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

2008…"Deeper, Darker, Scarier."

By Joe Average,
December 2007.
www.lifetoday.com.au

> **"The (spreading sub-prime) mortgage hole is worse than anyone saw. It is deeper, darker, scarier… (banks) are now looking at new reserves …my sense…is they don't have a clear picture of how this will play out …confidence is low."** (*Tony James, Blackstone Group.)*
>
> Robert Guy/Peter Wells, Financial Review, November 14, 2007.

This glum assessment made by the man at the helm of Blackstone Group, the world's biggest private equity company, makes it clear that the sub-prime problem is not going away anytime soon. James' opinion is backed up by Geoff Wilson (chairman Wilson Asset Management)… **"Bad news is a lagging indicator, not a leading indicator…For the next six to twelve months, we're going to see the impact that (the credit crunch) had on various people. It takes time to work through the system. There's always a knock-on effect…And when there's such an adjustment in pricing in any market, or the bursting of a bubble or a crash, then it does take time for the impacts of those sudden movements to present themselves."**

New York Deutsche Bank securities analyst Michael Mayo believes **"these events tend to become deeper and play out longer than most people initially expect…This is one of the slowest-moving train wrecks we've seen."**

Tyndall's Mal Whitten (portfolio manager) laments **"there's more and more negative news coming out of the U.S. so you can't ignore that…Quite clearly there's much more damage in the system than anyone thought."**

The Worst Yet to Come.

Other forecasters are warning that **the resulting housing slump won't bottom for at least another year, will most probably wipe up to 1.5 per cent from GDP, and will result in at least a half a million jobs being lost.** The losses being touted from the sub-prime mess are estimated up to $500 billion and rising, with up to $4 trillion being sucked out of credit markets. Credit Suisse Group estimates that problems with resetting home mortgages will continue to rise **through to 2010 until over 1.5 million homes are in default.** Some analysts are less sanguine and think this estimate is way too conservative.

A recent Goldman Sachs report is factoring in a future 15 per cent fall in house prices, assuming the economy and the powers that be (Wall Street, the Plunge Protection Team, and Central Banks) can skirt around an all out recession. Under a recession scenario a property crash of anywhere from 20 per cent, to 40 per cent or more becomes a chilling possibility. With the number of foreclosures increasing and looking to skyrocket another problem has cropped up for investors in securitized loans. Many of these loans have been sliced and diced into complex, exotic instuments so that the question of who actually owns the mortgage note has become obscure. Recent court rulings have hampered creditors' efforts to foreclose on delinquent borrowers because courts were not satisfied with the "proof of ownership" presented. Last month a federal judge (Christopher Boyco) in Cleveland dismissed 14 foreclosure applications filed by Deutsche Bank (as trustee for securitisation funds) citing that Deutsche had failed to prove ownership by producing the actual mortgages or notes.

This development is certain to cause a lot of angst among many other European, Asian and Middle Eastern investors who have their funds tied up in similar U.S. financial instruments. They too may find it very difficult to

take back possession of homes in the event of property owners defaulting on their mortgages and may find their funds frozen and not easily retrievable.

To make matters worse, concerns are being raised about the asset base of some Bond Insurers and whether they have the reserves to actually cover the trillions of dollars of debt they have guaranteed against default. **The share price of bond insurers Ambac Financial Group and MBIA have plummeted over 50 per cent this year.** Morgan Stanley head of credit strategy Greg Peters warns **"there is a huge domino effect on the financial system"** and should bond insurers have their ratings revised downwards then the investors in the insured securities will also be punished as their values decline.

Meanwhile, stresses keep building in the financial system with Freddie Mac fessing up to a $2 billion loss and looking for ways to raise more capital.

Jim Sinclair (www.jsmineset.com) puts the magnitude of the problem into perspective when he tells us:
"The size of the mountain of over the counter derivatives is above $450 trillion dollars. The size of the world economy is slightly above $145 trillion.
What do you think the risk factor is on $450 trillion worth of garbage paper, from CDOs, CBOs and now CLOs? Is it $2 trillion like the London Financial Times said yesterday, is it $20 trillion or maybe even $200 trillion?"

Dow Theory Sell Signal?

Technical analysis devotees like Tim Wood and Robert Prechter have been watching the Dow's recent gyrations carefully and are now warning that the "fat lady may have sung" (a euphemism for a stock market crash in the making).

