breakfast with
CORNERSTONE RESEARCH

The Economic Downturn And Securities Litigation

June 11, 2009

New York, NY

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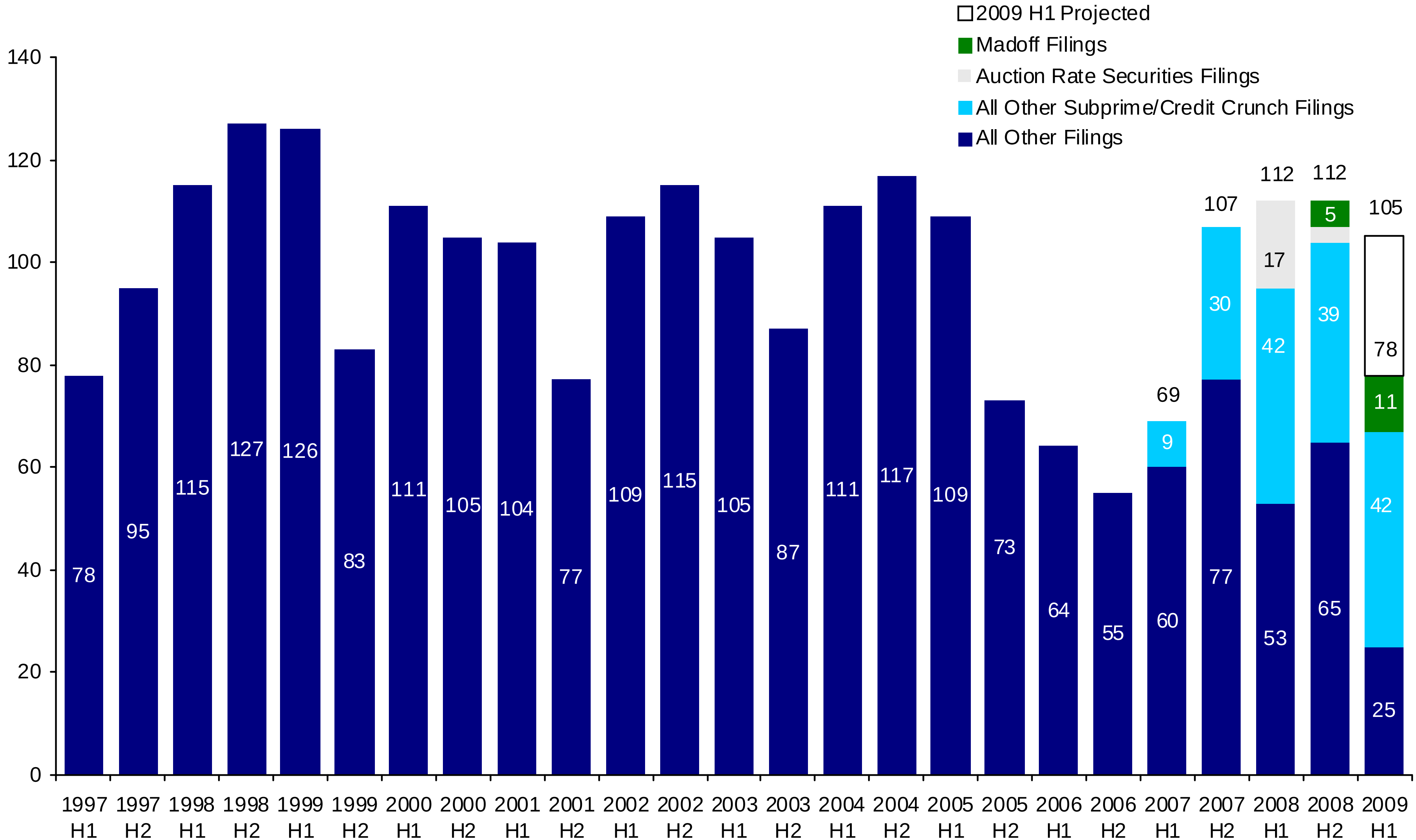
The Economic Downturn
And Securities Litigation

Developments in Securities Class Action Litigation

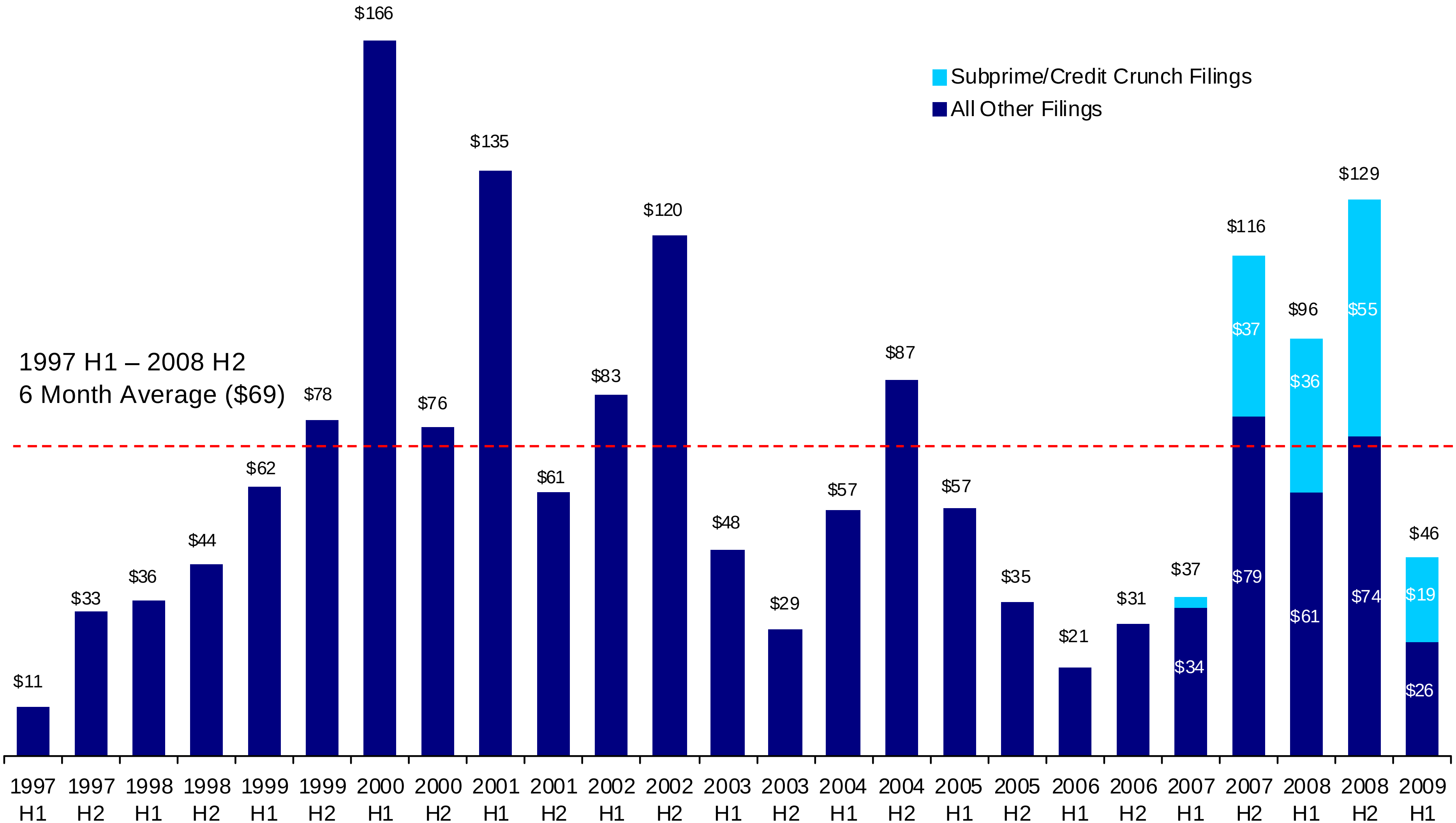
John Gould
Vice President,
Cornerstone Research

Number of Class Action Filings – by Half Year
1997 – 2009 YTD



DDL – by Half Year
1997 – 2009 YTD

Dollars in Billions



S&P 500 Securities Litigation Heat MapsTM
Percent of Market Capitalizations Subject to New Filings*
2000 – 2009

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Basic Materials	8.9%	0.0%	0.0%	0.0%	0.0%	5.6%	0.0%	0.0%	0.0%	0.0%
Communications	23.6%	28.0%	34.5%	1.7%	4.2%	1.7%	0.4%	7.2%	4.7%	0.6%
Consumer Cyclical	10.1%	4.6%	5.2%	2.7%	4.3%	4.8%	8.9%	3.3%	4.0%	0.9%
Consumer Non-Cyclical	20.6%	4.7%	22.2%	11.0%	15.3%	11.5%	12.0%	13.9%	11.2%	0.0%
Energy	0.0%	6.8%	8.2%	0.0%	44.2%	0.0%	0.0%	0.0%	0.0%	0.9%
Financial	3.2%	0.8%	30.1%	6.5%	22.3%	7.0%	0.0%	18.7%	54.9%	41.2%
Industrial	4.3%	0.0%	12.1%	4.7%	5.7%	6.5%	0.6%	0.3%	24.9%	18.9%
Technology	3.3%	29.5%	2.9%	0.7%	1.6%	13.7%	12.6%	0.0%	13.7%	0.0%
Utilities	9.2%	4.0%	42.1%	4.3%	5.0%	5.6%	0.0%	5.8%	4.1%	0.0%
All S&P 500 Companies	**11.6%**	**10.6%**	**18.7%**	**5.2%**	**12.5%**	**7.3%**	**5.0%**	**8.3%**	**17.1%**	**7.5%**

Legend	0%	0% – 5%	5% – 15%	15% – 25%	25%+

Note: * The chart is based on the market capitalizations of the S&P 500 companies as of the first trading day of each year. Industries are based on Bloomberg sector classifications. Percent of Market Capitalizations Subject to New Filings equals the total market capitalization of companies subject to new securities class action filings in federal courts in each sector divided by the total market capitalization of all companies in that sector.

Recent Top Settlements

Dollars in Millions

Case	Settlement Amount
United Health	$925.5
Merrill	$475.0
Royal Dutch Shell	$352.6
AIG	$241.5
Schering-Plough	$165.0
Brocade	$160.1
Converium	$114.5
HealthSouth	$109.0

Upcoming New York Events Sponsored by Cornerstone Research

Tuesday, September 15, 2009

- Breakfast Presentation by Erik Sirri, former Director of the Division of Trading and Markets, SEC.

Wednesday, October 14, 2009

- Breakfast Presentation – Antitrust Topics with Michael Keeley and Michele Burtis, Cornerstone Research

Joseph A. Grundfest

- A nationally prominent expert on capital markets, corporate governance, and securities litigation.
- Founded the award-winning Stanford Securities Class Action Clearinghouse, which is sponsored by Cornerstone Research, dedicated to providing detailed, online information about federal class action securities fraud litigation.
- Launched Stanford Law School's executive education programs, and continues to co-direct Directors' College.
- Quoted widely in the press on a variety of issues.

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The Economic Downturn And Securities Litigation

The Macro-Economy: Are We “There” Yet?

Joseph A. Grundfest
W. A. Franke Professor of Law and Business,
Stanford Law School;
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The Word of God

“And Joseph said to Pharaoh, ‘…The seven healthy cows are seven years… the seven lean and ugly cows…are seven years… God has revealed to Pharaoh what He is about to do. Immediately ahead are seven years of great abundance in all the land Egypt. After them will come seven years of famine…no trace of the abundance will be left in the land because of the famine thereafter, for it will be very severe.’”

“‘Accordingly, let Pharaoh find a man of discernment and wisdom, and set him over the land of Egypt…and let the grain be collected …as a reserve for the land for the seven years of famine.’ …Pharaoh said to Joseph, ‘since God has made all this known to you…I put you in charge of all the land of Egypt…’”

“When the famine became severe in the land of Egypt, Joseph…rationed out grain to the Egyptians. The famine however, spread out over the whole world. So all the world came to Joseph to procure rations, for the famine had become severe throughout all the world.”

Genesis 41:25-57

We Have Sinned

- Thou shalt follow countercyclical macro, capital adequacy, and accounting policies.
  - *We have sinned.*
- Thou shalt maintain prudent savings rates.
  - *We have sinned.*
- Thou shalt remember that the business cycle never dies.
  - *We have sinned.*
- Thou shalt remember that in a true crisis, correlations can collapse, panic can be global, there is a flight to quality, and the benefits of diversification can disappear.
  - *We have sinned.*

We Have Sinned, cont'd.

- Thou shalt remember that macro policy requires proper interpretation of the executive branches' dreams combined with the ability to "manage up."
  - *We have sinned.*
- Thou shalt appoint administrators who can run a banking system and manage the macro-economy, because Pharoahs are typically clueless. These administrators had better get it right.
  - We don't yet know whether we have sinned. Bernanke, Geithner, and Paulson are the modern day "Josephs" replete with predictions of doom and de facto control over the macro-economy. Only time will tell whether they have done a good job.

Jimmy

- Jimmy picks up smoking and drinking, and gains 180 pounds.
- Jimmy has a coronary.
- Jimmy winds up in the ER. Dramatic intervention, including open heart surgery, keeps Jimmy alive. But there are potential side effects.
  - “Pump head” (post-perfusion syndrome): a mental decrement that can follow cardio-pulmonary bypass procedures.
  - Functionality does not necessarily return to pre-intervention levels.
- Jimmy survives the acute crisis with the best possible outcome, but is still a weakened, overweight, alcoholic smoker whose problems have only just begun.
- How will Jimmy lose weight, get off the bottle, and chuck the cigs?

We Are Jimmy

- Historic debt load generated by the real estate bubble and low real interest rates. Note that these two factors are co-determined.
- Low savings rates that may now be changing.
- Large, unrecognized future deficits attributable to Medicare and Social Security obligations.
- Expenditures on consumption rather than human capital or infrastructure.
- Fiscal intervention not as timely, targeted, or temporary as experts prefer.
- Monetary intervention may avert deflation, but raises a risk of later inflation.

We Are Jimmy, cont'd.

- An energy policy that is inherently flawed, leaves the nation highly dependent on foreign sources of oil, and does little to clean the environment.
- A profound tension between the economically rational and the politically feasible.
- A large and growing deficit that leaves many unanswered questions about the economy's ability to generate sufficient offsetting growth
  - Is our current macro policy one of digging and filling holes (a wealth transfer) in the guise of investment activity, or is it actually productive investment?

Outline

Part I: Humility

Part II: History

Part III: Hope

Part IV: Horizon

Outline

Part I: Humility

- The world’s leading economists, traders, bankers, and regulators didn’t see this coming. Why?
- Given the experts’ track record, how much confidence can we have in forecasts and policy prescriptions?
- The story of VaR, and lessons for risk management techniques.

