The Oil Drum: Canada
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

The Round-Up: August 13th 2007

Posted by Stoneleigh on August 13, 2007 - 4:03am in The Oil Drum: Canada
Topic: Miscellaneous

This is a guest Round-Up by ilargi.

In a café Sunday afternoon, this old Bowie song was playing. Only when going back to the articles for the Round-Up, did it hit home. The addiction theme pops up time and again. Junkie behavior describes the market, and money that came from nowhere, from ashes, is now on its way back there. Hitting an all-time low?!

> Ashes to ashes, funk to funky
> We know Major Tom's a junkie
> Strung out in heavens high
> Hitting an all-time low

It's Monday , August 13, and tons of people await the coming week with sweaty palms. We thought it best to wait till Tuesday to post a new Round-Up, Monday could be real crazy after all, but we decided against it. There's too much good material. If need be, we can always update. The Fed is buying waste outright, and European and Asian institutional investors are knee-deep in that same waste. One thing should be clear: the money vehicles that all this is based on, are barely in their teens. And someone soon, having lost $billions, will question their legal status, and ask for an ID.

The Fed's Path

It has now become obvious to me the path of the Fed. No, Mr. Bernanke is not going to

be tough on markets. He is not going to give the medicine that is needed. He has chosen his path, the seeds of which were planted in his November 2002 speech about monetization (dropping dollars from helicopters).

The Fed today injected $65 bln of repos, extending credit to banks to shore up their liquidity needs. Normally the Fed only accepts treasuries as collateral. But the banks no longer have enough treasuries, or they don't want to sell their "safe" assets in exchange for credit. But they do have lots of risky assets like CDOs that everyone wants to get rid of. The Fed bent over and today announced they will take those "off their hands".

This is the monetization Mr. Bernanke referred to. He is talking tough in his rhetoric about inflation and keeping interest rates stable. I think he may stick to that. But out of the other side of his mouth he has decided to be even more aggressive by issuing credit to banks and buying risky assets for their balance sheet.

Mr. Bernanke thinks he can control markets. To be truly successful he must be willing to buy vast amounts of things like stocks and junk bonds in order to get the "liquidity" he wants into the markets.

This is alchemy finance in its truest form. All it will do is stave off the inevitable and make it worse when it happens.

The Greatest “Bait and Switch” of ALL TIME (PDF!!)

I recently spent some time with a senior executive in the structured product marketing group (Collateralized Debt Obligations, Collateralized Loan Obligations, Etc.) of one of the largest brokerage firms in the world. I was in Roses, Spain attending a wedding for a good friend of mine who thought it would be an appropriate time to put the two of us together (given our shared interests in the structured credit markets).

This individual proceeded to tell me how and why the Subprime Mezzanine CDO business existed. Subprime Mezzanine CDOs are 10-20X levered vehicles that contain only the BBB and BBB- tranches of Subprime debt. He told me that the “real money” (US insurance companies, pension funds, etc) accounts had stopped purchasing mezzanine tranches of US Subprime debt in late 2003 and that they needed a mechanism that could enable them to “mark up” these loans, package them opaquely, and EXPORT THE NEWLY PACKAGED RISK TO UNWITTING BUYERS IN ASIA AND CENTRAL EUROPE!!!!

He told me with a straight face that these CDOs were the only way to get rid of the riskiest tranches of Subprime debt. Interestingly enough, these buyers (mainland Chinese Banks, the Chinese Government, Taiwanese banks, Korean banks, German banks, French banks, UK banks) possess the “excess” pools of liquidity around the globe. These pools are basically derived from two sources: 1) massive trade surpluses with the US in USD, 2) petrodollar recyclers. These two pools of excess capital are US dollar denominated and have had a virtually insatiable demand for US dollar denominated debt...until now. They have had orders on the various desks of Wall St. to buy any US debt rated “AAA” by the rating agencies in the US.

How do BBB and BBB-tranches become AAA? Through the alchemy of Mezzanine-CDOs. With the help of the ratings agencies the Mezzanine CDO managers collect a

series of BBB and BBB- tranches and repackage them with a cascading cash waterfall so that the top tiers are paid out first on all the tranches – thus allowing them to be rated AAA. Well, when you lever ONLY mezzanine tranches of Subprime RMBS 10-20X, POOF…you magically have 80% of the structure rated "AAA" by the ratings agencies, despite the underlying collateral being a collection of BBB and BBB- rated assets…

This will go down as one of the biggest financial illusions the world has EVER seen. These institutions have these investments marked at PAR or 100 cents on the dollar for the most part. Now that the underlying collateral has begun to be downgraded, it is only a matter of time (weeks, days, or maybe just hours) before the ratings agencies (or what is left of them) downgrade the actual tranches of these various CDO structures.

When they are downgraded, these foreign buyers will most likely have to sell them due to the fact that they are only permitted to own "super-senior" risk in the US. I predict that these tranches of mezzanine CDOs will fetch bids of around 10 cents on the dollar. The ensuing HORROR SHOW will be worth the price of admission and some popcorn. Consequently, when I hear people like Kudlow on CNBC tell their viewers that the Subprime problem is "contained", I can hardly bear to watch.

Bernanke Panics & Gold Responds

Credit Crack

Countrywide is hooked on "credit crack". They continuously need more of it. [..] The overnight gyrations of CFC (gapping down to $24.76 and recovering all the way back up to $28.08 before settling at $27.86 down about 2.8% perhaps tells a story. If so what is that story? Is the Fed accepting mortgage backed garbage from CFC as collateral?
[..]
Whether or not gold was acting the way it did because of Bernanke's panic is hard to say. What's easier to say is that is how we should expect gold to behave if the Fed is willing to take toxic waste as collateral for temporary loans.

