



## **We (Finally) Faced the Big Elephant in the Market**

When the markets closed on Friday, many market experts were predicting that Lehman Brothers would become part of the Bank of America kingdom by the end of the weekend. Then again, many sports analysts were predicting last week that Ohio State had a chance to beat Southern Cal at home. As we all know, predictions do not always come true and the penalty for being wrong could be severe. For Ohio State, it meant a long trip back to Columbus and a drop in the polls. For a Wall Street firm founded eleven years before the start of the American Civil War, it meant filing bankruptcy. It also meant that Merrill Lynch, a 94-year old icon on Wall Street, will soon call Charlotte, North Carolina its home.

Such is the case with Lehman Brothers and Merrill Lynch. We have known for some time that Lehman was in very bad shape. What we did not know was that the firm's health was so poor that no White Knight stood up to catch its fall. That included the Federal Reserve and the world's leading commercial banks. The question to be answered is whether this speaks of a financial system that is terribly broken, or of a respected investment firm that was terribly managed. I am sure that the truth lies somewhere in the middle.

Lax oversight from the Federal Banking Commission, the Federal Reserve, and the SEC has given investment firms (such as Lehman) plenty of rope to hang themselves. There was no oversight of Lehman's aggressive business habits, especially from its Board of Directors that included four members who were 75 or older, a theatre manager, an 83 year-old actress, a former head of the Red Cross, and the CEO of Sotheby's. More than likely, most members of the Board did not understand the risky path the firm had taken while under their watch.

What amazes me is that only a handful of individuals can bring an entire global banking system to its knees. At Lehman Brothers, it was a CEO who listened to no one but himself. In 1995, a rogue broker in Barings Bank's Singapore office brought the collapse of the 233 year-old London institution. In 1994, Kidder Peabody's 130-year run on Wall Street came to an end when bond trader Joseph Jett booked \$350 million in false profits over a four-year span. In January 2008, one single trader at France's leading bank (Societe General) created \$7.2 billion in losses that brought the company to its knees.

On top of the firms listed above, Bear Stearns had to be saved earlier this year, AIG is now on life support, Citigroup has written off billions in bad investments, and Washington Mutual's stock price has fallen from \$46/share to \$2. The sad part of this situation is that nearly 3,000 innocent lives were lost and two wars have been fought in response to nineteen terrorists who failed in their quest to destroy the global financial system on September 11, 2001. Instead, about nineteen greedy CEO's and bond traders have succeeded where the terrorists had failed.

The events today will ripple around the globe tonight. At 10 p.m. Central Time, the Japanese market is down 5% and European markets will retreat as well. To take our minds off of Lehman and Merrill (sarcasm), Tuesday and Wednesday bring earnings reports from Goldman Sachs and Morgan Stanley. All eyes will be on AIG as well after the credit agencies downgraded the company and it now faces its own capital crunch. The markets are also facing a regularly scheduled Federal Reserve meeting on Tuesday where they will probably resist lowering

short-term rates in response to today's meltdown. The big question is what role the Federal government decides to play in the financial crisis.

### **An Important Fact to Remember**

Over the years, we have faced the Asian Financial Crisis, the implosion of Long-Term Capital Management, Mexico's peso crisis, the fallout in the Savings and Loans industry, and many other critical periods in the finance sector. Every time it has happened, widespread investor panic has been followed by a rational understanding that the world is not coming to an end. Do not get me wrong, there will be pain for some time to come. The costs to bail out financial institutes can be enormous and it is usually the taxpayer who foots the bill. Data indicates that the U.S. will require the equivalent of 5% of its GDP to bail out its failed banks, Fannie Mae and Freddie Mac, and other financial institutions. The problem is even greater in other areas of the globe. In China, non-performing loans are equal to 44% of its annual GDP, while Malaysia tops 50%. In Japan, non-performing loans have surpassed the \$1 trillion mark (USCC.gov).

### **The Brookmont Dividend Equity Strategy**

On a relative basis, our Strategy held up well versus the major indices and its specific benchmarks (Russell 1000 Value and Lipper Large-Cap Value). The Strategy does not own Fannie Mae or Freddie Mac, nor does it hold Lehman Brothers, Merrill Lynch, Bank of America, or American International Group (AIG). The table below includes performance results for Monday and for the month through September 15.

<b>Index</b>	<b>9/15/2008</b>	<b>Sept.</b>
<b>Brookmont Dividend Equity</b>	-2.91%	-1.90%
<b>Russell 1000 Value</b>	-5.66%	-7.10%
<b>Lipper Large-Cap Value</b>	-4.85%	-6.10%
<b>S&amp;P 500</b>	-4.78%	-6.90%
<b>Dow Industrials</b>	-4.42%	-5.03%
<b>S&amp;P Mid-Cap</b>	-4.40%	-7.05%
<b>S&amp;P Small-Cap</b>	-3.76%	-5.02%

(as of Sept 15, 2008)

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**Robert Bugg – Principal and Chief Investment Officer**  
214-932-6696

**Bill Leonard – Director of Client Relations**  
214-932-6855

**Neal Scott – Principal and Fixed Income Manager**  
214-932-6647

**Suzie Begando – Portfolio Manager**  
214-932-6712



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