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World straddles a wall of worry

'Humpty Dumpty' economy about to take a fall, but cracks can be fixed

By Thomas Kostigen, MarketWatch

Last update: 7:29 p.m. EDT April 8, 2008

SANTA MONICA, Calif. (MarketWatch) -- The International Monetary Fund released its semiannual Global Financial Stability Report on Tuesday, and it shows that the world economy is anything but stable.

Indeed, it showcases a "Humpty Dumpty" global economy that is about to fall and will need to be put back together again.

"The global financial system has undoubtedly come under increasing strains since the October 2007 [Global Financial Stability Report], and risks to financial stability remain elevated," the report says. The organization pointed to "a deterioration of credit quality, a drop in valuations of structured credit products, and a lack of market liquidity accompanying a broad deleveraging in the financial system."

Of course we know that the financial markets have been unhinged because of the subprime-mortgage crisis and the troubled financial instruments linked to it. But the IMF says the world's economic problems run deeper:

"The critical challenge now facing policymakers is to take immediate steps to mitigate the risks of an even more wrenching adjustment," it said, "including by preparing contingency and other remediation plans, while also addressing the seeds of the present turmoil." Click [here](#) to read the IMF report

The IMF is hardly a lone voice. Federal Reserve Board chairman Ben Bernanke earlier this month told Congress that "recession is possible," setting off alarms on Wall Street and around the world.

Thinning stocks

Yet despite the warnings from regulators, people in the consumer-finance industry are relatively upbeat. "If you can see the bottom it means things will be turning around a lot faster than people thought," one financial adviser tells me. This is a good way of spinning things positive and a reasonable position that promotes promise, and not-too-distant promise at that.

Such reasoning, I think, people could bear. Instead, the Fed and the IMF give vague notions of "recession" and "instability."

Meanwhile, Tiger 21, a peer-to-peer learning group for high-net-worth investors, released its members' asset allocation index. It's an interesting look at how the super-rich manage their assets: 31% in public stocks; 23% in real estate; 28% in fixed-income/cash; 11% in

hedge funds; and 7% in private equity.

"Given other alternative assets available to affluent investors, that 31% [in stocks] represents a relatively low allocation now as it was two years ago, but it shows that the high-net-worth community has not given up entirely on the public markets," Tiger 21 founder and chairman Michael Sonnenfeldt says. The group claims 160 members who collectively oversee \$10 billion of investments.

Going the distance

If there is a big-picture takeaway here, it's this: The markets are down and will likely fall further -- but they aren't out. They're sort of like Rocky Balboa: able to take a beating until they -- hopefully -- come out on top.

We're not in red-alert status or in the final round yet, but we are getting close. I, for one, am rooting for economic D-Day because then we'll know we've really hit bottom and can start building again.

In terms of solutions, Tiger 21 members are focused on wealth preservation over aggressive accumulation. Or as their allocations reveal: Discipline prevails, cash is king, but there is no rush to flee stocks.

The IMF on other hand is suggesting a number of initiatives to remedy the financial downturn, including overall risk-management strategies among the public and private sectors, managerial compensation structures, bank balance-sheet repairs, and further disclosures to help alleviate uncertainties about regulated financial institutions' positions.

Unwinding the ugly complexities of the subprime-mortgage fallout may seem like trying to plug holes in the Titanic -- but it doesn't look like the ship is being abandoned. People are choosing to stay on board, namely many of the first-class passengers. And that should be reassuring to some.

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