Part II: History

Part III: Hope

Part IV: Horizon

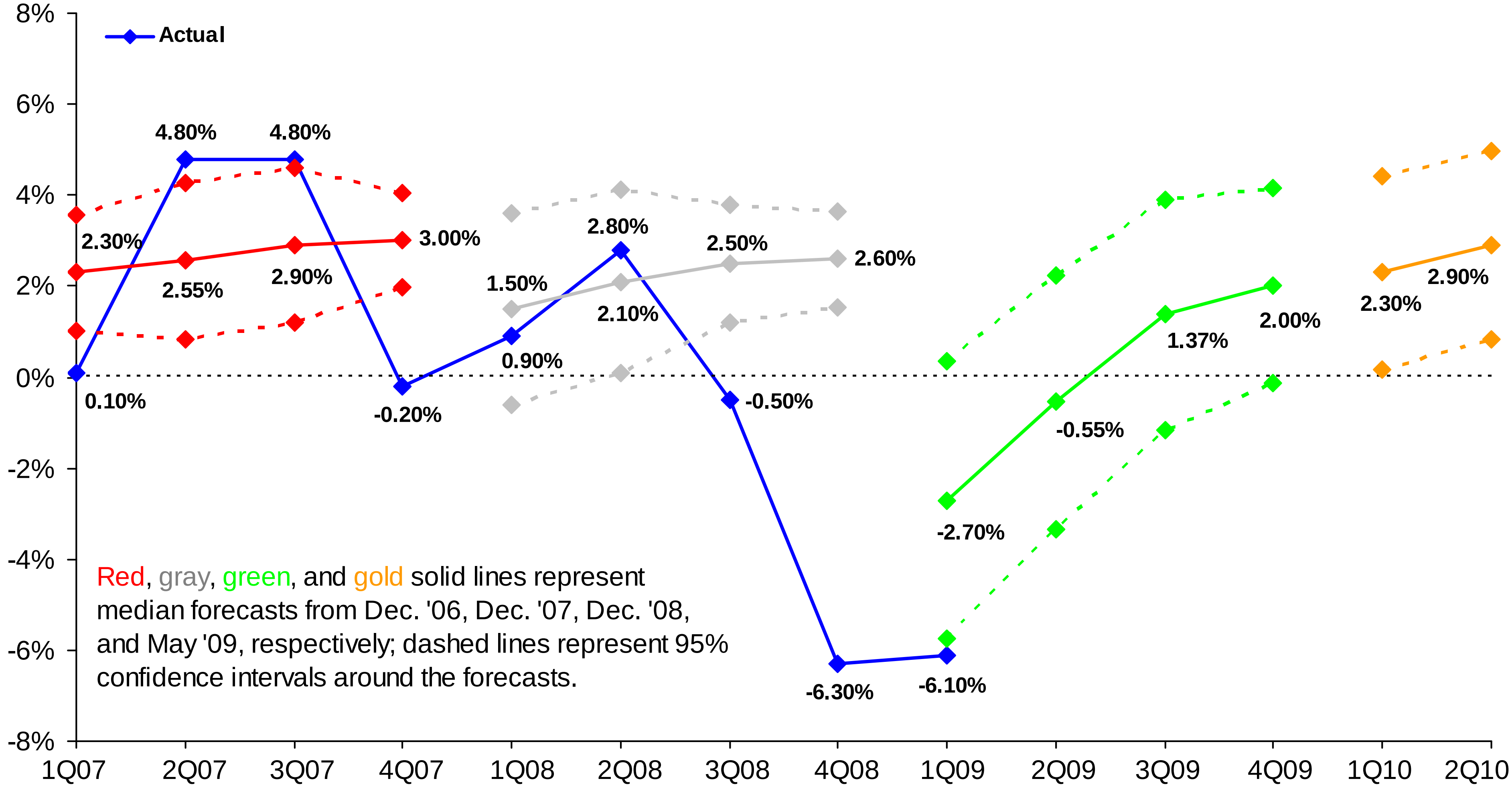
Humility

- Most forecasters failed to anticipate the economy's woes.
- The minority who foresaw it and credibly acted on it profited greatly, but were often marginalized as "doomsayers."
- Implications for confidence on a going-forward basis: if the experts got this so wrong so recently, how can we have confidence in their ability to navigate the current crisis?
- Implications for litigation in which plaintiffs allege a failure properly to value assets or to control for business risk.

Real GDP Growth: Actual vs. Projected

WSJ Survey of Economists: 1Q 2007 – 2Q 2010

Source: U.S. Bureau of Economic Analysis; *Wall Street Journal*

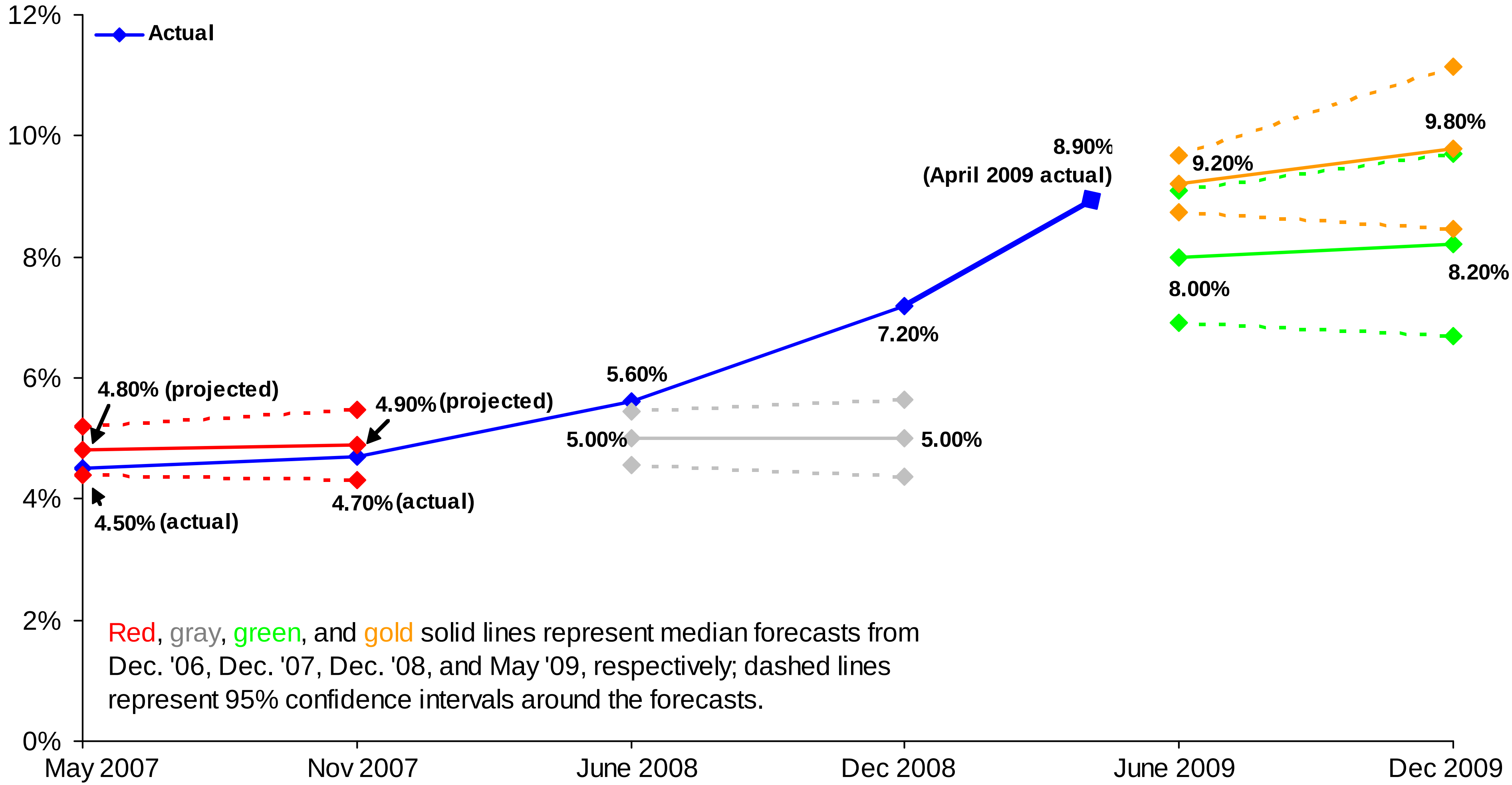


Note: 2007 forecasts from December 2006 Wall Street Journal survey. 2008 forecasts from December 2007 Wall Street Journal survey. 2009 forecasts from December 2008 Wall Street Journal survey. 1Q – 2Q 2010 forecasts from May 2009 Wall Street Journal survey. 1Q 2009 actual figure is pre-May 2009 revision.

Unemployment: Actual vs. Projected

WSJ Survey of Economists: May 2007 – December 2009

Source: U.S. Bureau of Labor Statistics; *Wall Street Journal*

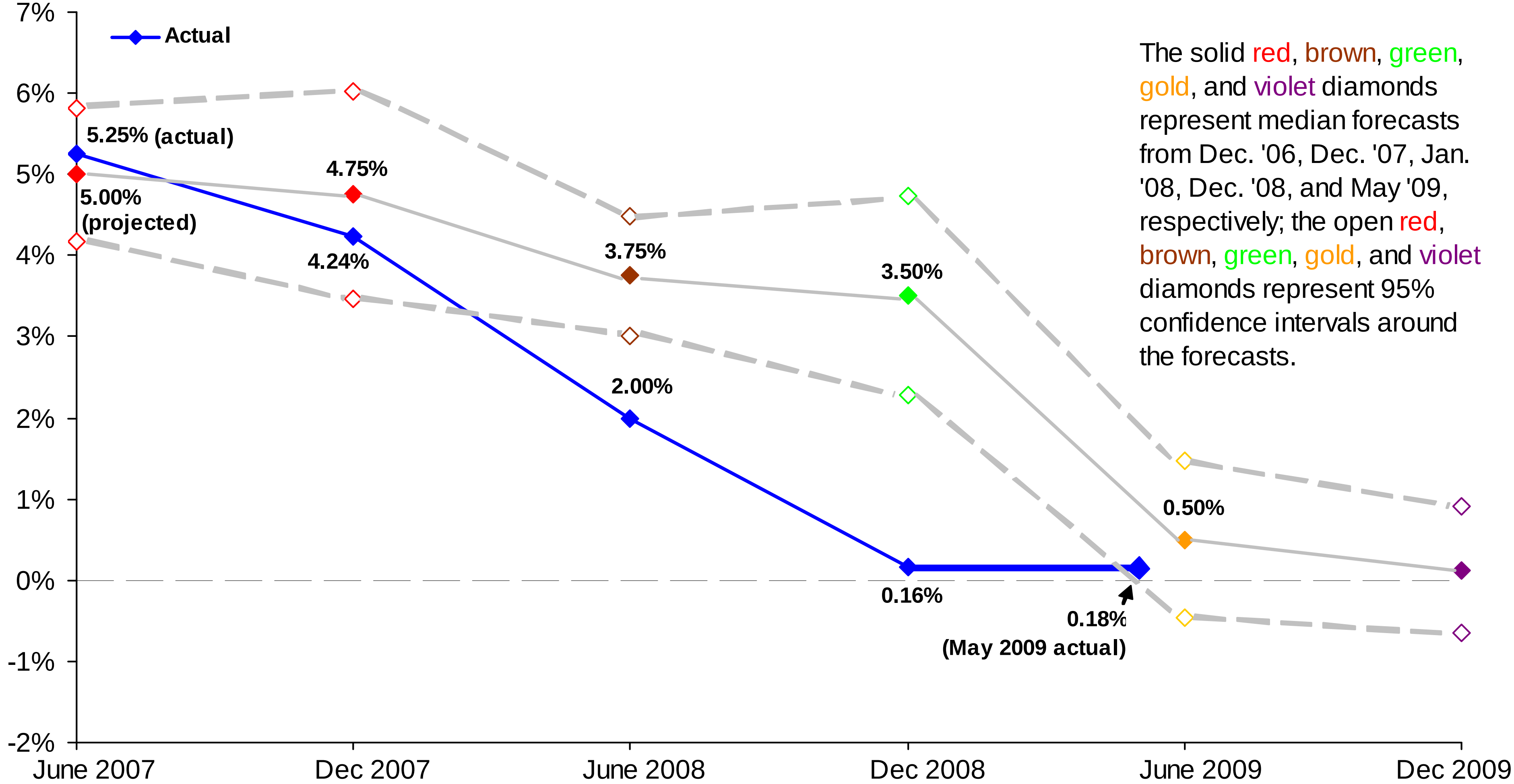


Note: 2007 forecasts from December 2006 Wall Street Journal survey. 2008 forecasts from December 2007 Wall Street Journal survey. 2009 forecasts from December 2008 and May 2009 Wall Street Journal surveys, respectively.

Federal Funds Rate: Actual vs. Projected

WSJ Survey of Economists: June 2007 – December 2009

Source: Federal Reserve; *Wall Street Journal*

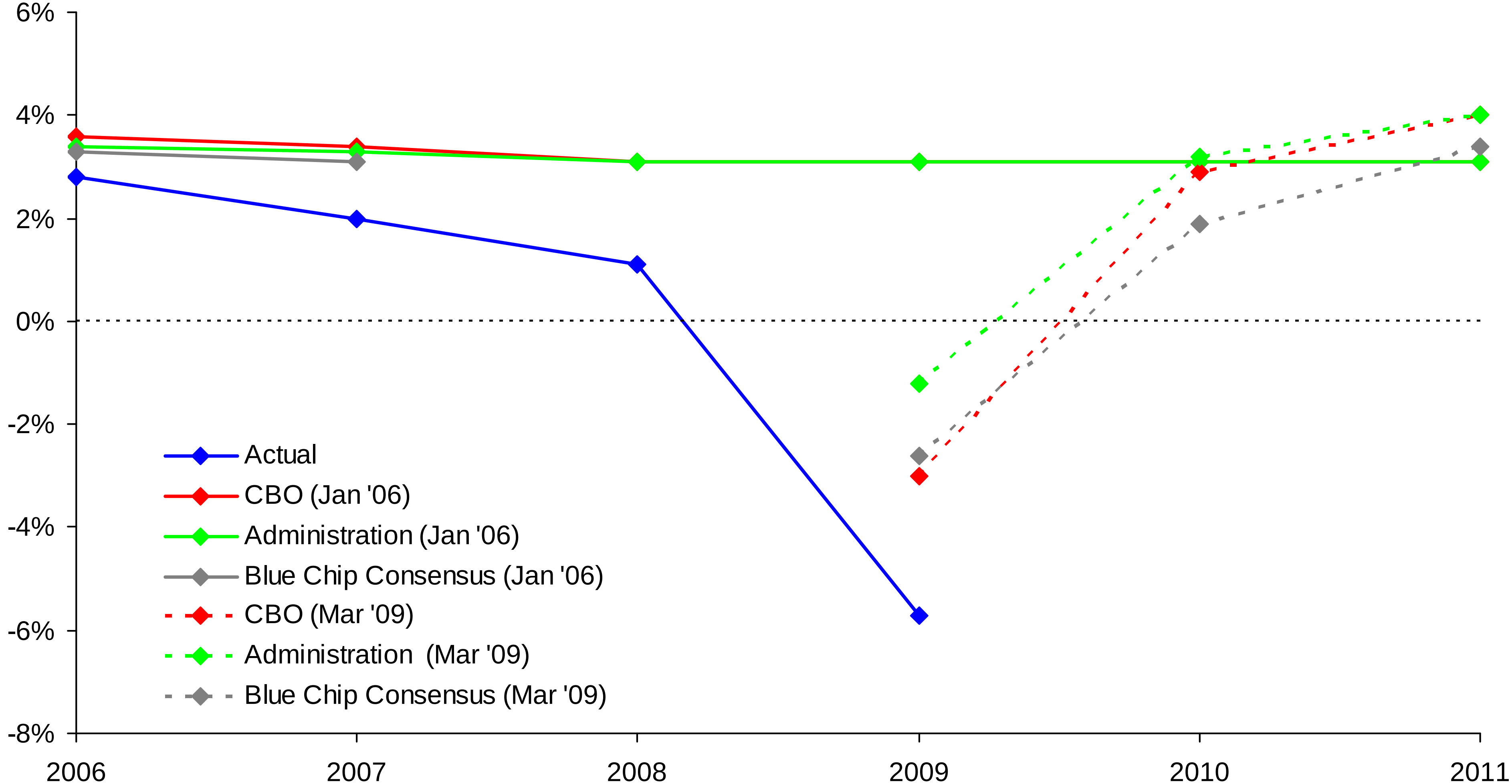


The solid red, brown, green, gold, and violet diamonds represent median forecasts from Dec. '06, Dec. '07, Jan. '08, Dec. '08, and May '09, respectively; the open red, brown, green, gold, and violet diamonds represent 95% confidence intervals around the forecasts.