But enabling addicts (which is what the Fed is doing) is morally wrong. See High Rate CDs and other Moral Hazards for more on that topic.

And the thing about addiction is that over time it takes stronger and stronger doses to achieve the same high. In 1980 it took $1 in debt to add $1 to the GDP. Today it takes closer to $7 or $8 in debt to add $1 to GDP and that of course presumes one believes today's GDP figures.

The problem with such addiction is that stronger and stronger doses eventually kills the patient. This is where we are today. Some junkies (consumers) have finally realized this on their own accord, most far too late to do any good, as debt has already hollowed out their livelihood just as heroin would have done. Some dealers (banks and brokerage houses) have belatedly realized the same thing and have stopped extending credit to credit junkies. A violent withdrawal is now underway. An enabling Fed is attempting to halt this "credit withdrawal" but as Succo suggests, the Fed is fighting a losing battle.

Five Things You Need to Know to stay ahead of the pack on Wall Street

Federal Enablers Inject Liquidity
The Federal Enablers responded to market concerns over the growing liquidity crisis by injecting $35 billion into financial markets in two separate enabling operations this morning.

- Too bad. Because what markets really need is not a Fed enabling, but a Fed intervention.
- We read a couple of headlines this morning - "Fed Intervenes in Markets" and "Federal Reserve Intervenes, Inject Liquidity" - and just shook our heads.
- That's not an intervention!
- An intervention occurs when family and friends get together to force someone to seek professional help for an addiction.
- The opposite of an intervention is an enabling.
- So the Fed further enabled financial markets this morning in two separate operations; the first was the addition of $19 billion in temporary funds to the banking system through the purchase of mortgage-backed securities to help meet demand for cash, and the second was an addition of $16 billion.
- Just as fueling an addict's addiction must, necessarily, end in destruction, so too must the Fed's enabling of credit addiction.
- As we've seen, credit expansion - like, say, heroin abuse - can forestall for longer than may seem plausible the inevitable destruction, but it simply cannot continue unfettered forever.
- Indeed, that is the Fed's gambit.
- Austrian economist Ludwig von Mises summed it up many years ago:

  "Credit expansion is not a nostrum to make people happy. The boom it engenders must inevitably lead to a debacle and unhappiness... Accidental, institutional, and psychological circumstances generally turn the outbreak of the crisis into a panic... The final outcome of the credit expansion is general impoverishment... Some people may have increased their wealth... but the immense majority must foot the bill for the malinvestments and the overconsumption of the boom episode."

The morning after the open-ended bailout

When the Fed, the European Central Bank, and Bank of Japan moved last week to bail out the entire financial industry worldwide, they offered the equivalent of a credit card with no limit and subsidized rates 1 or 2 percent below what would have been the free-market rate had they not stepped in.

What's more, it was done on a global basis to the tune of hundreds of billions in "liquidity." Thus the central banks have set a dangerous precedent.

One of the points made repeatedly in the financial press today is that no one in the banking industry or the central banks knows the extent of the losses. Take it a step further and you have to assume that no one knows the extent of the ongoing bailout either.

The bailout could end up being open-ended -- AND without borders. All commercial banks and hedge funds around the world will feel that it is their birthright to be given unlimited credit -- and now, it appears, the central banks, as a matter of fairness, will be at their mercy.

> [..]But wait a minute. Practically the WHOLE WORLD, not just the United States, is printing money to put the crisis at bay. How can the dollar go down against the euro when the people in charge of the euro are printing just as much currency as the people in charge of the dollar?
>
> Where the rubber meets the road, the open-ended bailout may translate into a massive depreciation of the world's major currencies against goods and services globally. In other words, chances are that the cost of living is about to erupt higher -- much higher than expected, and globally.

Busted Bonds & Financial Illusions

> MarketWatch is reporting $43 billion in loan deals pulled in past two weeks.
>
> In the past two weeks, another 13 corporate loan or bond deals have been postponed or reduced, representing slightly less than $43 billion, according to new research released Thursday by Baring Asset Management.
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> That lifts the total number of deals pulled since June 22nd to 46, analysts at the firm said. They valued those at more than $60 billion. Last year, no pulled deals were counted by the firm's research staff.
>
> The amount of incomplete cash-financed leveraged buyouts and management-led buyouts sitting on bank balance sheets remains substantial, wrote Toby Nangle, a fixed-income manager at Barings, in a note. "Given their inability to pass this credit risk on to the market, their short-term acquisition finance is increasingly looking like a series of long-term loans," Nangle added.
>
> 46 busted deals since June 22 is a lot of busted deals. Instead of being able to pass the trash, companies like Citigroup have already committed to funds the IPOs are stuck with it. Merrill Lynch, Lehman, Bear Stearns, etc all made fortunes passing the CDO trash to pension plans, life insurance companies, and foreign governments.

> Please watch these two videos in sequence, it's much more fun that way:

First, Jim Cramer takes a few steps back:

“Why I Took the Fed to Task on 'Stop Trading'”

And then iTulip interprets Cramer’s words:

“Now is the time to pray that it works”:

Fun for the whole family.

Did Big Lenders Cross The Line?

Until now prosecutors and pundits have laid much of the blame for the recent surge in mortgage fraud at the feet of the independent brokers who arranged the loans. But a growing number of lawsuits and complaints suggest that some big lenders may have also played a role.

