Scared? You Should Be.

By Joe Average,
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Long Road out of Eden.

"Having lunch at the Petroleum Club,
Smokin' fine cigars and swappin' lies.
'Gimme nother slice o' that barbecued brisket!'
....
We're riding to Utopia,
Road map says we'll be arriving soon.
Captains of the old order clinging to the reins,
Assuring us these aches inside are only growing pains.
But it's a long road out of Eden."

The Eagles latest hit album.

I wonder if any member of the Federal Reserve almost choked on his barbecued brisket when world financial markets threatened to go into meltdown while Wall Street was closed over the Martin Luther King Holiday.

On **"Black Tuesday"** January 22nd, 2008 world markets crashed...Australia down 7%, Japan down 5.7%, Shanghai down 7.2%, Jakarta down 7.7%, Hang Seng down 8.7%, FTSE down 5.5%, Paris and Frankfurt down 7%. These drops were on top of earlier falls since January 1st which had Germany down 19%, London down 13%, Hong Kong down 13%, Japan down 16% and saw Emerging Markets also hit by double-digit losses. The Australian market was down a bruising 24% from its high last November.

Concurrently, the second biggest French bank Societe Generale was frantically trying to extricate itself from an illicit $84 billion position in the markets perpetrated by a **"rogue trader"** which would see them realize an $8.2 billion loss and throw markets further into turmoil.

With futures markets predicting a 500 point fall at the opening bell on Wall Street the next morning and the threat of markets spinning further down into an unstoppable spiral, the phones must have run hot behind the scenes as the Fed went into damage control. Emergency measures in the form of an immediate, pre-emptive interest rate cut of 0.75% (the largest in almost twenty-five years) were followed by a further 0.5% cut a week later (an unprecedented 1.25% cut in one week) which was enough to act as a circuit breaker, at least for the moment.

As global financial markets and investors wait with bated breath to see where we go from here, it may be timely to look at some of the opinions flashing across the media.

Let's lead out with this ripper from the man who forecast the Dotcom Bust in his prescient book "Irrational Exuberance" ;

"People aren't scared yet – but once all this unwinds, they will be."
Professor Robert Shiller, Economist Yale University.

Global Economies Coupled to US?

"America is the culprit. If the US problems didn't exist, Japan's stock markets wouldn't be down this much."
Yoshio Nakamura, 65 year old investor watching Tokyo Stock Exchange fall.

"The market plunge came too quickly this time. It's horrifying. The worse thing is that I still don't understand what has happened. I'm very confused."
Chinese investor Xu Shaosong, as Shanghai's Composite plunged.

"If America unravels over the next six months and contaminates the rest of the world, all bets are off."
Graham Harman, Citigroup (Aust.) head investment strategy.

"If China doesn't decouple from the US, you will have problems in the resources sector. And if the credit crisis is a global phenomenon, which I think it is, there will be pressure on the banking sector."
Peter Morgan, 452 Capital's investment director.

"The American and Chinese economies are now inextricably linked...A slowdown in China would have big repercussions for us. The risks could be awful."
Carl Weinberg, chief economist High Frequency Economics.

"...the global economy (is) ***a world where national problems can quickly become global – and contagion can move as swiftly as the fastest communications."***
British Prime Minister Gordon Brown.

"Rogue Traders" and the Financial Sector.

"In 1987, it was a very short, sharp correction and you simply didn't have the excesses that you have today. Certainly there is more pain to come ...All the cockroaches are coming out of the cupboard at the moment."
Alistair Thompson, First State Investments Singapore.

"We have to put a stop to this financial system which is out of its mind and which has lost sight of its purpose."
French President Nicolas Sarkozy.

"It is not that traders were bad apples, but the institutions. Sumitomo, Barings, and Daiwa (all brought undone by rogue traders) ***were the rotten apples. They were rogue banks too interested in quick profits to structure themselves according to the basic rules."***
Toshihide Iguchi, "rogue trader" Daiwa 1995.

"They want the profit, but to get that profit they don't want to accept the risk. It is not that they don't want you to take it; they just don't want to see it. So you start out not declaring all your profits, keeping some in store. And then (you don't declare) ***losses – as long as it doesn't hit the P&L*** (profit and loss account)***, it's OK."***
David Bullen, "rogue trader" National Australia Bank.

"It's unbelievable!"...(on Societe Generale's $8.2 billion/ 5 billion Euro loss).
Patrizio Pazzaglia, Bank Insinger de Beaufort NV, Rome.

"Five million Euros means something, it's like the size of the town budget... but five billion is a crazy number...it doesn't mean anything."

Mayor of Pont L'Abbe, home of Societe Generale's "rogue trader" Jerome Kerviel.

Monoline Bond Insurers.

"The monolines are dead, their business model is dead. The government is going to have to recapitalize this industry or there will be communities in the US where they can't flush their toilets" (because they can't afford the services).

David Roche, investment consultant Independent Strategy, London.

"...the cream of the crap."...(the new borrowers targeted by troubled monoline ACA Capital Holdings Inc. which recently had its credit rating cut 12 levels to CCC by S&P.)

H. Russell Fraser, former Fitch Ratings executive, founder ACA.

Emergency Rate Cuts and the Credit Crunch.

