

Janet Tavakoli Gets 5 Stars!

December 30, 2011

A year ago, Muniland faced a Rubicon as Meredith Whitney's words caused a wholesale slaughter in the tax-free and taxable Muni bond market. Investors who listened sold their Munis at about the worst relative pricing they could experience. We have encountered Whitney all year. We took the opposite view and our clients have benefitted by owning their bonds and not panicking. We were buyers during the Whitney-exacerbated sell off. We have written about that many times. The comments are archived at www.cumber.com.

There is more to the Whitney saga. Today, it was superbly revealed by Janet Tavakoli in her Huffington Post column. With her full permission, we have reproduced the entire piece below. We thank Janet for allowing us to reproduce her column and wish her all the best for the New Year. We wish the same for you, dear reader. 2012 promises to be full of surprises and laced with volatility. We will do our best to help readers navigate through the storm. For those clients who have helped make Cumberland a success, we promise to try to anticipate the storm for you. Now to Janet's post. The link and the full text are below.

Here is the link.

[2011: The Year 60 Minutes Mised Americans About Municipal Bonds](#)

Huffington Post – December 30, 2011

Here is the full text.

In previous posts, I've mentioned serious fiscal problems that need to be addressed at state and local levels. This varies by region and some issues are potentially solvable.

I live in Illinois, which is ground zero for fraud, corruption, underfunded pension funds and general fiscal mismanagement. It's an example of one of the worst fiscal messes in the United States. This year Illinois hiked personal income taxes from 3% to 5%, and increased corporate taxes. We'll be slammed with hidden tax increases in utilities, purchases, and more. When now Mayor Rahm Emanuel left his post as White House Chief of Staff to run his election, the Chicago mayoral race centered partly around steps, including budget cuts, needed to solve Chicago's serious fiscal issues: See "[Third World America: Drowning in Debt and Chocking on Lies](#)," Huffington Post, June 24, 2011, and "[Fast-Tracking to Anarchy](#);" August 25, 2010.

On December 19, 2010, I was (at first) happy to see 60 Minutes highlight fiscal problems of states and municipalities. It explained how Illinois was late on payments to service suppliers, and it's a huge problem for people doing business with the state. The state's pension fund is underfunded and although 60 Minutes didn't mention it, state pension funds are the prey of Wall Street cronies that stuff them with losses and then propose fee-loaded leveraged financial products that are bets to make up the shortfall. Then 60 Minutes went completely off the rails by suggesting that these problems would lead to widespread defaults on municipal bonds in 2012. You can still view the segment, "[State Budgets: Day of Reckoning](#)," on the CBS web site.

A "Performance"

Instead of focusing on the implication of these problems to public services including police protection, fire departments, city maintenance, and city jobs (among other things), 60 Minutes let a pundit claim these problems translate into near-term massive municipal bond defaults. Meredith Whitney, the pundit, had written a report, "Tragedy of the Commons," which supposedly backed her claims.

Contrary to 60 Minutes's assertion, Meredith Whitney, a banking analyst, did not have a great track record. Gullible reporters had given her great PR for an October 31, 2007, call on Citigroup that had been correctly made many months earlier in her presence by my friend Jim Rogers, a legendary investor. They appeared on television together, and at the time she refuted Rogers. I was later bemused to see that either she or her PR flacks apparently took credit for my early warnings about serious problems at AIG. (See: "[Reporting v. PR: Meredith Whitney and AIG](#)," TSF, March 23, 2009.)

[Whitney was quoted](#) as claiming: "Clients are not pleased with my call and I have had several death threats." A 2008 Fortune cover story reported she had received "one death threat." (Perhaps clients were displeased that her ignoring Rogers had already cost them thirteen points and even then she didn't directly tell people to bail out.) With characteristic humor [Rogers quipped](#): "Gosh, I have never received a death threat ever for saying I was short a stock or that a company would be going bankrupt. What have I been doing wrong?"

Whitney told 60 Minutes: "You could see 50 sizable defaults. Fifty to 100 sizeable defaults. More. This will amount to hundreds of billions of dollars' worth of defaults....It'll be something to worry about within the next 12 months."

