



6th April 2009

Ever get the feeling you've been cheated ?

“Get a grip on financial regulation ! Hedge funds, short selling, spread betting, leveraged buyouts must be curtailed. Regulate them hard ! Better, ban them !”

- Reader's posting (“PCMyrs, Tonbridge”) on the BBC's G20 weblog.

Where to start ? With all due respect to PCMyrs, the financial crisis was not caused by the activities of hedge funds – a disparate and fast dwindling band of asset managers in any case following myriad trading approaches. It was not caused by short selling, either. For every short seller, there has to be a buyer taking the other side of the trade. One might as well suggest banning equity purchases, on the basis that they involve somebody else selling stock. This crisis was not caused by spread betting. It was not even caused by leveraged buyouts – although the recent rapid impoverishment of private equity fund holders was. If one can identify just one proximate cause of the Panic of 2007 - ..?, it was the uncontrolled growth of credit nurtured by weak regulators, fanatical central bankers and conflicted politicians, and supercharged by banks and, yes, greedy homeowners and investors. To suggest that ineffectual financial regulation should be replaced by the effective closure of free markets is akin to saying that because swimmers occasionally drown, water should be made illegal. Meanwhile, the G20 summit, in time honoured fashion, gave rise to all sorts of ludicrously unrealistic hopes of some “co-ordinated solution” by the participants. And workers in the City were obliged to co-exist, briefly, with a handful of jobs comfortably outnumbered but nevertheless goaded on by press photographers.

Spot the rioter



But to anyone with a hammer, all things look like a nail. And to a political establishment (and a largely fawning or unquestioning media), a witch-hunt against evil bankers has the expediency of drawing fire from problems altogether closer to home.

Banks collectively stampeded over a cliff due to a surfeit of animal spirits and a flawed belief in the primacy of flimsy risk modelling. We can debate the latter until the cows come home; animal spirits, on the other hand, is what capitalism does best. And while the outcome is often ethically fraught, as it is now, one has to say: compared to what? At least banks and their employees are profit-seeking entities. Politicians can't even claim that; their primary objective is simply to be re-elected. The money they spend is not theirs to spend; it is appropriated from taxpayers, both current and prospective. To that end, they will say and do, ultimately, anything and everything that appeals to the perceived majority of voters.

Politicians will no doubt take credit for the equity market rally that accompanied the G20 meeting last week. But politicians do not create wealth; at best, they can only redistribute it. This is a point well made by Luke Johnson writing in last week's Financial Times:

“Unfortunately, there is a rising chorus that free enterprise is at the root of all our economic problems. Union leaders, leftwing politicians and activists are using the downturn to attack free markets and extend their socialist franchise. As ever, they want more regulation, more state intervention and higher taxes on the rich. But, just as protectionism in the 1930s helped turn a recession into the Depression, so adoption of these anti-business policies will ensure this downturn becomes a slump. My profound concern is that risk-takers are being assaulted on all sides: lack of credit, lack of demand and armies of anti-capitalists out to demonise the private sector.”

The private sector did not cause this crisis. A relatively small coterie of ostensibly regulated financial interests (mostly commercial and investment banks, and most expressly **not** hedge funds) managed to persuade the executive branch that the financial system could not survive without taxpayers' money being funnelled toward them. A few trillion dollars, pounds and euros later, we seem no closer to resolution, because the prices of malinvestments entered into by those financial interests remain frozen or otherwise distorted, due to the lack of free market discipline. If you don't like the prices, simply don't accept them. Nationalisation of insolvent banks appears unacceptable to the US administration. So the regulators who were complicit in the problem are now complicit in its perpetuation. And many senior rent-seeking executives complicit in the problem, by and large, remain in position. This is not exactly free market capitalism.

Gillian Tett, also writing in last week's Financial Times, cites an unnamed 'global policy official'. Despite the cloak of anonymity, the conclusion hits the mark:

“The Americans are hiding behind stimulus and the Europeans are hiding behind regulatory reform. But that misses the real issue.”

In Gillian's words, the reluctance to debate the issue, or alternatively to obfuscate it, or simply lie about the issue, reflects “a desperate attempt to avoid telling taxpayers how much it might really cost to remove the toxic rot.” We are being lied to by our elected representatives. Ms. Tett points out that the IMF a year ago predicted \$1 trillion in credit losses. Their forecast today is \$2.2 trillion. That figure is itself more than 20 times bigger than the US government's initial estimate of the prospective credit losses. We have no special reason to trust the banks. But why on earth are people so keen to believe the politicians who created and then oversaw the regulatory environment that failed (including one G. Brown) or who allowed themselves to be

blinded to the bonfire of problems being stoked by casino capitalism courtesy of well-funded lobbyists (for example, the Republican Party) ?

True markets and a freely functioning pricing mechanism allow capital resources to be distributed efficiently to those most deserving of them. What passes for market capitalism in the US is now, through the so-called Public Private Partnership Investment Program, allowing a narrow coterie of financial interests to profit from preferential access to (distressed assets and) artificially cheap leverage. Sound familiar ? Nice work when overly easy credit can be both cause and remedy to an intractable problem of denial on the part of both government and Wall Street.

Tax havens, bankers' pay, new **improved** regulation (meet the new boss: same as the old boss) – all gigantic red herrings from the G20.

At the end of a Sex Pistols tour in January 1978, at the Winterland Ballroom in San Francisco, the band played precisely one number – a cover version of “No Fun” by the Stooges. The band had been formed in an economy beset by “trash on the streets, total unemployment..” Finishing the song, Johnny Rotten addressed the crowd:

“This is no fun. No fun. This is no fun – at all. No fun..

And just before he walked offstage,

“Ever get the feeling you’ve been cheated ?”

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