BRIEFING BOOK

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BERNIE MCSHERRY

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ABOUT BERNIE MCSHERRY

Intelligent Investing with Steve Forbes

Bernie McSherry is senior vice president of strategic initiatives at Cuttone & Co., where he is a member of the management committee involved with strategic planning and market strategy.

He has served in a number of leadership positions within the industry and has chaired several New York Stock Exchange committees and served as the NYSE governor for six terms.

He is a past president of the Alliance of Floor Brokers, an industry trade group and is a member of both the Security Traders Association of New York (STANY) and the National Organization of Investment Professionals (NOIP).

McSherry began his career as an options trader, overseeing floor operations for Walsh, Greenwood and Co. He founded McSherry & Co. in 1988. In 2000, McSherry & Co. was acquired by SunGard Global Execution Services. McSherry served as CEO of its New York and London-based broker dealers for two years following its acquisition. He then joined Prudential Equity Group before joining Cuttone & Co. in 2007. McSherry is a regular commentator on CNBC and other media outlet.

DEBRIEFING MCSHERRY

Intelligent Investing with Steve Forbes

By Dave Serchuk
April 29, 2009

Forbes: You've been on the floor of the New York Stock Exchange for 30 years. What's changed in that time?

Bernie McSherry: There's a lot fewer people than there used to be. For starters. The sophistication of the average investor and the way they interact with one another through the exchange has changed dramatically.

When I first came into the business it was basically stocks. Equity options were the most exotic instruments. And now we've got ETFs and you name it, and they all interact in ways that are far more complex than in those days.

What changed about the actual floor since you've been there?

The population has dropped dramatically, the Stock Exchange during its peak in the late 90s, probably there were 3500 people. There are probably 500 or so down there now who are actively trading. And the stock exchange the volume's dropped from well over 80% probably to the low 30's. The market is much more fragmented and the portion passing through the physical exchanges is much reduced.

Do we still need a floor?

I think we do for now, if you had asked me a couple of years ago I would have bet against it. In fact I had my own business that I sold a number of years ago because I didn't think it [the floor] was going to be viable long term. But on the openings and closes and the really thinly traded issues - those secondary and tertiary names - brokers are still effective at negotiating trades and finding liquidity. More effectively than the systems seem to be doing. Certainly you don't need a broker to buy or sell IBM or a Microsoft or a heavily traded name, but if you are going to trade Norfolk & Southern and you've got a little bit of stock to do, it's probably a good idea to speak to a broker.

Did automation help or hurt the floor when it came to this current crisis?

I think it hurt. One of the real benefits of having a specialist at the point of sale is he has the opportunity to slow the process down, or at least traditionally he did. We've taken a lot of that ability away from the specialists, so that volatility was able to feed on itself and we saw some real downdrafts in stocks that probably would have not taken place had a specialist had a traditional role. A few months one of the really bad days there was huge influx of selling on the close and the market wound up closing down about 700 points on the Dow. But the Exchange invoked Rule 48 and allowed the specialists to slow down the close and try to attract liquidity on the other side. Even though the market closed down about 700 points without that move it would have closed down 1200-1300 points. It would have sent a bad message to the community.

The specialists are putting breaks on volatility?

They did traditionally, that was always their role. They had much more control at the point of sale. They've lost a lot of that control, but the Exchange is providing them with an incentive to post liquidity, and put bids and offers in. And over the last several months the market share for the specialists has risen from 4% to about 12%, so it's been a near triple. Since the exchange added their new market model in the fall.

We've all been told about algorithms and dark pools, automation. Again, why do we need a physical floor?

First people have learned to game the algorithms. Snipers that detect when other programs are in place, and they find a way to manipulate those algorithms, and purchase stock or sell stock disadvantageously.

It's difficult to find liquidity. We have two or three dozen market centers trading, liquidity scattered all over the place and they can't negotiate in that environment as effectively as they did face to face in the open outcry market. Brokers are particularly good at ferreting out large blocks of stock. Face to face you establish a level of trust, and brokers are good at negotiating with one another where not everybody in the world is watching. If I were to post a million shares to buy on a system, I am pretty sure the stock would run away from me, and go straight up if everyone else stepped in front of that order.

When you are negotiating verbally, brokers do a mating dance. One will say I'm a buyer and the other will say that's good, because I've got a pretty good sell order here. And the buyer will then respond, and in a matter of seconds they will open one another up, and they can get a negotiation on. And they can print a block in an effective manner. That is the holy grail the exchange is trying to get back right now. But they haven't been successful just yet.

What do they need to do to bring back that human face?

It's hard to say, first they've got to keep people on the floor and keep people incentivized to stay there. Over the last couple of years the profitability's been taken away from the specialists. The reforms introduced took away the profitability but left the market maintenance requirements, and that's a losing proposition from profitability point of view.

So they're trying to find a balance now, relaxed those restrictions, getting some viability, making money.
Got to do that for brokers now. Brokers finding a hard time adding value. Do think they add value, but people only want to use them when they have to. We probably have to change how we price trades.

During the fall when the market was particularly volatile, people found that those algorithms were not that effective they were getting bad prices. In a thinly traded stock you can see someone buy 1000 shares manually and all of sudden the screen lights up and 5-7 programs will come in to buy that 1000 shares that are no longer there. The stock moves up 20-40 cents on low volume. So people were getting bad results.

A broker would look at that and say that's silly, I'm not going to pay up. And that's what brokers are good at. That's another thing people are good at, is noticing patterns and responding to them.

You've maintained a cautious optimism in your commentaries. Have you ever seen things this bad?

This is the scariest time I've seen in my career. In the fall after Lehman Brothers went down I was concerned that the system was on the verge of breaking. And I think we were only a few days away from it had the TARP, the original TARP program not been announced by Hank Paulson at the time, it bought a little time for things to stabilize, but it was very scary. And I was on the floor during the crash of '87 and I've been doing this for a long time. The scary part of the crash of '87 was the following day when the market opened high and began to sell of mid-day and the specialists were effectively broke.

You came to this in the late 70s during stagflation.

It was the end of the world. I came to the floor as young kid, and people told me I was crazy and nobody was making any money. And you could do better as a cab driver. And literally brokers were driving cabs at night in some cases to supplement their income. It was such a poor time to be in the business.

But this is worse?

Yeah, in some ways it is. Looking back it was a great time to get into the business. And a lot of kids are not going to come into the business because of how things have been recently. But some of them should think about where the market is going to be in 10 years versus where it is next month or next year. It's probably going to be better. Let's hope so.

