loans are used for. That's the job of the borrowers' primary regulators. In addition, if a bank with an FHLB advance goes under, the FHLB is at the head of the line to get repaid, so it has little reason to lend cautiously. And in a potential conflict of interest, the FHLBs are lending to their owners—the member banks. The result: Bountiful funding from the FHLBs could allow some banks to "gamble for salvation," getting into even deeper trouble.

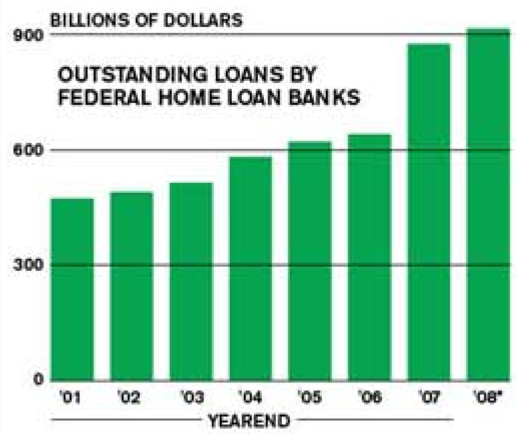
OVERSIGHT

True, the home loan banks don't go unscrutinized. Following a July 29 reorganization, they are regulated by the new Federal Housing Finance Agency, which also oversees Fannie and Freddie. Administrator James B. Lockhart III told *BusinessWeek* in an interview that the home loan banks are working effectively with the Federal Deposit Insurance Corp. and other regulators to make sure that financial institutions have access to funds. "They have provided a tremendous service to the banking industry and therefore probably to the banking regulators," says Lockhart. In addition, the home loan banks say they have an incentive to make loans that will be repaid. "The idea that we would lend recklessly just doesn't make good sense," says Alfred A. DelliBovi, president of the Federal Home Loan Bank of New York.

Still, concerns about the federal home loan banks' role grew after the July 11 failure of IndyMac Bancorp. The FDIC predicts it will cost $9 billion to work out, making it the costliest takeover in the agency's history. The bank's finances were so plainly precarious that, by the end, depositors were pulling out their money in droves.

Yet IndyMac increased its borrowings from the Federal Home Loan Bank of San Francisco more than 500% from the end of 2004 through early 2008. At the time it folded, loans of $10 billion from the San Francisco bank accounted for nearly a third of IndyMac's liabilities. Amy Stewart, a spokeswoman for the home loan bank, declined to comment on why it helped keep IndyMac afloat but said that, generally speaking, it doesn't like to pull the plug on borrowers. "It is not our role to cause a liquidity problem for a member institution," she said.

A GROWING FORCE



Data: Federal Home Loan Banks *As of June 30

The IndyMac failure came on the heels of the near-collapse of the nation's biggest mortgage lender, Countrywide Financial, which had borrowed even more heavily. As Countrywide spiraled downward in 2007, CEO Angelo Mozilo arranged for its banking unit to borrow $51 billion from the Federal Home Loan Bank of Atlanta. Senator Charles E. Schumer (D-N.Y.) charged that Countrywide was using the Atlanta lender as its "personal ATM." Bank of America acquired Countrywide this past summer, assuming all of its liabilities.

The problem for taxpayers is that if a bank that has borrowed from an FHLB fails, the home loan bank gets fully repaid, even if the collateral it holds proves insufficient. That raises the cost for the FDIC, which has to protect depositors by reaching deeper into its insurance fund—and, if necessary, tapping the Treasury.

Concerned that her agency is getting squeezed, FDIC Chairman Sheila C. Bair has taken shots at the home loan bank system recently. In an interview for an in-depth analysis in the November issue of *Bloomberg Markets* magazine, she said: "We really get a double whammy," adding that the agency has "a beef with excessive reliance on Federal Home Loan Bank advances." The FDIC is proposing to increase its premiums for deposit insurance on banks that rely more than average on home loan bank advances and on brokered deposits—another big source of concern. (Brokered deposits come from wealthier customers who parcel out their money among many banks so they can qualify for FDIC insurance on the entire amount.)

Several economists share Bair's worries. "My concern is that there is not enough oversight by the [FHLBs] of the risk that the commercial banks take when they use advances," says Timothy J. Yeager, a former economist at the Federal Reserve Bank of St. Louis who is now a finance professor at the University of Arkansas Sam M. Walton College of Business.

In theory, home loan bank advances needn't be destabilizing. Home loan banks should open and close their funding spigots in consultation with the borrowing banks' primary regulators, such as the FDIC or the Office of Thrift Supervision. Some of that may be happening: Advances that appear unwise could have been made at the request of a regulator that wants to tide a bank over a rough spot or ease it gently into receivership.

Still, the credit bubble was all about bad loans overlooked by bankers and regulators. In the rush to revive the U.S. economy, it's important to watch out for the FHLBs funding banks that really shouldn't get the money. |BW|

CHART BY LAUREL DAUNIS-ALLEN/BW

The Banks Mount A Charm Offensive

They're working overtime to soothe customers, hang on to deposits—and justify higher loan rates

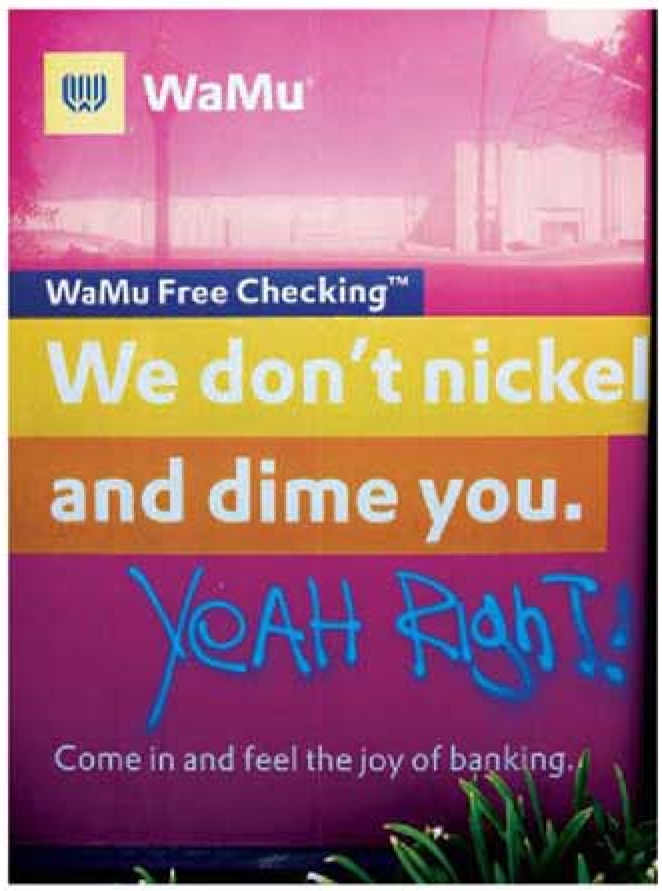
By Burt Helm

Since the financial crisis erupted, U.S. banks have been notably eager to reassure their customers. You can see it in their advertising, which typically features a variation of: Trust us. Your money is safe.

Behind the scenes, harried spin doctors are enlisting tellers, call-center jockeys, and loan officers in a massive charm offensive. The goal: to persuade people not to yank their cash and stuff it under the mattress. "We need to be sensitive to what's going on with people," says Tom Kelly, a communications manager at JPMorgan Chase.

Kelly, who says he has been working 13-hour days, describes a "neck-snapping pace." The going got especially hectic on Sept. 25, when JPMorgan agreed to buy Washington Mutual. Kelly knew WaMu branches and call centers on the West Coast were still open. He mass-e-mailed employees a script bewildered WaMu staff could use to soothe the customers.

In the days and weeks following the September meltdown, banks from WaMu to Bank of America all have been inundated with calls and branch visits. "There are more [types of] questions asked every day—questions that a year ago wouldn't have been thought of by our customers," says Debra DeCourcy, corporate communications chief with Fifth Third Bancorp. They have ranged from the basic ("Is my money safe?") to the sophisticated ("Are you well-capitalized?").



Grafitti on the entrance of a Washington Mutual branch in Los Angeles

HECTOR MATA/AP PHOTO

Banks have been quick to remind lower- and middle-income customers that the Federal Deposit Insurance Corp. guarantees savings and checking accounts up to $250,000. "Did you know that no depositor has ever lost a single penny in FDIC-insured funds?" goes a script written by Maritz, a customer-relations firm that works with several big banks. As for folks with heftier balances, the banks have been calling in the heavy artillery. BofA's Global Wealth & Investment Management division, for example, hosted 2,500 monied clients on a conference call with in-house economists and strategists who provided an assessment of market volatility and an educated guess on where the economy is headed.

Banks will soon face a quandary: How to start making money again without turning off recession-strapped customers

Every day seems to bring more disturbing economic and financial news—grist for anxious Americans to feed on. So banks are boosting efforts to ensure employees are up on current events and know what to say about them. BofA, for example, has added to its intranet site "Media Buzz," a collection of news stories customers may have read, as well as "Bank Watch," which flashes news of key developments in the financial-services industry accompanied by suggested talking points. When PNC Financial Services said it was buying National City on Oct. 24, BofA sent around a script aimed at customers who also had business with National City. The gist: Their deposits would be safe with PNC—but wouldn't they prefer to move their money to BofA, a bank with which they were already familiar?

In the coming months banks increasingly will face a central quandary: how to start making money again without turning off recession-swamped customers. Maritz has concocted soothing repartee aimed at folks who call to gripe about, say, a suddenly higher loan rate. The script essentially aims to achieve two things: placate Joe or Jane Borrower—and then sell him or her a new product. Sample question: "Why did you drop my home-equity-loan credit limit from $50,000 to $25,000?" The answer in essence: This is to protect you. If you need to sell your home, you won't be stuck owing more than it is worth. Oh, and by the way: Can I interest you in our rewards card? | BW |

Web 2.0 Startups: Who Will Survive?

Reid Hoffman on strategies for the downturn and why his LinkedIn will prosper

By Stephen Baker in Mountain View, Calif.

"Pull up a chair." Reid Hoffman waves a big arm toward his computer. It's not easy to maneuver in this office strewn with books, wires, and empty Amazon.com boxes. Hoffman, wearing sneakers and black shorts from a morning workout, opens up his page on LinkedIn, the social network for professionals that he founded six years ago. His in-box is jammed with solicitations for meetings and funding. He looks at one proposal from Minnesota and shakes his head: "Looks like it's based on bad math."

Hoffman cuts an unusual figure in Silicon Valley. He's a Californian with a philosophy degree from the University of Oxford, and his oversized body looks more heartland than coastal. But his brain is in sync with the Valley. In addition to founding LinkedIn, he has become in the past six years the leading angel investor in the so-called Web 2.0, the wave of Internet companies spawned this decade. With stakes in dozens of startups, including news aggregator Digg, blog software developer Six Apart, and the social network companies Facebook and Ning, Hoffman was widely envied during the boom.

