Fried in the Financial Sun

By The Mogambo Guru

04/28/08 If you were asked to tell a story about yourself, you'd probably omit some less-than-flattering facts in order to make yourself look better, right? Well, as the Mighty Mogambo points out, this might be a problem for someone who already has a penchant for lying.

There is a new report from the Comptroller of the Currency titled "OCC's Quarterly Report on Bank Trading and Derivative Activities, Fourth Quarter 2007", which shows that total bank holdings of derivatives is estimated to be "only" $164.2 trillion, whereas I seem to remember that the global glut of derivatives is upward of $700 trillion, which are both numbers so big that I cannot even begin to comprehend the enormity of them.

The report shows that the notional value of derivatives held by U.S. commercial banks has suddenly plunged by a whopping $8 trillion, which is (unbelievably) still only 5% of the total, and which merely takes the total down to the aforementioned-yet-still-staggering $164.2 trillion.

When I realized that $8 trillion is more than half of America's GDP, that is when I realized that "Houston, we seem to have a problem, as we are on fire, and we are tumbling out of control into the sun where we will soon be fried to a cinder."

And let's not forget that even this baleful news is the best that the banks can come up with, as the whole report is based on banks volunteering to tell stories about themselves, which is unbelievably the same as with, according to an article in the Financial Times, Libor rates, which are the agreed-upon interest rates that London bankers agree to charge on short term loans to each other.

The upshot of asking lying, greedy bankers (the villains of history) to tell the truth and let everyone know what disreputable, untrustworthy scum they are has now proved to be an unreliable system of self-regulation, and thus the Libor rate may be understated because the rate is based on self-reports of people who are bankers, which means that they are lying scumbags who falsely report that their short-term borrowing costs are lower than they are, because they know it looks bad that they are getting charged a high interest rate, which proves that the people who are loaning the money to them know what kind of lying, scumbag bankers (as redundant as that is) they are.

But it is these self-reports, like the American O.C.C reports, that are the backbone of the Libor rate, which affects lots and lots and lots of other rates.

By how much is the Libor lending rate understated? Maybe as much as 0.3%, which doesn't sound like that much, but when you are talking about trillions and trillions of pounds and euros of debt, it adds up to a lot of money! Now you see why they are so interested in lying!

And the last thing we need is higher interest rates, as Bloomberg.com reports that "U.S. corporate bankruptcies are accelerating as the economic slowdown compounds the end of easy credit", which is being made manifest by noting that a Merrill Lynch index showed that "The amount of distressed corporate bonds jumped to $206 billion April 11 from $4.4 billion in March 2007." Wow! What's that, an increase of 5,000% or something?

And another scary Bloomberg item was that loans are becoming harder to get, regardless of the interest rates, and "Banks worldwide are demanding 60% more in collateral from investors such as hedge funds to cut the risk of derivative trades going bad, the International Swaps and Derivatives Association said."

And another horror is that the stock market went up, which is Pretty Freaking Strange (PFS) since Barron's reports that the earnings of the Dow Jones Industrials went down, dropping to $225.53 from $234.49. This has produced the unbelievable price-to-earnings ratio of 57! Earnings are going down, but the stocks are going up! To a P/E of 57! Un-freaking-believable!

And not only that, but DJ Transportation index saw its earning drop, too, to $218.60 from $230.91, taking this index's P/E to 23!

And while the venerable S&P500 has not yet shown any more deterioration in its earnings, the fact that the market went up made the P/E of this index go to a lofty 21! All of this in the face of deteriorating conditions and economic collapse! This is beyond incredible!

How can you NOT run to gold in such crazy times? Ponder this question well, as a lot depends on your answering it correctly, much like when the minister asked you, "Do you take this woman to be your lawfully wedded wife?", and you know how well that turned out. So, like I said, ponder it well!

Until next week,

The Mogambo Guru
for *The Daily Reckoning*
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The Mogambo Sez: The nice thing about owning exclusively gold, silver and oil is that you make a lot of money when inflation is roaring like this, and you are sure to make a lot more in the future, too, which is even nicer!

There is a valuable lesson in there for you if you will look for it and then act on it. If not, then you are not as smart as you look! Hahaha!