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What Deutsche Bank Left Off Its List of 30 Market Risks

Ironically, one of the biggest risks to the global economy is Deutsche Bank's own derivatives business.

Volatility and risk are of primary concern to advisors and investors in 2019.

Deutsche Bank recently chimed in on these issues, releasing what it sees as the 30 primary risks for the New Year:

1. Algo-driven, risk parity-driven fire sale in equities and credit continues
2. Slowing growth in China and Europe slowing down the U.S. economy
3. Slowing growth in China and Europe triggering significant U.S. dollar appreciation
4. Tailing U.S. Treasury auctions and/or declining bid-to-cover ratios
5. Increased U.S. T-bill issuance continues to push 3-month Libor overnight Index Saw wider
6. Increased U.S. Treasury issuance pulls dollar out of investment-grade credit and equities
7. Higher hedging costs continue to lower European and Japanese appetite for U.S. credit
8. European Central Bank (ECB) quantitative-easing ending means less global demand for fixed income
9. Bank of Japan (BOJ) QE slowing means less global demand for fixed income
10. U.S. 2/10-year Treasury yield curve inversion has negative impact on confidence in credit and equity markets
11. U.S. corporate tax cuts continue to boost buy backs but not capital expenditures
12. Impact of potential U.S. government shutdown on markets
13. No deal Brexit in March could be negative for markets
14. No deal Brexit in March could be negative for U.K. economy and hence also European economy
15. U.S.–China trade war escalates further
16. U.S.–Europe trade war escalates further

17 Fed decides to ignore accelerating trade growth (this could threaten profit margins)

18 Fed decides to ignore accelerating wage growth (this could un-anchor inflation expectations)

19 Escalation of yellow-vest protests in France

20 European Parliament elections

21 Continued inflation of housing bubble in Germany

22 Italian fiscal situation

23 House price crash in Australia and Canada

24 Chinese economy less and less responsive to stimulus

25 China's current account deficit arrives faster than consensus expects

26 Japanese growth can get hit by China slowdown

27 Potential political changes in India, Argentina, South Africa, and Indonesia

28 Continued increase in global inequality

29 Fed and ECB re-start QE and risky assets don't rally

30 Monetary and fiscal policy are out of ammunition and the world experiences a Minsky moment

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The Deutsche Bank list is pretty comprehensive.

However, after reading through the various scenarios that can potentially trigger a black swan event, I realized that the author of the article—Torsten Slok, the bank's chief international economist—had neglected to point out the elephant in the room: the possible collapse of Deutsche Bank.

The stock price for Deutsche Bank recently broke the $8 mark and is looking eerily similar to Lehman Brothers. It holds a gargantuan quantity of derivatives, which have multiple layers of derivatives backing primary derivatives, reminiscent of the 2008 derivative debacle.

In June, the Wall Street Journal published an article, **"Deutsche Bank Fails Fed's Stress Test,"** citing "material weakness in capital planning" and the lender falling short in capabilities to forecast revenues and losses in key business lines and was deficient in risk-management controls.

Derivatives' Danger

There is another red flag that concerns Deutsche Bank, according to Simon Paige, a writer for **The Data Driven Investor** who also works for the emerging long/short crypto-currency investing group Bitcoin Enhanced. As a trader Paige works with cautioned (via email): "Be mindful of anything you do that has Deutsche Bank as counterparty—the largest derivative counterparty in the market and not much capital to back it up."

As Paige explains, "Because derivatives have spawned a financial system of mutual dependencies between institutions, there is no knowing which part of the system may be the trigger for general collapse (watch the movie "Margin Call"). If Deutsche Bank goes down, so may the institutions you bought your stocks, mutual funds, tracker funds and property funds from. The assets themselves would also likely lose some or all of their value."

How big is the derivatives market worldwide? Data for the Bank of International Settlements show that the value of these contracts was close to **$595 trillion as of June 30, 2018**.

The value of derivative-contract positions held by U.S. commercial banks stood at **$207 trillion as of Sept. 30, 2018**, according to the Office of the Comptroller of the Currency. (The market value of assets underlying these contracts, though, is $12.7 trillion.)

Apparently, we have learned little from the 2007-2008 economic crisis when it comes to derivatives, which Warren Buffet has referred to as "Financial Weapons of Mass Destruction."

The major irony of this global-risks list is that Deutsche Bank should have put itself at the top of the list.

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