Note: 2007 forecasts from December 2006 Wall Street Journal Survey. June 2008 forecasts from December 2007 Wall Street Journal survey. December 2008 forecasts from January 2008 Wall Street Journal Survey. June 2009 forecasts from December 2008 Wall Street Journal survey. December 2009 forecasts from May 2009 Wall Street Journal survey.

Real GDP Growth: Actual vs. Projected
2006 – 2011

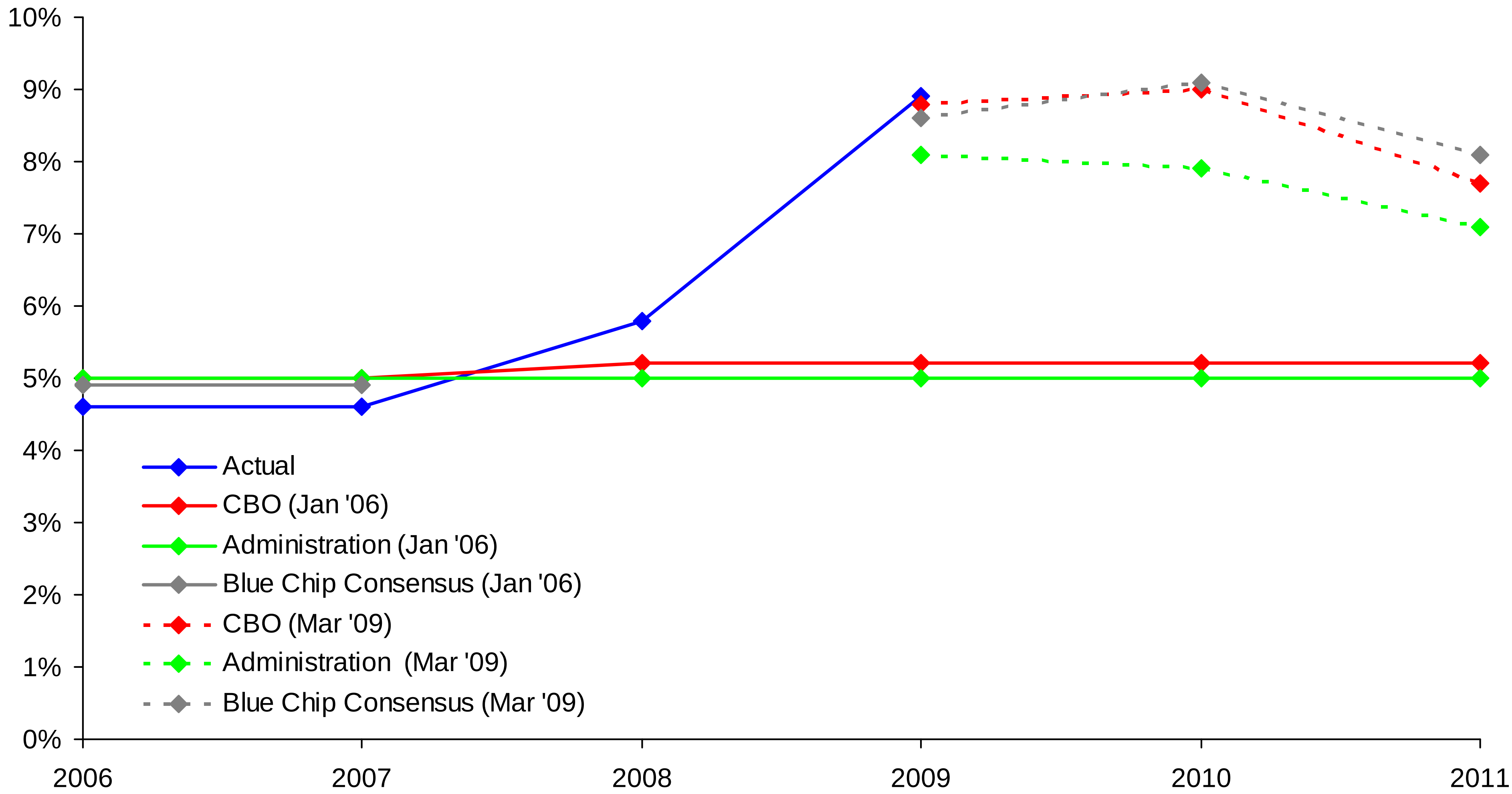
Source: Congressional Budget Office Budget and Economic Outlook; U.S. Bureau of Economic Analysis



Note: Real GDP growth for 2009 is the preliminary, annualized real GDP decline in the first quarter of 2009 (-5.7%). The January '06 forecasts for 2008 – 2011 are annual averages for the period. January '06 forecasts are forecasts of 4Q to 4Q percentage change in real GDP.

Unemployment: Actual vs. Projected
2006 – 2011

Source: Congressional Budget Office Budget and Economic Outlook; U.S. Bureau of Labor Statistics; Council of Economic Advisors



Note: Unemployment for 2009 is the unemployment rate for April 2009 (8.9%). The January '06 forecasts for 2008 – 2011 are the average for the period.

Where Are We Headed—More Decline?

- A rough consensus of economic forecasters:
  - V shaped recovery: 15%
  - U-shaped recovery: 10%
  - L-shaped prolonged stagnation (Japan's 'lost-decade'): 55%
  - Depression (defined as a decline of more than 10%, four times larger than the IMF's current expectations): 20%

David Wessel, *The Wall Street Journal*, April 23, 2009

- The recent drop in consumer spending and resulting pressure on retailing, manufacturing and service industries could last "quite a long time."

Warren Buffett, May 2, 2009

Where Are We Headed—More Decline?, cont'd.

- Bill Gross of PIMCO forecasts that economic growth in the U.S. will slow to an annual rate of 1 to 2 percent, while unemployment will stay at 7 percent to 8 percent for "years to come."

  Reuters, May 28, 2009

- Foreclosures are spreading from sub-prime to prime borrowers: 12% of all mortgages are at least one payment late or in foreclosure, and 6% of all prime loans are now delinquent.

  Mortgage Bankers Association, May 28, 2009

- "While the stimulus has given an impulse, it's like a sugar high unless you eventually get the credit system working."

  Robert Zoellick, May 30, 2009

Where Are We Headed—The Worst Is Over?

- "By no means are we out of the woods just yet. But from where we stand, for the very first time we're beginning to see glimmers of hope."

  Barack Obama, April 19, 2009

- "We are right to be somewhat encouraged, but we would be wrong to conclude that we are close to emerging from the darkness that descended on the global economy early last fall."

  Timothy Geithner, April 24, 2009

- "Six or eight weeks ago, there were no positive statistics to be found anywhere. The economy felt like it was falling vertically. Today, the picture is much more mixed. There are some negative indicators, to be sure. (But) there are also some positive indicators."

  Larry Summers, April 26, 2009

Where Are We Headed—The Worst Is Over?, cont'd.

- "The free-fall in the economy appears to have stopped."

  Peter Orszag, May 17, 2009

- Barton Biggs states "The system has had an incredible adrenaline shot, so I think we're going to have a pretty strong recovery."

  Bloomberg News, May 26, 2009

- Sharp increase in longer term interest rates beginning in mid-May of 2009.

Where Are We Headed—Strong Growth Ahead?

- “My reasoning leads me to conclude that the ultimate NBER trough of the current business cycle is likely to occur in May or June 2009, substantially earlier than is currently predicted by many professional forecasters.”

  Robert Gordon, Professor of Economics,
  Northwestern University, May 1, 2009

- “Now it looks like our V-shaped recovery is underway. When the NBER eventually gets around to declaring the recession end date, we think it will be May 2009. In our view, there are no more shoes to drop.”

  Brian Wesbury, Chief Economist, First Trust Adivisors, May 5, 2009

- “The Great Recession is over. As GDP growth resumes, we'll have to pay more attention to the risk of overstimulus and resurgent inflation.”

  Brad Schiller, Professor of Economics, University of Nevada, May 29, 2009

Where Are We Headed—Who Knows?

- But in the first three months of the $787 billion stimulus plan, only $100 million has been allocated, and even less has been spent.

Peter Orzag, May 17, 2009

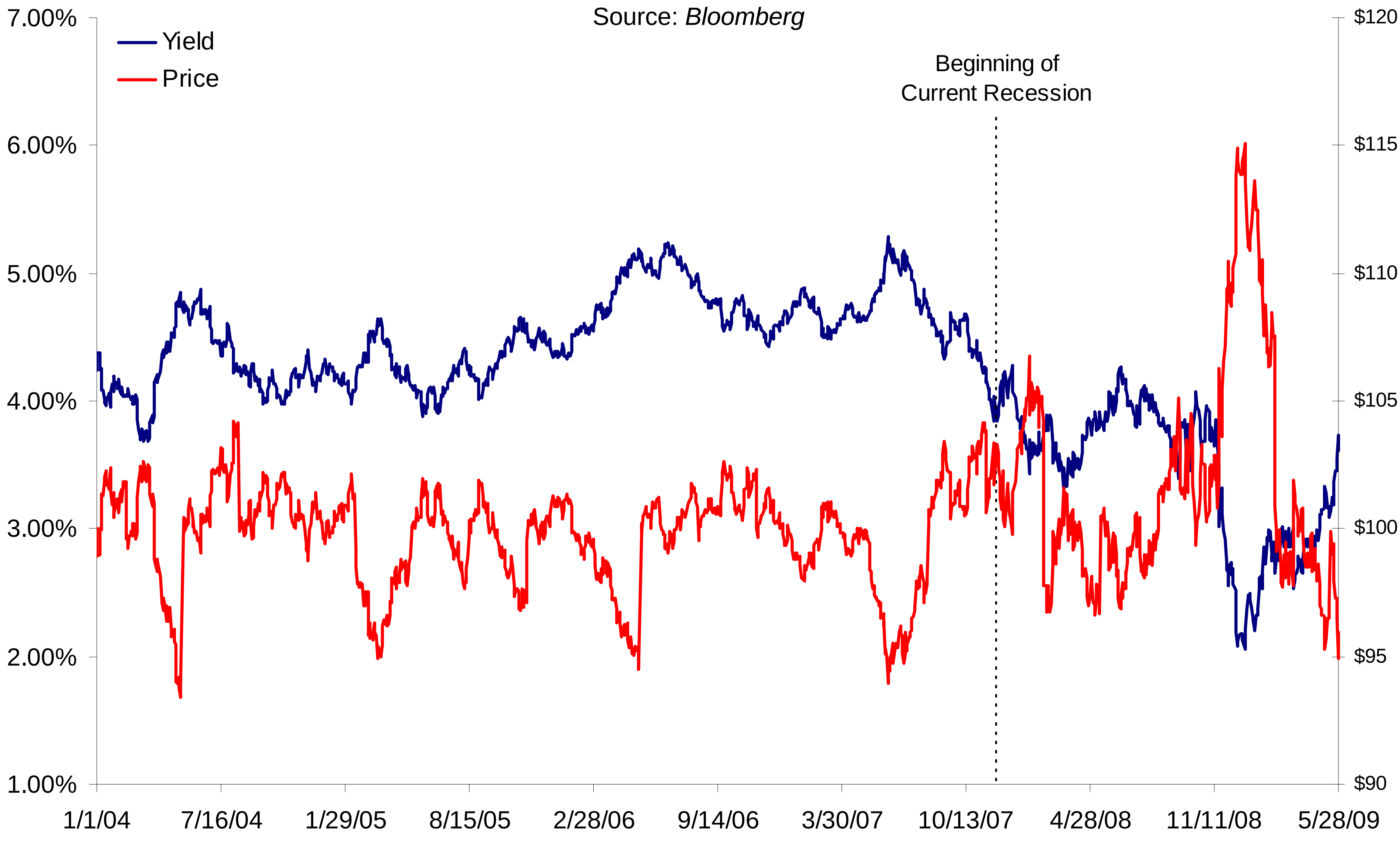
- *The New York Times* Op-Ed page on May 4, 2009, ran two editorials with diametrically opposed views on inflation. In "Inflation Nation," Allan Meltzer argued that current policies make significant inflation inevitable, while Paul Krugman in "Falling Wage Syndrome" feared that deflation will stifle any opportunity for recovery.

- PIMCO forecasts that the U.S. economy will turn around, but that when it does, the "new normal" involves unemployment of 8% and an annual growth rate of 2%, not 3%.

Bloomberg News, May 26, 2009.

10 Year Treasury Yield and Price

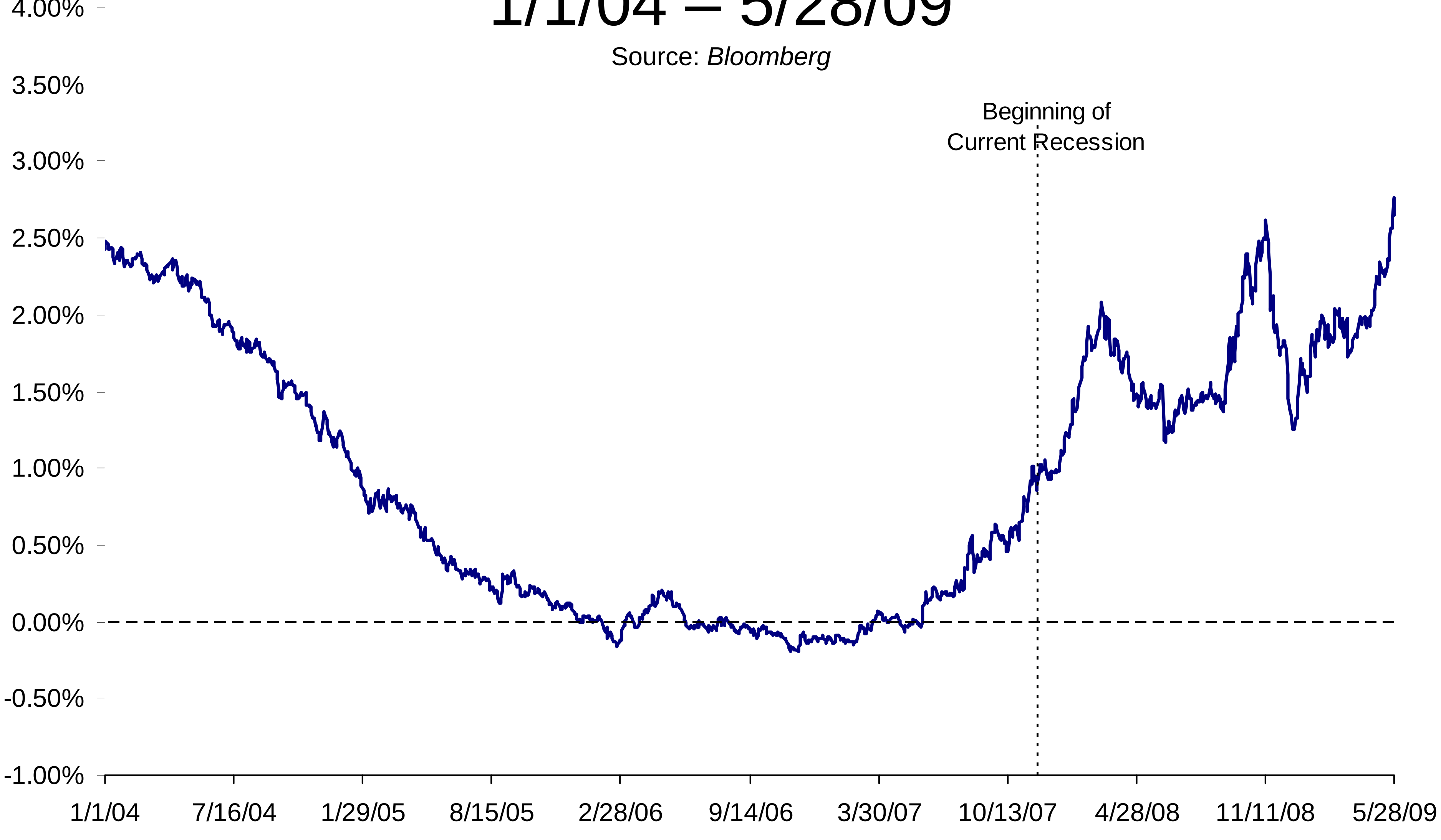
1/1/04 – 5/28/09



Yield Curve: Difference Between Yield for 10-Year and 2-Year Treasury Notes

1/1/04 – 5/28/09

Source: *Bloomberg*



The Story of VaR

- VaR: a statistical method for measuring “value at risk” at varying degrees of statistical confidence, relying on varying historic measures, and applying a range of statistical techniques.
- Adopted by regulators and became a generally accepted metric for assessing the trade-off between risk and return.
- Managements were rewarded for increasing return while holding VaR constant.

