The big short: inside the doomsday machine by michael lewis

Finance

The Big Short: Inside the Doomsday Machine by Michael Lewis The Big Short: Inside the Doomsday Machine by Michael Lewis is a non-fiction book investigating the underlying factors behind the emergence of the 2008 financial crisis in the United States. The book focuses mainly on the how the happenings of the bond and the subprime mortgage market during that time worked to the detriment of the stock market, eventually leading to its crash. In the course of elaborating these events, Lewis (2011) identifies the small group of men who foresaw this catastrophe, but did not warn the rest to protect their own interests, effectively contributing to the demise of the economy.

Lewis takes an interesting and fascinating approach when narrating the events as he does so from the perspective of the very mercenaries who formed this group. These were financiers at various hedge funds across the country and these hedge funds were not known by the general public. The prominent ones here were namely Steve Eisman of FrontPoint, Michael Burry of Scion Capital, and Charlie Ledley of Cornwall Capital Management (Lewis, 2011). Lewis underscores that such people possess idiosyncratic traits, which sees them manifest tendencies which elude mainstream practices, such as betting against the market against all odds. He further asserts that such people have a knack of gambling large stakes in the hope of landing even greater reward. I found his discernment remarkably insightful as this was the very approach which ended up costing the nation a great deal, and even more so to the ordinary individuals who were left without homes in the aftermath of the crisis.

The Big Short eases in the reader’s understanding by providing him with a brief introduction about the prevalent, lucrative financial consultancy culture which first arose in the 1980s. Lewis explains how mortgage bonds are sold to the public after grouping together a number of mortgages and dividing them into categories, or ' tranches', based on their rating. The payoffs and their timings varied across the different tranches.

The book moves on to the events of 2005, when these money managers, Micheal Burry in particular, sought to buy Credit Default Swaps (CDS) from various banks in an attempt to hedge against the risk of mortgage bond defaults. They were effectively betting against the market as it was widely expected that such defaults would not take place. Burry and Co. also subscribed to the developing Collateralized Debt Obligation(CDO) culture by investing great sums in these instruments. These securities in fact grouped together different mortgage bonds, with the resulting security typically having a better rating than most mortgage bonds themselves. Their seeming attractiveness brought the interest of most financiers, especially banks which sold them, who did so without thoroughly understanding the dynamics of the instrument.

However, at the turn of 2007, the U. S. housing market was in a miserable state. The borrowers started to default on the mortgage bonds and were forced out of their homes as a result, resulting in CDSs and CDOs coming through with significant payouts. However, this meant that many Wall Street banks which had made ill-informed decisions to invest heavily in the CDOs, found themselves with massive debts to pay. Morgan Stanley's debt figures rose to nine billion dollars. The American government therefore had to resort to bailing such banks out to sustain the economy, though even this meant that renowned ones such as Lehman Brothers were allowed to close. Other banks also started declaring bankruptcy, inadvertently spreading failure across the economy as the holders of CDOs were also not paid off. Lewis attributes this butterfly effect, which crippled the American economy across numerous sectors, a consequence of the self-seeking acts carried out for material gain by money managers. The overall book was an important book for creating awareness for the general public who were not aware and how these investment firms operate.

Reference

Lewis, M. (2011). The Big Short: Inside the Doomsday Machine. Penguin.