Eager to keep up loan volume and generate sales, the two groups allegedly colluded to falsify loan documents by beefing up income and lowballing outstanding debts. And some suits allege that lenders perpetrated the fraud on their own, even deploying teams of employees that resembled boiler-room operations.

This new wrinkle in the subprime saga may mean the mortgage woes battering the financial markets could get worse. It's clear that the problems go beyond risky loans based on poor underwriting. The FBI says industry fraud hit a record $1 billion in 2006, with insiders—brokers and underwriters—accounting for 80% of it. But given the spike in defaults and foreclosures, the abuse may prove to be far
more widespread. "The true level of fraud [will be] closer to $6 billion," says Damien Weldon, a vice-president for risk analytics at First American LoanPerformance (FAF), a research firm.

Asia and the vicious cycle of bank bailouts

It is generally a feature of any market crisis over the past 20 years that a well-known European bank would announce staggering losses, and then be bailed out by its government. True to form, this week we saw announcements from Germany and France about large losses of banks there on the US subprime crisis. Authorities immediately convened rescue groups for stricken banks, helping to avoid any further fallout. For their part, American bankers have been nervous about the fate of a largish investment bank, although any speculation about a failure is being pooh-poohed vehemently.

The process of taking losses on investment losses is euphemistically referred to as "haircuts" by bankers, even if the scale of losses absorbed would argue for more colorful phrases reminiscent of the Queen of Hearts. [3] While not every haircut needs a bailout, someone eventually pays. The most common form of a bailout is a direct rescue that is arranged through the good offices of a state-owned bank.

The more indirect route to a bailout is through interest-rate policies. Former US Federal Reserve chairman Alan Greenspan notoriously invoked the option to cut interest rates on many occasions, helping to thwart banking crises in the US, but creating in its place the asset bubble that now threatens the global financial system. Today's central bankers appear to be more focused on avoiding inflationary pressures, but they haven't been severely tested with a
crisis yet.

In particular, I find the social aspects of the US subprime crisis a matter of interest. It is not often in a democracy that a large and visible minority suffer the indignity of bankruptcies and losing their homes without repercussions on government. In the current situation, the preponderance of losses among younger families of a minority background mean that the chances of political intervention are simply too high.

Bear Stearns Fat Cats Cashed Out at the Top

Wall Street bank Bear Stearns (BSC) is right at the heart of the subprime mortgage meltdown. It's reeling from massive, multibillion-dollar losses at two hedge funds. And every investor who has watched the stock collapse from more than $172 to just $117.78 in a few months is probably kicking himself for not selling at least some back at the peak, before the crisis hit.

Four savvy investors did just that. Step forward, Alan Greenberg, Sam Molinaro, James Cayne and Warren Spector.

Who are they?

Top honchos at ... Bear Stearns. (Or they were: Spector has now left in a management shake-up. The others remain.) Between them, the four quietly cashed out more than $57 million worth of company stock before the crisis hit. The executives saved themselves nearly $16 million by their astutely timed sales, which were disclosed in a series of public filings. Those losses got passed on to the unlucky outside investors who bought the stock.

Bear Stearns declined to comment.

These executives did nothing wrong. Many of the stock sales were made as share options came due at the end of 2006. Certain executives had made similar big trades in previous years. The trades were made several months before problems surfaced at the company's hedge funds in May.

Furthermore, Bear Stearns executives are still holding plenty of stock in the company. Nonetheless, their timing last winter was notable for its good fortune, if nothing else. Once again it shows that company insiders seem to prove pretty good at knowing when their own stock is overvalued and when the future risks do not justify the price.

The facts?

Between the end of November 2006 and the end of March this year, former Bear Stearns boss -- and current executive committee chairman -- Greenberg sold 179,277 shares at an average price of about $161, raising a total of $28.8 million. Today the value of those shares has collapsed by $7.7 million to just $21.1 million. After deducting his stock option costs, Greenberg made $17.7 million in profits before tax. Had he waited till now to sell the shares, he would have made just $10 million.

Nice work if you can get it, as they say.

$100 Billion Bond Backup

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- S&P: “Any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision.”
- Moody's: "Moody's has no obligation to perform, and does not perform, due

diligence."

If investors are reluctant to trust Moody's, Fitch, or the S&P why would they want to buy debt? Equally important, if not even more important is the question: why should investors be willing to buy something that's likely to be cheaper tomorrow?

In the meantime the debt backs up. Is the Fed going to buy it all? I think not. [..]

Some are slower than others, but by now everyone (including Cramer and the Fed) should be realizing that it was the Fed's miracle financing that caused the corporate malinvestments, overcapacity, and consumer debt hangover problems we now face. Miracle financing caused the problems, so miracle financing sure won't be the cure. The miracles have now run out and the party is over regardless of what the Fed does or does not do. It's as simple as that.

And if banks are extremely unwilling to lend money right now, what makes anyone think banks would be willing to lend more money after a measly 25 or 50 basis point cut in an economy that is clearly slowing rapidly?

Yet the talking heads say "inflation is the Fed's big worry", "corporate profits will strengthen", and "the economy is strong". If inflation was the concern, and the economy was strong we would not be hearing Bush administration clowns repeating that mantra every other day, and we sure as heck would not be seeing $100 billion backups in bonds or unprecedented actions by central bankers worldwide to provide liquidity. Actions are clearly speaking louder than words.

The Shoddiest Export

For years, Americans have been able to pay for enormous trade deficits by exchanging IOU's for imported consumer goods. Unfortunately for foreign creditors, a substantial percentage of those IOU's have recently taken the form of mortgaged backed securities.