The Story of VaR

- Managements therefore had an incentive to write out-of-the-money options that would predictably generate large losses in the event the future differed significantly from the past.
  - Risk management techniques thus helped to amplify a certain form of risk.
- The root flaws of VaR, however calculated, are that:
  - It assumes a stable probability distribution
  - It ignores fat tail and long tail risk.

Lessons for Risk Management

- Pending legislation requires that publicly traded firms establish risk control committees.
  - A highly questionable proposition, even on a good day.
- The real lesson is not to impose more process, but to get more intelligent about how risk management is conducted.

Lessons for Risk Management

- In addition to traditional forms of statistical analysis that rely on stable probability distributions and ignore the tails of the distributions, expand the modes of analysis to include:
  - Scenario analysis, including various forms of stress tests. Here, the scenarios have to be realistic and should include "death states" to define their bounds. Treasury's recent stress tests are a good example of the process and the debate it can generate.
  - "LD-50" style analyses. LD-50 is a statistic used in pre-clinical trials to define the dose at which half the sample is killed by the drug. Which scenario creates a 50% risk of failure and what is the probability of that scenario occurring?
  - "Risk of Ruin" calculation. Risk of Ruin = ((1 - Edge)/(1 + Edge)) ^ Capital Units, where "edge" is defined as the probability of a favorable outcome, capital units is defined as total capital divided by the size of the position, and risk of ruin is the probability of being wiped out to zero. Can test sensitivity to "edge" estimates.

Litigation Implications

- Leading objective analysts and the government failed to foresee the current downturn and promoted risk control methodologies that inadvertently exacerbated the crisis.

- Managements that relied on commonly accepted forecasts and on commonly accepted risk control techniques could therefore have failed to avoid the adverse consequences of the current downturn and inadvertently exacerbated the crisis.

- Many class action securities fraud complaints allege that the issuer failed to disclose valuation issues related to the decline in asset values, but given the forecast errors by objective experts these allegations are easily attacked as relying on hindsight bias.

- Allegations that the issuer possessed undisclosed firm-specific information must, however, be subject to a separate form of analysis.

Outline

Part I: Humility

Part II: History

- How did we get into this mess?
- Is this time different? The modern history of financial crises.
- Which history should we study? The Great Depression or Japan's Lost Decade?

Part III: Hope

Part IV: Horizon

How Much Is $1 Trillion?

We need to calibrate this number because it is the new unit of measure.

- $1,000,000,000,000.00
- One thousand billion dollars.
- One million million dollars.
- One billion thousand dollars.
- $10^12.
- Approximately 7% of 2008 GDP.
- The total amount of personal income tax paid by all Americans in 2006.

Lessons of History

- Which lessons of history should we study? They can’t all be equally relevant.

- The leading candidates are:
  - The performance of economies following post World War II banking and financial crises.
  - The Great Depression.
  - Japan’s “Lost Decade.”

- But what about the possibility that this situation differs sufficiently from past experience that history is as likely to mislead as to inform?

Lessons of Recent Recessions

Reinhart and Rogoff, *The Aftermath of Financial Crises*, forthcoming, American Econ. Rev. 2009.

- Based on an analysis of all 18 major postwar banking crises in the developed world.
- Asset market collapses are deep and prolonged.
  - Real housing prices decline by 35% over a six year period.
  - Equity prices decline by 55% over a three and a half year period.

Lessons of Recent Recessions, cont'd.

Reinhart and Rogoff, *The Aftermath of Financial Crises*, forthcoming, American Econon. Rev. 2009.

- Profound declines in output and employment
  - Unemployment rises by 7 percentage points.
  - The down phase of the unemployment cycle lasts four years.
  - Output falls, peak to trough, by more than 9 percent.
  - Peak to trough output decline is two years: employment lags output.

Lessons of Recent Recessions, cont'd.

Reinhart and Rogoff, *The Aftermath of Financial Crises*, forthcoming, American Econ. Rev. 2009.

- The real value of government debt tends to "explode."
  - Average debt increase is 86%.
  - Historically, the major drivers of this debt increase have been a collapse in tax revenues and "often ambitious countercyclical fiscal policies aimed at mitigating the downturn."
- ***Bottom line:*** "One would be wise not to push too far the conceit that we are smarter than our predecessors…. The global nature of the crisis will make it far more difficult for many countries to grow their way out through higher exports, or to smooth the consumption effects through foreign borrowing"

Lessons of the Great Depression

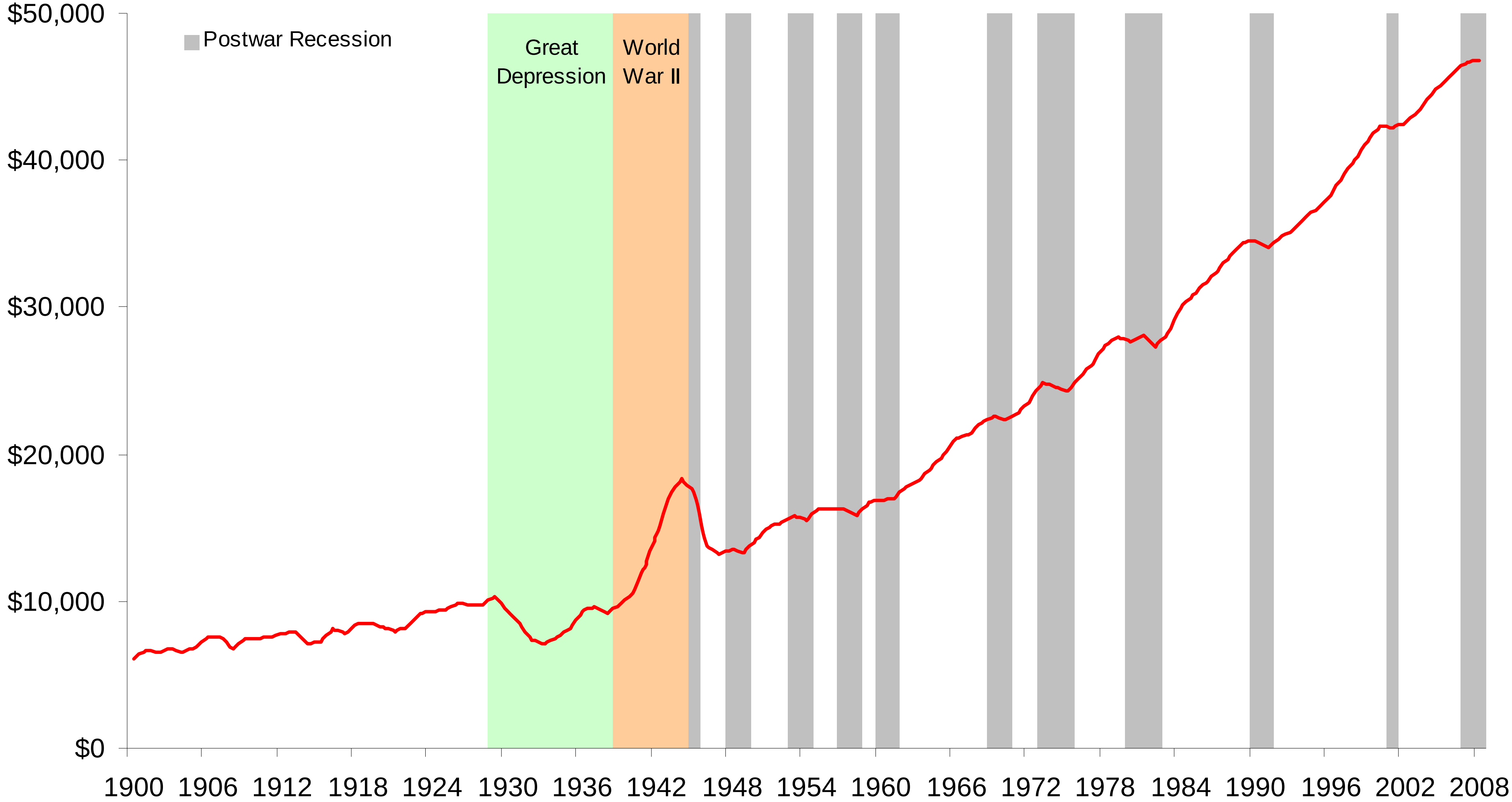
- Even if we have learned not to repeat the mistakes of the Great Depression, a bold assumption, we can make new mistakes and the current situation may differ sufficiently such that the Depression is at best a partial guide.

- The classic errors:
  - dramatic decline in the money supply,
  - failure to support the banking system,
  - excess concern about government deficits that led to contractionary policies once recoveries began, and
  - protectionist policies, as most famously illustrated by the Smoot-Hawley tariff.

- There is a debate in the literature as to whether World War II, and concern about the potential of war, was instrumental in ending the Great Depression.

United States GDP Per Capita
1900 – 2008

Source: Angus Maddison; NBER; PBS
(in 2008 EKS$)



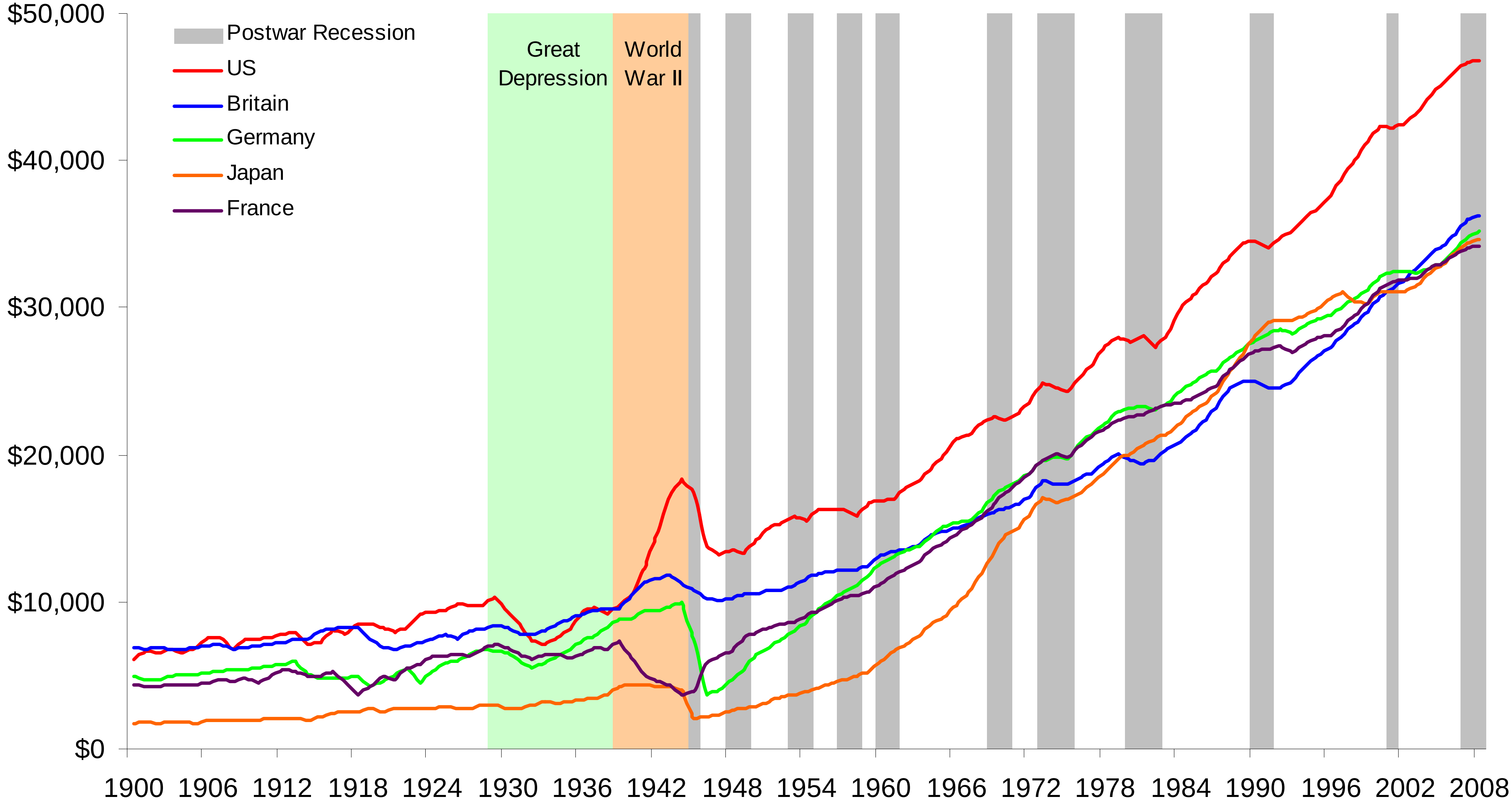
Note: EKS is a method used to obtain GDP parity across multiple countries.

GDP Per Capita of Selected Countries

1900 – 2008

Source: Angus Maddison; NBER; PBS

(in 2008 EKS$)



Note: EKS is a method used to obtain GDP parity across multiple countries.

