Philequity Corner (October 27, 2008)
By Valentino Sy

Bubbles Bursting

"*History is unfolding before our eyes… It definitely is once in a lifetime, one for the books.*" – (Philequity Corner article "The Rescue", Sept. 22, 2008)

The last few weeks have been nothing less than the financial version of "Armageddon." We have seen the impossible become possible, an unprecedented flight to safety with short-term US Treasury yields down to almost zero, record market gyrations, unparalleled central bank intervention, and a vicious circle of losses, capital reduction, credit contraction, forced liquidation and fire sales on almost all assets.

While bubbles are bursting everywhere, there have been no safe havens as discussed in our article *Nowhere to Hide* (see Oct. 13, 2008 issue of **The Philippine Star**). Thus far, we are witnessing the housing bubble, the credit bubble, the derivatives bubble, the equities bubble, the commodities bubble, the emerging market bonds bubble, the currencies bubble, the carry-trades bubble and the hedge funds bubble – all in such a short span of time.

Equities bubble

On Friday alone, Japan's Nikkei fell almost 10 percent, and markets in Hong Kong, India, and Korea registered similar declines. In Europe, the Pan-European Dow Jones Stoxx 600 fell 4.7 percent to its lowest since mid-2003. Meanwhile, in the US, trading in the futures of S&P 500 Index and DJIA were halted after declines of more than 6 percent triggered the limit-down restriction.

One year after the equities bubble burst, markets are now down by an average of 50 percent as shown below.

Global Equities Markets Performance

US Markets	2007 Price High	Current Price	%Chg from Peak
Nasdaq	2,861.5	1,552.0	-45.8%
S&P 500	1,576.1	876.8	-44.4%
DJIA	14,198.1	8,379.0	-41.0%
		Average	**-43.7%**
Other Major Markets			
Japan (Nikkei)	18,295.0	7,649.1	-58.2%
France (CAC)	6,168.2	3,193.8	-48.2%
Germany (DAX)	8,151.6	4,295.7	-47.3%
Australia (All Ordinaries)	6,873.2	3,869.4	-43.7%
U.K. (FTSE)	6,751.7	3,883.4	-42.5%
		Average	**-48.0%**
Asian Markets			
China (Shanghai Comp)	6,124.0	1,932.4	-68.4%
Hong Kong (Hang Seng)	31,958.4	12,618.4	-60.5%
Singapore (STI)	3,906.2	1,600.3	-59.0%
India (BSE Sensex)	21,206.8	8,701.1	-59.0%
Indonesia (JCI)	2,838.5	1,244.9	-56.1%
Korea (Kospi)	2,049.6	938.8	-54.2%
Taiwan (Taiex)	9,859.7	4,579.6	-53.6%
Thailand (SET)	924.7	432.9	-53.2%
Philippines (PSEi)	3,896.7	1,953.5	-49.9%
Malaysia (KLCI)	1,524.7	859.1	-43.7%
		Average	**-55.8%**

Source: Bloomberg

Commodities bubble

Similarly, there has been a precipitous collapse in commodity prices as people around the world are now convinced that the economy is in for a deep and prolonged recession.

On Friday, crude oil fell 5.4 percent despite an OPEC production cut, while copper declined 6.5 percent as demand for industrial metals waned on prospects of a global slowdown.

Only a few months after the commodities bubble peaked in July 2008, the Reuters/Jeffries CRB index of 19 commodities is now down to its lowest level since 2003. Individual commodities are down an average of more than 50 percent from their peaks. Note that most of the drop in prices happened in October.

	Price High	Date	Current Price	%Decline
Precious Metals				
Palladium	595.00	3/7/2008	171.75	-71.1%
Silver	21.36	3/21/2008	9.18	-57.0%
Platinum	2,301.50	3/7/2008	790.10	-65.7%
Gold	1,032.70	3/21/2008	702.85	-31.9%
			Average	**-56.4%**
Industrial Metals				
Nickel	54,200.00	5/18/2007	9,350.00	-82.7%
Zinc	4,658.00	12/1/2006	1,200.00	-74.2%
Lead	3,980.00	10/19/2007	1,287.00	-67.7%
Tin	25,500.00	5/16/2008	12,000.00	-52.9%
Copper	422.00	5/9/2008	174.05	-58.8%
			Average	**-67.3%**
Agricultural Commodities				
Wheat	1,284.25	3/14/2008	515.75	-59.8%
Corn	779.00	6/27/2008	390.25	-49.9%
Rough Rice	22.72	4/18/2008	15.04	-33.8%
Soybean	1,636.75	7/4/2008	881.00	-46.2%
Sugar #11	15.43	3/7/2008	12.00	-22.2%
			Average	**-42.4%**
Energy				
WTI Crude Oil	147.27	7/11/2008	66.84	-54.6%

Source: Bloomberg (data as of Oct. 24, 2008 4PM)

EM bonds bubble

Bonds, similarly, were not spared as the process of de-leveraging continues. Emerging market bonds have lost 23.8 percent in October alone, according to JP Morgan's EM Bond Index. Spreads of emerging market bonds over US Treasuries are now at six-year highs as investors fled toward quality.

Worse, there were no buyers for many emerging market bonds. In fact, losses for some of these bonds would amount to 80 percent to 90 percent as bids disappeared. Because fund managers cannot sell their emerging market bonds, they resorted to selling equities which were more liquid. This, in turn, caused the staggering drops in equities last week, particularly last Friday.

Once in a lifetime phenomenon

The most experienced businessmen, the most astute brokers and the best fund managers are unanimous in saying that they have never seen anything like this is their lifetime. Unlike the Asian Financial Crisis, the Tequila Crisis in Mexico, or the Russian default, which affected countries or regions, what we are witnessing is a worldwide crash. The banking system of the whole world would have collapsed if not for the intervention of the central banks.

Another difference with this financial market meltdown, is that we are witnessing a "SERIES OF EVENTS", that continue to pound the markets. This is unlike previous market crashes where there is one big catastrophe that precipitates the crash. In the 2008 financial meltdown, we are seeing "WAVE AFTER WAVE" of major events that has mangled the markets. Investors described this September to October decline as torture – A SLOW-MOTION MARKET CRASH.

Credit tsunami of the century

In our column two weeks ago, we called it a "FINANCIAL TSUNAMI". In his testimony to Congress last Wednesday, Greenspan described it as the "CREDIT TSUNAMI OF THE CENTURY."

In terms of losses, this financial tsunami has caused more financial destruction than past wars. It seems like we had gone into World War 3. The losses to everyone with a portfolio of assets are staggering. The only safe place was cash but only in US dollars, Japanese yen or Swiss francs. People holding cash in their home currencies, such as those in Europe, Canada, Australia and emerging countries, all lost money in US dollar terms.

Possible Turn is Near

Despite all the gloom and doom, there are some signals that a turn in the markets is near. The CBOE Volatility Index (VIX) or the so-called investors "fear index" shot up to a record high of 89.53. There were also extremely wild swings in the currencies and commodities markets – all of which are indications of "panic" and "capitulation". Prices often exhibit wild swings during market tops and bottoms. These wild swings in stocks, currencies and commodities typically characterize major inflection points.

As discussed in our column last week, those with cash and courage and with a long-term time horizon will be rewarded by this once-in-a-generation opportunity. While it is difficult to predict how deep prices will continue to fall, the reward-to-risk payout at this point in time appears to be very attractive.

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