

Dubai's Moon Shot

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Virtually unlimited access to cheap money blurs lines between what makes economic sense and what doesn't. If it can be financed it will be built. Dubai's plan to diversify away from petrochemicals made sense. Maybe it is even destined to become the Las Vegas of the Middle East, the Mecca of business travel and luxury.



Dubai, however, is like NASA; both have proven that anything is possible when you ignore economic costs.

Many technological discoveries were made in the process of putting a man on the moon; but the project did have, and was expected to have, a negative return on capital.

Dubai has followed a similar path. The *absolutely* impossible category may not include building [an underwater hotel](#), or [the tallest building in the world](#), at a cost of \$4.1 billion, or [a covered ski resort](#) in the middle of a desert, but these projects surely deserve a place in the category of *economically* impossible. Like putting a man on the moon, Dubai's projects were destined to have a negative return on capital. (At least NASA was up front about it).

Dubai's construction wonders were made possible by high oil prices and, more importantly, unlimited (at the time) global liquidity – subprime global lending on steroids.

Today Dubai, a city/state that could do no wrong just a few years ago, is defaulting on the debt it issued to finance its building boom. However, what is happening in Dubai is just the most recent, most vivid example of what took place all over the world until the economic crisis. Economically impossible endeavors with negative returns on capital were everywhere.

Dubai is just the latest to go bust.

Though everyone is talking about Dubai's potential default, the scope of the problem is greater. Think about how much energy (oil, coal, natural gas), materials (steel, concrete), and industrial products (cranes, tractors) – in other words, stuff – it took to build these economically impossible wonders. China, the most populous country in the



world, also masked its share of economically impossible projects through the guise of “stimulus” and at times outright censorship. China is the birthplace of [the largest shopping mall in the world](#), which is empty and a city built on spec for a million people that [remains mostly vacant](#). These two just scratch the surface. The rest of the world, including the US (after all, we built a lot of now-empty houses and condos) is swarming with economically impossible projects.

How many houses (or in the case of Dubai, mansions), factories, hotels, skyscrapers, shopping malls, and railroads will not be built because there are too many already built? And if this is not convincing enough, funding economically impossible projects will be difficult for a while, as lack of liquidity and insurmountable losses suddenly turn bankers into ... bankers. They find religion (at least for a little while) and start giving loans to folks who can actually pay them back.

Dubai is the exemplar of economically impossible activities that have taken place everywhere, and why one can't be optimistic that demand for stuff will return to levels even remotely close to what they were in the days when everything was economically possible and financeable.

Epilogue

My father lives a block away from my office. I stop by his house a few times a week on the way to work. We have breakfast (my stepmother makes a killer fake-egg omelet) and stimulating conversation. My father is a true renaissance man – a gifted teacher, scientist and inventor. He holds a PhD in electrical engineering, and to top all that he is a very [accomplished artist](#). The bottom line: he is a very wise man. This morning we discussed this Dubai article.

He asked me, “But why would people in Dubai spend billions of dollars on buildings if they have little chance of earning a return on it?” He added, “I would think they'd have rational voices at the table pointing out obvious holes in these multi-billion projects.”

At first I tried to explain that if things can get financed they'll be built. I sensed skepticism. Then I explained how groupthink works: under crowd pressure, especially after their predictions of the bubble bursting were proven “wrong,” as real estate prices kept climbing, skeptics were either turned into believers, got quiet, or got fired for being doomsayers and not being team players.

My father started to see what I saw, and then I told him a joke that I heard from Warren Buffet years back.

A very successful oilman dies. He faces Saint Peter, who says, “You've been a good man and normally I'd send you to heaven, but heaven is full. We only have a place in hell.”



The oilman says, “Any chance I could talk to other oilmen who are in heaven? Maybe I can convince someone to switch places with me?”

Saint Peter says, “It’s never happened before, but sure, I don’t see any harm in it.”

The oilman goes to heaven, finds an oilmen convention and yells, “They found a huge oil discovery in hell!” Oilmen are stampeding out of heaven to hell, and our oilman is running with them.

Saint Peter asks him “Why are you going to hell with them? I have a spot in heaven, you can stay.”

The oilman answers – “Are you kidding, what if it’s true?”

My father got it.

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