



IN Your INTEREST FINANCIAL PLANNING

October 2008

Dear Clients and Friends,

The financial news has been absolutely terrible and getting worse.

Actually, it is not so bad. It is a great time to take a good look at what makes you afraid and why. It is also the time where the foundations for a lot of fortunes are laid.

I will talk about what is actually going on, what the near future looks like and what can be done now.

What is going on?

As I write this on October 10th, a lot of people have to sell urgently - as much as possible. Wherever there are still buyers, there is a lot of trading and falling prices because so many people have to sell right now. This means stockmarkets and commodities are falling heavily and currencies like the Australian dollar that are held by a lot of speculators fall heavily as well.

This has nothing to do with sentiment or fundamental value. It will go on until those who have to sell have sold. In the meantime many things like the Australian dollar are very cheap.

The basic underlying problem is that the ratings system (AAA, AA, A, BBB etc) got corrupted through greed before the credit crunch.

As a result nobody knows what many financial assets are worth (many AAA, i.e. super safe assets are only worth 0-25% of what they were worth a few months ago) and therefore nobody knows who is solvent and who is insolvent.

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"I have a delivery for you: 1000 pens with the slogan 'Excellence is in the Detales' and 500 factory-second, slightly irregular coffee mugs that say 'Quality Matters'."

This is especially true for banks. Banks don't even trust each other and only lend to each other overnight if at all, and not for three to six months as they did in the past.

Therefore all banks hoard whatever cash they have and like to ask for repayment of cash they have lent, especially to risky activities like speculating. It is generally not so bad in Australia but overseas it is getting very difficult to borrow money and to extend any existing borrowings. A lot of speculators such as hedge funds

have to sell now at any price and areas that have liquid markets like commodities, most share markets in the world and the Australian currency get sold off. Many other markets are simply closed. People can't sell at all.

What the events of the last few days show you is where there has been large scale speculative activity – that's where the biggest movements have been.

It has nothing to do with sentiment, i.e. people's emotions. Emotions only play a role at the margin right now. The biggest influence is people having to sell to survive even if they have to sell their best assets – which are often the only items they can sell at all.

What does the near future looks like?

Anybody who knows exactly what the future looks like can turn \$10,000 into \$1 billion (you just have to 10-fold your money five times and you are there) within months, so clearly nobody knows how long this crisis will go on.

On the plus side, the rate cuts of the last few days show that the central banks have finally understood that the bushfire at the verandah is their most urgent priority and not any inflationary pressures in the next few years.

Another plus: The Great Depression and the Japanese lost decade of the 1990s happened because banks weren't helped when they were in trouble. This isn't happening now. Banks don't deserve to get helped but they are receiving help anyway. This is good and means that the crisis is working itself through in a hurry, which is very good.

A big minus is that many of the living dead, financially speaking, are still around. It may not be over while Allco, Centro, Babcock & Brown and City Pacific are still alive.

There are a lot of markets like Australian commercial property that are simply frozen, where there are very few transactions. Before trading conditions can improve you need to be able to trade at all.

What can be done now?

There is a huge amount of money sitting on the sidelines waiting to invest again. The owners of this money have a simple philosophy. They will invest when they know things won't go down any further.

They want both the higher long term returns from volatile investments like shares and the certainty of never losing money (which major Australian bank accounts probably provide) at the same time. This is a contradiction and just as when somebody tries to have their cake and eat it, something has to give.

Another approach is to say "What is cheap and what is not cheap at the moment?" and after we have gone through this savage unwinding process, which may be in the next few months, then it could well be worth buying something cheap again.

Please call me on 1300 889 657 to discuss this further.

Kind Regards,



Christoph Schnelle