

Tuesday, February 27, 2007

## **BOOM! Down Goes The Market!**

Oh boy - or is that "oh buy!"

Let's be honest here. The **fear factor** is out on Wall Street - and Main Street.

As well, to some degree, it should be. Fear and Greed are the twins that rule the markets, and they are always, to one degree or another, in evidence on the Street.

The old saying is that you buy when Fear is the only thing you can see on the Street, and you sell when Greed is the only thing you can see. And there's some truth in that - if you can discern what's actually there.

Of course its easy to say and hard to do when the markets are pushing new highs - or lows.

So what really happened today?

Let's take a look.

Over in China the government started talking about placing a capital gains tax out there - a first for China with its new marketplace. Of course the Chinese have been playing the same sort of games that other asian nations did a decade+ ago, mortgaging homes to buy stocks. And why not - the market over there was up more than 100% in the last year.

So they started to sell. Then something ugly happened - the Chinese have this rule that caps off losses, and closes the market in a given issue when it drops more than a certain amount. As stocks hit those limit downs, people discovered *they couldn't sell at all!*

Well, how much is a stock certificate worth *if you can't sell it at any price?* We know the answer to that, right? **It's only remaining use is as toilet paper or fire starters!**

That spooked people badly in other markets, which reacted badly too, and down went the FTSE and DAX. And THAT lent momentum over here.

So - was there a reason for the US market to drop 3+% in a day? Not really. But does there have to be a reason? No. There frequently isn't. Its a called a correction, and they happen all the time. Or at least they used to. 2% corrections, historically, are an "8 times a year" thing.

But the last one, for us, was almost a year ago.

We were massively overdue, and when things started to unravel the big institutional guys (and us small retail folks) saw the downdraft and we hit the **SELL NOW DAMNIT!** button.

Well, some of us did. I unloaded a few individual issues that I had 100% gains in - and why not? They weren't part my long-term portfolio and it was a damn good excuse to take the profit and bank it. The rest? I stood pat.

Tomorrow will come, the Sun will rise like it always does. And, in all probability, it won't be over tomorrow. Not yet anyway. But let's look at the analytics on this - 7 out of 10 times, the S&P has reversed the next day and closed up 1%+.

I wouldn't be surprised to find out that someone or something - a hedge fund or similar - "blows up" over this.

But are we in some kind of underlying crisis? That's the real question.

And.... for now.... the answer is "No".

Now are there issues down the road for the economy? Yes. There is an ongoing blow-up in the subprime credit market. This is not new though - and the stocks associated with this were already taken to the woodshed, tarred, feathered and beaten to a pulp. That show has already had its first run.

So what else? There's an issue with business inventories and capital spending (called "capex" in the industry.) How serious is it? The data's not in. But this is a potential issue down the road, as CapEx tends to foretell the economic future six to twelve months out.

But does this foretell a *recession*, which would be a good reason for a bear market - and a 20% decline in US Stock Prices? I don't see it.

What else?

There were plenty of margin calls issued this afternoon. I suspect that a big part of that 200-point gap-down this afternoon was an impending house call - or perhaps an *actual* one. Those *can* happen intraday and they're ugly. If some big investment house or hedge fund got one, and started it, computers can take over - once triggers are set a "piling on" effect occurs and in seconds billions of dollars worth of sell orders flood the markets as internal liquidity and margin equity limits are violated. Exactly where those are can't be known in advance, but they sure contribute to the mess.

What can we learn from the chart today? Two things - the 500-point downdraft *did not hold*. There was a near-immediate retracement of the entire thing. But then selling resumed, and half of the bounce was given back. So, from a standpoint of *is it over*, the answer, from a standpoint of simply looking at the chart, says *no, it is not*.

Will it be tomorrow? I don't know. Neither does anyone else. *Chasing bottoms is not productive*.

If you bailed today, then wait until the reversal has confirmed before you jump back in. You have to have a test of the previous low and it has to hold. So this means we need to see 100 down on the Dow tomorrow, but can't penetrate it. If that was to happen, it might indeed be a bottom, at least in the short term.