Intelligent Investing Panel

Credit Markets Start To Thaw

David Serchuk, 04.20.09, 6:00 AM ET

Credit markets are starting to thaw, though they are far from totally unfrozen. The Forbes Investor team even says that the suspension of mark-to-market accounting rules may actually serve to gum up the works once again. Overall, however, it seems the various stimulus programs put in place to loosen credit markets seems to finally be taking hold.

Some signs of spring have appeared in the credit markets. One key metric here is the Treasuries-over-eurodollars spreads, better known as the TED spreads. As these spreads narrow, they indicate healthier credit markets, more investor confidence and more interbank lending. Quite recently this spread narrowed to 94 basis points, down considerably from the 125 points it stood at in early January. This in turn was much narrowed from the spread's widest point of 463 reached in early October.

All of this is a roundabout way of saying that banks are lending more now than even a few months ago and investors are feeling more upbeat on the markets in general. TED spreads started to spike in August 2007, which loosely correlates with when the Standard & Poor's 500 started to begin its long and steady decline.

In London, the interbank offered rate, known as LIBOR, which tracks the interest banks charge each other, has also gradually declined. Recent readings show LIBOR rates falling to their lowest readings since the Lehman Brothers meltdown down in September. Again, generally speaking, the lower these rates are the more confidence there is perceived to be in the banking system, as lending increases and rates become more favorable.

Gerry Klingman, the president of Klingman Associates, says that while credit markets are no longer frozen solid, they're still not flowing freely. On the positive side he said that the high grade part of the corporate credit market is showing some real signs of life, and has been better able to raise cash. On the flipside, lower-quality, securitized loans remain frozen. He added that the Federal Reserve understands this, and continues to try to unfreeze all parts of the market, not just the high-grade part.

Bernie McSherry, the senior vice president of Cuttone & Co., added that the convertible bond market is also experiencing a revival. Convertibles, as they're known, are corporate securities, typically bonds, that can be converted for a set number of shares of another type of security at a predetermined price, typically common stock. "Underwriting is improving and a lot of that's due to the Fed," he says. Convertible bonds are often issued as a way for firms to raise capital while paying lower interest than straight debt.

Ron Sloan, senior portfolio manager with Invesco AIM, added that this nascent turnaround could be halted by the removal of mark-to-market accounting rules. These rules were effectively nullified on April 9 by the Financial Accounting Standards Board. Prior to this change, bank assets, including many toxic assets, were continually being written lower in accordance with what the market thought they were worth. The complaints about this were manifold. A big complaint was that firms were effectively being forced to take losses on unsold assets, killing their balance sheets unfairly.

Now these rules have been effectively nullified and once again banks have much more ability to set their own prices for these troubled assets.

The problem with this, Sloan says, is that now that banks can set their own prices for these assets they may in fact take much longer to unload. He envisions a giant game of chicken, where banks will try to hold out much longer to get what they think the assets are worth, versus what they had been marked to by the market. "And so this may actually serve to refreeze markets," he says. If this is so this recovery will then be prolonged, despite however many government programs are put in place, or however many dollars feed it.

The Big Slush

Forbes: How close are credit markets to actually being unfrozen? And how much of that is attributed to the work that's been laid down by the Federal Reserve and the Treasury? Is the money finally getting out?

Gerry Klingman: They may not be frozen any longer, but they're not warm and flowing freely. So, that's for sure. I think you clearly see LIBOR and inter-bank lending has gotten much repaired from where it was six months ago. And clearly, the ability for high-grade corporate credits to raise money has been improved dramatically. But lower credit quality, securitized loans are really still frozen. And I think the Fed understands that, which is why they're working on all these programs to continue to thaw the markets in the other parts of the credit markets, other than the high-grade.

Bernie McSherry: Yeah, I agree. I think the convertible bond market is showing signs of life. Underwriting is improving and a lot that's due to the Fed. But I think it's also curious that despite very low interest rates, we're not seeing a real spike in mortgage applications. And I think that is a function of the fact that qualification standards are much, much more stringent than they were.

Do you think that credit markets should be flowing a lot more freely, considering that there's still a lot of troubled assets out there?

Klingman: Well, "should" ... I'm not sure that's the right word. We need them to facilitate a end to this recession. So, clearly, lending standards were way too lenient a number of years ago and the pendulum swung too far to the other end, right now. And you can't blame banks for all of the sudden being prudent or financial institutions or investors for being overly prudent in this environment. But I think the Fed understands that we need to have more credit flowing in order to have a sustainable recovery. Not to the extent that we had before, perhaps, but at least more than we have right now.

What'll it take to get these things finally liquid again?

Klingman: Well, there are already 12 programs out. Hopefully there won't be 100 programs.

McSherry: They're running out of initials.

It'll be like Super Bowls; we'll have to go to Roman numerals. Ron, what do you think about this issue of the fact that we have, at best, a slushy, icy credit market?

Ron Sloan: Well, it's this chicken and egg thing. And there's even some speculation now that with the loss of mark to market ... maybe you're going to retard the ability to get [troubled assets] off the balance sheet. As if all of the sudden people will start playing a giant game of chicken in the sense that, "No, OK, well, if we don't have to mark these to market for regulatory purposes, maybe I'm not going to sell them."

And it's very close to 80 cents on the dollar where they're currently being carried at. And so this may actually serve to refreeze markets, interestingly enough. So we're in a heck of a fix here. And I don't know whether we need another acronym plan or not. But what's going to happen here may serve at cross-purposes of what all the acronyms are trying to accomplish. So, it's just going to take time.

Guys, do you feel, as Ron does, that repealing mark to market could have massive and bad unintended consequences?

McSherry: Yes, I do. I think the plan to get the toxic assets off the books of the banks is a good one. Or it's the best one we've come up with. But if banks can start valuing their own assets at whatever they think they are, which is basically a version of what is going to happen under this proposal, they have less incentive to move those assets off the books. And I'm deeply suspicious of any bank that is allowed to decide for themselves what those assets are worth, in terms of their own valuation.

Klingman: In general, I agree with both Ron and Bernie that mark-to-market is an important principle of transparency and accounting. I do think that it became a little bit dangerous, particularly last Fall when institutions that had no intention of selling those assets were driven to mark and keep marking things and at one point it looked like mark to marking into a black circular hole.

So, I do think that it is intelligent for them to have some ability to use some other metrics when assets intend to be held by a financial institution. But I do agree with Ron and Bernie that there is some risk now that if they dramatically change the rules away from mark to market that it could actually spook the markets and investors.

