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"It's the End of the World as We Know It (And I Feel Fine)"

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This past weekend, my children and I were watching one of our favorite animated movies "Chicken Little"! In the movie, aliens descend on the town of Oakey Oaks to retrieve a young alien that got "lost" on earth. In one scene, R.E.M.'s "End of the World as We Know It" plays in the background. At that moment, the feeling of hopelessness that the End of the World conjures up, took me back a year to the time of Lehman Brothers.

Last month, the media had numerous special reports on last year's crisis. For most people in the business, the fall of Lehman is a defining moment that forever will serve as a benchmark in time. With the events of last September so vivid in my mind, I thought it almost therapeutic to share my personal perspective.

For many of us in Houston, the demise of Lehman Brothers was a double whammy. It was the week before Lehman collapsed that Hurricane Ike slammed the Texas Gulf Coast. The impact was so severe that much of Houston was without power for almost two weeks. After a few days without power, my family abandoned me for air conditioning in Austin.

At that time, my only link to civilization at home was a small radio and a 15-year old pocket Casio TV with a one inch screen. That fateful weekend, I was glued to my Casio awaiting the good news that Barclay's or Bank of America would be buying Lehman Brothers. That news never came!

I sat in disbelief when it was reported that no deal would take place and that Lehman would be declaring bankruptcy. How could it be true? How could one of the greatest investment banks with arguably the best fixed income research be closing?

All of us in the business knew that the following Monday would be a crazy day. And, it was. But nothing prepared us for the ensuing events that happened over the next few months. The markets collapsed. And I mean just about **ALL** markets. Liquidity disappeared, T-bill yields went to zero and one of the largest money market funds "broke the buck."

The following box highlights a few market statistics from early August to late November of 2008. You can see extreme movements in all of the examples as it seemed that everything became highly correlated in one direction – South. Even worse, we could have filled this entire page with more examples. In the credit markets, the spreads on corporate bonds reached unimaginable levels that had not been experienced since the Depression. In stocks, almost six years of positive performance evaporated.

	3 Month T-bills	10 Year Treasury yields	10 Year (A) Financial spreads	10 Year (AAA) CMBS spreads	DJIA	VIX
Aug-08	1.85	4.05	225	309	11782	19
Nov-08	0.01	2.92	585	1383	7552	80
% Price Change		9.2	-29.5	-88.1	-35.9	

Source: Bloomberg

For all practical purposes, we then witnessed the collapse of other titans including AIG, Washington Mutual and Citigroup. The nightmare continued as we watched in disbelief as Goldman Sachs and Morgan Stanley were on the edge of collapse themselves. We would go to work wondering "Who's next?" Then, the answer came – Chrysler and GM.

With the extreme market reaction to Lehman's bankruptcy, the Treasury and the Federal Reserve responded with wartime urgency and academic brilliance. They moved with amazing speed as if capitalism itself was on the brink. Numerous programs were created including TAF, TSLF, TARP, TALF and CPFF to name a few. It was all hands on deck! We would go to work wondering "What's next?" Once again, the answer came – quantitative easing.

It is disappointing to hear some of the media chatter and criticism towards Paulson, Bernanke, Geithner and other policymakers. These detractors either have short memories or are not in the business. They clearly are unwilling to accept how close we really did come to the "brink."

So, have some investors finally learned the virtues of high quality investments and the importance of credit risk, counterparty risk and liquidity? Do they now understand that the only true valuation for an asset is at what price you CAN sell it? Hopefully, the answers are yes – at least until the next crisis. Remember, many of those same investors had forgotten the stock market crash in 1987, the savings and loan crisis, Long-Term Capital Management, the Asian contagion and inverse floaters.

Last September may have seemed like the "End of the World as We Know It." And as R.E.M. adds, "And I Feel Fine." And, so do I with the leadership at the Treasury and the Federal Reserve.

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