

# Ask the Advisor

*“The financial crisis – what happened?”*

*Mike in Canterbury*



The Perfect Storm, so aptly described in Sebastian Junger’s book of the same name, told the story of three huge storms coming together to form one mammoth storm with dire consequences. The financial crisis is a perfect storm.

The storm began brewing decades ago with a well-intentioned mandate for the expansion of subprime lending, loans made to less fortunate people who generally could not obtain loans because their ability to repay was questionable.

Most subprime loans were properly transacted by all parties involved. However, in the past decade the number of improperly transacted subprime loans skyrocketed, with plenty of deception on the part of lenders and even on the part of many borrowers. The

relaxation of subprime lending standards, driven in part by the new real estate fervor, precipitated a relaxation of lending standards for all loans – *making credit much easier to get.*

The new climate of more lenient lending standards combined with more relaxed oversight was, unfortunately, a breeding ground for greed. Real estate speculators, most of who were not even subprime to begin with, got in on the action by borrowing more money than they ever could have before to flip already overvalued properties for a profit.

Financial institutions joined the fray by packaging subprime loans and other mortgage-backed investments into complex investment instruments that were precariously over-

leveraged with the promise of implausibly high returns.

The result was a house of cards built on speculation, dangerously overvalued in the billions to trillions of dollars; the true underlying value, still unknown, is likely only a small fraction of what was the severely inflated value.

Subprime loans were only the tip of the iceberg. The real catalyst for disaster, greed aside, was government intervention, the lack of government intervention, the relaxation of lending standards followed by the contraction of lending standards, compounded with reckless real estate speculation and the subsequent real estate bubble that burst.

Add to that chaos, the dangerous leveraging of mortgage backed securities and Wall Street’s imprudent

compensation & investment practices, and all told, the result was a real mess, a perfect storm, a bubble, stratospherically valued beyond reason... *that simply burst.*

What can you do if you’re one of the millions of Main Street Investors cringing at the news? Assuming you are properly diversified and allocated, don’t worry - sit tight, don’t panic or do anything rash, and don’t get scared into selling just because the market is down.

The securities markets will eventually recover, and when they do, always remember to balance risk with return specific to your time horizon and tolerance for risk; always invest prudently based on what you need, and never invest speculatively based on what is going on in the market.

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