So, holding your assets for five years to get rid of a mark to market may be a lot more trouble than it's worth. But if you're actually trying to unload this stuff, mark to market is efficient?

Klingman: I think, in general, mark-to-market should be used, because things are worth what someone's willing to pay for it. But then there's the old adage that people talk about the value of their house all the time, but they really only find out what it's truly worth the day they buy it and the day they sell it. So, mark-to-market makes sense, but I do think that, within limits, there should be some ability for certain types of assets to have some flexibility.

This accounting principle has a lot of detractors. Why?

Sloan: Well, I would just say that it appears, for some purposes, to be a quick fix. [Warren] Buffet was out a couple of weeks ago basically saying, "Look, I want to know what mark-to-market is, but maybe we should look askance when it comes to regulatory requirements in terms of capital." And so, that's going to be one of the stress test issues. The stress test is going to be, basically, your capital efficiency. And maybe for those purposes, they want to start looking the other way.

Listen, the vast majority of assets on a bank's balance sheet are not going to be sold. And where this mark-to-market issue is not applicable. So, we're just dealing with this 20 to 30% of the assets. And that's the sticking point here.

And in that process, we're de-leveraging the banking system. Whatever assets you've got that are good, or whatever capital you've got that is good, you're just not going to lever up as much. And so, yes, requirements have gone up a lot. But actual loans are being lent by those banks that have big deposit bases. And they can therefore make loans in a de-levered world because they've got those big deposit bases.

Now, if you don't have those big deposit bases, all of the sudden, you're going to have to bring in your loans. It's going to look like you're more frozen on that basis than other people. So, there's a lot of moving parts here in these questions.

Yeah. And it sounds like, once again, the banks that actually have money are the ones that can do the business.

Sloan: And they are making loans. They are making loans, but they're not making as many as they used to, because they've tightened conditions and they're in the process of delivering their own balance sheets, in addition.

Ron, can you name me a couple of those banks, just for examples?

Sloan: Well, whether it's US Bank or whether it's Wells Fargo, [JPMorgan Chase Chief Executive] Jamie Dimon has come out and said the same thing. All those banks that said in the first part of this year, "Hey, you know, we're making money on an operating basis." Now that was a very narrow way to view that.

McSherry: Certainly was.

Sloan: And Dimon said, "Well, you know, March hasn't been as good to us as January, February were." But Wells Fargo went out and bought a huge asset base. US Bank went out and bought another huge deposit base. And those banks are increasing loans. And if you get into smaller banks that have a lot of capital, for the guys in New York, you know, People's United Financial up in Connecticut. There's a bank that is way over-capitalized, and it's continuing to grow its loan portfolio pretty aggressively.

And Bernie, you had some thoughts on the subject?

McSherry: No, I was just going to say, we're talking but building a deposit base. I'm looking forward to the day when I can hit the Goldman Sachs ATM down the block and get some cash.

But they're paying our money back early!

McSherry: Yeah. Well, our political leaders are making such a stink over compensation issues that the unintended consequences are the people going to rush to give that TARP money back. And it may retard some of their lending.

Is this a tactical mistake for people to be as outraged as they are over the various bonuses being paid with TARP money and the like?

Klingman: To be outraged is understandable. The general population in the country and the taxpayers are at least disheartened by the poor performance of financial institutions and the compensation levels. Having said that to paint all financial institutions and all executive as being incompetent and overpaid is wrong.

And I think Obama's gotten this right: If we focus too much on executive comp issues, in terms of time and energy and legislation, we're going to lose good people in good firms that we need to have part of this private-public partnership to get the credit markets and the economy going again.

Where will they go? They're not going to just disappear, right?

Klingman: They're not going to disappear, but I think, if you get to a point where, if you're involved in any of these programs, you have such tight compensation limits, you're going to have firms trying to get out of the programs. And I just think it's going to be very counter-productive.

Sloan: And remember, if AIG, as an example, were allowed to fail and go into a bankruptcy court, what would a bankruptcy judge do? He would appoint certain well-respected people. He would pay them going rates to do what is being done. That is, unclog these assets. So, I do feel it's way too myopic to focus on this. We understand the outrage. People are just lashing out. But it's way too myopic to focus on this. Because if it went to bankruptcy, all these things would be happening anyway.

Intelligent Investing Panel

Sell Gold, Buy Oil

Stephanie Dahle 04.22.09, 4:00 PM ET

Gold futures made a rebound on April 20 as the volatile stock market triggered investors to dive into the precious metal. But they may be diving in at the high end of gold's run, at least for now.

"The stock market got beat up pretty bad and anytime there is that kind of uncertainty, people turn to gold. Gold is, and has always been, the save haven investment." said Patrick Lafferty, commodity trading adviser with MF Global.

At $885 an ounce, the price for gold is historically high, particularly in comparison to oil prices. Typically, it takes 10 to 15 barrels of oil to buy an ounce of gold; currently, it would take close to 20 barrels. On the flipside, an ounce of gold traded at just 4.5 barrels of oil last summer when the former was at $666 an ounce and the latter was at $147 per barrel. We all know what happened next: Oil fell sharply from its historic highs and gold rose by over $200 per ounce. Still, oil fell farther and faster than gold rose, meaning it was more overpriced than gold was underpriced.

A similar reading of today's tea leaves has some people saying that despite being a safe haven, gold may still be on the expensive side.

"Long term it's still very bullish. Near term, it is a little high. Personally, I think gold has a ways to go," said Lafferty. "We're patiently waiting for the opportunity to buy gold. $820-$800 is the ideal number we're waiting for. That could change if there are any other fundamental changes."

That doesn't stop Lafferty from cautioning about possible inflation and pointing out that gold will be particularly safe in that environment. Still, there are other commodities that might be a bargain right now.

"From the standpoint of diversification, if you're able to get into the crude oil market below $45/barrel, I think you stand an excellent chance to make money on it. We think it will come back into the $70-80 barrel, in a 12- to 18-month range."

Bernie McSherry, Forbes Investor Team member and the senior vice president of Cuttone & Co., said that gold may indeed be a bit pricey at the moment, but that oil prices would rebound. Fellow FIT member Gerard Klingman, president of Klingman Associates, agreed that commodities are a good place to invest, but that diversification is key.

Ron Sloan, senior portfolio manager with Invesco AIM, agrees that gold has been a good deflationary hedge, but oil's low price makes it more attractive.

