THE BOOM - BUST ALERT
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"There is always a bull market raging somewhere on this planet" - *Byron King*

Insolvency Vets Un-mothballed.

By Joe Average,
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It seems that the Federal Deposit Insurance Corporation is getting ready for more financial institutions to fail as world credit markets convulse in the wake of the US housing collapse and a flight from SIVs... structured investment vehicles which are highly leveraged, complicated, based on assumptions now proven to be plain wrong, and now considered "toxic".

"The FDIC is looking to bring back 25 retirees from its division of resolutions and receiverships. Many of these agency veterans likely worked for the FDIC during the late 1980's and early 1990's, when more than 1,000 financial institutions failed amid the savings-and-loan crisis. 'Regulators are bracing for well over 100 bank failures in the next 12 to 24 months'..."

Damian Paletta, Feb.27, 2008 Wall Street Journal.

Who would have thought we'd see Bear Stearns (the fifth-largest US investment bank) start the cleansing process off and fail after having survived the Great Depression and a dozen recessions over the past 85 years. Bear shareholders were horrified to see their investment vaporize from $170 twelve months ago to the $2.00 offered by JP Morgan in a Fed-backed bail-out orchestrated to head off a full scale global rout.

Meanwhile, Standard & Poor's has just downgraded Goldman Sachs and Lehman Brothers from "Stable" to "Negative Outlook", and some analysts are wondering whether Citibank (which two years ago was leveraged 22:1 and is now leveraged 42:1) may be a good "short".

Since the early 90's the number of FDIC employees has dropped from around 15,000 to some 4.500. The agency will also need to seek outside help to enable it to properly oversee the 8,000 plus financial institutions for which it insures accounts.

Looks like the staff at banks making it onto the"high risk list" in the future might expect a visit from FDIC regulators (some of whom just might have a kind of mothbally smell about them).

Asian Markets Hit the Wall.

Many analysts were counting on Asian markets to "decouple" from the massive US economy and Europe should the latter stall and fall into recession. The theory was that the Asian economies would simply switch from their reliance on exporting manufactured goods to the West to selling to their own increasingly-better-off citizens and to developing their local service industries.

If anything, it looks like the old theory that "if the US economy catches a cold, the rest of the world catches pneumonia" still applies. **Much of the wealth of the new Asian middle class has suddenly vanished with the Shanghai Composite down 37% from its peak, the Shenzhen All Share down 27%, Hong Kong's Hang Seng down a third, Vietnam's Ho Chi Minh Index slashed by 50 %, and India's Sensex down 25%.**

Yet despite this crash in Asian share prices some analysts like Brett Arends (Wall Street Journal, March 22 2008) are warning ***"Asia still not cheap despite big falls...On many long-term measures like price-to-sales and price-to-book, for example, Chinese equities still look very expensive."*** So rather than bottoming anytime soon, these markets may have a lot further to fall.

The Federation of Hong Kong Industries estimates sky-rocketing labour costs and raw materials prices will result in the closure of 10% of the 70,000 Hong-Kong owned factories located in the nearby Pearl River Delta region of China. Some factories will be relocated deeper into inland China where costs are lower; others will be moved to cheaper regions like Vietnam, while some will simply shut down.

Now, with China's house prices faltering, property developers in "***extraordinarily difficult financial straits",*** political unrest in Tibet, and their main customers sliding into recession, China will be struggling to keep itself afloat let alone take over as the new locomotive engine for the global economy.

The Big Freeze Continues.

Thornburg Mortgage became another victim of ***"the worst*** (U.S.) ***housing market in a century...we are in a 100-year storm in the housing finance industry"*** (Dick Syron, C.E. Freddie Mac) who went on to say***... "We are not pretending the housing downturn has come to a bottom or anywhere near it. To the contrary, we are assuming that house prices have only fallen a third of their peak-to-trough decline."***

Carlyle Capital (a fund holding "triple-A rated paper" and geared 32:1) collapsed when nervous lenders seized its assets knowing that a 3% fall in value would wipe out the fund's equity.

Frightened investors in other funds rushed to cash out only to become ***"angry investors"*** when their savings were ***"frozen"*** by fund managers.

"ING freezes two Kiwi funds... Angry New Zealand investors are questioning why their ANZ *(Australia* & New Zealand Bank) ***financial advisers put them into funds now paralysed by the credit crisis.... ING New Zealand announced it was indefinitely suspending withdrawals. The funds were based largely on CDOs (collateralised debt obligations) and CLOs (collateralised loan obligations)."*** Maria Slade, The Australian, March 14th 2008.

Many of the 8,000 investors were retirees and had been assured by the bank's financial advisers that ***'it's as safe as being in the bank, but you get 1 per cent higher'.*** One retired couple had put their entire life savings into the fund only to see it lose 30% in value before being frozen. The husband has since suffered a nervous breakdown.