If you *did not* bail today, don't be tempted to do it tomorrow - or worse, to short in the morning! The reversal, when it comes, will likely be quite violent and you're almost certain to miss it if you're not in. The time to get out was *yesterday* - you missed it - so hold on. If you *did* get out today, wait until we have the reversal before you set your re-entry. You might miss the first percent of the comeback, but that's better than getting whacked with *another* 3-5% loss.

While you're waiting, make a list of things you want to own and the prices you'd like to pay. If you want to own WalMart, but didn't want to pay \$50, you might be able to get it at \$45 in a week or so. Target was over \$60, might be able to own that at \$55. Exxon-Mobil was expensive at \$75, but it might be able to be owned at \$65. There's a real opportunity to pick off some low-hanging fruit, and if you liked these stocks at their old prices, then why not buy 'em at a 5-10% - or larger - discount?

If you're a long-term investor and have some money on the side, when the market turns this is a clear opportunity. If you were considering dollar-cost averaging in, you might want to think about lump-summing in once the market turns, provided you're going into a broad index or basket of stocks - otherwise you need to be doing your shopping and investigation. For obvious reasons you don't want to be in any of the catalysts for

this - for example, sub-prime lending.

On balance, however, consider this - is the US Economy any different today than it was yesterday? Has anything happened *here* to change your view of the next 12 months economic-wise in the United States?

If you judge not, then this isn't the time to hit the **SELL** button for your portfolio. Quite to the contrary - its time to play on other people's fear.

The way to make money in the market is to be greedy when everyone else is fearful.

And when everyone else is greedy, that's when *you* get fear as your religion.

Posted by Karl Denninger at 19:40

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### **Musing on schools, performance, and "The Sum Of All Fears"**

This entry is going to be a bit different than my usual political stuff..... its going to focus on schools. I've picked on this day to write about this for two reasons - Florida Schools are currently administering their version of *academic assessment*, the FCAT, and I have been asked to help current students of my Alma Mater in addressing a free speech concern.

First, some history. When I was in my teen years I forced my parents to send me to a private, boarding high school. "Forced" is not an understatement - there was literal force used. The reasons were many and complex, but to this day I believe it was the right decision to make, and believe I was fully justified in doing so.

Anyway, the school I attended, The Leelanau School in Glen Arbor MI was where I graduated. And let me be clear - there was no measure by which that school was "perfect." I cannot, however, complain about the quality of *academic* instruction I received there.

But many of the basic problems that many educational institutions have - *fairness, transparency, even honesty and clean dealing* - were present there.

Over the last 25 years in the *public school system* some elements of accountability have improved. More information is being made available to parents. We are seeing more and more standardized testing, which of course *the schools and teachers are complaining about*, especially when that is then tied to pay. **Gee, what's wrong with pay for performance?** We do it everywhere *else* in our economy!

I actually *like* the FCAT here in Florida. As a parent, it continues to show me something important - that the school *underperforms* my child! That is, she continues to show FCAT performance that *exceeds* the "grade" performance that the school records for her actual routine work. Year after year this pattern has replayed, and it'll be interesting to see if we find the same thing this year as well. I bet we do, and it says to me that there are disparities in the *evaluation* of performance, or worse, there's a serious problem with *how testing and grading are done in relationship to the actual curriculum and state grade-level standards*. In any event, by the standards, my daughter is doing very well. A year ago just prior to the FCAT I had a drag-down

debate with the school principal during which she claimed that I should "expect" a certain level of FCAT performance given the evaluations she was bringing home. It was quite funny how her mouth snapped shut after the FCAT results came back.... that won't be a mistake Marti Gardner will make again, I suspect.

Anyway, on to the **real** purpose of this particular blog entry.

Over the last weekend I was contacted by a group of current students at *The Leelanau School*. They had run across my "[Open Letter](#)" to the school's Board of Trustees, published in August of last year, and were curious if I would help them with a free speech project.

