World Economy

Introduction

I am writing this document to try to give friends and family a better idea of what is currently happening, world wide and the impact of the economic turmoil on the following,namely:

- the South African economy,
- the companies for which we work and
- each person as an individual

Economics has a way of creating jargon, where the meaning is unclear and you have to have a doctorate in economics to understand much of what is said by these people. I attempt to simplify all jargon down to layman everyday terms.

Much of what is in this document has been procured from web sites like fin24, moneyweb.co.za, businessday.co.za, busrep.co.za, wsj.com (Wall street Journal) and moneymorning.co.za (Money Week Magazine). This documents is intended to be as accurate as possible, however all facts have not been independently verified. A perfect example would be where the Star newspaper converted the US currency of US$700 billion into R56 trillion rand and not R5.6 trillion, I have tried to keep all facts as accurate as possible.

What has happened?

Excess Liquidity

Background

About 10 years ago, US investment and retail banks developed a bond (mortgage) product for people that could NOT normally afford to purchase properties.
What they did was to bundle up tens of thousands of bonds from clients and sell them off to pension funds, investment banks and any other financial institutions. When they gave customers these bonds, they were given on ‘special terms’.
These special terms were that the client will pay only 2% interest per annum for the first 3 years and for the next 27 years the client would pay the variable bond rate (about 7% per annum).

Introducing Sub-prime bonds

The retail banks then took these bundles of bonds (now named "Sub-prime bonds") and sold them to the investment banks and any other financial institution world wide. The Investment banks specifically operate on very, very high gearing. This means that for every asset that they have on their balance sheet they would place bets in commodities and futures markets of between 20 and 33 times the value of the assets. This is best described by use of an example – let's say Lehman Brothers Investment Bank took on one of these assets at US$1billion, they would use this as collateral (a guarantee) in the derivatives market (commodities and futures markets) to purchase the ability to acquire or sell a position on any range of commodities (or financial indexes and/or shares) up to a value of US$33billion.

The futures market

What the investment banks would then do is use this 'excess liquidity' to buy future options to buy large amounts of many different types of commodities (and other financial instruments like shares and stock exchange indexes) on futures exchanges. They would then go and buy huge amounts of the physical commodity, causing a shortage of that commodity. They would then profit on exercising their futures positions.

It is easiest if I explain this by way of an example using oil.

E.g. Lehman Brothers would purchase many oil contracts for delivery at some time in the future to (say in 6 months time) at an exercise price of US100-00. They would then go to a different market (the oil market – which is not the same as the futures market) and buy so much oil that the price of oil is forced up to US$125-00. They would then exercise the futures option and be paid out in the following way – Price difference between futures price of US$100 and the spot price (world oil price) of US$125, which is US$25 multiplied by 1000 barrels of oil (all contracts are always in 1000's of barrels) multiplied by the number of contracts that they had taken out.

If they had purchased 100 000 contracts – the calculation would be 100 000 times 1000 barrels of oils times US$25. The answer is US$2,5billion!!!

The commodity markets were therefore manipulated up immensely by these investment banks using the sub-prime assets as collateral. This is why we saw such huge unprecedented increases in commodity prices.

This created a huge bubble environment in commodities – we all know how commodities prices have collapsed since 15 July this year.

All was well, but when it comes to trading of these futures markets, there are significant risks. Firstly, one bank could be betting the price up at exactly the same time that another large investment bank is sitting with too much oil and is busy off loading, so making money like this is risky and the only way to make sure that it works is to almost have a concerted effort between banks to ensure that if 1 bank was buying, they were all buying or if 1 bank was selling, they were all selling.

In the above example, it appears that market manipulation is extremely easy, it isn't, not unless you have 'endless' cash. Because all the investment banks are market participants, each believing that they have superior tools and staff, that they could make more money in these markets than the rest of them. So, in effect, 1 investment bank could be in a position where they have made US$602billion and lost US$600billion – giving them a net position of having made US$2billion.
Like wise, overnight (international markets never close), the price of gold may move US$3-00 up in price and the oil price moves down US$1 and they may once again be making a net loss because of ALL their open contracts.

