



AKROS CAPITAL, LLC

A Speculative Frenzy in Worthless Stocks

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"Management continues to remind investors of its strong belief that there will be no value for the common stockholders in the bankruptcy liquidation process, even under the most optimistic of scenarios. Stockholders of a company in Chapter 11 generally receive value only if all claims of the company's secured and unsecured creditors are fully satisfied. In this case, management strongly believes all such claims will not be fully satisfied, leading to its conclusion that the common stock will have no value."

– *Motors Liquidation Company ("old" General Motors Corporation)*

Stocks of worthless companies have been some of the best performers during the past month. Trading activity in these stocks has soared during the summer even as overall market volume has languished. Such extreme speculation is more characteristic of bull-market peaks than of favorable times to invest.

When General Motors Corporation filed for Chapter 11 bankruptcy protection on June 1st, its stock hit an intra-day low of 27 cents per share. That was still 27 cents more than the stock is currently worth according to the official company statement.



Chart courtesy of StockCharts.com

Because GM has emerged from bankruptcy, old GM now functions as a temporary shell for discarded assets to be sold off for the benefit of creditors. Its stock certificates have value only as museum curiosities.

Despite multiple public warnings and a ticker-symbol change from GMGMQ to MTLQQ.PK, old-GM stock closed Friday at 83 cents per share – up 124% from an intra-day low of 37 cents a month earlier and up 159% from its July 17th post-bankruptcy low of 32 cents. Although its miniscule stock price translates into less money changing hands, the 69 million old-GM shares traded on August 12th equal Microsoft's largest single-day volume for August and are more than double Wal-Mart's.

Fannie Mae

Fannie Mae lost \$15.2 billion last quarter, or \$2.67 per share. Like its sibling, Freddie Mac, Fannie owes the U.S. government about \$50 billion and has no significant capital of its own. Both enterprises are being kept on life support under federal conservatorship through ongoing government infusions of cash. Mounting losses and massive indebtedness to the government ensure that Fannie Mae's stock will remain worthless. Nevertheless, it has attracted frenzied activity recently as the next chart shows.



AIG

Last but not least is AIG. Like those previously mentioned, AIG is an otherwise-failed company that has been propped up by the government. As such, its stock is unlikely ever to have value. The Treasury and the Federal Reserve have pumped about \$175 billion into AIG so far, including an \$80 billion loan. An additional \$28 billion in TARP money remains available.

Even under a scenario that assumes an immediate return to previous levels of profitability, it could take AIG at least a decade to pay back the government. A more likely outcome is that the company eventually will be sold off in pieces. Even so, the 20% of AIG stock not already owned by the government has become a playground for speculators.



From an intra-day low of \$8.22 per share on July 10th, AIG has increased more than six fold to close at \$50.23 on Friday. Volume reached 148 million shares last Thursday – more than double Microsoft’s highest single-day volume for August and more than four times that of Wal-Mart.

Indications of a Frothy Market

While these are extreme examples, they serve to illustrate the high level of emotion that has begun to permeate the stock market in recent months. A certain amount of the activity in old GM may be attributable to ignorance, but impulsive actions based on ignorance are a form of speculation nonetheless.

Some investors apparently believe investing in government-run enterprises is a no-lose proposition in the bailout era. Short covering also has contributed to the strong moves in these stocks. Still, the primary factor at work here appears to be that the sudden spikes upward have attracted attention and fed upon themselves. Traders are jumping in without regard to fundamentals, perhaps in an attempt to recoup their bear-market losses quickly, or merely so as not to “miss out” on the gains being enjoyed by others. It is precisely this type of speculation that allows market tops to form as emotion inevitably wanes and reality begins to take root. Until then, speculation can continue to carry the market higher.

The Picture

After moving to higher ground the week before, the S&P 500 Index settled into a trading range last week between 1,016 and 1,040. Those short-term support and resistance levels are highlighted in the chart on the next page. Additional support should come in near 1,013, while the October 2008 high at 1,044 may provide further short-term resistance.

The index now has successfully cleared the resistance levels of 1,008 and 1,014, which respectively represent 3/8 and 38.2% retracements of the total decline sustained during the bear campaign. At this point one typically might expect to see a correction. In a secular bull market such a correction would represent an excellent opportunity to establish long-term investment positions. However, that is not the current circumstance.

Supporting the possibility of a correction is the failure of RSI and MACD to confirm the most recent highs in the index. In a sign that momentum may be faltering, both indicators have begun tracing out negative divergences from the price chart. Another factor in the near-term outlook is the 180-day time window calculated from the March lows. This period runs from September 2nd to September 8th and represents a “standard” timing for the beginning of a correction. Though only a rule of thumb, it may play out in connection with the employment report scheduled for release this Friday, September 4th.

That said, with seemingly the entire world now hoping for a correction, a standard outcome appears unlikely. A possible contrarian scenario might include a corrective move down followed by a weak move up to at best a marginal new high. With speculation increasing and complacency about the economy setting in, such a conclusion to the current cyclical bull campaign cannot be ruled out.



Chart courtesy of StockCharts.com

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