



# An Anatomy of a Collapse: Fannie Mae

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**CBSMarketwatch.com Newswire from Sept. 28th, 2005:**

*Lawmakers are trying to pass legislation tightening regulations on both Fannie Mae and its sister institution, Freddie Mac (FRE: news, chart, profile) . Both lenders have weathered accounting scandals and management shake-ups. On Wednesday, a Dow Jones Newswires report said Fannie Mae's restatement of past years' earnings may show its losses will be higher than the company has previously disclosed. Fannie is slated to restate finances from 2001 to mid-2004 and may book a loss of as much as \$10.8 billion ... Failure to file timely reports with the Securities and Exchange Commission could lead the New York Stock Exchange to delist Fannie's shares.*

And just like that, shares of Fannie Mae [[FNM](#)] slid 11% to a new 52-week low of \$41.34. In fact, this was more like a 432-week low, being that the last time the stock traded at that price was in July of 1997. Over the last few years the stock has been hit both hard and often, rallying in fits and spurts, but eventually falling to lower levels on each decline. In the end, stockholders have been once again reminded that any light they may have seen at the end of the Fannie Mae tunnel was that of a freight train heading their way. Unfortunately for most investors, however, who look little further than the latest fundamental recommendations pertaining to a Company, what was coming wasn't something easily conveyed by fundamental analysis. After all, the accusation above is quite specifically that the information fundamental analysts were basing their recommendations upon over the last few years was flawed. The very possibility of this scenario escapes most investors until every once in a while something exactly like this transpires. We saw it with Marsh & McLennan [[MMC](#)], we saw it with Enron, we saw it with WorldCom and we saw it with the Internet stocks. In fact, it was perhaps an Internet Analyst who described the role of a fundamental analyst as good as anyone has in the wake of the Internet unraveling.

**New York Times -- December 31st 2000: "How Did So Many Get It Wrong"**

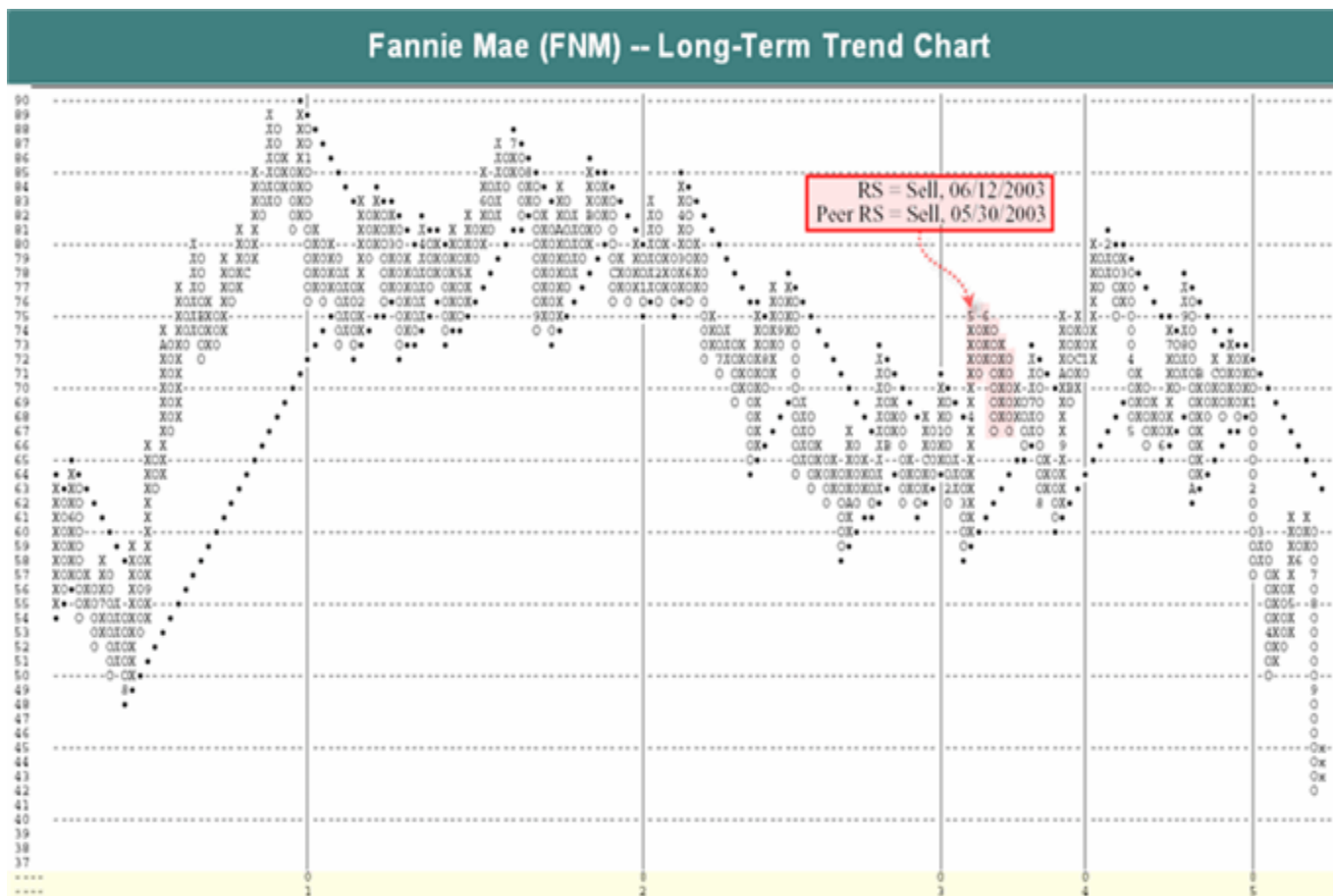
**Question:** "How can so many who are paid so much to scrutinize companies have blown it so spectacularly for their investor customers?"