Collapse of Sub-prime bonds
The Sub-Prime bonds were given this name for a good reason – they were of poor quality. The people that took out these bonds started to default on their repayments. The default rate of bonds that were packaged and bundled in 2004 is 3-4%, the default rate for bonds taken out in 2005 is about 12%, 2006 is currently running at 16% and bonds that were taken out in 2007 – 24% of all bond holders are defaulting on their repayments.
WOW – how can it get SOOO bad, so fast, you may be asking???
Well this is what these rocket scientists did – if you were 6 months in arrears, the US property prices had moved up so quickly that the house was already worth more than the outstanding balance. So your bank gave you a new bond, at the new value and they gave you a 125% - YES a 125% bond on your house. Let's say you originally purchased a house for US$ 200 000 over 30 years, after 6 months, the value of the house is now US$220 000, they would give you a bond for US$275 000 (125% of the US$220 000 value of the house). This is after you could not afford the re-payments on US$200 000!!
Clearly the problem will always keep on escalating along with house prices until the problem is identified and then house prices will come crashing down – which is still busy happening at the moment, they are 25% down so far. The BAD bondholders of 2004 are no longer bundled up with the people they were originally bundled up with, they are now in the 2007 bundle because every year they just got a new higher bond until the 'baddies' from all the previous years came home to roost in 2007.

Cause

Clearly this poor quality property 'investor' caused the entire problem and has almost caused the whole world economy to collapse. There are bankrupt pension funds in Norway, the European, US and almost all banks and governments are now suffering massive liquidity problems.
Governments all over the world are pumping liquidity into financial markets at neck breaking speed, but its just not enough, banks are going belly up every day. Mondays seem to be the worst days for bank announcements of insolvency.
Britain announced a £50 billion part-nationalisation of its eight main banks. The Bank of England will extend a £200 billion credit line to the banks.
"These sorts of measures aren't working any more," said Hiroichi Nishi, a broker at Nikko Cordial in Japan.
- "It's like you're trying to pump blood into a heart with clogged arteries."

How could it happen and who is to blame?

No, it is not the dumb fools that purchased the properties that they could not afford – they were sub-prime fools already. No, it was not the banks that sold the bond bundles either, they were participants in a willing buyer / willing seller contract when on-selling these contracts. No, it's not the purchasers fault either – although any market can only be sustained by a willing purchaser. These products were extremely complex to price in the first place – how could you ever know what the default rate was going to be when you purchased a bundle of bonds?
Certainly, I would be cheesed off if my pension fund purchased US$1billion worth of 'valueless' bonds.
They were not however valueless, Standard & Poor, Fitch and Moodies are the international rating companies that valued these 'investments' as investment grade.
The only way to value these investments is - to have the credit rating of the customer's that took out the bonds in the first place – but they didn't and they made all these bond bundles (sub-prime bonds) A-grade investments. So along came the unsuspecting pension funds and investment banks and bought them in their trillions of dollars from all over the world.
THE BLAME MUST BE ON THESE RATINGS COMPANIES.
Incidentally, they also give South Africa its investment rating – and it's not too pretty.

2007 events

In July 2007, the cracks began to show in Sub-prime and people began to see enormous default rates coming through (and this is LOOOONG before the agreed 3 year rate of 2% was re-set up to the market rate of about 7%). If you are only charging 2% interest and 24% of the customers in a bundle are defaulting, you will be in a negative cash position very quickly. At the same time property prices were recognized as being in a large bubble – prices were unsustainably high and began to drop.

The banks therefore stopped lending to the sub-prime market causing properties values to drop – slowly at first and then more quickly.

When prices stopped increasing, the "sub-primer's" found that they were now in a negative equity position (they owed more to the bank than the house was worth) with their houses and even more of them defaulted on their bond repayments.

The problem then escalated quickly – the faster that house prices dropped – the more people defaulted because of the negative equity in their houses.