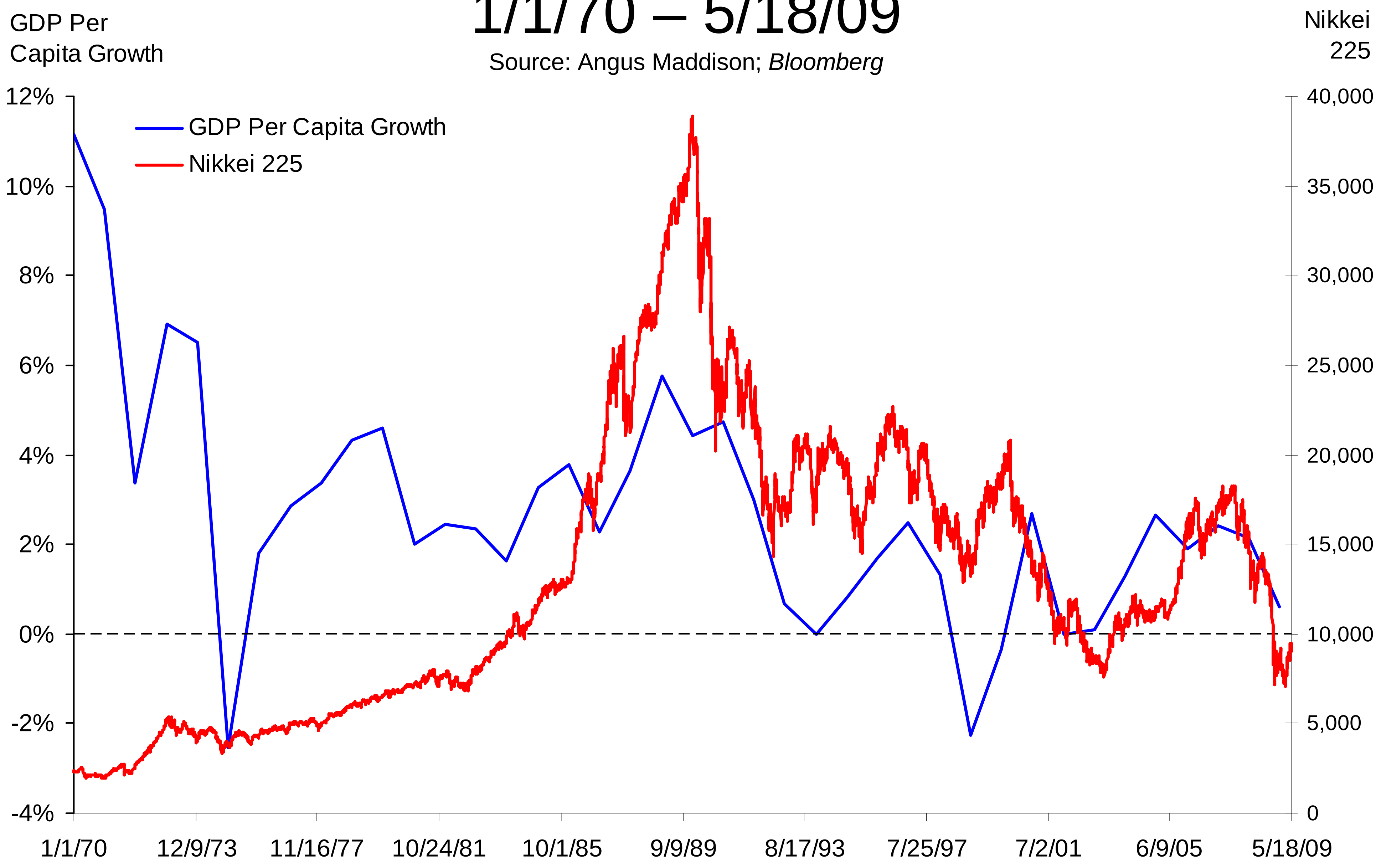
Lessons of Japan's "Lost Decade"

- Many observers see strong parallels between Japan's crisis and our current predicament.
  - Caused by easy credit and a real estate collapse following a speculative bubble.
  - Serious solvency issues in the banking sector.
  - Failure to mark assets to market for a protracted period.
- Bernanke blamed poor monetary policy for contributing to the lost decade: failure to lower interest rates fast enough.
- Wasteful infrastructure spending.
- Internal political dynamics made rational economic policy quite difficult.
- When the economy began to strengthen, stimulus was cut back in order to address concerns over budget deficits.

Japan GDP Per Capita Growth vs. Nikkei 225

1/1/70 – 5/18/09

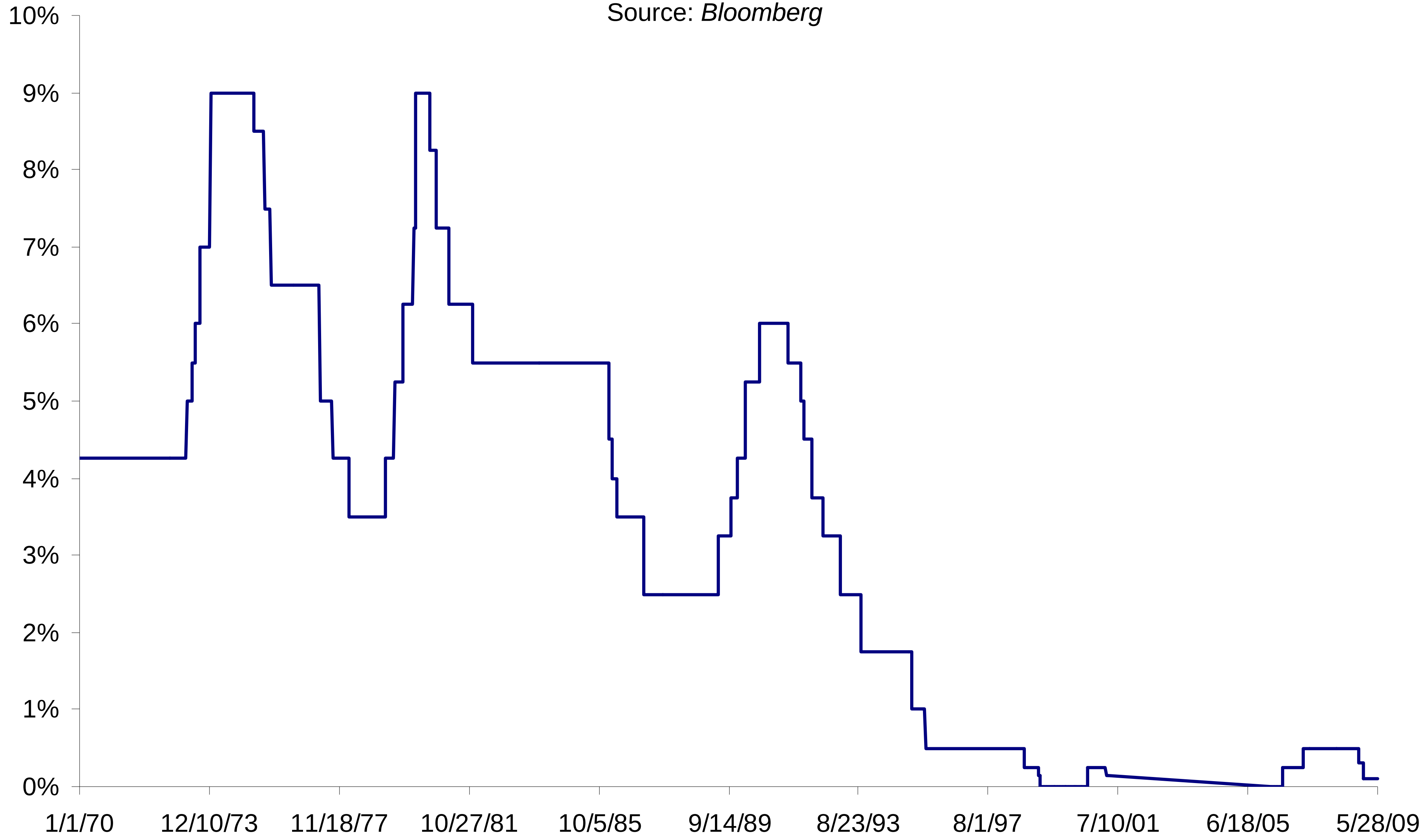
Source: Angus Maddison; *Bloomberg*



Bank of Japan Overnight Interest Rate

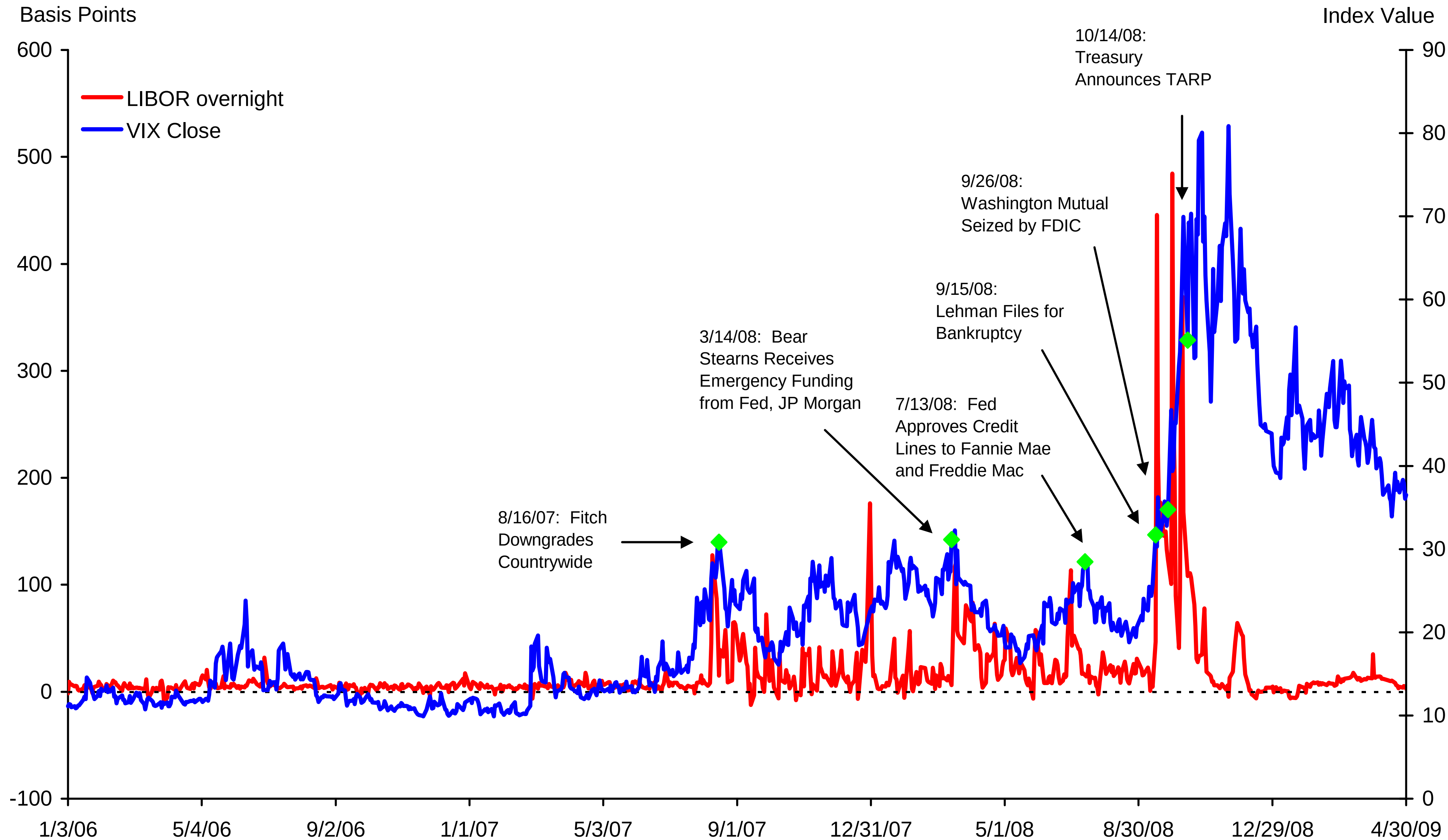
1/1/70 – 5/28/09

Source: *Bloomberg*



LIBOR Overnight Rate Spread Relative to the Federal Funds Rate and Chicago Board Options Exchange Volatility Index

Source: Federal Reserve; Bloomberg; Chicago Board Options Exchange



Outline

Part I: Humility

Part II: History

Part III: Hope

- ❖ How do we get out of this mess?
- ❖ The Fed is driving the bus: Deflation, inflation, consternation, or conflagration?
- ❖ Constraints imposed by populist zeal
- ❖ The systemic risk regulator and restructuring the regulatory environment.

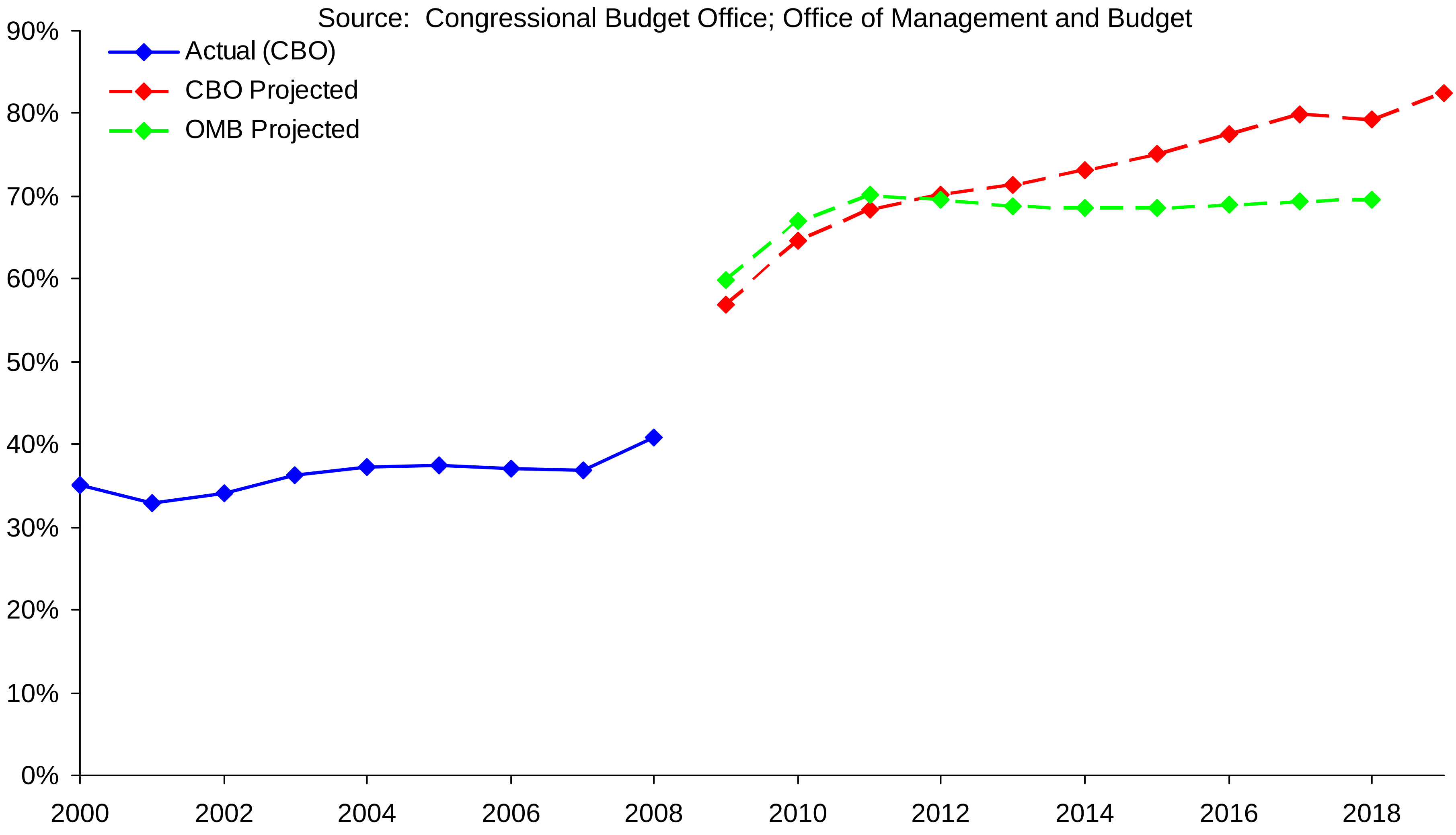
Part IV: Horizon

How Can Any Economy Address Increased Debt?

