



Surviving the Tsunami

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Preface

“If I mistake not, the distress...was produced by an enemy more formidable than hostile armies; by a pestilence more deadly than fever or plague; by a visitation more destructive than the frosts of Spring or the blights of Summer. I believe that it was caused by a mountain load of DEBT.”



Edward Everett , 1794 - 1865

(Referring to the Panic of 1857)

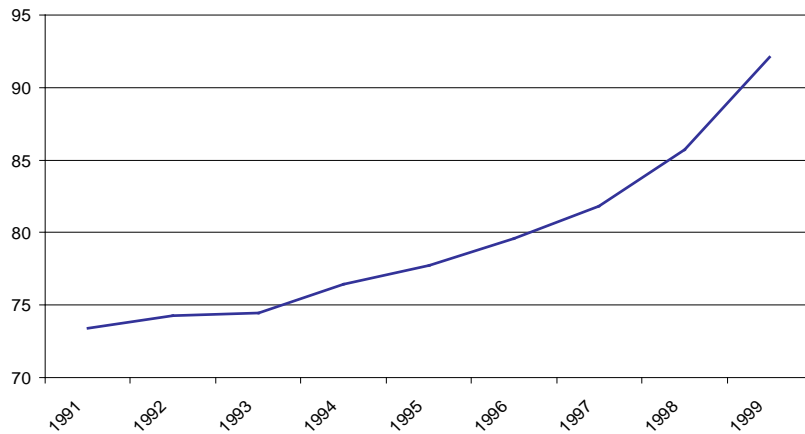
Outline

- Timeline of the crisis
 - The run-up: 1990s
 - The foundation: 2000 – 2006
 - The crises:
 - Subprime crisis: 2007H1
 - Credit crisis: Summer 2007
 - Financial crisis: 2008
 - Economic crisis: 2009
- Implications going forward
- Who's to blame?