Now he must navigate the downturn. As the economy dives and the market for public offerings dries up, venture firms are cutting off funding for startups and forcing their portfolio companies to slash costs and race for revenue. The DeadPool, a fixture from the dot-com crash in 2001, has reappeared on the TechCrunch blog, detailing firings, closures, and busted financing. In this unforgiving climate, Hoffman is putting in long hours, hammering out survival strategies, and scrounging for savings and revenue. "Without Reid, [many] entrepreneurs are left with limited options," says Peter Fenton, a partner at Benchmark Capital.

Hoffman won't discuss specific plans for companies he has stakes in, but he's free with his views on the industry overall. Internet companies with a service up and running and millions of users should fare O.K., though the likely ad recession may force them to make painful adjustments. This could apply to Facebook and, to a smaller degree, LinkedIn (which relies less on advertising). Early-stage startups face grimmer choices. Those lucky enough to attract investors, he says, should be ready to part with lots of equity—or sell out altogether. These days, survival trumps the prospect of a jumbo payday. "You want to stay in the game," says Hoffman.

NETWORKING IN HARD TIMES

Many Net startups won't make it. Outside Hoffman's orbit, outfits such as news site Thoof and music site Social.FM are shutting down. And Hoffman's brood is hardly immune. Seesmic, a Web video company, laid off 7 of its 21 employees in October. Hoffman sees more pain ahead. "You have to remember that in startups, most end up as corpses," he says.

But LinkedIn, he argues, may be a recession play. In tough times more workers shed the illusion that they're safe inside companies. "Essentially," Hoffman says, "every individual is a small business." He predicts that more workers will be networking outside

Web startup veteran Hoffman: "Every individual is a small business"

DAVE GETZSCHMAN

their companies—and using LinkedIn.

Hoffman sees his own network as the key to his influence. It extends from his associates at Oxford to partners at venture firms Sequoia and Benchmark Capital. These connections amount to what Hoffman calls his ecosystem. And he manages it on the same LinkedIn page he is furiously navigating. In essence, he built a tool to manage his life.

The question is whether the fast-growing LinkedIn can become as valuable for businesspeople worldwide as it is for Hoffman. With 30 million members, LinkedIn is no match in scale for giants MySpace.com and Facebook, each with more than 120 million members. But LinkedIn execs argue the company, currently profitable, should suffer less than the bigger social networks in any advertising downturn. Ads account for only 30% of its revenues, which are expected to hit \$75 million to \$100 million this year. Another 30% of revenue comes from corporate recruiting services, while the rest comes from premium subscriptions, which help users establish contacts and be located.

Hoffman trusts that survival instincts will lead professionals to nurture their networks—and pay for subscriptions. At the same time, Hoffman's team has convinced investors that the information pouring through LinkedIn will amount to a new "social" form of media.

On Oct. 22, Goldman Sachs, German software giant SAP, and The McGraw-Hill Companies, the parent of *BusinessWeek*, invested \$22.7 million in LinkedIn. (LinkedIn is also a technology partner in *BusinessWeek*'s new topic network, Business Exchange.) The new money, along with a \$53 million venture round last summer, gives LinkedIn a sizable stash as it heads into the downturn. These investments value the company at a bit more than \$1 billion. Hoffman's goal is for LinkedIn to be "a major Web company" with a market value above \$4 billion.

To guide LinkedIn, Hoffman and the board hired the veteran software executive Dan Nye last year. Hoffman, who admits to a chaotic management style, stayed on as board chairman and director of product development. Part of his CEO job, Nye says, is "wrestling to get the thinking out of Reid's head, package it, and get it to the other people."

It was at the bleakest stage of the dot-com bust, in 2002, that Hoffman began to build his empire. He had been a key partner at PayPal, the online payment company eBay bought that June for \$1.5 billion. Flush with his share, he looked for next-generation investments—and found himself nearly alone. "The common wisdom was that the consumer Net was dead," he recalls. "I thought it was just beginning."

So he devised a strategy. He would start a company to run the business side of the social Net—LinkedIn—and would join the consumer side as an investor. Even facing the downturn, he touts the economics of Internet businesses. "This is the only time in human history when, for somewhere between \$5 and \$30 million of capital investment, you can create a sustainable ecosystem for 10 million-plus people," he says.

When discussing his career, Hoffman can sound positively utopian. He regards LinkedIn as a system where the good are rewarded by the community for their deeds, while liars and cheaters are exposed.

Despite lofty visions, his advice to entrepreneurs is hard-boiled pragmatism. Hoffman urges them to focus first on financing—and only later to hone a product or service. It's financing, not products, that keeps them alive, he argues. And in a Silicon Valley now chronicled by the Dead Pool, survival is the game's new name. | BW |

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

The PayPal Mafia

Hoffman is one of many PayPal alumni who play big roles in the Valley. Jeffrey O'Brien wrote about the PayPal Mafia in the Nov. 26, 2007 *Fortune*.

To read O'Brien's blog, go to http://bx.businessweek.com/Web-20/reference

MATT HUYNH

A New Cautionary Tale For Investors in Russia

Mysterious litigation has targeted companies linked to the high-profile investment bank Renaissance

By Jason Bush

Mysterious lawsuits targeting prominent financial institutions could become the latest worry for foreign investors in Russia.

Earlier this year, Hermitage Capital Management, an investment fund managed by British bank HSBC, claimed that three of its subsidiaries had been besieged by Russian fraud artists. Hermitage alleged in public statements that a series of bogus suits, based on fake contracts to sell shares, had been filed against the units as part of a scheme to seize ownership of the subsidiaries and reclaim $230 million in taxes previously paid by Hermitage to the Russian government. Russian authorities are investigating these allegations.

Now, an apparently similar round of suits has come to light. These concern two units created by another financial giant: Renaissance Capital, the largest Russian investment bank and one of the most active sellers of Russian securities to Western investors.

The units in question, Financial Investments and Selen Securities, were formerly subsidiaries of Rengaz Holdings, a fund created by Renaissance Capital in 2004 to enable foreign investors to buy shares in Gazprom, the country's largest company. At the time, Russia prevented foreign investors from directly purchasing Gazprom shares traded in Russia. But funds such as Rengaz enabled investors to own shares in the energy company indirectly. Rengaz, via holding companies, owned Financial Investments and Selen Securities, which traded Gazprom shares.

RULE CHANGE

In January 2006 the Russian government lifted restrictions on foreign ownership of Gazprom shares, making vehicles such as Rengaz superfluous. The same month, Rengaz's Russian subsidiaries sold their shares in Gazprom, and Renaissance sold the subsidiaries. Simon Moyse, Renaissance's spokesman, says the companies "were sold as shell companies to individuals for purposes of liquidation."

But before they were liquidated, the two subsidiaries were involved in some perplexing activities. Russian court documents show that within weeks of being sold by Renaissance, the two units became the targets of a series of lawsuits. Filed in March and April 2006, the suits alleged that the two Renaissance-linked units had violated contracts to sell shares worth hundreds of millions of dollars. Renaissance's Moyse says the investment bank had no knowledge of these suits until *BusinessWeek* brought them to its attention—nor of any allegedly broken contracts.

In April 2006, just a month after the suits were filed, Selen Securities was ordered by the Moscow Higher Arbitration Court to pay $94 million in damages in a suit brought by a little-known company called Prior. (The court ordered the remedy to be paid to Prior's "legal successor," Megasel.) The same month the Arbitration Court of the Republic of Tatarstan, in the city of Kazan, some 500 miles east of Moscow, ordered Financial Investments to pay $372 million to yet another obscure company called Poleta.

Despite the substantial size of the claims, the two ex-Renaissance units made no attempt to contest the suits, instead conceding without a fight, court records indicate. And that, according to lawyers in Moscow uninvolved in the litigation, is astonishing by itself and could suggest collusion among the parties. "To not contest an amount like that seems unusual to me. That's a lot of cash," says Scott Antel, a partner in the Moscow office of international law firm DLA Piper.

A further mystery concerns the contracts that were the subject of the suits. According to Renaissance, the only purpose of the two subsidiaries was to buy and sell shares in Gazprom. But according to court documents, the units admitted breaching contracts to sell shares in companies unrelated to Gazprom: the Russian bank Sberbank and electricity company UES.

Despite the size of the claims, the ex-Renaissance units did not contest them, a fact that observers find astonishing

The court cases may be linked to yet another puzzle. The consolidated financial accounts for Rengaz Holdings, the former parent company of the two units, show that the subsidiaries owed $108.1 million in taxes on profits in 2006. This is the figure provided to investors, representing what was paid in taxes on their behalf. Renaissance's Moyse says this amount was paid in full before Renaissance sold the companies for liquidation.

Yet according to the financial accounts of the two subsidiaries themselves, provided to *BusinessWeek* by Rosstat, the Russian government's statistical arm, Financial Investments and Selen reported a total of just $1.2 million in taxes in 2006. So what happened to the other $106.9 million, the difference between the taxes Renaissance says it paid on behalf of investors and the taxes that the two units reported to the government? Renaissance's spokesman says he doesn't know the reason for the discrepancy.

Outside lawyers uninvolved in the situation say a possible explanation is that Selen Securities and Financial Investments subsequently claimed a refund from the tax authorities, using the questionable court judgments to lower their profit numbers—and their final tax bill. *BusinessWeek* couldn't corroborate this theory because the units no longer exist; public records led to dead ends.

A CURIOUS CASE

What's clear is that in 2006 the two units reported to the Russian government that they had $430 million in unspecified "other expenses." That amount is close in size to the legal damages awarded by the two courts. It also nearly matches the total profits that the two companies made from selling Gazprom shares.

Investors in Rengaz expressed bafflement over the situation. Stephen Barber, head of global marketing for Pictet Asset Management, says the firm's Eastern European Trust invested in Rengaz. "But if an investment bank were to approach us with a similar scheme in the future, I think we might say: 'No, thank you.'" He adds that any potential risks stemming from the curious litigation wouldn't affect Pictet's investors.

The companies that filed suit against the former Rengaz units are elusive. According to Russian records, Poleta was founded in October 2005, just five months before it filed for damages against Financial Investments. Accounts provided by Rosstat show that Poleta reported unspecified "other income" of $330 million in 2006—and almost identical costs. As a result, it paid a total of just 1,000 rubles, or $37, in taxes.

When *BusinessWeek* attempted to contact Poleta, using a Moscow phone number provided in the company's registration records, the person who answered said the number belonged to a private apartment. She denied any knowledge of Poleta.

Another head-scratcher: State documents show that the last owner of Selen has the same name as the owner of Prior, the company that originally filed suit against Selen. |BW|

Business Exchange

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Russian Cyberfraud

The Washington Post's Security Fix blog reported last month on Russian Business Network, which the newspaper described as based in St. Petersburg and providing Web-hosting services for "cybercriminals." Groups operating by means of Russian Business Network's computers are thought to be responsible for ID-theft scams in which cybercrooks use e-mail to lure people into entering personal and financial data at fake commerce and banking sites, the *Post* reported.