- There are only five possibilities.
  1. Continue to borrow as long as the world is willing to lend.
     - See European debt ratios as analogues.
     - How much of a debt load will the world support, and when does this string run out?
  2. Repudiate
  3. Increase taxes
  4. Reduce borrowing and consumption/investment
  5. Inflation
- Which is in our future?

U.S. Federal Debt as a Percentage of GDP: Actual and Projected

2000 – 2019

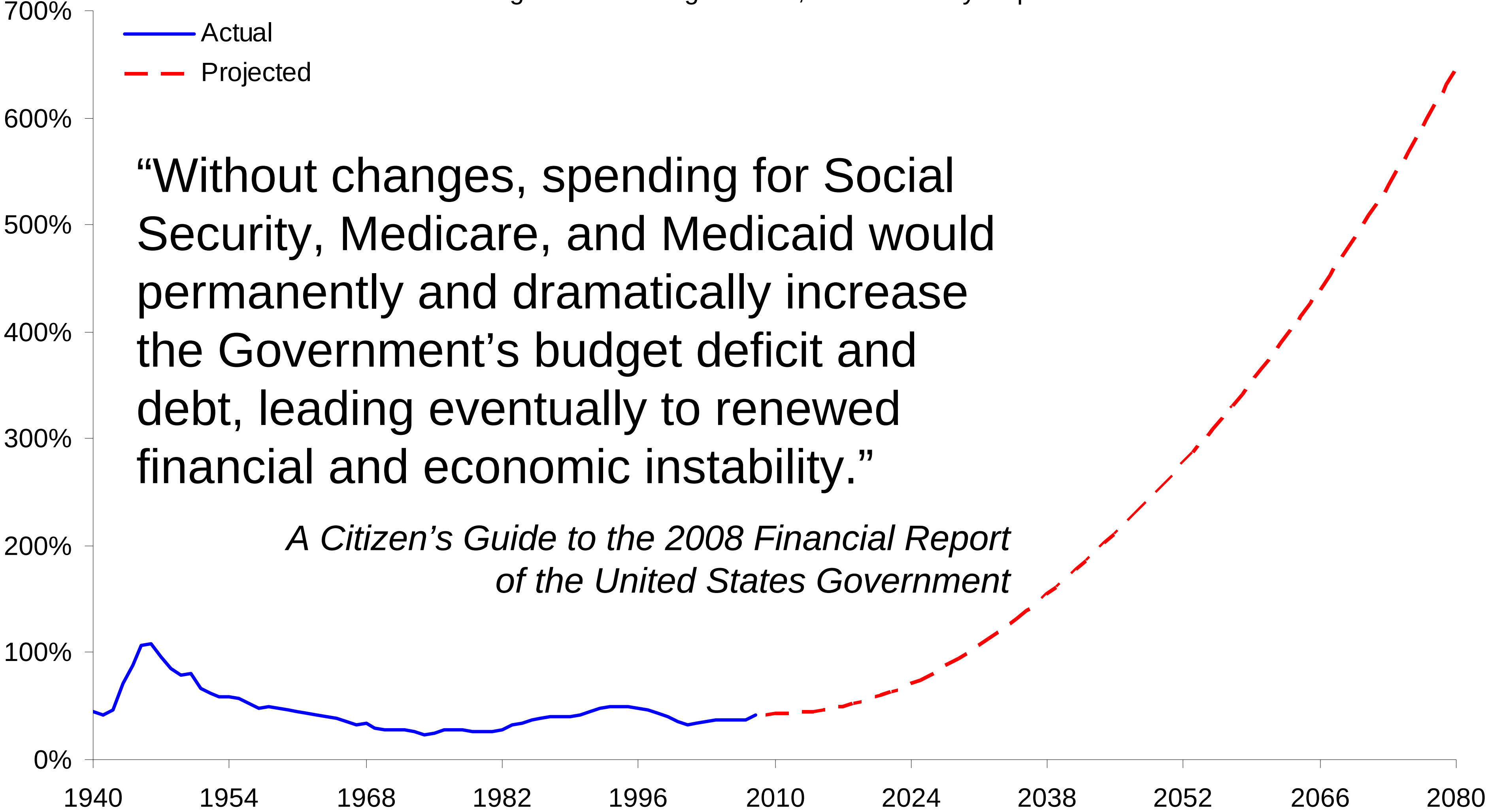


Note: CBO Projections based on the President's Spring 2009 proposed budget.

U.S. Government Debt Held by the Public as a Percentage of GDP: Actual and Projected

1940 – 2080

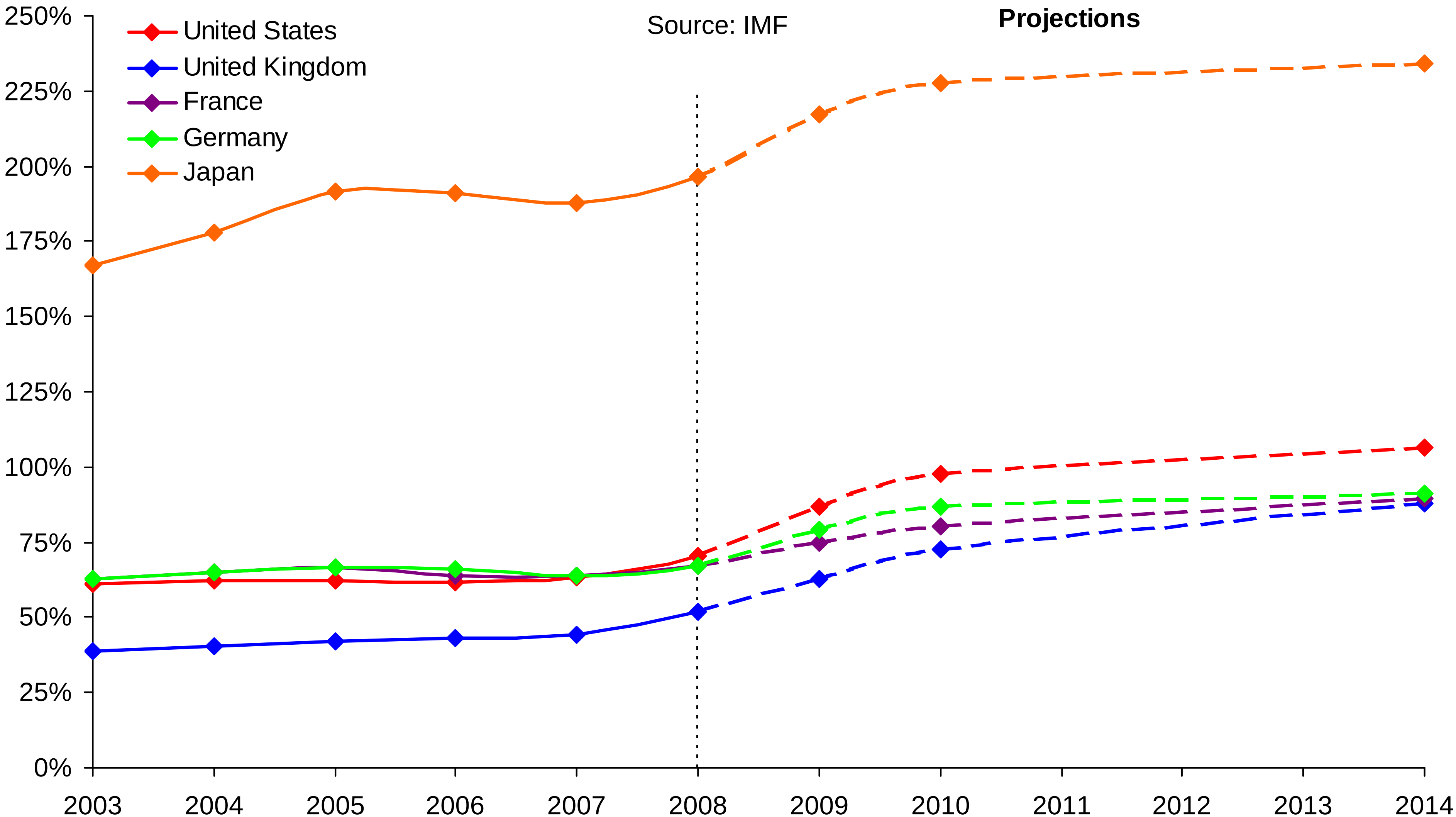
Source: Congressional Budget Office; U.S. Treasury Department



“Without changes, spending for Social Security, Medicare, and Medicaid would permanently and dramatically increase the Government’s budget deficit and debt, leading eventually to renewed financial and economic instability.”

A Citizen’s Guide to the 2008 Financial Report of the United States Government

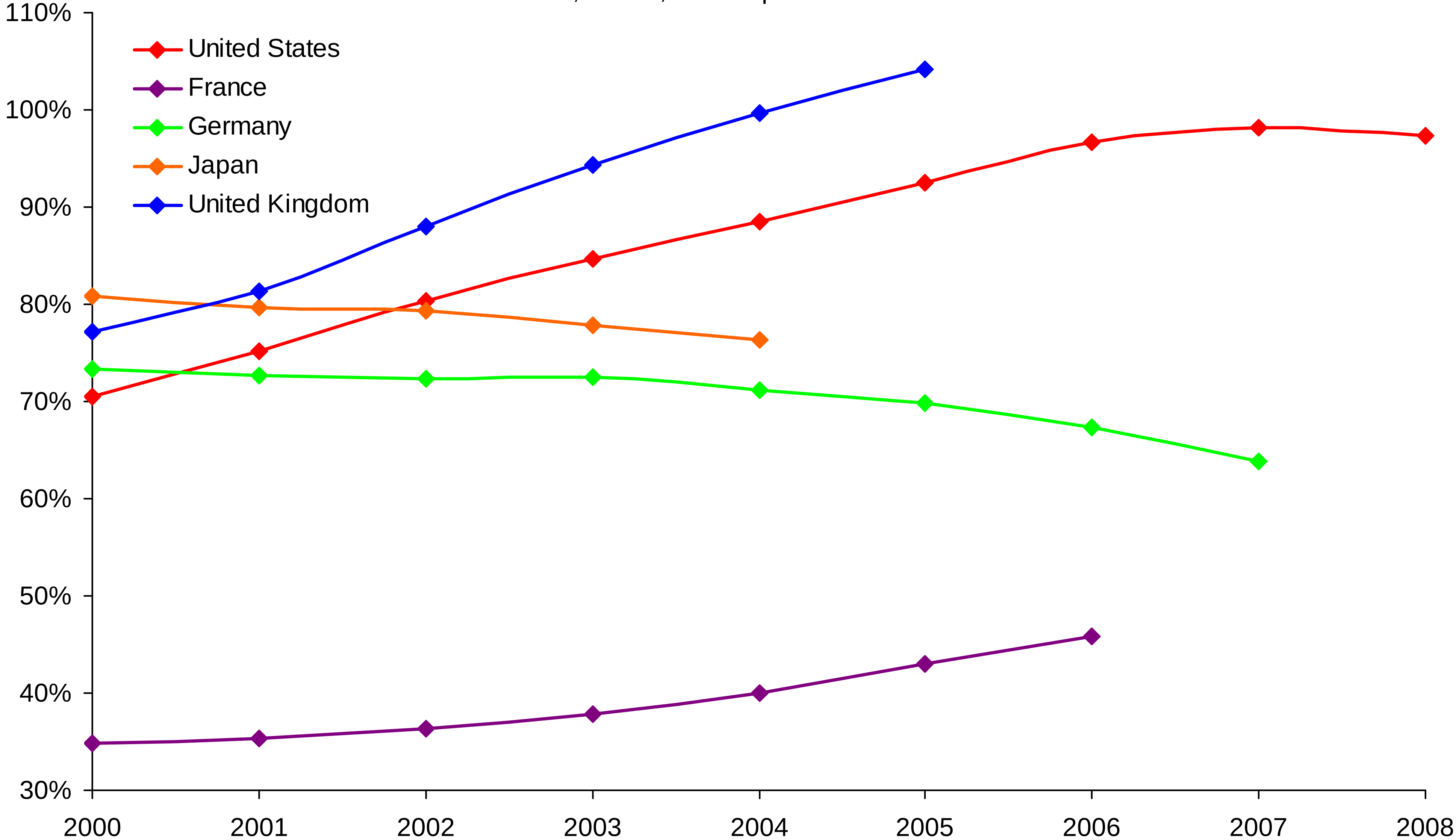
Gross Government Debt to GDP Ratio of Selected Countries: Actual and Projected
2003 – 2014



Household Debt to GDP of Selected Countries

2000 – 2008

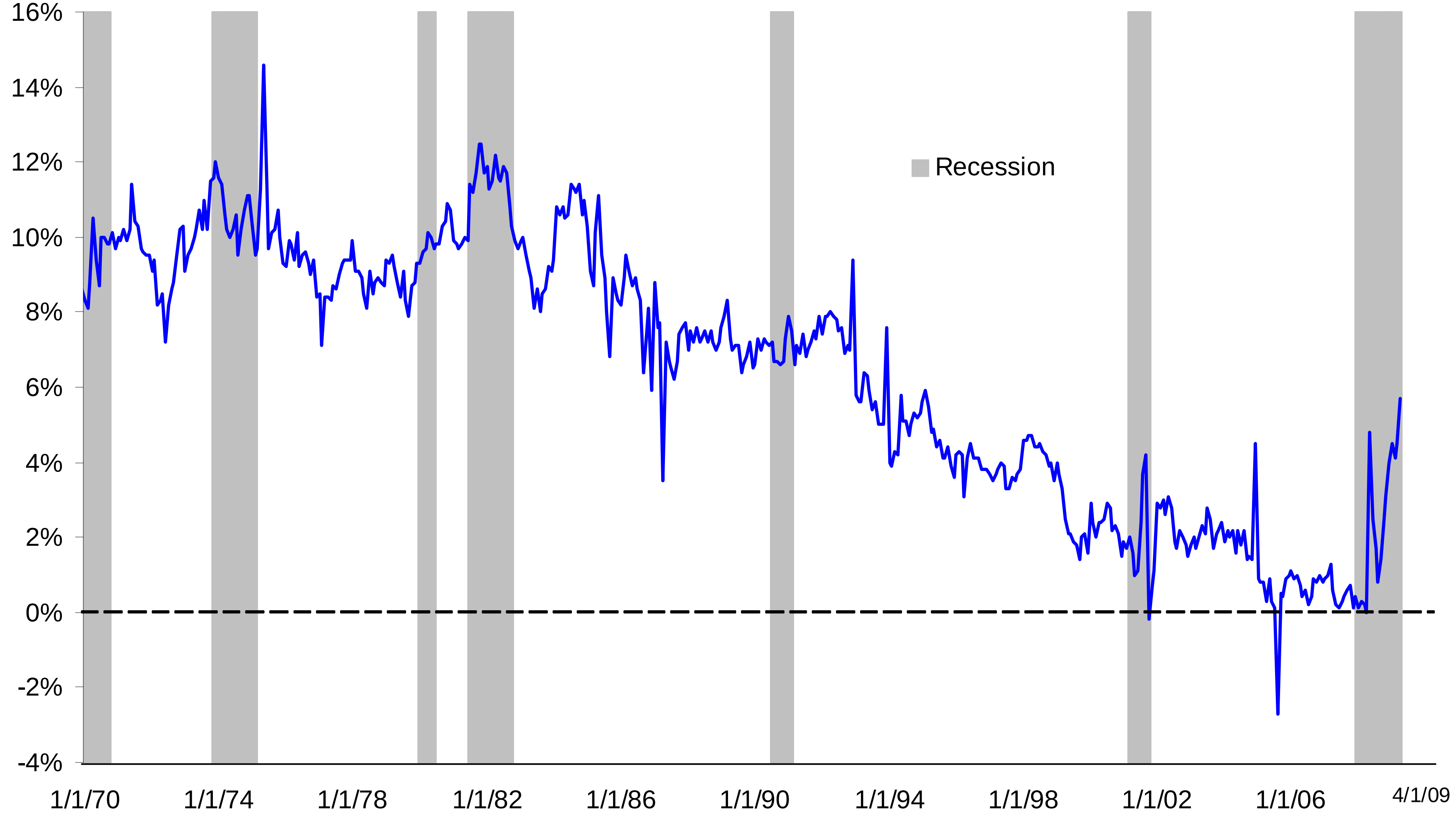
Source: IMF; OECD; U.S. Department of Commerce



U.S. Personal Savings Rate

1/1/70 – 4/1/09

Source: U.S. Department of Commerce



Will the Stimulus Work?

