StoneRidge Wealth Management
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The Quarterly Profit

The Fall of 2008

The Lehman Bros. Bankruptcy and The Great Recession

Ten years is a long time, and its easy to forget what happened after Lehman Bros. declared bankruptcy on September 15, 2008. Our housing bubble blew and the house of cards collapsed, sending our economy and the economies of most wealthy nations spiraling into The Great Recession. $15 trillion of household wealth disappeared. Businesses cut back or went bankrupt. 750,000 jobs were lost each month until a total of 9 million workers had lost their jobs. In one year, Elkhart Indiana's unemployment rate rose from 5.2% to 19.1%. Nearly 200 commercial banks had failed by the end of 2009, and another 250 failed by the end of 2011. The Dow dropped more than 50% from its 2007 high, and more than 10 million families lost their homes. The US government bailed out much of the auto industry, and took control of AIG, Fannie Mae and Freddie Mac. Merrill Lynch was insolvent and was taken over by Bank of America. Morgan Stanley /Smith Barney was taken over by Citi Group. Washington Mutual and Wachovia were insolvent and were absorbed by Wells Fargo. The Federal Govt. underwrote each of these mergers and take overs, and was highly criticized for bailing out the investment banks that caused much of the crisis in the first place. However, the collapse was so severe that if the Federal Govt. had not stepped in, the situation might well have spun completely out of control. Most leading economists believe that we were truly on the brink of a Global Depression.

What caused the crisis? It all started with the global money slosh, brought on by the astonishing pace of globalization over the last twenty years. Think of the financial world as a huge pan of liquid money, sloshing around the globe in search of higher return and relative safety. The Middle East wanted to protect its oil profits, China wanted to diversify to safer assets, and Germany and Japan were looking for a safe place to invest the huge amounts of personal savings by their aging populations. Interest rates in the U.S. were rising and Uncle Sam was still considered one of the safest havens in the world. The money began to pour in and there seemed to be no end to it. The US housing industry took off like a shot because of the magnitude of cheap money available. It is estimated that from 2004 through 2006, the U.S housing and mortgage industry sucked up two of every three savings dollars from China, Japan, Germany, Saudi Arabia, and Russia. Housing starts hit 2.1 million annually, which exceeded normal demand by about 40%. Investors around the world fell for the allure of securities backed by US real estate. After all, US real estate may not have been guaranteed, but at least it was safe; except that it wasn't. (continue...)

We all know that U.S. homeowners were using their growing real estate equity as private ATM Machines, and the total U.S. mortgage debt as a percentage of our Gross Domestic Product climbed to unprecedented levels. Household debt to GDP had been roughly stable at about 80% through 1993, but by 2003 it had risen to 120% and by 2006 to 130%. Although the housing industry was running out of new buyers, there seemed to be limitless money waiting to be invested. New and aggressive mortgages were being offered to home buyers who should never have been part of the mortgage lending equation, hence the term “sub-prime” for less than acceptable credit scores. Liars Loans and Ninja Loans (No Income, Job or Assets) kept the mortgage wheels rolling as the traditional ratios of mortgage loans to income were dismissed.

Investment banks including Lehman Bros., Merrill Lynch, Morgan Stanley, and Bear Stearns produced highly speculative securities to take advantage of the continuing global demand. Mortgages with similar attributes of region, terms of maturity and credit risk were deposited in dedicated corporations structured in the form of trusts. These were called CMO’s, (collateralized mortgage obligations) meaning that the real estate within the trusts was the collateral for those who invested in the trusts. The trust managers then issued securities that were claims on the income and principal of the CMO’s and marketed them throughout the world. However, the financiers on wall street went a step further and created another security called a CDO, or Collateralized Debt Obligation. Despite the fact that the investors in the CMO’s already had first rights to the interest and principal of the real estate within the trusts, the investment banks sold that interest and principal again. They took the CMO’s and sliced and diced them into different levels of risk and maturity and sold them to investors who were willing to buy second, third, or last priorities on the underlying mortgages.

Where it went from questionable to bizarre is that the credit ratings agencies rated the quality (relative safety) of the CDO’s above the CMO’s themselves. When it all began to unravel and the mortgage market collapsed, it was exposed that the investment banks had paid the credit rating companies huge sums for AAA ratings on these highly speculative investments. The ratings companies continued to participate in the charade because if they didn’t, they would lose the fees on this lucrative business to their competitors.

Warnings lights were flashing in the financial arenas and some economists were alarmed that we were heading for a fall. But others argued that “this time was different”. (a sentiment common to all bubbles) These voices included Alan Greenspan and Ben Bernanke, former Chairmen of the Federal Reserve. There was a general conceit that our financial systems were virtually invincible, and so sophisticated and fail-safe that a housing bust could not possibly affect the markets and the broad economy. Even the IMF (International Monetary Fund) in April 2007 stated that risks to the global economy had become extremely low, and that there were no great worries. (continue...)

The music kept playing until September 15, 2008 when Lehman Bros. filed bankruptcy. This was the pivotal event that burst the bubble and caused the house of cards to collapse. As US home construction abruptly stopped and millions of homeowners couldn't meet their mortgage obligations, investment banks all over the world suddenly found themselves holding many billions of dollars of CDO's and CMO's with no buyers in sight. Cash became scarce, traditional consumer and business lending slowed, and the global financial gears ground to a halt.

