



Bubble, bubble, toil and trouble

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During a speech to the House of Commons, the former British Prime Minister, Winston Churchill, made this observation: “History with its flickering lamp stumbles along the trail of the past, trying to reconstruct its scenes, to revive its echoes, and kindle with pale gleams the passion of former days”.

Man, as well as history, stumbles along the trail of time but unfortunately not enough effort is made to revive its echoes and from which we would surely learn how to avoid some past mistakes; if it is impossible to avoid them, then perhaps their impact can be reduced. One such instance would be this century’s great recession, following unbridled euphoria, when the volume of world trade fell about twice as fast as it did during the last century’s Great Depression. In the 15 months after the global economy peaked in June, 1929, commerce fell by some 10%; in the same period after the April 2008, turning point, global trade was down by 20%, according to Barry Eichengreen at the University of California and Kevin O’Rourke at Trinity College in Dublin.

Today, with unattractive American and European interest rates for investors on offer, and the shine disappearing from some of the developing economies (no longer can emerging markets be treated as a class rather than a mixed bag), good, safe returns are increasingly scarce, enticing many into new territory in their quest for higher returns but which can be a breeding ground for financial misery.

South America was at the core, in fact, of what can be justly described as the first international stock market crisis, brought about by the collapse of the South Sea Company which saw its stock eventually plunge by about 87%. There were other bubbles at this time and in 1720 the English parliament enacted the Bubble Act, requiring all joint-stock companies to receive a royal charter.

The South Sea Company had been formed in 1711 with The English government’s promise that it would have a monopoly over all trade in the Spanish colonies in South America in exchange for taking over the government’s debts attributed to the War of Spanish Succession (1701-1714). The value of the promise, of course, hinged on the outcome of the war and the Treaty of Utrecht, which effectively ended the war in 1713, unfortunately confirmed Spain’s sovereignty over its new world colonies. After that it was all downhill for the company, with its desperate directors circulating false claims of success and stories of non-existent South Sea riches.

One hundred years later, with Churchill’s lamp still only flickering, and echoes of the saga of the South Sea bubble far beyond earshot, the great South American bubble was created between 1822 and 1824. This was a time when the British economy was expanding, Napoleon was consigned to history, and interest rates were no more attractive than they are today. The former Spanish colonies were now republics and they were generating investor interest (bond rates of 6% were on offer).

This thirst to gain better returns encouraged lending to some of these new republics, such as Chile, Colombia and Guatemala. Lord Alfred Tennyson, in his poem Ulysses, extends an invitation to:

“Come, my friends,

‘Tis not too late to seek a newer world”.

It certainly wasn’t, but if Robert Frost mused that poetry “begins in delight and ends in wisdom”, it is obvious, as events would prove, that this is not always so.

This same financial climate was not only ripe with opportunity for investors, but for con men too, and at that time none came more grand than Gregor MacGregor, a Scottish adventurer who

had been made a Major-General in the Venezuelan republican army by Simón Bolívar. He was able not only to lure people to invest their savings in the bonds of a non-existent government, but he was able to get them to emigrate to Poyais, a newer world that did not exist.

The audacious mountebank even tried to encourage Nathan Rothschild, a member of the Rothschild banking dynasty, once described as the world's bankers, to participate in his ventures. This was at a time when another English romantic poet, Lord Byron, in his poem, *Don Juan*, wrote that the large loans to governments and royalty from the Rothschilds, and one other bank, Barings, meant that they were able to "seat a nation or upset a throne".

Wisely, the bait was not taken by Nathan even although MacGregor offered a Poyais bond at 6%; but, as with the other Latin American bonds in the market, the Rothschilds kept their distance – except in the case of Brazil which still retained both strong ties with Portugal and a monarchy (the Brazilian Emperor was married to an Austrian princess). The Rothschilds, as Lord Byron inferred, favoured royalty; in fact, Heinrich Heine, son of a banker and a renowned German poet-philosopher in the 19th century, suggested that "the Emperor of Brazil has pawned his diamond crown" to them.

What can be said is that the mendacious Scot created an elaborate publicity campaign. He declared that his "kingdom" (he called himself a prince) was so rich in natural resources that the revenue earned from export taxes, by a government that only existed in his imagination, would more than meet the interest payments on the bonds. Appetites were whet and some dropped their guard a little – just as others are doing today. Speculation, after all, can salt the dish on offer, making it more appetising, and one of MacGregor's pitches was that Poyais was strategically located near the Isthmus of Panama; even then talk of a canal was circulating and he took full advantage of that rumour.

MacGregor concentrated his efforts to find settlers in Scotland and instead of sour memories of the disastrous Darien scheme of 1698 coming to mind, which had promised to create Scotland's only colony in Central America where access to the Atlantic and Pacific oceans would bring marvellous trade opportunities, many Scots thought that it was time to redress the failed Panamanian venture. Unlike Poyais, (it is still a

malarial swamp to this day in modern-day Honduras) the Darien was very real. But just like the Darien it was the settlers' failure of leadership that sealed their fate after reaching Poyais, besides the added discomfort of malaria, yellow fever and malnutrition.

In the end, Simón Bolívar's former general had been able to fill seven ships with a mix of the disgruntled, the gullible, along with high-risk adventurers and those wanting to be part of something exclusive. One of the first ships to set sail in September 1822 was the Honduras Packet, which really should have been named the Honduras Racket. Those same passengers are not really any different from many people today who embark on similar voyages of absurdity. And just like the infamous Bernie Madoff, the New York-based fraudster who fell to earth in 2008, MacGregor played on the same irrational belief that one can always place additional trust in those from one's own religious or ethnic group.

But what really scuppered things for the hopeful travellers, as well as the investors, evoking the wrath of the duped, were market forces and politics (sound familiar?). Worries over the sustainability of the debt raised for new Latin American governments (some not yet recognised by Britain) was helped along by that insidious interloper in investment: rumour. Colombian debt specifically came under the spotlight and then Peruvian; eventually, and inevitably, the Poyais debt came into question. On the political front the French declared that they intended to depose the Spanish government, leading to fears of a Spanish default, which only made things worse.

By autumn 1823 the failure of the Poyais settlement, supposedly larger than Wales in area, reached London and MacGregor moved to France where he tried to raise fresh money by floating more Poyais bonds to pay off previous investors, in classic pyramid-scheme style. The flotation flopped and he eventually fled to Latin America, dying in Caracas in 1845.

One of the titles MacGregor gave himself was "Inca of New Grenada". I can only imagine what some of his victims in Scotland and London called him; the stinker of New Grenada seems far too mild a description.

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