Those looking to invest here might want to consider exchange-traded funds, which track indexes but trade like stocks. For gold you could consider the SPDR Gold Trust, which owns actual gold vs. shares in gold-related firms. Its been in operation since November 2004 and has a market capitalization of $24.4 billion, which is quite large for an ETF.

For those looking to invest in oil there are a few different options. One is the PowerShares DB Oil Fund, an ETF that seeks to directly track the performance of crude oil. Downsides here include the ETFs small size--its market cap is just $46.3 million--and its short track record.

Or you could consider the iShares S&P Global Energy Sector ETF, which tracks firms engaged in oil equipment and services, oil exploration and production, and oil refineries. Its been in business since November 2001 and has $524.1 million in market cap.

Sell Gold, Buy Oil

Forbes: Gold is trading at around $885 an ounce. And at that price, it's priced at around 20 barrels of oil, which is historically high. Does this mean gold's really out of whack and oil's really cheap? Does this mean oil's going to come up a lot? Should one buy oil and short gold? Should one buy gold and buy oil?

Gerard Klingman: You're right to separate the question. The first question we talk to with clients is whether or not we think that the result of all these programs the government has put forth to get us out of this financial crisis or recession could lead, at some point, to greater inflation. And I think there is, with the debt that's going to be created in this process that, you know, we believe that there could be significant amounts of additional inflation going out a year or two or three.

Which is a much better alternative than deflation, but still an issue. In that scenario, you do want to have commodities and real assets as part of your investment portfolio. So, we think there's a place in clients' portfolios for real assets and commodities. Then you get to the second issue of how do you play that?

And we personally think that because gold tends to, when there's a lot of fear in the world and it's a simple way to get exposure to that, that gold has gotten, we think, relative to other commodities is a little bit of a speculative bubble. So, we're encouraging more broad-based exposures to commodities, including gold, but as compared to just investing in gold.

Forbes: Where else should they look in addition to gold? What are other places to look?

Klingman: There's baskets of commodities, and whether it's through an exchange-traded fund or other ways to do it, where you're going to own not only gold but oil and copper and aluminum and silver and even agricultural commodities. All things that would, we think, be assets you'd want to own in an inflationary environment, as opposed to just gold.

Bernie McSherry: Yeah, I agree. And I think, you know, as economic recovery starts percolating through the world, hopefully soon, oil should recover. And we should see some upward movement in oil. Maybe not overnight, but over the next several months to a year, I think you'll see a little bit of an uptick in oil. So, I'd be hanging on for that. And I do agree that I think gold is overpriced.

Forbes: Ron, I would love to get your thoughts on this very subject.

Ron Sloan: Well, I think that the current disparity is a function of not necessarily hedging for inflation, which I agree with Bernie and Gerry that neither commodity, gold and oil, would be good inflationary hedges. But I think the disparity right now is a function of people looking to gold in a deflationary safety security environment. And I'm not so sure, historically, that gold has been a good deflationary hedge, especially if you look back to the '30s.

So, I think that right now, the disparity is probably not deserved. And I would agree that, you know, I think that probably there are some risks to an inflationary cycle. And therefore, the interest in oil to close that gap is probably a good one.

Forbes: OK. So, verdict--gold might be a little pricey. That's what I'm hearing.

McSherry: Sounds like we're all on the same page on that one.

Bet On Muni Bonds
Madalina Iacob 04.27.09, 4:00 PM ET

Municipal bonds and Treasuries have inverted their traditional relationship, with the former returning more than the latter. As a result, over the past several months more and more investors in long-term debt issues are looking to take advantage of this most unusual situation. And as for fears that municipals could default, the Forbes Investor Team says not to worry.

"We haven't seen such a rally for years. Yields are at their lowest point," says Matt Fabian, managing director at Municipal Market Advisors. And in the bond market when yields go down, prices go up. The tax exempted bonds yield has fallen 40 basis points in the last week. This rally is also helping those with lower-rated bonds unload them, Fabian says.

Historically, munis have yielded between 80% and 90% of Treasuries, says Annette Thau, author of the The Bond Book: Everything Investors Need to Know about Treasuries, Municipals, GNMAs, Corporates, Zeros, Bond Funds, Money Market Funds, and More.

Recently however the yield on a AAA 30-year bond has increased to 114% relative to Treasury Bills. Currently A-rated 10-year General Obligation paper yields 150 basis points more than AAA GOs, according to Muni Market Data-line. The spread from AAA to BAA in 10-year maturities was 39 basis points at the beginning of 2007. Now the spread is roughly 350 basis points--a near-tripling in less than nine months, according to a recent report released by Citigroup.

The muni market has rallied in the past weeks after demand for Build America Bonds has increased. Under the new scheme the state and local issuers will get a 35% rebate on the interest costs over the life of the issue. California has already taken advantage of this vehicle and sold 5.23 billion Build America Bonds in just the passed week.

"This is compelling because it shows California has plenty of capacity to issue bonds and raise cash. If California couldn't issue debt it would be a catastrophe," says Christopher Ihlefeld, a managing director from Thornburg Investment Management.

Such figures don't necessarily mean that California, or any states saddled with debt, has a better credit rating. Issuers have been able to offer debt because they have better access to borrowing, not because their credit quality has improved. Still the danger of default is small.

"If the federal government is bailing out companies, they will bail out a state. Investors should look at the underlying credit and stick to liquid issuers," says

Alexander Anderson, bond portfolio manager at the Los Angeles-based Envision Capital.

Still, with unemployment soaring and property taxes decreasing, many municipal bond insurers are in increasingly difficult positions. Among the red-flagged states investors should keep an eye on are Florida, California, Michigan and Indiana, analysts say. Also, there could be automaker-related fallout in cities, counties, school districts and special districts located in Michigan (general obligation rated Aa3/negative outlook), Indiana (general obligation rated Aa1/stable outlook) and Ohio (general obligation rated Aa1/negative outlook), the Citigroup report shows.

"It doesn't mean that these states have more default risk. It is just that the liquidity is very low and there aren't many buyers," Fabian said.

On the flip side, some analysts still see value in bonds coming from distressed areas, with Detroit Water and Sewer as an example. A Detroit Michigan Water bond rated A2 by Moody's maturing July 1, 2010, was yielding 5.26%. Thornburg Investment Management has also invested in Las Vegas, which has been hard-hit by the slump in the housing market. "These are high quality bonds in distressed regions," says Ihlefeld.

Gerard Klingman, president of Klingman & Associates and a Forbes.com Investor Team member, believes revenue bonds from primary purpose type facilities, like bridges and tunnels, are safe investments along with bonds rated AA and above. He also likes General Obligation Bonds and "pre-refunded" bonds guaranteed by a portfolio of Treasuries.