Sporting higher yields than Treasury bonds, investment grade ratings from reputable agencies, and juicy commissions for the investment banks that packaged them, these structured mortgage bonds have quickly become America's greatest export. Ironically, amid all the recent hoopla about defective Chinese exports, America has proved that when it comes to flooding the world with shoddy merchandise, nobody beats the good old USA.

This week, several of Wall Street's best foreign customers announced staggering losses on the American mortgaged backed securities they had been sold. The fundamental issue underlying these losses is that Americans borrowed more money than they can afford to repay. As initially low teaser rates expire and mortgage defaults increase, foreign lenders are discovering that the residential properties that collateralize the mortgage bonds are not worth anywhere near the loan amounts.

It will not be long before American borrowers come to a similar realization. When they do they will be faced with the shocking reality that all of their home equity is gone -- having disappeared just as quickly as did the paper profits of the Internet stock mania. However, this time around the situation is more dire. Although paper profits have vanished much as they did in 2001, all the mortgage debt, much of it about to get much more expensive to service, still remains.

When American homeowners come to grips with their diminished net worth, the excess consumption that has been the rule over much of the past decade will grind to a halt. If any money is left after making higher ARM payments, homeowners may actually decide to save some to
repair their personal balance sheets. As consumer spending collapses, the U.S. economy will plunge into a severe recession, compounding the problems in the housing market and exacerbating the recession.

The last straw will be the value of the U.S. dollar. Already teetering on a precipice, a recession will push it over the edge. As the dollar falls, interest rates and consumer prices will rise even more sharply, compounding the problems for both housing and the economy. In fact, the fear of further dollar declines has been the most important factor in restraining the Fed's ability to cut interest rates. Rather than admit its concern over the dollar, the Fed justifies current policy with assurances that the economy is strong and is not in need of stimulative rate cuts. In Jack Nicholson fashion, since Bernanke feels investors can not handle the truth he feeds them a lie instead.

Did Big Lenders Cross The Line?

Until now prosecutors and pundits have laid much of the blame for the recent surge in mortgage fraud at the feet of the independent brokers who arranged the loans. But a growing number of lawsuits and complaints suggest that some big lenders may have also played a role.

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This new wrinkle in the subprime saga may mean the mortgage woes battering the financial markets could get worse. It's clear that the problems go beyond risky loans based on poor underwriting. The FBI says industry fraud hit a record $1 billion in 2006, with insiders—brokers and underwriters—accounting for 80% of it. But given the
spike in defaults and foreclosures, the abuse may prove to be far more widespread. "The true level of fraud [will be] closer to $6 billion," says Damien Weldon, a vice-president for risk analytics at First American LoanPerformance (FAF), a research firm.

Not If They Snorted It First

Businessweek asks the question: "Did Big Lenders Cross The Line?"

A quibble about this part:

The most common ploy, inflating a borrower's income, accounts for 25% of all incidents of mortgage fraud, according to Fannie Mae. Fraud like this has been made easier by the emergence of a new breed of mortgages called "stated-income" loans, in which borrowers merely
sign papers certifying their income, with banks verifying only the source of that income,

not the amount. These risky loans carry greater interest rates—and therefore higher potential profits for the banks that underwrite them.

No. The "higher profits" do not come in because of a rate add-on for the stated income feature. First, the rate adjustment for stated income is supposed to be a matter of "risk-adjusted return" or risk-based pricing. In other words, the theory, at least, is that the increased probability of default on these loans makes up for that higher yield. The practical reality is that in the overwhelming majority of these cases the rate adjustment was ludicrously low.

Fed New York: Temporary Open Market Operations

A spot where you can follow on a daily basis what your tax dollars are doing

Housing 2007= Stocks 1929

Residential real estate can't be a productive investment like commercial or industrial real estate. Except for market appreciation, it doesn't earn income for the investor unless cash can be removed due to constant inflation in value. Your house only provides three tangible benefits: shelter, status and a tax dodge. And if you think about it, the last two of those are not always a sure thing. The status value might disappear if you are paying more than your can afford for it, and that tax deduction could be taken away if the rest of the world suddenly wants to collect on the US debt obligation. (But that is another tale altogether)

At various times during the 90s and especially after the Dot Bomb, it seemed like there had to be a moment when rationality would intrude on this manic market. But it didn't happen. I had to admit that the financial system knew how to put band aids on cancer. Greenspan flooded the system with cash (we all learned the word liquidity), markets recovered and asset prices were off on their wonderful trajectory. The sky was literally the limit.

For the past 25 years, we just haven't had the major correction in real estate prices. Instead we got flippers, and ATMs on the side of the house and hedge funds dividing up CDO tranches. Today, people assume that debt is merely another condition of modern life like traffic jams and global warming. It is definitely not seen as a bond of subservience to the lender which could limit total life options if not paid off. You just flip the property to the next fool and cash out.

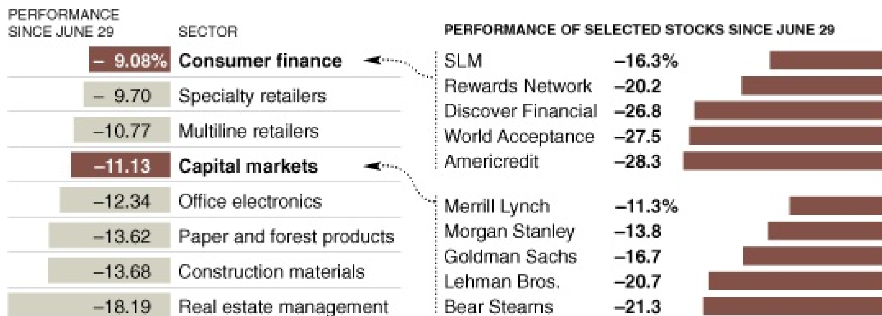
So we drank our own Kool Aid, believed that everything was possible, and ignored all of the grey beards who said we might have to make changes. Greenspan and Bernanke could print all the money we needed.