In October 2007, Ben Bernanke (Chairman of the US Fed – our equivalent is Tito Mboweni) told the US Congress that he needs US$50 billion to solve the problem. He was asked whether he was sure that US$50 billion would be enough and he assured Congress that the problem was a US$50 billion problem. They gave him the 'bail-out' money.

All the while, property prices continued to drop.

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Bear Stearns

Early in 2008, the first investment bank went belly-up. At the time, it appeared that it was an isolated case of mis-management and JP Morgan picked up the pieces.

Lehman Brothers

This is where the US Government made their first CRUTIAL error. On the weekend of 14 September they were trying to find a buyer for Lehman Brothers. Several banks were in the negotiations, BUT the US government refused to give any buyer any guarantees.

The reason that Lehman was having such financial difficulties was that their sub-prime bonds were draining cash very quickly. Because their cash reserves were running out, the rating agencies (the same fools that made these sub-prime bonds 'investment grade') down-graded Lehman Brothers, there was a colossal drop in their share price – so they couldn't raise cash anywhere.

The US has a rule – "Value your assets on a mark-to-market basis". It was this rule that annihilated Lehman. What it means is that everyday, you must value your assets for what you would get for them if you sold them today (immediately). Because the market had dried up for the sub-prime bonds – nobody knew how to value them, Lehman Brothers had to give them an almost zero value on their balance sheet.

So on Monday morning Lehman Brothers filed for Chapter 11 bankruptcy. The FALLOUT WAS UNIMAGINABLE because the US government did not really understand how investment banks operate. When you file for bankruptcy all you liabilities (US$613billion) are frozen and all people that you owe money must join the back of the line as a creditor. This drained US$613billion out of the US bank system.

The other 4 banks that would have had net positions of between 3 billion net owed to them or have owed Lehman 3 billion now were in a position where they had to give Lehman all the money that was owed to Lehman but would have to wait for the winding up of Lehman to get their money back (between them they were owed US$613billion). The next morning, the remaining 3 investment banks were therefore also ready to file for bankruptcy.

The US Government realized their error.

They realized that their decision to let Lehman fail could have Lehman Brothers take the entire US banking system with them and then the whole world financial system.

Henry Paulson; the Treasury Secretary is an ex-CEO of Goldman Sacks, he should have known the consequences – Bush has still not fired him. Paulson did not raise a single flag.
If Lehman had been second to ask the US Fed for a bail out, they would not have gone down.

Goldman Sacks were ALWAYS going to be safe with Paulson – the man with the purse strings as the Government Treasury Secretary and ex-CEO of Goldman Sacks. Paulson is an absolute idiot!

The Sub-prime bonds now got a new name, given to them by the US Fed – “Toxic Assets”.
There were 2 obvious reasons for Lehman’s demise:

- The rating agencies incorrect rating of these Toxic Assets
- The mark-to-market rule

The bailout

On the weekend of September 27th, Paulson went to the US Congress and asked them for US$700 billion, to be used to purchase these toxic assets that were lying on all the balance sheets of these companies. They took it to an emergency vote and …. Lo and behold, it was rejected by a small majority (mostly Republicans) – so the Bailout needed a bailout. World Stock markets began the “Great Slide”.

Liquidity was now gone from all markets world wide. Banks had no trust in each other or their clients.
It took until Friday night (3 October) with amendments totalling 350 pages added to Paulson's original 3 page request for funds before the bill was passed.

This situation is best described by Chris Hart, economist at Investment Solution, he said and I quote "World financial liquidity is now in a similar state to what a car engine would be if you drained it of all oil and replaced the oil with sawdust."

Banks world wide started to collapse, on Thursday 25 September, Kokkie Kooyman of Sanlam Investments saw Fortis (a huge Benelux bank) and they denied any cash flow problems, Monday 29 September, they were bailed out by the Benelux governments. Monday a week later ,German banks were given a US$50 billion bail-out by the German Government.

