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Legacy of the Financial Crisis: TBD (Resilience)

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Everywhere I look this week, the media is talking about changes in the financial environment since Lehman Brothers was allowed to declare bankruptcy five years ago. In today's high speed world, five years seems like a long time. But in historical terms it is more like a blink of the eye. If we look at past crises, five years was not enough time to even understand what had happened (and was continuing to happen). In 1934 the Great Depression was still in its early stages, with a second recession and many new regulations yet to come. The Roosevelt administration was just getting started, and their approach has been referred to as throwing darts and keeping the programs that seemed to work. It's intriguing to me that one of their initiatives, OASDHI (Social Security and its Medicare offshoot), is tied to many of the government debt issues today. These entitlements are the truly long-term sapling planted by FDR that have yet to play out and will ultimately determine his legacy.

Several situations exist today that have yet to fully play out and will ultimately determine the legacy of the recent financial crisis.

- Some debt levels have come down, mainly for the US consumer, but governmental debt remains high and developed countries continue to operate unsustainable entitlement programs.
- The Federal Reserve continues to manipulate interest rates, causing confusion in the market (for example, residential mortgages recently offered lower rates from private writers than for government guaranteed loans). When the current Quantitative Easing program is tapered, markets will react swiftly.
- Money market funds are struggling to offer positive returns due to the low interest rate environment, and have been taking risks in their underlying assets that would surprise those who own these funds primarily as replacements for cash. This is a good place to look for asset bubbles.
- Too big to fail has gotten only worse through "encouraged" acquisitions of undercapitalized banks by other big banks. Concentration risk is higher now than ever before.
- Regulations were promised after the financial crisis of 2008, but lobbyists have successfully deferred or changed the Dodd-Frank rules with a complex and confusing result. I believe this is similar to the 1930s, when only a second recession allowed the reformers to enact more strict regulations.

- Climate change and other longer term trends continue to progress down the path of change. Extreme weather events take resources away from production. So does proactive preparation for future trends in sea level and ocean acidity.

Demographics play an important role in many of the proposed solutions, as baby boomers continue to dominate our financial future. Entitlement programs, workforce participation rates and home ownership will all be impacted as this generation ages.

We should not assume that the crisis has passed, but seek ways to soften the next crisis. Those who used common sense to keep leverage down and are lifetime learners are more resilient and will weather future financial storms better than those who only react to recent events.

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