See, *The Leelanau School* is a private school. As such they can, and have a history of, totally ignoring student's free speech rights. Now certainly there's an argument to be made that certain forms of speech are disruptive to an educational environment - thus the (totally reasonable) bans on wearing clothing that has, for example, the phrase "f\* the principal", or a bare-chested woman displayed on it.

But mere words, printed on a page, are a different matter.

Anyway, these students have figured out how to get around internet filters and, at the same time, get themselves a high degree of protection from identification. They enclosed their first "issue" of their proposed underground newspaper, which contained enough information for me to be quite certain they really *were* students there. And they asked for help.

I have to admit, politically, these guys (and perhaps gals) seem to be a bit to the left of *Atilla The Hun*, and that's about as diametrically opposed to me, politically, as one can find. Yet I admire the intestinal fortitude to put in the effort (and it took quite a bit!) to not only find my letter, but also to find a way to protect themselves against almost-certain retributive action were they to publish "in the open."

So of course I said yes, and set them up a domain, a web server, and a copy of my forum (bulletin board) code.

What will this all mean for the school? I don't know. I do hope that *The Leelanau School* sees this forum not as a threat, but as an opportunity. Sure, politically, these folks are likely to be quite "politically incorrect." So what? Isn't one of our strengths our diversity? Perhaps the Administration will have the intestinal fortitude to weigh in and join the debate - in a format where they cannot wield a stick, but instead have to treat people as *people*, since they will have a hell of a time identifying "who's who" in an attempt to stick a boot on someone's neck.

With luck the web site and forum will sponsor an open and honest debate. Its obvious from reading the material that these *really are school students*. Its also obvious that there are a group of students that are willing to go to quite a bit of trouble to put their viewpoint out in public.

You have to admire that.

You can find the site at <http://www.leelanauunderground.org> - if you're curious about having a look "inside" a private school and its student body, from an unvarnished, uncensored point of view, have a gander. The site - and forum - are open to all.

Just like it should be.

Labels: [free speech](#), [school](#), [student rights](#), [The Leelanau School](#)

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Posted by Karl Denninger at 09:36

## More on Global Warming.....

As a follow-up to my recent spiel on this matter, I offer up the following cites, quotes, and figures...

"[According to UN data](#), deforestation accounts for around 25 percent of man-made emissions of carbon dioxide..... The destruction of world forests releases about two billion tonnes of carbon per year, most the loses coming in the tropical forests of Asia, South America, and Africa. "

"At 6 billion tons, [humans are then responsible for a comparatively small amount](#) - less than 5 percent - of atmospheric carbon dioxide," he said. "

"[In the report](#), the IPCC wrote that some 90 billion tons of carbon as carbon dioxide annually circulate between the earth's ocean and the atmosphere, and another 60 billion tons exchange between the vegetation and the atmosphere."

"Anyone who honestly examines global energy trends must reach these harsh conclusions. In 2004, [world emissions of carbon dioxide](#) (CO<sub>2</sub>, the main greenhouse gas) totaled 26 billion metric tons.....The IEA expects China to pass the United States as the largest source of carbon dioxide by 2009. "

"[Carbon dioxide is released in large quantities from natural processes](#), notably respiration by living organisms. Releases from respiration are balanced by a similar quantity taken up by photosynthesis. Other natural sources of carbon dioxide include volcanoes, forest fires and evaporation from seawater. Man-made releases of carbon dioxide are much smaller, accounting for about 4% of the total CO<sub>2</sub> currently being released to the atmosphere, and include burning fossil fuels (coal, oil and natural gas) and other fuels containing carbon (e.g. wood) mainly for power generation and transport."

"[NOAA research](#) estimates that 97% of atmospheric CO<sub>2</sub> created each year is from natural sources and approximately 3% is from human activities."

Now here's the problem - isn't it obvious that we've got some pretty wild variations in the numbers? Humans create 3% of the CO<sub>2</sub>. Or is it 4%. Or 5%? Or, if you believe the "26 billion ton" number for us, its what - 20% or more? As for raw figures, is it 2 billion tons? 4? 6? Or 26?

