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FINANCIAL INSTITUTIONS/US Banks

Bank Stocks Headed Lower Until Asset Valuations "Get Real"

SUMMARY

For the financial markets to stabilize, we believe banks need to swiftly address true asset values and adjust their books accordingly. As assets have repeatedly been marked down over the past year in what seems like a constant game of "catch up," investors have grown understandably wary of valuations and accordingly have revalued bank stocks with significantly lower valuations.

KEY POINTS

- We believe that banks' carrying valuations on mortgage related assets are still too high, but it varies by degree. While Case-Shiller is currently pricing 33% peak to trough house price declines, banks like Wachovia are using 12.9% (OFHEO index) assumptions. We note, even FRE and FNM no longer use OFHEO as a guide post as it has been proven far more unreliable than any other estimate. While banks such as BAC and JPM (through 2008) are using 30% and 24% peak to trough declines, respectively, banks such as C are using just 20% peak to trough assumptions. Note, Case-Shiller is already pricing over 15% declines from peak levels to date.
- Within this report, we build on our prior themes, notably the issue of downward pressure on home prices driven by growing supply of housing inventory and dramatically diminishing demand created by a notable lack of available leverage. As we do not expect the "buyers strike" for structured products which has lasted now for a year to end anytime soon, we do not expect this supply/demand phenomenon to change anytime soon.
- Because the securitization market provided close to 85% of U.S. mortgages from over the past decade, its absence means a commensurate absence of available funding. Since 70% of U.S. homes are mortgaged, a shutdown in such a crucial part of the lending market has enormous consequences. Put simply, less demand and more supply translates directly into lower prices.
- Due to the fact that Housing Price Appreciation assumptions are the most important variable assumption in a mortgage asset valuation, the fact that all banks under our coverage have unrealistic HPA assumptions will in our opinion lead to a material and protracted writedown and capital pressure scenario for the banks well into 2009.

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See "Price Target Calculation" and "Key Risks to Price Target" sections at the end of this report, where applicable.

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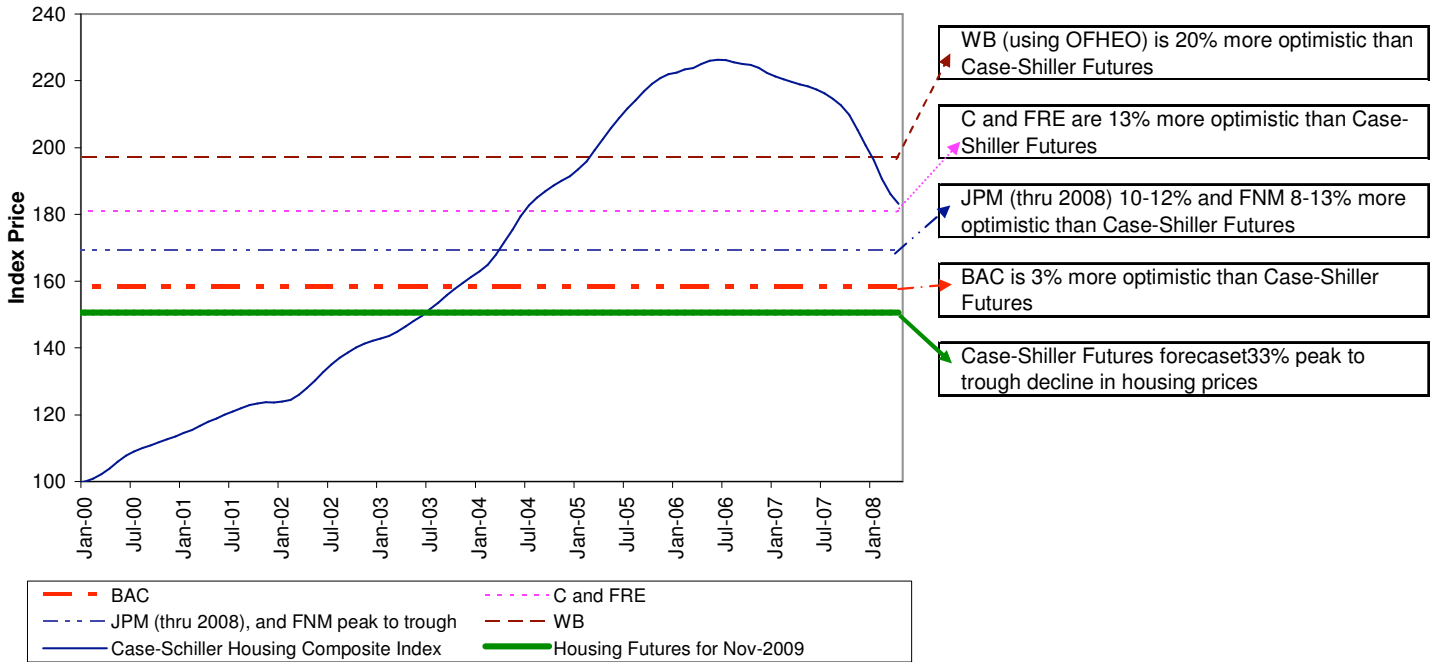
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Bank Asset Valuations Show Dramatic Divide in Underlying Assumptions

Below we present the Case-Shiller 10-City Composite Index, our banks' (and FNM and FRE) assumptions for peak to trough declines of the Index, and the traded futures of the Index. Each and every financial institution currently estimates a lower decline in housing prices than the futures market.

Exhibit 1. Bank HPA assumptions



Sources: Chicago Mercantile Exchange, Company Reports, Oppenheimer & Co. Inc.

The banks under our coverage universe: BAC, C, JPM, and WB predict smaller declines, varying by degree, in home prices per 1Q08 earnings calls and 2Q08 statements, as do FNM and FRE. Although both FNM and FRE each use their own indices that are more in tune with their respective portfolios, both provide Case-Shiller index equivalents.

Exhibit 2. Peak To Trough Declines of Case-Shiller 10-City Index

Expected Peak To Trough Declines	
Futures Market	-33%
BAC	-30%
C	-20%
FNM	-20-25%
FRE	-20%
JPM	~14-16% in 2008 (or ~23-25% from peak to 2008)
WB (uses OFHEO index)	-12.90%
WFC	NA

Sources: Chicago Mercantile Exchange, Company Reports, Oppenheimer & Co. Inc.

BAC: per discussions with management

C: 1Q08 Earnings Call on 4/18/08

FNM: 1Q08 Earnings Call on 5/6/08.

FRE: Conference Call on 5/20/08. 15% decline in FRE portfolio equals ~20% decline for Case-Shiller Index

JPM: 1Q08 Earnings Call on 4/16/08

WB: 1Q08 Earnings Call on 4/14/08

WFC: No Forecast Provided, Conference call on 5/29/08

Exhibit 3. Futures Market Case-Shiller 10-City Index vs. Bank Expectations

Bank Forecasts Are More Optimistic About Peak to Trough Declines Than Case-Shiller Futures Market By:	
BAC	3%
C	13%
FNM	8-13%
FRE	13%
JPM	10-12%
WB (uses OFHEO index)	20%
WFC	NA

Sources: Chicago Mercantile Exchange , Company Reports, Oppenheimer & Co. Inc.

We note that WFC specifically does not provide any information regarding its assumptions about home prices. We reference a quote made by John Stumpf, CEO of WFC, on May 29, regarding future home price depreciation and its effect on WFC's loan loss severity estimates: "We can't provide and won't provide guidance on what we see in the future or what we're planning, but we do look at our combined loan-to-values, we look at and we update those, we use a number of different tools, AVMs and other things, to get a current look at combined loan-to-value...".

Amongst our banks, BAC has relatively the most conservative view on home prices (and also the most in-tune with the futures market) at a peak-to-trough decline of 30%. The next closest to the futures market is JPM at a ~23-25% decline through 2008 (JPM has not made public any estimates regarding peak to trough decline, rather just through the end of 2008). C is next at -20% as of the 1Q08 conference call, and this level has nearly been reached with the ~19% decline seen through April 2008 data. Finally, WB uses OFHEO data rather than Case-Shiller for its Pick-A-Pay portfolio, and WB's expectations are for a 12.9% decline per OFHEO.

WB's Chief Risk Officer, Don Truslow, stated on the 1Q08 Earnings Call that WB had not considered its potential losses under Case-Shiller's loss rate, "We didn't run the model on Case-Shiller, again, because we didn't think that it really captured the dynamics of our portfolio." WB refers to its model for the Pick-A-Pay portfolio in this statement.

Fannie Mae expects Case-Shiller to decline by 20-25% from peak to trough, excluding the impact of foreclosed homes, as they are excluded from the Fannie Mae index. The previous chart indicates a 25% decline for FNM. Freddie Mac expects declines of at least 15% nationally on its index, equating to ~20% on the Case-Shiller Index. Both FNM and FRE expect less severe declines than the 33% anticipated by the futures market.

Herein, we analyze why we believe banks have far to go with respect to asset value write-downs based upon the game of "catch up" they are playing with HPA assumptions. We argue that the futures market (which has proven historically to be overly bullish with HPAs) is currently still too optimistic and that banks range by degree but across the board are far more aggressive than the market.

Currently, the futures market is pricing in peak to trough house price declines of 33% with house prices troughing in the second quarter of 2009 and declining by roughly 24% by the end of 2008. We note that home prices are already down over 15% from peak levels. While a doubling of home price declines on a percentage basis may seem extreme in and of itself, we argue that the same could have been said last year when the markets expected 10-15% peak to trough declines.

While we do not profess to know what peak to trough home price declines will ultimately be, we are inclined to believe that declines will at least be at the high end of expectations.

