

# The Great Unwinding



*By Dr. iur. Frederick Metz Shepperd  
CEO Shepperd Investors AG, Zurich*

The Euro and the European Union as we know them are under considerable pressure. The unemployment rate is increasing, the economic numbers are decreasing and the public equity markets are going sideways. Banks are no longer in traditional banking and selling assets, officially and unofficially, to get to the liquidity levels required by Basel III. Runs on banks are seen in Greece and Spain with surely more to follow. After Spain's bailout, there are countries like the UK, France and Germany (yes, Germany) with their own problems to solve internally. Investors can now receive 0% interest on bonds in Germany, buying a fleeting emotional sense of security in exchange for a sure economic loss. The investment wheel has come to a standstill and the wheel of business is grinding to a halt. It looks like chaos. Is this the new normal?

I call it the "Great Unwinding". It is not chaotic, except for the general public and those deeply involved in the deals and structures of the past. The financial systems in public and private sector borrowing have gone so far away from their true and intended purpose, that it will be a long and painful way back. They will have to unwind the transactions made and pay back debt

that they could not afford to borrow. The Amish community maintains some very basic values when it comes to business and investment. Most of the time. They work the land, they travel by horse and live well with generations of families living and working together. The population expands quite rapidly as a sign of their contentment. One of their sayings is that the further one gets away from the land, the harder and greater the fall. Sometimes, simple truths bring greater clarity.

Unfortunately, we have gotten far away from those truths and now it is time to return. One only needs to look at the repetitive problems on trading floors of a number of institutions to see what can happen when options are covered by a hedge and derivative is laid on top of derivate until your investment is so far away from basic, "grounded" investments along with an amazing risk of loss.

Phrases like "Honesty is the best policy", "The person taking the risk should get the reward" or "There is beauty in simplicity" sound foreign, quaint and antique to the young financial executive in Zurich. However, business is rapidly returning to these values and leaving the financial community in the turmoil it is experiencing. The Great Unwinding.

What we see now is that value and its reward in the future comes not from investment in complex financial transactions, it comes from getting back to basic business in the private sector. This has significant implications for the Zurich area, as value shifts to production and the means of production. At 0% interest, there is no money to be made on the "spread". Financial houses are living on smaller crumbs and will eventually be forced to close through no real fault of their own. The market simply no longer exists. Many other boutique houses for financial investments will experience severe problems going forward. As the value shifts away from the financial world, so does compensation, so does employment.

I spoke in New York City at a meeting including members of the Fed of New York about the coming problems for New York City in 2007. They reminded me that due to the Sarbanes Oxley Act and other legislation, New York was the "Gold Standard" of the world and nothing would happen in the future. A representative of Bear Stearns was also in the room. I warned that "no money" meant no money manager and no money manager meant no management company. It is simple economics, but no one wanted to see the obvious. I likened the situation to Detroit. Everyone comes to the auto companies to sell to them. As a result, they are the last to know when the world has changed. It happened in New York.

The world also comes to Zurich and Geneva. Zurich has been the "Global Capital Metropole". The risks are the same as in Detroit. Fortunately Switzerland still has many other advantages outside of the financial sector and survived the transition from its old industrial base quite well. The transition is underway in the financial world and will only grow.

The Great Unwinding is filled with much difficulty, as structures change and companies become a shadow of their former self. However, it is a great time to be ready to pick up assets the groups are leaving behind. Banks in Europe have sold off their aviation business, real estate and loan portfolios to the benefit of many investors. It is an advantage to work counter-cyclically and now is the time to be active in the market. For the financial industry, it is the Great Unwinding and the market is starting to punish the groups involved with its own brute force. However, for family offices and private investors, it is becoming the "Great Renewal". Newer, simpler, direct opportunities to invest are coming. They may be coming from a different direction and you may have to be pro-active to get them. But it's a great time for investment. This is when generational opportunities come your way. Be on the lookout!

*fmshepperd@shepperdinvestors.com*