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INVESTMENT INSTITUTE

Market Commentary

WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

# Twenty Percent Down

October 3, 2018

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Last Week's S&P 500 Index:
-0.5%

**Key takeaways**

- *The 10 year anniversary of the fall of Lehman Brothers brought back painful memories of the financial crisis to many investors.*
- *Too much leverage and not enough skin in the game almost always leads to a negative outcome.*

The conversation has died down over the last few weeks, but for a number of days the financial news headlines were swirling with stories surrounding the 10-year anniversary of Lehman Brothers filing for bankruptcy. That fateful day occurred on September 14, 2008. Depending on how you look at it, the event changed the world—at least for a good stretch of time. Many would argue we are still trying to work our way out of it. It's hard to argue with that line of reasoning when the Federal Reserve, after nearly three years and a total of eight rate hikes, still has the fed funds target back up only to a 2.0% to 2.25% range after dropping rates to virtually 0% in December 2008. And global central banks? They have hardly even started to "normalize" rates since the depths of the financial crisis.

But as the media coverage of the anniversary was rolled out, this strategist noticed that there was little attention paid to something very simple that could have possibly prevented, or at least lessened, the impact of the crisis. It's something I have rolled around in my mind many times over the last 10 years, and I am not the only one to voice this line of thinking.

Regular readers of this weekly piece know we like to look at complicated issues and break them down into their simplest components. Oftentimes it's a combination of the basics and a little common sense that gives the clearest view of the situation. And of all the issues we have tackled over the years, this one appears to be one of the most obvious. Yes, we can discuss the effects of mortgage derivatives and intertwined counterparty risks all we want, but the bottom line on the last decade's financial meltdown was that many homeowners, flippers, housing investors, and others caught on the wrong side of the housing tsunami were lacking one critical element: skin in the game.

Back in the mid-1980s when this strategist and his new spouse bought their first dwelling, the market (not the government) demanded that home buyers come up with a 20% down payment. If this down payment was borrowed from a parent or rich aunt or uncle, the lender needed to know the details. If it was a gift from anyone, paperwork had to be signed that stated nothing had to be paid back. Of course, there was always mortgage insurance, which was required for those putting down less than 20%. But that also made qualifying for the loan a lot tougher. It would surprise many currently in their 20s and 30s to learn you had to come up with a lot of cash to buy your piece of the American Dream.

But too much leverage and not enough skin in the game is always a bad (and sometimes lethal) combination. Loans of 125% of equity. Zero down. Remember those? But home values never go down. Yeah, right. Have a problem? Just walk away. The shocking thing is the government is still guaranteeing Federal Housing Administration (FHA) loans that have as little as 3.5% down. I'm not kidding.

But a simple home-buying concept could have possibly spared the globe much of the pain from the financial crisis. This strategist can sum it up in three words: twenty percent down.

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