The Dollar was king, everybody was buying our debt because we were the last remaining superpower. The sky was the limit. We Baby Boomers didn't worry that we had the lowest savings rate in history. We were going to cash out of our houses, and use the proceeds to fund our retirement. Or so we thought.

[Fannie Mae's Offer to Help Ease Credit Squeeze Is Rejected, as Critics Complain of Opportunism](http://www.nytimes.com/)

The Hardest Hit

Some stocks and sectors have been hit harder by the turmoil in the markets than others. Here are the eight worst-perfoming sectors in the Standard & Poor's 1500 since the end of June, and some of the companies in them.



Source: Bloomberg Financial Markets THE NEW YORK TIMES

Fannie Mae, the nation's biggest buyer of home loans, was blocked yesterday from expanding its mortgage holdings by 10 percent in what it called an effort to ease concerns about credit and shore up the struggling housing market.

The regulator overseeing Fannie Mae, the Office of Federal Housing Enterprise Oversight, or Ofheo, rejected the request, saying the company's principal market for mortgages was "liquid and working."

After reports circulated all week that it would do so, Fannie formally announced yesterday that it was seeking permission to buy an extra $72 billion in mortgages for its portfolio.

"Additional portfolio purchases would allow the company to bring much-needed liquidity to the housing segments that need it most urgently," Daniel H. Mudd, Fannie's chief executive, said in a statement. While Ofheo rejected the request, the regulator left open the possibility of changing its mind, saying it was keeping the matter under consideration.

Ofheo acknowledged that there are "credit and liquidity issues today" in certain segments of the debt markets, but it said the mortgages experiencing the most difficulty were concentrated in the area of subprime, Alt-A and jumbo loans, issues "outside the normal business" of Fannie Mae. The company traditionally buys conventional loans made to borrowers with good credit records, known as conforming loans.

In a four-page letter to Senator Charles E. Schumer, Democrat of New York, that it made public, the regulator also noted that both Fannie Mae and Freddie Mac, its smaller corporate cousin, remain "significant supervisory concerns." Both companies are still getting their financial statements in order after Ofheo investigators found lax internal controls and accounting errors totaling $11.3 billion.

Quarter-point US rate cut fully priced in

Investors moved on Thursday to fully price in a quarter percentage point cut in US

interest rates in the next two months in reaction to the turmoil in financial markets. Expectations shifted sharply from earlier in the week after a US Federal Reserve meeting on Tuesday that reaffirmed its existing monetary policy focus on inflation risks.

After that meeting, earlier expectations of a cut had once again receded. European markets are also now pricing in a reduced chance of an interest rate rise from the European Central next month, in spite of the bank's recent tightening bias. Neither the ECB nor the Fed has yet hinted at the possibility of rate cuts in the coming months. But dealers said further losses associated with US subprime mortgages and structured credit instruments could force rate cuts by central banks.

Inflation-busting Bernanke won't rush to ease the pain

Nobody understands the threat of a credit crunch better than Ben Bernanke, the chairman of the US Federal Reserve.

The soft-spoken professor made his name at Princeton studying how mayhem in the banking system can lead to economic slumps, where he published his famous tract: Inside the Black Box: the Credit Channel of Monetary Policy Transmission. So far, he has kept a cool nerve,
ignoring a growing chorus of traders, bankers, and pundits on Wall Street pleading for swift action to prevent the sub-prime mortgage debacle spreading through the US economy.

CNBC commentator Jim Cramer caught the mood of mounting anguish with his trademark hyperbole: "It is no time to be an academic. Open the darn Fed window. Bernanke has no idea how bad it is out there. The Fed is asleep," he said. On this side of the Atlantic, the European Central Bank has responded to the crunch with startling speed, opening its credit window to "unlimited" tenders on Thursday after the interbank lending system came close to freezing up.

It provided €95bn (£64bn) to the banks in the biggest one-day injection of liquidity since the launch of the euro, adding a further €61bn yesterday - though on a more restricted basis.

Jean-Michel Six, Europe economist for Standard & Poor's, said the ECB may have over-reacted. "It is true that we have a genuine crisis in confidence," he said. "The credit markets have been getting tighter and tighter, and nobody is ready to lend to anybody. But the exposure of European banks to US sub-prime is fairly limited and most of it is the good quality 'AAA' and 'AA' tranches.[sic..]

"By taking this action the ECB is suggesting that they know something that nobody else knows, and that there is more to come. It may take the markets a few weeks to overcome these suspicions," he said.

Bear falls foul of hedge fund trap

For many on Wall Street, the real surprise about the crisis triggered by the collapse of two Bear Stearns hedge funds is that it should have happened to Bear Stearns. Bear is

traditionally seen as the most cautious of the large Wall Street banks, happier taking its cut from client deals than taking risk itself. It has not followed the likes of Goldman Sachs by significantly increasing the amount of capital it puts at risk. However, it has sought to emulate Goldman's success in managing hedge funds.

In 2003, it raised $925m from investors for the High-Grade Structured Credit Strategies fund, run by Ralph Cioffi, who had enjoyed success trading mortgage-backed securities with Bear's own capital. The fund did well and last year Mr Cioffi raised $640m for another fund, which aimed to boost returns by taking on more debt. The funds were largely invested in securities rated AAA and AA by credit rating agencies. But as defaults on subprime mortgage soared, the prices of even the highest rated tranches of mortgage-backed bonds crumbled. "This stuff wasn't triple A. There's going to be a big debate about this," said a person close to Jimmy Cayne, Bear's chairman and chief executive.[..]

