A decade of recovery

On the 10-year anniversary of the financial crisis, Sunniva Kolostyak explores the impact and lessons from the market crash

Summary
- Despite still not being back to pre-crisis levels in some areas, the market is overall stronger since the financial crisis.
- Over the past 10 years, schemes have seen low growth and interest rates but regulations have made it safer for savers.
- Risk management has become more transparent.
- The next crisis will come from an area where conventional wisdom is wrong.

"The global financial crisis was the story of an over-leveraged, interconnected banking system, just waiting for a shock significant enough to bring the whole system to a crisis point."

That is at least how Epoch Investment Partners managing director and global portfolio manager Kevin Hebner sees it. The market crash in 2008 is often defined by the collapse of Lehman Brothers, which on the 15 September had its 10 year anniversary. The collapse unleashed a wave of chaos across global markets, leading to a decade of exceptionally loose monetary policy, according Hargreaves Lansdown's report.

"In the UK, it was also the catalyst for the government bailout of RBS and Lloyds, after the latter was persuaded to rescue HBOS just days after Lehman filed for bankruptcy," senior analyst Laith Khalaf explains.

The collapse is what some call the darkest period of the financial crisis. When the bank filed for bankruptcy, the global market threatened to cave in on itself, leading to a 4 per cent fall in the FTSE 100 and a 5 per cent fall in the S&P 500. Four days later the UK stock market had lost 9.5 per cent of its value and by Christmas the market had dropped almost a quarter.

According to Hargreaves Lansdown, £10,000 invested in the FTSE All Share just before Lehman's collapse was worth just £6,581 six months later. This has, however, since been reversed, as the same £10,000 would now be worth £14,893 without including dividends, and £21,352 with dividends reinvested.

But not everything is back to pre-crisis levels. As the deepest of the seven recessions since the 1950s, the 2008 crash caused the economic output to fall by 6.1 per cent, and it took 21 quarters for GDP to recover, according to ONS data. Unemployment, which rose to 8.5 per cent after the crash, has since receded to 4 per cent, but real wages are still below the levels seen in the period leading to the meltdown.

Low growth

The wide-ranging implications of the market crash reached the pensions industry as well. PLSA director of policy and research Nigel Peaple says one of the key consequences for schemes in the UK was a sustained period of low growth and low interest rates.

But it is not all bad, he points out. The last decade has led to a significant amount of new regulations that were aimed to provide "greater security and transparency across financial services".

"In the same period we've seen some fundamental changes within the pensions landscape, such as automatic enrolment – which has brought 10 million members into mainly defined contribution workplace pension saving –

and the further closure of many private sector defined benefit schemes to future accrual," Peaple says.

Final salary pension schemes saw a significant rise in pension liabilities as the gilt yields were driven to a record low following the crisis in a bid to ensue monetary policy, according to Bloomberg and the Pension Protection Fund (PPF). The 10-year gilt yield started at 4.5 per cent and fell to around 3 per cent directly after. It has since fallen below 2 per cent after the eurozone debt crisis, and to a little over 0.5 per cent after the EU referendum.

While lower interest payments on government debt is good for the treasury, some defined benefit schemes have, according to the PPF, seen deficits widen and have faced calls from their pension trustees to add more money to the pot.

Since the collapse, a typical gilt fund has produced a total return of 71 per cent for investors, Khalaf says. "It's difficult to see this trend continuing, with UK monetary policy tightening, albeit at a glacial pace. Unless that is, the UK suffers another economic shock, which would see safe havens like gilts rise in value again."

Learning from mistakes

While plausible, another economic shock would not strike in the same place, the industry claims, as the lessons learnt in the past 10 years would prohibit that. Barings head of macroeconomic and geopolitical research Christopher Smart says there are several top lessons to take away from the collapse of Lehman Brothers, first being the laws of gravity.

"When something falls from a great height, it needs a great deal of cushion to absorb the impact. Banks that were far too levered could hardly be expected to survive the impact – and they didn't. There will always be debates about the correct amount of loss-absorbing capital to have on hand, but it is almost always more than you think."

He also mentions that sound plumbing is another good investment as "the establishment of central clearing houses for derivatives represents a marked improvement in financial transparency," meaning it no longer casts doubt on flows through the entire system if a counterparty has an issue.

Smart also explains that too much regulation naturally strangles both innovation and growth and that good leadership matters as humans are emotional. Kempen Capital Management senior portfolio manager Rob Scammell agrees, saying the economy and financial markets will always be at the mercy of human nature and the debt cycle – but that over the past 10 years, pension funds have developed to become more resilient to their effects.

Before, Scammell points out, companies were worried about the solvency of counter parties and the quality of the collateral they posted. "Now with central clearing and collateral posted mostly in cash or high quality sovereign bonds derivative risk management has become notably more transparent."

The most forward-thinking schemes, with a clear distinction between how trustees dealt with the challenges of the crash, have lowered equity allocations and increased its LDI allocation following strategy reviews, he continues.

"It also explains the increasing popularity of alternative assets that provide fixed cashflows often linked to real assets, such as infrastructure," Scammell notes. But change has not been universal. "Some schemes still hope for a return of 2005 with high long-dated yields and rising equity valuations."

RBC Global Asset Management head of EMEA business development Paul Williams says that in terms of pension funds, there has certainly been a welcome focus on what positive impact asset managers are having on their clients.

"A focus on transparency, client protection, fee compression and the large scale move towards passive management have all conspired to ensure managers are demonstrating the value they add to clients."

What next?

As the laws of gravity state, the market will come down again, but Smart explains that it is not a question of when it will happen but where. His money is on new forms of finance developing outside the banking system.

"Odds are, the next real crisis will come from areas where conventional wisdom turns out to be fundamentally wrong. Last time, we discovered that house prices in Las Vegas are not uncorrelated with those in Miami. We also learned that a package of questionable debt does not become AAA-rated just because someone agrees to insure it."

Despite not believing the next crisis is close, Hebner says he believes that severe liquidity disruptions, which were at the core of the last crisis, will be a key attribute.

"Bull runs do not die of old age, they are either killed by seismic events or more often by central banks with changing fiscal policy."

Peaple says the PLSA supports regulations and policies that will protect future pensioners. "With many employers facing an uncertain economic future, we welcome government proposals to strengthen protection for savers, improve scheme funding and governance, and to facilitate pension scheme consolidation."

But as BlackRock's head of UK strategic clients Andy Tunningley says: "The ball is now in the schemes' court and trustees need to recognise how they need to take steps to prepare for such events. If anything, schemes do need to take some responsibility for resilience themselves and not rely on the system being their backstop."

Written by Sunniva Kolostyak