This is Not 2008

The equity market sell off has some analysts claiming it is the beginning of the next bear market, and prognosticating a major downturn similar to the 2008 financial crisis. Ignoring that these same "experts" have been calling for a bear market for years now, we believe the comparison to the 2008 financial crisis is off the mark, as we do not see the same signs that were present in 2008. In this month's publication, we examine the financial conditions of the 2008 financial crisis and contrast those to today, to show why we don't think it is 2008 all over again.

History of Bear Markets

Before examining the financial conditions, let's first look at historical bear markets to help frame the discussion. Bear markets are generally defined as a 20% decline from a previous peak. We tend to categorize bear markets into three types – recession, non-recession, and financial crisis bear markets. Since 1945, there have been 13 bear markets, 8 of which occurred with a recession, and 5 without. Of the 8 recession bear markets, one was a financial crisis (2008), which we define as a 50%+ decline. With that bear market still fresh in our minds, some notable "bears" are pointing to 2008 as the roadmap for the next bear market. History suggests otherwise.

From the table, we note that recession bear markets tend to be longer and deeper than non-recession bear markets. On average, recession bear markets see declines of 36% and last 20 months, while non-recession bear markets experience average declines of 24% and last 8 months. Financial crises, such as the Great Depression and the 2008 financial crisis, are obviously the most deleterious with declines in excess of 50%. For example, the S&P 500 declined 57% during the 2008 financial crisis and experienced numerous 50% declines during the Great Depression. The key points here are that:

1) financial crises are very rare;
2) recession bear markets are worse than non-recession bear markets; and
3) non-recession bear markets see average declines of 24%, and with the roughly 13% decline since the highs on the S&P 500, this would imply another 10% downside.

History Of Bear Markets

Market Peak Date	Market Bottom Date	Peak to Trough % Decline	Number of Months
11-Oct-07	9-Mar-09	-56.8%	17
24-Mar-00	9-Oct-02	-49.1%	31
17-Jul-98	8-Oct-98	-19.2%	3
16-Jul-90	11-Oct-90	-19.9%	3
25-Aug-87	4-Dec-87	-33.5%	3
28-Nov-80	12-Aug-82	-27.1%	21
21-Sep-76	6-Mar-78	-19.4%	18
11-Jan-73	3-Oct-74	-48.2%	21
29-Nov-68	26-May-70	-36.1%	18
9-Feb-66	7-Oct-66	-22.1%	8
12-Dec-61	26-Jun-62	-28.0%	6
2-Aug-56	22-Oct-57	-21.6%	15
29-May-46	13-Jun-49	-29.6%	36
Average Recession Bear Market		**-36.1%**	**20**
Average Non-recession Bear Market		**-24.4%**	**8**

Source: Bloomberg, Raymond James Ltd. Note: Recession bear markets are shaded light grey.

We continue to believe that recession odds are low, and as we outline below, we do not see the potential for a financial crisis. That leaves us with a non-recession bear market, which if it were to occur, then historically speaking, downside from current levels should be limited.

Then and Now

The US housing market was the epicenter of the 2008 financial crisis, so our discussion should start there. We analyzed a number of different housing statistics, comparing levels just prior to the peak in 2008 to today. Overall, we believe the US housing market is much stronger today, and is showing few signs of excess or strain. For example, home prices soared over 70% in the five years leading up to the 2008 financial crisis, resulting in home affordability declining to a 15 year low in 2006. In contrast, US home prices are up 27% over the last five years, with affordability still high. Home delinquencies are quite low today at 5% versus 9% then (subprime borrowers at 16% versus 25% in 2006), housing starts remain low (1.1 mln versus 2.2 mln in 2006), and housing supply remains low at 3.9 months versus a peak of 11.1 months in 2008. Finally, on an aggregate basis, total US mortgage debt as a percentage of GDP today is at 57% versus 74% in 2009. Across the board, we see a stronger US housing market today which is unlikely to drag down the US economy, and lead to a financial crisis.

US Housing Market Much Stronger Today Than 2008

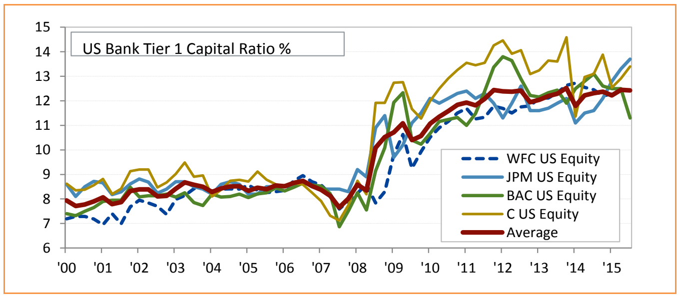
US Housing Statistics	Then	Now
Home Price Increase 5 Years Prior	73%	27%
Home Affordability Index (Higher the Better)	102	161
Home Deliquencies As a % of Total Loans	9%	5%
Subprime Deliquencies As a % of Total Loans	25%	16%
Total US Mortgage Debt As a % of GDP	74%	57%
Housing Starts in Millions	2.27	1.14
Housing Supply in Months	11.1	3.9

Source: Bloomberg, Raymond James Ltd. Note: Home prices are based on S&P/Case-Shiller Home Price Index.

Now it's important to emphasize that the cause of one crisis/bear market is generally not the cause of a subsequent one. For example, the 2000 bear market was due to the bursting of the technology bubble, while the subprime bubble caused the 2008 bear market. Some are pointing to the meltdown in the energy sector as the likely catalyst for the next bear market. However, the total loan/debt exposure for the US energy sector pales in comparison to the subprime market in 2008. According to BCA research, energy makes up about US$195 bln face value in the Barclays High Yield Index, and represents roughly 2% or US$190 bln in US bank loans. While this amount of at-risk debt is not immaterial, it is significantly lower than the $1.3 trillion of US subprime debt at its peak in 2007. While there are likely to be some defaults in the energy sector, which will have an impact on lenders and investors, it is unlikely to precipitate a financial crisis similar to 2008.

Another important reason why we believe a financial crisis will be avoided are the much improved balance sheets of the US banking sector. In 2008, the US banking system was the transmission mechanism for the deteriorating US subprime market and the global economy. As the subprime market imploded, extreme pressure was put on the US banks which were heavily exposed to this market through direct loans and derivatives. With banks being overleveraged and holding these distressed securities, it created a negative feedback loop which then spread globally. However, as a consequence of the financial crisis and new government legislation, US banks have significantly deleveraged their balance sheets and increased capital to help buffer against negative shocks. For example, the four largest US banks (Wells Fargo, JP Morgan, Bank of America, and Citigroup) have increased their Tier 1 capital ratios from roughly 8% in 2008 to over 12% today. US banks have significantly improved their balance sheets through equity raises, lower dividends, declining leverage, and holding higher percentages of government bonds. According to Credit Suisse's banking analyst "Bank balance sheets are as strong as they've been in decades....Earnings are more stable than they have been in decades, and capital ratios are at the highest levels in 80 years." As a result, we do not envision a bursting bubble scenario, like energy debt, which could lead to a negative feedback loop, like what occurred in 2008.

US Bank Balance Sheets Are In Better Shape Today



Source: Bloomberg, Raymond James Ltd.

This is not to say there are few risks to the global economy at present. One of the biggest risks over the long run remains the high global debt levels. While individual consumers and the broad corporate sector are in decent shape, government debt, and debt held by central banks remains bloated, which we continue to monitor closely. However, we believe the global financial system is much stronger today than it was in 2008, and we believe a financial crisis is unlikely to materialize, despite what doomsayers may say.

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