

Saturday, May 21. 2005

Waitin' for the derivatives blowup

Contrary to some of the cranks and financial doomsayers I follow, I am not a permabear and I don't really want to see the markets meltdown and the economy hit a recession (or worse). But over the years I've acquired an appreciation for how little I know about economics. Along with it I wonder if even I, an economic simpleton, can perceive the fundamental disconnect between the financial fairy-tale promoted by the US politicians and their cheerleading squad, CNBC, why isn't this painfully obvious to anyone with a pulse?

Example: So far there has been a conspicuous absence of fallout from the downgrade of Ford and GM's debt to "junk status". In a piece of jawboning worthy of an Orwell Award, "the car industry doesn't matter" to the economy anymore. George Ure has pointed out that conventional Dow theory posits that the Dow Transports Index lead the wider markets (if the transports tank, the rest of the market will soon after); and that at some point, all of the car manufacturers have been removed from the index.

The underground contrarian channels are abuzz with the fear of an impending derivatives blow-up brought upon by the downgrade and there is talk that some hedge funds are dutifully unwinding positions in anticipation of a particularly heavy redemption season this summer. The phrase "remember LTCM" is being bandied about.

In contrast to this, the USD has hit a 2005 high and gold is below its 200 day moving average and gold stocks took a beating. All this despite some pretty dismal news coming out in April and the economic news in May, like the jobs numbers, look pretty unrealistically massaged (over 90% of the "new jobs" created were a statistical construct based on "historical norms").

Having said all that, my personal maxim (Mark's Law of The Expected Unexpected?) is that meltdowns, disasters, market crashes, terrorist events and asteroid hits cannot occur when anybody is expecting it. And "anybody" includes contrarians, cranks and conspiracy theorists.

Contrarians can only position themselves ahead of a perceived shift, but they can't time it. As Douglas Casey once quipped, "Just because something is inevitable, doesn't make it imminent".

Cranks are usually onside with the contrarians but tend to hold their positions longer than necessary out of ideological beliefs. This would include goldbugs who were converts at the top of the 1980 spike and have been holding (or averaging down) ever since. Don't get me wrong, cranks are intelligent and entertaining and have my respect. My personal definition of "crank" isn't as derogatory as some may think. Kinda like 'nerd' used to be. Nowadays it's practically 'hip' to be a nerd.

I include George Ure's in this category. He's a well read economist and I have a deep appreciation for his self-sufficiency, but I've watched him try and fail to not only "time the market" (which he often nails on an intra-day basis but not long term) but to "time the meltdown". According to Ure, we're in a window right now which could see anything from a derivatives based market meltdown to "the big one", a large quake hitting the West coast, which George has been bracing for/calling for/hoping for? for such a long time it seems almost morbid.

Conspiracy theorists are always and by definition wrong. Asteroid hits which won't happen and world leaders who are not members of an alien reptilian race. As per the old maxim: Never ascribe to conspiracy that which can be explained by stupidity. For this reason I am not entirely sure I buy into the manipulation of the price of gold theory which has been floating around for a few years. I guess long term I'm not too worried about it. If paper currencies actually do blow up, it won't matter. If they don't, the secular uptrend is undeniable.

So will the markets meltdown this week? The contrarian/crank/conspiracy contra-indicator says no. I think over the medium term gold will head on to new highs and given the fact that Japan and China have all but ceased purchasing new US debt paper, the USD will sink, and once the French vote "oui" to the EU the Euro will surge, and when Iran starts selling in Euros next year World War III will start in earnest....(ah, off into conspiracy land again....sorry)

Posted by Mark Jeftovic in Venture Capital at 18:17