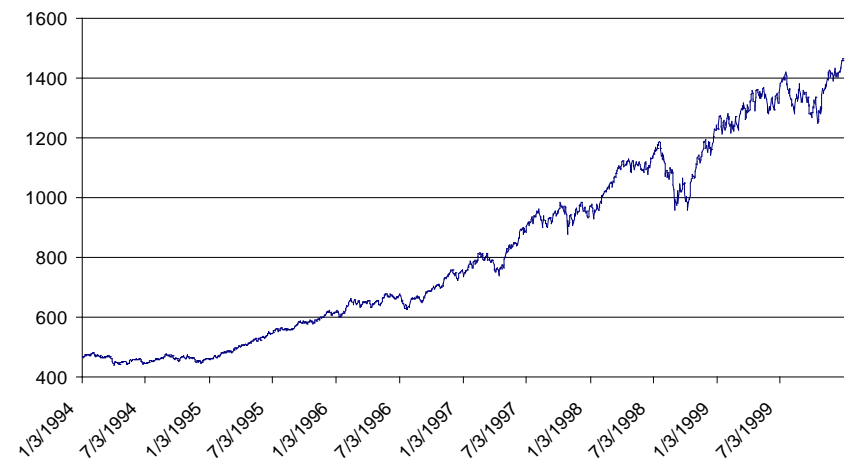
The run-up: 1990s

One-way markets

The good times were rolling
Case-Shiller Home Price Index



The good times were rolling
S&P 500 Equity Price Index



The New York Times

Fannie Mae Eases Credit to Aid Mortgage Lending

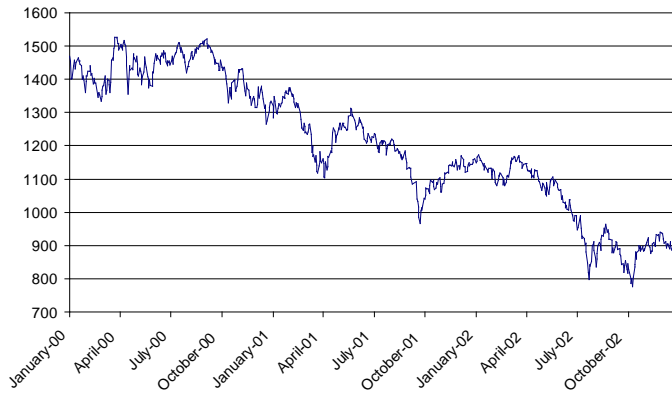
By STEVEN A. HOLMES

Published: September 30, 1999

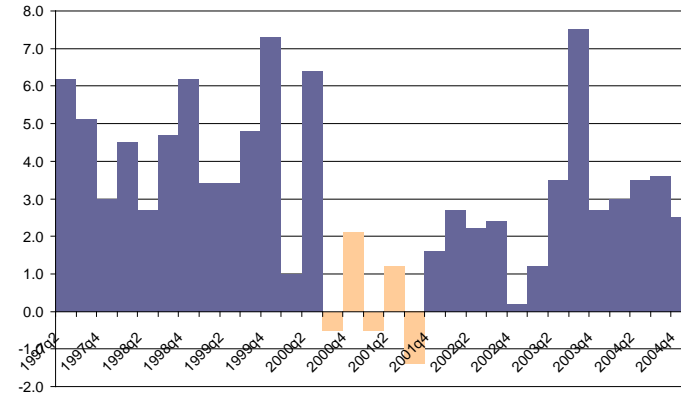
The foundation: 2000-2002

Three simultaneous events

S&P500 Equity Price Index



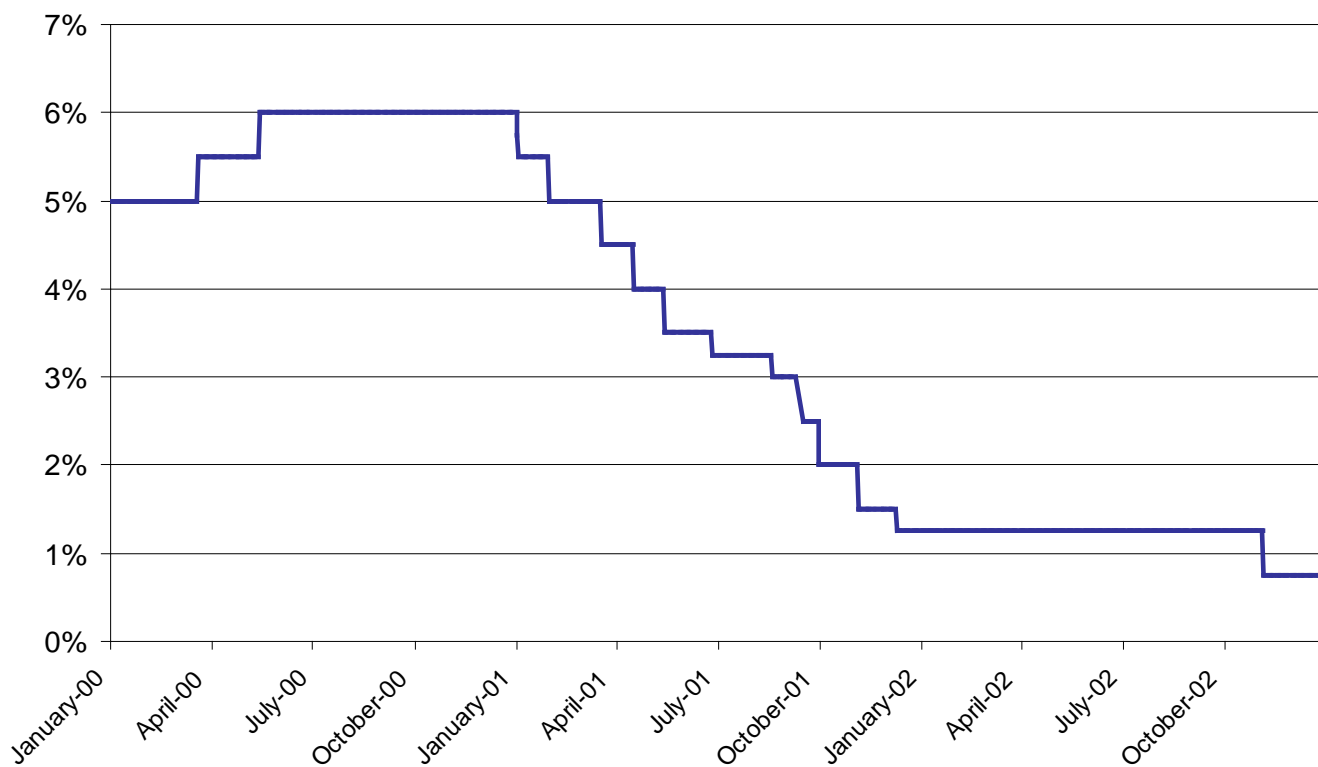
GDP Growth Rate



The foundation: 2000-2002

