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

Holding the (Toxic Debt) Bag.

By Joe Average,
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www.lifetoday.com.au

"Credit crunch will 'shred investment portfolios to ribbons.'
When creditors led by Merrill Lynch forced a fire-sale of assets (*of two Bear Stearns hedge funds in danger of collapsing)****, they inadvertently revealed that up to $2 trillion of debt linked to the crumbling sub-prime and "Alt A" property market was falsely priced on books… The banks halted the sale before "price discovery" set off a wider chain-reaction.***
"Who now holds these risks…? The honest answer is that we do not know." (The Bank of International Settlements) said.
Wobbles are turning to fears…This is how a credit crunch starts.
"This is the big one: all investment portfolios will be shredded to ribbons," said Albert Edwards, from Dresdner Kleinwort."
Ambrose Evans-Pritchard, 7/5/2007 www.telegraph.com.uk

CDO's (Collateralizes Debt Obligations)… CDS's (Collateralized Default Swaps)… MBS's (Mortgage Backed Securities)… High Grade Structured Credit Strategies Enhanced Leverage Funds…etc, etc, etc, are just some of the new financial machinations that make up the **mortgage derivatives market** that has been spawned this century. This gobbledegook of financial instruments and letters would be funny if it didn't now represent some $500 trillion of dangerously geared (up to 20 times) derivatives supported by artificially inflated house prices.

Artificially low interest rates coupled with financial deregulation and central bank money-printing (courtesy Alan Greenspan) has led to **the sub-prime debacle that now threatens to undermine many of the 6 million homes bought by Americans who borrowed close to 100% (in some cases 105%) of the purchase price**.

The tangled web that is the derivatives market has permeated up through all levels of the financial system. Local mortgage brokers were the first link in the chain, writing mortgages which they then on-sold to large investment banks, who in turn packaged them into mortgage-backed securities. Some of these were sold again to pension and insurance funds, while the more dubious tranches were offloaded onto Wall Street where they were given the blessing of some investment rating agencies and transformed into high investment grade instruments. The combination of a high grade rating and yields of 9 to 13 % meant that pension and superannuation funds were quick to add them to their portfolios.

When Bear Stearns' Enhanced Leverage hedge Fund lost 25% of its value in the first three months of 2007 creditors were quick to react (despite Bear Stearns' pledge to set aside US$3.2 billion). Merrill Lynch acted promptly to protect creditors and moved to force a fire-sale of assets.

BIG MISTAKE!

Bill Bonner (www.dailyreckoning.com) tells us: ***"The Financial Times reported this week that when vulture funds began to bid on the Bear's holdings the highest bid was only five cents per dollar of face value. Meanwhile, investors in the funds were offering their positions at 11 cents on the dollar – with no takers."***

Scary stuff. No wonder the attempt to sell off Bear Stearns' "assets" was quickly aborted and pushed underground and out of sight. This fire-sale had to potential to start a desperate panic to the exits if holders of these derivatives suddenly realized that their "high investment grade instruments" were in reality **toxic debt** that might be virtually **unsaleable in an emergency**.

Now Bear Stearns have fessed up revealing that **<u>one stricken fund has lost all…I repeat all… its value…while the other fund is only worth 9 cents or less in the dollar.</u>** Talk about a wipe-out!

No doubt there is a lot of soul searching going on at the moment amongst holders of this toxic debt as they anguish over how to quietly try to offload it to someone else without starting a panic among other holders, if that is indeed possible.

The very survival of many investors and funds may now depend on how they manage the present situation from here so as to ensure that *they* are not the last ones to be holding the bag (of Toxic Debt).

<u>The Confidence of Youth.</u>

In his recent article ***"Bring On The Bubbles!"*** (www.clifdroke.com) Clif Droke is quite scathing of those in the financial community that ***"have developed a severe case of bubble-phobia".***

But most of his venom is directed to some poor unfortunate who sent him an e-mail ***"chiding me for wanting to see a further expansion in money supply…there can never be too much liquidity. He had the audacity to write, "Please refrain from encouraging such notions." Please refrain indeed!"***

It seems Droke was greatly annoyed by the criticism because it is his firm wish to ***"convince the monetary authorities to…let the spigots run full force like they did in the late 90's. That would usher in times of economic prosperity the likes of which this country*** (the U.S. of A) ***has never seen."***

My first reaction was to think…"can I have some of what he's been smoking?"

But then it got worse.

It seems that Droke has his knickers in a knot over one other matter. He went on to make the following provoking statements;

"<u>Most of the anti-bubble sentiment comes from the staunchly conservative, well-to-do, over-50 crowd.</u> Truth be told, the bubble-phobia displayed by this group <u>is an outgrowth of the fear of change that people over the age of 50 often develop.</u> Bubbles bring rapid technological change and progress and the bubble-phobes among us are afraid of this. <u>The ones that are in a position to actually benefit from bubbles and are flexible enough to take advantage of them are typically under 50. They haven't yet become so set in their ways and are able to recognize the opportunities that bubbles bring and have no problem taking advantage of them. The under-50 crowd, in most cases, hasn't built up a solid nest egg yet and they're more likely to appreciate the immense opportunities for securing their financial futures.</u>
Bubbles can be indeed be used by the wise and prudent to get their financial houses in order….They were used to great effect by many in the late 90's as many individuals were able to extricate themselves from debt before the bear market and recession of 2000-2002 came along. <u>Bubbles can be used to raise funds for retirement</u> (now there's interesting investment advice for seniors) ***or to lay up an emergency reserve for the next recession.***
…join me in saying, "Give me one more bubble before it all ends." And to the bubble-makers: Make it a good one – a bubble for the ages!" (Emphasis added).

Now them's fighting words if ever I heard.

Yes I personally am over 50. I'm not real happy about it. I don't go around shouting it from the roof tops…but I sure resent the insinuation that I'm a fear-filled old fart because I might tend to have a different view on the matter of profligate or irresponsible economic policy and "bubbles".

I'll be the first to admit that I've lost some (sometimes I fear too much) of the **"confidence of youth"** that I had as a young buck. Life's school of hard knocks and a few too many mistakes or bad decisions along the way have a way of doing that to a body.

Mowahid Shah is right when he says ***"The great strength of youth is the confidence of youth…Confidence breeds daring, optimism and the capacity for risk-taking, which is inherent in any endeavour or consequence."***

I look back and question whether it is possible to hold on to the confidence of youth while still gaining the wisdom of age. Does the confidence of youth fade with age in too many of us to be replaced by the scepticism of maturity? I know darn well that I've certainly become more cautious as I come closer to retirement, and I lament the knowledge that I wouldn't be able to bounce that from a financial catastrophe like I could have done when I was a lot younger. That goes without saying…time is *not on* your side as you get older.

But I'm also mindful of a quote I once read in www.GolfDigest.com about a different game (but I think it still applies to the game of life):
"Of course, the wild card is how quickly the confidence of youth can be shattered by the reality of pressure. "The tour can eat you up and spit you out." (…as can life).

And as for Droke…now that age seems to have become an issue I've only one question to ask… "Just how bloomin' old are you anyway?"

All the best, Joe.

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