On top of the blow to its reputation, Bear faces lawsuits from fund investors who will lose virtually all their money.

Some of the banks are also considering legal action. More seriously, in spite of Bear's efforts to convince the market that it has ample liquidity to ride out the freeze in the credit markets, it is now facing "an old-fashioned funding run" says Brad Hintz, analyst at Sanford Bernstein.

"Trading lines are being pulled and repo lines are being reduced. The Japanese banks aren't answering Bear's phone calls, the commercial paper investors are passing on their paper."

Bears of August

AAAH August. The month of quiet workplaces, languorous beach days and mayhem in financial markets. As stock and bond markets around the world continued their roller-coaster ride last week, exhausted traders found themselves wondering: What is it about August that brings so many financial storms?

It certainly does seem that a good many market crises over the years have struck during the last full month of summer. In 1998, for example, Russia stopped paying its debt in August, and Long-Term Capital Management, a giant hedge fund, began what would become a $4 billion unraveling.

A year before that was the Asian crisis. Although it began in July when Thailand devalued its currency, the tailspin really got going in August when the country closed dozens of ailing finance companies in return for a $17 billion loan from the International Monetary Fund. The contagion soon spread to the Philippines, Malaysia and South Korea.

Bayou Capital Management, a $400 million hedge fund in Greenwich, collapsed in August 2005. Its enviable returns in previous years were found to have been almost completely fictitious, and its founder went to jail for fraud. This year's dog days of August have been just as traumatic, with violent moves up and down and across many markets. In all but two of the eight trading days so far this month, the Dow Jones industrial average has closed up or down by 100 points or more. The bond markets, which are not as transparent, have been whipsawed as well.

> Investors are running away from risks that they were happy to take just weeks ago, whether in potential takeover stocks, corporate bonds or securities backed by mortgages issued to borrowers with questionable credit. And with everyone trying to exit at once, market action is wild.

[The no-risk models that weren't]

> For something that everybody assured us was "contained," the subprime mortgage mess certainly has spread.
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> Last week, the hemorrhaging credit markets bled right into the stock market. The major indexes are still up for the year, thankfully, but the Dow Jones industrial average, which hit 14,000 just three weeks ago, has lost 5.4 percent of its value since then. And the Standard & Poor's 500 is down 6.4 percent from its July peak.
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> Why are the bond market's troubles something stock investors have to worry about? The easy answer is that all the markets, both here and around the globe, are intertwined. And in spite of Wall Street's insistence that diversification - and therefore safety - could be found in different types of assets, investors are once again learning that diverse holdings often behave similarly. This is especially true in periods of uncertainty like the one we are enduring now.
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> But there are other reasons the stock market is getting dinged by bond woes. One involves private equity firms, which provided perhaps the biggest push to stock prices when they paid significant premiums to acquire public companies. If these firms cannot borrow money in the bond market to finance their buyouts, or if they must pay more for those borrowings, their business models do not work as well. And that means the private equity bid for stocks fades away.
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> Even more surprising, to young hedge fund managers at least, is the manner in which the credit crisis has begun to hammer seemingly conservative equity investment funds. This is another explanation for the stock market's weakness last week.
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> Using what are known as market-neutral strategies designed by computer models, hedge fund traders have been blindsided by a correlation between bonds and stocks that they never expected. Portfolios of this stripe are often known as quantitative funds; some of their most common trades are called statistical arbitrage. These bets are suggested by brilliant mathematicians and academics, using computer models to scour the markets for interesting trading patterns that continue for long periods.

[Teachers group stands by BCE deal]

> The investor group taking BCE Inc. [BCE-T] private in a $34.8-billion buyout remains committed to the terms of the transaction and will not re-price the deal, a spokeswoman said Friday. Despite recent turbulence in debt markets, which could affect financings for many takeovers, the group led by the Ontario Teachers Pension Plan stands by the deal's terms, the Teachers' spokeswoman said. She also read a prepared comment from Jim Leech, senior vice-president at Teachers' Private Capital, which is the private

investment arm of the pension fund.

“Given the complex nature and size of this transaction, we can expect that rumours will arise from time to time,” Mr. Leech said. “However, the fact is we entered into an agreement and we are committed to the terms of that agreement.”

Peak Oil Hits the Third World

Africa

Some 25 of the 44 sub-Saharan nations are facing "unprecedented" and crippling electricity shortages with common power outages, even in South Africa. In Nigeria, Kenya, Tanzania, Uganda, Ghana and other parts of West Africa, drought has slashed the generating capacity of
hydroelectric dams, which is in turn crippling production of gold, aluminum, and other basic metals.

Uganda: Electricity shortages are frequent as the grid is strained beyond capacity, largely because drought has lowered the water level of the Nile River, reducing hydroelectric generation. Parts of the capital are blacked out for as much as a day at a time. The country has leased two 50-megawatt diesel-burning generators to compensate, reportedly costing the nation about as much as it would have cost to build two new hydroelectric dams. And in a horribly ironic twist, grid power shortages are shutting down a pipeline from Kenya, adding to the diesel shortages.

Zimbabwe: Critical gasoline and diesel shortages are ruining the economy, pushing the price of a liter of petrol to a staggering 120,000 Zimbabwe dollars. Fuel stations went completely dry in June, and there have been long queues at the few which had any to sell.