- A relatively small part of the stimulus has entered the market as of June 2009—approximately $100 billion.
- Several macro-economic forecast models suggest that the impact of the stimulus will be small and transitory.
- The political battles associated with TARP, the stimulus bill, and the compensation debate following the AIG retention bonus experience, have moved the policy front from Congress, with its control over traditional fiscal policy, to the Federal Reserve, which has aggressively used its emergency authority under Section 13(3) of the Federal Reserve Act.

Will the Stimulus Work?, cont'd.

Section 13(3) of the Federal Reserve Act.

"In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine … to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange…indorsed or otherwise secured to the satisfaction of the Federal Reserve bank: Provided, That… [a]ll such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe."

Battling Macro-Models

Source: *New Keynesian versus Old Keynesian Government Spending Multipliers*, Cogan, Cwik, Taylor and Wieland (2009)

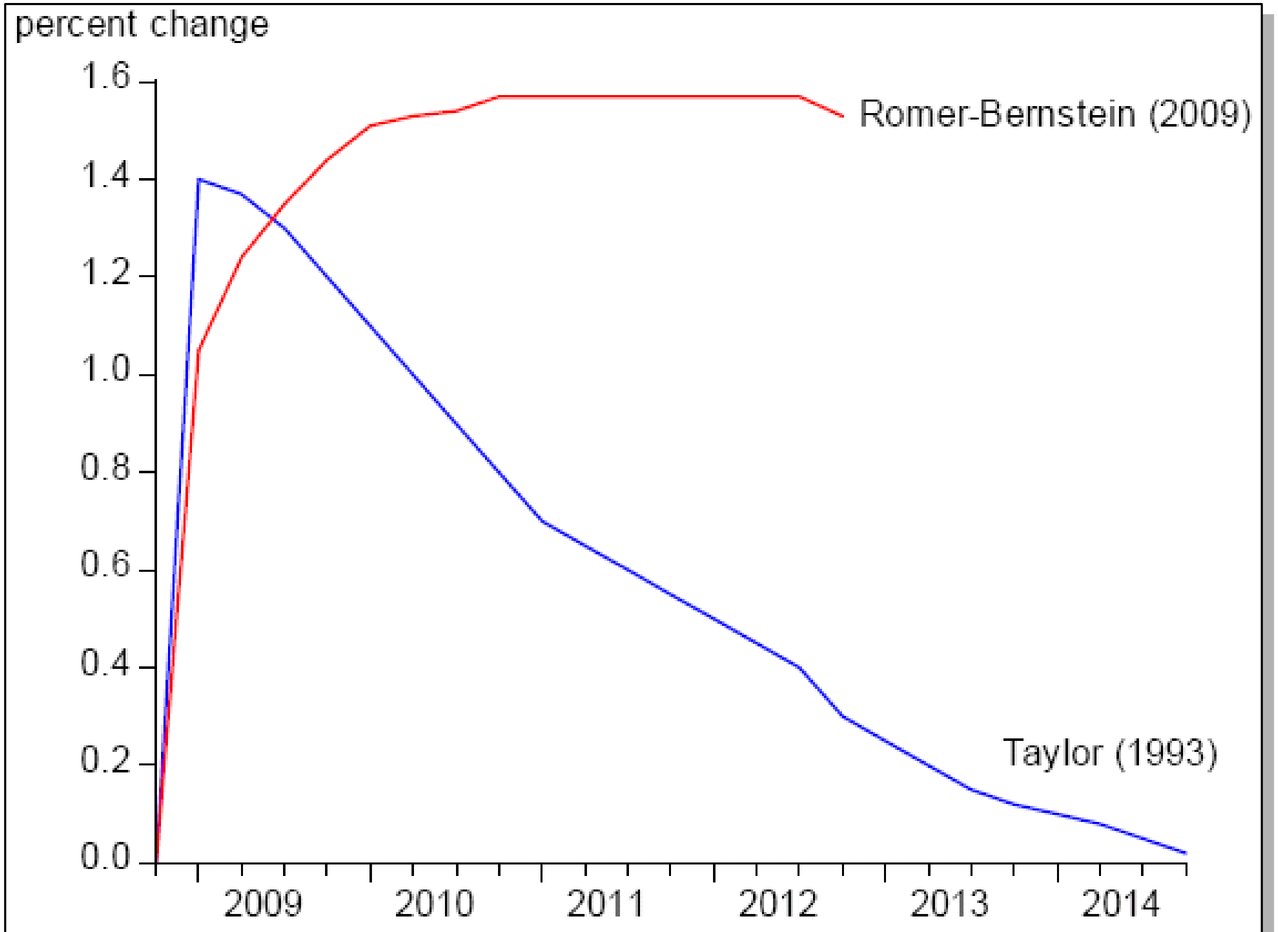


Figure 1. Estimated Impact on GDP of a Permanent Increase in Government Purchases of 1 percent of GDP

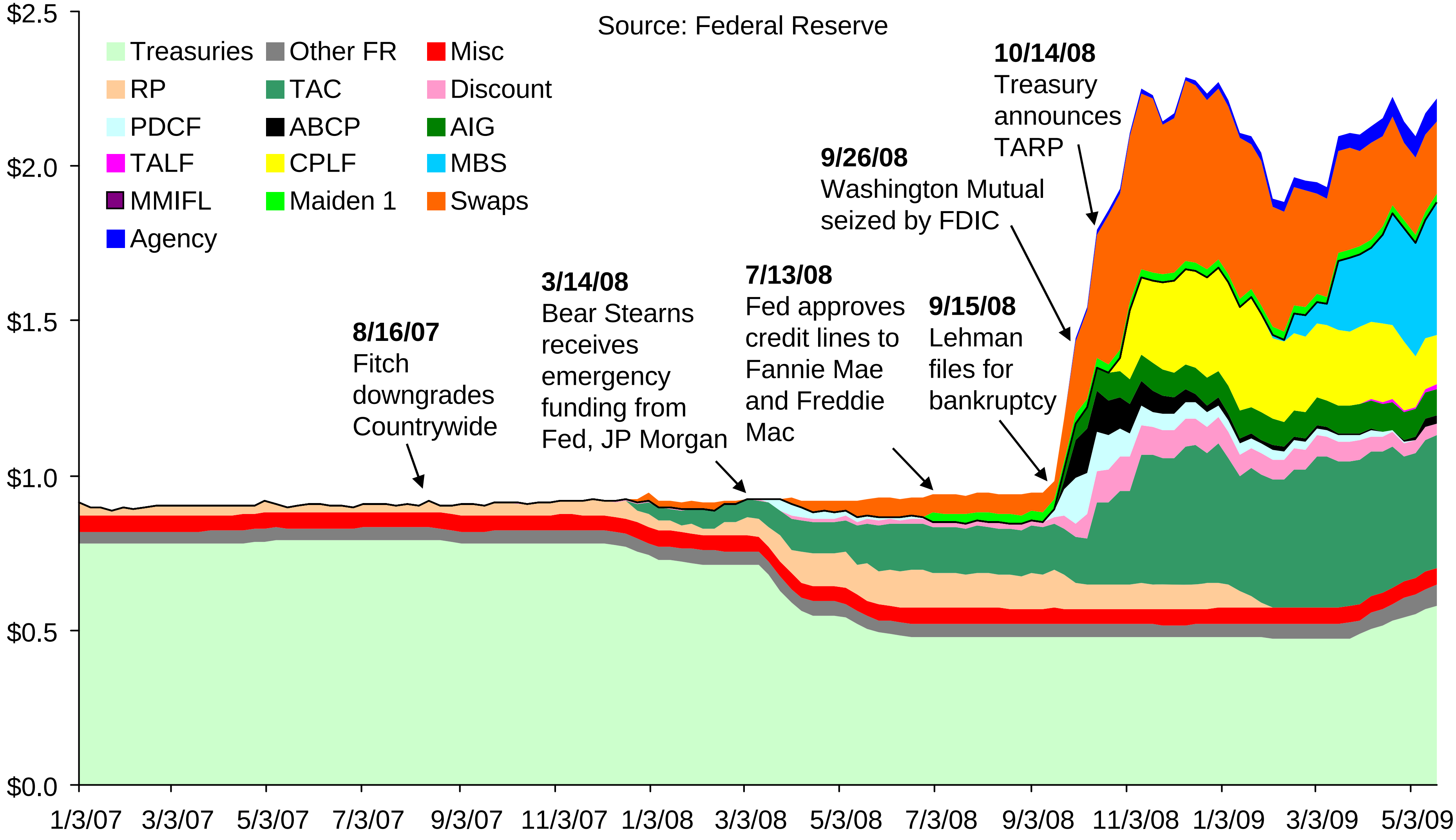
Battling Macro-Models, cont'd.

"The estimates reported here of the impact of such packages are in stark contrast to those reported in the paper by Christina Romer and Jared Bernstein. They report impacts on GDP for a broad fiscal package that are six times larger than those implied by government spending multipliers in a typical new Keynesian model and our calculations based on generous assumptions of the impacts of tax rebates and transfers on GDP."

Cogan, Cwik, Taylor and Wieland (2009)

The Fed's Exploding Balance Sheet: Federal Reserve Assets by Category

1/1/03 – 5/20/09



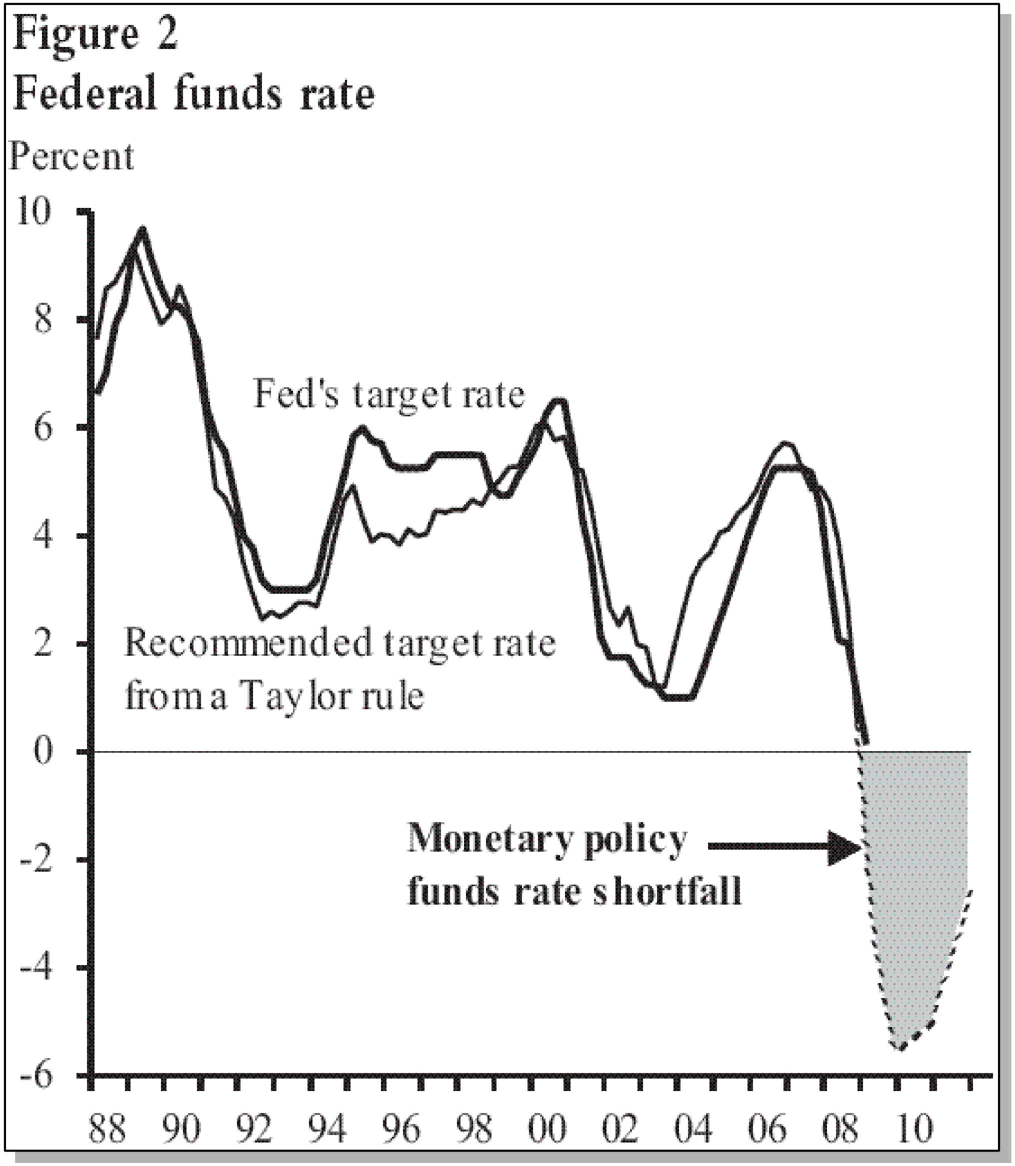
Federal Reserve Assets by Category
Category Descriptions

Source: Federal Reserve; Econbrowser.com

Abbreviated Category	Description
Treasuries	U.S. Treasury securities held outright
Other FR	Other Federal Reserve assets
Misc	Sum of float, gold stock, special drawing rights certificate account, and Treasury currency outstanding
RP	Repurchase agreements
TAC	Term auction credit
Discount	Sum of primary credit, secondary credit, and seasonal credit
PDCF	Loans extended to primary dealer and other broker-dealer credit
ABCP	Loans extended to Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
AIG	Sum of credit extended to American International Group, Inc. plus net portfolio holdings of Maiden Lane LLC II and III
TALF	Loans extended through Term Asset-Backed Securities Loan Facility
CPLF	Net portfolio holdings of LLCs funded through the Commercial Paper Funding Facility
MBS	Mortgage-backed securities held outright
MMIFL	Net portfolio holdings of LLCs funded through the Money Market Investor Funding Facility
Maiden 1	Net portfolio holdings of Maiden Lane LLC
Swaps	Central bank liquidity swaps
Agency	Federal agency debt securities held outright

Is the Stimulus Big Enough?

Source: *The Fed's Monetary Policy Response to the Current Crisis*, Rudebusch (2009)



Is the Stimulus Big Enough?, cont’d.

“This policy shortfall is sizable. Indeed, the Fed has been able to ease the funds rate only about half as much as the policy rule recommends. It is also persistent. According to the historical policy rule and FOMC economic forecasts, the funds rate should be near its zero lower bound not just for the next six or nine months, but for several years.”

