



Party on...but near an exit.

By Joe Average,
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www.lifetoday.com.au

“The party does get to be more fun – and besides there are no clocks on the wall. And then the clock strikes 12 And everything turns back to pumpkins and mice.”

Warren Buffett.

The Calm Before the Storm?

Stockbrokers, hedge fund managers and private equity high flyers have never had it so good. **A tsunami of cash, the strongest in living memory, is flooding the market** and bringing undreamed of wealth to some players in the form of bonuses.

The VIX index continues to wallow at record lows, fear has all but vanished from the world's markets, risk premium has totally collapsed and the bears appear to have been trampled into the dust by the overwhelming bullish sentiment.

Who on earth would want to leave a party this great? Certainly not brokers and fund managers. Bet big and you could be set for life...you could retire on this year's bonus alone. Bet big and lose? No problem! It's not your money! No one will make you pay back that bonus. The worst that might happen is you'll have to look for another job, dust yourself off and start over again.

We're assured constantly by the media and financial institutions that the **Greenspan experiment** has finally been proven a success. The much touted **“soft landing”** has been achieved. The various asset bubbles (stocks, real estate, commodities, emerging markets, credit etc) *haven't* burst or collapsed. Instead of a bust, we're entering into the **“Goldilocks economy”** phase...“not too cold, not too hot, just right”...as we consolidate and presumably prepare for the next boom cycle.

Unfortunately, there always have to be a few party-poopers around.

One prominent institutional broker has warned his clients that the stock market is presently **“like a monster truck, crushing everything in its path. Sure, it will end in tears...but until then all aboard and enjoy the ride”**.

Economic guru **Dr Mac Faber** has his clients seeking the **safety of cash** in the expectation that most **asset prices will be much lower in six months time**.

Gary “Irrational Exuberance” Shilling's Insight newsletter is forecasting a **global recession** along with a **meltdown in stocks and real estate**. Shilling believes **China will suffer a hard landing** which in turn will cause **commodity prices to nosedive**, and that **deflationary forces will return with a vengeance**. And, notwithstanding that the National Association of Realtors is to spend \$40 million on a campaign to convince would be buyers that the market has bottomed and “now is the time to buy”, he believes **prices will drop a lot further**. In fact, they would **need to drop 40% merely to revert to the historic mean**.

Meanwhile, **Robert Prechter** stands ready to remind us that we are now in the **final parabolic blow-off stage of this massive asset inflation**, and that **the crash back to earth will be just as meteoric**.

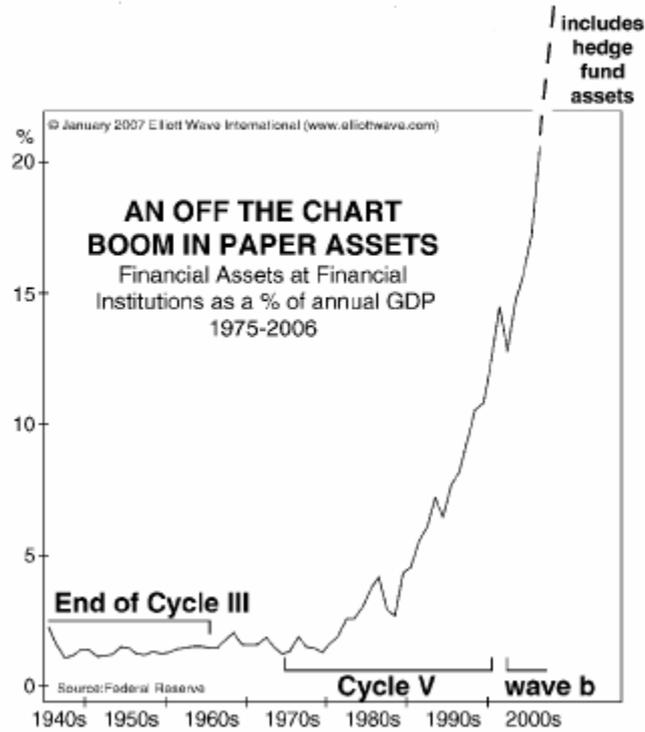


Chart courtesy Elliott Wave International www.elliottwave.com

"Let The Good Times Roll" ...Newsweek.

