Weekly Digest
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Investec
Wealth & Investment

The weekly insight into world stock markets

(Un)Happy Anniversaries

Two more or less notable anniversaries are celebrated this week. First, it's five most enjoyable years since I arrived at Investec. I have spent more time travelling around the country spreading the word than I expected to, but getting out and about is actually one of the more uplifting aspects of the job. Importantly it gets me away from "London-centric" thinking, but it's also highly informative to speak to a broad range of clients and intermediaries. Perhaps it says something about the long shadow of the financial crisis that most questions are still about what might go wrong next!

And that brings us to the more widely covered anniversary, the bankruptcy of Lehman Brothers on 15th September 2008. The increasingly concerning rumours over that weekend were certainly distracting, as were e-mails and texts from various bosses who were privy to the rescue negotiations – both my wife and I were working at Lehman, hardly a strategy designed to diversify employment risk! The upshot was that we drove into the office at 4am on Monday (not quite the first to arrive), and had everything we deemed valuable packed up in the car before the first reporters and camera crews had even got out of bed, let alone set up outside. Then we waited…

It's quite hard to describe the sense of shock that prevailed. Perhaps most peculiar was that here we were sitting on the giant trading floor of one of the most renowned (and aggressive) trading houses on one of the most momentous days in the history of financial markets… and no trading was going on! All the plugs had been pulled. Many colleagues were ashen faced, contemplating severe lifestyle retrenchment. The legend grew of one individual who had in the previous year triumphantly held on to his Lehman Brothers shares while leaving his ex-wife the measly family home in the divorce settlement. By lunchtime the place had become a feeding ground for head-hunters, but rather than coyly slipping out for a surreptitious coffee, everyone was completely open about their intentions and team members shared leads with each other.

As history records, the Japanese investment bank Nomura saw an opportunity to establish its brand in the European and Asian (ex-Japan) markets, and snapped up the business within a couple of weeks, locking in many key employees (yours truly not amongst them!) with generous guarantees. It was the most remarkable turnaround, although by 2016 Nomura had closed most of its European equities business.

Much will be written about Lehman's demise this week, some of it from a personal perspective, but much more from the perspective of financial markets. Lehman's bankruptcy has become shorthand for the whole financial crisis, although in many respects it is just one chapter in a long story. Lehman's culture and highly leveraged balance sheet might have been bywords for the excesses of the times, but they were far from unique. Its place in history was sealed by being in the wrong place at the wrong time. JP Morgan had already had its fingers burnt buying Bear Stearns, and Bank of America had its hands full with Merrill Lynch. Regulators decided that Barclays did not have the capacity to rescue Lehman (although it did end up buying the US business out of bankruptcy), and Goldman Sachs and Morgan Stanley were in similarly dire straits – they were helped to survive by being granted expedited commercial banking licences, a route to safety that was denied to Lehman. The US government decided the following day to bail out AIG, the insurance company, because it provided insurance against the default of the mortgage-backed products that were at the heart of the crisis. Whether or not Lehman was deemed expendable to set an example to others, or whether it was denied support owing to the abrasive nature of its CEO, Dick Fuld, is moot. It happened.

There are two key final points to make. The first is that leverage and the mismatching of the duration of assets and liabilities were at the heart of the crisis. A lot of people bought houses they couldn't afford with long-term mortgages that were provided with funds that could be recalled overnight. Many of these mortgages were packaged into securities that were geared up with even more debt, and then sold on to financial institutions that borrowed even more money to buy them. This perilous equilibrium persisted for some time, but falling US house prices lit the fuse and the bomb went off when everyone in the financial system started to ask for their money back – Lehman's demise was the catalyst for that. The rot only stopped when governments and central banks committed to providing unlimited liquidity to the system. That's why they continue to promise similar action at the slightest hint of financial market stress. I would venture that such a vicious liquidity squeeze is highly improbable today.

The upshot of this, and the second point, is that the promise of endless liquidity invites the assumption of more risk. Starting in 1987 with the stock market crash, and persisting through the rescue of Long-Term Capital Management in 1998, the Y2K bug risk at the turn of the millennium and its response the Taper Tantrum in 2013, the Federal Reserve has bent over backwards to provide support for financial assets and the economy. However, it is inconceivable that economic cycles have been abolished. In fact, they constitute a healthy periodic cleansing of the system. Investors who sought riches in the more gnarly corners of emerging markets are currently being reacquainted with risk, and the same will eventually happen in more "grown up" economies. That doesn't necessitate another crisis, but it certainly keeps us on high alert for signs of a cyclical downturn.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Royal Mail	4.4%
Centrica	3.3%
BT Group	2.6%
Whitbread	2.5%
BAE Systems	2.3%
Barratt Developments	2.1%
Smith & Nephew	2.0%

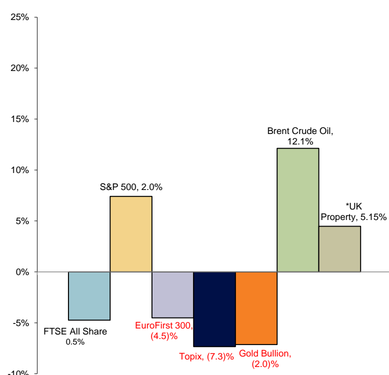
Source: FactSet

FTSE 100 Weekly Losers

WPP	-8.9%
Ocado Group	-8.8%
JUST EAT	-8.2%
Antofagasta	-7.6%
BHP Billiton	-7.6%
Fresnillo	-7.0%
Burberry Group	-6.4%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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