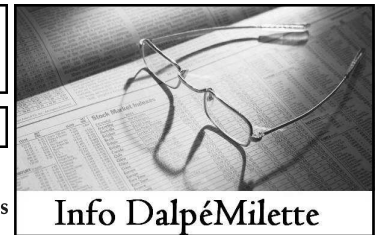


Sujet: Les meilleures compagnies au monde sont en vente ! / The best companies in the world are one again on sale !

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HUBRIS AND NEMESIS ON WALL STREET

Millennia ago, in the Hellenic morning of creation, the dramatist Sophocles wrote that hubris, alas, is followed by nemesis, that those whom the Olympian gods destroyed they first raised to great heights. Eerily enough, my thoughts turned to old Sophocles as I watched the Dow Jones open 200 points down on Friday, the Chicago Volatility Index at 32, gold and Uncle Sam debt soar as visceral fear gutted the bulls lulled into complacency by the EU's shock and awe package, the nemesis of the grizzlies unloosed on Wall Street. A month ago, in a balmy April in Dubai, the markets were somnolent, fat and happy in their don't worry, be happy state of hubris, when the Dow hit new highs, the VIX was a mere 16 and Greece's fiscal temper tantrums were about as important to the market as the financial zeitgeist in Xanadu, Shangri La and Lotusland. No more. This time the wolf is here. Why?

One, the subliminal fears of the markets have all converged with a vengeance last week. The EU's trillion dollar debt bailout triggered a short squeeze in Greek/club Med debt but, having made a mockery of the Maastricht Treaty and the ECB's fabled political independence, also act as a catalyst for a speculative, wolf pack run on the Euro.

Two, the Chinese property bubble is now targeted by the Politburo in Beijing as well as the Peoples Bank of China (PBOC). The Chinese government is determined to squeeze bank credit growth and make a preemptive strike against inflation that could threaten the social and political control of the Communist Party, so future reserve ratio hikes and interest rates rises are inevitable. Meanwhile, Shanghai shares have lost 20% from their August highs. The Middle Kingdom is now officially in a bear market. This is the reason Asian stock markets, with no exposure to Greek debt, have fallen so hard in the past month. Asian equities are no longer a warrant on global growth. Asian equities are now a warrant on Chinese liquidity. The sun, alas, now rises in Shanghai, not Wall Street.

Three, the SEC probe of Goldman Sachs has now morphed into a full scale judicial investigation of the world's biggest investment banks. Bankers are the whipping boys, the targets in the populist demonology of the Obama White House and the Democratic Party in an election year. While the memory of Elliott Spitzer convinces me that a draconian settlement will eventually emerge, the process will take at least six months. This creates systemic uncertainty in the banking systems and the stock market hates uncertainty. The "flash crash" only served to put the spotlight on the quants whose algorithmic program trades increasingly dominate the mood swings of the stock market indices. Surely a wild 1000 point swing in the world's most iconic stock market index (the Dow Jones) cannot but generate global angst? If hubris was VIX at 15, nemesis is clearly the VIX at 30. This is the message behind \$1240 gold.

Shakespeare sometime helps a market strategist make sense about the financial tempests that rage across the world. Is the zeitgeist on Wall Street like life, a tale told by an idiot, full of sound and fury, signifying nothing? Will black swans emerge, as Lehman, Obama, CDO's and Greece so clearly did in the last two years to eviscerate the financial markets once again? I hope not, even though it will not surprise me to see the index drop another 100 points on the S&P 500. Risk and sentiment is awful. The fundamental macro anchors of the market definitely are not. Let us analyze the bull entrails of Mr. Market, as Alexander of Macedon did before he faced the Persians at the battles of Issus and Gaugemela.

One, the economic data just keeps getting better. April industrial production was 0.8%. Non farm payrolls surged by 200,000 in April. Asian GDP growth has been phenomenal, with Singapore up an exceptional 32%. A protracted bear market is simply not consistent with 3% GDP growth in the American economy.

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Two, the debt woes of Europe and nervousness in the financial markets will compel the FOMC not to change its "extended policy" language at the June FOMC. The Fed is on hold the reason the two year Uncle Sam debt drifted down to 0.78 %. Economic growth accelerating. Inflation under control. Oil prices down \$15 from their highs. There is more than an echo of Goldilocks in all this but the Cassandras can point to the impact of Europe in deflation and a Chinese slowdown, hardly a positive augury for US exports as John Chambers of Cisco hinted?.

Three, valuations are nowhere near excessive in the US stock market. The broad US index is trading at 14 times earnings. Earnings in the 1Q were superb, even though the bulls had amply priced in the rosy scenario. In fact, several Street analyst even project \$100 EPS on the S&P 500 index next year, meaning that it trades at 11.6 times forward earnings.

Four, the best credits in the world are not the debt saddled governments of the Western world but the cash colossi tech companies of Silicon Valley. New product cycles, rising PC demand, incredible free cash flow, modest valuations (IBM at 11X, Intel at 12X, Microsoft at 14X, Google at 17X) make Silicon Valley a compelling investment theme.

Five, Obamacare is no longer a sword of Damocles hanging over the financial markets, though the SEC/New York Attorney General Investigations definitely dampen investor enthusiasm for the assets of a country where private business operates under a witchunt.

Six, the VIX at 31 means the bullish euphoria of April has now been wiped out. Fine. Bull markets thrive on fear, not greed. When vending machines dispense gold bars as ETF's, a metaphor for a profound global distrust of all paper money, something has changed in the world. Obviously, the excessive volatility means that buy on dip psychology must be jettisoned for now. The VIX is not the only gauge of investor fear. The rise in three month LIBOR and the Treasury-Eurodollar spread is far more ominous because it suggests that systemic risk has once again crept back into the international money market.

It was fascinating to meet Dr. Nassim Taleb last week in our offices in Dubai. Dr. Taleb is the author of the celebrated Black Swan investigation into the impact of highly improbable events in the markets, our personal life and even world history. Black swans can change everything, even our existential consciousness about the world. The rise of Hitler or Saddam, 9/11, the impact of the Internet, the collapse of the Soviet Union, Black Monday make a mockery of mathematical models that presume to predict the future. The stock market, the rise and fall of governments, fads, epidemics, even Icelandic volcanoes and Gulf of Mexico oil rig explosions all can and do change the world. Black swan logic forces an investor to focus on what he/she does not know, question the fragile empirical base of "knowledge". Herd instincts in investing, as we learnt the hard way in the past two years, can be devastating if their endgame and processes are uncritically accepted by bullish, leveraged lambs led to the inevitable slaughter.. It is difficult, even impossible, not to be influenced by emotion during times of extreme stress in the markets and life. Yet if ever there was time to imbibe the values of Zen, this is it. Keep the faith. The bull market is not dead, only scared clueless. The best companies in the world are once again on sale.

