



26th October 2009

Rage against the machine

“John Meriwether.. is in the process of setting up a new hedge fund – his third.”

- The Financial Times.

“Fool me once, shame on you. Fool me twice, shame on me.”

- Popular saying, though probably not in Greenwich, Connecticut.

A recent posting on the consistently excellent [Naked Capitalism](#) weblog (“Mainstream Media Reporting as Propaganda”) touches on one of the more frustrating aspects of the financial crisis – why have the media been so supine in the face of wholesale abuse of the public purse, and why have the bailouts not triggered broader social disquiet? In both the US and the UK, money is being distributed to banks from taxpayers – involuntarily – then passing straight through those organisations and speedily excreted out the other side in the form of bonuses. On the former topic, journalist Matt Taibbi (of “vampire squid” fame) commented that

“It’s literally amazing to me that our press corps hasn’t yet managed to draw a distinction between good news on Wall Street for companies like Goldman, and good news in reality.

“I watched carefully the reporting of the Dow breaking 10,000.. and not anywhere did I see a major news organization include a paragraph of the “On the other hand, so.. what?” sort, one that might point out that unemployment is still at a staggering high, foreclosures are racing along at a terrifying clip, and real people are struggling more than ever. In fact the dichotomy between the economic health of ordinary people and the traditional “market indicators” is not merely a non-story, it is a sort of taboo — unmentionable in major news coverage.”

Naked Capitalism’s Yves Smith believes that the press has been on a downward slope “for at least a decade,” thanks to strained budgets and more effective government and business spin control. (As Yves suggests, Adam Curtis’ documentary [The Century of the Self](#), available via Google Video, is practically required viewing in the context of business’ and politicians’ adoption of propaganda techniques to sell either products or policies.) The encroachment of web media and the blogosphere into the realms of traditional journalism probably hasn’t helped the cause of impartial or nuanced real economic coverage either. In any event, Yves argues that North Americans at least are largely getting the view of the economy from the vantage point of the bankers, as opposed to a broad swathe of the population. The lack of more vocal opposition to a cynical gerrymandering of the public purse by narrow banking interests may ultimately be a function of

ignorance, real or perceived: too many voters may feel that they don't know enough about the banking system to recognise when the wool is being pulled over their eyes. What beggars belief is that the British government could inject hundreds of billions into the banking system and provide life-or-death capital and equity to insolvent banks without seeking any form of control over subsequent remuneration policies. To get a sense of the growing anger at a banking sector seemingly impervious to popular sentiment, consider the responses on The Guardian's website to Goldman Sachs vice-chairman Lord Griffiths' absurd defence of 2009 banking bonuses as investments in the British economy. (Caution: the language is more than a little [ripe](#) – and these are the responses that *survived* removal by the moderator.)

The focus on bonuses is in any case something of a red herring. What is more urgent, but even less widely discussed, is how, 12 months' on from the cardiac arrest of the global banking system, banks show little sign of learning from the debacle or of coming close to putting their fiscal houses in order. Goldman Sachs has been the lightning rod for popular rage, an investment bank of almost mythical ability, but still a business that only exists today courtesy of extraordinary capital support from a contortionist government administration riddled with its alumni. It is now a broker-dealer that happens to enjoy lender of last resort backing from the US Federal Reserve. As John Gapper for The Financial Times put it, Goldman Sachs must be structured and regulated in such a way that it could be safely allowed to fail in any future financial crisis. There will surely be more.

Let us shift the focus to something cheerier. The fund managers at Blackrock draw attention to bear markets since the Great Crash of 1929, and more particularly to the bull phases that follow them. While the bear market that (may have) ended in March this year lasted about the average for a bear cycle at some 17 months, the average bull market bounce amounts to a recovery of 137% from the low (albeit with huge deviation around the mean). More to the point, the average bull market recovery lasts some 55 months – compared with the seven months that have elapsed since March. But then human beings are suckers for pattern recognition, and the past may not be prelude to the future. This has been an extraordinary financial crisis – it would only be consistent for the bounce phase to be out of the ordinary (whether in lasting duration or brevity) as well.

