ARCHEGOS & CREDIT SUISSE – TIP OF THE ICEBERG

written by Egon von Greyerz | April 8, 2021

Bill Hwang, the founder of the hedge fund Archegos that just lost $30 billion, probably didn't realise when he named his company that it was predestined for big things.

Archegos is a Greek word which means leader or one who leads so that others may follow.

ARCHEGOS THE FIRST OF MANY TO COME

This, until a few days ago, unknown hedge fund is a trailblazer for what will happen to the $1.5+ quadrillion derivatives market. I have warned about the derivatives bubble for years. Archegos has just lit the fuse and soon this whole market will explode.

I know that technically Archegos was a Family Office for favourable regulatory reasons. But for all intents and purposes I consider it a hedge fund.

Warren Buffett called derivatives financial weapons of mass destruction and he is absolutely right.

Greedy bankers have now built derivatives to a self-destructive nuclear weapon. Archegos shows the world that an unknown smaller hedge fund can get credit lines of $30 billion or more that quickly leads to contagion and uncontrollable losses.

And when the hedge fund's bets go wrong, not only do the investors lose all their money, also the banks which have recklessly financed Archegos' massively leveraged speculation will lose around $10 billion of their shareholders' funds.

It obviously will not affect the bankers' bonuses which will only be reduced when the bank has gone bust. Remember the Lehman crisis in 2008. Without a massive rescue package by central banks, Morgan Stanley, Goldman Sachs, JP Morgan etc would have gone under. And still the bonuses that year in these banks were the same as the previous year.

Absolutely scandalous and the very worst side of capitalism. But as Gordon Gekko said in the film Wall Street – Greed is Good! Well when it all finishes, it might not be as good as they think.

DERIVATIVES – A MONEY SPINNER THAT WILL SPIN OUT OF

CONTROL

Derivatives have been a money spinner for the major investment banks for decades. Today virtually all trading is in the form of derivatives. Very few portfolios are in the underlying instruments. Instead, anything from stock portfolios, ETFs, gold funds etc (and even gold stored in banks) use derivatives or synthetic instruments. In addition the interest and forex markets are all derivatives. Archegos' portfolio for example was in Total Return Swaps.

As we just saw, when derivatives implode, and the underlying securities are dumped by the prime broker at any price, the losses are instantaneous and irreparable.

Still, contagion was avoided this time with the banks taking all the losses. But that will not be the case next time when not just $30 billion of derivatives implode but multiples of that sum.

WHEN COUNTERPARTIES FAIL……… THE $1.5 QUADRILLION TIMEBOMB

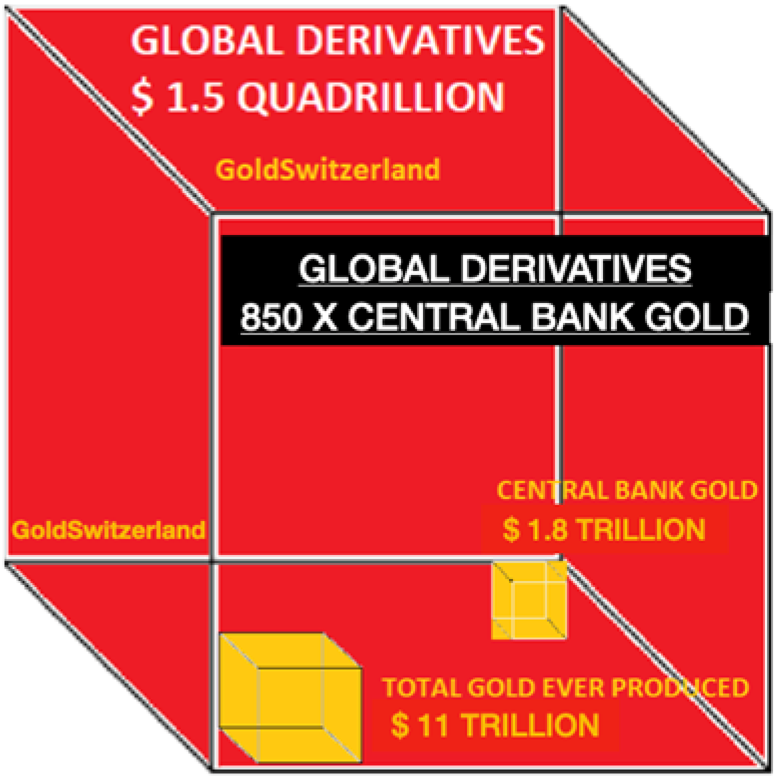
Defenders of derivatives which obviously includes all the investment banks and the BIS (Bank of International Settlement) in Basel, will argue that the net derivatives position is just a fraction of the gross which is estimated to be at least $1.5 quadrillion.

