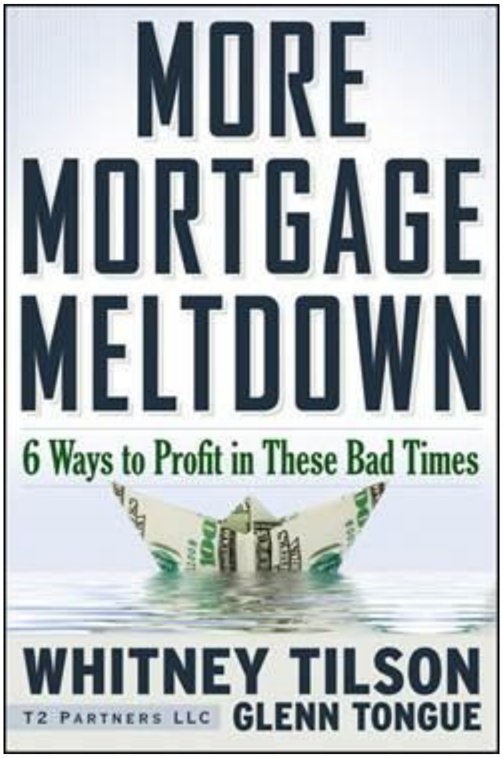
Sample Investment Email, sent 12/9/12

1) We're doing end of year cleaning/organizing in my office and have a handful of extra copies of our book, More Mortgage Meltdown. If you want a FREE copy mailed to you, email Kelli at KAlires@T2PartnersLLC.com – first come, first serve! Here's the cover and for more about the book, see www.moremortgagemeltdown.com:



The first half of the book is on the housing crisis: what happened, why, where we were as of the time of publication (early 2009 amidst the depths of the crisis), and what the future holds (a largely correct prediction that the market would remain stressed for many years).

The second half of the book is entitled *Profiting from the Meltdown* and has also stood the test of time well. Here's an excerpt:

> Having suffered along with almost all other investors during the severe market decline that began in September 2008 (which showed no signs of abating by early March 2009), we'll admit to having two feelings just about every day that we suspect are widely shared by other investors: first, we berate ourselves for being such idiots for not having foreseen the meltdown and gone to 100% cash or at least fully hedging our long positions. How did we miss something that seems 100% obvious (with the benefit of hindsight, of course,

> which is always 20/20)? Second, we want to stop the pain – and it's very painful losing money seemingly every day, month after month, especially when it's not only your own money, but more importantly also the savings many friends and family who have put their trust in you.
>
> There's an easy way to stop the pain and prevent future losses: sell everything and sit in cash until the situation stabilizes and stocks have started to recover. Surely there will be plenty of time to get back in, right? This is the approach taken by more and more investors every day, which is contributing to the market meltdown, but while we certainly wish we'd been smart enough to do this many months ago, it's not what we're doing today. Why? There are two reasons.
>
> First, when we look at our portfolio and evaluate every stock we own, trying to find something to sell, we can't find a single good candidate. For each stock, we've carefully evaluated the underlying businesses, come up with what we believe is a conservative estimate of its intrinsic value (making no optimistic assumptions; we think the economy will be in dire straits for the foreseeable future), and then compared this value to the current stock price. In each case, the stock is trading at a huge discount – anywhere from 35% to 80% – to its intrinsic value.
>
> Benjamin Graham, widely considered to be the father of value investing – he taught Warren Buffett – once said, "In the short run, the market is a voting machine but in the long run it is a weighing machine." By this, he means that over short periods of time, stocks can trade almost anywhere depending on the whims, fear and greed of investors, but over time they will trade based on the earnings and financial fundamentals of the underlying businesses. We're convinced that the market today (early March 2009) has become almost entirely a voting machine. We're also convinced that someday – we can't predict when – it will again become a weighing machine, and that we will be well rewarded for our patience.

There are full chapters on five long ideas (Berkshire, Amex, Wells Fargo, Resource America, and a distressed tranche of a pool of subprime mortgages) and one short idea (MBIA) (plus a chapter on shorting in general).

2) Jonathan Weil with some fascinating and relevant history of Glass-Steagall – it was passed NOT "not for the reasons usually cited" but "to protect consumers. The banking industry has a long history of preying on unsophisticated depositors by selling them garbage investments without regard to suitability." I've long said the financial industry preys on consumers – and now I see it has always been thus – though I suspect it reached a peak in 2007…

3) Before I get to the three articles below about Chinese frauds (mostly reverse merger), I want to tell a quick story. Last night I met a lawyer who runs a law firm in a major Chinese city and represents mostly foreign companies doing business in

China or with Chinese companies. When I told him the things I've written about rampant fraud, he agreed 100% -- in fact, before I could use the word myself, he said the country is a "kleptocracy".

About half of his clients, he said, are companies that have been defrauded (there's little that can be done; there is ZERO rule of law) and half are companies smart enough to hire his firm before being defrauded. He said the ONLY way to avoid being defrauded in a joint venture was to make the Chinese company invest in the foreign partner's assets outside of China, so that these assets could be seized if (when) the Chinese company tried to defraud its partner.

He also said industrial/internet espionage is widespread and when I mentioned the October 60 Minutes segment on Huawei (www.cbsnews.com/video/watch/?id=7424702n), he said he hadn't seen it, but any company that was dumb enough to hire Huawei for anything deserved what they would get: all their secrets being stolen.

4) Here's the first article, by Floyd Norris, on how international auditing firms are disgracing themselves:

> Imagine for a moment that you were auditing a company whose principal asset was trees that it would eventually cut down to sell the timber. Would you bother to verify whether the company actually owned the trees? Would you make sure that the trees the company showed to your auditors were the same trees it claimed to own?
>
> To the Canadian affiliate of Ernst & Young, the answer to both questions appears to be no.
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> How, asked one Ernst staff member involved in the audit in an e-mail to a colleague, "do we know that the trees" the auditors were being shown "are actually trees owned by the company? E.g. could they show us trees anywhere and we would not know the difference?" The answer was yes: "I believe they could show us trees anywhere and we would not know the difference," replied the colleague.
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> That did not lead Ernst to change its procedures. Nor did it bother to look at documents that it knew were crucial to answering the questions about the Sino-Forest Corporation, which was based in Canada but had its operations in China.
>
> Until the summer of 2011, Sino-Forest appeared to be a real success story, backed by underwriters like Credit Suisse and Toronto Dominion and with shares worth billions of dollars. Its bonds were rated as just under investment grade by Standard & Poor's and Moody's. Then a short-selling operation known as Muddy Waters said it thought the assets were greatly exaggerated. Sino-Forest appointed a group of its independent

directors to investigate, and in due course they concluded they could not even be sure just what trees the company claimed to own, let alone whether it owned them.

…However extensive the work, the audit failed to uncover the essential truth: the assets were fake.

Frauds, and audit failures, can happen in many countries. But China is a special case because the authorities there seem to be completely uninterested in getting to the bottom of scandals whose victims are American or Canadian investors. Even regulators in Hong Kong have voiced frustration with their mainland colleagues.

Last week China sent another delegation to the United States to talk about these issues with American regulators, and a Chinese official was quoted by The Financial Times as telling a Hong Kong audience that audit working papers should be shared with other regulators — something the Chinese supposedly agreed to a decade ago but had never actually done. "I think we'll shortly be able to work out a way to deliver those papers," he said.

…The firms maintain that they are caught in the middle between China and the United States, and that they cannot violate Chinese law by providing the documents. That has led to a standoff.

This might not matter so much if the auditors were doing decent jobs. But in many cases they have not, as can be seen from the succession of frauds that went undetected until short-sellers investigated. China has responded by throwing at least one such investigator in jail, which seems to have slowed the rate of such informal investigations. Are the auditors deliberately certifying frauds? Maybe some are, but that is not really necessary.

…Such tough talk may or may not be followed by real action if China keeps stalling, as seems likely. Already word has spread that the change in Chinese leadership may slow things down as new officials settle into their jobs.

The accounting oversight board could revoke the registrations of uncooperative Chinese firms, a move that would force their clients to stop trading in this country. But it seems unlikely the board or the S.E.C. would take such a step without approval of the State and Treasury Departments, and ultimately of the White House. Nor is it clear how that would help American investors who already own the securities.

The volume of new Chinese frauds seems to have declined, and there are few new listings of such companies — either because American investors have grown wary or because Chinese companies don't want to deal with regulators who think investor protection is important.

One can only imagine the conversations of Chinese corporate officials as they discuss how gullible Americans turned out to be.

5) A WSJ article on the lawyers and bankers who brought the fraudulent Chinese companies to the U.S. markets via reverse mergers – and now, rather than sitting in jail for what they did, are instead, in a burst of jaw-dropping chutzpah, profiting by taking them private after their stocks have collapsed!

> When U.S. investors clamored for exposure to China's booming economy, attorney Mitch Nussbaum steered dozens of Chinese companies onto the U.S. exchanges. As the markets turned hostile, he embraced another role: helping some of these companies go private.
>
> Mr. Nussbaum, a partner at the U.S. law firm Loeb & Loeb LLP who splits his time between New York and Beijing, is part of a cottage industry of lawyers and bankers forced to shift their business mix as investor appetite wanes for U.S.-listed Chinese companies. Investment banks such as Halter Financial Group and Roth Capital Partners LLC, which were instrumental in helping Chinese companies access the U.S. securities market, are also now helping companies leave the market, after years of pitching clients the benefits of going public.
>
> Demand remains weak for U.S.-listed Chinese companies, says Mr. Nussbaum, who chairs the firm's capital markets and Asia practice. "Investors don't want to invest, the stocks don't trade. If Chinese companies don't see the financing, why are they going to go through the process?"
>
> The development comes as the U.S. Securities and Exchange Commission brings an administrative proceeding against the Chinese affiliates of five major accounting firms that audited U.S.-listed, China-based companies. It's another sign that the era of reverse mergers—a back-door route to the securities market that involves combining a private company with an inactive, publicly traded shell—may have ended. Another has begun: Chinese companies going private.
>
> "Reverse mergers are dead, dead, dead," says Peter Huang, a Beijing-based partner at the law firm Skadden, Arps, Slate, Meagher & Flom, which didn't work on reverse mergers but is helping more than a dozen U.S.-listed Chinese companies go private. "I don't see any future for this space."

6) Another WSJ article along the same lines:

> In the rush to get Chinese companies onto U.S. markets, Huakang "David" Zhou was in the thick of it.
>
> Mr. Zhou, who is a consultant, and his son Peter Dong Zhou, a former broker, helped numerous Chinese companies go public in the U.S., according to Securities and Exchange Commission documents. The elder Mr. Zhou's New Jersey firm, Warner Technology & Investment Corp., "provides full services" for public listing, its website says, from business planning to legal advice.

But some companies Huakang Zhou worked with didn't turn out well for investors. Earlier this year, the New York Stock Exchange delisted American Oriental Bioengineering Inc., AOBI 0.00% which he helped with a "reverse merger" that brought it to the U.S., after AOB said its auditor found "inconsistencies" during its audit. Last year, Nasdaq delisted Advanced Battery Technologies Inc., ABAT 0.00% another Zhou-assisted reverse merger, because the exchange said the company failed to comply with toughened procedures for confirming its bank accounts.

And in July, the SEC said in court documents that Peter Dong Zhou and his father helped conceal wrongdoing involving another company, China Yingxia International Inc.

7) The WSJ with another powerful expose on the shameful practice of some small cap managers marking the tape at the end of a quarter:

The stock of Iridex Corp., IRIX -1.01% a maker of lasers used to treat visual ailments, had been hovering around $3.43 all day on June 29. At 3:55 p.m., five minutes before the market close, it took off.

It moved to $3.65, then $3.80. Less than a half second before the trading day and calendar quarter ended, Iridex jumped 4% to $4.17, capping a nearly 22% rise for the day.

Scott Shuda, a managing director at BlueLine Partners, an investment firm in Danville, Calif., and Iridex's largest shareholder, saw the stock jump. "Is it unusual for these little companies to move a lot?" he asks. "No. Is the timing suspect? Yes. I saw it and I thought, 'Somebody wants to move this stock up today.' "

The next trading day, July 2, Iridex dropped 10%—and it didn't hit $4 again until late October.

What happened to Iridex isn't unusual. A Wall Street Journal analysis of daily trading in roughly 10,000 stocks since 2004 found that on the final trading day of each quarter, there was a sharp increase in the number of stocks that beat the market by at least five percentage points, then trailed it by three points or more the next trading day.

