

# The Global Financial Crisis

Five Years On



January 2014

**Introduction** The onset of the Global Financial Crisis (GFC) just over five years ago might feel in some ways like a distant memory but it's certainly an experience New Zealand's trustees, fund managers and investors have not yet forgotten. We take a - not so nostalgic- look back at the GFC era, identifying key dates, reliving the extreme market volatility and distilling some lessons investors would do well to remember.

## Key dates: GFC peaks and troughs

- **9 August 2007** Banking system freezes as BNP ceases to support three hedge funds specialising in US mortgage-backed securities;
- **16 March 2008** Bear Sterns taken over by J P Morgan for \$10 US per share due to its losses on mortgage-backed securities. The share price had been \$172 US as late as January 2007;
- **15 September 2008** Lehman Brothers goes into Chapter 11 due to major losses;
- **6 March 2009** The Dow Jones Index falls to 6,626;
- **2 April 2009** In London, G20 agrees to a \$6 trillion fiscal package to support global economy including increased funding for the IMF;
- **9 May 2010** Focus moves from the private sector support to public sector as EU and IMF announce a support package for Greece.

## Investment markets as at 31 December 2008

The 2008 calendar year, while a tough year for equities, saw good returns for the fixed income market as interest rates fell and bond values rose. Losses incurred by NZ investors in the global markets were offset by falls in the NZ dollar (down 24%) as investors flocked to put their money into the US, viewing it as a global safe haven. The upper table to the right presents the 2008 results along with the results for 2006, which was the last year of strong investment performance. Markets were flat during the intervening year, 2007, reflecting the growing concern with the US sub-prime lending situation.

Sector		2008 %	2006 %
NZX50		-31.6	22.7
MSCI	Hedged	-38.3	20.0
	NZ\$	-21.4	16.5
NZ bonds		15.8	4.2
Global bonds		11.2	6.0
Cash		8.8	7.7

While the share market was still to fall further after December 2008 (hitting a low about March 2009), the lower table to the right compares various market indicators as that date and again five years later.

Year	Dec 08	Dec 13
Dow Jones	8,515	16,528
NZX 50	2,715	4,737
10 yr US bond yield	2.25%	3.04%
10 yr NZ bond yield	4.62%	4.71%

## Events since December 2008

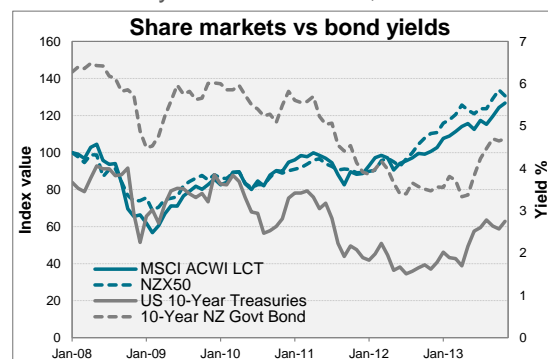
The role played by the public sector over the last five years in stabilising the global economies and putting them back on the road to recovery cannot be overstated. Perhaps the major feature of the GFC was the transference of the large amounts of private sector debt to the public sector as governments, in their efforts to maintain economic growth, came to the rescue of the private sector. Over the previous 20 years, with credit markets in full sway, the private sector had simply built up huge debts. The chart to the right illustrates the impact on the US, UK and NZ economies, using IMF data. The first set of numbers shows the different governments' net surplus/deficits over the period since 2007, revealing how the US and UK the deficits exceeded 10% of the government's revenue while in NZ we managed to contain the position to smaller levels. The second set of numbers show how real GDP fell in all three countries in the 2008 and 2009 years, to recover in 2010 albeit dipping again in 2011. Without the governments' actions, including the loose monetary policies, we could have seen more serious GDP falls as were experienced in the 1930s – see the table at the bottom of page 2.

Year	Government surplus/deficit			Growth rates		
	US %	UK %	NZ %	US %	UK %	NZ %
2007	-2.7	-2.8	3.2	1.8	3.4	3.5
2008	-6.5	-5.0	1.5	-0.3	-0.8	-0.8
2009	-12.9	-11.3	-1.5	-2.8	-5.2	-1.5
2010	-10.8	-10.0	-5.1	2.5	1.7	1.9
2011	-9.7	-7.8	-4.9	1.8	1.1	1.4
2012	-8.3	-7.9	-2.0	2.8	0.2	2.7
2013	-5.8	-6.1	-1.3	1.6	1.4	2.5

## Movement in investment markets since December 2008

As we know, the markets recovered and in the charts on page 2 we show the global and NZ share market and bond market changes over the period. The global shares are in local currency terms, eliminating the impact of changes in the NZ dollar.

Both the global and NZ share market numbers show a steady rise since early 2009. However, share markets fell sharply in June 2011 on the possibility Greece might default on its debt. Fears for the future of the Euro proved unwarranted as Merkel and Sarkozy hammered out a new deal to rescue Greece, but markets traded sideways as concerns continued over the Euro and rising unemployment. The 2011 year also saw major falls in 10-year US Treasuries. The small corrections in 2013 were due to the US Fed talking in May of ceasing its quantitative easing programme. The NZ market broadly followed the fortunes of the global markets although it did have a stronger 2012 than offshore jurisdictions. The global and NZ bond numbers also moved in sync, but again with more fluctuations in the global markets. The bond markets bottomed out in mid-2012 with 10-year US Treasury yields falling to 1.43% on 25 July 2012. An investor with a global government bond portfolio will have received a return of 6.7% per annum since January 2008.



Over the five-year period both equity and bond markets both fell and subsequently rose. There was a delay of nearly three years between the period when the share market started to recover and the bond market bottomed-out, providing a period when an investor could make money in both markets.

**So what to make of the last five years?**

It has certainly been a period where even the most astute and knowledgeable investor was challenged by events. The period saw markets experience major falls and a sustained if bumpy recovery. There were times when the recovery seemed fragile – the Dow Jones fell nearly 200 points to 10,817 on the 19th August 2011 in a little under a month. What is abundantly clear is that it would have been a different story without major government intervention. There is of course a cost to government intervention and the overhang of public debt arising will act as a restraint on future growth for a decade or more.

It goes without saying that if as an investor you believed in market timing and got it right you made a lot of money, but few would have achieved this. Those who found the fall in markets too difficult to contemplate, selling near the bottom and not re-entering until markets had recovered to a ‘safe level’ would similarly have lost significant sums over the period. With hindsight possibly the best and safest strategy was that pursued by investors who not only stayed invested but also topped up their allocation to shares as markets fell. But this strategy needed courage to implement even if one had a prescriptive approach already in place for such an event. What the period did demonstrate is the need for portfolios to be diversified to cushion the large falls in share markets – for example, sovereign bonds in an otherwise corporate bond portfolio, a spread of securities in any portfolio to cushion any specific falls in value and not too many global bank shares. The need for liquid assets to meet short-term calls was highlighted when investors with hedged global share positions needed to meet the monthly calls to cover losses as the NZ dollar fell. Despite the painful memories, the GFC has, we hope, left investors more aware of the risks in their portfolios and better placed to meet the specific investment objectives of their funds.

**GDP**

Year	US %	UK %
1930	-8.9	-0.9
1931	-7.7	-5.0
1932	-13.2	0.4
1933	-2.1	3.3
1934	7.6	6.2
1935	7.7	3.7
1936	14.2	4.9

**About Melville Jessup Weaver**

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