Hedge Fund Looting Is Fueling Hyperinflation

by Mike Billington

Over the past few years, hedge funds and private equity groups have taken an increasingly dominant equity position in a large number of major corporations, especially in the United States and Europe. Recent reports demonstrate that the holders of virtually unregulated masses of speculative capital are using their increased corporate power to loot these corporations, extracting short-term payoffs for their clientele (who, by law, come only from the super-rich) at the expense of corporate investment in real production, while also loading up these corporations with unneccesary future debt. This is indeed the nature of the beast, or, as Trevor Prichard, a director at Standard and Poor's, admitted to the *Financial Times* on Nov. 27, "Private equity groups are doing what they are designed to do—make money for their investors."

Economist Lyndon LaRouche describes it more truthfully: "A hedge fund comes in. It closes in on a corporation, threatens to use 'shareholder value' as a weapon, to force the corporation to gorge out more dividends—just like an ant with a heavy foot on an aphid. Then they go on to the next one. These corporations are victims. This is criminal, but it is allowed!"

According to the Nov. 28 *Wall Street Journal,* the companies in the S&P's 500-stock index will be paying out more than $500 billion in dividends and share buy-backs this year—an increase of more than 30% over 2004. The *Journal* acknowledges that the funds are the "driving force" behind much of this huge increase in dividends, pointing to the Carl Ichan & Co. hedge fund, which used its equity clout in Blockbuster and Time Warner to force higher dividend payments. The *Journal* also acknowledges that this diversion of funds from investments in future business expansion "could have major ramifications for investors, corporations, and the economy as a whole." It publishes a chart from S&P showing corporate profits exploding since 2003, but corporate capital spending collapsing in the same time period, except for a slight gain in the past year.

Leveraged Recapitalization and Mergers

Hedge funds are also using a trick which is well known to American homeowners, encouraged by Mr. Alan "irrational exuberance" Greenspan in order to keep the consumer spending boom going. Despite the collapse of productive employment, and of the incomes of families in the lower 80% of income brackets, families are encouraged to refinance their homes, extracting the paid-in capital to pay off charge cards, while piling up their mortgage debt as a burden for the future.

Equity funds are doing the same thing with their targetted corporations. By gaining control of a corporation, refinancing the corporate debt at the current lower rates, and extracting the "profits" as dividends, European private equity houses have "skimmed" (as the *Financial Times* called it) $14 billion so far this year from companies they already own, and they expect to top $17.5 billion by year end.

Another ramification of the looting process was reported in a Nov. 28 Reuters interview with Piero Novelli, the head of global mergers and acquisitions for UBS, Switzerland's largest bank. Mergers and Acquisitions (M&As) have grown by 56% in Europe this year, and by 34% in the United States, to nearly $1 billion on both sides of the Atlantic. "Hedge funds are the major discontinuity in corporate Europe," said Novelli, "which is making deals happen that were never feasible. These funds are able to exert pressure to push through deals. When news of a deal is leaked, within a few days these funds could own 20 to 25% of the shareholder register, and by the end of the deal, they could even sometimes own as much as 60%." As has always been the case with M&As, the process provides huge profits for the brokers and the shareholders (who are now increasingly hedge fund speculators) by *shutting down* production—just one form of the way shareholders profit from the destruction of the real economy.

Handelsblatt, the leading German financial newspaper, reported on Dec. 1 that we have reached the point at which even the leading German corporations are being targetted for takeover by groups of hedge funds and private equity funds, including Siemens, MAN Group, Linde Group, and DaimlerChrysler.

Hyperinflation

"This relates to something going on which we've been missing," LaRouche commented on Nov. 28, in a discussion of the role of hedge funds in the looting of corporations. "The U.S. raised the interest rates—prime interest rate—and leveraged up dividends by this hedge fund process, to draw money into the U.S. from Europe. So, therefore, if you look back, you'll find that the price of the dollar dropped relative to the euro for a while, going up towards $1.30 per euro, or 'teuro,' as its called. [The German word *teuer* means expensive.] Then it went down to about $1.15 or something like that, because this money was being sucked out of Europe by this high-dividend and high-interest-rate policy of the United States, of the outgoing Greenspan. But now, the Europeans—London—are going to raise the prime interest rate a quarter of a percent. So, you'll pull the plug the other way.