To read the Security Fix item, go to **http://bx.businessweek.com/russian-business**

Put Your Party Hat In a Desk Drawer

Lavish is out as companies learn to make do with less at meetings, parties, and off-sites

By Jena McGregor

In early November, Deloitte's tax and consulting partners were due to meet at the Walt Disney World Swan & Dolphin Resort in Orlando, followed by a Deloitte retiree gathering. But Deloitte decided to cancel both events in mid-September and host Web conferences instead. "We just don't want to be holding a big event in the bad economy," says Deloitte director Margaret Moynihan.

With corporate spending under intense scrutiny, managers are cutting back on gatherings and axing everything from hors d'oeuvres to high-priced speakers at those that remain. Even some incentive trips to reward top performers are getting dropped: Wachovia canceled a Greek cruise for 75 financial advisers and their spouses in October. (Wachovia and Deloitte say the moves were to keep advisers close to clients amid the turmoil.) Executives are conscious of the bleak outlook for 2009, not to mention public outrage over American International Group's luxury retreats after a massive government bailout. AIG has since cut 160 conferences and other events costing a total of more than $8 million. "Some companies are holding firm. Most are not," says Gary Seltzer, a founding partner of New York event production company Concentric Communications.

While the squeeze is prompting anxiety in the more than

$120 billion-a-year U.S. meetings industry—trade group Meeting Professionals International issued a "call to action" entitled "Saving the Economy Through Meetings"—it's also spurring companies to seek creative ways to cut costs without calling off scheduled events outright. Many have little choice, because they would face up to hundreds of thousands in cancellation fees. "The big shakeout on this will probably be in this coming calendar year," says Maritz Travel Vice-President Chris Gaia. That said, companies still need to reward top performers, bring global teams together, and network with customers. As Symantec's worldwide operations vice-president, John B. Sorci Jr., argues: "You lose something when you don't have those face to face meetings."

SHORTER GUEST LISTS

There are ways to hold events in a tough climate. Home Depot and Symantec are centralizing event planning and oversight to secure better deals. "Very few CFOs can say how much they're spending on meetings," says Hervé Sedky, general manager of global advisory services and meeting solutions for American Express. Others are holding smaller regional events within driving distance for attendees instead of one single national confab. That saves airfare and invites less scrutiny than one splashy event. Many are shortening trips, too. In August, Tennessee-based retail chain Tractor Supply saved $500,000 by trimming a day off its managers' meeting and limiting invites to store and district managers, leaving assistant-level supervisors off the list.

Off-site events such as board meetings and product launches are moving onto company property. Five years ago, when Ford Motor last introduced a redesigned truck, around 300 journalists converged at a private ranch in Texas to see it, leaving Ford with a tab of more than $2 million. When the automaker launched its F-Series pickup this October, it spent well under $1 million by hosting the event in Detroit and putting guests in a suburban hotel. Chief Marketing Executive James Farley makes no apologies: "This is a belt-tightening period, for sure." |BW|

–With Aili McConnon in New York and David Kiley in Detroit

CUTTING BACK THE CANAPÉS

With the economy in a tailspin, companies are trimming costs on meetings and events. Here's how:

GO LOCAL
To save on travel costs, some companies are planning multiple regional events rather than one big national confab.

MANAGE MEETINGS CENTRALLY
Adding companywide policies and technology can help score better deals with suppliers.

HOLD SHORTER EVENTS
Shaving just one night off a hotel stay, say some meeting planners, can bring costs down about 20%.

KOREN SHADMI

Yes, Virginia, There Is a Recession

With tight budgets and job jitters, kids are more apt to find tube socks than an Xbox under the tree

By Aili McConnon

For a glimpse of shopping trends this holiday season, consider Deborah Niemann-Boehle. The Joliet (Ill.) teacher says she "used to be one of those parents who spent $1,000 at Christmas and had presents sticking out from under the tree for a couple of feet in every direction." This year, instead of getting Xboxes or iPods, her three teens will receive clothes from Kohl's or J.C. Penney. She's crocheting hats and mittens and making goat milk soap for everyone else.

Last year in Boston, single mother Sonia Paz gave daughter Triana, 7, an electronic keyboard; this year it's turtlenecks and sweaters from Target. And Danville (Calif.) writer Leigh Chronister plans to buy her two young boys socks and underwear with their favorite cartoon characters.

Facing economic uncertainty, not to mention tighter credit, U.S. households are expected to scale back spending radically this year. As retailers brace for one of the slowest shopping seasons since the early 1990s, their focus has shifted to one area that promises to stay strong: kids' apparel. Chains such as Kohl's, J.C. Penney, and Macy's are gearing their advertising and in-store promotions toward children's clothing in a bid to garner what few discretionary dollars are being spent. Ellen Davis, a vice-president at the National Retail Federation, says that children's clothing may even outsell toys this year. "In previous years, that would have been a 'because you need it' purchase, not a gift," she says.

Kohl's, for one, has increased its marketing budget to stress gifts that play to hard times. It's running TV commercials featuring Cirque du Soleil dancers and promotions highlighting its new junior apparel lines. When people stretch their budgets, says Julie Gardner, chief marketing officer, "they take care of their kids first." Among the offerings: brightly colored Jumping Beans playwear for the under-seven set and the Abbey Dawn teen collection designed by singer Avril Levigne.

-4.5%

Expected change in U.S. department store sales this holiday, vs. last year

Data: TNS Retail Forward

NOSTALGIA

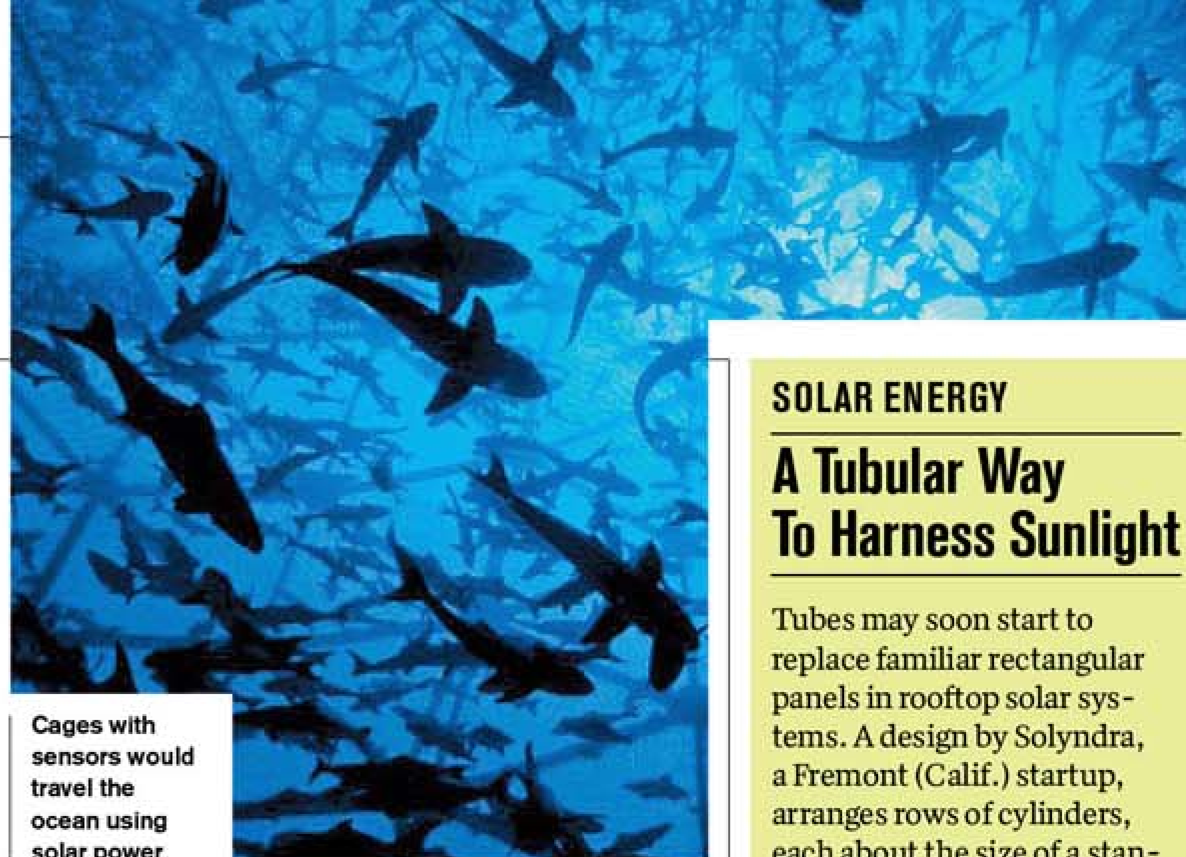
J.C. Penney is also betting big on youth clothing, with six new teen brands figuring heavily in holiday ads. "Even though the economy is tough, there will still be presents under the Christmas tree for children," says Penney spokesman Quinton Crenshaw, who plans to buy socks and a few basics for his nephews. "We believe that practical gifts will be very important for parents shopping for their children."

In tough times, it may also help to play up childhood whimsy. Macy's 2008 holiday campaign centers on eight-year-old Virginia O'Hanlon, who wrote to the *New York Sun* in 1897 to ask if Santa Claus was real. The company's "Believe" campaign features letter-writing stations and mailboxes for Santa in all of its stores. Macy's belief: Woo the kids and the parents will follow. Peter Sachse, Macy's chief marketing officer, says that themes of nostalgia and stability should resonate as "the consumer is looking around them and things are falling apart."

Then again, few want to see their children's smiles fall apart when deprived of toys on Christmas morning. Lauren Busch Singer, a Miami music producer and mother of two, says she wants to be practical but recognizes that "both of my boys would be making 'yucky' faces should they open up a 'Gap' box with sweaters." Then again, there's an even more prudent option. Tina Griffin of Lexington, S.C. will give her four children something that's sure to last longer than toys or clothes: U.S. savings bonds. |BW|

WESLEY BEDROSIAN

EDITED BY ADAM ASTON



Cages with sensors would travel the ocean using solar power

AQUACULTURE

Fish Farms That Roam the Sea

Floating fish farms are easier to tend when constructed in sheltered waters. But that means waste accumulates and breeds diseases, despite the motion of waves. So farmers tow the pens to new locations—thus burning fuel and creating more pollution.

Now, in waters off Puerto Rico, researchers from Massachusetts Institute of Technology working with Snapperfarm, a U.S. fish producer, are testing a self-propelled spherical fish cage made by Ocean Farm Technologies. About 20 yards wide, the fully submerged cage is designed to migrate from place to place using slow-moving propellers.

In the future, says Cliff Goudey, director of MIT's Offshore Aquaculture Engineering Center, the cages would be tied to floating platforms bearing lights, positional sensors, and monitoring gear—all powered by wave motion or solar cells. Such systems would be almost autonomous, though people would still have to replace the feed. Stocked with baby fish and launched from Panama, say, the farm would follow the Gulf Stream and show up months later near Miami when the fish are ready to harvest. Lockheed Martin may build remote management systems for such farms.

ELECTRIC CARS

Pull in, Plug in, Charge Up

Plug-in electric vehicles have an edge over hydrogen-powered cars for a simple reason: The infrastructure to support them, the electric grid, is already in place. At night, you just connect the car to an outlet in your garage.

