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Has Wall Street lost their edge?

Last week, traders were gloating over JPM's coup over Bear Stearns, without taking any consideration for the fallout. If someone offered you $100 for your home, although there was toxic waste in the backyard, would you accept? Of course, not – you would not sell for pennies on the dollar no matter how bad your property looked.

Offering $2 a share for previously one of Wall Street's most prestigious investment banks, was not only an insult to Bear Shareholders, but a revealing insight into the valuation process – if Bear is worth only $2 – how bad is the toxic debt they are holding? While everyone was applauding JPM's coup, only 1 voice was heard saying "how bad is the problem at Bear if it's worth only $2 a share?"

The message Wall St. is sending to the world's financial markets are that they have lost their edge, they do not know what they are doing – they are not professionals. Thinking they 'stole' Bear Stearns, in the final analysis they created more than the money they 'saved' in lawsuits, and loss of credibility. It doesn't take an MBA at Wharton to come to these conclusions – common sense will tell you if you purchase something for $2 it is worth $2, or as the expression goes 'you get what you pay for'.

Maybe you have known someone in your life who is the type of person that will drive 10 miles to save $.20 on a gallon of milk, spending $.30 in gas for the savings. It is common in old ladies, but not expected from the world's leading investment banks such as JPM, the firm who saved Wall St. from bankruptcy during the panic of 1909.

The mixed implications of the $2 offer were: Bear is junk, JPM is cheap, JPM is not serious. Of course, we are not privy to 100% of the information of the deal, nor were we there over the weekend as the deal transpired. However, we can make a strong analysis based on the results, and based on the information we do have.

What we know is that at a recent auction of government debt, foreign purchases declined by over 400%.[i] Since the FED has intervened to save Wall Street, the US Dollar has declined by more than 10%, a clear indication that foreign investors are not confident in the US backed Wall Street bailout.

M&A has been a significant trend on Wall Street, the theme being the consolidation of many firms into several – the merging of Main Street and Wall Street. Instead of small town banks owned and operated by the same guy who is the Mayor and the streets are named after, we are consolidating them into large national corporations, instead of 5,000 individual companies we are centralizing them into 1 company with 5,000 branch offices. But still, you don't want your local branch office to sue you or worse.. If JPM is acquiring a firm of quality, why fire any Bear employees? Why sell any Bear assets, if they are so valuable? In any case, why create a situation, where you will have lawsuits from multiple parties, lasting for over 5 years, with no winners? From any perspective, it doesn't appear to be a good deal. Yet, it is the driving force behind a stock market rally.

What is safe?

Swiss government bonds, farms, hard commodities, metals, or anything that has intrinsic value such as tools. A business should invest in what it does best, a professional should invest in professional development. Energy (electricity not oil), food production, and water should not be forgotten; the basic building blocks of any civilization. People can live without oil if need be – you can decide not to drive to work you can take a bus or ride a bike, but you cannot decide not to eat. In a volatile climate change, combined with rising fuel prices and corn being used for ethanol production, food will be in short supply and high demand.

The average investor does not have a magic bullet solution. Every portfolio should be designed based on specific requirements and circumstances. Saving for a retirement, and running a business, are on 2 opposite sides of the spectrum. If the world falls on hard times, service industries and luxury consumption may suffer. When spending is limited, and consumers need to choose between basic food groups or Gucci handbags, what do you think they will choose?

The rich cannot drive the economy – Bill Gates can only buy so many pair of shoes. What drives the world are the people, the consumer.

Middle class

What drives the world economy is the middle class. Throughout the industrial age, the middle class has served as a financier and consumer of elite products promulgated by Wall Street. The middle class is all but gone – leaving no one to subsidize the upper class. The fact is, the elite thrive on the middle class, and they are the cornerstone of modern society. Without a doubt, the rich have become superrich, but that is not a solid reason in the case for a good economy. A new yacht design includes a garden onboard, for those who want to have their cake and eat it too.[ii] This type of hyper-consumerism is not a driving force of the economy, because this yacht has no utility in itself. A yacht does not have the same use-value as a factory, or a commercial building, or many other alternatives. We are building jet airplanes with fireplaces, catering to a growing class of eccentric elites, while manufacturing declines.

Politics

In the meantime, the world waits for a US election, to reign in even worse policies than the bush administration. Politics is connected to the markets because the US government is financing their debt with the US Treasury, and the Fed, through the US Dollar and the sale of T-Bills. In the bond world, Treasuries have the highest credit rating because no one can imagine the Fed defaulting – but it can happen. In fact, the Fed has a set of protocols in place in the event of a default. It is not important to calculate the likelihood of a default, but one should understand that when foreign capital does not flow into the US, it is because they do not feel the US is a safe environment to invest in. Capital flows into the US are not only supporting US Government debt, it is supporting the DOW, and the real-estate market.

"If you don't feel safe in the currency how can you feel safe in the financial system. If you don't have a banking system, you don't have a capitalistic system." – Saxo Bank CIO

Regulation

Senator Frank is calling for a single, US regulator. Fast trains, legalized marijuana (another proposal by Senator Frank), and legalized gambling are all great ideas, but how practical are they? Imagine a government with 100 agencies, 100 agendas, combining into one. To make matters worse, the architects of this regulator are the same professionals who created the problem which regulator will supposedly solve. This is a logical paradox; however, it is the reality that needs to be dealt with. It is always dangerous to regulate something that is not fully understood, the result could be more disastrous than the problem that originally needed fixing.

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Not the end of the world

There are opportunities abound – no one who understands the markets and sees a commodity boom thinks it's the end of the world, far from it. However, if you are an employee of Bear Stearns, it is the end of the world. Things will change, however if you have been trained to run a race for 30 years and now you need to paddle a canoe, it may not be an easy adjustment, some may completely give up and not even try to adjust. The majority of the economy is comprised of superfluous 'industries' that shouldn't even exist in the first place. For example, you do not really need a broker to buy your stocks for you – it is possible to trade yourself. Yes, a broker may give you tips, and there is a value in having a good broker, but it is not a necessity. Neither is travelling, even for business, when you can have online meetings. It's not necessary to go out to eat at restaurants or bars, go to the barber, hire lawn care companies, or to live in a McMansion. It is not necessary to drive the latest car fresh off the dealers floor, when you can buy an old one for 20% of the price which works mechanically just as well, and insurance will even be less. This is not a philosophical observation, consumers will be forced to cut luxury consumption or cease to exist, because the financing has been extended well beyond its payment period, the bill is past overdue and there is only $1 to pay more than $50 in debt.

Overall analysis

Markets will become more volatile. Opportunities will emerge daily, but it will be necessary to capitalize on them almost immediately. Investing locally in anything with value or that has utility is the best bet for long term stability.

Last year, Elite E Services fund FXV1 returned over 65% on the year, and it was not the best rated CTA program in many tracking services – there are funds that did even better! Some FX traders have been making over 40% a year, consistently, for over 5 years! Sure there are many failed traders who have not had such success, but you don't have to invest with them! Invest with the winners with proven results, experience, and reputations.

Contact Elite E Services for more information about FX, Commodities, and Global Market Intelligence. www.eliteeservices.net 646-837-0059

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[i] http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/03/17/ccview117.xml The share of foreign buyers ("indirect bidders") plummeted to 5.8pc, from an average 25pc over the last eight weeks. On the Richter Scale of unfolding dramas, this matches the death of Bear Stearns.

[ii] An artists's impression of the onboard garden - a revolutionary concept in luxury yachts... http://www.dailymail.co.uk/pages/live/articles/news/worldnews.html?in_article_id=541299&in_page_id=1811