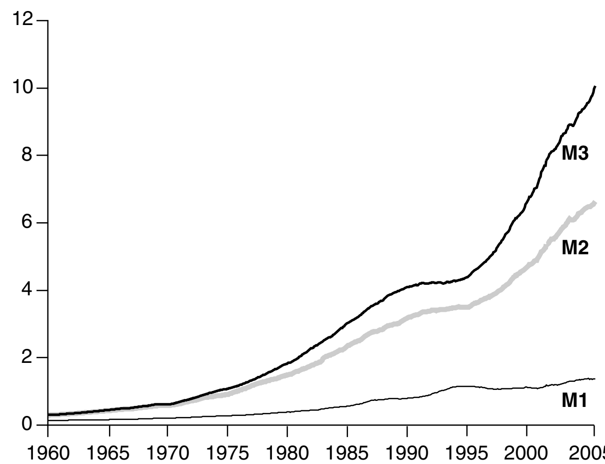
"Now, this is getting very close to the kind of back-and-forth tug of war, which leads to hyperinflationary explosions of all kinds, in Technicolor—and even with some colors that are otherwise not known to exist. This question of the interest-rate wars, and dividend wars: People don't have any assets, but by selling their aunt and uncle, and calling it a 'dividend,' they try to leverage something out of the hedge-fund market. The hedge-funds are being boosted by this. The hedge-fund grabs hold of a corporation; it forces it by so-called 'shareholder value,' to spill dividends out. The stock goes up a little bit, the fund makes a profit—and then they drop it, and go on and do something else.

"This is what's going on. This is *extremely* dangerous. This is really hyperinflationary stuff. We seem to be missing it, because people are looking at the effect of the reporting: 'Oh! The interest rate is up! Is that good or bad, or whatever?' This is a *process,* while they're looking for a *thing.*"

Bernanke Begins Warming Up the Hypercopters

Pumping Up the Bubble U.S. Money Supply, 1960-Oct. 2005

(By Month, $ Trillions)



Source: Federal Reserve

On Nov. 10, the Federal Reserve put a discreet bombshell on its website, announcing its intent to "cease publishing" the "M3" money supply figures. The announcement, buried in the statistical section, gave no reason for the move. However, Nov. 22 articles in both the *New York Post* and Bloomberg said the Fed asserted cost-cutting as the reason. Bloomberg's Caroline Baum said that the Fed determined it could save itself $500,000 a year and save depository institutions $1 million a year by discontinuing the publication of M3.

Before we start laughing too hard, a word about M3. The Fed measures the money supply in three broad categories, named M1, M2, and M3. M1 consists of currency, travellers' checks, and most ordinary deposits—basically cash and cash-equivalents. M2 includes M1, plus savings deposits, small-time deposits, and retail money-market funds—basically M1 plus money that is not immediately available, but relatively easy to get. M3, the broadest measure, includes M1 and M2, plus institutional money-market funds, large-denomination time deposits, repurchase agreements, and eurodollars—basically M2 plus large institutional and less fungible funds.

As of October 2005, M1 stood at $1.37 trillion, and M2 stood at $6.63 trillion. For the first time ever, M3 broke the $10 trillion level, ending the month at $10.06 trillion. Over the past year, M1 has grown at a 0.6% annual rate, compared to 4.0% for M2 and 7.3% for M3. M3 has doubled in the last ten years.

To understand what the Fed is doing, go back three years. On Nov. 19, 2002, Sir Alan Greenspan gave a speech at the Council on Foreign Relations in Washington, in which he promised that the Fed would, if necessary, bail out the financial system through its "unlimited power to create money." On Nov. 21, 2002, then-Fed Gov. Ben Bernanke told the National Economic Club that the Fed, with its ability to produce "as many U.S. dollars as it wishes, at essentially no cost," stood firmly behind the speculative bubble. Bernanke, now the incoming Fed Chairman, cited Milton Friedman's comment about dropping money from helicopters.

The idea that the Fed would stop tracking M3 during the worst financial storm in history, is ludicrous. The Fed is dropping the reporting of M3 because it is planning to do precisely what Lord Greenspin and Benny Bubbles said it would do: Drop money by the helicopter load, to try to keep the central banking system afloat.—*John Hoefle*