The Journal's analysis compared the performance of those 10,000 stocks to the one-day return of the Standard & Poor's 500-stock index. On days that didn't end the quarter, an average of 217 stocks beat that index by at least 5 percentage points then trailed it by at least three the next day. But on the final trading days of quarters, an average of 280 stocks did.

Regulators and market analysts have an explanation for the unusual pattern. They say some money managers wait until the waning moments of the quarter to bid aggressively for more shares of a stock they already own, which drives up the value of their entire position in the stock. That, in turn, boosts their performance at the very moment when they report results, making their funds look more appealing to potential investors. Even if the jump in stock price is only temporary, the managers can attract new money and earn higher fees.

The practice, known as "marking the close" or "portfolio pumping," is a form of "window dressing"—a term for a variety of techniques employed by asset managers to make their results look better at the end of the quarter. Some forms of window dressing, such as selling losing stocks right before reporting quarter-end holdings to investors, are perfectly legal. But regulators say marking the close violates prohibitions on deceptive trading in the federal securities laws.

Window dressing can distort prices in the U.S. stock market, long considered one of the most transparent in the world. If stock prices are pushed up deliberately, they might no longer reflect the fundamental value of companies, exposing investors to greater risk of a sudden decline.

8) Good to see the SEC following up on this earlier expose by the WSJ:

The Securities and Exchange Commission launched an inquiry into a $10 million sale of stock by Big Lots Inc. BIG -5.72% Chief Executive Steven Fishman before the company announced news that sank its stock, a person familiar with the inquiry said.

Big Lots said Tuesday that Mr. Fishman, 61 years old, intends to retire in order to spend time with his family. The discount retailer said it hadn't been contacted by the SEC and that the timing of Mr. Fishman's departure was coincidental to any regulatory interest.

The company said his trades were "properly made" at a time when they were allowed by the company. Mr. Fishman didn't return calls seeking comment.

Mr. Fishman's trading of Big Lots stock in March was cited in a **front-page article in The Wall Street Journal** last week. The article highlighted trades by corporate executives that were highly beneficial and occurred just before bad news hit, which spared the executives large price drops in their holdings.

9) This blogger, a computer science prof at MIT for many years, blasts Microsoft and Windows 8:

Suppose that you are an expert user of Windows NT/XP/Vista/7, an expert user of an iPad, and an expert user of an Android phone…. you will have no idea how to use Windows 8.

What are the best features of Android? A permanently on-screen Back button. A permanently on-screen Home button. Neither of these are present on the Windows 8 “tablet screen”. Every app developer implements the “Back” feature in a manner and location of his or her own choosing (Microsoft apps seem to put a big arrow on the top left of the screen; other developers used the bottom left; many screens do not have a Back option at all).

What is the best feature of iOS on the iPad? A permanent hardware Home button. It isn't as convenient as going "Back" on Android but at least it facilitates re-navigating to wherever you were. The closest thing to a full-time Home button in Windows 8 is the "windows" key on the keyboard (but the whole idea is that the keyboard is not always available/required).

What is the best feature of Windows XP/Vista/7? Click right on an object to get a context-dependent menu of useful functions. Android copied this feature: touch and hold an item in order to get a context-dependent menu of options. The Windows 8 tablet interface lacks this interface standard.

Microsoft has had since October 2008 to study Android. It has had since June 2007 to study iPhone. It seems as though they did not figure out what is good about the standard tablet operating systems.

10) The first of three articles about HP – a remarkable case study of how incompetent CEOs and an even worse board have brought a once-great, iconic company to its knees:

The dubious title of worst corporate deal ever had seemed to be held in perpetuity by AOL's acquisition of Time Warner in 2000, a deal that came to define the folly of the Internet bubble. It destroyed shareholder value, ended careers and nearly capsized the surviving AOL Time Warner.

The deal was considered so bad, and such an object lesson for a generation of deal makers and corporate executives, that it seemed likely never to be repeated, rivaled or surpassed.

Until now.

Hewlett-Packard's acquisition last year of the British software maker Autonomy for \$11.1 billion "may be worse than Time Warner," Toni Sacconaghi, the respected technology analyst at Sanford C. Bernstein, told me, a view that was echoed this week by several H.P. analysts, rivals and disgruntled investors.

11) Gregg Greenberg at TheStreet.com with a special version of his wonderful weekly missive, The 5 Dumbest Things on Wall Street, dedicated solely to HP and its missteps over the years:

Happy Thanksgiving Dumbest fans! Hopefully you enjoyed a fantastic Turkey Day filled with friends and family, and are now working off all that bird by battling the Black Friday crowds at a mall near you.

And speaking of thankfulness, you know what we here at the *Dumbest Lab* gave thanks for this Thursday while we were elbows deep in cranberry sauce and walnut stuffing?

You guessed it, the overflowing bounty of dumbness bestowed upon us by our good friends at **Hewlett Packard** (HPQ).

Yes, the once-proud tech company offered us yet another *amen* moment this Tuesday when it recorded a non-cash charge of around $8.8 billion related to its purchase of U.K. software maker **Autonomy** last year. In its conference call, HP said the majority of the impairment "is linked to serious accounting improprieties, disclosure failures and outright misrepresentations" that took place at Autonomy prior to HP's taking it over.

"These improprieties were discovered through an internal investigation after a senior member of Autonomy's management team came forward following the departure of [Autonomy CEO] Mike Lynch in May," said HP CEO Meg Whitman, during the company's earnings conference call. The company's shares finished Tuesday 12% lower on the news.

Improprieties our ass Meg! Woman up and call it a fraud if that's what you believe. Your stock is getting destroyed and famed shortseller Jim Chanos is dancing on your grave like he's at a P. Diddy party in East Hampton. This is no time to mince words. Your target, former Autonomy CEO Mike Lynch, is not pulling his punches in his defense, so why should you?

Seriously Meg, check out what he said in in an interview with *AllThingsD*: "Basically, we reject completely the assertion of HP. It's completely wrong. The reality of the situation is that when HP bought Autonomy it had hundreds of people involved in due diligence, which was described at the time as 'meticulous.' And KPMG, Barclays and Perella were all involved there. And they've actually run it for a year. To somehow admit a $9 billion elephant in the room just beggars belief, frankly."

See! It's now or never. Your fourth-quarter earnings of $1.16 a share may have exceeded Wall Street's profit estimate, but a two-penny beat is hardly a blowout and certainly not enough to knock this Autonomy hullabaloo out of the headlines. Not helping either is your tepid earnings outlook of 68 to 71 cents a share for next quarter, well below Wall Street's consensus view of 85 cents.

So what are you going to do Meg? Huh? How do you plan to turn this battleship around before it sinks under the weight of all those stupid executive decisions?

You know what. Don't answer us just yet. Why don't you think about it for a while? We have the entire weekend and a stack of turkey sandwiches to tide us over while we wait for you to figure out your future.

Oh, and just in case you need a refresher course on how you arrived at the edge of this cliff, we pulled up some of HP's greatest hits from our 5 Dumbest lists of the past two years.

12) Jonathan Weil on HP, Xerox and goodwill writedowns:

During the technology-stock bubble of the 1990s, it would have been a compliment to say a company had the potential to become the next Hewlett-Packard Co. That same line would have a very different meaning now.

Today, if someone called a company the next Hewlett- Packard, this would probably mean it is a prime candidate to book huge losses because of disastrous acquisitions. What might such a company look like? Consider Xerox Corp. (XRX)

At the start of 2007, Xerox had a stock-market value of $16 billion. Since then, the Norwalk, Connecticut-based printer and copier pioneer has paid about $9.1 billion to acquire 41 other companies. It has destroyed more value than it created. At $6.79 a share, Xerox's market value is $8.6 billion -- equivalent to 71 percent of its common shareholder equity, or book value.

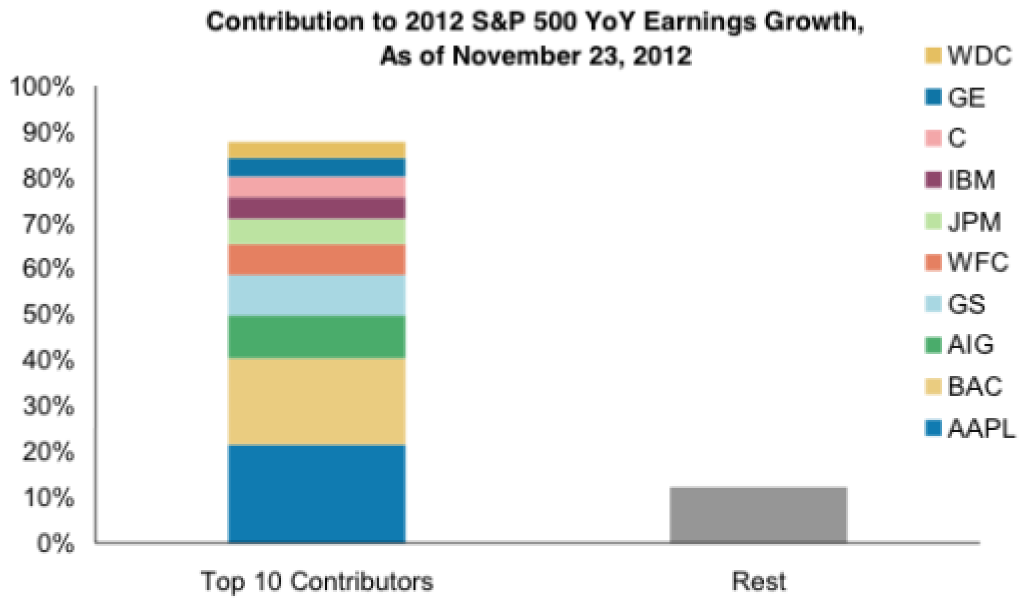
The most glaring sign that large writedowns may be needed at Xerox is a line on its books called goodwill, which is the intangible asset that a company records when it pays a premium in a takeover. Xerox's balance sheet would have investors believe that its goodwill alone, at $9 billion, is more valuable than what the market says the whole company is worth.

Xerox's goodwill obviously isn't worth that in reality. Goodwill exists only on paper and can't be sold by itself. It's a plug number, defined under the accounting rules as the difference between the purchase price for an acquisition and the fair value of the acquired company's net assets.

13) Interesting chart:

Exhibit 16

In 2012, Ten Stocks Are Driving about 88% of the Entire S&P500's Earnings Growth



Source: Factset, Morgan Stanley Research

War Veteran's Fund Losses Explain Glass-Steagall

By Jonathan Weil - Dec 6, 2012

One of the great debates to emerge from the financial crisis is whether the U.S. Congress should resurrect some form of the Depression-era Glass-Steagall Act and bring back the separation of commercial and investment banking. It should, but not for the reasons usually cited.

Put aside the tired arguments about whether the law's repeal in 1999 caused the crisis. It did help banks deemed too big to fail get larger, but the crisis had no single proximate cause. We would have systemically dangerous financial institutions even if the law had stayed in place.

There's a better argument for separating securities firms from commercial banks: to protect consumers. The banking industry has a long history of preying on unsophisticated depositors by selling them garbage investments without regard to suitability. This was a big reason Glass-Steagall was originally enacted.

Consider the $61 billion in settlements between large banks and the Securities and Exchange Commission over sales of auction-rate securities, the market for which collapsed in early 2008. Citigroup Inc., Bank of America Corp. and other banks told customers the securities were safe, highly liquid investments comparable to money-market funds. They weren't.

Cross Selling

At Wachovia Corp., the SEC said bank employees helped recruit retail depositors for the investments. Wachovia, which was bought by Wells Fargo & Co. (WFC) in 2008, later agreed to repurchase $7 billion of the securities. Regulators in Washington state made similar findings about Wells Fargo as part of a $1.3 billion settlement in 2009, saying the bank and its investment divisions "engaged in cross-selling in connection with ARS sales."

Cross-selling junk to mom and pop depositors wasn't limited to auction-rate securities. Last year the Memphis, Tennessee- based brokerage Morgan Keegan & Co. agreed to a $200 million settlement with state and federal securities regulators over seven mutual funds that lost $1.5 billion in 2007 and 2008. Morgan Keegan brokers sold the proprietary bond funds to more than 30,000 account holders. The SEC said the funds' managers mismarked their asset values.

Morgan Keegan, then a subsidiary of Regions Financial Corp. (RF), "targeted Regions Bank depository customers with maturing certificates of deposits or other depository assets," the Alabama Securities Commission and other state regulators said in their complaint. "More money could be made on broker- dealer fees than on the interest spread on interest-bearing deposits."

One of those customers was Donald G. Smith, 66, who owns an auto-repair business in Hot Springs, Arkansas. Several years ago, he and his wife had a $96,000 Treasury bond. After it matured, he said a Regions financial adviser sent him to see a Morgan Keegan broker in the same branch.