**Answer:** "Our research is driven by fundamental analysis and is not influenced by anything else," Mr. Noto (Internet Analyst, Goldman Sachs, at the time) said. He went on to explain that the companies he follows had their stock prices drop last spring not because their operations were failing, but because market psychology had changed. He downgraded the stocks much later because only then had it become clear through his research that the companies' results were deteriorating. In hindsight, he said "We should have lowered our ratings sooner. We regret that."

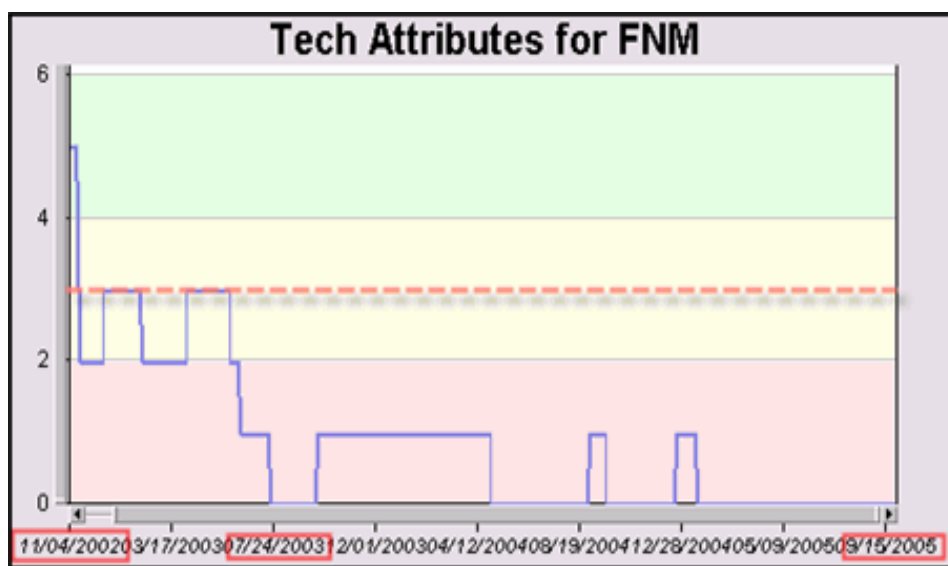
Fundamentals can serve an important role to investors, it can answer the question of "What companies to invest in," but it does not answer the equally important question of "When to own their stock." As you can see from the table below (data courtesy of CBS Marketwatch), while not every firm on Wall Street was raving about shares of Fannie Mae [FNM] at every turn over the last few years, the recommendations were generally constructive and at times quite positive. We eventually saw fundamental downgrades come in mass, but only after most of the damage was done to the stock.

