
Take a Reality Check

The Financial Blowout Is Currently Under Way

by EIR Staff

As the headlines in the accompanying collage make clear, the extreme turbulence in the financial and commodities markets has finally begun to convince even the most “Establishment” of financial press outlets, that the blowout of the bankrupt world financial system is under way. Over the two-week period beginning the second week in May, roughly \$2 trillion in market capitalization were erased. All major stock markets reported the biggest two-week losses since early 2003, with special emphasis on the so-called “emerging markets,” ranging from Russia to India, to the nations of South America. Some of the collapses have gone into double digits on one day alone.

Due to the sudden meltdown of stock prices and “carry trade” investments in “emerging markets,” further extended by derivatives bets based on such markets, several large banks and hedge funds are believed to have suffered extraordinary losses. This may help explain the short-term interruption of the commodity hyperinflation process. Banks and funds had to temporarily liquidate positions in commodities and other investments in order to get cash to cover losses in stocks, “carry trades,” and related derivatives. Thus, CRB, the world’s premier commodities index, fell by 6.4% within one week, the biggest weekly decline in 25 years.

Subsequent to the major sell-off, the commodity markets have gyrated wildly from one day to the other, creating a

highly unstable situation for the speculators.

“Everyone seems to be on the lookout for a Long-Term Capital type of situation,” said Steve Drobny of the consultancy Drobny Global Advisors, according to a Reuters wire of May 23. Drobny was referring to the 1998 Long-Term Capital Management blowout, in which only an emergency infusion of funds commandeered by the New York Federal Reserve Bank, stanching the threat of a freeze-up of the world financial system.

One hedge fund specialist, Crispin Odey, was quoted in the May 24 *Financial Times* Online mooting that the hedge fund “industry” itself is “doomed.” Odey, formerly with Baring’s, and the founder of the \$4.5 billion Odey Asset Management hedge-fund group, compared the coming fate of the hedge funds to what happened to Lloyd’s of London in the 1980s. Lloyd’s underwent a near-death experience at that point, and was only “saved” by a major campaign to bring in a raft of money from what are commonly referred to as the suckers. A similar process is likely under way in the hedge fund sector today, as reflected in the fact that pension funds and other low-brow investors are currently pouring money in that direction.

Odey told a roundtable discussion on hedge funds that they had grown so big because of the massive benefit of cheap money (read, the yen-carry trade), and that they were going to be in big trouble as inflation and interest rates rose. “The hardest thing to do is to think in a different way than the crowd, but in an inflation world, hedge funds get killed,” he said. If the hedge funds rely on getting monies from fund investments by institutional investors, “it’s a doomed industry,” Odey reportedly said.

In fact, the hedge funds are not a separate financial sector at all, but primarily an extension of the money-centered banks, especially the investment banks, which want to have arms-length instruments with which to carry out their speculative business. Some have vectored their investments toward actually laying claim to raw materials supplies, in anticipation of the inevitable collapse; others are simply scrambling for paper profits, or to eat their competitors.

What should be clear to all is that the bubbles—from debt, real estate, commodities, you name it—can only have one fate: They will pop. At that point, either sovereign governments move in to reorganize a credit system to rebuild the world economy for its people, or a financial dictatorship will reign over the collapse into a new dark age. Those who have worshipped the markets as gods will soon learn this truth, of which the recent turbulences are only a brief foretaste.

