

Back To Business?

Ruchika (2nd Year)

'Greed is good'. Recall something? Try this-Greed, for lack of a better word, is Good. Greed is right. Greed works. Greed clarifies, cuts through and captures the essence of the evolutionary spirit. Greed, in all of its forms – greed for life, for money, Knowledge has marked the upward surge of mankind.

These are the famous lines of the epic Gordon Gekko from the 1983 – The Wall Street . Gordon Gekko was that powerful character who exemplified the thinking of Wall Streeters and went on to become a rage. I wouldn't credit myself with a eureka moment, but watching Wall Street: Money Never Sleeps(All for Shia LeBouf)as to write this article. The research that- tedious, yes-but the interesting revelation was that the wall street today has shrugged off all it's lessons from the 2008 crisis and moved towards it's old ways

Back to Basics – what where the activities that thrived relentlessly at the Wall Street to have let the 1987 'Black Monday' stock market crash? Those were numerous cases of stock manipulation, insider trading, stock parking and other ways of earning illicit profits, carried out by the notorious faces of greed. These included Michael Milken (The Junk Bond King) and Ivan Boesky (Arbitrageur) among the first to be caught and jailed. John Merewether and Jeffrey Skilling weren't far behind. More recently was Lloyd Blankfein, who has been at the helm of Goldman Sachs since 2006. The India, Harshad Mehta too made a mark by looting banks of Rs. 4000 crores by rigging the stock market.

Now, guess who's back? The news has it that the Wall Street is 'alive' to these activities again and has learnt nothing from the subprime crash. The question that lurks is that has the US government done nothing. Definitely, the US government is determined to change forever how the Wall Street functions through a restriction on proprietary trading by banks, curbs on Executive Compensation and brings over the counter derivatives into exchange. But the disappointing and the appalling part is that the Wall Street isn't stopped by these steps. It is again well on its way to create the next bubble. So to say "greed" has returned to Wall Street.

A full fledged spiral of liquidity leverage and excessive risk-taking has taken hold on the Street. (Insiders say at least one bubble- and possibly two or three- are building up)

The new excess is taking place in the Government Bonds market. The irony is that the bubble formation is being encouraged by the US government only. The Federal Reserves has kept interest rates in the range of 0 to 0.25% with the hope that it would encourage plans to lend to people and business. That has not happened because the economy is in dumps. However, the investment banks have readily queued up to borrow from the Fed.

They put this money which currently gives a yield of about 2.6%. Thus, what the banks are doing is that they are borrowing from the government and lending it back to them buying bonds while the tax payer who is suffering from the lack of credit, effectively pays 2.6% to the rich banks.

Coming to Pension Funds, in the US the Pension Funds have a compulsion to earn a minimum rate of return because they promise to pay a certain level of pension to the elderly. But with the current slump situation and low interest rate, these banks are going to alternatives like hedge funds. A lot of US money is being sent abroad to carry trade, buying of bonds and currency in higher yielding economies.

The low interest rates too are acting as a catalyst of a new bubble. The whole cycle started again. Arbitrage too is proving harmful because one, it is highly leveraged. Second, the repo facility attached to government bonds is in turn leveraged too. The arbitrage works only as long as inflation remains extremely low. If inflation were to rise, the gap will quickly close and the entire brotherhood of the financial world will come to the market at once to sell. That will crash the bond market.

Also, last year in August US companies announced Mergers and Acquisitions (M&A) worth more than \$175 billion, a sharp rise from \$13 billion in the same month of 2009. Hostile bids and leveraged buyouts are all the rage again. Hedge funds too are becoming popular. There are various other companies that are raising money through initial public offerings. Neither the companies nor the investors are bothered that cash already in the system is lying uninvested.

The insiders of Wall Street already agree that many of these bets could fail miserably but nobody wants to stop the action for now. Danger looming?