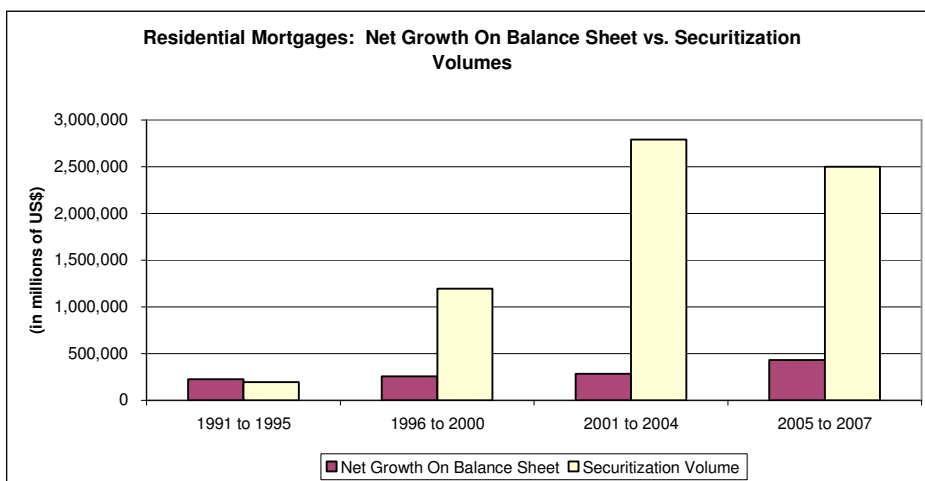
This leaves banks open for further losses/write downs varying by degree. BAC on the more conservative end and WB is an outlier as the most aggressive.

The Role of Securitization Driving Consumer Liquidity and Home Price Appreciation is Broadly Underestimated

The securitization market, what we refer to as “the great enabler,” provided for unprecedented housing demand and unprecedented U.S. home price appreciation. Since 2000 the market could be referred to as a demand driven market. However, when a year ago Chuck Prince said that while the music is playing, you’ve gotta dance, the music was in the process of coming to a grinding halt. The shutdown in the securitization market has had a profound and underappreciated impact on consumer liquidity and home price declines.

Securitized mortgages financed over six times the amount of mortgages as did traditional bank lending since 2000. To put this into context, until 1995, securitizations had accounted for no greater than 90% of the mortgage volume of on balance sheet bank lending. Our point here is that when the securitization markets came to a grinding halt last July, liquidity dried up dramatically and almost instantaneously. As the expression goes, “A rolling loan gathers no loss,” so too can it be applied to a consumer on the edge who can refinance and refinance to avoid default. After July, the consumer’s ability to refinance his way out of trouble diminished greatly. As we show below, there is a clear and direct correlation between liquidity and losses. Almost instantaneously, after liquidity dried up losses exploded.

Exhibit 4. Residential Mortgages: Net Growth on Balance Sheet vs. Securitization



Quarterly Average Securitization Volume (\$m)	
1991 to 1995	9,796
1996 to 2000	59,681
2001 to 2004	174,408
2005 to 2007	208,283
4Q07	43,027
1Q08	33,518
2Q08	30,180

Year	Level (\$M)		YoY Change (\$M)		YoY Change		Securitization as X Balance Sheet
	Net Growth On Balance Sheet	Securitization Volume	Net Growth On Balance Sheet	Securitization Volume	Net Growth On Balance Sheet	Securitization Volume	
1991 to 1995	222,157	195,915	NA	NA	NA	NA	0.9x
1996 to 2000	255,514	1,193,629	33,357	997,714	15%	509%	4.7x
2001 to 2004	283,899	2,790,527	28,386	1,596,898	11%	134%	9.8x
2005 to 2007	431,374	2,499,402	147,475	(291,125)	52%	-10%	5.8x

Source: Dealogic, SNL Financial, and Oppenheimer & Co. Inc.

While many assume that the securitization boom began in the 1990s, it is clear from the data shown above that the real securitization boom began this decade.

During the 1990s, residential mortgage securitization volumes averaged \$30.2 billion on a quarterly basis. From 1991 to 1995, residential mortgage securitization averaged \$9.8

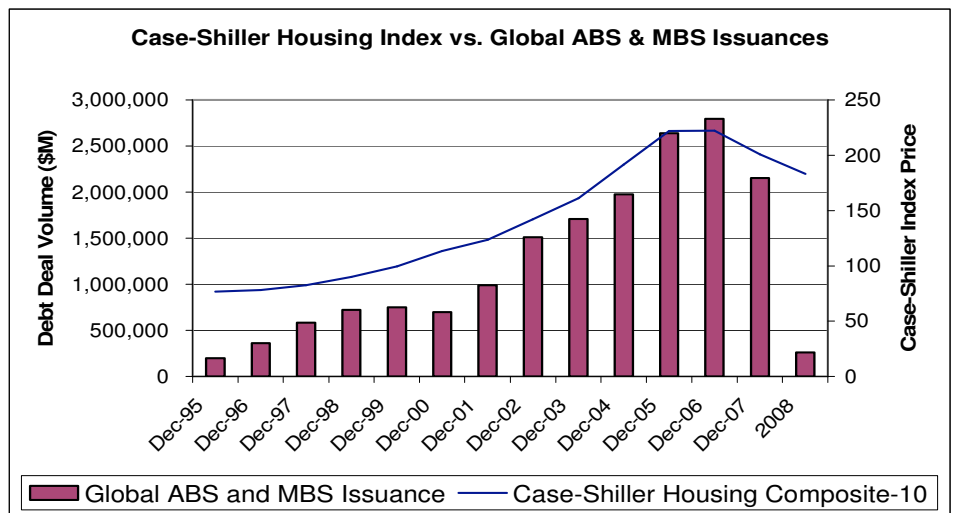
billion per quarter. From 1996 to 2000, the average quarterly volume increased to \$59.7 billion. The quarterly volume for residential mortgage securitization rose above \$100 billion for the first time in 2Q98. From 2001 to 2004, the average quarterly volume jumped to \$174.4 billion and further increased to \$208.3 billion per quarter from 2005 to 2007. Securitization dropped significantly to \$43 billion in 4Q07, \$33.5 billion in 1Q08, and \$30.2 billion in 2Q08.

Comparing securitization volume to on balance sheet growth illustrates the rapid expansion of the securitization market. From 1991 to 1995, on balance sheet residential mortgage loans increased by \$222 billion while \$196 billion in residential mortgages were securitized. From 1996 to 2000, securitizations surpassed on balance sheet loans, as securitization volume was \$1,194 billion vs. \$256 billion on balance sheet loan growth. Put another way, securitization volume was 4.7x on balance sheet loan growth during that time period. From 2001 to 2004, securitizations were 9.8x on balance sheet growth, at \$2,791 billion vs. \$284 billion. Securitizations were rapidly outpacing the on balance sheet loans, before slowing back to 1996 to 2000 levels in 2005-2007. From 2005 to 2007, securitizations were \$2,499 billion vs. \$431 billion in growth for on balance sheet loans, a multiple of 5.8x. During that three-year period, banks, savings institutions and bank holding companies grabbed a larger share of the residential mortgage market via on balance sheet loans, as volumes increased 52% from the previous four years. Volumes grew 52% from the previous time period, despite the period being 25% shorter.

Robust Securitization Volumes Drove Housing Prices Upwards, and Now the Shutdown In Securitization Is the Main Driver Downwards

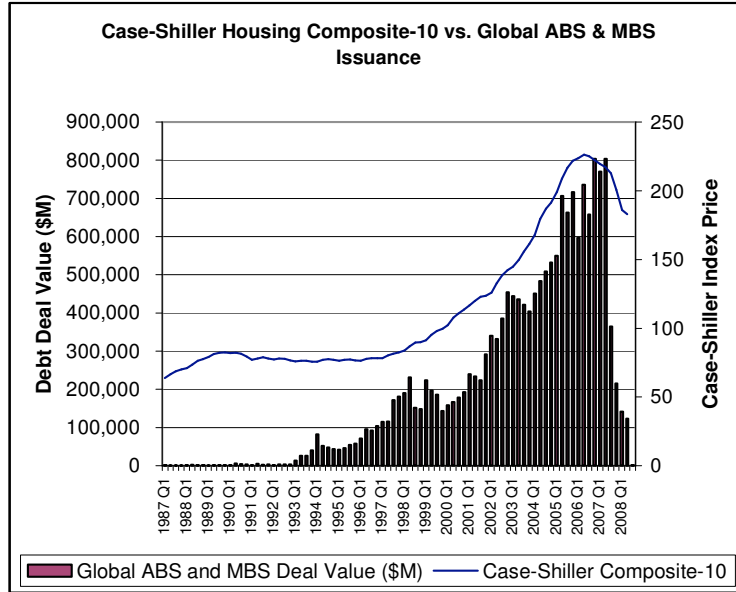
As the exhibit below shows, housing prices have had a undeniable correlation with global issuance of asset-backed and mortgage-backed securities. As we have argued before in prior notes, the liquidity provided by the securitization markets was the “Great Enabler” that allowed people to buy homes with cheap financing, thus, driving up home prices to excessive levels. With the abrupt halt to securitization issuance last summer, far fewer potential buyers can find funding to “enable” purchases. Similar to how the securitization market volumes have plummeted since the credit crisis hit, housing prices will likely go through a severe correction. We believe that the magnitude of the housing correction will be beyond that of market expectations.

Exhibit 5. S&P/Case-Shiller Housing Composite-10 Index vs. Global ABS & MBS Issuance (Annual)



Source: Standard & Poor's and Dealogic

Exhibit 6. S&P/Case-Shiller Housing Composite-10 Index vs. Global ABS & MBS Issuance (Quarterly)



Source: Standard & Poor's and Dealogic

The historical data of the Case-Shiller Housing Composite-10 spans back to January 1987. According to the index, housing prices experienced four extended periods of YoY declines. Three of those four periods occurred in the 1990s: August 1990 to February 1992 (19 consecutive months) with a 5% decline over the period; June 1992 to March 1994 (22 consecutive months) with a 3% decline over the period; and June 1995 to February 1996 (9 consecutive months) with a 1% decline over the period. The fourth extended period of YoY decline occurred seven months after the house price index hit a peak in June 2006 (price index value of 226.29). January 2007 to April 2008 represents 16 consecutive months of YoY declines in housing prices with 17% depreciation over the period. Housing prices have declined 19% from peak-to-trough.