He put the money in the funds the broker recommended, which soon crashed. The funds' holdings included complex instruments with names like synthetic collateralized debt obligations, first-loss pieces and pooled trust preferred securities. Smith, a Vietnam War veteran and former oilfield worker, said he isn't a sophisticated investor. His last year of school was eighth grade.

"I told her this was our nest egg, and we couldn't afford to lose it," he said, referring to the Morgan Keegan broker. Why did he trust Morgan Keegan? "It was right there inside the bank. One employee that I had trusted recommended me to another one."

After the Smiths filed claims against Morgan Keegan, a securities-industry arbitration panel in August awarded them about $11,000, after hearings fees, which was a small fraction of their losses.

Wealth Destruction

Their experience is reminiscent of a story about another bank customer: Edgar D. Brown, of Pottsville, Pennsylvania. His testimony at the 1933 Senate Banking Committee hearings on the 1929 stock market crash was recounted in Michael Perino's acclaimed book, "The Hellhound of Wall Street," about the committee's chief counsel, Ferdinand Pecora.

In 1927, Brown responded to an advertisement by City Bank (now Citigroup) offering to help with financial advice. Brown, who had $100,000 in cash and government bonds from selling a theater chain, received a reply from a salesman at National City Co., City Bank's securities affiliate.

The salesman said Brown should sell the bonds, borrow two or three times the money he had, and invest in securities the company recommended. "Brown took the company's advice, insisting only that he wanted bonds instead of stock," Perino wrote. "Other than that Brown trusted the company implicitly."

Perino wrote: "Over the next year a welter of bonds came in and out of Brown's portfolio. There were railroad bonds, utility bonds, and industrial bonds. Brown's foreign bond holdings spanned the globe -- Peruvian and Chilean bonds; bonds from the State of Rio Grande do Sul in Brazil; Vienna and Budapest bonds; the bonds of the Belgian National Railroad, Norwegian Hydro, German General Electric, and the Saxon Public Works; Greek, Italian, and Irish bonds. They seemed to have only one thing in common -- they all went down in value."

When Brown complained the next year, the salesman blamed Brown for insisting upon bonds. So Brown took his advice to buy stocks. "I bought," Brown testified, "thousands of shares of stock on their suggestion which I did not know whether the companies they represented made cake, candy or automobiles." Following the company's advice was, he thought, "the only safe thing to do." In 1929, at age 40, he lost almost everything.

Brown's testimony helped persuade Congress to pass Glass- Steagall that same year. It was a good idea at the time to separate securities firms from commercial banks. It still is.

December 6, 2012

Sorting Out a Chinese Puzzle in Auditing

By FLOYD NORRIS

Imagine for a moment that you were auditing a company whose principal asset was trees that it would eventually cut down to sell the timber. Would you bother to verify whether the company actually owned the trees? Would you make sure that the trees the company showed to your auditors were the same trees it claimed to own?

To the Canadian affiliate of Ernst & Young, the answer to both questions appears to be no.

How, asked one Ernst staff member involved in the audit in an e-mail to a colleague, “do we know that the trees” the auditors were being shown “are actually trees owned by the company? E.g. could they show us trees anywhere and we would not know the difference?” The answer was yes: “I believe they could show us trees anywhere and we would not know the difference,” replied the colleague.

That did not lead Ernst to change its procedures. Nor did it bother to look at documents that it knew were crucial to answering the questions about the Sino-Forest Corporation, which was based in Canada but had its operations in China.

Until the summer of 2011, Sino-Forest appeared to be a real success story, backed by underwriters like Credit Suisse and Toronto Dominion and with shares worth billions of dollars. Its bonds were rated as just under investment grade by Standard & Poor’s and Moody’s. Then a short-selling operation known as Muddy Waters said it thought the assets were greatly exaggerated. Sino-Forest appointed a group of its independent directors to investigate, and in due course they concluded they could not even be sure just what trees the company claimed to own, let alone whether it owned them.

This week brought the Sino-Forest case close to a conclusion. Ernst agreed to settle a shareholders’ suit for 117 million Canadian dollars, or about $116 million, while denying it was liable. The company agreed to come out of bankruptcy with its assets, whatever they might be, owned by the creditors. The company had tried to find buyers, and a number looked at the documents, but nobody bid. There still seems to be no certainty about how much, if any, timber the company owns.

While Ernst settled the shareholder suit, it said it would fight new charges by the Ontario Securities Commission that the audit firm failed to follow proper audit procedures. It was the commission suit, filed this week, that disclosed the e-mails exchanged by the auditors.

“We are confident that Ernst & Young Canada’s work was conducted in accordance with Generally Accepted Auditing Standards (GAAS) and met all professional standards,” the firm said in a statement. “The evidence we will present to the O.S.C. will show that Ernst & Young Canada did extensive audit work to verify ownership and existence of Sino-Forest’s timber assets.”

However extensive the work, the audit failed to uncover the essential truth: the assets were fake.

Frauds, and audit failures, can happen in many countries. But China is a special case because the authorities there seem to be completely uninterested in getting to the bottom of scandals whose victims are American or Canadian investors. Even regulators in Hong Kong have voiced frustration with their mainland colleagues.

Last week China sent another delegation to the United States to talk about these issues with American regulators, and a Chinese official was quoted by The Financial Times as telling a Hong Kong audience that audit working papers should be shared with other regulators —

something the Chinese supposedly agreed to a decade ago but had never actually done. “I think we’ll shortly be able to work out a way to deliver those papers,” he said.

The American regulators have heard those stories before. In July, the chairman of the China Securities Regulatory Commission, Guo Shuqing, told Mary L. Schapiro, then the chairwoman of the United States Securities and Exchange Commission, that he thought an agreement could be reached. It turned out that the Chinese insisted they would provide documents only if the S.E.C. promised not to use them in an enforcement proceeding without Chinese permission.

The week the S.E.C. filed court papers, in connection with its pending case against a Chinese affiliate of Deloitte, laying out case after case in which American regulators asked for assistance through obtaining audit work papers or even something as simple as verifying that a Chinese company existed. Repeatedly, the Chinese said something could be worked out, but somehow nothing ever was.

Separately, the S.E.C. this week filed proceedings against five Chinese audit firms — affiliates of the Big Four and of BDO — saying the five firms had refused to comply with S.E.C. subpoenas for audit work papers related to nine separate investigations of Chinese companies.

The firms maintain that they are caught in the middle between China and the United States, and that they cannot violate Chinese law by providing the documents. That has led to a standoff.

This might not matter so much if the auditors were doing decent jobs. But in many cases they have not, as can be seen from the succession of frauds that went undetected until short-sellers investigated. China has responded by throwing at least one such investigator in jail, which seems to have slowed the rate of such informal investigations. Are the auditors deliberately certifying frauds? Maybe some are, but that is not really necessary.

“It is the rare case when an auditor can be corrupted,” James Doty, the chairman of the United States Public Company Accounting Oversight Board, which was established a decade ago to regulate the industry, told an auditing conference at Baruch College last week. But, he added, “An auditor need only look the other way, accept a well-annotated rationalization, focus on corroborating evidence. An auditor need only say, ‘I don’t object.’ ‘It’s a matter of judgment.’ ‘The literature is unclear.’ ”

Greg Medcraft, the chairman of the Australian securities regulator, said this week that the quality of Australian audits, as shown by his agency’s inspections, had been declining. He said auditors were not getting sufficient evidence to support their conclusions and were not showing enough “professional skepticism” regarding what managements told them.

Mr. Doty’s board, like the S.E.C., has been doing a lot of talking to China. Every so often there appears to be progress, but there is no indication that the board will be allowed to take part in joint inspections with Chinese authorities of Chinese audit firms that certify the statements of companies traded in this country, or that take part in worldwide audits of major American multinationals.

When I talked to him this week, he sounded frustrated. He said the board was still pursuing an agreement, "recognizing that investors benefit from regulatory cooperation and that Chinese authorities want the credibility and respect of global investors that will come from conducting joint inspections and agreeing to an enforcement information sharing protocol.

"We are at a crossroads, though, and absent a near-term agreement that gives us meaningful access, will not hesitate to consider all appropriate and necessary alternatives to protect U.S. investors."

Such tough talk may or may not be followed by real action if China keeps stalling, as seems likely. Already word has spread that the change in Chinese leadership may slow things down as new officials settle into their jobs.

The accounting oversight board could revoke the registrations of uncooperative Chinese firms, a move that would force their clients to stop trading in this country. But it seems unlikely the board or the S.E.C. would take such a step without approval of the State and Treasury Departments, and ultimately of the White House. Nor is it clear how that would help American investors who already own the securities.

The volume of new Chinese frauds seems to have declined, and there are few new listings of such companies — either because American investors have grown wary or because Chinese companies don't want to deal with regulators who think investor protection is important.

One can only imagine the conversations of Chinese corporate officials as they discuss how gullible Americans turned out to be.

Reversal of Fortune | First in a Series

Tide Turns After a Flood of Chinese Listings

By KATHY CHU in Hong Kong and MICHAEL RAPOPORT in New York

HONG KONG—When U.S. investors clamored for exposure to China's booming economy, attorney Mitch Nussbaum steered dozens of Chinese companies onto the U.S. exchanges. As the markets turned hostile, he embraced another role: helping some of these companies go private.

Mr. Nussbaum, a partner at the U.S. law firm Loeb & Loeb LLP who splits his time between New York and Beijing, is part of a cottage industry of lawyers and bankers forced to shift their business mix as investor appetite wanes for U.S.-listed Chinese companies. Investment banks such as Halter Financial Group and Roth Capital Partners LLC, which were instrumental in helping Chinese companies access the U.S. securities market, are also now helping companies leave the market, after years of pitching clients the benefits of going public.

Demand remains weak for U.S.-listed Chinese companies, says Mr. Nussbaum, who chairs the firm's capital markets and Asia practice. "Investors don't want to invest, the stocks don't trade. If Chinese companies don't see the financing, why are they going to go through the process?"

The development comes as the U.S. Securities and Exchange Commission brings an administrative proceeding against the Chinese affiliates of five major accounting firms that audited U.S.-listed, China-based companies. It's another sign that the era of reverse mergers—a back-door route to the securities market that involves combining a private company with an inactive, publicly traded shell—may have ended. Another has begun: Chinese companies going private.

"Reverse mergers are dead, dead, dead," says Peter Huang, a Beijing-based partner at the law firm Skadden, Arps, Slate, Meagher & Flom, which didn't work on reverse mergers but is helping more than a dozen U.S.-listed Chinese companies go private. "I don't see any future for this space."

Accounting scandals, regulatory scrutiny and allegations by short-sellers have eroded investors' confidence in U.S.-listed Chinese companies, especially those that employed reverse mergers. Those companies typically undergo less regulatory scrutiny during the listing process than firms that launch IPOs. Many Chinese reverse-merger stocks are trading at a fraction of their levels two years ago.

Although Chinese technology firm YY Inc. YY -0.41% completed a U.S. IPO in November, shares priced at the bottom of the proposed range. While the IPO is a sign that "investor appetite for China-based companies may be slowly coming back," investors will be very selective about buying these companies, says Joseph Chan, a Shanghai-based partner at Sidley Austin LLP. The YY deal was the second in the U.S. this year, after an offering by Vipshop Holdings Ltd. VIPS +0.16%

So far this year, 25 U.S.-listed Chinese companies have announced plans to go private, compared with 16 companies in all of 2011. Some of the larger Chinese companies that have delisted or plan to do so include advertising company Focus Media Holding Ltd., FMCN -2.55% electric motor maker Harbin Electric Inc., and economy hotel chain 7 Days Group Holdings Ltd. SVN -0.95% Analysts say that some Chinese companies may be looking to delist to avoid the scrutiny that comes with being a public company.

None of the Chinese companies responded to requests for comment.

On going-private deals, investment banks advising China-based companies can earn 1% to 3% of the total transaction size, according to bankers. These deals are generally much less lucrative than the 3% to 7% banks earned on the amounts raised for these companies during U.S. IPOs, and the 10% or more earned, including the value of warrants, on capital raised during reverse merger deals on U.S. exchanges.

Tianfu Yang, chief executive of Harbin Electric, which became private in November 2011, told analysts in August of that year "privatization is a choice for the company to continue to be on the healthy path" given the difficult U.S. capital markets and numerous short-seller attacks on the company. His proposal to buy out the company, with financing by a bank and a private-equity fund, dating back to October 2010, would protect shareholders' interests, he said.