"The reason this crunch will be so much worse is that the chunk of the economy which is shuddering to a halt – homebuilding and housing dependent consumption – is six times bigger than the spending on IT, which triggered the last one. The magnitude dwarfs anything we saw seven years ago."

Stephen Roach, Morgan Stanley Asia.

"I see the risk of a credit crunch leading to a generalized meltdown of the financial system."

Nouriel Roubini, Economics Professor, New York University.

"It (the 1.25% rate cut) ***is a signal of how bad the Fed*** (the US Federal Reserve) ***thinks the future is looking."***

Professor Roberto Rogobon, M.I.T. Sloan School Management.

"This behaviour is not consistent with his (Fed chairman Ben Bernanke) ***academic work."***

Professor Economics Ray Fair, Yale.

Wall Street, SIVs and CDOs.

"For the Chinese, starting in early February, this will be the Year of the Rat. But on Madison Avenue, it's more likely to be the year of the cornered rat."

Suzanne Vranica, WSJ.com

"Everyone was passing the risk to the next deal and keeping it within a closed system... If you hold my risk and I hold yours, we can say whatever we think it's worth and generate fees from that. It's like...creating artificial value."

Ann Rutledge, R&R Consulting (structured finance), New York.

"It (CDO Norma) ***is a tangled hairball of risk... any savvy investor would have thrown this...in the trash."***

Janet Tavakoli, CDO consultant Chicago.

The American Consumer.

"Consumers are on the edge, but they haven't packed it in yet. They are worried about the up and down stock-market, falling house values and high gasoline prices. But they still have their jobs."

Mark Zandi, chief economist Moody's.

The "Trickle-Down Effect".

"A firehose has been showered on me, and nothing has trickled beneath. In the last seven-eight years what has happened is that the super-rich have gotten a huge break...the American worker went nowhere while the super-rich flourished, aided by the tax code. <u>It has been a marvellous time for these super-rich...but if you believe in a trickle-down theory, nothing has trickled since 1987</u>."

Warren Buffett, billionaire investor & CEO Berkshire Hathaway.

Falling Property Prices.

"We are in a historic housing bust right now, comparable to that of the Great Depression. The unravelling of that has unpredictable consequences."

Prof. Robert Shiller, co-founder Home Price Index.

"What's going on in the (U.S.) ***mortgage market is not a crisis of confidence that we can talk ourselves out of. It's a problem of structural insolvency, where many borrowers literally don't have the means to service their debt over the long term, because many of them were counting on rising home prices over the short term."***

John Hussman, president Hussman Funds.

"China's property prices have reached dizzying highs in recent years...markets in Shenzhen began to wobble in the middle of last year...<u>One report this month said Shenzhen real estate agent Chuanghui was shutting hundreds of branches because of declining interest from home buyers."</u>

Jonathan Cheng, WSJ.com

"In <u>Britain,</u> which had the first run on a UK bank for 150 years when home lender Northern Rock was unable to fund its obligations, <u>market analysts are warning of the danger of a property crash that could lead to house prices plummeting by as much as 50 per cent."</u>

Geoff Kitney, European correspondent Australian Financial Review.

"Markets are forecasting the biggest collapse in (UK) commercial property prices since World War II... (this) ***may pose almost as great a threat to Britain's banking system as the sub-prime crisis***... '***The ferocity of the price drop has taken many by surprise."***

The Economist.

The Big Freeze Begins.

"In recent weeks...<u>investors have rushed to redeem their shares in property funds, amid wide-spread fears that the (British) commercial property bubble has burst</u>...the scale of some of the redemptions...has plunged several funds into crisis....<u>withdrawals have been temporarily frozen by some funds,</u> including those run by Scottish Widows, a unit of Lloyds TSB Group; Dutch insurer Aegon's Scottish Equitable ($4.4 billion) ***Property Fund; and Aviva Plc's Morley Pooled Pensions Ltd Property Fund....<u>more freezes look likely</u> with British insurer Norwich Union*** (declaring it) ***will consider selling properties to meet redemptions...although freezing the fund is also an option."***

Sara Seddon Kilbinger, Wall Street Journal.

"Shares in British Land, the UK's leading property company, have fallen by nearly half and most funds are showing falls of between 20 to 40 per cent<u>. But investors stampeding for the exit are now finding that they cannot access their cash."</u>

Patrick Collinson, The Guardian.

"More than 10,000 investors in embattled (Australian) ***finance group MFS...have had $770 million worth of <u>investments frozen as the company battles to stave off collapse</u>...MFS is behind a $1 billion New Zealand financial planning firm that poured tens of millions of investor's money into three high-risk investment companies that have collapsed in the past six months. Mr Guy, <u>a financial planner</u> (had) $600,000 – <u>most of his life savings</u> in MFS*** (and is) ***waiting to see if the company will succeed in its attempts to stave off collapse... "I'm just horrified at what's happening"... <u>he had planned on retirement but the collapse in MFS shares meant he would probably be forced to continue working... "My wife kept saying we've got too much in one spot."</u>***

Anthony Klan, The Australian January 30-31, 2008.

All the best, Joe.

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