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WEALTH MANAGEMENT

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When Lehman Fell

Let's take an unpleasant stroll down memory lane:

Through the early and mid-2000s, home prices across the country surged. Americans purchased these homes, often with adjustable rate interest mortgages that carried lower "teaser" rates in the early years of the contract. The expectation was that home prices would continue to rise, allowing a cash out or easy re-finance down the road. When the housing bubble popped, these borrowers were unable to re-finance and their properties were underwater. They couldn't afford the adjusted, higher interest rate on the mortgages. As people began to default, the underlying securities that the mortgages were bundled into led to massive losses for banks that were over-exposed to sub-prime mortgage debt. That's the quick-and-dirty of what happened, at least.

Last month marked the ten-year anniversary of the catalyst event for the Great Financial Recession - The bankruptcy of Lehman Brothers.

The S&P 500 peaked on October 9, 2007. Over the next 11-or-so months, markets declined. Through the middle of September in 2008, the index was 17% off the highs set in 2007. A poor year in the market, to be sure, but nothing really remarkable compared to other "bad years" in the market. Then, on September 15, 2008, Lehman Brothers went bankrupt. The 15th was a Saturday, so the carnage that followed didn't actually begin until 9:30am on Monday, the 17th. Over the next 6 months, markets fell *a further* 45%. Domestic equities finally bottomed on March 9, 2009. All told, $100,000 invested 17 months prior would have declined to $45,100. That's a pretty lousy year-and-a-half holding return.

From the bottom, it took just over three years, until late March 2012 to recover back to those October 2007 highs. Investing over these 4 ½ years produced a 0% return. Let's have some perspective on this, though. This is effectively the same return you received by having your money in a bank account through the first half of this decade.

Since the recession, it's been easy to find credible-sounding rationale for why we are about to plunge into a bear market. There have been outlandish scenarios laid bare across the front pages of major, national newspapers. Calls of the Dow crumbling a further 90%. Gas prices over $10 per gallon. The dissolution of the United States… as in our country would no longer exist. Expecting black swan events somehow became the norm.

Meanwhile, since those March 2009 depths, US equities have produced strong returns for investors. Starting from that March 9th bottom, the S&P 500 has generated a total return of 421%. Wow. All told, since the recession, we've see above average market returns, minimal volatility, average economic growth, and falling unemployment. Basically things have been about as un-black swan-ish as you could imagine.

So much for all those predictions we read and heard about every day. Actually, here, I can do it too:

"I predict that overbuilt Chinese infrastructure coupled with a global mistrust of the Chinese supply chain will cause a collapse of global equity markets around Q4 of 2019."***

That seems reasonable enough, I could see it happening. Even if you spend too much time watching financial news and regularly traffic in pessimistic forecasts, you will forget this prediction. There will be another tomorrow; and the next day; and the day after that. It costs nothing to deliver these prophecies. There is no accountability for the missed calls that fail to come to pass. If they happen to be correct, and eventually someone will be, they will be celebrated for their discerning analysis and precognition. It's like playing the lottery *for free*. Those who despair are looked upon sagely. Those who suggest prosperity are looked upon as salesmen.

Meanwhile, CNBC is delighted to air this every day. Viewers tune-in in droves to learn about what they should be afraid of. People shrug off or forget good news and favorable forecasts. But, tell them they're in trouble - that gets their attention. We evolved as a species to be pessimistic by nature. The pessimists were the ones that hid or ran away when they heard an ominous noise in the bush. The optimists got eaten. It's a predisposition. I catch myself succumbing to these instincts, too. It's hard to block out.

Now, there is some benefit to listening to that instinct in small doses. Having enough caution to prioritize survival over opportunity is essential. The danger is prioritizing any negative outcome at all over opportunity. It is imperative to understand the difference in those sentences.

We work with clients to build portfolios that are designed to help clients avoid ruin. That doesn't mean that these portfolios will never go down. It simply means they are positioned to try and avoid the scenarios that would completely wipe them out. The unfortunate souls that were wiped out because of losses in their investment portfolios had no business taking the investment risks that they did.

If you had the grave misfortune of making a lump sum investment into US equities at the peak in 2007 and held on through the end of last quarter, your money would have grown to a little more than double its starting amount today, a gain of 137%. Investors who stuck with their plans and had the discipline to resist the urge to sell have come out of things just fine. Let this be a lesson for the future. Have a great quarter.

Thank you for reading,

John, Derek, Jon, Stacie & Kadeem

*** This is not a real prediction. Do not take this as financial advice. I am being facetious. *Unless, of course, this comes true in a year. In which case: Yes, CNBC, I will accept an appearance fee to be on your lunchtime program.*

Performance data from Morningstar, as of 9/30/2018.

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