The trend of U.S.-listed Chinese companies going private will continue for at least a few years, until U.S. investors regain their confidence in Chinese firms and the capital markets recover, said Donald Yang, managing partner at Abax Global Capital, an asset manager in which Morgan Stanley MS +1.37% owns a minority stake. Abax Global, which oversees $900 million in private-equity and hedge-fund assets in Hong Kong, has provided financing for a handful of companies going private, including Harbin Electric.

Taking companies private has become a major source of new China business for Roth Capital. The Newport Beach, Calif., firm is one of a growing number of banks that have sharply scaled back their mainland operations.

Roth Capital, which has raised more than $3.1 billion in financing since 2003 for China-based companies that went public in the U.S. through IPOs and reverse mergers, was hired this year as a financial advisor to independent committees in the going-private transactions of Yucheng Technologies Ltd. YTEC +0.26% and Shengtai Pharmaceutical Inc. SGTI -2.99% The Chinese companies didn't respond to requests for comment. Both are still in the process of going private.

The board-appointed committees' role is to evaluate the fairness of buyout offers made by the chairmen of Yucheng Technologies, a Chinese provider of information-technology services, and Shengtai Pharmaceutical, a maker of pharmaceutical raw materials such as glucose.

Some in the industry question whether companies seeking to retreat from public markets will want to deal with the same banks and law firms that brought them there.

Companies may think, "Why are you going back to the guy who got you into this?" says Jim O'Neill, co-founder of Jin Niu Investment Management in Beijing, which raises capital for Chinese companies and has advised three firms in the past year on going private. Mr. O'Neill said he has spoken with companies going private that are reluctant to hire the same advisors who took them public.

Roth Capital says it has no prior banking relationship with either company, but declined to comment further.

Argyle, Texas-based Halter Financial is advising Si Chen, chief executive officer of New York Stock Exchange-listed American Lorain Corp., ALN +1.61% a snack-foods company, on a going-private proposal he has made to shareholders. Halter, a major player in helping Chinese companies list in the U.S. through reverse mergers, also advised American Lorain on its 2007 reverse merger.

Halter and Mr. Chen didn't respond to requests for comment. American Lorain, whose stock has lost more than a quarter of its value since January 2012, declined to comment.

Meanwhile, Loeb & Loeb says it has worked on nearly a dozen going-private transactions for companies including Harbin Electric, Fushi Copperweld FSIN +0.21% and Yongye International Inc. YONG -2.33% Loeb & Loeb has an existing relationship with some of these companies: It represented Yongye in its reverse-merger transaction in 2008, and Harbin Electric and Fushi Copperweld in financing deals when they upgraded to the Nasdaq Stock Market NDAQ +0.08% from the OTC Bulletin Board in 2007.

The Chinese companies didn't respond to requests for comment.

Mr. Nussbaum said the firm's role in helping companies access the U.S. securities market years ago doesn't compromise its ability to represent them now.

In privatization transactions, "there's a role for someone who knows the company well," he said.

Scrutiny at the Gate: Firms' Role Questioned

By MICHAEL RAPOPORT

In the rush to get Chinese companies onto U.S. markets, Huakang "David" Zhou was in the thick of it.

Mr. Zhou, who is a consultant, and his son Peter Dong Zhou, a former broker, helped numerous Chinese companies go public in the U.S., according to Securities and Exchange Commission documents. The elder Mr. Zhou's New Jersey firm, Warner Technology & Investment Corp., "provides full services" for public listing, its website says, from business planning to legal advice.

But some companies Huakang Zhou worked with didn't turn out well for investors. Earlier this year, the New York Stock Exchange delisted American Oriental Bioengineering Inc., AOBI 0.00% which he helped with a "reverse merger" that brought it to the U.S., after AOB said its auditor found "inconsistencies" during its audit. Last year, Nasdaq delisted Advanced Battery Technologies Inc., ABAT 0.00% another Zhou-assisted reverse merger, because the exchange said the company failed to comply with toughened procedures for confirming its bank accounts.

And in July, the SEC said in court documents that Peter Dong Zhou and his father helped conceal wrongdoing involving another company, China Yingxia International Inc.

Peter Dong Zhou has settled SEC administrative charges that he violated securities laws related to China Yingxia. He neither admitted nor denied wrongdoing. Huakang Zhou hasn't been charged with any wrongdoing. He says he is a victim of China Yingxia.

AOB declined to comment. Advanced Battery couldn't be reached, but the company said at the time of its delisting that Nadsaq's new rules were "degrading" and that it was unable to comply. Representatives of China Yingxia, which collapsed in 2009, couldn't be located.

The Zhous are "gatekeepers"—the consultants, financiers, auditors and others who helped give Chinese companies access to U.S. capital markets. As this week's SEC action against major accounting firms in China illustrates, the SEC is scrutinizing such gatekeepers as part of its continuing probe of accounting questions at Chinese companies.

"We've said all along we're looking at all the players," said Kara Brockmeyer, co-head of an SEC working group that is conducting the probe. The action against the accounting firms indicates the SEC is "committed" to looking at the role the gatekeepers played, she said.

The SEC filed an administrative proceeding this week against the Chinese affiliates of five major accounting firms that have refused to cooperate with the commission's investigation of their clients. Also, Canadian regulators alleged the auditors of Sino-Forest Corp., one of the biggest Chinese accounting blowups, hadn't done enough to adequately audit the company.

The Chinese auditors say they are caught between clashing U.S. and Chinese laws; Ernst & Young, the Sino-Forest auditor, said it followed proper audit standards and did "extensive" work to verify Sino-Forest claims that were later brought into question.

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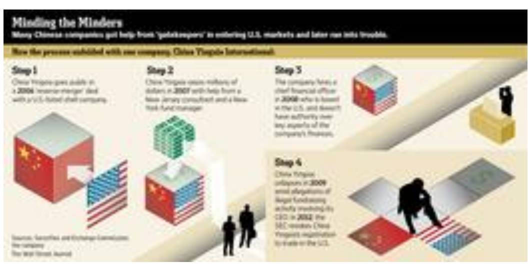


Investment-banking firms also are among the gatekeepers, and while no underwriting firms have been charged with any wrongdoing, some have worked for multiple Chinese companies that later faced questions over their accounting and business practices, a Wall Street Journal analysis of company filings shows. That raises questions among some industry observers about how much such gatekeepers knew or should have known about their clients' problems.

As more Chinese companies that raised capital in the U.S. have faced regulatory scrutiny, "the people who are culpable are the underwriters, the accounting firms and the lawyers," said Steven Dickinson, a partner at Harris & Moure PLLC in Seattle and co-author of the China Law Blog.

One attraction that pursuing gatekeepers holds for the SEC, a person close to the probe said: it is sometimes easier to get money out of U.S.-based gatekeepers than to recover it from companies and people in China.

Huakang Zhou said China Yingxia cheated its U.S. underwriters, attorneys and auditors. He said he hasn't had any contact with AOB for several years; he didn't provide any comment on Advanced Battery.

Over 100 U.S. traded Chinese companies have come under fire from regulators, auditors and short sellers alleging problems with their accounting or disclosure. The SEC has filed several China-related enforcement cases since February.

Most companies involved in the SEC's cases entered U.S. markets through reverse mergers, in which privately held Chinese companies merged with American shell companies to get their public listing. An industry of gatekeepers sprung up to help with such deals, though reverse mergers have since waned as investors grew more concerned about Chinese companies.

The Zhous helped China Yingxia come to the U.S. through a 2006 reverse merger, and acted as the company's "de facto management," the SEC indicated in court documents. But the Zhous allegedly doctored agreements to hide the fact that Peter Siris, a New York fund manager who invested in China Yingxia, improperly sold company shares and helped the company raise more than $2 million in 2007 even though he wasn't a registered broker.

Mr. Siris is another gatekeeper—he was a paid consultant to China Yingxia and other Chinese companies he invested in, the SEC said in court documents. Mr. Siris agreed to pay about $1.1 million to settle SEC civil charges of violating securities laws without admitting or denying wrongdoing. His lawyer couldn't be reached for comment.

Peter Dong Zhou's lawyer in the China Yingxia case said he no longer represents him, and a current attorney couldn't be located. Peter Dong Zhou agreed to pay about $73,000 in his settlement.

Huakang Zhou said in an interview in August that he was under SEC investigation, though the current status of it isn't clear. He declined to comment on Wednesday.

Fund Managers Lift Results With Timely Trading Sprees

By JASON ZWEIG and TOM MCGINTY

The stock of Iridex Corp., IRIX -1.01% a maker of lasers used to treat visual ailments, had been hovering around $3.43 all day on June 29. At 3:55 p.m., five minutes before the market close, it took off.

It moved to $3.65, then $3.80. Less than a half second before the trading day and calendar quarter ended, Iridex jumped 4% to $4.17, capping a nearly 22% rise for the day.

Scott Shuda, a managing director at BlueLine Partners, an investment firm in Danville, Calif., and Iridex's largest shareholder, saw the stock jump. "Is it unusual for these little companies to move a lot?" he asks. "No. Is the timing suspect? Yes. I saw it and I thought, 'Somebody wants to move this stock up today.' "

The next trading day, July 2, Iridex dropped 10%—and it didn't hit $4 again until late October.

What happened to Iridex isn't unusual. A Wall Street Journal analysis of daily trading in roughly 10,000 stocks since 2004 found that on the final trading day of each quarter, there was a sharp increase in the number of stocks that beat the market by at least five percentage points, then trailed it by three points or more the next trading day.

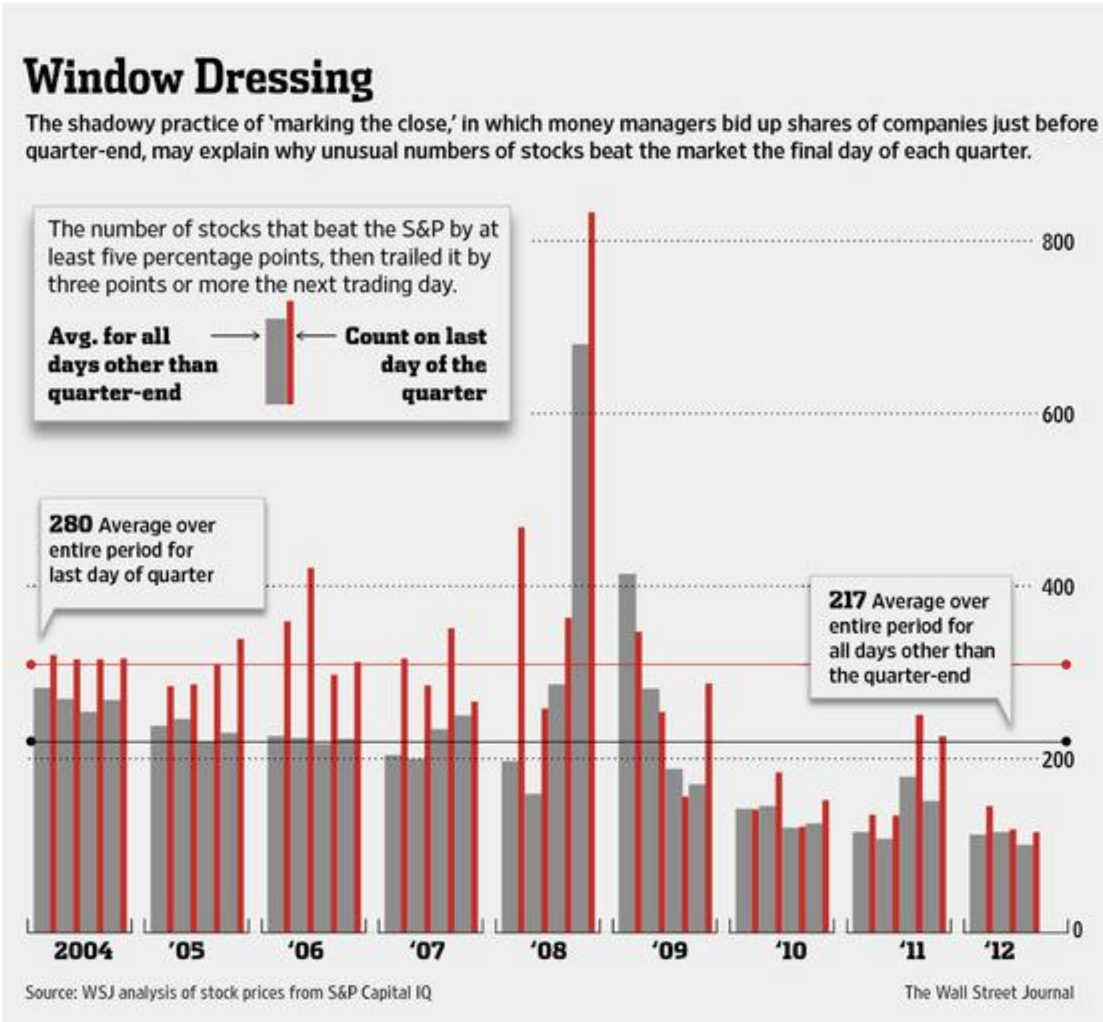
The Journal's analysis compared the performance of those 10,000 stocks to the one-day return of the Standard & Poor's 500-stock index. On days that didn't end the quarter, an average of 217 stocks beat that index by at least 5 percentage points then trailed it by at least three the next day. But on the final trading days of quarters, an average of 280 stocks did.

