U.S. economy could fall into persistent deflation-an outcome that they thought would be very costly. Some participants, however, anticipated that additional purchases of longer-term securities would have only a limited effect on the pace of the recovery; they judged that the economy's slow growth largely reflected the effects of factors that were not likely to respond to additional monetary policy stimulus and thought that additional action would be warranted only if the outlook worsened and the odds of deflation increased materially. Some participants noted concerns that additional expansion of the Federal Reserve's balance sheet could put unwanted downward pressure on the dollar's value in foreign exchange markets. Several participants saw a risk that a further increase in the size of the Federal Reserve's asset portfolio, with an accompanying increase in the supply of excess reserves and in the monetary base, could cause an undesirably large increase in inflation. However, it was noted that the Committee had in place tools that would enable it to remove policy accommodation quickly if necessary to avoid an undesirable increase in inflation.

That last bit is worrying for people who are counting on a non-stop continuation of POMO.

Committee Policy Action

Though the economic recovery was continuing, members considered progress toward meeting the Committee's dual mandate of maximum employment and price stability as having been disappointingly slow. Moreover, members generally thought that progress was likely to remain slow. Accordingly, most members judged it appropriate to take action to promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with the Committee's mandate. In their discussion of monetary policy for the period immediately ahead, nearly all Committee members agreed to keep the federal funds rate at its effective lower bound by maintaining the target range for that rate at 0 to 1/4 percent and to expand the Federal Reserve's holdings of longer-term securities. To increase its securities holdings, the Committee decided to continue its existing policy of reinvesting principal payments from its securities holdings into longer-term Treasury securities and intended to purchase a further \$600 billion of longer-term Treasury securities at a pace of about \$75 billion per month through the second quarter of 2011. One member dissented from this action, judging that the risks of additional securities purchases outweighed the benefits. Members agreed that the Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of incoming information and will adjust the program as needed to best foster its goals of maximum employment and price stability.

With respect to the statement to be released following the meeting, members agreed that it was appropriate to adjust the statement to make it clear that the unemployment rate was elevated, and that measures of underlying inflation were somewhat low, relative to levels that the Committee judged to be consistent, over the longer run, with its dual mandate. Nearly all members agreed that the statement should reiterate the expectation that economic conditions were likely to warrant exceptionally

low levels of the federal funds rate for an extended period. Members agreed that the statement should note that the Committee will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to 1/4 percent. The Committee directs the Desk to execute purchases of longer-term Treasury securities by the end of June 2011 in order to increase the total face value of domestic securities held in the System Open Market Account to approximately \$2.6 trillion. The Committee also directs the Desk to reinvest principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in September confirms that the pace of recovery in output and employment continues to be slow. Household spending is increasing gradually, but remains

constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising, though less rapidly than earlier in the year, while investment in nonresidential structures continues to be weak. Employers remain reluctant to add to payrolls. Housing starts continue to be depressed. Longer-term inflation expectations have remained stable, but measures of underlying inflation have trended lower in recent quarters.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Currently, the unemployment rate is elevated, and measures of underlying inflation are somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate. Although the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, progress toward its objectives has been disappointingly slow.

To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today to expand its holdings of securities. The Committee will maintain its existing policy of reinvesting principal payments from its securities holdings. In addition, the Committee intends to purchase a further \$600 billion of longer-term Treasury securities by the end of the second quarter of 2011, a pace of about \$75 billion per month. The Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of incoming information and will adjust the program as needed to best foster maximum employment and price stability.

The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization,

subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period.

The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Sandra Pianalto, Sarah Bloom Raskin, Eric Rosengren, Daniel K. Tarullo, Kevin Warsh, and Janet L. Yellen.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he judged that additional accommodation would do little to accelerate the economy's continuing, gradual recovery. In his assessment, the risks of additional purchases of Treasury securities outweighed the benefits. Mr. Hoenig believed that additional purchases would risk a further misallocation of resources and future financial imbalances that could destabilize the economy. He also saw a potential for additional purchases to undermine the Federal Reserve's independence and cause long-term inflation expectations to rise. Mr. Hoenig also believed it was not appropriate to indicate that economic and financial conditions were "likely to warrant exceptionally low levels of the federal funds rate for an extended period" or to reinvest principal payments from agency debt and mortgage-backed securities in long-term Treasury securities. In his assessment, this continued high level of monetary policy accommodation could put at risk the achievement of the Committee's long-run policy objectives.

It was agreed that the next meeting of the Committee would be held on Tuesday, December

14, 2010. The meeting adjourned at 1:15 p.m. on November 3, 2010.

Notation Vote

By notation vote completed on October 8, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on September 21, 2010.

Videoconference Meeting of October 15

The Committee met by videoconference on October 15 to discuss issues associated with its monetary policy framework, including alternative ways to express and communicate the Committee's objectives, possibilities for supplementing the Committee's communication about its policy decisions, the merits of smaller and more frequent adjustments in the Federal Reserve's intended securities holdings versus larger and less frequent adjustments, and the potential costs and benefits of targeting a term interest rate. The agenda did not contemplate any policy decisions and none were taken.

Participants agreed that greater public understanding of the Committee's interpretation of its statutory objectives could contribute to better macroeconomic outcomes. Participants expressed a range of views about the potential costs and benefits of quantifying the Committee's interpretation of its statutory mandate to promote price stability by adopting a numerical inflation objective or a target path for the price level. In the end, participants noted that the longer-run projections contained in the Summary of Economic Projections, which is released once per quarter in conjunction with the minutes of four of the Committee's meetings, convey considerable information about participants' assessments of their statutory objectives. Participants discussed whether it might be useful for the Chairman to hold occasional press briefings to provide more detailed information to the public regarding the Committee's assessment of the outlook and its policy decision making than is included in Committee's short post-meeting statements.

In their discussion of the relative merits of smaller and more frequent adjustments versus larger and less frequent adjustments in the Federal Reserve's intended securities holdings, participants generally agreed that large adjustments had been appropriate when economic activity was declining sharply in response to the financial crisis. In current circumstances, however, most saw advantages to a more incremental approach that would involve smaller changes in the Committee's holdings of securities calibrated to incoming data.

Finally, participants discussed the potential benefits and costs of setting a target for a term interest rate. Some noted that targeting the yield on a term security could be an effective way to reduce longer-term interest rates and thus provide additional stimulus to the economy. But participants also noted potentially large risks, including the risk that the Federal Reserve might find itself buying undesirably large amounts of the relevant security in order to keep its yield close to the target level.

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Sandra Pianalto, Sarah Bloom Raskin, Eric Rosengren, Daniel K. Tarullo, Kevin Warsh, and Janet L. Yellen.

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