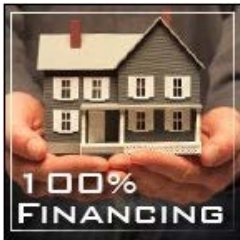
The Fed's response

Federal Reserve Discount Rate



The foundation: 2002-2006

Era of easy money



No Fees Home Equity Line of Credit

Thinking About
REFINANCING?
Got **Debt?**
Got **Dreams?**
Need **Cash?**
Fill out our Short Form for
4 FREE Quotes from Top
Lenders in 60 Seconds
No Obligation - 100% Free & Rollable - On Site

Don't let your mortgage get in the way.

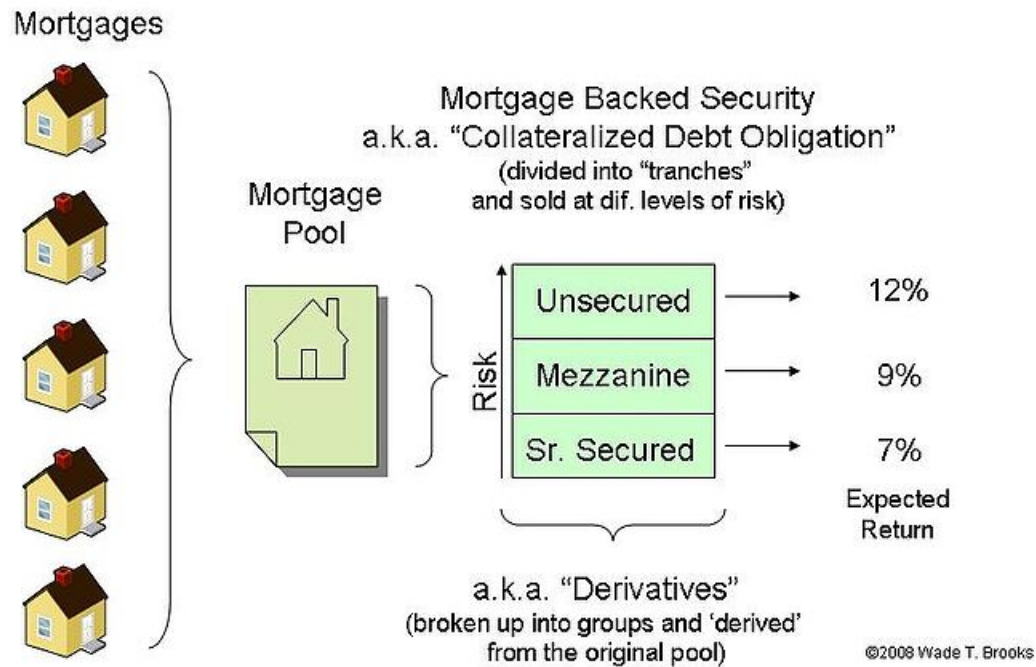
Click here to see if you could shrink your mortgage



Bob Hope: "A bank is a place that will lend you money if you can prove you don't need it."