Regulators and market analysts have an explanation for the unusual pattern. They say some money managers wait until the waning moments of the quarter to bid aggressively for more shares of a stock they already own, which drives up the value of their entire position in the stock. That, in turn, boosts their performance at the very moment when they report results, making their funds look more appealing to potential investors. Even if the jump in stock price is only temporary, the managers can attract new money and earn higher fees.

The practice, known as "marking the close" or "portfolio pumping," is a form of "window dressing"—a term for a variety of techniques employed by asset managers to make their results look better at the end of the quarter. Some forms of window dressing, such as selling losing stocks right before reporting quarter-end holdings to investors, are perfectly legal. But regulators say marking the close violates prohibitions on deceptive trading in the federal securities laws.

Window dressing can distort prices in the U.S. stock market, long considered one of the most transparent in the world. If stock prices are pushed up deliberately, they might no longer reflect the fundamental value of companies, exposing investors to greater risk of a sudden decline.

It isn't easy to spot or prove the window dressing of stocks. Regulators like the Securities and Exchange Commission generally can't match trades to the traders who placed them without first making a detailed examination of confidential records. And regulators must show that the trading was a deliberate attempt to distort prices, which can be difficult to prove, experts say.



Since the beginning of last year, the SEC has brought at least three cases against money managers for allegedly window dressing stocks in their portfolios. SEC spokesman John Nester says window dressing is an area of "ongoing interest" in the agency's investigations. Outgoing SEC chairman Mary Schapiro, speaking about securities fraud in general, said in an Oct. 11 speech that the regulator is "using newly developed analytics to identify suspicious trading patterns and relationships among multiple traders and across multiple securities."

The number of stocks that met the Journal's test for potential window dressing was greater on the final day of this year's third quarter than on 82% of the quarter's other trading days. Across all 35 quarters in the Journal's analysis, the quarter-end counts were greater than on 85% of the other trading days, on average.

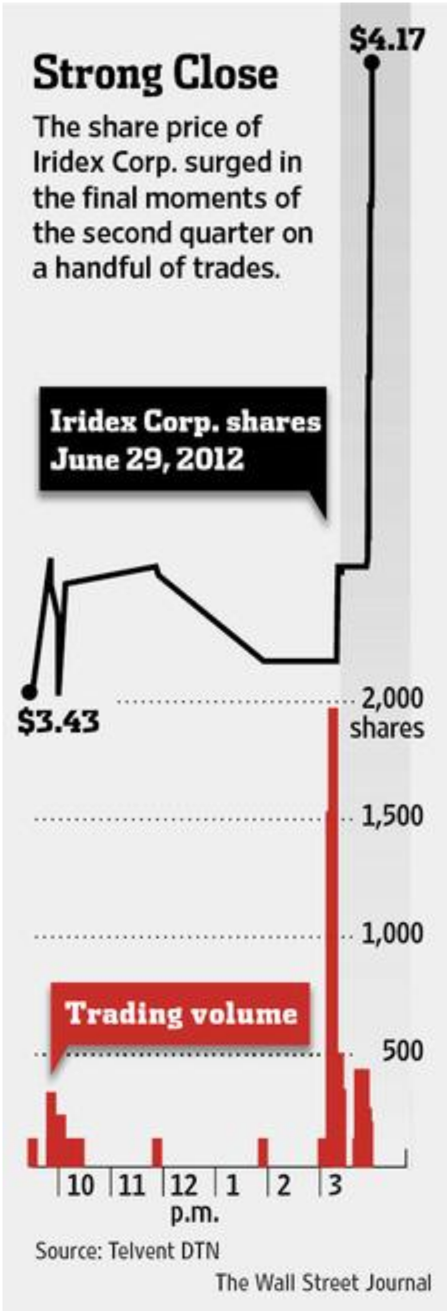
The Journal's test doesn't capture all instances of potential window dressing. For example, the SEC has brought at least one case in which a trader allegedly swooped in near the end of the final trading day of a quarter to keep a falling stock from declining even further.

Window dressing occurs much more frequently in small, thinly traded stocks, whose shares tend to swing widely, according to trading and securities-law experts.

Iridex has a market value of $36 million, making it about one-twentieth the size of the average U.S. "micro-cap" small stock. The day before Iridex's June pop, the stock had been down 22% for the quarter. Thanks to its last-minute surge, it closed the quarter down just 5.4%. Just like that, the company's market value rose to more than $37 million, from less than $31 million the prior day. Almost all that nearly $7 million gain came in the last five minutes of June 29.

A price jump at least temporarily benefits everyone who owns a stock, regardless of who caused it. It isn't possible to determine from public records who traded Iridex that day. Several money managers who hold Iridex say they had nothing to do with its rapid rise.

BlueLine Partners holds 29% of the company's stock. Mr. Shuda says the firm didn't trade the stock then, and that federal regulations on insider trading for large shareholders restrict BlueLine from buying or selling at the quarter's end.



Other beneficiaries of the stock's rise included Paragon Associates, a hedge fund in Dallas with more than 8% of the stock; Kennedy Capital Management of St. Louis, with a nearly 8% position; and Heartland Advisors of Milwaukee, which holds 5.5%.

Will Nasgovitz, a portfolio manager at Heartland, says his firm wasn't the buyer that day and doesn't know who was. "Someone wanted to own it," he says. For such small stocks, "it doesn't take much to move the needle."

Bradbury Dyer III, general partner at Paragon, says the buyer "certainly wasn't us, but it etched itself in my memory."

Richard Sinise, a portfolio manager at Kennedy Capital, says that for hedge funds whose fees are linked to performance, "there can be that urge on the last day to put all your cash into your stocks and get them to the price you think they should be at." He says Kennedy doesn't run any hedge funds and "it was not us" who traded Iridex that day.

According to SEC filings and the managers, none of these firms have reported selling any Iridex shares since that day. James Mackaness, Iridex's chief financial officer, said in an email that he is "not aware of anything" that could explain the jump in price on June 29.

A stock jump on the final day of a measurement period can boost a money manager's fees. Hedge funds typically collect annual fees equivalent to 2% of total assets and 20% of profits. Regulators and industry experts say a fund that already has a substantial holding in a small stock can drive up the value of its entire position by purchasing as few as 100 additional shares at a premium to their market price in the final moments of trading at the end of a measurement period. That can be enough to boost the entire fund's performance for the month, quarter or year—potentially attracting performance-chasing investors.

On the first day of the new measurement period, when the buying pressure subsides, the manipulated stock is likely to fall back to its previous level. But hedge funds generally don't report returns more often than monthly, so any subsequent decline in the manipulated stock doesn't show up until the next report.

The smaller the stock and smaller the fund that holds it, the more a fund manager stands to gain from manipulating it. Even an extra fraction of a percentage point of performance can be enough to nudge an investment fund into the top quarter of performers—the group most prospective clients prefer.

That can mean millions of dollars' worth of future inflows, and more fees, says Rabih Moussawi, a finance researcher at the Wharton School at the University of Pennsylvania who has studied window dressing. In a study slated for publication next year in the Journal of Finance, he and his colleagues found that the stocks most heavily owned by hedge funds outperformed the market by an average of 0.3 percentage points on the final day of the quarter—and underperformed by 0.25 points on the following trading day.

Recent cases brought by regulators show the difficulties of documenting that the shadowy practice causes material damages to other investors.

In April 2011, the SEC filed an enforcement action alleging that Donald L. Koch, a member of the board of overseers at Stanford University's Hoover Institution, had marked the close of three bank stocks in 2009 in accounts he ran for clients of his money-management firm, Koch Asset Management.

An SEC administrative judge recommended this May that Mr. Koch be barred from the investment-management business and ordered to pay $75,000 in civil penalties. Mr. Koch denies any wrongdoing and is appealing the initial decision. Through his lawyer, he declined to comment.

One stock Mr. Koch traded, according to the SEC, was High Country Bancorp HCBC +3.17% of Salida, Colo., which trades on the over-the-counter market then known as the "Pink Sheets."

According to the SEC, on Dec. 28, 2009, Mr. Koch told his broker at Huntleigh Securities Corp., in an email: "Please put on your calendar to buy HCBC 30 minutes to an hour before the close of market for the year. I would like to get a closing price in the 20-25 range, but certainly above 20." The stock was then at $15 per share. It was so illiquid that no shares at all had traded since Dec. 16.

The SEC alleged that Mr. Koch's broker at Huntleigh bought 3,200 shares, making his final trade, two minutes before the end of the trading day, at $19.50, where the stock closed. That lifted the total market value of High Country to $16.8 million, from $12.9 million, and boosted the value of the nearly 85,000 shares in Mr. Koch's clients' accounts to $1.6 million, from $1.3 million, according to the public filings.

High Country didn't trade again until Jan. 6, 2010, the third trading day of the next year, when it fell back to $15.

According to the SEC, the temporary boost to the prices of High Country and another small financial stock, Carver Bancorp, CARV +3.74% inflated the management fees Mr. Koch charged his investors by $4,169.78.

The SEC reached a settlement with Huntleigh and Mr. Koch's former broker. Huntleigh and the broker didn't respond to requests for comment.

In another SEC case, Eric Wanger, a Chicago-based hedge-fund manager, in July was ordered to pay a $75,000 civil penalty and barred from the securities industry for one year. The SEC alleged that Mr. Wanger had submitted artificially high buy orders in thinly traded stocks at the close of the final trading day of the month or quarter. As a result, the SEC alleged, the clients of his $14 million fund paid $2,269.81 in excess fees. Mr. Wanger agreed to the settlement without admitting or denying the allegations.

On March 31, 2009, the SEC alleged, he drove the price of Woodbridge Holdings Corp., a home builder that is no longer publicly traded, to 62 cents, from 40 cents, a half-hour before the market closed. On Sept. 30, 2010, the SEC said, he pushed the price of AltiGen Communications, ATGN 0.00% an Internet phone provider, to 75 cents, from 60 cents, less than two hours before the close.

"There are 15 alleged instances out of hundreds of purchases and no sales, resulting in an increase of less than $2,300 in management fees over 33 months," says Mr. Wanger's lawyer, Jim Kopecky of Chicago. "I don't think this is a case the SEC should have brought."

In April, the SEC filed a civil complaint against RKC Capital Management of Salt Lake City, alleging the firm had inflated the value of its $6 million hedge fund by repeatedly jacking up the price of a tiny stock, Global Pari-Mutuel Services, on the last day of the month, often "in the last few seconds or minutes of the day."

As a result, the SEC alleged, the fund's assets under management were 2% to 20% greater than they otherwise would have been, and RKC's fees were elevated by an unspecified amount.

Russell Cannon, the former portfolio manager of RKC, says he has shut down the fund and returned the capital to investors. The SEC allegations are "ridiculous," he says. "There was no scheme…. It was such a thinly traded stock that any trade that anybody placed could move it, and it was always a battle to find the correct closing value."

He says that even if the allegations, which he denies, were true, he couldn't have earned more than $7,200 in extra fees. The case is pending in federal district court in Utah.

Suspicious-looking trades continue to pop up. On the last day of the second quarter, the American-traded shares of Chinese food company Le Gaga Holdings Ltd. GAGA -0.26% climbed almost 16% to close at $4.90. Most of the gain came in the final 22 seconds of trading, when nine trades totaling 2,000 shares were executed. The final trade of 100 shares, which came in as the closing bell rang at 4 p.m., accounted for more than one-quarter of the day's gain.

Le Gaga's stock dropped 8.2% the next day and hasn't come close to $4.90 since.

Auke Cnossen, Le Gaga's chief financial officer, said in an email that "there was no news nor any developments at the company that may have contributed to this jump."

Big Lots Chief Probed by SEC

Fishman to Retire Amid Inquiry Into Stock Sale

By SUSAN PULLIAM And JEAN EAGLESHAM

The Securities and Exchange Commission launched an inquiry into a $10 million sale of stock by Big Lots Inc. BIG -5.72% Chief Executive Steven Fishman before the company announced news that sank its stock, a person familiar with the inquiry said.