That's a hell of a range, don't you think?

When alleged "scientists" cite numbers that vary by a factor of more than 10:1 (and if you look further you'll find even WIDER variation) you one thing is clear immediately - they're not reporting measurements. They are taking what is commonly called a "WAG" (I'm sure you can figure out what those letters stand for!)

Now try to figure out how much CO<sub>2</sub> is released by natural sources. Good luck. You get a similarly wild range of values.

Note that none - and I do mean none - of these numbers have uncertainties attached to them.

That's likely because the uncertainties are wildly larger than the measurements, and were they to be reported nobody would take their "figures" seriously!

What's worse is that CO2 in the form of carbonate and bicarbonate ions in the earth's oceans [absolutely dwarf atmospheric CO2](#). Indeed, were it all to be released it would weigh *40 times as much as the rest of the atmosphere does!* To put this in perspective, this means that there is an amount of CO2 "bound" in the oceans that is some **one hundred and twenty thousand times that in the atmosphere**.

Then there are those who believe that CO2 levels in the atmosphere are a *indicator* of global temperature. This, by the way, is not a "nuts" viewpoint, particularly when you look at oceanic heat content. See, chemical reactions and equilibrium levels are strongly correlated with temperature. With a reservoir of *one hundred and twenty thousand times* the atmosphere in the earth's oceans, and with *known* chemical reactions that buffer atmospheric CO2 levels (after all, the earth's surface IS 70% water) it is not unreasonable to believe that in fact atmospheric CO2 levels may be a **result** rather than a **cause** of global temperatures!

Fact is that we don't even have *the basic data necessary to draw conclusions* at this point. We can't even point with any reasonable scientific certainty to whether atmospheric CO2 levels are *a cause or an effect* of global temperatures!

I've seen *nothing* among the global-warming-is-manmade crowd that accounts for the oceanic buffering of CO2 content in the atmosphere - yet these chemical reactions are a known fact.

Finally, even if we **are** the source of a significant part of the reason for warming, what do you think we're going to be able to do about it given that China will surpass the United States as a CO2 emitter within the next two years.

It is essentially certain that if we demand that they stop **their** economic growth in order to "address" this issue we will either be ignored entirely or, far more likely, they will reply "NUTS!"

Then what?

Before we begin to make public policy - decisions that may impact our global competitiveness, economic growth and ultimately the future of our nation don't you think we should have answers to these questions?

I do.

Labels: [climate change](#), [co2](#), [global warming](#)

Posted by Karl Denninger at 21:54

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Then there are those who believe that CO<sub>2</sub> levels in the atmosphere are a *indicator* of global temperature. This, by the way, is not a "nuts" viewpoint, particularly when you look at oceanic heat content. See, chemical reactions and equilibrium levels are strongly correlated with temperature. With a reservoir of *one hundred and twenty thousand times* the atmosphere in the earth's oceans, and with *known* chemical reactions that buffer atmospheric CO<sub>2</sub> levels (after all, the earth's surface IS 70% water) it is not unreasonable to believe that in fact atmospheric CO<sub>2</sub> levels may be a **result** rather than a **cause** of global temperatures!

Fact is that we don't even have *the basic data necessary to draw conclusions* at this point. We can't even point with any reasonable scientific certainty to whether atmospheric CO<sub>2</sub> levels are *a cause or an effect* of global temperatures!

I've seen *nothing* among the global-warming-is-manmade crowd that accounts for the oceanic buffering of CO<sub>2</sub> content in the atmosphere - yet these chemical reactions are a known fact.

Finally, even if we **are** the source of a significant part of the reason for warming, what do you think we're going to be able to do about it given that China will surpass the United States as a CO2 emitter within the next two years.

It is essentially certain that if we demand that they stop **their** economic growth in order to "address" this issue we will either be ignored entirely or, far more likely, they will reply "NUTS!"

Then what?

Before we begin to make public policy - decisions that may impact our global competitiveness, economic growth and ultimately the future of our nation don't you think we should have answers to these questions?

