

To: Oakmont Corporation

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DABERIAM XXXVII

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Global Economic Indicators

World Economic Growth	2007 (IMF Estimate)	4.90%	2006 (World Bank)	4.00%	2005 (World Bank)	3.60%
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Base rates: 11 Feb 2008	USD	3.00%	EUR	4.00%	GBP	5.25%
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MSCI World Equity Index	31/01/2008	264.919	31/12/2007	299.916	YTD %	-11.67%
Gold (PM London Fix \$ per ounce)	31/01/2008	923.25	28/12/2007	833.75	YTD %	10.73%
Oil (WTI Crude \$ per barrel)	31/01/2008	91.76	28/12/2007	96.01	YTD %	-4.43%

On the first of February I wrote in irritation to the Financial Times criticising the bureaucratic and box-ticking regulations of Basle II and observing that it is the regulators that are partly to blame for the present problem, an old theme of mine. It has been interesting to see the flurry of correspondence and editorial that subsequently appeared.

It's also fascinating to see the different response to the breakdown of control in two different companies. Northern Rock, ostensibly a very straightforward bank, ex Building Society, borrowing money in the short term inter-bank markets to lend out as mortgages, failed as a result of its inability to continue borrowing as the markets noticed its deteriorating credit worthiness. The failure and its aftermath showed the glaring incompetence of the regulatory environment to spot the very old fashioned and simple risk of unmatched borrowing and lending. There is also a complete failure to point out the lending practices of Northern Rock were racy and unsustainable.

Nevertheless, in spite of the total failure of the management to appreciate the straightforward risks it was running, there seems to be a likelihood that the UK Government, having put in place a huge rescue operation, is going to hand the company back to most of the old management. Indeed none of the old management seems to have sustained any serious criticism or questioning.

Compare this with Société Generale where the failure in an enormously complex area of the bank has caused a public outcry and the pillorying of the management from the Chairman downwards, and set off a raft of investigations by the regulatory authorities from New York, through London and back to Paris. No public money has been lost or public rescue been mounted; while the events appear to have generated a loss of some \$5 billion or so, this is sustainable and now under control.

The difference between the two seems to be that one was an abject failure of the establishment system; the other was an internal failure of controls in an immensely complex part of the bank's operations. While Governments, Regulators and the Press have had a field day pillorying Société Generale Chairman Daniel Bouton, an enormously sophisticated and successful banker who has built an immensely impressive company, he has handled the crisis in his organisation impeccably with great speed and efficiency; the handling of Northern Rock has been a complete shambles in virtually every aspect.

On a different tack, it is worth observing in the context of the present economic crisis that we are probably nearing the bottom of the cycle. The world and his dog now knows there is a financial crisis and the unanimity of downward pointing forecasts indicates the turn is not too far away. We still have to get through the publication of the history of 2007 in the form of year-end accounts. Every Chief Financial Officer and auditor will be throwing the kitchen sink into the last few months of the year so as to have some hidden reserves to go into 2008. Clearly there is always a risk of systemic failure but it is now less likely than it was a month or two ago.

The US Government, in an unusual and highly impressive flash of unanimity, has created a financial stimulus to the US economy that will add a good 1% to the GDP of America in the second half of the year. The Fed has acted dramatically and impressively to address the situation. The Sovereign Funds of the Middle East and China are moving in an impressive fashion to take advantage of the confusion in the West, buying discounted assets, so putting liquidity back into the system.

The not-so-bad news is that markets will continue to be volatile and could continue to go down for a while, but the really bad news is that inflation rather than deflation is going to be the order of the day going forward.

The extraordinary phenomenon of Chinese industrialisation is slowing, but the price of its exports is rising along with the value of its currency, pushing up prices in the West. Oil in particular, and energy in general, will continue to rise in price as the political systems of the West continue to fail to address the energy needs of their economies as they are fearful of the green movements.

Unfortunately, the slow down needed to unravel the huge pile up of Government and private debt that has created a large part of the economic growth of the last few years will not push down inflation as it has done in the past because of the growing demands and successful management of the Chinese, Indian and other rapidly developing economies. 2008 will be "interesting times" but by the end we will be entering into a new world order, with China, India and Russia becoming clearly major players on the world stage. The "West" will have to be more conciliatory.