Unless of course, you don't have a garage. Now, Coulomb Technologies of Campbell, Calif., wants to provide service to city-dwellers and other drivers who lack handy access to an outlet for their cars. It's testing a subscription-based network in San Jose called ChargePoint, whose members use special key fobs to access outlets mounted on lamp posts, parking meters, or in parking lots. The power isn't free. Subscribers must register a credit card when they sign up for the service. Then, when they swipe the key fob, their usage is metered and charged to the card.

Outlets are mounted on parking meters in San Jose

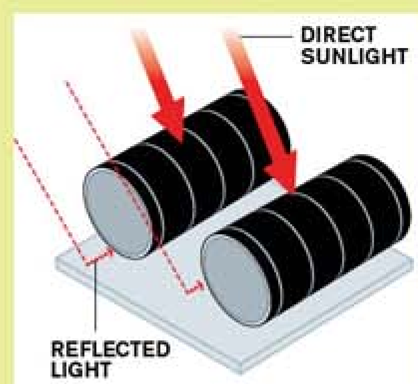
China is taking a different, top-down approach. It's starting to build a nationwide network of charging points to speed the adoption of electric vehicles. Electricité de France is working with carmakers on a similar idea. *–David Kiley*

SOLAR ENERGY

A Tubular Way To Harness Sunlight

Tubes may soon start to replace familiar rectangular panels in rooftop solar systems. A design by Solyndra, a Fremont (Calif.) startup, arranges rows of cylinders, each about the size of a standard fluorescent light. The approach promises to save money. With today's panel systems, each tile-shaped collector is anchored to custom racks—tilted to face the sun—which in turn are connected to the roof. That keeps them secure in high winds.

Solyndra's tubes don't require custom mountings, and gusts of wind pass right through without causing damage. Also, the tubes collect rays from every angle as the sun crosses the sky, and they even capture reflected light from below. Compared with heavier tiles, more of the lightweight tubes can fit on a roof, boosting output by 25%.



Solyndra's lower installation costs have attracted venture capital firms like Richard Branson's Virgin Green Fund and Madrone Capital, an investment arm of Wal-Mart's Walton family, which have pledged $600 million.

(BOTTOM, LEFT) PHOTOGRAPH BY KEVIN DIETSCH/UPI PHOTO; GRAPHIC BY DAVID FOSTER

After joining nikeplus.com, Seattle's Winters was inspired to run 50-mile races

This Social Network Is Up and Running

The Nike+ site draws hordes of runners, a success that may hold lessons for brand building on the Web

By Jay Greene

Nike is winning a new game that other corporations, from Coca-Cola to Verizon to General Motors, have tried unsuccessfully to play: building brand loyalty via online social networking.

In the two years since it launched Nike+, a technology that tracks data of every run and connects runners around the world at a Web site, nikeplus.com, Nike has built a legion of fans. In August, for instance, 800,000 runners logged on and signed up to run a 10K race sponsored by Nike simultaneously in 25 cities, from Chicago to São Paulo. Now the company is testing a social network to promote its basketball shoes.

How Nike+ benefits the company's bottom line is harder to gauge. Some analysts back up Nike's claims that the site is renewing the popularity of its running shoes. SportsOneSource, a Princeton (N.J.) market research firm, says Nike accounted for 48% of all running-shoe sales in the U.S in 2006. Today, its share is 61%. "A significant amount of the growth comes from Nike+," says Matt Powell, a SportsOneSource analyst.

SYNCHING WITH IPOD

But skeptics such as Sam Poser, a stock analyst at brokerage firm Sterne Agee & Leach in New York, say Nike+ attracts only serious runners, a drop in the bucket compared with its total customer base.

Overall, the use of social networks worldwide has grown 38% in the past year, according to market researcher comScore. But a recent McKinsey survey found that many companies struggle with Web 2.0 technology and that only 21% of the nearly 2,000 executives who responded were satisfied with the software available to launch blogs or create Facebook applications.

Nike's online strategy differs from those of other companies. Most have tried to create virtual communities through a build-it-and-they-will-come approach centered on a brand or specific product. Originally, the Beaverton (Ore.) company envisioned Nike+ simply as a clever way to combine music and running, not as a prototype for a new kind of marketing. "It was never about how can we convert some percentage of users [to buy Nike shoes]," says Stefan Olander, global director of Nike consumer connections.

The key to bringing runners onto the Web was the development in 2006 of a $29 Sport Kit sensor that, when synched with an iPod touch or nano, tracks runners' speed, mileage, and calories burned. When those run-

JOHN KEATLEY

ners dock their iPods, nikeplus.com launches, and the run data get uploaded. More important, the site is a virtual gathering place. Runners have collectively logged 93 million miles on nikeplus.com.

So far Nike has sold 1.3 million Nike+ iPod Sport Kits, according to SportsOneSource, and 500,000 Nike+ SportBands (at $59 apiece), wristwatch-like devices for runners who don't want to listen to music. While sales from these products total $56 million, that's just a rounding error at a company that posted $18.63 billion in sales in fiscal 2008.


Nike's Olander at first didn't foresee the marketing power of Nike+

LEE EMMERT

Robyn Winters, an assistant manager of a North Face store in Seattle, picked up a Nike+ kit and sneakers in 2006. Winters, 28, who had already run a half-marathon, credits Nike+ with boosting her enthusiasm for running and for Nike, too.

On nikeplus.com, she's part of a group of 90 runners who challenge each other to go faster and farther. Since first logging on, Winters has run two 50-kilometer races and one 50-mile race, and she plans to run two more 50-milers before yearend. This October, she bought a new pair of Nike shoes and two backpacks with Nike's Human Race logo on them—one for herself, the other for her husband.

Nike now hopes to score with another group of jocks: basketballers. The company is beta-testing Ballers Network, a Facebook application that lets players organize real-world games and manage their teams online.

Rivals are joining the race. Next year, adidas intends to introduce in the U.S. a sensor called miCoach that allows runners to upload heart rate and running data to a Web site via mobile phone. But an American miCoach will have a long way to go to catch up with Nike+. About 93 million miles, in fact. |BW|

FINANCE

Nonprofits Feel the Debt Squeeze, Too

Schools and hospitals that paid for projects with easy credit struggle to make interest payments

By Peter Carbonara

Stevenson University President Kevin J. Manning recently got bad news from the college's financial adviser at Bank of America. The suburban Maryland school, which had sold $122 million worth of bonds chiefly to pay for a second campus and new dormitories, had set aside $8.5 million to cover its interest payments. But the banker warned that if the turbulence in the credit markets continued, that tab could rise to $10.2 million—a big bite for a school with an annual budget of $85 million. "It's shocking," says Manning.

Encouraged by low interest rates in recent years, schools, hospitals, and other nonprofits aggressively tapped the debt markets to pay for buildings, equipment, and services. Many, like Stevenson, sold variable-rate demand notes, a type of bond tied to short-term interest rates. When Lehman Brothers collapsed in mid-September and panic swept the markets, the rates on those bonds quadrupled, jacking up nonprofits' monthly interest payments. Rates have eased in recent weeks, but they still remain much higher than normal. Now many institutions face the dual threats of bigger-than-expected bills on their debt and a weak financial environment that makes it hard to make up the funding gap by raising money from donors or raiding their endowments.

For some, those variable-rate demand notes were supposed to be a safe haven. Chicago's Swedish Covenant Hospital was among the many nonprofits that raised money by selling auction rate securities, bonds whose rates are set at periodic auctions.

University President Manning: A budget squeezed by interest costs

STEPHEN VOSS

Spooked by the subprime crisis, investors failed to show up for the auctions earlier this year, and the market collapsed. As a result, Swedish Covenant's interest costs jumped from $600,000 a month to $950,000.

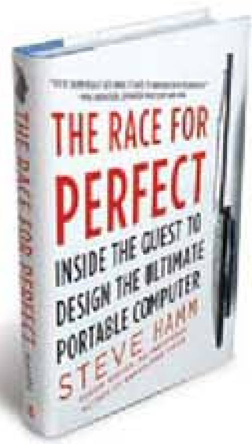
After that, Chief Executive Mark Newton replaced the hospital's auction rate securities with variable-rate notes. To avoid getting hit with a surprisingly large debt bill again, he also bought derivatives known as interest rate swaps, complex financial deals that protect against interest rate fluctuations. But those agreements have created another concern in the wake of Lehman's demise: the solvency of the parties on the other end of the deals. "I worry about counterparty risk," says Newton.

THE LEHMAN EFFECT

Institutions that had interest rate swaps with Lehman had to find new trading partners after the investment bank filed for bankruptcy. At least one, Simmons College in Boston, is still looking. That's a reason why credit rating agency Moody's Investor Services is considering downgrading Simmons' debt. If Moody's does cut the rating, the college's borrowing costs would rise. (Simmons' vice-president for finance wasn't available for comment.)

Meanwhile, nonprofits face some tough decisions. Guilford College in Greensboro, N.C., saw the rate on its bonds rise to 8.05% before settling down to 2.2% in late October. It can afford to meet its current debt obligations. But the uncertainty has President Kent Chabotar wary, especially because enrollment is off. He's cutting faculty and administrative jobs to keep costs in check. "Suppose rates spike again?" says Chabotar. "We've got to have [financial] flexibility."

Stevenson's Manning worries he won't be able to cover his debt costs if there's another jump in rates. Enrollment is off, and the state government reduced funding. The massive drop in stocks has slammed the endowment, which has eroded from $53 million to $40 million since June. Says Manning: "It's a little scary right now." |BW|