Big Lots said Tuesday that Mr. Fishman, 61 years old, intends to retire in order to spend time with his family. The discount retailer said it hadn't been contacted by the SEC and that the timing of Mr. Fishman's departure was coincidental to any regulatory interest.

The company said his trades were "properly made" at a time when they were allowed by the company. Mr. Fishman didn't return calls seeking comment.

Mr. Fishman's trading of Big Lots stock in March was cited in a **front-page article in The Wall Street Journal** last week. The article highlighted trades by corporate executives that were highly beneficial and occurred just before bad news hit, which spared the executives large price drops in their holdings.

Big Lots said CEO Steven Fishman, above, plans to retire.

The Journal analyzed trading by more than 20,000 executives since 2004 and found that 1,418 executives who traded their company's stock in the week before news was announced averaged gains of 10% (or avoided losses of 10%) within a week of their trades. That was far more than those who saw trades move against them.

Mr. Fishman's trades took place a bit more than a month before bad news hit. He sold $10.3 million of Big Lots stock on March 20 at a price of around $45, just before the end of the retailer's first quarter, according to regulatory filings. On April 23, the company told investors its sales had slowed, sending its shares down 24%, to $34, in a single day. Had Mr. Fishman waited to sell, the shares he sold for $10 million in March would have been worth $2.4 million less on April 24.

Following the decline, shareholders sued in an Ohio federal court, alleging that they were misled about the state of the business as Mr. Fishman and other executives were selling shares. Big Lots has declined to comment on the suit and hasn't filed a formal response to it.

The SEC probe is at an early stage, said the person familiar with the inquiry. Companies often are unaware of inquiries by investigators when they are at an initial stage. Such a move by regulators doesn't necessarily suggest there would be any finding of wrongdoing.

Like everyone else, executives are prohibited from trading based on important, nonpublic information. A decade ago, the SEC gave executives an avenue for trading even when they do possess private information through "10b5-1" plans, which involve a preset plan for trading. Having such a plan can be a strong defense against allegations of improper trading.

Mr. Fishman had such a 10b5-1 plan, but his March 20 trade was made outside of the plan, the company said.

The sale this year hit a nerve with investors and analysts who recalled 2010 trading activity, when Mr. Fishman, under his 10b5-1 plan, sold $8 million of Big Lots stock between April 23 and April 26 at an average price of $40.72. By May 7, the stock had fallen to $35, where it lingered as the company's business faltered in the second half of the year.

A Big Lots spokesman said Mr. Fishman, who joined Big Lots in July 2005, formally informed the company's board on Tuesday morning of his decision to retire after a successor is found.

Big Lots, which has 1,450 U.S. stores, said the timing of his retirement stems from a three-year retention plan awarded by the board to Mr. Fishman in March 2010 that was set to expire in January 2013.

The SEC has been trying to crack down on insider trading, filing 115 insider-trading enforcement actions in the two years through September. Few have centered on allegations of senior corporate officers trading their own stock. Often, the cases involving stock trading by executives have been brought in conjunction with broader fraud charges.

One exception is an SEC civil suit filed in July against Manouchehr Moshayedi, chairman and chief executive officer of STEC Inc., a Santa Ana., Calif., computer-chip maker.

In the complaint, filed in a California federal court, the SEC alleged that Mr. Moshayedi traded on inside information and made false and misleading statements in connection with the sale of $268 million of STEC stock owned by him and his brother, also a founder of the company. His brother wasn't accused of any wrongdoing.

A lawyer for Manouchehr Moshayedi said his client "has denied all charges, intends to vigorously defend the case" and remains "confident that an independent trier of fact will find that the commission's allegations against Mr. Moshayedi are without merit."

The SEC alleged that Mr. Moshayedi took advantage of an eightfold increase in STEC's share price by selling shares that he and his brother owned through a secondary offering, even though the CEO had learned that a critical agreement with EMC Corp. EMC -1.07% to buy its flagship "flash memory" product had fallen through.

An EMC spokesman declined to comment.

After learning that EMC "would never enter into another similar agreement with STEC again," the SEC alleged, Mr. Moshayedi proceeded with the secondary offering.

"As part of this scheme, Moshayedi entered into a secret side deal with EMC to have EMC commit to take…far more of the product than it actually needed—in exchange for an undisclosed $2 million price discount on the product," the SEC alleged.

Mr. Moshayedi "then announced third quarter revenue guidance for STEC that met analysts' consensus estimates," the complaint said. Mr. Moshayedi went ahead with the offering, the SEC alleged, without disclosing that EMC's demand for the product had dropped significantly.

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http://blogs.law.harvard.edu/philg/2012/12/05/christmas-gift-for-someone-you-hate-windows-8/

Christmas gift for someone you hate: Windows 8

Suppose that you are an expert user of Windows NT/XP/Vista/7, an expert user of an iPad, and an expert user of an Android phone…. you will have no idea how to use Windows 8.

What are the best features of Android? A permanently on-screen Back button. A permanently on-screen Home button. Neither of these are present on the Windows 8 "tablet screen". Every app developer implements the "Back" feature in a manner and location of his or her own choosing (Microsoft apps seem to put a big arrow on the top left of the screen; other developers used the bottom left; many screens do not have a Back option at all).

What is the best feature of iOS on the iPad? A permanent hardware Home button. It isn't as convenient as going "Back" on Android but at least it facilitates re-navigating to wherever you were. The closest thing to a full-time Home button in Windows 8 is the "windows" key on the keyboard (but the whole idea is that the keyboard is not always available/required).

What is the best feature of Windows XP/Vista/7? Click right on an object to get a context-dependent menu of useful functions. Android copied this feature: touch and hold an item in order to get a context-dependent menu of options. The Windows 8 tablet interface lacks this interface standard.

Microsoft has had since October 2008 to study Android. It has had since June 2007 to study iPhone. It seems as though they did not figure out what is good about the standard tablet operating systems.

One thing that Android and iOS do not address is how to handle the requirement of offering a legacy Xerox Alto-style mouse and windows environment. Microsoft here integrates the tablet and the standard Windows desktop in the most inconvenient and inconsistent possible way. Due to the desperation of the average consumer to watch television at all times on all devices, the typical computer screen is fairly wide. One would think therefore that it would be possible to use traditional applications in the left-hand two-thirds of the screen while running a tablet environment on the right-hand one-third of the screen. Windows 8 does not allow this. It is either the old Windows XP desktop or the new Android-like tablet environment. As far as I can tell they cannot be mixed except that a tablet app can be set to appear in a vertical ribbon on the left or right edge of the screen.

A reasonable user might respond to this dog's breakfast of a user interface by trying to stick with either the familiar desktop or the new tablet. However, this is not possible. Some functions, such as "start an application" or "restart the computer" are available only from the tablet interface. Conversely, when one is comfortably ensconced in a touch/tablet application, an additional click will fire up a Web browser, thereby causing the tablet to disappear in favor of the desktop. Many of the "apps" that show up on the "all apps" menu at the bottom of the screen (accessible only if you swipe down from the *top* of the screen) dump you right into the desktop on the first click.

Confused about how the tablet apps work and want to Google for the answer? You go to a Web browser in the desktop interface and can't see the tablet interface that you're getting advice on how to use. Keep your old Windows 7 machine adjacent so that you can Google for "How to use Windows 8″ on the old computer and have the pages continuously visible.

The only device that I can remember being as confused by is the BlackBerry PlayBook. I would find this machine a lot more useful if it simply ran Android as a sub-environment and did so in the right-hand third of the screen. Comments from those who love Windows 8 would be especially appreciated.

To end on a high note, some of the supplied apps are wonderful, e.g., the Bing Finance app. Swiping back and forth on a 27-inch screen is a great way to get a comprehensive picture of a lot of information quickly. (Of course, this would be equally true if one had a similar app on a 27-inch Android tablet… it is just that there aren't any high-res 27-inch Android devices of which I am aware.)

[This article is based on using Windows 8 on what may be the best current hardware: Dell XPS One 27 computer with a quad-core i7 CPU, 16 GB of RAM and a solid state hard drive accelerator ($2600). I will try to write a bit about the Dell hardware in a subsequent posting. The screen is beautiful. The supplied keyboard is tiny, as if made for a clown. The display tilts down easily, making it easy to get up from one's chair to read a web page while standing.]

[Separate issue: Given how misguided the whole design of Windows 8 seems to be, why have tech journalists given it basically positive reviews? My theory is that journalists love anything new, different, and complicated. Windows 8 is all of those things.]

From H.P., a Blunder That Seems to Beat All

By JAMES B. STEWART

Published: November 30, 2012

The dubious title of worst corporate deal ever had seemed to be held in perpetuity by AOL's acquisition of Time Warner in 2000, a deal that came to define the folly of the Internet bubble. It destroyed shareholder value, ended careers and nearly capsized the surviving AOL Time Warner.

Léo Apotheker, chief executive of Hewlett-Packard, with Catherine A. Lesjak, its chief financial officer, at a gathering in March 2011. Ms. Lesjak strongly opposed the acquisition of Autonomy.

The deal was considered so bad, and such an object lesson for a generation of deal makers and corporate executives, that it seemed likely never to be repeated, rivaled or surpassed.

Until now.

Hewlett-Packard's acquisition last year of the British software maker Autonomy for $11.1 billion "may be worse than Time Warner," Toni Sacconaghi, the respected technology analyst at Sanford C. Bernstein, told me, a view that was echoed this week by several H.P. analysts, rivals and disgruntled investors.

Last week, H.P. stunned investors still reeling from more than a year of management upheavals, corporate blunders and disappointing earnings when it said it was writing down $8.8 billion of its acquisition of Autonomy, in effect admitting that the company was worth an astonishing 79 percent less than H.P. had paid for it.

And it attributed more than $5 billion of the write-off to what it called a "willful effort on behalf of certain former Autonomy employees to inflate the underlying financial metrics of the company in order to mislead investors and potential buyers," adding, "These misrepresentations and lack of disclosure severely impacted H.P. management's ability to fairly value Autonomy at the time of the deal."

In an unusually aggressive public relations counterattack, Autonomy's founder, Michael Lynch, a Cambridge-educated Ph.D., has denied the charges and accused Hewlett-Packard of mismanaging the acquisition. H.P. asked Mr. Lynch to step aside last May after Autonomy's results fell far short of expectations.

But others say the issue of fraud, while it may offer a face-saving excuse for at least some of H.P.'s huge write-down, shouldn't obscure the fact that the deal was wildly overpriced from the outset, that at least some people at Hewlett-Packard recognized that, and that H.P.'s chairman, Ray Lane, and the board that approved the deal should be held accountable.

A Hewlett-Packard spokesman said in a statement: "H.P.'s board of directors, like H.P. management and deal team, had no reason to believe that Autonomy's audited financial statements were inaccurate and that its financial performance was materially overstated. It goes without saying that they are disappointed that much of the information they relied upon appears to have been manipulated or inaccurate."

It's true that H.P. directors and management can't be blamed for a fraud that eluded teams of bankers and accountants, if that's what it turns out to be. But the huge write-down and the disappointing results at Autonomy, combined with other missteps, have contributed to the widespread perception that H.P., once one of the country's most admired companies, has lost its way.

Hewlett-Packard announced the acquisition of Autonomy, which focuses on so-called intelligent search and data analysis, on Aug. 18, 2011, along with its decision to abandon its tablet computer and consider getting out of the personal computer business. H.P. didn't stress the price — $11.1 billion, or an eye-popping multiple of 12.6 times Autonomy's 2010 revenue — but focused on Autonomy's potential to transform H.P. from a low-margin producer of printers, PCs and other hardware into a high-margin, cutting-edge software company. "Together with Autonomy we plan to reinvent how both structured and unstructured data is processed, analyzed, optimized, automated and protected," Léo Apotheker, H.P.'s chief executive at the time, proclaimed.

Autonomy had already been shopped by investment bankers by the time H.P. took the bait. But others who examined the data couldn't come anywhere near the price that Autonomy was seeking. An executive at a rival software maker, Oracle, a company with many successful software acquisitions under its belt, told me: "We looked at Autonomy. After doing the math, we couldn't make it work. We couldn't figure out where the numbers came from. And taking the numbers at face value, even at $6 billion it was overvalued." He didn't want to be named because he was criticizing a competitor.

A former Autonomy executive laughed this week when I asked if even Autonomy executives thought H.P. had overpaid. "Let's put it this way," this person said. "H.P. paid a very full price. It was certainly our duty to our shareholders to say yes." (Former Autonomy executives declined to be named because of the continuing investigation.)