Exhibit 7. Historical of Quarterly Home Prices and Global Asset-Backed and Mortgage-Backed Securities Issuance Volumes

Quarter	Levels		YoY Change	
	Case-Shiller Composite-10	Global ABS and MBS Deal Value (\$M)	Case-Shiller Composite-10	Global ABS and MBS Deal Value
1987 Q1	63.87	1,976.85		
1987 Q2	66.59	618.68		
1987 Q3	68.87	796.77		
1987 Q4	70.22	612.73		
1988 Q1	71.12	1,103.10	11%	(44%)
1988 Q2	73.63	2,454.88	11%	297%
1988 Q3	76.40	1,745.02	11%	119%
1988 Q4	77.58	1,623.71	10%	165%
1989 Q1	79.12	749.14	11%	(32%)
1989 Q2	81.24	2,106.98	10%	(14%)
1989 Q3	82.25	2,171.63	8%	24%
1989 Q4	82.35	2,019.17	6%	24%
1990 Q1	82.02	1,847.54	4%	147%
1990 Q2	82.19	6,197.21	1%	194%
1990 Q3	81.39	3,937.53	(1%)	81%
1990 Q4	79.38	3,765.65	(4%)	86%
1991 Q1	77.00	1,761.31	(6%)	(5%)
1991 Q2	78.02	5,460.69	(5%)	(12%)
1991 Q3	78.88	2,578.59	(3%)	(35%)
1991 Q4	77.99	3,590.04	(2%)	(5%)
1992 Q1	77.31	1,043.41	0%	(41%)
1992 Q2	77.94	3,137.18	(0%)	(43%)
1992 Q3	77.76	3,659.37	(1%)	42%
1992 Q4	76.68	3,205.27	(2%)	(11%)
1993 Q1	75.91	13,618.08	(2%)	1205%
1993 Q2	76.51	26,016.89	(2%)	729%
1993 Q3	76.47	25,833.20	(2%)	606%
1993 Q4	75.71	40,729.14	(1%)	1171%
1994 Q1	75.73	82,060.07	0%	503%
1994 Q2	77.04	52,521.37	1%	102%
1994 Q3	77.57	47,444.12	1%	84%
1994 Q4	76.99	43,306.93	2%	6%
1995 Q1	76.38	41,728.98	1%	(49%)
1995 Q2	76.94	45,767.76	(0%)	(13%)
1995 Q3	77.43	54,507.41	(0%)	15%
1995 Q4	76.68	57,958.65	(0%)	34%
1996 Q1	76.49	71,753.66	0%	72%
1996 Q2	77.78	95,471.26	1%	109%
1996 Q3	78.37	91,857.81	1%	69%
1996 Q4	78.12	103,922.77	2%	79%
1997 Q1	78.29	115,172.60	2%	61%
1997 Q2	80.25	115,906.83	3%	21%
1997 Q3	81.57	171,988.37	4%	87%
1997 Q4	82.31	180,971.33	5%	74%
1998 Q1	83.87	190,759.03	7%	66%
1998 Q2	87.03	231,498.31	8%	100%
1998 Q3	89.58	151,987.42	10%	(12%)
1998 Q4	89.82	148,417.44	9%	(18%)
1999 Q1	91.31	223,757.41	9%	17%
1999 Q2	95.10	197,098.61	9%	(15%)
1999 Q3	97.99	186,187.63	9%	23%
1999 Q4	99.51	143,610.34	11%	(3%)
2000 Q1	102.24	157,936.82	12%	(29%)
2000 Q2	107.83	167,535.84	13%	(15%)
2000 Q3	110.90	178,007.34	13%	(4%)
2000 Q4	113.56	192,612.78	14%	34%
2001 Q1	116.69	239,481.77	14%	52%
2001 Q2	120.03	234,033.83	11%	40%
2001 Q3	122.89	223,594.28	11%	26%
2001 Q4	123.64	291,496.94	9%	51%
2002 Q1	125.92	340,416.02	8%	42%
2002 Q2	132.76	331,532.92	11%	42%
2002 Q3	138.62	385,554.18	13%	72%
2002 Q4	142.18	454,390.17	15%	56%
2003 Q1	144.84	444,694.83	15%	31%
2003 Q2	149.70	435,855.43	13%	31%
2003 Q3	155.77	422,107.45	12%	9%
2003 Q4	161.27	404,035.99	13%	(11%)
2004 Q1	167.91	451,008.89	16%	1%
2004 Q2	179.45	483,453.57	20%	11%
2004 Q3	186.91	509,278.67	20%	21%
2004 Q4	191.42	532,741.85	19%	32%
2005 Q1	199.21	549,801.00	19%	22%
2005 Q2	208.86	706,866.11	16%	46%
2005 Q3	216.77	663,361.86	16%	30%
2005 Q4	221.91	716,836.44	16%	35%
2006 Q1	223.75	597,578.95	12%	9%
2006 Q2	226.29	736,001.63	8%	4%
2006 Q3	225.09	658,051.46	4%	(1%)
2006 Q4	222.39	803,506.48	0%	12%
2007 Q1	219.67	770,049.36	(2%)	29%
2007 Q2	217.37	803,496.74	(4%)	9%
2007 Q3	212.71	364,597.70	(6%)	(45%)
2007 Q4	200.76	215,590.57	(10%)	(73%)
2008 Q1	186.13	142,005.37	(15%)	(82%)
2008 Q2	183.15	122,827.39		(85%)
2008 Q3		1,358.54		

One quarter after the securitization markets hit a peak volume of \$6.2 billion in 1990-Q2, house prices fell YoY for six straight quarters (beginning in 1990-Q3) before pausing for a brief quarter (1992-Q1). The securitization issuance volumes followed with a decline of six straight quarters beginning two quarters after (beginning in 1991-Q1) the start of the house prices downtrend.

The first quarter of 2007 began a trend of accelerating house price declines after the securitization markets hit a recent peak of \$803.5 billion in 2006-Q4. House prices declined 2% YoY in 2007Q1 and accelerated to a 15% YoY decline in 2008-Q1.

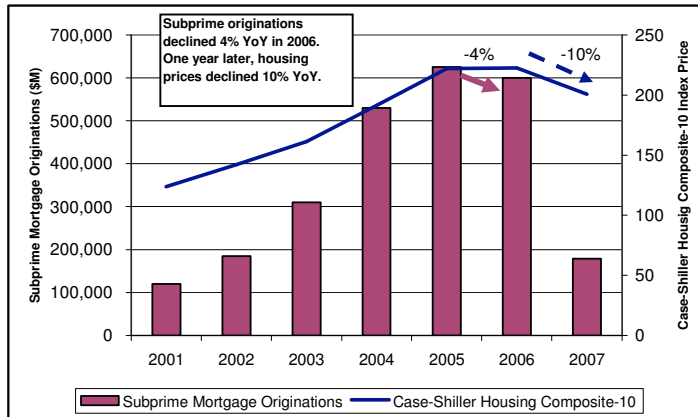
¹ Data for S&P/Case-Shiller Housing Composite-10 in 2008-Q2 is as-of April-2008.
² Data for Global Debt Issuance in 2008-Q3 is as-of 7/10/2008.

Source: Standard & Poor's and Dealogic

The exhibit above highlights the trend of housing prices and the securitization markets on a quarterly basis. One quarter after the securitization markets hit a peak volume of \$6.2 billion in 1990-Q2, house prices fell YoY for six straight quarters (beginning in 1990-Q3) before pausing for a brief quarter (1992-Q1). The securitization issuance volumes followed with a decline of six straight quarters beginning two quarters after (beginning in 1991-Q1) the start of the house prices downtrend. During these periods, the average YoY decline in house prices (1990-Q3 to 1991-Q4) was 3% and the average YoY decline securitization issuance volumes (1991-Q1 to 1992-Q2) was 23% a quarter. At the end of period of the securitization volumes downtrend, housing prices resumed their price declines with eight consecutive quarters of declines averaging 1% a quarter.

Other than the slight YoY house price declines between 2Q and 4Q of 1995, house prices consistently appreciated on a YoY basis until 2007-Q1. The first quarter of 2007 began a trend of accelerating house price declines after the securitization markets hit a recent peak of \$803.5 billion in 2006-Q4. House prices declined 2% YoY in 2007-Q1 and accelerated to a 15% YoY decline in 2008-Q1. The securitization market volumes began plummeting two quarters after the house price downturn starting with a 45% YoY decline in 2007-Q3. For the next three quarters, the securitization volumes fell 73%, 82%, and 85% YoY. We note here that we believe the lack of liquidity in the subprime liquidity market caused the initial decline in home prices and therefore liquidity has been the clear driver for home price declines. That is made clear by the fact that when the broader securitization market, beyond subprime, began to contract, national home prices began their more precipitous decent.