A Wild Guess

Subsequently, Whitney wouldn't justify her analysis saying "Quantifying is a guesstimate at this point." ("[Whitney Municipal-Bond Apocalypse Short on Specifics](#)," by Max Abelson and Michael McDonald, Bloomberg News, Feb 1, 2011.) 60 Minutes admitted it had never reviewed her much-touted report. The report never mentioned sizable defaults, only that there "invariably" would be defaults. Bloomberg also reported that 60 Minutes was wrong about her "untarnished" track record. Since she started her company in 2009, about two-thirds of her stock picks since starting her company underperformed market indexes. A 2008 Fortune cover story ranked Whitney 1,205th out of 1,919 equity analysts the previous year, based on stock picks.

Whitney told Bloomberg's reporters: "A lot of this is, you know it, but can you prove it? There are fifth-derivative dimensions that I don't think I need to spell out to my clients." As a derivatives expert I can attest that this is gibberish. But I want to hear her explanation of "fifth-derivative dimensions," because I adore a good belly laugh.

Genuine Research via Bloomberg

Bloomberg is also the financial news service that has done great early work on fraud and related municipal bond defaults, because that's a worthy story. Municipal credit issues are granular and the severity of the problem -- or non-problem -- depends on the specific situation.

In September 2005, Bloomberg broke a story about Jefferson County's hair raising problems, "[The Banks that Fleeced Alabama](#)," by Martin Z. Braun, Darrell Preston and Liz Willen. According to the article, "taxpayers blame the \$160 million in fees JPMorgan Chase and other banks have charged to arrange the county's financing--in deals that were never put out to bid." This year, [Jefferson County filed](#) for bankruptcy.

As the year wore on, Meredith Whitney waffled and by May she told a Bloomberg radio host: "In the cycle of this municipal downturn, I stand by it. But we never

had a specific estimate for that." Fortunately, Joe Mysak, a Bloomberg print reporter, exposed that for the nonsense it was. Whitney had indeed given a one-year time frame on 60 Minutes and had called for hundreds of millions of dollars in defaults with 50 to 100 or more sizable defaults. (["Meredith Whitney Trips Over Her Muni Default Tale,"](#) May 19, 2011.)

A Stellar Performance

Whitney's prediction of "hundreds of billions" of defaults was way off the mark. Even with Jefferson County's \$943 million filing, defaults for 2011 were down from 2010. Bonds that dipped into reserves to make payments totaled only \$24.6 billion according to Richard Lehmann, publisher of the Distressed Debt Securities Newsletter. Defaults defined as bonds that missed payments are down to only \$2.1 billion from \$2.8 billion in 2010. In 2011, municipal bonds had stellar performance as an asset class returning more than 10% of potentially tax exempt returns. They beat the S&P, treasuries, corporate bonds and most commodities. (["Whitney's Armageddon Belied by '11 Returns,"](#) by Martin Z. Bruan, Bloomberg News, December 16, 2011).

CNBC Schools 60 Minutes

As for the actual analysis in Meredith Whitney's "Tragedy of the Commons" report, it seems that it had serious flaws, at least when it came to Nevada.

Nevada State Treasurer Kate Marshall appeared on CNBC to debunk Whitney's claim that Nevada's municipal bonds were troubled. Marshall challenged Whitney's analytics saying (among other things) that Whitney apparently misinterpreted a PEW report on pension plan liabilities. Nevada only represented 1/16th of the plan, and state employees pick up half the tab. Marshall then explained why Nevada's municipal bond claims paying ability is much better than it would appear to the casual observer. The economy was still tough, but Nevada managed in anticipation of the ongoing crunch. Property tax revenues dropped, but sales tax revenues were up, gambling revenue was up, and business modified tax revenues were up. Her cash position in June 2011 was much better than 2010.

Thank you, Janet.

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investors. Ms. Tavakoli has more than 20 years of experience in senior investment banking positions, trading, structuring and marketing structured financial products. She is a former adjunct associate professor of derivatives at the University of Chicago's Graduate School of Business. Author of: [*Credit Derivatives & Synthetic Structures*](#) (1998, 2001), [*Collateralized Debt Obligations & Structured Finance*](#) (2003), [*Structured Finance & Collateralized Debt Obligations*](#) (John Wiley & Sons, September 2008). Tavakoli's book on the causes of the global financial meltdown and how to fix it is: [*Dear Mr. Buffett: What an Investor Learns 1,269 Miles from Wall Street*](#) (Wiley, 2009).

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