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Entering 'Jurassic Market'

By J Dwight , *Populist Economics*
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The credit crisis was likened to "Jurassic Park" at a recent economics and market conference at Leen's Lodge in Grand Lake Stream.

In the Jurassic Park of credit, the "smart guys" thought it cool to create new investment animals from the DNA of ancient beasts. First they started easy, you know, with duckbills and the like. They were able to control these new beastly creations.

Then, pointing to their success controlling the innocuous investment herbivores, these smart guys made more aggressive, risky contraptions, kind of like, oh, velociraptors and tyrannosaurus rex.

These investments were really cool and were soon all over the place. The smart guys were patting themselves on the back and raking in the money. But, then the animals stopped behaving like they thought they would - which justified their lax security - and then guess what.

The power went out.

So now, the market is in the middle of rounding-up these credit beasts and either killing them off or restricting them significantly. It is painful and messy. There are casualties and unforeseen consequences and setbacks.

The pain hit Maine in the form of the state treasurer David Lemoine's ill-considered investment of $20 million into the now-collapsed structured investment vehicle - read genetically engineered monster - Mainsail II. Despite repeated claims of "no subprime," the filings of Mainsail clearly showed subprime assets in its portfolio.

Merrill Lynch, which sold Maine into Mainsail, just liquidated similar assets for 22 cents on the dollar, which is about the same ratio velociraptors liquidated the human population of Jurassic Park.

A recent report by RealtyTrac noted the number of Mainers facing foreclosure increased by over 2,000 percent in the second quarter of 2008, compared to the same period in 2007. However, the sample size is small. Compared to the overall number of households, Maine's troubled are less than two tenths of one percent.

But, wealthy homeowners are having trouble securing mortgages to complete multi-million dollar homes on the coast of Maine, according to some. Normal sources, markets and products of capital are gone.

Err, extinct. (Those darn velociraptors again.)

At the end of the day, though, we cannot escape by helicopter, like in the movie.

We have to do the difficult work of fixing what the "smart" people unleashed upon the market.

View from the lodge

This year's group at Leen's Lodge was larger than years past (the conference has been held annually since 2002).

Thirty-four people attended, including a television crew from CNBC. This small, diverse group provides a great chance to learn - and argue - with wide-ranging opinions.

Attendees included: two senior economists from major banks, seven well-known market commentators, four investment managers, three hedge-fund managers, one Federal Reserve member, one international interest rate economic commentator, one think-tank economist, two commodities traders and one agriculture market economist, three fixed income portfolio managers, a collateral-debt-obligation manager, hedge-fund lawyer and a well known bank analyst who advises the Federal Open Market Committee.

The consensus at Grand Lake Stream was that inflation unemployment and interest rates would increase over the next year. Trouble spots are deteriorating home values, automaker woes, further bank failures, concerns about home equity losses still to come, the federal budget, energy prices and the prospect of unemployment above 6 percent and perhaps 7 percent before this cycle ends.

I'm in the high 6 percent camp and had plenty of company at Leen's Lodge.

- Maine-based banks are strong and conservatively underwritten compared to others across the nation. Even so, they likely cannot avoid having their operations affected by national upheaval. The Federal Reserve has an official list of 90 "troubled" banks, but unofficially, according to experts, the number is actually more than 700.

It seems like bad news. Yet in the banking crisis of the early 1990s, about 2,500 banks failed.

- Last year, at this time, a barrel of oil was about $67. As of this writing it is $115.

I'm on record saying the upward slope for oil is over, for now, and I believe the price it will drop below $100. (But we'll see; last year I bet it would be below $66.50. One can only hope.)

I burn heating oil, like most of Maine, but it's clear more wood be used this winter in the furnace. This might be difficult to gauge in the suburbs and cities, but trust me, rural Maine is switching to wood. The buzz of chainsaws is as common as the whine of mosquitoes. Behavior is changing in response to higher prices.

It just takes longer than one would think.

But that also sums the Maine economy in a nutshell.

Maine economic indicators lag, so its problems seem to last longer than the national situation. The state didn't participate much in the recent upswing, so it probably won't be hurt too much in this downdraft.

Unless there's a T-Rex out there we don't know about.

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