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Revisiting the Global Financial Crisis: A Generational Low

MARCH 2019

Snapshot

- On March 9, 2009, the S&P 500 Index closed at 677, its lowest price since September 1996. Headlines forced investors to confront a "lost decade" for portfolio growth.
- The March 2009 bottom coincided with policy developments that began thawing frozen lending markets and likely helped tip sentiment from lower-conviction selling to buying.
- Credit spreads, which indicate the increased costs for riskier borrowers, started to tumble in early March and returned to relatively normal levels by the end of 2009, with stock-market volatility moving in tandem.

On March 9, 2009, the S&P 500 Index closed at 677, its lowest price since September 1996. From the high-water mark on October 9, 2007, the peak-to-trough decline totaled 56.8%. Headlines forced investors to confront a "lost decade" for portfolio growth, presumably because "lost dozen years" didn't roll off the tongue quite as easily.

Stopping a Freight Train

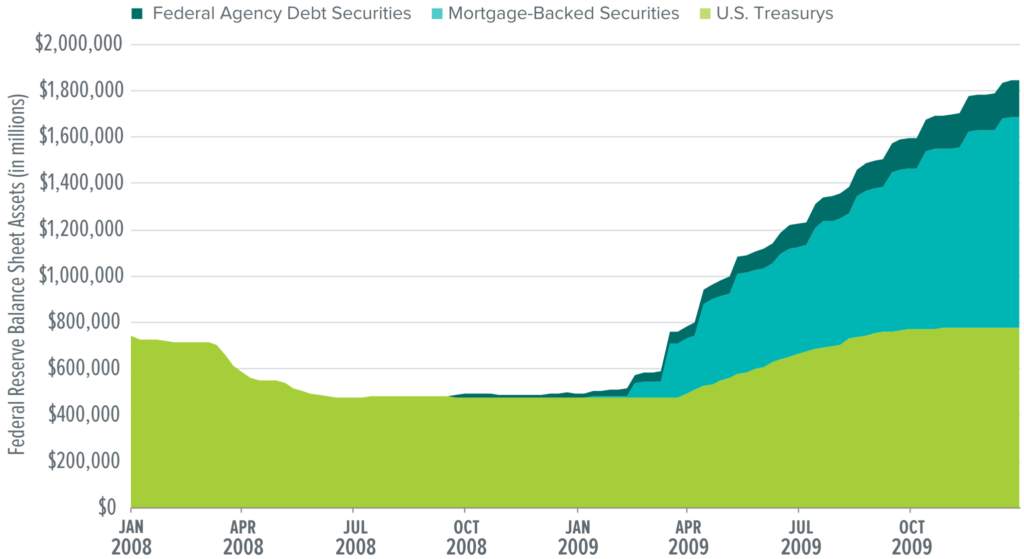
There are two ways to stop a runaway train: apply the emergency brakes or wait for it to derail.

Since derailment often results in a disaster, policymakers came at the first tactic from several different angles. The Federal Reserve's (Fed) late-November 2008 announcement of quantitative easing (QE) and mid-December move to near-zero interest rates, along with the rollout of Troubled-Asset Relief Program (TARP) funds, corresponded with a multi-week pause in the selloff through the end of the year. When selling resumed in early 2009, volatility had softened and price declines weren't as steep.

The March 2009 bottom coincided with policy developments that likely played an important role in tipping sentiment from lower-conviction selling to buying.

- QE asset purchases: The Fed's effort to buy Treasury, mortgage and government-sponsored agency assets on the open market expanded sharply in early March. Securities held outright on the Fed's balance sheet grew by $200 billion during March alone (Exhibit 1).
- Term Auction Facility: The largest of the Fed's crisis-era liquidity programs at the time peaked in size during the weeks of March 4 and 11 with about $500 billion in loans. The program was conducted in close coordination with other major central banks to meet demand for short-term U.S. dollar liquidity.
- American Recovery and Reinvestment Act: Signed by then-President Obama in mid-February 2009, more than one-third of its initial $790 billion price tag was dedicated to tax cuts and it would generate $114 billion in outlays during 2009.

Exhibit 1: Securities Held Outright by the Federal Reserve



Source: Board of Governors of the Federal Reserve System

This multi-front effort to push liquidity into the financial system began thawing frozen lending markets. Credit spreads, which indicate the increased costs for riskier borrowers, started to tumble in early March and returned to relatively normal levels by the end of 2009, with stock-market volatility moving in tandem.