Sectors that have been traditionally more risky are multifamily housing projects, industrial development revenue bonds, tobacco bonds, casino bonds and land development deals.

"I would be careful with hospitals, nursing homes and any land development bonds. I would invest in sewers and utilities. Even in bad times people are still going to flush their toilet," says Evan Rourke at MD Sass Muni Team.

You can invest here via exchange-traded funds, but some analysts recommend caution. The iShares S&P National Municipal Bond Fund ETF offers a 3.6% yield this year but some believe it is not well diversified. "A couple of ETFs seem to have an over exposure. It's not easy to replicate the index they are tracking. It is very different from equities where the market allows you to purchase percentages. In our market it's not so cut and dry and there are numerous issues that go into the index," says Constantine Mallas, portfolio manager at T. Rowe Price.

So be cautious but not too cautious to invest here. Ronald Sloan, senior portfolio manager with Invesco AIM, says that Vallejo, Calif., offers an interesting study for those interested in municipal bonds. What happened in Vallejo is the municipality had a large round of contract renegotiations with its employees before the current economic meltdown.

Now that the state's been hit hard there is fear that it could default on its muni-obligations. But Sloan says that the city is currently trying hard to claw back some concessions made to the workers in order to pay back the muni-bond holders. "So, certainly investment grade and general obligation bonds are probably pretty darn safe," he says.

Bernie McSherry, senior vice president of Cuttone & Co., notes that these renegotiation efforts could potentially open a can of worms as municipalities consider suspending obligations from their own workers in order to meet their bond obligations.

This, of course, is terrible for these workers, but very good for investors in these bonds.

Backing Up Muni Bonds

Forbes: There's much recent talk of municipal bonds defaulting. How much of this is simply fear, vs. the reality of actual widespread default?

Gerard Klingman: I think what is a reality is, when you really talk about if you buy a investment-grade municipal bond, certainly general obligation, but even a necessary revenue bond, the likelihood that you will not get your interest and principal paid back if you hold that to maturity is very, very, very small. That doesn't mean in a financial crisis like we experienced that you will not have everybody flying away from anything that smells of risk and into Treasury bills paying zero return, that the value of them might not decline.

Bernie McSherry: Yeah, I think the interesting one is the case of the town in California. I think it's Vallejo … they're close to default. And they're trying to pursue a way of suspending their obligations to their pension funds for the municipal workers. And if that goes through, and early court cases seem to say that's a possibility, that could open a real can of worms across this country as towns and cities try to renegotiate existing labor maintenance.

Ron Sloan: Well, what happened in that particular case, because I'm from California, and Vallejo is not a town too far away, is they had accelerated a renegotiation of those contracts shortly before to the benefit of the pension holders, and made big salary increases to firemen and police in that town shortly before it became obvious that this was a city that was in financial trouble. So, what in effect the town is trying to do is claw back some of those maybe forward or honest, perhaps, negotiations with those municipal employees.

Klingman: What we're saying is that, in general, even municipalities that have difficulties, generally, they are going to find ways to deal with the financials short of not paying on their bonds.

Sloan: Yeah and, you know, in California the whole damn state's in trouble. But they just had a very successful bond offering … and we're already in junk status. And we have an oversubscribed offering of $6 billion. So, certainly investment-grade and GO bonds are probably pretty darn safe.

Klingman: I think, in general, municipal bonds, particularly general obligation, but even revenue bonds from primary purpose type facilities, bridge, tunnels, I think are very safe investments in general. And you know, the relative yields were more attractive a couple of months ago in the absolute depths of the crisis.

But, relative to Treasuries right now, if you're talking about five-year treasuries yielding under 2% and five-year municipals yielding, you know, 2.5% and they're tax-free. That's a relative value for a minimal amount of additional risk. Although, I will say you do have more liquidity, obviously, in Treasuries, in terms of if you need to sell them before maturity.

Intelligent Investing Panel
Stressed Over The Tests
David Serchuk, 04.29.09, 6:00 AM ET

The results of the bank stress tests are not in yet, but insiders are already trying to handicap the winners and losers. And standing out in the loser pile are Citigroup and Fifth Third Bancorp, says Vince Farrell, chief investment officer of Soleil Securities and a member of the Forbes Investor Team.

Whether banks fail the tests will depend, Farrell says, on whether the government allows existing reserves to count, which only makes sense. He adds that according to his analyst, Carol Berger, should reserves and earnings not count, Citigroup, Wells Fargo, PNC and Bank of New York would all fail and need to raise additional capital. Where it gets really interesting is if reserves and earnings are included. If this is allowed, Citi and Fifth Third Bancorp, as stated above, still likely fail and would need to raise more capital.

But "failure" is a relative term here, as the government has made it clear that it plans to backstop absolutely everything. "No bank 'fails' since they have access to government capital," Farrell says.

Even if certain banks can't fail the stress tests, the federal government can. Bernie McSherry, senior vice president of Cuttone & Co., warns that the public sees that the government has a vested interest in spinning the results of the test as positively as it can. But this can be a problem as traders already know this--meaning that if the news is good from the tests, you shouldn't expect any real rallies. But if the news is bad, despite the government's backing, watch out! "Investors will be upset, assuming that despite their best efforts, the Feds can't put any lipstick on the pig that is our banking system," he says. Meaning that putting on a happy face here could actually backfire on the government.

The results of the tests will start being released to the public on May 4.

Another possibility is that the weaker players in the banking industry will get snapped up by foreign players unencumbered by domestic Troubled Asset Relief Program money and its various attached strings.

By the nature of the financial crisis, large domestic firms won't be in their typical buying positions, analysts say, as pressure is applied to get behemoths like Citi to go on a diet rather than bulk up still more.

Michael Ervolini, the head of behavioral finance firm Cabot Research, wondered aloud whether once the results of the stress tests are in, investors will become more relaxed and confident in financial markets. Ervolini said this might be possible as it could help investors reset their expectations about wealth and the desire to take on risk.

But McSherry said he doubted whether any stress will be reduced by the tests, at least for investors. "A low ranking could create a negative loop that could make things worse."

Stressing Over the Tests

Forbes: So far, there has been little in the way of specifics regarding what the actual outcome of the stress tests will be. Is this preferable? What do you want to find out from the stress tests? If banks aren't being punished for failing the tests, as seems to be the case, why have the tests at all? What sort of impact will the tests actually have on the banks and the financial markets?

