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Financial

## Peering Over the Cliff, Saying 'I Told You So'

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James Grant, whose cluttered office at Two Wall Street overlooks Trinity Church, has been warning about financial disaster of one form or another for nearly 25 years. Two years ago, for example, when the now-beleaguered Morgan Stanley was trumpeting a 61 percent jump in profits, Grant wrote a pessimistic analysis titled "over the cliff with Morgan Stanley."

Now much of the financial industry has gone over the cliff. And as one of the most incorrigible bears on the street, the editor and author of the gloomy Grant's Interest Rate Observer should be doing a victory lap and saying "I told you so."

When reached by phone yesterday, Grant tried not to gloat. "What are the costliest words in finance?" he said. "One is 'it's different this time' and the other is 'I told you so.' It brings down the wrath of the gods."

The gods have sent down plenty of wrath already, so much that even Grant admits he has been surprised by the "ferocity and violence" of events that have shaken the financial world over the past two weeks.

"Nobody has been bearish enough," Grant said. "I, looking back on it, was not nearly enough of a calamity hollerer. What you did not read in Grant's was that the socialization of credit risk, a long-run trend, would yield in a few weeks an outright nationalization of our financial system. That sentence we did not write. So many things have happened in so dramatic and so violent a way that one is thunderstruck."

Kenneth **Rogoff**, an economics professor at Harvard University and former chief economist of the International Monetary Fund, also has reason to point to his foresight. At a conference a year ago, he predicted that a major bank would fail. In July he doubted Treasury Secretary Henry M. Paulson Jr.'s assertion that Fannie Mae and Freddie Mac could remain in the same form. They were "toast," **Rogoff** said.

And then a month ago, after many analysts thought the worst of financial instability had passed with the rescue of Bear Stearns, **Rogoff** told another group that more failures were on the way among the financial institutions that had been reporting awe-inspiring profits and annual bonus payments in the tens or even hundreds of millions of dollars.

"We on the outside have been saying: 'How is it possible to manufacture money like that? How can Goldman give out those bonuses? How could financial services be a third of the economy?' " **Rogoff** said. "And the answer was that it was taking much bigger risks than it should have."

Profiting from that sort of wisdom is no easy thing, however. Charles D. Zender, co-portfolio manager of the Grizzly Short Fund at Leuthold Weeden Capital Management in Minneapolis, says that his fund has been betting largely on a decline in financial stocks for the past two years. Recently it has been betting against some consumer

discretionary shares. It has about 75 equally weighted positions.

But Zender cautions that the fund is one of the smallest at Leuthold Weeden, where other funds search for stocks that will rise. "Our philosophy has always been that there have been up markets and down markets," he said. "They go up about 70 percent of the time and down about a third of the time. This is one of those ugly times."

That's made the Grizzly fund look like a beautiful creature -- at least for now. It was up 40 percent from Jan. 1 through the close of business Wednesday. It was down 5 percent or so Thursday. It isn't meant to be a buy and hold fund, he says; over the past five years, its returns are slightly negative.

"Who knows where it will be tomorrow," Zender said.

When it comes to tomorrow, the long-term pessimists are still, well, pessimistic. "I think the central banks are going to next wear the goat horns," said Grant, saying that the Fed and other central banks would lose credibility as they wade deeper into managing banks and insurance companies.

Referring to former Federal Reserve chairman Alan Greenspan and current chairman Ben S. Bernanke, Grant said that "in the old days, when the maestro ran the Fed, people attributed to him qualities of clairvoyance. Then the next guy came and, though mere mortal, was given the benefit of doubt. He turns out not to have been much of a prophet."

**Rogoff** says, "I think the government will ultimately be pressed to take more radical measures." He predicts an expansion of federal deposit insurance, a new institution similar to the Resolution Trust Corporation, which bailed out savings and loan institutions two decades ago, and the need for the Treasury and Fed to shell out \$1 trillion to restore stability.

Among the gloomiest -- and most prescient -- of economic prognosticators has been Nouriel Roubini, an economic professor at New York University and founder of RGE Monitor, an economic consulting and commentary firm.

In the past two weeks, Roubini has been lashing out at the Bush administration on his blog. He calls the president, Treasury secretary and Fed chairman "comrades Bush, Paulson and Bernanke" and brands them as "laissez faire voodoo-economics zealots." He says the United States has turned into the "United Socialist State Republic of America," bringing "socialism for the rich, the well-connected and Wall Street" and making sure "profits are privatized and losses are socialized."

Grant, for one, has a bit more humility. One reason may be that in March, he recommended that people buy American International Group, the insurance giant that the federal government just seized control of to prevent the cash-short firm from causing even greater market turmoil. He points out, however, that he reversed his opinion in May, at which point, he notes, "the stock still had two digits attached to it." After the federal takeover, AIG now sells for \$2.69 a share.

"The best words I wrote this year were 'I was wrong on AIG,' " Grant said.

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