Exhibit 8. Decline in Subprime Origination Volumes Kicked Off the First Leg Down in Home Prices from 2006-2007



Year	Levels		Year-over-Year Change	
	Case-Shiller Housing Composite-10	Subprime Mortgage Originations (\$M)	Case-Shiller Housing Composite-10	Subprime Mortgage Originations
2001	123.64	120,000		
2002	142.18	185,000	15%	54%
2003	161.27	310,000	13%	68%
2004	191.42	530,000	19%	71%
2005	221.91	625,000	16%	18%
2006	222.39	600,000	0%	(4%)
2007	200.76	179,000	(10%)	(70%)

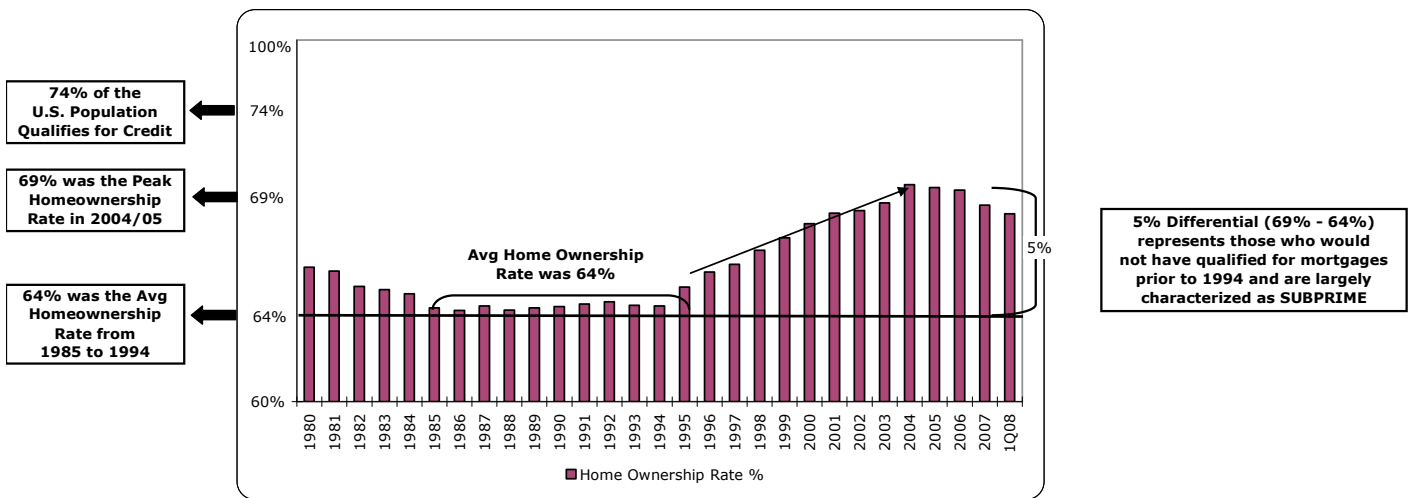
Source: Standard & Poor's, Inside Mortgages, and Fitch Ratings

The exhibit above illustrates how the declines in subprime mortgage originations in 2006 led to the declines in housing prices in 2007. Subprime mortgage originations grew over 4.4x 2001 to 2004 with growth peaking at 71% YoY in 2004. Growth dramatically slowed to 18% YoY in 2005 and then fell 4% in 2006. The 4% decline in subprime mortgage originations correlated with the flattening of house prices and a year later to a decline in housing prices of 10%.

Demand/Supply Market Turns Quickly Into Supply/Demand Market as Less Liquidity Is Driving Home Ownership as Well as House Prices Down

From 1965 to 1994, the average home ownership rate in the United States was ~64%. From 1995 to 2008, the home ownership rate increased, peaking in 2004 at 69%. Since 2004, the rate has declined to 67.8% as of 1Q08. Clearly, decreases in the home ownership rate indicate a falling number of homebuyers. As the rate moves directionally towards its historical average, the depreciation in home prices is perpetuated.

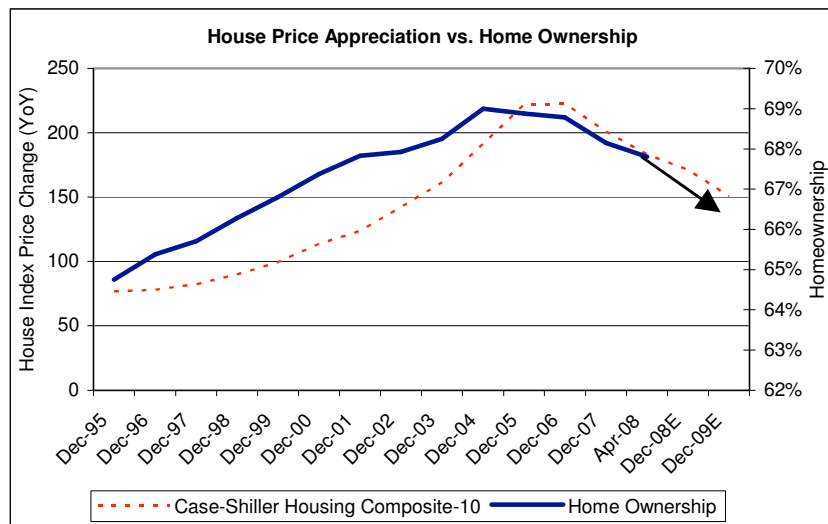
Exhibit 9. Home Ownership



Source: U.S. Census Bureau and Oppenheimer & Co. Inc.

Below we present the Case-Shiller 10-City index vs. the home ownership rate in the U.S. As home prices climbed from 1995 to 2006, the home ownership rate moved in tandem, hitting its peak at 69% in 2004. Currently, both metrics are decreasing, and as the Case-Shiller index is expected to fall into November 2009, we expect the homeownership rate to move directionally in tandem, towards its 1965-1995 average of ~64%.

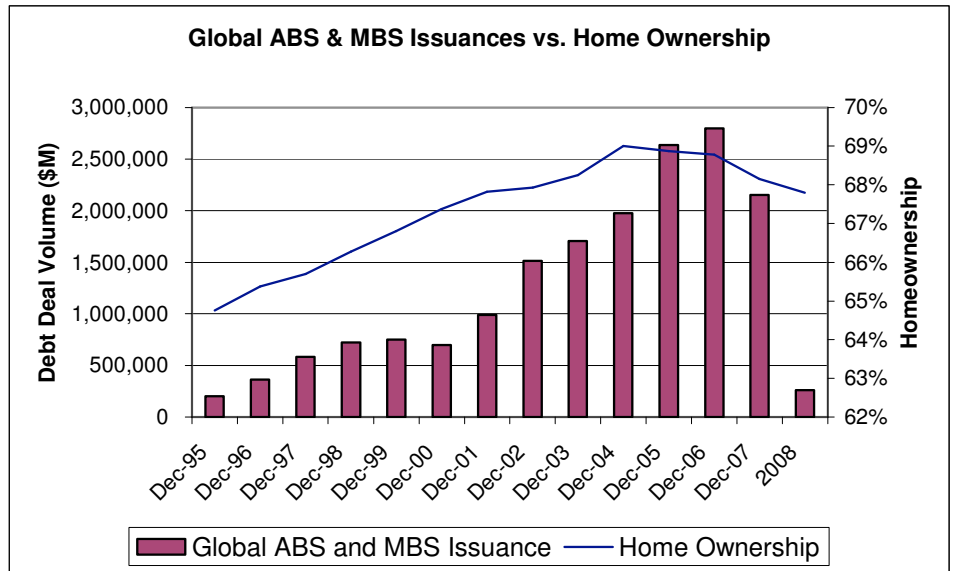
Exhibit 10. Case-Shiller vs. Home Ownership



Source: Chicago Mercantile Exchange, Standard and Poor's, U.S. Census Bureau and Oppenheimer & Co. Inc.

Home ownership in the U.S. has been declining since 2004 when it hit a peak at 69%. The only other time that home ownership declined was in 1993 when the rate was at a low of 64%. We expect home ownership to fall given the liquidity squeeze on consumers given the shutdown of the securitization markets. Lower home ownership translates into lower potential demand and subsequently lower home prices.

Exhibit 11. Global Asset-Backed and Mortgage-Backed Securities Issuance vs. Home Ownership

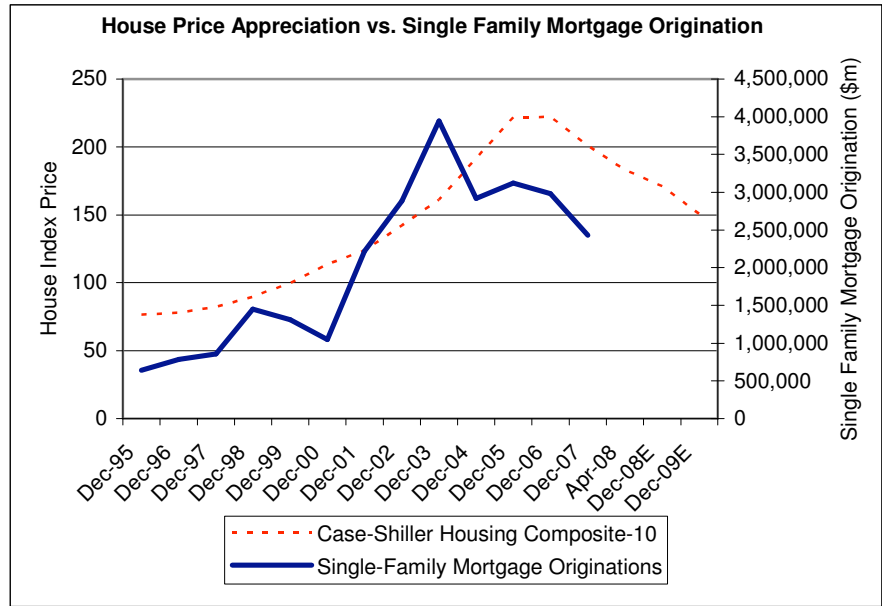


Source: Dealogic and U.S. Census Bureau

With the securitization market closed, we expect originations to decline as well, as banks simply can not provide the origination volume that the securitization market provided. As shown previously, from 2001 to 2004 the securitization market provided 9.8x the liquidity of on-balance sheet bank loans. From 2005 to 2007 this multiple dropped to 5.8x. Put another way, from 2005 to 2007 banks' lending represented only 15% of mortgage loans. At a time when banks face significant capital constraints, we expect originations to continue to decrease.

Below we present the Case-Shiller 10-City vs. single family mortgage originations. Although home prices moved up more steadily, both metrics increased dramatically from 1995 to 2003, with annual originations increasing 517% from 1995 to 2003. Although declining from their peak, originations remained at elevated levels as Case-Shiller continued to rise until 2006. Currently both metrics are decreasing, with the Case-Shiller index futures suggesting a decline until November 2009.