Barclays Bank
On Wednesday the 8th October Barclays (who purchased a division of Lehman brothers) were part nationalized and given access to £200billion along with 7 other large British banks.
The problem was that Barclays were marking the Toxic Assets down as they lost money and not on a Mark-to-market basis. The Barclays method of calculating the value of these toxic assets will probably be accepted in hind-site as it is an appropriate method under international accounting practice.
The sour yanks that caused the crap in the first place were the ones throwing the stones at John Varley. (Peter Hahn ex-MD of Citibank, currently a "Capital Markets Expert" at Cass Business School – I think they send all ex-MD's of Yank banks back to school when they have completed their tenure as MD – I'm not 100% certain but I believe that its Grade 5 that they have to re-enter at school).

So what's happening now?
Internationally, we have seen rates drop world-wide, US down to 1.5%, UK down to 4.5%, EU down to 4%. Australia down from 7 to 6%. These drops in interest rates worked for about 45 minutes before the stock markets continued their downward spiral.
Interest rates have absolutely no effect on the markets in current conditions. Why? Because, even if I earn 50% interest per annum and the person that must repay me cant, I lose my capital – so right now CASH is king, whether you are a client of a bank – Iceland banks don't have cash to

repay local and foreign clients or inter-bank lending. They all are suffering from the same thing - NO LIQUIDITY!!! MARKETS ARE FROZEN!!!!!
Central Banks are pumping lots of money (trillions of US Dollars - but still nowhere near enough) into the system at an unprecedented rate.

Today – 10 October 2008
Today, stock markets gave up between 5 and 10% world wide. I thought of stopping writing this document because – why inform people what is going on after the fact?
Well, it is not after the fact! The markets still have a long way to fall!!!
Why? Well we do know from what I have stated previously that this problem has a built in 3 year factor. These “Toxic Loans” only move up from 2% to the going market rate (about 7%) after a 3 year period. So hold onto the reins – this baby has got a long way to still fall, and liquidity is going to be a huge problem until 2011 at least.
So on I go.

What will happen next?

On the CIA website we are told that world GDP for 2007 was US$ 65 Trillion (total value of what the world produces annually). The value of the derivatives markets world wide was US$ 466 Trillion for 2007. There is and was way too much cash in the world derivatives markets due to immense gearing (Lehman 33 times gearing, is just 1 example).
There has to be a **monster** unwind of this gearing.

Banks & Property
Banks will continue to fail world wide, in countries that you may never have even heard of. It goes something like this – as liquidity drains from the markets and share prices drop a bank cannot get their ratio’s correct because they cannot just call in 20% of their home mortgages, overdrafts, car finance deals (they can only do it on defaulters) as their cash reserves dry up.
Houses are fairly illiquid and this is where the majority of bank debt is in - houses. Could you imagine what would happen to house prices if banks ran out of cash and called on 20% of home owners to re-pay these loans? Carnage in the property market.
Well, banks have already said that home purchasers must put down a deposit of 20% causing almost no liquidity in the property market in South Africa. The only way to sell is to drop your price (at the moment).
But as property prices decelerate at an even faster rate, banks do not want to finance a house for US$200 000 when they know that in a years time that same property will only fetch US$160 000 and in 2 years time is only worth US$140 000. So they will ask for even bigger deposits – causing

the property markets to go into free fall. Who has 40 – 50% deposits to buys houses? Very few people.

This quote was found on a Moneyweb article: **“It does not matter whether the US gives its banks a $700bn get-out-of-jail card, Europe guarantees all retail deposits, Australia slashes interest rates and Russia buys a stake in Iceland for $5,4bn — banks will not lend to their kind, companies or home buyers, if they reckon the money will not be repaid.”** Very true!