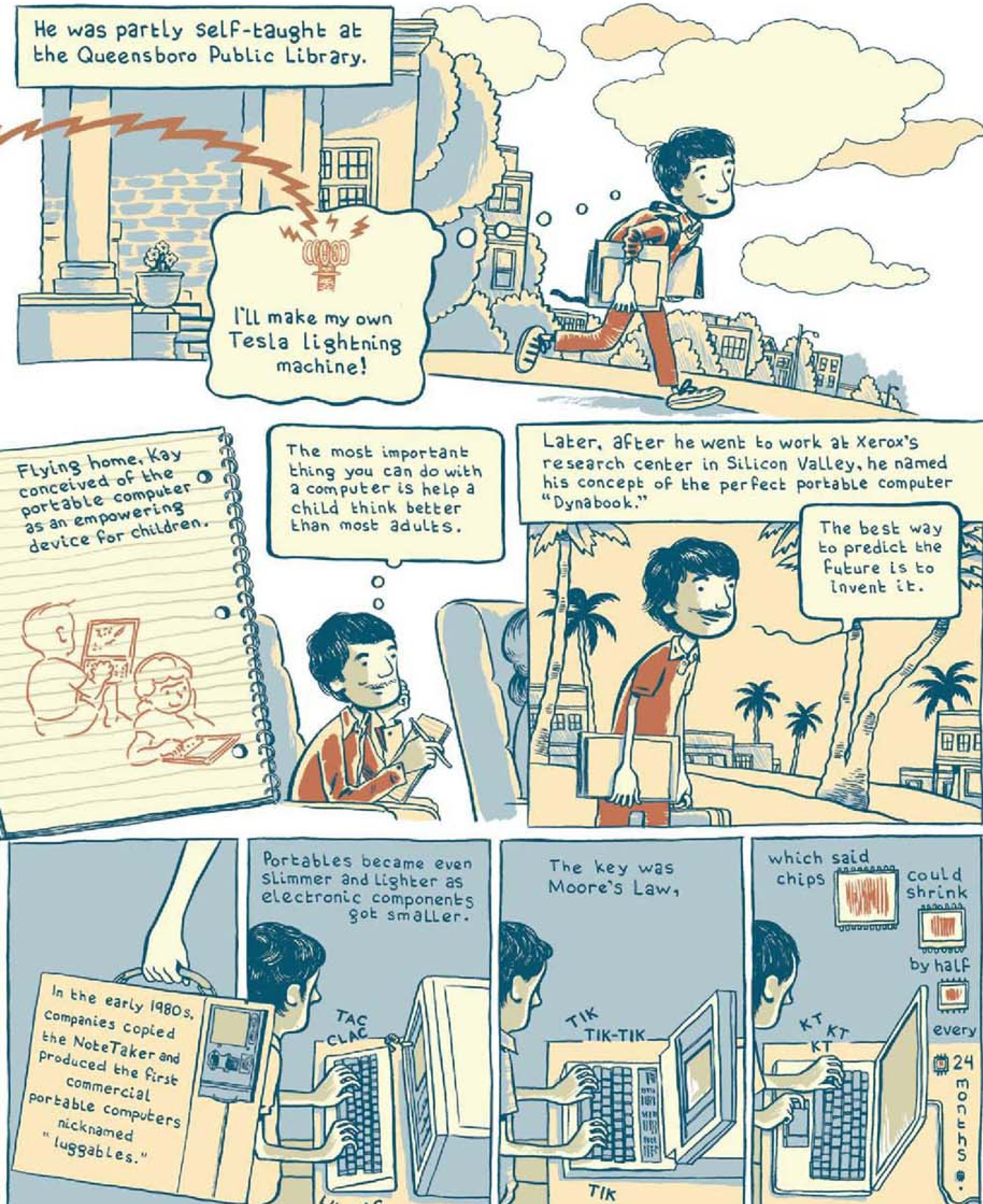


THE LONG ROAD TO THE LAPTOP

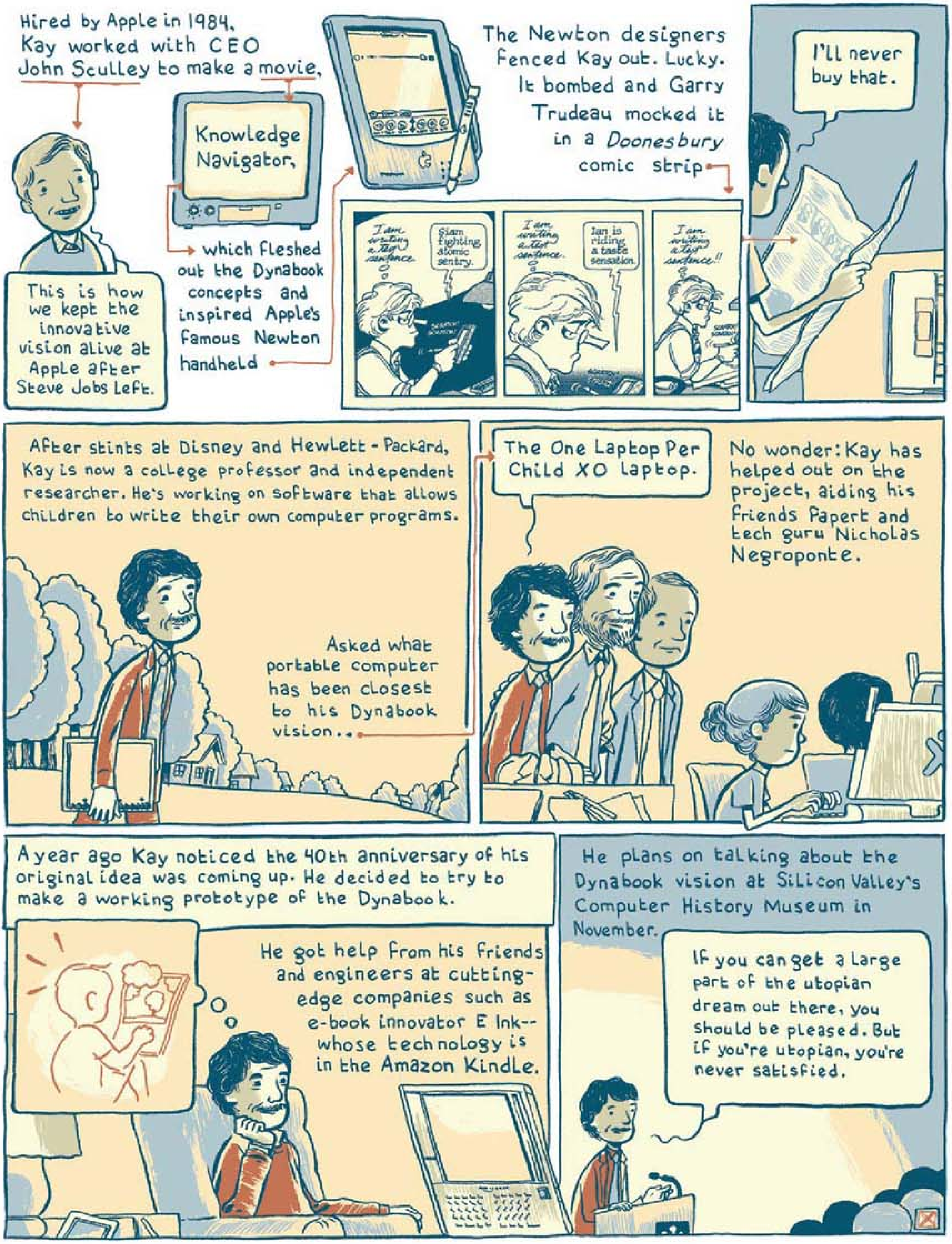
By Steve Hamm
Illustration by
Joseph Lambert

How one visionary conceived of the portable PC as an empowering device for children

BusinessWeek Senior Writer Steve Hamm's new book, *The Race for Perfect: Inside the Quest to Design the Ultimate Portable Computer*, chronicles the four-decade history of mobile computing. This graphic adaptation explores the role of Alan Kay, whose ideas shaped the development of today's laptops, handhelds, and smartphones.



COURTESY OF THE CENTER FOR CARTOON STUDIES


Hired by Apple in 1984, Kay worked with CEO John Sculley to make a movie,
Knowledge Navigator,
which fleshed out the Dynabook concepts and inspired Apple's famous Newton handheld
This is how we kept the innovative vision alive at Apple after Steve Jobs left.
The Newton designers fenced Kay out. Lucky. It bombed and Garry Trudeau mocked it in a *Doonesbury* comic strip
I am writing a test sentence.
Siam fighting atomic sentry.
I am writing a test sentence.
Ian is riding a taste sensation.
I am writing a test sentence!!
I'll never buy that.
After stints at Disney and Hewlett-Packard, Kay is now a college professor and independent researcher. He's working on software that allows children to write their own computer programs.
Asked what portable computer has been closest to his Dynabook vision...
The One Laptop Per Child XO laptop.
No wonder: Kay has helped out on the project, aiding his friends Papert and tech guru Nicholas Negroponte.
A year ago Kay noticed the 40th anniversary of his original idea was coming up. He decided to try to make a working prototype of the Dynabook.
He got help from his friends and engineers at cutting-edge companies such as e-book innovator E Ink--whose technology is in the Amazon Kindle.
He plans on talking about the Dynabook vision at Silicon Valley's Computer History Museum in November.
If you can get a large part of the utopian dream out there, you should be pleased. But if you're utopian, you're never satisfied.

SHOULD YOU JOIN THE GOLD RUSH?

By Aaron Pressman

Stock markets around the world have fallen off a cliff in the past month—and the price of gold, long seen as a safe haven in times of turmoil, has plummeted as well. After hitting an all-time high of more than $1,000 in March, gold dropped to $681 on Oct. 23 before bouncing back to $740 in early November. The bumpy ride has included three gold rallies—after the collapse of Bear Stearns, the seizure of Fannie Mae, and the failure of Lehman Brothers. But each rally was followed by a sharp sell-off. ¶ Gold's recent gyrations were caused mainly by hedge funds and other big investors desperate to raise funds to cover losses and meet creditor demands. In order to do that, they have been getting out of deals made during the past few years to buy gold and other commodities with money borrowed in Japan and the U.S. On a more fundamental level, the dollar's recent rise and the fall in the price of oil have turned off investors who buy gold when they are worried about runaway inflation as a result of higher consumer prices or a plunge in the value of the dollar.

Despite the short-term fluctuations, gold still has a role in portfolios as insurance against worst-case scenarios like a devaluation of the dollar due to spiraling government debt, argues John Hathaway, manager of the Tocqueville Gold Fund. While most economists have supported the government's bailout plans, the moves are likely to increase the federal debt by more than $1 trillion. The Federal Reserve isn't worried about inflation now—it's fighting off a massive bout of falling prices, or deflation, such as occurred during the Great Depression. "The Fed has created more money in the past three weeks than in the previous 28 years," Hathaway says.

The crisscrossing patterns of long-term investors buying and short-termers getting out is best illustrated in the different markets where gold trades. At the Comex, where hedge funds typically buy and sell futures contracts on gold, the number of contracts in active use fell from more than 483,000 contracts in July to 319,000 in October, a 34% decline. At the same time, $2.8 billion poured into exchange-traded funds that buy gold and tend to be used for longer-term investments. Individual investors have bought so much gold directly from government mints that the U.S., Austria, and South Africa have had to suspend sales of gold coins until they can make more.

The recent moves fit with research showing that investors benefit more by holding gold over long periods to help diversify portfolios rather than moving in and out of gold only in times of stress. A review of markets around the world from 1995 to 2005 found that adding gold to a portfolio of stocks slightly improved returns with less volatility. But when the study, written by two lecturers at Trinity College Dublin, looked at gold's short-term moves around moments of crisis, they found that the benefit of buying gold ended quickly—after about two weeks. Although a variety of asset classes can help diversify portfolios, Dirk Baur, one of the study's co-authors, notes that gold's diver-

ILLUSTRATIONS BY LOU BEACH

sification benefit is strongest when the stock market is falling. Other diversifiers, like emerging markets stocks, start acting more like U.S. stocks in times of trouble.