Ghana: Electricity shortages are causing load shedding blackouts, costing the economy on the order of US $5 million a day. Ghana, among others, has compensated by leasing huge gas generators to produce emergency power--at exorbitant rates.

Nigeria: An acute shortage of fuel occurred in June due to strikes by unionized oil labor over wages, a hike in fuel prices, and the sale of two refineries. Nigeria Labour Congress (NLC) has vowed to cripple the government of Oyo State if it makes good on its threat to eliminate some of the state work force. Abductions, killings and robberies have plunged the oil-producing parts of the country into chaos. Only 19 of 79 power plants even work, and blackouts are costing the economy $1 billion a year. In Nigeria, Angola and other nations, most businesses and many residents run private generators because the grid is so unreliable, adding to their economic and air pollution woes. Imagine: "I've been on the 20th floor of an apartment building in Luanda, and there would be generators on all the verandas, with the racket, the fumes."

Senegal: State power company Senelec has been unable to pay for supplies of fuel for its oil-fired power stations, leading to cuts in electricity supply. China has come to its rescue with a 370 million yuan loan to fund a new distribution network, in addition to its commitment to build a 250 megawatt coal-fired power station there.

Kenya: Gasoline and diesel shortages in Nairobi are grounding industrial and personal transport alike, and price hikes appear likely.

Gambia: Shortages of gasoline and diesel are taking an economic toll across the country, with many empty petrol stations and long lines at stations that have fuel to sell--but only to customers holding coupons from Shell.

Russian Oil for the Welfare of Russia

PERHAPS YOU HAVE heard of a Russian oil company called OAO Oil and Gas Co. RussNeft. Until recently, RussNeft was an independent, vertically integrated oil holding company that ranked among the top 10 oil and gas enterprises of Russia. Despite the similarity of names, RussNeft is not to be confused with the state-owned oil company Rosneft.

RussNeft and Its Oil Output

In recent months, RussNeft has lifted and delivered about 3% of total Russian oil output. The oil reserves of RussNeft (or what the Russians call the “net effective pay”) are estimated to exceed 630 million tons (about 4.6 billion barrels, using a conversion factor of 7.3 barrels per ton), and its annual oil production is near 17 million tons (about 124 million barrels per year). RussNeft’s oil output translates into about 324,000 barrels per day, or, by comparison, slightly more than 40% of the total daily oil output of Alaska’s North Slope. And by way of further comparison, the daily worldwide oil output of a well-regarded Western independent oil company such as Anadarko Petroleum is about 190,000 barrels per day (110,000 from the U.S. Gulf of Mexico and 80,000 from overseas operations). So RussNeft is quite a bit larger than Anadarko, and a significant player in the Russian oil business by any measure.

Can Charter protect Algonquins from uranium rush?

A historical drama – past versus present – is being played out north of Sharbot Lake, about 100 kilometres southwest of Ottawa. The catalyst in the drama is uranium. The past is represented by Ontario's Mining Act; the present by the Algonquin, especially by two Algonquin Indian bands, the Shabot Obaadjiwan and the Ardoch.

The Mining Act is a throwback to feudal times, and to the notion that the Crown owned all the land, while nobility and freeholders held only an interest in properties they occupied. These interests were called estates or tenures.

The legacy is that under the Mining Act, the Crown continues to own subsurface mineral rights on land across most of Ontario. There's a second legacy from the past, dating from the 1800s. It's the concept that mining is the highest and best use of the land.

These two legacies have allowed prospectors and mining companies to swagger across the landscape pretty much ignoring local landowners. Some of this began changing in 1982, when former prime minister Pierre Trudeau enshrined the Charter of Rights and Freedoms in the Constitution. The Charter said aboriginal rights must be recognized, including rights that might be acquired in future by land claims. It's over this provision that the historical drama at Sharbot Lake is unfolding.

Alberta labour flexes its muscle

> "We live in Canada's most prosperous province, in its fast-est-growing city and with the highest cost of living in the country, so being what it is, and believing this [commodity] cycle is different than past cycles, now is the time to capitalize, in a capitalist society, on that situation. Our members and our trades are in higher demand now than they have ever been," he said. Industry executives have been silent observers throughout this unsettling summer, and not necessarily because oilsands players -- Nexen Inc., OPTI Canada Inc., Suncor Energy Inc., Petro-Canada, Royal Dutch Shell PLC and Canadian Natural Resources Ltd. -- are not directly involved with negotiations. For many companies, the reality is it's difficult to determine exactly what impact a strike would have on each project.
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> "I would expect that should a job action arise, you will very quickly see companies standing up and saying this is how I'm affected," said Mark Friesen, an oilsands analyst with First Energy Capital Corp. in Calgary. He started to raise red flags about the growing labour unrest early on, and says it would be unwise to give the unions any more leverage than they already have.
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> His warnings about labour uncertainty come on the heels of new financial burdens and other uncertainties thrown at the oilsands sector over the past year, including the Alberta government's royalty review now underway -- under which breaks to oilsands developers are being re-evaluated --and which is due to be released at the end of the month.
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> "Everyone wants a piece of the pie and all I'm saying is that the pie might not be as big as everyone thinks," Mr. Friesen said.
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> "I think we're basically back at a point where we need higher oil prices to put this thing back in a comfort zone. We need a confidence they'll stay above US$60, long term."

Water woes, water wars?