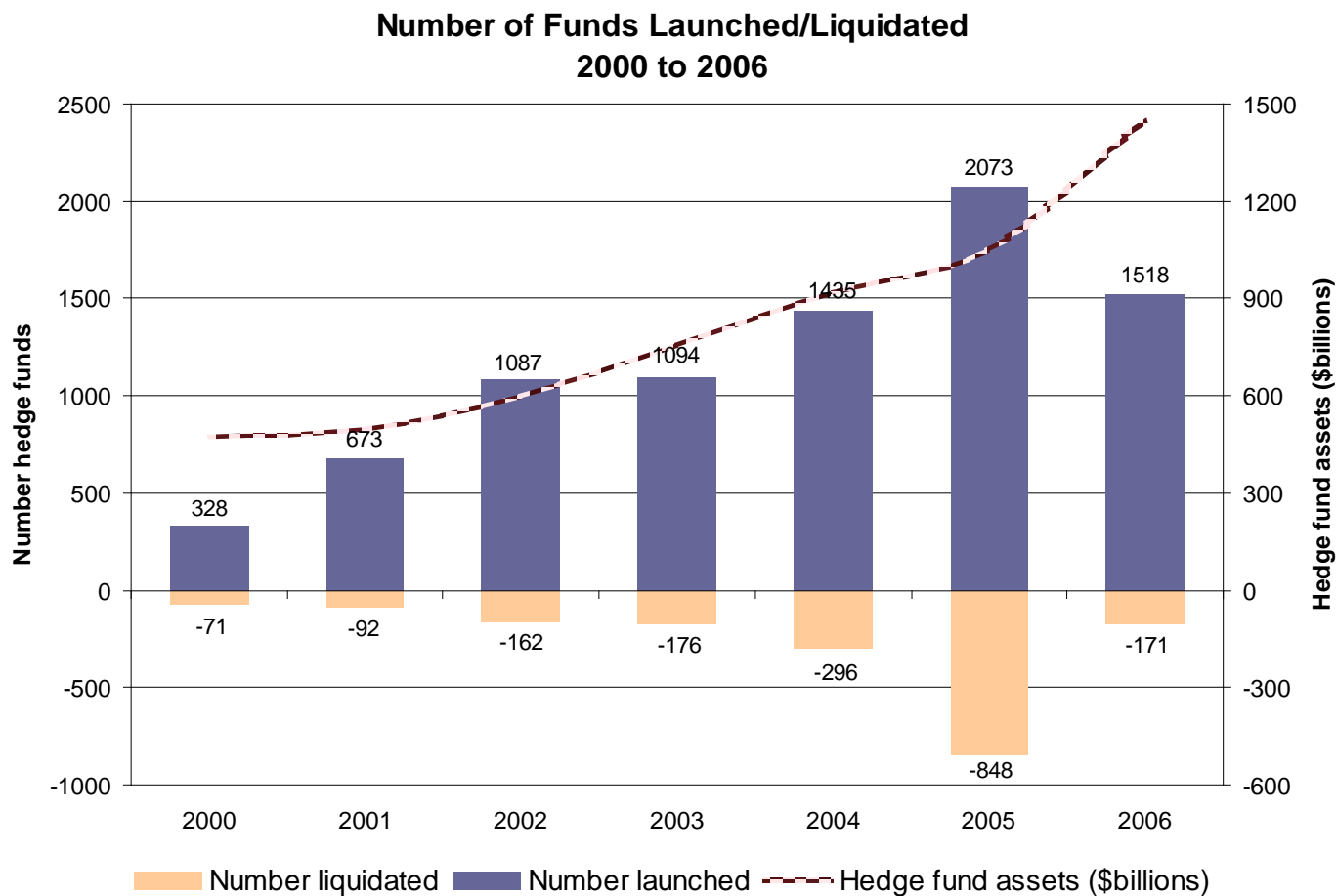
An aside: Securitization

Mortgages turned into tradable securities



The foundation: 2002-2006

Love affair with leverage



Subprime crisis begins: 2007H1

Mortgage companies failing and banks in trouble



M. Twain: "Get your facts first. Then you can distort them as much as you please."

Subprime crisis becomes a credit crisis: 2007

A lesson in contagion



Dillon Read & Co.