Bernie McSherry: My main concern centers on the credibility of our officials at this point in time. I think that the investing public recognizes that the government has an interest in putting as positive a spin as possible on any results. Confidence is being slowly rebuilt, and you can detect a distinctly more optimistic tone emanating from Washington lately. That could be a problem. Information will be leaking out over the next several trading sessions. Traders assume that the government will spin it positively and if the news is good, the market isn't likely to rally as much as we might expect. If the news is bad, look out! Investors will be upset, assuming that despite their best efforts, the Feds can't put any lipstick on the pig that is our banking system.

Vince Farrell: [On] Friday, April 24, the Feds talked to the banks about the results of the stress tests. The criteria to be applied were leaked to the papers and it seems comprehensive to me. The banks have to assume that unemployment goes to 10.3%. Additionally, they need to apply an 8.5% loss ratio for first lien mortgages over two years, 8% loss on commercial and industrial loans, 12% on commercial real estate loans and a 20% loss on credit card portfolios. After taking those theoretical hits, the bank has to show a 3% tangible capital ratio.

The key in the computations is will the Feds allow existing reserves to count (makes no sense not to) and will you assume some level of normalized earnings for the next two years. According to my ace analyst, Carole Berger, if reserves and earnings don't count there would be four banks that fall short and would need to raise capital. Those four would be Citi, Wells Fargo, PNC and Bank of New York. But if reserves and earnings were to be included, then only Citi and Fifth Third need to raise capital.

Secretary Geithner's statement the other day that the banking system has enough capital seems to ring true. The sooner this news gets disseminated, the better the environment will be.

Forbes: Wow Vince, even if reserves are allowed to count Citi and Fifth Third still fail? Geez, Louise. What happens then?

Farrell: Citi's numbers probably change when the government exercises its 45% stake (or whatever it is.) Fifth Third has to raise capital and will have six months to do it. If they can't, Geithner has said the government would be investor of last resort. Shareholders get diluted. No bank "fails" since they have access to government capital.

Michael Ervolini: One item that may be of interest is how does the stress test help with getting everyone feeling more relaxed and confident? If you desire, we can talk about the need to "reset" our understandings about our wealth, our ability to capture return and our willingness to accept risk. Once we take on this fundamental reset we can then begin to think more about the future and investing prudently.

Without resetting, we remain mired in holding on to our losses and feeling disappointed and angry. Behaviorally, this is related to anchoring and loss aversion.

McSherry: I'm far from certain that the stress test will help folks relax. I'm concerned with how the information will be disclosed and whether the ranking will impact public willingness to do business with banks that are low on the list. A low ranking could create a negative feedback loop that could make things worse.

Farrell: If my note before is directionally correct that most of the banks "pass" the stress test, I think the results should be announced and the clarity would ease tensions.

The next issue is to get the P-PIP program underway, and the only way to do that is to issue the rules of the game.

THE MCSHERRY INTERVIEW

Intelligent Investing with Steve Forbes

[00:08] Steve: Choking on the VAT

Welcome, I'm Steve Forbes. It's a pleasure to introduce you to my guest, Bernie McSherry, a 30 year veteran of the NYSE trading floor and an astute analyst of investor psychology. But first--

Paul Volcker's Economic Recovery Advisory Board has been given the task of simplifying our ridiculous tax code. Of course they won't be implementing the prudent, fair and simple flat tax solution -- that's just too much change for this president.

But beware of a Value Added Tax. What nonsense!

The VAT is a typically French improvement on the sales tax. It's levied on every transaction in the economy, from goods to services. Of course, manufacturers and service providers just pass these taxes onto consumers in the form of higher prices.

It's a way of taxing consumers without telling them they're being taxed.

A sales tax gets added at the register, right in front of the consumer's eyes. The VAT is baked into the sticker price. A $50 item in Europe could have upwards of $10 in value added taxes hidden within it.

Obama wants to use the proceeds from this European style tax to provide European style healthcare and European style college tuition to everyone. The VAT may be right for France but wrong for America.

In a moment, my conversation with Bernie McSherry.

[01:31] E-trading

STEVE FORBES: Well, Bernie, thank you for joining us. One of the things that investors sometimes overlook is the mechanics of trading. How the thing is done makes such a difference in both short-term and long-term pricing of assets. You've been on the floor for 30 years. One, what changes have you seen? And, two, why do we need a floor today? Or perhaps this volatility shows we do need a new floor today.

BERNIE MCSHERRY: Well, in terms of the changes, I don't think we're going to have enough time to really cover that. It's been amazing. When I first got there, everything was paper driven. Everything was open outcry. And now we're in a position where, on the trading floor at the New York exchange, probably 70

percent or so of the business is executed electronically. So that's really changed quite a lot.
However, people are still there and they're making a difference. And they're adding value particularly around the openings and the closes. And strategies where people are buying one asset and selling another, people off the floor are reluctant to tip their hand electronically on those things. And they give orders to brokers on the floor who represent their interests.

STEVE FORBES: And in terms of volatility, what has been the impact of electronic trading on volatility do you think?

BERNIE MCSHERRY: Well, you know, a lot of that stuff was brought in during a period of historically low volatility just prior to all this craziness that we've seen over the last year or so. And the systems worked pretty well. But people discovered last fall that the systems weren't infallible. And in some cases, they were exacerbating the volatility. And people then pulled orders away from those algorithms and gave them to brokers. And then we saw a little bit of an uptick in terms of the volume that went to brokers.

STEVE FORBES: So has the share of specialists gone up in recent months?

BERNIE MCSHERRY: Yes, it has. The exchange instituted a new model back in the fall. And they gave incentives to specialists. They rebranded them. They're now designated market makers, although we all still call them specialists.

STEVE FORBES: Right.

BERNIE MCSHERRY: They give them incentives to post bids and offers. And their market share has gone from about three percent to about 12 percent. So it's been pretty significant. It's adding some nice depth and liquidity to the market.

STEVE FORBES: Is that one reason why we don't always see in the last 20 minutes the violent fluctuations we saw a few months ago?

BERNIE MCSHERRY: Yes, that's part of it. I think most of that probably has to do with the fact that people have calmed down a bit. They've processed what's gone on. And they've taken a more measured view of the economy and the market in general. But there was some craziness back in the fall there. And I'd rather not go back and repeat that again, that's for sure.