Exhibit 12. Case-Shiller vs. Single Family Mortgage Origination

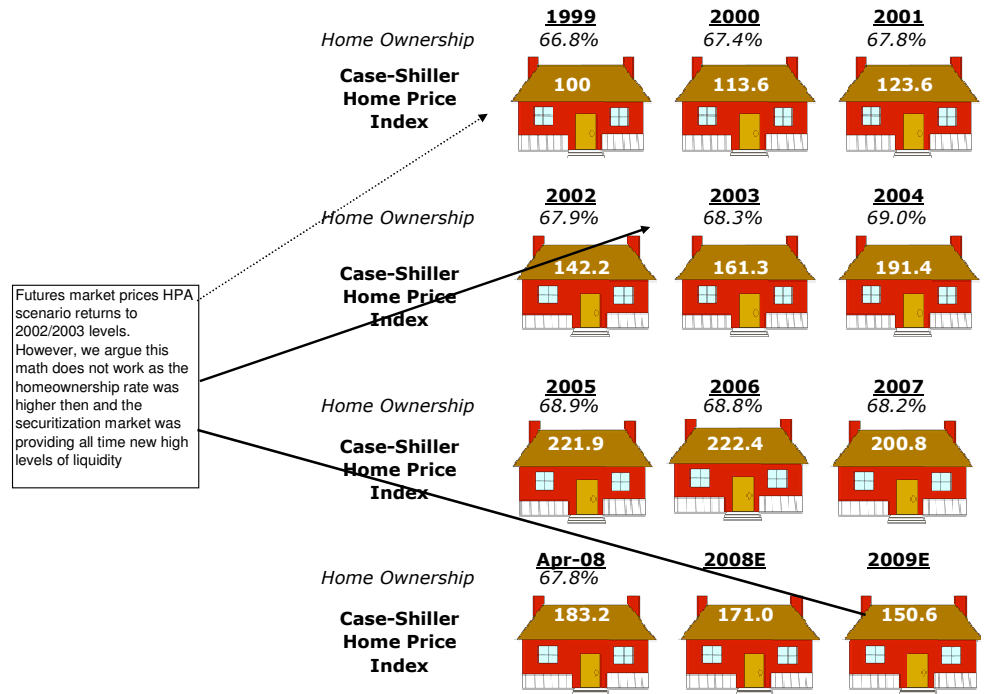


Source: Standard and Poor's, OFHEO and Oppenheimer & Co. Inc.

Securitization Boom Created More Homebuyers, Driving Up Prices and Home Ownership Rate

At the start of 2000, the U.S. home ownership rate was 66.8% and the Case-Shiller Home Price Index was 100. By 2005, the home ownership rate increased to 68.9% and the Case-Shiller Home Price Index rose to 221.9. After these numbers stayed virtually flat in 2006, they began decreasing dramatically, as through April 2008, home ownership levels decreased to 67.8% and Case-Shiller dropped to 183.2. Effectively, home ownership returned to 2001 levels. The decrease in the Case-Shiller Index to 183.2 indicates that home prices have dropped below August 2004 levels (185). Due to constrained liquidity, we estimate that at least 5 million fewer Americans will be able to A) put down 20% for a mortgage, B) qualify for a mortgage, or C) find a bank to fund a mortgage.

Exhibit 13. Home Ownership and Appreciation from Case-Shiller's Starting Point of 100 in January 2000



E indicates estimates implied by the CME Housing Composite Futures

Source: Standard and Poor's, Chicago Mercantile Exchange, OFHEO and Oppenheimer & Co. Inc.

Currently, the futures markets are pricing in returns to 2002/2003 levels. This doesn't make sense to us as we simply ask why stop there? Home ownership levels were higher then than those today, and securitization volume was breaking out to new highs in those years.

According to the Case-Shiller Housing Composite 10 Cities Index, housing prices have declined 19% from peak-to-trough already. In this report, we argue that the magnitude of house price declines in the next few years could likely exceed market expectations and will most likely exceed the expectations of company managements.

The Case-Shiller Home Price Index was conceived by Karl E. Case and Robert J. Shiller in 1980. These indexes measure home prices across the U.S. based on recorded changes in home values using a repeat sales methodology. The indices have a base value of 100 in January 2000; an index value of 125% represents a 25% appreciation since January 2000 for a typical home from the subject market.

We looked at the S&P/Case-Shiller Housing Composite 10 Cities Index which is a value-weighted average of the 10 original metro area indices (Boston, Chicago, Denver, Las Vegas, Los Angeles, Miami, New York, San Diego, San Francisco, and Washington D.C.).

We also looked at the CME Housing Composite futures based on the Case-Shiller Housing Composite 10 Cities Index. These futures, which began trading in May 2006, were originally designed to offer institutional and individual investors the opportunity to gain or hedge real estate risk exposures. The CME Housing futures offer some insight to market expectations of future housing prices. We caveat, however, that the CME Housing Futures market is not that deep and liquid and may not be a reliable proxy of market expectations of housing prices. As of June 9, 2008, the total open interest for CME housing futures (Housing Composite index and the individual indices for the ten cities) was 435 contracts with a notional value outstanding of approximately \$17.6 million. Despite that, the CME Housing Futures do offer some useful information given that they

are the only available proxy of expected future house prices tied to the Case-Shiller Indices.

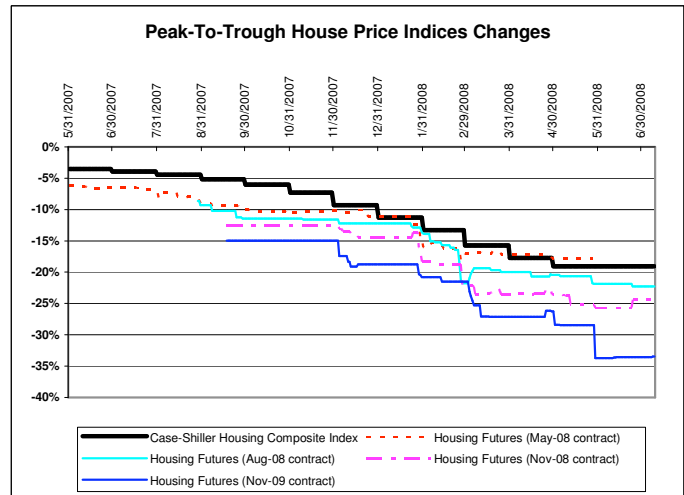
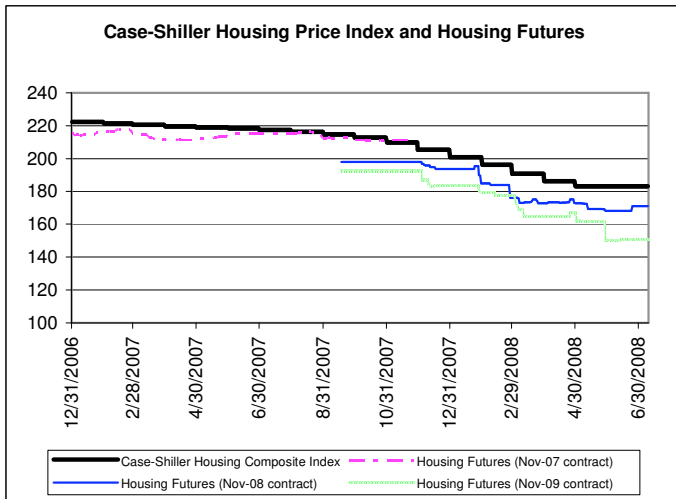
Exhibit 14. CME Housing Futures Liquidity (as-of 7/9/2008)

Housing Futures	Open Interest	Notional Outstanding
Boston	18	696,600
Chicago	43	1,547,450
CSI Housing Comp Futures	48	1,994,050
Denver	11	327,250
Las Vegas	48	1,745,550
Los Angeles	49	2,058,150
Miami	54	2,521,450
New York	66	3,008,150
San Diego	30	1,196,350
San Francisco	60	2,121,150
Washington D.C.	8	375,400
TOTAL	435	17,591,550

As-of: 7/9/2008

Source: Chicago Mercantile Exchange

Exhibit 15. Historical and Implied Housing Price Levels



Source: Standard & Poor's, Chicago Mercantile Exchange, and Bloomberg

As of April 2008, the S&P Case-Shiller Housing Composite-10 index price was 183.15, down from the Dec-07 level of 200.76 or a 9% decline YTD. The CME Housing Composite Futures imply a decline of 15% near the end of 2008 (Nov-08 contract at 171 as of 7/9/2008) and 25% near the end of 2009 (Nov-09 contract at 150.6 as-of 7/9/2008) from the Dec-07 levels.

Exhibit 16. CME Case-Shiller Housing Composite Futures Contract Table

CSI Housing Composite Futures

As-of: 7/9/08

Contract Date	Settlement Prices ¹	CSI Index HIGH ²	Futures vs CSI High	Implied House Price Change
Aug-08	175.80	226.29	(50.49)	(22.3%)
Nov-08	171.00	226.29	(55.29)	(24.4%)
Feb-09	160.80	226.29	(65.49)	(28.9%)
May-09	155.40	226.29	(70.89)	(31.3%)
Nov-09	150.60	226.29	(75.69)	(33.4%)
Nov-10	151.40	226.29	(74.89)	(33.1%)
Nov-11	153.00	226.29	(73.29)	(32.4%)

¹ CSI Housing Composite futures settlement price as-of 7/7/2008.