They have also been rejoined by the venerable Richard Russell (who had recently deserted the bear-camp and turned bullish… **"true I did continue to 'hope' ".** In his news letter, which has been going out to subscribers for more than 50 years, Russell now is also warning… **"It was a noble battle, it was a battle that seemed almost endless. But today the great battle ended. Today the D-J Industrial Average closed below its August 16 low of 12845.78, thereby confirming the prior violation of the Transportation Average. In doing so, the stock market and the Dow Theory have spoken – they have confirmed the existence of a primary bear market. The Transports broke under their August 16 low of 4672.35 back on November 7."**

The Next Big Thing...Cash?

"European banks are facing a new wave of financing troubles as the markets they borrow money from take a turn for the worse… 'There's a genuine fear here of bank failure' (strategist at Barclays Capital Tim Bond)… 'Liquidity, specifically cash, is king right now…if you do not have it, and need to access the capital markets, you are likely to have to pay dearly in the current environment' (Lehman Brothers Holdings Report).

Carrick Mollenkamp/Mark Whitehouse, 27 Nov 2007, THE AUSTRALIAN.

"Anything below 12,500 (in the Dow) could trigger program-trading and crash the market.
The global credit crisis has hit Asia with a vengeance for the first time, triggering a massive flight to safety…Yields on three-month deposits in China and Korea have plummeted to near 1pc…caused by panic withdrawals from money market funds and credit derivatives…On Tuesday Chinese government officials ordered a complete halt to bank lending."

Mike Whitney, 25 November 2007 www.pacificfreepress.com

"I now see the risk of a severe and worsening liquidity and credit crunch leading to a generalized meltdown of the financial system."

Professor Nouriel Roubini, Stern School of Business NY.

"CRASH IS COMING, WARNS TOP INVESTOR…The man responsible for investing $41 billion of the (Australian) State's money (chief investment officer…Victorian Funds Management, Leo de Bever) has warned mum-and-dad investors to prepare for a massive sharemarket crash…repercussions of the $300 billion subprime lending crisis in the US."

Jason Dowling/Peter Weekes, Nov 4, 2007, THE AGE.

"The global banking system now faces the risk of a general flight towards cash and liquid level one assets (refer new US FAS 157 accounting standard) on a scale that has not been seen since the early 1930's. Already British banks are showing signs of near panic."

William Rees-Mogg, Nov 12, 2007, www.timesonline.co.uk

The message seems clear. There are a lot of nervous investors around the globe and more than a few are moving to the safety of cash. But even these investors need to be careful where they park their cash because as Professor Roubini warns, in an extreme financial crisis we may see a run on weaker banks as frightened customers scramble to withdraw their savings.

Some banks may be forced to close their doors, while others may respond by putting a limit on the amount that may be withdrawn by customers. In an article entitled **"Transfer Limits Have Potential To Block Run On Bank"** (www.www.jsmineset.com November 17,2007) Jim Sinclair alerts us to the fact that some banks appear to be altering account agreements to **"put in place a tool to prevent an electronic run on an institution such as the one which recently occurred in Great Britain. If you have $1,000,000 in such an account …it would take you 100 months to withdraw the funds."**

The Times They Are a Changing.

On November 24th Australian Prime Minister John Howard's Liberal Party was crushed at the ballot box. The devastating political defeat was all the more remarkable because only three years prior Howard had won the previous election with such a huge majority that pundits declared it was "a massive, two term (ensuring) victory".

The Australian nation has just experienced a decade where many Aussies have more than doubled their wealth (thanks to a massive credit-fuelled real estate boom) and a China-driven commodities boom; during this time unemployment has fallen to record lows below 4 per cent. So what went wrong?

It seems there were four main issues that brought about Howard's downfall.

1. Housing affordability is the lowest it's been for some thirty years. During this purple economic decade the rich certainly got very much richer. However, further down-market (and despite their new debt-fuelled affluence) many new home owners are now struggling with rising mortgage repayments and cost-of-living expenses. Meanwhile, disenfranchised first home buyers who can't afford to buy a home are not at all happy and have turned from being disillusioned to angry.

2. Many workers feel the low unemployment figures have been achieved through an Industrial Relations policy that had also decreased job security and increased pressure on salaries in some sectors. Post election, even some employers now admit that the Howard government may have pressed too hard for work-place reforms which were seen by many workers as being "unfair".

3. Howard's refusal to ratify Kyoto and his casual approach to global warming did not sit well with much of the electorate.

4. As Iraq continues to spiral into chaos, many Australians began to question Howard's judgement (What…no weapons of mass destruction?) especially as he seemed in no hurry to plan an exit strategy. Unlike former British Prime Minister Tony Blair, who saw the writing on the wall and had the sense to retire before he was pushed, Howard stayed on too long. He just couldn't see that "the times they are a changing".

All the best, Joe.

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