BEAR STEARNS



SENTINEL



Being too far ahead of your time is indistinguishable from being wrong.

The credit crisis blossoms: Summer 2007

- Liquidity dries up
 - Lenders stop providing financing
 - Banks hoard cash
- Central banks inject hundreds of billions of dollars into financial system
- Everyone's hit
 - Credit markets seized up
 - Equity markets impacted
 - Hedge funds delever due to volatility spike
 - Losses in credit space force MultiStrat funds to reduce their market neutral allocations
 - Margin calls cause further de-levering
 - Currency markets impacted
 - Carry unwinds
 - Real estate markets impacted
 - Housing prices slide



Credit crisis becomes a financial crisis: 2008



JPMORGAN CHASE & CO.

Gjedrem: "Concerted rate cuts were a strong card...with a two-hour impact."

Financial crisis becomes an economic crisis: 2008Q4

- Crisis deepens the week of Oct 6-10
- No signs of letting up in Q4
 - All major banks everywhere in the developed world require support
 - Equities
 - Nikkei 225 back to 1982 levels
 - Poland down 50%
 - Russia down 70%
 - As of Nov 16, SP500 down 50% over 12 months
 - Extreme volatility in equity, currency, commodity markets
 - IMF bailing out Hungary, Ukraine, Iceland, Pakistan, Belarus
- As of Dec 24, Fed had “spent” \$1,200b on financial assets and emergency loans (x-TARP)
- Turns into an economic crisis
 - Auto sales plummet
 - Unemployment skyrocketing
 - All major economies – developed and emerging – in deep recessions
 - Response: Massive stimulus packages, exceeded only by the two world wars

Keynes: The markets can stay irrational longer than you can stay solvent.

Economic implications

Recession will be worse than consensus expects

- Consensus: Recovery begins this summer
- Three reasons that's a pipedream
 - Linked to a financial crisis
 - Wealth destruction
 - Ineffective stimulus
- Market implications

Long-run implications of the crisis

- The financial landscape has changed
 - Government regulation
 - Leverage and hedge funds
 - Entire sectors (and careers) have disappeared
 - New focus on risk modelling
 - Disappearance of investment banks
- Size and role of government
- Labor force implications



Who's to blame?

- Regulators
- Fed Reserve
- Wall Street
- Banks
- Ratings agencies
- Government
- Misplaced incentives
 - Bonus structure implies incentives are to maximize short-term gains
 - Credit ratings agencies paid by issuer of the MBS
 - Home appraisers paid by issuer of the mortgage
 - Securitization implies incentives are to maximize volume of loans and MBSs.
- Calvin

Fool me once...

FANNIE MAE TO LOOSEN RULES FOR HOME-LOAN REFINANCING

2009-02-05 17:07:59.999 GMT

BY JODY SHENN

Feb. 5 (Bloomberg) -- Fannie Mae, the mortgage-finance company under U.S. government control, will loosen rules for homeowners seeking to lower their loan payments by refinancing.

Fannie Mae will drop some credit-score requirements, reduce income-documentation standards and waive the need for appraisals in some cases, according to a notice yesterday to lenders posted on the Washington-based company's Web site. The changes apply to loans that the company owns or guarantees.

Fannie Mae's changes will include allowing borrowers ... to qualify for refinancing with credit scores below its 580 minimum. The program also lowers income-documentation requirements to one current pay stub, according to the notice.