Still Waiting for a Real Bottom

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We remain amazed at the endless procession of punditry parading its certainty amidst the panic. The markets have not recovered. Equity selection and strategy remain mired in the defining myopias and manias of the 2003-2007 Bull Run. Prices have fallen, firms have failed and so very little has been learned. The lessons of the post tech bubble markets are starting to emerge. There is no systemic evidence that these lessons are being factored. In fact, with each trading session since 10 October, 2008, it becomes increasingly clear that group delusions of reassembling Humpty Dumpty are the order of the day. We should have learned that integrated, globalized economies are defined by profound interdependence and that debt is excusable only insofar as it is more productive than costly. Lowering credit cost and standards only inflates bubbles; it does not assure returns sufficient to cover obligations.

We have all learned - brutally - that debt can not substitute for income and cheap policy contrived credit provision can not replace prudent business modeling. Or have we? De-leveraging financial firms by leveraging the Fed and Treasury is not a solution. Like credit creation and rule relaxation, it is a stop-gap measure. It is only productive if the time it buys is productively utilized to develop and follow a new basic business strategy. Want to see an example? Stay tuned regarding the auto industry bridge loans. We have changed the cooks and are following the same rotten recipe. The Fed has expanded its balance sheet by $1.38 trillion this year with much more to come. The Treasury has spent $350 billion of the TARP and will have deployed the second $350 billion well before 2009 draws to a close. Everyone is playing reg arb, regulation arbitrage. Furious effort is made to move in front of increasingly large, often rushed and seldom wise intervention.

Past agreed mergers and acquisitions were withdrawn more quickly than new deals were announced in 2008. Until this change, the best informed market agents are signaling that credit cheapening is insufficient to cover recession risk adjusted return. We have seen global markets sell off in fear of global recession only to buy back assets as macroeconomic data reveals that September nightmare scenarios are stronger than December conditions. China trades (FXI/FXP) make this very clear. Pundits forecast a recovery 6 months away - they adopted this stance the day they admitted recession.

We are left to wonder what connection this may have to the standard market uptick that occurs 6 months before macro recovery. All moments are for buying? Leading lights are pessimistic about oil, but believe in global growth recovery? Fueled, we suspect, by optimism alone? Base metals are weak and growing weaker. China will grow at 5% next year? Trillions of Dollars, Euros, Yen, Yuan, Won are newly printed and floating but, when folks sniff, recovery gold trades flat?

All of this is to say, assets are not moving on the basis of cogent strategies and worked out possibilities. Precious few are reformulating predictions and prices for a world of lower growth, higher political instability and bad debt galore. Elementary noise correlation observations based on recent mild recessions are no substitute for studying the structural changes that are being forced by the massive size of recent imbalances and losses. Rash greed and bald fear go at each other like crazed pit bulls in a wildly oscillating battle to the death. Each day, sometimes each hour, unfolds as though it were an independent trial. It isn't unless we are just biding time until the 1990s return? They won't, you can't jump in the same market river twice. You have changed and so has the river.

Obama will buoy spirits. His inauguration will not, in and of itself, change the rules, the losses, the debts or the opportunities we face. We must do that, rebasing our economy and investment guidelines. Spending a trillion dollars on infrastructure, schools, transport, and energy is as good a way as any to limit the depth and breadth of recession pain. It is not a plan to shore up corporate profits, growth rates or stock prices. It is an idea of how to improve lives and prevent political instability and violence. If it works at all it will do very little for the most equity investments.

When M&A begins to pick up with modest premiums toward economies of scope and scale, a real bottom can be debated. When asset prices move together and according to plausible rebound scenarios, we will have turned a corner. When reduced debt loads are payable from wages, earnings and taxes we will have learned and implemented the lessons of the bubbles that defined our asset markets and national economy for many years. Until then, we will see violent rallies, painful slides and surprised sages. The past is not coming back. It was ill founded, dangerous and created the sell-off. The sell-off was a symptom; our macro economy was the disease. Bringing back the symptoms seldom cures the affliction.