



Are Financial Markets Doomed? MF Global Bankruptcy Strikes at the Core of Markets

Davide Accomazzo

Email: davide@cervinocapital.com

Happy families are all alike; every unhappy family is unhappy in its own way. LeoTolstoy, Anna Karenina, Chapter 1

In a bull market everyone is happy, the sky is the limit and we all feel like “wunderkinds”. We see cracks but we disregard them as insignificant, we may notice incompetence and malice but the show must go on.

Then the inevitable moment of reckoning occurs, bull times turn into bears and the sky is suddenly not limitless but heavy and suffocating. Disasters like the Lehman moment in 2008 happen and great destruction touches society at its core. The only silver lining, you may think, is that something must be learned and that things can only get better from here.

Fast forward to the fall of 2011 and “enjoy” the MF Global moment. The bankruptcy of this once powerful derivative broker may not have, so far, scared markets as much as Lehman but to the eyes of the careful analyst it is actually much more dangerous and systemically insidious.

MF Global had been around for more than 200 years facilitating commodity trading around the world; in some exchanges up to 80% of the volume was attributed to MF Global. This changed recently when disgraced ex New Jersey Governor Jon Corzine was chosen to run the firm. Eighteen months later, MF Global is bankrupt thanks to a series of actions that make Lehman look like child’s play.

Corzine levered up the firms’ capital to a ratio as high as 40 to 1 in risky bets on European sovereign debt. Sounds like 2008 all over again? Weren’t we going to fix the leverage issue with banks? I guess not. Corzine also levered his political capital to intimidate regulators in order to have rules changed or kept in his favor. Doesn’t it sound very familiar again? But additionally, the MF saga really strikes a deadly blow to financial markets: while no formal indictments have been put forward yet, it is clear that \$600 million of customer segregated funds have been lost, stolen, vaporized (you pick your favorite). In commodity trading, customer funds are fully segregated from the bank capital to ensure safety in cases like bankruptcy. It is the cornerstone of the brokerage industry. The CFTC, the commodity regulatory body, is supposed to oversee this process and the Chicago Mercantile Exchange (the largest derivative exchange in the US) is responsible for managing this process as well.

Almost three weeks after the filing of MF Global bankruptcy, customers of the bank still have their accounts frozen (only open positions were transferred to new brokers with a percentage of minimum margin needed to hold the exposure) and there are questions whether they will recover 100% of their funds.

Even though customers are not part of the bankruptcy dynamic since their funds are outside of the bank’s balance sheet, the Trustee in charge of the process is holding everyone hostage.

If our financial markets cannot guarantee safety of funds deposited with brokers or banks, our economic system will fall into a dark medieval state that will impoverish all. Liquidity will dry up, spreads will widen, prices and volatility will become intolerable. While it is clear that the system of incentives in Wall Street continues to push at best risky behavior and at worst illegal activities, our regulators and legal system continue to abdicate their responsibilities.

This is very serious as people’s faith in financial markets cannot be broken once again.

Posted by Prof. Davide Accomazzo at [9:16 AM](#)

Tom Busby is the founder, President and Chief Instructor of the Day Trading Institute in Mobile, Alabama. Tom has traded the S&P 500 every day (but six) since its inception in 1982, and is well known throughout the trading community. In 1996, he founded the Day Trading Institute to teach others his unique method of using the S&P 500 as the market leader for trading futures, options, equities and other securities. The Day Trading Institute teaches its students how to approach the market using technical analysis combined with risk management techniques. More information about Tom Busby and the educational and informational services of the Day Trading Institute may be obtained by calling toll-free 800.745.7444 or by email to info@dtitrader.com. Visit their web site at <http://www.dtitrader.com>.

DTI • 1555 University Boulevard South • Mobile, Alabama 36609
251-652-1555 • Toll Free: 800-745-7444 • Fax: 251-344-8587

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