I do.

Labels: [climate change](#), [co2](#), [global warming](#)

Posted by Karl Denninger at 21:54

## Let's Talk About Health Care

With my "opening salvo" on the budget, I want to explore something serious in much more depth.

The Health Care crisis.

What health care crisis, you ask? For starters, the following:

- Medicare and Medicaid currently consume 25% of the federal budget. In 30 years, if we do not fix the mess, they will consume *all of it*. Obviously, that can't happen - and also obviously, we can't raise taxes enough (no matter whether we'd like to or not) to pay for it either.
- Health care costs, *especially prescription drugs and hospitalization expenses*, are growing at astronomical rates - from anywhere from two to three times the rate of inflation and sometimes more. *This cannot continue without bankrupting our nation, as it is grossly outstripping the growth in GDP.*

A big part of the health care cost escalation, *especially in the area of hospitalization costs*, are coming from the explosion of indigent health care being provided to various people in our society. A non-trivial amount (half or more; in some cases 90%+) is going to illegal immigrants. *The cost of this care is being "taxed" to everyone else who can and does pay, either through insurance or directly.*

Then there is the troubling statistic that outlines in stark relief exactly what we're dealing with - 90% of all health care dollars you expend in your life are spent in the last year of your life, on average.

We *must* have an honest debate and discussion in this country about health care, entitlement, and exactly where the limits are to a "right" to health care. Note that there is *no mention of any sort* of a right to health care in our Constitution - just as there is no right to a job or a place to live. Instead, we have a right to *try to acquire the wealth necessary to purchase such things*, but not a right to the goods and services themselves.

This much is certain - we cannot continue to provide health care to illegal aliens on our dime, nor can we afford to continue to provide health care on demand at the standard of "best and most expensive" to conditions that come from lifestyle choices.

As just one example, there are now *very expensive* drugs for Type II diabetes. There are also zero cost means of managing *many* people's Type II diabetes - first and foremost among them for *many* (but not all) sufferers would be losing 50, 100 or more pounds! We simply *must* have the debate about what such a patient is *entitled* to have other people pay for. Is it the \$500/month drug? Is it the old, off-patent drugs, which are very cheap (\$30/month), even though that drug might not control the condition well - or even at all? Or is it nothing - until and unless the patient, if they are obese, lose the weight?

Nobody is going to argue that *if you can afford* to buy a \$400 a month drug out of your own pocket that you should not be able to do so.

Yet we *must* have an honest discussion about the **fact** that no nation can afford to provide on-demand health care at the standard of "best and most expensive" for all conditions, irrespective of how they were contracted or the individual's personal culpability in the disease process.

Should we try to go down that road, we will end up with a system similar to Canada. You won't like it. In Canada it is *illegal* to privately purchase health care. Even if you have a *billion dollars* you cannot buy a heart

procedure until your turn in the queue comes up. The *supply* of health care is rationed, all the diseases that strike mankind are listed in an order determined by the government, and if **your** disease falls below the line where funds are allocated - you don't get treated. At all.

For this reason Canadians come here and pay for treatment themselves! Increasingly, they are also going overseas to other nations, as are patients in the United States. Without the need to pay for indigent care, many nations can provide first-world-quality heart surgery for a *fraction* of what it costs in the US.

Medicare and Medicaid are unsustainable programs folks. So is our current critical care (hospital) system, where indigent patients and illegal aliens are paid for by the rest of us, directly and indirectly. The legendary \$30 aspirin in the hospital exists because the illegal immigrant who comes in having a heart attack is treated *at no cost to them*, and somehow that \$50,000 has to be recovered. So \$10,000 of that bill goes onto **your** routine appendicitis case.

Within the next 30 years, Medicare and Medicaid, if we do not reform this mess, will consume the **entire** federal budget. Long before we get there, the system will collapse.

We owe our children - and grandchildren - better.

Labels: [budget](#), [Health care](#), [medicaid](#), [medicare](#), [unfunded mandates](#)

Posted by Karl Denninger at 17:27

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Posted by Karl Denninger at 17:27

### **Bush's Budget does NOT cut spending**

Oh here we go with the lies from Washington.

