The Great Global Macro Experiment, Revisited by Boombustblog

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I wrote the following on 9/1/2007, the first day of the blog's existence. As you read it, remember, the dot.com bubble and bust, historically low interest rates, real estate and credit bubble, concerted global interest rate reductions to historically negative real rates, rinse lather repeat... Someone asked me in the comments section, before they subscribed to my paid research, if I was as successful going long as I was going short. Well, my numbers actually looked better long than short - its easier work!

I jump "traditional" asset classes like a floozy jumps bed linen. You see, my asset class of choice is the global economic boom-bust cycle. Guys like Bernanke and Greenspan are the one's who allow me to feed my kids. They pump, dump, inflate to the extreme to bubble and crash, deflate to the extreme to bubble and burst, etc. Let me know if the following 1 year old + article sounds familiar, afterward I will post a graph of what I do for a living (there is a reason why I call this the BoomBustBlog

For those who feel the world has decoupled from the US economically - and in the financial markets, I bring you â€œThe Great Global Macro Experimentâ€•

Macro-economic theory and research as well as the theme in general credited to Dr. Drobny. For the record, the piece this is derived from a Drobny piece that was written towards the beginning of the year. It may seem to state the obvious now, but it was quite predictive when it was written.

Once upon a time, there was a man at the helm of the Federal Reserve during one of the most explosive equity market bubbles in the history of the US. Technology stocks, and internet stocks in particular, exploded in price by several hundred percent, fledgling start-ups with no profit, often no revenue, and speculative business models were being brought public at astronomic multiples, and vast fortunes were being made as mom and pop investors bought IPOs in margin accounts. The Chieftain warned of the â€œirrational exuberanceâ€• in the markets and the dangers that ensued, but oft to no avail, as the market shot up higher and higher. This was an obvious speculative bubble, and during the past extreme bubbles in this country, previous Chieftains pricked them with higher interest rates which invariably led to a recession or worse shortly thereafter.

Now, this chieftain, being the historian that he was, knew the historical effects of the pricking the bubble, so he tried to talk it down through speeches of â€œirrational exuberanceâ€•. Since that did not work, he decided to try something different from all of his predecessors, and wait for the market to collapse on its own, which, of course, it did. After the market crashed, this chieftain lowered interest rates to near 1% (in terms of real rates) and consequently flooded the US with inexpensive money in the form of easy credit. Since the US is the economic epicenter of the world, the flooding of the US with money is the equivalent of flooding the world with money, and the result was that risky assets US wide and world wide became more liquid, and thus from a liquidity perspective, perceived as less risky. This love fest with risky assets ranged from real estate and mortgages to derivatives, commodities and emerging market debt (and practically everything in between). As a result of this â€œGreat Global Macro Experiment,â€• real estate (primarily residential) led the US out of the dotcom implosion caused recession and powered the economy for the 6 years.

As a matter of fact, the speculative excesses of the real estate industry, and consequently the mortgage industry that financed it, easily matched if not surpassed that of the dot com era just a few years ago. The Chieftain in seeing this, raised interest rates in an attempt to soak up some of the liquidity that he flooded the world with, but his efforts were to no avail. For the first time in the history

of US Fed Reserve Chieftains, the power to directly or even indirectly affect interest rates was out of his reach. He remarked that for some strange reason, that he did not understand, as he would raise rates, the market rates would actually decrease. Thus, one effect of the experiment was that the Chieftain and the fed lost the power to directly manipulate market rates.

As the real estate and mortgage markets crashed (as all speculative bubbles do), this author and investor predicts that real estate will lead us into a recession, the same as it led us out of one several years ago. The difference between now and then is that the entire globeâ€™s risky assets were â€œmispricedâ€• downward due to excessive and easily available credit and liquidity, thus as the US goes the world will follow. Think about the fact that it took 6 years for the bubble to form, it will not dissipate in 6 months or even 16 months, due to the illiquid nature of the base asset. These are not internet stocks sold in a minute and settled by the end of the day. My experience in selling residential in the NE of the US was a 90 day marketing period to sell a property. These days, many properties have been on the market over 6 months and have not sold (in a fairly wide cross section of locations). Now, if it takes six months or more to move property that is part of a 10 month inventory supply (donâ€™t believe many of the official reports that exclude condos, coops, and multi-family residences that have the inventory stated lower) and that marketing time is getting longer, not shorter, how healthy do you think the environment is??? As the US real estate market (residential, and soon commercial) is tanking, the opaque derivative structures that allowed banks to write loans bigger than their balance sheets follow. This will ripple throughout the world as speculative real estate and exotic financing vehicles follow the same paths in Europe, Africa, Asia, and South America. Spainâ€™s residential real estate market is currently on fire and 92% of the mortgages issued are ARMs, most of which are concentrated to the lower income buyers. Sound familiar? Similar scenes in Brazil. UK residential prices have soared, Australia up nearly 3 times (relative), China homebuilders and contractors or roaring, condos in Dubai everywhereâ€¦ Add in the US exported structured productsâ€¦ Practically all of the popularized risky assets are destined to follow suit, not just real estate â€“ expect pressure in the emerging market debt markets as a follow-through.

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