Rudebusch (2009)

Populism and the Political Dimensions of the Crisis

- History may teach that Washington's political environment will prevent rational economic policy from being adopted.
- Earmarks in the stimulus bill.
- TARP and compensation restrictions imposed on recipients.
- The 90% tax that the House would have imposed post-AIG-retention-bonus.
- FASB's amendments to FAS 157 following threats to FASB's independence and existence in Congressional hearings.
- The Merrill-BoA transaction, and the United States Government as "control person" of a large segment of the financial sector.
- An increasing burden is borne by the Federal Reserve because it can act without Congressional authority.

Outline

Part I: Humility

Part II: History

Part III: Hope

Part IV: Horizon

- Implications for the Legal Profession

The Market for Legal Services

- Decline in partnership profits.

- Decline in associate headcount.
  - "The pace of law firm layoffs may be slowing, but the numbers continue to grow, hitting more than 10,000 this month for the year of 2009 alone."

ABA Journal, May 28, 2009

- The lament of the senior associate.
  - "Lower pay for lawyers could be a lasting effect of the recession, according to recruiter Jerome Kowalski of Kowalski & Associates. 'These meganumbers in terms of compensation are just going to disappear'"

ABA Journal, May 28, 2009

The Market for Legal Services, cont'd.

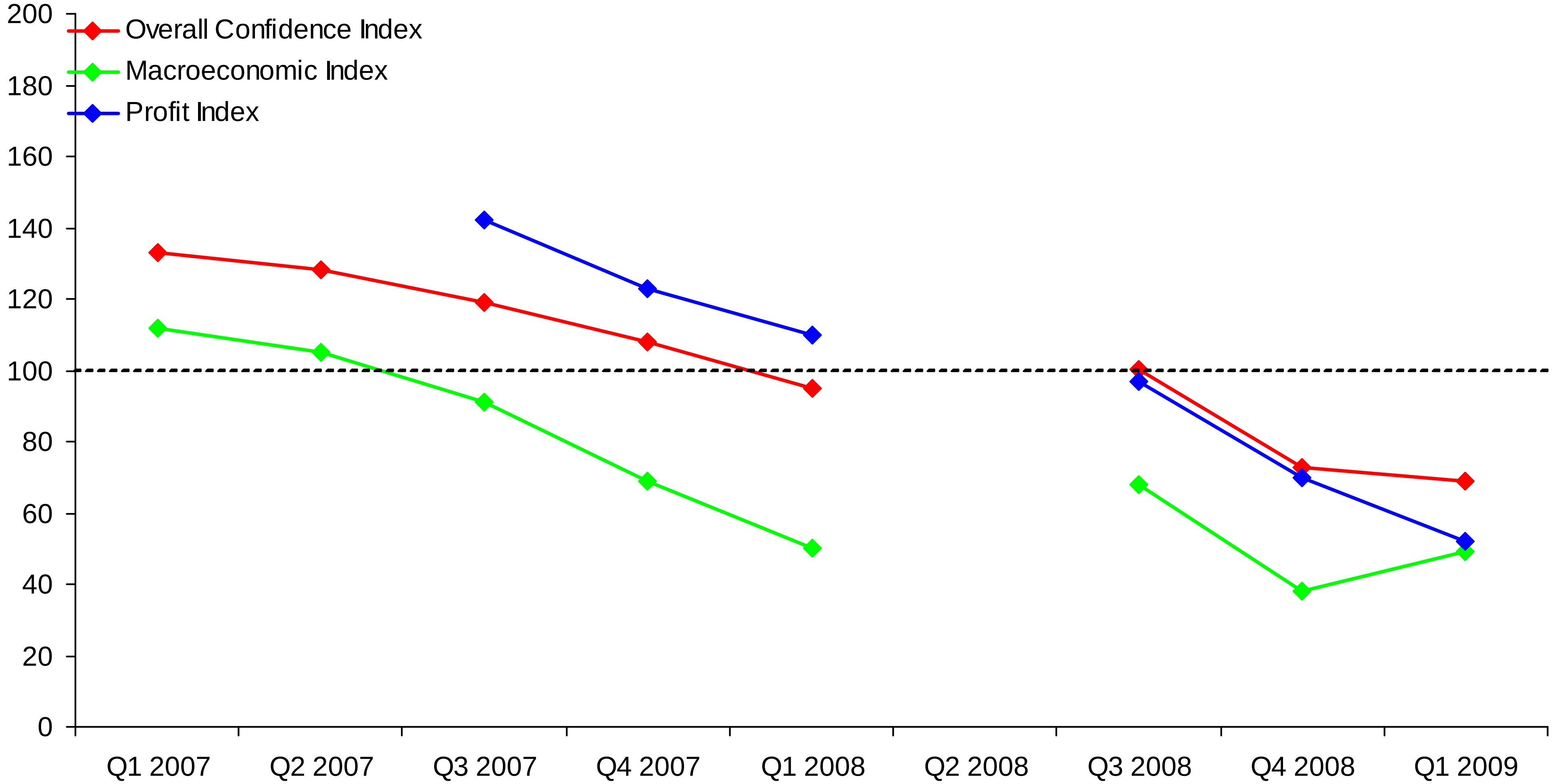
- Law firm vulnerability
  - What do the leases look like?
  - What is the fixed cost structure?
  - How healthy are the clients?
  - What is the business mix?

The Outlook for the Legal Industry

- Discounting: the hidden secret.
- Specialization, specialization, specialization.
- Is this the opportunity for new business models in select practice areas?
  - Vantage Law Partners Model
  - Increased reliance on technology to control costs
  - Increased risk sharing through fixed fee commitments and "contingency" arrangements.

Managing Partner Confidence Index
Q1 2007 – Q1 2009

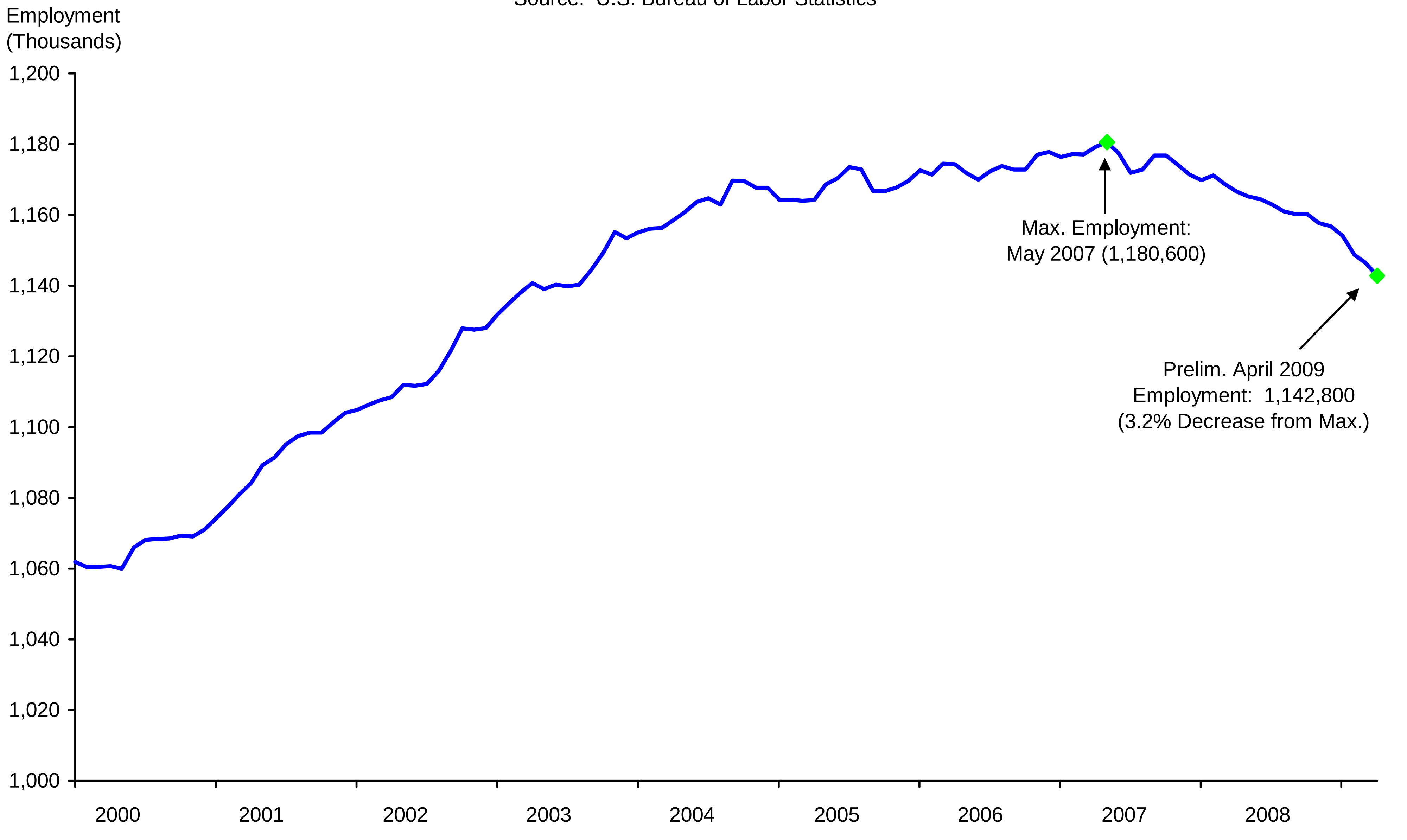
Source: Citigroup Law Watch



Note: Index values greater than 100 suggest a more positive outlook while index values less than 100 suggest a more negative outlook. The Profit Index reflects the surveyed partners' outlook for profits at their particular firm. Q1 2007 Macroeconomic Index figure is as reported in the Q1 2007 report.

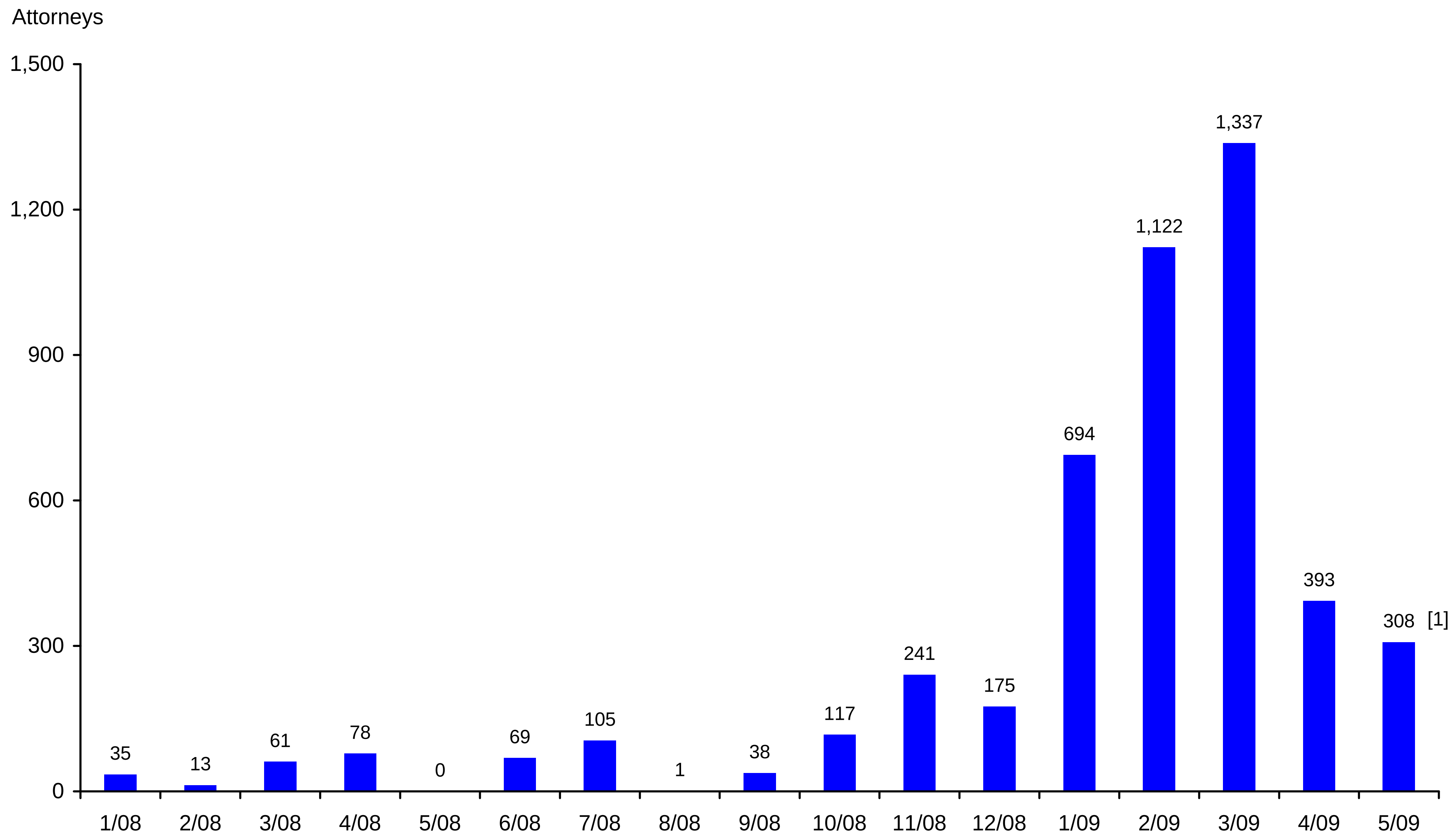
Total Employment in Legal Services Industry
January 2000 – April 2009

Source: U.S. Bureau of Labor Statistics



Attorney Layoffs by Month Since January 2008

Source: Lawshucks



Note:

[1] Data for May 2009 go through May 14, 2009.

Layoffs at Am Law 100 Law Firms
January 2008 Through Mid-May 2009

Source: Lawshucks; 2008 Am Law 100; U.S. Bureau of Labor Statistics

Number of Attorneys Laid Off	3,299	
Total Attorneys (Non-Equity Partners)	63,045	
% of Attorneys Laid Off [1]	5.2%	
Decrease in Nonfarm Private Employment (1/08 to 4/09)	5,888,000	
Total Nonfarm Private Employment (1/08)	115,689,000	
% of Decrease in Employment	5.1%	
	Median	**Mean**
Number of Attorneys Laid Off Per Firm	17	33
As % of Total Attorneys (Excluding Non-Equity Partners) [1]	3.4%	5.0%

Note:

[1] Calculated as Total Lawyers (as reported by Am Law 100) less Total Equity Partners (as reported by Am Law 100). Total Lawyers represents full-time equivalent lawyers as of 8/31/08 (for firms with fiscal years ending after 8/31) or at fiscal year end (for firms with fiscal years between 3/31 and 8/31). Total Equity Partners represents persons who file a Schedule K-1 tax form and receive no more than half their income on a fixed-income basis.

Changes in Revenue per Lawyer and Profit per Partner from 2007 to 2008 [1]

Source: 2008 Am Law 100

	Revenue per Lawyer		Profit per Partner	
	Mean	**Median**	**Mean**	**Median**
Am Law 100	(0.15%)	(0.50%)	(2.56%)	(2.80%)
Top 25 by Profit per Partner	(4.08%)	(3.70%)	(6.99%)	(4.70%)

Note:

[1] Mean and median revenue per lawyer (profits per partner) exclude firms with revenue per lawyer (profits per partner) listed as "N/A".

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CORNERSTONE RESEARCH

The Economic Downturn And Securities Litigation

June 11, 2009

New York, NY

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