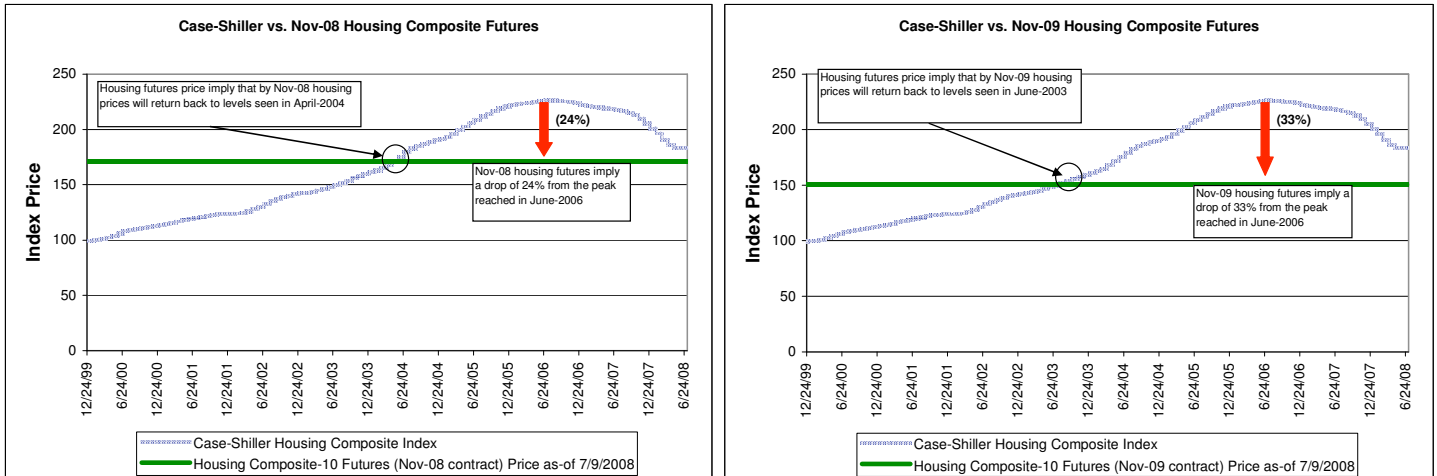
² S&P/Case Schiller Composit 10-Cities Index high set in June 2006.

Source: Bloomberg and Standard & Poor's

Housing futures imply a housing price peak-to-trough drop of 24% by November 2008. Under this scenario, home prices would return to levels last seen in April 2004, essentially wiping out the home price appreciation since that date. Housing futures imply a housing price peak-to-trough drop of 33% by November 2009. Under this scenario home prices would return to levels last seen in June 2003, essentially wiping out five years of home price appreciation.

Currently the Case-Shiller 10-city index has declined by ~19% from the peak in June 2006 through April 2008. The projections of the future market indicate that a further drop of 7% is expected from April 2008 to November 2008.

Exhibit 17. Case-Shiller Housing Composite-10 vs. Implied Housing Price Index Levels (2008)



Source: Chicago Mercantile Exchange, Bloomberg, and Oppenheimer & Co. Inc.

Currently the Case-Shiller 10-city index has declined by ~19% from the peak in June 2006 through April 2008. The projections of the future market indicate that a further drop of 18% is expected from April 2008 to November 2009.

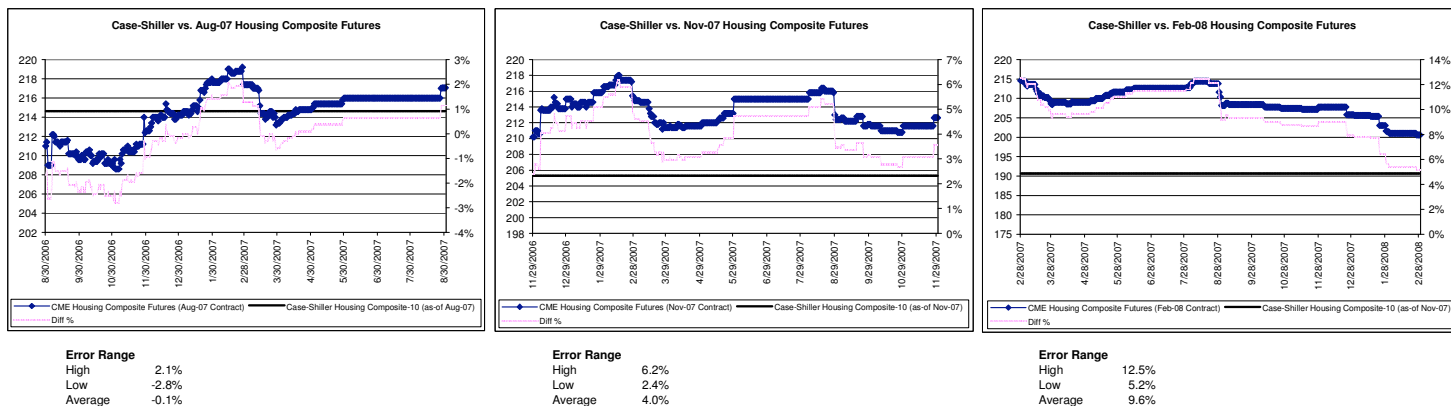
CME Housing Composite Futures Historically Have Been Too Optimistic

We found that the expected housing prices implied by the CME housing futures market tend to be overly optimistic. This is evident from examining the three recently expired futures contracts: Aug-07, Nov-07, and Feb-08. According to data compiled from Bloomberg and the CME, these futures contracts show that the futures markets have increasingly overestimated actual house price levels and by wider margins. For example, the Aug-07 contract was the most accurate by a narrower error margin whereas the more recent Feb-08 contract was the most optimistic with the widest error margin. We infer that market expectations of future housing prices as proxied by the CME Housing futures are overly optimistic with greater uncertainty.

To gauge the accuracy of the implied pricing of the CME Housing futures, we compared the “tradeable” Case-Shiller Housing Composite-10 versus three CME Housing Composite futures contracts. These three futures contracts were the Aug-07, Nov-07, and Feb-08 contracts. We calculated the error as: (futures prices at a specific trade date less the actual index price at expiration date) divided by the actual index price at expiration date.

The charts below illustrate the overestimation of housing prices implied by the CME futures. The blue lines with diamond markers represent the daily trading prices of the futures and the solid black lines represent the month-end closing price of the actual Case-Shiller Housing Composite index. For the most part, the daily trading prices of the futures fall above the actual price of the Case-Shiller index suggesting that market expectations are overly optimistic of future housing prices.

Exhibit 18. Case-Shiller Housing Composite-10 (Actual Prices) versus CME Housing Composite Futures



Source: Chicago Mercantile Exchange and Bloomberg

As the exhibit above shows, the CME Housing futures (Aug 2007 contract) underestimated the actual housing price at six months or greater until expiration and overestimated six months or less until the August 2007 expiration. On average, the Aug-07 CME Housing Composite Futures underestimated the actual Case-Shiller index price by 0.1%. The error for the Aug-07 CME Housing Composite Futures ranged from (2.8%) to 2.1%.

The actual S&P/Case Shiller Housing Composite-10 index closed at 214.62 as-of August 2007 month-end. The Aug-07 CME Housing Composite Futures closed at 211.4 one year prior to expiration (-2% error difference), 214 nine months prior to expiration (0% error difference), 217.4 six months prior to expiration (1% error difference), and 215.8 three months prior to expiration (1% error difference). The Aug-07 futures settled at 217.07 at expiration, 2.45 index points above the actual Case-Shiller Housing Composite-10 index or 1% error difference.

The CME Housing futures (Nov-2007 contract) consistently overestimated the actual housing price throughout the life of the contract. On average, the Nov-07 CME Housing Composite Futures overestimated the actual Case-Shiller index price by 4%. The error for the Nov-07 CME Housing Composite Futures ranged from 2.4% to 6.2%.

The actual S&P/Case Shiller Housing Composite-10 index closed at 205.31 as-of November 2007 month-end. The Nov-07 CME Housing Composite Futures closed at 210.2 one year prior to expiration (2% error difference), 215.4 nine months prior to expiration (5% error difference), 213.2 six months prior to expiration (4% error difference), and 216 three months prior to expiration (5% error difference). The Nov-07 futures settled at 212.65 at expiration, 7.34 index points above the actual Case-Shiller Housing Composite-10 index or 4% error difference.

The CME Housing futures (Feb-2008 contract) consistently overestimated the actual housing price throughout the life of the contract. On average, the Feb-08 CME Housing Composite Futures overestimated the actual Case-Shiller index price by 10%. The error for the Feb-08 CME Housing Composite Futures ranged from 5.2% to 12.5%.

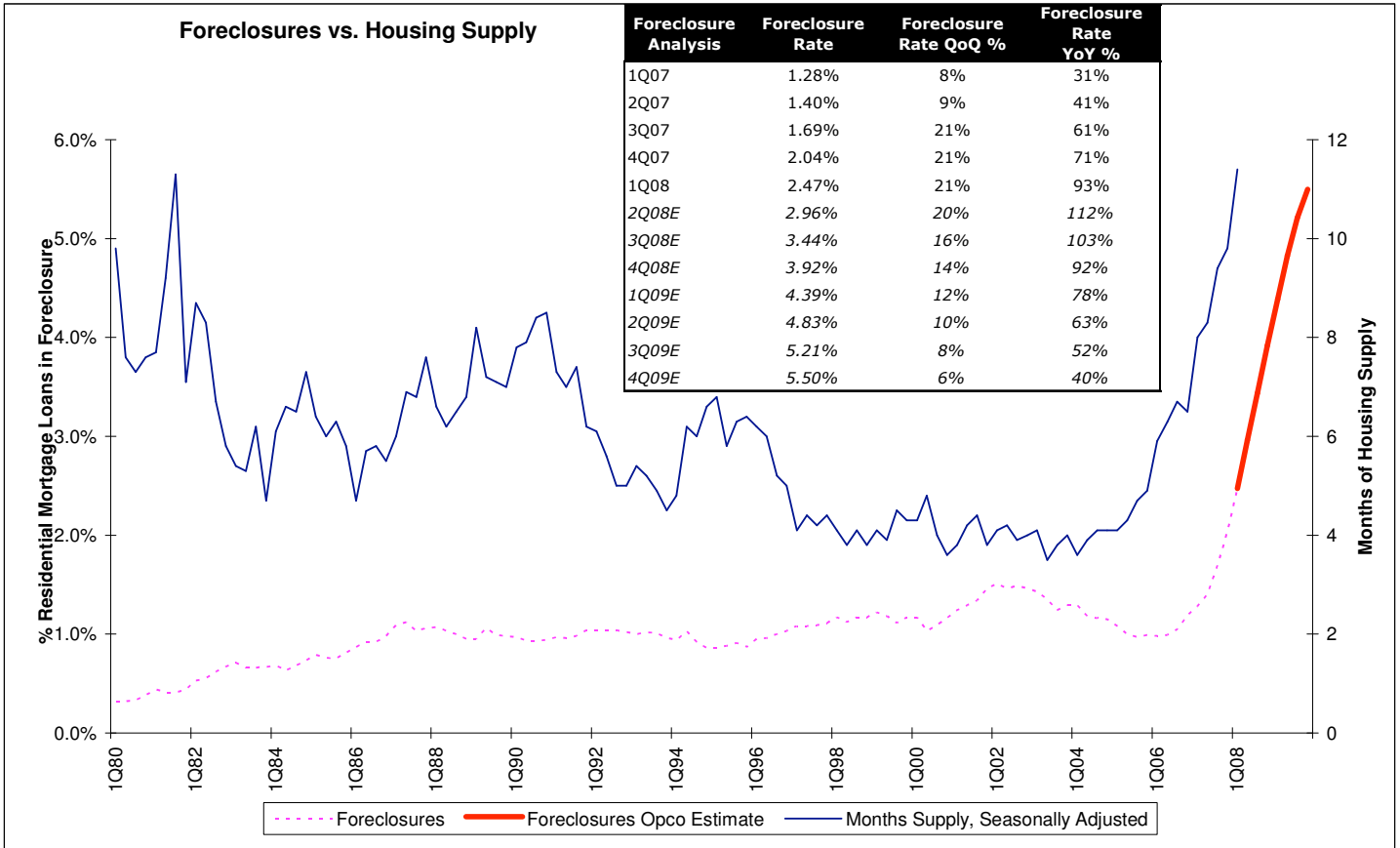
The actual S&P/Case Shiller Housing Composite-10 index closed at 190.68 as-of February 2008 month-end. The Feb-08 CME Housing Composite Futures closed at 214.6 one year prior to expiration (13% error difference), 211.6 nine months prior to expiration (11% error difference), 213.8 six months prior to expiration (12% error difference), and 207.2 three months prior to expiration (9% error difference). The Feb-08 futures settled at 200.55 at expiration, 9.87 index points above the actual Case-Shiller Housing Composite-10 index or 5% error difference.

