

## Down to the Sea in SHIPs

In the ninth and tenth centuries, Vikings raided the British Isles, Carolingian Europe, the Byzantine Empire and just about everywhere else. History books invariably describe Vikings as having “raided, and later settled” Ireland and Britain, leading us to wonder about their icebreaker upon that “settlement” landing: “Hey, how are y’all doing? Remember us?” Wagnerian opera and *Hagar the Horrible* aside, the Vikings did not wear horned helmets – consider how dangerous that would be in close quarters in the longboats. Many modern portrayals of Vikings seem to emphasize their lack of cleanliness, but we guess that the average Anglo-Saxon they were fighting was hardly fresh as a daisy, either.

Another band of marauders has been ravaging the financial world in recent years, and the devastation wreaked by the investment product factories on Wall Street would do any Nordic berserker proud. Their techniques are a bit different from those of the Vikings, luring investors into becoming excited about new types of investments that ultimately flop. While the old Vikings savaged their enemies with longboats and clubs, this new breed prefers to rely on acronyms – SIVs, CDOs, CLOs, CDSs, and the like. Look at the portfolio of your fixed income manager. You might find bonds, as you would expect, but you also might find nothing but acronyms opaque to even dedicated practitioners. Now, many highly competent and ethical managers (including some we use) find derivatives useful and effective, but, as usual, moderation, transparency and simplicity are virtues.

We recently read that an investment bank with a sterling reputation, so far untouched by the credit contagion, faces the potential of several billion dollars of balance sheet write-downs relating to a killer-acronym of which we were previously unaware. When does it stop? When we run out of all acronym letter combinations? We can no longer enjoy our alphabet soup for fear that a group of noodle-letters will spontaneously come together, resulting in a \$4.2 billion write-down by a major financial institution.

We propose collecting all species of fixed income derivatives into a new genus with the acronym SHIPs for “Securities of High Intensity Pain.” Vikings apparently disdained both maps and asking directions (one does not stumble across Newfoundland, after all, if one is using a map), but we suggest borrowing a page from their mapmaking contemporaries. Any financial firm that relies excessively on SHIPs should have its balance sheet stamped in red with the warning “Here there be dragons,” accompanied by little pictures of sea monsters.

*We never pay any-one Dane-geld,  
No matter how trifling the cost;  
For the end of that game is oppression  
and shame, And the nation that pays it is  
lost!*  
~ Rudyard Kipling

Vikings perfected the practice of extortion and the protection racket with an élan that would make the Soprano family jealous. Vikings demanded payments, termed “Danegeld,” from regional leaders as insurance against Viking raids. They were clever enough not to specify any timeframe for their agreement, so they could demand more Danegeld any time they felt they could get away with it. Imagine if our government informed us on June 15 that it was tax day again. With our new breed of raiders,

the Danegeld takes the form of government bailouts. The major commercial and investment banks have insinuated themselves into the economy to such an extent that regulators fear economic disaster if there is a major failure, no matter how stupid the bank has been or how deserving of extinction. Accordingly, if a bank takes extreme risks and everything works out, the executives are geniuses and the bank keeps all the profits. If disaster strikes, regulators rush to prevent contagion and the head Vikings (er, bank executives) receive a nice severance. Moral hazard kicks in, and in the future, banks are even more likely to take ever bigger risks, assured of not being allowed to go under. Policy makers should note, however, that history was unkind to those who buckled under Viking threats. We refer to the first English king to pay Danegeld as Aethelred the Unready.

As both taxpayers and professionals in the same industry as the new raiders (and therefore likely to bear the burden both of the resulting bad publicity about Wall Street and the new regulations that will result), we at Sigma find this terribly frustrating. To be a hardliner on bailouts risks comparisons to the grouch in the *60 Minutes* Point-Counterpoint parody from the movie *Airplane!* who says of the passengers in a distressed airliner, “They bought their tickets, they knew the risk....I say, let’em crash.” Perhaps if we knew what regulators know, we also would be petrified of allowing any major bank or investment firm to go under, given the possible resulting contagion and destruction of investor confidence. We have no desire to damage the security markets, but it also seems clear to us that our new breed of Viking will not stop until they encounter pain.

We have no unique foresight about when the credit crisis will end, but that is no reason not to have an active defense. We have battened down the hatches of our portfolios and tilted towards caution until the problems caused by the new Vikings have passed. If you would like help from an investment adviser striving to reduce portfolio threats from marauders with killer acronyms, contact us at (503) 419-3938 or through [www.sigmainvestment.com](http://www.sigmainvestment.com).