[03:53] A Human Exchange

STEVE FORBES: Now, you've made the observation that on heavily traded stocks like a Microsoft, you really may not need human beings, that the electronics can work perfectly well, but in less traded stocks, there is a role to play. Do you think we need perhaps a new exchange for smaller stocks and just have a one-tier, two-tier, four-tier kind of exchange? One electronic, one semi-human, one fully human?

BERNIE MCSHERRY: Yes, I think something like that is we're in the process of evolving towards that now. The big names that are very liquid, there's not a lot of money that a broker can save for you. You know, if something is offered at 30 cents in very large size, I'm probably going to pay 30 cents when I get there and I'm not going to really make a difference.
But if a stock that's thinly traded, those secondary and tertiary names, those stocks really fluctuate quite a lot. And the algorithms aren't really good at spotting those breaks in patterns. And human beings are good at pattern recognition. We notice when you're forming. We notice them when they are interrupted and a broker is adding value there.
If you look at the exchange volume, I'd say about 30 percent of the volume overall is going to the floor of the New York Stock Exchange of overall listings. But if you look at the secondary and tertiary names, that buy-in percentage is closer to 50 percent because people are finding value there.

STEVE FORBES: And is that something recognized by regulators, something to be encouraged? Or are they just sort of taking hands off and watching it all unfold?

BERNIE MCSHERRY: Well, I think initially there was a bit of a bias against the exchange in the terms of I guess the exchange was probably not embracing change for quite some time.

STEVE FORBES: Right.

BERNIE MCSHERRY: And the regulators wanted to nudge them along and were not really listening to their arguments very well. Now that we've come through a particularly volatile period, I think there's some recognition that it's a good idea to have a central market of some sort. It's easier to regulate. It's better pricing. And we've had a proliferation of market centers. There are probably 30 or so out there now. And it's very difficult for people to trade large blocks of stock because it's so fragmented. So I think the momentum is swinging back a little bit, and we'll see. But I think the regulators would probably prefer to see a little more consolidation.

STEVE FORBES: And in terms of trading large blocks, some advances have been made. Maybe you can touch on those, or at least changes, whether you call them advances or not depends on your perspective, but changes. And what more changes do you think? You mentioned block traders don't want to have their hands revealed. And they're always trying to find ways, dark pools and the like, to figure out ways to have their strategy unfold without people seeing it unfold, in effect.

BERNIE MCSHERRY: Right. Well, that's one of the benefits of human trading. People develop relationships over time, colleagues, competitors. You have a reputational effect when you walk into a crowd. And if you squander that, you're going to have a hard time getting information.

Brokers used to do a mating dance. They'd walk into the crowd and say, "Well, I'm a buyer." And then somebody would respond and say, "Well, I'm a pretty good Seller." And then the buyer would respond by saying, "Well, I have a fairly large buy order." And then the seller would say, "You know, I'm not afraid of a sized bid." And in a matter of seconds, they could print a million shares or so on the tape, get it traded at a fair price for everybody in a way that didn't reveal their hands to people who were outside of that actual trade.

In an electronic system, if you try to put a bid like that into a system, everybody in the world sees it. They run in front of it and drive the price up or down in front of you. So they haven't really been able to replicate that exactly. There are some efforts now. The New York Block Exchange is an example.

There are a few other systems that are trying to come up with a way of replicating that dynamic. But it's very difficult when somebody is involved anonymously with it because there's no real penalty to be paid if you don't behave well.

STEVE FORBES: So there's no real way yet to chop up a block and have it done in a way where people aren't figured out what's going on?

BERNIE MCSHERRY: Right. People are slicing them up and they're getting them into the market. But it takes a lot longer time. The price impact is far more uncertain. And there are some systems that have been developed to bring buyers and sellers together. But they are not as effective as the old way just yet. But people are working on it. I have no doubt that technology will catch up at some point.

[07:37] Credit Regulation

STEVE FORBES: Why have there not been an exchange yet or clearinghouses yet on exotic instruments like credit default swaps and the like?

BERNIE MCSHERRY: Yes, that's a tough question. I suspect that too many people are making too much money by not having one. I suspect that we'll see something like that now. We've seen some real problems in that area. And I think we have to get them into a vehicle that will regulate it. And we'll get a good look at what's going on.

STEVE FORBES: Why do you think the regulators haven't been more proactive in trying to create that or encourage that? After all, we saw back in the early 1970s having exchange for options had a huge impact, positive impact.

BERNIE MCSHERRY: It's surprising to me. You know, I think it was part of the overall climate. We were in a period where we were trying to have less regulation in virtually all parts of our lives. And I think there were a lot of big players in the space who had a vested interest in influencing the regulators in a way that prohibited that from happening. I suspect if we all did it all over again, we'd probably move to an exchange-type setting sooner rather than later we wish we had done it.

[08:34] Efficient Pricing

STEVE FORBES: You once said not long ago that we may have to change how we price trades. What did you mean by that? Having more human interaction with some of the smaller equities?

BERNIE MCSHERRY: The way the market, the way the industry has always priced trades, it tends to be in a per-cents-a-share or mills, slices of per-cents-per-share. And you tend to charge the same amount whether you're trading IBM, which is a very easy trade, or you're trading Norfolk and Southern, which is a very difficult trade perhaps because of the intention required to trade it properly. And you paid the same amount.
I've always thought that it would be a good idea to have some kind of a variable pricing scheme in place that you pay truly for what effort that the individual was executing on your behalf was the effort they were putting into it. I'm not sure we're ever going to get there, but I think it would be a good idea.

STEVE FORBES: Why hasn't that happened? I mean, one can understand with something like in banking, with FDIC, political pressures go against charging banks different rates depending on the risk pool they have. But you guys aren't part of the government yet. Why hasn't that come into pass yet?

BERNIE MCSHERRY: I think nobody's really had the gumption to step forward with that plan. And if you tried to charge more for those difficult trades, I suspect the customers would just go to the folks who are charging less for them until they were out of the water. So I suppose the market is telling us that you probably should price them the same way. But from my point of view, it seems there's different effort put into different types of trades, and they probably should be priced differently.

STEVE FORBES: Sounds like airlines and fares.

BERNIE MCSHERRY: Yes, a little bit like that.

[09:57] Uptick Rule

STEVE FORBES: What's your feeling about the uptick rule? Should there be restoration of a variation of it?