Owning gold may provide some peace of mind over the long run, but there's no consensus among analysts about what short-term path gold's price will take. Merrill Lynch's precious metals team predicts gold will hit $1,500 as government actions to end the credit crunch eventually spark inflation. J.P. Morgan analysts think continuing turmoil in financial markets should support gold prices but predict it will trade at an average of $875 next year. At Barclays Capital, analysts reckon that a weakening dollar and a decline in hedging by gold producers will push gold to $970 by 2009's second quarter. Among the more bearish forecasters, Deutsche Bank analysts warned gold could hit $600 in the next few months and expect an average price of $750 next year because investors will continue to be more worried about deflation than inflation. And UBS has cut its 2009 forecast to $700.

NUGGETS OF SAFETY

For investors seeking diversification, the simplest way to buy into the yellow metal is to purchase shares of an exchange-traded fund that owns gold, such as the SPDR Gold Trust. The ETFs own huge amounts of actual gold stored in vaults. The amount hit a record of almost 1,093 metric tons worldwide at the end of September, according to the World Gold Council.

But some of the most ardent gold bugs are wary of owning gold through ETFs. Concerned that elements of the financial system could break down and cripple the firms running the ETFs, they favor buying gold bullion either in coins or small bars that can be kept in a safe deposit box. Jim Cook, president of Minnesota precious metals dealer Rarity Investments, says he had his best week ever in the month of October, selling $6 million worth of coins and bars. "The financial system has created so much paper that it's becoming suspect," says Cook, who has been in the business for more than 35 years. Reputable dealers offer gold coins at a markup of only a few percentage points over the value of the gold itself. Investors should steer clear of coins being sold at huge markups.

Stocks of gold-mining companies have

Business Exchange

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Collapsing Mining Stocks

This year's collapse in gold-mining stocks, with the Philadelphia Stock Exchange's Gold & Silver Index down 70% from March to late October, is comparable to a half-dozen similar crashes since the 1930s. Boris Sobolev of the Resource Stock Guide newsletter notes that typically the stocks hit bottom after losing about two-thirds of their value. In the wake of current turmoil, however, he thinks shares of small-cap mining companies may never recover. Sobolev writes: "Most...will never see their prior peaks of glory."

To read the article, go to **http://bx.businessweek.com/investing-in-commodities/reference** fallen much further than the price of gold and may offer compelling valuations. The manager of the $63 billion Fidelity Contrafund, Will Danoff, who made a killing buying depressed gold stocks in 1999 and 2000, added shares of Goldcorp over the summer and, as of Sept. 30, had 3% of his fund in gold miners. His two biggest positions in mining outfits are Goldcorp, at 1%, and Kinross Gold, at 0.5%.

As you'd expect, mutual funds specializing in gold mining stocks have done poorly of late, with Morningstar's precious metals category down 53% for the year. A thirst for assets probably sparked the Oct. 31 reopening of the Vanguard Precious Metals & Mining Fund (it closed in February 2006, when gold had almost reached $600). The fund is down 59% this year, trailing some 87% of its peers, but is a top performer over 5- and 10-year periods.

EXAGGERATED SWINGS

Mining companies, which have fixed operating costs to get gold out of the ground, can see profits swing rapidly when the price of gold goes up or down, points out Michael Bradshaw, manager of the Evergreen Precious Metals Fund. So gold-mining stocks, down about 50% as a group in 2008, will see a more exaggerated gain in price from a recovery than will gold itself, he says. For example, when gold prices rose earlier in the decade from around $400 an ounce to more than $600, Goldcorp's net income shot up from $51 million in 2004 to $286 million in 2005 and $408 million in 2006. Top holdings in Bradshaw's fund, which can also own physical gold, include Kinross Gold, Rangold Resources, and Agnico-Eagle Mines.

Whether owned as coins, through funds, or via individual stocks, gold should make up just a small slice of a portfolio. Rozanna Patane, a financial adviser in York, Me., says she will be putting a small amount—under 5%—of her clients' assets in gold as a long-term hedge against inflation and dollar depreciation. In the short term, says Patane, "it may have some appeal as more bad news appears about profits worldwide." |BW|

THE OUTLOOK FOR BLACK GOLD

Consumers may drive the U.S. economy, but oil greases the wheels of the Standard & Poor's 500-stock index. So when UBS trimmed its earnings targets for the S&P 500 (calculated as combined earnings divided by shares outstanding) on Oct. 31, the revised projections had as much to do with the price of oil as with factors such as consumer spending. After predicting a mild to average recession, UBS now expects gross domestic product to decline through March 2009 before flattening out in the second quarter. Here are three forecasts for S&P 500 earnings. —*Ben Levisohn*

PRICE OF OIL	IMPACT ON THE S&P 500 EARNINGS
$60	Just weeks ago, UBS projected oil around $90 a barrel in 2009. Now it's saying $60. "The forces of deleveraging are greater than the commodity price relief to the economy," says David Bianco, the firm's chief U.S. equity strategist. He expects the recession to be "as bad as we've seen in the past handful of decades" and to limit S&P 500 earnings per share to $73, down from a projected $74 for 2008.
$75	When oil was near $150, Bianco had to convince clients prices were too high. Now he's saying they're too low. He doesn't believe the amount of oil extracted can only decline but thinks getting crude out of the ground will cost more and could push the price to about $75. That's positive for oil service companies, industrials, and alternative energy. At this price, S&P earnings could be $80 per share.
$100	A fragile economy and weak demand make triple-digit oil unlikely in 2009. But production remains tight, Bianco says, and any disruption in supply could push the price back over $100. In this case, strong oil wouldn't benefit the S&P. With Americans already on edge, $100 oil would be devastating for consumer confidence and the economy. It could push S&P earnings per share under $70.

EDITED BY SUZANNE WOOLLEY

ESCAPING THE IRA TRAP

Americans age 70½ and older must make annual withdrawals from IRAs—a percentage of assets based on the account's value on the last day of the previous year. IRA assets totaled about $4.7 trillion at the end of 2007, but three months later were down 4% and are likely lower now given the Standard & Poor's 500-stock index's 27% drop since Mar. 31. "Most of us are going to get killed," lamented an investor at the Baron Funds annual conference in New York on Oct. 24.

The AARP is on the case: CEO Bill Novelli wrote to Treasury Secretary Henry Paulson calling for a "temporary freeze" on mandatory withdrawals. But IRA expert Ed Slott says a halt isn't likely. So this age group, which owns about 24% of IRA assets, must either cash out large chunks from diminished IRAs by yearend—or face big tax penalties. Financial planners say to tap liquid IRA holdings first to avoid selling securities at a loss. Seniors who don't need cash for living costs can make a withdrawal "in kind" to move stocks or bonds to a non-IRA brokerage account. They'd owe tax on the distribution, but wouldn't lock in a loss. And the charitably inclined can roll over as much as $100,000 to a cause. Go to www.irahelp.com for info. *–Tara Kalwarski*

24%

Approximate percentage of IRA assets owned by seniors age 70 and up

Data: Internal Revenue Service

CALL IT AN ART EQUITY LOAN

Even the most rarefied connoisseurs have a pawn shop of sorts: The major auction houses, as well as a few commercial banks, allow collectors to borrow against their art treasures. "It's not the cheapest source of funds out there, but these days it is one of the very few options" for raising cash, says Jan Prasens, managing director at Sotheby's Financial Services.

Christie's focuses mainly on consignments, with advances amounting to as much as 50% of the low estimate for an item to be put up for sale. At Sotheby's, collectors can go the consignment route, too, but the auction house specializes in loans against a particular item, without a planned sale. Such term loans, which start at $1 million and currently carry a rate of 7% to 9%, are typically paid back within a year.

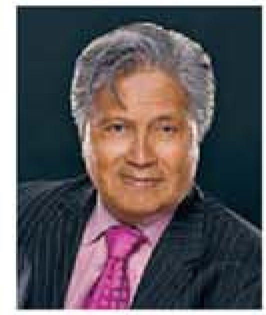
More art collectors seem to have tapped their Picassos and Pollocks for cash in 2008. Sotheby's expects its 2008 portfolio of term and consignment loans to exceed the $176 million total for such loans on its books at yearend 2007. *–Lauren Young*

BEWARE THE BEAR MARKET FUNDS

As of Oct. 31 the S&P 500 was down 33% for the year, and most stock mutual funds are down as much, if not more. On the flip side, bear market funds, designed to do the opposite of what the broad market does, are up an average of 40% over the same period.

While U.S. stock funds have had net outflows this year, bear funds have seen net inflows. But trying to hedge bets by moving into one of the funds now is not a good idea, says Morningstar analyst David Kathman, who points to the risky strategies the funds often use. Many achieve their returns by short-selling futures on stock and commodity indexes, which can make the funds very volatile—especially given recent daily market swings of as much as 10%. Just three weeks ago, for example, bear funds boasted a 69% return for the year. "For most people, the best way to hedge risk is through old-fashioned portfolio construction," says Kathman. He suggests simply buying more bonds if you think the market will fall further. *–T.K.*

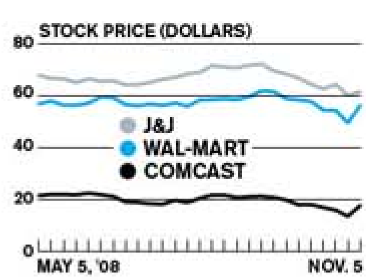
KATHERINE STREETER



STALWARTS TO STICK WITH IN TROUBLED TIMES

Despite the market's 486-point drop on Nov. 5, most strategists are betting on a spirited advance that could last six months or so. They call it a "relief rally" following the end of a long and acrimonious Presidential campaign. But soon after any brief period of euphoria, attention will return to the market's biggest fear: How long and how deeply will recession roil the economy? Many investment pros fear the worst, so they don't expect the market to post record highs in 2009. After the election lift, "it's back to the fundamentals, which aren't looking good," says John Maloney, president of M&R Capital Management. True, market psychology could brighten because of the election of Barack Obama. But that may be overshadowed, some strategists say, if the economic outlook remains as dark as it is right now. And whatever economic policies President-elect Obama launches won't kick in soon enough to provide immediate help.

J&J, WAL-MART, AND COMCAST: STEADY



Data: Bloomberg Financial Markets

In October, the Institute for Supply Management index showed that "manufacturing declined at its fastest pace in 26 years," says Maloney. That measure of factory activity tumbled to 38.9 in October from 43.5 in September. Since 50 is the dividing line between expansion and contraction, it suggests that the recession may be even worse than many anticipate. Instead of a 1% drop in gross domestic product, the economy may experience a 2%-to-3% drop during this period, warns Maloney. In any case, a defensive strategy is vital: He favors big pharmaceutical companies, such as Johnson & Johnson (JNJ); cable services like Comcast (CMCSA), the largest in the U.S.; and drugstore chains, such as CVS Caremark (CVS).

During the previous 18 Presidential election years, the Standard & Poor's 500-stock index posted positive total returns in the fourth quarter, with one exception: the year 2000. "But it would take a very powerful rally to bring the S&P 500 back into positive territory this fourth quarter," warns Jeffrey Kleintop, chief market strategist at LPL Financial, given October's precipitous stock drop.

