

Sunday, August 28, 2005

CAT5 "perfect storm" shaping up in the financial markets?

Speaking as a guy who believes it is inherently impossible to predict things like stock market crashes, earthquakes and alien invasions, I'm getting numerous signals today that are food for thought on their own and ominous in aggregate. On one hand there is Hurricane Katrina which is barreling down on New Orleans, and if it hits can cause a lot more damage and fallout than we're accustomed to seeing from hurricanes, even bad ones. Apparently there's only been three other CAT5's in history and tonight Stratfor Global Intelligence sent out a breaking news report titled The Geopolitics of Katrina. Stratfor's core business is meticulously researched analysis, they are not in the "breaking news" business. The last time I received a breaking news alert from them was about 10 hours before the Iraq War II started, telling readers that bombers had been spotted departing from bases in Europe.

The economic effects from a full-on Katrina hit on the oil refineries and ports of Louisiana could be hard hitting. In fact the overnight oil price has already spiked past \$70/barrel as I type this (gold is up a couple bucks an ounce in fairly short order as well).

This combined with the fedspeak out of Jackson Hole this weekend make for an interesting couple weeks ahead. The speeches contained a couple of startling nuggets once you remove the circular, double-talk which the Fed carefully crafts to glaze over as many eyes as possible while bluffing at an appearance of transparency. Greenspan pronounced the housing bubble all but "ready-to-pop" in that understated hocus-pocus which is his trademark: "The housing boom will inevitably simmer down. As part of that process, house turnover will decline from currently historic levels, while some house price increases will slow and prices could even decrease".

Which is nice non-threatening way to state that the housing bubble which has been fueled entirely by reckless credit expansion is about ready to pop.

Governor Donald Kohn waxed philosophic on the pitfalls of financial derivatives and had this to say:

The risk is that private agents overestimate the ability or willingness of central banks to damp volatility in asset prices or the economy, or that they fail to appreciate that future policy actions depend on an imperfectly predictable economic outlook. But developments should have partially alleviated some of these concerns. Investors have had an opportunity to observe that policy actions in 1987, 1998, and 2001-03 cushioned the economy, but they did not stop major declines in the prices of equity in 1987 and 2001 or of risky credits in 1998. Short-term rates have risen substantially in the past year, reducing the profitability of "carry trades" without triggering an unwinding that drove long-term interest rates higher or widened risk premiums. And expectations that policy tightening would remain gradual over the near-term have not stopped long-term rates from fluctuating substantially in response to incoming data; the movements of future or forward rates out the yield curve after surprises in data have been at least as large since 2003 as they were before.

That is not to say that we have nothing to worry about. As I already noted, Alan Greenspan, himself, has often been concerned about market complacency--as recently as his latest monetary policy testimony. People may well perceive the economy as more stable than it is or central banks with greater power than we have to smooth the economy or to foresee our own actions.

Which, as George Ure notes, sounds like a nice soft way to tell the financial bankers in fedspeak/doublespeak: "If the derivatives blow up, don't assume we (the Central Bank) will be able to fix it".

These long-winded innocuous sounding pronouncements sound unimportant, barely comprehensible and boring. They are carefully crafted to appear to be just that. They are not. These statements are analyzed six-ways from Sunday by hordes of financial analysts and trillions of dollars worth of assets and perhaps more importantly, derivatives of assets, will slosh around the global economy based on their conclusions.

Any one of these factors on their own could make things interesting. All of them coming together in one shot could be pretty wild.

Posted by Mark Jeftovic in Venture Capital at 21:48