BERNIE MCSHERRY: Yes, I think there should be. In a minimum increment of a penny that we're trading in, it's difficult to see how effective it's going to be. And I know academic study after academic study says that the plus-tick rule has no effect and it really should not be in place. But I've been in the business so long and seen so many people get swept up with emotion that I think that some kind of a safeguard like that is necessary.
You know, when I was a broker on the floor, I was a governor of the exchange for a while. And we would be very reluctant to halt trading in bank stocks and brokerage stocks. And when we reopened them, if we were going to reopen them more than three points from the prior last sale, we'd have to get permission from the CEO of the stock exchange. It was a big deal.
Back in the autumn I watched some bank stocks go down 30 or 40 points in 20 minutes and then go back up 20 points right after that. And I don't think that volatility serves anyone well. I think a workable plus-tick rule with perhaps some sort of a circuit broker built into it may be the way to go. But I think something is necessary, yes.

STEVE FORBES: Yes, I mean, even though we got rid of the eights and that kind of a system, there ought to be a way to get an uptick rule.

BERNIE MCSHERRY: Yes, I think a circuit broker sounds like the best way to go.

STEVE FORBES: Yes. What about enforcing rules against naked short selling, especially with the ETFs? Where are the police on that one?

BERNIE MCSHERRY: Yes. You know, I've been reading lately and experience on the floor tells us that people are doing less of it. So I guess the cops are on the job and they're paying attention. But we certainly were suspicious of a lot of activity that we saw in stocks that appeared to be fairly thinly traded. People seemed to be able to get their hand on a lot of stocks and short it and knock it down. You know, we have to get that stuff out of there. We have to get manipulative selling out of the marketplace. Hopefully we're taking some steps towards that.

[11:40] Crash of '87

STEVE FORBES: Have you ever seen things this bad? Have you ever seen anything in the 30 years that matches what we've seen over the last few months?

BERNIE MCSHERRY: The day after the crash of 1987 was probably the worst I've seen. The market opened up that morning and rallied fairly well. And it began to falter about 11:00, maybe 12:00, and then began to plunge. The

specialists were all out of money. They were tapped out and it looked like the place was going to break down.
The Fed flooded the market with money, made loans and gave liquidity to all the specialists. And that was a bad time. And I'd say the days following the failure of Lehman Brothers were right up there with that sort of a feeling. It was scary. I don't think the public really understands just how close we were to the system actually breaking. We were within a couple of days of it, in my opinion.

STEVE FORBES: Yes, sort of a true version of cardiac arrest of the financial system.

BERNIE MCSHERRY: Yes. On a very high level.

[12:31] Green Shoots

STEVE FORBES: Yes. How do you see things unfolding now? You usually keep an optimistic demeanor or try to keep some perspective amid all the hand wringing.

BERNIE MCSHERRY: You know, in terms of market levels, I'm trying to be tempered in my optimism. I've been relatively bearish the last couple of months. But in recent weeks, it's the cliché of the month, but green shoots are everywhere. And the market is seeing signs of recovery. I think we've rallied quite a bit recently. And I'm not so sure I'd jump in with both feet right now because I think we've seen a good chunk of what we're going to get for a while. And there may be a little bit of a pullback that's out there and we can all get a buying opportunity.

STEVE FORBES: So you don't see this as a sucker's rally or a bear market rally? This could be the beginnings of something real?

BERNIE MCSHERRY: I hope so. I was going with the bear market rally until a couple of weeks ago. And I've seen some bad news that's come into the market. And the market just keeps shrugging it off. We've had some terrible GDP numbers. We've had some real scares out there that nobody seems to care about. They keep coming back to buy. So that tells me we might be in for something a little more substantial.

STEVE FORBES: Yes, there does seem to be buying power unlike a few months ago where you might get an uptick and then, boom, just nobody came into buy when the things started to fall again.

BERNIE MCSHERRY: Yes, I think some investors are coming back into the market. We've had a traders' market for a lot of months now. But most of the investors, most of the folks were scared out of the market and they've gone to

cash. So what we saw for a long time there were people just buying and then selling out quickly, and we had a lot of volatility.
I think that some of that cash is moving back into the game. There are a lot of hedge funds out there who have to justify their existence. And if they sit on cash for too long, they've already missed 15 or 20 percent. So they want to get back into it. And I think we're starting to see that sense of urgency come back.

[14:13] Risky Business

STEVE FORBES: And what do you think the market in the last few months has taught us about risk? And how can we be prepared to do it better in the future? What do you see unfolding?

BERNIE MCSHERRY: Boy, that's a tough one. I think it's the nature of markets. We're going to have this sort of thing every now and then, you know? We used to think about specialists and the needs for them. The specialists, for instance, they're very profitable during good times. So people took away a lot of their profitability. But there were two or three days every decade that you wish you had them around to help cushion some of the blows.
And we saw a lack of that in this last go-around. And I think perhaps a way of slowing down the market a little bit at crucial times to allow some of the emotion to dissipate would be a good idea. But people have certainly learned some lessons about hedging. And they've certainly learned about buying assets that they really don't understand.

STEVE FORBES: Right. So what do you think is the one big misplaced assumption left today?

BERNIE MCSHERRY: Misplaced assumption? Well, I think it's one that is perhaps in the past. A few weeks earlier we were talking about it was the end of the world. Everybody went with the idea that this was never going to be fixed. I think a lot of folks who were responsible in their own lives, who were not in trouble financially personally pulled back, put their wallets away and said, "I'm not going to spend anything because this is a terrible time."
I think we're starting to see that perhaps the world has not come to an end. And people are out there buying that barbecue grill or that new spring outfit they wanted. And I'm seeing a little life come back in the market. So maybe that's it.

[15:40] Stay Liquid

STEVE FORBES: Over the 30 years, what is the best financial lessen you've learned? Or maybe it was before you went on the floor.

BERNIE MCSHERRY: The best lesson I've learned is to stay liquid and stay in cash. Well, not necessarily cash but stay out of debt. I've known a lot of folks in this business, who, as they did better, they bought the bigger house, they took on a lot of debt. They leveraged themselves up. Kind of what we've seen in the general economy.

STEVE FORBES: Right.

BERNIE MCSHERRY: And I learned that lesson early on that things can turn quickly against you. And it's best to keep those debt levels to manageable levels.

STEVE FORBES: Yes, there is a morning after.

BERNIE MCSHERRY: Absolutely.

STEVE FORBES: What's your bold prediction for the future?

BERNIE MCSHERRY: I think we're going to see a bit of a mild rally. I think the market could be up around the 8,600, 8,700 level towards the end of the year in terms of the Dow. But there could be some bumps between now and then. And I would look for those bumps as buying opportunities.

STEVE FORBES: Bernie, thank you very much.

BERNIE MCSHERRY: Thank you. Pleasure to be here.