Exhibit 2: Corporate Bond Spreads and U.S. Equity Volatility

Source: ICE Benchmark Administration Limited (IBA), Cboe

In addition to government efforts, the economy received a major boost from the collapse in oil prices during the depths of the financial crisis. It's no surprise that an inflation-sensitive commodity fared poorly in an environment that produced the sharpest deflationary readings in at least 60 years. West-Texas Intermediate crude oil peaked at $145 per barrel in July 2008 before collapsing to $31 in late-December, and then bounced along the bottom for most of first-quarter 2009.

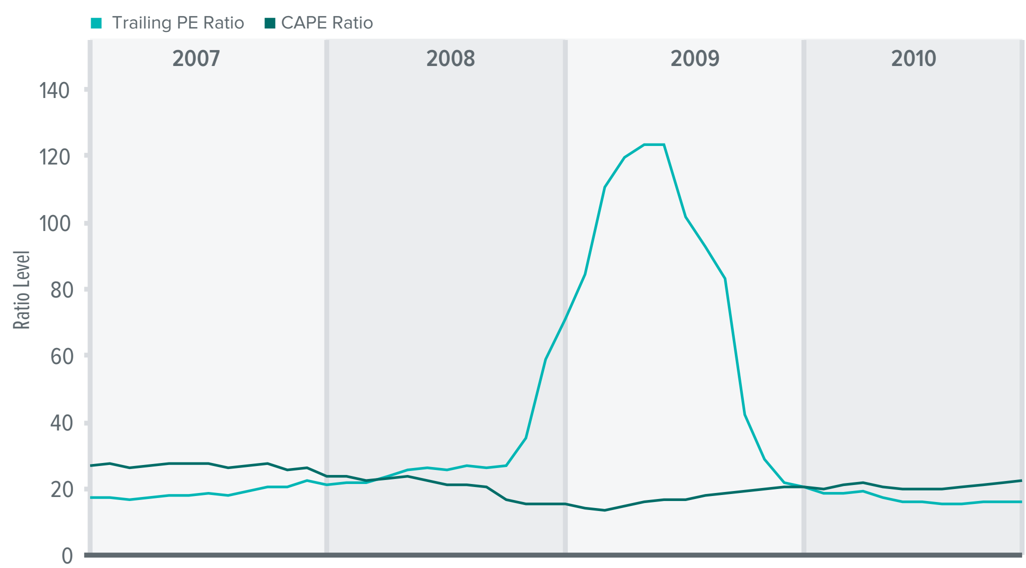
SEI's View

Market bottoms are created by low asset prices, so it's easy to assume that stocks were cheap in March 2009. That assessment, of course depends on the valuation method being used.

Using the price to earnings ratio to evaluate asset prices shows that, although equity prices collapsed, corporate profits actually fell at a much sharper rate. Accordingly, by this valuation method, stocks remained quite expensive relative to their recent earnings. For about five months in 2009, beginning in March, the S&P 500 sported a trailing price to earnings ratio north of 100. Not exactly a heart-warming buy signal given that the historical average was 18.5 over the 30 years prior to 2008.

Looked at using the cyclically adjusted price-to-earnings (CAPE) ratio (which uses 10-year average earnings to smooth out periodic abnormalities and provide a more stable picture of valuations) the picture is much different. In March 2009, this measure fell to its lowest level in more than 20 years, and it has spent the following decade expanding. Through this longer-term view—which we advise in all market environments but will admit is much more challenging when the going gets tough—investors might have recognized the opportunity developing at the bottom.

Exhibit 3: Valuations Depend on Frame of Reference



Source: Robert Shiller

"The lost decade" may be the most memorable headline from the bear-market bottom 10 years ago. But there were also references to the period as a "generational low" that—intentional or not—hinted at the rare opportunity. Ten years later, it's hard to refute the wisdom of maintaining a long-term perspective in challenging market environments.

Exhibit 4: An Extended Timeline of the Global Financial Crisis

*S&P/Case-Shiller 20-City Composite Index.

Index Definitions

S&P 500 Index: The S&P 500 Index is a market-capitalization weighted index that consists of 500 publicly traded large U.S. companies that are considered representative of the broad U.S. stock market.

Glossary

Price to Earnings Ratio: Equal to market capitalization divided by after-tax earnings. The higher the P/E ratio, the more the market is willing to pay for each dollar of annual earnings.

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice and is intended for educational purposes only.

Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

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