Scott Armiger, vice-president and portfolio manager at Christiana Bank & Trust, which has assets under management of $1.7 billion, says that in light of what is happening currently, "we are overweight [in our portfolios] in companies that provide consumer staples, and underweight in financial stocks." He thinks the best strategy is to stay with such stalwarts as J&J, Wal-Mart Stores (WMT), and Walt Disney (DIS). These companies provide a safe haven for investors—offering goods and services that consumers need to keep buying even during recessions, according to Armiger.

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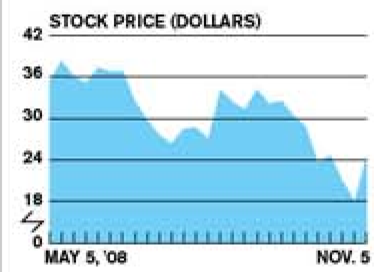
WMS STOCK TOOK A TUMBLE



Data: Bloomberg Financial Markets

Raking It In at WMS Industries

Casinos and gambling are on the ropes, punched out by the economic slowdown. Even so, WMS Industries (WMS), a designer and maker of video and slot machines and video lottery terminals, is reeling in fat sales and profits. Its thriving foreign operations have offset the weak U.S. market. But its shares have slumped. After hitting 41 in February, they're now at 24.81.

The big price drop—as earnings rise—adds to the stock's long-term appeal, says Alan House, an analyst at Value Line. The largest WMS stakeholder is Viacom Chairman Sumner Redstone, with almost 8%.

Robert LaFleur of Susquehanna International Group, which is seeking to do business with WMS, says the company is one of the few compelling stories in this weak economy. He foresees profits of $1.50 a share in 2008 and $1.68 in 2009, compared with $1.14 in 2007. | BW |

BRAD TRENT; CHARTS BY DAVID FOSTER

OPINION

MEDIA CENTRIC | JON FINE

The Scoop on the Associated Press

The news co-op is flush and growing, but newspapers' woes could force big changes

CEO Curley: The AP's $30 million in cash will help cushion its recent rate cuts

(FROM TOP) BRAD TRENT; JENNIFER S. ALTMAN

This is an especially delicious moment for news, a time of big change and bigger challenges, so you'd think it'd be sweet to run the rare massive news organization whose business is growing. But this is a delicate juncture for Tom Curley, CEO of the Associated Press. Today the 162-year-old AP is poised to loom larger than ever as a news entity, given how American newspapers are slashing staff. Unless the very factors that could enable its rise don't destroy it first.

The AP is a strange beast: a long-running cooperative success story, owned by around 1,500 newspapers and employing 3,000 journalists spread across 97 countries. Its formulaic, just-the-facts reportage is easily parodied—just ask *The Onion*—but it has unmatched reach. The AP boasts that more than half of the world sees an AP story ever day. It sells to more than 15,000 news outlets worldwide, including 5,000 radio and TV stations and 4,000 Web sites. The business is notionally run as a nonprofit, but in 2007 its revenues were $710.3 million, up 5% from '06. This year—thank you, oh interminable election season!—revenues should jump 6%, says Curley. The AP also has around $30 million in the bank. Unlike most news organizations, it has avoided layoffs and diversified its business. Once wholly dependent on dailies, the AP now gets 17% of its revenue from Web sites and 17% from U.S. broadcast outlets.

The problem, though, is the 27% of revenue—the biggest single source—that comes from U.S. newspapers, and those papers' increasing restiveness. More than 100 newspapers, including the entire Tribune chain, have announced plans to cancel their AP subscriptions. According to AP bylaws, two years must elapse between giving notice and actual cancellation, but losing newspapers means the AP loses their fees and the right to distribute their stories. AP executives point out that historically, many papers that threatened to drop the AP never did, and regarding Tribune, Curley says: "It's not fathomable for me to imagine that [Tribune owner] Sam Zell walks away from an equity stake in an organization that may be worth north of a couple billion dollars." The AP just cut some rates—its $30 million in cash will pay for that—and it promises a fuller response at its annual meeting next April. Curley says, not unreasonably, that certain threats could just be negotiation and adds: "Some of the people putting in cancellation notices are contracting for hundreds of thousands of dollars of new [AP] services."

A CNN WIRE SERVICE

Still, the brute facts are that it's expensive to run a breaking-news organization, and the AP isn't insulated from the declining market value of news. "The issue is not whether the AP is valuable," says Jim Willse, editor-in-chief of Newark (N.J.)'s 345,000-circulation *The Star-Ledger*, which just laid off around 40% of its newsroom. "It's how much we can afford to pay for that value in a time of diminishing" revenue. A paper the size of *The Star-Ledger* pays more than $1 million a year for the AP. The calculus facing the Willses of the world is that you could hire 10 or more full-time reporters for that sum—and, in the au courant theory of newspapering, you put those bodies on local news and leave national and international to other outlets.

In September a pre-layoff *Star-Ledger* produced an entire issue without AP stories. "I doubt any reader noticed," said Willse. His paper did this, he says, "to make sure the AP understood that it was more than possible to live without the service." It may only become more so. CNN is starting a wire service; details are scanty, but more will be revealed at a planned December meeting with editors. Elsewhere, start-ups—PA SportsTicker is one—offer stock tables or sports scores cheaply, and GlobalPost is assembling a network of international correspondents for a 2009 launch. Ohio's eight largest papers have formed the Ohio News Organization—or, heh heh, OHNO—to pool in-state reporting. OHNO member *The Columbus Dispatch* plans to cancel the AP, and Susan Goldberg, editor of Cleveland's *The Plain Dealer*, told me how she combined efforts with *Pittsburgh Post-Gazette* on a recent story.

There are layers of irony at play. One is that, under Curley and head of strategy Jim Kennedy, the AP has consistently outlined a more interesting vision for a traditional news organization to evolve in today's environment—setting up new ways to share content and articulating the premium value of breaking news—than almost any newspaper owner. Another is that the AP has ankle weights when it comes to making certain moves; an Associated Press-owned online portal could never launch, since it would compete with those to whom it sells its stories. And many of those grousing the loudest about the AP are newspaper editors, exactly the kind of news junkies who least want to see the AP harmed. But if there's a gun pointed at these editors' heads—and in business terms, there is—they'll try to save what's left of their papers first.

At least 100 papers say they plan to ditch the AP, but CEO Curley says some of that could just be bargaining-table posturing

The AP in 1942: Today its roster of 3,000 journalists in 97 countries is unmatched

BERNARD HOFFMAN/TIME LIFE PICTURES/GETTY IMAGES

One bold move could be to ditch the collective structure. But Curley, unprompted, told me that "nothing is being studied or discussed around structure—an IPO, or changing from a cooperative." The AP is faced with reinventing what it can, mollifying its big customers, and like them, is confronted with a future where it is paid less. A world with a weakened AP is not one I'd like to consider: Its news service would never be replicated. But you don't get to choose the collateral damage major changes to the media landscape bring, as legions of other news entities have been finding out. |BW|

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For Jon Fine's blog on media and advertising, go to businessweek.com/innovate/FineOnMedia.

Apple Laptops: The Hits Keep Coming

The latest MacBook and MacBook Pro enhancements should keep the hot streak going

Apple is the only company I know that can tell its customers what they want and make them like it. Nobody else has pulled that off since Henry Ford decreed that consumers could get a Model T in any color they liked as long as it was black. The latest MacBook and MacBook Pro computers suggest that Apple has not lost its touch.

The difference between Apple and the rest of the industry is stark. Dell sells 26 laptop models, each available in many configurations, while Apple offers five, with few hardware options. The average selling price for MacBooks and MacBook Pros in September was $1,483, compared with $689 for Windows notebooks, according to market researcher NPD Group. The point isn't that Macs are overpriced for what they are but that Apple offers only high-end products. Yet despite these seeming disadvantages in variety and price, NPD notes, Macs grabbed nearly 18% of the U.S. retail notebook market in September, a jump of nearly three percentage points since last year.

It's not easy to come up with a dramatic design breakthrough in what is largely a mature product category. Last year, Apple offered the revolutionary MacBook Air, but its extreme thinness and lightness was achieved at a sacrifice in functionality that wouldn't be O.K. in its workhorse laptops.

The latest notebooks should keep Apple's winning streak going. The two new products are a 15-in. MacBook Pro (from $1,999) and a 13.3-in. MacBook (from $1,299), now in a Pro-like aluminum case. Rounding out Apple's family are the old white MacBook ($999), the 17-in. MacBook Pro (from $2,799), and the Air (from $1,799). The last two models got processor and graphics upgrades but are otherwise unchanged.

The most striking feature of the new laptops is their huge and extremely usable touch pad. I have long preferred pointing sticks to touch pads, but Apple's latest innovation might change my mind. As in the last generation of MacBooks, this pad uses multitouch: One finger moves the cursor, two fingers scroll the display. What's new is there's no button—just press firmly on the pad, and you feel a button-like click. One finger gives a standard mouse click. Press with two and you bring up a menu appropriate for what you are doing, just like a right click on the mouse. It's simple, and it works.

The MacBook Pro can be set at maximum graphics or a lower level for better battery life

The new touch pads are huge and extremely usable. There's no button—just press firmly to feel a button-like click

The MacBook Pro is equipped with two Nvidia graphics adapters. Users can switch between a GeForce 9600M GT to get maximum performance for games, video editing, or other graphically intense applications, and a less capable 9400M chip for best battery life. Expect similar dual-graphics technology to show up on high-end Windows notebooks as well.

MacBook fans may find some other changes disconcerting. Apple is relentless in scrapping old technologies. This time, that may be painful for users of older external monitors and video cameras. Both new Mac models use an external video connector called DisplayPort that only plugs directly into the new $899 Apple LED Cinema Display. For all other monitors, you'll need a $29 adapter. Try using an older video camera and there's a worse catch. Apple has eliminated the FireWire port on the MacBook, rendering cameras that connect to computers only with a Firewire cable unusable. The Pro does have a FireWire port, but it's a new version, called 800, so you'll need another adapter cable to use it with a FireWire 400 camera.

With special software, it is now easy to run Microsoft Outlook and other Windows programs on the Mac. I use VMware's Fusion 2.0 virtual machine software on the MacBook Pro, and the results are so good that I'm longing to take a Mac laptop on the road. But that's where Apple's limited variety is a problem. At 4½ lb., even the 13-in. MacBook is too heavy, while the Air is too limited. Oh, well. Apple has never tried to be all things to all people. It may not solve my problem, but Apple's way seems to work just fine for the company and most of its fans. | BW |

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(TOP) BRAD TRENT

Art Dudes Descending a Staircase

An insightful—and gossipy—look at the buyers, curators, critics, and makers of contemporary art

The art world makes strange bedfellows. On one side are some of the world's savviest businesspeople, from hedge fund powerhouse Steven Cohen and French luxury-goods mogul François Pinault to London advertising pioneer Charles Saatchi, all of whom are mega-collectors of contemporary art. On the other side are the artists and the often bizarre works for which the collectors lay out millions. Offering a view of this scene is *Seven Days in the Art World* by Sarah Thornton. The book is a knowledgeable, insidey, and wonderfully written attempt to explain the interconnection between the collectors and dealers who make up the art market, and the artists, curators, art professors, and art fair directors who help set taste. By the end of the book, you almost understand how Cohen could shell out $8 million for a rotting 14-foot shark pickled in formaldehyde, as he did three years back when he bought from Saatchi a signature work by celebrated British artist Damien Hirst.