"Too late to duck out of Drake hedge fund... Many investors in a hedge fund run by Drake Capital Management are trying to pull their money out. They are finding out hedge funds love to take investor's money but cannot always give it back... The New York money manager... is struggling with losses related to the credit crunch, has received withdrawal notices from about half its hedge fund investors... (so) ***has moved to halt withdrawals... from its $US2.7 billion Drake Global Opportunities fund.***
Drake is one of several hedge fund firms that have locked in investors as markets have soured.
Drake was also likely to stop investor withdrawals from its two other hedge funds.
On Tuesday, GO Capital Asset Management (Amsterdam-based with $US870 million under management***)...told investors it would suspend redemptions until March next year. "***

Cassell Bryan-Low, Gregory Zuckerman, Wall Street Journal, March 14th 2008.

Helpless investors are now finding out that lurking amongst all the fine print of their fund's prospectus is the power to invoke a "gate" or freeze on withdrawals when assets can't be disposed of in an orderly fashion for a reasonable value (such as when too many investors want to cash out at the same time).

As one fund manager explained***... "It is a pre-emptive measure to safeguard the interests of our investors."*** Some funds exercise the right to freeze withdrawals if more than around 20 % of investors head for the exits. This not only protects the remaining investors but also ensures the manager and the fund's employees keep their jobs.

However, investors who didn't quite make it out in time may find themselves in the sorry state of not only being unable to access their money, but having to pay ongoing management fees throughout the freeze. They may also have to face seeing the asset value of the fund plunge further; and if their luck really runs out may face the prospect of their fund going into liquidation as did the two failed Bear Stearns' funds that folded nine months ago (and triggered the current crisis).

A Quickie 2-3 Week Crash?

The history books tell us that **economic booms and asset bubbles can often take quite a while to unravel and deflate.**

Take, for example, the Great Depression.

After peaking in October 1929 at 381 (and not to be surpassed again until 1954), the Dow Jones took more than two and a half years to bottom in July 1932 at just 41, a loss of approximately ninety percent of its value. Investors fought doggedly and continued to "buy the dips" as one "dead cat bounce" after another ground them lower and lower. The "death of a thousand cuts" you might say.

So it is a bit bizarre to hear someone like Macquarie Bank's division director Lucinda Chan complaining that the present stock market is ***"dysfunctional"*** because confidence-sapped investors are fleeing to the safety of cash...***"Chan's frustration in trying to explain the falling prices to clients is palpable.***
"We knew there would be a pull-back, but I'd rather have the 1987 crash of two or three weeks and just plummeting, then clean up the mess and let's move on'...(I guess she means back to the good old days of rising stock prices)***...'But this is like six months of nonsense. There are no margins to make money because there's more downside than there has been up days."*** Lisa Macnamara, The Australian March 8, 2008.

While Chan is fretting for her "quickie crash" other brokers are stressing because ***"The man in the street doesn't want to buy shares anymore...fear is feeding on itself...There's nothing short of a panic in leveraged financial stocks."***

Central Banks to Monetize Debt?

The article by Chris Giles and Krishna Guha on the ***Financial Times*** website (March 21, 2008) seems to have caused quite a stir... ***"Central banks on both sides of the Atlantic are actively engaged in discussions about the feasibility of mass purchases of mortgage-backed securities*** (MBS) ***as a possible solution to the credit crisis.***
Such a move would involve the use of public funds to shore up the market ... and restore confidence by ending the current vicious circle of forced sales, falling prices and weakening balance sheets... taxpayers would be assuming the credit risk."

The report states that the Bank of England seems ***"most enthusiastic to explore the idea. The*** (US) ***Federal Reserve is open in principle to the possibility...but only as a last resort. The European Central Bank appears least enthusiastic."***

Economist Adam Smith argued in his book ***"The Wealth of Nations"*** in 1776 that the global economy was best left to ***"free markets"*** and ***"the invisible hand"*** where all individuals pursued their own self-interest un-hobbled by too much government intervention.

The latest machinations of the Central Banks will have Adam Smith rolling over in his grave. No ***"invisible hand"*** for them. Rather they are acting out in the open, making it clear they may be prepared to buy up as much of the financial world's malinvestments as necessary to preserve the current world order, and don't mind if they stick taxpayers around the globe with the bill.

Interesting Quotes.

"The scariest thing I've read recently...Tim Geithner (president Federal Reserve Bank of New York) ***came as close as a Fed official can to saying we're in the midst of a financial meltdown.***
The Fed's latest plan is to turn itself into Wall Street's pawnbroker....$US200 billion may sound like a lot of money, but when you compare it with the size of the markets that are melting down –there's $11 trillion in US mortgages outstanding – it's a drop in the bucket... we can only hope that, in the end, a bail-out won't be necessary. But hope is not a plan."

Paul Krugman, The New York Times, Tuesday 11th 2008.

"If you have leverage, you're stuffed.
There are people who have been hanging on by their fingernails who can't hold on much longer."

Alex Allen (CIO), Eddington Capital Management, Bloomberg, Wed. 12th 2008.

A UK Labour Party official***..."Ordinary people have been scared by what has happened here. One bank*** (Northern Rock) ***saved from collapse by nationalization; another near thing last week*** (UK's biggest home mortgage provider HBOS). ***People are saying, 'What the hell is going on? What the hell are you going to do about these cowboys? We have to show them we are in charge."***

Geoff Kitney, Australian Financial Review March 26th 2008.

All the best, Joe.

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