Wall Street's reaction to Hewlett-Packard's announcement was swift and harsh. Mr. Sacconaghi wrote, "We see the decision to purchase Autonomy as value-destroying." Richard Kugele, an analyst at Needham & Company, wrote "H.P. may have eroded what remained of Wall Street's confidence in the company and its strategy" with "the seemingly overly expensive acquisition of Autonomy (cue the irony) for over $10B."

Mr. Apotheker addressed the issue two days later, at a Deutsche Bank technology conference. "We have a pretty rigorous process inside H.P. that we follow for all our acquisitions, which is a D.C.F.-based model," he said, in a reference to discounted cash flow, a standard valuation methodology. "And we try to take a very conservative view."

He added, "Just to make sure everybody understands, Autonomy will be, on Day 1, accretive to H.P.," meaning it would add to earnings. "Just take it from us. We did that analysis at great length, in great detail, and we feel that we paid a very fair price for Autonomy. And it will give a great return to our shareholders."

But few seem to have seen such an analysis. At least one large shareholder asked Mr. Lane, the chairman, if the company had performed such an analysis and asked what growth assumptions were used in the model. Mr. Lane seemed unfamiliar with any discounted cash flow analysis but contended the price was justified because Autonomy was unique and critical to H.P.'s strategic vision.

At least one high-level Hewlett-Packard executive, Catherine A. Lesjak, the former acting chief executive and currently the chief financial officer, was implacably opposed to the deal and spoke out internally. According to an account in Fortune magazine, which H.P. hasn't disputed, Ms. Lesjak made an impassioned presentation to the board and argued that the deal wasn't in the best interests of shareholders. One person who spoke to her the day the deal was announced said she was afraid she'd be fired for being so outspoken. The week after the deal was announced, she canceled an appearance at a road show meant to defend the deal and its terms.

In the days after the announcement, Mr. Lane heard from a chorus of disgruntled major shareholders. According to Mr. Sacconaghi, who said he spoke to many of them, "Not one person thought H.P. should do this deal. There was so much bitterness. They were begging Ray Lane to find a way out to get out of the deal, but he said they were stuck."

The Hewlett-Packard spokesman said Ms. Lesjak and Mr. Lane declined to comment. Mr. Apotheker couldn't be reached, but he had earlier told The Wall Street Journal that H.P.'s due diligence was "meticulous and thorough" and that although the latest allegations were a "shock," he still believed in Autonomy's potential.

Mr. Apotheker was fired by H.P. on Sept. 22, less than a month after the announcement. Mr. Lane "did listen to shareholders, and his reaction was to fire Léo," Mr. Sacconaghi said. "But he should also have hired a team of forensic accountants to scrutinize Autonomy's accounting and find an excuse to get out of the deal. There were rumors swirling then that the accounting was fishy."

The former Autonomy executive said: "There was chatter they were trying to get out of the deal. But we were never presented with anything concrete."

The Autonomy acquisition was a disaster almost from Day 1. Mr. Lynch and other former Autonomy executives said this was entirely H.P.'s fault. "We tried really hard to make this work," the former Autonomy executive said. "Instead of doing it the Autonomy way, which is to sweep problems out of the way and move full steam ahead, we got bogged down in H.P. process." Far from increasing revenue at the forecast double-digit rates, Autonomy's revenue started to drop precipitously.

H.P.'s current chief executive, Meg Whitman, who inherited the mess but was on the board when it approved the deal, went from glowing comments in November 2011 — "I am really excited about this acquisition," which would be "priority No. 1, 2 and 3 for 2012" — to announcing just six months later, in May 2012, that Autonomy "had a very disappointing license revenue quarter, with a significant decline year-over-year resulting in a shortfall to our expectations."

Still, no one was prepared for a write-down of the magnitude H.P. announced last week, let alone allegations of fraud. Far from being "accretive," as promised by Mr. Apotheker, the acquisition pulled Hewlett-Packard down. The company announced a loss of $6.9 billion for the latest quarter, largely because of the Autonomy mess. H.P. shares were trading at just over $31 when the deal was announced. This week, they were nearly $13, a drop of 58 percent.

Is the Autonomy deal really worse than the legendary AOL fiasco? "Worst" is a subjective standard, and H.P. contends that Autonomy remains a uniquely valuable asset that will someday prove its worth. It's also true that Autonomy is only one of several blunders that have hurt H.P.'s performance. It has no tablet in the market for this holiday season, and its personal computer division is still reeling from the aborted possibility of getting rid of it.

Still, the AOL deal was never alleged to be a huge fraud. And based on the impact on shareholders, a case can be made that Autonomy is worse. At the time the AOL-Time Warner deal was announced in January 2000, the combined value of the two companies was more than $300 billion. By the time Gerald Levin announced that he was stepping down as chief executive of AOL Time Warner in December 2001, the value of the company was about $159 billion, down nearly 50 percent. H.P.'s value has declined by an even higher percentage since the Autonomy deal was announced, to $25 billion from over $61 billion.

Moreover, Time Warner's decline occurred during the collapse of the Internet bubble, when the broad Standard & Poor's 500 dropped nearly 50 percent. During Mr. Lane's tenure, the S.& P. 500 has gained nearly 19 percent. Adjusted for relative performance to the broad market, H.P.'s shareholders have suffered far more than Time Warner's did.

And whatever else might be said, Time Warner survived, spun off AOL to shareholders, and today is a profitable company with a market capitalization of $45 billion. Hewlett-Packard has a market value of just over $25 billion, and vulture investors are rumored to be circling it as a candidate for a takeover or dismemberment.

Autonomy "will arguably go down as the worst, most value-destroying deal in the history of corporate America," Mr. Sacconaghi asserted.

Whichever deal turns out to be worse, what they have in common may prove to be a more enduring legacy. Just as Autonomy was supposed to transform H.P. into a software powerhouse, AOL was meant to transform old-media Time Warner into an Internet darling. So-called transformative thinking by some board members and top management rendered traditional valuations irrelevant and silenced critics.

In both cases, that thinking proved delusional.

The 5 Dumbest Things on Wall Street: The All-HP Edition

Gregg Greenberg

11/23/12 - 07:00 AM EST

NEW YORK (TheStreet

) -- Happy Thanksgiving Dumbest fans! Hopefully you enjoyed a fantastic Turkey Day filled with friends and family, and are now working off all that bird by battling the Black Friday crowds at a mall near you.

And speaking of thankfulness, you know what we here at the *Dumbest Lab* gave thanks for this Thursday while we were elbows deep in cranberry sauce and walnut stuffing?

You guessed it, the overflowing bounty of dumbness bestowed upon us by our good friends at **Hewlett Packard** (HPQ).

Yes, the once-proud tech company offered us yet another *amen* moment this Tuesday when it recorded a non-cash charge of around $8.8 billion related to its purchase of U.K. software maker **Autonomy** last year. In its conference call, HP said the majority of the impairment "is linked to serious accounting improprieties, disclosure failures and outright misrepresentations" that took place at Autonomy prior to HP's taking it over.

"These improprieties were discovered through an internal investigation after a senior member of Autonomy's management team came forward following the departure of [Autonomy CEO] Mike Lynch in May," said HP CEO Meg Whitman, during the company's earnings conference call. The company's shares finished Tuesday 12% lower on the news.

Improprieties our ass Meg! Woman up and call it a fraud if that's what you believe. Your stock is getting destroyed and famed shortseller Jim Chanos is dancing on your grave like he's at a P. Diddy party in East Hampton. This is no time to mince words. Your target, former Autonomy CEO Mike Lynch, is not pulling his punches in his defense, so why should you?

Seriously Meg, check out what he said in in an interview with *AllThingsD*: "Basically, we reject completely the assertion of HP. It's completely wrong. The reality of the situation is that when HP bought Autonomy it had hundreds of people involved in due diligence, which was described at the time as 'meticulous.' And KPMG, Barclays and Perella were all involved there. And they've actually run it for a year. To somehow admit a $9 billion elephant in the room just beggars belief, frankly."

See! It's now or never. Your fourth-quarter earnings of $1.16 a share may have exceeded Wall Street's profit estimate, but a two-penny beat is hardly a blowout and certainly not enough to knock this Autonomy hullabaloo out of the headlines. Not helping either is your tepid earnings outlook of 68 to 71 cents a share for next quarter, well below Wall Street's consensus view of 85 cents.

So what are you going to do Meg? Huh? How do you plan to turn this battleship around before it sinks under the weight of all those stupid executive decisions?

You know what. Don't answer us just yet. Why don't you think about it for a while? We have the entire weekend and a stack of turkey sandwiches to tide us over while we wait for you to figure out your future.

Oh, and just in case you need a refresher course on how you arrived at the edge of this cliff, we pulled up some of HP's greatest hits from our 5 Dumbest lists of the past two years.

5. **Whitman Channels Obama** -- *Originally published on Oct. 5, 2012*

Why shouldn't Meg Whitman blame the previous administration for her economic problems?

If it's working for President Obama in his race against Mitt Romney, then it may help her keep her job as well.

The Hewlett Packard CEO, who took the top job last year after a failed run for the California governorship, pointed the finger at her predecessors for the company's recent failings at an investor conference on Wednesday. Whitman told the crowd that HP's excessive turnover in the corner office -- three CEOs in the past three years -- is preventing a quicker turnaround for the troubled tech giant.

Whitman also lowered the company's profit projections for fiscal 2013 to $3.40 to $3.60 per share. The Street had already penciled in earnings of $4.17 per share. Shares of HP sank 13% to $15 on her buck-passing.

"My belief is that the single biggest challenge facing Hewlett-Packard has been changes in CEOs and executive leadership, which has caused multiple inconsistent strategic choices and frankly some significant executional miscues," Whitman told the crowd. "This is important because as a result it is going to take longer to right this ship than any of us would like."

So how does Captain Meg plan to turn the ship around?

Well, unlike President Obama and the national economy, she is actually counting on widespread lay-offs to help resuscitate HP's fortunes. The company is already in the process of canning 29,000 employees over the next two years to get costs into line with slowing corporate spending and plummeting PC demand.

Hmmm. We wonder what Governor Whitman would have said to HP CEO Whitman about all those lay-offs had she won that political race. Luckily (or perhaps unluckily) HP CEO Whitman will never be forced to answer that question.

So when will Whitman -- who last year at her inauguration pronounced "I believe HP matters -- it matters to Silicon Valley, California, the country and the world" -- get things at HP moving again?

"Fiscal year 2015 will be the year of acceleration," said Whitman. "Revenues should be growing faster than cost."

2015 huh? At this rate that's still pretty ambitious Meg.

Maybe you should ask for four more years.

4. **Meg's Marty McFly Moment** -- *Originally published on March 23, 2012*

Honestly, we don't know if Hewlett-Packard's move this week to merge its PC and printer divisions is dumb. Clearly the company needs to slash costs as its revenue -- especially its hardware sales -- continues to shrink. And for all we know right now, this could be Meg Whitman's first real managerial masterstroke in her quest to turn this once-proud tech titan around.

For the record, the printing and PC units together made up about half of HP's $30 billion revenue in its fiscal first quarter. Revenue from the printing division was down 13% in 2011 to $25.8 billion from a high of $29.6 billion in fiscal 2008, while sales in the PC division have dropped 6.4% over the same period to $39.6 billion in 2011.

That said, while we can't assess how dumb Meg's reorganization plan is at this point in time, we guarantee you this Dumbest fans: It will be dumb at some point.

Maybe next month or maybe next year. Or we may even have to wait ten years to revisit Meg's maneuver. But mark our words folks, there will come a moment when an HP restructuring will be Dumbest-worthy, so we might as well get it over with now.

How do we know this? Why are we so certain? Well, let's rev the Dumbest DeLorean up to 88 miles per hour and go back to the future, shall we?

In September 2001, in what former HP CEO Carly Fiorina calls a "decisive move" to provide "significant cost structure improvements," the company purchases Compaq Computer for $25 billion and merges it with its printer division. HP sales double over the next five years, however, 80% of the company's business remains printer-related and the company's board never forgives Carly for the deal.

Fast forward to February 2005: Carly gets canned, complete with a $42 million exit package.

Enter new CEO Mark Hurd, who splits the printer and PC businesses into separate divisions in order to lessen the company's dependency on printer-related items. He also lessens the number of employees at the company, slashing headcount at its once-vaunted R&D operation.

Fast forward to August 2010: Hurd gets canned, complete with a $34 million exit package.

Enter new CEO Leo Apotheker, who tries to get rid of the entire PC business through a sale or spin-off. Everybody thinks Leo is just plain loony.

Fast forward a mere 11 months to September 2011: Apotheker gets canned before anybody even learns to pronounce his last name, complete with a $25 million exit package.