Insurers

The next industry that is going to collapse in the US is the insurance industry; many of them underwrote large chunks of this sub-prime debt. They will be the so called “second-round” effects of sub-prime. This will cause as big a problem in the financial industry. Governments will try to come to their rescue as well. When they start experiencing cash difficulties, they will start selling assets to generate cash, as soon as that happens – you know that they are in trouble, the rating agencies will start to down-grade them, so they will need to raise even more cash. A perfect example so far has been AIG - the US’s biggest insurer. They needed to raise about US$85billion in less than 2 days – the government bailed them out. AIG is going to need a lot more funds from the US government in the future as they make huge losses on their toxic assets that are lying on their balance sheet.

Insurers will collapse on an unprecedented scale in the next 4 years.

South African short term insurers and life assurers should be safe, I do not expect failures, and however their balance sheets and profits will weaken as their investments on the stock market fall through the floor.

Currency

"The Icelandic government have told me, believe it or not, they have no intention of honouring their obligations there," Finance Minister Alistair Darling told BBC radio, adding that London would compensate savers due to "extraordinary circumstances."

No government can guarantee their own banks as well as all other countries as well for investments made by their citizens in foreign countries, it is impossible!

In South Africa the rand is falling at an unprecedented rate, why, well it has nothing to do with fundamentals what so ever. If you are a British or American bank and your liquidity dries up, if you have any cash anywhere in the world, you suck it back to where you need the money, no

matter what rate you get, so get ready for a massive run on the SA rand. It is not because we have poor economic policies, it is foreign liquidity desperation!
Where will the rand go to? It is any bodies guess. It could easily get to US$1 to R20. Do not panic, the main risk is that our government cannot fund us at this extremely low rate.
The rand will strengthen again, once this liquidity crisis in huge first-world economies abates.

China, Russia, Brazil and India

These countries sit with about +-US$2.5 trillion (I am not certain of the exact amount) in reserves. Even if they loaned every cent to the US, UK and Europe, it is nowhere near enough to solve this gigantic problem.
There is the old saying that when the US catches a cold, the rest of the world gets flu.
In this case the US's problem is not a cold or flu, it is deadly pneumonia – so the rest of the world is in for humungous catastrophes.
Not even these countries with such large amounts of reserves will be safe, they will also go into recessions, and their economies are very closely tied to the financial well being of the US.
A very large amount of China's exports end up in the USA, Japan has been in a recession for over 20 years now – the same will happen in China – when you enter a recession consumption of everything is cut back dramatically. The only things we have to have are FOOD. The USA will cut back on their imports immensely from China, causing massive problems in China. They have developed huge capacity in China to feed the US's unabating consumptive consumer. This capacity cannot be taken up domestically. Chinese people save about 50% of their salaries and have always been enormous savers and consume as little as possible. They will not suddenly start splurging and take up the huge fall in the US exports.
So, they will have to shut down factories that are currently feeding the US's enormous appetite for their products, forcing them into a recession.
During 1987 Japan was growing at 8% per year, it had grown by 8% for decades. Then the US had a recession and Japan came tumbling down. It had factories that could produce hundreds of thousands of cars a month. In short: its production facilities were so oversized and expensive to maintain, within years many Japanese firms went bankrupt trying to maintain them. Currently, when the US stops importing oil, China immediately picks up the oil to maintain and increase its production facilities. So I feel we might see China failing to sell its products in the developed world and then dumping them on the developing world soon. I can't help but think the world is building up immense production and supply side imbalances. And China will sometime in the future have a spectacular meltdown like Japan did as planned US demand simply does not materialize.

SA Banks

How safe are SA's banks? Well they are currently holding up fairly well. But, you do not end up with a run of cash from every bank in the world, except South Africa! Anton Rupert made a statement that because of exchange controls we are doing very well. This will change!!!!!

The reserve bank has increased interest rates since June 2006; bank clients are taking extreme strain. In the second half of this year, more and more SA consumers are defaulting on their mortgage, vehicle and overdraft repayments. Earnings will drop. We are merely behind the curve.

Most people 30 years of age and older will remember the Asian credit crisis that took place in 1998 where interest rates in South Africa ran up to 24.5%. This liquidity crisis is not just an Asian crisis; this is a world wide crisis. Money will have to run out of South Africa to "try" to shore up foreign governments and foreign banks extremely urgent requirements for cash.