--- Following the Fundamental Recommendations ---						
** Data source used: CBSMarketwatch.com						
Date	Symbol	Company	Broker	New	Old	Comments
8/15/2005	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Merrill Lynch			Cuts price target to \$64 from \$76.50
8/11/2005	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Wachovia Securities			Drops research coverage; has concern over future of business model
8/8/2005	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	J.P. Morgan			Removed from firm's focus list as recent weakness in the stock has sent it below internal
7/19/2005	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Banc of America Securities	Sell		Sets \$53 price target
1/24/2005	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Keefe Bruyette & Woods	Market Perform	Underperform	Ups price target to \$67 from \$65; cites valuation and co.'s decision to cut dividend
9/27/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Prudential Equity Group	Neutral Weight	Overweight	Believes requirement to carry extra capital could slow growth
9/27/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Morgan Stanley	Equal-Weight	Overweight	Cuts price target to \$72 from \$81; cites uncertain growth outlook given federal fraud charges
9/23/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Friedman Billings Ramsey	Market Perform	Outperform	Cites concern over possible restatement; lowers price target to \$65 from \$102
9/23/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Wachovia Securities	Market Perform	Outperform	Believes negative headlines regarding uncertainty over potential restatement or resolution of accounting issues will create a significant overhang in the stock
7/8/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Susquehanna Financial Group			Net Positive
5/10/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	JMP Securities			Discontinues coverage to align analyst resources to small- and mid-cap companies
5/4/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	CIBC World Markets			Discontinues coverage due to disruption in analyst coverage
2/5/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Keefe Bruyette & Woods			Suspends coverage
1/22/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Wachovia Securities	Outperform	Market Perform	Believes potential regulatory changes are expected by the market and already priced into stock. Thinks shares are "simply too cheap to ignore" at current levels. Calls company "one of the most attractively-priced financial stocks in the large cap sector."
1/14/2004	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	CIBC World Markets	Sector Outperformer		Sets \$84 12-18 month price target
12/18/2003	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	JMP Securities	Market Outperform	Market Perform	Says co. likely to be a 'significant beneficiary' of the unwinding of the carry trade that is ubiquitous among depository institutions
9/2/2003	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Merrill Lynch	Buy	Neutral	Says recent share price strength in the face of negative news flow suggests the stock may have bottomed
8/12/2003	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Goldman Sachs	In-Line		
7/15/2003	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Keefe Bruyette & Woods	Market Perform	Outperform	Says certain issues could dampen potential for outperformance in stock
<b>----- Technical Attribute Rating for FNM falls below 3 -----</b>						
6/12/2003	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Wachovia Securities	Market Perform	Outperform	On belief co. faces increased risk of higher capital requirements imposed by regulators
3/11/2003	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Raymond James	Market Perform	Strong Buy	Thinks multiple compression on shares likely to continue
1/31/2003	<a href="#">FNM</a>	<a href="#">Fannie Mae</a>	Goldman Sachs	Outperform	In-Line	Says valuation model now shows co. to be trading at discount to its economic value

Unlike fundamental analysis, however, technical analysis is not dependent upon corporate balance sheets and other information released and derived from corporate sources. Technical analysis is based upon price action, and in the case of Point & Figure analysis it is a function of supply and demand. If more sellers exist at a specific price than do buyers willing to buy, the price will fall. If there are more buyers and sellers willing to sell at a specific price, the price will rise. If buying and selling is equal at a given price, the price will remain unchanged; when you break the stock down to the lowest possible common denominator there is simply nothing more important. Regardless of why there are more buyers or more sellers on any given day, and at any given price, that imbalance of supply and demand is very simply recorded on a Point and Figure chart. At any point in time this chart can then provide an objective point of view for the stock; while it can say very little about the Company itself. Over time it becomes clear whether supply or demand has control of a stock, and we know that we are much better off owning stocks that are being controlled by demand. There are times to own a stock, and there are times to own a Company, there are fortunately scenarios when these two times overlap, but we must respect the fact that this won't always be the case. For this reason, above all others, we must have a checks and balances approach to investing; marrying the fundamentals and technicals together.



The beauty of the Point & Figure chart is that it has no preconceived bias, it doesn't care whether Fannie Mae is held by just about every mutual fund manager on the planet, or that it is an S&P 500 company, or that it is one of the largest Financial institutions in the world. The chart only cares about the daily highs and lows of the stock price, and over time that tells a interesting story of its own. The price action was enough to suggest that FNM shares be avoided long ago; more than two years ago in fact. It was then that the combination of trend and relative strength analysis concluded that the stock was likely to perform poorly both on an absolute basis and also when compared to other opportunities in the market and peer group. The technical attribute rating fell below 3, or investment grade status, back in June of 2003 and has remained below investment grade status since then.



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