Enter former eBay chief Meg Whitman as CEO and fast forward to this past Wednesday.

"This combination will bring together two businesses where HP has established global leadership," said Whitman in a statement about the new road HP intends to take.

Or should we say old road since this is simply a return to the Carly days?

Then again, to paraphrase *Back to the Future's* Doc Brown, where they're going, they don't need roads.

Think about it. Who needs roads when you repeatedly throw your entire business up in the air and your CEO out the door?

3. **Lucky Leo Cashes Out** - - *Originally published on Sept. 30, 2011*

Honestly, we can't think of a better job in the world than getting fired as CEO of Hewlett-Packard. Can you?

Check this out. HP stock was trading at $42 a share on Sept. 30, 2010 when Leo Apotheker replaced the scandal-tarred Mark Hurd as CEO. Fast forward to Sept. 22, 2011 and the shares were barely above $22 when the company formally announced Meg Whitman would be replacing Apotheker in the company's top job.

Yep, HP lost nearly half its market value in barely a year under Leo's astute stewardship. So how much is he likely to walk away with for all his success? Over $25 million, according to some sources, after adding up his annual salary, signing bonus, relocation assistance, severance pay and stock grants that vest immediately upon his departure.

Lucky Leo is in line to pocket all that dough for wrecking a company and getting ousted. Damn, that sure is good work if you can get it.

And because HP is so screwed up, Leo is not even the first guy -- or gal -- to snag a serious payday from HP's board before being sent packing. In fact, that pretty much is the protocol at the printer maker. (Wait! Do they still make printers anymore? Or did they drop that business with the tablets? Oh, who knows anymore? Who cares anymore?)

Mark Hurd, who left in a cloud of sex and shame, received a cash severance payment of $12.2 million before jumping to an executive job at **Oracle** (ORCL). The total value of his exit package was eventually estimated at $34 million.

HP CFO Cathie Lesjak filled in as CEO after Hurd took off, bridging the gap between Hurd and Apotheker. She was granted a $1 million cash bonus and $2.6 million in stock grants for her three months of "exceptional service." And Carly Fiorina, who left as CEO in 2005, was given a $21.4 million cash severance in addition to another $21.1 million in stock grants.

All-in HP has spent the better part of $80 million, conservatively speaking, on exit packages for its past four CEOs, including Lesjack's brief stint. Meanwhile, shareholders have seen the value of their holdings decimated.

To which we say, congratulations Meg. Good luck with your new gig. Here's hoping you get canned as soon as possible. Seems to guarantee quite a payday.

2. **HP's Catastrophic Conference Call** -- *Originally published on Aug. 26, 2011*

We can only believe that Bill Hewlett and Dave Packard would be rolling over in their garage if they had heard HP CEO Leo Apotheker on last week's catastrophic conference call.

Shares of the technology giant took their biggest intraday shellacking in three decades last Friday, tumbling 20% after Apotheker issued forecasts that missed analysts' estimates and unveiled strategic changes that had Wall Street analysts scratching their heads.

In a bid to boost margins, Apotheker laid out a series of major maneuvers, including jettisoning the company's personal computer business, closing its tablet and smartphone hardware unit and acquiring the enterprise software provider **Autonomy Corp.** for about $10.3 billion.

Yes, Leo wants to follow **IBM's** (IBM) lead in going from hardware to software. That much is obvious. How he plans to undo all the expensive acquisitions made by his predecessors? We have no idea.

All we can say is that Jerry Seinfeld's fictional, borderline-senile "Uncle Leo" made more sense than his highly compensated corporate namesake running HP.

On the call, Apotheker, who joined HP last November from **SAP** (SAP) after Mark Hurd was booted for still unexplained sexual harassment shenanigans, said he plans to discontinue the products that run WebOS software, the same line Hurd acquired just last year in the $1.2 billion purchase of Palm Inc.

Why the shift away from the WebOS hardware business? Well, Leo refused to talk to analysts about that. As for the software part, however, he did say that they are "looking at all of our strategic options."

Thanks for the update, Leo. That's very helpful. It's good to know you are looking at your own business. You needed a press conference for that?

Likewise, he said he plans to spin off, sell, or do something inexplicable with HP's Personal Systems Group, or PSG, which is essentially the Compaq Computer business purchased by former CEO Carly Fiorina in 2001 for $25 billion.

"So what the board and the management team have been working very diligently over the last period is to really look at all of our options and what the board has decided to do, together with the management team, is to look at all of the strategic options around PSG," said Leo.

Um, excuse us for asking Leo. But what on earth does that mean? And why are you saying it to a bunch of analysts who will crucify both you and your stock if you don't give them something of value to plug into their Excel valuation spreadsheets?

But while Leo still has not found what he is looking for in HP's old business lines, he certainly sees a savior in Autonomy. So much so that he is paying a mammoth 10 times sales and about 25 times earnings for the outfit.

But when asked on the call about Autonomy's organic growth rate, sans the numerous acquisitions it's made over the past few years, Leo would not talk about "any forward-looking growth rates."

That's hilarious. Leo is "looking" everywhere for ways to improve HP's fortunes except the one direction HP needs to move: Forward.

1. **Blundering Hurd** -- *Originally published on Aug. 13, 2010*

Thank you, Mark Hurd. The summer has been more dull than dumb until you and your friends Jodi and Larry came along.

The Hewlett-Packard CEO was sent packing by his board on Friday for falsifying documents in order to conceal an inappropriate connection with Jodi Fisher, a former contractor and B-movie actress, who claimed she was sexually harassed. Hurd, well known at HP for relentlessly cutting costs (and employees) also allegedly used his influence to make sure Fisher was paid for work she never performed.

That doesn't seem out of the ordinary, does it? CEO gets involved with a woman other than his wife and winds up paying the consequences. Pretty familiar territory, right?

Wrong. This story gets stranger and sillier as it goes along.

It turns out that Fisher, who starred in such cinematic classics as *Body of Influence 2* and *Intimate Obsession*, was never intimate with Hurd at all, despite his wining, dining and expense-form forging. Fisher's mouthpiece, celebrity attorney Gloria Allred, released a statement saying she "never had an affair or intimate sexual relationship" with Hurd and that she was "surprised and saddened that Mark Hurd lost his job over this."

Excuse us, Jodi. But lost his job over what? We still don't know what you two crazy cats did! And it's most likely we'll never know because you privately settled with Hurd, presumably for big bucks.

The same can't be said for HP shareholders, though. They are paying quite publicly for Hurd's misbehavior and not just because the stock lost nearly 10% over the whole inane episode. Hurd's buddies on the board gave him a kingly sendoff package of $12.2 million in severance payments and a host of other goodies, including more time to exercise his 775,000 options and nearly 350,000 shares of restricted stock units.

That's not a bad haul for a CEO who set the rules and was then dismissed for breaking them (although a messy exit does seem to fit the pattern for HP brass, considering what happened to former CEO Carly Fiorina and Chairwoman Patricia Dunn).

In hard times like these, it's good to have a friend, however. And Hurd has a good one in Oracle CEO Larry Ellison.

In an email to *The New York Times*, Ellison minced no words by saying the HP board made the "worst personnel decision since the idiots on the **Apple** (AAPL) board fired Steve Jobs many years ago." Ellison added that the HP board "failed to act in the best interest of HP's employees, shareholders, customers and partners."

Frankly, we don't what Larry knows about Hurd's harassment charge. He may know a lot more -- or a lot less -- than we do, but that's never stopped him before from prematurely weighing in on a subject that does not involve him.

Truthful or not, HP general counsel Michael Holston would probably disagree with Ellison's account. On a conference call Friday with analysts, Holston said the facts that drove the decision to can Hurd "had to with integrity, had to do with credibility, had to do with honesty."

Stop it, Mike. You are embarrassing yourself. This whole embarrassing affair had to do with infidelity, had to do with veracity and had to do with insincerity.

And by denying it, and not revealing the truth, you are only adding to the stupidity.

Who Will Be the Next Hewlett-Packard?

By Jonathan Weil Nov 29, 2012 6:17 PM ET

During the technology-stock bubble of the 1990s, it would have been a compliment to say a company had the potential to become the next Hewlett-Packard Co. That same line would have a very different meaning now.

Today, if someone called a company the next Hewlett- Packard, this would probably mean it is a prime candidate to book huge losses because of disastrous acquisitions. What might such a company look like? Consider Xerox Corp. (XRX)

At the start of 2007, Xerox had a stock-market value of $16 billion. Since then, the Norwalk, Connecticut-based printer and copier pioneer has paid about $9.1 billion to acquire 41 other companies. It has destroyed more value than it created. At $6.79 a share, Xerox's market value is $8.6 billion -- equivalent to 71 percent of its common shareholder equity, or book value.

The most glaring sign that large writedowns may be needed at Xerox is a line on its books called goodwill, which is the intangible asset that a company records when it pays a premium in a takeover. Xerox's balance sheet would have investors believe that its goodwill alone, at $9 billion, is more valuable than what the market says the whole company is worth.

Xerox's goodwill obviously isn't worth that in reality. Goodwill exists only on paper and can't be sold by itself. It's a plug number, defined under the accounting rules as the difference between the purchase price for an acquisition and the fair value of the acquired company's net assets.

‘Reference Points’

Asked about the possible need for large writedowns, a Xerox spokeswoman, Karen Arena, noted that the company will conduct its annual goodwill-impairment test this quarter.

“Share price is just one of several reference points we use to validate our assumptions,” she said. “We also look to our operational results, including cash flows, revenue growth and profit margins.”

Most of the goodwill on Xerox’s balance sheet arose from the company’s $6.5 billion acquisition in 2010 of Affiliated Computer Services Inc., a provider of information-technology services. Xerox allocated $5.1 billion of the purchase price in that deal to goodwill. Xerox’s latest balance sheet also showed $2.9 billion of other intangible assets, the bulk of which are customer relationships acquired from Affiliated Computer.

Suspiciously high goodwill was the same indicator I pointed to in an Oct. 4 blog post suggesting that more large writedowns were needed at Hewlett-Packard. (HPQ) The Palo Alto, California-based maker of computers and printers traded for a significant discount to book value at the time, and its goodwill exceeded its market value by $7.5 billion.

Hewlett-Packard last week disclosed an $8.8 billion writedown of goodwill and other intangible assets from its 2011 purchase of the U.K. software maker Autonomy Corp. It said more than $5 billion of the charge was related to financial-reporting improprieties by Autonomy. The disclosure sent Hewlett-Packard’s shares down 12 percent in a day.

Regardless of whether the allegation proves correct, Hewlett-Packard paid way too much for Autonomy, which had a reputation for aggressive accounting long before it was bought. (Just ask the analysts at the financial-research firm CFRA in New York, who wrote 14 reports from 2001 to 2010 raising doubts about Autonomy’s accounting and disclosure practices.)

Hewlett-Packard had allocated $6.9 billion of its $11 billion purchase price for Autonomy to goodwill. The writedowns disclosed last week were only the latest of their kind. Three months earlier, Hewlett-Packard recorded a $9.2 billion writedown largely related to its buyout of Electronic Data Systems Corp. in 2008.

Dubious Leaders

A search for other companies with strangely high goodwill values turned up several notable examples. Credit Agricole SA (ACA), the French bank that trades for about a third of its book value, shows goodwill of 16.9 billion euros ($21.9 billion). By comparison, its stock-market value is 14.6 billion euros.

Telecom Italia SpA (TIT), which trades for about 60 percent of its book value, has goodwill of 36.8 billion euros and a market capitalization of only 13.2 billion euros. Fiat SpA (F), the Italian automaker, trades for less than half of book and shows goodwill of 10.4 billion euros -- more than twice its market value. Nasdaq OMX Group Inc. trades for 78 percent of book and shows $5.3 billion of goodwill; its market cap is $4 billion.

Those kinds of numbers -- where the balance sheets are clearly out of whack with market sentiments -- don't necessarily mean the companies will be required to slash asset values. But they are strong indicators that big writedowns may be needed. The test under the rules ultimately comes down to management's cash-flow projections, and whether they are strong enough to justify the goodwill on the books. That's why goodwill writedowns can be an important signal about the future.

Xerox had an infamous accounting scandal more than a decade ago that resulted in a $10 million fine by the Securities and Exchange Commission. The penalty was a record at the time for an accounting-fraud case. Six former executives, including former Chief Executive Officer Paul Allaire, paid $22 million in SEC settlements in 2003. The last thing Xerox and its CEO, Ursula Burns, should be giving investors is a reason to wonder whether they can trust the company's numbers.

The market has already decided it has one.