Where will interest rates go – its certainly not going to be down in the medium to long term, so gear up for increases in interest rates in South Africa!

Please note this is not a reflection on Tito Mboweni or Trevor Manual, they have been doing a sterling job. This is a world wide problem that South Africa just cannot avoid.

We only have US$34 billion in reserves, no where near enough to protect the SA Rand and a run on our currency.

In July FNB withdrew loans to professionals which had been approved at least 12 months earlier. It was a brave move, and hind-sight will prove the decision to be correct. They cited an example of a Dentist that had put a R3 million deposit down on a house and purchased his house for R10million. His bond repayments were about R70 000 per month on the R7million that he owed when he first took out the bond. Interest rates moved up 5% in South Africa from 10.5% to 15.5% and his repayments moved up to R110 000 per month. He could not afford the repayments and his house had to be sold at a very low value on auction.

The biggest error that FNB made was that the Public Relations exercise was not handled correctly. They protected people that previously had qualified for high loan amounts that would almost definitely default on their repayments at sometime in the future.

Well done to FNB for having the guts to do the right thing.

SA Government

We will also have a large drop in tax revenues. In the good times, our fiscal policies allowed property prices to move up quickly, because of this we had tax collections climbing at a faster rate than ever before. Taxes from property transfers; VAT; Including far more people in the Pay as you earn (PAYE) net and companies' taxes allowed for these revenues to fly. This has all come to an end, government is going to have to balance the budget on much lower inflows of funds or they will have to start running large deficits.

The SA government also has large deficits on our current account, what this means is that we import much more than we export – the same problem that the US has faced for years. The excess revenues that we have been collecting have been financing these deficits.
As a country, we have to be more productive so that we do not have to start running budget deficits. These deficits would have to be funded by foreign funds. Clearly the interest rates that we would pay on these funds would have to be higher than they are at the moment, in this huge liquidity crisis. Long term averages, over 30 years, suggest that interest rates are about 15-16% in South Africa. We have only just got back to the long term average; we are currently at 15.5%. More pointers that interest rates will more than likely are moving upwards in the medium term.

The International Monetary Fund
Every month the IMF reduces the expected world GDP figures for 2009 and 2010. They seem clueless as to the real effects of what is going on. They have a vested interest in there being no recession and therefore every statement that they make is “very cautious”.
I have no trust in figures published by the IMF – they are currently predicting world GDP to grow by 0.1% for 2009. I am convinced that world GDP will decline for a good number of years.

Inflation vs. Deflation
Most economists will have us believe that you are either in an inflationary (prices of goods, services and assets moving up) environment OR a deflationary (prices of goods, services and assets moving down) environment. BEWARE!!! They are not mutually exclusive.
What will more than likely happen is that assets prices like houses and cars will move down (deflationary) and prices of goods and services like food and other consumables move UP.
This is an extremely, extremely scary environment to be in because – all your assets can end up having negative value (Purchase price 3 years ago = R1million, house value after property price deflation = R600 000, amount owed to the bank is still about = R1million). In this example you owe R400 000 more than what the house is worth. At the same time inflation on goods and services increases, eating up more and more of your disposable income.
People give up hope, become de-motivated and stop paying their bonds, undermining the entire financial system in a country and in the world. Banks ask for even larger deposits when purchasing a house and the property market goes down further – because very few people have loose cash.
Those people that have been net savers and are loaded with cash will pick up extremely good bargains, so try to pay off debt, whilst interest rates are still “relatively low” so that you can pick up the bargains in 3 to 4 years time.
Mild inflation does serve its purpose, it stimulates demand. Because prices keep moving up people buy now instead of later to take advantage of the lower prices now.

Deflation causes people to delay purchasing because – why buy now when I will get it cheaper later. Deflation in Japan has caused there to be no stimulus of demand – so they are in a recession and have been in a recession since 1997 and just cannot get out of it.
Deflation is very bad for any economy.