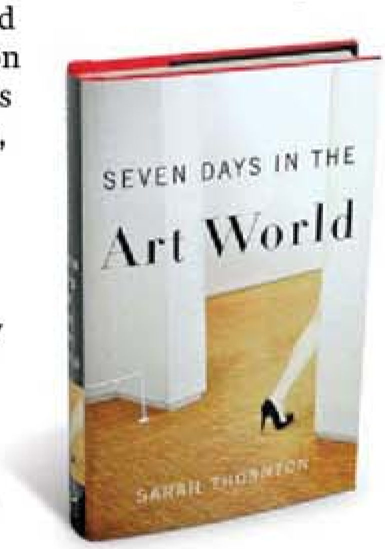
Thornton, a London writer who holds a PhD in sociology, immersed herself in various artistic milieux for five years, conducting some 250 interviews that she later distilled into seven chapters. Each chapter describes a visit to an event or place that typifies the enterprise, but Thornton also imparts an enormous amount of additional information in chatty asides and digressions. The author compares herself to "a cat on the prowl" ("curious and interactive but not threatening"), and she isn't particularly critical of what she sees and hears. But her examples of the art scene are vivid and cleverly chosen.

Among other things, we watch the legendary auctioneer Christopher Burge prepping for and then conducting a sale at Christie's, join the frenzied shopping at Switzerland's influential but overcrowded Art Basel fair, and sit in on deliberations for Britain's prestigious Turner Prize, which can double the winning artist's prices overnight.

Thornton has a keen eye for detail—especially sartorial detail. Here's how she portrays big-time Miami collectors Mera and Donald Rubell as they're about to start a tour of Art Basel (with son and co-collector Jason): "They're wearing running shoes and baggy trousers with pockets and toggles in unlikely places, like funky grandparents setting out on a long hike. They are so unostentatious, so inconspicuously wealthy, that I've heard them referred to as 'the Rubbles.'" The family's big concern is to avoid letting on which artists they're interested in—something that might cause lesser collectors to jump in and start buying. They confer in a whispered powwow at one booth, and Jason apparently imparts their judgment to the dealer during a seemingly innocuous half-hug.

Thornton has distilled 250 interviews into seven sketches of places or events that are emblematic of the art trade

Equally fascinating is Thornton's visit to the three Japanese studios of artist Takashi Murakami, whose cartoon-like work is *de rigueur* for any cutting-edge contemporary collector. Like Renaissance masters, many top artists employ legions of assistants to execute their paintings and sculptures, and Murakami's antiseptic quarters seem like a cross between an assembly line and a semiconductor clean room. The helpers wear white cotton gloves and work "in silence or in their own iPod worlds," never deviating from the artist's strict instructions. When Thornton asks one assistant if there's any room for creativity, she responds: "None at all."



Seven Days in the Art World by Sarah Thornton; Norton; 274 pp.; $24.95

There are moments when the book drags. Many readers won't want to wade through the chapter on the "crit" (art school shorthand for a self-critique of students' work) at California Institute of the Arts in Valencia, which lasted 15 hours and must have seemed interminable even to the participants. In addition, Thornton could easily have added a few pages on emerging art markets, perhaps by profiling a top Chinese contemporary artist.

It seems likely that the art market is headed into its first major slump since 1990. Results at Christie's and Sotheby's big London auctions in October were tepid, and the New York season opener at Sotheby's on Nov. 4 was downright disappointing, with major works, including paintings by Modigliani and Giacometti, failing to draw any bids at all. Nevertheless, committed collectors will keep buying. For them, the art world will go on much as Thornton describes it in her compulsively readable new book. | BW |

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FINANCIAL MELTDOWN
THE CAUSE OR A SYMPTOM?

"It's Not a Crisis of Confidence" (BusinessWeek.com, Oct. 27) asked: What if the financial meltdown is a symptom, not a cause? What if we face a wrenching readjustment of the worldwide economy? Those questions drew plenty of comment from readers, many of whom agreed with the article's conclusion that today's problems go far beyond any financial excesses. At the root are some long-accepted, but simply unsustainable, patterns of global technology transfer, trade, and finance. *–Michael Mandel*

This has been coming for years. Conversations among manufacturing managers (like me) have been about the unsustainability of moving all manufacturing to China. How will the West pay for Chinese goods forever? It must break down at some point. It just has.

Screen name: Marksany

Right on.... The rising incomes in the East are not yet high enough to maintain the level of consumption that the falling incomes in the West can no longer sustain.

Screen name: Frank Sayegh

Thanks for mentioning the people at the bottom of this heap. Workers started massively losing ground 20 years ago or so, with downsizing, outsourcing, part-timing, and all.

Until the needs of people who work, who actually make things and provide services, are addressed, nothing will stop the decline of the American economy.

Screen name: Jeannine

As countries like China, India, and Brazil continue to develop their internal markets, they will have less need for the Western consumer.

So this financial crisis may be a good thing in the long run: These countries will finally be weaned from the overleveraged Western consumer and will focus on developing their own consumer culture.

We've become too accustomed to watching markets and thinking that financial geniuses will save us.

Screen name: E Nuff Sed

We need to figure out what we're going to sell to the rest of the world.

ChewYourGrouse.blogspot.com

We did create products to export, and they were called mortgages.

Screen name: cobude

THE BAILOUT
THIS BANK INTENDS TO LEND

"So Where Are All the Loans?" (News, Nov. 10) uses part of a statement by SunTrust Banks' CEO to illustrate its point that banks may not be willing to lend as much as hoped in the current environment. It's accurate that our CEO, James M. Wells III, said in a press release that "as long as the current uncertain and challenging economic environment persists, maintenance of capital at elevated levels is desirable." But in the same statement from which this quote was pulled, he noted that SunTrust also expects to deploy capital received through the Treasury's Capital Purchase Program in areas such as expansion of lending, expansion of business capabilities, and the exploration of potential acquisitions.

I want to be crystal clear that any perception created by your story that SunTrust may not use the Treasury capital to support additional lending is not consistent with our plans—nor what our CEO said.

Barry Koling
Director,
Corporate Communications
SunTrust Banks
ATLANTA

CREDIT CARDS
COMEUPPANCE FOR THE PLASTIC PUSHERS

Anyone with reasonably good credit knows just how the big firms are preparing for the coming crunch ("The Credit-Card Blowup Ahead," News, Oct. 20). As Bank of America cardholders, we've been getting up to three phone pitches a week and four pieces of mail a day from the bank urging us to borrow more.

We could keep warm all winter by burning the credit-access checks they've sent. Yet we feel no obligation to help the poor company, especially after it changed its terms and raised fees to squeeze every extra nickel out of us.

Laronda Blessing
DURHAM, N.C.

CORRECTIONS & CLARIFICATIONS

"Sony Chases Apple's Magic" (What's Next, Nov. 10) misidentified the hotel where Sony CEO Howard Stringer met with company software chief Tim Schaaff. It was Tokyo's Westin Hotel, not the Hilton Tokyo.

COMPANY INDEX

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names.
Companies listed only in tables are not included.

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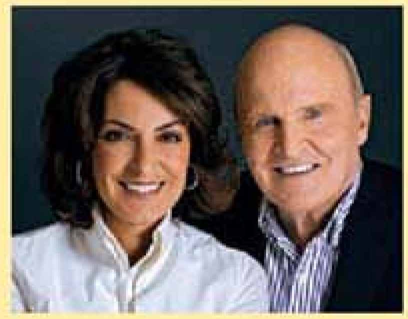

Three Reasons Obama Won

Business leaders have a lot to learn from the campaign he ran

This column is not about ideology. The election is over. And while we believe John McCain is a great American whose economic platform made better sense for business, especially in terms of free trade, tax policy, and job creation, we look forward with hope to the Presidency of Barack Obama. If his is an America for all people, as he has so passionately promised, then surely it will also serve the interests of the millions of hard-working small-business owners and entrepreneurs who are so much a part of this country's strength and future.

But enough of politics.

This column is about the lessons business leaders can take from McCain's loss and Obama's win. Because even with the differences between running a campaign and a company, three critical leadership principles overlap. And it was upon those principles that Obama's decisive victory was built.

Start with the granddad of leadership principles: a clear, consistent vision. If you want to galvanize followers, you simply cannot recast your message. Nor can you confuse or scare people. McCain's health-care policy, for example, had real merit. But his presentation of it was always confoundingly complex.

Meanwhile, Obama's message was simple and aspirational. He talked about the failings of George W. Bush. He talked about change and hope and health care for all. Over and over, he painted a picture of the future that excited people. He also set a perfect example for business leaders: Stick to a limited number of points, repeat them relentlessly, and turn people on.

The next leadership principle should sound familiar: execution. In their seminal book by the same name, Larry Bossidy and Ram Charan made the case that execution isn't the only thing a leader needs to get right, but without it little else matters. This election proves their point. In nearly two years of steady blocking and tackling, Obama's team made few mistakes. From the outset, his advisers were best in class, and his players were always prepared, agile, and where they needed to be. McCain's team, hobbled by a less cohesive set of advisers and less money, couldn't compete.

Obama engaged audiences while sticking to his plan

Another, perhaps bigger, execution lesson can be taken from Obama's outmaneuvering of Hillary Clinton for the Democratic nomination. She thought she could win the old-fashioned way, by taking the big states of New York, Ohio, California, and so on. He figured out an unexpected way to gain an edge—in the usually overlooked caucuses.

The business analog couldn't be more apt. So often, companies think they've nailed execution by doing the same old "milk run" better and better. But winning execution means doing the milk run perfectly—and finding new customers and opening new markets along the way. You can't just beat your rivals by the old rules; to grow, you have to invent a new game and beat them at that, too.

Elements of his victory: a clear and consistent message, superb and innovative execution, and the support of "high-level friends"

Finally, this election reinforces the value of friends in high places. From the start, Obama had support from the media, which chose to downplay controversies involving him. Meanwhile, after the primaries, McCain began to take a beating. In the end, no one could dispute that Obama's relationship with the media made a difference.

As a business leader, you can't succeed without the endorsement of your board. Every time you try to usher in change, some people will resist. They may fight you openly in meetings, through the media, or with the subterfuge of palace intrigue. And you'll need to make your case in all those venues. But in the end, if your board has your back, defeat can be turned into victory.

That's why you need to start any leadership initiative with your "high-level friends" firmly by your side, convinced of the merits of your character and policies. But that's not enough. If you want to keep your board as an ally, don't surprise them. Think about McCain's "gotcha" selection of Sarah Palin. Scrambling to catch up with the story, the media was not amused.

Surely pundits will scrutinize this election for years to come. But business leaders can take its lessons right now. You may have winning ideas. But you need much more to win the game. | BW |

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Jack and Suzy look forward to your questions. You can e-mail them and view their new Web site at welchway.com. For their PODCAST, go to businessweek.com/search/podcasting.htm

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