In response to a colleague's request for clarification of what Financial Service CEOs/CIOs/CTOs need to consider for IT strategy to serve the needs of CCOs/CSOs/CPOs in the next 12 months given the current Credit Crisis:

I believe that undervaluation of the Dollar is not the case. In the free Foreign Exchange market economy, the Dollar is valued exactly what it should be. And the Dollar and other currencies are valued on a continuous basis to the tune of $2-3T of FX transactions daily in Dollar terms! If anything the Dollar is over-valued. From cumulative trade deficits during the past eight years, there is a huge current account balance overhang—almost 3T in total Dollar reserves in China, Japan, Taiwan, Russia, Korea and Singapore alone.

It is these Dollar reserves that have contributed to the current situation. First, they precipitated low long interest rates early in the '00 decade. Now, as interest rates have been lowered by the Fed in response to weakening economic conditions, seeking better returns, the excess Dollar reserves are being converted into Euros, Pounds and Yuan, thus putting further downward pressure on the Dollar. Foreign investment in US assets is a positive event. Let's have none of this adversity to foreign ownership of US based assets. It's a bugaboo. That is xenophobia at its worst—blaming foreigners for our basic excesses. A devout stoic, my esteemed late father-in-law was fond of saying, "The successful satisfaction of need lies more in its elimination than in its fulfillment." Not very stimulating to the economy, but hey, it is an idea whose time has come.

But, for the moment, of course, demand for Oil is the story. Oil is denominated in Dollars, so as the Dollar drops, Oil goes up because our "friends" in OPEC and Russia want constant value for their precious black commodity. Also, Gold has made an amazing comeback, as well, and just may return as the World Monetary Standard. (Up the guard on Fort Knox—and 399 Park Avenue where CitiGroup warehouses much of the Middle Eastern Sheiks' gold assets! Forget about ***Die Hard 2*** and the Fed Downtown being robbed. The Gold it holds, if any, is peanuts compared to Fort Knox and 399 Park). Feeding back into our economy, increasing cost of oil and concomitant gas prices reduce disposable income which depresses the US economy even further into the current virtual, come real Recession. What part of vicious cycle don't we understand?

But, the World suffers as well since the US market demand for all goods and commodities drives the world economic growth. China and India are just emerging with their growing domestic markets. BTW, foreign participation in this increased demand is heavily controlled by Beijing and New Delhi. Economically, the US did much better when India was poor and China (and the Soviet Union) opposed world capitalism instead of exploiting it. The defeat of Soviet Communism was an advantage that ended with the Russian Bond default in 1998—lasting only 9 years!

Since the mid 90's, the Chinese (trade imbalance to their advantage) invested their Dollars in long bonds. This tended to keep long rates down and created an abnormal condition in the fixed income markets, the inverted yield curve (def: short interest rates > long interest rates) in the earlier part of this decade. Since fixed mortgage rates are pegged to long rates—mostly 10-yr and 30-yr--this made the Collateralized Debt Obligation debacle possible along with collusion of the rating agencies (yet another chapter of the current financial bust saga). This was especially true as the Fed lowered short rates which created the affordable Adjustable Rate Mortgages in the short-term. The defaults came as the Fed began to raise rates and the marginally affordable ARMs became overbearing for the holders.

Contributing heavily to the problem was mortgage underwriting misfeasance and malfeasance. The no-money-down/no-document mortgage was the beginning since the taker of the loan had no skin in this real estate game or bore all the risk if they had equity in their property. Securitization of these loans into Collateralized Debt Obligations was the next step, especially with their lack of transparency. Lenders then quickly shed these assets from their balance sheets leaving all entities buying such securities (including Special Purpose Vehicles—talk about opacity!!) holding the proverbial bag. The Commercial and Investment Banks took their skin out of the game in the name of improving returns because they could reduce the reserve assets held usually in lower risk (and yielding) investments It was a massive pyramid scheme, but the pyramid was on its apex, not its base—a highly unstable situation. This was done all in the name of fees in the current quarter. The problems accumulated while few managed the growing risk adequately as it turned out except for the venerable Goldman.

When the music stopped, many were left with bad loan inventory. The resulting credit crunch as financial institutions write down these assets is hobbling the economy, in general, and the rapidly deflating housing market, in particular. Mercifully, this deflation is slowing down. We appear to be halfway through this version of Financial Hell—$500B of the $1T (based on my wet finger to the wind guesstimate) of bad and questionable assets to be written down.

Winston Churchill said, "When you're going through Hell, keep going!" So let's speed our journey. We are in the Eighth Circle of Dante's ***Inferno*** somewhere near the Evil Counselor burning in the Eighth Tranche (err, that's Trench, Tranche is a cash flow stream of a CDO): [***http://www.divinecomedy.org/divine_comedy.php3?display?HWL?Inferno?27?0?0????????1?***] and like the soul of the flame in line 66, "without the fear of infamy, I answer." to the entreaty of line 55 "…thee tell us who thou art;" [cf. ***http://en.wikipedia.org/wiki/Guido_da_Montefeltro*** for a historical description of Count Guido and his damnation. Remember, financial asset management and attendant advice is equally dangerous. Ask the indicted Bear Stearn's hedge fund managers whose CDO funds' failure in May 2007 precipitated the general awareness of this current crisis.

The impedance to recovery right now is mortgage rates are rising (to encourage institutions to make such loans); but that, in effect, raises the price of housing. This dampens the inchoate demand that is emerging as bottom fishers appear. I have two properties for sale, one in Walnut Creek, CA, and one in Charlotte, NC. The number of potential buyers has increased dramatically in the past month. I am not alone in this observation according to my agents. In is my not so humble opinion, we will be well into 2009 before any recovery can get a decent foothold.

Connecting this to an IT strategy of open standard development environments requires a long and strong bridge. It is all about expense reduction, first, and the creation of low cost structure, second. This is where Data Center Optimization (the three trends of Consolidation, Capacity Growth, Going Green) comes into play. Open standard development is part of the low cost structure creation—business functionality developed AND maintained at commodity pricing levels. Time to market is not a concern at the moment, but will be by 2009Q4-2010Q1.

Re-regulation as a result of the current credit crisis impacts development and maintenance when current systems have to be remediated and/or new systems built. That is where my argument for a new infrastructure for Policy Enforcement via Guarded Commands/XACML comes into play.

Stay tuned.