How long will this meltdown last?
In 1929, it took 4 years for the stock markets to bottom out (1929 – 1932). During this period the Dow Jones Industrial Average lost 89% of its value. However, the US economy remained in recession until 1939. The US economy only came out of the recession because the economy was stimulated by the start of World War II. They had to manufacture weapons and large amounts of machinery for the allies. It took the Dow Jones Industrial Average until 1954 to get to the same point that it had been in September 1929 – that was 25 years!!!

Why do I think 2007(2008) is the same as 1929?
Many commentators are saying that 2008 will never be the same as 1929. The reasons they say are that prior to 1929 the Fed was raising rates and not dropping them, so they argue that 2008 is very different.
I don't believe for 1 moment that they are correct. TRUST between organizations, dramatic falls in asset prices are the drivers behind this fall. It is going to be very long and brutal. Company's earnings will fall in every industry.
The core of this fall is that 3 years minimum has been built into this fall. By resetting the interest rates up from 2% to 6.5% on the Sub-prime – Toxic assets, **banks world wide have at least another 3 to 4 years of write downs of these toxic assets**.
This is a once in a century market collapse.
We will not experience another meltdown like this in our life times.
No government with any amount of legislation can force one business to trust another and force that business to lend to another. Until trust is regained we will remain in a downward spiral.
Stock exchanges world wide will lose gigantic amounts of money until normalcy returns.
US GDP dropped from US$85billion in 1929 to US$55billion in 1939 – a 35% drop in GDP over 11 years.
This is not going to be a quick "V-shaped" drop, it is going to be a long and protracted "U-shaped" stock and property market collapse.

World Cup Soccer
South Africa is lucky to have the Soccer World Cup in the middle of this malaise. All the contracts are nearing completion so most of the money has already been spent – stadiums must be ready for the Confederations Cup to be held in June 2009.

In addition, the price of Steel, Cement and all other required commodities is currently dropping, so I do not expect huge budgetary over runs. The **Soccer World Cup will be a nice buffer**, but it will not save us totally. We will not have big spenders coming to South Africa in 2010; we will have the people that have got savings built up that are keen football fans. By 2010, we will be in the right in the middle of this collapse.
Thank you so much to New Zealand for voting against us, so that we didn't get the World Cup in 2006. We need it far more in 2010!

Economists
Over time select economists that get thinks right most of the time, there are many that are saying that after these large sell-off's that it is time to get back into the market. For every opinion that 1 economist gives there are a few that will have exactly the opposite opinion. I never ever listen to economists that work for banks – banks have a vested interest in the world financial economy and its well being – so always paint a prettier picture than what is actually happening.
They always seem to be way behind the curve with their predictions. They are predicting a property up tick in the second quarter of 2009, it is the same economists that were telling us in December 2007 that inflation would peak in February 2008 – it hasn't peaked yet.
Never listen to fund managers whose company income is based on earning a percentage on the value of money on the funds, their advice will be "Stay invested because the market has already fallen so dramatically".
Some fantastic economists that I have found seem to get it right more often than not are:

Mike Schussler
Chris Hart
Dr Azzar Jamine

I have also found the Money week magazine to be extremely accurate in their predicting of and reporting on this catastrophic financial event. Their web address is www.moneymatters.co.za

Retrenchments & Unemployment
Early in 2009, the next rounds of retrenchment will begin; some companies have already done some limited retrenching. This problem will accelerate; all companies in the financial services sector are going to retrench people in huge quantities - Insurers, life assurors, banks etc.
These people that are retrenched will **not** be able to find replacement work anywhere. There are going to be many, many skilled people all competing for very few vacancies.

Banning Short-selling

Markets can and will move up and they will move down when there are bubble conditions in liquidity, there has been excess liquidity in the financial markets since the early 1980's (it was called Reagonomics (after Ronald Reagon) – low inflation and low unemployment – usually the two do not go together).