Yes, of course the net position theoretically is much smaller after netting. **But when counterparties fail, gross remains gross.** And this is what we are likely to see within the next few years.

Archegos is a very good example of what the world will experience on a much bigger scale – $1.5 quadrillion will not disappear quietly. The banks managed to stop contagion this time but they won't once it starts in earnest.

The cube below represents all the known derivatives in the world of $1.5 quadrillion. The real number is probably considerably higher.

The $1.5Q is 850X declared central bank gold. What will the gold price be after the derivatives implode? Probably too high to fathom!



When the biggest financial bubble in history unravels the massively over-leveraged financial system, led by the implosions of the $1.5 quadrillion derivatives monster, will be paralysed as stock, bond and property values just evaporate in a cloud of smoke.

WHEN ASSET VALUES DIE

The world will then realise that all the printed money and all credit which backed these assets had ZERO value which some of us have been clear about for years.

Despite the pipe dreams of the Keynesians and the MMT rubbish theories, money created out of thin air must always have ZERO value.

And when the world discovers that the debt has ZERO value, they will wake up from their sweet dreams and realise that the artificial wealth they have built up was all based on a lie.

Starting with the closing of the gold window in 1971, the world has built up an edifice of grossly overvalued assets that will soon find their intrinsic value of nearer ZERO.

Many will argue that many of these assets will still have a value whether it is a sound business or a high quality commercial building with good tenants.

That argument is valid as long as the business has no debt and/or can service its debts from revenue.

Same with leveraged commercial property. Bricks and mortar have little value if it is not income producing. When tenants can't pay the rent, the bank will call in the loans and foreclose on the building.

In a world with $300 trillion of debt, most assets are heavily leveraged. Debtors with no profits or income will quickly become insolvent and the bank will become holders of major assets that collapse in value. The banks cannot afford to hold on to these assets and will sell them in ongoing fire sales.

Very few people will have liquid and marketable assets at that point. And the debt financing will become non-existent.

HOLDERS OF REAL MONEY OR GOLD & SILVER WILL FIND BARGAINS

As in every period of crisis in history holders of liquid real assets like gold and silver will be able to pick assets for 5 cents on the dollar. This sounds impossible today but people familiar with for example the Weimar Republic will know that this actually happened then and also in other times in periods of major crises.

That will be the time when a property that is today worth say $1.1 million or 20 kilos of gold can be acquired for $1 kilo which is a 95% discount, measured in gold.

This obviously sounds totally unrealistic today **but history proves that it happens time and time again.**

FIRST TIME IN HISTORY A DEBT COLLAPSE IS GLOBAL

This time the debt bubble is bigger than any time in history. But not only that, this is the first time ever that a debt collapse is global.

Every corner of the world is in the same situation – North America, South America, Europe, Africa, China, Japan and even Russia. Some countries like China might be able to deal with their debt internally but every single country in the world will suffer as the financial system implodes and world trade collapses.

THE DARK AGES

The biggest economic collapse in history so far is probably the fall of the Roman Empire which happened gradually but the final fall of Rome was in 476 AD when the Germanic leader Odoacer disposed of Romulus Augustulus. From then on no Roman emperor would ever rule from Rome.

The late 5th century is considered the start of the Dark Ages that lasted 900 years until the Renaissance or late 14th century. Other historians define it as a 500 year period. The Dark Ages was a period of cultural and economic decline. But there was clearly not a 900 year solid decline. Many areas prospered much earlier.

So whether we will get an extended period of decline after the current economic and financial bubbles, only future historians will know. What is certain though is that a debt and asset implosion of the magnitude that the world is now facing will have devastating effects for our children and grandchildren. But whether it will last 50 years or 500 years, only history will tell us.

CREDIT SUISSE AND THE WILD BUNCH OF PRIME BROKERS

Hedge fund leverage can only happen with the total cooperation and backing of major banks. Archegos had Prime Brokerage relationships with Goldman Sachs, Morgan Stanley, Nomura and Credit Suisse.

These foolhardy banks extend trading lines of billions of dollars so that hedge funds can leverage themselves to a level which will not just jeopardise the hedge funds but also the banks themselves and eventually the financial system.

