

# U.S. Crisis Underscores Global Links

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NEW YORK -- The sharp declines this month in many stock markets worldwide proves that not all that happens in Vegas stays in Vegas.

That city is among those areas of the United States hard hit by a slumping housing market. Combine that with a strong global appetite in recent years for investments based on U.S. mortgages bundled together, and a dotted line begins to emerge between faltering home loans in once-hot housing markets and troubles for hedge funds in Australia and banks in Europe.

"The speed at which the integrated markets now affect each other - that will probably be the biggest observation of what is going on now," said Georges Ugeux, chief executive of the investment bank Galileo Global Advisors and former head of the international group at the New York Stock Exchange. "The interconnection has now a level of immediacy that it means if there is coughing going on in New York people might have the flu in Germany the next day. There is no cover."

What started out as a storm in one corner of the debt market spread worldwide in a matter of days, exposing often overlooked ties among far-flung markets and illustrating how normally cool-headed investors can act in lockstep when frightened.

By comparison, some previous financial upheavals such as the Asian financial crisis that erupted a decade ago with the collapse of Thailand's currency have taken longer to work its way around to the United States.

But in recent years, a big market has emerged for mortgages that are combined and sold off in the debt markets in a process known as securitization. That allowed institutional investors from all over to get a piece of a hot U.S. housing market and enjoy the steady income from homeowners paying down their mortgages.

It all worked well for years until fissures began appearing in the U.S. housing market. Many of the mortgages contained in those investments were given to borrowers with weak, or subprime, credit. Many such homeowners now face ballooning mortgage payments in flat or even sinking housing markets. When home values were rising at a steady clip, homeowners who ran into financial difficulty could sign away their problems by refinancing. This is no longer possible for many borrowers, causing a financial pinch for homeowners and distant investors alike.

The many players in the subprime debt markets can make it difficult to tell who owns what, stirring widespread fear among investors. Situations like that of the French bank BNP Paribas illustrate the concern. It said earlier this month it had frozen three funds together worth about \$3.79 billion and wouldn't make investor redemptions until it could determine net asset values of its holdings. France's biggest bank by market value had previously said it held a "cautious risk policy."

Other examples, like the collapse of two Bear Stearns funds with risky mortgage-backed investments, underscored a sense that such troubles could erupt anywhere.

"When the markets get shock news they become more volatile and short-run correlations become even higher. Your screen is either all green or all red wherever you look," said Alan Brown, group chief investment officer at Schroder Investment Management Ltd. in London.

Besides helping fuel the housing run-up, cheap access to capital made corporate dealmaking a breeze in recent years and led some big-time investors to rely on hefty financing to complete takeovers. The subprime problems made banks uneasy at the prospect of making loans and led to flagging confidence in debt markets worldwide.

"People thought that was just a U.S. phenomena but it does affect the rest of the world because, as we discovered, the lenders to all those leveraged deals were just as much financed by foreign banks as U.S. banks," Ugeux said.

While the wide spectrum of big investors holding subprime debt spread the risk, that's likely of little comfort to most investors.

"At one level you could argue that by securitizing all these debt, the risks get diversified across the entire system, but the other argument is you don't know where they all end up," Brown said. He said uncertainty about which investors might be holding bad debt has eroded confidence in many markets, making it harder for them to operate normally.

The resulting stock market and credit market shudders in recent weeks are short-term events and don't reflect a major increase in how tightly global economies are connected, said Robert Brown, chief investment officer at Genworth Financial Asset Management.

"Those are temporary. When they're done with, then all of the regions go back to a normal level of differentiation. That's nice because it makes it a lot easier to find opportunities," he said.

The markets saw evidence of that trend last week - Asian and European stocks calmed when more stable trading returned to Wall Street.

Robert Brown contends the simultaneous growth seen in the past decade among the United States and other developed economies as well as developing nations is coincidental, not a reflection of an ever more linked global economy.

"We don't believe asset categories around the globe are any more correlated than in the past," he said.

But whether markets eventually grow more intertwined or less so, many investors worldwide will have to first ferret out where subprime debt rests and whether they will be affected.

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