In recent weeks governments banned the short selling (definition: - sell shares that you haven't purchased, when the price drops, you purchase the shares so that you have bought and sold the same shares, you just sell them before buying them because you believe that share prices will drop) of shares. All that they are doing is to delay the inevitable. By banning short selling, fund managers were unable to protect the value of funds under management in pension funds, unit trusts etc.

The ban on short selling was removed on Friday and we only just saw the start of a monster sell off and short selling of shares.

What to do now?

We are only a few weeks into this dramatic period of a recession which will lead to a depression – it will be another Great Depression. Whether the markets will lose 89% of their value will only be known in a few years time.

Some immediate actions:

- Cut your losses if you have multiple properties and are already in financial stress
- Do not believe that property markets anywhere will bounce back in the next 2 – 3 years
- Rent your property for now if you don't already own your property
- Try to get rid of as much debt as possible as quickly as possible.
- Cut your losses on the stock market – it has still got a loooong way to fall
- Do not purchase any financed assts – like cars or furniture on credit
- During the Great Depression salaries were rolled back by 40%. So do not expect salary increases, even although there may be inflation
- Expect inflation to escalate – world wide

What I would do if I had a few million to invest?

I would make the following investments:

High Risk

Buy the option to **sell** the Fini index on the Safex for December 2009 and another contract for 2010. I believe that Banks and Assurers are in for a dramatic fall.

Purchase the option to **buy** gold company shares for December 2009 and another contract for December 2010. Gold in circumstances like this is a very good store of value.

Medium Risk

Buy the Absa Gold ETF – as mentioned above, gold is a store long term value.
Buy shares in Sabmiller – people consume much more alcohol during these very stressful times, their share price will first fall in sympathy with the other shares.
Don't let go of your BEE shares in MTN, Vodacom (Yebo Yethu) and Sasol, they will do well over a 10 year period.

Remember, because the financial companies are in such distress, there will be wild sell off's in Gold as they liquidate some cash because they are desperate not to go insolvent i.e. they are doing it because they have to, not because they want to – slowly and surely the smart money is moving into gold and will continue to move into gold. This movement into gold will in the long term override and sell-offs in gold and over time the gold price will move up dramatically.

Possible Solutions

1. Rating Agencies like Moodies, Standard & Poors and Fitch have caused the largest proportion of the problem by, giving these toxic assets investment grade ratings. They should be very heavily penalized. They should not be allowed to give ratings at all on assets that they do not understand. The only way that an accurate rating could have been done was if the clients credit scoring was sold along with each Sub-prime mortgage bundle – interestingly enough, they would then never have found a purchaser.
2. No banks should ever be allowed to sell debt bundles. Why did they not keep this debt on their own balance sheets? Because they knew all along that they were "toxic". Only way for a bank to acquire assets like this is if an entire division of 1 bank is sold to another.
3. National Governments will have to nationalize most banks; I am not normally a proponent of dramatic actions like this; however I believe that it would restore liquidity in world markets. This action would have to be coordinated. If the action was not well co-coordinated, you could end up like in the case of the Ireland Central Bank guaranteeing bank deposits – suddenly money from all over the world came pouring into Ireland and out of other countries where the central bank had

not guaranteed deposits, at an extremely fast pace – causing major problems in Ireland for a few days. Greece had the same problem.

General

I have made every attempt to keep all facts correct – however there may be a few incorrect facts. I have also tried to show what actions I would take. I am NOT a financial advisor.
Please feel free to make the corrections, and let me know what the errors are.
Please feel free to forward this document to your friends – to try to give people perspective on how bad this economic melt down will more than likely get to.
This meltdown will create an investment opportunity in 3-4 years time that will create unbelievably cheap investment opportunities. Be ready with cash, to take advantage of this opportunity!

I would like to wrap up with a definition of what a recession is as per Warren Buffet and Foord Asset Management:

"Bear markets are characterised by periods of lower global liquidity, rising inflation, rising interest rates, negative earnings news and resulting negative sentiment"

Good Luck

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