Foreclosures Continue To Rise

On June 5, the Mortgage Bankers Association released 1Q08 data showing a sharp rise in loans in foreclosure. The percentage of loans in foreclosure was 2.47% in 1Q08 up from 2.04% in 4Q07, matching our estimates and reaching the highest levels on record, dating back to 1979.

The Census Bureau releases data on the seasonally adjusted housing supply based on the current sales rate. Through 1Q08, there was 11.1 months of supply, with supply rising in tandem with foreclosures. We expect foreclosures to continue to rise throughout 2008 and 2009.

Exhibit 19. Foreclosures vs. Housing Supply



Source: Mortgage Bankers Association, Bloomberg, and Oppenheimer & Co. Inc.

Loan Portfolios

Below we present loan exposures, net charge-offs, and delinquencies by category for our bank universe.

BAC has the largest home equity exposure at \$118 billion, followed by JPM at \$95 billion and WFC at \$84 billion. BAC also has the largest mortgage portfolio, at \$266 billion, followed by WB at \$170 billion and C at \$151 billion.

We note that of BAC's \$266 billion in residential mortgage exposure, ~\$160 billion of credit risk is mitigated through synthetic securitization and credit protection agreements through government sponsored agencies. The synthetic securitization (reimbursing losses beyond 10bps) covers the \$133.5 billion of BAC mortgages that fall into this bucket. BAC also has credit protection agreements covering \$27.2 billion in mortgages, providing full protection on conforming residential mortgage loans that become severely delinquent.

Exhibit 20. Bank Loan Books and Credit Quality as of 1Q08

Consumer Loans					Commercial Loans				
Home Equity	Portfolio (\$b)	NCOs	Delinquencies		CRE	Portfolio (\$b)	NCO	Delinquencies	
BAC	118	1.71%	1.33%		BAC	63	0.70%	0.36%	
C	62	1.45%	3.16%		C	24	NA	NA	
JPM	95	1.89%	3.99%		JPM ¹	15	3.51%	2.44%	
WB	60	0.47%	0.72%		WB	48	1.10%	3.95%	
WFC	84	2.34%	0.27%		WFC	56	0.22%	0.07%	
					¹ JPM: Category is Commercial Real Estate Banking per 1Q08 Earnings Presentation				
Mortgage	Portfolio (\$b)	NCO	Delinquencies		C&I (mix varies by company)	Portfolio (\$b)	NCOs	Delinquencies	
BAC	266	0.10%	0.09%		BAC	219	0.14%	0.09%	
C	151	1.00%	3.02%		JPM ²	68	0.48%	0.66%	
JPM Prime	45	0.48%	5.64%		WB	119	0.39%	0.76%	
JPM Subprime	16	3.82%	~15.00%		WFC	91	1.01%	0.03%	
WB Traditional	49	0.23%	1.15%		² JPM: Includes Middle Market Banking, Mid-Corporate Banking, and Real Estate Banking				
WB Pick-A-Pay	121	0.79%	3.82%						
WFC	91	0.41%	0.35%						
Managed Cards	Portfolio (\$b)	NCO	Delinquencies	Delinq. Days	Small Business	Portfolio (\$b)	NCO	Delinquencies	
BAC	184	5.19%	2.71%	90-day	BAC	20	7.21%	2.72%	
C US	138	5.83%	1.57%	90-day					
C INTL	32	4.99%	2.29%	90-day					
JPM	151	4.37%	1.84%	90-day					
WFC	19	5.89%	2.36%	90-day					
Auto	Portfolio (\$b)	NCO	Delinquencies		Commercial Lease	Portfolio (\$b)	NCO	Delinquencies	
C	17	3.40%	0.69%		BAC	22	0.27%	0.14%	
JPM	47	1.10%	1.44%		WFC	7	0.53%	NA	
WB	26	2.31%	0.25%						

Source: Company reports and Oppenheimer & Co. Inc.

Below we present a table of the capital raised by our banks from 3Q07 to 1Q08, as well as the uses of that capital. We note that C has raised most the capital, but also has used the most, arriving to the net capital usage of \$23.9 billion.

Exhibit 21. 3Q07 to 1Q08 Bank Capital

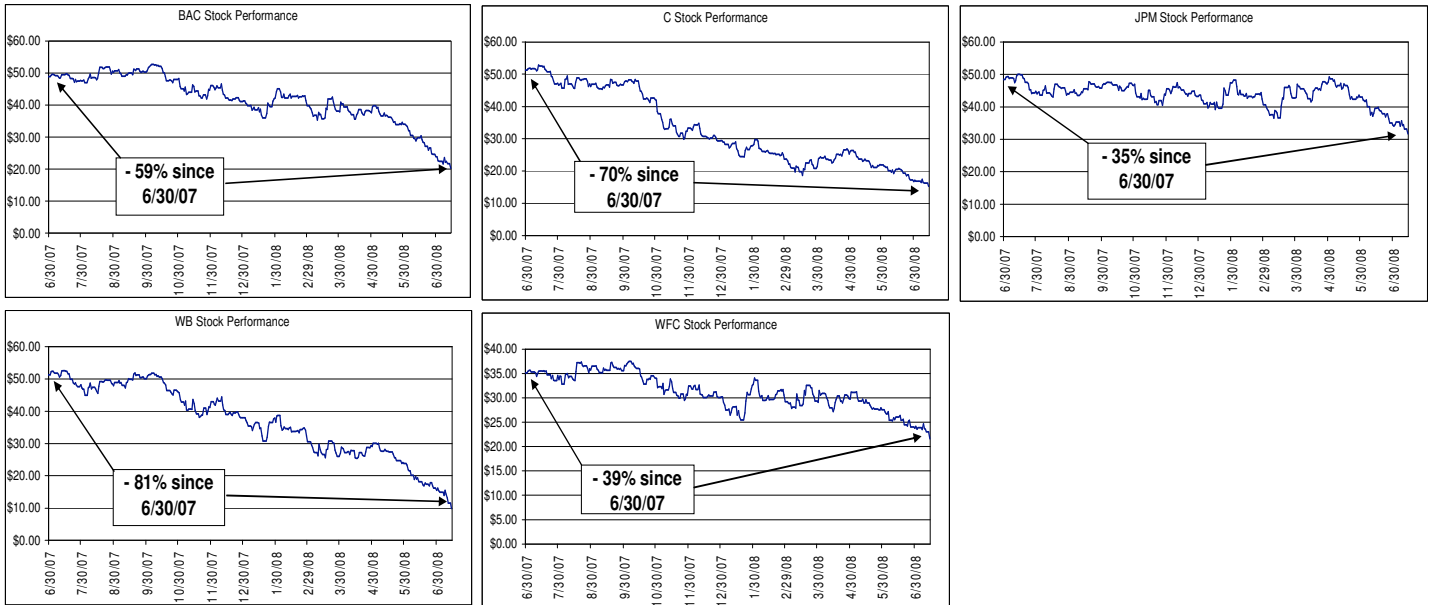
3Q07 to 1Q08 (\$b)	Capital Raised	Writedowns	Provision	Net
BAC	20.9	-12.5	-11.4	-3.0
C	43.4	-49.2	-18.1	-23.9
JPM	10.0	-5.3	-8.8	-4.0
WB	14.7	-6.1	-4.7	3.9
WFC	5.1	0.0	-5.5	-0.5

Sources: SNL Financial, Company reports, and Oppenheimer & Co. Inc.

Valuation

“Reversion to the mean” mentality is a fool’s game, in our opinion, in the midst of unprecedented capital destruction. Below we show the rapid, steep decline in the stock prices of our bank universe.

Exhibit 22. Historical Stock Performance



Source: FactSet and Oppenheimer & Co. Inc.

Below we present historical valuation analysis for our banks, using the previous 1990-1991 and 2001-2003 credit cycles. We apply the peak and trough price/book and price/tangible multiples to current book value and tangible book value to reach trough price levels on historical multiples, however, these are unprecedented times with historical valuation ranges providing little real relevance today.