Swiss banks used to be a bastion of prudence and conservatism. But they are now at the very top of risk taking banks (don't store your gold with them or any other Swiss bank).

Switzerland has a major problem due to the size of its banking system which is 5X Swiss GDP. **Thus in case of a major contagion the Swiss financial system is too big to save**.

SWISS NATIONAL BANK – THE WORLD'S BIGGEST HEDGE FUND

The additional problem is of course the Swiss National Bank – SNB – which is the largest hedge fund in the world with assets of CHF 1 trillion (USD 1.1trillion) which is 145% of Swiss GDP. For comparison, the Fed's balance sheet is 27% of US GDP.

The majority of the balance sheet is in foreign exchange speculation and held in dollars and euros. The SNB also has major positions in US tech stocks – $8.5 billion in Apple, $6.b in Microsoft, $5.2 in Amazon plus a lot more.

So not only is the Swiss banking system too big for the country but the Swiss national bank is extremely vulnerable to a decline in the dollar and euro plus US tech stocks.

None of this could have happened in the late 1960s and 1970s when I was in Swiss banking. But when both the Swiss National Bank and the commercial banks leverage their positions to the hilt in derivatives and currency speculation, the whole Swiss financial system is at risk.

Nobody should hold major assets in a national banking system which is as exposed as the Swiss one.

CREDIT SUISSE – IS IT INCOMPETENCE OR JUST BAD LUCK

So let’s look how Credit Suisse (CS) which is Switzerland’s second biggest bank has fared lately.

CS has gone from bad to worse, both in risk management and losses. In Q4 2015 they lost CHF 6 billion in write offs and trading losses. In late 2016 CS agrees to pay $5.3b to resolve a probe by the US Department of Justice for mis-selling mortgages.

In 2020 CS faces another $680m in relation to US mortgage securities. In 2021 CS has so far taken a $450m write down on investment in the hedge fund York Capital. A massive $3 billion is expected to be lost on the collapsed Greensill Capital. That sum is equal to Credit Suisse’s net income in 2020.

And the next disaster for Credit Suisse is Archegos. The losses are likely to exceed $6 billion.

The amount of losses that CS has had is clearly not just bad luck. It is based on incompetence combined with a level of greed which rewards success for individuals whilst at the same time jeopardising the bank and the system.

Although Credit Suisse has already lost over $20 billion in recent years, there is probably a lot more hidden in this once venerable Swiss bank. Whatever the management declares has little validity since they don’t seem to have a clue of the real risk picture of the bank.

So is Credit Suisse a real disaster waiting to happen? Time will tell (but in the meantime I wouldn’t store gold with them or any other bank).

What is fairly certain is that the Archegos & Credit Suisse disasters are just the tip of the iceberg.

CS is just one of the banks losing unacceptable amounts of money. Nomura, Morgan Stanley, Goldman Sachs and several more gamblers.

So Credit Suisse is clearly not the only bank taking these shameless bets.

The whole banking world is in the same predicament. And due to the total interdependence of the financial system, even sound banks will not survive.

BANKS FACE SHOCKWAVES OF LOSSES

All these casinos that are called banks are every day making bets that put the bank at risk. In an orderly and controlled market, they make enormous amounts of money for themselves. But when the tide turns and they no longer can manipulate the market to their advantage, there will be shockwaves of losses.

When stock and bond markets fall at the same time, the collateral of the banks will not even reach fire sale levels. And that will be the way that the derivatives market disappears for good or at least for many, many years.

Anyone who believes that their assets held within a bank will be safe should think again. I am not just talking about money but also all the securities held by the bank as custodian. Under pressure the bank will use these assets as collateral for their trading loans. This has happened many times before like in 2007-8.

When you put your assets in the financial system, it is like putting them in a timebomb which has already been lit. It is only a matter of time before it all explodes. And you will have a hard time finding anything of value among the rubble.

RISK NOW GREATER THAN ANY TIME IN HISTORY

As I have spelt out many times, I am not a pessimist, nor a prophet of doom and gloom. I just analyse risk and then look at the potential consequences if/when things go wrong.

I consider risk greater now than in any time in history. And please don’t believe that more worthless debt in the form of MMT, QE etc will solve the problem. It will just make the explosion bigger.

In every crisis in history, physical gold and silver has been the best form of insurance. Don’t believe it will be different this time.