So here we sit 10 years later, wondering if the markets are overvalued and whether another bubble might be developing. Anything is possible of course, but my personal opinion is that we will continue to enjoy positive trending in the economy and the markets for the next several years. I agree with those economists who maintain that we did not fully recover from 2008's Great Recession until the early spring of 2017, and that we may be in the early stages of the next growth cycle. While talking heads claim that our bull market may be the longest in history, they might consider that the bull climbed to the Dow's 14,000 level for the first time in October of 2007, but didn't regain that plateau until February of 2013; I suggest that our current bull market began then. Much is being made of the Dow at 26,000 and that the markets are overheated. Why? As we approach Labor Day, the Dow is up about 3.5% Year to Date and the S&P is up about 6.5%; solid returns despite the political issues, but hardly overheated. Let's never forget the lessons from The Great Recession as we consider the possibility of market loss. But equally important, let's embrace the probability of market growth, and strategize for both.

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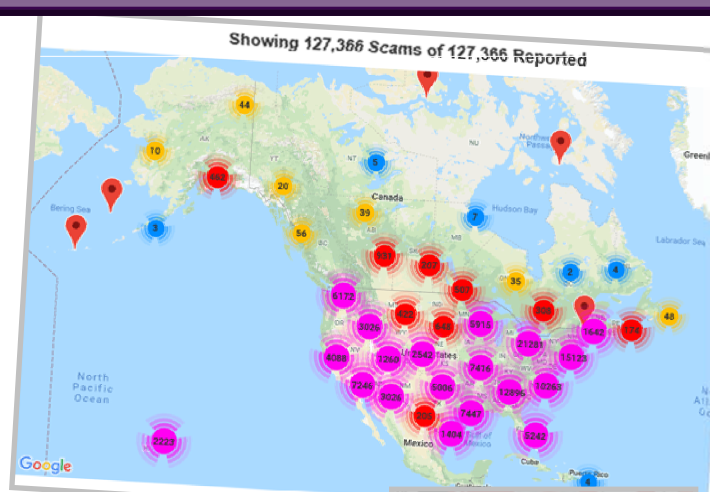
Protecting Yourself– Tools to Help...

How can you tell the difference between the truth or a scam? There are currently 127,366 reported scams to the BBB. We live in a digital world with social media, phone predators, fake tech support, tax collectors, email phishing, and mailbox surfing, please protect yourself. We are happy to help at StoneRidge! As a reminder, please bring any personal documents you wish to shred to your scheduled appointment or stop by our Beaverton Office. You can research current scams and report news one at www.bbb.org



There are thousands of new scams every year, and you can't keep up with all of them (we know, we try!). But if you can just remember these TEN THINGS, you can avoid most scams and help protect yourself and your family.

10 Steps to Avoid Scams

1. Never send money to someone you have never met face-to-face. Seriously, just don't ever do it. And really, really don't do it if they ask you to use wire transfer, a prepaid debit card, or a gift card (those cannot be traced and are as good as cash).

2. Don't click on links or open attachments in unsolicited email. Links can download malware onto your computer and/or steal your identity. Be cautious even with email that looks familiar; it could be fake.

3. Don't believe everything you see. Scammers are great at mimicking official seals, fonts, and other details. Just because a website or email looks official does not mean that it is. Even Caller ID can be faked.

4. Don't buy online unless the transaction is secure. Make sure the website has "https" in the URL (the extra s is for "secure") and a small lock icon on the address bar. Even then, the site could be shady. Check out the company first at bbb.org. Read reviews about the quality of the merchandise, and make sure you are not buying cheap and/or counterfeit goods.

5. Be extremely cautious when dealing with anyone you've met online. Scammers use dating websites, Craigslist, social media, and many other sites to reach potential targets. They can quickly feel like a friend or even a romantic partner, but that is part of the con to get you to trust them.

6. Never share personally identifiable information with someone who has contacted you unsolicited, whether it's over the phone, by email, on social media, even at your front door. This includes banking and credit card information, your birthdate, and Social Security/Social Insurance numbers.

7. Don't be pressured to act immediately. Scammers typically try to make you think something is scarce or a limited time offer. They want to push you into action before you have time to think or to discuss it with a family member, friend, or financial advisor. High-pressure sales tactics are also used by some legitimate businesses, but it's never a good idea to make an important decision quickly.

8. Use secure, traceable transactions when making payments for goods, services, taxes, and debts. Do not pay by wire transfer, prepaid money card, gift card, or other non-traditional payment method. Say no to cash-only deals, high pressure sales tactics, high upfront payments, overpayments, and handshake deals without a contract.

9. Whenever possible, work with local businesses that have proper identification, licensing, and insurance, especially contractors who will be coming into your home or anyone dealing with your money or sensitive information. Check them out at bbb.org to see what other consumers have experienced.

10. Be cautious about what you share on social media and consider only connecting with people you already know. Be sure to use privacy settings on all social media and online accounts. Imposters often get information about their targets from their online interactions, and can make themselves sound like a friend or family member because they know so much about you.

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