Exhibit 23. Historical Valuation Analysis

Current P/B and P/TB vs. 1990-1991 Credit Cycle										1990-1991 Cycle Multiples Applied to Current BV and TBV			
	Current Price	Current BV	Current P/B	P/B Min	P/B Max	Current TBV	Current P/TB	P/TB Min	P/TB Max	Price Min on P/B	Price Max on P/B	Price Min on P/TB	Price Max on P/TB
BAC	20.15	31.22	0.6x	0.6x	1.6x	12.62	1.6x	0.9x	1.7x	18.40	48.85	11.30	21.69
C	15.22	20.73	0.7x	0.4x	0.9x	10.20	1.5x	0.4x	1.1x	8.00	19.36	4.51	11.05
JPM	31.69	36.94	0.9x	0.4x	1.1x	22.38	1.4x	0.4x	1.1x	14.93	41.36	9.05	25.06
WB	9.84	36.40	0.3x	0.7x	1.4x	13.60	0.7x	1.8x	2.2x	24.61	52.62	23.89	29.95
WFC	21.57	14.58	1.5x	0.9x	2.1x	10.28	2.1x	NA	NA	13.62	30.65	NA	NA

Current P/B and P/TB vs. 2001-2003 Credit Cycle										2001-2003 Cycle Multiples Applied to Current BV and TBV			
	Current Price	Current BV	Current P/B	P/B Min	P/B Max	Current TBV	Current P/TB	P/TB Min	P/TB Max	Price Min on P/B	Price Max on P/B	Price Min on P/TB	Price Max on P/TB
BAC	20.15	31.22	0.6x	1.6x	2.5x	12.62	1.6x	2.4x	3.7x	48.60	77.08	30.40	47.14
C	15.22	20.73	0.7x	1.6x	4.4x	10.20	1.5x	2.7x	5.7x	33.76	90.93	27.11	58.28
JPM	31.69	36.94	0.9x	0.7x	2.6x	22.38	1.4x	1.1x	4.3x	26.85	97.75	23.74	96.75
WB	9.84	36.40	0.3x	1.2x	2.2x	13.60	0.7x	2.0x	3.4x	44.76	80.34	27.36	45.76
WFC	21.57	14.58	1.5x	2.4x	3.6x	10.28	2.1x	3.8x	6.1x	35.71	53.09	38.74	63.05

Current P/B and P/TB vs. 1990-2008										1990-2008 Multiples Applied to Current BV and TBV			
	Current Price	Current BV	Current P/B	P/B Min	P/B Max	Current TBV	Current P/TB	P/TB Min	P/TB Max	Price Min on P/B	Price Max on P/B	Price Min on P/TB	Price Max on P/TB
BAC	20.15	31.22	0.6x	0.6x	3.3x	12.62	1.6x	0.9x	5.1x	18.40	102.18	11.30	64.38
C	15.22	20.73	0.7x	0.4x	5.3x	10.20	1.5x	0.4x	5.7x	8.00	109.15	4.51	58.28
JPM	31.69	36.94	0.9x	0.4x	3.6x	22.38	1.4x	0.4x	5.1x	14.93	134.33	9.05	114.31
WB	9.84	36.40	0.3x	0.3x	4.0x	13.60	0.7x	0.7x	5.8x	9.88	144.41	9.84	78.52
WFC	21.57	14.58	1.5x	0.9x	4.4x	10.28	2.1x	2.1x	7.2x	13.62	64.16	21.21	73.89

Current P/B and P/TB vs. 2003-2008										2003-08 Multiples Applied to Current BV and TBV			
	Current Price	Current BV	Current P/B	P/B Min	P/B Max	Current TBV	Current P/TB	P/TB Min	P/TB Max	Price Min on P/B	Price Max on P/B	Price Min on P/TB	Price Max on P/TB
BAC	20.15	31.22	0.6x	0.6x	2.5x	12.62	1.6x	1.6x	5.1x	20.15	77.69	20.15	63.90
C	15.22	20.73	0.7x	0.7x	2.8x	10.20	1.5x	1.5x	4.8x	15.22	57.31	15.17	49.29
JPM	31.69	36.94	0.9x	0.9x	1.9x	22.38	1.4x	1.4x	3.3x	31.69	71.89	31.69	74.26
WB	9.84	36.40	0.3x	0.3x	2.1x	13.60	0.7x	0.7x	3.9x	9.88	76.58	9.84	52.74
WFC	21.57	14.58	1.5x	1.5x	3.1x	10.28	2.1x	2.1x	4.6x	21.57	44.65	21.57	46.97

Comp Table

Below we present a comp table for our bank universe. Our FY2008 and FY2009 estimates indicate that banks are getting more expensive on a P/E basis as estimates are lowered. On a FY2008 P/E basis excluding C and WB due to negative earnings in FY2008, WFC is the most expensive at 18.0x followed by JPM at 17.6x. Excluding C and WB, the group's average 2008 P/E is 14.9x. For P/E based on FY2009 and excluding WB due to negative earnings, C is the most expensive at 33.8x, followed by JPM at 18.4x. The group's average P/E based on our FY2009 estimates is 17.4x, well above the 2003-2007 average forward P/E ratio of 12.0x.

On a price to book basis, WFC is the most expensive at 1.5x followed by JPM at 0.9x. On a price to tangible book basis, WFC is the most expensive at 2.1x, followed by BAC at 1.6x.

Exhibit 24. Comp Table

	BAC	C	JPM	WB	WFC
Stock Price	20.15	15.22	31.69	9.84	21.57
Opco FY2008 EPS	2.19	-2.15	1.80	-1.35	1.20
Opco FY2009 EPS	2.90	0.45	1.80	-0.35	1.90
P / Opco FY2008E	9.2x	nm	17.6x	nm	18.0x
P / Opco FY2009E	6.9x	33.8x	17.6x	nm	11.4x
Consensus FY2008 EPS	2.41	-0.66	2.58	1.27	2.14
Consensus FY2009 EPS	3.53	2.49	3.40	2.40	2.43
P / Consensus FY2008E	8.4x	nm	12.3x	7.7x	10.1x
P / Consensus FY2009E	5.7x	6.1x	9.3x	4.1x	8.9x
2003-2007 Avg Forward P/E	11.1x	11.8x	11.9x	11.9x	13.5x
Book Value	31.22	20.73	36.94	36.24	14.58
Price / Book	0.6x	0.7x	0.9x	0.3x	1.5x
Tangible Book Value	12.62	10.20	22.38	13.60	10.28
Price / Tangible Book	1.6x	1.5x	1.4x	0.7x	2.1x

Source: Reuters, SNL Financial, FactSet, company reports and Oppenheimer & Co. Inc.

Exhibit 25. Ratings

Company	Ticker	Opco Rating	Stock Price
Bank of America	BAC	Perform	20.15
Citigroup	C	Underperform	15.22
JP Morgan	JPM	Perform	31.69
Wachovia	WB	Underperform	9.84
Wells Fargo	WFC	Underperform	21.57

Sources: Reuters and Oppenheimer & Co. Inc.

Important Disclosures and Certifications

Analyst Certification - The author certifies that this research report accurately states his/her personal views about the subject securities, which are reflected in the ratings as well as in the substance of this report. The author certifies that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

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Important Disclosure Footnotes for Companies Mentioned in this Report that Are Covered by Oppenheimer & Co. Inc.:

Stock Prices as of July 15, 2008

Bank of America (BAC - NYSE, 20.15, PERFORM)
 Citigroup Inc. (C - NYSE, 15.22, UNDERPERFORM)
 JP Morgan Chase & Company (JPM - NYSE, 31.69, PERFORM)
 Wachovia (WB - NYSE, 9.84, UNDERPERFORM)
 Wells Fargo & Company (WFC - NYSE, 21.57, UNDERPERFORM)

All price targets displayed in the chart above are for a 12- to- 18-month period. Prior to March 30, 2004, Oppenheimer & Co. Inc. used 6-, 12-, 12- to 18-, and 12- to 24-month price targets and ranges. For more information about target price histories, please write to Oppenheimer & Co. Inc., 300 Madison Avenue, New York, NY 10017, Attention: Equity Research Department, Business Manager.

Oppenheimer & Co. Inc. Rating System as of January 14th, 2008:

Outperform(O) - Stock expected to outperform the S&P 500 within the next 12-18 months.

Perform (P) - Stock expected to perform in line with the S&P 500 within the next 12-18 months.

Underperform (U) - Stock expected to underperform the S&P 500 within the next 12-18 months.

Not Rated (NR) - Oppenheimer & Co. Inc. does not maintain coverage of the stock or is restricted from doing so due to a potential conflict of interest.

Oppenheimer & Co. Inc. Rating System prior to January 14th, 2008:

Buy - anticipates appreciation of 10% or more within the next 12 months, and/or a total return of 10% including dividend payments, and/or the ability of the shares to perform better than the leading stock market averages or stocks within its particular industry sector.

Neutral - anticipates that the shares will trade at or near their current price and generally in line with the leading market averages due to a perceived absence of strong dynamics that would cause volatility either to the upside or downside, and/or will perform less well than higher rated companies within its peer group. Our readers should be aware that when a rating change occurs to Neutral from Buy, aggressive trading accounts might decide to liquidate their positions to employ the funds elsewhere.

Sell - anticipates that the shares will depreciate 10% or more in price within the next 12 months, due to fundamental weakness perceived in the company or for valuation reasons, or are expected to perform significantly worse than equities within the peer group.

Rating	IB Serv/Past 12 Mos.			
	Count	Percent	Count	Percent
OUTPERFORM [O]	355	48.63	135	38.03
PERFORM [P]	348	47.67	114	32.76
UNDERPERFORM [U]	27	3.70	7	25.93

Although the investment recommendations within the three-tiered, relative stock rating system utilized by Oppenheimer & Co. Inc. do not correlate to buy, hold and sell recommendations, for the purposes of complying with FINRA rules, Oppenheimer & Co. Inc. has assigned buy ratings to securities rated Outperform, hold ratings to securities rated Perform, and sell ratings to securities rated Underperform.

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