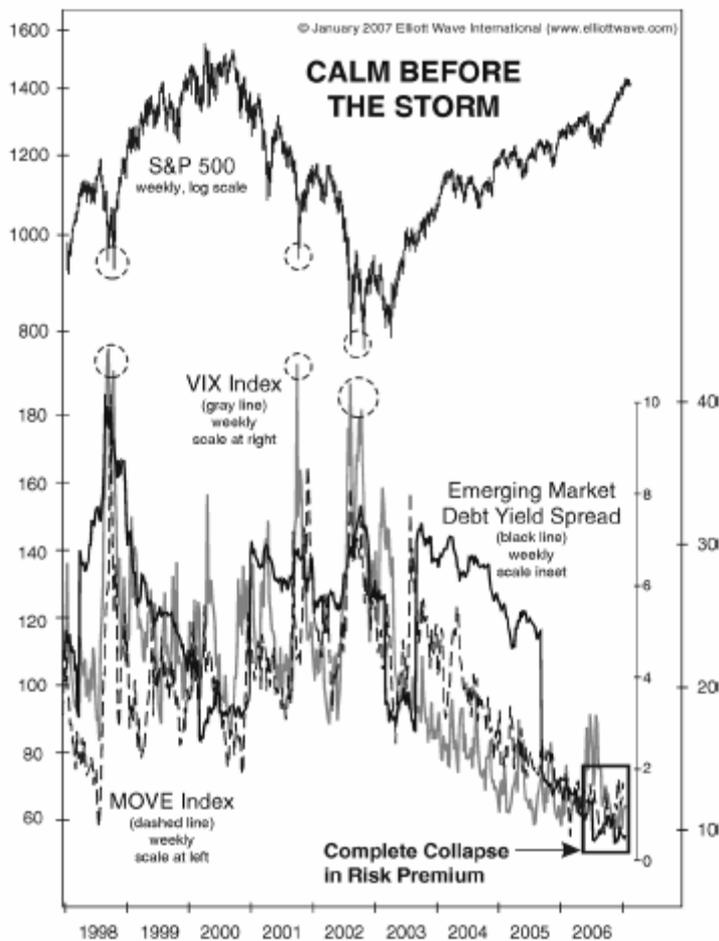


Chart courtesy Elliott Wave International www.elliottwave.com

"More than 70% of U.S. companies rated by Standard & Poors have below-investment grade, or junk, ratings. That's a record." The Wall Street Journal.

Taking away the punch bowl.

Most people think of the Japanese as being a rather conservative, disciplined lot and more inclined to saving rather than profligate spending and credit binges. Therefore, it came as quite a surprise to learn that **Japanese financial regulators are suddenly reigning back consumer finance** companies both domestic and foreign.

New laws will slash the maximum rate lenders can charge for consumer loans from a hefty 29 per cent down to 20 per cent by end 2009. Even more harsh (and almost surreal in the current environment of governments running printing presses red-hot and endless easy credit) is to be told **the total amount consumers will now be allowed to borrow will be capped at a measly one third of annual income!** Talk about turning off the tap!

This has prompted Citigroup to announce that it will drastically cut back its consumer finance operations in Japan, whilst at the same time posting a U.S.\$370 million loss by its Japanese office in the fourth quarter. This must really cause Citigroup some angst following the forced closure of its Japanese private banking arm two years ago when financial regulators discovered violations of banking laws.

I wonder **what would happen to the global asset boom if instead of being able to borrow seemingly endless amounts of credit** (ARMs, no-deposit loans, low-doc loans, "4 years interest free!" etc,etc) consumers were forced to act conservatively (dare I say responsibly) and only allowed to borrow up to one third of their annual income. I can see many workers in the mortgage industry on the verge of having an apoplectic fit simply at the thought.

The Blame Game Begins.

Australians have just learnt that they have been given the dubious distinction of "**The Award for the Nation with the Least Affordable Housing**", confirming the nation is facing an **unprecedented housing affordability crisis**. Many young first home buyers have well and truly had the door to home ownership shut firmly in their face.

Demographia (www.demographia.com) released the results of its "International Housing Affordability Survey" in January 2007, warning that **the slump in home affordability will slash household spending, retard economic growth, and push up unemployment.**

The United States, which scored 14 out of 25 of the world's least affordable markets (No.1 L.A., No.2 San Diego, No.3 Honolulu, No.4 San Francisco....etc) still came in overall **much more affordable than Australia relative to income**. While **Canadian housing was ranked half as expensive as Australia overall.**

Not surprisingly, the blame game has begun. Politicians and economists are pointing the finger at rapacious local governments blaming restrictive land development policies, excessive local taxes and exorbitant infrastructure costs.

Local governments deny these charges. They quote the then Governor of the Reserve Bank of Australia (Ian Macfarlane) who told a House of Representatives Committee last August that while infrastructure costs *had* indeed added to the cost of new housing, the main reason house prices were so high was low interest rates. Encouraged by "**mainly tax incentives, plus a history of inflation....(buyers) borrowed the money and drove up house prices, so the whole stock of ... houses basically doubled in price.**"

Local government planners blame **low interest rates for creating the huge surge in demand that artificially inflated house prices as buyers fought each other in a mad scramble to buy as many properties as they possibly could with their borrowed money.**

So who's to blame? The people who supplied the punch bowl?...or the party animals who didn't know when enough is enough? Maybe the answer is **they're both to blame**, but I'd suggest **the Federal authorities are most to blame**. They're supposed to know better and are in positions of responsibility. Their duty should be to always protect the gullible or naïve public from itself... just like the Japanese government now appears to be trying to do.

All the best, Joe.
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