Heartwood
Investment Management

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Investment Insight

Weekly Insight

Ten years on from the financial crisis, have we learned enough?

Fear and greed typically characterise the beginning and end of economic cycles (the natural fluctuations between periods of growth and recession). But although the basic fundamentals defining the health and stability of financial assets tend to dominate the intervening periods, the last decade has not been without drama.

Since the global financial crisis, investors have had to deal with a European debt crisis, a Japanese earthquake, a US/China growth soft patch and, more recently, President Trump's protectionist threats. Were it not for various waves of support from policymakers in the major central banks (and, in the case of China, the government) the world economy could be in an entirely different place today.

Therein lies a key lesson: policy accommodation must be employed meaningfully and quickly if confidence is to be readily restored. Indeed, delays and half measures proved unhelpful in the wake of the 2008 crisis. The US Federal Reserve may have appeared relatively prompt in its quantitative easing (QE) response, but two subsequent rounds of QE suggest that it could have been bolder (and packed more firepower) from the outset. Equally, US government intervention (including housing programmes) were slow to make their way through Congress.

Elsewhere, while the European Central Bank and Bank of Japan did ultimately step up to the plate, they took their time to enter the fray. A more synchronised and timely response from central banks might have proven more effective in kick-starting the cycle and moving on from the crisis, and could serve the global economy more effectively in future cycles.

What's more, all of the major players in international monetary policy – the heads of the US, UK, European and Japanese central banks – have been replaced at least once since 2008. Precisely how this new set of policymakers will react to recessionary challenges remains unanswered for the time being.

Another lesson is the importance of fiscal responsibility; it pays to repair the roof when the sun is shining. While growth since the 2008 crisis has been patchy in places, and not without its challenges, a recovery of sorts has undoubtedly taken place over the past ten years. And although governments have laboured under distractingly large deficits, it is still possible that they could have taken a more aggressive policy approach during the recovery period – removing support to create a higher base from which to provide it again when the need arises.

Meanwhile, household debt (as a proportion of GDP) has lowered over the past decade, but this good news could be offset by the corporate sector, where debt levels have moved in the opposite direction. Corporate sector borrowing is picking up just as interest rates move higher in the US, meaning that balance sheet liabilities are effectively rising alongside the cost of borrowing itself. For as long as earnings and growth appear strong, this should not cause alarm. But should earnings falter, or economic fears emerge, the stress of higher leveraging on the corporate sector could prove problematic. Our exposure to credit markets remains low and highly selective as a result.

In this sense, the Fed's interest rate rises may already be laying the foundations for the next recession. On the other hand, investors must remember that economic cycles cannot be avoided, only mitigated. Ten years on from the global financial crisis, the Fed is likely seeking not to limit the current boom, but to lessen the amplitude of the next bust.

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Clear Thinking

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