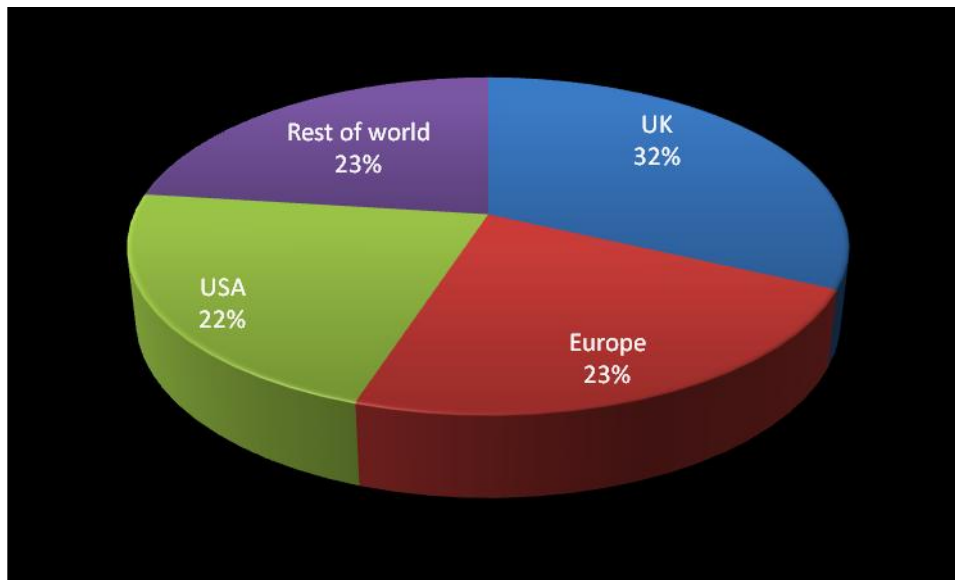
Bear markets since 1929, with the duration of subsequent bull markets

Peak	Trough	Decline	Duration of bear market (months)	% change to next peak	Duration of subsequent bull market (months)
19-Sep-29	12-Jul-32	-85.5%	34	299.6%	57
11-Mar-37	31-Mar-38	-53.8%	12	121.3%	100
17-Jun-46	23-May-47	-25.6%	11	90.4%	69
08-Jan-53	14-Sep-53	-14.8%	8	219.4%	100
13-Dec-61	27-Jun-62	-27.5%	6	77.1%	44
16-Feb-66	07-Oct-66	-21.4%	8	48.0%	26
29-Nov-68	26-May-70	-36.1%	18	73.0%	32
08-Jan-73	11-Oct-74	-40.6%	21	97.4%	74
20-Nov-80	12-Aug-82	-27.1%	21	228.8%	61
25-Aug-87	04-Dec-87	-33.5%	4	64.8%	32
16-Jul-90	11-Oct-90	-19.9%	3	300.8%	95
20-Jul-98	08-Oct-98	-19.0%	3	58.8%	18
27-Mar-00	09-Oct-02	-49.0%	31	101.5%	61
09-Oct-07	09-Mar-09	-56.8%	17		
Average		-34.9%	14	137.0%	55

Source: Credit Suisse

While emerging markets are getting most of the attention (and fund flows), Blackrock also highlight the geographic diversification on offer from companies nominally centred in the UK, a stock market that is also the third largest in the world after the US and Japan. As the pie chart below shows, FTSE 100 company earnings are surprisingly diverse by region – which is probably just as well given that the recovery in the UK economy, unlike that so far of its stock market, is likely to be disturbingly sickly. And for UK-based exporters, a dismally weak local currency is nothing short of a blessing in disguise. So whether or not you nurse somewhat sceptical feelings about the durability of the current equity rally, we would argue there is unusual value within the UK market relative to others, and further unusual value within the more defensive sectors that yield healthily more than Gilts and with the prospect of material capital gains over the medium term to boot.

Distribution of FTSE 100 company earnings by region



Source: Blackrock, Datastream. As at 31 August 2009.

In relation to the issue of bank regulation, Mervyn King is surely right to advocate the return of some form of Glass-Steagall, the late and much lamented US Act introduced after the Great Crash to formally separate commercial from investment banking – and which was repealed by the ill-conceived Gramm-Leach-Bliley Act in 1999. The FT's Lex column, however, seems to be in thrall to politicians (or banks), citing both Northern Rock and HBoS as apparent proof that reviving Glass-Steagall would have been of little use during the financial crisis. Banks get into trouble, whether led by traders or loan officers. What matters is how that trouble is resolved. In the case of Northern Rock, it was resolved by explicitly political response, namely bailing out a fringe mortgage lender based in a Labour constituency. In the case of HBoS the response was political too: the bank was rushed into a shotgun marriage with Lloyds, with no less a financial mastermind than Gordon Brown as officiate and cheerleader. In both cases, full nationalisation could have been undertaken, but it was evidently deemed unpalatable in the case of HBoS. The decision to let Lehman Brothers fail was inherently political as much as regulatory – hardly surprising when its competitor Goldman Sachs, whose profits do not seem to have suffered unduly from the collapse of a major rival, has managed to insinuate itself into every influential part of the US administration.

Lex suggests that it is bad for the City for Mervyn King, in his support for Glass-Steagall, to be out of step with the government, the FSA and other regulators. Given that the worst banking crisis in living memory occurred on the latter's watch and under their supposed oversight and supervision,

there can surely be no finer endorsement for Mr. King's views. What is bad for all of us is a political system that capitulates to banking interests over those of taxpayers and allows financial lobbyists effective control of public spending. Greedy and incompetent bankers may be at the heart of this crisis, but venal politicians are not exactly far behind them.

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