> When water ecologist David Schindler shouts "mush" these days, he really means it.
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> The University of Alberta professor had been driving and breeding sled dogs since the late 1970s in Manitoba, but more recently has seen his passion melt away with the warming planet. He says when he moved to Alberta in 1989, the province had 10 sprint races for sled dogs. Today there are none, and his complement of dogs has dwindled to 16 from 100.
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> "There aren't any now, none," Schindler confirms. "Lack of snow, mid-winter melts that flood the track. Drivers come from thousands of miles away, and some get upset when they've been driving for a week and find there is no race, no prize money, not even gas money."
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> The experience serves as a very personal reminder of global warming and the challenges that lie ahead for Canadians to adapt to changing climates and weather - especially fluctuations in water and snow levels. Schindler asserts there is "huge potential" for more international disputes in future under global warming as Canada and

the U.S. wrestle over precious dwindling water resources in the shared lakes and rivers along the two nations' boundary, including waters flowing out.

Get ready for food-price spike

Donald Coxe has a useful tip for investors. The global portfolio strategist for BMO Financial Group calls it the "Rule of Page Sixteen": Never invest on the basis of a story on Page One of the newspaper, but the one on Page 16 that is destined for page one. The Page One story of this week was turbulence in the stock markets over concerns about exposure of banks to subprime mortgages and the global credit crunch that led central banks to flood markets with money.

The Page 16 story? Turn to last Wednesday's Wall Street Journal, page C6 actually. Buried inside an earnings round-up is one sentence about Dean Foods Co., the largest milk processor in the United States. Second-quarter profit fell 1.6% due to higher raw milk prices, the story said. What it failed to add was that CEO Greg Engles said Dean is "being challenged by the most stubbornly inflationary dairy markets in history," a global phenomenon that "feels like a perfect storm, and it isn't over."

The culprit: rising costs to feed the cows. As private-equity captains and hedge-fund managers run for cover, the cost to feed cows, chickens -- and billions of people--is the not-yet front-page news everyone will be talking about, soon. Inflation is back.

1934 and all that

In the global mean, 2005 remains the warmest (as in the NCDC analysis). CRU has 1998 as the warmest year but there are differences in methodology, particularly concerning the Arctic (extrapolated in GISTEMP, not included in CRU) which is a big part of recent global warmth. No recent IPCC statements or conclusions are affected in the slightest.

Sum total of this change? A couple of hundredths of degrees in the US rankings and no change in anything that could be considered climatically important (specifically long term trends).

However, there is clearly a latent and deeply felt wish in some sectors for the whole problem of global warming to be reduced to a statistical quirk or a mistake. This led to some truly death-defying leaping to conclusions when this issue hit the blogosphere. One of the worst examples (but there are others) was the 'Opinionator' at the New York Times (oh dear).

He managed to confuse the global means with the continental US numbers, he made up a story about McIntyre having 'always puzzled about some gaps' (what?) , declared the the error had 'played havoc' with the numbers, and quoted another blogger saying that the 'astounding' numbers had been 'silently released'. None of these statements are true. Among other incorrect stories going around are that the mistake was due to a Y2K bug or that this had something to do with photographing weather stations. Again, simply false.

But hey, maybe the Arctic will get the memo.

Rising temperatures "will stunt rainforest growth"

Global warming could cut the rate at which trees in tropical rainforests grow by as much as half, according to more than two decades' worth of data from forests in Panama and Malaysia. The effect — so far largely overlooked by climate modellers — could severely erode or even remove the ability of tropical rainforests to remove carbon dioxide from the air as they grow.

The study shows that rising average temperatures have reduced growth rates by up to 50% in the two rainforests, which have both experienced climate warming above the world average over the past few decades. The trend is shown by data stretching back to 1981 collected from hundreds of thousands of individual trees.

If other rainforests follow suit as world temperatures rise, important carbon stores such as the pristine old-growth forests of the Amazon could conceivably stop storing as much carbon, says Ken Feeley of Harvard University's Arnold Arboretum in Boston, who presented the research at the annual meeting of the Ecological Society of America in San Jose, California.

The plight of the native bumblebee

In the wooden storage boxes of the University of Vermont's insect collection, there are plenty of examples of a native bumblebee species (Bombus affinis) that has a black head, broad yellow stripes, and no common name. Generations of net-wielding undergrads added fresh specimens to the university's collection up until the 1990s.

Since 1999, however, and in spite of searching across fields and through forests, Leif Richardson, a Vermont-based bumblebee researcher, hasn't seen a single member of that species. He knows of four other once-common Vermont bumblebee species that have all but disappeared from the state as well.

Bumblebees and honeybees have experienced sharp declines recently. News reports of late have focused on Colony Collapse Disorder (CCD), a mysterious syndrome that has killed off as many as 90 percent of the honeybees in some beekeepers' hives in 35 states, including New Hampshire but not Vermont.

Sockeye collapse could have grave implications

First Nations leaders and fisheries officials have scheduled an emergency meeting for tomorrow to discuss how to deal with what's fast becoming a disastrous season for the sockeye salmon fishery. With unexpectedly low numbers of sockeye returning to the Fraser River, aboriginal leaders are concerned their impoverished communities will have a tough time feeding themselves this winter.

"The people in the communities tend to be older folk or very young families with dependent children. They can't go to the nearby supermarket and buy fish or any of the other meat products. It's just not an option for them because their household budgets are so small," says Ernie Crey, senior fisheries advisor for the Sto:lo Nation in Chilliwack. "They rely heavily on Fraser River sockeye runs for their annual intake of protein. It's just that simple."

So far this year, there has been no commercial or recreational sockeye fishery due to low returns. Aboriginal fishing for food, cultural and ceremonial uses has continued, but the yields have been so low that they're unlikely to sustain the small, isolated communities on the Fraser through the winter.

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