

To: Oakmont Corporation

From: Damon de Laszlo

DABERIAM XLIII

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Global Economic Indicators

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| World Economic Growth | 2007 (IMF Estimate) | 4.90% | 2006 (World Bank) | 4.00% | 2005 (World Bank) | 3.60% |
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| Base rates: 30 September 2008 | USD | 2.00% | EUR | 4.25% | GBP | 5.00% |
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| MSCI World Equity Index | 30/09/2008 | 232.793 | 31/12/2007 | 299.916 | YTD % | -22.38% |
| Gold (PM London Fix \$ per ounce) | 30/09/2008 | 884.50 | 28/12/2007 | 833.75 | YTD % | 6.09% |
| Oil (WTI Crude \$ per barrel) | 30/09/2008 | 100.64 | 28/12/2007 | 96.01 | YTD % | 4.82% |

When I last put pen to paper in August, I was expecting economic deterioration and that “the pessimism was likely to continue to grow”. I was also thinking that “we seem to be getting near to the bottom of an economic downturn”.

It is difficult to remember all the individual events since August, but one only needs to observe the result was the total unravelling of the banking system around the world as the financial institutions ceased to trust each other. Individual people, not surprisingly, took their lead from the publicity surrounding this breakdown of trust and decided to panic, i.e., sell their stocks and shares, mutual fund holdings and anything else that was negotiable.

Churchill once observed that, the *American Government can always be trusted to do the right thing – after it has exhausted all other options.* This wartime comment could be applied today to all the Governments of the Western world. The crisis has probably peaked in October '08 which hopefully is the turning point. The leaders of the Governments around the world met to take concerted action outside the regulatory systems and to throw the weight of Government guarantees behind the financial institutions.

Many books will be written and few lessons learned. It is sufficient to observe that continuing periods of time during which nothing goes wrong encourage complacency and forgetfulness about risk. During such periods, bureaucracy is encouraged to do what it does best – covering the system in form filling and box ticking. Bureaucracy by its very nature suppresses or avoids imagination. This allows imaginative institutions, i.e., the private sector to develop in an evolutionary fashion by working and taking advantage of areas of least resistance

It is worth quoting from the FT, 18 October: Lord Turner, the new Chairman of the UK's Financial Services Authority, protests that supervision on the cheap explains the FSA's failure to flag the risks in the landscape of British banking - his solution is pushing for higher regulatory fees!

The problem with systems and formulae, from the hard equations of physics to the rather abstruse equations of economics, is that practitioners forget that they all have parameters outside of which they do not function. The risk assessments made within the financial systems of the world make no allowances for the famous black swan that Tabel used to illustrate the highly improbable event.

In a short note such as this, it is not worth listing the dozens of failures of the regulatory systems that, coupled with the linear extrapolation of ever increasing prosperity from a spiralling debt phenomenon, led to the collapse of the exciting innovations of the last few years.

The explosion of lending to individuals became circular as property prices were bid up, creating huge amounts of liquidity, fanned the flames of asset inflation primarily in property and commodities. The rising inflation encouraged Central Banks to raise interest rates and choke off liquidity, which combined with changes in some fundamental accounting and regulatory practices produced this black swan event.

Timing of the collapse by definition was difficult to predict and the collapse and its ramifications are greater than predicted as the whole system has failed, rather than the more expected and less violent descent into a conventional recession. The question to address is, what is the likely rational outcome of an irrational event?

A lesson I learned from a cousin of mine who, after the crash of the 1930s, even though he was a banker, never bought Equities again and only held Government Stock – turning what was a relatively large fortune into a small one through the ravages of inflation by the time he died in the early eighties.

Evolutionary theory tells us that life as we know it is likely to proceed but there will be new innovations bolted on to the old system. Habit and Government action will fix the system; the banking system is stuttering back into life and while world trade and commerce has been severely dented, it will recover. The halving of commodity prices, oil from \$145 to \$70 pbl, will effectively transfer hundreds of billions of dollars back to the consuming countries helping to repair national and personal balance sheets. While the destruction of possibly trillions of dollars of debt around the world will cause negative GDP growth.

After the next six to nine months the economies around the world will return to a slower growth mode. At some unexpected point, stock markets are likely to recover rapidly as they anticipate the change from negative to positive GDP.

The other interesting possible by-product of the crisis and the transfer of huge amounts of liquidity from the commodity producing countries, is the likely reduction in the flow of funds to terrorist organisations. To make a wild prediction, there may be a return of some frugality by the population in general and barring an event in the

short term, a respite from global terrorism, at least until economic recovery starts again to push up oil and other commodity prices.

The run up to Christmas is not going to be fun but next year has a silver lining!

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22nd October 2008