Rohr Report
The Fiddler's Notion℠

Excerpted from:
Capital Markets Observer
Volume IV Number 14 Thursday, October 2, 2008

Rules Moot in Failure of Will

There was an excellent editorial in this past weekend's Financial Times that expounded "In praise of free markets" (attached.) It was a very balanced perspective on not over-reacting by rushing into poorly thought new rules and regulations. In essence a cogent plea to not throw out the free market baby with any unethical behavior bathwater.

While that is certainly good advice, the normally well-informed letters published in response have unfortunately been fixated on either how problems developed or apportioning blame. That misses the editors' primary point of there being an "…even greater risk: that the politicians now… draw the wrong conclusions…"

As important as that consideration is for the general maintenance of the free market, the same risk applies to specific aspects of the future situation. Among the most troubling are lack of trust in meaningful analysis, and misguided inference that crisis mitigation triage is a good guide for future structures.
In his FT Comment ("New banking rules: tread carefully", September 30) London School of Economics director Sir Howard Davies exhibits an extensive knowledge of regulatory implications, while expressing extreme skepticism that analysts can project implications of current problems. (It is attached for your direct review.) Did his "diligent Google search" really fail to find any warnings of the crisis that was forming from "celebrated commentator Harry (and I presume Harriet) Hindsight"?

It is typical that academics and politicians do not trust analysts' abilities. In this case that would need to include the financial Times' own Gillian Tett's insightful and prescient observations on the major problems brewing in the credit bubble from 2005 onward. Amongst more than a few analysts we were also very pointed on the degree to which central bankers, and especially the Fed, were risking the return of irrational exuberance if they failed to cool expectations from late 2006 onward.

In a July 2006 letter the FT was kind enough to publish we noted "…the degree to which the US economy and stock market remain drivers for their international brethren." And "…its desire to be everybody's friend will actually make the Fed its own worst enemy."

This review of economic report releases, general news, market tendencies, and/or specific technical trend contingencies is strictly for educational purposes. This information is provided without specific consideration of the portfolio requirements, suitability for financial risk, or psychological state of any recipient. Any use of this information to implement actual trades or investments is the sole responsibility of the individual or entity authorizing that decision. This waives your right to claim of explicit or incidental liability for financial loss or forgone profit against Rohr International, Inc. or any of its informational contributors under all circumstances. By review of the previous and following comments you confirm these specific stipulations.

A service of Rohr International, Inc.
© 2008 All international rights reserved. Redistribution strictly prohibited without written consent.

Rohr Report
The Fiddler's Notion℠ Excerpted from:
Capital Markets Observer Volume IV Number 14 Thursday, October 2, 2008

The belated recent attempt to stress test banks' risk management systems can not match the real test: central banks showing the will to cool economies. Especially once the DJIA hit a new all-time high in late 2006, my analysis included the centuries-old observation from French fabulist Jean de La Fontaine, "Our destiny is frequently met on the very paths we take to avoid it."

The Fed either had an inability to comprehend, or lack of desire to act upon the degree to which strong equities and easy credit would foment excessive asset appreciation assumptions. That was a clear failure to test new credit market instruments' resilience. The FT's head economic analyst Martin Wolf was very right about the efficacy of central banks leaning against bubbles. Last weekend's editorial provides an accurate box score for the Greenspan Doctrine of no central bank action to deflate bubbles in their early phases: Crises 2, Central Bankers 0.

The implications for future regulatory and market structures are interesting. While Messrs. Greenspan and Bernanke both expressed concerns about the irregularities in the mortgage market, they were quick to note it was not within their bailiwick. *Au contraire*. It was within their power to use the crude tool of higher base rates and more hawkish pronouncements, and (discreetly) signal banks under their direct oversight that bogus mortgages being spun into exotic debt derivative securities was no longer acceptable.
The same can be said of the SEC in regard to securities firms, and UK super-regulator FSA buying into it being 'so different this time' that a 'borrow short and lend long' model was not presenting an extensive risk at the now failed Northern Rock. All were a lack of will or analysis, not of rules; and that is a tougher problem requiring address.

Which is why the second wrong conclusion which has gained quite a bit of support would be to cede major additional regulatory powers to the Fed. The justification that it is shelling out huge sums and therefore needs more oversight is a misguided knee-jerk institutionalization of temporary triage.
What the recent situation has made clear is the Fed providing extensive and sustained liquidity injections borders on making fiscal policy. And that is something which even Alan Greenspan says is not useful in combination with its need to employ its balance sheet to modulate the economy.

While regulatory reform is indeed desirable, central banks must also get back to more willful and anticipatory control of their respective economies. They remain the only participants with both the power and incentive to prevent a bad hangover by pulling the punchbowl when the party gets too raucous.

A service of Rohr International, Inc.
© 2008 All international rights reserved. Redistribution strictly prohibited without written consent.