

### **We are living difficult times**

One of the most visible consequences of the credit crunch and of the deleveraging process is the collapse of big hedge funds, as well as the need for fresh cash most of the other are experiencing. Following margin calls, technical selling has accelerated generating a sell-off of assets, mainly commodities or small and mid caps, at any price, as if investors wanted to get rid of their assets without any consideration of price or volume.

There has been a massive liquidation by hedge funds; carry trades are unwinding very fast. Even hedge funds with good positive performances have seen redemption requests increase as other desperately need the money to meet their obligations.

The credit crunch and deleveraging processes are now really taking their toll.

What is happening these days in the banking sector is just another illustration, with the difficulties of Lehman Brothers and Merrill Lynch which will undoubtedly spread to other banks.

Central banks are so far cool-blooded: the European Central Bank announced a special operation offering unlimited overnight liquidity to markets. Earlier, it has told the market it was ready for a possible intervention as it continues to closely monitor the conditions in the euro area money market.

Ten of the world's biggest banks have joined to create a \$70B liquidity fund to help other banks go through the consequences of Lehman's failure.

Finally, the Federal Reserve agreed to take equities as collateral for emergency loans for the first time ever.

In the mean time, Credit default swaps showed the cost of insuring corporate debt against the risk of default rose sharply.

What does it mean? it is showing the situation is *serious* and that Central Banks consider it this way. This is the Central Banks' responsibility to assure the market liquidity that funds are available on sufficient quantities so the crisis does not extend to the "real economy" and the system does not collapse. The level of interest rates appears to be secondary at this point and the European interest rates will not be cut. This may not be the case for the US interest rates.

Do we run the risk of a collapse of the US Dollar? If investors start to consider US interest rates are in fact negative and start fleeing the US, this could trigger a massive disruption in the balance of payment and a sharp fall of the US Dollar. Consequently we could see a massive rise in interest rates, recession spreading all over the world and a very strong euro. Let's hope the co-ordinated action of Central Banks, as well as common sense, will protect us from such scenario. But it is not impossible.

On what to do now, I leave it to everyone, optimistic, realistic, or pessimistic.