The media lies too, for example, right here: <http://www.msnbc.msn.com/id/16989248/>

â€œIn real terms, Bushâ€™s plan is going to have very substantial cuts by the fifth year of this budget in all of the domestic priorities from education and health care to law enforcement and veterans,â€• Conrad said.

“With Democrats in control, we will have different priorities.”

Uh huh. Pull the other one Conrad.

Only in the world of Washington is a slower increase in spending "a cut."

If you spend \$100 on groceries this week, and next week spend \$105, that's an increase. But in Washington, if you spent \$100 on Medicare this week, wanted to spend \$110 on it next week, but actually only spent \$105, that's "a cut".

Of course if you actually read the above story, you learn that these "cuts" are in fact just smaller increases. But the byline says *"Big increases for the military, cuts for domestic programs"*

As with most things in the media and big government, its not about the truth any more.

Its all about spin.

We, as Americans, should demand better.

Posted by Karl Denninger at 15:56

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"The worst" is being billed as more than 1 million people dead and hundreds of billions of dollars in cost by 2100.

It is, indeed, now pretty much accepted science that the climate is warming. What's not settled, however, is *why* the climate is warming, nor whether we can do anything about it.

The report blames man-made emissions, but there the science is simply not present to the degree it's sold. For example, look around for scientific data on how much carbon dioxide is released from natural sources (that is, not under our control) every year. I've done this research, and I've found figures that differ by *two orders of magnitude* (that is, by more than 100 times!) Ditto for the figures on "man made" releases!

When you combine the limits of error on both of these figures, you find that on a scientific basis there is more than a 10,000:1 range on the **percentage** of CO<sub>2</sub> that man releases into the atmosphere! And that's just CO<sub>2</sub> - then we have to talk about Methane (which is also a greenhouse gas), with nearly all of that release being "natural" (think "cow farts"). When we start including other than CO<sub>2</sub> in the computations we have severe problems because it is known, for example, that some ice packs trap huge amounts of methane gas, and thus as they melt that gas is released.

The report all sounds awful and a poster child for "immediate action", but one needs to step back a bit before we all close our garage doors, turn off our lights, and hunker down under a blanket. In short, we should challenge the science - because by definition, there is no such thing as "consensus" when true science is involved. That all these scientists are claiming "consensus" means that what we have instead is politics - by scientists.

First, let us deal with the experimental uncertainty. We know, for example, that there was a period of time known as the "Medieval Warm Period" from 800-1300 AD, and that this period largely coincides with the Medieval Solar Maximum (1100-1250AD.) While there is argument over whether the climate elements of the MWP were global in nature (we seem to have some problem with western-nation sort of records in large parts of the world for that period - big surprise, right?) what is known is that there is both written (by the Vikings) and archaeological evidence that **grapes** were being grown in Greenland. The Vikings took advantage of the ice-free seas in the the North Atlantic to colonize Greenland and other outlying lands. Radiocarbon dating has shown that peak sea temperatures of about 1C warmer than today during the MWP, and there is solid archaeological evidence that the MWP reached as far as Japan.

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Does this mean that we should ignore the issue? No. That the climate is changing is a given - the climate of the earth is **always** in flux. We should - indeed, we must - take note of the changes that occur, the cyclic alterations over time that inexorably will affect us.

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Clearly, if man is going to act, we need to agree on a few basic principles:

*We must also determine what percentage of the increase is due to a loss of sequestration capability, and where that loss is taking place. That is, when you cut down a forest for lumber and do not replace it with new saplings, you remove CO<sub>2</sub> absorption capability. If I release one ton of CO<sub>2</sub>, so long as I add one ton of CO<sub>2</sub> sequestration capability over the time I release the ton of CO<sub>2</sub>, my actions are net neutral and have no effect on climate.*

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Labels: [global warming](#), [politics](#), [science](#)

Posted by Karl Denninger at 13:29

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